

Euro Economics Weekly

H2 GDP Uptick Too Small to Stop ECB QE

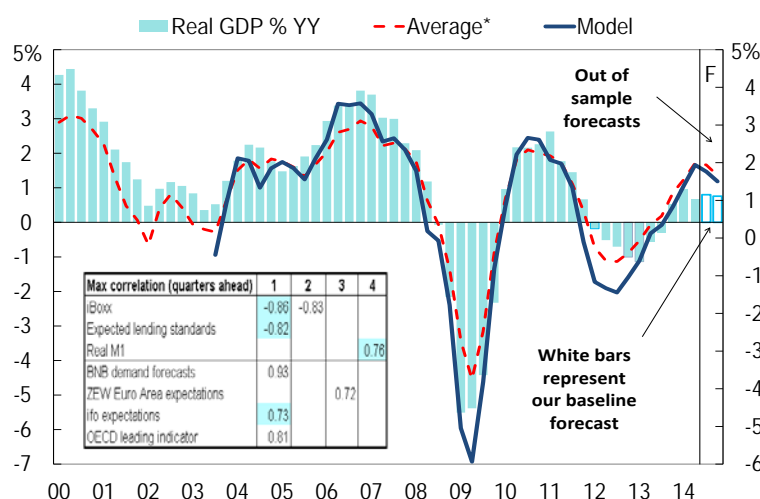
- **Soft start to 2014** — Surveys have over-estimated GDP growth in H1 2014 and a combination of one-off factors distorted the distribution of growth between Q1 and Q2. But economic activity has been disappointing enough to prompt the ECB to cut rates again in September adding to the policy measures already taken in June.
- **Upward revisions to H1-14 GDP growth likely, in coming years** — our analysis of revisions to euro area (EA) real GDP suggests that the underlying pace of economic activity is probably closer to 1% in the last four quarters than the current 0.5% YY Eurostat estimates. Hence, with a more supportive monetary policy stance and a weaker euro, the euro area's vulnerability to shocks is perhaps less acute.
- **How does the ECB respond to weak business sentiment and 'low-flation'?** — Yet our models point to significant risks of weaker business confidence in the quarters ahead and to very limited upside potential in the inputs of our composite PMI model. We expect the large output gap and likely persistence of 'low-flation' to lead the ECB to launch a large purchase programme soon, including public debt.

Figure 1. Citi Forecasts

| | \$/€ | Euro Repo | 10-yr Bunds | £/€ | UK Bank Rate | 10-Yr Gilt Bund |
|-------|------|-----------|-------------|------|--------------|-----------------|
| 4Q 14 | 1.34 | 0.05 | 0.75 | 0.80 | 0.50 | 177 |
| 2Q 15 | 1.33 | 0.05 | 1.25 | 0.79 | 1.00 | 177 |

Source: Citi Research

Figure 2. Euro Area — Real GDP Growth (%YY), Average and Model Forecasts, 2000–2014F



Sources: Haver and Citi Research

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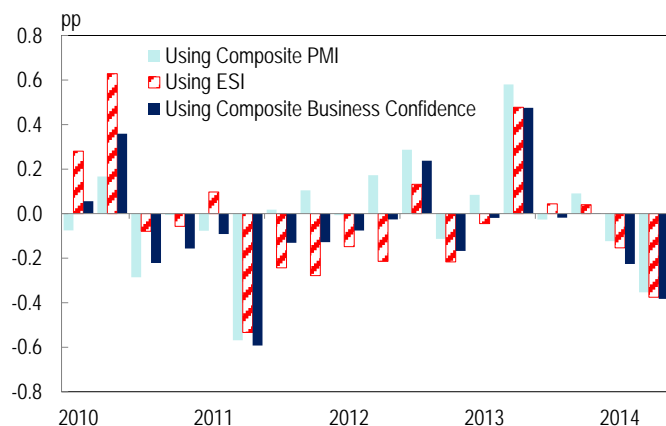
Upside Risks? Too Few and Far Between

Historically, business confidence readings have been good coincident guides of economic activity. However, since the second half of 2012, the forecast errors in predicting GDP growth have grown larger. In the first half of 2014, forecast errors were the most sizeable since the middle quarters of 2011, and both Q1 and Q2 GDP outcomes undershot the consensus forecast by a significant margin. In the first section, we identify an over-prediction bias in estimating real GDP growth from the most widely-used survey data, both at the country and sector level. We also find that euro area GDP tends to be revised up in periods when the initial forecast undershooting is the largest. In the second section, we review our short-term GDP model and business confidence turning points and conclude that there is very limited upside potential to H2 GDP growth.

How useful are surveys for predicting GDP growth?

We construct a system of univariate regression equations relating real GDP growth to i) composite PMIs, ii) the economic sentiment indicator (ESI) of the European Commission and iii) our composite business confidence (CBC, averaging ESIs and manufacturing PMIs) indicator, for all euro area countries in the period from 1999 to 2014. The model with the highest R squared is the composite PMI, followed by the CBC and the ESI. We find that both the composite PMI as well as the ESI have overestimated real GDP QQ growth in 2014 (see Figure 3). The over-estimation bias in H1-14 has been noticeable, averaging 0.24pp for the composite PMI, 0.26pp for the ESI and 0.3pp for our composite indicator. For Q2-14, the models pointed to 0.4% QQ GDP growth, but Eurostat indicated that GDP had largely flat-lined at 0.03% QQ, implying an average forecast error for the three regressors of 0.37pp.

