

## ECB Sees No Risk of Stress in Bank Funding Conditions

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

### Summary

**ECB no longer sees risk of stressed bank funding conditions.** In its bi-annual Financial Stability Review the ECB cited as the biggest risk the possibility of a “reversal of risk assessments in financial markets, and consequently reversal of the compressed yields”, with the other major risks being low bank profitability and the possible reemergence of sovereign debt sustainability concerns.

**German Chancellor Merkel says Eastern European countries need not necessarily choose between EU and Russia** for future relations.

**No quick choice for EC presidency.** German Chancellor Merkel said after a summit of EU leaders that they now needed to have consultations about a number of positions including the EU's High Representative for Foreign Affairs, the next European Commission as well as the Presidents of the European Council and Eurogroup.

**EA – Economic Sentiment Indicator back to 2011 levels.** The European Commission's Economic Sentiment Indicator for the EA rose by 0.7 points to 102.7 in May (Citi: 102.6, Consensus: 102.2), leaving it 0.2sd above its long-term average and at its highest reading since July 2011. Across countries France weakens, while Germany and the periphery improve. For further details see **Economic Sentiment Strengthens, But France Stays Weak.**

**EA – Weak M3 data for April, but rate of decline for private sector loans moderates.** Growth in broad monetary aggregate M3 for April fell to 0.8% YY (Consensus: 1.1%, Citi: 1.2%), weakest reading since Sep 2010, and after 1.0% growth in March. In terms of the counterparts, the growth rate of loans to households and non-financial corporations (adjusted for sales and securitisation) improved slightly to -1.5% YY in April from -2% over the previous four months. For further details see **Weak M3 but fall in private sector loans eases in April.**

**Spain – Q1 14 GDP confirmed at +0.4% QQ** due to strong domestic demand.

**Bank of Spain says economy continues to improve in Q2,** as a higher contribution from domestic demand offset weaker export dynamics.

**Spain – House prices fall by 3.5% YY in Q1 14,** lowest pace of contraction since Q4 10. House prices are now 30.8% lower than at their peak in 2008.

**Italy – Business confidence deteriorates in May,** falling by 1.9 pts MM to 86.9, lowest since Jan 14, and standing 0.1sd below its long-term average

**UK:** The EU Commission's monthly activity survey index edged down slightly in May, but was still the second highest reading since 1988 and consistent with very strong GDP growth – see **Confidence Among People In Full-Time Work At New Record High.**

**Switzerland: Solid Gain In Q1 GDP, SNB Unlikely To Match ECB Easing.**

29 May 2014

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With thanks to Ann O'Kelly

Economics

Western Europe

Industrialised G7 Countries

### Recent Research

#### Euro Area — Economic Sentiment Strengthens, But France Stays Weak

28 May 2014

The European Commission's Economic Sentiment Indicator (ESI) for the Eurozone rose by 0.7 pts to 102.7 in May (Citi: 102.6, Consensus: 102.2), leaving it 0.2sd above its long-term (LT) average and at its highest reading since July 2011. All components were up this month, with the largest gains in consumer sentiment (-7.1 in May vs. -8.6 in April, 0.7sd above the LT average) and service sector confidence (3.8 vs. 3.5, but still 0.4sd below the LT average)

Ebrahim Rahbari | Antonio Montilla

#### Euro Area — Weak M3 but fall in private sector loans eases in April

28 May 2014

Growth in the broad monetary aggregate M3 fell to 0.8% YY (Market

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**Note that today is a holiday in many European countries** (Ascension Day).

## Today's News in Detail

**ECB no longer sees risk of stressed bank funding conditions.** In its bi-annual Financial Stability Review report that was published yesterday, the ECB noted three main risks for the Eurozone financial system. The biggest risk according to the ECB was now the possibility of a *“reversal of risk assessments in financial markets, and consequently reversal of the compressed yields”*. Previously, the ECB had highlighted the possible *“reemergence of sovereign debt sustainability concerns and ...of stress in the sovereign debt markets”* as the biggest risk, whereas ECB Vice President Constancio noted that this risk had now subsided, relegating it to third place. The second biggest risk according to the ECB comprises risks to the banking system owing to its low profitability, which was aggravated by low growth and low inflation. One of the risks the ECB used to highlight was dropped from the list of main risks altogether: the risk of bank funding conditions becoming stretched, as Constancio said it no longer saw *“any possibility of that sort of risk emerging in the next 18 months.”* The report further highlighted continued progress by Eurozone banks in their balance sheet repair as these built up capital and continued to deleverage.

