

# Euro Economics Weekly

## ECB: Focus on Collateral Rules rather than Direct Purchases

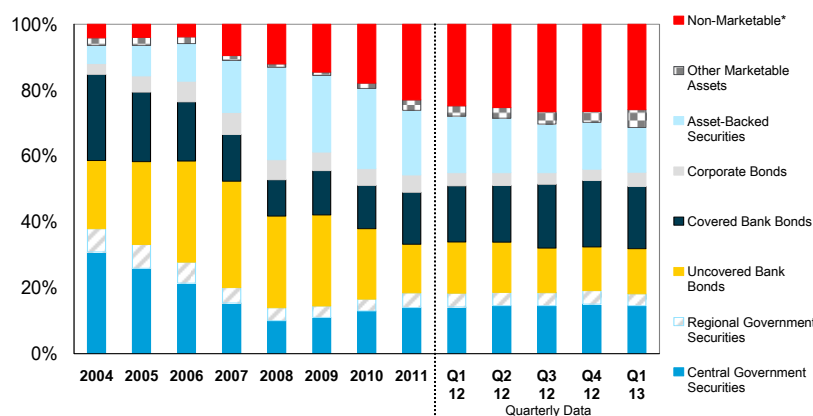
- We expect the Governing Council to leave its main policy rates unchanged at the June 6 meeting. Having lowered its refinancing rate by 25bp at the last meeting, the ECB is likely to argue that the conditions are in place for a recovery in economic activity during the second half of 2013, even if we think that the Governing Council will conclude that the risks to economic activity remain skewed to the downside.
- Turning to inflation, we expect the ECB's assessment of risks around its medium-term outlook for price stability to be balanced. In terms of non-standard measures, we would be surprised if a fully-fledged plan to improve the transmission of monetary policy to SMEs were ready to be unveiled only a month after the ECB officially started consulting with the EIB and the European Commission.
- Rather, we believe that some announcements on a loosening of the collateral policy (including lower ABS haircuts) are probable. We expect a significant part of the Q&A session to focus on deflation risks and the pro and cons of a negative deposit rate.

Figure 1. Citi Market Forecasts

	\$/€	Euro Repo	10-yr Bunds	£/€	U.K. Bank Rate	10-yr Gilt-Bund	SKr/€	SEK Policy Rate	NOK/€	NOK Policy Rate	SFr/€	CHF Policy Rate	CHF Spread vs Bunds
3Q 13	1.27	0.50	1.40	0.87	0.50	66	8.58	0.75	7.46	1.50	1.26	0.00	-75
3Q 14	1.25	0.25	1.50	0.87	0.50	91	8.53	0.75	7.33	1.75	1.27	0.00	-85

Source: Citi Research

Figure 2. Euro Area — Use of Collateral in Eurosystem Refinancing Operations, 2004-2013



Sources: European Central Bank and Citi Research

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## ECB Preview: Collateral Loosening Expected to be Preferred Over Direct Purchases

**No fireworks expected at the June meeting, only a month after the May rate cut. In terms of non-standard measure announcements, we think that a further loosening of collateral policies could be on the cards**

We expect the Governing Council to leave its main policy rates unchanged at the June 6 meeting. Having lowered its refinancing rate by 25bp at the last meeting, the ECB is likely to argue that monetary policy remains very accommodative and that the conditions are in place for a recovery in economic activity during the second half of 2013, even if we think that the Governing Council will conclude that the risks to economic activity remain skewed to the downside. Turning to inflation, we expect the ECB's assessment of risks around its medium-term outlook for price stability to be balanced. In terms of non-standard measures, we would be surprised if a fully-fledged plan to improve the transmission of monetary policy to SMEs were ready to be unveiled only a month after the ECB officially started consulting with the EIB and the European Commission. Rather, we believe that some announcements on a loosening of the collateral policy (including lower ABS haircuts) are probable. Later steps could take the form of harmonized framework, eventually leading to direct purchases. We expect a significant part of the Q&A session to focus on deflation risks and the pro and cons of a negative deposit rate.

### New Lower Eurosystem Staff Projections

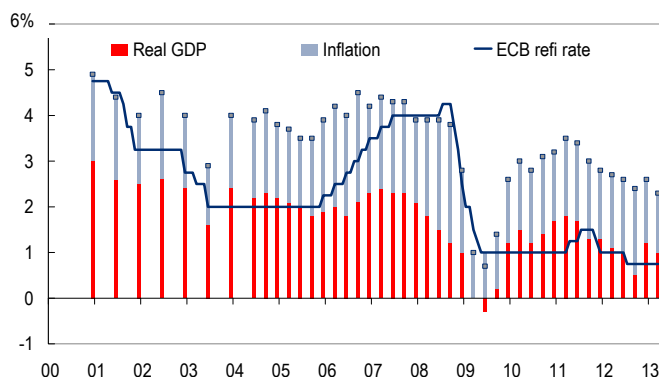
**New Eurosystem Staff Projections are expected to show a slight downward revision to 2013 numbers, but largely unchanged 2014 estimates**

The Governing Council will publish its new Eurosystem staff projections, which we expect to show a slight reduction in the mid-points for GDP and inflation (see Figure 3). We forecast that the mid-point for 2013 GDP will be revised down by 0.1pp to -0.6%, while the 2014 GDP mid-point will be lowered by 0.1pp to 0.9%. These would compare to our baseline scenario of -0.7% and 0.0%, respectively. We suspect that the Governing Council's assessment of the balance of risks to economic activity will not have changed much since the May meeting, although last month's 25bp rate cut should have at least partially addressed some of the downside risks such as i) the possibility of even weaker-than-expected domestic and global demand and ii) slow or insufficient implementation of structural reforms in the euro area.

