

# Week Ahead

Focus: New Yield Forecasts

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## Outlook for economy recovers only slowly

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On interest rate markets, concerns about an economic slowdown that goes beyond its current magnitude continue to prevail. Sentiment and risks, rather than available data, are crucial. In fact, first quarter GDP growth in both the Eurozone and the US exceeded market expectations.

Our forecasts had been based on a brightening of sentiment. The main reasons for this were the avoidance of hard Brexit, progress or agreement in the negotiations between the US and China and, ultimately, better economic data as a result. Some of these assumptions have come true, but the markets remain concerned. Both US and German 10y government bond yields are close to this year's lows. It is therefore time for us to correct our expectations.

The postponement of the Brexit decision only led to a relatively brief reaction from the markets, which was probably due to the fact that the issue could become acute again in the autumn. In fact, little progress has been made since. A solution is therefore not in sight and it is to be feared that activity will only become hectic again shortly before the deadline at the end of October is reached. However, we remain of the opinion that hard Brexit should ultimately be avoided, which is the most important thing from the point of view of the economy and thus the markets. After the prospect of imminent agreement, negotiations between China and the US suffered a significant setback with the increase in US tariffs and the prospect of further tariffs. The outcome is completely open. We assume that the recent increase in US tariffs is part of the negotiating strategy and that a solution will be found in the coming weeks. But the risk of escalation has certainly increased. Finally, we turn to market sentiment. Obviously the market is asking for more data to look to the future with more confidence. We expect stable growth for the Eurozone in the coming quarters. This should remove fears of a further downturn from the market, but not more. In the US, growth should slow down somewhat in the coming quarters as the effects of the tax cuts diminish. However, this slowdown starts from a high level and the US economy should therefore still achieve growth above its long-term potential. Overall, we remain more confident about the future than the markets. At the same time, however, the risks are considerable, not least because they depend on political decisions. From the current low level, however, we are more likely to see a brightening of sentiment. For our yield forecasts for Germany and the US, this still means an increase in yields ahead, although at a slower pace than originally assumed.

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Note: Past performance is not necessarily indicative of future results.

In addition, we are also postponing the date of the ECB's first interest rate hike (deposit interest rate) by three months to June 2020. This is indirectly attributable to the economic slowdown. In the European Commission's spring forecast, expectations for both income growth and the output gap were lowered. In our experience, these figures are included in the ECB's inflation forecasts. We therefore expect a downward revision of the ECB's

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inflation forecasts, which will be announced in June. It will therefore take longer for progress towards the ECB's inflation target to become apparent and, accordingly, for the first rate hike to take place.

Finally, yields on US Treasuries. As shown above, we expect a slower rise. However, we now also expect the yield plateau to be reached earlier than originally assumed. We had assumed a steeper yield curve by the end of the year. However, the recent decline in inflation data, although temporary, has reduced the likelihood that markets will perceive any inflation risks by the end of the year.

## Economic calendar

Ctry	Date	Time	Release	Period	Consens	Prior
<b>Eurozone</b>						
EA	15-May	11:00	GDP q/q	1Q P	0.4%	0.4%
EA	15-May	11:00	GDP y/y	1Q P	1.2%	1.2%
DE	15-May	8:00	GDP y/y	1Q P	0.7%	0.6%
<b>USA</b>						
	10-May	14:30	Inflation y/y	Apr	2.1%	1.9%
	15-May	14:30	Retail Sales mom	Apr	0.3%	1.6%
<b>China</b>						

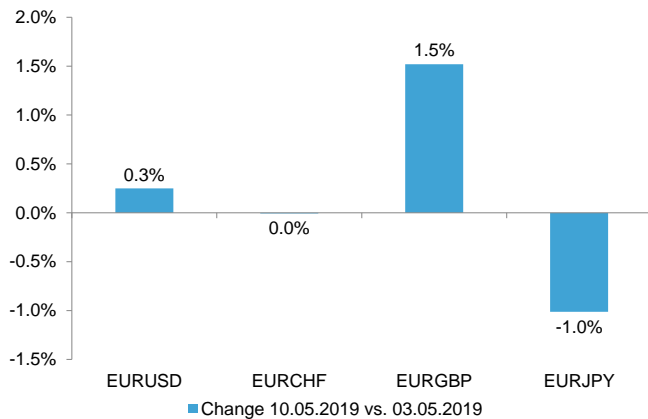
Source: Bloomberg, Erste Group Research

## Central bank events

	Date	Time	Event
<b>ECB</b>			
	15-May	18:30	Peter Praet, The Role of the ECB in the EU
	16-May	09:30	Peter Praet, Strengthening the International Role of the Euro
<b>Fed</b>			
	13-May	15:10	Richard H. Clarida, The Federal Reserve's Review of its Monetary Policy Strategy, Tools, and Communication Policies

