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The world economy is not out of the woods yet as it continues to face several steep challenges. However, broadly improved PMI data in January raise hopes that the downturn has passed its trough. Meanwhile, headline inflation continued to decelerate, but still remains above target, and labor market tightness contributes to strong wage growth, keeping core services inflation elevated. Conditions still warrant some further monetary policy tightening, as suggested by the broad guidance that came out by a number of major central banks at their latest policy meetings.

Macro Picture

USA: solid Q4 GDP print masks rapidly slowing underlying growth momentum

EA: Eurozone may avoid an earlier expected technical recession this winter

UK: unexpected November GDP growth likely only delays a looming recession

CESEE: flash Q4 GDP estimates verify the anticipated slowdown

Markets

FX: USD index volatile, closing -1.34% lower intra-month on expectations of slower Fed hiking pace

Rates: significant retracement for EU and US yields on the back of lower inflation prints and market expectations of approaching terminal rates

EM: strong performance continued due to the slowdown in the US hiking cycle and China's re-opening

Credit: spreads continue to move tighter due to more optimistic macro expectations and strong IG demand; EU primary market remains quite active.

Policy Outlook

USA: the Fed stands by the December dot plot, indicating at least another two 25bps hikes

EA: the ECB pledged another 50bps rate hike in March, but more open on subsequent policy steps

UK: the new BoE future guidance indicates that the tightening cycle is nearing its end

CESEE: as growth brakes, sovereigns exploit the positive momentum in bond markets

Key Downside Risks

DM: China's recovery stalling, persistently high inflation, escalation of the Ukraine war, enforced EU gas rationing, renewed uptrend in commodity prices, more infectious coronavirus variants

EM: increased financial vulnerability of already fragile economies from the blend of high debt levels, lower growth, and higher financing costs, China's reopening focusing primarily on internal demand

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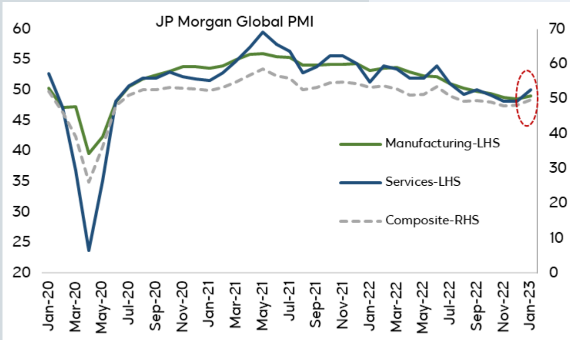
Macro Views

Latest world economic & market developments

Broadly improved PMI data in January raise hopes that the downturn in global economic activity has likely passed its trough

After a continuous deterioration since mid-2022, PMI data broadly improved across several major economies in January, raising hopes that the downturn may have passed its trough and the global economy is taking a turn for the better. The J.P. Morgan Global Composite Output PMI edged up from December's 48.2 to a six-month high of 49.8, and though still in contractionary territory, it stands just only a few pips below the non-change threshold of 50.0. Undoubtedly, one month data do not make a new trend and the world economy is not out of the woods yet as it continues to face several steep challenges. However, it is encouraging to see signs of improvement for the first time in many months. This holds especially as the speed of the downturn in several closely watched forward-looking components, including new orders, though still below 50.0, eased to the lowest in recent months. The global manufacturing PMI edged up to 49.1 from 48.7 in December, signaling a slower pace of decrease, and the respective index for services rose to 50.1 from 48.1, pointing to an increase in output for the first time since July 2022. Much of the January's global PMI output rebound is owned to Asia, especially China and Japan which both returned to expansion after reopening, while Eurozone had also had an impact, albeit only marginal, thanks to lower natural gas prices. In contrast, the US, UK and Australia, , among others, saw output decreases.

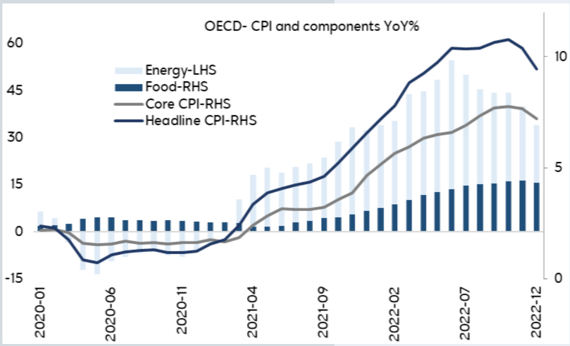
Figure 1: Improved January's PMI data raise hopes that the downturn in global economy activity may have passed its trough



Source: Markit, Eurobank Research

On the inflation front, global CPI gains continued to moderate in December, reflecting both a decline in oil prices and household energy relief measures in Europe. However, the deceleration is not sufficiently large, as headline CPI still remains well above central bank comfort zones. More worryingly, the decline in core CPI is far more modest and less broad-based, as continued tight labor markets across a number of economies contribute to strong

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



Source: OECD, Eurobank Research

wage growth, keeping core services inflation elevated. Obviously, cumulative rate tightening so far has only had a limited impact on labor markets, taking into account that the latter respond to a tighter monetary policy with a time lag. That said, conditions still warrant some further monetary policy tightening, as suggested by the broad guidance that came out of a number of major central banks that convened in early February. As policy turns more restrictive, some central banks opt to slow their pace hikes, including the Fed, signaling though that the downshift does not mean a pause is imminent. And though some shifts in the language contained some surprises, market expectations for a dovish pivot in the not-too-distant future may prove premature.

Developed Economies

US: According to the advance estimate, US Q4 GDP rose by a robust annualized rate of 2.9%, but likely overstates the economy's growth momentum, masking a sharp deterioration in consumer spending and business investment. That said, final sales to domestic purchasers — GDP excluding inventories and trade — rose by half compared to Q3 (0.8% vs. 1.5%), with the private sector subset rising by an even weaker 0.2% (vs. 1.1% in Q3). Along these lines, activity-based indicators pertaining to the end of Q4 2022/early Q1 2023 are decelerating sharply, making clear that the economy is weakening in a broad-based fashion, and the risk of a recession, though mild, by mid-year is non-negligible, as the impact of tightening Fed policy will weigh more forcefully in economic activity in the period ahead. Meanwhile, though both headline and core CPI dropped in December for the third consecutive month still remained elevated, and wage growth continues to run above the 3.5% level that is deemed consistent with the Fed's inflation target. Against this background, the Fed stuck at the February meeting to the latest (December 2022) dot plot, indicating at least another two 25bps hikes, before policy is sufficiently restrictive to return inflation to 2% over time.

Euro area: Eurozone Q4 2022 GDP surprised to the upside, rising by 0.1%QoQ, according to the preliminary flash estimate, downplaying market expectations for a modest contraction, largely owed to Ireland where GDP grew by a hefty 3.5%QoQ, contributing more than 0.1ppt to Eurozone GDP growth. Moving into early 2023, leading indicators pertaining to January (e.g., PMI, consumer confidence) point to a stronger pace of economic activity. Though we are still at the start of Q1, January's encouraging activity indicators that followed surprising Q4 2022 GDP growth expansion, suggest that an earlier expected technical recession this winter will likely be avoided, notwithstanding a downward revision in Q4 GDP estimate. Meanwhile, headline CPI dropped further to 8.5%YoY in January amid lower energy prices, while core remained stuck at December's 5.2%YoY record high, as a drop in services prices was more than offset by a strong rise in non-energy industrial goods inflation. Amid improved growth prospects and sticky core inflation, the ECB pledged another 50bps rate hike at the next policy meeting in March, before evaluating the subsequent path of policy on the back of "more balanced" inflation risks.

