Euro Economics Weekly

Portugal – What After June 2014?

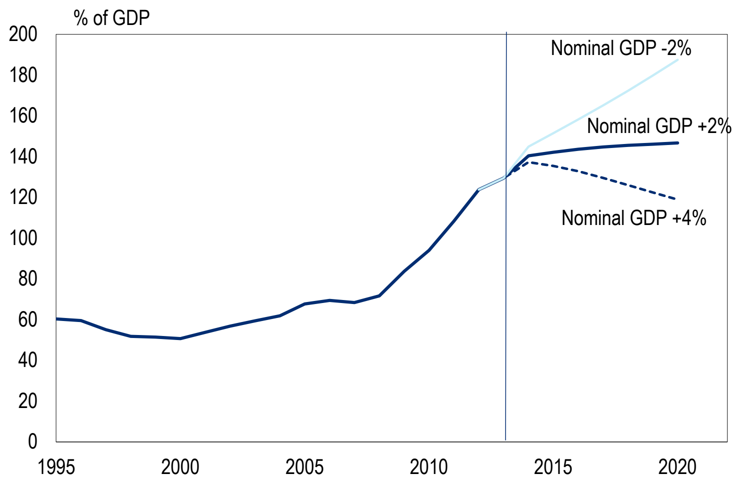
- The Portuguese bailout programme ends in June 2014 and it remains uncertain if Portugal will require additional help. Given the fiscal tightening still to come, on-going private deleveraging and ensuing poor nominal GDP growth prospects, doubts still exist about the sustainability of the Portuguese public debt in our view.

- Government financing needs over the 2014-2016 period are large, therefore we anticipate a precautionary credit line for Portugal will be agreed before June 2014. However, a second full bailout programme remains a clear risk in the event of market sentiment deteriorating. In any case, we think a Greek-style public debt restructuring unlikely in the near future, but a restructuring of some government contingent liabilities is still possible.

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	1.37	0.50	1.80	0.83	0.50	102	8.68	1.00	7.77	1.50	1.25	0.00	-85
2Q 14	1.36	0.50	1.80	0.82	0.50	127	8.85	1.00	7.70	1.50	1.25	0.00	-77

Figure 2. Portugal — General Government Debt (Pct. of GDP), 1995-2020F



Note: See Note 4 in the text for the assumptions used in these simulations
Sources: Eurostat, Haver Analytics and Citi Research

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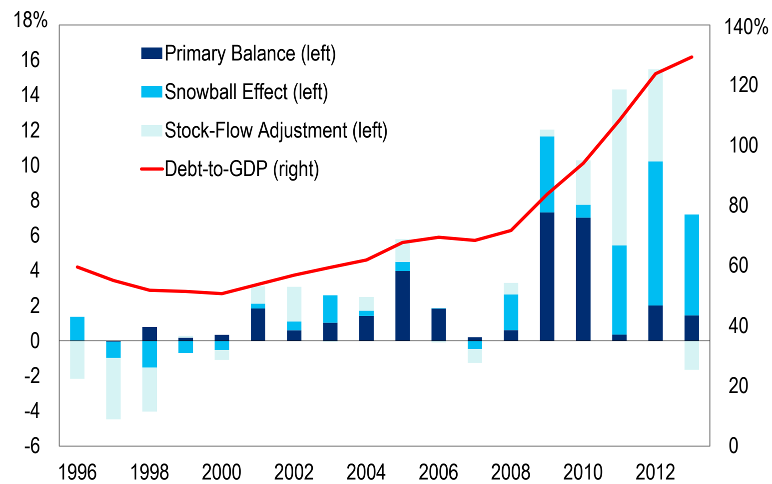
Portugal – What After June 2014?

We think public debt sustainability remains an unresolved issue ahead of the end of the bailout programme

Portugal is approaching the end of its bailout programme in June 2014. Whether the country will be able to navigate alone after that date, without the support of an IMF/EU financial lifeline and without sovereign debt restructuring, remains highly uncertain in our view. The economic adjustment — in its fiscal, private deleveraging and external components — is slowly progressing, but we think it remains far from complete. Crucially, major uncertainty remains around the future path of the government debt ratio due to poor nominal GDP growth prospects. However, the Portuguese government remains committed to programme implementation and this ensures some additional help could be made available by the other euro area member states either in the form of a precautionary credit line or as a full bailout package, if needed. We believe that some form of restructuring of government liabilities is likely before new help is agreed, but probably not of marketable debt securities.

Figure 3. Portugal — Government Debt Dynamics (Pct. of GDP), 1996-2013F



Sources: Eurostat, Haver Analytics and Citi Research

Market sentiment on Portugal has been significantly less supportive than on Ireland

To be sure, two and a half years after the bailout programme was initiated, Portugal has made quite some progress with respect to its main imbalances. We use Ireland as a comparison, since it is a similar-sized, equally bailed-out country, undergoing a comparable economic re-adjustment, but much closer to successfully exiting its programme (the Irish programme ends in December 2013). Despite some similarities, Ireland's government bond yields have been about 220pb lower than Portugal's this year, suggesting better hopes for a full return to sustainable market financing.

The fiscal adjustment

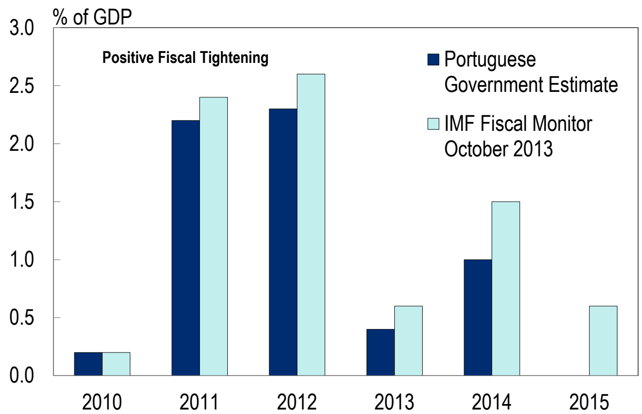
The process of rebalancing the Portuguese government accounts is probably only half way through

Portugal's government deficit has declined from around 10% of GDP in 2010 to around 6% of GDP this year[1], entailing a cumulative improvement in the structural balance of 5.5-6pp of GDP over four years (IMF Fiscal Monitor estimate). This is actually a bigger structural adjustment than Ireland's. Despite this, the general government gross debt-to-GDP ratio has continued climbing higher as a result of very negative "snowball effects" (capturing the difference between nominal GDP growth and the average cost of debt) and of large stock-flow adjustments (mainly bank recap costs and the realisation of contingent liabilities) (see Figure 3). The

[1] The updated government estimates in the 2014 Budget presented this week acknowledge the fiscal deficit will come at 5.9% of GDP in 2013, although extra revenues from a tax amnesty before year-end could lower the deficit below that level. We forecast a fiscal deficit of 6.0% of GDP.