**We do not expect any change in the assessment of the balance of risks**

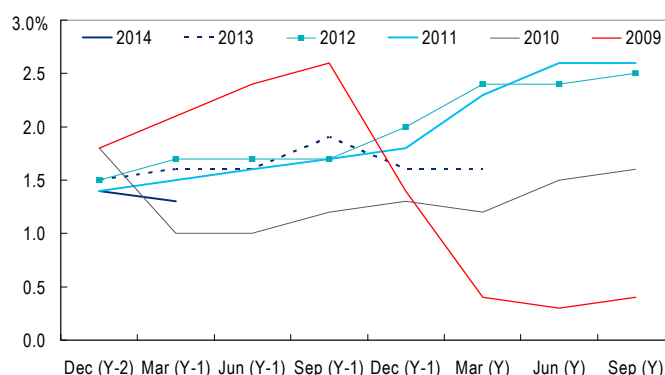
Turning to inflation, the recent trajectory of energy prices and trends in the exchange rate do not suggest that the mid-points will have been revised much. Our expectation is that the mid-point for 2013 HICP will be lowered by 0.1pp to 1.5% and the 2014 mid-point will be left unchanged at 1.3%. These numbers would match our own projections. Figure 4 illustrates how low (and below target) such mid-points would be from an historical perspective, having been lower only in March 2009.

**Figure 3. Euro Area — Mid-Points of HICP and GDP Staff Projections, Two Years Ahead, Dec 2000-Mar 2013**



Sources: European Central Bank and Citi Research

**Figure 4. Euro Area — Mid-Points of HICP Staff Projections, Two Years Ahead, Dec 2007-Mar 2013**



Sources: European Central Bank and Citi Research

## Deleveraging and credit dynamics

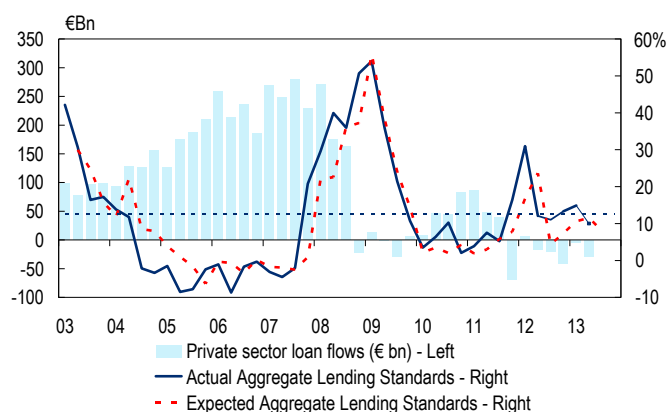
**Little improvement in credit flows, despite a smaller net proportion of banks tightening lending standards**

The ECB is concerned about the lack of bank lending to the real economy, particularly to non-financial firms. ECB data released last Wednesday show that loan flows to euro area residents were negative to the tune of €28bn in April, a contraction of 0.5% YY (see Figure 5). The flow of credit to households for mortgages remained weak, up 0.3% YY in April, while that to non-financial corporates has continued to fall, contracting at a rate of 3%<sup>1</sup>. Although the underlying trend points to some possible modest relaxation in lending standards in the second half of 2013, we doubt that the upcoming asset quality review to be conducted by the ECB in the first half of 2014<sup>2</sup> will encourage senior loan officers to adopt a fundamentally different attitude in the next few quarters.

**The explicit link between deleveraging and downside risks to price stability points to some growing concerns**

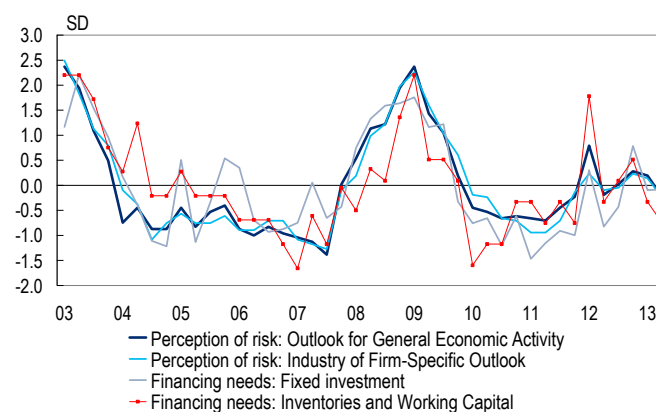
In a speech on 22 May, ECB Executive Board member and chief economist Peter Praet noted that *"we have to be very attentive that the balance sheet adjustment doesn't lead to macro conditions that will put pressure on the downside of price stability"*. He added that getting banks to lend more had taken on *"particular prominence"* in the ECB's current strategy. Banque de France Governor Christian Noyer also remarked in May that the ECB is *"currently considering additional measures to reduce fragmentation in the euro area"*. We interpret these comments as one of the clearest indications yet that the Governing Council is studying reductions in valuation haircuts. Furthermore, we note that Praet's speech is making an explicit link between deleveraging and downside risks to price stability. Coming from the ECB's chief economist, this could signal a growing degree of concern by the Executive Board that the current process of indebtedness adjustment will need to be counter-balanced by policy action, supplementing the obvious need for banks to improve their capital positions.

