

Italian Political Crisis Intensifies

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Summary

Italy: Governing coalition breaking up, confidence vote expected on Wednesday. On Saturday, centre-right PdL leader Berlusconi called for his ministers' resignation from the grand-coalition government, apparently in response to the government decision to go ahead with the VAT hike on 1 October. PM Letta has not yet accepted the resignations and will reportedly ask for a confidence vote in Parliament on Wednesday, and is looking for a new majority in the Senate in the meantime. Comment: whether the outcome of the current turmoil is a new "Letta-bis" government (with the support of some PdL MPs unhappy with their leader's hawkish line) or early elections before year-end or the current coalition sticking together (on some compromise with Berlusconi), political instability will likely remain very high in coming weeks.

Greece: extremist right party Golden Dawn's leaders arrested. The police on Saturday arrested Golden Dawn leader Michaloliakos, five Golden Dawn MPs and at least 13 party officials following an investigation by a Supreme Court prosecutor into criminal activities linked to the party.

Portugal – municipal elections deliver blow to governing coalition. Reuters reports that partial results showed the Socialist to be ahead with 40% of the votes, while the main governing party (PSD) followed with 34%.

Germany: SPD convention votes to start exploratory coalition talks with CDU/CSU, but also plans a member referendum. In the first post-election opinion polls, the **CDU increased its share of voting intentions. CDU/CSU politicians reject tax increases.**

Austria: Grand Coalition likely. In Sunday's general election, the centre-left SPÖ remained the largest party with 27% of the votes ahead of its coalition partner, the centre-right ÖVP (24%). The far-right FPÖ came third with 21%, and far-right parties overall gained more than 30% of the vote. Comment: A renewed Grand Coalition of SPÖ and ÖVP appears likely.

EU Commission welcomes 2014 French budget – EU Commissioner Rehn said that *"France has made a huge effort to restore its public finances, and this draft budget law is characterised by responsibility and prudent policy making"*. Separately, in a survey by Viavoice, **40% of French people see some signs of recovery** in economic activity.

Spanish 2014 budget unveiled – FM Montoro on Friday announced the draft 2014 budget which aims to bring the deficit to 5.8% of GDP from a projected 6.5% in 2013. Separately, **Spanish banks to increase provisions** to cover for the new classification of renegotiated loans, citing bank accounts as March 2013.

Data Roundup: Sluggish German retail sales in August, Upward revisions to GDP in Belgium and Denmark. In **Slovakia** economic sentiment improves, while

30 September 2013

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Economics

Western Europe

Industrialised G7 Countries

Recent Research

Global Political Insights — Showdown, Shutdown or Meltdown? Political Risks on the Rise in US, Italy, Greece, Germany, as Geopolitical Risks Decline

Global, EMEA, North America, Western Europe, CEEMEA

The past forty-eight hours have seen a significant rise in the developed-markets political risk temperature, with a US government shutdown now considerably more likely and Eurozone political risks on the rise. Political developments in Italy and Greece over the weekend have added to pressure on fragile ruling coalitions, making early elections more likely. Compounding the Eurozone political risk outlook is complications to the coalition-forming process in Germany.

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Euro Economics Weekly — New ECB LTRO? Not Like Waiting for Godot

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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in **Slovenia** fiscal risk remains.

Citi's latest **Emerging Markets Macro and Strategy Outlook** asks "Will Developed Markets' Recovery Be Emerging Markets-Friendly?" <https://ir.citi.com/e9kxJfcqRb9eG%2fRqgJ9rh3H4m8mVlf11dSSS2%2belwfFe6WU148TwLvG9AMdsYo9PgNADRWEcBA%3d>

