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Western Europe

Euro Economics Weekly

Enhanced Forward Guidance, ECB-Style

- The euro area economy is recovering but we do not expect any meaningful acceleration because of persistent euro-area specific headwinds. Having dropped our long-held call for a 4Q-13 refi rate cut, we now look for unchanged rates at the September 5 ECB meeting (and beyond), penciling in a first hike in 4Q-16.
- We expect the Governing Council (GC) to ratchet up its forward guidance rhetoric and rely on additional non-standard measures to combat unwarranted increases in short-end rates. We believe that the ECB will object to the EONIA 1Y1Y rate, having risen above the 0.5% refi rate and will send a dovish signal to control this uptrend.
- While it will likely be difficult for the ECB to introduce some forward guidance benchmarks, we believe that some explicit reference to money and credit aggregates would be compatible with its monetary policy framework, as would a one-year extension to the horizon of ECB staff projections (from two to three years).

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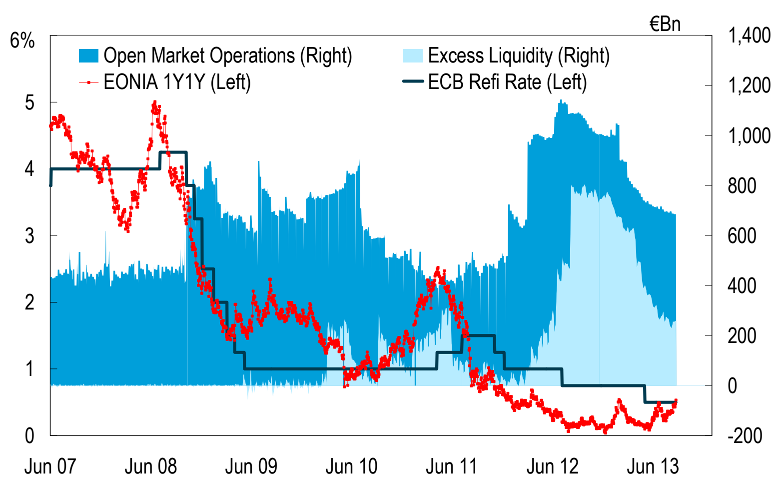
Figure 1. Citi Market Forecasts

	$/€	Euro Repo	10-yr Bunds	£/€	U.K. Bank Rate	10-yr Gilt-Bund	SKr/€	SEK Policy Rate	NOK/€	NOK Policy Rate	SFr/€	CHF Policy Rate	CHF Spread vs Bunds
4Q 13	1.33	0.50	1.70	0.87	0.50	102	8.88	1.00	7.96	1.50	1.25	0.00	-75
2Q 14	1.30	0.50	1.80	0.88	0.50	107	8.83	1.00	7.86	1.50	1.25	0.00	-77

Source: Citi Research

Figure 2. Euro Area — OMO, Excess Liquidity, EONIA 1Y1Y Forward Rate and ECB Refi Rate, Jul 2007-Aug 2013



Sources: European Central Bank, Bloomberg and Citi Research

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Enhanced Forward Guidance, ECB-Style

We no longer expect the ECB to cut interest rates in 4Q-13

The euro area economy is recovering, although we do not expect any meaningful acceleration in the pace of quarterly growth in 2014 compared to 2H-13, mainly because of persistent euro-area specific headwinds (private sector deleveraging, fiscal tightening, rising unemployment and a strong euro). Nevertheless, as part of the August Global Economic Outlook and Strategy, we dropped our long-held call for an ECB rate cut in 4Q-13. Instead, we expect the Governing Council (GC) to ratchet up its forward guidance rhetoric and rely on non-standard measures to combat unwarranted increases in short-end rates. We look for unchanged rates at the September 5 meeting (and beyond), and the re-iteration of the August forward guidance statement.

More arguments in favour of a low but stable refi rate

Our view change reflects a number of factors

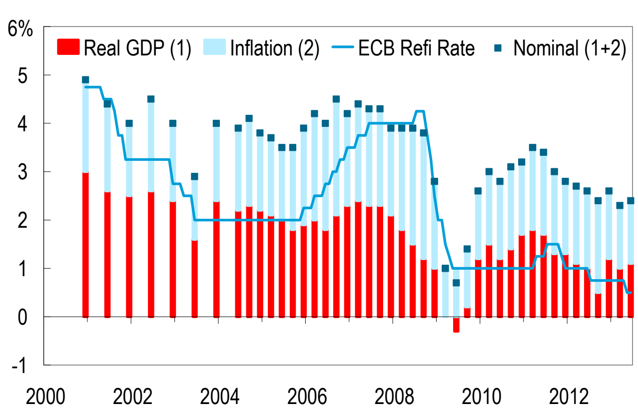
We no longer expect the ECB to cut the refi rate or deposit rate in our base case, although easing could come back on the agenda if financial conditions tighten abruptly or growth prospects worsen. Our view change reflects a number of factors:

- we expect that the new set of staff macroeconomic projections to be unveiled at the September 5 meeting will show a modest 0.1pp upward revision in the 2013 and 2014 GDP growth mid-points to -0.5% and +1.2%, respectively (Figure 3);
- we expect a change in the September assessment of the balance of risks to economic activity. Instead of the "*downside risks*" label that has been the norm since September 2011, the GC could adopt a "*balanced*" view instead;
- some stabilisation in inflation rates, and a probable end to the trend of downward revisions of the 2014 HICP mid-point (maintained at 1.3%), together with a slight upward drift in market-based and survey-based inflation measures (Figure 4);
- the growing unease of many central bankers about the already excessively low level of rates, and their explicit preference for having recourse to non-standard measures instead of a change in the main refi rate.

