Economics

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Euro Weekly

How Comprehensive Can A Solution Be?

- The announcement by Angela Merkel and Nicolas Sarkozy that they would present a comprehensive package to address the euro area sovereign debt and banking crises by the end of the month has created a new dynamic at the political level. This has raised expectations for the Council meeting of the EU Heads of State and Government on 23 October.

- While we expect progress in many areas, including debt sustainability in Greece, bank capitalisation, support for the Italian and Spanish sovereign bond markets and euro area governance, we do not expect that summit will be able to end the crisis. (Jürgen Michels, see page 2.)

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Figure 1. Citi Market Forecasts

	$/€	Euro Repo	10-yr Bunds	£/€	U.K. Bank Rate	10-yr Gilt-Bund	SKr/€	SEK Policy Rate	NOK/€	NOK Policy Rate	SFr/€	CHF Policy Rate	CHF Spread vs Bunds
End 4Q 11	1.29	1.00	1.50	0.85	0.50	50	9.34	2.00	7.90	2.25	1.23	0.00	-77
End 2Q 12	1.26	1.00	1.35	0.84	0.50	30	9.11	2.00	7.80	2.25	1.20	0.00	-69

Source: Citi Investment Research and Analysis

Figure 2. Euro Area -- Indicative Calendar of Likely Events

October		
14-15	G-20	G-20 Finance Ministers' Meeting (Paris)
20?	Greece	EU/IMF Troika completes review of Greece
20?	EU	Economic & Financial Committee of senior officials from EU-27 Finance Ministries. Likely focus: bank recapitalisation
21?	Euro Area	Eurogroup. Likely focus: release of next tranche of Greek aid, second Greek package and EFSF leverage
22?	EU	EcoFin Council of EU Finance Ministers. Likely focus: bank recapitalisation
23	EU	European Council. Likely focus: bank recapitalisation, G20 preparation, other issues (e.g. climate change)
	Euro Area	Euro-Area Summit. Likely focus: Greece, bank recapitalisation, EFSF leverage, euro-area governance.
November		
1	Euro Area	Mario Draghi starts term as ECB President
3	Euro Area	ECB Meeting
3-4	G-20	Summit of Heads of State and Government, Cannes
Early Nov	Greece	Next tranche of EU/IMF likely made available to Greece

Sources: Citi Investment Research and Analysis

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How Comprehensive Can A Solution Be?

EU summit outcome is likely to be a large step forward…

The announcement by Angela Merkel and Nicholas Sarkozy that they would present a comprehensive package to "*guarantee financial stability for Europe and provide a sustainable solution to the problems*" by the end of October has created a new dynamic at the political level. By postponing the Euro Area (EA) and EU Council meetings of the Heads of State and Government from 18-19 October to 23 October, they have more time to work on a solution and 23 October is now the deadline to present the package.

…but unlikely to end the sovereign debt and financial crises

The already-available proposals suggest that the political debate has entered a new dimension as it now encompasses most euro area problems: (i) the unsustainable fiscal situation in Greece which requires debt restructuring, (ii) the lack of growth-enhancing measures in Greece and the other bailout countries, (iii) the weak banking sector, (iv) the liquidity problems of the Italian and Spanish sovereigns, and (v) a non-working EA governance system. This alone is a significant step forward. However, it seems some issues are still not on the agenda (e.g. unsustainable fiscal position in Portugal and Ireland). Furthermore, it remains uncertain if the recent market pressure has been strong enough to force the EA leaders to agree on a comprehensive package at the 23 October summit. While we expect an agreement on a package that will address all the problems mentioned above, we doubt that the summit will provide "a big bang solution" for the euro area sovereign debt and banking crises.

Greece

Despite target failure in 2011, Troika supports disbursement of next tranche to Greece

While the full report of the Troika (IMF, ECB and EU Commission) on the progress in Greece remains outstanding, in the initial statement the Troika supports the disbursement of the sixth tranche of the first Greek package. According to the Troika, Greece is able to meet the fiscal targets in 2012 if the government implements the recently-announced additional fiscal measures and the requested adjustments under the programme. However, the Troika stressed that Greece is neither able to meet the 2011 fiscal target nor the privatisation revenue target, because of "*slippages in the implementation of some of the agreed measures*" and a deeper-than-expected recession.

