Global Macro Themes & Market Implications for the EA Periphery and the CESEE

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I. Snapshot

Overview

Macro Picture

- **USA:** Growth acceleration on forthcoming stimulative fiscal policy, especially from H2 2017 onwards
- **EA**: Industrial production supports growth, but investment still lacks momentum
- **UK:** Growth expected to slow on hard Brexit worries
- **Japan**: Growth mainly driven by external demand
- **EM:** Growth pickup, especially in LatAm as Brazil emerges out of recession
- **CESEE:** Q4 GDP data confirmed that regional economies are in good shape

Policy Outlook

- **USA:** Three Fed rate hikes by end-2017 priced-in
- **EA:** ECB maintains easing bias in spite of rising headline HICP
- **Japan:** BoJ on hold, as it remains concerned on the inflation outlook
- **UK:** BoE neutral stance; Brexit risks offset expectations for inflation target overshoot
- **CESEE:** Limited room for further monetary and fiscal stimulus

Summary

Global growth gains momentum at the beginning of the year, amid renewed oil-driven global inflationary pressures. Politics take centre stage, ahead of looming elections in several major euro area countries. Uncertainty regarding the US administration's policy changes prevails

Markets

- **FX:** USD well supported short-term but we favor EUR upside; Brexit developments to set the tone for the GBP
- **Government bonds:** USTs, Bunds to remain under pressure on reflation outlook; short term support from positioning and political risks
- **EM:** Higher DM rates should weigh on the asset class short-term, especially following the YTD rally, but see any widening as a buying opportunity
- **Credit:** Tight spreads and low yields signal for caution ahead
- **Commodities:** Turning up after a long bear market with industrial metals and energy leading the way

Key Risks

- **Trump disappointment:** Trump's fiscal stimulus falls short of expectations; US fails to accelerate
- **US aggressive trade protectionism:** Trade & currency war likely, jeopardizing anemic global trade and, hence, weighing on the global growth momentum
- **A steeper Fed rate-hike trajectory ahead**: EM capital flows negative
- **EU political risks escalation:** Populist parties increase popularity or even come into power in upcoming EU elections: bearish for EU periphery government bonds

Macro Views

Latest Macroeconomic Developments & Outlook

World Economic Outlook		The positive global growth momentum seen in late 2016 amid broad-based gains in developed economies and emerging markets has probably been sustained in early 2017. PMI indices for the first two months of this year suggest the cyclic recovery in global industrial activity is gaining traction, driven by strong demand in most of major developed economies. However, rising global price pressures mainly due to the rebound in commodity and oil prices may start to weigh on consumption. Furthermore, prevailing political jitters on both sides of the Atlantic could weigh on sentiment. The risk of a rise in US protectionism has also the potential to hamper the current global growth momentum. Adding to the above, prevailing uncertainty regarding Trump's policies is casting a shadow on an expected modest acceleration in global growth to c. 3.4% in 2017 from 3.1% in 2016.
Developed Economies	**US**	Real GDP growth has picked up significantly in the first months of the year, following a sub-par increase of 1.6% in 2016. The gradual improvement in labor market conditions and the upward trend in inflationary pressures bode well for quarterly growth rates above potential, which is currently estimated close to 2.0% for the US economy.
	Euro Area	Recent economic indicators point to better growth dynamics in both the manufacturing and the services sectors. February PMI indices signal upside growth momentum, with the services index surging to a nearly 6-year high. Nevertheless, the stronger economic outlook remains clouded by a heavy political agenda that increases concerns about euro break-up risks.
	Periphery	The majority of periphery euro area economies retained a positive momentum in Q4 2016, with private consumption remaining the key growth driver. Portugal was among the main outperformers mainly supported by an acceleration in domestic demand related to rebounding investment. On the flipside, Greece was a laggard, as the high degree of uncertainty relating to the delays encountered in reaching a staff level agreement on the 2nd programme review takes its toll on domestic economic activity. Sentiment indicators pertaining to the first two months of 2017 suggest that the improving trend has remained intact.
	Japan	Industrial production and exports appear to be picking up in line with the strengthening of the global manufacturing cycle. The post-US election JPY depreciation should support manufacturers' profits in the months ahead, constituting a positive factor for business investment. Nevertheless, measures of underlying inflationary pressures remain subdued, despite some recent acceleration in headline prices.
Emerging Economies	**BRICS**	Brazil and Russia are expected to exit from recession in 2017, more than offsetting the modest growth deceleration in China (to 6.5% in 2017 from 6.7% in 2016). India's GDP will continue to expand at the fastest pace among major economies, with growth forecasted at 7.2% in 2017 from 6.6% in 2016.
	CESEE	GDP growth flash estimates for Q4-2016 confirmed that these economies are in relatively good shape and broadly met their respective full year projections. On average, consumer sentiment, services and retail trade are on an improving trend as consumers continue to benefit from rising real wages, firmer labor markets and low inflation.

Global Macro Themes & Implications

Theme	Implications
Prevailing uncertainty over US administration's policy changes	In his long-awaited address to Congress in late February, US President Donald Trump repeated many of his campaign promises, but was short of specific details on the scope or extent of potential tax changes and infrastructure spending plans. He only outlined that "his economic team is developing historic tax reforms" and that he will ask "Congress to approve legislation that produces $1trn in infrastructure investment". The aforementioned speech followed comments by US Treasury Secretary Steven Mnuchin that Congress approval of tax reforms could be delayed into late 2017, and any impact on the domestic economy this year is likely to prove limited. Nevertheless, details on the US administration's policies should be forthcoming in the next few weeks, when the government presents a budget proposal to Congress.
Fed turns more hawkish	At the semi-annual testimony before the Senate Banking Committee in mid-February, Fed's Chair Janet Yellen adopted a slightly hawkish tilt regarding the near-term Fed policy deliberations. She argued that, in the absence of negative surprises, "gradual" increases in the federal funds rate were probably warranted emphasizing that "waiting too long to remove accommodation would be unwise". In the same wavelength, a number of voting and non-voting FOMC policymakers signaled support for near-term rate tightening, highlighting that risks to the growth outlook seem tilted to the upside, unemployment is likely close to the equilibrium rate and stock markets remain buoyant. Against this background, market consensus is for three Fed rate hike by the end of 2017, assuming that economic indicators continue to surprise positively and the US administration provides some clarity on its economic policy.
Headline inflation continues to rise in developed markets	January inflation data in the majority of developed economies confirmed an uptrend in headline CPI, mainly driven by a rebound in commodity and energy prices. However, in the absence of a sustainably convincing upward trend in underlying inflationary pressures, and especially in nominal wage growth, the firming in headline prices is judged to be transient and, thus, is unlikely to cause a marked shift in the monetary policy of the majority of central banks.

Global Macro Themes & Implications

Theme	Implications
Increasing political uncertainty ahead of upcoming key ballots in major euro area economies	Fears over populism risk in Europe prevail ahead of a string of looming ballots in the region this year. The first major electoral event will be the parliamentary elections in the Netherlands on March 15, ahead of France's presidential elections in April/May. ***Netherlands:*** The majority of recent opinion polls suggest that the populist anti-immigration and anti-EU far-right Freedom Party (PVV) is likely to be the largest party in parliament, but short of securing an absolute majority to govern (the Netherlands has not had a single party government in the post-war period). Up to now, nearly all parties have ruled out a co-operation with PVV, suggesting that the latter will fail to form a coalition government. Should this be the case, lengthy coalition talks will start, with the new government likely to consist of a broad coalition of at least five pro-EU mainstream parties. However, even in opposition, a strong result by PVV is likely to have repercussions for the domestic political scene and for Europe. ***France:*** According to a number of recent opinion polls, far-right National Front leader Marine Le Pen, who has vowed to take France out of the EA and redenominate French public debt into Francs, remains favorite to win the first round of presidential election on May 23rd, but would lose the May 7th run-off against either centrist Emmanuel Macron who is running as an independent or centre-right Francois Fillon. Even though nearly all polls suggest that Le Pen is unlikely to become the next French President, investors are growing increasingly nervous. The unexpected outcome of the UK referendum and the US Presidential election suggests that polls are not always reliable. Risks prevail mostly related to the attitude in the second round of left -wing voters as well as right-wing voters votes —if Fillion does not make it to the second round- amid fears that a majority of them could potentially abstain or even switch to France's National Front (FN) lured by the additional welfare benefits Le Pen is promising.
ECB: substantial degree of monetary accommodation is still warranted	The accounts of the ECB January monetary policy meeting supported the view that a substantial degree of monetary accommodation is still warranted, dismissing talk of tapering/QE exit at this stage. Governing Council members acknowledged that although the economy has evolved in line with the Euro system staff macroeconomic projections presented at the December meeting, uncertainty prevails and risks remain skewed to the downside, predominantly related to global factors. On the inflation front, they argued that, in spite of the recent rise in headline inflation, there are no signs yet of a convincing upward trend in underlying inflation, partially due to the prevailing labor market slack. Regarding the implementation of the APP programme, the ECB officially acknowledged for the first time that there was a "trade-off" between purchasing below the depo rate and deviating from the capital key, leaving the door open for more purchases of peripheral debt in the future in case core sovereign paper becomes more scarce or/and peripheral bond yields fall below the depo rate.

