

Week Ahead

Focus: ECB decides, Eurozone industrial production, snap elections in UK

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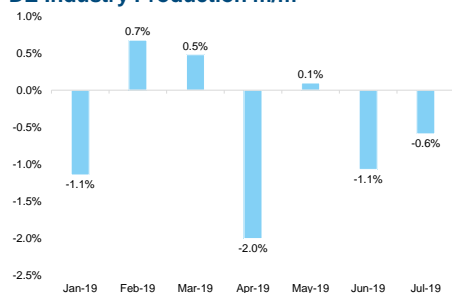
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ECB – will markets be disappointed?

The ECB Governing Council's meeting on Thursday next week will receive even more attention than developments in the United Kingdom (see article below). The question is what measures will be taken to stimulate the economy. We are assuming a package. The most likely measure is a change in the guidance. The minimum period for unchanged or lower interest rates should be significantly extended from the current mid-2020 level; twelve months seems realistic to us. The Governing Council could also switch to a symmetrical inflation target. This would mean allowing a period of overshooting after a period of inflation undershooting the inflation target. This would allow the ECB to react later to the first signs of a rise in inflation, which should dampen interest rate expectations. The second measure with a high probability is to lower the deposit rate. We expect it to be 10 basis points, so the interest rate should then be -0.5%. In addition, a second higher deposit rate is likely to be agreed, at which banks can deposit funds with the ECB up to a certain level. Finally, we also expect the announcement of a new asset purchase program. Of all the measures, however, the greatest uncertainty is about this. We expect a program that will last at least one year and have a size of EUR 40bn monthly, with a composition similar to previous programs.

The market reaction to these decisions could well be significant. In the run-up to the meeting, the ECB gave hardly any indications as to which steps or to what extent they could be expected. Uncertainty is correspondingly high. The markets seem to expect a massive easing of monetary policy and for us the risks of disappointment prevail. The consequence would be price losses for government bonds.

DE Industry Production m/m



Source: Statistical Office Germany, Erste Group Research

Is Germany facing recession?

Germany's industrial production continued its weakness in July and, contrary to market expectations, fell by 0.6% compared to the previous month. This is a disappointment after production already fell by 1.1% in June compared to May. However, this development is in line with the weak sentiment of German industry, which dropped to a multi-year low in August. Germany's industry continues to suffer from the global trade conflict, Brexit (exports to the UK have been falling for two years), as well as deep structural problems in the automotive industry (automobile production has collapsed by around 20%).

Due to this continued weakness in industry at the beginning of the third quarter, we believe that the danger of a technical recession in Germany has increased. Industrial production data for the Eurozone as a whole will be published next week. We expect industry in France and Spain to perform comparatively better. Based on our models, we expect stable GDP growth of around +0.2% to +0.3% q/q for the Eurozone in the third quarter, thanks to a

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Note: Past performance is not necessarily indicative of future results

sustained stable domestic economy, despite a possible recession in Germany.

United Kingdom – markets awaiting further decisions

This week, the British Parliament managed to take control of the Brexit procedure. The British prime minister is obliged, should there be no agreement with the EU by October 19, or should Parliament agree to a hard Brexit, to request a delay of three months (January 31, 2020) in the withdrawal date in Brussels. The markets reacted to these events with relief. Indeed, the clear opposition of MEPs to the Prime Minister's line has somewhat reduced the likelihood of hard Brexit. However, the outcome remains completely open. Next week, there will already be another attempt by the prime minister to trigger new elections. Should this happen and elections take place before October 31, the door would be wide open for hard Brexit, as Boris Johnson is currently far ahead in the polls. If not, the government crisis will remain in any case. Boris Johnson has said that he would "rather be dead in a ditch" than apply for an extension in Brussels. So he will probably pull out all the stops to implement the October 31 departure date. Furthermore, it is completely unclear how the EU will deal with the situation. If, for example, new elections in the United Kingdom do not take place until October 31, it remains to be seen whether an extension will be approved. The prospect of a returning Prime Minister Johnson will cast doubt on the usefulness of an extension.

We expect eventful weeks ahead, with ups downs for the outlook for Brexit. This will be reflected in the corresponding volatility in the markets. The outcome is highly uncertain. For us, the probability of hard Brexit continues to predominate.

Forecast adjustment

We have made slight adjustments to our forecasts due to the further deterioration of the environment. We now expect interest rates in the US to be cut in October in addition to September. After that, we expect interest rates to remain stable, which should disappoint the markets. We have slightly lowered our yield forecast for Germany for next year. Details on our outlook can be found in our current publication [Interest Rate Outlook](#)

Economic calendar

Ctry	Date	Time	Release	Period	Consens	Prior
Eurozone						
EA	6-Sep	11:00	GDP q/q	2Q F	0.2%	0.2%
EA	6-Sep	11:00	GDP y/y	2Q F	1.1%	1.1%
USA						
	6-Sep	14:30	Wages y/y	Aug	3.1%	3.2%
	6-Sep	14:30	Unempl. Rate	Aug	3.7%	3.7%
	6-Sep	14:30	Chg. Non-Farm Payrolls	Aug	162.1 Tsd	164.0 Tsd
	12-Sep	14:30	Inflation y/y	Aug	1.7%	1.8%
China						
	10-Sep	3:30	Inflation y/y	Aug	2.6%	2.8%

