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Developed Markets
Western Europe

Euro Economics Weekly

ERS: An Alternative Solution to OMT?

- **More solidarity now to avoid debt restructuring later** – As euro area (EA) countries get closer to primary surpluses, applying some mechanism to lower the cost of sovereign debt financing would be a solution to avoid having to contemplate tackling excessive debt burdens at a future date. With the ECB's Outright Monetary Transactions (OMT) under threat, finding a mechanism to support spread compression could prove very valuable if the risk free rate begins to increase.

- **The European Reward System (ERS)** – We think that this latest proposal has a reasonably good chance of being accepted by member states as it does not require treaty changes, it limits the size of conditional budgetary transfers and it supports restoring debt sustainability. We also understand that it has strong political backing from Paris. A mechanism to accelerate spread consolidation across the EA could soon become necessary at a time when financial market volatility could hamper investors' risk appetite. A reasonable (and politically acceptable) initial premium limit would be around 200bp, in our view, potentially narrowing to 150bp in the second year and 100bp in the third.

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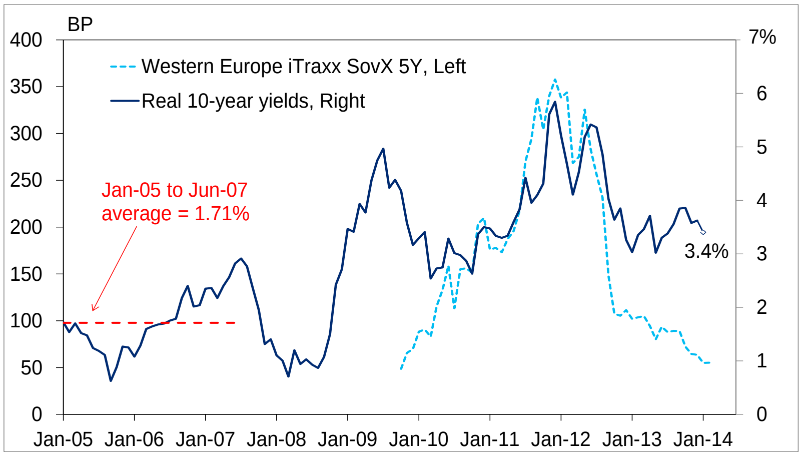
Figure 1. Citi Market Forecasts

	$/€	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
2Q 14	1.39	0.00	1.70	0.80	0.50	137	9.10	0.75	8.05	1.50	1.25	0.00	-68
4Q 14	1.40	0.00	1.80	0.80	0.50	153	9.00	0.75	7.86	1.50	1.26	0.00	-73

Source: Citi Research

Figure 2. EA – Periphery Real 10-Year Yields and W. Europe CDS, Jan-05 to Feb-14



Sources: Bloomberg and Citi Research.

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

A solution to hasten spread convergence?

The perception of risk-adjusted returns has improved significantly

To date, the emerging market turmoil has had little impact on the peripheral sovereign debt market. And with investors' attention no longer focused on the EA as a source of risk, one could be forgiven for thinking that the sovereign debt outlook could be smoother than in the last few years. To be sure, real interest rates in periphery debt continue to look attractive, justifying investors' appetite for returns. There is also a general feeling among investors that the outlook is more predictable as break-up risk has receded, the ECB stepped it with its 'whatever it takes', member states implement structural reforms and narrow their budget deficits.

But weakness in nominal GDP and the relatively elevated level of average funding costs remain problematic

But the problem of excessive debt levels has not been addressed, and some member states will struggle to generate enough revenues to convincingly allay fears of public debt restructuring in the next few years unless the disinflationary forces that dampen nominal GDP growth can be tackled successfully. Policymakers would be well-advised to use this relative period of calm to enhance the EA's financial architecture and introduce some of the instruments that have been proposed to deepen financial integration between member states, while delivering more solidarity.

Main aspects of the proposal, scenarios and questions, and comparison with existing plans

This note discusses the latest initiative to tackle the elevated real cost of sovereign debt issuance in the periphery. We review the main aspects of the proposal, analyse scenarios, assess its usefulness in addressing financial fragmentation, and ask whether this mechanism could be adopted soon.

Governments should be mindful of over-reliance on the ECB

Limits to the ECB's actions mean that governments should show more solidarity now to avoid larger problems later

When ECB President Mario Draghi argued in the summer of 2012 that the EA's central bank would do "*whatever it takes*", the market listened. But, with doubts about the OMT's legality, this remains an imperfect situation that governments might seek to address. We suspect that for some EU governments, 2014-15 could be the window to launch meaningful initiatives to ensure that solidarity goes beyond alleviating some of the pain associated with dealing with the flow problem of budget deficits. As countries get closer to primary surplus positions, applying some mechanism to lower the cost of financing should be the obvious solution to avoid having to contemplate tackling excessive debt burdens at a future date. The period after the European Parliamentary elections could provide such a window of opportunity.

Emerging market turbulence could provide the necessary wake-up call about the fragility of export-led recoveries

We believe that the tensions resulting from the turmoil in emerging markets could provide the necessary wake up call for EA governments that more needs to be done, and that there is a real need to go beyond the theoretical debate about what the EA should look like in ten years' time. So far, EM issues remain largely domestic (external debt values are holding up) and the impact on global trade is difficult to gauge. But for EA member states that rely on net exports to compensate for weakness in domestic demand, any deterioration in external economic perspectives will be another obstacle to their ability to tackle already elevated public debt burdens. Finding a mechanism to prevent spread widening or support spread compression could prove immensely valuable if/when the risk free rate begins to increase.

What is the European Reward System (ERS)?

