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The global economic expansion appeared to continue through August, as reflected in the latest PMI data. However, widening disparities across sectors and regions, along with increased downside risks to growth, have raised fears that the modest recovery seen in the first half of 2024 may be losing momentum. Meanwhile, the disinflation trend remains intact, suggesting that upside risks are probably less pronounced than they were a few months ago. With inflation concerns receding, growth risks have increasingly moved into focus, providing room for major central banks to gradually reduce the restrictiveness of monetary policy.

Macro Picture

USA: recent data aligns with soft landing narrative, easing downturn concerns

EA: services inflation elevated, while underlying growth momentum remains weak

China: soft and hard data suggest the economy is going through a downshift

Japan: real labour earnings grow in June and July for first time in more than two years

CESEE: Q2 GDP growth prints point to a mixed yet positive trend in the region

Markets

FX: EUR/USD up, touching 1.12 before September Fed meeting; JPY carry trade unwinds

Rates: EU and US rates expected to continue bull steepening given rising growth concerns

EM: sovereign spreads were little changed in the last part of the summer despite geopolitics

Credit: market attention shifted to whether Fed cuts rates by 25bps or 50bps in September

Policy Outlook

USA: moderating labour market and continued disinflation set the stage for gradual Fed cuts

EA: ECB remains cautious on dialling back policy restriction amid sticky services inflation

Japan: BoJ sounding hawkish after raising rates in July, suggesting more hikes could follow

CESEE: with disinflation having progressed, CBs' stance considered pivotal for growth dynamics

Key Downside Risks

DM: political developments lead to a long-lasting upheaval in financial conditions, growing trade restrictions, heightened geopolitical tensions, renewed energy shock

EM: lingering geopolitical uncertainty; multifaceted dependency on the outcome in the US elections in November

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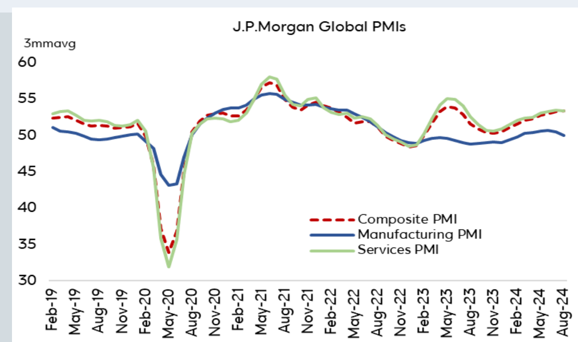
Macro Views

Increased downside risks to growth and easing inflation concerns give room for major central banks to gradually reduce policy restrictiveness

The global economic expansion appeared to continue through August, as reflected in the latest PMI data. The global composite PMI rose by 0.6pts to 52.8, approaching its long-term average. Despite this positive figure, disparities across sectors and regions, along with mounting concerns about growth risks, have raised fears that the modest recovery seen in the first half of 2024 may be losing momentum. Services remained the primary driver of global growth, with the respective PMI rising 0.5pts to 53.8, indicating that activity in the sector continues to be robust. However, manufacturing is still struggling. After briefly rising above the 50-mark in the first half of the year, the manufacturing PMI dropped to 49.5 from 49.7 in July, remaining in contractionary territory for a second straight month, though still performing above last year's average. Regionally, India recorded the strongest growth in combined manufacturing and services activity, followed by the US. However, expansion was more moderate in China and the Eurozone, while Germany and Canada experienced downturns, highlighting widening geographic divergence. Meanwhile, downside risks to the global growth outlook have intensified in recent weeks, driven by weaker-than-expected macroeconomic data from a number of major economies.

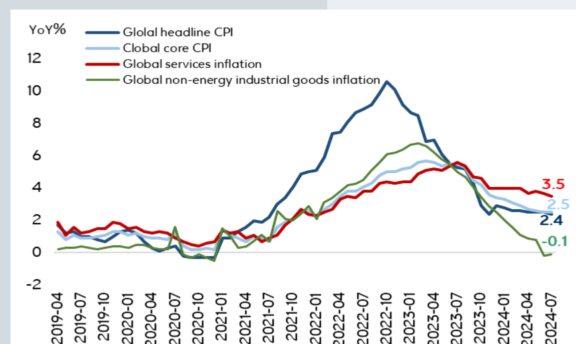
Figure 1: Services remain the primary driver of global growth



Source: Bloomberg, Eurobank Research

China continues to grapple with its economic challenges, US labour market conditions are gradually softening, and Germany's industrial sector remains particularly weak. Rising geopolitical tensions have further intensified concerns about the health of the global economic expansion amid growing fears of a broader regional conflict. Despite these uncertainties, investors remain generally optimistic that, while global growth is projected to slightly soften this year, it is expected to remain broadly resilient to the challenges it continues to face. However, there is increasing caution that the risk of a prolonged and pronounced slowing trend in economic activity cannot be ruled out, especially if the weakness in manufacturing spills over into business services.

Figure 2: The disinflation narrative remains intact



Source: Bloomberg, Eurobank Research

Meanwhile, the disinflation trend remains intact. Headline inflation continues to moderate as global goods, food and energy inflation have dropped close to pre-pandemic levels. Core inflation remains somewhat elevated, driven primarily by persistently high services inflation, though it is expected to gradually decline. As growth slightly moderates, labour markets in major economies are likely to loosen further, exerting downward pressure on wage growth. That said, while it is still early for major central banks to declare victory – and bringing inflation back to its 2% target still poses challenges – recent progress suggests that upside risks are less pronounced than they were a few months ago.

With inflation concerns receding, growth risks have increasingly moved into focus, providing room for major central banks to gradually reduce the restrictiveness of their policies. However, none of them has yet indicated an intention for a quick sequence of rate cuts. Instead, they are adopting a cautious stance towards easing, with regards to the speed and likely overall scale of rate cuts, as they aim to balance the goal of price stability against the risk of dragging the economy into recession.

Developed Economies

US: Incoming data suggests that economic activity still looks healthy, underpinned by resilient consumer spending and strong income gains. This has fueled optimism that fears of a sharp recessionary downturn, sparked by weaker than expected non-farm payrolls in early August, may had been overstated. Real personal consumption expenditures (PCE) maintained solid momentum in early Q3, while real personal income also continued to grow in July, However, this income growth trailed behind July's real PCE gain, causing a renewed decline in the personal saving rate, as consumers appeared comfortable dipping into their wealth, buoyed by strong stock market performance and favorable labour market conditions, despite a gradual moderation. Meanwhile, the disinflation narrative remains intact, reinforcing the likelihood of the Fed initiating rate cuts at its September 18 meeting. This is supported by recent dovish signals from Fed officials amid increasing evidence that inflation is moving sustainably toward the 2% target, echoing Chair Jerome Powell remarks at Jackson Hole in late August that the "time has come for policy to adjust".

Euro area: After more than a year of stagnation, the economy rebounded in the first half of 2024, with GDP growth rising by a downwardly revised 0.2%QoQ in Q2 after increasing 0.3%QoQ in Q1. However, the expenditure breakdown is less encouraging as growth was mainly driven by strong net exports, while domestic demand, particularly private consumption, remained weak, highlighting subdued underlying growth momentum. Meanwhile, flash HICP for August showed inflation dropping to a three-year low of 2.2%YoY. But core inflation remained persistently high, falling by only 0.1ppts to 2.8%YoY. While core goods inflation decelerated notably, services inflation reaccelerated. However, the ECB's focus appears to be slightly shifting toward growth risks, as indicated by the minutes from the July meeting which, along with the 1.1ppts decline in negotiated wages growth to 3.6% in Q2, reinforced expectations for a rate cut at the upcoming September 12 meeting.

Emerging Economies

EM: focus shifts towards worrying economic data from the two biggest developing economies, China and India, and the lingering geopolitical instability stemming from the two war fronts in the Russia-Ukraine and the Middle East, which is not waning. There is scant data allowing any optimism over China's current economic standing and growth prospects, with most high-frequency soft and hard data suggest that the economy is going through a significant shift. Achievement of the 5% growth target in 2024 is under incremental pressure, meaning that the proper policy mix is pivotal in the months ahead. India's GDP growth fell to a five-quarter low of 6.7%YoY in fiscal Q1 2025 (April-June) from 7.8%YoY in the previous quarter and below the market consensus which foresaw a 6.9%YoY growth rate. Drivers of the deceleration are considered reduced government spending during the national elections in April-June and slowing consumption. The uncertainty over the outcome of elections weighed on investments and consumption but its effect on the economy is seen as being confined to the past, with our forecast for the current year trimmed just a tad to 6.9% from 7.0% previously.

CESEE: the Q2 GDP growth prints point to a mixed yet positive trend in the region. With the EU-27 economies growing by 0.8%YoY/0.2%QoQ compared to 0.7%YoY/0.3%QoQ in Q1. Poland is one of the few peers that posted both annual and quarterly improved growth rates. Q2's annual growth print ranked second, following Malta, and the quarterly rate ranked first. GDP expanded by 4%YoY/1.5%QoQ from 1.8%YoY/0.8%QoQ in Q1, which translated into 2.9%YoY growth in H1-2024 from 0.2% in FY2023. The solid performance was primarily driven by private and public consumption. In Hungary, the economy decelerated on both an annual and quarterly basis. GDP continued to grow by 1.3%YoY compared to 1.6%YoY in Q1, yet it contracted by -0.2%QoQ after growing 0.7%QoQ previously. The annual deceleration was broadly attributed to the steep contraction of investments by 15.4%YoY. However, solid private consumption meant the loss steam was modest and will not stop the economy from rebounding in 2024. The Czech economy also held firm expanding by 0.6%YoY/0.3%QoQ from 0.4%YoY/0.4%QoQ in the previous quarter with the increase in gross fixed capital formation behind the mild annual pick up. Along with the outlined above growth dynamics, PMIs in Poland and Czechia improved in August, capturing presumably the optimism from the recent GDP data. However, all CEE3 are still below 50, largely due their dependency on the German economy.

Markets View

Foreign Exchange

EUR/USD: touched the psychological resistance level of 1.12 primarily based on Fed rate cut expectations for Sep-tember's meeting. However, the start of the month has reversed the pair a bit lower, currently at 1.1040 pricing a potential market overreaction during August, with talks over a more conservative first cut by the Fed than previously anticipated. Technicals like the MACD signal are currently at a bearish crosso-ver, suggesting that downward momentum could be building. Support levels include 1.0850, 1.0620 and 1.0580, while resistance levels include 1.1180,1.1220 and 1.13. Implied volatility for 1M, 6M and 9M currently at 5.945%, 5.8575% and 6.365% respectively.

EUR/JPY: JPY based carry trades experienced a major sell-off, mostly due to massive unwind flows during August. EUR/JPY, currently at lows around 158, lost almost 10% on the move, having seen highs around 175.40 in July. The pair is oscillating around 160 at the moment, with mixed signals both from technicals and car-ry fundamentals as well. Support levels include 155, 153.50 and 152.20 and resistance ones 161.6, 165.1 and 170.35. Implied volatility for 1M, 6M and 9M currently at 9.425%, 9.3% and 9.61%.

Rates

EU: swap rates moved lower after a volatile month. As of September 9, the 10yr swap was trading in 248bps, down from 258bps at the beginning of August, but having printed a low of 240bps earlier in the month. The slope of the curve is steeper, with 5s-30s trading at -8bps, up from -20bps at the beginning of August. Looking forward, the bull steepening is expected to continue as the market anticipates another 25bps rate cut at the September meeting, and a downward revision of growth forecasts However, the pace and depth of rate easing beyond September remains heavily dependent on incoming economic data, and there's no pre-commitment to any specific policy path.

US: swap rates closed the month of August significantly lower. As of September 9, the 10-year swap rate was trading at 325bps, down from 360bps at the beginning of August. The curve is steeper, with 5s-30s trading at 1bp, up from -12bps. Going forward, we expect rates to remain volatile and USD Rates to con-tinue the bull steepening movement, at a slower pace, as a string of weak employment data – JOLTS, ADP and NFP – each depicted a gradual softening labour market. The key question now is whether the Fed will cut rates by 50bps this month instead of 25bps or retain this option for its meetings in November and December.

Emerging Markets Sovereign Credit

EM sovereign spreads were little changed in the last part of the summer. In central Europe, Bulgarian EUR sovereign bonds underperformed their peers with the 10yr ASW spread ending 5bps wider at 122bps at the end of August. Hungarian and Serbian EUR bonds were the best performers, with the 10yr benchmarks ending the month approximately 5bps tighter in asset swap terms, at 200bps and 208bps respectively. In the Middle East, there was a new escalation between the Israel and the Hezbollah, but the impact on the region's sovereign spreads was minor. The Israeli external debt spreads are almost un-changed from the end of July. In Latam, there were plenty of headlines concerning the approval of the Mexican constitutional reforms, something that led Mexican external debt to underperform. The 10yr USD benchmark's spread ended 14bps wider at 206bps. In Asia, the Indonesian EUR sovereign spreads were almost unchanged, with the 10yr EUR ASW closing at 105bps for the period observed. We are cautious on adding EM risk here, as spreads remain at tight levels and the US economy presents deteriorating economic indicators and increasing volatility. A risk of recession tends to widen EM spreads.

Corporate Credit

August proved to be a volatile month for financial markets, after a weak US jobs report early in the month raised fears that the US might be heading into a downturn. With investors reassessing expectations about future rate cuts, the VIX index of volatility spiked to levels last seen in March 2020 and risk assets slumped across the board. Calm returned as the month progressed, following positive data on the US economy, which helped ease fears about an imminent recession. Later, Fed Chair Powell's dovish message at Jackson Hole helped cement investors' conviction that rate cuts are on the horizon. Expectations got a further boost from CPI data that showed core inflation falling to its lowest levels since April 2021. Going into September, the most recent US jobs report showed that payrolls rebounded less than expected in August and the unemployment rate retraced some of its prior rise. With all those developments, equities managed to advance in August across both sides of the Atlantic, but lost momentum in early September. As of September 9, the S&P 500 registered a 0.7% decline from the start of August, led by the Magnificent 7 (-4.0%) while Stoxx 600 shed -0.5%, underperforming vs. the DAX and CAC 40 (+1.6% and +0.3% respectively). Commodities declined, with Brent crude reaching its lowest levels since December 2021 (c. $71/bbl; -9.9%from the start of August).

In credit, European synthetics outperformed relative to the US. European credit spreads tightened during this time period, with Main -3bps and Xover -7bps vs. -0.6bps and +1.6bps for CDX IG and CDX HY respectively. In EUR Corporate cash, IEAC stand 11bps higher since the start of August, with IHYG up10bps during the same period. Utilities and Snr Financials outperformed among EUR IG cash sectors (+5bps and +10bps respectively), while there were no notable underperformers. In High Yield, Snr Financials and Tech outperformed (c. -50bps each), while Utilities were the biggest laggard (+135bps). The European primary market saw fairly decent activity despite the summer lull, with total issuance in August exceeding €101bn. Activity

increased in September, amid benign conditions with total monthly issuance reaching €57bn as of early September.

