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The global economy enters Q4 with positive momentum, primarily driven by the unexpected resilience of the US economy. However, widening sectoral divergences, persistent regional imbalances, escalating geopolitical tensions and softening labour market conditions in most developed markets have raised concerns about how long this will continue for. At the same time, inflation continues to trend down, allowing major central banks to shift toward less restrictive monetary policy stances. In fact, the global easing cycle is already well underway across various regions and is expected to gather pace in the coming months, helping to mitigate the downside risks to growth.

Macro Picture

USA: GDP upward revisions and stronger income fundamentals align with soft landing narrative

EA: growth likely decelerated further in Q3 while inflation concerns are easing

China: policy in flux to boost the economy and reverse the dampened sentiment

Japan: new prime minister says his government will continue to focus on raising real wages

CESEE: fiscal slippages in key economies from heightened geopolitical risk and elections

Markets

FX: EUR/USD lower towards 1.09; focus on Middle East escalation and US November elections

Rates: volatility in EU and US rates expected to persist after strong US NFP report

EM: sovereign spreads tighter amid the start of Fed cutting cycle and China's stimulus

Credit: cash credit continues to rally, with EUR HY cash outperforming

Policy Outlook

USA: markets scale back expectations for aggressive Fed rate easing after strong payrolls

EA: rising expectations for ECB cut in October amid weak growth outlook and faster disinflation

Japan: BoJ cautious over further rate hikes, waiting for confirmation of US soft landing

CESEE: idiosyncratic risks tap the brake on further monetary easing and stretch public finances

Key Downside Risks

DM & EM: Middle East conflict escalates into a broader regional confrontation, sharply higher commodity prices and market-based inflation expectations, lingering uncertainty over China's growth prospects, material changes in trade policy dependent on the outcome in the US elections

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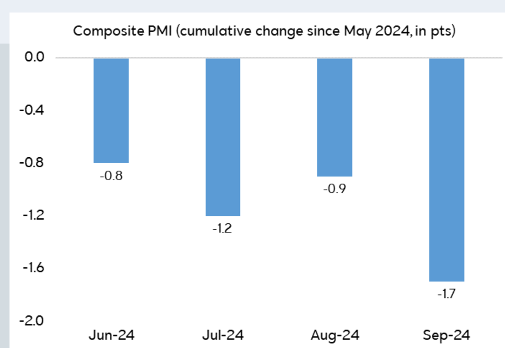
Macro Views

Easing inflation allows major central banks to shift toward a less restrictive policy stance as near-term growth risks threaten continuing economic momentum

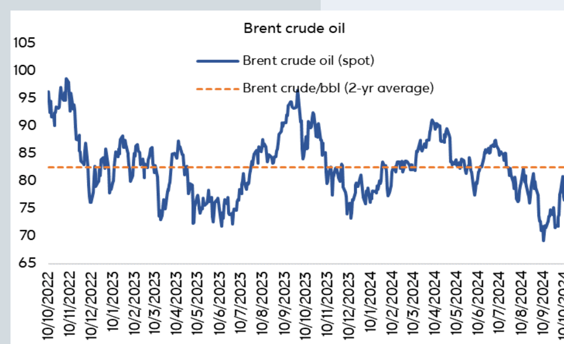
The global economy enters Q4 with positive momentum, primarily driven by the surprisingly strong performance of the US economy. This optimism persists despite continued weakness in the global manufacturing sector, as evident in the latest PMI survey, which showed a third consecutive month of contraction in September (-0.9pts to 48.8) following a brief rise above the threshold of 50 earlier this year. Factors likely contributing to this decline include political uncertainty ahead of the November US presidential elections, ongoing cyclical and structural challenges in Germany's industrial sector and concerns over China's growth prospects (prior to new stimulus announcements). Meanwhile, the global services PMI continued to expand, albeit at a slower pace (-0.9pts to 52.9), raising worries that the sector may be feeling the effects of the manufacturing slowdown. Consequently, the composite PMI dropped by -0.8pts to 52.0, with emerging markets, particularly India, faring better than developed economies, especially the Eurozone where activity lagged. Despite this decline, the level of the September composite PMI still indicates continued expansion for the 11th month in a row and points to a solid global growth pace of around 2.8%, not far below its historic average. Even so, the cumulative 1.7pts drop in the composite PMI since May, widening sectoral divergence, persistent regional imbalances and a sharp decline in key forward-looking indicators, such as new orders and future output, raise concerns about the near-term global growth. Softening labour market conditions around developed markets in recent months (with the notable exception of the Eurozone, despite lacklustre growth), also poses downside risks. Additionally, rising geopolitical tensions in the Middle East have heightened concerns about global growth in Q4 and beyond. Fortunately, so far these tensions have not yet significantly impacted economic activity, as reflected by oil prices, which, though off recent lows, are still below year-to-date averages, suggesting that an oil price shock is not considered the base case scenario.

Figure 1: Sharp cumulative drop in composite PMI since May fuels concerns over near-term growth



Source: Bloomberg, Eurobank Research

Figure 2: Despite the recent rise, Brent crude prices remain below the 2-yr average



Source: Reuters, Eurobank Research

Meanwhile, the disinflation trend has remained intact in recent months, with both headline and core inflation significantly down from their 2022 highs. In August, headline inflation eased further (OECD index at 4.7%YoY, down from 5.4%YoY in July), driven largely by a renewed drop in consumer energy prices. Core inflation, while still elevated due to persistently high services inflation, also edged lower, though more gradually (OECD index at 5.2%YoY, down from July's 5.5%YoY%). Undoubtedly some caution remains over whether inflation is sustainably moving toward target, but the risk of large upside surprises has likely dissipated.

As inflation concerns continue to recede, growth risks have come into sharper focus, allowing major central banks to shift toward a less restrictive policy stance. Indeed, the global easing cycle is already underway across various regions and is expected to gather further steam in the coming months, helping to mitigate downside growth risks.

Developed Economies

US: September's stronger-than-expected non-farm payrolls reversed much of the labour market weakness observed during the summer months, aligning with the BEA's latest GDP revisions which indicated that the economy has been expanding faster than previously estimated from Q1 2019 to Q1 2024. This upward adjustment was largely driven by consumer spending and fixed investment, accompanied by even larger revisions in gross domestic income (GDI), reflecting stronger wealth and income fundamentals. Consequently, market confidence has grown that the labour market remains fundamentally solid, despite gradual easing, and earlier fears of a sharp US downturn were probably overstated, with the economy appearing to be on course for a soft landing, which could enable the Fed to take a more cautious approach to rate easing than previously anticipated. US forward rates now assign around 50bps of Fed rate easing by December and 145bps cumulatively by late 2025 compared to expectations of 65bps and 190bps, respectively, before the release of the September payrolls report.

Euro area: Incoming data have raised concerns that, as inflation worries are gradually fading, the economy is set for further deceleration in Q3. This follows already modest GDP growth of 0.3%QoQ and 0.2%QoQ in Q1 and Q2, respectively, with prospects likely to remain lacklustre in Q4. Hard data is equally discouraging. Meanwhile, disinflation is accelerating. September's flash HICP fell by 0.4ppts to 1.8%YoY, below the ECB's 2.0% target for the first time in over three years, largely due to lower energy inflation. Core inflation also eased, slipping to 2.7%YoY from 2.8%YoY as services inflation fell by 0.1ppts to 4.0%YoY, driven by the fading Paris Olympics effect. Easing inflation concerns, combined with increasing downside growth risks and recent dovish comments by President Christine Lagarde to the European parliament, have raised expectations of a more aggressive ECB rate easing cycle than previously anticipated. Investors are almost fully anticipating a third 25bps rate cut at the upcoming 17 October meeting, compared to a probability of around 40% in late September.