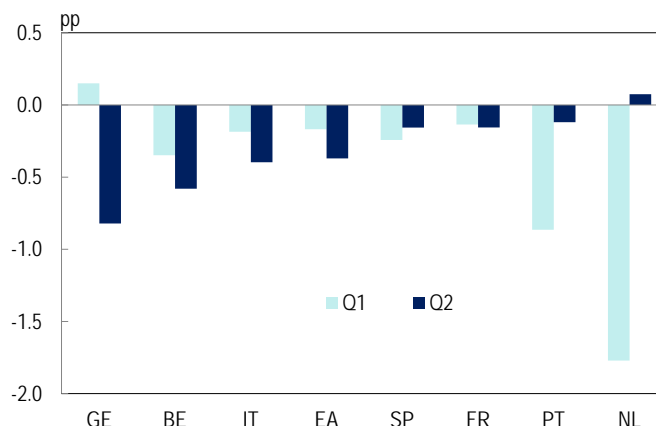
Figure 3. Euro Area — Estimated Residuals of Real GDP QQ Growth from Econometric Models (pp), Q1 2010 to Q2 2014



Note: residuals correspond to actual real GDP growth (% QQ) minus estimated fitted values (from univariate regressions models of real GDP growth % QQ)

Sources: Haver, Eurostat, European Commission and Citi Research

Figure 4. Selected Euro Area Countries — Average of Estimated Residuals of Real GDP QQ Growth from Econometric Models (pp), Q1 and Q2 2014



Note: residuals correspond to actual real GDP growth (% QQ) minus estimated fitted values (from univariate regressions models of real GDP growth % QQ). For the Netherlands, Belgium and Portugal, the composite PMI does not exist

Sources: Haver, Eurostat, European Commission and Citi Research

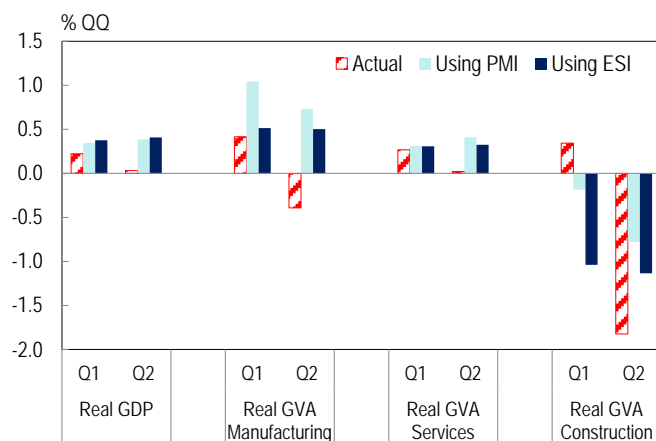
Across countries, we find that the largest GDP forecast errors in Q2 2014 were in Germany (partly compensating for the 1Q overshooting), Belgium and Italy (see Figure 4), with actual real GDP growth at least 0.4pp below predicted values. By contrast, survey data under-estimated real GDP growth in the Netherlands, albeit by a very small amount (0.1pp) after a very large over-estimation in Q1.

As a further step, we test whether similar inconsistencies between surveys and hard data are evident at an industry/sector level. We find that the over-estimation bias is also present in the manufacturing and services sectors, with the error the largest in the former (see Figure 5). Construction survey indicators failed to pick-up the Q1 rebound in activity as well as the large drop in Q2.

In our view, there are many reasons for this divergence, with the large decline in construction sector activity in Q2 partly explained by a payback after a decent Q1, probably influenced by the unusually warm weather. We calculate that average temperatures in Germany and the Netherlands during Q1 were around 2.5°C higher than over the past twenty years. Incidentally, the clement weather depressed demand for heating fuels by European customers, leading to a fall in Dutch exports of natural gas in Q1. The Bundesbank estimated that the mild winter might have boosted German GDP (in particular construction activity) in Q1 by 0.3pp and potentially weighed on Q2 GDP growth by a similar margin.

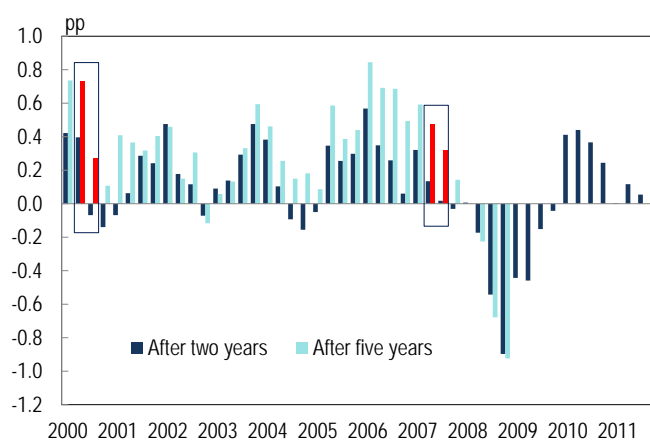
Another factor specific to Q2 and likely to have contributed to the over-prediction of GDP growth by the surveys is the abnormally large number of 'bridge days' – holidays falling on Tuesdays and Thursdays prompting some employees to take an additional day off – that are not reflected in normal calendar adjustments for both GDP and other economic data. We also believe that the late timing of Easter could have also played a role in dampening the level of economic activity.

Figure 5. Euro Area – Gross Value Added Growth and Estimated by Econometric Models (% QQ), Q1 2014 to Q2 2014



Source: Citi Research

Figure 6. Euro Area – Revisions to Real GDP YY Growth Two and Five Years after the First Release (pp), 2000 to 2011



Sources: OECD and Citi Research

We suspect that there could be another angle in some of the temporary divergence between surveys and GDP growth in certain episodes when the forecast error turns out to be particularly large. Analysis of OECD data detailing revisions to real euro area GDP since 2000 shows that the median revision to YY growth has been modest, worth 0.1pp two years after the first estimate is released (0.2pp excluding the 2007-2009 period), but rising to 0.3pp (0.4pp) after five years (see Figure 6). However, we note that the large negative forecast errors in H1 2014 may imply that future revisions could exceed the medium upward adjustments calculated over the last 13 years. We identify two periods when surveys over-predicted actual GDP growth, Q2/Q3 2000 and Q2/Q3 2007, highlighted in Figure 6. In the subsequent five years, the annual growth rate of real GDP in those quarters was revised upward to the tune of 0.3-0.7pp. Assuming that the same relationship applies to 2014, it is probable that the very GDP data in the first half of 2014 underestimate the underlying pace of economic activity.

In order to test this, we construct a model of final (i.e. five years after first release) real GDP annual growth using the first YY real GDP growth release and composite PMI as explanatory variables for the EA. The model shows that the revisions in YY real GDP growth are significantly correlated to survey data available in real time, and implies that the H1 2014 YY real growth may be revised upward by 0.3-0.4 in 5 years. This suggests that the underlying pace of GDP growth could be closer to 1% YY in the last four quarters than the 0.5% current estimate.

