

Week Ahead

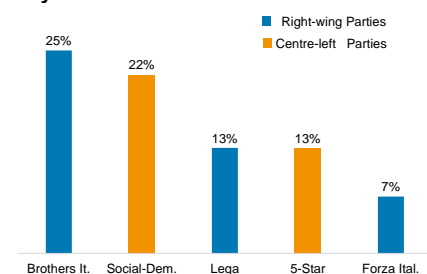
Focus: IT elections, EZ inflation, US interest rates

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Italy Poll data



Source: Politico, Erste Group Research

Italy - Right-wing parties likely to inherit Mario Draghi's government

Italy's citizens will decide on the future composition of both chambers of the parliament in this Sunday's (September 25) election. Following a 2020 referendum, the number of seats to be allocated in both chambers has been significantly reduced. Since Italian electoral law is complicated, the composition of the two chambers after the election will probably differ from the election results achieved at the national level.

Based on current polls, it is highly likely that the right-wing parties will win the election. The party with the strongest vote is likely to be the "Brothers of Italy," led by Georgia Meloni. Its current success is based primarily on the fact that it was the only major parliamentary party not to be part of the coalition of Mario Draghi's compromise government. It will most likely form a coalition with Salvini's Lega party as well as Berlusconi's Forza Italia. A possible center-left coalition consisting of Social Democrats and the 5-Star Movement currently has little chance of success.

From a political perspective, Georgia Meloni would mean a 180-degree turn to Mario Draghi. She wants to strengthen and expand the rights of the nation states within the EU. At least she is not actively seeking to leave the EU or the monetary union. Nevertheless, cooperation with Brussels will not be free of friction under Prime Minister Meloni. It is also questionable how the money from the EU recovery plan will be used. Draghi's government has drawn up a plan to fully utilize the possible financial framework via grants and secured loans in the coming years. However, the ongoing drawdown of funds is conditional on progress in reforms that must follow the recommendations of the EC. Conflicts between Brussels and a right-wing populist government in Rome are highly likely with regard to the implementation of these reforms. This could stall the flow of funds to Italy, with corresponding negative consequences for the country's growth prospects.

It now remains to be seen how the government will be composed after the election. However, 2018 showed that the government program of a populist government (at that time consisting of 5-Star and Lega) can cause significant damage to Italy's economy from the perspective of the financial markets. The markets reacted at the time with a significant widening of spreads for Italian government bonds. However, with TPI (Transmission Protection Instrument), the ECB has recently created another instrument (in addition to reinvestment and OMT) to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy in the euro area. As a result, the ECB is able to purchase securities from affected sovereigns in the secondary market.

Major Markets & Credit Research

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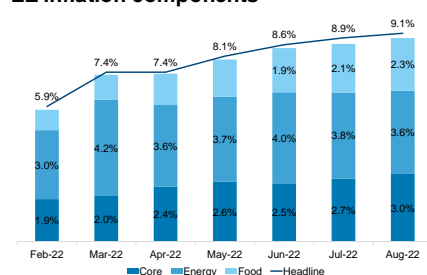
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Note: Past performance is not necessarily indicative of future results

From the ECB's perspective, a significant widening of risk premiums for Italian government bonds after the formation of a government could be classified as such a threat to the transmission of monetary policy. However, if this widening is based on a budget plan that seriously threatens the country's debt sustainability, the question must be asked whether this widening should be classified as unjustified. Very likely, however, the ECB will stand in the way of a strong sell-off of Italian bonds. In theory, however, the very existence of the TPI should counteract an excessive widening of risk premiums, even in the event of a budgetary confrontation course with the Commission.

EZ - Inflation on high level expected

EZ inflation components



Source: Eurostat, Erste Group Research

Next week, a flash estimate for Eurozone inflation in September (September 30) will be released. In August, inflation rose to 9.1%. Key drivers have been food prices and core inflation. In contrast, upward pressure from energy prices has eased slightly due to a significant drop in fuel prices, while upward pressure from electricity and gas prices has continued to rise significantly to an annual rate of change of 49%.

We expect inflation to remain at a high level in September. Firstly, inflation-curbing measures in Germany expire in September, which means that a significant increase in the inflation rate in Germany is to be expected. In addition, the rise in food prices and core inflation is likely to continue. The effect of energy prices on inflation is difficult to forecast in the short term. While the upward pressure on fuel prices should continue to ease, the price momentum for electricity and gas is likely to increase further. For 2022 as a whole, we expect an inflation rate of 7.9%. In 2023, we forecast a decline to 4.1%. However, this forecast is based on the assumption that there will be a significant easing on the European energy markets from the end of October at the latest.

