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Global indicators for Q1 2024 have generally exceeded expectations. Growth prospects are getting brighter, but inflation is coming down more slowly than before, particularly in services. Monetary policy is unlikely to remain in its current restrictive setting for long though. Central bankers are still expressing caution about cutting rates too soon, but they also concede that discussions about it have started. However, they insist that they will be guided by incoming economic data and say they need to see more evidence that inflation will return to target in a durable manner. While the first rate cuts are getting closer, questions linger over the course of easing after that, as well as where the terminal policy rate will eventually settle.

Macro Picture

USA: indicators suggest that economic activity likely remained solid through Q1

EA: tentative signs that economic activity may have turned the corner

Japan: annual spring salary negotiations bring big raises for employees at large corporations

CESEE: improved sentiment on the back of retreating inflation and monetary easing

Markets

FX: EUR and GBP both bearish; FX vol at lows, presents opportunities for long positioning

Rates: EU and US rates expected to move lower, but at slow pace given recent macro data

EM: sovereign spreads further tightened, supported by the steady guidance from the Fed

Credit: focus remains on macro data and central banks; issuance likely to pick up in April

Policy Outlook

USA: the median dot for 2024 still implies 75bps of easing, but the Fed remains data dependent

EA: the ECB hints at June for first rate cut, with wage data holding the key to the policy outlook

Japan: BoJ hiked in March, finally putting an end to negative interest rate policy

CESEE: divergent speeds on rates cutting by CBs given the multifaceted inflationary conjuncture

Key Downside Risks

DM: disinflation slowing leads to tight monetary policy for longer, commodity prices spike and renewed threat of supply chain disruptions as geopolitical tensions escalate

EM: natural disasters such as the earthquake in Taiwan give short-lived hiccups in the semiconductors industry; sharper geopolitical fragmentation leads to risk repricing

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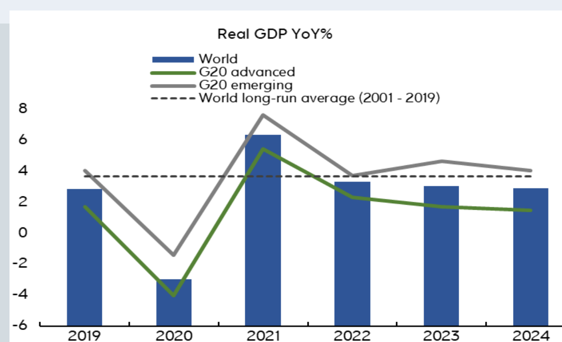
Macro Views

As global growth prospects brighten, the pace of disinflation has stalled leaving major CBs reluctant to pre-commit to a particular course for rate cuts

Global indicators for Q1 2024 have generally exceeded expectations, pointing to brighter near-term growth prospects. Solid March flash PMI surveys from a number of developed economies show an extended uptrend for the composite index for the fifth consecutive month to a new high since mid-2023, underpinned by robust private sector balance sheets, resilient labour markets and a diminishing drag from inflation. The services sector remained robust, with the PMI index rising for a fifth straight month, comfortably remaining in expansionary territory. Concurrently, the manufacturing sector continued to exhibit signs of renewed life, after the respective global PMI index in February climbed above the 50.0 threshold – that signals expansion – for the first time since August 2022. Regional activity is also showing signs of better balance, offering a glimmer of hope that the global expansion is transitioning towards a phase of stable and robust growth. While US economic growth continues to show resilience, activity in China appears to be stabilising, the Eurozone is showing tentative signs of bottoming out and the UK's GDP rebounded in January after contracting in H2 2023. For 2024, global GDP growth is expected to decelerate mildly, to 2.8%, indicating a soft landing following a robust 3.1% expansion in 2023. Geopolitical uncertainty remains high, past monetary policy tightening continues to affect economic activity, savings buffers built during the pandemic are gradually dwindling and fiscal policy is expected to be less supportive as governments aim to manage high debt levels.

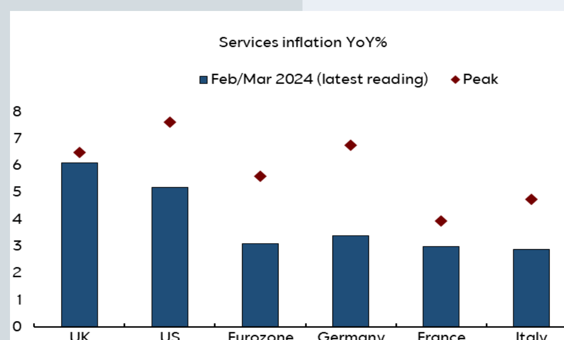
Figure 1: Global growth is expected to decelerate mildly in 2024



Source: OECD, Bloomberg, Eurobank Research

Meanwhile, the pace of disinflation has slowed unexpectedly. While global headline CPI growth remains on a slight downward trajectory, global core inflation has seen a more gradual decline. The deflationary trend in goods prices, driven by easing supply-chain pressures and softening global goods demand, appears to be losing some momentum lately, possibly due to the latest disruptions in global shipping routes. More worryingly, pressures on global services prices persist, primarily due to high wage growth in most developed economies. Even in countries which have experienced subdued growth, including the Eurozone and the UK, labour

Figure 2: Services inflation remains high



Source: BLS, Eurostat, ONS, Eurobank Research

markets remain relatively tight. Unemployment rates stand below pre-pandemic levels despite signs of cooling in recent months, probably due to labour hoarding and demographic factors, among other reasons.

Nevertheless, monetary policy is unlikely to remain excessively restrictive for long. Major central banks are maintaining a cautious stance on early rate cuts, but they are also signalling that discussions have started on dialling back policy restriction. Still, they remain firmly committed to a data-dependent policy mode emphasizing the need for further evidence to build enough confidence that inflation will return to target in a timely manner. Overall, while the prospect of the first rate cuts is not too distant, questions remain over the rate-easing path and eventual terminal rate.

Developed Economies

US: the economy continues showing its resilience as robust wage growth and healthy household balance sheets spur consumption. Real GDP for Q4 2023 was unexpectedly revised higher by 0.2ppts to an annualised rate of 3.4%, reflecting primarily upgraded estimates of consumer spending (+0.3ppts to 3.3%). The momentum in personal consumption expenditure growth appears to have carried over into this year. Real personal consumption expenditure (PCE) rose by a robust 0.4%MoM in February, a substantial rebound following January's weather-related 0.2%MoM drop. Personal income rose by a lower than expected 0.3%MoM in February mainly due to dividend income (-3.7%MoM), while compensation of employees grew by 0.7%MoM after rising 0.4%MoM in the prior three months, reflecting a hefty gain of 0.8%MoM in wages and salaries. On the inflation front, the headline PCE price index softened to 0.3%MoM in February from January's 0.4%MoM gain (2.5%YoY vs. 2.4%YoY), and core PCE was up by 0.3%MoM, decelerating from 0.5%MoM (2.8%YoY vs. 2.9%YoY). These figures were almost in line with expectations, keeping open the prospect that the Fed will start a rate easing cycle in June. The Fed's updated dot plot at the March policy meeting continued to point to three incremental cuts this year, but considering the economy's continued resilience, risks seem skewed towards fewer or delayed cuts.

Euro area: incoming sentiment indicators (flash composite PMI, economic sentiment and consumer sentiment for March) provide a glimmer of hope that the worst may be over for economic activity, hinting at a modest recovery potentially starting in late Q1 or early Q2. The annual rate of adjusted loans to the private sector also saw a decent pick up in February, indicating that the most significant impact of past rate hikes on bank lending is probably over. Meanwhile, inflation data for March surprised to the downside, after coming in slightly firmer than expected in the previous two months, increasing the chances of a first ECB rate cut being delivered in June, as President Lagarde has strongly hinted. Both headline and core inflation fell by 0.2ppts to 2.4%YoY and 2.9%YoY respectively. The disinflationary trend for core industrial goods remained intact (-0.5ppts to 1.1%YoY), but services inflation remained sticky (at 4.0%YoY for the fifth consecutive month), mostly influenced by high wage growth (Q4 2023 compensation per employee down by 0.6ppts to 4.5%YoY, though still above levels consistent with the ECB's inflation target). Not surprisingly, the ECB has deliberately refrained from committing to a pre-defined rate easing path thereafter, with developments in wages holding the key to the monetary policy outlook.