The debate about forward guidance and about the publication of minutes suggest a greater focus on the policy stance rather than the level of the policy rate

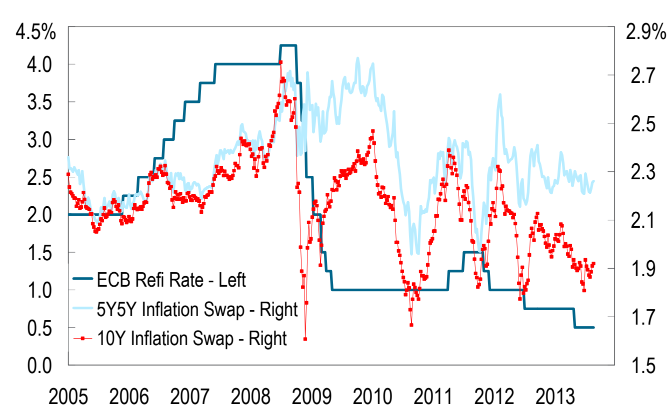
Separately, we believe that the discussion about enhanced forms of forward guidance, perhaps through the extension of the inflation forecast beyond the standard two-year-ahead period, illustrates some reluctance to rely on traditional tools when the refi rate is close to the zero bound. In addition, the debate about greater central bank transparency related to the more timely publication of minutes shows some desire for greater predictability of monetary policy.

Figure 3. Euro Area — Staff Macroeconomic Projections Two-Years Ahead, Dec-00-Jun-13



Sources: European Central Bank and Citi Research

Figure 4. Euro Area — Market-Based Measures of Inflation, Jan-05-Aug-13



Sources: Bloomberg and Citi Research

The September 5 meeting will likely see a decision to leave rates unchanged

Hence, we forecast unchanged ECB interest rates on September 5 and for the foreseeable future. With inflation set to remain comfortably below its "*less but close to 2%*" medium-term objective, the GC will likely reiterate that the monetary policy stance will continue to be "*geared towards maintaining the degree of monetary accommodation warranted by the outlook for price stability and promoting stable money market conditions*". In order to limit the risk of a further upward drift in money market rates related, among other things, to the reduced liquidity surplus, we expect the GC to maintain its forward guidance statement that it expects "*the key ECB interest rates to remain at present or <u>lower</u> levels for an extended period of time*" [our emphasis]. We believe that the ECB will object to the EONIA 1Y1Y rate having risen above the 0.5% refinancing rate and will send a dovish signal to control this uptrend.

Understanding the conditionality aspect of forward guidance

Forward guidance was introduced to lower market rates

By adopting forward guidance on 4 July, the ECB reacted to the fact that a large amount of monetary accommodation resulting from the 25bp May refinancing rate cut had been effectively withdrawn. Since the July ECB meeting short-end market interest rates (such as EONIA 1Y1Y) have risen by 22bp (see Figure 2 on the front page), suggesting that the GC will likely need to enhance its forward guidance framework and/or introduce additional non-standard measures to stop the uptrend.

The ECB will likely re-iterate its forward guidance message as long as the outlook for inflation remains subdued…

In a speech entitled "Forward guidance and the ECB"[1], chief economist Peter Praet reflected on the new framework as an "*indirect channel to engineer an easing of credit conditions, broadly defined, even though the level of the short-term rate remains constant*". By anchoring short-dated interest rates, the GC aims to provide the maximum degree of monetary policy accommodation. However, Mr Praet also stressed that the framework was conditional on the assessment of the outlook for price stability, suggesting that as long as the primary objective of the monetary policy strategy is met, the ECB would likely stand by its forward guidance.

…especially when credit and money growth are consistently unsupportive of consumption and investment

Mr Praet highlighted the need for a central bank devoted to price stability to distinguish clearly between episodes of falling inflation in conditions of surging productivity and a booming economy, and those of falling inflation when "*aggregate demand is persistently dragging, and credit and money growth are consistently unsupportive of households' consumption and firms' investment*". As long as the second scenario is relevant, and given the already very low level of the policy rate, we expect the GC to keep its forward guidance statement, clarifying its message to economic agents and imparting a sense of stability in the monetary policy stance.

Forward guidance also protects against idiosyncratic shocks

In conclusion to his speech, Mr Praet remarked that forward guidance "*ensures that our monetary policy stance is not excessively vulnerable to shocks that are disconnected from the underlying economic and monetary conditions in the euro area*". This comment suggests that the framework will likely stay in place for some time, although its re-statement might not be explicit beyond the next few meetings[2], assuming the market understands that it is valid until further notice.

But Buba's Weidmann made an explicit link between forward guidance and uncertainty

In its August monthly bulletin, the Bundesbank indicated that "*forward guidance does not rule out an increase in the benchmark rate if greater inflation pressure emerges*". Forward guidance is therefore not unconditional and cannot supersede the ECB's single mandate of preserving medium-term price stability, and therefore cannot change the bank's "*monetary policy action*". Mr Weidmann linked explicitly

[1] http://www.ecb.europa.eu/press/key/date/2013/html/sp130806.en.html

[2] President Draghi indicated during the August 2013 press conference that "*we may not repeat the words (on forward guidance) if we are convinced that you and the markets understand that, if we do not say anything, it does not mean that we have changed our mind*".

the use of forward guidance with the prevalence of "uncertainty", a situation which requires the GC to communicate its monetary policy stance more clearly. In our view, these comments suggest that forward guidance would probably be shelved relatively quickly in the event of some significant reduction in uncertainty, related to either economic activity or inflation prospects.