Introducing the European Reward System

There is a new policy initiative proposed by Christian Dargnat, President of the European Fund & Asset Management Association (EFAMA). Mr. Dargnat's European Reward System (ERS) is presented as an "*innovative, simple and constructive proposal to definitely solve the Eurozone financial crisis*", promoting the "*re-establishment of fair financing by allowing Eurozone states to benefit from a communal rate of issuance*".

What's in it for creditor countries?

Most of the highly rated EA sovereign bond issuers have benefited from the 'flight to safety' dynamics during the crisis and have been able to borrow at record low rates since the start of the EA sovereign debt crisis. The question is whether these 'beneficiary' member states should, now that the crisis has abated, share some of this benefit with their periphery neighbours. From a financial stability angle, a system involving a limited financial transfer helping to address some fragility in important trading partners would make some sense, especially in a period of very low inflation when the sustainability of debt dynamics is questionable. This should be assessed against the potential direct cost of restructuring a higher debt burden at a future date and the indirect cost associated with economic loss from lower export dynamics resulting from a persistently muted domestic demand picture.

Key features of the ERS

The ERS's main aspect revolves around a member state benefiting ex-post from a budgetary transfer from other member states participating in the scheme on two conditions: **i**) that the country has adhered to a set of budget criteria defined ex-ante and **ii**) that its average cost of funding in the preceding year has exceeded the average funding costs of all participating members in the ERS by a certain premium.

No need for treaty changes, and low risk of moral hazard

The proposal claims to address some of the principal shortfalls of other schemes. In our view, the two most important aspects of the ERS are that it **i**) keeps the existing national ownership of debt, therefore avoiding the need to modify existing treaties, and **ii**) allows for ex-post transfers, which would reduce the risk of free-riding and could make it easier for national parliaments to vote for a conditional budgetary line.

The system amounts to an interest rate ceiling on sovereign debt issuance …

The ERS author argues that as the system should *"convince financial markets that each state will satisfactorily meet its commitments*", and that this improvement in confidence will allow investors to demand a lower risk premium, leading to "*a convergence that is more fair and sustainable*". While we agree that a financial incentive in the form of a rebate would appeal to most governments, and likely make them more likely to stick to their fiscal targets and deliver structural reforms that are achievable at a limited political cost, it is not obvious that the framework would automatically put a ceiling on a member state's borrowing costs. Investors might continue to demand a relatively large interest rate premium if they have concerns about debt sustainability and/or the ability of the government to deliver on the terms laid out ex-ante.

… only for countries that meet certain eligibility criteria

The author also stipulates that "*for the certification ERS to be credible, it must be discriminatory […] on the grounds of budget disequilibrium*", indicating that Spain and Portugal would not have been eligible in 2013, whereas Italy and Ireland would have qualified. We are not sure we understand fully the rationale behind this selection progress, and would argue that as long as countries can demonstrate market access, and are not in a Troika programme, they should be ERS-eligible.

How much would it cost the creditor countries?

Germany's funding cost is the reference rate, over which a spread is applied

The proposal has been calibrated using a premium limit of 100bp over the German reference funding rate in five maturity buckets (3, 5, 10, 15 and 30 years). To get a sense of the size of countries' contributions we take France as an example. In 2013, it issued around €68bn of 10-year OATs at an average funding cost of 1.79%. But in the ERS framework, France's reference issuance cost would be 2.63% (Germany's 1.63% average funding cost for the 10-year Bund + 100bp of ERS premium). Incorporating other member states' funding costs using the same formula, France would find itself at an advantage compared to the ERS 10-year yield average of 2.98%, and would have to contribute around €1.8bn for the 10-year segment[1].

[1] [(2.63% - 2.98%) / 100] * €67.9bn * 7.42 (average duration).

Possible ERS Scenarios

We run scenarios based on the ERS template, adjusting the list of participants and estimating the likely contributions transfers for certain premium levels, based on 2013 issuance and spread levels.

The full cohort scenario would likely produce an 'acceptable' budgetary transfer at a 200bp premium limit

Case 1: we assume that the full cohort of EA member states signs up to the ERS system and we select a 200bp premium limit over the German funding cost. This scenario would require a total budgetary contributions of €6bn, to be split between the core (Germany, Austria, Netherlands) and soft core euro (France, Belgium) area member states (see Figure 3). At a 100bp premium limit (which is designed to represent the floor in terms of financing costs, a level lower than what the Bank of Italy[2] has judged in the past to be a 'fair BTP-Bund spread'), the ERS framework would require total budgetary transfers worth €16.3bn to four member states (Italy, Spain, Ireland and Portugal) based on the debt amounts issued during 2013.

Italy would be the largest beneficiary in € terms, but Portugal would be in % of GDP terms

Given the amount of debt issued, Italy would be the biggest beneficiary, but expressed as a percentage of GDP, the largest beneficiary would be Portugal with 0.9% of GDP, followed by Spain with 0.7%, Italy with 0.5% and Ireland with 0.3%. Given the associated budgetary cost of 0.6% of GDP in Belgium, 0.5% of GDP in Austria and 0.4% of GDP in France, we doubt that the 100bp premium limit would be acceptable at present for contributing countries which still have to deliver sizeable amounts of budgetary consolidation themselves. A premium limit of 200bp would likely be more adequate, with the maximum contribution from 'creditor nations' around the 0.2% level.

A restricted scenario would likely produce an 'acceptable' budgetary transfer at a 200bp premium limit

Case 2: we look at a restricted ERS where not all periphery country are eligible for financial assistance, either because the member state is not eligible in the first place or because the certification was made impossible by a member state not fulfilling its targets. Excluding Spain and Portugal as potential recipients of ex-post budgetary transfers, one finds that a 150bp premium would still likely yield 'acceptable' levels of budgetary contributions totaling €7.0bn for the creditor member states. The largest contributions would be worth around 0.2% of GDP in Belgium and Austria and around 0.1% for France, Germany and the Netherlands (see Figure 4).

