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Western Europe

Euro Economics Weekly

The Eurozone Investment Collapse And The Juncker Plan

- Eurozone investment trends are very weak, compared to their own history and trends in other advanced economies, and the outlook for Eurozone investment remains subdued. Even though investment weakness is probably both suffering from, as well as contributing to, poor overall growth prospects in the Eurozone, boosting investment would be one way to moderate the Eurozone's shortage of aggregate demand and boost growth prospects.
- The EU's planned investment Offensive or 'Juncker plan', centred around the new European Fund for Strategic Investment (EFSI), promises to boost Eurozone investment incrementally by cumulatively at least €315bn in 2015-17. In our view, this target seems very ambitious, as the public funding component is small and the appetite for private investors to finance the incremental funding needs uncertain.
- However, there is an intriguing possibility that additional national contributions to the EFSI could be a 'backdoor' route to modest fiscal easing in the Eurozone, which could address the plan's shortcomings of a lack of capital and the possibility of crowding out private investments.

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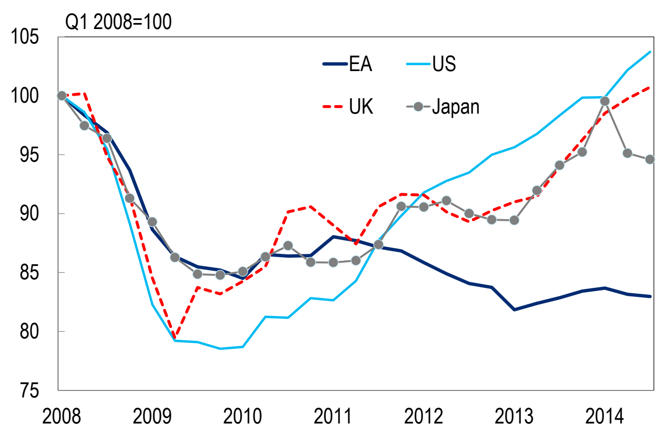
Figure 1. Citi Forecasts

	$/€	Euro Repo	10-yr Bunds	£/€	UK Bank Rate	10-Yr Gilt Bund
2Q 15	1.12	0.05	0.85	0.78	0.50	162
4Q 15	1.07	0.05	1.15	0.78	0.75	147

Source: Citi Research

Figure 2. Euro Area — Selected Countries – Real Gross Fixed Capital Formation (2008 Q1=100), 2008-14 Q3



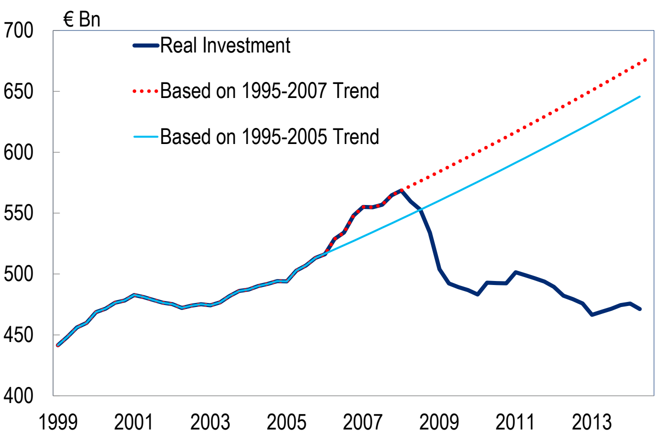
Sources: BEA, Cabinet Office, Eurostat, ONS and Citi Research

Eurozone Investment and the Juncker Plan

The need to raise gross fixed capital formation (hence fore 'investment') has become a major policy focus in the Eurozone, for three reasons: first, investment is still 17% below the pre-crisis peak and therefore the largest contributor to the poor growth performance of the Eurozone since 2008. Second, most observers agree that the Eurozone has both a supply and a demand problem and more investment could potentially be a way to address both (i.e., increase demand in the present and potentially boost supply in the future). Third, boosting investment currently seems to resonate with German policymakers, due to its supply-side orientation, but also the fact that investment has also been weak in Germany in recent years.

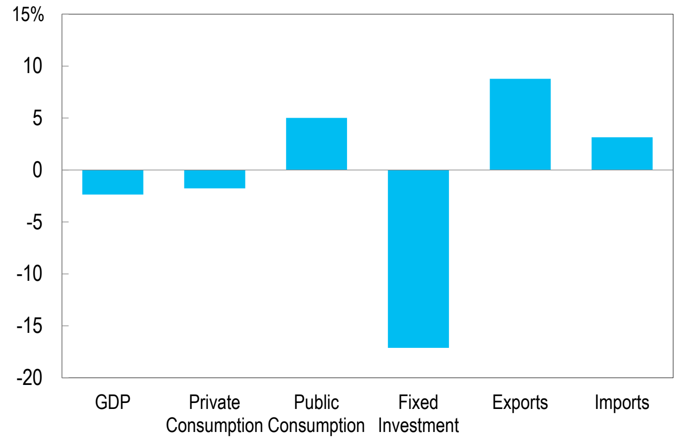
In this publication, we assess different reasons why investment is so weak in the Eurozone currently and assess whether the Juncker plan will result in a significant pick-up of investment.

Figure 3. Euro Area – Real Investment (Bn Constant 2010 Euros), 1999–2014



Sources: Eurostat and Citi Research

Figure 4. Euro Area – Change in Real GDP and Components Between Q1 2008 and Q2 2014 (%)



