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GLOBAL & REGIONAL MONTHLY

The pace of global economic recovery seems to have slowed at the start of Q3, although economic activity continues to expand. Global PMIs suggest that output growth decelerated in both manufacturing and services, mirroring a loss of momentum in the US and the euro area, while China and Japan slipped into contractionary territory. Upside risks to inflation and worries that elevated price pressures have started to have second-round effects on wages seem to be the focus for major central banks and their future monetary policy decisions.

Macro Picture

USA: The economy continues to expand, albeit at a slower pace than previously expected

EA: Growth momentum remains robust, although the pace of expansion seems to have slowed

UK: Supply chain and recruitment difficulties put a break on economic recovery

EM: The spread of the Delta variant and the slowdown in China clouds the economic outlook

CESEE: Better than anticipated Q2-2021 GDP data strengthen optimism for growth prospects

Markets

FX: Recent USD strength reversed post hawkish ECB and Jackson Hole

Rates: EU and US rates moved higher on hawkish ECB comments and expectations regarding US tapering

EM: Dovish message from Jackson Hole led to spread compression in EM. China slowdown continues

Credit: Spreads slightly wider in August from very tight valuations, expected to trade moderately wider towards Q4

Policy Outlook

USA: A formal taper announcement by the Fed expected later this year

EA: Accommodative ECB policy stance, although a slower pace of PEPP purchases is expected

UK: The BoE signaled progress in achieving conditions for tightening

CESEE: Central Banks in the CEE tighten their stance further, Central Banks in SEE remain on hold

Key Downside Risks

Imposition of stricter activity restrictions; sustained increase in inflation; premature withdrawal of fiscal/monetary support

EM sphere: The brake on the Chinese economic growth; the low levels of vaccination; limited room for policy support

Special Topics in this issue:

- Digital Currencies: where to from here? Key characteristics of the emerging landscape

- Cyprus Macroeconomic Outlook: Challenges & Opportunities

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September 2021

Contents

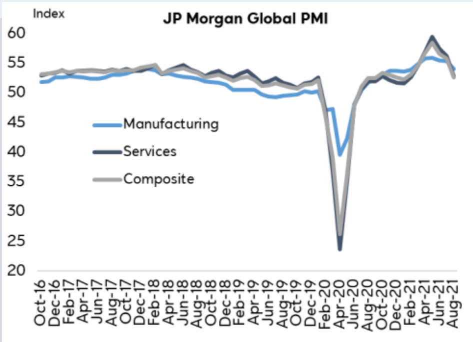
Macro Views

Latest Macroeconomic Developments & Outlook

World Economic Outlook

The pace of the global economic recovery seems to have slowed at the start of Q3, although the economic activity continues to expand. The J.P. Morgan Global Composite Index expanded for the fourteenth month in a row, but dropped to a 7-month low of 52.6 in August from 55.8 in July as growth decelerated in both manufacturing and services. The slowdown mirrored weakness mainly in Asia, especially in Japan and China where output growth fell into contractionary territory, while the US and the euro area also experienced weaker rates of growth. The J.P. Morgan Global Manufacturing PMI fell to a 6-month low of 54.1 in August from 55.4 in July, with supply chain distortions constraining output growth and driving up input costs. Turning to services, the J.P. Morgan Global Services Index declined significantly to a 7-month low of 52.9 in August from 56.3 in the prior month, as growth slowed in the US, the euro area, and the UK, while activity contracted in China and Japan.

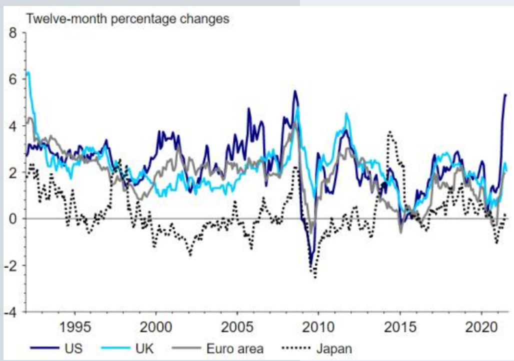
Figure 1: JP Morgan Global PMIs



Source: Refinitiv Datastream, Eurobank Research

Upside risks to inflation and worries that elevated price pressures have started to have second-round effects on wages seem to be the focus for major central banks and their future monetary policy decisions. In the US, although certain FOMC members have explicitly supported an imminent Fed tapering start as the economy has returned to its pre-pandemic level, Powell's comments and weaker employment growth in certain Covid-sensitive sectors due to the spread of the Delta variant increased the possibility for a formal taper announcement in Q4. In the euro area, the ECB seems closer to an announcement for a slower pace of PEPP purchases by the end of the year amid upward revisions to growth and inflation forecasts coupled with accommodative financing conditions.

Figure 2: G4 Headline Inflation



Source: Refinitiv Datastream, Fathom Consulting, Eurobank Research

Developed Economies

US: According to the BEA's second estimate, real GDP growth was upwards revised by merely 0.1ppts to 6.6%QoQ saar in Q2, up from 6.3%QoQ reported in Q1. Entering into Q3, high frequency data continue to suggest some moderation in economic momentum. Personal spending growth eased in July, while both headline and core retail sales fell over the same month. Real GDP growth in 2021 will likely prove softer than previously expected as the positive effect of the pandemic-related measures fades away and lingering supply chain constraints weigh on industrial activity. Provided that the economic expansion continues in line with Fed's expectations, the September FOMC statement will likely acknowledge that substantial economic progress has been made for inflation and employment, paving the way for a formal taper announcement in Q4.

Euro area: The final Eurozone Composite PMI was revised downwards by 0.6pts in August, coming in at 59.0 from 60.2 in July which was the highest level in more than 15 years. Services business activity decelerated only slightly, retaining its strong momentum despite the spread of the Delta variant in the summer months. The manufacturing sector continued to expand - albeit at a slower pace - showing some easing in supply chain disruptions. Along the same lines, the EC ESI fell marginally by 1.5pts to 117.5 in August, with services reporting the strongest decline. Overall, growth momentum has remained robust in recent months with leading indicators well above long-term averages, although the pace of expansion seems to have slowed somewhat in the beginning of Q3. The strong economic rebound, higher realized and expected inflation and accommodative financing conditions move the ECB closer to a slower pace of PEPP purchases.

Emerging Economies

BRIC: In July's WEO, the IMF raised **Brazil's** real GDP growth forecast to 5.3% for 2021 from the 3.7% expected in April, but cut its forecast to 1.9% for 2022 from 2.6% previously. Overall, the IMF's decision to raise its GDP growth forecast for 2021 is in line with other FI's forecasts, such as the World Bank. While on the pandemic front, there is sizable de-escalation in daily cases, the decision of the Supreme Court to investigate the President's involvement in the voting procedure of the 2018 elections has led to political turmoil. As in the case of Brazil, the IMF raised its 2021 GDP growth projection for **Russia** to 4.4% from 3.8% forecast in April and cut its projection for 2022 by 0.7pps to 3.1%. GDP is projected to rebound strongly this year on the back of recovering investments and consumer demand amid easing lockdown restrictions and robust exports supported by favorable global oil market dynamics. However, geopolitical tensions and a low vaccination rate (25.8%) are downside risks to the outlook. In **India**, the second wave of the pandemic lasted throughout Q2 and will have a big toll on this year's GDP growth. The IMF shaved off 3ppts of its FY2021 economic growth forecast in July's WEO, pinning it at 9.5% from 12.5% projected in April. Despite the severe Covid-19 surge in Q2, GDP grew in that period at a record pace of 20.1% YoY, accelerating from 1.6% YoY in Q1, according to provisional data recently released. The print was underpinned by extremely low base effects as during Q2 2020 the country was under nationwide lockdown that brought economic activities to an almost standstill. Low vaccination rate - currently around 11% - and possible Covid-19 resurgences in Q4 2021 pose risks to the downside. The evident cooling of the **Chinese** economy in July has led to a sharper than expected slowdown. The deceleration so far can be broadly attributed, inter alia, to the floods in the Henan province in July, which caused the suspension of economic activity in the said region. Looking ahead, the Delta variant spread in mid-August to more than half of the country's 34 provinces will weigh on the Q3 2021 economic performance, while the government's crackdown on the technology and education sectors will take its toll as well. Nevertheless, despite the loss of steam, GDP growth in 2021 is expected to exceed 8%.

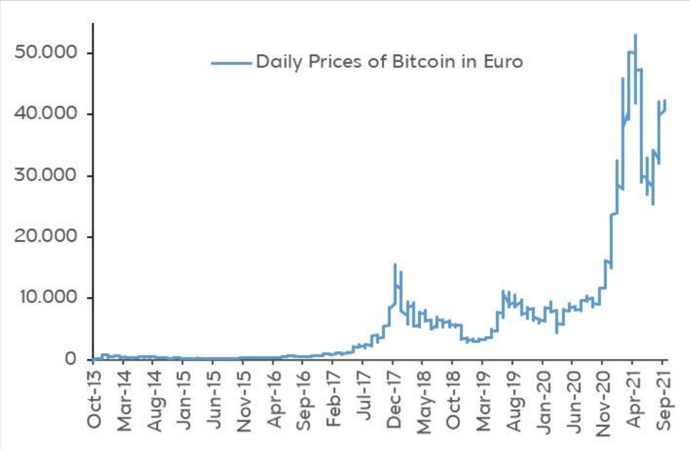
CESEE: As of early September 2021, the epidemiological situation in many countries of the Central, Eastern and Southeastern Europe (CESEE) has shown signs of deterioration compared to early July. Having weathered the third wave of infections, countries are now becoming increasingly confronted with a new wave – the fourth one since the beginning of the pandemic – with the number of Covid-19 infections, hospitalizations and fatalities trending higher. During the past two months, most countries in the region accelerated their vaccination programs converging to the EU average. Further progress in the vaccination programs could turn out to be a game changer for the regional prospects in H2-2021 compared to the previous three waves, thus minimizing the socioeconomic cost of a fourth wave, if it materializes. On the economic data front, the flash GDP estimates of the first quarter took center stage in the past month. A number of statistics authorities across the region released flash Q2-2021 GDP estimates that surprised to the upside on average, laying the foundations for a stronger regional rebound in H2-2021.

Special Topics

I. Digital Currencies: Where to from here? Key characteristics of the emerging landscape

Progress in technology over the last decade has dramatically altered the way consumers, corporations and financial institutions interact with each other. The emergence of fintech companies and digital currencies has made payments possible without cash or the intervention of banks. Financial markets haven't been left unaffected by the blooming digital trend. One of the applications of this trend is the cryptocurrencies, which have been popping out rapidly in the past decade and continue to do so. From an investor's perspective, back in 2012 bitcoin – the most predominant digital currency – was trading at EUR10 when it recently has surpassed EUR50k (figure 3). Taking into account, the importance and size digital currencies are gaining in the global financial markets, in the following lines, we attempt to present the current landscape in the types of money and outline the risks and opportunities of the rapid changes taking place therein.

