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Despite improved risk-on sentiment since the end of March, incoming economic data for a number of countries illustrate that the depth of the ongoing recession is unprecedented in modern times, including sharp unemployment increases and a first-ever plunge in oil future prices below zero. Nevertheless, global economic activity seems to be bottoming out in Q2, with lockdowns and social distancing measures starting to ease as many countries are cautiously reopening their economies. We have downgraded our 2020 GDP growth projection to -2.5% from -1.8% previously, followed by a strong GDP growth rebound of around 5.0% in 2021 according to our forecasts based on provisional data.

Macro Picture

USA: Longest US expansion comes to an end in Q1, Q2 GDP set for a much larger decline

EA: Q1 GDP contracts sharply, Q2 should mark the peak of the crisis

UK: April PMIs imply risks of a record quarterly contraction in Q2

EM: Lockdown measures to prevent the spread of Covid-19 come at a heavy economic cost

CESEE: Timid steps towards economies reopening- further evidence from surveys point to deep recession

Markets

FX: Major CB decisions have been the key drivers of FX pairs once again this month. Range trading has prevailed but we still see USD upside

Rates: European and US yields are close to the low ends of their recent ranges as low for longer prevails and CBs are on the bid

EM: EM credit remains under pressure and has underperformed credit due to the lack of CB buying and worsening fundamentals

Credit: Outperformed on the back of CBs announcing extra supportive measures and despite significant primary market supply

Policy Outlook

USA: Fed to use its tools "forcefully, proactively, and aggressively", a more explicit outcome-based policy accommodation is likely

EA: Provision of liquidity expanded, extra QE via PEPP in the pipeline

UK: BoE likely to ease monetary policy further to tackle the economic fallout of the pandemic

CESEE: Heavy fiscal and monetary arsenal mobilized against the pandemic fallout

Key Downside Risks

More prolonged global economic downturn: The impact of the pandemic proves larger and longer than currently expected; escalation of geopolitical conflicts, such as US/China trade tensions

EM fragility: EM are hit harder by the pandemic as many policy measures to fight it may prove less effective

Special Topics in this issue

Covid-19 & Tourism industry: Sensitivity of advanced economies and the CESEE region

Oil market crash: The impact of Covid-19 and the price war between Saudi Arabia & Russia

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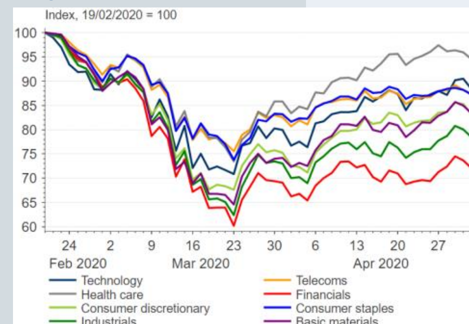
Macro Views

Latest Macroeconomic Developments & Outlook

World Economic Outlook

Risky assets have recovered strongly since the end of March, with global equity markets trending upwards and partly erasing the dramatic losses recorded earlier this year (Figure 1). Policymakers around the world have acted promptly to combat the devastating economic impact of COVID-19 and keep economies in a state of "suspended animation" for some time, with central banks taking extraordinary measures to support the flow of credit and governments approving discretionary fiscal easing that has surpassed the cumulative fiscal response to the 2008 Global Financial Crisis. Despite improved risk-on sentiment, incoming economic data for a number of countries illustrate that the depth of the ongoing recession is unprecedented in modern times, including sharp unemployment increases and a first-ever plunge in oil future prices below zero. GDP prints fell short of expectations in Q1, with output declines of 4.8%QoQ saar and 3.8%QoQ in the US and Euro area, respectively, leading to downward revisions for the whole year. Private consumption took a sharp hit globally as households seem to have adjusted their behavior well in advance of restrictions on people's movement engaging in precautionary saving. The economic disruption stemming from the outbreak of the new coronavirus continued to weigh heavily on global industry during April. The JPMorgan Global Manufacturing PMI dropped to its lowest level since March 2009 (39.8 in April from 47.3 in the prior month), with the cyclically-sensitive new orders-to-inventory ratio falling to its lowest level on record. Although Chinese Manufacturing PMI was relatively resilient in April compared to the rest of the world, the recent recovery in manufacturing has stalled mostly due to the collapse in global demand that has led to a substantial drop in export sales. Nevertheless, global economic activity seems to be bottomed out in Q2, with lockdowns and social distancing measures starting to diminish as many countries are cautiously reopening their economies. For 2020 as a whole, we have downgraded our GDP growth projection to -2.5% from -1.8% previously, followed by a partial recovery with an above trend growth rate of around 5.0% in 2021 according to our forecasts based on provisional data. The risks are skewed to the downside as there is considerable uncertainty around the coronavirus related macroeconomic disruption and the related tensions in financial and commodity markets.

Figure 1: DS Global equities by sector



Source: Refinitiv Datastream, Fathom Consulting

Developed Economies

US: Q1 GDP declined by a higher-than-expected 4.8%QoQ saar led mostly by a 7.6%QoQ contraction in personal consumption and a 8.6% drop in investment. Incoming high-frequency data point to a record quarterly output contraction in Q2 of ca. 35%QoQ saar -more than three times the largest downturn in the post-World War II period- and a surge in the unemployment rate around 20% in April. Our baseline scenario assumes that social distancing measures are in place at least until the first half of May, potentially paving the way for a gradual normalization of economic activity in the second half of the month. Overall, we have downgraded our US GDP growth outlook for 2020 to -5.5% from -4.5% previously, with higher expected growth in H2 partially offsetting our downward revisions to growth in H1 2020.

Euro area: "Flash" Q1 GDP contracted by 3.8%QoQ, probably due to a sharp drop in domestic demand coupled with a weak external environment. Leading indicators point to a further deterioration in Q2, with the IHS Markit Composite PMI plunging to a new record low of 13.6 in April, down from 29.7 in March. Overall, real GDP is expected to contract by 7.0% in 2020, while - according to the ECB estimates - GDP could contract by 5%-12% this year, depending on the duration of the lockdown measures, the ability of the adopted policies to contain the consequences on the economy as well as the shape of the recovery. Following the ECB's additional measures at its April meeting we expect an enlargement of PEPP in the months ahead. Apart from monetary policy, a robust recovery would entail sustained government stimulus, a real challenge in the periphery given their high debt-to-GDP ratios. Following short-term emergency measures worth €540bn including safety nets for workers (SURE), loan guarantees for businesses (EIB) and sovereigns (ESM), a Recovery Fund that EU leaders have agreed on to kick-start the economic recovery after the crisis is of vital importance, although details on size and funding remain highly uncertain.

Periphery: The two biggest EMU peripheral economies, Italy and Spain, have been the most affected EU countries by the COVID-19 outbreak and have experienced the most restrictive containment measures. Encouraged by the easing pressure in hospitals as the virus contagion is slowing, albeit at a very gradual pace, Italian authorities started lifting lockdown measures very gradually on 4 May, beginning with manufacturing. However, several services including tourism-related activities will remain closed or restricted into the summer, suggesting a long lasting and more disruptive containment period that is anticipated to take a heavy toll on Italy's already frail economy. Meanwhile, confirmed cases in Spain are the highest in the EU (c. 216K) and the death toll is the second only to Italy (c. 25k). The government announced a plan for a gradual exit from the lockdown, comprising of four phases, starting on 11 May, with the aim for the economy to return to normality within two months. However, even if lockdown restrictions are lifted by then, activity is unlikely to return to normality so soon, especially in labor-intensive sectors. Importantly, tourism which is a key growth driver for Spain, is likely to be among the most hit sectors from the pandemic. Against this background, both countries are expected to experience a record pace of GDP growth contraction in 2020 to the tune of 9%, with risks skewed to the downside, especially if COVID-19 is not brought under control before the end of the tourist season and lock-down measures have to be reintroduced to avoid a new wave of infections.

Emerging Economies

BRIC: Following the declaration of state of calamity in March 20, **Brazil**'s government announced in early April that it would create a "war budget" to tackle the economic repercussions from the global Covid-19 pandemic. The plan would separate any emergency Covid-19 spending from the government's federal budget. Although the exact nominal value of the war budget has not been confirmed, authorities estimated that total measures may reach BRL600–800bn or 6–10% of GDP. Regarding soft data, the deterioration in business sentiment was widespread in April as the index fell to 58.2, the lowest reading in the 19-year history of the series and below March's 97.5. The Central Bank of **Russia** cut the key policy rate by 50 basis points to at an over six-year low of 5.50% on April 24. The decision, which marked a return to the monetary easing cycle after a brief pause in March, was broadly anticipated by the markets as it was imposed by a rapidly worsening economic outlook due to the Covid-19 pandemic. The Markit Manufacturing PMI plunged to an all-time low of 31.3 in April, from 47.5 in March. The collapse is broadly attributed to a record decline in both output and new orders driven by Covid19-related factory closures and lockdowns. **India**'s Prime Minister, Narendra Modi announced on April 14 that the national lockdown, which was first enforced on March 25 will last until May 3. However, fiscal stimulus worth ca 1% of GDP has been announced so far by federal and state governments, including cash transfers to lower-income households and an easing of the criteria for receiving unemployment benefits so as to mitigate the effects of the lockdown on the economy. **China**'s GDP contracted by -6.8%YoY in Q12020, compared to +6%YoY expansion in Q42019. While it is the worst performance since 1992, when China started to publish quarterly data, the print came as no surprise to the market (consensus at -6% contraction) as it was more than evident that efforts to contain the Covid19 outbreak would take a heavy toll on the country's economic output. The GDP print along with hard data in March could leave some room for assuming that the worse is behind. Specifically, industrial production rebounded to -1.1%YoY in March from -13.5%YoY in February while retail sales recovered more slowly, to -15.8% in March from -20.5% in February.

CESEE: Taking into account the official statistics and the relevant metrics of infections, hospitalizations and fatalities per country, it would be fair to say that the broader CESEE region seems to have largely addressed the spread of Covid-19 more successfully than Western Europe & USA. Now, the economies of the broader CESEE region are making gradual, timid steps towards reopening after the lockdown period. Evidence from economic sentiment and business surveys seem to confirm our fears that in 2020 the CESEE economies will be confronted with a deep recession, more severe than the Great Recession in 2008.

Special Topics

Tourism is considered to be among the hardest hit service sectors by the COVID-19 outbreak

The global economic impact is more than evident in recent economic data, with countries highly exposed to the COVID-19 pandemic posting the larger Q1 GDP declines. Strict restrictive measures have resulted in low demand for nonessential services, shut down workplaces and households that are more inclined towards precautionary savings. Meanwhile, travel restrictions, the cancellation of flights, planned visits as well as business and sport events weigh heavily on many service sectors. Recent leading indicators point to deteriorating business activity. According to IHS Markit Global Sector PMI, the COVID-19 outbreak hit the global economy sharply in March, particularly in service-related sectors. Ten global service sectors registered the fastest declines in activity on record during the month, led by tourism and recreation, real estate and transportation. Furthermore, banks and insurance also posted the sharpest contraction since the 2008 global financial crisis (Figure 2). Trade, transport, accommodation and food services activities account for a large part of total gross value added for many advanced economies as is evident in Figure 4. Greece, Portugal, Italy and Spain are among the countries with the largest shares of services, above the EU average, while core European countries like Germany and France, the US and China experience lower respective shares than the periphery.