Emerging Economies

EM: the major events in the emerging markets sphere since our previous publication are the earthquake in Taiwan and the municipal elections in Turkey. The outcome was in favour of the main opposition party CHP as it prevailed in the two largest cities, Istanbul and Ankara, just like it did in the previous ballot back in 2019. A few days before the elections, the central bank of Turkey proceeded with a surprise 500bps interest rate hike, which brought the key policy rate to 50%. March's CPI print, released a few days later, vindicated the move as inflation spiked further to 68.5%YoY from 67.1%YoY in February. A series of central bank monetary policy committees also took place in central and southeastern Europe. However, there were no surprises there, as markets had anticipated the policy rate hikes from Czechia and Hungary, as they also did the decisions by Poland and Romania's central banks to hold fire. The earthquake in Taiwan, aside from the grave humanitarian cost, also roiled markets as the world's biggest chipmaker, Taiwan Semiconductor manufacturing Co (TSMC), evacuated factory premises. More than 70% of production has already resumed, but some short-term hiccups cannot be ruled out in the total supply chain of semiconductors, pushing prices in the sector upwards, if only temporary. Aside from these events, the big picture across equities and currencies in March was positive, with the key gauges broadly faring well. The MSCI EM equities index recorded gains of 2.76%MoM, the respective currency index held firm, retreating by only 0.42%MoM, which was a respectable performance considering that March was a good month for the USD, as measured by the DXY, which increased 1.32%.

CESEE: March held an improvement in sentiment indicators for major countries in the region, signaling rosier expectations. The ESI in Poland, Czechia, Hungary, and Romania perked up, bringing it broadly in line with the general trend in the EU and EA. So did manufacturing PMIs, but with some cross-country differentiation. Beyond the tepid turnaround of the soft data, retreating inflation has led to key policy rate (KPR) cuts by major central banks in the region. The central banks of Czechia and Hungary proceeded with additional rate cuts in the monetary policy committee (MPC) meetings held in March, by 50bps and 75bps respectively. Both decisions were widely expected by market participants. Despite the improvement in the soft data, revised growth outlooks released in March by two rating agencies, Fitch and S&P, had trimmed growth 2024 forecasts for Poland to 2.2% and 2.9%, respectively, from 2.5% and 3.1%. The discrepancy between sentiment indicators and growth forecasts makes it hard to draw safe conclusions but could be indicative of the prevailing fragility of economic prospects, not just for Poland but also for the wider region. Still, Moody's affirmation in the same month of the country's creditworthiness reminds us that along with the fragility, there is also economic resilience.

Markets View

Foreign Exchange

EUR/USD: market sentiment for EUR/USD has turned bearish in recent weeks. A break below 1.0773 could pave the way for a potential downward push towards 1.0671. Further bearish momentum could potentially target the 52-week low near 1.0448. RSI (30) is currently at 46.111 indicating that technically the market is also in bearish territory. MACD signal is currently at a bullish crossover, suggesting that upward momentum could be building but not yet quite strong to cancel out the bearish sentiment. Support levels include 1.0665, 1.0611 and 1.0558, while resistance levels include 1.1058,1.1113 and 1.1168. 1M, 6M and 9M implied volatility currently at 5.165%, 5.46% and 5.7275% respectively. We are vol buyers here on a 6M-9M horizon.

GBP/USD: similar analysis for GBP/USD also suggests a bearish market bias, while a break below 1.2559 could potentially target the 1.235 territory. Currently RSI (30) shows 47.502 and indicates a technically set mid-term bearish area. Support levels include 1.2433, 1.2371 and 1.2308 and resistance ones 1.2952, 1.3016, and 1.308. 1M, 6M and 9M implied volatility currently at 5.725%, 6.27% and 6.585% respectively. We are again vol buyers here on a 6M-9M horizon.

Rates

EU: EU swap rates have traded within a narrow range in the past month. The 10yr swap rate remained with-in a narrow range around approximately 2.58%, reaching a peak of 2.72% during this period. The yield curve slope remained anchored, with the 5s30s spread trading around -35bps. The implied normal volatility has declined at all tenors amid muted market movements. Looking ahead, interest rates are expected to decline but at a very slow pace as the ECB is unlikely to start monetary easing before June.

US: swap rates closed the month mixed amid low volatility. The 10yr swap rate is trading at 380bps, levels similar to the beginning of the month having traded as high as 390bps. The curve shift has also consolidated, close to -25bps. Looking forward, we expect yields to move lower but at a very slow pace given that the Fed has indicated that it is likely to delay and probably reduce the number of rate cuts given recent macroeconomic data.

Emerging Markets Sovereign Credit

EM sovereign spreads continued their downward trend, supported by the Fed not raising the median 2024 dots at its last policy meeting, which constituted a dovish surprise. The EMBI Global Index tightened by 22bps and is now at 287bps. In CEEMEA, Hungarian EUR bonds continued outperforming their peers, while Romanian sovereign external debt is still trading at the same levels as Serbian government bonds. In South Africa, volatility remains elevated due to election noise, while in Turkey the central bank surprised the market as it delivered a 500bps rate hike, setting its policy rate at 50%. In Latam, Chilean and Mexican USD

bonds outperformed their peers, with yields on the 10yr tenor ending approximately 5bps lower on the month. In Asia, Chinese government bond yields closed lower at the end of March with the curve bull flattening and the 20yr tenor being the best performer on the curve. We remain constructive on EM fixed income due to the favourable global risk environment.

Corporate Credit

Following a strong February, March proved to be another positive month for risk assets, even as central bank speakers continued to caution on the timing and pace of rate cuts, as well as concerns about stubborn inflation. Macro remained in focus, with February's non-farm payrolls in the US exceeding expectations, supporting a soft-landing narrative, albeit indicative of a cooler if still resilient labour market. On the central bank front, the Fed, the ECB and the BoE kept rates unchanged, as widely expected, with the Fed appearing notably relaxed despite upside surprises to inflation in January and February, and the ECB leaning in a dovish direction. Meanwhile, in a surprise move, the Swiss National Bank proceeded with a rate cut, being the first central bank among the G10 to do so in this cycle, while Sweden's Riskbank became the latest G10 central bank to signal it's approaching the start of rate cuts. Against this backdrop, European equities advanced further reaching new record highs. Stoxx 600 registered gains of 3% since the end of February, while the Dax outperformed, ending 4.3% higher. Overseas, the S&P 500 ended the month with gains of 2.3%, with the volatility gauge at a 2-month low (VIX at 12.78pts). In politics, US congressional leaders reached a deal to keep the Federal government open through September 30, avoiding a partial government shutdown.

In credit, synthetics traded within a narrow range in March both in Europe as well as the US. European spreads ended the month broadly unchanged, with Main -0.5bps and Xover -5bps. Both indices performed broadly in line with US spreads (CDX IG unchanged and CDX HY -4bps since the beginning of March). In EUR Corporate cash, IEAC continued to underperform vs. HY, ending 9bps tighter on the month, with IHYG +10bps since the beginning of March, mainly due to large idiosyncratic moves in the high-yield space. Financials continued to outperform among EUR IG cash (Snr Fins -11bps, Sub Fins -16bps) while Utilities, Energy and Materials lagged (-5bps each). In High Yield, Energy outperformed (-31bps), along with Sub Fins (-22bps) and Technology remained a notable underperformer (+111bps). Activity in the European primary market declined somewhat, to €157bn in March from €170bn in February, in what was the busiest first quarter for issuance on record (€679bn priced in Q1).

