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Global GDP growth strengthened slightly further in December after a five-month downtrend through October, reinforcing optimism that the worst is probably behind us and that expansion continues into 2024, though at a modest pace. Meanwhile, disinflationary progress has slowed, while still-strong labor markets and renewed increases in global shipping costs, make major Central Banks reluctant to conclude that the battle against inflation is close to an end. Hence, pushing back against market expectations for imminent rate cuts, major CBs are making it clear that cuts are still some way off, as they need time for convincing evidence that inflation is on a sustained path back to target.

Macro Picture

USA: household spending retains momentum, but economic challenges intensify

EA: data consistent with continued stagnation, though the trough probably already reached

UK: forward-looking indicators signal improved growth momentum around the turn of the year

CESEE: GDP contracted in 2023 in major peers, paying the toll from high inflation in 2022

Markets

FX: EURUSD breaks below 1.09 due to repricing of rate cut expectations

Rates: EU and US short-term rates to move slightly higher on the back of CBs easing coming later than previously expected

EM: sovereign yields moving lower on the back of market expectations of CBs interest rate cuts

Credit: markets seeking signs that CBs will stick to the dovish pivot narrative in the medium term

Policy Outlook

USA: Fed will maintain restrictive policy until inflation moves steadily down towards target

EA: ECB remains on “guard” amid uncertainty over the path of wages and firms’ profit margins

UK: BoE likely to soften its hawkish stance as inflation and wage growth are moderating sharply

CESEE: disinflation opens the door for monetary easing and poses tailwinds to growth in 2024

Key Downside Risks

DM: escalating geopolitical tensions, stickier inflation forces CBs to maintain tight policy for longer or even hike rates further, political uncertainty ahead of elections in several countries

EM: heightened geopolitical fragmentation results in global supply chain disruptions; political uncertainty and fiscal perils from the series of ballots

Special Topic in this issue:
→ Global Economic Outlook for 2024

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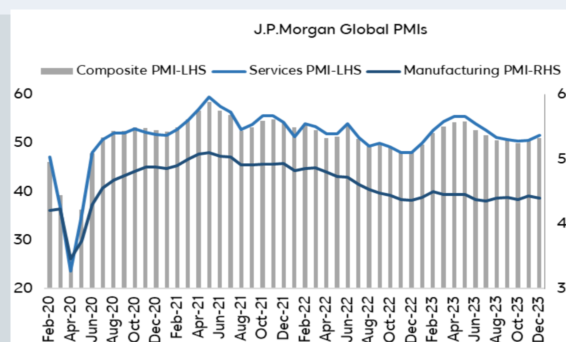
Macro Views
Latest world economic & market developments

Global expansion continues at a moderate pace, while major CBs push back against market expectations of rapid rate cuts

Ending a five-month declining trend through October after surprising mid-year strength, the global composite PMI improved in December for the second consecutive month, reinforcing market optimism that the global growth downturn has likely passed its trough. In detail, the headline index ticked up by 0.5pts coming in at 51.0, its highest level since July after a cumulative decline of 4.4pts in the period from May to October. Yet, it remained below its long-term average of around 53.0, suggesting that expansion continued at the end of 2023, though at a modest pace. Meanwhile, sectoral and regional divergences persist. Services strength proved to be the driving force behind the latest improvement in the composite PMI. Services PMI edged up for the second month in a row, up by 1pts to a five-month high of 51.6, continuing to expand for the eleventh consecutive month on the back of labor market tightness and easing inflationary pressures. On the flipside, manufacturing production remained the main drag on economic growth. The respective global print remained stuck in contraction territory recording another print below the threshold of 50 for the sixteenth consecutive month, at 49.5, 0.4pts lower from November, weighed down by high levels of inventories, reduced new orders and the post-pandemic shift in consumer spending from goods to services. More worryingly, still subdued trade activity suggests that output is unlikely to rebound any time soon, as suggested by the renewed decline in new orders, both domestic and external. All in all, the two-month rise in the global composite PMI, November and December, combined with a renewed uptrend in global consumer confidence in December (though still at depressed levels by historical standards), supports market hopes for a soft-landing scenario and confounding worries over the risk of an imminent slip into a deep downturn, mainly thanks to still strong labor markets (despite signs of softening in a number of major economies), healthy private sector balance sheets and fading inflation drags. Geographically, the Eurozone remained among the main drags on global private activity, while Asian economies fared relatively better than the developed ones, led by India.

Figure 1: Expansion continues into year-end driven by the services sector

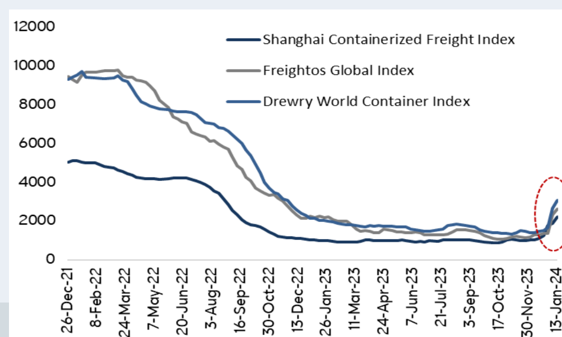


Source: Bloomberg, Eurobank Research

On the inflation front, though still above CBs' target, global headline CPI decelerated further in November but by a slower pace than earlier this year as the impact of base effects is fading. At the same time, global core inflation continued to move further below 2022 highs, remaining though relatively stickier due to pressures in services sectors against a backdrop of labor market tightness. That said, services inflation is still nearly double compared to pre-pandemic levels, while core goods inflation remained the main driver of

core disinflation. However, the notable weakness in core goods throughout 2023, is likely to prove transitory after the renewed increases in global shipping costs due to Red Sea disruptions. Assuming that these increases eventually pass through into higher final goods prices, global core disinflation progress may come to a halt, taking also into consideration that stickiness in core services looks likely to persist for some time. Amid concerns about a renewed uptrend in core goods inflation, in an environment of still-tight labor markets, major CBs are reluctant to conclude that the battle against inflation is close to an end. As such, pushing back against market expectations for aggressive rate cuts soon, major CBs are making it clear that cuts are still some way off, as they need time for convincing evidence that inflation is on a sustained path back to target.

Figure 2: Renewed increases in global shipping costs due to Red Sea disruptions



Source: Bloomberg, Eurobank Research

Developed Economies

US: incoming hard data (e.g., retail sales, real personal spending) suggests that household spending remains resilient going into the end of 2023, while the labor market is softening, though gradually, remaining tight overall. Yet, economic challenges are intensifying. The impact of past Fed rate hikes has yet to be fully felt, savings are nearly depleted, the effects of favorable legislation on investment is fading, financial conditions remain tight in spite of recent modest loosening, and the student loan moratorium has come to an end. Against this backdrop, US growth is expected to slow in the coming quarters, as suggested by forward-looking indicators. But with consumer spending — the main engine of US growth — retaining momentum, the expected slowdown is likely to be relatively contained, allowing us to stick to the view of a soft landing rather than outright recession this year. In an environment of still rather resilient economy and overall labor market tightness, the Fed needs some time for convincing evidence that inflation is moving steadily down towards levels consistent with its target and labor market imbalances are materially moderating. As such, it is not expected to start cutting rates before late Q2 2024.

Euro area: real GDP virtually stagnated over Q4 2022 to Q3 2023, growing by an average growth rate of 0.0%QoQ after a mild contraction of 0.1%QoQ in the last quarter, reflecting the ongoing drag from the monetary tightening and subdued global industrial activity. Looking ahead, activity data (e.g., industrial production, retail sales) suggest that economic weakness will likely continue in the coming quarters, with increased risks of another mildly negative GDP growth print in Q4. Yet, in an encouraging note, high frequency indicators (PMI, EC consumer confidence) provide hopes that economic activity is stabilizing at low levels after bottoming out in in late Q3/early Q4, easing worries over a further sharp deterioration after

Q3's modest contraction. Meanwhile, disinflation is progressing, but the road to the ECB 2% target will likely be bumpy, as December's CPI data suggested. Taking into account recent tentative signs of stabilization in economic activity while waiting for concrete evidence suggesting that inflation is moving back to 2% on a sustained basis, the ECB is not likely to pivot to monetary easing before late Q2 2024.

Emerging Economies

EM: 2024 is set to be another year of a widening differential between growth in advanced and developing economies. According to the latest Global Economic prospects of the World Bank released in early January, the global economy is projected to grow by 2.4% in 2024 from 2.7% in 2023 with average growth in emerging market and developing economies (EMDE) expected at 3.9% vs 4.0% in 2023 and 1.2% in the advanced economies (DM) from 1.5% in the previous year. Despite the expectation that growth in EMDE will hold firm in 2024 with a negligible deceleration on cards (3.9% vs 4.0%), pronounced vulnerabilities tilt growth risks to the downside amid, among other things, elevated debt, and financing costs. The economic fundamentals and prospects of the developing part of the world have been challenged throughout 2023 and will continue to be in 2024 by a series of geopolitical, political and environmental risks outlined in the Special Topic of this issue (p.13-15).

CESEE: the prevailing impression is that growth in 2024 will pick up compared to 2023. From an average regional growth rate close to 4% in 2022, aided by the post pandemic stimulus, growth is expected to land close to 1% in 2023, having been hampered by the erosion of real disposable income and increased financing costs. The disinflationary process that has unfolded since early 2023, and the consequent monetary easing, are expected to pose tailwinds to growth in 2024, lifting it close to 3%. The economies of Hungary and Czechia probably contracted in 2023 but are expected to return to growth this year, while Poland and Romania are probably also heading for a rebound in 2024. Yet, challenges in the region continue to linger on. The prolonged war between Russia and Ukraine continues to threaten the security of neighboring peers, pressuring them to keep military and defense expenditure high in a year when the European Commission intends to propose to the Council the opening of Excessive Deficit Procedures (EDP) in spring 2024. Additional fiscal risks stem from the parliamentary and presidential ballots to be held in Croatia and Romania. A strong mitigant against the above risks could be the vigorous use of funds under the RRF, which has entered a more mature stage of implementation, given its expiry at the end of 2026.

Markets View

Foreign Exchange

EUR/USD: the market bias for EURUSD has turned from bullish to cautiously neutral after the retracement at the start of the year from above 1.11 during December 2023 to below 1.09 territory currently. A break above 1.1023 could pave the way for a potential upward push towards 1.111. Further bearish momentum could potentially target the 1.0790 level. Relative Strength Index below 30 (RSI <30) is currently at 49.452, indicating that the market is in bearish territory. The Moving Average Convergence Divergence (MACD) signal is currently at a bullish crossover, suggesting that upward momentum could be building, but at a consolidated level indicating weak signal conviction. Support levels include 1.0769, 1.0715, and 1.066 while resistance levels include 1.1133,1.1188, and 1.1243. 1M, 6M and 9M implied volatilities are currently at 6.7, 6.515, and 6.505%, respectively.