Figure 3. Case 1: Un-Restricted ERS – All countries are eligible

Country	In/Out	€ bn	% of GDP	€ bn	% of GDP	€ bn	% of GDP
Premium		100bp		150bp		200bp	
Italy	1	7.5	0.48%	4.2	0.27%	1.0	0.07%
Spain	1	6.9	0.68%	5.1	0.50%	3.2	0.32%
France	1	-7.3	-0.36%	-5.0	-0.24%	-2.8	-0.13%
Germany	1	-5.1	-0.18%	-3.4	-0.12%	-1.7	-0.06%
Ireland	1	0.5	0.28%	0.4	0.23%	0.5	0.29%
Austria	1	-1.4	-0.45%	-1.0	-0.31%	-0.6	-0.18%
NL	1	-2.2	-0.37%	-1.5	-0.25%	-0.8	-0.14%
Belgium	1	-2.2	-0.57%	-1.6	-0.41%	-0.9	-0.23%
Portugal	1	1.4	0.86%	1.3	0.78%	1.1	0.68%

Source: Citi Research

Figure 4. Case 2: Restricted ERS – Not all countries are eligible

Country	In/Out	€ bn	% of GDP	€ bn	% of GDP	€ bn	% of GDP
Premium		100bp		150bp		200bp	
Italy	1	10.6	0.68%	6.5	0.42%	2.6	0.17%
Spain	0						
France	1	-4.7	-0.23%	-2.9	-0.14%	-1.4	-0.07%
Germany	1	-3.2	-0.12%	-1.9	-0.07%	-0.8	-0.03%
Ireland	1	0.6	0.35%	0.5	0.29%	0.5	0.33%
Austria	1	-0.9	-0.29%	-0.6	-0.19%	-0.3	-0.09%
NL	1	-1.4	-0.23%	-0.9	-0.15%	-0.4	-0.07%
Belgium	1	-1.3	-0.35%	-0.9	-0.25%	-0.5	-0.12%
Portugal	0						

Note: 1/0 for eligible vs. non-eligible

Source: Citi Research

[2] http://www.bancaditalia.it/pubblicazioni/econo/quest_ecofin_2/qef128/QEF_128.pdf

An unlikely scenario to test what level of financial burden could still be acceptable without any Aaa/AAA rated countries

Case 3: In this scenario, none of the Aaa/AAA-rated countries are willing participants, with domestic electorates rejecting the idea that more solidarity is necessary to increase the chances of the EA's survival. This would be improbable, in our view, but worth investigating to provide a gauge of what could be done if the political will in other member states was sufficiently strong, irrespective of the issues this would raise regarding solidarity and what model should be applied to deepening the European Economic and Monetary Union. A premium limit of 200bp would also be workable, in our view, leaving Italy as a marginal recipient of budgetary transfers (€80mn) while not overburdening France (0.2% of GDP) and Belgium (0.3% of GDP). At 250bp, Italy would become a net contributor to the ERS to the tune of €1bn, the exact amount that Spain would be eligible to receive (see Figure 5). If this proposal were to ever be given serious consideration, we believe that policy makers would struggle to reach some agreement about a starting premium limit below 200bp, at least initially.

The premium limit could be lowered each year, assuming compliance with original targets and gradual fall in issuance costs

Assuming that the certification progress were to work smoothly in the first year of implementation and investors lowered the risk premium associated with peripheral sovereign debt, it would be likely that a narrower premium limit (in increments of 50bp) could be agreed without too much effort for the following year, narrowing to 100bp in the third year.

Figure 5. Case 3: Non Aaa/AAA ERS – Exclude the hard core countries

Country	In/Out	€ bn	% of GDP	€ bn	% of GDP	€ bn	% of GDP	€ bn	% of GDP
Premium		100bp		150bp		200bp		250bp	
Italy	1	4.7	0.30%	2.3	0.15%	0.1	0.00%	-1.0	-0.06%
Spain	1	5.4	0.53%	4.2	0.40%	2.7	0.27%	1.0	0.10%
France	1	-9.9	-0.48%	-6.7	-0.33%	-3.7	-0.18%	-1.3	-0.06%
Germany	0								
Ireland	1	0.4	0.21%	0.3	0.18%	0.4	0.26%	0.5	0.32%
Austria	0								
NL	0								
Belgium	1	-2.9	-0.77%	-2.1	-0.55%	-1.2	-0.31%	-0.4	-0.10%
Portugal	1	1.3	0.78%	1.2	0.72%	1.1	0.65%	0.9	0.54%

Note: 1/0 for eligible vs. non-eligible

Source: Citi Research

Many questions remain about this ERS proposal

What conditionality?

The question about which conditionality criteria to apply will no doubt be the subject of lengthy political debates, but it is arguable that as long as countries decide to embark on a structural reform programme or deliver a certain amount of budgetary savings, both of which could be measurable, the selection of metrics to ensure the conditionality is met should be relatively straightforward. Using the European Commission as a referee in the process could be the easiest solution.

How do you maximize the number of core countries participating in the ERS?

Assuming that participation is voluntary, some member states could decide not to get involved, arguing that the compression in spreads achieved so far is sufficient proof that the spread convergence process is already underway, not requiring any more efforts in terms of solidarity. Finland for instance would spring to mind as a potential refractor given its request for guarantees when the EFSF was created. The obvious solution is to set a relatively high premium limit. But note that our third scenario shows that the absence of one or several member states would not necessarily matter too much in terms of the financial burden that would have to be borne by the remaining participants.

Will the ERS fly? Paris appears to be a strong proponent

What is the state of play? Who is in the loop?