Assuming that business surveys remain close to current levels, it is likely that GDP growth will accelerate a little in the second half of 2014 after the clear underperformance in the first half. While idiosyncratic shocks are always possible, it seems that the greater contribution that the ECB is making towards easier financial conditions through its looser monetary policy stance will protect from some of the downside risks that have emerged in the last few months.

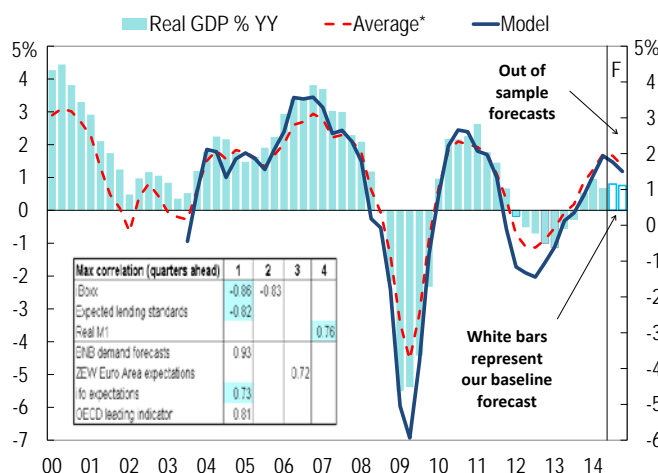
Short-term models and turning points

At the start of July, we assessed the growing risks of a faltering EA recovery. Information gathered since has reinforced these earlier concerns. As we approach Q4, one of the key questions for investors is whether the euro area business confidence will weaken further in coming months or whether the more accommodative ECB policy stance and signs of relaxation in budgetary adjustments efforts will bolster confidence. We take a look at our short-term GDP growth model, and our composite business cycle turning point.

Short-term GDP growth model points to fading momentum

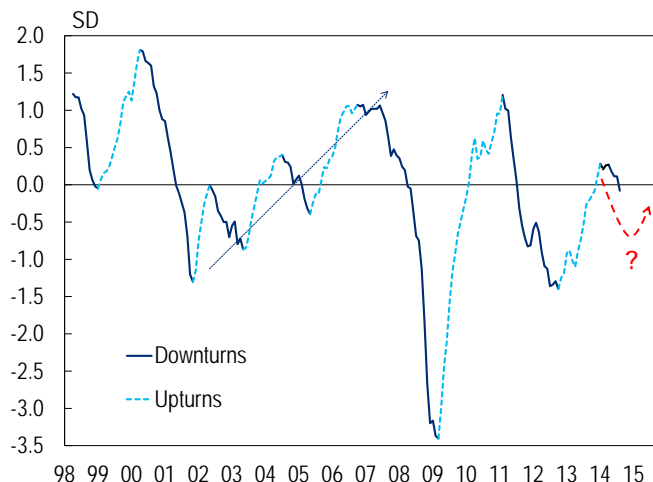
First we update our short-term euro area GDP model. We ran seven different regressions of seven different leading indicators against the annual growth rate of euro area real GDP.

Figure 7. Euro Area — Real GDP Growth and Leading Indicator Models, Q1 2000 to Q4 2014F



Sources: Haver and Citi Research

Figure 8. Euro Area — Composite Business Confidence, Jan-98 to Aug-14



Sources: European Commission, Haver and Citi Research

Five equations suggest that euro area YY GDP growth likely peaked in the second quarter of 2014. Only two equations suggest that further acceleration is likely: these are the ZEW survey and €iBoxx non-financial corporate spreads, suggesting that more upside is probable until 4Q-14 and 1Q-15, respectively. Overall, the implied slowdown in economic activity is modest, worth 0.1pp of YY euro area GDP growth.

Our multivariate model, which is based on a smaller number of inputs (non-financial corporate spreads, aggregate lending standards, M1 and the Ifo survey), projects a slowdown of a largely similar magnitude, worth 0.2pp in Q3-14.

Looking ahead to the fourth quarter, both methods point to GDP growth likely slowing further, with an average projected decline of 0.3pp in the YY growth rate. (see Figure 7). Yet, an important caveat is that our model has been overestimating GDP growth by around 0.5pp in 2013 and by almost one percentage point in the year to date, pointing to a similar result to our previous analysis.

At this stage, we interpret our model results as suggesting that the short-term balance of risks to our baseline GDP trajectory probably lie to the downside. Very preliminary indications with respect to Q1-15 (based on the average of four leading indicators) point to the annual rate of GDP growth being largely similar to that in Q4-14, suggesting little acceleration in economic activity. Overall, these findings point to the possibility of modest downside risks to our GDP baseline, which envisages quarterly gains in GDP to the tune of 0.25% QQ in both Q3 and Q4-14.

How far are we from business confidence bottoming out?

Second, we analyse recent trends in our composite business confidence indicator (an arithmetic average of the European Commission's sentiment survey and the manufacturing PMI). As of August, this indicator is back below its historical average at -0.08sd after falling for four months. A similar dynamic has been seen across most euro area member states reviewed here, despite some differences: Austria and the Netherlands have been experiencing a fall in business confidence since December 2013, while Greece is treading water, remaining close to its historical average. We widen the scope of the research [we did in March 2014](#) to gauge whether the recent falls in business confidence marks the start of a new trend. Analysis of previous cycles suggests that confidence will probably erode further in coming months.

