1 November 2013 | 16 pages

Western Europe

Euro Economics Weekly

Why the ECB Should Worry About the Strong Euro

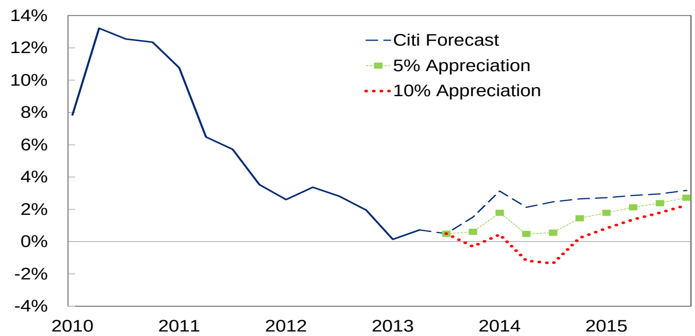
- The euro is at its highest level in nominal trade-weighted terms since November 2011, even though the euro area economy remains weak. We think that the current nominal and real level of the euro exposes the euro area (EA) economy to substantial risks, given how open the euro area is, how sensitive its exports are to the exchange rate, and how reliant growth in the euro area is on (net) exports. Further appreciation would magnify these risks.
- So far, the ECB has treated the exchange rate mostly with 'benign neglect'. We think that is probably likely to change, if the euro appreciation is sustained or extends further and inflation remains very low. Consensus-building about some form of action from the ECB Governing Council will probably be made easier by the fact that virtually all EA countries are likely to be adversely affected by the euro appreciation and that inflation is very low. But institutional constraints and a lacking consensus on *how* to respond implies that the ECB is likely to only consider a modest response to a tightening in financial conditions. We expect increasing references to the exchange rate by ECB officials, even though their uncoordinated nature will probably limit the effectiveness of such 'open mouth operations'. We think that the probability of interest rate cuts (refi rate only first, deposit rate possibly later) and of additional non-standard measures has also increased, even though the November meeting will still be too early for such decisions, in our view.

Figure 1. Citi Market Forecasts

	$/€	Euro Repo	10-yr Bunds	£/€	UK Bank Rate	10-yr Gilt-Bund	SKr/€	SEK Policy Rate	NOK/€	NOK Policy Rate	SFr/€	CHF Policy Rate	CHF Spread vsBunds
4Q 13	1.38	0.50	1.80	0.83	0.50	102	8.87	1.00	8.08	1.50	1.25	0.00	-82
2Q 14	1.40	0.50	1.80	0.82	0.50	127	8.94	1.00	8.01	1.50	1.25	0.00	-78

Source: Citi Research

Figure 2. Euro Area — Export Volume Growth (%YY), 2010-2015F



Note: Exports of goods and services in constant euros. Actual data up to Q2 2013. 5% and 10% appreciation assume an appreciation of the real effective exchange rate of such magnitudes in Q4 2013, with a long-run elasticity of exports to the REER of 0.56. Sources: Eurostat and Citi Research

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

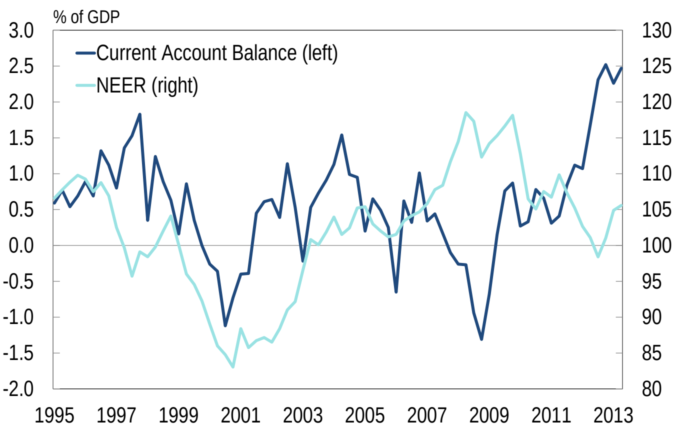
The ECB Should Worry About Euro Strength

Sustained real appreciation is likely to have substantial adverse effects on most euro area countries

As a result, the chances for further ECB easing have risen, even though the November meeting will probably be too early for a refi rate cut or additional non-standard measures

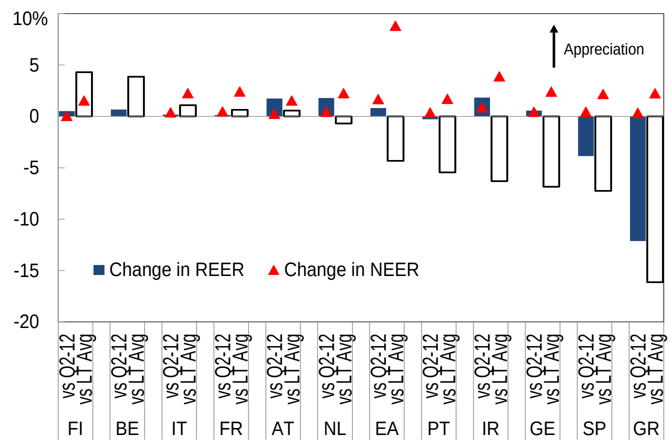
Recently, the EURUSD cross surpassed its YTD high and is at the highest level since November 2011, when the euro area (EA) for various reasons went into a recession that it has only just gotten out of.[1] The euro's real appreciation has been smaller than its nominal one and a pickup in world GDP and trade growth and a slow recovery of domestic demand in the EA will probably avert another recession this time. But given the sensitivity of EA exports to the exchange rate, the openness of the EA and its reliance on (net) exports to generate growth, we think the adverse effects of sustained real euro appreciation on the economy could be substantial in most EA countries and therefore likely to become a larger focus for policymakers.

