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GLOBAL & REGIONAL MONTHLY

As revealed in the August PMI surveys from several major economies, global economic activity contracted for the first time in more than two years, primarily as a result of a downturn in developed economies. However, though acknowledging recession risks, several major central banks retain a hawkish stance making clear that, as inflation remains significantly above target, they are unlikely to pivot away from their steady pace of tightening any time soon, aiming to keep inflation expectations well anchored and restore price stability.

Macro Picture

USA: Incoming data point to a rebound in Q3 growth amidst signs of slowing inflation

EA: Winter recession risks on gas supply uncertainty, while inflation keeps rising

UK: New support measures will likely help the economy to avoid a protracted recession

CESEE: Solid economic momentum up to H1-2022 with downside risks ahead, amid unabated inflation

Markets

FX: USD and CHF continue to act as safe havens as Russia/Ukraine war rattles markets

Rates: EU and US rates remain high due to inflation considerations

EM: Assets summer rally halted after the hawkish message from the Fed Chair Powell at the Jackson Hole symposium

Credit: Spreads wider in August, expected to trade in a broader range on the back of inflation, higher rates, and recession worries

Policy Outlook

USA: The Fed remains committed to restore price stability, despite potential economic pain

EA: Persistently high inflation points to further aggressive ECB rate tightening near term

UK: Though a recession is looming, further BoE tightening is widely expected as inflation surges

CESEE: With inflationary pressure untamed, regional CBs continue onto monetary tightening

Key Downside Risks

DM: Supply constraints complicate the switch away from Russian energy, high inflation for longer than anticipated, tighter global financial conditions, renewed COVID-19 outbreaks, and lockdowns

EM: Negative spillover from DM's deceleration, unfavorable trade environment in case US dollar keeps strengthening; further tightening of global financial conditions

Contributing Authors:

Maria Kasola
Research Economist
mkasola@eurobank.gr

Paraskevi Petropoulou
Senior Economist
ppetropoulou@eurbank.gr

Michail Vassileiadis
Research Economist
mvassileiadis@eurobank.gr

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Special thanks to the Global Markets team (Global_Markets_Trading@eurobank.gr), Eurobank Bulgaria and Eurobank Serbia

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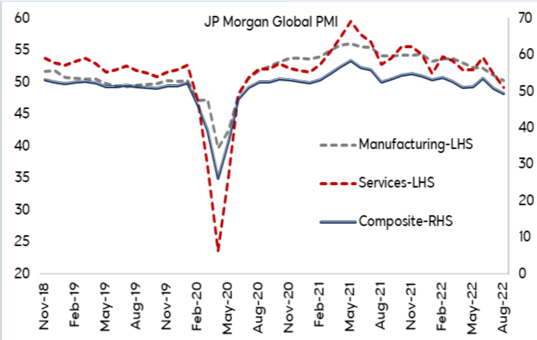
Latest world economic & market developments
Continued loss of global growth momentum

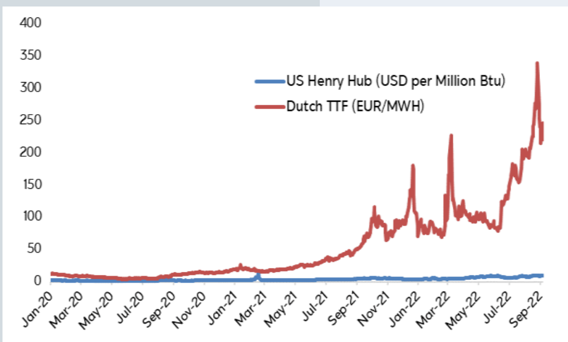
As was revealed in the August PMI surveys from several major economies, global recovery continues to lose momentum and downside risks are building. The J.P. Morgan Global Composite Index delivered its fifth consecutive monthly decline as both manufacturing and service activity slowed down, falling from 50.8 in July to 49.3, pointing to economic activity contraction for the first time since June 2020 (Figure 1). The downturn was primarily driven by a further decline in output and new orders, especially in developed markets, suggesting that persistently high inflation is weighing considerably on global demand. The global services PMI dropped to 49.2 from July's 51.5, below the benchmark of 50 for the first time since June 2020 and below its manufacturing equivalent which stood at 50.3, for the first time since January. Encouragingly, the global employment PMI, though lower for the second month in a row following June's record highs, continued to point to solid gains in hiring, while input and output prices, albeit still at elevated levels, dropped further on lower commodity and freight costs. That said, global CPI-related data for July pointed to tentative signs of slowing inflation across a range of economies, including the US, easing the drag on consumer purchasing power and lifting sentiment which still remained at historically very low levels. The deceleration in headline CPI was mainly driven by a large decline in oil prices amid mounting growth concerns and, to a lesser extent, a moderation in food inflation. Core inflation, still high by historical standards, eased marginally on a modest drop in goods price pressures amid a demand-driven slowdown in supply chain disruptions. Notable exception to the softening inflation trend was the Eurozone, among other major economies, as the recent surge in European natural gas prices prevented any near-term inflation moderation, pushing headline inflation further up, instead (Figure 2).

Figure 1: Global business activity contracted in August for the first time since June 2020



Source: Bloomberg, Eurobank Research

Figure 2: European gas prices sharply higher



Source: Bloomberg, Eurobank Research

However, amidst signs of global inflation having passed its peak, labor markets remain tight across most economies — in spite of early indications that they are probably starting to soften in the US and the UK— and wage growth remains strong, suggesting that several major central banks, despite acknowledging the risk of recession, are unlikely to pivot away from their steady pace of tightening any time soon amid concerns over a de-anchoring of long-term inflation expectations and a wage price spiral as inflation remains significantly higher than target. That said, with the BoJ the only one sticking to a dovish stance, major central banks' hawkish communication at the Jackson Hole Symposium in late August made clear that, despite downside growth risks, they need to follow through with additional tightening, as they remain resolute in restoring price stability.

Developed Economies

US: According to the second estimate, Q2 GDP was revised higher by 0.3ppts to an annualised rate of -0.6%, after contracting by -1.8% in Q1, but real GDI —consistent with continuing labor market tightness— rose by 1.4% in Q1 after increasing by 1.8% in Q1, suggesting that economic conditions do not probably meet the NBER's formal definition of a recession which takes into account a sustained decline in a wider range of economic factors. Looking ahead, incoming, data point to a rebound in Q3 while, on the inflation front, after months of upside surprises, the July CPI data were weaker than expected, with the headline reading decelerating to 8.5%YoY from a four-decade high of 9.1%YoY in June largely due to a drop in energy costs. In spite of July's slowing in inflation, Fed Chair Jerome Powell retained the hawkish tone of recent FOMC communications at the Jackson Hole conference, making clear that, despite potential pain to households and businesses, the Fed needs to follow through with additional rate tightening to push inflation back to target and that restoring price stability will likely require keeping a restrictive policy stance for some time, downplaying market expectations for a Fed shift to an easing policy stance next year.