Figure 3: Bitcoin values have skyrocketed since the launching of the first cryptocurrency



Source: Bloomberg, Eurobank Research

- ✓ **The current landscape in the types of money**

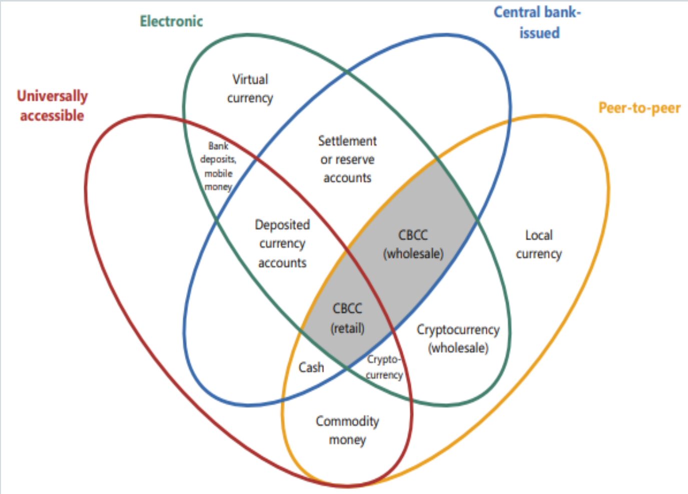
Following the spree of digital currencies in the past decade that have led the use of cash to plummet and have altered dramatically the map of money as a means of payment, the European Central Bank[1] (ECB) and the Bank of International Settlements (BIS), along with other Central Banks (CBs) and international financial institutions (IFIs) have consistently tracked and described the new types of currency. So far, the most recent, concrete and broadly accepted taxonomy of money is visualised in the Money Flower (figure 4), conceptualised by the BIS in 2017[2]. The concept combines two former segregations of currencies, one

[1] https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf
[2] https://www.bis.org/publ/qtrpdf/r_qt1709f.pdf

referring to cryptocurrency (CPMI, 2015)[3] and another to Central Bank Digital Currency (BJERG, 2017)[4]. The Money Flower classifies currencies into four key categories based on the following properties:

i. the issuer of the currency (central bank or other),
ii. the form of the currency (electronic or physical)
iii. the accessibility of the currency (universal or limited) and
iv. the transfer mechanism of the currency (centralised or decentralised).

Figure 4: The Money Flower by the BIS depicts the taxonomy of money



Source: BIS, Central Bank Cryptocurrencies, 2018

From the above diagram, one can roughly understand that the most distinguishing classification in currencies is the one between cash and digital currency with the latter used as a blanket term in order to describe all electronic money that includes e-money[5] and virtual currency. It is with this more simplistic approach compared to the BIS Money Flower that the ECB, back in 2012, classified money as shown in figure 5 and introduced the term of virtual currency.

Figure 5: The Money Matrix by the ECB, a simpler approach in the taxonomy of money

		Money Format	
		Physical	Digital
Legal Status	Regulated	Bank Notes & Coins aka Cash	E-money
			Commercial bank money aka deposits
	Unregulated	Certain types of local currencies	*Virtual Currency*

Source: ECB, Virtual Currency Schemes, 2012

[3] https://www.bis.org/cpmi/publ/d137.pdf
[4] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2985381
[5] According to the Electronic Money Directive (2009/110/EC), "electronic money" is monetary value as represented by a claim on the issuer which is: stored electronically; issued on receipt of funds of an amount not less in value than the monetary value issued; and accepted as a means of payment by undertakings other than the issuer. Although some of these criteria are also met by virtual currencies, there is one important difference. In electronic money schemes the link between the electronic money and the traditional money format is preserved and has a legal foundation, as the stored funds are expressed in the same unit of account (e.g. US dollars, euro, etc.). In virtual currency schemes the unit of account is changed into a virtual one (e.g. Linden Dollars, Bitcoins).

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Virtual currency is a type of unregulated digital currency that is not issued or controlled by a central bank (CB). By breaking down further the virtual currency segment, both centralized and decentralized virtual currencies exist, with the latter not having a central administrator, but relying on block chain networks, which are cryptography-based. The cryptography-based virtual currency is known as cryptocurrency. The lack of a central administrator lies at the kernel of the inception of cryptocurrencies as the absence of administration and control is substituted by the Distributed Ledger Technology (DLT)[6]. On the flipside, a centralized virtual currency has a central administrator, which typically is the issuer of the currency. The most known centralised virtual currency is XRP, initially released in 2012, while the most famous decentralised virtual currency, i.e. cryptocurrency, is Bitcoin, introduced in 2009 by a group of IT programmers.

As we conclude with the mapping of physical and digital currencies, by glancing at figure 4 one more time, it is evident that Central Bank Digital Currencies (CBDCs) lie at the core of the Money Flower, representing the common ground of all currencies by meeting, in theory at least, all 4 criteria (issuer, form, accessibility, transfer mechanism); CBDC is a currency provided by a CB, digital, universally accessible and with DLT functionality.

✓ **Central Bank Digital Currencies**

Given the optimum characteristics CBDCs appear to have, plans for the creation of CBDCs are flourishing, fuelled by the catalytic role the pandemic has played in the increased volume of digital payments. Currently, 81 countries around the world are exploring the creation and adoption of a CBDC, with a few having a lead and some lagging behind. Surprisingly, the first country to have already mastered the CBDC requirements is the Bahamas, which launched the nationwide CBDC, the Sand Dollar, in October 2020.

- The leaders: People's Bank of China (PBoC) and Sweden's Riksbank

With the e-CNY[7] experiment at play since 2014, the PBoC, through 20 CBDCs in a pilot stage currently, is planning to replace physical cash with the e-renminbi or digital yuan. Managing a CBDC with an audience of 1bn participants presents difficulties, but the Chinese government appears determined to push through and cross the line first in the launching of a CBDC. The economic upstreaming for an economy that accounts for ca. 20% of the world GDP (although its currency, the yuan, amounts to ca.2% of reserve currencies when the respective figure for the US dollar is 63%) is a strong incentive for seeking an early mover advantage, as this would allow China to establish the yuan as an alternative reserve currency to the US dollar. Feedback from participants in the experimental trials that started in April 2020 suggests that the digital yuan so far appears convenient and secure, boosting further the speed of the testing phase.

[6] Distributed Ledger Technology (DLT) refers to the technological infrastructure and protocols that allow for simultaneous access, validation, and record updating in an immutable manner across a network that is spread across multiple entities or locations. DLT, more commonly known as the blockchain technology, was introduced by Bitcoin and is now a totem in the technology world, given its potential across industries and sectors. In simple words, the DLT is all about the idea of a "decentralized" network against the conventional "centralized" mechanism, and it is deemed to have far-reaching implications on sectors and entities that have long relied on a trusted third-party.
https://www.investopedia.com/terms/d/distributed-ledger-technology-dlt.asp

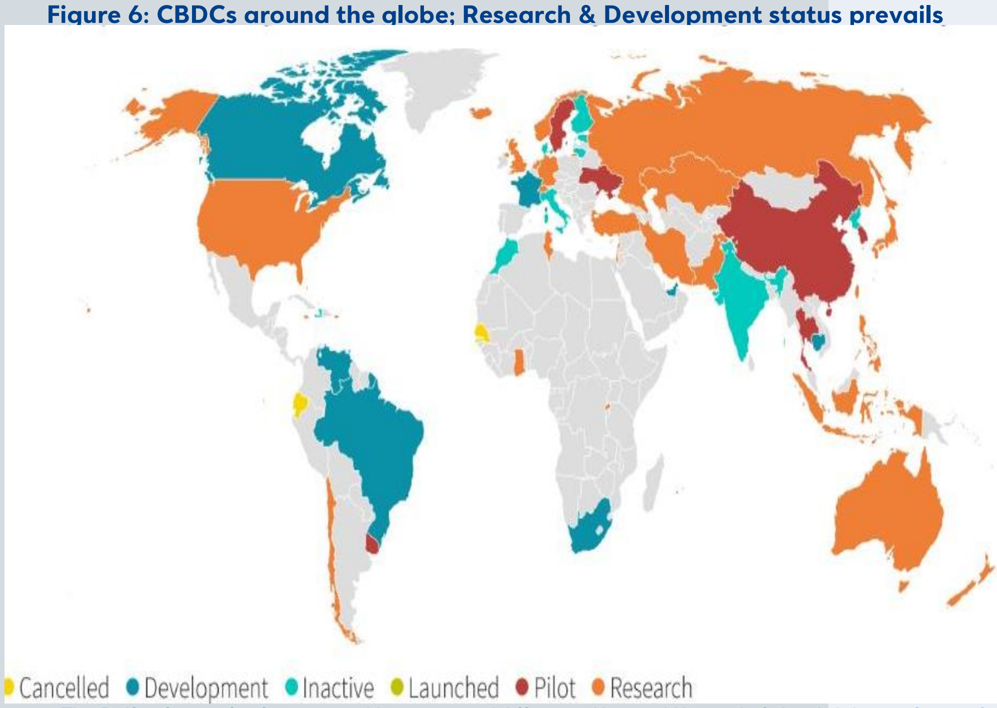
[7] The e-CNY, or the digital yuan, is a centralized, cash-like digital currency that is expected to be primarily used for retail payments in China. The PBoC and e-CNY operating institutions conduct large scale e-CNY pilot programs in multiple cities across the country

The e-krona project in Sweden started in 2017 with the Riksbank researching alternatives to cash since 2012. The country is galloping towards a cashless society as it enjoys tailwinds stemming from its legal framework, the small (ca 10mn) and tech-savvy population and the rooted trust in institutions and new technologies of the Swedish people.

- the laggards: the ECB and the Fed

The ECB announced in mid-July its decision to investigate the issuance of a CBDC, the digital Euro, which will not substitute the existing fiat money but circulate in parallel with paper, coins and e-deposits. The currency could be launched in less than two years from now while the trial period is scheduled to last at least until 2026. It is expected to assist in the downsizing of the grey economy as it will be more efficiently monitored with embedded transactional costs significantly reduced.
Contrary to China, the US is not in a hurry to attain the "early mover advantage" in researching the adoption of a CBDC given the status of the US dollar as the world reserve currency. Be that as it may, the Boston Fed has assigned researchers at the MIT to build and test "with boldness and ingenuity" the computing systems needed to support a US-backed CBDC.

Figure 6: CBDCs around the globe; Research & Development status prevails



Source: The Belfer Center for Science and International Affairs at Harvard Kennedy School, Atlantic Center & Reuters Research

- Global infrastructure and coordination is required

Whether an early bird or a follower, most of the major CBs of the developed economies, are aware that along with the individual R&D that each one conducts, close and effective cooperation should be of high priority, given the existing financial interconnectedness in global markets. One of the greatest challenges is the interaction between different CBDCs. Questions are raised regarding the impact that a parallel system of CBDCs will have on the value of every domestic currency and the existing exchange regimes. Taking into account the above, the BIS, acting from an institutional perspective, has recently attempted to describe the fundamental features and explore a suitable framework within which, CBDCs could be engineered and launched with safety. Assessing the progress made so far by the Bank of Canada, the ECB, the Sveriges Riksbank, the Swiss National Bank, the BoE and the Fed on the research and trials for CBDCs, the BIS[8], through stirring committees and working groups with the above CBs has recently come up with the following fundamental principles that a CBDC should meet in order to be able to act as an important instrument in the public policy objectives of each CB:

i. "Do no harm". New forms of money supplied by a CB should continue to support the fulfilment of public policy objectives and should not interfere with or impede a CB's ability to carry out its mandate for monetary and financial stability.
ii. Coexistence. CBs have a mandate for stability and to proceed cautiously in new territory. Different types of CB money – new (CBDC) and existing (cash, reserve or settlement accounts) – should complement one another and coexist with private money (eg commercial bank accounts) to support public policy objectives. Central banks should continue to provide and support cash for as long as there is sufficient public demand for it.
iii. Innovation and efficiency. Without continued innovation and competition to drive efficiency in a jurisdiction's payment system, users may adopt other, less safe instruments or currencies. Ultimately, this could lead to economic and consumer harm, potentially damaging monetary and financial stability. There is a role for the public and private sectors in the supply of payment services to create a safe, efficient and accessible system. Private economic agents should generally be free to choose the means of payment they use to carry out their transactions.

