

Week ahead

Italy – elections scheduled for March 4; Five Star Movement open to coalitions US – Labor Market Report: Non-farm payrolls disappoint

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Italy's president sets course for new elections

On December 28, 2017, Italy's president set a course for new elections after signing a decree to dissolve the Parliament. The government set the election date for March 4, 2018. Based on current poll data, the 5-star-movement leads with 27-29%, ahead of the socialists, with around 23-25% support. The two center-right-wing parties Forza-Italia and Lega-Nord taken together have approval rates of around 28-30%. Based on current electoral law, a party or party alliance would need a majority of around 40% to form a new government alone, but this goal is nowhere in sight. Concerning future coalitions, the outlook has changed quite dramatically, as the Five Star Movement has abandoned its self-imposed restriction not to participate in government coalitions. This gives more options for the composition of any future Italian government. However, the head of the Five Star Movement did not believe a coalition with right-wing parties would be possible.

*For the markets, the risks to Italy's membership in the Eurozone will be the crucial topic watched during the coming weeks. We think that the chances of Italy leaving the monetary union are very low, but the upcoming election campaigns could **make the markets nervous**. The Five Star Movement is no longer insisting on a referendum on EMU membership, seeing this as only a last resort should the EU refuse to implement reforms. However, there are also other Euro-skeptic political parties, namely Forza Italia and especially Lega (formerly Lega Nord). During the upcoming campaign, anti-Euro rhetoric is set to heat up and the markets could react both to this and to the changing probabilities of the composition of the future government. Until now, events have only triggered small market movements. The risk premium of Italian government bonds over Germany increased slightly. However, further widening of the spread during the coming weeks looks likely.*

Depending on the final election results, the process of forming a new government after March 4, 2018, could be lengthy and difficult. Above all, there is a substantial danger that the new government (if, for example, the socialists and center-right-wing parties would have to form a coalition) will hardly be able or willing to push through a decisive reform agenda because of substantial compromises and different ideologies. This is despite the urgent need for substantial reforms of the Italian economy in terms of labor and goods markets. In the short term, we do not believe that this endangers the current cyclical upswing. However, due to these unsolved problems, we are rather pessimistic with regards to the mid-term prospects for Italy's economy.

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Indications of past performance are no guarantee of a positive performance in the future

US labor weaker than expected in December

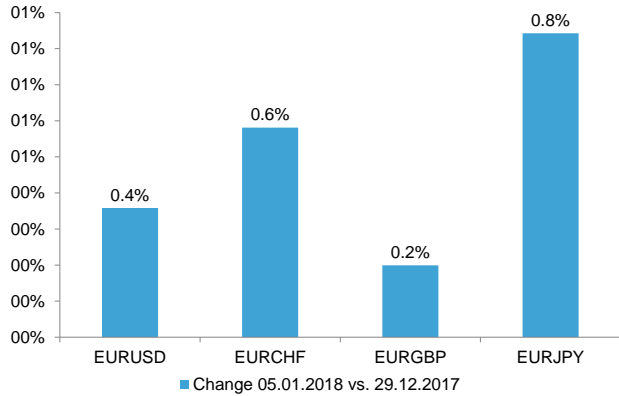
Non-farm payrolls increased by 148,000 in December, clearly below

market expectations of a gain of 190,000. In addition, the numbers for the two previous months were revised downwards by 9,000 in total. The disappointment was augmented, as ADP (a private human resource company) data released yesterday had given cause for optimism. The other relevant numbers of the labor market report matched market estimates. The unemployment rate remained unchanged at 4.1% and average hourly earnings increased by 0.3% compared to the previous month and 2.5% in a yearly comparison.

In total, today's data was somewhat disappointing. However, we see the slower creation of non-farm payrolls within the means of a fluctuation. Accordingly, we do not make any change to our mid-term positive outlook for the US economy.

