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After a stronger than expected performance in H1 2023, global GDP growth continues to moderate in early Q4 2023. However, strong labor markets, healthy balance sheets and fading inflation drags, support optimism for a soft-landing scenario, confounding worries over a slip into a deep downturn. Meanwhile, while major CBs are mindful of lags in monetary policy transmission, the battle to drive inflation back to target is not over yet. Reacting to such a mix of factors, they slightly softened their tightening bias, retaining though a "high-for-long" stance, making clear that monetary policy should remain sufficiently restrictive for some time to ensure a sustained return of inflation to target.

Macro Picture

USA: after stellar Q3 performance, GDP growth seems poised to slow amid intensified headwinds

EA: incoming data consistent with persistent stagnation over the next few quarters

UK: forward-looking indicators continue to point to a subdued growth outlook

CESEE: both supply and demand hard data point to lower growth in Q3

Markets

FX: EUR/USD rebounds to 1.07 from 1.04 on a dovish leaning FOMC November policy outcome

Rates: EU, US rates expected to have reached their peak and continue bull steepening

EM: sovereign fixed income spreads tighter despite outflows and increased geopolitical risks

Credit: markets shifted from “higher for longer” to “soft landing” despite weaker Q3 earnings

Policy Outlook

USA: the Fed softens its tightening bias in view of significantly tighter financial conditions

EA: ECB’s increased growth cautiousness suggests that rates may have reached their peak

UK: BoE likely done hiking rates, dependent on how wage growth and services inflation progress

CESEE: central banks reluctantly start to cut rates as growth taps the brake

Key Downside Risks

DM: escalating geopolitical tensions; persistent inflation pressures force CBs to keep rates higher for longer than expected; a sustained rebound in commodity prices and supply chain disruption

EM: prolonged geopolitical risks in a plethora of developing regions; further escalation of the Middle East conflict

Special Topic in this issue:

→ Revamped geopolitical risks in the Middle East jeopardise potential trade ties with Asia

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November 2023

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Macro Views

Latest world economic & market developments

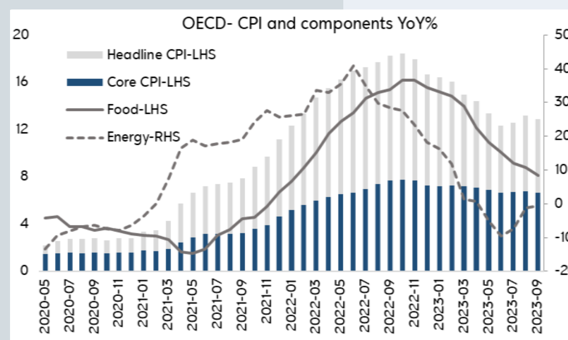
Economic activity continues moderating, while major CBs maintain a “high-for-long” stance to ensure price stability on a sustained basis

After a stronger than expected performance in the first half of the year on the back of lower energy prices and China’s reopening, global GDP growth looks to have moderated in recent months, reflecting the increasing drag of major central banks’ aggressive monetary policy tightening, needed to rein in inflation. Consistent with this narrative, the global composite PMI continued its downward trend in October for the fifth straight month after peaking in May, down by a further 0.5pts to a nine-month low of 50.0, the threshold of expansion and contraction, suggesting that economic activity stagnated. However, though October PMIs overall suggest that global growth continues moderating, strong labor markets (despite recent signs of softening in a number of major economies), healthy balance sheets and fading inflation drags, have been encouraging, raising hopes for a soft-landing scenario and confounding worries over the risk of an imminent slip into a deep downturn. That said, the global services PMI fell for the fifth consecutive month, down by another 0.3pts to 50.4, but still above the neutral mark of 50.0, pointing to continued activity expansion. Meanwhile, manufacturing production remained the main drag on economic growth. The respective global PMI print fell to a three-month low of 48.8, down from 49.2 in September, stuck in contractionary territory for the fourteen month in a row, the longest streak of deterioration since the downturn in the period between December 2000 and February 2002, while still subdued trade activity suggests that output is unlikely to rebound any time soon. Geographically, global expansion in October was led by India, while, on the flipside, weakness was especially apparent in the Eurozone, with the October PMIs raising questions whether the economy is close to a recession. According to market consensus, the global economy is expected to slow from 3.5% in 2022 to a still positive, though sub-trend pace of 2.8% in 2023, with risks remaining skewed to the downside as several steep challenges prevail. On the inflation front, global headline CPI decelerated further in September, though modestly, as the impact of energy base effects is fading. At the same time, global core inflation continued to move further below 2022 highs, though by a slower pace,

Figure 1: World trade remains subdued, pointing to ongoing manufacturing sector weakness

Source: CPB Netherlands Bureau for Economic Policy Analysis, Eurobank Research

Figure 2: Disinflation is progressing, though slowly



Source: OECD, Eurobank Research

staying sticky above major CBs' comfort zones. Core goods inflation slipped further, remaining the main driver of core disinflation amid a continued easing of supply chain bottlenecks and ongoing manufacturing sector weakness, while services price inflation rebounded against a backdrop of labor market tightness.

Meanwhile, major central banks are mindful of lags in monetary policy transmission and the potential impact on global economic activity from persistent tightening in global financial conditions. At the same time, they are well aware that the battle to drive inflation back to target is not over yet and further disinflation progress may prove harder as base effects fade, while uncertainty about geopolitics in the Middle East keep risks to oil prices to the upside. Reacting to such a mix of factors, major central banks slightly softened their tightening bias, supporting the notion that their hiking cycle has probably come to an end. However, regardless of whether rates have already reached terminal levels, or have to rise slightly further, major CB's retain a "high-for-long" stance, making clear that monetary policy should remain sufficiently restrictive for some time to ensure a sustained return of inflation to target.

Developed Economies

US: economic growth accelerated sharply in Q3 2023 with GDP expanding by a stellar 4.9%QoQ saar after growing 2.1%QoQ in Q2 2023. The main growth driver was personal consumption, which accelerated to 4.0%QoQ saar from just 0.8%QoQ saar in the prior quarter, contributing more than half of overall GDP growth. With real disposable income rising by only 1.9%QoQ saar, the slowest pace since Q1 2022, the surge in personal consumption was mostly financed by a big fall in the personal savings rate, which dropped from 5.2% to 3.8%. But with savings nearly depleted, personal consumption is likely to slow in the coming quarters, taking also into account persistently high inflation, tighter credit conditions, softening labor market conditions, the resumption of student loan payments in October and elevated geopolitical uncertainty. That said, GDP growth seems poised to slow in Q4, but a turn to below-trend growth is far from certain. Against this backdrop, the Fed kept the door open for later hikes at its November policy meeting, though, softened its tightening bias amid concerns that significantly tighter financial conditions, if sustained, would weigh on economic activity.

Euro area: GDP growth contracted by a mild 0.1%QoQ in Q3, slightly below market consensus for a flat reading, following an upwardly revised figure for Q2 of 0.2%QoQ from 0.1%QoQ previously. Looking into Q4, data are consistent with sustained stagnation. The composite PMI unexpectedly dropped further into contractionary territory in October to a fresh post-pandemic low, external demand remains subdued, and tightening monetary policy is transmitting forcefully to the real economy. In a more encouraging note, though, the pace of tightening in lending standards has moved broadly sideways, the labor market remains tight, while the ongoing disinflationary progress and continued strength in wage growth should support real income and household consumption in the coming months, helping the economy avoid a fully-fledged recession. However, downside growth risks are far from over as consumer confidence remains weak and

households seems to have gone into precautionary savings over the last few quarters. Against this backdrop, the ECB's tightening cycle has probably already come to an end, with markets pricing in fully a 25bps rate cut by June 2024.

