Week ahead

US Fed –monetary policy stance confirmed
Eurozone – labor market and retail sales in focus; public debt dropped in 3Q15
Japan – new move to fight deflation

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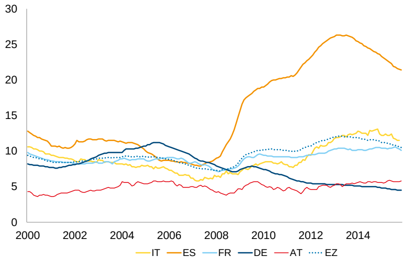
US Fed: Keeping cool, but expressed some concern

Careful reading of the US central bank's statements show that they have kept their cool (see Short Note), given the current circumstances (e.g. weak global demand, lower commodity prices). The implications of lower energy and import prices should be transitory and should – together with a further strengthening of the labor market – move inflation back to 2% in the medium term. In December, they stated the risks to be balanced, but no assessment on risks was explicitly indicated this time. However, the committee expressed some concern about external factors and said that it is 'closely monitoring global economic and financial developments and is assessing their implications for the labor market and inflation'. In our view, an interest rate hike in March is still possible and the Fed will decide on this based on incoming data (in particular labor market data). Next week, the labor market report will be issued on Friday and we expect financial markets to pay significant attention to that release.

Labor market continously improves
unemployment rate IT, ES, FR, DE, AT and EZ



Source: Datastream, Erste Group Research

Eurozone – labor market and retail sales in focus; public debt dropped in 3Q15

December data for the labor market and December retail sales for the Eurozone will be released next week. The Eurozone labor market further improved in November (unemployment rate dropped to 10.5%). For December, we expect stabilization or a further slight drop to 10.4%. It is pleasing that the November data in France confirmed the positive trend, with the unemployment rate falling during the last three months from 10.6% to 10.1%. Youth unemployment, however, continues to climb (25.7% in November), which in turn lowers the quality of human capital and thus burdens the long-term growth prospects of France's economy. **The continuously improving labor market, together with rising real income levels (supported by low energy prices), remains the main growth driver for the Eurozone recovery.** The release (due February 3) of retail sales data for December will also be of interest. Even though growth dynamics somewhat eased in November (+1.4% y/y), we expect growth acceleration in December, supported by the labor market and real income gains.

Based on Eurostat data, the public debt-to-GDP ratio for the Eurozone declined in 3Q15 to 91.6% (previously 92.3%). **This positive trend is, however, mainly driven by the cyclical recovery** and not by structural measures. With regard to structural reforms, several countries of the Eurozone – among the big countries France and Spain especially – are under pressure in order to adapt their state expenses to the growth potential.

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Italy – agreement with EU for bad bank

As is already known, Italy's banks are suffering from high numbers of non-performing loans (around EUR 200bn) which poses a downward threat to the ongoing recovery of the Italian economy. In order to improve the situation of the financial sector and speed up the consolidation process, the Italian government already implemented reforms by the end of last year. In addition**, Italy, has reached an agreement with the European Commission regarding the modalities for a bad bank.** The details are, however, complex, because state aid to banks is largely forbidden since the implementation of the banking union. Therefore, Italian banks will have to pay for any warranties provided if they transfer loans to a bad bank. **This agreement is an important step, even though it will take time until the process starts and until the positive results start to show up** in the books of Italian banks.

Positive indications regarding the financial sector came last week from the ECB's quarterly lending survey. It showed that Eurozone banks have eased their credit standards for enterprises as well as for households, mainly due to rising competition. Italian banks are mainly responsible for the net easing of credit standards vs. enterprises. This shows the positive response of Italian banks to the economic recovery. Another positive aspect is the fact that the credit easing was focused on the SME segment. This is very important, as SMEs are heavily dependent on the banking channel for their financing. In addition, demand from enterprises for credit for investment purposes rose further, which is an encouraging development in light of the thus far dampened investment activity in the Eurozone. For 1Q16, the banks expect further net easing of the lending standards.

