21 February 2014 | 20 pages

Developed Markets
Western Europe

Euro Economics Weekly

German Inflation: Lower For a Little Longer

- German inflation has been subdued recently, falling to 1.3% YY in January after 1.5% in 2013 and 1.6%pa in the 2000-2012 average. The weakness in German inflation has had two main drivers: First, 'imported' inflation has been very weak, deducting up to 1pp from CPI inflation over the last year. Second, domestic price pressures have remained low, as a sluggish economy held down wage pressures.

- We expect domestic price pressures to increase in the course of this year and beyond, as a strengthening economy and the prospect of a national minimum wage raise wage growth. Continued disinflationary pressure from the strong euro and low energy and import prices should still keep inflation quite low in 2014 (we expect 1.5%), but we expect stronger domestic price pressure to push up inflation in 2015 to 1.9%.

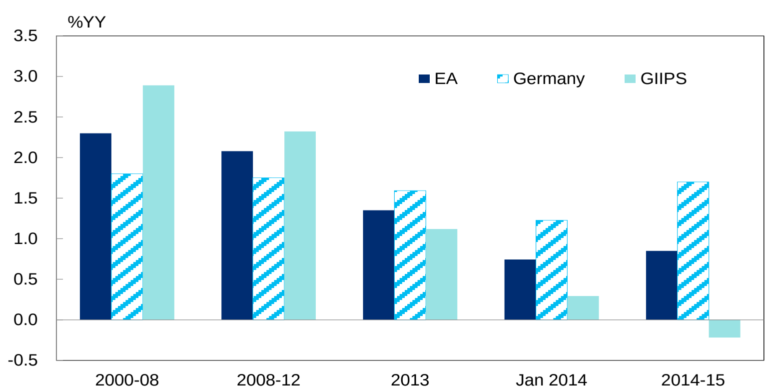
- German consumer prices and unit labour costs are outgrowing the Eurozone periphery by 1pp and 2-3pp per year, respectively. That is enough to help those countries generate current account surpluses, but too low to lift the Eurozone out of the deflation 'danger zone' or to help the periphery address their debt sustainability challenges. Importantly, it is probably too *high* for the ECB to adopt QE.

Figure 1. Euro Area

	$/€	Euro Repo	10-yr Bunds	£/€	UK Bank Rate	10-yr Gilt-Bund	SKr/€	SEK Policy Rate	NOK/€	NOK Policy Rate	SFr/€	CHF Policy Rate	CHF Spread vsBunds
2Q 14	1.39	0.00	1.70	0.80	0.50	158	8.71	0.75	8.12	1.50	1.24	0.00	-73
4Q 14	1.40	0.00	1.80	0.80	0.75	183	8.79	0.75	7.95	1.50	1.26	0.00	-77

Source: Citi Research

Figure 2. Euro Area — Consumer Price Inflation (YY%), 2000-2015F



Note: Based on the HICP definition. Sources: Eurostat and Citi Research

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Ebrahim Rahbari

German Inflation: Lower For a Little Longer

German inflation remains weak, as Germany continues to import disinflation, but growing domestic price pressures are likely to push inflation in Germany higher in the course of this year, but only slowly and gradually

External price pressures are likely to remain muted and have the potential to thwart the rise in German inflation

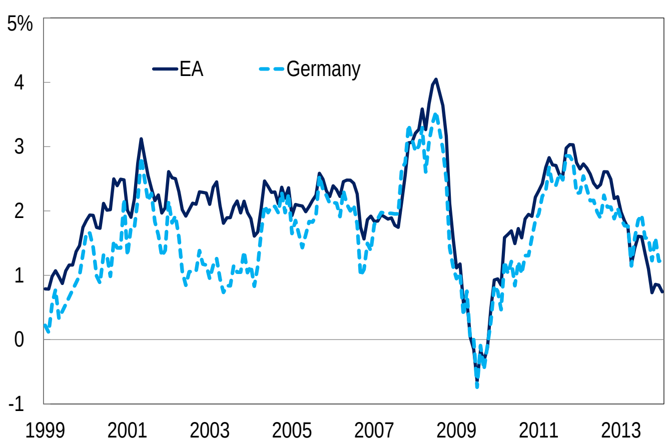
German inflation is too low to allow to allow the periphery to address its debt sustainability challenges, but likely too high to put much pressure on the ECB to carry out QE in meaningful size.

German inflation continues to be weak, falling to 1.3% YY (national definition, 1.2%YY for the HICP definition) in January after coming in at 1.5% for the 2013 average. Germany thus made the third-largest contribution to the fall in Eurozone inflation over the past 12 months after Italy and Spain (see Figure 4) and undershot consensus inflation expectations which in early 2013 expected German inflation to be 2% in 2013. The main driver of German disinflation has been external: stable energy prices, the strong euro and low import prices of many of Germany's main trading partners have probably reduced German inflation by up to 1pp over the past year. Domestic price pressures have been a little more mixed, but even there a still-sluggish economy and high inward migration kept wage pressures in check recently and price expectations of consumers and businesses remain muted.

Looking forward, inflation in Germany should continue to be low for some time (we expect February inflation of 1.3%YY and 1.1%YY for the national and HICP definition) and rise only very gradually. Domestic price pressures should gradually increase over the course of 2014, as a stronger economy and a tightening labour market translate into higher wage growth. In addition, the introduction of a national minimum wage from 2015 may add cumulatively more than 0.5pp to the price level in the coming 2-3 years. Meanwhile, external disinflationary pressures should persist, as the euro remains strong and import and energy prices weak, but moderate somewhat over time. Overall, we therefore expect inflation to remain to be 1.5% in 2014 and rise to 1.9% in 2015.

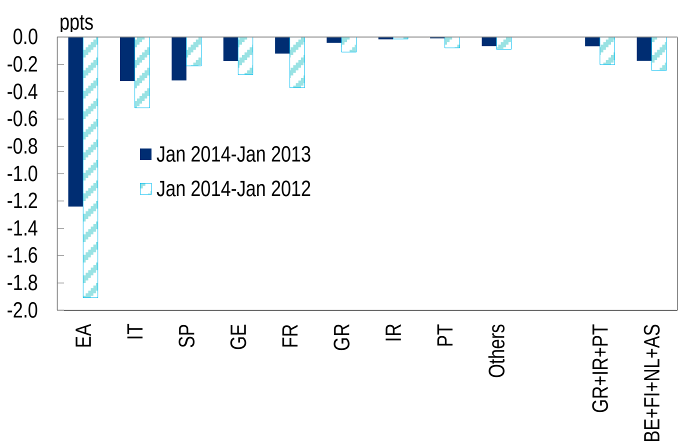
This inflation outlook is quite benign for Germany, but not so much for the rest of the Eurozone. In 2013, German inflation was above that in the rest of the Eurozone for the first time since the creation of EMU and it now runs roughly 1pp above inflation in the GIIPS countries on average. That differential is roughly of the same size (but the opposite direction) as the pre-crisis inflation differentials in EMU and it is likely to widen in the next two years (see Figure 2 on the Front Page). But low German inflation keeps the Eurozone in the deflation danger zone and aggravates debt sustainability challenges in the highly indebted Eurozone periphery. On the other hand, German inflation (and the prospect of higher inflation) is probably too high for the ECB to carry out meaningful quantitative easing (QE).

