Week Ahead

Focus: EZ inflation and electricity prices, US inflation

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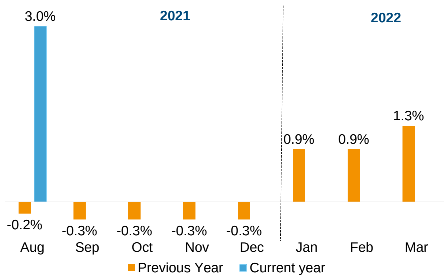
EZ - Inflation at multi-year high in August

Eurozone headline inflation rose to a multi-year high of 3.0% y/y in August. Several factors played a role in this. In the previous year, the Eurozone inflation rate fell sharply to a level of -0.2% y/y (due to the pandemic) in August. This low comparative value from the previous year contributed significantly (through the base effect) to the marked rise in inflation in August this year. In addition, the rise in European electricity prices, which continued unabated in August, added further momentum to energy price inflation. This exerted additional upward pressure on inflation in August.

Based on the current energy price dynamics, we raise our inflation forecast for 2021 to 2.2% (previously 2.0%) and for 2022 to 1.8% (previously 1.6%). The comparative inflation figures from the previous year will be very low at -0.3% y/y until December. Due to this base effect, we therefore expect inflation to remain high at around 3.0% or even above until the end of 2021. However, the comparative values will rise significantly with January. We therefore forecast a gradual decline in the level of inflation in the Euro Area from January 2022.

EZ – Headline inflation current year vs. previous year

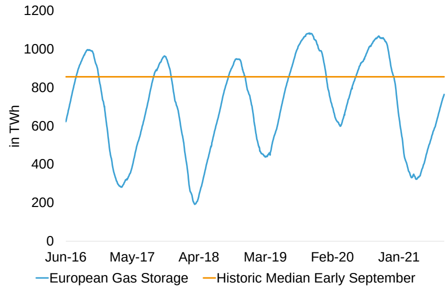


Source: Eurostat, Erste Group Research

EZ - When will rise in electricity prices end?

The main drivers for the increase in electricity prices in 2021 are gas and CO2 prices. However, weak wind speeds in many parts of Europe have also affected the energy yield of wind power plants and exerted additional upward pressure on electricity prices. The increase in gas prices was triggered by a long and cold winter in 2020/21, which increased demand for fossil fuels. As a result, Europe's gas storage inventory is still well below historical averages as of early September. The increased use of fossil fuels triggered an increased demand for CO_2 certificates, as a result of which their price has also risen significantly since the beginning of the year. After the EU Commission announced a few weeks ago that it wanted to accelerate the annual reduction of CO_2 certificates within the framework of the Green Deal until 2030, this further increased the price of certificates, as was to be expected.

European Gas Storage



Source: agsi, Erste Group Research

The course of the winter of 2021/22 will play a role in the further development of Europe's electricity prices. In the case of a cold winter 2021/22, energy demand and thus gas demand would remain high. In view of the currently historically low stocks of European gas storage facilities, this could ensure persistently high gas and electricity prices in the coming months. The demand for CO_2 allowances would remain equally high if the use of fossil fuels remained strong, thus further supporting the CO_2 price. A mild winter, on the other hand, could, based on our assessment, contribute to an easing of the situation for electricity prices through lower demand for gas and, at the same time, CO_2 certificates. In view of the increasing importance of wind power in the energy mix, the development of wind

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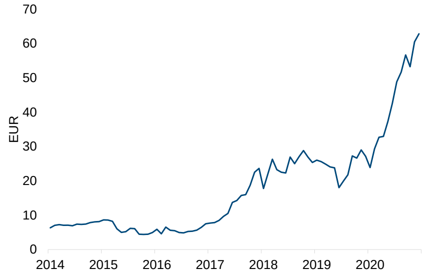
speeds will also have an increasing influence on the development of electricity prices. Even if electricity prices remain at the current high level after the strong increase or continue to rise slightly, we estimate that the dynamics of energy prices will gradually decline in 2022, due to the increase in the comparative values from the previous year.

EZ - What does the rise in electricity prices mean for growth?