[>> Back to the Top](#)

**Merkel: Choice for Eastern European countries between EU and Russia does not have to be “either/or”.** Bloomberg reports that German Chancellor Merkel said that Germany and the EU wanted each country to be able to *“choose its own path”* with respect to relations with Russia and that the EU would not push for an *“either/or”* decision by Eastern European countries between Russia and the EU. Merkel noted that association treaties between EU and Eastern European countries would enhance political, economic and cultural ties. A deputy parliamentary leader from Merkel's CDU party added that the threat of further sanctions from the Group of Seven and the EU *“is working”* and argued that the threat of *“intensified measures”* needed to be left on the table. Talks between the EU, Russia and Ukraine on the latter two countries' dispute about gas supplies are to continue on Friday, while Russia called for *“emergency steps”* to contain violence in Eastern Ukraine following reports of ongoing fighting there.

[>> Back to the Top](#)

**No quick choice for EC presidency.** Following the European Parliament elections and the ensuing discussions by EU leaders yesterday, Bloomberg reports that the choice of the next European Commission President would likely be part of a package of appointments. German Chancellor Merkel said that after the summit of EU leaders that they now needed to *“have consultations”* about positions, including the EU's High Representative for Foreign Affairs and the next European Commission as well as the Presidents of the European Council and Eurogroup. French President Hollande reportedly backed Jean-Claude Juncker, the former Luxembourg PM and head of the Eurogroup, who was also the lead candidate of the centre-right EPP party that came first in the EP elections. But leaders from the UK, Sweden, the Netherlands and Hungary were reportedly opposed to his choice, while Italian PM Renzi said that he was more interested in discussing how *“we can spend EU money well to create jobs and employment rather than simply talking about a position or an appointment.”*

[>> Back to the Top](#)

**Spain – Q1 GDP confirmed at 0.4% QQ.** The National Statistics Institute (INE) confirmed today that Spanish GDP rose by 0.4% QQ (up by 0.5% YY) in Q1 14, highest QQ growth since Q1 08, and after a gain of 0.2% QQ (-0.2% YY) in Q4 13. QQ GDP growth was due to a positive contribution from domestic demand (of

1.1% Citi 1.2%) in April, the weakest reading since September 2010. Growth in the narrower M1 aggregate eased in April to a 20-month low of 5.2%YY from 5.6% in March, as the growth rate of currency in circulation moderated to 5.3% (vs. 6.5% in Mar), which might be related to the late timing of Easter in 2014 relative to last year.

Ebrahim Rahbari | Antonio Montilla

## UK — Confidence Among People In Full-Time Work At New Record High

28 May 2014

The European Commission's monthly activity survey index edged down to 118.5 in May from 119.5 in April. The April figure was the highest since 1988 (when real GDP growth was 5.6% YY) and the latest figure is second highest since 1988. This is the broadest monthly activity survey in the UK, and this reading (like other recent months) is consistent with continued very strong GDP growth. Confidence among people in full-time work edged up again and is the highest since data began in 1990.

Michael Saunders

## Switzerland — Solid Gain In Q1 GDP, SNB Unlikely To Match ECB Easing

28 May 2014

GDP rose 0.5% QQ seasonally adjusted in Q1, after a gain of 0.2% QQ in Q4. With solid economic growth, reduced deflationary pressures and rising capacity use, we do not expect the SNB to match the expected nearterm easing by the ECB. Nevertheless, with inflation still close to zero, the SNB probably will continue to defend the CHF1.20/€ FX cap.

Michael Saunders

## Denmark — Underlying Growth Weaker than Suggested by 1Q GDP Data

28 May 2014

As expected, the Danish economy recovered at the outset of the year, showing stronger-than-expected GDP growth of 0.9% QQ. The gain was driven by a substantial rise in private consumption (2.0% QQ) and strong investment activity (3.4% QQ). Although

+0.7% after -0.6% in Q4), which compensated for a negative net export contribution (of -0.2% after +0.4% in Q4), driven by rising imports (+1.5% vs. 0.6% in Q4) as well as falling exports (-0.4% vs. 0.8% in Q4). In particular, private consumption rose strongly by 0.4% QQ, after 0.5% in Q4, helped by falling inflation, less fiscal tightening, and a less negative dynamic in the labour market. In addition, business investment rose by 2.4% QQ, in line with the rising trend in 2013, while construction investment fell by 3.3% QQ (vs. -0.1% QQ in Q4), largest QQ decline since Q2 2013. Comment: the economic improvement in Q1 was mainly driven by a pickup in domestic demand on the back of reduced fiscal tightening, better labour market dynamics, improved confidence and less stringent financial conditions. We expect the economic momentum will be maintained over 2014.

