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Concerns are mounting for a slowdown in global growth, mostly coming from the Ukraine crisis-induced supply shock amid sharply higher energy and key commodity prices. However, labor market strength, improved pre-war fundamentals, supportive fiscal policies to mitigate the impact from rising energy costs and excess private savings accumulated during the pandemic, are expected to help the global economy weather the current shock and growth to remain in an above-trend pace, though much will depend on how quickly the conflict will be resolved and whether it will escalate further.

Macro Picture

USA: Economy on a solid footing but challenges mount

EA: The Ukraine crisis has clouded the growth outlook amid new and severe headwinds

UK: After peaking in Q1, growth should lose momentum amid a significant drag in real incomes

EM: Energy and commodity prices trim GDP growth and push inflation higher

CESEE: Energy and commodities dependence on Russia taking a toll on GDP growth

Markets

FX: USD and CHF act as safe havens along with commodity currencies as Russia-Ukraine rattles markets

Rates: EU and US sharply higher on the back of higher inflation and CBs catching up with economic data

EM: Assets recovering after some progress in peace talks but risks still elevated with rising US rates as headwind. Commodity exporters to outperform

Credit: Spreads tighter in March, expected to trade in a wide range with increased volatility in Q2 on inflation and Ukraine risks.

Policy Outlook

USA: More aggressive tightening ahead

EA: Despite growth risks from the war, the ECB speeds up tapering on persistently high inflation

UK: Further BoE policy tightening likely amid rising concerns about second round inflation effects

CESEE: Regional central banks confronted with increased stagflationary risks

Key Downside Risks

DM: The Ukraine crisis escalates, new infectious variants prompt renewed Covid-19 restrictions, de-anchoring of inflation expectations

EM: Credit downgrades and limited access to capital markets, stagflation, increased pressure on commodity importers, need for defensive expenditure on already burdened public finances

Special Topics in this issue

→French presidential elections: An important milestone for France and Europe

→Eurozone - Ukraine crisis: The economy's vulnerability mainly stems from its dependency on energy imports from Russia

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April 2022

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Contents

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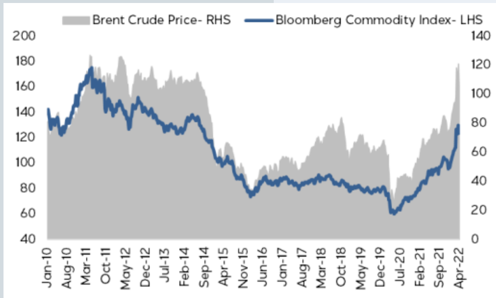
Macro Views
Latest world economic & market developments

Concerns are mounting for a potential slowdown in global growth, mostly coming from the Ukraine crisis-induced supply shock

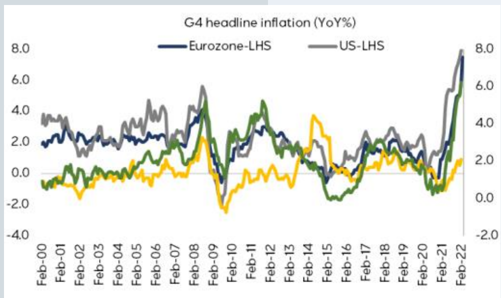
Surveys and incoming hard data pertaining to the early two months of the year had been sending an encouraging signal that, after two years dominated by the pandemic, economic activity was on a path of re-acceleration, led by the services sector, as the Omicron drag was fading. However, Russia's invasion of Ukraine in late February and the sanctions imposed by the West altered growth prospects, with the global economy facing sharply higher commodity prices — though already elevated before the war— further disruption for key commodity markets and supply chains (Russia is a major global producer and exporter of a range of key commodities), tightening financial conditions and immense geopolitical uncertainty (Figure 1). While energy prices are down from their early March peaks, Brent crude is still up around 10% compared to pre-war levels, while the FAO Food Price Index reached a fresh record high last month, exceeding the previous peak of early 2011. Against this background, concerns are mounting for a potential slowdown in global growth from March onwards, mostly coming from the supply shock amid the war-induced surge in energy and other key commodity prices, leading to sizable revisions for higher inflation and slower growth this year. In support of the above, the J.P.Morgan Global Manufacturing PMI fell to an 18-month low of 53.0 in March, down from 53.7 in February, amid multiple headwinds, including stretched global supply chains, rising inflationary pressures and elevated geopolitical tensions. In a similar worrying signal, consumer sentiment measures from several major economies weakened sharply in March, likely reflecting uncertainty about the Ukraine crisis, higher commodity prices and the sharp deterioration in households' real income. Consumer confidence fell further in the US and the UK despite tight labor markets and higher than expected March PMIs, with the deterioration unsurprisingly largest in the Eurozone given its dependence on Russian energy supplies. Indeed, inflation, which had been surprising persistently to the upside even before Russia's invasion of Ukraine, continues to

Figure 1: The Ukraine crisis-induced surge in commodity prices ...



Source: Bloomberg, Eurobank Research

Figure 2: .... has driven up inflation further



Source: Bloomberg, Eurobank Research

surge, reaching fresh multi-year highs across several countries around the globe (Figure 2). Meanwhile, incoming data suggest that labor market conditions continue to improve, pushing down unemployment rates and supporting households' incomes. Continued labor market strength, combined with improved pre-war fundamentals, supportive fiscal policies to mitigate the impact from rising energy costs and excess private savings accumulated during the pandemic, are expected to help the global economy weather the current supply shock and growth to remain in an above-trend pace, though much will depend on how quickly the conflict will be resolved and whether it will escalate further, possibly even beyond the borders of Ukraine. While acknowledging the risks around the Ukraine crisis, several DM Central Banks continue to tilt hawkish, signaling more focus on price stability than the potential downside impact to growth from the war, as it has become clear that inflation will remain high for longer than initially expected, while evidence of tightening labor markets is mounting, and long-term inflation expectations are rising globally.

Developed Economies

US: Economic activity in the US remains on a solid footing with both the manufacturing and services sectors expanding further in March, while the labour market is strong with employment and earnings increasing. The picture is blurred however by very high inflation, which has skyrocketed to four-decade highs, burdening households, particularly the most vulnerable ones. Against this background, the Fed embarked on a new tightening policy cycle in March, raising the target range for the federal funds rate by 25bps to a range of 0.25 to 0.50 percent, while more aggressive tightening ahead is increasingly more probable in order to ensure price stability. Markets currently price in 9 more 25bps hikes in 2022, fueling worries over a recession further down the road, although Fed Chair Jerome Powell appears optimistic about a soft landing. Meanwhile, the Ukraine crisis is expected to have a less pronounced negative impact on the US economy than elsewhere, as the US is a large oil producer country, while its industry is less dependent on oil than in the past.

Euro area: The Ukraine crisis has clouded the Eurozone's growth outlook as it creates new and severe headwinds that could affect ecconomic activity mainly through the war-induced supply shock and confidence. The supply shock, stemming from sharply higher commodity prices, should weigh on firms' competitiveness and households' purchasing power, while immense uncertainty about the persistence of energy price increases, may dampen households' discretionary spending and make companies more cautious about investment decisions. Elevated commmodity prices push already high inflation further up, with HICP surging to a new record high of 7.5%YoY in March. High inflation, heightened uncertainty and exacerbated supply chain disruptions suggest that growth this year is expected to be significantly weaker than projected before the outburst of the war. However, improved labor market conditions, mitigating measures to soften the impact from rising energy costs and NGEU funds, should help the economy to continue expanding at an above trend growth rate. High inflation prompted the ECB to speed up tapering in March, but the Central Bank also decided to change the forward guidance to have more flexibility to adjust policy in either direction, in the wake of the Ukraine crisis.

Emerging Economies

EM: As the war between Russia and Ukraine continues, the economic prospects for the EM, at least for 2022, wane. With many developing economies across the entire EM sphere (LatAm, EMEA and Asia-Pacific) still struggling to leave behind the Covid-19 related negative repercussions, the current war has started to transmit unfavorable shocks, mainly through the skyrocketing energy and commodities costs that evaporate disposable incomes and intensify the disruptions in supply chains, which in many areas have not recovered yet from the pandemic shock. Frontier markets with high indebtedness and strong dependency on imports for their energy and commodities sufficiency will suffer more, amid the quicker monetary tightening in the developed world, which along with increased uncertainty is pushing the cost of debt service at higher levels. It is no coincidence that in March EMs like Egypt, Tunisia and Sri Lanka turned to the IMF for financial assistance as all three economies have been dented by the increased costs of energy and commodities. Assuming that the turmoil continues, as no decompression is visible at the time of writing, sovereign debt insolvencies or/and downgrades will keep adding worries over a looming EM crisis.

CESEE: As Russia's invasion in Ukraine unfolds, forecasts over the GDP growth rate in the CESEE region in 2022 are starting to be revised downwards, uncertainty over the final turnout of the war increases and overall risks are tilted to the upside. More specifically, in late March, the EBRD revised its 2022 figure to ca 3% from ca 4.5% in November, on the back of the lingering supply shock in the energy and commodities markets. The shortage of commodities is starting to pass through supply chains, increasing the already high pressure at prices levels. Along these lines, the approach by the regional central banks differs across the area with some countries about to end their tightening cycle (i.e. in Czechia), others most probably continuing in an effort to tame persistent inflation (i.e. in Poland and Romania) and fewer ones not having embarked on rate hiking yet (i.e. in Serbia). With most of the economies having planned to undergo sizable fiscal consolidations in 2022 in order to put back on track their public finances following the pandemic related fiscal impulse in 2020 and 2021, budgets will most probably have to be revised factoring in urgent expenditures for defense and expenses related with the hosting and welfare of Ukraine refugees.

Special Topics

I. French presidential elections: An important milestone for France and Europe

This year is an election year for France with the presidential elections taking place on 10 and 24 April and the parliamentary elections on 12 and 19 June. Both are important for France and Europe, where France holds the Presidency of the Council of the European Union this semester. In the following sections, we discuss the forthcoming presidential elections, the candidates and the policy issues that are in the center of interest.

In the 2017 presidential elections, former investment banker Emmanuel Macron ran for the first time and managed to get elected by a significant margin, becoming France's youngest leader since Napoleon. For his main opponent, Marine Le Pen, it was her second candidacy and although she failed to get elected, it was the first time since 2002 that a candidate of the National Front party made it to the second round. It was also the first time in the history of the Fifth Republic that the runoff did not include a nominee from the traditional left or right parties.

In the 2022 presidential elections, 12 candidates have secured the required 500 valid sponsorships in order to be eligible to run for office. The candidates, the political parties with which they participate in the elections and their political direction, are presented in Table 1.

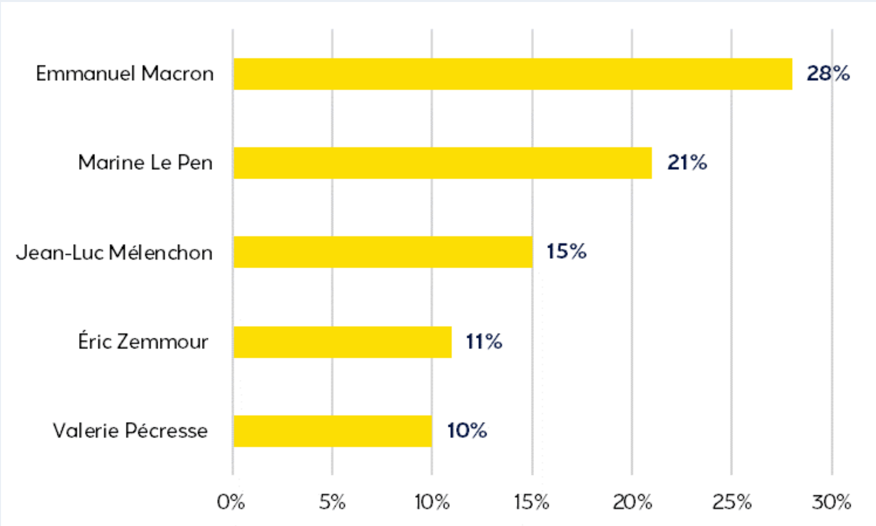
Table 1. French 2022 presidential elections: candidates, political parties and political direction.