Figure 3. Germany and Euro Area — Consumer Price Inflation (YY%), 1999-2014



Note: based on HICP definition.
Sources: Eurostat and Citi Research

Figure 4. Euro Area — Contribution to Change in Euro Area Inflation (pp), Jan 2012-Jan 2014



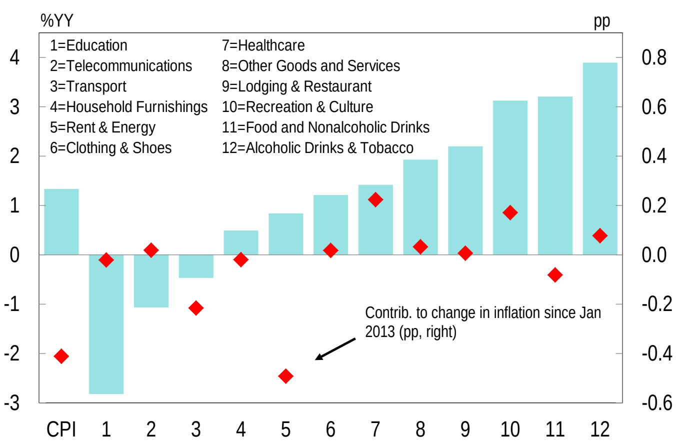
Note: based on HICP definition.
Sources: Eurostat and Citi Research

Germany imports disinflation…

Germany mostly imports disinflation, as the euro remains strong and energy and other import prices low

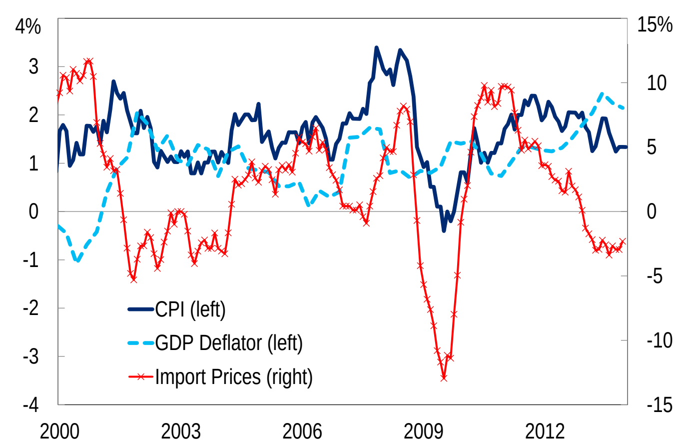
In our view, low German inflation is driven by a variety of factors, but the main drivers are external. Put differently, Germany has 'imported' disinflationary pressures, in three related ways. First, the contribution of energy prices to CPI inflation has fallen substantially, as world prices for oil and commodities remained range-bound. In fact, lower price increases in the rent & energy component of the German CPI can explain the entire fall in German inflation over the last twelve months, with energy-intensive transport prices the second largest contributor category to falling German inflation (see Figure 5). Second, euro strength (Germany's broad nominal effective exchange rate has appreciated by 6% since mid-2012) probably led some exporters to Germany to accept declining margins to safeguard their price competitiveness, and fed through to lower import prices for some products. Third, euro area exporters have trimmed costs and prices in an attempt to generate some export growth, also putting downward pressure on import prices.

Figure 5. Germany — Rate of Price Increase by Product Category (% YY), 2014



Note: Based on national CPI definition. HH are households.
Sources: Statistisches Bundesamt and Citi Research

Figure 6. Germany — Consumer Price Inflation and GDP deflator inflation (YY%), 2000-2014



Note: CPI is based on national definition.
Sources: Statistisches Bundesamt and Citi Research

Imported disinflation has probably lowered CPI inflation by up to 1pp over the last year

German import prices (which include the prices of goods not included in the CPI, such as capital goods) fell by 2.5% YY in 2013. The OECD estimated that roughly 25% of final German household consumption was imported in 2005, a share that is bound to have gone up further since and implying that imports alone may have shaved around 3/4 pp off German CPI inflation. The indirect effect may have been even larger, as some domestic firms probably tried to avoid raising prices to safeguard their own price competitiveness. Inflation measured by the GDP deflator, which excludes import prices, is running almost 1pp higher than CPI inflation in Germany currently (even though it has also fallen recently, see Figure 6).

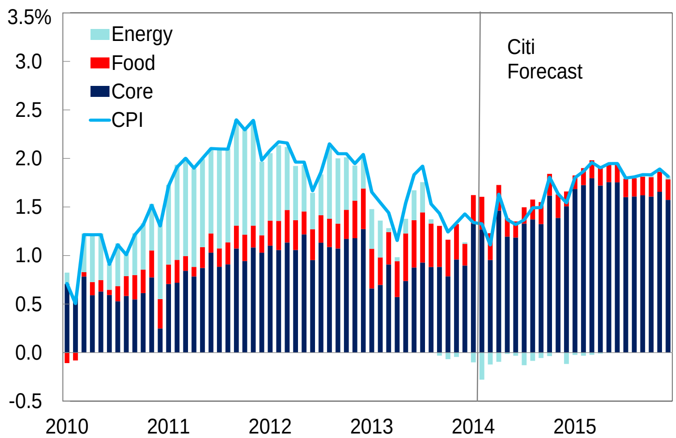
These external disinflationary effects are likely to persist, in our view. Futures prices suggest relatively stable commodities prices, and the euro is likely to modestly appreciate further in trade-weighted terms in 2014-5. The amount of slack in the export sectors of the Eurozone periphery is slowly starting to fall (which will eventually put upward pressure on import prices), but for now slack remains ample. Falling slack in the EA will likely be compensated by rising slack in EM, which could put downward pressure on the prices of imports from some EM countries.

…while domestically, the picture is more mixed.

