23 January 2015 │ 20 pages

Developed Markets
Western Europe

Euro Economics Weekly

QE(1) Is Here — What Else Could The ECB Do?

- The ECB's decision to launch QE, with €60bn of purchases of private and public debt securities per month until at least September 2016, went beyond our expectations and the general market consensus. Even so, changes to the ECB's stance or additional measures may still be needed in the future to achieve the ECB's inflation target or to respond to future adverse shocks.
- In the near-term, further easing (if needed) may take the form of additional cuts in the deposit rate or modifications (or additions) to the TLTROs, in our view. In the medium-term, substantial further ECB easing, if needed, would likely take the form of additional purchases of government bonds and, to a lesser extent, private sector fixed-income assets. Purchases of equity, loans or foreign exchange would only be considered — at least in size — once the scope for purchases of eligible fixed-income assets is largely exhausted, in our view.
- To ensure that monetary policy is effective in raising inflation, a combined monetary-fiscal stimulus (i.e. 'helicopter money') would be required, but we consider it as a last-resort measure and do not expect such a stimulus in the foreseeable future.

Ebrahim Rahbari
+44-20-7986-6522
ebrahim.rahbari@citi.com

Guillaume Menuet
+44-20-7986-1314
guillaume.menuet@citi.com

Michael Saunders
+44-20-7986-3299
michael.saunders@citi.com

Antonio Montilla
+44-20-7986-3282
antonio.montilla@citi.com

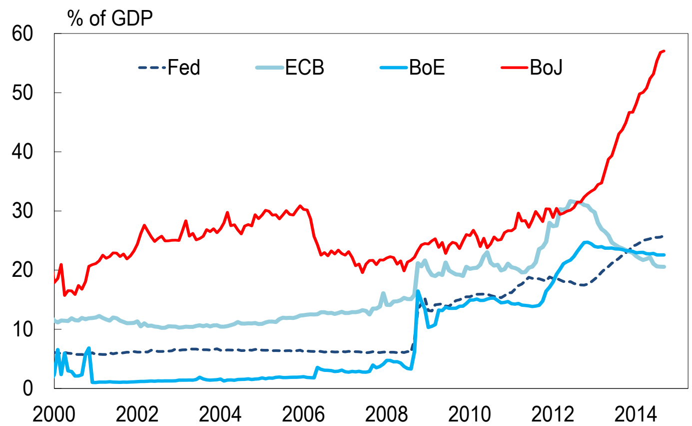
Ann O'Kelly
+44-20-7986-3297
ann.okelly@citi.com

Figure 1. Citi Forecasts

	$/€	Euro Repo	10-Yr Bunds	£/€	UK Bank Rate	10-Yr Gilt Bund
2Q 15	1.12	0.05	0.55	0.75	0.50	126
4Q 15	1.08	0.05	0.65	0.75	0.50	161

Source: Citi Research

Figure 2. Selected Economies — Central Bank Balance Sheet (% of GDP), 2000-14



Sources: Federal Reserve, ECB, Bank of England, Bank of Japan and Citi Research

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

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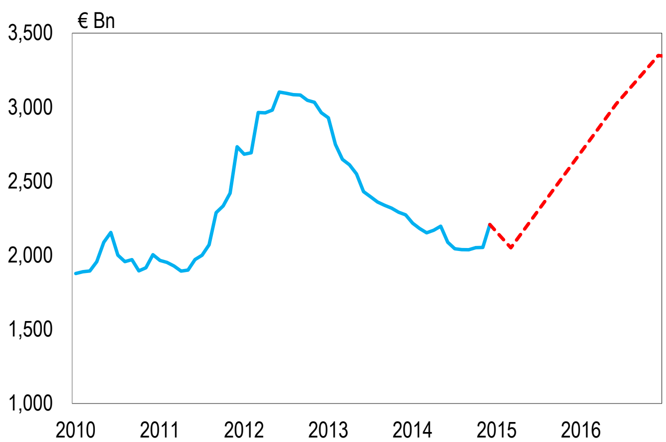
QE(1) Is Here — What Else Could The ECB Do?

On January 22, the ECB announced a broad-based outright purchase ('QE') programme under which it will buy €60bn of public and private debt securities per month. These purchases are currently *"intended to be carried out until end-September 2016...and until we see a sustained adjustment in the path of inflation which is consistent with our aim of achieving inflation rates below, but close to 2% over the medium term."* In our view, this decision is a major easing step — similar in terms of monthly purchase amounts to the QE2 and QE3 programmes in the US — and somewhat exceeds our expectations in terms of the overall volume of purchases, but, importantly, also the degree to which the overall horizon of purchases could be open-ended, if inflation prospects remain low. Nevertheless, it is quite possible that the programme will need to be amended or that further easing might be necessary over time. In this note we consider the options that the ECB has to ease further in the future.

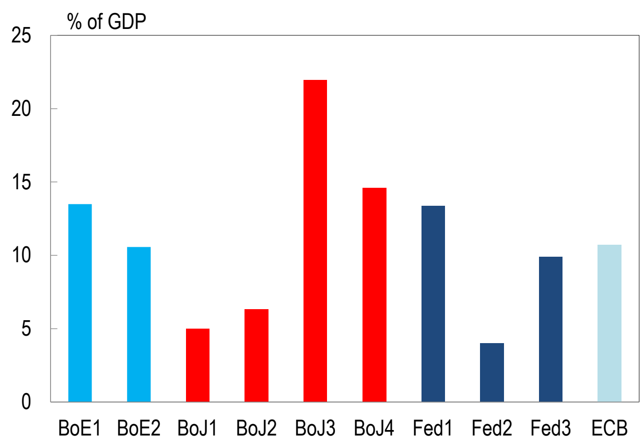
Figure 3. Eurosystem — Balance Sheet Size (€Bn), 2010-2016F



Note: The red line is a Citi forecast, assuming €60bn of ECB asset purchases per month from March 2015 and a takeup of €30bn each in the remaining six TLTRO instalments.

Sources: ECB and Citi Research

Figure 4. Selected Countries — Central Bank Asset Purchases (% of GDP)



Note: BoE1 and BoE2 were announced in 2009 and 2011. BoJ1 ran from 2001-03, BoJ2 from 2010-12, BoJ3 from 2013-14 and for BoJ4, which is ongoing, we show the annualized equivalent. Fed QE1 ran in 2008-09, QE2 in 2010-11 and QE3 in 2012-14.

