

ECB's Draghi Gives Another Nod to Possibility of Full QE

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Summary

ECB's Draghi: ready to “alter the size and/or composition of unconventional interventions” – transitioning from “a monetary-policy framework predominately founded on passive provision of central-bank credit to a more active and controlled management of our balance sheet”. On **inflation**, the ECB President noted that policy makers would “focus in particular on repercussions of damped growth dynamics” and “closely monitor risks to price stability”.

EC's Barroso says ECB should use all available instruments.

EC's Barnier: EU bank liquidity rules to differ from Basel to take into account European “specificities”. The European variant is expected to include support for “high quality asset –backed debt”

S&P: success of German Eurosceptic AfD party likely complicates Eurozone policies, as it could toughen the German government's response to the Eurozone economic crisis.

Germany: Bundesbank Monthly Report notes that special factors distorted the July rebound and suggests sentiment reading are a better guide to current economic momentum in Germany.

Germany's Economy Minister Gabriel proposes six-point plan to support German competitiveness, including lowering energy costs and improving domestic infrastructure.

France: PM Valls tells Mrs. Merkel “his mission is to reform France” – also welcomed the fall in the Euro as a “step in the right direction”.

France: INSEE business confidence and PMIs confirm weakness in activity.

Italy – Lower public deficit and debt ratios on new ESA2010 methodology. 2013 debt-to-GDP ratio now estimated by ISTAT at 127.9%, down from 132.6% previously. **Industrial orders fall by 1.5% MM in Jul**, replicating the June decline and confirming risks of a negative GDP growth reading in Q3 14.

Spain – Catalan Premier to call early regional elections simultaneously with independence referendum, scheduled for Nov 9, daily *El Mundo* reports.

Spain – Tourist arrivals rose strongly in August 2014, up by 8.8% YY, highest monthly arrivals ever recorded.

Greece – banks to get €3bn extra capital from recognition of deferred tax assets, *Ekathimerini* reports, avoiding the use of state-funded recapitalisation fund (HFSF) after the stress tests.

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With thanks to Antonio Montilla and Ann O'Kelly

Economics

Western Europe

Industrialised G7 Countries

Recent Research

Scandi Economics Update — Intensive Days Ahead for Sweden's Löfven

23 September 2014

Sweden — Riksbank Deputy Governor Ekholm said yesterday she does not see any imminent need for more stimulus, but does not rule out additional easing should inflation miss estimates. In such a case, she would prefer cutting the repo rate further as an initial step rather than postponing rate increases.

Sweden — Social Democratic leader Löfven and the Green Party have started talks on how to form a new coalition government. Mr Löfven must report back to the Speaker of Parliament by noon on Friday 26 September. The four alliance parties have made it clear that they are open to cooperating with a new SocDem-led government on individual issues, but only if Mr Löfven stands by previously reached agreements on defence, migration and free schools.

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

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Today's News in Detail

ECB Draghi: ready to “alter the size and/or composition of unconventional interventions” – ECB President Mario Draghi indicated in his quarterly testimony to the European Parliament’s Economic and Monetary Affairs committee that “*we are starting a transition from a monetary-policy framework predominately founded on passive provision of central-bank credit to a more active and controlled management of our balance sheet*”. On **non-standard measures**, President Draghi stressed that “*we stand ready to use additional unconventional instruments within our mandate, and alter the size and composition of our conventional interventions should it become necessary to further address risks of a too prolonged period of too low inflation*”. On **inflation**, the ECB President noted that policy makers would “*focus in particular on repercussions of damped growth dynamics*” and “*closely monitor risks to price stability*”. On **TLTROs**, Mr. Draghi remarked that the €82.6bn allotted amount was “*within the range of take-up values we had expected based on banks’ revealed behaviour under previous programmes*”, stressing the need to assess the September and December operation “*in combination*”. On **ABS purchases**, Mr. Draghi confirmed that the ECB would be buying “*senior and guaranteed mezzanine tranches*”. Comment: President Draghi used the testimony to modify the ECB’s message, making a clear reference to the possibility of changes in the size and/or composition of unconventional tools. The active management of the balance sheet requires that the central bank controls quantity, with the price already set at a record low and banks’ appetite for more liquidity likely to be restricted by a lack of demand. We believe that this language is likely to appear again in the ECB’s future statements and open the door to a fully-fledged QE programme including public sector assets later in 2014 or in early 2015 once the ECB has concluded that the risk of persistent ‘low-flation’ needs to be combatted more aggressively to deliver on its price stability mandate.

