

## Economics

17 June 2011 | 16 pages

# Euro Weekly

## Uncertainty Regarding Greece and Inflation

- Euro area inflation is likely to peak around 3%YY in coming months. Supported by benign base effects and likely declining oil prices, inflation rates probably will moderate substantially in autumn 2011 and spring 2012. However, we expect that further gains in food prices and roughly stable core inflation rates will leave inflation above 2% in 2012. In this environment, we expect that the ECB will continue with gradual rate hikes — 25bp per quarter — after the widely-expected rate hike in July. However, in case of a larger than currently expected slowdown of the economy, the ECB might delay the post-July rate hikes (Jürgen Michels, see page 2).
- Some consensus seems to have been reached among Greece's official lenders on further liquidity support for the country, reducing the risks of a short-term Greek default. However, domestic political risks in Greece are on the rise. Political and economic fatigue has become more evident recently, jeopardising further chances of Greece meeting its economic and fiscal targets (Giada Giani, see page 6).

### Michael Saunders

+44-20-7986-3299

michael.saunders@citi.com

### Jürgen Michels

+44-20-7986-3294

juergen.michels@citi.com

### Giada Giani

+44-20-7986-3281

giada.giani@citi.com

**Figure 1. Citi Market Forecasts**

	\$/€	Euro Repo	10-yr Bunds	£/€	U.K. Bank Rate	10-yr Gilt-Bund	SKr/€	SEK Policy Rate	NOK/€	NOK Policy Rate	SFr/€	CHF Policy Rate	CHF Spread vs Bunds
End 3Q 11	1.37	1.50	3.45	0.85	0.75	50	9.02	2.25	7.89	2.50	1.25	0.50	-110
End 1Q 12	1.47	2.00	3.75	0.87	1.25	55	8.85	2.75	7.82	3.00	1.33	1.00	-105

Source: Citi Investment Research and Analysis

**Figure 2. Greece — Timeline of Events**

Greek Front	
Friday, 17 June	Prime Minister, George Papandreou, presents the new cabinet
Sunday, 19 June	Parliamentary debate starts on the vote of confidence
Tuesday, 21 June, late evening	Vote of confidence in the new government
Sometime late June	Parliamentary approval of the new austerity package, depending on the result of the confidence vote. If confidence vote fails, early elections probably will be called
Lenders' Negotiation Front	
Friday, 17 June	Merkel-Sarkozy meeting
Sunday, 19 June	Eurogroup (euro area finance ministers) meeting. Likely to discuss the disbursement of the next tranche of EUR12bn to Greece
Monday, 20 June	Eurogroup (euro area finance ministers) meeting. Likely to discuss the second bailout package for Greece
Thursday 23/Friday 24 June	EU Council (EU Heads of State and Government) meeting. Decisions on the EFSF enlargement, future ESM shape and possibly the Greek crisis
Sometime in late June/early July	Disbursement of the next tranche of EUR 12bn to Greece, subject to parliamentary approval of the measures in Greece
Monday, 11 July	Eurogroup (euro area finance ministers) meeting. Decision on the second Greek bailout package and private sector involvement

Source: Citi Investment Research and Analysis

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contact michael.saunders@citi.com

or jan.maguire@citi.com

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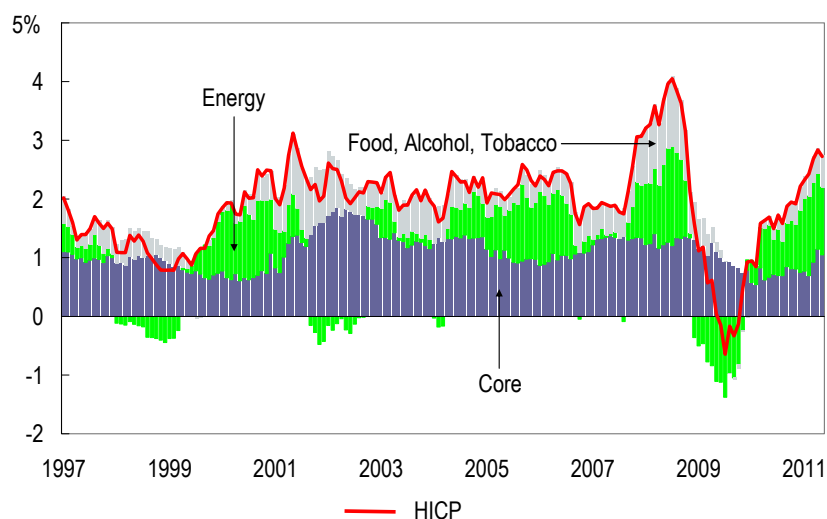
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## Euro Area — Inflation Outlook

### Inflation outlook key for future ECB rate decisions

The sovereign debt crisis and the question of the involvement of private investors in the second Greece rescue package have featured heavily in recent statements by ECB officials. But, ECB President Jean Claude Trichet and his fellow Board Members left no doubt that the outlook for inflation would be the dominating factor for setting interest rates in coming quarters. After five months of consecutive gains, euro area inflation edged down to 2.7% YY in May, still well above the ECB's comfort zone. Looking ahead, we expect inflation rates to peak around 3% YY in coming months. After that, strong base effects probably will contribute to a substantial reduction in headline inflation rates. However, while there is still low underlying inflationary pressure — mainly reflecting modest wage growth — we expect that further gains in food prices and stable core inflation rates will keep headline inflation rates above the ECB's goal of inflation "*below, but close to 2%*". With this outlook for inflation, we expect the ECB to go ahead with further rate hikes unless there are signals of a substantial economic slowdown.