Sources: National Central Banks and Citi Research

Further easing may be needed

In our view, the €1.1trn of planned purchases of the bonds of Eurozone governments, European public institutions and private covered bonds and ABS, are likely to bring the Eurosystem's balance sheet above its 2012 levels (see Figure 3). But the disinflationary (and currently deflationary) pressures in the Eurozone are powerful and require sustained and large stimulus as a response — after all, Eurozone inflation is now negative and therefore much lower than inflation in the US at the times when QE2 and QE3 were announced (1.0% YY and 1.7% YY for the core PCE deflator). We currently do not expect the ECB to meet its inflation target in 2016-17. The Eurozone may also be hit by adverse shocks in the future that require renewed monetary stimulus.

What can the ECB do?

According to the ECB's Statute, the ECB can buy any asset in *'financial markets'* and lend funds (or assets), based on *'adequate collateral.'*[1] The Statute therefore

[1] 18.1. In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may:

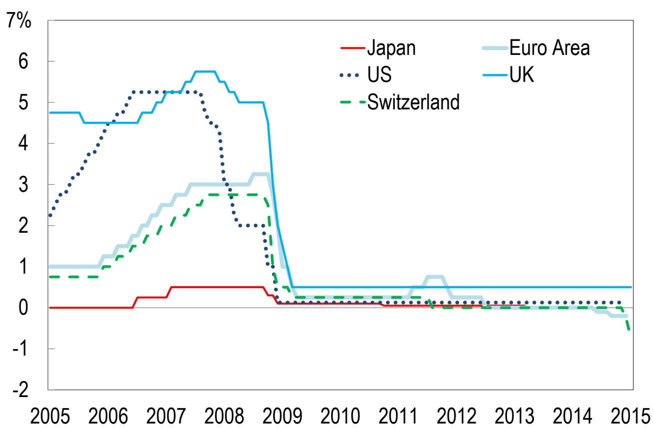
allows the ECB to buy not only fixed-income assets, but also equity or commodities, including in foreign currency. The definition of 'operating in financial markets' is not defined further, but the Statute appears not to grant the ECB the option of buying real assets (such as real estate) or of providing transfers to Eurozone households or businesses (and the Treaty of course explicitly rules out transfers to governments). The Statute can of course be changed, but such a change in practice requires unanimity among the 19 Eurozone members, and we consider it unlikely that changing the ECB's Statute will be on the agenda for the foreseeable future. It is worth noting that the ECB has the ability to buy a much broader range of securities than the Fed, which can only buy government assets or those guaranteed by the US government or a federal US agency (even though the BoE and BoJ can also buy a broad range of assets).

How to pick the right monetary instrument?

Monetary policy is transmitted through changes in lending standards and rates, asset prices, the exchange rate and expectations of future conditions and policy. The choice of monetary instruments is determined by their relative effectiveness in achieving these intermediate aims, as well as a number of political, technical/operational and risk management constraints. These considerations suggest to us that, should additional action be needed, the ECB will be more likely to mostly add to existing programmes rather than introducing new types of measures.

Where is the effective lower bound on interest rates?

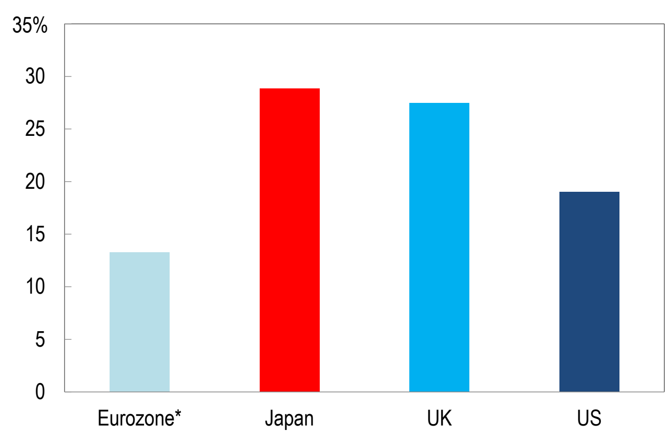
Figure 5. Selected Countries — Central Bank Policy Interest Rate (%), 2005-2015



Note: For the ECB, the deposit rate is shown.

Sources: BoJ, Federal Reserve, SNB, ECB, BoE and Citi Research

Figure 6. Selected Countries — Central Banks' Holdings of Central Government Bonds (% of Total Stock Outstanding), 2014



Note: *In the case of the Eurozone, the share represents planned government purchases divided by the currently outstanding Eurozone central government debt securities with >1 year maturity.

Sources: ECB, Federal Reserve, Bank of Japan and Citi Research

In our view, the bulk of further ECB easing will likely be delivered through further asset purchases (see below). But the next small easing move may well be another rate cut. In an environment where large-scale asset purchases and the ECB's

— operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in euro or other currencies, as well as precious metals;

— conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral.

TLTRO create substantial excess liquidity, the deposit rate is the ECB's effective policy rate. And indeed in September 2014, when the ECB reduced its refi rate by 10 basis points to 0.05% (and the deposit rate by 10 basis points to -0.2%, see Figure 5), ECB President Draghi said about the refi rate that "we are at the lower bound, where technical adjustments are not going to be possible any longer." For all practical purposes, it is therefore appropriate to focus exclusively on the ECB's deposit rate among the ECB's key interest rates.

In our view, there is substantial uncertainty about where the effective lower bound (ELB) for interest rates (and in this case the deposit rate) is. The lower bound exists because of the existence of (zero-interest-bearing) currency and the level of the ELB should be determined by the carrying, storage and safe-keeping costs of currency. To our knowledge, these costs are not reliably estimated and therefore neither is the ELB. In this context, the recent decision by the Swiss National Bank to lower its policy rate to -0.75% is worth noting. There are, of course, many differences between Switzerland and the Eurozone, but the extent to which the demand for Swiss currency evolves in coming months may give us some insight into where the ELB lies. The ECB will therefore likely carefully monitor developments in Switzerland as well as the effect QE in the Eurozone has in the presence of a negative deposit rate.

Overall, it is possible, in our view, that further modest inflation undershoots, a stronger-than-expected euro or weaker activity data therefore will induce the ECB to cut the deposit rate further in coming months or quarters, unless the experience in Switzerland turns out to be discouraging.

