Week ahead

ECB – Draghi to defend current monetary stance
Eurozone – April manufacturing PMI expected to stabilize
Italy – new attempt to restructure banking sector
Emerging Markets – China: positive economic data lifts outlook

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Draghi could try to talk euro down

Thursday of next week **will see the first meeting of the ECB Council after the massive monetary loosening delivered on March 10.** This would be reason enough to almost rule out any change in the monetary stance. Adding to this expected outcome is slightly improving economic data during the last couple of weeks and an increase of the oil price, the weakness of the latter being one of the reasons for the expansionary measures implemented. Risks from Emerging Markets, the main concern for the ECB since late summer of last year, have subsided, as indicated by several capital market indicators. The recent IMF forecast for growth in Emerging Markets in 2016 was cut by 0.2 percentage points, but the forecast for China, which is the main focus of the ECB (and the US Fed), was increased by the same amount.

So, the most interesting part next week will be the statements by ECB President Draghi. He will confirm the monetary stance of not planning any further monetary loosening, but to be prepared to do so, if the environment should deteriorate. ***We do not expect the risk assessment to be changed, and risks should continue to be seen on the downside.*** *Draghi will likely be asked by journalists on the topic of helicopter money, which at the previous press conference he called 'an interesting concept'. After a number of high-ranking ECB officials already stated that the topic is not on the table, Draghi will likely need to back-pedal, too. Draghi will likely also have to comment on the recent criticism of the ECB's monetary policy by German politicians.*

The highest risk for the wording Draghi will use comes from the currently high euro exchange rate. It is conceivable that he will try to talk the euro down by highlighting the downward risks and using very dovish wording. The fact is, however, that the picture for the Eurozone's economy has rather brightened during the last several weeks. However, this will not be put in the foreground by Draghi, as he would not want to steer market expectations in the resulting direction.

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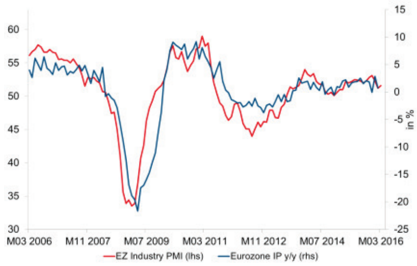
Eurozone – April PMI and consumer confidence expected to stabilize

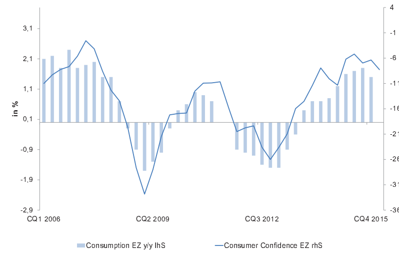
On April 22, the preliminary Purchasing Manager Index (PMI) for April will be published for Germany, France and the Eurozone. The Eurozone index increased slightly from February (51.2) to March (51.6), with positive impulses mainly coming from smaller countries. The main drivers were new orders, increasing new business exports and positive employment development. In contrast, apart from Greece, industry-intensive France and Germany had a negative impact on the index in March. France

PMI and industrial production



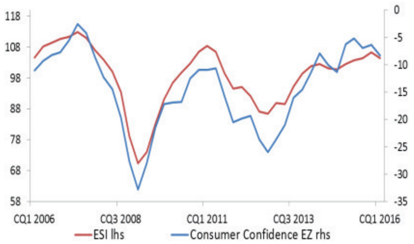
Source: Bloomberg

Consumption EZ and Consumer Confidence



Source: Eurostat, Erste Group Research

Consumer Confidence and ESI



Source: Eurostat, Erste Group Research

recorded a slight decline in exports in March, which caused additional stress for companies already facing relatively weak domestic demand. However, Germany published positive data for important industrial sectors (retail and construction).

*Due to the still soft economic development, we expected **sluggish development of the PMI survey data for April** in comparison to March.*

Next week, the preliminary **flash estimate of consumer confidence for April will be published.** This first estimate gives an idea of the development of private consumption in the Eurozone for 2Q16. In addition, due to its high weight in the calculation of the Economic Sentiment Indicator (ESI), consumer confidence is an important indicator for the development of the ESI. Consumer confidence has weakened steadily in recent months but still remains above its long-term average. The data exhibits negative signals for April, especially with respect to the expectations of households regarding their financial and economic situation over the next 12 months.