Figure 3. Euro Area — Inflation and Contribution from Components, 1997–May 11

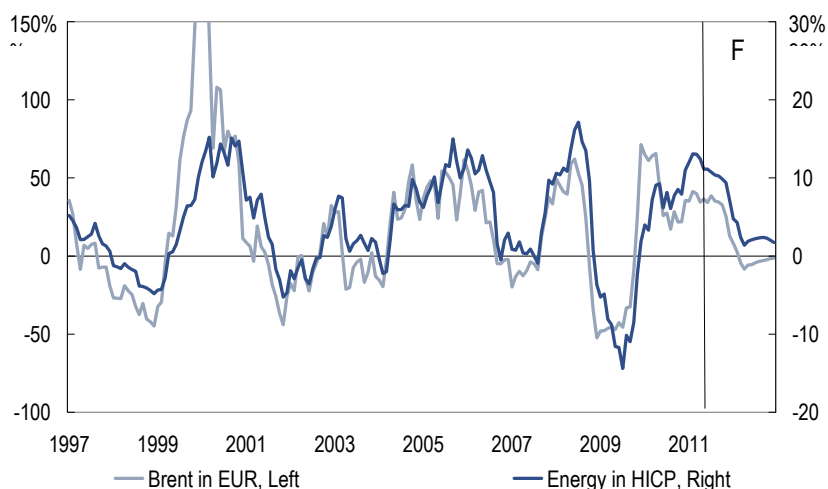


Sources: Haver and Citi Investment Research and Analysis

### Energy prices have been the main driver of inflation

The increase in energy prices has been the driving factor behind the rise in headline inflation rates since the trough at -0.6% YY in July 2009 (see Figure 3). While base effects played a significant role in the sharp gain in YY rates, there was also a substantial gain in the energy component of the HICP — which now has a weight of 10.4% of total HICP — by 22% between March 2009 and May 2011. This gain in the HICP energy component has been led by a surge in crude oil prices by 156% in USD terms and 132% in EUR terms during that period. With the latest rebound in oil prices, increasing energy prices probably will propel overall inflation again in June. However, based on the current pricing of the futures, prices for Brent are likely to moderate in coming quarters and in combination with our exchange rate forecast, EUR-denominated oil prices are likely to decline. Although feeding through with some lag into the energy price component of the HICP, the decline in oil prices is likely to lead to a drop in the YY rate of the HICP energy prices from currently 11.1% to around 9% by the end of 2011 and 2% in mid-2012 (see Figure 4).

Figure 4. Euro Area — Oil and Energy Prices, 1997-2012F

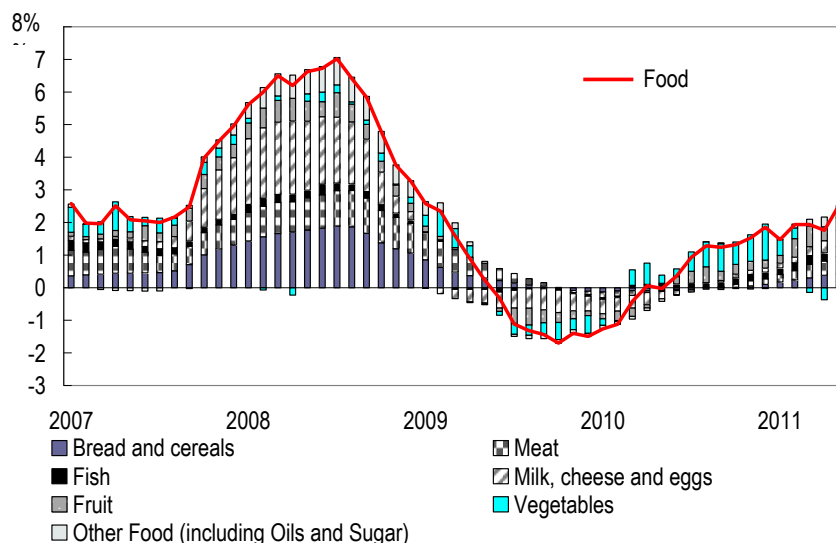


Sources: Ecowin and Citi Investment Research and Analysis

#### Upside pressure on food prices limited so far...

While increasing prices for food, alcohol and tobacco also contributed to an increase in headline inflation in recent months, the contribution so far has been less than half of the contribution those price gains had on headline inflation in the previous period of surging food prices in 2008. The split of food prices shows uneven developments (see Figure 5). After increasing significantly in 2010 and early 2011, in recent months a drop in prices for vegetables limited the increase in total food prices. With the current fall in prices for vegetables due to uncertainty caused by the E.Coli/EHEC bacterium, vegetable prices probably will drop in June, limiting the gain in the YY rate of food prices and the headline HICP. However, with the recent drought, vegetable prices (with a weight of 11% of food prices and 1.6% of the HICP) are likely to increase again in late summer/ autumn.