Our understanding is that the ERS proposal has not only been discussed at length between French officials, including President Hollande and his technical advisers, but has also been reviewed by many experienced financial market participants, some of whom have held key positions in international organisations, as well as central bankers. From a political standpoint, such an initiative would meet some of the demands made by Spain on a number of occasions throughout the crisis, and would restore France's perceived ability to influence the agenda on deepening EA economic governance. We believe President Hollande showing some initiative at the European level would be viewed positively, given his political difficulties domestically.

Would the scheme find a sympathetic ear in Berlin?

So far, we gather that the proposal is still in the early stages of discussion. But if one gauges the level of interest in Germany for additional support towards EA member states implementing structural reforms, the proposal to entrench a new system of "legally binding contracts" made ahead of the 19 December EU summit suggests that additional financial contributions would be on the table[3]. Although the idea of a "partnership", involving "national ownership" of the reform contracts in exchange for "solidarity payments" is not defunct, it could probably be resuscitated if presented in more amenable terms.

How does this fit in the evolving architecture of the monetary union?

The political dimension of European economic integration will require member states to adopt more rules fostering closer cooperation, particularly about economic governance. We believe that this system of rewarding countries for delivering on key objectives that would improve their ability to remain in the currency area makes sense and that the associated cost in terms of budgetary impact on 'creditor' member states should be limited provided that the premium threshold is fixed at a reasonable level, but the insurance benefits could still be substantial.

Would this plan be welcomed by the ECB?

The ECB has been urging governments to do more

The European Central Bank (ECB) has frequently reminded governments of the importance of playing their role "*in a responsible manner*" arguing that there are limits to monetary policy with respect to what a central bank can do. Executive Board Member Yves Mersch[4] on 9 December 2013 stressed that governments and businesses can help to achieve sustainable economic growth, most importantly by taking advantage of low interest rates to invest in productivity. In this respect, a system designed to accelerate the trend of sovereign spread convergence would be an important step in the right direction. Indeed, the lower the risk-free rate on government debt, the larger the potential positive effect in helping reduce fragmentation. This would likely improve the monetary policy transmission mechanism and therefore should be encouraged by the ECB, whose Governing Council has been arguing for some time that the governments should be more forthcoming with policy initiatives.

The ERS also paves the way for more progress towards common debt issuance

The principle of greater solidarity has also been highlighted by ECB President Draghi who argued on 6 May 2013 that it "*would also be necessary to introduce reforms that further reduce the barriers between individual Member States, and that affirm the principle of solidarity, as proposed recently in the "Four Presidents' Report*"[5]. The document makes an explicit reference to four essential building

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[3] http://www.theguardian.com/business/2013/dec/19/angela-merkel-resistance-eurozone-reforms-brussels-summit

[4] https://www.ecb.europa.eu/press/key/date/2013/html/sp131209.en.html

[5] Herman Van Rompuy (in collaboration with José Manuel Barroso, Jean-Claude Juncker and Mario Draghi), "Towards a genuine economic and monetary union", 5 December 2012, http://ec.europa.eu/economy_finance/focuson/crisis/documents/131201_en.pdf

blocks for a "*stable and prosperous EMU*". With some progress being already evident on the first block (integrated financial framework), the attention is focusing on the second one, the integrated budgetary framework. This will require among other things, "*commensurate steps towards common debt issuance*". A table of the main proposals presented to date is provided below.

Figure 6. Various Proposals Leading to Common Issuance of EA Sovereign Securities

Main criteria	Blue-Red bonds	Euro-bills	Stability Bonds	Redemption Fund	ESBies	ERS
Phase-in period, lead time	3-5 years	Short	3-5 years	3-5 years	Short	Short
Eligibility (who is in/out?)	All, but Programme countries post-restructuring	Those with market access	Not programme countries	Not programme countries	Not programme countries	Those with market access
Size/Guarantees (% of GDP)	up to 60%	Up to 10%	None	Over 60% (around 27% of EA GDP)	up to 60%	Up to 100% of issuance
Term horizon	15-20 years	1 year	Maturity of newly issued debt	20 years	3 years	None
Conditionality	SGP 2.0, FC, 2P, 6P, earmarking and collateral	Budgetary and economic criteria	SGP 2.0, FC, 2P, 6P, earmarking and collateral	SGP 2.0, FC, 2P, 6P, earmarking and collateral	None	SGP 2.0, FC, 2P, 6P
Solidarity (JS, S)	Blue: JS, Red: None	JS	JS or S	JS	None	In m/t on ERS certified debt
Legal	Treaty and economic governance changes	No treaty changes, but creation of EA DMO	Treaty and economic governance changes	Treaty, constitutional and economic governance changes	Creation of EA DMO	Limited

Notes: JS = Joint and Several, S = Several, SGP 2.0 is revised Stability and Growth Pact. FC = Fiscal Compact, 2P = two-pack, 6P= six-pack

Sources: Bruegel Institute and Citi Research

Conclusions

Completing the financial and budgetary architecture of the EA…

Many attempts have been made to complete the financial/budgetary architecture of the EA to restore debt sustainability and deepen financial integration, including the creation of a single risk-free instrument (see Figure 6) that would not be associated with a single member state, allowing in future the ECB to intervene more effectively for financial stability purposes. Banking Union is aiming to sever the link between governments and their banks, while discussions about common issuance are taking place to formalise risk-sharing arrangements. From a debtor perspective, these allow insuring against interest and liquidity shocks that exacerbate debt sustainability concerns, and from a creditor perspective they improve stability/liquidity, while reducing the probability of default. Other suggestions have been made, such as creating a budget for the EA[6].