✓ **Going forward: Drivers, Risks, Opportunities & Challenges**

Marc Andreessen, an American entrepreneur, investor, software engineer and partner in one of the top five crypto venture capital funds (Andreeseen Horowitz[9]) recently said that the maturity of virtual currencies today is similar to that of the internet in 1992, i.e. still on the borders but close to becoming mainstream; In other words, investing in and using virtual currencies stands at an inflection point, with the demand for digital currencies being driven by essential fundamentals. In support of the above, according to a recent survey by the Economist Intelligence Unit[10] (figure 7), 64% of the respondents used digital payments for over half their purchases in the past year, while 34% of them considered the trivial purchases and payments as the key reason for using a digital currency.

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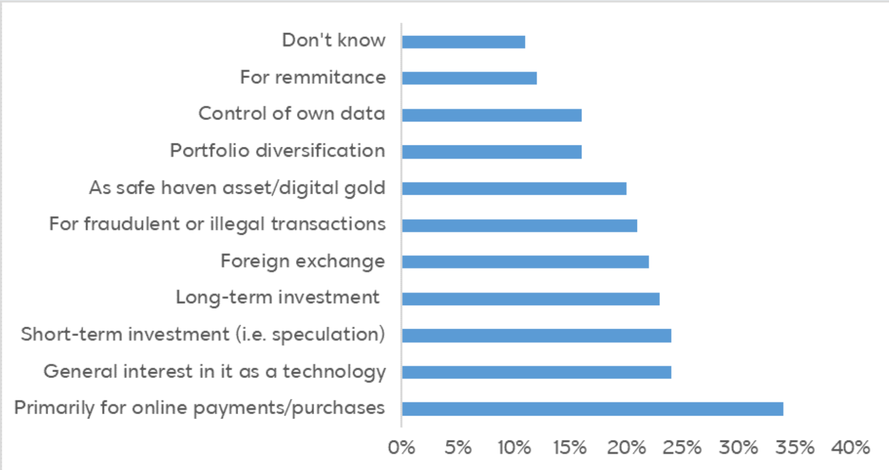
[8] https://www.bis.org/publ/othp33.pdf
[9] https://a16z.com/
[10] The survey involved 3,048 people, half of whom are from developed economies, with the other half from emerging markets. With respect to age, 61% of respondents were 18-38 years old, reflecting the tech-savvy generation.

Figure 7: Demand for Digital Currencies is broadly driven by strong fundamentals, such as online frequent payments & purchases



Source: The Economist Intelligence Unit (EIU)

Market developments also reveal the surging appetite for virtual currencies in the last two years either through, inter alia, the launch of the Libra cryptocurrency backed by Facebook or the announcements of old fashioned and creditworthy payment systems such as Visa, Mastercard and Paypal for the trial development of virtual platforms for transactions. Digital currencies are estimated to have a positive effect both on the developed and the developing world primarily through the reduction of transactional costs. In particular, low-income countries that are dependent on remittances from abroad, are expected to benefit substantially[11]. On the flipside, risks of cyberattacks and financial contagion in the exchange rating systems necessitate extremely careful handlings, especially in the CBDC sphere. Additionally, the pseudo anonymity of many cryptocurrencies makes them attractive for money laundering and terrorism financing. Last but not least, the environmental impact of the virtual currencies IT infrastructure, especially those that operate decentralised through DLT technology, is considered a drawback due to the heavy energy demands of servers in order to save and process data[12]. We conclude with the key takeaways of a recent article published by the World Economic Forum[13]:"...the successful adoption of digital currencies is tied with keeping sight of the bigger picture, which extends far beyond each country's borders. The digital money transition/revolution will happen in a global scale and for this to happen progress in IT infrastructure, regulation, supervision and the legal framework is required. Legal loopholes must close so that cryptocurrencies are not a weapon that serves money laundering..."

[11] The World Bank has recently attempted to quantify the boost to remittances towards low-income countries from the adoption of digital wallets and the adjunctive cost reduction and it appears to approach $16bn per year. Given the brave amounts of IT infrastructure and intelligence required, the EM sphere will be affected subsequently and not directly as it is expected that developed economies will adopt digital currencies first with a spill over towards EM.
[12] https://www.bloomberg.com/news/articles/2021-08-27/bitcoin-etf-pledges-to-reduce-carbon-footprint-by-planting-trees
[13] https://www.weforum.org/agenda/2021/07/new-rules-tools-cryptocurrencies/

II. Cyprus Macroeconomic Outlook: Challenges & Opportunities

- The economic impact of the pandemic has so far turned out less severe than initially anticipated despite the country's high sensitivity as a small, open and services-oriented economy
- Factoring in the very good performance in Q1 and the solid growth performance in Q2, economic activity is now projected to rebound by more than 5% in 2021. Further acceleration to 4% seems to be on the cards in 2022 underpinned by the RRF funds booster to investments
- Cyprus needs to focus on both pending legacy issues and pressing new challenges in the post-Covid19 environment to enhance its medium-term growth prospects

The onset of the Covid19 pandemic interrupted Cyprus's strong economic growth trajectory over the past few years. The strong growth momentum ahead of the Covid19 crisis - Cyprus expanded on average by 4.6% in 2015-2019 - allowed the economy to recoup all output losses incurred in the period 2012-2013. But also after the outbreak of the pandemic, the outcomes have been better than initially expected. In 2020, real GDP contracted by -5.1%, outperforming initial pessimistic official and international organizations' forecasts. Unemployment climbed to 7.6% up from 7.1% in 2019, which was however cushioned by the sizeable job retention support policies. Mirroring the deep recession and the government's support measures, the country's fiscal position shifted into a deficit after several years of surpluses. The general government recorded a deficit of -5.1% of GDP in 2020 compared to a surplus of +1.5% of GDP in 2019. This led to a significant increase in general government debt to around 118% at the end of the year, which, however, also includes a sizeable cash buffer, up from 94% in 2019.

The economic impact has so far turned out less severe than initially anticipated despite the country's high sensitivity as a small, open and services-oriented economy, with tourism being one of its core industries. The over-performance can be broadly attributed to the quick, sizeable and still ongoing financial support from the government and the extensive use of banks' loan moratoria, which placed Cyprus first in the relevant EU ranking in 2020. On top, Cyprus' EMU membership enabled it to have access to EU and ECB assistance, which allowed for maintaining market access and investment-grade status.

In late July, Moody's, the only rating agency from the main four (S&P, Fitch, Moody's, DBRS) not to have assigned Cyprus investment grade, upgraded its long-term sovereign rating from Ba2 to Ba1 (one notch below investment grade) with a stable outlook. The rating agency cited Cyprus' decreased banking sector's risks, the resilience of the economy against the pandemic shock and robust medium term GDP growth prospects supported by sizeable EU funds. Furthermore, in early September S&P affirmed the long-term sovereign rating at BBB (investment grade) changing the outlook from stable to positive. The decision reflects the view that following the pandemic shock in 2020 and beyond the related near-term uncertainty in 2021, S&P could upgrade Cyprus's rating within the next 24 months if the country`s economic and budgetary performance continue to strengthen, supported by the government`s implementation of structural reforms.

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Despite sporadic lockdown measures in H1-2021, economic activity also remained relatively resilient strengthening optimism for the near-term prospects. The acceleration of the vaccination program combined with the improvement of the weather conditions led to a further improvement in the Covid-19 related metrics in Q2-2021 and a further relaxation of restrictions. Factoring in the very good performance of Q1 and the solid growth performance in Q2, underpinned by favorable base effects from phasing out last year's restrictions and strong sentiment improvement, economic activity is projected to rebound by more than 5% in 2021. The ongoing rebound is in line with the world economy recovery and is driven by public and private consumption and the recovering exports' services. The near-term outlook and developments depend on the pandemic dynamics and the vaccination program rollout. The sharp rise in Covid-19 cases since mid-June has raised fears that the fourth wave of infections has arrived. On the positive side, the latest ECDC data (as of September 6) show that 78.3% of the population vs. 76.9% in EU/EEA has received at least the first vaccine dose and 74.0% vs. 69.3% in EU/EEA has been fully vaccinated.

Tourism's contribution in this year's rebound is limited. After a catastrophic year (in 2020 arrivals decreased by -84.1% and revenues by -85.4%), tourism only partially in 2021. Although the prospect of attracting visitors from the tourism markets of UK, Russia and Israel, which accounted for 60% of total arrivals in 2019 looks promising, uncertainty persists both due to epidemiological and geopolitical reasons. So far, tourist arrivals were higher by 33.4% YoY in the 7M-2021, but 79.1% YoY lower from H1-2019. Tourism revenues increased to €135,8mn in June 2021 compared to only €6,7mn in June 2020, a month when restrictive measures against Covid19 were still in place. In H1-2021, tourism revenues came in at €258,8mn compared to €122,0mn in the corresponding period of 2020, up by 112.1%. Nevertheless, tourism revenues were still lower by 74.2% from their respective reading of H1-2019.

Looking ahead, our baseline scenario calls for GDP growth of 4% in 2022. Domestic demand is expected to be the main growth driver but net exports' contribution will strengthen as exports recovery gathers pace. Assuming the pandemic restrictions come to an end by 2022, fiscal and financial support measures will be gradually phased out turning public consumption's contribution negative. Private consumption is expected to maintain the lion's share in GDP but dynamics are expected to slow down in the medium term due to improving employment and access to financing rather than wage increases. With the termination of the Cyprus Investment Program, investments will receive a booster from the Recovery and Resilience Facility (RFF) funds.

The absorption of the RRF funds is going to be pivotal for the medium-term economic prospects. The effect is expected to be mostly felt from 2022 onwards taking into account the time needed for some of the projects to mature. The Cypriot plan provides for a total of €1.2bn, which breaks down into €1bn in grants and €0.2bn in loans, with the Ministry of Finance estimating that these resources will mobilize an additional €1.4bn in private funds, while investments and reforms will raise GDP by 7% cumulatively in the period 2022 - 2026. Headline inflation has turned positive in 2021 (7M-2021: +0.9% YoY, July: 2.7% YoY) on base effects from last year's energy prices slump. HICP is forecasted to remain in relatively high levels in 2022 underpinned by high energy but also non-energy and services prices as the economy recovers.

The medium term outlook prospects depend heavily on the ability of the economy to adapt to the post-Covid19 environment addressing the remaining legacies of the past and at the same time tackling with a new set of pressing challenges. After the initial post-program success in a number of areas (public finances, banking sector etc.), further progress has stalled. The economy is increasingly confronted with a new set of challenges both internal and external that need to be addressed for the economy not to backtrack. More specifically, we have pointed out the following areas of focus:

- *Banking sector risks have subsided but are still material:* Even though a big chunk of NPEs has been removed from the banking sector balance sheet (-82.0% since 2014), they have not been removed from the broader economy. Moreover, the NPEs ratio is still relatively high by EU standards (18.1% as of May 2021). The new NPEs from the phasing out of support measures and the end of the moratoria posts an additional challenge for the banking sector. Finally, any reversal of the foreclosure framework reform would obstruct ongoing NPL resolution and jeopardize financial stability.
- *High private sector indebtedness:* Private sector debt has been on a declining trend in recent years. Nevertheless, it still stood at €56.5bn in Q1-2021, which corresponds to 273% of GDP. Household and corporate debt stood at €19.6bn or 95% of GDP and €36.9bn or 178% of GDP respectively. Corporate debt has been on a steadily declining trend, down by 34% cumulatively, since December 2016.
- *Reform fatigue:* Cyprus must not miss the opportunity to fix its investment climate and increase its growth potential. Despite some progress, the reform of the judicial system is a long standing issue, which is still pending. In the new post-Covid19 era, growth-enhancing policies ought to support the upgrade of digital infrastructure, the transition to a greener economy and the accumulation of human capital. To that end, the absorption and effective use of RRF funds could turn out to be the catalyst for facilitating the switch to a new growth model for the country.
- *Risks of backtracking from prudent macroeconomic policies:* These could emanate either from the fiscal risks of future Supreme Court decisions or the lack of a majority in the Parliament. The introduction of the National Health System poses additional medium-term fiscal risks.
- *Domestic political risks in the run up to Presidential elections in 2023:* In the parliamentary elections held in late May, a more fragmented parliament emerged with all three major political parties having suffered electoral losses. In principle, the parliamentary election results are not a game changer as the system of the country is presidential representative republic. Therefore, policy continuity is not at risk but the efficiency of the government cabinet now depends on the ability of the ruling Democratic Rally (DISY) party to form alliances with four smaller parties in order to pass legislation in the parliament. This is critical given that a number of structural reforms are deemed as prerequisites for Cyprus to tap the EC's RRF funds.
- *Political risks of geopolitical frictions in the Eastern Mediterranean sea:* Tensions could emerge and escalate on both political and military fronts driven by the revisionist policies of Turkey in the broader region.