Due to the current soft economic situation and ambiguous signals in recent months, we expect consumer confidence to remain at current levels. For the future, the declining unemployment rate and associated rise in employment are expected to have a positive influence on consumer confidence.

Inflation for March revised upwards by 0.1 percentage points

Inflation was revised upwards for March, from -0.1% y/y to 0.0% y/y. The fall in energy prices has accelerated in March compared to February, which increased downward pressure on inflation. In contrast, service prices have developed very positively and, at 1.4% y/y, show their highest increase since May 2013. Core inflation remains at 1% and shows no indication of either an upward or downward trend.

With regard to the stabilizing economic situation, we expect inflation to increase from 0.1% y/y in 1Q to 0.4 % y/y in 2Q.

Italy – attempt to restructure banking sector

Media reports this week have shed some light on the first details regarding the intended setting up of a mainly **privately funded vehicle** (Atlas Fund) aimed at **bailing out weak Italian financial institutions**. The vehicle is to be funded with EUR 5bn provided by healthy banks, insurers and wealth managers. The funds are intended to be used for capital increases or for the purchase of subordinated tranches of non-performing loans. In exchange, the government has promised Italian banks that it will streamline bankruptcy laws, which should allow creditors to get their money sooner. In addition, investors will be granted some tax benefits. It remains, however, to be seen whether the fund satisfies strict European Commission rules on government aid, since at least one bank due to invest in the fund is majority state-owned.

*Italian banks are currently suffering from **a sizeable pile of non-performing loans (EUR 360bn). This is a drag on the ongoing recovery of the Italian economy** (recent economic data remained below general expectations)[1]. With the restructuring of its ailing banking sector,*

[1] In this context, the BIS has recently published an interesting study ('Why bank capital matters for monetary policy') that emphasizes the importance of a well-capitalized banking sector for loan growth in an economy.

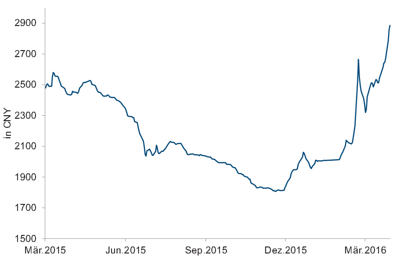
Italy faces the problem that, under the new EU rules on government aid, public support to banks can only be granted after certain private creditors have been bailed in to a certain degree. This is, however, politically very unpopular, since such a bail-in would not only affect institutional investors but could also affect single investors holding subordinated debt.
At least in the short term this new initiative seems to have convinced investors (visible in the rising share prices of Italian banks). ***The simplification of bankruptcy laws in our opinion increases the probability that the market for non-performing loans in Italy will finally start moving****.* ***We thus consider this step positive for the growth prospects of Italy's economy****, although it will take some time before these measures bear fruit. A critical aspect, however, is the fact that the new vehicle is another attempt to shift the burden of restructuring costs for ailing banks onto healthy financial institutions. Therefore, rating agency Fitch is of the opinion that Italy's large banks face considerable contingency risks*[2]*.*