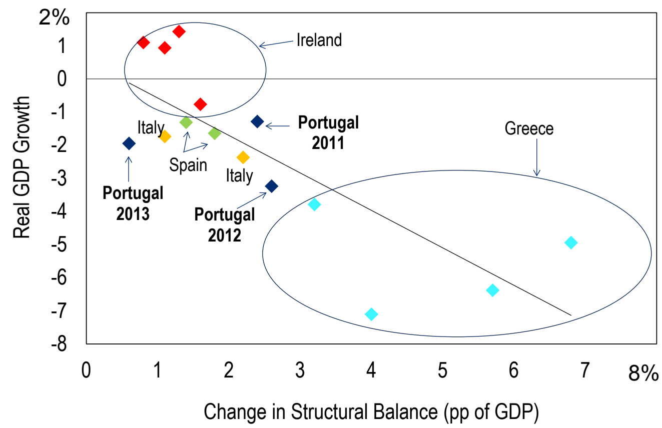
pace of debt-to-GDP increases is expected to slow down in 2013 thanks to privatisation revenues (worth some 2.5% of GDP). Overall, the debt increase in Portugal has not been significantly different from Ireland's over the last three years.

Figure 4. Portugal — Change in Structural Fiscal Balance, 2010-2015



Sources: Portuguese Treasury, IMF Fiscal Monitor October 2013, and Citi Research

Figure 5. Selected Euro Area Countries — Changes in Fiscal Policy And Real GDP Growth, 2010-2013



Sources: IMF Fiscal Monitor October 2013, Haver Analytics and Citi Research

2014 Budget envisages a step up in fiscal consolidation efforts…

However, with gross general government debt approaching 130% of GDP and a fiscal deficit at around 6% of GDP (or 4% in structural terms), additional fiscal tightening is needed in our view. Indeed, the 2014 Budget foresees that the size of fiscal tightening will increase again in 2014, after a meaningful slowdown in 2013. The 2014 Budget presented this week confirmed the fiscal deficit target of 4.0% of GDP for 2014, implying a structural improvement of 1.0% of GDP (more than double the structural improvement estimated for 2013, at 0.4pp of GDP). Note that the structural fiscal balance narrowed much more in 2011-12, by 2¼-2½pp of GDP each year (see Figure 4)[2]. In order to bring down the nominal deficit to 4% of GDP, the 2014 Budget encompasses budget-cutting measures worth €3.9bn, or 2.3% of GDP for next year.

…although some measures could still be ruled illegal by the Constitutional Court

We argue that the confirmation of a very ambitious 2014 deficit target, despite recently rising political fatigue around austerity, is aimed at re-affirming Portugal's commitment to fiscal rectitude and at fostering investors' confidence ahead of the planned return to market financing in 2014. However, we see clear risks that some of the budget measures could be challenged in front of the Constitutional Court in coming months and then declared illegal (as happened already in four recent cases). This would therefore reduce the overall size of budgetary cuts for 2014.

Despite previous fiscal tightening, fiscal sustainability remains dubious in our view …

Yet, fiscal sustainability remains dubious in our view. The Debt Sustainability Analysis (DSA) in the latest IMF Review (July 2013) finds that a combination of *"plausible shocks"* could make the Portuguese public debt unsustainable. This is partly because there are large amounts (larger than in other countries) of unrecognised contingent liabilities of the government, which may still lift the public debt ratio in coming years. The IMF DSA assumes a plausible shock equal to 15% of GDP from contingent liabilities. In our baseline scenario we assume that 9% of GDP in debt of state-owned enterprises (SOEs), currently still classified outside the general government, will migrate onto the government balance sheet in 2014.

[2] The IMF October 2013 Fiscal Monitor estimates the decline in the structural deficit to be 0.6pp of GDP in 2013, and of 1.5pp of GDP in 2014.

…mainly due to poor nominal GDP prospects

Moreover, Portugal needs both further budgetary adjustments and a marked acceleration in nominal GDP growth to return to fiscal sustainability. Fiscal tightening alone will not do the job in our view. A debt-to-GDP ratio well above 100% means that the debt-to-GDP trajectory becomes highly sensitive to slightly different assumptions on nominal GDP, much more so than to changes in the budget balance projections or interest rates.[3] This is because lower economic growth makes the "snowball effect" more negative and also causes a worsening in the fiscal balance.

Nominal GDP should return to pre-crisis growth rates to ensure a decline in the public debt ratio to 120% by 2020

Portuguese nominal GDP has fallen on average by an annualised rate of 2¼% since the inception of the programme in Q2 11 (-1.8% YY on average in H1 13). The front page chart shows some simulations to estimate the nominal GDP growth rate likely required to set the public debt ratio on a declining trend. We estimate that nominal GDP growth in 2014-2020 needs to recover to 3.5%-4% annually — that is the average growth in 2002-2007 — to bring the debt ratio down to 120% by 2020. If nominal GDP growth remains negative at -2%, the debt ratio would explode. In the intermediate scenario (close to our baseline) where nominal growth improves to -1% in 2013-14 and progressively to +2.0% by 2018, the debt ratio only stabilises at around 145-150% of GDP (see Figure 2 on the Front Page).[4]

Private Deleveraging and External Rebalancing

Fiscal austerity likely to remain a negative headwind on growth in 2014

It remains unclear to us how Portugal could quickly return to pre-crisis nominal growth rates given large headwinds from still-needed fiscal consolidation and ongoing private sector deleveraging. Fiscal drag is set to become more negative in 2014 relative to 2013, although probably less severe than in 2011-12 and perhaps also less severe than the recently-proposed 2014 Budget envisages. But with 86% of the planned budgetary measures being spending cuts (which usually have a more negative impact on short-term growth than equivalent tax increases), we estimate that a reduction in the structural deficit in the order of 1pp-1.5pp of GDP may reduce 2014 real GDP growth by at least 0.5-0.75pp (see Figure 5).