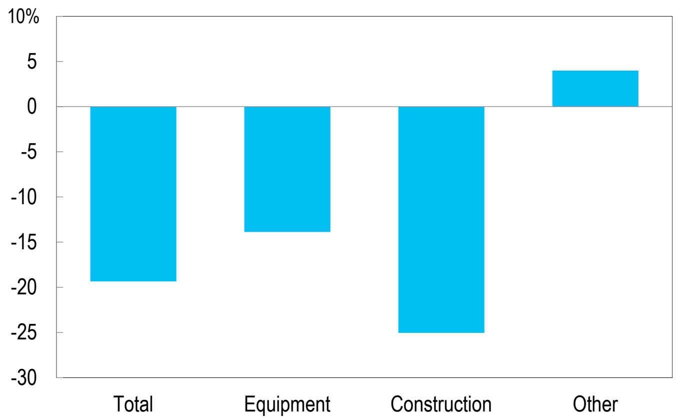
Sources: Eurostat and Citi Research

Eurozone investment is very weak

In Q3 2014, Eurozone investment was 17% below its pre-crisis (Q1 2008) peak. In Q3, it fell for the second quarter in a row (after fourth quarters of positive growth) and YY% investment growth turned negative again. In nominal terms, investment is 13% below its peak. Relative to the pre-crisis trend, real investment is 37% below its pre-crisis (1995-2005) trend in real terms (see Figure 3), and relative to GDP investment is at 19.6%, compared to the 1995-2005 average of 21.5%. Investment has by far been the weakest component of Eurozone expenditures in the post-crisis period (see Figure 4). It has also been weaker in the post-crisis period than in the US, UK or Japan (see Figure 2, on the Front Page), despite the fact that investment recoveries in those other countries after the crisis are also considered to have been disappointing.

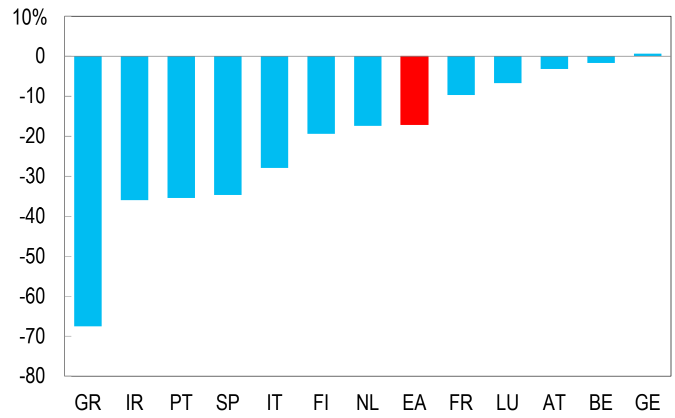
The fall in investment has been largest for construction investment, which fell by 25% between Q1 2008 and Q2 2014 in real terms (see Figure 5) and accounted for more than 70% of the decline in investment. But equipment investment, the second major component of investment, also fell sharply (by 14%). By contrast, other investment (mostly investment in intangibles, such as software, patents and licenses) has grown by 4% since Q1 2008.

Figure 5. Euro Area – Change in Real Investment and Components Between Q1 2008 and Q2 2014 (%)



Sources: Eurostat and Citi Research

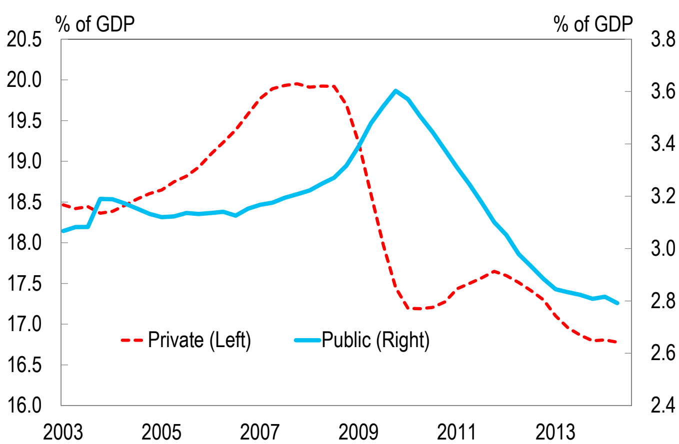
Figure 6. Selected Countries –Change in Real Investment Between Q1 2008 and Q2 2014 (%)



Sources: Eurostat and Citi Research

The investment decline has been broad-based across Eurozone countries. Investment is below 2008 levels in virtually all Eurozone countries except Germany (see Figure 6), even though the extent of the decline varies sharply (in Greece, real investment has declined by almost 70% since 2008). Public investment has also fallen sharply (see Figure 7), by 16% relative to 2009 in nominal terms. Even though the fall in public investment has therefore been proportionally even sharper than for private investment, public investment only accounts for a small share of total investment (and therefore only for a small share of the fall in total investment).

Figure 7. Eurozone – Private and Public Investment (% of GDP, 4Q Sum), 2003-Q2 2014



Sources: Eurostat and Citi Research

Figure 8. Selected Countries – World Bank Doing Business Survey 2014

	Ease of Doing Business Rank	Paying Taxes Rank	Overall Tax Rate
US	7	47	43.8
UK	8	16	33.7
Finland	9	21	40.0
Sweden	11	35	49.4
Ireland	13	6	25.9
Germany	14	68	48.8
Switzerland	20	18	29.0
Austria	21	72	52.0
Portugal	25	64	42.4
Netherlands	27	23	39.0
Japan	29	122	51.3
France	31	95	66.6
Spain	33	76	58.2
Belgium	42	81	57.8
Italy	56	141	65.4
Luxembourg	59	20	20.2
Greece	61	59	49.9
Cyprus	64	50	23.2

Sources: World Bank and Citi Research

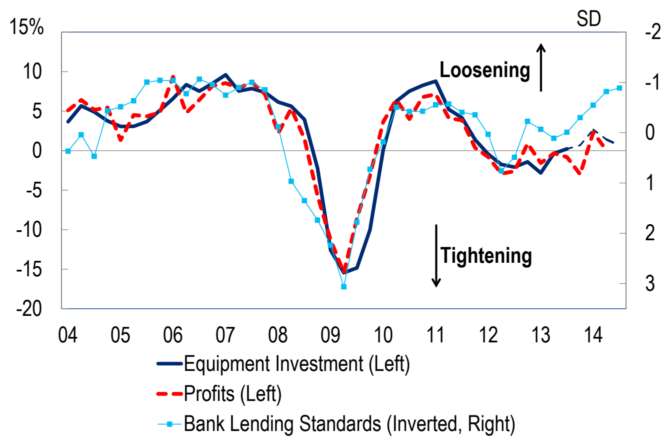
Why is Eurozone investment very weak?