Emerging Economies

EM: focus shifts towards the Middle East and fears over a further escalation of the conflict. On Tuesday, October 1, Iran launched 200 missiles at Israel, with the latter's military response in the coming days, considered certain as stated by Prime Minister Benjamin Netanyahu. As expected, the escalation rattled oil markets with the price of Brent on Thursday registering its biggest daily gain (+5%) since the beginning of the year. Additional focal point of concern remains the ailing status of the Chinese economy, following a series of gloomy economic data releases. The data came on top of an understanding since early 2024 that the economy is ailing from structural issues and subdued demand. Against this background, a raft of monetary easing actions was declared, yet markets are not convinced yet that policy makers have delivered the optimum mix of economic policy. That was witnessed in the recent slide in equity markets and to halt and reverse it, the Ministry of Finance will hold an ad hoc press conference on October 12 over “intensifying countercyclical” adjustments to fiscal policy.

CESEE: regional central banks (CBs) are confronted with different risk profiles among the CEE3 plus Romania and this was reflected in the decisions of the latest MPCs. In Poland, the Key Policy Rate (KPR) was kept at 5.75% for an eleventh month in a row, in line with market expectations. CPI inflation surged to 4.9%YoY in September from 4.3%YoY in August on the back of swelling energy prices that kept on increasing on double-digit prices since July 2024. Milder, though persistent, inflationary pressures in both Hungary and Czechia allowed for additional cuts in October, which brought the benchmark interest rates at 6.5% (from 6.75%) and 4.25% (from 4.5%) respectively. The CB of Romania held fire in this month’s session and kept the KPR steady at 6.5%. Despite the decrease in the latest available CPI print, inflation remained elevated at 5.1%YoY in August (vs 5.4%YoY in July). Pressures stemming from increased wages and the expansionary fiscal policy could result in another hold decision by the CB, which could abide the time for presidential elections in late November to be completed.

Markets View

Foreign Exchange

EUR/USD: continued lower towards the 1.09 territory, further validating the reversal at the start of the month. Volatility a bit higher mostly due to Middle East conflict escalation and US elections ahead. Support levels include 1.0850, 1.0620 and 1.0580, while resistance levels include 1.1080,1.1120 and 1.12. Implied volatility for 1M, 6M and 9M currently at 7.4875%, 6.435% and 6.235% respectively.

EUR/JPY: JPY based carry trades range traded after the big sell-off during the previous couple of months, but nervous in terms of both implied volatility and fundamentals. Eyes are mostly on the new Japanese prime minister's policies. Implied volatility is still at high levels compared to its past history. EUR/JPY, currently at around 162, could potentially break out towards 165 as the next resistance stop, or retrace down to 155 or even below. Support levels include 156.5091, 155.7187 and 154.9282 and resistance ones the 165.3168, 166.1352 and 166.9536. Implied volatility for 1M, 6M and 9M is currently at 11.485, 10.655% and 10.27% respectively.

Rates

EU: swap rates saw notable shifts following a volatile month. As of October 7, the 5yr swap is currently trading at around 238bps after reaching a low of 214bps earlier in the month. The curve's slope has slightly steepened, with the 5s-30s spread at -7bps, an increase from -9bps at the start of September, though it hit a high of 7bps. Looking ahead, we expect rates to decline further, as the market has already priced in a 25bp rate cut at the next ECB meeting, driven by weaker-than-expected economic data. However, volatility is likely to remain elevated, as the ECB reiterated in its last meeting that it is not committed to any specific policy path.

US: swap rates ended the month significantly lower. As of October 7, the 5yr swap rate is now trading at 353bps, down from 365bps at the start of August, although it had reached a low of 310bps earlier in the month. The curve has steepened, with the 5s-30s spread at -10bps, up from -12bps, after hitting a high of 10bps. Looking ahead, we expect US rates to remain above recent lows, as the economy continues to show strong labour demand, with job openings exceeding expectations according to JOLTs August data. The front end of the curve has now ruled out the possibility of a 50bps rate cut, shifting towards the Fed's baseline of two 25bps cuts by the end of the year.

Emerging Markets Sovereign Credit

There was a strong performance for EM fixed income in the final month of the third quarter, boosted by a 50bps cut by the Fed and some significant stimulus announcements from China. New escalations in the Middle East had a minimal effect on spreads. The EMBI Global Index is almost 30bps tighter than at the end of August and stood at 312bps as of October 7. In the Middle East, the clearer underperformer were the Israeli bonds, with the external debt spreads rising to new highs after the escalation of the conflict between Israel and Hezbollah. However, emerging interest from investors buying the dips kept the levels relatively contained, with the short-end EUR bonds closing approximately 30bps wider from the end of August. Turning to central Europe, Bulgarian and Serbian EUR bonds were the best performers (10yr spreads at 30bps and 15bps tighter respectively for the observation period), with the latter also getting the IG rating upgrade from the S&P at the start of October. Polish government bonds, on the other hand, were the underperformers, with the 10yr EUR spread ending slightly wider at 80bps. In LATAM, spreads ended tighter, helped also by the sharp rise of US rates after the strong NFP numbers on October 4. Mexican and Chilean USD spreads ended more than 10bps tighter than at the end of August. The start of the Fed's cutting cycle, along with China's stimulus, will probably keep maintain support for EM assets. However, we are cautious as the geopolitical risks are rising and spreads remain relatively rich.

Corporate Credit

Financial markets ended up defying the usual "September effect" as prospects for central bank cuts helped support a risk-on move. At the end of August, Fed Chair Powell said at Jackson Hole that the time has come for policy to adjust. The Fed went on to deliver a 50bps rate cut at their September meeting, marking the first cut since March 2020. The decision to cut by more than 25bps was taken as a sign that the central bank would react quickly to any economic deterioration, and as a result markets moved to price in a more rapid easing cycle. Meanwhile in Europe the ECB moved to cut rates by 25bps in mid-September, followed by 25bp cuts in Sweden and in Switzerland. Against this backdrop, risk as-sets advanced post-central bank actions, but put in a weaker performance later on amid data indicating that recent economic performance was stronger than previously thought, offering contrary signs against an imminent downturn (e.g. US Q2 GDP revised up to show annualized growth of +3%, headline PCE inflation slightly below expectations, above-consensus jobs report). Heightened geopolitical tensions in early October, after an Iranian missile strike against Israel, led to a broader market selloff. Against this backdrop, European equities were slightly lower as of October 7 compared with the end of August (Stoxx 600 -1.1%), alongside a 1.0% decline for the CAC 40 and mild gains for the DAX (+0.9%). Over in the US, equities advanced during this period, with the S&P 500 +1.8% led by tech stocks (Magnificent 7 +5.9%). Oil prices saw their worst monthly performance in almost two years in September but recovered in early October (+0.7% from the end of August to > $79/bbl. Safe haven assets also rose, with gold exceeding $2,600/oz (a fresh all-time high in nominal terms).

In credit, European synthetics widened, underperforming compared with the US. Since the beginning of September, Main widened by +5.8bps while Xover closed +25.1bps wider (vs. CDX IG +3.5bps, CDX HY

+8.2bps). Cash remained well supported, despite increased activity in the primary market. In EUR Corporate cash, IEAC was -3bps during this period, with IHYG -11bps during the same period. Sector-wise, there were no notable outperformers and underperformers in the IG space. In High Yield, Snr Financials outperformed (-200bps), while Technology was the biggest laggard (+60bps). The European primary market saw in-creased activity following the summer lull, with total issuance in September exceeding €180bn (vs. €101bn in August). October remains active amid benign conditions with total monthly issuance in excess of €17bn as of October 7.