Emerging Economies

EM: the key development since our latest issue comes from the geopolitical front and pertains to the war that burst out on October 7 between Hamas and Israel. While fears over a further escalation that could result in a more protracted rampage in the Middle East continue to linger, yet the performance of VIX, the so-called "fear gauge", suggests that markets might have fully digested the incident. Turning to developing Asia, China's sequential growth rate picked up to 1.3%QoQ in Q3 from 0.5%QoQ in Q2, adding to the broader impression that the slowdown has bottomed out. Still, industrial production and retail sales in September expanded on a slower pace on a monthly basis suggesting that the recovery momentum may prove weak. On top of these worries, fresh inflationary data suggest that the economy could be sliding back to deflationary grounds, confirming, thus, the necessity of the declared additional fiscal stimulus which will swell the fiscal deficit for 2023 in the efforts to stimulate domestic demand. Despite the doubts that cloud China's growth momentum, prospects for growth in the wider EM space remained unchanged in the IMF's October WEO compared to previous assessments in July and April with growth forecasts for 2023 and 2024 laying at 4.0% for both years.

CESEE: only Czechia has released a flash estimate among the core countries in the region, according to which GDP contracted by 0.6%YoY when market expected a milder print of -0.3%YoY. Similarly went the sequential print as it came in at -0.3%QoQ with the consensus pointing to a standstill. With Q3 growth data ante portas for the rest of regional peers, retail sales and industrial production in key economies of the region point to deceleration during the said quarter. Retail sales in September for all CEE3 continued to shrink compared to August while in Romania they remained on a growing, though decelerating, pace since July. On a similar and even more intense vein went the industrial output which contracted in all four aforementioned economies in the last couple of months. At the same time, inflation continues to remain on a downward path across the region broadly assisted by high base effects from the same period last year. In view of the above, and taking also into account the persistent employment shortages that add pressure on the heated labor markets, regional central banks (CBs) appear to be walking on a tight rope with respect to the decision over the right timing for embarking on a monetary loosening cycle. That said, since September the Polish CB has delivered cumulatively 100bps of interest rate cutting, setting the key policy interest rate at 5.75% from 6.75% in August with the CB of Hungary lifting the torch in October's MPC when it eased its base rate by 75bps bringing it to 12.25%.

Markets View

Foreign Exchange

EUR/USD: the pair has been trading in a relatively narrow range since the start of Q4, consolidating the gains made in Q3. It is currently facing resistance at the 1.0774 level, which is the 250-day Exponential Moving Average (EMA). As long as the pair remains below this level, the downside potential remains prominent. The next mid-term support level is identified at 1.0410. While we remain slightly bullish on the pair towards even the 1.10 territory, we set tighter intraweek stops to avoid heavy swings.

GBP/USD: touched then fell back below the 250-day moving average of 1.2385, coming from the region of 1.2050 in October. We identify the next key support level at 1.1835 and resistance at 1.2650. As the downside bias for the GBP/USD pair remains in place in Q4, we are positioned for a potential consolidation of the pair at around 1.22.

Rates

EU: swap interest rates sold off in October, primarily due to weak data releases, indicating that yields may have already passed their peak for this economic cycle. The 10yr swap rate is currently at 320bps, rebounding from a low of 310bps. The yield curve slope has steepened for the fourth consecutive month, with the 5s30s spread trading at -15bps, having reached as high as -10bps. Looking ahead, it is anticipated that rates' volatility will diminish, and yields in the front end will trend lower. This expectation is grounded on the fact that euro area inflation receded to a two-year low of 2.9%YoY in October, down from the previous month's 4.3%YoY and falling below the consensus estimate of 3.1% from a Reuters poll of economists. This deceleration in inflation may prompt a shift towards lower yields, influencing market dynamics in the coming months.

US: swap rates ended the month on a downward trajectory amid considerable volatility. The 10yr SOFR swap rate currently stands at 445bps. The yield curve has continued to steepen, with the 5s30s spread increasing to -18 bps from -40bps at the start of September. Looking ahead, there is an anticipation that rates will drop further. The US jobs and services prints released on November 3 have contributed to an evolving rally, gaining momentum as data came in weaker than expected. This rally may extend significantly if this data trend persists. Interestingly, the curve could continue to steepen, this time from the front end, as investors are adjusting their expectations – given the likelihood of no further Fed hikes – and are now anticipating an earlier start to rate cuts.

Emerging Markets Sovereign credit

Emerging market spreads have shown resilience in the face of "higher for longer" core rates and persistent outflows, while the Israel-Hamas conflict has had no major spillover to the EM space so far. The EMBI Global Index tightened by 7bps and is currently standing at 357bps, having previously reached as high as 385bps during the month. In CEEMEA, the obvious outperformer was Israeli government bonds, where spreads widened by more than 70bps while S&P affirmed the country's AA- rating but changed the outlook to negative from stable. In Asia, China's NPC standing committee approved a new fiscal stimulus package in order to finance new infrastructure projects, while the Bank of Indonesia hiked its policy rate by 25bp to 6.0% in a surprise move. We are cautious but supportive on adding EM risk as spreads should benefit from a potential end to the Fed's hiking cycle.

Corporate credit

October was another weak month for markets, amid heightened geopolitical risk and economic data that helped support the "higher for longer" narrative. On the geopolitical front, an attack by Hamas on Israel on October 7 led to concerns about a broader escalation and drove a rise in oil prices (Brent crude +9% in the days following the attack, but endinglower than before the war intramonth]) and safe haven assets (Gold +7.3% in October). The Fed, the ECB and the BoE kept rates unchanged at their latest meetings, as widely expected, with the US and European central banks softening their tightening bias, leading to a relief rally in early November, which helped recover part of September and October's sell-off. On the data front, the US economy showed continued resilience, with data surprising on the upside for the most part amid ongoing inflationary pressure. As such, futures continued to price in a chance that the Fed might deliver another hike by the January 2024 meeting. European data was much weaker, but there was better news on the inflation side, as flash CPI for the euro area fell to a two-year low. European natural gas prices saw a third consecutive monthly rise, ending +15% for the month. Against this backdrop, there was increased volatility in equities throughout the month, but they managed to close fairly flat with the VIX declining to its lowest levels since Q1 2022 in early October (S&P 500 +1.6%MoM, Stoxx 600 -1.3% MoM).

In credit, European spreads widened for most of October but tightened towards the end of the month and the early part of November. Itraxx Main ended -2.5bps and Xover ended -15bps intramonth. Moving broadly in line with US synthetics. In EUR Corporate cash, IEAC ended +10bps and IHYG +38bps since the beginning of October. Comms and Technology outperformed among EU IG cash (+1bps and +7bps respectively) while Industrials and Snr Financials lagged (+12-13bps). In High Yield, Energy outperformed (+17bps), while Technology lagged behind (+220bps). Activity in the EU Primary market remained muted in October, with total issuance at €70bn from €126bn in the previous month, and has remained slow by early November.

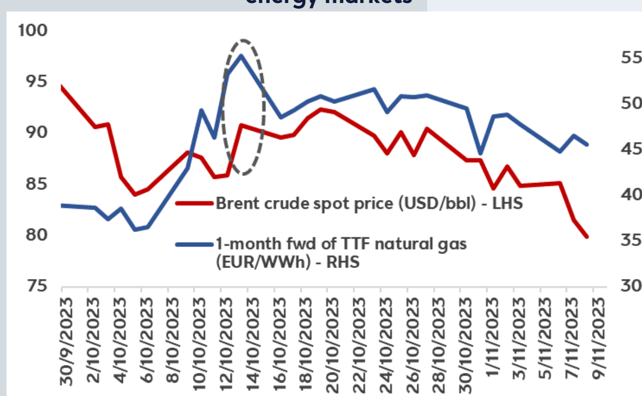
At the start of November, markets seem to some extent to have shifted from a "higher for longer" narrative towards a "soft landing" one, despite the weaker tone of the third-quarter earnings season, following a dovish tilt by central banks.