Domestic price pressures are generally also muted, but not uniformly so

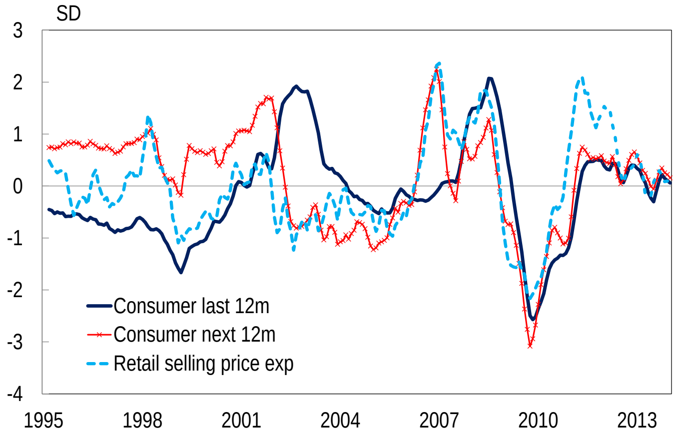
Core inflation in Germany (ex-food and energy) is also very low at 1.1% YY in January (seasonally-adjusted), even though it rose quite sharply in January from 0.6% YY in December mostly on base effects. Only five of the 12 main product categories in the CPI contributed to the decline in CPI inflation over the past year (see Figure 5), most of which probably include a fairly high import component. Only in five categories is the rate of price increase currently below their respective long-term average.[1] The price of more labour-intensive (and therefore presumably more domestically driven) services is running at 1.9% YY vs 0.8% for goods. Yet even on the domestic side, price pressures mostly remain muted and price expectations of consumers and businesses remain close to their long-term averages (see Figure 8).

Figure 7. Germany — Consumer Price Inflation (YY%), 2010-2015



Note: HICP.
Sources: Statistisches Bundesamt and Citi Research

Figure 8. Germany — Price expectations (sd from LT Average), 1995-2014



Sources: European Commission, ifo and Citi Research

Wage growth has decelerated in 2013, as the economy was sluggish, but is likely to pick up again

A key reason for the lack of bigger domestic price pressure is subdued wage growth, in our view. After a pickup in the pace of nominal wage growth over the course of 2011-2, 2013 saw a deceleration again. Thus, labour costs and gross wages and salaries in the total economy in Germany grew by a mere 1.6% YY and 1.8% YY in Q3 2013, respectively, after 3% pa increases in 2011-12 (see Figure 9) and of 2% pa on average in 2000-12. Negotiated wage growth is running at a slightly higher pace, but still below the increases in previous years. And the German National Statistical Office reported this week that real wages in Germany actually fell in 2013 for the first time in four years, by 0.2% on account for falling bonus payments.

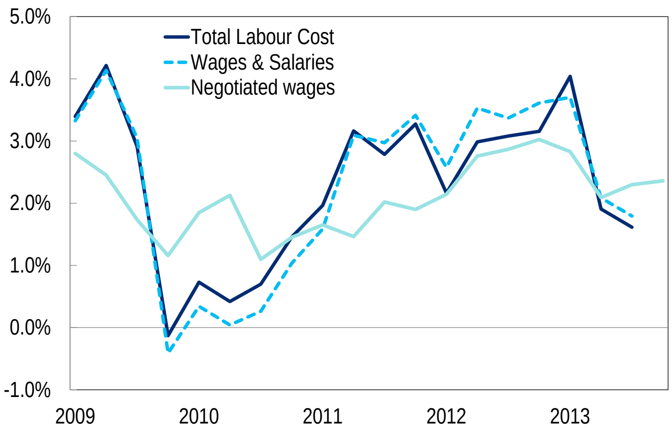
In our view, much of the weakness in labour incomes can be explained by a sluggish economy, a focus of job creation on low-paid and flexible jobs in recent years and the fact that continued inward migration reduced wage pressures. GDP growth in Germany was only 0.5% after 0.9% growth in 2012. And while employment grew by almost 200k to a new record-high of 42m, the labour force grew by more, mostly due to net inward migration.

[1] The other seven where price increases are above their long-term average are the two food & drinks categories, clothing, telecommunications, recreation, lodging and 'other goods and services'.

As the economy gathers pace, we consider it likely that wage growth will also pick up. We expect real GDP growth of around 2% pa in 2014-5, which should support nominal wage growth to also pick up, to 2.5-3% YY in 2014 and 3-3.5% YY in 2015.[2]

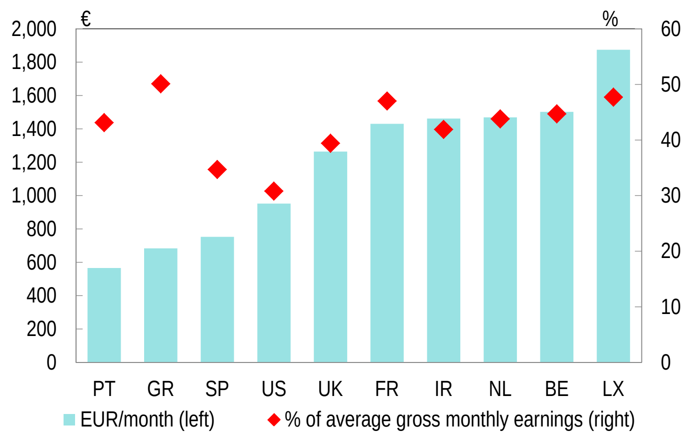
Will the minimum wage push up inflation?

Figure 9. Germany — Nominal Wages and Labour Costs (% YY), 2009-2013



Sources: Statistisches Bundesamt and Citi Research

Figure 10. Selected Countries — Minimum wage (per Month and as % of Average Gross Monthly Earnings), 2013



Sources: Eurostat and Citi Research

The national minimum wage to be introduced in 2015 will likely push up the price level by more than 0.5pp cumulatively

A related factor that will probably modestly increase inflation in Germany in the next few years is the introduction of a nationally binding minimum wage (NMW).[3] The new German government announced in its coalition agreement that it will introduce such a minimum wage at the beginning of 2015, planned at a level of €8.50/hour and with exemptions from the minimum wage to be phased out by the beginning of 2017, with an agreement on the final plans expected in the spring.

A study based on micro data from the German Socio-Economic Panel Study (SOEP) suggested that 11% of German workers earned less than €8.50 per hour in 2013, and that such workers earned on average 30% less.[4] The effects of a minimum wage are complex and much will depend on the exact scope and level of the minimum wage, but auxiliary assumptions can at least give us a sense of the magnitudes of its potential effects on inflation. We make the following ones: i) no exemptions or job losses, ii) full pass-through of labour costs to prices, iii) wages account for 50% of total costs, iv) domestic goods account for 75% of final consumption, v) employees affected by the NMW work as much as the average employee, and vi) there are no effects on employees earning more than the NMW or any second-round effects. Under these assumptions, the NMW would have a potential impact on the German price level of 1.3 pp.