Figure 3. Euro Area — Current Account Balance (% of GDP) and Nominal Effective Exchange Rate (Q1 99=100), 1995-2013



Note: Nominal effective exchange rate (NEER) is broad nominal effective exchange rate and a higher value signifies an appreciation.
Sources: ECB, IMF and Citi Research

Figure 4. Euro Area — Nominal and Real Effective Exchange Rate Appreciation (%), 1999-2013 Q2



Note: REER is real effective exchange rates (unit labour cost-deflated harmonized competitiveness indicator of the ECB). LT Avg are post-1999 averages and latest values are for Q2.
Sources: ECB and Citi Research

The euro nominal effective exchange rate is at its highest rate since November 2011

The increase in the euro nominal exchange rate has been broad-based. Across the 33 bilateral euro exchange rates that are provided daily by the ECB, only two currencies (the Israeli shekel and the Romanian leu) have appreciated vis-à-vis the euro in the past year.[2] The effective (broad trade-weighted) nominal euro exchange rate in late October is up by 4% since the start of the year and 6% since mid-2012, similar to the appreciation of the euro vs the US dollar. The growing current account surplus, less loose monetary policy relative to other countries, and portfolio capital inflows amid perceived relative safety of euro assets and the nascent economic recovery in the EA have probably contributed to the appreciation.

The (unit labour cost-deflated) real effective exchange has also appreciated in the past year

The nominal euro appreciation overstates the impact on the EA's cost competitiveness. The EA's *real* effective exchange rate (REER, deflated by unit-labour costs according to the ECB's Harmonised Competitiveness Indicator), which is a better measure of export cost competitiveness, was up by 1%YY in Q2 (the latest available data) and 3% since end-2012, as (relative) unit labour costs (ULCs) have fallen. Since Q2, based on recent relative ULC trends, the EA REER may have appreciated by another 2% bringing the total real appreciation to 5% YTD, still leaving it below (but close to) its long-term average and 14% below its 2010 average. Few EA countries have had real appreciations of note over the four quarters up to Q2 (Figure 4), and ULC-deflated REERs are above their post-1999

[1] Even though in 2011, the recession was driven by a contraction in domestic demand.

[2] In addition, Bulgaria, Denmark, and Lithuania have pegged their exchange rate to the euro.

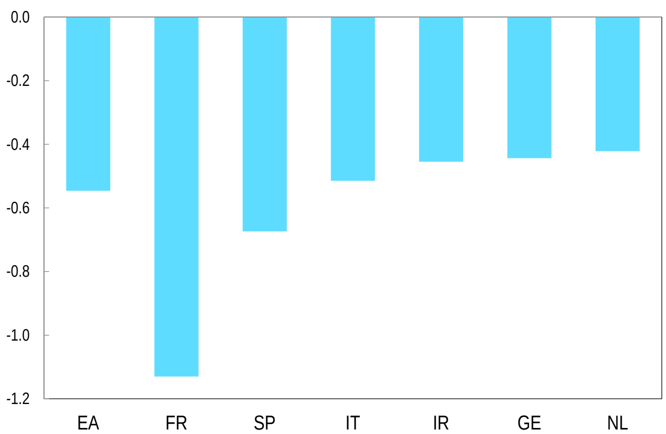
average for only a handful of countries. But given the weakness of the economy, the euro's real value should probably be weaker.[3]

Sustained real appreciation is likely to have material negative effects on the EA economy, for five reasons:

How much does euro appreciation hurt?

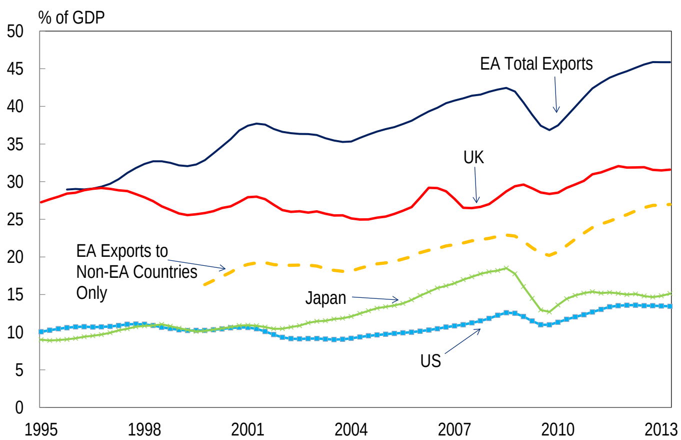
Even though the euro's real appreciation has not been dramatic so far, it should still be of concern to policymakers, in our view, for five reasons.

Figure 5. Selected EA Countries — Estimated Long-Run Elasticity of Export Volumes with Respect to the Real (ULC-deflated) Effective Exchange Rate, 1997-2013



Note: Long-run elasticity of export volumes to the real effective (ULC-deflated) exchange rate estimated through an error correction regression of export volumes on the REER, a weighted average for foreign import growth and a trend on quarterly data from Q1 1997 to Q2 2013. A higher REER implies an appreciation.
Sources: ECB, Eurostat and Citi Research

Figure 6. Selected Countries — Exports Relative to GDP, 1995-2013



Note: 4Q sum of exports of goods and services in nominal local currency divided by 4Q sum of nominal local currency GDP.
Sources: Eurostat, BEA, Bank of Japan and Citi Research

1. **A 10% real euro appreciation tends to reduce EA export volumes by 5% in the long run**
2. **The EA is quite open**
3. **(Net) exports are a major driver of GDP growth in the EA**
4. **Euro appreciation hurts firm profits**
5. **The euro could appreciate (much) further**

First, euro appreciation hurts export growth prospects with a long-run elasticity of volumes of around -0.5 according to our estimates, meaning that a 10% euro appreciation lowers EA export volumes by about 5% in the long-run (Figure 5).[4] An additional 10% real appreciation would probably be enough to negate *any* growth in EA exports for 2014 (see front page chart).