Nominee	Party	Political direction
Emmanuel Macron	En Marche!	Liberal, Pro-European
Marine Le Pen	National Rally	Far-right, Eurosceptic
Valerie Pecresse	The Republicans	Centre-right economically liberal culturally conservative
Eric Zemmour	R! Reconquête	Far-right
Jean-Luc Mélenchon	La France Insoumise	Democratic socialist, left-wing populist
Yannick Jadot	Europe Ecology – The Greens	Green, centre-left to left
Nathalie Arthaud	Workers' Struggle	Far-left
Philippe Poutou	New Anticapitalist Party	Far-left
Fabien Roussel	French Communist Party	Communist
Anne Hidalgo	Socialist Party	Centre-left social-democratic
Jean Lassalle	Résistons!	Centre-right
Nicolas Dupont-Aignan	Debout la France	Right to far-right

According to the electoral system, if a candidate receives more than 50% of the votes in the first round on April 10, she/he wins the election, but current polls place the front-runner significantly below this threshold. If no candidate crosses the 50% vote threshold in the first round – as will most likely be the case this year – the two candidates with the most votes proceed to the second round on April 24. The winner is then decided as the nominee who receives the higher proportion of the votes.

Incumbent President Emmanuel Macron steadily leads in the polls for first round intentions, albeit by a decreasing margin as the elections approach, while Marine Le Pen is the most likely candidate to also make it to the second round, ahead of Jean-Luc Mélenchon, Éric Zemmour and Valerie Pécresse. As of 1 April, opinion polls for first round shares of the vote were as follows (Figure 3):

Figure 3. Opinion polls for first round shares of the vote for the five leading candidates (1 April 2022).



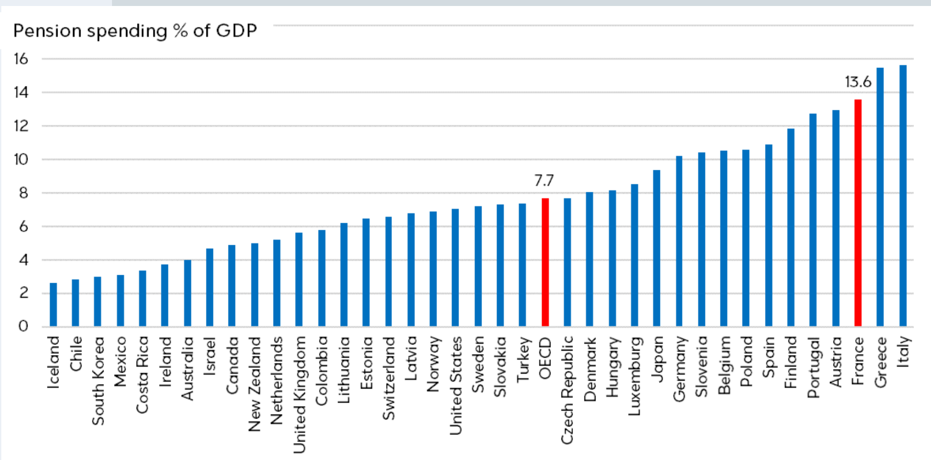
Source: Reuters, press

Next we will look at the main points of the front-runners' election campaign programs and their positions in key policy areas.

1. Pension reform

A priority for Emmanuel Macron is the progressive increase of the retirement age from 62 to 65 years of age. This would be the second attempt to this reform, which was initially met with strong resistance from trade unions and workers in sectors that enjoy favourable retirement regimes and was eventually suspended because of the pandemic. On the retirement age, Marine Le Pen advocates no increase, Jean-Luc Mélenchon favours bringing it back to 60, Valerie Pécresse believes it should be raised to 65 by 2030, whilst Éric Zemmour proposes a more moderate increase. Note that according to latest OECD data, France's spending on pensions amounts to 13.6% of GPD, the third highest among OECD countries, behind Italy and Greece (Figure 4).

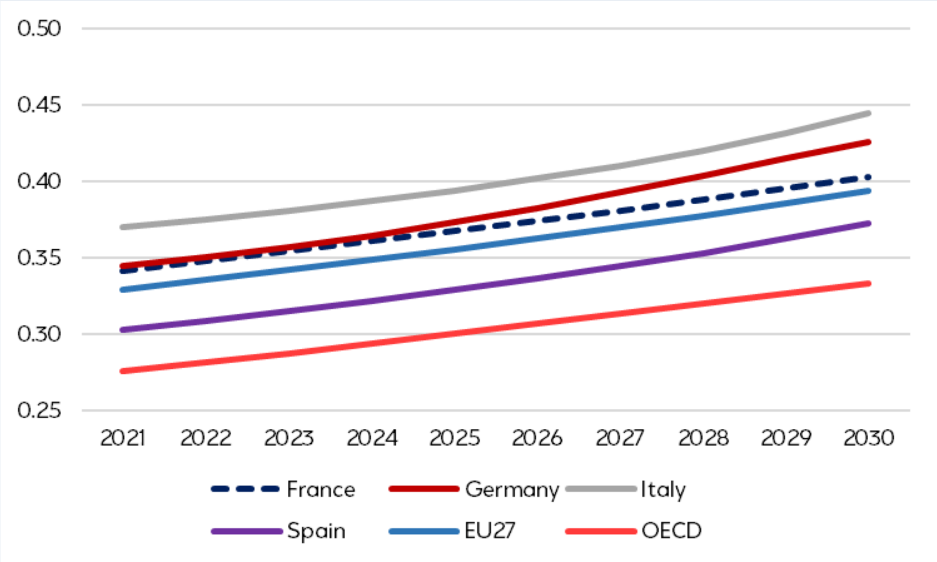
Figure 4. Spending on pensions as a percentage of GDP (latest available data)



Source: OECD

At the same time, the old age dependency ratio, i.e. the ratio of older dependents (people older than 64) to the working-age population (those between 15-64) is projected to increase in the coming years at levels above the EU27 and OECD averages (Figure 5).

Figure 5. Old age dependence ratio

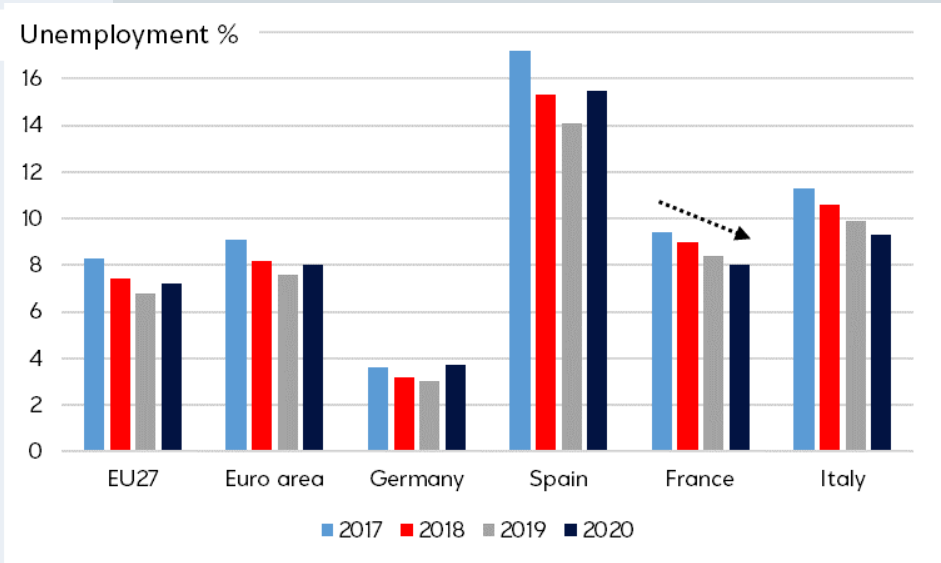


Source: OECD

2. Labour market

Unemployment fell from 9.4% in 2017 to 8.0% in 2020 (Figure 6), decreasing also between 2019 and 2020, when it inched up in most EU countries due to the Covid-19 pandemic.

Figure 6. Unemployment rate 2017-2020



Source: Eurostat

Emmanuel Macron supports the continuation of the labour market reforms that were implemented in the period 2017-2019 and included, among others, more flexibility in the wage bargaining process and lower social security contributions. Additionally, he proposes tripling to €3,000 the exceptional bonus to employees that is exempt from taxes and social security contributions. Marine Le Pen proposes to exclude wage increases up to a limit from employers' social security contributions, extend support for families and reduce production taxes. Valerie Pécresse suggests that decisions on working hours be made at the company level and favours more work incentives for the unemployed, as well as the abolition of employer social security contributions for apprentices in companies with less than 10 employees. Marine Le Pen and Éric Zemmour favour reducing labour taxes instead of raising the minimum wage, while Marine Le Pen also proposes introducing a monthly training voucher of €200 to €300 for trainees and their employers. Finally, Jean-Luc Mélenchon advocates the increase of the minimum wage and a 32-hour working week for certain professions.

3. Tax reform

Emmanuel Macron advocates lower inheritance taxes and generally raising household purchasing power through tax cuts, including the abolition of the fee for state broadcasting, the equivalent to the BBC license fee in the UK. He also plans to reduce production taxes for businesses in the order of €7bl annually, namely taxes on turnover, staff and buildings rather than profit, by abolishing the CVAE, a value-added deduction charged by local authorities. Marine Le Pen proposes the reduction of the VAT from 20% to 5.5% on fuel, fuel oil, gas and electricity, and the exemption from income tax for young people up to 30 years old, as well as corporation tax for entrepreneurs under 30 years old for the first 5 years. Valerie Pécresse proposes the reduction of electricity taxes, the expansion of budget support for households, the increase of the R&D tax deduction for SMEs and lower production taxes. Finally, Éric Zemmour favours a reduction in social security contributions for low-income workers, as well as lower production taxes and tax rates for small businesses.