Special Topic

Revamped geopolitical risks in the Middle East jeopardise potential trade ties with Asia

Current developments in the Middle East – apart from their devastating human cost, which falls outside the scope of this note – roiled analysts and investors, who primarily focused on the conflict's potential impact on energy markets. Indeed, fears of a broader escalation in the geographic region were reflected in higher oil and gas prices – although these have since dropped back towards (or even below) pre-war levels. Specifically, on October 6, the day before the Hamas attack on Israel, the price of brent crude traded at $85/bbl, climbing to $92/bbl almost two weeks later before falling to its current level of $80/bbl. The one-month forward contract price of natural gas on the Dutch TTF stood at €36.65/MWh the day before the conflict, rising above €55/MWh a week later only to retreat to about €46/MWh currently. Containment of the energy price shock does not in any way mean that uncertainty is over, even if its impact has been curbed. A look at the performance of VIX, Wall Street's so-called "fear gauge", suggests that markets might have fully digested the incident. The index peaked at almost 22 on October 20, but has since dropped to nearly 15, which is even lower than the 17.5 mark on the eve of the war. The prevailing concern, even though not clearly captured in key market gauges at the time of writing, is that a possible further sustained escalation in energy prices from a more protracted conflict – at a time when inflation is slowing but still above target for most major central banks – could trigger a new wave of inflationary pressures in the near term. Central bankers would have a paucity of tools for dealing with such a wave given that interest rates already stand at multi-decade highs. Against this backdrop, we think it is necessary to highlight another negative medium-to-long term consequence of the ongoing crisis, namely the impact of the developing conflict on global trade and supply chains. More specifically, this is a medium-term headwind for one of the most important announcements from September's G20 meeting in New Delhi – the construction of a new economic corridor connecting India to Europe through the Middle East (IMEC). The trade route, on top of the inflow of investments in infrastructure (roads, ports, railways) it will bring for the countries it passes through, is expected to strengthen trade flows with India, its starting point. According to the IMF's latest World Economic Outlook, India was the world's fifth-largest economy in terms of nominal GDP in 2022, behind the US, China, Japan and Germany. In purchasing power parity terms, it rises to the third largest, exceeded only by the US and China and accounting for 7.2% of world GDP, or USD11.2tn, at PPP. The external shocks of 2022 did cause the economy to lose a bit of its momentum, with inflation high thanks to rising global energy and food prices and financial and economic conditions deteriorating around the world. This caused India's economic growth to slow to a still-potent 7.2% in 2022 from 9.1% the year before. Having achieved

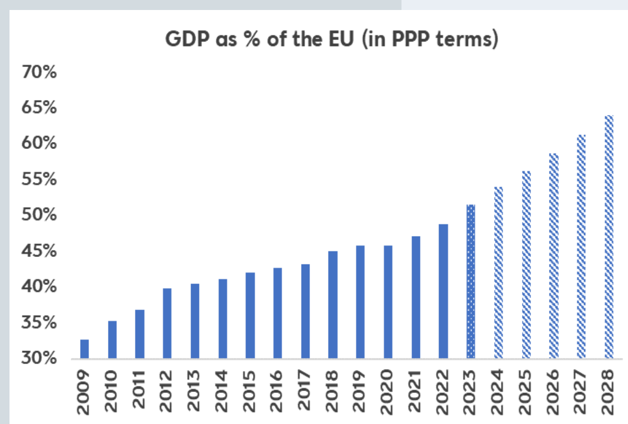
Figure 3: ...the burst of the war in the Middle East rattled energy markets



Source: Bloomberg, Eurobank Research

a 5.5% average GDP growth rate over the past decade, 2023 is expected to remain an above-trend year, despite the further slowdown, as growth is anticipated close to 6.0%. Looking ahead, the IMF's published forecasts up to 2028 point to a solid economic expansion with growth rates in the range of 6.0% throughout the next five years. India's population is 1.4bn, of which about 300mn belong to a middle class that is estimated to have a high propensity to consume according to western standards, while almost 60% are under the age of 35. These demographics, combined with the dynamism and export orientation that the economy has shown for at least a decade, make it an extremely important trading partner. As the Indian economy transforms by becoming more export oriented, it is developing new trade ties and strengthening existing ones. India's key trade partners as of August 2023 were the US, the United Arab Emirates and China. While the country has strong bilateral trade ties with several EU countries (Netherlands, Germany and France are among India's top 10 trade partners), a trade agreement between the EU as a whole and India has not been inked yet, despite being in the works. The EU and India started negotiations for the trade pact in 2007 but talks stalled in 2013 due to differences in issues including customs duties on automobiles and spirits and the movement of professionals. After a nine-year lull, the EU and India last year revived negotiations to forge a free trade agreement that could act as a counterbalance to China's growing influence in the Indo-Pacific region. Spain's Deputy Trade Minister Xiana Mendez, who represented the Spanish rotating presidency of the European Council at a meeting of trade ministers in the Spanish city of Valencia earlier in October, said that "we've felt a political impetus on India's behalf and we want to reinforce the negotiations". This was in the warm afterglow of September's G20 summit and the accompanying IMEC announcement. However, these prospects and opportunities could go wasted in the current geopolitical climate, which is expected to postpone progress of the trade corridor given that it would have to pass through the conflict zone. That means delaying the creation of economic synergies, with direct infrastructure benefits for the emerging economies involved, the flourishing of international trade, and the creation of another geostrategically important trade hub.

Figure 4: India's growth potential and global trade prospects could link through the IMEC



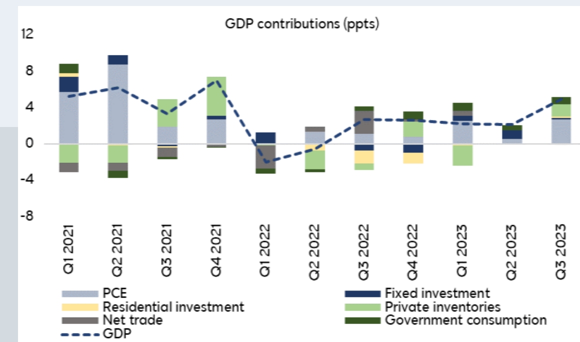
Source: IMF, Eurobank Research

US

After stellar Q3 performance, GDP is expected to slow amid growing headwinds

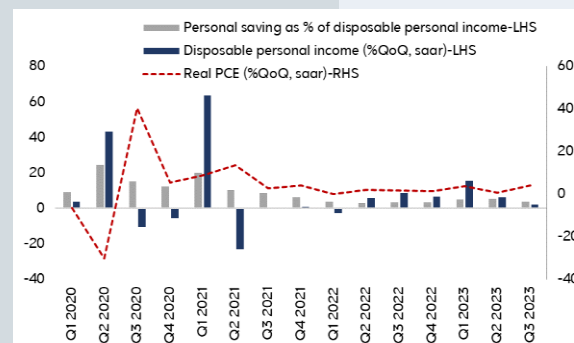
Economic growth accelerated sharply in Q3 2023 with GDP expanding by a stellar 4.9%QoQ saar, after growing 2.1%QoQ in Q2 2023. The main growth driver was personal consumption, which accelerated to 4.0%QoQ saar from just 0.8%QoQ saar in the prior quarter, contributing 2.7ppts, more than half of overall GDP growth. With real disposable income rising by only 1.9%QoQ saar, the slowest pace since Q1 2022 and sharply lower than the 6.1%QoQ saar in Q2, the surge in personal consumption was mostly financed by a big fall in the personal savings rate, which dropped from 5.2% to 3.8%. But with savings nearly depleted, personal consumption is likely to slow in the coming quarters, taking also into account persistently high inflation (September's headline and core CPI at 3.7%YoY and 4.1%YoY respectively), tighter credit conditions (bank credit growth dropped by -0.46%YoY in September after turning negative in August for the first time in more than ten years), softening labor market conditions (ECI at a near two-year low of 4.3%YoY in Q2, though still above levels consistent with the Fed's inflation target), the resumption of student loan payments in October and elevated geopolitical uncertainty. There were other positive contributors to GDP growth in Q3, but the outlook for those also looks gloomy. Notably, higher inventories (+1.3ppts) will likely act as a drag on growth in the coming quarters, government consumption (+0.8ppts) is expected to be less supportive in the period ahead given the split Congress and House Republican demands for deep spending cuts, and residential investment (+0.2ppts) will probably resume declining after the recent spike in mortgage rates to fresh multi-decade highs. That said, GDP growth seems poised to slow in Q4, but a turn to below-trend growth is far from certain. On a monthly basis, PCE rose by 0.4% in September consistent with a carry-over effect of 1.1%QoQ saar into Q4. Real median household net worth is 37% higher than before the pandemic, according to the Fed's latest Survey of Consumer Finances, while certain forward-looking indicators (October's PMI surveys) suggest continued resilience to tighter monetary conditions. The labor market also remains tight despite recent signs of softening. Against this backdrop, the Fed kept the door open for another rate hike at its November policy meeting, though, softened its tightening bias amid concerns that significantly tighter financial conditions, if sustained, would weigh heavily on economic activity.

