Moody's Upgrades Greece One Notch to Caa3

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Economics

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Summary

Greece's sovereign rating goes up a notch to Caa3 says Moody's, also assigning Greece a stable outlook, citing: i) significant fiscal consolidation under the structural adjustment programme, likely allowing a primary budget balance in 2013 and a surplus in 2014, ii) some improvement in the medium-term economic outlook thanks to a cyclical recovery and progress on structural reforms, and iii) reduction in the interest burden following previous restructurings.

Germany: Polls suggest that SPD voters in general would approve coalition agreement – but only SPD party members can vote in upcoming referendum.

ECB's Coeuré says QE not warranted, EC's Rehn sees long period of low inflation. This week's Eurosystem staff projections will be crucial in gauging the likelihood of additional ECB monetary policy support. Inflation is set to undershoot the ECB's target for a long period of time, according to our baseline forecasts, and we believe that such readings will be too low for the ECB to ignore, unless the recovery in economic activity were to surprise strongly to the upside – see also ***Euro Economics Weekly - Is Deflation Good or Bad for the Eurozone Periphery?***

French labour market reforms: Sunday work in focus. Labour Minister Sapin called for a "*controlled relaxation*" of the ban on Sunday work, saying it should be organised on a "*regional basis*", hours ahead of the release today of a government-commissioned report designed to clarify which sectors will be allowed to do business on Sunday and under what conditions.

Belgium to lower VAT on energy in April 2014 from 21% to 6%, as part of a set of measures designed to stimulate the economy and control wage rises.

Spain – Current account surplus widened to €6.2bn (0.6% of GDP) in Jan-Sep 2013, vs. a deficit of €15.7bn (1.5% of GDP) in Jan-Sep 2012. The 12M sum CA surplus stood at €7.1bn (0.7% of GDP) in Sept, largest level since 1986.

Spain – Government approves law allowing banks to increase capital, based on the retreatment of €30bn holdings of deferred tax assets (DTAs). The change in DTAs will not affect the government's debt or deficit in the short or medium term, Economy Minister De Guindos noted.

Slovenia – Underlying weakness in GDP, although it surpassed expectations in 3Q. The statistical office said that seasonally-adjusted GDP remained flat on a quarterly basis in 3Q13, with a milder year-on-year contraction of 1.2% SA in 3Q13, below our forecast of -2.3%.

Recent Research

Euro Economics Weekly — Is Deflation Good or Bad for the Eurozone Periphery?

29 November 2013

The unweighted average of Greece, Ireland, Italy, Portugal and Spain is now flirting with deflation. The fall in domestic price pressures is driven by large output gaps, falls in energy prices, and relatively less loose monetary policy than in other major economies. Given a strong euro and low inflation in the rest of the Eurozone and most other advanced economies, low inflation or outright deflation may also be needed to regain export competitiveness in periphery countries.

Ebrahim Rahbari | Guillaume Menuet | Giada Giani | Michael Saunders | Ann O'Kelly

UK Economics Weekly — Policy Post-Guidance

29 November 2013

With the economy recovering strongly, we expect the jobless rate to hit the 7% threshold in late 2014. Whatever the

Today's News in Detail

Greece's sovereign rating goes up a notch to Caa3 says Moody's – Moody's upgraded Greece's government bond rating to Caa3 from C on Friday, also assigning Greece a stable outlook. This is the first upgrade for Greece since 2002. The press release accompanying the rating decision highlighted three main drivers: i) significant fiscal consolidation under the structural adjustment programme, likely allowing a primary budget balance in 2013 and a surplus in 2014; ii) some improvement in the medium-term economic outlook thanks to a cyclical recovery and progress on structural reforms; and iii) a reduction in the interest burden following previous restructurings. Moody's notes that these drivers reduce the likelihood of further PSI as a condition for further financing. In terms of upside risks, Moody's notes that i) easing of political uncertainty, ii) continuation of structural reforms, and iii) sustained primary surpluses could change the rating in a positive direction, but that opposite developments would likely push the rating down. Comment: this rating announcement is in keeping with the general trend of improvement across the euro area periphery, where sovereign bond yields have fallen during the course of 2013. Positive rating migration is unlikely to be sustained in the short-term however, unless the cyclical recovery surprises to the upside, in our view.