Eurogroup likely to disburse next tranche and amend 2nd Greek programme…

While EU President Jose Manuel Barroso interpreted the report as a clear signal to go ahead with the disbursement of the €8bn tranche in November, the German Finance Ministry was not keen to give a green light for the disbursement. However, with the full Troika report likely to be available on 20 October, the Eurogroup is likely to approve the next tranche at the extra meeting before the EU summit, probably on 21 October (see figure 2, front page). At this meeting, the Eurogroup will probably also discuss the second Greek package, including PSI (Private Sector Involvement). The question of Greek debt sustainability is likely to dominate this discussion. In that respect German Finance Minister, Wolfgang Schäuble, has already expressed his doubts that, in the current framework, Greece is in a sustainable position and has asked for a larger contribution from the private sector. And Mr. Barroso suggested an "adequate" PSI would be required, while French Finance Minister Francois Baroin said that haircuts under the PSI would be larger than 21%.

…including a larger PSI haircut, but probably no OSI at this point

These comments suggest that the initial version of the PSI is off the table. This PSI proposal included a 21% NPV reduction for Greek bondholders, which because of the principal guarantee for the longer maturity bonds would only have led to a small reduction of the Greek debt.[1] However, while a larger haircut for the private sector seems to be targeted, the decision makers so far want to prevent Official Sector Involvement (OSI) – including the other euro area countries and the ECB and only

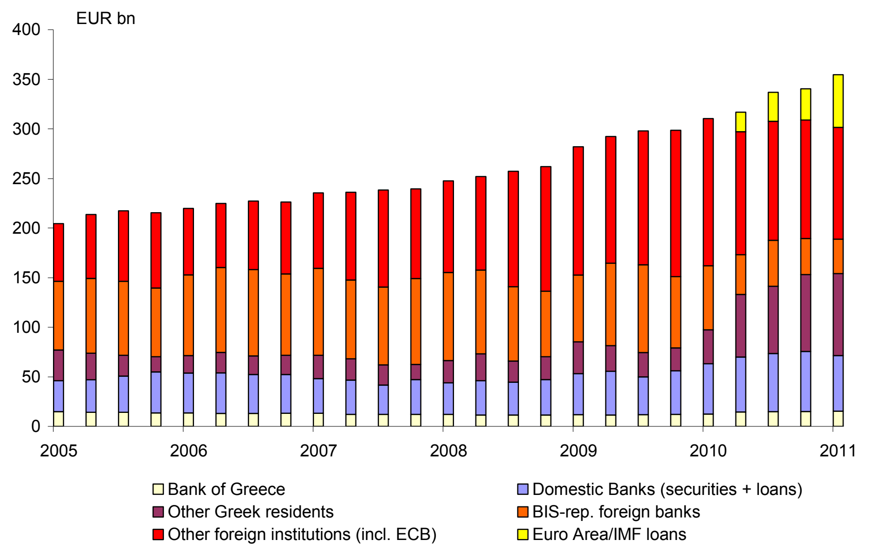
1 Euro Weekly: Summit Agreement Leaves Many Questions Open, 22 July 2011

excluding the IMF. However, as we have argued before, a substantial reduction of the Greek debt burden looks achievable only if OSI takes place.[2] Given the lukewarm acceptance of the attractive first PSI measure, it looks unlikely that there will be widespread acceptance of a PSI with larger haircuts on a voluntary basis. And if coercive action should be taken, and given the pari-passu status of the public lenders ex the IMF, an OSI and also a "*credit event*" are likely to take place.

PSI only would reduce effectiveness of haircut…

In case there is no OSI – and assuming that the next tranche of the programme will be disbursed – only €239bn out of the €362bn of total Greek sovereign debt will be covered by a haircut. In this case, a 50% haircut – as mentioned by some newspapers in recent days – of the debt without any sweeteners (e.g. Greek guarantees for remaining debt), would lead to an initial debt reduction of around €120bn (55% of GDP). Hence the 2011 debt-to-GDP ratio would fall from around 160% to around 105%.

Figure 3. Greece -- Central Government Gross Debt (EUR bn)



Sources: Haver, BIS, ECB, BoG, Citi Investment Research and Analysis

…and required recapitalisation of the banks will reduce the effectiveness further

However, as the domestic banks hold €45bn of Greek debt, this is likely to require additional capital injections for the banking sector (see Figure 3). Based on the EBA data, regarding the holdings of the banks, this would require additional capital injections for the banking sector of around €16bn (7.3% of GDP) in order to maintain a Core Tier 1 capital ratio of 7% and around €21bn (9.4% of GDP) to hold a Core Tier 1 capital ratio of 9%. As the Greek banks do not have the capacity to get this extra capital in the market, the government will probably have to request this extra funding from the EFSF. Hence, instead of a reduction of the debt-to GDP ratio to 105%, we estimate a 50% PSI haircut would reduce the Greek debt to only around 112% of GDP (in the case of a 7% capital ratio) and 114% (in the case of a 9% core capital ratio). Note, that this would still ignore the need for additional bank recapitalisation as a result of additional private sector writedowns.