GBP/USD: moving average (MA) trend-following analysis suggests a bullish market bias, with a break above 1.2794 potentially able to target the 1.2931 territory. Currently RSI (<30) shows 52.021 and indicates a technically set mid-term bullish area. The MACD signal's bullish crossover suggests an upward momentum as well. Support levels include 1.2498, 1.2435, and 1.2372 and resistance ones 1.2922,1.2986, and 1.305. 1M, 6M and 9M implied volatilities currently at 7.44, 7.305, and 7.555%, respectively.

Rates

EU: swap interest rates have exhibited relative stability amidst market volatility, increasing by around 10bps across all tenors. The 10-year swap rate remained contained around 262bps. The yield curve slope remained anchored, with the 5s30s spread trading around -10bps. Looking forward, it is anticipated that volatility will stabilize, and yields in the front end will move slightly higher, given that the market has already priced in seven cuts for the year, and inflation shows signs of stabilization.

US: swap rates started the year significantly higher at all tenors. The 10-year SOFR Swap Rate is trading at 361bps, up from 347bps at the beginning of the month. The yield curve continued to steepen, with the 5s30s spread now at -9bps, up from -25bps at the end of December. Looking ahead, a persistence of volatility in swap rates is anticipated in the short term as stronger-than-expected inflation data have pushed back the start of rate cuts to June from March, which was the initial pricing of the market. Going forward, the yield curve is expected to steepen, and both 2s10s and 5s30s are likely to move higher as rate cuts start to materialize.

Emerging Markets Sovereign credit

The positive risk sentiment seen in November continued in December with yields dropping and spreads further tightening. The EMBI Global Index tightened by 17bps by the end of the year, but reversed some of these gains at the start of 2024 and is now at 333bps vs 341bps at the end of November. In CEEMEA, the central bank of Israel started the year with a 25bps monetary easing, while the bank of Poland kept its hawkish tone. Hungary issued a new 12y USD bond at 5.74%. In Latam, we saw strong interest in Mexican bonds as the disinflationary process continues. In Asia, Chinese sovereign bond yields moved lower while monthly inflation is slightly negative. In Taiwan, the Democratic Progressive Party retained the presidency (40.1% of votes) but experienced a significant drop in votes compared to the past two elections and lost its legislative majority. We remain constructive but cautious on EM sovereign fixed income, as the Fed will soon start its easing cycle, but with rising geopolitical tensions in the Middle East posing some risks.

Corporate credit

December held continued optimism that a soft landing was coming into view, whereby inflation would be back at target levels without a recession, allowing central banks to start cutting rates. This momentum continued into early 2024, with risk assets advancing across the board, before paring back part of the move in the last few sessions. The latter came after an upside surprise in the latest US headline CPI print as well as comments from central bankers who warned about the risks of cutting prematurely, thus pushing back on the rate discussion. Overall, markets still assign a high probability of a Fed cut by March (74%), and more conservative chances of a similar move by the ECB and the BoE (likelihood at 29% and 31% respectively). Against this background, equities saw a strong year-end rally, which started in November and has continued into 2024. Since the beginning of December, Stoxx 600 is registering gains of 2.4% while the S&P 500 advanced 4.7%. During the same period, synthetics tightened further, both in Europe as well as overseas. Demand for risky assets and a rally in sovereign bonds continued to support corporate debt, which saw spreads tightening further, particularly in the HY space. Increased geopolitical risk has led to volatility in commodities, after the US and the UK carried out air strikes against Houthi rebels in Yemen in retaliation for attacks on commercial ships in the Red Sea and Taiwan's election was won by the "separatist" incumbent DPP, heightening risks in the region. On the politics front, attention is on US elections, after former US President Trump easily won the first test of his election year, securing more than 51% of the vote so far in the Iowa Caucus, well ahead Florida Governor Ron DeSantis (21%) and former South Carolina Governor Nikki Haley (19%).

In credit, European spreads tightened further following a strong November, with the Itraxx Main -7bps and Xover -42bps December-to-date. Both indices moved broadly in line with US synthetics. In EUR Corporate cash, IEAC underperformed vs. HY, ending +5bps, with IHYG -20bps since the beginning of December. Financials outperformed among EUR IG cash (Snr Fins +2bps, Sub Fins -1bps) while Technology continued to lag (+14bps December-to-date). In High Yield, Consumer Staples (-83bps) and Financials outperformed (Snr Fins -39bps, Sub Fins -51bps), while Technology was a notable underperformer (+326bps). Activity in

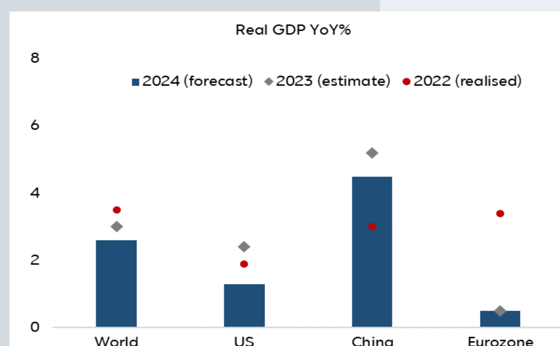
the European Primary market was muted in December as the seasonal lull took hold, while issuance picked up in 2024 with borrowers rushing to take advantage of attractive spreads to secure liquidity ahead of their yearly funding plans. Looking ahead, attention remains on data, as the market seeks signs that will sustain the central bank dovish pivot narrative. US politics and geopolitical developments will also remain in focus in the medium term. Credit sentiment remains conducive for issuance, with fresh mandates indicative of a busy January.

Special Topic: Global Economic Outlook for developed and developing economies and commodity markets

I. Global Economic Outlook

After the global economy outperformed even the more optimistic expectations in 2023, expanding by a solid, though below trend pace of 3.0% despite aggressive monetary tightening and several negative shocks, growth is expected to decelerate further this year. The full impact of past monetary policy tightening has yet to be felt, savings buffers accumulated during the pandemic have steadily declined from peak levels early last year, fiscal policy is likely to tighten moderately in the US and the Eurozone and China continues to face structural challenges, mainly protracted weakness in the real estate market. However, the risk of the global economy experiencing a hard landing looks rather low. The anticipated rise in unemployment as economic activity continues to slow will likely be contained as firms face difficulties in finding workers with the right skills or experience. Meanwhile, the combination of decreasing inflation and still-strong wage growth as labor markets are expected to remain quite tight, should support real incomes and private consumption. In addition, monetary tightening has so far generated little erosion in the health of the private sector, while leading indicators suggest that global trade and manufacturing activity are close to bottoming out – or have already done so – thanks to lower energy prices and easing global supply chain pressures.

Figure 3 : Global GDP growth is seen decelerating mildly this year



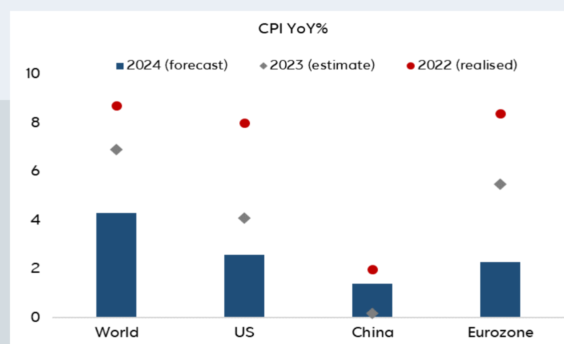
Source: Bloomberg, Eurobank Research

Against this backdrop, global GDP growth is seen decelerating mildly to 2.6% this year followed by a gradual recovery towards 3% in 2025, with a growing divergence across economies expected to persist. The emerging economies are projected to perform generally better than the advanced economies thanks to policy easing and lower food prices, with growth rates in India and other Asian economies (ex-China) remaining robust or even accelerating. The US economy is seen decelerating from a projected 2.4% in 2023 to 1.2% in 2024, avoiding an outright recession, but with a soft patch in mid-year, while the Eurozone is likely to continue to stagnate, growing by an anemic 0.5% in 2024 and the UK recording lackluster growth of 0.3%. However, growth risks are skewed to the downside. Importantly, heightened geopolitical risks, mainly as a result of the recent outbreak of conflict between Israel and Hamas and the Russian invasion of Ukraine – which enters its second year in February – could lead to a significant increase in oil and gas prices that would likely lower global growth. Greater than projected sensitivity to tighter monetary policy and persistent tightening of financial conditions could lead to a deeper slowdown in economic activity, while China's ailing property sector creates another downside risk to the global growth outlook. Stickier inflation could force central banks to maintain a tight policy for longer than expected, or even hike rates further. Moreover, political risks remain elevated. 2024 is an election year posing risks of a rise in policy uncertainty amid increased social polarization and

populism. National elections are scheduled in more than 20 countries with a total population of over 4 billion people, around half the world's population, including the US (presidential elections in November) and Europe (parliamentary elections in summer), representing more than 60% of global GDP.

In contrast to growth dynamics, inflation dynamics are expected to look somewhat similar around the globe, as most countries should continue to experience gradual disinflation amid an anticipated further slowdown in global economic activity, softening labor markets, dissipating effects of the main price shocks (supply side shock, Ukraine war-energy shock) and tightening financial conditions. Headline inflation is expected to moderate further from the Q3 2023 peak, averaging 4.3% in 2024, though remaining above central bank target in most DM economies, as the fading of favorable energy price effects slows the progress of disinflation. Core inflation is also likely to continue falling but slightly more gradually given continued upward pressure on labor costs and service prices.

Figure 4 : Most countries around the world should continue to experience gradual disinflation



Source: Bloomberg, Eurobank Research

In this environment, major central banks are expected to adopt a less restrictive monetary policy stance. Provided that they are convinced inflation is on a steady downward trend towards target, DM central banks (aside from the BoJ) will likely start to normalize policy gradually, entering a rate cutting cycle later this year (both the Fed and the ECB are expected to start cutting rates in late Q2 2024), while EM central banks should continue easing. The key upside risks to inflation stem from still healthy wage growth which may keep services inflation sticky, and geopolitical tensions which, if escalated, could push up commodity prices and result in significant disruptions to global supply chains.

