

# Week Ahead

Focus: Interest rate decisions by the ECB and the US Fed, EZ inflation and 4Q GDP

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## What will ECB Governing Council signal?

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Next week, the ECB Governing Council will meet and will most likely decide on the next 50 basis point (bp) rate hike. The key interest rates will then be 2.5%, 3.0% and 3.25%. What will be more exciting is what outlook the ECB Governing Council will give for the further course of action. The markets' attention will focus on whether there are any changes compared with the wording in December. At that time, the Governing Council had put in place 'significant further rate hikes' at a 'steady pace'. This was a clear indication that a 50bp rate hike was likely, at least for the February meeting. Since then, however, there have been mixed messages from members of the Governing Council about what might happen thereafter. While some members were clearly in favor of an unchanged pace, there were also voices that brought a 25bp hike into play at the March meeting. Thus, it is foreseeable that there will be heated discussions within the Governing Council next week on what to signal to the markets for the then upcoming March meeting.

We assume that there will be an agreement on an unchanged wording compared to December. Although the latest data showed a renewed drop in the inflation rate in December, this was exclusively attributable to lower contributions from energy prices. Core inflation, on the other hand, which predominantly reflects domestically generated price pressures, continued to rise. On the day before the ECB meeting next week, the inflation rate for January will be published. However, we expect a slight decline in core inflation at best. This should be decisive for holding out the prospect of a 50bp rate hike for March as well. The ECB economists' next forecasts on inflation and growth will also only be available in March, which also argues for leaving things unchanged next week. On the other hand, the significant decline in wholesale energy prices in Europe during the last few weeks would argue for a weakening of the statements compared to December, as price pressures are generally reduced and the ECB's next inflation forecasts in March should be lower. However, based on the statements of a number of members of the Governing Council, this should not be enough to restate the interest rate outlook next week, in our view. We expect a rate hike of 50bp in March.

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## EZ – Inflation should continue to fall

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Next week (February 1), a first flash estimate of Eurozone inflation in January will be published. In December, inflation fell to 9.2% y/y, mainly due to a decline in energy price dynamics. In contrast, food inflation and core inflation picked up again slightly.

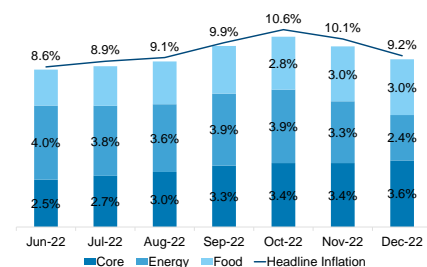
Due to a largely sideways movement of global oil prices and a significant decline in European electricity and gas prices, we expect energy prices to continue to fall in January. However, the decline in electricity and gas

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Note: Past performance is not necessarily indicative of future results

**EZ – inflation by components**



Source: Eurostat, Erste Group Research

prices will probably only have a dampening effect on energy prices in the medium to long term, due to the longer-term supply contracts and price commitments to households. In contrast, we expect a somewhat delayed decline in food prices and core inflation. In summary, we expect a further slight decline in inflation in January, mainly due to the declining dynamics of energy prices. This trend should continue in the coming months.

**EZ – Weak GDP momentum expected in 4Q**

In addition, a first flash estimate of Eurozone GDP growth in 4Q will be published next week (January 31). In 3Q, GDP growth weakened to +0.3% q/q. The high prices for gas imports were the main negative factor, which had a strong impact on the foreign trade balance. In contrast, consumption and investment have performed comparatively well.

Since gas prices already fell significantly in 4Q22, this should have had a supporting effect on the foreign trade balance and thus on the economy in 4Q. On the other hand, we expect consumption and investment to have weighed on growth in 4Q. Overall, we therefore expect stagnation or a slightly shrinking GDP in the Euro Area in 4Q22. In the course of 1H23, we expect a gradual acceleration of growth momentum, due to falling energy prices and brightening leading indicators.