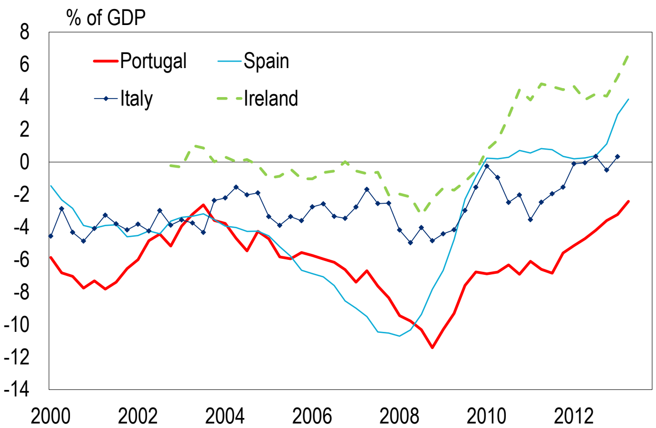
Household deleveraging is at a fairly advanced stage…

The process of private sector deleveraging is at a more advanced stage than the government's, especially in the household sector. Household debt as a percent of GDP is slowly coming off its peak, and the financial balance of the household sector is recording its largest surplus on record (4Q sum at 7.8% of GDP in Q2 13), mirroring a similarly large increase in the household saving rate (12.0% in Q2 13, up from a trough of 5% in 2008). The rise in the saving rate has exacerbated the negative impact of fiscal consolidation on private consumption in the past couple of years. Further increases in the saving rate are still possible, but given its historically high level, we reckon it is reasonable to expect consumer spending to move broadly in line with disposable income in coming quarters.

[3] According to the IMF DSA 400bp increase in the interest rate on all debt in 2013-15 has a similar effect on the debt ratio as a reduction in potential GDP growth of 1pp. Note that with 30% of the outstanding debt in official loans with low interest rate, a show of 400bp in the interest on all debt would entail a much larger shock on market rates.

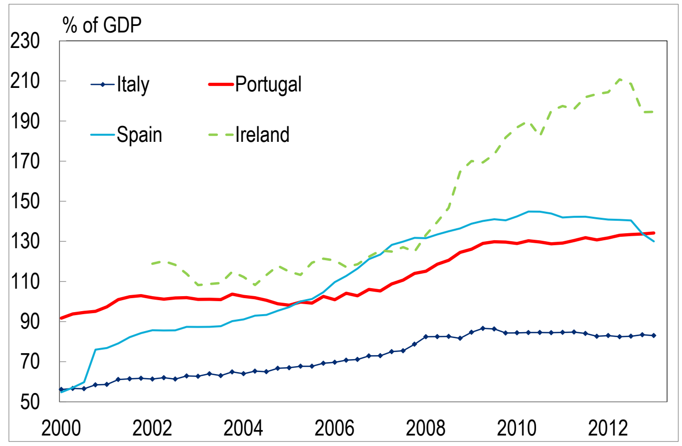
[4] In these simulations we use 2013 data as a fixed starting point (public debt estimated at 129.5% of GDP) and we apply shocks to nominal GDP between 2014 and 2020. We assume no additional fiscal measures are adopted beyond the 2014 Budget. We assume the headline fiscal balance responds to the output gap with an elasticity of 0.47. Under the high-growth scenario of +4% nominal GDP growth, we assume the output gap turns positive in 2015 (from -3.5% in 2013) and grows up to +3.0pp of GDP by 2020. Under the low-growth scenario of -2%, the output gap remains negative at around 3.5% of GDP until 2020. Under the intermediate scenario (nominal GDP growth rising to +2.0% by 2018), the output gap remains negative but it is slowly closing towards zero by 2020.

Figure 6. Selected Euro Area Countries — Non-Financial Corporations' Financial Balance (Pct. of GDP), 2000-Q2 2013



Sources: Eurostat, Haver Analytics and Citi Research

Figure 7. Selected Euro Area Countries — Non-Financial Corporations' Debt (Pct. of GDP), 2000-Q2 2013

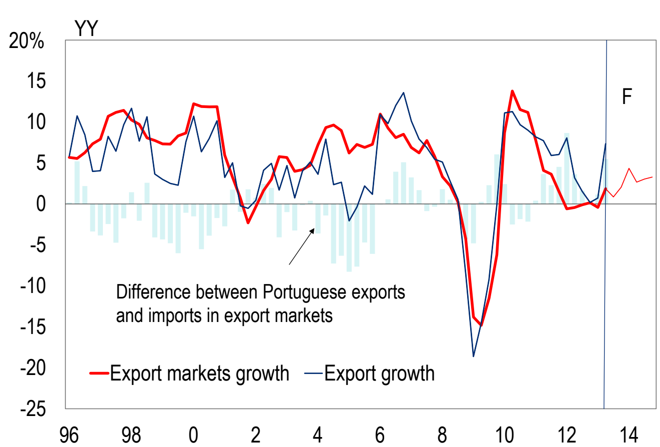


Note: Debt is defined as loans plus outstanding debt securities.
Sources: Eurostat, Haver Analytics and Citi Research

…while corporate deleveraging has not yet properly started

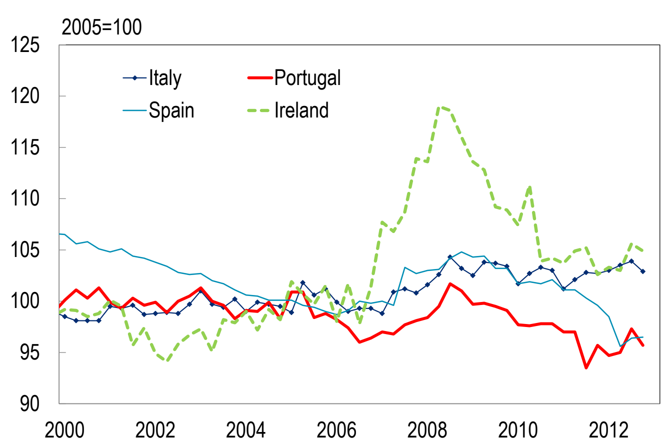
On the other hand, the corporate sector is not yet deleveraged, in contrast to other euro area, highly-indebted, countries (see Figures 6 and 7). The financial balance of non-financial corporations is still negative (-2.4% of GDP in the four quarters ending in Q2 13), albeit much less than it used to be (-10% of GDP in 2007). The non-financial corporate sector debt-to-GDP ratio is high and has not yet stabilised (134.2% of GDP in Q2 13). Hence we expect employment and investment growth to remain weak at least until the corporate financial balance moves into positive territory on a sustainable basis and the debt burden starts to diminish. Finally, domestic banks are also deleveraging (total banks' assets have fallen by 10% in the last 15 months), but their reliance on central bans liquidity remains high and, recently, trending higher (€51.6bn, or 9.9% of total assets, in Aug-13, up from €47.8bn or 8.7% of assets in Mar-13). We reckon private deleveraging is going to remain a major headwind on economic growth for the next few years.

Figure 8. Portugal — Exports and Export Markets Growth, 1996-2014F



Sources: Eurostat, Haver Analytics and Citi Research

Figure 9. Selected Euro Area Countries — CPI-Deflated Unit Labour Costs (2005=100), 2000-Q2 2013



Sources: Eurostat, Haver Analytics and Citi Research

Exports have been gaining market share…

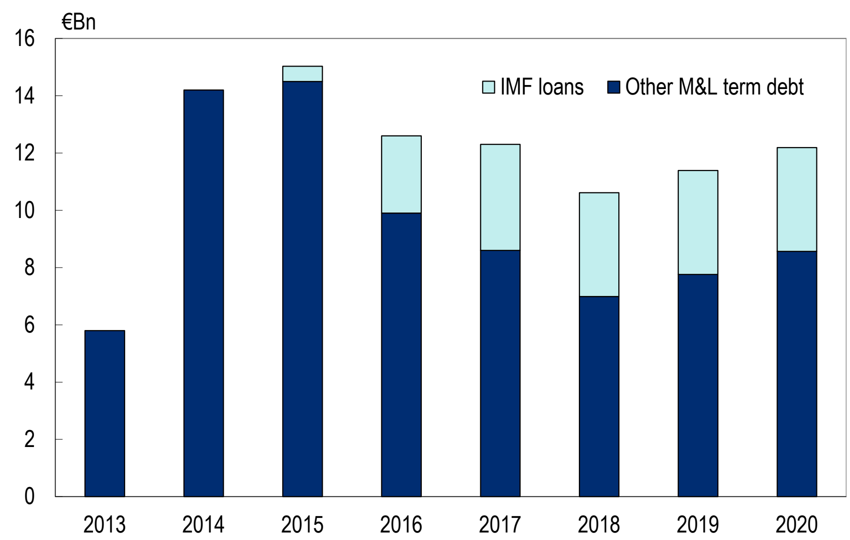
Many have argued that the best hope for an economic recovery in Portugal rest on external rebalancing, supported by competitiveness gains boosting Portuguese exports. The improvement in the current account position has indeed been remarkable — from -11% of GDP in 2009 to a small surplus in H1 13 — mainly driven by a narrower trade deficit in the goods sector. Exports (goods and services, real terms) have gained market share in foreign markets and import penetration has started to decline, validating the assumption of improved competitiveness of the productive sector driven by recent declines in unit labour costs (see Figures 8 and 9).

…but they are still too small as a share of GDP to completely offset domestic demand weakness

However, it remains uncertain what part of the Portuguese external adjustment is structural versus cyclical (i.e., due to cyclically weak imports). The net international investment position remains highly negative and has been still widening (-121% of GDP in H1 13), requiring a large permanent current account surplus (or much higher nominal GDP growth) to guarantee a stabilization in external net liabilities as percent of GDP. Moreover, exports remain small as a share of GDP relative to other small economies (exports represent 40% of GDP in Portugal, against shares above 80% in Belgium/the Netherlands and above 100% in Ireland). Finally, a striking difference with Ireland remains Portugal's relatively lower attractiveness of foreign direct investment (positive flows worth 4% of GDP in Portugal in 2011-12 against 15% of GDP in Ireland).

Large funding needs over the next three years

Figure 10. Portugal — Government Debt Repayment Schedule, 2013-2020



Sources: IMF, Portuguese Treasury and Citi Research

Recent supportive developments from better growth numbers

Aside from these medium-term considerations, market sentiment on Portugal has actually been fairly positive since the beginning of the year – with the exception of a bout of turbulence around the political turmoil in July. Economic data have been supportive: GDP rose in Q2 (+1.1% QQ) for the first time since 2010 and monthly data suggest that Q3 QQ GDP growth may also be marginally positive (but probably lower than in Q2). We think this is probably the result of the significant slowdown in the pace of fiscal tightening relative to last couple of years as well as of the sharp deceleration in inflation (from 3% in mid-2012 to 0.3% YY in Sept 13) which boosts real incomes and real spending. The cash position of the sovereign is also reportedly fairly good: the Portuguese Treasury is expecting cash reserves of

€11.1bn, or 6.7% of GDP, at the end of this year, although this includes €6.4bn of unused bank recap funds from the European rescue facilities.

Yet, challenges for next three years remain sizeable

However, redemptions of medium-long term debt will increase significantly from €5.8bn this year to €14.2bn in 2014, €15bn in 2015 and €12.6bn in 2016 (see Figure 10). Note, that the 7-year extension of the maturities of EFSF/EFSM loans agreed last June has removed a redemption hump in 2016.[5] In addition, we think the fiscal deficit will likely overshoot by at least €1-1.5bn per year the government's estimates for the next three years (current government projections are €6.7bn, €4.3bn, €2.1bn, for 2014, 2015 and 2016 respectively). In total, debt repayments and fiscal deficits will probably generate total financing needs over the period 2014-2016 of at least €55bn (34% of GDP), assuming the current outstanding amount of t-bills (€20.6bn in Aug-13) is entirely rolled over. And this is not taking into account any other financing needs from bank recaps or SOEs funding. The remaining EU/IMF funds of the current aid programme amount to €8.1bn and have to be disbursed by June 2014, leaving funding needs of around €47bn to be met from other sources.

More help needed, of what type?

We expect a precautionary credit line to be agreed for Portugal before June 2014, but a second full bailout programme remains a clear risk

That said, it seems quite likely to us that at least a precautionary credit line from the European rescue mechanism will be necessary to support Portugal over the next three years. An Enhanced Conditions Credit Line (ECCL) is the most likely option in our view, given the likely lack of eligibility for a Precautionary Conditioned Credit Line (PCCL).[6] But risks of a full second bailout programme are material, in our view, given still high costs of debt financing (not that far from the level of 7% on 10Y bonds when Portugal lost market access in 2011) and risks around budget implementation/economic growth. A negative ruling by the Constitutional Court on some important parts of the 2014 Budget could reduce significantly the budgetary adjustment planned for 2014 and obstruct much-needed structural reforms of the public administration system. This could be enough to undermine fragile market sentiment and derail plans to return to market funding. On the other hand, it remains uncertain what level of resistance a second fully-funded bailout programme for Portugal — assuming it is in the order of €50bn — would encounter in anti-bailout European Parliaments (eg, Germany, Netherlands or Finland). However, the recent EU/ECB/IMF statement on the 8th/9th review of the Portuguese programme clearly reaffirmed the euro area's commitment to *"support Portugal until full market access is regained"* noting that *"Portugal's culture of political and social dialogue remains an important asset to the programme."*[7]

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[5] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/137563.pdf

