

GLOBAL & REGIONAL MONTHLY

The effective closure of the Strait of Hormuz and severe damage to oil and gas infrastructure in the Middle East are keeping energy prices elevated and posing risks of broader disruptions to global supply chains. The scale and duration of the conflict remain uncertain. However, if disruptions persist, the risk of a stagflationary shock will intensify, testing the resilience of the global economy and its capacity to absorb price shocks. Meanwhile, major central banks appear more concerned about the inflationary implications of the energy shock than risks to growth, with their recent communication pointing to a hawkish tilt aimed at preventing inflation from becoming entrenched. Discussions around fiscal stimulus to cushion the impact of the energy shock are emerging, but fiscal imbalances in major economies pose significant constraints.

Macro Picture

USA: inflation overshooting is a main worry for the Fed; GDP poised to rebound in Q1

EA: the energy supply shock changes the outlook; risks of higher inflation and lower growth

China: property sector strain and end of government subsidies will challenge growth

Japan: workers see real wage improvements; central bank sees output gap as positive

CESEE: growth risks tilted to the downside from energy dependence and inflation pressures

Markets

FX: dominated by energy shock and geopolitics, implied volatility elevated

Rates: sold off sharply due to conflict and energy shock; EUR underperforming on inflation risks

EM: sovereign spreads widened amid higher energy prices and cross-asset selloff

Credit: orderly but material widening in credit spreads amid broader risk-off conditions

Policy Outlook

USA: inflation woes and doubts about the effects of the conflict likely to keep Fed on hold for longer

EA: ECB's hawkish tilt at the March meeting signals its readiness to hike rates, if needed

Japan: circumstances aligning for rate hike, with April meeting looking likely

CESEE: sustained monetary tightening and fiscal measures to cushion energy price shock

Key Downside Risks

DM & EM: longer-lasting closure of oil and gas production facilities in the Middle East; persisting disruptions to exports through the Strait of Hormuz; rising inflation expectations; sharply tighter global financial conditions; abrupt repricing in AI-related stocks; reescalation of trade tensions; US wealth effects driven by risk-off environment; delays/administrative bottlenecks in Germany's public investment projects; fiscal imbalances across major economies

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Macro Views

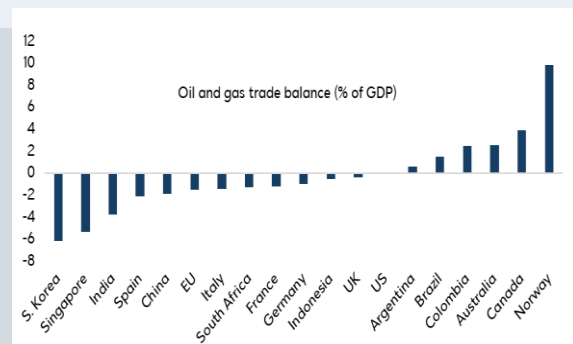
Energy-supply shock fuels inflation and tests global economic resilience; major central banks signal a hawkish tilt

The Middle East conflict has entered its fifth week, the Strait of Hormuz — a critical choke-point through which roughly 20% of the world’s oil and liquefied natural gas passes — remains effectively closed and more than 40 major energy infrastructure sites in the region, including oil fields, refineries and pipelines, have been shut down or severely damaged. These developments are keeping energy prices elevated and increase the risk of broader disruptions in global supply chains. Oil and its derivatives are key inputs in the production of a wide range of downstream products, while at the same time, the supply of products for which Gulf countries are among the world’s main suppliers — such as aluminium, fertilizers and helium, a gas essential for semiconductor manufacturing — is being disrupted.

The scale and duration of the conflict remain uncertain. However, a prolonged period of elevated energy prices would create upward pressure on inflation and pose significant downside risks to global economic activity, testing its resilience. Higher energy prices increase inflationary pressures and, if sustained, may lead to second-round effects, primarily through higher wage growth. Rising pressures erode households’ real purchasing power and increase production costs for businesses, with the magnitude of the impact depending on the energy-intensity of the affected goods. Increased uncertainty also dampens consumer spending and leads firms to scale back investment and hiring. A prolonged disruption could result in significant energy shortages, further weighing on economic growth. However, the global economy has become progressively less dependent on oil — although somewhat more sensitive to natural gas — while energy intensity has declined to around 40% since 1990, reflecting the higher share of renewables in power generation and improvements in energy efficiency.

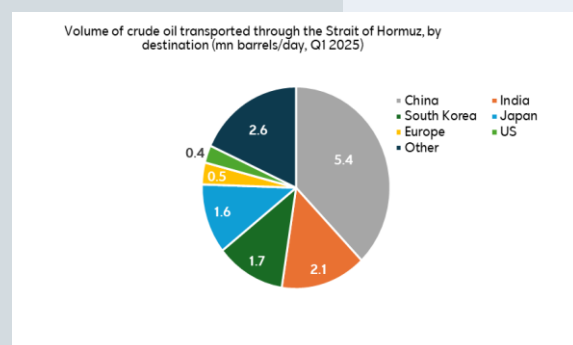
At the country level, the growth impact will vary depending on several factors, most notably oil import dependence, the energy intensity of domestic production, the energy mix and policy response. Higher

Figure 1: As net energy importers, Asia and Europe are vulnerable to energy price spikes



Source: UN Comtrade, Eurobank Research

Figure 2: The main bulk of oil flowing through the Strait of Hormuz is heading toward Asia



Source: IEA, Eurobank Research

energy prices worsen the terms of trade for net energy-importing countries, particularly those with relatively high energy intensity, while the opposite holds for net energy-exporting countries. That said, as a net energy-exporter in recent years, the US is relatively more insulated from the energy shock. By contrast, Europe appears vulnerable, along with several Asian economies, particularly South Korea, Japan and India which are heavily reliant on imported fuel flows through the Strait of Hormuz.

Inflation trends differed across economies prior to the Middle East conflict, with inflation remaining above central bank targets in several major economies, including the US and the UK. Nevertheless, global price pressures were largely contained. However, incoming March inflation data from major economies are already beginning to show the impact of the ongoing Middle East conflict. Energy shocks tend to affect inflation quickly, as higher input costs pass through to consumer prices, pushing them sharply higher. It should be noted, however, that despite some potential similarities, the current energy-supply shock is different from that in February 2022, when inflation surged to decade highs. That episode coincided with the post-pandemic reopening, a period marked by strong pent-up demand. Labour markets were significantly tighter, fiscal policy was considerably more aggressive and monetary policy provided substantial stimulus.

Central banks are likely to look through any temporary inflation spike, as long as inflation expectations remain well anchored. However, if price pressures are perceived as more persistent, the anchoring of expectations may no longer be assured. In such a scenario, policymakers may be forced to respond — by delaying policy easing or even tightening monetary policy — to prevent inflation from becoming entrenched. Against this backdrop, and on the back of concerns over a potential upward spiral in consumer prices, communication from both the Fed and the ECB at their March policy meetings pointed to a hawkish tilt, suggesting that policymakers are increasingly more concerned about the inflationary implications of the energy shock rather than the risks to growth. In line with this shift, markets adjusted policy rate expectations in a hawkish direction. For the Fed, investors now expect rates to remain unchanged throughout the year, compared to two 25bps cuts anticipated prior to the conflict. Similarly, markets now price in around 60bps of ECB rate tightening by year-end, whereas previously rates were expected to remain on hold.

Debates around fiscal stimulus to cushion the impact of higher energy prices have intensified, with several European governments already introducing unilateral measures through domestic legislation. However, coordinated efforts appear unlikely at this stage, as fiscal imbalances in major economies pose significant constraints.

Developed Economies

US: activity indicators for the period prior to the onset of the conflict — given the absence of hard data thereafter — have been mixed but still point to above-trend growth in Q1, as economic activity rebounds following the longest-ever government shutdown. As a net energy exporter, the US is unlikely to experience a meaningful impact from the energy-supply shock. The main effect of higher energy prices will be felt in headline inflation. The Fed is likely to look through a brief, energy-driven spike in headline inflation, provided it does not feed into core or de-anchor inflation expectations. Still, this argues for a pause in rate cuts, as inflation remains well above target. That said, Fed Chair Jerome Powell focused on the ongoing inflation overshoot and upside risks to inflation expectations, rather than downside risks to the labour market at the post-March meeting conference. Futures are currently pricing in stable rates by year-end, vs. 60bps of easing prior to the conflict.