**US Fed to proceed more cautiously**

Next week, interest rates will continue to rise in the US. We expect a hike of 25 basis points (bp) and thus a smaller increase than in December. This is also in line with market expectations. However, at the last meeting in December, neither the decisive FOMC body nor Fed Chairman Powell provided clear guidance on the level of the next interest rate step. A 50bp hike is therefore also conceivable next week. However, a number of factors argue against it. At the press conference in December, Powell had emphasized that the speed of further rate hikes would not be decisive, but that it was more a matter of determining the end point. Also, the effects of earlier rate hikes could not yet be assessed and would only become apparent later. These statements indicate a more cautious approach. It is obviously a matter of fine-tuning the level of interest rates. The FOMC sees progress in fighting inflation, but further confirmation of the sustainability of the turnaround is needed to announce an end to rate hikes. The December inflation data, released after the December FOMC meeting, was a step in that direction. A further decline in the inflation rate was shown and easing price pressures in many components of the basket of goods were evident. Recent speeches by Fed officials also noted progress in fighting inflation and a simultaneous outlook for a weak economy.

Thus, a rate hike of 25bp next week is emerging quite clearly for us. The outlook that the FOMC and Fed Chairman Powell will give the markets should not change much. Further interest rate hikes are likely to be in the cards, precisely because the data is not yet sufficient to confirm a sustained downturn in inflation. We expect another rate hike of 25bp in March, which should be the end of the rate hikes.

## Economic calendar

Ctry	Date	Time	Release	Period	Consens	Prior
<b>Eurozone</b>						
EA	31-Jan	11:00	GDP q/q	4Q A	0.0%	0.3%
EA	31-Jan	11:00	GDP y/y	4Q A	1.7%	2.3%
EA	1-Feb	10:00	PMI Index	Jan F	48.8 Index	48.8 Index
EA	1-Feb	11:00	CPI flash y/y	Jan	9.1%	9.2%
DE	31-Jan	10:00	GDP y/y	4Q P	1.3%	1.3%
DE	1-Feb	9:55	PMI Index	Jan F	47.0 Index	47.0 Index
FR	31-Jan	7:30	GDP y/y	4Q P	0.5%	1.0%
FR	1-Feb	9:50	PMI Index	Jan F	50.8 Index	50.8 Index
IT	31-Jan	11:00	GDP y/y	4Q P		2.6%
IT	1-Feb	9:45	PMI Index	Jan		48.5 Index
<b>USA</b>						
	1-Feb	14:15	ADP Employment	Jan	165.7 Tsd	235.0 Tsd
	1-Feb	16:00	PMI Index	Jan	48.1 Index	48.4 Index
	3-Feb	14:30	Wages y/y	Jan	4.4%	4.6%
	3-Feb	14:30	Unempl. Rate	Jan	3.6%	3.5%
<b>China</b>						
	1-Feb	3:45	PMI Index	Jan	50.3 Index	49.0 Index

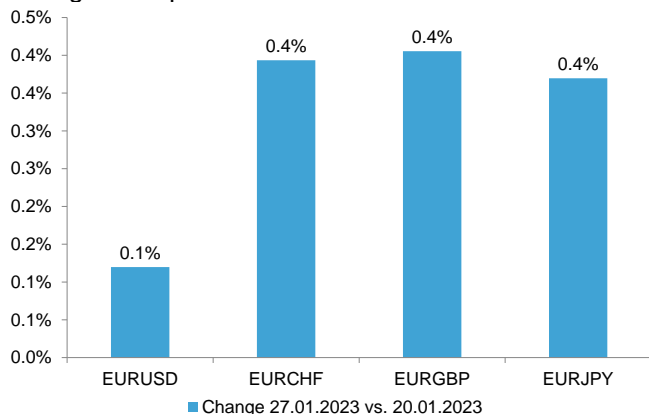
## Central bank events

	Date	Time	Representative	Forum	Location
<b>ECB</b>	2-Feb	14:15	ECB Council	Monetary policy decision	ECB
	2-Feb	14:45	Christine Lagarde	Press conference	ECB
<b>Fed</b>	1-Feb	20:00	FOMC	Monetary policy decision	US Fed
	1-Feb	20:30	Jerome Powell	Press conference	US Fed