**Figure 5. Euro Area — Aggregate Lending Standards and Private Sector Loan Flows, 1Q 2003-2Q 2013**



Sources: European Central Bank and Citi Research

**Figure 6. Euro Area — Perception of Risks and Financing Needs, 1Q 2003-2Q 2013**



Sources: European Central Bank, National Central Banks and Citi Research

**Fixing the supply side with liquidity is no guarantee of tackling the demand shortfall**

Undoubtedly, the situation in terms of aggregate lending standards is less stressed than it was a few quarters ago, thanks to a more comfortable liquidity situation. Senior loan officers are showing some normalization in their perception of risk, both for their expectations of the general economic outlook and of the industry or firm specific outlook. Assuming that a financial institution has enough capital and/or a

<sup>1</sup> In the first four months of 2013, the cumulative flow of new loans to households amounted to €10.8bn versus €18.1bn in the same period last year. For new loans to firms, the cumulative outflow stood at €34.7bn versus an outflow of only €0.7bn in the same period last year.

<sup>2</sup> Euro Areas Sovereign Debt Crisis Update, 29 May 2013, Citi

reasonably healthy balance sheet, this reduction in the perceived degree of risk should, all things being equal, lead to some pick-up in loan flows. This is where a measure of loan demand is useful. Senior loan officers still report a net fall in the demand for financing, particularly when related to fixed investment (see Figure 6 on page 3). The situation with respect to inventories and working capital has remained weak, with net demand position slightly negative, suggesting that there is not much underlying improvement in business cycle dynamics.

### The debate on non-standard measures

#### What is the state of the discussion on non-standard measures?

Given that only a month has elapsed since the May 25bp interest rate cut and the somewhat better tone in sentiment surveys (the ESI rose in May for the first time in three months to 89.4, -0.9sd), we do not expect the Governing Council to debate the outlook for interest rates much. Instead, it will probably focus its attention on taking additional steps related to its non-standard measures. In the last few weeks, a large number of Executive Board Members have expressed varying opinions on topics such as credit easing (with a strong focus on SME lending), the possibility of a negative deposit rate and the deleveraging cycle. Banque de France governor Noyer recently remarked that the ECB is considering the possible introduction of additional monetary policy instruments to reduce fragmentation which is an *"obstacle to the smooth transmission of our monetary policy"*. ECB chief economist Peter Praet also confirmed that the ECB was looking at *"all possibilities"*, remarking that *"monetary policy will continue employing its existing instruments and if necessary to expand its instrument set within the safeguards established by its strategy"*. We review these discussions to get a better sense of what is possible in terms of policy announcements in the next few meetings.

Figure 7. Euro Area — Levels of Valuation Haircuts Applied to Eligible Marketable Assets

Credit Quality	Residual Maturity (Years)	Liquidity Categories								Category V
		Category I		Category II		Category III		Category IV		
		Fixed Coupon	Zero Coupon	Fixed Coupon	Zero Coupon	Fixed Coupon	Zero Coupon	Fixed Coupon	Zero Coupon	
Steps 1 and 2 (AAA to A-)	0-1	0.5	0.5	1.0	1.0	1.5	1.5	6.5	6.5	16
	1-3	1.5	1.5	2.5	2.5	3.0	3.0	8.5	9.0	
	3-5	2.5	3.0	3.5	4.0	5.0	5.5	11.0	11.5	
	5-7	3.0	3.5	4.5	5.0	6.5	7.5	12.5	13.5	
	7-10	4.0	4.5	5.5	6.5	8.5	9.5	14.0	15.5	
	>10	5.5	8.5	7.5	12.0	11.0	16.5	17.0	22.5	
Step 3 (BBB + to BBB-)	0-1	5.5	5.5	6.0	6.0	8.0	8.0	15.0	15.0	Not eligible
	1-3	6.5	6.5	10.5	11.5	18.0	19.5	27.5	29.5	
	3-5	7.5	8.0	15.5	17.0	25.5	28.0	36.5	39.5	
	5-7	8.0	8.5	18.0	20.5	28.0	31.5	38.5	43.0	
	7-10	9.0	9.5	19.5	22.5	29.0	33.5	39.0	44.5	
	>10	10.5	13.5	20.0	29.0	29.5	38.0	39.5	46.0	

Sources: European Central Bank and Citi Research.

#### Lower haircuts for ABS in refinancing operations are clearly on the table

The ECB is toying with the idea of reducing haircuts on asset-backed securities (ABS) whose market value has tended to outperform their expectations. BdF's Noyer suggested that the ECB Governing Council is mulling over lowering haircuts on ABS for refinancing operations<sup>3</sup>. This approach, if implemented, would allow financial institutions to obtain more liquidity for the asset that they currently hold and would contribute to a slight relaxation in the monetary policy stance. Note that while the share of ABS within the eligible marketable asset pool was 5.8% as of 1Q 2013,

<sup>3</sup> As of June 2012, the ECB widened its list of acceptable collateral, including securities backed by loans to SMEs, subject to a second-best rating of at least "triple-B" at issuance and at all times subsequently, subject to a valuation haircut of 26%.