Macro Themes & Implications in CESEE

Fourth wave of infections in the region ante portas. Flash Q2-2021 GDP estimates surprised to the upside. Central Banks in the CEE region tighten their monetary policy stance further.

As of early September 2021, the epidemiological situation in many countries of the Central, Eastern and Southeastern Europe (CESEE) has shown signs of deterioration compared to early July. Having weathered the third wave of infections, countries are now becoming increasingly confronted with a new wave – the fourth one since the beginning of the pandemic – with the number of Covid-19 infections, hospitalizations and fatalities trending higher in the last couple of months. The virus's mutations – especially the delta one – has been at the epicenter of global media attention. The rise in infections worldwide has raised the red flag for the CESEE region as well, with the region now confronted with a fourth wave in autumn.

During the past two months, most countries in the region accelerated their vaccination programs converging to the EU average. Further progress in the vaccination programs could turn out to be a game changer for the regional prospects in H2-2021 compared to the previous three waves, as it will minimize the socio-economic cost of the fourth wave. Nevertheless, progress is not even among countries. As of early September, Hungary ranked first in the vaccination process having provided at least one dose to 67.7% of its adult population. The procurement of vaccines from China and Russia made the difference as it helped bypass supply bottlenecks. The Czech Republic and Poland ranked second and third having provided at least one dose to 65.8% and 59.7% of their adult population respectively. In contrast, Bulgaria and Romania disappointed, lagging behind with the respective figure being 22.1% and 33.1% respectively. During the previous month, Turkey made impressive progress in its vaccination program doubling the vaccination rate (% of total population) from 19.7% in late May to 40.2% in late June and further to 58.7% in early September.

On the economic data front, the flash GDP estimates of the first quarter took center stage in the past month. A number of statistics authorities across the region released flash Q2-2021 GDP estimates that surprised to the upside on average, laying the foundations for a stronger regional rebound in H2-2021. On the negative side, regional divergence increased among countries. In some cases, the strength of the recovery was impressive. On a seasonally adjusted basis, Hungary and Slovakia were among the top performers expanding by +2.7% QoQ and +2.0% QoQ respectively. Poland (+1.9% QoQ) and Romania (+1.8% QoQ) followed suite posting relatively descent readings as well. The Czech Republic (+0.6% QoQ), Bulgaria (+0.4% QoQ) and Lithuania (+0.4% QoQ) were regional underperformers faring much lower than the Euroarea (+2.0% QoQ) and the EU-27 (-0.4% QoQ) in Q2-2021.

The better than anticipated growth performance in H1-2021, the improvement of the epidemiological conditions and the acceleration of the vaccination programs across the CESEE region, has reignited optimism for the growth prospects of the broader CESEE region in 2021-2022. The rise of sentiment indicators close to, if not above, their pre-pandemic levels also sent an optimistic signal for the economic outlook, creating strong expectations for the growth readings of Q3. Yet the pandemic is still far from over and the road to normalization is full of challenges. Provided that the vaccination programs remain on track and the economic impact of a fourth wave remains manageable, the CESEE region is now expected to have covered more quickly the lost ground of 2020 by the end of the year. As a result, on average, regional economies could reach their pre-pandemic GDP levels by the end of Q3-2021 instead of 2022 previously expected. The impact of the RRF funds is expected to be felt on the medium-term prospects.

Finally, the Central Banks of Central Eastern Europe (CEE), who were the first to initiate the tightening cycle in June, have proceeded with further monetary policy tightening during the summer months. More specifically, during the past month, the Central Banks of Hungary and the Czech Republic hiked rates further, demonstrating their willingness to proceed with policy normalization in the aftermath of the pandemic. The stronger than anticipated growth rebound both in the region and globally, the tighter labor markets and the inflation come-back compels the Central Banks to reassess their policy options for inflation expectations not to be de-anchored.

CESEE Markets Developments & Outlook

Bulgaria

Eurobond yields slid across all maturities, with notable drops posted on the long-end of the curve, namely the 2030 and 2035 papers with 9 bps declines each. Local papers on the other hand, remained unchanged across the entire yield curve. In June, the Ministry of Finance continued to stay on the sidelines by not holding any auctions, as the interim government is in the process of assessing the financial health of the country. Recently, however, the Ministry announced its intention to borrow EUR100mn from the local market in September. The election stalemate remains at the epicenter of attention with new elections appearing certain. Finally, the Delta strain will most probably prove a strong headwind for the business environment, as Bulgaria remains among the nations with the lowest vaccination rates.

Serbia

Unlike the Central Bank of Hungary that recently paved the way for monetary tightening in the CESEE region, the National Bank of Serbia (NBS) does not plan to hike its Key Policy Rate at its meeting in September. In August, the NBS decided to hold fire and leave the KRP unchanged at 1% despite acknowledging inflationary pressures as a bit worrying. Aligned with the view of other major Central banks, the NBS considers the recent inflationary pick-up towards the upper band of the targeted range as a transitional phase and expects mid-term inflation to gradually move back into the 1.5%– 3% range. In terms of economic growth, in the latest inflation report, the Bank revised its GDP growth to 6.5% from 6% previously projected for 2021, while the long term average economic growth, i.e. for the next 10 years was also revised from 4% to 4%-5%.

In the FX space, during the previous month, the value of the dinar against the Euro remained unchanged and as things stand, the pair is unlikely to deviate from this status. The EUR/RSD rate has been steady since the beginning of the year at 117.55 and strong economic growth potential, adequate FX reserves and negligible fiscal deficit seem to have restrained the dinar from moving in either way.

Concluding with developments on the fixed income market, government bond yields extended their decline in August on the back of the continuing international demand for the papers included in the J.P. Morgan indices. The yields of these bonds dropped by 7-12 bps on a monthly basis and compared to June, when the inclusion took place, they have dropped by 30 bps along the entire curve. As a result, the 4.5-year, 6.5-year and the 11-year bonds are currently traded at 2.18%, 2.38% and 3.23%, respectively.

Eurobank

Eurobank Research

Markets View

Foreign Exchange

EUR/USD: With the Fed's taper decision being the main theme around the recent price movements of the dollar, the pair oscillated between 1.19 and 1.1664, to end the month close to the upper end of the range. The price movement was also partly explained by the market's expectation that the ECB will need to follow the reduction in the bond-purchasing schemes as well, with the Eurozone inflation fluctuating around 3% YoY in August and the vaccination rate being ahead of the US one. We expect the stabilization of the pair's price around 1.18, floating in a trading range of up to 150 pips, i.e. covering the price bands already formed by the recent movements. In case the 1.19 level is broken upwards, the pair could see the 1.1950, while no further space towards higher levels is expected under the current rhetoric and macro numbers levels.

GBP/USD: The same Fed tapering theme has also triggered the latest downward pressure of the dollar against the pound. Additionally, the pound-related effects of fears over a potential tax hike and concerns about the Brexit aftermath added a downward pressure to the pound, stabilizing the pair's price at levels close to 1.3850. In case there is no upward break-out above 1.39 after the main macro numbers announcement of the NFPs in the US and the UK PMI, as well, we expect a price consolidation around the current levels until the end of next month, with the trading range again spanning in a max of 150 pips bandwidth.

Rates

EU: EU rates increased sharply in August, with 10y swaps trading at 1bp, up from -8bps at the beginning of the month. The steepness of the curve also increased, with 5s-30s trading at 66bps from 61bps. Looking forward we expect rates to rise further and the steepening to continue as signs of inflation continue to emerge and the ECB is becoming more hawkish. The economic recovery and supply shortages drove German inflation to a 13-year high in August. A potential risk to this view could be a rise in the Delta Variant Covid19 infections in Europe.

US: US rates increased slightly in August, with the 10y swap rate trading at 135bps, up from 120bp at the beginning of the month. The shape of the curve remained anchored, with 5s-30s trading at 80bps. Looking forward we expect US rates to move higher and the curve to steepen as FED Chair Jerome Powell, at his Jackson Hole Speech last week, left open the possibility of a tapering announcement in 2021, and inflation and unemployment economic releases continue to be strong.

Emerging Markets credit

The highly anticipated Jackson Hole Symposium proved to be dovish, as Chair Jerome Powell kept his options open rather than laying out a clear timeline for tapering. This was supportive for risky assets and led EM credit spreads tighter. The EMBI Global Index closed at 313bps at the end of August, 12bps lower on the month. In CEEMEA, both Turkish and South African sovereign spreads significantly compressed. In Latin America, spreads ended modestly tighter. The Banco Central de Chile lifted the policy rate by 75bps, surprising the markets that were expecting a 50bps rise. In Asia, weak data from China further contributed to the widening of the gap between EM and DM in the manufacturing sector, while spreads ended marginally tighter. We keep a neutral appetite on EM as a possible increase in US rates and the slowdown in China pose considerable risks.

Corporate credit

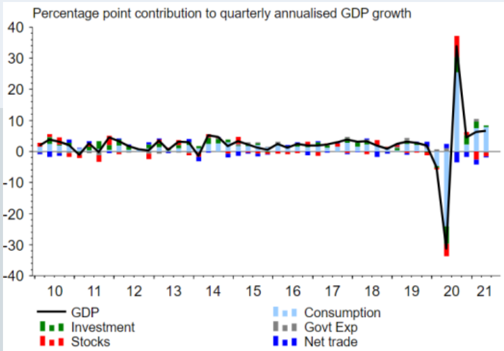
EUR IG cash corporate spreads were slightly wider in August, with spreads on most grades and sectors ending +3/+5bps overall, as light activity, continuous supply and very tight valuations weighted on the overall sentiment. CDS Indices spreads on the contrary were tighter both in IG and HY, outperforming cash, and ending the month around YTD tights. Some compression was evident with lower rating grades ending tighter than higher quality ones. ECB guidance is still supportive of Credit going into September. Sector wise, in EUR IG, Financials were +2.5bps wider, Real Estate +3.5bps wider, Oil & Gas +3bps wider, Health Care +5.5bps wider, Telecoms +3.5bps wider, Industrials +3bps wider, Consumer Goods +4.5bps wider, Utilities +3.5bps wider, Technology +3bps wider and Basic Materials +3.5bps wider. US IG names spreads were mostly unchanged to -2/+2bps on the month, with Health care +3bps wider making it the slight underperformer. Financials were -1.5bps tighter, Real Estate -2bps tighter, Oil & Gas, Telecoms, Technology and Industrials were unchanged, Consumer Goods +1.5bps wider, Utilities +2bps wider, and Basic Materials -3.5bps tighter.

