

Economics

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Euro Weekly

Debt Restructuring Better Early Than Late

- With lower global growth, Greece's non-compliance with the programme conditions and increasing opposition in creditor countries to further bail-outs, we now expect a substantial and probably coercive debt restructuring of the Greek sovereign by the end of 2012 at the latest and likely much sooner (by the spring of 2012 or even December 2011). We expect Ireland and Portugal to follow Greece into sovereign debt restructuring soon afterwards, mainly because of 'political contagion'. In order to reduce the debt-to-GDP levels to 60% (80%) in 2012, it would require debt haircuts (ex IMF) of 67% (54%) in Greece and about 53% (34%) in Portugal and Ireland.
- We expect that there will be an agreement between Greece and the Troika, probably with more control for the Troika on policy implementation, to continue funding after a default and the Eurosystem probably will continue to fund Greek banks. This would allow Greece to stay in the euro area. We also expect an expansion of the lending capacity of the EFSF, and additional national programmes to recapitalise banks.
- With multiple debt restructurings taking place, we expect the euro area to fall back into recession and the ECB to cut rates back to 1.0% by 1Q 2012 (Jürgen Michels, Willem Buiter, Ebrahim Rahbari, Giada Giani and Guillaume Menuet).

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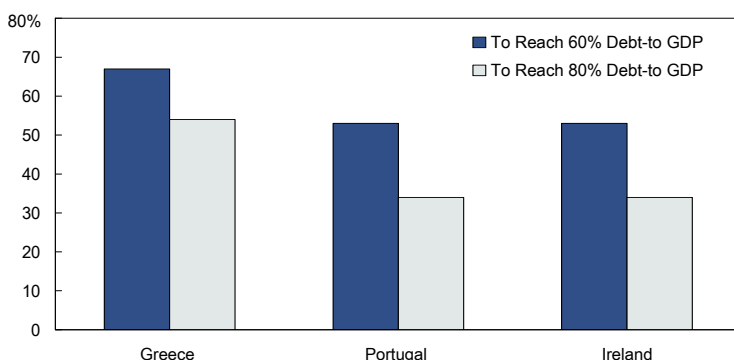
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Figure 1. Citi Market Forecasts

	\$/€	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 4Q 11	1.40	1.50	2.00	0.85	0.50	20	9.37	2.00	7.83	2.25	1.11	0.00	-130
End 2Q 12	1.38	1.00	2.40	0.83	0.50	20	9.04	2.50	7.77	2.75	1.14	0.00	-120

Source: Citi Investment Research and Analysis

Figure 2. Greece, Portugal Ireland — Required Haircuts to Reduce Debt to 60% (80%) in 2012



The calculation assumes that IMF is excluded from haircuts. Sources: Citi Investment Research and Analysis

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Debt Restructuring Better Early Than Late

With no comprehensive solution of the problems in sight, multiple sovereign debt restructurings are likely...

In this note, we revisit the likely timing of debt restructuring for Euro Area (EA) sovereigns. Although our focus is on sovereign insolvencies, these are the likely outcome of multiple interacting and mutually reinforcing financial disfunctionalities in the European Union. We are facing the likelihood of multiple sovereign defaults in the outer periphery of the EA — Greece, Ireland and Portugal. In addition there is the problem of sovereign illiquidity despite likely fundamental sovereign solvency in the inner periphery of the EA — Italy and Spain. If handled badly, illiquidity could threaten default, and the risks of this happening could spread beyond the periphery into the core EA, notably Belgium and France. Finally, there is the European Union (EU)-wide problem of undercapitalised banks threatened with insolvency by the impairment of their exposures to the risky EA sovereigns. All these problems are reinforced by the lack of effective political leadership in the European Union and the Euro Area. Neither the heads of state/heads of government of the member states, nor the leaders of the European institutions, including the European Commission, the European Council and the ECB, have been able to move beyond a strategy of trying to put out the most urgent immediate fire. There has been no sign of a comprehensive solution to the problem of excessive sovereign debt and deficits and of inadequate banking sector capitalisation. Following each new emergency, the authorities are farther behind the curve.

...starting with Greece, followed by Portugal and Ireland, but all are likely to stay in the euro area

We now expect the Greek sovereign to engage in substantial and probably coercive debt restructuring by the end of 2012 at the latest and likely much sooner (by the spring of 2012 or even December 2011), but not in the immediate future (say, the next 2 months). We expect Ireland and Portugal to follow Greece into sovereign debt restructuring soon afterwards, mainly because of 'political contagion'. This means that there is a high probability that three substantial debt restructurings could take place by the end of 2012. Our central scenario includes continued Troika funding for both the Greek sovereign and the Greek banks following the Greek sovereign default, with Greece remaining in the EA. The same applies to Ireland and Portugal.

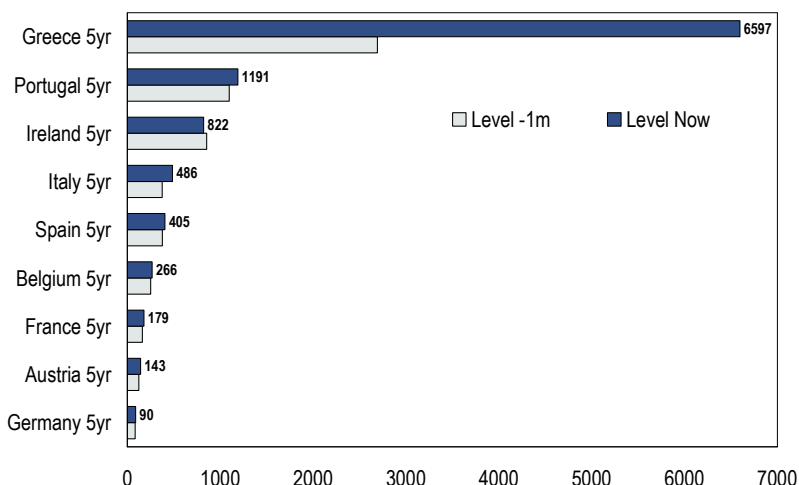
...creating extra stress for Spain and Italy in particular

We also expect both political and financial contagion from a Greek default to reach Spain and Italy, where CDS continued to rise over the last month (see Figure 3). Our central scenario is that a combination of actions by creditor nations, the ECB and the Spanish and Italian governments will be sufficient to ensure that there will be no sovereign default in either Spain or Italy, and that both countries remain members of the EA.

Path remains uncertain and determined by political acceptance in creditor and debtor countries

We recognise, however, that as regards the continued membership of Greece, Ireland, Portugal, Spain and Italy in the EA, there are now significant uncertainties and path dependencies, mainly driven by the steady shrinking of the space occupied by responses that are politically acceptable to both creditor and debtor countries in the EA.

Figure 3. Selected Countries: 5yr Sovereign CDS



Sources: Bloomberg and Citi Investment Research and Analysis

There have been reasons to wait with debt-restructuring until 2013/14...

Previously, we expected substantial EA sovereign debt restructuring to be delayed to 2013 or even 2014.¹ Three reasons underlay our assessment. First, moderate economic growth and a mixture of regulatory forbearance, market and regulatory nudges, and support from the public purse could have allowed banks in the core EA and EU to reduce their exposure to EA periphery sovereigns and banks and to build up their capital bases over the coming years. Provided growth did not falter, by 2013/14 EA banks would likely be in a better position to withstand the write-downs resulting from EA sovereign defaults without the need for an additional politically damaging round of bail-outs and publicly-funded recapitalisations of banks in the 'core' Euro Area and non EA member states of the EU. Second, a number of institutional mechanisms would be ready by the middle of 2013, notably special resolution regimes for banks at national and EU-wide level and the European Stability Mechanism (ESM), which is supposed to include at least some form of a sovereign debt restructuring mechanism. Third, the timing of elections, notably presidential elections in France in 2012 and a number of state elections in 2011 and 2012, and a general election in Germany in 2013 has made it politically inopportune to realise early the financial cost of official support to the EA periphery from the Greek Loan Facility, the EFSF and the ECB. These three reasons implied that the cost of waiting, at least until 2013, was lower in the eyes of policy makers than the cost of implementing an immediate debt restructuring now.

...but the value of the option of waiting dropped substantially in recent weeks

In recent weeks, in our view three developments have changed the environment in which policymakers operate sufficiently to change their likely course of action. First, global growth expectations for the near-to-medium term, and growth expectations for the euro area in particular, have come down markedly. Low growth implies that the scenario under which banks would be able to build up capital to be in a better position in a few years' time to withstand write-downs on periphery exposure has become rather far-fetched. Second, Greece has become so blatantly non-compliant with the conditionality of its programme that it is becoming increasingly difficult to fudge the quarterly Reviews of Greece's performance under the programme by the Troika. A positive assessment is necessary for disbursement of the next installment of the Greek financial support package and for the approval of the second Greek

¹ See ["The Debt of Nations", Global Economics View, 7 January 2011, Citi](#)

Amended EFSF will give more room to deal with first round impact of debt restructuring

bailout package. Third, opposition in creditor countries to further bail-outs to the euro area periphery has risen quickly, to the point where the cost of waiting may in fact now exceed the cost of a near-term debt restructuring. Further delay inexorably shifts the burden of the losses resulting from sovereign debt restructuring from the original private creditors to the official creditors, including the ECB.

In addition, since Spain and Italy are now also involved, the political and economic calculus of providing further support to Greece (and possibly to Ireland and Portugal) has changed. The negative feedback loops between effects from fiscal tightening to lower economic growth and from lower economic growth to worse fiscal performance have also become more evident. In our view, these developments together imply that the option value of delaying deep sovereign debt restructuring in the outer periphery has reduced substantially. After the implementation of the amended version of the EFSF, the existing official facilities could handle the direct implications of an orderly deep sovereign debt restructuring of Greece, Ireland and Portugal, a recapitalisation of the banks of these three countries, and of the banks in the core EA exposed to the outer periphery.

Greece: Default in the Next 12 Months

Immediate default unlikely...

But the option value of waiting has not disappeared entirely just yet. The Fifth Review of the IMF/EU/ECB agreement for Greece has still not concluded, raising the spectre of Greek default in the immediate future. In our view, however, a very near-term Greek default, say in the next month, is still unlikely. Greece does not face any bond redemptions until mid-December. More importantly, a Greek default now rather than in a few months time would not be in anyone's interest, and certainly not in the interests of its EA creditors.

...as EFSF is not expanded and Greek government is ill-prepared

A key argument for allowing the Greek sovereign some more time is that this would allow member states to conclude approval of the enlarged and enhanced EFSF, which would have the ability to lend to and intervene in favour of non-programme sovereigns through contingent funding facilities and to support EA banks in non-programme countries. The Greek government would need to deal with the implications of Greek sovereign default for the Greek economy, something for which it appears ill-prepared, but more importantly it needs money; it does not have to pay public wages, salaries and pensions from mid-October, so it has a strong incentive to find an agreement with its Troika creditors.

Last minute agreement between Greece and Troika likely...

A last-minute agreement between the creditors and the Greek government therefore appears likely. After lengthy conference calls with its official creditors, the Greek government finally announced a new set of fiscal measures, which should pave the way for an agreement with the EU/IMF Troika on the disbursement for the next tranche of the first bailout programme by mid-October.

...but Greece is off course to meet programme targets

Still, the Greek programme is clearly and likely irredeemably off course. Both a deeper-than-expected recession, which worsened Greece's fiscal performance, and the unwillingness/inability of the Greek government to deliver in a number of areas, including structural reforms, expenditure control and tax collection, likely played a part.² Our expectation that the Troika will nevertheless deem Greece technically compliant with the programme in its review and find it in them to pay out yet another tranche has little to do with increasing confidence that this time will be different. Rather, as noted above, the agreement stems from a realisation that the costs of Greek default now rather than a bit later would be higher than increasing exposure to the Greek sovereign by a further €8bn.

² See ["Greece – Stuck in the Mud", Euro Weekly, Giada Giani, 9 September 2011, Citi](#)

**December review might pave way for
debt restructuring**

By the time of the next review, in December 2011, however, that may already no longer be true. EFSF approval and further analytical and technical work on additional banking sector support measures and discussions with the ECB should make substantial headway over the coming weeks and months. We thus see a substantial chance that Greece would be declared non-compliant by the time of the Sixth Greek Programme Review (in December 2011/January 2012) or the Seventh Review (in March 2012/April 2013). In the case that Greece is more cooperative and agrees in some areas to a loss of control on the implementation of policies, it looks more likely that the Troika will find an agreement to go ahead with Greek debt restructuring without a formal declaration of non-compliance. In that case, it would be much easier to continue the funding of Greece with EFSF funding after the debt restructuring. Recent press reports quoting the Greek Finance Ministry talking about a 50% haircut to bond holders in an orderly way, which would be *"agreed and coordinated effort by many"* suggests that talks in that respect with the Troika are underway.

**Non-approved second bailout package is
hurdle for positive Troika assessment in
5th review**

Another obstacle that may be put forward by the IMF to the release of the upcoming sixth tranche is the lack of secured financing for the Greek government over the next 12 months — the same request the IMF made in June for the approval of the fifth tranche. That request forced EA countries to formulate and agree on a second Greek bailout programme at the EU Summit on 21 July. However, the commitment to provide Greece with additional funding of €109bn until 2014 has been made conditional on the implementation of a private-sector involvement scheme (PSI) aimed at extending substantially the maturity of the Greek debt (from the current 7 years to around 23 years). A 90% participation in the PSI scheme was targeted in order to reduce Greece's liquidity needs for the next three years by €54bn. Most of the pieces have not yet fallen into place. The PSI participation rate is still unknown, but likely to be short of the targeted 90%. Furthermore, many EA states have not yet approved the proposal for the second bailout package. Hence, without the formal approval of the second bail-out, Greece is facing a large financing gap over the next 12 months. Even if the PSI transaction can still go ahead with less than 90% participation, the hurdle for euro area countries to commit more money to Greece (at least €109bn, more if PSI participation falls short of the target) remains high.

What Would A Greek Debt Restructuring Look Like?

**Greek debt-to-GDP ratio will be 163.5%,
with 20% held by official lenders**

We expect Greek general government debt to reach €360bn or 163.5% of GDP at the end of 2011. Including the sixth, but excluding a seventh tranche of the Greek programme, at that time, €73bn (20% of the total) will be official debt, of which €53bn are bilateral loans from other EA member countries and €20bn from the IMF. Estimates of current outright ECB holdings of Greek government debt are in the vicinity of €50bn of principal (€40bn at cost value), leaving €240bn or 66% of the total in the hands of the private sector if we assume no further outright purchases of Greek sovereign debt by the ECB (which have long since stopped).