In our view, it is likely that the ECB will also create additional fixed-rate long-term funding facilities in coming years (the current TLTRO facilities all mature on 26 September 2018). It may further increase the availability of funding under the existing or any new TLTRO facilities, e.g. by increasing the 3x multiple of new lending relative to the benchmark that it currently applies or by widening the range of eligible collateral. It is very likely, too, in our view, that the current full allotment allocation will be extended in line with the maturity of the TLTROs.

The ECB could also adjust its communication, e.g. by strengthening its forward guidance. For instance, the ECB could adopt temporal guidance, such as committing to keep rates low until, say, 2018, or it could adopt forward guidance à la Fed or BoE, with rates constant and/or asset purchases continuing subject to certain ‚knock-outs'. Another version of a verbal commitment would be a commitment to certain yield or price targets, including potentially the exchange rate. However, in our view, such commitments are unlikely, even in the coming years.

Additional bond purchases

In our view, the ECB will continue to focus on asset purchases (rather than, say, policy rates) as their main instruments of further policy easing in coming years and the ECB's communication on 22 January suggests that the size and duration of the current purchase programmes are likely to be quite flexible over time. A modest tweaking of the purchase programme will therefore be an alternative to another rate cut or a change to the ECB's funding facilities, while additional asset purchases will be the main conduit for major further easing.

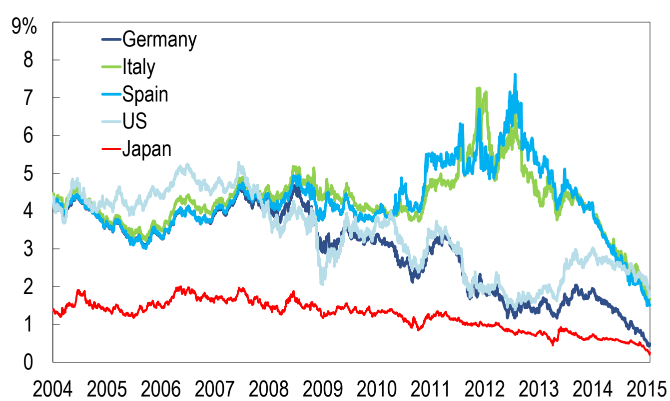
There is plenty of scope to expand government bond purchases in the future and we expect these to be the primary instrument for further monetary easing. At the currently intended end-date, the Eurosystem would hold roughly 13% of the stock of Eurozone government debt securities, less than half of the share of domestic government debt securities held by the BoJ (where the share continues to rise) or

the BoE, and still significantly below the share held by the Fed. The ECB would also remain significantly below the self-imposed 33% share of the outstanding stock of the debt of each issuer that ECB President Draghi mentioned in the January press conference or the 25% limit of each debt issue (which is presumably to avoid having a blocking minority for potential future debt restructuring decisions).

However, it is worth noting that (nominal) government bond yields are already very low, with 10Y Bund yields below 0.5% on January 22 (see Figure 7). The ECB could of course try to push the entire Bund curve to zero or even negative yields. The ECB could over time change the composition of its purchases towards the higher-yielding government bond markets, but political and risk management concerns will probably cap the appetite for such a change in the composition of purchases. Of course, the yields of, say, Spanish and Italian government bonds are also already very low at below 1.5%.

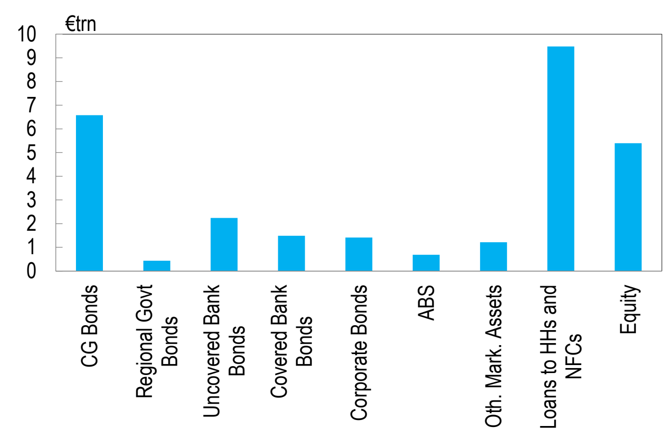
The ECB could relax some of the constraints of the current purchase programme to tilt it towards higher-yielding government bond securities. For instance, it could lengthen its maturities (from the current 2-30 years), or it could widen the range of eligible assets (i.e. lower the rating threshold). It could also increase the 33% issuer limit that President Draghi referred to in the press conference. However, an increase in size or an extension of the horizon are likelier, in our view, than such changes, as maturities are already quite long and eligibility quite broad.

Figure 7. Selected Countries — Nominal 10Y Government Bond Yields (%), 2004-15



Sources: Bloomberg and Citi Research

Figure 8. Euro Area — Size of Eurosystem-Eligible Collateral By Category (€Trn), Stock of Outstanding Bank Loans to Households and Non-Financial Corporations (€Trn) and Equity Market Capitalisation (€Trn), 2014



Note: CG is Central Government.

Sources: Eurostat, ECB and Citi Research

Further ECB easing programmes will therefore likely (continue to) include other (i.e. private) fixed-income assets, too, including covered bonds and ABS, even though they will continue to account for a relatively small share of overall purchases even for a potential QE2 or QE3 programme. It is quite likely that the ECB will, over time, add (non-financial, perhaps also financial) corporate bonds to the mix, if continued stimulus is needed. The size of the Eurozone covered bond, ABS and non-financial and financial corporate bond markets currently eligible for ECB collateral operations is around €5.8trn (see Figure 8). The ECB currently owns just 3% of the stock of covered bonds and less than 0.5% of the stock of eligible ABS and no corporate bonds outright for monetary policy purposes. There is therefore clearly plenty of scope to increase private sector purchases further, beyond the already-planned

purchases of ABS and covered bonds. However, it is worth noting that the yields on these assets are also very low by historical comparison and have tightened considerably since the ECB announced its private sector purchase programmes in September 2014, but in a world of very low yields, the ECB may well choose to push these yields down even further, should additional stimulus be needed. However, a large rise in the share of private securities in ECB purchase programmes is probably likely only when the scope for government purchases looks to be nearly exhausted. This is not an issue in the next year or two, in our view.

