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Notwithstanding concerns that the recent banking sector turmoil may lead to some further tightening in bank lending standards and a reduction in credit supply, inflation persistence is keeping pressure on major central banks for further monetary policy tightening. However, uncertainty over banking sector developments has made them more cautious and, though several raised rates further in March, they softened their forward guidance, acknowledging that a further tightening in credit conditions was an approximate substitute for additional rate hikes bringing, thus, terminal rates closer.

Macro Picture

USA: growth continues to expand in Q1, but banking stress will likely drag down GDP in the period ahead

EA: activity has likely regained some momentum in Q1, but banking stress presents a key risk

UK: likely escaping a Q1 GDP growth contraction, though challenges prevail

CESEE: signs of inflation easing but tight labor markets challenge the disinflation process

Markets

FX: EUR/USD aiming for new year-to-date highs as rate differentials are turning in favour of the EUR

Rates: EU and US rates are expected to trade range bound as inflationary pressures are abating while systemic risks rise

EM: sovereign fixed income ended modestly wider with duration likely benefiting from more dovish Fed amid financial sector stress

Credit: calmness returned to markets lately, with investors focusing on the pace of future rate hikes

Policy Outlook

USA: Fed softens its forward guidance amid an expected intensification of tightening in credit conditions

EA: ECB on data-dependent mode amid uncertainty related to financial market developments

UK: BoE pledging to hike further if there is evidence of more persistent inflationary pressures

CESEE: central banks in a wait-and-see mode amid heightened uncertainty

Key Downside Risks

DM: escalating tensions in the banking sector with lasting impact on financial conditions and economic sentiment, persistently high inflation necessitating further monetary tightening, a sustained rebound in commodity prices and supply chain issues, China's recovery stalling

EM: OPEC+ oil cut rattling the inflationary outlook which has begun to approve, increasing borrowing costs tilting debt distress risks to the upside as financial risks mount

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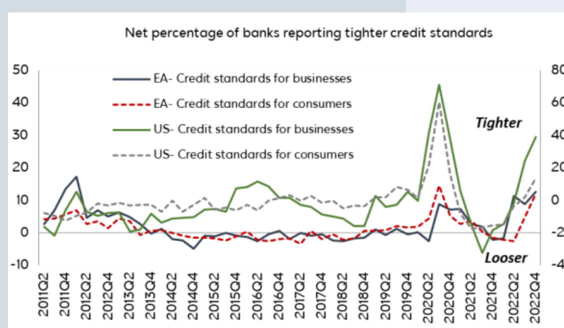
Macro Views
Latest world economic & market developments

Further tightening in credit conditions amid ongoing financial sector stress likely to bring CB's terminal rates closer

Despite concerns that the recent banking sector turmoil may lead to some further tightening in bank lending standards and a reduction in credit supply, incoming data (albeit backward looking as they mostly cover the period before the onset of banking stress in the US and Europe) continue to point to a pickup in global GDP growth in Q1. That said, global manufacturing output PMI continued to expand in March for the second consecutive month, coming in at 50.6, 0.1pt below last month, though still 2.7pts above its November low, while a stabilization in the new orders sub-component and expectations of a further easing in global supply chain pressures ahead, support optimism that the worst of the manufacturing sector is likely behind us, and its gradual recovery that started early this year will remain supported in the coming months.

Figure 1: Credit conditions have tightened materially, even before the recent banking sector turmoil

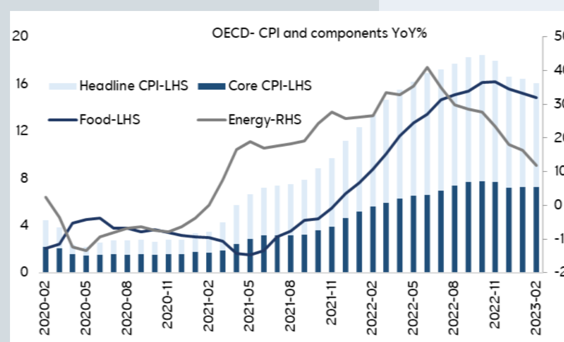


Source: ECB, Federal Reserve Bank of St. Louis, Eurobank Research

With investors still concerned over whether banking sector stress will prove largely temporary and spillovers to the economy limited, it remains to be seen whether upcoming data will continue to show economic resiliency as we head into Q2. Undoubtedly, much will also depend on whether China's firm reopening bounce gathers steam and whether the US and Eurozone retain a positive growth momentum, as persistently high inflation continues to weigh on consumer purchasing power and banking stress might accelerate the pass-through from tighter monetary policy to the real economy.

Notwithstanding ongoing banking worries, inflation persistence is keeping pressure on central banks for further monetary tightening. Global headline inflation continued to decelerate in February as energy prices dipped further and food prices moderated, but core inflation continued to surprise to the upside, remaining sticky and well above central banks' comfort zones, as

Figure 2: Core CPI is proving sticky to come down on persistent labor market tightness



Source: OECD, Eurobank Research

persistent labor market tightness in several major economies contributes to strong wage growth, keeping core services inflation elevated. However, uncertainty about banking sector developments has made several major central banks more cautious after tightening aggressively over the past year, and though some of them raised rates further in March — including the Fed and the ECB — they softened their forward guidance, acknowledging that a further tightening in credit conditions amid ongoing financial sector stress was an approximate substitute for additional rate hikes, bringing, thus, terminal rates closer.

Developed Economies

US: activity data for February 2023, though not as robust as the January data flow, generally reaffirmed that economic growth continued to expand following a slightly downward revised annualized GDP print of 2.6% in Q4 2022 (from 2.7% previously), reflecting favorable economic conditions prior to the recent turmoil in the US banking sector. At the same time, progress in taming price pressures has been slow, as inflation data for February continued to indicate that the disinflation momentum in Q4 2022 has not carried into this year. Though the above could have justified an aggressive hike at the March policy meeting, the Fed adopted a more prudent approach and increased rates by 25bps, amid uncertainty about the economic outlook in light of an expected further tightening in credit standards following the emergence of banking sector stress. The Atlanta Fed's GDPNow model projects annualized GDP growth at 1.7 for Q1, while for the full year 2023, market consensus points to a 1.0% rate, indicating a meaningful decline in economic activity later this year, as banking stress will likely accelerate the pass-through from tighter monetary policy to the real economy.

Euro area: flash March PMIs, the first business survey covering the period after the onset of the banking stress (sample period 10-22 March), surprised significantly to the upside, confirming the improving near-term momentum of economic activity since the start of the year, as it is probably too soon to see spillover effects from increased uncertainty. Meanwhile, hard data available to date have been more mixed, consistent with feebly, though still positive GDP growth in Q1, further supporting optimism that an earlier expected technical recession around the turn of this year, has so far been avoided. However, as evident in bank lending data, ECB monetary tightening is already feeding through the credit channel, while the recent stress in the banking sector could further increase banks' perception of risk, likely leading to additional credit tightening and, thus, introducing additional downside risks for the Eurozone's growth outlook. Amid uncertainty related to the developments in financial markets and their potential impact on growth and inflation outlook, the ECB adopted a data-dependent approach at the March 16 meeting and moved ahead with the previously signaled 50bps hike to tame persistently high inflation.

