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Global economic recovery continues, though the momentum has slowed down, underscoring downside risks to the near-term growth outlook, mainly stemming from the supply shock caused by the war in Ukraine and the reimposition of mobility restrictions in several cities of China under the country's strict zero-Covid policy. Nevertheless, focusing more on restoring price stability against a backdrop of persistently high inflation and rapidly tightening labor markets, most of the major central banks have pivoted towards policy normalization earlier and/or more rapidly than expected only a few months ago, amid concerns about second round effects on wages and de-anchoring of inflation expectations.

Macro Picture

USA: Q1-2022 real GDP fell by 1.4% on Covid-19 resurgence and decrease of government support

EA: Economic activity enters Q2 on a firm footing, but downside risks loom

UK: Growth likely to slow from Q2 onwards amid a significant drag in households' real incomes

EM: The continuing war and China's unabated zero-Covid policy pose growth risks to the downside

CESEE: Protracted war, soaring inflation and bottlenecks in supply chains prove Q2's headwinds

Policy Outlook

USA: Fed attacks inflation more aggressively, on the back of strong growth momentum

EA: Despite growth risks, ECB rhetoric has turned marginally hawkish as inflation is broadening

UK: In spite of looming recession risks, BoE likely to tighten policy further to tame high inflation

CESEE: Central Banks tighten further to tame persistent inflationary pressures

Markets

FX: USD and CHF act as safe havens along with commodity currencies as Russia/Ukraine war rattles markets

Rates: EU and US sharply higher on the back of higher inflation, but growth remains resilient

EM: Assets under heavy pressure in April. Rising inflation expectations and renewed China's lockdowns pose significant risks

Credit: Spreads wider in April, expected to trade in a wide range with increased volatility/dispersion in Q2, on inflation/Ukraine risks

Key Downside Risks

DM: The escalation of the Ukraine crisis, a sharper than anticipated slowdown in China, new infectious variants prompt renewed Covid-19 restrictions, de-anchoring of inflation expectations

EM: Prolonged risk-off sentiment, credit downgrades, low-income sovereign debt restructurings as the portion of distressed debt increases, capital outflows towards DM with local currencies depreciations against major ones

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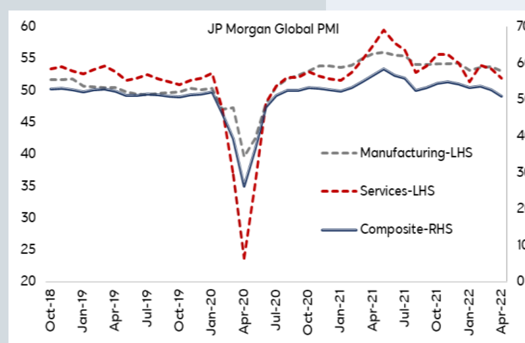
Macro Views

Latest world economic & market developments

Global economic recovery continues, though the momentum has slowed down, underscoring downside risks to the near-term growth outlook

As was revealed in the April global PMIs, economic recovery continues, though the momentum has slowed down, underscoring downside risks to the near-term growth outlook (Figure 1). These mainly stem from the supply shock caused by the war in Ukraine and the reimposition of Covid-19 restrictions in several cities of China following the recent surge in Omicron cases, threatening to exacerbate global supply chain disruptions and raising concerns for slowing growth with potential spillovers to the rest of the world.

Figure 1: Global economic recovery continues but the momentum has slowed down

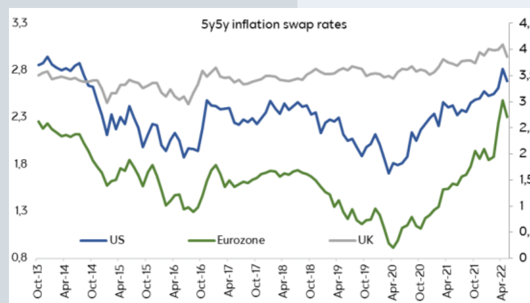


Source: Bloomberg, Eurobank Research

In more detail, the global composite PMI index dropped by 1.7 points to a 22-month trough of 51.0, lower compared to the Q1 average of 53.2. Reflecting robust underlying fundamentals, in spite of the April drop, the index still remained above the 50 points threshold and was in line with the average of the last two years before the outbreak of the pandemic, suggesting that the world economy weathers relatively well so far the impact of the war and the lockdowns in China. The April global PMI slowdown was largely drivey by China's composite PMI which dropped to its lowest level since February 2020, largely because of continuing lookdowns under the country's strict zero-Covid policy.

In the April World Economic Outlook, the IMF argued that the economic damage from the war in Ukraine will contribute to a significant slowdown in global growth amid worldwide spillovers through commodity markets, trade and financial linkages. Real GDP growth is expected to decline from 6.1% in 2021 to 3.6% in 2022 and 2023, by 0.8 and 0.2ppts lower respectively compared to the January projections. On inflation, the Fund argued that price pressures are likely to remain elevated for longer, primarily driven by war-induced commodity increases and broadening price pressures, a view justified by the inflation-related components of the April global PMIs, which revealed that average output prices rose to a fresh record high rate, as companies passed on to consumers a further near all-time high increase in input costs. High inflation has

Figure 2: Inflation expectations keep rising globally



Source: Reuters, Eurobank Research

raised people's concern about their personal financial outlook, acting as a drag on consumer sentiment, which has also deteriorated due to geopolitical uncertainty.

While acknowledging near-term downside growth risks, the mix of persistently high inflation and rapidly tightening labor markets, has encouraged most of the major central banks to pivot towards policy normalization earlier or/and more rapidly than expected only a few months ago. Focusing more on restoring price stability than downside growth risks, several central banks, not just deliver earlier and larger rate hikes, but also move aggressively to reduce their balance sheets, amid mounting concerns about second round effects on wages and de-anchoring inflation expectations, as it has become clear that inflation will remain high for longer than initially expected, while long-term inflation expectations keep rising globally (Figure 2). With markets pricing in higher rates in the coming months in nearly every economy except Russia, a debate has spurred on how far rates will need to rise to bring inflation under control, without triggering a sharp slowdown in economic growth.

Developed Economies

US: In Q1-2022, US real GDP decreased by 1.4% annualized (advance estimate) compared to an increase of 6.9% in Q4-2021. The decline, the first since Q2-2020, largely reflects the resurgence of Covid-19 cases from the Omicron variant along with decreases in government pandemic assistance payments. The drivers of the decline were decreases of net exports, private inventory investment and government spending, which were partly offset by increases in personal consumption expenditures, nonresidential and residential fixed investment. Inflation persists, remaining well-above the Fed's 2% long-run goal, as demand remains strong and supply continues to face constraints, whilst Covid-related disruptions in China and particularly the war in Ukraine put additional upward pressure to prices. The US job market has continued to tighten with the unemployment rate in March at a post-pandemic low of 3.6% and job openings at a series high of 11.5mn. In this context and in line with expectations, at the 3-4 May policy meeting, the Fed raised the fed funds rate by 50bps to a target range of 0.75%-1.00% and will begin QT on 1 June. Looking ahead, the Fed appears determined to use all available means to curb inflation but, amidst the high degree of uncertainty stemming from geopolitical turmoil, it stresses the importance of remaining agile to adjust its policy in light of economic and financial developments.