Figure 5: Consumer spending contributed more than half of Q3 GDP growth



Source: BSL, Eurobank Research

Figure 6: Q3 PCE mainly financed by personal savings as disposable income slowed sharply



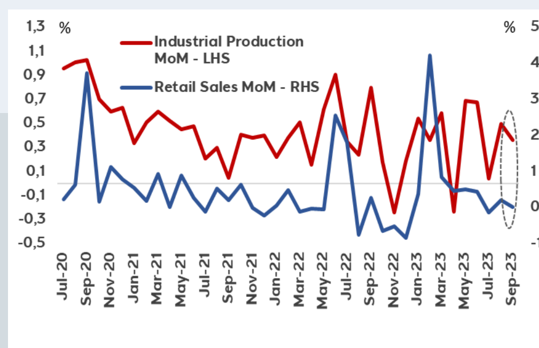
Source: BLS, Eurobank Research

China

Growth out of the ditch but road ahead remains bumpy

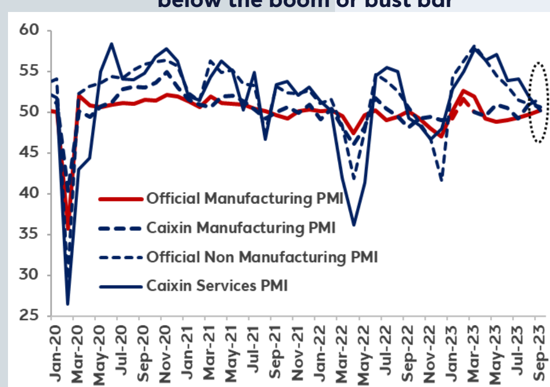
Q3 GDP growth print came in at 4.9%YoY above market expectations over a 4.5%YoY growth rate, still decelerating compared to the previous quarter. With the GDP expanding by 4.5%YoY and 6.3%YoY in Q1 and Q2 respectively, growth rate averaged 5.2%YoY in the first three quarters, requiring a growth rate of no less than 4.4%YoY in Q4-2023 so as for the official target of around 5.0% to be achieved. Sequential growth rate picked up to 1.3%QoQ in Q3 from 0.5%QoQ in Q2, adding to the broader impression that the slowdown has bottomed out. Yet, industrial production and retail sales in September expanded on a slower pace than in the previous month suggesting that the recovery momentum may prove weak and require further policy aid. Industrial output growth tapped the brake to 0.36%MoM in September compared to 0.50%MoM in August and so did retail sales growth (almost idle at 0.02%MoM in September vs 0.22%MoM in August). In view of the above, October's forward-looking data revealed the lingering uncertainty in the business sector over the course of the economy ahead, despite the more positive view of other market participants. September's uptick in the official and the Caixin manufacturing PMIs proved feeble as they both dipped again to contractionary grounds of 49.5 from 50.2 and 50.6 respectively in September when market expectations stood higher and above the boom or bust bar of 50. Messages from the sentiment over services were not clear as official non-manufacturing PMI may have slid to 50.6 in October, from 51.7 in September but Caixin services purchasing managers index climbed to 50.4 in October from September's 50.2 which was the lowest of the year. Signs over a challenging economic period as demand fails to gain a solid footing have not been ignored by policy makers. A new fiscal stimulus package of CNY1trn or ca USD140bn was approved aiming at financing infrastructure investments in the shape of tantamount sovereign bonds under issuance. The respective action will swell the 2023 annual budget deficit to 3.8%, exceeding the traditional 3% of GDP deficit ceiling. The twice-a-decade Central Financial Work Conference was also held in late October with no radical or surprising key takeaways but expected declarations over a stable financial system that could support growth.

Figure 7: Hard data from both supply and demand sides point to weak recovery momentum



Source: Bloomberg, Eurobank Research

Figure 8: ..pushing back the manufacturing PMIs below the boom or bust bar



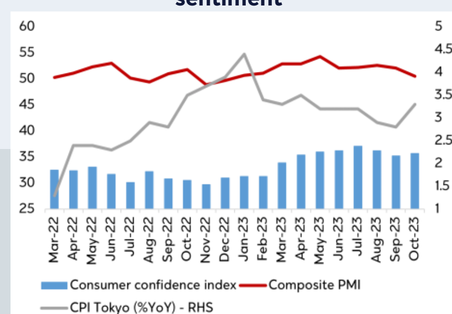
Source: Bloomberg, Eurobank Research

Japan

Data point to subdued growth in H2

After a solid momentum in H1, growth is expected to be subdued in H2 mainly due to high inflation and weak global demand. Industrial production contracted by 1.3%QoQ in Q3 after a 1.4%QoQ rise in Q2, possibly associated with only modest growth in real exports of goods (+0.8%QoQ from +2.4%QoQ in Q2). Retail sales accelerated (+2.3%QoQ vs +0.5%QoQ in Q2), suggesting that private consumption probably improved in Q3 after a 0.6%QoQ decline in Q2. To some extent, this is backed by slightly higher nominal wages (monthly average scheduled earnings +1.4%YoY in Q3 from +1.3%YoY in Q2), as labor market conditions remain robust (September unemployment rate -0.1ppts to 2.6). However, the improvement in consumption was probably modest, as inflationary pressures eroded households' purchasing power, with September's headline CPI decelerating only marginally from August by 0.2ppts to 3.0%YoY. Leading indicators suggest that growth will probably remain muted in Q4, reflecting the effects of the global economic slowdown. The Composite PMI fell to 50.5 in October, 1.6pts down from September, entirely driven by the services sector. The consumer confidence index rebounded by 0.5pts to 35.7 in October but remained below the Q3 average of 36.2. A further recovery is expected due to growing momentum in wages, a persistently tight labor market in the services sector (October's service PMI report highlighted a renewed increase in employment) and accumulated savings during the pandemic. However, the elevated inflation will likely continue to weigh on the recovery in consumer sentiment.

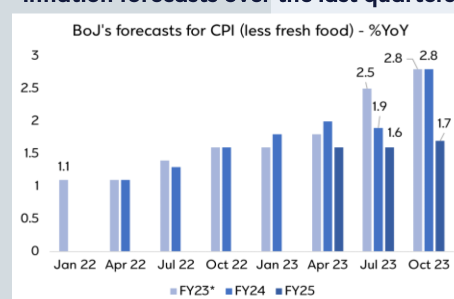
Figure 9: Muted growth is expected in Q4, with moderate recovery in consumer sentiment



Source: Bloomberg, Cabinet Office Japan, Statistics Bureau Japan, Eurobank Research

Notably, the October headline Tokyo CPI, a leading indicator for nationwide inflation, re-accelerated to 3.3%YoY from 2.8%YoY in the prior month, signaling that prices will likely remain elevated. Against this backdrop, we maintain our forecast for annual 2023 GDP growth of 1.8% due to the favorable carry-over effects of drivers that outperformed in H1, such as external demand. Meanwhile, at the Oct 30-31 monetary policy meeting, the BoJ decided to conduct the yield curve control policy with greater flexibility, stating that it will regard the upper bound of 1.0% for 10yr JGB yields as a "reference", and any rise in yields through fixed-rate purchase operations will be determined by the bank "taking account of market rates and other factors", switching from the previous strategy of purchasing 10yr JGBs "at 1.0% every business day". The BoJ's decision possibly reflects concerns about inflationary pressures which were embodied in the sharp upward revisions to inflation forecasts over the last quarters.