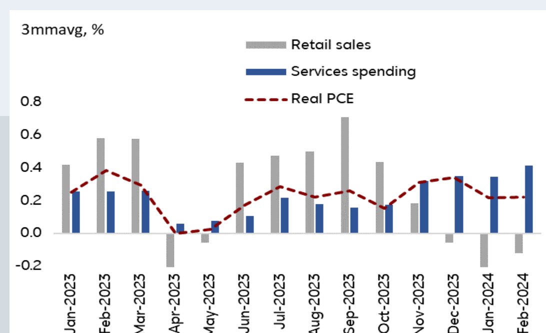
Looking ahead, the focus remains on macro and central bank commentary, as investors seek fresh signs that will shed light on the timing and speed of rate cuts. With primary issuance having tapered off in the run up to Catholic Easter, we expect activity to pick up in April as credit sentiment remains conducive for issuance.

US

Indicators show economic activity likely remained solid through Q1

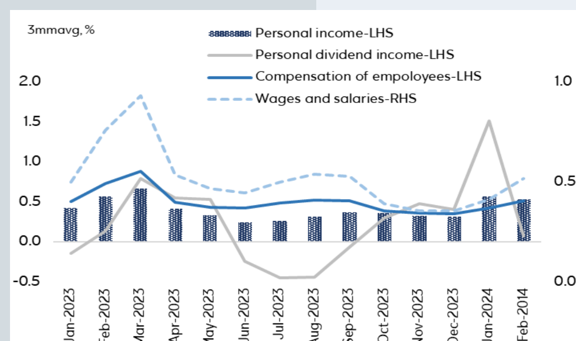
The economy continues showing its resilience as robust wage growth and healthy household balance sheets spur consumption. According to the BEA's third estimate, real GDP for Q4 2023 was unexpectedly revised higher by 0.2ppts to an annualised rate of 3.4%, reflecting primarily upgraded estimates of consumer spending (+0.3ppts to 3.3%) after the incorporation of more complete services consumption data. The revised estimate implies a GDP growth rate of 4.4% in H2 2023, nearly twice the 2.2% rate in the first half of the year. The momentum in personal consumption expenditure growth appears to have carried over into this year. Real personal consumption expenditure (PCE) rose by a robust 0.4%MoM in February, a substantial rebound following January's weather-related 0.2%MoM drop. The increase was driven by a 0.6%MoM rise in spending on services, boosted by transportation services (2.6%MoM). Goods spending also increased, though modestly, up by 0.1%MoM, in line with the flat reading for February's retail sales control group. The high level of consumer spending continued to be financed by personal savings, with the respective rate falling by 0.5ppts to 3.6%, well below pre-pandemic levels (6.4-8.5%). Personal income rose by a lower than expected 0.3%MoM in February mainly due to dividend income (-3.7%MoM), while compensation of employees grew by 0.7%MoM after rising 0.4%MoM in the prior three months, reflecting a hefty gain of 0.8%MoM in wages and salaries. Taking into account the February bounce in real PCE, the Atlanta Fed's GDPNow growth model estimate for Q1 2024 was revised up by 0.5ppts to 2.8%. This revision also considers a recent string of resilient data (e.g., durable goods orders, housing starts, building permits) which reinforces the view that the weakness in retail sales and industrial production earlier this year was probably just a temporary soft patch. On the inflation front, the headline PCE price index softened to 0.3%MoM in February from January's 0.4%MoM gain (2.5%YoY vs. 2.4%YoY), and core PCE was up by 0.3%MoM, decelerating from 0.5%MoM (2.8%YoY vs. 2.9%YoY). These figures were almost in line with expectations, keeping open the prospect that the Fed will start a rate easing cycle in June. The Fed's updated dot plot at the March policy meeting continued to point to three incremental cuts this year, but considering the economy's continued resilience, risks seem skewed towards fewer or delayed cuts.

Figure 3: Weakness in February's goods spending in has been offset by a strong bounce in services



Source: BSL, Census Bureau, Eurobank Research

Figure 4: Personal income growth slowed in March, while employee compensation rose strongly



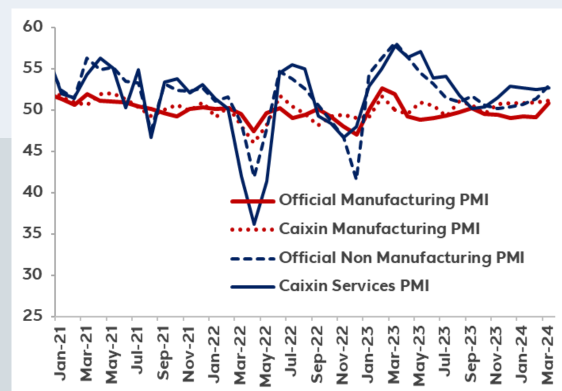
Source: BLS, Eurobank Research

China

Recent data offers hopeful signs, but broad-based recovery not here yet

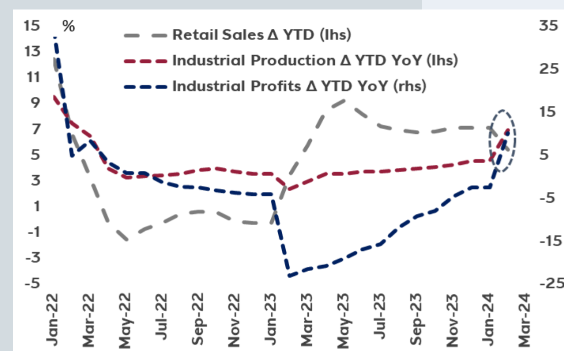
For the first time in several months, all forward-looking indicators improved in March. Official and Caixin manufacturing and services PMIs came in stronger than expected, probably affected by the presentation of official economic targets at the National People's Congress in early March and following economic data that allows for some optimism. While all PMIs moving upwards in a single month does not necessarily mean that the economy has gained renewed momentum, it does suggest that prospects ahead have improved, which is also captured in consumer confidence, which has been increasing since November 2023 after standing in a low plateau for the previous six months. Retail sales lost some steam in the first two months of the year, increasing 5.5%YoY compared to 7.4%YoY in December, but industrial production firmed a bit further by expanding 7%YoY in January-February from 6.8%YoY in the last two months of 2023 with markets expecting milder growth of 5.6%YoY. The picture gets even better for the industrial sector when considering profits, which finally managed to increase in February after falling for 19 months in a row. While the gauge of retail sales does not mean that consumption will necessarily follow suit, the February CPI print does suggest that demand could be reviving. Inflation spiked to 0.7%YoY from -0.8%YoY in January after hovering close to zero for most of the previous twelve months. Unfortunately, with no prospects in sight for a tangible improvement in the real estate sector, a broad-based turnaround in the economy is hard to see right now. New and used home prices continued to shrink for at least the past 12 months. That said, since the start of 2024 the rate of decrease has been smaller, offering some hope that they might start growing again soon, and that this in turn sparks a more lasting improvement in consumer confidence.

Figure 5: Forward looking data is perking up ...