II. Developed Economies

US: the economy is projected to expand by an above-trend 2.4% annualized growth rate thanks to resilient consumption, ample fiscal support and strong investment boosted by the supportive CHIPS and Inflation Reduction Acts, defying earlier market expectations for a recession in 2023. However, reflecting the lagged effect of tighter credit and financial conditions, a less-supportive fiscal policy, depleted savings buffers, fading effects of favorable legislation on investment and the resumption of student loan payments, economic activity is expected to lose momentum in 2024 after it starts decelerating in Q4 2023. Our baseline scenario is for GDP growing by a still positive, though well below trend annualized rate of 1.3%. That said, we share the view of a soft landing rather than outright recession as consumer spending — the main engine of growth which accounts for around 70% of GDP — is expected to slow down but not to collapse. Unemployment will rise but the increase is likely to be rather contained with the labor market remaining tight overall, on the view that many firms face difficulties in finding available and experienced employees. In

addition, in spite of aggressive monetary policy tightening, private sector balance sheets remain generally healthy and the transmission of tighter monetary policy to financial conditions has been rather limited thus far. Disinflation, which progressed rapidly in 2023 owing in large part to fading supply shocks, is expected to continue this year as economic activity slows and labor market tightness eases. However, sickly core services ex-housing inflation will likely keep core PCE — the Fed's preferred gauge of inflation — above target through end-2024 as the labor markets cools, but only gradually. In an environment of slowing but still rather resilient economic activity and overall labor market tightness, the Fed needs some time for convincing evidence that inflation is moving steadily down towards levels consistent with its target and that labor market imbalances are materially moderating. It is not expected to start cutting rates before late Q2 2024, at a gradual pace, after having delivered a cumulative tightening of 525bps since March 2022.

Eurozone: the economy showed unexpected resilience in 2023 to the gas supply crisis induced by the war in Ukraine, with the economy stagnating in the year up to Q3 (0.0%QoQ on average), defying initial expectations of a sharp slowdown. In Q4, expectations are for another quarter of stagnation or a mild technical recession after the small 0.1%QoQ contraction in Q3, mostly reflecting the ongoing drag from the monetary tightening and subdued global industrial activity, with full-year GDP seen at 0.5%YoY. Looking ahead, risks are for sustained stagnation in the coming quarters as headwinds will likely remain strong. The transmission of the ECB's past rate hikes continues to unfold, the labor market is modestly softening after around two years of stagnation, and fiscal policy will likely be less supportive mainly due to the removal of the energy support measures adopted in 2022. However, disinflation combined with still-healthy wage growth amid overall tight labor market conditions should support household disposable income, while the projected modest recovery in global trade later this year is also anticipated to bring some relief to economic activity. For 2024, we pencil in an average GDP growth rate of 0.5%, the same as last year, with a notable increase in economic activity not expected before Q4, when the negative effect of the past monetary tightening will likely have faded. Headline inflation is expected to continue dropping further below the October 2022 peak of 10.6% – though at a lower speed as positive energy base effects are fading – averaging 2.5% this year from 5.4% in 2023. But core inflation is seen remaining stickier, moving downwards more slowly due to wage dynamics, ending the year in the 2.5% area. Amid weak growth and ongoing disinflation, the ECB is expected to start cutting rates by end Q2, but at a gradual pace due to still above-target inflation.

Germany: the coalition government substantially tightened its fiscal stance for this year with its mid-December announcement of expenditure cuts and revenue increases to fill a funding gap of around €17bn for the 2024 budget. That gap came after the Constitutional Court ruled that the reallocation of unused Covid recovery funds was unconstitutional, and is set to considerably hinder economic activity. Furthermore, business fixed investment, which expanded strongly in 2023 on easing supply shortages, should weaken sharply this year as the volume of order books in the machinery and equipment industry is severely deteriorating with tightening financial conditions. Meanwhile, the recession in residential construction should deepen, as reflected in the steady rise in the number of canceled projects due to higher mortgage rates and elevated construction costs. Healthy nominal wage increases combined with an expected further deceleration in inflation should support household spending, which was surprisingly weak last year. Yet, the potential of

any consumer spending recovery should be limited given subdued consumer confidence and concerns about the outlook of the labor market as the prospects for the Eurozone's largest economy remain gloomy. Against this background, the risk of economic activity continuing to shrink this year remains high, with annual GDP expected to contract by 0.1% after, according to a preliminary estimate, a 0.3% decline in 2023. With respect to prices pressures, the current disinflation trend should continue this year, though more gradually, mostly thanks to energy prices which are expected to remain in slightly negative territory in annual terms. Headline HICP is seen increasing by an average 2.6% from 5.9% in 2023, while stickier services inflation is expected to keep core higher throughout the year.

France: after rising by an estimated 0.8% in 2023, economic activity is expected to remain sluggish in the coming quarters due to slowing growth in services and protracted weakness in manufacturing on the back of higher interest rates and subdued global trade. However, GDP growth is likely to regain some momentum in late 2024, supported by an expected modest improvement in the global environment and a slight acceleration in household spending thanks to rising real incomes. Those are the result of a combination of robust (albeit slowing) wage growth and lower inflation, and they partially offset slowing gross fixed capital formation, which is affected by tighter credit conditions. For the whole year, GDP is seen averaging a still below trend growth rate of 0.7%, with developments in the labour market (unemployment has started to increase modestly over recent months) posing an important downside risk to our forecasts, taking into consideration the subdued growth outlook. On the inflation front, headline CPI is expected to continue slowing, averaging 2.4% in 2024 from an estimated 4.9% in 2023, though remaining above pre-pandemic levels mainly due to stickier services inflation.

Italy: the Italian economy looks like it avoided a technical recession in 2023, expanding 0.1%QoQ in Q3 2023 after a 0.4%QoQ contraction in Q2, while GDP probably stagnated in Q4. With the ECB hiking rates to combat inflation, the monetary transmission mechanism was effective in tightening financial conditions in Italy as credit growth to the private sector turned negative early in the year, with the business lending falling 5.1%YoY in November. As a result, gross fixed capital formation has been falling on a year-on-year basis since Q2 2023 and we expect this investment contraction to continue through Q1 2024. However, Italy's labour market has so far shown great resilience in the face of the economy's slowdown, and with real earnings also bolstered by the drop in inflation we expect consumption to support a pickup in headline GDP growth to 0.2%QoQ in Q1 2024 and to 0.3%QoQ in each of the remaining three quarters of the year thereafter. The European Commission is not expected to launch an Excessive Deficit Procedure against Italy before elections to the European Parliament in June, and the government's defiant stance towards Brussels in choosing a more gradual pace to post-pandemic fiscal consolidation does present a potential upside risk to growth forecasts in the short term. That said, under our base case we do not currently see much contribution from government consumption to GDP growth in 2024. For the year as a whole, we expect Italy's economic growth to slow to 0.5% from 0.7% in 2023. If the absorption of RRF funds proceeds smoothly the recovery in investment should pick up pace in 2H 2024 and drive GDP growth to 1.1% in 2025.

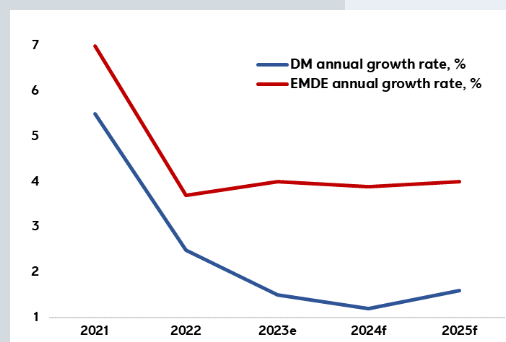
UK: the economy appears to have weathered 2023 better than seemed likely at the start of the year, although challenges remain with inflation higher than its developed economy peers and the Bank of England

currently sounding more hawkish on the course for interest rates than other major central banks. GDP probably remained flat on a quarterly basis in Q4, meaning that full-year growth for 2023 would have been 0.5% – a rate that we see slowing to 0.3% this year, but with growing momentum from H2 2024 as the economy is buoyed by lower energy prices and higher real wages. While inflation remains higher than its peers, disinflation has been fairly rapid in the final quarter of 2023, with CPI growing 4%YoY in December, a drop of 2.7ppts compared to its rate in September. A 10-15% drop in energy bills coming in April should help the disinflationary momentum in 1H, though the BoE will probably wait to see that a near 10% increase in the National Living Wage in the same month does not trigger a new inflationary wave before it starts easing monetary policy. The average rate of inflation is expected to slow to 2.8% this year. Futures markets are fully pricing a first rate cut by the central bank's June MPC meeting and imply a cumulative 134bps of cuts this year. The exact timing of the general election due this year adds another layer of uncertainty to the UK's outlook, as does the unknown makeup of economic policies that the next government will follow. While the opposition Labour Party – which holds a roughly 20-point lead in opinion polls – has stressed the need for fiscal prudence, it will face mounting pressure to increase spending on the UK's straining public services should it secure a majority.

III. Developing Economies

2024 is set to be another year of a widening differential between growth in advanced and developing economies. According to the latest Global Economic prospects of the World Bank released in early January[1], the global economy is projected to grow by 2.4% in 2024 from 2.7% in 2023 with average growth in emerging market and developing economies (EMDE) expected at 3.9% vs 4.0% in 2023 and 1.2% in the advanced economies (DM) from 1.5% in the previous year. Despite the expectation that growth in EMDE will hold firm in 2024 with a negligible deceleration on cards (3.9% vs 4.0%), pronounced vulnerabilities tilt growth risks to the downside amid, among other things, elevated debt and financing costs. The economic fundamentals and prospects of the developing part of the world have been challenged throughout 2023, and will continue to be in 2024 by the following:

Figure 5: 2024 set to be another year of a widening differential between growth in DM and EMDE



Source: World Bank, Global Economic Prospects January 24, Eurobank Research

- ✓ A series of geopolitical risks

⇒ The war between Russia and Ukraine will be two years old in February 2024, with no end at sight for the time being

⇒ The concern for further escalation of tension between China and Taiwan remains widespread, especially now that the party supporting Taiwan's autonomy has rewon the recent election

[1] https://www.worldbank.org/en/publication/global-economic-prospects

⇒ The conflict between Israel and Hamas is rattling the already fragile region Middle East with second-round effects such as the latching onto the conflict of the Houthi movement in Yemen. The latter escalation has distorted the global shipping activity that involves navigating the Red Sea, pushing freight costs higher and posing serious risks to global supply chains

⇒ Venezuelan President Nicolas Maduro's intention to annex almost the two-thirds of Guyana, a small South American nation, rich in oil reserves

- ✓ Political risks

A streak of elections in many EMDE – among them India, Indonesia, South Korea, Iran, Pakistan, Russia, Mexico, and Venezuela – are scheduled in 2024, with Taiwan having already voted in mid-January. Not all ballots carry the same political risk. For instance, India's election in April is considered low risk; PM Narendra Modi is expected to be reelected and renew his third mandate with the Indian people for continuing liberisation of the economy. Yet ballots in Poland and Argentina in 2023 held surprises as the outsiders Donald Tusk and Javier Milei prevailed. These two outcomes increase to some extend the uncertainty in the elections to be held in 2024 and pose serious fiscal perils stemming from pre-election spending from current governments. Indicatively, the Institute of International Finance (IIF) warned that the "tsunami" of 2024 elections could add to an already record glut of global debt estimated to have reached USD310trn by the end of 2023.