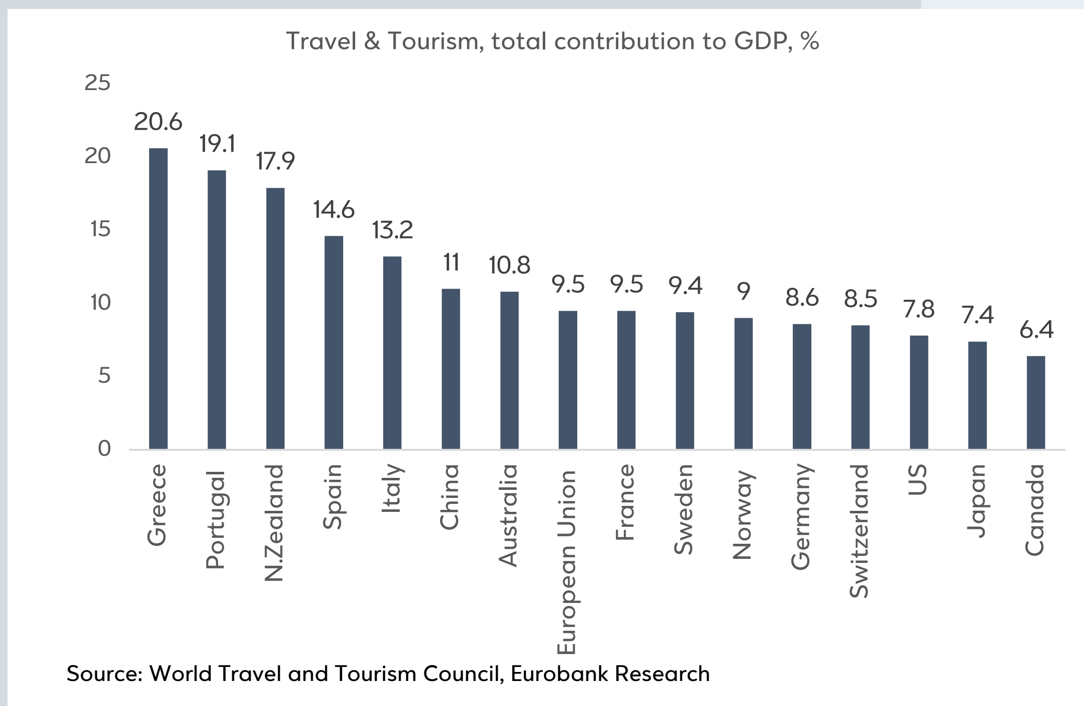
Figure 2: Ten services sub-sectors register record contractions in March

Source: HIS Markit, Eurobank Research

Tourism, in particular, is considered to be one of the hardest hit sectors by the COVID-19 outbreak, while recovery once major lockdown measures are lifted, may be slow. This is due to the potential long-term behavioral changes, with people likely to become more cautious about travelling abroad.

The direct contribution of the travel and tourism industry accounted for 3.3% of the total global GDP in 2019, up from 2.3% in the prior year, while its total contribution accounted for 10.4% of the total GDP worldwide. According to the United Nations World Tourism Organization (UNWTO) estimates, global international tourist arrivals will decline by 20% - 30% in 2020 compared to 2019, equivalent to a loss of $300-450bn in international tourism receipts. For the sake of comparison, the SARS outbreak in 2003 led to a decline in tourism receipts by just 0.4% that year. The OECD estimates that the implied hit from the crisis could bring a 45-70% decline in the international tourism economy in 2020, while, once the pandemic is brought under control, it may take at least 10 months for the tourism sector to return to normality. Countries where tourism accounts for a relatively high share of GDP, such as Greece, Italy, Spain and France (Figure 3, 6), and employment is highly concentrated on that sector, will unavoidably be the most heavily affected by travel restrictions and pandemic-related uncertainty. According to estimates by the Italian Tourism Federation, tourist arrivals in Italy in 2020 are expected to drop by more than 60% compared to 2019, with the number of tourists expected to drop to the lowest level in around 60 years. According to official estimates, Asia is expected to see the highest overall drop in travel and tourism revenue in 2020, particularly China, while in Europe around €1bn in revenues per month is expected to be lost, with Italy and Spain being the most affected.

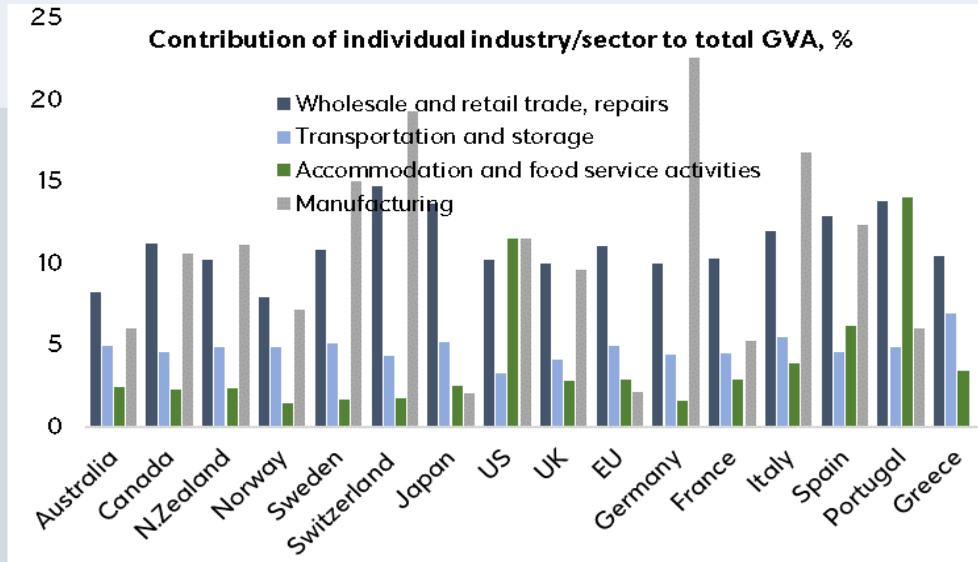
Figure 3: The COVID-19 outbreak expected to hit particularly hard EU periphery countries where tourism accounts for a relatively high share of GDP



Source: World Travel and Tourism Council, Eurobank Research

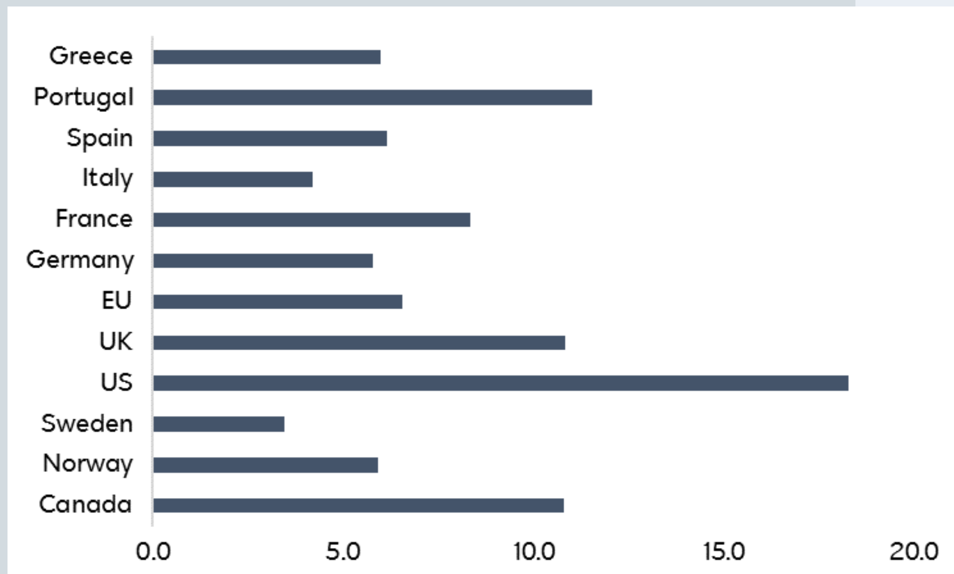
Air travel will be hit particularly hard. Some airlines, such as low cost ones, have ceased operations with around 2mn passenger flights cancelled until 30 June (Figures 4, 5).

Figure 4: Transportation and storage among the lowest contributors to total GVA



Source: OECD, Eurobank Research

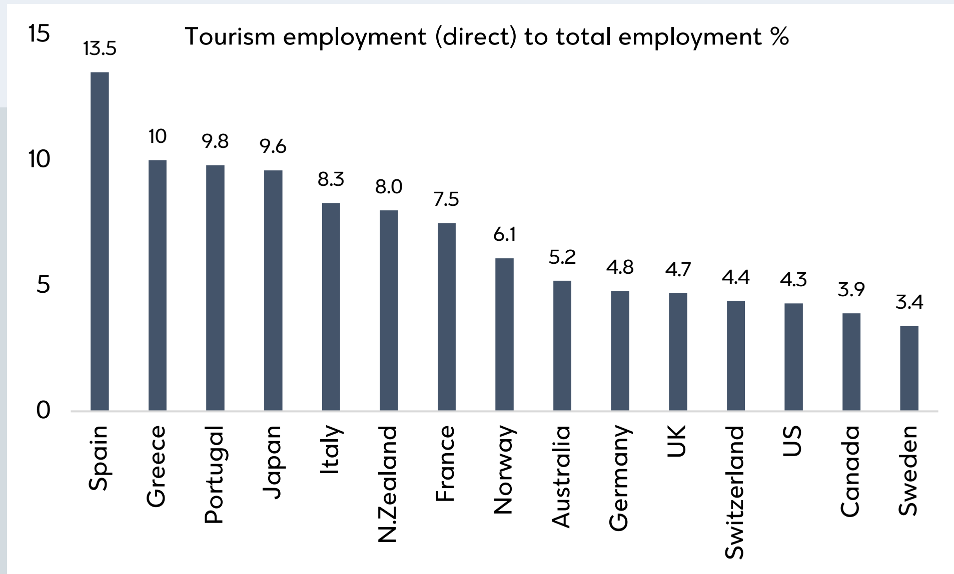
Figure 5: The contribution of US air transport to transportation and storage (% of GVA), is the highest among major economies



Source: OECD, Eurobank Research

The World Travel and Tourism Council projects that in 2020, the tourism sector could lose 100.8mn jobs globally, out of which 64.3mn in Asia, 13mn in Europe and 8.2mn in the US. The travel and tourism industry accounts for 330mn jobs worldwide and over the last five years, one in four new jobs was generated by that sector. The negative impact of COVID-19 on the labor market is estimated to amount more than five-fold to that in the 2008 Global Financial Crisis, with the travel and tourism industry projected to add 2.9% directly in global unemployment.

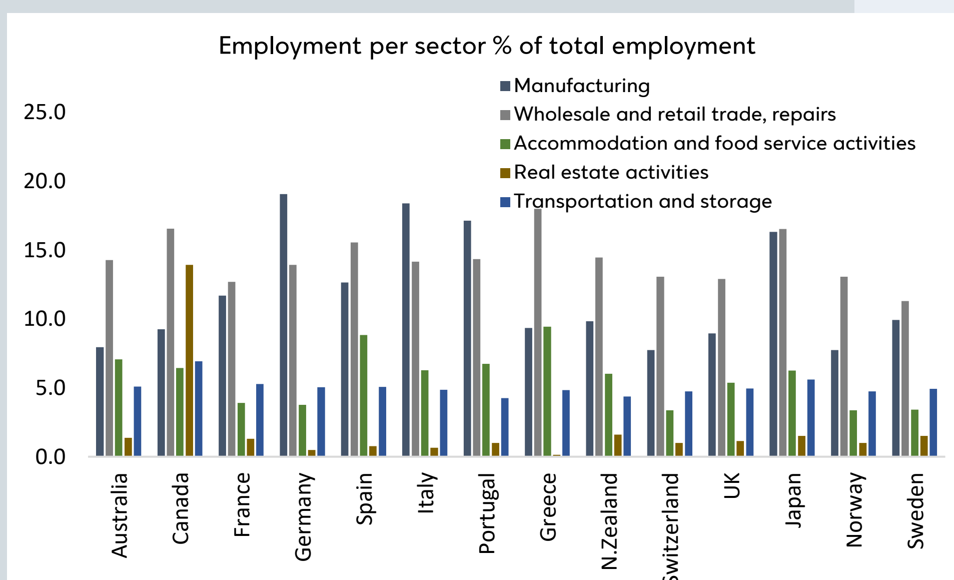
Figure 6: Employment in EMU periphery economies is highly concentrated in tourism



Source: Source: OECD, Eurobank Research

In general, workers who will be hit the most from the economic shock of the COVID-19 pandemic are those employed in service sector activities, including accommodation, food services, retail trade, real estate and business activities, that have been severely affected by the significant decline in economic activity as a result of the containment measures. These sectors are generally labour intensive and employ 1.25 billion individuals globally, around 38% of the global workforce (Figure 7).