Emerging Economies

EM: As China's reopening proceeds swiftly and faster than initially expected the outlook for the EM space improved intramonth, under the assumption that the rebound of the world's second biggest economy will have positive spillover effects for the global economy. Indicatively, in its fresh World Economic Update, the IMF revised upwards the 2023 EM growth forecast to 4.0% from 3.7% in October 2022 with the revision broadly attributed to the rebound of China[1] and Russia[2] with the latter finally not sinking into a deep, war-driven recession as earlier anticipated. China's rebound is expected to be mostly driven by pent-up demand, spontaneously unleashed after three years of restrictions. That said, the EMs that are about to benefit instantly are those feeding China's consumption, especially the tourism-related part concentrated in Asia, namely Thailand, Vietnam and Malaysia. Before hard data in the next couple of months start to sketch the effects of the reopening, market reaction during the past month has been buoyant bringing along sizable inflows towards EM, after a challenging 2022 in terms of assets performance. Indicatively, the MSCI Emerging markets index is up about 6% so far this year, after reporting losses of ca 20% in 2022 and so is the JP Morgan EMBI + index, which tracks liquid emerging market fixed and floating-rate debt instruments issued by sovereign entities, having risen above 3% year-to-date after declining about 25% last year. Both benchmark EM assets performance indices mirror the spurred optimism, however, challenges and risks have not shoved off as geopolitical risks intensify and a blend of high debt levels, global lower growth, and higher financing costs sharpen the economic and financial vulnerability of already fragile developing economies.

CESEE: The flash estimates of Q4 2022 GDP in some countries of the region (e.g., Serbia, Poland, Czechia) affirmed the expected growth slowdown on an annual basis. However, the print in some peers is slightly stronger than anticipated. Although the Q4 GDP breakdown into expenditure components will be released later in February and in early March, according to the flash estimates press releases, the deceleration in most cases is mainly owed to weakening household consumption, on the back of heightened inflationary pressures, and, in some cases, deteriorating net exports, highlighting the worsening external environment. To tackle high inflation implications, central banks in the region have already proceeded with successive hikes in key policy rates (Romania, Serbia etc.) and some further monetary tightening could continue ahead, which, however, will weigh on investments. Meanwhile, taking advantage of the fixed income spree at play since the start of 2023 in the region, a significant number of bond issuances has been completed (Serbia, Bulgaria, Poland, Czechia etc.), with strong demand from investors, indicating their degree of confidence to the countries' long-term prospects. Although the outlook for 2023 is surrounded by significant uncertainties, mainly related to the war between Russia and Ukraine, it is not as gloomy as in late 2022. In its Winter Forecast released recently, the Vienna Institute for International Economic Studies (WIIW) assessed that regional countries have proved to be resilient to the war crisis and although economic activity has slowed significantly, most of them will continue to grow in 2023. According to the WIIW, a full-year

1 2023 growth forecast 5.2% vs 4.4% projected in Oct and 2022 realised growth 3.0%
2 2023 growth forecast 0.3% vs -2.3% seen in Oct and 2022 realised growth contraction 2.2%)

recession will most probably be largely avoided, with the exceptions of Hungary and Russia whose economies are forecast to contract, as most regional peers "have probably already digested most of the economic shock caused by the Ukraine war".

CESEE Markets Developments & Outlook

Bulgaria

In mid-January 10-year sovereign bonds were successfully placed at the amount of EUR1.5bn. The titles, offered with an interest rate coupon of 4.50%, achieved a spread to the average interest rate swap of 215bps and a yield of 4.78%, resulting in an average price of 97.815%. From the outset, the issue attracted significant interest from investors, with the order book exceeding the size of EUR7.0bn. The said issue complemented the sovereign debt yield curve and increased the liquidity of the government debt.

Serbia

Negligible fluctuations have been spotted in the FX local markets since the beginning of 2023, as the National Bank of Serbia remains vigilant about the stability of the EUR/RSD rate. On the flipside, the local sovereign bond market has been quite active. 5-year and 10-year Eurobonds denominated in USD were issued totaling to USD1.75bn. The 5-year bonds were issued at the amount of USD750mn with a coupon rate of 6.25% and a yield, after the FX hedge, of 6MEuribor + 2.90%. The 10-year bond totaled to USD1bn with a coupon rate of 6.50% and a final interest rate of 6MEuribor + 3.10%. Yields for both papers have already dropped by ca 60bps, indicating the vivid interest on the said papers in the secondary market. In detail, the 5-year and 10-year Eurobonds are currently traded at 5.70% (vs the issuance yield of 6.33%) and 6.20% (vs the issuance yield of 6.81%), respectively. Regarding the local FI market, RSD yields have been moving in line with those of Serbian and other regional Eurobonds. Indicatively, the 3-year, 5-year and 10-year RSD bonds have retreated by ca 30bps compared to the end of 2022, currently trading at 6.00%, 6.20% and 6.90% respectively.

Markets View

Foreign Exchange

EUR/USD: the pair is trading above 1.07 currently, with the market digesting the US NFP numbers and the Fed's higher for longer commentary, ahead of Eurozone CPI and GDP data in the upcoming days. We see a strong support level around 1.0730-1.0750 where bulls seem to be positioned with a view that the trend will continue towards the 1.10 territory. We believe the first psychological level towards this upside movement is positioned around the 1.08-1.0850 range, above which the breakout move would be rapidly evolved towards the 1.09 territory.

EUR/GBP: currently the pair is trading in a range between 0.89 and 0.90 with the latter acting as the psychological resistance level. The poor fundamentals of the UK economy and the consensus of a final 25bps hike in March by the BoE have kept the pair consolidating around this range, though a breakout consensus above 0.90 is also active. We are positioned towards an extension of the current trading range with moves around a 1.5% band, while waiting for the official Eurozone CPI and GDP data in the upcoming days, to reassess the probability of the breakout above 0.90. Downside movement is assigned with a low probability mainly due to the current purely price momentum-based sentiment.

Rates

EU: short term interest rates consolidated at lower levels post ECB meeting, where although the central bank raised interest rates by 50bp, bringing the deposit rate to 2.50%, President Christine Lagarde failed to provide enough hawkish commentary to justify the significant hikes priced in Europe. The 5y Swap rate is trading at 283bps, down from 295bps at the beginning of the month. The slope of the curve remains close to -50bps at the 5s-30s part of the curve. Looking forward, we expect the volatility to fall further and a 50bps increase at the next monetary policy meeting which is already priced in.