- ✓ Environmental risks

The increased severity of climate-related events recorded by the United Nations for 2023 compared to 2022 is mirrored in the count of human losses stemming from floods, wildfires, cyclones, storms, and landslides, which increased by 30%. Most of the disastrous events took place in developing parts of the world such as Storm Daniel in Libya in September and Typhoon Doksuri, which caused significant rainfall and flooding throughout at least 16 cities and provinces in north-eastern China in July. Natural disasters impose a greater social and economic toll on the emerging part of the world as the recovery and restoration in destroyed infrastructure is always costly, with many EMDE being over-leveraged and some at the brink of debt distress. The growing concern over environmental risks is apparent in the recent Global Risks Report for 2024 by the World Economic Forum, where extreme weather conditions rank by and large as the highest risk that could lead to a material crisis on a global scale in 2024.

Taking all the above into account, we attempt to briefly sketch the unfolding 2024 backdrops for major and significant developing economies across Asia and Europe:

China: the FY2023 5.2%YoY growth rate may have passed the "around 5.0%" bar set as the official target by the Politburo, but this has been jeopardized quite a few times within the year and ad-hoc policy stimulus had to be deployed to secure the current outcome. 2023 has been more of a year of dashed hopes given the much awaited but undelivered turnaround in the pivotal real estate sector and the frail economic sentiment that came along and appears to have been passed on to 2024, with added fears over lay-offs in property development firms, dampening private consumption and postponed investment decisions. While fiscal and monetary policy has remained accommodative since April 2023 – when the loss of growth momentum started to become more evident – the key question is whether policy easing will continue in 2024,

and to what extent. A growth rate no less than 4.5% is expected in 2024, with the view to stand around these levels in the medium term ahead.

India: the economy lost some of its momentum in 2022 as inflation remained elevated due to rising global energy and food prices and global financial and economic conditions deteriorated. This was translated into a decreasing – though still high – growth rate of 7.2%, from 9.1% in 2021. Having achieved a 5.5% average GDP growth rate over the past decade, 2023 is expected to have remained an above trend year, despite the further slowdown, as growth rate is anticipated close to 6.0%. We attribute this year's projected deceleration to stressed financial conditions from the extensive monetary tightening of the last three years (currently the key policy rate stands at 6.5%, compared with 4.0% back in April 2020). Looking ahead, available forecasts up to 2028 by the IMF point to solid growth momentum with growth rates in the range of 6.0% throughout the next five years. In particular, investment is considered a key growth driver in 2024 given that private consumption growth is expected to decelerate on the back of fading post-pandemic demand impetus. For 2024, we anticipate growth to stand within the 6.0% range, i.e. close to 6.3%.

Central and Eastern Europe: the prevailing impression is that growth in 2024 will pick up compared to 2023. From an average regional growth rate close to 4% in 2022, aided by the post pandemic stimulus, growth is expected to land close to 1% in 2023, having been hampered by the erosion of real disposable income and increased financing costs. The disinflationary process that has unfolded since early 2023, and the consequent monetary easing, are expected to pose tailwinds to growth in 2024, lifting it close to 3%. The economies of Hungary and Czechia probably contracted in 2023 but are expected to return to growth this year, while Poland and Romania are probably also heading for a rebound in 2024. Yet, challenges in the region continue to linger on. The prolonged war between Russia and Ukraine continues to threaten the security of neighboring peers, pressuring them to keep military and defense expenditure high in a year when the European Commission intends to propose to the Council the opening of Excessive Deficit Procedures (EDP) in spring 2024. Given the inelastic nature and the inherent momentum of defense spending, public finances of the CEE-4 and the Baltics will be squeezed. Additional fiscal risks stem from the parliamentary and presidential ballots to be held in Croatia and Romania. While the European Parliament elections, which will be held in all EU states, will have a neutral impact on the fiscal spending of each member state, they do carry some political risk dependent on the outcome of the elections and how this will affect decision making and the passage of legislation within the European parliament. A strong mitigant against the above risks could be the vigorous use of funds under the RRF, which has entered a more mature stage of implementation, given its expiry at the end of 2026.

Economies in the wider CESEE region

Turkey: persistently high inflation, stemming mainly from the devaluation of the lira after the shift to tight monetary policy from June 2023 onwards, will dampen household consumption and GDP growth in 2024. In contrast, investment will be fueled by the reconstruction process following last year's earthquakes, whereas in the external sector, the favorable effects of currency depreciation will be partially undermined by rising wages and high costs for businesses from soaring interest rates. Based on the above, growth in Turkey is expected to weaken in 2024 close to 3.2% from 4.2% in 2023.

Cyprus: a strengthening of private consumption is expected in 2024, as the labour market will further tighten, but also thanks to government measures to tackle inflation, as well as from higher wage indexation. Particularly strong demand for real estate in 2023, with sales at an at least 16-year high, will boost construction activity, but the market outlook is linked to developments in the Gaza war due to the high share to transactions Israeli investors hold. Business headquartering policy and implementation of the revised RRF will stimulate investment this year. On the external balance, a protracted war will negatively affect tourism revenue. On the other hand, recent credit rating upgrades (Moody's, Scope Ratings) could attract foreign investment capital, mainly in financial services. As a result of these factors, growth is projected to moderately strengthen, from 2.3% in 2023 to 2.7% this year.

Bulgaria: growth is expected to cool down to 1.9%YoY in 2023 from 3.9%YoY in 2022, with the average annual 9M2023 growth rate standing at the same level. We anticipate a mild rebound in 2024 mainly backed by the sustained positive momentum of investment, which was spotted in Q3-2023 and is expected to extend into Q4-2023 and 2024. The dynamics that will cause investment to embark on a virtuous cycle in 2024 and result in a forecast of 2.5% for headline growth broadly stem from the more protracted EU-funds absorption under the RRF. Additional tailwinds could come from recovering trading activity with key trading partners, underpinning exports. We embrace the entry into the Schengen area from March 2024 positively. Yet the limitations of access only by air and sea mean the benefits are mostly restricted to tourism.

IV. Commodity Markets

Trends in demand and prices of energy commodities and industrial metals in 2024 are expected to be driven by the pace of growth in China, mainly in the metals-intensive property sector, the pace of monetary policy easing from the major CBs; developments in the war in Gaza and tensions in the broader region; and idiosyncratic supply factors for some commodities.

Crude Oil: the war in Gaza caused the strongest uncertainty about the smooth supply of oil products in 2023, due to a possible involvement of Iran and a wider destabilization in the Middle East region, with the price of Brent crude oil rising as high as $93.79/bbl in mid-October. The likelihood of such a development diminished shortly after the burst of the war but has been increasing since early December due to the Yemeni Houthi rebels' attacks on shipping in the Red Sea and counterstrikes by western allies. Amid this further escalation of tension in the region, Brent crude oil price has until now edged up moderately, to $81.45/bbl in December 26. Another development that was expected to lead to a rise in oil prices was a decision by OPEC+ members to further limit their output in 2024. Despite extending voluntary output cuts by 900 kb/d decided in November for Q1 2024, crude oil prices fell afterwards amid doubts in the oil markets over the implementation of the new cuts. Angola's recent decision to leave OPEC backed those doubts and likely undermined the organisation's credibility. Besides these supply-side developments, non-OPEC+ oil production is projected to expand in 2024 by 1.2 mb/d, mainly from an output increase in the US, but also in Brazil, Guyana, and Canada. This expansion slightly exceeds the anticipated milder-than-2023 increase of global oil demand in 2024, by 1.1 mb/d after a 2.1-2.2 mb/d rise last year, coming almost entirely in 2024 from rising consumption in non-OECD countries, mainly in China and India. Based on oil price trends

in Q4 2023 amid new geopolitical tensions and expected supply and demand factors for 2024, crude oil price will on average trade slightly higher than in 2023, with the Brent price projected to average between $81-83/bbl after $80.14/bbl last year and average WTI price at $78-79/bbl from $77.73/bbl in 2023.

Natural Gas: milder-than-usual northern hemisphere winter 2022/2023 and autumn 2023, combined with successful diversification in EU gas suppliers following the Russian-Ukrainian war, and with production at a new all-time high in Q4 2023 (105Bcf/d) in the US, resulted in historically high inventories prior to winter 2023/2024 and the reduction of natural gas prices at the end 2023 - early 2024 to much lower levels compared to the same period a year earlier. On November 1st, 2023, the average filling level of gas storages across the EU stood at 99.4%, almost 10ppts above the last 5-year average and a filling target of 90%. On January 2,, 2024, the European (TTF) gas price fell intrasession to €30.16/MWh, an almost 5-month low, 64.95% and 22.56% below its respective level one and two years ago. The US (Henry Hub) gas price fell on December 13, 2023, to an at least 10-year low of $2.208/MBtu. Although US gas prices escalated afterwards, reaching $3.380/MBtu in mid-January, on news about delays in the Golden Pass LNG project in Texas, on an annual basis they remained lower by 18.8%. In 2024, up-to-now forecast favorable weather conditions that suggest moderate gas consumption amid high inventories, stepwise implementation of the coal-to-gas switching policy in China; and mildly slower global economic growth relative to 2023 illustrate a rather bearish picture on the demand side. On the supply side, projected output and export increases, especially in US LNG but from H2 2024 onwards, backed by large-scale investments (e.g., new LNG export facility in Plaquemines, Louisiana, Golden Pass LNG project) are undermined by recent developments in the Red Sea causing LNG vessels to avoid transiting the Suez-Canal and rising transportation costs. Under these expected demand and supply factors, natural gas prices are projected to rise moderately this year in the US, with the EIA recently projecting an average natural gas spot price for 2024 of $2.66/MBtu after an average price of $2.57/MBtu in 2023 (+4.7%). In contrast, for the European (TTF) natural gas Fitch Ratings projects a 7.6% price fall this year.

Regarding the price outlook for the most significant industrial metals in 2024, China's effects will in most cases be pivotal due to vulnerabilities in the country's real estate sector. Elevated interest rates and a stronger US dollar were also a drag on demand for industrial metals such as iron ore, copper, aluminium, zinc and nickel in 2022-2023, through the financial strain on the manufacturing and construction sectors from high borrowing costs and the fact that the markets where these commodities are mainly traded (LME, NY COMEX) price in US$. **Iron ore (62% fe)** prices stayed above the key $100/t level for most of 2023, moving continuously higher since September and reaching an 18-month high by the end of the year ($136.4/t), mainly on the back of stimulus measures taken by the Chinese government in Q3 2023 to boost investment, especially in the property sector. On average in 2023 iron ore prices rose by 1.5%, to $114.5/t. The latest Chinese government plan aiming to revive the steel-intensive property sector includes the provision of at least 1tn yuan (approx. $137bn) of low-cost financing for urban village renovation and affordable housing programs. On the supply side, slow growth globally has dampened the impact of China's real estate sector weaknesses. Indicatively, total iron ore production from the top-4 miners globally reached 287mn metric tons in Q3-2023, falling by 2%YoY, in part due to operational and maintenance issues. There are few concerns over iron ore supply in 2024, such as constrains on Brazilian exports from suspension of operations at Tubarão port and uncertainty about state curbs in China's steel output, which,

however, last year were smaller than expected, living space for an average output increase by 1.7%YoY in January-September 2023. The average iron ore price this year is expected at $120/t, almost 5.0% higher than the year before.

