

EU Parliament and ECB Agree on SSM

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According to *Handelsblatt*, the **European Parliament has reached a deal with the ECB on the SSM**. The compromise negotiated by ECB's Draghi and EP's Schulz addresses the issue of ECB accountability to MEPs on banking-related matters. The formal vote will reportedly take place on Thursday.

ECB's Asmussen discusses Minutes publication, forward guidance and liquidity position, arguing in favour of including who voted for what and the reasoning behind that vote in the Minutes. Mr. Asmussen also noted that *"the ECB remains ready to act if (liquidity) conditions deteriorate."*

Italian politics – Tensions easing, vote postponed, uncertainty continues. Senate committee in charge of deciding on Silvio Berlusconi's impeachment did not hold yesterday the much-feared vote to oust the PdL leader from parliament, and scheduled a more detailed discussion for Thursday. Signs emerged of easing tensions within the main parties, reducing the risk of an imminent government fall. But the schedule of the impeachment vote remains uncertain and bound to be revised on a daily basis, keeping political uncertainty high.

Germany: Greens are struggling in polls, *Handelsblatt* reports, losing 2pp from last week to 9% of voting intentions. Comment: implications for the election outcome not all that clear, depending on whether Greek supporters migrate to the centre-left SPD or decide not to vote.

French Fin Min to unveil main aspects of 2014 Budget today, including a budgetary effort of €18bn (0.9% of GDP) for 2014, of which €15bn from expenditure savings.

Italy – GDP details shows a larger QQ decline in Q2 (-0.3%), with a major negative contribution from inventories (-0.4% QQ). Comment: recent indicators point to a flat reading for Q3 GDP growth, but we doubt growth can accelerate any further into year end.

Greece – Jan-Aug state primary balance posts a surplus of €2.9bn, much better than targets and better than 2012 results. But one-off effects contributed to lift YTD revenues, which would have otherwise been quite weak.

Greece still needs financial help, once or possibly twice, ECB's Coene said, although he sounded more optimistic on the political willingness to support Greece.

Spain – government mulling over upgrading GDP forecasts in 2014 Budget.

ECB's Coene argues that Belgian banks continue to lend to the real economy and that their action has been refocused domestically

Slovenia – Latest t-bill auction, flat industrial production in July and new proposal on restructuring indebted companies

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Economics

Western Europe

Industrialised G7 Countries

Recent Research

Norway — Surprise Jump in Inflation again in August

In August, underlying inflation again surprised on the high side, overshooting Norges Bank's forecast by a full percentage point (following a 0.5pp overshoot in July). With the overall gain in recent months being broad-based, this suggests that inflation is accelerating faster than expected. One thing is for sure, following today's massive inflation overshoot, NB is likely to revise up substantially its forecasts for inflation and interest rates in the upcoming MPR.

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Norway — Centre-Right Victory

A center-right government is set to be formed following yesterday's general election. We do not expect any changes to the broad outline of economic policy, although a non-socialist government is likely to make its presence felt on structural issues. While fiscal policy looks set to become somewhat more

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Today's News in Detail

European Parliament agrees with ECB about Single Supervisory

Mechanism (SSM). *Handelsblatt* reports that the European Parliament has found an agreeable solution in its dispute with the ECB about the nature of ECB accountability to Parliament, according to a spokesman of EP President Schulz. The heads of the parliamentary groups in the EP are expected to assess the compromise which was negotiated by ECB President Draghi and Schulz on Tuesday and should they signal that they could agree to the proposal, the formal vote would take place on Thursday.

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ECB's Asmussen discusses Minutes publication, forward guidance and liquidity position - ECB Executive Board member Jörg Asmussen argued again that *"in my personal view, the minutes summarizing the main policy discussions should include who voted for what and the reasoning behind that vote."* He was quoted by Bloomberg adding that *"publishing the minutes in such a way will sharpen our mandate, because the ECB will then have to explain why its decisions are in line with its European mandate."* Mr. Asmussen acknowledged that at the same time, the ECB has been only *"moderately successful"* in curbing *"overreactions"* in rates to economic data. Mr. Asmussen also discussed the liquidity situation, noting that *"the ECB remains ready to act if conditions deteriorate."* Comment: the debate about the *"timely"* publication of ECB minutes is ongoing and it seems that sufficient progress has not been made for an announcement as early as the middle of September when the ECB Governing Council will meet to discuss matters not directly related to monetary policy. We would expect a common position to be agreed before year-end, as greater disclosure of Governing Council's discussion should help investors gauge the strength of the forward guidance commitment that could be stronger than currently assumed.