Figure 10: The BoJ has revised sharply its inflation forecasts over the last quarters



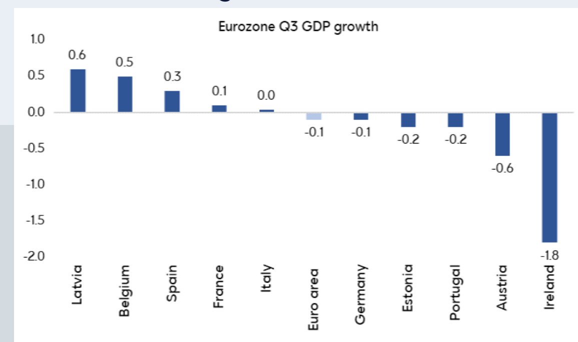
Source: Bank of Japan, Eurobank Research
*FY refers to fiscal year

Euro area

Data consistent with sustained stagnation over the next few quarters

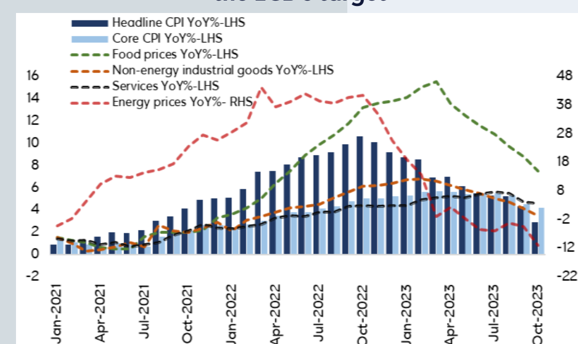
Economic GDP growth contracted by a mild 0.1%QoQ in Q3, slightly below market consensus for a flat reading, following an upwardly revised figure for Q2 of 0.2%QoQ from 0.1%QoQ previously (the expenditure and supply-side breakdown of the Q3 GDP report is not yet available). However, the weaker-than-expected Q3 GDP print was largely due to a 1.8%QoQ contraction in Ireland, where data are usually volatile and often subject to big revisions. Excluding Ireland, the Eurozone Q3 print was flat, in line with the ECB's latest forecast and slightly below the 0.1%QoQ average growth rate of the four largest economies. Looking into Q4, data are consistent with sustained stagnation. The composite PMI unexpectedly dropped further into contractionary territory in October to a fresh post-pandemic low (-0.7pts to 46.5), reflecting a deterioration in both services and manufacturing activity. External demand remains subdued, and tightening monetary policy is transmitting forcefully to the real economy. The annual growth rate of adjusted loans to the private sector decreased further in September to an eight-year low of 0.3%YoY from August's 0.7%YoY, while the ECB's Q3 Bank Lending Survey revealed tighter credit standards for both households and enterprises amid heightened risk perception, as well as lower than expected demand for borrowing mainly on the back of higher interest rates. In a more encouraging note, though, the pace of tightening in lending standards has moved broadly sideways, despite additional ECB tightening and a worsening Eurozone growth outlook. The labor market remains tight (August's unemployment rate matched June's 6.4% record low), while the ongoing disinflationary progress (October's headline and core CPI down to 2.9%YoY and 4.2%YoY respectively, though still above the ECB's target) and continued strength in wage growth (compensation per employee at a record high of 5.6%YoY in Q2) should support real income and household consumption in the coming months, helping the economy avoid a fully-fledged recession. However, downside growth risks are far from over as consumer confidence remains weak (-0.1pts to -17.9 in October) and households seems to have gone into precautionary savings over the last few quarters (saving rate up by 0.4pts in Q2 to 14.9%, the highest since Q1 2022). Against this backdrop, the ECB's tightening cycle has probably already come to an end, with markets pricing in fully a 25bps rate cut by June 2024.

Figure 11: Volatile Irish data dragged Q3 GDP growth lower



Source: Eurostat, Eurobank Research

Figure 12: Inflation slowing but still above the ECB's target



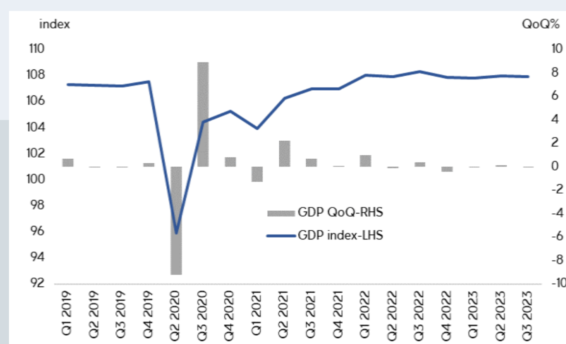
Source: Eurostat, Eurobank Research

Germany

Forward-looking indicators point to a further GDP contraction in Q4

Economic activity returned to contraction in Q3 as GDP dropped by 0.1%QoQ, according to the flash estimate, following an upward revision in Q2 and Q1 figures by 0.1ppts each to 0.1%QoQ and 0.0%QoQ respectively. Even more worryingly, Germany continues to lag behind most of its major Eurozone peers, barely standing above its pre-pandemic GDP level nearly three years on. The detailed breakdown of the GDP data will be published on 24 November, but according to the press release by the Statistical Office (Destatis) household final consumption expenditure was weak, whereas positive contribution came from business fixed investment. Indeed, the rebound in real household income — amid rising wage growth and decelerating inflation (October's CPI at 3.8%YoY is the lowest level since August 2021) — has so far failed to support private consumption. This is reflected in retail sales, which unexpectedly dropped by 0.8%MoM in September, the fourth consecutive monthly decline taking the Q3 average to -1.2%QoQ. Presumably, any rise in disposable income may ended up again in a higher saving rate (Q2 saving rate up by 1.2ppts to a 1 ½ year high of 11.9%), while energy uncertainty amid heightened geopolitical concerns and a renewed slump in the Gfk consumer confidence indicator in November (down 1.4pts to a seven-month low of -28.1), leave no hopes for a strong recovery in private consumption any time soon. Meanwhile, with orders books in the manufacturing sector continuing to decline, it is doubtful whether the Q3 improvement in business fixed investment — which likely reflected lagged effects from easing supply chain bottlenecks — can last longer, particularly given tightening financing conditions and subdued global demand for goods. The trend in new industrial orders points clearly to the downside (down by near 4%YoY from January to September) which is likely to be reflected in a further decline in manufacturing production in the coming months. The manufacturing PMI remains substantially low, despite the October increase (+1.2pts to 40.8), as is also the case for the IFO business climate index (+1.1pts to 86.9). Prospects for residential construction remain gloomy, with residential building permits on a steady downtrend since May 2022, falling by a further 31.5%YoY in August to a fresh 10-year low. We expect GDP to shrink again in Q4, though the H1 upward revisions point to modest upside risks to our annual 2023 forecast for a 0.3% contraction (barring a downward revision to Q3 GDP).

Figure 13: GDP only barely higher than before the pandemic



Source: Destatis, Eurobank Research

Figure 14: Leading indicators consistent with GDP contraction in Q4 2023

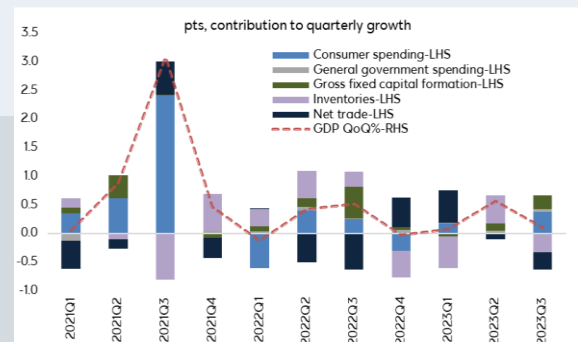
Source: Destatis, Eurobank Research

France

GDP growth expected to remain subdued in Q4

Real GDP rose by 0.1%QoQ in Q3 2023, a sharp deceleration from an upwardly revised growth rate of 0.6%QoQ in the prior quarter. However, underlying details were more encouraging than the headline, showing that final domestic demand added 0.7pts to GDP growth, offsetting a negative contribution from net exports and inventories (each of which subtracted 0.3pts from Q3 GDP growth). Consumer spending re-accelerated, growing by 0.4%QoQ, following a stagnation in the prior quarter, on the back of rising real disposable income as inflation has slowed (HICP decelerated further in October, down by 1.1pts to 4.5%YoY, the lowest level in more than 1½ years), and wage growth remained strong (labor cost index increased 4.5%YoY in Q2, up from 3.8%YoY in Q1). This rebound in consumer spending was mainly supported by stronger goods consumption (0.8%QoQ, the first increase since Q3 2021), led by food products, while services consumption decelerated (0.1%QoQ vs. 0.2%QoQ in Q2). Gross fixed capital formation remained strong, in spite of higher interest rates, rising by 1.0%QoQ after 0.5%QoQ in Q2, driven by spending of non-financial corporations (up by 1.5%QoQ vs. 0.9%QoQ in Q2), while public spending grew by 0.6%QoQ for the second consecutive quarter.