However, this estimate is likely to be too high, in our view. First, despite the much-touted desire of the centre-left SPD party in government to apply the NMW without

[2] See Euro Economics Weekly - Germany 2014 Outlook: Recovery And Rebalancing

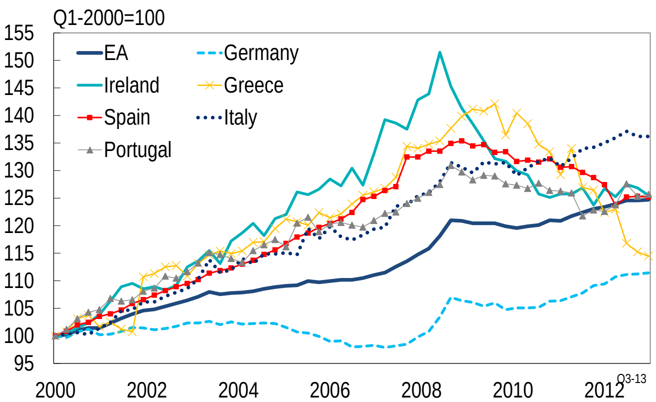
[3] See https://www.cdu.de/sites/default/files/media/dokumente/koalitionsvertrag.pdf

[4] See Mueller, K. and V. Steiner, "Distributional effects of a minimum wage in a welfare state – The Case of Germany", DIW working paper, 30 October 2013, http://www.wiwiss.fu-berlin.de/fachbereich/vwl/steiner/forschung/MW_inequality_29-10-2013.pdf?1383324203. There is some uncertainty about the share of employees affected. For instance, another DIW publication suggested that up to 17% of German workers currently earned less than €8.50/per hour.

exemptions, significant exemptions are likely, in our view, to limit potential job losses. Such exemptions are particularly likely for apprentices, part-time employees and the marginally employed.[5] Since these account for a sizable share of the workers earning less than €8.50/hour currently (according to the National Statistical Office, one seventh to one tenth of German employees are marginally employed and almost half of these earn less than €8.50/hour, compared to 16% of part-time and 8% of full-time workers), the potential effect of the NMW on wages and prices could be much reduced. Job losses and productivity increases are also likely to further reduce the impact on prices, and firms may prefer to reduce their margins, at least initially, rather than pass through cost increases fully to prices. On the other hand, second-round effects and spillover effects on employees earning more than the NMW currently may raise the effect of the NMW on prices. Acknowledging the residual uncertainty, a cumulative impact of perhaps half our reference calculation (i.e. around 0.6 pp) over the coming three years seems plausible to us, with the bulk of the increase taking place around the beginning of 2015.

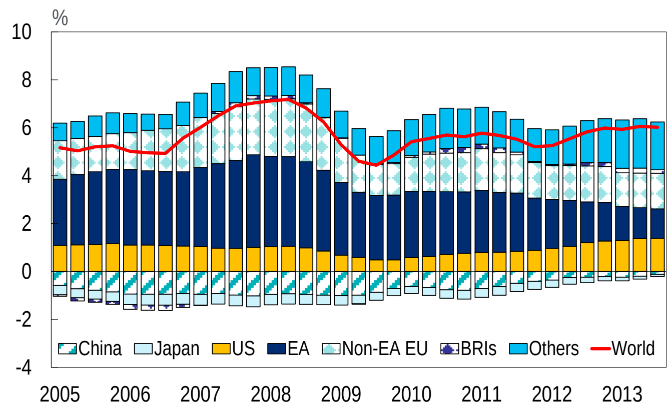
Will German inflation support intra-Eurozone rebalancing?

Figure 11. Euro Area — Nominal Unit Labour Costs (Q1 2000=100), 2000-Q3 2013



Sources: Eurostat and Citi Research

Figure 12. Germany — Bilateral Trade Balance (% of GDP), 2005-2013



Note: Based on exports and imports of goods and services in current euros. BRIs are Brazil, Russia and India.
Sources: Eurostat and Citi Research

German inflation is 1 pp above inflation in the periphery — high enough to allow those countries to generate current account surpluses...

…but too low to help the Eurozone periphery address their debt sustainability challenges and likely too high to put much pressure on the ECB to carry out meaningful QE

As noted above, Germany's inflation rate in 2013 was above that of the Eurozone in 2013 for the first time since EMU was created: German HICP inflation was 1.6%, while non-German inflation in the Eurozone was at 1.3%. In the more recent data, that gap is somewhat larger, as inflation fell more quickly in the rest of the Eurozone during the course of 2013 (see Figure 3). Thus, as of January, German inflation was at 1.2% YY vs 0.6% YY for the EA ex-Germany and 0.3% YY for the weighted average of the GIIPS (Greece, Ireland, Italy, Portugal and Spain) countries.

The inflation differentials are quite similar in size (though of course opposite in direction) to the pre-crisis differences: in 2000-2008, German inflation was roughly 0.5pp below inflation in the rest of the Eurozone, and roughly 1 pp below average inflation in the GIIPS countries. In addition, Germany's unit labour costs have grown faster than those in the Eurozone for the last 10 quarters, by around 1pp pa vs the Eurozone average and by around 2.5 pp relative to the GIIPS countries. These inflation differentials have allowed most periphery countries (except Italy) to narrow their ULC differentials to Germany significantly in recent years, even though except

[5] The coalition agreement explicitly allows for exemptions but only until end-2016, when the NMW is meant to apply to all employment relationships.

in Greece periphery ULCs are still high compared to their levels in 2000 (see Figure 11). Aided by sometimes savage import compression in the EA periphery, Germany's bilateral trade surpluses with the rest of the Eurozone have also narrowed substantially in recent years, to 1.2% of German GDP in Q3 2013 (for the four-quarter sum), compared with almost 4% of GDP in late 2007 (see Figure 12).

However, low German inflation is also failing to push up Eurozone inflation meaningfully. Germany's contribution to Eurozone inflation has fallen substantially (Germany contributed 0.6pp to Eurozone inflation in 2011 vs 0.3 pp currently) — too small to take the Eurozone out of the deflation 'danger zone'.[6] In 2000-07 when German inflation rates were below the Eurozone average, average Eurozone inflation ran at 2.2% pa, roughly three times the latest pace of Eurozone inflation. One major difference is thus that the rebalancing process is taking place at low levels of inflation, which raises the real burden of debt for highly indebted periphery countries and therefore aggravates their debt sustainability challenges (German private and public debt was of course also much lower in the pre-crisis period than it is in the periphery currently). On the other hand, German inflation (and the prospect of a moderate increase in inflation in the next two years) is probably too high to put much pressure on the ECB to carry out meaningful QE.