US: rates retraced significantly last month, primary driven from the lower CPI prints and market expectations of a Fed pivot. Fed Chair Jerome Powell said at the post meeting news conference that "the disinflationary process has started". The 5y swap is trading close to 375bps, quite lower from 400bps at the beginning of the month. The curve remains inverted with the 5s-30s part of the curve close to -50bps, having traded as high as -30bps since the beginning of the month. Looking forward, we expect volatility to fall further and rates to consolidate around the current levels given that the 25bps hike at the last meeting was widely expected and the assessment on the economy was mostly unchanged.

Emerging Markets Sovereign credit

The slowdown in the US hiking cycle, along with the so far smooth China's reopening has led EM duration to rally further with inflows into EM bonds accelerating. The EMBI Global Index closed at 368 bps at the end of January, 20 bps tighter on the month. In CEEMEA, we had an impressive rally with South African bonds performing strongly, while the Hungarian bonds lagged a bit, suffering a one notch downgrade from S&P to BBB-. In LATAM, we saw bold interest for local fixed income, as the central banks seem to have reached the peak in their hiking cycles. In Asia, the Bank of Japan decided to keep its yield curve control intact, while Chinese assets have performed very well after the country's re-opening. We are constructive on EM assets as the momentum is good, the volatility remains contained and the China reopening appears to be progressing according to plan. However, as valuations get tighter and positioning heavier, we think that investors will turn to idiosyncratic risks.

Corporate credit

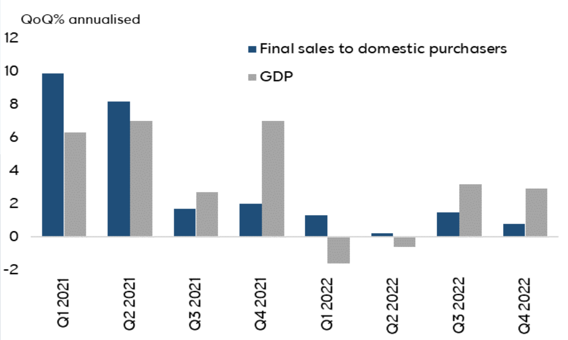
European credit kicked the year off on a strong start in January, which proved to be one of the busiest months for issuance in recent history. Markets remained on risk-on mode throughout the month, supported by a brighter macro-outlook following the decline in energy prices (to their lowest levels since 2021), which sparked positive revisions in EU economic forecasts. In other positive news, China's reopening has also led to more optimistic expectations about the country's economic performance, propelling risk-off sentiment even further. All credit indices were in positive territory in January, with EUR corporate cash underperforming both USD and GBP. European Investment Grade (IG) was 11bps tighter in January with Financials outperforming, (Sr -37bps, Sub -28 bps tighter respectively) while Technology and Consumer Staples were laggards (tightening by only 5bps and 7bps respectively). High Yield (HY) was 60bps tighter with Consumer Staples tighter by 163bps followed by Telecoms and Senior Financials (-80 bps and -77 bps respectively). On the other hand, Technology was a notable underperformer, tightening by approximately 9bps. On the other side of the Atlantic, IG and HY ended 10bps and 54bps tighter, performing in line with the EU. Following last week's central bank policy decisions and US payroll data, we expect spreads to continue to move tighter on the back of lower gas prices, bolstered Chinese growth and strong IG demand. We expect Europe's primary market to remain quite active as credit risk gauges hover around low levels. Earnings season continues in the background, with European oil heavyweights due this week.

US

Solid Q4 GDP print masks rapidly slowing underlying growth momentum

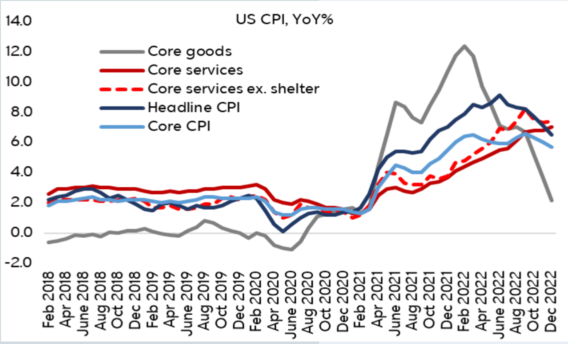
According to the advance estimate, US Q4 GDP rose by a still robust annualized rate of 2.9% after a 3.2% growth in Q3, suggesting that the economy continued to perform strongly following a 1.1%QoQ annualized decline in H1. However, the better-than-expected Q4 GDP print likely overstates the economy's growth momentum, masking a sharp deterioration in consumer spending and business investment. More than two thirds of the Q4 growth came from volatile components, namely inventories and net exports (imports -4.6% vs. exports -1.3%), contributing 1.5ppts and 0.6ppt, respectively. Personal consumption grew by 2.1%, slightly slower from 2.3% in Q3, but this largely reflects dwindling excess savings, as the personal savings rate stood at 2.9%, close to a 17-year low of 2.7% in Q3 following an historic high level of 26.4% in Q2 2020. Fixed investment fell by a hefty 6.7% driven by a near 27% drop in residential investment, while non-residential investment (essentially business investment) edged up by a meagre 0.7%, with spending on equipment falling by 3.7%. That said, final sales to domestic purchasers — GDP excluding inventories and trade, a much stronger gauge of GDP growth in the coming quarters than GDP itself — rose by half compared to Q3 (0.8% vs. 1.5%) and less than half the Fed's estimate of potential growth, with the private sector subset rising by an even weaker 0.2% (vs. 1.1% in Q3). Along these lines, activity-based indicators pertaining to the end of Q4 2022/early Q1 2023 (e.g. ISM surveys, IP, retail sales), are decelerating sharply, making clear that the economy is weakening in a broad-based fashion, and the risk of a recession, though mild, by mid-year, is non-negligible, as the impact of tightening Fed policy will weigh more forcefully in economic activity in the period ahead (given the lags of monetary policy). Meanwhile, though both headline and core CPI dropped in December for the third consecutive month, still remained elevated (6.5%YoY and 5.7%YoY, respectively), non-housing core services inflation (technically the PCE core inflation index) which tends to be more sensitive to wage costs, has not yet embarked on a downward trend, and wage growth continues to run well above the 3.5% level that is historically consistent with the Fed's inflation target. Against this background, the Fed stuck at the February meeting to its latest dot plot (December 2022), indicating at least another two 25bps hikes, before policy is sufficiently restrictive to return inflation to 2% over time.