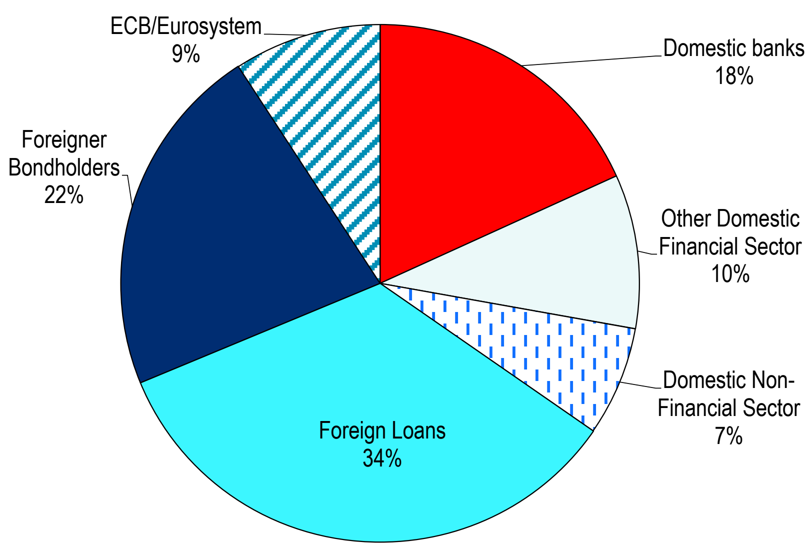
[6] A Precautionary Conditioned Credit Line (PCCL) is available for fundamentally sound countries as regards to debt sustainability, respecting the Stability and Growth Pact (SGP) and the excessive deficit procedure, track record of access to capital markets on reasonable terms, sustainable external position, and the absence of bank solvency problems. An Enhanced Conditions Credit Line (ECCL) is available to countries that do not comply with some of the eligibility criteria for PCCL. Under the PCCL the beneficiary country is obliged to adopt corrective measures aimed at addressing such weaknesses and avoiding any future difficulties in respect of access to market financing. Both credit lines can be drawn via a loan or primary market purchase and have an initial availability period of one year and are renewable twice, each time for six months. When precautionary financial assistance is granted, a MoU is concluded with the beneficiary ESM Member.

[7] http://europa.eu/rapid/press-release_MEMO-13-850_en.htm

We do not expect additional help to be accompanied by Greek-style public debt restructuring

Whichever official support instrument is eventually agreed, we believe this is unlikely to encompass private sector involvement (PSI) similar to the Greek PSI. This is firstly because the Greek PSI (and successive debt buyback) has failed to restore debt sustainability in Greece. Another sovereign debt restructuring could destabilise the currently benign market sentiment in the euro area and European policymakers would likely try hard to avoid this.[8] Second, the Portuguese debt is at 130% of GDP, while the Greek ratio was approaching 200% of GDP in 2012. Third, it is not that obvious that a debt restructuring of Portuguese government bonds would deliver public debt sustainability. Portuguese government bonds held by foreign investors amount to some €48bn, if one excludes around €20bn still held by the ECB/Eurosystem. This represents only 22% of total general government debt of €217bn in July 2013, implying that the savings to be made from a bail-in of foreign private creditors are rather limited (see Figure 11). In case of PSI, domestic bondholders — banks and other financial institutions — would probably require additional support from the state, reducing the overall benefits of the operation in terms of fiscal sustainability.[9] One final reason to avoid drastic actions before end of the current programme is probably also the desire to wait for the AQR, BSA and stress tests of the Portuguese banks to be completed in the autumn of 2014.

Figure 11. Portugal — Government Debt By Holders, Jul 13



Sources: Bank of Portugal and Citi Research

Political considerations will weigh in the decision to avoid meaningful debt restructuring measures for Portugal

To be sure, there probably still exists a trade-off between what makes economic sense in a medium-term horizon and the political implications of any action on sovereign debt in the current European context. We reckon a large PSI + OSI to reduce significantly the debt burden of the Portuguese government may be necessary to decisively restore fiscal sustainability and allow the economy to accelerate again. But these actions will likely spark major contagion effects

[8] Although this could have been because the total Greek debt restructuring (PSI + OSI) was done too late and on far too small a scale, and because there has been no face-value write-down in the OSI component.

[9] While we reckon the internal-external dimension is important, sovereign debt restructuring through PSI can be sensible even if it leads to the restructuring of systemically important private entities that have a concentrated exposure to the sovereign.

throughout the rest of the euro area and they would probably raise the risks of other sovereigns having to restructure their debt. We believe these political considerations, and the fact that, after all, providing additional support for Portugal involves a relatively small amount of resources, will prevail in the decision to be taken around the end of the Portuguese programme in H1 2014.

Some government contingent liabilities could still be restructured to lower financing needs/debt burden…

Nevertheless, this does not exclude some other form of restructuring of government liabilities before a new programme is signed. As we noted above, liabilities of state-owned enterprises are sizable (€48bn, according to Bank of Portugal data) of which €21.5bn are currently not included in the general government balance sheet. These liabilities could potentially be restructured before being eventually transferred onto the government balance sheet, in order to limit financing needs and/or avoid further large rises in the general government debt-to-GDP ratio. Equally, modifications to the terms of the debt held within the general government (€35bn) or the non-tradable part of the debt (€18bn, mainly saving certificates) could also be explored to reduce financing needs. Finally, an interest-payment-holiday period on official loans (similar to the one agreed for Greece) is also possible as it would contribute to reduce funding needs (official loans account for 1/3 of total public debt) and constitutes an NPV haircut.

...but these are unlikely to be enough to fully restore sustainability

Some of these restructuring measures could entail negative effects for domestic financial institutions (Portuguese banks have an exposure of 7.6% of their assets towards their sovereign), which may then require some additional capital needs. But these effects would probably have limited contagion effects outside of Portugal. On the other hand, we doubt these measures will be able to dispel all the doubts regarding future debt sustainability of the Portuguese government, hence allowing it to obtain full market access.

Political developments and possible rulings from the Constitutional Court will be key factors to determine the type of future assistance for Portugal

The type of future official assistance to be eventually agreed for Portugal will depend on the developments of the next few months. Eurogroup head Dijsselbloem said this week that the discussion on Portugal's programme exit will be initiated in Q1 2014. One crucial element will be played by Portuguese politics. Even after the increase in political fatigue around austerity and a government reshuffle following a government crisis in July, the Portuguese government remains committed to programme implementation and to the troika's requests. This provides an important support for Portuguese assets, as we believe risks of uncontrolled defaults or Portugal's exit from EMU are far more limited than they were, for example, in Greece in 2012. However, if political turbulence resumes — perhaps around possible further negative rulings by the Constitutional Court on some budget measures — it may easily derail fragile positive sentiment and jeopardise the planned return to market access in H1 2014. If this happens, a second bailout package with a greater weight on sovereign debt restructuring through OSI and PSI would become increasingly likely in our view.