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Italy politics – tensions easing, vote postponed, uncertainty still to reign.

The Senate committee in charge of deciding on Silvio Berlusconi's impeachment did not hold yesterday the much-feared vote to oust PdL leader Silvio Berlusconi from parliament. The PdL speaker in the committee withdrew the three questions presented on Monday on which the committee was supposed to vote yesterday, in reported signs of reconciliation between Pdl and the other main political parties. A new meeting has been scheduled for Thursday and it has reportedly been agreed that a longer discussion on the merits of the case will be allowed to take place, as PdL requested, with the vote probably not taking place until next week. A meeting between centre-left PM Letta and deputy PM Angelino Alfano (PdL) took place last night – another sign of possibly easing tensions within the government coalition. And President Napolitano once again intervened to ask the parties to avoid a government crisis. Comment: as we have been arguing in the past few days, it remains doubtful to us whether any of the main political parties has a major interest in the government falling and even less in going to early elections. However, centre-left PD seems torn between ensuring political stability and calls from its supporters to oust the much-contested centre-right leader Berlusconi. The centre-right PdL is committed to preventing their leader being forced out of Parliament, but in our view the PdL may not go as far as bringing down the government (which would not guarantee Mr Berlusconi's future political career, anyway). Opinion polls suggest PdL may not be able to win an absolute majority if early elections were to be held today; moreover, if the current governing coalition breaks down, an alternative coalition (of PD and the more moderate MPs from the anti-establishment party M5S and from PdL itself) could probably be forged to support a new government and avoid the ballot boxes. However, even if the risk of an imminent government collapse may have receded, the schedule of the vote on Berlusconi's impeachment remains

expansionary next year, it will still be within what the fiscal policy rule allows for. In other words, the election outcome should not have any lasting impact on financial markets.

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Euro Economics Weekly — Germany — Four More Years

There are two main scenarios for the outcome of the German election on September 22: either the current CDU/FDP coalition will win a majority, or if it does not, a CDU/SPD 'Grand Coalition' will most likely result. Although the election is too close to call, Chancellor Merkel would remain Chancellor in both scenarios, most likely leaving German Eurozone policy to be gradual, cautious and reactive.

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UK Economics Weekly — Housing is Recovering, Not Bubbling

After persistent weakness in recent years, a range of indicators indicates that the housing market is now recovering strongly, with a marked rebound in mortgage approvals, turnover, starts and prices. We do not regard the housing recovery as a bubble. There is a large backlog of pent-up demand. We expect house prices to rise by about one third over the next 3-4 years, helping to lift the overall economy further.

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Euro Area — ECB Reiterates Forward Guidance, with Some Dovish Hints

As expected, the ECB Governing Council (GC) left all policy rates and non-standard measures unchanged at today's meeting. It also reiterated its forward guidance statement – "the key ECB interest rates to remain at present or lower levels for an extended period of time", as in the past two months. However, a few dovish hints appeared in today's press conference.

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UK — UK Data and Household Rate Expectations

uncertain and is likely to be revised on daily basis. Political uncertainty is bound to stay very high in coming days or weeks.

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Germany: Greens are struggling in polls. *Handelsblatt* reports on the poor performance of the Green Party in recent polls on German voting intentions. The latest Forsa poll gives the Greens only 9% of voting intentions, down 2pp from the week before. Comment: The Greens have struggled recently in the polls, even though the reasons are not clear. Possible reasons are: poor response from potential voters to Green Party positions on raising taxes (and spending) as well as discouraging meat consumption. Another interesting possibility is whether some voters on the centre-left may have switched their allegiances to the SPD, as they see little chance of the Greens being part of the next government. The implications of a weak Green performance are not all that clear. Should they simply migrate to the SPD, it would probably have little effect on the relative probabilities of a win for CDU/FDP vs the chances of a Grand Coalition, while low turnout by potential Green voters would presumably boost the chances of the former.

