

# Euro Area: Sovereign Debt Crisis Update

## ECB Officials Suggest Unchanged Rates in March

- **ECB officials do not suggest rate cut in March.** ECB's Asmussen expects 1Q GDP to be stronger than 4Q with a very gradual recovery over the course of the year, adding that monetary policy conditions in the euro area are accommodative. Separately, Bank of France Governor Noyer says in WSJ that the transmission of monetary policy is more important than a reduction in interest rates. Noyer also expects that excess liquidity levels will remain *"very significant"*. On the euro, he said that exchange rate changes will influence the inflation outlook. In his view, economic fundamentals do not provide reasons for the euro to be pushed higher. Bundesbank's Weidmann welcomed that *"the G-20 agreed that competitive devaluations have no winners."* Comment: these statements suggest that a rate cut in March is unlikely. However, with upside pressure on the currency, ongoing economic weakness and signs of inflation being significantly below target, we expect the ECB to cut rates during 2013.
- **Italian Election.** Yesterday Stefano Fassina, chief economic official in the centre-left Democratic Party, said his party was committed to rapid economic reform and that outgoing premier Mario Monti must have a frontline political role. However, in an interview Monti said *"We have nothing in common with the left-wing coalition."* Separately, Silvio Berlusconi repeated his demands for a more activist ECB, warning that otherwise some countries might have to leave the euro.
- **Greece – 24-hour general strike** today against the austerity measures.
- **Hollande visits Athens**, mainly to demonstrate solidarity, but also offering to mobilize investments.
- **Portugal:** Government's debt agency chief says he expects Portugal to get full market access in 2013. Comment: This would most likely qualify for OMT purchases. However, the hurdles for full market access are very high.
- **Fears that FTT will harm Portugal** from the head of the Lisbon stock exchange.
- **SPD chancellor candidate Peer Steinbrück** said, according to Bloomberg, that a decision to rule out further haircuts reflected *"blackmail"* by bond investors.
- **Germany's IG Metall demands 5% wage increase** for steelworkers. Comment: we expect a wage increase around 3% in that sector.
- **German vote on Cyprus package not before April**, says CDU representative.
- **German price data.** January inflation of 1.7% YY confirmed (HICP at 1.9% YY). Producer prices increased by 0.8% MM 1.7% YY in January.
- **Decline in French inflation** in January to 1.4% YY (HICP) and 1.2% (national CPI).
- **French manufacturing business climate increased** from 87 in Jan to 90 in Feb. There was a strong gain in companies' own-production outlook from -14 in to +2.

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**Jürgen Michels**

+44-20-7986-3294

juergen.michels@citi.com

**Giada Giani**

+44-20-7986-3281

giada.giani@citi.com

**Guillaume Menuet**

+44-20-7986-1314

guillaume.menuet@citi.com

**Michael Saunders**

+44-20-7986-3299

michael.saunders@citi.com

**Tina Mortensen**

+44-20-7986-3284

tina.mortensen@citi.com

**Ann O'Kelly**

+44-20-7986-3297

ann.okelly@citi.com

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- **ECB officials do not suggest rate cut in March.** At a speech in Bratislava, ECB Executive Board Member Jörg Asmussen said that he expects 1Q GDP to be stronger than in 4Q and that he expects a very gradual recovery over the course of the year. Mr. Asmussen, in line with the February ECB press conference statement, said that monetary policy conditions in the euro area are accommodative. Separately, Bank of France Governor Christian Noyer said in an interview with *Wall Street Journal* that the transmission of monetary policy is more important than a reduction in interest rates. He said that *"there is no particular interest in cutting rates by a few cents if it only impacts Germany or core countries"*. Mr. Noyer was also relaxed in respect of the reduction in liquidity through the LTRO repayments as, in his view, excess liquidity levels will remain *"very significant"*. On the development of the euro, he said that exchange rate changes will influence the inflation outlook. Similar to Bundesbank President Jens Weidmann, Mr. Noyer talked positively about the G20 statement, saying that *"will help currencies to stay in line with economic fundamentals and from this point of view there is no reason for the euro to be pushed higher"*. According to Mr. Weidmann, quoted by FAZ, the statement shows that *"the G-20 agreed that competitive devaluations have no winners. In the future, difficult economic situations in some countries will not be addressed with protectionism and currency manipulation."* Comment: the statements from ECB officials suggest that a rate cut in March is unlikely. However, with upside pressure on the currency, ongoing economic weakness and signs that inflation is significantly below the *"below, but close to 2%"* target, we expect the ECB to cut rates in the course of 2013. We expect a first 25 bp rate cut (refi rate only) in 2Q, followed by a second refi rate cut in 2H to 0.25% and at that stage also a cut of the deposit rate to negative.
- **Italian Election.** Yesterday Stefano Fassina, chief economic official in the centre-left Democratic Party, said that his party was committed to rapid economic reform and that outgoing premier Mario Monti must have a frontline political role. According to Mr Fassina, divergences between Mr. Vendola, leader of the small Left, Ecology and Freedom (SEL) party which is part of the centre-left alliance, and Mr. Monti *"are enormously exaggerated,"* adding that Vendola had signed a pact to follow majority decisions in the coalition, in which the PD would be dominant. However, in an interview with daily *Il Messaggero* on Tuesday, Mario Monti said that *"We have nothing in common with the left-wing coalition."* Separately, Silvio Berlusconi repeated his demands for a more activist ECB, saying that if the monetary union *"continues to not have a bank to guarantee government bonds and is not prepared to print money, some countries may be forced to return to their national currency"*. Comment: Mr. Fassina suggests that they strongly want a reform-oriented coalition with Mr. Monti.
- **General Strike in Greece.** A 24-hour country-wide general strike started in Greece this morning. The two biggest trade-unions organized the strike to protest against the government's austerity policy. Comment: The strike is a reminder of how difficult the implementation of additional austerity measures and structural reforms in Greece will be.
- **Hollande visits Athens.** At his first visit to Athens, French President Francois Hollande said that *"We're here to show our solidarity, our support and above all our confidence"*. He also said that he wants to help in mobilizing investments in Greece, mentioning the exploration of natural gas deposits as an example. Comment: The visit is mainly a demonstration of solidarity with Greece.
- **Portugal hopes to get full market access.** Joao Moreira Rato, the chief of the government's debt agency IGCP, said yesterday that *"We expect Portugal to*