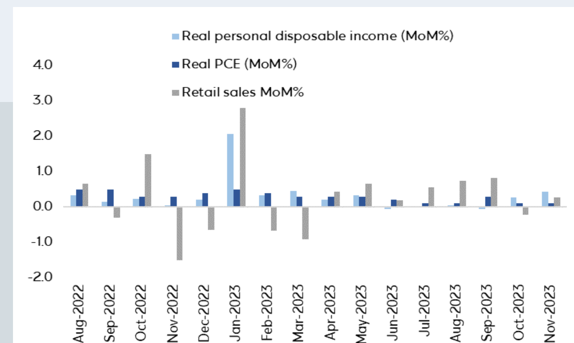
The slump in China's property market was also a major headwind for **copper** demand in 2023. The spike in prices (3-month ahead at the LME) in January last year, up to $9356/t (+11.8 from end-December 2022), in the aftermath of the termination of the zero-Covid policy in China, was followed by a 15.5% decline by May, mainly due to weaker-than-expected growth performance of the Chinese economy in Q1-2023. The surge of prices afterwards was short-lived, up to July, compensating for 2/3 of the previous losses, with the downward momentum resuming afterwards, mainly due to the weakening property sector in China. Because of these effects, the average 3m-ahead LME copper price for last year was down by 3.0% compared to 2022. Therefore, a sustainable recovery of the property market in China, will be a critical factor for a long-term upward trend in copper prices, in 2024 and the years ahead. Long-term copper perspectives are supported from energy production transition to renewables. An expected weaker US dollar after the Fed adopts a monetary easing stance, most probably since late Q2 2024, will boost copper and other industrial metals' demand. Some disruptions are expected on the supply side, as currently, two of the mines on which a significant part of the projected supply increase in 2024 was based on, in Panama and Peru, are not operating, due to community or wider reactions which led to their shutdown. In contrast, Chinese production of refined copper is heading for a new record, backed by the expansion of the country's smelting and refining capacity. Cooper prices will rise moderately in 2024 according to recent forecasts by BMI, a Fitch Solutions company, by a bit more than 3%, averaging $8800/t this year.

US

GDP expected to slow in the coming quarters as headwinds intensify

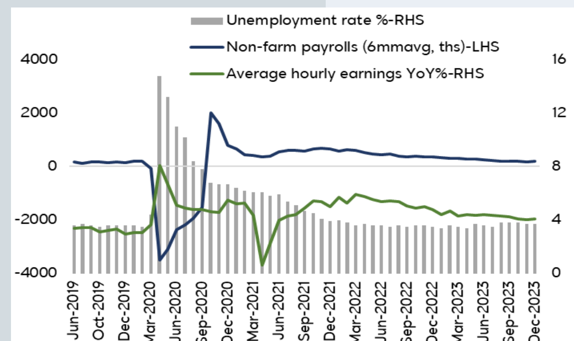
According to the final estimate, Q3 2023 GDP growth was revised 0.3ppts lower from the second estimate to 4.9%QoQ saar, effectively matching the first advance estimate which pointed to the fastest rise since Q4 2021. As before, the main growth driver was private domestic final purchases (+3.0%QoQ saar), mainly supported by personal consumption which was reassessed 0.5ppts lower, though to a still robust 3.1%QoQ saar (+2.1ppts). Meanwhile, incoming hard data suggests that household spending remains resilient going into the end of 2023. Retail sales unexpectedly rose by 0.3%MoM in November following an upwardly revised drop of 0.2%MoM in October and a 0.8%MoM gain in September, and real personal spending rose by a higher than expected 0.1%MoM over the same month, along with a 0.4%MoM rise in real disposable income, the largest monthly improvement since May. Meanwhile, the labor market is softening, though gradually, remaining tight overall (average hourly earnings at 4.1%YoY in November after peaking at 5.5% in mid-2022, but still above levels consistent with the Fed's inflation target). Yet, economic challenges are intensifying. The impact of past Fed rate hikes has yet to be fully felt, savings are nearly depleted (4.1% in November, well below pre-pandemic levels), the effects of favorable legislation on investment are fading, financial conditions remain tight in spite of recent modest loosening, and the student loan moratorium (the second largest source of household debt after mortgages) has come to an end. Against this backdrop, growth is expected to slow in the coming quarters, as suggested by forward-looking indicators, notably the ISM services index which dropped by more than 2pts to a seven-month low of 50.6 in December and the respective figure for manufacturing which remained well into contraction territory (47.4). But with consumer spending — the main engine of US growth — retaining momentum, the expected slowdown is likely to be relatively contained, allowing us to stick to the view of a soft landing rather than an outright recession this year. In an environment of slowing but still rather resilient economy and overall labor market tightness, the Fed needs some time for convincing evidence that inflation is moving steadily down towards levels consistent with its target and labor market imbalances are materially moderating. As such, it is not expected to start cutting rates before Q2 2024.

Figure 6: Consumer spending retained momentum going into the end of 2023



Source: BSL, Census Bureau, Eurobank Research

Figure 7: Labor market still tight overall



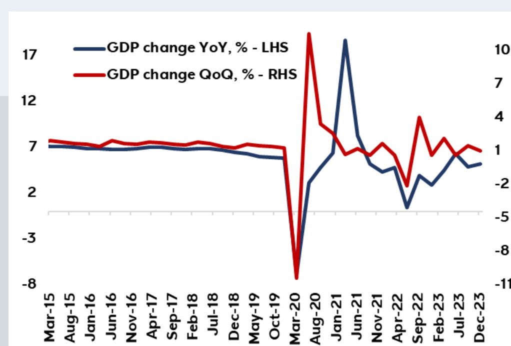
Source: BLS, Eurobank Research

China

Growth target for 2023 achieved, downside risks for 2024 linger on

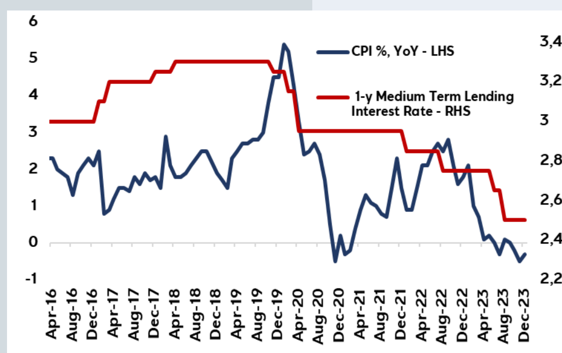
The economy grew by 5.2%YoY in Q42023 from 4.5%YoY, 6.3%YoY and 4.9%YoY in Q1, Q2 and Q3 respectively, bringing the FY2023 growth rate to 5.2%, compared with 3.0% in 2022. The annual Q4 print came slightly below the 5.3% market and so did the QoQ reading, which came in at 1.0% from 1.3% in the previous quarter. We consider the quarterly reading more representative of the standing of the economy in the last quarter as the annual was favored by positive base effects from the country still under the zero covid health policy in the same quarter of 2022. The 5.2%YoY growth rate may have passed the "around 5.0%" bar set as the official target by the Politburo, but this has been jeopardized quite a few times within the year and ad-hoc policy stimulus had to be deployed to secure the current outcome. In a nutshell, 2023 has been more of a year of dashed hopes given the much awaited but undelivered turnaround in the pivotal real estate sector and the frail economic sentiment that came along and appears to have been passed on to 2024, with added fears over lay-offs in property development firms, dampening private consumption and postponed investment decisions. This picture is underlined by recent hard data, as retail sales growth in December failed to sustain November's brisk momentum. It came in at 7.4%YoY after 10.1%YoY in November and 7.6%YoY and 5.5%YoY in October and September respectively. Industrial output growth may have fared a bit better, rising to 6.8%YoY from 6.6%YoY in November – the consensus estimate of market participants was for a constant growth rate in December. However, property investments kept contracting in December by 9.6%YoY, which is slightly worse than market expectations, and is the eleventh straight contraction. On top of this, inflation came in negative for a third month in a row, raising questions over aggregate demand in the economy and bringing the annual average inflation rate to 0.2%. Reasoning along these lines, markets were broadly expecting the PBoC to proceed with some monetary easing and reduce the 1-year medium term lending facility rate by 10bps to 2.40% in mid-January. But the cut didn't happen, presumably due to fears over further depreciation on the yuan. As it is, China's currency depreciated 6.0% against the US dollar in 2023. All in, 2024 is expected be a below trend year in terms of growth with our view stable at 4.5%.

Figure 8: Despite the subdued growth, with Q42023 quarterly print being the lowest in the post pandemic era



Source: Bloomberg, Eurobank Research

Figure 9: ..and the fears over deflation and what this could mean for demand, policy influx is handled cautiously



