ISSN: 2241-4851

Eurobank Research

EUROBANK

GLOBAL & REGIONAL MONTHLY

Global recovery continues but has lost momentum, 2022 enters on a weaker than previously expected position. Meanwhile, inflation continues to surprise to the upside, while labor markets are tightening across most developed economies, raising the risk of a more lasting period of elevated price pressures. Amid concerns that stubbornly high inflation could become entrenched into inflation expectations, several Central Banks take a more hawkish stance and appear ready to remove policy accommodation more rapidly than earlier expected, overlooking the perceived transitory Omicron drag on economic growth.

Macro Picture

USA: Economy on a solid footing but challenges persist

EA: GDP returned to its pre-crisis level in Q4 2021, although growth decelerated sharply

UK: November GDP bounce does not indicate a trend improvement in the short-term outlook

EM: Mounting inflationary pressures trim disposable incomes, clouding the GDP growth outlook

CESEE: Sizeable fiscal space is devoted in countering elevated energy prices

Markets

FX: USD strength has paused as Fed QE tapering seems priced in and ECB took a hawkish tilt

Rates: EU and US rates remain very volatile with the level of both curves increased in anticipation of earlier than expected interest rate hikes

EM: Assets under pressure as Fed hawkishness, geopolitical risks, and inflation uncertainties keep volatility elevated

Credit: Spreads wider in January, expected to continue to move moderately wider in Q1 on CBs tapering and rate hikes

Policy Outlook

USA: Fed signals rate hike in March 2022

EA: Hawkish shift in ECB rhetoric

UK: The BoE delivered another rate hike in February as inflation risks outweigh growth concerns

CESEE: Central banks turn more hawkish in order to tame the surging inflation

Key Downside Risks

DM: New infectious variants that prolong the pandemic, longer period of elevated price pressures, de-anchoring of inflation expectations, aggressive monetary policy tightening, increased geopolitical tensions

EM: A further spike in energy prices amid elevated geopolitical risks (e.g. Russia-Ukraine) and idiosyncratic stressed cases (e.g. Turkey) weigh on the growth outlook

Special Topics in this issue

Eurozone inflation: Attention turns to wage growth this year

Ukraine-Russia crisis: Implications for Europe's energy sufficiency

Contributing Authors:

Anna Dimitriadou
Economic Analyst
andimitriadou@eurobank.gr

Maria Kasola
Economic Analyst
mkasola@eurobank.gr

Paraskevi Petropoulou
Senior Economist
ppetropoulou@eurobank.gr

Special thanks to the Global Markets team (Global_Markets_Trading@eurobank.gr), Eurobank Bulgaria and Eurobank Serbia, as well as Mrs. Elia Tsiampaou for their valuable contribution in this issue

February 2022

Contents

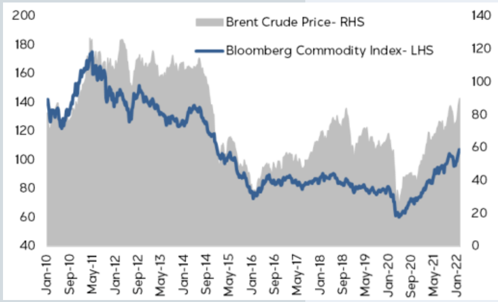
Macro Views

Latest Macroeconomic Developments & Outlook

World Economic Outlook

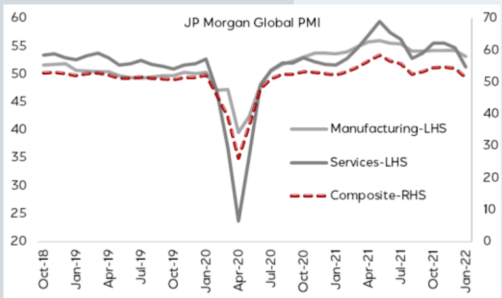
As was revealed in the January PMI surveys from several major economies, global recovery continues but has lost momentum, entering 2022 on a weaker than previously expected position. The re-introduction of tighter restrictions in winter that resulted in a reduction in mobility as the Delta strain and, later, the Omicron variant, took their toll on the national health systems, remains a drag on global growth. Meanwhile, pandemic-related supply issues, rising energy prices and higher commodity prices more broadly, as well as increased agricultural prices, have resulted in elevated price pressures, eroding households' purchasing power and denting sentiment. In fact, inflation has been surprising to the upside in recent months, rising not just above pre-pandemic levels for most of the world, but also above many Central Banks' inflation target, as well. That said, Bloomberg's Commodity Index hit a fresh record high in early February, taking cumulative gains above 10% on a YTD basis. Supporting the view for a deceleration in global growth at the start of 2022, the J.P. Morgan Global Composite Output Index dropped from 54.3 in December to a 1½-year low of 51.4 in January. Manufacturing PMI fell by 1.1pts to a 15-month trough of 53.2, while services PMI declined by a relatively higher 3.4pts to 51.3, the lowest level since summer 2020. Meanwhile, labor markets are tightening across most developed economies, notably in the US and the UK, posing upside risks to wage growth. The combination of unexpectedly high inflation and tightening labor markets, raises the risk of a more lasting period of elevated price pressures. Amid concerns that stubbornly high inflation could become entrenched in long-term inflation expectations, several Central Banks, including the Fed and the BoE, take a more hawkish stance and appear ready to remove monetary policy accommodation more rapidly than expected just a few months ago, overlooking the perceived transitory Omicron drag on economic growth. Overall, elevated inflation is expected to persist for longer than earlier expected, while 2022 global GDP growth is seen moderating to 4.3% from 5.9% in 2021.

Figure 1: Commodity prices continue to trend higher



Source: Bloomberg, Eurobank Research

Figure 2: Signs of deceleration in GDP global growth at the start of 2022



Source: Bloomberg, Eurobank Research

Developed Economies

US: The economy grew by 5.7% in 2021, the fastest pace since 1984, after contracting by 3.4% in 2020, the biggest decline in 74 years. Real GDP increased by 6.9% annualized in Q4-2021 (from 2.3% in Q3), primarily reflecting increases in private inventory investment. Onto 2022, data point to solid economic activity growth, while the factors that slow it down are still related to the disruptions caused by the pandemic, namely labour and material shortages as well as soaring prices. Manufacturing and services continued to grow in January for the 20th month in a row, albeit at a slightly eased rate of expansion, while sentiment for the period ahead is optimistic. The labour market that remains tight along with high inflation triggered the hawkish shift of the Fed at the 25-26 January FOMC meeting, which announced a rate hike at the subsequent meeting in March 2022, should the economy continue to evolve in line with expectations. Markets do not rule out more than four hikes until the end of the year, if there are indications that inflation is becoming entrenched.

Euro area: Eurozone GDP grew by 0.3%QoQ in Q4, sharply lower from 2.3%QoQ in Q3, probably due to the reintroduction of tighter activity measures, and supply pressures, which, albeit modestly eased, remained elevated continuing to weigh on industrial output. As suggested by the renewed decline in the composite PMI for January, GDP growth is likely to remain subdued at the beginning of 2021. The Omicron wave has just peaked or is close to the peak, while supply bottlenecks are far from resolved, contributing to higher inflation, which has constituently surprised to the upside in recent months. That said, Q1 GDP growth is expected roughly the same as in the prior quarter, with the economy likely to regain momentum by spring, driven by an easing in activity restrictions on the back of an improved epidemiological picture. Meanwhile, the ECB did not change its monetary policy at the January policy meeting, in spite of the unexpectedly high inflation rates. However, the tone of President Christine Lagarde at the press conference marked a shift towards a hawkish direction, reinforcing market expectations for a possible acceleration of the exit from QE and the beginning of rate normalization before the end of the year.

Emerging Economies

EM: While waiting for the Q42021 and FY2021 GDP growth data to be released across the EM sphere, the focus turns to the mounting inflationary pressures in January, which have become more persistent during the last quarter for many large developing economies, such as Russia and Brazil, pushing the respective countries' Central Banks into key policy interest rate hikes. The exception remains Turkey, where inflation in January reached almost 50% on an annual basis without any hawkish turn being visible in the foreseeable future by the Central Bank of Turkey so as to revert or at least put a break on the rally of prices. The pandemic also remained in the spotlight in many geographic parts of the emerging sphere, the handling of which is broadly related to idiosyncratic factors in each country. In the above context and as geopolitical risks continue to increase, due to the escalation of the conflict between Russia and Ukraine, the growth outlook ahead is perceived as fragile and uneven. That said, the IMF, in the latest World Economic Outlook, revised downwards its annual GDP growth forecast for 2022 to 4.8% from 5.1% in October, keeping its forecasts for 2023 almost unchanged to 4.7% from 4.6% previously.

CESEE: With regional Q4GDP growth prints due in the end February (so far only the Czech Republic and Serbia have released flash estimates for Q4), focus in the previous month turned to the continuing inflationary pressures that have been building up vigorously in the last quarter. All major regional economies (Poland, Hungary, the Czech Republic, Romania, Serbia and Bulgaria) posted increased CPI prints in December, which in some countries approached more than 10-year highs. Specifically, in Bulgaria inflation spiked to 7.8% YoY from 7.3% YoY in November, reverting to inflationary levels of 2008, while the picture is identical in Serbia where Inflation accelerated to 7.9% YoY in December from 7.5% YoY in the previous month, hitting its highest level since 2013. While none of the two aforementioned countries have proceeded with any interest rate hike in response to the price pressures, mostly due to idiosyncratic factors, all other major peers, Romania, Poland, Hungary and the Czech Republic continued their hawkish stance by increasing either the key policy rates or the one week repo interest rates, given the general view that inflationary pressures do not just stem from energy prices but are also evident in core inflation as well. Concluding with a favorable development broadly related with the reforms agenda, which is diachronically a matter of concern for the region, the OECD decided to open accession discussions with 6 candidate countries for OECD Membership in January with the three of them belonging to the region (Bulgaria, Croatia and Romania). While there is no specific timeframe for the accession, as it is dependent on the completion of prerequisites, the whole procedure is well-received as it will activate a roadmap of changes in the candidate countries' legislation, policy and practices required to bring them in line with OECD standards and best practices, thus 'serving as a powerful catalyst for reform'.

Special Topics

I. Euro area inflation: Attention turns to wage growth this year

The Covid-19 pandemic has exerted a pronounced impact on the world economy, both on the demand and the supply side, contributing to a sharp increase in inflation to multi-decade highs, well above many Central Banks' inflation target. Along these lines, Eurozone inflation, which was thought to have peaked at 5.0%YoY in December, unexpectedly rose in January to a fresh record high of 5.1%YoY, as much-anticipated base effects were mostly offset by higher energy prices, while core CPI, which excludes volatile energy, unprocessed food, alcohol and tobacco prices, dropped less than expected to 2.3%YoY from December's more than ten-year high of 2.6%YoY. Assuming inflation expectations stay well-anchored, inflation is expected to decrease this year, especially in H2 2022. Covid-related factors that boosted Eurozone inflation last year, including supply-demand imbalances and a sharp rebound in services consumption after the lifting of pandemic-related restrictions in the middle of 2021, are seen as mostly temporary and are anticipated to gradually wane this year. The dropping of base effects linked to last year's German VAT re-hike, delayed winter clothing sales and changing HICP weights, are also anticipated to contribute to a decline in inflation, though oil prices are likely to remain a significant issue for policymakers over the coming months, as the Brent Crude has surpassed $90/bbl for the first time since late 2014 and geopolitical tensions do not show signs of abating.