Enhancing forward guidance

We doubtful that the Governing Council would agree to introduce numerical targets or benchmarks…

Some commentators and investors have argued that the ECB should enhance its forward guidance framework by introducing some benchmarks to better anchor market rates. In our view, this is easier said than done in the case of the ECB. President Draghi was explicit in the last press conference, stipulating that "*with this* [strategic single inflation mandate] *framework, we did not discuss the introduction of thresholds or quantitative benchmarks*". In response to another guidance-related question, he added that "*parameters are not specified in quantitative terms as thresholds […] but they are expressed in qualitative terms*". We doubt that thresholds on unemployment or the output gap could be introduced anytime soon.

…but we see an intermediate solution to enhance forward guidance

Nevertheless, we believe that it would be possible for the ECB to make some explicit reference to money[3] and credit aggregates growing at a sufficient (to be determined) rate to alleviate concerns about their negative impact on aggregate demand. However, we believe that it will be very difficult for the ECB to commit to a timescale beyond its "extended period of time" reference, mainly because of the 'no pre-commitment' requirement of monetary policy if inflation were to surprise to the upside. While some intermediate thresholds could be eventually introduced (perhaps including some proxy for the output gap), there would likely be an explicit inflation knock-out in order to reference its primary inflation mandate.

A longer-dated inflation horizon could solve many problems

Another option would be for the GC to extend the horizon of staff macroeconomic projections by an extra year to a three-year horizon. This would amount to providing a more explicit timeframe. In practical terms, it would mean that at the December meeting, the furthest new mid-point for the inflation projection would refer to 2016 instead of 2015 under the current framework. We suspect that the mid-point would show a persistent inflation undershoot of the "less but close to 2%" level.

What could the ECB do to keep financing conditions supportive?

Additional non-standard measures could take the following form:

Beyond these potential enhancements in the forward guidance framework, the ECB could try to influence the amount of excess liquidity in the system or the market's perception of the likely amount of future excess liquidity by introducing additional non-standard measures such as:

- extending the guarantee to banks of fixed rate full access to funding beyond July 2014 to the end of February 2015 to match the maturity of the second 3-year LTRO. This would amount to a significant step in the provision of abundant liquidity, in our view;

- more VLTROs (possibly specifically designed to foster lending to SMEs), helping address the problem of persistently negative private sector loans growth rates. A new facility could for instance be launched to coincide with the publication of results from the ECB Asset Quality Review and the subsequent stress tests to be conducted in the autumn of 2014. Another VLTRO could also be offered before the expiry of the two 3-year LTROs on 29 January and 26 February 2015;

[3] In the early days of the ECB and until 2003, its two-pillar approach was using a 4.5% reference value for the M3 broad money aggregate.

- ending the sterilisation of direct purchases (currently €192.5bn) made through the SMP programme. While such a decision would likely have only a limited direct impact on market rates, we would expect its signaling effect to be more significant as it would imply a change in previous ECB rhetoric despite some likely significant resistance from some GC members.

A refinancing rate cut and outright purchases could be a last resort

There would always be the option of an ECB refinancing rate cut, if all other measures had failed, and the last resort of outright purchases (outside of the OMT framework), if the GC felt the need to tackle the risk of worrying deflation dynamics, encompassing longer-dated bonds.

Improving transparency

The timely publication of minutes of Governing Council meeting would be another option

In addition to discussing non-standard measures, and getting to grips with its forward guidance framework, the ECB is mulling over changes to its communication policy. One of these focuses on the publication of minutes to provide according to President Draghi "*a richer communication of the rationale behind its decisions*". Because the euro area is a multiple member state construct, it will be crucial for any changes to protect the independence of GC members, who are required to act in their personal capacity, not as representatives of their own country. In this respect, it was important to hear that Bundesbank President Jens Weidmann was the last central banker to support the timely publication of minutes from GC meetings. Nevertheless, he reiterated the need to manage the risk that their publication may *"hinder free discussion"* presumably by restricting the content to the main lines of arguments[4], and most likely by avoiding any references to the name of central bank governors.

But disclosing the voting records of each Governing Council member might be a step too far

In a similar vein, we doubt that a voting record disclosing the names of central bank governors would be acceptable to all members, despite some explicit support from Executive Board Member Joerg Asmussen. A compromise could be the publication of the splits between those in favour, those against and those who abstained. Nevertheless, we agree with some of the arguments expressed against disclosing central bankers' individual voting records[5]. While their status as representatives of a euro area institution should ensure their independence from a national bias, too much transparency could create some issues, not only from a financial market standpoint in the form of higher volatility, but also politically — it would, in our view, increase the risk of some politicians thinking that they could hold some sway over 'their' man in Frankfurt.

We would expect a formal decision to publish minutes to be taken before year-end, perhaps as early as October once the exact modalities have been agreed

The Executive Board of the ECB indicated that it would present a proposal in the autumn, perhaps only in October given the need for more time to reach a consensus on the modalities. We suspect that an announcement on the publication of minutes could be made during any of the mid-month ECB GC meetings since the issue is not directly related to monetary policy and interest rate decisions.