Figure 15: GDP growth decelerated in Q3 but domestic demand rebounded



Source: INSEE, Eurobank Research

Looking ahead, GDP growth is expected to remain subdued in Q4, as suggested by recent lackluster forward-looking indicators. The composite PMI rose by a modest 0.5pts to 44.6 in October, remaining below August's 46.0 reading, while INSEE business confidence dropped by 1.8pts to 98.5, below its long-term average for the first time since April 2021, and INSEE consumer sentiment remains low (at 84 in October). However, strong nominal wage growth, still-elevated household savings (18.5% of disposable income in Q2, above the 15.5% pre-pandemic average) and a strong labor market (September's unemployment rate of 7.3% was close to the record low of 7.1% marked earlier this year), should prevent economic activity from contracting. Following the upwardly revised Q2 GDP figure, we revised our 2023 GDP growth projection to 0.8% from 0.6% previously, though still below the government's 1.4% forecast in its FY 2024 budget, which envisions a drop in the budget deficit to 4.4% from 4.9% of GDP in 2023, with an ultimate target of reaching 2.7% of GDP in 2027.

Figure 16: Strong wage growth and ample savings should prevent the economy from contracting

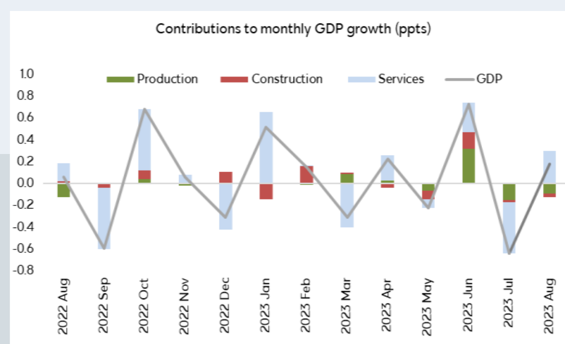
Source: INSEE Eurobank Research

UK

Forward-looking indicators continue to point to a subdued growth outlook

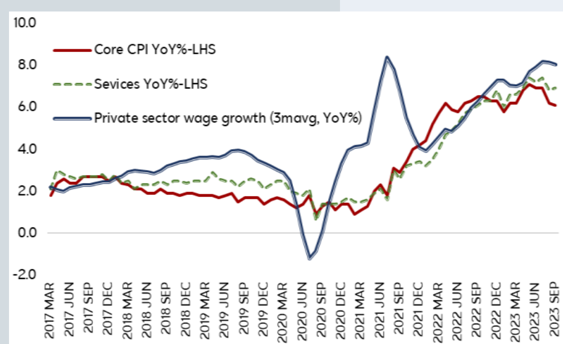
GDP recovered modestly in August rising by 0.2%MoM, following a downwards revised contraction of 0.6%MoM in July (from -0.5%MoM previously). The August gain was led by services which increased by 0.4%MoM, while both industrial production and construction contracted (-0.7%MoM and -0.5%MoM respectively), continuing to unwind large June increases. July and August prints suggest that GDP should grow by at least 0.2%MoM in September so as Q3 growth to avoid falling into contractionary territory. Still, September data look rather gloomy (e.g., construction PMI, retail sales, RICS house price balance) suggesting that the risk of a modestly negative growth rate seems non-negligible. A flat or negative September GDP print would increase the negative carry-over effect into Q4 and the odds of a marginal recession in H2. Indeed, forward-looking indicators for Q4 point to subdued activity, though not deeply recessionary (e.g., October PMIs, Gfk consumer confidence), allowing us to keep unchanged our 0.5% GDP growth projection for the whole of 2023. Meanwhile, disinflation is progressing slowly. The headline CPI surprised to the upside in September, holding steady at 6.7%YoY against expectations for a modest decline. This was mainly driven by services inflation which edged up from August's 6.8%YoY to 6.9%YoY, partially offsetting a renewed drop in core goods inflation (to 4.7%YoY from 5.2%YoY), and, thus, allowing core CPI to drop by just 0.1ppts to 6.1%YoY. Stubbornly sticky services inflation is probably unsurprising in the context of continued strength in wage growth. Private sector regular pay growth slowed only marginally in September, from 8.1% 3mmavg/YoY to 8.0%, remaining not far from the June peak of 8.2%, although unemployment data (up by 0.1pts in July to a near two-year high of 4.3%) and vacancies (down by 10k in September, 24% below the May 2022 peak) point to a loosening labor market. Amid concerns that the prospect for the return of inflation to the 2.0% target remains distant, the BoE adopted a slightly more hawkish tone at its November policy meeting — though decided again to keep rates unchanged — as the new forecasts showed CPI ending slightly above 2% in two years' time (based on the MPC's mean projection using market expectations for interest rates), despite weaker growth projections. Under our central scenario we expect the next move in rates to be to the downside. However, the door to further tightening remains open, if needed, with the BoE focusing on how wage growth and services inflation progress.

Figure 17: August GDP was led by the service sector



Source: ONS, Eurobank Research

Figure 18: The BoE remains way off target amid strong wage growth and sticky services inflation



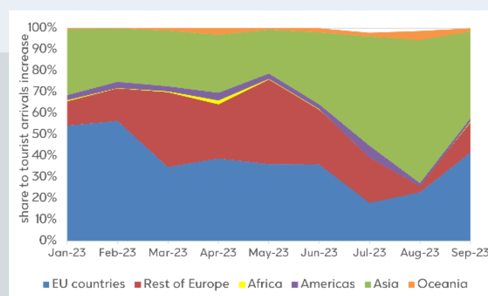
Source: ONS Eurobank Research

Cyprus

Signs of weakening household demand, real estate market and transport equipment expected to boost investments

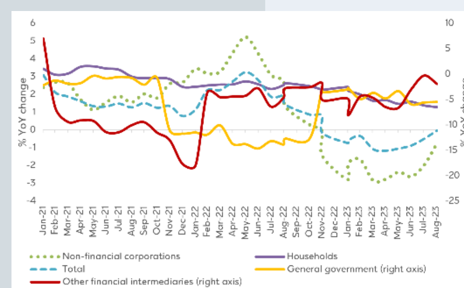
Ahead of the flash Q3 2023 GDP release, due in November 14, growth in retail trade volume, a major determinant of private consumption which was the main GDP growth driver in Q2 2023, eased to 4.2%YoY in September, a ten-month low. Accordingly, the Q3 2023 average print in retail sales stood at +6.2%YoY, slightly below the 6.8%YoY increase in Q2 2023. The weakening mainly reflects the rebound of inflationary pressures from August onwards, with HICP inflation at 4.3%YoY in September from 2.4%YoY in July, mainly due to a reverse of the falling trend in transport (+2.6%YoY in September vs. -6.5%YoY in July) and housing – utility prices (+0.3%YoY against -2.3%YoY). These price dynamics are expected to be at least mitigated by cuts in excise duties on transport fuel and heating oil since November. As analysed in previous bulletins, household consumption will remain supported at least in the remainder of 2023 by partial wage indexation from June onwards, and the strong decline of unemployment, to a 12.5-year low level in Q2 (5.9%). In investments, a new trend reversal after the switch from a strong rise in Q1 (+84.2%YoY) to a decline in Q2 (-5.6%YoY) is most possible in H2 2023, anchored on base effects from transport equipment and a robust real estate market, with sales in the January-October period higher by 19.0%YoY and the increase continuing up to early-Q4 (+11.5%YoY in October). Provided that the recent dynamics in bank credit will continue, with the 1.2%YoY contraction in June turning to stagnation in September, from a similar trend towards non-financial corporations (from -2.4%YoY to -0.7%YoY), a gradual acceleration of business investments is expected from Q4 onwards. Recent developments in the external balance remain tilted to the downside, as the overall trend in July-August remains negative, with the deficit widening by 3.1%YoY, instead of a contraction by 14.0%YoY in Q2. Tourism revenues kept rising annually in July-August, at a slightly slower pace relative to Q2 (+20.0% vs. +27.4%), albeit faster than tourist arrivals (+14.3%), which showed signs of resurgence in September (+17.9%). Given that the Israeli tourist market was the fastest growing in the January-September period, accounting for 27.1% of the increase in overall arrivals, the implications of the current developments in the Middle East region will be of utmost importance for tourism in Q4 and even more in 2024. In view of the above mixed dynamics in GDP determinants, our growth forecast for 2023 remains unchanged to 2.2%.