Whereas temporary factors that lifted inflation last year are anticipated to gradually is expected to fall back in 2022 due to base effects, growth moderation and expectations that global supply fade away, other factors that affect the medium-term inflation outlook, are likely to prove more lasting. As such, developments in the labor market and the evolution of wages, in particular, are getting much attention1. Indeed, a number of ECB Governing Council members have argued that a sustained pickup in inflation is unlikely without an acceleration in pay growth. The Eurozone labor market is tightening and, as economic recovery remains on track, it is expected to continue doing so gradually in the coming months. According to the latest data, the unemployment rate has been falling rapidly in recent months coming in at an historic low of 7.0% in December 2021, below the February 2020 pre-pandemic level of 7.4%, following a post-pandemic peak of 8.6% in August 2020. Under such a scenario, the risk over high inflation becoming embedded into long-term expectations, leading thus to a wage-price spiral2 and material wage growth, appears to be an issue of concern.

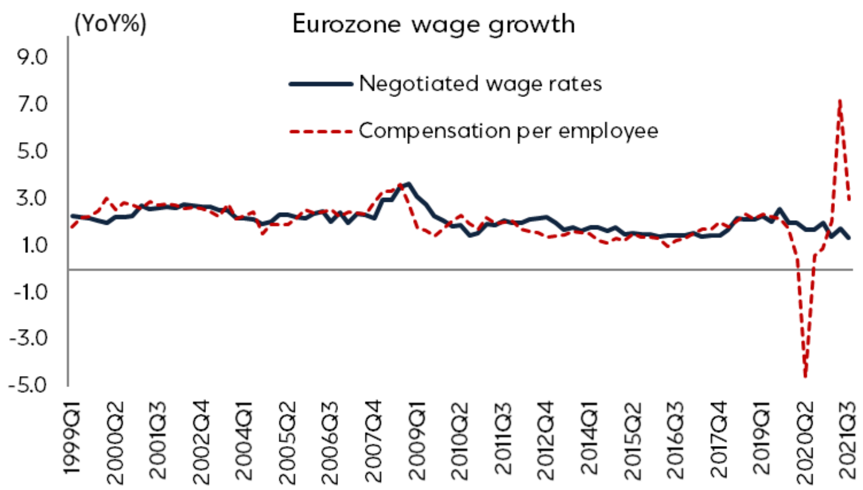
Measures of wage growth in the Eurozone

There are two main measures of wage growth in the Eurozone. The first is compensation per employee, which takes into account all forms of compensation paid by employers to their employees and is the basis for the ECB's wage growth forecasts. The second is the indicator of negotiated wage rates for which the ECB does not provide forecasts. In contrast to the compensation of employee measure, the latter does not incorporate

[1] The account of the December ECB meeting underlined that wage growth is "an essential aspect for assessing underlying inflationary pressures" and so far remained relatively limited.
[2] EBC Chief Economist Philip Lane has argued that for a possible wage-price spiral to emerge wage growth should point to a persistent upward shift in the growth rate rather than a one-off shift in the level

certain pay components such as bonuses and overtime pay. Actually, it measures the outcome of collective wage agreements which cover two to three years ahead, which means that it affects wage growth not only in the current year but also in the future. These two measures tend to correlate closely, but have been diverting significantly since the emergence of the pandemic. As depicted in Figure 3, compensation per employee has shown a lot of volatility, making it difficult to interpret during the pandemic, due to huge swings in hours worked by employees who went in short-term work compensation schemes. Under these schemes, firms are allowed to reduce the number of hours worked by their employees and pay less compensation, while the government paid part of the furloughed employees' lost salary (the part of the salary paid by the government has been counted as social transfer rather than as compensation). That said, while compensation per employee is probably more comprehensive, with some 2.5m jobs across the Eurozone still being supported by short-term compensation schemes (from a peak above 30mn, around 20% of the labor force at the height of the pandemic's first phase in April 2020), the indicator of negotiated wage rates could likely provide a relatively clearer direction of wage growth this year.

Figure 3: The two main measures of wage growth in the Eurozone have diverted since the emergence of the pandemic



Source: ECB, Eurobank Research

Recent evidence hardly point to the risk of a wage-price spiral

So far, there are no clear signs of a material increase in wage growth. The latest key negotiated pay deals that were sealed in major Eurozone economies last year mostly resulted in one-off pay uplifts and moderate increases in the pay base for the next couple of years. That was likely due to low inflation in the first year of the pandemic and labour unions' perception that the current bout of elevated inflation would likely prove temporary. In fact, inflation plays a key role in wage negotiations —wages in the Eurozone tend to have a strong correlation with current and past inflation (Figure 4) — as labour unions struggle for inflation compensation (collective bargaining). In addition, amid concerns over the disruptive impact of the pandemic on labor markets, unions were likely more focused on protecting employment and securing flexibility, rather than higher wages.

Looking ahead, as the Eurozone economy keeps recovering, the labor market is expected to continue tightening gradually and labor market slack should be steadily eroded, leading to an upward pressure on wages. Recent evidence of labor shortages across sectors and hefty increases in the minimum wage in some EA countries (most notably in Germany where, as of 1 October 2022, the minimum wage will rise from €9.82/hour currently to €12/hour following a 9% increase in H1 2022 compared to its 2021 level of €9.60/hour), should also contribute to pushing wages higher. However, assuming that inflation expectations stay well-anchored, wage growth (based on the indicator of negotiated wage rates) is anticipated to pick up, but only modestly. The view for a relatively modest pick-up in wages this year is mostly based on the following factors: (i) Hours worked are still below pre-pandemic levels. They have declined far more than employment due to short-term work schemes which, along with other forms of job-retention schemes, have been widely used in the EA in order to cushion the impact of the pandemic on jobs and the labour income (Figure 5); (ii) Recent labor market reforms have increased flexibility in the labor markets; and (iii) The labor market slack will likely increase in due course as several emergency government support measures for businesses have or are about to come to an end (including guarantees on state-backed loans and loan moratoria), likely resulting in an increase in bankruptcies; (iv) Wage indexation, that ties labor contracts to inflation, currently covers a much smaller share of labor contracts in several EA economies than before the Global Financial Crisis, thanks to widespread labor market reforms. That said, sustained wage pressures may take time to emerge[3].

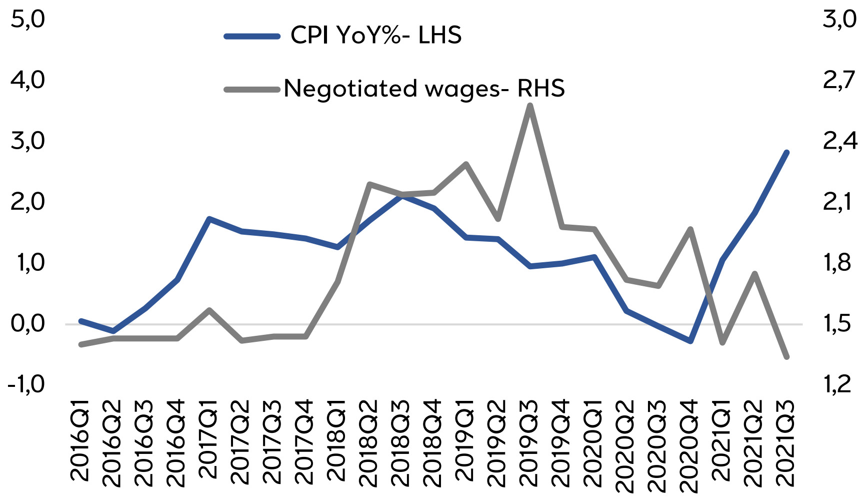
In theory, the level of annual wage growth consistent with the ECB's 2% inflation target, should be equal to 2% plus labor productivity growth (in the last 20 years, labor productivity growth has averaged 0.4% based on productivity per persons and 0.9% based on productivity per hours worked). Based on this, wages should rise somewhere in the range between 2.5%-3.0% to be consistent with the ECB's inflation target. In an interview on 25 January 2022, ECB chief economist Philip R. Lane said that "... for inflation to be around 2 per cent and allowing for a typical increase in labour productivity of about 1 per cent, then wages should be growing around 3 per cent a year in the euro area on average to be consistent with the 2 per cent target. We are not, right now, seeing wage increases in that zone. But of course, we will continue to look at this throughout the year".

Nevertheless, the longer inflation remains elevated, the higher the risk for it to start feeding through more persistently to wages. Under such a scenario, labor unions may view the current bout of high inflation as a norm rather than temporary across the Eurozone and raise their demands, leading to higher base pay rises. In addition, amid squeezed profit margins, firms may have no choice but to pass higher costs on to consumers (wages account for a large share of companies' costs). The next most important wage negotiations in the Eurozone will be held in autumn in Germany (the metal and electronics industry, and federal public services, covering more than 6.5mn employees). Those deals are likely to form the base for workers' pay demands next year, taking into account that the labor market in Germany is much tighter relative to other

[3] According to the ECB's latest staff projections (December 2021), the growth of compensation per employee was revised up for 2021 and 2022 at 4.2% and 3.8% respectively (from 3.5% and 3.9%, previously), but the respective figure was settled lower at 2.9% for both 2023 and 2024, suggesting that the Central Bank sees a relatively flat Phillips curve. This explains the ECB's medium-term inflation projection for a decline in the headline CPI below its 2.0% target at 1.8% both in 2023 and 2024, following an expected increase to 3.2% in 2022.