Euro area: escalating tensions in the Middle East and the effective closure of the Strait of Hormuz have led to energy supply disruptions and soaring energy prices, feeding rapidly through to fuel, heating oil and electricity costs. Beyond inflation, the supply-driven energy shock also represents a headwind to growth. As a large net energy importer, the euro area is among the most vulnerable to higher energy prices. This vulnerability is further exacerbated by the region's increased reliance on LNG. However, with core inflation still above target and concerns about inflation expectations becoming de-anchored, the ECB adopted a hawkish tone at its March policy meeting signalling greater concern about the inflationary implications of the energy shock than about growth. Barring a significant decline in energy prices, the ECB appears set to raise rates to ensure that inflation expectations remain firmly anchored, with futures markets currently pricing in 60bps of tightening by year-end.

Emerging Economies

EM: emerging market (EM) economies are facing a more challenging macroeconomic environment as the Middle East conflict has triggered a stagflationary threat, primarily through higher energy prices and tighter global financial conditions. While many EMs entered 2026 with solid momentum, supported by resilient domestic demand and a technology-driven upswing, the outlook has since deteriorated. While growth expectations have not been revised down yet, inflation projections for 2026 have been revised upwards from 2.65% in late February to 2.80% at the end of March, reflecting the pass-through of higher energy and commodity prices. This combination is constraining policy space and complicating the macroeconomic adjustment. The impact remains uneven across countries. Energy-importing economies, especially in Asia, are the most ex-posed, facing significant terms-of-trade shocks, currency pressures and widening ex-ternal imbalances. In contrast, commodity exporters may benefit from improved price dynamics, although gains are likely to be tempered by weaker global demand. Additional supply disruptions in key inputs, including fertilisers and industrial materials, are further weighing on production and food price dynamics. Policy responses have shifted accordingly. Many central banks have paused or reversed easing

cycles to contain inflation and support exchange rate stability, while governments are relying on targeted fiscal measures to mitigate the impact of higher energy costs. However, limited fiscal space in several economies raises concerns over debt sustainability if the shock persists.

CESEE: the macroeconomic outlook is increasingly shaped by the energy shock stemming from the Iran conflict, compounded by rising domestic political and fiscal risks. While underlying growth drivers remain broadly intact, the region is entering a more fragile phase, characterised by persistent inflationary pressures, constrained policy flexibility and heightened market sensitivity. Elevated oil and gas prices are feeding directly into inflation, interrupting the prior disinflation trend and increasing the risk of second-round effects. Given the region's structural dependence on energy imports, the impact is particularly pronounced, significantly narrowing the scope for monetary easing. Market expectations have shifted away from rate cuts, with central banks likely to maintain a restrictive stance for longer—and, in some cases, potentially tighten further—to anchor inflation expectations and support exchange rate stability. Domestic demand continues to provide some resilience. Private consumption remains supported by solid wage growth and still-tight labour markets, particularly in Poland and Czechia, while investment is underpinned by ongoing EU fund absorption. However, growth dynamics are becoming increasingly uneven and more exposed to policy constraints. Romania represents a key vulnerability, as fiscal consolidation measures weigh on demand and confidence amid limited policy space. In Hungary, rising political uncertainty ahead of elections is complicating the policy mix and exacerbating macroeconomic imbalances.

Markets View

Foreign Exchange

EUR/USD: held near 1.1590 at the start of April, pressured by persistent risk off flows linked to Middle East tensions and elevated energy driven inflation risks that continue to support USD demand. Support sits at 1.1500 -1.1450, while resistance remains at 1.1650–1.1700, consistent with the current 1.1450–1.1650 range. Implied volatility remains modestly elevated on short tenors, reflecting front loaded geopolitical uncertainty, while longer dated vols remain anchored. The overall bias is mildly bearish unless risk sentiment improves.

USD/JPY: traded with a firm upside bias at the start of April as the Iran driven energy shock amplified US–Japan divergence, keeping the yen vulnerable and supporting multi-year high pressures toward the 160 area. Support sits near 152.50, while resistance is layered toward 155.65-160, where intervention risks increase. Implied volatility remains elevated amid geopolitical uncertainty, reflecting the pair’s sensitivity to oil price shocks and shifting rate differentials. Overall bias stays bullish unless energy markets stabilize and BoJ intervention materializes.

Rates

EU: rates were dominated by the escalation of the US–Israel–Iran conflict in March, with risks around the Strait of Hormuz and disruption to key energy infrastructure triggering a sharp repricing of inflation expectations. Fears of oil reaching \$150/bbl or higher drove a significant sell-off, with 2yr up ~60bps in the month, 5yr ~45bps and 30yr ~10bps, resulting in a pronounced bear flattening with ESTR futures briefly pricing up to four 25bp ECB hikes by the end of the year. Flow dynamics diverged from typical risk-off patterns, with swap spreads and basis tightening (notably 3s6s and €STR/6s) as hike expectations dominated. Curve moves were extreme and headline-driven, with 10s30s collapsing from ~30bps into negative territory, while volatility spiked 4–5 standard deviations before easing slightly into month-end. Looking ahead, EUR rates remain highly sensitive to geopolitical developments: de-escalation would likely trigger bull steepening and unwind the amount of hikes priced in, while a prolonged energy shock would reinforce bear flattening and renewed volatility, particularly given Europe’s exposure as a net energy importer.

US: rates also sold off in March on the back of the geopolitical escalation, though the move was more contained given the US’s energy exporter status. By late March, following the latest FOMC meeting, markets had shifted from pricing in three Fed cuts to expecting unchanged policy rates by year-end. Swap rates rose across the curve (2yr +35bps to 3.58%, 5yr +30bps to 3.82%, 30yr +20bps to 4.09%), alongside a bear flattening bias, while volatility increased but remained below EUR levels. Price action stayed highly headline-driven, amid continued Middle East developments. Looking forward, US rates are expected to remain reactive to geopolitical risk, with de-escalation likely leading to bull steepening and renewed easing expectations, while a sustained conflict would keep inflation risks elevated and curves bear-flattened.

Emerging Markets Sovereign Credit

The Middle East conflict, which drove a surge in inflation expectations and a broad cross-asset sell-off in March, weighed meaningfully on emerging markets, with spreads widening for the first time since April 2025. The EMBI Global Index moved 30bps wider from the end of February to around 260bps, a level last seen in October 2025. Middle Eastern sovereigns showed relative resilience, as the initial sell-off, despite geographic proximity, was followed by a quick stabilization, with Saudi Arabia and Israel 10yr USD spreads widening by 10bps before retracing to near flat levels by April 1st. In Asia, the Indonesian 10yr EUR spread performed poorly by widening 20bps to reach 173bps. In Latam, 10yr Mexican and Chilean USD spreads widened by 10–15bps in USD, while Romania and Serbia lagged in CEE with the 10yr EUR spreads over swap rates widening by more than 30bps amid higher gas prices. Despite elevated volatility, continued inflows into EM debt reflect the attractiveness of higher carry versus developed markets. Any de-escalation in the Middle East alongside lower oil prices would likely act as a strong catalyst for EM tightening.

Corporate Credit

March was dominated by the escalation of the US-Israel-Iran conflict, which erupted on February 28 and rapidly became the defining macro event of the year so far. What began as a targeted US-Israeli military operation against Iran quickly broadened into a regional crisis after Iran declared the Strait of Hormuz effectively closed on March 4, triggering the largest global energy supply disruption since the 1970s oil crisis.

As the war continued through March, initial expectations for a brief conflict were increasingly priced out, taking Brent Crude to almost \$120/bbl at the highs. The energy shock fed directly into inflation expectations, leaving the Fed on hold at 3.50–3.75% for the remainder of the year and driving a broad sell-off across assets.

European equities have been under pressure, with the STOXX 600 down -8% in March and the DAX -10.3%. On the last day of the month, after the European close, markets bounced on the renewed hopes that the US-Iran conflict is approaching an end, narrowing the S&P 500's March decline to -5.1% and the NASDAQ's to -4.9%.