Second, the euro area is quite open and increasingly so. Exports (to non-EA countries alone) amount to 27% of GDP vs 15% in Japan and 13% in the US, and this export share having risen by around 10pp since 2000, implying that the same percentage change in exports will affect the EA more than Japan or the US. **Third,** the EA recovery is very export-dependent and likely to remain so for the foreseeable future. Since 2010, net exports have contributed almost 1% annually to EA GDP growth, on average, and substantially more in a number of EA periphery countries where domestic demand collapsed.[5] **Fourth,** euro appreciation can affect firms'

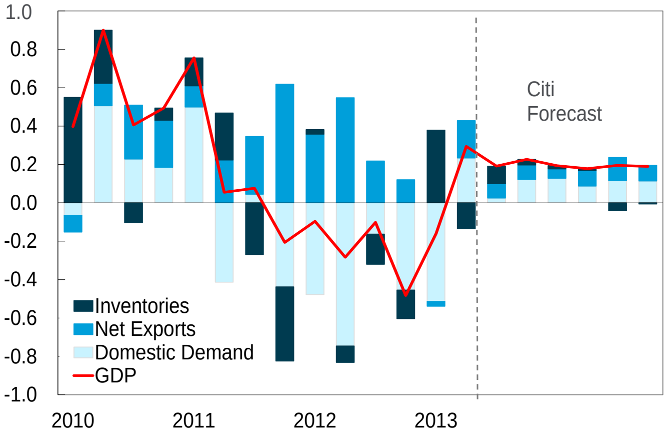
[3] The real CPI-deflated effective exchange rate appreciation was roughly similar to the euro's nominal appreciation – 4% since start-of-year and 6%YY up to end-September, leaving the CPI-deflated REER still close to its long-term average. REERs deflated by GDP deflators are in between CPI- and ULC-deflated REERs (and significantly below its LT average).

[4] We estimate the elasticity of real exports to the ULC-deflated REER through an error correction model which includes the EA export market (weighted import growth of the main export destinations) on data from Q1 1997 to Q2 2013. There are many reasons why export sensitivities may have risen or fallen over time, with the empirical evidence inconclusive. See also Di Mauro et al (2008), "The Changing Role of the Exchange Rate in a Globalised Economy", ECB Occasional Paper 94.

[5] Imports also respond to changes in the exchange rate, but their elasticity is generally found to be lower than that of exports for the euro area. Interestingly, the EA's Area-Wide Model suggests that

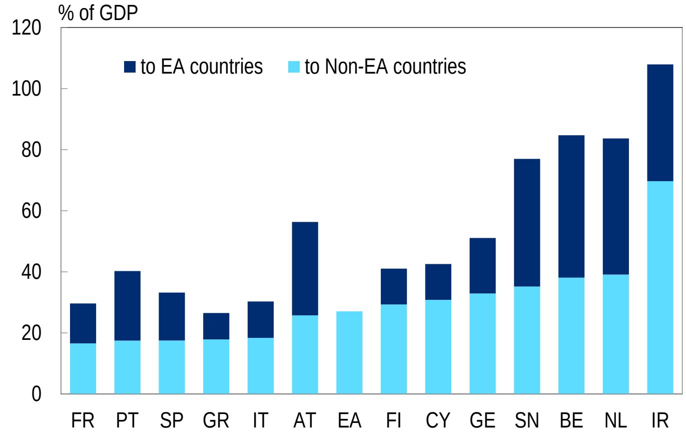
profits separately from its impact on export volumes, as firms probably will absorb the loss in cost competitiveness partly by a reduction in profit margins. This is most relevant for EA countries with many multinational businesses, such as Ireland, the Netherlands and Belgium. Sustained euro strength can persistently hurt business investment more generally, which is a concern given how weak EA business investment has been in recent years already.

Figure 7. Euro Area — Composition of GDP Growth (%QQ), 2010-2013



Note: In constant 2005 Euros.
Sources: Eurostat and Citi Research

Figure 8. EA Countries — Exports (% of GDP), 2013 Q2



Note: Ratio of 4Q sums of exports of goods and services and GDP in nominal euros.
Sources: Eurostat and Citi Research

Fifth, there is no evident sign that any of the drivers of euro appreciation that we pointed out above (low inflation, less loose relative monetary policy, current account surpluses and capital inflows) are abating, let alone reversing, meaning that the euro could appreciate yet more.[6]

Most EA countries are likely to be substantially affected by euro appreciation

Across the EA, the countries that are likely to have the most to lose from euro appreciation on the export side are those that are i) more open ii) have a high sensitivity of exports to the exchange rate, and iii) are more reliant on export growth (or conversely, where domestic demand is weakest). Ireland, the Netherlands and Belgium (and Germany among the larger economies) are the most open countries in the EA, measured by total exports or exports to non-EA countries relative to GDP, while France, Portugal, Spain, Greece and Italy do not export much to the non-EA world (see Figure 8). But many of the latter countries have disproportionately relied on (net) exports to support GDP growth in recent years. Export volumes are quite sensitive to real (effective ULC-deflated) exchange rate movements in all EA countries we consider, but France stands out in our estimations (see Figure 5). Notwithstanding the cross-country differences, in our view the commonalities are thus more relevant: virtually all EA countries appear to be relatively strongly affected by the euro appreciation according to at least one of the criteria.

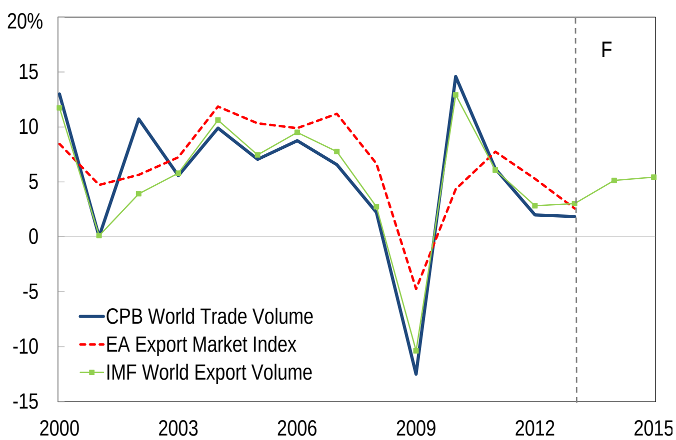
imports actually *fall* in response to a real euro appreciation, as the negative effects on output outweigh the expenditure switching effects of euro appreciation towards imports. See ECB (2008), op. cit.