Euro area: According to the preliminary flash estimate, Eurozone GDP rose by 0.2%QoQ in Q1, in line with ECB expectations. Though the expenditure breakdown is not yet available, preliminary details for France and Spain point to a slowdown in consumption growth mostly due to Covid-19 restrictions at the start of the year, geopolitical uncertainty following the outbreak of the war in Ukraine and elevated inflation. That said, though headline inflation appeared to show tentative signs of stabilization in April, core CPI accelerated by a higher than anticipated 0.8pp to a fresh record high of 3.7%YoY, suggesting that price increases are becoming broad-based and the risk of second-round effects is rising. This holds especially as long-term inflation expectations continue to rise steadily, while the labor market continues to improve rapidly. Looking ahead, some high frequency indicators such as April PMIs, suggest that economic activity entered Q2 on a firm footing. Nevertheless, a plunge in the European Commission's consumer confidence to the second

lowest ever in April mostly due to real income worries linked to high inflation and mounting geopolitical uncertainty, signals risks of a slowdown in economic growth. Against this background, focusing more on restoring price stability than downside growth risks, the rhetoric of several ECB members has moved to a marginally hawkish direction lately amid concerns about second-round inflation effects, increasing the probability of a rate lift-off in the foreseeable future.

Emerging Economies

EM: The continuing war between Russia and Ukraine as well as China's unabated zero-Covid policy leave limited room for optimism regarding the economic outlook ahead. Soaring energy and commodities cost, stemming primarily from the sanctions regime that the war has evoked, evaporate EMs' disposable incomes for consumption to a greater extent than in DMs. In support of the above, in the recently released WEO, the IMF anticipates a wider differential between EMs' and DMs' inflation in 2022 than that foreseen just a couple of months earlier. Specifically, inflation in the EM sphere is forecast to climb to 8.7% in 2022 from 5.9% in January with the relative figures for the DMs standing at 5.7% and 3.9% respectively. Extensive lockdowns in China, which are not expected to wane anytime soon and have already lasted longer than initially anticipated, intensify the disruptions in global supply chains, rattling the production process in many EMs and dampening the economic sentiment worldwide. Adding to the aforementioned headwinds (war and zero-Covid tactic) the Fed's recent tightening and a potential rate lift-off of the ECB rates in the foreseeable future – already discounted by the markets – the picture gets gloomier as capital outflows from fragile EMs towards DMs and increased costs for EMs' debt service are already factored in by many economic agents, in a time when the percentage of low income sovereign debt at or close to distress status, based on IMF estimates, has almost doubled to 60% in the past 6 years.

CESEE: On the same footing with the entire EM sphere, the longer than expected war, the soaring inflation and the disruptions in supply chains, which have not been fully resolved since the peak of the pandemic, create obstacles that are hard to overcome. Q1-2022 GDP growth prints, which have gradually started to be released will most probably not capture the full picture as the deterioration in the economy was more protracted in March, while the positive carry-over effect from 2021's last quarter in some economies assisted as well. Along these lines, Serbia's Q1 GDP flash estimate came in at 4.3% YoY from 7.0% YoY in Q4-2021 surprising to the upside as the market consensus was for a 3.5% YoY expansion. Similarly, in Czechia, GDP expanded by 4.6% YoY in Q1 from 3.6% in Q4-2021, surpassing market expectations. GDP flash estimates for rest regional economies are anticipated from mid-May onwards. Meanwhile, on the monetary front, Central Banks' tightening continues in full swing in an effort to tame the persistent inflationary pressures, as April's annual CPI prints stand above 10% in most of the region's peers. The uncertainty over the course of economic things in the near term is mirrored in both Poland's and Czechia's manufacturing PMIs, which are the sole economies in the region running such surveys and for which both readings came in weaker compared to March, albeit above the 50 benchmark, which separates expansion from contraction.

CESEE Markets Developments & Outlook

Bulgaria

Eurobond yields shot up on all maturities, with similar moves across the entire curve. 2027-2028 tenors saw 77-78bps rises, while the longer maturity bonds, namely the 2030, 2035 and 2050 papers reported 75-91bps spikes. On the short-term spectrum, 2023 shot up to positive levels with a 36bps rise, while the 2024 Eurobonds rose by 63bps. Local papers experienced weak yield spikes with the most active ones being the 8- and 10-year tenors, hitting 10 and 3bps spikes, while the 20-year tenor spiked by 30bps. The Ministry of Finance continued its auction activity after resuming it in March. During April, two auctions were held for EUR250mn each, one on the long-term end and one on the short-term end, namely a 10.5-year tenor, which was withdrawn by the Ministry due to the lack of interest, and a 3.5-year tenor, which was successful.

Even though at least three-quarters of Bulgaria's gas imports come from Russia and the country's gas reserves are filled only up to 17%, the decision of the Russian state-owned company Gazprom to halt gas supplies to Bulgaria, was met with assuasive statements from the government. The Energy Minister, Alexander Nikolov, stated that supplies to customers were guaranteed for at least a month ahead, while the Prime Minister (PM), Kiril Petkov, assured that the country is actively exploring alternative sources, strongly related to the Greece-Bulgaria Gas Connection. The PM said that Bulgaria is negotiating additional quantities of gas from Azerbaijan to be received before the expected completion of the gas connection with Greece, which is anticipated in late June. Furthermore, the government is in advanced talks with the US and Egypt for gas supplies, hoping that natural gas prices from these sellers will not be higher than Gazprom's.

Serbia

After hitting a two-and-a-half-year low at 117.75/80 in March, the dinar stabilized and regained its strength on the back of the Central Bank's restrictive monetary decisions in April. Specifically, the key policy rate hike of 50bps (to 1.50% from 1.00%), along with the Central Bank's interventions in the FX market, resulted in gradual strengthening of the local currency. The EUR/RSD pair lost 0.12% of its value on the monthly basis, finishing the month at 117.60/65.

On the flipside, the fixed income market is still under pressure as global uncertainties continue. Yields of the RSD denominated T-bonds extended their upward trend, increasing by 50-80bps compared to the previous month, with the 4-year, 6-year and 11-year bonds currently trading at 5.00%, 5.30% and 5.80%, respectively.

Markets View

Foreign Exchange

EUR/USD: Amid the Russia/Ukraine war escalation concerns, as well as the ongoing divergence between the ECB and Fed on inflation curbing policy actions, the pair broke lower to reach 1.05 and has remained in the 1.05 - 1.06 range for the past few sessions. While skeptical about how strong a view regarding the future path can be, we retain our bullish bias, with a target setting above the 1.10 territory. We believe ECB has to follow the Fed in curbing inflation, as the necessary policy action. Recent macroeconomic numbers have been the worst of both worlds with slowdown in the European economy and increase in inflationary pressures. 'Stretched' technical levels imply support levels at 1.05 and 1.03.

EUR/GBP: Recession fears in the UK have triggered a heavy sell-off of the GBP especially post the BoE rate announcement. Talks regarding the European embargo on oil imports from Russia have added to the pressure and have led the pair towards the 0.8550 level. We stay bullish on the pair, with a target level of 0.86 and higher, while also setting the 0.90 level as the most probable medium-term target.

Rates

EU: Rates rose sharply in April after a very volatile month. At the time of writing 10yr swaps are trading at 1.80% up from 1.20% at the start of April. The slope of the curve has remained stable with 5s-30s trading at 3bps, and hovering around zero for most of the month. The 2s10s continued to steepen as traders kept paying the belly of the curve (10y), with the hiking cycle ahead of us and the market trying to force the ECB's hand as it has remained behind the curve compared to the Fed. Looking forward, we expect rates to remain volatile and eventually rise further but at a slower pace, as tighter monetary policy makes it harder for countries like Italy to cope with their towering debts.

US: Rates closed April significantly higher across all tenors. The 10yr swap rate is trading at 3.12%, up from 2.45%, another very large monthly move. The slope of the curve remained anchored, with 5s30s trading inverted at -20bps for most of the month. The curve has flattened sharply bringing most tenors up to 20yrs at around the same level as a significant number of hikes is priced in despite the Fed taking 75bps hikes out of the table. Looking forward, we expect rates to remain volatile and eventually rise further as inflation remains elevated, but the pace of the rise should slow as we approach quickly the Fed's terminal rate.