…and dealing with the risk of persistently elevated cost of funding

EA sovereign risk has receded significantly (Figure 2, Front Page) and the lower degree of banking stress, together with further progress towards Banking Union are making investors' more comfortable with the EA periphery. But in light of the upward pressure on the risk-free rate symbolised by the 10-year US Treasury yield, the associated upward drift in the German Bund yield and the German Constitutional Court's decision to refer the ECB's OMT to the European Court of Justice, it is debatable whether periphery bond spreads will continue to tighten rapidly without much improvement in domestic fundamentals and faster nominal GDP growth.

The ERS is a good candidate to deliver spread compression

This begs the question of what could be done next at the EA level to build on the significant improvements of the last few years and ensure that its most vulnerable economies are offered the required financial protection they would require, should the need arise. In our view, the ERS is a good candidate as it does not require treaty changes, limits the size of conditional budgetary transfers and helps answer concerns about debt sustainability. As a result, we believe that it could be an efficient way of delivering spread compression across the EA at a time when financial market volatility hampers investors' appetite for risk.

[6] http://www.tresor.economie.gouv.fr/File/392340

Key Economic Indicators (10 February – 14 February 2014)

Monday 10 February		Forecast	Last
06:45	Switzerland: Unemployment, Jan		
07:30	France: Bank of France Business Sentiment, Jan	101	100
07:45	France: Industrial Production, Dec	-0.5% MM, 0.3% YY	1.3% MM, 1.5% YY
	Manufacturing Production, Dec	-0.2% MM, 0.2% YY	0.2% MM, 1.6% YY
09:00	Italy: Industrial Production, Dec	0.5% MM	0.3% MM
09:00	Norway: Consumer Prices, Jan	-0.3% MM, 2.0% YY	-0.1% MM, 2.0% YY
	CPI-ATE, Jan	-0.5% MM, 2.0% YY	-0.1% MM, 2.0% YY
09:30	Euro Area: Sentix Investor Confidence, Feb		
10:00	Greece: Industrial Production, Dec		
11:00	Latvia: GDP, 4Q		
Tuesday 11 February		**Forecast**	**Last**
07:00	Sweden: PES Unemployment Rate, Jan	4.6%	4.6%
Wednesday 12 February		**Forecast**	**Last**
07:45	France: Balance of Payments, Dec		
08:15	Switzerland: Consumer Prices, Jan		
09:00	Norway: Mainland GDP, 4Q	0.4% QQ	0.5% QQ
10:00	Euro Area: Industrial Production, Dec	-0.4% MM	1.8% MM
10:30	UK: BoE *Inflation Report*		
Thursday 13 February		**Forecast**	**Last**
00:01	UK: RICS House Price Survey, Jan		
07:00	Germany: HICP, Jan Final	-0.7% MM, 1.2% YY	0.4% MM, 1.2% YY
	National CPI, Jan Final	-0.6% MM, 1.3% YY	0.4% MM, 1.4% YY
08:15	Switzerland: Producer & Import Prices, Jan		
08:30	Netherlands: Consumer Prices, Jan		
08:30	Netherlands: Retail Sales, Dec		
08:30	Sweden: Riksbank Interest Rate Decision	Unchanged at 0.75%	0.75%
08:30	Sweden: LFS Unemployment Rate, Jan	8.3% NSA, 8.0% SA	7.5% NSA, 8.0% SA
09:00	Euro Area: ECB Monthly Bulletin		
10:00	Greece: Unemployment Rate, Nov		
Friday 14 February		**Forecast**	**Last**
06:30	France: GDP, 4Q Flash	0.4% QQ, 0.8% YY	-0.1% QQ, 0.2% YY
07:00	Germany: GDP, 4Q Flash	0.3% QQ, 1.3% YY	0.3% QQ, 0.6% YY
07:45	France: Nonfarm Payrolls, 4Q	0.0% QQ, -0.5% YY	-0.1% QQ, 0.2% YY
08:00	Spain: HICP, Jan Final	0.3% YY	0.3% YY
08:30	Netherlands: GDP, 4Q Flash	0.1% QQ, 0.0% YY	0.2% QQ, -0.6% YY
08:30	Netherlands: Trade Balance, Dec		
09:00	Italy: GDP, 4Q Flash	0.3% QQ, -0.7% YY	0.0% QQ, -1.8% YY
09:30	UK: Construction Output, Dec		
09:30	Italy: General Government Debt, Dec		
09:30	Portugal: GDP, 4Q Flash		
10:00	Greece: GDP Flash, 4Q NSA YY		
10:00	Cyprus: GDP Flash, 4Q		
10:00	Euro Area: GDP, 4Q Flash	0.3% QQ, 0.5% YY	0.1% QQ, -0.4% YY
10:00	Euro Area: Trade Balance, Dec		
11:00	Ireland: Trade Balance, Dec		