Figure 19: As the Israeli tourist market was the fastest growing in 2023, developments in the Middle East will be of utmost importance for tourism from Q4 2023 onwards



Source: CYSTAT, Eurobank Research

Figure 20: Provided that the slowdown in credit contraction towards non-financial businesses continues, it could accelerate investments growth



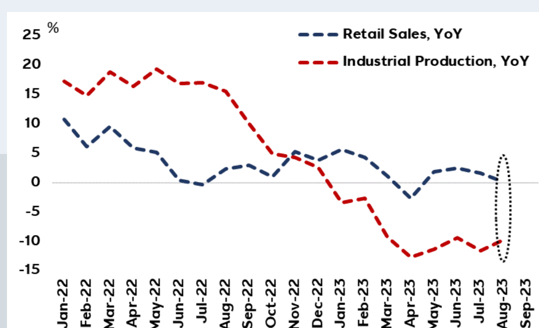
Source: Central Bank of Cyprus, Eurobank Research

Bulgaria

Growth tapping the brake in FY2023; inflation cooling, still, way to go

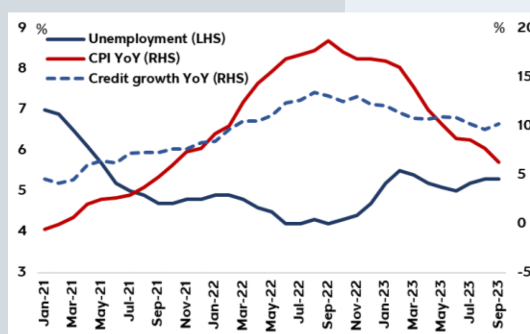
A few days before the release of the flash Q3 GDP estimate on November 14, the National Statistical Institute stepped into an upward revision of the FY2022 GDP growth reading by 0.5ppt, bringing it to 3.9% from 3.4% previously. The revision points to more moderate consumption and stronger gross capital formation, related, though primarily, to inventories. Data for the first two quarters of 2023 were also updated resulting to an H1 average growth rate of 2.05%YoY from 1.95%YoY previously. Given the small difference in the figures, the official growth forecast of the Ministry of Finance for FY2023 remains unchanged at 1.8%, well-anchored with the 1.7% forecast by the IMF in October's WEO and a bit more optimistic with the 1.4% projection of the World Bank in early October. Either or, by any of the aforementioned forecasts including ours at 1.7%, there is evident deceleration between 2022 and 2023 which is broadly expected to come from the subdued private consumption on the back of weaker growth in employment and consumer credit while a bigger negative contribution of net exports to GDP growth is also factored in given the weaker external demand. With the Q3 print ante portas, available hard data referring within the respective quarter broadly suggest growth deceleration in annual terms and sequential stability; retail sales growth decelerated for a second consecutive month to 0.1%YoY in August, compared to 1.6%YoY growth in July, while on monthly terms the retail trade volume remained almost idle following mild contractions in both June and July. Industrial output contracted by 9.7%YoY in August, at an easing pace compared to the 11.6%YoY decline in July but picked up by 1.3%MoM after a -1.2%MoM contraction respectively. October resumed with Fitch Ratings affirming the country's sovereign rating at BBB and keeping the outlook positive. The rating decision was grounded on strong public finance while inflation deescalating continuously since October 2022, coming in at 6.3%YoY in September compared to 7.7%YoY in August. However, unfavourable demographic trends and weak investments as a percentage of GDP pose downside risks to growth which could be mitigated by the positive spillover from the prospect of the eurozone accession in 2025.

Figure 21: faltering economic data ...



Source: National Statistical Institute of Bulgaria , Eurobank Research

Figure 22: ...despite firm labour market and deflation, point to lower growth in Q3



Source: National Bank of Bulgaria, National Statistical Institute of Bulgaria, Eurobank Research

Turkey

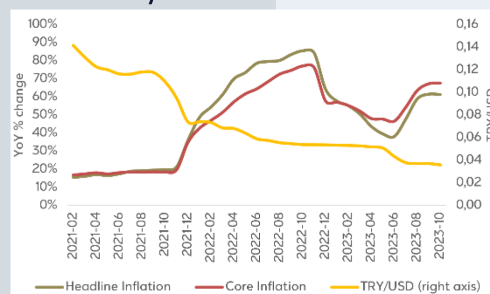
Aggressive monetary tightening weighs mainly on private consumption, but trade balance improves

Inflation readings in Q3 2023 above the central bank's (TCMB) expectations were the main reason behind the fifth consecutive rise of the policy rate in October, by another 500bps, to 35%. On the other hand, in the press release following the new rate increase, the TCMB considered the pass-through to consumer prices from tax hikes, increased wages and falling exchange rates as largely completed. Such dynamics could explain the halt in the recent acceleration of headline inflation in October, to 61.4%YoY, after a 3-month strong rising streak, from 38.2%YoY in June to 61.5%YoY in September. Nonetheless, the lira (TRY) has not appreciated after the latest policy rate hike and remains weak against the USD, close to 0.035, 30.6% lower relative to the May's average, before the monetary policy shift to a tightening stance, and -35.2%YoY, which will sustain inflation from imports. A technical boost to inflation is also expected from November onwards, as from June to October, when gas use for heating was negligible, gas consumption up to 25 m3 was fully subsidized by the state and Turkstat had set a zero price for this part of consumption. On the back of such factors, the TCMB recently revised its inflation forecasts to 65% for end-2023, and to 36% for end-2024, up from 58% and 33% respectively in July. The resurgence of high inflation will weigh on household consumption growth, with weakening effects already evident, as the increase in the retail sales volume decelerated in August to 17.7%YoY, a 9-month low. On the other hand, the goods trade balance improved in Q3 as the TRY depreciated, with exports (in USD terms) expanding by 2.6%YoY, instead of a fall by 5.9%YoY in Q2 and imports falling by 4.2%YoY, against a 2.8%YoY decline. But support from tourism moderated in Q3, with receipts (in USD terms) rising by 13.1%YoY, albeit less than in Q2 (+23.5%YoY). Aggressive monetary policy tightening will weigh on investments, as credit expansion (PPI real effective rate adjusted) towards non-financial businesses decelerated in July-August, to a still vigorous 60.1%YoY, albeit slower than the 78.9%YoY pace in Q2. These trends could be mitigated by the further relaxation in October of macroprudential measures on banks' commercial loans. The escalation of the reconstruction process due to the earthquakes, reflected on accelerating state capital transfers in Q3, will boost investment activity. Under these differing dynamics in GDP components, our 2023 growth forecast for 2023 is revised slightly upwards, to 4.0% from 3.7%.