Figure 9. Selected Countries -- Business Confidence Filters and Estimated Distance to Turning Points, Aug-14

| | Length (Filter 1) Downturn | | | | Amplitude (Filter 2) Downturn | | | | Level (Filter 3) Business Confidence | | | Total Distance to turning point |
|-----------|-------------------------------|---------------------|---------------|-------------------|----------------------------------|-------------------------|--------------------------------------|-------------------|---|---------------------|--------|---------------------------------------|
| | Current # Mths | Hist. avg # Mths | Min # Mths | Implied # Mths | Avg chg (sd) | Peak to current (sd) | Hist. avg. peak to trough (sd) | Implied # Mths | Aug-14 (sd) | Avg. trough (sd) | # Mths | # Mths |
| Countries | 1 | 2 | 3 | A | 4 | 5 | 6 | B | 7 | 8 | C | D |
| France | 5 | 13.6 | 8 | 5.8 | -0.14 | -0.60 | -1.89 | 9.5 | -0.69 | -0.76 | 0.5 | 4.1 |
| Italy | 4 | 14.6 | 7 | 6.8 | -0.13 | -0.61 | -1.86 | 10.0 | -0.24 | -0.82 | 4.7 | 6.5 |
| Euro area | 4 | 14.2 | 10 | 8.1 | -0.11 | -0.35 | -1.73 | 12.1 | -0.08 | -0.80 | 6.3 | 8.2 |
| Spain | 2 | 15.2 | 7 | 9.1 | -0.09 | -0.19 | -1.23 | 11.0 | 0.40 | -0.27 | 7.1 | 8.6 |
| Germany | 7 | 14.0 | 6 | 3.0 | -0.09 | -0.60 | -1.95 | 15.6 | 0.12 | -0.91 | 11.9 | 10.6 |

Note: A = $0.5 \cdot [(1)-(2)] + 0.5 \cdot [(1)-(3)]$; B = $(5)-(6)/(4)$; C = $[(8)-(7)]/(1)$; D = $0.5 \cdot [\text{AVG}(A,B)] + 0.5 \cdot C$

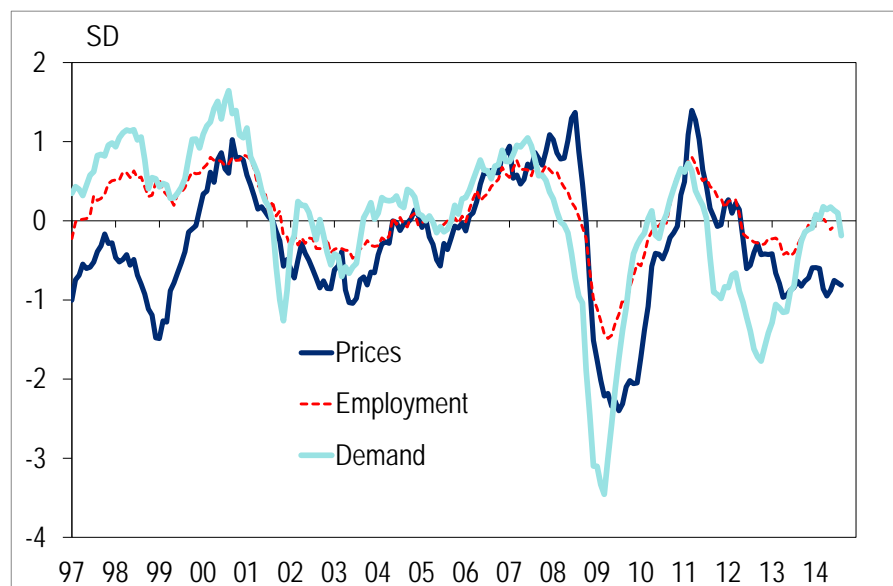
Source: Citi Research

Indeed, the shortest phases of falling business confidence lasted 10 months, between April 1998 and January 1999, and between August 2004 to May 2005, with the third shortest being a 12-month correction between June 2002 and May 2003. Yet, we stress that the latter two episodes of falling business confidence happened in what turned out to be a longer cycle of improving confidence (higher highs and higher lows) represented by the long upward sloping arrow in Figure 8. Note that the estimates that we present below are based on historical averages, excluding the phase between November 2006 and March 2009, which compasses unusually large adjustments related to the great financial crisis (GFC).

The aggregate reading in the last column (Figure 9 on page 5) suggests that France could be four months away (Dec-14) from business confidence bottoming out. Another four months could be necessary for the euro area (to April 2015) and an extra two months in Germany (to Jun-15), mainly given how high confidence is compared to historical averages.

We think however that recent developments could halt the fall in business confidence. Yet, private sector agents could be convinced that the ECB is fully committed to implement further non-standard measures to defend its price stability mandate. The recent weakening in the EUR/USD (and effective exchange rate) and possible extension of this trend would likely be a powerful and visible signal of the central bank's ability to reinforce its credibility. In our view, increases in private sector employment and inflation expectations would be relevant gauges of the strength of the monetary transmission signal (see Figure 10).

Figure 10. Euro Area — Private Sector Expectations, Jan-97 to Aug-14



Sources: European Commission and Citi Research

Conclusions and policy implications

It is possible that business confidence will stabilise in coming months, contradicting the historical evidence that downturns last more than just a few months. However, we doubt that the private sector in the euro area will immediately take on board the latest easing in the ECB's monetary policy stance. If anything, the growing clamour by some governments to relax the euro area budgetary consolidation efforts illustrates how weak the economic recovery still is. It also highlights the fragility of the euro area upswing to idiosyncratic shocks. Hence, our baseline remains that there is still room for declines in business confidence going into year-end.

The ECB Governing Council has acknowledged that economic activity had been weaker than expected in the second quarter, partly reflecting one-off factors. With regards to the third quarter, the September statement noted that *"survey data available up to August indicate a loss in cyclical growth momentum, while remaining consistent with a modest expansion"*. The 2014 and 2015 mid-point of the Staff Projections were revised down by 0.1ppt to 0.9% and 1.6% respectively. Looking ahead, the ECB statement noted that *"the key factors and assumptions shaping the outlook for growth need to be monitored closely"*. In particular, the ECB stressed

that “*the loss in economic momentum may dampen private investment, and heightened geopolitical risks could have a further negative impact on business and consumer confidence*”. We interpret this statement as saying that further declines in economic sentiment in coming months would likely lead to a further ratcheting down in GDP growth expectations in December 2014.

Overall, we argue that there is very limited upside potential to H2 GDP growth. To be sure the weaker euro, the ECB's strategy of balance sheet expansion and signs of a gradual recovery in global demand should help support faster growth in euro area exports. We conclude that the likely failure of surveys to increase noticeably by year-end and evidence of another disappointing reading in GDP when the Q3 GDP become available in the middle of November will likely prompt the ECB to reassess its estimates of the output gap and conclude that the risks of a persistent undershooting of its price stability mandate must be addressed with additional non-standard measures. We continue to expect that the ECB Governing Council will widen the scope of its asset purchase programme to include government bonds in the latter part of 2014 or in early 2015.