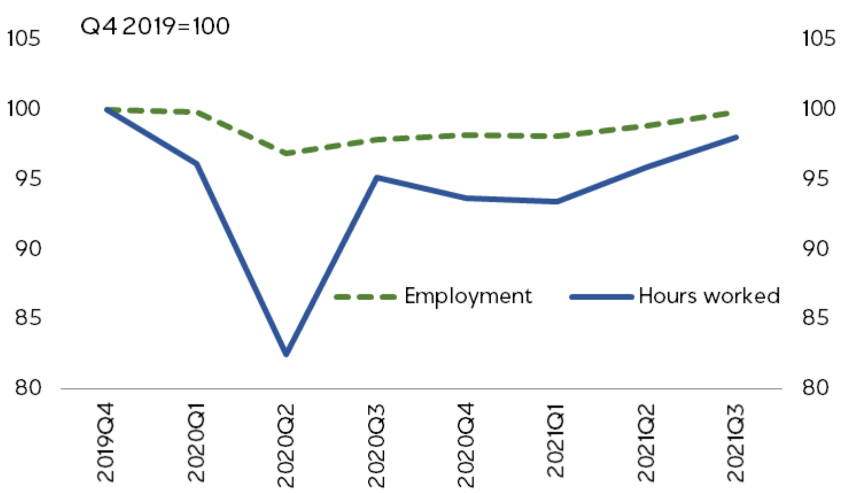
major EA economies. Whether pay demands will be modest and the expected pick up in wages this year will prove temporary, or, union demands will rise sharply, changing the wage growth outlook rapidly, will highly depend on whether Eurozone inflation declines in the course of 2022, especially in H2, as is currently expected

Figure 4: Wages in the Eurozone tend to have a strong correlation with inflation



Source: ECB, Eurostat, Eurobank Research

Figure 5: Hours worked still below pre-pandemic levels

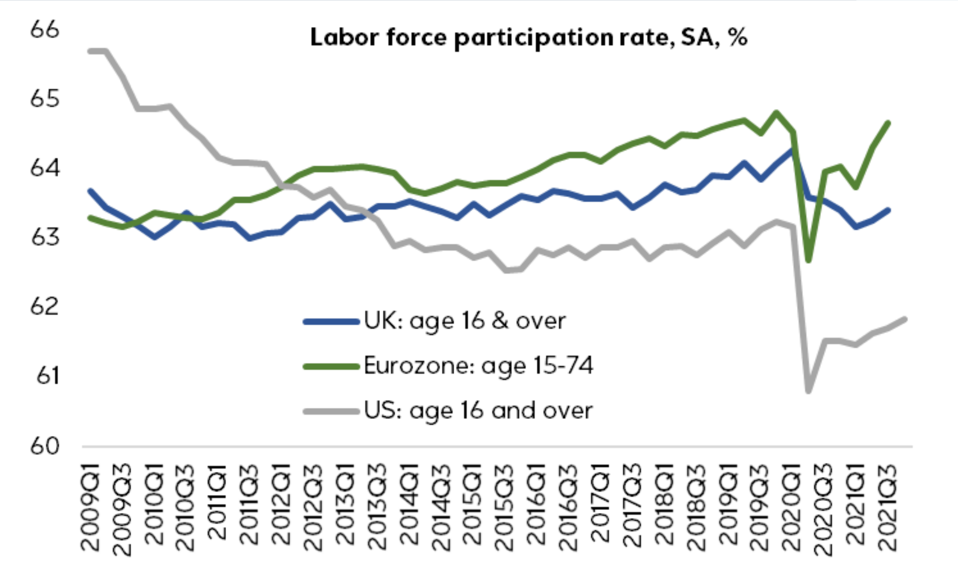


Source: ECB, Eurobank Research

Why wage growth in the Eurozone is significantly weaker than in the US and the UK?

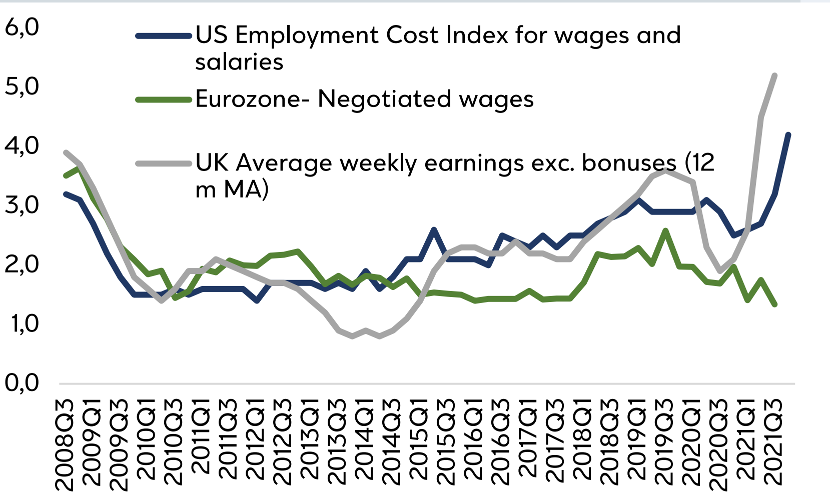
In comparison with both the US and the UK, labor market participation in the Eurozone has recovered relatively faster from the pandemic shock. The respective rate is broadly back to its pre-pandemic level, while in the US and the UK, there is still room for improvement (Figure 6). This is mostly due to different measures adopted by governments to contain the impact of the pandemic on employment and firms (job-retention schemes in the Eurozone vs. the Paycheck Protection Program and enhanced unemployment benefits in the US), while, in the UK, the labor market has been heavily affected by a post-Brexit drop in international immigration. The developments in the participation ratio after the emergence of the pandemic, have contributed to a tighter labor market in the US and the UK compared to that in the Eurozone, as measured by the vacancies to unemployment ratio, one of the most direct measures of labour market tightness (Figure 7). The latter should explain why wage growth in the US and the UK is significantly higher than in the Eurozone and why the ECB does not feel the urgency to follow the other two major Central Banks in lifting interest rates any time soon.

Figure 6: Labor market participation has recovered faster in the Eurozone than in the US and UK



Source: Eurostat, BLS, ONS, Eurobank Research

Figure 7: The labor market in the Eurozone relatively less tight compared to that in the US and the UK



Source: Eurostat, BLS, ONS, Eurobank Research

II. Ukraine-Russia crisis: Implications for Europe's energy sufficiency

Tensions between Russia and Ukraine go back a long way. Through a quick retrospective glance, Ukraine became independent following the collapse of the Soviet Union 30 years ago and since then, it has been gradually approaching the West for reasons beyond the scope of this piece. Following the annexation of Crimea by Russia in 2014, the world is witnessing a resurgence of the conflict between the two countries, which has intensified since October 2021 without an easy to define specific triggering event. Ever since, the result is mounting pressure, which could even lead to a war between the two. In the following lines we briefly attempt to highlight the risks at stake for Europe given its high dependency on Russia for covering its needs in energy and commodities.

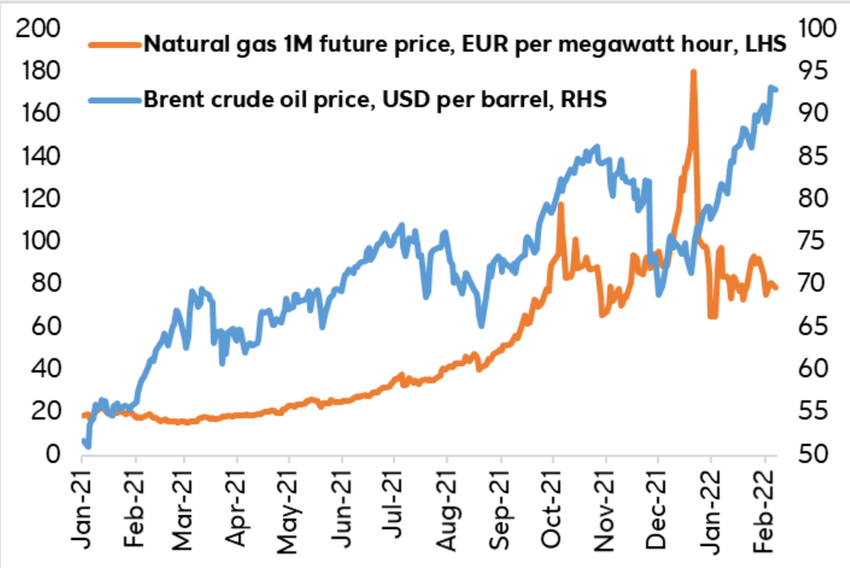
Regardless of whether Russia is planning a full scale invasion or is considering a smaller or even hybrid[4] invasion in order to annex some additional Ukrainian territory close to the eastern borders between the two[5], Europe is facing, inter alia, the risk of Russia shutting down the pipelines that feed the continent with a substantial share of natural gas as some of the supply networks cross through Ukraine[6]..

In order to understand Europe's energy dependency on Russia, it is of essence to lay down the energy profile of the EU. According to Eurostat, up to 2019[7], oil (crude oil and petroleum products) continued to be the most significant energy source for the European economy, despite a long downward trend, while natural gas remained the second largest energy source. After a slight increase in the period between 2014 and 2017, the use of oil was again on the decline, whereas a certain fluctuation was observed in natural gas, with levels picking up again in 2019. As the continent is not self-sufficient in its energy supplies, imports cover the deficit. Main imported energy products are petroleum products (including crude oil, which is the main component), accounting for almost two thirds of energy imports into the EU, followed by gas (27%) and solid fossil fuels (6%). In 2019[8], almost two thirds[9] of the extra-EU's crude oil imports came from Russia, Iraq, Nigeria, Saudi Arabia, Kazakhstan and Norway, with only Russia's stake accounting to approximately one third of the total crude oil imports. A similar analysis[10] shows that almost three quarters of the EU's imports of natural gas came from Russia (41%), Norway (16%), Algeria (8%) and Qatar (5%), while over three quarters of solid fuel (mostly coal) imports originated from Russia (47%), the United States (18%) and Australia (14%). The aforementioned figures reveal Russia's key role as the main EU supplier of crude oil, natural gas and solid fossil fuels.

[4] Hybrid invasion pertains, among others, to cyber-attacks that cause disruptions in the telecommunication systems, disinformation, psychological operations such as bomb threats.
[5] Through the region of Donbass which is ca 30% controlled by pro-Russian separatists. The invasion to Ukraine from this location is considered easier as the resistance in this territory is considered to be limited.
[6] Up to 2014, 14% of the total imports of natural gas from Russia to Europe where passing through Ukraine, providing the latter with lucrative fees that would be missed in case of the operation of Nord stream 2 which begins from Russia and ends up to Germany but bypasses Ukraine as it follows the same route with the already functioning Nord Stream 1, crossing the Baltic sea.
[7] EU's fuel imports breakdown by type of fuel, Eurostat
[8] EU's fuel imports breakdown by exporting country, Eurostat
[9] The two thirds of total crude oil imports of the EU break down into 27% by Russia, 9% by Iraq, 8% by Nigeria and Saudi Arabia each and 7% by Kazakhstan and Norway each (see footnote #5).
[10] see footnote #5

Since early January, Russia has reduced the flows of natural gas that pass through Ukraine towards Europe by more than half, pushing benchmark prices of the fuel to all-time highs. Specifically, the Dutch TTF gas futures price, which is considered a Europe-wide natural gas price benchmark, reached EUR84.67 per MWh on January 31 2022 for contracts with delivery in February 2022 on the back of supply shortage in the continent.