Euro area: According to the flash estimate, Euro area HICP accelerated to a fresh record high of 9.1%YoY in August from 8.9%YoY in July, primarily driven by core inflation which surged to a higher than expected 4.3%YoY from 4.0%YoY, mainly owning to a rise in core goods inflation amid persistent input cost driven inflation momentum and, to a lesser extent, by food inflation. Meanwhile, as reflected by incoming high frequency indicators pertaining to Q3, Eurozone growth momentum is fading after real GDP grew by 0.8%QoQ in Q2, broadly unchanged relative to 0.7%QoQ in Q1, supported by the lifting of Covid-related restrictions after the Omicron wave. However, amid growing gas supply uncertainty following Gazprom's recent announcement that supplies through Nord Stream 1 will be halted indefinitely, the risk of recession in winter seems high. Though European countries make efforts to minimize the risk of shortages with the adoption of a gas savings plan over August-March and filling up of gas reserves to a minimum of 80% by November, getting through the winter without targeted quantitative restrictions/rationing if gas flows from Russia do not resume, seems high unlikely. But with the majority of the GC members firmly focused on persistently high inflation amid concerns over a de-anchoring of inflation expectations, hawkish ECB commentary at the Jackson Hole symposium supports expectations for further aggressive rate tightening in the near term to prevent a further worsening of the inflation outlook.

Emerging Economies

CESEE: With all Q2-2022 GDP prints having been released till the first week of September, it is evident that regional economies have so far weathered carefully the adversities from the inflationary pressures which had been at play since Q1-2022 and have intensified during Q2-2022, following the burst out of the war in Ukraine. Marching into Q3-2022, hard data, such as retail sales and industrial production, point to some loss of steam with July's and August's ESI data showing tepid fluctuations. Price pressures remain unabated in the region with all economies continuing to post double digit inflation prints up to July. Considering the above, along with the gloomy perspectives as regards the EU's energy sufficiency in winter (Q4 2022 and Q1 2023), given the latest declarations by Russia over the gas flows through Nord stream 1, risks are tilted to the downside as regards the growth prospects in the region. At the same time, central banks that have already entered monetary tightening cycles in order to tame the spiraling inflation and ease the downward pressure on the local currencies, follow through with continuing interest rate increases, in tandem with several major central banks (i.e. the ECB, the Fed, the BoE). The response among central banks is uniform but the magnitude and speed of the responses vary per each economy with some gearing up, such as Serbia that adopted a hawkish stance at a later stage compared to its peers, and others ready to end the hiking cycle, such as Czechia, Poland and Romania, once the assessment of economic data allows for it.

CESEE Markets Developments & Outlook

Bulgaria

Yield spreads opened up significantly in the global markets, following the continuing higher than expected inflation figures as well as the lingering turmoil between Russia and Ukraine. Eurobond yields continued their upward trend across all maturities, with similar movement across the entire curve. 2027-2028 tenors posted a fall of -2 and a rise of 9 bps, respectively. The longer maturity bonds, namely the 30-y and 35-y marked 11-20 bps increases, while the 50-y tenor fell by 7 bps. On the short-term spectrum, the 2024 Eurobonds rose by 67 bps. Local papers registered mixed movements with the most active considered the 3-y tenor, which fell by 41 bps, while the 10-y tenor and the 20-y fell by 30 and 15bps respectively. The Ministry of Finance did not hold any auctions in August. The new caretaker government, appointed by President Rumen Radev in early August has not provided any information regarding the intentions of a new Eurobond issuance.

Serbia

The earlier shock on the dinar caused by the Russian invasion in Ukraine has gradually ceased to rattle markets, turning the Central Bank (NBS) from primarilly a seller to a buyer of hard currencies. According to the latest data from Central bank, during the first six months of 2022 remittances amounted to RSD2.1bln, 31.8% higher compared to the same period last year. Moreover, Serbia's reluctancy to impose sanctions on Russia attracts additional flows of foreign currencies as the banking system acts also as a proxy that safeguards funds and savings, vital for the going concern of Russian corporates. On the steamy monetary front, the NBS has kept lifting its policy rate, albeit, at a slower level compared to other peers. The rationale beneath the slower reflects in the battle with surging inflation lies on the perseverance of the growth dynamics of the economy, which remains a key national priority.

Markets View

Foreign Exchange

EUR/USD: Strong bullish DXY sentiment combined with the market's worries over the energy crisis in Europe have led the pair to fall below parity and even below 0.99 territory. Mitigating inflation in both the US and EU will determine the central banks' policy perspective and as such we might be viewing the pair building up a low support level around parity. While slightly bullish on the euro to cross up the 1.00 even towards the 1.03 level, we will remain cautious on the energy related talks medium-term, watching over some trading range/mean reverting opportunities around the current levels' range, even leaving some space for slightly lower to e.g. 0.97 - adding on our longs.

EUR/GBP: With the pair following the market's general energy related concerns as well as the seem-to-be non-transitory effects of the inflation in both the EU and the UK, it touched the 0.83 level in August on a bearish medium-term downwards trend. The market seems to be expecting, though, that the newly elected Prime Minister Liz Truss's promised policy package would help the economy mitigate some portion of the turmoil, driving the pair on the territory of 0.87. We believe that this level and slightly higher, i.e. 0.88-0.8850 would be a good standing point for the pair at least short-to-medium term, where we will encounter the trading range of 1% moves around this new equilibrium.

Rates

EU: Interest rates increased sharply in August, with the 10y swap rate trading at 250bps up from 160bps in the beginning of August. The slope of the curve has decreased with maturities between 5 and 30 years trading at -15bps down from 20bps at the beginning of the month but also a low of -20 bps in mid-August has been marked. Looking forward we expect EU rates to remain volatile at high levels as the European Central Bank is prepared to deliver another 50bps increase in interest rates at the September policy meeting, with an even bigger move not to be excluded as inflation hit another record high.

US: Interest rates closed August significantly higher at all tenors. The 10yr swap rate is trading at 330bps, up from 270bps at the beginning of August. The shift of the curve decreased sharply with maturities between 5 and 30 years trading close to -35bps, down from 1bp at the beginning of the month. Looking forward, we expect rates to remain at high levels as the Fed is seen sticking to sharp interest rate hikes in coming months to cool inflation. A potential risk could be a rise in US employment or a slowdown in wage growth.

Emerging Markets Sovereign credit

Mid July's powerful rally of EM assets continued in August with investors expecting a less aggressive Fed. However, Chair Powell appeared very hawkish at the Jackson Hole symposium as he pledged to deliver a forceful policy response, something that erased part of these gains. Trading activity remained sub-dued. The EMBI Global Index closed at 421 bps at the end of August, 25 bps tighter on the month. In CEEMEA, Romanian and South African sovereign bonds had a solid performance, while Serbia lagged this move. In Latam, spreads ended also tighter, with the Chileans rejecting the draft new constitution in a referendum by a wide margin (62% vs 38%), something that should take some pressure off the central bank. In Asia, spreads remained tighter than in the other EM regions. We remain cautious as a strong dollar environment, an increase in US nominal rates, and pressure on equity prices do not bode well with EM spreads that will likely remain under pressure.