Figure 5. Euro Area — HICP Food Prices and Contribution from Components, 2007–May 11

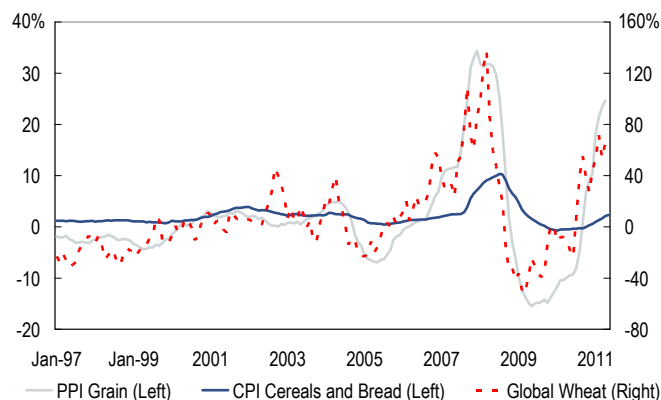


Sources: Haver and Citi Investment Research and Analysis

...but higher food price gains are in the pipeline

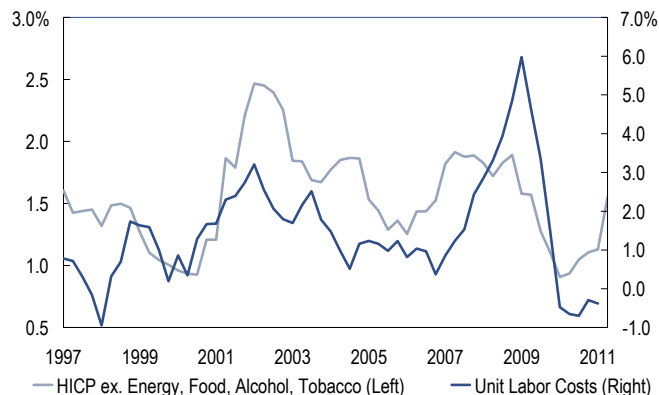
Apart from that, there are clear trends of rising prices for meat, fish and dairy products, which are partly reflecting a change in the behaviour of retailers — e.g. the “*butter war*” among German retailers regarding the lowest prices for dairy products seems to have ended — and also the move in global prices for these goods. As we have argued last year, particularly prices for bread and cereals (with a weight of 18% of food prices and 2.6% of the HICP) follow developments in global prices for these goods.<sup>1</sup> In that respect, the surge in producer prices for grain products by 24.7% YY in April signals that there are more gains in prices for bread and cereals in the pipeline (see Figure 6). We expect that the YY rate (currently at 2.3%) is likely to at least triple in the course of this year. With this development, we expect an increase in the YY rate of food prices from currently (May) 2.7% to around 4½% by the end of 2011 and around 5% in mid-2012.

Figure 6. Euro Area— Producer and Consumer Prices for Cereals and Global Wheat Price (Pct. YY), 1997–May 2011



Sources: Haver and Citi Investment Research and Analysis

Figure 7. Euro Area Countries — Core Inflation and Unit Labor Costs (Pct. YY), 1997–2Q 2011



Sources: Haver and Citi Investment Research and Analysis

Core inflation little cause for concern...

As Figure 3 shows, the contribution of core inflation (weight of 70.3% of headline HICP) has been modest so far. We do not think that this will change much in coming months. Indeed, after some temporary upward distortions in recent months, partly due to indirect tax increases and distortions caused by the change in the seasonal adjustment procedure in some countries, the core inflation rate is likely to moderate somewhat during the summer. With further indirect tax hikes in the pipeline and probably somewhat higher unit labor costs, we expect core inflation rates around 1½% for the time being.

...as wage growth remains modest

Regarding the domestic price pressure, ongoing negative YY rates in unit labor costs (available up to 1Q 2011) suggest that there is still little reason to be concerned (see Figure 7). While increasing from 1.5% YY in 4Q to 1.9% in 1Q 2011, the growth rate of negotiated wages remains 0.8 standard deviations below its long-term average. Looking forward, upbeat hiring plans of euro area companies — despite the recent slowdown — suggest that negotiated wage growth is likely to increase in coming quarters (see Figure 8). Normally, negotiated wages follow moves in employment plans with a lag of around one year. However, as recent wage agreements in strong-performing Germany remained modest and wage moderation in most periphery countries is on its way, we expect negotiated wages not to increase much more than 2½ % YY in the course of the year.

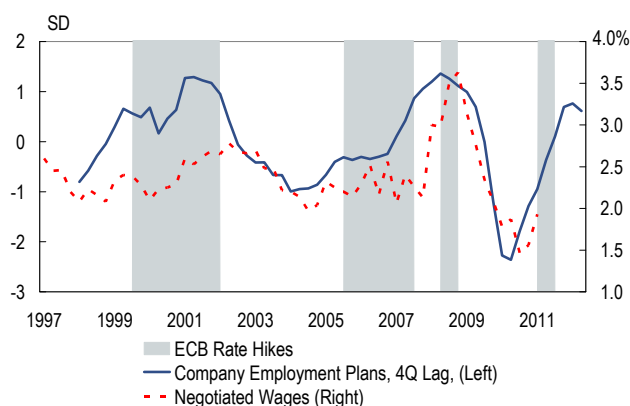
Uncertainty about the output gap

The development of wages and underlying price developments will be also determined by the remaining slack in the economy coming out of the recent

<sup>1</sup> Euro Weekly: Low Inflationary Pressure, Despite Wheat Price Surge, 6 August 2010