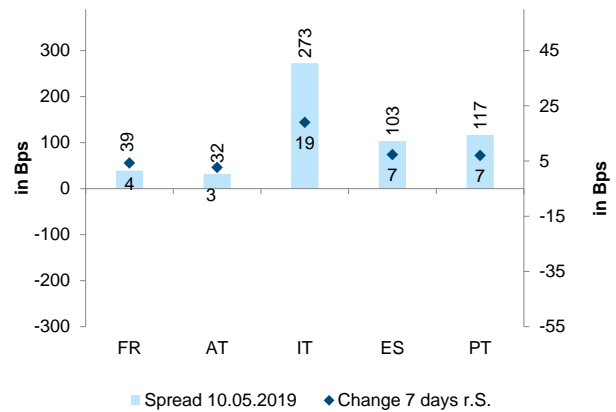
## Forex and government bond markets

**Exchange rates EUR: USD, CHF, GBP and JPY**  
 Changes compared to last week



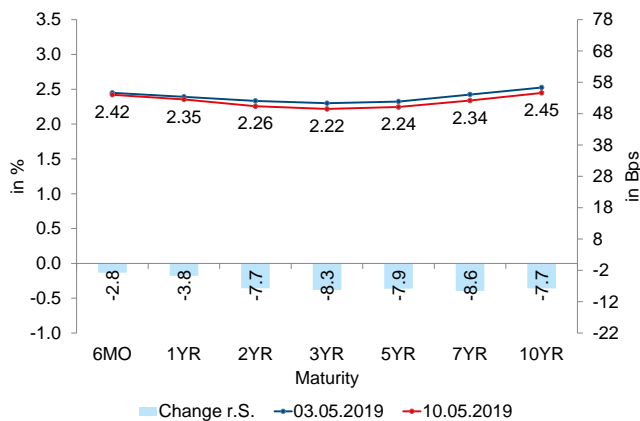
Source: Bloomberg, Erste Group Research

**Eurozone spreads vs. Germany**  
 10Y government bonds



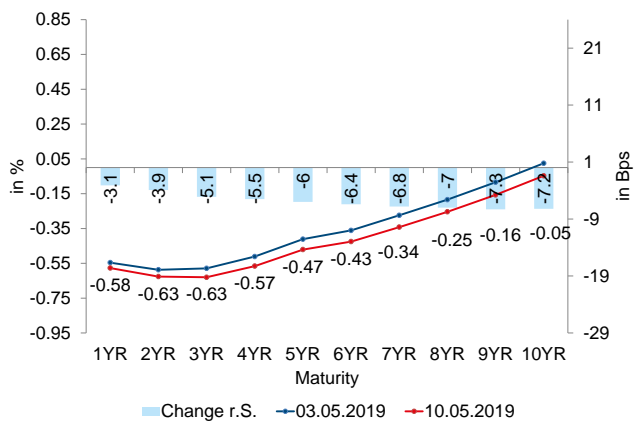
Source: Bloomberg, Erste Group Research

**US Treasuries yield curve**  
 Changes compared to last week



Source: Bloomberg, Erste Group Research

**DE Bund yield curve**  
 Changes compared to last week



Source: Bloomberg, Erste Group Research

## Forecasts<sup>1</sup>

GDP	2017	2018	2019	2020
Eurozone	2.4	1.8	1.3	1.4
US	2.3	2.9	2.5 ↑	2.1

Inflation	2017	2018	2019	2020
Eurozone	1.5	1.7	1.4	1.6
US	2.2	2.4	1.8	1.9

Interest rates	current	Jun.19	Sep.19	Dec.19	Mar.20
ECB MRR	0.00	0.00	0.00	0.00	0.00
3M Euribor	-0.31	-0.30	-0.30	-0.30	-0.30 ↓
Germany Govt. 10Y	-0.04	0.20 ↓	0.30 ↓	0.50 ↓	0.50 ↓
Swap 10Y	0.48	0.50 ↓	0.60 ↓	0.80 ↓	0.80 ↓

Interest rates	current	Jun.19	Sep.19	Dec.19	Mar.20
Fed Funds Target Rate*	2.39	2.38	2.38	2.68	2.68
3M Libor	2.55	2.70	2.70	3.00	3.00
US Govt. 10Y	2.45	2.60 ↓	2.70 ↓	2.80 ↓	2.80 ↓
EURUSD	1.12	1.15	1.18	1.18	1.20

\*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

<sup>1</sup> Note: In accordance with regulations, we are obliged to issue the following statement: Forecasts are not a reliable indicator of future performance.

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