Emerging Economies

EM: the turmoil in the financial sector of the US and Europe weighted intramonth in the key gauges of EM assets performance, reflecting the broad impact of the incidents with distressed banks on both sides of the Atlantic. The MSCI EM equities index dipped by 5% the next day the takeover of Credit Suisse by UBS was announced (Sunday, March 19) but has erased substantial losses in the period, thereafter, implying that EM investors have digested the stress on the back of positive news such as the economic resilience shown in the US, EA and China in the early months of this year, with some positive spillover of EMs at sight. The respective currency index, the MSCI EM FX, proved more resilient but also recorded losses during March, having recouped some by now, after going through a bumpy February given the USD's strengthening during the said month. The EM bonds space also reacted to the financial sector jitters with the JP EMBI yields index spiking in mid-March but also in early April following the OPEC+ oil cut announcement which casted a shadow over the impact of the decision on oil prices and inflation in turn, not only on the developing universe, but at whole. Along these lines, crosscurrents from China's rebound proceeding and DM solid economic standing from one hand and financial stress, increased borrowing costs and major central banks' uncertain monetary policy deliberations ahead from the other, given the improving but stubborn inflationary landscape, keep the growth outlook broadly unchanged in the wider EM space but also shift the balance of risks as uncertainty increases.

CESEE: fears over an economic slowdown in Q1 in the region are getting corroborated based on released hard data for February. Retail sales in Romania, Hungary and Serbia were on a downturn and so was industrial production in Hungary and Serbia. For those economies that publish PMIs, the manufacturing proxy slid further in Poland, remaining in contracting grounds (48.3) and the same counts for Czechia which remained idle at 44.3 in March. In Hungary, the index also dipped for a second month in a row but way above (55.3) the 50 benchmark that separates expansion from contraction. On the flipside, inflation, while it remains elevated in all peers, has begun to show maigre signs of de-escalation which is embraced positively by regional banks in their decision making over the next steps they have to walk through before they terminate the current monetary tightening cycle, they have embarked upon more than a year ago. Along these lines, central banks of Czechia, Poland, Romania and Hungary that convened during March and early April held fire and adopted a data-dependent stance assessing from one hand the cooling in the economy as evident from hard data and forward-looking PMIs and the mild decompression in inflation from the other. Noteworthy is the exception of the National Bank of Serbia that proceeded with an additional hike, setting the key policy rate at 6.00% from 5.75%, as idiosyncratic factors in the energy sector in the country prevent inflation from sliding. Concluding with a positive development since our latest issue, coming from the sovereign credit ratings front, in late March, Fitch Ratings affirmed Romania's sovereign credit rating, at BBB- but revised its outlook to stable from negative, grounding the improvement, inter alia, on stabilising public debt, gradual fiscal consolidation, and greater political stability.

Markets View

Foreign Exchange

EUR/USD: the euro gained ground against the USD in March on positive Eurozone data, marking a high above 1.0950 and approaching 1.1033 year-to-date peak (February 2). Updated labour cost data for the Eurozone show that wages are now growing at a higher pace than in the US for the first time in a decade and this is starting to be reflected in interest rate differentials as well. Major resistance at 1.1033, which we expect to be broken in the coming months opening further upside. Strong support remains at 1.0750.

EUR/GBP: we see risks skewed to the downside for GBP as the perceived policy divergence will continue to weigh on the currency, as the BoE is likely to pause its hiking cycle. The GBP remains most sensitive to risk markets but has become more correlated to bond yield movements. EUR/GBP remains above the long-term uptrend support line. We expect this to hold and the pair to move towards 0.90 in the medium term.

Rates

EU: swap rates rallied in March due to concerns over a new global banking crisis. In particular the 10y Swap was trading at 287bps at the time of writing down from 325bps at the beginning of the month. The swap curve steepened sharply with 5s30s trading at -55bps up from -75bps at the beginning of the month. Looking ahead, yields are expected to remain range bound assuming no further surprises from the global banking sector. The market is pricing a 25bps hike for the next ECB meeting, but there are voices supporting a 50bps hike as core inflation has remained sticky. The recent decision by OPEC+ to cut production may also contribute to inflation, potentially prompting the ECB to stick to its higher for longer policy.

US: swap rates fell sharply across all tenors during March on the back of the banking turmoil in the US and Europe. The 10-year swap rate fell from 400bps at the start of the month, to 340bps and the yield curve steepened, with 5s30s trading near -35bps in early April, much higher than -80bps at the beginning of March. This steepening was driven by the collapse of SVB, which raised fears over the financial system, leading to an extraordinary government effort to reassure depositors and provide a backstop for other regional banks. Market is now pricing no further hikes for the Fed and almost 80bps of cuts by the end of the year. Looking forward, we expect yields to trade in a range.

Emerging Markets Sovereign credit

Sovereign spreads widened, especially at the short end, as US rates surged on market aligning with the Fed and ECB hawkish rhetoric. However, events with SVB and Credit Suisse led to a more dovish pricing by investors in both EUR and USD rates. This helped EM spreads to tighten and reverse some of the month's losses. The EMBI Global Index closed at 399bps at the end of March, 30bps wider on the month. In CEEMEA,

Romania's latest months' rally paused, while in South Africa the local government bonds suffered some modest losses after the central bank hiked by 50bps with the market expecting only 25bps. In LATAM, Chile and Mexico sovereign bonds were little changed. Concerning the latter, Banxico unanimously decided to slow the pace of hikes to 25bps following its hawkish 50bps surprise in February, bringing the overnight rate to 11.25%. In Asia, Chinese bonds continue to have limited offshore investment interest as global uncertainties maintain a limited risk sentiment. We are cautious but constructive on EM duration in the short to medium term, as the Fed has turned more dovish on financial sector stress.

Corporate credit

During March, global markets posted heightened volatility. Earlier in the month, investor focus was on inflation and expectations for central bank terminal rates, but the narrative changed rapidly after the collapse of Silicon Valley Bank and growing concerns about Credit Suisse, which eventually led to a forced marriage with UBS. As concerns grew about the financial system, investors speculated whether central banks might pause their current hiking cycles. By the end of the month however, there were signs of calm returning to markets once again, with measures of volatility coming down from multi-year highs.

With investors less concerned about aggressive rate hikes, US equities saw solid gains both on a month-on-month (+4%) as well as on a year-to-date basis (+7%) while European equities ended the month flattish, still registering +7% gains YTD. Credit indices ended the month slightly wider on both sides of the Atlantic, but still holding up on a year-to-date basis in both regions. USD credit outperformed vs. EUR and Investment Grade fared better vs. High Yield. Both itraxx Main and Xover ended a tad wider month-on-month (+6bps and +33bps respectively), with European IG 10bps wider March-to-date. Utilities, Energy and Healthcare outperformed (-3.5-4.0bps tighter each) while Snr and Sub Financials were laggards (widening 32bps and 26bps respectively). High Yield was 57bps wider March-to-date with Energy and Industrials faring better (+16-18bps wider each) and Snr Financials and Technology being notable underperformers (widening by 213bps and 185bps respectively). In the US, CDX IG ended flat while HY widened 12bps. USD IG cash ended flattish, with the exception of Snr and Sub Financials, which underperformed (+35-57bps wider) and HY underperformed vs IG.