ECB data show that ABS amounted to 13.6% of the total in terms of usage for refinancing operations, a level not very different from the 14.6% share of central government securities (see Figure 2, on the Front Page). ECB's Peter Praet noted that the ECB is looking at how it calculates haircuts on ABS that it accepts as collateral, suggesting that the ECB *"could go even further later on"*. He also added that the ECB had also been looking at ABS standardisation and market information and that it was in discussions with the European Investment Bank (EIB) to *"take part of the credit risk"*.

#### ECB's Liikanen calls on joint EU and national efforts for SME lending

Given the absence of simple solutions to get lending flowing to small businesses, Finland's central bank governor Governing Council member Erkki Liikanen remarked that the ECB would keep an open mind on all policy tools. Answering a question from journalists as to whether the ECB could buy ABS securities, Mr. Liikanen replied that *"all options must be evaluated with an open mind"* and confirmed that the central bank was also seriously considering measures to help bolster lending to SMEs. He noted that the discussion was taking place at the level of European institutions, but indicated that moves on the national level should be considered, due to each country's knowledge of its domestic market. He recommended that *"we should move on both levels"*.

#### EIB guarantees

Would the ECB find itself in a position to buy ABS of SME loans? This is an option that has been debated and some central bankers have supported the idea in principle, according to a Die Welt article published in early May. However, we suspect that a first step in this process would probably require the involvement of the European Commission and the EIB to design a framework, and for the latter to provide partial guarantees. We do not think that the discussion has evolved sufficiently at this point for the Governing Council to be in a position to make any announcements at the June meeting. On a related topic, we doubt that governments would be keen to participate in another round of capital increases<sup>4</sup>. But in light of previous discussions about leveraging the ESM and the EFSF, we suspect that most governments could be willing to redirect some of the EIB capital towards a guarantee system for SMEs, which would multiply its efficacy.

#### A relatively high hurdle to buy, given some strong opposition from some Governing Council members

As a second step, purchases could be envisaged, but we would argue that given the opposition from a number of governors (including the Bundesbank's Weidmann, as well as ECB's Asmussen and Mersch who warned about the risk of subsidising the market) a consensus in favour of such action could take some time to be reached. Yet, direct purchases on the secondary market are part of the ECB's toolkit: they were made with the Securities and Market Programme (€197bn outstanding) and the two Covered Bond Purchase programmes (€62bn outstanding). Nevertheless ECB vice president Vitor Constancio dampened expectations that the ECB could play a major role in the provision of credit to SMEs. While presenting the ECB's semi-annual financial stability review, he noted that it *"is a very small thing indeed, very small"*, adding that *"let's not overblow this thing. It's an option, I won't say more"*.

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<sup>4</sup> The EIB confirmed on 8 January 2013 that its 27 EU shareholders had approved a €10 billion capital increase, which will be fully paid in. The capital increase will allow the EIB to provide up to €60 billion, over a 3 year period, in additional lending for economically viable projects across the European Union.

**Any programme would likely be limited in size (we estimate less than €40bn) and could first require a bigger pipeline of issuance**

In our view, for the ECB to purchase ABS of SME loans, it would probably require the pool to be sufficiently large<sup>5</sup> and diverse so that it could not be accused of favouring some countries over others. While a transparent enough framework to package and value these securities would be a good way of freeing up balance sheet's in some banks, it is debatable whether the pipeline would be sufficiently sizeable to make a difference. We doubt that the Governing Council would be willing to purchase large amounts of ABS securities at this stage: it bought some 4.5% of the eligible covered bonds in its two programmes, and some 3.6% of eligible sovereign debt through the SMP. Applying this range to the eligible ABS would suggest a potential purchase programme of €30-38bn. Note, however, that this would probably represent a minimum threshold, and that it could become necessary to scale this up over time if the fragmentation issue were to persist. An alternative option could include a euro area version of the UK Funding for Lending Scheme (FLS)<sup>6</sup> — although its effectiveness has been limited to date.

### The negative deposit rate debate

**President Draghi says the ECB is technically ready, but mindful of the unintended consequences**

With the ECB having narrowed its interest rate corridor to  $\pm 50$ bp around the main refinancing rate, market participants have been wondering whether the ECB could push its deposit rate into negative territory at the time of the next rate cut. President Draghi was explicit during his May press conference that the ECB was “*technically ready*”, but warned that “*are several unintended consequences that may stem from this measure. We will address and cope with these consequences if we decide to act. We will look at this with an open mind and we stand ready to act if needed*”. In March, Mr. Draghi, answering a question on the risks had replied that “*the unintended consequences of a measure like that can be serious, as similar experiences in other monetary jurisdictions have shown. I think in the past I have described this as ‘unchartered waters’*”.

**Some of the main Governing Council members concur**

The debate has been ongoing within the central banking sphere. Banque de France Governor Christian Noyer echoed some of the concerns expressed by Executive Board Member Jörg Asmussen on previous occasions. Mr. Noyer argued that he is not convinced about the necessity of pushing the deposit rate into negative territory to encourage banks to lend their excessive cash position, worrying that banks could instead increase their lending costs to compensate the loss. He argued that previous examples of negative interest rates elsewhere indicate that the outcome is not “*resounding*” and that the issue is “*technically very delicate*”.