Source: Bloomberg, Eurobank Research

Figure 6: ... and so is industrial activity



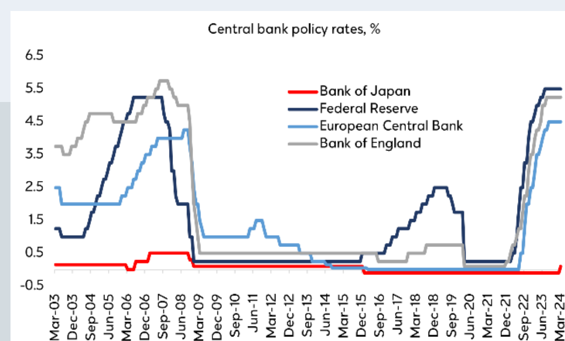
Source: Bloomberg, Eurobank Research

Japan

Historic end to negative interest rates still left yen in need of stabilisation

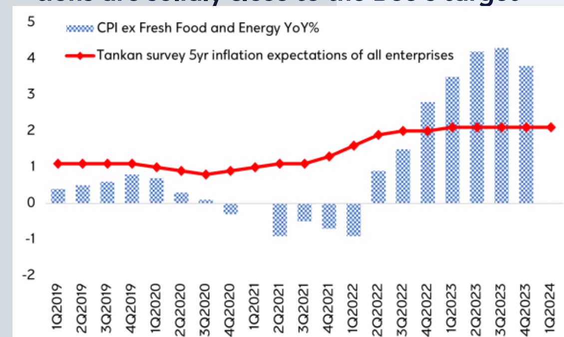
In the end, the Bank of Japan wouldn't wait any longer. At its March 19 meeting, the central bank hiked its policy rate to a 0%-0.1% range from -0.1%, finally ending the epoch of negative interest rates. It also announced it was scrapping the yield curve control policy, which had put an upper bound of 1% on the yield of 10yr JGBs, as well as ending purchases of ETFs. However, the BoJ said that it will continue buying JGBs, and its communication since the meeting was perceived by investors as relatively dovish. That meant that the market reaction in the days following the BoJ's policy outcome was to continue the yen sell off, driving the USD/JPY rate to 34-year intraday highs before settling below the 152 level following verbal warnings from the Ministry of Finance over potential intervention in FX markets to curb the currency's rapid decline. While the hike was well flagged in the weeks leading up to the decision, previously it was thought that April was the likeliest date for a move. That's because the later date would have given the BoJ time to digest the results of the *shunto* spring wage negotiations, as well as its quarterly Tankan survey of business sentiment. As it turned out, the first results from the ongoing *shunto* round were enough to convince the BoJ to act. Days before the policy meeting, Japan's largest confederation of trade unions, Rengo, announced that its members had secured pay rises of 5.3% for this year – the most in decades – compared with 3.8% in the corresponding talks last year. Much of the central bank's confidence to hike stemmed from the belief that the large increases from the *shunto* negotiations – which only cover employees at Japan's larger corporations – will filter down to workers at smaller firms and ensure that the pick up in inflation to the central bank's target will be demand-led and durable. The latest data for labour cash earnings, which is more reflective of pay conditions for workers in the latter category, showed these increasing 2%YoY in January, up from 0.8%YoY in December. The latest national CPI print showed headline inflation accelerating to 2.8%YoY in February from 2.2%YoY. As for the Tankan survey, which was released on April 1, it showed an above-consensus improvement in conditions for the service sector in Q1, but a slight deterioration for manufacturing. The survey also showed that all businesses expect YoY inflation at 2.1% in five years time, further supporting the BoJ's confidence of inflation sustainably returning to target.

Figure 7: Despite a first rate hike in 17 years, BoJ policy remains ultra loose



Source: Bloomberg, Eurobank Research

Figure 8: Firms' forward inflation expectations are solidly close to the BoJ's target



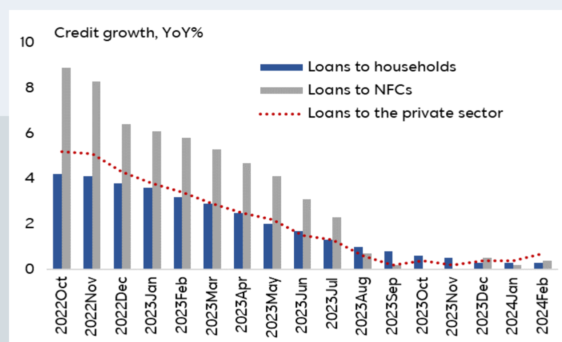
Source: Bloomberg, Eurobank Research

Euro area

Tentative signs that economy may have turned the corner

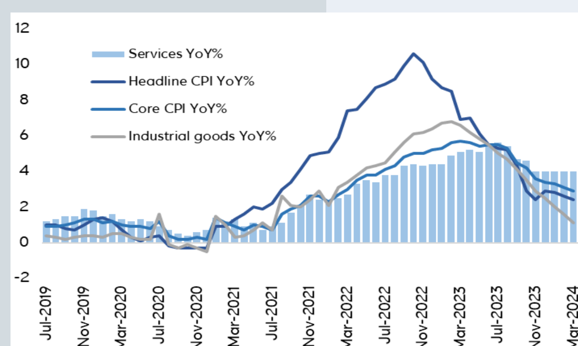
Incoming sentiment indicators provide a glimmer of hope that the worst may be over for economic activity, hinting at a modest recovery potentially starting in late Q1 or early Q2. The flash composite PMI for March slightly exceeded expectations, reaching 49.9 (+0.7pts), the highest level since June last year. This improvement contributed to a Q1 average of 49, higher than the 47.2 recorded in the previous quarter. However, despite the fifth consecutive monthly increase, the index remained below the 50 threshold, albeit marginally, indicating ongoing lacklustre activity in the private sector overall. The pace of expansion in services continued to accelerate (+0.9pts to 51.1), while the rate of contraction in manufacturing intensified (-0.4pts to 46.1), although partly driven by an improvement in the supplier delivery times sub-index. Furthermore, the EC's economic sentiment indicator saw a modest increase in March, posting the first gain in three months with a reading of 96.3 (+0.8pts), the highest since May 2023, albeit still low by historical standards. Consumer confidence also rose further (+0.6pts to -14.9), though it remained below its long-term average. The rate of credit growth also saw a decent pick up in February, indicating that the most significant impact of past rate hikes on bank lending is probably over. The growth rate of adjusted loans to the private sector advanced by a multi-month high of 0.7%YoY from January's 0.4%YoY, owing to increasing loan flows to NFCs (+0.2ppts to 0.4%YoY), while the rate for households remained unchanged (+0.3%YoY) for the third consecutive month. Meanwhile, inflation data for March surprised to the downside, after coming in slightly firmer than expected in the previous two months, increasing the chances of a first ECB rate cut being delivered in June, as President Lagarde has strongly hinted. Both headline and core inflation fell by 0.2ppts to 2.4%YoY and 2.9%YoY respectively. The disinflationary trend for core industrial goods remained intact (-0.5ppts to 1.1%YoY), but services inflation remained sticky (at 4.0%YoY for the fifth consecutive month), mostly influenced by high wage growth (Q4 2023 compensation per employee down by 0.6ppts to 4.5%YoY, though still above levels consistent with the ECB's inflation target). Not surprisingly, the ECB has deliberately refrained from committing to a pre-defined rate easing path thereafter, with developments in wages holding the key to the monetary policy outlook.

Figure 9: The slowdown in credit growth may have bottomed out



Source: ECB, Eurobank Research

Figure 10: Services inflation is keeping the ECB's focus on developments in wages