Unconventional unconventional policy

Most of the measures we describe above could be categorised as 'conventional unconventional' monetary policy, even from the perspective of the ECB. Should the ECB consider these to be mostly exhausted (for monetary, technical or political reasons), the ECB would still have additional options, including buying loans, equity or foreign assets.

Purchasing **loans** outright would make sense for the ECB from at least two perspectives. First, loans are the primary instrument through which the Eurozone households and non-financial businesses fund themselves. Second, the ECB already accepts loans (‚credit claims') as collateral in its usual refinancing operations, both in its permanent framework as well as its additional framework. However, we think that the ECB will be quite reluctant to buy loans, as assessing and pricing the loans, most of which are unrated, is complex and labour-intensive and selling them eventually could be difficult, too (as they are not marketable assets). The ECB will therefore in our view be likely to prefer to buy bundles of loans in securitised form.

Equities are not eligible as collateral for ECB funding operations and many listed firms on stockmarkets in the Eurozone have major operations outside the Eurozone. But equity markets are relatively large and liquid, which is why we think that the ECB could eventually end up buying index funds for ETFs on the Eurozone stockmarkets (the Bank of Japan currently holds ¥4trn of equities and the SNB has a large equity portfolio).

For the ECB to consider buying **foreign assets**, two conditions will likely need to be satisfied, in our view. First, the ECB would have to want to push down the value of the euro further. Second, there will have to be some degree of political coordination between the ECB and the Eurozone finance ministers and between the Eurozone and some other major economies, such as the US or Japan. Of course, foreign exchange intervention is relatively routine in small, open economies (e.g. Switzerland or Denmark), but is relatively rare in the Eurozone, US or UK.

Helicopter money

We have highlighted above that the ECB still has a number of options to ease monetary policy further. All of these options have their drawbacks and the effectiveness of monetary policy to stimulate real activity and achieve inflation rates in line with central bank targets has generally disappointed in recent years. In this context, it is worth noting that to be sure that inflation rates rise and an inflation target is reached, pure monetary policy options may not be sufficient. Only a combined monetary-fiscal stimulus, i.e. helicopter money, whereby a temporary fiscal stimulus is combined with a permanent increase in the money supply, can be certain to lift inflation. To achieve such stimulus is outside of the remit of the ECB. It is also more difficult in the Eurozone, with its 19 finance ministries (some of whom, only consider fiscal stimulus to be appropriate in very limited circumstances) and

one central bank, than in other economies. In general, we expect fiscal policy to continue to play only a modest role in supporting the Eurozone economy in the near future, characterised by tolerated budget deficit overshoots in countries under the Excessive Deficit Procedure and modest easing in countries with fiscal buffers (i.e. Germany). Even that is more supportive for growth than the intense austerity imposed in 2010-12 and QE itself will indirectly contribute to modest fiscal easing by reducing interest rates further, with the fiscal dividends likely to be spent rather than used for debt reduction. But overall, the onus for supporting growth in the Eurozone will mostly fall on the ECB and monetary policy.

Figure 9. Key Economic Indicators (26 January – 30 January 2015)

		Forecast	Last
Monday 26 January		**Forecast**	**Last**
08:00	Spain: Producer Prices, Dec		
08:30	Netherlands: Producer Confidence, Jan		
09:00	Germany: ifo Business Climate, Jan	106.5	105.5
09:30	UK: BBA Advances for House Purchase, Dec		
14:00	Euro Area: Eurogroup Meeting of EA Finance Ministers, Brussels		
Tuesday 27 January		**Forecast**	**Last**
	EU: EcoFin Meeting of EU Finance Ministers, Brussels		
08:30	Sweden: Producer Prices, Dec		
08:30	Sweden: Trade Balance, Dec		
09:30	UK: Service Sector Output, Nov	0.3% MM, 3.7% YY	0.3% MM, 3.4% YY
09:30	UK: GDP, 4Q Preliminary	0.7% QQ, 2.9% YY	0.7% QQ, 2.6% YY
17:00	France: Jobseekers – Net Change, Dec	11.7K	27.4K
	Total Jobseekers, Dec	3,500.0K	3,499.3K
Wednesday 28 January		**Forecast**	**Last**
07:00	Germany: GfK Consumer Confidence, Feb		
07:00	Germany: Retail Sales, Dec	-0.1% MM, 2.8% YY	0.5% MM, 1.9% YY
07:45	France: Consumer Confidence, Jan	85	90
09:00	Norway: LFS Unemployment Rate, Nov	3.9%	3.8%
11:00	Ireland: Retail Sales, Dec		
11:00	Ireland: Residential Property Prices, Dec		
19:00	US: FOMC Outcome		
Thursday 29 January		**Forecast**	**Last**
07:00	UK: Nationwide House Prices, Jan		
08:00	Spain: Retail Sales, Dec	2.6% YY	2.2% YY
08:00	Sweden: Consumer Confidence, Jan	99.8	99.0
	Manufacturing Confidence	106.1	106.4
08:30	Sweden: Household Lending, Dec	6.0% YY	5.9% YY
08:30	Sweden: Retail Sales, Dec	-0.3% MM	0.5% MM
08:55	Germany: Unemployment, Jan	-15K MM SA, 271K MM NSA	-27K MM SA, 47K MM NSA
09:00	Euro Area: M3, Dec	3.9% YY	3.1% YY
09:00	Italy: Contractual Wages, Dec		
10:00	Italy: Consumer Confidence, Jan	100	99.7
	Business Confidence, Jan	97.1	97.5
10:00	Euro Area: Economic Sentiment, Jan	101.4	100.7
11:00	UK: CBI Retail Survey, Jan		
13:00	Germany: HICP, Jan Flash	-1.05 MM, -0.2% YY	0.1% MM, 0.1% YY
	National CPI, Jan Flash	-1.0% MM, -0.2% YY	0.0% MM, 0.2% YY
Friday 30 January		**Forecast**	**Last**
00:01	UK: GfK Consumer Confidence, Jan		
07:00	Germany: Import Prices, Dec	-0.4% MM, -2.5% YY	-0.8% MM, -2.1% YY
07:45	France: Consumer Spending, Dec	0.1% MM, -1.2% YY	0.4% MM, -1.1% YY
07:45	France: Producer Prices, Dec		
08:00	Switzerland: KOF Economic Barometer, Jan		
08:00	Spain: GDP, 4Q Flash	0.5% QQ	0.5% QQ
08:00	Spain: HICP, Jan Flash	-1.5% YY	-1.1% YY
09:00	Italy: Unemployment Rate, Dec	13.5%	13.4%
09:00	Norway: Retail Sales ex Petrol Stations, Dec	-0.2% MM	0.2% MM
09:00	Norway: Registered Unemployment Rate, Jan	3.0%	2.7%
09:00	Norway: Norges Bank Daily FX Purchases, Feb		
09:30	UK: Mortgage Approvals, Dec	59,500 MM, -16.8% YY	59,029 MM, -16.9% YY
10:00	Euro Area: Unemployment Rate, Dec	11.4%	11.5%
10:00	Euro Area: HICP Flash, Jan	-0.5% YY	-0.2% YY
10:00	Greece: Retail Sales, Nov		
14:00	Belgium: GDP, 4Q		