Today's News in Detail

Italy – Governing coalition breaking up, confidence vote expected on Wednesday. On Saturday centre-right PdL leader Silvio Berlusconi called for his ministers' resignation from the grand-coalition government, apparently as a response to the government decision to go ahead with the VAT rate hike on 1 October. In fact, the decision comes after two months of constant threatening from Mr Berlusconi to pull the plug on the government after his conviction for tax fraud in July and increasing chances of being ousted from parliament. Yet the long-threatened action sent the PdL into disarray, as some PdL ministers expressed their uneasiness with this extreme action. Ministerial resignations have yet not been accepted by PM Letta: Mr Letta has reportedly agreed to wait until Wednesday before reporting to Parliament and to ask for a confidence vote, after a meeting on Sunday night with President of the Republic Napolitano. PM Letta is reportedly buying time to find a new majority in the Senate in case PdL withdraws its backing from the government, possibly also with the support of some PdL MPs who may desert in disagreement with Mr Berlusconi's extreme positions. A PdL meeting is scheduled for Monday evening to address the party's increasing divisions. After his Saturday statement, Mr Berlusconi said on Sunday that the PdL could continue to support the government if the planned tax hikes (VAT and property tax) were scrapped. Comment: whether the outcome of the current turmoil is a new "Letta-bis" (or Letta no. 2) government (with the support of some PdL MPs unhappy with their leader's hawkish line), or early elections being called before year-end, or the current coalition sticking together (on some compromise with Silvio Berlusconi), political instability will likely remain very high in coming weeks. Immediate elections (without any changes to the electoral system) would likely fail once again to deliver a definite result and would jeopardise the approval of the 2014 Budget. A Letta-bis government – the most likely development in our view – may be able to pass the budget and make some changes to the electoral law, but it would probably be less stable than the current one, as reliant on a thinner majority. All parties seem to be preparing the ground for early elections in spring 2014 – which remains our base case scenario for the medium-term, even if a new government is forged in the meantime. We think this would be a welcome outcome given the current government's inability to agree on many fronts, although it is still uncertain whether a clearer political majority can emerge from the ballot boxes next spring.

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Greece – extremist right party Golden Dawn's leaders arrested on criminal charges. In a surprise move, the police on Saturday arrested the leader of extremist party Golden Dawn, Nikos Michaloliakos, as well as five Golden Dawn MPs and at least 13 party officials following an investigation by a Supreme Court prosecutor into criminal activities linked to the party. Press reports late last week suggested possible mass resignations by Golden Dawn MPs as a result of the allegations, a move that could prompt by-elections to replace the departing MPs. *Ekathimerini* reports that the arrested Golden Dawn members were expected to appear before a magistrate Tuesday or Wednesday on charges of belonging to a criminal organization. The newspaper also reports that the government is working to suspend state funding to political parties whose leaders or MPs face criminal charges. Comment: if some or all 18 Golden Dawn MPs leave

Despite some suggestions that the ECB is not yet willing to commit to offering another LTRO, we believe that the case is compelling enough to expect some announcement over the next 3 to 6 months, possibly as early as December. In our view, the only issues that still need to be resolved by the Governing Council are the exact timing and length of the facility as well as its interest rate characteristics.

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UK Economics Weekly — The Squeeze on Living Standards

The unprecedented squeeze on living standards continues. Real wages are down 1-2% YoY and have now been falling for 5-6 years. We suspect that real wages will continue to fall in YoY terms in H2 this year, and probably also in 2014. We expect that the decline in real wages will not prevent the economy picking up, with recovery driven more by housebuilding, exports and lower savings than by real wage gains. But, to some people, it may not feel like much of a recovery for a while.

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Global Political Insights — Showdown, Shutdown or Meltdown? Political Risks on the Rise in US, Italy, Greece, Germany, as Geopolitical Risks Decline

Global, EMEA, North America, Western Europe, CEEMEA

The past forty-eight hours have seen a significant rise in the developed-markets political risk temperature, with a US government shutdown now considerably more likely and Eurozone political risks on the rise. Political developments in Italy and Greece over the weekend have added to pressure on fragile ruling coalitions, making early elections more likely. Compounding the Eurozone political risk outlook is complications to the coalition-forming process in Germany.

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Global Economics View — Forward Guidance: More than Old Wine in New Bottles and Cheap Talk?

Parliament by-elections have to be held, with high chances for the current thin majority supporting the government to be completed eroded. In consequence this would increase significantly the probability of early elections, and the worrying uncertainty of their outcome. In that scenario, with two of the three main parties (leftish SYRIZA and right Golden Dawn) openly against the Greek bailout programme and in part against the euro, resurgence of Grexit risks are likely.

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Portugal – municipal elections delivers a blow to governing coalition. The preliminary results of the municipal elections held on Sunday showed that the governing Social Democratic coalition lost ground in favour of the Socialist opposition party and of independent runners. Reuters reports that partial results showed the Socialists ahead with 40% of the votes, while the main governing party (PSD) following with 34%. The President of the Republic stressed that these were municipal elections and they should not threaten the stability of the central government. Comment: while a poor result for the current governing coalition was to be expected, given growing austerity fatigue, the divisions within the governing coalition may grow bigger after the defeat at the local elections. The main point of divergence remains the course of fiscal policy, with strong calls for a further relaxation of the fiscal targets set by the troika.