There is a fairly long list of potential reasons why Eurozone investment is so weak. We stress the following:

1. **Poor access to funding and lack of risk capital.** Bank lending rates to businesses are still 20bp higher in real terms than they were in the pre-crisis (2003-07) period (and much more in Eurozone periphery countries). Bank lending standards are also tight, having tightened for most of the period since 2008, even though they have eased somewhat recently (see Figure 9). In addition, many non-financial corporations and banks in the Eurozone are still in the process of balance sheet repair, even after the completion of the ECB's Comprehensive Assessment and continued deleveraging efforts.

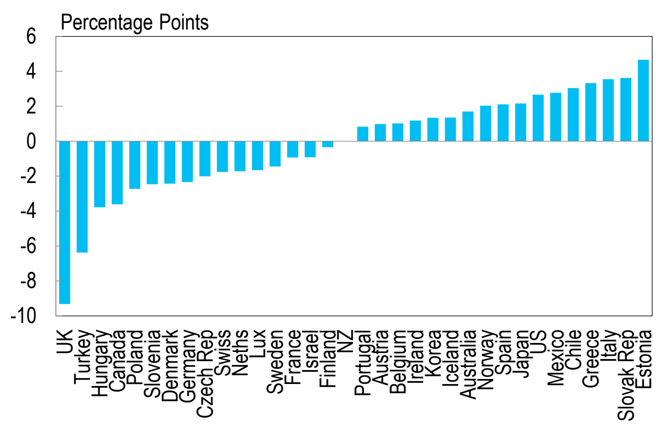
2. **Regulatory and other policy-based barriers to investment.** Many Eurozone countries score quite poorly compared to other advanced economies in the World Bank's Doing Business survey (with France 31st, Spain 33rd, Italy ranking 56th, and Greece 61st, see Figure 8) , which assesses countries based on the legal environment as well as quantifiable practical experiences (so-called "time and motion indicators").

Figure 9. Euro Area – Real Equipment Investment (%YY), Non-Financial Corporate Profits (%YY) and Changes in Bank Lending Standards to the Private Sector (sd), 2004–2014F



Sources: Eurostat and Citi Research

Figure 10. OECD Countries - Change in Average Tax Wedge From 2007-2013 for Single Parent at 67% of Average Earnings, With Two Children



Sources: OECD and Citi Research

3. **Poor and uncertain overall growth prospects.** If capital-output ratios are to be kept stable, the amount of gross investment will depend directly on the expected growth rate of GDP. Under an assumption of 5.5% depreciation, gross investment of 22% of GDP (in line with the 1995-2005 average in the Eurozone) is needed to sustain a capital-output ratio of 3.05 (the average for the Eurozone in 1995-2014), if real GDP growth is expected to be 1.75%. If growth expectations instead fall to 1%, the required investment ratio falls to 19.6%, i.e. a fall in Eurozone growth expectations from 1.75% to 1% could potentially explain the entire observed fall in gross investment relative to GDP after the crisis.

   The above calculation reflects longer-term considerations. Over shorter periods, investment tends to be highly correlated with firm profits (see Figure 9) and profit growth in the Eurozone remains very subdued. Uncertainty over future growth and demand can similarly dampen investment demand, and some measures of uncertainty, such as the so-called Economic Policy Uncertainty indices (which measure how often uncertainty-related terms are mentioned in the media) indeed suggest that uncertainty levels in the Eurozone remain relatively high compared to the pre-crisis period.

4. **High taxes now or in the future.** The World Banks' Doing Business report highlights that overall tax rates on businesses in the Eurozone are often quite high in international comparison, particularly in Belgium, France or Italy (see Figure 8). In addition, even if taxes in the Eurozone are not presently very high, high levels of public debt in many Eurozone countries raise the risk that taxes may have to rise substantially in the future.

The Juncker plan

On November 26, 2014, EU Commission President Juncker presented the EU Investment Offensive. Its aim is to boost investment by an additional €315bn over 2015-17 (i.e. investment that would not have taken place without the Offensive). It consists of three parts:

1. **The European Fund for Strategic Investments (EFSI).** This fund is based on €16bn of EU guarantees (which in turn are based on €8bn of funds in the EU budget) as well as €5bn of EIB capital, implying €21bn of potential risk absorption. European institutions (probably the EIB) are supposed to provide another €63bn or so in investment in subordinated debt of the EFSI, with the remaining €231bn (of senior debt) to be provided by the private sector, according to the EC's calculations. In addition, member countries have the option to contribute additional capital to the EFSI.

2. **Selecting and supporting specific investment projects in identified focus areas** (including energy, transport, broadband, education, research and innovation and projects in line with existing EU projects under its Structural and Cohesion policy, Trans-European Networks and Connecting Europe Facility). The three 'key criteria' for projects to be deemed eligible are i) that the projects are "EU value-added projects in support of EU objectives", ii) economic viability and value – prioritizing projects with high socio-economic returns, and iii) projects that can start at the latest within the next three years.

3. **A roadmap to make Europe more attractive for investment** and remove regulatory bottlenecks for investment and pursue structural reforms more broadly. The EC specifically mentions "Capital Markets Union" as well as removing barriers to the integration of telecommunications, energy, transport and other services markets across the Eurozone.

The plan is supposed to be implemented from the middle of 2015, even though the EIB has already announced that it will consider funding eligible projects before then.

The Juncker plan in principle aims to address potential funding and capital shortages as well as regulatory barriers and may therefore perhaps also boost near- and long-term growth prospects. However, in our view, it is far from certain that it will achieve its objectives.

In particular, the only €13bn of risk capital (€8bn from the EU budget, €5bn from EIB capital, amounting to 0.1% of 2014 annual EU GDP or 0.5% of EU investment) or up to €63bn of public funding support (still only 0.5% of GDP, 2.3% of investment) are rather small, which therefore reduces the likelihood that existing capital and funding shortfalls will be addressed effectively. In our view, it is highly uncertain if private investors will be prepared to provide the remaining 85% of residual funding needs, especially if such projects provide "socio-economic" rather than mainly financial returns. We stress that projects with a high socio-economic rather than financial return may be highly desirable (in particular if they boosted employment, which is one of the EU objectives highlighted in the Offensive), but they leave open how private investors would be compensated for their investment. To the extent that

the Offensive will be successful in generating the private funding contributions, they may not be truly incremental, i.e. they may crowd out investment that would otherwise have taken place. We will have some more information on the nature of the projects at some point in December 2014 when the EC/EIB Taskforce is supposed to deliver a first list with specific projects to be funded.