Debt-to-GDP ratio likely to increase again substantially in 2012

However, even after a 50% PSI restructuring at the end of 2011, we would expect an ongoing recession and probably a deficit of around 5% of GDP in 2012. The debt-to-GDP ratio would likely then increase again to close to 130% of GDP in

2 Euro Weekly: Debt Restructuring Better Early Than Late, 23 September 2011

2012. This suggests that, unless there is a decisive improvement in the economy as a result of large EU-funded investment projects and a substantial improvement in tax collection, we don't believe Greece will return to a sustainable fiscal path following a 50% PSI haircut.

EU-funded growth enhancement might ease recession in Greece, but unlikely to end it any time soon

As we expect that public funding for the second Greek package will only be provided under the condition of more control in the implementation of fiscal policy and the privatisation programme, some improvement in the efficiency of the public administration is likely. And we also expect that, in addition to the EU funds unused by Greece, the 23 October summit might start a new initiative – either funded by the EU itself or by the EIB – to fund new infrastructure projects in Greece and the other fiscally-strained countries. While those measures are likely to slow the GDP contraction in Greece, we do not expect that the boost will be strong enough to end the recession in the next 3 or 4 years.

Greek fiscal problems unlikely to be solved

Overall we expect that the summit measures will be a step in the right direction for Greece, but we doubt that the measures will be bold enough to put Greece back on a sustainable fiscal path.

Banks

Solution for bank problems only likely in combination with measures to support Italian and Spanish sovereign bonds

As already discussed in the case of Greece, and as the government intervention in case of Dexia has demonstrated, the sovereign budget problems have severe repercussions for the weak European banking system. In that respect we welcome the initiatives of governments to strengthen the capital base of banks. However, given the substantial impact of sovereign debt developments on the banks, a stabilisation of the banking sector will be only possible if there are also measures to improve the stability of the sovereign. In that respect, we believe the outlook for Italian and Spanish debt is much more important than the outlook for Greece, Portugal and Ireland.

Advanced negotiations regarding bank capital support

Although no measures to address banking weakness have yet been approved, there already seems to be a consensus regarding measures among policy makers. As EU President Barroso outlined earlier this week, banks should increase their capital ratios to temporarily hold a "s*ignificantly higher capital ratio of highest quality capital*". He said that these criteria for bank capital should be the same in all EU countries. If banks are unable to raise extra capital in the market, national governments have to provide it through recapitalisation programmes and, if the sovereigns also have problems in getting funding, they should take the opportunity to tap the EFSF. Compared to the October 2008 bank recapitalisation plan, the current proposal would have the advantage that the same minimum capital criteria in all countries would be applied, and that it offers a backstop funding facility for countries that do not have the means to recapitalise their banks.

Far-reaching European-wide bank support scheme unlikely

However, in the absence of an EA bank recapitalisation facility for at least the euro area or special resolution regimes for banks in all countries, the risky relationship between sovereigns and the banking sector will likely remain. Unfortunately, given the unpopularity of bank support programmes among the electorate, the core countries have been unwilling to use the EFSF as a European bank recapitalisation facility. Hence, EA or EU-wide bank solutions look unlikely and to us the most far-reaching solution in that respect might be the introduction of a European deposit guarantee scheme to reduce the risk of bank runs. But, because of the lack of funding, even such a guarantee scheme would likely be difficult to install.

Substantial need for fresh bank capital in countries with weak sovereigns

Given the strained situation of some sovereigns and the limitations of the EFSF – even after the recent increase in firepower to €440bn – the amount of bank recapitalisation required in case of haircuts on sovereign debt and a recession in the euro area is important. In order not to get too specific regarding scenarios on sovereign haircuts and to have a figure quickly available for the amount of fresh capital needed, the EBA seems to be using the data from the July stress tests and calculating the capital needed in order to achieve a higher Core Tier 1 capital ratio – probably 9%. So far it is unclear by which deadline the banks would have to meet this elevated capital ratio. According our banking team calculations, banks from countries with sovereigns that are probably unable to tap the market for extra funding currently (Greece, Italy, Ireland, Portugal and Spain) would require around €104bn of extra capital. Banks from other euro-area countries, where we expect the government to fund the bank recapitalisation without having to tap the market and where in some cases banks might be in the position to get market funding, they estimate the amount would be €75.9bn.[3]

Bank support might endanger current credit ratings in France and Belgium

Within the second group would be France (which would require €34bn extra capital, 1.7 % of GDP) and Belgium (€1.4bn, 0.4% of GDP). These estimated capital injections from the sovereigns alone are not likely to jeopardise the current sovereign rating of both countries. But the recent developments in Belgium, where the sovereign purchased the Belgian division of Dexia for €4bn (6.3% of GDP), suggest that the impact can be much larger and might have implications on the ratings.

