Week Ahead

Focus: Eurozone sovereign bonds, EZ PMI data

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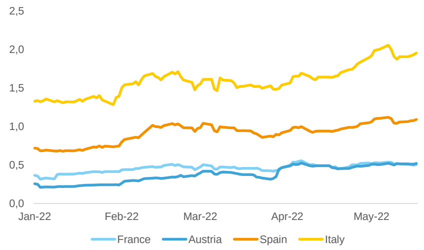
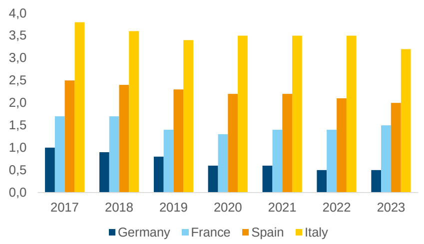
10y Government bond yield spreads vs. Germany, in pp



Source: Market data provider, Erste Group Research

Interest payments on public debt, in % of GDP



Source: European Comission, Erste Group Research

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Note: Past performance is not necessarily indicative of future results

How much of a burden do rising interest rates put on government budgets?

Rising yields on the bond market and foreseeable key interest rate hikes by the ECB raise questions about the sustainability of public finances, especially for those countries that are already highly indebted. Rising yield spreads between bonds of European sovereign issuers could be seen as a sign of increasing market nervousness. Markets are nervous, but in our view, due to other reasons. The war in Ukraine, the tensions between Russia and the West, and the declining support from the ECB's securities purchases are the key factors for us. This is indicated, for example, by the fact that even countries with the best credit ratings have had to accept a widening of their yield spreads vs. German Bunds since the beginning of the year.

But back to government budgets. Their development depends on both expenditures, of which interest payments are only one, and revenues. For interest payments, the current interest rate level plays a minor role for the time being (depending on the share of short-term debt). The level of interest rates in the past has a relevant meaning, due to the refinancing of maturing bonds. The yield on the Italian government bond, for example, fluctuated between 5% and 6% in 2012. Issues at that time are now being refinanced at around 3%, so even after the recent rise in yields, there is relief for the budget.

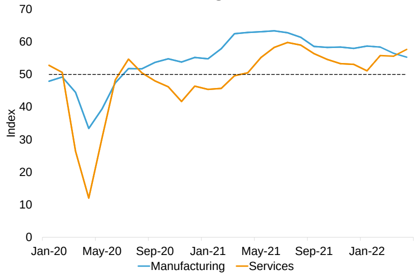
Overall, the European Commission assumes in its latest spring forecast that interest payments will rise for Eurozone countries in total. This is starting from a low level, and in 2023 they will still be nominally lower than in 2019. However, the development differs significantly between the countries. Italy, which is often in the focus of investors due to its high debt, will pay just about as much for interest service in 2023 as it did in 2018. In terms of interest payments measured in terms of economic output, which is the relevant indicator, Italy is estimated by the European Commission to have the lowest value in 2023 since the establishment of the Eurozone.

After the pandemic years, public budgets should recover. However, this recovery starts from different levels for the countries. Of the four major countries, France, Italy and Spain will still not reach the (suspended) Maastricht criterion of a 3% of GDP budget deficit in 2023.

Overall, the fading pandemic should usher in a recovery in public budgets, which higher interest payments will not stand in the way of. Of course, there are risks to the economy and thus to public budgets. An increase in nervousness and selling pressure on the bond markets can never be ruled out. However, we see the risk of this in political developments. The rising interest burden, on the other hand, should be a bearable burden for government budgets.

EZ – PMI data for May expected

EZ PMI manufacturing vs services



Source: Market data provider, Erste Group Research

Next week (May 24), a first flash estimate of the Purchasing Managers' Index for the Eurozone, Germany and France for the month of May will be published. In April, sentiment in the service sector rose above that of industry for the first time in a long time. While service providers are benefiting from the end of the Covid related restrictive measures, industry is suffering from high energy prices and renewed supply bottlenecks.

In May, we expect a continuation of the sentiment seen in April, with a comparatively better mood among service providers. Over the next few months, however, companies in the Eurozone will have to deal with a cooling of the global economic situation. This week in the US, retail giants Walmart and Target already weighed heavily on Wall Street with disappointing 1Q22 figures and a weak 2022 outlook. Investors are additionally concerned by a strong inventory build-up by both companies. Eurozone consumer sentiment has plunged just as sharply since March, as consumers are suffering greatly from the high inflation. With final demand slowing, high inventories in individual sectors could now exacerbate the ongoing downturn in the economy.