As we indicated above, regulatory barriers to investment may be important, but at this stage it is not clear how successful the Investment Offensive will be in reducing these, not least as it is by no means the first or only time initiative that is supposed to encourage such structural reforms in the EU.

Could the Juncker plan imply any fiscal easing?

We currently expect real fixed investment to grow by a mere 0.9% in 2015 and 2.4% in 2016, after 0.3% growth in 2014 and have not penciled in any meaningful incremental effect of the Investment Offensive, implying that it may be a source of upside risk to our forecasts.

There is another reason why the Offensive could end up providing a boost to investment and growth: it may be a backdoor to modest fiscal easing. At first sight, it seems to be clear that the Investment Offensive *does not* imply any fiscal easing. This is because the plan is supposed to boost investment "without creating new debt" and the EU contributions are meant to come from existing resources. However, there is an intriguing possibility that it will allow (at least counterfactually) some fiscal easing to take place. This is because of the option for EU member states to provide additional capital to the EFSI and, importantly, the EC has said that *"in the context of the assessment of public finances under the Stability and Growth Pact, the Commission will take a favourable position towards such capital contributions to the Fund."* This clause raises the possibility that, for example, the French government could pay an additional, say, €10bn into the EFSI without falling (even more) foul of EU budget rules.

If member states make significant contributions and if such capital contributions are exempted from the EU's fiscal rules, this could help to mitigate the two main concerns we have about the prospects for success of the EFSI: there would be a larger public funding contribution and, since this may come from countries which are otherwise restricted by the EU's fiscal rules from spending more, these funds are more likely to be incremental. We stress that for these contributions we are not counting on any leverage effects, but that these could on the other hand apply to projects that produce a socio-economic return, but not a suitable financial return to attract private investors (such as investments in education or to boost job growth).

In our view, the option to solicit national contributions and treat these favourably under the EU's fiscal framework is related to a long-standing discussion of whether investment spending should be exempted from the EU deficit limits altogether. Currently, the EU's Stability and Growth Pact already includes a provision that allows investment to be deducted from calculated deficits, provided that economic growth is negative or below potential, the 3% deficit threshold is not breached (so countries are not under the EDP) and that the investments are co-funded by the EU. Our understanding is that a more general exception for investment was blocked by a number of countries (notably Germany) for fear of allowing the fiscal rules to be circumvented too easily. For the current clause to be meaningfully different this existing flexibility would need to be expanded, in particularly by allowing this possibility even for countries under the EDP or by widening the types of spending that would be eligible. In our view, this could be more palatable for countries that were previously opposed (e.g. Germany), for two reasons: first, the provision would

be explicitly limited to the lifetime of the EFSI (2015-17), and, second, because it will be the EFSI, working with the EC, that decides how the money will be spent, rather than individual member countries. This is why we think the possibly of national contributions to the EFSI raises the possibility of a – probably modest – fiscal boost (public investment is currently roughly 0.3pp of GDP below the 02-07 average), on top of what the EFSI could otherwise achieve.

However, a number of factors could stand in the way of such effects and we stress that we have not currently factored in any boost into our forecasts. First, the EC may not in fact totally or partially exclude EFSI contributions from its deficit calculations for countries under the EDP or expand the type of spending – presumably it will clarify its treatment in coming months. Second, it is not clear how willing the individual member countries will be to contribute to the Fund. After all, it is the EFSI that will select projects and disburse the funds. Even though countries can presumably propose projects, the possibility that the funds will not be reinvested in their own country could reduce their willingness to contribute (one possibility to address such concerns may be to create 'national compartments' within the EFSI, even though that would also limit the degree to which spending could be channeled towards the weaker economies). Third, the EFSI and the EC may be very slow and/or conservative to approve projects that meet the conditions of the Fund and/or exclusion from deficit calculations. At this point, we therefore cannot take the national contributions and their effects for granted, but we think that they might end up becoming as or more significant than the basic EFSI set-up.

What else could be done to boost Eurozone growth?

In our view, the situation in the Eurozone calls for major additional policy stimulus. In that regard, the Investment Offensive is desirable, but unlikely to be sufficient, and additional policy measures are needed to boost employment growth and lift inflation towards the ECB's target. In the light of very high unemployment, which is a drag on growth through the reduction in household income and the atrophy of skills for those directly affected, but also by boosting precautionary saving motives of those that are not, measures to boost job growth would be particularly desirable, in our view. Lowering the tax wedge, particularly for those on low incomes, could be an effective way to boost job growth. In the UK, the tax wedge for those on low pay levels has been reduced markedly in recent years (for a single person at 67% of average earnings, with two children, by 9.3pp between 2007-13 to 6.3%) (see Figure 10), boosting low-wage employment. By contrast, in many Eurozone countries the tax wedge on low-wage earners has *risen* in recent years and is very high (e.g. it is 30% in Spain, 37% in France, 39% in Greece for a comparable person). However, the UK example also shows that reducing the tax wedge can come at a quite high fiscal cost, which raises the question of how such a measure could be financed, in the absence of intra-Eurozone fiscal transfers (a more flexible labour market in the UK than in many Eurozone countries may also have made it easier for the reduction in the tax wedge to be effective in boosting job growth).

As regards the interaction of the Investment Offensive with monetary policy, it is clear in our view, that the Offensive does not materially reduce the need for more monetary easing, not least because it will only be rolled out slowly. ECB President Draghi welcomed the Investment Offensive in the November press conference as the only current initiative that could potentially support an adjustment in the overall Eurozone fiscal stance that the ECB has advocated. However, we do not think that the Investment Offensive materially raises or lowers the likelihood or timing of potential further ECB easing. We continue to expect the ECB to announce a broad-based asset purchase programme in Q1 2015, focused on government bonds, most likely at the January meeting.

Figure 11. Key Economic Indicators (8 December – 12 December)

Monday 8 December		Forecast	Last
07:00	Germany: Industrial Production, Oct	1.4% MM, 2.4% YY	1.4% MM, 0.3% YY
07:30	France: Bank of France Business Sentiment, Nov	96	96
08:15	Switzerland: Consumer Prices, Nov		
08:15	Switzerland: Retail Sales, Oct		
08:30	Sweden: Household Consumption, Oct	0.4% MM	-0.4% MM
09:30	Euro Area: Sentix Investor Sentiment, Dec		
09:30	UK: Industrial Production, Oct		
	Manufacturing Output, Oct		
	Euro Area: Extraordinary Eurogroup Meeting, Brussels		
Tuesday 9 December		**Forecast**	**Last**
06:45	Switzerland: Unemployment, Nov		
07:0	Germany: Labour Cost Index, 3Q		
07:00	Germany: Trade Balance, Oct		
07:45	France: Trade Balance, Oct		
07:45	France: Budget Balance, Oct		
09:30	UK: Industrial Production, Oct	0.3% MM, 2.0% YY	0.6% MM, 1.5% YY
	Manufacturing Output, Oct	0.3% MM, 3.3% YY	0.4% MM, 2.9% YY
10:00	Greece: Consumer Prices, Nov		
10:00	Malta: GDP, 3Q		
	EU: EcoFin Meeting, Brussels		
Wednesday 10 December		**Forecast**	**Last**
07:45	France: Industrial Production, Oct	-0.2% MM, -0.2% YY	0.0% MM, -0.3% YY
	Manufacturing Production, Oct	-0.3% MM, -0.5% YY	0.6% MM, 0.2% YY
07:45	France: Non-Farm Payrolls, 3Q	-0.2% QQ, -0.2% YY	0.1% QQ, -0.1% YY
08:30	Netherlands: Industrial Production, Oct		
09:00	Norway: Consumer Prices, Nov	0.2% MM, 2.0% YY	0.1% MM, 2.0% YY
	CPI-ATE, Nov	0.1% MM, 2.4% YY	0.2% MM, 2.5% YY
09:30	UK: Trade Balance – Goods & Services, Oct	£-2.5 Billion	£-2.8 Billion
10:00	Greece: Industrial Production, Oct		
Thursday 11 December		**Forecast**	**Last**
00:01	UK: RICS House Price Survey, Nov		
07:00	Germany: HICP, Nov Final	0.0% MM, 0.5 % YY	-0.3% MM, 0.7% YY
	National CPI, Nov Final	0.0% MM, 0.6% YY	-0.3% MM, 0.8% YY
07:45	France: HICP, Nov	-0.1% MM, 0.4% YY	0.0% MM, 0.5% YY
	Consumer Prices, Nov	-0.1% MM, 0.4% YY	0.0% MM, 0.5% YY
	CPI Ex Tobacco Index, Nov	125.76	125.92
08:30	Sweden: Consumer Prices, Nov	-0.1% MM, -0.2% YY	0.1% MM, -0.1% YY
	CPIF, Nov	0.0% MM, 0.6% YY	0.1% MM, 0.6% YY
08:30	Sweden: Unemployment Rate, Nov	7.4% NSA, 8.0% SA	7.5% NSA, 8.1% SA
08:30	Switzerland: Swiss National Bank Monetary Policy Assessment		
09:00	Norway: Norges Bank Interest Rate Decision	Unchanged at 1.50%	1.50%
09:00	Italy: Industrial Production, Oct	-0.1% MM	-0.9% MM
09:00	Euro Area: ECB Monthly Bulletin		
10:00	Greece: Unemployment Rate, Sep		
11:00	Ireland: Consumer Price, Nov		
11:00	Ireland: GDP, 3Q		
11:00	Ireland: Balance of Payments, 3Q		
Friday 12 December		**Forecast**	**Last**
07:00	Sweden: PES Unemployment Rate, Nov	4.1%	4.2%
07:45	France: Current Account, Oct		
08:00	Spain: HICP, Nov Final	-0.5% YY	-0.2% YY
08:30	Netherlands: Trade Balance, Oct		
09:00	Italy: Consumer Prices, Nov Final		
09:30	UK: Construction Output, Oct		
10:00	Euro Area: Industrial Production, Oct	0.5% MM	0.6% MM
10:00	Euro Area: Employment (National Accounts), 3Q		