**The list of cons appears to be lengthy**

What would be the rationale for such a move? First, it seems that the pros would have to clearly outweigh the cons, a non-exhaustive list of which could include some disruption to the repo market due to negative yields, to the money market fund industry, lowering banks' profitability<sup>7</sup>, an earlier repayment by banks of their surplus liquidity, and more generally some market distortion. What could trigger such policy action? Perhaps a realization that the euro is sharply appreciating on a trade-weighted basis (see Figure 8) and a near-term deflation risk, although our forecasts suggest that this is unlikely to be the case over the 2-year horizon.

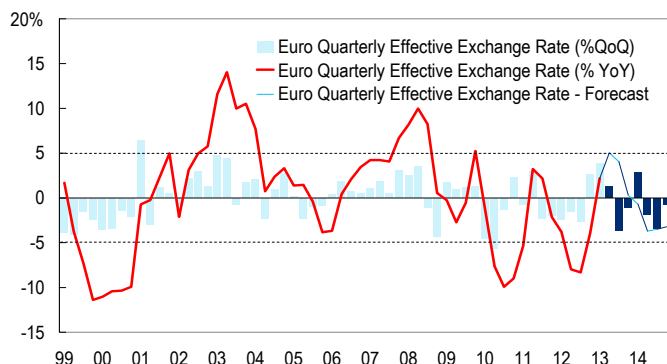
<sup>5</sup> The situation is being addressed by some national central banks, particularly BdF. See Euro Area: Sovereign Debt Crisis Update: 1Q GDP Growth Disappoints, Once Again – 15 May 2013.

<sup>6</sup> See “UK - Lending Remains Weak, Especially for SMEs” Michael Saunders, 31 May 2013, Citi

<sup>7</sup> Net interest margins would be impacted, making the task of accumulating additional capital through retained earnings more difficult, unless banks decide to charge and/or pass on some of the cost to their customers.

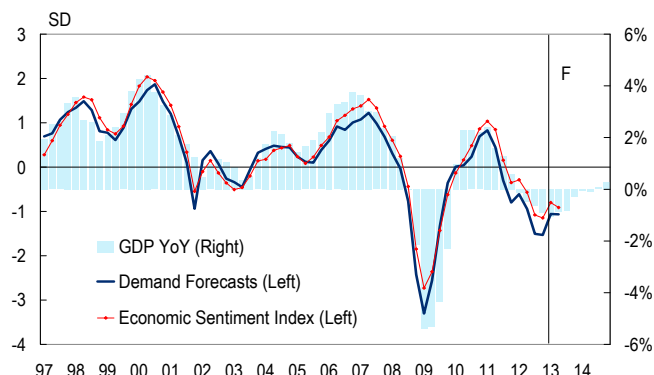


Figure 8. Euro Area — Euro Effective Exchange Rate, 1Q 99-4Q 14



Sources: European Central Bank and Citi Research

Figure 9. Euro Area — Demand Forecasts, Economic Sentiment Index and Real GDP Growth, 1Q 97-4Q 14



Sources: European Commission and Citi Research

### The FX argument is not particularly powerful at this stage

This was one of the arguments used by the Danish National Bank in early July 2012 when it decided to cut its CD rate to negative 0.20%. Citi's analysis of the Danish experience<sup>8</sup> with negative rates suggests that it had the desired effect and technical issues appear to have been manageable, without major adverse consequences. We believe that the ECB would probably come around to the view that it can experiment with a negative deposit rate in a situation of persistent downside risks to its medium term objective of price stability. This is not our baseline scenario. By refusing to commit to discussing the deposit negative rate further, we suspect that the ECB President is signaling that the Governing Council wants to keep all its options open.

### Neither is the threat of deflation

The main objective of pushing the deposit rate into negative territory would be to lower the money market rates, hoping for some transmission of the looser monetary policy stance to the real economy, and circumvent the notional threshold of zero lower bound, but also to help re-start interbank lending towards periphery banks and further encourage carry-trade purchases of sovereign bonds. Given the absence of a clear near-term threat of deflation (which Mr. Mersch estimated to be no bigger than 10-15%) and the ECB's expectation of some recovery in economic activity in 2H-2013 (see Figure 9), we think that this kind of policy action is unlikely to be followed in the near-term. On the issue of forward guidance, we believe it will be difficult for the ECB to circumvent its "no pre-commitment" stance.

### Conclusions

**ECB refinancing rate is likely to stay low for an extended period of time. We still look for another 25bp cut in 4Q-13**

We expect the ECB to reaffirm that its monetary policy stance will remain accommodative for as long as necessary, but suspect that the hurdle to another interest rate will be high, unless the recovery fails to materialize in the second half of 2013. As has been the case previously, we believe that the consensus view of a rebound in economic activity later this year will prove to have been too optimistic.

**Non-standard measures are going to be where additional policy action comes, in our view, but purchases are unlikely to start immediately.**

In the meantime, the Governing Council will likely announce additional non-standard measures, focusing primarily on a loosening of its collateral rules rather than launching a new direct purchase programme in our view. If lending volumes were to weaken further during the third quarter, we believe that a modest amount of purchases could be enacted. Turning to the negative deposit rate debate, we feel that the threat of deflation would probably have to be more serious for the Governing Council to act.

