

Week ahead

Brexit – Brits hesitate to trigger leave process

Eurozone – Inflation surprises on the upside in June

Emerging Markets – industry sentiment remains subdued in June

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Brexit – British PM steps down, uncertainty about next steps

Already last Friday, David Cameron announced his resignation by October in response to the Brexit decision. Thus, the referendum has already triggered a political crisis in the UK. Cameron also made clear that, under his leadership, the leave process will not be triggered. It is thus clear that the UK will need a reshuffle of its government before any negotiations with the EU can even start. Even snap elections cannot be ruled out at this stage. The process is even more complex, since the steep market reactions have spread uncertainty among the British people. But across the British Channel, the referendum has left its mark as well and the leaders of the European Commission and the European Parliament have been exposed to criticism.

*It seems as if the **politicians in the UK have been taken by surprise by the outcome of the referendum and now have to adapt to the new situation.** One thus has to expect that some time will pass until the withdrawal negotiations will start officially. In addition, some sources say that it might be possible that, under certain conditions (snap elections or renegotiations), the UK might never trigger the leave process. In any case, **the economic damage has already been done.** The significant decline of the British pound (30-year low vs. the USD) indicates that investors have already started to withdraw capital from the UK in light of the heightened uncertainty. Companies and investors will not wait with their decisions until the UK and EU have reached an agreement. **We thus expect that the UK economy will already in 3Q experience a significant slump in growth. The Eurozone, however, should in comparison develop better; we expect just subdued growth in 3Q.** According to media reports, ECB head Draghi has this week told the heads of European governments that the ECB expects weaker economic growth (0.3-0.5%) for the Euro Area over the next three years.*

*In general, the **uncertainty caused by the political instability remains high.** We expect that several **elections due over the course of the next 12 months in different countries will have a substantial impact on financial markets.** First of all, the US is going to elect a new president in November this year. Due to the extreme positions of Republican candidate Donald Trump, these elections could be explosive. **From the perspective of the Eurozone, the elections in the Netherlands (Parliament) and France (president) next spring will be in focus,** since in both countries, populist parties are on the rise. However, it remains to be seen if the current political and economic chaos in the UK dampens the support for the populist parties in the Netherlands or France. Finally, in autumn 2017, parliamentary elections in Germany are due; they will also be of global interest.*

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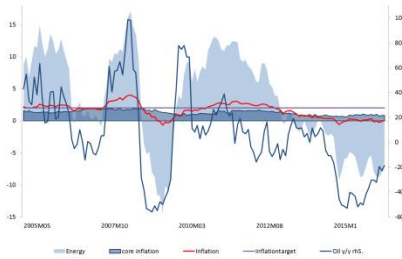
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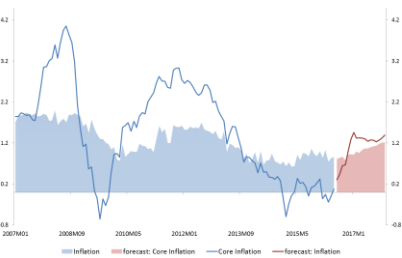
Eurozone – inflation (+0.1% y/y) surprises on upside in June

Eurozone: Inflation



Source: Bloomberg, Erste Group Research, Eurostat

Eurozone: Inflation forecast



Source: Erste Group Research, Eurostat

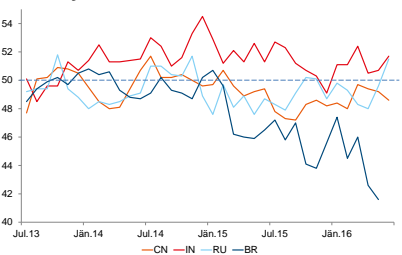
The flash estimates for inflation and core inflation released this week surprised on the upside. Total inflation for June stood at +0.1% y/y (vs. -0.1% y/y in May) and core inflation came in at +0.9% y/y (+0.8% y/y in May). For headline inflation, the energy component plays a major role, which, given the positive oil price development (stabilization), has exerted less downward pressure compared to previous months. With regard to core inflation, it can be seen that services seem to have stabilized at close to +1.0% y/y. Industry goods displayed less positive development, with price changes declining further, to +0.4% y/y (previously +0.5% y/y).