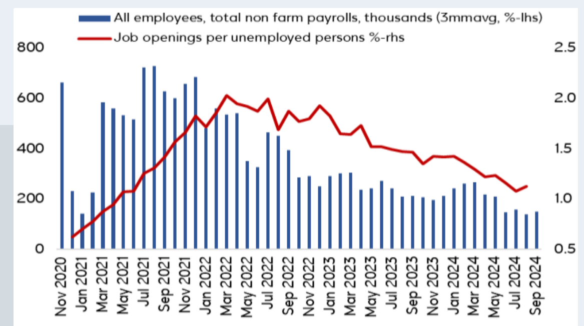
While markets remain data-driven and the main focus continues to be on central banks, increasing attention is being placed on the upcoming US elections in early November and geopolitical developments in the Middle East. Investors have priced out the probability of a 50bp Fed cut at the November meeting, expecting a 25bps cut instead following a blockbuster non-farm payrolls report in early October. After the October 10 CPI report, attention shifts to the upcoming central bank monetary policy decisions (ECB on October 17; Fed on November 7) and US elections (November 5). Cash credit continues to rally, with EUR HY cash outperforming. The Q3 earnings season kicks off on October 11 with large US banks.

US

Markets scale back expectations for aggressive rate cuts after strong payrolls

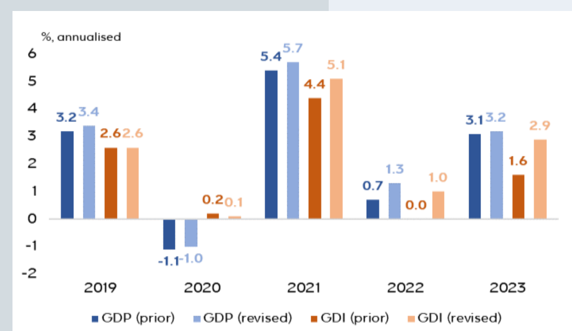
September's stronger-than-expected non-farm payrolls reversed much of the labour market weakness observed during the summer months, aligning with the BEA's latest GDP revisions which indicated that the economy has been expanding faster than previously estimated from Q1 2019 to Q1 2024. This upward adjustment was largely driven by consumer spending and fixed investment, accompanied by even larger revisions in gross domestic income (GDI), a conceptual equivalent to GDP measured using data from the income side of the accounts. These revisions, which reflect stronger wealth and (non-wage) income fundamentals, boosted savings and helped alleviate concerns that household spending might experience a sharp decline as savings would be exhausted (savings up to 5.2% in Q2 2024, nearing pre-pandemic levels of 6-7%). Consequently, market confidence has grown that the labour market remains fundamentally solid, despite gradual easing, and the economy still has momentum, in line with Chair Powel's remarks at the September post-FOMC press conference. Earlier fears of a sharp US downturn were probably overstated, with the economy appearing to be on course for a soft landing, which could enable the Fed to take a more cautious approach to rate easing than previously anticipated. Specifically, non-farm payrolls rose by a robust 254k in September, with a cumulative upward revision of 72k for the prior two months, raising the 3mmavg to 186k/month, up from 140k/month in August. Additionally, the unemployment rate fell for the second consecutive month, dipping 0.1ppts to 4.1%, below the Fed's 4.2% projection of the median longer-run unemployment rate, as household employment gains (430k) outpaced the labour force increase (150k). Average hourly earnings also surprised to the upside, rising 4.0%YoY from an upwardly revised 3.9%YoY in August, surpassing the Fed's inflation-consistent target of around 3.5%YoY. Strong wage growth, paired with the upward revision in household income and savings from the GDP benchmark revisions, points to resilient consumer spending — the key US growth driver — as reflected in retail sales which unexpectedly rose 0.1%MoM in August following a strong 1.1%MoM increase in July. Against this background, US forward rates now assign around 50bps of Fed rate easing by December and 145bps cumulatively by late 2025 compared to expectations of 65bps and 190bps, respectively, before the release of the September payrolls report.

Figure 3: Labour market conditions are easing, but only slowly



Source: BLS Eurobank Research

Figure 4: GDP and GDI revisions point to faster expansion and stronger income fundamentals



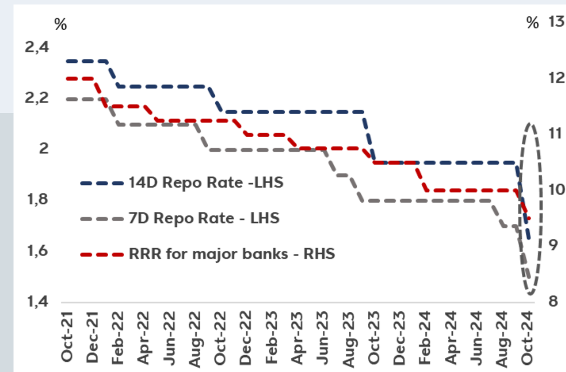
Source: BLS, Eurobank Research

China

Policy makers yet to convince markets over adequacy of fiscal stimulus

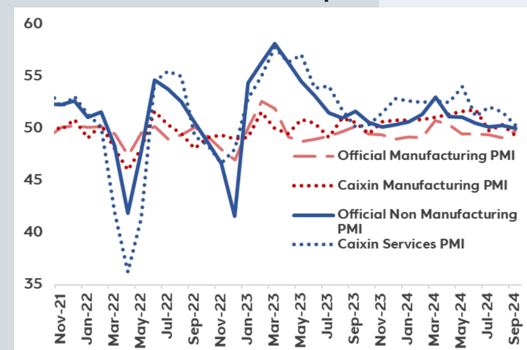
Authorities have since late September been announcing a raft of policy measures following a series of gloomy economic data releases. Indicatively, industrial production and retail sales in August expanded at a slower pace compared to July (4.5%YoY vs 5.1%YoY and 2.1%YoY vs 2.7%YoY respectively), coming below market expectations for a more modest deceleration. The data came on top of an understanding since early 2024 that the economy is ailing from structural issues and subdued demand. Against this background, a policy response was anticipated, and it finally came. In a set of monetary easing actions, the PBoC lowered the 7- and 14-day reverse repo rates by 20bps bringing them to 1.50% and 1.85% respectively, cut the RRR for major banks to 9.5% from 10.0% and reduced the interest rates on existing mortgages by 0.5 ppts on average. By contrast, the National Development and Reform Commission (NDRC, China's economic planning bureau) did not declare explicit fiscal measures aside from the planned issuance of CNY200bn in 2024 in advance of 2025. Instead, it reiterated its certainty that the 5% GDP growth target will be achieved and its pledge of a broad array of countercyclical measures. The lack of details on spending disappointed market participants who expected a more concrete set of stimuli, ending the equity rally that took place in key Asian markets during the last month. In an effort to backstop the slide in equity markets (*the CSI dipped by ca 7% at its open on October 9*), the Ministry of Finance will hold an ad hoc press conference on October 12 over "intensifying countercyclical" adjustments to fiscal policy. While waiting for the outcome of that briefing, sentiment in the economy remains offbeat, as reflected in the continuing slide of the consumer confidence index (85.80 in Aug from 86 in July, close to the all-time low of 85.5 in November 2022) and most PMIs contracting in September, with the sub-index of new orders in the Caixin gauges touching two-year lows.