Emerging Markets Sovereign credit

The global macro and geopolitical environment remained challenging for EM assets with bond markets suffering significant outflows as US rates and the USD continued to rise. The EMBI Global Index closed at 378 bps at the end of April, 30 bps wider on the month. CEEMEA was the worst among EM regions. Russia avoided a default by sending the dollar payment for the bond due on 4th April 2022 just before the end of the 30 days grace period on the 4th of May, while the Central Bank of Russia lowered its key policy rate by 300bps to 14%. The EUR- and USD-denominated Hungarian government bond spreads rose significantly, as the country appears increasingly at odds with the European Union over rule-of-law issues, as well as regarding new sanctions on Russia. In LatAm, inflation continued to surprise to the upside in Brazil, while EUR-denominated hard currency Mexican sovereign bonds suffered some heavy losses with the 5y tenor underperforming. In Asia, China's policy of Zero Covid and subsequent lockdowns have been a drag on growth and EM spreads. On April 26, President Xi chaired the 11th meeting of the Central Committee for Financial and Economic Affairs (CFEA) and called for all-out efforts to build a modern infrastructure system. We remain on the sidelines concerning EM duration as inflation expectations keep rising and concerns about China's growth persist, with rising US rates and a stronger USD providing extra headwinds.

Corporate credit

EUR investment grade bond spreads on most rating grades and sectors were +5/+20bps wider in the past month (ending 5/5/22). CDS Index spreads were on average +20/+25bps wider in investment grade and +110bps wider in high yield. Widening was led by the very worrying mix of Russia/Ukraine ongoing war and higher rates/inflation prints, but also additional Covid-19 worries resurfacing in China. Fed already in a steep hiking path, and ECB is expected to follow very soon. Sector-wise, in EUR IG, Financials were +24bps wider, Real Estate +35bps wider, Energy +15bps wider, Health Care +4bps wider, Telecoms +11bps wider, Industrials +7bps wider, Consumer Goods +9.5bps wider, Utilities +11.5bps wider, Technology +11bps wider and Basic Materials +6.5bps wider. US IG names spread were +12/+21bps wider in the same period, mostly in line with EUR ones. Specifically, Financials were +14.5bps wider, Real Estate +16bps wider, Energy +17bps wider, Health care +16bps wider, Telecoms +20bps wider, Technology +16bps wider, Industrials +15bps tighter, Consumer Goods +12bps wider, Utilities +18bps wider, while Basic Materials were +21bps wider.

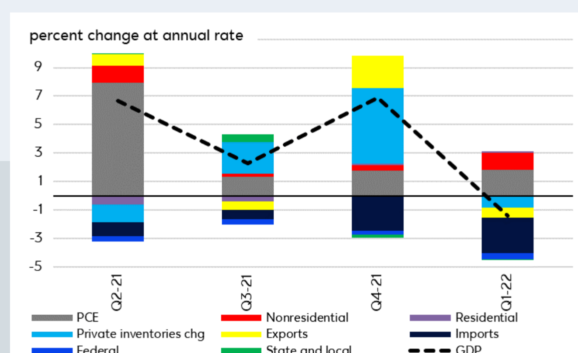
Rating-wise, EUR IG spreads in BBB were +19bps, in A +8.5bps, in AA +5bps, and in AAA unchanged. In the EUR HY universe CCC spreads were +85bps, B were +90bps, while BB were +55bps. In the USD IG space spreads in BBB were +19bps, in A +11.5bps, in AA +9bps, and in AAAs +9bps. Ukraine war continuation coupled with severe inflation fears, CBs reactions as well as Covid-19 risks, are already inducing very high volatility in the market. Key issue is the scarcity of liquidity with spread moves being abrupt and violent. We expect elevated spread volatility to persist in the short and medium term. Additionally, we expect already high spread dispersion to persist, as this is a progressively weakening environment for credit. We expect spreads to trade wider and in a wide range, with EUR ones marginally more affected by the Ukraine war and the expected macro weakness. The potential backstop of high cash on the sidelines might cap the widening of higher quality names, while all-in-yield levels might also induce buyers' interest in current and higher levels.

US

Fed attacks inflation more aggressively, trusting the strong growth momentum

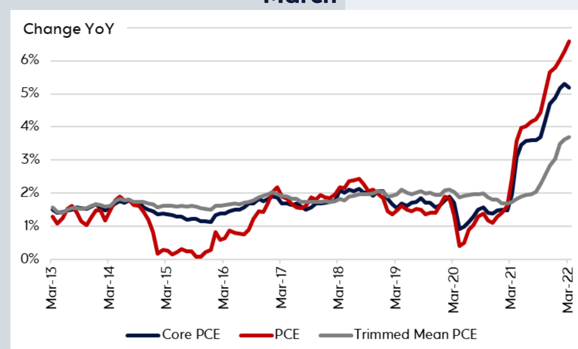
In Q1-2022, real GDP decreased by 1.4% annualized (advance estimate) compared to an increase of 6.9% in Q4-2021. The decline, the first since Q2-2020, is largely due to a resurgence of Covid-19 cases and decreases in government pandemic support. The drivers of the decline were a significant increase in imports (+17.7%) indicating strong domestic demand, coupled with a notable fall in exports (-5.9%), reflecting faltering foreign demand, as well as decreases in private inventory investment and government spending. The negative impact was partly offset by increases in personal consumption expenditures (PCE), nonresidential and residential fixed investment (Figure 3). In fact, PCE – the largest component of GDP (c. 70%) – grew at the fastest pace in three quarters, due to considerable increases in durable goods and services consumption. Nevertheless, the slower pace of increase in February and March, after a strong rebound in January, may be a harbinger for a more cloudy outlook ahead. Inflation persists (Figure 4) remaining well-above the Fed's 2% long-run goal, as demand remains strong and supply continues to face constraints, whilst price increases are more widespread (core PCE 0.3%MoM/5.2%YoY in March). The Covid-related disruptions in China and particularly the war in Ukraine, put additional upward pressure to prices and exacerbate the element of uncertainty going forward. The US job market has continued to tighten, with the unemployment rate in March at a post-pandemic low of 3.6% and job openings at a series high of 11.5mn, meaning that the number of vacancies per unemployed worker stands at a record high of 1.9. In this context and in line with expectations, at the May policy meeting, the Fed raised the fed funds rate by 50bps to a target range of 0.75%-1.00% and will begin QT on 1 June. Looking ahead, although Fed Chair Powell fended off the prospect of a 75bp hike for the time being, he confirmed that 50 bps rate hikes are on the table for the next couple of meetings. Overall, the tone of the Fed remains broadly hawkish, as the central bank appears determined to use all available means to curb inflation, while retaining the discretion to adjust its policy in light of economic and financial developments.