Rating-wise, EUR IG spreads in BBB- was +2bps, in BBB +2.5bps, in BBB+ +4bps, in A- +3bps, in A +3bps, in A+ +3bps, in AA- +3.5bps, in AA +2.5bps, and in AA+ +1.5bps wider. In the EUR HY universe CCC was -40bps tighter, B grade was -18 bps tighter, while BB was -7.5bps tighter. Rating-wise in US IG the BBB rating bucket was the outperformer (BBB- -10bps, BBB, BBB+ were unchanged), while A and AA grades were mostly unchanged. Technical for cash continues to remain strong both in EUR and US, with supply well received, and cash balances ready to buy the dip. Tapering discussion is still in early stages, but given inflation persistence and supportive macro data, especially in the US, CBs support will come under questioning sooner than later. Therefore, we expect spreads to trade range-bound to slightly wider in the short term, and possibly moderately widen towards Q4 and year end.

USA

The economy continues to expand, albeit at a slower pace than previously expected

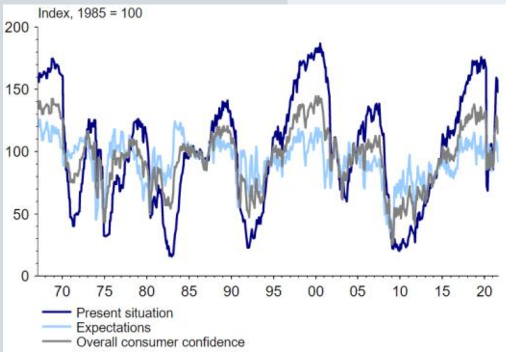
Figure 8: US GDP breakdown



Source: Refinitiv Datastream, Fathom Consulting

According to the BEA's second estimate, real GDP growth was upwards revised by merely 0.1ppts to 6.6%QoQ saar in Q2, up from 6.3%QoQ reported in Q1. Nonresidential fixed investment was revised higher to 9.3%QoQ from 8.0%QoQ, while net trade subtracted only 0.2pps from overall growth vs 0.4pps reported initially, offsetting a larger decline in residential investment of 11.5%QoQ (9.8% in the advance estimate) and a bigger drag from private inventories (1.3pps vs. 1.1pps initially). Entering into Q3, high frequency data continue to suggest some moderation in economic momentum. Personal spending growth eased in July, increasing by 0.3%MoM after a 1.1%MoM rise in the prior month. The increase in services spending (+1.0%MoM) was partially offset by a decline in goods consumption, especially for the durable goods that dropped by a hefty 2.3%MoM, while July headline and core retail sales fell by 1.1%MoM and 1.0%MoM, respectively. Meanwhile, consumer confidence deteriorated in August amid mounting worries about the Delta variant and its economic repercussions, with the Conference Board's respective index falling to a six-month low of 113.8 from 125.1 in July and the University of Michigan's index at a 10-year low of 70.3 from 81.2 in the prior month. Overall, the economic momentum in 2021 seems softer than previously expected as the positive effect of pandemic-related measures fades and lingering supply chain constraints weigh on industries. Despite the economic deceleration, the US economy continues to expand with Fed Chair Jerome Powell noting at his speech at the annual Jackson Hole Symposium that "prospects are good for continued progress toward maximum employment". Although certain FOMC members have explicitly been in favor of an imminent tapering start, Powell reiterated his view from the July FOMC meeting for a Fed tapering later this year. Powell's speech focused on the inflation spike, which largely reflects transitory factors, expressing the view that inflationary pressures will likely soften over time. Provided that the economic expansion continues in line with the Fed's expectations, the September FOMC statement will likely acknowledge that substantial economic progress has been made regarding inflation and the labor market, paving the way for a formal taper announcement in Q4.

Figure 9: US Conference Board Consumer Survey



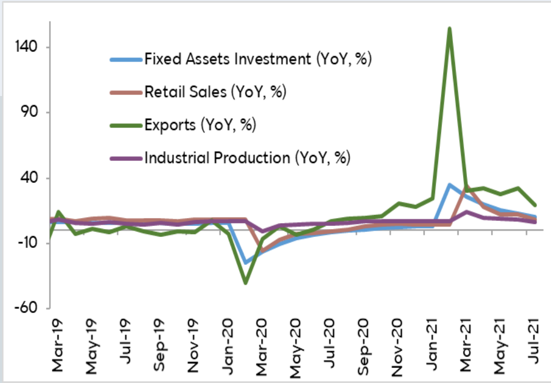
Source: Refinitiv Datastream, Fathom Consulting, Eurobank Research

China

The evident cooling of the economy in July has given way to a sharper than expected slowdown

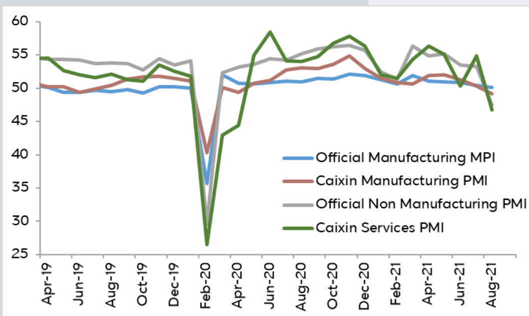
The Q2-2021 GDP print came in at 7.9%YoY down from 18.3%YoY in Q1 and a tad lower from the market consensus of 8%, setting the H1-2021 GDP growth rate at ca.13.1%. Ever since, the evident cooling of the economy in July has given way to a sharper than expected slowdown based on recent hard and soft data referring both to the demand and supply side. Retail sales expanded by 8.5%YoY in July vs 12.1%YoY in June, well below market estimates at 10.9%YoY and so did real estate and fixed assets investments and industrial production. July's manufacturing PMIs, both official and Caixin, decelerated with the trend continuing in August as well. The deceleration so far can be broadly attributed, inter alia, to the floods in the Henan province in July, which caused the suspension of economic activity in the said region. Looking ahead, the Delta variant spread in mid- August to more than half of the country's 34 provinces will weigh on the Q3 economic performance. Despite the fact that at the time of writing the surge is considered fully contained, the draconian measures to eliminate new infections, such as isolating cities, canceling flights and closing down entertainment venues, will come at an economic cost, while there is a strong chance that these measures will be repeated until the end of the year, as new outbreaks keep arising. The above landscape, which is shaped by natural disasters and the resurgence of the pandemic, coincides with the roll out of a vigorous reforms agenda by the government. The government's crackdown on the technology and the education sectors, as an anti-trust policy attempt, has already put pressure on the labor market and, consequently, on domestic consumption. Undoubtedly, there will be, as it already has, policy reaction in order to restrain the aforementioned economic adversities at play. In mid-July, the PBoC stepped into a 50bps RRR, the first in 18 months, freeing up almost USD150bn of liquidity to be infused in the economy as lending. As the cut has not been translated into credit pickup, with total social financing growth approaching February 2020 lows, an additional RRR cut is likely to come in H2-2021 in order to further facilitate credit expansion and support the economy.

Figure 10: July's hard data point to deceleration of the economy



Source: Bloomberg, Eurobank Research

Figure 11:... while the same is implied for Q3 by forward looking data

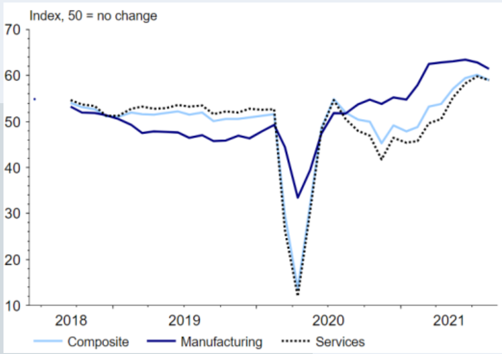


Source: Bloomberg, Eurobank Research

Euro area

Growth momentum remains robust, although the pace of expansion seems to have slowed somewhat in the beginning of Q3

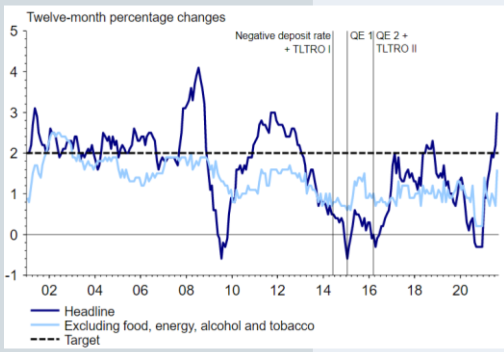
Figure 12: Euro area PMIs



Source: Markit,, Refinitiv Datastream, Fathom Consulting, Eurobank Research

The final Eurozone Composite PMI was revised downwards by 0.6pts in August, coming in at 59.0 from 60.2 in July that was the highest level in more than 15 years. Services business activity decelerated only slightly to 59.0 from July's 59.8, retaining its strong momentum despite the spread of the Delta variant in the summer months. The manufacturing sector continued to expand - albeit at a slower pace - showing some easing in supply chain disruptions, with the respective PMI falling to a six-month low of 61.4 in August from 62.8 in the prior month, marking the second successive monthly slowing since June's record pace of growth. Along the same lines, the European Commission's Economic Sentiment Indicator (ESI) fell marginally by 1.5pts to 117.5 in August, with services reporting the strongest decline (-2.1pts to 16.8), followed by the consumer (-0.9pt to -5.3) and industrial confidence indices (-0.8pt to 13.7). On a positive note, retail trade and construction confidence indicators rose by 0.2pt and 1.5pts to 4.6 and 5.5, respectively. On the inflation front, headline HICP increased by 0.8pps to a 10-year high of 3.0%YoY in August, driven by a 0.9pps rise in core inflation to 1.6%YoY. Non-energy industrial goods inflation surged by 2.0pps to 2.7%YoY, partly due to the timing of France's and Italy's summer sales, while services inflation increased by 0.2pp to 1.1%YoY on higher transport prices. Overall, growth momentum remained robust in recent months with leading indicators well above long-term averages, although the pace of expansion seems to have slowed somewhat in the beginning of Q3. The strong economic rebound, higher realized and expected inflation and accommodative financing conditions move the ECB closer to a slower pace of PEPP purchases. Following recent comments by ECB Chief Economist Philip Lane highlighting that a reduction of the pace of asset purchases is just a necessary adjustment and should not be read as the commencement of a tapering process, the announcement for lower purchases may come as early as at the ECB's September monetary policy meeting, reinforced by upward revisions to growth and inflation estimates, or alternatively, at the December meeting at the latest. The ECB will likely reduce its monthly PEPP purchases to ca. €60-70bn from about €80bn in the past six months, keeping the asset purchase program (APP) at a monthly pace of €20bn.