Writedowns of private sector exposure will probably require additional capital injections

While the targeted approach has the above-mentioned advantages for the decision makers, it also has disadvantages. The main issue is that a 9% Core Tier 1 capital rate might not be large enough to guarantee that banks do not fall below the minimum required ratio of 5% in the case of widespread sovereign haircuts, which will likely be accompanied by larger writedowns of private sector exposure, mainly caused by the economic slowdown (recession in the periphery countries). Furthermore, the calculations for the 9% capital ratios are based on the banks' reporting of their risk provisioning, which in some cases might not be adequate. Hence, the capital need for euro area banks might exceed the above-mentioned total of c.€180bn.

Increase Firepower of EFSF to Support Italy and Spain

Large parts of extended-EFSF either committed or earmarked

After the final ratification in Slovakia, the amended version of the EFSF is now in place, giving the EFSF more flexibility and an increase in total guarantees from the EA member countries of €780bn, or €726bn excluding the step-out countries (Greece, Ireland, Portugal). This will give the EFSF an effective capacity to provide financial assistance of €440bn. Out of this the EFSF is already committed to around €44bn – €26bn for the Portuguese and €17.7bn for the Irish programmes. And out of the remaining funds, around €100bn might be used to provide additional assistance for Greece – including the European contribution to the second Greek package and the outstanding amount of the first Greek package of around €27bn. Hence, around €300bn are left in the EFSF bucket, out of which around €100bn are likely to be required to recapitalise the banking sector. Note, that while the EFSF framework agreement is ambiguous in many areas, it is very specific in Article 1(c) that the EFSF may use "*facilities to finance the re-capitalisation of financial institutions in a euro-area Member State by way of a loan to the government of such Member State (whether or not it is a programme country)*".

[3] See "*European Banks & The Grand Solution*", Citi, Stefan Nedialkow, et al., October 13, 2011

ECB is unwilling to directly support EFSF leverage

As the member states are reluctant to increase the amount of guarantees further, partly because it might endanger their own credit ratings, and the EFSF is trying to defend its own AAA rating, there is only a limited range of possibilities to increase the firepower of the EFSF.[4] As the departing ECB President Jean Claude Trichet highlighted in an FT interview, the ECB is unwilling to be involved in increasing the EFSF firepower. And it seems that Germany and the EU Commission do not want to involve the ECB directly either.[5] In that respect, the French proposal to transfer the EFSF into a bank with the ECB giving this institution access to its open-market operations seems to be off the table. However, there might be ways to involve the ECB indirectly, e.g. by providing funding to an SPV, which gets guarantees from the EFSF.

EFSF might act as a bond insurer

Among the different proposals made, the most likely to be implemented is something similar to the "*Achleitner Plan*", suggesting that the EFSF should provide a first-loss insurance for new bond issuance in countries that have funding difficulties (Italy, Spain). So far such an idea has not been rejected by German officials and recent comments from ECB Vice President Vitor Constancio suggest that it would have the blessing of the ECB.[6] One of the advantages of this insurance scheme would be a reduction of the rollover risk for existing bonds, and therefore it would probably also help to stabilise the secondary market. However, the willingness of investors to buy these bonds will depend on the coverage and the quality of the insurance. And therefore it might require additional support from the ECB or from other sovereigns, either through the IMF or a G20 initiative.

Achleitner plan has too optimistic assumptions…

According to the "Achleitner Plan" such an insurance scheme would give the EFSF an effective capacity of €2900bn. This assumes that the total amount of the member countries' guarantees (€780bn) would be leveraged by 3.7 times. This assumes that the insurance scheme would provide a first loss coverage of 40% for bonds issued by Greece, Portugal and Ireland and 25% for Spain and Italy.

…but insurance solution might increase bond market support ability of EFSF to €800 or €1000bn

In our view, these assumptions about the effective power of the EFSF are far too large. In our view investors will be only willing to welcome an insurance from the EFSF if comes with a backing from an AAA-rated EFSF. As a consequence, the maximum amount that might be used as an insurance scheme is €440bn. As around €240bn of this amount is either committed to existing programmes or will probably be needed to fund the next Greek programme or to recapitalise the banks, the leverage exercise can only be based on guarantees of €200bn. In case of a 25% first loss insurance this would be able to cover the issuance of €800bn, while a 20% insurance would cover a volume of €1000bn. In both cases, the scheme should be able to insure the aggregated new bond issuance of Italy and Spain for around 3 years.