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area			
Feb 12 10:00 London Time	*Industrial Production, Dec*	Forecast: -0.4% MM	Prior: 1.8% MM
	Industrial activity likely contracted in December, after a large gain in Nov. Average growth for 4Q should come in at 0.5% QQ relative to 3Q, when growth was nil in quarterly terms. A positive QQ reading would be consistent with the improvements in business surveys indicators seen the end of last quarter, suggesting an acceleration in the pace of expansion in production.		
Feb 14 10:00 London Time	*GDP, 4Q Flash*	Forecast: 0.3% QQ, 0.5% YY	Prior: 0.1% QQ, -0.4% YY
	GDP growth has probably accelerated somewhat in 4Q relative to the previous quarter, posting a 0.3% QQ gain after a meagre 0.1% QQ in 3Q. While the periphery has shown signs of accelerating activity at the end of last year, hard data for core countries have been somewhat weaker, limiting the pick-up at the euro area aggregate level. We expect GDP to grow at the same pace in 1Q 14.		
Germany			
Feb 13 07:00 London Time	*HICP, Jan Final*	Forecast: -0.7% MM, 1.2% YY	Prior: 0.4% MM, 1.2% YY
	National CPI, Jan Final	Forecast: -0.6% MM, 1.3% YY	Prior: 0.4% MM, 1.4% YY
	We expect the final readings for German inflation in December to confirm the flash readings for both the national and the harmonised measures. YY% inflation surprised on the downside in January, leaving HICP inflation at its lowest rate since April 2013.		
Feb 14 07:00 London Time	*Real GDP, 4Q Flash*	Forecast: 0.35 QQ, 1.3% YY	Prior: 0.3% QQ, 0.6% YY
	We expect 4Q GDP growth to be close to the pace for 3Q. PMIs and industrial production suggest a stronger pace of activity, but weak retail sales (which are below 3Q averages) suggest that private consumption was probably slowing down the GDP increase in 4Q (GDP composition will be released on Feb 25)		
France			
Feb 10 07:30 London Time	*Bank of France Business Sentiment, Jan*	Forecast: 101	Prior: 100
	Every sentiment survey has shown some improvement in French business confidence in January. The composite PMI showed a slower rate of contraction in private sector activity (3-mth high of 48.5), INSEE's Business Cycle Turning Point rose to a three-year high and the EC's ESI posted its largest gain in three months taking the index to a 21-month high. We believe that the BoF sentiment reading will rebound to 101, and see some slight upside risks after President Hollande's formal embracing of supply side reforms and promises of lower corporate taxation.		
Feb 10 07:45 London Time	*Industrial Production, Dec*	Forecast: -0.5% MM, 0.3% YY	Prior: 1.3% MM, 1.5% YY
	Manufacturing Production, Dec	Forecast: -0.2% MM, 0.2% YY	Prior: 0.2% MM, 1.6% YY
	Capacity utilisation fell noticeably in December hitting its lowest level in four months, underscoring the risk of a correction in industrial production growth. With order books increasing only gradually, the rapid drop in finished products inventories suggests that industrialists could have reduced production and filled their orders from existing stocks. We anticipate that IP rose by only 0.1% QQ in 4Q. Looking ahead, better signals from both personal and general output expectations point to some further acceleration in IP growth in coming quarters.		
Feb 14 06:30 London Time	*Gross Domestic Product, 4Q Flash*	Forecast: 0.4% QQ, 0.8% YY	Prior: -0.1% QQ, 0.2% YY
	The flash estimate of 4Q GDP is forecast to show a 0.4% QQ gain after a 0.1% contraction in 3Q. It is clear from the better tone in business surveys that the recovery is slowly materialising. Final domestic demand likely remained weak (+0.1% QQ) with both public consumption and GFCF still contracting a little, leaving private consumption as the only sizeable contributor, helped by frontloading ahead of the 1-Jan-14 VAT rate hike. Looking ahead to 2014, we forecast GDP growth to expand by 0.9% (just enough to arrest the uptrend in unemployment), after 0.2% in 2013 and 0.0% in 2012.		
Feb 14 06:30 London Time	*Non-Farm Payrolls, 4Q F*	Forecast: 0.0% QQ, -0.5% YY	Prior: -0.1% QQ, 0.2% YY
	Non-farm private payrolls should be close to stabilising according to surveys of private sector employment. Readings for the fourth quarter showed some improvement of 0.3sd to -0.1sd, with upticks in both the BdF and INSEE surveys. Better cyclical dynamics and some promises made by the government with respect to lowering labour costs further are positive drivers and reinforce our base case scenario of a return to a situation of modest net job creation in 1Q-14. In 4Q-13, we still expect the industry sector excluding construction to be the worst performer.		
Netherlands			
Feb 14 08:30 London Time	*Gross Domestic Product, 4Q Flash*	Forecast: 0.1% QQ, 0.0% YY	Prior: 0.2% QQ, -0.6% YY
	4Q GDP is likely to show a modest 0.1% QQ uptick, but the balance of risks appears skewed to the upside given the better performances in neighbours France and Belgium (0.4% QQ). In our view, the Dutch recovery will lag that of its peers, capped by the fragility of consumer demand, fiscal drag and downward pressures on house prices. But the continued modest improvement in business sentiment is one of the drivers behind our decision to revise up our 2014 GDP forecast by 0.1ppt to 0.5%. We forecast GDP to expand by 0.9% in 2015.		
Italy			
Feb 10 09:00 London Time	*Industrial Production, Dec*	Forecast: 0.5% MM	Prior: 0.3% MM
	Industrial activity should have continued to expand in December, posting the third consecutive monthly gain. An sizable increase in the manufacturing PMI in December (to 53.3) and a large rebound in imports from non-euro area countries (generally positively associated with output growth) indicate December should have been quite a favourable month for industrial activity. Industrial output should post a quarterly gain of 1.2% QQ in 4Q – largest gain since 2Q 2010.		
Feb 14 09:00 London Time	*GDP, 4Q Flash*	Forecast: 0.3% QQ, -0.7% YY	Prior: 0.0% QQ, -1.8% YY
	GDP is expected to expand for the first time in 4Q 13 by 0.3% QQ, after lagging behind the recovery seen in the rest of the euro area since 2Q 14. We think the improvement in export growth and the boost to corporate liquidity provided by the repayment of government arrears (worth 1.3% of GDP in 2H 13) contributed to lift economic activity at the end of last year.		