Figure 3: Solid Q4 GDP print masks rapidly slowing underlying growth momentum



Source: BLS, Eurobank Research

Figure 4: Core services ex. shelter inflation has yet to embark on a downward trend



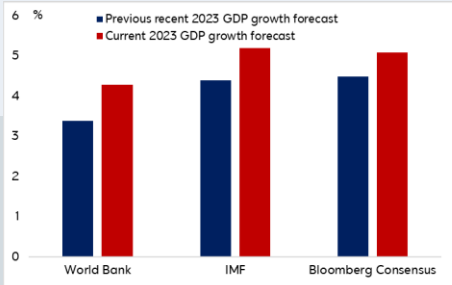
Source: BLS, Eurobank Research

China

Embarking towards a pro-growth, still bumpy, 2023

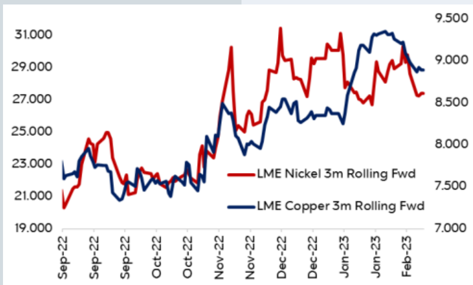
Real GDP growth slowed down to 2.9%YoY in Q42022 from 4.8%YoY, 0.4%YoY and 3.9% in Q1, Q2 and Q3, weighed down by the severe lockdowns major Chinese cities were under during the biggest part of the last quarter of 2022. For the full year 2022, GDP grew by 3.0%, which is well below the official target of around 5.5% and ranks as the second slowest pace in the last fifty years. However, with the pivot decision in late November over the long-waited abandonment of the zero-covid policy, the 2023 growth story is put on a more optimistic trail. After three years of restrictions and isolation, high frequency data, such as passenger traffic, which increased by ca 50%YoY in January point to vivid mobility while, specifically during the last 10 days of January, i.e. the holiday period of the Lunar New Year, long distance travelling with train and airplane more than doubled compared to the previous two years, lagging behind, however, from 2019 levels. Available hard data, such as retail sales, have not yet captured the positive momentum of January, yet the same month's services PMIs (54.4 vs 41.6 in Dec) bode well with the robust tourism traffic while the respective manufacturing index returned to expansion territory (50.1) for the first time since September 2022. Along these lines, the outlook has ameliorated with the improvement mirrored in the growth forecasts of IFIs for 2023. Indicatively, in early January, the World Bank projected a 4.3% growth rate, upped by 0.9ppt since June 2022, while the IMF, at the end of the same month, expected growth at 5.2% vs 4.4% in the previous WEO in October 2022. On top of these two, market consensus on the same gauge has improved by 0.6ppt within January, currently standing at 5.1%. All in all, the economy appears to have geared up towards a strong recovery which will be primarily driven by the pent-up demand for consumer goods and services. It is highly likely that the latter two segments will recover spontaneously with no specific economic policy impulse required. However, the same assumption over the lack of necessity for policy stimulus cannot be inferred for the troubled and pivotal real estate sector, posing challenges ahead. Reflectively, new property sales by the 100 largest Chinese developers continued to shrink in January in both annual (-32.5%YoY) and monthly terms (-48.6%MoM), implying that the roll out of property policies in force since mid-November 2022 has not kicked in yet.

Figure 5: While growth forecasts for 2023 keep improving ...



Source: World Bank, IMF, Bloomberg, Eurobank Research

Figure 6:..markets discount its consumption-led trail...



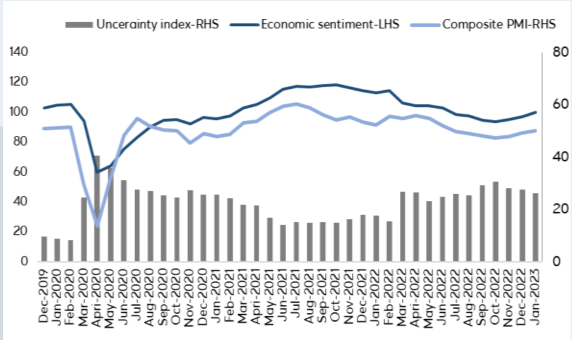
Source: Bloomberg, Eurobank Research

Euro area

Eurozone may avoid an earlier expected technical recession this winter

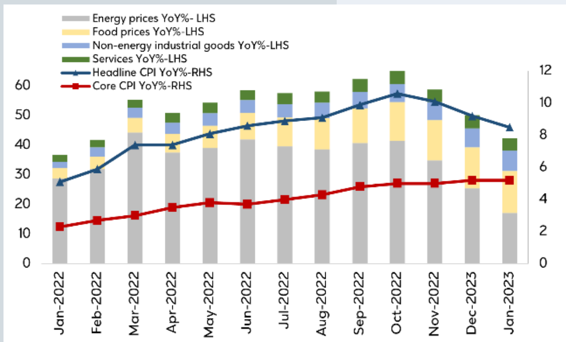
Eurozone Q4 2022 GDP surprised to the upside, rising by 0.1%QoQ, according to the preliminary flash estimate, downplaying market expectations for a modest contraction. But this is largely owed to Ireland where, likely thanks to certain activities of multinational corporations, GDP grew by a hefty 3.5%QoQ, contributing more than 0.1ppts to Eurozone GDP growth. Meanwhile, data from a number of individual countries suggest that domestic activity (private consumption and investment) was weak amid persistently high price pressures and tighter financial conditions, while net trade was the main growth driver, amid lower imports rather than higher exports (a breakdown of Eurozone GDP growth is due on 8 March). Moving into early 2023, leading indicators pertaining to January point to a stronger pace of economic activity. Indicatively, the composite PMI rose for the third consecutive month, moving back in expansionary territory for the first time since June 2022 (+1.0ppt to 50.3), with improvements across both manufacturing and services, on the back of lower energy prices and easing supply chain disruptions. Similarly, the EC consumer confidence continued to increase for a fourth month in a row (+1.3ppts to -20.9), reflecting a slowdown in price pressures and reduced concerns over gas rationing thanks to the relatively mild weather and high gas storage levels. Overall, though we are still at the start of Q1, January's encouraging activity indicators that followed the surprising Q4 2022 GDP growth expansion, suggest that an earlier expected technical recession this winter will likely be avoided, notwithstanding a downward revision in Q4 GDP estimate. However, for the full 2023 year we stick to our projection for a broad GDP growth stagnation, as ECB tightening will have an effect over the course of the year and high price pressures should continue to erode consumer purchasing power. That said, headline CPI dropped further to 8.5%YoY in January amid lower energy prices, while core remained stuck at December's 5.2%YoY record high, as a drop in service prices was more than offset by a strong rise in non-energy industrial goods inflation. Amid improved growth prospects and sticky core inflation, the ECB pledged another 50bps rate hike at the next policy meeting in March, before evaluating the subsequent path of policy on the back of "more balanced" inflation risks.