Figure 11. Key Economic Indicators (22 September – 26 September 2014)

| Monday 22 September | | Forecast | Last |
|------------------------|---|-------------------|--------------------|
| 09:00 | Italy: Industrial Orders, Jul-Aug | | |
| 15:00 | Euro Area: Consumer Confidence, Sep Flash | -11.0 | -10.0 |
| | Greece: Current Account, Jul | | |
| Tuesday 23 September | | Forecast | Last |
| 07:45 | France: Manufacturing Confidence, Sep | 95 | 96 |
| | Own-Company Production Outlook, Sep | -5 | -7 |
| 07:45 | France: GDP Details, 2QF | 0.0% QQ, 0.1% YY | 0.0% QQ, 0.8% YY |
| 09:00 | Euro Area: Manufacturing PMI, Sep Flash | 50.8 | 50.8 |
| | Services PMI, Sep Flash | 53.3 | 53.5 |
| | Composite PMI, Sep Flash | 52.7 | 52.8 |
| 09:30 | UK: Public Sector Net Borrowing (Ex RM, APF & Fin. Intervention), Aug | £12.0 Billion | £12.4 Billion |
| | Fiscal Year To Date, Apr-Aug | £49.0 Billion | £47.6 Billion |
| 09:30 | UK: BBA Loans for House Purchase, Aug | | |
| Wednesday 24 September | | Forecast | Last |
| 08:00 | Sweden: Consumer Confidence, Sep | 100.4 | 96.9 |
| | Manufacturing Confidence, Sep | 102.1 | 106.7 |
| 08:30 | Netherlands: GDP Details, 2Q | 0.5% QQ, 0.9% YY | -0.4% QQ, 0.1% YY |
| 08:30 | Netherlands: Producer Confidence, Sep | | |
| 09:00 | Italy: Consumer Confidence, Sep | 102.4 | 101.9 |
| 09:00 | Germany: ifo Business Climate, Sep | 104.8 | 106.3 |
| 09:00 | Norway: LFS Unemployment Rate, Jul | 3.3% | 3.3% |
| 11:00 | Ireland: Residential Property Prices, Aug | | |
| 14:00 | Belgium: Business Confidence, Sep | -8.5 | -7.3 |
| 17:00 | France: Jobseekers – Net Change, Aug | 10.0K | 26.1K |
| | Total Jobseekers, Aug | 3,434.4K | 3,424.4 |
| Thursday 25 September | | Forecast | Last |
| 08:00 | Spain: Producer Prices, Aug | | |
| 08:30 | Sweden: Producer Prices, Aug | | |
| 08:30 | Sweden: Household Lending, Aug | 5.6% YY | 5.5% YY |
| 09:00 | Italy: Contractual Wages, Aug | | |
| 09:00 | Euro Area: M3, Aug | 1.8% YY | 1.0% YY |
| 10:00 | Italy: Retail Sales, Jul | | |
| 11:00 | UK: CBI Retail Survey, Sep | | |
| Friday 26 September | | Forecast | Last |
| 07:00 | Germany: GfK Consumer Confidence, Oct | | |
| 07:00 | Germany: Import Prices, Aug | 0.0% MM, -1.8% YY | -0.4% MM, -1.7% YY |
| 07:45 | France: Consumer Confidence, Aug | 85 | 86 |
| 08:30 | Sweden: Trade Balance, Aug | | |
| 09:00 | Italy: Business Confidence, Sep | 97.6 | 95.7 |