Macro Themes & Implications in CESEE

Theme	Implications
Challenging macroeconomic outlook in 2017	Q4 2016 GDP growth flash estimates confirmed that regional economies remained in relatively good shape last year. In 2017, the macroeconomic outlook is expected to be more challenging. Last year's performance, at least in part, reflects lax monetary policies from both major and regional central banks as well as the impact of lower energy prices on household-corporate and sovereign balance sheets. Given that energy prices are already on a normalization course and that interest rates in the region are already at historic lows, while the Fed tightening cycle has already kicked off for about a year now, the room for further monetary easing is limited. At the same time, prospects for fiscal relaxation appear rather constrained, while several key risks lie ahead from an international perspective (new US administration's policies & ECB and Fed monetary policies, Brexit, European elections).
Inflation pressures building up	This year's headline inflation data across the region have both exceeded expectations and reached multi-month highs, reflecting the pass through of rising world commodity prices, base effects and increasing price pressures globally. To this end local yields have mostly moved higher so far in 2017.
Rising euroscepticism	The rising popularity of euro-sceptic and populist parties across Europe may hinder the implementation of much needed economic reforms as well as delay the euro convergence or EU accession process in the region.
European political risks on the forefront	A series of key political events in Europe this year, mostly concentrated in the first half, pose as a key risk to the region's growth prospects and asset performance (Brexit, elections in Netherlands, France, Germany). The looming Presidential elections in April in Serbia and snap general elections in Bulgaria take centre stage from a CESEE perspective. Geopolitical tensions in the Middle East, and potential noise in the Balkans (eg. related to the Kosovo issue) or frictions due to the ongoing refugee crisis are among other possible risk sources.

CESEE Markets Developments & Outlook

Country	CESEE Markets Developments & Outlook
Bulgaria	• Equities cover lost ground in the 2H of February, to end marginally higher than January • Both local and Eurobond yields are trending south in February. Local bonds outperforming Eurobonds on lower primary market supply and a better than expected fiscal outcome • Domestic appetite for local paper remains very strong in recent auction • Political uncertainty is the key downside risk
Cyprus	• Room for further sovereign upgrades provided that focus remains on reducing NPEs and commitment to pending reforms • 10Y Cypriot bonds continued to outperform Portuguese, yet spread between the two declined by 25bps in February • Real estate prices recorded in Q3-2016 the first QoQ increase since 2009
Romania	• Assets across the board recover ground in February after the government decision to repeal the controversial judicial emergency decrees. Focus shift to budget execution risks. • EUR/RON returned back to lower levels after testing the 4.55 level. Risks skewed to the upside amid fears for renewed political jitters and heightened fiscal concerns
Serbia	• The dinar has remained within tight trading range over recent months, with Central Bank action mitigating any sharp moves from either bound. Taking into account that SNS candidate and incumbent PM Aleksandar Vucic is likely to win the presidential election, in an outcome that strengthens the government's mandate for the implementation of additional reforms, the dinar is likely to be faced with appreciation pressures. To that end, NBS action is likely to cap any significant movements from either side of the range. • A gradual rise in local yields is likely as inflation pressures modestly build up and the probability for higher Fed rates increases

The Trader's View

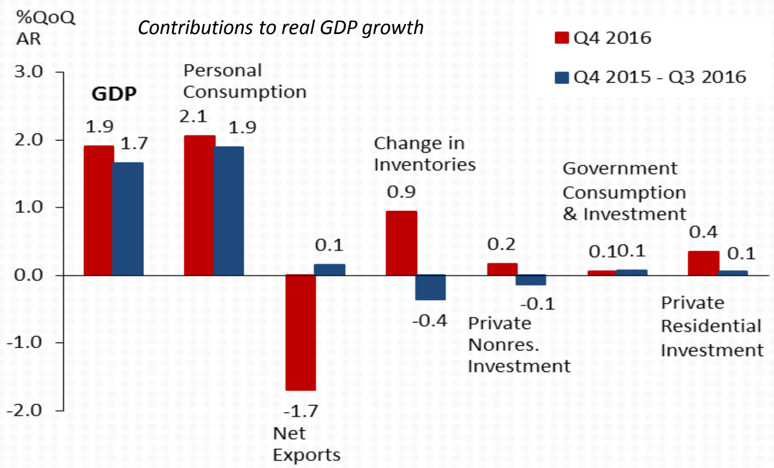
Asset Class	Outlook
Foreign Exchange	**EUR/USD**: French politics and repricing of Fed hike expectations weighed on EURUSD during February. The pair moved from 1.08 to 1.05 still trading within the wider range of 1.08 – 1.0380 which has kept for the last 4 months. We expect the overall picture to remain the same as the French elections and the FOMC rate decision on 15/3 will favour the dollar. Critical support levels are around 1.040-1.035 and a break should lead to parity and beyond, which is not our base case. **USD/JPY**: The pair tracked closely the 10y treasury yield and remained in the 112 – 115 range. The catalyst for a break higher will by a hawkish outcome from the FOMC meeting or risk off sentiment that we expect ahead of the French elections. **GBP/USD**: No major headlines for UK during February resulted in a stable GBPUSD that stayed around 1.25 for most of the month. Sentiment is in favour of USD for the reasons mentioned above but any UK specific headlines are expected to give direction to the pair. We prefer selling GBP on rallies towards 1.25-1.26 area.
Government Bonds	**US:** Strong macro-economic data and hawkish Fed talk have led Fed Fund futures to price a 90% probability of a March hike from less than 30% a month ago. The ensuing selloff saw rates spike by 10bps across the curve with the short end underperforming, driving both cash and swaps sharply flatter. The speed of the move could pave the way for a potential correction but the path of least resistance remains to be for higher rates supported by positive inflation expectations, strong PMIs and a robust labour market. **EU:** Data out of the Eurozone has continued to surprise positively but political risks remain a quagmire. French elections and the possibility of a Le Pen victory in May fueled a flight to quality bid for the most part of February bringing the Schatz yield to -95bps a historic low. Although inflation data provide support for the reflation trade -affecting the long end - the short end looks underpinned not only by jittery politics but also the ECB's QE programme with the central bank looking to buy ~EUR 80bn of 1-6y Germany by year end. This and the edginess of the markets ahead of the French elections should keep the curve steep and swap spreads wide, keeping a strong selloff scenario contained and widening the Bund – UST spread, something that we would use to position for a compression of the spread by year end.
EM hard currency debt	EM external debt has acted as a safe haven, so far this year, from the EU government sell off and recorded another good performance in February. Given the recent rally and the US rates outlook we expect short term profit taking, but fundamentals continue to improve. Any significant widening in spreads/rise in yields should provide attractive medium-term buying opportunity. Idiosyncratic risks will remain a key driver for name selection and tactical entry points.
Corporate credit	USD credit overall outperformed EUR in the past month, with HY a stellar performer, as the latter was hindered by French, Dutch and peripheral names widening, mostly banks. We still expect wider spreads from current levels in IG and HY, in both currencies, and a difficult year for total returns in IG. Overall we would take profit in corporate credit and lower our exposure in financials in light of potential buy opportunities in the next few months at better spread/yield levels, especially in European financials.
Commodities	We expect oil to break out of its two years range and head higher, but positioning is extreme and needs to clear before further upside. Gold and Silver, despite their recent EU politics driven rally, will face headwinds with more Fed hikes ahead. Industrial metal prices have been boosted by the momentum of the new US government expected policies and although medium term we remain bullish, short term the rally on pure expectations seems overextended.

II. Advanced Economies

- USA
- Euro Area
  - ❖ Periphery (Italy, Spain, Portugal, Cyprus)
- Japan
- UK

USA: business investment rebound bodes well for the US growth outlook

Robust domestic demand, but trade weighed on growth



Large US trade deficits trigger the new US administration to impose tariffs

Source: US BEA, US Census Bureau, Eurobank Economic Research

Latest Economic Developments

According to the advance BEA's estimate, real GDP growth decelerated to 1.9%QoQ saar in Q4 2016 from 3.5% in Q3, underpinned by robust personal consumption expenditures and a rebound in residential investment following two negative quarters. Nonresidential fixed investment remained soft, while net exports were a significant drag on GDP growth. The broad-based strength in imports possibly contributed to strong inventory accumulation, which added 1.0pps to growth. High-frequency indicators suggest that growth momentum should remain intact at the start of 2017, with January retail sales capitalizing on positive price effects and a modest rebound in the manufacturing sector that started in the latter part of 2016 still on track, coinciding with a cyclical upturn in global industrial activity. Investment spending should start benefiting from higher commodity prices, which are on average 30% up from early 2016 lows.