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Germany: Polls suggest that SPD voters in general would approve coalition agreement – but only SPD party members can vote in upcoming referendum. *Handelsblatt* quotes polls by Emnid (commissioned by *Bild am Sonntag*) and Forsa (commissioned by *Welt am Sonntag*) that find 66% and 78% of SPD voters, respectively, would approve the coalition agreement with the CDU/CSU. *Handelsblatt* reports on a number of party events around Germany where the party leadership campaigned in favour of the agreement and generally found a positive atmosphere. SPD party chief Gabriel said that he was confident that the party members would back the agreement. SPD general secretary Nahles said that the approval of the coalition agreement was not a done deal, that the vote by the party membership was binding, and that the party leadership would resign if the vote failed. Comment: SPD voters may largely be in favour of the coalition agreement, **but only party members get to vote in the SPD's party referendum on the coalition agreement, and no poll of the party members alone was available**. The SPD has now sent the coalition agreement to its party members in its party magazine and the leadership will appear at numerous events over the next week or so before the voting process starts.

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ECB's Coeuré says QE not warranted, EC's Rehn sees long period of low inflation – Executive Board Member Benoit Coeuré gave an interview to *Nikkei Asian Review* on Friday in which he indicated that while outright asset purchases are possible in principle, they are not warranted on a large scale, given current inflation prospects. Mr. Coeuré acknowledged that disinflation must be looked at carefully, but noted that the Governing Council does not see a deflation threat at the moment, according to Bloomberg. Separately, European Commission Vice President Olli Rehn in an FT interview on Friday remarked that while the ECB will if necessary take action to prevent inflation, we are experiencing a *"rather long period of low inflation"*. He stressed the need for inflation to be somewhat faster *"in the surplus countries of the euro zone"*, so that we could see *"an impact on the exchange rate"* and thus *"improve the chances of rebalancing moving smoother and faster, especially in Southern Europe where that is needed the most"*. Comment: Mr. Rehn's comments are interesting as he often attends the Governing Council meetings. This week's Eurosystem staff projections will be a crucial factor in gauging the likelihood of additional monetary policy support from the ECB. Inflation is set to undershoot the ECB's target for a long period of time, according to our baseline forecasts, which envisage a renewed downturn towards

exact timing, markets probably cannot rely on guidance to anchor rate expectations much beyond 6-7 quarters or so. This note aims to sketch out the MPC's options once the 7% jobless threshold is hit. We expect the MPC will seek to return real rates to roughly zero (ie lifting Bank Rate to about 2%) in 2015-16, but will keep Bank Rate below a neutral level for some time.

Michael Saunders | Ann O'Kelly

ECB — Seen on Hold in December, but More Easing Likely in 2014

28 November 2013

We expect the ECB to leave its key rates unchanged on Dec 5. The focus will be new Staff Projections, extending to 2015. The outlook for muted inflationary pressure calls for reiteration of forward guidance, leaving the door open to more accommodation in 2014. We believe that non-standard measures will be insufficient on their own given rising disinflationary risks. Hence we also pencil in a 25bp rate cut in the refi rate to 0% and a 10bp cut in the deposit rate to -0.1% around Jun-14.

Guillaume Menuet

Denmark — Economy Heading For A Mild Recovery

29 November 2013

After being stagnant for the past three years, the Danish economy extended its recovery in 3Q; up 0.4% QQ after a 0.6% QQ gain in 2Q. Despite these very positive signs, we note that the economy barely grew in the three first quarters of the year compared to the same period last year (up by 0.1% YY). Hence, although we expect the economy to maintain momentum in the final quarter of the year, the weak starting point implies meager growth of around 0.3% YY for 2013.

