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While uncertainty prevails over an eventual relaxation of China's Zero-Covid policy, global economic growth continues to decelerate, as the post-pandemic rebound has faded, and headwinds are intensifying. Amid growth concerns, oil prices dropped to early 2022 lows, contributing to a softening in global headline inflation momentum. Yet, inflation remains above target, suggesting that several major CBs will follow through with additional tightening. However, this may not prevent them from downshifting the pace of rate hikes amid worries over a faster and stronger transmission of tightening to economic activity.

Macro Picture

USA: Continued expansion, except for the real estate sector, despite tighter financial conditions

EA: The economy seems poised for a recession, but likely a mild one, starting in Q4

UK: Q3 GDP fall likely marks the start of a recession as the cost-of-living squeeze continues

CESEE: Evident slowdown in H2 mirrored in the Q3 GDP estimates; tight labor markets and signs of inflation peaking

Markets

FX: USD index weakened sharply on slower Fed hiking pace expectations and risk on sentiment

Rates: Both EU and US yields moved lower as rate hike expectations have been revised into moving at a slower pace

EM: Hopes of a faster reopening in China and a slowdown in the pace of Fed hikes have led to a more favorable macro landscape for assets

Credit: Spreads materially tighter in November with CDS indices outperforming cash bonds. Volatility to remain low and spreads to trade sideways as year-end illiquidity kicks in.

Policy Outlook

USA: The Fed expected to slow the pace of hikes, but restrictive policy likely to be held for longer

EA: The ECB likely to proceed with smaller hikes as tightening cycle is closer to the terminal rate

UK: The BoE will likely slow the pace of rate hikes as fiscal policy is set to tighten by 2027/28

CESEE: Protracted slowdown in developed Europe will spillover in the region, stretching fiscal and monetary policy space

Key Downside Risks

DM: Enforced EU gas rationing, high inflation for longer, over-tightening of monetary policy, pronounced growth slowdown in China, further escalation of the Ukraine war

EM: Slower growth in DMs, continuing monetary tightening by major CBs through policy rates hiking puts under stress local EM currencies and triggers capital outflows, volatile commodity prices derail inflation from stabilizing

Special Topic in this issue

→ Trends in prices of commodities affected by the war in Ukraine (1st Part)

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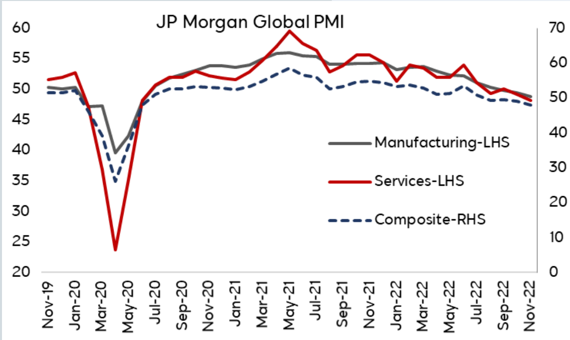
Macro Views
Latest world economic & market developments

Continued loss of global growth momentum, while lower energy prices contributed to a softening in headline inflation momentum

While uncertainty prevails over an eventual relaxation of China's Zero-Covid policy, the downturn in global economic activity extended in November into its fourth consecutive month, as the post-pandemic rebound has faded, and headwinds are intensifying. Persistently high inflation erodes purchasing power, while the simultaneous central bank monetary policy that has turned to outright restrictive in some cases (especially in the US) is tightening global financial conditions. Delivering its fifth consecutive monthly decline after moving below the benchmark of 50 in August for the first time in two years, the J.P. Morgan Global Composite PMI dropped from 49.0 in October to 48.0 in November, pointing to an accelerating downturn of economic activity, with output falling at the quickest pace in almost 2 ½ years following a similarly steep drop in new orders and pointing, thus, to risks of more weakness ahead. Global manufacturing PMI fell further into contraction territory from October's 49.4 to 48.8, marking its third consecutive sub-50 reading and the lowest in 29 months, a level not witnessed outside of recessions. The global services PMI also fell to a 29-month low of 48.1 from 49.2 in October, signaling contraction in three out of the last four months.

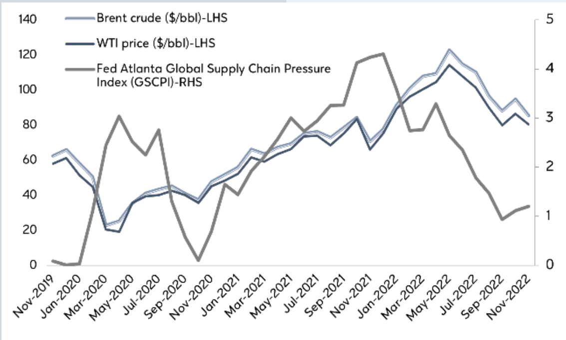
Figure 1: November PMIs point to an accelerating downturn of economic activity



Source: Markit, Eurobank Research

Encouragingly, global supply chain pressures continued to fade, especially in the goods sector, as indicated by a further recovery in the global delivery times PMI and a further drop in input prices, although China's zero-Covid policy continues to be a source of considerable uncertainty and the threat of a disruption in natural gas supply still hangs over the Eurozone economy. Meanwhile, amid mounting global growth concerns, the Brent oil price has dropped below $80/bbl, levels last seen early this year, before Russia's invasion of Ukraine in February. Largely driven by falling oil prices, Eurozone headline HICP halted a 17-month rising streak in November, dropping from a fresh record peak of 10.6%YoY in October to a lower-than-expected 10%YoY, while core inflation held at 5.0%YoY for the second consecutive

Figure 2: The drivers behind softer global headline inflation momentum



Source: Fed Atlanta, Bloomberg, Eurobank Research

month. Adding to tentative signs of softening in global headline inflation momentum, US CPI moved further lower in October to a nine-month trough of 7.7%YoY from September's 8.2%YoY after reaching a peak of 9.1%YoY in June. While global headline inflation has likely passed or is within reach its near-term peak, the deceleration is not sufficiently large, as it still remains unacceptably high relative to the central bank target. Meanwhile, the labor market remains remarkably tight across most economies and wage growth continues to run strong, suggesting that several major central banks are expected to follow through with additional tightening —with the BoJ the only one sticking to a dovish stance — as they remain resolute in preventing a de-anchoring of inflation expectations and a wage price spiral. However, this may not prevent them from downshifting the pace of rate tightening amid growing concerns over a faster and stronger transmission of policy tightening to economic activity, as rates have already moved closer or even deeper into restrictive territory. Though the key assessment is how much tighter policy needs to be and how long rates need to be held at restrictive territory for the Fed to restore price stability on a sustained basis, clearly hints for a slower pace of tightening to 50bps at the upcoming 13-14 December meeting have been recently provided by a number of FOMC participants, including Chair Jerome Powell. In light of the deceleration in Eurozone November headline HICP and a looming recession, the ECB may also follow through with a 50bps rate hike at the 15 December policy meeting, while compounding this by announcing the start of its balance sheet run-off through QT from early next year.

Developed Economies

US: Challenging expectations of a near-term US recession amid tighter financial conditions, the majority of hard data has come in fairly strong, pointing to continued expansion, except for the real estate sector which continues to falter in the face of multi-year high mortgage rates. In contrast to encouraging hard data which give the Fed the green light to raise rates substantially further into restrictive territory to restore price stability while awaiting concrete signs of a softening in labor market conditions and price pressures, recent soft indicators mostly surprised to the downside, suggesting that the risk of a US slide into recession in the not-too-distant future is non-negligible, as the impact of tightening Fed policy will be mostly felt in the period ahead. Meanwhile, consumer price inflation decelerated sharply in October, though still well above target, supporting expectations that the peak has probably passed, and the Fed could slow the pace of rate tightening in the upcoming policy meetings. However, as Chair Jerome Powell reiterated recently, the terminal interest rate would likely need to be "somewhat higher" than expected in September, while restoring price stability would likely require holding rates at restrictive territory for "some time.

Euro area: The composite PMI marginally improved in November for the first time in seven months, but still remained below the critical level of 50. Along similar lines, the EC economic sentiment rose slightly in November, the first increase since the start of the Ukraine war, though not far from September's all-time low. That said, after GDP unexpectedly grew in Q3, the economy still seems poised for a recession, though a mild one, starting in Q4. Meanwhile, headline inflation surprised to the downside in November, dropping from October's 10.6%YoY record high to a lower than expected 10.0%YoY, the first deceleration since mid-

2021, mainly due to lower energy prices. However, uncertainty about the path of inflation prevails while there are no signs of underlying inflationary pressures waning yet, as core inflation remained stubbornly high at 5.0%YoY. That said, it is too early to conclude that inflation has already embarked on a sustained downward trend. Yet, this might not prevent the ECB from slowing the pace of rate tightening at the 15 December meeting to 50bps as the tightening cycle is closer to the terminal rate, while compounding this with the announcement of the start of QT from early next year.

Emerging Economies

EM: In their fresh global economic outlooks, S&P Global Ratings and Fitch Ratings, both raised their GDP growth forecasts for Brazil to 2.9% and 3.0% respectively for 2022 from 2.5% expected in September but trimmed their 2023 forecast to 0.5% and 0.7% in turn on the back of global economic deceleration and domestic policy uncertainties. With the ninth sanction package by the EC against Russia underway, the economy of Russia will prove more resilient that initially thought with 2022's recession estimated not to fall below -3%. The World Bank in its latest India Development Update revised upward the growth estimate for FY23 (Apr-Mar) to 6.9% YoY from 6.5% YoY previously, adding that India will remain one of the world's fastest growing large economies and that a slowdown in other emerging markets could prove beneficiary to the country, as it emerges as an increasingly attractive investment destination. Nevertheless, downside risks from the slowdown in the EU and the US were also highlighted. Finally, the dominant development in the EM sphere this month is the gradual abandonment of the zero-Covid strategy in China, imposed, among others, by recent incidents of social unrest against suppression but also faltering economic data.