Central Bank Watch

At the semi-annual testimony before Congress, Fed's Chair Janet Yellen adopted a slightly more hawkish than expected tone citing that, should both employment and inflation evolve in line with the Central Bank's projections, "a further adjustment of the federal funds rate" would probably be needed in upcoming FOMC meetings. In her view, the pace of wage growth has picked up relative to that recorded a few years ago and inflation has moved higher over the past year, mainly due to the fading effects of past declines in energy and import prices. Meanwhile, macroeconomic data have recently surprised on the upside, with core PCE -the Fed's preferred inflation measure index- reporting its biggest monthly increase in four years, reinforcing market expectations for an imminent interest rate hike. Adding to this, Fed officials have recently sounded more hawkish, raising the likelihood of a March hike. Fed Funds futures are currently implying (as of 3/3) a 90% probability for a 25bps rate hike in March, compared to around 38% a week ago. The Fed's median forecast, as well as market expectations, currently point to three 25bps rate increases in 2017, in March, July and December, with the target range reaching 1.25-1.50% by year-end. In any case, the timing and the pace of Fed tightening will be largely dependent on the timing and magnitude of fiscal stimulus under Donald Trump administration.

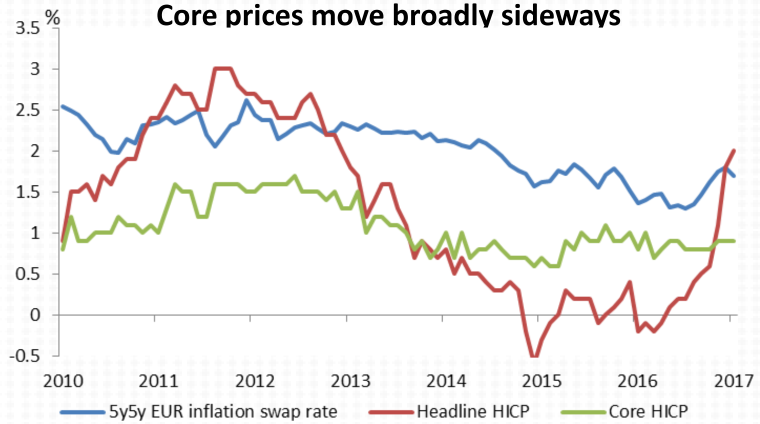
Risks

The timing and the extent of prospective fiscal stimulus under the new US administration, including tax reforms and healthcare legislation, remain highly unclear. Fiscal policy could have a limited positive impact on the US economy this year, should the relevant legislation changes fail to be approved by the Congress by summer. Meanwhile, a protectionism trade policy, though still uncertain, constitutes a key risk for the US economic outlook.

Euro area: moderate recovery on firm domestic demand; external and internal political risks on the rise

Industrial production has recently strengthened

Higher headline HICP driven by energy and food prices; Core prices move broadly sideways



Source: ECB, Eurostat, Eurobank Economic Research

Latest Economic Developments

Euro area GDP growth was revised downwards by 0.1pps to 0.4%QoQ in Q4 2016, growing by a similar pace to Q3. Growth was mainly driven by domestic demand, with robust private consumption growth in line with buoyant consumer confidence surveys (particularly in Germany and France). Net trade should have been fairly neutral to growth, as stronger exports were accompanied by stronger imports consistent with the improvement in domestic demand. Looking ahead at the start of 2017, continued employment growth and a gradual-albeit moderate-recovery in labor compensation growth should continue to support private consumption, expecting the latter to slow only marginally on the back of higher headline HICP. Meanwhile, Euro area February "flash" composite PMI index surged to its highest level since April 2014, suggesting that confidence remains on an upward trend in Q1 2017 despite heightened political woes.

Central Bank Watch

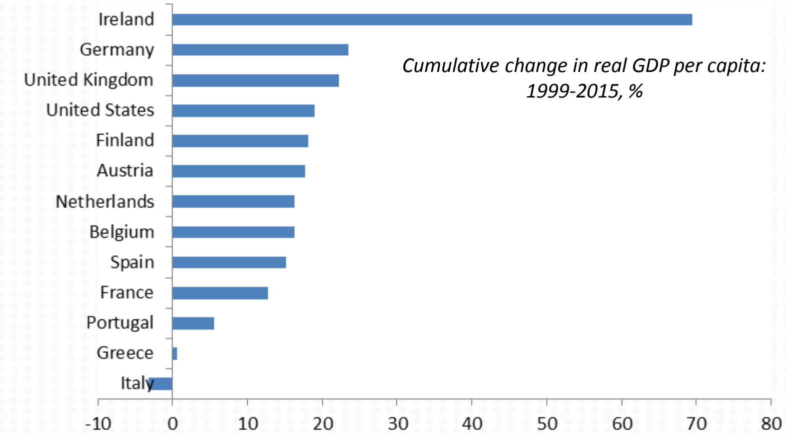
The ECB Minutes from the January monetary policy meeting supported the view that a substantial degree of monetary accommodation is still warranted and, thus, ECB tapering talk seems premature. According to the Governing Council, although the euro area economy has evolved in line with the staff's macroeconomic projections, uncertainty prevails and risks remain skewed to the downside, while there is no evidence so far of second-round effects despite the recent rise in headline HICP. Regarding the implementation of the APP programme, the ECB noted that "limited and temporary deviations" from the capital key purchases rule "were possible and inevitable", with the Central Bank willing "to make further adaptions" to securities lending arrangements, if needed. We continue to believe that the ECB could possibly taper its QE program later in the year, should it become more confident that the recent inflation rise is sustainable.

Risks

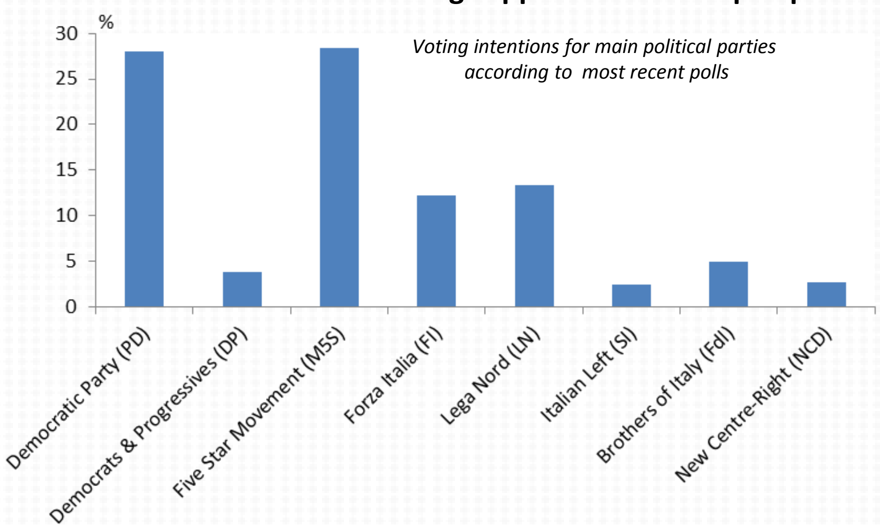
Several political events in 2017, including Dutch Parliamentary elections in mid-March, French Presidential elections in April/May and German general elections in September, could increase uncertainty and possibly weigh on consumer, corporate and market sentiment. Meanwhile, the lack of sufficient structural reforms in several euro area countries could potentially depress the growth outlook. On the external front, the Brexit process as well as the US trade protectionism could pose a serious threat to the euro area economic recovery.

Italy: modest economic recovery on track, with the political backdrop the major source of concern

Italy's unsatisfactory economic performance…



…is consistent with increasing support for Euroscepric parties



Source: IMF, Various polling firms, Eurobank Economic Research

Latest Economic Developments

According to ISTAT statistics office's preliminary data, real GDP came in slightly weaker than expected in Q4 2016, increasing by 0.2%QoQ from 0.3%QoQ in the prior quarter. Domestic demand was the main driver of growth, while net trade acted as a drag. Meanwhile, from a value added standpoint, both manufacturing and services sectors contributed positively. Overall, we continue to expect Italy to remain on a modest recovery path in the quarters ahead primarily led by domestic demand with GDP rising +0.9% in both 2017 and 2018.