[6] Euro appreciation could also have negative consequences through the financial account and the liability side of the EA's external balance sheet. A higher value of the euro may make euro nominal assets in particular less unattractive for foreign investors. In addition, the euro area is a net debtor in domestic currency and a net lender in foreign currency implying that a euro appreciation is associated with a capital loss.

A pickup in world GDP and trade growth will generally lift EA exports too

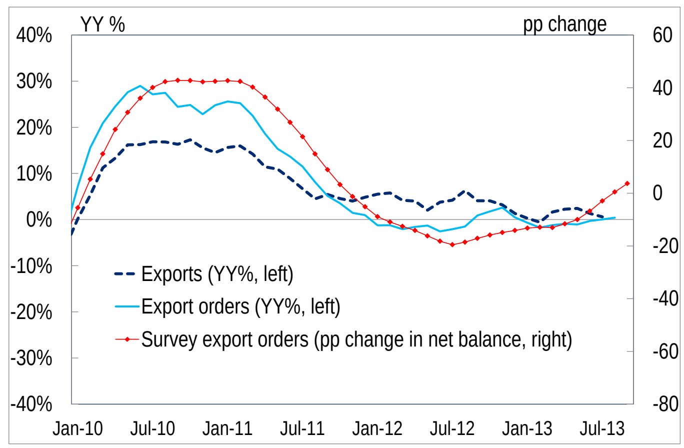
Given the reasons discussed above, it is perhaps surprising that EA policymakers have not focused more on exchange rate developments.[7] We think that there are three main reasons. First, the recent euro appreciation does not put its real value outside its historical norm. Second, EA policymakers are counting on a recovery in world trade to support EA exports. Indeed, the IMF expects growth in world trade to be 5-6% on average in 2014-18, up from 3% in 2013 (even though the available data suggests that world trade remains sluggish for now, see Figure 9). A rising tide in EA export markets should lift EA export boats (EA export volumes generally rise one-for-one with an increase in export markets in the long-run, ceteris paribus) and is also a major driver of our forecasts of positive EA export growth in coming years.

Figure 9. Selected EU Countries — World trade volume growth (%YY), 2000-2015F



Note: CPD data are for manufacturing exports only and 2013 is Jan-Aug average. EA export market index is the weighted average growth of real imports by the EA's main trading partners.
Sources: CPB, Eurostat, IMF and Citi Research

Figure 10. Euro Area — Growth in Exports and Export Orders (YoY Change of 3M averages), 2010 – 2013



Note: All series are for industrial exports only and expressed as 3M averages.
Sources: EC, Eurostat and Citi Research

Recent export orders data have improved, suggesting that export growth may in fact pick up in the near-term

Indeed, the latest high-frequency export data in the EA contain some encouraging signs. Exports have remained relatively sluggish at less than 1% YY growth in volume terms for goods exports in August. But industry export orders have been improving gradually and quite sharply according to the survey data (with six consecutive monthly increases up to October), suggesting that export growth could pick up somewhat in Q4. The improvement in export assessments has been broad-based, with increases in recent months in most EA countries and marked improvements in Belgium, France, Italy and Spain. But even after the recent improvements, the latest EU Commission survey show that export order books remain below long-term averages for the EA as a whole as well as most EA countries (but not for Germany, Italy and the Netherlands).

A strong euro also puts downward pressure on already-low EA inflation

Modest growth plus the direct effects of a strong currency will likely keep inflation in the EA well below the ECB's target for an extended period of time. The flash reading of EA HICP inflation for November came in at 0.7% YY, the lowest rate since November 2009, with core inflation (ex-energy, food, alcohol and tobacco) of 0.8% YY at the lowest YY% rate since the data started in 1997.[8] Estimates of the elasticity of consumer price inflation in the EA to the exchange rate suggest that a

[7] Even though that is now partly changing. See e.g. the comments by the Spanish Economy Ministry: http://www.mineco.gob.es/portal/site/mineco/menuitem.ac30f9268750bd56a0b0240e026041a0/?vgnextoid=c98a8e0af4902410VgnVCM1000001d04140aRCRD&vgnextchannel=864e154527515310VgnVCM1000001d04140aRCRD

[8] Core inflation in January-February 2010 was also at 0.8%YY.

10% nominal effective EA appreciation would lower HICP inflation by around 1pp over two years, and 1.5pp over three years.[9] Relative to the latest ECB Staff forecasts (from September, but which are based on exchange rates in the first half of August), the euro NEER has appreciated by 1.5%, translating into maybe a 0.15pp further downward push to inflation for 2014 (in September, the ECB expected 2014 HICP inflation to be 1.3%).

Why hasn't the ECB responded already?

The ECB has few formal constraints when it comes to reacting to foreign exchange developments

The possibly most important reason for the lack of policy action lies in the peculiarities of decision making in exchange rate matters in the euro area, in our view. The division of authority between the central bank and the Treasuries is rarely well specified.[10] The lack of a single EA Finance Minister actually leaves the ECB in a more powerful position as regards exchange rate matters than the Fed in the US, where the Treasury tends to take the lead on foreign exchange interventions.[11] The European Treaties are silent on the allocation of authority for foreign exchange interventions, but EA finance ministers reached an understanding in 1999-2000 to give the ECB 'sole competency' for deciding the timing, level and amount of foreign exchange intervention. The ECB subsequently used this authority when it intervened (to support the euro) in September and November 2000. While that understanding is presumably subject to revision at any stage and ECB actions are to be guided by its mandate for price stability, there are no formal barriers for the ECB to act on, let alone talk about, exchange rate developments, including but not limited to market intervention.

