Week Ahead

Focus: US labor market report, FOMC meeting, EZ GDP forecast, AT GDP forecast

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Massive misjudgment of US labor market

Expectations for the labor market in May were grossly misjudged, even considering the extreme environment. The unemployment rate was reported at 13.3%. This is 1.4 percentage points lower than in April. The market had expected 19%. The market expected non-farm payrolls to decline by 7.5mn. The actual figure was an increase of 2.5mn, an error of 10mn. In manufacturing, the increase in employment was 225,000, where the market had expected a decline of 400,000.

The loosening measures that began have thus led to a much faster recovery of the labor market than expected. This is good news from the economy and gives hope. At the same time, however, it should not be forgotten that, in April, the decline in employment was just under 20.7mn, so the recovery still has a long way to go.

FOMC could become more specific

Next week, the FOMC of the US Fed will meet and decide on further monetary policy. The general direction will not change. The Fed will continue to signal that liquidity will be available in sufficient quantities and at low interest rates. We expect that isolated market speculation about a rate cut below zero will be rebuffed and that the FOMC's outlook will again not include the possibility of a rate cut. However, the FOMC may become a little more specific about how long interest rates should remain at current levels and announce a target period to give the markets more certainty.

This consideration could also apply to the Fed's purchases of securities. The currently unlimited purchases of US government bonds and mortgage bonds could be transferred to a new QE program, with specified monthly purchasing volumes and a timeframe. This would also give the markets a better planning capability for this area. Such a program could be announced next week, but details seem unlikely. Since the market assumes that the central bank's supply of liquidity will remain very generous and a QE program should meet these expectations, we do not expect a strong market reaction. In the end, however, the specifications of the program will be decisive.

Finally, next week - after an interruption in March - the estimates of the FOMC meeting participants on the most important economic variables will be announced again. The environment suggests that the dispersion of estimates will be much wider than usual. On the other hand, there should be broad agreement on the interest rate path. The estimates will presumably show no change in key interest rates over the entire forecast horizon - that is, until the end of 2022.

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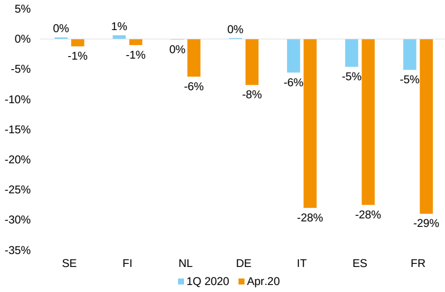
EZ: Sharper decline in GDP expected in 2020

Now that the incidence of infection is largely under control in almost all countries in the Eurozone, the economy is being gradually opened up. However, necessary safety measures (distance and hygiene rules), with the aim of preventing a second wave of infection, are now leading to longer-lasting business losses in many areas of the service industry than we had previously assumed. Against this backdrop, we are lowering our GDP forecast for 2020 to -7.1% (previously -4.7%).

In the first published economic data for 2Q (retail sales for April) the different trends at country level continued. In France, Italy and Spain, retail sales in April fell by around 30% from the 1Q average. In contrast, the decline in the Netherlands and Germany was limited to around 6-8%. In Finland and Sweden, retail sales even stabilized, largely at 1Q levels. The main reason for the comparatively good economic performance of North-West European countries is the use of less harsh restriction measures in conjunction with greater confidence in the personal responsibility of citizens. A comparatively strong economic dependence on tourism certainly put an additional strain on retail sales in Italy, France and Spain in April. It is thus becoming increasingly clear that the economic damage caused by the coronavirus crisis will be most severe in South-Western Europe. This regionally varying development underlines the importance of the EU recovery fund (see *Weekly Outlook* *of 29 May) to support the countries and regions most affected by the corona crisis and thereby stabilize the entire European Economic Area.*

Retails sales; change vs. previous quarter



Source: Eurostat, Erste Group Research

AT: Deeper recession expected in 2020

As the situation with the number of Covid-19 infections is further improving, Austria continues to gradually open up its economy. The weekly GDP indicator, developed by OeNB as an estimator of changes in the economic development, reached its lowest point in March and showed a clear improvement in April. However, since then, it has stagnated, despite some further steps like opening gastronomy. One of the reasons is the significantly slower than previously assumed relaxation of restrictions. While the gastronomy and services sector resumes its functions, their work load is still far from normal levels. This is partly because of the restrictions on the number of clients, distance between tables and opening times, and partly because of the decline in demand, as people’s willingness to spend money has significantly dropped in the environment of uncertainly and rising unemployment. Thus, the negative effect of the Covid-19 on private consumption is turning out to be stronger and more prolonged than initially assumed.

Another important pillar of the Austrian economy is tourism. This week, Austria opened its borders with the neighboring countries, except Italy. However, international tourism remains largely restricted. *In view of the globally very different situation with COVID-19 infections, we cannot expect all borders to be opened soon and thus a corresponding contribution of tourism to GDP in the second half of the year. Therefore, we have further revised our expectations for Austrian GDP growth in 2020 downwards and now expect a recession of -6.0% in 2020. For 2021, we currently forecast a recovery of +4.2%.*

Economic calendar

Ctry	Date	Time	Release	Period	Consens	Prior
Eurozone						
EA	9-Jun	11:00	GDP q/q	1Q F	-4.0%	-3.8%
EA	9-Jun	11:00	GDP y/y	1Q F	-3.2%	-3.2%
USA						
	10-Jun	14:30	Inflation y/y	May	0.3%	0.3%
China						
	10-Jun	3:30	Inflation y/y	May	2.6%	3.3%