Figure 5: A raft of monetary policy measures at play…



Source: Bloomberg, Eurobank Research

Figure 6: ..in the effort to reverse the dampened sentiment and underpin demand



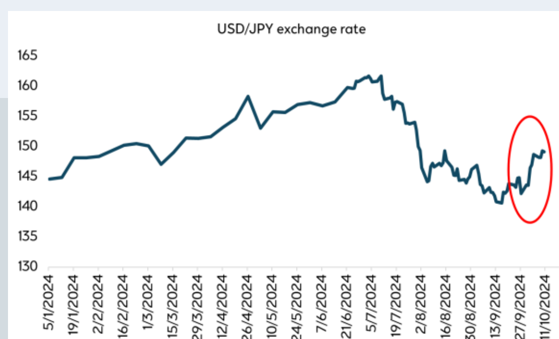
Source: Bloomberg, Eurobank Research

Japan

New prime minister dissolves parliament with elections set for later this month

Shigeru Ishiba became Japan's new prime minister after winning a hotly contested race on September 27 to succeed Fumio Kishida as leader of the governing Liberal Democratic Party. Considered a maverick within the LDP, and an opponent of the policies advocated by Shinzo Abe, the 67-year-old politician succeeded in his fifth attempt at winning the party leadership. He has now called parliamentary elections for October 27 to reinforce his mandate, which he is nearly certain to win since the LDP has ruled almost continuously since 1955, with only two brief interludes. In terms of economic policies, Ishiba has sent out mixed signals. Despite his historical opposition to the expansionary fiscal and monetary policis of Abe, he surprised markets on his first full day in office by suggesting that now was not the time for further rate hikes, while in his first speech to parliament he emphasised the need to fight deflation. He has pledged to continue Kishida's efforts to raise real wages. He later stressed that his comments on rate hikes were misinterpreted and intended to indicate his alignment with BoJ Governor Kazuo Ueda, but the yen has still depreciated 4.9% against the dollar since Ishiba took office, with the USD/JPY standing at around 149 as of October 9. After the BoJ kept its policy rate unchanged at 0.25% at its September 20 meeting, Ueda appeared to rule out an interest rate hike in October, saying that he needed more confidence in a soft-landing scenario for the US so as to avoid the kind of market rout seen in August. Futures markets are currently pricing in a 46% probability of a cumulative 25bps of BoJ interest rate tightening by January 2025. However, Ueda also expressed confidence that the wage-price cycle is building momentum. Since then, earnings data for August showed that real wages dropped 0.6%YoY, reversing two straight increases in the previous months, which were the first in more than two years. In nominal terms, labour cash earnings increased 3.0%YoY in August, compared with a downwardly revised 3.4%YoY the month before. However, the BoJ can look at underlying wage strength, with August's poor figures largely due to smaller bonus payments. Base pay increased 2.9%YoY in August – its fastest pace since the 1990s – from 2.6%YoY in July. Meanwhile, the BoJ's quarterly Tankan survey showed that business sentiment was stronger than expected in Q2, also strengthening the case for rate hikes later this year or early in 2025.

Figure 7: The yen has weakened 4.9% against the dollar since Ishiba took office



Source: Bloomberg, Eurobank Research

Figure 8: Japanese workers saw real wages fall in August after two month of growth

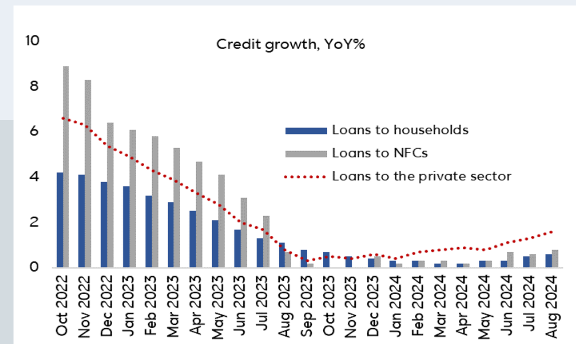
Source: Bloomberg, Eurobank Research

Euro area

Growth prospects are gloomy as inflation concerns ease

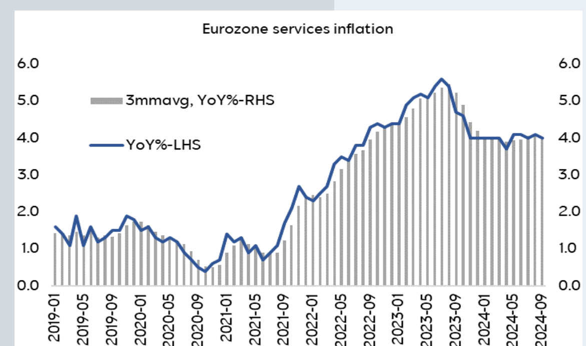
Incoming data have raised concerns that, as inflation worries are gradually fading, the economy is set for further deceleration in Q3. This follows already modest GDP growth of 0.3%QoQ and 0.2%QoQ in Q1 and Q2, respectively, with prospects likely to remain lacklustre in Q4. The composite PMI fell sharply in September to 49.6 from 51.0, slipping into contractionary territory for the first time since February. While weakness was evident across sectors, the decline was mainly driven by a larger-than-expected unwinding of the August boost from the Paris Olympics, which impacted France's service sector. Providing further evidence of a gloomy underlying growth picture and suggesting downside risks to the ECB's latest projections for 0.2%QoQ GDP growth in both Q3 and Q4, the EC economic sentiment dropped in September (-0.3pts to 96.2), erasing most of the gains recorded in August. Hard data is equally discouraging. Retail sales rose by 0.2%MoM in August, marking an improvement from the previous month's revised flat reading, though remaining below May's recent peak. Private sector credit showed a pickup in August (+0.3ppts to 1.6%YoY), but the pace of lending remained sluggish due to still-high interest rates and ongoing economic uncertainty. Meanwhile, disinflation is accelerating. September's flash HICP fell by 0.4ppts to 1.8%YoY, below the ECB's 2.0% target for the first time in over three years, largely due to lower energy inflation. Core inflation also eased, slipping to 2.7%YoY from 2.8%YoY as services inflation fell by 0.1ppts to 4.0%YoY, driven by the fading Paris Olympics effect. However, wage growth remains well above levels consistent with the inflation target (compensation per employee increased 4.2%YoY in Q2) and might increase again toward year-end (according to the ECB's forward-looking negotiated wage tracker). Still, the recent weakening in business activity, as reflected in the latest PMIs, is expected to start feeding into services inflation, while lower headline inflation reduces risks of second-round effects into the upcoming wage negotiations. Easing inflation concerns, combined with increasing downside growth risks and recent dovish comments by President Christine Lagarde to the European parliament, have raised expectations of a more aggressive ECB rate easing cycle than previously anticipated. Investors are almost fully anticipating a third 25bps rate cut at the upcoming 17 October meeting, compared to a probability of around 40% in late September.

Figure 9: There are signs of recovery in bank lending but the pace remains slow



Source: ECB, Eurobank Research

Figure 10: Services inflation momentum shows tentative signs of slowing



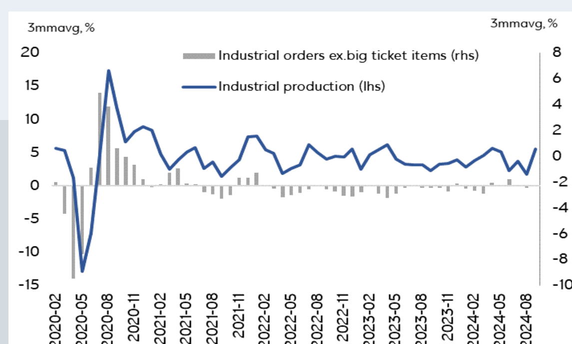
Source: Eurostat, Eurobank Research

Germany

Economy stuck in a vicious cycle of stagnation

Confounding hopes early in the year that Germany had emerged from stagnation, GDP shrunk again in Q2, by 0.1%QoQ, after a 0.2%QoQ GDP rebound in Q1, following a 0.5%QoQ contraction in Q4 2023 and an average growth of just 0.1%QoQ over the first three quarters of last year. More worryingly, weak leading indicators, along with soft hard data for Q3, offer little optimism for a swift economic recovery. The IFO business climate index fell for the fifth consecutive month in September, hitting its lowest level since January (-1.2pts to 85.4). Both current conditions and expectations fell further below their respective long-term averages, with pronounced weakness in manufacturing, which dropped to its lowest level in more than four years, even below the trough seen at the height of the 2022 energy crisis. This is consistent with the sharp decline in the flash manufacturing PMI (down to a one year low of 40.6), while services also weakened (from 51.2 to 50.6), pushing the composite index further into contractionary territory (-0.9pts to 47.5). Hard data also fail to alleviate stagnation fears. Industrial output increased by 2.9%MoM in August, rebounding from a sharp decline in the previous month. However, this was largely a technical recovery, driven by the resumption of activity following planned factory shutdowns in July.