The ECB has treated the exchange rate mostly with benign neglect so far

A lack of consensus on the role of the exchange rate and about policy tools has probably contributed to the benign neglect

In its recent communications, the ECB has mostly treated the exchange rate with 'benign neglect'. ECB President Draghi and other ECB officials have noted on many occasions that the exchange rate is a major input into their monetary policy strategy, but have mostly carefully avoided commenting on the level of the exchange rate. The less loose relative monetary policy of the ECB (including the nearly 10pp of GDP reduction in the size of the ECB's balance sheet since Q2 2012) has likely been a major factor in the euro appreciation, suggesting that the exchange rate may not have played too prominent a role in recent monetary policy *decisions*, either.[12]

In our view, the benign neglect of the ECB has much to do with a lack of consensus within the ECB's Governing Council on the risks that exchange rate appreciation poses (or a consensus that risks are small) and a lack of consensus about which policy tools, if any, to use. The ECB also generally tries to avoid being seen as doing the governments' bidding amid (possibly exaggerated) concerns about threats to its independence. The return to positive GDP growth and some continued export growth has probably also made it easier for the ECB to be relaxed about the lack of agreement. But sustained euro appreciation is likely to increase the pressure for the ECB to react. The fact that euro appreciation will probably have adverse effects on most EA countries and that there is no formal need to negotiate with finance ministers should in principle make it easier for the ECB Governing Council to act.

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[9] See ECB (2008), op.cit.

[10] See also Henning (2006), "The External Policy of the Euro Area: Organizing for Foreign Exchange Intervention", Peterson Institute for International Economics

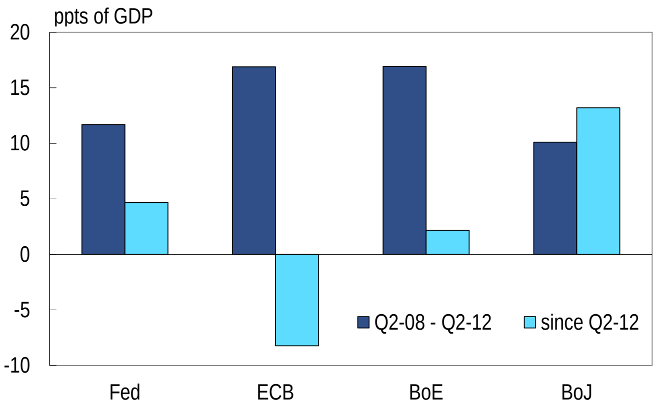
[11] The Fed has the authority to carry out FX interventions on its own initiative, but this is generally interpreted to apply only in exceptional circumstances, while it usually acts in an advisory fashion. The Bank of England does have the ability to intervene in foreign exchange markets for monetary policy purposes. See also http://www.bankofengland.co.uk/statistics/Pages/reserves/2013/jan/intro.aspx.

[12] Even though the ECB does not tire to emphasise that monetary policy remains highly accommodative (in an absolute sense).

Very low inflation also calls for ECB easing

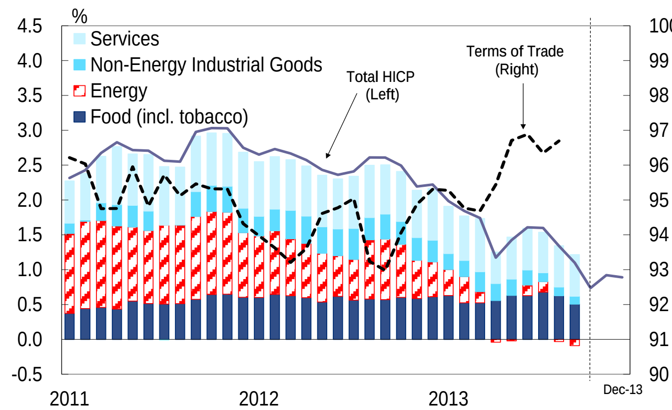
Given that inflation is now far below target, the direct price stability implications of the euro appreciation make further easing more likely. This is despite the fact that it would in general seem more appropriate for a central bank to 'look through' the first-round effects of the appreciation on inflation (as a positive terms of trade shock) and only react to the second-round effects (including the effect on inflation through widening output gaps). But the recent unexpected fall in EA inflation would probably call for further easing by itself.

Figure 11. Selected Countries — Change in Central Bank Balance Sheet Size (pp of GDP), 2008-Q3 13



Note: Total central bank assets as % of GDP.
Sources: Eurostat and Citi Research

Figure 12. Euro Area — HICP Inflation (%YY), 2011 – 2013F



Note: Terms of trade are the ratio of export prices over import prices.
Sources: Eurostat and Citi Research

We expect some 'open mouth operations' with respect to the exchange rate

That still leaves the question open of what tools to use. In the near-term, it seems likely that ECB officials will express a range of views on the exchange rate in an uncoordinated fashion and emphasise downside risks to inflation (and that the topic will be discussed at the GC meeting next week).[13] But we think that the ECB may break with its tradition of not commenting on the level of the exchange rate and use some measure of 'open mouth operations' with regard to the euro in due course.

The probability of a rate cut or non-standard measures has also increased

Such rhetorical statements are only likely to be effective if they are backed up by potential policy action. Both conventional and non-standard measures can be expected to have an effect on the exchange rate. In our view, the relative likelihood of a rate cut and non-standard measures depends on the perceived balance of risks from low inflation and euro appreciation versus (downside) financial stability risks. A cut in the refi rate while leaving the deposit rate unchanged (and thus narrowing the corridor between refi and deposit rate) may offer a 'cheap' and relatively riskless way for the ECB to signal that it means business with regard to appreciation and inflation/deflation concerns, and buy time to consider more effective measures. The probability of an eventual cut in the deposit rate has also risen, but given its higher perceived risks, it would probably only follow a cut in the refi rate and require more sustained real euro appreciation. The ECB will also continue to consider non-standard measures (we still expect another LTRO by Q1 2014), but a lack of funding pressure of periphery banks may tilt the balance of probabilities towards rate cuts over time. In any case, the November meeting will probably come too early for these decisions, while the December meeting (when the ECB will provide its forecasts for 2015 for the first time) is likely to be a more important event.

