

EU Summit: More Flexibility in Budget Rules, But No Wholesale Changes

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

Summary

EU Summit – more flexibility in budget rules likely to be agreed by EU leaders today, likely to imply more time to reach deficit targets for countries implementing structural reforms.

EU Stability Pact – little appetite for a wholesale change, even in France. French FinMin Sapin indicated he would not support changes in the way budget deficits are calculated, arguing that the current rules already allowed “*much flexibility*”. French Foreign Minister Laurent Fabius remarked that “*it was out of the question to change treaties at the moment*”.

ECB sources: no hurry to take further monetary action – MNI cited two sources indicating that the GC wished to assess the impact of its June actions before deciding to act further, suggesting that a period of six to nine months could be necessary. Another part of the article underscored that if further action was required, reaching “*unanimity*” on QE would likely be difficult.

Germany – import prices stable in May, still falling by 2.1% YY. **Preliminary state CPI data point to a 0.1pp uptick in headline inflation in June** (from 0.9% YY in May for the pan-German CPI).

Germany – Economy Minister Gabriel sees room for compromise with EU Commission on planned energy reform.

France – jobless count increases to new record high – the total number of registered jobless rose by 24,800 to 3,388,900 in May. This seventh successive uptick again exceeded the 6k consensus, leaving the jobless total up 4.1% YY.

France – Q1 14 GDP confirmed flat in QQ terms, but private consumption rebounds in May by 1.0% MM, above expectations.

Italy – 2014 GDP growth revised to 0.2% by business group Confindustria, 2015 revised to 1.0%, says recovery to be slow and risks to the downside.

Spain – Fiscal reform proposal is credit negative, Moody's says, as it falls short of initial recommendations made by the government-appointed tax commission and poses significant risks for meeting the agreed budgetary targets.

Spain – HICP Inflation slows to 0% YY in June, in line with our forecasts and slightly weaker than consensus (of 0.1%), down from 0.2% in May.

Spain – Retail sales remain strong in May, rising by 1% MM, above our expectations (+0.3% MM), and after the strong rebound in April (1.1% MM).

European Economies: Following on from our [Global Economic Outlook and Strategy](#) of 25 June 2014, we publish fuller details of our macroeconomic forecasts for European countries, including forecasts for additional economic indicators in [European Economic Forecast Highlights - June 2014](#).

27 June 2014

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With thanks to Antonio Montilla and Ann O'Kelly

Economics

Western Europe

Industrialised G7 Countries

Recent Research

ECB Preview — Rendez-vous in September?

26 June 2014

ECB rates to be left unchanged in July — we expect the ECB to leave all its key interest rates unchanged at the next Governing Council (GC) meeting on July 3. As is customary at the meeting following significant policy changes, we look for the ECB to argue that its decisions to lower the deposit rate into negative territory, narrow the interest rate corridor and announce changes to its liquidity policies (full allotment fixed rates for the MRO until Dec-2016 and the new TLTROs) were justified in light of recent indications of moderation in business surveys, persistently low HICP readings and negative credit growth. We doubt that the ECB will be in a position to make an announcement about the ABS purchase programme just yet.

Guillaume Menuet

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Today's News in Detail

EU Summit – more flexibility in budget rules. Reuters reported yesterday the draft conclusion of the EU Summit concluding today in Brussels, showing that European Union leaders will probably agree to apply the EU Stability fiscal rules as flexibly as possible to support economic growth. *“Given the persistently high debt and unemployment levels, as well as the challenges of an ageing society and of supporting job creation, particularly for the young, fiscal consolidation must continue in a growth-friendly and differentiated manner,”* the draft of conclusions seen by Reuters said. It remains uncertain as to what exactly “flexibility” means. It reportedly could imply more time to reach the structural budget deficit targets when countries are implementing structural reforms (so even for countries like Italy that have already brought the headline deficit below the 3% of GDP threshold) or the exclusion of government spending from government deficit calculations. The Italian newspaper *La Stampa* reports PM Renzi is lobbying for the exclusion from the government deficit of the national co-funding of EU structural funds. Comment: the final agreement on the increased flexibility is *de facto* a formalization of the recent trend of much reduced fiscal austerity and in some cases outright fiscal expansion (in Italy for example, albeit small in size).

[>> Back to the Top](#)

EU Stability Pact: little appetite for a wholesale change, even in France – French FInMin Michel Sapin indicated on Thursday that he would not support changes in the way budget deficits are calculated, arguing that the current rules already allowed “*much flexibility*”. French Foreign Minister Laurent Fabius remarked that “*it was out of the question to change treaties at the moment*”. Comment: what transpires from these remarks, in our view, is the limited appetite for wholesale changes in treaties that would undoubtedly open the door to more demands and would in all likelihood be rejected by European voters and/or parliaments at the current juncture. European governments and the Commission will likely refocus their attention on the ‘growth’ component of the Stability and Growth Pact, and we doubt that countries missing their budget deficit targets because of a shortfall in GDP growth would be expected to make up the shortfall with additional tax collection, as long as the expenditure side of the equation is largely achieved, as well as supplemented by structural reforms.