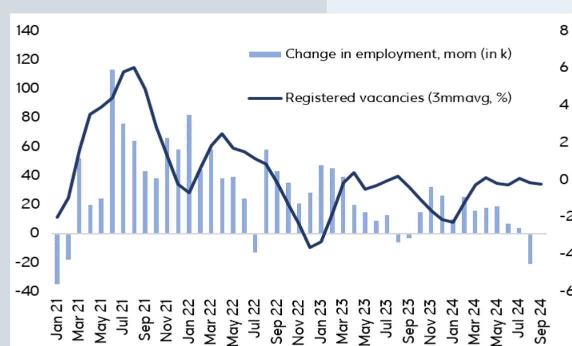
Figure 11: The sharp increase in August industrial production fails to alleviate stagnation



Source: Destatis, Eurobank Research

Meanwhile, on the expenditure side, private consumption is unlikely to offer significant relief, despite improved household purchasing power due to strong wage growth and declining inflation (HICP below 2.0%YoY in August for the first time since March 2021). Consumer sentiment remains cautious, probably reflecting a deteriorating labour market as prolonged economic weakness takes its toll. Unemployment rose for the 21st straight month in September (+17k, bringing the cumulative increase since 2022 to 0.5mn), employment fell (-21k), marking the first decline since September 2023 and the largest since early 2021, while the number of vacancies continued to gradually decline (-1k to 674k, the lowest since May 2021). The recent announcement of potential cost-cutting measures in the automotive industry and rising bankruptcies are expected to further worsen labour market conditions. On the political front, the SPD's victory in the Brandenburg state election, following its poor performance in the previous two regional elections in eastern Germany, provided a much-needed boost for Chancellor Scholz ahead of the party conference (8-10 December) and reduces the likelihood of early elections.

Figure 12: Prolonged economic weakness has likely started to affect the labour market



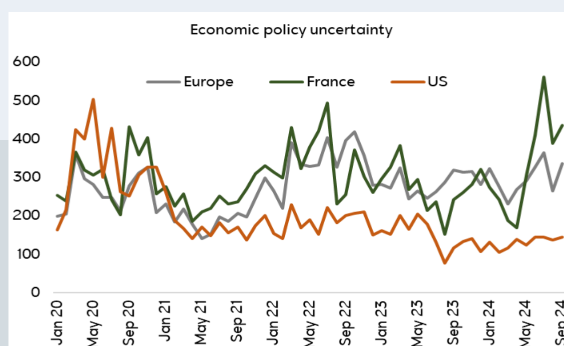
Source: Eurostat, Eurobank Research

France

Country gets new centre-right government, but major risks remain

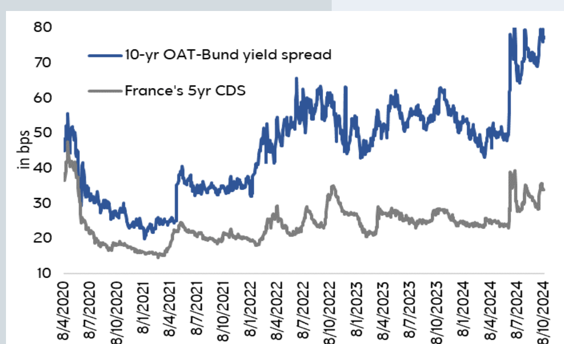
Political uncertainty has significantly eased since the second round of snap legislative elections in July with the formation of a centre-right coalition government under PM Michel Barnier last month. However, substantial risks remain, as reflected in the Economic Policy Uncertainty Index which, although retreating from recent highs, still exceeds both the European average and that of the US ahead of its November presidential elections (Figure 14). The government's longevity is uncertain. It lacks a clear majority in the 577-seat National Assembly and depends on coalition partners with different political agendas. Crucially, there is no explicit agreement on key policy issues between those parties, raising concerns about the government's ability to implement the significant fiscal consolidation needed to restore public finances and comply with EU fiscal rules. In his general political declaration to the National Assembly, the PM pledged to reduce the budget deficit in 2025 by around 1ppt (to 5.0% from an estimated 6.1%-of-GDP this year). According to press reports, the overall fiscal consolidation will amount €60bn (c. 2% of GDP), while the PM indicated that two-thirds of this fiscal effort would come from spending cuts — though no specifics were provided — and one-third from temporary tax increases on large corporations and higher-income individuals (details are expected when the budget is submitted to the National Assembly on 10 October). Acknowledging the fragility of the political support for the government and the limited policy space for fiscal consolidation, exacerbated by weak growth momentum, the PM also announced a delay in the target to reduce the budget deficit below 3% of GDP, extending the deadline from 2027 to 2029. This reflects the challenges of balancing fiscal reforms with the coalition partners' policy priorities, whose support is essential for the government's survival. The stability of the government also heavily depends on the stance of the far-right Rassemblement National (RN), with party leader Marine Le Pen signalling recently that her party would not back a motion of no-confidence in the near term. On the macroeconomic front, the economy has not been significantly impacted by policy uncertainty thus far. After GDP growth of 0.2%QoQ in both Q1 and Q2, we anticipate a bounce to 0.3-0.4% in Q3, mainly driven by the Olympics boost. This is expected to be followed by stagnation in Q4 as the effect fades, with full-year growth projected at 1.1%.

Figure 13: Rising policy uncertainty



Source: Economic Policy Uncertainty, Eurobank Research

Figure 14: Yield spreads have widened, and CDs imply sovereign credit rating downgrades



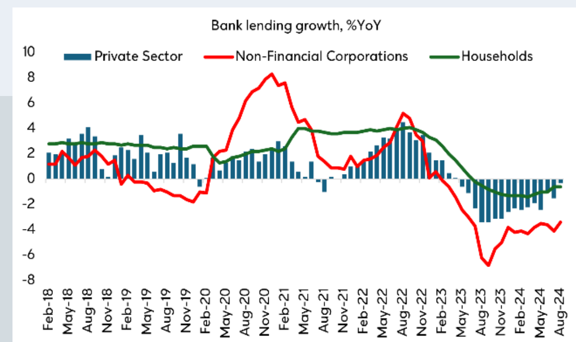
Source: Bloomberg, Reuters, Bloomberg, Eurobank Research

Italy

Government ponders taxing company profits to align budget with EU rules

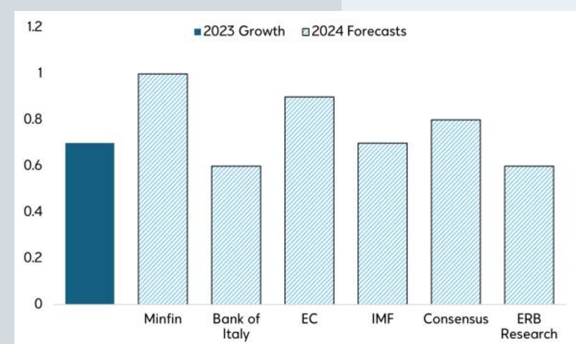
As with other EU countries, Italy is in the final days of trying to nail down the specific budget measures that it has to submit to the European Commission to bring its budget deficit below 3% of GDP. On September 27, the government submitted its new fiscal plan, which projected that the budget deficit will drop to 3.8% of GDP this year from 7.2% in 2023, before narrowing further to 3.3% in 2025 and 2.8% the year after. That would bring it back into compliance with EU fiscal rules and out of the Excessive Deficit Procedure that it was placed under in June. To hit those projections the government needs to come up with concrete proposals for how it will find €25 billion of budget savings, with media reports indicating that they have only reached about half of that amount so far. The government's determination not to reverse a €10billion tax cut to wages, which was a key election pledge, has led it searching elsewhere for solutions, including special taxes for companies deemed to have profited from the post-pandemic inflationary environment. While this time around the measure is meant to apply to a broader swathe of companies, it resembles the government's failed attempt last year to raise a special levy on Italy's banks, and it could run into opposition from the Forza Italia party, which forms part of the ruling coalition. The government is also stepping up efforts to privatise assets. Meanwhile, there are signs that tight monetary conditions are taking momentum out of the Italian economy, with bank lending to the private sector contracting continuously since May 2023. The manufacturing sector, which accounts for 15.4% of GDP, is stuck in a rut, with industrial production falling 3.3%YoY in July, a 26th straight drop. An unexpected 1.1pt drop in the manufacturing PMI to 48.3 in September dragged Italy's composite PMI below the 50 threshold separating expansion from contraction. The composite PMI dropped to 49.7 from 50.2, while the services PMI fell more than expected to 50.5 from 51.4. This means the government faces strong headwinds in meeting its growth target for 2024 of 1%, after last year's 0.7% expansion, which has been revised down from 0.9%. The Bank of Italy has already cast doubt on that 2024 forecast, noting that Istat's revision of last year's growth rate mechanically lowers the carry-over effect for this year's annual growth by 0.2ppts to 0.4ppts.