EU CO_2-allowance (price per ton in EUR)



Source: Market data provider, Erste Group Research

The dynamics of the rise in CO_2 prices to historic highs of over EUR 60 per tonne in such a short time poses problems for households and industry. Given the delayed pass-through, households will not feel the full impact of the current rise in electricity prices until 2022. In Spain, this has already triggered political discussions on how low-income households can be compensated for the rising expenditure on energy.

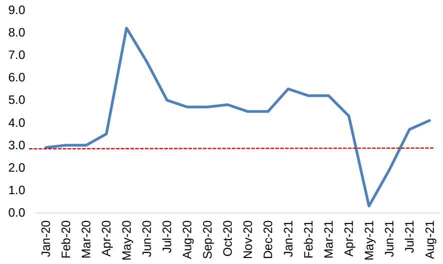
We assume that the significant increase in energy costs will have a slightly dampening effect on consumption in the Eurozone. However, this effect should be mitigated by policy measures (e.g. targeted financial subsidies). On the other hand, the high CO_2 and electricity prices will accelerate investments in the expansion of renewable energy sources. Investments in energy efficiency (e.g. real estate, industry) will also gain momentum. Both thematic areas will already receive substantial public funding for investments under the EU Recovery Plan. In the current market environment, it will now be easier to top up the public funds with private money and thus reinforce the positive growth effect. Overall, the short-term effect on the growth dynamics of the Eurozone should therefore be neutral to slightly positive. In the long run, the capital stock of the Eurozone should grow faster, due to the increasing investment dynamics. A strengthened capital stock should increase labor productivity, which should raise the long-term growth potential. The transformation of the energy sector should also increase value added within the Eurozone. In contrast, spending on fossil fuels to foreign economies will decrease.

What's next for US inflation?

Next week, the inflation data for August will be published in the US. Inflation data is currently more a risk factor in the US than in the Eurozone due to massive price increases in individual areas during the spring months. Together with strong contributions from energy prices, this pushed the inflation rate above 5%. The question is whether these effects will remain temporary or whether a sustained higher price dynamic has been triggered. Some prices that had risen massively in the spring recently showed a leveling off, which speaks for temporary effects.

However, the US labor market will be decisive for medium-term price increases. Wages have picked up somewhat recently. For all private sector employees, hourly wages show a somewhat higher growth rate than before the crisis, although the basis for comparison is now "crisis months" from the previous year. Averaging may still have contributed to the higher growth in hourly wages, however, as large differences between wages and the impact of the crisis on employment across sectors create distortions. However, a number of sectors show accelerated growth in hourly wages. So the shortage of labor is likely to have had an impact. The question is how long this will last.

Average hourly earnings in the private sector, y/y in %



Source: Bureau of Labor Statistics, Erste Group Research

We believe this will be a temporary phenomenon, as the US labor market still has reserves and consumer demand has been fuelled by stimulus packages and catch-up effects during the last few months. In July (latest available data), job openings were 3.5mn higher than in January 2020, which contrasted with 2.9mn more unemployed. But on top of that, there are more than 3mn Americans who have not yet returned to the labor market. The reason for this could have been the generous unemployment benefits that expired at the beginning of September or other factors that can be traced back to the pandemic. The key thing for us is that a temporary shortage of labor is most likely. However, how quickly people will return to the labor market and how much demand will be fuelled by reductions in pent-up savings in the future remain factors of uncertainty.

Economic calendar

Ctry	Date	Time	Release	Period	Consens	Prior
Eurozone						
USA						
	14-Sep	14:30	Inflation y/y	Aug	5.3%	5.4%
	16-Sep	14:30	Retail Sales mom	Aug	-0.9%	-1.1%
China						

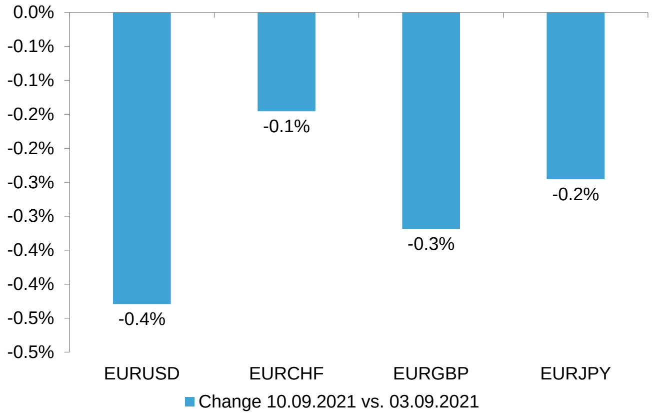
Central bank events

	Date	Time	Event
ECB	14-Sep	11:30	Edouard Fernandez-Bollo, speech, Euromoney/ECBC Covered Bond Congress
	15-Sep	17:00	Philip Lane, presentation: *The ECB's Monetary Policy Review* , IMFS Webinar
Fed			No monetary policy relevant events