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[4] This would help give a better account of the reasoning behind the decisions

[5] Bloomberg on August 1 2013 made reference to the fact that Governing Council member Ewald Nowotny, head of Austria's central bank, said last year he is wary of publishing minutes soon after the meetings as it may prompt governors to act more in their own national interest.

Conclusions

Better data points to no rate cut, unless financial conditions deteriorate rapidly

In light of the better 2Q GDP and the gradual improvement in the flash August PMIs[6], we believe that the ECB will not cut interest rates unless financial conditions deteriorate rapidly (significant euro effective exchange rate appreciation, contagion from US bond market sell-off) and/or its assessment of the recovery were to be challenged by a sudden collapse in external demand forecasts.

Some enhanced form of forward guidance will probably be required to combat the upward drift in short-end market rates

We believe that there are many options available to the ECB to anchor short-term market rates at a low level to provide maximum accommodation for an extended period of time, even within the strict boundaries of its inflation targeting framework. Enhancing its forward guidance will not be straight forward and will likely require some debating within the GC, but the ECB has shown in the past that its reaction function can evolve when circumstances demand it.

We forecast the refinancing rate to remain at a record low for an extended period of time, probably until 4Q-16.

The euro area is lagging its US and UK peers with respect to medium-term recovery prospects. An extended period of very low rates will be the outcome of a slowly shrinking output gap and contained inflation pressures. We continue to put the timing of the first ECB rate hike around 4Q-16, more than three years from now. The refinancing rate would likely follow a very gradual upward trajectory over the forecast horizon, reaching 1% by the end of 2017.

[6] The composite euro area flash PMI surprised to the upside, with a 1.2-point gain to 51.7, comfortably exceeding the 50.9 consensus. This fourth successive uptick already means that the 3Q average will likely show a sizeable 2.7 point increase versus 2Q-13, pointing to some acceleration in GDP growth.

Key Economic Indicators (26 August — 30 August 2013)

During The Week		Forecast	Last
07:00	UK: Nationwide House Prices, Aug		
Monday 26 August		**Forecast**	**Last**
08:00	Spain: Producer Prices, Jul		
08:30	Sweden: Producer & Import Prices, Jul		
	UK: Bank Holiday		
Tuesday 27 August		**Forecast**	**Last**
08:30	Sweden: Household Lending, Jul	4.7% YY	4.7% YY
08:30	Netherlands: Producer Confidence, Aug		
09:00	Germany: ifo Business Climate, Aug	106.8	106.2
17:00	France: Jobseekers — Net Change, Jul	25K	14.9K
	Jobseekers – Total	3,304.4K	3,279.4K
Wednesday 28 August		**Forecast**	**Last**
07:00	Germany: GfK Consumer Confidence, Sep		
07:00	Germany: Import Prices, Jul	0.7% MM, -2.1% YY	-0.8% MM, -2.2% YY
08:00	Sweden: Consumer Confidence, Aug	100.5	100.3
08:00	Sweden: Manufacturing Confidence, Aug	95.2	93.8
09:00	Italy: Retail Sales, Jun		
09:00	Euro Area: M3, Jul	2.0% YY, 2.1% 3-M YY	2.3% YY, 2.8% 3-M YY
11:00	UK: CBI Reported Sales, Aug		
c. 12:00	UK: Mark Carney gives first on-the-record speech as Bank of England Governor – Derby & Nottinghamshire Chamber of Commerce, Nottingham		
Thursday 29 August		**Forecast**	**Last**
07:45	France: Business Confidence, Aug	97	95
	Own-Company Production Outlook, Aug	5	1
07:45	France: Quarterly Survey of Industrial Investment, Jul	-2%	-4%
08:00	Spain: GDP Details, 2Q	-0.1% QQ	-0.5% QQ
08:00	Spain: HICP Flash Estimate, Aug	1.6% YY	1.9% YY
08:15	Switzerland: Unemployment, 2Q		
08:15	Switzerland: National Accounts, 2012		
08:30	Sweden: Retail Sales, Jul	0.2% MM	0.6% MM
08:55	Germany: Unemployment, Aug	5K MM	-7K MM
09:00	Italy: Consumer Confidence, Aug	97.8	97.3
10:00	Italy: Business Confidence, Aug	93.1	91.7
10:00	Italy: Contractual Wages, Jul		
11:00	Ireland: Retail Sales, Jul		
13:00	Germany: HICP, Aug Preliminary	0.2% MM, 1.8% YY	0.5% MM, 1.9% YY
	National CPI, Aug Preliminary	0.2% MM, 1.8%YY	0.4% MM, 1.9% YY
Friday 30 August		**Forecast**	**Last**
00:01	UK: GfK Consumer Confidence, Aug		
07:00	Germany: Retail Sales, Jul	1.1% MM	-0.8% MM
08:00	Switzerland: KOF Economic Barometer, Aug		
08:00	Spain: Retail Sales, Jul	-5.1% YY	-5.0% YY
09:00	Norway: Retail Sales, Jul	0.3% MM	-0.2% MM
09:00	Norway: LFS Unemployment Rate, Jun	3.5%	3.4%
09:00	Norway: Registered Unemployment Rate, Aug	2.7%	2.8%
09:00	Italy: Unemployment Rate, Jul	12.1%	12.1%
09:30	UK: Personal Borrowing, Jul		
09:30	Slovenia: GDP, 2Q	-0.2% QQ, -2.5% SWDA	-0.7% QQ, -3.3% YY SWDA
10:00	Italy: HICP Flash Estimate, Aug	1.1% YY	1.2% YY
10:00	Euro Area: Unemployment Rate, Jul	12.1%	12.1%
10:00	Euro Area: HICP Flash Estimate, Aug	1.3% YY	1.6% YY
10:00	Euro Area: Economic Sentiment, Aug	93.2	92.5
11:00	Italy: Producer Prices, Jul		
	Spain: Budget Balance, Jul YTD	€-44 Billion	€-40 Billion
	Greece: Retail Sales, Jun		