Figure 8: Spiking energy prices as jitters between Russian and Ukraine intensify



Source: Bloomberg, Eurobank Research

Energy analysts are not optimistic over the course of prices of both natural gas and crude oil coming from Russia in case an invasion materialises. Indicatively, some oil traders[11] do not exclude the possibility of oil climbing close to USD100 per barrel from roughly USD90 currently, thus approaching 2014 highs. Letting aside the pain that could be felt in the pockets on the EU citizens, a tail risk exists of disruptions in heat and lightning provision in some EU countries in case Russia reduces volumes of natural gas, as that would be very difficult to fully cover by alternative sources, such as liquefied natural gas. On this wavelength, the Sheikh Tamim bin Hamad Al Thani, the Emir of Qatar, stated clearly in the previous week that his emirate cannot cover the shortage caused in an extreme case of disruption impelling the Energy Commissioner of the EU, Kadri Simson, to talks with Kazakhstan and the US in order to secure adequate amounts of LNG in case of rupture with Russia.

Russia also holds a pivotal role in the global commodities market as it is the world's largest exporter of wheat, followed closely by Ukraine. Wheat is considered a commodity with limited elasticity in terms of demand and use. Additionally, Russia controls critical stakes of global exports in metals, namely aluminum and copper, and chemicals such as urea and potash, which are key ingredients to fertilisers.

Given the above, Europe's dependency on Russia is more than obvious, yet there is also much at stake for Russia as well, as the EU is one of its key energy and commodities' trading partners. The strong cash position

[11] Bloomberg consensus as of 07/02/2022

that the Central Bank of Russia is sitting on, with deposits reaching the amount of USD600bn, provide the latter with some buffers, at least in the near term.

Given swift changes in geopolitical realities, the EU is at crossroads regarding its energy profile. That said, the threat of cancelation of Nord Stream 2 is not only a measure of sanctions against Russia on behalf of Germany[12], but also a reconsideration regarding the energy supply mix. The recent crisis could act as an alarm over the need to decrease the high dependency from a specific provider and revise diversification strategies and energy sources' portfolios in general.

[12] Nord Stream 2 will run the same path with Nord Stream 1 but once in operation it will provide mostly Germany with natural gas. The separate infrastructure Germany has pursued in order to autonomously control its energy requirements has been a matter of strong debate among the EU countries.

CESEE Markets Developments & Outlook

Bulgaria

Eurobond yields rose across all maturities. In specific, the 2030 paper rose by 30 bps, followed by the 2024 tenor by 22 bps. Local papers also rose across the board, with the 5 year tenor exhibiting the highest increase, namely a 10 bps change. During January, the Ministry of Finance did not hold any auctions, it announced however, that it will raise up to EUR 3.7bn in debt through local and international markets.

Serbia

Market developments in January were triggered by the surging inflation in the economy and are dominated by the government's intervention in order to tame the consequences of the increasing prices and the heavy cost of energy. One clear example of the above is the freeze in five basic food-essentials (sugar, flour, oil, pork and milk), which was introduced on November 30 and is now extended for three more months. Additionally, due to shortages in the electricity production, Elektroprivreda Srbije, a state-owned utility electric power company, is forced to import electricity from abroad and for this reason an additional cost has been created, calculated at EUR250ths per day. However, citizens and corporates have not felt this extra burden in their pockets yet, as the extra daily cost has not been passed through to them fully. Taking the above into consideration, a second wave of inflation is yet to come and it is expected most probably after April's elections when the electricity prices will start to incorporate more regularly the additional costs.

Given the view of the National Bank of Serbia on the inflationary outlook, i.e. that it will start to stabilise after Q2-2022 and that the triggers of inflation are mostly imported, no interest rate hike is anticipated in Q1-2022. For the time being, the dinar remains stable against the euro, hovering within its trading range 117.55-60.

In the fixed income space, amid expectations of the Fed's imminent tightening, the Serbian government bonds curve was moved higher as well. However, the initial increase of the yields was followed by a period of consolidation, resulting in a slight downward shift during the last week of January. The 4-year, 6-year and 11-year RSD denominated bonds are currently trading at 3.30%, 3.60% and 4.00%, respectively.

Markets View

Foreign Exchange

EUR/USD: With the pair touching the 1.11 last month, President Lagarde's hawkish rhetoric opening the door for a potential quantitative tightening until summer, led the moves upwards to the 1.1450+ territory. We believe ECB will eventually align with Fed on the tightening front, and we wait for inflation real numbers' validation of the bullishly expressed expectations for the pair to reach even higher levels, even above 1.16 until the end of year. With the MA(25) being on 1.1320 below the MA(250) on 1.1734, gives a good standing point for a further push higher for next month as well, while maybe trading ranging with trading potentially ranging around the 1.17 (+-150 pips) territory for Q2, until new information is available regarding the ECB's future actions.

GBP/USD: Under the same rationale, last month saw BoE already incorporating and following a quantitative tightening logic in its rhetoric, with its very recent rate hike driving the GBP against the "ECB-silent" EUR down to 0.83. Eventually ECB's recent rhetoric, suggests the whole dynamics to be a medium to long-term opportunity above even 0.86. MA(250) 0.85365 gives a medium term target level where for Q2 we might experience a "silent" trading range, while anticipating the next move by ECB for a further push higher.

Rates

EU: Interest rates increased in January, with the 10y swap rate trading at 58bps up from 38bps in the previous month. The slope of the curve decreased sharply, with 5s-30s trading at 15bps. Looking forward we expect rates to remain volatile, with a bias for higher levels. Euro area inflation in January hit another record high putting pressure on the ECB to act. President Lagarde mentioned at the ECB press conference that concern about inflation data was unanimous and refused to rule out tightening of monetary policy in 2022, giving an unexpected by the market hawkish tilt

US: Rates increased significantly in January, with the 10yr swap rate at 1.88% from 1.60% at the beginning of the month. The slope of the curve flattened, with 5s-30s trading at 20bps from 36bps. Looking forward we expect US rates to remain volatile as there is significant dislocation between the market and the Fed's rhetoric. US policymakers essentially confirmed they'll raise interest rates in March but spoke cautiously about what might follow, signaling a desire to keep options open in the face of an uncertain outlook for inflation and the ongoing pandemic. Despite that, the market is pricing 5 hikes for 2022, with a potential 50bps hike in March.

Emerging Markets credit

The hawkish tone of FED's Chair Powell and the increased equity volatility put EM assets under pressure in January, with sovereign bond curves steepening. The EMBI Global Index closed at 344 bps at the end of January, 14 bps higher on the month. In CEEMEA, Russian assets significantly underperformed due to the rise of geopolitical tensions between Russia and the west, concerning the former's decision to amass a large number of troops at the border with Ukraine, while in South Africa the SARB raised its policy rate by 25bp in response to rising risks from global policy normalisation. In LATAM, spreads ended the month modestly wider, while in Chile Mario Marcel, current central bank governor, was announced as Boric' s minister of finance, a strong signal that reaffirms Boric' s words of moderation. In Asia, spreads were little-changed. A gradual pick up in M&A activity was the driver of the recent rally in the Chinese real estate sector, while Korea's economic momentum maintained a steady pace of expansion despite the Omicron variant outbreak. We believe conditions will remain challenging for EM, at least in the near term, due to uncertainties about inflation and the FED policy path, along with volatility in the global equity markets and geopolitical risks.

Corporate credit

EUR IG EUR IG cash corporate spreads on most rating grades and sectors were +4/+10bps wider in the period from 01/01/2022 to 04/02/2022, with lower grades, and weaker credits, underperforming the rest of the market. CDS Indices spreads were on average +10/+15bps wider in IG and +50/55bps wider in HY. Covid19 related fears abated gradually, while the centre stage towards the end of January is taken by inflation fears, higher rates and CBs being considerably behind the curve, not a promising mix going forward. ECB meeting 3/2/22 delivered a mixed/hawkish tilt, which sparked more volatility and wider spreads. Sector wise, in EUR IG, Financials were +7.5bps wider, Real Estate +11bps wider, Oil & Gas +10.5bps wider, Health Care +4bps wider, Telecoms +3.5bps wider, Industrials +1.0bps wider, Consumer Goods +2.5bps wider, Utilities +4bps wider, Technology +3.0bps wider and Basic Materials +2.5bps wider. US IG names spread were +6 to +20bps wider in the same period. Specifically, Financials were +11bps wider, Real Estate +22.5bps wider, Oil & Gas +13.5bps wider, Health care +14.5bps wider, Telecoms +12bps wider, Technology +15.5bps wider, Industrials +10.5bps wider, Consumer Goods +12.5bps wider, Utilities +12bps wider, while Basic Materials were +19.5bps wider.

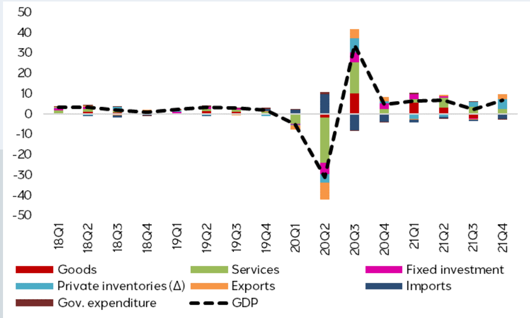
Rating grade wise, EUR IG spreads in BBB were +5.5bps wider, in A +1.5bps wider, in AA unchanged, and in AAA +4bps wider. In the EUR HY universe CCC spreads were +40bps wider, B grade were +45bps wider, while BB were +24bps wider. Rating grade wise, US IG spreads in BBB were +14bps wider, in A +10bps wider, in AA +9.5bps wider, and in AAAs +10.5bps wider. The rising fears of aggressive CBs tapering and rate hikes, on their quest to keep inflation checked, is expected to produce repricing at wider levels and induce more volatility going forward. Covid19 developments are on the back seat for now but can still deliver a negative surprise for credit (especially for the most affected sectors). To this end, EUR credit is expected to maintain its relative outperformance to US in the short to medium term, while credit spreads are expected to trend wider with IG credit being sensitive to rates. We also expect considerably higher realised volatility going forward.