Emerging Markets – China: positive economic data lifts outlook

China – Bloomberg GDP indicator

Source: Bloomberg

China – domestic steel prices in CNY



Source: Bloomberg

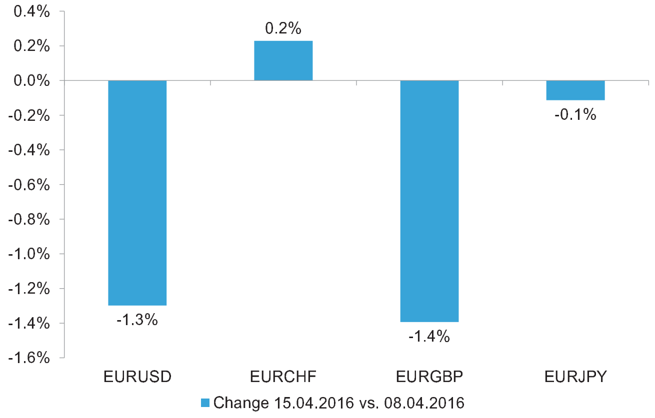
This week's **economic data from China has been rather encouraging**. Based on official data, 1Q16 GDP growth slowed down slightly to 6.7% y/y (previously 6.9% y/y). In addition, several economic (industrial production, retail sales, export growth) as well as credit data for March have been published. **The data displays a positive dynamic, with the majority being above market expectations**. The Bloomberg China GDP indicator (7.1% growth indication for March) confirms this positive development. **The outlook for 2Q16 remains good**, since domestic steel prices (indicator for rising industrial activity) continued their steep decline in April. This shows that the first positive consequences of the measures announced in March (fiscal and monetary) have emerged. Recently, the mega infrastructure project initiated by the Chinese government for the construction of a new silk road (expansion of the trade infrastructure between China and Europe on land and water) has generated increased investors interest through the start-up of the Asian Infrastructure Investment Bank (AIIB).

For the time being, after the turbulence at the start of the year, the situation has calmed down. This is also ***positive for the economic outlook of the Eurozone for 2Q16****. However, the long-term structural problems of China have not been solved. One thus cannot rule out that capital flight out of China could speed up again in the coming months if uncertainty again increases.* ***It is therefore advisable to remain vigilant. In general, we think that the recent recovery is more sustainable when compared to the easing of the situation in autumn 2015.*** *The main difference is the fact that China's leadership announced concrete measures in March. In addition, communication between officials in China and capital markets has improved in recent months. A further argument in favor of a sustainable recovery is the significant positive trend reversal of capital flows (for the first time in several months, substantial inflows of USD 37bn registered in March) into Emerging Markets (especially Asia and Latin America).* ***Nevertheless, it remains to be seen how the next steps of the US Fed will affect capital flows*** *into China and other Emerging Markets. If conditions do not change materially,* ***we expect the Fed to hike rates in June****.* ***This could lead to rising pressure on the renminbi in May, which could also lead to the more rapid decrease of Chinese FX reserves.***