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area			
Aug 28 09:00 London Time	***M3, Jul***	**Forecast: 2.0% YY, 2.1% 3-M YY**	**Prior: 2.3% YY, 2.8% 3-M YY**
	The weakening trend in the annual growth rate of M3 likely continued in July. This reflects the recent acceleration in the pace of contraction in credit to the non-financial private sector, which dropped to -3.2% YY in June from -3.1% in May and -2.3% YY in Dec-12. Loans to businesses are still mainly driving the overall decline in credit flows, but households' new loans have also turned negative in the past couple of months.		
Aug 30 10:00 London Time	***Unemployment Rate, Jul***	**Forecast: 12.1%**	**Prior: 12.1%**
	The July unemployment rate remained unchanged for the fourth consecutive month at the record-high level of 12.1%. The recent stabilisation is likely to be temporary in our view, reflecting positive seasonal hiring in Mediterranean countries, rather than an underlying improvement in the labour market. We expect the unemployment rate to resume rising in 4Q.		
Aug 30 10:00 London Time	***HICP, Aug P***	**Forecast: 1.3% YY**	**Prior: 1.6% YY**
	Inflation probably dropped back to 1.3% in August, the lowest level since the April trough of 1.2%, after temporarily rising to 1.6% YY in June-July. Further favourable base effects in the energy component explain most of the decline in the headline YY rate. Core inflation was probably unchanged at 1.3% YY in August – the same level as the previous three months.		
Aug 30 10:00 London Time	***Economic Sentiment, Aug***	**Forecast: 93.2**	**Prior: 92.5**
	Economic sentiment likely posted another gain in August, although perhaps a smaller one than in the previous three months. Both industrial and consumer confidence indices likely edged higher. Although both indices remain slightly below their long-run average, the recent gains have brought them fairly close to it, suggesting GDP growth could be settling at just slightly positive rates of expansion in H2.		
Germany			
Aug 27 09:00 London Time	***Ifo Business Climate, Aug***	**Forecast: 106.8**	**Prior: 106.2**
	We expect a second successive uptick in the ifo Business Climate index in Germany in August. Fairly strong data, in particular for industrial production and signs of a bottoming of the economic cycle in the eurozone economy have boosted sentiment for German business, while euro strength and fading momentum in EM export markets is still limiting the improvement.		
Aug 28 07:00 London Time	***Import Prices, Jul***	**Forecast: 0.7% MM, -2.1% YY**	**Prior: -0.8% MM, -2.2% YY**
	We expect German import prices in July to rise, but mostly due to seasonal effects, leaving the year-on-year decrease roughly unchanged. Continued euro strength and the lack of weakness in the prices of exports by other euro area countries contain the upward pressure on import prices. However, recent oil price increases mean that the downward impact of commodity prices is moderating.		
Aug 29 08:55 London Time	***Unemployment, Aug***	**Forecast: 5K MM**	**Prior: -7K MM**
	The German labour market is 'stagnant' as the Bundesbank noted recently and we expect unemployment in August to remain almost flat on the month, leaving the unemployment rate at 6.8% (national definition) where it has remained since April. Relatively large pay increases and rising immigration should put upward pressure on joblessness trends, but are mostly matched by robust domestic demand and strengthening momentum in investment and exports.		
Aug 29 13:00 London Time	***HICP, Aug Preliminary*** ***National CPI, Aug Preliminary***	**Forecast: 0.2% MM, 1.8% YY** **Forecast: 0.2% MM, 1.8% YY**	**Prior: 0.5% MM, 1.9% YY** **Prior: 0.4% MM, 1.9% YY**
	We expect German inflation to tick down slightly to a 1.8%YY rate for both the national and the HICP version. Food prices are still rising very fast, but the rate of growth should stop rising. Meanwhile, core inflation has been rising since April after having fallen for the six months prior to that. We expect the rise in core inflation to continue in coming months, as wages continue to increase and boost household spending.		
Aug 30 07:00 London Time	***Retail Sales, Jul***	**Forecast: 1.1% MM**	**Prior: -0.8% MM**
	After a fall in June, we expect a sizable increase in German retail sales in July. Consumer confidence indicators have continued for around six months and are now firmly above long-term averages, while unemployment expectations have fallen and price trends have remained very contained.		
France			
Aug 27 17:00 London Time	***Jobseekers – Net Change, Jul (000s)*** ***Jobseekers, Jul (000s)***	**Forecast: 25K** **Forecast: 3,304.4K**	**Prior: 14.9K** **Prior: 3,279.4K**
	The second quarter saw a significant slowdown in the rising trend of jobseekers, with around 55K added to the registry compared to almost 100K in 1Q-13. In light of the recent deterioration in employment expectations measures, particularly from the Banque de France survey, we expect that the total number of jobseekers will increase again in July, by some 30K, close to the 35K average seen in the first four months of 2013. The government is focusing its efforts on increasing the number of subsidized jobs contracts from September onwards.		
Aug 29 07:45 London Time	***Business Confidence Indicator, Aug*** ***Own-Company Production Outlook, Aug***	**Forecast: 97** **Forecast: 5**	**Prior: 95** **Prior: 1**
	Business confidence rose by two points in July, beating the consensus forecast of a one-point gain to 94. We look for a similar-sized gain in August. Note that the INSEE survey continues to undershoot the rebound in the manufacturing PMI by a sizeable margin. We expect some catch-up will occur in coming months, provided that business leaders shed some of their pessimism with respect to the government's actions. Personal output expectations likely rose again for the fourth successive month to match the Feb-13 high.		
Aug 29 07:45 London Time	***Quarterly Survey of Industrial Investment, Jul***	**Forecast: -2%**	**Prior: -4%**
	Although we still anticipate that industrialists will envisage a decline in their investment plans for 2013, the rebound in business confidence since the April survey would tend to support a slight ratcheting up in their forecast. Poor corporate profitability remains the main impediment to a more positive outlook, but in some cases the need to renew obsolete equipment after years of under-investment will require some outlays.		