<sup>8</sup> See [Denmark - Negative Interest Rates – The Experience So Far](#), Tina Mortensen, 28 September 2012, Citi:

### Key Economic Indicators (3 June – 7 June 2013)

Monday 3 June		Forecast	Last
07:30	Sweden: PMI, May	49.3	49.6
08:00	Norway: PMI, May	50.1	48.9
09:00	Euro Area: Manufacturing PMI, May Final	47.8	46.7
09:30	UK: Manufacturing PMI, May	49.5	49.8
	Italy: State Sector Borrowing Requirement, Jan-May	€52.0 Billion	Jan-May 2012: €35.5 Billion
Tuesday 4 June		Forecast	Last
08:00	Spain: Registered Unemployment, May	-100K	-46K
08:30	Sweden: Service Production, Apr	-0.4% MM	-0.9% MM
10:00	Euro Area: Industrial Producer Prices, Apr		
11:00	Ireland: Industrial Production, Apr		
11:00	Ireland: Residential Property Prices, Apr		
Wednesday 5 June		Forecast	Last
07:00	Finland: GDP, 1Q		
09:00	Euro Area: Services PMI, May Final	47.5	47.0
	Composite PMI, May Final	47.7	46.9
09:30	UK: Services PMI, May	52.5	52.9
10:00	Euro Area: Retail Sales, Apr	-0.2% MM, -0.8% YY	-0.1% MM, -2.2% YY
10:00	Euro Area: GDP Details, 1Q	-0.2% QQ, -1.0% YY	-0.6% QQ, -0.9% YY
11:00	Portugal: GDP Details, 1Q		
14:00	Belgium: GDP Details, 1Q	0.1% QQ, -0.5% YY	-0.1% QQ, -0.5% YY
16:30	Ireland: Exchequer Return, May		
Thursday 6 June		Forecast	Last
06:30	France: Mainland Unemployment Rate, 1Q	10.6%	10.2%
	Mainland Unemployment Change, 1Q	+95K	+124K
08:15	Switzerland: Consumer Prices, May		
08:30	Netherlands: Consumer Prices, May		
10:00	Cyprus: HICP, May		
11:00	Germany: Incoming Orders, Apr SA	-2.5% MM, -0.8% YY	2.2% MM, -0.4% YY
11:00	Ireland: Unemployment, May		
	Greece: Unemployment Rate, Mar		
12:00	UK: MPC Outcome		
12:45	Euro Area: ECB Outcome (Press Conference at 13:30)		
Friday 7 June		Forecast	Last
07:00	Germany: Labour Cost Index, 1Q		
07:00	Germany: Trade Balance, Apr		
08:00	Spain: Industrial Production, Apr		
08:30	Netherlands: Industrial Production, Apr		
09:00	Norway: Manufacturing Production, Apr	-1.2% MM, 2.3% YY	-0.7% MM, 3.2% YY
09:30	UK: Trade Balance – Goods & Services, Apr	£-3.0 Billion	£-3.1 Billion
09:30	UK: New Construction Orders, 1Q		
09:30	UK: BoE/GfK Inflation Expectations, May		
10:00	Cyprus: GDP Details, 1Q		
11:00	Germany: Industrial Production, Apr SA	1.0% MM, 0.2% YY	1.2% MM, -2.5% YY
	Greece: GDP Details, 1Q (NSA, YY %)		

Sources: National statistical offices, central banks and Citi Research



## Economic Indicators

### Euro Area

Jun 3 09:00 London Time	<b>Manufacturing PMI, May Final</b>	<b>Forecast: 47.8</b>	<b>Prior: 46.7</b>
	The flash manufacturing PMI rebounded in May, reversing the weakness of the prior two months. We expect the final reading to confirm the flash estimate. The level of the PMI remains 0.7 standard deviations below its long-run average and still suggests weak industrial output growth in 2Q.		
Jun 5 09:00 London Time	<b>Services PMI, May Final</b> <b>Composite PMI, May Final</b>	<b>Forecast: 47.5</b> <b>Forecast: 47.7</b>	<b>Prior: 47.0</b> <b>Prior: 46.9</b>
	The services and composite PMI are both expected to be confirmed in line with the flash estimate at 47.5 and 47.7, respectively. For the composite PMI this would be the second consecutive monthly increase, after the temporary decline at the start of the year. However, at 47.1 on average in 2Q, the composite PMI is still consistent with close to zero or slightly negative QQ GDP growth.		
Jun 5 10:00 London Time	<b>Retail Sales, Apr</b>	<b>Forecast: -0.2% MM, -0.8% YY</b>	<b>Prior: -0.1% MM, -2.2% YY</b>
	Retail spending has probably fallen further in April, reflecting the recent declines in retail sector sentiment, although the annual rate should be lifted higher because of favourable base effects. After gaining 0.3% QQ in Q1, if our forecast is correct, the level of the retail sales index in April would be 0.4% below the 1Q average.		
Jun 5 10:00 London Time	<b>GDP Details, Q1</b>	<b>Forecast: -0.2% QQ, -1.0% YY</b>	<b>Prior: -0.6% QQ, -0.9% YY</b>
	The second release of GDP is likely to confirm the drop of 0.2% QQ as reported in the preliminary estimate. The breakdown of components will likely show a small positive print for household consumption, but still largely negative reading on investment (-1.5%) and government consumption (-0.2%). Exports may have also dropped (by 0.6% QQ) again after a 1% QQ decline in 4Q12.		

