

## Dijsselbloem Calls for Reform of Fiscal Rules

Summary | Today's News in Detail | Latest Issues of Sovereign Debt Crisis Update | Macroeconomic Research | Recent Research

### Summary

**Eurogroup chairman Dijsselbloem calls for conditionality to be applied to budget deficit target extensions**, suggesting deficit target extensions have to be linked to implementation of structural reforms.

**Eurogroup's Dijsselbloem says plans to directly recapitalize banks to be finalized by year-end.** Dijsselbloem also said Spanish banks should still be "be closely monitored", although their liquidity position has improved and he called for more labour market reforms in Spain.

**ECB's Coeuré says "Europe has emerged from the danger zone. It's time for us to get our act together, to reform and to grow"**, calling for prioritising public spending towards investment that boosts productivity and labour and goods market flexibility.

**French government must do more on expenditure reduction says BdF's Noyer**, calling for "a reduction in absolute terms". The Governor called for more structural reforms to lift potential growth.

**French President Hollande's popularity ratings fall to new record low.** A BVA poll shows Francois Hollande had become the most unpopular French president on record, falling to 26% of positive opinions.

**Italy – business sentiment posts sixth consecutive monthly rise in Oct**, highest level since August 2011.

**Italy – Mr Berlusconi's daughter denies she will take on party leadership**, amid ongoing battle within the PdL party (soon to be renamed Forza Italia) to find a successor to Mr Berlusconi, after his likely ousting from parliament.

**France – consumer confidence weaker than expected in October**, unchanged on Sept levels and still below long-run average.

**Spain – Weak retail sales in September, down by 2.8% MM** (after +3.5% MM in Aug). On a yearly basis, retail sales rose by 2.3% mainly due to strong positive base effects. Mortgages approvals continued to plunge in August by 41.7% YY to 12,147 approvals, the lowest level since 2003.

**Portugal exit from bailout programme "a bit more worrying" than for Ireland or Spain**, head of the Eurogroup Dijsselbloem said in an interview yesterday.

**Ireland may not need credit line to exit bailout**, says FinMin Noonan.

**Slovenia – No breaking news from IMF's Article IV visit**, expect proposals on banking sector resolution by end of 2013.

29 October 2013

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Economics

Western Europe

Industrialised G7 Countries

### Recent Research

#### Euro Economics Weekly — Italy and Spain Look Well Positioned For Job Growth

25 October 2013

As sentiment surveys continue to recover across the euro area, some improvement in employment expectations suggests that job creation will become a feature of the economic landscape once again. Most member states have made significant efforts to reform labour markets and lower the cost of labour, attempting to lower the threshold of GDP growth at which job creation becomes positive.

Guillaume Menuet

#### UK Economics Weekly — Growth Dividend For The Public Finances

25 October 2013

The improving economy and recent fiscal data are likely to provide a favourable backdrop for the Autumn Statement (scheduled for December 4). We expect the Chancellor will introduce measures to tackle three key issues:

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## Today's News in Detail

**Eurozone chairman calls for conditionality for budget deficit target extensions.** The FT reports that Eurogroup Chairman and Dutch Finance Minister Jeroen Dijsselbloem stated that the currency union needs “*more instruments*” to tackle deficits and low growth and suggested linking ‘*giving more time on the fiscal side and economic reforms*’. Mr Dijsselbloem’s remarks followed his criticism that Brussels’ new “*leniency*” in extending deficit targets came without any conditions. Dijsselbloem argued that the deadline for fiscal targets can only be extended if these were tied more concretely to the completion of structural reforms to enhance growth. Comment: Mr Dijsselbloem’s comments tie in with ongoing discussions about “*reform contracts*”, a proposal that had been mostly written off, but is supported by Germany and is likely to be discussed in detail at the EU Council in December.