Figure 13: Euro area HICP inflation



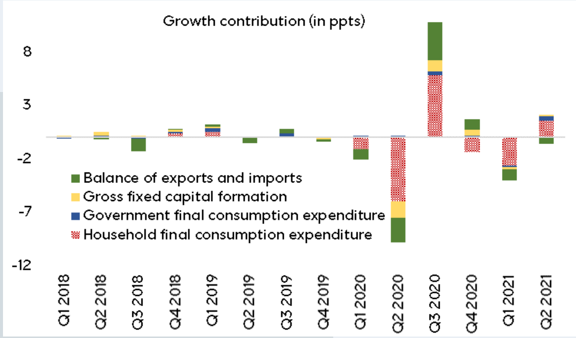
Source: Refinitiv Datastream, Fathom Consulting

Germany

Healthy GDP growth in Q2 as consumption rebounds strongly

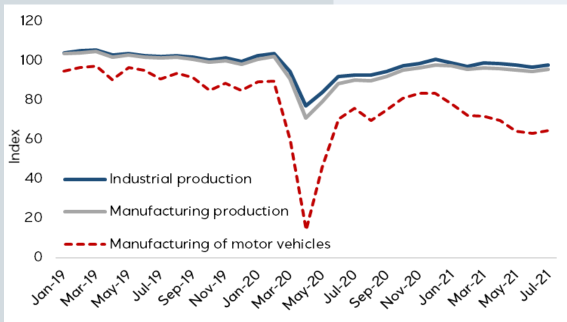
German GDP grew by a healthy 1.6%QoQ in Q2, slightly higher than the flash estimate of 1.5%QoQ, leaving economic activity c. 97% below the Q4 2019 pre-pandemic level following an upwards revised contraction of 2.0%QoQ in the prior quarter. The biggest growth driver was personal consumption, increasing by 3.2%QoQ and contributing 1.6ppts amid improved consumer confidence, as the sharp drop in new Covid-19 cases allowed in May a broad reopening of the economy (Figure 14). The second largest positive contribution came from government spending (0.4pts and growth 1.8%QoQ), likely supported by additional testing and vaccination spending. The contribution from fixed capital formation was moderate (+0.1ppts) mirroring the effects of the supply chain disruptions, while net exports had a material negative contribution (-0.6ppts) since imports (+2.1%QoQ) grew by a much stronger pace than exports (+0.5%QoQ). Looking ahead, another strong growth increase is expected in Q3 on the view that, since the reopening only started in the last few weeks of Q2, the bulk of the economic rebound is expected to materialize in Q3. However, going further ahead, leading indicators point to a sharply lower growth in Q4. Indicatively, the ZEW Indicator of Economic Sentiment that gauges economic activity six months ahead recorded in August the third decline in a row falling by 22.9pts to the lowest level since November 2020 of 40.4pts, the IFO business climate index fell unexpectedly in August for the second month in a row (99.4 from 100.7), and the PMI manufacturing dropped in August for the first time in four months to a six-month low of 62.6, all reflecting worries over rising infection numbers and global supply bottlenecks of intermediate products in manufacturing, such as semiconductor shortages. The said problem is likely to persist until at least the end of the year in view of the complex production chain that requires high upfront investment, putting pressure on prices, reducing disposable income and, eventually, weighing on consumption. We see growth peaking at above 3.0%QoQ in Q3 before easing close to 0.5%QoQ in Q4, with the economy growing by 3.4% in the year as a whole. In the political sphere, there are now less than three weeks to go until the 26 September federal election, with opinion polls suggesting that the result is too close to call.

Figure 14: Private consumption led GDP growth in Q2 2021



Source: Federal Statistical Office, Eurobank Research

Figure 15: Supply chain disruptions continue to weigh on vehicle production



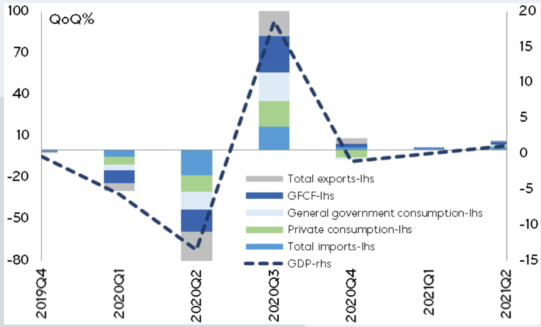
Source: Federal Statistical Office, Eurobank Research

France

GDP bounced back in Q2 as the economy reopens

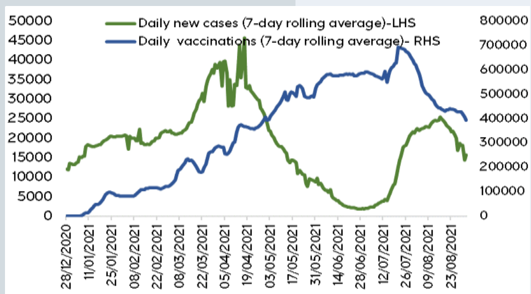
France's GDP bounced back in Q2 growing by 1.1%QoQ, upwards revised from the first estimate of 0.9%QoQ after a flat reading in the prior quarter, also revised up from -0.1%QoQ earlier reported. Final domestic demand was the main contributor, adding 1.2ppts to overall growth thanks to: (i) a 1.0%QoQ increase in household expenditure as the release of pent-up demand led to a strong rebound in services consumption, after the relatively swift withdrawal of lockdown measures that started in early May with the lift of restrictions on domestic travel and then the re-opening of restaurants, shops and bars after a four-week nationwide lockdown in April, and (ii) a 2.4%QoQ rise in gross fixed capital formation that took it above its Q4 2019 pre-pandemic levels mainly supported by household investment (+4.1%QoQ). Net trade subtracted 0.2ppts as the pace of growth in imports (1.7%QoQ) outpaced that of exports (1.0%QoQ), offsetting a slight positive contribution of 0.1ppt from the change in inventories. All in all, France's GDP remained 3.2% below its Q4 2019 pre-pandemic level, having narrowed the gap from 4.2% in the prior quarter. With tight restrictions now disappeared as the bulk of containment measures were removed in the end of June, GDP is expected to increase further in July, as evidenced by recent robust sentiment indicators (including July's INSEE business climate and INSEE consumer confidence), but will likely lose some ground in August and remain stable in September as the decision for the mandatory use of the Covid-19 health pass to access a range of services, effective from early August, will likely exert a negative impact on economic activity. Improving labor market conditions (payroll employment returned in Q2 to pre-pandemic levels after rising by 1.2%QoQ), EU recovery funds (France received the first tranche from the Resilience and Recovery Facility in mid-August amounting to €5.1bn) will likely allow a slightly faster normalization of economic activity in Q4, with the gap to the pre-crisis GDP level expected to be closed by year-end. For the full year, we have revised out GDP growth estimate to 6.0% from 5.8% previously, following the stronger than expected H1 2021 growth performance. The main downside risks to our estimate stem from the spread of the Delta variant and the slowing vaccine roll-out.

Figure 16: GDP bounced back in Q2 2021



Source: iNSEE, Eurobank Research

Figure 17: PM Emmanuel Macron has announced measures aiming to boost vaccine take-up



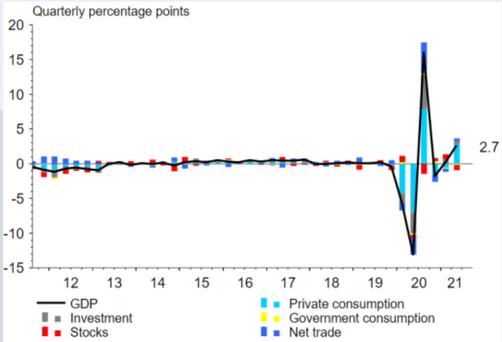
Source: Our World In Data, Eurobank Research

Italy

Strong initial GDP estimate for Q2 leads to upgraded growth forecasts for 2021

According to the initial estimate published by the Italian national statistical office Istat, real GDP accelerated by 2.7%QoQ in Q2 up from 0.2%QoQ in Q1, bringing its annual rate of expansion up to 17.3% from -0.7%YoY in Q1. In more detail, household consumption expenditure increased by 5.0%QoQ (after -1.1%QoQ in Q1), more than offsetting a 0.9%QoQ decline in government spending (following a -0.5% fall in Q1), while gross fixed capital formation growth softened somewhat to 2.4%QoQ compared to the prior's quarter rise of 3.8%QoQ. Furthermore, imports and exports increased by 2.3%QoQ (from 2.5%QoQ in Q1) and 3.2% QoQ, (from 0.6%QoQ) respectively, while the carry-over annual GDP growth for 2021 is currently 4.7%. Looking into Q3, PMI indices point to robust growth in both the manufacturing and the services sectors. The manufacturing PMI rose to 60.9 in August from 60.3 in July, signaling an improvement for the fourteenth month in a row and staying close to record highs. The August services PMI remained at July's 14-year high of 58.0, with new business inflows rising rapidly amid solid demand conditions. Meanwhile, the composite business confidence indicator (IESI) softened somewhat by 1.9pts to 117.7 in August, staying, however, well above its long-term average of ca. 100. Confidence across all sectors (services, industry, construction, consumer) registered mild declines, with the exception of retail trade confidence that increased by 3pts to a six-year high of 14.8. On a positive note, Istat's consumer confidence fell marginally by 0.4pts to 116.2 in August, within small distance from July's three-year high of 116.6. Following the strong rebound of the economy in Q2, the government has reportedly raised its 2021 growth forecast from about 5.0% in July to close to 6.0%. The government's updated forecasts will be included in the Economic and Financial Document (DEF) to be published on September 27, along with its updated fiscal targets. After the higher than expected initial estimate of Q2 real GDP growth, we have upgraded our 2021 GDP growth projection to 5.5% from 5.0% in July, underpinned by highly expansionary fiscal policy, as the country seems to be the biggest beneficiary of EU funding with an envelope of €191.5bn (~11.6% of GDP) from the Resilience and Recovery Facility (RRF), followed by Spain that is expected to receive €69.5bn (~6.2% of GDP).

Figure 18: Italy contributions to GDP growth



Source: Refinitiv Datastream, Fathom Consulting

Figure 19: Italy consumer and business confidence

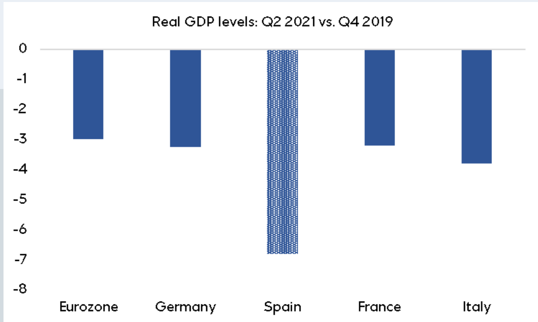
Source: Refinitiv Datastream, Fathom Consulting

Spain

Sustainable economic recovery supported by tourism rebound

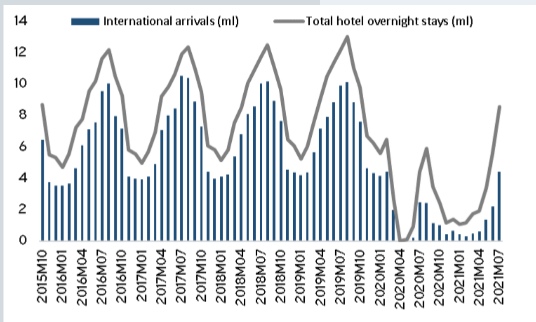
After a 0.4%QoQ GDP contraction in Q1 2021 triggered by tighter restrictions imposed in January to contain the third Covid-19 wave, the Spanish economy swung back into expansion in Q2. Real GDP rebounded by a robust 2.8%QoQ as the accelerating vaccine rollout allowed for a gradual lifting of restrictions, remaining though 6.8% below Q4 2019 pre-crisis levels and lagging behind all other major EA economies (Figure 20). Private consumption was the main growth driver (+6.5%QoQ vs. -0.4%QoQ in Q1) supported by looser restrictions, stronger consumer sentiment and improved labor market conditions (the unemployment rate dropped from 16.0% in Q1 to a more than a year low of 15.2% in Q2). Government consumption also gained (+0.8%QoQ), probably thanks to increased healthcare spending, while investment contracted for the second quarter in a row (-1.5%QoQ) and net exports had a negative effect on growth, as imports (+2.9%QoQ) outpaced exports (+0.4%QoQ) amid strengthening private consumption. Looking forward, sentiment indicators pertaining to Q3 (July's PMIs, August's EC consumer sentiment) point to a continued economic recovery, also supported by a stronger than expected rebound in tourism during the summer high season (the direct and indirect share of tourism in Spain's GDP stands at 14.6%, much higher than the 6.9% average of the other three major EA economies). The number of international arrivals increased in July by near 80% compared to the same month last year but still 55% below July 2019 levels, while total hotel overnight stays nearly doubled compared to July 2020 levels albeit 30% below 2019 levels (Figure 21). Meanwhile, Spain received the first tranche from the Resilience and Recovery Facility (RRF) in mid-August amounting to €9bn, which should continue to support growth in H2 2021 while an additional €10bn will likely be granted by year-end. So far, Spain has requested a total of €69.5bn (6.2% of 2020 GDP), in grants only, that will be disbursed in eight instalments, subject to certain milestones and concentrated in the 2021- 2023 period. For the full year, we project GDP to grow by 5.8%, lower than the Bank of Spain's more optimistic projection of 6.2%, with the spread of the Delta variant, though, clouding Spain's economic outlook.