### Germany

Jun 6 11:00 London Time	<b>Incoming Orders, Apr SA</b>	<b>Forecast: -2.5% MM, -0.8% YY</b>	<b>Prior: 2.2% MM, -0.4% YY</b>
	After two successive quarterly gains, we expect German factory orders to start the second quarter on a weaker footing. Both incoming orders and the stock of orders have been somewhat disappointing in March and April according to the ifo survey. We estimate that there was enough of a rebound in orders in the past couple of quarters to lift industrial production (and GDP) in the second quarter (particularly after the disappointingly soft 1Q performance that was impacted by unusually harsh weather conditions).		
Jun 7 11:00 London Time	<b>Industrial Production, Apr SA</b>	<b>Forecast: 1.0% MM, 0.2% YY</b>	<b>Prior: 1.2% MM, -2.5% YY</b>
	We forecast a third successive gain in industrial production in April. Although there had been some erosion in business confidence in the last couple of months, the ifo survey for May sent a strong signal of improving dynamics, particularly in the current conditions series, arguing in favour of a rebound in production. A solid entry point into 2Q would be in line with our forecast of a better showing for the overall economy.		

### France

Jun 6 06:30 London Time	<b>ILO Mainland Unemployment Rate, 1Q</b> <b>Mainland Unemployment Change (000s)</b>	<b>Forecast: 10.6%</b> <b>Forecast: 95K</b>	<b>Prior: 10.2%</b> <b>Prior: 124K</b>
	The labour market is continuing to deteriorate, as indicated by the monthly increases in unemployment (23 <sup>rd</sup> in a row) and quarterly job losses (fourth consecutive). We estimate that the ILO total number of unemployed climbed by some 95k in 1Q-13, likely contributing to a 0.4pt jump in the mainland jobless rate to 10.6%, equalling its 4Q 1997 high. Although unemployment expectations are showing signs of stabilising, the temporary jobs dynamics point to more upticks in the jobless rate until the spring of 2014.		

### Belgium

Jun 5 14:00 London Time	<b>GDP, SA and WDA, 1Q Final</b>	<b>Forecast: 0.1% QQ, -0.5% YY</b>	<b>Prior: -0.1% QQ, -0.5% YY</b>
	Belgium recorded a modest gain in 1Q GDP, the first increase in four quarters. We expect that household spending and net trade added to GDP with an offset from investment spending. On an annual basis, the economy was reported to have contracted by 0.5% for the third successive quarter. The persistence of weak business survey readings points to some downside risks to 2Q, compared to our -0.1% QQ forecast.		

### Italy

Jun 3	<b>State Sector Borrowing Requirement, May</b>	<b>Forecast: €52bn</b>	<b>Prior (Jan-May 2012): €35.5</b>
	With three months of data available, state sector budget data have shown some good resilience to the ongoing economic recession. Stripping out the several one-off items, the cash-basis underlying state deficit remained broadly stable in the first four months of 2013 relative to the same period of 2012. The fiscal dynamics are expected to worsen to some extent in the second half of 2013, as the new government intends to reverse some VAT rate hikes.		

### Spain

Jun 4 08:00 London Time	<b>Registered Unemployment, May ('000)</b>	<b>Forecast: -100K MM</b>	<b>Prior: -46K MM</b>
	Registered unemployment (non-seasonally adjusted figures) has stopped growing since last December, actually showing some monthly declines. This is mainly due to some changes in the criteria to access unemployment benefits for some groups of workers, rather than signs of stabilisation in the labour market. It could actually also reflect more long-term unemployed not eligible for unemployment benefits. We expect a flat reading in seasonally-adjusted terms for May, which would translate into a 100K decline in non-seasonally adjusted terms. Total registered unemployed amount to just below 5mln, while total unemployment (as measured by the labour force survey) is rising fast and exceeded 6mln in 1Q13.		

## Economic Indicators

### Sweden

Jun 3 07:30 London Time	<b>PMI, May</b>	<b>Forecast: 49.3</b>	<b>Prior: 49.6</b>
	The PMI fell 2.5 points to 49.6 in April, the first below-50 reading in three months, and hence continues to stand below its long-term average of 54.4. The ongoing deterioration in the euro area PMI since February (although recovering slightly in April) suggests that confidence likely will fall back marginally further in May, before recovering again.		
Jun 4 08:30 London Time	<b>Service Production, Apr</b>	<b>Forecast: -0.4% MM</b>	<b>Prior: -0.9% MM</b>
	Despite a negative reading in March, service production recovered during the first quarter of the year and rose by 1.0% QQ, well above the gains in previous quarters. Developments in survey indicators have been mixed with the service sector PMI improving 1.3 points to 48.6 in April, while sentiment in the private sector, according to the NIER business tendency survey, fell from 16 in March to 11 in April). Both the services PMI and private service-sector sentiment, however, remain below their historical average, pointing to subdued growth ahead.		

### Norway

Jun 3 08:00 London Time	<b>PMI, May</b>	<b>Forecast: 50.1</b>	<b>Prior: 48.9</b>
	We expect the Norwegian PMI to correct slightly higher after falling below 50 in April. The downbeat picture painted in the PMI report is at odds with that from other business surveys, which continue to signal expansion in the sector, albeit at a moderately slowing pace. We note that the PMI is not closely watched by Norges Bank as there often are problems with the seasonal adjustment procedure. Also, the PMI covers a very small sample compared to e.g. Norges Bank's own Regional Network Report and the quarterly manufacturing survey from Statistics Norway.		
Jun 7 09:00 London Time	<b>Manufacturing Production, Apr</b>	<b>Forecast: -1.2% MM; 2.3% YY</b>	<b>Prior: -0.7% MM; 3.2% YY</b>
	Our model points to another fall in April, following moderate gains in the period Dec-12 to Feb-13. Indications from Statistics Norway's latest quarterly business tendency survey suggest that momentum in manufacturing is about to slow again, although continuing to show positive growth on an annual basis. To be precise, the survey indicates slightly below-trend growth in the sector ahead.		