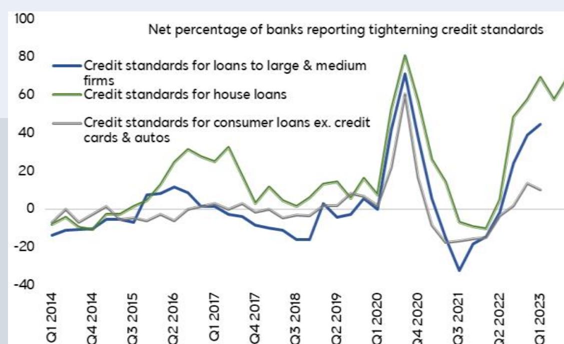
A relative sense of calm has returned to markets since late March, with investor focus remaining on the pace of future rate hikes as they assess whether last month's events prove to be an isolated incident and whether the fallout from the recent financial crisis has translated into a meaningful slowdown of the economy. Following a rather muted March in terms of new issuance, and provided that credit conditions remain fairly good, activity in the European primary market should pick up after the Easter holidays as a slew of new mandates has piled up.

US

Banking stress might accelerate the pass-through from tighter monetary policy to the real economy

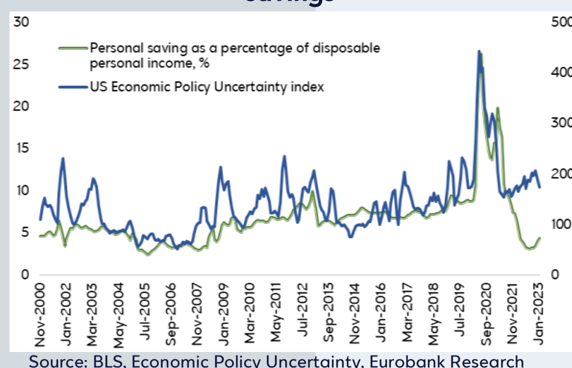
Activity data for February 2023, though not as robust as the January data flow, generally reaffirmed that economic growth continued to expand following an annualized GDP print of 2.6% in Q4 2022, reflecting favorable economic conditions prior to the recent turmoil in the US banking sector. Retail sales declined by 0.4%MoM in February, but the softness of its own print reversed only some of the January's upward revised 3.2%MoM gain, industrial production defied expectations of a monthly decline and held flat, following a solid upward revised 1.3%MoM increase in January, while a variety of housing indicators have firmed in recent months, reversing a small portion of last year's significant weakening, supported by lower mortgages rates from early November to early February (though rates have moved up again in the period thereafter). At the same time, progress in taming price pressures has been slow, as inflation data for February continued to indicate that the disinflation momentum in Q4 2022 has not carried into this year. Headline CPI rose by 0.4%MoM in February, unchanged from January, translating into a 6.0%YoY increase from 6.4%YoY in the prior month, while core CPI accelerated in February for the second consecutive month, rising by 0.5%MoM from 0.4%MoM and taking the annual rate down by a meager 0.1ppt to 5.5%. Core goods prices were flat, but core service inflation remained in an upward trend, rising by 0.6%MoM, mainly driven by an upside surprise in housing prices, though prices in the labor-intensive core services excluding housing category also accelerated, as persistent labor market tightness continues to exert an upward pressure on wages (January's average hourly earnings up 4.6%, above levels historically consistent with the Fed's inflation target). Though the above could have justified an aggressive hike at the March policy meeting, the Fed adopted a more prudent approach and increased rates by 25bps, amid uncertainty about the economic outlook, in light of an expected further tightening in credit standards following the recent emergence of banking sector stress. The Atlanta Fed's GDPNow model projects annualized GDP growth at 1.7% for Q1, while for the full year 2023, market consensus points to a 1.0% rate, indicating a meaningful decline in economic activity later this year, as banking stress will likely accelerate the pass-through from tighter monetary policy to the real economy.

Figure 3: Credit conditions will likely tighten further after the recent banking sector turmoil



Source: Fed, Eurobank Research

Figure 4: Uncertainty over banking developments may also weigh on GDP via increased savings

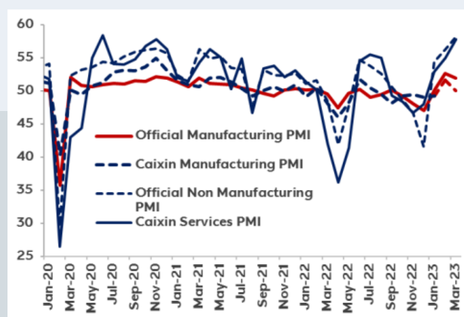


Source: BLS, Economic Policy Uncertainty, Eurobank Research

China

Post-Covid recovery on track with its vigor under stress

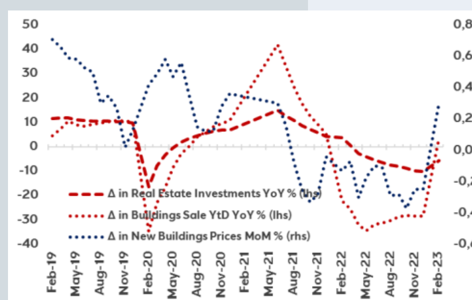
Figure 5: Crosscurrents in PMIs test the vigor of the rebound..



Source: Bloomberg, Eurobank Research

Post-Covid recovery remains on track, but its vigor is put under stress, based on the latest economic activity indicators. Manufacturing PMI, both the official and the Caixin, came in lower in March compared to February with the retreat being more evident in the Caixin print whose questioned sample pertains to export-oriented SMEs while the official index focuses on larger companies. The official gauge stood at 51.9 from 52.6 in February and a few notches above market expectations of 51.6 while the Caixin stood at 50.0 from 51.6 in the previous month and below the market consensus of 51.5. While we remain reluctant, yet alert, to interpret the retreat in March's prints into a troubling signal given the boost in February's readings from the Chinese Lunar Year, the common denominator of both indices, that is the faster growth of orders for the domestic market compared to the new export orders, could prove an omen of further fallout in exports in March from -6.8%YoY year-to-February, underlying the dependency of the current rebound on internal demand. The prevailing optimism during the couple of previous months gets further clouded, albeit modestly, by looking at the unemployment rate which was expected to be somewhat suppressed given the broad reopening of the economy (market expectations at 5.3%), but instead, it rose to 5.6% in February from 5.5% in January, though still below December's 5.7%. Nevertheless, the official non-manufacturing PMI jumped sharply to 58.2 in March from 56.3 in February, with the increase stemming mainly from the construction activity. The said behavior of the index bodes well with year-to-February data which point to a tentative recovery in the real sector, with the latter though not out of the woods yet. Indicatively, home sales contracted by -3.6%YoY year-to-February compared to -24%YoY in FY2022, property investment declined by -5.7%YoY in January-February from -10%YoY in FY2022 with market foreseeing a -8.5%YoY decrease and construction starts shrunk by -9.4% during the same two months vs -39%YoY in FY2022. All in all, indeed there is a concrete base upon which the rebound evolves, but it has not gained, at least not yet, a solid footing. Along these lines, the PBoC proceeded in mid-March with a 25bps RRR cut, stressing out, thus, its intention to "make a good combination of macro policies, improve the level of services for the real economy, and keep liquidity reasonably sufficient in the banking system."