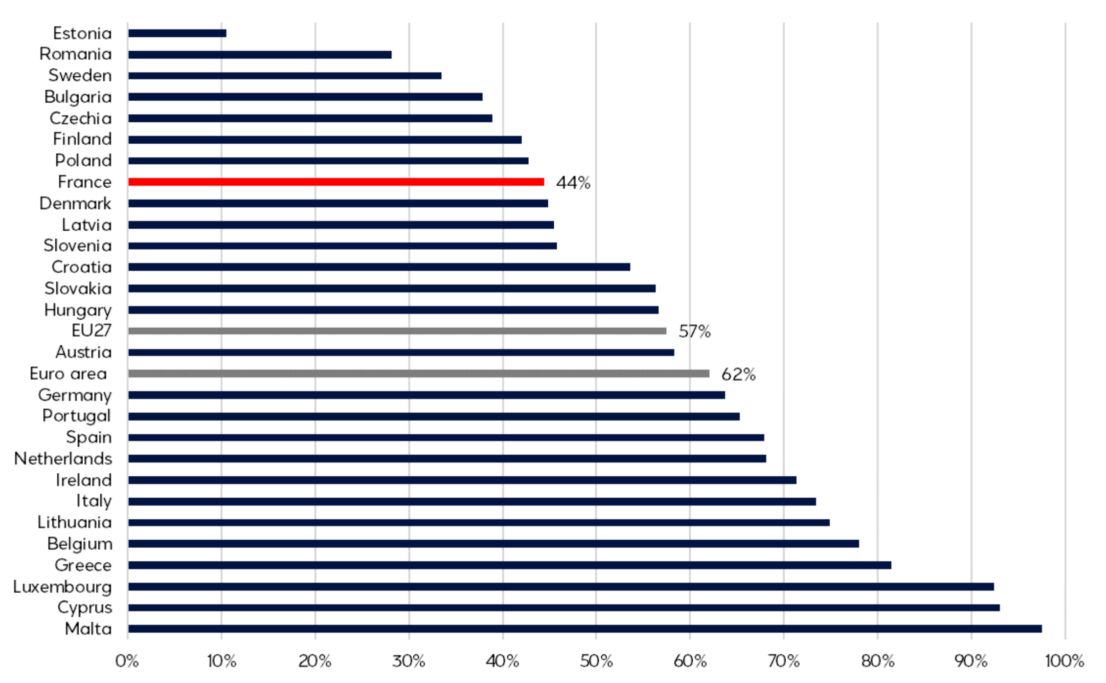
4. Fiscal policy

In its January 2022 report “The overall situation of public finances (at the end of January 2022)”, France’s official auditor (Cour Des Comptes) warned about the high public deficit and public debt. According to latest data, in 2022, nearly two years after the outbreak of the health crisis and while economic activity has exceeded its pre-crisis level, the country’s deficit is expected to remain elevated, after reaching -6.5% in 2021 and -8.9% in 2020, keeping the public debt around 110% of GDP. As a result, France would diverge from the group of EU countries whose debt to GDP is around 60%, such as Germany, the Netherlands and Austria, which is becoming increasingly important, particularly in view of the potential review of European budgetary rules. In this background, Emmanuel Macron wishes to raise annual military spending to €50bn by 2025 and invest €30bn in "future sectors", such as nuclear energy, semi-conductors and artificial intelligence. At the same time, he pledges to progressively curtail the public deficit by financing the higher expenditures through stronger economic growth, lower unemployment, reduced social security fraud and a more efficient government. Marine Le Pen and Éric Zemmour also favour increasing military spending but oppose public employment cuts. Valerie Pécresse aims at reducing public debt to 100% of GDP in ten years through interventions in pensions, unemployment insurance, public employment, tax fraud and bureaucracy. She also advocates renegotiating EU budgetary contributions. Finally, Jean-Luc Mélenchon wishes to raise public employment.

5. Energy policy

The French economy relies upon imports of oil, natural gas and solid fossil fuels in order to meet its energy needs to a lesser extent compared to most other EU countries (Figure 7), which largely owes to the relatively high share of nuclear energy in the energy consumption mix. Nevertheless, rising energy prices due to supply-demand imbalances and, more recently, due to the Russia-Ukraine war, have made the need for energy self-sufficiency even more urgent.

Figure 7. Energy dependence[1]



Source: Eurostat

Emmanuel Macron is in favour of more nuclear reactors as a means to reduce carbon emissions and bolster the country's energy independence. To this end, he considers that the state should regain the control of some firms in the energy sector and invest in electric car battery production and renewable and nuclear energy. Marine Le Pen and Éric Zemmour advocate abandoning wind projects and gradually dismantling existing farms, expanding the nuclear and hydroelectric sectors and investing in hydrogen. Valerie Pécresse stands for the expansion of energy production from both nuclear plants as well as renewable sources. Finally, Jean-Luc Mélenchon is against nuclear energy production.

1 The energy dependence indicator shows the extent to which an economy relies upon imports in order to meet its energy needs. It is calculated as net imports divided by the gross available energy. Energy dependence = Net imports / Gross available energy. Net imports are calculated as total imports minus total exports. Gross available energy is a calculated value, defined as: Primary production + Recovered & recycled products + Imports – Exports + Stock changes Energy dependency may be negative in the case of net exporter countries while positive values over 100 % indicate the accumulation of stocks during the reference year.

6. EU policy

The candidates' stance towards the EU is increasingly important at the present juncture, where the Union is called upon to deal with new, more urgent and demanding challenges. Emmanuel Macron is a fervent Europeanist and advocates strengthening the strategic and economic self-sufficiency of the EU. In this context, he aims at building a "European metaverse" to compete with US tech giants and make Europe more independent on that front. On budgetary rules, he proposes revising the 3% budget deficit rule by leaving out public investment for defense and the green transformation. Valerie Pécresse's EU policies are similar to those of Emmanuel Macron, although she opposes further EU enlargement. Contrary to Emmanuel Macron and Valerie Pécresse, Marine Le Pen is a Eurosceptic who broadly based her 2017 presidential campaign on an anti-EU narrative, going as far as pledging to hold a referendum on France's EU membership, unless the EU agreed to revert to a looser coalition of nations with neither a single currency nor a border-free area. She has since abandoned this extreme rhetoric but remains a Eurosceptic vowing to prevent the application of European laws that contradict the French constitution. Éric Zemmour and Jean-Luc Mélenchon also advocate more leeway against EU policies, while the former additionally opposes further EU enlargement.

In addition to the above policy areas, the political controversy extends to other fields as well, such as climate change, defense, immigration, health, agricultural policy and education, in which the candidates express quite different positions. Overall, the positions of the main candidates in the forthcoming French presidential elections span a wide range in the political spectrum, not just between the traditional right and left, but also in other dimensions such as between liberalism and conservatism. To the extent that each candidate represents a significant share of the electorate, it can be inferred that there are significant contradictions within the French society. Therefore, whoever becomes President will have a difficult job ahead of her/him, reconciling differences and striking delicate balances in order to implement her/his policy.

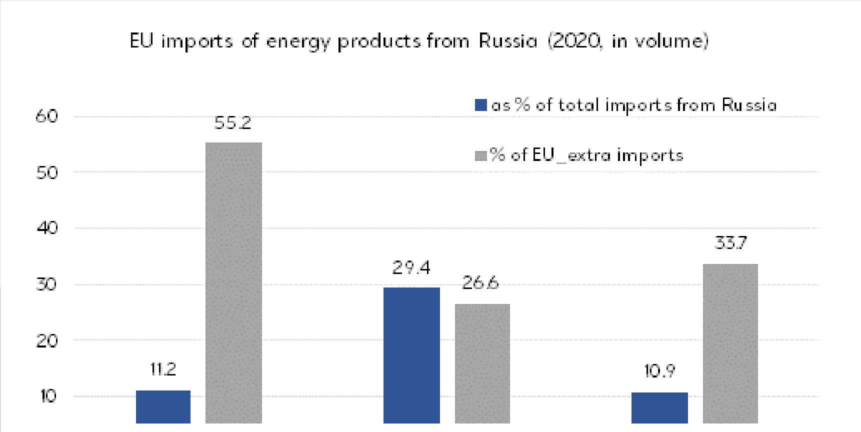
II. Eurozone-Ukraine crisis: The economy's vulnerability mainly stems from its dependency on energy imports from Russia

Eurozone data pertaining to the first two months of the year, just before the invasion of Russia of Ukraine on February 24, suggested that the economy was on a recovery path after two years dominated by the pandemic. Activity was regaining momentum supported by the gradual lifting of Covid-19 restrictions, while supply constraints, albeit still severe, had started to ease. Though inflation pressures were already elevated, market consensus was for an above-trend GDP growth pace of around 4.0% in 2022, mostly driven by robust domestic demand amid a continuing improvement in labor market conditions and the ongoing fiscal and monetary policy support. Then came the Ukraine crisis however, injecting a high degree of uncertainty into the growth outlook. Though it would be rather premature to try to assess the magnitude of impact as the situation in Ukraine is still evolving, the war will unavoidably have severe consequences on the Eurozone's economic outlook through a number of channels. These mostly include: (i) trade relationships; (ii) banking and investment exposure; (iii) economic uncertainty; and (iv) commodity prices, especially energy. The channels, though, which will mostly affect real GDP and inflation, are probably the last two. This is because, with the exception of the Baltic countries, Russia represents a small share of euro area trade (Eurozone exports and imports to/from Russia accounted c. 4% and c. 5.5% of total exports/imports in 2020, broadly in line with the 2014-2019 average) and the banking exposure of major European countries to Russia (according to BIS Q3 2021 data), is no higher than 1% of GDP.

Though trade and financial spillovers could be relatively limited, the Eurozone is heavily reliant on Russian energy products. In 2020, the EU imported from Russia 55% of its total natural gas imports, c. 27% of its imports of petroleum oil products and c. 34% of its total coal imports (Figure 8), shares significantly higher than those of other major trading partners (Figures 9, 10, 11). The latter clearly highlights the large dependence of the EU on Russia and underlines the high difficulty it faces in substituting or sourcing them from other markets — especially in a short period of time — especially given that Russia is the main supplier to a number of countries that are simultaneously looking for alternative providers following the wide-ranging sanctions imposed.

Besides energy, the EU imports from Russia several other commodities, including metals and fertilizers. Based on 2020 data, the EU's dependence on Russia is high on fertilizers, accounting for near 30% of product total imports, while reliance on Russia is also elevated for mineral fuels and nickel, accounting for 29.5% and c. 24% of product total imports. Russia is also an important supplier of certain agricultural products, especially wheat, accounting for nearly 70% of the EU's product total imports (Figure 12).

Figure 8 : The EU imports a sizable share of energy products from Russia



Source: Eurostat, Eurobank Research

Figure 9 : Europe is highly dependent on oil imports...

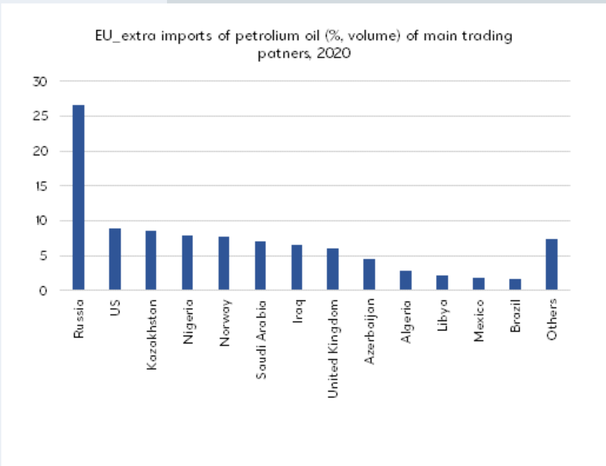


Figure 10: ...natural gas imports ...

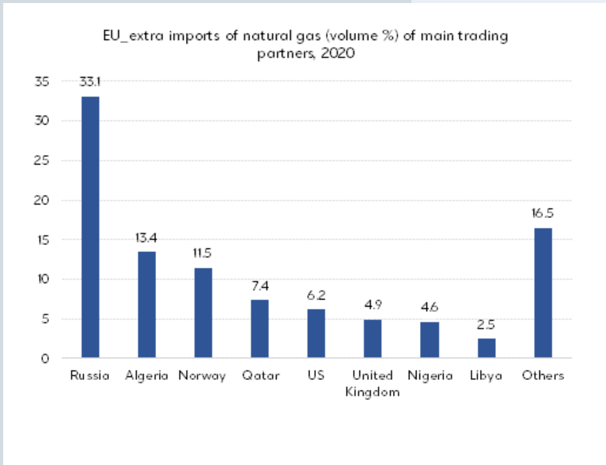


Figure 11:... coal imports...