Figure 7: improved January's activity indicators suggest increased chances for Eurozone to avoid winter recession



Source: European Commission, PMI, Eurobank Research

Figure 8: Headline CPI fell further in January, while core remained at record highs for the second consecutive month



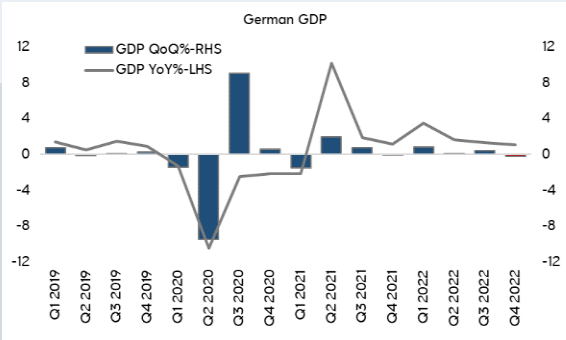
Source: Eurostat, Eurobank Research

Germany

Q4 GDP contraction increases the risk of a technical recession

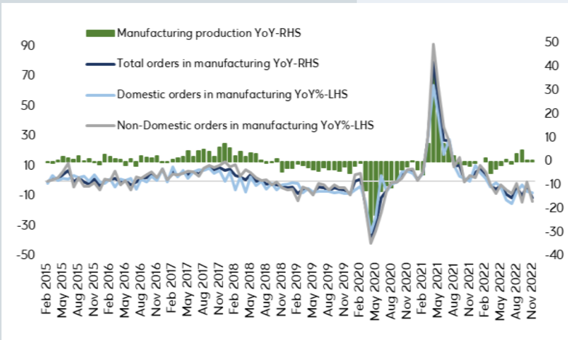
In contrast to the preliminary full year 2022 GDP estimate that indicated a flat quarterly growth (the release did not contain a quarterly breakdown), Q4 2022 GDP contracted by 0.2%QoQ, according to the flash estimate, partly reversing the 0.4%QoQ increase in Q3. As was cited by the statistical office (Q4 2022 detailed results due for release on 24 February), private consumption was the main drag on growth, reflecting the burden of persistently high inflation and deteriorating financial conditions due to rising ECB interest rates, while pent-up demand for travel and contact-intense services after the removal of Covid-19 restrictions, which supported private spending in Q3, has probably faded. That said, still-significant accumulated savings (savings rate at 11.5% in 2022, still above the average pre-pandemic level), the remarkable resilience of the labor market (the ILO unemployment rate dropped to the all-time low of 2.9% in December), and the government's one-off payment of household energy bills in December, apparently did not prevent private consumption from shrinking. Undoubtedly, the economy continues to face several steep challenges, and the negative Q4 GDP print likely increased the risk of a technical recession as output may drop further in Q1 2023. Price pressures should continue to weigh on households' purchasing power, consumers will feel the pressure of price hikes by utility companies for gas and electricity as the long-term price-fixed contracts that expired in January will be adjusted to reflect the past increases in wholesale prices, while IP which has held up reasonably well so far, may not be able to decouple much longer from falling new orders on the back of weakening external demand (new industrial orders have dropped by c. 20% since peaking in July 2021). However, reduced fears over a gas rationing scenario (gas storages c. 80% of their capacity as of end-January compared to a five-year average of c. 60%), lower energy prices and improving sentiment indicators pertaining to January (e.g., GfK consumer climate, IFO business climate, PMIs) suggest that, even if a technical recession realises, it should be shallow and short-lived. Overall, we still expect GDP to contract this year, -0.4%, but less than -0.6% projected at end-2022.

Figure 9: Q4 2022 GDP quarterly decline likely marked the start of a technical recession



Source: German Federal Statistical Office, Eurobank Research

Figure 10: Declining industrial orders could weigh heavily on IP in the foreseeable future



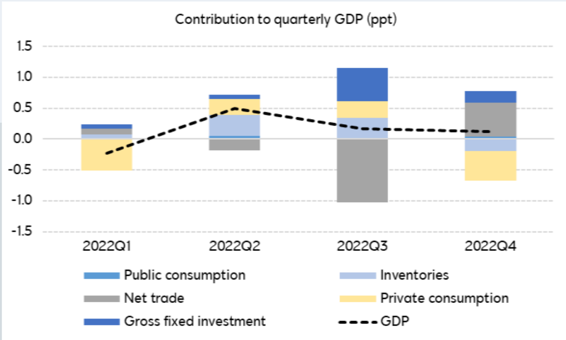
Source: German Federal Statistical Office, Eurobank Research

France

Recession averted in late 2022, but challenges prevail at the beginning of 2023

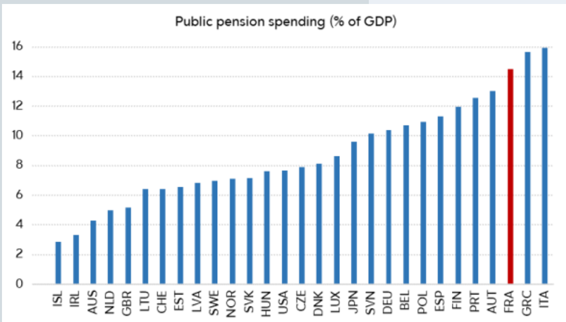
The French economy narrowly avoided recession in Q4 2022, expanding by a meagre 0.1%QoQ after 0.2%QoQ in the prior quarter. This brought the average annual growth for the full year to 2.6%, with most of it coming from the post-pandemic recovery in H2 2021 (carry-over effect). The unexpected positive Q4 GDP growth print was entirely owed to net trade (+0.5ppt), as imports fell by a higher pace than exports (-1.9%QoQ vs. -0.3%QoQ, respectively), partially reflecting the improved domestic energy production after a number of nuclear plants reopened. Domestic demand (excluding changes in inventories) which is usually the main growth driver, was a drag on economic activity (-0.2ppt), on the back of a sharp decline in consumer spending (-0.9%QoQ) as the cost-of-living crisis is taking a toll, partially offsetting gross fixed investment which continued to expand, albeit by a slower pace (0.8%QoQ vs. 2.3%QoQ in Q3) thanks to business investment resilience to higher energy prices and borrowing costs(+1.2%QoQ). Looking ahead to the early 2023, the latest sentiment indicators paint a mixed picture and, while not pointing to risks of a recession, they leave no room for optimism for a strong rebound. The composite PMI fell slightly in January, remaining below the threshold of 50 for the third consecutive month (at 49.1), consumer confidence declined slightly remaining well below the long-term average of 100 (at 80), but encouragingly, the INSEE business index stood 2ppts above its long-term average (102.1) on the back of reduced risks of energy shortages this winter and lower gas and electricity wholesale prices. Undoubtedly, the economic backdrop continues to look challenging. Fiscal policy is becoming less expansionary following the end of the fuel tax rebate and the 15% rise in the regulated prices of gas that partially explains the renewed increase in HICP inflation to 6.0%YoY in January. Higher ECB interest rates and elevated inflation should continue to weigh on household purchasing power, raising also questions over whether the resilience of business investment could be sustained for long. Risks seem skewed for a modest GDP contraction in Q1, taking also into account the massive national strikes and protests to the proposed pension reform, with annual GDP expected to rise by a modest 0.3% for the whole year.

