Week Ahead

Focus: EZ and US inflation

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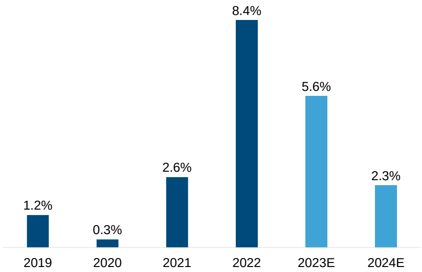
EZ – Inflation 2019 – 2024E



Source: Eurostat, Erste Group Research

EZ – inflation should fall in 2023

Thanks to a further decline to 9.2% y/y in December (previously 10.1% y/y), inflation in the Eurozone has very likely passed its peak. Inflation has fallen mainly due to a significant decline in the upward momentum of energy prices. Based on the current development of energy prices (sideways trend in oil prices, as well as a sharp drop in electricity and gas prices), the downward momentum in energy prices is very likely to continue in the coming months.

By contrast, food price inflation has again risen slightly. However, due to the decline in prices for agricultural commodities on world markets, we also expect food prices to fall in the coming months.

Unfortunately, core inflation rose again in December to 5.2% y/y (previously 5.0% y/y). Obviously, it will take some time for the declining trend in energy prices to have a dampening effect on prices for goods and services. So far, the development of producer prices has been a good leading indicator for core inflation. A gradual downward trend in producer prices has been apparent since mid-2022. This should also be reflected in falling core inflation rates from the second quarter at the latest.

Overall, we therefore expect inflation rates to fall continuously in the coming months, mainly due to energy and food prices. However, core inflation will remain a factor of uncertainty in the medium term. Here, we expect a gradual decline only with a time lag. Core inflation, as a reflection of price pressures within the Eurozone, plays a key role in the ECB's monetary policy stance. If core inflation continues to rise or falls only with a significant time lag, this will influence the ECB's monetary policy decisions.

For 2023 as a whole, we expect inflation to fall to 5.6%. In 2024, we expect an even steeper decline to 2.3%, mainly due to further declines in electricity and gas prices (the currently falling electricity and gas prices on the exchanges will probably only be passed on to consumers with a long time lag). Our forecast for 2024 currently differs significantly from that of the ECB at 3.4%. The ECB expects energy price pressures to rise again in 2024 due to the discontinuation of fiscal support. However, given the current sharp decline in electricity and gas prices, we expect the ECB to lower its inflation forecasts somewhat in March, as its current assumptions for gas prices are well above the current price level. We expect further interest rate hikes totaling 125 basis points.

How far will US inflation fall?

This week, inflation data for the US for December was published. As expected by the market, the inflation rate fell from 7.1% to 6.5%. This was

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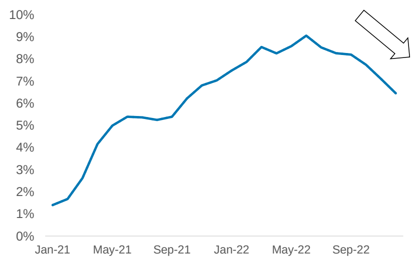
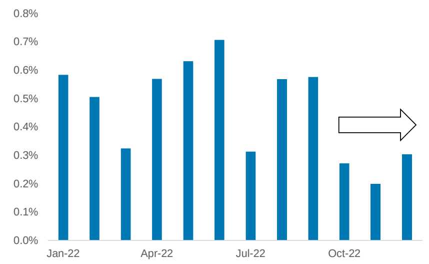
Note: Past performance is not necessarily indicative of future results

US inflation, y/y in %



Source: Bureau of Labor Statistics, Erste Group Research

US core inflation, m/m in %



Source: Bureau of Labor Statistics, Erste Group Research

a continuation of an existing trend. The US inflation rate had already peaked in the summer of 2022. Energy prices made a significant contribution to the decline in the inflation rate since. Not only did oil prices fall, but at the same time, the basis of comparison from the previous year also rose. The latter will continue well into the spring, so that the contribution of energy prices to inflation should decline further and eventually turn negative. Lower contributions from food prices are also emerging. Developments on global markets have already begun to be reflected in consumer prices.

In addition, since October, core inflation, which includes all areas other than energy and food, has been easing. Price jumps compared with the previous month have eased significantly. The development of goods prices was the main factor in this, reflecting the easing of supply bottlenecks. With a further normalization of the situation, inflationary pressures in this area should also decline further. By contrast, there are no signs of any easing in prices for services. Particularly important here is the continued rapid rise in housing costs, which have contributed more than a third to the latest inflation rate. But here, too, there are good arguments for a slowdown in price expansion. Some indications are already pointing to easing rent increases triggered by the slump in the real estate market. For other services, however, inflation could be sticky. This is because personnel is generally the biggest cost factor here and the US labor market is still very tight.

All in all, there are clear signs of a further significant drop in the rate of inflation in the US over the coming months. The open question is whether it will go far enough to satisfy the central bank. In our view, the downturn on the real estate market and a generally weak economy suggest that it will. Thus, we expect only two more rate hikes of 25 basis points each.