[>> Back to the Top](#)

ECB sources: no hurry to take further monetary action – MNI reported on Thursday that the Governing Council (GC) is in no hurry to take further monetary action for the next few months. The newswire cited two sources indicating that the GC wished to assess the impact of its June actions before deciding to act further, suggesting that a period of six to nine months could be necessary. Another part of the article underscored that if further action was required, reaching “*unanimity*” on QE would likely be difficult. Comment: we expect key interest rates to be unchanged for an extended period of time and the upcoming GC meeting to tell investors [rendez-vous in September](#). We doubt that the ECB will be in a position to make an announcement about the ABS purchase programme just yet.

[>> Back to the Top](#)

Germany – import prices stable in May, still falling by 2.1% YY. German import prices were unchanged in May and in line with consensus expectations. Year-on-year, the decline in the import price index moderated to -2.1% from -2.4% in April. **Preliminary state CPI data for Saxony and Rhineland-Palatinate show a 0.1pp uptick in headline CPI inflation**, as the rebound in holiday-related prices is partly offset by larger discounts in clothing.

UK — FPC Report, Announcement and Press Conference

26 June 2014

The BoE's Financial Policy Committee (FPC) today announced macro-prudential tightening measures aimed at limiting financial stability risks. The FPC did not use raise capital ratios, but announced that (1) lenders will have to assess borrowers' ability to service their loans if Bank Rate were to rise by 3% at any point over the first five years of the loan; (2) "The PRA and the FCA should ensure that mortgage lenders limit the proportion of mortgages at loan to income multiples of 4.5 and above to no more than 15% of their new mortgages." The cap will apply to borrowers with both a single income and multiple incomes. These measures aim to restrain the fringe of lending with high loan-to-income ratios rather than the mainstream.

Michael Saunders

Sweden — RB Forecast: Rate Cut and Lower Conditional Interest Rate Path

25 June 2014

At the 3 July monetary policy meeting, we expect the Riksbank board to cut the key policy rate, likely by 25bp to 0.50%, and to revise its conditional interest rate path lower. We reckon the rate path will continue to discount a non-negligible probability of additional near-term monetary policy easing, at the same time as the timing of initial tightening likely will be postponed by some quarters (2Q-15 in April). Persistent low inflation and ongoing inflation undershoots will force the Riksbank to cut its inflation forecast, which, in our view, will be the key driver behind the lowering of the conditional interest rate path. Inflation trends look weak enough to justify even lower interest rates, but we expect the Riksbank will continue to attach some weight to household debt, although macroprudential measures are under way. Still, we continue to see an outside chance of another rate cut later this year.

Tina Mortensen

Euro Economics Weekly — A

[>> Back to the Top](#)

Germany – Economy minister sees compromise with EU Commission on energy reform. *Handelsblatt* reports that the German Economy Minister Gabriel saw room for compromise with the EU Commission on the planned German energy reform. In a letter to the EU Competition Commissioner Almunia, Gabriel reportedly said that he understood concerns about protectionism in national energy markets, which is why the planned energy reform stipulated that future tenders would, at least in part, be open to foreign electricity providers, unlike in other EU countries. Comment: the energy reform is planned to be approved by the Bundestag today and the EU Commission was critical that imported electricity was subject to renewable energy levies even though it was not fully eligible for public subsidies for renewable energy.

[>> Back to the Top](#)

France – jobless count increases to new record high. INSEE reported on Thursday afternoon that the total number of registered jobless had risen by 24,800 to 3,388,900 in May. This seventh successive uptick again exceeded the 6k consensus, leaving the registered jobless total up 4.1% YY. The splits showed that every age group had recorded an increase. Finance Minister Michel Sapin acknowledged that there was not enough growth at present to stop unemployment from rising. Comment: this amounts to yet another disappointment for the government in its fight against unemployment. This steady uptrend also highlights the difficulties that the administration is facing when trying to convince businesses that the time to start employing additional workers is now. While the policies designed to provide businesses with corporate tax credit and reduction in social security contributions will likely produce some results over time, the limited amount of visibility with respect to expenditure cuts probably remains the biggest obstacle to enhanced credibility.