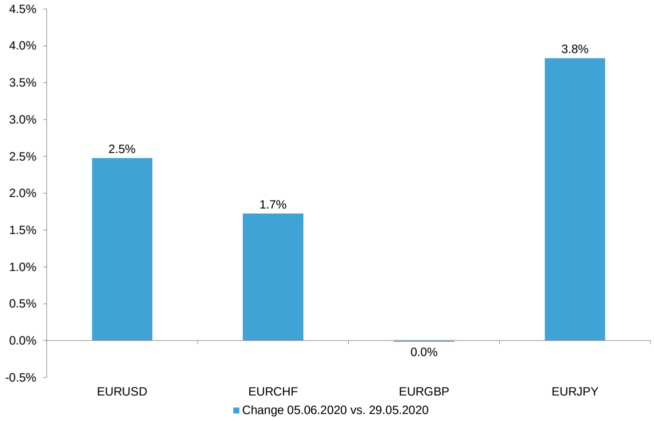
Central bank events

	Date	Time	Event
ECB	8-Jun	15:45	Christine Lagarde, introductory statement before the Committee for Economic and Monetary affairs, European Parliament
	10-Jun	13:00	Isabel Schnabel, speech at seminar at the Florence School of Banking and Finance, Florence
	10-Jun	15:30	Luis de Guindos, speech at the Institute of International European Affairs, Dublin
Fed	10-Jun	20:00	Monetary policy decision
		20:30	Jerome Powell, press conference

Source: Market Data Provider, ECB, Federal Reserve, Erste Group Research

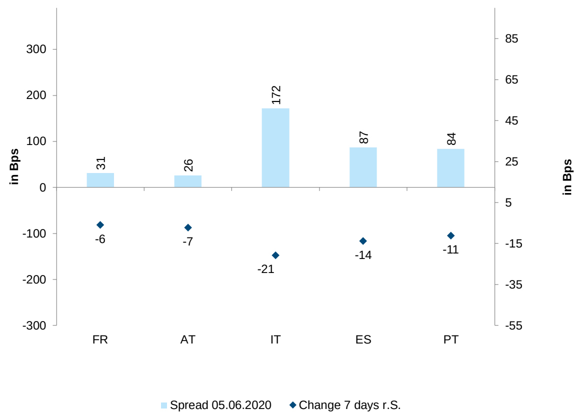
Forex and government bond markets

Exchange rates EUR: USD, CHF, GBP and JPY
Changes compared to last week



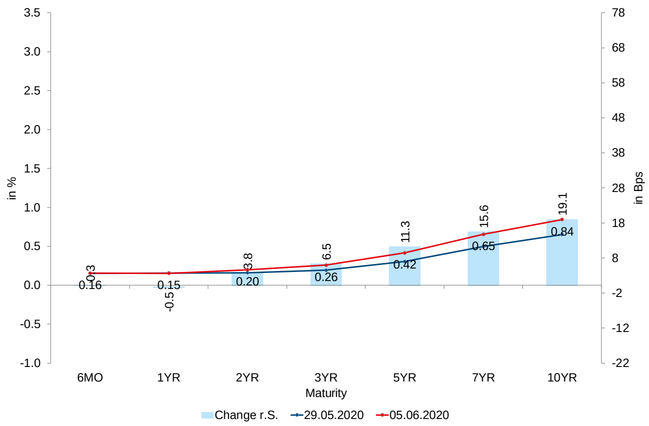
Source: Market Data Provider, Erste Group Research

Eurozone spreads vs. Germany
10Y government bonds



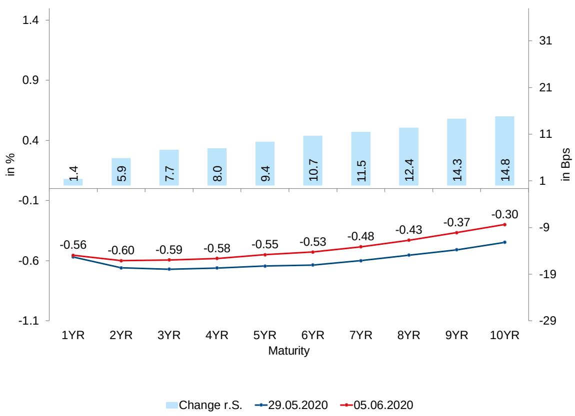
Source: Market Data Provider, Erste Group Research

US Treasuries yield curve
Changes compared to last week



Source: Market Data Provider, Erste Group Research

DE Bund yield curve
Changes compared to last week



Source: Market Data Provider, Erste Group Research

Forecasts[1]

GDP	2018	2019	2020	2021
Eurozone	1.9	1.2	-7.1 ↓	5.4 ↑
US	2.9	2.3	-5.5	5.4

Inflation	2018	2019	2020	2021
Eurozone	1.7	1.2	0.3	1.2
US	2.4	1.8	0.7	2.0

Interest rates	current	Sep.20	Dec.20	Mar.21	Jun.21
ECB MRR	0.00	0.00	0.00	0.00	0.00
3M Euribor	-0.35	-0.40	-0.40	-0.40	-0.40
Germany Govt. 10Y	-0.30	-0.40	-0.20	-0.10	0.00
Swap 10Y	-0.03	-0.10	0.10	0.20	0.30

Interest rates	current	Sep.20	Dec.20	Mar.21	Jun.21
Fed Funds Target Rate*	0.06	0.13	0.13	0.13	0.13
3M Libor	0.33	0.40	0.40	0.40	0.40
US Govt. 10Y	0.85	0.80	1.00	1.10	1.20
EURUSD	1.14	1.10	1.10	1.12	1.14

*Mid of target range

In case of changes to our forecasts compared to the previous issue, arrows show the direction of the change.
Source: Market Data Provider, Erste Group Research

[1] Note: In accordance with regulations, we are obliged to issue the following statement: Forecasts are not a reliable indicator of future performance.

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