*have full market access in a matter of months still in 2013.*" In his view "regaining full market access means having a liquid curve in various maturities up to 10 years and so that we can issue repeatedly." Comment: If Portugal manages to issue bonds in the way the head of the debt agency described, the country will most likely qualify for OMT purchases. However, in our view the hurdles to regaining such a full market access are very high.

- **Fears that FTT will harm Portugal.** Luis Laginha, the head of the Lisbon exchange said in respect of the planned Financial Transaction Tax (FTT): "For countries like Portugal that have a great need to attract capital, any such onerous move can only produce the opposite affect from what is intended". Comment: Portugal is one of the eleven countries planning to introduce the FTT as early as 2014, as proposed by the EU Commission last week. We doubt that the Commission proposal will be implemented in full and the start date of January 2014 looks very ambitious to us.
- **Steinbrück wants more contributions from banks and investors.** Bloomberg reports that the SPD chancellor candidate Peer Steinbrück said that Europe's crisis management is hostage to banks and big investors. He said that a decision to rule out further haircuts reflected "blackmail" by bond investors.
- **IG Metall demands 5% wage increase for steelworkers.** Yesterday the labour union announced that it is calling for a 5% wage gain for 70,000 steel workers. Note that this is not a demand for a wage increase in the more important metal and mechanical engineering industry, with its 3.4 million employees. In the last wage round in the sector, IG Metall asked for a wage gain of 7% and there was agreement on a wage increase of 3.8%. Comment: we expect a wage increase around 3% in the sector.
- **German vote on Cyprus package not before April.** The debate on the Cyprus bailout programme goes on. Yesterday, Michael Grosse-Broemer, a senior CDU representative said that the German parliament will not vote on a Cyprus package before April.
- **German price data.** The statistical office confirmed the flash estimate for January inflation of 1.7% YY (HICP at 1.9% YY), but revised down the December 2012 reading as part of broader change in the underlying basket from earlier reported 2.1% YY to 2.0% YY. In January consumer prices were down by 0.5% MM, mainly reflecting seasonal prices moves. However, there were extraordinary factors: the increase in electricity prices of 9.9% MM (due to extra fees for alternative energy production) was roughly offset by the fall in prices for health services of 4.9% MM, which reflected the cancellation of the fee to visit a GP. Separately, producer prices increased by a larger-than-expected 0.8% MM in January, leading to an increase in the YY rate from 1.5% in December to 1.7% in January. Comment: The data suggest that there is little upside price pressure in Germany.
- **Decline in French inflation.** In January, HICP inflation was 1.4% YY, slightly below the consensus and our forecast and slightly down compared to the 1.5% reported for December. The national CPI reading was lower than expected as well and declined from 1.3% YY in December to 1.2%.
- **Increase in French Business climate.** The business climate in the manufacturing sector increased from slightly upwardly revised 87 in January to 90 in February. This was above the consensus forecast of 87 and our forecast of 88. There was a strong gain in companies' own production outlook from -14 in

January to +2 in February. However, the composite business confidence indicator for all sectors remained unchanged at 87 in February. Comment: After the disappointing January reading, the rebound in confidence was stronger than expected, probably supported by a recovery in exports.

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