Insurance solution probably in line with legal framework

Such an insurance scheme would probably be in line with the amended EFSF framework, therefore a ratification of the 17 member countries would not be required, and could be probably designed so that it does not conflict with the non-bailout criteria in the EU treaty.

[4] See "Still Too Early For A "Grand Plan", Jürgen Michels, et al, September 28, 2011

[5] The proposal of Jose Manual Barroso says: "*Moreover, the firepower of the backstop mechanisms should be enhanced by maximising the use of the EFSF, without increasing the guarantees underpinning it and within the rules of the Treaty of Lisbon, in particular on monetary financing.*"

[6] At a speech on Monday he said "in order to maximize its efficiency, the EFSF´s resources should be dedicated to enhance sovereign debt new issuance of securities, thus multiplying their effect."

Earlier introduction of ESM will probably be difficult

In addition, we expect that the summit will make a decision to bring forward the ESM from mid-2013 to mid-2012. However, as there is not even a final text for the framework agreement of the ESM available and the procedure for the required small EU treaty change has not even started, a mid-2012 target looks ambitious to us.

Governance

All support measures require unanimous decision of EA country governments

While there are now, thanks to the amended EFSF framework, more advanced proposals regarding the funding of banks and strained euro area countries on the table, all these measures have to be approved unanimously by the 17 EA member country governments, and in case of Germany and Finland also by parliament (at least in a subcommittee), which is a national law requirement in these countries.

Core countries require more influence on budget policy in countries which ask for financial assistance

As we have learned in recent days from several core country representatives, additional financial support to the weak countries will likely only come in exchange for a tighter fiscal framework and the ability of the EU to intervene in the national budget policies of countries that require such assistance. The Dutch Finance Minister Jan Kees de Jager is most outspoken in that respect. Under the current EU Treaty such influence on national decision processes is not foreseen. Therefore German Chancellor Angela Merkel has repeatedly asked for changes in the EU Treaties. But as such a change requires ratification by all 27 member countries – in several countries by referendum – it would take years to enact those changes. It is very unlikely that such a change will get approval at all.

Catalogue of conditions to get EFSF funding likely

At least for the Dutch, it seems to be necessary to put in place at the 23 October summit at least some kind of additional influence on countries receiving financial assistance. One way of doing this would to set up a book of conditions that countries which get funding from the EFSF, either under a full programme or in other forms of financial assistance (including funding for bank recapitalisation and support in sovereign bond markets), have to follow. In addition, we expect that the EU summit will agree to introduce an automatic penalty system for countries that breach the Stability and Growth Pact.

What can we expect from the Summit?

We expect progress on many areas at the 23 October summit, but as German Chancellor Angela Merkel said today, the summit will not provide a big bang to solve the sovereign debt crisis. In that respect, markets might be disappointed again and even after implementing support measures for other euro area governments and the banking sector, the likely upcoming defaults in Greece, Portugal and Ireland will create substantial challenges for the euro area economy, which looks likely to slip into recession in 4Q.

Key Economic Indicators (17 October – 21 October 2011)

		Forecast	Last
Monday 17 October		**Forecast**	**Last**
09:00	Norway: External Trade, Sep		
Tuesday 18 October		**Forecast**	**Last**
07:00	EU-25: New Car Registrations, Sep		
09:30	UK: Consumer Prices, Sep	0.3% MM, 4.8% YY	0.6% MM, 4.5% YY
	CPI Ex Food, Drink, Tobacco, Energy, Sep	0.7% MM, 3.2% YY	0.7% MM, 3.1% YY
	Retail Prices, Sep	0.5% MM, 5.3% YY	0.6% MM, 5.2% YY
	RPIX – Excludes Mortgages, Sep	0.5% MM, 5.4% YY	0.6% MM, 5.3% YY
10:00	Germany: ZEW Economic Expectations, Oct	-48	-43.3
10:00	Italy: Current Account, Aug		
	Greece: Unemployment Rate, Jul		
Wednesday 19 October		**Forecast**	**Last**
07:00	Switzerland: Trade Balance, Sep		
08:30	Sweden: Unemployment, Sep		
09:00	Euro Area: Balance of Payments, Aug		
09:00	Italy: Industrial Orders, Aug	2.8% MM, 6.3% YY	1.8% MM, 10.1% YY
09:30	UK: BoE Minutes (Oct 6)		
10:00	Euro Area: Construction Output, Aug		
13:00	Norway: Norges Bank Monetary Policy Meeting		
Thursday 20 October		**Forecast**	**Last**
07:00	Germany: Producer Prices, Sep	0.2% MM, 5.4% YY	-0.3% MM, 5.5% YYY
08:30	Netherlands: Consumer Confidence, Oct		
08:30	Netherlands: Unemployment, Sep		
09:30	UK: Retail Sales Volumes, Sep	0.9% MM, 0.7% YY	-0.2% MM, 0.0% YY
	Greece: Current Account, Aug		
15:00	Euro Area: Consumer Confidence, Oct Flash	-21	-19.1
Friday 21 October		**Forecast**	**Last**
07:45	France: Business Confidence, Oct	96	99
	Own-Company Production Outlook, Oct	0	4
	Production Outlook, Oct	-30	-29
09:00	Germany: ifo Business Climate, Oct	105	107.5
08:30	Netherlands: Consumer Spending, Aug		
09:30	UK: Public Sector Net Borrowing (Ex Costs of Fin. Intervention), Sep	£14.5 Billion Deficit	Year Ago: £15.5 Billion Deficit
	Fiscal Year To Date, Apr-Sep	£65.9 Billion Deficit	Year Ago: £70.8 Billion Deficit
10:00	Euro Area: General Government Deficit and Debt, 2010 (2nd Notification)		
11:00	Ireland: Trade Balance, Jul		