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Germany: SPD convention votes to start exploratory coalition talks, but also plans member referendum. On Friday, the SPD convention approved with a very large majority the beginning of exploratory talks with Chancellor Merkel's CDU/CSU to form a Grand Coalition. However, at the same time, the convention decided to put any resulting agreement to a binding member referendum, which is meant to take place ahead of the party congress on November 14. *Handelsblatt* reported that SPD politician Kraft, who leads the regional government in North Rhine Westphalia and is widely expected to take on a greater role in the party at the national level as well, noted that the SPD was “*not afraid of a Grand Coalition*” but that it was also not afraid of a CDU-Green coalition, or new elections. SPD party head Gabriel said that the SPD would enter the coalition negotiations “*with confidence*”. According to *Handelsblatt*, the SPD was demanding a national minimum wage, a statutory cap on rent increases, a pension reform, higher taxes for the wealthy to fund greater support for municipalities, education and infrastructure. The FT reports that a senior CDU politician promised to give priority to the negotiations with the SPD over talks with other parties, but CSU head Seehofer and several other CDU politicians sharply criticised the decision to leave the final decision to a member referendum. Meanwhile, the head of the Left Party once again encouraged the SPD to start exploratory talks with his party, too. The Green Party at its own party convention also decided to proceed with exploratory talks with “*all parties in the Bundestag*”. Comment: The decision to leave the final coalition agreement to a member referendum has two purposes in our view: to avoid a split in the SPD party (where there are many reservations about a Grand Coalition) and to improve its bargaining position in these negotiations. It is a risky move, however, as even successful coalition negotiations could eventually be voted down by the member base which would throw the German political landscape into some uncertainty. It would also likely complicate coalition negotiations, as leading CDU/CSU politicians may be reluctant to cave in to SPD demands. Initial talks between CDU and SPD should begin this week.

Germany: CDU gains in polls. In the first set of opinion polls after the German election (by *Emnid* and *Forschungsgruppe Wahlen*), the CDU's share of voting intentions exceeded its share of votes in the election. In both polls, it got 43% of voting intentions (vs 41.5% in the election), while the Greens (7% in both polls, 8.4% in the election) and the FDP (3% in both polls, 4.8% in the election) lost support relative to the election (where they had also fared poorly). The SPD's

Based on the recent experience in Canada, the US, the euro area and the UK, the best approach to signaling longer-term monetary policy intentions, in an operational manner, typically has three components.

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Scandi Economics Update —

Sweden — Riksbank speeches — Poll: Government trails opposition — Labour market data — Data preview. Most important indicators out this week are manufacturing PMI and service production.

Norway — Consumption expected to recover in August — Moderating credit growth — October FX purchases — Data preview. Manufacturing PMI.

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support was at 26% in the polls, close to its election result, while the Left fared slightly better (9% and 10%, respectively, vs 8.6% in the election). At 6% and 5%, respectively, the AfD would have had enough support to enter parliament according to the two polls. Comment: In our view, these polls are suggestive that a fresh election would leave Chancellor Merkel's CDU/CSU with even stronger support, but the AfD's entry into parliament would still leave it in need of a coalition partner.

Germany: CDU/CSU politicians reject tax increases. German FM Schäuble denied plans to raise income tax rates, saying that he saw *"no reason to, as the State did not have a revenue problem"*. Bavarian regional PM (and CSU head) Seehofer and federal Labour Minister von der Leyen also ruled out tax increases. Meanwhile, SPD politicians highlighted the need to raise revenues for higher spending on education and to support the regions and municipalities, which would probably necessitate raising top income tax rates. Comment: In our view, some revenue increases are likely to be part of any coalition agreement of the CDU/CSU with either the SPD or the Greens.

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Austria: Grand Coalition likely. In the federal election for the Nationalrat (lower house of parliament) in Austria on Sunday, the centre-left SPÖ remained the largest party with 27.1% of the votes (-2.2% relative to the last election in 2008), according to the preliminary official results, ahead of its coalition party, the centre-right ÖVP (23.8%, -2.2%). The far-right FPÖ came third with 21.4% (+3.9%) and the Greens fourth (11.5%, +1.0%). Two new parties also exceeded the 4% threshold to enter parliament, the euro-sceptic Team Stronach (5.8%) and the liberal New Austria (NEOS) party (4.8%), while the far-right BZÖ failed to clear the threshold. Comment: Even though both coalition partners lost vote shares, it is widely expected that a Grand Coalition will be continued under Chancellor Werner Faymann (who announced that he would seek a stable government *"without the FPÖ"*), even though ÖVP head Spindelegger noted that he was ready for negotiations, but could not say at this point whether these would be successful. Such a coalition would have a majority of 99 out of 183 parliamentary seats. The preliminary result does not include postal votes and, according to national broadcaster ORF, postal votes would likely marginally boost the vote shares of ÖVP, NEOS and Greens while they would slightly reduce the vote shares of SPÖ and FPÖ. It is worth noting that turnout in the election was very low at 66%, compared to 79% five years ago, and that far-right or associated parties (FPÖ, BZÖ, Team Stronach) gained more than 30% of all votes.