Sources: National statistical offices, central banks and Citi Research

Figure 12. Economic Indicators – Comments: Euro Area, Germany, and France

| | | | |
|-----------------------------------|--|-----------------------------|---------------------------|
| Euro Area | | | |
| Sep 22 15:00 London Time | Consumer Confidence, Sep Flash | Forecast: -11.0 | Prior: -10.0 |
| | We expect a continuation of the recent weakening trend in consumer sentiment, as economic activity has likely lost momentum and discussions around the 2015 budgetary measures may have intensified households' negative perceptions around the economy. | | |
| Sep 23 09:00 London Time | Manufacturing PMI, Sep Flash | Forecast: 50.8 | Prior: 50.8 |
| | Services PMI, Sep Flash | Forecast: 53.3 | Prior: 53.5 |
| | Composite PMI, Sep Flash | Forecast: 52.7 | Prior: 52.8 |
| | After very weak PMI data in August, we forecast some signs of stabilisation in September. At 50.8, the manufacturing PMI would still be some 0.1 SD below its long-term average, and at 51.1 the 3Q average would be still well below the 2Q reading (52.4). This would leave little room for a rebound in GDP growth in 2H, after the poor performance in 1H. Some further weakness is likely in the service sector as this indicator usually lags the manufacturing index. A roughly stable reading for the composite PMI would ensue, now broadly in line with its long-term norm. | | |
| Sep 25 09:00 London Time | M3, Aug | Forecast: 1.8% YY | Prior: 1.0% YY |
| | M3 annual growth probably continued to improve in August, albeit from a historically very low pace reflecting the ongoing shrinking of banks' balance sheets. Annual growth in private sector loans probably became slightly less negative than the -1.0% YY rate recorded in July, but the flows of net credit to non-financial corporations were probably still negative in MM terms (despite the large fall of nearly €16bn in July). | | |
| Germany | | | |
| By Sep 30 07:00 London Time | Import Prices, Aug | Forecast: 0.0% MM, -1.8% YY | Prior: -0.4% MM, -1.7% YY |
| | July saw the rate of decline in German import prices widening again after three months where the rate of decline had moderated quite sharply from -3% YY to closer to -1% YY, with declines in the prices of imported energy the main driver. In August, we expect import prices to remain quite stable, leaving the year-on-year decline in import prices at -1.8% YY. | | |
| Sep 24 09:00 London Time | Ifo Business Climate, Sep | Forecast: 104.8 | Prior: 106.7 |
| | The German ifo business climate has fallen for four months in a row and five months out of the past six. In September, we expect yet another fall, even though by slightly less than in the previous two months. We expect both the current situation and the expectations indicator to weaken further, but the current situation index, which is still almost one standard deviation above its long-term average, will probably weaken by more, in our view. The decline in the expectations measure leaves it fairly close to its long-term average and we would expect it to probably bottom out in the next few months, unless the German economy weakens further. | | |
| France | | | |
| Sep 23 07:45 London Time | Manufacturing Confidence Indicator, Sep | Forecast: 95 | Prior: 96 |
| | Own-Company Production Outlook, Sep | Forecast: -5 | Prior: -7 |
| | Manufacturing confidence probably declined for the fifth successive month, falling by one point to 95 in September, some 0.5sd below its historical average. Note that the manufacturing PMI also fell to a 15-month low, suggesting that activity had contracted further. We believe that manufacturing confidence will likely stabilise and recover a little in coming quarters partly due to additional monetary policy stimulus delivered by the ECB and a clearer communication strategy from the government, now openly embracing the supply side reform agenda, although geopolitical concerns will act as a headwind. Own-company output expectations could recovery a little in September after the sharp drop in August. | | |
| Sep 23 07:45 London Time | Gross Domestic Product, 2Q F | Forecast: 0.0% QQ, 0.1% YY | Prior: 0.0% QQ, 0.8% YY |
| | The final estimate of 2Q GDP is expected to be unrevised at 0.0% QQ. At the second decimal level (-0.01%), this would amount to the lowest quarter reading since 3Q-13 (-0.08% QQ), mainly because of a pull-back in gross fixed capital formation (-1.1% QQ), alongside an inventory drawdown (-0.1ppt) and a negative net trade contribution (-0.1ppt). Looking ahead to the third quarter, we do not anticipate any improvement in domestic demand, likely registering a 0.1% QQ increase. The French economy is struggling to recover, and we expect that 2014 will mark the third successive year of GDP growth around 0.4%. The sensitivity of French exports to a significant depreciation of the euro effective exchange rate means that we are more constructive with respect to 2015 (0.9%) and 2016 (1.7%), assuming that more reforms are delivered. | | |
| Sep 24 17:00 London Time | Jobseekers – Net Change, Aug (000s) | Forecast: 10K | Prior: 26.1K |
| | Jobseekers, Aug (000s) | Forecast: 3,434.4 | Prior: 3,424.4K |
| | We look for a 10K increase in the total number of registered jobseekers in August, stretching the series of successive upticks to ten months. Private sector employment expectations rebounded a little in August, likely correcting the unexpectedly strong worsening in July. With GDP growth having flat-lined in the first two quarters of 2014, it will be impossible for unemployment dynamics to improve before the start of the fourth quarter. This will also require a pick-up in business confidence, assuming that employers embrace the government's message about its willingness to reform the labour market and to continue to deliver a reduction in employers' social security contributions. | | |
| Sep 26 07:45 London Time | Consumer Confidence Indicator, Sep | Forecast: 85 | Prior: 86 |
| | Household confidence is expected to record a one-point drop to an eight-month low of 85 in September. While this should be enough to avoid a further decline on a quarterly basis, the underlying consumer spending dynamics remain weak, with the low inflation rate providing only a modicum of support to household expenditure. Prospect of income tax cuts for lower-income households in 2015 could support confidence in coming months, but the relentless increase in unemployment and the very low popularity ratings for the government and President Hollande suggest that few households will likely be in a position to release some of their pent-up demand in the near future. | | |

Sources: National Statistical Offices, National Central Banks, Bloomberg, and Citi Research forecasts

Figure 13. Economic Indicators – Comments: Italy, Netherlands, Belgium, Sweden, Norway, and UK