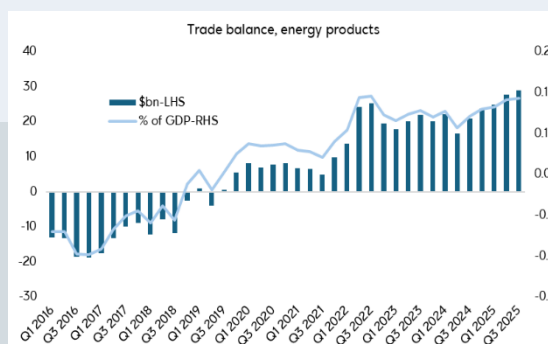
Credit markets widened but the move remained orderly relative to the scale of the macro shock. In March, iTraxx Main has widened 11.7bps to 67bps, while iTraxx Crossover has widened 71bps to 334bps. In Euro IG cash, spreads were 9.9bps wider, led by Consumer Discretionary (+14.2bps). High yield cash has also widened (+37.1bps), with Industrials underperforming sharply (+54.7bps) while Technology has outperformed, tightening 54bps.

US

GDP poised to rebound in Q1; sticky inflation a main worry for the Fed

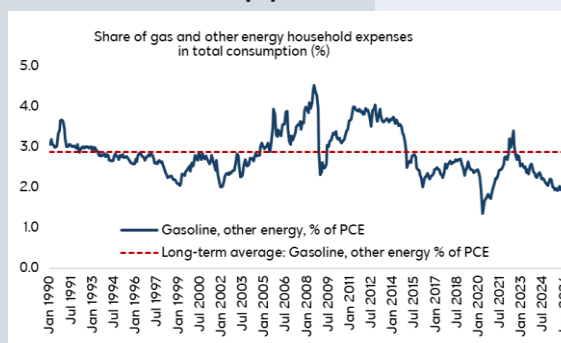
Activity indicators for the period prior to the onset of the conflict — given the absence of hard data thereafter — have been mixed, but still point to above-trend growth in Q1, as economic activity rebounds following the longest-ever government shutdown (early October to mid-November). This follows a downward revision to Q4 GDP growth, which was halved to 0.7%QoQ saar, mainly reflecting a 0.5ppt downgrade in private domestic final purchases growth to 1.9%QoQ saar. January's core capital goods orders disappointed (0.0%MoM) and real personal consumption spending rose by just 0.1%MoM for the third consecutive month. However, income fundamentals remain supportive. Personal income increased by a solid 0.4%MoM, supported by a 2.8% Cost-of-Living Adjustment for Social Security and legislated tax cuts. Meanwhile, job openings rose less than expected in February's JOLTS survey (6.88mn). Nevertheless, this followed a sizeable upward revision to January's figure (+0.3mn to 7.24mn), with the three-month moving average continuing to signal ongoing stabilisation in labour market conditions. As a net energy exporter, the US is unlikely to experience a meaningful impact from the energy-supply shock. This is also partly because the price shock comes at a time when the share of household spending for gasoline and other energy goods has declined sharply since the 2022 energy crisis to below historical norms. The main effect of higher energy prices will be felt in headline inflation, adding to existing pressures from trade tariffs. The Fed is likely to look through a brief, energy-driven spike in headline inflation, provided it does not feed into core or de-anchor inflation expectations. Still, this argues for a pause in rate cuts, as inflation remains well above target (January's headline and core PCE at 2.8%YoY and 3.1%YoY, respectively). That said, Fed Chair Jerome Powell focused on the ongoing inflation overshoot and upside risks to inflation expectations, rather than downside risks to the labour market at the post-March meeting conference, while emphasizing a high degree of uncertainty about the impact of the conflict. Further rate cuts may still be possible, but with the labour market broadly stable, this would require a resumption of disinflation. Futures are currently pricing in stable rates by year-end, vs. 60bps of easing prior to the conflict.

Figure 3: The US has been a net energy producer since late 2019



Source: BLS, Eurobank Research

Figure 4: Household spending on energy goods has declined sharply since the 2022 crisis



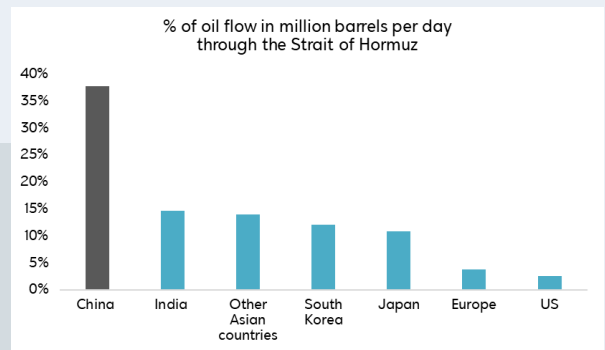
Source: BLS, Eurobank Research

China

Growth about to slow as export resilience partially offsets domestic strains

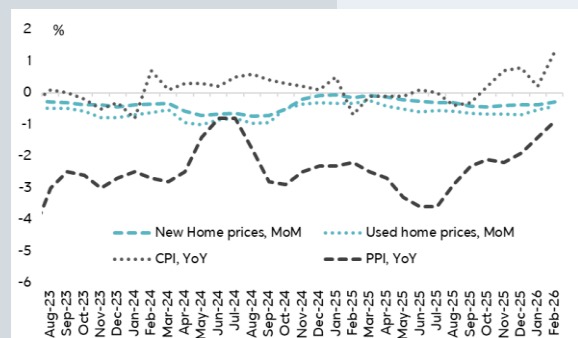
The economy is entering a phase of moderating growth, with GDP expected to ease from 5.0% in 2025 to around 4.5% in 2026 and somewhat lower in 2027. Recent indicators point to a partial stabilisation in activity, supported by manufacturing strength and resilient exports, although persistent domestic weaknesses—most notably in the property sector—continue to weigh on the outlook. Manufacturing activity has regained momentum, with the official PMI returning to expansionary territory in March (50.4 vs 50.1 in February), driven primarily by high-tech and equipment manufacturing. By contrast, the services sector continues to expand at a more moderate pace (50.1 vs 49.9 in February), while construction remains under pressure. External demand remains a key pillar of growth. Export performance has strengthened, with new export orders reaching a two-year high in March (+39.6%YoY vs. +10%YoY in February), supported by global demand for China’s “New Three” green technologies—electric vehicles, lithium-ion batteries and solar panels. This is helping to offset softer domestic demand. On the price front, producer price dynamics are showing signs of a turnaround. After a prolonged period of deflation, the Producer Price Index is expected to return to positive territory, driven by higher global commodity and energy prices. However, the widening gap between input and output prices will prove a critical factor in corporate profitability, particularly among small and medium-sized firms with limited pricing power. Consumer price inflation remains subdued, with CPI projected at 0.9% in 2026, reflecting weak domestic demand and persistent disinflationary pressures. Geopolitical developments have so far had a limited direct impact on China’s economy. The country’s diversified energy mix and strategic reserves provide a buffer against external shocks, while the global push towards energy transition may further reinforce China’s position in green technologies. Meanwhile, some easing in US trade tariffs offers marginal support, although broader trade tensions remain a downside risk. Policy is expected to remain supportive but measured. The PBoC is likely to prioritise exchange rate stability, suggesting that further monetary easing may be delayed. Fiscal policy is expected to play a more active role, particularly through infrastructure investment, to cushion the economy against ongoing domestic headwinds.

