

Week ahead

Eurozone – ECB to remain on track

Eurozone – will manufacturing sentiment decline further in July?

ECB Governing Council to confirm end of net asset purchases by end of year

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No significant new decisions are expected to be made at the ECB Governing Council meeting next week, as the medium-term course was already set at the meeting in June. While the envisaged timing of measures is not set in stone yet and the ECB continues to emphasize that its monetary policy will ultimately depend on the incoming data, in our view it seems very likely that the timeline set in June will be followed. According to this schedule, the next step is to reduce monthly net asset purchases from the current EUR 30bn to EUR 15bn starting by October, followed by a definitive end of net asset purchases in December. Progress in the sustainable adjustment of the inflation path towards the ECB's inflation target is the condition for this. These advances are tied to three criteria. In the Governing Council's view, these criteria were satisfied, as the forecasts of ECB economists show rising inflation rates over the next few years, inflation expectations on the market have improved and moved closer to the ECB's inflation target and cost pressures have strengthened, due to increasing capacity utilization. Another crucial aspect was the conviction that the desired inflation path is increasingly less dependent on monthly net asset purchases.

All in all, the set path for monetary policy depends on the continuing strength of the economy. Without ongoing satisfactory economic growth, inflationary expectations of both the ECB economists as well as those in the markets are likely to falter. Capacity utilization, and thus cost pressure, would not increase further and the ECB Governing Council would therefore lose its confidence in being able to achieve the inflation target without purchasing securities. From the perspective of the ECB Governing Council, the economic slowdown that took place in the first half of the year does not threaten their targets, not least because it started from a very high level. Initial indicators suggest that we can expect roughly the same rate of growth for the third quarter as in the second quarter. Thus, we see no reason for the ECB Governing Council to rethink their decisions from June at next week's meeting.

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Indications of past performance are no guarantee of a positive performance in the future

It seems possible, although unlikely, that specifications on the reinvestment of redemption payments from the ECB's portfolio will be published. President Draghi announced this in June for 'one of the upcoming meetings'. At present, the ECB has only decided to reinvest no later than two months after the month of the redemption payment. Redemptions of bonds issued by public issuers may only be reinvested in issues of the same jurisdiction. This restriction does not apply to securities of private issuers. Here, reinvestments should roughly illustrate the market capitalization of investable securities. It is possible that at 'one of the upcoming meetings', these existing specifications will be reconsidered, allowing for a certain shift in weightings in the portfolio between the classes of securities of public and private issuers. It seems unlikely in our

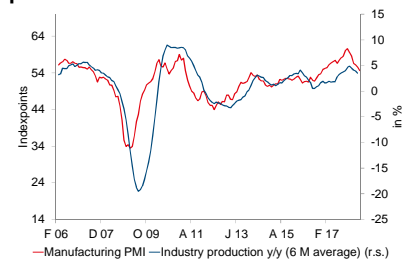
view that the weightings between government issuers will change. There are also questions that have remained unanswered so far, such as regarding the maturity structure of reinvestments. Will the ECB aim to keep the duration of its portfolio constant, or, if possible, prefer longer maturities? We do not expect any clarification regarding these issues at the upcoming meeting; to us, this seems far more likely in September.

Eurozone – manufacturing sentiment expected to rise slightly in July

Next week (July 24), a first flash estimate of the manufacturing sentiment of the Eurozone, Germany and France will be published. This data is of particular interest, as it is one of the first key data points regarding the economic situation for 3Q18. Since the beginning of the year, sentiment has continuously decreased from very high levels to a recent level of 54.9 index points. Among other things, this development reflects the growing global uncertainty caused by the ongoing trade conflict.

*Since mid-June, we have witnessed an increase in the signs of an early turnaround in sentiment. For example, the expectations of the manufacturing sector in Germany, based on the survey conducted by the ifo-Institute in June, have already stabilized. **We therefore already anticipate a slight increase in the flash estimate of the manufacturing purchasing managers' index for July.***

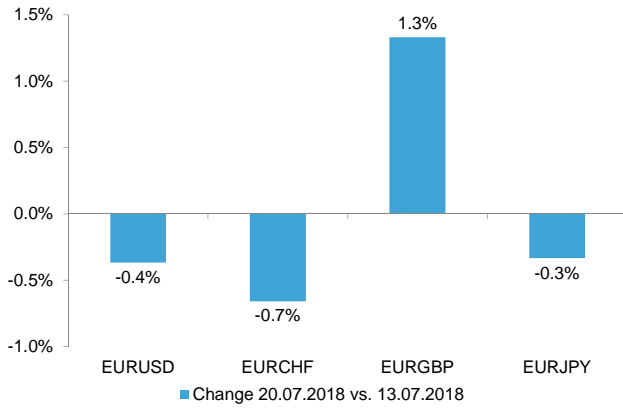
EZ: Manufacturing PMI vs. industry production