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French Fin Min to unveil main aspects of 2014 Budget – French business daily *Les Echos* reports that the French government will likely announce a budgetary effort of €18bn (0.9% of GDP) for 2014, of which €15bn (€9bn from the central and local government, and €6bn from social security) will come from expenditure savings. The €3bn of tax revenues are expected to come primarily from an intensification of the fight against tax evasion. On the issue of reducing the rate of corporate taxation from 33% to 30%, the paper suggests discussions are on-going and that the change could only apply from 2015. Finance Minister Pierre Moscovici and budget Minister Bernard Cazeneuve are scheduled to give a press conference at 10:30 (London time) on the main aspects of the 2014 budget. *Les Echos* report that the 2014 GDP baseline is expected to be revised down to 0.8% or 0.9% from the 1.2% pencilled in last April. After a probable deficit of slightly over 3.7% of GDP in 2013, the paper suggests that the government is targeting a budget deficit of 3.5% of GDP in 2014, and 3.0% in 2015. Comment: the budget will contain more tax measures than the headline figure will suggest, with €6bn of VAT rates hikes (already voted last autumn, but effective 1st January 2014) as well as €6bn of additional taxes to compensate for the 2013 expiring one-offs. The full budget will be unveiled on 25 September.

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Italy – GDP details show a larger QQ decline in Q2 (-0.3%), with a major negative contribution from inventories (-0.4% QQ). Private consumption remained very weak (-0.4% QQ), while business investment showed the first gain after nine quarterly declines. Exports expanded (+1.2% QQ, +0.2% YY) but at a still very muted pace relative to other euro area countries (for example Spain). Comment: the recession extended into Q2, and while recent indicators point to a flat reading for QQ GDP growth in Q3, we doubt growth can accelerate any further into year end.

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Greece – Jan-Aug state primary balance posts a surplus of €2.9bn, against the target for a primary deficit of €2.5bn and a primary deficit of €1.4bn in the same period of 2012, the Greek Finance Ministry said yesterday. YTD revenues were up by 5.6% YY in the first eight months of 2013 (partly thanks to one-off revenues from the transfers of ECB/Eurosystem profits on Greek bond holdings in July), while YTD primary expenditures were down by 7.2%. Comment: fiscal numbers remain broadly on track up to August, although this was partly due to some one-off deficit-reducing measures which may or may not be reflected in the

The ONS report that industrial production was stable MoM in July, with a small gain in manufacturing output (up 0.2% MoM) offset by declines in mining and utilities. Also out today, the quarterly BoE/NOP survey shows a marked decline (from 34% to 29%) in the share of people that expect interest rates to rise in the year ahead. The MPC's forward guidance policy seems to be getting some early success in convincing the general public that interest rates will stay low.

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UK — No Change from the BoE

As expected, the MPC left Bank Rate and QE unchanged at today's meeting. The MPC chose not to make any form of rate protest at the recent rise in market rate expectations. We suspect the MPC will only put their money where their mouth is -- ie resume asset purchases to drive market rates lower -- if the rise in market rates threatens to hit growth quite severely and push growth below trend. With the recent string of upside surprises in data, that pain threshold probably has not yet been reached.

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Scandi Economics Update —

Western Europe

Norway — Surprise jump in inflation again in August — Solberg: Oil spending well within fiscal rule.

Sweden — Parliament hearing on financial stability and macro-prudential policy — Prospera inflation expectations — Weak industrial production in July — Registered unemployment.

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final general government budget figures.

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Greece still needs financial help, once or possibly twice, ECB'S Coene said yesterday, arguing that *"It's clear that we are not yet at the end of the Greek problem"*, Reuters reported. However, Coene also sounded more optimistic on the political aspect of financial support for Greece: *"The problem at the start was about the willingness of other countries to help. This has been resolved by the governments and also by the ECB"*. Comment: as we have argued on many occasions, restoring financial sustainability and economic viability in Greece is now very much down to politics and the willingness of official lenders to grant further support measures and meaningful debt relief.

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Spain – government mulling over upgrading GDP forecasts. Spanish Economic Minister Luis De Guindos said yesterday the government will raise its GDP growth forecasts when preparing the 2014 Budget to be unveiled at the end of September. The official estimates currently foresee GDP falling by 1.3% in 2013 and expanding by 0.5% in 2014. The minister said the recessionary phase will come to an end in H2 2013. Comment: while we agree that GDP may stop falling in the second half of this year, we do not think the economy will be able to accelerate into 2014, as major headwinds from private deleveraging and tight fiscal policy will likely remain in place.