[13] See e.g. Reuters, "Nowotny says ECB has to live with strong euro", 29 October 2013

Key Economic Indicators (4 November – 8 November 2013)

During The Week		Forecast	Last
07:00	Germany: Insolvencies, Aug (by Nov 13)		
08:00	UK: Halifax House Prices, Oct		
Monday 4 November		**Forecast**	**Last**
09:00	Euro Area: Manufacturing PMI, Oct Final	51.3	51.1
09:30	Euro Area: Sentix Investor Confidence, Nov	5.0	6.1
	Italy: State Sector Borrowing Requirement, Oct YTD	€93 Billion	Jan-Oct 2012: €58.4 Billion
16:30	Ireland: Exchequer Return, Oct		
Tuesday 5 November		**Forecast**	**Last**
07:00	Sweden: Services PMI, Oct	53.1	53.3
08:00	Spain: Registered Unemployment, Oct	106K	26K
08:15	Switzerland: Consumer Prices, Oct		
08:30	Sweden: Services Production, Sep	0.2% MM	1.5% MM
09:30	UK: Services PMI, Oct	60.0	60.3
10:00	Euro Area: Industrial Producer Prices, Sep		
10:00	Euro Area: EU Commission’s Autumn Economic Forecasts		
Wednesday 6 November		**Forecast**	**Last**
08:30	Sweden: Riksbank Minutes		
09:00	Euro Area: Services PMI, Oct Final	50.9	52.2
	Composite PMI, Oct Final	51.5	52.2
09:30	UK: Industrial Production, Sep	1.2% MM, 2.5% YY	-1.1% MM, -1.5% YY
	Manufacturing Output, Sep	1.2% MM, 0.8% YY	-1.2% MM, -0.2% YY
10:00	Euro Area: Retail Sales, Sep	0.2% MM, 1.2% YY	0.7% MM, -0.5% YY
11:00	Germany: Incoming Orders, Sep	0.7% MM, 5.7% YY	-0.3% MM, 3.1% YY
Thursday 7 November		**Forecast**	**Last**
06:45	Switzerland: SECO Consumer Confidence, Oct		
08:00	Spain: Industrial Production, Sep	1.6% YY	-2.0% YY
08:30	Netherlands: Consumer Prices, Oct		
08:30	Sweden: House Prices, Oct		
09:00	Norway: Manufacturing Production, Sep	0.8% MM	-0.7% MM
11:00	Germany: Industrial Production, Sep	0.1% MM, 1.2% YY	1.4% MM, 0.1% YY
12:00	UK: MPC Outcome		
12:45	Euro Area: ECB Outcome (Press Conference at 13:30)		
Friday 8 November		**Forecast**	**Last**
06:45	Switzerland: Unemployment, Oct		
07:00	Sweden: Registered Unemployment Rate, Oct	4.5%	4.6%
07:00	Germany: Trade Balance, Sep		
07:45	France: Trade Balance, Se		
07:45	France: Industrial Production, Sep		
07:45	France: Industrial Investment Survey, Oct		
08:15	Switzerland: Retail Sales, Sep		
08:30	Netherlands: Industrial Production, Sep		
08:30	Sweden: Industrial Production, Sep	0.7% MM	-2.3% MM
09:30	UK: Trade Balance – Goods & Services, Sep	£-2.5 Billion	£-3.3 Billion
09:30	UK: Construction Output, Sep		
	Greece: Industrial Production, Sep		
	Greece: Consumer Prices, Oct		