Figure 7: Employment in wholesale and retail trade, repairs & manufacturing account for more than 50% of total employment



Source: OECD, Eurobank Research

Box: CESEE region Tourism& Travel industry sensitivity to Covid19

Figure 8: Tourism & Travel Ranking (% of GDP, 2018)

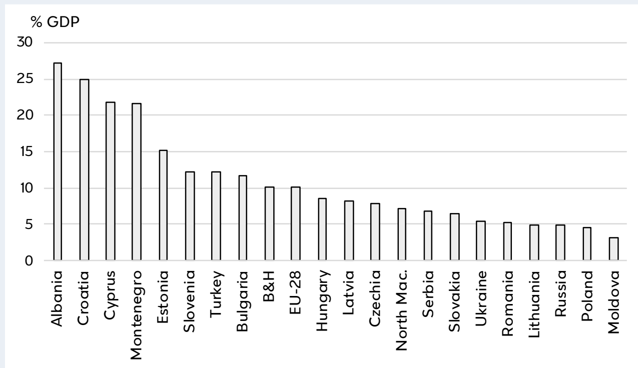


Figure 9: Tourism & Travel % of GDP 2010-2018

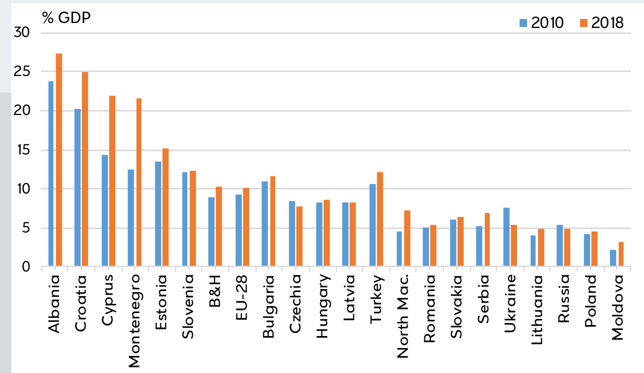


Figure 10: Tourism & Travel (% of GDP, 2018)

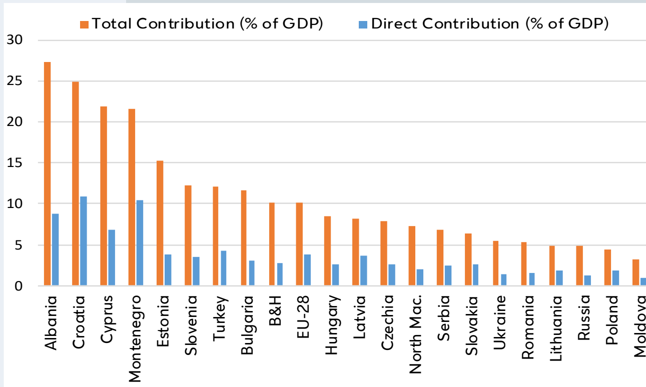


Figure 11: Capital Investment Ranking (% of Total, 2018)

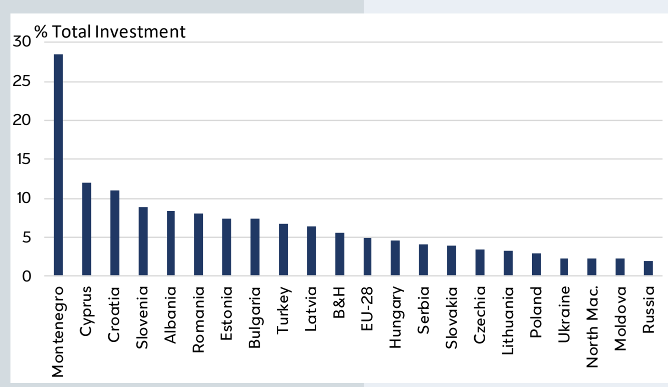


Figure 12: Tourism & Travel (% of Employment)

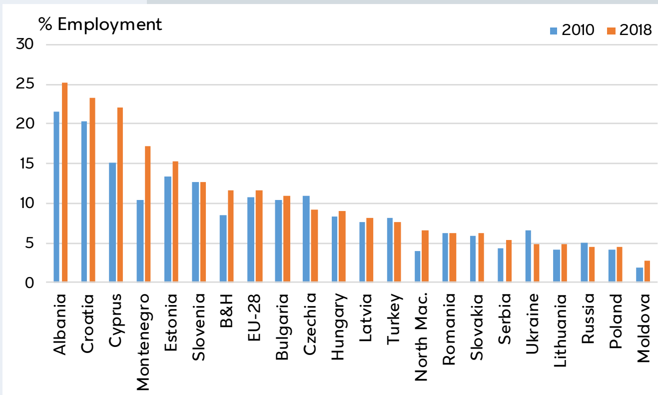
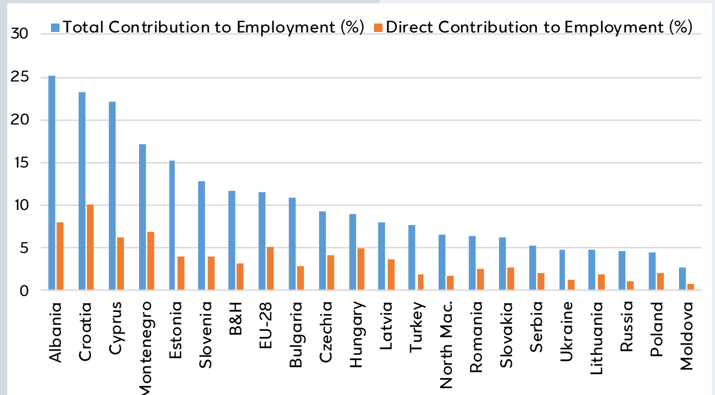


Figure 13: Tourism & Travel (% of Employment, 2018)



Source: World Tourism Travel Council, Eurobank Research

Key points

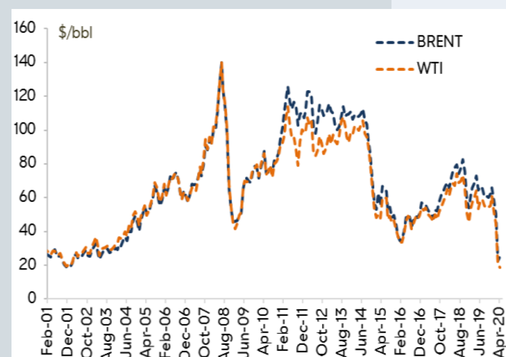
- The contribution of Travel & Tourism (T&T) to the economies of the CESEE region varies significantly, but overall has increased since 2010. T&T contributes directly an amount ranging between 1% and 11% to individual country GDP. Adding up the indirect contribution, the total share of T&T to GDP reaches as much as 3%-27% (Figures 8, 9, 10).
- The contribution of Travel & Tourism industries to employment is also very important. The direct ranges between 0.8%-10% but if combined with the indirect contribution the relevant shares add up to 2.8%-25% (Figure 12, 13).
- Those economies who have a more developed T&T industry attract relatively more capital investment in that area as a percentage of their total investment (Figure 11).
- From a geographical point of view, some economies of Southeastern Europe (Albania, Croatia, Cyprus, Montenegro), appear highly dependent on T&T both from an economics and from employment point of view. The relevant share of T&T to GDP stands between 21%-27% significantly above the EU average (10.1%). In this group of small and open economies, the weight of T&T as percentage of GDP has increased by at least 3.5-9ppts compared to 2010. Accordingly, the contribution of T&T to total employment stands between 17%-25% compared to 11.6% in EU-28.

The Covid-19 pandemic and the price war between Saudi Arabia and Russia have pushed oil markets into havoc

Supply and Demand Shock

In early March, oil markets experienced an unprecedented dual shock, from both the demand and supply side. Since the beginning of the year, both Brent and WTI have lost more than 2/3 of their value, currently standing at $32/bbl and $25/bbl respectively, approaching 20-year lows. Lockdown measures in order to contain the Covid-19 pandemic around the globe sent almost one third of the global population in lock-down and put many economies in a standstill mode, freezing production, disrupting supply chains and banning travelling. Oil experts reckon that the demand for crude oil in April has shrunk between 20 and 30m b/d, compared to 80 m b/d, which was considered regular in the pre Covid-19 period. On top of the above, during March and by mid-April, Saudi Arabia, ranking 1st among net oil exporting countries and Russia, ranking 2nd, entered into an oil price war, as they initially failed to agree on oil production cuts in early March in Vienna, where OPEC+ countries convened to agree on production cuts that could brake falling prices due to the virus outbreak. Russia refused to participate in additional cuts, staying intact with its reluctant signalling back in February when OPEC dropped the idea. The reluctance of its stance can be broadly attributed to the doubts over the actual effect of the proposed cuts, along with the ample oil inventories that provide the country with tolerance against low prices even for a prolonged period of time. On the rebound, Saudi Arabia proceeded with unexpected price cuts ranging from $6 to $8/bbl to buyers in Europe, Asia, and the United States and production increases from 9.7mn b/d to 12.3mn b/d, when Russia planned to increase oil production only by 0.3mn b/d. The announcements triggered a free fall in oil prices, with Brent price plunging by 30%, the largest drop since the Gulf War, and the WTI price by 20% in one day on March 9. Finally, after almost a month of negotiations and under the diplomatic weight of the US, OPEC+ reached a historic agreement on April 12, effective from May 1, to jointly cut production by 9.7mn b/d, the biggest oil output cut ever close to 10% of global production, and that additional output reductions would follow from other G20 countries such as Brazil, Canada and Norway[1]. However, analysts and investors appear reluctant regarding the effectiveness of such a tumultuous yet decisive agreement. The agreement may have partially relieved markets and according to experts it backed oil prices from plunging further. Still its impact on crude prices was disproportionally smaller compared to the nominal size of the decided output cut.

Figure 14: Crude Oil prices reaching 20 year lows



Source: Bloomberg, Refinitiv, Eurobank Research

[1] Not a G20 country

Market shock translates into an inventory shock

Apparently, the time lag of almost 2 months between the crash of oil demand by ca 20% since February and the OPEC+[2] production cut agreement in early May is about to prove pivotal in the questioned success of the historic deal. Within these two months the global economy has been awash with oil and the main reason for this oil flood looks pretty straight forward: demand is falling faster than supply, and storage capacity is limited. An article by the Council of Foreign Relations (CFR), published on April 20, argued that if global oil demand does not pick up sufficiently in the next few weeks, then lack of access to physical oil storage facilities will force some oil production to shut-in, with Africa, Latin America, and Russia being the most exposed to risk of curtailments caused by the shortage of storage capacity. Moreover, according to Energy Aspects, global oil-storage capacity on land amounts to 4,200mn barrels, with capacity of only 956mn barrels being available as of early April. Alternative ways of storage such as in vessels have limitations (analysts estimate that ca 70mn barrels of storage in this form is available) and are getting extremely expensive, as freight costs for Very Large Crude Carriers (VLCCs) have more than doubled since February given the high demand. Taking into account the above, the April 20 remarkable session when the May 2020 WTI contract traded at -$37.63 p/b has a rather uncomplicated explanation. In a nutshell, that specific day, oil producers were paying oil buyers to take the commodity off their stock over fears that storage capacity could run out in May.

Where to from here?

As things stand, we consider that the near term oil market landscape will be broadly shaped by the speed of the global demand recovery. As it is unlikely for this to happen earlier than June or even July, an increase in oil demand should not be expected sooner than that. Additionally, the compliance of the OPEC+ members with the decision of April 12 is of essence in an effort to mitigate oversupply dynamics in the market. While demand is estimated to have fallen between 20mn b/d and 30mn b/d, the imposed cuts by the agreement bridge that gap only halfway, rendering its loyal implementation of utmost importance[3]. While several OPEC states in the past have proved inconsistent with their inked commitments regarding oil production cuts, the track record implies that credible cuts can be expected from Saudi Arabia, Russia, the U.A.E. and Kuwait, i.e. countries that all rank high among OPEC members in oil production volumes. Concluding, despite the prevailing uncertainty stemming primarily from the unchartered dynamics of global demand in the foreseeable future, market consensus anticipates a slow recovery by the end of the year with WTI and Brent prices standing above S40/bbl but with no second wave of the Covid-19 pandemic taken into account.