CESEE: The big picture in the region sums up to some anticipated loss of steam in economic growth as mirrored in the final Q3 GDP growth prints. Specifically, in Romania, Hungary, Czechia, Bulgaria and Serbia, GDP growth in Q3 decelerated on a quarterly basis compared to Q2, with private consumption, broadly, considered the common denominator beneath the downturn, given the hit on disposable income from the persistent inflationary pressure. That said, October's inflation prints revealed mild signs of ease on a monthly basis in core regional economies such as Hungary and Romania but also peripheral peers such as Bulgaria. However, the said meagre retreat cannot be interpreted as a clear downward trend. On the contrary, in its Autumn Forecast released in mid-November, the EC cited signs of inflation remaining high and broad stagnation in the EU economy throughout 2023 which will inevitably drift the region towards the same direction. Concluding with a development from the international relations sphere, on December 6, the annual EU-Western Balkans summit took place in Tirana. The agenda pertained, inter alia, to 'tackling jointly the consequences the Russian aggression against Ukraine and intensifying political and policy engagement' and while the event bore no major news, it drew substantial attention as it was the first-ever summit between EU and the Western Balkans region to take place in a Western Balkans nation, Albania, symbolising, thus, the clear EU perspective of the region.

CESEE Markets Developments & Outlook

Bulgaria

The rattle in global markets from the high inflation and the effort to tame it along with the domestic political uncertainty and the ongoing war between Russia and Ukraine are the key drivers behind any fluctuations of local papers and Eurobonds. Eurobond yields moved on a downward path across all maturities; on the short-term spectrum, the 2023 Eurobonds fell by 39bps while the longer maturity bonds, namely the 2034 and 2035 papers, saw a huge drop of 104 bps and 114 bps, respectively. Local papers moved both ways with the 2-year tenor rising by 27 bps, the 5-year tenor sliding by 104 bps and the 15-year tenor picking up by 24 bps.

Serbia

With the agency of Public Debt determined not to admit any sign of weakness, at least for the time being, yields at the primary market will in majority lag those at the secondary market. That said, the government will need to secure additional sources of financing in order to cover the EUR2.2bln deficit through 2023. Taking into consideration the weak domestic demand for bonds, mostly due to non-competitive yields and stretched liquidity, borrowings outside the domestic terrain will be pursued. Towards that end, the government has already secured RSD2.4bln through a new agreement with the IMF in the shape of a Standby Facility (SBA) and will most probably sought for additional funding close to RSD4.5bn through bilateral agreements. In any case, inflation is expected to deescalate drastically by the end of 2023, i.e. sliding close to 4% and averaging throughout the year between 8% and 9% from 12% in 2022, making the local sovereign papers more appealing to investors, but the said forecast, most probably, will take approximately the first half of the year to realise. The flattening of the RSD bond curve continued in November, moving in line with other regional markets. Yields at the long end have dropped by an average of 50bps after hitting six-year highs during the 3rd week of October. Currently, the 3-year, 5-year and 10-year RSD denominated bonds are traded at 6.50%, 7.00% and 7.50%, respectively. Turning to the FX space, the EURRSD cross will hold its ground unless robust demand for hard currencies depletes the Central Bank's reserves, which at the time of writing, stand at EUR16.8bn, maintaining an upward trend despite the harsh financial conditions worldwide.

Markets View

Foreign Exchange

EUR/USD: Keeping its bullish momentum above parity, the pair seems to be heading to even higher levels towards 1.10 in the mid-term. One of the main factors driving this move is the slower tightening pace signalled by the Federal Reserve, which, however, seems to be moderately weighted by the market due to the downward projected growth estimates globally and in Europe particularly. We remain bullish on the pair with a target of 1.10, even possibly higher in the medium term. In the near-term we expect consolidation in the 1.04 – 1.06 range before further upside. A downside risk to our view is the upcoming ECB meeting on Dec 15.

EUR/GBP: The risk of further higher inflation in the UK as well as the deteriorating economic and financial conditions in the EU are the two main forces tuning the pair in the 0.8550-0.8650 channel. The trading range is expected to be maintained until the end of the year.

Rates

EU: Rates decreased significantly during November with the 10y swap rate retreating by 40bps and trading around 2.60% at the time of writing. Slope of the curve inverted further with the 5s-30s trading at -70bps, almost 15bps lower since the beginning of November. Looking forward, the ECB is expected to continue its hiking trajectory in the Dec 15 meeting and increase policy rates by 50 bps with the deposit rate reaching 2% by the end of 2022.

US: Rates retreated significantly during November. The 5yr swap rate is now trading at 3.8%, having lost 50bps since the beginning of November. The curve remains inverted at -25bps in the 5s -10s tenor and -0.59 bps in the 5s-30s tenor, pricing, thus, a recession. Looking forward, the Fed is expected to continue its hiking cycle, reaching a terminal rate of 5%, albeit at a slower pace compared to some weeks ago.

Emerging Markets Sovereign credit

Expectations that the Fed will moderate the pace of interest rate increases, inflation normalization and anticipations on China reopening from the lockdowns, led EM assets to rally harshly. The EMBI Global Index closed at 388 bps at the end of November, 60 bps tighter on the month. In CEEMEA, Romania and Serbia had a very strong performance, while in Poland the NBP raised the Key Policy Rate (KPR) by 50bps, below the market expectations of a 75bps. In South Africa, sovereign bonds have underperformed on a potential resignation of President Cyril Ramaphosa. In LATAM, the risk on mode helped sovereign spreads to tighten. In Asia, Chinese assets had a solid performance as the market trades the China reopening. We remain constructive but also cautious on EM fixed income. The peak in inflation and the China reopening should prove very favorable for EM assets, however, there are also several risks that lurk on the horizon, like persistent inflation, deeper than expected recessions and worse geopolitics.

Corporate credit

European credit continued its march tighter in November on the back of signs that inflation momentum was beginning to ease across the key economies and with downside surprises coming from both the US and the Euro Area in the latest data. In addition, the prospect of China gradually moving away from its zero Covid strategy propelled risk sentiment even further.

The biggest driver was undoubtedly the downside surprise in October's US CPI which came out on November 10. The monthly increase in core CPI was the slowest in over a year which inevitably re-ignited the "Fed pivot" narrative with market pricing in a slowdown in the pace of rate hikes to just 50bps in December. The latter slower pace seems to be cemented on the final day of the month in a speech by Fed Chair Powell, who said that "the time for moderating the pace of rate increases may come as soon as the December meeting". However, the very strong NFP and the ISM services reading that followed have contributed to the re-emergence of hawkish fears.

Europe's Investment Grade (IG) was 25bps tighter during the past month with Materials and Financials outperforming (-42bps and -40bps tighter respectively) while Communications and Technology lagged, tightening by only 12bps and 9bps respectively. High Yield (HY) was 79bps tighter with Consumer Staples tighter by 147bps followed by Financials that finished 93bps tighter. On the other hand, Energy and Communications underperformed, tightening by approximately 32bps each. In the US, IG and HY ended 10bps and 43bps tighter, underperforming the EU.

Moving into the end of 2022 we expect spread moves to be dictated by the usual inflation/Fed pivot narrative. Absent any surprises from CBs, we expect rates' volatility to remain low and credit to trade sideways as year-end illiquidity kicks in.

Special Topic: Trends in prices of commodities affected by the war in Ukraine (1st Part)

Introduction

The long-lasting discussions and negotiations in the EU about imposing a cap on fuel prices keep public interest high on developments in energy products markets, mainly of petroleum, compressed natural gas and liquified natural gas. Processed energy goods are used by households for transports and heating purposes and are also a significant production input for the business sector, mainly manufacturing. The interest is reinforced by the fact that winter in the northern hemisphere has started and there are no signs that the war in Ukraine will end soon, thus paving the way for the lifting of sanctions imposed to the Russia and a gradual restoration of the energy supplies from Russia, including the ban by the EU -decided in May - on all Russian oil imports by sea by the end of this year.

The importance of Russia for the EU and the global economy is not limited to the production and supply of energy products. Russia holds large shares to world exports of metals, metallic and non-metallic ores used in various manufacturing sectors, such as palladium (26.1% in 2020, highest share globally), platinum (16.6% in 2020, 2nd highest share), raw nickel (14% in 2020, highest share), raw aluminium (9.0% in 2020, 2nd share), semi-finished iron (18.8%, highest share) and coal (12.0% in 2018, third share). Prior to the war, Ukraine also had an important role in the global supply of certain metals, unprocessed and processed food products, as it accounted in 2020 for 39.2% of global exports of seed oils (highest share globally), 12.8% of exports of corn (4th highest share), 9.0% of exports of wheat (5th share), 3.0% of exports of iron ore (5th share) and 12.7% of exports of semi-finished iron (2nd share), both used in steel production. Overall, the significance of both countries' exports of certain goods to the world economy highlights the importance of mapping the recent trends in the related markets. In this context, the remainder of this special topic focuses on the price trends and their determinants in 2022 for aluminium, steel-iron ore and coal. In a special topic in early 2023 the price trends in the food commodities whose global trade is affected by the war in Ukraine will be examined.