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ECB's Coene on the Belgian banking system - European Central Bank Governing Council member Luc Coene, who also is head of the National Bank of Belgium, spoke on RTBF Radio, indicating that Belgian banks continue to lend to the real economy, and that their action has been refocused domestically. Speaking on Belgian radio RTB, Mr. Coene added that Belgium was now better armed to tackle its bank problems. He warned that liquidating the country's largest bank prematurely would likely cost Belgium billions of euros.

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Slovenia – MinFin sold €100.9mn in t-bills and slightly increase its cash buffer

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MinFin sold €55.1mn of 12M t-bill with yield at 2.95%, €25.3mn of 6M t-bill at 1.45% and €20.5mn of 3M t-bill at 0.49%. While the yields of 6M and 12M t-bills were unchanged compared to June auction, the 3M yield increased by 10bp. The sold amount exceeded the initial plan of €60mn. The next auctions of t-bills with the same maturities will be held on 8 October and 10 December. An amount of around €366mn (including t-bills) is due for redemption in Sep-Dec this year (of which €335mn in 4Q13, while MinFin assumes only €78.2mn taking into account t-bills in net terms), followed by €3.4bn in 2014 (with €1.5bn in April and October among the largest amounts), while MinFin assumes €3.1bn, if there t-bills are rolled over. Comment: Banking statistics suggest to us central government bank deposits of €4.2bn in July this year (up from an average €3bn in 2012). The conservative scenario (that takes into account the redemption profile, no issuance of t-bills in forthcoming months, a €2bn deficit this year, followed by 3.4% and 2.4% deficits in the next two years, gradual monthly recapitalization payments of €1.2bn from Oct12 until end of 2014 and redemption of bad loans in the bad bank at €1.5bn in 2015 due to the transfer of €2bn bad loans and does not assume any privatization revenues) suggests to us government deposits of €2bn in 1Q14 and zero in 2Q14. A less conservative scenario that assumes rollover of t-bills and no cash expenditures related to the banking sector suggests to us a cash buffer of €3bn in 1Q14, €1.2bn in 2Q14 and €0.9bn in 3Q14.

Slovenia – Industrial production flat in July, but export order-books look

supportive

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Industrial production fell slightly by 0.1% MM in July, which resulted in and easing of YY contraction to zero from -1.4% (SA) a month ago. The July outturn was worse than we expected (1% MM). As industrial confidence improved only slightly in August owing to worse production expectations and higher inventories, but order books (also export order books) improved after dropping in July, we expect industrial production to remain flat on a monthly basis also in August, which is likely to result in a 2% YY contraction due to adverse base effects, which will however be offset in September by benign base effects, which will continue also in 4Q13. As a result we expect industrial production to fall by 0.3% YY in 3Q13 after -1% in 2Q13 (-0.7% in 2012), followed by 1.6% YY growth in 4Q13. We expect industrial production to be supported by improved foreign demand (and industrial production in the euro area). August's improved assessment of export order books in manufacturing suggests export dynamics remaining around 5%-7% YY growth after 2.5% YY average growth in the first seven months of 2013 after which the trade deficit in goods narrowed to 2% of GDP in July 2013 from -4% a year ago, which also reflects a milder increase in imports by an average 0.1% YY in Jan-Jul this year. Comment: For the time being, we think that this outcome remains consistent with our forecast of a 2.2% YY fall in GDP this year after -2.4% last year, followed by 0.3% contraction in 2014. We expect GDP to fall cumulatively by 0.5% in 2H13 with ongoing headwinds from fiscal policy. Though external demand prospects are improving, we think that the announcement of complex banking stress-test results by the end of 2013 is likely to keep uncertainties high, with negative consequences for domestic demand.

Slovenia – Proposal to speed up restructuring of indebted companies.

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The new Justice Ministry proposal is expected to support a smooth financial restructuring procedure without stepping into court procedures. According to the proposal, the management of companies, once aware of insolvency on a year horizon, should offer a framework agreement to creditors, according to Slovenian Press Agency. The proposal includes a creditors' option for debt-to-equity conversion, and management changes once creditors' equity reaches 50%. The agreement on restructuring has to be signed by creditors holding at least 50% of total claims (75% in some cases). Comment: To speed up the restructuring process (by September this year) was part of one of the nine recommendations of the European Commission to Slovenia in early June this year. According to the World Bank's *Doing Business* statistics, Slovenia was ranked in 42nd place on the issue of resolving insolvency because it takes four years (Germany 1.2 years), costs 18% of estate (Germany 8%) and the recovery rate was 50% (Germany 78%).