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EU Commission welcomes 2014 French budget – EU's economic and monetary affairs commissioner Olli Rehn indicated last week that *"France has made a huge effort to restore its public finances, and this draft budget law is characterised by responsibility and prudent policy making"*. Speaking alongside French Finance Minister Pierre Moscovici at a joint press conference in Brussels, Mr. Rehn made no references to France's structural reform agenda or any allusion to the recently announced pension reform. Mr. Moscovici was keen to play down the significance of the new budgetary surveillance powers given to the Commission arguing that *"Europe does not pose a constraint. Europe is not a problem. In France, Europe is a solution"*. Comment: It seems that the French government's strategy of intense discussions with Brussels is paying off. The split of expenditure savings and revenue measures is going in the right direction (80%-20%) and the macroeconomic projections are more realistic than they used to be in the past, partly because of the new scrutiny of France's High Council of Public Finances. Note that on the topic of structural reforms, rather than following EC recommendations to the letter, the government is delivering modest adjustments to the pension system designed to deliver some savings through an

increase in the number of years of contributions to obtain a full pension rather than lifting the minimum legal retirement age.

France recovery watch – 40% of French people surveyed by Viavoice see some signs of recovery in economic activity, according to French business daily *Les Echos*. But 54% of respondents put taxes at the top of their list of factors threatening their purchasing power. Separately, *Le Monde* reported that French private sector wages will likely grow by 2.5% in 2014 according to a survey by HR consultancy Mercer, which surveyed firms between April and July. While 12% of firms surveyed envisaged a reduction in staffing levels (down from 17% in 2013), only 20% are planning to hire in 2014 (down from 24% in 2013).

Comment: the tentative recovery seen in 2Q GDP will likely extend into 3Q, with household and business sentiment surveys continuing to signal some improvement, albeit with headline readings still below their long-term averages. We continue to expect the French economy to underperform in terms of GDP growth in coming years, owing to the record fiscal pressure and some probable lack of significant job creation undermining growth in overall household disposable income.

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Spanish 2014 budget unveiled – Finance Minister Cristobal Montoro announced last Friday that the government's 2014 Budget was *"one for economic recovery which would allow the government to open the door to job creation"*.

The Budget aims at bringing the fiscal deficit to 5.8% of GDP in 2014, down from a projected result of 6.5% in 2013, with a broadly unchanged deficit for the central government (3.8% of GDP in 2013 to 3.7% in 2014). In addition, the 2012 final deficit figure was adjusted to 6.84% of GDP (from 6.98% previously announced), reflecting better local governments results. Figures for the impact of the budget on the government accounts were not made available. However, according to the Stability Programme presented in April (which held the same nominal fiscal targets), total tightening measures for 2014 would amount to 1.6% of GDP (vs. 3.6% in 2013 and 4.2% in 2012). The FinMin ruled out any additional tax increases to reach its budget deficit target of 5.8% of GDP in 2014. In addition, the government revised up its 2014 GDP forecast to 0.7% (from 0.5%) and now expects the unemployment rate to start falling in 2014 to 25.9% (from 26.6% in 2013). The budget will be presented in parliament today, and more details are likely to become available. **Separately, the credit rating agency**

Fitch issued a positive comment on Spain, raising its GDP growth forecast for this year (to -1.4% from -1.6% previously) and expecting the government to meet its fiscal deficit targets in 2013 and 2014. Comment: the 2014 budget reflects a considerable reduction in the pace of fiscal austerity relative to the last two years. We believe this could create some upside risks to our growth forecast (of -0.2% in 2014). Our forecasts for the Spanish budget deficit stand at 6.0% in 2014, suggesting that the government will also probably have to identify additional budgetary savings in order to hit the fiscal target.

Spanish banks to increase provisions – According to the newspaper *El Pais* Spanish banks should make further provisions of about €5.0bn to cover for the new classification of renegotiated loans, citing bank accounts as March 2013. The contribution of provisions varies greatly between entities, the newspaper says. Comment: the increase of provisions will likely further worsen the already tight financial conditions in the Spanish economy.