Raw Aluminium[1]

The aluminum production process can be broken down into three stages; first bauxites, which contain aluminum, are extracted from the ground. Second, bauxites are processed into alumina or aluminum oxide, and finally in stage three, pure aluminum is produced using electrolytic reduction, a process in which aluminum oxide is broken down into its components using electric current. The top-5 producers of aluminum globally in 2021 were China (39mn Metric Tons-MT), India (3.9 mn MT), Russia (3.7 mn MT), Canada (3.1 mn MT) and United Arab Emirates (2.1mn MT). The top-5 raw aluminum exporters globally in 2020 included Canada ($5.5bn or 11.1% of total), Russia ($4.5bn or 9.0%), United Arab Emirates ($4.4bn or 8.9%), India ($3.9bn or 7.9%) and Norway ($2.6bn or 5.2%). On the imports side, the US ($6.8bn or 13.7%), the Netherlands ($3.9 or 7.9%), Germany ($3.6 or 7.2%), Japan ($3.3bn or 6.8%) and China ($3.1 or 6.3%)

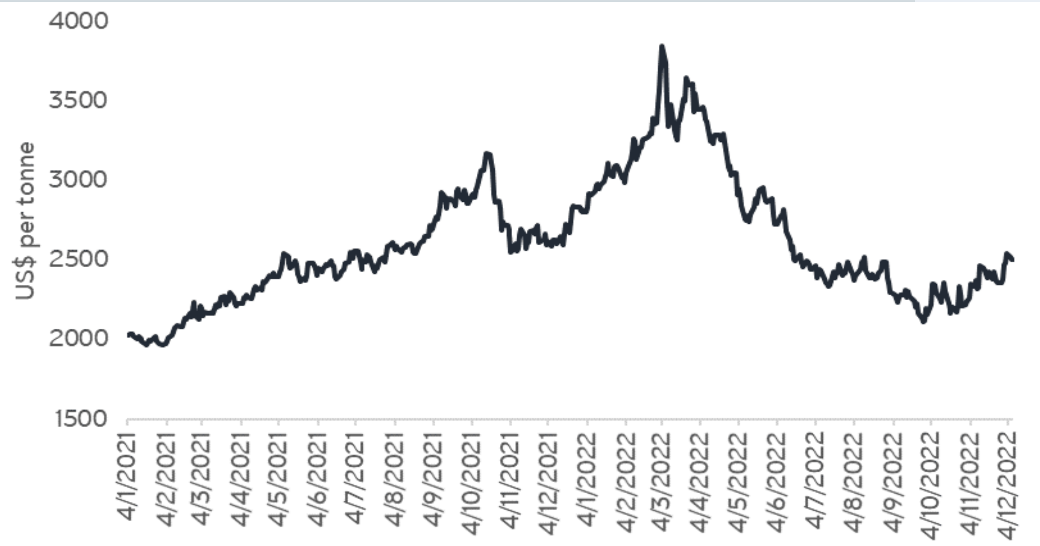
[1] Harmonized System 1992 4-digit (HS4) classification code: 7601

rank first. Aluminium is mostly traded in the London Metal Exchange (LME), the New York Mercantile Exchange (COMEX) and the Shanghai Futures Exchange (SHFE). The lot size is 25 metric tons.

According to the data presented above, Russia is both a major producer and exporter of aluminium. Furthermore, the largest aluminium producing company outside of China is Rusal, a Russian company which produced 3.76mn MT in 2021, accounting for 6% of the worldwide production. The fact that Europe is Rusal's biggest customer, accounting for 40% of its sales revenues, indicates the periphery's strong dependence on Russia's production and the potential adverse effects of the war in Ukraine in case sanctions to aluminium imports are imposed.

Regarding the trend in the 3-month aluminium futures price in 2022 and its main determinants, the war in Ukraine intensified the rise that had started in Nov-21, from a level just below $2.500/ per tonne (Figure 3).[2] On March 4, the price reached a multi-year high ($3.970/t), on fears over supply disruption, from strong signs that metal flows from Russia were increasingly restricted due to transportation issues or self-sanctions of exporters and buyers. 10 days after, the 3-month futures had declined by more than 18% (~$3.250/t in 14/3), but followed next an upward trend, leading to $3675 per metric ton by end-March 2022, a rise attributed among other factors to market dislocation between the most important exchanges for aluminium, LME and SHFE, that distorts trade flows and had pushed more than 30.000 tonnes of raw aluminium in Chinese bonded zones in the beginning of 2022 in order to enter the country, limiting global supply, but eventually these were re-exported, in much higher prices. Such developments strengthened the implications of self-sanctioning against Russian aluminum by supply chain participants, ranging from banks to shippers, tightening further the physical liquidity on top of an already stretched market.

Figure 3: London Metal Exchange Aluminium 3-month futures (bid price)



Source: Bloomberg, Eurobank Research

During April and up to mid-May the 3-month aluminium futures fell, returning by the end of this period to pre-war levels (of Dec-21, ~$2.650/t). But in the next two weeks, it rose by almost 12% (+11.8%, to~$2.970/t). The continuous negotiations during that period in the EU for a ban on oil imports from Russia, resulting in

[2] Analysis based on futures prices from the London Metal Exchange (LME)

end-May to a decision for a gradual embargo, which would halt 90% of Russia's crude imports by year-end, raised fears over additional sanctions to the EU from the country's part, including cuts in exports of metals. However, such a reaction was not decided and the trend in aluminium and other metals prices was reversed. The price continued to drop in the June-September period, reaching by the end of the latter month a 19.5-month low ($2.102/t). The main cause behind the decline was that China's primary aluminum production hit successive records in July and August, surging by 5.6%YoY (3.43 million tonnes) and 9.6%YoY (3.51 million tonnes) respectively. Accordingly, output in China in the first eight months of the year gained 2.1%, reaching 26.47 million tonnes.

In October and in the first half of November the price exhibited a moderate increasing trend, reaching $2.445/t in Nov 15 (+16.3% compared to end-September), however on an annual basis it was ca 6.3% lower. The rise started on news that the LME was discussing the possibility of banning Russian metals (aluminium, nickel and copper) from being traded and stored in its system, due to the risk that most of their quantities would end up dumped into its warehouses, as buyers were becoming less willing to accept them for next year's supplies. On November 11 the LME finally decided not to put a ban, as a significant portion of the market was still planning to buy the country's metals in 2023. The recent return of lockdowns and covid-related restrictions in China softened expectations for a demand revival in metals. On the other hand, the latest reports suggest that the ongoing virus controls are affecting operating rates at significant aluminium fabricators in certain provinces of the country (e.g. Guangdong). Given the already very high level of aluminium production in China in 2022 and the fact that LME has recently decided after an internal inquiry process to continue storage and trading of Russian metals, there are no foreseeable factors pushing aluminium prices up in the period ahead.

Steel-Iron[3] and Iron Ore[4]

Steel production is based on iron ore and/or scrap. Furthermore, semi-finished iron or non-alloy steel products, are intermediate products and need further processing in order to be converted to final steel goods. Both Russia and Ukraine held prior to the war world-leading positions to exports of iron ore and semi-finished iron.[5] In 2020, Ukraine provided 3.0% of global exports of iron ore (4th highest share globally) and Russia 1.45% (7th share), whereas in the same year these countries were by far the world's leading exporters of semi-finished iron, with 18.8% (Russia) and 12.7% (Ukraine) respectively. Furthermore, Russia was also a major exporter of final iron and steel products, with a share of 4.8% (5th share). These figures clearly depict the importance of both countries for the steel and iron production globally. Steel trading takes place on the London Metal Exchange (LME) and the New York Mercantile Exchange (NYMEX).

Regarding the importance of Russia and Ukraine iron ore and steel production for the EU, 29.9% of EU iron ore imports in 2021 ($4.86bn) came from these two countries, mainly from Ukraine (17.3%). Furthermore, in 2021, 20.7% of total final steel products imports in the EU (6.28 million MT) came from the two countries, mainly from Russia (12.3%).[6] As part of the fourth package of sanctions to the Russian Federation, the EU

[3] HS 2-digit classification code: 72
[4] HS 4-digit classification code: 2601
[5] HS 4-digit classification code: 7207
[6] European Steel in Figures 2022, The European Steel Association, Eurofer https://www.eurofer.eu/assets/publications/brochures-booklets-and-factsheets/european-steel-in-figures-2022/European-Steel-in-Figures-2022-v2.pdf

banned the import of certain steel products (rolled steel and pipes) from Apr 1, 2022. The eighth package of sanctions, imposed on Oct-22, expanded the list of such restrictions, but postponed their entry into force to the least until Sep 23.