Sources: National statistical offices, central banks and Citi Investment Research and Analysis

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Economic Indicators

Euro Area			
Oct 20 15:00 London Time	***Consumer Confidence, Oct Flash***	**Forecast: -21**	**Prior: -19.1**
	We expect a fourth consecutive fall in consumer sentiment in October. In addition to ongoing tightening in financing conditions the continuing sovereign debt crisis is likely to cause a further deterioration in consumer confidence in October. We expect a fall to the lowest reading since August 2009.		
Germany			
Oct 18 10:00 London Time	***ZEW Economic Expectations, Oct***	**Forecast: -48**	**Prior: -43.3**
	Despite the recent rebound in equity markets, the ongoing uncertainty regarding the sovereign debt crisis is likely to lead to an eighth consecutive fall in ZEW business expectations to the lowest reading since November 2008. With the ongoing reduction in unemployment, the current business situation is likely to stabilise around the September reading of 43.6. However, the combined index of the current situation and business expectations is likely to fall from 0.2 in September to -2.2 in October, the first negative reading since March 2010.		
Oct 20 07:00 London Time	***Producer Prices, Sep***	**Forecast: 0.2% MM, 5.4% YY**	**Prior: -0.3% MM, 5.5% YY**
	With the rebound in energy prices we expect producer prices to rise month on month in September. However, we expect that the YY rate will continue to edge down.		
Oct 21 09:00 London Time	***Ifo Business Climate, Oct***	**Forecast: 105**	**Prior: 107.5**
	We expect a fourth consecutive fall in the ifo business climate. We expect a fall in business expectation from 98 in September to 95 in October, the lowest reading since June 2009. Furthermore, after remaining pretty stable in September, the assessment of the current business situation will probably drop from 117.9 in September to 115.3 in October, the lowest reading since August 2010. The decline in business confidence is probably greater in export-oriented sectors.		
France			
Oct 21	***Own-Company Production Outlook, Oct***	**Forecast: 0**	**Prior: 4**
07:45	***Production Outlook Indicator, Oct***	**Forecast: -30**	**Prior: -29**
London Time	***Business Confidence Indicator, Oct***	**Forecast: 96**	**Prior: 99**
	Industrial confidence likely deteriorated again in October given the widespread slowdown in economic activity and lack of clarity regarding the next steps that Europe might take to deal with the spreading sovereign debt crisis. Personal output expectations are expected to have fallen to 14-month low, while the general expectations probably stabilised after four months of very sharp declines.		
Italy			
Oct 19 09:00 London Time	***Industrial Orders, Aug***	**Forecast: 2.8% MM, 6.3% YY**	**Prior: 1.8% MM, 10.1% YY**
	Industrial orders are likely to be up 2.8% MM in August from 1.8% MM in July. Despite this recent rise, orders would remain close to early 2006 levels, 11.3% down from the pre-crisis peak (February 2008). The rise in Industrial orders may only reflect the high volatility of summer data (biased by methodological difficulties in estimating plant closures and seasonal adjustment methodologies). Furthermore, survey based indicators on orders in Italy are showing a decline.		
United Kingdom			
Oct 18	***Consumer Prices, Sep***	**Forecast: 0.3% MM, 4.8% YY**	**Prior: 0.6% MM, 4.5% YY**
09:30	***CPI Ex Food, Drink, Tobacco, Energy, Sep***	**Forecast: 0.7% MM, 3.2% YY**	**Prior: 0.7% MM, 3.1% YY**
London Time	***Retail Prices, Sep***	**Forecast: 0.5% MM, 5.3% YY**	**Prior: 0.6% MM, 5.2% YY**
	RPIX – Excludes Mortgages, Sep	**Forecast: 0.5% MM, 5.4% YY**	**Prior: 0.6% MM, 5.3% YY**
	Increases in energy prices probably will send CPI inflation higher this month, heading up to a peak of about 5.0% YY in coming months. There is some uncertainty over the timing of the pass through of energy prices, and we assume increases of about 5% MM in energy prices for both September and October.		
Oct 20 09:30 London Time	***Retail Sales Volumes, Sep***	**Forecast: 0.0% MM, 0.7% YY**	**Prior: -0.2% MM, 0.0% YY**
	Retail sales volumes have been roughly flat since late 2009 and, with housing weak and real wages falling, retail sales will probably remain stagnant in coming months. Nominal spending is not very weak, but this is all being eaten up by higher inflation.		
Oct 21	***Public Sector Net Borrowing, Sep***	**Forecast: £14.5 Billion Deficit, £65.9 Billion Deficit Fiscal Year To Date**	
09:30	***(Figures Exclude Costs of Financial Intervention)***	**Year Ago: £15.5 Billion Deficit, £70.8 Billion Deficit Fiscal Year To Date**	
London Time			
	The fiscal deficit is falling slowly, and rather more slowly than implied by the Office for Budget Responsibility's (OBR) forecast. Their forecast for the deficit over the full year (£121.8bn) requires the deficit to fall by £15bn over the fiscal year (an average drop of £1.2bn per month). In practice, the deficit has fallen by £3.9bn over the first five months of the year, an average drop of £0.8bn per month, only about 60% of the required pace. The deficit is likely to overshoot the OBR's forecast by £5-£6bn over the full year.		