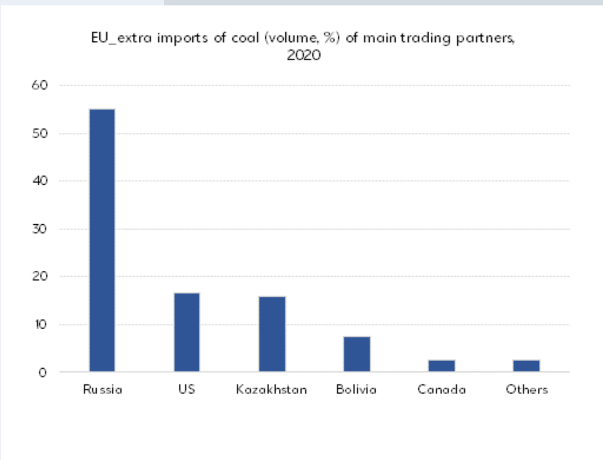
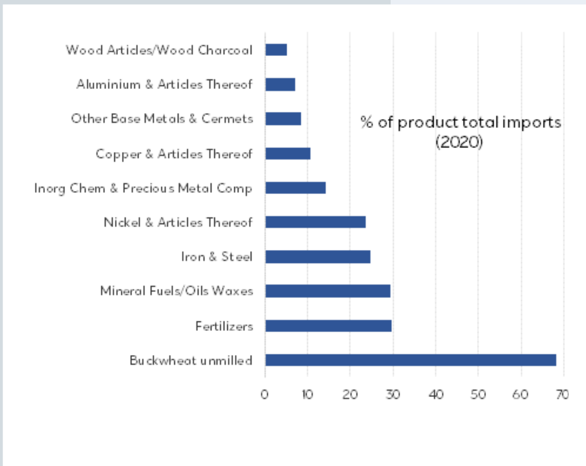


Figure 12:... and several other commodity imports from Russia



Source: Eurostat, Eurobank Research

With the Ukraine crisis exacerbating already serious supply disruptions and amid concerns that Russia could ban exports of some (or all) products or that Western countries would ban imports of some (or all) Russian products, commodity prices — already elevated before the war — have surged further, eroding households' real incomes (especially as nominal wages are rising at a modest pace of c. 2.5% in the Eurozone), impairing investment decisions for corporates and weighing on their profitability. Oil exacerbates prices have risen above $100/bbl for the first time since 2014, the Bloomberg Commodity Price Index has increased by more than 10% since the outburst of the Ukraine crisis, while, on average, wheat prices gained in March more than 45% compared to the January average. These would have a negative impact on real GDP growth and would result in more persistent inflation pressures, with a dampening effect on household and corporate confidence.

The precise magnitude of the growth and inflation impact of the Ukraine crisis to the Eurozone is hard to gauge at the current stage. Many unknowns remain, including how quickly the conflict will be resolved, whether it will escalate further and spread beyond the Ukrainian borders, as well as the negative spillovers from sanctions on Russia and the compounding effect of all transmission channels to the economy. But without doubt, downside risks prevail for the Eurozone's 2022 growth outlook, mainly through the pass-through of commodity price shocks, especially energy, on consumers and firms. According to the ECB's latest staff forecasts (March 2022)2, in an 'adverse scenario' which assumes stricter sanctions on Russia as well as disruptions to global value chains, the Ukraine conflict is expected to reduce Eurozone GDP growth by 1.2ppts in 2022 (to 2.5% vs. 3.7% under a baseline scenario) and 1.4ppts (to 2.3%) in a 'severe scenario' which assumes stringent cuts in energy supply, a stronger correction in financial markets and larger second-round effects from rising energy prices. Along similar lines, in its latest Economic Outlook (March 2022) the OECD argued that, among regions, the Eurozone is expected to be the hardest hit from the Ukraine crisis in 2022 (-1.4ppts to 2.9%) due to its energy dependence on Russia.

In an effort to avoid tail risks of turning this supply shock into a pronounced slowdown in economic activity, most European government have already implemented a range of fiscal mitigation measures. These mostly include direct transfers to low-income households, the reduction of energy taxes and caps on energy prices, likely financed through additional debt as the Stability and Growth Pact will remain suspended this year. On this issue, the OECD claims that a well-targeted rise in final government spending of 0.5% of GDP for one year in all OECD economies to cushion the effects of the commodity and food price shocks on households and companies, could offset around one-half of the estimated decline in output, without adding significantly to inflation.

In light of the high uncertainty on the growth outlook and persistently elevated inflation pressures, the ECB sought to maximize its flexibility in its latest meeting, aiming to have the optionality to adjust policy in either direction, once more information on the economic repercussions of the Russia-Ukraine conflict is available. Undoubtedly, with inflation already elevated in the Eurozone (HICP rose to a fresh record high of 7.5%YoY in March), the ECB clearly remains on the path to policy normalisation. The Central Bank discontinued net asset purchases under the PEPP at the end of March and the APP programme will likely

2 ECB staff macroeconomic projections for the euro area, March 2022 (europa.eu)

come to an end in Q3 (as suggested by the ECB under its baseline scenario), while the prospect of higher interest rates by the end of the year cannot be ruled out. Nevertheless, markets are fully pricing-in cumulative rate tightening of more than 50bps by end-2022, with the first 25bps rate hike expected in September. However, this may prove exaggerated if concerns over growth increase in the coming months and the ECB may have to downgrade its growth forecasts again (for both Q2 and Q3, the ECB expects GDP growth close to 1.0%QoQ following 0.2% QoQ in Q1). In addition, wage growth, an essential element for assessing the underlying inflationary pressures, may remain muted, keeping medium term inflation in line with the ECB's 2.0% target (according to the latest data, nominal negotiated wage growth stood at 1.6%YoY in Q4 2021, close to a record low of near 1.4%YoY in the prior quarter).

CESEE Markets Developments & Outlook

Bulgaria

Yield spreads widened significantly following the higher-than-expected inflation figures as well as the recent invasion of Ukraine by Russia. Eurobond yields exhibited modest moves across most maturities with the 2028-2030 tenors moving by 18 and 16 bps respectively. Due to a technical issue, a large discrepancy has emerged on the long end of the yield curve, resulting in the BVAL values corresponding falsely to the actively traded bank quotes. Local papers experienced strong yield spikes with the most active ones being the 8- and 10-year tenors, i.e. up by 99 and 82 bps respectively, with the push behind the spike being the recent auctioning activity by the Ministry of Finance. In March, two EUR250mn auctions were held, one on the short-term end of the curve with a 3.5-year tenor, and the other one on the mid-term end of the curve, with a 7.5-year tenor

Serbia

Pressure on Serbia to join sanctions against Russia is mounting and is expected to intensify after the recent elections. Indicatively, the announcement of Jadranski Naftovod (JANAF), a crude oil transportation company in Croatia, stated that the company would suspend oil deliveries to Naftna Industrija Srbije (NIS), due the fact that Gazprom is a majority shareholder of NIS, from May 15 onwards in the form of new sanctions against Russian companies could dampen the growth outlook and force Serbia to align its stance towards Russia with that of the EU.

As things stand, the factors that could rapidly decompress the level of prices, which increased by 8.8% YoY in February, are not visible in the near future. In fact, March's print is expected to lie somewhere around that area. After elections, the National Bank of Serbia will most probably proceed with some tightening by increasing the Key Policy Rate, a move that is, however, not sure to prove effective in bringing inflation down, as most of its part is considered imported, driven by global price dynamics. The FX rate will most probably remain protected, under the assumption that foreign reserves remain strong.

Markets View

Foreign Exchange

EUR/USD: The pair rebounded from a low of 1.08 to a high of 1.1185 on the announcement of Russia re-moving some military forces from Ukraine but is again moving lower as the war continues and the Fed is significantly ahead of the ECB in terms of tightening monetary policy. Trading currently around 1.10 we expect to revisit the recent lows as the real rates differential between the US and Europe favors further USD strength. The April ECB meeting will be of great importance for direction for the EURUSD, as infla-tion numbers in Europe are beating expectations fast, while at the same time the growth outlook is downgraded due to the effects of the war, with rising risks for stagflation.

EUR/GBP: Under the same sentiment around the 'constructive' but not clear enough talks regarding a potential road to peace in the Russia/Ukraine war, the pair has been range trading around 0.83 (low 0.82 and high 0.85 in March). We are biased to the long side with a view for a move towards 0.86 post the dovish hike by the BoE.

Rates

EU: EU rates increased sharply in March after a very volatile month. At the time of writing 10yr swaps are trading at 1.20% up from 0.65% at the start of February and having printed a high of 1.27%. The curve has bear flattened, with 5s-30s trading at 3bps, while hovering around zero for the last week of the month. The belly has been under pressure as traders are selling the mid part of the curve while buying the wings (5y, 30y), in anticipation of a potential rate hiking cycle. Looking forward we expect rates to remain vola-tile and eventually rise further as inflation in Europe has skyrocketed to a forty-year high of 7.3% in March.

US: US rates were significantly higher in March after a very volatile month. The 10yr swap rate is trading at 245bps, up from 180bps at the beginning of the month and having traded as high as 255 bps. The curve continued to flatten sharply with 2s-10s and 2s-30s inverting. In particular 2s-30s is trading at -40bps down from 15bps at the beginning of the month. Going forward we expect the path of the front end of the curve to stay in line with what the markets have already priced in (9 more rate hikes in 2022 with Fed Funds rate at 2.475%). The curve should keep inverting via a combination of aggressive rate hikes by the Fed but the market is already pricing rate cuts in 2023 and further out. The inversion indi-cates that recession risks for the US economy have increased. Implied volatility is expected to stay ele-vated on geopolitical risks and volatile economic numbers.

Emerging Markets Sovereign credit

EM assets are still facing the most difficult year in a decade due to the escalation of the Russia/Ukraine war, rising US rates and China's renewed Covid lockdowns. Despite that, EM spreads have rebounded in the last three weeks of March after some limited progress on the peace talks. The EMBI Global Index closed at 347 bps at the end of March, 64 bps tighter on the month and at levels seen before the start of the Russian hostility. More specifically, EM EUR bonds have recovered strongly after having underper-formed from the end of January due to the unexpected turn by the ECB and the increased geopolitical risks for CEE issuers. In CEEMEA obviously the worst performers remain Russia and Ukraine, but we saw some good buying interest in Serbia and Romania, which led spreads tighter, along with the short end EUR Polish government bonds. However, liquidity remained relatively thin. Concerning the hard currency payments of Russian bonds, the settlements have been successful so far, with the highest challenge being the maturity of 2bn USD of Russia 22s in 04/04/22. In Latam, Chile and Colombia surprised the market with smaller hikes than expected, while Peru was downgraded by one notch to BBB by S&P. In Asia, renewed COVID lockdowns in China are thickening the fog over the outlook as the last Omicron surge has affected 28 out of the 31 provinces. We saw some two-way trading in Indonesia with good buying interest in the EUR short-end bonds. We remain cautious concerning EM assets favouring countries, which are commodity exporters.