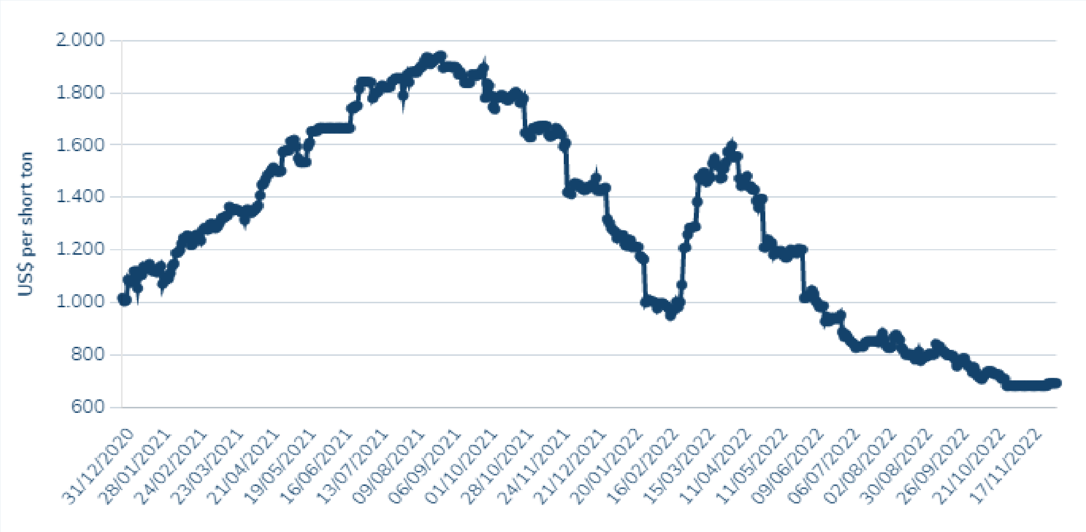
On the exchange markets side, the 2-month hot rolled coil (HRC) steel futures for purchases from China, the world's biggest exporter, had hit in May 2021 a multi-year high (~$1060 per tonne, Figure 4),[7] as the country was rapidly recovering from the first wave of the pandemic because of various factors, including strong reheating of the construction sector activity. The increase of electronic vehicles production globally was another factor boosting steel demand. These trends in the demand side were combined with higher prices of iron ore, accounting for close to half of steel's production cost, by over 40%YoY in the Jan to mid-May-21 period. Up to early June 21, the price of 2-month China HRC futures had declined by almost 17%, to $880/t and fluctuated somewhat higher than this level until Oct-21. In the next month the price fell by another 22.6%, to $725/t, ca 32.5% lower compared to May's multi-year highs. The main driver of the easing of prices during May – Nov-21 was restrictions placed on steel productions in China by policymakers, in order to lower pollution ahead of the 2022 Winter Olympics in Beijing, pushing down demand for iron ore and significantly lowering its prices (-50% in Jul-Sep-22). However, up to Oct-21 steel prices and profit margins were relatively unchanged for a 5-month period, as strong demand persisted. The significant weakening of sentiment in the property development sector in China in Q4 2021 pushed further down demand for steel, weighing on prices and profit margins. In the US, rising energy costs, oversupply and weak demand, were the main causes behind the sharp decline of the LME 2-month US HRC futures in H2 2021 by 51.2%, at $950/t (Figure 5).

Figure 4: LME Hot Rolled Coil FOB China (Argus) steel (2-month futures)

Source: London Metal Exchange, Eurobank Research

[7] Analysis based on futures prices from the London Metal Exchange (LME)

Figure 5: LME Hot Rolled Coil FOB N America (Platts) steel (2-month futures)



Source: London Metal Exchange, Eurobank Research

Mainly because of the above developments in H2 2021, iron ore and steel prices fluctuated at relatively low levels in early 2022. The war in Ukraine led to a strong increase of steel futures in its first two weeks, especially those for US steel (LME 2-month China HRC futures: +19.2%, at $950/t, LME 2-month US HRC futures: +55.2%, at $1480/t). The rise in US steel continued up to early April, reaching $1600/t, however, on a yearly basis the increase of prices was less pronounced (+18.5%). The more intense and prolonged price hike in US products was attributed -besides the Ukraine crisis- to an increase in raw material pricing and shortage of labour.[8]

Steel prices eased significantly afterwards in the US, whereas a more gradual fall had started in China since Mar-22. During April-May of this year, 2-month US HRC futures in London declined by 37.5%, to ~$1.000/t, remaining on a moderate downward trend up to end-August (another -17.3% compared to May, to $828/t). A new phase of decline started in September, resulting up to the beginning of December to cumulative losses of ca 19% and multi-year low levels (~$682/t). Fears over a recession in the US, after two consecutive quarters of negative QoQ GDP change (Q1-Q2 2022) and weakening manufacturing and housing indicators, kept many buyers on the sidelines up to August, afraid of being saddled with overpriced steel inventories should the downturn intensify. Rapidly rising interest rates on the back of persistently high inflation have deteriorated sentiment further. Currently, many US steel producers share the view that the price of HRC could be below $650/t in early-2023, even reach pre-pandemic levels ($500-600/tonne), as high interest rates will weigh significantly on housing and investment in general, but also on consumer demand for manufacturing goods. The only upside risk is associated with possible electricity and natural gas shortages that could restrain steel production, thus limiting supply to the markets.

Turning to developments in steel production in China during the war, the decline of property investment was the main cause of the rapid reverse of the steel price uptake after the blast of the war in Ukraine and its fall in H1 2022 and up to July. According to the National Bureau of Statistics of China, investment in property development went down by 6.4%YoY in Jan-July 22. From early March to mid-June, the LME 2-

[8] https://www.industrialtube.com/blog/2022/04/12/the-state-of-steel-april-2022/

month China HRC futures fell by 39.5%, at ~$575/t. A new decline phase started in October, up to mid-November, resulting to a fall to 12.6% (to $520/t), associated mainly with the resurgence of lockdowns in many cities of China. According to experts, China's pig iron and steel production will continue falling in both November and December due to weak end-user demand because of the winter season and the government's demand to cap production at 2021 levels. Some steel market participants expect new construction sales to recover in 2023, mainly due to the low performance of 2022. However, according to a recent report by S&P, any serious measures to stimulate demand are expected to be announced no earlier than in March next year.[9]

Coal[10]

Coal is primarily used as fuel to generate electric power. In coal-fired power plants, bituminous coal, subbituminous coal, or lignite is burned. The heat produced by the combustion of the coal is used to convert water into high-pressure steam, which drives a turbine producing electricity. The significance of the Russian coal production for global supply was highlighted in the introduction of this special topic. In addition, the EU was in 2021 the largest importer of Russian coal, with 51.86 million metric tons (24.57% of total exports from Russia). In 2020, EU imports from Russia accounted for 46.7% of its total coal imports, by far the highest share among the countries of origin of imported coal. In response to Russia's invasion of Ukraine, the US announced a ban on Russian coal imports in March. The EU followed with a similar decision in early April, as part of the fifth package of sanctions against Russia, however the embargo was set to start on August 10. Some Japanese and South Korean utilities also announced they would no longer buy Russian coal. Together, the EU, Japan and Korea accounted for about 44.4% of Russia's 2021 coal exports.

Regarding trends in coal spot prices, after falling in 2020 due to the implications for the global economy of the restrictive measures for the pandemic, they rebounded throughout 2021, especially in H2, as supply could not increase quickly enough to meet the big jump in demand, particularly in China. In early Oct-21, the Argus/McCloskey's Coal Price Index (ARA API2), which tracks cost, insurance, and freight (CIF) prices, climbed to an unprecedented $274/t (Figure 6). To narrow the gap between demand and supply, China boosted coal production in H2 2021. In combination with setting a coal price cap, at 700 yuan/t, by the end of the year, coal prices had eased significantly, at the area of $120/t, however on an annual basis they were 69% higher. Prior to the war, in Jan-22, in response to domestic shortfalls as producers focused on higher-priced exports, the government of Indonesia, the world's second biggest coal producer-exporter, suspended exports, causing prices in the Asia-Pacific region to rise back to the high levels of Oct-21, as well as a broader price increase (API2 CIF at $178/t in end-Jan-22).

The shock of the war in Ukraine and the following sanctions against Russia, especially from the US, drove coal prices to a new all-time high in Mar-22 (ARA API2 CIF at $438/t on March 9). That said, Chinese prices were less affected by Russia's invasion, owing to subdued domestic demand and enhanced production, under the government's guidance since Dec-21, easing inflationary pressures also elsewhere. With the end of the heating season in the northern hemisphere, seaborne thermal coal prices eased slightly in Apr-22 (CIF ARA at 281.5/t). But, as Russia reduced gas flows to the EU in Q2 2022, fears over a complete cut off

[9] https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/metals/111022-poor-steel-mill-margins-in-china-diminish-demand-for-low-alumina-cargoes
[10] Standard International Trade Classification (SITC) code: 503222

elevated. These were reinforced by the EU decision in end-May to ban most Russian oil imports by Dec-22, prompting European energy companies to buy more coal and pushing prices up, with the API2 CIF reaching $370/t in June. Flooding in Australia in Q2 2022, the world's second largest coal exporter, also hampered production and disrupted supply networks. Successive interruptions in Nord Stream 1 flows in July and August and eventually its shutdown in Sep 1, predominantly the launch of the EU coal embargo in August 10, sustained coal prices in this period around June's high levels.

Figure 6: Argus/McCloskey's Coal Price Index (ARA API2 CIF)

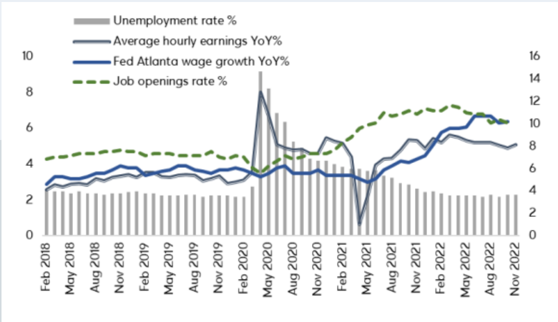
Source: Bloomberg, Eurobank Research

The prices of key thermal seaborne coal grades deteriorated from mid-September to November, amid signs that supplies will be sufficient to meet winter demand in both Europe and Asia (e.g. no harsh autumn), returning to levels prior to the war in Ukraine. The extension of the coal price cap in China in 2023 decided in Nov-22, at 675 yuan/t, and the implications of recurring lockdowns for the country's economic activity, are deterring factors to a rise in coal prices in late-2022 and the beginning of 2023. Indonesia and India have announced higher production targets for next year, as part of their goal to meet domestic needs internally, thereby reducing their supplies from the Asian thermal coal trading markets, but also leaving more space for the rest of the market participants.

