

Week in Focus

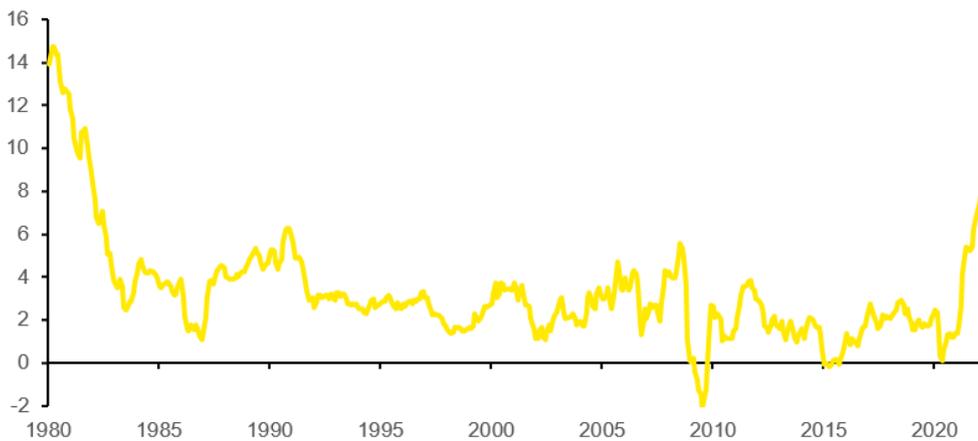
24 June 2022

Recession in the US and consequences for Europe

Stubbornly high inflation, even higher U.S. key interest rates – we now expect a recession for the U.S. and show what this could mean for the euro area and the markets. Page 2

U.S. inflation rises to 40-year high

Consumer Price Index, change vs. previous year, in percent



Sources: IHS, Commerzbank Research

Data preview from 27 June until 1 July 2022

Economic Data Preview: Contrary to the ECB's expectations, the inflation rate in the euro area probably rose to a new all-time high of 8.4% in June. **Page 7**

Editor:

Bernd Weidensteiner

+49 69 136 24527

bernd.weidensteiner@commerzbank.com

Chief Economist:

Dr. Jörg Krämer

+49 69 136 23650

joerg.kraemer@commerzbank.com

Recession in the US and consequences for Europe

Dr Jörg Krämer

Tel: +49 69 136 23650

At our monthly forecast meeting, we raised our already high inflation forecasts once again. At the same time, economic risks have increased due to the monetary policy braking maneuvers, and we now even expect a recession in the US. Hanging over all our forecasts like a sword of Damocles is the possibility that Putin will permanently and completely turn off the gas tap.

Anyone who read last Friday's "Week in Focus" will have noticed that we had significantly tightened our inflation warnings. At our monthly forecast meeting, we have now backed up our words with deeds. We have once again significantly raised our inflation forecasts for the US and the euro area.

Inflation peak to be reached only in autumn

For the euro zone and the US, we do not expect inflation to peak until the fall, with inflation rates of over 9% in the USA and 8½% in the euro zone. We have raised our inflation forecast for the euro zone for the coming year sharply from 2.5% to 4% – mainly because gas and electricity prices are expected to remain high for longer than previously assumed. In addition, food prices are likely to rise even more strongly in 2023 because the increase in production costs (energy, fertilizer, etc.) will be passed on to consumers. For the US, we have raised the inflation forecast for 2023 from 4.5% to 5.0%.

Elevated economic risks

Due to stubbornly high inflation, the Federal Reserve has accelerated the pace of interest rate hikes and made it clear that it will probably raise its key rate more than generally expected. These more extensive rate hikes by the central bank of the world's largest economy pose a significant economic risk, as do reduced Russian gas supplies. Yesterday's slump in the euro area's purchasing managers' index for manufacturing once again showed how fragile the economic situation is (Chart 1).