Figure 3: Q1 GDP decline driven mainly by net exports and inventories



Source: US Bureau of Economic Analysis, Eurobank Research

Figure 4: Inflation persists but may have peaked in March



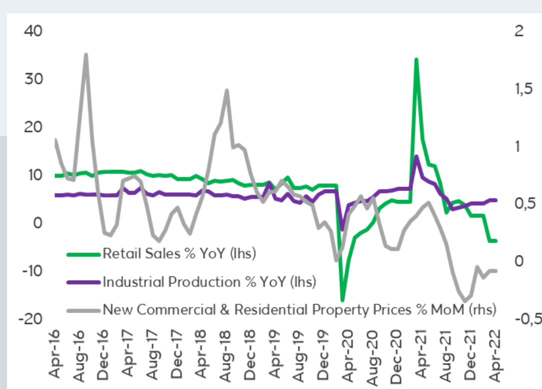
Source: Bureau of Labor Statistics, Federal Reserve Bank of Dallas, Eurobank Research

China

Clouds ahead amid longer than expected lockdowns

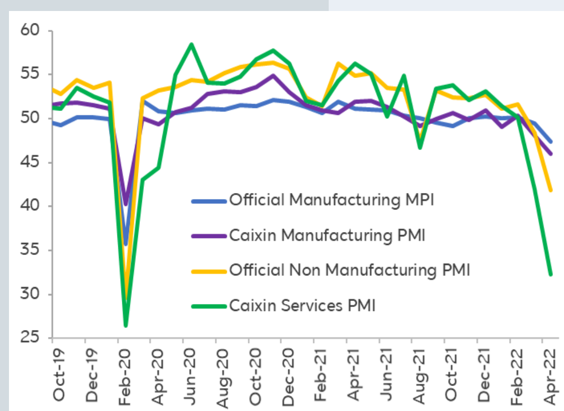
Q1-2022 GDP growth rate came in at 4.8%YoY from 4.0%YoY in Q4-2022 and stood above the market consensus at 4.2%YoY. While the growth print for Q1 appeared robust, hard data in March point to some loss of steam in the economy with the deterioration continuing throughout April. The key elements behind the cooling are the incremental lockdowns in the last couple of months due to the Omicron strain resurgence. Retail sales recorded a negative growth rate for the first time since mid-2020, dropping by -3.5% YoY in March, while the real estate market continues to send corrective signals, as prices of commercial and residential new built properties continue to decrease on a monthly basis for 15 months in a row. Doubtlessly, the massive lockdowns in major cities, such as Shanghai, that have lasted longer than initially thought and the unabated zero-Covid policy, have already weighed on the economic performance and their toll will most probably continue to swell, as is evident in the forward-looking PMIs. April's prints reflect the disappointment in market participants for the near-term outlook. The official non-manufacturing PMI tumbled to 41.9 from 48.4 in March and the manufacturing PMI slid by 2.1 points to 47.4, with both readings being the next worst since February 2020, when the pandemic spread. On the same footing, the April Caixin manufacturing PMI declined to 46 from 48.1 in March. Along these lines, the People's Bank of China announced a 25bps RRR cut for almost all banks with the size of the reduction being smaller than expected, as it was the first time the said ratio was trimmed by 25bps instead of a multiple of 50bps as usual. The reluctance of policy makers for a bolder move reveals the worries about imminent inflation risks, despite the modest recent readings (1.5%YoY in April vs 0.9%YoY in both February and January). The persistently elevated geopolitical tension with the huge imprint on energy markets will at some point inevitably transfer some price pressure to China as well, from energy and commodities imports.

Figure 5: Continuing loss of steam in the economy...



Source: Bloomberg, Eurobank Research

Figure 6:...weighs on the expectations of the economic agents for the outlook ahead



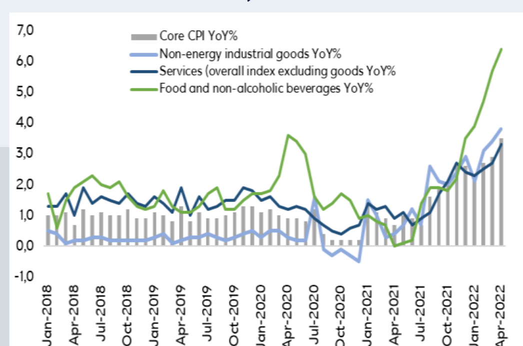
Source: Bloomberg, Eurobank Research

Euro area

Economic activity enters Q2 on a firm footing, but downside risks loom

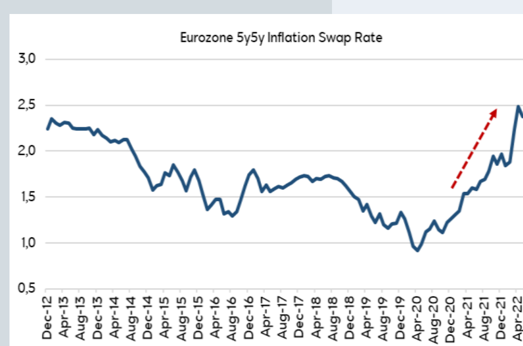
According to the preliminary flash estimate, Eurozone GDP rose by 0.2%QoQ in Q1, in line with ECB expectations, lifting output slightly above its pre-pandemic level. Though the expenditure breakdown is not yet available (due for release with the third estimate on 8 June), preliminary details available for France and Spain point to a slowdown in consumption growth mostly due to extended Covid-19 restrictions at the start of the year to address the Omicron wave, increased uncertainty following the outbreak of the war in Ukraine as well as elevated inflation. That said, though headline inflation appeared to show tentative signs of stabilization in April after the steep upward trajectory in recent months (up by just 0.1pp to 7.5%YoY, amid a slight deceleration in energy prices and government interventions to cap energy prices), core CPI accelerated by a higher than anticipated 0.8pp to a fresh record high of 3.7%YoY, suggesting that price increases are becoming broad-based (Figure 7) and the risk of second-round effects is rising. This holds especially as long-term inflation expectations continue to rise steadily (5y5y inflation swap rate at a more than a decade high of 2.4% in early May), while the labor market continues to improve rapidly (the unemployment rate dropped by a further 0.1pp to a new all-time low of 6.8% in March, well below the European Commission's natural rate of unemployment estimate, after hitting a peak of 8.6% in August 2020). Looking ahead, some high frequency indicators such as April PMIs, suggest that economic activity entered Q2 on a firm footing. The composite PMI unexpectedly rose from 54.9 to a seven-month high of 55.8 in April. Manufacturing PMI fell (-0.7pts to 55.5) pressured by high energy prices, weakening demand and intense global supply disruptions, while services PMI rose more than expected (+2.1pts to 57.7) reflecting continued reopening effects after several Covid-19 restrictions were lifted. Nevertheless, a plunge in the European Commission's consumer confidence to the second lowest ever in April (-22), signals risks of a slowdown in economic growth mostly due to real income worries linked to high inflation and mounting geopolitical uncertainty. Against this background, focusing more on restoring price stability than downside growth risks, the rhetoric of several ECB members has moved to a marginally hawkish direction lately amid concerns about second-round inflation effects, increasing the probability of a rate lift-off in the foreseeable future.