Key Economic Indicators (21 October – 25 October 2013)

During The Week		Forecast	Last
Monday 21 October		**Forecast**	**Last**
07:00	Germany: Producer Prices, Sep	0.1% MM, -0.7% YY	-0.1% MM, -0.5% YY
09:00	Italy: Industrial Orders, Aug		
10:00	Euro Area: General Government Deficit and Debt, 2012 (2nd Notification)		
Tuesday 22 October		**Forecast**	**Last**
07:00	Switzerland: Trade Balance, Sep		
09:30	UK: Public Sector Net Borrowing – ex RM, APF & Fin. Intervention, Sep	£12.0 Billion	Year Ago: £12.1 Billion
	Fiscal Year to Date, Apr-Sep	£58.9 Billion	Year Ago: £62.6 Billion
Wednesday 23 October		**Forecast**	**Last**
07:45	France: Business Confidence, Oct	99	97
	Own-Company Production Outlook, Oct	9	13
08:30	Netherlands: Consumer Spending, Aug		
09:30	UK: MPC Minutes		
09:30	UK: BBA Mortgage Lending, Sep		
09:30	UK: BoE Agents' Summary of Business Conditions, Oct		
10:00	Euro Area: Quarterly Data on Government Debt, 2Q		
15:00	Euro Area: Consumer Confidence, Sep Flash	-14.4	-14.9
Thursday 24 October		**Forecast**	**Last**
	European Council, Brussels, Oct 24-25		
08:00	Spain: Unemployment Rate, 3Q	26.0%	26.3%
08:30	Sweden: Riksbank Interest Rate Decision	Unchanged at 1.00%	1.00%
09:00	Norway: Norges Bank Interest Rate Decision	Unchanged at 1.50%	1.50%
09:00	Italy: Consumer Confidence, Oct	101.6	101.1
09:00	Euro Area: Manufacturing PMI, Oct Flash	51.8	51.1
	Service PMI, Oct Flash	52.0	52.2
	Composite PMI, Oct Flash	52.5	52.2
10:00	Italy: Contractual Wages, Sep		
11:00	UK: CBI Industrial Trends Survey – Quarterly Industrial Confidence, Oct	+10%	Jul: +33%
	CBI Monthly Output Expectations, Oct	+30%	Sep: +33%
	CBI Monthly Order Books, Oct	+5%	Sep: +9%
	CBI Monthly Selling Prices, Oct	0%	Sep: +3%
17:00	France: Jobseekers – Net Change, Sep	30.0K	-50.0K
	Jobseekers, Sep	3,285.7K	3,235.7K
Friday 25 October		**Forecast**	**Last**
08:00	Spain: Producer Prices, Sep		
08:15	Sweden: Consumer Confidence, Oct	100.1	98.0
	Manufacturing Confidence, Oct	97.8	94.2
08:30	Sweden: Household Lending, Sep	4.9% YY	4.8% YY
08:30	Netherlands: Producer Confidence, Oct		
09:00	Italy: Retail Sales, Aug		
09:00	Germany: ifo Business Climate, Oct	106.9	107.7
09:00	Euro Area: M3, Sep		
09:30	UK: GDP Preliminary Estimate, 3Q	0.7% QQ, 1.5% YY	0.7% QQ, 1.3% YY
09:30	UK: Services Output, Aug	0.3% MM, 1.4% YY	0.2% MM, 1.8% YY
During the Weekend		**Forecast**	**Last**
	Europe & UK: Clocks put back one hour during the night of 26/27 October		

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area

Oct 23 15:00 London Time	***Consumer Confidence, Oct***	**Forecast: -14.4**	**Prior: -14.9**
	With households' unemployment expectations in September at their lowest level since mid-2011, we expect further gains for the aggregate consumer sentiment in the euro area. Reduced fiscal austerity and falling inflation have contributed to the improvement in consumer confidence. Country-wise, the largest gains have been witnessed by France, Spain, Italy and to some extent Portugal – among the countries which experienced the most significant slowdown in fiscal tightening relative to last year.		
Oct 24 09:00 London Time	***Manufacturing PMI, Oct Flash*** ***Services PM, Oct Flash*** ***Composite PMI, Oct Flash***	**Forecast: 51.8** **Forecast: 52.0** **Forecast: 52.5**	**Prior: 51.1** **Prior: 52.2** **Prior: 52.2**
	We expect a bounce-back in the manufacturing PMI, after a surprising decline in September. The service sector PMI is likely to go in the opposite direction in October, leaving the composite PMI up only marginally. The pace of increase in the composite PMI has slowed down since August, suggesting limited room for much acceleration in economic activity in 4Q 13.		

Germany

Oct 21 07:00 London Time	***Producer Prices, Sep***	**Forecast: 0.1% MM, -0.7% YY**	**Prior: -0.1% MM, -0.5% YY**
	Import prices are falling in year-on-year terms and we expect this trend to have continued in September. A strong euro and still-weak external conditions (weakening the price of intermediate goods imports) and contained cost pressure from energy costs and wages are the main contributors.		
Oct 25 09:00 London Time	***Ifo Business Climate, Oct***	**Forecast: 106.9**	**Prior: 107.7**
	We expect a slightly weaker reading for the ifo business climate in October. German sentiment readings continue to be robust, but both the composite PMI and the ZEW current conditions component have slightly weakened recently and the hard data have also been somewhat mixed. A slight increase in the ifo business climate index would still leave it more than almost one standard deviation above its long-term average		

France

Oct 23 07:45 London Time	***Business Confidence Indicator, Oct*** ***Own-Company Production Outlook, Oct***	**Forecast: 99** **Forecast: 9**	**Prior: 97** **Prior: 13**
	Business confidence is expected to have increased in October, reflecting a gradual improvement in the broader economy. We look for a two-point gain following an unexpected one-point drop in September. From an industrial sector and export perspective, the euro remains a headwind. The own production expectations series is where we expect some correction after the very large gain in September, although the indicator is likely to remain slightly higher than the long-run average.		
Oct 24 17:00 London Time	***Jobseekers – Net Change, Sep (000s)*** ***Jobseekers, Sep (000s)***	**Forecast: 30.0K** **Forecast: 3,285.7K**	**Prior: -50.0K** **Prior: 3,235.7K**
	Unemployment figures for September will likely show a sizeable increase of around 30K, unwinding a large proportion of August's erroneous compilation of jobless claims related to some failure in the reporting process. While economic activity is recovering modestly, we doubt that the strength of the rebound is sufficient to make sizeable dents in the jobless total, and that the unemployment rate will fall much before spring 2014.		