**Uncertain how debt restructuring will
take place**

Even though we put a high probability on the occurrence of a substantial Greek debt restructuring, there is significant uncertainty surrounding the nature of the deal, including the size of haircuts imposed. In order to determine the likely size of haircuts, we need to make assumptions about a target debt level (or target debt to GDP ratio) and about the treatment of different types of creditors.

**Likely that non-IMF public sector and
private sector will be involved**

We will assume throughout that the IMF will be made whole. In our central scenario, all other types of holders, including official lenders and the ECB will, however, be involved — that is, there will be both private sector involvement (PSI) and official sector involvement (OSI). PSI will be a political necessity for donor countries. OSI will be needed to limit the impact of the debt restructuring on EA banks. Both PSI

and OSI will be needed to deliver substantial debt relief. We recognise that, unlike most of the Greek sovereign debt securities, the loans made to Greece by the Greek Loan Facility (and the loans made to Ireland and Portugal by the EFSF) are not under Greek law but under English law.³ This may make restructuring the official loans to Greece less straightforward than that of Greek sovereign debt issued under Greek law. But in any case, any defaulted official loans to the Greek sovereign will end up in Paris Club mediation. The treatment meted out there tends to be intensely political and could end up being quite favourable to Greece.

Haircuts depend on targeted new debt level, but could be up to around 70%

Two plausible targets for post-restructuring debt-to-GDP ratios are either 60% of GDP (the Stability and Growth Pact reference value) or 80% — which is close to the current euro area average ex Greece. Assuming uniform haircuts on all creditors bar the IMF, these assumptions would imply a haircut of 67% and 54%, respectively. If we exempt bills, haircuts would rise to 70% and 57%, respectively. Exempting both bills and foreign-issued debt (which we assume to account currently for around 10% of the total) would bring the haircut to 79% and 64%, respectively, assuming that the ECB only purchased debt issued under Greek law.

Not clear if debt restructuring will be coercive or not

In our view, it is possible that debt restructuring will be technically voluntary, including a potential menu of options that is offered to creditors to deliver the same NPV haircut but different combinations of maturity extensions and cuts to principals or interest payments. Since there would be a material NPV loss, rating agencies would see this as a default event. However, only in case that there are elements of coercive action involved, the action would also lead to a credit event and trigger CDS.

ECB might face losses of outright holdings up to €24bn

A 54% or 67% haircut to Greek sovereign debt (assuming only the IMF debt will be made whole) would imply a substantial hit of around €17bn to €24bn (as the ECB bought below par) to the regulatory capital of the ECB/Eurosystem through its SMP outright holdings of Greek sovereign debt. In addition, the ECB is exposed to the sovereign through the Greek debt it holds as collateral through its usual lending operations. We assume that the ECB will obtain a concession by EA/EU policymakers to temporarily guarantee the Greek exposure through its collateral holdings, similar to what was agreed as part of the yet-to-be-approved Second Greek Bailout Package. As a result of the losses that the ECB would take on its outright exposure, we think the ECB is likely to ask for another capital injection from National Treasuries (technically through the National Central Banks (NCBs) shortly after any debt restructuring agreement.

Without public sector involvement, private sector might face up to a 100% haircut

Another possibility would be for the Greek sovereign to decide to make the ECB whole, or at least to limit the haircut on ECB holdings to the difference between the face value of the debt and the average purchase price of the debt the ECB holds. Another option — though a remote one, in our view — is that all official lenders (IMF+EA countries+ECB) may be made whole. In that case, private creditors' claims on the Greek government would have to be wiped out entirely (100% haircut) to reach a target debt-to-GDP ratio of 60% (78% haircut to reach the debt ratio target of 80%.

Smaller haircuts might take place...

A final possibility worth mentioning is that policymakers in the EA may once again not agree to take a bold step towards crisis resolution and may only agree to a much smaller haircut for Greece, say to bring its debt-to-GDP ratio to the next highest level in the Eurozone, or to, say, 100%. Initial haircuts would correspondingly be lower at 34% (to bring the debt ratio to the euro area's next

³ Note that if the PSI is implemented, the share of English law securities is likely to increase substantially.

highest level, the 120% of GDP in Italy) or 49% to bring it to 100%. This would be close to the scenario mentioned by the Greek Finance Minister according to Greek newspapers. The reason to follow such action would likely be less to limit the impact on EA banks, but more to limit popular anger in donor countries and popular and political contagion to other countries with still higher debt-to-GDP ratios, notably Portugal. Of course, such a course of action would only be the latest in half-measures that will only delay the further necessary level of debt restructuring (and further raise its economic collateral damage by prolonging the duration of the crisis).

...which are likely to keep expectations of additional steps in the future high

If the markets believed that further haircuts would have to follow, the secondary market price of the remaining debt would remain depressed and Greece would remain excluded from the markets. If banks were recapitalised only to make up for the capital depletion caused by the first restructuring, these banks would continue to be seen as undercapitalised given the likelihood of further rounds of sovereign debt restructuring. The banks, too, would not be able to fund themselves in the markets.

Greek Troika Funding Post-Default: How Much Is It Worth To Keep Greece In The EA?

Even 100% haircut of total debt would not solve Greece immediate funding problems

We expect Greece to still face a primary general government deficit of around €6bn (2.7% of GDP) at the end of this year. Thus, even in the extreme (and unlikely) case that Greece were to default on 100% of its outstanding debt (including the debt to the IMF and the debt issued under foreign law), it would face a continued funding need in 2012. In the likelier case in which the IMF gets repaid in full and other creditors suffer a less-than-complete wipeout, one would have to add the interest payments on the remaining debt and, assuming that private creditors will be unwilling to finance the Greek sovereign in the near-term even post-default, any redemptions in 2012 to the total funding need of the Greek sovereign.

Troika is likely to continue the funding of Greece after debt restructuring, when it gets more control of policy implementation

We expect that the remaining funding gap after any kind of debt restructuring will be filled by the Troika. The reason is that a refusal by the Troika to provide further funding to the Greek sovereign would substantially increase the likelihood of a Greek EA exit. We consider the political and economic cost of a Greek EA exit to still be higher than the cost of providing additional funding. However, the Greek bailouts are already deeply unpopular in a number of EA countries. A substantial Greek debt restructuring and possibly required additional aid for the banking systems in other countries would further inflame tempers. That a rational political and economic calculation of the costs of Greek EA exit favours extending further funding would therefore not be enough. Politicians in donor countries would require some quid-pro-quo from Greece in order to sell the action to their electorates. Such a concession by Greece could once again include further austerity measures, but after a series of disappointments, it is questionable that such offers would do the trick. It may be more likely that the donor countries ask for more control of the fiscal and structural adjustment process — a limited transfer of fiscal and regulatory decision power. If Greek politicians and the Greek electorate accept, the show (and the Troika funds) will go on.

But, without agreement with Troika...

But it is certainly possible that in this situation, no agreement between creditors and the Greek government can be reached, i.e. no agreement can be found that is politically acceptable to both politicians and voters in creditor countries and in Greece. This scenario includes the case of an initial agreement between the Troika and the Greek government, only for the Greek government to fall subsequently over the question of the deal they agreed to. Troika funding for the Greek sovereign would then likely cease. Importantly, ECB funding for Greek banks (including signing off on Greek ELA) may also stop then, as continued access to the ECB for Greek banks was subject to Greece's compliance with the Troika programme.