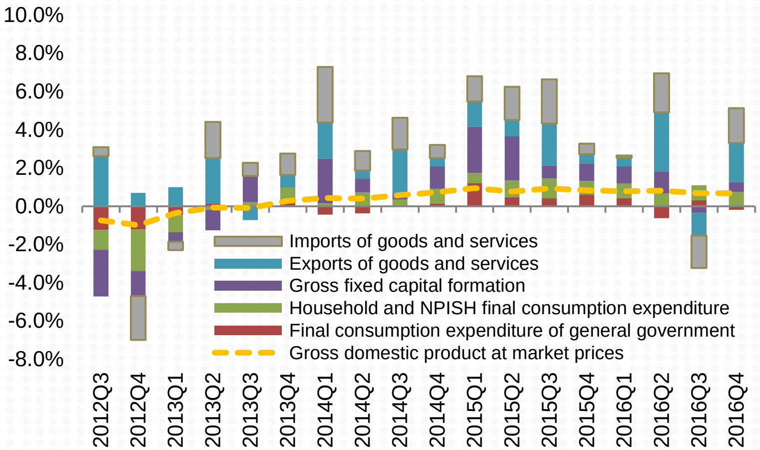
Risks

Political developments: The Democratic Party (PD) will hold its primaries to elect a new leader on 30 April, with the outcome expected to be ratified by the party's assembly on 7 May. The deadline for submitting candidacies for the PD leadership race is 6 March, with three candidates having declared their intention to run so far: former PM Matteo Renzi (the frontrunner), current Justice Minister Andrea Orlando, and Apulia Region Governor Michele Emiliano. Said that, snap elections before the summer don't seem to be on the cards, given that in such a case parliament should be dissolved by late April. In our view, the most likely scenario is that the government will remain in place until the end of the current legislature in Q1 2018. Nevertheless, we cannot rule out early elections between late September and mid-October, as the PD might prefer elections to be held before submitting its 2018 budget draft to the European Commission by mid-October (and to parliament a few days later) and before receiving a response in February 2018, especially in case there is a government crisis within the coalition backing the current administration. The split of the PD into the Democratic (PD) and the Democratic & Progressist (DP) parties after the disagreement, among others, on the date of the convention constitutes a key element to watch as Eurosceptic parties could gain an ample majority in the parliament in the following election.

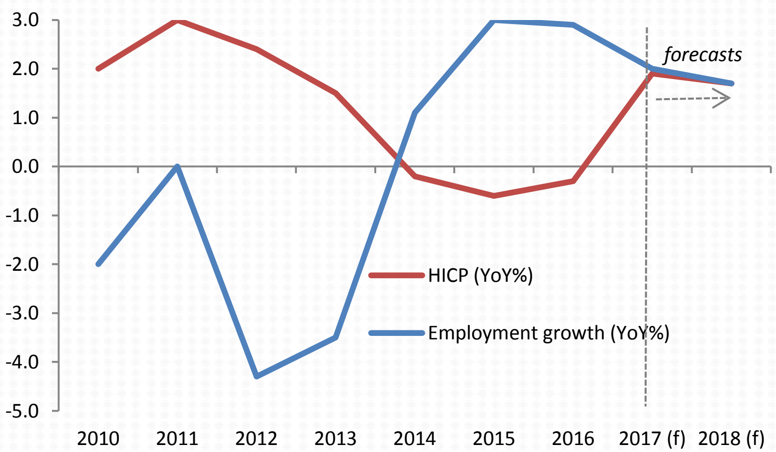
Banking woes: In contrast to Spanish banks' NPL ratios that have been on a downward trend over the last few quarters, Italian banks' NPL ratios have only began to recently stabilize while profitability remains weak on the back of modest credit growth and narrowing lending margins. Furthermore, while Italy's parliament has recently approved the government's decision in December to create a €20bn fund to support troubled banks, including Monte dei Paschi di Siena, the conditions under which public support will be disbursed and/or the extent of private sector's burden are highly uncertain and could potentially have negative implications for financial stability.

Spain: real GDP growth continued to outpace the EA average in Q4 2016 for the 13th consecutive quarter

Real GDP growth & contributors (QoQ%)



Higher inflation & slower employment seen to dent real household income growth



Source: Eurostat, Eurobank Economic Research

Latest Economic Developments

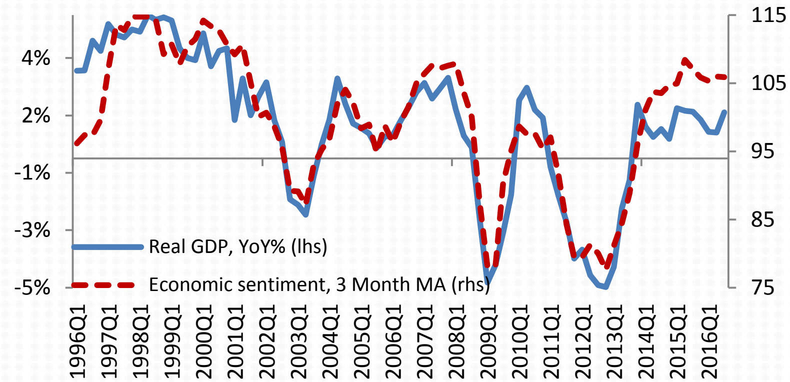
Spain continued to grow faster than the euro area average in Q4 for the 13th quarter in a row with GDP rising 0.7%QoQ, the same growth pace as in the previous quarter. Private consumption remained the main growth driver, supported by the ongoing improvement in labor market conditions, accelerating credit growth and elevated consumer confidence. The unemployment rate fell to a seven-year low of 18.7%YoY in Q4 2016 following an all-time peak of 26.3% in Q1 2013 thanks to solid employment growth, albeit somewhat slower compared to Q3. Investment growth shifted into positive territory after recording a negative figure in Q3 2016 for the first time since Q1 2013. Net exports had a positive growth contribution with imports continuing to grow more slowly than exports. For the full year 2016, displaying resilience to external and domestic uncertainties, real GDP rose by 3.2%, the same pace as in 2015 and almost double than that of the Eurozone (1.7%), compared to 1.4% in 2014 and following cumulative contraction of c. 9.0% in the period between 2009 and 2013. The Spanish economy retained a positive momentum at the start of 2017 with the PMI manufacturing index coming in at 54.8 in February, down from a 2 ½ year high of 55.6 in January but still above a multi-year low of 51.0 marked in August 2016 with improving demand continuing to support marked rises in new orders and production. Real GDP growth is set to moderate to 2.3% in 2017, though remaining higher than a projected 1.6% average for the euro area, as private consumption is expected to lose some momentum on the back of a gradually waning positive effect of temporary factors (i.e., oil prices, reduced income tax rates for 2015 & 2016), higher inflationary pressures and slower employment growth.

Political risks for Mariano Rajoy's minority government

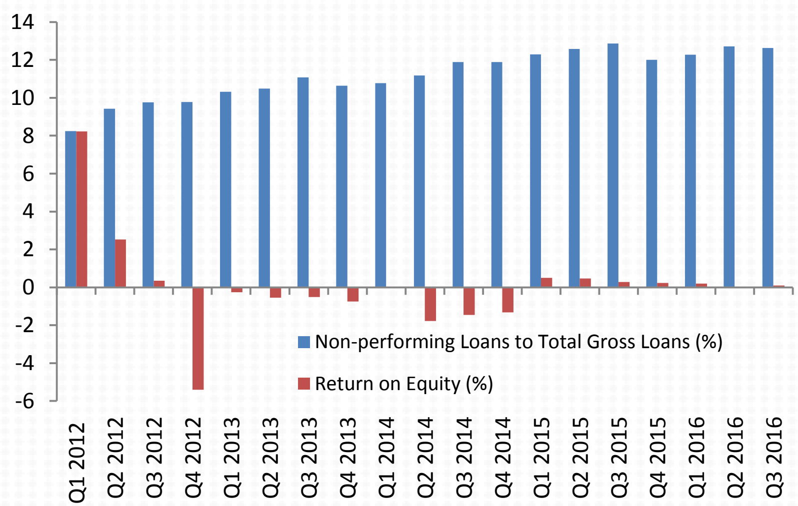
The submission of the pending 2017 Budget to Parliament for approval, a likely secession referendum in Catalonia and risks of reversal of labor market reforms adopted in 2012 when Prime Minister Mariano Rajoy's right-wing People's Party (PP) enjoyed an absolute parliamentary majority, are some of the main challenges the minority government will likely have to face in the months ahead. Negotiations on the 2017 Budget are still ongoing while the Socialist Workers' Party (PSOE) which supported Marian Rajoy to form a relative majority in parliament in October 2016 following the inconclusive outcome of the June 2016 general election, seems unwilling to support it before its Party Congress scheduled for May. Meanwhile, aiming to compromise for securing approval of major reforms ahead, the government approved in December 2016 a gradual increase in the minimum wage from €655.2 currently to €800 by January 2018. In addition, though an independence referendum in Catalonia would be against the Spanish Constitution, the Catalan government reportedly plans to hold it in early summer.

