# Week ahead

## China – will economy stumble over trade conflict?
## EZ – will inflation rise further in June?
## Greece – support marathon coming to an end!

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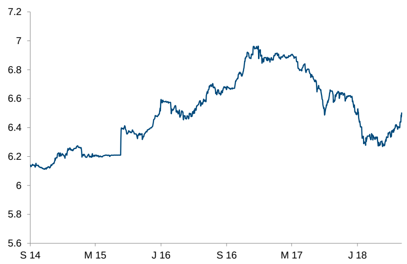
**Yuan weakens against USD**




*Source: Bloomberg, Erste Group Research*

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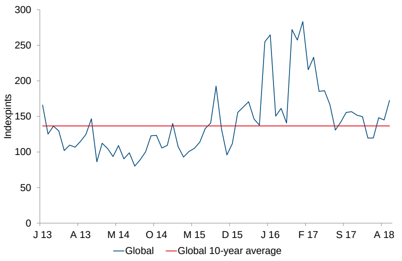
### China – US-President Trump escalates trade conflict further

Now that the US has imposed punitive duties on the goods of major trading partners, the economies affected by these measures, such as China, will impose their own punitive tariffs on US imports. As a consequence, President Trump continued to escalate the situation earlier this week, threatening to impose additional punitive tariffs of more than USD 200bn on Chinese goods, if China does not respond seriously to US demands. The US is essentially calling for a comprehensive opening of the Chinese domestic market to foreign investors as well as better protection of intellectual property rights and a faster decline in the trade surplus with the US. President Xi touched upon these demands in a speech given at the Boao Asia Forum. China has, for example, already specifically announced a gradual opening of the financial sector to foreign investors. In addition, China has lowered tariffs on a wide range of consumer goods (including cars and car parts). But Xi also insisted that China must follow its own developmental logic and therefore will not tolerate being forced by the US to rush any steps.

**At first glance, the US has a clear advantage in the event of further escalation** in the trade dispute due to the significant trade deficit with China. On closer inspection, however, **China also has the potential to threaten the United States**. Among other things because China has already become a very important sales market for several US companies. These companies could therefore be at risk of coming into the crosshairs of China should it consider further retaliatory measures. It can therefore be assumed that representatives of US firms with a strong focus on the Chinese market are lobbying against further punitive tariffs in the US. However, due to the increasing complexity of global supply chains (additionally compounded by corporate tax avoidance strategies), trade data alone is not a reliable measure of actual added value in an economic region. Therefore, China's advantage in trade with the US is quite likely below the official figures. However, the trade surplus in relation to China's economic output is already declining overall due to the transformation of China's economy towards a service orientated economy and strengthening of domestic consumption. In comparison to the US, however, a turnaround in the Chinese trade balance is still not visible, even though the US achieves a surplus in trade in services with China. China's central bank expects this surplus to continue to grow rapidly in the coming years. The US should, for example, benefit from the opening of the Chinese financial sector due of its comparative advantage in financial services. For these reasons, it can be expected that even without punitive measures the trade imbalances between China and the US will be reduced in the coming years.

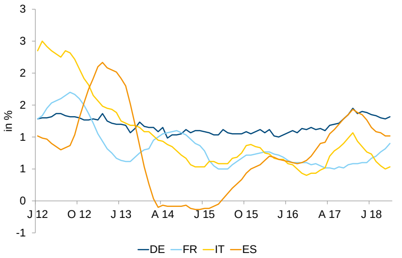
*The recent verbal escalation by Trump has triggered a significant weakening of the yuan against the USD this week. **This indicates that***