Corporate credit

EUR investment grade bond spreads on most rating grades and sectors were -5/-20bps tighter in the past month after reaching 1.5yr wides early to mid-March. CDS Index spreads were on average -8/-12bps tighter in investment grade and -50bps tighter in high yield, on a roll-adjusted basis. Covid19 in the backseat, with centre stage taken by Russia/Ukraine war and all the important side effects, coupled with a heavy mix of higher rates/inflation prints. Fed and ECB coming meetings critical as FED already in the hiking cycle and ECB potentially starting well within 2022. Sector-wise, in EUR IG, Financials were -10bps tighter, Real Estate -5bps tighter, Energy -20bps tighter, Health Care -13bps tighter, Telecoms -18bps tighter, Industrials -12bps tighter, Consumer Goods -5.5bps tighter, Utilities -3bps tighter, Technology -9bps tighter and Basic Materials -4bps tighter. US IG names spread were -2/-15bps tighter in the same period, underperforming EUR ones. Specifically, Financials were -11bps tighter, Real Estate -5bps tighter, Energy -20bps wider, Health care -9bps tighter, Telecoms -15bps tighter, Technology -15bps tighter, In-dustrials -4bps tighter, Consumer Goods -2bps tighter, Utilities -9bps tighter, while Basic Materials were -15bps tighter.

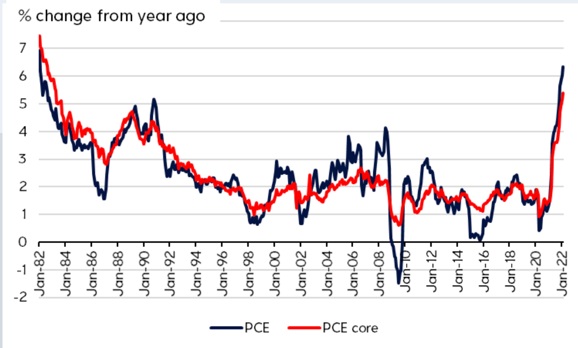
Rating-wise, EUR IG spreads in BBB were -11bps, in A -14bps, in AA -15bps, and in AAA -20bps. In the EUR HY universe CCC spreads were +75bps, B were -35bps, while BB were -37bps. In the USD IG space spreads in BBB were -3.5bps, in A -5bps, in AA -5.5bps, and in AAAs -12bps. The Ukraine situation and inflation fears/CBs reaction are the main risk factors going forward, both able to induce very high volatili-ty in the market. We expect spread volatility to remain elevated in the medium term. Additionally we ex-pect spread dispersion to increase closely related to fundamentals and sector. We expect spreads to trade in a wide range, skewed to wider levels, with EUR ones to potentially underperform USD ones given the relatively increased macro vulnerability of EU. The potential backstop of high cash on the side lines should cap the widening to more reasonable levels medium term, but liquidity is very limited and therefore spread spikes will be more frequent to observe in the short term.

US

Economy less vulnerable to Ukraine crisis than elsewhere, but challenges mount

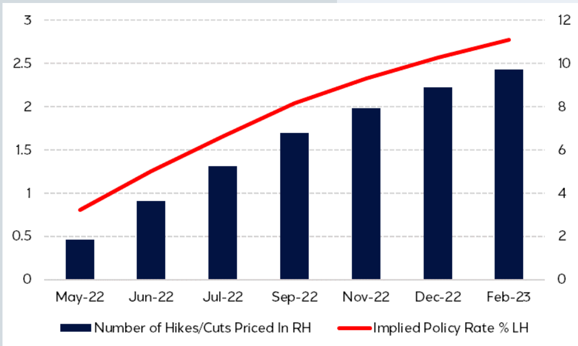
Economic activity in the US remains strong on the back of pent-up demand and robust business spending, in spite of fiscal pullback and geopolitical tensions. Both the services and manufacturing sectors expanded in March for the 22nd month in a row (ISM Services PMI at 58.3 from 56.5 and ISM Manufacturing PMI at 57.1 from 58.6) on the back of higher demand and eased labour shortages, although concerns are being voiced over increasing uncertainty due to the Russia-Ukraine war and rising Covid-19 cases. The labour market remained robust in March, with total private nonfarm payroll employment rising by another 455k (486k in February) and initial jobless claims declining further (4-week moving average at 209k on 26 March from 212k one week earlier). Average hourly earnings (private employees) continued their 12-month upward streak in March, rising marginally to USD31.7/hr (from USD31.6/hr in February). Inflation, however, continues to soar, with PCE inflation climbing to 6.4% in February, a level not seen since Jan-1982 (Figure 13). Against this background, on 16 March the Fed raised the target range for the federal funds rate by 25bps to a range of 0.25 to 0.50 percent, kicking off a tigheting cycle, while since then, several Fed policymakers, including Chair Jerome Powell, have stated that the Committee is determined to move even more rapidly to tame inflation in the period ahead. At the time of writing, markets price in 9 more 25bps hikes in 2022 (Figure 14). Aggressive monetary policy comments spurred a massive bond selloff in the early days of April, driving the 2yr10yr yield curve to invert briefly, fueling worries over a potential recession in the economy further ahead. On the matter, Fed Chair Jerome Powell appeared reassuring in a speech on 21 March, remaining optimistic about a soft landing, despite uncertainty. Meanwhile, the Ukraine crisis is expected to weigh on the US economy, through slower global economic activity, further disruptions to the supply chains and higher oil and commodity prices, but the impact is likely to be less pronounced than elsewhere, as the US is a large oil producer and thus rising oil prices will benefit the oil-producing regions of the country, partly offsetting the negative impact, whereas its industry is less dependent on oil than in the past.

Figure 13: Inflation shoots up to multi-decade highs



Source: US Bureau of Economic Analysis, Eurobank Research

Figure 14: Markets price in more aggressive tightening



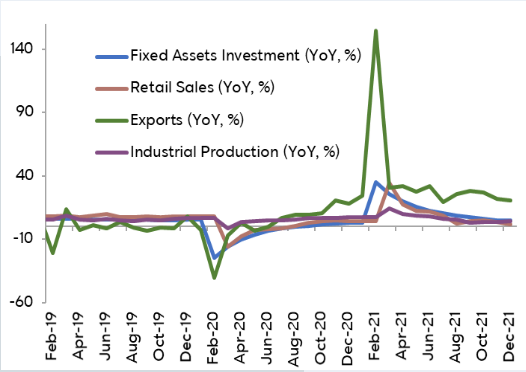
Source: Bloomberg, Eurobank Research

China

GDP growth target at 5.5%, which albeit lowest in three decades, still challenging to achieve

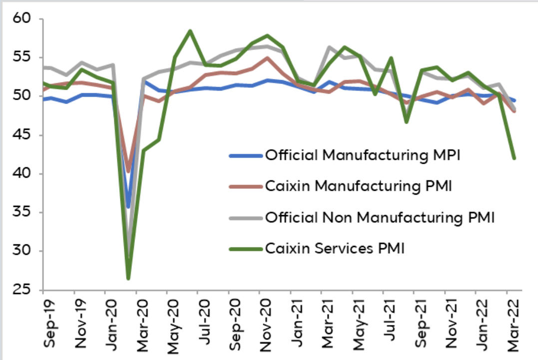
Though overshadowed by the Russian invasion in Ukraine, the Two Sessions i.e. the Chinese People's Political Consultative Conference (CPPCC) and the 14th National People's Congress (NPC), concluded in early March by setting ambitious targets for 2022, and thus attracting substantial market attention. The key takeaway pertains to the 2022 GDP growth target, which was set at c. 5.5%, substantially lower from the 8.1% print achieved in 2021. The market consensus stands currently at 5.0%, while recent economic data , such as new home sales as of February, which failed to remain stable for a second month in a row and slightly eased by 0.12% MoM, imply that the set target will require targeted policy incentives. Additionally, forward looking data such as the official and the Caixin manufacturing PMI readings in March, verify the clouded outlook of the economy as they both fell below the 50-benchmark that separates expansion from contraction. Apart from the Russia –Ukraine war impact, the drag on March's PMIs was also affected by the Covid-19 outbreak, which has again put large cities such as Shenzhen, the national technological hub, and Shanghai, the country's financial center, into lock downs, posing downside risks for Q1's GDP growth rate, due in April 18. Though it is rather early to assess the impact of the war on China, it is considered manageable so far, while spillovers are expected to affect the economy indirectly i.e. through the commercial ties with Europe, which is one of China's biggest trading partners and is expected to be the hardest hit. Strangely enough, China is perhaps the sole large economy to benefit from the war as the isolation of Russia by the West will push downwards Russian oil, natural gas and commodities prices for China and at the same time inflate prices for high technology equipment purchases by Russia from China. Furthermore, despite the price pressure on the EM sphere as a whole, China is facing the weakest headwinds as regards the inflationary outlook; the increase of prices remains subdued, with inflation not exceeding 1% as of March 2022.

Figure 15: As shown from 2021 year-end data loss of steam...



Source: Bloomberg, Eurobank Research

Figure 16:...continues in Q1 with all PMIs below the 50 benchmark



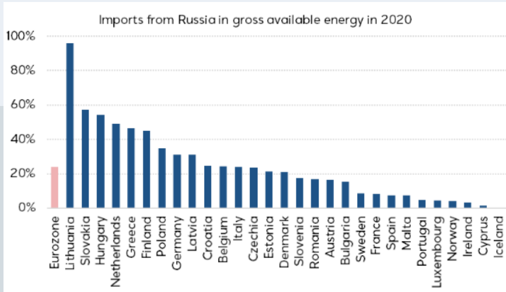
Source: Bloomberg, Eurobank Research

Euro area

The Ukraine crisis has clouded the growth outlook amid new, severe headwinds

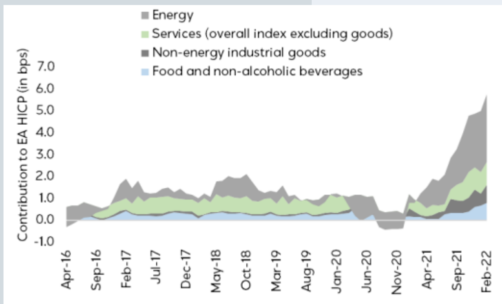
After slowing somewhat in late 2021 and January 2022, following the resurgence of the Covid-19 pandemic, sentiment surveys for February (PMIs, confidence indicators) suggested that the Eurozone was regaining some momentum, supported by a gradual lifting of Covid-19 restrictions amid improved health conditions and somewhat easing, albeit still severe, supply chain distributions. Nevertheless, as of late February, the Ukraine crisis has clouded the Eurozone growth outlook as it creates new and severe headwinds that could affect economic activity through a number of transmission channels. These include trade and financial links, but they are limited and have been reduced since the Crimea crisis in 2014. The Eurozone, however, is heavily reliant on energy imports from Russia (Russia accounts for c. 45%, 25% and 45% of gas, oil and coal imports, respectively), suggesting that the main important source of risk for the economy comes from higher energy prices (Russia is a major producer and exporter of energy products as well as several other key commodities). The supply shock stemming from elevated energy prices should weigh on firms' competitiveness and households' purchasing power. Intensifying the negative impact on growth from the energy channel, immense uncertainty about the persistence of energy price increases, may dampen households' discretionary spending and make companies more cautious about investment decisions, The supply shock pushes already elevated inflation further up, with HICP surging by 1.6pp to a new record high of 7.5%YoY in March, mostly driven by higher energy prices. Elevated inflation, heightened uncertainty and exacerbated supply chain disruptions suggest that growth this year is expected to be significantly weaker than projected before the outburst of the war. However, markedly improved labor market conditions (the unemployment rate dropped by a further 0.3pp to 6.8% in February, below the EU Commission's NAIRU estimate), mitigating measures to soften the impact from rising energy costs and NGEU funds, should help the economy to continue expanding at an above trend growth rate. High inflation prompted the ECB to speed up tapering of APP net purchases at its policy meeting in March, but the Central Bank also decided to change the forward guidance to have more flexibility to adjust policy in either direction in the wake of the Ukraine crisis.