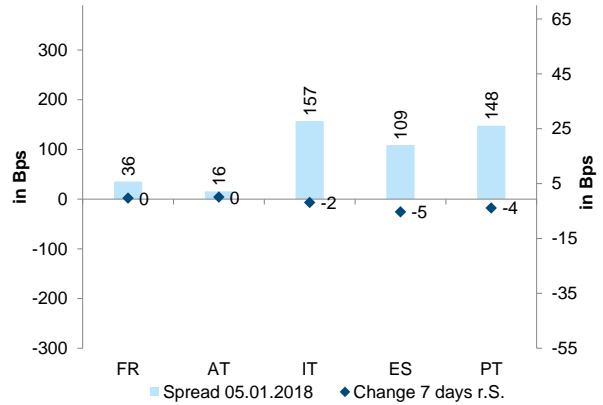
Forex and government bond markets

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



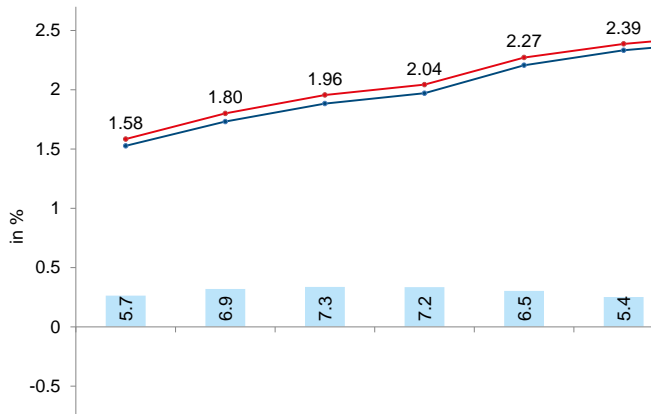
Source: Bloomberg, Erste Group Research

Eurozone – spreads vs. Germany
10Y government bonds



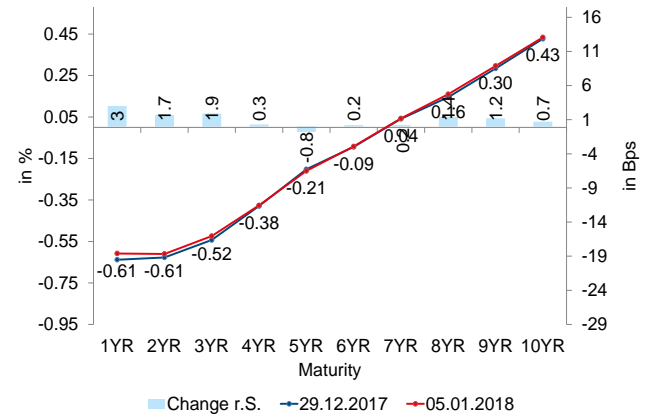
Source: Bloomberg, Erste Group Research

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
5-Jan	8:00	DE	Retail Sales y/y	Nov	2.3%	4.4%
	8:45	FR	CPI m/m	Dec P	0.4%	0.4%
		FR	Inflation y/y	Dec P	1.3%	1.3%
	11:00	IT	Inflation y/y	Dec P	1.1%	1.0%
		IT	CPI m/m	Dec P	0.3%	0.3%
	14:30	EA	PPI y/y	Nov	2.5%	2.8%
		US	Wages y/y	Dec	2.5%	2.5%
	16:00	US	Trade Balance	Nov	-49m	-49m
		US	Unempl. Rate	Dec	4.1%	4.1%
		US	Chg. Non-Farm Payrolls	Dec	192.1 thd	228.0 thd
		US	ISM Non-Manufacturing	Dec	57.6 index	57.4 index
		US	Durable Goods Orders	Nov F		1.3%
	7-Jan	n.a.	CN	Forex Reserves	Dec	3127bn
8-Jan		FR	Consumer Conf.	Dec		-3.4 index
		DE	Consumer Conf.	Dec		5.3 index
		IT	Consumer Conf.	Dec		-7.8 index
		AT	Consumer Conf.	Dec		10.2 index
	11:00	EA	Retail Sales y/y	Nov	2.3%	0.4%
		EA	Consumer Conf.	Dec F	0.5 index	0.5 index
EA		Business Conf.	Dec	114.7 index	114.6 index	
9-Jan	8:00	DE	CA Balance (m)	Nov	26 m	18 m
		DE	Trade Balance	Nov	22m	19m
		DE	Ind. Prod. y/y	Nov	1.9%	-1.4%
	8:45	FR	Trade Balance	Nov		-4956m
		FR	CA Balance (m)	Nov		-2227 m
	11:00	EA	Unempl. Rate	Nov	8.7%	8.8%
10-Jan	n.a.	CN	CNY new loans	Nov	1006bn	1120bn
		CN	M2 yoy	Nov	9%	9%
	3:30	CN	Inflation y/y	Dec	1.9%	1.7%
		CN	PPI y/y	Dec	4.9%	5.8%
	8:45	FR	Ind. Prod. y/y	Dec	2.9%	5.5%
		n.a.	FR	Cap Util.	Dec	
		11:00	EA	Ind. Prod. y/y	Nov	3.3%
11-Jan	14:30	US	Jobless Claims	Dec	243.2 thd	250.0 thd
		US	PPI y/y	Nov	2.9%	3.1%
	10:00	IT	Ind. Prod. y/y	Jan 6	3.8%	3.1%
12. Jän.	14:30	US	Retail Sales mom	Dec	0.4%	0.8%
		US	Inflation y/y	Nov	2.1%	2.2%
	11:00	US	CPI m/m	Dec	0.2%	0.4%
		EA	Trade Balance	Dec		19038m
	8:00	DE	Inflation y/y	Dec		1.6%

Source: Bloomberg, Erste Group Research

FORECASTS¹⁾

GDP	2015	2016	2017	2018	2019
Eurozone	2.0	1.8	2.4	2.4	2.2
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	0.43	0.50	0.70	0.90	1.10
Swap 10Y	0.89	0.80	1.00	1.20	1.40

Interest rates	current	Mar.18	Jun.18	Sep.18	Dec.18
Fed Funds Target Rate*	1.42	1.63	1.88	2.13	2.13
3M Libor	1.70	1.90	2.20	2.40	2.40
US Govt. 10Y	2.46	2.60	2.70	2.80	3.00
EURUSD	1.20	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

Erste Group Research

Week ahead | Macro, Fixed Income | Eurozone, USA

05 January 2018

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