Figure 20: As of Q2 2021, Spain's recovery is lagging behind other major EA economies



Source: Eurostat, Eurobank Research

Figure 21: Tourism rebounded stronger than expected during the summer high season



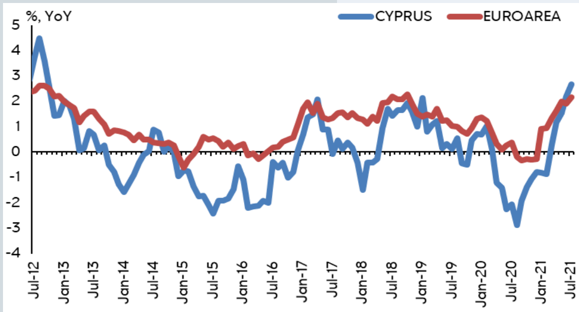
Source: Spanish Statistical Office (INE), Eurobank Research

Cyprus

Strong Q2 GDP print creates expectations for overperformance in FY2021

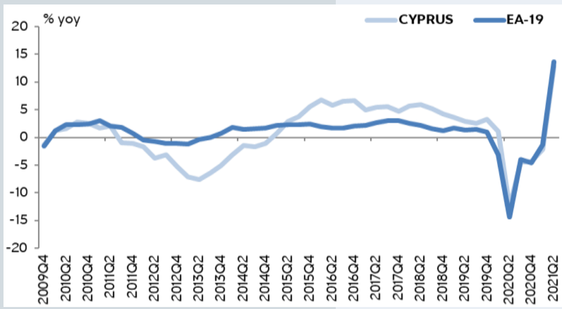
Underpinned by favorable base effects from the phasing out of last year's restrictions, the economy rebounded strongly in Q2-2021. According to the revised estimate, GDP on a seasonally adjusted basis expanded by +0.2% QoQ in Q2-2021 compared to +1.7% QoQ in Q1-2021 vs. +1.3% QoQ in Q4-2020. The latter translates into +12.9% YoY in Q2-2021, a tad below the Euroarea (+13.6% YoY), up from -1.6% YoY in Q1-2021, compared to -4.4% YoY in Q4-2020. Overall, the GDP print has surprised to the upside, strengthening optimism for the full-year prospects. To that end, the Ministry of Finance (MoF) has upgraded the GDP projection for 2021 from 3.7% to 4.5%-5% in mid-May after the announcement of the Q1-2021 GDP data and then higher to 5.5% in mid-August. The international organizations' forecasts are still lagging behind. According to the latest EC summer economic forecasts (July 2021), the economy is anticipated to rebound by +4.3% in 2021 (vs. 3.1% in the spring 2021 forecast) and +3.8% in 2022 (unchanged vs. the spring 2021 forecast), which is below the Euro area for both years. Meanwhile, the economic sentiment has been on an improving trend in Q3. The Economic Sentiment Indicator (ESI) climbed again in August close to its highest level since the start of the pandemic. The ESI improved by 2.9 points to 104.9 in August up from 102.0 in July and 105.0 in June. The Employment Expectations Indicator (EEI) declined by 1.5 points to 103.5. The rise in the ESI index was driven mostly by improvements in the retail and services sectors and smaller gains in consumer and industrial confidence, while construction was the only component to post a small decline. The improvement in the retail and services mirror the upward revision of future demand expectations underpinned by the acceleration of the vaccination program (78.3% of the adult population vs. 76.9% in EU/EEA-has received at least the first vaccine dose) and the lift of the containment measures. On the fiscal front, according to the preliminary results released by CYSTAT, the general government recorded a €684,9mn deficit in January-July 2021 almost unchanged from €686,5mn in January-July 2020. As a percentage of GDP, the general government deficit improved to -3.1% in 7M-2021 vs. -3.3% in 7M-2020. Mirroring the deep recession and the government's support measures, the country's fiscal position shifted into a deficit after several years of surpluses. The general government recorded a -5.7% of GDP in 2020 compared to a surplus of +1.5% of GDP in 2019.

Figure 22: HICP inflation in positive territory since March 2021



Source: Eurostat, Eurobank Research

Figure 23: The economy rebounded strongly on an annual basis in Q2-2021 in line with EA-19



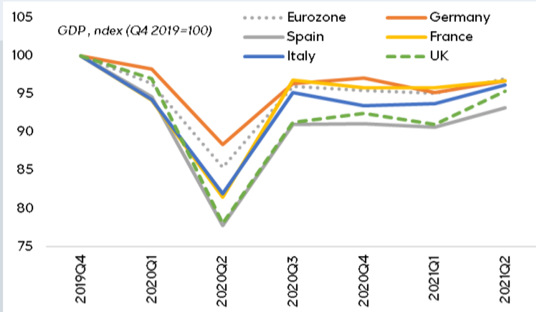
Source: Eurostat, Eurobank Research

UK

Economic recovery is losing steam on supply chain and recruitment difficulties

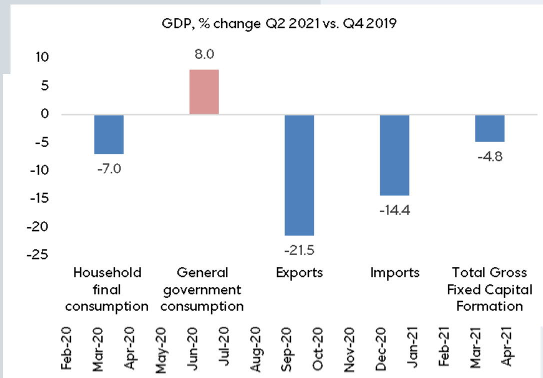
After a 1.5%QoQ contraction in Q1 when the country was in the third national lockdown, UK GDP rebounded in Q2 growing by 4.8%QoQ, which is slightly lower compared to the BoE's 5.0%QoQ projection, leaving the level of economic output 4.4% below its pre-pandemic Q4 2019 level and lagging behind many other developed economies (Figure 24). The lower-than-anticipated Q2 GDP growth rate was mostly driven by the disappointing May performance (+0.6%MoM). However, economic recovery regained momentum in June (+1.0%MoM) thanks to the services sector (+1.5%MoM vs. +0.7%MoM in May), with health activities contributing the most on the back of a resurgence in patient visits to GPs, and hospitality benefitting from its first full month of indoor dining since COVID-19 restrictions were eased on 17 May. For Q2, GDP growth owed mostly to household consumption, which grew by 7.3%OoQ and contributed 4.1ppts, while government consumption was also strong, rising by 6.1%QoQ and adding 1.5ppts to headline growth. On a negative tone, net trade subtracted 0.9ppts and business investment dropped for the second quarter in a row (-0.5%QoQ), reaching levels well below those recorded in the recovery from the first lockdown in late 2020. The above resulted from a sharp drop in government investment (-9.7%QoQ), while business investment grew by just 2.4%QoQ, half the overall Q2 GDP growth rate, reflecting a further sharp drop in transport equipment (-17.6%QoQ followed by -50.8%QoQ in Q1), due to global supply chain bottlenecks and the global semiconductor shortage. Timelier data (including August PMIs) indicate that economic growth may have slowed further at the start of Q3 after a step down in July (weaker-than-expected retail sales and GfK consumer confidence), as supply chain bottlenecks continued to put a break on economic recovery, while recruitment difficulties appeared to prove more persistent. Looking ahead in Q4, economic growth is likely to lose some more steam by the end of the year, as the planned unwinding of income support over the coming months, notably the Job Retention Scheme and the temporary VAT cut for hospitality businesses, remain sizable headwinds to UK output. We now expect 2021 GDP growth at 6.5%, lower compared to 6.7% previously, with risks skewed to the downside.

Figure 24: The UK recovery is lagging behind many other developed economies



Source: Eurostat, ONS, Eurobank Research

Figure 25: Government consumption is the only component to be above pre-pandemic levels



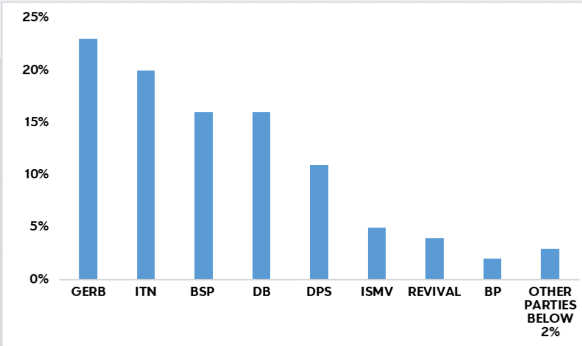
Source: ONS, Eurobank Research

Bulgaria

Despite the lingering political uncertainty, the strong Q2 flash GDP estimate spurs optimism on the full year print

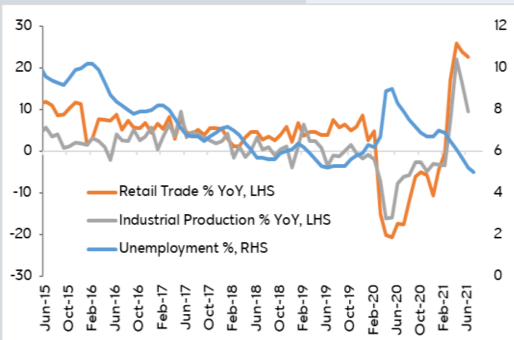
According to the Q2-2021 flash estimate, GDP expanded by 9.6% and 0.4% on a yearly and quarterly basis respectively. While the print on an annual basis compares favorably with that in the previous quarter (9.6% in Q2 vs -1.8% in Q1), some loss of steam is detected on a QoQ basis (0.4% in Q2 vs 2.5% in Q1). Until the release of the preliminary data that will provide a more thorough assessment of the GDP growth drivers, flash data point to private consumption and investments on the expenditure side as the components that supported the economy the most in Q2. Private consumption is more likely to continue to contribute positively in Q3 driven by the absence of restrictive measures in the summer amid manageable levels of daily Covid-19 cases. However, the delay in the submission of the national recovery plan to the EC may result in additional delays in the disbursement of the RRF funds and ultimately weigh negatively on investments in H2-2021. The Bulgarian resilience plan has not yet been submitted due to the prevailing rocky political landscape since April. The inability to form a viable government - after two parliamentary elections and an equal number of unsuccessful attempts for a coalition government - casts a shadow on the near term outlook of the economy. However, the aforementioned impasse will most probably be overcome by the end of the year through a third round of elections, this time jointly parliamentary and presidential. Concluding, the political risk is considered manageable as there is a broad consensus among analysts, including us, that the euro adoption and further European integration aspirations, that both help the economy reform and provide additional funds, are strong priorities in the political agenda of the country, which can hardly be derailed by any new government. GDP growth in H1-2021 is roughly estimated at 3.9% YoY and as we anticipate that in Q3 the economy will remain on track, we revise our 2021 GDP growth forecast to 4.5% from 3.5%, under the assumption that the Delta variant will have a mild negative impact on economic activity in Q4.

Figure 26: Latest polls continue to point to a fragmented parliament...