Economic Indicators

Spain			
Feb 14	*HICP, Jan Preliminary*	Forecast: 0.3% YY	Prior: 0.3% YY
08:00			
London Time	According to the flash estimate, inflation remained stable at 0.3% YY in January, in line with our expectations, and at the same level as the previous two months. Fuel prices were down slightly in January, reflecting lower oil prices, however the announced increase in electricity tariffs (by 2.3% MM) should still move HICP energy inflation upward (from 0.2% YY in Dec). In our view, this should be compensated by further easing in food price inflation as well as on-going weakness in core prices. Still ample spare capacity will probably push core inflation lower in coming months, likely to negative territory. We expect HICP inflation to average -0.2% YY over 2014.		
Sweden			
Feb 11	*PES Unemployment Rate, Jan*	Forecast: 4.6%	Prior: 4.6%
07:00			
London Time	Weekly data indicate that registered unemployment was stable in January. Data lately are painting a positive picture of the labour market.		
Feb 13	*Riksbank Interest Rate Decision*	Forecast: 0.75%	Prior: 0.75%
08:30			
London Time	We expect the Riksbank to maintain the repo rate and its rate path unchanged when it presents the Monetary Policy Report on 13 February. In other words, the Bank is expected to continue to signal a 16% chance of another near-term rate cut and initial tightening early next year. Growth and labour market forecasts are unlikely to be revised much. With unemployment starting to trend lower, we reckon the December interest rate cut probably is the last in this cycle. That said, ongoing subdued inflation data likely implies that the Riksbank will maintain its downside bias in the conditional interest rate path throughout the first half of this year.		
Feb 13	*LFS Unemployment Rate, Jan*	Forecast: 8.3%	Prior: 7.5%
08:30	*LFS Unemployment Rate, Jan, SA*	Forecast: 8.0%	Prior: 8.0%
London Time			
	In line with the seasonal pattern, we expect to see a jump in the non-seasonally adjusted LFS unemployment rate in January (the average January increase over the past decade has been 7.8pp). Meanwhile, on a seasonally-adjusted basis, the jobless rate is seen stable in January and employment continuing to rise, confirming the positive picture of the labour market.		
Norway			
Feb 10	*Consumer Prices, Jan*	Forecast: -0.3% MM; 2.0% YY	Prior: -0.1% MM; 2.0% YY
09:00	*CPI-ATE, Jan*	Forecast: -0.5% MM; 2.0% YY	Prior: -0.1% MM; 2.0% YY
London Time			
	In the CPI figures for January there lies more uncertainty than usual. We expect CPI-ATE to decline 0.5% M/M in January, broadly in line with the declines in recent years. In December, underlying inflation undershot Norges Bank's forecast by 0.3pp. This is clearly enough to have a downward effect on the Bank's conditional interest rate path. However, given high monthly volatility, Norges Bank has downplayed the importance of inflation on the near-term outlook for interest rates. Nevertheless, it the gap persists, this would in isolation support a lowering of the rate path. A new Monetary Policy Report, though, is not due until 27 March, implying that we will by then have both January and February inflation data at hand. If our CPI-ATE forecast proves to be right, the gap versus Norges Bank's forecast will decrease to a 0.1pp undershoot.		
Feb 12	*Mainland GDP, 4Q*	Forecast: 0.4% QQ	Prior: 0.5% QQ
09:00			
London Time	Demand-side indicators released thus far suggest that momentum in mainland GDP (i.e. excluding oil, gas and shipping) has peaked and that the economy is heading towards a more moderate growth phase with below-trend mainland GDP growth. Domestic consumption of goods has been particularly weak and is in for a third sequential decline in 4Q. And investment growth is likely to remain weak. On balance, we expect growth to moderate slightly in 4Q (0.4% Q/Q), which is in line with Norges Bank forecast.		

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

Key Economic Indicators (17 February – 21 February 2014)

Monday 17 February		Forecast	Last
10:00	Italy: Current Account, Dec		
	Euro Area: Eurogroup Meeting, Brussels		
Tuesday 18 February		Forecast	Last
	EU: EcoFin Meeting, Brussels		
07:00	EU-27: New Car Registrations, Jan		
08:30	Sweden: Consumer Prices, Jan		
09:00	Italy: Trade Balance, Dec		
09:00	Euro Area: Current Account, Dec		
09:00	Norway: Trade Balance, Jan		
09:30	UK: Consumer Prices, Jan	-0.4% MM, 2.1% YY	0.4% MM, 2.0% YY0
	CPI Ex Food, Drink, Tobacco, Energy, Jan	-0.6% MM, 1.9% YY	0.1% MM, 1.7%YY
	Retail Prices, Jan	-0.4% MM, 2.6% YY	0.5% MM, 2.7% YY
	RPIX – Excludes Mortgages, Jan	-0.4% MM, 2.7% YY	0.5% MM, 2.8% YY
09:30	UK: Producer Input Prices, Jan	-0.6% MM, -2.9% YY	0.1% MM, -1.2% YY
09:30	UK: Producer Output Prices, Jan	0.2% MM, 0.8% YY	0.0% MM, 1.0% YY
	Ex Food, Drink, Tobacco, Energy, Jan	0.1% MM, 0.8% YY	0.1% MM, 1.0% YY
10:00	Germany: ZEW Economic Expectations, Feb		
Wednesday 19 February		Forecast	Last
08:30	Netherlands: Consumer Spending, Dec		
09:30	UK: LFS Unemployment, Oct-Dec	-194K QoQ, 7.0% Rate	-167K QoQ, 7.1% Rate
	Claimant Count Unemployment, Dec	-30K MoM, 3.6% Rate	-24K MoM, 3.7% Rate
09:30	UK: MPC Minutes		
10:00	Euro Area: Construction Output, Dec		
	Greece: Current Account, Dec		
Thursday 20 February		Forecast	Last
07:00	Switzerland: Trade Balance, Jan		
07:00	Germany: Producer Prices, Jan		
07:45	France: Consumer Prices, Jan		
08:30	Netherlands: Consumer Confidence, Feb		
08:30	Netherlands: Unemployment, Jan		
09:00	Italy: Industrial Orders, Dec		
09:00	Euro Area: Flash PMIs, Feb		
11:00	UK: CBI Industrial Trends Survey – Output Expectations, Feb	+24%	+23%
	CBI Order Books, Feb	+6%	-2%
	CBI Selling Prices, Feb	+10%	+20%
15:00	Euro Area: Consumer Confidence, Feb Flash		
Friday 21 February		Forecast	Last
08:00	Sweden: Business & Consumer Surveys, Feb		
09:00	Italy: Consumer Prices, Jan Final		
09:30	UK: Retail Sales Volumes, Jan	-2.0% MoM, 4.0% YoY	2.6% MoM, 5.3% YoY
09:30	UK: Public Sector Net Borrowing, Jan		
	Spain: Trade Balance, Dec		