Corporate credit

Europe's IG credit spreads were significantly wider during the period 1/8/22- to 6/9/22, despite August starting on a risk-on tone. As the month progressed, growth and inflation worries as well as concerns around Central Banks' policies weighted on the markets. EU IG credit spreads ended the month around +30/40bps wider, while CDS indices ended +19bps wider in IG and +63bps wider in HY.

Sector-wise, in EUR IG, Financials were around +45bps wider, Real Estate +80bps wider, Energy +35bps wider, Health Care +40bps wider, Telecoms +35bps wider, Industrials +38bps wider, Consumer Goods +45bps wider, Utilities +28bps wider, Technology +34bps wider and Basic Materials +40bps wider. US IG credit spreads were around +15bps wider in the same period outperforming EUR credit. Specifically, Financials were +8bps wider, Real Estate was unchanged, Energy +13bps wider, Healthcare +17bps wider, Telecoms +13bps wider, Technology +13bps wider, Industrials +12bps wider, Consumer Goods +15bps wider, Utilities +10bps wider, while Basic Materials were +5bps wider.

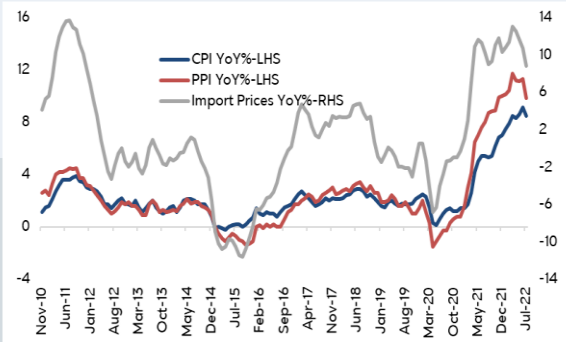
Rating grade wise, EUR IG BBB were +45bps wider, A were +40bps wider, AA were +35bps wider, and AAA were +33bps wider. US IG BBB were +10bps wider, A were +11bps wider, AA were +11bps wider, and AAA were +8bps wider. Moving into the end of Q3 and ahead of winter, market themes remain inflation persistence and the impact on growth from higher rates, as well as the probability of a recession and its magnitude. We expect spreads to remain volatile on the wider end of the recent distribution by year-end, with potential spikes on negative macro data coupled with market illiquidity.

US

In spite of potential economic pain, the Fed is committed to restore price stability

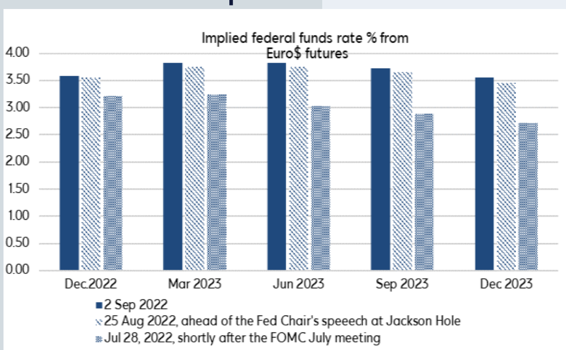
According to the second estimate, Q2 GDP was revised higher by 0.3ppts to an annualised rate of -0.6%, after contracting by -1.8% in Q1, solely driven by real consumer spending (revised up to 1.5% from 1.0%). While real GDP contracted for two consecutive quarters —meeting the formal definition of a technical recession— real GDI (a theoretically equivalent measure of GDP formed using the income side of the accounts), consistent with continuing labor market tightness, rose by an annualised rate of 1.4% in Q1 after increasing by 1.8% in Q1, suggesting that the economy continued growing slowly. That said, economic conditions do not probably meet the NBER's formal definition of a recession which takes into account a sustained decline in a wider range of economic factors. Looking ahead, data pertaining to Q3 point to a modest rebound. Among others, July's IP increased by 0.6%MoM following lackluster growth in the prior two months, August's capital goods shipments advanced further (+0.7%MoM), July's personal income rose by just 0.2%MoM but core retail sales increased by a higher-than-expected 0.8%MoM solely driven by the non-store retailer category, Conference Board consumer confidence increased in August after three months of consecutive declines, while housing-related indicators remained in a downward trend pressured by higher mortgage rates. Meanwhile, after months of upside surprises, the July CPI data were weaker than expected, with the headline reading decelerating to 8.5%YoY from a four-decade high of 9.1%YoY in June (Figure 3), largely due to a drop in energy costs, while core CPI rose by 0.3%MoM, the slowest pace since March, with the annual rate holding steady at 5.9%YoY. Adding to signs of slowing price pressures, July's headline PPI unexpectedly dropped by 0.5%MoM (9.8%YoY%), the first decline in more than two years, and core decelerated to a five-month low of 0.2%MoM (5.8%YoY). In spite of July's slowdown in inflation, Fed Chair Jerome Powell retained the hawkish tone of recent FOMC communications at the Jackson Hole conference, making clear that, despite potential pain to households and businesses, the Fed needs to follow through with additional tightening to push inflation back to target while restoring price stability on a sustained basis will likely require keeping a restrictive policy stance for some time, downplaying market expectations for a policy shift to an easing policy stance next year.