Tina Mortensen

Sweden — Weak 3Q GDP, But Upward Revisions To 1H 2013

29 November 2013

GDP growth was up a meagre 0.1% QQ in 3Q, and with a 0.1% QQ contraction in the previous quarter, GDP has on average been flat over the last two quarters. Although GDP undershot the

0.5%-0.6% YY in March 2014. We believe that such readings will be too low for the ECB to ignore, unless the recovery in economic activity were to surprise strongly to the upside – see ***Euro Economics Weekly - Is Deflation Good or Bad for the Eurozone Periphery?***

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French labour market reforms: Sunday work in focus. Labour Minister Michel Sapin called for a "*controlled relaxation*" of the ban on Sunday work, saying it should be organised on a "*regional basis*", hours ahead of the release of a government-commissioned report – designed to clarify which sectors will be allowed to do business on Sunday and under what conditions – to be presented by PM Jean-Marc Ayrault on Monday. French business daily *Les Echos* cited unidentified government sources indicating that the report would likely restrict the analysis only to sectors such as furniture and gardening retailers, which in 2009 received exemptions to the ban on Sunday work. Weekly newspaper *Le Journal du Dimanche* indicated that the report also recommends allowing city mayors to raise the number of Sundays a year shops can open to 12 from 5. Comment: although the report will only be the latest in a long list of many which have highlighted the need for more flexibility in terms of labour laws, it is doubtful whether this will prompt a fundamental change in working practices, in our view. The key aspect is the government's willingness to reform the system to provide more clarity and largely rubber-stamp a practice which is becoming more widespread. Given French President Hollande's priority is lowering unemployment, the most likely outcome of the reform is that rules will be relaxed slightly.

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Belgium to lower VAT on energy in April 2014 – An official statement from the Belgian government confirmed that it had agreed a cut in the tax on electricity bills to 6% from 21% from April 2014. The measure will apply until January 2014, subject to a review by September 2015. The government indicated that this decision was part of a set of measures designed to stimulate the economy and control wage rises. Comment: With electricity spending accounting for 2.875% of the basket, the impact on the overall inflation measure should be around 0.4ppt. This would go some way towards following the recommendations of Belgium National Bank Governor Luc Coene who has been highlighting relentlessly that the euro area's sixth largest economy needs to do more to improve its competitiveness. We believe this is a step in the right direction, especially if the measure were to remain permanent. Note that a more powerful strategy would be to completely remove any wage indexation to inflation, except for the lower paid.

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Spain – Current account surplus widened in September. Bank of Spain reported that the Spanish current account (CA) recorded a surplus of €6.2bn (0.6% of GDP) in the period Jan-Sep 2013, vs. a deficit of €15.7bn (1.5% of GDP) in Jan-Sep 2012, and after a positive balance of €2.6bn (0.3% of GDP) in Jan-Aug 2013.The 12M sum CA balance stood at a surplus of €7.1bn (0.7% of GDP) in September, largest level since 1986. According to the BoS, this development reflected a "*significant*" improvement in the income and services balances together with a further correction in merchandise trade deficit. Comment: we expect the CA surplus to improve further to €11.6bn (1.1% of GDP) by year-end.

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Spain – Government approves law allowing banks to increase capital – On Friday, the Spanish government adopted the text allowing banks to account €30bn of deferred tax assets (DTAs) as capital, Economy Minister Luis de Guindos said. This represents roughly 60% of the €50bn of DTAs Spanish banks hold in their books. Mr de Guidos noted that DTAs included under the rule consist of those linked to generic provisions, pension funds and some negative

Riksbank's forecast by a wide margin in 3Q (0.4pp on the quarter), a strong upward revision to the first (and second) quarter more than offset this, indicating upside risks to the Central Bank's full-year 2013 forecast of 0.7% YY. Reflecting historical revisions, we raise our GDP forecast for this year to 0.9% YY (from 0.6% YY), and expect the Riksbank to do the same. The upward trend in sentiment indicators points to accelerating GDP growth ahead, and we confirm our full-year 2014 GDP forecast of 2.2% YY.