Portugal: real GDP surprised to the upside in Q4, overall 2016 growth revised higher

Real GDP growth vs. economic sentiment



Baking sector remains key concern for Portugal's outlook



Source: Eurostat, IMF, Eurobank Economic Research

Latest Economic Developments

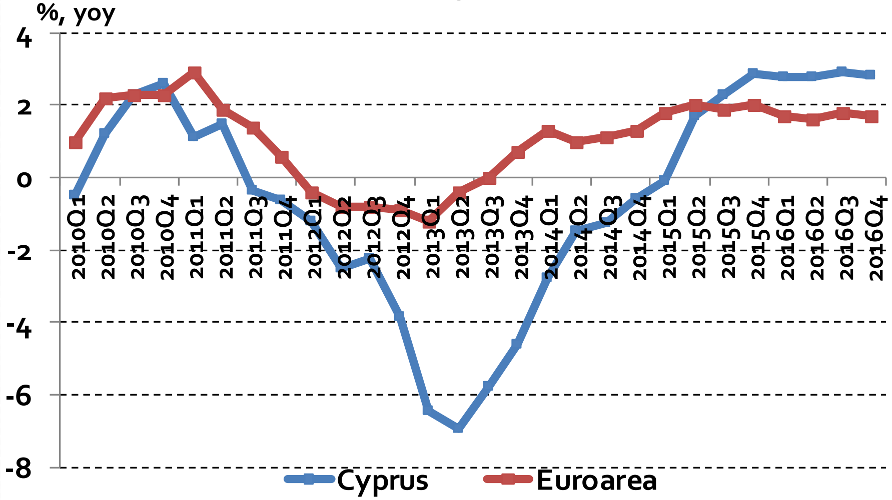
Portugal's Q4 real GDP growth surprised to the upside rising by a higher than expected 0.6%QoQ with the annual rate accelerating from 1.6% in the prior quarter to 1.9%, the highest in three years. According to Portugal's statistics office, increased domestic demand and rebounding investment underpinned this positive result while net trade contribution to growth was negative as solid domestic demand pushed imports higher. For the whole of 2016, the stronger than expected Q4 reading pushed real GDP growth to 1.4%, higher than 0.9% previously projected, but lower than 1.6% in 2015 mainly due to a slower pace of private consumption growth as households continued to lower their savings. The saving rate is estimated at 4.5% of disposable income at end-2016, close to a 4.4% historical low recorded in the prior year, at a time that, in spite of its modest decline over the last few years, household debt ratio remains at relatively high levels compared to historic standards. Adding to the positive economic news flow that was released over the last few weeks, economic sentiment rose in February for the sixth month in a row coming in at 110.6, the highest since late 2000, led by a further improvement in the industrial, services and retail confidence indicators. Taking into account these positive developments, we have revised upwards our real GDP growth forecast for 2017 to 1.4%, 0.2 pps higher from our estimate last month, even though we still expect domestic consumption to lose some momentum on the back of higher inflation and limited room for a further drawdown on households' savings. However, downside risks prevail, stemming mainly from the high level of private indebtedness and the poor health of the banking sector.

Banking sector remains a key concern for Portugal's outlook

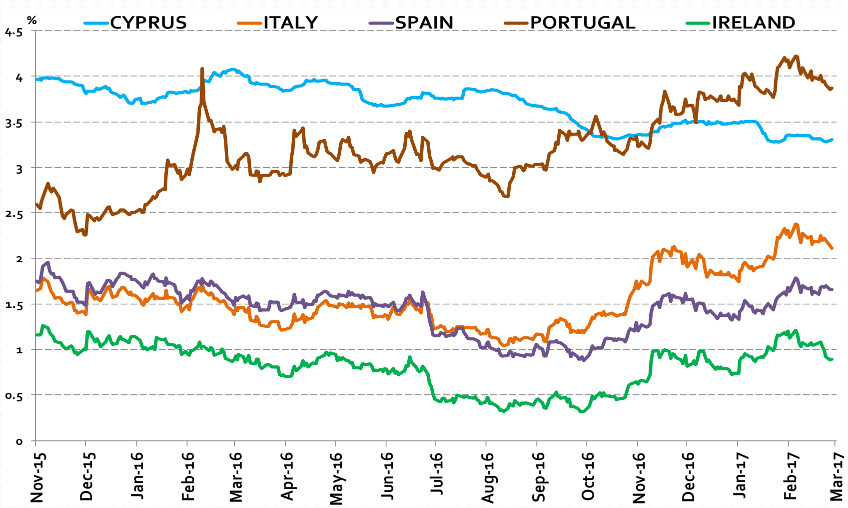
The agreement between Portugal and EU in late summer 2016 on the recapitalization of Portugal's largest state-owned bank, Caixa Geral De Depositors, with a public fund injection of €2.7bn, scheduled to take place by early March, prevented a bail-in of domestic deposits, driving public debt higher. Nova Banco's privatisation plan - the bank carved out of Banco Espirito Santo (BES) - failed to make any significant progress with Minister of Finance Mario Centero saying recently that the option of nationalization cannot be ruled out (August 2017 final deadline for the bank's privatization). Meanwhile, banks' profitability remains subdued and bad loans at elevated levels (NPL ratio at 12.6% of total loans in Q3 2016, close to an all-time high of 12.9% in Q3 2015). Given these challenges, the government may have to intervene again to support the banking sector, adding pressure on the country's finances, hampering growth prospects and raising the risk of a rating downgrade by DBRS (the only of the four major rating agencies to rate Portugal in investment grade).

Cyprus: a visible turn-around story

Real GDP growth %



10Y Generic Bond Yields



Source: Eurobank Research, National Authorities, Bloomberg

Economic Outlook

The Q4-2016 flash estimate of GDP growth was strong. On a seasonally adjusted basis, growth expanded by +0.5% QoQ/+2.8% YoY in Q4, marginally lower than +0.8% QoQ/+2.9% YoY in Q3 vs. +0.6% QoQ/+2.9% YoY in Q4-2015. The consumption rebound most probably continued in Q4 driven by the strong sentiment improvement mirroring the lasting progress within the expired adjustment program, a flourishing tourism sector (+19.8% YoY in tourist arrivals in FY2016, an all-time record high in the history of the Republic), lower energy prices on an annual basis, lower unemployment (down for a third consecutive year to 13.3% in 2016 from 15.0% in 2015), expectations from the announced fiscal relaxation and a rise in real incomes.

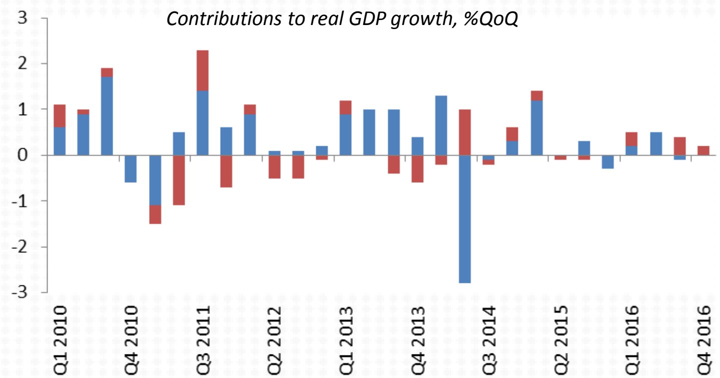
After a three year recession, between 2012 and 2014 , and a cumulative drop of 10.5% in GDP, the economy expanded by +1.7% YoY in 2015 and +2.8% YoY in 2016, above all initial official forecasts. The FY2016 growth rate was the highest since 2008, and among the highest in Euro area. In our view, solid real GDP growth performance - on average 3% per year - is expected to continue in 2017-18 driven by the recovering consumption dynamics, that reflect improved consumer confidence and the envisaged fiscal relaxation at the expense of reducing public debt faster, strong tourism revenues mirroring the enrichment of the tourist product and the evolving geopolitical crisis in the neighboring competing destinations, further banking sector conditions normalization as domestic banks get more liquidity from increased deposits and more balance sheet support from viably restructured NPEs .

Risks & Challenges

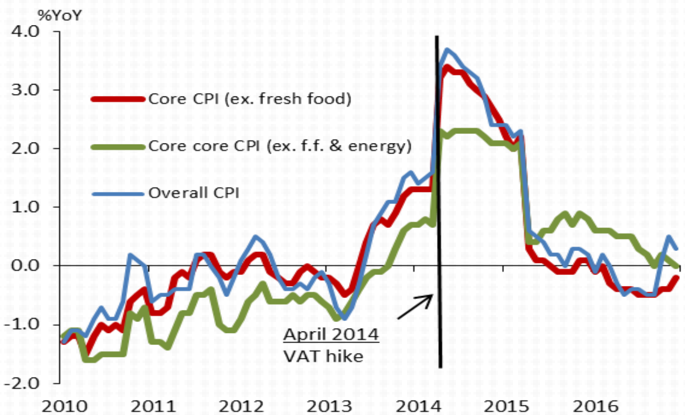
On the domestic front, the risk of complacency is looming as the reform momentum seems to have stalled ahead of the Presidential elections in 2018. Still, a handful of unfinished structural reforms need to progress in the areas of privatizations, public and health sectors, while addressing the challenges of a still high NPLs stock. The banking system NPE ratio, a more conservative asset quality EBA methodology, which inflates NPL numbers by including restructured loans for a probation period of at least 12 months edged up to 49.5% in October2016, up from 45.8% in December 2015, compared to 47.8% in December 2014. On the external front, downside risks stem from a resurfacing of core Euroarea political and sovereign crisis and a more protracted recession in Russia-a source of high-end tourism and second most important trading partner.