| | | | |
|-----------------|---|--|--------------------------|
| Italy | | | |
| Sep 24 09:00 | Consumer Confidence, Sep | Forecast: 102.4 | Prior: 101.9 |
| London Time | The recent sequence of negative economic data and discussions about new austerity measures possibly necessary in the 2015 Budget have likely led to a further decline in consumer sentiment in September, to 0.3SD below its long-term average. | | |
| Sep 26 09:00 | Business Confidence, Sep | Forecast: 97.6 | Prior: 95.7 |
| London Time | A small rebound is likely in industrial business sentiment in September, given a much larger-than-expected fall in August (-3.4 points, possibly related to some statistical distortions, not unusual in August). Yet, even with the September rebound, the index would remain below its long-term average suggesting very subdued industrial output dynamic. | | |
| Netherlands | | | |
| Sep 24 08:30 | Gross Domestic Product, 2Q F | Forecast: 0.5% QQ, 0.9% YY | Prior: -0.4% QQ, 0.1% YY |
| London Time | We look for the final estimate of 2Q GDP to be unrevised, more than offsetting the upwardly revised 0.4% QQ drop (-0.6% prev.) in 1Q. But domestic demand contracted again, falling by 0.6% QQ in 2Q-14 after a 0.4% drop in 1Q-14, highlighting some underlying weakness. Net trade's contribution was strong (1.2pp) thanks to a 7th successive gain in exports (+0.6% QQ, 2.9% YY) while imports declined by 1.1% QQ (1.6% YY), highlighting the vulnerability of recovery to potential negative external shocks. | | |
| Belgium | | | |
| Sep 24 14:00 | Business Confidence, Sep | Forecast: -8.5 | Prior: -7.3 |
| London Time | We expect that business confidence likely declined in September, unwinding the modest uptick seen in August. In the past few months, businesses have noticeably scaled back their hiring expectations, partly as a consequence of a decline in demand forecasts in the last five months. Although the recent weakening of the euro should help exporters in this small albeit very open economy, we suspect that the worries related to geo-politics and material slowdown experienced in main trading partners such as Germany and France in 2Q will have some impact on business confidence. | | |
| Sweden | | | |
| Sep 24 08:00 | Consumer Confidence, Sep | Forecast: 100.4 | Prior: 96.9 |
| London Time | Sentiment indicators suggest that consumers still appear reluctant to spend, which stands in clear contrast to strong sentiment readings in the retail sector and also strong growth in actual private consumption in 2Q. The low sentiment readings are somewhat worrying as household spending is expected to be the main growth driver behind economic recovery. Strong income growth, an improving labour market and higher asset prices, meanwhile, suggest that consumer confidence should improve ahead. Household inflation is expected to tick slightly higher, but to stay at a low level (was 0.2% YY in August). | | |
| Sep 24 08:00 | Manufacturing Confidence, Sep | Forecast: 102.1 | Prior: 106.7 |
| London Time | The Economic Tendency Indicator climbed 2.4 points to 103.2 in August, and being 3.2 points above the historical average, the indicator suggests that growth in the Swedish economy is slightly above a normal level. The manufacturing indicator rose by 5.1 points and accounted for the bulk of the gain. The strong upturn was unexpected, but driven by the same factors that pushed confidence lower during the spring and early summer (production expectations, backlogs of orders and inventories). We reckon that the recent SEK depreciation may have helped lift manufacturing sentiment, but note that the outlook for manufacturing is dependent on developments in the international business cycle, in particular in Germany. The NIER indicator now signals a healthy upturn in the sector, clearly contrasting the weak development in hard data. In September, we expect some setback for manufacturing confidence. | | |
| Sep 25 08:30 | Household Lending, Aug | Forecast: 5.6% YY | Prior: 5.5% YY |
| London Time | Annual lending growth is showing signs of acceleration, although the upturn has been somewhat weaker than expected. Given ongoing gains on the housing market, we see a clear risk that household lending could pick up further ahead. Ongoing signs of faster lending growth likely imply that the Riksbank, the FSA and the government will return their focus to financial stability concerns. Meanwhile, with ongoing very low inflation and the associated risk of falling inflation expectations, we do not reckon that lending growth will become an issue for monetary policy again. Instead, ongoing house price gains and accelerating lending growth suggest that additional macro prudential measures are likely in the pipeline – with an amortization requirement being the most likely near-term measure. Here, we note that the Riksbank's latest forecast assumes a gradual acceleration in household lending to around 6.5% YY in early-2016. | | |
| Norway | | | |
| Sep 24 09:00 | LFS Unemployment Rate, Jul | Forecast: 3.3% | Prior: 3.3% |
| London Time | Although the Labour Force Survey is very volatile on a monthly basis: the trend is clear; strong employment growth has outpaced growth in labour supply, pushing unemployment lower. This clearly contrasts with Norges Bank's forecast of rising unemployment (3.5% this year and 3.75% next year). If anything, this reduces the probability of a near-term rate cut. We note, though, that Norges Bank tends to put more emphasis on the timelier and less volatile unemployment figures from labour offices. | | |
| United Kingdom | | | |
| Sep 23 09:30 | Public Sector Net Borrowing, Aug (Ex RM, APF and Fin. Intervention) | Forecast: £12.0 Billion Deficit, £49.0 Billion Deficit Fiscal Year To Date Year Ago: £12.4 Billion Deficit, £47.6 Billion Deficit Fiscal Year To Date | |
| London Time | The fiscal deficit over the year to date is likely to remain a little above last year's level, with revenues continuing to run below target. Although the economy is growing strongly, the mix of job-rich and pay-poor growth yields less tax revenue than the normal mix of rising real wages and slower job growth. The fiscal deficit may slightly overshoot the government's forecasts over the full year. | | |

Sources: National Statistical Offices, National Central Banks, Bloomberg, and Citi Research forecasts.

Figure 14. Key Economic Indicators (29 September – 3 October 2014)

| During The Week | | Forecast | Last |
|----------------------|---|-------------------|-------------------|
| 07:00 | Germany: Retail Sales, Aug (by Sep 30) | 0.7% MM, 1.4% YY | -1.1% MM, 1.0% YY |
| Monday 29 September | | Forecast | Last |
| 08:00 | Spain: HICP, Sep Flash | | |
| 08:00 | Spain: Retail Sales, Aug | | |
| 08:30 | Sweden: Retail Sales, Aug | | |
| 09:30 | UK: Mortgage Approvals, Aug | 67.0K MM, 5.9% YY | 66.6K MM, 7.9% YY |
| 10:00 | Euro Area: Business & Consumer Surveys, Sep | | |
| 13:00 | Germany: Consumer Prices, Sep Flash | | |
| Tuesday 30 September | | Forecast | Last |
| 00:01 | UK: GfK Consumer Confidence, Sep | | |
| 06:45 | Switzerland: GDP, 2Q (according to ESA 2010) | | |
| 07:45 | France: Consumer Spending, Jul-Aug | | |
| 07:45 | France: Producer Prices, Aug | | |
| 08:55 | Germany: Unemployment, Sep | | |
| 09:00 | Italy: Unemployment, Aug | | |
| 09:00 | Norway: Retail Sales, Aug | | |
| 09:00 | Norway: Credit Indicator C2, Aug | | |
| 09:00 | Norway: Norges Bank Daily FX Purchases, Oct | | |
| 09:00 | Switzerland: KOF Economic Barometer, Sep | | |
| 09:30 | UK: Service Sector Output, Jul | 0.4% MM, 3.6% YY | 0.3% MM, 3.6% YY |
| 09:30 | UK: GDP, 2Q (3 rd Release – ESA 2010) | 0.8% QQ, 3.2% YY | 0.8% QQ, 3.0% YY |
| 09:30 | UK: Balance of Payments, 2Q | | |
| 10:00 | Euro Area: HICP, Sep Flash | | |
| 10:00 | Euro Area: Unemployment Rate, Aug | | |
| 10:00 | Italy: Consumer Prices, Sep Flash | | |
| 10:00 | Greece: Retail Sales, Jul | | |
| 11:00 | Italy: Producer Prices, Jul-Aug | | |
| | Spain: Budget Balance, Aug | | |
| Wednesday 1 October | | Forecast | Last |
| 07:30 | Sweden: Manufacturing PMI, Sep | | |
| 08:00 | Norway: Manufacturing PMI, Sep | | |
| 09:00 | Euro Area: Manufacturing PMI, Sep Final | | |
| 09:30 | UK: Manufacturing PMI, Sep | 53.5 | 52.5 |
| 09:30 | UK: Labour Productivity, 2Q | | |
| | Italy: Budget Balance, Sep | | |
| Thursday 2 October | | Forecast | Last |
| 08:00 | Spain: Unemployment, Sep | | |
| 08:30 | Sweden: Industrial Production, Aug | | |
| 08:30 | Sweden: Services Production, Aug | | |
| 09:30 | UK: Construction PMI, Sep | | |
| 10:00 | Euro Area: Industrial Producer Prices, Aug | | |
| 12:45 | Euro Area: ECB Outcome – Press Conference at 13:30 | | |
| Friday 3 October | | Forecast | Last |
| 07:30 | Sweden: Services PMI, Sep | | |
| 09:00 | Norway: Unemployment Rate, Sep | | |
| 09:00 | Italy: 2013 National Accounts according to ESA 2010 | | |
| 09:00 | Euro Area: Services PMI, Sep Final | | |
| | Composite PMI, Sep Final | | |
| 09:30 | UK: Services PMI, Sep | 60.0 | 60.5 |
| 10:00 | Euro Area: Retail Sales, Aug | | |