Tina Mortensen

Norway — Regional Network Report: No Growth Pick-Up On The Cards

289 November 2013

Norges Bank's Regional Network Report confirms the picture of a downshift in economic activity since autumn: Norges Bank's contacts reported that overall output growth had *"slowed somewhat"* over the past three months, and the level of the indicator fell below expectations back in August. The expectation indicator was also revised lower, and with a value of 0.7 now points to below-trend mainland GDP growth of around 0.4% QQ in 4Q 2013, i.e. below Norges Bank's forecast of a quarterly 0.6% gain.

Tina Mortensen

UK — FLS Support For Mortgages Scaled Back

28 November 2013

The BoE and Treasury announced today that, as of the start of 2014, new mortgage lending will no longer count towards banks' ability to tap the Funding for Lending (FLS) scheme, which will therefore become solely focused on business lending. We doubt these changes will significantly alter the macro backdrop. .

Michael Saunders

Norway — Norges Bank Forecast: Stable Policy Rate at 1.50%

27 November 2013

At the upcoming monetary policy meeting on 5 December, we expect Norges Bank to keep the key policy rate stable at 1.50%, and to leave the

tax bases. The change in DTAs will not affect the government's debt or deficit in the short or medium term, De Guindos reiterated. Comment: while the final amount was lower than the one banks had originally requested (around €50bn), the change in DTA treatment should significantly strengthen banks' capital position ahead of the upcoming comprehensive analysis by the ECB next year. The troika is expected to return today to Madrid to start its final review of the financial assistance programme for Spanish' banks.

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Slovenia – Underlying weakness in GDP, although it surpassed expectations in 3Q

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The statistical office said that seasonally adjusted GDP remained flat on a quarterly basis in 3Q13 after the revision showed a milder contraction in 1H13 (cumulatively by 0.4% compared to -0.8% published initially) and different GDP quarterly dynamics in 2H12, which led to a more benign base effect for 3Q13. As result, all three factors contributed to a milder GDP year-on-year contraction of 1.2% SA in 3Q13, below our forecast of -2.3%. The GDP contraction was even milder at -0.6% YY in 3Q13 for non-seasonally adjusted data after -1.5% a quarter ago. For the time being, we know that the milder YY GDP contraction was driven (again) by stronger export activity (4.9% YY nsa in 3Q13 after 2.2% in 2Q13). However, the contribution of net exports to GDP growth remained unchanged at 1.9%pts. By contrast, there was a first positive contribution from inventories to GDP growth (0.6%pts) after almost 19 consecutive quarters of negative contribution (an average of 6.8%pts according to the previously published seasonally adjusted data). Nevertheless, this was the only factor that led to a milder contraction of domestic demand (-2.8% YY vs. -3.5% a quarter ago) as all remaining parts showed a larger contraction in 3Q13 than in 2Q13 (households -3% YY, government -3.4% and fixed investment -4.4%). Comment: Better quarterly GDP dynamics in 1Q-3Q13 represents a positive risk to our forecast of a total 2.3% YY contraction in 2013 after -2.4% in 2012, while the worse YY dynamics in effective domestic demand points to ongoing underlying weakness in the economy. This domestic weakness is continuously influenced in a negative manner by banking sector uncertainty. This resulted in a large contraction of private loans of 8% YY in October, which reflects an 11% contraction of loans to non-financial companies and a 3% contraction of loans to households. However, GDP contraction of around -1.7% YY in 2013 is more likely if we assume a 0.5% QQ contraction in 4Q13 GDP that would result in a milder YY contraction of around -1% in the last quarter of 2013 after -1.2% in 3Q13. Nevertheless, as there was a worse dynamic in domestic demand in 3Q13, we do not see too much upside risk to our 2014 forecast of a GDP contraction of -0.9% YY. We assume a total 0.6% contraction during 1H14, followed by GDP stabilisation in 3Q14 and a mild quarterly gain by end-2014. However, this assumes a continuing export driven recovery, banking sector resolution in 1Q14 and, the most important in our view, political stability, which we expect to be under pressure after the AQR and stress test (to be published on 13 December) and ongoing fiscal consolidation. We do not expect any strong recovery in 2015 (with GDP YY growth of 0.8%) as banking credit is likely to remain lacklustre.