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[2] OPEC+ was founded in 2016 and basically pertains to a cooperative initiative between the 13 OPEC countries with 10 more net oil exporting states, among which Russia is considered the most prominent. OPEC+ countries control over 50% of global oil supplies and about 90% of proven oil reserves. The trigger for the OPEC+ formation was the need for more intense control on oil prices on behalf of OPEC countries, following the increased production of shale oil by the US that led, along with other factors, to another oil price crash in 2014.

[3] President of the OPEC Conference and Algeria's Minister of Energy Mohamed Arkab stated in early May that "in the face of unprecedented difficulties facing the oil market, it is of the utmost importance that all the signatory countries fully implement the voluntary production reduction agreement and that the objective is to ensure a conformity of over 100%".

Macro Themes & Implications in CESEE

The economies of the broader CESEE region are making gradual, timid steps towards reopening after the lockdown period. Evidence from economic sentiment and business surveys seem to confirm our fears that in 2020 the CESEE economies will be confronted with a deep recession, more severe than the Great Recession in 2008.

As of early May, taking into account the official statistics and the relevant metrics of infections, hospitalizations and fatalities per country, it would be fair to say that the broader CESEE region seems to have largely addressed the spread of Covid-19 more successfully than Western Europe & USA. In order to achieve, that CESEE governments introduced tough social distancing measures, ban on travelling – some even resorted to a mandatory curfew – and a general lockdown. Most economic and social activities were suspended with shopping malls, restaurants, stadiums, schools, universities etc. being shut down. Production units in several industries also closed, thus putting the broader region's small open economies under severe stress.

Now, most of the governments are taking gradual and timid steps to reopening their economies based on roadmaps that describe the gradual steps in to lift the restrictive measures. Those exit strategies provide for the expiration of the state of emergency regimes allowing for some removal of movement restrictions preserving at the same time some safety measures. At the same time, unrestricted movement is gradually being restored with citizens required to follow certain safety rules. Restrictions on public gatherings plus the mandatory use of face masks in certain instances will remain in place for longer. During the first phase, small retail businesses (beauty salons, non-food shops) - but not shopping malls – are allowed to reopen and public transportation is restored. In the second phase, shopping malls, hotels, educational centers and sport facilities will be allowed to reopen.

In this post-Covid19 shock environment, international organizations and rating agencies have started revising downwards their forecasts and publishing their views to reflect the new harsh realities. In its new World Economic Outlook (WEO) released in mid-April, the IMF warned that the world is confronted with its worst recession since the Great Depression of the 1930s, adding that the output losses of the Covid19 pandemic is expected to be larger than the losses that triggered the global financial crisis in 2009. Thus, the IMF slashed growth forecasts dramatically across the board in advanced and emerging economies due to the impact from the Covid-19 pandemic. In the IMF baseline scenario, which assumes that the pandemic fades in the 2H-2020 and containment measures are gradually unwound — the global economy is set to contract by -3% in 2020 followed by a rebound of 5.8% in 2021 as economic activity normalizes, helped by policy support. To make things worse, if the outbreak spills over well into the 2H-2020, so that market pressures continue and health care systems are further strained, growth contractions will be even more

severe. To illustrate the magnitude of the forecast revisions, the relevant forecasts for 2020 stood at +3.4% in October 2019 and 3.3% in January 2020.

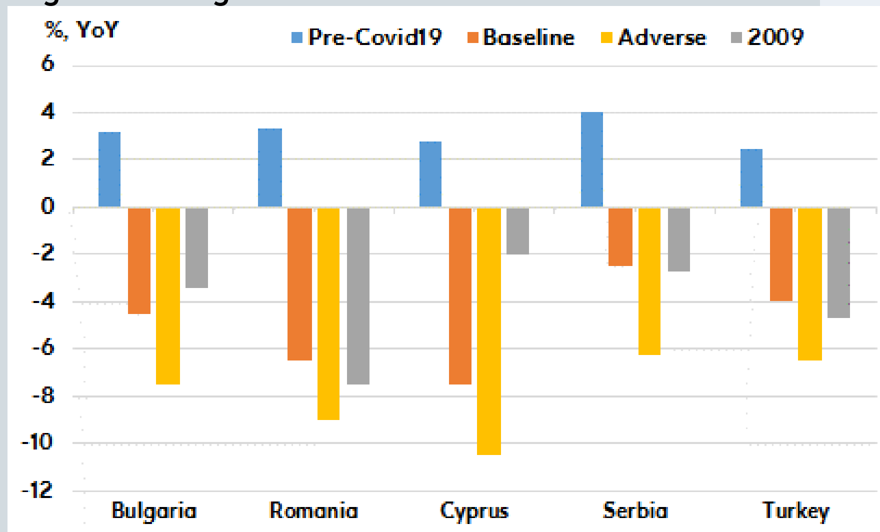
In such an environment, according to the WEO, the emerging and developing Europe is expected to contract by -5.2% in 2020 and then bounce back by 4.2% in 2021. The relevant forecasts for 2020 stood at 2.5% in October 2019 and 2.6% in January 2020. IMF now forecasts that all economies in the region will face painful contractions in 2020, yet the rebound will not be symmetrical for everyone in 2021. In particular, for the economies of our focus, Bulgaria is now expected to contract by -4% in 2020 and rebound by +6% in 2021. Serbia is forecasted to contract by -3% in 2020 and expand by +7% in 2021, Romania by -5% in 2020 and +3.9% in 2021, Turkey by -5% in 2020 and +5% in 2021 and finally Cyprus by -6.5% in 2020 and +5.6% in 2021.

Accordingly, rating agencies have started publishing the outcomes of their extraordinary sovereign reviews and changing their forecasts accordingly. The combination of severe output contraction with the impact of the announced fiscal support packages will have a detrimental impact on the public balance sheets augmenting financing needs and pushing fiscal deficits and gross debt ratios through the roof. So far, there has been no downgrade in the long-term sovereign rating of any CESEE government and the probability appears low at least in the short-term given the temporary nature and the symmetry of the shock – as well as the level of institutional response both on a country and a multilateral level-across bond issuers. However, the outlook of the sovereign rating has been revised downwards from positive to stable in some cases. From that point of view, Fitch (Bulgaria, Cyprus, Croatia, Poland, Ukraine) and S&P (Hungary, Serbia) were among the first to start downgrading the outlook of some government debt from positive to stable, which means that it is highly unlikely that we see an upgrade in the next twelve to fourteen months. In that the case of Romania, we anticipate rating pressure to ramp up as the fiscal metrics of the country were vulnerable and at the borderline even before the Covid19 break out. Fitch and Moody's have already acted by revising their outlooks on the Baa3/BBB- ratings to negative. S&P had already placed Romania on negative outlook since December.

The economic impact on the broader CESEE region is yet to be seen in official national accounts data and the high frequency hard data, which so far cover the period of the first two or three months of the year. However, survey data, both economic sentiment indicators and PMI manufacturing releases are now available for both March and April. The decline of both indices in March did not reflect the full impact of the Covid19 outbreak on economic sentiment and business managers' expectations, given that in many countries the survey responses were collected before the adoption of strict containment and social distancing measures. In April, the economic sentiment readings for both advanced and emerging European economies released earlier this month plunged to a shocking extent. All sub-indices declined with the consumer, industry and services registering the biggest declines, plummeting to new multi-year lows. The picture of the Markit PMI manufacturing releases in April is equally devastating. PMI indices dropped steeply across the board, in some cases the plunge seen was even steeper than that seen in the Great Recession. Although the data does not tell us much more that we already know they do solidify the argument that the Covid19-induced recession will most probably turn out to be deeper.

As things stand, forecasting economic growth in such a toxic world environment is subject to huge uncertainties and downside risks. In our previous monthly issue we presented our baseline scenario, in which we assumed the outbreak to peak around late April to May, with social distancing measures to start receding in June and economic activity to gradually normalize in H2-2020 and accelerate further in 1H-2021, given the temporary nature of the shock. Nevertheless the speed of recovery still remains a key question mark. Thus, in the light of the current developments that confirmed our earlier stipulated assumptions, we reiterate our previously downgraded monthly forecasts for the economies of our focus to deep negative territory, with the risks remaining pronounced on the downside, followed by a swift rebound thereafter in 2021. Moreover, we have prepared an adverse scenario to account for a potential outlook deterioration in the Covid19 pandemic. In the adverse scenario, it is assumed that uncertainty with respect to the impact of the Covid19 pandemic doesn't end by the end of May so that lockdown measures, even if they may not be exactly the same as before), will have to be enacted again or sporadically enforced throughout the following months, discouraging travel and tourism, so that return to full normality becomes even more gradual and slow throughout the 2H-2020 on to 2021 (Figure 15).

Figure 15: GDP growth forecasts revision in 2020 in CESEE economies



Source: National Statistics, Eurobank Research

CESEE Markets Developments & Outlook

Bulgaria

Eurobond yields continued to rise across all maturities, ranging between 32-80 bps. The largest mover was the 2035 tenor, which saw its yield spiking by 80 bps, followed by the 2028 tenor with a 72 bps rise during April. Local papers also had an eventful month, with the 5 and 7 year tenors seeing yields spiked by 20 bps, while the 10-year papers climbed by 45 bps. During April, the Ministry of Finance held two 5-year auctions and one 10-year auction during April. The 10 year issue was successful, raising BGN200mn with strong market interest .Out of the 5-year auctions, BGN200mn were raised in the first, while the bids of the second were rejected by the Ministry of Finance.

Serbia

Since the outbreak of pandemic, the number of infected population has reached 9,464 and the number of fatalities stands at 193. Currently, the number of daily new cases has started to recede and the country is slowly getting back into normality. According to the latest news, the 47-days curfew will end on Thursday, May 7th. On Monday, May 4th, coffee shops and restaurants reopened and bus transportation started to operate again within Serbia. However, precautionary and social distancing measures are still in place. Central Bank measures to provide liquidity to the banking system were effective so far as we haven't seen any major disruptions. The EUR/RSD pair has been remarkably stable due to the fact that the National Bank of Serbia (NBS) has put strong efforts to tame any sudden and exaggerated moves. Specifically, ca EUR400mn have been spent, coming from the FX reserves of the NBS. A big chunk of RSD pressure came from large Government Bonds maturing in April and denominated in local currency as substantial foreign capital rushed back into hard currencies causing pressure on the dinar. The IMF expects Serbia's economy to contract by 3% while local officials project a significantly milder drop in the GDP output at a range of 1.5% to 1.8%. Our own projection lies somewhere in between. The announced €5.1bn package of measures to support economy will be mostly financed with new borrowings (partially from Eurobonds and partially from issuing RSD nominated government bonds). Consequently, fiscal deficit will end up at least 7% this year. We expect to see significant drop in remittances from abroad which will weigh on the current account deficit. Overall, Serbia had a strong start at the beginning of the year with Q1 GDP growth reaching a staggering 5%YoYand accumulated reserves amounting to EUR13.1bn,providing enough tools to fight the effects of COVID pandemic. As a result of all potential difficulties that lie ahead, S&P downgraded Serbia's outlook from positive to stable keeping its BB+ rating unchanged.

Markets View

Foreign Exchange

EURUSD: The pair moved inside a tight 1.07-1.10 range during April balancing between negative economic releases from both sides of the Atlantic and positive announcements from the Fed and the ECB. The latest market mover for the EUR was the German Constitutional Court's decision that the ECB has violated the "proportionality" principle. We remain seller of rallies and expect the March lows (1.0636) to be broken. Support comes at 1.0770 with resistance at 1.10 (current 1.0842)

GBPUSD: GBP has remained surprisingly resilient in the face of more QE announced by the BoE and the general hit taken by the UK from COVID19. The pair remains in the tight 1.23/1.265 range. We continue to expect a top to be formed here and a retest of the March lows to materialize within the year. Support comes at 1.2350 and 1.2166 with major resistance at 1.2650.

USDJPY: The pair moved lower during April inside a 109.40 – 106.20 range. We expect the pair to break lower and test at least the 105.20 area and potentially 103.10 as the JPY traditionally acts as a safe haven ccy, although we do not expect to see the March lows in the near term. The upside is capped at the moment at 106.90 and 107.50.