Figure 15 : Bank credit to Italy's private sector has been contracting continuously since May 2023



Source: ECB, Eurobank Research

Figure 16: Government's 1% GDP growth target for 2024 looks difficult to reach



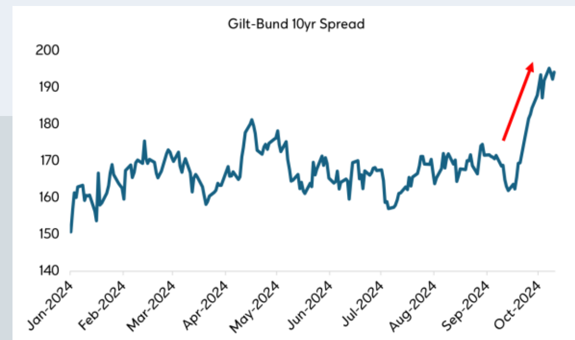
Source: Bloomberg, Eurobank Research

UK

Budget announcement in focus as government seeks ways to fund infrastructure

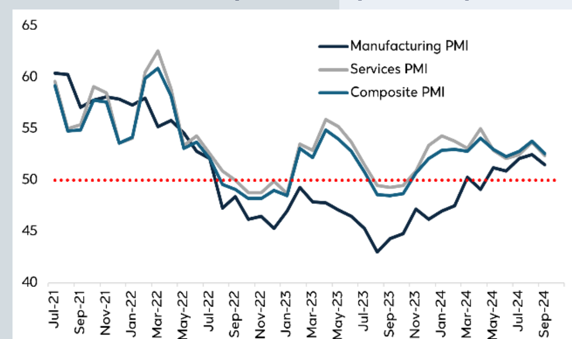
Having made a fumbling start to governing following its July election victory, the budget announcement on October 30 offers the Labour party the chance to refocus attention on its economic plans for the next five years. The autumn budget is one of the major set-piece events in the UK's political calendar, and as such Finance Minister Rachel Reeves has been the focus of much scrutiny in the last three months. In particular, Reeves has said that the previous government left a £22 billion "fiscal hole" that would require tough choices to fill. That has already led to an unpopular decision to cut eligibility for the winter fuel allowance given to pensioners, which, in parallel to a separate controversy around donations to Labour politicians, including to the prime minister, has led to a plunge in the government's popularity just months after being elected in a landslide. Some of the budget focus in recent weeks has shifted towards whether the government might amend its fiscal rule that is the source of the shortfall – which states that the public debt must be falling in the fifth year of the Office of Budget Responsibility's forecasts – to allow more borrowing for spending on infrastructure investment. However, that could test the gilt market as the spread on 10yr UK government bonds over their German counterparts has spiked 33bps between September 13 and October 7, to 194ps, the most in more than two years. Meanwhile, recent data shows some signs of weaker momentum for the UK economy. GDP growth was revised lower for Q2, expanding 0.5%QoQ compared with an an initial reading of 0.6%QoQ, with the year-on-year print revised down 0.2ppts to 0.7%. There are also signs of a slowdown in more forward-looking indicators, notably the GfK consumer confidence index, which in September unexpectedly plunged 7pts to -20, its biggest drop since 1976. While the government obviously can't be held accountable of the Q2 GDP revision, the GfK survey indicated that the drop in consumer confidence seemed to be in response to the government's messaging that the budget would bring painful measures. Slightly better news came from the PMIs readings, which despite falling by more than expected in September still remained comfortably above the crucial 50 threshold, corresponding to continued expansion of output, in manufacturing, services and construction. The composite PMI fell 1.2pts to 52.6.

Figure 17: UK over German bond spreads have spiked over the past month



Source: Bloomberg, Eurobank Research

Figure 18: PMIs dipped in September, but remain in expansionary territory



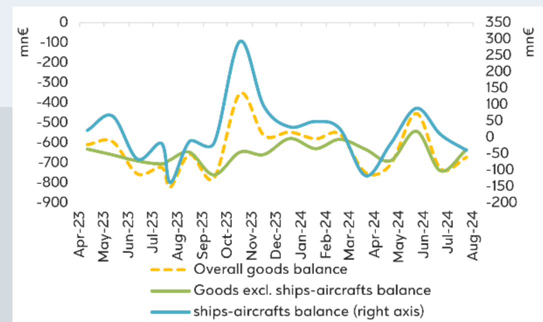
Source: S&P Global, Bloomberg, Eurobank Research

Cyprus

Tourism on the frontline of exports in Q3, construction boosts investment

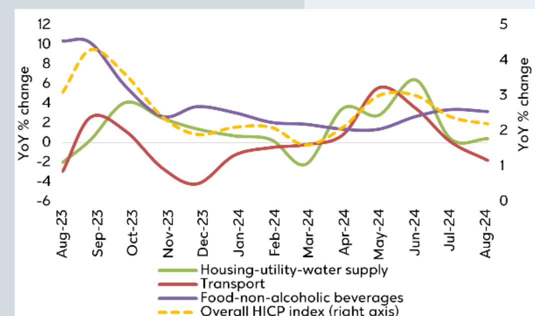
Short-term dynamics in the external sector components improve in Q3 2024 relative to the previous quarter, underpinning GDP growth. Tourist arrivals expanded at the heart of the tourism season, in August, by 8.5%YoY, faster than in Jan-Jul-24 (+3.1%YoY), with the rise in tourism receipts up to July broadly in line with that of the number of tourists (+4.3%YoY). The downward trend in the goods deficit strengthened in July-August, as it narrowed by 9.2%YoY after a 2.5%YoY decline in Q2 2024. By contrast to Q2, improvement did not come from a stronger increase of exports relative to imports, but from exactly the opposite dynamics. Both falls are mostly related to trade of ships-aircrafts, thus they likely won't be fully sustainable in the next months. Turning to recent developments in domestic demand, amid a rebound in disinflation in July–August (2.4%YoY and 2.2%YoY respectively, down from 3.0%YoY in May-June), retail volume growth accelerated in August to 5.7%YoY, the fastest pace so far this year, up from a weak 1.2%YoY print in July. The moderate increases to the salaries of civil servants (1.5%-2.4%) and public sector pensioners from October onwards, for the first time since 2009, are expected to similarly boost their consumption demand. But consumption volume in the period ahead will also be affected by the abolition since October of the disinflationary measures that remained effective, namely the subsidisation of electricity consumption and nulling the VAT mainly on food items (meat, vegetables, bread, milk, etc.). This is because in parallel with the strong slowdown in housing-utility and transport inflation in Jul-Aug-24, that in part led to the lifting of measures, food inflation escalated, reaching 3.2%YoY in August from 1.4%YoY in May and will further accelerate once the 0% VAT is abolished. Regarding recent trends in investment, construction permits skyrocketed in June, increasing by 196.7%YoY in surface terms and 211.3%YoY in value terms, after increases of 13.4%YoY and 8.4%YoY in Jan-May. Although this development is due to administrative issues, as the municipal authorities processed much more applications in view of the transfer from July 1st of the authority to issue them to the regional administrations, it is linked to a real estate market activity in H1 2024 near its 16-year high in 2023 (-1.8%YoY in the number of transactions) and is expected to boost construction activity in H2 2024. Because of the upward dynamics in tourism and construction, our growth forecast for 2024 is revised upwards by 0.2ppts, to 3.5%.