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EC’s Barroso: ECB should use all available instruments: Bloomberg reports that the current European Commission President Barroso said that “*we certainly think that the ECB should use all the instruments available to counter the risk of deflation*”, calling deflation risk a “*worrying development recently*” and noting that inflation at the European level was well under the target. However, Barroso said that he thought the Eurozone would avoid a recession and that “*the existential crisis regarding the Euro is over*”. Barroso also said that he is confident that the UK will stay in the EU and that “*the very arguments that the UK government used for Scotland to remain in the United Kingdom can be used for the UK to stay in the European Union*”.

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EC’s Barnier: EU bank liquidity rules to differ from Basel. Bloomberg reports that the EU’s financial services commissioner Barnier said that the EU will make changes to liquidity rules agreed on by global regulators when applying the measure to its banks. Barnier rationalised the variation, as there are “*specificities*” in Europe that need to be taken into account in the rule, when speaking to the European Parliament’s Economic and Monetary Affairs Committee. Among the changes to Basel rules, Barnier suggested measures to spur the recovery of the EU market for “*high-quality asset-backed debt*”. Barnier said that the EU will present its proposal on the liquidity coverage ratio in early October.

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S&P: German Eurosceptic party likely complicates Eurozone policies. Bloomberg reports that the rating agency S&P said in a statement that the rise of

Euro Economics Weekly — H2 GDP Uptick Too Small to Stop ECB QE

19 September 2014

Surveys are a better indicator of real activity levels than Eurostat estimates. The potential for upward revisions to H1-14 GDP growth suggests that the underlying pace of GDP growth is closer to 1% YY. The euro area’s presumed vulnerability to shocks is therefore perhaps less acute. But short-term models point to risks of slower economic activity and weaker business confidence in the quarters ahead. Large output gap and likely persistence of ‘low-flation’ to lead the ECB to launch a large purchase programme soon including public debt.

Guillaume Menuet | Giada Giani | Ebrahim Rahbari | Michael Saunders

UK Economics Weekly — After the “No” Vote

19 September 2014

With the clearcut “No” vote, the immediate uncertainties of possible implications of Scottish independence are likely to recede. We expect that markets will focus on three key issues: First, data and business surveys suggest that economic growth remains well above the pre-crisis average. Second, labour market slack is shrinking fast, with a rapid drop in unemployment and a sharp rise in vacancies. We expect the jobless rate will fall below 6% by the end of this year and fall below 5% about a year from now. Third, UK political uncertainties are unlikely to vanish totally, with the prospect of wrangling over “devo-max” for Scotland, the UK general election in May 2015 and possible EU referendum in 2017 or so.

Michael Saunders | Ann O’Kelly

UK — Scotland Referendum Produces Clear “No” Vote

19 September 2014

With most of the results in, the BBC and other news media put the Scottish independence result at about 55%:45% in favour of the “No” vote (against independence). The SNP leadership has conceded defeat. We highlight four

the Alternativ für Deutschland (AfD) party could toughen the German government's response to the Eurozone economic crisis, even though it did not point to potential rating implications at this point. An S&P credit analyst said that *"any signs of Germany hardening its stance could diminish the confidence of financial investors in the robustness of multilateral support upon which any Eurozone sovereign could draw, should it be required."* **Comment:** we agree that the growing popularity of the AfD makes it more difficult (and less likely) for the German government to agree on measures that are deemed to support struggling Eurozone countries at the expense of Germany.

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Germany: Bundesbank's Monthly Report notes special factors distorting July rebound. In its monthly report the Bundesbank noted that after a very weak Q2, German macro data for July surprised on the positive side. However, the Bundesbank argued that the strong July readings were distorted by special factors, including the effects on industrial production from an unusual timing of school holidays and the effect of large (and long delayed) shipbuilding orders on industrial orders. The Bundesbank therefore suggests that sentiment indicators, which continued to weaken in July and August, were a better guide to the underlying growth momentum in Germany.