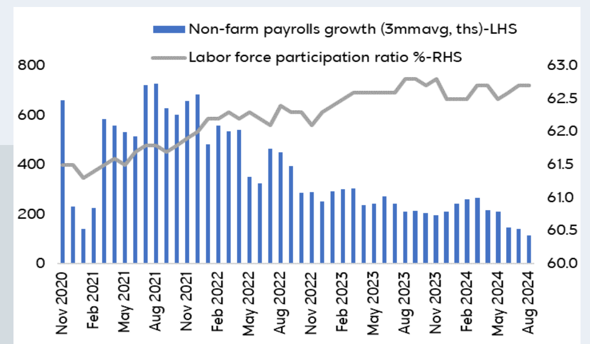
Markets remain data-driven and the main focus continues to be on central banks. With investors having priced in fully the chance of a 25bps rate cut at the 18 September meeting, the main uncertainty is whether the Fed will opt to begin its easing cycle with a more aggressive 50bps cut. Before the Fed, the ECB convenes on 12 September where a 25bps cut is widely expected.

US

Recent data aligns with soft landing narrative, easing downturn concerns

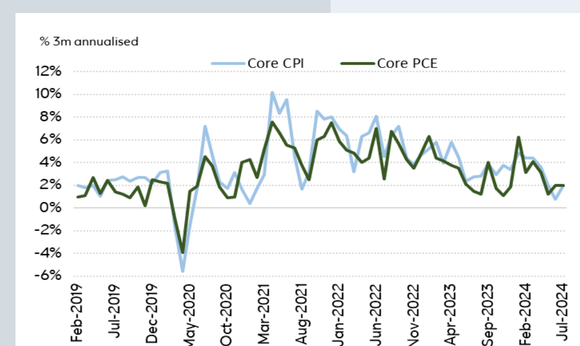
Incoming data suggests that economic activity still looks healthy, underpinned by resilient consumer spending and strong income gains. This has fueled optimism that fears of a sharp recessionary downturn, sparked by weaker than expected non-farm payrolls in early August, may had been overstated. Real personal consumption expenditures (PCE) maintained solid momentum in early Q3, rising 0.4%MoM in July, surpassing the previous three-month average of 0.3%MoM. The stronger than expected July PCE print came alongside a substantial upward revision to Q2 PCE, which was raised by 0.6ppts to an annualized rate of 2.9%. This revision more than offset slight downward adjustments to net exports and fixed investment, lifting Q2 GDP growth to 3.0% from the 2.8% previously reported, far above the 1.4% pace in Q1. On the income side, real personal income also continued to grow in July, up by 0.1%MoM, in line with the average monthly growth rate seen from January through June. However, this income growth trailed behind July's real PCE gain, causing a renewed decline in the personal saving rate (-0.2ppts to 2.9%), as consumers appeared comfortable dipping into their wealth, buoyed by strong stock market performance and favorable labour market conditions, despite a gradual moderation. The 3mmavg of non-farm payrolls growth has fallen to a four-year low, but the recent uptick in the unemployment rate (August: 4.2%, 0.1ppts above the Fed's assessment of NAIRU) largely reflects increases in labor supply (figure 3). Meanwhile, the disinflation narrative remains intact, reinforcing the likelihood of the Fed initiating rate cuts at its September 18 meeting. This is supported by recent dovish signals from Fed officials amid increasing evidence that inflation is moving sustainably toward the 2% target, echoing Chair Jerome Powell remarks at Jackson Hole in late August that the "time has come for policy to adjust". Inflation data for July showed a slight easing for the fourth straight month, largely driven by core goods inflation, with the 3m annualized rate of both core PCE and CPI slowing materially from strong prints in Q1 (figure 4). As of early September, OIS forward rates are pricing in 110bps of easing by the end of the year and an additional 140bps in 2025. However, given the prospects of a soft landing and generally tepid inflation, the Fed may proceed more cautiously than markets expect.

Figure 3: Labour market is moderating gradually



Source: BLS Eurobank Research

Figure 4: The disinflation narrative remains intact



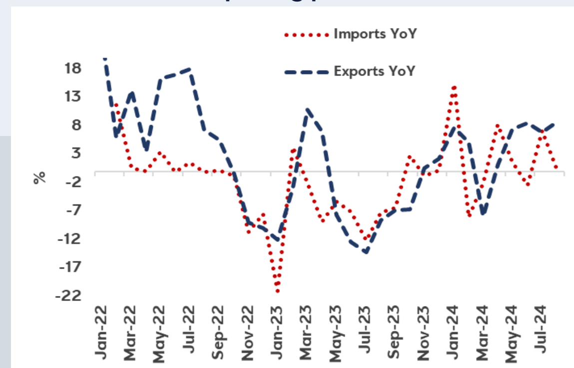
Source: BLS, Eurobank Research

China

The economy is going through a downshift

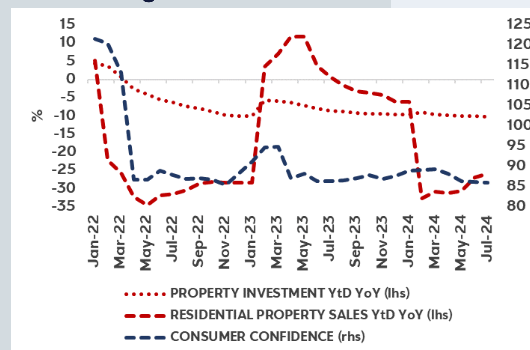
There is scant data allowing any optimism over the country's current economic standing and growth prospects. Most high-frequency soft and hard data suggest that the economy is going through a downshift. Retail sales in July inched up to 2.7%YoY from 2.0%YoY in June and came above market expectations only by a tad as this month's data is seasonably affected in a positive manner with a higher propensity for consumer spending during this month of the year. External trade data in August held good news only for the exporting part with exports increasing 8.7%YoY, the fastest pace in the last 17 months, from 7.0%YoY in July and with markets holding a more conservative view for a 6.8%YoY expansion. We read beneath the spike a rush for orders from trade partners abroad before additional tariffs on Chinese products make them more expensive and less competitive and thus, we remain vigilant on how long this positive momentum will last. Imports, on the flipside, increased only 0.5%YoY from 7.2%YoY in July. Market participants were caught off guard as they foresaw a milder slowdown to 2.5%YoY. Apparently, sliding consumer confidence and climbing youth unemployment amid a battering real estate sector weigh on domestic demand. Specifically, consumer confidence in July slid further from 86.2 in June to 86 which is just above the all-time low of 85.5 recorded in November 2022 during the Covid-19 pandemic. The youth unemployment rate reached a new high of 17.1% in July from 13.2% in June clouding the labour market prospects and implying corporates' hesitance on new hirings coming as a side effect of deferred investing plans amid the wider sentiment of uncertainty. Data from the real estate sector keep sending worrying signals as new and used home prices kept decreasing in July (-0.65%MoM and -0.8%MoM respectively) and so have property investments (-10.2%YoY Jan-July). All in all, the achievement of the government's 5% growth target in 2024 is under incremental pressure, meaning that the proper policy mix is pivotal in the months ahead.

Figure 5: Trade data are comforting only for the exporting part...