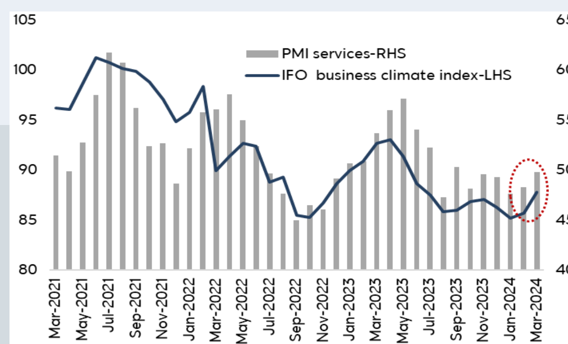
Source: Eurostat, Eurobank Research

Germany

The worst may be over, but no sustained near-term recovery in sight

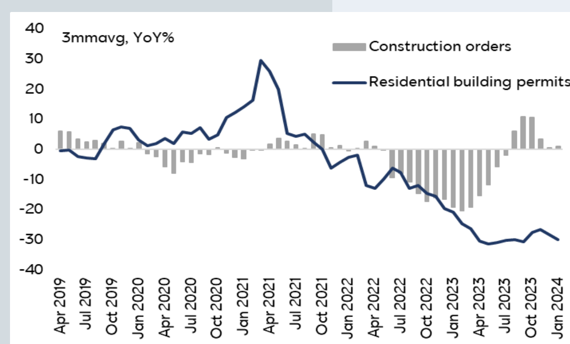
March brought a surprise improvement in German business sentiment and with it hope that the country's economic downturn may be close to bottoming out. This encouraging turn may have come too late to prevent another slight contraction in Q1 2024, and thus a mild technical recession after the 0.3%QoQ drop in real GDP in the last quarter of 2023. The Ifo business climate index — a pivotal leading indicator — increased for a second consecutive month, rising by 2.3pts to 87.7. This trend was observed across all sectors of the survey, driven primarily by a 1.2pts surge in the current conditions component, reaching a three-month high of 88.1. The composite PMI also surprised positively in March, climbing by 1.1pts to 47.4, fuelled by an uptick in the services index to 49.8, a tad below expansionary territory. Despite these encouraging sentiment indicators, hard data have been disappointing thus far in the year. Industrial production rose in January for the first time since April 2023 (+1.0%MoM). Still, it remained 0.4% below the Q4 average, while a sharp drop in January's new manufacturing orders (-11.3%MoM) indicates another potential contraction in industrial output in Q1. Similarly, retail sales dropped for the fourth consecutive month in February (-1.9%MoM), despite a still-tight labour market and elevated wage growth, leaving the January-February average down by 1.1% relative to Q4 2023. The GfK Consumption Climate indicator improved further in April (+1.4pts to -27.4). Nevertheless, the spending propensity component dropped further to almost two-year lows and the willingness to save remained close to its GFC peak amid geopolitical uncertainty and fiscal concerns, dampening hopes for a swift consumption recovery. Meanwhile, high financing costs continue to hinder investment activity, particularly in the construction sector, as evidenced by sharp declines in construction orders (-7.4%MoM) and residential building permits (-5.5%MoM) in January. Overall, risks appear tilted towards another quarterly contraction in Q1, especially given the impact of large-scale national strikes earlier this year. Growth momentum is expected to pick up in H2 driven by easing financial conditions, a slight pickup in world trade and improved private consumption supported by higher real wage growth. However, any rebound is expected to be weak since structural challenges remain. For the whole of 2024, we stick to our projection of another GDP contraction of 0.1%.

Figure 11: There has been a surprising strong recent improvement in business sentiment



Source: Bloomberg, Eurobank Research

Figure 12: Construction activity continues to decline



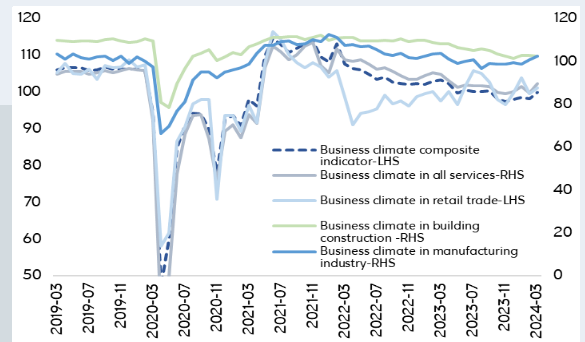
Source: Destastis, Eurobank Research

France

More restrictive fiscal policy will likely weigh on economic growth

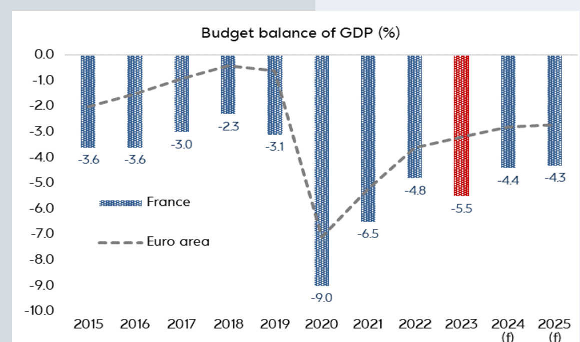
Economic activity indicators for Q1 2024 have been disappointing so far, suggesting that GDP growth is likely to remain subdued. That aligns with the trend of stagnation observed in the preceding two consecutive quarters, largely due to weak domestic demand. January saw household consumption expenditure on goods declining by 0.3%MoM, effectively erasing December's gain of the same magnitude. Similarly, industrial production experienced a greater-than-expected decline of 1.1%MoM following a slightly uptick of 0.4%MoM in December, primarily. Despite the sluggish start to Q1 2024, there is a glimmer of hope for a gradual recovery beginning in Q2 2024, as indicated by the improvement seen in the INSEE business survey for March. Unlike the negative sentiment portrayed by the March PMI survey, where business activity in both services and manufacturing sectors deteriorated taking the composite index down by 0.4pts to 47.7, the INSEE's March survey provided a more optimistic outlook. Considered as a relatively better indicator for short-term forecasts by the Ministry of Finance, the INSEE survey revealed a 2pts gain in the business climate composite indicator, rebounding to its long-term average of 100, with sentiment improving in all sectors except for construction. Certainly, falling inflation coupled with a tight labour market (negotiated wages seen rising 3.5%YoY in 2024), alongside improving INSEE consumer confidence (up by 0.1pts to 91 in March, matching January's two-year high) and lower interest rates, are expected to underpin a gradual pick up in domestic demand. However, downside risks persist, primarily due to increasing uncertainty surrounding fiscal policy. Driven by disappointing fiscal revenues, the budget deficit widened to 5.5% of GDP in 2023, exceeding the government target by 0.6ppts, compared to 4.8% in 2022. For 2024, the government aims to reduce the budget deficit to 4.4% of GDP. However, given a starting point of a significantly higher-than-expected public deficit in 2023, meeting the 2024 target appears challenging. The government has announced extra spending cuts worth €10bn (c. 0.3% of GDP). However, this would only address half of the 0.6ppts gap, indicating that additional expenditure savings will likely be required to achieve the 2024 fiscal target and prevent a potential sovereign credit rating downgrade. Considering the prospect of much tighter fiscal policy, we have revised our 2024 GDP growth forecast lower by 0.1ppts to 0.7%.

Figure 13: INSEE business sentiment points to a gradual recovery in economic activity starting in Q2