Rates

EU: Lower for longer persists in the Eurozone, with no expected rates increases or decreases in the near future. The bund traded at a high of -0.29 before reversing lower to settle at -0.59 on the back of the German CC decision. The ECB decision on 30 April did not affect core markets much, despite their rally. The unconditional liquidity support under the PELTROs did cause non-core curves to steepen, but the long end came under pressure as market was expecting some kind of extension of the PEPP. We consider German yields fair at current levels.

US: US yields remained range-bound despite significant moves in other assets (see oil, credit), as increased issuance, especially of T-bills was met with significant buying by the Fed. Issuance is expected to move further out the curve so we should see some pressure/steepening of 2-10s, but do not expect yields to rise significantly from current levels. There are two opposing forces for yields, on one side the Fed that keeps rates low while on the other side the reopening of the economy is expected to reverse some of the recent slowdown.

Emerging Markets credit

Fundamental concerns remain for EM credit and the recovery of spreads from the 23 March high came to an end in April significantly underperforming DM credit due to the lack of central bank buying programs and continued downgrade of growth outlook and projection of increasing Debt/GDP ratios. Also the epicentre of COVID-19 is increasingly shifting to EM from DM. In some DM countries, the pace of viral outbreaks and deaths is showing signs of plateauing, allowing some economies to announce or consider a gradual easing of lockdown measures. In contrast, the recent trend in EM has seen confirmed virus cases rise, resulting in several EM countries either reversing decisions to end lockdowns or extending lockdown periods. EM USD Sovereigns posted a one month 2.9% total return versus 5.2% for US IG and 3.8% for EUR IG. The weak link was LatAm, with Asian names practically flat and EMEA outperforming. We saw good primary market supply, north of $55bn, driven by higher rated issuers with significant concessions to the secondary market. Investment grade names outperformed high yield ones meaningfully and the short end of the curve fared better as the dollar funding pressures abated following the extra measures announced by the Fed. Despite the murky outlook we would be buyers of short end high quality issuers and avoid high yield names like Turkey and South Africa.

Corporate credit

Continued support by central banks (inclusion of fallen angels as eligible collateral by the ECB, further measures/clarifications announced by the Fed about its corporate purchase program and support for the short end via CP buying program) led to a continued tightening of credit spreads. EUR IG credit curves, despite a circa 55bps tightening, remained relatively flat and performance was similar across ratings with financials outperforming. In USD IG on the other hand the short end of the curve outperformed significantly as USD funding pressures abated, while we saw significant compression between BBB and A as well as A and AA. In EUR HY corporates outperformed financials and credit curves traded significantly less inverted (dropped from 400 to 300 bps inversion) with B outperforming BB and CCC. The performance was similar in US HY and surprisingly Oil & Gas outperformed despite the historic moves in oil. The primary market continued to set records of supply in both Europe and US, although HY new issuance in Europe remains dormant. Throughout the month concessions in the primary narrowed significantly with some names now issuing at no premium to the secondary. We consider the ECB corporate buying superior to the Fed despite not including fallen angels, as it has significantly less constraint for its participation to the primary and secondary market. We are conformable with holding short end (up to 7-8 years) investment grade corporates eligible for CB buying. We remain cautious in HY as defaults loom large and the universe is expected to increase significantly with more downgrades coming.

Eurobank

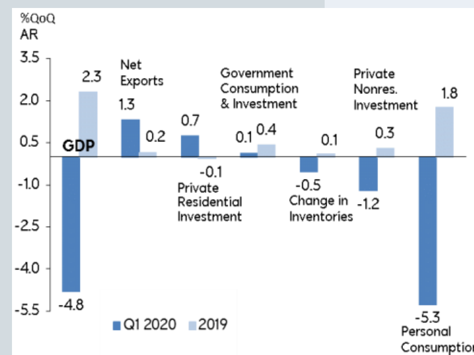
Eurobank Research

US

GDP fell short of expectations in Q1, and is poised to decline more deeply in Q2

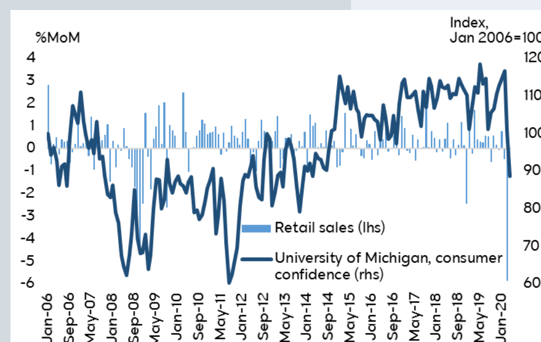
The US economy seems to be experiencing the most severe contraction in the post-World War II period. Ending the longest US expansion on record that had started in Q3 2009, Q1 GDP declined by a higher-than-expected 4.8%QoQ saar - the steepest decline since Q4 2008 when GDP fell by 8.4% QoQ saar - led mostly by a 7.6%QoQ contraction in personal consumption and a 8.6% drop in investment amid a deep plunge in equipment (-15.2%) and structures (-9.7%). Residential investment partly offset the weakness in nonresidential investment, recording a firm 21%QoQ saar and contributing 74ppt to Q1 growth. Meanwhile, existing home sales dropped by 8.5%MoM in March to 5.27mn units, while a sharper decline is expected in April due to stay-at-home orders set in place in mid-March. New home sales, which are calculated at the time of contract signing, fell by 15.4%MoM in March, to an annual rate of 627k units, with the Northeast and West regions that were initially the Covid-19 pandemic hot spots in the US being hit the most. Regarding labor market conditions, initial jobless claims are still at extremely high levels (~4.5mn the week ending April 18), although they appear to have passed their peak following sharp job losses in late-March/early-April. Reopening plans, which differ considerably across regions, currently take centre stage, with states accounting for ca. 18% of GDP planning to partially have reopened until mid-May. Our baseline scenario assumes that social distancing measures will be in place at least until the first half of May, potentially paving the way for a gradual normalization of economic activity thereafter. Overall, we have downgraded our US GDP growth outlook for 2020 to -5.5%, with higher-than-expected growth in H2 partially offsetting our downward revisions to growth in H1 2020. Recognizing that the ongoing coronavirus crisis poses extensive risks to the economic outlook over the medium-term, the Fed stood ready at its April meeting to use its tools “forcefully, proactively, and aggressively” making it clear that there are no limits to the extent of its policy accommodation until the US economy is solidly on a recovery path. Further information on forward guidance and balance sheet policy could be released at the June meeting when updated economic projections are released, potentially with a more explicit outcome-based policy accommodation.

Figure 16: Q1 GDP contracts more than expected...



Source: BEA, Eurobank Research

Figure 17: ... with personal consumption being the largest drag on overall growth



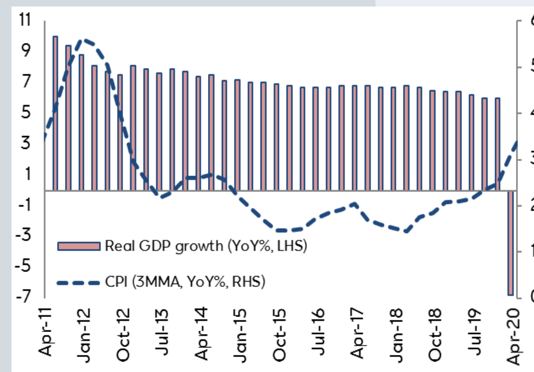
Source: Refinitiv Datastream, Eurobank Research

China

Following Q1 GDP contraction print at -6.8% YoY, the road to recovery turns up bumpy

GDP contracted by -6.8%YoY in Q12020, compared to 6%YoY growth in Q42019. While it is the worst performance since 1992, when China started to publish quarterly data, the print came as no surprise to the market (consensus at 6%) as it was more than evident that efforts to contain the Covid19 outbreak would take a heavy toll on the country's economic output. Breaking down the headline figure into sectors, the primary sector (production) was down by -3.2%YoY from 3.1%YoY, the secondary industry (manufacturing) plunged to -9.6%YoY from 5.8%YoY and the tertiary sector (services) sunk to -5.2%YoY from 6.6%YoY, all compared to Q42019. The GDP print along with hard data in March could leave some room for assuming that the worse may be behind for China's economy. Specifically, industrial production rebounded to -1.1%YoY in March from -13.5%YoY in February while retail sales recovered more slowly, to -15.8% in March from -20.5% in February. Still, official April's manufacturing PMI that fell from 52.0 in March to 50.8 in April, implies that the recovery is still fragile.

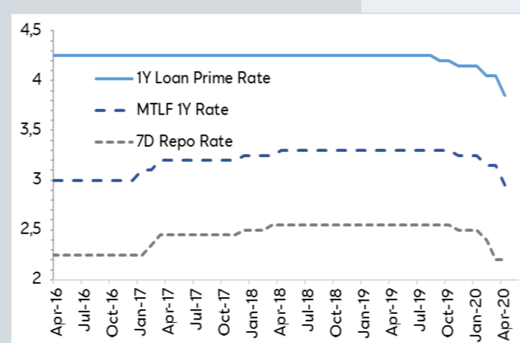
Figure 18: Q1 GDP growth sinking in the battle with Covid-19



Source: Bloomberg, Eurobank Research

March's hard data, also, reveal a differential between recovery in supply and demand that starts to unfold. In any case, high frequency data point to an accelerating recovery. Daily coal consumption of major electricity producers has accelerated and more than 95% of large and medium-sized industrial enterprises outside the Hubei Province had resumed operations by mid-March, pointing to a gradual pickup in activity since mid-February. Regarding China's next big challenge, the second-wave infections, those have faded significantly since mid-April. There are continued efforts to contain imported and asymptomatic cases either with the compulsory use of face masks or with tracking applications, among others. In this context, the National People's Congress (NPC) will most probably open in mid-May, deferred since mid-March due to the pandemic outbreak, with all eyes on the economic growth target for 2020 and the policy agenda to achieve it.

Figure 19: Monetary easing continues in support of GDP growth



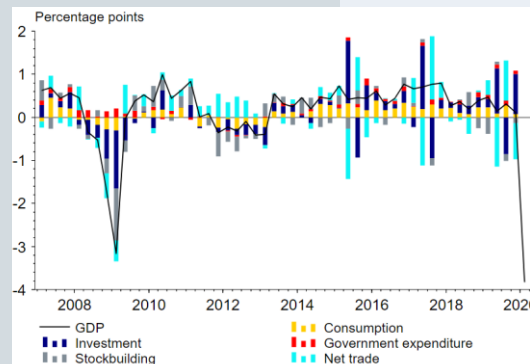
Source: Bloomberg, Eurobank Research

Euro area

GDP contracts sharply in Q1, additional monetary and fiscal support is expected

"Flash" Q1 GDP contracted by 3.8%QoQ, following a 0.1%QoQ increase in Q4 2019, with a symmetrical plunge across major euro area economies (France, Spain, Italy). Although a detailed decomposition at the aggregate level is not available yet, the expenditure breakdown in France and Spain suggest that a sharp drop in domestic demand probably led the overall GDP decline, coupled with a weak external environment. Leading indicators point to a further deterioration in Q2, with the IHS Markit Composite PMI plunging to a new record low of 13.6 in April, down from 29.7 in March. The April Composite PMI reported by far the largest monthly output downfall in over two decades of survey data collection, and was actually consistent with a quarterly GDP contraction of approximately 7.5%. Containment measures weighed the most on the service sector, with the business activity index plummeting 14.4pts to just 12.0 in April as many companies operating in sectors such as hospitality, accommodation, restaurants, travel and tourism were enforced to shut down. Manufacturing also experienced a substantial fall, with the respective index declining to 33.4 from 44.5 in March, as certain non-essential businesses have closed and others faced reduced demand or were constrained by shortages of staff and inputs. Business and consumer surveys should improve in May with the gradual planned lifting of lockdown measures, so we expect a bounce in Q3 although consumers and firms could be rather cautious, implying only a gradual economic recovery. Overall, real GDP is expected to contract by 7.0% in 2020, down from 6.0% previously, taking into account that Q1 GDP fell short of our expectations and that current economic statistics are subject to revisions, most probably to the downside given that the containment measures complicate sectoral data collection, as communicated by national statistical agencies. Given the exceptional nature and depth of the recession coupled with subdued inflationary pressures, the ECB took further steps to ease monetary and financial conditions (see Table 1), and left the door open for any future increase in length, size or extension to any type of assets. That said, we look for an enlargement of PEPP at the June meeting, although it could be announced earlier if market conditions warrant. OMT could not be entirely ruled out, but the ECB seems to consider it a backstop in case there is a severe deterioration.