Chart 1 - Euro area: demand for industrial goods has noticeably weakened

Euro area manufacturing Purchasing Managers' Index, new orders sub-component, seasonally adjusted



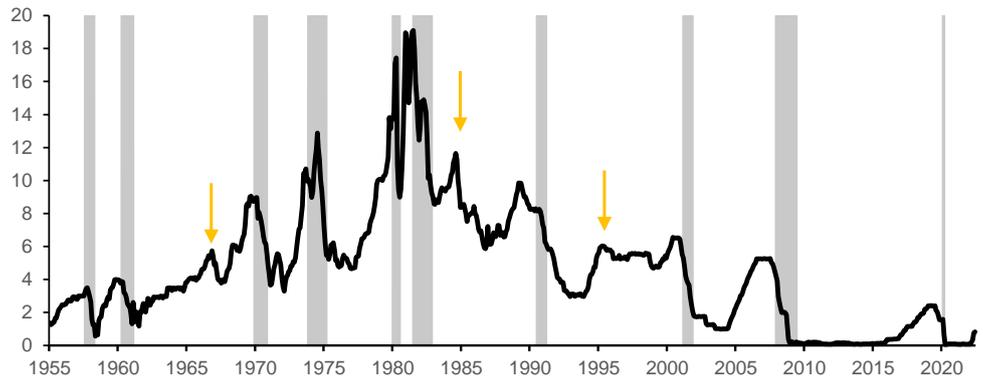
Source: IHS, Commerzbank Research

Recession in the U.S.

In the US, three out of four rate hike cycles since the early 1950s have ended in recession (chart 2). We already saw the US economy on the brink of recession in 2023. In view of the likely faster and more extensive interest rate hikes, we now explicitly expect a temporary decline in US gross domestic product in the first half of next year. As a consequence, economic output in the US is likely to decline slightly by 0.5% on average in the coming year (previously: +1.7%). The recession we forecast is thus unlikely to be as deep as the one following the financial crisis of 2008, because this time there are no significant macroeconomic imbalances – such as the very high level of household debt prior to the financial crisis.

Chart 2 - Soft landing: Only 1 in 4 attempts succeeds

Effective fed funds rate, monthly average in %. Grey-shaded areas: recessions as determined by the NBER. Arrows indicate soft landings.



Source: IHS, NBER, Commerzbank Research

Significantly lower growth in Germany and the EMU

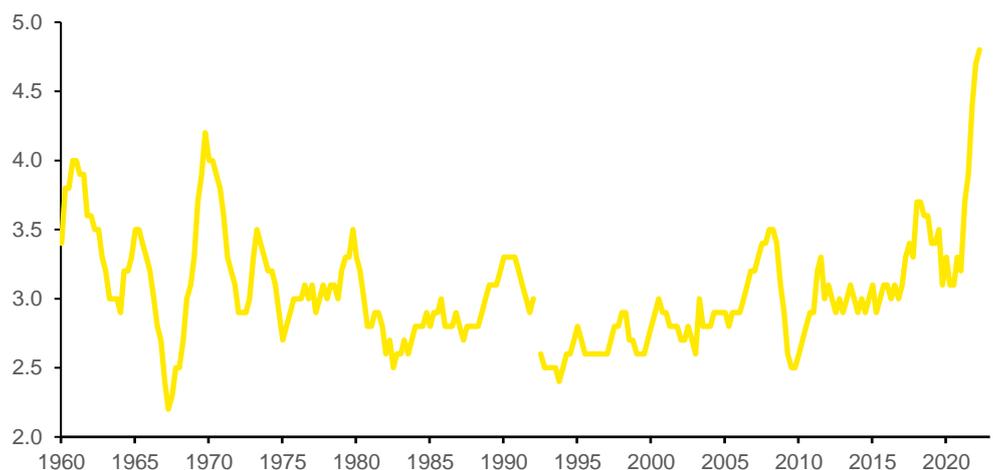
The USA is still the world's largest economy and an important trading partner for Germany. In this respect, a recession there is also a warning signal for Germany and the euro area – especially as energy prices should continue to rise significantly due to reduced Russian gas supplies, which will reduce consumers' purchasing power.

We have lowered our growth forecasts significantly, from 2.5% to 1.0% for Germany in 2023. We have reduced the 2023 forecast for the euro zone from 2.1% to just 0.8%. We are thus significantly more cautious than the average of economists (2.0%).