Figure 3: Inflation has likely passed its peak



Source: BLA, Eurobank Research

Figure 4: Increased Fed rate tightening expectations



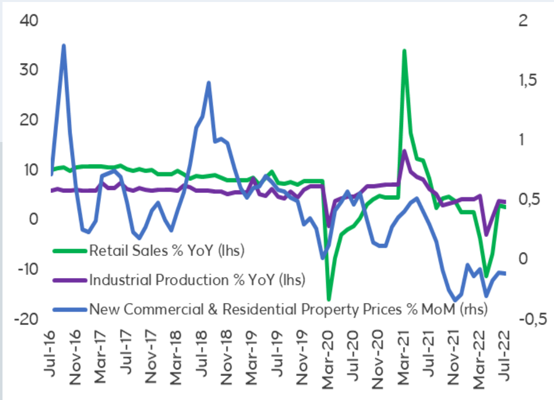
Source: Bloomberg, Eurobank Research

China

Economy appears unable to gain a recovery momentum

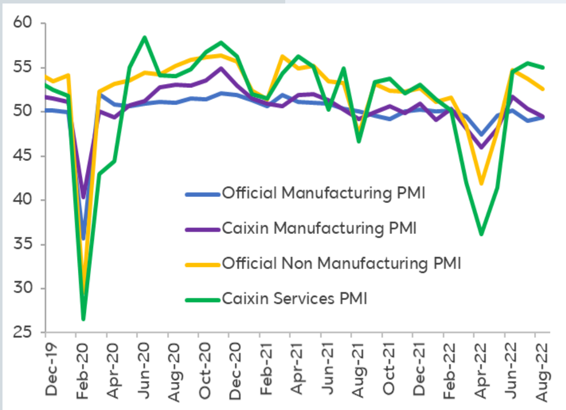
Among the most important data releases since our last issue in July we pick out the Q2-2022 GDP growth print which came in marginally positive, +0.4% YoY, indicating that the economy stood almost still after expanding by 4.8% in the previous quarter. The key drivers of the slowdown, which is more evident by looking at the quarterly print which marks a -2.6% contraction from a +1.3% expansion in Q1-2022, are the extensive lockdowns during the said period given the local virus burst outs and the continuing Covid-19 zero tolerance policy that put the economy on an on-off mode for a prolonged period in many regions. The Q2-2022 print came below market expectations which were already low at 1.2%YoY, pushing further downwards the FY-2022 forecast at 3.5% (H1-2022 growth rate at 2.5% YoY). Marching into Q3-2022, hard data do not allow for much optimism either from the supply or the demand side with the economy appearing unable yet to regain a recovery momentum. Industrial production expanded by 3.8% YoY in July, a tad lower from June and below the market consensus at 4.3% YoY, while retail sales growth also eased in July to 2.7% YoY from 3.1% YoY, beating to the downside market expectations over a 4.9% YoY increase. The said data bode well with August's manufacturing PMIs, with both official and Caixin, stuck to contracting territory and with the respective composite indices, which mirror a more-broad based perception over the economy, deteriorating compared to the previous month, albeit keep sending expanding signals. Along these lines, the extensive economic policy deployed in the last couple of months comes as no surprise but at the same time points the limitations of some interventions adopted. Specifically, the counter-clockwise -compared to the rest of the world- 1-y and 5-y loan prime interest rates cuts in August, were decided on the grounds of improving the liquidity conditions but have also increased the pressure on the already weakened yuan, against a broadly stronger USD (USDCNY at 6.95 in late August from 6.34 in late March). The downward pressure triggered additional measures in early September, such as FX RRR cuts, in order to keep the yuan from depreciating further as it has lost almost 6% of its value against the dollar since the start of 2022.

Figure 5: Hard data suggest that the economy has hit the bottom…



Source: Bloomberg, Eurobank Research

Figure 6:…and the same is implied in terms of economic sentiment



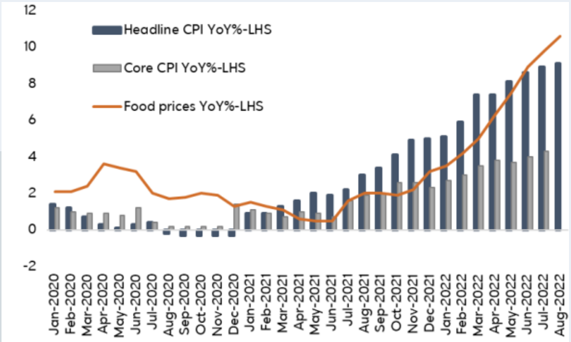
Source: Bloomberg, Eurobank Research

Euro area

Winter recession risks amidst soaring inflationary pressures

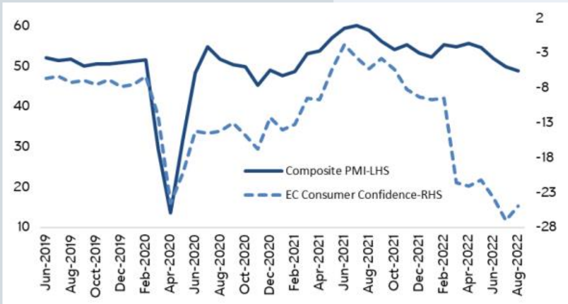
According to the flash estimate, Euro area HICP accelerated to a fresh record high of 9.1%YoY in August from 8.9%YoY in July. The upside surprise was primarily driven by core inflation which surged to a higher than expected 4.3%YoY from 4.0%YoY, mainly owning to a rise in core goods inflation (to 5.0% from 4.5%), amid persistent input cost driven inflation momentum and to a lesser extent to food inflation (to 10.6% from 9.8%) (Figure 7). More worryingly, inflation has probably not yet peaked and a further increase in the coming months, cannot be ruled out. Food inflation is expected to continue rising on the back of high food producer prices and recent wholesale gas and electricity price rises will pass through to consumer prices. In addition, the fuel tax cut expired in Germany on September 1 along with the special discounted public transport ticket, and in Italy the fuel discount is set to come to an end on 20 September. Turning to economic activity, as reflected by incoming high frequency indicators pertaining to Q3, growth momentum is fading after real GDP grew by 0.8%QoQ in Q2, broadly unchanged relative to 0.7%QoQ in Q1, supported by the lifting of Covid-related restrictions after the Omicron wave. In more detail, weighed down by elevated inflation which dents consumers' real disposable income, EC consumer confidence stood at -24.9 in August, the second lowest ever following July's -27 historical trough, while the composite PMI fell further into contraction territory in August (48.9) as services sector activity joined manufacturing and moved below the 50 level for the first time since March 2021 (Figure 8). However, amid growing gas supply uncertainty following Gazprom's recent announcement that supplies through Nord Stream 1 will be halted indefinitely, the risk of recession in winter seems high. Though European countries make efforts to minimize the risk of shortages with the adoption of a gas savings plan over August-March and filling up of gas reserves to a minimum of 80% by November, getting through the winter without targeted quantitative restrictions/rationing if gas flows from Russia do not resume, seems high unlikely. But with the majority of the GC members firmly focused on persistently high inflation amid concerns over a de-anchoring of inflation expectations and a wage price spiral, hawkish ECB comments at the Jackson Hole symposium support expectations of further aggressive rate tightening in the near term to prevent a further worsening of the inflation outlook.

Figure 7: High inflation in August was driven by core and food prices



Source: Eurostat, Eurobank Research

Figure 8: Forward looking indicators point to softening Eurozone growth ahead



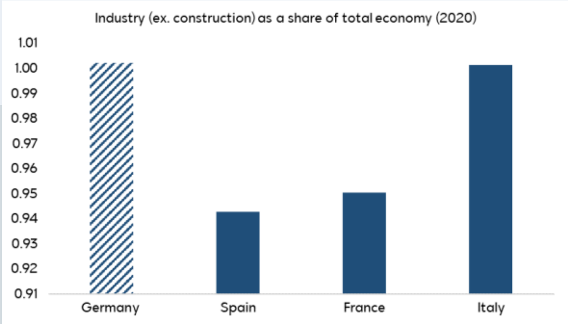
Source: European Commission, Bloomberg, Eurobank Research