In light of the current robust economic recovery, an increase in core inflation should be expected. The recovery in core inflation has, however, stalled since mid/end-2015. This suggests that second-round effects are starting to play a role. In concrete terms, it seems that the low oil prices are affecting core inflation via production costs and production prices. Producer prices are currently 4% below levels from last year. Weak development of wage growth can also be an indicator of second-round effects. Faced with low inflation expectations, employees command lower wages and the high unemployment rate further weakens the bargaining position of employees. In order to prolong the trend of a declining unemployment rate, a stable economic recovery and structural reforms in many Eurozone countries are required.

Based on current oil prices, the economic recovery, low inflation expectations and the political situation, we forecast core inflation of +0.9% y/y by the end of 2016 and an increase to +1.2% y/y by the end of 2017. For headline inflation, we forecast an average level of +0.3% y/y for 2016 and +1.3% y/y for 2017.

Emerging markets – industry sentiment remained subdued in June

Industry-PMI CN, IN, RU and BR



Source: Bloomberg, Erste Group Research

Unlike in the Eurozone, industry sentiment remained subdued in major emerging markets in June. Only in Russia, supported by a stabilizing crude oil price in a range of USD 45-50 per barrel, was a significant improvement visible. Also in India, the data points to growth of industrial production.

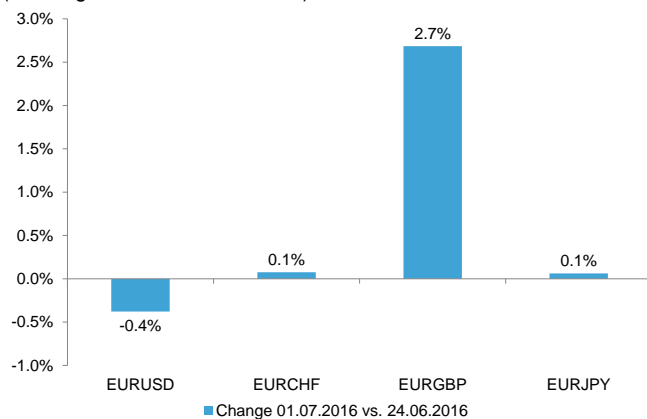
*The published data shows that the Eurozone cannot expect significant growth impulses from emerging markets. **Due to structural issues in several of these countries, we do not expect a clear improvement of the situation during the next few quarters.** Nevertheless, the situation has stabilized for the time being.*

Forex and government bond markets

Exchange rates EUR: USD, CHF, GBP and JPY

change last week

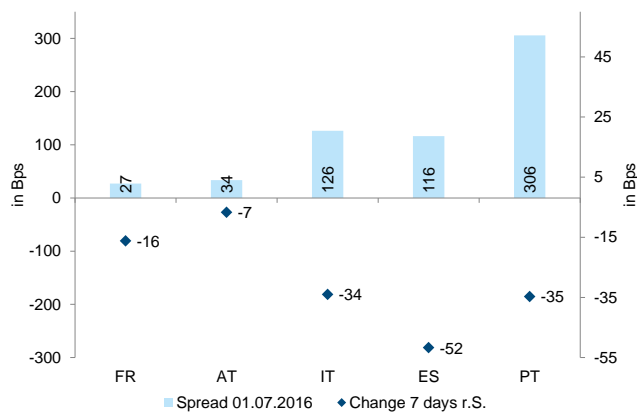
(+ stronger euro / - weaker euro)