The fact that we are not forecasting a recession for Germany and the euro zone, unlike for the US, is mainly due to the bulging order books in the manufacturing sector, which are fuller in Germany, for example, than even in the early 1960s when the country was still in a reconstruction boom (Chart 3). If China gradually relaxes its zero-corona policy from the turn of the year and the supply bottlenecks ease, German companies could start to work off their high order backlogs. If they took two years to normalize, this would increase the level of gross domestic product by 1.5% over this period. This shows how high the pent-up demand is.

Chart 3 - German industry: Record high for orders in hand

Orders on hand in production months, industry excluding food and beverages, seasonally adjusted quarterly figures



Source: IHS, Ifo, Commerzbank Research

Central banks – between inflation and growth fears

More inflation, less growth – the Fed and the ECB are likely to behave differently in this area of tension.

- **Federal Reserve:** Fed chair Jerome Powell has said that the Fed is focusing on fighting inflation and accepting rising economic risks. It is likely to raise its key interest rate to as high as 4.0%, rather than just 3.5% as we previously expected, due to the increased inflation

risks. As far as the pace of rate hikes is concerned, the Fed is likely to raise its key rate by a further 75 basis points at each of the next two meetings. For the November and December meetings, we expect steps of 50 and 25 basis points; by the end of the year, the key rate would then stand at 4.0%. After that, the Fed is likely to keep the key rate constant for the time being due to the rising risks of recession and then cut it again for the first time around the middle of the year in response to the recession that will then be visible.

- **ECB:** We have also discussed intensively whether the ECB, like the Fed, will raise its key rate more than previously forecast because of the higher inflation risks. But traditionally, the ECB reacts very sensitively to a deterioration in the economic outlook. We have therefore decided to confirm our previous ECB forecast despite higher inflation: After a 25 basis point rate hike announced in July, the ECB is likely to raise its key rates by 50 basis points in September, as envisaged. After that, we see four further increases of 25 basis points each, so that the deposit rate would stand at 1.5% in the spring. A majority for these rate hikes will probably come about because the hawks in the Governing Council are likely to agree to a new low-threshold aid package for the highly indebted southern states. Under such a so-called anti-fragmentation instrument, the ECB is likely to tolerate only fairly low risk premiums for the bonds of the southern countries compared with German government bonds. If spreads rose above these lowish thresholds, the ECB could sell German government bonds and invest the proceeds in Italian government bonds, for example, according to agency reports. Such a swap would have the advantage that the stock of all bonds held by the ECB would remain unchanged, the money supply would not increase and thus the goal of lower inflation again would not be thwarted. But of course, such a program would definitively remove the incentives for countries like Italy to tackle necessary reforms and put their public finances in order.

Consequences for financial markets

Bond yields: More inflation and higher US key interest rates in themselves suggest that the rise in bond yields is not quite over yet. On the other hand, there are increasingly clear signs of a recession in the US, to which the Fed is likely to respond by lowering key rates again in the end. All in all, we have made little change to our forecasts for the yield on the ten-year German government bond. We continue to assume that the rise in yields is not quite through yet with a view to the end of the year (see forecast tables at the end of the document).

EUR-USD: The EUR-USD exchange rate is likely to continue to suffer initially from special factors such as the Ukraine war and the risk of a halt in Russian gas supplies. But with the U.S. recession and Fed rate cuts we expect next year, the expected interest rate advantage of the US dollar should diminish again and EUR-USD should recover.

DAX: For equities, we remain more cautious than ever. According to our new forecasts, economic risks have increased significantly not only in the USA but also in the euro zone. Analysts are likely to significantly downgrade their still far too optimistic estimates for the corporate earnings of DAX companies. All in all, the correction in the DAX is unlikely to be over yet.

Natural gas supply as major risk

Hanging over all these forecasts like a sword of Damocles is the possibility that Putin will permanently turn off the gas tap completely. If this were to happen, the German economy would be plunged into a severe recession; in such a risk scenario, a collapse in GDP like that seen after the financial crisis (2009: -5.7%) would be realistic. First, all energy prices would rise massively, so that significantly more purchasing power would flow abroad than in the two oil price shocks of the 1970s. Second, in such a scenario, gas purchases would be rationed for numerous energy-intensive sectors, causing production there to collapse. Third, it would eliminate many inputs for other manufacturing sectors, leading to further production declines. If such a severe recession were to occur, the ECB would cancel its cycle of interest rate hikes and not resume them until the crisis was over.