Germany

The energy crisis is expected to hit hard the economy

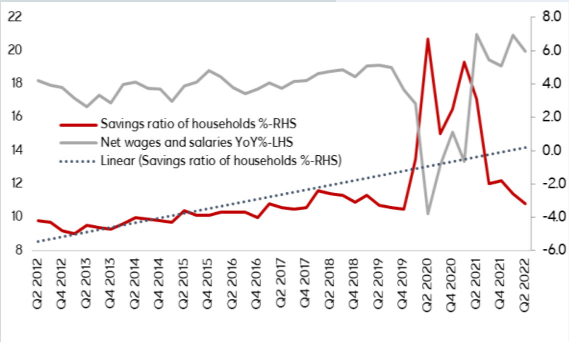
Germany's Q2 GDP was revised to 0.1%QoQ (1.7%YoY), slightly above the flash estimate of 0.0%QoQ, but still a marked slowdown from 0.8%QoQ (3.5%YoY) in the prior quarter, largely underperforming the rest of the EA (0.8%QoQ, 4.1%YoY). Private and government consumption were the growth drivers (+0.4ppts and +0.5ppts, respectively), while investement had a negative contribution (-0.3ppts) entirely due to construction which dropped sharply (-3.4%QoQ), giving back Q1 weather-related gains (+3.1%QoQ), while net exports were also a drag on growth (-0.6ppts) as imports grew by a relatively higher pace compared to that of exports (+1.6%QoQ vs. +0.3%QoQ, respectively). Looking ahead, as suggested by the substantial worsening of several sentiment indicators, including the August PMI surveys, August's ZEW expectations and August's GfK consumer climate, Germany's growth outlook looks gloomy as the escalating energy crisis is expected to hit hard the Eurozone's biggest economy, given its high supply dependence on Russian gas flows and its large industrial base (Figure 9). Amid sharply higher gas prices, a recent survey by the Association of German Chambers of Commerce and Industry (DIHK) unveiled that 16% of companies intend to reduce production as it is no longer profitable, while mounting gas supply uncertainty amid risk of rationing in winter—even though gas storage facilities are now more than 80% full — dents businesses' incentive for investment. In addition, elevated gas prices push up inflation, eroding household purchasing power and weighing on consumption, at a time when savings are back to pre-Covid levels (Figure 10). Though expected to be partially offset from the temporary cut to the VAT rate on gas (from the standard rate of 19% down to the reduced rate of 7%), the new gas levy (2,419 cents per KWh plus VAT) due in effect from 1 October, which will be used to compensate gas importers for higher purchase prices, is expected to push inflation higher in the coming months, with the headline CPI projected to move into double-digit territory in Q4 from August's 7.9%YoY. Overall, we have revised our 2022 GDP lower forecast to 1.4%YoY after growth of 2.6%YoY in 2021, which implies negative quarterly growth in H2, taking into account that the carry-over effect from 2021 amounts to 0.8%.

Figure 9: The large industrial base makes Germany particularly vulnerable to the energy crisis



Source: Eurostat, Eurobank Research

Figure 10: Household saving ratio back to pre-Covid 19 levels



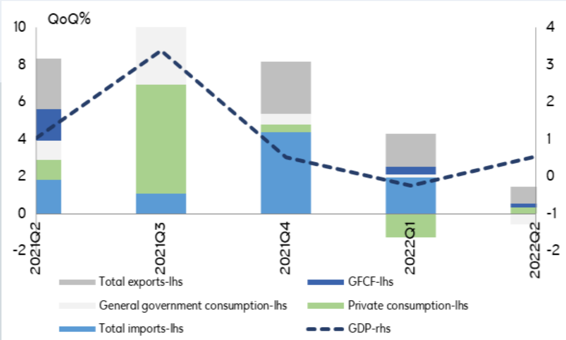
Source: Federal Statistical Office, Eurobank Research

France

Economic growth expected to continue at a moderate pace

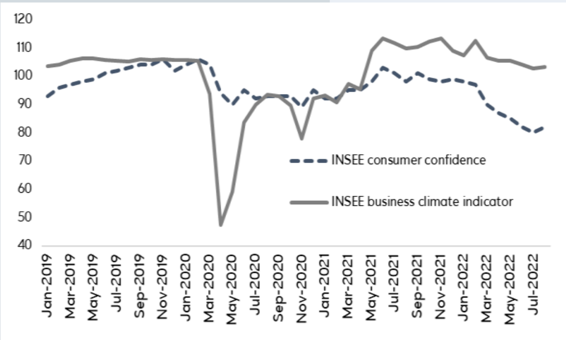
France's GDP bounced back in Q2, rising by a firmer than expected 0.5%QoQ mainly supported by consumer spending (+0.3%QoQ vs. -1.2%QoQ in Q1) after having fallen by -0.2%QoQ in the prior quarter (Figure 9). Public spending contracted by the sharpest pace since Q2 2020 (-0.5%QoQ), while fixed investment continued to expand, albeit modestly, despite tighter financial conditions (+0.2%QoQ), and net exports had a positive contribution to growth (0.6ppts) as imports held steady (0.0%QoQ) and exports, particularly services, rose (0.9%QoQ) on the back of a weaker currency. Looking ahead, incoming data for Q3 point to continuing moderate growth of around 0.2%-0.3%QoQ supported by the government rebate on fuel prices, higher wages thanks to indexation rules on the minimum wage which have risen by a further 2.01% as of August 1, high accumulated excess saving (Q4 2021: 16.9% of disposable income) and the economy's relatively limited dependence on gas compared to other big Eurozone economies. The INSEE consumer confidence index rose to 82.0 in August from July's 80.0, though still below its long-term average of 100, and the INSEE business climate summary indicator edged up to 103.4 from a more than a year low of 102.8 in the prior month, in contrast to the August PMI-Markit survey which showed a drop in the composite PMI from 51.7 to a 17-month low of 50.4 driven by a sharp decline in services (51.2 from 52.3). On the inflation front, HICP dropped from July's 6.8%YoY record high to 6.5%YoY in August, sharply lower than 9.1%YoY in the Eurozone, on the back of lower energy prices as fuel prices declined, while regulated prices for gas and electricity remained capped for retail customers. Aiming to contain energy inflation and offer some salve to consumers' purchasing power, the National Assembly in August approved an additional package of measures worth €20bn as well as an amended 2022 budget, envisioning, inter alia, regulated prices for gas and electricity to remain frozen until the end of the year, and the subsidy on petrol prices to be also extended until end-2022. More crucially for the economy's long-term prospects, given the lack of majority in Parliament, President Emmanuel Macron will likely face significant hurdles to pass reforms that are part of the government's strategy and aim to reduce the budget deficit long-term, including a rise in the legal retirement age from 62 to 65.