[>> Back to the Top](#)

**Spain – Bank of Spain: economy continues to improve in Q2.** In its latest monthly bulletin, the Bank of Spain (BoS) noted that the Spanish economy is showing signs of further improvement at the start of Q2, as a higher contribution from domestic demand offset weaker export dynamics. In particular, the BoS noted that the pickup in domestic demand was driven by rising car sales, better than expected labour market dynamics, a continuation in the growth momentum in business equipment investment, and some signs of stabilization in construction. Comment: we agree with the BoS that the Spanish economy will likely keep the same pace of marginal economic expansion (of around 0.4% QQ) in Q2

[>> Back to the Top](#)

**Spain – House prices fall by 3.5% YY in Q1 14, lowest pace of contraction since Q4 10,** data from the Ministry of Development showed. Prices for non-subsidized housing dropped by 3.8% YY, easing from an average 5.8% decline in 2013. According to this measure, house prices are now 30.6% lower than their peak in 2008, and are back to 2004 levels. Separately, the number of mortgages approvals rose by 2% YY in Mar to 16,624, largest YY growth rate since Mar 2010, INE data showed yesterday. The increase however was affected by temporary effects due to the later timing of Easter in 2014 relative to last year, INE noted. Comment: House prices are still high relative to incomes and/or to rents are still somewhat above their long-term average, which is why we think that a stabilisation in house prices is not yet imminent.

[>> Back to the Top](#)

**Italy – Business confidence deteriorates sharply in May,** falling by 1.9 pts MM to 86.9 (from 88.8 in Apr and 88.2 in Q1), lowest since Jan 14, and standing 0.1sd below its long-term average. The decline was driven by a deterioration in services sector confidence (falling by 3.8 pts MM to 87.4), as well as in the construction sector (-1.7 pts MM to 72.9), while business confidence in the manufacturing sector remained stable at 99.7 (in line with long-term average). Comment: the decline in business confidence in May follows the sizeable retrenchment in equity prices and signs of weakening export demand.

[>> Back to the Top](#)

## Latest Issues of Sovereign Debt Update

### Race Wide Open for European Commission Presidency

28 May 2014

Race for EU Commission Presidency wide open - Merkel favours "broad tableau" of candidates, although EPP's Juncker remained her choice. EU leaders put off further sanctions on Russia after Ukraine election. German import prices fall. France: consumer spending falls, consumer confidence unchanged. Italy: consumer confidence improves again. Spain has turned corner but more efforts

clearly a positive surprise, today's numbers need to be seen in light of the 0.5% QQ surprise drop in 4Q-13, which to a large extent reflected technical issues in relation to a mild winter, two storms and volatile ship investments.

Tina Mortensen

### Norway — Ongoing Recovery for Private Consumption

28 May 2014

The weak trend in private consumption throughout most of 2013 appears to have been broken, with momentum in Norwegian retail sales and domestic spending on goods recovering further in April. The markedly stronger-than-expected domestic goods spending since the turn of the year supports our forecast of above 2% Y/Y growth in private consumption this year. More importantly, it also suggests that Norges Bank will likely have to revise up its forecast of 1.75% y/y from the June Monetary Policy Report.

Tina Mortensen

### Euro Economics Weekly — Soft Growth, Low HICP And Weak SPF Point To ECB Cut In June

23 May 2014

We think the combination of low inflation, a weak survey of professional forecasters (SPF) and soft GDP growth, together with the strong signal given in May make it very difficult for the Governing Council to change their mind at the last minute. A negative deposit rate beckons, in our view, as part of a decision to lower all key interest rates alongside new liquidity measures, including a probable extension of the full allocation fixed rate MRO window until 2016.

Guillaume Menuet | Ebrahim Rahbari | Giada Giani | Michael Saunders | Antonio Montilla

### Italy — Q1 GDP Downward Surprise and Political Uncertainty

23 May 2014

The recent re-widening of Italian yield spreads has been attributed by some commentators to the negative Q1 GDP print (-0.1% QQ, vs. +0.2% expected) and the increased uncertainty around Sunday's EU elections. While we still think Italian GDP growth is structurally

needed, says IMF. Spain's central govt deficit narrows, retail sales rebound. Danish GDP rebounds in 1Q.

[Ebrahim Rahbari](#) | [Guillaume Menuet](#) | [Antonio Montilla](#)

## ECB's Draghi Lays Out Case for Credit Easing

27 May 2014

ECB's Draghi comments on "anatomy and physiology of disinflation", makes case for credit easing. EU Parliament results: NEAPs (new, extreme or alternative parties) do well as expected, taking first place in UK, Greece and France. No clarity on front runner for next EU Commission President. Belgium's general election: Flemish separatists N-VA ahead. EU Commission considers sovereign risk weights, details Russia sanctions, plans flat rate contribution to resolution funds.

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## BuBa's Weidmann Dampens Hopes of ABS Purchases

23 May 2014

Weidmann dampens hopes of ABS purchases. Schäuble rules out new ESM programs. German 1Q GDP confirmed at 0.8% QQ. S&P upgrades Spain one notch to BBB stable outlook. Spain: Emigration of foreigners and retirement behind fall in labour force, tourist arrivals up strongly. Dutch EP election: Anti-EU Freedom Party does less well than expected. Fitch upgrades Greece one notch to B stable outlook. Greece: pick up in exports. Portugal's state govt budget improves further.