Figure 19: Ships-aircrafts balance a significant determinant of the total goods balance also in 2024



Source: Cystat, Eurobank Research

Figure 20: Utility and transport prices behind disinflation, but food inflation is up despite measures



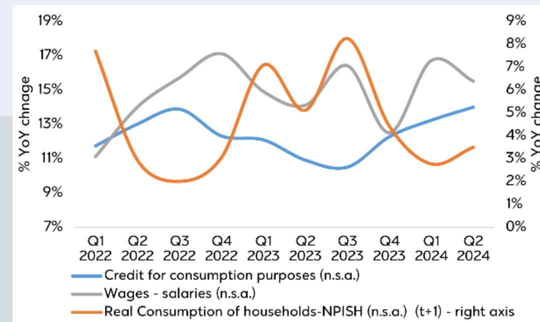
Source: Cystat, Eurobank Research

Bulgaria

Wage increases and credit expansion boost demand, weaken disinflation

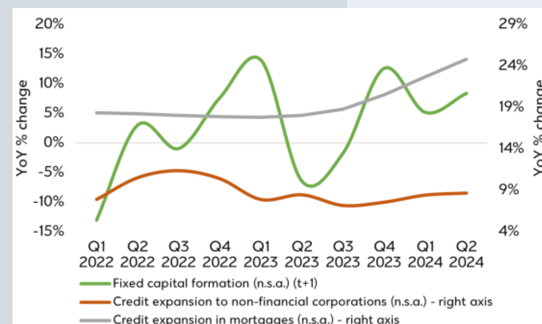
With snap elections only 3.5 weeks away, polls continue to indicate that, excluding the recently split MRF party, the other four parties with the most seats in the current parliament are not far from their vote shares in the June elections. As was assessed in our previous issue, provided the polls are confirmed by the forthcoming elections results, uncertainty about the formation of a government is not expected to wane soon after the election day, with possible implications for the implementation of reforms linked to EU funds and Eurozone accession. Regarding recent inflation developments, which affect the criteria on which country's ability to join single currency will be judged, HICP inflation decelerated to a three-year low of 2.4%YoY in August from 2.8%YoY in July. However, the recent slowdown is largely due to a one-off base effect from transport prices (+3.3%MoM in Aug-23) that led to a strong deceleration in transport annual inflation. Core inflation decelerated in August only to 2.9%YoY from 3.1%YoY in July, with the monthly overall HICP pace marginally positive (+0.1%), as in most months of 2024. In its latest Regional Economic Prospects report, the EBRD assessed that the rise in the minimum wage in early 2024 has contributed to a return of inflationary pressures. As wages and salaries continue surging (+15.5%YoY in Q2 2024) – partly due to salary hikes in the public sector – such pressures are most likely to be sustained in H2 2024. Support to household consumption, as well as to the housing market, comes also from rapid credit expansion to households, by 19.0%YoY in Q2 2024, with preliminary data for July-August pointing to a further acceleration towards 20%YoY. A boost to household demand from these factors is evident from the increase in retail volume of 5.6%YoY in July-August, exceeding the average increases of 1.2%YoY and 5.4%YoY, in Q1 and Q2 respectively. Industrial production grew by a weak 0.6%YoY in July, slightly up from a flat print in June and a 0.3%YoY rise in Q2 2024, on account of a spike in utility production (+26.3%YoY from -23.8%YoY in June) whereas the trend in manufacturing switched to falling for the third time this year. In the external sector, the trade deficit resumed its sharp deterioration in July after a temporary respite in the previous month (+37.9%YoY against +2.6%YoY). Amid the above mixed short-term dynamics in economic activity our growth forecast for 2024 remains unchanged at 2.2%.

Figure 21: Wage and credit growth drive private consumption with a lag of one to two quarters…



Source: Bulgarian National Bank, Statistical Institute Bulgaria, Eurobank Research

Figure 22:… whereas investment appears more linked to mortgages than credit to non-financial businesses



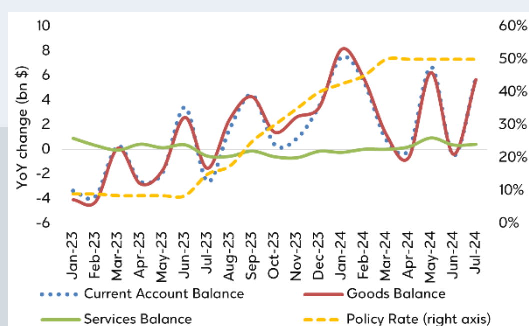
Source: Bulgarian National Bank, Eurobank Research

Turkey

Monetary tightening inadequate for fast disinflation, but is improving net exports

Disinflation weakened significantly in September, as headline inflation decelerated to only 49.4%YoY from 52.0%YoY in August and 61.8%YoY in July. The monthly pace also accelerated anew, to 3.0% from 2.5% the month earlier, which is double that required for the annual print to meet the end-year target of the central bank of Turkey (TCMB), 39.5%. The monthly spike came from a range of goods and services, mainly from rents (contribution of 0.4ppts), tertiary education due to the start of the school year (+0.3ppts), road transport, on the back of increases in the special levy on fuels (+0.2ppts) and dairy products (+0.2ppts). Regarding potential monetary policy reactions to waning disinflation, given that the reference to possible additional tightening was not included by the TCMB in the September post-rate-setting meeting press release for the first time in eight months, it is more likely that the central bank will increase the use of sterilisation tools if needed. As some of these price increases have become entrenched in recent months (e.g. in rents and road transport), they are expected to continue in the short term, eroding households' purchasing power further. Persisting inflationary pressures and no mid-year minimum wage indexation, as in 2022-2023, led retail trade volume growth to two-year lows in May and July, of 6.8%YoY and 7.1%YoY respectively. Those are the smallest increases since August 2022. By contrast, the restructuring of individual debt obligations for borrowers unable to meet their repayment schedules, through extension of the restructuring period to up to 60 months, allowed recently by the Banking Regulation and Supervision Agency, effectively increases the disposable income of borrowers. Monetary tightening continues improving net exports, through falling imports of goods. In July, the current account balance posted a surplus of $566mn against a deficit of $5.3bn a year ago, with the improvement stemming by 96.4% from the goods balance, mainly on account of less imports. Exports of both goods and services continued expanding, by 13.5%YoY and 9.4%YoY respectively, benefited from the protracted lira depreciation, albeit by less than in early 2024 (-19.5%YoY in July vs. -38.9%YoY in Q1), a sign of the gradually improving credibility of monetary policy. On the fiscal front, measures to strengthen revenues were enacted in August. However, the greater deterioration in the general government balance in the same month came from the expenditure side, through higher compensation of civil servants' payments and Finance Ministry transfers. In view of the above mixed dynamics in key GDP components, our growth forecast for 2024 remains unchanged to 3.5%.

Figure 23: Monetary tightening improves net exports through the goods balance...