Figure 11: Q2 GDP bounced back mostly favored by consumer spending



Source: INSEE Eurobank Research

Figure 12: Sentiment indicators point to continuing modest growth



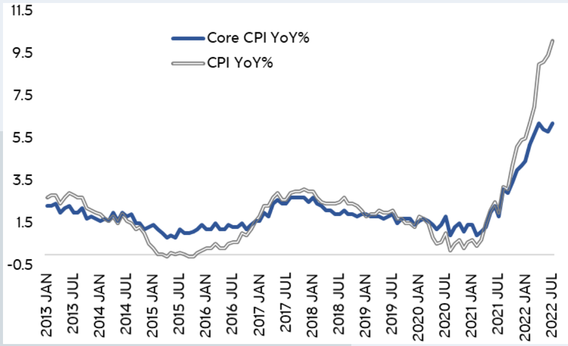
Source: INSEE, Research

UK

Truss government expected to take swift action to tackle the cost-of-living crisis

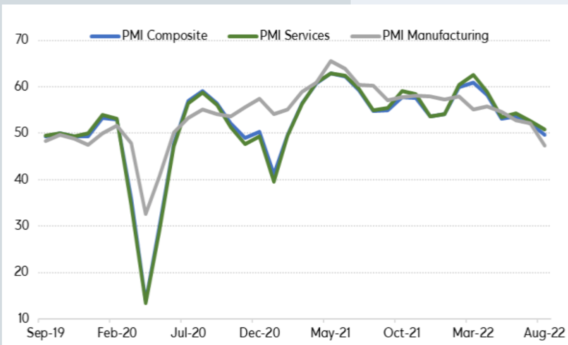
Liz Truss became the new Prime Minister and the new Tories leader after winning the leadership contest among Conservative Party members at an extremely challenging time, as the UK cost-of-living is surging amid persistently high inflation (CPI at a fresh multi-decade high of 10.1%YoY in July). Against this background, fiscal support measures to tackle the cost-of-living crisis will likely be top priority for the Truss government, as the incoming PM vowed during the Tory leadership contest. Proposed policies include, among others, reversing the corporation tax increase from 19% to 25% planned from April 2023, and reversing the 1.25ppts National Insurance Contribution rise which took place in April, while according to some press reports, she is also considering capping household energy bills (Ofgen has already announced an 80% rise in the household energy cap from October) or intervening in wholesale energy markets, providing support to both households and firms. The new targeted support measures Truss's government is reportedly planning to present soon, will likely increase fiscal funding pressures and push budget deficit higher, at a time the BoE is expected to start active gilt sales. With respect to economic activity, the fiscal package should support aggregate demand, raising inflation in the medium-term and generating upside risks to GDP growth, likely helping the UK economy to avoid a protracted recession, as the MPC's latest forecasts envision (a five-quarter recession from Q4 2020 with a peak to trough GDP fall of 2.1%). However, as suggested by recent sentiment indicators, a recession, likely shorter or/and milder than earlier expected, seems inevitable following a growth rate of just 0.1%QoQ in Q2, after the composite PMI dropped to 46.0 in August from July's 52.1, the largest decline since April 2020, and the GfK consumer confidence plunged to a fresh record low (Figure 14). All in all, expectations for upside risks to GDP growth from the new support measures and increased inflation pressures medium-term, leave the door open for further BoE rate tightening following a 50bps rate hike in August, the biggest hike since 1995, amid concerns that "a longer period of persistently high inflation will lead to more enduring domestic price and wage pressures".

Figure 13: Inflation at a fresh 40-yr high in July



Source: ONS, Eurobank Research

Figure 14: PMI surveys point to a looming recession



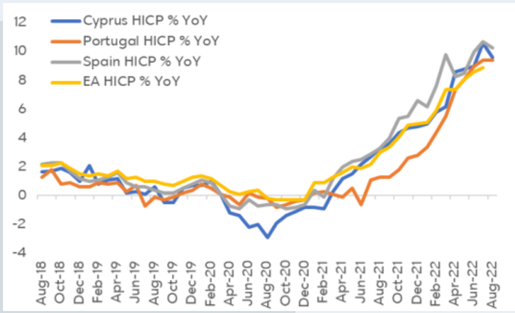
Source: Bloomberg, Eurobank Research

Cyprus

Strong support from the tourism sector, but inflation pressures escalate

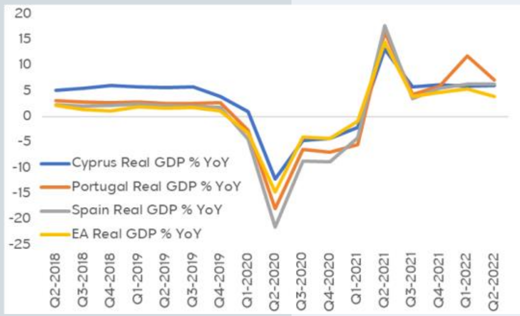
The final GDP estimate for Q2 2022 reaffirmed the continuation of the strong growth momentum on annual terms, as GDP expanded by 6.1%YoY, similarly to Q1 2022 (6.0%YoY), but pointed to some deceleration on a quarterly basis (0.6%QoQ vs 1.3% in Q1 2022). The continuation of the recovery was backed by exports of services (+17.3%YoY), which came from the resurgence of tourist inflows, while exports of goods (+16.1%YoY) also contributed positively. Nonetheless, the external balance deteriorated, as the demand for imports was much stronger (+24.8%YoY). The pick-up of investment activity was another contributor to growth, with fixed capital formation increasing by 31%YoY. Despite soaring inflation, household consumption expanded by 6.8%YoY, supported by measures to tame the energy crisis (ca 1.4% of GDP) . On the flipside, public consumption remained broadly stable (+0.4%YoY), indicating the government's efforts for a mild fiscal consolidation which resulted to both primary and overall budget surpluses in the January-July period. The resilience of the economy to external shocks and the expectation that the fiscal position will continue improving are the main reasons behind the S&P's recent upgrade of the long-term credit rating by one notch to BBB. Inflationary pressures are expected to intensify in H2 2022, as inflation remained steadily above the Eurozone average during April-July (average 9.3%YoY vs 8.3%YoY). Accordingly, household consumption is expected to be dampened, in line with falling consumer confidence. The higher than in 2019 tourist arrivals from certain countries (e.g. Germany, Poland, Greece) will likely cover many of the losses from Russia in Q3 2022 and further close the gap in tourism revenues. That said, the extraordinary performance of the tourism sector in Q4 2021 (ca 20% of revenues in 2021), when it reached pre-pandemic levels, puts a limit on the positive base effect of previous quarters. The implementation of the RRP and higher industrial production in H1 2022 (+4.2%YoY), are rendered as the key drivers of investment for the remainder of the year but the adverse geopolitical momentum remains a drag. Considering the above, we revise upwards our GDP growth forecast for 2022 to 4%, which stands in-between the Summer EC forecast at 3.2% and the >5% of the Cypriot Ministry of Finance.