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

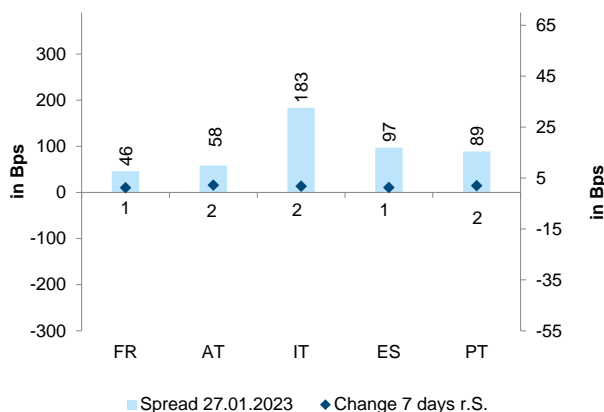
## Forex and government bond markets

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



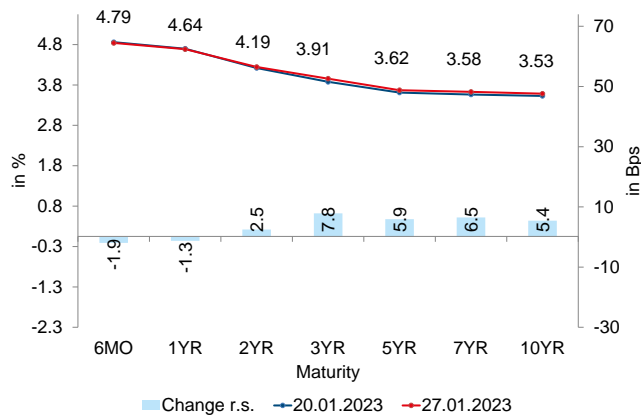
Source: Market Data Provider, Erste Group Research

### Eurozone spreads vs. Germany 10Y government bonds



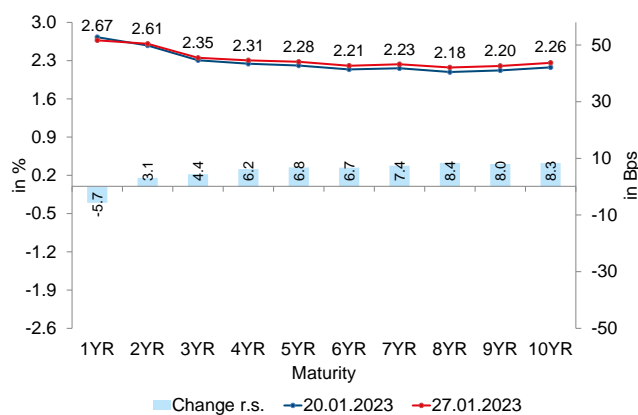
Source: Market Data Provider, Erste Group Research

### 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<sup>1</sup>

<b>GDP</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>
<b>Eurozone</b>	5.3	3.4	0.5	0.7
<b>US</b>	5.7	2.0	1.0	1.1

<b>Inflation</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>
<b>Eurozone</b>	2.6	8.4	5.6	2.3
<b>US</b>	4.7	8.0	2.9	1.9

<b>Interest rates</b>	<b>current</b>	<b>Mar.23</b>	<b>Jun.23</b>	<b>Sep.23</b>	<b>Dec.23</b>
<b>ECB MRR</b>	2.50	3.50	3.75	3.75	3.75
<b>ECB Deposit Rate</b>	2.00	3.00	3.25	3.25	3.25
<b>3M Euribor</b>	2.47	3.11	3.20	3.24	3.28
<b>Germany Govt. 10Y</b>	2.27	2.20	2.00	1.90	1.90
<b>Swap 10Y</b>	2.86	2.80	2.50	2.40	2.40

<b>Interest rates</b>	<b>current</b>	<b>Mar.23</b>	<b>Jun.23</b>	<b>Sep.23</b>	<b>Dec.23</b>
<b>Fed Funds Target Rate*</b>	4.33	4.88	4.88	4.88	4.63
<b>3M Libor</b>	4.81	4.96	4.96	4.96	4.71
<b>US Govt. 10Y</b>	3.54	3.50	3.30	3.10	2.80
<b>EURUSD</b>	1.09	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*

<sup>1</sup> 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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