Week ahead

Germany, US - Bond-rally is temporary
EZ - Slightly higher inflation expected in March

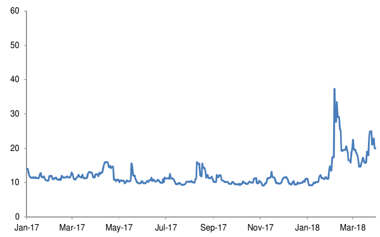
Analysts:
Rainer Singer
rainer.singer@erstegroup.com

Margarita Grushanina
margarita.grushanina@erstegroup.com

Import-tariffs and stock market volatility will not choke-off the economy

After a significant rise of government bond yields, a countermovement set in mid-February. The rally started with the announcement of US tariffs on steel- and aluminum imports and concerns that more trade barriers could occur, i.e. a trade war. Only a few weeks later the US government did indeed decide to impose further duties on USD 60 billion of imports from China. Almost simultaneously the affair concerning the alleged unjustified use of Facebook-data by the Cambridge Analytica company brought additional uncertainty.

VIX Index



Source: Bloomberg, Erste Group Research

US-tariffs and potential countermeasures by countries, which in turn would have significantly affected exporting US-companies, as well as the possibility of more restrictive data protection laws with negative effects on technology shares triggered fears on markets. Among other things this can be clearly seen on the VIX-index which reflects the volatility of the US-stock market (S&P index). The safest assets – government bonds – benefited from this uncertainty and yields declined.

We think the rally on the bond markets is of a temporary nature. We have already argued in earlier editions of the *Week ahead* why the tariffs decided by the US should have no macroeconomic consequences. The respective imports were too low from the very start. Furthermore, many countries have been exempted from customs duties on imports of steel and aluminum in the meantime, if only temporarily for most of them. Regarding imports from China the above-mentioned volume concerned is likely to be just a negotiating position and one will see what remains in the end. US stock market volatility should also calm.

It cannot be ruled out that the volatility on the stock markets could lead to uncertainty among consumers and that consumer spending slows down, temporarily. However, the growth rate of the US economy should be restored since the underlying factors remain positive. The labor market and the industry are developing very well and there is a massive fiscal stimulus to come, in the form of tax cuts and higher expenditures.

We therefore stick to our yield forecasts. We are being helped in this by the fact that we previously predicted a sideways movement up to midyear after the rise in yields at the beginning of the year. Based on the current level we therefore expect only moderate yield increases. The volatility should stay high since the market is in a transition phase. Due to the ongoing economic upswing the markets will have to learn again to cope with a less accommodative monetary policy of central banks and eventually with inflation risks. This means that the correct pricing of bonds will become more difficult. In conclusion, we recognize the recent bond price increases as an opportunity to take profits.

Major Markets & Credit Research

Gudrun Egger, CEFA
(Head)

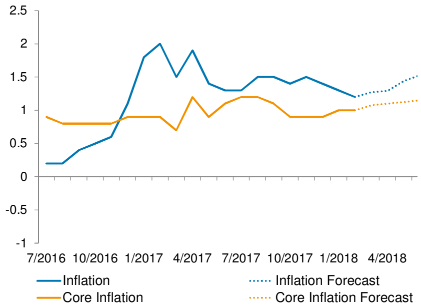
Rainer Singer
(Senior Economist Eurozone, US)

Gerald Walek, CFA
(Economist Eurozone)

Margarita Grushanina
(Economist Austria, Quant Analyst EZ)

EZ – slightly higher inflation expected in March

Core inflation is expected to gradually increase



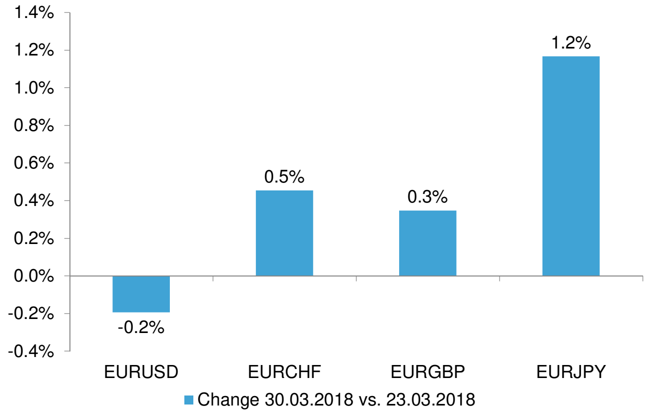
Source: Eurostat, Erste Group Research

Next week (April 4), a flash estimate of the Eurozone aggregate inflation will be announced. In February, Eurozone headline inflation slightly decreased to 1.2% y/y, from 1.3% y/y in January. The decrease came mostly from the weaker dynamics of food and energy prices. Core inflation remained stable at 1.0% y/y.