**Global Economic Policy Uncertainty Index**




*Source: economicpolicyuncertainty, Erste Group Research*

**Core-inflation DE, FR, IT and ES (6-month average)**




*Source: Bloomberg, Erste Group Research*

***investors fear negative impact on China's growth prospects in the event of additional punitive tariffs.*** *If the weakness of the yuan continues, then similarly to 2014 and 2015, China's FX-reserves could come under pressure, which could further increase investor nervousness. The politically induced uncertainty on the global economic outlook increased significantly in May and will supposedly rise further in June. The Chinese central bank has already responded to this uncertainty and announced that it is ready to take comprehensive measures to support the economy. In addition, China also has the option to prevent a possible slowdown in growth with a fiscal stimulus.* ***If sentiment towards China continues to deteriorate as a result of the trade dispute, then, given the importance of China's economy, dampening effects on Eurozone growth cannot be ruled out in the coming quarters.*** *We will therefore closely monitor the ongoing development of the data over the coming weeks.*

### EZ - Inflation stable at +1.8% y/y to +1.9% y/y expected for June

Next week (June 29), the first flash estimate of headline inflation for the Eurozone for June will be released. In May, total inflation rose significantly to +1.9% y/y (previously +1.2% y/y). The main drivers of the increase were energy prices (+6.1% y/y). Fortunately, core inflation also rose to its highest value for the year, at +1.1% y/y. Following a period of weakness based on a six-month average, an upwards trend in core inflation is now emerging again in Germany, Italy and Spain. The positive development of core inflation in May has certainly also played a role in the ECB's considerations regarding the end of the purchasing program.

***Based on persistently high energy prices, we expect stable development of total inflation of the euro area in June, at approx. + 1.8% y/y to + 1.9% y/y.*** *Later in the year, we expect a gradual increase in core inflation, in line with continued growth in the euro area above its potential. However, upward pressure on core inflation should remain restrained, in part due to a very fragmented labor market in the Eurozone. For the full year, we expect total inflation for the Eurozone to be + 1.6% on average.*

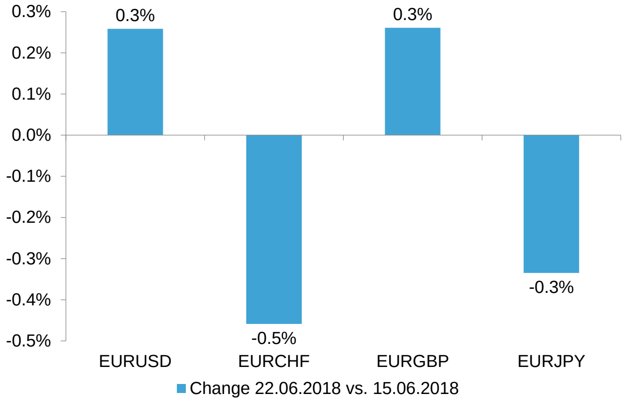
### Greece leaving ESM aid program

The Eurogroup (Finance Minister of the Eurozone) has announced that Greece has successfully completed the latest review of the ongoing aid program. According to the Eurogroup, thanks to fiscal and structural reforms, Greece is leaving the aid program as a strengthened economy. Cooperation with the Commission's Structural Reform Support Service should help Greece to implement targeted structural reforms in the coming years, with the aim of improving Greece's long-term growth prospects. This will also be necessary because the European institutions consider an ambitious growth strategy coupled with a tight fiscal policy as a cornerstone to ensure the future debt sustainability of Greece (debt ratio to GDP of 178.6%). Evidently, this is not expected to be sufficient, as the European partners have also provided additional support to Greece. In order to improve medium- to long-term debt sustainability, profits from certain aid programs will be re-transferred to Greece. In addition, the current capitalization of interest on certain aid funds will be extended by a further 10 years, and the average duration of aid funds will also be increased by a further 10 years. Furthermore, Greece will be provided with a financial buffer of EUR 24.1bn, which should cover refinancing requirements for the next 22 months.