Source: Bloomberg, Eurobank Research

Figure 6: ...while the hampered consumer confidence still weighs on the real estate sector



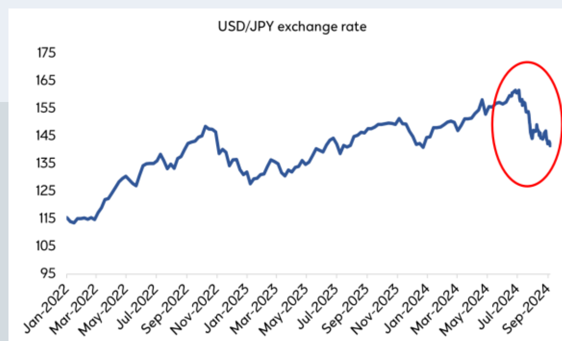
Source: Bloomberg, Eurobank Research

Japan

Wage growth supports BoJ's hawkish stance; country's premier stands down

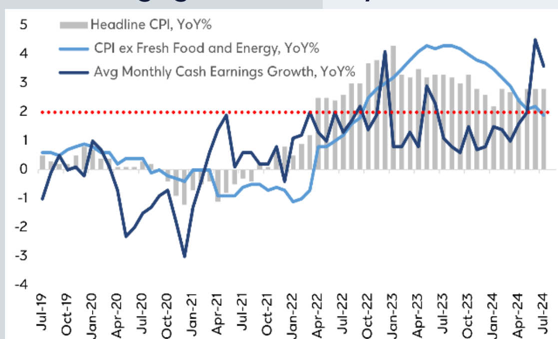
The market volatility at the beginning of August, in which the yen carry trade unwind played a role, was a reminder that macro events in Japan still have the capacity to carry financial shockwaves around the world. While the proximate cause for that shock was a weak US jobs report that led to increased Fed rate easing expectations, the other side of that trade was the Bank of Japan hiking interest rates by 15bps to 0.25% at its July policy meeting and signalling that it will raise them further if inflation continues along the projected course. Behind the BoJ's increasingly hawkish tone is mounting evidence that the 5.1% average negotiated salary increase secured at the annual spring labour talks is filtering through to the wider economy. Labour cash earnings in June increased 4.5%YoY, well above the consensus estimate of 2.4%YoY and the first increase in real terms in more than two years, followed by a 3.6%YoY rise in July, which was also higher than markets anticipated. The central bank expects that growing labour earnings will fuel demand-led inflation close to the 2% target – as opposed to price increases owing to supply shocks and a weak yen raising the import costs. July's inflation data showed headline nationwide CPI growth unchanged at 2.8%YoY, while growth in the Tokyo CPI for August – seen as a leading indicator for nationwide trends – accelerated to 2.6%YoY from 2.3%YoY the previous month as services inflation picked up 0.2ppts to 0.7%YoY. Meanwhile, the latest GDP figures showed that the economy grew an annualised 2.9%QoQ in Q2, above the consensus estimate of 2.3%QoQ, rebounding after contracting an annualised 1.8%QoQ in the first three months of the year. The BoJ is not expected to hike rates at the upcoming September 19-20 meeting, coming so soon after its last hike spooked markets, leading the Topix index to fall 12.2% on August 6. In the aftermath of that event, central bank officials reassured investors that the BoJ would not increase interest rates when markets are unstable, but Governor Kazuo Ueda has insisted that hikes remain on the table. As of early September, futures markets imply a 34% probability that the central bank will hike rates by 25bps by the end of the year. August was also eventful in politics, with Prime Minister Fumio Kishida announcing he won't seek a second term as leader of the ruling LDP party. The field is wide open in the contest to replace him, to be held on September 27, with the winner to succeed him as the country's premier.

Figure 7: The USD/JPY has come off July highs that induced official intervention



Source: Bloomberg, Eurobank Research

Figure 8: Japanese workers are seeing real wage gains after two years



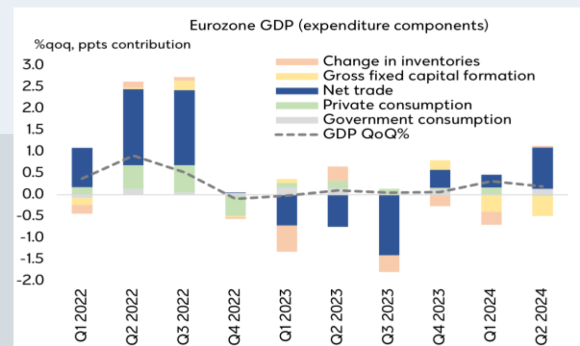
Source: Bloomberg, Eurobank Research

Euro area

Services inflation elevated, while underlying growth momentum remains weak

After more than a year of stagnation, the economy rebounded in the first half of 2024, with GDP growth rising by a downwardly revised 0.2%QoQ in Q2 after increasing 0.3%QoQ in Q1. However, the expenditure breakdown is less encouraging as growth was mainly driven by strong net exports, while domestic demand, particularly private consumption, remained weak, highlighting subdued underlying growth momentum. Moving into Q3, available hard data and sentiment indicators so far have been marginally negative, suggesting a similar or slightly weaker pace of growth compared to the prior two quarters. While the August flash composite PMI saw a surprise increase of 1pts to 51.2, this was driven by a surge in services (+1.4pts to 53.3), largely due to a temporary boost from the Olympics in France which is unlikely to be sustained. Furthermore, the European Commission consumer sentiment indicator edged down by 0.5pts to -13.5 in August, and economic sentiment improved only slightly, up by 0.6pts to 96.6, remaining below its long-term average. Meanwhile, reflecting the impact of still restrictive ECB rates, July's credit data pointed to ongoing weak bank lending dynamics. Private sector credit growth saw a modest uptick (+0.2ppts to 0.5%YoY) that was partially offset by a downtick in lending to non-financial corporates (-0.1ppts to 0.6%YoY). The signal from hard data is not encouraging either. Retail sales edged up by just 0.1%MoM in July, offsetting only part of June's 0.4%MoM drop and remaining 0.1% below May's level, offering little hope for a strong recovery in household consumption despite improving real incomes. Meanwhile, flash HICP for August showed inflation dropping by 0.4ppts to a three-year low of 2.2%YoY, largely due to a significant decline in energy prices (-3.0%YoY following July's 1.2%YoY increase) driven by base effects. However, core inflation remained persistently high, falling by only 0.1ppts to 2.8%YoY. While core goods inflation decelerated notably (0.4%YoY from 0.7%YoY), services inflation reaccelerated (to 4.2%YoY from 4.0%YoY), which is a concern for the ECB. However, the ECB's focus appears to be slightly shifting toward growth risks, as indicated by the minutes from the July meeting which, along with the 1.1ppts decline in negotiated wages growth to 3.6% in Q2, reinforced expectations for a rate cut at the upcoming September 12 meeting. Despite this decline, wage growth remains well above levels consistent with the 2% inflation target, supporting the view that the ECB will retain a cautious approach to easing policy beyond September.

Figure 9: Net exports were the main growth driver in H1, while domestic demand remained weak