Sources: National statistical offices, central banks and Citi Research

Figure 10. Economic Indicators – Comments: Euro Area and Germany

Euro Area			
Jan 29 09:00 London Time	***M3 Money Supply, Dec***	**Forecast: 3.9% YY**	**Prior: 3.1% YY**
	We look for a sizeable increase in the M3 annual growth rate to a 25-month high of 3.9%, corresponding to a 0.2% MM uptick in December. We estimate that adjusted flows of private sector lending were positive for the fifth successive month, worth around €2.7bn in November, totalling around €10bn in the fourth quarter. This would be enough to drive the annual growth in private sector loans to -0.1% YY from -0.2% in November. We anticipate that private sector lending will turn positive in 2015 (after a projected drop of around €15bn in 2014).		
Jan 29 10:00 London Time	***Economic Sentiment, Jan***	**Forecast: 101.4**	**Prior: 100.7**
	We forecast that the Economic Sentiment indicator (ESI) compiled by the European Commission is likely to increase in January, having trodden water in the last couple of months. Recent signs of improving business confidence, ranging from the industrial sector and retail, alongside a slightly more constructive tone from households, should translate into another modest gain to 101.4. Based on this January estimate, the 1Q-15 ESI average is likely to increase for the first time since 2Q-14, likely moving above its historical average. We suspect that the combination of much lower oil prices, a neutral fiscal stance and easier financing conditions will support an uptrend in economic sentiment throughout 1H-15.		
Jan 30 10:00 London Time	***Unemployment Rate, Dec***	**Forecast: 11.4%**	**Prior: 11.5%**
	The jobless rate probably fell by 0.1pp to 11.4% in December after four months of stable readings. To be sure, economic activity has slowed in the last couple of quarters, and this is reflected with a lag in terms of unemployment dynamics. Some catch-up in terms of additional unemployment rate falls is expected in the next few quarters, especially if economic activity were to accelerate on the back of lower oil prices, assuming that households spend most of the unexpected windfall. We expect unemployment rate falls to gain momentum in 2H-15.		
Jan 30 10:00 London Time	***HICP, Jan Flash***	**Forecast: -0.5% YY**	**Prior: -0.2% YY**
	We look for a 0.3bp decline in the annual rate of inflation to a new all-time low of -0.5% YY in January, validating the ECB's decision on Jan 22 to launch a QE programme in March 2015. We estimate that consumer prices likely fell by 1.4% MM in January, its largest monthly drop on record, and within the volatile items segment look for another sharp 3.0% MM drop in energy prices, while food prices are likely to increase modestly in January. Core HICP is likely to have been largely stable in January (but marginally at the second decimal level), notably because of lower services price inflation. Looking ahead to February, we estimate that inflation rates will fall further, likely hitting a new record low of -0.6% YY. We anticipate 1Q-15 inflation to average -0.5% YY, and inflation rate to only return into positive territory by 4Q-15 at +0.5% YY.		
Germany			
Jan 26 09:00 London Time	***Ifo Business Climate, Jan***	**Forecast: 106.5**	**Prior: 105.5**
	We expect the German ifo business climate to rise further in January, with both the current conditions and the sentiment component improving. This would be the third consecutive monthly increase after having fallen for six consecutive months previously. With the expected increase, the ifo business climate would be at the highest level since July 2014 and 0.7 standard deviations above the long-term average		
Jan 28 07:00 London Time	***Import Prices, Dec***	**Forecast: -0.4% MM, -2.5% YY**	**Prior: -0.8% MM, -2.1% YY**
	German import prices are falling fast again, mostly driven by falling energy prices. In December, we expect import prices to have fallen by 2.5% YY, the largest fall since March 2014.		
Jan 29 08:55 London Time	***Unemployment, Jan***	**Forecast: -15K MM SA, 271K MM NSA**	**Prior: -27K MM SA, 47K MM NSA**
	The German labour market has regained some momentum again in the last few months after the late summer and early autumn had suggested that its momentum was stalling. In January, we expect another small fall in German unemployment in seasonally-adjusted terms (still implying a large increase in the number of unemployed on a non-seasonally-adjusted measure), which would leave the (seasonally-adjusted) unemployment rate at 6.5%, the lowest level since 1991.		
Jan 29 13:00 London Time	***HICP, Jan Flash***	**Forecast: -1.0% MM, -0.2% YY**	**Prior: 0.1% MM, 0.1% YY**
	National CPI, Jan Flash	**Forecast: -1.0% MM, -0.2% YY**	**Prior: 0.1% MM, 0.2% YY**
	We expect German inflation to turn negative in January for the first time since September 2009 for both the HICP and the national definition. The drop is mostly based on fast-falling energy prices, but the prospect of continued weak energy prices suggests that German inflation could remain in negative territory for some time and would rise only gradually thereafter.		
Jan 30 07:00 London Time	***Retail Sales (ex Cars), Dec SWDA***	**Forecast: -0.1% MM, 2.8% YY**	**Prior: 0.5% MM, 1.9% YY**
	In December, we expect German retail sales (excluding car sales) to be relatively flat, after two months of increases, which left retail sales 2%YY higher in November. Survey measures on the retail side (confidence of the retail sector, and consumer confidence) have been improving again of late, suggesting that private consumption growth continues to be the main support of German GDP growth. With our expected reading for December, retail sales would be 1.4% higher in the Oct-Dec average than in the 3Q average.		