Economic calendar

Ctry	Date	Time	Release	Period	Consens	Prior
Eurozone						
USA						
	18-Jan	14:30	Retail Sales mom	Dec	-0.9%	-0.6%
China						

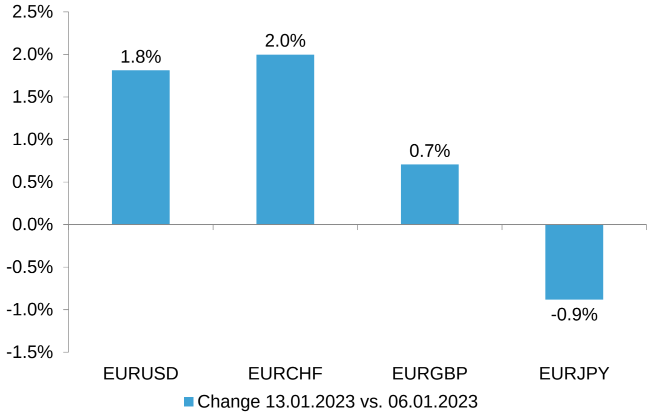
Central bank events

	Date	Time	Representative	Forum	Location
ECB	19-Jan	11:30	Christine Lagarde	Discussion	World Economic Forum
	19-Jan	13:30	ECB Council	Accounts	ECB Council
	19-Jan	18:00	Isabel Schnabel	Discussion	Finanzwende e.V.
	20-Jan	11:00	Christine Lagarde	Discussion	World Economic Forum
Fed	19-Jan	19:15	Lael Brainard	Speech	University of Chicago
	20-Jan	19:00	Christopher Waller	Speech	Council of Foreign Relations

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

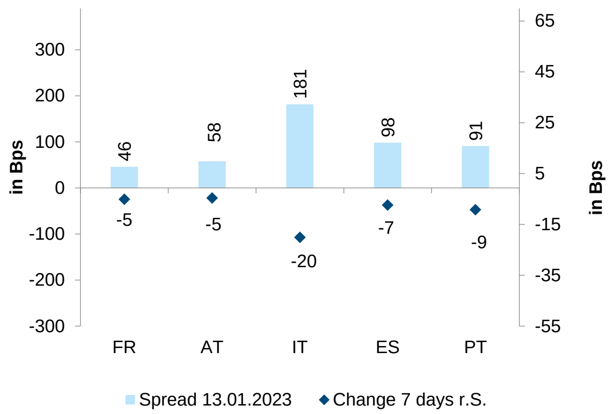
Forex and government bond markets

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



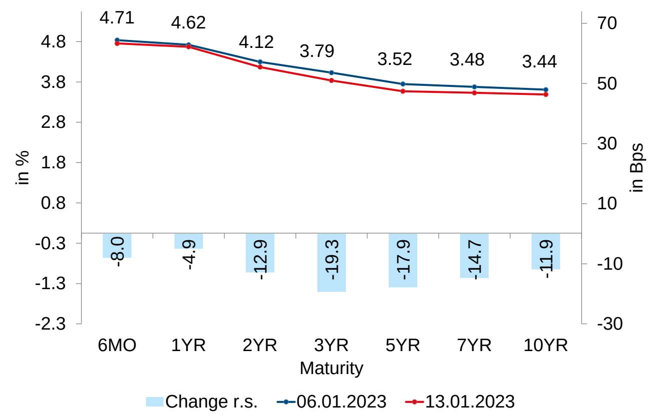
Source: Market Data Provider, Erste Group Research

Eurozone spreads vs. Germany
10Y government bonds



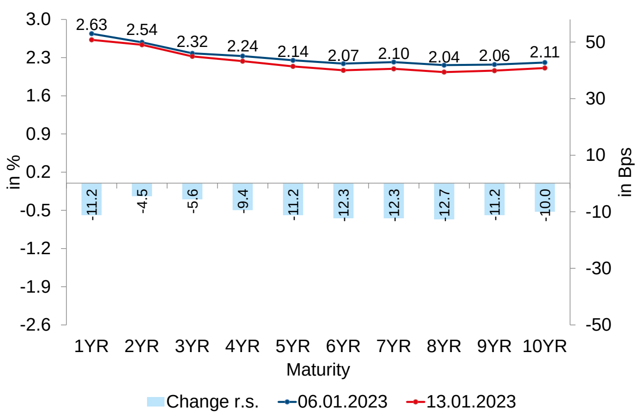
Source: Market Data Provider, Erste Group Research

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	2021	2022	2023	2024
Eurozone	5.3	3.4	0.5	0.7
US	5.7	2.0 ↑	1.0 ↑	1.1 ↓

Inflation	2021	2022	2023	2024
Eurozone	2.6	8.4	5.6	2.3 ↑
US	4.7	8.0 ↓	2.9 ↓	1.9

Interest rates	current	Mar.23	Jun.23	Sep.23	Dec.23
ECB MRR	2.50	3.50 ↑	3.75 ↑	3.75 ↑	3.75 ↑
ECB Deposit Rate	2.00	3.00 ↑	3.25 ↑	3.25 ↑	3.25 ↑
3M Euribor	2.29	3.13 ↑	3.22 ↑	3.26 ↑	3.29 ↑
Germany Govt. 10Y	2.11	2.20	2.00	1.90	1.90
Swap 10Y	2.69	2.80	2.50	2.40	2.40

Interest rates	current	Mar.23	Jun.23	Sep.23	Dec.23
Fed Funds Target Rate*	4.33	4.88	4.88	4.88	4.63
3M Libor	4.82	4.96	4.96	4.96	4.71
US Govt. 10Y	3.44	3.50	3.30	3.10	2.80
EURUSD	1.08	1.08 ↑	1.08	1.10 ↑	1.12 ↑

*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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Published by:

Erste Group Bank AG
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Head Office: Wien
Commercial Register No: FN 33209m
Commercial Court of Vienna

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