Source: Eurostat, Eurobank Research

Figure 10: Wage growth has probably peaked in a majority of EA countries

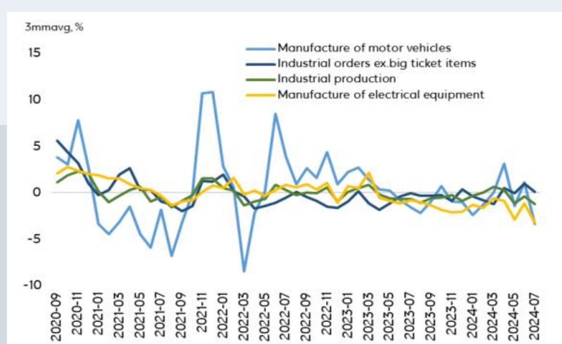
Source: ECB, Eurobank Research

Germany

Hopes fade that the country can escape stagnation

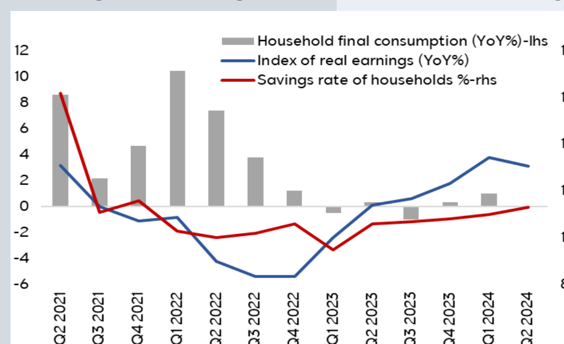
Optimism early this year that Germany had emerged from stagnation, following a GDP rebound of 0.2%QoQ in Q1 after a 0.5%QoQ contraction in Q4 2023 and a sluggish 0.1%QoQ average growth rate in the first three quarters of last year, now appears misplaced. GDP fell back into contraction in Q2 (-0.1%QoQ), with the largest drag stemming from plunging investment (-0.5ppts) which had been temporarily boosted by weather-related gains in construction in the previous quarter. Private consumption also failed to provide support to economic growth (-0.2ppts), despite expectations of a significant increase in real wage growth this year based on collective-bargaining agreements between January and June. Net trade was another weight on growth (exports -0.2%QoQ, imports stagnant), while positive contributions from government spending (+0.2ppts) and inventories (+0.4ppts) prevented a deeper contraction. Heading into Q3, lacklustre leading indicators and weak hard data cast doubt on any imminent recovery, fuelling concerns of prolonged stagnation. The composite PMI, which dipped back into recessionary territory in July, fell further in August to a five-month low (-0.7pts to 48.4). Both the services (-1.3pts to 51.2) and manufacturing sectors (-0.8pts to 42.4) showed declines, reflecting rising global growth concerns, ongoing geopolitical tensions and heightened policy uncertainty in the run-up to the US president election. The prominent IFO business climate index also failed to provide any relief, declining for the fourth straight month in August to its lowest level in six months (-0.4pts to 88.6), weighed down by a weaker current assessment and diminishing business expectations. Hard data has been no more reassuring. Industrial output plunged -2.4%MoM in July, marking the second largest decline this year, driven by steep contractions in automotive production (-8.1%MoM) and the electoral equipment sector (-7.0%MoM). Meanwhile, domestic manufacturing orders remained weak and core industrial orders ex. big-ticket items failed to gain any respite, signalling persistent weakness in industrial activity for the near term. Against this backdrop, any hopes for recovery hinges on private consumption. However, the GfK consumer climate indicator dropped in August to a three-month low (-3.4pts, to -22), while households' propensity to spend remains muted, reflected in persistently high savings rates (+0.3ppts to 11.3% in Q2). That said, we maintain our forecast for mild GDP contraction this year.

Figure 11: Industrial production keeps declining



Source: Destatis, Eurobank Research

Figure 12: Households cautious about spending income gains, opting instead to increase savings



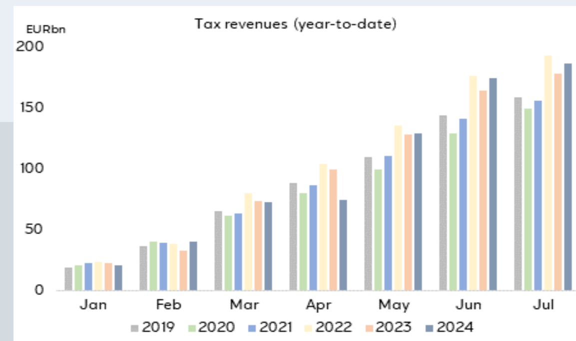
Source: Destatis, Eurobank Research

France

Political uncertainty has been reduced, but significant risks remain

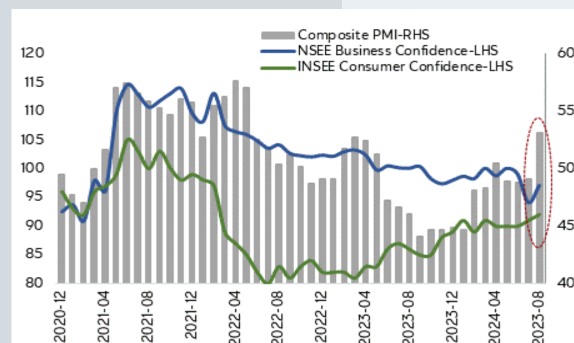
Nearly two months after the second round of snap legislative elections in July, President Emmanuel Macron appointed Michel Barnier as the new prime minister. Barnier, a seasoned politician with extensive experience, including four cabinet posts and stints as an EU Commissioner and Brexit negotiator, faces the immediate challenge of forming a government that can defeat a non-confidence vote in the 577-seat National Assembly (an absolute majority of 289 seats is required). Direct opposition will likely come from the left-wing New Popular Front (193 MPs). However, Barnier is likely to garner support from his centre-right party (formerly Les Républicains), while the presidential coalition is expected to refrain from opposing him (47+166=213 MPs). Thus, the stance of the far-right Rassemblement National (126 MPs), which will be based on Barnier's policy proposals according to the party leader, will prove crucial on whether the new government will survive. The next major challenge for the new government, which is expected to pursue a fiscal consolidation in line with EU fiscal rules, is preparing the 2025 budget, with the possibility of amending the 2024 budget. The former caretaker administration warned that, unless an additional €15bn in savings or revenue-raising measures are enacted, the deficit could rise to 5.6% of GDP in 2024, exceeding the official target of 5.1% according to the Stability Programme, from 5.5% in 2023, which triggered the opening of an EDP in summer. This warning was followed by a note from the Director General of the Treasury indicating that the 4.1% target for next year "seems very difficult to achieve" and the deficit could climb to 6.7% by 2026 if no corrective measures are taken. On the macroeconomic front, the economy remained stuck on a sluggish growth trend in Q2, with GDP revised down by 0.1ppts to 0.2%QoQ, matching the pace in Q1, supported by net exports (+0.1ppts). However, domestic demand remained subdued. Investment fell for the third straight quarter (-0.4%QoQ), government spending slowed (-0.2ppts to 0.6%QoQ), and household consumption saw a modest recovery (0.1%QoQ vs. -0.1%QoQ in Q1). Under a scenario of policy continuity, prospects for H2 look brighter. GDP is expected to accelerate to 0.3-0.4%QoQ in Q3, partly due to the Olympics, but also supported by improved private consumption and a pick-up of investment as monetary policy eases. Full-year growth is projected to reach 1.1%.

Figure 13: Potential fiscal slippage in 2024 due in part to underperforming tax revenues



Source: France's Treasury, Eurobank Research

Figure 14: GDP is expected to accelerate in Q3, partly due to the Olympics



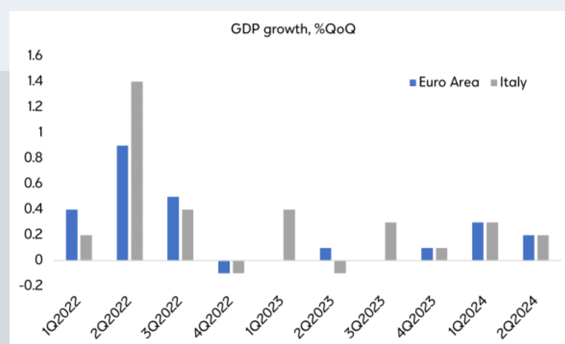
Source: INSEE, Bloomberg, Eurobank Research