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Data Roundup: Germany: Retail sales remain sluggish. Retail sales excluding cars were up by 0.5% MM and 0.3% YY in August (Consensus: 0.8% MM/0.6% YY), but the July reading was revised up to -0.2% MM from -1.4% MM. The August reading left the July-August average at 0.2% over 2Q. **Belgian 2012 GDP revised up** - Belgium's national bank said on Friday that the economy contracted by 0.1% in 2012 instead of the 0.3% previously pencilled in.

Denmark: 2Q GDP Revised Slightly Higher: 2Q GDP growth was revised up by 0.1pp to 0.6% QQ in 2Q. The gain reflected increasing exports (1.8% QQ), investment (up 0.1% QQ) and government consumption (0.7% QQ), while private consumption also showed a minor gain (0.1% QQ). Meanwhile, imports also rose in 2Q (0.6% QQ) and stocks declined (deducting 1.0% from overall GDP). In the first half of the year, GDP fell by 0.1% YY. Comment: The Danish economy has on average been stagnant since the economic crisis took hold in late-2008, primarily driven by also stagnant private spending and waning exports. Given the substantial growth setback in late-2012, the economy entered 2013 at a very subdued level, indicating barely any growth this year. We are witnessing some green shoots in the economy (consumer confidence and Dankort debit card sales are rising), though, and our forecast assumes moderately increasing growth ahead, driven by rising domestic demand. Although implemented economic reforms have not had the intended effect in the short-term, they should bolster the fundamental structure of the economy, thus making it better positioned to benefit from economic recovery once the cycle turns in earnest.

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Slovakia – Economic sentiment indicator improves for third month in a row in September, but driven solely by industry.

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Industrial confidence improved to levels last seen around March this year, with both expectations and order-books improving in September, driven by better assessment of foreign order-books. However, this improvement does not actually signal growth in order-books, but rather stabilization. This still in our view suggests a deceleration of industrial production in seasonally adjusted terms to 1.2% YY in 3Q13 from 3.1% a quarter ago and 9.1% a year ago. In contrast, other sectors showed worsened confidence, which represents a downside risk to recovery in domestic demand, particularly private consumption, which increased by 1.1% QQ in 2Q after 0.3% growth in 1Q13 (after on average contracting for three years in a row, on average by -0.6% YY in 2010-12). We expect Slovak GDP to increase by 0.3% cumulatively in 2H13 after 0.3% QQ in 2Q13, which is likely to slow GDP growth to 0.8% YY in 2013 from 2% in 2012 (we assume weaker export and industrial activity owing to strong base effects and weaker fixed investment owing to lower utilization of production capacities reported in July) before its recovery to 1.8% growth next year reflecting a better outlook for foreign demand.

Slovenia – Fiscal risk remains in place.

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The government meets today to adopt budget proposals for 2014 and 2015, which target a narrowing of deficits to 2.9% and 2.4% of GDP respectively. According to the Slovenian Press Agency (SPA) the proposed draft assumes revenues of €8.63bn and expenditures of €9.64, which we think it represents a 7% YY increase on the revenue side and 0% on the expenditure side if we compare it to the 2013 budget plan, but it could represent a 13% and 2% increase if we compare the 2014 proposal to our projection of total 2013 revenue and expenditure based on the year-to-date development of 2013's budget compared to seasonal development in recent years. Though the Slovene government will send its proposed 2014 budget to the European Commission on 1 October, it seems that recent political tensions have limited a government effort to continue fiscal consolidation through the expenditure side (e.g. a proposed, but not realized, cut in pensions) and the government is likely to rely more on the revenue side through a proposed higher real estate tax (€216mn according to the SPA), unchanged corporate income tax at 17% (versus its initial proposal of a drop to 15% in 2015), a July hike in VAT rates to 22% and 9.5% from 20% and 8.5% initially, and generally higher revenues thanks to its effort to combat the grey economy. Moreover, the High Court said that unpaid salaries to some public

employees from 2008 should be paid, which represent an additional expenditure of €170mn, which is 0.5% of GDP (the August central government deficit reached 4.1% of GDP on a 12month cumulative basis). Though this is likely to be reflected in some lowering of salaries of public employee ahead, it will result in further ad-hoc expenditure cuts unless we see a stronger recovery on the revenue side. Comment: Though proposed measures are likely to increase the revenue side of the 2014 budget, we expect that the EC is likely to criticize the mix of consolidation measures due to a likely optimistic projection of the revenue side, while the expenditure side is likely to remain flat at best. All in all, although the general focus is now on banking sector resolution, now expected to be proposed by end November, fiscal issues are likely to remain another negative factor for Slovenia.