Sources: National statistical offices, national central banks, Bloomberg, and Citi Research forecasts.

Figure 11. Economic Indicators – Comments: France, Italy and Spain

France			
Jan 27 17:00 London Time	***Jobseekers – Net Change, Dec*** ***Total Jobseekers, Dec***	**Forecast: 11.7K** **Forecast: 3,500.0K**	**Prior: 27.4K** **Prior: 3,499.3K**
	We look for a fourth successive gain in the total number of registered jobseekers in December. However, we expect the rate of increase to slow after two particularly bad months when the average increase (+28k) was more than 3/4 above the rolling 12-month average gain (+16k). With business confidence showing tentative signs of rebounding and private sector employment expectations at a two-and-a-half-year high in December, we continue to see some room for a gradual slowdown in the pace of unemployment increases in 1Q-15. With a cut in employers' social security contributions effective from January 2015, and the reform agenda being gradually implemented, we expect the pick-up in economic activity to translate into job creation in coming quarters.		
Jan 28 07:45 London Time	***Consumer Confidence, Jan***	**Forecast: 85**	**Prior: 90**
	It is hard to estimate what the impact of the terror attacks in France will be on household confidence in January. We forecast that consumer confidence will drop by 5 points in January to 85, unwinding all the gains of the past six months. However, we estimate that the surge in the popularity of the French President and his prime minister in recent polls indicates that once the initial shock has been absorbed, households will refocus on the underlying dynamics of consumer spending and will spend a significant part of the windfall from lower inflation and the rapid decline in oil and energy prices when these filter through to final prices.		
Jan 30 07:45 London Time	***Consumer Spending, Dec***	**Forecast: 0.1% MM, -1.2% YY**	**Prior: 0.4% MM, -1.1% YY**
	Retail confidence surveys compiled by INSEE and Markit for December were largely stable after a noticeable gain in November. We believe that the trends that were in place in November (low-flation and improving confidence) continued in December, adding to households' disposable income trends. We look for a small gain in consumer spending of 0.1% MM in December, implying a noticeable fall in the quarterly average worth 0.6% QQ. We would note that the lack of job creation remains a major headwind for faster growth in consumer spending, given the limited prospects of a drop in households' savings ratio.		
Italy			
Jan 29 10:00 London Time	***Consumer Confidence, Jan***	**Forecast: 100**	**Prior: 99.7**
	We expect consumer confidence to have remained broadly stable in Jan (100 vs. 99.7 in December) mainly reflecting a payback after very weak dynamics over the previous months. This however will still leave consumer confidence standing 0.5sd below its long-term average. Poor confidence levels and negative employment growth are likely to continue capping private consumption growth in Italy in coming periods.		
Jan 29 10:00 London Time	***Business Confidence, Jan***	**Forecast: 97.1**	**Prior: 97.5**
	We expect business confidence to fall by 0.4pp MM in January, after rises of 1pp and 0.3pp in December and November, respectively, and mainly reflecting the continued deterioration in Italy's main economic data over the previous months. This will leave the business confidence index standing 0.4sd below its long-term average, suggesting subdued industrial output dynamic at the start of 1Q.		
Jan 29 09:00 London Time	***Unemployment Rate, Dec***	**Forecast: 13.5%**	**Prior: 13.4%**
	We estimate the jobless rate to have increased to a new record-high of 13.5% in December, rising from 13.4% in Nov and 12.8% on average in 3Q. We expect employment fell by 0.1% MM in December, after -0.2% MM in Nov and -0.3% MM in Oct, while we estimate the labour force to have continued rising by around 0.9% YY in December. Job creation in Italy has been lagging the rest of the euro area periphery, in part due to the large pool of idled workers (under the so-called Cig scheme) included in official employment statistics, but not actually working.		
Spain			
Jan 29 08:00 London Time	***Retail Sales, Dec***	**Forecast: 2.6% YY**	**Prior: 2.2% YY**
	We expect real retail sales (SA) to fall back in December (by 1.5% MM), mainly reflecting a payback after the strong rise registered in November (of 1.8% MM). We estimate this will translate into the YY growth rate (WDA) rising to +2.6% in December (from +2.2% in Nov) boosted by base effects. Overall we expect real retail sales to have remained broadly flat QQ in 4Q (after a 0.8% QQ increase in 3Q).		
Jan 30 08:00 London Time	***GDP, 4Q Flash***	**Forecast: 0.5% QQ**	**Prior: 0.5% QQ**
	We estimate real GDP rose by 0.5% QQ (1.8% YY) in 4Q 14, marking the sixth consecutive quarter with positive QQ real GDP growth. Real economic growth continues to be driven by a recovery in domestic demand. We expect private consumption to continue rising strongly in 4Q (after 0.8% QQ in 3Q), boosted by some pick-up in real disposable income stemming from net job creation, reduced fiscal tightening, and negative inflation. Gross fixed capital formation has also likely continued to expand strongly in 4Q (we estimate by 1.6% QQ), and we expect construction investment to show its third consecutive QQ expansion. On the other hand, rising imports are likely to continue to cap net exports' contribution to real growth. Overall, we estimate Spanish real GDP to have risen by 1.4% in 2014, after -1.2% in 2013.		
Jan 30 08:00 London Time	***HICP, Jan Flash***	**Forecast: -1.5% YY**	**Prior: -1.1% YY**
	We expect the annual HICP inflation rate to fall to a new record-low of -1.5% YY in Jan, from -1.1% YY in Dec and -0.5% YY in Nov, driven mostly by lower fuel prices. We estimate energy inflation dropped to a five-year low of -11% YY in January, while food inflation has likely fallen back into negative territory (after 0.2% YY in Dec). In addition, we project core inflation (i.e. excluding fresh food and energy) to have remained unchanged at -0.2% YY in January. Overall we expect HICP inflation to remain in negative territory in coming months.		

Sources: National statistical offices, national central banks, Bloomberg, and Citi Research forecasts.