Figure 20: PMIs indicate that the economy is already contracting by ~10%



Source: Refinitiv Datastream / Fathom Consulting

Table 1: Additional ECB measures focused on the provision of liquidity to the banking sector

Liquidity measures at the April ECB meeting to support the transmission mechanism of monetary policy and bank lending
• Interest rate on LTRO III reduced by 25bp to -0.5% (6/2020-6/2021) • For banks meeting the lending threshold of 0% introduced on 12/3/2020, the interest rate can be as low as -1% • Start of the lending assessment period brought forward to 1/3/2020 • A new series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs) will be conducted on a monthly basis, starting 19 May, under a fixed rate and full allotment procedure to strengthen the already generous liquidity backstop, with an interest rate of -0.25%

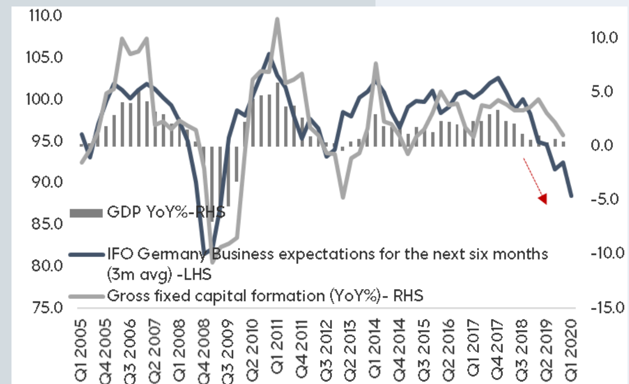
Source: ECB, Eurobank Research

Germany

Gradual lift of lockdown, but H1 technical recession inevitable

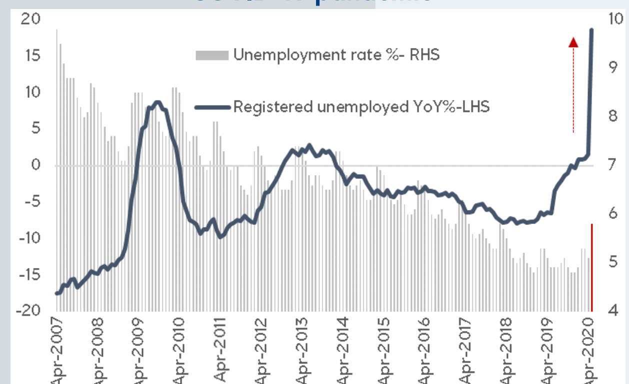
The lockdown that was implemented on 22 March, albeit laxer than in most western Europe countries, has started gradually being lifted. Encouraged by the slowdown in new cases and the resilience of the healthcare system, which was among the best prepared in Europe, the government announced in mid-April a cautious step-by-step loosening of containment measures. Smaller shops reopened on 20 April but social distancing measures will remain in place until at least 10 May and large public events will remain banned until at least the end of August. However, data releases leave no doubt that a technical recession in H1 2020 is inevitable as a result of the economic damage from the coronavirus containment measures. The IFO business sentiment dropped further in May marking a new historic low of 74.3, with business expectations declining massively (Figure 13). GfK consumer confidence continued to deteriorate in May plunging from April's 2.7 to -23.4, moving into negative territory for the first time in around 20 years (even in the Global Financial Crisis the respective index did not turn negative). The flash April composite PMI declined sharply to a new all-time low of 17.1, mainly pressured by further weakness in the services sector, while the number of registered unemployed marked in April the highest monthly increase since early 2009 (Figure 14). Admittedly, Germany's fiscal discipline and low debt servicing costs allowed the government to support the economy meaningfully through the adoption of various fiscal measures, amounting to c. 50%-of-GDP (including state guarantees), among the more ambitious globally. Against this background, Germany is probably better positioned than other major Euro area economies for a swifter recovery when the pandemic is under control. Nevertheless, assuming lockdown measures are not reintroduced later this year, full year GDP is still expected to contract for the first time since 2009 by 6.5%, revised down from -5.5% previously, with the lockdown anticipated to weigh acutely on Q2 (release scheduled for 15 May).

Figure 21: IFO business expectations index nosedived to all-time lows in April



Source: Federal Statistical Office (Destatis), Bloomberg, Eurobank Research

Figure 22: Unemployment severely affected from the COVID-19 pandemic



Source: Federal Statistical Office (Destatis), Eurobank Research

Eurobank

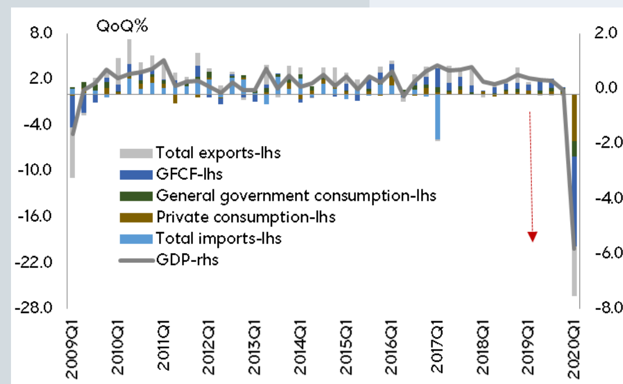
Eurobank Research

France

Q1 GDP contracts by a record pace as COVID-19 takes a toll

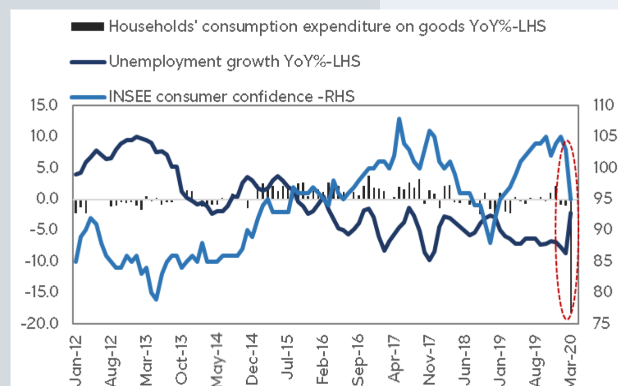
France's Q1 GDP contracted by 5.8%QoQ, the largest quarterly drop since the GDP series began in 1949, after a 0.1%QoQ decline in Q4 2019, suggesting that the economy is already in recession. The sharp activity decline reflects the magnitude of the severe economic ramifications of the lockdown measures that have been in place since 17 March to contain the spread of the COVID-19 outbreak. Domestic demand was the main component behind the historic Q1 decline, driven by private consumption, which dropped by 6.1%QoQ after rising by 0.3%QoQ in the prior quarter, subtracting 3.2ppt from GDP growth. Investment growth contracted by 11.8%QoQ led by construction, reflecting a significant decline in investment spending and cutting 2.8ppt from Q1 GDP growth. Net exports also had a negative contribution (-0.2ppt) as the decline in exports (-6.5%QoQ) outpaced that of imports (-5.9%QoQ), while inventories added to GDP (+0.9ppt) after dropping for three consecutive quarters. Looking ahead to Q2, risks are for a more pronounced quarterly contraction, despite the government's plan for some relaxation in containment measures as of 11 May. Nursery and primary schools will reopen on a voluntary basis along with retail shops and markets but entertainment and catering activity is unlikely to go back to normal before mid-July, pointing to persisting difficulties encountered by businesses in terms of final demand. Assuming that the containment period is not extended further, expectations are for a gradual recovery in Q3, with the government's fiscal package amounting to around €110bn (c. 5% of GDP) and state guarantees to protect companies against bankruptcies and employees against layoffs, expected to help offset a significant part of the drop in economic activity. For the full year 2020, we have downgraded our GDP growth forecast to -8.0% from -6.0% previously, while budget deficit is expected to rise to c. 10%-of-GDP from 3%-of-GDP in 2019 and the debt-to-GDP ratio above 100% from 96% in 2019.

Figure 23: Flash Q1 GDP marks the largest quarterly decline since World War II



Source: France's INSEE, European Commission, Eurobank Research

Figure 24: The hit of lockdown to economic activity has been unprecedented across sectors



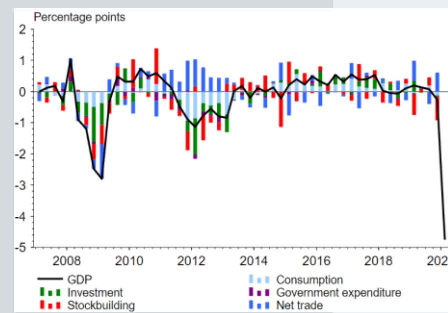
Source: France's INSEE, Eurostat, Bloomberg, Eurobank Research

Italy

Increasing government debt introduces challenges for public debt sustainability

With strict lockdown measures in place since the beginning of March, Italian Q1 GDP dropped by 4.7%QoQ following a 0.3% fall in the prior quarter. Although a complete expenditure decomposition is not available yet, the economic fallout was broad-based across activities, with both the services and manufacturing sectors being deeply hit. Consumer and business confidence indicators suggest that widespread business closures coupled with draconian restrictions on people's movement weigh heavily on economic activity. The IHS Markit Manufacturing PMI plunged to its lowest level ever recorded in over 22 years of data collection (31.1 in April, down from 40.3 in March), signaling a substantial worsening in manufacturing conditions. Following a larger than expected quarterly contraction in Q1, we have downgraded our 2020 GDP forecast to -9.0% from -8.5% previously, before returning to a positive growth rate of ca. 4.0% in 2021. According to Italy's economic and financial document for 2020, the government projects a GDP contraction of 8.0% in 2020, followed by a 4.7% acceleration in the following year.

Figure 25: Q1 GDP contracts by 4.7%, broad based weakness across activities



Source: Refinitiv Datastream / Fathom Consulting

Italy started to gradually ease its lockdown on 4 May, but there is need for continuing government stimulus so as to ensure a sustained economic recovery. Following the €25bn of discretionary fiscal measures[4] in the first half of March to contain the economic downturn, with liquidity measures worth around €750bn, the Italian government has been planning to approve further budget support of ca. €55bn since mid-April, but the said package has not yet been unveiled due to differences between the coalition partners on how to use the available resources. The government envisages a budget deficit of 10.4% and a public debt close to 156% of GDP in 2020, before narrowing to ca. 5.7% and 152.7% of GDP respectively in 2021. Rising public debt levels introduce challenges for public debt sustainability. In an extraordinary review, Fitch downgraded Italy's sovereign rating to BBB-, the lowest investment grade rating. Although the outlook was set at stable, suggesting that there is a low risk of a further downgrade in the near term (see Figure 26), worries about Italian debt sustainability could escalate again in the coming months, particularly if the anticipated fiscal support from the EU Recovery Fund proves insufficient to ease the country's fiscal burden.