Italy

Oct 24 09:00 London Time	***Consumer Confidence, Oct***	**Forecast: 101.6**	**Prior: 101.1**
	Consumer confidence has been improving quite markedly since the beginning of the summer, mainly driven in our view by reduced fiscal austerity (two major tax payments in the summer were delayed) and falling inflation. We expect this trend to have continued in October, although a negative impact may have stemmed from the increase by 1pp in the VAT rate. Note that the current level of the index (0.6 standard deviations below its long-run average) is still probably consistent with marginally negative growth in private consumption.		

Spain

Oct 24 08:00 London Time	***Unemployment Rate, 3Q***	**Forecast: 26.0%**	**Prior: 26.3%**
	Monthly data on affiliations to the social security system suggest employment may have posted a quarterly gain in 3Q (by 0.1% QQ) – the second since 3Q 10 after 0.9% QQ in 2Q 13. This would be partly explained by seasonal factors, but also in adjusted terms the pace of job shedding probably eased further, reflecting a better-than-expected summer hiring season. Together with a falling labour force (partly driven by discouraged workers) the unemployment rate may have edged lower in 3Q. We think this does not mark a change in the underlying trend of the labour market. We expect the unemployment rate to rise to 27.4% in 2014.		

Norway

Oct 24 9:00 London Time	***Interest Rate Decision***	**Forecast: 1.50%**	**Prior: 1.50%**
	We expect Norges Bank to keep the key policy rate stable at 1.50% and to issue a relatively neutral statement. For sure, Norges Bank will note the substantial downside surprise in annual core inflation in September, which, on the face of it, indicates downside risks to the bank's near-term inflation forecasts. In turn, with one additional inflation release ahead of the December MPR, the outcome will prove very important for the Bank's inflation projections and conditional interest rate path. As of now, downside risks to the short-end of the rate path prevail, in our view; to be sure, we do not expect a rate cut, but rather that the timing of initial tightening will be postponed further. However, a weaker-than-expected NOK and a substantial downward revision of the Bank's mainland GDP forecasts in September should act partly as an offset.		

Economic Indicators

Sweden			
Oct 24 08:30 London Time	***Interest Rate Decision***	**Forecast: 1.00%**	**Prior: 1.00%**
	We expect a split Riksbank board (4:2) to leave the key policy rate unchanged at 1.0% and to confirm its conditional interest rate path from September, hence maintaining its near-term easing bias (a 16% probability of a near-term rate cut) and continuing to signal an initial interest rate hike in late-2014. A slightly lower 2013 GDP growth forecast, following the downward revision to actual 2Q GDP, and lower-than-expected inflation in August support such an outcome. We expect that financial stability considerations will continue to figure highly among the majority board, at least until the newly-announced tools become operational. In turn, we see a slight risk that the Central Bank could remove its downside bias given the recent re-acceleration in house prices. We only see minor changes to the Riksbank's economic forecasts in the October Monetary Policy Report.		
Oct 25 08:15 London Time	***Consumer Confidence, Oct***	**Forecast: 100.1**	**Prior: 98.0**
	Consumer sentiment fell moderately in September, and is now two points below its long-term average. House prices have recovered in recent quarters and some house price indicators suggest slight upward pressure in the housing market also ahead. At the same time, car sales were up 3.0% YY in September, the second consecutive gain, and the labour market continues to develop slightly more strongly than expected (both unemployment and employment, though, are still rising). Meanwhile, the equity market has, on average, moved sideways, so far in October and hence continues to stay close to the Oct-07 highs. On balance, this points to improving consumer confidence in October. Inflation expectations are low and fell in October following the September spike to 1.8% YY.		
Oct 25 08:15 London Time	***Manufacturing Confidence, Oct***	**Forecast: 97.8**	**Prior: 94.2**
	Following five consecutive months with above-50 and gradually increasing readings for the PMI (to 56.0 in September, the highest since mid-2011), we expect NIER manufacturing to recover in October (note, NIER sentiment tends to lag the PMI slightly). Ahead, we expect the manufacturing sector to gradually recover, but it will be a bumpy road and some setbacks should be expected in periods.		
Oct 25 08:30 London Time	***Household Lending, Sep***	**Forecast: 4.9% YY**	**Prior: 4.8% YY**
	Lending to households was stable at 4.8% YY in August, and is above the growth pace a year ago (4.5% YY). The largest part of households' loans consists of housing loans (63%), which in August had an annual growth rate of 5.1% (4.7% YY a year ago and down from 10.5% YY in early 2010). Given the rebound in the housing market (house prices have increased slightly over the past seven months), we see a clear risk that household lending could pick up further in the remainder of the year. Given the Riksbank majority board's focus on financial stability considerations, this clearly speaks in favour of stable rates ahead.		
United Kingdom			
Oct 22 09:30 London Time	***Public Sector Net Borrowing, Sep*** ***(Ex RM, APF and Financial Intervention)***	**Forecast: £12.0 Billion Deficit, £58.9 Billion Deficit Fiscal Year To Date** **Year Ago: £12.1 Billion Deficit, £62.6 Billion Deficit Fiscal Year To Date**	
	Over the first five months of the fiscal year, the underlying fiscal deficit has fallen by £3.7bn from last year, and it appears to heading for a sizeable undershoot versus the OBR's £120bn forecast. We expect the September deficit to be similar to a year ago, hence keeping the numbers on course for an undershoot. We will be looking closely to see if the marked improvement in the economy starts to feed through more clearly to revenues.		
Oct 24 11:00 London Time	***CBI Industrial Trends Survey, Oct***		
	Quarterly Industrial Confidence, Oct	**Forecast: +10%**	**Prior (Jul): +33%**
	Monthly Output Expectations Net Balance, Oct	**Forecast: +30%**	**Prior (Sep): +33%**
	Monthly Order Books Net Balance, Oct	**Forecast: +5%**	**Prior (Sep): +9%**
	Monthly Selling Prices Net Balance, Oct	**Forecast: +0%**	**Prior (Sep): +3%**
	Last month's figure showed a sharp improvement in order books and output expectations, with output expectations at their highest since 1995. We expect another month with strong underlying readings, but in recent years there has been a regular tendency for the October survey to weaken compared to the September one, possibly because of a larger sample for the quarterly survey. For example, the order books series has weakened in October in 14 of the past 15 years. Given that, it would not be a surprise if orders and output weaken a bit this month.		
Oct 25 09:30 London Time	***GDP, Q3 Preliminary Estimate***	**Provisional: 0.7% QQ, 1.5% YY**	**Prior: 0.7% QQ, 1.3% YY**
	Available data suggest that compared to the 2Q levels, industrial production in July-August rose by 0.6% while construction output rose by 2.0% and services output in July rose by 0.4%. Based on these readings and buoyant surveys for September, we expect the first release will show growth of 0.7%-0.8% QQ, although there is considerable uncertainty relating to the services data for August released at the same time.		
Oct 25 09:30 London Time	***Service Sector Output, Aug***	**Forecast: 0.3% MM, 1.4% YY**	**Prior: 0.2% MM, 1.8% YY**
	Surveys suggest that service sector output is growing strongly, although the ONS report that retail sales volumes fell back in August. We expect these data will show continued modest growth, consistent with fairly strong GDP growth but not as buoyant as surveys imply. There is an upside risk to our forecast in that the official data may catch up with the surveys at some point.		