***Once Greece has left the aid program, it can be assumed that Greece's political and economic developments will receive more media attention in future.*** *The next crucial date will be the general* *election in September 2019. Despite all reform efforts, Greece continues, in our assessment, to show substantial deficits in almost all economically relevant core areas, from infrastructure to education to market efficiency. This burdens the medium- to long-term growth prospects. We therefore believe that it will not be easy for Greece to fulfill the ambitious growth strategy of the European institutions.*

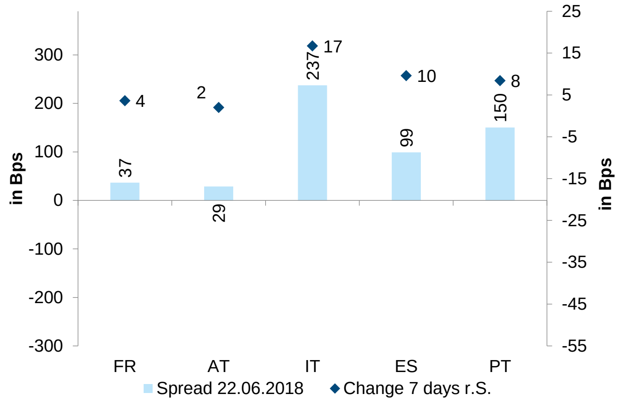
## Forex and government bond markets

### Exchange rates EUR: USD, CHF, GBP and JPY
change last week
(+ stronger euro / - weaker euro)



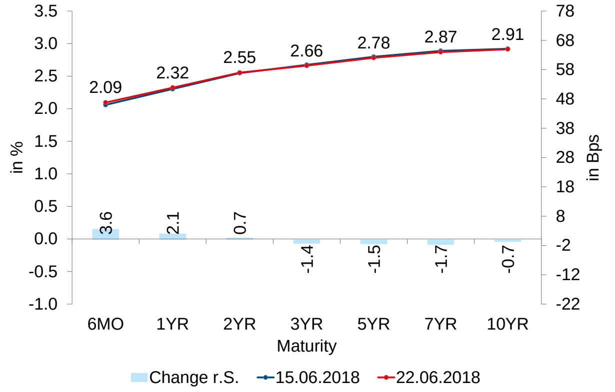

*Source: Bloomberg, Erste Group Research*

### Eurozone – spreads vs. Germany
10Y government bonds



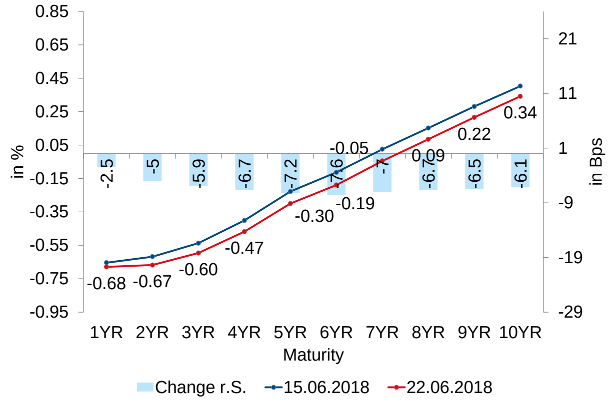

*Source: Bloomberg, Erste Group Research*

### US Treasuries yield curve
change last week




*Source: Bloomberg, Erste Group Research*

### DE Bund yield curve
change last week




*Source: Bloomberg, Erste Group Research*

## Economic calendar

| Date | Time | Ctry | Release | Period | Consens | Prior |
|---|---|---|---|---|---|---|
| 22-Jun | 8:45 | FR | GDP y/y | 1Q F | 2.2% | 2.2% |
| | | FR | GDP q/q | 1Q F | 0.2% | 0.2% |
| | 9:00 | FR | PMI Manufacturing | Jun P | 54.0 index | 54.4 index |
| | 9:30 | DE | PMI Manufacturing | Jun P | 56.3 index | 56.9 index |
| | 10:00 | EA | PMI Manufacturing | Jun P | 55.0 index | 55.5 index |
| 25-Jun | 9:00 | AT | Ind. Prod. y/y | Apr | | 3.9% |
| | 16:00 | US | New Home Sales | May | 663.7 thd | 662.0 thd |
| 26-Jun | | US | Consumer Conf. | Jun | 127.8 index | 128.0 index |
| 27-Jun | n.a. | DE | Retail Sales y/y | May | | 1.2% |
| | 10:00 | AT | PMI Manufacturing | Jun | | 57.3 index |
| | 12:00 | IT | PPI y/y | May | | 1.4% |
| | 14:30 | US | Durable Goods Orders | May P | -1.2% | -1.6% |
| 28-Jun | n.a. | FR | Consumer Conf. | Jun | | -5.3 index |
| | | DE | Consumer Conf. | Jun | | 5.9 index |