Figure 6: ..amid some relief over the prospects of the real estate sector



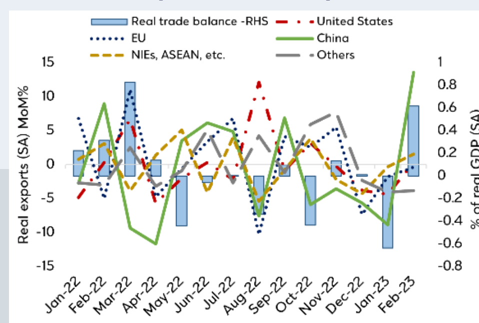
Source: Bloomberg, Eurobank Research

Japan

Recent activity indicators improved while core inflation accelerated

Q4 2022 real GDP growth was revised downwards to 0.0% QoQ from 0.2% QoQ mainly driven by a downward revision in private consumption to 0.3% QoQ growth from 0.5% QoQ, while exports and gross fixed capital formation changes were revised slightly upwards to 1.5% QoQ from 1.4% QoQ and to -0.4% QoQ from -0.5% QoQ respectively. Overall, annual GDP growth in 2022 was revised to 1.0% from 1.1%. Recent activity indicators improved, with preliminary data suggesting a 4.5% MoM increase in industrial production in February from -5.3% MoM in January, recovering part of January's decline. Consumer spending appears getting gradually stronger, as retail sales growth accelerated for a third consecutive month in February, to 1.4% MoM from 0.8% MoM in January. Real exports rose by 1.5% MoM in February from -2.8% MoM in January, thanks to increased demand from China, as economic activity rebounded after Lunar Year holidays. Overall, the trade balance in February as a share of GDP was +0.6%, comparing to -0.6% in January. Leading indicators continue showing a divergence across sectors, with March PMI estimates pointing to a further expansion in services to 55.0 from 54.0 in February and the manufacturing PMI rising from 47.7 to 49.2, suggesting a slower pace of contraction.

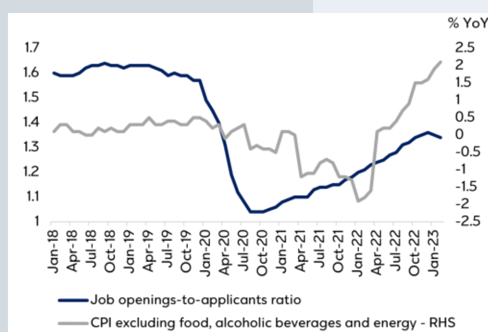
Figure 7: External demand rise in February was driven by increased exports to China



Source: Bank of Japan, Eurobank Research

Focusing on price developments, February headline CPI inflation decelerated to 3.3% YoY from 4.3% YoY in January, mainly due to a fall in energy prices. However, core CPI, excluding all types of food, alcoholic beverages and energy accelerated from 1.9% YoY in January to 2.1% YoY, the highest rate since March 2015, while the equivalent measure for Tokyo stood at 2% YoY in March comparing to 1.7% YoY in February. The persistence in core inflation could be associated with labor market tightness, with the job openings-to-applicants ratio having an increasing trend, despite a mild deceleration over the last two months. Furthermore, preliminary results for the annual spring wage negotiations between unions and employers ("shunto") as announced by the Japanese Trade Union Confederation (Rengo), suggest a deal for an average 3.8% wage hike, the highest since 1993. The prospects of higher wages, in combination with rapidly rising core prices may accelerate monetary policy normalization, turning the BoJ towards a less dovish stance. Finally, 10yr JGB yields fell below the 0.5% cap after the recent banking turmoil, easing pressures for the BoJ which had to purchase large amounts of government bonds over the last months, especially after the tweak in the yield curve control policy last December.

Figure 8: Core inflation accelerated, as labor market tightness persists



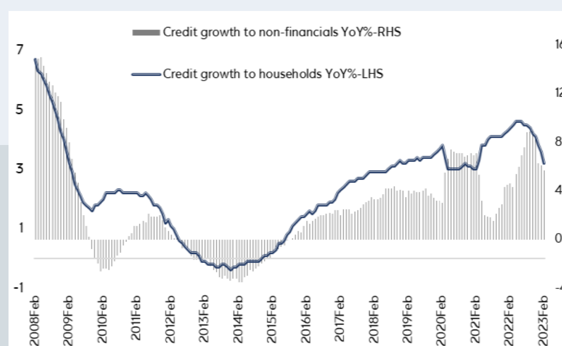
Source: Ministry of Health Labour and Welfare of Japan, Statistics Bureau of Japan, Eurobank Research

Euro area

Banking stress introduces further downside risks to the growth outlook

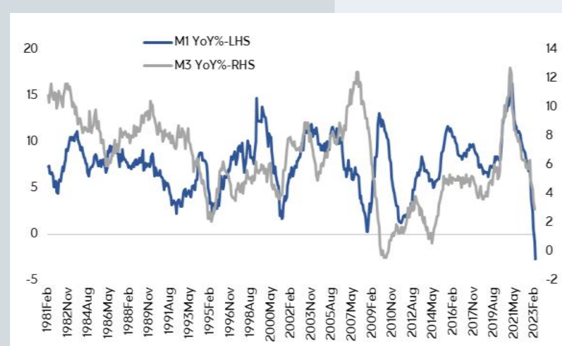
Flash March PMIs, the first business survey covering the period after the onset of the banking stress (sample period 10-22 March), surprised to the upside, confirming the improving near-term momentum of economic activity since the start of the year, as it is probably too soon to see spillover effects from increased uncertainty. Driven by services (+2.3pts to 55.0) that more than offset persistent weakness in manufacturing (-1.2pts to 47.3), the composite PMI rose more than expected, from February's 52.0 to a near one-year high of 53.7 and consistent — according to the S&P Global Market Intelligence — with GDP growth of 0.3%QoQ in Q1. Meanwhile, hard data available to date have been more mixed, consistent with feeble, though positive GDP growth in Q1, further supporting optimism that an earlier expected technical recession around the turn of this year, has so far been avoided. Industrial production rose by a higher than expected 0.7%MoM in January following a 1.3%MoM decline in December, mostly thanks to highly volatile Irish output (9.3%MoM), while retail sales were up by a mild 0.3%MoM in January, translating into a carry-over effect of -0.6ppt into Q1 2023, from -0.9ppt in Q4 2022. However, as evident in bank lending data, ECB monetary tightening is already feeding through the credit channel, while the recent stress in the banking sector could further increase banks' perception of risk, likely leading to additional credit tightening and, thus, introducing additional downside risks for the Eurozone's growth outlook. Bank lending to households (+3.2%YoY) and non-financials (+5.7%YoY) remained in a downward trend in February for the sixth and fourth consecutive month, respectively amid weak loan demand, as suggested by the latest ECB bank lending survey, and tightening lending standards. Monetary aggregates also showed sharp declines in money supply growth, with the so-called narrow money growth M1 — a leading indicator for economic activity — contracting in February by a record high of -2.7%YoY after turning negative in January for the first time ever. Amid uncertainty related to the developments in financial markets and their potential impact on growth and inflation outlook, the ECB adopted a data-dependent approach at the March 16 meeting and moved ahead with the previously signaled 50bps hike to tame persistently high inflation.