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area			
Nov 4 09:00 London Time	*Manufacturing PMI, Oct Final*	Forecast: 51.3	Prior: 51.1
	The flash estimate showed the manufacturing PMI rose slightly in October, by around the same extent as the September decline. The index level remains in line with its long-term average, suggesting activity in the industrial sector will probably be expanding in 4Q, but at a fairly muted pace. Still subdued readings are likely to be recorded by periphery countries Italy and Spain, now that the manufacturing PMI has caught up with the levels in core countries.		
Nov 4 09:30 London Time	*Sentix Investor Confidence, Nov*	Forecast: 5.0	Prior: 6.1
	We expect a second consecutive decline for the Sentix investor confidence indicator in November (the index peaked at 6.5 in Sept). Current conditions probably eased for the first time in Nov, given that the recent data has surprised a little bit to the downside, suggesting modest growth in Q4-13 GDP. With respect to the expectations component, the stronger euro and some indications of slower global GDP growth probably argue for a small decline too.		
Nov 6 09:00 London Time London Time	*Services PMI, Oct F* *Composite PMI, Oct F*	Forecast: 50.9 Forecast: 51.5	Prior: 52.2 Prior: 52.2
	The flash estimate has already shown that the Oct services PMI has reversed most of the Sept gain. The composite PMI – which averages activity indicators for the manufacturing and the service sectors – also posted a decline (-0.7 points) in October, the first drop in seven months. We expect these readings to be confirmed in the final reports. This level of the composite PMI is consistent with modest quarterly GDP growth of around 0.2%-0.3%.		
Nov 6 10:00 London Time	*Retail Sales, Sep*	Forecast: 0.2% MM, 1.2% YY	Prior: 0.7% MM, -0.5% YY
	We forecast only a modest rise in retail spending in September, after two pretty strong readings in July and August. The annual rate is bound to increase sharply and move back into positive territory because of base effects. This would be the first positive reading in annual terms since April 2011.		
Germany			
Nov 6 11:00 London Time	*Incoming Orders, Sep*	Forecast: 0.7% MM, 5.7% YY	Prior: -0.3% MM, 3.1% YY
	In September, we expect incoming orders in Germany to register a significant increase, after two consecutive monthly falls. Both the assessment of orders and new incoming order components of the October ifo survey were positive, and would thus confirm the positive (if volatile) trend in German manufacturing orders.		
Nov 7 11:00 London Time	*Industrial Production, Sep*	Forecast: 0.1% MM, 1.2% YY	Prior: 1.4% MM, 0.1% YY
	After a fairly large increase in August, we expect industrial production in Germany to remain close to unchanged in September on a seasonally and working-day-adjusted basis. Survey indicators and incoming orders suggest a continued positive trend in industrial production.		
France			
Nov 8 07:45 London Time	*Industrial Production, Sep* *Manufacturing Production, Sep*	Forecast: % MM, % YY Forecast: % MM, % YY	Prior: % MM, % YY Prior: % MM, % YY
Italy			
Nov 4	*State Sector Borrowing Requirement, Oct*	Forecast: €93 Billion	Prior (Jan-Oct 2012): €58.4 Billion
	The October YTD state budget deficit will probably remain well above last year's levels. The sizable widening of the cash deficit lately has been mainly due to the reimbursements of government arrears, as well as the decision to suspend the payment of the very controversial property tax (IMU) in June. Moreover, several one-off borrowing-reducing measures were adopted in 2012 at the peak of market tensions. Yet the underlying trend in the government's budget balance is worsening, as the plans to tighten fiscal policy further in 2013 have been largely dismissed. We see some re-widening in the general government fiscal deficit in 2013, possibly exceeding the target of 3%.		
Spain			
Nov 5 08:00 London Time	*Registered Unemployment, Oct ('000)*	Forecast: 106 MM	Prior: 26 MM
	Registered unemployment usually rises in October, due to the ending of the labour-intensive holiday season. We estimate most of the expected MM increase to be driven by seasonal factors. Registered unemployment, however, has recently been less representative of the developments in the labour market than the labour force survey, due to changes in the criteria to access jobless claims and probably to the rising share of long-term unemployed (no longer eligible for jobless claims). Total unemployment (as measured by the labour force survey) stood at 5.9mln in 3Q 13, against 4.7mln jobless claimants.		
Nov 7 08:00 London Time	*Industrial Production, Sep*	Forecast: 1.6% YY	Prior: -2.0% YY
	Relatively feeble survey data (manufacturing PMI, business' assessment of industrial new orders and production trends) suggest industrial production probably was down by 0.1% MM in September, after a rise of 0.6% MM in August. All consistent with a modest rebound in industrial production in 3Q (amid real GDP growth of 0.1% QQ). A strong positive base effect from last year is likely to push the annual rate of industrial output higher in September (to 1.6% YY). Going forward business confidence indicators continue to improve suggesting industrial production may remain resilient in Q4.		

Economic Indicators

Sweden			
Nov 5 08:30 London Time	*PMI Services, Oct*	Forecast: 53.1	Prior: 53.3
	Service-sector PMI corrected lower in September following the nearly 12-point rise in July (the largest on record in the index's history), which was only marginally reversed in August. The series, however, is very volatile and one gets a more precise picture by looking at three-month moving averages. On this basis, the services PMI has hovered around 50 for the past year, and stood at 51.7 in Jun-Aug 2013 and 54.6 in Jul-Sep. Service sector sentiment according to NIER has increased steadily since late 2012, while the picture is mixed for the domestic sectors. Service production was weak in 2Q, but is expected to recover during the second half of the year.		
Nov 5 08:30 London Time	*Service Production, Sep*	Forecast: 0.2% MM	Prior: 1.5% MM
	Service sector production was weak in 2Q (-0.6% QQ), but has improved slightly heading into the third quarter (was 0.2% above the 2Q average in July and August combined). Hence, this confirms indications from survey indicators that growth is about to gear up in the service sector; the services PMI has now been above 50 for three consecutive months, with the three-month moving average reaching 54.6 in Jul-Sep – the highest since mid-2011. NIER service sector sentiment has improved steadily since late-2012.		
Nov 8 07:00 London Time	*Registered Unemployment Rate, Oct*	Forecast: 4.5%	Prior: 4.6%
	In line with the seasonal pattern, we expect the registered jobless rate to fall marginally in October. Weekly figures point in the same direction.		
Nov 8 08:30 London Time	*Industrial Production, Sep*	Forecast: 0.7% MM	Prior: -2.3% MM
	Industrial production was markedly weaker than expected in August, but growth in the previous month turned out somewhat stronger than suggested by the initial data. Hence, despite the massive downward surprise, momentum in Swedish industry is gradually improving; following a very weak first half of the year (1Q: -0.1% QQ, 2Q: -2.1% QQ), activity in the sector was 1.5% QQ above the 2Q average in July and August combined. Ahead, the well above-50 PMI readings in recent months, including the well-above 50 readings for the orders index as well as for the production index, point to ongoing recovery in industrial production. The NIER survey, meanwhile, has been somewhat choppy of late. On balance, we expect the manufacturing sector to recover gradually in the second half of the year, but it will be a bumpy road and some setbacks should be expected at times.		
Norway			
Nov 7 9:00 London Time	*Manufacturing Production, Sep*	Forecast: 0.8% MM	Prior: -0.7%MM
	Momentum remains strong in the manufacturing sector (i.e. excluding energy and mining); output increased 2.5% QQ in 2Q – the strongest quarterly gain in five years – and the July and August readings combined were 1.0% above the 2Q average. Manufacturing production, though, seems to have been running somewhat ahead of demand, which points to moderation in the near-term. That said, sentiment indicators have improved in recent months, albeit not being good guides to developments in actual production in recent years.		
United Kingdom			
Nov 5 09:30 London Time	*Services PMI, Oct*	Forecast: 60.0	Prior: 60.3
	The services PMI edged lower in September after eight consecutive gains – the longest run of improving figures since 2003. Nevertheless, the September figure remains very high (3rd highest since the survey began in the mid-90s) and hence a figure anywhere close to current levels would continue to indicate very strong growth.		
Nov 6 09:30 London Time	*Industrial Production, Sep* *Manufacturing Output, Sep*	Forecast: 1.2% MM, 2.5% YY Forecast: 1.2% MM, 0.8% YY	Prior: -1.1% MM, -1.5% YY Prior: -1.2% MM, -0.2% YY
	Surveys indicate that the trend in manufacturing output is buoyant and hence we expect that the decline in August will be reversed this month. A figure in line with our forecast would put manufacturing output up by 0.9% QQ in 3Q after the 0.8% gain in 2Q2.		
Nov 8 09:30 London Time	*Trade Balance – Goods & Services, Sep*	Forecast: £-2.5 Billion	Prior: £-3.3 Billion
	The trade deficit has been disappointingly wide in the last couple of months, reflecting weaker export figures. But, with surveys suggesting that export orders have improved sharply, we expect that the trade deficit will fall back this month.		