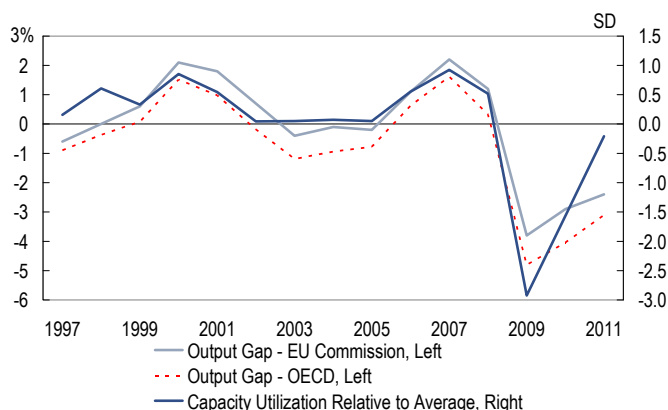
recession. In that respect, there is currently increased uncertainty how large the negative output gap in the euro area is. The estimations of the EU Commission and the OECD suggest that the output gap in the euro area is still sizable — in a range between 1¼% and 1½% of potential GDP. In contrast to these estimates, recent moves in capacity utilisation in the manufacturing sector — normally a measure close to the outcomes of the EU Commission and OECD estimates — signal that the output gap has almost closed in 1H 2011 (see Figure 9). With this uncertainty regarding the current stance of the economy, it remains uncertain GDP growth in coming quarters will affect inflation.

**Figure 8. Euro Area — Employment Plans and Negotiated Wages, 1997 – 2Q 2011**



Sources: Haver and Citi Investment Research and Analysis

**Figure 9. Euro Area — Output Gap, 1997–May 2012**



Sources: Haver, EU Commission and Citi Investment Research and Analysis

**With inflation likely above 2% in 2012, the ECB is likely to go ahead with further rate hikes**

Overall, we expect that inflation will peak around 3%YY in coming months. Supported by benign base effects and likely declining oil prices inflation rates, inflation probably will moderate substantially in autumn 2011 and spring 2012. However, we expect that further gains in food prices and roughly stable core inflation rates will leave inflation rates on average at 2.1% YY in 2012. This would be above the midpoint of the ECB's staff projection (1.7%) and the ECB's medium-term target of "below, but close to 2%". Based on our inflation scenario — which suggests that some of the upside risks relative to the ECB's staff base scenario will materialise — we expect that the ECB will continue with gradual rate hikes — 25bp per quarter — after the widely-expected rate hike in July. However, in case of a larger than currently expected slowdown of the economy, the ECB might delay post-July rate hikes.

## Greece — Still in the Midst of the Storm

**Some short-term positive news, but political risks still high**

The pace of developments in the Greek saga has accelerated over the past week. With many fronts open for negotiations, once again policymakers seem to have opted for fixing the most imminent problem — the EUR 12bn disbursement to Greece in the next few weeks — while some uncertainties remain on the financing of a second Greek bailout and the role of the private sector in it. As we argued last week, it seems pretty likely now that a second bailout program for Greece will be put in place and we think the role of the private sector will probably be limited to some form of voluntary commitment to debt rollover over the next two to three years. Yet, we reckon the key uncertainty surrounding all these decisions remains the domestic political developments in Greece. Risks of running into early elections, perhaps later this year, have increased, with the possible outcome looking highly uncertain. This in our view would further reduce the chances of Greece being able to deliver on its deficit and privatization targets and it would potentially jeopardize further the ability/willingness of official and private creditors to continue their support to Greece.

**Events in the next few weeks will likely shape Greece's future**

The intense schedule of events over the next few weeks is likely to keep market attention on Greece high, as these events will likely be crucial in shaping out Greece's future (see Figure 2 on the front page). The major uncertainty remains around the domestic political developments, in our view. The cabinet reshuffle announced this week by the Greek Prime Minister, Mr Papandreou, is probably aimed at regaining some support from his Socialist Party (PASOK), amidst a broader battle to gain parliamentary approval for the new austerity measures. While we think that the vote of confidence after the presentation of the new ministries — scheduled for Tuesday 21 June in the evening — is likely to pass, this does not necessarily guarantee approval of the fiscal package. This still seems the required condition for the IMF (and presumably for the euro area governments) to continue their financial support to Greece.

**The Socialist governing party losing support on all fronts...**

Mr. Papandreou's evident loss of support over the last few weeks — likely caused by the intensification of street protests as well as by the PM's failure to get the main opposition party on board for the new austerity package — suggests to us that the chances of early elections at some point later in the year have probably increased. A recent opinion poll last week suggested that the main opposition party New Democracy (ND) is now in the lead with 31%, while PASOK follows with 27%. This is a further deterioration relative to one month ago, when PASOK and ND were equally positioned at around 32%. Last week's survey also showed 38% of the respondents would not vote in the next election. For the first time since the last general elections in 2009, the popularity of the Prime Minister has fallen to the same level as his main opponent from ND, Mr Samaras.

**...increasing the chances of early elections**

The results of potential early elections are far from clear at this stage but would most likely fail to deliver a strong majority. Early elections would also imply more time will be wasted before starting the implementation of the new fiscal austerity measures and privatization process, jeopardizing the ability of Greece to meet its targets on the fiscal deficit and privatization receipts.