[6] See also "The Euro Area Now and Japan Then: Separated by One Large Shock", *Euro Economics Weekly*, 31 January 2014, Citi

Key Economic Indicators (24 February – 28 February 2014)

During the Week		**Forecast**	**Last**
07:00	UK: Nationwide House Prices, Feb		
Monday 24 February		**Forecast**	**Last**
08:30	Netherlands: Producer Confidence, Feb		
09:00	Germany: ifo Business Climate, Feb	110	110.6
10:00	Euro Area: HICP, Jan Final	0.7% YY	0.8% YY
14:00	Belgium: Business Confidence, Feb		
Tuesday 25 February		**Forecast**	**Last**
07:00	Germany: GDP Details, 4Q	0.4% QQ, 1.4% YY	0.3% QQ, 0.6% YY
07:45	France: Business Confidence, Feb	101	100
	Own-Company Production Outlook, Feb	13	9
08:00	Spain: Producer Prices, Jan		
09:00	Italy: Retail Sales, Dec		
09:30	UK: BBA Mortgage Advances, Jan		
10:00	Italy: Consumer Confidence, Feb	98.5	98.0
10:00	EU Commission's Winter Economic Forecasts		
11:00	UK: CBI Retail Survey, Feb		
Wednesday 26 February		**Forecast**	**Last**
07:00	Germany: GfK Consumer Confidence, Mar		
08:30	Sweden: Retail Sales, Jan	0.5% MM	-0.8% MM
09:00	Norway: LFS Unemployment Rate, Dec	3.5%	3.5%
09:00	Italy: Contractual Wages, Jan		
09:30	UK: GDP, 4Q (2nd Release)	Provisional: 0.7% QQ, 2.8% YY	3Q: 0.8% QQ, 1.9% YY
09:30	UK: Service Sector Output, Dec	0.3% MM, 3.1% YY	0.4% MM, 2.6% YY
17:00	France: Jobseekers – Net Change, Jan	-5.0K	+10.2K
	Total Jobseekers, Jan	3,298.2K	3,303.2K
Thursday 27 February		**Forecast**	**Last**
06:45	Switzerland: GDP, 4Q		
07:00	Germany: Import Prices, Jan	0.5% MM, -1.8% YY	0.0% MM, -2.3% YY
07:45	France: Consumer Confidence, Feb	87	86
08:00	Spain: GDP Details, 4Q	0.3% QQ	0.1% QQ
08:15	Switzerland: Unemployment Rate, 4Q		
08:30	Sweden: Household Lending, Jan	5.0% YY	4.9% YY
08:30	Sweden: Trade Balance, Jan		
08:55	Germany: Unemployment, Feb		
09:00	Italy: Business Confidence, Feb	98.0	97.7
09:00	Euro Area: M3, Jan	1.2% YY	1.0% YY
09:30	UK: Migrations Statistics Quarterly Report		
10:00	Euro Area: Economic Sentiment, Feb	101.3	100.9
11:00	Ireland: Quarterly National Household Survey – Unemployment, 4Q		
11:00	Ireland: Residential Property Price Index, Jan		
13:00	Germany: HICP, Feb Flash	0.7% MM, 1.1% YY	-0.6% MM, 1.2% YY
	National CPI, Feb Flash	0.6% MM, 1.3% YY	-0.6% MM, 1.3% YY
Friday 28 February		**Forecast**	**Last**
00:01	UK: GfK Consumer Confidence, Feb		
07:00	Germany: Retail Sales, Jan	1.2% MM, 0.3% YY	0.0% MM, 1.3% YY
07:45	France: Consumer Spending, Jan	-0.6% MM, 1.0% YY	-0.1% MM, 1.4% YY
07:45	France: Producer Prices, Jan		
08:00	Spain: HICP, Feb Flash	0.0% YY	0.3% YY
08:00	Switzerland: KOF Economic Barometer, Feb		
08:30	Sweden: GDP, 4Q	0.4% QQ	0.1% QQ
08:30	Sweden: Producer Prices, Jan		
09:00	Norway: Registered Unemployment Rate, Feb	2.9%	3.0%
09:00	Norway: Retail Sales, Jan	0.1% MM	0.1% MM
09:00	Italy: Unemployment Rate, Jan	12.7%	12.7%
10:00	Italy: HICP, Jan Flash	0.5% YY	0.6% YY
10:00	Euro Area: Unemployment Rate, Jan	12.0%	12.0%
10:00	Euro Area: HICP, Feb Flash	0.6% YY	0.7% YY
10:00	Greece: Retail Sales, Dec		
11:00	Ireland: Retail Sales, Jan		
	Spain: Current Account, Dec		

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area

Feb 24 10:00 London Time — *HICP, Jan F* — Forecast: 0.7% YY — Prior: 0.8% YY

Inflation should be confirmed at 0.7% YY in the final January print, as incoming information from member states' HICPs has been consistent with a decline in the headline rate at the euro area level. Core inflation (ex. fresh food and energy) probably stayed put at 0.9% YY in Jan, while the HICP ex-food, energy and tobacco went slightly higher to 0.8%, from a downwardly-distorted 0.7% Dec print. In general, price pressures continue to subside at a slow but constant pace.

Feb 27 09:00 London Time — *M3, Jan* — Forecast: 1.2% YY — Prior: 1.0% YY

After the weak M3 growth print observed in December, probably distorted by year-end effects and the AQR snapshot on banks' balance sheets, a payback likely occurred in January, although the growth rate in broad money remains very subdued by historical standards. The most important piece of information to look out for in the report will still be the dynamic in credit flows. December credit flows to the business sector recorded the smallest decline in nine months. A similar pattern could be observed in January, with further easing in private deleveraging forces after the pressure imposed by the AQR snapshot. The annual growth rate of credit to the private sector will remain largely negative around December's level – an all-time low of -2.1% YY.

Feb 27 10:00 London Time — *Economic Sentiment, Feb* — Forecast: 101.3 — Prior: 100.9

The back-to-back uninterrupted monthly gains over the past nine months have taken the level of euro area economic sentiment back to its long-run average in January. We expect sentiment to edge slightly higher in February. The improvement in the January composite PMI – normally a slightly leading, albeit more volatile, indicator relative to the EU Commission sentiment indicator – suggests that some further gains are in the pipeline for overall sentiment. The more domestically-oriented sectors of the economy (i.e., services, retail and construction) are still catching up with the more advanced stage of the recovery in industry, leading the overall index higher.

Feb 28 10:00 London Time — *Unemployment Rate, Jan* — Forecast: 12.0% — Prior: 12.0%

The unemployment rate has roughly remained stable throughout 2013 at 12.0% (except for a temporary rise to 12.1% in Q2/Q3). We expect it to have remained unchanged at this level in January but we expect it to start edging lower from Q2 14.

Feb 28 10:00 London Time — *HICP, Feb P* — Forecast: 0.6% YY — Prior: 0.7% YY

Base effects in the energy component should push headline inflation lower again in February, to 0.6% YY. Oil prices – the main drivers of the energy component – continued to trend slightly lower, as opposed to upside tensions in early 2013, generating favourable base effects. These should continue compressing the headline inflation rate until April, barring a large surge in oil prices in the meantime. Food prices are also contributing to keep inflation very subdued, together with the generalised weakness in core inflation. HICP ex- food, tobacco and energy likely remained unchanged at 0.8% YY in Feb.