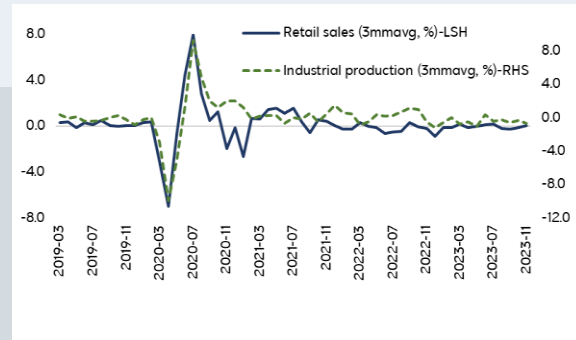
Source: Bloomberg, Eurobank Research

Euro area

Poised for continued stagnation, though the trough probably already reached

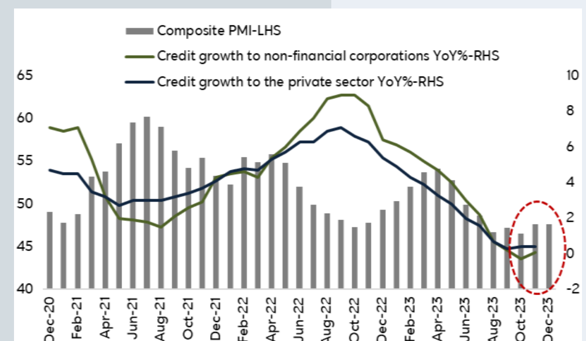
Real GDP effectively stagnated over Q4 2022 to Q3 2023, growing by an average growth rate of 0.0%QoQ after a mild contraction of 0.1%QoQ in the last quarter, reflecting the ongoing drag from monetary tightening and subdued global industrial activity. Looking ahead, activity data suggests that economic weakness will likely continue in the coming quarters, with increased risks of another mildly negative GDP growth print in Q4. Retail sales declined by 0.3%MoM in November, the fourth monthly drop so far this year, with the annual rate falling for the 14th consecutive month and confirming an ongoing negative trend. Industrial production dropped by 0.3%MoM in November, the third consecutive monthly drop, leaving the October-November average 1.3% below the Q3 average. Yet, in an encouraging note, high frequency indicators provide hopes that economic activity is stabilizing at low levels after bottoming out in late Q3/early Q4, easing worries over a further sharp deterioration after Q3's modest contraction. Composite PMI for December was revised substantially upward relative to the flash estimate, +0.6pts matching November's 47.6 after October's 35-month low of 46.5. Yet, the index remained in contraction territory, with the Q4 PMI average standing below that of Q3 (-0.5%), indicating that the ECB's forecast for a rebound of GDP growth to 0.1%QoQ in Q4 2023 and an acceleration to 0.2%QoQ in Q1 2024 will likely prove optimistic. Adding to hopes that the worst in terms of growth is probably behind us, the EC's consumer confidence index improved by 2.4pts to 96.4 in December following a 0.4ppts cumulative increase in the prior two months, though it is still low by historical standards. The transmission of tighter monetary policy via the banking sector continues, but November's annual credit data showed a modest improvement from October as the growth rate of loans to non-financial corporations increased to 0.1% from -0.3%. Meanwhile, disinflation is progressing, but the road towards the ECB's target will probably be bumpy, as December's CPI data suggests (headline CPI up by 0.5ppts to 2.9%YoY), mainly because of fading energy base effects and strong wage growth (compensation per employee at 5.2%QoQ in Q3). Taking into account tentative signs of stabilization in economic activity, while waiting for concrete evidence suggesting that inflation is moving on a sustained path back to target, the ECB is unlikely to pivot to monetary easing before late Q2 2024.

Figure 10: Activity data point to continued stagnation ...



Source: Eurostat, Eurobank Research

Figure 11: .. but the trough has probably already been reached



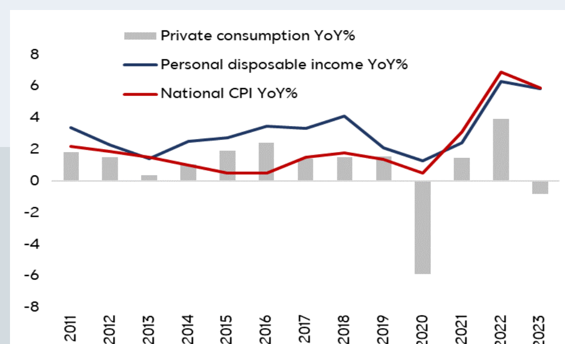
Source: ECB, Bloomberg, Eurobank Research

Germany

Tighter fiscal stance for 2024 should provide further headwinds to growth

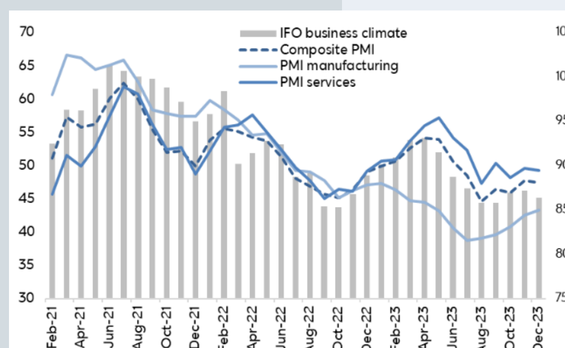
Real GDP contracted by 0.3%YoY in 2023, the weakest annual growth since 2020, according to the preliminary estimate that is derived without any hard data for the month of December. Household consumption dropped by 0.8%YoY due to higher inflation, offsetting an increase of 5.9%YoY in household disposable income. Gross fixed capital formation fell by 0.3%YoY on the back of weak construction investment (-2.1%YoY) amid higher interest rates and rising construction costs, government consumption declined by 1.7%YoY as most of the Covid support measures were scaled back, while net trade had a positive contribution on growth (+0.6pts) as exports dropped less than imports (-1.8% v. -3.0%YoY). Following a state of stagnation in H1 2023 (0.0%QoQ in Q1, 0.1%QoQ in Q2), economic activity shrunk by 0.3%QoQ in Q4, according to a preliminary estimate, but the economy narrowly escaped a technical recession as Q3 GDP was revised up by 0.1ppts to flat. However, growth prospects remain gloomy and a strong recovery near term appears unlikely, as suggested by a number of lackluster forward-looking indicators. The composite PMI remained in contraction territory in December for the sixth month in a row, at 47.4, and headline Ifo business climate unexpectedly dropped sharply in December to 86.4pts (-0.8pts). This probably came on the back of renewed fiscal woes following the Constitutional Court's ruling late last year that the reallocation of €60bn of unused debt for tackling the Covid-19 pandemic from the second supplementary 2021 budget to the Climate and Transformation Fund (KTF) was unconstitutional. Aiming to fill the ensuing funding gap of around €30bn for the 2024 budget (c. 0.7% of GDP), the coalition government reached an agreement for a combination of additional revenues (e.g., a new plastic levy, an increase in the CO2 emission price) and expenditure cuts (e.g., cancellation of a subsidy for electricity network charges). These consolidation measures are expected to save around €17bn, while another €12.7bn is set to be achieved via lower KTF spending. With the overall tighter fiscal stance expected to weigh on economic activity, while the ECB's monetary tightening is still-unfolding and the US is expected to lose momentum in the coming quarters, we revise lower our 2024 GDP growth projection to -0.1%.

Figure 12: Private consumption fell in 2023 as high inflation offset an increase in disposable income



Source: Destatis, Eurobank Research

Figure 13: Sentiment indicators provide little hope for a sustained recovery near-term



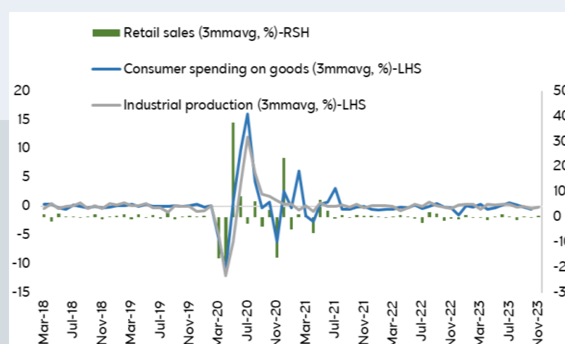
Source: Bloomberg, Eurobank Research

France

Bracing for continued sluggish growth over the coming quarters

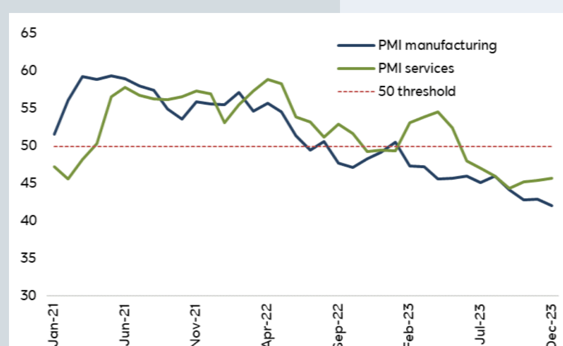
Real GDP growth has been sluggish since late 2022, with the average Q2 2022-Q3 2023 growth rate standing at 0.1%QoQ, mainly pressured by lower household consumption, while net trade, thanks to tourism, made a significant positive contribution. Looking into Q4, growth momentum has likely remained subdued, as suggested by relatively weak hard data for the first two months of the quarter, while lackluster forward-looking indicators provide little hope for a strong recovery any time soon. Indicatively, retail sales were up by 0.4%MoM in November after October's 0.4%MoM decline, but still point to a negative carry over effect of 0.3% into Q4. Consumer spending on goods rose by 0.7%MoM in November, though not strong enough to fully offset October's 0.9%MoM drop, while industrial production was up 0.5%MoM following three consecutive monthly declines, albeit still 0.5% lower relative to the Q3 average. Meanwhile, the composite PMI rose by 0.2pts in December from the prior month's level, coming in at 44.8, but below the threshold of 50 for the seventh consecutive month and the recent peak of 46.0 in August, as manufacturing weakness has spread to the far larger services sector. The INSEE business climate indicator slightly improved in December, rising by 0.6pts to 97.7, along with household confidence, +1pts to 89, but both still continued to stand below their long-term average (100). Furthermore, the employment climate remained stable in December at November's 100, its lowest level since spring 2021, confirming a modest cooling in the labor market and suggesting that unemployment (which rose in Q3 for the second quarter in a row, up by 0.2pts to 7.4% from 7.1% in Q1) is likely to continue rising, though modestly, in the coming quarters due to the muted near-term growth outlook and the expected increase in the labor force as a result of the higher statutory retirement age (from 62 to 64 years). All in all, we expect growth to stagnate in Q4, with full year GDP at a below trend growth rate of 0.8%, but higher than the projected EA average thanks to France's structural features (i.e., less export exposure to China) but mostly, due to well-targeted fiscal policy support. Economic activity is not expected to regain any momentum before late 2024, with full year GDP projected at 0.7%, supported by an expected modest improvement in the global environment and a household spending reacceleration thanks to rising real incomes, partially offsetting slower gross fixed-capital formation due to tighter credit conditions.