[>> Back to the Top](#)

France – Q1 14 GDP confirmed flat in QQ terms, private consumption rebounds in May. The final reading of Q1 GDP confirmed zero growth at the start of 2014, with a small downward revision to the YY rate to 0.7% from 0.8% in the first estimate. As expected, private consumption dropped by 0.5% QQ, in the aftermath of the January VAT rate hike, while investment declined for the third consecutive quarter (-0.8% QQ). More positive news from the May data on consumer spending, which showed a pick up by 1.0% MM (consensus: 0.3%), following the April decline (-0.3% MM).

[>> Back to the Top](#)

Italy – 2014 GDP growth revised to 0.2% by business group Confindustria. The largest business lobby in Italy Confindustria lowered its GDP growth forecast to 0.2% in 2014 from 0.7% projected in Dec 13. 2015 GDP expected to expand by 1.0%, against 1.2% projected in Dec 13. Confindustria said that the Italian recovery will be slow and risks to the forecasts remain to the downside. Confindustria expects a rebound in Q2 GDP of 0.3% QQ, although it warns that this has yet to be confirmed by the monthly data. Employment expected to return to expansion only in 2015, after falling by another 0.6% in 2014.

[>> Back to the Top](#)

Spain – Fiscal reform proposal is credit negative, Moody's says. In a brief credit note released yesterday, rating agency Moody's said the Spanish government's fiscal reform proposal, which envisages tax cuts for personal and corporate income taxation, is a 'credit negative' as it falls short of initial recommendations made by the government-appointed commission of tax experts. The credit agency noted that the measures do not include the commission's most far-reaching proposal of pursuing a fiscal devaluation, i.e. making the tax system more growth-friendly by shifting the tax burden from direct

Great Rotation towards Eurozone Portfolio Assets?

20 June 2014

The Eurozone is experiencing record net capital outflows, yet at the same time portfolio inflows are positive for both debt and equity portfolio investment, notably into the Eurozone periphery, and the difference between overall capital outflows and net portfolio inflows is at a record high currently. One way to rationalise these flows is that foreign investors are more optimistic about the expected risk-adjusted returns of bonds and equities in the Eurozone or are reducing underweights in those areas, whereas they have been keen to reduce their deposits in Eurozone banks.

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

UK Economics Weekly — How Resilient Will The Economy Be To Rising Rates?

20 June 2014

Market pricing is now roughly consistent with our long-held view that the MPC will start to hike in Q4 this year. But, we also believe that rates will rise faster and further than markets project - in a benign way. The MPC and consensus seem to believe the economy is fragile, and hence even a small rise in rates will cause growth to slow markedly. We are more confident in the economy's underlying strength, and look for Bank Rate to rise to about 2.5% at end-2015, and 3-4% in 2017-19 or so. We stress that such a path would not be monetary overkill; rather it would aim to slow real GDP growth to 2½% or so in 2016 as the jobless rate falls to 5%.

Michael Saunders | Ann O'Kelly

Scandi Economics Update — Will Acceleration in Swedish Producer Prices Feed through to CPI?

27 June 2014

Sweden — Norman's concern.

Sweden — Weaker SEK behind acceleration in producer prices.

Sweden — May retail sales.

Norway — Sideways labour market trend.

Tina Mortensen

taxes on labour and capital to indirect and environmental taxes. In addition, Moody's noted that the lack of replacement revenues poses risks to achieving the fiscal targets in the coming years. Comment: the announced fiscal reform envisages across-the-board tax cuts for workers and corporates without corresponding expenditure or revenue compensating measures (i.e., net fiscal expansion). According to the government calculations, the tax reform will have a net deficit-increasing impact of 0.5% of GDP spread over two years (2015 and 2016). Spain has committed to reduce its fiscal deficit from 5.5% of GDP expected for this year to 4.2% in 2015 and to 2.8% in 2016. We reckon that these fiscal targets would have been hard to achieve even without any loosening of the fiscal stance.

[>> Back to the Top](#)

[>> Back to the Top](#)

Spain – HICP inflation slows to zero in June. The flash estimate of Spanish HICP came at 0% YY in June, in line with our forecast but below consensus (0.1%), falling from 0.2% in May and 0.3% YY in Apr, INE data released this morning showed. CPI inflation went down from 0.2% YY in May to 0.1% YY in June. INE stated that the slowdown in the annual rate was due to lower prices of food and non-alcoholic beverages this year compared to 2013 as well as some slowdown in electricity prices. Comment: the slowdown in June was likely the result of weak food prices and some easing in the inflation rate for energy (we estimate to +2.2% YY from +3% in May) driven by adverse base effects and by some reduction in electricity tariffs (as households are starting being repaid the announced Q1 electricity price rebates). Overall we project HICP inflation to fall further over the summer months into negative territory over the impact of the electricity rebates.