Figure 7: Price pressures are broadening out, and…



Source: Eurostat, Eurobank Research

Figure 8 : … long-term inflation expectations continue to rise steadily



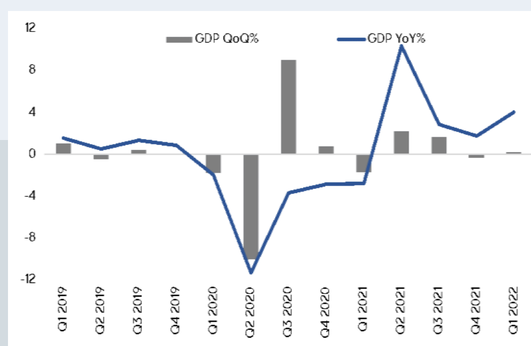
Source: Reuters, Eurobank Research

Germany

Technical recession avoided but growth outlook clouded

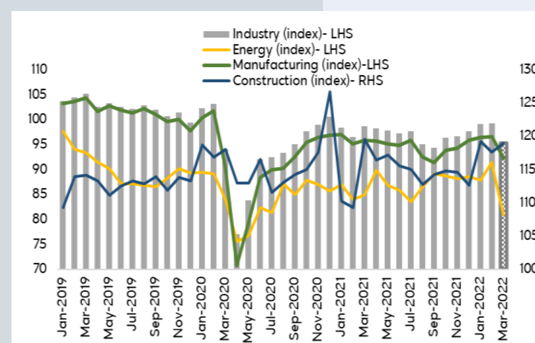
According to the flash estimate, Q1 GDP grew by a slightly higher than expected 0.2%QoQ after a 0.3%QoQ contraction in Q4 2021, suggesting that the German economy avoided a technical recession (Figure 9). On an annual basis, Q1 GDP grew by 4.0%, a hefty rebound from 1.8% in the prior quarter due to basis effects as Q1 GDP 2021 (-2.8%YoY) was massively hit by the pandemic-induced decline in the services sector and retail trade. While the detailed breakdown has yet to be released (due on 25 May), the Federal Statistical Office reported that net exports were a drag on economic growth, while the largest positive contribution came from investment, without however clarifying whether this was inventory or fixed investment. On consumption, it did not provide any information and pointed out that "the economic consequences of the war in Ukraine have had a growing impact on the short-term economic development since February", highlighting uncertainty of the Q1 GDP flash estimate, as several March data indicators were not yet available. One important driver for economic activity in Q1 is likely to have been IP, which expanded in January and February (+1.4%MoM and 0.1%MoM, respectively), supported by a modest easing of supply shortages and a positive carry-over effect from Q4 2021. However, March data published a few days after the flash Q1 GDP estimate, showed that support from IP to overall activity has faded as it fell substantially (-3.9%MoM), marking the first negative figure in the last six months on the back of renewed disruptions in supply chains following the outbreak of the war in Ukraine (Figure 10). In view of the lockdown measures in China which likely intensified supply bottlenecks and the sharp drop in forward-looking components of the April manufacturing PMI (i.e., orders below 50 for the first time since June 2020), IP is likely to remain under pressure in the coming months. Adding to downside risks for GDP growth in the short-term, persistently high inflation (CPI at a fresh 40-year high of 7.4%YoY in April) and a drop of the consumer confidence indicator GfK to a new record low in April (-26.5) on geopolitical uncertainty and concerns about personal finances, pose headwinds to private consumption, even though some business surveys such as the April services PMI remained surprisingly buoyant (+1.8 points to 57.9) on easing Covid-19 restrictions. For 2022, the government now projects GDP growth at 2.2%, down from 3.6% expected in January.

Figure 9: The German economy avoided a technical recession…



Source: Federal Statistical Office, Eurobank Research

Figure 10 : ..but Q2 GDP growth prospects look gloomy as support from IP starts to fade



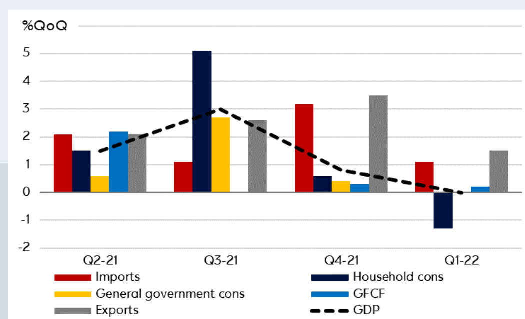
Source: Federal Statistical Office, Eurobank Research

France

Soft data point to increased activity in April, but demand may weaken ahead

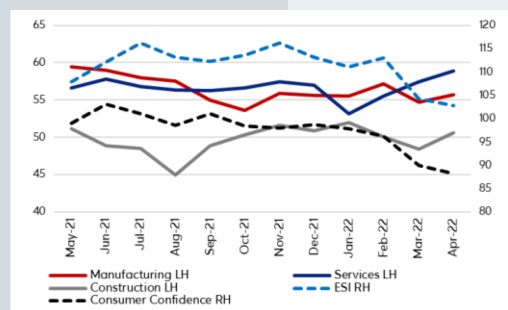
Incumbent President Emmanuel Macron secured a second term in the presidential elections in April, becoming the first President to be re-elected in France in 20 years. His lead over his opponent Marine Le Pen, was however, significantly lower than in the 2017 elections, whilst the analysis of the electoral result reveals deep divisions across the French society. Focus now turns to the parliamentary elections in June, as the President will need the support of the Assemblée nationale in order to get laws passed. Moving on to economic developments, Q1-2022 GDP stagnated after a deceleration of 0.8%QoQ in Q4-2021 and a rebound of 3.0%QoQ in Q3-2021 (Figure 11). The Q1-2022 result was caused by a significant reduction in households' consumption (-1.3% from +0.6%), while gross fixed capital formation slightly decelerated (+0.2% from +0.3%). Overall, internal demand excluding inventory changes, had a negative contribution of -0.6pts to GDP growth, after +0.5pts in Q4-2021. Foreign trade continued to expand but at a slower pace. The increase of exports was higher (+1.5% after +3.5%) than that of imports (+1.1% after +3.2%) and thus the contribution of net trade to GDP growth was slightly positive (+0.1pts from +0.0). Beyond Q1, soft data paint a mixed picture (Figure 12). In April, the Economic Sentiment Indicator contracted for the second month in a row (-1.4pts), but at a noticeably milder pace compared to March (-8.8pts). Consumer confidence (INSEE synthetic index) continued to decline, coming in at 88, well below the long-term average (100). April PMIs indicate expansion of production across all sectors. In manufacturing (PMI at 55.7 from 54.7 in March), activity grew on the back of new orders growth, with several clients placing advanced purchases in anticipation of increased prices and supply disruptions. In services, (PMI at 58.9 from 57.4 in March) demand continued to rebound amid fewer restrictions. Finally, in construction, activity returned into expansionary territory (PMI at 50.6 from 48.4 in March), but only marginally and driven exclusively by civil engineering activity, as construction work fell. Overall, despite the improvement of activity in all sectors, the outlook is weighed by sustained price pressures and supply difficulties, while risks are tilted to the downside with respect to demand.

Figure 11: GDP stagnated in Q1-2022 due to a decline in household consumption



Source: INSEE, Eurobank Research

Figure 12: April soft data paint mixed picture for outlook ahead



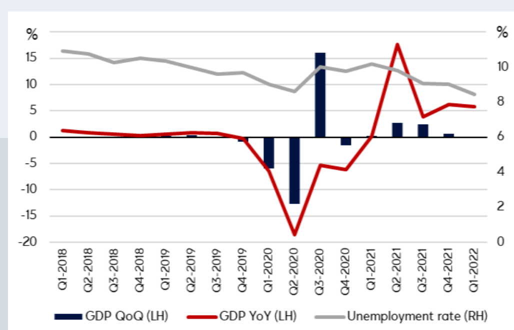
Source: European Commission, S&P Global, INSEE, Eurobank Research

Italy

Headwinds more pronounced in industry and construction heading into Q2

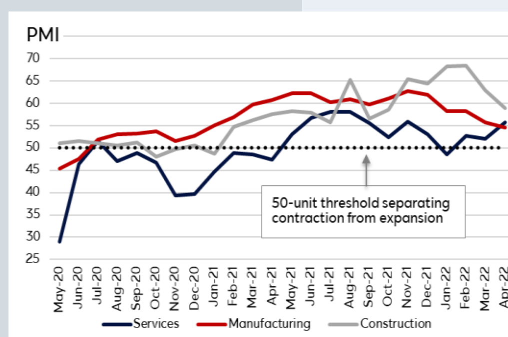
According to the preliminary estimate, Q1-2022 real GDP declined by -0.2% on a quarterly basis – for the first time since Q4-2020 – down from +0.7% in the prior quarter (Figure 13) and decelerated on an annual basis, growing by +5.8% against +6.2% in the previous quarter. The quarterly drop was due to a decline of value added in services, potentially due to the surge in Covid-19 cases because of the Omicron variant in that period. The primary sector (agriculture, forestry and fishing) grew at a positive rate, whilst industry recorded no change. From the demand side, there is a positive contribution by the domestic component and a negative one by the net export component. Despite the slow down in economic activuty, unemployment continued to decline in Q1 (Figure 13), and in March it stood at 8.3%, declining for the fifth month in a row, with employed perons increasing and unemployed persons decreasing for five consecutive months. Industrial production and construction rebounded noticeably in February with the relative indices increasing by +14.4%MoM and +3.9%MoM respectively. Beyond the first two months of the year however, soft data paint a less rosy picture in these sectors. The S&P manufacturing PMI dropped for the second month in a row in April, at 54.5 from 55.8 in March and 58.3 in February (Figure 14), the weakest level of expansion since June 2020. Accordingly, growth in the construction sector slowed to a six-month low in April with the S&P construction PMI falling to 59 from 62.9 in March and 68.5 in February (Figure 14). Both the manufacturing and the construction sectors struggle with supply shortages, inflated costs and dampened demand due to the war in Ukraine, while confidence for the period ahead has weakened in view of mounting uncertainty. Meanwhile, retail trade continued to contract for the second month in a row in February, but at a much less vigorous pace, with the index of retail trade sales dropping by -6.2%MoM from -25.9%MoM in January. Services soft data were more upbeat in April however, with the S&P services PMI registering 55.7 from 52.1 in March (Figure 14), as activity growth and new work accelerated to five-month highs, while the pace of job creation was the strongest since July 2007. Should the services sector continue to be resilient, boosted by a good performance of the tourism sector, it could support the economy as we move into the second quarter of 2022.