Figure 17: Eurozone is heavily dependent on energy imports from Russia



Source: Eurostat, Eurobank Research

Figure 18: Inflation is surging, mostly driven by higher energy prices



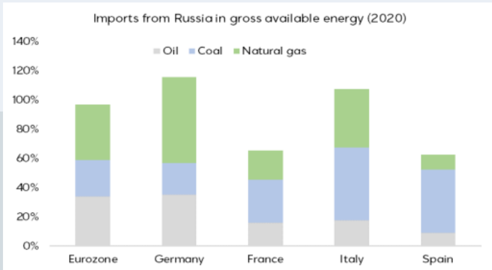
Source: Eurostat, Eurobank Research

Germany

Risks of a technical recession

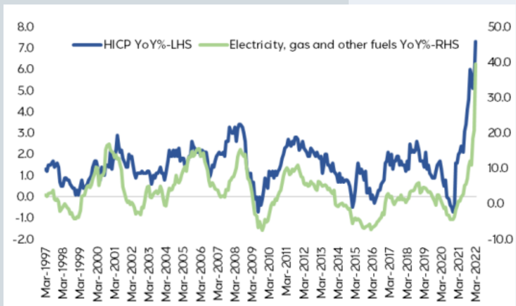
After a -0.3%QoQ contraction in Q4 2021, the prospects for the German economy appeared bright entering into the new year. Business sentiment indicators improved considerably in the first two months (Composite PMI, IFO, ZEW), and German industry was on the road to recovery, with production rising by 0.2%MoM in February, the fifth consecutive monthly improvement, partially supported by a modest easing in global supply disruptions. But just as the impact from the pandemic was starting to fade encouraging the government to announce a three-step process of easing restrictions in mid-February, Russia's invasion of Ukraine altered growth prospects, pushing up energy prices and leading to further disruptions for key commodities and supply chains. Against this environment, investor confidence plunged and business expectations deteriorated sharply across sectors in March, mostly in manufacturing, amid concerns of supply shortages and higher input costs. Though the headline numbers of the PMIs held up reasonably well (Composite PMI at 55.1 from February's 55.6), ZEW expectations recorded their largest monthly drop ever and moved back into negative territory for the first time since March 2020 at the start of the pandemic (-93.9pts to -39.3), in a sign of risks of lower economic output ahead, even a technical recession, given Germany's high dependence on energy supplies from Russia, especially natural gas (Figure 19). Along these lines, the Ifo business climate declined by 7.7pts to a 14-month low of 90.8, mainly driven by a pronounced drop in expectations (-13.3pts to 85.1), the largest fall since April 2020, with the Ifo institute revising lower its 2022 GDP growth forecast to between 2.2% and 3.1% from 3.7% back in December. The latest rise in energy prices pushed already elevated inflation even higher in March, to 7.3%YoY, the highest since 1981, suggesting considerable drag in households' real incomes, though the accumulation of a large stock of household savings during the pandemic (13.5% of disposable income in Q4 2021) should provide a cushion for private consumption. Aiming to ease the burden of surging energy prices to households and companies, the coalition government announced two fiscal packages (worth more than 0.5% of GDP), while Chancellor Olaf Scholz committed to speed up efforts to reduce Germany's energy dependence by, inter alia, constructing two new LNG terminals and building up coal and gas reserves.

Figure 19 : Germany is heavily reliant on natural gas imports from Russia



Source: Eurostat, Eurobank Research

Figure 20: Higher energy prices push up inflation further



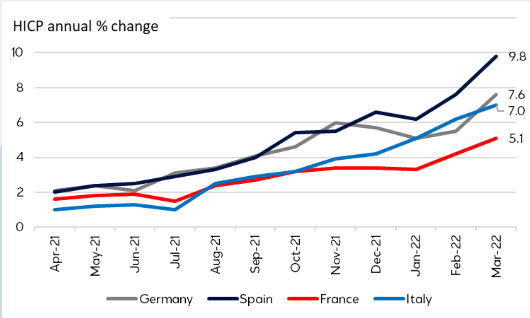
Source: Federal Statistical Office, Eurobank Research

France

Final stretch for the presidential elections amid increased economic uncertainty

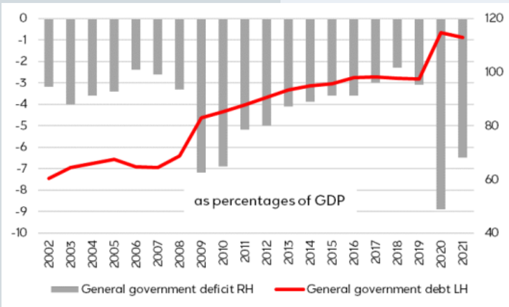
Focus this month turns to the presidential elections that take place in two rounds, on 10 and 24 April. The two candidates most likely to make it to the 2nd round are the incumbent President Emmanuel Macron and Marine Le Pen, with the first one leading in polls. These elections are of great importance to both France and Europe, as they take place in a time of crisis, where EU members are called upon to deal with great challenges individually and collectively, and as the two front-runners differ significantly on many key policy areas. In the current juncture, the French economy, albeit healthy, shows signs of slowing down with the March Manufacturing PMI retreating to 54.7, the lowest reading since November 2021, indicating a deceleration in output growth on the back of intensifying geopolitical tensions and inflationary pressures. HICP inflation climbed to a record-high 5.1%YoY in March, mainly due to soaring energy prices. Nevertheless, inflation in France remains below that of the other major EU economies (Figure 21), which may be explained by the fact that the country is less reliant on imports to meet its energy needs, with the Eurostat energy dependence indicator at 44%, against 64% in Germany, 73% in Italy and 68% in Spain. In order to tackle the rising energy costs, the government has taken measures that so far amount to €30bn and are intended for both households and businesses. Furthermore, energy self-sufficiency is at the heart of the presidential election campaign, with both Macron and Le Pen advocating the expansion of nuclear power generation. Meanwhile, headwinds from the Ukraine-Russia war are mounting, as the end of the conflict is not yet in sight, fueling uncertainty. At the same time, Covid-19 cases are rising again, while retail and recreation mobility still remains below pre-pandemic levels, despite the fact that restrictions have become laxer. Increasing uncertaintly is reflected in the economic sentiment indicator, which dropped to a near one-year low of 105.7 in March, posting a higher decline (-7.1) than in the EU (-5.3) and the Euro area (-5.4). On fiscal policy, the general government deficit for 2021 came in at €160.9bn, accounting for 6.5% of GDP, below previous estimates, after reaching 8.9% in 2020 and 3.1% in 2019 (Figure 22). France's fiscal stance is central to the presidential elections, as its high debt sets it apart from other countries, such as Germany, the Netherlands and Austria, whose debt-to-GDP ratio is close to 60%.

Figure 21: HICP below other major EU economies



Source: Eurostat, Eurobank Research

Figure 22: General government debt and deficit declined in 2021



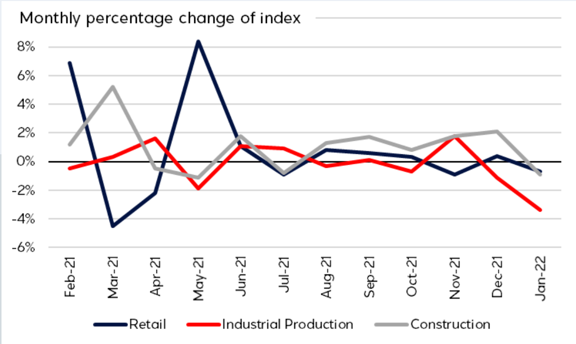
Source: INSEE, Eurobank Research

Italy

The impact of the Ukraine crisis is becoming visible

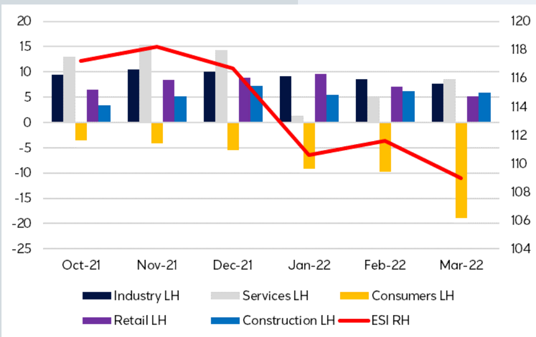
Hard data pertaining to the beginning of the year point to deteriorating economic activity. In January, retail trade s.a. contracted by 0.7%MoM in volume terms, after increasing by 0.4%MoM in December; industrial production s.a. decreased by 3.4%MoM, decelerating further from -1.1%MoM in December 2021; construction output fell by 0.9%MoM in January, after growing for five months in a row (Figure 23). Unemployment inched down marginally in February, coming in at 4.8%, from 4.9% in the previous month, continuing its declining course. The war in Ukraine, which started in late February, began being felt in March with the economic sentiment indicator dropping by 2.6 units, at the lowest level since April 2021 (Figure 24). Conditions in the manufacturing sector continued to improve in March for the 21st month in a row, with the Manufacturing PMI coming in at 55.8 from 58.3 in the previous month. The pace of growth slowed noticeably, as new orders rose at the weakest pace in 15 months. On a similar footing, business activity in the services sector increased further in March but at a milder pace, with the services PMI registering 52.1 from 52.8 in February. Concerns over inflationary pressures and supply difficulties are now exacerbated by the uncertainty stemming from the geopolitical crisis. Inflation continued to rise in March, with the HICP flash reading reaching 7.0%YoY driven primarily by soaring energy prices. According to the Eurostat energy dependence indicator, Italy covers through imports c. 73% of its total energy needs, while around 20%-25% of its total energy needs are covered by oil and natural gas imports from Russia. Therefore, as long as geopolitical tensions continue, energy prices are not expected to ease. In an effort to tackle the problem, the Italian government announced on 29 March additional measures of €4.4bn, on top of a €16bn package adopted in the previous months, envisaging energy cost subsidies to companies and consumers. The measures will be financed by a levy on the extra profits of energy companies that have benefited from the soaring energy prices in the past months, so as not to burden the public deficit. On Covid-19, in spite of rising cases, Italy's state of emergency ended on 31 March, meaning laxer preventive measures ahead of the summer tourism season.

