Week Ahead

Focus: EU bond issuance, EZ PMI data, EZ commodity prices and inflation

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EU recovery plan coming – also to financial markets

The European Commission's recently published spring economic forecasts showed a better assessment of economic activity this year and next than at the beginning of the year. The forecast was raised to 4.3% for 2021 and to 4.4% for 2022. In the winter, growth of 3.8% had been forecast for both years. A major reason for the upward revision was the prospect of the impact of the European Recovery Plan (Next Generation EU).

Indeed, implementation has picked up speed. The Commission has until the end of June to evaluate the countries' submitted reconstruction and resilience plans. After that, the Council has another four weeks to approve the plans. The European Recovery Plan has total volume of EUR 750bn (price-indexed), of which EUR 390bn is financial aid and EUR 360bn is loans. Not all the conditions are yet in place, as eight member states still have to ratify the Own Resources Decision, which governs the financing of the recovery plan, but this seems to be only a formality.

Once these legal foundations are in place, the European Commission will start issuing bonds to finance Next Generation EU, which could be as early as June. Over 5.5 years (until 2026), issuance volume of EUR 800bn is expected. The average issuance volume will thus be around EUR 150bn per year. For comparison: Germany issued EUR 12bn net in 2019, and France issued EUR 65bn (we use 2019, as the crisis year 2020 is of little significance). During the early years, however, it will probably be more, as the EU wants to implement and finance the majority of the projects by 2024. Ultimately, however, it will depend on how much funding is called up by the member states. However, the EU should become one of the largest, probably even the largest, issuer in the Euro bond market. During the coming years, the outstanding volume will approach that of German Bunds. Thus, the yield premium that is currently paid over German Bunds should slowly disappear, as there are hardly any differences in credit ratings. All major rating agencies, with the exception of S&P, give EU issues the highest credit rating, while Germany has the best rating with all rating agencies. The EU will offer a wide range of maturities in its future issues and thus form its own yield curve. In our view, the first issues should still bring a slight yield premium, as is currently the case with the bonds already issued by the EU to finance the SURE program (support for labor policy measures in the member states). However, as the liquidity of EU bonds increases, this yield premium should disappear.

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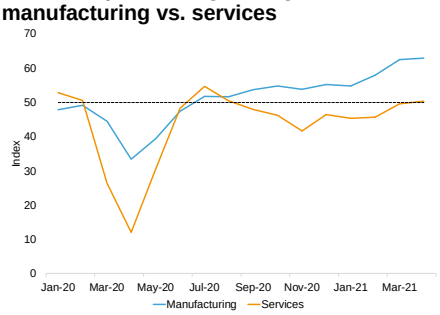
EZ - service providers on the rise?

Already in April, the mood of service providers brightened slightly from a level dampened by the restrictive measures. The mood in industry also improved slightly in April, despite historical records. Industry is currently benefiting, among other things, from the fact that in many Eurozone

Eurozone purchasing managers indices, manufacturing vs. services



Source: Market data provider, Erste Group Research

countries the entire leisure and culture sector had to be largely shut down for six months. This temporarily created disposable income for many households, which was partly spent on additional consumption of consumer durables (e.g. furniture, cars, electronics). With the gradual and sustained opening of the services sector in the coming weeks, demand for consumer durables is likely to decline again, which should also lead to a normalization of the industrial order situation.

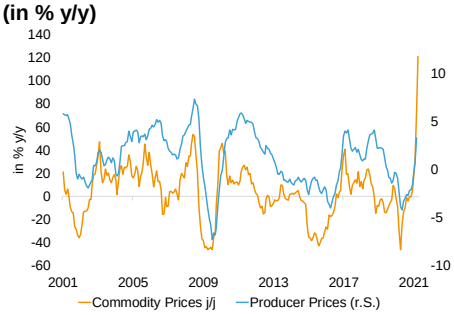
In view of the rapid vaccination progress and opening steps already taken in some Eurozone countries (e.g. Spain), we expect a significant rise in services sentiment in May (published on May 21). In contrast, we expect sentiment in industry to flatten out or fall slightly from the historical highs in April. Meanwhile, around 30% of citizens (with a focus particularly on vulnerable groups) in the Eurozone have received at least one vaccination dose. Thanks to the continued rapid pace of vaccination, the expected opening steps in the services sector during the coming weeks should be sustainable and not trigger a new wave of infection. We therefore expect a dynamic recovery of the Eurozone economy from 2Q onwards, which should be driven primarily by the opening of the services sector.