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Latest Issues of Sovereign Debt Update

S&P Cuts Dutch Rating to AA+, Raises Spanish Outlook

29 November 2013

S&P says Netherlands no longer AAA, but revises Spain's outlook to Stable. ECB seen on hold in Dec. Germany's FinMin rules out tax increases. French unemployment falls for second time. Italy's President asks for confidence vote on

conditional interest rate path about unchanged or slightly lower; to be sure, we do not expect a rate cut, but rather that the timing of initial tightening (mid-2014 at present) likely will be postponed further.

Tina Mortensen

Scandi Economics Update — Scandi PMIs on the Agenda

2 December 2013

Sweden — Manufacturing PMI seen improving in Nov — Weak 3Q GDP, but upward revisions to 1H 2013 — Data preview.

Norway — Manufacturing PMI expected to fall slightly in Nov — Total credit growth likely to moderate to 6.1% Y/Y in Oct — RNR: No growth pick-up on the cards — Data preview. Most important event this week is Norges Bank's interest rate decision and release of its Monetary Policy Report (Thu).

Denmark — Economy heading for a mild recovery.

Tina Mortensen

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new governing coalition. Italy: credit to private sector falls again. Spain: House prices fall in 3Q but at slower pace. Portugal: economic sentiment improves. Greece: no deal with troika before Eurogroup meeting. Greek bank deposits and bank credit keep falling.

Giada Giani | Guillaume Menuet | Ebrahim Rahbari

ECB’s Constancio – Negative Deposit Rate Only in Extreme Situations

28 November 2013

ECB negative deposit rate only in extreme situation, says Constancio. ECB supervisor-to-be Nouy promises rigorous stress tests. ECB sees systemic risk measures return to pre-crisis levels. Germany: CDU, CSU and SPD party leaders present coalition agreement. French unemployment to fall steadily soon, says government. Berlusconi expelled from Italian Senate. Bank of Italy capital shares re-evaluation approved. Portugal's pension reform envisages raising retirement age.

Giada Giani | Guillaume Menuet | Ebrahim Rahbari

ECB Ponders a Sort of “Funding for Lending” LTRO

27 November 2013

ECB considers LTRO linked to bank lending. ECB's Liikanen on Eurosystem's capacity to find solutions, ECB's Coeure on inflation, ECB's Mersch on liquidity. Germany: coalition deal (almost) reached. French President seeks Spain's support for growth plan at Dec EU Summit. Italy passes 2014 Budget. Spain's state budget deficit rises, Spain's banks to increase capital. Belgium's CB head calls for improved competitiveness. Ireland not eligible for OMT, says Asmussen. Portugal passes 2014 Budget.

Guillaume Menuet | Giada Giani | Ebrahim Rahbari

ECB’s Coeuré Seeks Safety Margin Against Deflation

26 November 2013

ECB seeks safety margin against deflation - Linde on rate cut vs asset purchases - Praet on balance sheet recession. Buba says ECB should not permanently supervise banks. Dutch CB expects capital raising after ECB tests. German coalition talks in end phase. Italy: confidence vote on 2014 Budget. Spain's central government deficit rises. Greece narrows gap with troika on 2014 budget. Portugal Constitutional Court upholds extension of working week. Slovenia's better sentiment in November.

Guillaume Menuet | Giada Giani | Ebrahim Rahbari

Portugal – Pension Cuts Sent to Constitutional Court

25 November 2013

Portugal's President sends public pension cuts to Constitutional Court. ECB's Coeure sees long period of low rates, Asmussen warns about activism. Ongoing debate on ECB Minutes. ECB and ESRB sovereign debt risk weight plans. Germany's coalition talks remain difficult. Buba deputy head expects some banks to fail ECB test. French tax reform talks begin. No changes to Italy's 2014 Budget, says FinMin. Spain on track says IMF. Greece: IMF says new fiscal measures to be less than in the past.

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Appendix A-1

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