Sources: National statistical offices, central banks and Citi Research

Figure 15. Recent Research

| | | |
|--|-------------------------|--------------|
| Euro Area - Sovereign Debt Update | | |
| First TLTRO Take-Up Disappoints at €82.6bn | European Economics Team | Sep 19, 2014 |
| ECB Comprehensive Assessment Likely on Oct 26 | European Economics Team | Sep 18, 2014 |
| ECB May Buy Low-Rated ABS | European Economics Team | Sep 17, 2014 |
| OECD Downgrades Eurozone Outlook, Calls for QE | European Economics Team | Sep 16, 2014 |
| Eurogroup Disagrees on Mezzanine ABS Guarantees | European Economics Team | Sep 15, 2014 |
| Euro Area | | |
| Euro Area - ECB Cuts Rates and Announces Asset Purchase Programme | Guillaume Menuet | Sep 4, 2014 |
| Euro Area - Euro Area: What Are The Prospects For Fiscal Easing? | Ebrahim Rahbari | Sep 3, 2014 |
| Euro Area - Inflation Hit a New 5-Year Low | Giada Giani | Aug 29, 2014 |
| Euro Area - ECB Preview: Will Draghi Highlight Downside Risks to Inflation? | Guillaume Menuet | Aug 28, 2014 |
| Euro Area - ECB Draghi Notes Fall in Inflation Expectations | Guillaume Menuet | Aug 26, 2014 |
| Global Economic Forecasts – August 2014 | Michael Saunders | Aug 26, 2014 |
| Euro Area - PMIs Suggest Very Little Room for Economic Rebound in H2 14 | Giada Giani | Aug 21, 2014 |
| Euro Area - SPF Survey: Downward Drift In 2014-15 Inflation Expectations | Guillaume Menuet | Aug 14, 2014 |
| Euro Area: NFC Net Borrowing Falling More Slowly | Antonio Montilla | Aug 12, 2014 |
| European Economic Indicators – Week Ahead | Michael Saunders | Aug 8, 2014 |
| Euro Area - ECB – Happy To Wait And See, For Now | Giada Giani | Aug 7, 2014 |
| Italy - Why is the Economy Underperforming so Badly? | Giada Giani | Aug 6, 2014 |
| Europe: Monthly Inflation Profiles for Selected Countries | Ann O'Kelly | Jul 31, 2014 |
| European Economic Forecast Highlights, July 2014 | Ann O'Kelly | Jul 31, 2014 |
| Euro Economics Weekly | | |
| Euro Area: Housing Sector Close to a Turnaround | Antonio Montilla | Sep 12, 2014 |
| Low-inflation Is Here To Stay | Giada Giani | Sep 5, 2014 |
| Is the Period of German Outperformance Over? | Ebrahim Rahbari | Aug 29, 2014 |
| ECB QE: Why, When and How? | Guillaume Menuet | Aug 22, 2014 |
| What's Behind the Periphery Growth Outperformance? | Giada Giani | Aug 15, 2014 |
| How Might Russia Developments Affect The Eurozone Economy? | Ebrahim Rahbari | Aug 1, 2014 |
| France: More Reforms to Jump Start Confidence? | Guillaume Menuet | Jul 25, 2014 |
| Public Debt Sustainability: Has It Really Been Restored? | Giada Giani | Jul 18, 2014 |
| Why Banking Union Matters: Then and Now | Ebrahim Rahbari | Jul 11, 2014 |
| Is The Euro Area Recovery at Risk of Faltering? | Guillaume Menuet | Jul 4, 2014 |
| Weak Pay Trends Imply Further Inflation Undershoot | Giada Giani | Jun 27, 2014 |
| A Great Rotation towards Eurozone Portfolio Assets? | Ebrahim Rahbari | Jun 20, 2014 |
| Labour Market Slack | Giada Giani | Jun 13, 2014 |
| ECB TLTRO: Ambitious But Probably Not Enough, QE Lies Ahead | Guillaume Menuet | Jun 6, 2014 |
| Negative Deposit Rate: Limiting Risks, Limited Upside | Ebrahim Rahbari | May 30, 2014 |
| Chief Economist Publications | | |
| Global Economic Outlook and Strategy — August 2014 | Willem Buiter | Aug 20, 2014 |
| Scandi and Swiss | | |
| Scandi Economics Update | Tina Mortensen | Sep 12, 2014 |
| Norway - Norges Bank Removes its Near-Term Easing Bias | Tina Mortensen | Sep 18, 2014 |
| Sweden - Riksbank Minutes Suggest Monetary Policy Will React Asymmetrically to Near-Term Inflation | Tina Mortensen | Sep 17, 2014 |
| UK | | |
| UK - Scotland Referendum Produces Clear "No" Vote | Michael Saunders | Sep 19, 2014 |
| UK - Labour Market Data and BoE Agents | Michael Saunders | Sep 17, 2014 |
| UK - Drop in Food Prices Brings CPI Inflation Down | Michael Saunders | Sep 16, 2014 |
| UK Economics Weekly | | |
| More Questions Regarding Scottish Independence | Michael Saunders | Sep 12, 2014 |
| Resolving The Labour Market Puzzles | Michael Saunders | Sep 5, 2014 |
| Rewriting the Economy's Past and Present | Michael Saunders | Aug 29, 2014 |
| Scottish Independence Referendum: Less Than A Month To Go | Michael Saunders | Aug 22, 2014 |
| Change in Rate View | Michael Saunders | Aug 15, 2014 |
| IR to Signal Shift in the MPC's Outlook | Michael Saunders | Aug 8, 2014 |

Source: Citi Research

Appendix A-1

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