Week ahead

US - Markets to look to Washington
Monetary Policy - Fed, ECB and SNB hold course

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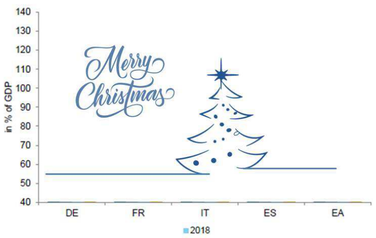

We wish all our readers a merry Christmas and a happy New Year. Our next Week Ahead will be published on January 5, 2018.

Hectic week ahead for US Congress

The US capital seems set for everything but a tranquil pre-Christmas week. The markets will be closely watching events in Washington to see whether a tax package passes both chambers of Congress successfully. In the Senate, where the Republicans only have a slim majority, concerns reemerged in this regard in recent days. So, intensive negotiations still seem necessary over the weekend. A failure to pass a tax package before Christmas would clearly disappoint the markets. In addition, politicians have to agree on the extension of government funding. The deadline is December 22. It is likely that any agreement will again be on a short-term solution, pushing the issue into next year. No agreement would result in a government shutdown. However, this seems highly unlikely, as the political pressure to at least find a temporary solution ahead of the holiday season is especially high.

US-Fed increases forecasts for growth, but not for inflation

As expected, the interest rate setting body of the US Fed (FOMC) increased the range for the key rate by 0.25% to 1.25-1.5% at the meeting this week. In total, meeting participants did not change their interest rate expectations for the years ahead. The median expectation continues to call for three rate hikes next year and two hikes in 2019. The only major change to the forecasts for macro indicators was for next year's growth rate. The median projection now foresees a growth rate for the fourth quarter of 2.5% y/y vs. 2.1% y/y previously. Looming tax cuts were one factor for this change, but not the only one, as Chair Yellen specified later in the press conference. Forecasts for the development of the unemployment rate were lowered slightly. However, this should not result in increased inflationary pressures. Participants' inflation expectations remained unchanged compared to September.

We keep our expectation for three rate hikes next year unchanged.

ECB more confident, but not confident enough

As expected, the ECB Council left all monetary variables unchanged at the last meeting of the year. Accordingly, President Draghi had little news to report at the press conference. He repeatedly stated the greater confidence of the Council that inflation will converge with the ECB's inflation aim, which was based on the significantly increased growth projections of ESZB economists, especially for next year. However, the Council did not want to go any further than that, as the increased growth projections did not lead to higher inflation projections. The forecasts for inflation were increased, but this was exclusively due to higher oil prices entering the calculations. Projections for core inflation, which is a better

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measure for the price pressure generated domestically, were even reduced.

We expect the press conferences during the coming months to follow a similar pattern as the one this week, with little news released. Only around mid-year is it likely that the ECB Council will start to signal to the markets how asset purchases will evolve after September. We expect another reduction before the program comes to an end, rather than an abrupt end in September, in order to secure a slow transition.

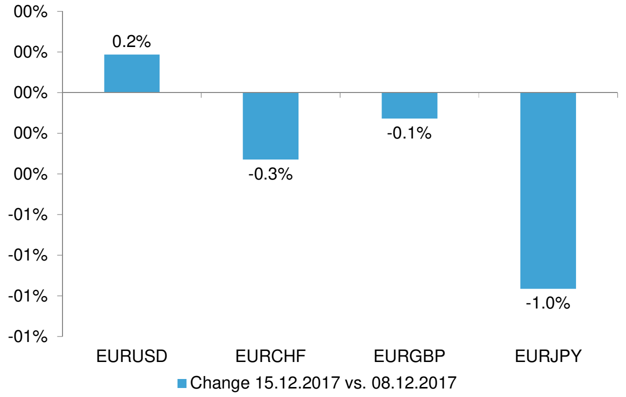
SNB sticks to expansionary monetary policy and significantly raises inflation forecast

This week, the SNB has kept the target range for the 3-month Libor between -1.25% and -0.25%, while keeping the interest rate level for deposits at the national bank at -0.75%. The SNB acknowledges that the overvaluation of the CHF has continued to decline (recently also against the USD), however, it still remains overvalued in the opinion of the SNB. Overall development is still fragile and thus negative interest rates and the willingness of the SNB to intervene on FX markets are still necessary. For 2018, the SNB has raised its inflation forecast significantly, from +0.4% to +0.7%.

Since the election of Macron as French president in early May, in combination with the strong dynamics of the Eurozone economy, the CHF has weakened substantially against the euro due to brightened sentiment of investors with regard to the Eurozone. This development shows that financial safe havens are currently less in demand. Consequently, sight deposits at Swiss banks have been continuously shrinking since September. In the short term, the Swiss franc is moving in a trading range of between 1.16 and 1.17. We continue to expect, in alignment with our expectation of modest yield increases of German bunds at the long end, a continued weakening of the Swiss franc against the euro, to around 1.18 by 3Q18.