Figure 9: ECB monetary tightening is already feeding through the credit channel



Source: ECB, Eurobank Research

Figure 10: Continued decline in money supply growth



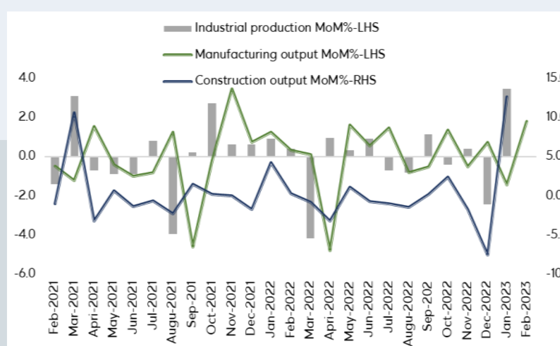
Source: ECB, Eurobank Research

Germany

GDP growth likely to contract in Q1 2023, but less compared to the prior quarter

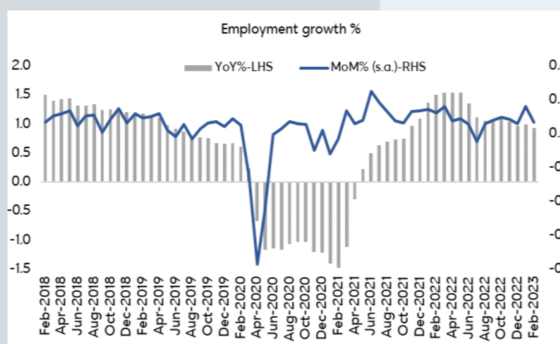
After a GDP growth contration of -0.4%QQ in Q4 2022 mostly driven by a sharp decline in private consumption amid persistently high inflation and deteriorating financial conditions on the back of rising ECB rates, risks seem skewed to a further decline in output in Q1 2023, as the economy continues to face steep challenges. Private consumption is likely to act again as a drag on GDP growth (-1.0%QoQ in Q4 2022) on the view that persistently elevated price pressures should continue to erode purchasing power, as evident in February's retail sales (although they account for around one third of total spending) which unexpectedly fell by -1.3%MoM (note that while real retail sales dropped by 7.1%YoY, nominal sales were up 2.6%YoY, reflecting the drag from inflation). Business fixed investment is also likely to shrink again in Q1 (-2.5%QoQ in Q4 2022) pressured by rising borrowing rates and continuing material scarcity (as evident in the IFO's February survey), while lower global growth should hit exports. However, as also indicated by the Deutsche Bundesbank in its latest monthly economic report, a likely Q1 2023 GDP growth contraction is projected to have been softer than in Q4 2022, thanks to lower wholesale energy prices, government support measures and optimism that inflation has passed its peak (HICP further down at 7.8%YoY in March). The industrial sector is beginning to recover, as production increased by a 1½ year high of 3.5%MoM in January, mainly helped by construction. The labor market continues to look solid (employment growth was kept at around 1.0%YoY in February), and high frequency indicators also point to some improvement in near-term growth momentum. In contrast to the March ZEW survey which showed a substantial deterioration in financial market participants' economic expectations as a reaction to the recent banking stress, the IFO headline business climate index rose for the fifth consecutive month, to 93.3, and the composite PMI advanced by +1.9ppts to a ten-month high of 52.6. Following a shallow recession in Q1, we expect a return of GDP growth to positive territory from Q2, though the overall momentum is likely to remain modest due to the pass-through of monetary policy tightening, setting the stage for a broad GDP growth stagnation this year.

Figure 11: The industrial sector is beginning to recover



Source: German Federal Statistical Office, Eurobank Research

Figure 12: Employment continues to increase solidly



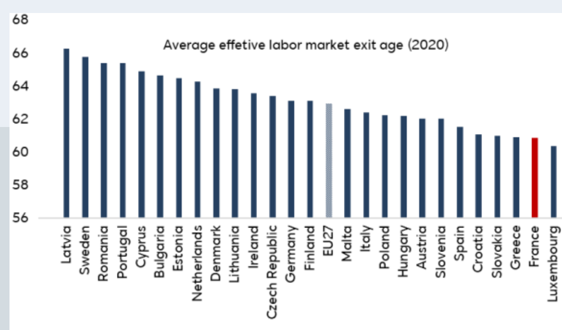
Source: German Federal Statistical Office, Eurobank Research

France

Social unrest related to the pension reform should temporarily dent GDP in Q1

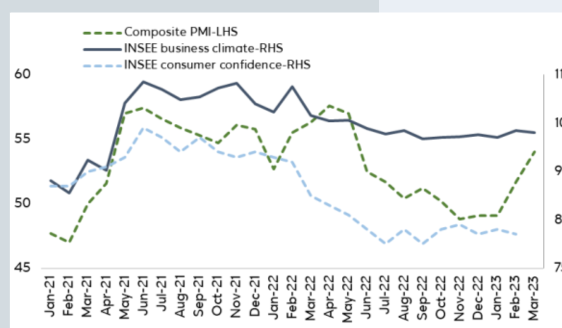
After months of negotiations, controversial pension reform that envisions inter alia (i) a gradual increase in the age of labour market exit from 62 to 64 years by 2030; and (ii) an increase in the career length required to qualify for full pension benefits from 42 to 43 years by 2027, and which is expected to improve both public finances and potential growth (the government estimates that it will close a €13bn projected shortfall in the pension system by 2030), was turned into law, by overriding, though, the normal parliamentary procedure. President Emmanuel Macron, whose party and its allies hold only 250 out of the 577 seats in parliament, made significant concessions to attract votes from the conservative party, Les Républicains (including abandoning his initial plan to raise the retirement age to 65), but his attempt failed. Having no guarantee that the law would pass, the government decided to force the bill through the activation of a special constitutional clause, known as Article 49.3 — rather than a vote by MPs in the National Assembly — under which the bill is adopted unless the government loses a confidence vote. Two no-confidence motions were submitted that were rejected by the National Assembly by a narrow margin. However, the government's decision to override the parliamentary vote resulted in escalated social unrest that will likely stay for longer, presumably undermining President Macron's political ability to move forward with the rest of his reform agenda. Meanwhile, the latest business surveys for Q1 2023 point to still positive but subdued GDP growth, especially in view of ongoing social tensions which are expected to weigh on economic activity, though modestly and temporarily, as previous similar experiences in France have shown. More fundamentally, persistently high inflation continues to hinder household purchasing power, higher ECB interest rates are also expected to continue to weigh on domestic demand, weaker global growth is likely to weigh on exports, and banking concerns might lead to a further tightening in credit conditions. All said, we expect GDP to stagnate in H1 before an anticipated deceleration of inflation in H2 on energy prices base effects should allow for a gradual recovery, taking the annual print for the whole year at 0.5% compared to 2.6% in 2022.