Source: Central Bank of Turkey, Eurobank Research

Figure 24: ...yet it has not led to significant disinflation, weighing on household consumption growth

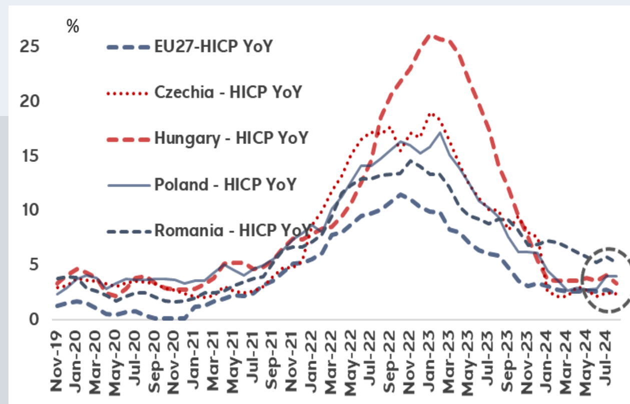
Source: Turkstat, Eurobank Research

CESEE

Divergent stance by central banks so far, limited room for easing ahead

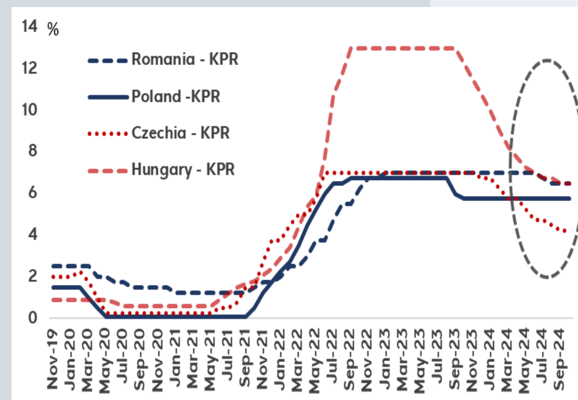
Regional central banks (CBs) are confronted with different risk profiles among the CEE3 plus Romania and this was reflected in the decisions of the latest MPCs. In Poland, the Key Policy Rate (KPR) was kept at 5.75% for an eleventh month in a row, in line with market expectations. CPI inflation surged to 4.9%YoY in September from 4.3%YoY in August on the back of swelling energy prices that kept on increasing on double-digit prices since July 2024. The said development poses upside inflationary risks and most probably defers in early Q2-2025 the decision of interest rates cuts as the Chair of the CB, Adam Glapiński indicated in the press conference following the MPC. Milder, though persistent, inflationary pressures in both Hungary and Czechia allowed for additional cuts in October, which brought the benchmark interest rates at 6.5% (from 6.75%) and 4.25% (from 4.5%) respectively. In Hungary, inflation improved sizably in September decelerating to 3.0%YoY, from 3.4%YoY and 4.1%YoY in July setting the ground for the unanimous decision for this month's rate cut. However, forward guidance from the horse's mouth, i.e. the CB's governor, Barnabas Virag was rather restrictive, pointing to small chances of further easing in Q4-2024. On the flipside, in Czechia, where inflationary pressures have been tamed sooner than in adjacent economies and CPI inflation came in at 2.6%YoY in September from 2.2%YoY in both previous months, room for further easing appears more ample, subject that inflation in the coming months does not continue to spike. Finally, on the same footing with Poland, the CB of Romania held fire in this month's session and kept the KPR steady at 6.5%. Despite the decrease in the latest available CPI print, inflation remained elevated at 5.1%YoY in August (vs 5.4%YoY in July). Pressures stemming from increased wages and the expansionary fiscal policy could result in another hold decision by the CB, which could abide the time for presidential elections in late November to be completed.

Figure 25: With disinflation having plateaued..



Source: Eurostat, Eurobank Research

Figure 26: ..some regional central banks tap, temporarily, a brake on easing ...



Source: Central Bank of Romania, Poland, Czechia & Hungary, 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)		
	2023	2024f	2025f	2023	2024f	2025f	2023	2024f	2025f	2023	2024f	2025f	2023	2024f	2025f
World	3.2	3.0	3.0	6.8	4.6	3.5									
Advanced Economies															
USA	2.9	2.9	1.8	4.1	2.9	2.2	3.6	4.1	4.4	-3.3	-3.4	-3.3	-6.5	-6.6	-6.5
Eurozone	0.4	0.7	1.3	5.5	2.4	2.1	6.6	6.5	6.5	1.7	2.6	2.5	-3.6	-3.1	-2.8
Germany	-0.3	-0.1	0.9	6.1	2.4	2.1	5.7	6.0	6.1	6.0	6.8	6.5	-2.5	-1.8	-1.5
France	0.9	1.1	1.1	5.7	2.4	1.8	7.4	7.5	7.5	-1.4	-0.3	-0.2	-5.5	-6.1	-5.2
Periphery															
Cyprus	2.5	3.5	3.7	3.9	2.3	1.6	6.1	5.0	4.5	-12.1	-8.4	-7.0	3.3	4.0	3.7
Italy	0.7	0.6	1.0	6.0	1.2	1.7	7.2	7.4	7.3	0.0	1.3	1.4	-7.4	-4.5	-3.9
Portugal	2.3	1.7	1.9	5.3	2.4	1.9	6.5	6.5	6.4	1.4	2.2	1.4	1.2	0.3	0.4
Spain	2.7	2.7	1.7	3.4	3.0	2.2	12.2	11.6	11.3	2.7	2.5	2.4	-3.6	-3.1	-2.9
UK	0.4	1.1	1.4	7.4	2.6	2.3	4.0	4.3	4.4	-2.0	-3.4	-2.8	-4.9	-3.8	-3.1
Japan	1.7	0.0	1.2	3.3	2.5	2.0	2.6	2.6	2.5	3.6	4.0	3.8	-5.2	-4.2	-3.5
Emerging Economies															
BRIC															
Brazil	2.9	2.2	2.0	4.6	4.2	3.5	8.0	7.2	7.4	-1.0	-1.5	-1.7	-8.9	-7.4	-6.6
China	5.2	4.8	4.4	0.2	0.5	1.5	5.2	5.2	5.1	1.8	1.3	1.1	-4.6	-4.8	-4.8
India	7.6	6.9	6.6	5.7	4.5	4.5		NA		-0.9	-1.1	-1.1	-5.8	-4.9	-4.5
Russia	3.6	3.3	1.6	6.0	7.5	5.2	3.2	2.7	3.0	2.5	2.8	2.8	-1.9	-1.6	-1.0
CESEE															
Bulgaria	1.8	2.2	2.9	9.6	2.9	2.3	4.3	4.4	4.1	-0.3	0.2	0.2	-1.9	-2.9	-2.9
Turkey	4.5	3.5	3.2	53.4	59.8	26.2	9.4	8.7	8.2	-4.1	-2.2	-1.3	-5.3	-4.8	-3.5

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

Eurobank Fixed Income Forecasts

	Current	December 2024	March 2025	June 2025	September 2025
USA					
Fed Funds Rate	4.75-5%	4.23-4.5%	3.79-4.05%	3.44-3.7%	3.2-3.45%
3m SOFR	4.66%	4.32%	3.91%	3.53%	3.27%
2yr Notes	4.01%	3.5%	3.38%	3.27%	3.21%
10yr Bonds	4.07%	3.74%	3.69%	3.67%	3.68%
Eurozone					
Refi Rate	3.65%	3.35%	3.05%	2.75%	2.55%
3m Euribor	3.22%	3.15%	2.86%	2.6%	2.47%
2yr Bunds	2.25%	2.26%	2.16%	2.07%	2.04%
10yr Bunds	2.26%	2.21%	2.22%	2.2%	2.21%
UK					
Repo Rate	5%	4.7%	4.4%	4.1%	3.85%
3m Sonia	4.79%	4.52%	4.29%	3.9%	3.77%
10-yr Gilt	4.18%	3.81%	3.76%	3.72%	3.67%
Switzerland					
3m Saron	0.84%	0.92%	0.93%	0.93%	0.93%
10-yr Bond	0.49%	0.60%	0.65%	0.71%	0.75%

Source: Bloomberg (market implied forecasts)

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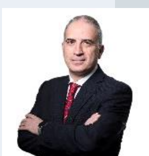

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