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Germany's Gabriel: Economy Minister proposes six-point plan to support German competitiveness. *Handelsblatt* reports that German Economy Minister and Deputy Chancellor Gabriel presented a six point plan to improve German competitiveness in a speech in front of the German industrial association BDI. The focal points of his initiative include securing the supply of skilled employees, lowering energy costs, a moratorium on bureaucracy for new firms, supporting entrepreneurship, and improving domestic infrastructure.

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France: PM Valls tells Mrs. Merkel "his mission is to reform France" – PM Manuel Valls met with German Chancellor Angela Merkel on Monday for talks in Berlin. Mr. Valls indicated that *"when it comes to reforms, we will do them because it is in our own interest"*. He explained that *"the Germany will like the France that carries out reforms. My mission is to reform France"*. Mrs. Merkel noted that *"this is an impressive number of measures that France is undertaking"*, adding that *"I see these great efforts and the evaluation of these will be up to the European Commission"* according to Reuters. Mr. Valls also noted while visiting an Airbus factory in Hamburg that the Euro had fallen, and that *"anything that helps competitiveness in this area is a step in the right direction"*. **Comment:** Mr. Valls' trip to Germany was probably a necessary step towards convincing Berlin about the need to be more adventurous with a European investment programme. On the aspect of overhauling France's economy, it is possible that the list of measures presented to Mrs. Merkel is more extensive than its public version that only contains a draft "low on growth" and the Responsibility Pact aiming to trim employers' social security contributions and cut red tape. In our view, more will be needed in coming quarters to revamp business confidence.

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France: business confidence and PMIs confirm weakness in activity – INSEE reported that **industrial confidence** was unchanged at 96 in September, matching the consensus forecast (Citi 95). While industrialists' assessment of past production was reported to have weakened in September, the assessment of order books was stable, and the stock of finished goods was assessed to have fallen to a five months' low. Both personal and general output perspectives rose to a three-month high. Overall business confidence dropped by one-point to a 13-month low of 91 (-0.9sd below its historical average). The **composite PMI** fell by 0.9 point to a three-month low of 49.1, with 1.7-point drop in services to a 3-

points. First, debate over Scotland's form of government will probably continue. Second, support for independence is roughly 10 percent higher than polls indicated six months ago, and is sufficiently high that the referendum is likely to be followed by a "neverendum" scenario. Third, UK political uncertainties will not vanish, given the approach of the UK general election in May 2015 and possible EU referendum in 2017-18 or so. Fourth, the economy remains strong, and labour market slack is shrinking fast. We stick with our base case that the MPC are likely to start to hike rates in the next six months, either Q4-2014 or (slightly more likely) Q1-2015.

Michael Saunders

Norway — Norges Bank Removes its Near-Term Easing Bias

18 September 2014

As expected, Norges Bank left the key policy rate unchanged at 1.50%, and raised the conditional interest rate path in the short term, closing the door for a near-term rate cut. While the press release stressed that: *"The analyses in the monetary policy report presented today imply that the key policy rate will remain at the present level to the end of 2015, rising gradually thereafter"* (basically unchanged from the wording in June), we note that a first rate hike in the September conditional interest rate path is not fully priced in until 1Q-17 (one quarter later than in the June path). The revisions to the rate path support our view that Norges Bank will stay on hold until higher key rates abroad ease the otherwise large appreciation pressure on the NOK. Hence, we maintain that initial tightening is unlikely to commence until 2016.

Tina Mortensen

UK — Labour Market Data and BoE Agents

17 September 2014

There are several points of interest in today's data. First, the jobless rate continues to fall rapidly, reaching 6.2% in May-July from 7.7% a year earlier. The drop in the jobless rate over the last year (1.5 percentage points) is the sharpest since 1989. The jobless rate is

month low of 49.4 more than offsetting the 2.3-point gain in manufacturing to 48.8. Comment: while confidence in the industrial sector appears to be stabilizing gradually, helped by the government's greater focus on competitiveness and the cheapening of the Euro, the weakness of domestic demand is permeating to the services sector. We continue to believe that France is on course to underperform its peers in coming quarters.