Figure 13: France's effective age of labour market exit is currently one of the lowest in the EU



Source: OECD, Eurobank Research

Figure 14: Leading indicators point to still positive but subdued GDP growth in Q1



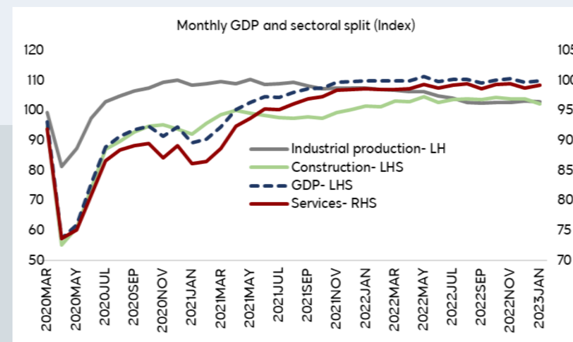
Source: INSEEE, Bloomberg, Eurobank Research

UK

Likely escaping a Q1 GDP growth contraction, but several challenges prevail

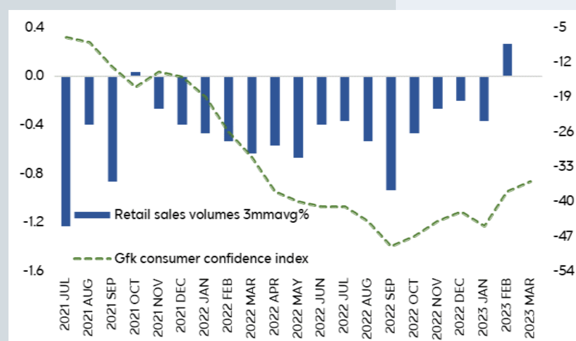
January GDP surprised to the upside, rising by a higher than expected 0.3%MoM after a 0.8%MoM contraction in the prior month, driven by a 0.5%MoM rebound in the services sector —the UK's growth engine — as one-off factors that weighed on its growth in December (i.e., strikes, adverse weather) faded. In contrast, manufacturing remained in a downward trend (-0.4%MoM) and construction dropped markedly (-1.7%MoM), likely reflecting the negative impact of rising rates. Meanwhile, activity data for February and March continue to point to an improving near-term growth momentum, challenging the BoE's projection for a -0.1%MoM contraction in Q1, after GDP growth rates in the last two quarters of 2022 were revised higher (Q4 at 0.1%QoQ from 0.0%QoQ, Q3 at -0.1%QoQ from -1.1%QoQ) thanks to stronger public and private consumption (boosted by the government's Energy Bill Support Scheme) that took the annual rate for the whole year at .1% from 2.0% previously. Indicatively, retail sales rose by a marked 1.2%MoM in February following an upward revised gain of 0.9%MoM in January, consumer sentiment rose in March for the second consecutive month (+2pts to -36), and flash March composite PMI, though it came in lower than expected (-0.9pts at 52.2), remained comfortably into expansionary territory and sustained the main bulk of its large gain in January (+4.6pts). Meanwhile, fiscal policy will turn more supportive from April, as the government delivered in the Spring Budget additional fiscal support worth £21.6bn (0.8% of GDP) for FY 2023-24 (by also canceling the planned 20% increase in energy bills for another three months). But though there are some reasons for cautious optimism over the UK's near-term outlook, further out, the economy still faces steep challenges. Notably, the 425bps of BoE rate tightening has yet to fully feed through to the real economy, and persistently high price pressures should continue to erode consumer purchasing power. Overall, we still expect the economy to contract this year, -0.4%, but less than -0.6% earlier projected. On the monetary policy front, the BoE delivered at the March meeting the eleventh consecutive increase taking the bank rate to 4.25% and pledged to hike further on the condition of more persistent inflation pressures.

Figure 15: January GDP surprised to the upside driven by the services sector



Source: ONS, Eurobank Research

Figure 16: Activity data for Q1 point to a more positive near-term growth trend



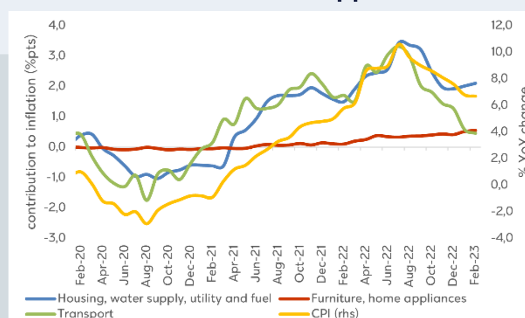
Source: ONS, GfK, Eurobank Research

Cyprus

Signs of unabated tourism growth and streamlining of the NPLs arrangement framework to support exports and credit expansion

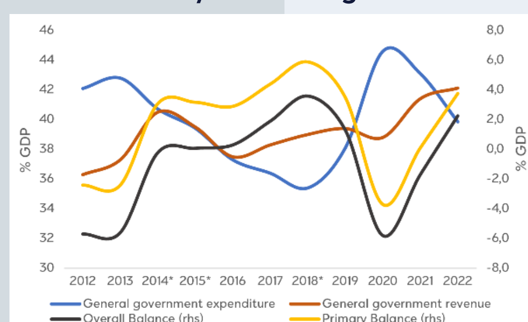
Growth dynamics are strengthening recently in some of the main 2022 GDP growth drivers. The expansion of the volume of retail trade accelerated in January (+6.3%YoY), despite a very strong increase in January 2022 (+13.4%YoY), and in February (+7.3%YoY), reaching a 12-month high in the latter month. The increase is backed by weakening inflation and income boosting developments in the public sector in January (full restoration of memorandum cuts, indexation allowance). This robust rise in a significant part of household consumption will be supported in the next quarters by the (partial) wage indexation agreement in the business economy to be reached soon, tighter labour market conditions, especially in the ICT sector, as well as by further easing of inflation. In the exports front, tourist arrivals thrived in the first two months of 2023 (+106%YoY in January, +66%YoY in February), a trend also reflected in tourism revenues (+61.7%YoY in January). These dynamics are expected to continue, albeit weaker than in early 2023, mainly due to much more visitors from European (e.g., United Kingdom, Greece, Poland) and Middle East countries (e.g., Israel). The improvement in the services balance will likely be partially offset by the deterioration in the goods balance, due to stronger demand for consumer goods and a significant worsening in the ships balance. Much higher interest rates for businesses and households combined with lingering uncertainty about the foreclosure suspension on the part of the banking sector will probably sustain in the first months of 2023 the weakened investment momentum in Q4 2022. That said, no further suspension of the real estate protection scheme in March combined with the recommendation by the new Minister of Finance to banks for prioritizing debt restructuring over foreclosure for NPLs settlement, and the forthcoming introduction of a reduced VAT rate for sales of first residences up to a certain surface area, are expected to heat up credit expansion, mainly to households. On the contrary, some delays in implementing the milestones for the second and third tranche of the RRF are expected to hamper related investment. However, this will not deter investment in sectors with robust activity last year and favourable prospects for 2023, such as tourism, ICT sector and retail trade. In view of the aforementioned dynamics, average growth in 2023 is now expected to be slightly stronger than previously projected, around 2.3%.

Figure 17: Effects of falling prices in Energy and Transport to inflation exceed its deceleration and are partially offset by increases in Furniture-home appliances



Source: Eurostat, Eurobank Research

Figure 18: Fiscal overperformance in 2022 led to the recent sovereign rating upgrade by Fitch Ratings



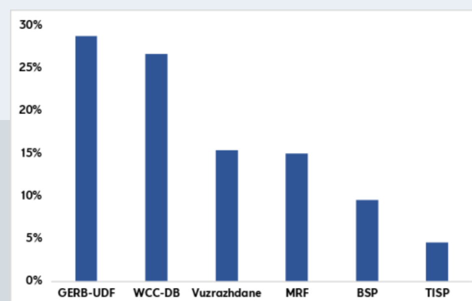
Source: Eurostat, Ministry of Finance, Eurobank Research