Figure 13: Q1-2022 GDP contracts QoQ, but unemployment keeps decreasing



Source: ISTAT, Eurobank Research

Figure 14: Manufacturing and construction struggle, services more resilient into Q2



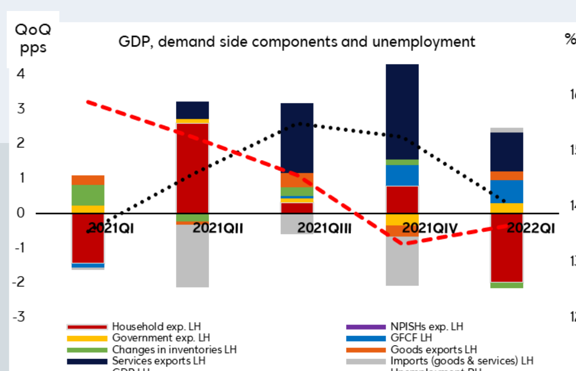
Source: S&P Global, Eurobank Research

Spain

Headwinds slow activity but a potential rebound in tourism can support growth

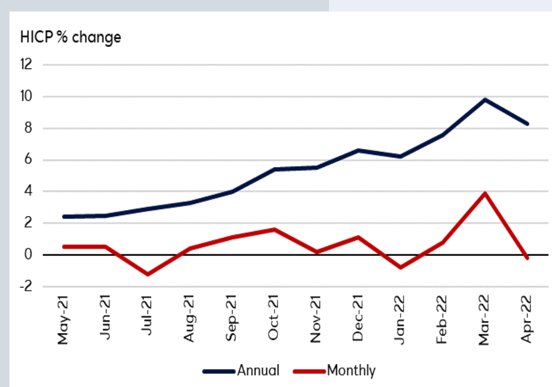
In Q1-2022, Spanish real GDP increased by 0.3%QoQ, 1.9pps lower than in Q4-2021, driven primarily by foreign demand, with exports of services contributing 1.1pps and exports of goods 0.3pps, aided by the postitive contribution of imports of goods and services (+0.1pps) (Figure 15). On the flipside, domestic demand subtracted 1.2pps from the quarterly growth rate due to the negative impact of private consumption and particularly that of households (-2pps), which was only partially offset by investments (+0.7pps) and government consumption (+0.3pps). On an annual basis, GDP grew by 6.4% in Q1-2022, compared to 5.5% in the previous quarter. The unemployment rate for the said period increased from the previous quarter to 13.7% from 13.3% in Q4-2021, after declining for five consecutive quarters (Figure 15). Manufacturing activity in April recorded the weakest overall improvement since February 2021, (PMI at 53.3 from 54.2 in March) dragged by recent transport strikes, uncertainty over the ongoing war in Ukraine, inflation concerns and fewer new orders. The slow down is also mirrored in the March industrial production index, which fell by 1.8%MoM, driven by declines in the production of all goods categories, except non-durable ones which rose marginally. On the other side, the services sector enjoyed a strong month in April (services PMI jumped to 57.1 – best reading since Nov-21 – from 53.4 in March), amid looser Covid-19 restrictions. Price increases remain a source of conrcern in both the manufacturing and the services sectors. That said, the advance HICP reading for April indicates that inflation may have peaked in March, as the montlhy change was negative (-0.2%) for the first time after two months, while the annual change was noticeably lower (8.3%) than in the previous month (9.8%) (Figure 16). Overall, it appears that the clouds on the horizon are thickening as the war in Ukraine continues and supply problems persist. The recovery of tourism – which exhibited a strong dynamic in February and March – may serve as a counterweight, but the price increases and the war could deter potential visitors going forward.

Figure 15: GDP drops, unemployment picks up in March



Source: INE, Eurobank Research

Figure 16: Inflation may have peaked in March



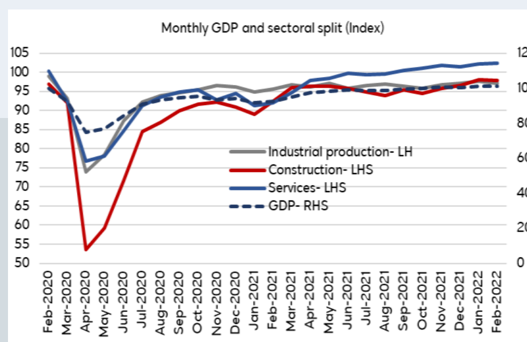
Source: INE, Eurobank Research

UK

Growth likely to slow from Q2 onwards amid a significant drag in real incomes

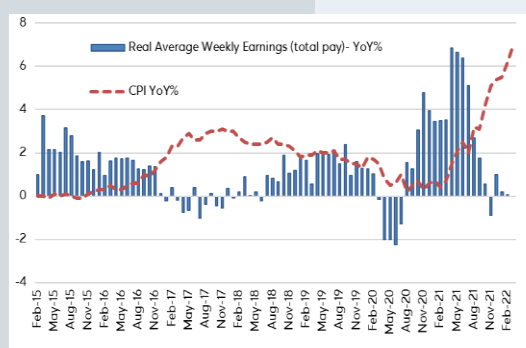
According to the latest data, GDP grew by a lower than expected 0.1%MoM in February, a marked slowdown following a strong rebound of 0.8%MoM in January, which came after an Omicron-induced contraction of 0.2%MoM in December (Figure 17). Services was the key growth driver (+0.2%MoM) led by consumer-facing services (+0.7%MoM), especially tourism related activities and accommodation, reflecting a rebound in activity following the pandemic resurgence in December and January. The gain in services was partially offset by a decline in construction (-0.1%MoM) due to the impact of Storm Eunice, which hit the UK in mid-February and a drop in industrial production (-0.6%MoM) driven by manufacturing and, in particular, lower car production amid lingering supply shortages. February GDP points to a carry-over for Q1 at 1.0%, suggesting that — barring material revisions — the BoE's Q1 GDP growth forecast of 0.9%QoQ is likely to be beaten, on the assumption of another modest gain in March, amid expectations for some further recovery in consumer-facing services as Covid-related effects dissipate further. However, for the remainder of the year the economic environment looks more challenging, and we expect economic growth to slow sharply, as the higher cost of living takes a toll on households' real disposable incomes. In combination with persistently high inflation (CPI accelerated to a fresh 30-year peak of 7.0%YoY in March), BoE monetary tightening and the war-induced sharp increase in commodity prices, as of April, the energy regulator Ofgem is set to increase the energy price cap by 54%, while a 1.25% National Insurance levy is also scheduled to be imposed. Accumulated savings (6.8% in Q4 2021) and fiscal policy stimulus for household income, in effect since October (0.8% of GDP), should provide some support, but are not expected to prevent a further squeeze in households' real incomes. Not surprisingly, GfK consumer confidence dropped further in April to its second lowest on record (-7 points to -38), while real average weekly earnings have declined sharply (Figure 18). Meanwhile, the BoE delivered the fourth rate hike in a row in May that took the Bank Rate to 1.0% from 0.75% and, despite its concerns over a looming recession risk due to the cost-of-living crisis, it left the door open to further tightening in the foreseeable future amid a tight labour market and risks of de-anchoring of inflation expectations.