Japan: positive growth performance for a fourth consecutive quarter

Positive growth momentum continues on the back of strong exports



Inflation far off the BoJ's 2% target



Source: Economic & Social Research Institute Japan, Ministry of Internal Affairs & Communications, Bloomberg, Eurobank Economic Research

Latest Economic Developments

Real GDP growth was positive for a fourth quarter in a row in Q4 2016, increasing by 0.2%QoQ q/q mainly on the back of strong net trade that added 0.2pps to overall economic activity. Private consumption stagnated, partly due to a weather-induced spike in vegetable prices in Q4 that weighed on household spending. Nevertheless, vegetable prices have stabilized in the first months of 2017 and consumer sentiment has improved, suggesting that household consumption should likely rebound in Q1 2017. Meanwhile, the FY16 second supplementary budget should give boost to public investment from Q1 onwards supporting growth. Furthermore, industrial production continues to be underpinned by an upward trend in exports, amid stronger demand stemming primarily from Asia. Adding to this, Japan's manufacturing PMI increased to 53.5 in February from 52.7 in the prior month, with the production sub-index surging to its highest level in nearly three years.

Central Bank Watch

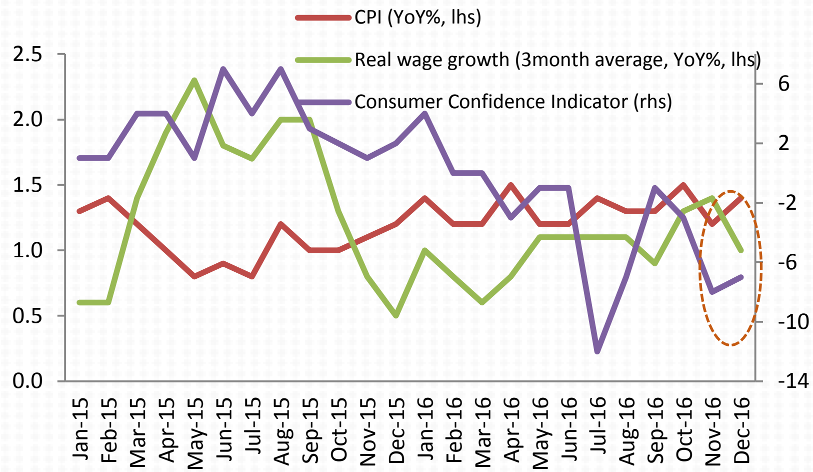
We expect the BoJ to keep unchanged its monetary policy throughout 2017, maintaining both the short-term policy rate at -0.1% and the target for 10-yr JGB yields "around 0.0%". Although the recent JPY depreciation is expected to exert upward pressure on core inflation towards 1.0% or higher later in the year, the inflation rise is not likely to be sustained in the foreseeable future, should JPY embark on a steady upward path. From this respect, the spring wage negotiations will likely be an important gauge, given that its outcome will affect the inflation outlook and, hence, the BoJ's policy related to the 10-yr JGB yield target. Meanwhile, the pace and timing of the Fed's tightening path is a key issue for the BoJ's policy deliberations, as a more hawkish than currently expected FOMC stance could increase the chances for the BoJ to hike rates in case of a pronounced JPY depreciation.

Risks

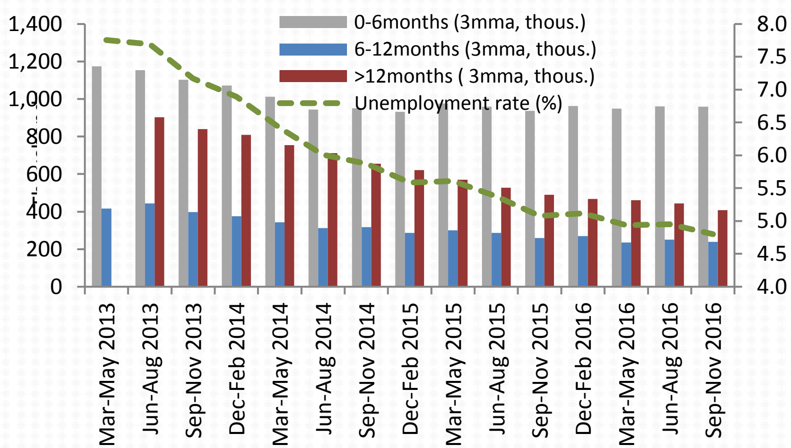
The Trump administration's trade protectionism could pose a downside risk to Japan's economic outlook. Nevertheless, any negative impact should probably be modest, as Japan does not seem to be a primary target of Trump's bilateral trade negotiations (with the exception of the auto sector). Furthermore, increasing uncertainty surrounding the external environment could be translated into weaker Japanese wage growth and investment dynamics than currently anticipated.

UK: in spite of the upward revision in Q4 GDP, 2016 real GDP growth was reassessed lower

Rising inflationary pressures weigh on real wage growth



Only long-tern unemployed are finding jobs



Source: Eurostat, ONS, Eurobank Economic Research

Latest Economic Developments

Confirming further the UK economy's resilience in the aftermath of the Brexit referendum outcome, Q4 real GDP was revised upwards to 0.7% QoQ from a preliminary estimate of 0.6% QoQ mainly on the back of stronger-than-expected industrial production and construction output. The biggest positive contribution came from net trade which added 1.3ppts to Q4 real GDP growth driven by a hefty increase in exports as a consequence of the weaker GBP. Total fixed investment remained subdued with recent related surveys pointing to continued weakness at the beginning of 2017. Household consumption grew by 0.7%QoQ, the slowest pace of growth since Q4 2015 following an upwardly revised 0.9%QoQ in Q3 while disappointing retail sales in January for the third month in a row pose risks for further weakness in the quarters ahead. Inflationary pressures continued to build, denting households' purchasing power. In addition, the actual triggering of Article 50 –expected by end March- should weigh on consumer confidence amid worries over a hard Brexit. Real GDP growth is projected to slow to 1.5%YoY in 2017 from a downwardly revised 1.8%YoY for 2016 vs. 2.0%YoY initially, on the back of a downwardly revised pre-referendum Q1 GDP 2016.

Approval upon amendments by the House of Lords could delay activation of Article 50

After securing approval by the House of Commons, the EU (Notification of Withdrawal) Bill was submitted thereafter to the House of Lords, in line with the UK Supreme Court's ruling. With a majority of 358 votes to 256 in favor, Lords requested in early March an Article 50 amendment that would force the government to guarantee the rights of EU citizens living in the UK when the country leaves the EU. The Commons is reportedly set to debate the requested amendment on March 13 and 14. In case the said amendment is rejected, the Bill will have to go back and forth between the two chambers, potentially derailing the government's self-imposed March-end deadline for launching Brexit negotiations.

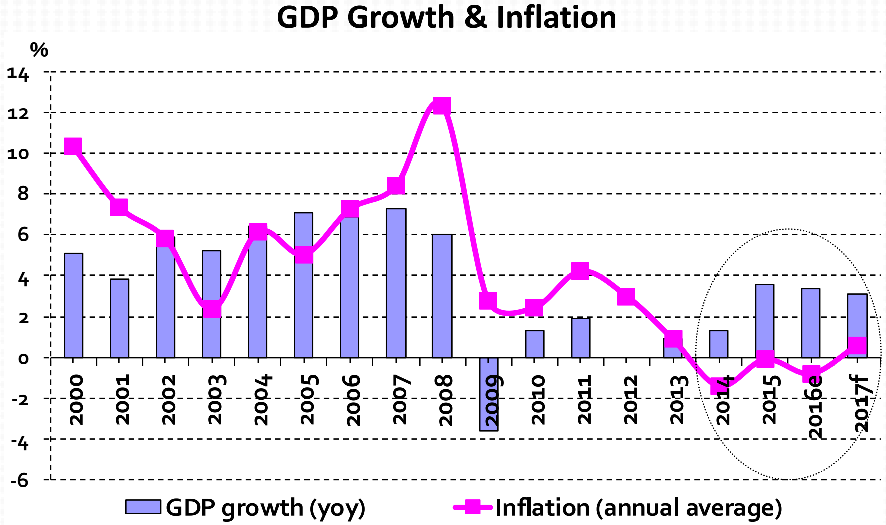
BoE expected to retain a neutral stance on its monetary policy in the coming months