Source: INSEE, Eurobank Research

Figure 14: The 2023 budget deficit exceeded the government target by 0.6ppts



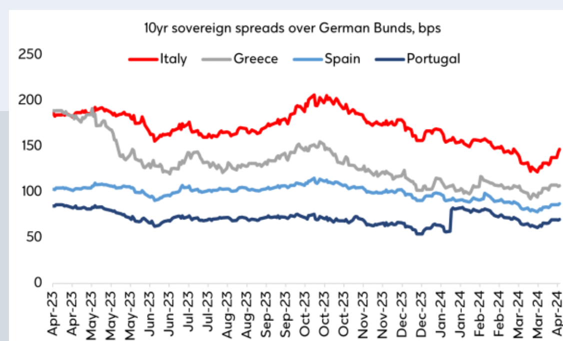
Source: AMECO, Eurobank Research

Italy

Government admits that it is braced for Brussels to open EDP over its budget

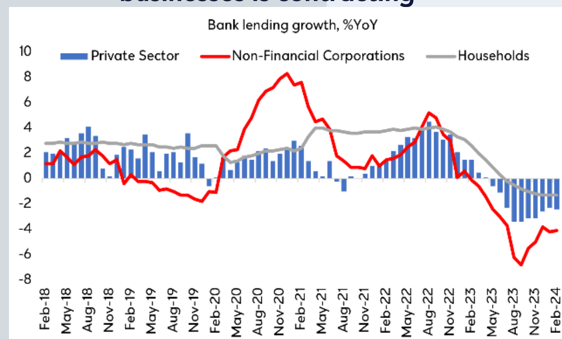
After the fiscal shock of 2023, where Italy's budget deficit came in at 7.2% of GDP, far overshooting the official target, the finance minister told lawmakers on April 3 that the government expects the European Commission to open up an Excessive Deficit Procedure against the country. Precedent and produral issues continue to mean that such a move will almost certainly only happen after the June elections to the European Parliament. However, public admission by one of the highest-ranking officials in Prime Minister Giorgia Meloni's government that they are braced for it to materialise, adds an air of inevitability to this happening once the ballot boxes have been put away. As a reminder, the 2023 deficit narrowed from an upwardly revised 8.6% the year before, while the government's most recent forecasts had been that it would come in at 5.3% and shrink further to 4.3% this year. The targets were already controversial, since EU rules require Italy to close the deficit to 3% of GDP. Meanwhile, the yield spread between Italian and German 10-year bonds, after reaching a three-year low in the middle of March, has since started increasing again. Although that's driven by wider currents in fixed income markets and not unique to Italy, the widening of eurozone peripheral spreads is nevertheless most notable in Italy. The spread has increased 24bps from its March 18 low of 122bps, though remained lower than it was at the start of the year. Credit conditions are also tight for the Italian economy. After the rate contraction in adjusted bank lending to the non-financial corporations slowed to 3.8%YoY in December from a recent peak of 6.8%YoY three months earlier, conditions have stalled since. The latest data shows that credit contracted 4.1%YoY in February, compared with a 4.2%YoY drop in January. Despite these conditions, Italy's manufacturing PMI in March unexpectedly crossed the 50-threshold signifying improved business activity, jumping to 50.4 from 48.7 in February. Manufacturing confidence also increased in March, to 88.6 from 87.3, though the consumer confidence index unexpectedly dipped by 0.5pts to 96.5. In other macroeconomic data, the headline EU-harmonised inflation rate slowed to 0.8%YoY in February from 0.9%YoY the month before. The jobless rate increased in the same month, rising to 7.5% from an upwardly revised 7.3% in January. Finally, retail sales rose 1%YoY in January, up from 0.3%YoY the month before, while the contraction in industrial production deepened to 3.4%YoY from 2.1%YoY in December.

Figure 15: Italy has been at the forefront of a peripheral spread widening in the last month



Source: Bloomberg, Eurobank Research

Figure 16: Bank lending to households and businesses is contracting



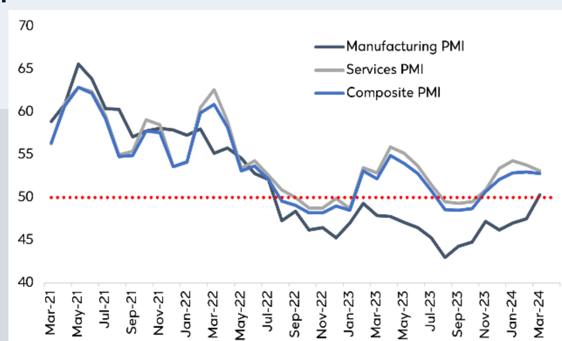
Source: ECB, Eurobank Research

UK

Surprise manufacturing expansion shows economy gaining momentum

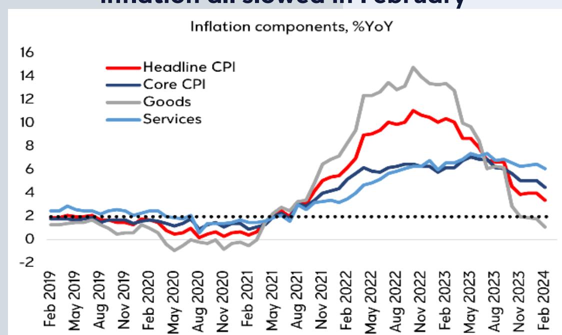
Prospects are continuing to brighten for the UK economy with inflation slowing more than expected and manufacturing business activity expanding in March for the first time in almost two years. While final GDP data for Q4 2023 confirmed that the UK ended last year in a technical recession, contracting 0.3%QoQ after shrinking 0.1%QoQ in Q3, January's 0.2%MoM GDP expansion was already signalling that the economic slowdown was likely to prove mild. The March surprise in the manufacturing PMI, which jumped to 50.3 from 47.5 in February – crossing the 50 threshold that indicates expansion for the first time since July 2022 – confirms that the UK economy is proving more resilient than seemed likely a a few months ago. The expansion was driven by stronger domestic demand, with both production and new orders increasing, according to S&P Global. On the flipside, the trend in new export orders remained weak. The service sector, the key pillar of the UK's economy, saw a decrease in its PMI reading in March, falling to 53.1 from 53.8 the month before, while the composite PMI slipped to 0.2pts to 52.8. Despite these drops, both readings remained strong, and combined with the gathering momentum from manufacturing we are revising our GDP growth forecast for 2024 upwards 0.1ppts to 0.5%, which makes us more optimistic than the consensus. On the inflation front, headline CPI rose 3.4%YoY in February, down from 4%YoY the month before, while core CPI growth slowed to 4.5%YoY from 5.1%YoY. Both readings were 0.1ppts below the consensus forecasts and were driven by disinflation in both goods and services. Energy base effects are likely to drive rapid disinflation in the coming months, bringing the UK's inflation rate closer into line with other developed country peers and paving the way for monetary easing from the Bank of England. However, before moving ahead it is likely that central bank policy makers will also want to see the effects on inflation of a 10% increase in the national living wage that came into effect this month. As things currently stand, the market-implied probability of an interest rate cut by June is 77% – lower than for the ECB but now higher than for the Federal Reserve – with a first fully-priced in cut in August. A cumulative 73bps of easing is priced in for all of 2024. Meanwhile, the Nationwide house price index unexpectedly fell 0.2%MoM in March, rising 1.6%YoY. Against that, February's 60.4k mortgage approvals were more than January's and above expectations.

Figure 17: Manufacturing business activity expanded in March for the first time since 2022



Source: ONS, Eurobank Research

Figure 18: Headline, core, goods and services inflation all slowed in February



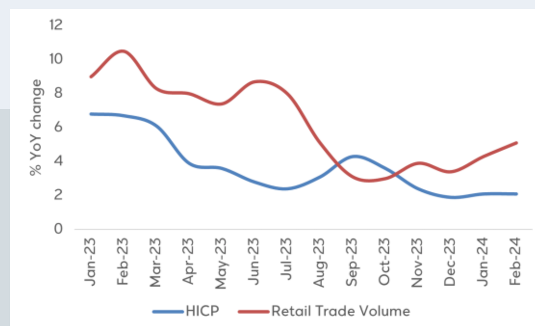
Source: S&P Global, Bloomberg, Eurobank Research

Cyprus

Signs of dynamics improving in real estate and tourism sectors

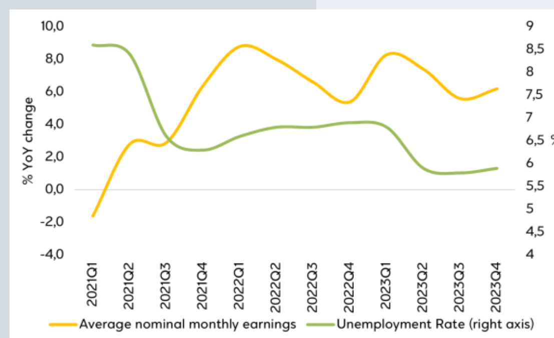
Despite disinflationary measures, the inflation rate was unchanged in February from January, at 2.1%YoY, with the monthly trend turning positive for the first time in the last five months (+0.8% after -1.2%). Weakening disinflation in transport (-0.5%YoY from -1.3%YoY the month before), a category affected by the said measures, and faster price increases in clothing-footwear (2.8%YoY from 1.0%YoY), were what prevented the annual rate from falling. Regarding trends in other goods/services categories affected by the disinflationary policies, inflation weakened in both food – non-alcoholic beverages (2.1%YoY vs. 3.1%YoY) and housing – utility – water supply (0.3%YoY from 0.7%YoY). Amidst these inflation dynamics, driven mainly by gradually rising oil prices since December and higher wage indexation, the recent further extension of most of the disinflationary measures up to June – as foreseen in our previous issues – could curb inflationary pressures and support private consumption, which remains robust, as retail trade volume growth rose 4.7%YoY in January-February. But a significant inflation deceleration in the months ahead is not much expected, due to the termination of the reduced excise duty on fuels. Credit expansion in February for a third consecutive month (+1.5%YoY) increases the possibility of a same trend towards non-financial businesses in the following months, which could boost investment. After another year of buoyant activity in the real estate sector in 2023 (transactions at a 16-year high), its dynamics are not clear in early 2024; the number of sales fell in January for the first time in 23 months (-3.2%YoY) but rose again in February (+13.5%YoY). Nonetheless, the spike in the last two years could continue fueling activity in construction. A negative base effect on gross fixed capital formation is expected in Q1 from extensive investment in shipping a year ago, which also deteriorated the external balance. Tourism is also sending mixed signals. The fall in arrivals in January (-2.9%YoY) was reversed in February (+5.0%YoY), resulting so far in a subdued increase of 1.6%YoY in 2024. The sharp deceleration relative to 2023 (+20.1%YoY) is mainly due to the war in Gaza (arrivals from Israel: -25.7%YoY), combined with declines in other countries that drove last year's increase (UK, Romania). These drops were mostly offset by a further increase in Poland (+42.3%YoY). However, it is still early for an assessment of the tourist sector's prospects this year. Given the recently improving, yet uncertain, trends in core activities for the Cypriot economy, our growth forecast for 2024 remains unchanged at 2.7%.