**Next tranche of IMF/euro area loans more likely to be disbursed now...**

On the other hand, some marginally more positive developments have occurred in the past week on the other negotiating front — the one among the official lenders of Greece. Some consensus emerged on Thursday on the disbursement of the next tranche of loans (EUR12bn) due by end-June/early July. The IMF said it would be ready to continue its support to Greece subject to the approval of the new austerity measures. This suggests it lifted in some way the previous additional condition it had required for a formal agreement among European policymakers on official financing for the next 12 months (the second Greek bailout program). The IMF seems to have accepted the verbal commitment from European policymakers that

eventually the money will be put on the table to fill the funding gap for Greece. The IMF spokeswoman said on Thursday *"progress is being made in the discussions to ensure the full financing of the program, and we anticipate a positive outcome on this at the next Eurogroup meeting"*. This was reinforced by the EU Commissioner Olli Rehn's official statement *"I am confident that Sunday, the Eurogroup will be able to decide on the disbursement of the fifth tranche of the loans for Greece in early July. And I trust that we will also be able to conclude the pending review, in agreement with the IMF."*

...although still subject to political developments in Greece

Yet, uncertainty remains around what would happen in case the Greek Parliament does not approve the new austerity package and whether official lenders would be still willing to go ahead with the next disbursement. We think probably yes, but we reckon risks of a more negative development are still quite elevated.

The second Greek bailout is taking shape, with a soft version of private sector involvement...

At Friday's informal tête-à-tête between Angela Merkel and Nicolas Sarkozy, some consensus seems also to have emerged on the other issue of how to finance the second Greek bailout, although a final decision may not be reached until 11 July (the scheduled Eurogroup meeting for July). In contrast to some press reports earlier in the week, Ms Merkel said it would not be in the interest of Germany to delay a decision until September. With regard to the much-debated issue of whether and how to involve private investors in the program financing, Merkel and Sarkozy said that this involvement would have to be completely voluntary, not triggering a credit event and coordinated with the ECB. Ms Merkel added that *"a Vienna-style initiative would be a basis for the involvement of the private sector."* Hence Germany seems to have given in on its tougher proposal to achieve a broad-based extension of the outstanding Greek bonds. A softer voluntary debt rollover of expiring bonds over the next two to three years, probably with European and Greek private banks as the main participants, seems the most likely outcome — at least in the short term — of the negotiations on private sector burden sharing in financing Greece.

...which may please the ECB

As argued last week, this solution would probably prevent rating agencies from downgrading Greek bonds to "D" (defaulted) grade. This week Fitch said in a report that if a Vienna-style deal was implemented, they would proceed with the downgrade of the Greek sovereign bonds *"to a low non-investment grade rating — probably in the region of 'CCC'"* (from the current B+), but they would likely not assign a default "D" rating to these securities. This would reflect the fact that they will be still repaid in line with their original terms, albeit with a commitment to roll over the principal immediately into new securities. However, Fitch said in this scenario they would still downgrade the Greek sovereign's Issuer Default Rating to "RD", restricted default. But this outcome would probably be acceptable for the ECB in order to be able to continue accepting the Greek paper as collateral in their open market operations. Even in the case the ECB would not accept these, it would probably tolerate that the Central Bank of Greece accepts this collateral in the Emergency Liquidity Assistance (ELA).

A broad-based debt restructuring in the medium term still highly probable

All in all, although the short-term risks of a missed payment on the Greek debt may have diminished somewhat in recent days, we still believe that a broader-based involvement of the private sector — either in terms of a more coercive extension of the bond maturities or, eventually, of outright haircuts to the principal — remains a clear possibility for the future. Recent events have proved that political and economic fatigue has already emerged, probably earlier than we (and perhaps official creditors) had expected. This further reduces the chances of a successful implementation of the Greek adjustment program to restore financial sustainability for the country. Eventually a debt restructuring will have to happen, in our view, but probably not before the end of the new bailout program, some time in 2013-14.



**Key Economic Indicators (20 June –24 June 2011)**

<b>Sunday 19 June</b>		<b>Forecast</b>	<b>Last</b>
18:00	Euro Area: Eurogroup Meeting of euro area Finance Ministers (Luxembourg)		
<b>Monday 20 June</b>		<b>Forecast</b>	<b>Last</b>
07:30	Euro Area: Eurogroup Meeting continues		
07:00	Germany: Producer Prices, May	-0.2% MM, 5.9% YY	1.0% MM, 6.4% YY
09:00	Italy: Industrial Orders, Apr	-4.5% MM	+8.1% MM
09:00	Euro Area: Balance of Payments, Apr		
10:00	Euro Area: Labor Cost Index, 1Q		
14:00	EU: ECOFIN Meeting of EU-27 Finance Ministers (Luxembourg)		
<b>Tuesday 21 June</b>		<b>Forecast</b>	<b>Last</b>
09:30	UK: Public Sector Net Borrowing, May	£17.0 Billion Deficit	May 2010: £18.3 Billion Deficit
	Fiscal Year To Date, Apr-May	£27.0 Billion Deficit	Apr-May 2010: £25.5 Billion Deficit
10:00	Germany: ZEW Economic Expectations, Jun	-3.0	3.1
11:00	UK: CBI Industrial Trends: Output Expectations, Jun	+24%	+20%
	CBI Order Books, Jun	-2%	-2%
	CBI Selling Prices, Jun	+26%	+24%
	Greece: Current Account, Apr		
<b>Wednesday 22 June</b>		<b>Forecast</b>	<b>Last</b>
07:45	France: Industrial Confidence, Jun	105	107
08:15	Sweden: Consumer Confidence, Jun	17.6	17.9
	Manufacturing Confidence, Jun	9	11
08:30	Sweden: Unemployment Rate, May	7.8%	7.9%
08:30	Netherlands: Consumer Confidence, Jun		
09:00	Norway: LFS Unemployment, Apr		
09:30	UK: MPC Minutes (Jun 9)		
09:30	UK: BoE Agents' Summary of Business Conditions (Jun)		
10:00	Euro Area: Industrial New Orders, Apr	0.8% MM, 13.8% YY	-1.6% MM, 12.3% YY
13:00	Norway: Norges Bank Interest Rate Announcement	Unchanged at 2.25%	2.25%
15:00	Euro Area: Consumer Confidence, Flash Estimate, Jun	-13	-12
17:30	US: FOMC Outcome		
<b>Thursday 23 June</b>		<b>Forecast</b>	<b>Last</b>
07:00	Switzerland: Trade Balance, May		
08:30	Sweden: Producer Prices, May	0.1% MM, 2.0% YY	0.0% MM, 1.9% YY
08:30	Netherlands: GDP, 1Q Details		
08:30	Netherlands: Unemployment, May		
09:00	Italy: Consumer Confidence, Jun	105.5	106.5
09:00	Euro Area: Manufacturing PMI, Jun Flash	54.5	54.7
	Services PMI, Jun Flash	55.5	56.0
	Composite PMI, Jun Flash	55.4	55.8
09:30	UK: BBA No. of Mortgage Approvals for Home Purchase, May		
11:00	UK: CBI Retail Survey, Jun		
<b>Friday 24 June</b>		<b>Forecast</b>	<b>Last</b>
	EU: European Council of EU Heads of State and Government		
07:45	France: Consumer Confidence, Jun	83	84
08:00	Spain: Producer Prices, May		
08:30	Netherlands: Consumer Spending, Apr		
08:30	Netherlands: Producer Confidence, Jun		
09:00	Norway: Unemployment Rate, Apr	3.3%	3.3%
09:00	Germany: ifo Business Climate, Jun	113.2	114.2
09:00	Italy: Retail Sales, Apr		
09:30	UK: Investment by Insurance Companies and Pension Funds, 1Q		
10:30	UK: BoE Financial Stability Report and Press Conference		