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Latest Issues of Sovereign Debt Crisis Update

Coeuré Says Forward Guidance is to Limit Market Volatility

ECB's Coeuré and Constancio on forward guidance. ECB's Asset Quality Review to focus on four areas of bank lending, says FT. Germany: SPD party convention today to vote on holding on exploratory coalition talks, Green party faces leadership decisions. Italy's PM Letta to call confidence vote next week. Spain probably exited recession in 3Q. Portugal's Constitutional Court rejects part of 2012 labour market reform.

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French 2014 Budget Unveiled

French 2014 Budget details. French unemployment drops unexpectedly in Aug. Germany: CDU-Green coalition talks come closer. Italy's PdL MPs vote to resign if Berlusconi ousted. Italy's new fiscal projections indicate fiscal consolidation is over. Portugal's central government deficit widens in Jan-Aug. Greek government seeks debt re-profiling, not haircuts. Greek privatisation targets to be revised down again. Italian and French consumer confidence rises. We lift growth forecasts for euro area.

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ECB Downplays Near-Term LTRO Option

ECB's Coeuré and Constancio on LTRO options, Mersch on Asset Quality Review. Germany's opposition SPD positions itself post election. Germany's CDU does not rule out tax increases as part of coalition negotiations. Italy's government repays debt arrears of €11.3bn. Italian exports still failing to recover. Spain's public sector wages to be frozen in 2014 budget, central govt deficit rises to 4.62% of GDP. Business confidence falls in France, rises in Germany but less than expected.

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Draghi Stresses Need for Very Accommodative Policy Stance

Draghi testifies before EU Parliament, stresses need for very accommodative policy stance. Draghi on Single Resolution Mechanism, Rehn on reforms and fiscal consolidation. German political parties begin coalition discussions, parliamentary groups meet today to elect leaders. Greece starts 2014 budget negotiations with Troika. Spain's Rajoy sees economy exiting recession in 3Q. Spain's Bad Bank Sareb to offer haircut on small property developers' debts.

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Merkel's Victory Paves Way for Political Continuity

Merkel's election win clear vote for continuity, including in EA crisis. ECB's Liikanen on monetary policy support, banking union. President Hollande's approval rating slumps. Italy's FinMin Saccomanni threatens to quit if VAT hike blocked. Spain's public services to be de-indexed from CPI. Moody's says 2014 Dutch budget plans credit negative. Belgium targets 2014 deficit of 2.25% of GDP. Greek state's real estate assets possible collateral for new loan. EA flash composite PMI up in Sep.

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Macroeconomic Forecasts

European Economic Forecast Highlights — September 2013

Western Europe

This companion to Global Economic Outlook and Strategy - September 2013 contains detailed more quarterly forecasts for main European countries to end 2014, as well as annual forecasts to 2017.

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Global Economic Outlook and Strategy — September 2013

Global, Pan Asia, GEMS, Americas, EMEA, Asia, Australia

We have a slight tilt to forecast upgrades this month, and we look for growth of 2.5% in 2013 (up a tenth from last month) and 3.2% in 2014 (unchanged). Over the last six months as a whole, we have raised our 2014 growth forecast for advanced economies by 0.5%, while cutting our 2014 EM forecast by 0.5%. Our forecasts are below consensus in all four BRIC countries. The recovery in advanced economies is unlikely to cause early tightening, given ample slack. .

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Emerging Markets Macro and Strategy Outlook — Will DM's Recovery Be EM-friendly?

GEMS, Asia, CEEMEA, Latin America, Global

Of the EM central banks that have held policy meetings since last week's FOMC, the governors of the two largest - India's and South Africa's - have both emphasized the temporary nature of the relief that emerging economies will enjoy from the Fed's decision. If that's the case, and if capital flows to EM continue to become scarcer, the market will rely more and more on signs that EM can export its way out of its problems. There is some good news: strengthening export growth from China and Korea in August was part of the story behind the EM rally that we've seen since early September. But we have some reasons to question whether the EM export recovery we'll see will be really robust. This makes us cautious about the economic environment EM is about to enter. While export data seem likely to continue to recover, we think the recovery might be a shallow one, and thus not a reason to discount the growth risks that have plagued EM in the past couple of years.

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Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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