Bulgaria

Pyrrhic victory of GERB-UDF leaves the country in political gridlock

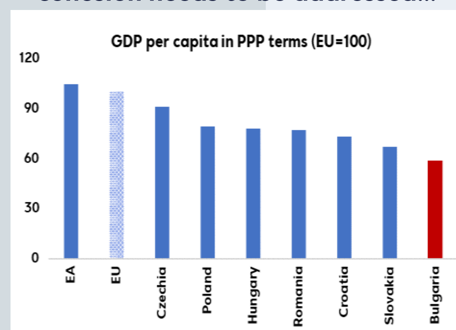
The results of the parliamentary elections on April 3 will most probably prevent the country from overcoming the political impasse it has hit on. The fifth ballot held in the last two years has led to a continuing fragmented parliament of six parties with the voters' turnout at 40.6% being broadly identical with recent elections. The political coalition between GERB and UDF gathered 26.5% of total votes translated into 69 seats and the collaboration between the We Continue Change (WCC) and Democratic Bulgaria won 24.5% of votes, which converted to 64 seats. As the National Assembly consists of 240 parliamentary seats and at least 121 constitute a majority, the insufficient seats obtained by each party along with the thin difference between the two which both have at helm the two former Prime Ministers (GERB with Boyko Borisov and WCC with Kyril Petkov) point to exploration of coalition governmental schemes or snap elections, most probably in autumn along with local elections, given the slim chances over a fruitful coalition government between the elected parties. The lack of a stable government in the country over the last two years has taken a clearly negative toll on the economy; it has postponed the euro adoption for after 2024 and has posed serious delays in the disbursement of the second tranche of the RRF as this is tied with 66 prerequisites, out of which 22 must be approved by the parliament, entailing thus bold political will. Moreover, while we march into the second quarter of the year, the economy does not have yet a ratified fiscal budget in place for 2023. Taking into account the above, the flow of economic data and other relevant developments during the last month are considered of secondary importance in our view as despite their usefulness in the assessment of the short-term outlook, the underlying dynamics in the political stage, as outlined above, undermine to a worrying extend the medium-term (and even long-term) prospects of the economy which continues to rank last in terms of PPP as of 2022 within the EU. Nevertheless, by looking at the releases of hard data within March, we encounter at a mixed landscape in economic activity in early 2023. Industrial output decelerated by 3%MoM with the annual print shaped at -4.3%, touching negative grounds for the first time since February 2021. Construction output increased by 0.8%MoM but slipped by 0.4%YoY. With both previous gauges signalling lower activity so far in 2023 compared to early 2022, retail sales twist the said impression as they increased by 5.6%YoY in January from 3.8%YoY in December.

Figure 19: Fragmentated parliament prolongs the political gridlock ...



Source: Central Electoral Commission of Bulgaria, Eurobank Research

Figure 20: ...in a period when economic cohesion needs to be addressed...



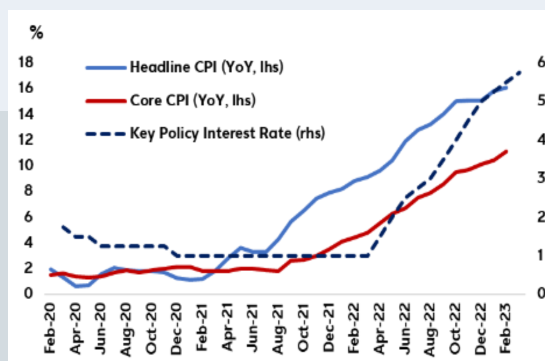
Source: Eurostat, Eurobank Research

Serbia

High inflation and decelerating credit growth hampering private consumption

In line with market expectations, the National Bank of Serbia (NBS) delivered at the April's MPC session an additional 25bps rate increase, setting the Key Policy Rate (KPR) at 6.00%. The increase is the 13th in a row of the current hiking cycle at play since April 2022, translated into 500bps of cumulative tightening up to date. The decision was well reasoned on the grounds of inflation remaining in a rising trend since July 2021, with prospects over imminent decompression considered limited. That said, the CPI print came in at 16.1%YoY in February accelerating from 15.8%YoY and 15.1%YoY in January and December respectively while, in monthly terms, headline inflation increased by 1.4%, unchanged compared to the previous month.

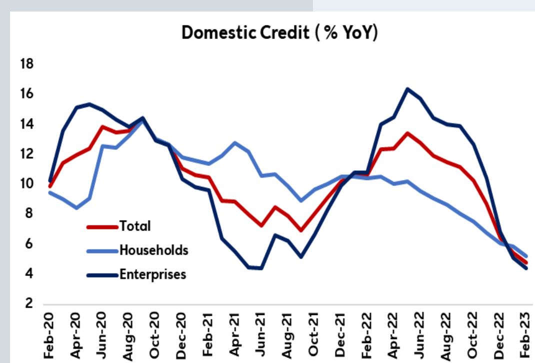
Figure 21: Increasing borrowing costs to tame inflation…



Source: National Bank of Serbia, Statistics Bureau of Serbia, Eurobank Research

While the NBS anticipates prices to ease in H2-2023 before rising further in Q1-2023, routed increases in energy prices by 8% for at least the next 12 months render inflationary pressures hard to ease. Along these lines, core inflation climbed to 11.1%YoY in February from 10.4%YoY in January, boding well with one-year ahead-inflation expectations of market participants and the business sector that remain unchanged in the past three months at 8.0% and 10.0% respectively, signalling the broad-based perception that prices are anticipated to keep increasing intensively for at least another year. The interaction between spiralling inflation and the necessary interest rates increases to tame the rising trend has an evidently decelerating imprint in the credit growth since the beginning of the year; credit growth slowed down to 4.8%YoY in February from 5.5%YoY in January, 6.5%YoY in December and 11%YoY during 2022 on average. While high base effects from last year are identified in the credit easing, so is the tightening of monetary policy during the same period, with the credit fallout attributed to both retail and corporate sectors. In view of persistent inflation and rising borrowing costs, private consumption, which traditionally ranks as the highest contributor to GDP growth, will be put under stress, undermining growth prospects at whole. That said, the behaviour of retail sales in Q1 and especially in February (-3.8%YoY vs +1.8%YoY in January and +5.6% FY2022 average) forebode, among other factors, for an almost identical compared to the 2022 GDP growth rate, i.e. 2.3%, with the capacity for wages and pension increases - within the fiscal perimeter of a 3.3% of GDP deficit envisaged in the 2023's ratified budget - able to tilt growth risks to the upside.

Figure 22: …weigh on credit growth



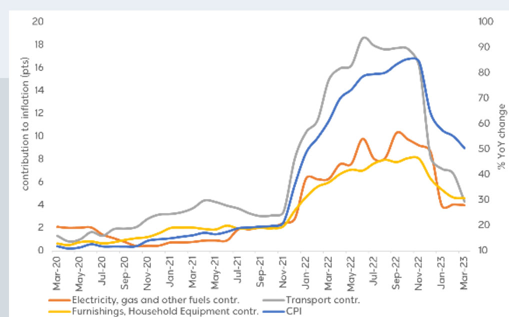
Source: National Bank of Serbia, Eurobank Research