Figure 5: China’s dependency on Iranian oil reverses the inflationary dynamics



Source: IEA, Eurobank Research

Figure 6: ..yet domestic strains in the real estate sector persist



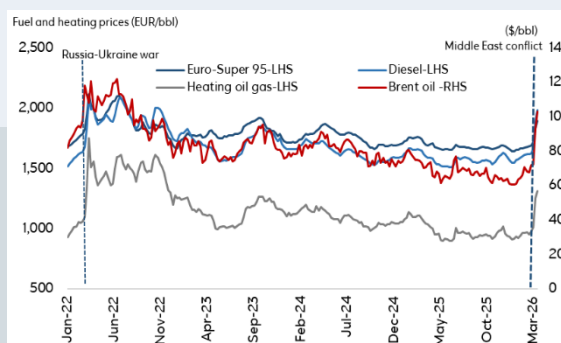
Source: Bloomberg, Eurobank Research

Euro area

Energy supply shock brings risks of higher inflation and lower growth

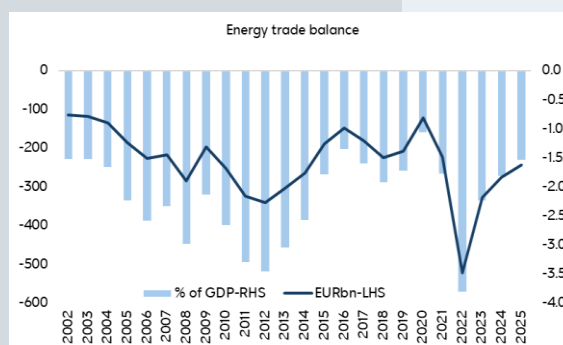
Escalating tensions in the Middle East and the effective closure of the Strait of Hormuz have led to energy supply disruptions and soaring energy prices, feeding rapidly through to fuel, heating oil and electricity costs. Concerns about inflationary pressures are intensifying, with the full effect likely to depend on the duration and breadth of the disruption in energy markets, as well as the emergence of second-round effects. Beyond inflation, the supply-driven energy shock also represents a headwind to growth. As a large net energy importer, the euro area is among the most vulnerable to higher energy prices. This vulnerability is further exacerbated by the region's increased reliance on LNG, as it exits a cold winter with gas storage levels significantly below recent norms (below 30% as of late March, the lowest since the 2022 energy crisis). Consumer spending and business investment could come under pressure through increased geopolitical and economic uncertainty. There is also uncertainty regarding the extent to which the anticipated growth drivers of defence and infrastructure spending will support economic activity. Both sectors are highly energy-intensive, suggesting that rising input costs may limit the growth impulse associated with fiscal expansion. The combination of downside risks to growth and upside risks to inflation is already reflected in March's sentiment indicators. The composite PMI fell by 1.4pts to a ten-month low of 50.5, driven by the services sector (-1.8pts to 50.1), while input price inflation rose to its highest level since early 2023, particularly in manufacturing. Similarly, the European Commission's consumer sentiment index fell 4pts to -16.3, its lowest level in over two years. However, with core inflation still above target (2.3%YoY in March) and concerns about inflation expectations becoming de-anchored, the ECB adopted a hawkish tone at its March policy meeting —supported by updated hawkish forecasts and scenarios — signalling greater concern about the inflationary implications of the energy shock than about growth. Barring a significant decline in energy prices, the ECB appears set to raise rates to ensure that inflation expectations remain firmly anchored, with futures markets currently pricing in 60bps of tightening by year-end.

Figure 7: Fuel and heating prices follow higher oil prices



Source: Eurostat, Reuters, Eurobank Research

Figure 8: Eurozone is a large net energy importer



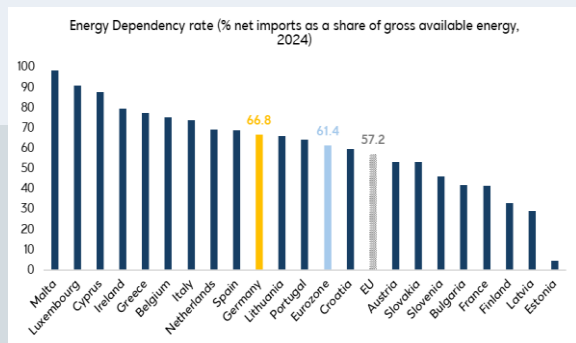
Source: Eurostat, Eurobank Research

Germany

Middle East conflict likely to push back the expected economic recovery

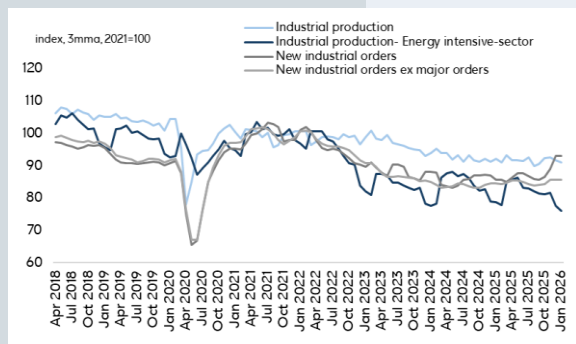
The energy price shock and global supply chain disruptions resulting from the ongoing conflict in the Middle East are expected to pose significant headwinds to the economy. Germany appears particularly exposed, given the large share of its manufacturing sector (19.5% of total GVA) and its high energy dependency. This vulnerability persists despite Germany's energy-use intensity of output remaining among the lowest in the euro area. Heightened geopolitical uncertainty, tighter financial conditions arising from expectations of higher ECB rates and growing competitiveness challenges, also cloud the economic outlook, suggesting that the anticipated boost following last year's historic fiscal shift toward significantly increased spending on defence and infrastructure-related investment, is likely to be derailed. Recent data reinforce this cautious view. Hard data for January disappointed, contrasting with relatively positive sentiment surveys for the same month – and point to an economy struggling to gain traction after GDP grew by a modest 0.2% in 2025 following two years of stagnation, largely due to structural challenges. Industrial production declined unexpectedly, -0.5%MoM, led by a sharp drop in manufacturing output (-2.5%MoM), particularly in metals and pharmaceuticals, following an upwardly revised decline of -1.0%MoM in December. More concerning, energy-intensive industries — accounting for around 20% of total industrial GVA and about 15% of total employment — have fallen back close to post-reunification lows, remaining roughly 27% below their early-2018 peak. Meanwhile, new industrial orders plunged 11.1%MoM, reversing the strong gains recorded in the previous two months, which had been largely driven by defence-related sectors facing capacity constraints. Looking ahead, the overall growth outlook will depend heavily on the duration of the conflict and the persistence of elevated energy prices, both of which remain highly uncertain. At this stage, 2026 GDP growth is projected at 0.8%, revised down from 1.0% previously. However, growth is still expected to strengthen to 1.4% in 2027, assuming global energy markets stabilise by year-end and the boost to domestic demand from Germany's fiscal stimulus will intensify as the year progresses. The Middle East conflict will also alter the inflation trajectory, with HICP now projected to average 2.9% in 2026, up from a previous forecast of 2.2%.

Figure 9: Germany shows significant reliance on energy imports



Source: Eurostat, Eurobank Research

Figure 10: Industrial production struggles to gain momentum



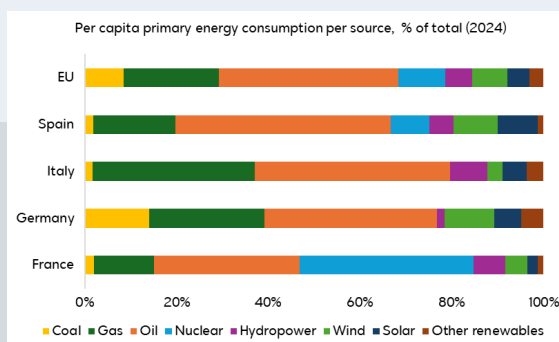
Source: Destatis, Eurobank Research

France

Spillovers from the Middle East conflict are becoming visible in the economy

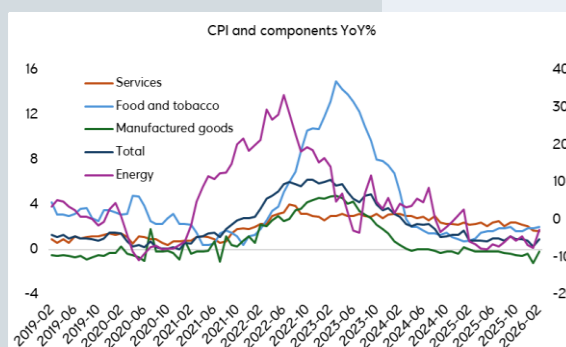
The economy entered 2026 with positive momentum, mainly supported by easing political uncertainty following approval of the budget and a rebound in business investment, largely driven by AI-related spending. However, economic prospects have deteriorated since the outbreak of the conflict in the Middle East, as reflected in a range of worsening sentiment indicators for March, on the back of elevated geopolitical and economic uncertainty, higher energy and transport costs, rising price pressures on several raw materials with significant exposure to Middle Eastern supply (e.g. copper, steel, aluminium products), and the recent rise in long-term interest rates driven by expectations of ECB monetary policy tightening. INSEE consumer confidence, which had just begun to recover in February with a modest 0.1pt increase after remaining broadly unchanged throughout 2025, fell back 2pts to 89 in March, moving further below the long-term average, with households becoming markedly more pessimistic about their future financial situation. The INSEE business climate in the manufacturing sector deteriorated sharply (-3pts to 99), with production expectations and order books declining. The composite PMI also fell markedly, down 2.6pts to 51.9, the lowest level since last December, driven by weakness in the services sector. At the same time, higher rates, deteriorating economic conditions and still challenging public finances — with a budget deficit still close to 5% of GDP and a commitment to reduce it below 3% of GDP by 2029 — suggest limited fiscal space for the government to cushion the energy shock. That said, the adverse impact of higher energy prices is likely to be less pronounced than in its major EA peers, reflecting the smaller share of manufacturing (10.7% of total GVA) and lower reliance on fossil fuels thanks to its strong nuclear capacity. Nevertheless, the overall impact will depend on the duration and intensity of the conflict. At this stage, GDP growth for 2026 is projected at 0.8% GDP, down from 1.0% expected earlier this year, while inflation is anticipated to average 1.8%. Inflation was relatively low prior to the onset of the conflict (February: 1.1%YoY vs. 1.9%YoY EA average), partly reflecting regulated electricity prices and moderate wage dynamics (2025 wage growth: 1.5%YoY vs. 3.4%YoY EA average).