Source: Bloomberg, Erste Group Research

Eurozone – spreads vs. Germany

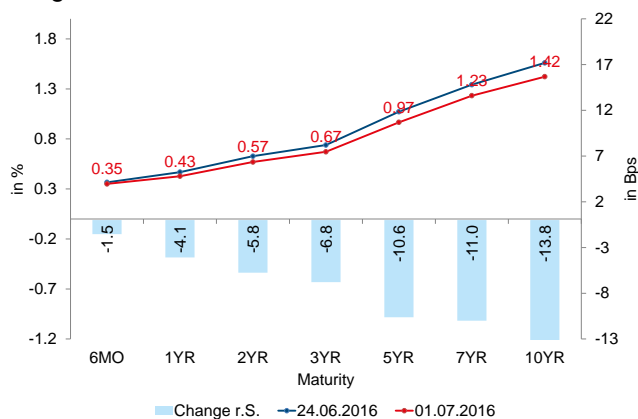
10Y government bonds



Source: Bloomberg, Erste Group Research

US Treasuries yield curve

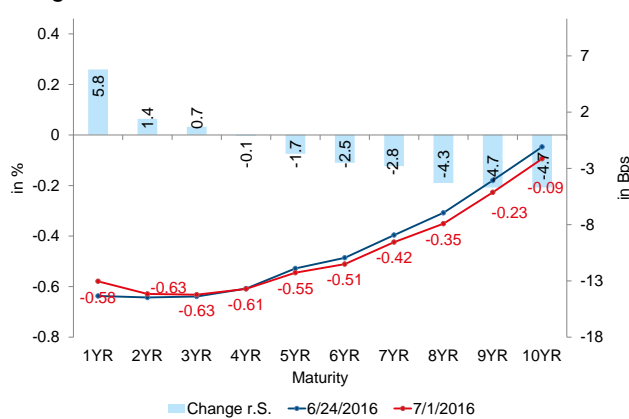
change last week



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
1-Jul	3:45	CN	PMI Manufacturing	Jun	49.2index	48.6index
	9:500	FR	PMI Manufacturing	Jun F	48.0index	47.9index
	9:45	IT	PMI Manufacturing	Jun	52.4index	52.4index
	9:55	DE	PMI Manufacturing	Jun F	54.1index	54.4index
	10:00	EA	PMI Manufacturing	Jun F	52.4index	52.6index
	11:00	EA	Unempl. Rate	May	10.1%	10.2%
	16:00	US	PMI Manufacturing	Jun	51.2index	51.3index
4-Jul	11:00	EA	PPI y/y	May	-4.1%	-4.4%
5-Jul	11:00	EA	Retail Sales y/y	May	1.7%	1.4%
	16:00	US	Durable Goods Orders	May F	-2.2%	-2.2%
6-Jul	14:30	US	Trade Balance	May	-40m	-37m
	16:00	US	ISM Non-Manufacturing	Jun	53.4index	52.9index
7-Jul	n.a.	CN	Forex Reserves	Jun	3164bn	3192bn
	8:00	DE	Ind. Prod. y/y	May	-0.1%	0.8%
	8:45	FR	Trade Balance	May		-5219m
		FR	CA Balance (m)	May		-2821m
	14:15	US	ADP Employment	Jun	151.6thd	173.2thd
	14:30	US	Jobless Claims	-	266.8thd	268.0thd
8-Jul	n.a.	FR	Cap Util.	Jun		78.5%
	8:00	DE	CA Balance (m)	May	26m	29m
		DE	Trade Balance	May	24m	26m
	8:45	FR	Ind. Prod. y/y	May	0.7%	1.9%
	14:30	US	Wages y/y	Jun	2.7%	2.5%
		US	Unempl. Rate	Jun	4.8%	4.7%

Source: Bloomberg, Erste Group Research

FORECASTS

GDP	2013	2014	2015	2016	2017
Eurozone	-0.5	0.9	1.5	1.3	1.6
US	1.9	2.4	2.4	1.9	1.9

Inflation	2013	2014	2015	2016	2017
Eurozone	1.3	0.5	0.1	0.3	1.5
US	1.5	1.6	0.1	1.3	1.9

	current	Sep.16	Dec.16	Mar.17	Jun.17
ECB MRR	0.00	0.00	0.00	0.00	0.00
3M Euribor	-0.29	-0.25	-0.25	-0.25	-0.22
Germany Govt. 10Y	-0.13	0.10	0.50	0.90	1.20
Swap 10Y	0.35	0.40	0.80	1.20	1.50

	current	Sep.16	Dec.16	Mar.17	Jun.17
Fed Funds Target Rate*	0.41	0.38	0.63	0.88	1.13
3M Libor	0.65	0.66	0.94	1.19	1.44
US Govt. 10Y	1.41	1.60	2.10	2.40	2.80
EURUSD	1.11	1.12	1.10	1.12	1.14

*Mid of target range

	current	Sep.16	Dec.16	Mar.17	Jun.17
Austria 10Y	0.19	0.30	0.70	1.10	1.40
Spread AT - DE	0.32	0.20	0.20	0.20	0.20

Source: Bloomberg, Erste Group Research

Erste Group Research

Week ahead | Macro, Fixed Income | Eurozone, USA

01 July 2016

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