EZ - what do commodity prices say about the inflation outlook?

The dynamic rise in global commodity prices has caused uncertainty in recent weeks. However, despite the recent increases, prices of major commodities are still below historical highs (e.g. energy -60%; industrial metals -11%, agricultural commodities -10%). Currently, all commodity classes are benefiting from the recovery of the global economy after the corona pandemic.

In addition, the development of e-mobility and renewable energies plays a decisive role for industrial metals. The future development of the global infrastructure for renewable energies has received a political tailwind in recent months: among others, through US President Joe Biden, while China also set itself ambitious climate targets for the first time in 2020. Significant quantities of industrial metals and steel are needed for the development of renewable energies as well as for the switch to e-mobility. Against this backdrop, a sustained upward trend in prices for industrial metals and steel is conceivable or is already being anticipated by market participants through the latest developments in prices for industrial metals.

Commodity prices vs. EZ producer prices (in % y/y)

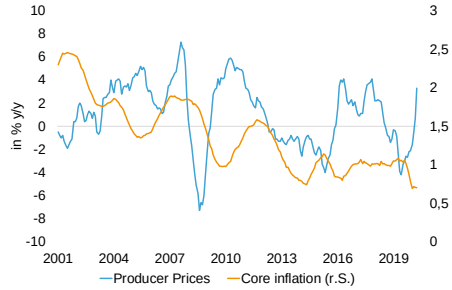


Source: Bank of Canada, Eurostat, Erste Group Research

The weather phenomenon 'La Nina' is currently playing a decisive role in the prices of agricultural commodities. This is a temporary cooling of the Pacific Ocean with negative consequences for the weather situation in the world's most important growing regions for agricultural commodities. This dampens the prospects for crop yields in both the northern and southern hemispheres, to which the market has responded with price increases. However, the temperature of the Pacific Ocean has returned to normal since April, which should stabilize the weather, especially in the southern hemisphere. This should improve the outlook for crop yields and thus have a dampening effect on agricultural commodity prices in the coming months.

The key question is whether the current rise in commodity prices could have a lasting impact on Eurozone inflation. First, historically there is a clear link between the development of producer prices in the Eurozone and global commodity prices. However, due to base effects, the dynamics of price increases in producer and commodity prices should weaken in the coming

EZ producer prices vs. EZ core inflation (in % y/y)



Source: Eurostat, Erste Group Research

months. Crucial for the ECB's monetary policy stance, however, is the question of whether the increases in producer prices could subsequently have an impact on core inflation (headline inflation adjusted for energy and food prices). If one looks at the development over the past 20 years, there is hardly any connection between the dynamics of producer prices and core inflation. We therefore expect at best a moderate impact from the rise in producer prices on core inflation in the coming months. As already described in our last Week Ahead, the labor market and wage developments, on the other hand, are decisive for the outlook for core inflation.

Economic calendar

Ctry	Date	Time	Release	Period	Consens	Prior
Eurozone						
EA	18-May	11:00	GDP q/q	1Q P		-0.6%
EA	18-May	11:00	GDP y/y	1Q P		-1.8%
FR	21-May	9:15	PMI Index	May P		58.9 Index
DE	21-May	9:30	PMI Index	May P		66.2 Index
EA	21-May	10:00	PMI Index	May P		62.9 Index
USA						
	14-May	14:30	Retail Sales mom	Apr	1.0%	9.7%
China						

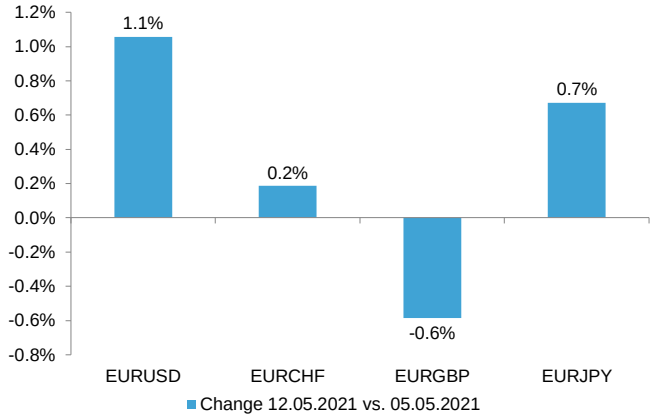
Central bank events

	Date	Time	Event
ECB			Calendar for next week will be released by the ECB on May 14
Fed	19-May	20:00	FOMC Minutes, Meeting of April 27-28