Figure 23: Retail, industry and construction deteriorated in Jan-22



Source: ISTAT, Eurobank Research

Figure 24: Geopolitical woes take a toll on sentiment

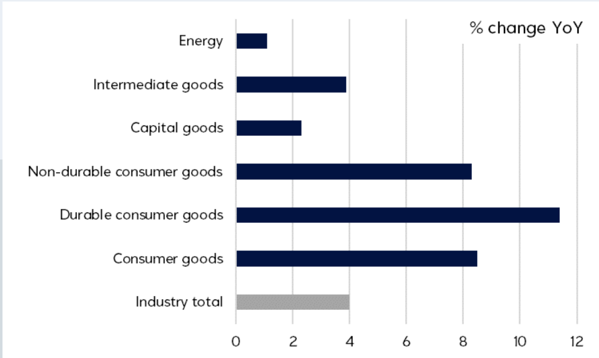


Source: EC, Eurobank Research

Spain

Price pressures intensify dampening sentiment

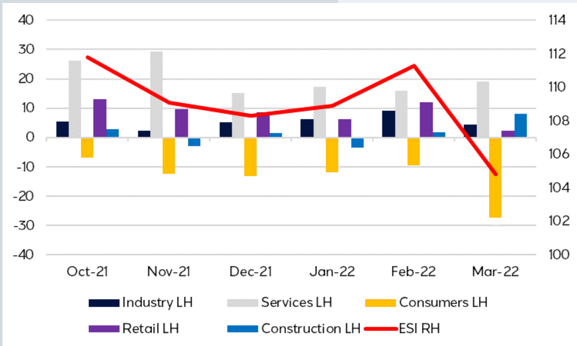
Figure 25: Industrial production picks up on an annual basis in January



Source: INE, Eurobank Research

Hard data for the economic activity in the first two months of the year show a rather sluggish progress, with some indicators showing small improvement and others recording mild deterioration. Industrial production in January accelerated on an annual basis by 4% (Figure 25), but declined on a monthly basis, by -0.1% slightly better compared to the December 2021 reading of -0.5%MoM. Among the individual sectors, only the production of durable consumer goods increased (+1.5%MoM). Retail trade increased in February by 0.7%MoM, after having contracted by 0.3%MoM in January, with all sectors except food recording positive monthly growth rates. Tourism seems to be picking up, with international tourist arrivals in January and February reaching 60% and 71% respectively of the 2020 corresponding levels, just before the outburst of the Covid-19 pandemic. Having said that, soaring inflation and geopolitical tensions may negatively affect the sector's performance in the coming months. Inflation galloped in March, with the flash headline CPI climbing to 9.8%YoY, the highest annual increase since May 1985. The estimated core CPI (excl. food and energy) reached 3.4%YoY, the highest since September 2008. Against this background and with the Ukraine-Russia war raging since late February, the Economic Sentiment Indicator slid by 6.5 points in March (Figure 26), with expectations however increasing in the services and construction sectors. The manufacturing sector continued to grow at a more moderate pace in March with the Manufacturing PMI coming in at 54.2 down from 56.9 in February, but concerns about rising inflation, resulted in a drop in orders for the first time in 14 months. In order to tackle high energy cost, the Spanish government adopted a €16 billion emergency plan, envisaging €10 billion in loans and €6 billion in subsidies. Additionally, the EU granted Spain and Portugal permission – the so called "Iberian exception" – to put a cap on electricity market prices, on the grounds that the Iberian peninsula is largely detached from the rest of the EU power grid. In the longer run, the government intends to reduce the country's dependence on energy, as currently its energy imports make up for 68% of its total energy needs and boost RES production.

Figure 26: Economic Sentiment drops in March



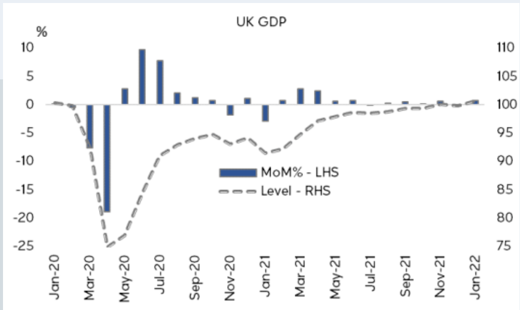
Source: EC, Eurobank Research

UK

After peaking in Q1, growth should slow amid a significant drag in real incomes

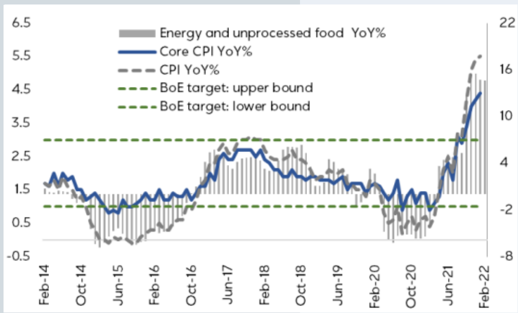
After a 0.3pts upward revision in Q4 2021 GDP growth to 1.3%QoQ, the economy appeared to continue expanding at a fairly robust pace in Q1 2022. In January, UK GDP surprised on the upside rising by 0.8%MoM, the highest monthly pace since June 2021, thanks to a bounce in services from December's Omicron-related weakness (Figure 27). As suggested by a string of positive incoming data, the strength in activity has probably continued in February following the government's decision to allow Plan B Covid-19 measures to expire and people to return to their offices, as well as in March, by which time all remaining social restrictions had come to an end amid an improved epidemiological situation. In support of the above, the labor market continued to recover in the early months of the year, with the timely PAYE payrolls measure of employment increasing by 275k in February, the strongest monthly gain since data collection began in 2014. Moreover, the composite PMI defied expectations for a pronounced decline in March given the various headwinds the economy is facing related to surging inflation and the Ukraine crisis, rising from February's 59.9 to 60.9, supported by the services sector which continued to signal strong growth on a post-pandemic demand bounce. However, for the remainder of the year the economic environment looks more challenging, suggesting that growth will likely lose momentum, amid a significant drag in households' real incomes. In combination with persistently high inflation (CPI at a fresh 30-year peak of 6.2%YoY in February), BoE monetary tightening and the war-induced sharp increase in commodity prices, as of April, the energy regulator Ofgem is set to increase the energy price cap by 54% while a 1.25% National Insurance levy is also scheduled to be imposed. Accumulated savings and fiscal policy stimulus for household income announced since October (0.8% of GDP) should provide some support, but are not expected to prevent a further squeeze in real incomes. Meanwhile, the BoE delivered the third rate hike in a row in March that took the Bank Rate back to its pre-pandemic level of 0.50% and, despite its more cautious tone on the economic outlook, further tightening in May cannot be ruled out amid mounting concerns about second round inflation effects.

Figure 27: GDP growth surprised on the upside in January but headwinds loom



Source: ONS, Eurobank Research

Figure 28: CPI inflation at a fresh 30-yr high in February and is expected to rise further



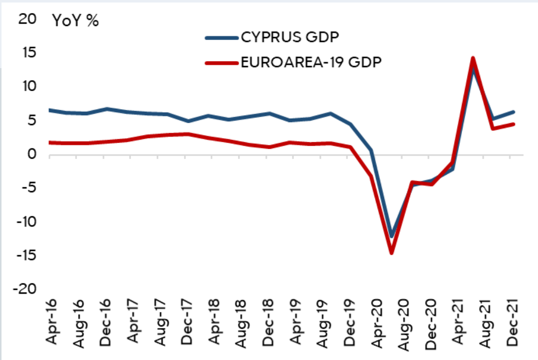
Source: ONS, Eurobank Research

Cyprus

The Russia-Ukraine war will take a toll on the economy through the channel of tourism

After a 5.2% GDP growth contraction in 2020, the economy grew by 5.5% in 2021, following the final Q42021 GDP growth reading of 6.4% YoY in early March from 5.3%, 13% and -2.1% in the previous three quarters. While the economic momentum was expected to remain solid for 2022 assisted by investments through the RRF and demand for tourism, the invasion of Ukraine by Russia has clouded the growth outlook. The negative spillover is expected to be primarily transmitted through the tourism channel given the traditionally high share of Russian tourist flows on the island.

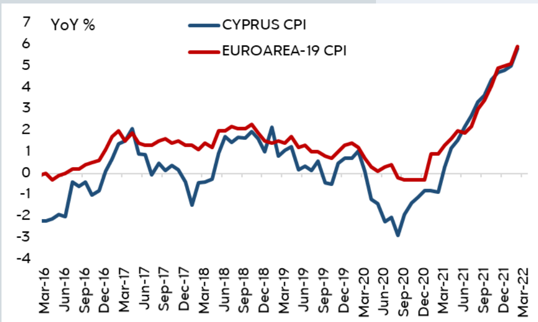
Figure 29: Economic growth in FY21 slightly above the Euroarea trend ….



Source: Eurostat, Eurobank Research

Russia is the origin of almost 20% of tourist arrivals in Cyprus with the respective sector not having returned to its pre-pandemic levels yet. Assuming that sanctions are not lifted before the summer and flight bans continue, it will be difficult for the Russian tourism flows to be substituted by other markets, especially at this period of the year. Along these lines, in late March, in the concluding statement that followed the completion of the Article IV mission, the IMF reduced its GDP growth forecast for 2022 to 2.0% from 3.6% in October 2021. At the same time, in his welcoming speech for the President of the ECB, Christine Lagarde, who paid a scheduled visit to Cyprus, the Governor of the Central Bank of Cyprus, Constantinos Herodotou, also trimmed, albeit to a milder extent, the said forecast to 2.7% from 3.6% before the war. Exports will also be negatively affected by the commercial, mainly financial, services that diachronically the island provides to Russia and which account for almost 20% of the services Cyprus provides outside the EU. Last but not least, energy and commodities prices along with supply chain disruptions continue to inflate the cost of living with February's CPI print coming in at 6.6% from 5.4% in January and 4.8% in December. Taking into account all the above along with the hit on private consumption from the surging inflation, we revise our GDP growth forecast for 2022 downwards to 2.5% from 4.1%, with risks skewed to the downside.

Figure 30: …with hiking inflationary paths staying in tandem



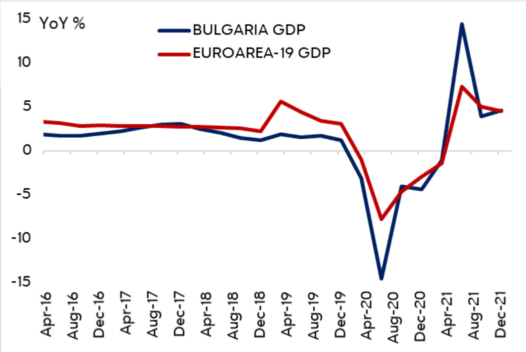
Source: Eurostat, Eurobank Research

Bulgaria

Having approached its pre-pandemic level, the economy is confronted with uncertainty over the growth and inflationary outlook

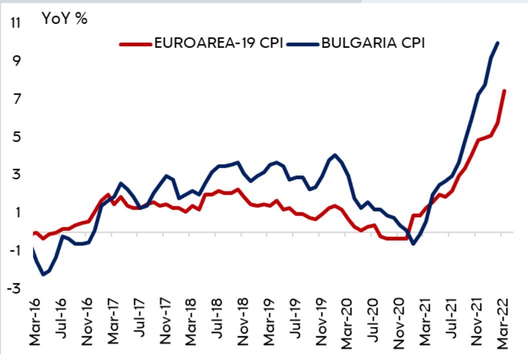
The final Q4-2021 GDP print came in at 4.7%YoY slowing down from 5.0%YoY in Q3 and 7.3%YoY in Q2 and picking up from -1.4%YoY in Q1. The figure surpassed the previous flash estimate of 4.5%YoY, bringing the FY 2021 GDP growth print at 4.2%. Having shrunk by 4.2% in 2020 and expanding by the same pace in 2021, the economy has finally approached its pre-pandemic levels but is currently confronted with the negative impact of the Russia-Ukraine war, which is hard to quantify at the moment. The channels of transmission of the current crisis include energy, commodity prices and supply chain disruptions, which will all weigh on the GDP growth and inflationary outlook in 2022. Additionally, the tourist flows from Russia, which traditionally accounted for a significant portion of the total tourist arrivals will be limited if not zero this year taking a toll on services exports and domestic consumption. An encouraging fact is that the banking system does not seem to be facing direct risks from the Russia-Ukraine war, as there are no Russian banks in the country and the local banks' exposure to Russia is considered limited. The inflationary trajectory continues to worry with February's CPI print climbing to 10.0% YoY, the highest rate since October 2008, from 9.1% YoY in January and 7.8% in December, with the pressure continuing to stem primarily from food and fuel price increases. Looking ahead and taking into account the limited optimism in the EU-Russia discussions over, inter alia, the energy supplies and also the high dependency of Bulgaria on Russia for natural gas and other commodities, a prices decompression should not be anticipated any time soon. That said, the trimming of the disposable income will be larger than initially thought, adversely affecting private consumption, which traditionally contributes the lion's share to the headline GDP growth rate.