### United Kingdom

Jun 3 09:30 London Time	<b>Manufacturing PMI, May</b>	<b>Forecast: 49.5</b>	<b>Prior: 49.8</b>
	The manufacturing PMI has been below 50 for three months in a row and we expect another sub-50 reading this month, reflecting the drag from the continued euro area recession.		
Jun 5 09:30 London Time	<b>Services PMI, May</b>	<b>Forecast: 52.5</b>	<b>Prior: 52.9</b>
	The services PMI has strengthened for four months in a row, after previously weakening for four consecutive months. We look for the index to slip slightly this time – and in any case it probably will remain well below its longrun average of about 55.		
Jun 7 09:30 London Time	<b>Trade Balance – Goods &amp; Services, Apr</b>	<b>Forecast: £-3.0 Billion</b>	<b>Prior: £-3.1 Billion</b>
	The trade deficit has been roughly stable in recent months, with both import volumes and export volumes weakening. We expect little change in the deficit in coming months, with imports capped by sluggish domestic demand and exports held back by the euro area recession.		

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

## Key Economic Indicators (10 June – 14 June 2013)

Monday 10 June		Forecast	Last
06:45	Switzerland: Unemployment, May		
07:30	France: Bank of France Business Sentiment, May	96	94
07:45	France: Industrial Production, Apr		
08:15	Switzerland: Retail Sales, Apr		
08:30	Sweden: Industrial Production, Apr		
09:00	Norway: Consumer Prices, May		
09:00	Italy: Industrial Production, Apr		
10:00	Italy: GDP Details, 1Q		
	Greece: Industrial Production, Apr		
	Greece: HICP, May		
Tuesday 11 June		Forecast	Last
00:01	UK: RICS House Price Survey, May		
06:45	Switzerland: SECO Economic Forecasts		
08:30	Sweden: Consumer Prices, May		
09:30	UK: Industrial Production, Apr	0.0% MM, -0.7% YY	0.7% MM, -1.4% YY
	Manufacturing Output, Apr	-0.3% MM, -0.6% YY	1.1% MM, -1.4% YY
Wednesday 12 June		Forecast	Last
06:30	France: Nonfarm Payrolls, 1Q		
07:00	Germany: Consumer Prices, May Final		
07:45	France: Consumer Prices, May		
08:00	Spain: HICP, May Final		
09:00	Italy: Consumer Prices, May Final		
09:30	UK: Claimant Count Unemployment, May	-5,000 MM, 4.5% Rate	-7,300 MM, 4.5% Rate
	LFS Unemployment, Feb-Apr	-15,000 QQ, 7.8% Rate	+15,000 QQ, 7.8% Rate
10:00	Euro Area: Industrial Production, Apr		
Thursday 13 June		Forecast	Last
08:15	Switzerland: Producer and Import Prices, May		
08:30	Netherlands: Retail Sales, Apr		
09:00	Euro Area: ECB Monthly Bulletin		
	Greece: Unemployment, 1Q		
Friday 14 June		Forecast	Last
07:00	Sweden: PES Unemployment Rate, May		
08:00	Spain: Labour Costs, 1Q		
08:30	Netherlands: Trade Balance, Apr		
09:30	Italy: General Government Gross Debt, Apr		
09:30	UK: Construction Output, Apr		
10:00	Euro Area: HICP, May Final		
10:00	Euro Area: Employment, 1Q		

Sources: National statistical offices, central banks and Citi Research

Recent Research Publications	Author	Date
<b>Euro Area</b>		
Euro Area: Sovereign Debt Crisis Update	Guillaume Menuet	May 31, 2013
Selective euro area deposit 'jogs' continued in April	Ebrahim Rahbari/Antonio Montilla	May 30, 2013
European Economic Forecast Highlights - May 2013	Ann O'Kelly	May 23, 2013
Euro Area - ECB Cuts Refi Rate By 25bp, Does Not Rule Out More To Come	Giada Giani	May 2, 2013
ECB - Rate Cut Likely in May or June	Jürgen Michels	Apr 4, 2013
<b>Euro Economics Weekly</b>		
Removing Grexit from the Baseline Scenario	Giada Giani	May 24, 2013
Watching for Positive Surprises: Favour GIPS over France	Guillaume Menuet	May 17, 2013
Euro Area Disinflationary Pressures	Giada Giani	May 10, 2013
Italy and Spain — "We Will Die of Austerity Alone"	Giada Giani	May 3, 2013
Muted Profits Dynamics Point to Sub-Par Recovery Prospects	Guillaume Menuet	Apr 26, 2013
<b>Chief Economist Publications</b>		
Global Economic Outlook and Strategy - May 2013	Willem Buiter	May 22, 2013
<b>Scandi</b>		
Scandi Economics Update	Tina Mortensen	May 24, 2013
Sweden - Sharply Undershooting Inflation in April	Tina Mortensen	May 14, 2013
Norway - Stable Interest Rate at 1.50%, No Change to Outlook	Tina Mortensen	May 8, 2013
<b>UK</b>		
UK - