

Italy – Government Rejects Publicly Funded Bad Bank

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

Summary

Italy – Treasury says a government-sponsored bad bank is not necessary, after the Bank of Italy suggested that bolder, system-wide, measures may be required to reduce the burden of bad loans on Italian banks' balance sheets. The Treasury said that the government already does its part in trying to ease the credit crunch through guaranteed funds and initiatives to support investments.

Italian banks may face a capital shortfall of €10-15bn after stress tests, says Italian banking association head. EBA stress tests reportedly to exclude Monte dei Paschi di Siena from standard assumptions, taking 2014-2016 balance sheet projections rather than Dec-13 balance sheet as starting point.

Italy – bad loan growth picked up in Dec, to 24.7% YY from 22.8% YY in Nov, possibly in preemptive move to clean up balance sheets ahead of AQR.

Italy – December industrial output down by 0.9% MM, weaker than expected.

German government to lift its 2014 growth forecast to 1.75% in Annual Economic Report.

France must do more with its structural reform agenda, says Rehn, given that France is one of the countries granted an extension of the fiscal targets on the condition that it undertakes "*serious economic reforms*".

France – GDP growth to slow in 1Q-14 says BdF to 0.2% QQ, from 4Q-13 GDP growth expected to come at 0.4% QQ (first 4Q GDP estimate out on Friday this week).

Spain – Public sector reform has allowed €7.4bn savings so far, PM Mariano Rajoy noted yesterday, roughly 26% of total expected savings (of €28.9bn) by 2015.

Spain – Electricity prices should decrease by 3% under new tariff-setting system, according to daily *El Pais*, quoting sources from the industry ministry. The new system will use the average of wholesale market prices to set electricity bills on a monthly basis.

Slovenia – Government ready to issue USD3.5bn in a dual tranche.

Today's News in Detail

Italy – Treasury rebuffs calls to set up government-sponsored bad bank.

11 February 2014

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With thanks to Antonio Montilla

Economics

Western Europe

Industrialised G7 Countries

Recent Research

Norway — Temporary Factors Lift Inflation in January

10 February 2014

Core inflation surprisingly accelerated to 2.4% YY in January (up 0.4pp from Dec), overshooting Norges Bank's forecast by 0.3pp. As actual inflation undershot Norges Bank's forecast by 0.3pp in December combined with the fact that the uptick in inflation in January was driven by temporary factors (unusually small price cuts during the winter sale on clothing, footwear and furniture), we see no need to change our view of a stable sight deposit rate throughout 2014.

Tina Mortensen

Euro Economics Weekly — ERS: An Alternative Solution to OMT?

7 February 2014

We think that the European Reward System has a reasonably good chance of being accepted as it does not require treaty changes, it limits the size of

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The Italian Treasury stated yesterday that the government already does its part in trying to lighten the credit crunch through guarantee funds and vehicles to support investments – such as the EIB and the Italian Fund Investment (IFI) – but it is not available to use domestic or European tax-payers money to manage the deteriorated assets in the banks' balance sheet. The note suggested privately-funded initiatives should instead be considered. The note came in response to the suggestion made by Bank of Italy Governor Ignazio Visco on Saturday to consider bolder, system-wide, measures to reduce the burden of impaired assets on the banks' balance sheets. Deputy Governor Salvatore Rossi said yesterday that Italy's weak public finances do not allow for a government-funded bad bank, Reuters reports. Reuters had reported that Italy's two largest lenders are in the process of setting up internal funds, co-funded with international investors, which would hold some of their bad assets.

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Italy – The banks may face a capital shortfall of €10-15bn after stress tests, the head of the Italian banking association said yesterday, reported by Bloomberg. Mr. Sabatini said the figure is in line with previous estimates by the Bank of Italy and that banks will have several ways to fund this gap, including selling non-core assets and additional deleveraging. He admitted that the smallest institutions with a capital ratio already close to 8% could consider strengthening their capital base. Separately, a Reuters story reports an Italian government official saying that the EBA will not use the end-2013 snapshot of the balance sheet for those banks that had mandatory EU-approved state aid and restructuring plans in place in 2013 – such as Monte dei Paschi di Siena. For these institutions stress tests would be applied to 2014-2016 balance sheet projections. Comment: attention to Italian banks' balance sheets has been growing recently, ahead of the asset quality review (AQR) and EBA stress tests. Aside from the stress induced by their large exposure to government debt, Italian banks have been affected to a smaller extent by the financial crisis than their counterparts in other periphery countries, due to the absence of similar credit boom-bust cycles in Italy. However, Italian output losses due to the prolonged recession have been the largest in the euro area after Greece. Real GDP is still 9.1% lower than the 2008-Q1 peak, a bigger gap than Ireland's (8.0%), Spain's (7.4%) or Portugal's (7.2%). This is resulting now in a large surge of impaired banks' assets which are absorbing an increasing amount of liquidity and reducing credit availability to the economy.