Figure 11: France has a relatively lower reliance on fossil fuels, thanks to its strong nuclear capacity



Source: Our word in data, Eurobank Research

Figure 12: Inflation was relatively low before the onset of the Middle East conflict



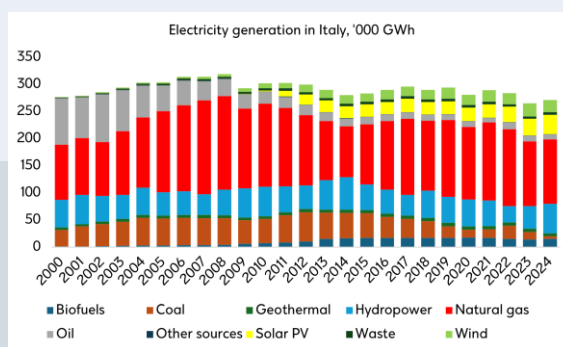
Source: INSEE, Eurobank Research

Italy

Referendum defeat and war present Meloni with biggest challenge so far

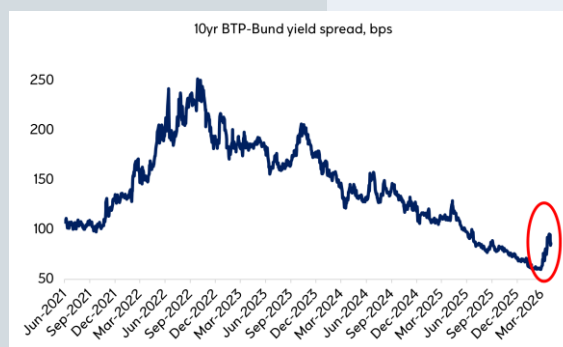
Prime Minister Giorgia Meloni's government is facing the biggest challenge of her premiership so far due to defeat by a wide margin in a referendum on judicial reform and the economic shock from the war in the Middle East that threatens to derail Italy's economy. The prime minister expended considerable political capital in the campaign and the seven-point margin of defeat on March 23 was seen as voters signalling their disapproval of her government despite the subject of the referendum itself being a relatively technical matter – the principal change being the establishment of separate career tracks for judges and prosecutors. However, rather than cranking up tensions in her three-party coalition, the leaders of both junior parties ruled out early elections. The country is due to hold a general election by the end of 2027, with the government, which came to power in September 2022, set to become the longest serving of the postwar era later this year. Managing the economic fallout of the US-Israeli war with Iran will be the major challenge of this period, with Italy likely to be hit harder than other EU countries because of its higher dependence on LNG from Qatar as part of its energy mix. Meloni was in Algeria in late March to try to secure more LNG supplies from there after Qatar declared *force majeure* on some of its contracts, and the country introduced a temporary cut in fuel taxes, costing EUR500mln, and approved a controversial EUR3bn package to strip carbon costs from power bills. The strain that such relief measures could put on the budget, combined with the return of political uncertainty, led to an increase in the spread of 10yr BTP yields over 10yr Bunds, which rose 28bps in March to 90bps. Reflecting concern about the war, consumer confidence sank 4.8pts to 92.6 in March, below the consensus expectation of 95.6. However, economic sentiment fell just 0.1pts to 97.3 as manufacturing confidence unexpectedly rose 0.3pts to 88.8. That was reflected in the March manufacturing PMI, which rose by more than the consensus estimate to 51.3 from 50.6. Energy prices were also a factor in the March inflation print. The harmonised index of consumer prices rose 1.5%YoY, the same rate as in February, which was below the consensus estimate of 1.7%YoY. While higher energy prices pushed the headline inflation rate up, that was counterbalanced by the fading effects from the winter Olympics, which were held in Milan in February and were responsible for a spike in prices in that month's data.

Figure 13: Italy uses the most natural gas in electricity generation in Europe



Source: International Energy Agency, Eurobank Research

Figure 14: After a long decline, Italian-German yield spreads have started to widen



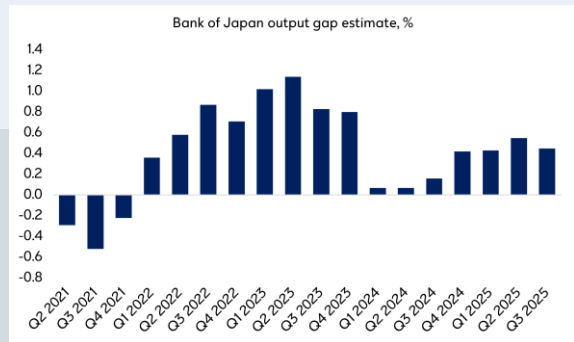
Source: Bloomberg, Eurobank Research

Japan

Likelihood high that central bank will raise interest rate at this month's meeting

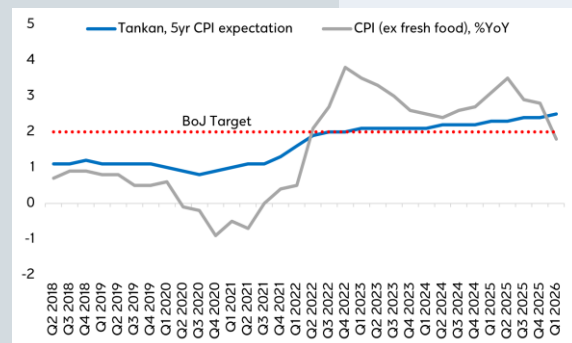
Circumstances are aligning for the Bank of Japan to continue its slow monetary tightening cycle with another interest rate hike, probably as soon as this month. Several indicators, including an upward revision of Q4 growth and signs of durable wage gains, have bolstered the macroeconomic case for further tightening. Uncertainty from the war in the Middle East has inhibited the central bank from sending clear signals, though higher energy prices add to inflationary pressures that justify more hikes. Derivates markets are currently pricing in a 67% probability of a 25bp increase in the policy rate to 1.0% at the BoJ's April 28 meeting and have fully priced in a hike by the July meeting. The central bank last month released several new policy indicators that support continuing with rate hikes, including an estimate that the country has had a positive output gap since Q1 2022, and that the estimated potential growth rate stands at 0.65%. The Japanese economy expanded 1.2% last year after growth in Q4 was revised upwards to an annualised 1.3%QoQ from the flash reading of 0.2%QoQ saar. That owed to stronger contributions across all segments of domestic demand except inventories, with household consumption and private non-residential investment both making substantially improved growth contributions. Another encouraging signal for the central bank was that nominal labour cash earnings in January unexpectedly rose 3%YoY, compared with 2.4%YoY in December. The 1.4%YoY increase in real terms was the first rise in 13 months. Meanwhile, the country's largest labour union group reported its latest tally showed workers had received an average 5.09% wage gain in the annual *shunto* spring salary negotiations, an important feature of Japan's economic calendar. If sustained – the final tally is released on April 28 – it would mark the third straight year that employees have won a pay increase above 5%, coming after last year's 5.3% rise. A further piece of the jigsaw supporting a rate hike is the central bank's quarterly Tankan survey, which showed that manufacturers' confidence continued to get better in Q1, despite the increase in crude oil prices. Crucially, for monetary policy implications, the survey suggested that manufacturers appear to be willing to pass on higher oil prices to consumers, as reflected in rising inflation expectations. The headline inflation rate in February unexpectedly fell to 1.3%YoY from 1.5%YoY in January, while the core rate, which excludes fresh food, dropped 0.4ppts to 1.6%YoY.