...Greece might be forced to exit the EA

Having lost access to funding for both sovereign and banks, Greece is likely to throw in the towel and exit the EA. We have written extensively about the costs of EA exit both for Greece and for the rest of the EA, so we will only note here that the costs for both would likely be very substantial. But that such a scenario is unpleasant unfortunately does not rule out its occurrence.

Some implausible options that Greek might stay in EA in case of no Troika agreement

Three rather implausible alternative scenarios exist that would see Greece remain in the EA despite failure to agree on a new programme with the Troika. The first is that the Troika simply decides that, after talks have broken down, it will give Greece a free lunch, i.e. grant funding without conditionality, based on the economic and political calculation that a Greek exit would be more costly. A second scenario would see Troika funding for the Greek sovereign cease, but Eurosystem funding (and Greek ELA) for Greek banks to continue. The third — remote — option would be that Greece gets funding from outside the euro area, e.g. through loans from BRIC countries.

Current PSI initiative created more “inconvenience”

There is a further ‘inconvenience’ in the central scenario that we have touched upon above: The Second Greek Bailout Package and in particular the bond buyback/private sector involvement (PSI) part of it. At the 21 July Emergency Summit, EA Heads of State and Heads of Governments (HoSHoGs) agreed to lend Greece the funding for the debt exchange and additional funds to buy back some of its outstanding bonds at a discount. It is clear that going through with the buyback would make little (economic) sense if a more substantial Greek sovereign debt restructuring were to take place in the very near future. All the deal would do would be to shift exposure from existing private bank creditors to official lenders. Such an opaque, indirect bail-out of EA banks may well have desirable features from the perspective of EA policymakers, particularly because it would reduce the size of any needed further bank bailout that would result from the envisaged deep sovereign debt restructuring.

Current PSI programme might be delayed

We are tempted to conclude that implementation of the buyback programme would be put off for the time being. One issue that could be of concern is that any delay in the agreed buyback programme may be interpreted as a clear indication that sovereign default was imminent, with potentially destabilising consequences in Greece and elsewhere. Legislative calendars and procedures may offer a helping hand there. While the 2nd Greek bailout package was agreed at the same time by the HoSHoGs as the reform of the EFSF, national approval schedules for the two initiatives have already been separated, with the EFSF approval discussions coming first in some countries. Further delays by a few weeks may already open the window for a more substantial debt restructuring, particularly given that, as just noted, EFSF approval would have happened already. .

Financial And Political Contagion To Portugal And Ireland: Default And Exit Scenarios

Greece default will have impact on the other two bailout countries

Deep Greek sovereign debt restructuring and continued funding for the Greek sovereign will be unpopular in creditor countries. But that is not the only headache it will cause. Both financial and political contagion to Portugal and Ireland are virtually assured, in our view. Since both sovereigns have access to funding under their respective EU/IMF programs until 2013 and since there are still quite a lot of funds left in the programme kitties to support domestic banks, we believe that the risks and impact of political contagion outweigh those of financial contagion. A Greek default would further raise the market assessment of the likelihood of default by these sovereigns, leading to a further widening of spreads over Bunds of yields on Irish and Portuguese sovereign debt, which would probably delay the return to market funding in both countries. Other financial assets would also likely be affected. In particular, pressures on Irish banks and deposit outflows could reaccelerate.

Ireland and Portugal probably will also ask for debt relief...

German, Dutch and Finnish voters are unlikely to be the only ones to judge that the Greek sovereign and Greek taxpayers got off fairly lightly with a deal that offers debt relief and further funding in return for efforts of questionable determination to tighten their belts. Irish and Portuguese voters and politicians are likely to demand the same lenient treatment, in particular given that they have so far stuck to the conditions of their bail-out programmes. In the Portuguese case, austerity has only just begun and the risk of falling behind on programme targets is substantial, both due to implementation risks and the effects of likely further downward disappointments in economic activity. But in the Irish case austerity had started long before negotiating a Troika agreement.

...in order to reduce need for painful austerity measures

We believe it would have been hard enough to convince voters in Ireland and Portugal to endure many more years of harsh austerity simply to make their sovereign creditors whole, particularly if many of these are foreigners, banks, or both. If we add to this scenario of inherently weak political support for open-ended austerity and the near-certain public perceptions in Ireland and Portugal of being treated unfairly relative to the Greek debtors, we see a high probability that their governments will ask for substantial debt relief — and that they will be granted this wish.

Greek restructuring must be involved with costs to make it unattractive for Portugal and Ireland

The only way to avoid political contagion would be if the costs to Greece of a deep Greek debt restructuring (in the form of loss of control on the implementation of the programme measures, for instance) were large enough for the Irish and Portuguese not to seek debt relief. To be clear, we see the high likelihood of default/debt restructuring in Portugal and Ireland, based on their perceived self-interest. Whether they would opt for default/deep restructuring will therefore clearly depend on their assessment of the relative costs and benefits. While a default probably will reduce pressure to implement painful austerity measures, a sovereign default is also costly. Newly-elected governments in both Ireland and Portugal invested political capital in preventing default and consolidating public finances. There is stigma attached to sovereign default, too. There are the costs of having to bail out or recapitalise domestic banking sectors, insurance firms or pension funds post-sovereign default.⁴ And both Ireland and Portugal would still run primary deficits in 2012 (estimated at 4.2% of GDP in Ireland, 1% of GDP in Portugal) and would either have to tighten further abruptly or obtain further Troika funds post-default. We would expect such funding to be forthcoming.

Creditor nations will try to prevent debt restructuring in Portugal and Ireland

Creditor nations will also have an incentive to avoid debt restructuring in economies other than Greece. They could continue to try to paint the Greek case as an exception — one that did not create a precedent — though the reasoning would be somewhat suspect. Should Ireland manage to eke out even modest growth at that stage — a high hurdle given the challenging growth prospects in the EA and globally — there would also be a potentially more powerful precedent to point towards for an economy that would have managed to emerge (really to start to emerge) from its debt problems by way of austerity and adjustment, and without a formal default. The significance of this precedent should not be underestimated, as it would be the first example in which the downward spiral between a poor fiscal condition and a weak economy would be overcome. Until now, additional EA countries have become embroiled in the turmoil, but no country has yet managed to decisively step back from the abyss.

⁴ There are also medium/long-term costs of having to pay higher yields on sovereign debt due to a history of default, but we suspect these prospects will play a relatively minor role in the decision in the case of Ireland and Portugal in the current crisis.

Some positive signs in Ireland, but outlook is likely to deteriorate again

The Irish example does give some cause for hope. GDP growth has returned recently. Irish GDP growth surprised to the upside in Q2, rising 1.6% QoQ, having increased (an upwardly revised) 1.9% QoQ in Q1, driven mostly by investment and net exports. GNP is also growing. However, Ireland is not out of the woods yet. The challenging global growth outlook is set to weigh on the prospects for further Irish export growth. Financial turmoil and stock market weakening could raise losses from NAMA and imply that revenues from asset sales by Irish banks under their restructuring programme will disappoint. Thus, it is possible that despite the impressive efforts Ireland has made, it will suffer a renewed downturn. In any case, we believe that it would be political contagion that would drive Ireland's decision to restructure its debt rather than immediate economic necessity.