Germany

Feb 24 09:00 London Time — *Ifo Business Climate, Feb* — Forecast: 110 — Prior: 110.6

The ifo business climate index is at its highest value since mid-2011 and roughly 1.5 standard deviations above long-term averages. Despite the positive surprise in the 4Q first reading for GDP, we therefore consider the upside potential in February to be somewhat limited and expect a roughly flat reading with a bit of downside risk.

Feb 25 09:00 London Time — *Real GDP Details, 4Q* — Forecast: 0.4% QQ, 1.4% YY — Prior: 0.3% QQ, 0.6% YY

We expect the first reading for German 4Q GDP to be confirmed at 0.4% QQ. The press release by the German Statistical Office already noted at the time that growth in 4Q was mostly driven by net exports, while fixed investment also rose significantly. On the other hand, private consumption fell slightly despite the continued positive momentum in the labour markets, while inventories also fell.

Feb 27 07:00 London Time — *Import Prices, Jan* — Forecast: 0.5% MM, -1.8% YY — Prior: 0.0% MM, -2.3% YY

We expect German import prices to rise on seasonal factors in January. Base effects mean that such an increase would lower the rate of YY-declines to below 2% for the first time since February 2013. The last four months have generally seen a moderation in the downward pressure of import prices

Feb 28 07:00 London Time — *Retail Sales, Jan* — Forecast: 1.2% MM, 0.3% YY — Prior: 0.0% MM, 1.3% YY

We expect German retail sales (excluding cars) to register a fairly strong increase in January after the Oct-Dec average remained roughly flat over the 3Q average. Base effect will nevertheless mean that the YY rate of increase will drop to just a 0.3% increase, highlighting that private consumption growth remains sluggish, even though we expect a gradual pickup in the rate of growth in the course of 2014.

Feb 28 13:00 London Time
HICP, Feb Flash — Forecast: 0.7% MM, 1.1% YY — Prior: -0.6% MM, 1.2% YY
National CPI, Feb Flash — Forecast: 0.6% MM, 1.3% YY — Prior: -0.6% MM, 1.3% YY

We expect the flash readings for German inflation in February to be stable for the national CPI at 1.3% YY and to tick down slightly for HICP inflation to 1.1% YY. The latter would be the lowest level since April, but mostly driven by base effects. We expect inflation in Germany to only rise very slowly and gradually in 2014, mostly in 2H.

France

Feb 25 07:45 London Time
Business Confidence Indicator, Feb — Forecast: 101 — Prior: 100
Own-Company Production Outlook, Feb — Forecast: 13 — Prior: 9

French manufacturers are expected to feel a little more confident about 2014 in February, with President Hollande determined to push through his Responsibility Pact designed to reduce labour charges and eventually lower corporate taxation for SMEs, provided enough expenditure savings can be identified. With order books improving slightly and capacity utilisation increasing modestly, we believe that the strength of the euro remains one of the key impediments to faster output growth, a situation that is likely to cap the rebound in personal production forecasts.

France continued			
Feb 26 17:00 London Time	*Jobseekers – Net Change, Jan (000s)* *Jobseekers, Jan (000s)*	Forecast: -5.0K Forecast: 3,298.2K	Prior: +10.2K Prior: 3,303.2K
	We look for a 5,000 drop in the number of registered jobseekers in January. Slightly faster economic activity and indications that the services sector had created some jobs for the second successive quarter in 4Q-13 makes us a little more confident that the mainland jobless rate will peak earlier (1Q-15 at 10.6%). Meanwhile, very low inflation is adding a little more than expected to household disposable income. Employment expectations in the private sector were largely unchanged in January, within touching distance of their long-term average.		
Feb 27 07:45 London Time	*Consumer Confidence Indicator, Feb*	Forecast: 87	Prior: 86
	Households are feeling much less pessimistic about unemployment than about their future living standards, financial situation or ability to make large purchases. As a result, the recovery in consumer confidence appears a little fragile, underpinned by the very low inflation backdrop and the fact that firms probably refrained from hiking their prices against a backdrop of very weak demand. We look for a one-point gain in February to a 19-month high of 87, but do not expect much acceleration in consumer spending in the quarters ahead given the lack of job creation.		
Feb 28 07:45 London Time	*Consumer Spending, Jan*	Forecast: -0.6% MM, 1.0% YY	Prior: -0.1% MM, 1.4% YY
	Consumer spending is forecast to decline for the second successive month in January. We estimate that the January 1, 2014 VAT rate hike likely made households more keen to purchase big-ticket items in 4Q-13, arguing for some pay-back in the first quarter of 2014. Note that passenger car registrations declined by 13% MM in January. Nevertheless, with household sentiment recovering gradually and retailers also expressing greater confidence about the outlook, we believe that household spending will again contribute to GDP growth in the second quarter.		
Italy			
Feb 25 09:00 London Time	*Consumer Confidence, Feb*	Forecast: 98.5	Prior: 98.0
	Consumer sentiment should show another modest gain in February. Note that the index has a break in the series in June 2013, when it jumped by one standard deviation in only one month (from -2.2 to -1.2 st. dev. below its long-run average), therefore comparisons with the long-term average are somewhat misleading. If one corrects for this break, the level of consumer confidence has failed to show much improvement since last summer.		
Feb 27 09:00 London Time	*Business Confidence, Feb*	Forecast: 98.0	Prior: 97.7
	We expect a small bounce back in Feb business climate, after an unexpected drop in January. The pace of improvement in business confidence has clearly slowed since last autumn, despite the liquidity situation of the corporate sector doing very well (as strong growth in corporate bank deposits shows), on the back of large repayments of government debt arrears. The level of confidence in the industrial sector remains some 0.2 standard deviations below its long-run average, lagging behind other euro area countries and suggesting only marginally positive GDP growth.		
Feb 28 09:00 London Time	*Unemployment Rate, Jan*	Forecast: 12.7%	Prior: 12.7%
	The unemployment rate is expected to remain stable at 12.7% in January, despite still falling employment, thanks to a reduction in the labour force.		
Feb 28 10:00 London Time	*HICP, Feb P*	Forecast: 0.5% YY	Prior: 0.6% YY
	Inflation probably declined further by another 0.1pp in February, to 0.5% YY, mainly on base effects in the energy component. Fuel prices have continued to drift lower in recent weeks, on the back of falling oil prices. This would be the lowest headline inflation print since the 2009 trough. CPI inflation probably also eased by 0.1pp, to 0.6% YY. Core CPI inflation is expected to have remained unchanged at 1.0% YY in Feb, at the same subdued level as in January and close to an all-time low (only Dec-13 was lower at 0.9% YY).		
Spain			
Feb 27 08:00 London Time	*GDP, 4Q F*	Forecast: 0.3% QQ	Prior: 0.1% QQ
	We expect the final 4Q GDP reading (+0.3% QQ, highest quarterly rate since 1Q 08) to confirm the end of recession in the Spanish economy in 2H 2013, after two years of QQ contractions. Private consumption likely rose marginally in 4Q, amid falling inflation, less fiscal tightening, and first signs of employment growth. Recent gains in business confidence together with improvements in firms' financial position should keep business investment rising in 4Q. On the other hand, net exports' contribution to real growth was likely zero in 4Q (after deducting 0.1pp in 3Q), reflecting a weakening in both exports and imports		
Feb 28 08:00 London Time	*HICP, Feb P*	Forecast: 0.0% YY	Prior: 0.3% YY
	We expect the annual HICP inflation rate to slow to 0% YY in February, from 0.3% YY over the previous three months. Lower fuel prices and some negative base effects will probably drive HICP energy inflation into negative territory, offsetting an additional increase in the electricity tariffs on February (of 0.2% MM). On the other hand, we expect further easing in food price inflation as well as on-going weakness in core prices (excl. fresh food and tobacco), with prices of services likely remaining in negative territory. Still ample spare capacity however will probably push core inflation lower in coming months, likely to negative territory. We expect HICP inflation to average -0.2% YY over 2014.		
Sweden			
Feb 26 08:30 London Time	*Retail Sales, Jan*	Forecast: 0.5% MM	Prior: -0.8% MM
	Retail sales surprisingly fell in December, but following three very strong readings out of the last four months. Average retail sector activity was up 0.8% QQ in 4Q, up from 0.5% QQ in 2Q and 0.4% QQ in 3Q. Current levels of consumer and retail confidence support an upward trend in private consumption, and fiscal policy measures are expected to support spending this year.		
Feb 27 08:30 London Time	*Household Lending, Jan*	Forecast: 5.0% YY	Prior: 4.9% YY
	Lending to households was stable at 4.9% YY in December, staying above the growth pace of a year ago (4.5% YY). The largest part of households' loans consists of housing loans (63%), which in December had an annual growth rate of 5.3% (4.6% YY a year ago and down from 10.5% YY in early 2010). Given the rebound on the housing market (house prices have increased throughout most of 2013), we see a clear risk that household lending could pick up further ahead. Although this is well in line with the Riksbank's expectations (forecasting a pick-up to around 5%-5.5% YY), we reckon the board would be more comfortable with a slowdown in lending growth.		