Sources: National statistical offices, central banks and Citi Research

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

Euro Area			
Dec 12 10:00 London Time	***Industrial Production, Oct***	**Forecast: 0.5% MM**	**Prior: 0.6% MM**
	We anticipate IP to have risen by 0.5% MM (sa) in October after a 0.6% MM gain in September, reflecting a solid gain in Germany. However, we anticipate that France and Italy will join Spain in the group of countries registering a decline in industrial output at the start of the fourth quarter. We continue to expect industrial production to decline on average in 4Q (-0.2% QQ) after a 0.4% drop in 3Q. The fragility of business confidence and recent weakness in the ratio of new orders to stocks of finished goods do not point much acceleration in the short-term.		
Germany			
Dec 8 07:00 London Time	***Industrial Production incl Construction, Oct***	**Forecast: 1.4% MM, 2.4% YY**	**Prior: 1.4% MM, 0.3% YY**
	September saw a smaller-than-expected bounceback in German industrial production after the large decline in August (largest decline since January 2009), even though that was compensated by a slight upward revision of the August figure. In October, we expect IP to register a noticeable increase. Activity measures in some of the surveys have actually fallen in October, but factory orders rose strongly, which historically suggests a rise in IP as well. With the expected increase in IP in October, IP would be 1.3% above the 3Q average, highlighting upside risk to industrial activity and GDP growth in Germany in 4Q relative to our forecast.		
Dec 11 07:00 London Time	***HICP, Nov Final***	**Forecast: 0.0% MM, 0.5% YY**	**Prior: -0.3% MM, 0.7% YY**
	National CPI, Nov Final	**Forecast: 0.0% MM, 0.6% YY**	**Prior: -0.3% MM, 0.8% YY**
	We expect the final readings for German inflation in November to confirm the flash readings for both the national definition and the HICP at 0.6% and 0.5%, respectively. For both definitions, this is the lowest level of inflation since February 2010, highlighting that in Germany, inflation is far away from 2% currently. For now, we expect inflation to be close to bottoming out, unless energy prices fall further, and to very slowly start creeping up over the course of 2015.		
France			
Dec 8 07:30 London Time	***Bank of France Business Sentiment, Nov***	**Forecast: 96**	**Prior: 96**
	We expect business sentiment to have been unchanged at 96 (-0.3SD) in November, reflecting two opposing trends in the INSEE survey (2-point gain in industrial confidence to a six-month high of 99) and the manufacturing PMI survey (0.1-point drop to a three-month low of 48.4). Note that the forecasts with respect to production and inventories have been declining in the Sep and Oct surveys. But we suspect that the steady weakening in the euro since the middle of October could have alleviated some of the downside risks envisaged by the majority of industrialists.		
Dec 10 07:45 London Time	***Non-Farm Payrolls, 3Q Final***	**Forecast: -0.2% QQ, -0.2% YY**	**Prior: 0.1% QQ, -0.1% YY**
	We expect the final 3Q non-farm payrolls to confirm a 0.2% QQ decline. The preliminary estimate showed a 34K drop in the total number of non-farm private sector employment in the third quarter, more than unwinding the 8K gain in the second quarter. With GDP growth largely flat-lining in the last couple of quarters, we doubt that private sector employment will recover much before 4Q-14. Industrial and construction sector jobs are likely to continue declining, in our view, with services (and temporary employment) remaining the most likely swing factor.		
Dec 10 07:45 London Time	***Industrial Production, Oct***	**Forecast: -0.2% MM, -0.2% YY**	**Prior: 0.0% MM, -0.3% YY**
	Manufacturing Production, Oct	**Forecast: -0.3% MM, -0.5% YY**	**Prior: 0.6% MM, 0.2% YY**
	We forecast that industrial production fell by 0.2% MM in October, beginning the fourth quarter on a weak footing, with an implied contraction of 0.3% versus the 3Q average. Anecdotal evidence has been mixed (with capacity utilisation recovering mildly but the ratio of orders to finished goods falling). In recent months, our model has tended to overestimate the extent of the decline in IP. Overall, we expect a partial unwind of the 0.5% QQ gain in production, estimating that the stock-building visible in 3Q GDP is not going to be repeated in 4Q.		
Dec 11 07:45 London Time	***HICP, Nov***	**Forecast: -0.1% MM, 0.4% YY**	**Prior: 0.0% MM, 0.5% YY**
	Consumer Prices, Nov	**Forecast: -0.1% MM, 0.4% YY**	**Prior: 0.0% MM, 0.5% YY**
		Forecast: 125.76	**Prior: 125.92**
	We look for a 0.1% MM decline in the HICP measure, pushing the headline rate down to 0.4% YY, a decimal point short of its Sep-14 cycle low. We anticipate that the rapid decline in energy prices will likely contribute to a further slowdown in the annual rate of inflation to 0.3% in December, and possibly lower, depending on how fast the pass-through can operate. Core inflation looks set to remain weak in coming months, limiting the expected rebound in headline inflation rates due to favourable base effects. French inflation should average 0.8% in 2015 after 0.5% in 2014.		
Italy			
Dec 11 09:00 London Time	***Industrial Production, Oct***	**Forecast: -0.1% MM**	**Prior: -0.9% MM**
	Weak business surveys data suggest industrial output kept contracting in October, after a 0.9% MM fall in September. With the manufacturing PMI falling back below the 50-mark in October and November (49) there is little room for a rebound in output in coming months. We expect the Italian economy to remain in recession territory in 4Q (after real GDP contracted by 0.1% QQ in 3Q and 0.2% QQ in 2Q).		
Spain			
Dec 12 08:00 London Time	***HICP, Nov Final***	**Forecast: -0.5% YY**	**Prior: -0.2% YY**
	According to the flash estimate, HICP inflation fell to -0.5% YY in November, from -0.2% YY in October. We expect the split to confirm that the decline in HICP inflation was driven by lower fuel and electricity prices, bringing energy inflation further into negative territory (after -1.1% YY in October). In addition, we project core inflation (i.e. excluding fresh food and energy) to have remained unchanged in November (at -0.3% YY). Overall, we expect HICP inflation to remain in negative territory in coming months.		

Sources: National statistical offices, national central banks, Bloomberg, and Citi Research forecasts