Figure 15: in terms of GDP growth, Cyprus performs similarly to peripheral peers, but better than the EA average



Source: Eurostat, Eurobank Research

Figure 16: ... however, inflation is marginally higher than the EA since past April



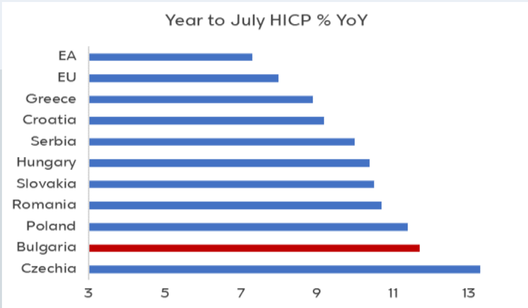
Source: Eurostat, Eurobank Research

Bulgaria

Solid economic momentum up to H1-2022 with downside risks ahead

Q2-2022 final GDP growth reading came substantially below the robust flash estimate of 4.8% YoY/1.1% QoQ released in mid-August, coming in at 4.0% YoY/0.8% QoQ. In terms of expenditure, the key contributor remained private consumption whose deceleration explains the decrease of the annual headline growth print. With the GDP growth print of the previous quarter at 4.2% YoY/0.9% QoQ, the H1-2022 GDP growth rate is calculated at 4.1% YoY from 5.2% YoY in H2-2021. June's hard data, both from the supply and demand side, point to some loss of steam in the last month of Q2-2022, raising, thus, concerns over the growth momentum going into Q3. In detail, retail sales decelerated by -1.4% YoY in June from +0.4% YoY in May and so did, more vigorously, the industrial production volume which shrunk by -6.8% YoY from a +1.4% YoY expansion in May. The key concern of the economy remains the persistent inflationary pressures stemming from surging energy and food prices. Headline CPI, after averaging to 2.8%YoY in 2021, rose to 17.3% YoY in July, approaching 24-year highs, from 16.9% YoY and 15.6% YoY from June and July respectively, and bringing the year-to-July average reading at 13.7%, which is among the highest in the CESEE region. Along these lines, recent developments on the fiscal front allow for some optimism as the budget execution between January-August has led to a surplus of ca BGN1.7bn, increased by 85% on an annual basis and calculated at 1.1% of projected GDP. However, the well-established trend of the last quarter to be the most loaded in terms on expenditures along with the random expenditure of the upcoming snap elections, scheduled for October 2, leave limited room for additional fiscal measures in order to support the disposable income which is trimmed by the high inflation. All in all, the political instability Bulgaria is under for at least the past 18 months clouds the outlook, beyond the above-mentioned loss of economic steam and unabated inflation. Indicatively, it may also jeopardise the disbursement of the second tranche of the RRF, as the latter is tied with a series of prerequisites such as reforms-related bills which need to be ratified by the appearing fragmented parliament. Considering the above, and despite the satisfying performance in terms of GDP growth in H1-2022, we remain prudent regarding our +2.9% GDP growth forecast for 2022, revising it only by a tad upwards compared to July.

Figure 17: Inflationary pressures, among the highest in the region



Source: Eurostat, Eurobank Research

Figure 18: ...take a toll on the Q2-2022 growth rate

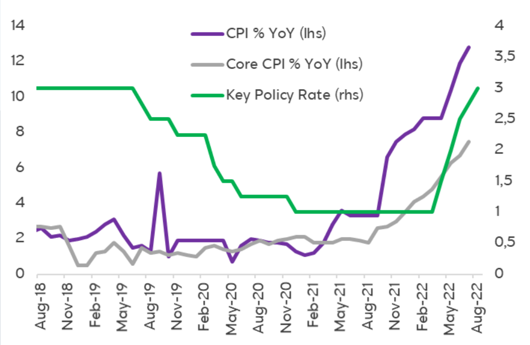
Source: Eurostat, Eurobank Research

Serbia

Solid H1-2022 GDP growth performance with risks tilted to the downside

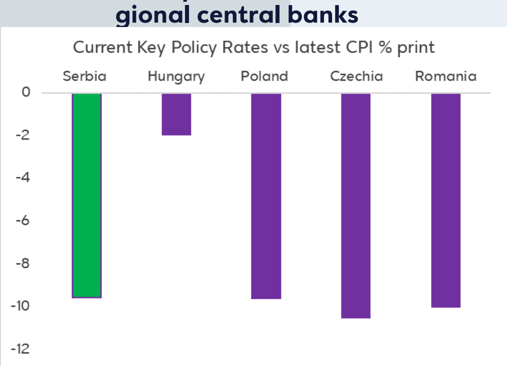
Q2-2022 final GDP growth reading came a tad below the flash estimate of 4.0% YoY released in early August whereas on a quarterly basis, economic output picked up to 1.2% from 0.5% in Q1-2022. By breaking down the annual figure into the expenditure components, the key contributor remained private consumption, followed by public expenditure and investments while net exports trimmed the headline 3.9% print as the weight of imports on the GDP exceeded that of exports, even though the latter increased more vigorously than the former. While the H1-2022 annual growth print stands at 4.1%, recent hard data, both from the supply and demand side, point to some loss of steam in both June and July, raising, thus, concerns over the growth momentum of Q3-2022. Industrial production (IP) decelerated to -1.6% YoY in July from +3.7% YoY in June and +8.7% YoY in May, while retail sales (RS) growth decelerated to +4% YoY in July from 4.8% YoY and 5.1% YoY in June and May respectively. Beneath the IP slowdown, we assume the cooling in the external demand with many EU countries, Serbia's key trading partners, poised for a GDP growth deceleration in the last two quarters of 2022. The RS downbeat came, presumably, on the back of surging inflation which remains unabated and its toll on private consumption through the trimming in the disposable income is starting to become more evident. That said, the CPI came in at 12.8% YoY in July from 11.9% YoY in June and 10.4% in May, bringing the January to July average at 10.1%. The inflationary outlook gets gloomier once observing the core CPI trajectory which averages between January and July at 5.6%, with July's print rising to 7.5% from 6.7% in June, implying thus, that inflationary pressures have become more broad-based. In view of the above, in the last three months, the National Bank of Serbia (NBS) delivered three additional hikes, bringing the Key Policy Interest Rate (KPR) to 3.50% from 2.50% in June. Despite the challenges and the downside risks above described, the economy is expected to weather the adverse geopolitical circumstances. The latter view is also shared by Fitch Ratings which affirmed the country's sovereign credit rating at BB+ with the outlook kept stable in late August.

Figure 19: The NBS speeds up with interest rate hikes



Source: Bloomberg, Eurobank Research

Figure 20: ...broadly in tandem with the rest regional central banks

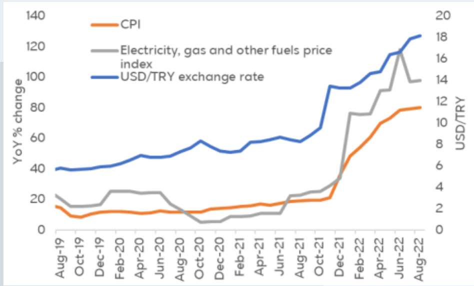


Source: National Central Banks & Statistics Offices, Eurobank Research

Turkey

Unconventional monetary policy and high inflation undermine growth prospects

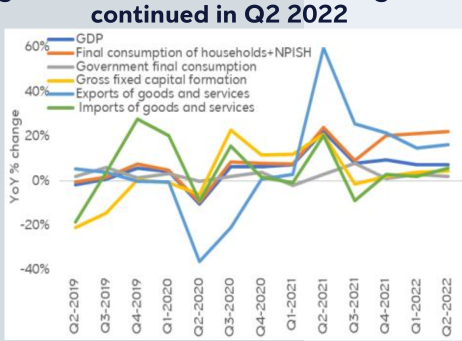
Figure 21: Currency devaluation and surging energy prices fuel soaring inflation…