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

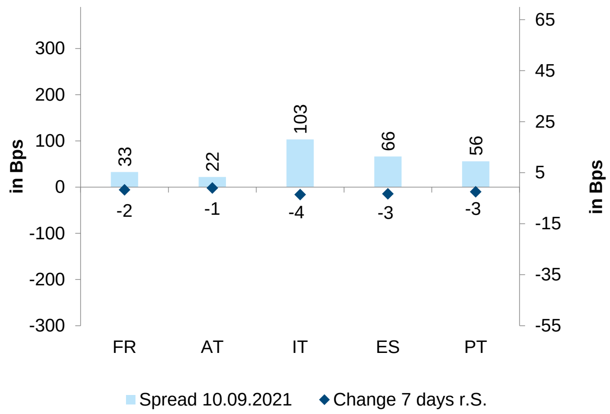
Forex and government bond markets

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



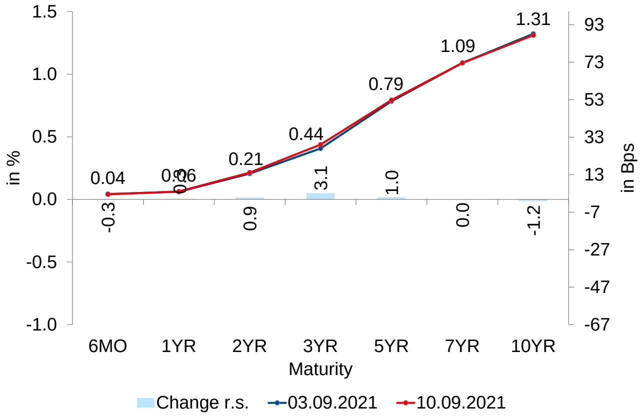
Source: Market Data Provider, Erste Group Research

Eurozone spreads vs. Germany
10Y government bonds



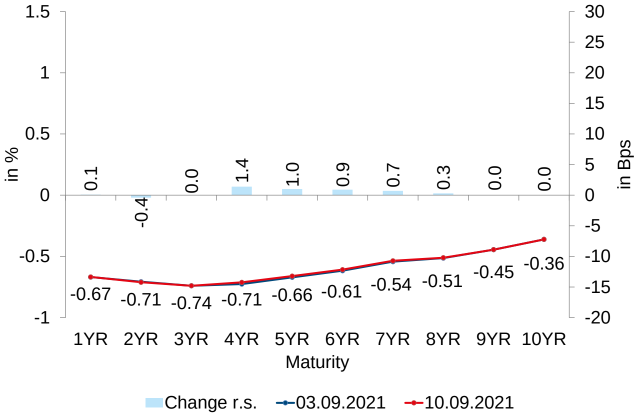
Source: Market Data Provider, Erste Group Research

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	-6.5	4.4	4.1
US	2.3	-3.5	5.9 ↓	3.3

Inflation	2019	2020	2021	2022
Eurozone	1.2	0.3	2.2 ↑	1.8 ↑
US	1.8	1.2	4.0	2.6 ↑

Interest rates	current	Dec.21	Mar.22	Jun.22	Sep.22
ECB MRR	0.00	0.00	0.00	0.00	0.00
3M Euribor	-0.54	-0.54	-0.54	-0.54	-0.54
Germany Govt. 10Y	-0.36	-0.20 ↓	-0.10 ↓	0.00 ↓	0.10
Swap 10Y	0.00	0.10 ↓	0.20 ↓	0.30 ↓	0.40

Interest rates	current	Dec.21	Mar.22	Jun.22	Sep.22
Fed Funds Target Rate*	0.08	0.13	0.13	0.13	0.13
3M Libor	0.12	0.20	0.20	0.20	0.20
US Govt. 10Y	1.31	1.50 ↓	1.60 ↓	1.80 ↓	1.80
EURUSD	1.18	1.20	1.20	1.20	1.18

*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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