Source: Market Data Provider, ECB, Federal Reserve, Erste Group Research

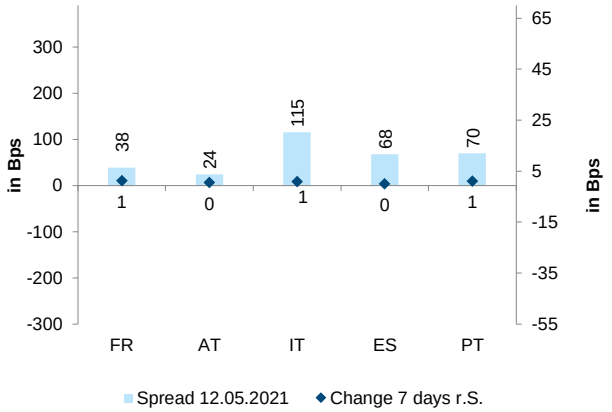
Forex and government bond markets

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



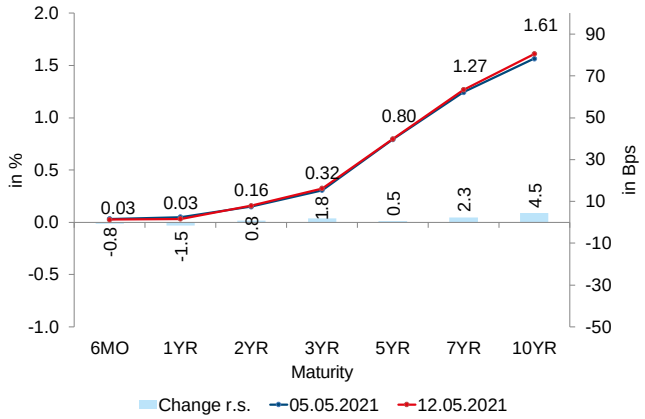
Source: Market Data Provider, Erste Group Research

Eurozone spreads vs. Germany
10Y government bonds



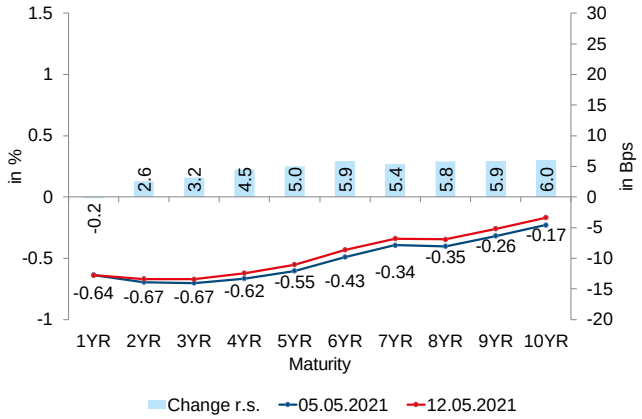
Source: Market Data Provider, Erste Group Research

US Treasuries yield curve
Changes compared to last week



Source: Market Data Provider, Erste Group Research

DE Bund yield curve
Changes compared to last week



Source: Market Data Provider, Erste Group Research

Forecasts[1]

GDP	2019	2020	2021	2022
Eurozone	1.3	-6.6	4.0	3.4
US	2.3	-3.5	6.1	3.3

Inflation	2019	2020	2021	2022
Eurozone	1.2	0.3	1.5	1.2
US	1.8	1.2	2.2	1.9

Interest rates	current	Jun.21	Sep.21	Dec.21	Mar.22
ECB MRR	0.00	0.00	0.00	0.00	0.00
3M Euribor	-0.53	-0.54	-0.54	-0.54	-0.54
Germany Govt. 10Y	-0.17	-0.30	-0.20	-0.10	0.00
Swap 10Y	0.14	0.00	0.10	0.20	0.30

Interest rates	current	Jun.21	Sep.21	Dec.21	Mar.22
Fed Funds Target Rate*	0.06	0.13	0.13	0.13	0.13
3M Libor	0.17	0.20	0.20	0.20	0.20
US Govt. 10Y	1.61	2.00	2.10	2.20	2.20
EURUSD	1.21	1.16	1.16	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: Market Data Provider, 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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