Figure 31: Economic growth in FY21 in tandem with the Euroarea ....



Source: Eurostat, Eurobank Research

Figure 32: ...with inflationary pressure proving more persistent



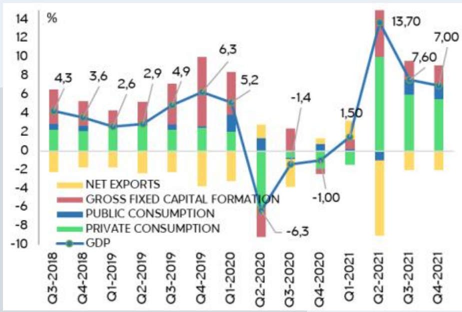
Source: Eurostat, Eurobank Research

Serbia

The energy dependency on Russia clouds the outlook ahead

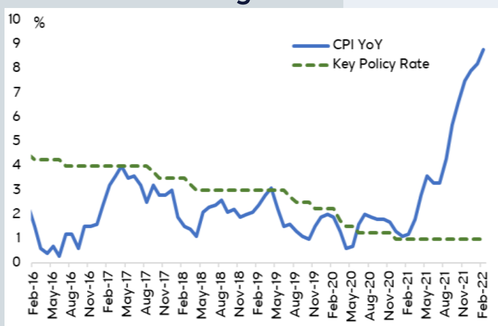
The Russia-Ukraine war casts a thick shadow over the economic outlook of Serbia, which succeeded in expanding its economic outlook by 7.5% in 2021 and prospects over 2022 before the invasion remained prominent. The close ties between Serbia and Russia are translated into high dependency on the energy front as Serbia imports almost 60% of its oil and 100% of its natural gas from Russia. Natural gas flows into Serbia through a bilateral agreement that expires in 2022 and envisages preferential prices, having rendered so far the economy largely immune to negative market dynamics. The transactional terms need to be renewed at a very tricky moment for the global energy markets with Serbia consuming more natural gas in the past few years. The rest trade ties with Russia are of a substantially smaller scale compared to energy. Indicatively, in recent years exports of other goods towards Russia account for around 5% of total exports, with ,approximately, the same percentage applying to imports. In the aforementioned context, many IFIs are about to or have already downgraded their GDP forecasts for 2022. The EBRD in the recently released Regional Economic Prospects, trimmed 2022's GDP growth rate by 1ppt to 3.3% from 4.3% in November, while the IMF, upon the completion of the second review of the PCI in late March, stated that it will soon revise its forecast downwards from 4.5% in its latest forecast in October 2021. On the same footing and amid the prevailing uncertainty, we revise our forecast to 3.5% from 4.5% in February, expecting that the inflationary pressure will continue to be fueled through higher energy and commodities costs and supply chain disruptions in the foreseeable pressure, taking, thus, a toll on private consumption and the headline GDP growth. Additional major developments came recently from the political front, as on April 4 presidential, parliamentary and local elections took place with the key outcome being the prevalence of Aleksandar Vucic as president and his party, SNS - Serbian Progressive Party.

Figure 33: Private consumption contributed the most in FY2021 headline GDP growth print



Source: Serbian Statistics Office, Eurobank Research

Figure 34: Key Policy Rate hike loading amid soaring inflation



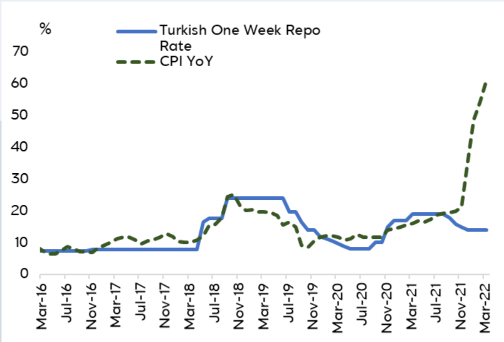
Source: Eurostat, Eurobank Research

Turkey

Global and domestic challenges weigh on the GDP growth outlook

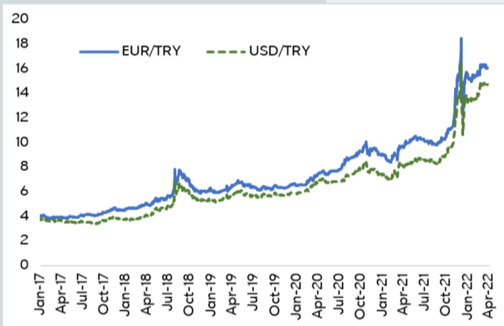
After being one of the few economies in the globe that posted positive GDP growth rate in 2020 (+1.6%), the economy grew by 11% in 2021, following the final Q42021 GDP growth reading of 9.1% YoY from 7.5%, 21.9% and -7.2% in the previous three quarters. The economic output is expected to continue expanding in 2022 albeit at a slower pace, following the Russia-Ukraine war. The impact will be primarily felt through Turkey's dependency on Russia and Ukraine as the former buys from the latter two almost 80% of its total imports on grain commodities. Trade ties between Turkey and the other two countries in the pivotal segment of nutritional imports will be adversely affected and it will be hard to swiftly substitute such a big portion of imports with alternatives. Additionally, for as long as the rampage between the two countries does not ease, prices on grain commodities will be hard to decompress, which will exert more pressure on the already twisted inflationary landscape. That said, inflation climbed to 61.1% YoY in March from 54.4% YoY and 48.7% YoY in February and January respectively. On a monthly basis, inflation increased by 5.5% YoY with energy and food price increases contributing the most. Another channel through which the crisis may be transmitted is the services trade, particularly tourism. Russia and Ukraine were the origin markets of almost 19% and 8% respectively of tourists that visited Turkey in 2021. Although Turkey does not participate in the sanctions, a brave drop in arrivals from Russia should be anticipated, while those from Ukraine should be written out altogether. In the above context and given the adherence of the monetary policy to unorthodox principles, S&P Global recently downgraded Turkey's long term sovereign credit in local currency rating to B+ from BB-, equalizing it to that of the foreign currency rating. It also cut its GDP growth forecast for 2022 to 2.4% from 3.7%, on the same footing with the EBRD that slashed its forecast to 2.0% from 3.5% in November 2021.

Figure 35: As monetary policy remains unorthodox...



Source: Bloomberg, Eurobank Research

Figure 36: ...the pressure on the lira continues



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	2023f	2021	2022	2023f	2021	2022f	2023f	2021	2022f	2023f	2021	2022f	2023f
World	5.9	3.8	3.5	4.3	5.3	3.3									
Advanced Economies															
USA	5.7	3.4	2.3	4.7	6.2	2.7	5.4	3.6	3.5	-3.6	-3.6	-3.4	-10.8	-5.3	-4.4
Eurozone	5.3	3.1	2.4	2.6	6.0	2.2	7.7	7.1	7.0	2.4	2.4	2.5	-6.9	-4.2	-2.7
Germany	2.9	2.5	2.8	3.2	5.8	2.3	3.5	3.4	3.2	6.7	6.4	6.0	-4.6	-2.8	-1.0
France	7.0	3.3	2.2	2.1	4.2	2.0	7.9	7.4	7.1	-0.9	-1.4	-1.1	-8.1	-5.2	-4.2
Periphery															
Cyprus	5.5	2.5	3.3	2.5	2.0	1.5	7.5	6.7	6.4	-10.0	-8.0	-8.0	-3.5	-2.0	-2.0
Italy	6.6	3.2	2.1	2.0	6.1	1.9	9.5	8.9	8.6	3.4	2.8	2.9	-9.0	-5.5	-3,9
Portugal	5.4	5.3	2.5	0.9	1.8	1.3	6.0	6.3	5.9	-0.7	-0.4	-0.4	-4.4	-3.2	-2.3
Spain	5.1	5.1	3.5	3.0	5.8	2.0	14.8	13.9	13.1	0.9	1.3	1.4	-8.3	-5.5	-4.3
UK	7.5	3.8	1.8	2.6	6.6	3.2	4.6	4.0	4.0	-3.4	-3.5	-3.5	-7.6	-4.1	-2.7
Japan	1.8	2.3	1.7	-0.3	1.3	0.8	2.8	2.7	2.5	2.8	2.1	2.5	-6.4	-6.5	-4.5
Emerging Economies															
BRICs															
Brazil	4.8	0.5	1.6	8.2	8.4	4.4	13.6	12.5	11.7	-1.6	-1.3	-1.3	-5.1	-6.8	-6.5
China	8.1	5.2	5.1	0.9	2.3	2.2	4.9	3.7	3.7	1.5	1.2	1.3	-3.8	-4.5	-4.5
India	9.	7.8	7.0	5.4	5.0	4.6		*NA*		-1.5	-1.8	-1.5	-6.8	-6.0	-5.0
Russia	4.7	-8.6	-1.5	6.7	20.0	10.1	4.8	7.0	6.5	6.5	7.0	6.2	0.3	0.5	0.3
CESEE															
Bulgaria	4.2	2.6	2.8	3.3	5.7	2.6	5.5	5.9	4.7	-0.5	-2.9	-1.5	-3.9	-5.5	-3.5
Serbia	7.5	3.5	4.1	4.0	6.0	3.8	11.0	10.3	9.5	-4.4	-5.0	-5.0	-4.2	-3.0	-2.0
Turkey	11.0	3.3	3.3	19.6	55.0	22.0	12.0	12.5	12.5	-2.0	-5.5	-3.0	-3.4	-4.5	-3.5

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

Eurobank Fixed Income Forecasts

	Current	June	September	December	March
USA					
Fed Funds Rate	0.25-0.50%	0.92-1.15%	1.28-1.55%	1.52-1.80%	1.67-1.90%
3m SOFR	0.70%	0.72%	1.11%	1.34%	1.59%
2yr Notes	2.44%	1.72%	1.86%	1.96%	2.09%
10 yr Bonds	2.42%	2.16%	2.22%	2.30%	2.40%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.10%	0.25%
3m Euribor	-0.45%	-0.51%	-0.39%	-0.18%	0.01%
2yr Bunds	-0.06%	-0.38%	-0.36%	-0.30%	-0.25%
10yr Bunds	0.54%	0.29%	0.36%	0.45%	0.52%
UK					
Repo Rate	0.75%	0.95%	1.15%	1.20%	1.35%
3m Sonia	0.93%	0.98%	1.12%	1.26%	1.38%
10-yr Gilt	1.58%	1.45%	1.54%	1.60%	1.69%
Switzerland					
3m Saron	-0.75%	-0.74%	-0.74%	-0.70%	-0.63%
10-yr Bond	0.53%	0.22%	0.30%	0.39%	0.48%

Source: Bloomberg (market implied forecasts)

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