Source: Bloomberg, Erste Group Research

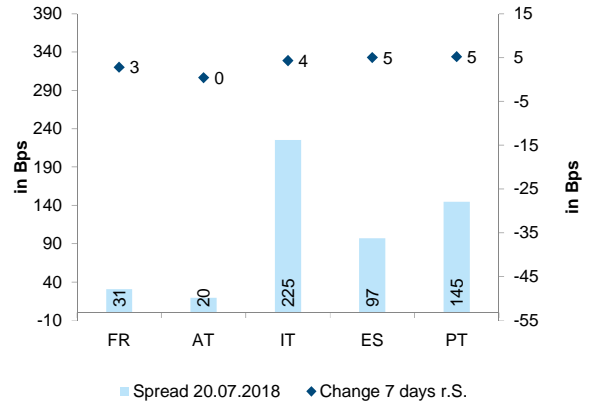
Forex and government bond markets

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



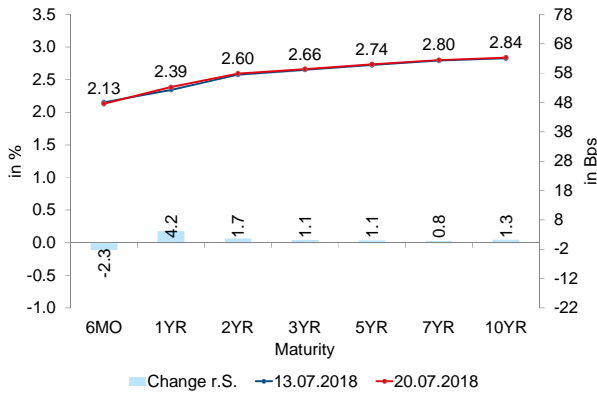
Source: Bloomberg, Erste Group Research

Eurozone – spreads vs. Germany
10Y government bonds



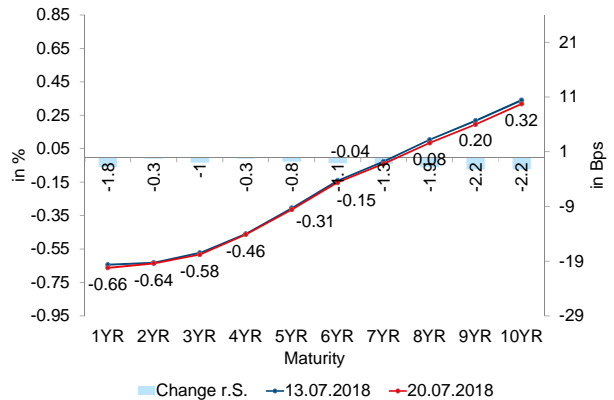
Source: Bloomberg, Erste Group Research

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
20-Jul	8:00	DE	PPI y/y	Jun	3.0%	3.0%
	10:00	IT	CA Balance (m)	May		3009 m
		EA	CA Balance (m)	May		
23-Jul	16:00	US	Existing Home Sales	Jun	5.5 m	5.4 m
		EA	Consumer Conf.	Jul A	-0.6 index	-0.5 index
24-Jul	9:00	FR	PMI Manufacturing	Jul P	52.3 index	52.5 index
	9:30	DE	PMI Manufacturing	Jul P	55.8 index	55.9 index
	10:00	EA	PMI Manufacturing	Jul P	54.8 index	54.9 index
25-Jul	8:45	FR	PPI y/y	Jun		2.9%
	9:00	AT	Ind. Prod. y/y	May		5.9%
	16:00	US	New Home Sales	Jun	670.4 thd	689.0 thd
26-Jul	13:45	EA	Target Rate (lending)	-	-0.40%	-0.40%
		EA	Target Rate	-		0.00%
	14:30	US	Durable Goods Orders	Jun P	3.3%	-0.4%
		US	Jobless Claims	-	221.3 thd	207.0 thd
27-Jul	n.a.	DE	Retail Sales y/y	Jun		-1.6%
	7:30	FR	GDP y/y	2Q A	1.9%	2.2%
		FR	GDP q/q	2Q A	0.4%	0.2%
	10:00	AT	PMI Manufacturing	Jul		56.6 index
		IT	PPI y/y	Jun		2.7%
	14:30	US	GDP q/q	2Q A	4.1%	2.0%
	16:00	US	Univ. Michigan Index	Jul F	97.3 index	97.1 index

Source: Bloomberg, Erste Group Research

FORECASTS¹⁾

GDP	2015	2016	2017	2018	2019
Eurozone	2.0	1.8	2.4	2.3	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	0.33	0.60	0.70 ↓	0.90	1.00
Swap 10Y	0.86	0.90	1.00	1.20	1.30

Interest rates	current	Sep.18	Dec.18	Mar.19	Jun.19
Fed Funds Target Rate*	1.91	2.13	2.38	2.63	2.88
3M Libor	2.35	2.40	2.70	2.90	3.20
US Govt. 10Y	2.85	3.20	3.30	3.50	3.50
EURUSD	1.16	1.14	1.13	1.15	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

Erste Group Research

Week ahead | Macro, Fixed Income | Eurozone, USA

20 July 2018

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