Figure 13. Economic Indicators – Comments: Sweden, Norway and United Kingdom

Sweden			
Dec 8 08:30 London Time	***Household Consumption, Oct***	**Forecast: 0.4% MM**	**Prior: -0.4% MM**
	Household consumption slipped 0.5% QQ in 3Q, following a 1.1% QQ gain in both the first and the second quarters. Following a weak third quarter, we expect private spending to rebound in the final quarter of the year; strong income growth, an improving labour market and higher asset prices remain supportive.		
Dec 11 08:30 London Time	***Consumer Prices, Nov*** ***CPIF, Nov***	**Forecast: -0.1% MM, -0.2% YY** **Forecast: 0.0% MM, 0.6% YY**	**Prior: 0.1% MM, -0.1% YY** **Prior: 0.1% MM, 0.6% YY**
	Core inflation rebounded slightly more than expected in October, overshooting the Riksbank's forecast by 0.1pp. Meanwhile, downward pressures from energy and food commodities suggest downside risks to the Riksbank's inflation forecasts heading into 2015. In turn, pressures are likely to return for extraordinary monetary policy loosening to prevent an unnecessarily long period of large output gap and very low inflation. Our November forecasts are in line with the Riksbank's, but declining food and oil price pose downside risks to our projections.		
Dec 11 08:30 London Time	***Unemployment Rate, Nov***	**Forecast: 7.4% NSA, 8.0% SA**	**Prior: 7.5% NSA, 8.1% SA**
	Unemployment remains sticky; the signs of declining unemployment in September were reversed in October with the jobless rate rising 0.3pp to 8.1% SA. Employment was also weak in October (26K vs. 101K in Sep), but this is likely a reaction to very strong growth over the summer. For sure, lead indicators suggest that employment is set to strengthen further ahead. Nevertheless, given accelerating population growth we reckon the decline in unemployment most likely will be very gradual. The Riksbank's average unemployment forecast for 4Q is 7.7%, and with current labour market stickiness, this suggests unemployment likely will decline more gradually than currently envisaged by the Riksbank.		
Dec 12 07:00 London Time	***PES Unemployment Rat, Nov***	**Forecast: 4.1%**	**Prior: 4.2%**
	Short-term indicators point to ongoing improvement on the labour market ahead. In line with the seasonal pattern, we expect the registered unemployment rate to fall slightly in November.		
Norway			
Dec 10 09:00 London Time	***Consumer Prices, Nov*** ***CPI-ATE, Nov***	**Forecast: 0.2% MM, 2.0% YY** **Forecast: 0.1% MM, 2.4% YY**	**Prior: 0.1% MM, 2.0% YY** **Prior: 0.2% MM, 2.5% YY**
	Core inflation came out spot on Norges Bank's forecast in November. Headline inflation is showing signs of turning lower as food prices and rents are starting to ease. Furthermore, imported goods prices are expected to ease next year as the effect from previous NOK depreciation wears out. Note that the November inflation data is out the day before the release of the Monetary Policy Report, and hence, will not influence the new conditional interest rate path.		
Dec 11 09:00 London Time	***Interest Rate Decision***	**Forecast: Unchanged at 1.50%**	**Prior: 1.50%**
	With ongoing declines in oil prices, market sentiment regarding the Norwegian economy has turned very negative. We note, though, that the important Regional Network Report suggested only a marginal growth slowdown (not a slump) ahead despite an expected marked drop in oil investment activity next year. In other words, the report supports our call for a stable sight deposit rate in December. For comparison, current market pricing discounts around a 40% probability of a rate cut before yearend, and sees a 50bp lower policy rate by mid-2015.		
United Kingdom			
Dec 9 09:30 London Time	***Industrial Production, Oct*** ***Manufacturing Output, Oct***	**Forecast: 0.3% MM, 2.0% YY** **Forecast: 0.3% MM, 3.3% YY**	**Prior: 0.6% MM, 1.5% YY** **Prior: 0.4% MM, 2.9% YY**
	Business surveys suggest that manufacturing output continues to grow quite strongly, and hence we anticipate another solid gain this month. A figure in line with our forecast would put the level of IP 0.6% above the 3Q average and hence would set the stage for another strong quarterly gain.		
Dec 10 09:30 London Time	***Trade Balance – Goods & Services, Oct***	**Forecast: £-2.5 Billion**	**Prior: £-2.8 Billion**
	The trade figures have been a little volatile recently, but the deficit in January-September as a whole totalled £21.4bn, a little below the deficit for the same months of 2013 (£23.2bn). Both exports and imports are sluggish, according to the ONS data, and we do not anticipate any change in this trend in the October data.		

Sources: National statistical offices, national central banks, Bloomberg, and Citi Research forecasts.

Figure 14. Key Economic Indicators (15 December – 19 December)

Monday 15 December		**Forecast**	**Last**
08:15	Switzerland: Producer & Import Prices, Nov		
08:30	Netherlands: Retail Sales, Oct		
11:00	UK: CBI Industrial Trends Survey: Output Expectations, Dec	+15%	+12%
	CBI Order Books, Dec	+3%	+3%
	CBI Selling Prices, Dec	-3%	-1%
Tuesday 16 December		**Forecast**	**Last**
07:00	EU-27: New Car Registrations, Nov		
07:00	UK: Bank of England's half-yearly *Financial Stability Report*		
08:30	Sweden: Riksbank Interest Rate Decision		
09:00	Italy: Trade Balance, Oct		
09:00	Euro Area: Manufacturing PMI, Dec Flash		
	Services PMI, Dec Flash		
	Composite PMI, Dec Flash		
09:30	UK: Consumer Prices, Nov	0.0% MM, 1.2% YY	0.1% MM, 1.3% YY
	CPI Ex Food, Drink, Tobacco, Energy, Nov	0.1% MM, 1.5% YY	0.2% MM, 1.5% YY
	Retail Prices, Nov	0.0% MM, 2.2% YY	0.0% MM, 2.3% YY
	RPIX – Ex Mortgages, Nov	0.0% MM, 2.3% YY	0.0% MM, 2.4% YY
09:30	UK: Producer Input Prices, Nov	-1.2% MM, -9.0% YY	-1.5% MM, -8.4% YY
09:30	UK: Producer Output Prices, Nov	-0.3% MM, -0.6% YY	-0.3% MM, -0.5% YY
	Ex Food, Drink, Tobacco, Energy, Nov	0.0% MM, 1.0% YY	0.1% MM, 0.9% YY
10:0	Germany: ZEW Economic Expectations, Dec		
10:00	Euro Area: Trade Balance, Oct		
Wednesday 17 December		**Forecast**	**Last**
08:00	Spain: Labour Cost Index, 3Q		
09:30	UK: LFS Unemployment, 3-M Average, Aug-Oct	-95,000 QQ, 5.9% Rate	-115,000 QQ, 6.0% Rate
	LFS Unemployment, Single Month, Oct	5.7% Rate	6.1% Rate
	Claimant Count Unemployment, Nov	-20,000 MM, 2.8% Rate	-20,400 MM, 2.8% Rate
	Average Earnings Ex Bonus, Oct	1.8% YY, 1.6% 3-M Average	1.8% YY, 1.3% 3-M Average
09:30	UK: Bank of England MPC Minutes (Dec 4)		
09:30	UK: BoE Agents' Summary of Business Conditions, Dec		
10:00	Euro Area: HICP, Nov Final		
10:00	Euro Area: Labour Cost Index, 3Q		
19:00	US:FOMC Outcome		
Thursday 18 December		**Forecast**	**Last**
	EU: European Council, Brussels (to Dec 19)		
06:45	Switzerland: SECO Economic Forecasts, Dec		
07:00	Switzerland: Trade Balance, Nov		
08:00	Sweden: Business and Consumer Surveys, Dec		
08:30	Netherlands: Consumer Confidence, Dec		
08:30	Netherlands: Unemployment, Nov		
09:00	Germany: ifo Business Climate, Dec		
09:30	UK: Retail Sales Volumes, Nov	0.4% MM, 4.4% YY	0.8% MM, 4.3% YY
10:00	Italy: Current Account, Oct		
10:00	Euro Area: Job Vacancies, 3Q		
10:00	Euro Area: Construction Output, Oct		
10:00	Greece: Unemployment Rate, 3Q		
14:00	Belgium: Consumer Confidence, Dec		
Friday 19 December		**Forecast**	**Last**
	EU: European Council, Brussels (to Dec 19)		
00:01	UK: GfK Consumer Confidence, Dec		
07:00	Germany: Producer Prices, Nov		
07:45	France: Industrial Confidence, Dec		
08:30	Netherlands: Consumer Spending, Oct		
09:00	Norway: Unemployment, Dec		
09:00	Italy: Industrial Orders, Oct		
09:00	Euro Area: Balance of Payments, Oct		
09:30	UK: Public Sector Net Borrowing (Ex Public Sector Banks), Nov	£16.3 Billion Deficit	£15.7 Billion Deficit
	Fiscal Year To Date, Apr-Nov	£82.5 Billion Deficit	£76.2 Billion Deficit
10:00	Italy: Contractual Wages, Nov		
11:00	UK: CBI Retail Survey, Dec		