Sources: National statistical offices, central banks and Citi Investment Research and Analysis



## Economic Indicators

### Euro Area

Jun 22 10:00	<b>Industrial New Orders, Apr</b>	<b>Forecast: 0.8% MM, 13.8% YY</b>	<b>Prior: -1.6% MM, 12.3% YY</b>
London Time	After the sharp fall in March, that probably reflected some impact from the events in Japan, industrial orders are likely to rebound in April, as some available national reports suggest.		
Jun 22 15:00	<b>Consumer Confidence, Jun Flash</b>	<b>Forecast: -13</b>	<b>Prior: -12</b>
London Time	We expect a third consecutive decline in consumer confidence in June, partly reflecting the fiscal tightening feeding through in many member countries. There might be also a temporary negative impact from the E.coli outbreak on consumer sentiment in some countries, particularly Germany.		
Jun 23 09:00	<b>Manufacturing PMI, Jun Flash</b>	<b>Forecast: 54.5</b>	<b>Prior: 54.7</b>
	<b>Services PMI, Jun Flash</b>	<b>Forecast: 55.5</b>	<b>Prior: 56.0</b>
London Time	<b>Composite PMI, Jun Flash</b>	<b>Forecast: 55.4</b>	<b>Prior: 55.8</b>

Following the sharp fall in May, we expect another decline in the PMI readings in June. However, the expected third fall in the last four months is likely to be smaller than in May. We expect the PMI readings to stay above 50 and even above their long-term average readings in June, suggesting a slowdown in GDP growth, but not a sharp one.

### Germany

Jun 20 07:00	<b>Producer Prices, May</b>	<b>Forecast: -0.2% MM, 5.9% YY</b>	<b>Prior: 1.0% MM, 6.4% YY</b>
London Time	The temporary drop in energy prices probably contributed to a small decline in producer prices compared to the previous month. However, the YY rate remains elevated and the feed through of the earlier increase in commodity prices seems not to be over yet.		
Jun 21 10:00	<b>ZEW Economic Expectations, Jun</b>	<b>Forecast: -3.0</b>	<b>Prior: 3.1</b>
London Time	ZEW Business expectations probably will drop into negative territory for the first time since October 2010. In addition to the intensification of the sovereign debt crisis, fears of a slowdown in the US economy probably contributed to the fall in business expectations of financial experts, the survey participants. However, after reaching a new record high in May, the assessment of the current business situation is likely to stay unchanged at that unprecedented high level of 91.5 in June. The combined ZEW (expectations and situation) index is likely to decline from 47.3 in May to 44.2 in June, but remaining 1½ standard deviations above its long term average.		
Jun 24 09:00	<b>Ifo Business Climate, Jun</b>	<b>Forecast: 113.2</b>	<b>Prior: 114.2</b>
London Time	After remaining unchanged in May at a level close to its all time high, we expect a decline in the ifo business sentiment in June. The decline is probably led by a fall in business expectation from 107.4 in May to 105 in June. However, a roughly unchanged assessment of the current business situation – we expect 121.5 in June compared to 121.4 in May – probably will prevent a large drop in ifo. We expect that all sectors continue to report significantly above-long-term average readings.		

### France

Jun 22 07:45	<b>Industrial Confidence, Jun</b>	<b>Forecast: 105</b>	<b>Prior: 107</b>
London Time	We expect a second consecutive decline in industrial confidence in June. However, the June reading is likely to remain a ¼ standard deviation above the long term average.		
Jun 24 07:45	<b>Consumer Confidence, Jun</b>	<b>Forecast: 83</b>	<b>Prior: 84</b>
London Time	Following the increase in May, which might have been caused by the drop in energy prices, we expect a decline in June, bringing the index back to the readings in March/April.		