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Latest Issues of Sovereign Debt Crisis Update

Delays in Berlusconi and Banking Union Votes

Western Europe

Italy's Senate Committee votes on Berlusconi's impeachment possibly tonight - government at risk. EU Parliament delays vote on Single Supervisory Mechanism. In Germany, the SPD advances in another poll. EU's Rehn says Commission needs more details about French competitiveness strategy. French unemployment insurance reform debate delayed. Greece: July data still weak, but government eyes smaller 2013 GDP decline. Slovenia: recent trends in voter preferences. Slovakia: IP decelerates in July.

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Italy: Senate Committee Reviews Berlusconi Impeachment

Western Europe

Italy's Senate Committee starts debating Berlusconi's impeachment today - we believe a compromise may still be found to delay the vote, keeping Berlusconi in parliament for a few more months. German election: SPD makes some headway in opinion polls. Slovenia: Government guarantees up to €1.03bn for two small banks. French 2014 Budget and 3Q GDP. Spain's pension reform to result in about 6% lower pension benefits. Portugal's 2Q gain in private consumption. Greece to tap unused EU fund.

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ECB Dovish Hints, But No Changes to Forward Guidance

ECB reiterates forward guidance statement, but presents dovish hints. French corporate taxes could drop in 2014, says FinMin, but few French voters believe tax pressure will drop soon. German banks do not want common deposit insurance. Germans fear euro crisis. Italy's President warns against government collapse. Italy's tax revenues rise. Spain's weak industrial activity. ECB won't join in debt relieving measures for Greece. Portugal and Ireland working on precautionary credit lines.

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Italy – Uncertainty on Future of Letta Government

Italy's PM Letta says "The government can last longer", but we believe probability of govt collapse has clearly increased. ECB's Asmussen on state of play for banking union and the weaknesses of the bank resolution framework. German SPD chief accuses Merkel of breaking German law on eurozone actions. More signs of a limit to increase in French fiscal pressure. Spain's FinMin upbeat on 2014 economy. Fitch fairly upbeat on Greek progress in restructuring banks, Dijsselbloem says new aid likely.

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Berlusconi Threatens to Pull Support from Government by Friday

Despite Berlusconi's threats, we still believe an Italian government collapse is in no party's interest. German public sceptical on further eurozone support measures - poll. OECD raises EU growth forecasts. Estimated savings of 3.7% of GDP from Spain's public administration reform. Greek govt at odds with troika on overhaul of state-owned companies. German public confident on future. ECB's Asmussen calls for G20 reform. Ireland's tax receipts. Slovene privatisation schedule.

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Spain Presents New Pension Reform

Spain's proposed pension reform introduces intergenerational "sustainability factor". ECB's Coeure supports publication of ECB Minutes, warns against imposing constraints on OMT. German FinMin rejects retroactive ESM direct bank recap. Competitiveness discussions by French firms, government. Italy's state sector cash balance worsens. Spain's registered unemployed broadly unchanged. Greece sees YTD general government primary budget surplus. Slovenia's nonperforming claims increase further.

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Macroeconomic Forecasts

European Economic Forecast Highlights — August 2013

Western Europe

This companion to Global Economic Outlook and Strategy - August 2013

contains detailed quarterly forecasts for the main European countries to end 2014. Tables 20-21 give annual forecasts to 2017 for growth, inflation, short-term interest rates, current balance, fiscal balance and government debt. Table 22 shows the change in our forecasts from last month. Figures 23-25 compare current forecasts for each country.

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Global Economic Outlook and Strategy — August 2013

Global, Pan Asia, GEMS, Americas, EMEA, Asia, Australia

We cut 0.1% off our 2013 global growth forecast this month (to 2.4%), but lift our 2014 forecast by 0.1% to 3.2%. We highlight four key issues that will shape the economic and market outlook in coming months: Fed tapering, Japan's consumption tax hike choices, the EM slowdown, plus renewed focus on issues of longterm fiscal sustainability in various EMU periphery countries. We pencil in the first Fed hike for 2015, with an even longer period of ultra-low rates likely from the ECB, BoJ and BoE.

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Appendix A-1

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