Italy

Latest growth print shows country is something of a bellwether for euro area

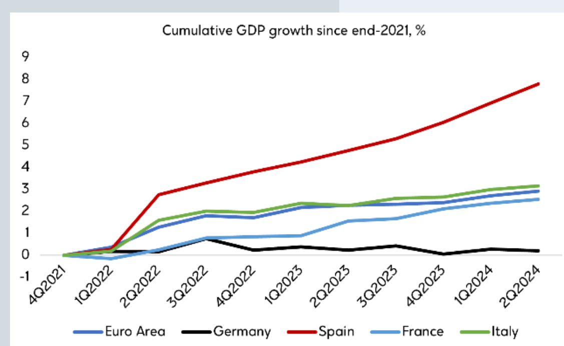
Quarterly GDP growth exactly matched that of the euro area as a whole for a third straight quarter in Q2. It seems appropriate at a moment when Italy's most eminent statesment of recent decades, Mario Draghi, has produced a much-anticipated report on the future of industrial strategy in the European Union that the country he recently led has become something of a weather vane for the economy of the Eurozone currency bloc as a whole. GDP grew 0.2%QoQ in Q2 after expanding 0.3%QoQ in Q1 and eking out a 0.1%QoQ increase in the last three months of 2023. Taking a longer look at the economic course of the euro area's four biggest economies since the pandemic, Italy's GDP has most closely tracked that of the euro area as a whole, growing a cumulative 3.2% since Q4 2021, just a shade higher than the currency bloc's somewhat mediocre 2.9% expansion. While it can only look on enviously at Spain's soaring economy that has grown 7.8% during this period, it at least avoids the "sick man of Europe" tag attached to Germany, which has only managed to grow 0.2%. Meanwhile, Italy is returning to a place of price stability more quickly than the euro area as a whole. Headline HICP inflation stood at 1.3%YoY in August, down after briefly spiking to 1.6%YoY in July, while Italy's core HICP growth slowed 0.1ppts to 2.3%YoY last month – bringing it close to the ECB's 2% target. Beyond the macroeconomic performance, Italy's budget is in sharp focus this month as the government has to submit plans by September 20 to the European Commission showing it will raise funds to bring it into conformity with the EU's fiscal rules after it was put under an EDP in June. The country's budget deficit came in at 7.4% of GDP last year, and the government has pledged it will take the measures necessary to bring it below 3% in 2026, meaning it will have to make some tough choices in the weeks ahead to find €25 billion of savings for 2025, with recent reports suggesting it has so far found half of that. Even in this, however, Italy is not far outside EU mainstream given that several other countries were placed in an EDP at the same time, including France, which faces greater political hurdles to passing budget cuts. As such, the spread of 10yr BTPs over Bunds – a key indicator of fragmentation risk in the euro area – has stayed in a stable range through the summer, standing at 143bps as of September 11.

Figure 15: Italy's last three quarterly GDP growth prints have matched that of the EA



Source: Eurostat, Eurobank Research

Figure 16: Italy's recovery since the pandemic has also closely tracked the EA overall



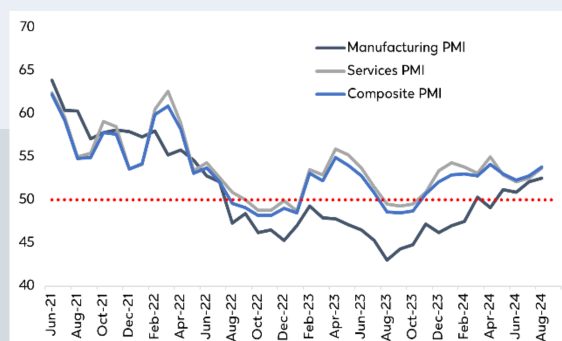
Source: Eurostat, Eurobank Research

UK

Economy continues cyclical upswing as government prepares spending cuts

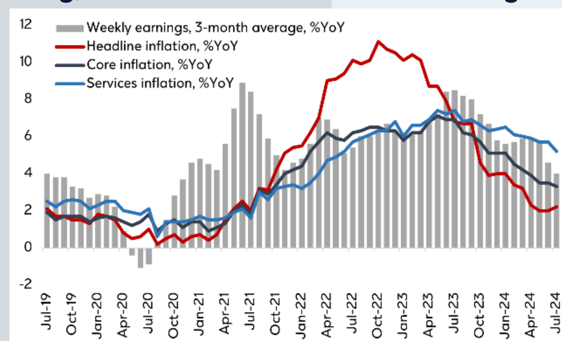
As the new Labour finance minister has been warning members of her own party to brace for unpopular spending cuts in next month's announcement of the budget, economic indicators released over the summer show that the country continues to be in a happy spot in its business cycle. GDP grew 0.6%QoQ in Q2, 0.1ppts less than in the first three months of the year but at a level indicating that the economy is continuing its healthy recovery from a shallow recession at the end of last year. Services output grew 0.8%QoQ, which offset 0.1%QoQ drops in both the production and construction sectors. In expenditure terms, household consumption, government spending and gross capital formation all increased, offsetting a drop in net trade. In terms of business confidence indicators, the August PMIs for manufacturing, services and construction and the composite were all well above the 50 threshold signalling the difference between expansion and contraction, with the composite PMI increasing 1.0pts to 53.8. Meanwhile, the Bank of England began its easing cycle, cutting its policy rate by 25bps to 5.0% at its August 1 meeting as inflation concerns have eased. Since then, the July CPI print showed headline inflation accelerating 0.2ppts to 2.2%YoY, less than the consensus estimate of 2.3%YoY, with core slowing more than expected to 3.3%YoY from 3.5%YoY in June. Central bank decision makers will also have been heartened by average weekly earnings growth falling to 4.0%YoY in the three months through July from 4.5%YoY in June. Rounding out the encouraging picture, the July unemployment rate fell 0.1ppts to 4.1%. Against this bright backdrop, the new government, elected on July 4, has started drawing accusations of being the "doom and gloom government". This is in response to Finance Minister Rachel Reeves repeatedly messaging that "tough choices" will be needed to cover £22 billion of budget overspending if the government is to meet its chosen fiscal rules. Controversy in recent weeks has centred on plans to cut eligibility for the winter fuel allowance given to pensioners, though decisions on cutting back on infrastructure investment plans will be more consequential in terms of the UK's long-run growth potential. Capital gains and inheritance taxes are also likely to increase. This fiscal tightening could give space for the BoE to ease monetary policy more quickly than expected. As of early September, markets price in fully a 25bps rate cut by November.

Figure 17: PMI indicators are all currently above the 50 threshold and ticking upwards



Source: S&P Global, Bloomberg, Eurobank Research

Figure 18: Wage and price pressures are easing, even if services inflation remains high



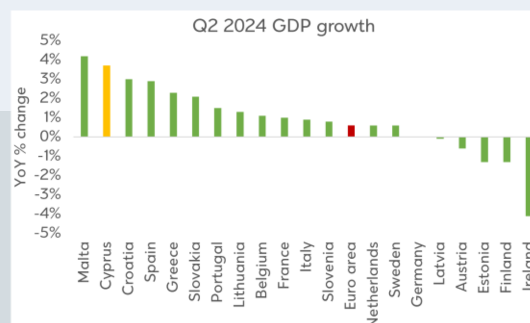
Source: ONS, Bloomberg, Eurobank Research