Figure 11: Q4 GDP growth entirely owed to net trade



Source: INSEE, Eurobank Research

Figure 12: France is among the EU countries with the highest pension spending as % of GDP



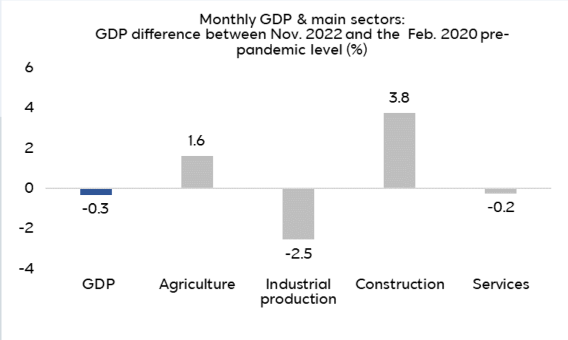
Source: OECD, Economic Research

UK

Unexpected November GDP growth likely only delays a looming recession

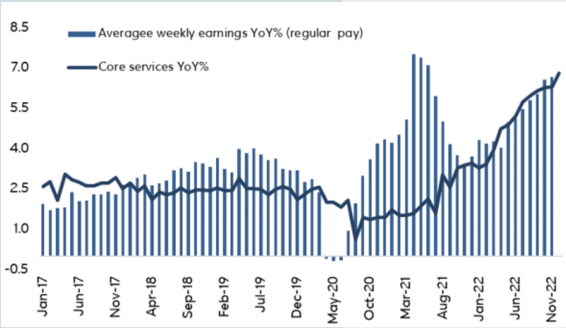
UK GDP surprised to the upside in November growing by 0.1%MoM against expectations of a modest contraction. The increase was exclusively led by services (+0.2%MoM, +0.15ppts), partially supported by the start of the World Cup. Industrial production continued to drop for the eight consecutive month (-0.2%MoM, -0.04ppt) mostly pressured by manufacturing, while construction output was flat. Despite the unexpected GDP growth in November, the actual level of output, as measured by monthly GDP, was still 0.3% below its pre-pandemic level (Feb. 2020), largely due to industrial production (Graph 13). Nevertheless, the economy appears to weather the cost-of-living crisis better than earlier expected, with November GDP translating into a positive Q4 carry-over to the tune of 0.1%QoQ. This increases the chances Q4 GDP not to come in negative, preventing a technical recession after Q3 GDP dropping by 0.3%QoQ. Barring any material revisions, for Q4 GDP to be negative, this would require December GDP falling deeply in negative territory (at least -0.5%MoM). However, it is a close call, as worker strikes in December pose near-term downside growth risks and December's activity indicators point to a weakening economic environment. In any case, the broader picture for the UK economy is still challenging and a non-negative Q4 GDP print would rather delay than avert a looming recession, as several headwinds remain. Notably, higher BoE interest rates have yet to fully feed through to household consumption and business investment, public policy will be relatively less supportive in 2023 as much of the energy support will dissipate, and persistently high price pressures should continue to erode consumer purchasing power. That said, headline inflation fell to 10.5%YoY in December from 10.7%YoY in the prior month, though core was stronger than expected, remaining steady at 6.3%YoY, on the back of strong services inflation (6.8%YoY) driven by rising wage growth amid a persistent tight labor market. However, the expected recession by mid-year is likely to be shallower than earlier projected, thanks to lower energy prices and improved external backdrop following China's reopening and better than earlier expected Eurozone growth prospects. All in all, we now expect 2023 GDP to shrink by -0.7%, less than -0.9% previously.

Figure 13: In spite of November's unexpected GDP growth, output remained below pre-pandemic levels



Source: ONS, Eurobank Research

Figure 14: Persistent strength in services inflation driven by accelerating wage growth



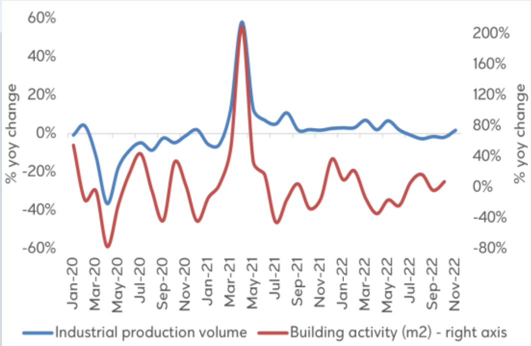
Source: ONS, Eurobank Research

Cyprus

Implementation of investment-related reforms needed to offset weakening exports

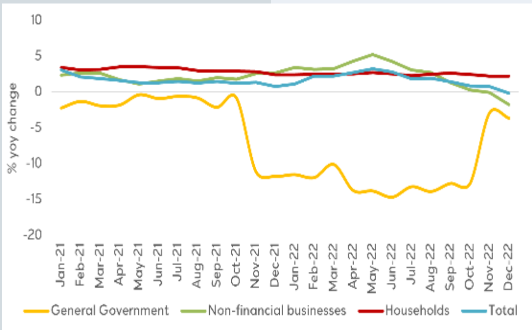
As According to the latest trends in short-term indicators of economic activity, headwinds in Q4 2022 in the main growth drivers in the previous three quarters, namely tourism and investments, persist. In November, tourism receipts fell on an annual basis for the first time since Mar 21, by 7.5%, in line with the marginal rise in tourist arrivals (+0.6%YoY in Nov 22). The 13.5%YoY increase of the latter in Dec 22 led to an average rise of 3.6%YoY in Q4 2022 vs. 37.6%YoY in Q3 2022, highlighting the reduced support from the tourism sector lately to the Cypriot economy. On the investments front, the number of building permits fell in Oct 22 for the fifth consecutive month, albeit by a slower pace than earlier in the year, by 2.6%YoY against -10.7%YoY in Q3 2022. As analysed in previous issues, this weakening is related to the protracted foreclosure suspension for loans, with its implications extending over credit expansion to the non-financial sector, which turned negative at late 2022 (-0.2%YoY), for the first time in the last two years. Another possible deterring factor to investment activity is the downturn in the volume of industrial production since Q3 2022, which was slightly reversed in Nov 22 (+1.9%YoY). On the flipside, the volume of retail trade widened in Dec 22 by 4.0%YoY and its increase in Q4 2022 averaged 3.0%YoY vs. 1.7%YoY in the previous quarter, signaling a bounce-back in household consumption, on the back of government support measures. The extension of the aforementioned adverse dynamics in 2023 will depend on, first, the intensity and duration of a likely economic downturn in the EU in H1 2023, affecting both exports and investment appetite, and second, when the foreclosure suspension will be withdrawn or drastically revised. Developments concerning the latter issue are expected after the formation of a new government following the recent presidential elections, but should not be further pushed behind, as they are related to RRP implementation and future RRF disbursements. Publicly funded investments in 2023 will most probably be higher than last year, with means of the disbursed first RRF tranche and future ones. Inflation pressures will be eased in the public sector given the completion of the 4.5-year plan in Jan 23 to restore the memorandum cuts in salaries, as well as the indexation allowance for 2023.