USA

Economy on a solid footing but challenges persist

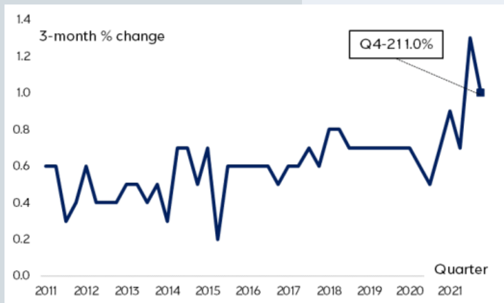
The economy grew by 5.7% in 2021, the fastest pace since 1984 after contracting by 3.4% in 2020, the biggest decline in 74 years. GDP increased at a 6.9% annualized rate (Figure 9) in Q4-2021 (from 2.3% in Q3), primarily reflecting increases in private inventory investment (4.9pps contribution) and less so in exports, private consumption and fixed investment that were partly offset by a decrease in government spending and higher imports. Onto 2022, data point to solid economic activity growth, though the growth momentum continues to face pandemic-related headwinds. Manufacturing continued to grow in January for the 20th month in a row, albeit at a somewhat slower pace, with the ISM index registering at 57.6 from 58.8 in the prior month, driven by demand, while supply difficulties persisted despite signs of improvement. Sentiment remained strongly optimistic, while concerns centre mostly around input and labour shortages as well as soaring prices. Similarly, services continued to expand in January for the 20th month in a row, with the pace of expansion moderating slightly (ISM Services index came in at 59.9 in January, 2.4pts lower than December), weighed primarily by new export orders, staffing challenges, inflationary pressures and supply bottlenecks. The labour market appears to be resilient against the Omicron surge, with total nonfarm payroll employment rising by 467K in January – significantly above expectations for 150K – and the unemployment rate standing at 4%, little changed from 3.9% in the previous month. Strong growth, in conjunction with a tight labour market and high inflation (core PCE price index at 4.9%YoY in December, from 4.7%YoY in November and 4.2%YoY in October), led the Fed to decide at the 25-26 January FOMC meeting to proceed with a rate hike at the Mar-22 meeting, assuming that conditions will be appropriate for doing so. Markets now anticipate at least four rate hikes in 2022 and a rapid drawdown of the balance sheet starting in Q3 2022, while an even faster tightening could be triggered by indications that inflation is becoming deep-rooted, such as higher employment cost (Figure 10), inflation expectations, and labour market slack.

Figure 9: Contributions to Percent Change in real GDP



Source: BEA, Eurobank Research

Figure 10: Evolution of Employment Cost Index



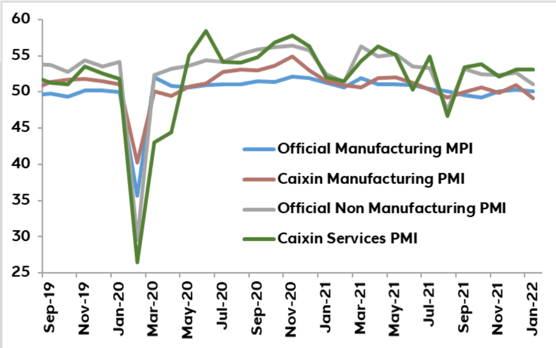
Source: BLS, Eurobank Research

China

Against the global trend, monetary policy eases in an effort to reverse the economic deceleration

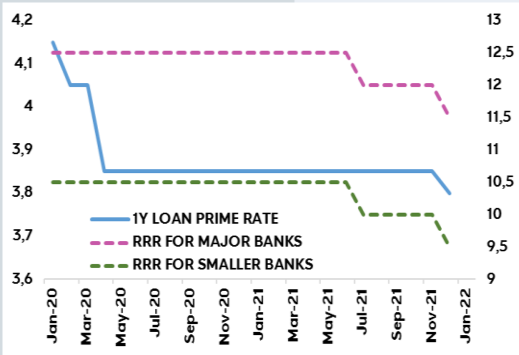
The economy rebounded in 2021 posting a real GDP growth rate of 8.1% from 2.2% in 2020. While the said print is a decade-high, assisted among other factors by low base effects, the growth rate of the last quarter along with additional hard data point to some deceleration. Real GDP expanded by 4.0% YoY in Q4-2021, following growth rates of 4.9% in Q3, 7.9% in Q2 and 18.3% in Q1, while on a quarterly basis the rate stands at 1.6% QoQ from 0.7% QoQ in Q2. The real estate sector remained under pressure with new home prices continuing to decrease for a fourth month in arrow, after continuously growing for more than 6 years. Additionally, property investment continued to grow by 4.4% in FY2021 (although in December such investments decelerated), but with evident loss of steam compared to 2020 and 2019 when property investment grew by 7.0% and 9.9% respectively. On the flipside, industrial production remained solid in December, growing by 4.3% from 3.8% in November and above the 3.7% market consensus, presumably due to the heavy pipeline of works that the Winter Olympic Games have brought about. Looking into 2022, January's both official and Caixin PMIs leave limited room for optimism as their moderation was broad-based, spanning both manufacturing and non-manufacturing activities. Still, the past month's PMI readings are hard to interpret as it is unclear whether the deterioration in sentiment stems from the Lunar Year festivities or the local Covid-19 lockdowns, both of which hamper economic activity. In the above context, economic policy remains supportive in order to halt or even reverse the deceleration. The People's Bank of China (PBoC) cut the one-year loan prime rate (LPR) by 10bps to 3.70% from 3.80% and the five-year loan prime rate (LPR) by 5 bps to 4.60% from 4.65%, the latter's first cut since April 2020. Prior to this easing, in December, the PBoC delivered a 50bps RRR cut – the second such move in 2021, following the unexpected cut in July – and a 5bps cut in the one-year (LPR) bringing it to 3.80. With major Central Banks around the globe already having opened or being about to open a tightening cycle, China's monetary policy is moving against the global trend, as its inflationary outlook is substantially milder.

Figure 11: Forward looking PMIs decelerate in January…



Source: Bloomberg Eurobank Research

Figure 12: …deploying monetary policy stimulus



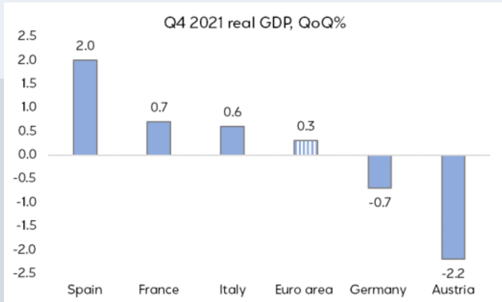
Source: Bloomberg, Eurobank Research

Euro area

Growth decelerated sharply amid tighter Covid-19 restrictions

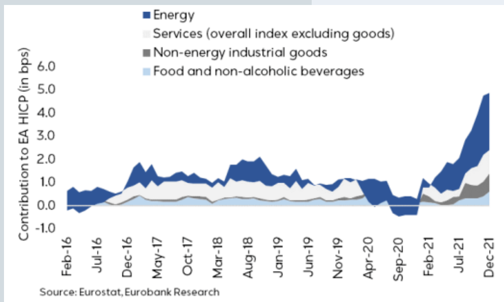
Eurozone Q4 GDP grew by 0.3%QoQ, slightly higher than the ECB's December forecast of 0.2%QoQ, with the level of output recovering to pre-pandemic levels. Even so, this is a sharp deceleration from 2.3%QoQ in Q3, which is probably due to the reintroduction of tighter activity measures in several countries as the winter Covid-19 wave and the emergence of the Omicron variant put a heavy strain on the health systems (the full breakdown of growth by expenditure will be released along with the third GDP growth estimate on March 8). In addition, supply pressures, albeit modestly eased, remained elevated, continuing to weigh on industrial output, with Q4 carry-over currently at -0.9%QoQ. Across EA countries, Q4 GDP growth rates differed widely, due to the timing and severity of restriction measures (Figure 13). As suggested by the renewed decline in the composite PMI for January (-1.0pt to 52.3 on the back of a -2.0pts decline to 51.1 in the services sector mostly due to Covid-19 restrictions and voluntary distancing), GDP growth is likely to remain subdued at the beginning of 2021. The Omicron wave has just peaked or is close to the peak (i.e., Germany, France), while supply bottlenecks are far from resolved, contributing to higher inflation, which has constituently surprised to the upside in recent months, eroding households' purchasing power and denting sentiment. In fact, Eurozone inflation, which was thought to have peaked at 5.0%YoY in December, unexpectedly rose in January to a fresh record high of 5.1%YoY, as much-anticipated base effects were mostly offset by higher energy prices (+6.0%MoM). Q1 GDP growth is expected roughly the same as in the prior quarter, with the economy likely to regain momentum by spring, driven by an easing in activity restrictions on the back of an improved epidemiological picture. Meanwhile, the ECB did not change its monetary policy with respect to interest rates, QE and forward guidance at the January policy meeting, in spite of the unexpectedly high inflation rates. However, the tone of President Christine Lagarde at the press conference marked a shift towards a hawkish direction, reinforcing market expectations for a possible acceleration of the exit from QE and the beginning of rate normalization before the end of the year.

Figure 13: Strong growth differentials among EA economies in Q4 2021



Source: Eurostat, Eurobank Research

Figure 14: Energy represents a major driver of higher EA inflation



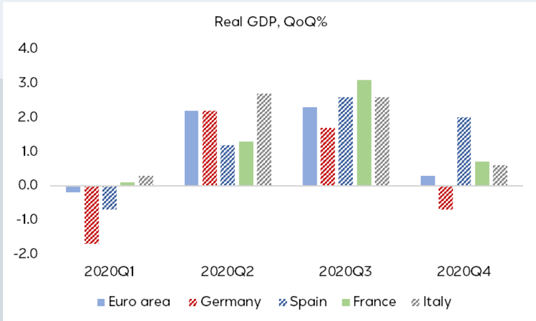
Source: Eurostat, Eurobank Research

Germany

On the brink of a technical recession

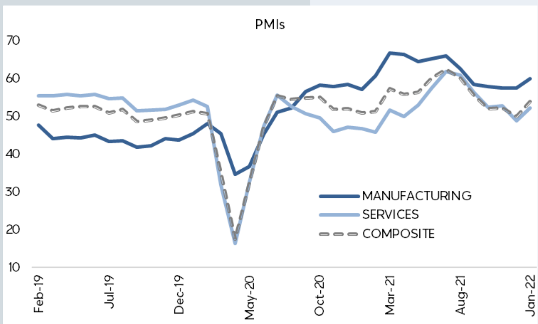
German Q4 GDP contracted by 0.7%QoQ, the first contraction in economic activity since Q1 2021, as the increase in industrial production was offset by the pandemic-induced decline in the services sector and retail trade. For the whole year 2021, GDP growth was revised slightly higher to 2.8% from 2.7% initially reported, following the inclusion of BioNTech's licensing income. Even so, real GDP was 1.5% lower than the Q4 2019 pre-pandemic level, with Germany underperforming its major EA peers, as elevated global supply-chain bottlenecks, increased material prices and weakness in China, its biggest trading partner, were a drag on manufacturing activity on which the Eurozone's biggest economy is highly reliant. For Q1 2022, another modest decline in real GDP cannot be ruled out as the Omicron variant continues to be spreading rapidly and stricter pandemic measures remain in place, while supply shortages and China's zero-Covid policy continue to hamper manufacturing output. However, from the spring onwards, the German economy is expected to recover strongly, on the back of a service sector reopening effect and a strong rebound in industrial production given the substantial backlog of orders, as supply constraints are anticipated to ease further on the assumption of a seasonal easing of the pandemic and a subsequent lift of certain activity restrictions. In support of the above, a recent string of business sentiment indicators for January surprised positively. The composite PMI (Figure 16) bounced back into positive territory hitting its highest level since September 2021 (to 53.8pts from 49.9pts) on the back of a noticeable improvement in both the services (+3.5pts to 52.2) and manufacturing output (+2.4pts to 59.8). Along these lines, the Ifo business climate index increased significantly after six consecutive declines (to 95.7 from 94.8) exclusively driven by a hefty improvement in the forward looking expectations component (+2.5pts to 95.2), and the ZEW expectations index rose strongly to the highest level since July 2021 (+21.8pts to 51.7pts). For the whole 2022, economic recovery is anticipated to expand by 3.9%, while strong employment growth, rising wages and accumulated savings should also support private consumption once pandemic-related issues abate.