Figure 17: February GDP was weaker than expected but Q1 GDP likely to outperform BoE expectations



Source: ONS, Eurobank Research

Figure 18: The higher cost of living takes on a toll on households' purchasing power



Source: ONS, Eurobank Research

Cyprus

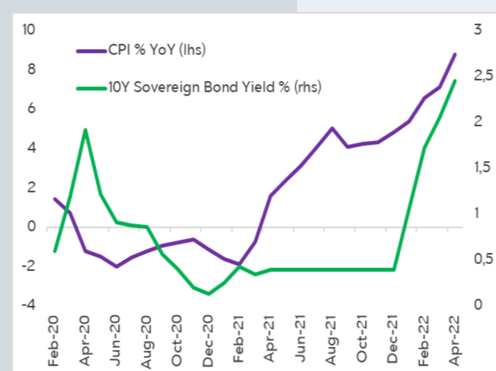
Positive carry over effect from Q4-2022 will fuel Q1-2022 GDP print, but thereafter challenges loom

The Q4-2021 GDP growth print at 6.4% YoY implies a positive carry over effect into Q1-2022 which, however, may not be enough for the economy to continue on such a solid footing in 2022, given the obstacles ahead. Industrial production continued to expand by 3.4% YoY in February, albeit at a slower pace compared to January (+5.2% YoY), while unemployment in March continued to lie below 2-year lows as it slid further to 5.9% from 6.3% in February and 8.2% one year ago. On the same footing, tourist arrivals in March increased more than tenfold on an annual basis in 2021 and doubled compared to March 2020, when the pandemic had just started to kick in outside China. All in all, the current level of arrivals so far in 2022 approaches 70% of those in 2019, which was until recently set as the benchmark year for return to normality, i.e. as to pre-pandemic levels. However, the ongoing dispute between the West and Russia over the latter's invasion in Ukraine bodes adversely for such an accomplishment, considering the traditionally high share of Russian tourists arriving to Cyprus (ca 20%). The hit on tourism but also on services, as Cyprus disciplines so far with the sanctions imposed against Russia at an EU level, will take their toll on the economy, which may however not be clearly visible yet in the Q1-2022 GDP growth print, due in mid-May. The spiraling prices add negatively as well to the outlook, with inflation accelerating to 8.8%YoY in April, up from 7.1% in March, bringing the year-to-April average change to 7.0% from 4.8% in FY2021. Private consumption will be dampened through the trim on the disposable income by inflation, as evident on the volume of retail sales in March that contracted by 2% YoY. Along these lines, we revise our forecast for 2022 a bit lower, i.e. to 2.3% from 2.5% in the previous month on the grounds that, inter alia, the substitution of Russian arrivals with alternative markets will need time beyond 2022. Concluding on a positive tone, in April, DBRS Morningstar upgraded the sovereign credit rating from BBB (low) to BBB, and changed the trend from positive to stable, on the grounds of stronger-than-anticipated growth and public finances during 2021 and supportive conditions for debt reduction in the medium-term.

Figure 19: The pivotal role of tourism in the Cypriot economy put under stress..

Source: CYSTAT, Bloomberg Eurobank Research

Figure 20: ...and the inflationary pressures that mount cloud the outlook ahead



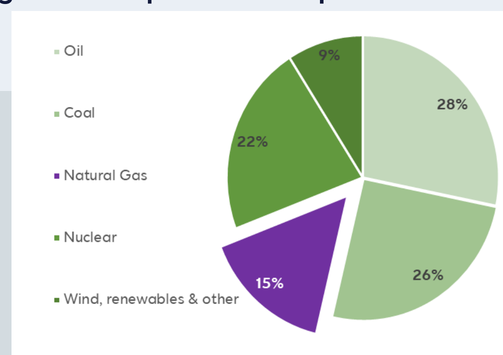
Source: Bloomberg, Eurobank Research

Bulgaria

The natural gas halt from Russia adds to the already elevated pressure on the economy

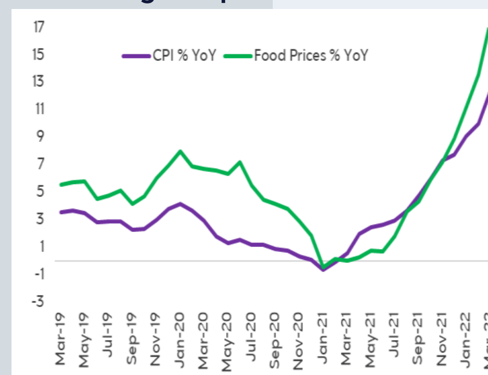
The geopolitical tension escalated further in late April as the Russian state-owned Gazprom informed officials in Poland and Bulgaria that it will suspend natural gas deliveries towards the said countries effective from May onwards, given their continuing payments in euros instead of rubles as Russia had requested in late March. Despite the high energy dependency of Bulgaria on Russia, with the latter being the source of close to 90% of Bulgaria's imports in natural gas, the government stated that no restrictions on gas consumption are on the table for the time being and alternative sources are already being explored. Towards that end, Bulgaria is aiming at diversifying its energy portfolio by increasing the amounts of gas imported from Azerbaijan through Greece, with the required infrastructure for the supply expected to be operational in September. Additionally, the limited use of natural gas - it accounts for 15% of the country's total energy basket, with the remaining 77% consisting of oil, coal and nuclear sources - eases partially the worries over the effect of the gas supply halt on the economy. The said energy suspension found the economy at a soft spot, as inflation keeps soaring for almost 12 months in a row, with March's print reaching 14-year highs. CPI climbed to 12.4%YoY in March, reaching July 2008 highs, from 10.0%YoY in February and 9.1%YoY in March on the back of energy and food prices galloping. Other recent economic hard data also leave limited room for optimism; retail sales picked up by 6.6%YoY in February, decelerating from 11.1%YoY in January. Beneath the slump we read the trim on the disposable income from inflation and the uncertainty from the war, which sparked off around that time. In the same month, industrial output growth slowed down to 14.5%YoY, easing from 17.2%YoY in January, while on a monthly basis, it decreased by 0.8%, contracting for the first time since May 2021. This economic landscape combined with the ongoing geopolitical turmoil urged national authorities such as the Ministry of Finance and the Central Bank of the country, as well as IFIs, such as the IMF and the WB to bravely undercut their GDP forecasts for 2022 and partially for 2023 in April. Similarly, we stick to our 2.6% and 2.8% estimates for 2022 and 2023 respectively, following the downgrade in our previous issue, with risks tilted to the downside as regards GDP growth and to the upside as regards inflation.

Figure 21: The limited use of natural gas mitigates the impact from Gazprom's halt….