Source: TCMB ,Turkstat, Eurobank Research

The Central Bank of Turkey (TCMB) cut its main interest rate in mid-August for the sixth consecutive time in the last 11 months, by 100 basis points, to 13%, thus continuing the unconventional monetary policy stance. The TCMB's asserted that its aim is to preserve favourable financing conditions in support of growth in industrial production and preserve the positive employment trend. Falling nominal interest rates, in combination with soaring inflation, led real interest rates into even more negative grounds, weighing on investors' confidence and resulting to capital outflows and large depreciation of the Turkish lira (USD/TRY:+89.9% during October 2021-August 2022). On the other hand, extensive money market interventions and administrative measures by the TCMB (e.g. obligation for exporters to convert part of their foreign currency revenue into TRY, exchange rate protection for lira-denominated deposits, collateral requirements in government bonds for loans/ credit expansion etc.), have prevented further devaluation and capital flights. The inflationary pressures from the TRY depreciation are intensified by the hike in energy prices. The inflation rate stood at 80.2%YoY in August, a 24-year high, with a YtD increase of 44.1 ppts. Despite surging inflation, capital outflows and heightened uncertainty, real GDP increased on average by 7.5%YoY in H1 2022, mainly due to much higher private consumption (+21.9%YoY), reflecting credit expansion and supportive fiscal policy (increase in public sector wages, measures for energy consumption). Also, the external balance recorded significant surpluses (ca 6.0% of GDP), as demand for exports, both for goods and services, benefits by the weakening of the lira, whereas investment picked up moderately (4.4%YoY), on the back of strong credit expansion to businesses (+52.2%YoY in H1 2022). Looking forward, risks are mainly on the downside. The recent increases in energy prices will sustain high inflation and pressures on real disposable income, which, however, could be, partially offset by State subsidies. Additional macroprudential measures for banks prevent a further depreciation of the TRY but will weigh on credit expansion and investment. On the other hand, TRY devaluation together with the relocation of supply chains because of the war, will continue boosting exports. In view of the presidential elections ahead in June 2023, expansionary fiscal policy will continue, coming along with a significant impact on public finances.

Figure 22: …however, robust YoY growth continued in Q2 2022



Source:Turkstat, 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	6.1	2.9	2.7	4.7	7.2	4.4									
Advanced Economies															
USA	5.7	1.6	1.0	4.7	8.0	3.7	5.4	3.7	4.0	-3.7	-4.1	-3.8	-10.8	-4.3	-4.0
Eurozone	5.2	2.8	0.8	2.6	8.0	4.3	7.7	6.8	7.0	2.5	1.3	1.8	-5.1	-4.5	-3.3
Germany	2.6	1.4	0.5	3.2	8.0	4.6	3.6	3.5	3.3	6.7	3.9	4.4	-3.7	-3.5	-2.2
France	6.8	2.4	0.9	2.1	5.9	3.7	7.9	7.3	7.3	-0.9	-1.1	-1.1	-6.5	-5.6	-4.9
Periphery															
Cyprus	5.5	4.0	2.7	2.2	8.0	3.0	7.5	6.0	5.5	-7.2	-8.5	-8.0	-1.8	-0.4	-0.7
Italy	6.6	3.3	0.6	2.0	7.5	3.9	9.5	8.3	8.5	3.4	0.3	0.8	-7.2	-5.7	-4.6
Portugal	5.4	6.1	1.9	0.9	6.1	2.5	6.6	5.8	5.7	-0.7	-2.1	-1.5	-2.8	-2.2	-1.6
Spain	5.1	4.4	1.9	3.0	8.6	3.5	14.8	13.2	13.1	0.9	0.5	1.0	-6.9	-5.3	-4.4
UK	7.4	3.5	0.0	2.6	9.3	6.9	4.6	3.9	4.3	-3.4	-5.7	-4.5	-7.5	-4.5	-3.1
Japan	1.8	1.5	1.6	-0.3	2.1	1.3	2.8	2.6	2.5	2.9	1.5	2.0	-6.4	-6.5	-4.5
Emerging Economies															
BRICs															
Brazil	4.8	1.8	0.8	8.3	9.6	5.4	13.6	9.9	9.8	-1.6	-1.1	-1.4	-5.1	-7.1	-7.4
China	8.1	3.5	5.2	0.9	2.3	2.3	4.4	4.1	3.9	1.8	1.9	1.1	-5.6	-4.6	-4.3
India	8.7	7.2	6.4	5.4	6.6	5.0		*NA*		-1.5	-3.2	-2.2	-6.9	-6.5	-5.8
Russia	4.7	-6.4	-3.0	6.7	14.4	6.9	4.8	5.5	5.0	6.7	10.1	6.5	0.4	-1.6	-1.3
CESEE															
Bulgaria	4.2	2.9	3.0	3.3	12.5	5.8	5.3	5.4	4.7	-0.4	-1.8	-0.7	-4.1	-4.1	-3.0
Serbia	7.4	3.5	4.0	4.1	9.0	5.0	11.0	10.5	10.0	-4.4	-6.5	-5.7	-4.1	-3.5	-2.5
Turkey	10.3	5.8	3.3	19.4	72.0	38.4	12.0	10.7	9.8	-2.2	-6.2	-3.6	-3.2	-4.0	-4.3

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

Eurobank Fixed Income Forecasts

	Current	June	September	December	March
USA					
Fed Funds Rate	2.25-2.50%	2.78-3.05%	3.29-3.55%	3.39-3.65%	3.36-3.60%
3m SOFR	3.02%	2.83%	3.36%	3.53%	3.55%
2yr Notes	2.49%	3.21%	3.31%	3.26%	3.16%
10 yr Bonds	3.34%	2.99%	3.06%	3.06%	3.03%
Eurozone					
Refi Rate	0.50%	1.00%	1.50%	1.65%	1.65%
3m Euribor	0.82%	0.69%	1.11%	1.22%	1.28%
2yr Bunds	1.17%	0.85%	1.00%	1.10%	1.08%
10yr Bunds	1.65%	1.19%	1.26%	1.26%	1.34%
UK					
Repo Rate	1.75%	2.15%	2.55%	2.60%	2.50%
3m Sonia	2.58%	2.10%	2.34%	2.34%	2.09%
10-yr Gilt	3.07%	2.20%	2.21%	2.21%	2.06%
Switzerland					
3m Saron	0.37%	0.28%	0.59%	0.90%	1.06%
10-yr Bond	0.95%	0.84%	0.97%	1.09%	1.16%

Source: Bloomberg (market implied forecasts)

Research Team

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

Dr. Stylianos Gogos
Research Economist
sgogos@eurobank.gr
+ 30 214 40 63 456

Maria Kasola
Research Economist
mkasola@eurobank.gr
+ 30 214 40 63 453

Paraskevi Petropoulou
Senior Economist
ppetropoulou@eurobank.gr
+ 30 214 40 63 455

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

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

Michail Vassileiadis
Research Economist
mvassileiadis@eurobank.gr
+ 30 214 40 59 709

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