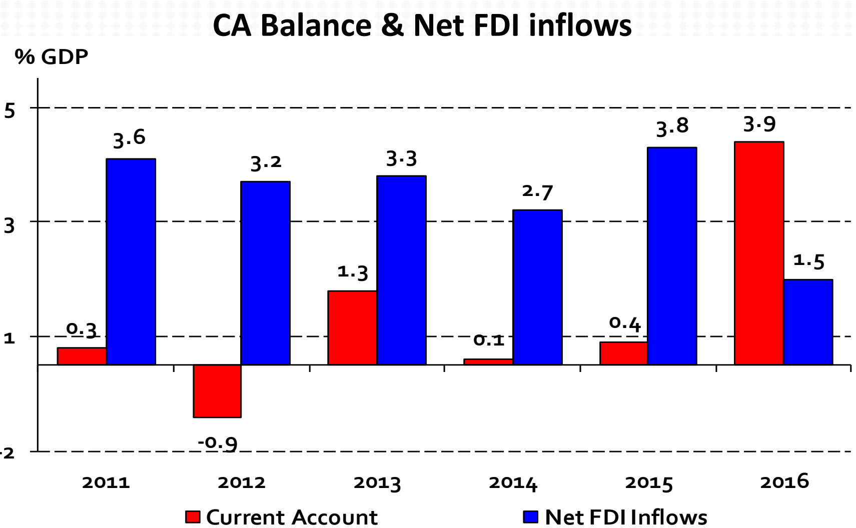
In its February Inflation Report, the BoE revised higher its real GDP growth projections for the forecast horizon 2017- 2020 while inflation forecasts were little changed. More importantly, it revised down its estimate of the "equilibrium unemployment rate" from 5.0% to 4.5% vs. the current rate of 4.8%, implying more slack than previously anticipated in the labor market, and thus, less domestically generated inflationary pressures. With wage growth remaining well below its pre-crisis average of c. 4%, the above could presumably provide some leeway to the BoE to tolerate a bit longer an inflation target overshoot, in an attempt to support the economy following the Brexit referendum outcome.

III. Selected CESEE economies

- Bulgaria
- Romania
- Serbia

Bulgaria: early parliamentary elections in late March





Source: Eurobank Research, National Authorities

Latest Economic Developments

Growth remained on track in Q4-2016, bringing the FY2016 at 3.4%, an inch down from 3.6% in FY2015. Bulgaria is expected to register a second consecutive year of strong-above potential-growth in 2017. Private consumption dynamics are broadly set to remain strong as the economy benefits from a more expansionary fiscal policy stance, an improving labor market, catching up wages and still relatively low energy prices. Investments are going to receive support from improved EU funds absorption in the new programming period while a vibrant export oriented manufacturing sector and an emerging tourism industry boosts net exports.

From a macro fundamentals point of view, the country is now in much better shape to withstand an internal or external shock. The country's external and fiscal position is strong - the banking sector capital position is solid and the buffers (fiscal and FX reserves) are sizeable. Budget execution outperformed the target by a wide margin in 2016 (+1.6% of GDP surplus vs -2.0% deficit target). The CA balance -in surplus for a fourth consecutive year-climbed to +3.9% of GDP in FY16 up from -25.2% in FY07.

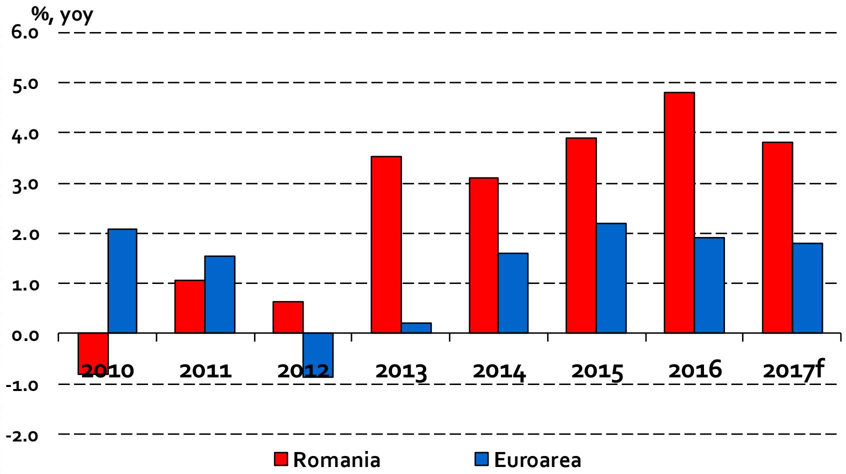
Risks &Challenges

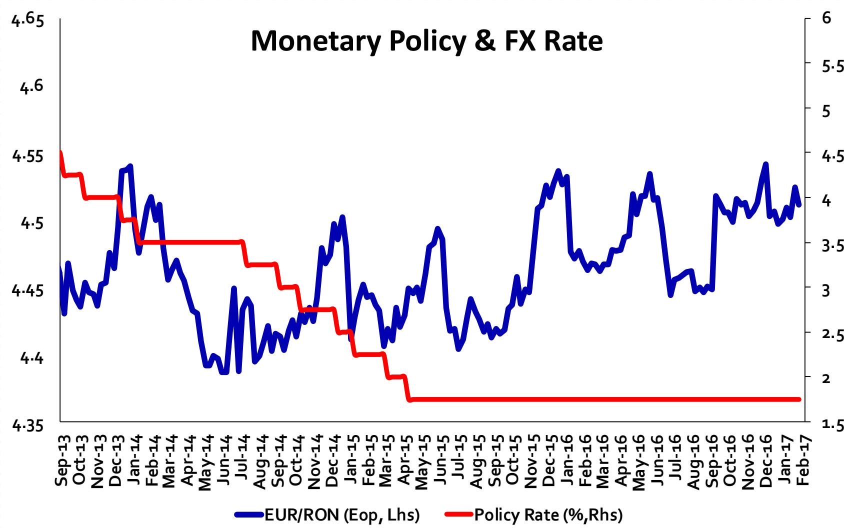
Snap parliamentary elections take centre stage in late March. It is high likely that it will be a tight race between the two major parties- GERB and BSP. If that happens the winner will most probably have no absolute majority in the new parliament, making other parties weight in the process of cabinet formation more important. Although it has proved relatively resilient to multiple past internal and external shocks, there is a high degree of uncertainty how the economy could react to a prolonged period of domestic political instability.

Even though the macroeconomic assumptions, upon which the 2017 budget is built, are relatively conservative, the probability of a policy regime change or an unstable new government have increased fiscal uncertainty and budget execution risks for the year, given the previous experience of 2013-2014.

Romania: fiscal risks on the rise

GDP growth





Source: Eurobank Research, National Authorities, Bloomberg

Latest Economic Developments

According to the flash estimate release, real GDP on an unadjusted basis expanded by 4.7% YoY in Q4-2016 bringing the FY estimate at 4.8%. On a seasonally adjusted basis, growth stepped up to +1.3% QoQ/+4.8% YoY in Q4-2016 –above analyst call for +1.0% QoQ/+4.3% YoY- compared to +0.5% QoQ/ +4.4% YoY in Q3-2016 vs. +0.9% QoQ/+4.5% YoY in Q4-2015. It is common knowledge that growth is largely driven by private consumption, financed by an overly expansionary fiscal policy, and leads to a revival of macroeconomic imbalances. Hence, the economy is driven close to, if not above, its potential growth rate at the expense of pushing government finances off consolidation track and deteriorating the external position. As a result, the CAD jumped to 2.4% of GDP in 2016 up from only 1.1% in 2015 and 0.4% in 2014. Looking ahead, a soft landing scenario is the most likely outcome in 2017. Although the incoming government, after the December 2016 parliamentary elections, has already vowed to provide additional fiscal stimulus (1.1% of GDP), in the 2017 budget, in order to fulfill its pre-electoral promises, it will most probably need to adopt a more conservative stance in H2. Assuming no policy change, the projected fiscal deficit is expected to swell well above the 3% of GDP threshold in 2017.

Central Bank Watch

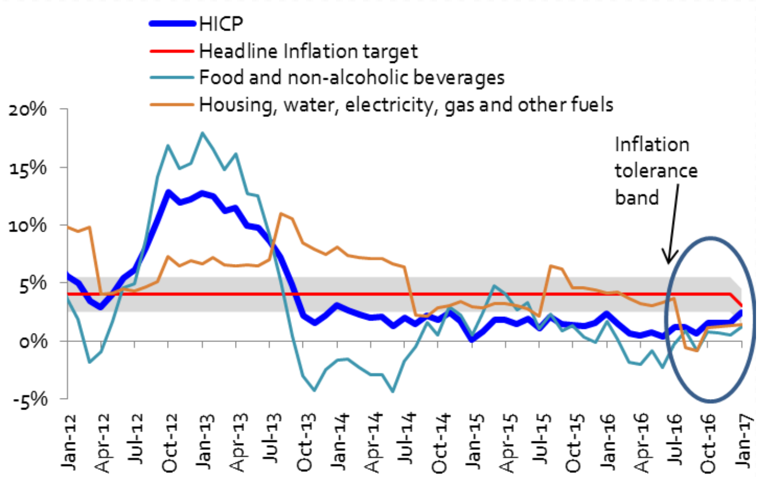
NBR continues to be on wait-and-see mode, leaving the key policy rate unchanged at 1.75% and MRRs on FX and RON denominated liabilities unchanged at 10% and 8% respectively. There are still a number of elevated risks, both internal and external, that NBR is increasingly aware of and will specify the timing of the initiation of the tightening cycle. On the external front, there is a still high degree of uncertainty regarding the impact of President Trump's policies and a heavy European election calendar. On the domestic front, the NBR has taken note of increasing fiscal risks for the economy stemming from the pro-cyclical expansionary policies.