Sources: National statistical offices, central banks and Citi Research

Title	Author	Date
Euro Area – Sovereign Debt Update		
German Constitutional Court Refers OMT to ECJ	European Economics Team	Feb 7, 2014
ECB To Stay On Hold For Now	European Economics Team	Feb 6, 2014
Euro Area PMI Hints at Accelerating GDP in 1Q14	European Economics Team	Feb 5, 2014
Greece: Third Bailout Not To Be Agreed Until Mid-Year	European Economics Team	Feb 4, 2014
ECB Liquidity Policy under the Spotlight	European Economics Team	Feb 3, 2014
Euro Area		
Euro Area - German Constitutional Court Leaves OMT in Limbo	Ebrahim Rahbari	Feb 7, 2014
ECB: No Change, But Action Likely In March -	Ebrahim Rahbari	Feb 6, 2014
Euro Area - Assessing Vulnerabilities to an EM Slowdown	Michael Saunders	Feb 3, 2014
ECB Preview - ECB Likely to Resist Pressure to Act at February Meeting	Guillaume Menuet	Jan 31, 2014
Euro Area - Inflation Surprises Once Again to the Downside in January	Giada Giani	Jan 31, 2014
Euro Area - Bank Lending Survey Confirms Supply-Side Improvement	Guillaume Menuet	Jan 30, 2014
Euro Area - Weak Money Supply But Stabilisation In Credit Dynamics	Guillaume Menuet	Jan 29, 2014
European Economic Forecast Highlights - January 2014	Ann O'Kelly	Jan 23, 2014
Euro Area - Composite Flash PMIs – Strong Start To 2014	Guillaume Menuet	Jan 23, 2014
ECB - Door Firmly Open to Easing to Address Two Contingencies	Guillaume Menuet	Jan 9, 2014
ECB January 9 Meeting Preview - Many issues to attend do, but no decisions expected yet	Guillaume Menuet	Jan 3, 2014
Euro Economics Weekly		
The Euro Area Now and Japan Then: Separated by One Large Shock	Ebrahim Rahbari	Jan 31, 2014
Spain Is Becoming More German	Giada Giani	Jan 24, 2014
Belgium: Politics the Likely Main Wild Card in 2014	Guillaume Menuet	Jan 17, 2014
Germany 2014 Outlook: Recovery And Rebalancing	Ebrahim Rahbari	Jan 10, 2014
2014 Outlook: GDP Risks, Credit Dynamics and Inflation Update	European Economics Team	Jan 6, 2014
Spain: 2014 Outperformer?	Giada Giani	Dec 13, 2013
Why Is France Underperforming? And How To Fix It	Guillaume Menuet	Dec 6, 2013
Is Deflation Good or Bad for the Eurozone Periphery?	Ebrahim Rahbari	Nov 29, 2013
Is This the End of Austerity?	Giada Giani	Nov 22, 2013
Recovery Watch: SME Lending is Key	Guillaume Menuet	Nov 15, 2013
One Shock Away from Deflation	Giada Giani	Nov 8, 2013
Why the ECB Should Worry About the Strong Euro	Ebrahim Rahbari	Nov 1, 2013
Italy and Spain Look Well Positioned For Job Growth	Guillaume Menuet	Oct 25, 2013
Portugal – What After June 2014?	Giada Giani	Oct 18, 2013
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
Chief Economist Publications		
Global Economic Outlook and Strategy - January 2014	Willem Buiter	Jan 22, 2014
Scandi		
Sweden - Recovery Underway In Manufacturing, Surprise Drop In Services	Tina Mortensen	Feb 7, 2014
Scandi Economics Update - Production and Orders Data set the Agenda	Tina Mortensen	Feb 7, 2014
Sweden - Riksbank Forecast: Stable Interest Rate and Path	Tina Mortensen	Feb 5, 2014
Norway - Weak Momentum In Private Spending	Tina Mortensen	Jan 31, 2014
UK		
UK - MPC – All Eyes on the Inflation Report	Michael Saunders	Feb 6, 2014
UK - PMI Edges Down, Still Points to Solid Growth;	Michael Saunders	Feb 5, 2014
UK - Highlights of the BoE Data and EC Survey	Michael Saunders	Jan 30, 2014
UK - GDP Data Show Solid Growth	Michael Saunders	Jan 28, 2014
UK - YouGov Reports Lower Inflation Expectations	Michael Saunders	Jan 27, 2014
UK - Carney Speech	Michael Saunders	Jan 24, 2014
UK - Change of UK Rate View	Michael Saunders	Jan 22, 2014
UK Economics Weekly		
How Vulnerable Is the UK to EM Strains?	Michael Saunders	Feb 7, 2014
Is Growth Credit-Led?	Michael Saunders	Jan 31, 2014
After Forward Guidance…"Fuzzy Guidance"	Michael Saunders	Jan 24, 2014
What Will the MPC Say When Unemployment Hits 7%?	Michael Saunders	Jan 17, 2014
Inflation Convergence and Divergence	Michael Saunders	Jan 10, 2014
2014 Outlook — Recovery and the New Normal	Michael Saunders	Jan 8, 2014

Source: Citi Research

Appendix A-1

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