Figure 15: Headwinds in Q4 2022 in key sectors of economic activity



Source: CYSTAT, Eurobank Research

Figure 16: Fall in credit to the non-financial sector in Dec 22 after 2 years, from the same trend towards businesses



Source: Central Bank of Cyprus, Eurobank Research

Bulgaria

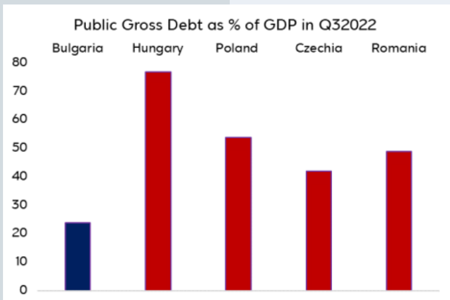
GDP growth cooling and delays on the euro adoption

The year kicked off on a positive footing as on January 18 Bulgaria tapped the bond markets with a EUR1.5bn 10-year Eurobond. Investors' interest proved strong as the size of orders exceeded EUR7bn resulting to a 4.78% yield. Three weeks later the bond trades at lower yield levels (ca 4.48%) while its mid-swap spread has also retreated, implying the continuing strong appetite among participants in the secondary market. Despite the spotted favorable market window and the fixed income spree at play since the start of 2023 in the CESEE region, the interim government has decided not to pursue the pumping of additional funds from the international markets, in the anticipation of a new regular government to submit a budget bill for 2023 (so far that of 2022 is prolonged and executed) and a new parliament to approve it. That said, parliamentary snap elections - the 5th in the last two years - will be held on April 2, following all three unfruitful exploratory mandates over a coalition government, with the most recent polls still pointing to a fragmented parliament. Along these lines, fresh comments by Fitch Rating on the announcement of elections highlighting the political instability as a drawback in 2023's growth, mainly in the shape of delays in the RRF disbursements, came as no surprise. Additional headwinds on the near-term economic outlook stem from the inflationary pressures which remain broadly unabated. Both on annual and monthly terms, HICP picked up in December, bringing the annual average rate of 2022 at 13.0%. Such a print sets a clear barrier for the timely (i.e. on January 1 2024) euro adoption, which will most probably be mirrored in the coming convergence reports by both the EC and the ECB. Prospects over a quick decompression of inflation are also undermined, apart from the international energy commodity and food prices, from the historically low unemployment rate which is estimated at 4.5% in 2022 and expected to remain around these levels in 2023. Given the unfavourable demographic trends, labour shortages are expected to prove stubborn despite this year's forecast GDP growth deceleration to 1.5% from 3.0% in 2022, on the back of a slowdown in government consumption growth and sluggish implementation of investment projects under the RRP whose completion will most probably tip in 2024's growth rate, instead of 2023's. Despite the challenges laid out above, the economy emits resilience which is well routed in the sound public finances (public debt 23.7% of the projected GDP as of Q32022) and upon which, inter alia, Moody's Rating Agency based the affirmation of the Baa1 sovereign rating in early February, keeping the stable outlook.

Figure 17: Amid growth retarding cross-country due to high inflation...

Source: Statistics Office of each country depicted, Eurobank Research

Figure 18: ...the lowest indebtedness of Bulgaria in the region adds resilience...



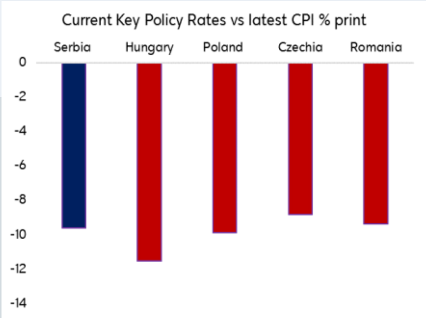
Source: Eurostat, Eurobank Research

Serbia

Q4 GDP growth print lands steeply to 0.4%YoY from 3%YoY in 9M2022

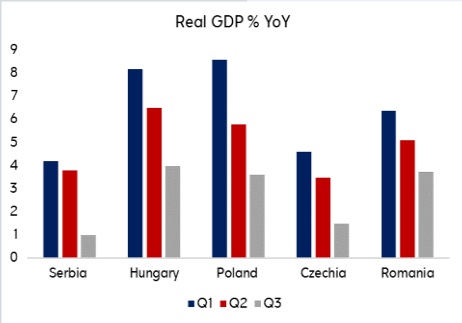
The flash estimate of Q42022 GDP growth came in at 0.4%YoY on January 31, verifying the preliminary estimation the Serbian statistics office released at the turn of the year, according to which GDP growth in 2022 cooled down to 2.3% from 7.5% in 2021. While the breakdown of the GDP into the expenditure components for Q42022 will be released at the end of February, revealing the key contributors of growth, it is private consumption, in our view, that primarily led growth in the first half of 2022 (+4.0%YoY) but its retreat in the second half resulted in the clear deceleration of economic activity (+0.7%YoY). With the trajectory of retail sales growth throughout 2022 considered as a proxy for the course of private consumption, we attribute the Q42022 growth deceleration, among other factors, to the sharp retail trade growth slowdown in November (+1.3%YoY vs 5.0%YoY in October and Jan-Oct average 6.6%YoY) and marginal decrease in December (-0.2%YoY). As outlined in previous issues, the toll inflation has taken on the economy through the hampering of private consumption became visible in Q32022 (GDP growth +1.0%YoY vs 3.8%YoY in Q2) and intensified further in Q42022 (GDP growth +0.4%YoY). Inflation stabilised at 15.1%YoY in December, the same as in November, averaging in 2022 at 11.9%, while on a monthly basis, consumer prices rose by 0.5% in December compared to 1.0% in November. Moreover, prospects over a quick decompression of inflation are undermined by the historically low unemployment rate of 8.9% in Q32022 which reflects the growing labor shortages. Along these lines, the monetary tightening the National Bank of Serbia (NBS) has been following ceaselessly during the past 11 months has almost never caught markets off guard, in the sense that the adopted remedy of the cumulative 450bps Key Policy Rate increase which currently sets the key policy rate at 5.50% is in line with the monetary policy regional economies follow under similar inflationary circumstances. In the above outlined macroeconomic context, the Ministry of Finance (FinMin) did not let the opportunity window of sovereign bonds issuance unexploited. Taking advantage of the fixed income spree at play since the start of 2023 in the region, the FinMin tapped the financial markets by raising ca RSD53bn in 2 and 121/2 -year sovereign bonds, USD1.75bn in 5 and 10-year Eurobonds and EUR37.5mn in 2-year bonds, with the majority of the 7 issuances attracting substantial investors' bids, signaling a indication of strong demand.

Figure 19: Despite the monetary tightening among peers…



Source: Central Bank of each country depicted, Eurobank Research

Figure 20: …unabated inflation took a visible toll on growth in 2022…



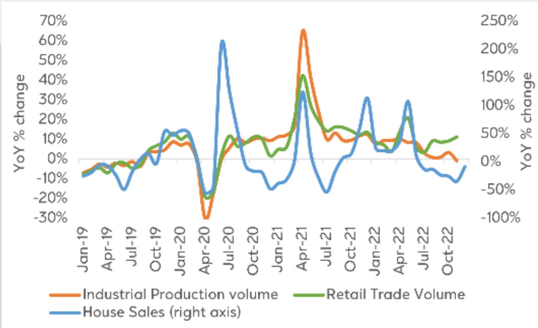
Source: Statistics Office of each country depicted, Eurobank Research

Turkey

State support and central bank policies the most dominant factors of economic activity ahead