Figure 15: Germany dragged Eurozone growth down in Q4 2021



Source: Eurostat, Eurobank Research

Figure 16: January PMIs suggest a strong recovery in economic activity is likely to be in the pipeline



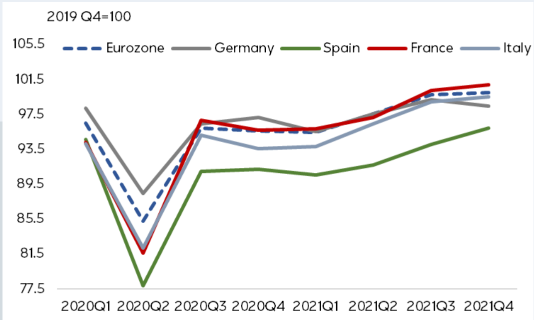
Source: Bloomberg, Eurobank Research

France

One of the Eurozone's star performers in 2021

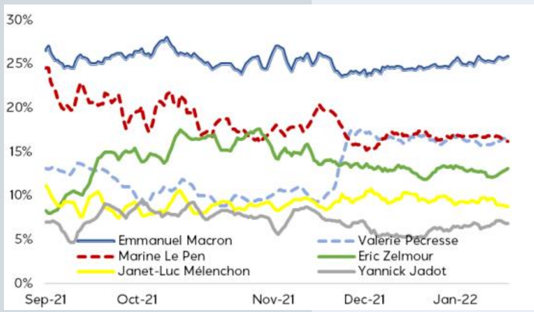
French GDP growth slowed to a still solid 0.7%QoQ n Q4 2021 following an upward revised 3.1%QoQ in the prior quarter, reflecting a slowdown in services activity as the post-re-opening effect faded out. On the demand side, Q4 GDP growth was driven by private consumption (+0.2pts), which returned to its pre-crisis level, as well as public consumption (+0.1pt) that was driven by health expenditure. Investment was another growth driver (+0.1pts) thanks to solid business investment, while stockbuilding added 0.4pts, partially offsetting the adverse impact of inventories in the prior two quarters. For the full year 2021, the French economy outperformed its major EA peers growing by 7.0% (Figure 17), mostly thanks to its relatively lower vulnerability to supply chain disruptions, and the more advanced recovery in private consumption supported by the strong performance of the labor market. Looking ahead, the economy is set to slow further at the start of 2022. The activity restrictions adopted to contain the spread of Omicron, especially on unvaccinated people, are curbing social consumption services, while surging energy costs, albeit mitigated by government support measures, should weigh on private consumption. However, as suggested by PMI and INSEE surveys for January, the impact of the aforementioned headwinds seems to be less acute on activity than initially feared, consistent with our view for GDP growth decelerating in Q1 2022 but still remaining positive. On the assumption that the Omicron situation does not turn out to be more severe than currently assumed, we project Q1 GDP growth weakness to be short-lived and economic activity to rebound in subsequent quarters driven by supportive fiscal policy, accumulated excess savings and the solid pace of the labor market. For the whole year, we pencil in a GDP growth rate of 4.0%. On politics, recent opinion polls (Figure 18) continue to place President Emmanuel Macron ahead of the other candidates in the first round (10 April) with a comfortable margin. However, it is very unclear which of the two runner ups will make it to the run-off (24 April) against the incumbent president, far-right Marie Le Pen or center-right Valérie Pécresse who has seen a boost in her popularity after her nomination in early December.

Figure 17: France outperforms its major EA peers



Source: Eurostat, Eurobank Research

Figure 18: President Emmanuel Macron continues to lead by a wide margin



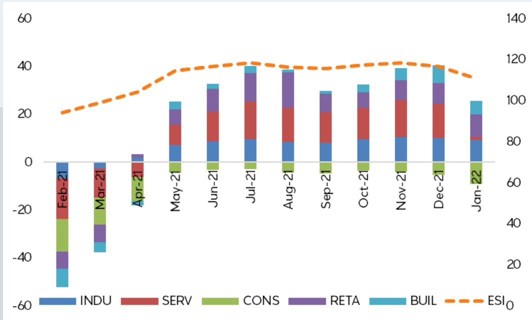
Source: Press reports, Eurobank Research

Italy

Draghi's stay as PM dissipates political clouds to the outlook

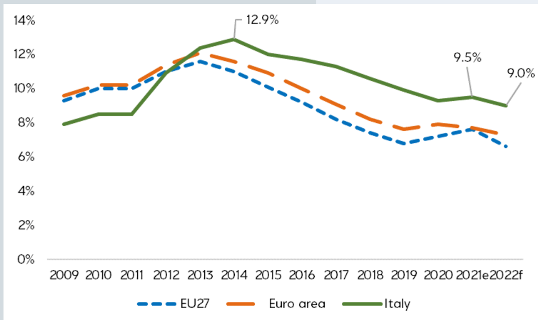
The growth momentum was maintained towards the end of the year with real GDP growing by 6.4%YoY in Q4-2021, above market expectations and at an accelerating pace compared to Q3 (4.0%YoY). Quarter on quarter growth slowed to 0.6%, from 2.6% previously, weighed down by the negative contribution of the net export component. The carry-over annual GDP growth for 2022 is equal to 2.4%. Moving onto 2022, economic sentiment at 110.6 in Jan-22 (Figure 19) receded slightly from the multi-year highs of the previous months, remaining however, close to the 12-month MA of 111.8. Expectations appeared subdued in all sectors except from retail trade. The strong momentum of manufacturing continues with the IHS Markit Manufacturing PMI comfortably exceeding the 50-unit threshold at 58.3 in January, showing however, signs of a slowdown in the pace of expansion, due more to supply-side constraints rather than weaker demand. Price pressures tightened in Jan-22 with the HICP inflation jumping to 5.3%YoY (from 4.2%YoY previously and 5.1%YoY in the EA) and surging input prices weighing on firms' expectations regarding production in the coming months. Meanwhile, despite a slight deterioration at the beginning of 2021, labor market conditions improved thereafter, with unemployment dropping further to 9% in Dec-21, indicating that the downward trend of previous years is likely to continue as the pandemic subsides (Figure 20). On the political front, Mario Draghi's stay as Prime Minister, following the re-election of Sergio Matarella as President, is viewed as a welcome outcome as Draghi can ensure stability and implementation of the country's broad reform agenda, a pre-requisite for Italy to receive the RRF funds (€191.5bn). Additionally, in view of the potential revision of EU fiscal rules and taking into account Italy's high debt (debt to GDP ratio at c. 155% in 2021), Draghi's position in tackling over-indebtedness primarily through structural reforms and less through higher taxes and spending cuts, is of increased importance to the country. Indicatively, after it became known that Draghi would remain PM, Italy's 10-year government bond yield fell to 1.294%, hitting its lowest level since 14 January 2022.

Figure 19: ESI eases but remains elevated



Source: European Commission, Eurobank Research

Figure 20: Unemployment likely to ease further once pandemic fades out



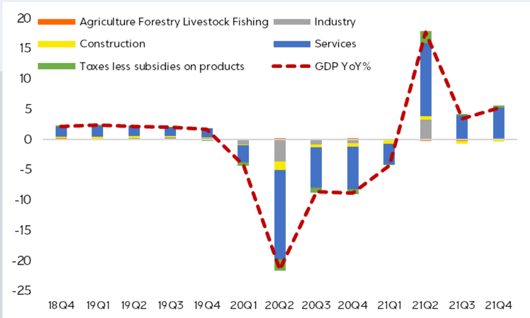
Source: Eurostat, Eurobank Research

Spain

Economy poised to pick up steam once current headwinds subside

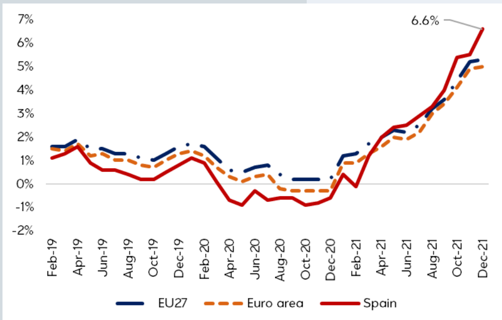
GDP growth accelerated further in Q4-2021 coming in at 5.2%YoY from 3.4% in Q3-2022, supported by a strong performance in the services sector, which contributed 7.5pps to growth and less so by industry, which contributed 1.2pps. The primary sector and construction weighed on growth but in a less severe degree compared to the previous quarter (Figure 21). Going onto 2022, the carry-over effect is equal to 3.1%. Soft data bode well for the start of the year with the ESI in January increasing by 0.6pts, in contrast to the declines in the EU27 and the Euro zone. Expectations remained strong in industry and retail trade and improved among consumers, where in the prior month confidence had dipped into a nine-month low. The IHS Markit Manufacturing PMI for the same period remained unchanged at 56.2, well above the 50-unit no-change threshold indicating sustained output expansion for the twelfth consecutive month. Demand strengthened from both domestic and international buyers, while manufacturers' confidence for the coming period hit a four-year high. Having said that, continued supply-side constraints and persisting price-pressures – with HICP at record highs above 6%YoY in the past two months – make the road ahead more bumpy (Figure 22). Another potential headwind may come from the course of the pandemic, where although the prevailing view is that it is on the way of becoming endemic, unexpected developments cannot be ruled out. However, the steady decline in unemployment, which receded further to a new multi-year low of 13% in Dec-21, implies that the economy has shown resilience in the face of the last wave. Looking ahead, a strong boost is expected from the RRF, from which Spain is eligible to receive a total of €69.5bn in grants. In August, Spain received €9bn in pre-financing, while in December, it was the first Member State to receive the first payment under the RRF, amounting to €10bn after having fulfilled 52 milestones, spanning a broad reform agenda. Overall, the economy is likely to go through a soft patch in the short-term period ahead, dragged by persisting inflation and a potential pandemic resurgence, but is poised to pick up steam vigorously once these factors subside.