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**Spain should reform more, Eurogroup’s Dijsselbloem said** yesterday. According to Dijsselbloem, Spain should do more in terms of reforming its labour market, including a rise in the retirement age and changes in working hours, *El Pais* reports. Mr Dijsselbloem noted that the Spanish labour market should be more “*dynamic*” with more “*modern*” labour contracts, as the unemployment rate still remains very high, especially among young people. **On the topic of Spanish banks**, Dijsselbloem said in a letter to the Dutch parliament that while the “*liquidity position of the banks has improved*”, “*the situation in the banking sector should therefore be closely monitored*”, as the “*weak economic situation continues to put pressure on the Spanish banking sector*”. Separately, **Bank of Spain Deputy Governor Fernando Restoy** said that the latest data “*support the expectation of a gradual recovery in the Spanish economy that may have started in the 3Q*”. Regarding the banking sector, Mr Restoy noted that Spanish banks are “*reasonably capitalised*” and their leverage ratios are “*relatively low if we compare them with other European lenders*”. According to Mr Restoy the main challenges still remain the “*persistent fragmentation of European markets*” and “*the consequent link between sovereign risk and bank risk*”, Bloomberg reported.

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**ECB’s Coeuré on the euro area’s next steps** – ECB Executive Board Member Benoit Coeuré indicated in a speech entitled “*Lessons from East Asia for the euro area*” at the Asia Europe Economic Forum in Beijing that “*Europe has emerged from the danger zone. It’s time for us to get our act together, to reform and to grow*”. Reuters reported that Mr. Coeuré said countries should prioritise public spending towards investment that boosts productivity and ensure that labour and goods markets are flexible to promote investment in new business models. On the issue of openness, he added that “*Europe needs to avoid protectionist temptations and calls for re-nationalisation*”. Comment: one of the many ECB speakers who continue to stress that the euro area still needs to do a lot more to fix the imbalances and problems that led to the sovereign debt crisis. Greater labour market flexibility probably needs to be a focal point for governments in coming years, if only to partly offset the impact of a strong euro.

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**French government must do more on expenditure reduction, says BdF’s Noyer** – Banque de France Governor Christian Noyer indicated in an interview with the Financial Times released on Monday that the French government should accelerate the reduction in expenditure, delivering “*a reduction in absolute terms*”. Mr. Noyer added that the French government must push for further “*accelerated*” labour cost and labour market reforms and reforms of product and service markets. Mr. Noyer noted that while French growth should return to its potential “*or higher*” in 2015, “*it is crucial that France raises its potential through*

easing upward pressure on household energy prices, improving SME finance and encouraging business investment — alongside sizeable downward revisions to the UK’s debt and deficit outlook.

[Michael Saunders](#)

## UK — Strong GDP Data

**25 October 2013**

The ONS report that real GDP rose 0.8% QQ in Q3, after the 0.7% gain in Q2. With strong GDP, buoyant surveys and loose financial conditions, recovery is finally here. With reduced headwinds from deleveraging and the EMU crisis, plus supportive monetary conditions, we expect growth will remain strong in coming quarters, and we forecast GDP growth of 3.0% for 2014 – well above consensus.

[Michael Saunders](#)

## Sweden — Broad-Based Recovery In Sentiment

**25 October 2013**

The October survey from NIER showed a broad-based upturn in sentiment with both consumer and business confidence rising above the historical average, and reaching the strongest levels since June 2011. In turn, the economic tendency indicator gained 3.4 points to 101.6, suggesting that economic activity in Sweden now is running at or slightly above a trend-rate pace.

[Tina Mortensen](#)

## Norway — Hitting The Limits Of Growth Outperformance

**25 October 2013**

Although Norway is likely to continue to outperform most of Europe, momentum has peaked and the economy is heading towards a more moderate growth phase with below-trend mainland GDP growth in coming years.

[Tina Mortensen](#)

## UK — YouGov Report Jump in Inflation Expectations

**24 October 2013**

The median for inflation expectations in the year ahead jumped to 3.2% in October from 2.5% in September, and is the highest since Oct-2011. The median

*structural reforms*". Comment: the 2015 budget will be the real test of the government's ability to deliver real change in its expenditure policy as the fiscal pressure will have reached maximum level during 2014 and the room for manoeuvre on extracting additional ad-hoc revenues will likely be exhausted.