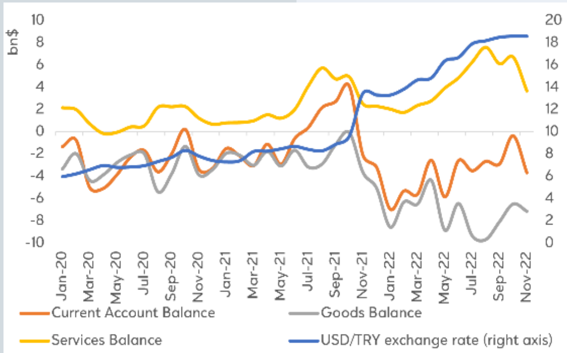
Ahead of the Q4 2022 and FY 2022 GDP estimate in end February, recent short-term trends in sectors of economic activity indicate that either decelerating or falling dynamics prevailed in end 2022. Production volume in the industry sector shrunk in November in annual terms for the first time since Jun 20, by 1.3%. This fall is linked to weakening exports of goods, whose expansion loses pace since May 22, standing at 0.5%YoY in November from 27.1%YoY in April, an indication of the fading benefits of the Turkish lira (TRY) devaluation due to the unconventional monetary policy stance by the Central Bank of Turkey (TCMB). Also in Nov 22, turnover in the services sector (excl. retail trade) spiked by 128.3%YoY, however this rise was the smallest in the last nine months. On the contrary, the increase in the volume of retail trade accelerated further in the same month, to 11.3%YoY, the strongest rise since Jun 22, a trend in line with improving consumer confidence, despite soaring inflation, which reached a multi-year high in past November (85.5%YoY). As the increase in imports of goods is also weakening since Aug 22, stronger demand in retail trade is covered to a growing extent by domestically produced goods. De-escalating inflation since Dec 22 (57.6%YoY in January), on the back of falling prices of energy goods globally and domestically (e.g. from successive cuts in the electric power price cap for industrial consumers), but also because of further macroprudential measures to support the TRY exchange rate in January and, most possibly, in the months ahead, is expected to stimulate household consumption in H1 2023. Household income is also strengthened by the 54.7% increase in the net minimum wage in January, which however will hold back inflation decline. The fluctuation of the TRY exchange rate at lower levels w.r.t a year ago (e.g. vs. USD) will moderately improve the current account balance, through lower goods imports. Weakened industrial production and rapidly falling house sales will deter investments. The normality of part of the Turkish economy will be affected by the strong earthquakes in the south and center parts of the country. On the other hand, due to this adverse event, extensive packages of support measures will be taken, giving a boost to the hit regions and the overall economy, probably since Q3 2023.

Figure 21: Growth decelerating or falling dynamics prevail recently in economic sectors



Source: Turkstat, Eurobank Research

Figure 22: Fading benefits from the Turkish lira devaluation in Q3 2022, due to the falling services surplus



Source: Turkstat, Eurobank Research

Eurobank Macro Forecasts

	Real GDP (YoY%)			CPI (YoY%, avg)			Unemployment rate (% of total labor force)			Current Account (% of GDP)			General Budget Balance (% of GDP)		
	2022e	2023f	2024f	2022e	2023f	2024f	2022e	2023f	2024f	2022e	2023f	2024f	2022e	2023f	2024f
World	3.4	2.1	2.9	8.8	5.3	3.6									
Advanced Economies															
USA	2.1	0.5	1.2	8.0	3.8	2.5	3.6	4.2	4.8	-3.8	-3.3	-3.2	-5.5	-4.5	-4.7
Eurozone	3.5	0.1	1.3	8.4	5.8	2.3	6.7	7.0	7.0	-0.5	0.8	1.4	-3.8	-3.6	-3.1
Germany	1.8	-0.4	1.3	8.6	6.6	2.9	5.3	5.6	5.4	3.6	4.2	4.2	-2.6	-2.8	-2.0
France	2.6	0.3	1.2	5.9	5.1	2.3	7.3	7.6	7.7	-1.8	-2.3	-1.5	-5.1	-5.3	-4.8
Periphery															
Cyprus	5.3	2.0	2.7	8.1	4.0	2.0	6.3	6.1	5.7	-10.8	-8.0	-6.0	1.4	0.6	1.0
Italy	3.9	0.1	1.0	8.7	6.5	2.0	8.1	8.4	8.4	-0.2	-0.2	0.1	-5.5	-4.9	-4.2
Portugal	6.9	0.6	1.6	8.1	5.3	2.3	6.0	6.2	6.1	-2.0	-1.7	-1.3	-1.8	-1.3	-0.9
Spain	5.5	1.0	1.9	8.3	4.1	2.5	12.9	13.0	12.8	0.4	0.3	0.5	-4.9	-4.4	-3.9
UK	4.1	-0.7	0.8	9.1	7.0	2.5	3.7	4.5	4.7	-5.0	-4.2	-3.6	-6.7	-5.4	-3.7
Japan	1.3	1.3	1.0	2.5	2.0	1.7	2.6	2.5	2.4	1.6	1.5	2.0	-6.7	-5	-3.8
Emerging Economies															
BRICs															
Brazil	3.0	0.8	1.8	9.3	4.9	4.0	9.5	9.4	9.5	-2.6	-2.2	-2.3	-4.8	-7.8	-7.4
China	3.0	4.9	5.0	2.1	2.2	2.2	4.9	4.0	4.0	2.2	1.5	1.3	-5.1	-4.8	-4.5
India	7.0	6.0	6.0	6.7	6.6	5.0		NA		-3.2	-2.7	-2.6	-6.2	-6.0	-5.7
Russia	-3.0	-3.0	1.5	13.8	13.8	5.9	3.9	4.5	4.5	10.6	5.4	4.2	-2.0	-3.0	-1.4
CESEE															
Bulgaria	3.1	1.3	2.5	15.2	8.7	4.1	4.5	4.8	4.7	-0.8	-1.1	-0.5	-2.9	-3.0	-3.0
Serbia	2.3	2.5	3.2	11.9	9.7	4.7	10.1	10.5	9.8	-8.6	-8.1	-7.5	-3.1	-3.3	-2.5
Turkey	5.2	2.5	3.5	72.0	38.4	17.6	10.7	9.8	9.2	-5.5	-4.2	-5.0	-0.7	-2.2	-1.3

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

Eurobank Fixed Income Forecasts

	Current	December	March	June	September
USA					
Fed Funds Rate	4.50-4.75%	4.73-5.00%	4.80-5.05%	4.72-4.95%	4.49-4.75%
3m SOFR	4.71%	4.89%	4.98%	4.82%	4.54%
2yr Notes	4.75%	5.00%	5.05%	4.95%	4.75%
10yr Bonds	4.50%	4.73%	4.80%	4.72%	4.49%
Eurozone					
Refi Rate	3.00%	3.40%	3.60%	3.60%	3.55%
3m Euribor	2.57%	2.86%	2.95%	2.95%	2.91%
2yr Bunds	2.62%	2.50%	2.54%	2.34%	2.04%
10yr Bunds	2.30%	2.33%	2.31%	2.25%	2.06%
UK					
Repo Rate	4.00%	4.15%	4.20%	4.20%	4.15%
3m Sonia	4.05%	4.06%	4.08%	4.04%	3.86%
10-yr Gilt	3.24%	3.44%	3.40%	3.37%	3.20%
Switzerland					
3m Saron	1.17%	1.45%	1.55%	1.52%	1.52%
10-yr Bond	1.28%	1.44%	1.51%	1.45%	1.37%

Source: Bloomberg (market implied forecasts)

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