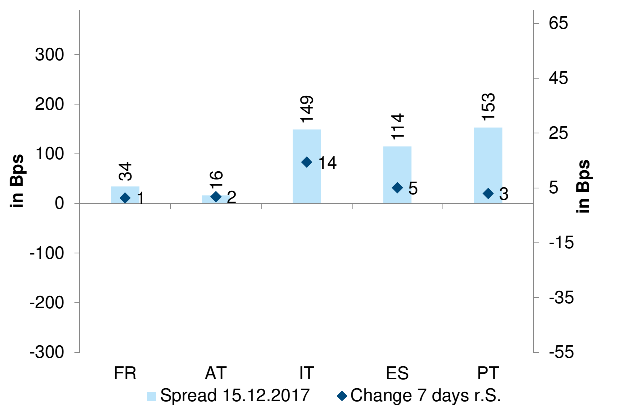
Forex and government bond markets

Exchange rates EUR: USD, CHF, GBP and JPY
change last week
(+ stronger euro / - weaker euro)



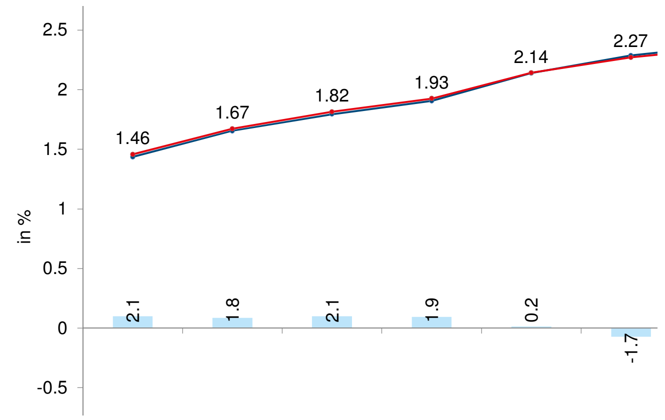
Source: Bloomberg, Erste Group Research

Eurozone – spreads vs. Germany
10Y government bonds



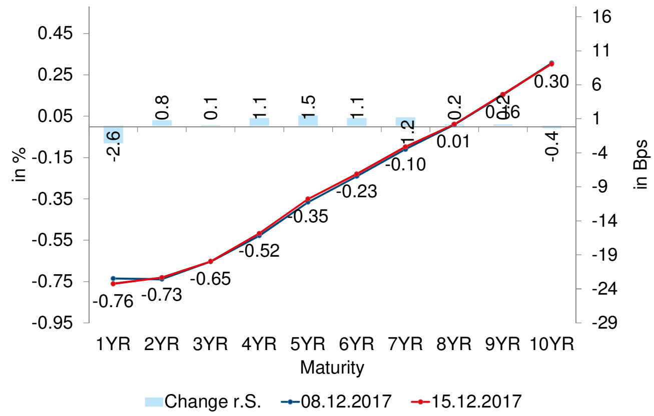
Source: Bloomberg, Erste Group Research

US Treasuries yield curve
change last week



Source: Bloomberg, Erste Group Research

DE Bund yield curve
change last week



Source: Bloomberg, Erste Group Research

Economic calendar

Date	Time	Ctry	Release	Period	Consens	Prior
15-Dec	n.a.	US	Ind. Prod. y/y	Nov		2.9%
	11:00	EA	Trade Balance	Oct	24m	25044m
18-Dec	9:00	AT	Inflation y/y	Nov		2.2%
		AT	CPI m/m	Nov		0.1%
	10:00	IT	Trade Balance	Oct		3990m
	11:00	EA	CPI m/m	Nov		0.1%
		EA	Inflation y/y	Nov F		1.5%
19-Dec		EA	Wages y/y	3Q		1.8%
	14:30	US	CA Balance (q)	3Q	-116 m	-123 m
20-Dec	8:00	DE	PPI y/y	Nov		2.7%
	10:00	IT	CA Balance (m)	Oct		4307 m
		EA	CA Balance (m)	Oct		38 m
	16:00	US	Existing Home Sales	Nov	5.5 m	5.5 m
21-Dec	14:30	US	GDP q/q	3Q T	3.3%	3.3%
		US	Jobless Claims	Dec 16	236.3 thd	225.0 thd
	16:00	EA	Consumer Conf.	Dec A		0.1 index
22-Dec	8:45	FR	PPI y/y	Nov		1.5%
		FR	GDP y/y	3Q F		2.2%
		FR	GDP q/q	3Q F		0.5%
	9:00	AT	Ind. Prod. y/y	Oct		3.7%
	14:30	US	Durable Goods Orders	Nov P	2.2%	-0.8%
		US	PCE Deflator	Nov	1.8%	1.6%
	16:00	US	Univ. Michigan Index	Dec F	97.7 index	96.8 index
		US	New Home Sales	Nov	655.6 thd	685.0 thd

Source: Bloomberg, Erste Group Research

FORECASTS[1])

GDP	2015	2016	2017	2018	2019
Eurozone	2.0	1.8	2.3	2.3	2.0
US	2.9	1.5	2.2	2.4	1.9

Inflation	2015	2016	2017	2018	2019
Eurozone	0.1	0.2	1.5	1.6	1.7
US	0.1	1.2	2.2	2.2	1.9

Interest rates	current	Mar.18	Jun.18	Sep.18	Dec.18
ECB MRR	0.00	0.00	0.00	0.00	0.00
3M Euribor	-0.33	-0.30	-0.30	-0.30	-0.30
Germany Govt. 10Y	0.30	0.50	0.70	0.90	1.10
Swap 10Y	0.79	0.80	1.00	1.20	1.40

Interest rates	current	Mar.18	Jun.18	Sep.18	Dec.18
Fed Funds Target Rate*	1.17	1.63	1.88	2.13	2.13
3M Libor	1.59	1.90	2.20	2.40	2.40
US Govt. 10Y	2.35	2.60	2.70	2.80	3.00
EURUSD	1.18	1.13	1.11	1.10	1.12

*Mid of target range

Source: Bloomberg, Erste Group Research

[1] By regulations we are obliged to issue the following statement: Forecasts are no reliable indicator for future performance

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