Figure 15: The BoJ now believes the output gap has been positive since the start of 2022



Source: Bloomberg, Bank of Japan, Eurobank Research

Figure 16: Firms' inflation expectations are rising further above the BoJ target



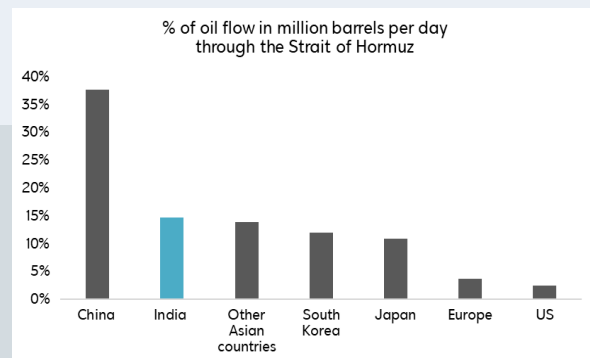
Source: Bloomberg, Bank of Japan, Eurobank Research

India

External shock from the Middle East weighs on growth and price stability

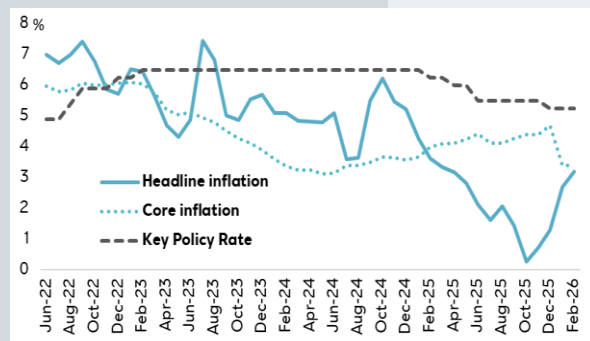
The economy is entering a period of cooling growth as the external shock from the Iran conflict tests its underlying resilience. While India began FY2027 from a relatively favourable macroeconomic position, characterised by low inflation (3.2% YoY in February 2026) and positive real interest rates, the sharp rise in energy prices and tightening global financial conditions have materially weakened the outlook. The most immediate impact stems from the surge in oil prices, with the Indian crude basket averaging USD 113.5 per barrel in March, marking a sharp monthly increase more than 60%. As a large energy importer, India remains highly exposed to such shocks, which are already feeding through to inflation and weighing on domestic demand. At the same time, global risk aversion has triggered significant capital outflows, with record foreign investor equity withdrawals and increased pressure on the Indian rupee, which has depreciated to historic lows despite sizeable central bank intervention. Domestic demand—particularly private consumption, which accounts for nearly 60% of GDP—is expected to soften as higher fuel costs erode disposable income and dampen discretionary spending. At the same time, rising input costs and supply disruptions are placing additional pressure on corporate profitability, while elevated uncertainty is weighing on investment sentiment. Policy is currently focused on maintaining macroeconomic stability. The Reserve Bank of India has adopted a managed float approach, using foreign exchange reserves to smooth currency volatility while avoiding aggressive interest rate tightening. Administrative and macroprudential measures have also been deployed to curb speculative pressures in FX markets. At the same time, fiscal policy faces increasing constraints, as higher energy prices are expected to significantly raise subsidy spending, particularly on fertilisers, increasing the risk of fiscal slippage. Overall, while India's macroeconomic fundamentals remain comparatively resilient, the balance of risks has shifted to the downside. A prolonged energy shock would likely result in sustained sub-7% growth, higher inflation and increased fiscal pressures, limiting policy flexibility and exposing the economy to further external vulnerabilities.

Figure 17: oil supply constraints pose upside inflationary risks



Source: IEA, Eurobank Research

Figure 18: ..and limit the room for more accommodative monetary policy



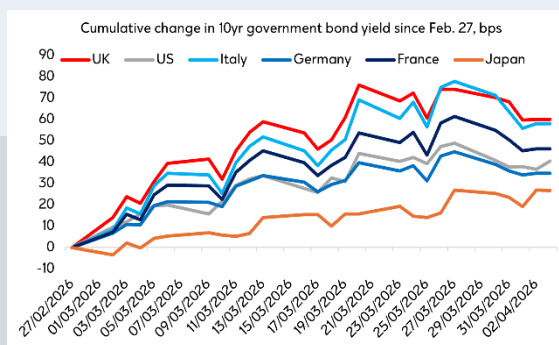
Source: NSO, Eurobank Research

UK

Changed geopolitical environment puts BoE's monetary policy in a squeeze

The war in the Middle East has completely upended the UK's monetary policy picture, with futures markets at one point pricing in as many as four 25bp interest rate hikes this year, from pricing in two cuts on February 27. The Bank of England kept rates unchanged at its March 19 meeting, which was the expected outcome after the war started, but the minutes of the meeting were perceived by markets as extra hawkish, contributing to the surge in rate-hike bets. However, the extent of the market reaction led several members of the Monetary Policy Committee to try to row back tightening expectations. This included BoE Governor Andrew Bailey, who said in an interview with Reuters on April 1 that markets are "getting ahead of themselves" in pricing in rate hikes. While market rate hike expectations have now come down from their peak, UK government bonds remain under pressure, with the steepest rise in yields among developed markets, as investors anticipate the government's finances coming under renewed strain because of the war. As of April 2, the yield on 10yr Gilts had risen 60bps since the war's outbreak to 4.83%. The cornerstone of the government's fiscal policy is maintaining so-called headroom against its budget targets, and a slowdown in growth could undercut tax revenue and constrain the government's ability to respond to the shock without jeopardising its fiscal rules. The impact on inflation has been muted so far, with headline CPI increasing 3.0%YoY in March, the same rate as the month before and in line with the consensus estimate. However, the OECD said last month that the UK looks set to be particularly hard hit by an inflation shock, changing its CPI growth forecast for this year to an average 4% from 3.4% in 2025, compared with a prior forecast that it would slow to 2.5%. According to a BoE survey published in early April, UK companies plan bigger price increases in the coming year than they previously intended with respondents in March indicating planned price increases of 3.7% compared with 3.4% in February. Meanwhile, the country's Food and Drink Federation said it expected food inflation to reach between 9% and 10% this year, after previously forecasting that it would be around 3.2%. In other economic releases, the manufacturing PMI slipped 0.7pts to 51.0 in March, remaining above the 50 threshold that separates expansion from contraction.

Figure 19: Gilt yields have risen more than other developed market equivalents since the war's outbreak



Source: Bloomberg, Eurobank Research

Figure 20: Company executives expect to push through bigger price increases in the next year



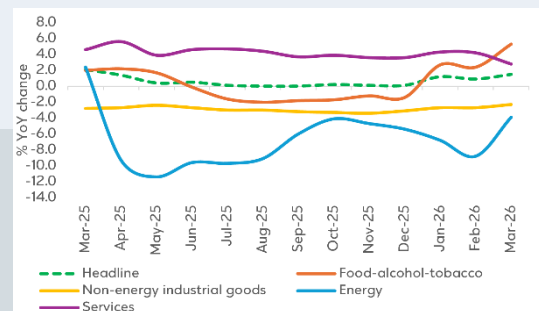
Source: Bloomberg, Bank of England, Eurobank Research