[>> Back to the Top](#)

Spain – Retail sales remain strong in May, rising by 1% MM, above our expectations (+0.3% MM), and after the strong rebound in April (1.1% MM). On a yearly basis, retail sales (WDA) rose by 0.5% YY, after an increase of 0.7% YY in April. Comment: according to the press release the strong reading in May retail sales was mainly accounted for by food products (2.8% MM), and household equipment (1%). We expect retail sales to post positive growth in the coming months, on the back of reduced fiscal tightening, marginal improvements in employment, and subdued inflation.

[>> Back to the Top](#)

Latest Issues of Sovereign Debt Update

French GDP Growth Revised Lower

26 June 2014

France: INSEE sees downside risk to govt's 2014 GDP forecast, but consumer confidence rises. Germany: Agriculture Minister warns of higher food prices from minimum wage, Energy Minister dismisses EC concerns on energy reform. Italy: consumer confidence falls, retail sales rebound. Bank of Spain says economy improving. Support for independence rises in Catalonia. Netherlands: risk of wider budget deficit. Belgium: N-VA gives up trying to form government. Greek CB governor says economy stabilising

Giada Giani | Guillaume Menuet | Ebrahim Rahbari

French President Calls for €240bn Investment Initiative

25 June 2014

Hollande calls for more ambitious growth and investment agenda. Juncker says EU budget rules will not be changed. EU summit to decide on top EU posts this week. ECB: Knot concerned that recent improvement could threaten reforms, Nowotny says EU close to deflation. Schäuble says France must focus on

structural reform. Renzi presents 1,000-day programme. Spain's state budget deficit narrows slightly. Business confidence up in Belgium, stable in Holland. Portugal's budget surplus improves.

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

ECB's Nowotny: Multiple Euro-Area Bond Markets Problematic for QE

24 June 2014

ECB's Nowotny says multiple EA bond markets problematic for QE. BuBa's Weidmann warns against loosening Stability Pact. EU's van Rompuy says Stability Pact needs no change. German EU Commissioner Öttinger to remain in post. German govt debates future of solidarity charge. French FinMin downplays recessionary impact of budget savings. Renzi obtains "full use" of Stability Pact flexibility. Spain's FinMin gives details of fiscal reform, despite EU warning. Spain's tourist arrivals up strongly.

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

Juncker Set To Become Next EU Commission President

23 June 2014

Juncker set to be nominated as next EC President. ECB's Draghi: low rates for extended period and QE. ECB's Nowotny: no rate hike before 2016. Most EU banks see no need to raise capital after stress tests. ECB's Coeuré supports risk-based contributions to bank resolution fund. Germany to get 30% female board quota in 2016. German, French PMIs weaken. Italy: govt to unlock public infrastructure investment. Spain's govt approves fiscal reform. Belgium's budgetary shortfall.

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

Bol Expects 0.5pp Boost to GDP from ECB Measures

20 June 2014

Bol says recent ECB measures to boost Italy's GDP by 0.5pp over 2014-16. Eurogroup signs off on next bailout tranche for Cyprus but not for Greece. IMF calls on ECB to buy assets if inflation remains stubbornly low. Spain's government to approve long-awaited fiscal reform today. Moody's raises its growth forecast for Greek GDP. China to invest in Greece. Greek govt planning 15-20% reduction in heating oil tax. German producer prices very weak in May.

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[>> Back to the Top](#)

Macroeconomic Forecasts

European Economic Forecast Highlights — June 2014

26 June 2014

This companion to the June issue of Global Economic Outlook and Strategy gives 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](#)

Europe — Monthly Inflation Profiles for Selected Countries

26 June 2014

Updated monthly inflation forecasts after release of Global Economic Outlook and Strategy on 25 June 2014.

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

Global Economic Outlook and Strategy — June 2014

25 June 2014

Our global growth forecasts are unchanged this month, at 3.0% for 2014 and 3.5% for 2015, a modest pick-up from last year's pace (2.5%). We highlight three key themes. First, in contrast to the EM downgrades in 2013 and early 2014, our overall 2014-15 EM growth forecasts have now been stable for three months in a row. Second, we believe that the weakness in US Q1 GDP growth is not representative of underlying growth or the current pace of growth. With very supportive financial conditions, we look for a strong rebound in activity in Q2 as the adverse weather effects fade, with growth in subsequent quarters staying at 3%+. Third, we expect substantial monetary policy divergence among advanced economies, with easing by the BoJ and ECB later this year but tightening late this year from the BoE and in mid-2015 from the US Fed.

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

Foreign Exchange Forecasts — June 2014

20 June 2014

No significant change at the June FOMC gives at least a short term green light to carry trades, especially with volatility still suppressed by the same Central Bank largesse.

[Jeremy Hale](#) | [Maximilian Moldaschl](#) | [Guillermo Mondino](#) | [Alexander Demyanets](#)

[>> Back to the Top](#)

Appendix A-1

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