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**French President Hollande's popularity ratings fall to record low** – A BVA poll for the regional press showed on Monday that French President Francois Hollande had become the most unpopular French president on record. Polling institute BVA noted that the main reasons for the 4-point drop to just 26% of positive opinions in his actions had been some of the latest tax hikes, unemployment and rows over the government's immigration policy. Some 84% of those surveyed on Oct. 24-25 believed government policy was not efficient and 74% said it was not fair. Reuters noted that as President Hollande is dragging his Socialist party's approval ratings down, the far-right National Front keeps progressing, with the two parties now with the same approval ratings. Comment: record low popularity ratings are nothing new for the French President and his Prime Minister Jean-Marc Ayrault. The problem is that despite a timid recovery in economic activity, French voters will likely express their frustration at the upcoming municipal elections and European elections in the spring of 2014. The political damage could be serious in our view, likely forcing the government to push more aggressively for expenditure cuts and perhaps even remove of the country's multiple administrative layers to make more savings.

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**Italy – business sentiment posts sixth consecutive monthly rise in Oct.** The manufacturing business sentiment indicator rose to 97.3 in Oct, from 96.8 in Sept, highest level since August 2011. The monthly increase (0.5 points) was smaller than in previous months, but the level is now almost back to its long-run average. Comment: the recent upward moves in business sentiment have closed the gap with other surveys (eg, manufacturing PMI) and suggest the economy is expanding again (albeit very modestly). We reckon the acceleration in the repayment of government arrears (some 0.8% of GDP were paid back by end-Sept) are helping to lift business confidence.

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**Italy – Mr Berlusconi's daughter denies she will take on PdL leadership.** The Italian centre-right party PdL (soon to be renamed Forza Italia) is battling to find a successor to current leader Mr Berlusconi, as he will soon face a vote in the Senate which will likely ban him from public offices. Several media in the past few days had speculated Mr Berlusconi's daughter Marina could replace him, but she denied these speculations once again yesterday. Against other suggestions about a possible split of the party (with government loyalists separating from the most hawkish party members), PdL's secretary Angelino Alfano declared yesterday that Mr Berlusconi remains the party leader. *La Stampa* reports two poll results suggesting that Mr Berlusconi by himself can still enjoy some 15%-18% of voting intentions, irrespective of whether Mr Berlusconi is the party candidate or just the party leader. Comment: the divisions within PdL may still jeopardise the stability of the Letta administration, especially after, as it seems likely, the Senate will oust Berlusconi from Parliament.

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**Spain – Weak retail sales in September.** Retail sales fell by 2.8% MM in September, after an increase of 3.5% MM in August, according to INE data released this morning. On a yearly basis, retail sales rose by 2.3% mainly due to strong positive base effects. Comment: While the monthly decline probably reflects a payback after the large increase in August, the quarterly figure remains positive and suggests that private consumption likely rose marginally in 3Q.

for inflation expectations over the longer term (next 5-10 years) surged from 3.3% YoY in September to 3.9% YoY in October and is the highest since June-2011. These results are bound to worry the BoE, especially in the context of the improving economy. We will monitor closely results in coming months to see if this upturn is sustained.

Michael Saunders

## UK — CBI Report Rising Optimism, Greater Labour Shortages

24 October 2013

The quarterly business confidence series rose from 7% in July to 24% in October, matching the level of April 2010: business confidence has not been higher since 1994. In turn, the growth in new orders over the last three months matches the July-2010 figure as the third-highest of the last 15 years, while the series for readings for expected new orders and employment intentions remain well above average. The pickup in output is pushing up capacity use and reports of skilled labour shortages.

Michael Saunders

## Sweden — Riksbank with a Slightly Dovish Tilt

24 October 2013

As expected, the Riksbank (4:2 split) left the key policy rate unchanged at 1.0% at today's monetary policy meeting, and maintained its near-term easing bias. Meanwhile, the Bank was slightly more dovish than expected as it lowered its conditional interest rate path marginally for 2014-15 (by 1-6bp). In other words, the Central Bank raised the probability of a near-term interest rate cut to 20% (16% previously), and postponed the timing of initial monetary tightening from Sep/Oct to Oct/Dec.