Economic Indicators

Italy

Aug 29 09:00 London Time	***Consumer Confidence, Aug***	**Forecast: 97.8**	**Prior: 97.3**
	Aside from the one-off gain in consumer sentiment in June due to methodological changes in the computation of the series, in underlying terms sentiment has been improving over the past couple of months, 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 continue in August. Note that the current level of the index is still probably consistent with a negative growth rate in private consumption.		
Aug 29 09:00 London Time	***Business Confidence, Aug***	**Forecast: 93.1**	**Prior: 91.7**
	Business sentiment probably continued to improve in August, posting the fourth consecutive monthly gain and catching up with the gains recorded by the manufacturing PMI in recent months. Yet, the level remains some 1 standard deviation below the long-run average suggesting still close-to-zero GDP growth in the next couple of quarters.		
Aug 30 09:00 London Time	***Unemployment Rate, Jul***	**Forecast: 12.1%**	**Prior: 12.1%**
	Mainly thanks to a slowdown in the pace of growth in the labour force, the unemployment rate has been rising slightly less fast lately (it actually dropped by 0.1pp in June). The pace of decline in employment has also eased slightly, but we think we are still far away from positive job creation. Unemployment may be temporarily stabilising, but further increases in the labour force and still sluggish employment dynamics are likely to push it higher in coming months.		
Aug 30 10:00 London Time	***HICP, Aug P***	**Forecast: 1.1% YY**	**Prior: 1.2% YY**
	HICP Inflation should have edged down again by 0.1pp in August, hitting its lowest point since Feb-10. Favourable base effects in the energy component plus larger-than-usual price rebates during summer sales are behind the further easing in headline inflation. The planned VAT hike in October, if implemented, will likely lift inflation back to 1¾% YY by year-end, but in general inflationary pressures will probably stay very muted.		

Spain

Aug 29 08:00 London Time	***GDP, 2Q F***	**Forecast: -0.1% QQ**	**Prior: -0.5% QQ**
	Although the flash estimate suggested a less negative than expected GDP dynamic in 2Q, we believe the GDP breakdown will show final domestic demand remained in deep recessionary territory (-0.7% QQ, in line with 1Q 13), while net exports and inventories together probably added some 0.5pp to GDP growth. Less negative domestic demand contributions to GDP growth are expected in 2H, probably just enough to have a non-negative GDP quarterly growth rate.		
Aug 29 08:00 London Time	***HICP, Aug P***	**Forecast: 1.6% YY**	**Prior: 1.9% YY**
	With sizable favourable base effects in the energy component (reflecting a large fuel price increase in summer 2012), the annual inflation rate likely fell back to 1.6% YY in August, almost matching the temporary low of 1.5% in May. Aside from the May print, inflation would be at its lowest level since H1 2010. Recent upward tensions in food prices (probably weather-related) should have started to abate. We expect inflation to fall substantially in coming months, probably below the 1% YY mark, as the effects of the 3-pp VAT rate hike in Sept-12 exits the annual comparison.		
Aug 30 08:00 London Time	***Retail Sales, Jul***	**Forecast: -5.1% YY**	**Prior: -5.0% YY**
	Retail spending in real terms dropped by 0.7% MM in June, after two quite strong monthly readings in April and May. We expect a small uptick, by 0.2% MM in July, supported by the start of summer sales and as a payback after a weak June reading. We think consumer spending is likely to remain weak, but probably moving sideways rather than plummeting as in 4Q 12 and 1Q 13. Falling inflation may provide some boost to real disposable income and hence real spending, but only to a minor extent, in our view.		
Aug 30 London Time	***Budget Balance, Jul YTD***	**Forecast: €-44 Billion**	**Prior: €-40 Billion**
	The central government budget deficit in the first six months of 2013 has only marginally improved relative to the same period of 2012, suggesting a slowdown in the pace of deficit reduction seen in 2012. We think the same pattern prevailed in July, with a monthly deficit of some €4bn, which would bring the YTD level to €44bn, down from €48.3bn in Jan-Jul 2012.		