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Italy – lower public deficit and debt ratios to GDP on new ESA2010

methodology. The Italian national statistical office ISTAT published yesterday the new annual series of the national accounts and public sector accounts for the years 2009-2013. The level of 2013 nominal GDP was revised upward by 3.8%, but real GDP dynamic was left almost unchanged, at -2.3% in 2012 (-2.4% previously estimated) and at -1.9% in 2013. The 2013 general government budget deficit was revised slightly lower, to 2.8% of GDP, compared with 3.0% previously estimated. As a result of these revisions, ISTAT estimated the public debt-to-GDP ratio stood at 127.9% in 2013, quite significantly lower than 132.6% previously estimated. The debt ratio increased from 122.2% in 2012 and 112.5% in 2009.

Italy – industrial orders fall by 1.5% MM in July, replicating the June decline. Foreign orders were the main driver of the slowdown (-2.1% in Jul, -3.5% in Jun), while domestic order growth remained sluggish. Comment: together with weak industrial production and export data in July as well as falling business confidence in August, we believe this suggests GDP growth may turn out negative again in Q3 14.

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Spain – Catalan Premier to call early regional elections to be held

simultaneously with independence referendum, daily *El Mundo* reports citing unknown sources. This would reportedly allow the Catalan government to send Catalan voters to the polls even in the (very likely) case the independence referendum is banned by the Constitutional Court. The Catalan Parliament passed last Friday a regional law to call the independence referendum, but the law is expected to be struck down by the High Court and the referendum effectively banned. Catalan Premier Mas said this week that he intends to call the referendum in the next few days, as soon as the law is published in the official regional gazette. Comment: early regional elections in Catalonia have been our base case scenario in the case the referendum was called off (see [Spain - What's Next For Catalonia Following Congress Rejection?](#))

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Spain – Tourist arrivals rose strongly in August 2014. The number of foreign tourists visiting Spain rose to 9.1m in August, an all-time high of monthly arrivals, and 8.8% YY above Aug 13, data from the Ministry of Industry, Energy and Tourism showed. Year-to-date 45.4m foreign tourists have visited Spain, 7.3% above Jan-Aug 2013. Comment: the strong figures in the Jan-Aug period come after Spain received over 60 million tourist arrivals in 2013, an all-time record.

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Greece – banks to get €3bn extra capital from recognition of deferred tax

assets, *Ekathimerini* reports. Including deferred tax assets in the capital calculations will have to be approved by the European banking Authority if it has to enter into the calculations for the stress tests. The practice has been used in other euro-area periphery banking sectors to support capital positions.

Ekathimerini reports that this accounting change would allow Greek banks to

again below the MPC's forecasts (the August Inflation Report projected the jobless rate for May-July at 6.3%). The single month jobless rate for July alone is 5.9%, down from 6.4% three months earlier. Second, job growth continues to be concentrated in sectors with relatively low pay levels. Third, there is no sign that Job growth in Scotland is being hit by pre-referendum nerves.

Michael Saunders

Sweden — Riksbank Minutes Suggest Monetary Policy Will React Asymmetrically to Near-Term Inflation

17 September 2014

The minutes from 4 September monetary policy meeting confirmed the Riksbank's wait-and-see stance following the larger-than-expected 50bp rate to 0.25% in July and above-forecast inflation in recent months.

The tone of the minutes, meanwhile, were more dovish than expected, not least as the Riksbank emphasised that it has an asymmetrical reaction function – with the tolerance level for downside inflation surprises staying low. Also comments related to the timing and pace of monetary policy tightening had a dovish tilt, with a softer tone from the “hawks” on the board and a generally increased focus on interest rate expectations abroad.

Overall, the minutes support our view that rate hikes are remote, and we continue to believe that initial tightening is unlikely to happen until 2016.

Tina Mortensen

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avoid accessing the state-funded recapitalisation fund (HFSF) in the aftermath of the stress tests and leave the €11bn cash reserves in the fund intact.