Figure 12. Economic Indicators – Comments: Sweden, Norway and United Kingdom

Sweden			
Jan 29 08:00 London Time	***Consumer Confidence, Jan***	**Forecast: 99.8**	**Prior: 99.0**
	Although improving slightly in December, consumer sentiment stays at depressed levels. Strong income growth, a gradually improving labour market and higher asset prices suggest that consumer confidence should improve further ahead. However, ongoing high uncertainty and weak European growth prospects pull in the opposite direction. In January, we expect consumer confidence to rebound somewhat, helped along by the lower oil price. Household inflation is expected to stay around current levels (of 0%).		
Jan 29 08:00 London Time	***Manufacturing Confidence, Jan***	**Forecast: 106.1**	**Prior: 106.4**
	The Economic Tendency Indicator gained 2.0 points to 105.8 in December. Being 5.8 points above the historical average, the indicator suggests that growth in the Swedish economy is above a normal level. The construction, retail and services indicators rose, while the manufacturing indicator fell. The outlook for manufacturing is dependent on developments in the international business cycle, in particular in Germany. The NIER indicator continues to signal a decent upturn in the sector, clearly contrasting the subdued development in hard data.		
Jan 29 08:30 London Time	***Household Lending, Dec***	**Forecast: 6.0% YY**	**Prior: 5.9% YY**
	Annual lending growth is accelerating. Given ongoing gains on the housing market, we expect household lending to pick up further ahead. Increasing pressure on macro prudential measures with e.g. tougher amortization requirements already having been announced, meanwhile, should contribute to dampening lending growth a tad ahead. With ongoing very low inflation and the associated risk of falling inflation expectations, we maintain that lending growth not will become an issue for monetary policy any time soon.		
Jan 29 08:30 London Time	***Retail Sales, Dec***	**Forecast: -0.3% MM**	**Prior: 0.5% MM**
	Retail sales were surprisingly firm in November after a strong gain also in October, supporting our view that domestic demand will continue to be a driver for GDP growth this year. Still, survey data imply that the retail sector has lost some momentum towards the end of last year and we risk a setback in December.		
Norway			
Jan 28 09:00 London Time	***LFS Unemployment Rate, Nov***	**Forecast: 3.9%**	**Prior: 3.8%**
	Labour market indicators continue to send mixed signals: while registered unemployment has been surprisingly benign in recent months, the jobless rate as measured by the Labour Force Survey has gained rather markedly since the second quarter to the highest level since spring 2006. Momentum, especially, in employment has been subdued and actually declined 0.2% on average in the three-month period Sep-Nov from the previous three-month period, to be only 0.4% higher than a year earlier – the slowest annual growth rate since 2Q-13. Historically, Norges Bank has put more weight to registered unemployment as the LFS series is much more volatile and occasionally sees random changes. That said, it is hard to dismiss the message of weakness in labour demand from the LFS survey.		
Jan 30 09:00 London Time	***Retail Sales (ex Petrol Stations), Dec***	**Forecast: -0.2% MM**	**Prior: 0.2% MM**
	Monthly metrics point to improving consumption growth; households' domestic spending on goods (accounts for a little less than 50% of overall private consumption) is 0.8% above the 3Q average in October and November combined, hence more than offsetting the 2Q drop (-0.5% QQ). Ahead, improving conditions on the housing market (existing home prices are in an upward trend) and a relatively resilient labour market should support private consumption in the near-term. In addition, we note that income growth remains robust, and is running ahead of consumption. However, following two consecutive gains, we expect to see some minor setback in December.		
Jan 30 09:00 London Time	***Registered Unemployment Rate, Jan***	**Forecast: 3.0%**	**Prior: 2.7%**
	The trend in registered unemployment at the labour office has been surprisingly benign, with unemployment in seasonally adjusted terms showing a second consecutive decline in December. In January, we expect the registered unemployment rate to rise 0.3pp to 3.0% on a non-seasonally-adjusted basis.		
United Kingdom			
Jan 27 09:30 London Time	***Service Sector Output, Nov***	**Forecast: 0.3% MM, 3.7% YY**	**Prior: 0.3% MM, 3.4% YY**
	Surveys suggest that service sector output continues to expand rapidly, and hence we expect another solid gain. Such a figure would put the YY rate at the highest since early 2008, with the prospect of continued buoyant growth in coming months.		
Jan 27 09:30 London Time	***GDP, 4Q Preliminary***	**Forecast: 0.7% QQ, 2.9% YY**	**Prior: 0.7% QQ, 2.6% YY**
	Partial data suggest that the economy continued to grow strongly in 4Q, led by the service sector rather than industrial production. Such a figure would mark the first time since 2002-03 that the economy has grown by at least 0.4% QQ for eight consecutive quarters. No details on the split between consumer spending, exports and investment are likely to be available at this stage.		
Jan 30 09:30 London Time	***Mortgage Approvals, Dec***	**Forecast: 59,500 MM, -16.8% YY**	**Prior: 59,029 MM, -16.9% YY**
	We expect a slight rise in the number of mortgage approvals for home purchase from the November level, reflecting the stimulus from record low mortgage rates amidst strong job growth. Even a modest rise in approvals would be a notable landmark given that approvals have weakened in MM terms for five months in a row.		

Sources: National statistical offices, national central banks, Bloomberg, and Citi Research forecasts.

Figure 13. Key Economic Indicators (2 February – 6 February 2015)

During The Week		**Forecast**	**Last**
08:00	UK: Halifax House Prices, Jan		
Monday 2 February		**Forecast**	**Last**
07:30	Sweden: Manufacturing PMI, Jan		
08:00	Spain: Unemployment, Jan		
08:00	Norway: Manufacturing PMI, Jan		
09:00	Norway: Credit Indicator C2, Dec		
09:00	Euro Area: Manufacturing PMI, Jan Final		
09:30	UK: Manufacturing PMI, Jan	53.0	52.6
17:00	Italy: Budget Balance, Jan		
Tuesday 3 February		**Forecast**	**Last**
07:00	Switzerland: Trade Balance, Dec		
09:30	UK: Construction PMI, Jan		
10:00	Italy: HICP, Jan Flash		
10:00	Euro Area: Industrial Producer Prices, Dec		
Wednesday 4 February		**Forecast**	**Last**
07:30	Sweden: Services PMI, Jan		
09:00	Euro Area: Services PMI, Jan Final		
	Composite PMI, Jan Final		
09:30	UK: Services PMI, Jan	56.5	55.8
10:00	Euro Area: Retail Sales, Dec		
	Euro Area: ECB Non-Monetary Policy Meeting		
Thursday 5 February		**Forecast**	**Last**
06:45	Switzerland: SECO Consumer Confidence, Jan		
07:00	Germany: Incoming Orders, Dec		
07:45	France: Industrial Investment Survey, Jan		
08:30	Sweden: Industrial Production, Dec		
09:00	EU: European Commission releases Winter Economic Forecasts		
12:00	UK: MPC Outcome		
Friday 6 February		**Forecast**	**Last**
00:01	UK: KPMG/REC UK Report on Jobs		
07:00	Germany: Industrial Production, Dec		
07:45	France: Budget Balance, Dec		
07:45	France: Trade Balance, Dec		
08:00	Spain: Industrial Production, Dec		
08:15	Switzerland: Retail Sales, Dec		
09:00	Norway: Industrial Production, Dec		
09:30	UK: Trade Balance, Dec		