Slovenia

Aug 30 09:30 London Time	***GDP, 2Q***	**Forecast: -0.2% QQ, -2.5% YY SWDA**	**Prior: -0.7% QQ, -3.3% YY SWDA**
	We expect GDP fell by 0.2% QQ in 2Q13 after -0.7% a quarter ago (GDP fell on average by 0.7% per quarter also in 2012). If this materializes, GDP would ease its YY contraction to -2.5% from -3.3%. While industrial output further eased its contraction in YY terms to -0.6% in June and construction to -11.3% (both slightly better than we expected), exports decreased, although this may reflect temporary distortions from a drop in the number of working days. July sentiment indicator remains stable, with slightly worse confidence in manufacturing, while services show some improvement. Though external demand prospects are improving, we think that the announcement of complex banking stress test results by the end of 2013 is likely to keep uncertainties high, with negative consequences for domestic demand. Our forecast envisages 2.2% contraction in 2013, the same as in 2012, while the government forecasting office IMAD expects -2.4% in 2013. We assume a milder contraction in government consumption and probably milder fixed investment, while better export activity than government. The whole time series will be published on 2 Sep.		

Sweden

Aug 27 08:30 London Time	***Household Lending, Jul***	**Forecast: 4.7% YY**	**Prior: 4.7% YY**
	Lending to households ticked slightly higher in May to 4.7% YY – 0.1pp above the April pace, and held steady in June. The largest part of households' loans consists of housing loans (63%), which in June had an annual growth rate of 4.9% (4.8% 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 last six months and housing starts were basically flat in 1Q following two-digit declines in the past five quarters), we see a clear risk that household lending could pick up further in the second half of the year. Given the Riksbank majority board's focus on financial stability considerations, this clearly speaks in favour of stable rates ahead.		

Economic Indicators

Sweden continued			
Aug 28 08:00 London Time	***Consumer Confidence, Aug***	**Forecast: 100.5**	**Prior: 100.3**
	Consumer sentiment improved further in July, and is now basically in line with its long-term average (0.5 points above). House prices have recovered slightly in recent quarters and some house price indicators suggest slight upward pressure in the housing market also ahead. At the same time, the equity market has continued to improve from late-June and is now above the early-2011 high and back to pre-crisis levels. Meanwhile, car sales fell further in July (-2.3% YY) and developments on the labour market remain somewhat mixed, with both unemployment and employment rising. On balance, this points to a marginal gain in consumer confidence in August. Inflation expectations are low and are expected to stay low given very low current levels of inflation (1.5% YY in July).		
Aug 28 08:00 London Time	***Manufacturing Confidence, Aug***	**Forecast: 95.2**	**Prior: 93.8**
	Following three consecutive months with above-50 readings for PMI, we expect NIER manufacturing confidence to improve in August (NIER sentiment tends to lag PMI slightly). Manufacturing confidence disappointed in July and is somewhat below its long-term average. Although the indicator is at growth level, it does not signal a strong recovery. Overall, we expect the manufacturing sector to gradually recover throughout the year, but it will be a bumpy road and some setbacks should be expected in periods.		
Aug 29 08:30 London Time	***Retail Sales, Jul***	**Forecast: 0.2% MM**	**Prior: 0.6% MM**
	Retail sales have been off to a strong start this year with average activity up 1.6% QQ in 1Q and 0.7% QQ in 2Q. The overall gain has been driven by durable goods sales and food consumption. Following the ongoing improvement in retail and consumer sentiment, we expect retail sales to increase again in 3Q. Current levels of consumer confidence support an upward trend in private consumption this year.		
Norway			
Aug 30 9:00 London Time	***Retail Sales, Jul***	**Forecast: 0.3% MM**	**Prior: -0.2% MM**
	Despite a downward correction in June, supportive fundamentals suggest consumption growth should stay robust ahead (relatively firm labour market, solid real disposable income, low interest rates and ongoing house price gains, albeit moderating).		
Aug 30 9:00 London Time	***LFS Unemployment Rate, Jun***	**Forecast: 3.5%**	**Prior: 3.4%**
	Following an increase in LFS unemployment to 3.7% in February, up from a low of 3.0% in the second quarter of 2012, the Norwegian labour market now appears to have stabilized. According to the May LFS survey, unemployment in May (average of Apr-Jun) fell 0.1pp to 3.4%. Meanwhile, employment growth has moderated since mid-2012, although picking up pace slightly in May. Employment thus rose 0.1% YY in May, after being flat in the previous month. Meanwhile, growth in the labour force has not showed any abrupt slowing. We expect the labour market to continue stabilizing in the second half of the year.		
Aug 30 9:00 London Time	***Registered Unemployment Rate, Aug***	**Forecast: 2.7%**	**Prior: 2.8%**
	The labour market in Norway remains relatively firm. In line with the seasonal pattern, we expect the registered jobless rate to fall 0.1pp to 2.7% in August.		

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

Key Economic Indicators (2 September – 6 September 2013)