Figure 19: Retail trade volume growth robust despite inflation still slightly above 2%



Source: CYSTAT, Eurobank Research

Figure 20: Rapid nominal wage growth didn't stop unemployment falling to a 14-year low in Q4 2023



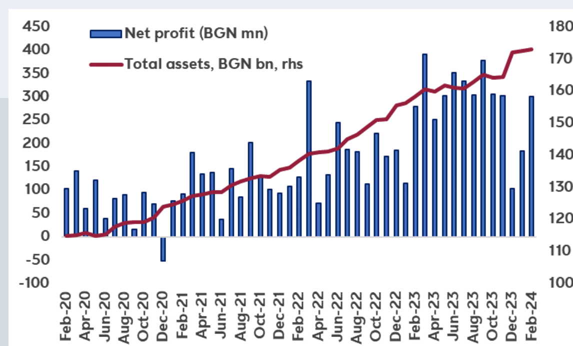
Source: CYSTAT, Eurobank Research

Bulgaria

Reemergence of political instability tilts growth risks to the downside

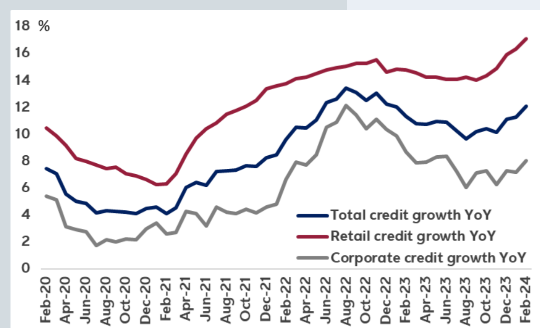
Recent reports from both domestic and international institutions have provided forecasts and outlooks for 2024 and beyond. Following the completion of the Article IV Mission, the International Monetary Fund has lowered its growth forecast for 2024 to 2.75% from an earlier 3.2% in October 2023 and 3.5% in April 2023. Despite this downgrade, an economic rebound to 2.75% from 1.8% in 2023 is expected, largely due to increased public investment driven by enhanced absorption of EU funds, thanks to the Recovery and Resilience Facility programme reaching a mature phase, as mentioned in our previous column. The Ministry of Finance is more optimistic, projecting growth for the current year above the market consensus of 2.6%, while our forecast remains at 2.2%. Recent data suggest the possibility of a slight upgrade, as inflation continues to decline, reaching 3.3%YoY in February from 3.8%YoY in January, nearing levels not seen since August 2021. This is a significant improvement from the 20-year high of 18.7%YoY in September 2022. Additionally, monthly CPI data for February showed a 0.3%MoM increase in prices, matching the average over the past 12 months and lower than January's 0.5% MoM rise. Banking sector data from February is also positive, with credit growth accelerating to 12.1%YoY from 11.3%YoY in January, with strong growth in both corporate and retail segments. This trend has been upwards since September 2023, with nominal growth rates in double digits. Provided the non-performing loan ratio continues its steady decline or stabilizes around the current 6%, the banking sector's profitability, which remains strong in 2024 based on data up to February, could support economic growth by encouraging banks to keep providing liquidity to the economy. However, we are closely monitoring the unfolding political situation. The recent collapse of the coalition between GERB and WCC-DB has led to the establishment of a caretaker government until a permanent one is formed. With snap elections becoming more likely, political uncertainty could delay reforms needed for euro adoption and slow the bureaucratic momentum necessary for maximizing EU funds, potentially tilting growth risks downward.

Figure 21: Robust banking sector profitability.....



Source: National Bank of Bulgaria, Eurobank Research

Figure 22: ...and solid credit expansion incentivise banks to support growth



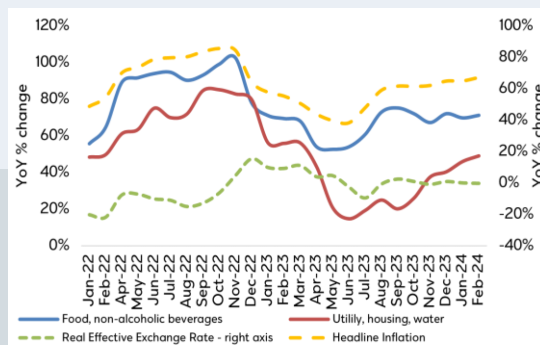
Source: National Bank of Bulgaria, Eurobank Research

Turkey

New broom at central bank shocks markets with massive interest rate hike

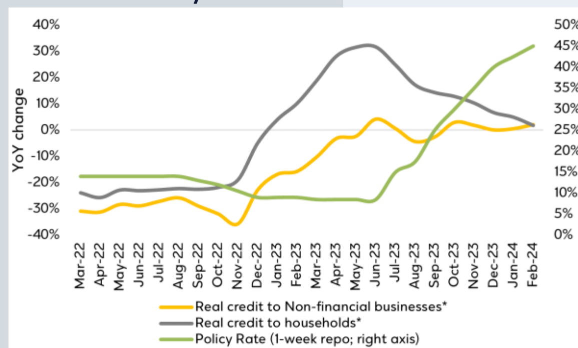
In an unexpected move that surprised markets in March, the central bank (TCMB) announced a significant base rate hike of 500bps, taking it to 50%. The decision was a demonstration of the new governor's strong commitment – clearly stated following his appointment – to tighten monetary policy until inflation trends downwards towards the medium-term TCMB target of 5%. This policy shift follows a surge in inflation in February to 67.1%YoY, reaching a 15-month peak, from 64.9%YoY in January. The monthly inflation rate moderated to a still rapid 4.5% from 6.7%. Following the rate hike, the central bank's hawkish forward guidance indicated that further tightening would be considered if inflation looks like deteriorating significantly and persistently. This stance has made price developments in the coming months critical for the path that monetary policy will follow for the remainder of 2024. The latest inflation spike in March, to 68.5%YoY, with the monthly pace slower than in February, but still at a brisk 3.2%, certainly deters monetary easing in the period ahead. The recent rate increase, along with other credit measures such as reducing loan growth ceilings (excluding those for exports and investment), is likely to slow down real credit growth, or possibly turn it negative, in the coming months. This would especially affect households, which saw a 1.8%YoY increase in credit in February, the smallest rise in 14 months, another factor hampering their purchasing power besides inflation. Credit to non-financial businesses increased 2.1%YoY from 0.6%YoY in January. The 57.4%YoY rise in nominal state capital payments in January and February, together with the carryover effect from their December spike (+669.3%YoY, TL799.9bn or $27.45bn), will drive gross fixed capital formation growth at least in Q1. In February, the external balance showed notable improvements, largely attributed to base effects from the previous year's earthquakes. The goods trade deficit continued to narrow significantly, by 44.2%YoY, with increased exports and reduced imports contributing almost equally. This trend is expected to continue. Additionally, foreign visitor numbers spiked 22.7%YoY from 2.1%YoY in January, also reflecting base effects from the earthquakes. While these external sector trends were mostly anticipated, the rapid pace of monetary tightening was not, leading us to adjust our 2024 growth forecast downward by 0.2ppts to 3.0%.