Economic calendar

Ctry	Date	Time	Release	Period	Consens	Prior
Eurozone						
DE	23-May	10:00	Ifo Index	May	91.2 Index	91.8 Index
FR	24-May	9:15	PMI Index	May P		55.7 Index
DE	24-May	9:30	PMI Index	May P	53.3 Index	54.6 Index
EA	24-May	10:00	PMI Index	May P	54.6 Index	55.5 Index
DE	25-May	8:00	GDP y/y	1Q F	3.4%	3.7%
USA						
	26-May	14:30	GDP q/q	1Q S	-1.3%	-1.4%
	27-May	14:30	PCE Deflator	Apr	6.2%	6.6%
China						

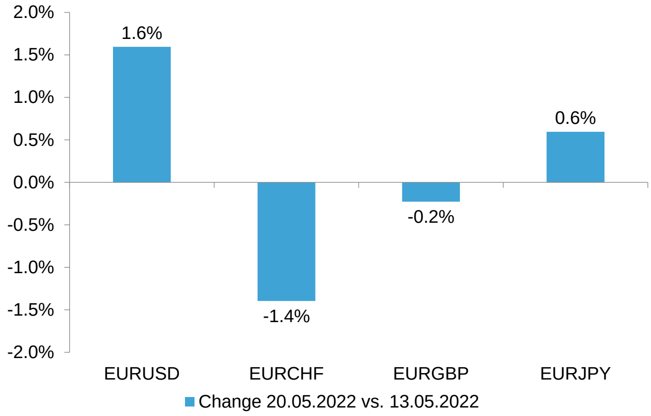
Central bank events

	Date	Time	Representative	Forum	Location
ECB	24-May	20:00	Christine Lagarde	speech	World Economic Forum
	25-May	09:00	Fabio Panetta	speech	Goethe Unversität Frankfurt
	25-May	11:45	Philip Lane	speech	German Bernacer Preis
	27-May	13:35	Philip Lane	panel discussion	Bank of Japan
Fed	25-May	20:00	FOMC	Minutes	

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

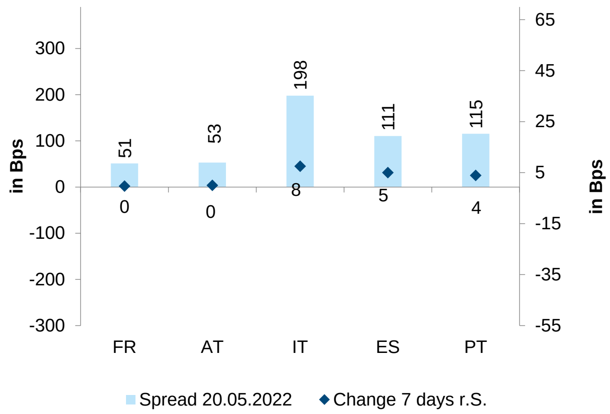
Forex and government bond markets

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



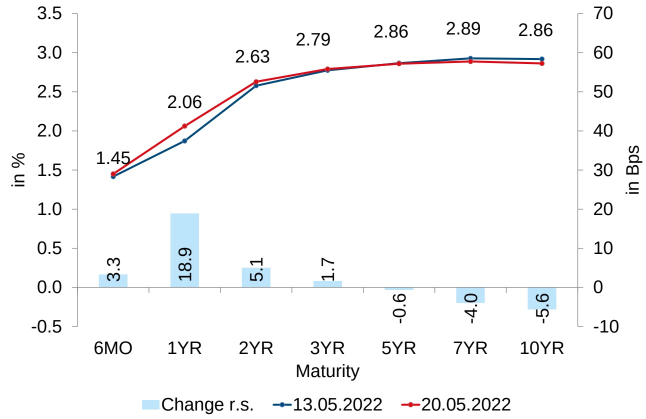
Source: Market Data Provider, Erste Group Research

Eurozone spreads vs. Germany
10Y government bonds



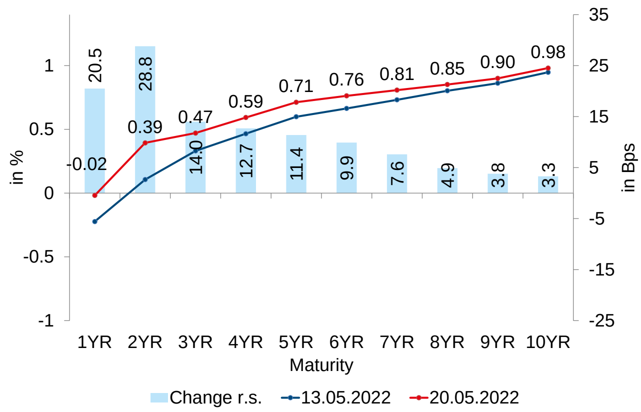
Source: Market Data Provider, Erste Group Research

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	2020	2021	2022	2023
Eurozone	-6.5	5.3	2.8	2.6
US	-3.5	5.7	2.6	2.1

Inflation	2020	2021	2022	2023
Eurozone	0.3	2.6	6.4	2.4
US	1.2	4.7	6.4	2.0

Interest rates	current	Jun.22	Sep.22	Dec.22	Mar.23
ECB MRR	0.00	0.00	0.25	0.50	0.50
ECB Deposit Rate	-0.50	-0.50	0.00	0.25	0.25
3M Euribor	-0.35	-0.33	0.00	0.07	0.25
Germany Govt. 10Y	0.97	0.70	0.70	0.80	0.90
Swap 10Y	1.71	1.50	1.50	1.50	1.40

Interest rates	current	Jun.22	Sep.22	Dec.22	Mar.23
Fed Funds Target Rate*	0.83	1.38	1.88	2.38	2.38
3M Libor	1.48	1.63	2.04	2.46	2.46
US Govt. 10Y	2.85	2.60	2.60	2.50	2.50
EURUSD	1.06	1.08	1.13	1.13	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: 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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