Tina Mortensen

## Norway — Norges Bank: Stable Rate, Neutral Statement

24 October 2013

As expected, Norges Bank kept the key policy rate unchanged at 1.50% at today's meeting and issued a broadly neutral statement, echoing the conclusions from the September Monetary Policy Report.

**Spanish mortgages approvals plunged in August.** The number of mortgages granted for home purchases fell by 41.7% YY in August to 12,147, the lowest level since 2003. YTD home mortgages decreased by 27.8% relative to Jan-Aug 2012, while the average value of home mortgages fell by 8.2% YY to €95,702 Comment: the adjustment in the housing sector is far from being completed regardless of recent macro data pointing out to a timid recovery in the Spanish economy.

Tina Mortensen

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**Portugal exit from the bailout programme “a bit more worrying” than the exit for Ireland or Spain,** head of the Eurogroup Dijsselbloem said in an interview yesterday in Madrid. Comment: the debate on whether Portugal will need a full second bailout or will manage to re-access capital markets and hence require only a precautionary programme, remains unresolved. Dijsselbloem said last week that the discussion on Portugal will only be initiated in Q1 14.

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**Ireland may not need credit line to exit bailout, says FinMin.**

Ann O'Kelly 44 20 7986 3297

According to the *Irish Times*, Finance Minister Michael Noonan said “the option of not having a programme is still a strong option” after meeting IMF officials yesterday in Washington to discuss Ireland's exit from the bailout programme. “It's still an open question. It's finely balanced... We're funded into 2015 so we're not taking a big risk to go it alone”, he remarked, and went on to say that “What we're trying to do is to establish what the principals of the troika are thinking about Ireland's exit”. He also said that a decision on Ireland's exit strategy would not be made until a government was formed in Germany: “It's not really possible to make a decision while there's no government in Germany” and he suggested that a decision would be made after the SDP conference on Nov 15 but before the end of November. Later yesterday he had a private dinner with IMF head Christine Lagarde. Next week on Tuesday, FinMin Noonan meets with Eurogroup head Dijsselbloem to discuss Ireland's bailout exit. Meanwhile, the troika arrives today in Dublin for the final programme visit, with discussions expected to focus on 1) the recent budget and particularly the overruns in health spending and 2) the question of an emergency credit line.

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**Slovenia - No breaking news from IMF's Article IV visit, expect proposals on banking sector resolution by end of 2013.**

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The IMF's general conclusion from its Article IV visit is that recapitalisation of the banking sector does not make sense without restructuring the corporate sector and privatisation. IMF recommendations are particularly focused on better corporate governance in the banking sector, privatisation (the 15 companies already named should be the beginning) and attracting FDI. The results of the banking sector tests (asset quality review and stress tests) are expected to be known soon for policymakers, but we understand that they should be made public together with policy measures (that will influence the size of recapitalisation) by the end of 2013. Regarding the level of the transfer price for bad loans (which will be set for transfer into the BAMC) we feel that the IMF would probably favour a lower level than was originally proposed (38% of gross value) by saying that “a strong cash protocol should ensure that bonds issued by BAMC are quickly repaid”.

The IMF expects the general government deficit (excluding the impact of the banking sector) at 4.25% of GDP in 2013 (wider due to a weaker economy). However, the IMF sees negative risks for the 2014 deficit due to: i) ongoing weakness in the economy; ii) the cuts in expenditure are discretionary rather than the result of structural reforms; iii) higher tax revenues are not sure as they

reflect a larger tax base rather than higher tax rates. As result, the IMF proposes a contingency austerity measures of 1% of GDP in case of negative development of the government budget.

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## Latest Issues of Sovereign Debt Crisis Update

### EU Council Kicks Banking Union Decisions to December

28 October 2013

EU Council: no decisions on major agenda items. Asmussen on need for national backstops. German coalition talks start on tricky issues. Italy's coalition parties may now have incentive for elections in spring 2014. Fitch affirms Italy's rating, Moody's warns of bail-in risk for weak Italian banks. French Govt backs down on levy on popular investment and savings vehicles. Spain's Govt to repay bank loan early. Portugal's lower corporate tax rate. Greek Govt's savings on social security spending.