US interest rates to continue to rise rapidly for time being

This week, as expected, the Federal Reserve raised its key interest rates by 75 basis points (bp). In addition, there were also the results of the latest survey of members of the interest rate-setting body FOMC on expectations for the main macro indicators. This latest survey had taken place in June. Compared to June, respondents significantly revised upward their expectations for the level of policy rates during the coming years. This is in no way a determination of the interest rate path, but rather 'just' shows the expectations of the individual members at present. On the other hand, a significant decline in the inflation rate is still expected in the coming years. What has changed, however, are the efforts required to achieve this decline. Not only will interest rates have to be raised more, the economy will have to be slowed down more and the unemployment rate will have to rise more. The central bank is prepared to accept this.

In our view, the FOMC members' interest rate path carries the risk of overshooting. However, since the interest rate steps are expected in the foreseeable future (next few months), the potential for a deviation from the expected path of the FOMC members is small. We are therefore raising our interest rate forecasts and now expect the FOMC to raise rates by 75bp at its next meeting in early November. In terms of crucial data, labor

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market data and inflation for September will still be published by then. Both indicators should continue to follow the trends that have triggered strong rate hikes over the past few months - hence another big rate hike. Two more sets of data will then be available for the December meeting, which should show a cooling and thus justify an interest rate step of only 25bp, although the labor market and inflation remain difficult to forecast. Our forecasts are 25bp below the median of the FOMC members. However, this seems acceptable, as 9 out of 19 FOMC members also expect this development. We then expect the last rate hike in January 2022.

The higher expectations for key rates also lead us to expect a slower decline in 10Y yields. The rise of the euro vs. the dollar should also be slower.

Economic calendar

| Ctry | Date | Time | Release | Period | Consens | Prior |
|-----------------|--------|-------|---------------|--------|------------|------------|
| Eurozone | | | | | | |
| EA | 30-Sep | 11:00 | CPI flash y/y | Sep | 9.6% | 9.1% |
| DE | 26-Sep | 10:00 | Ifo Index | Sep | 86.7 Index | 88.5 Index |
| USA | | | | | | |
| | 29-Sep | 14:30 | GDP q/q | 2Q T | -0.6% | -0.6% |
| | 30-Sep | 14:30 | PCE Deflator | Aug | 6.0% | 6.3% |
| China | | | | | | |
| | 30-Sep | 3:45 | PMI Index | Sep | | 49.5 Index |

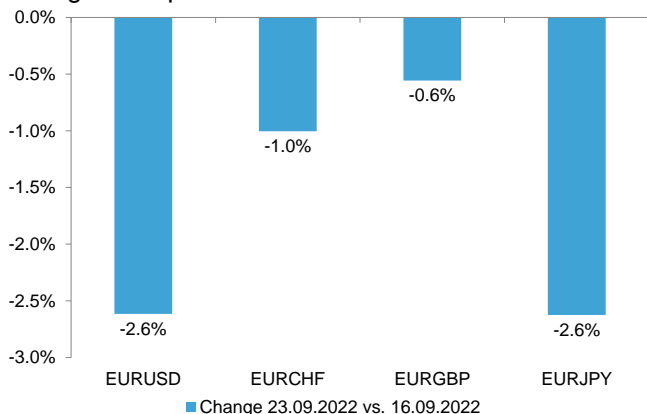
Central bank events

| | Date | Time | Representative | Forum | Location |
|------------|--------|-------|------------------------------------|------------------|---|
| ECB | 26-Sep | 15:00 | Christine Lagarde | Speech | European Parliament |
| | 27-Sep | 15:00 | Luis de Guindos | Speech | ECB Money Market Contact Group |
| | 28-Sep | 09:15 | Christine Lagarde | Discussion | Atlantik Council |
| | 29-Sep | 10:00 | Luis de Guindos | Speech | BIS and Bank of Lithuania |
| | 29-Sep | 19:00 | Philip Lane | Panel discussion | Federal Reserve Bank of Cleveland and ECB |
| | 30-Sep | 17:30 | Isabel Schnabel | Panel discussion | La Toja Forum |
| Fed | | | No monetary policy relevant events | | |