Sweden continued			
Feb 28 08:30	*GDP, 4Q*	Forecast: 0.4% QQ	Prior: 0.1% QQ
London Time	Judging from the monthly data during 4Q, GDP looks set to undershoot the Riksbank's 0.7% QQ forecast; both manufacturing and service sector production barely expanded in the final quarter of 2013 and exports remained weak. Meanwhile, monthly data suggest private consumption likely accelerated slightly from the 3Q pace. Important inputs ahead of the GDP release are inventories and capacity use data (due the week before the GDP release).		
Norway			
Feb 26 09:00	*LFS Unemployment Rate, Dec*	Forecast: 3.5%	Prior: 3.5%
London Time	The Labour Force unemployment rate is expected to remain unchanged in December (Nov-Jan 3m average). Over the past year, unemployment has held fairly stable, while employment growth has recovered despite the slowdown in economic activity since spring. The stable development in the jobless rate hence reflects an increasing labour force. Looking ahead, we expect unemployment to stay around current levels and employment should continue to grow at the current rate. Note that Norges Bank's preferred unemployment measure is registered unemployment which was stable at 2.6% in December. The Central Bank expects registered unemployment to rise slightly in coming quarters		
Feb 28 09:00	*Registered Unemployment Rate, Feb*	Forecast: 2.9%	Prior: 3.0%
London Time	Registered unemployment decreased by slightly less than 100 persons in January, less than in previous years. Norges Bank forecasts an increase in unemployment from 2013 to 2014 (from 2.75% to 3.0%). In line with the seasonal pattern, we expect the registered jobless rate to fall slightly back in February.		
Feb 28 09:00	*Retail Sales, Jan*	Forecast: 0.1% MM	Prior: 0.1% MM
London Time	Norwegian retail sales and domestic spending on goods recovered slightly in 4Q; following a 0.3% QQ drop in 2Q and a 1.4% QQ decline in 3Q, goods consumption in 4Q gained 0.3% QQ. This year, consumer growth is expected to stay moderate due to lower real wage growth. A somewhat weaker labour market and a cooler housing market could also curb consumers' propensity to spend		
United Kingdom			
Feb 26 09:30	*GDP, 4Q 2nd Release*	Provisional: 0.7% QQ, 2.8% YY	Prior (3Q): 0.8% QQ, 1.9% YY
London Time	We do not anticipate any revision to the headline figures for GDP growth, unless there is a major surprise in the service sector figures published at the same time. The split of the GDP data is likely to show a modest slowdown in consumer spending growth to roughly 0.5% QQ from 0.8% QQ in 3Q, with another 1%-2% QQ gain in investment and a pullback in stockbuilding after sizeable gains in the prior two quarters.		
Feb 26 09:30	*Service Sector Output, Dec*	Forecast: 0.3% MM, 3.1% YY	Prior: 0.4% MM, 2.6% YY
London Time	Surveys suggest that service sector output is expanding quite strongly, and hence we expect these figures to show another solid gain. A reading in line with our forecast would lift the YY rate above 3% for the first time since 2008.		

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

Key Economic Indicators (3 March – 7 March 2014)