Sources: National statistical offices, central banks and Citi Research

Figure 15. Recent Research from the European Economics Team

Euro Area - Sovereign Debt Update		
ECB Strengthens Dovish Tone Despite Lack of Unanimity	European Economics Team	Dec 5, 2014
ECB to Modify Language to Cement Expectation of Action in Q1	European Economics Team	Dec 4, 2014
Franco-German Ministers' Meeting Yields No New Measures	European Economics Team	Dec 3, 2014
ECB ABS Purchases Started Slowly;	European Economics Team	Dec 2, 2014
ECB's Lautenschläger Currently Opposes Government Bond Purchases by ECB	European Economics Team	Dec 1, 2014
Euro Area		
Euro Area - See You In January Says Draghi, Downplaying Lack Of Unanimity	Guillaume Menuet	Dec 4, 2014
Global Economic Forecasts - December 2014	Michael Saunders	Dec 3, 2014
European Economic Forecast Highlights, December 2014	Ann O'Kelly	Dec 3, 2014
Euro Area - ECB's Constancio on QE and EU's Juncker on Investment Plan	Guillaume Menuet	Nov 26, 2014
Euro Area - Dovish Draghi stresses need for aggressive B/S expansion	Guillaume Menuet	Nov 21, 2014
Euro Area - Draghi Reinforces Balance Sheet Targeting, More Easing Ahead	Guillaume Menuet	Nov 6, 2014
Euro Area - EC forecasts points to non-compliance for some 2015 budgets	Guillaume Menuet	Nov 4, 2014
Euro Area - Will the ECB do a BoJ? Unlikely at the Nov meeting, in our view	Guillaume Menuet	Oct 31, 2014
Euro Area - Comprehensive Assessment Ends With A Whimper	Ebrahim Rahbari	Oct 26, 2014
Spain - Catalonia Referendum: Will it Happen? If So, What?	Antonio Montilla	Oct 10, 2014
ECB - ECB: 'Let's See' First, But Leaves Door Open To QE	Ebrahim Rahbari	Oct 2, 2014
Euro Area - ECB Preview: Will all be revealed on Oct 2?	Guillaume Menuet	Sep 25, 2014
Italy - Growth and Inflation keep undershooting expectations	Giada Giani	Sep 25, 2014
Euro Area - ECB Cuts Rates and Announces Asset Purchase Programme	Guillaume Menuet	Sep 4, 2014
Euro Economics Weekly		
ECB QE: Stacking Up The Evidence	Guillaume Menuet	Nov 28, 2014
Spain: Improving Economy, Politics The Main Risk	Antonio Montilla	Nov 21, 2014
Will Germany Let the ECB Do QE?	Ebrahim Rahbari	Nov 14, 2014
Door Open to QE, Favouring January over December	Guillaume Menuet	Nov 7, 2014
Credit And The Eurozone Malaise	Ebrahim Rahbari	Oct 31, 2014
Will the Euro Area Suffer from Oil Blues?	Guillaume Menuet	Oct 24, 2014
How Much Will the Weaker Euro Boost Eurozone Growth?	Ebrahim Rahbari	Oct 17, 2014
France: Rejecting Austerity, For Now	Guillaume Menuet	Oct 10, 2014
Greece — Six Crucial Months Ahead	Giada Giani	Oct 3, 2014
Focus On The ECB's Balance Sheet	Ebrahim Rahbari	Sep 26, 2014
H2 GDP Uptick Too Small to Stop ECB QE	Guillaume Menuet	Sep 19, 2014
Euro Area: Housing Sector Close to a Turnaround	Antonio Montilla	Sep 12, 2014
Low-flation 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
Chief Economist Publications		
Prospects for Economies and Financial Markets in 2015 and Beyond	Willem Buiter	Dec 1, 2014
Scandi and Swiss		
Scandi Economics Update	Tina Mortensen	Dec 4, 2014
Norway - Investment Survey Implies Drop in Oil Investments in 2015, But Estimate Revised Up	Tina Mortensen	Dec 4, 2014
Denmark - Surprisingly Strong GDP Growth in 3Q	Tina Mortensen	Nov 28, 2014
UK		
UK - Autumn Statement	Michael Saunders	Dec 3, 2014
UK - PMI and BoE Data	Michael Saunders	Dec 1, 2014
UK - Cameron Speech	Michael Saunders	Nov 28, 2014
UK Economics Weekly		
Low Rates and Low Oil to Keep Economy Buoyant	Michael Saunders	Nov 28, 2014
How Likely is Brexit? What Would the Effects Be?	Michael Saunders	Nov 21, 2014
Golden Scenario	Michael Saunders	Nov 14, 2014
The UK's Achilles Heel	Michael Saunders	Nov 7, 2014

Appendix A-1

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