Figure 23: Monetary tightening will weigh on investments, as credit growth to non-financial businesses decelerated in July-August

* PPI real effective rate adjusted
Source: Central Bank of Turkey, Eurobank Research

Figure 24: Higher interest rates weakened credit growth towards businesses, but have not affected yet credit towards households



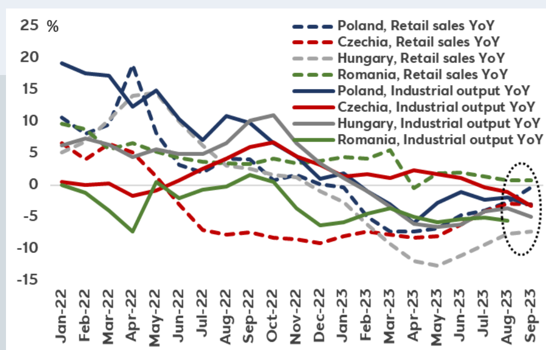
Source: Turkstat, Central Bank of Turkey, Eurobank Research

CESEE

Monetary ease reluctantly unfolds as growth taps the brake

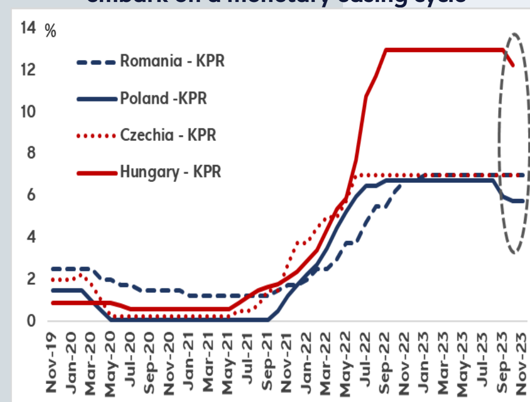
With only Czechia having released a flash estimate of the Q3 GDP data among the core countries in the region, assessment over the course of the economies during Q3 is mainly based on hard data from both the supply and demand side. These, more or less, indicate that growth tapped the brake in the third quarter of the year while a glance in the forward-looking PMIs that CEE3 publish shows that omens for early Q4 are not rosier. In detail, GDP in Czechia contracted by 0.6%YoY when market expected a milder print of -0.3%YoY. Similarly went the sequential print as it came in at -0.3%QoQ with the consensus pointing to a standstill. With Q3 growth data ante portas for the rest of the peers, retail sales and industrial production in key economies of the region point to deceleration during the said quarter. Specifically, retail sales in September for all CEE3 (Poland, Hungary and Czechia) continued to shrink compared to August while in Romania they remained on a growing, though decelerating, pace since July. On a similar and even more intense vein went the industrial output which contracted in all four aforementioned economies in the last couple of months. At the same time, inflation continues to remain on a downward path across the region (Poland 8.2%YoY vs 10.2%YoY, Hungary 12.2%YoY vs 16.4%YoY, Czechia 6.9%YoY vs 8.5%YoY and Romania 8.9%YoY vs 9.4%YoY between September and August respectively) broadly assisted by high base effects from the same period last year, with each passing month underlying that price peaks are behind. In view of the above and taking also into account the persistent employment shortages that add pressure on the heated labor markets, regional central banks (CBs) appear to be walking on a tight rope with respect to the decision over the right timing for embarking on a monetary loosening cycle. That said, since September the Polish CB has delivered cumulatively 100bps of interest rate cutting, setting the key policy interest rate at 5.75% from 6.75% in August with the CB of Hungary lifting the torch in October's MPC when it eased its base rate by 75bps bringing it to 12.25%. MPCs in Czechia and Romania have both raised their base rates at 7% since April 2022 and January 2023 respectively, deciding to hold fire for another month, presumably on the back of the comparatively better shape of these two economies, as evident in the IMF's recent WEO forecasts.

Figure 25: deteriorating hard economic data pointing to growth deceleration in Q3…



Source: Eurostat, Eurobank Research

Figure 26: …push central banks to reluctantly embark on a monetary easing cycle



Source: Central Banks of CEE3 & Romania, 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)		
	2022	2023f	2024f	2022	2023f	2024f	2022	2023f	2024f	2022	2023f	2024f	2022	2023f	2024f
World	3.5	2.8	2.6	8.7	6.1	4.4									
Advanced Economies															
USA	1.9	2.3	1.0	8.0	4.2	2.7	3.6	3.7	4.3	-3.8	-3.1	-3.0	-5.4	-6.1	-5.1
Eurozone	3.4	0.5	0.7	8.4	5.6	2.7	6.7	6.5	6.7	-0.6	1.2	1.6	-3.6	-3.4	-3.0
Germany	1.8	-0.4	0.5	8.6	6.1	2.9	5.3	5.7	5.6	4.4	5.9	5.6	-2.5	-2.4	-1.4
France	2.5	0.8	0.8	5.9	5.7	2.7	7.3	7.3	7.3	-2.0	-0.7	-0.5	-4.8	-4.9	-4.5
Periphery															
Cyprus	5.6	2.2	2.9	8.1	4.1	2.3	6.8	6.2	5.8	-9.1	-11.0	-8.0	2.3	3.3	3.5
Italy	3.7	0.8	0.7	8.7	6.2	2.4	8.1	7.7	7.6	-1.5	0.7	1.3	-8.0	-5.3	-4.3
Portugal	6.8	2.3	1.3	8.1	5.4	2.7	6.0	6.6	6.6	-1.2	1.4	0.5	-0.3	-0.3	-0.2
Spain	5.8	2.3	1.4	8.3	3.6	3.1	12.9	12.1	12.0	0.6	2.1	1.7	-4.7	-4.1	-3.4
UK	4.3	0.4	0.4	9.1	7.4	3.0	3.7	4.2	4.7	-4.9	-3.5	-3.2	-4.3	-5.1	-3.6
Japan	1.0	1.8	1.1	2.5	3.3	2.5	2.6	2.6	2.5	2.1	3.1	3.1	-6.7	-5.5	-4.0
Emerging Economies															
BRICs															
Brazil	2.9	3.0	1.5	9.3	4.7	4.0	9.5	8.2	8.5	-2.8	-2.1	-2.2	-4.6	-7.5	-6.8
China	3.0	5.1	4.6	2.0	0.6	1.9	4.9	5.3	5.1	2.2	1.5	1.2	-4.7	-5.5	-4.5
India	7.0	6.2	6.4	6.7	5.4	4.7		NA		-2.1	-1.5	-1.7	-6.4	-5.9	-5.3
Russia	-2.1	1.9	1.2	13.8	5.7	5.4	3.9	3.3	3.4	10.2	2.1	3.0	-2.2	-2.7	-1.5
CESEE															
Bulgaria	3.4	1.7	2.5	15.3	9.6	4.1	4.3	4.4	4.5	-0.7	-0.5	-0.3	-2.8	-3.1	-3.0
Turkey	5.4	4.0	3.1	72.0	53.2	35.6	10.5	9.6	8.9	-5.4	-6.8	-5.5	-0.9	-4.0	-2.3

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

Eurobank Fixed Income Forecasts

	Current	December-23	March-24	June-24	September-24
USA					
Fed Funds Rate	5.25-5.50%	5.30-5.55%	5.25-5.50%	5.00-5.25%	4.63-4.90%
3m SOFR	5.37%	5.42%	5.32%	5.07%	4.73%
2yr Notes	5.50%	5.55%	5.50%	5.25%	4.90%
10yr Bonds	5.25%	5.30%	5.25%	5.00%	4.63%
Eurozone					
Refi Rate	4.50%	4.50%	4.45%	4.30%	4.10%
3m Euribor	3.97%	3.98%	3.95%	3.82%	3.62%
2yr Bunds	3.21%	2.75%	2.57%	2.52%	2.43%
10yr Bunds	2.69%	2.64%	2.52%	2.40%	2.32%
UK					
Repo Rate	5.25%	5.30%	5.30%	5.15%	4.85%
3m Sonia	5.24%	5.30%	5.29%	5.17%	4.87%
10-yr Gilt	4.30%	4.10%	3.94%	3.78%	3.65%
Switzerland					
3m Saron	1.70%	1.70%	1.70%	1.65%	1.53%
10-yr Bond	1.14%	1.15%	1.11%	1.08%	1.06%

Source: Bloomberg (market implied forecasts)

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