Figure 14: Hard data suggest another quarter of stagnation in Q4 2023



Source: INSEE, Eurobank Research

Figure 15: Manufacturing weakness has spread to the far larger services sector



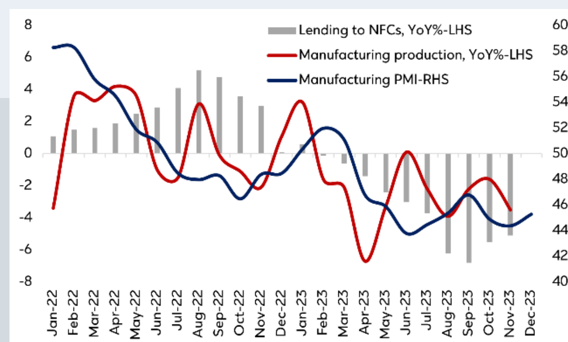
Source: Bloomberg Eurobank Research

Italy

Resilient consumers prop up the economy as industrial sector gets squeezed

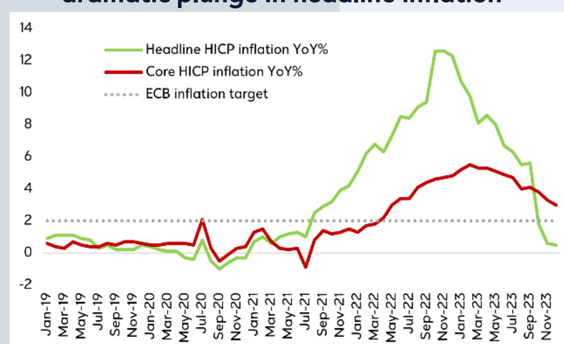
Manufacturing bore the brunt of tight monetary conditions and subuded world trade as 2023 drew to a close. Industrial production shrank 3.1%YoY in November, a bigger output drop than in October, when is contracted 1.1%YoY, while on a monthly basis IP fell 1.5% in November. The manufacturing picture wasn't much brighter when looking at the survey data, as the manufacturing business confidence indicator dropped 1.2pts in December to 95.4 – its lowest level since 2020. Manufacturing PMI did pick up to 45.3 from November's reading of 44.4, but it remained well below the 50 threshold that signals deteriorating operating conditions for a ninth straight month. However, a brighter picture emerges when looking at other parts of the Italian economy – not least resilience in the labour market, where the unemployment rate fell back down to 7.5% in November. The rate has hovered at or just above that level since June, having not been so low since 2009 until this year. Meanwhile, headline inflation slowed to 0.5%YoY, having peaked at 12.6%YoY in late 2022. Although the steep plunge in the inflation rate owes much to energy price base effects – December's rate of core inflation slowed 0.3ppts to 3% – headline inflation is expected to average 2% this year, down from 6% in 2023 and bringing it back to the ECB's target. That's helping real incomes, and while the capital-intensive industrial sector has borne the brunt of tightening credit conditions – lending to non-financial corporations contracted 5.1% in November – Italian consumers are helping to prop up the economy. Retail sales increased an annual 1.5% in November, up from 0.5% the month before. Broadening out from retail, December's services PMI reading improved slightly to 49.8, putting it just a whisker below the 50 threshold, while composite PMI increased to 48.1 from 47 in November. Taken all together, it is likely that Italy's slowdown has already bottomed out, avoiding a technical recession since GDP was probably flat on a quarterly basis in Q4, following a 0.1% expansion in Q3 and a 0.4% contraction in Q2. December's last-gasp agreement by EU finance ministers on a new set of fiscal rules does increase the odds that the European Commission will start an Excessive Deficit Procedure against Italy – given that Prime Minister Giorgia Meloni's government has resisted a faster pace of fiscal consolidation. However, this is not expected to happen before European Parliament elections in June, so won't affect the country's macroeconomic prospects in coming quarters.

Figure 16: Tighter monetary conditions have taken a toll on manufacturing



Source: Bloomberg, Eurostat, ECB, Eurobank Research

Figure 17: Energy price base effects caused a dramatic plunge in headline inflation



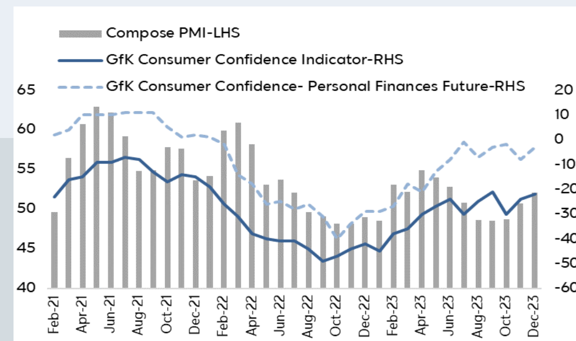
Source: Eurostat, Eurobank Research

UK

Improved growth momentum around the turn of the year

After an unexpected contraction of 03%MoM in October, GDP rebounded in November growing by 0.3%MoM, partly due to the unwinding of strike effects. Growth was led by a 0.4%MoM gain in services, industrial production grew by 0.3%MoM largely driven by a rebound in manufacturing, while construction fell by 0.2%MoM, the second consecutive monthly decline, as a result of the continued rainy weather and, mainly, higher interest rates. Barring a downward revision in GDP figures, growth should be at least 0.0%MoM in December, in which case Q4 would be flat. A print below that level would mean that the UK would fall into a technical recession, albeit a mild one, after a 0.1ppts downward revision in Q3 GDP to -0.1%QoQ. Even worse weather in December and the resumption of strikes by junior doctors should weigh on growth. However, a string of encouraging forward looking indicators support optimism that a 0.0% growth print in December could be a realistic scenario, taking full-year GDP growth to 0.5%. GfK consumer confidence improved in December for the second month in a row (+0.2pts to -22). More importantly, the composite PMI rose unexpectedly sharply in December, led by improved services, up by 1.4pts to 52.1, the highest level since June as the cost-of-living squeeze is moderating.

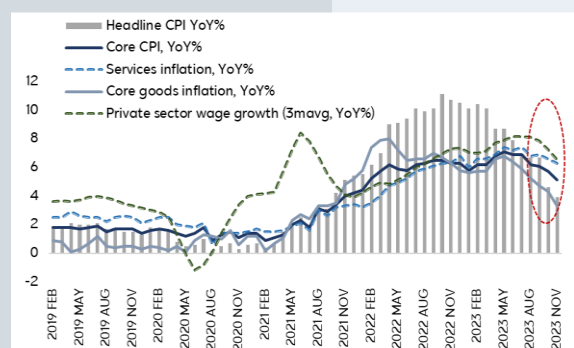
Figure 18: Leading indicators point to improved growth momentum



Source: Bloomberg, Eurobank Research

Against this backdrop, expectations are for a gradual improvement in economic activity in the period ahead, with growth turning slightly positive in Q1 2024 before gaining further momentum from Q2 2024 onwards thanks to an incoming 10% rise in the National Living Wage and a 10-15% drop in energy bills, both from April. Expectations of lower BoE rates later this year and the likelihood of some fiscal loosening ahead of a looming general election are also expected to help the economy partially offset persistent headwinds this year, including subdued global growth. Inflation (November headline CPI at a 2-yr low of 3.9%YoY) and wage growth (private sector regular pay dropped in November to a more than a year low of 6.5% 3mmavg/YoY) have been moderating more quickly of late, though they still remain at levels above those consistent with the BoE's target. Though the data do not suggest a dovish BoE pivot in the imminent future, the quick moderation of wage growth and inflation over the last couple of months are expected to somewhat soften the BoE's current hawkish stance. Investors do not expect the first BoE rate cut before May/June.

Figure 19: Wage growth and inflation have been moderating more quickly of late



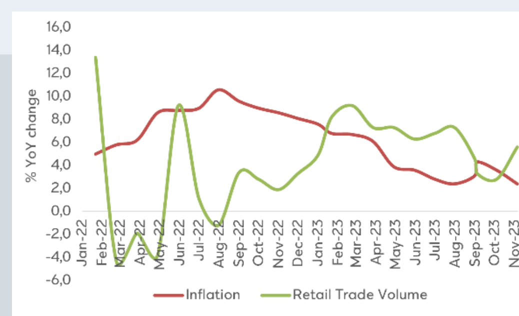
Source: ONS Eurobank Research

Cyprus

Disinflation fuels private consumption, headwinds from the Gaza war on tourism

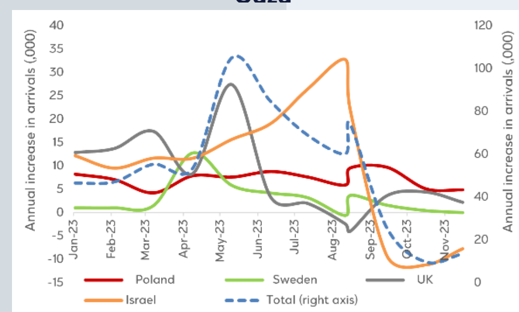
Disinflation continued in December for a third consecutive month, backed by relevant fiscal measures since November/December (cuts in excise duties on fuels, nulling the VAT on fresh meat and vegetables, subsidizing electricity consumption), with the annual headline print falling to 1.9% -a 30-month low- from 4.3% in September. The ease of inflationary pressures is reflected in the acceleration of retail sales growth in November to 5.6%YoY, the strongest rise in four months. The disinflationary measures are expected to support real disposable income and household consumption at least in H1 2024, as those that will last the longest expire at the end of May. As mentioned in previous issues, private consumption increase was supported in end-2023 by stronger partial wage indexation and a tighter labour market, expected to continue in 2024. Regarding recent dynamics in investment, the real estate market weakened significantly in November-December, with the rise in the number of sales decelerating to 7.2%YoY and 1.6%YoY, respectively, from an average pace of +19.0%YoY in January-October, a possible implication of the war in Gaza given the high share of Israeli buyers for most of last year. Nonetheless, sales hit a 16-year high in 2023, therefore supply is very tight in some areas, which will fuel building activity in 2024. The implementation of the revised Recovery Plan and the NRRP will be stronger investment drivers this year than in 2023. In contrast, significantly higher interest rates amid monetary tightening (at a nine-year high of around 5.6-6.0% for business loans in November, depending on the loan size), are a deterring factor to investment, contributing to moderate negative credit growth towards NFCs throughout 2023, a trend expected to continue in most of 2024, as gradual monetary easing will most probably start in late Q2. A positive base effect on investment is expected in Q4 2023 from negative capital formation in transports a year earlier. The effects of the war in Gaza are evident mostly on tourism, as the increase in tourist arrivals declined in Q4 2023 to 7.4%YoY from 23.4%YoY in 9M2023, mainly due to the change of trend in arrivals from Israel to -40.2%YoY from +77.7%YoY, respectively. A protracted war will pose a significant downside risk for the tourism outlook, as it will be difficult to fully replenish a strong fall from Israel with rises in European markets in a year of expected subdued growth in the EU. Considering the above factors, our growth forecast for 2023 remains unchanged at 2.3%, with a mild acceleration projected for 2024 (2.7%).