Sources: National statistical offices, central banks and Citi Research

Figure 14. Recent Research from the European Economics Team

Euro Area - Sovereign Debt Update		
ECB Mulls QE Programme of €50bn Per Month	European Economics Team	Jan 22, 2015
ECB's BLS Shows Further Easing of Lending Standards	European Economics Team	Jan 21, 2015
ECB's Coeuré: Brussels Should Decide on Risk-Sharing	European Economics Team	Jan 20, 2015
ECB QE: Partial or No Risk-Sharing Between NCBs	European Economics Team	Jan 19, 2015
Euro Area		
Euro Area - ECB Launches QE, Removes Balance Sheet Constraint	Guillaume Menuet	Jan 22, 2015
Euro Area - ECB QE: A Done Deal, Uncertainty is Over Details	Guillaume Menuet	Jan 15, 2015
Euro Area - ECJ's Preliminary Green Light for OMT Also Opens Door for QE	Ebrahim Rahbari	Jan 14, 2015
Euro Area - Inflation set to drop further in Jan-15 after -0.2% YY in Dec-14	Guillaume Menuet	Jan 7, 2015
Euro Area - Greece: Failed Presidential Poll Reinforces Political Uncertainty	Ebrahim Rahbari	Dec 29, 2014
Euro Area - Inflation Slowdown Confirmed, Negative December Print Seen	Guillaume Menuet	Dec 17, 2014
Euro Area - Greece: Snap Presidential Elections Highlight Political Uncertainty in Wake of Troika Decision To Extend Bailout	Ebrahim Rahbari	Dec 9, 2014
Euro Area - See You In January Says Draghi, Downplaying Lack Of Unanimity	Guillaume Menuet	Dec 4, 2014
Global Economic Forecasts - December 2014	Michael Saunders	Dec 3, 2014
European Economic Forecast Highlights, December 2014	Ann O'Kelly	Dec 3, 2014
Euro Area - ECB's Constancio on QE and EU's Juncker on Investment Plan	Guillaume Menuet	Nov 26, 2014
Euro Area - Dovish Draghi stresses need for aggressive B/S expansion	Guillaume Menuet	Nov 21, 2014
Euro Area - Draghi Reinforces Balance Sheet Targeting, More Easing Ahead	Guillaume Menuet	Nov 6, 2014
Euro Area - EC forecasts points to non-compliance for some 2015 budgets	Guillaume Menuet	Nov 4, 2014
Euro Area - Will the ECB do a BoJ? Unlikely at the Nov meeting, in our view	Guillaume Menuet	Oct 31, 2014
Euro Economics Weekly		
Is Grexit Risk Back?	Ebrahim Rahbari	Jan 9, 2015
2015 Year Ahead: Low-flation, Politics And QE	Guillaume Menuet	Jan 6, 2015
Will Political Risk Matter in 2015?	Guillaume Menuet	Dec 12, 2014
The Eurozone Investment Collapse And The Juncker Plan	Ebrahim Rahbari	Dec 5, 2014
ECB QE: Stacking Up The Evidence	Guillaume Menuet	Nov 28, 2014
Spain: Improving Economy, Politics The Main Risk	Antonio Montilla	Nov 21, 2014
Will Germany Let the ECB Do QE?	Ebrahim Rahbari	Nov 14, 2014
Door Open to QE, Favouring January over December	Guillaume Menuet	Nov 7, 2014
Credit And The Eurozone Malaise	Ebrahim Rahbari	Oct 31, 2014
Will the Euro Area Suffer from Oil Blues?	Guillaume Menuet	Oct 24, 2014
How Much Will the Weaker Euro Boost Eurozone Growth?	Ebrahim Rahbari	Oct 17, 2014
France: Rejecting Austerity, For Now	Guillaume Menuet	Oct 10, 2014
Greece — Six Crucial Months Ahead	Giada Giani	Oct 3, 2014
Focus On The ECB's Balance Sheet	Ebrahim Rahbari	Sep 26, 2014
H2 GDP Uptick Too Small to Stop ECB QE	Guillaume Menuet	Sep 19, 2014
Euro Area: Housing Sector Close to a Turnaround	Antonio Montilla	Sep 12, 2014
Low-flation Is Here To Stay	Giada Giani	Sep 5, 2014
Is the Period of German Outperformance Over?	Ebrahim Rahbari	Aug 29, 2014
ECB QE: Why, When and How?	Guillaume Menuet	Aug 22, 2014
What's Behind the Periphery Growth Outperformance?	Giada Giani	Aug 15, 2014
Chief Economist Publications		
Global Economic Outlook and Strategy — January 2015	Willem Buiter	Jan 21, 2015
Scandi and Swiss		
Scandi Economics Update	Tina Mortensen	Jan 23, 2015
Denmark - DNB Cuts Interest Rates Further	Tina Mortensen	Jan 22, 2015
Switzerland - SNB Ends Exchange Rate Cap, Cuts Rates	Michael Saunders	Jan 15, 2015
UK		
UK - Labour Market Data and MPC Minutes	Michael Saunders	Jan, 21, 2015
UK Economics Weekly		
How Big is Political Risk in Fiscal Policy?	Michael Saunders	Jan 16, 2015
The Consumer Is Back	Michael Saunders	Jan 9, 2015
2015 Outlook — NICE Economy, Difficult Politics	Michael Saunders	Jan 6, 2015

Source: Citi Research

Appendix A-1

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