Source: Our World in Data, Eurobank Research

Figure 22: …but the continuing price pressure on vital goods poses serious risks



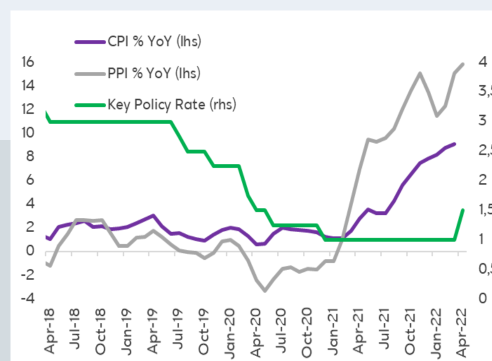
Source: NSI, Eurobank Research

Serbia

Q1-2022 flash estimate points to firm GDP growth but risks loom ahead

GDP growth rate flash estimate came in at 4.3%YoY in Q1-2022, surprising to the upside as the market consensus was for a 3.5%YoY expansion. While the lack of further breakdown of national accounts obscures the drivers of growth, the average 10.6% increase of retail sales in Q1 suggests that private consumption held firmly. However, the continuity of the momentum in Q2-2022 is questionable given the persistently increasing inflation that trims the disposable income, suggesting that part of the increased retail sales in Q1-2022 could be attributed to stockpiling under the fear of unabating inflation.

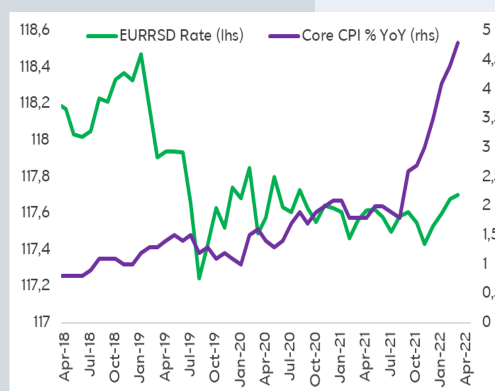
Figure 23: The Central Bank entered last the tightening circle in the region…



Source: Bloomberg, Eurobank Research

In March, CPI came in at 9.1%YoY from 8.8%YoY and 8.2%YoY in February and January respectively and while the core print in March increased more mildly compared to the headline print (4.8%YoY from 4.4YoY in February), implying that expectations over higher prices are not yet thoroughly entrenched, April's PPI continued to increase by 18%YoY from 14.5%YoY on average in Q1, clouding further the prices outlook and its impact on both the supply and demand side. However, the fact that real wages growth remains positive supporting consumption remains encouraging. It accelerated to 4.2%YoY in February from 3.9%YoY in January with the nominal increase reaching 13.4%YoY in February from 12.4%YoY one month before. Along these lines, in its April's Monetary Policy Committee (MPC) meeting, the National Bank of Serbia (NBS) decided to raise the key policy rate (KPR) by 50 bps to 1.50%. The hike was the first since February 2013 with Serbia being the last economy in the region with unchanged key interest rate policy during the past 12 months as all other regional banks had already initiated the tightening cycle. The increase was broadly anticipated by markets with some more tightening factored in for 2022 as inflationary pressures are not expected to wane anytime soon. The under-discussion EU oil embargo against Russia could push energy prices even higher translating into higher CPI prints in the months to come, despite the privileged pricing Serbia enjoys in its natural gas imports from Russia and which will have to be reviewed, based on the existing purchasing contract, in the end of 2022. Concluding, despite the solid Q1-2022 GDP performance, impasses lie ahead for the remaining of the year with risks tilted to the downside regarding GDP growth and to the upside as regards inflation.

Figure 24: ..while supporting the dinar and keeping, thus, inflation expectations from de-anchoring



Source: Serbian Statistics Office, 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)		
	2021	2022f	2023f	2021	2022	2023f	2021	2022f	2023f	2021	2022f	2023f	2021	2022f	2023f
World	6.1	3.5	3.4	4.7	5.9	3.6									
Advanced Economies															
USA	5.7	3.1	2.1	4.7	6.9	3.0	5.4	3.6	3.5	-3.5	-3.7	-3.5	-10.2	-4.8	-4.2
Eurozone	5.4	2.8	2.4	2.6	6.5	2.4	7.7	7.3	7.2	2.5	2.3	2.3	-5.1	-4.0	-3.0
Germany	2.9	2.2	2.7	3.2	6.6	2.7	3.6	3.5	3.3	6.7	6.0	6.1	-3.7	-3.3	-1.6
France	7.0	3.1	2.1	2.1	4.6	2.3	7.9	7.3	7.1	-0.9	-1.4	-1.3	-7.0	-5.2	-4.2
Periphery															
Cyprus	5.5	2.3	3.2	2.2	6.5	3.0	7.5	7.7	7.0	-7.6	-9.0	-8.0	-1.8	-1.5	-1.0
Italy	6.6	2.7	2.0	2.0	6.1	2.0	9.5	8.9	8.6	3.3	2.0	2.2	-7.2	-5.5	-4,0
Portugal	5.4	4.9	2.5	0.9	4.1	1.6	6.6	6.1	5.9	-0.7	-1.2	-1.3	-2.8	-3.1	-2.4
Spain	5.1	4.7	3.2	3.1	6.9	2.1	14.8	13.5	13.1	0.9	1.1	1.4	-7.0	-5.7	-4.3
UK	7.2	3.8	1.6	2.6	7.2	3.4	4.6	4.0	4.0	-3.4	-3.5	-3.6	-7.6	-4.0	-2.7
Japan	1.8	2.1	1.8	-0.3	1.5	0.9	2.8	2.7	2.5	2.8	1.8	2.2	-6.4	-6.5	-4.5
Emerging Economies															
BRICs															
Brazil	4.8	0.5	1.6	8.3	8.4	4.4	13.6	11.6	11.1	-1.6	-1.0	-1.3	-5.1	-7.5	-6.9
China	8.1	4.8	5.1	0.9	2.2	2.2	4.4	4.0	3.7	2.0	1.5	1.1	-3.8	-4.7	-4.5
India	8.8	7.5	6.5	5.4	6.0	4.9		*NA*		-1.5	-2.7	-2.3	-6.9	-6.5	-6.0
Russia	4.7	-10.3	-1.5	6.7	19.0	11.2	7.5	7.0	6.0	6.5	9.7	6.5	0.4	-2.5	-2.0
CESEE															
Bulgaria	4.2	2.6	2.8	3.3	10.4	5.1	5.5	5.5	5.5	-0.4	-1.8	0.7	-4.1	-5.5	-3.5
Serbia	7.0	3.0	35.	4.1	7.7	4.7	10.1	10.4	9.5	-4.4	-5.5	-5.3	-4.2	-3.0	-2.0
Turkey	11.0	3.0	3.3	19.4	60.0	25.0	12.0	12.5	12.8	-2.2	-3.8	-2.6	-3.4	-4.0	-2.8

Sources: European Commission, IMF, OECD, Bloomberg, Eurobank Research

Eurobank Fixed Income Forecasts

	Current	June	September	December	March
USA					
Fed Funds Rate	0.75-1.00%	1.17-1.40%	1.71-1.95%	2.09-2.40%	2.40-2.65%
3m SOFR	1.19%	1.05%	1.56%	1.97%	2.29%
2yr Notes	2.72%	2.57%	2.69%	2.74%	2.82%
10 yr Bonds	3.15%	2.64%	2.71%	2.76%	2.84%
Eurozone					
Refi Rate	0.00%	0.00%	0.05%	0.15%	0.35%
3m Euribor	-0.43%	-0.47%	-0.36%	-0.15%	0.1%
2yr Bunds	0.32%	0.00%	0.06%	0.16%	0.31%
10yr Bunds	1.14%	0.57%	0.64%	0.69%	0.78%
UK					
Repo Rate	1.00%	1.10%	1.25%	1.35%	1.45%
3m Sonia	1.12%	1.00%	1.16%	1.34%	1.48%
10-yr Gilt	2.00%	1.65%	1.72%	1.78%	1.85%
Switzerland					
3m Saron	-0.70%	-0.73%	-0.73%	-0.66%	-0.50%
10-yr Bond	0.97%	0.54%	0.58%	0.66%	0.74%

Source: Bloomberg (market implied forecasts)

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