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

Key Economic Indicators (11 November – 15 November 2013)

		Forecast	Last
Monday 11 November		Forecast	Last
09:00	Italy: Industrial Production, Sep		
09:00	Norway: Consumer Prices, Oct		
	EU: EcoFin Meeting of EU-28 Finance Ministers on Budget		
Tuesday 12 November		Forecast	Last
00:01	UK: RICS House Price Survey, Oct		
07:00	Germany: HICP Final, Oct		
07:30	France: Bank of France Business Sentiment, Oct		
08:30	Sweden: Consumer Prices, Oct		
09:00	Italy: HICP, Oct Final		
09:30	UK: Producer Input Prices, Oct		
09:30	UK: Producer Output Prices, Oct		
09:30	UK: Consumer Prices, Oct		
	Retail Prices, Oct		
Wednesday 13 November		Forecast	Last
08:00	Spain: HICP, Oct Final		
08:30	Netherlands: Trade Balance, Sep		
08:30	Netherlands: Retail Sales, Sep		
09:30	UK: LFS Unemployment Jul-Sep		
	Claimant Count Unemployment, Oct		
09:30	Italy: General Government Debt, Sep		
10:00	Euro Area: Industrial Production, Sep		
10:30	UK: Bank of England's *Inflation Report*		
Thursday 14 November		Forecast	Last
06:30	France: GDP, 3Q Flash		
07:00	Germany: GDP, 3Q Flash		
07:45	France: Balance of Payments, Sep		
07:45	France: Consumer Prices, Oct		
07:45	France: Nonfarm Payrolls, 3Q		
08:15	Switzerland: Producer & Import Prices, Oct		
08:30	Sweden: Unemployment, Oct		
08:30	Netherlands: GDP, 3Q Flash		
09;00	Euro Area: ECB Monthly Bulletin		
09:00	Italy: GDP, 3Q Flash		
09:30	UK: Retail Sales, Oct		
10:00	Cyprus: GDP, 3Q Flash		
10:00	Portugal: GDP, 3Q Flash		
10:00	Euro Area: GDP, 3Q Flash		
	Greece: Unemployment Rate, Aug		
	Greece: GDP, 3Q		
14:00	Euro Area: Eurogroup Meeting of EA Finance Ministers (Brussels)		
Friday 15 November		Forecast	Last
	EU: EcoFin Meeting of EU-28 Finance Ministers (Brussels)		
09:00	Italy: Trade Balance, Sep		
09:00	Norway: Trade Balance, Oct		
10:00	Euro Area: HICP, Oct Final		
10:00	Italy: Current Account, Sep		

Sources: National statistical offices, central banks and Citi Research

Title	Author	Date
Euro Area – Sovereign Debt Crisis Update		
Euro Area Core Inflation Falls to Record-Low Levels	European Economics Team	Nov 1, 2013
ECB Will Offer Additional Liquidity, Nowotny Says	European Economics Team	Oct 31, 2013
ECB's Nowotny Sees No Need for Action on the Euro	European Economics Team	Oct 30, 2013
Dijsselbloem Calls for Reform of Fiscal Rules	European Economics Team	Oct 29, 2013
EU Council Kicks Banking Union Decisions to December	European Economics Team	Oct 28, 2013
Euro Area		
Euro Area - ECB AQR: More Detail, but not on Public Backstop	Ebrahim Rahbari	Oct 23, 2013
Euro Area - Under No Pressure to Act, ECB Stays Put and Gives Little Away	Guillaume Menuet	Oct 2, 2013
European Economic Forecast Highlights - October 2013	Ann O'Kelly	Sep 27, 2013
German Elections Outcome - Big Merkel Win, Grand Coalition Government Most Likely	Ebrahim Rahbari et al	Sep 23, 2013
German elections - Four More Years – A Multi-Asset View	Ebrahim Rahbari et al	Sep 12, 2013
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Euro Economics Weekly		
Italy and Spain Look Well Positioned For Job Growth	Guillaume Menuet	Oct 25, 2013
Portugal – What After June 2014?	Giada Giani	Oct 18, 2013
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Euro Area Recovery? Not Strong Enough	Giada Giani	Aug 16, 2013
What do the US Pickup and China Slowdown Mean for Euro Area Growth?	Ebrahim Rahbari	Aug 9, 2013
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German Exports — Down But Not Out	Ebrahim Rahbari	Jul 19, 2013
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Sweden - Broad-Based Recovery In Sentiment	Tina Mortensen	Oct 25, 2013
Norway - Hitting The Limits Of Growth Outperformance	Tina Mortensen	Oct 25, 2013
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Growth Dividend For The Public Finances	Michael Saunders	Oct 25, 2013
We Stick to 3% Growth Forecast for 2014	Michael Saunders	Oct 18, 2013
Why Is the UK Suddenly Doing So Well?	Michael Saunders	Oct 11, 2013
Fiscal Red Ink Receding	Michael Saunders	Oct 4, 2013
The Squeeze on Living Standards	Michael Saunders	Sep 27, 2013
Change to Rate View	Michael Saunders	Sep 20, 2013
Scenarios for the Jobless Rate	Michael Saunders	Sep 13, 2013

Source: Citi Research

Appendix A-1

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