We expect slightly higher headline inflation in March, at levels around 1.3% y/y*, partly due to better dynamics in food and energy prices in the second half of the month. Core inflation should move closer to 1.1% y/y. In general, we expect a gradual increase of core inflation in the coming months, supported by a sound macroeconomic recovery in most of the Eurozone countries. For the whole year 2018, we forecast average headline inflation of 1.4%, dampened by the base effects of the increased energy prices the year before.*

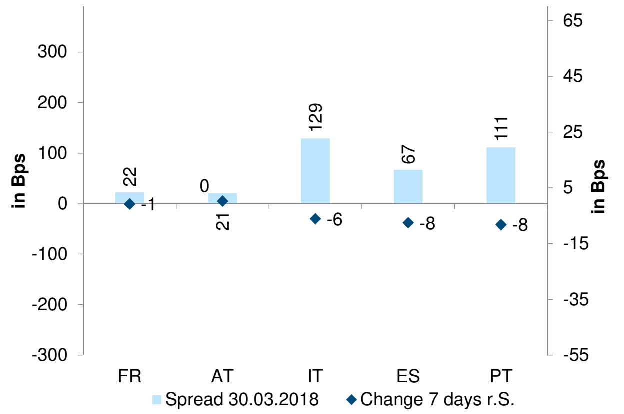
Forex and government bond markets

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



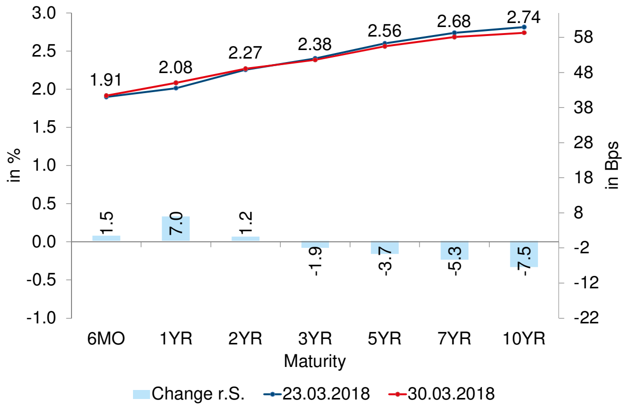
Source: Bloomberg, Erste Group Research

Eurozone – spreads vs. Germany
10Y government bonds



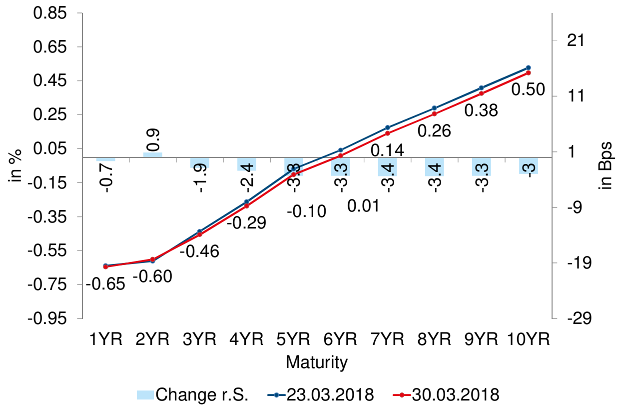
Source: Bloomberg, Erste Group Research

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
30-Mar	8:45	FR	CPI m/m	Mar P	0.8%	1.1%
		FR	PPI y/y	Feb		1.5%
		FR	Inflation y/y	Mar P	1.4%	1.7%
	11:00	IT	Inflation y/y	Mar P	0.8%	0.5%
		IT	CPI m/m	Mar P	2.1%	-0.5%
2-Apr	3:45	CN	PMI Manufacturing	Mar	51.6 index	51.6 index
	16:00	US	PMI Manufacturing	Mar	59.9 index	60.8 index
3-Apr	8:00	DE	Retail Sales y/y	Feb	2.2%	2.3%
	9:500	FR	PMI Manufacturing	Mar F	53.6 index	53.6 index
	9:45	IT	PMI Manufacturing	Mar	55.4 index	56.8 index
	9:55	DE	PMI Manufacturing	Mar F	58.4 index	58.4 index
	10:00	EA	PMI Manufacturing	Mar F	56.7 index	56.6 index
4-Apr	11:00	EA	Unempl. Rate	Feb	8.5%	8.6%
	14:15	US	ADP Employment	Mar	201.9 thd	234.7 thd
	16:00	US	ISM Non-Manufacturing	Mar	58.9 index	59.5 index
		US	Durable Goods Orders	Feb F		3.1%
5-Apr	11:00	EA	Retail Sales y/y	Feb	2.3%	2.3%
		EA	PPI y/y	Feb	1.5%	1.5%
	14:30	US	Jobless Claims	Mar 31	228.3 thd	215.0 thd
		US	Trade Balance	Feb	-56m	-57m
6-Apr	8:00	DE	Ind. Prod. y/y	Feb	0.2%	-0.1%
	8:45	FR	Trade Balance	Feb	-5157m	-5560m
		FR	CA Balance (m)	Feb		-1643 m
	14:30	US	Wages y/y	Mar	2.7%	2.6%
		US	Unempl. Rate	Mar	4.0%	4.1%
		US	Chg. Non-Farm Payrolls	Mar	190.3 thd	313.0 thd