Creditor nations might try to sweeten the existing bailout programmes

However, since both sides have an incentive to avoid at least an official declaration of default for the other peripherals, there may be scope for another fudge, according to which Ireland and Portugal are offered some additional sweeteners in return for complying with the conditions of the programs. The nature of such a deal is unclear to us at best at present. It could involve a further lengthening of maturities on the official loans for Ireland and Portugal. Programme targets may also be made less ambitious or less painful. Ultimately, the question becomes whether there are attractive enough sweeteners that can be offered to the Irish and Portuguese (while still acceptable to creditor country voters) for the Irish and Portuguese to prefer avoiding near-term substantial debt restructuring. We think this scenario is possible, but not likely.

More pressure on Portugal and Ireland in case that Greece would exit EA

Political and financial contagion to Ireland and Portugal would be more intense and more damaging if Greece left the Euro Area. Greek EA exit would significantly raise the perception of the likelihood of subsequent EA exit by Ireland and Portugal and that perception could prove self-fulfilling. Financial contagion to Ireland and Portugal would surely be more severe in the case of Greek EA exit and is likely to include a reacceleration of deposit flight out of Ireland and Portugal and other forms of investors running for the exit.⁵

Irish And Portuguese Debt Restructuring In Numbers

Ireland and Portugal have debt above 100% at end of 2011

Irish and Portuguese general government debt will likely stand at fairly similar levels of 110% of GDP (€172bn) and 108.5% (€85bn), respectively, at the end of 2011 and at 117% of GDP (€188bn) and 120% of GDP (€210bn) in 2012. If we take the average of the two as our benchmark (roughly reflecting the possibility that debt restructuring in Ireland and Portugal takes place in the middle of 2012), around €50bn of total sovereign debt both in Ireland and in Portugal would be held by official lenders, while the rest (75%) would be held by private creditors.

Haircuts of more than 50% required to get debt-to-GDP ratios back to 60%

If we made the same assumptions as in our benchmark case for Greece, namely that the IMF will be repaid in full, but that all other creditors will be haircut to return the sovereign's debt-to-GDP ratio to either 60% or 80% of GDP, we arrive at estimates of haircuts of 53% to 34%, respectively, both in the case of Ireland and Portugal.

Total losses of debt restructuring could be up to €400bn (4.5% of EA GDP)

Total losses from default in Greece, Ireland and Portugal would amount to circa €400bn (in case of 60% debt ratio target) or 4.5% of EA GDP (€300bn losses or 3.5% of euro area GDP in case the debt-to-GDP ratio target is 80%). Of that, €50-

⁵ See ["A Greek Exit from the Euro Area: A Disaster for Greece, a Crisis for the World", *Global Economics View*, Willem Buiter, 13 September 2011 Citi.](#)

€70bn would be borne by official lenders (ex-ECB), €35-€45bn by the ECB and €220-300bn by private creditors. While these sums are non-negligible, they are clearly manageable for EA creditor nations. For EA banks, such losses should also not represent insurmountable challenges, though we think it likely that at least selective recapitalisations with the aid of the public purse would be necessary. Comments by the head of the French banking supervisor, that 15 to 20 European banks would need extra capital, supports our view.

Impact On The Rest Of The Euro Area

Debt restructuring likely to affect rest of the euro area, and Italy and Spain in particular

As markets have clearly demonstrated, the impact of a sovereign default in Greece is not likely to stop after Portugal and Ireland. Investors are likely to get increasingly concerned about the situation in Spain and Italy. And with sovereign bonds of the third- and fourth-largest euro area countries coming under pressure, we expect that the pressure on the banking sector of all euro area countries — particularly in France — and probably on a global level is likely to increase.

Additional austerity measures likely in Spain and Italy, but this will probably not be enough to restore market confidence

In order to restore market confidence, both Italy and Spain are likely to react to additional market pressure with extra austerity measures and structural reforms. However, as these measures are likely to create even deeper recessions in both countries, it is unlikely that extra austerity will have the desired impact on markets. Therefore, official purchases of Italian and Spanish bonds are required to prevent a liquidity shortage in both countries. In that respect, the EFSF, once it probably gets the ability to intervene in the secondary markets, is likely to start with bond purchases. However, as we have highlighted before, the size of the EFSF — even under the amended version — is too small to have a lasting impact. As the ECB continues to be reluctant to increase the asset purchases under the SMP, there is a need to increase the power of the EFSF. In that respect, it is worth mentioning that in the G20 statement of the finance ministers and central banks, the euro area countries agreed to implement decisions to “*maximise the impact of the EFSF*”. In that respect, we have repeatedly suggested changing the guarantee structure of the EFSF from a pro rata basis to a joint and several basis, or to give the EFSF a bank status, which would allow access to ECB open market operations.⁶

Introduction of more flexible EFSF will take time

Such changes of the EFSF structure have again to be approved by the member states. Therefore a more flexible EFSF than currently proposed probably will not be available before the end of the year. Furthermore, with the clear opposition of the Bundesbank to accept the EFSF as a bank, the German parliament probably will be reluctant to take this route. However, there might be more acceptance to give the ESM, which will operate with own capital, such a status. Therefore, according to press reports, there are plans to advance the implementation of the EFSF from mid 2013 to the beginning of 2013 or mid 2012. However, as the implementation of the ESM requires the limited EU treaty change — which has to be approved by all 27 EU countries — a start of the ESM in mid 2012 looks unlikely to us.

New measures to support banking sector seem to be under way

Regarding the recapitalisation of banks, it becomes more likely that the stronger EA countries will step up their national rescue facilities. If required, these national programmes might be funded by the EFSF. As EU Commissioner Joaquin Almunia suggested this week, the Commission is willing to extend the exemptions for bank aid beyond the end of 2011, suggesting that national recapitalisation initiatives are under way. In addition, the ECB is likely to provide extra liquidity assistance. As the Belgium governor Luc Coene suggested, this could include extra LTROs with a maturity of up to 12 months or even longer. While we expect the ECB to provide 12M LTRO quickly (probably in October), we regard LTROs of more than 12 months as unlikely for the time being.

⁶ See ["The Future of the Euro Area: Fiscal Union, Break-Up or Blundering Towards a 'You Break It You Own It Europe'", Global Economics View, Willem Buiter, 9 September 2011, Citi](#)

Multiple sovereign defaults are likely to lead to euro area recession and ECB rate cuts

But despite the near-term supporting measures by the ECB and the use of the amended EFSF probably from mid October onwards, the impact of a debt restructuring in Greece and probably Portugal and Ireland in the next 12 months is likely to create more downside risks for the euro area GDP. Although core countries (mainly Germany) are likely to put in place fiscal stimulus packages, the core countries would suffer from a more pronounced economic slowdown and also might end in a recession. While we are still in the process of updating our euro area forecast (the new forecasts will be published on Wednesday, September 28) our current GDP forecast of 0.6% for 2012 — which is well below the latest IMF forecast of 1.1% — looks too optimistic under our new base scenario of multiple defaults taking place in 2012. It looks now more likely that the euro area economy will slip into a recession. As a consequence, the ECB is likely to react not just with additional non-standard measures, but also with a reduction in interest rates. With a likely increase in inflation in September, a cut of the refi rate in October still looks uncertain, but with the fall of the PMI's below 50, the probability of a rate cut even in the near-term has increased. We now expect that the ECB will cut the refi rate back to 1.0% in 1Q 2012.