Cyprus

Domestic demand boosts GDP growth in Q2, despite net exports weakening

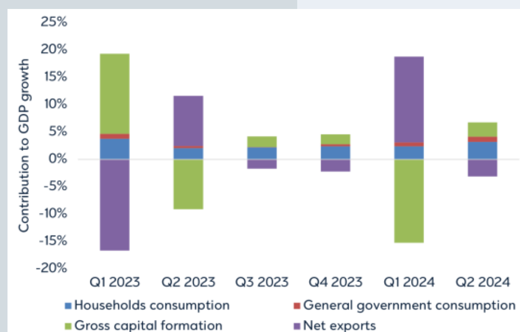
Annual GDP growth accelerated further in Q2 2024, to 3.7% from 3.3% in Q1 2024, the second-best growth performance in Q2 in the Eurozone, while quarterly growth eased mildly, to 0.7% from 1.0%. Household consumption remained the main growth driver (+5.3%YoY from +3.9%YoY in Q1), mainly on the back of a tight labour market, with unemployment at a 16-year low for Q2 (4.6%), despite a rebound in inflation (to 2.7%YoY from 1.9%YoY in Q1). Growth was also boosted by a recovery in fixed capital formation (+11.1%YoY vs. -34.3%YoY in Q1), mainly in transport equipment and housing. Net exports deteriorated moderately, to -0.9% from +0.1% of the quarterly GDP in Q1, despite a stronger rise in exports (+3.7%YoY after +1.8%YoY), exclusively based on exports of services, as the fall in imports in Q1 was reversed (+7.3%YoY after -13.0%YoY). On the production side, the boost to GDP came from services sectors (retail trade, tourism, transport, ICT) and construction. Activity in the latter is backed by a buoyant real estate market in previous years, which has lost some steam in 2024 due to geopolitical developments. However, the overall trend in the January-July period is positive (real estate sales +1.8%YoY), with a strong spike in July (+21.7%YoY). As mentioned in previous reports, the return to credit expansion in 2024, at an accelerating pace (+2.0%YoY in July, a two-year high), mainly from more credit towards non-financial businesses (+1.5%YoY in July from -0.7%YoY in Dec-2023), also supports investment growth. Tourist arrivals rose similarly in June (+5.5%YoY) and July (+5.3%YoY), reaffirming a moderate upward trend in tourism this year (Jan-Jul 2024: +3.1%YoY), accompanied by an analogous increase in tourism revenues (+4.2%YoY in H1 2024). The goods balance posted a marginal deterioration in July (-0.8%YoY), from a stronger fall in exports relative to imports, whereas in H1 2024 the decline in the latter was stronger. In any case, after a 7.9% fall in real terms last year, exports of goods have continued declining in 2024 (also -7.9%YoY in H1 2024), an indication of their deteriorating competitiveness. Disinflation recovered in July and August (2.4%YoY and 2.2%YoY respectively in the flash estimate), mainly due to weakening energy products prices reflected in utility and transport costs. Provided that this trend in energy prices continues, together with the disinflationary measures, they will sustain inflation weakening for the remainder of 2024, boosting household consumption. Dynamism in the components of domestic demand leads us to revise upwards our growth forecast for 2024 to 3.3%.

Figure 19: Second-best GDP growth performance in the Eurozone in Q2...



Source: Eurostat, Eurobank Research

Figure 20: ...exclusively from domestic demand components, as the impact of net exports turned negative



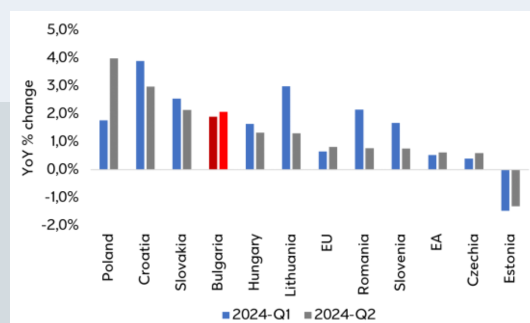
Source: Cystat, Eurobank Research

Bulgaria

GDP growth remains firm in Q2; new snap elections to be held in October

Real GDP growth came in at 2.1%YoY in Q2 2024, mildly higher than the Q1 2024 and Q4 2023 growth rates (1.9%YoY and 1.7%YoY respectively). Investments, which expanded for the first time in seven quarters (+14.1%YoY from -5.3%YoY) and household consumption (+3.0%YoY) were the key growth drivers. Net exports slightly deteriorated, due to a rise in imports after a five-quarter continuous fall (+4.9%YoY), while the decrease in exports eased to 0.3%YoY from 2.1%YoY. However, given that the last parliamentary elections were held on June 9, the Q2 GDP figures barely reflect any possible effect from the subsequent inability of the political parties to form a coalition government, which led to the proclamation of another snap elections in late August for October 27 (the sixth one in the last 3.5 years). On the other hand, the country has often been under similar political conditions in the recent years, without significant implications for economic growth. Polls show that the four parties with the most seats in the outgoing parliament remain close to their June elections vote shares, but have not accounted yet for the recent split in the party that came second in the June elections (MRF). Provided that the October elections results are close to the polls, uncertainty about the formation of a government is not expected to wane soon after the elections day. The new snap elections delay the implementation of reforms related to EU funds and Eurozone accession and will probably also stall the disbursement of the second tranche from the RRF. Regarding trends in short-term indicators in early Q3, the stalling of the disinflationary trend since May continued in July, with inflation at 2.8%YoY, up from 2.5%YoY in April, mainly due to rising transport (+5.2%YoY) and hotels-restaurants prices (+9.1%YoY), undermining the country's efforts to achieve the inflation criterion for the euro adoption. Amidst this inflation rebound, retail volume expanded 2.3%YoY in July after an average 3.2%YoY drop in Q2. An accelerating strong credit expansion, especially towards households (19.6%YoY in July) and less towards businesses (8.7%YoY), could continue fuelling private consumption and investment, but also sustain a rising trend in inflation. Weighing the upside dynamics in short-term indicators against the potential implications of a protracted lack of a stable government, we are leaving our GDP growth forecast for 2024 at 2.2%.

Figure 21: Outperformance in GDP growth relative to the EU average and most CESEE countries in Q2



Source: Eurostat, Eurobank Research

Figure 22: Disinflation has halted by rising transport and accommodation – restaurants

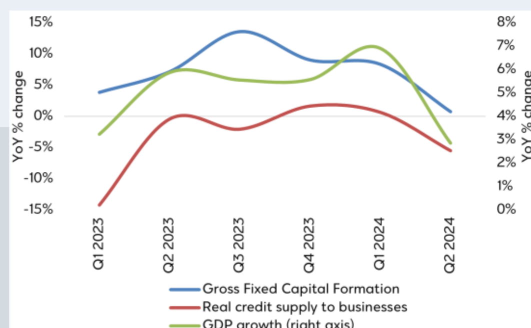
Source: National Statistical Institute Bulgaria, Eurobank Research

Turkey

Monetary tightening weighs on Q2 GDP growth, yet inflation moves above target

GDP growth slowed down to 2.9%YoY in Q2 2024 from 6.9%YoY in Q1 2024, a four-year low pace, below the market forecasts for a 3-3.2%YoY growth. On a quarterly basis, GDP stagnated in Q2 (+0.1%), after a 1.4% increase a quarter earlier. The weakening in the annual print is mainly due to a strong deceleration in investment expansion (0.7%YoY from 8.0%YoY in Q1), probably because of the severe monetary tightening policy stance of the central bank (TCMB). Household consumption growth also decelerated, to 2.9%YoY from 6.9%YoY, despite the decline of unemployment to an 11-year low for Q2 (8.8%), a development related to the uncertainty of a part of households over their financial condition in H2 2024, as in contrast to the previous two years, the minimum wage was not increased in July to curb inflationary pressures on income. However, civil servants and retirees received a raise in July, compensating for purchasing power losses over the past six months. The weakening in the two most significant components of domestic demand was reflected in a stronger fall in imports (-5.8%YoY from -2.3%YoY in Q1) which led to a marginal improvement in net exports, as the growth in exports slowed to 0.4%YoY from 3.6%YoY.

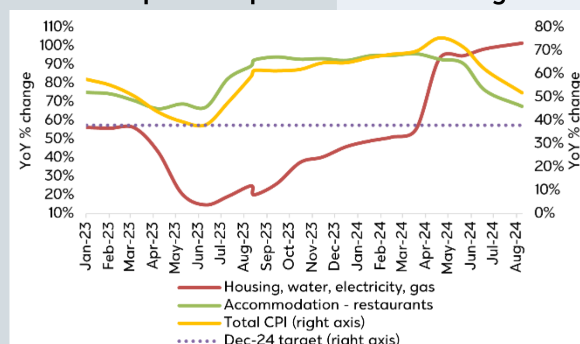
Figure 23: Monetary policy tightening weighed on investment and GDP growth…



Source: Central Bank of Turkey, Turkstat, Eurobank Research

Persistent high inflation in July and August (52%YoY in the latter month), mainly on the back of increases in taxes and administered prices (utility, natural gas, special levy on all types of fuels etc.) is expected to continue in the coming months, driving inflation by end-2024 higher than the TCMB target (38%) and sustaining downward pressures on households' real spending. Amidst unfavourable financing conditions, investment could be boosted in H2 2024 by large foreign direct investment inflows both in Q1 2024 (+$17.2bnQoQ) and Q2 2024 (+$18.8bnQoQ), as there is usually a time interval between acquiring capital and implementing an investment project. Developments in the external sector of the economy remained tilted to the upside in July, as the goods balance continued improving (deficit: -41.8%YoY), mainly from rising exports and less from falling imports, and tourist in-flows increased, although at much slower pace than in Q2 (+2.6%YoY vs. +8.9%YoY). Regarding Turkey's medium-term prospects, Fitch Ratings on September 8 improved its sovereign rating by one notch, to BB-, with a stable outlook, on the grounds of significantly improved external buffers, reduced contingent FX liabilities and expectations of a consistent policy mix, especially on monetary issues. Considering mainly the weakening household consumption dynamics in Q2 and its unfavourable prospects for the remainder of the year, our growth forecast for 2024 is trimmed by 0.2ppts, to 3.6%.