Monday 2 September		**Forecast**	**Last**
07:30	Sweden: PMI, Aug		
08:00	Norway: PMI, Aug		
09:00	Euro Area: Manufacturing PMI, Aug		
09:00	Norway: Credit Indicator C2, Jul		
09:30	UK: Manufacturing PMI, Aug Final	55.0	54.6
	Italy: Budget Balance, Aug		
Tuesday 3 September		**Forecast**	**Last**
06:45	Switzerland: GDP, 2Q		
08:00	Spain: Unemployment, Aug		
09:00	Norway: Unemployment???		
09:30	UK: M&A Involving UK Companies, 2Q		
10:00	Euro Area: Industrial Producer Prices, Jul		
Wednesday 4 September		**Forecast**	**Last**
07:45	France: Producer Prices, Jul		
09:00	Euro Area: Services PMI, Aug Final		
	Composite PMI, Aug Final		
09:30	UK: Services PMI, Aug	60.5	60.2
10:00	Euro Area: Retail Sales, Jul		
10:00	Euro Area: GDP, 2Q (2nd Release)		
Thursday 5 September		**Forecast**	**Last**
	G-20 Summit (St Petersburg, 5-6 September)		
06:30	France: Unemployment, 2Q		
08:30	Sweden: Riksbank Monetary Policy Outcome		
08:30	Sweden: Services Production, Jul		
08:30	Netherlands: Consumer Prices, Aug		
11:00	Germany: Incoming Orders, Jul	-0.5% MM, 3.1% YY	3.8% MM, 4.2% YY
12:00	UK: MPC Outcome		
12:45	Euro Area: ECB Outcome		
Friday 6 September		**Forecast**	**Last**
07:00	Germany: Labour Cost Index, 2Q		
07:00	Germany: Trade Balance, Jul		
07:45	France: Trade Balance, Jul		
07:45	France: Budget Balance, Jul		
07:45	France: Consumer Confidence, Aug		
08:00	Spain: Industrial Production, Jul		
08:15	Switzerland: Consumer Prices, Aug		
09:00	Norway: Industrial Production, Jul		
09:30	UK: Industrial Production, Jul	0.1% MM, ,-1.6% YY	1.1% MM, 1.2% YY
	Manufacturing Output, Jul	0.0% MM, -1.0%YY	1.9% MM, 2.0% YY
09:30	UK: Trade Balance – Goods & Services, Jul	£-2.0 Billion	£-1.5 Billion
09:30	UK: New Construction Orders, 2Q		
10:00	Cyprus: GDP Details, 2Q		
11:00	Germany: Industrial Production, Jul	0.4% MM, 1.5% YY	2.4% MM, 2.1% YY
11:00	Portugal: GDP Details, 2Q		

Sources: National statistical offices, central banks and Citi Research

Title	Author	Date
Euro Area – Sovereign Debt Crisis Update		
ECB's Nowotny Sees Little Need for Rate Cut	European Economics Team	Aug 23, 2013
Italian Government at Risk on Berlusconi's Future in Politics	European Economics Team	Aug 22, 2013
Greek Debt Back at the Centre of Political Debate	European Economics Team	Aug 21, 2013
Political Uncertainty: Germany and Italy in the Spotlight	European Economics Team	Aug 20, 2013
Moody's Sees Risks of Rating Downgrade for Netherlands	European Economics Team	Aug 19, 2013
Euro Area		
European Economic Forecast Highlights - August 2013	Ann O'Kelly	Aug 22, 2013
Germany - Is the Current Coalition Heading For Four More Years?	Ebrahim Rahbari	Aug 19, 2013
The euro area isn't working – labour market reforms in the euro area and why they won't solve the euro area job crisis;	Ebrahim Rahbari and Deimante Kupciuniene	Jul 11, 2013
Taking Stock of Labour Market Rigidities and Reforms in the Euro Area	Ebrahim Rahbari and Deimante Kupciuniene	Jul 11, 2013
ECB - Unanimous Governing Council Enacts Forward Guidance	Guillaume Menuet	Jul 4, 2013
Euro Economics Weekly		
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
Slovenia: ESM Assistance for Bank Recap Would Make Sense	Guillaume Menuet	Jun 21, 2013
Spain's External Rebalancing	Giada Giani	Jun 14, 2013
Financial Conditions Neutral, At Best, on Growth	Giada Giani	Jun 7, 2013
ECB: Focus on Collateral Rules rather than Direct Purchases	Guillaume Menuet	May 31, 2013
Removing Grexit from the Baseline Scenario	Giada Giani	May 24, 2013
Watching for Positive Surprises: Favour GIPS over France	Guillaume Menuet	May 17, 2013
Euro Area Disinflationary Pressures	Giada Giani	May 10, 2013
Chief Economist Publications		
Global Economic Outlook and Strategy - August 2013	Willem Buiter	'Aug 21, 2013
Ireland		
Ireland - Back in Recession	Michael Saunders	Jun 28, 2013
Scandi		
Scandi Economics Update	Tina Mortensen	Aug 13, 2013
Denmark - Faltering Recovery	Tina Mortensen	Jul 17, 2013
Sweden - Inflation Bang on Riksbank Forecast in June	Tina Mortensen	Jul 11, 2013
Switzerland		
Switzerland - Deflation Ending, But Policy Will Stay Loose	Michael Saunders	Aug 12, 2013
UK		
UK - Retail Sales Rise Again	Michael Saunders	Aug 15, 2013
UK - MPC Minutes And Labour Market Data	Michael Saunders	Aug 14, 2013
UK - Inflation Edges Down, Further Decline Likely	Michael Saunders	Aug 13, 2013
UK Economics Weekly		
The Upturn and Unemployment	Michael Saunders	Aug 16, 2013
Four More Years!	Michael Saunders	Aug 9, 2013
Guidance on Guidance	Michael Saunders	Jul 19, 2013
Improving – Can Do Better	Michael Saunders	Jul 12, 2013
The MPC's Declaration of (Monetary) Independence	Michael Saunders	Jul 5, 2013
Carney's Challenge	Michael Saunders	Jun 28, 2013
Selloff Reinforces the Case for Forward Guidance	Michael Saunders	Jun 21, 2013
Growing, But Not (Yet) Really Recovering	Michael Saunders	Jun 14, 2013

Source: Citi Research

Appendix A-1

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