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Latest Issues of Sovereign Debt Update

Catalan Parliament Passes Law to Call Independence Referendum

22 September 2014

Catalan Parliament passes referendum law. ECB: Visco on euro decline, Coeure on need for time. Criticism from BuBa's Weidmann. Germany against using ESM to boost investment. Schaeuble warns of bubble risk. German govt won't delay bank reform but may align with EU rules. German tax revenue rises. France: Sarkozy comeback. Moody's maintains France's rating. Greek govt targets bailout exit by Dec, Syriza leads polls. Portugal's coincident activity indicator falls.

[Ebrahim Rahbari](#) | [Guillaume Menuet](#) | [Giada Giani](#)

First TLTRO Take-Up Disappoints at €82.6bn

19 September 2014

TLTRO take-up disappoints. ECB on TLTRO and asset purchases. ECB's new voting rota. Call for lower German taxes. Germany: govt to revise proposed bank regulation, trade unions back TTIP trade talks. France's Hollande finds it "hard" but will tough it out. Italy: IMF optimistic, Senate passes crucial labour amendment, postal privatisation timetable slips. Spain's govt to raise GDP forecast in 2015 budget. Spanish banks: TLTRO take-up, NPL ratio. Slovenia's new government. Scotland's No.

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ECB Comprehensive Assessment Likely on Oct 26

18 September 2014

Date soon for ECB's Comprehensive Assessment. EC's Katainen warns on future market risk. EU Jobs Summit possible on Oct 8. France's new EconMin: "we are paying price of lost decade". Italy's govt proposes easing rules on dismissal for new workers. Spain's Rajoy says Scottish referendum a "torpedo" against the EU. Catalan Parliament declares in favour of Catalan referendum. Netherlands targets narrower budget deficit in 2015. Belgium: talks continue on coalition govt. Greek banks' TLTRO needs.

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ECB May Buy Low-Rated ABS

17 September 2014

ECB may buy lower-rated ABS. ECB to redraft confidentiality agreement with banks. ECB's Liikanen reaffirms ECB's willingness to do more. Germany: Schäuble sees no need to change fiscal policy in light of worse economic outlook, ZEW survey continues to decline. France's PM Valls wins confidence vote. Italy: Confindustria slashes GDP forecasts, PM Renzi pledges labour market reform, FinMin rules out VAT hike. Greece: Syriza's programme costed by Finance Ministry. Slovenia: fiscal update.

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OECD Downgrades Eurozone Outlook, Calls for QE

16 September 2014

OECD says QE warranted in Euro area, cuts GDP forecasts. Regulators discuss changes to ABS rules. EU banks object to ECB stress test confidentiality agreement. German deputy FinMin says ECB policy relies on reforms being

effective. France: confidence vote today after PM Valls' policy speech. OECD and S&P cut Italy's GDP forecast for 2014-15. Spain: Catalonia may hold early regional election if referendum called off. Catalonia regional govt. not to comply with 2015 fiscal target says PM Mas.

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Macroeconomic Forecasts

Foreign Exchange Forecasts — Policy Divergence Kicks In – September 2014

19 September 2014

Divergent monetary policies in G10 economies finally sparked FX volatility in September. As the carry trade gradually fades, to be replaced by a more dynamic “monetary surprise” driver, we expect USD gains to continue and be extended. We expect EUR and most other European currencies will be the biggest losers. It feels like a lower EUR is the only intermediate objective the ECB has to stabilize falling inflation expectations. We expect ongoing monetary ease to facilitate this with EUR likely to fall to 1.10-1.20 and CHF, SEK, and NOK also likely to suffer. Given a respite in UK political uncertainty, and a still strong economy, we forecast gains for GBP vs. EUR but expect some downside vs. USD. We expect stability in USD/EM over 0-3m but risks seem one-sided towards EM-weakness and, over 6-12m, we see USD gaining as we approach outright Fed tightening. Our forecasts imply 4-5% EM depreciation.

[Jeremy Hale](#)

Europe: Monthly Inflation Profiles For Selected Countries

5 September 2014

Updated monthly inflation forecasts for Euro Area, Germany, France, Italy, and Spain.

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

European Economic Forecast Highlights, August 2014

21 August 2014

This companion to the August issue of Global Economic Outlook and Strategy gives more detailed forecasts for the main European countries to 1Q16, together with 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](#)

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Appendix A-1

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