US

The economy continues to expand solidly, but risk of recession non-negligible

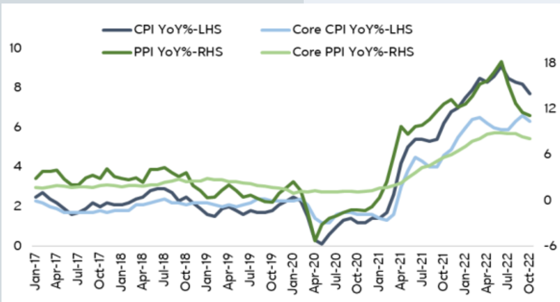
Figure 7: Limited evidence of material slowing in labor market conditions



Source: BLS, Eurobank Research

According to the final estimate, US Q3 GDP was revised up to an annualized rate of 2.9%QoQ from 2.6%QoQ previously, marking a turnaround in economic activity after a 1.1% annualized GDP decline in H1. Details of the revision were generally indicative of stronger demand, with real final sales to domestic purchasers (GDP excluding inventories and net trade) re-estimated at 0.5% from 0.1%, while net exports continued to account for basically all of the GDP growth (+2.93ppts). Challenging expectations of a near-term US recession amid tighter financial conditions, the majority of hard data released over the past few weeks has come in fairly strong, pointing to continued expansion, except for the real estate sector which continues to falter in the face of multi-year high mortgage rates. Reflecting solid household demand, October retail sales advanced by a hefty 1.3%MoM, while real personal spending grew by a nine-month high of 0.5%MoM, faster than the 0.4%MoM increase in personal income, as a persistently tight labor market allowed households to continue whittling away excess savings (household saving rate down by 0.1ppt in October to a 17-year low of 2.3% as a percentage of disposable income). Economic resilience, among others, was also evident in October new orders for durable goods which rebounded by 1.0%MoM, more than offsetting September's 0.9%MoM decline. In contrast to encouraging hard data which give the Fed the green light to raise rates substantially further into restrictive territory while awaiting concrete signs of a softening in labor market conditions and price pressures, soft indicators mostly surprised to the downside. These include the November ISM Manufacturing PMI which dropped into contraction territory for the first time since May 2020 (-1.2ppts to 49.0), suggesting that the risk of a US slide into recession in the not-too-distant future is non-negligible, as the impact of tightening Fed policy will be mostly felt in the period ahead (given the lags of monetary policy). Meanwhile, consumer price inflation decelerated sharply in October, though still well above target (headline and core CPI down to 7.7%YoY and 6.3%YoY, respectively), supporting expectations that the peak has probably passed, and the Fed could slow the pace of rate tightening in the upcoming policy meetings. However, as Chair Jerome Powell reiterated recently, the terminal interest rate would likely need to be "somewhat higher" than expected in September, while restoring price stability would likely require holding rates at restrictive territory for "some time".

Figure 8: US inflation peak has likely passed



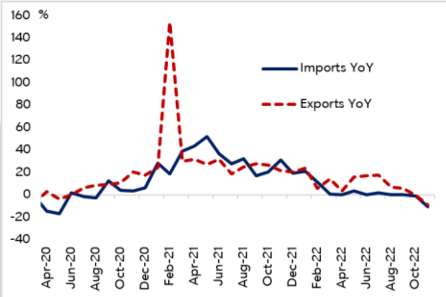
Source: BLS, Eurobank Research

China

Zero-Covid policy finally, though gradually, into the ditch

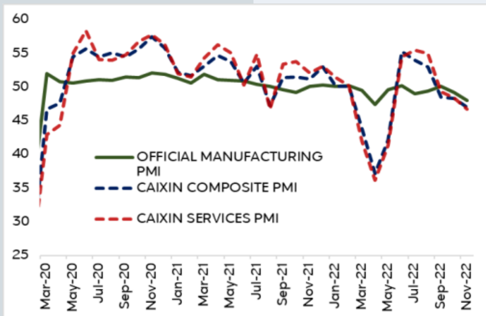
The social unrest across the country against lockdowns, following the resurgence of Covid-19 cases in late November, triggered the long-waited abandonment of the Zero-covid strategy which was also decided on an adjacent basis, that of the adverse impact it had on the economy during the past 2.5 years. In early December, the Politburo pledged for a turnaround in the economy in 2023 with the absence of any reference to zero covid in its official statement read by markets as a pivot to the beginning of cohabitation with the virus. The announcement came after the release of sliding November PMIs while the disappointing exports data for the same month bode well for the said widely anticipated decision as apparently the weakening in external demand needs to be counterbalanced by unleashing the domestic pent-up demand. Imports also disappointed as they also shrunk, suggesting that the Covid-related restrictions weighed on both supply chains and household spending. In detail, exports and imports contracted by 8.7%YoY and 10.6%YoY in November, respectively, following the milder contractions of 0.3% and 0.7% in October, while both prints came visibly below market expectations. Returning to PMIs, all - excluding the Caixin manufacturing which stayed almost stable, but still below the 50 threshold - faltered, remaining into contractive territory, beating the market consensus to the downside, and implying that the rift in the economy can get deeper for as long as restrictions remain in place. All in all, the exit from zero-Covid strategy had turned into an aged demand, well-grounded from an economic and social necessity perspective. Nevertheless, there are reasonable fears that the new modus vivendi and operandi under a looser approach against Covid-19, jointly with little natural immunity and modest levels of vaccination among the eldest and more sensitive groups of population, will come with an influx of cases and given the infectiousness of the current Omicron strain, will put the health care system under serious stress. That said, some hence and forth in the loosening of restrictions cannot be ruled out, with any social and economic cost this may bring. In a nutshell, even though the transition to the new status quo carries critical perils, markets embraced positively the movement relaxations in Beijing and Shanghai in early December, as those were interpreted as the first step towards loosening; in a knee-jerk reaction, the yuan appreciated against the dollar pushing the USDCNY cross below the 7 mark for the first time since mid-September, while bourses in major Chinese and affiliated cities, such as Shenzhen and Hong Kong also briefly gained.

Figure 9: Exit from Zero-Covid policy imposed by faltering trade data …



Source: Bloomberg, Eurobank Research

Figure 10: …and gloomy forward-looking PMIs, among other factors



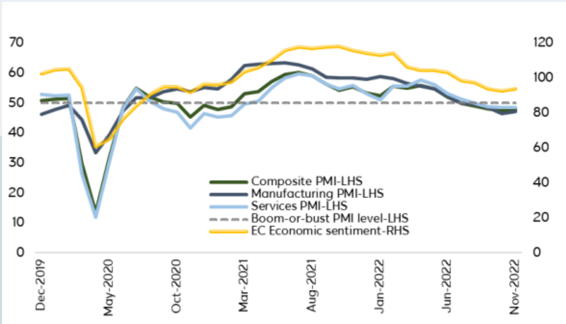
Source: Bloomberg, Eurobank Research

Euro area

Still poised for a recession, but likely a mild one

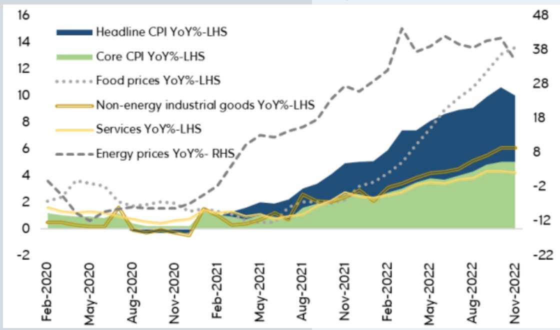
Eurozone composite PMI marginally improved in November for the first time in seven months, coming in at 47.8 from October's 47.3. The unexpected bounce was driven by manufacturing (47.1 vs. 46.4), on the back of a further easing in supply chain disruptions as well as reduced fears over winter gas shortages amid mild weather and high European gas storage levels (around 95%, above the minimum EU target), irrespective of an edging down on services (48.5 vs. 48.6). In spite of the November increase, the composite PMI remained below the critical level of 50 for the fifth consecutive month, while key forward looking components, including output across both the manufacturing and services sectors, stood at very low levels. That said, after GDP unexpectedly grew in Q3, the Eurozone economy still seems poised for a recession, though a mild one, starting in Q4, as persistently elevated price pressures erode consumer purchasing power and higher energy prices squeeze firms' profit margins. In support of the above, the EC economic sentiment was up by 0.1ppt to 93.7 in November, the first increase since the start of the Ukraine war, owning to consumer confidence which bounced by 3.6ppts to -23.9, but still remained not far from September's -28.7 all-time low. Reflecting a pretty gloomy consumer mood, retail sales dropped by a near one-year high of 1.8%MoM in October, with the carryover for Q4 standing at -1.3%QoQ. Meanwhile, headline inflation surprised to the downside in November, dropping from October's 10.6%YoY record high to 10.0%YoY, the first deceleration since mid-2021, mainly due to lower energy prices. However, uncertainty prevails about the path of headline inflation, not only because of the high volatility in energy prices, but also because some government measures adopted to cushion the impact of higher energy prices expire at the end of this year. Furthermore, there are no signs of underlying inflationary pressures waning yet, as core inflation remained stubbornly high at 5.0%YoY, with goods inflation flat (6.1%YoY) and services inflation easing slightly (4.2%YoY vs. 4.3%YoY). That said, it is too early to conclude that inflation has already embarked on a sustained downward trend. Yet, this might not prevent the ECB from slowing the pace of rate tightening at the 15 December meeting to 50bps as the tightening cycle is closer to the terminal rate, while compounding this with the announcement of the start of QT from early next year.