Figure 23: Inflation spike in February mainly due to food-utility components, not from lira depreciation



Source: Central Bank of Turkey, Turkstat, Eurobank Research

Figure 24: Monetary tightening continues weighing mainly on credit to households



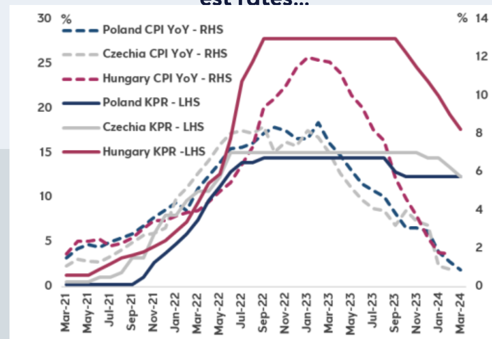
*PPI and CPI adjusted, respectively
Source: Central Bank of Turlkey, Eurobank Research

CESEE

Improved sentiment on the back of lower inflation and interest rates

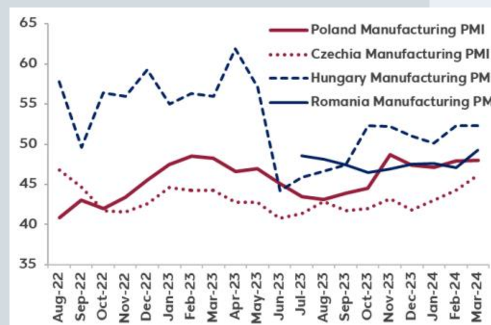
March held an improvement in sentiment indicators for major countries in the region, signaling rosier expectations. The ESI in Poland, Czechia, Hungary and Romania perked up, bringing it broadly in line with the general trend in the EU and EA. So did manufacturing PMIs, but with some cross-country differentiation. The index may have improved in Romania, Czechia and Poland, yet it remained below the 50-threshold separating expansion from contraction while in Hungary it has passed the bar since November 2023. Beyond the tepid turnaround of the soft data, retreating inflation has led to key policy rate (KPR) cuts by major central banks in the region. The central banks of Czechia and Hungary proceeded with additional rate cuts in the monetary policy committee (MPC) meetings held in March, by 50bps and 75bps respectively. Both decisions were widely expected by market participants. As things currently stand, the KPR and the latest available headline CPI print (Feb 2024) in Czechia stand at 5.75% and 2%YoY respectively, with those for Hungary at 8.25% and 3.7%YoY. While the central banks of Poland and Romania decided to hold their fire in April's MPCs, as markets expected, Poland's has already delivered cumulatively 100bps of easing since September 2023, slashing the KPR to 5.75%. The March flash CPI print for that country came in at 1.9%YoY, which was lower than both the 2.3%YoY consensus and the previous month's reading of 2.8%YoY. The central bank of Romania faces a more stubborn inflationary landscape, pushing back the window of opportunity for some monetary easing until later in 2024, when signs of entrenched disinflation could become clearer. Despite the improvement in the soft data, revised growth outlooks released in March by two rating agencies, Fitch and S&P, had trimmed growth 2024 forecasts for Poland to 2.2% and 2.9%, respectively, from 2.5% and 3.1% previously. The discrepancy between sentiment indicators and growth forecasts makes it hard to draw safe conclusions but could be indicative of the prevailing fragility of economic prospects, not just for Poland but also for the wider region. Still, Moody's affirmation in the same month of the country's creditworthiness reminds us that along with the fragility, there is also economic resilience.

Figure 1: retreating inflation and interest rates...



Source: local statistics bureaus and central banks, Eurobank Research

Figure 22: ..spur some optimism for the prospects ahead



Source: S&P Global, MLBKT, KHS, BCR, 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)		
	2023e	2024f	2025f	2023	2024f	2025f	2023e	2024f	2025f	2023e	2024f	2025f	2023e	2024f	2025f
World	3.1	2.8	3.0	6.8	4.0	3.4									
Advanced Economies															
USA	2.5	2.2	1.7	4.1	2.9	2.4	3.6	4.0	4.1	-3.1	-3.0	-2.9	-6.5	-6.1	-6.0
Eurozone	0.4	0.5	1.3	5.5	2.4	2.1	6.5	6.6	6.6	1.9	2.0	2.0	-3.4	-2.9	-2.7
Germany	-0.3	-0.1	1.1	6.1	2.5	2.1	6.0	6.5	5.7	6.0	6.5	6.1	-2.4	-1.7	-1.4
France	0.7	0.7	1.3	5.7	2.6	2.0	7.4	7.5	7.4	-1.4	-1.0	-1.0	-4.9	-4.5	-4.3
Periphery															
Cyprus	2.5	2.7	3.0	3.9	1.8	1.2	6.1	5.8	5.5	-10.5	-8.0	-7.0	2.9	3.1	3.3
Italy	0.9	0.6	1.1	6.0	1.6	2.0	7.7	7.6	7.5	0.1	1.0	1.2	-7.2	-4.5	-3.9
Portugal	2.3	1.4	1.9	5.3	2.4	2.0	6.5	6.6	6.5	1.6	1.1	1.4	0.7	0.0	0.0
Spain	2.5	1.6	1.9	3.4	3.0	2.2	12.1	11.8	11.4	2.2	2.0	2.0	-4.0	-3.3	-3.0
UK	0.1	0.5	1.2	7.4	2.5	2.1	4.0	4.3	4.4	-2.8	-2.9	-2.9	-5.0	-3.6	-2.6
Japan	1.9	0.7	1.1	3.3	2.3	1.8	2.6	2.5	2.4	3.5	3.6	3.5	-5.2	-4.1	-3.5
Emerging Economies															
BRICs															
Brazil	2.9	1.7	2.0	4.6	3.9	3.5	8.0	8.1	8.3	-1.4	-1.5	-1.7	-8.4	-6.8	-6.3
China	5.2	4.6	4.3	0.2	0.8	1.7	5.2	5.2	5.1	1.8	1.3	1.1	-4.6	-5.1	-5.0
India	7.5	6.5	6.5	5.4	4.5	4.5		NA		-1.1	-1.3	-1.6	-5.8	-5.1	-4.5
Russia	3.6	2.0	1.1	6.0	6.7	5.0	3.2	3.1	3.2	2.9	2.5	2.2	-2.3	-1.9	-1.2
CESEE															
Bulgaria	1.9	2.2	2.6	9.6	3.6	3.1	4.3	4.6	4.4	0.3	0.5	0.8	-3.0	-3.0	-3.0
Turkey	4.5	3.0	3.5	53.4	48.6	30.2	9.4	8.9	8.6	-4.1	-2.5	-1.5	-5.3	-3.7	-2.0

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

Eurobank Fixed Income Forecasts

	Current	June 2024	September 2024	December 2024	March 2024
USA					
Fed Funds Rate	5.25-5.50%	5.04-5.30%	4.72-4.95%	4.36-4.60%	4.02-4.25%
3m SOFR	5.30%	5.08%	4.82%	4.44%	4.12%
2yr Notes	5.50%	5.30%	4.95%	4.60%	4.25%
10yr Bonds	5.25%	5.04%	4.72%	4.36%	4.02%
Eurozone					
Refi Rate	4.50%	4.25%	3.60%	3.20%	2.95%
3m Euribor	3.89%	3.65%	3.34%	3.03%	2.81%
2yr Bunds	2.87%	2.32%	2.07%	1.89%	1.84%
10yr Bunds	2.36%	2.18%	2.10%	2.11%	2.09%
UK					
Repo Rate	5.25%	5.10%	4.70%	4.30%	3.85%
3m Sonia	5.18%	4.87%	4.55%	4.22%	3.73%
10-yr Gilt	3.93%	3.82%	3.70%	3.61%	3.56%
Switzerland					
3m Saron	1.42%	1.61%	1.54%	1.43%	1.29%
10-yr Bond	0.63%	0.83%	0.82%	0.83%	0.83%

Source: Bloomberg (market implied forecasts)

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