Figure 21: Quarterly GDP annual growth and supply components



Source: INE, Eurobank Research

Figure 22: Inflation (HICP YoY%) at record – high levels



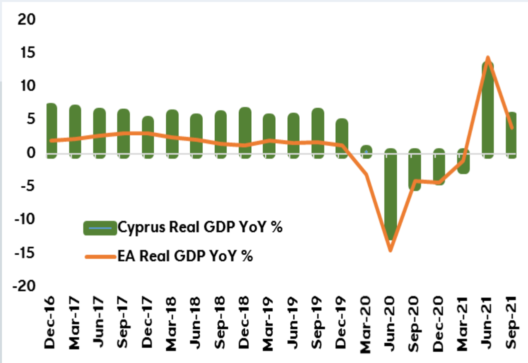
Source: Eurostat, Eurobank Research

Cyprus

Favorable market developments in January from the 10-year sovereign bond issuance

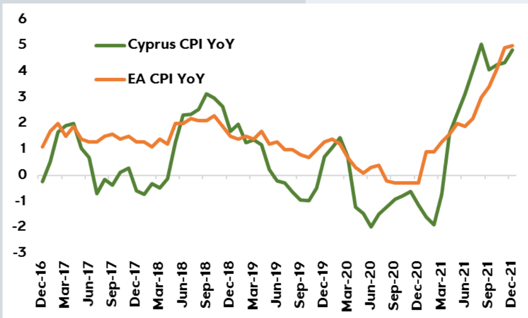
Cyprus kicked off the year on a worrying tone as since early December the country had surrendered to the most severe Covid-19 wave since the beginning of the pandemic. While during the last two weeks of January there was an evident downward trend in the daily Covid-19 cases, this was suddenly reversed. This rapid deterioration probably fueled the modest decline in the economic sentiment indicator in January, had remained substantially below the EU average throughout 2021 and has been swinging up and down in the last quarter. After the cooling of the GDP growth in Q3 (+3.7% YoY in Q3 vs +14.2% YoY in Q2 and -1.2% YoY in Q1), which brought the 9M2021 GDP growth rate at +5.6%, the available data for the last quarter point to a mixed picture. More specifically, retail trade increased by +5.3% YoY in volume in November but at a slower pace compared to October (+6.2% YoY in volumes), building permits picked by 17.3% YoY in October, remaining firm compared to September (+17.7% YoY) and industrial production continued to grow by 4.4% YoY in November, picking up from October and September but with the increase broadly milder compared to the previous months of 2021. The landscape is clearer with regard to the monetary front, where inflation is on a hiking mode, in synch with the Euro area trend. January's print came in at 5.4% YoY from 4.8% YoY in December, surpassing by far any other reading in the last 6 years, while building up almost continuously throughout 2021. The upward pressure in prices is broadly imported as it stems from the global energy and commodity prices rally. Taking into account the above and while the Q42021 GDP reading with the breakdown in the components is due in late February, we stick to our forecast over a 4.9% GDP growth rate in 2021 and we anticipate some moderation in 2022 and 2023, but with GDP growth rates continuing to stand above the long-term potential in both years, assisted by demand for tourism and investments under the RRF; Concluding with a favorable market development, the 10-year sovereign bond issued in mid-January lured investors' interest as the offers book was 7.8 times oversubscribed. The title, which offered a 0.95% annual coupon, was issued at a 0.99% yield which, however, spiked modestly in the first days of trading, presumably affected by the general market turmoil in the respective period.

Figure 23: Q3 GDP growth pace above EA average despite the loss of steam



Source: Eurostat, Eurobank Research

Figure 24: Domestic inflationary pressures are broadly aligned with the EA average



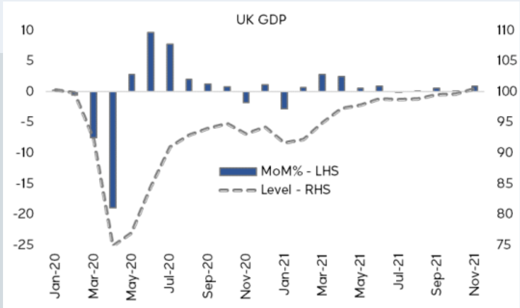
Source: Eurostat, Eurobank Research

UK

November GDP growth bounce likely to be short-lived

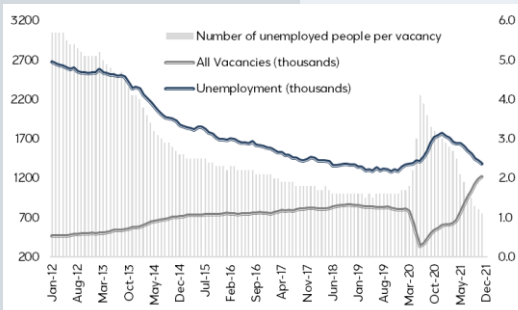
After a disappointing 0.2%MoM growth print (revised up by 0.1%MoM) in October 2021, UK GDP rose by a higher than expected 0.9%MoM in November 2021, surpassing its Q4 2019 pre-crisis level for the first time (Figure 25). The strength was widespread across all sectors. Services were the main growth driver, with output rising by 0.7%MoM, mostly supported by the earlier Christmas shopping season. Construction output surged by 3.5%MoM, the highest monthly growth rate since March 2021, likely thanks to unusually mild weather, while industrial output grew by 1.1%MoM, the first increase in the last three months, probably favored by a tentative improvement in supply-side conditions. However, with "Plan B" Covid-related restrictions kicking in from early December, and rising prices continuing to erode consumers' real disposable income — headline CPI inflation surprised to the upside in December for the third consecutive month, rising to 5.4%YoY, 0.9pts higher than the BoE's central case scenario in its November Monetary Policy Report — the November GDP growth bounce is likely to be short-lived and output to fall back in the last month of 2021, as suggested by a sharp 3.7%MoM drop in December retail sales, which unexpectedly took the annual growth rate into negative territory (-0.9%). Weaker-than-anticipated PMIs surveys for January and a sharp drop in the GfK consumer confidence index over the same month (to an 11-month low of -19), on the back of Omicron-related woes, rising inflation and higher BoE interest rates, point to a further slowdown at the start of 2022, before growth regains momentum in early Q2 on the assumption that the accelerated boosted program brings an end to the new pandemic wave. Meanwhile, the labor market continues to tighten, in spite of the end of the furlough scheme. The unemployment rate dropped further to 4.1% in the three months to November, just above its 4.0% pre-pandemic level, as labor force participation remains subdued, and the ratio of unemployed persons to the number of vacancies dropped to fresh record lows (Figure 26). In spite of near-term growth woes, amid concerns about a likely de-anchoring of long-term inflation expectations on the back of labor market tightness and persistence in domestic inflation pressure, the BoE followed up its December rate hike with a 25bps increase in February, taking the Bank Rate to 0.50%.

Figure 25: UK GDP back above pre-pandemic levels



Source: ONS, Eurobank Research

Figure 26: Tightening labor market



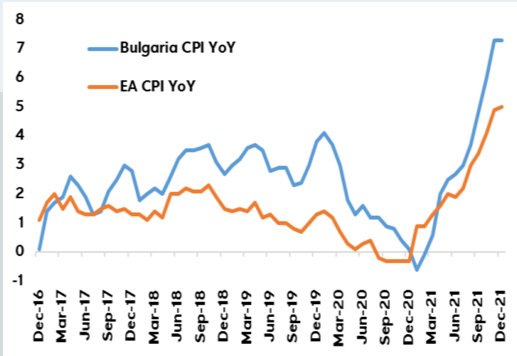
Source: ONS, Eurobank Research

Bulgaria

Persistent inflation and pandemic-related uncertainty hamper the economic growth outlook

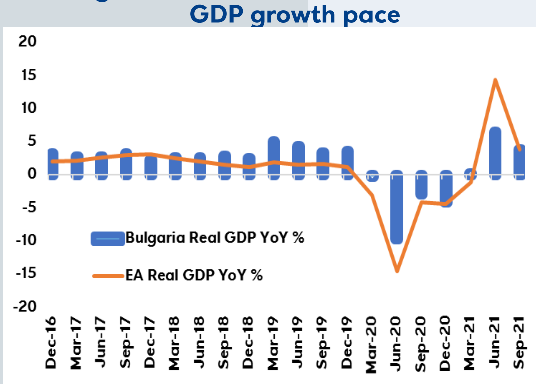
The major developments of the previous month come from the fiscal front. Delays in the government formation during the previous year resulted in 2022 starting without a ratified budget in place. The draft 2022 budget, which was eventually approved by the four-party coalition in late January, envisages a budget deficit of 4.1% of GDP, against 3.1% of GDP in 2021, which came in lower than the 3.6% targeted for this year. Had it not been for the embedded expenditures to cushion the economic impact of the pandemic, the budget deficit target would have been limited to 2.5% of GDP. The key assumptions of the budget are 4.8% GDP growth rate, 5% unemployment rate and 5.6% average annual inflation. Inflationary pressures in particular, are expected to remain elevated throughout 2022 and recede from 2023 onwards, anchored to the global elevated energy and commodity prices. Indeed, the December CPI print came in at 7.8% YoY, the highest since 2008, climbing to these levels swiftly within the past year . While some deceleration is expected in the first months of 2022, given the parliamentary decision to freeze heating and electricity prices at their December level until March in order to contain the inflationary burden on households, prices are expected to remain elevated throughout the year in tandem with the energy prices heated landscape. In our view, the persistently high inflation will hamper the GDP growth outlook, setting the growth rate at a lower level than that foreseen in the budget. The utilisation of the RRF funds and the provision on the budget for public investments worth 5.8% of GDP will most probably increase the contribution of investments to the headline GDP growth rate. Still, the loss of steam in private consumption, which is traditionally the largest GDP growth contributor, through the increased prices that will curtail the disposable income, can hardly be offset this year, even by increased investments. In a nutshell, the newly formed government endeavors to find the fine balance between fostering growth and securing the soundness of public finances, which has been challenged in the past two years in the fight against the pandemic. In this context, persistent inflation, mostly imported and thus harder to tame, limited policy space given the Maastricht criteria that need to be kept fulfilled in order for the country to adopt the euro by 2024 and the idiosyncratic vulnerability against the pandemic, which stems from the low rates of vaccination in the country, pose risks to the downside.

Figure 27: Inflationary pressures surge...