Figure 26: Fitch downgraded Italy's sovereign rating to BBB-

Source: Refinitiv Datastream, Eurobank Research

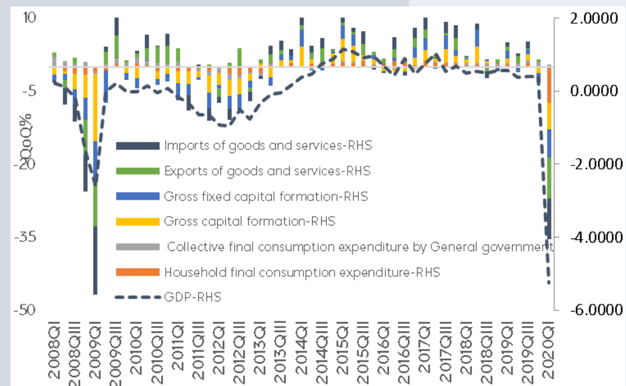
[4] The €25bn fiscal stimulus includes taxes' suspension to households and firms, wage support, and a state guarantee scheme for bank loans

Spain

With only 2 ½ weeks of lockdown, Q1 GDP contracted by a record pace

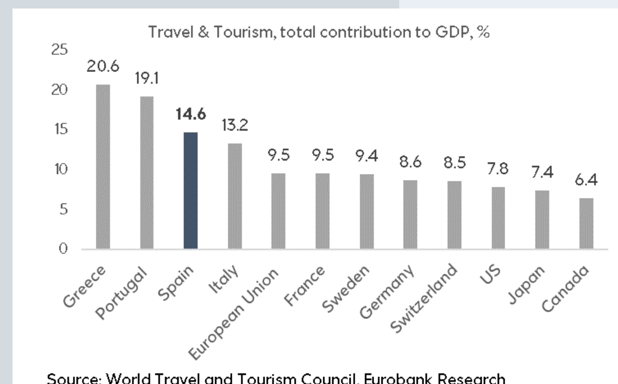
Spain's Q1 GDP contracted by a record pace of 5.2%QoQ, even though the national lockdown was in place for just 2-½ weeks (introduced on 14 March). Domestic demand collapsed sharply, primarily driven by a 7.5%QoQ decline in household consumption, while general government consumption grew by 0.5%QoQ, likely due to healthcare-related expenses. Gross fixed capital formation also contracted sharply by 5.9%QoQ, along with external demand, with exports growth falling by 8.4%QoQ. Looking ahead into Q2, risks are for a pace of contraction at least twice as that in Q1, on the view that only 2-½ weeks were affected by containment measures in Q1 while the said measures were in place in Q2 at least five weeks. The government announced a plan for a gradual ease of the lock-down, comprising of four phases. Starting on 11 May, shops, hotels and restaurants are allowed to reopen but will have to operate at very low capacity. Each phase will last around two weeks and progress towards further relaxation will be dependent on epidemiological, transport and socio-economic data, with a particular focus on the capacity of the Spanish healthcare system, in terms of primary care and intensive care beds. The government's aim is for the economy to return to normality within two months. However, even if all lockdown restrictions are lifted by mid-July, activity is unlikely to return to normality, especially in labor-intensive sectors, including restaurants and accommodation. Importantly, tourism which is a key growth driver for Spain (accounting for c. 15% of GDP), is likely to be among the most gravely hit sectors by the pandemic. It is worth noting that around 50% of tourism arrivals in Spain are foreigners, especially from Germany and France (c. 13% each). Against this background and assuming that lock-down measures are not reintroduced in the winter to avoid a new wave of infections, 2020 GDP is expected to contract by 9.0%, revised downwards from -7.5% previously.

Figure 27: With only 2-½ weeks of lockdown, Q1 2020 GDP contracted by a record pace



Source: Spanish Statistical Office (INE),, Eurobank Research

Figure 28: Tourism, an important growth driver for Spain, is expected to be hit hard from the pandemic



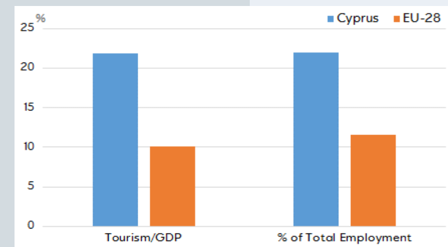
Source: World Travel and Tourism Council, Eurobank Research

Cyprus

Economy confronted with the biggest shock since 2013

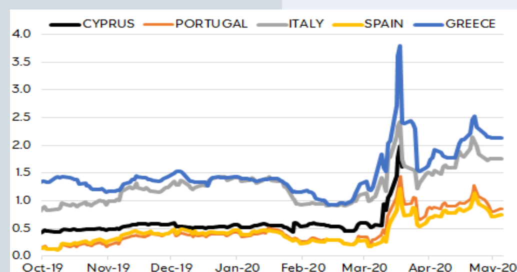
In early April, the Public Debt Management Office (PDMO) sold a combined amount of €1.75bn with a new dual tranche transaction, consisting of a new €1.25bn 7Y and a new €500mn 30Y bonds whereby, the increased gross borrowing needs for 2020 of €3.25bn will be covered. The issues were over-subscribed with total bids amounting to €1.8bn for the 7Y and over €775mn for the 30Y bond while the corresponding yields came at 1.57% and 2.34% respectively. Undoubtedly, under these circumstances, the dual bond issue is a success helping the government to timely secure the much-needed liquidity to finance the budget expansion. First, the relative cheap borrowing costs are rooted both in the ECB intervention through the €750 billion PEPP, but also in the fiscal consolidation efforts of the previous years. Access to the EU Covid-19 related financial aid is very limited. Cyprus is eligible to a €400m loan from the €200bn EIB fund set up for cash-strapped companies and €160m from the EU Commission's €100bn jobless reinsurance plan. Finally, an additional €70mn would come from readjustments to state contributions to the EU budget. Third, timing is of essence given that many governments are lining up for bond issuances while rating agencies are readjusting their assessments. S&P and FITCH have affirmed the long-term sovereign rating of Cyprus at BBB- but the latter revised the outlook from positive to stable in early April. In addition, Moody's changed the outlook of the domestic banking sector from positive to stable. The deepening of the Covid-19 crisis – the second economic shock in less than seven years – finds Cyprus in a position of relative strength. Yet the shock will most probably push the economy to outright recession, given that it is small, open and services oriented with tourism & travel having a substantial direct and indirect contribution (21.9% of GDP, 22% of total employment). The first indication is the crash of the economic sentiment indicator (ESI) in March-April by 37.2 points cumulatively. All sub-indices were in red with the consumer and services registering the biggest declines, plummeting to multi-year lows. The ESI declined below its long-run average, standing at levels comparable to those seen between late 2012 and 1H-2013, at the peak of the previous banking crisis and bail-in events. Under the assumption that the lock-down measures will be gradually phased out in May and there will be a return to normality from June onwards, in our baseline scenario, we forecast that the output losses could be contained at -7.5% in 2020 followed by a strong rebound in 2021.

Figure 29: The contribution of tourism & travel industry is pivotal to the economy



Source: WTCC, Eurobank Research

Figure 30: Long-term Cypriot government bond yields declined on ECB intervention



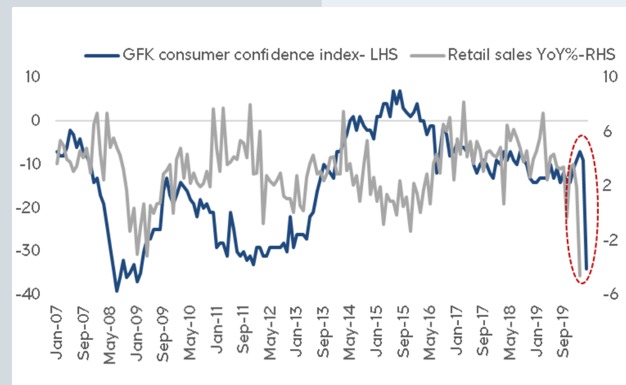
Source: Bloomberg, Eurobank Research

UK

April PMIs imply risks of a record quarterly GDP contraction in Q2

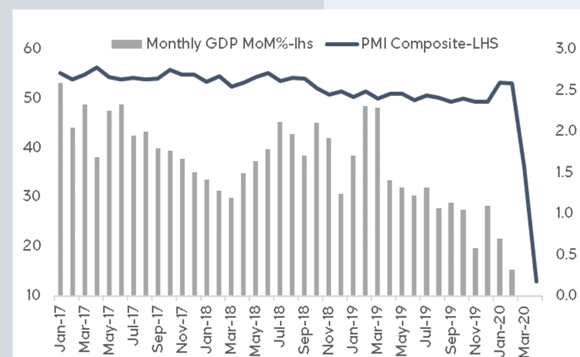
The UK has been in a strict lockdown since 23 March and the government has laid out certain conditions for considering an easing of containment measures. These mostly include a reduction in the number of deaths and new confirmed virus cases, expansion in critical care capacity and a significant increase in social contact infrastructure and testing. Meanwhile, as is the case in other European countries, talks of an exit plan are gathering pace, with PM Boris Johnson announcing recently the government's plan to unveil a roadmap for easing lockdown in early May. However, it may take weeks, if not months, before the government's conditions for a considerable relaxation of containment measures are met, while, the UK ranks fourth globally in terms of infection growth rates and the death toll has jumped to the highest in Europe. Meanwhile, the adverse impact of the lockdown measures on economic activity is already explicitly evident (Figure 23). Retail sales dropped by a record 2.3%YoY in March and the GfK consumer confidence fell from -7 in February to a 12-year trough of -34 in March, the largest monthly drop ever. April's Composite PMI fell by 23pts to a record low of 12.9, with services shrinking at a faster pace than manufacturing, though both headline PMIs plunged at all-time lows. According to HIS Markit, the April PMI survey reading is consistent with GDP falling by approximately 7%QoQ in Q2 but the actual contraction could be even greater, in part because the PMI excludes the vast majority of the self-employed and the retail sector, which have been especially hard-hit by the COVID-19 containment measures. The expected sharp decline in Q2 GDP is anticipated to be accompanied by a hefty decline in corporate revenues and a pronounced rise in unemployment, in spite of the authorities' policy measures to tackle the economic fallout from the pandemic. Should this be the case, the economy's attempt to recover once the pandemic is over may prove subdued, while uncertainty around the future UK/EU relationship will also continue to act as a drag on GDP growth. We downgrade our 2020 GDP growth forecast to -8.0%, the biggest contraction in history, from -5.0% in April as the lockdown is set to last for longer and the path to exit will likely be more gradual than earlier expected.

Figure 31: The adverse impact of lockdown on economic activity is already explicitly evident



Source: ONS, Bloomberg, Eurobank Research

Figure 32: April Composite PMI points to a sharp decline in Q2 GDP



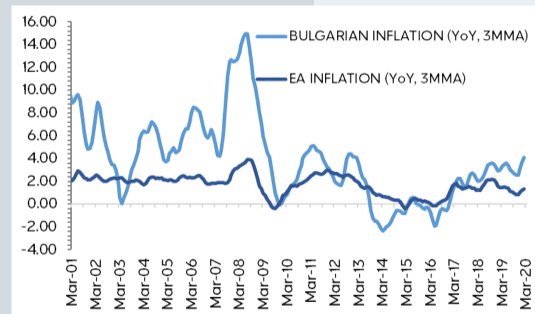
Source: ONS, Bloomberg, Eurobank Research

Bulgaria

Healthy public finance and ERM II entry could lessen the extent of the recession

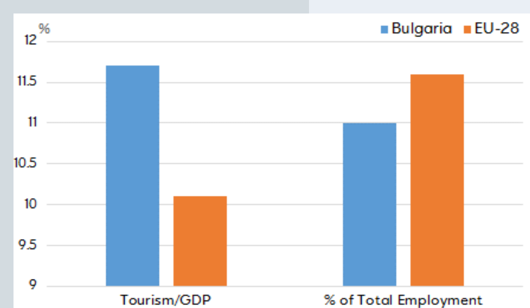
As Covid-19 started to spread in the country in early March, we revised our GDP growth forecasts from 3.2% for FY2020 in February to a -4.5% contraction in 2020 in early April. During the last month, confirmed incidents have climbed to 1,588 from 500. Even though developments and limited hard data during this period leave us cautious regarding the depth of the expected contraction, we maintain our GDP contraction forecast for 2020 unchanged under the assumption that the curve will flatten by the end of May and containment measures will be lifted in H12020. Despite the surge of unemployed people who reached 291,426 in late April, increased by 45% compared to early March, the average number of newly registered unemployed per day, started to decrease after Easter, according to data from the employment agency. We anticipate that the rise in unemployment, regardless how short-lived it may prove to be in an optimistic scenario, will affect private consumption that contributes, expenditure-wise, almost half of the GDP growth for at least the past three years. However, there are some important mitigating factors that could ease the depth of the recession in Bulgaria, compared to the rest of the countries in the region. Primarily, according to recent data from Eurostat, Bulgaria was the country with the second-lowest debt to GDP ratio of 20.4% in the European Union at the end of 2019, following Estonia, while since 2016 the country has been achieving incremental budget surpluses at an average of 1%. Consequently, compared to its peers, Bulgaria has more fiscal room to support the recovery of the domestic demand. On the monetary front, the government appears to have left behind any reservations regarding the Euro adoption as seemed to be the case back in February and is now heading decisively towards the ERM II accession, looking for additional support to counter the economic impact of the pandemic. That said, following a request by the Bulgarian National Bank (BNB), the ECB and the BNB have agreed to set up a EUR2bn swap line to provide liquidity in euro for Bulgaria. The maximum maturity for each drawing will be three months and the swap line will remain in place until 31 December 2020, unless there is need for extension. The swap line will equip the BNB with the necessary EUR liquidity so that it does not resort to its foreign reserves.