Figure 11: Forward looking indicators still point to a recession, but likely a mild one



Source: European Commission, Bloomberg, Eurobank Research

Figure 12: Headline CPI falls in November on lower energy inflation, while core CPI remains stubbornly high



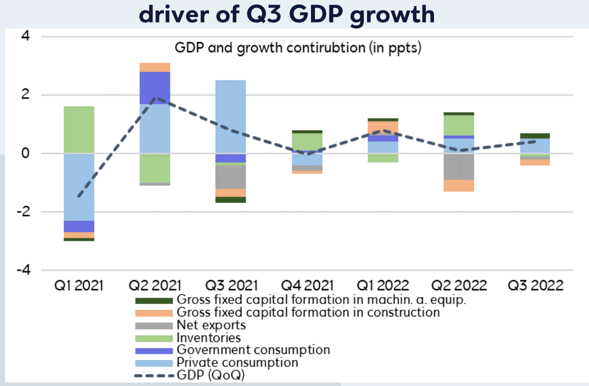
Source: Eurostat, Eurobank Research

Germany

The expected growth downturn is likely to be less pronounced than earlier feared

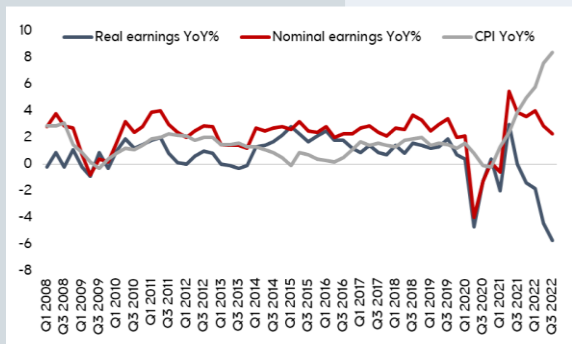
German Q3 GDP was revised modestly higher to 0.4%QoQ from 0.3%QoQ in the flash estimate, with the economic output rising above the pre-pandemic level for the first time (100.3% of Q4 2019), despite the economic headwinds posed by the slowing global growth momentum, ongoing supply chain disruptions, tighter financial conditions, and elevated price pressures. Private consumption was the main growth driver (+1.0%QoQ, +0.5ppt), thanks to strong pent-up demand for services after the reopening of the domestic and foreign economies, while investment in machinery and equipment was the second biggest positive contributor to GDP growth (+2.7%QoQo, +0.2ppt). However, as suggested by recent leading survey indicators and high frequency data, growth prospects look gloomy, and the positive Q3 GDP growth print has likely delayed rather than postponed a looming recession. Retail sales dropped by a hefty 2.6%MoM in October after embarking on a sustained weakening trend in March, GfK consumer climate, though slightly improved in December (-40.2), remained close to October's -42.8 historical low and real earnings dropped by 5.7%YoY in Q3 for the fourth consecutive quarter, marking the longest declining streak ever. That said, private consumption growth momentum is unlikely to be sustained in Q4, especially as inflation is expected to stay in double digits in the coming months, continuing to erode consumer purchasing power. Headline CPI fell in November for the first time in four months to 10.0%YoY following October's 70-year high of 10.4%YoY, solely driven by lower fuel and heating oil prices. However, inflation has likely not reached a peak yet. Food prices continued to rise strongly in November, while the price-fixed contracts of retail customers for gas and electricity that expire at the end of the year, will be adjusted in January to the post Ukraine-war levels. Meanwhile, rising interest rates, high energy prices and weakening external demand, pose headwinds for machinery and equipment investment. Overall, 2022 GDP is expected at 1.6%YoY after a drop of c. 1.0%QoQ in Q4, before contracting by 0.6%YoY in 2023, less than 1.1%YoY previously projected, as the anticipated economic downturn is likely to be less pronounced, thanks to reduced gas rationing risks amid high storage levels and the recently announced government fiscal support via energy price caps from March 2023, with retroactive payments for January and February.

Figure 13: Private consumption was the main driver of Q3 GDP growth



Source: Federal Statistical Office, Eurobank Research

Figure 14: Real earnings declined in Q3 for the fourth consecutive quarter



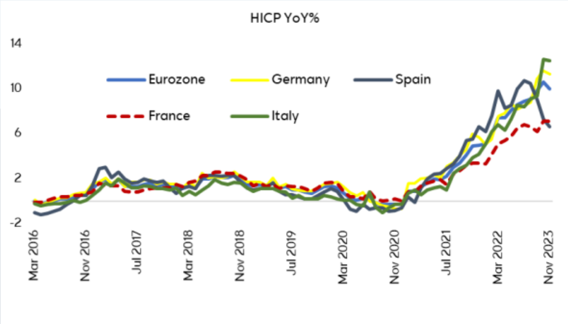
Source: Federal Statistical Office, Eurobank Research

France

GDP expected to slow further in Q4, before entering a mild recession in early 2023

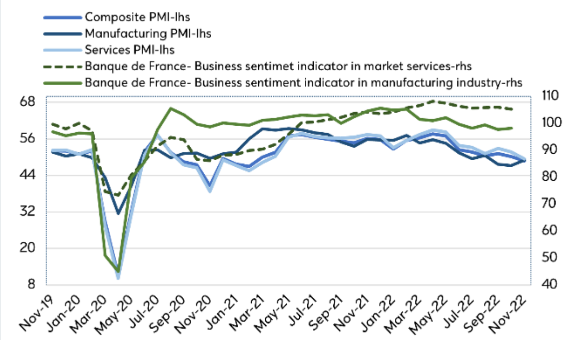
After having bounced in Q2 rising by 0.5%QoQ following a -0.2%QoQ contraction in Q1, GDP decelerated again in Q3 growing by a meagre 0.2%QoQ. Net trade was a drag on growth as the post-pandemic boost from foreign tourism has started to fade, while household consumption was flat after a rise of 0.3%QoQ in Q2, suggesting that rising inflation —though far lower than in many other major EA economies thanks to the various measures taken by the government to caution the impact of higher energy prices— has started to weigh more markedly on consumer purchasing power. Looking ahead, sentiment indicators suggest that economic momentum will ease further in Q4 as the post-pandemic boost to the service sector — France's growth engine — has come to an end, though government support measures and solid conditions in the labor market (unemployment at a more than a decade low of 7.3% in Q3) will likely prevent the economy from entering negative growth territory. Indeed, the composite PMI fell from 50.2 to 48.8 in November, pointing to the first contraction in the private sector since February 2021. While the manufacturing PMI rose from October's 2 ½ year low of 47.2 to 49.1, the services PMI unexpectedly fell into contractionary territory for the first time in 20 months, reaching 49.4 from 51.7, in line with the business surveys of the Bank of France which suggested a slower pace of expansion in services in October, a trend that is projected to continue in November. However, looking into early 2023, the prospect of the economy entering into a recession, though a mild one, seems likely, as the headwinds it is currently facing are expected to intensify, especially on the view that the energy crisis is set to weigh more significantly due to the government's waning support (both regulated electricity and gas prices will increase by 15% in January and February, respectively, and then be capped for the remaining of 2023, while rebates on fuel prices will be abolished and will be replaced with more targeted support measures). Meanwhile, President Macron managed to pass the 2023 budget through parliament by using article 49.3 of the constitution after surviving two non-confidence motions. The next hurdle the government has to face is whether it will manage to secure parliamentary approval of several upcoming laws regarding key policy issues, including the pension reform, that plans to present early next year.

Figure 15: French inflation remains lower than in many other major EA economies



Source: Eurostat, Eurobank Research

Figure 16: Sentiment indicators point to continued expansion in Q4, but at a slower pace



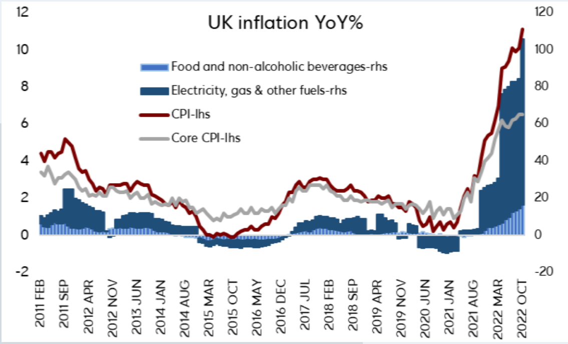
Source: Banque de France, Bloomberg, Economic Research

UK

Q3 GDP contraction likely marks the start of a prolonged recession

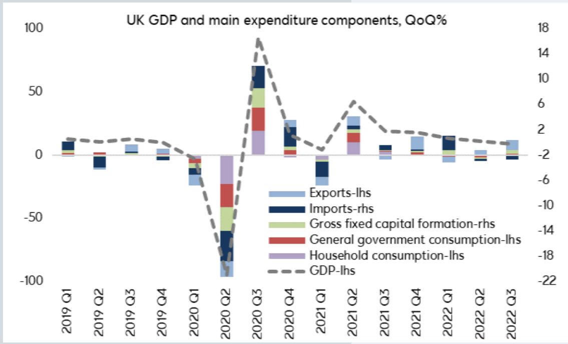
UK headline CPI surprised to the upside in October, rising by 1ppt to a 41-year peak of 11.1%YoY, driven mostly by a further increase in energy prices. Reflecting a hefty rise of 5.3%YoY in domestic housing and household services as a result of rising household energy bills, gas and electricity inflation rose from c. 70%YoY in September close to 90%YoY, an increase which would have been higher, though, had the government not introduced the Energy Price Guarantee. Food and non-alcoholic beverages also made an upward contribution to inflation, rising from 14.5%YoY to 16.2%YoY, the highest in excess of 42 years. Pointing to persistent underlying inflationary pressures, core inflation was flat at 6.5%YoY, but above consensus of 6.4%YoY, as a drop in non-industrial goods (6.7%YoY from 7.0%YoY) was more than offset by an increase in services (6.3%YoY from 6.1%YoY) mainly on the back of higher wages (weekly earnings of 5.7%YoY 3month average in September). After the announcement of the UK government's Autumn Statement that envisioned, among others, an extension of a cap level for the average household energy bill from April 2023 to March 2024 (from £2500 to £3000 as of October 2022), headline inflation has likely reached a near-term peak in October, beyond which it is seen gradually decelerating on the back of an expected decline in core goods and energy inflation, though moderately, as food prices and services inflation are seen remaining elevated. That said, further BoE rate hikes would be required over the coming months for a sustainable return of inflation to target. However, risks of a slower pace of rate tightening ahead have increased after November's 75bps hike, the highest in decades, given the BoE's recent relatively dovish commentary and the significant fiscal consolidation of £55bn per annum by 2027/28 (c. 2% of GDP) presented in the Autumn Statement to ensure the sustainability of fiscal finances. But as price pressures are expected to remain elevated and interest rates to rise further while the external environment is weakening, headwinds to economic activity will likely intensify, pushing the economy into recession after GDP dropped by -0.2%QoQ in Q3, the first negative print since the pandemic (Q1 2021). According to the OBR, Q3 GDP marks the start of a five-quarter recession with a peak to trough fall of 2.1%, slightly less pessimistic, though, than 3% the BoE's November MPR forecasts envisioned.