Risks &Challenges

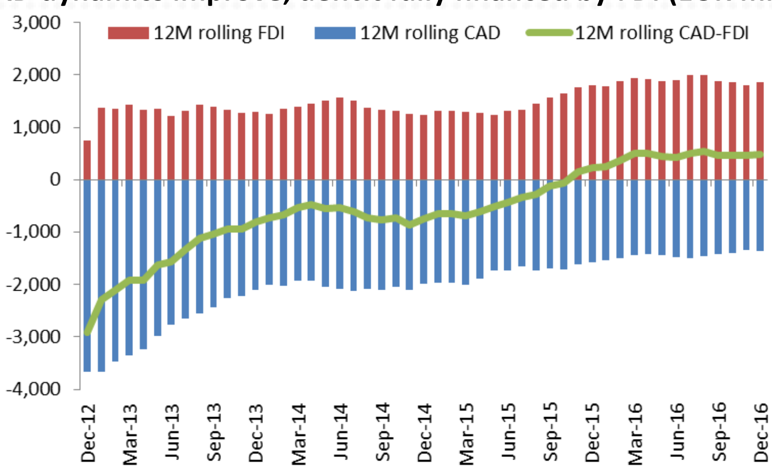
The street protests and the domestic and international institutions public outcry forced the government to scrap its highly controversial judicial reform plan widely perceived as a setback to the anticorruption campaign. However, given the credibility and prestige damage plus the confrontational relationship between the President and the Prime Minister, political tensions could resurface again. Meanwhile, the focus now shifts to the budget execution, where downside risks - the 2017 budget assumptions are overly optimistic - may put the government on a collision course with EU institutions.

Serbia: 2016 economic recovery led by net exports

Headline inflation enters target band in January (YoY)



CAD dynamics improve; deficit fully financed by FDI (EUR mn)



Source: Eurobank Research, National Authorities

Latest Economic Developments

According to final data, real GDP growth was confirmed at 2.5%YoY in Q4 2016, in line with a preliminary estimate, bringing the pace of increase for the full-year to 2.8%. The breakdown of the data showed that net exports were the main driver of economic activity in Q4 as well as for the whole of 2016, as exports' growth significantly outpaced that of imports. Investments continued to exert a positive input thanks to strong FDI inflows, while private consumption also rebounded amid improved labor market conditions (LFS unemployment rate at a record low of 13.0% in Q4 2016) and increased consumer lending (total loans to households increased by 10.5%YoY in Dec16). Government expenditure also supported economic activity, partly in reflection of favorable base effects. All in all, a further pick up in real GDP growth is anticipated this year and the next as last year's positive trends are expected to continue and private consumption is anticipated to recover further on real wage growth and targeted increases in public wages and pensions. The aforementioned improvement in trade, that supported economic activity last year, was also reflected in the current account data, as the full-year shortfall narrowed by 13%YoY to € 1.37bn in 2016, equivalent to a record low of 4.0% of GDP.

Central Bank Watch

Headline consumer inflation rose to a 1-year peak of 2.4%YoY in January. The move higher was mainly driven by base effects and temporary factors such increases in the prices of cigarettes and petroleum products as well as rising fruit and vegetable prices in view of adverse weather conditions. This shift in prices pushed CPI within the target band (1.5-4.5%) for the first time since early 2014. That said, as of this year the target band has been revised lower from 2.5-5.5% before. Meanwhile, a rise in price pressures had been anticipated by markets and the Central Bank alike as global oil prices rise further, aggregate demand recovers and inflation rises internationally. That said, headline CPI is expected to remain within the targeted range throughout 2017. To that end, we expect the Central Bank to maintain a cautiously accommodative monetary policy.

Risks & Challenges

The main risk domestically is Serbia at present is the looming Presidential election that will be held on April 2nd, while a potential 2nd round will take place on April 16th. Ending weeks of speculation, Prime Minister Aleksandar Vucic has been nominated as the ruling SNS party's candidate. The prospect of snap general elections, that had been speculated as a possibility to take place in tandem with the presidential, was recently officially rejected. All in all, albeit this is a key event to look forward, it is does not appear to bear risks for significant changes in the domestic political landscape as Prime Minister Vucic is likely to easily win the looming elections (according to opinion surveys, he could win the election in the first round), while the opposition appears to still be fragmented and weak and is unlikely to pose a threat to the ruling coalition alliance or its presidential candidate.

IV. Eurobank Macro Forecasts

Eurobank Macro Forecasts

	GDP (YoY%)			CPI (YoY%)			Current Account (% of GDP)			General Budget Balance (% of GDP)		
	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018
World	3.1	3.4	3.6	2.9	3.3	3.3						
Advanced Economies												
USA	1.6	2.3	2.5	1.2	2.3	2.6	-2.5	-2.7	-2.8	-4.1	-3.7	-3.3
Eurozone	1.7	1.5	1.7	0.3	1.4	1.4	3.7	3.5	3.3	-1.8	-1.5	-1.5
Germany	1.9	1.5	1.7	0.4	1.5	1.5	9.0	8.7	8.5	0.6	0.4	0.3
France	1.3	1.4	1.7	0.3	1.3	1.4	-2.1	-2.3	-2.6	-3.3	-2.9	-3.1
Periphery												
Cyprus	2.8	3.0	2.8	-1.1	0.5	1.7	-2.8	-3.3	-3.4	-0.3	-0.6	-0.1
Greece	-0.2	0.3	1.7	-1.1	0.0	1.0	0.1	-0.6	0.0	-7.5	-1.1	-1.1
Italy	0.7	0.9	1.0	0.0	1.2	1.4	2.8	2.5	2.1	-2.4	-2.4	-2.5
Portugal	1.4	1.4	1.4	0.7	1.2	1.4	0.5	0.8	1.2	-2.7	-2.2	-2.4
Spain	3.2	2.3	2.1	-0.4	1.6	1.5	1.7	1.5	1.5	-4.6	-3.8	-3.2
UK	1.8	1.5	1.4	0.7	2.5	2.6	-6.0	-4.3	-3.9	-3.3	-2.7	-2.2
Japan	0.9	0.8	0.5	-0.2	0.5	0.6	3.7	3.3	3.3	-5.2	-5.1	-4.4
Emerging Economies												
BRIC												
Brazil	-3.5	0.2	1.5	9.0	5.4	4.8	-0.8	-1.3	-1.5	-10.4	-9.1	-8.0
China	6.7	6.5	6.0	2.1	2.3	2.4	2.4	1.6	1.4	-3.0	-3.3	-3.0
India	6.6	7.2	7.7	5.5	5.2	5.3	-1.4	-2.0	-2.2	-6.7	-6.6	-6.2
Russia	-0.6	1.1	1.2	7.2	5.0	4.5	3.0	3.5	3.9	-4.0	-1.5	-0.8
CESEE												
Bulgaria	3.5	3.0	3.0	-0.7	0.6	1.2	3.0	1.5	1.2	-0.8	-1.4	-0.7
Romania	5.0	3.5	3.6	-1.8	1.5	3.1	-3.0	-3.2	-3.4	-2.8	-3.7	-3.2
Serbia	2.8	3.0	3.5	1.2	2.1	3.0	-4.0	-3.9	-3.9	-1.4	-1.3	-1.3

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

Eurobank Fixed Income Forecasts

	2017 (eop)				
	Current	March	June	September	December
USA					
Fed Funds Rate	0.5-0.75%	0.75-1.0%	0.75-1.00%	1.00-1.25%	1.00-1.25%
1 m Libor	0.78%	0.91%	1.11%	1.17%	1.40%
3m Libor	1.10%	1.17%	1.33%	1.48%	1.63%
2yr Notes	1.30%	1.32%	1.49%	1.65%	1.78%
10 yr Bonds	2.47%	2.47%	2.55%	2.61%	2.70%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.36%	-0.33%	-0.30%	-0.28%	-0.26%
2yr Bunds	-0.86%	-0.86%	-0.82%	-0.80%	-0.77%
10yr Bunds	0.29%	0.30%	0.35%	0.42%	0.50%
UK					
Repo Rate	0.25%	0.25%	0.25%	0.25%	0.25%
3m	0.35%	0.37%	0.37%	0.40%	0.42%
10-yr Gilt	1.20%	1.20%	1.25%	1.30%	1.35%
Switzerland					
3m Libor Target	-0.73%	-0.72%	-0.82%	-0.85%	-0.85%
10-yr Bond	-0.21%	-0.18%	-0.15%	-0.12%	-0.08%

Source: Bloomberg (market implied forecasts)

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