Source: Politico, Eurobank Research

Figure 27: ...but the economy remains on track as of Q22021



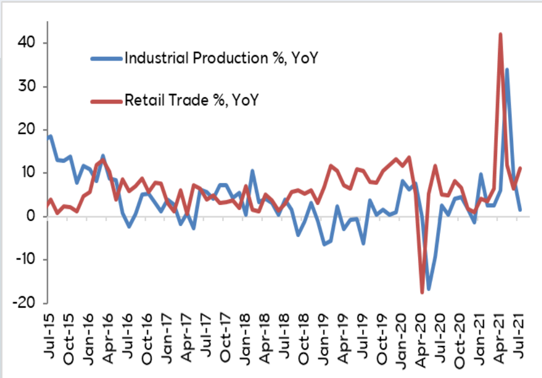
Source: Bloomberg Eurobank Research

Serbia

The stagnation in the vaccination campaign along with the uncertainty caused by the Delta strain keeps the economy from entering into goldilocks.

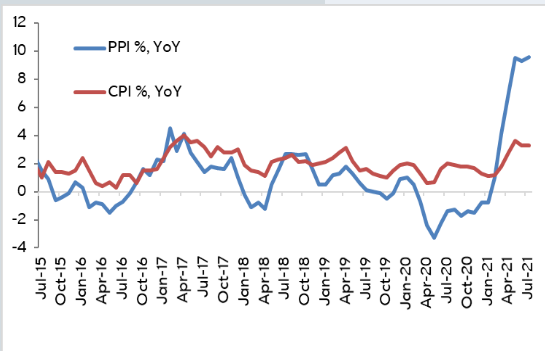
The Q2-2021 GDP growth print confirmed officials' expectations over a double digit GDP growth print. GDP expanded by +13.7% vs +1.7% YoY in Q1. The Q2 reading is a 20-year high, surpassing the initial estimates of both the Ministry of Finance and the National Bank of Serbia (NBS). That said, the latter revised upwards its GDP growth forecast for 2021 to 6.5% from 6%, following the +13.4% YoY flash estimate in early August and the assessment of hard data that point to a stronger-than-anticipated contribution of construction. Currently, the H1-2021 GDP growth stands at ca. 7.7%, rendering the official 6.5% forecast set by the Ministry of Finance achievable. We, on the flipside, adopt, for the time being, a more conservative stance keeping our view stable at 5.5%. Indeed there is a strong macroeconomic momentum unfolding currently in Serbia and the ambitious public investments programme will most probably have a positive impact in H2-2021. However, the vaccination progress has shown signs of loss of steam in Q2, coinciding with the surge of the Delta variant in the country. The country's vaccination rate was second, following the UK's at the start of the year but now most EU countries have surpassed it, while at the same time daily cases are on an upward trend since the beginning of August. Additionally, hard data on both the supply and the demand side, such as industrial production and retail sales, continue to expand but with some deceleration since May, which continued till July, especially for the IP element. Concluding with recent monetary developments, inflationary pressures that are visible since the beginning of the year appear to be easing since June with signs of stabilisation in July. July's inflation print came in at 3.3% YoY, the same as in June from 3.6% YoY in May, which was a 4-year high. The aforementioned prices landscape allowed the NBS to maintain its key policy rate (KPR) unchanged at 1% in August's meeting, securing thus supportive liquidity conditions in contrast to other CESEE economies, such as Hungary, where more persistent inflationary pressures forced central banks into monetary tightening through interest rate hikes and QE wind down.

Figure 28: Economy remains on track but with some loss of steam on the supply side...



Source: Bloomberg, Eurobank Research

Figure 29: while the inflationary pressures on the supply side show limited pass through so far to the headline inflation



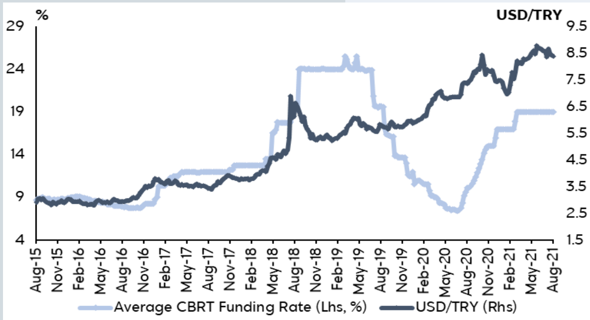
Source: Bloomberg Eurobank Research

Turkey

Strong GDP growth performance in Q2-2021

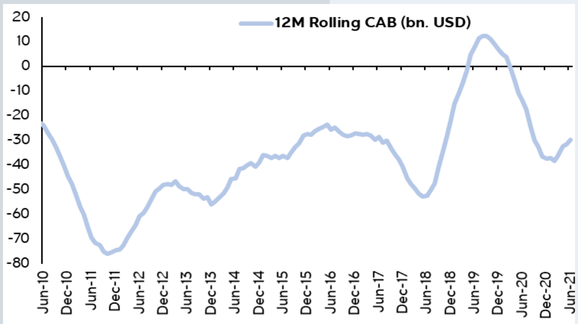
GDP performance remained strong in the second quarter of the year underpinned by favorable base effects. On a seasonally and calendar adjusted basis, GDP expanded by 0.9% QoQ in Q2-2021, compared to 2.2% QoQ in Q1-2021, 15.9% QoQ in Q3-2020 and -11.0% QoQ in Q2-2020. On an annual basis, GDP skyrocketed by 21.9% YoY in Q2-2021 up from an upwards revised 7.2% YoY in Q1-2021, 5.8% YoY in Q4-2020 and 4.1% YoY in Q1-2020. Consumption, both private (23.1% YoY in Q2 vs. 7.4% YoY in Q1) and public (4.6% YoY in Q2 vs 1.2% YoY), was the main contributor to GDP growth, investments remained on a recovery trend (20.3% YoY in Q2 vs. 12.4% YoY in Q1), while net exports' contribution remained positive for a second quarter in a row. Overall, even though downside risks to the growth outlook in H2 do exist, GDP growth is now forecasted to rebound by 7.5% in 2021 and settle back to trend growth around 4% in 2022. The expansion reflects a large positive carryover from the sharp activity rebound in H2-2020. Turkey was among the few economies in the world to avoid a recession in 2020 expanding by 1.9%. The expansion was driven by large credit provision by state-owned banks and extensive liquidity support at the expense of exacerbating pre-pandemic vulnerabilities such as high inflation, low FX reserves, large external financing needs, and dollarization. The CBRT left its key policy rate (KPR) – the 1-week repo rate – at 19.0% in early August, meeting markets' expectations. CBRT reiterated its commitment to maintain a tight policy stance until the significant fall in the inflation report's forecast path is achieved. In addition, the report of the central bank speaks of upside inflation outlook risks stemming from recent increases in import and administered prices, demand conditions, supply constraints in some sectors, inflation volatility in the summer due to the easing of Covid19 related restrictions and high levels of inflation expectations. Inflation already climbed to 19.25% YoY in August – a two-year high – up from 19.0% YoY in July and 17.5% YoY in June, well above the revised year-end target of 12.4% in 2021 and the mid-term target of 5%. The print surprised to the upside analysts' consensus expectations (Actual: +1.1% MoM vs +0.6% MoM) and limits CBRT's room for maneuver. In an illustration of the increasing cost-led price pressures, PPI increased further to 45.5% YoY in August vs. 44.9% YoY in July for a 15th month in a row, up from 42.9% YoY in June. On top, upside inflation risks do exist from the food and energy inflation and the continued pass-through from earlier FX depreciation.

Figure 30: Lira came under strong depreciation pressure on concerns for CBRT independence



Source: Bloomberg, Eurobank Research

Figure 31: 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	-3.2	6.0	4.5	3.2	3.5	3.2									
Advanced Economies															
USA	-3.4	6.6	4.0	1.2	3.8	2.7	8.1	5.5	4.2	-3.0	-3.6	-3.3	-15.6	-13.5	-6.5
Eurozone	-6.4	4.6	4.3	0.3	2.0	1.5	7.9	8.1	7.9	2.2	2.6	2.5	-7.2	-7.5	-4.2
Germany	-4.9	3.4	4.6	0.4	2.8	1.7	3.9	3.8	3.7	7.0	7.5	7.0	-4.2	-6.0	-2.5
France	-8.0	6.0	4.0	0.5	1.7	1.5	8.0	8.1	8.2	-1.9	-1.4	-1.2	-9.2	-8.5	-5.2
Periphery															
Cyprus	-5.1	5.5	4.0	-1.1	1.2	1.5	7.8	7.5	6.7	-11.4	-10.0	-8.0	-5.7	-4.7	-2.5
Italy	-8.9	5.5	4.2	-0.2	1.4	1.2	9.3	10.3	9.9	3.2	3.2	3.0	-9.5	-11.5	-8.5
Spain	-10.8	5.8	5.6	-0.3	2.2	1.4	15.5	14.8	14.2	0.7	1.7	1.9	-11.0	-8.4	-4.9
Portugal	-7.6	4.1	5.0	-0.1	0.9	1.3	7.2	7.5	6.7	-1.3	-0.5	-0.5	-5.7	-5.0	-3.5
UK	-9.8	6.5	5.0	0.9	2.1	2.4	4.3	5.0	5.2	-3.5	-3.8	-4.2	-12.3	-9.6	-4.8
Japan	-4.7	2.6	2.4	0.0	0.1	0.6	2.8	2.9	2.7	3.2	3.5	3.5	-10.1	-9.0	-5.5
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	8.2	5.5	2.5	1.5	2.3	4.2	3.9	3.6	1.5	1.7	1.3	-6.9	-5.8	-4.3
India	-7.7	9.2	6.9	6.2	5.5	4.8		*NA*		0.9	-0.8	-1.2	-9.3	-6.8	-6.0
Russia	-3.0	3.5	2.5	3.4	5.5	4.0	5.8	5.5	5.0	2.2	3.5	3.0	-4.3	-1.5	-0.7
CESEE															
Bulgaria	-4.2	4.5	4.1	1.7	2.5	2.3	5.1	4.8	4.5	1.2	2.0	1.5	-3.0	-4.4	-2.5
Romania	-3.9	7.5	5.0	2.3	4.0	3.5	5.0	5.3	4.8	-5.0	-6.0	-5.5	-9.0	-8.0	-6.0
Serbia	-1.0	5.5	4.5	1.6	2.8	2.2	9.7	12.8	10.4	-4.3	-4.5	-4.7	-8.1	-6.9	-3.0
Turkey	1.8	7.5	4.0	12.3	16.5	12.5	13.2	12.5	12.0	-5.1	-3.5	-2.5	-4.5	-4.0	-3.5

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

Eurobank Fixed Income Forecasts

	Current	September 2021	December 2021	March 2022	June 2022
USA					
Fed Funds Rate	0.00-0.25%	0.00-0.25%	0.00-0.25%	0.00-0.25%	0.03-0.30%
1 m Libor	0.08%	0.12%	0.14%	0.17%	0.21%
3m Libor	0.12%	0.17%	0.20%	0.24%	0.29%
2yr Notes	0.21%	0.25%	0.29%	0.36%	0.46%
10 yr Bonds	1.32%	1.47%	1.64%	1.74%	1.83%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.55%	-0.52%	-0.50%	-0.49%	-0.47%
2yr Bunds	-0.71%	-0.65%	-0.64%	-0.65%	-0.62%
10yr Bunds	-0.37%	-0.24%	-0.18%	-0.12%	-0.02%
UK					
Repo Rate	0.10%	0.10%	0.10%	0.15%	0.15%
3m	0.06%	0.10%	0.12%	0.14%	0.18%
10-yr Gilt	0.70%	0.77%	0.87%	0.95%	1.02%
Switzerland					
3m Libor Target	-0.76%	-0.74%	-0.74%	-0.74%	-0.74%
10-yr Bond	-0.34%	-0.21%	-0.13%	-0.07%	-0.02%

Source: Bloomberg (market implied forecasts)

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