[2] Fitch ratings – Press Release

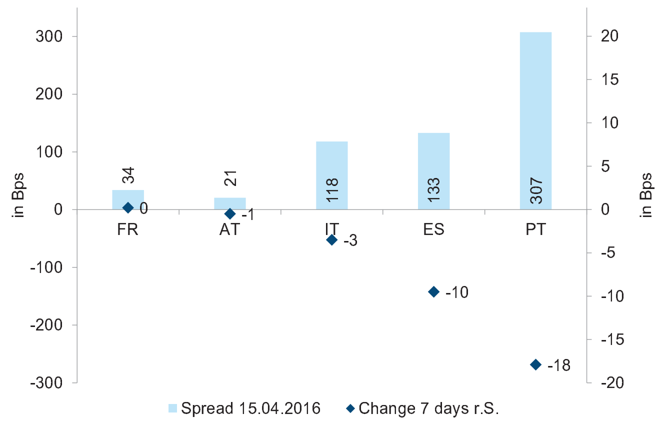
Forex and government bond markets

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



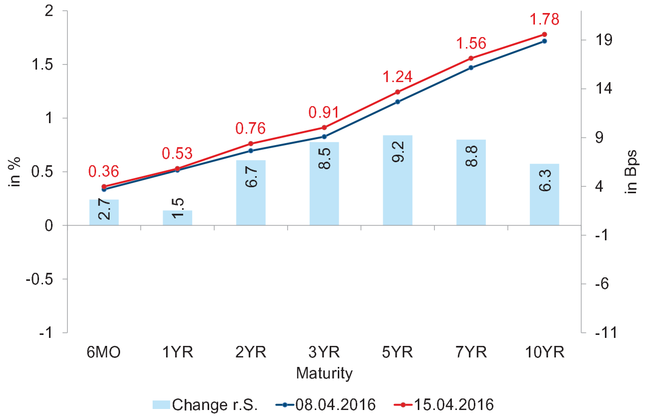
Source: Bloomberg, Erste Group Research

Eurozone – spreads vs. Germany
10Y government bonds



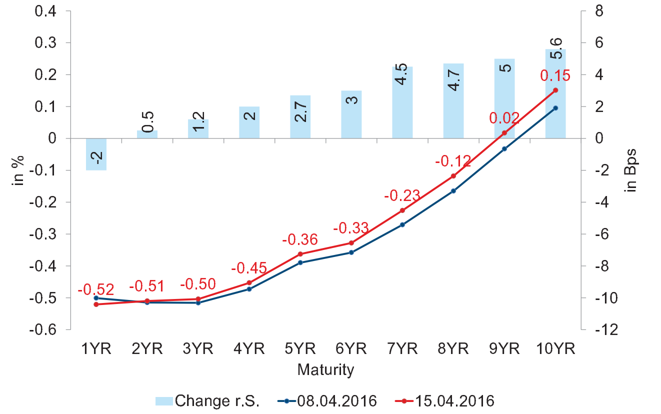
Source: Bloomberg, Erste Group Research

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-Apr	n.a.	CN	Ind. Prod. y/y	Mar	5.9%	6.8%
		CN	Unempl. Rate	1Q		4.1%
		CN	CNY new loans	Mar	1070bn	1370bn
		CN	M2 yoy	Mar	14%	13%
	10:00	IT	Trade Balance	Feb		35m
	11:00	EA	Trade Balance	Feb	21m	21221m
	16:00	US	Univ. Michigan Index	Apr P	91.7index	91.0index
19-Apr	10:00	EA	CA Balance (m)	Feb		25m
	10:30	IT	CA Balance (m)	Feb		-1068m
20-Apr	8:00	DE	PPI y/y	Mar	-2.9%	-3.0%
	16:00	US	Existing Home Sales	Mar	5.3thd	5.1thd
21-Apr	13:45	EA	Target Rate (lending)	-	-0.40%	-0.40%
		EA	Target Rate	-		0.00%
	14:30	US	Jobless Claims	-	269.7thd	253.0thd
	16:00	EA	Consumer Conf.	Apr A	-9.2index	-9.7index
22-Apr	9:00	FR	PMI Manufacturing	Apr P	49.8index	49.6index
	9:30	DE	PMI Manufacturing	Apr P	51.0index	50.7index
	10:00	EA	PMI Manufacturing	Apr P	51.8index	51.6index
25-Apr	9:00	AT	Ind. Prod. y/y	Feb		1.5%

Source: Bloomberg, Erste Group Research

FORECASTS

GDP	2013	2014	2015	2016	2017
Eurozone	-0.5	0.9	1.5	1.6	1.8
US	1.9	2.4	2.4	2.3	2.3

Inflation	2013	2014	2015	2016	2017
Eurozone	1.3	0.5	0.1	0.6	1.5
US	1.5	1.6	0.1	1.5	2.1

	current	Jun.16	Sep.16	Dec.16	Mar.17
ECB MRR	0.00	0.00	0.00	0.00	0.00
3M Euribor	-0.25	-0.25	-0.25	-0.25	-0.22
Germany Govt. 10Y	0.14	0.50	0.70	1.00	1.30
Swap 10Y	0.53	0.80	1.00	1.30	1.60

	current	Jun.16	Sep.16	Dec.16	Mar.17
Fed Funds Target Rate*	0.37	0.63	0.88	1.13	1.63
3M Libor	0.63	0.93	1.18	1.59	1.80
US Govt. 10Y	1.77	2.30	2.70	3.00	3.10
EURUSD	1.13	1.08	1.08	1.10	1.12

*Mid of target range

	current	Jun.16	Sep.16	Dec.16	Mar.17
Austria 10Y	0.35	0.65	0.85	1.15	1.45
Spread AT - DE	0.21	0.15	0.15	0.15	0.15

Source: Bloomberg, Erste Group Research

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