Figure 4. Calendar of Important Upcoming Events

September		
22		EFSF amendments have now been passed by Belgium, France, Ireland, Italy, Luxembourg, Greece, Spain
23-25	Global	IMF and World Bank Annual Meetings, Washington
25-27	G-20	G-20 Ministerial Meeting on Work and Employment
27	Austria	Finance Committee meets to consider EFSF Bill, to go to special Parliament session on Sep 30
27	Slovenia	EFSF vote in Parliament?
27	Cyprus	Cabinet to discuss EFSF, followed by Parliament vote
28	Finland	EFSF vote in Parliament?
29	Estonia	Plans to hold EFSF vote
29	Germany	EFSF amendments to be considered by Parliament
October		
	Netherlands	EFSF vote likely in first week of October
	Malta	EFSF vote likely after Parliament reconvenes on Oct 3
3	Euro Area	Eurogroup Meeting
4	Euro Area	ECOFIN Meeting
6	Euro Area	ECB Meeting, Berlin
9	Poland	Parliamentary Elections
14-15	G-20	G-20 Finance Ministers' Meeting (Paris)
17-18	Euro Area	European Council, Brussels
20	Spain	General Election
31	Euro Area	ECB: President Trichet's term ends
November		
	Portugal	EU/ECB/IMF Troika completing second review in November
1	Euro Area	ECB: President Draghi's term starts
3	Euro Area	ECB Meeting
3-4	G-20	G-20 Summit, Cannes, France
7	Euro Area	Eurogroup meeting, Brussels
8	Euro Area	ECOFIN meeting
18	Euro Area	ECOFIN Meeting re Budget, Brussels
29	Euro Area	Eurogroup meeting, Brussels
30	Euro Area	ECOFIN meeting, Brussels
December		
	Greece	Disbursement of 7th tranche: €5bn?
8	Euro Area	ECB Meeting, Frankfurt
9	Euro Area	European Council, Brussels
13	US	FOMC Meeting
14	Ireland	EU/ECB/IMF Troika 4th review of Ireland completed
	Portugal	EU/ECB/IMF Troika completing third review
31	EU	Polish Presidency of EU ends – Denmark assumes 6-month presidency

Source: Citi Investment Research and Analysis

Key Economic Indicators (26 September – 30 September 2011)

During The Week		Forecast	Last
07:00	UK: Nationwide House Prices, Sep		
Monday 26 September		Forecast	Last
08:30	Netherlands: Producer Confidence, Sep		
08:30	Sweden: Trade Balance, Aug		
09:00	Italy: Consumer Confidence, Sep	96	100.3
09:00	Germany: ifo Business Climate, Sep	104	108.7
18:00	France: Jobless Change, Aug	+20K	+36.1K
Tuesday 27 September		Forecast	Last
	Spain: Budget Balance, Jan-Aug	€-29.9 Billion	Year Ago: €-34.8 Billion
07:00	Germany: GfK Consumer Confidence, Oct		
08:30	Sweden: Producer Prices, Aug		
09:00	Euro Area: M3, Aug	1.4% YY, 1.8% 3-M YY	2.0% YY, 2.1% 3-M YY
09:00	Italy: Contractual Wages, Aug		
10:00	Italy: Hours Worked, 2Q		
11:00	UK: CBI Retail Survey, Sep		
Wednesday 28 September		Forecast	Last
	Germany: HICP, Sep Preliminary	0.0% MM, 2.6% YY	0.0% MM, 2.5% YY
	National CPI, Sep Preliminary	0.0% MM, 2.5% YY	0.0% MM, 2.4% YY
06:30	France: GDP, 2Q Details	0.0% QQ, 1.6% YY	0.9% QQ, 2.1% YY
07:00	Germany: Import Prices, Sep	-0.9% MM, 6.3% YY	0.8% MM, 7.5% YY
08:15	Sweden: Consumer Confidence, Sep	3.0	4.3
	Manufacturing Confidence, Sep	-5	-3
09:00	Italy: Business Confidence, Sep	94.2	99.9
Thursday 29 September		Forecast	Last
	Germany: Parliament debates EFSF Amendments and second Greek Bailout		
08:00	Spain: Real Retail Sales, Adj, Aug	-5.9% YY	-3.9% YY
08:00	Spain: HICP Flash Estimate, Sep	3.0% YY	2.7% YY
08:30	Sweden: Retail Sales, Aug	-0.5% MM SA	-0.7% MM SA
08:55	Germany: Unemployment, Sep	-4K	-8K
09:00	Italy: Debt to GDP, 2Q		
09:00	Norway: Household Consumption of Goods, Aug	0.4% MM SA	-1.0% MM SA
09:00	Norway: Retail Sales, Aug	0.2% MM SA	-0.7% MM SA
09:30	UK: Personal Borrowing, Aug		
10:00	Euro Area: Economic Confidence, Sep	93	98.3
	Industrial Confidence, Sep	-8	-3
	Consumer Confidence, Sep	-19	-17
Friday 30 September		Forecast	Last
00:01	UK: GfK Consumer Confidence, Sep		
07:00	Germany: Retail Sales, Aug	-1.0% MM	0.3% MM
07:45	France: Manufactured Goods Consumption, Jul-Aug	0.2% MM, 0.9% YY	1.2% MM, 1.8% YY
07:45	France: Producer Prices, Jul-Aug	0.1% MM, 5.9% YY	-0.1% MM, 6.1% YY
08:00	Norway: Registered Unemployment Rate, Sep		
08:30	Netherlands: Producer Prices, Aug		
09:00	Italy: Unemployment Rate, 2Q	8.1%	8.2%
09:00	Norway: Credit Indicator C2, Aug	6.4% YY	6.3% YY
10:00	Italy: HICP, Sep	3.7% YY	2.3% YY
10:00	Euro Area: HICP Flash Estimate, Sep	2.8% YY	2.5% YY
10:00	Euro Area: Unemployment Rate, Aug	10.0%	10.0%
10:30	Switzerland: KOF Economic Barometer, Sep		
11:00	Italy: Producer Prices, Aug		
14:00	Belgium: GDP, 2Q Details	0.7% QQ, 2.6% YY	1.0% QQ, 3.0% YY
	Greece: Retail Sales, Jul		

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

Economic Indicators

Euro Area

Sep 27 09:00	M3, Aug	Forecast: 1.4% YY, 1.8% 3-M YY	Prior: 2.0% YY, 2.1% 3-M YY
London Time	With adverse base effects, we expect M3 YY growth to drop in August. However, the monthly comparison probably will show a second consecutive modest increase: M3 is likely to edge up by around 0.1% MM in August. Loan growth to the private sector is also likely to be up by 0.1% MM after increasing by 0.2% MM in July.		
Sep 29 10:00	Economic Confidence, Sep	Forecast: 93	Prior: 98.3
	Industrial Confidence, Sep	Forecast: -8	Prior: -3
London Time	Consumer Confidence, Sep	Forecast: -19	Prior: -17
	Available data from member countries and the flash estimate for consumer confidence suggest a further broad based decline in confidence in the euro area. The further escalation of the sovereign debt crisis and global financial market turbulence probably are the main factors behind the fall in sentiment. If our forecast is correct, sentiment will be lowest reading since November 2009.		
Sep 30 10:00	HICP, Sep Preliminary	Forecast 2.8% YY	Prior: 2.5% YY
London Time	The inflation rate is likely to increase back to the April high of 2.8% YY. In addition to higher energy prices (mainly reflecting the rebound in oil prices) the VAT increase in Italy is likely to push euro area inflation rates higher as well. Unless there is a large fall in oil prices, inflation is likely to stay around the elevated level up to the end of the year, as additional indirect tax increases, e.g. in France, are likely to come through.		
Sep 30 10:00	Unemployment Rate, Aug	Forecast: 10.0%	Prior: 10.0%
London Time	The unemployment rate is likely to remain unchanged in August. However, seasonally adjusted unemployment claims are likely to increase for a fourth consecutive month.		