Figure 33: Gap between EA's and Bulgaria's inflation widens



Source: Bloomberg, Eurobank Research

Figure 34: Tourism's contribution to economic activity stands below EU28 average



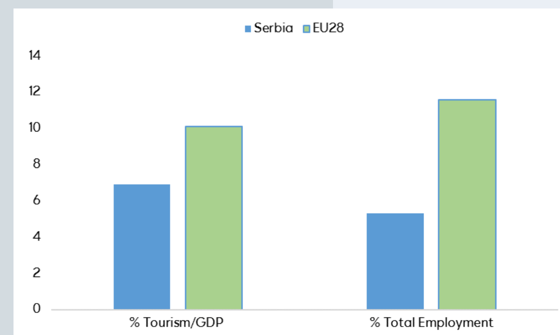
Source: WTCC, Eurobank Research

Serbia

Fiscal stimulus may keep the economy from deep recession but will weigh on public finances

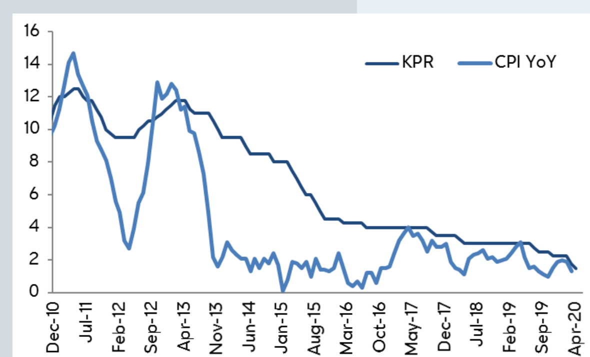
Within one month, confirmed incidents have climbed to more than 9,000 from 1,500 in early April in a country with 7mn population. That said, while the Q4 GDP print in early March stood at 6.2% YoY, the highest since 2008, Serbia's economy, just like almost every other country confronted with the Covid-19 pandemic, is heading towards a recession in 2020, making a U-turn in its growth trajectory after almost 5 years of continuous economic growth at an average rate of 3.1% YoY. However, it is proving complicated to estimate the magnitude of the recession. In support of the prevailing fragility of forecasts, in its Europe and Central Asia spring economic update, released in early April, the World Bank (WB) downgraded its 2020 GDP growth projection for Serbia and expected the economy to contract by -0.5% due to adverse impacts of the COVID-19 pandemic. At the end of the same month, according to its latest Western Balkans Regular Economic Report, the WB revised again downwards its 2020 GDP forecast for the country and currently expects, under its baseline scenario, the economy to shrink by -2.5%. For the time being, we keep our GDP contraction forecast for 2020 unchanged to -2.5%, under the assumption that the curve will flatten by the end of May and containment measures will be lifted within H12020. While we anticipate that exports and investments performance will weigh on the growth output, given the recessionary world economic environment, we expect the large fiscal package worth ca 11% of GDP to act as a backstop to the economic fallout, primarily through the channels of public and private consumption. Nevertheless, such an ambitious fiscal expansion amid economic recession will be mirrored in the rise of the public debt which is forecast to climb to 60% of GDP from 52% as of FY2019. Concluding, parliamentary and presidential elections initially scheduled for April 26th will take place on June 21st. As the time for the lift of the state of emergency approaches, so is the time for elections, with the latest opinion polls continuing to signal that the ruling coalition will retain its parliamentary majority.

Figure 35: Tourism's contribution to economic activity stands below EU average



Source: WTTC, Eurobank Research

Figure 36: Monetary easing continues in efforts to contain the recession



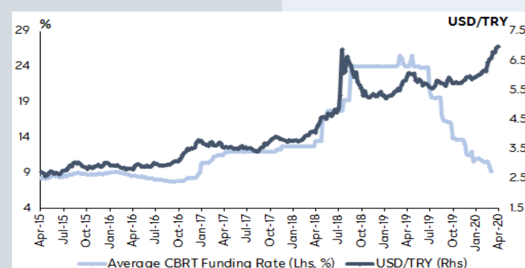
Source: Bloomberg, Eurobank Research

Turkey

Aggressive Central Bank rate cuts continue despite ongoing lira weakness

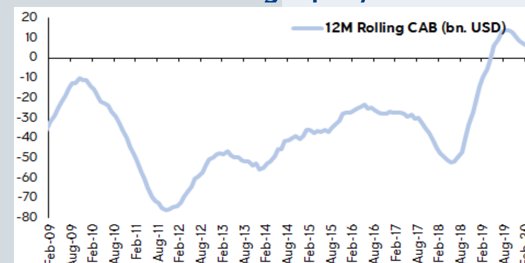
On April 22nd, the Central Bank of Turkey (CBRT) cut its key policy rate (KPR) for the eighth consecutive time, the 1-week repo rateby 100bps from 9.75% to 8.75%, bringing the cumulative easing since July to 1,475bps. The decision was far more aggressive than the relevant surveys' consensus of Reuters and Bloomberg (the median forecast was for a 50bps cut). In the accompanying statement, CBRT underlined that there are increased downside risks to its year-end inflation projection of 8.2% YoY (March: 11.9% YoY), stemming from sharply lower energy prices and weakened domestic demand conditions given the negative impact of Covid19 pandemic, which created the scope for additional easing. In our view, further rate cuts cannot be ruled out in the near future given that the policy mix is currently focused on providing additional support to growth. Further rate cuts are also warranted by the expanionary stance of major Central Banks and the substantially weaker global growth environment. On the other hand, the aggressive monetary policy stance has pushed real interest rates into deep negative territory, stoking up concerns for the lira and for a resurgence in inflation at a later stage. Lira has been on a steady depreciation trend in the last months (currently at 6.98/$ as of April27, -17.5% Ytd). The relatively low, by any metric, FX reserves capacity of CBRT complicate the situation further. Meanwhile, the deepening of the Covid-19 crisis finds the economy in a very fragile position as it had just emerged out of a technical recession in Q4-2019. As of late April, the pandemic has begun to weigh on the economy but the full impact remains to be seen in the coming months. The PMI Manufacturing index declined to 48.1 in March against 52.4 in February, for the first time in three months. The seasonally adjusted manufacturing confidence index dived by 36.9pts in April on top of 8.1pts in March to 62.3pts, which is the steepest decline since Aug-Sep 2018. Accordingly, the services confidence index halved to 46.1pts vs. 92.5pts in March. Although the retail trade confidence decline was softer, the index still fell by 26.5pts to 75.2pts. The seasonally adjusted capacity utilisation rate also slumped by 14.3pps m/m to 61.9% in April. On top, the consumer confidence index dived by 3.3pts on a monthly basis to 54.9pts, the lowest level ever recorded in the data series since 2004, on broad-based deterioration in the financial situation, employment and inflation outlook assessments. The latter reflects the impact of the delayed containment measures, that was not fully captured in the previous month print

Figure 37: Lira on a weakening trend, trading at multi-month lows



Source: Bloomberg, Eurobank Research

Figure 38: Macroeconomic imbalances have been unwinding rapidly in 2018-19



Source: National Authorities, Eurobank Research

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Eurobank Macro Forecasts

	Real GDP (YoY%)			CPI (YoY%, avg)			Unemployment rate (% of total labor force)			Current Account (% of GDP)			General Budget Balance (% of GDP)		
	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f
World	2.9	-2.5	5.0	3.5	2.8	3.2									
Advanced Economies															
USA	2.3	-5.5	4.0	1.8	0.8	1.8	3.7	10.5	8.5	-2.3	-2.6	-2.8	-5.8	-15.0	-9.0
Eurozone	1.2	-7.0	4.5	1.2	0.2	1.1	7.5	9.5	8.5	3.3	3.4	3.6	-0.6	-8.0	-3.5
Germany	0.6	-6.5	6.0	1.4	0.5	1.2	3.2	4.0	3.5	7.6	6.1	7.4	1.4	-7.0	-1.5
France	1.3	-8.0	7.5	1.3	0.6	1.0	8.5	10.0	9.5	-0.8	0.0	-0.4	-3.0	-9.9	-4.0
Periphery															
Cyprus	3.2	-7.5	5.0	0.5	-0.5	0.5	7.1	10.0	9.0	-7.1	-10.0	-9.0	2.8	-4.0	0.0
Italy	0.3	-9.0	4.0	0.6	0.0	0.8	10.0	12.0	10.5	3.0	3.1	3.1	-1.6	-9.0	-4.0
Portugal	2.2	-6.5	5.6	0.3	0.0	1.0	6.5	9.5	7.2	0.0	-0.6	-0.4	0.2	-6.5	-1.8
Spain	2.0	-9.0	6.5	0.8	0.0	1.0	14.1	18.6	17.0	2.0	3.0	2.8	-2.8	-10.0	-6.5
UK	1.4	-8.0	6.0	1.8	1.2	2.0	3.8	6.7	6.0	-2.0	-10.2	-4.5	-2.0	-10.0	-7.0
Japan	0.7	-4.0	2.0	0.5	0.0	0.2	2.4	3.0	2.4	3.6	1.7	1.9	-2.8	-7.0	-3.0
Emerging Economies															
BRICs															
Brazil	1.1	-1.5	2.5	3.7	3.5	3.7	11.9	11.6	10.8	-2.7	-2.8	-3.1	-5.9	-6.5	-5.8
China	6.1	2.5	6.0	2.9	3.3	2.1	3.6	4.1	4.0	1.2	0.8	0.6	-4.9	-5.2	-4.6
India	6.1	1.8	5.0	3.7	4.8	4.0		*NA*		-0.9	-1.0	NA	-3.8	-3.5	-3.4
Russia	1.3	-1.7	2.0	4.5	3.2	4.0	4.6	4.7	4.6	4.8	2.9	2.9	1.5	-5.0	0.5
CESEE															
Bulgaria	3.4	-4.5	3.0	2.5	1.5	2.0	4.2	7.5	6.5	4.0	-2.0	0.0	-1.0	-4.0	0.0
Romania	3.8	-6.5	5.0	3.8	2.5	3.5	3.9	8.5	6.0	-4.7	-4.0	-3.5	-4.1	-7.5	-4.0
Serbia	4.8	-2.5	4.0	2.2	1.0	3.0	13.1	14.0	13.0	-5.8	-6.5	-5.0	0.2	-5.0	-0.5
Turkey	0.7	-4.0	3.0	15.2	10.0	9.0	13.8	13.7	12.9	0.5	-1.0	-1.5	-3.0	-5.0	-4.5

Source: EU Commission, IMF, OECD, Bloomberg, Eurobank Research

Eurobank Fixed Income Forecasts

	Current	June 2020	September 2020	December 2020
USA				
Fed Funds Rate	0.00-0.25%	0.00-0.25%	0.00-0.25%	0.00-0.25%
1 m Libor	0.25%	0.43%	0.37%	0.38%
3m Libor	0.47%	0.83%	0.71%	0.73%
2yr Notes	0.19%	0.26%	0.34%	0.43%
10 yr Bonds	0.67%	0.65%	0.78%	0.90%
Eurozone				
Refi Rate	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.30%	-0.43%	-0.44%	-0.45%
2yr Bunds	-0.78%	-0.70%	-0.66%	-0.63%
10yr Bunds	-0.56%	-0.54%	-0.43%	-0.36%
UK				
Repo Rate	0.10%	0.10%	0.10%	0.10%
3m	0.45%	0.34%	0.28%	0.27%
10-yr Gilt	0.22%	0.30%	0.41%	0.50%
Switzerland				
3m Libor Target	-0.59%	-0.73%	-0.73%	-0.73%
10-yr Bond	-0.56%	-0.53%	-0.49%	-0.45%

Source: Bloomberg (market implied forecasts)

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