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### EU Leaders Confident about Compromise on Banking Union

25 October 2013

After first day of EU Summit, leaders generally sounded confident of compromise on banking union and SRM by yearend. ECB's Asmussen not overly worried about exchange rate. French unemployment continues to rise. Italy's consumer confidence unexpectedly drops to lowest level since June. Spain: Job creation only after real GDP growth of 1%, says government minister. Portugal's YTD central government deficit still slightly above 2012 level.

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### Draghi Warns Banks May Fail ECB Assessment

24 October 2013

Draghi says ECB won't hesitate to fail banks, has "no doubt whatsoever" that backstops will be there. ECB's Angeloni expects bank assessments to be more credible, as ECB has to deal with outcome. ECB's Mersch notes reduced financial fragmentation. Germany's coalition negotiations start with Europe issues. Italy's Senate votes to set up committee on constitutional reform. Spain exits recession in 3Q says BoS. Portugal: Fitch confirms rating, outlook. Greece: no debt relief before summer 2014.

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### ECB's Comprehensive Assessment – First Details

23 October 2013

ECB: details of Comprehensive Assessment include list of banks to be included and capital ratio to be applied by Asset Quality Review. EU Commission adopts 2014 work programme. Germany: Coalition negotiations begin. German govt slightly raises 2014 growth forecast. Portugal's UTAO says fiscal tightening in 2013 less than minimum required. Greece: Govt's financial balance in 2Q hit by support to banks. French govt mulls corporate tax cut in 2015. French industry minister says euro too strong.

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### ECB Could Delay SSM “in an Emergency Situation”

22 October 2013

ECB could delay SSM start in "emergency", stresses backstops must be in place. ECB's Knot no fan of narrower rates corridor. EBA issues draft standards for NPL and forbearance definitions. Italy's three main trade unions to strike over 2014 Budget. Portugal seeks precautionary credit line. Spain's private sector continues



deleveraging. French SME loan securitisation initiative almost ready. Germany's Bundestag meets today for first time post election. Slovenia: rise in nonperforming claims.

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## Macroeconomic Research

### European Economic Forecast Highlights — October 2013

24 October 2013

This companion to Global Economic Outlook and Strategy gives detailed quarterly forecasts for the main European countries to end 2014, together with annual forecasts to 2017 for growth, inflation, current balance, fiscal balance, primary balance and government debt.

Ann O'Kelly

### Global Economic Outlook and Strategy — October 2013

23 October 2013

Our global growth forecasts are unchanged this month, at 2.5% for 2013 and 3.2% for 2014 (at current exchange rates). We make a marginal (0.1pp) upward revision to our 2014 euro area forecast — led by upgrades to Portugal and Spain. The exact timing of the start of Fed tapering is highly uncertain, but we now expect that tapering will be pushed back to March, with asset purchases not ending fully until late 2014. The ECB is likely to introduce a new LTRO in Q1, with extra BoJ easing in 2014.

Willem Buiter

### Emerging Markets Macro and Strategy Outlook — Has EM growth-pessimism gone too far?

25 October 2013

Pessimism about EM growth has gathered pace in recent months, but could the pessimism be overdone? EM growth-pessimism seems to sit uncomfortably with recent data. For one thing, the gap between PMIs in DM and those in EM seems to be closing a bit. On balance, though, we still don't see upside risks to EM growth as too visible. Demographic threats to EM growth are becoming more prominent. So while the near-term seems favorable for EM assets, the rally we anticipate might be a nervous one.

Guillermo Mondino

### Perspectives — The Global Demographic Transition—What Role Are China & Other Emerging Asian Economies Likely to Play?

21 October 2013

In previous work, we have documented the features of aging populations in the advanced economies. We now cast these issues against the broader backdrop of global demographics. Specifically, is aging in the advanced economies a problem specific to those economies or a more general feature of the global landscape? To what extent do more favorable demographics in the emerging markets offset aging in the advanced economies?

Nathan Sheets

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# Appendix A-1

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