Source: Bloomberg, Erste Group Research

FORECASTS[1])

GDP	2015	2016	2017	2018	2019
Eurozone	2.0	1.8	2.3	2.4	2.2
US	2.9	1.5	2.3	2.8	2.2

Inflation	2015	2016	2017	2018	2019
Eurozone	0.1	0.2	1.5	1.4	1.6
US	0.1	1.2	2.2	2.2	1.9

Interest rates	current	Jun.18	Sep.18	Dec.18	Mar.19
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	0.50	0.70	0.90	1.10	1.30
Swap 10Y	0.96	1.00	1.20	1.40	1.60

Interest rates	current	Jun.18	Sep.18	Dec.18	Mar.19
Fed Funds Target Rate*	1.68	1.88	2.13	2.13	2.38
3M Libor	2.31	2.20	2.40	2.40	2.70
US Govt. 10Y	2.74	3.00	3.10	3.20	3.30
EURUSD	1.23	1.15	1.14	1.13	1.16

*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

Contacts

Group Research

Head of Group Research	
Friedrich Mostböck, CEFA	+43 (0)5 0100 11902
Major Markets & Credit Research	
Head: Gudrun Egger, CEFA	+43 (0)5 0100 11909
Ralf Burchert, CEFA (Agency Analyst)	+43 (0)5 0100 16314
Hans Engel (Senior Analyst Global Equities)	+43 (0)5 0100 19835
Christian Enger, CFA (Covered Bonds)	+43 (0)5 0100 84052
Margarita Grushanina (Economist AT, Quant Analyst)	+43 (0)5 0100 11957
Peter Kaufmann, CFA (Corporate Bonds)	+43 (0)5 0100 11183
Stephan Lingnau (Global Equities)	+43 (0)5 0100 16574
Carmen Riefler-Kowarsch (Covered Bonds)	+43 (0)5 0100 19632
Rainer Singer (Senior Economist Euro, US)	+43 (0)5 0100 17331
Bernadett Povazsai-Römhild (Corporate Bonds)	+43 (0)5 0100 17203
Elena Statelov, CIIA (Corporate Bonds)	+43 (0)5 0100 19641
Gerald Walek, CFA (Economist Euro, CHF)	+43 (0)5 0100 16360
Macro/Fixed Income Research CEE	
Head CEE: Juraj Kotian (Macro/FI)	+43 (0)5 0100 17357
Zoltan Arokszallasi, CFA (Fixed income)	+43 (0)5 0100 18781
Katarzyna Rzentarzewska (Fixed income)	+43 (0)5 0100 17356
CEE Equity Research	
Head: Henning Eßkuchen	+43 (0)5 0100 19634
Daniel Lion, CIIA (Technology, Ind. Goods&Services)	+43 (0)5 0100 17420
Michael Marschallinger	+43 (0)5 0100 17906
Christoph Schultes, MBA, CIIA (Real Estate)	+43 (0)5 0100 11523
Vera Sutedja, CFA, MBA (Telecom, Steel)	+43 (0)5 0100 11905
Thomas Unger, CFA (Banks, Insurance)	+43 (0)5 0100 17344
Vladimira Urbankova, MBA (Pharma)	+43 (0)5 0100 17343
Martina Valenta, MBA	+43 (0)5 0100 11913
Editor Research CEE	
Brett Aarons	+420 956 711 014
Research Croatia/Serbia	
Head: Mladen Dodig (Equity)	+381 11 22 09178
Head: Alen Kovac (Fixed income)	+385 72 37 1383
Anto Augustinovic (Equity)	+385 72 37 2833
Milan Deskar-Skrbic (Fixed income)	+385 72 37 1349
Magdalena Dolenec (Equity)	+385 72 37 1407
Ivana Rogic (Fixed income)	+385 72 37 2419
Davor Spoljar, CFA (Equity)	+385 72 37 2825
Research Czech Republic	
Head: David Navratil (Fixed income)	+420 956 765 439
Head: Petr Bartek (Equity)	+420 956 765 227
Vit Machacek (Fixed income)	+420 956 765 456
Jiri Polansky (Fixed income)	+420 956 765 192
Michal Skorepa (Fixed income)	+420 956 765 172
Pavel Smolik (Equity)	+420 956 765 434
Jan Sumbera (Equity)	+420 956 765 218
Research Hungary	
Head: József Miró (Equity)	+361 235 5131
Gergely Ürmössy (Fixed income)	+361 373 2830
András Nagy (Equity)	+361 235 5132
Orsolya Nyeste (Fixed income)	+361 268 4428
Tamás Pletser, CFA (Oil&Gas)	+361 235 5135
Research Poland	
Director of Research: Tomasz Duda (Equity)	+48 22 330 6253
Deputy Director: Magdalena Komaracka, CFA (Equity)	+48 22 330 6256
Marek Czachor (Equity)	+48 22 330 6254
Mateusz Krupa (Equity)	+48 22 330 6251
Karol Brodziński (Equity)	+48 22 330 6252
Research Romania	
Head: Horia Braun-Erdei	+40 3735 10424
Mihai Caruntu (Equity)	+40 3735 10427
Dumitru Dulgheru (Fixed income)	+40 3735 10433
Eugen Sinca (Fixed income)	+40 3735 10435
Dorina Ilasco (Fixed Income)	+40 3735 10436
Research Slovakia	
Head: Maria Valachyova, (Fixed income)	+421 2 4862 4185
Katarina Muchova (Fixed income)	+421 2 4862 4762
Research Turkey	
Ender Kaynar (Equity)	+90 212 371 2530