Turkey

Easing inflation and pre-earthquakes wage increases support demand

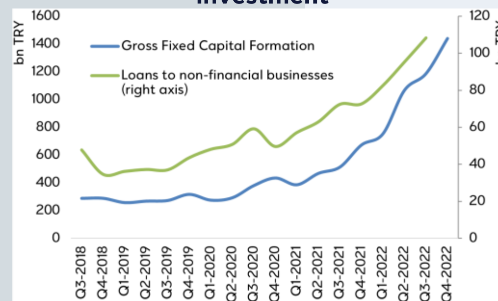
With indicators on economic activity referring to Feb-23 to be released in the coming weeks, providing initial evidence about the implications of the earthquakes that occurred that month, the latest data for Jan-23 point to growth acceleration in early-2023. The retail volume expanded in Jan-23 by 34.1%YoY, a 22-month high increase, backed by a new rise in the minimum wage by 55% in the same month. Industrial production stood higher by 3.9%YoY, the strongest expansion since Jul-22, supported by domestic demand, as the increase in nominal exports of goods eased significantly in Q4 2022, to 1.3%YoY against 10.5%YoY in Q3 2022. However, when figures about economic activity from Feb-23 onwards will be released, they should be interpreted cautiously, e.g., due to issues of no data reporting from the regions hit by the earthquakes. Indicatively, according to Turkstat, field prices for the CPI calculation in Feb-23 could not be collected in 3 provinces. Also, the survey for the Consumer Confidence index (CCI) in Mar-23 could not be conducted in 7 provinces. With this in mind, soft data indicate a moderate weakening in economic activity recently, as the Economic Sentiment index fell marginally both in Feb-23 (-0.2pts) and Mar-23 (-0.3pts). The decline is more pronounced in retail trade (-8.4pts cumulatively), moderate in services (-1.3pts), with the CCI slightly increasing (+1.0pt). With the earthquakes most probably being a major determinant of the results in the presidential elections ahead, as evident in most of the recent polls, potential changes to the economic and monetary policy post-elections are an emerging issue. Meanwhile, monetary policy remains accommodative, given the new policy rate cut in Feb-23 (-50bps), albeit with repercussions for the TRY (-1.7% vs. USD in the period between the latest rate cut and April 3, -30.8%YoY) and the other relevant measures subsequently announced by the Central Bank of Turkey. The state aid already provided to the affected households, amounting to TRY 17.7bn (approx. $0.93bn) is considered inadequate. On the other hand, more inflation easing measures were taken, with the energy market regulator EPDK cutting the power price cap by another 13.1% as of April 1, the fourth reduction so far this year, supporting inflation deceleration (to 50.5%YoY in Mar-23, a 13-month low) and private consumption. Overall, official growth projections for 2023 eased moderately after the earthquakes (OECD: 2.8%, -0.2ppts, Fitch: 2.1%, -0.3ppts).

Figure 23: 2/3 of inflation decline from Nov-22 to Mar-23 came from prices in Energy, Transport and Furnishings-Household Equipment



Source: Turkstat, Eurobank Research

Figure 24: Despite negative implications of the loose monetary policy for the TRY ex-change rate, credit expansion supports investment



Source: Central Bank of Turkey, 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)		
	2022e	2023f	2024f	2022e	2023f	2024f	2022e	2023f	2024f	2022e	2023f	2024f	2022e	2023f	2024f
World	3.4	2.4	2.8	8.8	5.6	3.6									
Advanced Economies															
USA	2.1	1.0	1.0	8.0	4.3	2.6	3.6	3.9	4.6	-3.7	-3.2	-3.1	-5.5	-5.3	-5.4
Eurozone	3.5	0.5	1.2	8.4	5.6	2.4	6.7	6.9	6.9	-0.7	0.9	1.3	-3.7	-3.7	-3.2
Germany	1.8	0.0	1.1	8.6	6.2	2.6	5.3	5.4	5.2	4.1	4.8	5.0	-3.2	-2.8	-2.1
France	2.6	0.5	1.0	5.9	5.4	2.6	7.3	7.4	7.5	-2.2	-1.8	-1.4	-5.1	-5.1	-4.8
Periphery															
Cyprus	5.6	2.3	2.9	8.1	4.0	2.0	6.8	6.3	6.0	-9.1	-8.0	-6.0	2.3	1.5	2.0
Italy	3.7	0.5	0.9	8.7	6.6	2.3	8.1	8.1	8.1	-1.3	-0.5	0.2	-5.2	-4.8	-3.9
Portugal	6.8	0.9	1.5	8.1	5.5	2.3	6.0	6.4	6.2	-1.3	-1.0	-0.8	-1.8	-1.2	-0.8
Spain	5.5	1.3	1.5	8.3	4.1	2.6	12.9	13.1	12.6	0.6	0.8	1.0	-4.9	-4.4	-3.8
UK	4.1	-0.4	0.8	9.1	6.5	2.4	3.7	4.3	4.6	-4.9	-3.9	-4.0	-5.0	-5.4	-3.6
Japan	1.0	1.0	1.2	2.5	2.3	1.5	2.6	2.5	2.4	2.1	1.7	2.1	-6.7	-5.1	-4.0
Emerging Economies															
BRICs															
Brazil	2.9	0.9	1.7	9.3	5.3	4.2	9.5	9.3	9.5	-2.9	-2.4	-2.4	-4.6	-7.8	-7.3
China	3.0	5.5	5.0	2.0	2.3	2.3	4.9	4.1	4.1	2.2	1.3	1.0	-4.7	-4.9	-4.7
India	6.9	6.0	6.3	6.7	5.3	4.8		NA		-2.6	-2.1	-2.2	-6.4	-5.9	-5.3
Russia	-2.1	-1.7	1.5	13.8	5.8	4.9	3.9	4.2	4.2	10.2	4.7	3.5	-2.2	-3.6	-2.0
CESEE															
Bulgaria	3.4	1.3	2.5	15.3	8.9	4.1	4.3	4.5	4.4	-0.3	-0.5	0.2	-2.9	-3.0	-3.0
Serbia	2.3	2.3	3.2	11.9	9.7	4.7	9.4	9.5	9.2	-6.9	-6.8	-6.3	-3.1	-3.3	-2.5
Turkey	5.4	2.2	3.5	72.0	43.4	23.6	10.5	12.0	11.5	-5.5	-6.8	-5.5	-0.9	-2.5	-1.3

Sources: European Commission, World Bank, IMF, OECD, Bureaus of National Statistics, Bloomberg, Eurobank Research

Eurobank Fixed Income Forecasts

	Current	June-23	September-23	December-23	March-24
USA					
Fed Funds Rate	4.75-5.00%	4.99-5.25%	4.94-5.20%	4.80-5.05%	4.39-4.65%
3m SOFR	4.92%	5.13%	5.05%	4.86%	4.53%
2yr Notes	5.00%	5.25%	5.20%	5.05%	4.65%
10yr Bonds	4.75%	4.99%	4.94%	4.80%	4.39%
Eurozone					
Refi Rate	3.50%	4.05%	4.10%	4.10%	4.00%
3m Euribor	3.06%	3.47%	3.51%	3.48%	3.32%
2yr Bunds	2.51%	2.97%	2.77%	2.50%	2.31%
10yr Bunds	2.21%	2.66%	2.49%	2.33%	2.26%
UK					
Repo Rate	4.25%	4.40%	4.35%	4.25%	4.10%
3m Sonia	4.31%	4.32%	4.33%	4.18%	4.03%
10-yr Gilt	3.44%	3.49%	3.34%	3.15%	3.11%
Switzerland					
3m Saron	1.46%	1.83%	1.83%	1.83%	1.88%
10-yr Bond	1.16%	1.59%	1.52%	1.44%	1.41%

Source: Bloomberg (market implied forecasts)

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