Germany

Sep 26 09:00	Ifo Business Climate, Sep	Forecast: 104	Prior: 108.7
London Time	We expect a third consecutive fall in the ifo business climate. We expect a fall in business expectations from 100.1 in August to 95 in September, the lowest reading since June 2009. Furthermore, the assessment of the current business situation probably will drop from 118.1 in August to 114 in September, the lowest reading since August 2010. The decline in business confidence is probably widely spread among sectors.		
Sep 28	HICP, Sep Preliminary	Forecast: 0.0% MM, 2.6% YY	Prior: 0.0% MM, 2.5% YY
	National CPI, Sep Preliminary	Forecast: 0.0% MM, 2.5% YY	Prior: 0.0% MM, 2.4% YY
	Unchanged consumer prices compared to the previous month likely reflect divergent trends between higher prices for fuel and heating oil together with higher prices for clothing on one side and a drop in prices for tourism related services after the holiday season. After edging down in August, we expect a small increase in the harmonised inflation rates in September.		
Sep 28 07:00	Import Prices, Aug	Forecast: -0.9% MM, 6.3% YY	Prior: +0.8% MM, 7.5% YY
London Time	After a larger than expected gain in July, we expect a drop in import prices, mainly reflecting the fall in oil and other commodity prices.		
Sep 29 08:55	Unemployment, Sep	Forecast: -4K	Prior: -8K
London Time	Despite the slowdown in the economic recovery and lower (but still positive) employment plans, we expect another small decline in seasonally adjusted unemployment claims. In Germany's overall upbeat employment environment, most school-leavers will find a job and are not likely to make claims. The unemployment ratio is likely to remain unchanged at a record low for pan Germany of 7.0%.		
Sep 30 07:00	Retail Sales, Aug	Forecast: -1.0 % MM	Prior: +0.3% MM
London Time	Following two consecutive gains in retail sales we expect a drop in August. However, in the first two months of 3Q on average, retail sales probably will be up by 1.8% QQ. New car registrations suggest that car sales did well in August.		

France

Sep 26 18:00	Jobless Change, Aug	Forecast: 20K MM	Prior: 36.1K MM
London Time	The summer (and late spring) has not been kind to the jobless total. More of the same is likely in August. Although employment expectations still remain above their long-term average, the latest PMI survey points to fresh job destruction in September, clouding the job market outlook further. We fear that the economy will not expand at a fast enough pace to stabilise the jobless rate in 2012.		
Sep 28 06:30	GDP, 2Q Details	Forecast: 0.0% QQ, 1.6% YY	Prior: 0.9% QQ, 2.1% YY
London Time	Limited revisions are possible between the different splits, but the contribution from domestic demand will remain negative at around -0.3ppt, given the sizeable contraction in household expenditure during the third quarter. Annualised GDP growth is forecast to moderate to 0.8% in the second half of 2011 from 2.1% in the first half. We see downside risks for 2012 stemming principally from corporate investment.		
Sep 30 07:45	Manufactured Goods Consumption, Jul-Aug	Forecast: 0.2% MM, 0.9% YY	Prior: 1.2% MM, 1.8% YY
London Time	This volatile measure is expected to expand modestly after a very tough second quarter when spending retrenched by 1.8% QQ. The backdrop of weakening confidence and still elevated inflation is not constructive. Neither is the steady increase in unemployment since May 2011 with a cumulative increase of 107K in the total number of registered jobless.		
Sep 28 07:45	Producer Prices, Jul-Aug	Forecast: 0.1% MM, 5.9% YY	Prior: -0.1% MM, 6.1% YY
London Time	Oil prices rose in July but fell in August, pointing to continued volatility in the energy component of the domestic PPI. Some deceleration in the headline rate is expected during in the summer months. First, last year's sharp increases are dropping out of the calculation. Second, firms' pricing power dynamics are deteriorating against the backdrop of softer demand.		

Economic Indicators

Belgium			
Sep 30 14:00 London Time	GDP, 2Q Details We expect Belgium's outperformance (0.7% QQ) compared to the eurozone average (0.2% QQ) to be explained by a decent performance in investment spending underpinning domestic demand. However, with business confidence losing 14 points in the past five months, we expect GDP growth to be close to zero in 3Q.	Forecast: 0.7% QQ, 2.6% YY	Prior: 1.0% QQ, 3.0% YY
Italy			
Sep 26 09:00 London Time	Consumer Confidence, Sep Consumer sentiment was likely hit in September by a second round of fiscal austerity measures (including an immediate VAT hike from 20% to 21% introduced on 17 Sep), continued turbulence on financial markets and on the political scene. If our forecast is correct, the level of the index would be the lowest since summer 2008.	Forecast: 96	Prior: 100.3
Sep 28 09:00 London Time	Business Confidence, Sep After a surprising increase in Aug (probably related to seasonal adjustment) business sentiment likely plummeted in Sep on the back of intensified market pressures on Italian sovereign bond and equity markets. If correct, the index level would stand at 0.8 standard deviations below its long-run average, suggesting industrial output growth is going to slow substantially in 4Q.	Forecast: 94.2	Prior: 99.9
Sep 30 09:00 London Time	Unemployment Rate, 2Q We think the unemployment rate in 2Q continued along a mild downward trend seen in the past 18 months. However, going forward we believe the slowdown in economic activity will likely prevent further declines in the unemployment rate.	Forecast: 8.1%	Prior: 8.2%
Sep 30 10:00 London Time	HICP, Sep The HICP has been depressed in Jul-Aug by a methodological change in the computation of prices for seasonal products, leading to a sharp fall in the YY rate in July from 3% to 2.1%. This is likely to be reversed in Sep, when the summer sales season ends. A 1pp VAT hike was introduced on 17 Sep, and this is also likely to lift Sep inflation. The CPI YY rate, unaffected by methodological changes, likely increased from 2.8% to 3.4%.	Forecast: 3.7% YY	Prior: 2.3% YY
Spain			
Sep 27	Central Government Budget, Jan-Aug The budget likely kept improving in Aug, with the Jan-Aug cumulated figure (on accrual basis) around 15% below the level prevailing in the same period of 2010. However, the improvement at the central government level, albeit still significant, has been losing speed in the past couple of months as revenue growth is ebbing. We think the improvement at the central government level relative to 2010 is not enough to offset the slippages at the local level. We expect the year-end overall deficit to be above the government target of 6% of GDP.	Forecast: €-29.9 Billion	Year Ago: €-34.8 Billion
Sep 29 08:00 London Time	Real Retail Sales Adj. (Aug) Favourable base effects lifted the YY rate for retail spending in July, but this is likely to be reversed in Aug. The outlook, however, remains extremely weak, with a likely decline of 0.5% MM in real retail spending.	Forecast: -5.9% YY	Prior: -3.9% YY
Sep 29 08:00 London Time	HICP, Sep Flash Fuel price increases and a rebound in clothing prices at the end of the summer sales season are likely to drive inflation back to 3% in Sep. However, we think this will be a temporary increase and we expect the recent downward trend to resume in 4Q. We see inflation ending the year at around 2¼% YY.	Forecast: 3.0% YY	Prior: 2.7% YY
Sweden			
Sep 28 08:15 London Time	Consumer Confidence, Sep We expect consumer confidence to fall to 3.0 in September. The indicator has been trending downwards since the peak of 23.7 in January this year and in August saw the largest drop since 2008, falling from 12.0 to 4.3. Confidence is now below the 10-year average of 8.8.	Forecast: 3.0	Prior: 4.3
Sep 28 08:15 London Time	Manufacturing Confidence, Sep We expect the confidence indicator for the manufacturing sector to continue its downward trend in September and fall to -5. Such a move would put the indicator below its long-term average of -4.7 for the first time since December 2009. This would be consistent with the continued negative trend we have seen in the PMI, which historically has been the leading sentiment indicator.	Forecast: -5	Prior: -3
Sep 29 08:30 London Time	Retail Sales (SA), Aug Following a drop in July we expect a 0.5% MM drop in Swedish retail sales in August. The outlook for the retail sector is not very appealing with confidence in the sector falling for the third consecutive month in August, while at the same time consumers' purchasing plans over the coming 12 months are as low as at the start of 2009.	Forecast: -0.5% MM	Prior: -0.7% MM
Norway			
Sep 29 09:00 London Time	Household Consumption of Goods (SA), Aug After negative readings for two consecutive months we expect a rise in the consumption of goods indicator in August. The fact that the number of car registrations increased in August points towards a larger rise in the household consumption of goods indicator than in retail sales.	Forecast: 0.4% MM	Prior: -1.0% MM
Sep 29 09:00 London Time	Retail Sales (SA), Aug In July, Norwegian retail sales saw its first drop since March this year. We forecast a small rebound of 0.2% MM for sales in August.	Forecast: 0.2% MM	Prior: -0.7% MM
Sep 30 09:00 London Time	Credit Indicator (C2), Aug After falling to 6.0% in June the credit growth indicator came back to 6.3% in July. We expect that the YY credit growth measure will rise to 6.4% in August, the same level as in April-May. Nevertheless, this is still relatively slow credit growth compared to the 10-year average rate of 9.9%.	Forecast: 6.4% YY	Prior: 6.3% YY