Treasury - Erste Bank Vienna

Group Markets Retail Sales	
Head: Christian Reiss	+43 (0)5 0100 84012
Markets Retail a. Sparkassen Sales AT	
Head: Markus Kaller	+43 (0)5 0100 84239
Equity a. Fund Retail Sales	
Head: Kurt Gerhold	+43 (0)5 0100 84232
Fixed Income a. Certificate Sales	
Head: Uwe Kolar	+43 (0)5 0100 83214
Corporate Treasury Product Distribution AT	
Head: Christian Skopek	+43 (0)5 0100 84146

Fixed Income Institutional Sales

Group Securities Markets	
Head: Harald Müller	+43 (0)5 0100 84890
Institutional Distribution non CEE:	
Head: Margit Hraschek	+43 (0)5 0100 84117
Thomas Almen	+43 (0)5 0100 84323
Bernd Bollhof	+49 (0)30 8105800 5525
Charles-Henry La Coste de Fontenilles	+43 (0)5 0100 84115
Rene Klasen	+49 (0)30 8105800 5521
Christian Kössler	+43 (0)5 0100 84116
Karin Rattay	+43 (0)5 0100 84118
Bernd Thaler	+43 (0)5 0100 84119
Bank Distribution:	
Head: Marc Friebertshäuser	+49 (0)711 810400 5540
Sven Kienzle	+49 (0)711 810400 5541
Michael Schmotz	+43 (0)5 0100 85542
Ulrich Inhofner	+43 (0)5 0100 85544
Klaus Vosseler	+49 (0)711 810400 5560
Andreas Goll	+49 (0)711 810400 5561
Mathias Gindele	+49 (0)711 810400 5562
Institutional Distribution CEE:	
Head: Jaromir Malak	+43 (0)5 0100 84254
Institutional Distribution PL and CIS	
Pawel Kielek	+48 22 538 6223
Michal Jarmakowicz	+43 50100 85611
Institutional Distribution Slovakia	
Head: Sarlota Sipulova	+421 2 4862 5619
Monika Smelikova	+421 2 4862 5629
Institutional Distribution Czech Republic	
Head: Ondrej Cech	+420 2 2499 5577
Milan Bartos	+420 2 2499 5562
Barbara Suvadova	+420 2 2499 5590
Institutional Asset Management Czech Republic	
Head: Petr Holecek	+420 956 765 453
Martin Perina	+420 956 765 106
Petr Valenta	+420 956 765 140
David Petracek	+420 956 765 809
Blanca Weinerova	+420 956 765 317
Institutional Distribution Croatia	
Head: Antun Buric	+385 (0)7237 2439
Željko Pavičić	+385 (0)7237 1494
Natalija Zujic	+385 (0)7237 1638
Institutional Distribution Hungary	
Head: Peter Csizmadia	+36 1 237 8211
Attila Hollo	+36 1 237 8209
Gabor Balint	+36 1 237 8205
Institutional Distribution Romania and Bulgaria	
Head: Ciprian Mitu	+43 (0)50100 85612
Stefan Mortun Racovita	+40 373 516 531
Institutional Equity Sales	
Head: Brigitte Zeitlberger-Schmid	+43 (0)50100 83123
Werner Fürst	+43 (0)50100 83121
Josef Kerekes	+43 (0)50100 83125
Cormac Lyden	+43 (0)50100 83120
Business Support	
Bettina Mahoric	+43 (0)50100 86441

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Published by:

Erste Group Bank AG
Group Research
1100 Vienna, Austria, Am Belvedere 1
Head Office: Wien
Commercial Register No: FN 33209m
Commercial Court of Vienna

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