During the Week		Forecast	Last
08:00	UK: Halifax House Prices, Feb		
Monday 3 March		**Forecast**	**Last**
07:30	Sweden: Manufacturing PMI, Feb		
08:00	Norway: Manufacturing PMI, Feb		
09:00	Norway: Credit Indicator C2, Jan		
09:00	Italy: GDP and Debt, 2013		
09:00	Euro Area: Manufacturing PMI, Feb Final		
09:30	UK: Manufacturing PMI, Feb		
09:30	UK: Personal Borrowing, Jan		
10:00	Portugal: Industrial Production, Jan		
	Italy: Budget Balance, Feb		
Tuesday 4 March		**Forecast**	**Last**
08:00	Spain: Unemployment, Feb		
09:30	UK: Mergers & Acquisitions involving UK Companies, 4Q		
10:00	Euro Area: Industrial Producer Prices, Jan		
16:30	Ireland: Exchequer Return, Feb		
Wednesday 5 March		**Forecast**	**Last**
07:30	Sweden: Services PMI, Feb		
08:30	Sweden: Industrial Production, Jan		
08:30	Sweden: Services Production, Jan		
09:00	Norway: Balance of Payments, 4Q		
09:00	Euro Area: Services PMI, Feb Final		
	Composite PMI, Feb Final		
09:30	UK: Services PMI, Feb		
10:00	Euro Area: Retail Sales, Jan		
10:00	Euro Area: GDP Details, 4Q		
11:00	Ireland: Unemployment Rate, Feb		
Thursday 6 March		**Forecast**	**Last**
06:30	France: LFS Unemployment Rate, 4Q		
08:30	Sweden: Average House Prices, Feb		
08:30	Netherlands: Consumer Prices, Feb		
10:00	Greece: Unemployment Rate, Dec		
11:00	Germany: Incoming Orders, Jan		
12:00	UK: MPC Outcome		
12:45	Euro Area: ECB Outcome – Press Conference at 13:30		
Friday 7 March		**Forecast**	**Last**
06:30	Switzerland: Unemployment Rate, Feb		
07:45	France: State Budget Balance, Jan		
07:45	France: Trade Balance, Jan		
08:15	Switzerland: Consumer Prices, Feb		
08:15	Switzerland: Industrial Production, 4Q		
09:00	Norway: Industrial Production, Jan		
09:00	Italy: Producer Prices, Jan		
10:00	Euro Area: Balance of Payments, 4Q		
11:00	Germany: Industrial Production, Jan		

Sources: National statistical offices, central banks and Citi Research

Title	Author	Date
Euro Area – Sovereign Debt Update		
Spain's Congress Rejects Catalonia's Proposal for Self-Determination Referendum	European Economics Team	Feb 21, 2014
New French-German FTT Proposal Due in May	European Economics Team	Feb 20, 2014
EcoFin Approves Political Agreement with EP on Deposit Guarantee Schemes	European Economics Team	Feb 19, 2014
No Negative Deposit Rate Without Refi Cut — Nowotny	European Economics Team	Feb 18, 2014
Renzi to be Designated New Italian PM as Soon as Today	European Economics Team	Feb 17, 2014
Euro Area		
Euro Area - German Constitutional Court Leaves OMT in Limbo	Ebrahim Rahbari	Feb 7, 2014
ECB: No Change, But Action Likely In March -	Ebrahim Rahbari	Feb 6, 2014
Euro Area - Assessing Vulnerabilities to an EM Slowdown	Michael Saunders	Feb 3, 2014
ECB Preview - ECB Likely to Resist Pressure to Act at February Meeting	Guillaume Menuet	Jan 31, 2014
Euro Area - Inflation Surprises Once Again to the Downside in January	Giada Giani	Jan 31, 2014
Euro Area - Bank Lending Survey Confirms Supply-Side Improvement	Guillaume Menuet	Jan 30, 2014
Euro Area - Weak Money Supply But Stabilisation In Credit Dynamics	Guillaume Menuet	Jan 29, 2014
European Economic Forecast Highlights - January 2014	Ann O'Kelly	Jan 23, 2014
Euro Area - Composite Flash PMIs — Strong Start To 2014	Guillaume Menuet	Jan 23, 2014
Euro Economics Weekly		
Could Eurozone Politics Return to the Fore?	Giada Giani	Feb 14, 2014
ERS: An Alternative Solution to OMT?	Guillaume Menuet	Feb 7, 2014
The Euro Area Now and Japan Then: Separated by One Large Shock	Ebrahim Rahbari	Jan 31, 2014
Spain Is Becoming More German	Giada Giani	Jan 24, 2014
Belgium: Politics the Likely Main Wild Card in 2014	Guillaume Menuet	Jan 17, 2014
Germany 2014 Outlook: Recovery And Rebalancing	Ebrahim Rahbari	Jan 10, 2014
2014 Outlook: GDP Risks, Credit Dynamics and Inflation Update	European Economics Team	Jan 6, 2014
Spain: 2014 Outperformer?	Giada Giani	Dec 13, 2013
Why Is France Underperforming? And How To Fix It	Guillaume Menuet	Dec 6, 2013
Is Deflation Good or Bad for the Eurozone Periphery?	Ebrahim Rahbari	Nov 29, 2013
Is This the End of Austerity?	Giada Giani	Nov 22, 2013
Recovery Watch: SME Lending is Key	Guillaume Menuet	Nov 15, 2013
One Shock Away from Deflation	Giada Giani	Nov 8, 2013
Why the ECB Should Worry About the Strong Euro	Ebrahim Rahbari	Nov 1, 2013
Italy and Spain Look Well Positioned For Job Growth	Guillaume Menuet	Oct 25, 2013
Portugal — What After June 2014?	Giada Giani	Oct 18, 2013
Chief Economist Publications		
Global Economic Outlook and Strategy - January 2014	Willem Buiter	Jan 22, 2014
Scandi		
Scandi Economics Update	Tina Mortensen	Feb 14, 2014
Sweden - Non-Event Riksbank Meeting, But Some Interesting Aspects	Tina Mortensen	Feb 13, 2014
Norway - Stronger-Than-Expected 4Q Mainland GDP	Tina Mortensen	Feb 12, 2014
Sweden - Recovery Underway In Manufacturing, Surprise Drop In Services	Tina Mortensen	Feb 7, 2014
UK		
UK - Retail Sales Slip, Trend Solid	Michael Saunders	Feb 21, 2014
UK - Unemployment Ticks Up, Other Capacity Guides Tighten	Michael Saunders	Feb 19, 2014
UK - CPI Inflation Undershoots Again	Michael Saunders	Feb 18, 2014
UK - BoE Inflation Report	Michael Saunders	Feb 12, 2014
UK - Household Interest Rates Still Drifting Lower	Michael Saunders	Feb 11, 2014
UK - MPC — All Eyes on the Inflation Report	Michael Saunders	Feb 6, 2014
UK - PMI Edges Down, Still Points to Solid Growth;	Michael Saunders	Feb 5, 2014
UK - Highlights of the BoE Data and EC Survey	Michael Saunders	Jan 30, 2014
UK - GDP Data Show Solid Growth	Michael Saunders	Jan 28, 2014
UK Economics Weekly		
What Does the "Next Phase of Forward Guidance" Amount To?	Michael Saunders	Feb 14, 2014
How Vulnerable Is the UK to EM Strains?	Michael Saunders	Feb 7, 2014
Is Growth Credit-Led?	Michael Saunders	Jan 31, 2014
After Forward Guidance…"Fuzzy Guidance"	Michael Saunders	Jan 24, 2014
What Will the MPC Say When Unemployment Hits 7%?	Michael Saunders	Jan 17, 2014
Inflation Convergence and Divergence	Michael Saunders	Jan 10, 2014

Source: Citi Research

Notes

Notes

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Appendix A-1

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