### Italy

Jun 20 09:00	<b>Industrial Orders, Apr</b>	<b>Forecast: -4.5% MM</b>	<b>Prior: +8.1% MM</b>
London Time	We expect a large negative payback in industrial orders in Apr, after a surprisingly strong rise in Mar (probably led by some big-ticket orders from abroad). Survey-based indicators suggest the underlying trend is still a moderately positive one for manufacturing sector activity, mainly supported by decent export growth.		
Jun 23 09:00	<b>Consumer Confidence, Jun</b>	<b>Forecast: 105.5</b>	<b>Prior: 106.5</b>
London Time	Consumer sentiment rebounded quite strongly in May, probably reflecting in part the drop in fuel prices but perhaps also some statistical distortions around the seasonal adjustment procedure. We expect a small payback in June. Still, the index level remains fairly subdued, at around minus 1 st. dev. below its long-run average. While consumer confidence has a poor correlation with consumer spending, we reckon this confirms the persistent weakness in households' real disposable income and hence in their ability to spend.		

### Norway

Jun 22 09:00	<b>Unemployment Rate, Apr</b>	<b>Forecast: 3.3%</b>	<b>Prior: 3.3%</b>
London Time	We forecast the unemployment rate (seasonally adjusted), measured by the Labour Force Survey (LFS), to be unchanged in April. The registered unemployment rate, which historically is highly correlated with the LFS data, was pretty much unchanged in April after stripping out seasonally factors.		
Jun 22 13:00	<b>Norges Bank Rate Decision</b>	<b>Forecast: Unchanged at 2.25%</b>	<b>Prior: 2.25%</b>
London Time	The Norwegian key policy rate is likely to be kept on hold today at 2.25%. However, we expect the Bank to shift up the front end of their published rate path in the Monetary Policy Report (MPR), also out today. In addition, we believe the Central Bank will keep the medium-term rate outlook pretty much unchanged (see <a href="#">Norway: Stable Rates and Hawkish Rate Path Expected</a> .)		

## Economic Indicators

### Sweden

Jun 22 08:15 London Time	<b>Consumer Confidence, Jun</b>	<b>Forecast: 17.6</b>	<b>Prior: 17.9</b>
	After a small rise in May, mainly because of higher sentiment on households' own economy, we expect the consumer confidence indicator to fall back to the level of April this year.		
Jun 22 08:15 London Time	<b>Manufacturing Confidence, Jun</b>	<b>Forecast: 9</b>	<b>Prior: 11</b>
	We expect a drop in the manufacturing confidence indicator in June, following last month's unexpected jump. While the PMI indicator (Sweden's other manufacturing survey) clearly has been trending downwards since May last year, the manufacturing confidence indicator (which historically has been following the PMI) has been jumping around at a very high level, averaging 10.6 for the first months of this year.		
Jun 22 08:30 London Time	<b>Unemployment Rate, May</b>	<b>Forecast: 7.8%</b>	<b>Prior: 7.9%</b>
	Following a drop in the unemployment rate in April, to 7.9% from 8.1% in March, we expect the unemployment rate to continue down in May.		
Jun 23 08:30 London Time	<b>Producer Prices, May</b>	<b>Forecast: 0.1%MM, 2.0%YY</b>	<b>Prior: 0.0% MM, 1.9% YY</b>
	After stable prices for three consecutive months, we forecast a small 0.1% MM rise in producer prices in May.		

### United Kingdom

United Kingdom Jun 21 09:00 London Time	<b>Public Sector Net Borrowing, May</b> <i>(Figures Exclude Costs of Financial Intervention)</i>	<b>Forecast: £17.0 Billion Deficit, £27.0 Billion Deficit Fiscal Year To Date</b> <b>Year Ago: £18.3 Billion Deficit, £25.5 Billion Deficit Fiscal Year To Date</b>		
	The April deficit figure rose above the levels of a year ago because of adverse base effects from the Bank Bonus Tax a year ago. However, with that effect now past, we expect the May data to show the fiscal deficit again falling versus a year ago, in line with the general recent trend. Moreover, we highlight that in recent years the ONS recently have tended to revise down the deficit figures for earlier months, and after such revisions the fiscal data often look rather better than they first appeared.			
Jun 21 11:00 London Time	<b>CBI Industrial Trends Survey, Jun</b>			
	<b>Monthly Output Expectations Net Balance, Jun</b>	<b>Forecast: +24%</b>		<b>Prior: +20%</b>
	<b>Monthly Order Books Net Balance, Jun</b>	<b>Forecast: -2%</b>		<b>Prior: -2%</b>
	<b>Monthly Selling Prices Net Balance, Jun</b>	<b>Forecast: +26%</b>		<b>Prior: +24%</b>
	There are signs of some headwinds from supply chain disruption in recent months, with a marked rise in shortages of inventories among manufacturers of consumer goods in April. We expect this survey to soon show some anticipation that these constraints will ease a bit, lifting output expectations for the coming months.			