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Italy – bad loan growth picked up in December, to 24.7% YY from 22.8% YY in November, possibly in preparation for AQR. The stock of non-performing loans (NPL) rose to €155.8bn (10% of GDP) or 8.1% of total outstanding loans in December 2013, data from the Bank of Italy showed. NPLs to businesses jumped from 12.6% of total loans in Nov to 13.3% in Dec, in a significant acceleration relative to the rate of bad asset recognition of the previous months. Households' NPL ratio increased to 6.5% from 6.3% in Nov. Comment: banks may have been forced by the regulator to recognise a higher share of impaired asset in the NPL group ahead of the snapshot taken in Dec 13 for ECB's upcoming asset quality review.

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Italy – December industrial output down by 0.9% MM, weaker than expected. A large drop (-2.5% MM) in capital goods production was the main driver behind the decline in the overall index, while the recent strength in output for intermediate goods (more likely to be affected by the improvements in foreign demand and re-stocking) continued in December (+0.1% MM, +5.7% YY).

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Germany – government to lift 2014 growth forecast. Reuters reports that the

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 could soon become necessary at a time when financial market volatility could hamper investors' risk appetite.

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

Euro Area — German Constitutional Court Leaves OMT in Limbo

7 February 2014

German Constitutional Court (GCC) takes dim view of OMT, refers case to ECJ. The GCC said that it saw 'important reasons' to assume that the OMT exceeds the ECB's mandate and violates the Treaty's monetary financing prohibition and was therefore inclined to see the OMT as 'ultra vires' (beyond the ECB's powers).

[Ebrahim Rahbari](#)

UK Economics Weekly — How Vulnerable Is the UK to EM Strains?

7 February 2014

The UK continues to grow strongly, with solid gains in IP, car sales and house prices. However, with recent strains in a range of emerging markets (EM), this note aims to assess the extent to which the UK is vulnerable to potential EM weakness. The UK economy is very globalized, but the UK's direct export exposure to EM is relatively low. Recent experience suggests that – provided US and EMU growth prospects do not worsen sharply -- further steady EM downgrades will not derail the UK's recovery.

[Michael Saunders](#) | [Ann O'Kelly](#)

Sweden — Recovery Underway In Manufacturing, Surprise Drop In Services

7 February 2014

Although the production data is very volatile and industrial production barely expanded in the fourth quarter, a recovery still seems to be on the way. Meanwhile, the surprise drop in Dec service sector production is somewhat

German government is to raise its 2014 growth forecast slightly from 1.7% to 1.75% in its Annual Economic Report that is due to be presented today and approved by the cabinet tomorrow. According to the report, exports are expected to rise by 4.1%, while employment would rise by 240k to a new record high of 42.1m (lowering the jobless rate from 6.9% to 6.8%).

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France must do more with its structural reform agenda says Rehn - EU Economic and Monetary Affairs Commissioner Olli Rehn told Reuters in an interview at the Reuters Euro Zone Summit that some countries were granted an extension of the correction deadline for the excessive deficit *"on the condition that these countries undertake serious economic reforms"*. Mr. Rehn stressed that *"there is much room for significant intensification in structural reforms in many member states like France and Italy"*. *Les Echos* notes that negotiations between Paris and Brussels have already started as part of the Stability and Growth Pact multi-annual (2015-17) budget submissions to be made in April. The newspaper writes that there are six priority areas for expenditure savings: i) public sector remunerations, 2) health spending, 3) solidarity & income support policies, 4) public sector employment, 5) local authorities and 6) government subsidies for housing, transport and the environment. Comment: in light of recently announced objectives of lowering corporate taxes and labour costs, the government will likely be required to make more savings in its 2015 budget, and in subsequent years if it wants to continue its effort to improve French corporate margins. The tough choices (yet to be announced) will have to be publicised soon, although we suspect that more details will only emerge for 2016-17 after the EP elections at the end of May.