Sources: National Statistical Offices, National Central Banks, Bloomberg, CIRA forecasts

Key Economic Indicators (24 October – 28 October 2011)

During The Week		Forecast	Last
07:00	Germany: Incoming Orders, Aug (by Oct 28)		
07:00	Germany: Import Prices, Sep (by Oct 28)		
07:00	Germany: Retail Sales, Sep (by Nov 2)		
Monday 24 October		**Forecast**	**Last**
08:30	Netherlands: Producer Confidence, Oct		
09:00	Euro Area: PMIs, Oct Flash		
10:00	Euro Area: Industrial New Orders, Aug		
Tuesday 25 October		**Forecast**	**Last**
07:00	Germany: GfK Consumer Confidence, Oct		
07:45	France: Consumer Confidence, Oct		
08:00	Spain: Producer Prices, Sep		
08:30	Sweden: Producer Prices, Sep		
09:00	Italy: Retail Sales, Aug		
09;30	UK: BBA Mortgage Advances, Sep		
10:00	Italy: Consumer Confidence, Oct		
Wednesday 26 October		**Forecast**	**Last**
07:45	France: Quarterly Business Confidence, Oct		
09:00	Italy: Industrial Confidence, Oct		
11:00	UK: CBI Quarterly Industrial Trends Survey, Oct		
17:00	France: Jobless Change, Sep		
Thursday 27 October		**Forecast**	**Last**
	Germany: Consumer Prices, Oct Preliminary		
08:00	Spain: Retail Sales, Sep		
08;30	Sweden: Riksbank Interest Rate Announcement		
09:00	Euro Area: M3, Sep		
10:00	Euro Area: Business & Consumer Surveys, Oct		
Friday 28 October		**Forecast**	**Last**
00:01	UK: GfK Consumer Confidence, Oct		
07:45	France: Manufactured Goods Consumption, Sep		
08:00	Spain: HICP, Oct Flash		
08:00	Spain: Labour Force Survey, 3Q		
08:15	Sweden: Business & Consumer Surveys, Oct		
08:30	Netherlands: Producer Prices, Sep		
09:00	Norway: Unemployment Rate, Oct		
09:00	Italy: Contractual Wages, Sep		
10:30	Switzerland: KOF Economic Barometer, Oct		
14:00	Belgium: GDP, 3Q Preliminary		

Sources: National statistical offices, central banks and Citi Investment Research and Analysis