Figure 24: …yet increases in administered prices and tourism prices keep inflation far from target



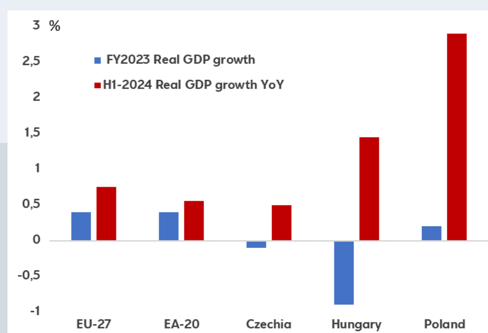
Source: Turkstat, Eurobank Research

CESEE

Poland surfaced as the frontrunner in the region based on Q2 GDP data

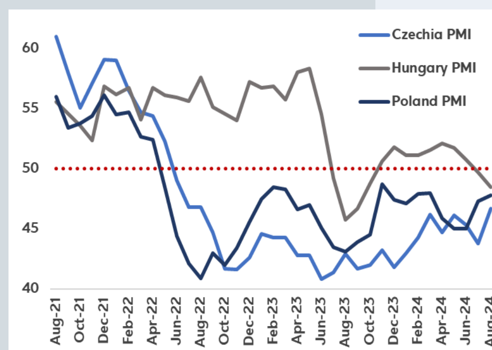
Q2 GDP growth prints point to a mixed yet positive trend in the region. With the EU-27 economies growing by 0.8%YoY/0.2%QoQ compared to 0.7%YoY/0.3%QoQ in the previous quarter, Poland is one of the few peers that posted both annual and quarterly improved growth rates. Q2's annual growth print ranked second, following Malta, and the quarterly rate ranked first. GDP expanded by 4%YoY/1.5%QoQ from 1.8%YoY/0.8%QoQ in Q1, which translated into 2.9%YoY growth in H1-2024 from 0.2% in FY2023. The solid performance was primarily driven by private and public consumption. Private consumption increased by 4.7%YoY, a tad higher than Q1, and contributed more than half to the headline annual growth, the same as in the previous quarter. Public consumption kept increasing vigorously above 10%YoY (10.7%YoY in Q2 vs 10.9%YoY in Q1) underpinned by the loose fiscal deficit targets Poland had adopted since 2023. This loosening tilts the overall economic risks of the country to the upside as the fiscal impulse is forecast to continue up to 2025. In Hungary, the economy decelerated on both an annual and quarterly basis. GDP continued to grow by 1.3%YoY compared to 1.6%YoY in Q1, yet it contracted by -0.2%QoQ after growing 0.7%QoQ previously. The annual deceleration was broadly attributed to the steep contraction of investments by 15.4%YoY, which have been negatively contributing to growth since Q4-2022, albeit to milder extents in all previous quarters. However, solid private consumption meant the loss steam was modest and will not stop the economy from rebounding in 2024. That said, H1-2024 growth is set at 1.5%YoY vs the -0.9%YoY contraction in 2023. The Czech economy also held firm expanding by 0.6%YoY/0.3%QoQ from 0.4%YoY/0.4%QoQ in the previous quarter with the increase in gross fixed capital formation behind the mild annual pick up. Along with the outlined above growth dynamics, PMIs in Poland and Czechia improved in August, capturing presumably the optimism from the recent GDP data. However, they all, including Hungary that slid in August, are still below 50, largely due their dependency on the German economy, which has also struggled with contracting manufacturing PMI since July 2022.

Figure 25: Growth in H1-2024 improved...



Source:Eurostat, Eurobank Research

Figure 26: ..pushing the PMI in Poland and Czechia higher



Source:S&P Global, MLBKT, KHS, , 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	3.3	3.1	3.1	6.7	4.6	3.5									
Advanced Economies															
USA	2.5	2.5	1.7	4.1	2.9	2.3	3.6	4.1	4.3	-3.3	-3.4	-3.3	-6.5	-6.7	-6.5
Eurozone	0.4	0.7	1.3	5.5	2.4	2.1	6.6	6.5	6.5	1.6	2.5	2.5	-3.6	-3.0	-2.7
Germany	-0.3	0.1	1.0	6.1	2.4	2.2	5.7	6.0	6.1	6.0	6.8	6.5	-2.5	-1.8	-1.4
France	0.9	1.1	1.1	5.7	2.5	1.9	7.4	7.5	7.5	-1.4	-0.0	-0.1	-5.5	-5.4	-4.6
Periphery															
Cyprus	2.5	3.3	3.6	3.9	2.6	1.6	6.1	5.0	4.5	-12.1	-8.5	-7.0	3.1	3.5	3.7
Italy	0.9	0.8	1.0	6.0	1.2	1.8	7.2	7.0	7.2	0.5	1.7	1.8	-7.4	-4.7	-3.7
Portugal	2.3	1.8	1.9	5.3	2.4	1.8	6.5	6.5	6.3	1.4	1.6	1.4	1.2	0.3	0.4
Spain	2.5	2.6	2.0	3.4	3.1	2.2	12.2	11.7	11.3	2.6	2.6	2.4	-3.6	-3.1	-2.9
UK	0.1	1.1	1.3	7.4	2.6	2.3	4.0	4.4	4.6	-3.3	-2.6	-2.6	-5.0	-3.6	-3.0
Japan	1.7	0.1	1.2	3.3	2.4	1.9	2.6	2.5	2.4	3.6	4.0	3.7	-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	3.3	2.8	4.3	4.4	4.1	-0.3	0.2	0.2	-1.9	-2.9	-2.9
Turkey	4.5	3.6	3.2	53.4	58.7	21.2	9.4	8.6	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	September 2024	December 2024	March 2025	June 2025
USA					
Fed Funds Rate	5.25-5.50%	4.98-5.25%	4.52-4.75%	4.11-4.35%	3.76-4.40%
3m SOFR	4.93%	5.02%	4.63%	4.23%	3.89%
2yr Notes	3.69%	4.10%	3.90%	3.71%	3.54%
10yr Bonds	3.72%	3.98%	3.93%	3.87%	3.82%
Eurozone					
Refi Rate	4.25%	3.65%	3.40%	3.10%	2.85%
3m Euribor	3.46%	3.45%	3.19%	2.90%	2.64%
2yr Bunds	2.23%	2.48%	2.32%	2.24%	2.17%
10yr Bunds	2.18%	2.30%	2.26%	2.28%	2.27%
UK					
Repo Rate	5.00%	5.00%	4.65%	4.35%	4.05%
3m Sonia	4.85%	4.84%	4.44%	4.19%	3.83%
10-yr Gilt	3.88%	3.90%	3.80%	3.76%	3.70%
Switzerland					
3m Saron	0.95%	0.95%	0.83%	0.87%	0.90%
10-yr Bond	0.45%	0.58%	0.62%	0.66%	0.73%

Source: Bloomberg (market implied forecasts)

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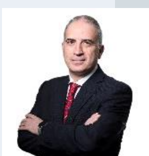

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