Source: Eurostat, Eurobank Research

Figure 28: ...amid loss of steam in the GDP growth pace

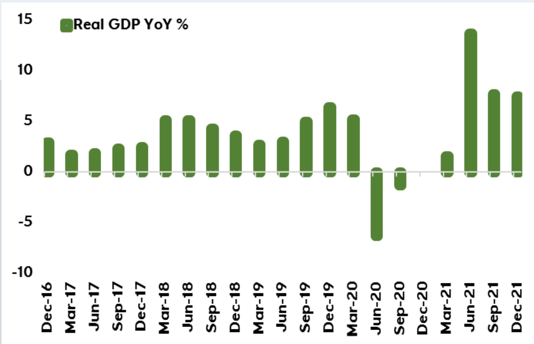


Source: Eurostat Eurobank Research

Serbia

After a solid economic performance in the past two years, despite the pandemic-related turbulence, the economy is expected to cool down a bit in 2022

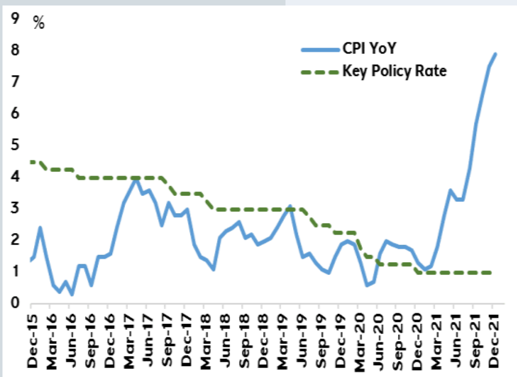
Figure 29: Strong economic rebound in FY2021...



Source: Bloomberg, Eurobank Research

According to the recently released flash estimate, Serbia's real GDP expanded by 6.9% YoY in Q4 2021, slowing down from 7.7% YoY in Q3 and 13.6% YoY in Q2 and picking up from 1.6% YoY in Q1. Assuming that the flash estimate is confirmed by the final print with further breakdown of national accounts due in late February, the FY 2021 GDP growth print stands at 7.5%, confirming the recent statistical estimate and beating the forecasts of local authorities and IFIs. Behind the solid economic performance of the outgone year, there was extensive fiscal support amounting to ca. 4.2% of the projected GDP (vs ca 13.0% in 2020), while strong FDI flows that are estimated to have reached ca. 7.5% of the projected GDP also assisted. Looking ahead, the economy is expected to slightly cool down posting a 4.5% GDP growth rate in 2022, broadly and almost equally driven by (public and private) investments and private consumption. Regarding the latter component, while the fact that 2022 is an elections year during which the disposable income will be as ring-fenced as possible, the inflationary outlook appears challenging and will most probably take a substantial toll on consumption. Inflation accelerated to 7.9% YoY in December from 7.5% YoY in the previous month, hitting its highest level since 2013. The main upward pressure on the headline index came from food prices, especially vegetables and meat prices, forcing the government in late January to extend the freeze in prices of five basic food items for the next three months. During the said period when prices will be regulated, the National Bank of Serbia anticipates their level to remain elevated and to de-escalate from H2 onwards, proceeding in tandem with the course of global prices in the energy and commodities markets. In this framework, the NBS inflation held fire in January's monetary policy committee by keeping the key policy rate at 1% and while it is broadly expected that some monetary tightening will follow this year, this is not anticipated before Q2. Concluding with a quick note on the political landscape, the upcoming elections are scheduled for 3 April with a triple ballot over the presidency, the members of parliament and the municipal elect in the country. No major surprises are expected as President Aleksandar Vucic and his right wing SNS party, will most probably be re-elected, dominating the country's political scene for the last decade.

Figure 30: ..will facilitate the monetary tightening, evidently required in 2022..



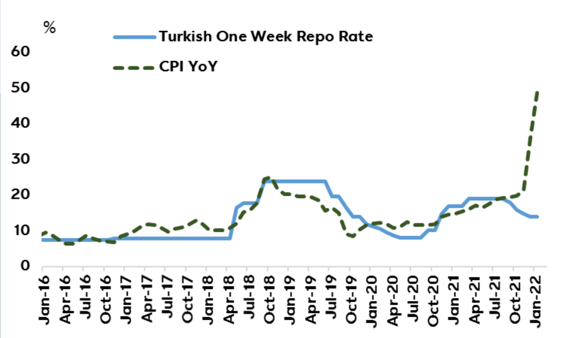
Source: Bloomberg Eurobank Research

Turkey

January's CPI print skyrocketed to 48.7% YoY and further escalation cannot be ruled out

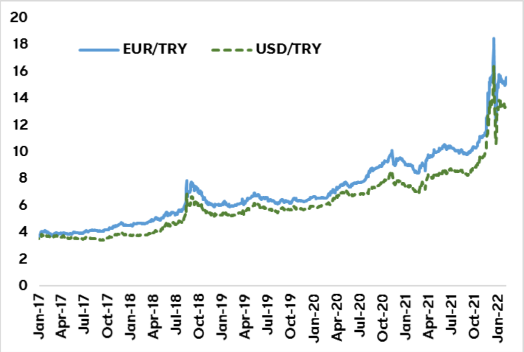
Inflation accelerated to 48.7% YoY in January for the eighth month in a row, approaching almost 20-year highs. The reading is the highest since April 2002 and has sizably increased from 36.1% YoY in December. On a monthly basis, consumer prices increased by 11.1% while both readings, annual and monthly, beat the market consensus to the upside. The spike was driven by rising energy and food prices while the weak lira weighed as well. Winter is traditionally a high inflation period in Turkey as the cold weather adds pressure on food and energy prices. Energy prices rose more than 75% YoY from 45% YoY in December, while prices in food items, which roughly account for one quarter of the consumer basket, accelerated to ca 55% YoY, amid severe weather conditions. The inflationary outlook remains worrying, even when excluding the volatile component of fuels and energy, as the core inflation rose by ca 40% YoY in January from around 30% YoY in December. Second round effects are anticipated in the future and are already incorporated in the headline inflation, triggered by pass through dynamics from the supply side of the economy, as producers stand unable to absorb both the imported and the domestic price pressures. Indicatively, the PPI increased by more than 93% YoY in January, vs 80% YoY in December 2021 and 26% YoY in January 2021. The Central Bank of Turkey estimates that inflation will peak at 55% around May, before falling sharply in Q3-2022 and closing at 23.2% at the end of the year. However, it is broadly expected it that it will remain higher over time. That said, based on a recent Reuters poll with the participation of 13 economists, inflation at the end of 2022 is estimated at 35% with a variation range from 27.6% to 42%. To the question of whether the worst is over, the prevailing view is that the weakening of the lira will continue to add more pressure on prices, while President Tayyip Erdogan's rhetoric, which continues to support the unorthodox monetary policy of consecutive interest rate cuts when inflation is soaring, adds to the gloomy outlook.

Figure 31: Unorthodox monetary policy continues...



Source: Bloomberg, Eurobank Research

Figure 32: testing the limits of the local currency



Source: Bloomberg, 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)		
	2021	2022f	2023	2021	2022f	2023	2021	2022f	2023	2021e	2022f	2023	2021e	2022f	2023
World	5.9	4.3	3.6	4.3	4.7	2.8									
Advanced Economies															
USA	5.7	3.9	2,5	4.7	4.8	2,4	5.4	3.7	3,5	-3.5	-3.4	-3.3	-10.8	-6.1	-4.6
Eurozone	5.2	4.0	2.5	2.6	3.2	1.8	7.7	7.3	7.1	2.7	2.5	2.4	-7.1	-4.0	-2.6
Germany	2.8	3.9	2.6	3.1	3.9	1.8	5.7	5.1	4.9	6.6	6.5	6.0	-4.3	-2.5	-1.0
France	7.0	4.0	2.3	2.1	2.6	1.6	7.9	7.7	7.5	-1.2	-1.4	-1.0	-8.2	-5.0	-4.0
Periphery															
Cyprus	4.9	4.1	3.3	2.5	1.7	1.5	7.5	6.7	5.0	-10.0	-8.0	-8.0	-3.5	-2.0	-2.0
Italy	6.3	4.2	2.1	2.0	3.0	1.4	9.5	9.0	8.6	3.4	3.0	2.9	-9.4	-5.5	-3.8
Spain	5.0	5.4	3.5	3.0	3.6	1.5	14.8	14.4	13.1	0.8	1.4	1.4	-8.4	-5.4	-4.3
Portugal	5.3	5.2	2.5	0.9	1.8	1.3	6.6	6.3	5.9	-0.7	-0.4	-0.4	-4.4	-3.2	-2.3
UK	7.0	4.5	2.2	2.6	4.8	2.2	4.6	4.2	4.0	-3.1	-3.5	-3.2	-8.1	-3.9	-2.6
Japan	1.7	2.9	1.4	-0.3	0.8	0.7	2.8	2.6	2.5	3.0	2.9	3.0	-6.4	-6.2	4.5
Emerging Economies															
BRICs															
Brazil	4.7	0.7	2.0	8.3	7.4	3.8	13.6	12.5	11.7	-1.4	-1.3	-1.3	-5.7	-6.8	-7.1
China	8.1	5.2	5.1	0.9	2.3	2.2	4.9	3.7	3.7	1.9	1.5	1.3	-5.6	-4.7	-4.7
India	9.2	7.8	7.0	5.4	5.0			*NA*		-1.5	-1.8	-1.5	-6.8	-6.0	-5.0
Russia	4.2	2.6	2.1	6.7	6.4	4.1	4.9	4.6	4.5	6.8	6.0	3.6	-0.3	0.7	0.3
CESEE															
Bulgaria	4.0	4.1	3.5	3.3	5.0	2.6	5.5	5.0	4.7	-0.5	0.9	2.3	-3.9	-2.5	-2.1
Serbia	7.2	4.5	4.1	3.0	5.0	3.2	9.3	10.3	9.5	-4.1	-4.2	-4.2	-4.9	-3.0	-2.0
Turkey	9.0	3.3	3.0	19.4	30.0	17.0	13.1	12.5	12.0	-3.2	-2.2	-2.0	-3.4	-4.2	-3.5

Sources: European Commission, IMF, OECD, Bloomberg, Eurobank Research

Research Team

Dr. Tasos Anastasatos | Group Chief Economist
tanastasatos@eurobank.gr | + 30 214 40 59 706

Anna Dimitriadou
Economic Analyst
andimitriadou@eurobank.gr
+ 30 210 37 18 793

Dr. Stylianos Gogos
Research Economist
sgogos@eurobank.gr
+ 30 210 37 18 733

Maria Kasola
Economic Analyst
mkasola@eurobank.gr
+ 30 214 40 63 453

Paraskevi Petropoulou
Senior Economist
ppetropoulou@eurobank.gr
+ 30 210 37 18 991

Dr. Theodoros Rapanos
Economic Analyst
v-trapanos@eurobank.gr
+ 30 214 40 59 711

Dr. Theodoros Stamatiou
Senior Economist
tstamatiou@eurobank.gr
+ 30 214 40 59 708

Elia Tsiampaou
Economic Analyst
etsiampaou@eurobank.gr
+ 30 214 40 59 712

More available research at: https://www.eurobank.gr/en/group/economic-research
Subscribe electronically at: https://www.eurobank.gr/el/omilos/oikonomikes-analuseis/forma-ekdilosis-endiaferontos
Follow us on twitter: https://twitter.com/Eurobank_Group
Follow us on LinkedIn: https://www.linkedin.com/company/eurobank