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France – GDP growth to slow in 1Q-14 says BdF. French industrial production rose by 0.3% QQ in 4Q-13 according to figures released by INSEE on Monday, but output fell by 0.3% MM in December due to weak refining and food production. Separately, the Bank of France forecast that the economy would grow 0.2% QQ in 1Q-14, with its January business survey noting that both industrial and services companies had reported that they expected business to pick up this month. INSEE will report its first 4Q GDP estimate on Friday: we look for a 0.4% QQ gain, but acknowledge some downside risks. Comment: the recovery in business sentiment is lagging that in many of its peers, as uncertainty persists about the perceived ability of the government to add sufficient vigour to reform the economy and drive hard on delivering improvements in competitiveness. We continue to forecast that the French recovery in economic activity will likely lag behind the euro area average in both 2014 and 2015.

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Spain – Public sector reform has allowed for €7.4bn savings so far. PM Mariano Rajoy said yesterday that the reform of the public administration has translated into €7.4bn of savings for the government so far, roughly 26% of total expected savings (of €28.9bn) by 2015. In particular, Mr Rajoy noted that so far the government has implemented 23% of the planned measures, including measures relating to public employment, restructuring of institutions, and improvements in the management of public services. Comment: the progress so far in the implementation of the public sector reform seems a bit limited in our view. In particular, the government has recently stated that it is planning to cut income and corporate taxes in 2015, as part of a general overhaul of the tax system. In our view, the government does not have much room for a meaningful reduction in taxation without some additional savings from the expenditure side.

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Spain – Electricity prices should decrease by 3% under the new system, according to daily *El País* quoting sources of the industry ministry. The new

worrying (accounts for 50% of GDP), and suggests that 4Q GDP growth likely will undershoot the Riksbank's 0.7% Q/Q 4Q GDP projection (and even our 0.5% Q/Q forecast). We maintain our view that economic activity is likely to pick up this year, but recovery will be protracted

Tina Mortensen

ECB: No Change, But Action Likely In March —

6 February 2014

Unchanged today, but we now expect a March rate cut. The ECB disappointed market hopes of action today, keeping its interest rates, non-standard measures unchanged and not ending SMP sterilisation. But ECB President Draghi opened the door to action in March. We therefore bring forward the timing of the refi rate cut to March, looking for a 15bp cut in the refi rate (leaving the deposit rate at zero).

Ebrahim Rahbari | Guillaume Menuet

UK — MPC – All Eyes on the Inflation Report

6 February 2014

The MPC left Bank Rate and QE unchanged. The MPC are likely to unveil the next phase of forward guidance at next week's "Inflation Report". Inevitably, such a framework will be far less precise than the current forward guidance framework aimed to be. In future, the MPC are likely to put more emphasis on a range of guides to labour market slack, and this may well include the concept of under-employment – that is, people who would like to work more hours than currently or get an extra job.

Michael Saunders

Sweden — Riksbank Forecast: Stable Interest Rate and Path

5 February 2014

We expect the Riksbank to maintain the repo rate and its rate path unchanged at the upcoming 13 Feb meeting. Hence, the Bank is expected to continue to signal a 16% chance of another near-term rate cut and initial tightening early next year. With improving growth metrics and indications that unemployment is likely to decline soon, we reckon the Dec interest rate cut

system will scrap tenders for determining electricity bills, while prices will be set monthly, based on an average of wholesale market prices. According to the newspaper the new system has reportedly been submitted to the regulator, the CNMC, this week in order to have it applied by April. Comment: the government expects the new system should reduce market intervention in setting electricity prices and eventually allow for savings on consumers' power bills. However, the energy tariff deficit remains considerably high (at €3.6bn), suggesting that price increases may need to be implemented later in the year.

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Slovenia – Government ready to issue USD3.5bn in a dual tranche. If the issuance of USD3.5bn (€2.6bn) is completed, Slovenia would cover 74% of its planned 2014 gross borrowing requirements (GBR) of €3.5bn. If financing reserves of €2.5bn from the end of 2013 are added (excluding the cash recapitalisation of the three state-owned banks), this would mean that the GBR of €4.2bn for 2015-2016 is also 38% covered. Comment: It seems that the GBR for 2014 is now covered. However, there are still two downside risks, that is another capital injection into the banking sector (into smaller local banks) or into quasi-government companies and an eventual larger fiscal deficit.

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Latest Issues of Sovereign Debt Update

France Gears Up for Political Battle for a Lower Euro

10 February 2014

France's Montebourg says necessary to bring euro to "reasonable and acceptable" level. Mixed reaction to German Constitutional Court decision to refer OMT to ECJ. ECB Supervisory Board's Nouy says ready to see some banks disappear. ECB perhaps to publish Minutes. German IP below consensus in Dec. French govt targets 2Q date for Responsibility Pact. Bank of Italy calls for "bad bank". Italy's centre-left ahead in EP polls. Spain's govt scraps electricity auctions. Portugal's 10Y bond.