Japan – BoJ causes disruptions on global markets with implementation of negative interest rates

The Bank of Japan (BoJ) surprised markets this week with the announcement that it would enhance the existing QE program with the implementation of negative interest rates. With this new measure, the BoJ wants to achieve the price stability target of 2% at the earliest possible date. The vote in favor of negative interest rates was very close (5 to 4). The BoJ will apply a negative interest rate of -0.1% to current accounts that financial institutions hold at the bank. The BoJ will cut the interest rate further into negative territory if such a move is judged necessary. The BoJ will adopt a three-tier system in which the outstanding balance of each financial institution's current account at the bank will be divided into 3 tiers. To each outstanding balance, a different interest rate will be applied (+0.1%, 0% or -0.1%). In the Eurozone and the US, yields have come under pressure and stock markets have risen. It seems as if investors are entering into debt in yen (in anticipation of currency devaluations) and investing the funds on global markets. However, it remains to be seen how sustainable this development will be.

Economic calendar

Date	Time	Ctry	Release	Period	Consens	Prior
29-Jan	7:30	FR	GDP y/y	4Q A	1.2%	1.3%
		FR	GDP q/q	4Q A	0.2%	0.2%
	8:00	DE	Retail Sales y/y	Dec	2.0%	1.5%
	8:45	FR	CPI m/m	Jan P	-0.9%	-1.0%
		FR	PPI y/y	Dec		-2.8%
		FR	Inflation y/y	Jan P	0.4%	0.4%
	9:00	AT	PPI y/y	Dec		-2.0%
		AT	GDP q/q	4Q		0.0%
		AT	GDP y/y	4Q		1.1%
	10:00	IT	PPI y/y	Dec		-4.2%
	14:30	US	GDP q/q	4Q A	0.8%	2.0%
	16:00	US	Univ. Michigan Index	Jan F	92.7index	93.3index
1-Feb	9:500	FR	PMI Manufacturing	Jan F		50.0index
	9:45	IT	PMI Manufacturing	Jan		55.6index
	9:55	DE	PMI Manufacturing	Jan F	52.1index	52.1index
	10:00	EA	PMI Manufacturing	Jan F	52.3index	52.3index
	14:30	US	PCE Deflator	Dec	0.6%	0.4%
	16:00	US	PMI Manufacturing	Jan	48.4index	48.2index
2-Feb	11:00	EA	Unempl. Rate	Dec	10.5%	10.5%
		EA	PPI y/y	Dec	-2.7%	-3.2%
3-Feb	11:00	IT	Inflation y/y	Jan P	0.3%	0.1%
		IT	CPI m/m	Jan P	-2.3%	-0.1%
		EA	Retail Sales y/y	Dec		1.4%
	14:15	US	ADP Employment	Jan	199.3thd	256.9thd
	16:00	US	ISM Non-Manufacturing	Jan	55.2index	55.3index
4-Feb	14:30	US	Jobless Claims	Jan	280.5thd	278.0thd
	16:00	US	Durable Goods Orders	Dec F	-0.8%	-5.1%
05. Feb.	8:45	FR	Trade Balance	Dec		-4630m
		FR	CA Balance (m)	Dec		-1395m
	14:30	US	Wages y/y	Jan	2.3%	2.5%
		US	Trade Balance	Dec	-43m	-42m
		US	Unempl. Rate	Jan	5.0%	5.0%
		US	Chg. Non-Farm Payrolls	Jan	202.0thd	292.0thd

Source: Bloomberg, Erste Group Research

FORECASTS

GDP	2013	2014	2015	2016	2017
Eurozone	-0.5	0.9	1.5	1.8	1.9
US	1.9	2.4	2.4	2.7	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	1.6	2.1

	current	Mar.16	Jun.16	Sep.16	Dec.16
EURUSD	1.09	1.06	1.07	1.08	1.10

	current	Mar.16	Jun.16	Sep.16	Dec.16
ECB MRR	0.05	0.05	0.05	0.05	0.05
3M Euribor	-0.16	-0.25	-0.25	-0.25	-0.25
Germany Govt. 10Y	0.36	0.60	0.80	1.10	1.40
Swap 10Y	0.70	0.90	1.10	1.40	1.70

	current	Mar.16	Jun.16	Sep.16	Dec.16
Fed Funds Target Rate*	0.38	0.63	0.88	1.38	1.88
3M Libor	0.62	1.00	1.30	1.80	2.20
US Govt. 10Y	1.94	2.40	2.70	3.00	3.20
EURUSD	1.09	1.06	1.07	1.08	1.10

*Mid of target range

	current	Mar.16	Jun.16	Sep.16	Dec.16
Austria 10Y	0.61	0.80	0.95	1.25	1.55
Spread AT - DE	0.25	0.20	0.15	0.15	0.15

Source: Bloomberg, Erste Group Research

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