Sources: National Statistical Offices, National Central Banks, Bloomberg, CIRA forecasts

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## Key Economic Indicators (27 June –1 July 2011)

During The Week		Forecast	Last
07:00	Germany: Import Prices, May		
07:00	Germany: Retail Sales, May (by 1 July)		
Monday 27 June		Forecast	Last
08:30	Sweden: Trade Balance, May		
09:00	Italy: Contractual Wages, May		
Tuesday 28 June		Forecast	Last
	Germany: HICP, Jun Preliminary		
07:00	Germany: GfK Consumer Confidence, Jun		
08:30	Sweden: Retail Sales, May		
09:00	Italy: Producer Prices, May		
09:30	UK: Balance of Payments, 2Q		
09:30	UK: GDP, 1Q 3 <sup>rd</sup> Release		
10:00	Italy: Industrial Confidence, May		
17:00	France: Jobless Change, May		
Wednesday 29 June		Forecast	Last
06:30	France: GDP Details, 1Q		
08:00	Spain: Retail Sales, May		
09:00	Norway: Credit Indicator C2, May		
09:30	UK: Services Output, Apr		
09:30	UK: No. of Mortgage Commitments for House Purchase, May		
10:00	Euro Area: Business & Consumer Surveys, Jun		
10:30	Switzerland: KOF Economic Barometer, Jun		
Thursday 30 June		Forecast	Last
00:01	UK: GfK Consumer Confidence, Jun		
07:45	France: Manufactured Goods Consumption, May		
07:45	France: Producer Prices, May		
08:00	Spain: HICP, Jun Preliminary		
08:30	Netherlands: Producer Prices, May		
08:30	Sweden: Household Lending, May		
08:55	Germany: Unemployment, Jun		
09:00	Euro Area: M3, May		
09:00	Norway Retail Sales, May		
09:00	Norway: Household Consumption of Goods, May		
10:00	Italy: Consumer Prices, Jun Preliminary		
10:00	Euro Area: HICP, Jun Preliminary		
	Greece: Retail Sales, Apr		
Friday 1 July		Forecast	Last
07:30	Sweden: PMI, SA, Jun		
08:00	Norway: Unemployment Rate, Jun		
09:00	Norway: PMI SA, Jun		
09:00	Italy: Unemployment, 1Q		
09:00	Euro Area: Manufacturing PMI, Jun Final		
09:30	UK: Manufacturing PMI, Jun		
10:00	Euro Area: Unemployment, May		
18:00	Italy: Budget Balance, Jun		

Sources: National statistical offices, central banks and Citi Investment Research and Analysis

Recent Research Publications	Author	Date of Publication
<b>Euro Area</b>		
<a href="#">Euro Area — Sovereign Debt Crisis Update</a>	Jürgen Michels	June 17, 2011
<a href="#">ECB — Preparing the Next ( Probably Not the Last ) Rate Hike</a>	Jürgen Michels	June 9, 2011
<a href="#">Spain — Industrial Output Slowing On Weakening Domestic Demand</a>	Giada Giani	June 6, 2011
<a href="#">ECB — Preview Preparing the Next Hike</a>	Jürgen Michels	June 6, 2011
<a href="#">European Economic Forecast Highlights</a>	Ann O'Kelly	May 26, 2011
<a href="#">Spain — Decent Q1 GDP Growth Hides Weak Domestic Demand</a>	Giada Giani	May 18, 2011
<a href="#">ECB — Preparing For A July Rate Hike</a>	Jürgen Michels	May 5, 2011
<b>Euro Weekly</b>		
<a href="#">Negotiation Time</a>	Giada Giani	June 10, 2011
<a href="#">Italy — Lagging Behind</a>	Giada Giani	June 3, 2011
<a href="#">Recovery in Core Countries Continues</a>	Giada Giani	May 27, 2011
<a href="#">Spain — The Twin Political and Fiscal Risks</a>	Giada Giani	May 20, 2011
<b>Nordics</b>		
<a href="#">Norway — Stable Rates and Hawkish Rate Path Expected</a>	Michael Saunders	June 17, 2011
<a href="#">Sweden — Inflation Slightly Softer in May</a>	Michael Saunders	June 14, 2011
<a href="#">Norway — Core Inflation Pushed Down By Air Fares</a>	Michael Saunders	June 10, 2011
<a href="#">Sweden — Industrial Production Growth Likely to Have Peaked</a>	Michael Saunders	June 10, 2011
<b>Switzerland</b>		
<a href="#">Switzerland — SNB On Hold Again</a>	Michael Saunders	June 16, 2011
<b>Global</b>		
<a href="#">Global Economics View: TARGETing the wrong villain: Target2 and intra-Eurosystem imbalances in credit flows</a>	Willem Buiter	June 9, 2011
<a href="#">Global Economic Outlook And Strategy</a>	Willem Buiter	May 25, 2011
<b>UK</b>		
<a href="#">UK — Retail Sales Slip Amidst High Inflation</a>	Michael Saunders	June 16, 2011
<a href="#">UK — BoE Governor's Speech</a>	Michael Saunders	June 16, 2011
<a href="#">UK — Mixed Unemployment News, Strong Private Jobs Growth</a>	Michael Saunders	June 15, 2011
<a href="#">UK — CPI Inflation Still Heading to About 5%</a>	Michael Saunders	June 14, 2011
<a href="#">UK — Risks from Inflation Expectations</a>	Michael Saunders	June 13, 2011
<b>Sterling Weekly</b>		
<a href="#">In Need of Some " Strong Vigilance "</a>	Michael Saunders	June 10, 2011
<a href="#">Uncertainties Keep MPC On Hold</a>	Michael Saunders	June 3, 2011
<a href="#">The (Re) Balancing Act</a>	Michael Saunders	May 27, 2011
<a href="#">More Jobs, Less Pay</a>	Michael Saunders	May 20, 2011

Source: Citi Investment Research And Analysis

## **Notes**

## Appendix A-1

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