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German Constitutional Court Refers OMT to ECJ

7 February 2014

German Constitutional Court refers OMT to ECJ. ECB likely to cut in March. ECB's Liikanen on EM and Noyer on euro. Disagreements on SRM. BdF's Noyer says more reforms needed in France. Hollande's approval ratings fall. Italy: Renzi's Senate proposal, rising calls for Renzi to replace Letta as PM. Independence is preferred option for Catalans. Dutch eurosceptics say EU exit would lift GDP growth. Fitch revises up GDP forecast for Portugal. Greece's 2013 recession less than expected, says FinMin.

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ECB To Stay On Hold For Now

6 February 2014

No change in ECB rates expected today - we believe the Governing Council will prefer to wait for March macroeconomic forecasts. Euro area retail sales post surprisingly large fall in Dec. Deficit of German regions falls to €0.5bn in 2013. French President Hollande aims to speed launch of Responsibility Pact. Support for Spain's ruling PP continues to fall. Greece: maturity extension and 50bp interest rate cut on bilateral loans, reports Bloomberg, but denials by Germany and EU Commission.

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Euro Area PMI Hints at Accelerating GDP in 1Q14

probably is the last in this easing cycle.

[Tina Mortensen](#)

Scandi Economics Update — Temporary Factors behind higher Norwegian Inflation

11 February 2014

Sweden — FinMin: Tougher bank rules needed to help weaken the SEK — Yet another opinion poll confirming opposition lead — Stable registered jobless rate in January.

Norway — Temporary factors lift inflation in January — PM: A bit more weakness to come, economy face competition and productivity challenges.

[Tina Mortensen](#)

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5 February 2014

Rise in Jan EA composite PMI suggests a pickup in GDP growth in 1Q. ECB reshuffles responsibilities of Executive Board members. EBRD to start investing in Greece, Portugal, Cyprus. Greece's 2013 primary surplus may reach 0.8% of GDP, possibly resolving troika stumbling block. Greece's opposition Syriza party would seek debt write-off of 60% of GDP, if elected.

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Greece: Third Bailout Not To Be Agreed Until Mid-Year

4 February 2014

Third Greek bailout not to be agreed until mid-year. Little new at ECB's AQR press conference. Draghi to seek Bundesbank support to end SMP sterilisation. ECB's Lautenschläger on SSM at EU Parliament. Juncker as main centre-right candidate for EC president. German Foreign Min on EU treaty renegotiation. French spending review and corporate tax talks. Italy's 4Q GDP growth and state sector cash balance. Spain's manufacturing PMI, registered unemployment. Slovakia's solid fiscal revenue in Jan.

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Macroeconomic Forecasts

European Economic Forecast Highlights — January 2014

23 January 2014

This companion to Global Economic Outlook and Strategy - January 2014 gives detailed quarterly forecasts for the main European countries to end 2015 and annual forecasts to 2018 for growth, inflation, current balance, fiscal balance, primary balance and government debt.

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

Global Economic Outlook and Strategy — January 2014

22 January 2014

We are pushing up our global growth forecasts this month, and now look for global GDP growth (at current exchange rates) to rise from 2.5% in 2013 to 3.3% in 2014 and 3.4% in 2015, up by 0.1pp for 2013, 0.2pp for 2014 and 0.1pp for 2015 from our previous forecast. This year will, we expect, mark a return to sustained above-average global growth rates, whereas global growth has been below average for three consecutive years (2011-13) and indeed in five of the last six years.

[Willem Buiter](#) | [Michael Saunders](#) | [Robert V DiClemente](#) | [Kiichi Murashima](#)

Emerging Markets Macro and Strategy Outlook — The 'Fragile 5': A Progress Report

GEMS, Asia, CEEMEA, Global, Latin America – 24 January 2014

The 'F5' - Brazil, India, Indonesia, South Africa and Turkey - were at the heart of EM's underperformance in 2013, but investors have become more discriminating lately: the IDR, BRL and INR have been the best-performing EM currencies since the start of the year, while the ZAR and TRY have been the worst. We don't pretend to have a full 'theory' of how investors should discriminate among these economies over the next few months, but some trends are becoming clear.

[Guillermo Mondino](#) | [David Lubin](#) | [Johanna Chua](#)

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Appendix A-1

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