Figure 17: October print likely marks a near-term peak for inflation



Source: ONS, Eurobank Research

Figure 18: Q3 GDP contraction marks the first negative growth print since the pandemic



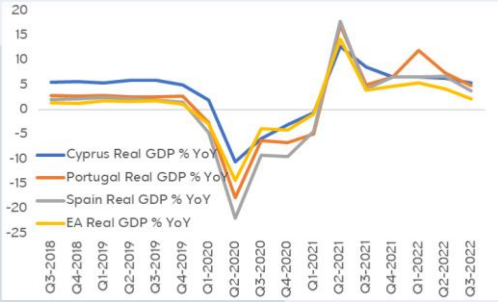
Source: ONS, Eurobank Research

Cyprus

Growth slowdown in Q3 2022 from weakened exports and fixed investments

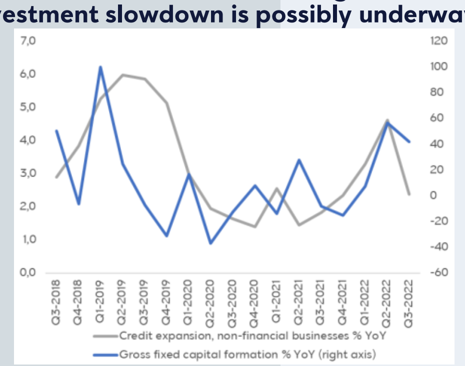
The strong growth momentum in Cyprus in H1 2022 eased in Q3 2022, as output expanded by 5.4%YoY, after an increase of 6.3%YoY in Q2 2022. However, on a quarterly basis, GDP expansion accelerated to 1.3%QoQ, from 0.3% in Q2 2022. Growth came for another quarter mainly from an increase in exports (+11.5%YoY), especially of services (+12.6%YoY), as tourism receipts reached 91.8% of their 2019 level, with the rise, however, moderating compared to Q2 (+17.5%YoY). Furthermore, the external balance deteriorated on a yearly basis in Q3 2022, posting a deficit of €9.8mn, instead of a surplus of €298mn a year ago, as imports expanded by 18.5%YoY. The pick-up of investments (+42.4%YoY) was the second most contributing factor to growth in Q3 2022. That said, it stemmed almost entirely from higher inventories (+€317.2mnYoY), as gross fixed capital formation expanded marginally (+€24.7mnYoY), posting a strong deceleration (+2.3%YoY vs +29.8%YoY in Q2). Despite all-time high inflation (9.7%YoY), household consumption widened by 6.9%YoY, slightly less than in H1 2022 (+7.8%YoY) and public consumption increased further (+2.6%YoY against +0.4%YoY in H1). The escalation of decelerating trends in the main growth drivers in Q3, namely tourism and investments, constitutes the most significant negative risk in the period ahead. As highlighted in previous issues, the higher level of tourism receipts in Q4 2021 compared to Q3 2021 in seasonally adjusted terms, will weaken exports growth in Q4 2022, adding to the adverse momentum in the global economy on exports. The strong deceleration of credit expansion towards non-financial businesses since past May, resulting to a 21-month low in October (0.3%YoY, against 5.2%YoY in May), signifies a potential further slowdown in investments in Q4 2022. This trend is linked to the protracted debate about the extension of the foreclosure suspension, weighing on the banking sector (e.g. through limiting NPL sales), but also inhibiting progress in the milestones related to the country's RRP and future RRF disbursement. Another source of uncertainty in the near term is the outcome of presidential elections on Feb-23. On the other hand, fiscal overperformance in 2022, also highlighted in the recent EC post-programme surveillance report, strengthens confidence. Considering these developments, we expect average GDP growth in 2022 at 5.3%.

Figure 19: in terms of GDP growth, Cyprus performed better in Q3 2022 to peripherical peers and the EA average



Source: Eurostat, Eurobank Research

Figure 20: as fixed investments follow the trend in business credit with a time lag, a further investment slowdown is possibly underway



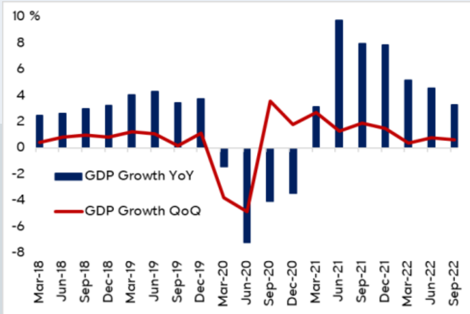
Source: Central Bank of Cyprus, Eurobank Research

Bulgaria

Euro adoption undermined by high inflation, but remains key priority

The final Q3 GDP growth estimate beat to the downside the 3.2% YoY flash estimate released in mid-November and mirrored the anticipated cooling of the economy in the second half of the year. The reading came in at 0.6% QoQ from 0.7% QoQ in Q2 while on an annual basis it dropped to 2.9% from 3.9% and 4.4% in Q2 and Q1 respectively. The breakdown of the GDP components from the expenditure side revealed government consumption and investments as the key drivers of deceleration. With the average 9M2022 GDP growth currently at 3.7%YoY, the FY2022 is expected to stand at 3.0%.

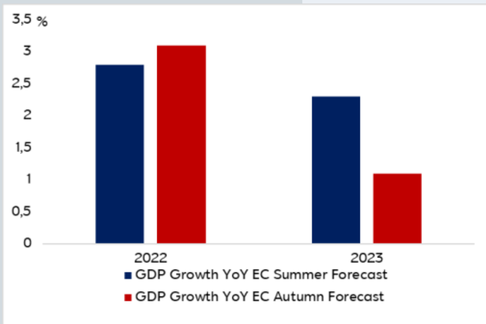
Figure 21: Evident cooling in the economy in Q3…



Source: Bulgarian Statistical Institute, Eurobank Research

However, a more pronounced slowdown is on the cards for 2023 given the overall deterioration of the economic activity in Europe that will negatively affect, primarily, exports, and also hamper the economic sentiment. Additional headwinds in consumption are expected from the uncertainty that prevails in the political landscape with no immediate solution to the lingering impasse expected anytime soon. On the other hand, the tight labor market, with unemployment on a downward trend for at least the past 18 months (historic low of 3.7% in Q3-2022) and the extensive nominal wage increases during the last 6 months (+14.7%YoY in Q3-02022), expected to continue throughout 2023, will support somewhat domestic demand, acting as a counterbalance to the above-mentioned drag. A potential spiral effect between wage increases and already high inflation is deemed manageable as the feed from wages is expected to be kept at bay, given the challenging domestic and external demand dynamics that will avert rapid wage increases. After 20 months of continuing increase, annual inflation in October came in lower compared to the previous month, albeit well above single digit levels; CPI retreated to 17.6% from 18.70% in September and landed a tad below August's print at 17.70%, bringing the YtD average at 15.0%. Despite the slight relief from the eased headline print, concerns remain as the vital food prices component remained on an upward trend, marking a 26.34% annual increase. All in all, the course of inflation is rendered key for the economic outlook in the next couple of years. Letting aside any delays in investment decisions that come along with rapid change in prices for a prolonged period, persistent inflation could also trigger setbacks for the euro adoption. The latter possibility was clearly stated by both Fitch Ratings and S&P recently, with both rating agencies, despite the challenges ahead, affirming the country's sovereign rating at BBB and BBB/A-2 respectively.