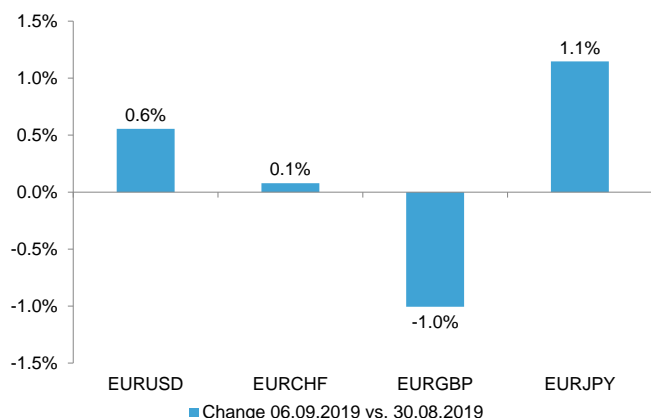
Central bank events

	Date	Time	Event
ECB			
	12-Sep	13:45	ECB Council decision on monetary policy
	12-Sep	14:30	Mario Draghi, press conference
Fed			
	6-Sep	18:30	Jerome Powell, Discussion Economic Outlook and Monetary Policy

Source: Bloomberg, Central Banks, Erste Group Research

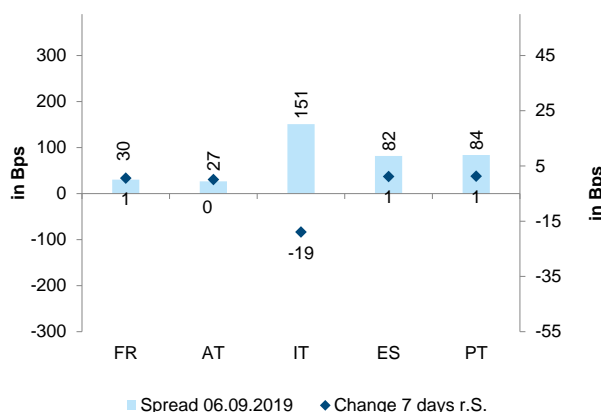
Forex and government bond markets

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



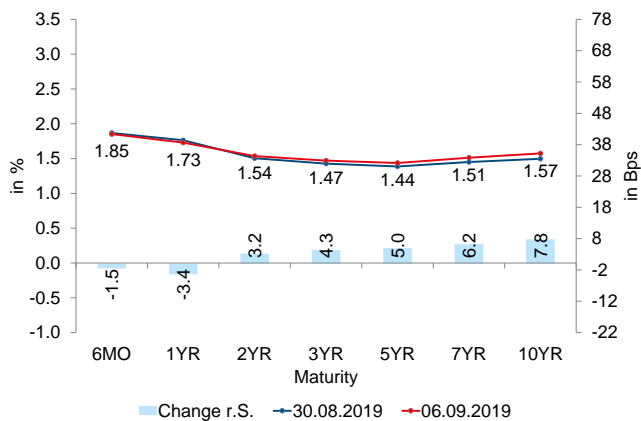
Source: Bloomberg, Erste Group Research

Eurozone spreads vs. Germany
 10Y government bonds



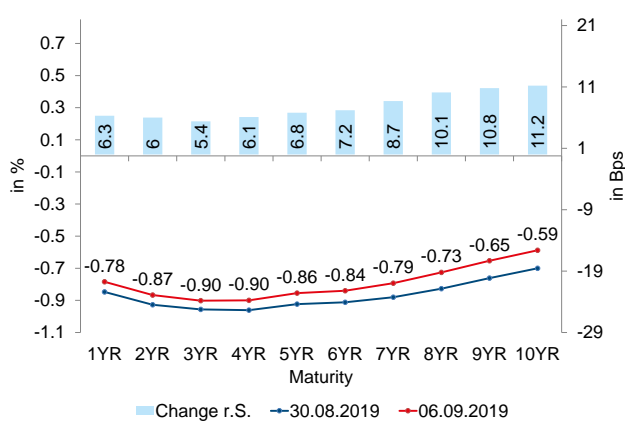
Source: Bloomberg, Erste Group Research

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

Forecasts¹

GDP	2017	2018	2019	2020
Eurozone	2,4	1,8	1,1	1,0
US	2,3	2,9	2,3	2,1

Inflation	2017	2018	2019	2020
Eurozone	1,5	1,7	1,3	1,5
US	2,2	2,4	1,8	2,0

Interest rates	current	Dec.19	Mar.20	Jun.20	Sep.20
ECB MRR	0,00	0,00	0,00	0,00	0,00
3M Euribor	-0,44	-0,50	-0,50	-0,50	-0,50
Germany Govt. 10Y	-0,59	-0,40	-0,40 ↓	-0,40 ↓	-0,20
Swap 10Y	-0,16	-0,10	-0,10 ↓	-0,10 ↓	0,10

Interest rates	current	Dec.19	Mar.20	Jun.20	Sep.20
Fed Funds Target Rate*	2,13	1,63 ↓	1,63 ↓	1,63 ↓	1,63
3M Libor	2,11	1,80 ↓	1,80 ↓	1,80 ↓	1,80
US Govt. 10Y	1,57	1,80 ↓	2,00	2,00 ↓	2,10
EURUSD	1,10	1,10	1,12	1,15	1,15

*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 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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