Figure 20: Disinflation, a major determinant of household consumption growth in 2023, is expected to be supported in 2024 by relevant fiscal measures



Source: CYSTAT, Eurobank Research

Figure 21: Correlation between increases in total tourist arrivals and arrivals from Israel in 2023 poses risks for tourism outlook due to the war in Gaza



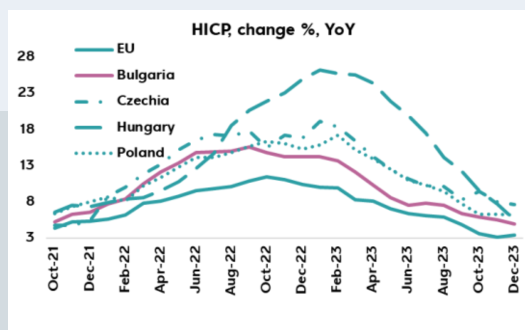
Source: CYSTAT, Eurobank Research

Bulgaria

Tailwinds to growth in 2024 from the awaited revival of investments

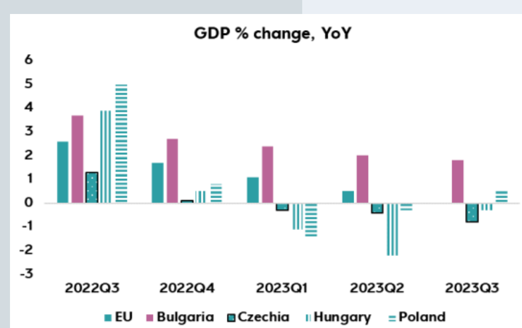
The average 9M2023 growth rate stood at 1.9%YoY, following the preliminary Q3 growth print which came in at 1.5%YoY, 0.2ppts lower than the flash estimate and 0.3ppts lower than the reading of the previous quarter. The deceleration was broadly attributed to the cooling of private consumption, traditionally the key growth contributor, as it expanded by 4.9%YoY, almost half that of Q2 (9.6%YoY). The slowdown in headline growth could have been more prominent had it not been for the tailwind of net exports as the contraction of imports (-6.8%YoY in Q3 vs -10.4%YoY in Q2) outpaced those of exports which continued to contract almost at the same pace in the last two quarters (-2.8%YoY in Q3 vs -2.4%YoY in Q2). The narrowing of the trade deficit was also mirrored in the improvement of the current account as the 12-month moving average almost balanced in September delivering a small surplus of 0.6% of projected GDP in October on the back of improved trade balance dynamics. Additional support in Q3 came from investment which, after contracting since the start of 2023, finally picked up by 12.6%YoY from -1.7%YoY and -6.5%YoY in Q2 and Q1 respectively. Our forecast for 2023 remains unchanged at 1.9%YoY and, thus, this translates to the expectation of an identical reading for Q4, with the flash estimate due in mid-February. We anticipate growth to pick up from 1.5%YoY to 1.9%YoY on the back of sustained positive momentum for investment, which we expect to extend into 2024. The dynamics that will cause investment to embark on a virtuous cycle in 2024 and result in a forecast of 2.5% for headline growth broadly stem from the more protracted EU-funds absorption under the RRF. Given the sufficient – so far – collaboration among the coalition government between the two collaborating parties, GERB and PP-DB, the political instability has been ditched, fueling, thus, the reforms agenda which proceeds more vigorously in the effort to enter the eurozone in 2025 and allowing for some optimism over the effective use of RRF funds. That said, growth risks in 2024 appear broadly balanced. Things are expected to loosen on the fiscal front, although remaining within the growth stability pact perimeter, as the budget deficit target for 2024 is set at 2.9% of GDP, up from 2.2% in 2023. This increase will to a large extent finance salaries and pensions, posing upside risks to the disinflation process, which went favorably throughout 2023.

Figure 22: Faster disinflation process throughout 2023 ...



Source: Eurostat, Eurobank Research

Figure 23: ..resulted in growth decelerating milder, compared to other key regional peers



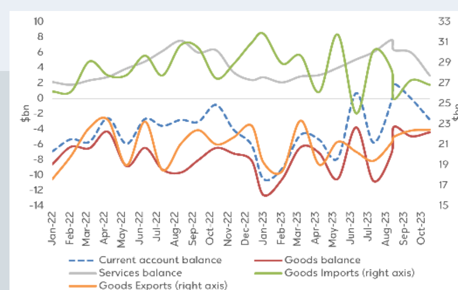
Source: Eurostat, Eurobank Research

Turkey

Inflation resumes escalating despite further monetary tightening

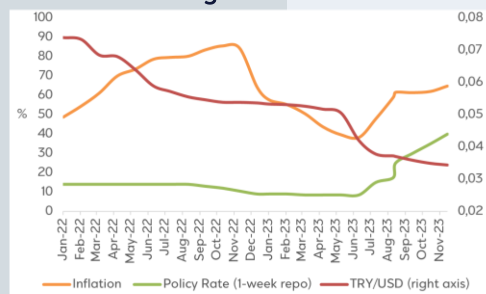
Despite aggressive monetary tightening throughout H2 2023, with another policy rate increase in December by 250bps, both headline and core annual inflation accelerated in the same month, reaching 13-month highs (64.8% and 68.0%, respectively), mainly due to the lira devaluation (-2.2%MoM in Dec-23, -47.1% in Dec-23 relative to May-23, the last month before the change in monetary policy stance). The year-end headline reading matches the relevant projection in the latest central bank inflation report released in early November (65.0%), which also forecast that headline inflation will rise throughout H1 2024. Consequently, strong downward pressures from inflation on real household income -already evident from the continuous slowdown in retail sales growth from August onwards, with the November reading hitting a 12-month low (+13.2%YoY)- are expected to continue beyond Q4 2023. These negative effects will be temporary mitigated in 2024 by another minimum wage raise as of January (+49.1%), as previous increases in 2022 and 2023 inflated production cost and fed into higher prices of goods and services, eventually sustaining rampant inflation. In contrast, labour market tightening, as the unemployment rate in 2023 will hit a 10-year low (9.4%) and is projected to move further lower in 2024, will provide a firmer support to household consumption. On the business sector side, costs are burdened from soaring lending rates. Remarkably, up to November these had no negative implications for real credit expansion to non-financial businesses (PPI adjusted) as the annual pace was mildly positive in that month (+1.9%) and October (+3.0%), from a -9.6% average fall in January-May last year. However, these increases should be greatly attributed to the relaxation of macroprudential measures concerning commercial loans and export loans, which could sustain moderate credit expansion in the period ahead. A significant boost to investment and employment in Q4 2023 and in 2024 is expected from the reconstruction process after the Feb-23 earthquakes, with the relevant capital transfers spiking close to TRY622.7bn ($21.4bn) in December and expenditure allocated for this purpose in the 2024 state budget amounting to $35.4bn (TRY1.03tn). The favorable effects of currency depreciation for the current account balance have been limited thus far, as its deficit decline in Jun-Nov-23 (-51.8%) came exclusively from the goods balance and is mainly due to the fall in global prices of imported fossil fuels. Under the above developments and expected trends, growth will accelerate in Q4 2023 and Q1 2024, with base effects providing boost in the latter period and weaken afterwards. Accordingly, GDP growth will average 4.2% in 2023 and ease to around 3.2% in 2024.

Figure 24: Current account balance improved from the lira devaluation during monetary tightening mainly due to lower goods imports, rather than higher exports



* Source: Central Bank of Turkey, Eurobank Research

Figure 25: Despite further aggressive monetary tightening the lira continues to weaken, fueling high inflation



Source: Turkstat, Central Bank of Turkey, Eurobank Research

Eurobank Macro Forecasts

	Real GDP (YoY%)			CPI (YoY%, avg)			Unemployment rate (% of total labor force)			Current Account (% of GDP)			General Budget Balance (% of GDP)		
	2022	2023f	2024f	2022	2023f	2024f	2022	2023f	2024f	2022	2023f	2024f	2022	2023f	2024f
World	3.5	3.0	2.6	8.7	6.9	4.3ger- man									
Advanced Economies															
USA	1.9	2.4	1.3	8.0	4.1	2.6	3.6	3.6	4.2	-3.8	-3.1	-3.1	-5.4	-6.5	-6.0
Eurozone	3.4	0.5	0.5	8.4	5.5	2.3	6.7	6.5	6.7	-0.6	1.7	1.8	-3.6	-3.3	-3.0
Germany	1.8	-0.3	-0.1	8.6	6.1	2.7	5.3	5.7	6.0	4.3	6.2	6.3	-2.3	-2.1	-1.7
France	2.5	0.8	0.7	5.9	5.7	2.6	7.3	7.3	7.4	-2.0	-1.1	-0.9	-4.8	-4.9	-4.6
Periphery															
Cyprus	5.1	2.3	2.7	8.1	4.0	2.3	6.8	6.2	5.8	-9.1	-11.0	-8.0	2.3	3.4	3.7
Italy	3.7	0.7	0.5	8.7	6.0	2.0	8.1	7.7	7.8	-1.5	0.3	1.0	-8.0	-5.4	-4.5
Portugal	6.9	2.2	1.1	8.1	5.3	2.5	6.0	6.6	6.6	-1.2	1.4	1.2	-0.3	0.7	0.1
Spain	5.8	2.4	1.4	8.3	3.4	2.8	12.1	11.8	11.6	0.6	2.2	1.9	-4.7	-4.0	-3.4
UK	4.5	0.5	0.3	9.1	7.4	2.9	3.7	4.1	4.6	-4.9	-2.7	-2.4	-4.4	-4.7	-3.6
Japan	1.0	2.0	0.8	2.5	3.2	2.3	2.6	2.6	2.5	1.9	3.4	3.4	-6.7	-5.9	-4.1
Emerging Economies															
BRICs															
Brazil	3.0	3.0	1.6	9.3	4.6	3.9	9.5	8.1	8.2	-2.7	-1.7	-1.8	-4.6	-7.9	-7.0
China	3.0	5.2	4.5	2.0	0.2	1.4	5.5	5.2	5.0	2.2	1.5	1.2	-4.7	-5.0	-5.0
India	7.0	6.5	6.3	6.7	5.7	5.4		NA		-2.1	-1.5	-1.7	-6.4	-5.9	-5.4
Russia	-1.2	3.0	1.4	13.8	6.0	6.4	3.9	3.2	3.1	10.2	3.3	3.9	-2.1	-2.6	-2.2
CESEE															
Bulgaria	3.9	1.9	2.5	15.3	9.6	3.9	4.5	4.9	4.5	-1.4	0.5	0.3	-2.9	-3.0	-3.0
Turkey	5.4	4.2	3.2	72.0	53.4	41.6	10.5	9.5	8.9	-5.4	-6.8	-5.5	-0.9	-4.6	-2.3

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

Eurobank Fixed Income Forecasts

	Current	March 2024	June 2024	September 2024	December 2024
USA					
Fed Funds Rate	5.25-5.50%	5.22-5.45%	4.90-5.15%	4.46-4.70%	4.07-4.30%
3m SOFR	5.3%	5.28%	4.99%	4.60%	4.27%
2yr Notes	5.50%	5.45%	5.15%	4.7%	4.3%
10yr Bonds	5.25%	5.22%	4.9%	4.46%	4.07%
Eurozone					
Refi Rate	4.50%	4.45%	4.2%	3.9%	3.6%
3m Euribor	3.89%	3.92%	3.67%	3.4%	3.16%
2yr Bunds	2.55%	2.64%	2.44%	2.31%	2.23%
10yr Bunds	2.22%	2.31%	2.2%	2.19%	2.21%
UK					
Repo Rate	5.25%	5.25%	5.05%	4.7%	4.3%
3m Sonia	5.19%	5.18%	4.88%	4.63%	4.35%
10-yr Gilt	3.77%	3.9%	3.81%	3.72%	3.62%
Switzerland					
3m Saron	1.65%	1.73%	1.61%	1.48%	1.36%
10-yr Bond	0.79%	0.87%	0.89%	0.87%	0.89%

Source: Bloomberg (market implied forecasts)

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