Cyprus

Swift measures to tame an increase in inflation; Foot-&-Mouth Disease adds risks

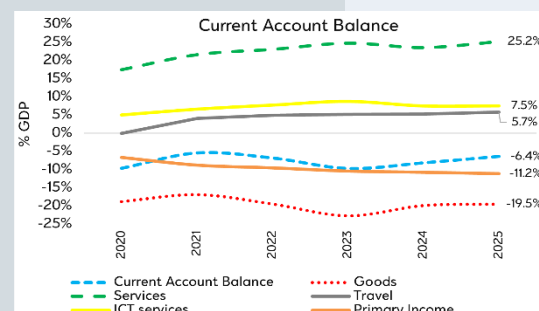
As the conflict in the Middle East persists, the government introduced a package of measures on March 26 to mitigate the associated inflationary pressures. The most significant measures include: (1) a further reduction in the VAT rate on electricity to 5%, from the already reduced 9% (down from 19% since April 2025). This measure will apply from May 1, 2026, through the end of March 2027 for all residential consumers; (2) a reduction in excise duty on transport fuels by 8.33 cents/litre in Q2 2026; and (3) a zero VAT rate on meat, poultry, and fish from April 1 to September 30, 2026. Other, more targeted measures focus on the tourism and agriculture sectors. The total fiscal cost of the new measures is estimated at €100m and is considered manageable, given the fiscal surplus of 2.6% of GDP in 2025 (€939.2m). The measures are well aligned with recent inflation dynamics, as headline inflation accelerated to 1.5% in March from 0.9% in February, driven by a moderation in energy deflation (to 3.9% from 8.8%) and a rise in food inflation (to 5.4% from 2.3%). In any case, base effects, from the passing of one year from the first electricity VAT reduction in April 2025, would boost inflation in the period ahead. A further adverse development is the outbreak of Foot-and-Mouth Disease in February, with implications not only for inflation but also for economic activity and exports. In response, authorities have culled affected livestock —primarily sheep and goats— and implemented widespread vaccinations, covering nearly all cattle and around three-quarters of sheep and goats, with pigs to follow. However, vaccination triggers a ban on exports of meat and dairy products -haloumi is excluded- to the EU under European Food Safety Authority regulations, prompting Cypriot authorities to seek alternative markets outside the EU. Imports are also expected to rise, particularly for meat and livestock. Despite these challenges, Cyprus entered this period with strong momentum carried over from 2025 and resilient domestic demand, supported by a robust labour market and sustained investment activity, particularly in construction. This is reflected in the 5.9%YoY increase in retail trade volume in January–February. Risks to the external sector could intensify if the regional conflict persists, affecting key industries such as tourism, shipping and logistics, and ICT, whereas mixed effects are expected on the real estate sector.

Figure 21: Inflation acceleration in March from food-alcohol-tobacco and energy prices



Source: Eurostat, Eurobank Research

Figure 22: CAB improvement from the services surplus, despite higher primary income deficit



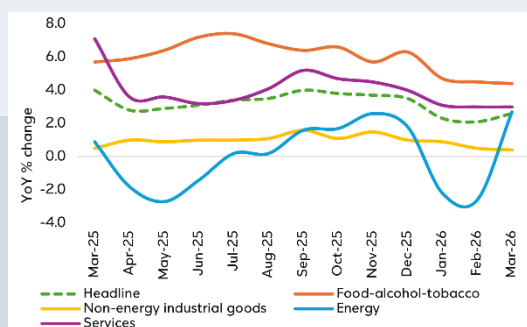
Source: Central Bank of Cyprus, CYSTAT, Eurobank Research

Bulgaria

Initial modest estimates of crisis impact; slight inflation acceleration in March

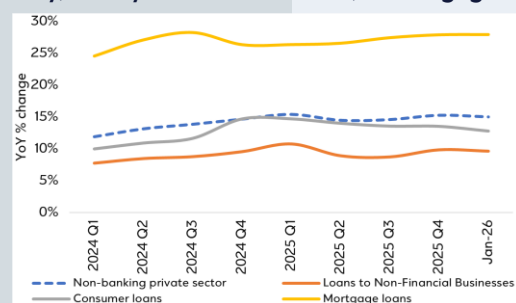
Two and a half weeks ahead of the parliamentary elections scheduled for April 19, opinion polls continue to indicate that no single party is likely to secure an outright majority. Nonetheless, the formation of a coalition government including the political project associated with former President Rumen Radev, which is currently ahead in the polls, appears increasingly likely. Meanwhile, the parliament approved on March 18 a further extension of the 2025 budget. It also adopted new fiscal measures, including a 12.6% increase in the minimum wage (vs. +15.4% in 2025) and a 5% public sector wage indexation. The latter is less than half of the 11% increase envisaged in the withdrawn 2026 draft budget. Importantly, this implies a decoupling of public wage growth from minimum and average wage increases, reversing a previous linkage that contributed to a sharp rise in compensation spending (+20% in 2025). The budget extension also allows municipalities to reallocate government-funded capital subsidies toward urgent repair spending (e.g., roads and public buildings). This adjustment is likely to weaken the link between capital transfers and long-term investment projects. Turning to developments related to the ongoing geopolitical crisis in the Middle East, the Bulgarian Fiscal Council assessed the macroeconomic impact of a 25% increase in average oil prices in 2026 relative to the previous year. Under this scenario, inflation would rise by 0.4 to 1.0ppt, depending on the degree of pass-through from Eurozone prices and the level of domestic market competition. The fiscal deficit could widen by 0.15–0.35ppts, reaching 3.25%–3.5% of GDP, assuming no mitigating policy measures are introduced for households or businesses. In parallel, the Bulgarian National Bank (BNB) has published a baseline and two adverse scenarios evaluating the inflationary impact of the ongoing geopolitical crisis in the Middle East. In the baseline case, inflation is projected to increase modestly to 3.7% in 2026 (from 3.5% in 2025), before easing to 3.2% in both 2027 and 2028. Under the mild adverse scenario, inflation would exceed the baseline by 0.7ppts in 2026, 1.4ppts in 2027, and 0.6ppts in 2028. In the severe scenario, the deviations rise to 1.2ppts, 3.4ppts, and 2.3ppts, respectively. Provisional data for March indicate that annual inflation accelerated to 2.6%, up 0.5ppts from February, an increase broadly in line with the Eurozone (+0.6 points). This acceleration was driven entirely by energy prices.

Figure 23: Inflation acceleration in March due to energy prices; yet, the pace is slower than a year ago



Source: Eurostat, Eurobank Research

Figure 24: Strong credit expansion continued in January, mainly toward households, in mortgages



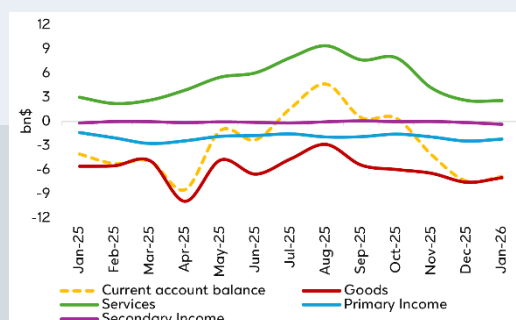
Source: Bulgarian National Bank, Eurobank Research

Turkey

Inflation surprises to the downside in March; slowdown in construction takes hold

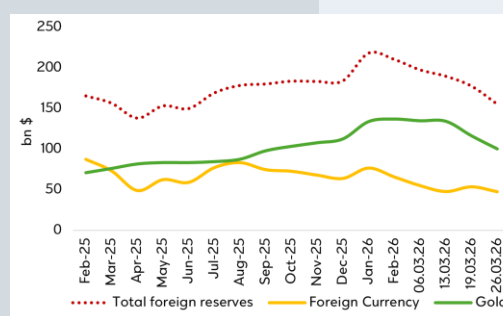
As stated in our previous report, after five consecutive rate cuts since August, which lowered the policy rate down to 37% from 46%. the Central Bank of Turkey (TCMB) paused its monetary easing cycle at the first rate-setting meeting following the escalation of geopolitical tensions in the Middle East. The decision was justified based on the grounds of heightened uncertainty stemming from geopolitical developments and rising energy prices. During the first four weeks of the conflict, TCMB foreign exchange reserves declined by \$18.1bln (-26.1%), while gold reserves fell by a further \$36.8bln (-27.5%), reflecting ongoing efforts to support the Turkish lira (TRY) and mitigate depreciation risks. It should be noted, however, that a significant portion of the decline in gold reserves is attributable to the concurrent drop in global gold prices. Despite these interventions, the TRY depreciated by almost 0.9% over the period vs the USD, broadly in line with its average monthly decline of 0.9% recorded in January–February. In contrast to inflationary trends observed elsewhere, both the headline annual and monthly inflation prints decelerated in March, to 30.9% from 31.5% and 1.9% from 3.0%, respectively. Although annual energy inflation accelerated relative to February, by 6.1%, price dynamics in food (-4.1%) and other goods (-1.3%) softened, while services inflation rose modestly (+0.6%). Prior to the conflict, short-term indicators for January had already signaled a moderation in the pace of economic expansion. In particular, construction output growth—one of the key drivers of GDP in 2025—remained subdued for a second consecutive month, easing to 8.2%YoY from 8.5%YoY in December and 14.1%YoY in Q4 2025. On the flipside, retail trade volume showed some resilience, with growth accelerating modestly to 17.5%YoY from 16.6%YoY in December and 15.6%YoY in Q4 2025. However, activity across the broader services sector stagnated, marking the first such occurrence since 2020, following a 3.6%YoY increase in Q4 2025. In the external sector, the sharp deterioration in the current account balance in Q4 persisted into January, with a contraction of 69.1%, driven primarily by widening deficits in the goods and primary income balances. Given Turkey’s strong trade linkages with Middle Eastern economies, which accounted for 13.6% of goods exports over 2022–2024, pressures on the external balance are likely to intensify further from March onward.