Figure 22: … point to a sharper downturn in 2023



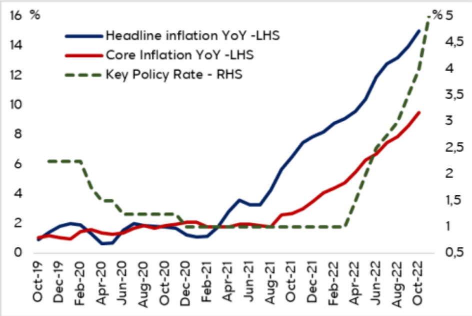
Source: EC, Eurobank Research

Serbia

Final Q3 GDP growth estimate confirms the economic downturn

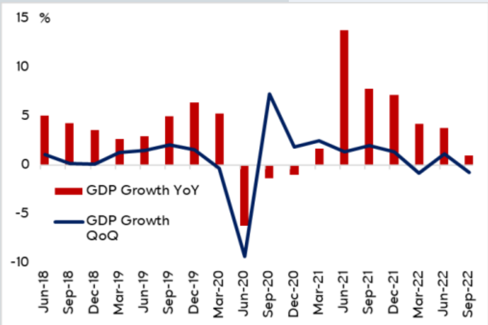
The final Q3 GDP growth estimate came a tad below the 1.1% YoY flash estimate released in mid-November and mirrored the anticipated cooling of the economy in the second half of the year. The reading came in at -0.7% QoQ from 1.2% QoQ in Q2 while on an annual basis it dropped to 1.0% from 1.1% and 4.2% in Q2 and Q1 respectively. The breakdown of the GDP components from the expenditure side revealed consumption, both public and private, and investments as the key drivers of deceleration. With the average 9M2022 GDP growth currently at 2.1%YoY, the FY2022 is expected to stand at 3.0% with October's hard data released so far marking the absence of dynamics that could reverse the downturn; industrial output stood almost still (-0.1% YoY) compared to a 0.3% YoY contraction the month before while retail sales growth remained almost still at 5.0% YoY from 5.2% YoY in September. A more pronounced slowdown is anticipated in 2023 given the weaker global demand but also idiosyncratic factors such as the poorer than expected agricultural crop. The said view is also shared by the EC, the EBRD and the National Bank of Serbia (NBS), as evident in their recent forecasts. In line with market expectations, the NBS proceeded earlier today with an additional rate increase by 50bps bringing the Key Policy Rate to 5.0% amid continuing global cost-push pressure and rising import prices, which are reflected in the latest inflation reading, that of October (15.0% YoY vs 14% YoY and 13.2% YoY in September and August respectively). Since our previous issue, developments also came from the fiscal front as the parliament adopted the revised 2022 budget, that is targeting a deficit to RSD 279.1bn or 3.9% of the projected GDP compared to the initial target of RSD200.2bn or 3% of GDP. Among other factors, the budget had to be revised given the downward revision of the GDP growth forecast for 2022 which at the initial budget was penciled-in at 4.5%, while recently, it was lowered to 3.0% by the Ministry of Finance. In early December, the parliament also started to debate on the 2023 budget which is expected to envisage a milder, compared to this year's, deficit of 3.3% of GDP, under the assumption of a 2.5% GDP growth in 2023.

Figure 23: Inflationary pressures impose continuing monetary tightening...



Source: National Bank of Serbia, Eurobank Research

Figure 24: ... despite the evident cooling in the economy in Q3...



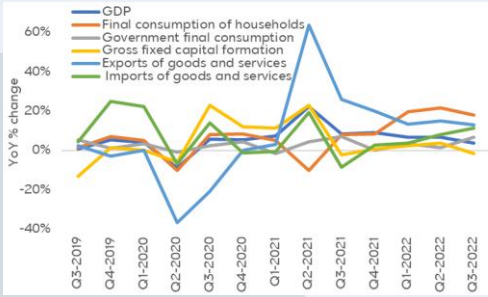
Source: Statistics Office of the Republic of Serbia, Eurobank

Turkey

Increased State support did not avert growth slowdown in Q3

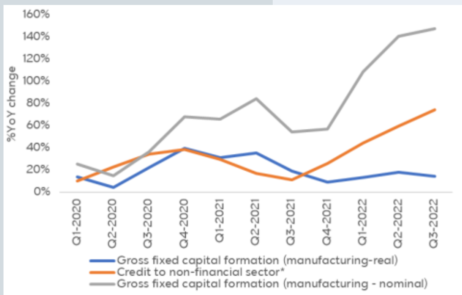
Growth in Turkey eased significantly in Q3 2022, as GDP expanded by 4.0%YoY, down from 6.9%YoY in Q2 2022. The Q3 2022 print was the lowest after the blast of the pandemic in Q2 2020. On a quarterly basis GDP was flat (-0.1%), instead of an increase of 1.9% in the previous quarter. The deceleration on an annual basis was mainly driven by a fall in investment by 1.2%YoY, in contrast to an increase of 3.8%YoY in Q2. Robust household consumption expansion eased somewhat, to 18.1%YoY from 21.9%YoY a quarter earlier, on the back of pressures on real income by soaring inflation. Further Turkish Lira (TRY) depreciation (-20.5%YoY vs USD) and the hikes in energy prices during summer boosted imports (+11.5%YoY from +8.1%YoY), whereas the support to exports from the depreciation weakened, as their widening decelerated to 13.2%YoY from 15.2%YoY in Q2. The much stronger expansion of government consumption, by 7.0%YoY against 1.7%YoY in Q2 prevented a bigger growth deceleration. The trends in the GDP components mainly reflect the implications of the unconventional monetary policy followed by the Central Bank of Turkey (TCMB), with successive policy rate cuts despite surging inflation and capital flights (financial account: 77.5%YoY deterioration in Q3). The caused uncertainty weighs significantly on investment appetite, despite robust credit expansion to the non-financial sector (+74.5%YoY in Q3). Besides, the extensive macroprudential measures on banks, preventing a further depreciation of the TRY and supporting the financing of the Turkish State, put pressures on banks' balance sheets. The benefits of the TRY depreciation are eroding, as the current account balance deteriorates significantly, both the goods and the services components. The strong boost to GDP by domestic consumption despite surging inflation, through successive wage increases and social aid measures, stresses the balance sheets of the private sector and, to a lesser extent, public finance. Most of these negative effects are expected to continue in Q4 2022 and H1 2023. That said the macroprudential measures, to be extended according to the latest Monetary Policy Committee decision on the key rate, will restrain the TRY devaluation and its implications. The continuation of the expansionary fiscal policy, as evident in the increases in social aid spending (+73%) and energy subsidies (+100%) in the 2023 budget, will continue supporting households' income.

Figure 25: Growth decelerated in Q3 2022, from falling investment and decelerating household consumption



Source: Turkstat, Eurobank Research

Figure 26: Ample credit expansion to businesses triggered nominal investment in manufacturing, but the real increase is moderate



*non-financial businesses and individual corporations
Source: Turkstat, Central Bank of Turkey (TCMB), 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	6.0	2.9	2.1	4.7	8.8	6.5									
Advanced Economies															
USA	5.9	1.8	0.4	4.7	8.1	4.3	5.4	3.7	4.6	-3.7	-3.9	-3.3	-10.9	-4.0	-5.7
Eurozone	5.3	3.2	0.3	2.6	8.5	6.1	7.7	6.8	7.2	2.3	0.2	1.0	-5.1	-3.5	-3.7
Germany	2.6	1.6	-0.6	3.2	8.8	7.5	3.6	3.1	3.5	7.4	3.5	4.0	-3.7	-2.3	-3.1
France	6.8	2.6	0.4	2.1	5.8	4.4	7.9	7.7	8.1	-0.8	-1.7	-2.0	-6.5	-5.0	-5.3
Periphery															
Cyprus	6.6	5.3	2.3	2.2	8.0	4.0	7.5	6.3	5.6	-7.2	-8.0	-10.0	-1.8	2.7	2.0
Italy	6.7	3.8	0.3	1.9	8.7	6.6	9.5	8.3	8.7	3.1	-0.1	0.1	-7.2	-5.1	-3.6
Portugal	5.5	6.6	0.7	0.9	8.0	5.8	6.6	5.9	5.9	-1.2	-1.5	-0.9	-2.9	-1.9	-1.1
Spain	5.5	4.5	1.0	3.0	8.5	4.8	14.8	12.7	12.7	0.9	0.3	0.4	-6.9	-4.6	-4.3
UK	7.5	4.2	-0.8	2.6	9.0	8.2	4.5	3.8	4.5	-2.0	-5.6	-6.0	-8.0	-6.4	-4.4
Japan	1.8	1.5	1.3	-0.2	2.3	1.6	2.8	2.6	2.4	2.9	1.6	2.2	-6.7	-6.9	-4.5
Emerging Economies															
BRICs															
Brazil	5.2	2.7	0.8	8.3	9.3	4.9	13.5	9.6	9.6	-1.6	-2.0	-1.8	-4.4	-5.3	-7.7
China	8.1	3.2	4.9	0.9	2.2	2.3	4.0	4.1	4.0	1.8	2.0	1.3	-3.8	-5.7	-5.0
India	8.7	7.0	6.0	5.1	6.7	5.1		*NA*		-1.1	-3.4	-2.7	-6.2	-6.4	-6.0
Russia	4.7	-3.0	-3.0	6.7	13.8	6.2	4.8	4.2	5.0	6.7	10.8	6.7	0.4	-1.7	-2.5
CESEE															
Bulgaria	7.6	3.0	1.8	3.3	15.0	8.2	5.5	4.8	4.9	-0.5	-1.7	-1.5	-3.9	-4.1	-3.5
Serbia	7.0	3.0	2.7	4.1	11.5	8.2	10.1	10.2	9.8	-4.4	-9.0	-8.2	-4.7	-3.5	-3.1
Turkey	10.3	6.0	3.3	19.4	72.0	38.4	12.0	10.7	9.8	-2.2	-4.7	-3.6	-3.2	-4.0	-4.3

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

Eurobank Fixed Income Forecasts

	Current	December	March	June	September
USA					
Fed Funds Rate	3.75-4.00%	4.25-4.50%	4.76-5.00%	4.75-5.00%	4.65-4.90%
3m SOFR	4.47%	4.46%	4.81%	4.79%	4.64%
2yr Notes	4.35%	4.56%	4.56%	4.36%	4.08%
10 yr Bonds	3.55%	4.03%	4.01%	3.89%	3.74%
Eurozone					
Refi Rate	2.00%	2.50%	2.95%	2.95%	2.90%
3m Euribor	1.98%	2.23%	2.59%	2.62%	2.57%
2yr Bunds	2.02%	2.16%	2.26%	2.10%	1.95%
10yr Bunds	1.82%	2.25%	2.36%	2.23%	2.13%
UK					
Repo Rate	3.00%	3.50%	4.15%	4.15%	4..15%
3m Sonia	3.61%	3.62%	4.02%	3.98%	3.86%
10-yr Gilt	3.11%	3.69%	3.64%	3.52%	3.41%
Switzerland					
3m Saron	0.83%	1.11%	1.46%	1.55%	1.58%
10-yr Bond	1.05%	1.42%	1.55%	1.53%	1.48%

Source: Bloomberg (market implied forecasts)

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