| | | IT | Consumer Conf. | Jun | | -7.2 index |
| | | AT | Consumer Conf. | Jun | | 11.2 index |
| | 11:00 | IT | Inflation y/y | Jun P | | 1.0% |
| | | IT | CPI m/m | Jun P | | 0.3% |
| | | EA | Consumer Conf. | Jun F | -0.1 index | -0.5 index |
| | | EA | Business Conf. | Jun | 112.3 index | 112.5 index |
| | 14:00 | DE | Inflation y/y | Jun P | 2.3% | 2.2% |
| | | DE | CPI m/m | Jun P | 0.2% | 0.6% |
| | 14:30 | US | GDP q/q | 1Q T | 2.2% | 2.2% |
| | | US | Jobless Claims | - | 221.4 thd | 218.0 thd |
| 29-Jun | 8:45 | FR | CPI m/m | Jun P | | 0.5% |
| | | FR | PPI y/y | - | | 2.3% |
| | | FR | Inflation y/y | Jun P | | 2.3% |
| | 9:00 | AT | PPI y/y | Jun P | | 1.4% |
| | 14:30 | US | PCE Deflator | Jun P | 2.2% | 2.0% |
| | 16:00 | US | Univ. Michigan Index | May | 99.1 index | 99.3 index |
| | 11:00 | EA | CPI flash m/m | May | 2% | 2% |

*Source: Bloomberg, Erste Group Research*

## FORECASTS[1])

| GDP | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Eurozone | 2.0 | 1.8 | 2.4 | 2.4 | 2.2 |
| US | 2.9 | 1.5 | 2.3 | 2.8 | 2.2 |

| Inflation | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Eurozone | 0.1 | 0.2 | 1.5 | 1.6 | 1.7 |
| US | 0.1 | 1.2 | 2.2 | 2.2 | 1.9 |

| Interest rates | current | Sep.18 | Dec.18 | Mar.19 | Jun.19 |
|---|---|---|---|---|---|
| ECB MRR | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 3M Euribor | -0.32 | -0.30 | -0.30 | -0.30 | -0.30 |
| Germany Govt. 10Y | 0.35 | 0.60 | 0.80 | 0.90 | 1.00 |
| Swap 10Y | 0.90 | 0.90 | 1.10 | 1.20 | 1.30 |

| Interest rates | current | Sep.18 | Dec.18 | Mar.19 | Jun.19 |
|---|---|---|---|---|---|
| Fed Funds Target Rate* | 1.92 | 2.13 | 2.38 | 2.63 | 2.88 |
| 3M Libor | 2.33 | 2.40 | 2.70 | 2.90 | 3.20 |
| US Govt. 10Y | 2.92 | 3.20 | 3.30 | 3.50 | 3.50 |
| EURUSD | 1.17 | 1.14 | 1.13 | 1.16 | 1.16 |

*Mid of target range

In case of changes to our forecasts compared to the previous issue, arrows show the direction of the change.

*Source: Bloomberg, Erste Group Research*

[1] By regulations we are obliged to issue the following statement: Forecasts are no reliable indicator for future performance

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