Research contacts (E-Mail: firstname.surname@commerzbank.com)

Chief EconomistDr Jörg Krämer
+49 69 136 23650**Economic Research**Dr Jörg Krämer (Head)
+49 69 136 23650Dr Ralph Solveen (Deputy Head; Germany)
+49 69 136 22322Dr Christoph Balz (USA, Fed)
+49 69 136 24889Dr Michael Schubert (ECB)
+49 69 136 23700Dr Marco Wagner (Germany, Italy)
+49 69 136 84335Bernd Weidensteiner (USA, Fed)
+49 69 136 24527Christoph Weil (Euro area, France,
Switzerland)
+49 69 136 24041Hao Zhou (EM)
+65 6311 0166**Interest Rate & Credit Research**Christoph Rieger (Head)
+49 69 136 87664Michael Leister (Head Rates)
+49 69 136 21264Rainer Guntermann
+49 69 136 87506Hauke Siemßen
+49 69 136 49496Ted Packmohr
(Head Covered Bonds and Financials)
+49 69 136 87571Marco Stoeckle
(Head Corporate Credit)
+49 69 136 82114**FX & Commodities Research**Ulrich Leuchtmann (Head)
+49 69 136 23393Antje Praefcke (FX)
+49 69 136 43834Elisabeth Andreae (FX)
+49 69 136 24052Tatha Ghose (FX)
+44 20 7475 8399Charlie Lay (FX)
+65 63 110111You-Na Park (FX)
+49 69 136 42155Daniel Briesemann (Commodities)
+49 69 136 29158Carsten Fritsch (Commodities)
+49 69 136 21006Barbara Lambrecht (Commodities)
+49 69 136 22295**Other publications (examples)**

Economic Research: Economic Briefing (up-to-date comment on main indicators and events)
Economic Insight (detailed analysis of selected topics)
Economic and Market Monitor (chart book presenting our monthly global view)

Commodity Research: Commodity Daily (up-to-date comment on commodities markets)
Commodity Spotlight (weekly analysis of commodities markets and forecasts)

Interest Rate & Credit Research: Ahead of the Curve (flagship publication with analysis and trading strategy for global bond markets)
European Sunrise (daily comment and trading strategy for euro area bond markets)
Rates Radar (ad-hoc topics and trading ideas for bond markets)
Covered Bonds Weekly (weekly analysis of the covered bonds markets)

FX Strategy: Daily Currency Briefing (daily comment and forecasts for FX markets)
FX Hot Spots (ad hoc analysis of FX market topics)

To receive these publications, please ask your Commerzbank contact.

In accordance with ESMA MAR requirements this report was completed 24/6/2022 07:40 CEST and disseminated 24/6/2022 07:40 CEST.

This document has been created and published by the Group Research department (GM-R) within the Group Management division of Commerzbank AG, Frankfurt/Main or Commerzbank's branch offices mentioned in the document. Commerzbank AG is a provisionally registered swap dealer with the CFTC.

Please note that the author(s) certify that (a) the views expressed in this report accurately reflect their personal views; and (b) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this document. The research analyst(s) named on this report are not registered / qualified as research analysts with FINRA. Such research analyst(s) may not be associated persons of Commerz Markets LLC and therefore may not be subject to FINRA Rule 2241 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

It has not been determined in advance whether and in what intervals this document will be updated. Unless otherwise stated current prices refer to the most recent trading day's closing price or spread which may fluctuate.

Conflicts of interest

Disclosures of potential conflicts of interest relating to Commerzbank AG, its affiliates, subsidiaries (together "Commerzbank") and its relevant employees with respect to the issuers, financial instruments and/or securities forming the subject of this document valid as of the end of the month prior to publication of this document*:

Please refer to the following link for disclosures on companies included in compendium reports or disclosures on any company covered by Commerzbank analysts: <https://commerzbank.bluematrix.com/sellside/Disclosures.action>*

*Updating this information may take up to ten days after month end.