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

Economic Indicators

Key Economic Indicators (3 October – 7 October 2011)

During The Week		Forecast	Last
09:00	UK: Conservative Party Annual Conference, Manchester, Oct 2-5		
09:00	UK: Halifax House Prices, Sep		
Monday 3 October		Forecast	Last
07:30	Sweden: Manufacturing PMI, Sep		
08:15	Switzerland: Retail Sales, Aug		
09:00	Norway: Manufacturing PMI, Sep		
09:00	Euro Area: Manufacturing PMI, Sep		
09:30	UK: Manufacturing PMI, Sep	47.0	49.0
18:00	Italy: Budget Balance, Sep		
	Euro Area: Eurogroup Meeting (Brussels)		
Tuesday 4 October		Forecast	Last
	EU: ECOFIN Meeting (Brussels)		
08:00	Spain: Unemployment, Sep		
10:00	Euro Area: Industrial Producer Prices, Aug		
Wednesday 5 October		Forecast	Last
09:00	Euro Area: Services PMI, Sep		
	Composite PMI, Sep		
09:30	UK: Services PMI, Sep	49.0	51.1
09:30	UK: GDP Details, 2Q (3 rd release, incl annual "Blue Book" Revisions)	Provisional: 0.2% QQ, 0.7% YY	1Q: 0.5% QQ, 1.6% YY
09:30	UK: Balance of Payments, 2Q	£-11.8 Billion	£-9.4 Billion
10:00	Euro Area: Retail Sales, Aug		
10:00	Euro Area: GDP Details, 2Q (3 rd release)		
Thursday 6 October		Forecast	Last
08:00	Spain: Industrial Production, Aug		
08:30	Sweden: Services Output, Aug		
08:15	Switzerland: Consumer Prices, Sep		
08:30	Netherlands: Consumer Prices, Sep		
09:30	UK: Service Sector Output, Jul	0.0% MM, 2.9% YY	-0.1% MM, 1.6% YY
09:30	UK: BoE Housing Equity Withdrawal, 2Q		
11:00	Germany: Incoming Orders, Aug		
12:00	UK: MPC Outcome		
12:45	Euro Area: ECB Outcome (Press Conference at 13:30)		
Friday 7 October		Forecast	Last
06:45	Switzerland: Unemployment, Sep		
09:00	Norway: Industrial Production, Aug		
09:30	UK: Producer Prices, Sep		
11:00	Germany: Industrial Production, Aug		
During the Weekend		Forecast	Last
	Poland: General Election (Oct 9)		

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

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Recent Research Publications	Author	Date of Publication
Euro Area		
Euro Area — Sovereign Debt Crisis Update	Jürgen Michels	Sep 23, 2011
ECB: Jürgen Stark Leaves ECB Executive Board	Jürgen Michels	Sep 9, 2011
ECB: No Need For Additional Non-Standard Measures Yet	Jürgen Michels	Sep 8, 2011
European Economic Forecast Highlights: August 2011	Ann O'Kelly	Aug 25, 2011
Euro Weekly		
Euro Weekly: Italy's Austerity Drive — Too Little, Too Late	Giada Giani	Sep 16, 2011
Greece — Stuck in the Mud	Giada Giani	Sep 9, 2011
Unchanged Refi, But Lower Market Rates	Jürgen Michels	Sep 2, 2011
Nordics		
Norway — Norges Bank Keeps Rates on Hold	Michael Saunders	Sep 21, 2011
Norway — We Expect Norges Bank to Keep Rates on Hold	Michael Saunders	Sep 19, 2011
Norway — How Much NOK Strengthening Can Norges Bank Take	Michael Saunders	Sep 8, 2011
Sweden — Riksbank Keep Rates Unchanged at 2.0%	Michael Saunders	Sep 7, 2011
Switzerland		
Switzerland — SNB Announces One-Sided FX Peg	Michael Saunders	Sep 6, 2011
Global		
Sovereign Ratings Outlook — September 2011	Michael Saunders	Sep 12, 2011
Global Economics View: A Greek Exit from the Euro Area: A Disaster for Greece, a Crisis for the World	Willem Buiter	Sep 13, 2011
Global Economics View: The future of the euro area: fiscal union, break-up or blundering towards a 'you break it you own it Europe'	Willem Buiter	Sep 9, 2011
Global Economic Outlook And Strategy	Willem Buiter	Aug 24, 2011
UK		
UK — CBI Survey Points to Further Weakness	Michael Saunders	Sep 22, 2011
UK — Minutes Help Prepare Ground for QE	Michael Saunders	Sep 21, 2011
UK — IMF Cuts Growth Forecasts	Michael Saunders	Sep 20, 2011
UK — Relative Productivity Slips Further	Michael Saunders	Sep 20, 2011
UK — QB Helps Prepare Ground for QE	Michael Saunders	Sep 19, 2011
Sterling Weekly		
The Lost Generation	Michael Saunders	Sep 16, 2011
QE: Why? When? How Much? Will It Work?	Michael Saunders	Sep 9, 2011
MPC Edging Towards More QE	Michael Saunders	Sep 2, 2011

Source: Citi Investment Research And Analysis

Notes

Notes

Notes

Appendix A-1

Analyst Certification

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