Figure 25: Current account deterioration before war, from higher goods and primary income deficits



Source: Central Bank of Turkey, Eurobank Research

Figure 26: Falling foreign reserves to support the lira; lowest foreign currency reserves since May 2021



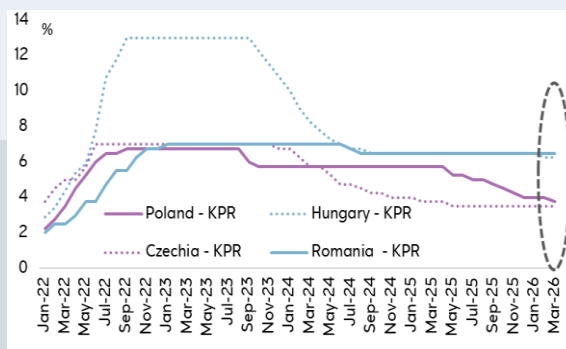
Source: Central Bank of Turkey, Eurobank Research

CESEE

Energy shock and rising political risks

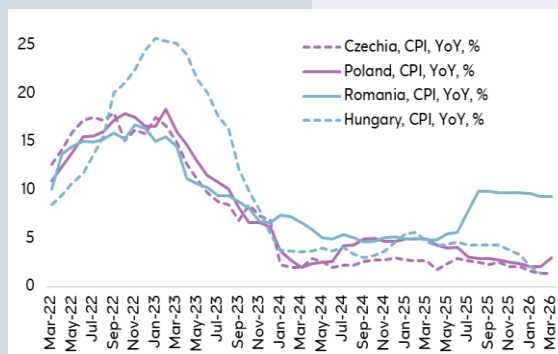
The macroeconomic outlook is increasingly defined by the energy shock stemming from the Iran conflict, compounded by rising domestic political and fiscal risks. While core growth drivers remain broadly intact, the region is entering a more fragile phase, characterised by persistent inflationary pressures, constrained policy flexibility and heightened market sensitivity. Elevated oil and gas prices are feeding directly into inflation, interrupting the prior disinflation path and increasing the likelihood of second-round effects via food and core components. Given the region's structural dependence on energy imports, the impact is particularly pronounced, significantly narrowing the scope for monetary easing. Market expectations have shifted decisively away from rate cuts, with central banks likely to maintain a restrictive stance for longer—and, in some cases, potentially tighten further—to anchor inflation expectations and safeguard exchange rate stability. Notwithstanding these headwinds, domestic demand continues to provide a degree of resilience. Private consumption remains supported by robust wage growth and still-tight labour markets, particularly in Poland and Czechia. Investment activity is also expected to remain comparatively firm, underpinned by the ongoing absorption of EU funds. However, growth dynamics are becoming increasingly uneven and more exposed to policy constraints. Romania constitutes a key source of downside risk. Elevated fiscal imbalances are necessitating consolidation measures, including tax increases and expenditure restraint, which are weighing on household demand and confidence. At the same time, limited fiscal space curtails the authorities' capacity to mitigate the impact of higher energy costs, heightening macroeconomic vulnerabilities. In Hungary, political risks are intensifying ahead of forthcoming elections, further complicating the policy mix. A more accommodative fiscal stance in the near term may delay necessary adjustment, exacerbating existing imbalances. Overall, the CEE region is entering a period of heightened fragility. A prolonged energy shock linked to the Iran conflict would likely entrench inflation at elevated levels, erode real incomes and weaken consumer confidence, while increasing the risk of capital outflows from more vulnerable economies. In this context, policy trade-offs are becoming increasingly acute, with limited room to balance macroeconomic stability against growth support.

Figure 27: Room for accommodative monetary policy put under stress..



Source: Bloomberg, Eurobank Research

Figure 28: ..as the region's energy dependence becomes evident on price levels



Source: Bloomberg, 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)		
	2025	2026f	2027f	2025	2026f	2027f	2025	2026f	2027f	2025	2026f	2027f	2025	2026f	2027f
World	3.3	2.9	3.1	4.1	3.6	3.3									
Advanced Economies															
USA	2.1	2.3	2.0	2.7	3.0	2.5	4.3	4.5	4.3	-3.6	-3.2	-3.2	-5.9	-6.2	-6.3
Eurozone	1.4	0.9	1.3	2.1	2.6	2.1	6.3	6.2	6.1	2.6	1.9	1.6	-3.2	-3.3	-3.4
Germany	0.2	0.8	1.4	2.3	2.9	2.1	6.3	6.3	6.0	4.5	4.0	3.7	-2.4	-3.6	-3.7
France	0.9	0.8	1.1	0.9	1.8	1.6	7.7	7.8	7.7	-0.3	-0.2	-0.1	-5.4	-5.2	-5.1
Periphery															
Cyprus	3.8	2.6	3.5	0.8	2.6	2.1	4.4	4.5	4.1	-7.0	-6.4	-6.0	2.6	2.0	3.4
Italy	0.5	0.6	0.8	1.6	2.0	1.8	6.1	5.8	5.7	1.1	1.0	1.0	-3.0	-2.9	-2.8
Portugal	1.9	2.1	1.8	2.2	2.0	2.0	6.0	6.0	5.9	1.2	1.0	1.1	0.2	-0.2	-0.4
Spain	2.8	2.3	2.0	2.7	2.4	2.0	10.5	9.9	9.6	2.9	2.5	2.5	-2.7	-2.5	-2.4
UK	1.4	0.9	1.3	3.4	2.7	2.3	4.8	5.3	5.2	-2.4	-2.9	-2.7	-4.5	-3.8	-3.4
Japan	1.2	0.8	0.9	3.2	2.0	2.0	2.5	2.5	2.5	4.8	4.5	4.4	-1.4	-2.8	-2.9
Emerging Economies															
BRIC															
Brazil	2.3	1.8	1.8	5.0	4.0	3.9	6.0	5.7	6.2	-3.0	-2.8	-2.7	-8.3	-8.5	-7.8
China	5.0	4.6	4.4	0.1	0.9	1.0	5.2	5.1	5.1	3.8	2.9	2.7	-5.1	-5.4	-5.6
India	7.5	6.8	6.7	2.1	4.1	4.3	4.9	4.9	4.9	-1.0	-1.2	-1.2	-4.4	-4.3	-4.0
Russia	1.0	0.9	1.3	8.7	5.7	4.5	2.2	2.4	2.8	2.4	2.1	1.7	-2.6	-2.3	-2.0
CESEE															
Bulgaria	3.2	2.4	3.0	3.5	3.4	2.7	3.5	3.9	3.6	-5.7	-4.5	-2.3	-3.2	-3.3	-2.9
Turkey	3.6	3.5	4.0	35.2	29.5	22.7	8.4	8.5	8.1	-1.4	-1.3	-1.4	-4.1	-3.8	-3.0

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

Eurobank Fixed Income Forecasts

	Current	June 2026	September 2026	December 2026	January 2027
USA					
Fed Funds Rate	3.5-3.75%	3.43-3.68%	3.26-3.51%	3.12-3.37%	3.07-3.32%
3m SOFR	3.6739%	3.56%	3.4%	3.28%	3.22%
2yr Notes	3.8581%	3.55%	3.47%	3.39%	3.37%
10yr Bonds	4.3595%	4.2%	4.15%	4.13%	4.13%
Eurozone					
Refi Rate	2.15%	2.19%	2.19%	2.18%	2.19%
3m Euribor	2.103%	2.03%	2.05%	2.05%	2.07%
2yr Bunds	2.612%	2.12%	2.13%	2.16%	2.18%
10yr Bunds	2.991%	2.87%	2.91%	2.96%	2.97%
UK					
Repo Rate	3.75%	3.64%	3.52%	3.42%	3.32%
3m Sonia	3.8237%	3.43%	3.34%	3.3%	3.23%
10-yr Gilt	4.83%	4.36%	4.32%	4.28%	4.28%
Switzerland					
3m Saron	-0.05%	-0.02%	-0.02%	-0.01%	0.02%
10yr Bond	0.36%	0.38%	0.42%	0.46%	0.48%

Source: Bloomberg (market implied forecasts)

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