[Ebrahim Rahbari](#) | [Guillaume Menuet](#) | [Giada Giani](#)

## Weidmann Says Not Clear if ECB Will Act in June

22 May 2014

Buba's Weidmann says not clear if ECB will act in June. Gonzalez Paramo says negative depo rate would help fight disinflation. EU countries sign agreement on Single Resolution Fund. Italy, France support public funds for "precautionary recaps" after ECB stress test. EU Parliament elections start. Sarkozy calls for EU reform. EA consumer confidence at 7-yr high. Falls in French industrial confidence and composite PMI. Greece: Syriza's leader sets election target of 4-6% lead over ruling ND.

[Giada Giani](#) | [Guillaume Menuet](#) | [Ebrahim Rahbari](#)

## ECB To Reduce Frequency of Policy Meetings?

21 May 2014

ECB mulls less frequent policy meetings, say sources. ECB's Liikanen says QE would require more credit risk and sharing it. EP elections: centre-right parties likely to win, says PollWatch. Germany's nominal exports to Russia and Ukraine fall strongly. Germany: No. 2 in OECD immigration ranking for 2012. Italy: improvement in housing market, rise in new industrial orders. Spain's real GDP growth at least 0.4% QQ in 2Q, says EconMin. Greece: PM's 2014-21 growth plans, house price declines ease.

[Giada Giani](#) | [Guillaume Menuet](#) | [Ebrahim Rahbari](#)

[>> Back to the Top](#)

## Macroeconomic Forecasts

### European Economic Forecast Highlights — May 2014

22 May 2014

This companion to Global Economic Outlook and Strategy - May 2014 gives

weaker than in most other euro countries and likely to undershoot consensus once again this year, a modest cyclical recovery remains underway in our view.

[Giada Giani](#)

## UK Economics Weekly — Will Macro-Pru Allow “Low for Longer”?

23 May 2014

Following recent BoE comments, it seems likely that the BoE's FPC will soon announce macro-pru tightening focused on housing. We expect the FPC will lift sectoral capital ratios on mortgages with high LTV and high loan-to-income ratios, and also recommend that the Help to Buy scheme is scaled back. Such a recommendation on HTB is likely to be implemented immediately. But, we do not expect that such measures will seriously derail the housing market or significantly affect the overall economy.

[Michael Saunders](#) | [Ann O'Kelly](#)

## Scandi Economics Update — Riksbank Ingves Wants Forced Amortization

29 May 2014

**Nordics** — All the Nordic markets are closed for Ascension Day holiday.

**Sweden** — Riksbank Ingves wants forced amortization — Ingves: Riksbank will do what it can to bring inflation to target.

**Norway** — Ongoing recovery for private consumption.

**Denmark** — Underlying growth weaker than suggested by 1Q GDP data — PM: Now is not the time for a euro referendum.

[Tina Mortensen](#)

[>> Back to the Top](#)

more detailed forecasts for the main European countries to end 2015. Figures 20-21 give annual forecasts to 2018 for growth, inflation, current balance, fiscal balance, primary balance and government debt.

[Ann O'Kelly](#) | [Michael Saunders](#) | [Guillaume Menuet](#) | [Giada Giani](#) | [Ebrahim Rahbari](#)

## **Global Economic Outlook and Strategy — May 2014**

**21 May 2014**

This publication contains updated forecasts for a wide range of economies, interest rates and currencies by the Citi economists and strategy teams. We expect the ECB to loosen policy at the June meeting, with a lower refi rate, negative deposit rate and a probable extension of the full allocation fixed rate MRO window until 2016. We look for further easing subsequently, with QE in 4Q. The BoJ remains likely to loosen further but is unlikely to act before the autumn — and maybe even later.

[Willem Buiter](#) | [Guillermo Mondino](#) | [Michael Saunders](#) | [Kiichi Murashima](#) | [David Lubin](#)

## **Emerging Markets Macro and Strategy Outlook — Is the rally safe?**

**23 May 2014**

Late last year, we identified three forces that would shape the outlook for EM economies and asset prices in 2014. The first was the outlook for capital flows to EM; the second was the outlook for China; and the third was the outlook for EM exports. As things stand, none of these three forces are generating much in the way of bad news for EM. Yet we think there are reasons to doubt that this benign environment for EM can be sustained. This isn't the same as saying the rally is about to end. But we think the factors governing the EM rally are not well-entrenched.

[Guillermo Mondino](#) | [David Lubin](#) | [Johanna Chua](#)

[>> Back to the Top](#)



# Appendix A-1

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