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

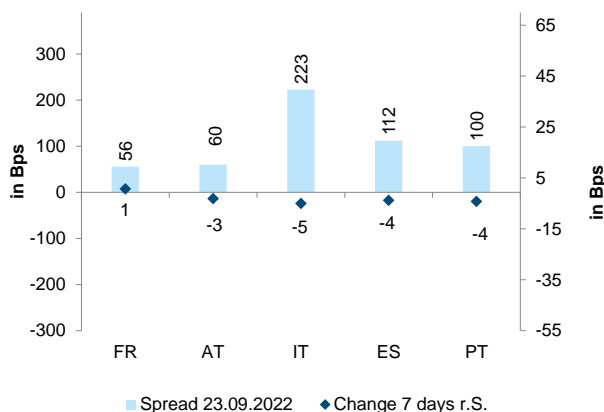
Forex and government bond markets

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



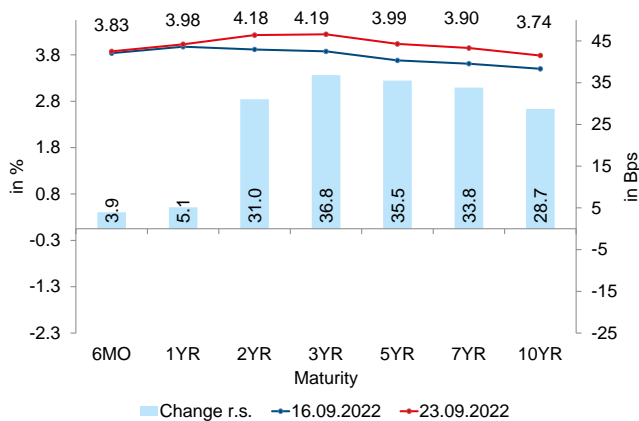
Source: Market Data Provider, Erste Group Research

Eurozone spreads vs. Germany 10Y government bonds



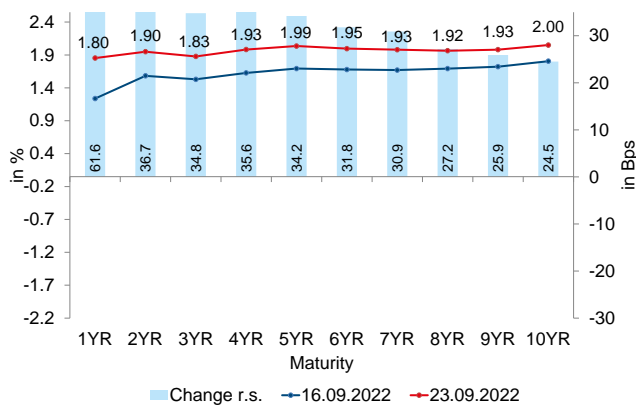
Source: Market Data Provider, Erste Group Research

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

Forecasts¹

| GDP | 2020 | 2021 | 2022 | 2023 |
|----------|------|------|------|------|
| Eurozone | -6.5 | 5.3 | 2.7 | 1.0 |
| US | -3.5 | 5.7 | 1.6 | 1.4 |

| Inflation | 2020 | 2021 | 2022 | 2023 |
|-----------|------|------|------|------|
| Eurozone | 0.3 | 2.6 | 7.9 | 4.1 |
| US | 1.2 | 4.7 | 8.0 | 3.0 |

| Interest rates | current | Dec.22 | Mar.23 | Jun.23 | Sep.23 |
|-------------------|---------|--------|--------|--------|--------|
| ECB MRR | 1.25 | 2.25 | 2.25 | 2.25 | 2.25 |
| ECB Deposit Rate | 0.75 | 1.75 | 2.00 | 2.00 | 2.00 |
| 3M Euribor | 1.15 | 1.97 | 1.97 | 1.97 | 1.97 |
| Germany Govt. 10Y | 2.05 | 1.80 | 1.80 | 1.80 | 1.80 |
| Swap 10Y | 2.87 | 2.60 | 2.50 | 2.40 | 2.30 |

| Interest rates | current | Dec.22 | Mar.23 | Jun.23 | Sep.23 |
|------------------------|---------|--------|--------|--------|--------|
| Fed Funds Target Rate* | 2.33 | 4.13 ↑ | 4.38 ↑ | 4.38 ↑ | 4.38 ↑ |
| 3M Libor | 3.60 | 4.38 ↑ | 4.46 ↑ | 4.46 ↑ | 4.46 ↑ |
| US Govt. 10Y | 3.77 | 3.20 ↑ | 2.90 ↑ | 2.80 ↑ | 2.80 ↑ |
| EURUSD | 0.97 | 1.03 ↓ | 1.06 ↓ | 1.07 ↓ | 1.09 ↓ |

*Mid of target range

The new ECB's interest rates will only become effective September, 14

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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