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

Key Economic Indicators (28 October – 1 November 2013)

During The Week		**Forecast**	**Last**
07:00	Germany: Retail Sales, Sep (by Oct 31)		
07:00	Germany: Import Prices, Sep (by Oct 31)		
07:00	UK: Nationwide House Prices, Oct		
Monday 28 October		**Forecast**	**Last**
08:30	Sweden: Retail Sales, Sep		
09:00	Italy: Business Confidence, Oct		
11:00	UK: CBI Retail Survey, Oct		
Tuesday 29 October		**Forecast**	**Last**
07:00	Germany: GfK Consumer Confidence, Nov		
07:45	France: Consumer Confidence, Oct		
08:00	Spain: Retail Sales, Sep		
09:30	UK: Personal Borrowing, Sep		
	Spain: Budget Balance, Sep		
Wednesday 30 October		**Forecast**	**Last**
08:00	Switzerland: KOF Economic Barometer, Oct		
08:00	Spain: GDP, 3Q Flash		
08:00	Spain: HICP, Oct Flash		
08:55	Germany: Unemployment, Oct		
09:00	Norway: LFS Unemployment, Aug		
09:00	Norway: Retail Sales, Sep		
10:00	Euro Area: Business & Consumer Surveys, Oct		
13:00	Germany: HICP, Oct Flash		
14:00	Belgium: GDP, 3Q Flash		
18:00	US: FOMC Outcome		
Thursday 31 October		**Forecast**	**Last**
00:01	UK: GfK Consumer Confidence, Oct		
07:45	France: Consumer Spending, Sep		
07:45	France: Producer Prices, Sep		
09:00	Italy: Unemployment, Sep		
10:00	Italy: HICP, Oct Flash		
10:00	Euro Area: HICP, Oct Flash		
10:00	Euro Area: Unemployment, Sep		
11:00	Italy: Producer Prices, Sep		
11:00	Ireland: Unemployment Rate, Oct		
	Spain: Current Account, Aug		
	Greece: Retail Sales, Aug		
Friday 1 November		**Forecast**	**Last**
07:30	Sweden: Manufacturing PMI, Oct		
08:00	Norway: Manufacturing PMI, Oct		
09:00	Norway: Unemployment Rate, Oct		
09:00	Norway: Credit Indicator C2, Sep		
09:30	UK: Manufacturing PMI, Oct		
	Italy: Budget Balance, Oct		
During the Weekend		**Forecast**	**Last**
	North America: Clocks put back one hour during the night of 2/3 November		

Sources: National statistical offices, central banks and Citi Research

Title	Author	Date
Euro Area – Sovereign Debt Crisis Update		
SPD and CDU/CSU to Start Formal Coalition Talks	European Economics Team	Oct 18, 2013
Spain to Exit Programme by Year-End	European Economics Team	Oct 17, 2013
No Agreement on EA Common Bank Recap Facilities	European Economics Team	Oct 16, 2013
CDU and SPD Coalition Talks Still Without Breakthrough	European Economics Team	Oct 15, 2013
New Backstop Facility for Ailing Banks Under Scrutiny	European Economics Team	Oct 14, 2013
Euro Area		
Euro Area - Under No Pressure to Act, ECB Stays Put and Gives Little Away	Guillaume Menuet	Oct 2, 2013
European Economic Forecast Highlights - September 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
Euro Area - ECB Reiterates Forward Guidance, with Some Dovish Hints	Giada Giani	Sep 5, 2013
Euro Economics Weekly		
Will the ECB's Comprehensive Assessment of Banks be the Euro Area's TARP Moment?	Ebrahim Rahbari	Oct 11, 2013
Italy – Political and Banking Fragility	Giada Giani	Oct 4, 2013
New ECB LTRO? Not Like Waiting for Godot	Guillaume Menuet	Sep 27, 2013
Housing Not Yet Turning Around	Ebrahim Rahbari	Sep 20, 2013
Loan Dynamics: Renaissance by Year-End	Guillaume Menuet	Sep 13, 2013
Germany — Four More Years	Ebrahim Rahbari	Sep 6, 2013
Greece — More Drama, Fewer Systemic Risks	Giada Giani	Aug 30, 2013
Enhanced Forward Guidance, ECB-Style	Guillaume Menuet	Aug 23, 2013
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
Low(er) ECB Rates: For How Long?	Guillaume Menuet	Jul 26, 2013
German Exports — Down But Not Out	Ebrahim Rahbari	Jul 19, 2013
On Italy’s Fiscal Woes and Euro Area’s Dismal Labour Market	Giada Giani	Jul 12, 2013
France a Year On: How Much Progress?	Guillaume Menuet	Jul 5, 2013
Small steps towards banking union: the ECB should be pleased	Guillaume Menuet	Jun 28, 2013
Chief Economist Publications		
Global Economic Outlook and Strategy - September 2013	Willem Buiter	Sep 25, 2013
Scandi		
Scandi Economics Update	Tina Mortensen	Oct 18, 2013
Norway - Banks Expect Lending Margins To Narrow In 4Q	Tina Mortensen	Oct 17, 2013
Sweden - Riksbank Forecast: Stable Rates, Confirmation of Rate Path	Tina Mortensen	Oct 16, 2013
Switzerland		
Switzerland - Economy Continues to Grow Solidly	Michael Saunders	Sep 3, 2013
UK		
Retail Sales Show Buoyant Trend	Michael Saunders	Oct 17, 2013
UK - Buoyant Employment, Weak Productivity	Michael Saunders	Oct 16, 2013
UK - CPI inflation Stable at 2.7%	Michael Saunders	Oct 15, 2013
UK - Unexpected Weakness in Trade and IP	Michael Saunders	Oct 9, 2013
UK Economics Weekly		
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
Housing is Recovering, Not Bubbling	Michael Saunders	Sep 6, 2013
Assessing Vulnerabilities to the EM Slowdown	Michael Saunders	Aug 30, 2013

Source: Citi Research

Notes

Notes

Appendix A-1

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