Disclaimer

This document is for information purposes only and does not take into account specific circumstances of any recipient. The information contained herein does not constitute the provision of investment advice. It is not intended to be and should not be construed as a recommendation, offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or commitment whatsoever. Investors should seek independent professional advice and draw their own conclusions regarding suitability of any transaction including the economic benefits, risks, legal, regulatory, credit, accounting and tax implications.

The information in this document is based on public data obtained from sources believed by Commerzbank to be reliable and in good faith, but no representations, guarantees or warranties are made by Commerzbank with regard to accuracy, completeness or suitability of the data. Commerzbank has not performed any independent review or due diligence of publicly available information regarding an unaffiliated reference asset or index. The opinions and estimates contained herein reflect the current judgement of the author(s) on the date of this document and are subject to change without notice. The opinions do not necessarily correspond to the opinions of Commerzbank. Commerzbank does not have an obligation to update, modify or amend this document or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

In order to address potential conflicts of interest Commerzbank's Research department operates independently of other business units of the bank. This is achieved by way of physical and administrative information barriers and separate reporting lines as well as by written internal policies and procedures.

This communication may contain trading ideas where Commerzbank may trade in such financial instruments with customers or other counterparties. Any prices provided herein (other than those that are identified as being historical) are indicative only, and do not represent firm quotes as to either size or price. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Any forecasts or price targets shown for companies and/or securities discussed in this document may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Commerzbank or by other sources relied upon in the document were inapposite.

Commerzbank and or its affiliates may act as a market maker in the instrument(s) and or its derivative that has been mentioned in our research reports. Employees of Commerzbank and or its affiliates may provide written or oral commentary, including trading strategies, to our clients and business units that may be contrary to the opinions conveyed in this research report. Commerzbank may perform or seek to perform investment banking services for issuers mentioned in research reports.

Neither Commerzbank nor any of its respective directors, officers or employees accepts any responsibility or liability whatsoever for any expense, loss or damages arising out of or in any way connected with the use of all or any part of this document.

Commerzbank may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Commerzbank endorses, recommends or approves any material on the linked page or accessible from it. Commerzbank does not accept responsibility whatsoever for any such material, nor for any consequences of its use.

This document is for the use of the addressees only and may not be reproduced, redistributed or passed on to any other person or published, in whole or in part, for any purpose, without the prior, written consent of Commerzbank. The manner of distributing this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves about and to observe such restrictions. By accepting this document, a recipient hereof agrees to be bound by the foregoing limitations.

Additional notes to readers in the following countries:

Germany: Commerzbank AG is registered in the Commercial Register at Amtsgericht Frankfurt under the number HRB 32000. Commerzbank AG is supervised by both the German regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Graurheindorfer Strasse 108, 53117 Bonn, Marie-Curie-Strasse 24-28, 60439 Frankfurt am Main and the European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany.

United Kingdom: This document has been issued or approved for issue in the United Kingdom by Commerzbank AG London Branch. Commerzbank AG, London Branch is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority and with deemed variation of permission. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website. This document is directed exclusively to eligible counterparties and professional clients. It is not directed to retail clients. No persons other than an eligible counterparty or a professional client should read or rely on any information in this document. Commerzbank AG, London Branch does not deal for or advise or otherwise offer any investment services to retail clients.

United States: To the extent this report is distributed to U.S. investors, it is restricted from being sent to U.S. retail investors. Commerz Markets LLC ("CMLLC") is a U.S. registered broker-dealer and wholly owned subsidiary of Commerzbank AG. For securities purposes, Commerzbank AG provides this report as a third-party report, therefore the involved research analysts may not be registered with FINRA and the reports are not subject to the full provisions of FINRA Rule 2242. Any securities transactions by US investors resulting from this report must be effected with CMLLC. CMLLC is a member of FINRA and SIPC. Banking and swap services in the U.S. will be provided by Commerzbank AG in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act. Commerzbank AG is not a member of SIPC and is a provisionally registered swap dealer with the CFTC.