Recent Research Publications	Author	Date of Publication
Euro Area		
Euro Area – Sovereign Debt Crisis Update	Ann O'Kelly	Oct 14, 2011
ECB: Au-Revoir President Trichet, With A Liquidity Farewell Gift	Jürgen Michels	Oct 6, 2011
European Economic Forecast Highlights, September 2011	Ann O'Kelly	Sep 29, 2011
Euro Area: Still Too Early For A "Grand Plan"	Jürgen Michels	Sep 28, 2011
Euro Area — Sovereign Debt Crisis Update	Jürgen Michels	Sep 23, 2011
ECB: Jürgen Stark Leaves ECB Executive Board	Jürgen Michels	Sep 9, 2011
Euro Weekly		
Euro Weekly: Spain – Tough Tasks For The New Government	Jürgen Michels	Oct 7, 2011
Euro Weekly: ECB and France – Difficult Decisions Ahead	Jürgen Michels	Sep 30, 2011
Euro Weekly: Debt Restructuring Better Early Than Late	Jürgen Michels	Sep 23, 2011
Euro Weekly: Italy's Austerity Drive — Too Little, Too Late	Giada Giani	Sep 16, 2011
Greece — Stuck in the Mud	Giada Giani	Sep 9, 2011
Nordics		
Norway — Norges Bank Keeps Rates on Hold	Michael Saunders	Sep 21, 2011
Norway — We Expect Norges Bank to Keep Rates on Hold	Michael Saunders	Sep 19, 2011
Norway — How Much NOK Strengthening Can Norges Bank Take	Michael Saunders	Sep 8, 2011
Sweden — Riksbank Keep Rates Unchanged at 2.0%	Michael Saunders	Sep 7, 2011
Denmark — Near-Term Outperformance, Longer-Term Worries	Michael Saunders	Sep 7, 2011
Switzerland		
Switzerland – PMI Falls Sharply	Michael Saunders	Oct 3, 2011
Switzerland — SNB Announces One-Sided FX Peg	Michael Saunders	Sep 6, 2011
Global		
Global Economic Outlook and Strategy September 2011	Willem Buiter	Sep 28, 2011
Sovereign Ratings Outlook — September 2011	Michael Saunders	Sep 12, 2011
Global Economics View: A Greek Exit from the Euro Area: A Disaster for Greece, a Crisis for the World	Willem Buiter	Sep 13, 2011
Global Economics View: The future of the euro area: fiscal union, break-up or blundering towards a 'you break it you own it Europe'	Willem Buiter	Sep 9, 2011
UK		
UK – Employment Falls Sharply	Michael Saunders	Oct 12, 2011
UK – Pension Fund Deficits Soar	Michael Saunders	Oct 11, 2011
UK – BCC Highlight Economic Slowdown	Michael Saunders	Oct 11, 2011
UK – Deloitte's Survey Shows Companies Retrenching	Michael Saunders	Oct 10, 2011
UK – MPC Restarts QE	Michael Saunders	Oct 6, 2011
UK – GDP Revisions Show Bigger Boom, Deeper Recession	Michael Saunders	Oct 5, 2011
UK – CE Won't Prevent QE	Michael Saunders	Oct 4, 2011
UK – YouGov Report Little Change in Inflation Expectations	Michael Saunders	Sep 28, 2011
UK – Broadbent Speech	Michael Saunders	Sep 26, 2011
UK — CBI Survey Points to Further Weakness	Michael Saunders	Sep 22, 2011
UK — Minutes Help Prepare Ground for QE	Michael Saunders	Sep 21, 2011
UK — IMF Cuts Growth Forecasts	Michael Saunders	Sep 20, 2011
Sterling Weekly		
QE2 Sets Sail	Michael Saunders	Oct 7, 2011
Launching QE2	Michael Saunders	Sep 30, 2011
Large QE on the Way Soon	Michael Saunders	Sep 23, 2011
The Lost Generation	Michael Saunders	Sep 16, 2011
QE: Why? When? How Much? Will It Work?	Michael Saunders	Sep 9, 2011

Source: Citi Investment Research And Analysis

Notes

Notes

Appendix A-1

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% of companies in each rating category that are investment banking clients	45%	42%	37%	50%	43%	46%
Citi Investment Research & Analysis Global Closed End Fund Coverage	34%	52%	14%			
% of companies in each rating category that are investment banking clients	0%	19%	0%			
Citi Investment Research & Analysis Quantitative World Radar Screen Model Coverage	30%	40%	30%			
% of companies in each rating category that are investment banking clients	28%	21%	20%			
Citi Investment Research & Analysis Quantitative Decision Tree Model Coverage	48%	0%	52%			
% of companies in each rating category that are investment banking clients	54%	0%	45%			
Citi Investment Research & Analysis Asia Quantitative Radar Screen Model Coverage	20%	60%	20%			
% of companies in each rating category that are investment banking clients	26%	24%	20%			
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% of companies in each rating category that are investment banking clients	16%	0%	22%			

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