Canada: The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. Under no circumstances is the information contained herein to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. In Canada, the information contained herein is intended solely for distribution to

Permitted Clients (as such term is defined in National Instrument 31-103) with whom Commerz Markets LLC deals pursuant to the international dealer exemption. To the extent that the information contained herein references securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, any trades in such securities may not be conducted through Commerz Markets LLC. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed upon these materials, the information contained herein or the merits of the securities described herein and any representation to the contrary is an offence.

European Economic Area: Where this document has been produced by a legal entity outside of the EEA, the document has been re-issued by Commerzbank AG, London Branch for distribution into the EEA. Commerzbank AG, London Branch is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority and with deemed variation of permission. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website.

Switzerland: This is an advertisement in the meaning of FIDLEG. The financial instruments mentioned in this publication do not constitute a participation in a collective investment scheme in the sense of the Swiss Collective Investment Schemes Act (CISA). This publication, the information contained herein as well as any other publication in connection with the financial instruments mentioned herein may be distributed exclusively to qualified investors as defined in the CISA and may only be made available to such qualified investors.

Singapore: This document is furnished in Singapore by Commerzbank AG, Singapore branch. It may only be received in Singapore by an institutional investor, an accredited investor or an expert investor as respectively defined in section 4A of the Securities and Futures Act, Chapter 289 of Singapore ("SFA") pursuant to section 274 or section 275 (as applicable) of the SFA. Nothing in this document constitutes accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication. Further, the communication/information provided herein does not constitute a "financial advisory service" within the meaning of the Financial Advisers Act, Chapter 110 of Singapore ("FAA") and therefore, the regulatory requirements and duties that may be owed to a client pursuant to or in connection with the FAA are not applicable to the recipient in connection with this communication. Recipients are advised to seek independent advice from their own professional advisers about the information contained discussed herein.

Hong Kong: This document, may only be made available in Hong Kong by Commerzbank AG, Hong Kong Branch to 'professional investors' within the meaning of the Securities and Futures Ordinance (Cap.571) of Hong Kong and any rules made there under, and persons whose ordinary business is to buy or sell shares or debentures.

Japan: This information and its distribution do not constitute and should not be construed as a "solicitation" under the Financial Instrument Exchange Act (FIEA) of Japan. This information may be distributed from Commerzbank international branches outside Japan solely to "professional investors" as defined in Section 2(31) of the FIEA and Section 23 of the Cabinet Ordinance Regarding Definition of Section 2 of the FIEA. Please note that Commerzbank AG, Tokyo Branch has not participated in its preparation. Any instruments referred in this report cannot be introduced by the Branch. You should contact the Corporate Clients division of Commerzbank AG for inquiries on availability of such instruments.

Australia: Commerzbank AG does not hold an Australian financial services licence. This document is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for Commerzbank AG under Class Order 04/1313. Commerzbank AG is regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) under the laws of Germany which differ from Australian laws.

People's Republic of China (PRC): This document is furnished by Commerzbank AG and is only intended for institutions that are eligible for financial transactions. No-one else may rely on any information contained within this document. Any derivative transactions by PRC persons may only be entered into by PRC financial institutions which are permitted to conduct derivatives business in the PRC and have obtained all necessary regulatory approvals in the PRC.

© Commerzbank AG 2022. All rights reserved. Version 22.03

Commerzbank Offices

Frankfurt	London	New York	Singapore	Hong Kong
Commerzbank AG	Commerzbank AG	Commerz Markets LLC	Commerzbank AG	Commerzbank AG
DLZ - Gebäude 2, Händlerhaus	PO BOX 52715	225 Liberty Street, 32nd floor,	71, Robinson Road, #12-01	15th Floor, Lee Garden One
Mainzer Landstraße 153	30 Gresham Street	New York,	Singapore 068895	33 Hysan Avenue,
60327 Frankfurt	London, EC2P 2XY	NY 10281-1050		Causeway Bay
				Hong Kong
Tel: + 49 69 136 21200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 631 10000	Tel: +852 3988 0988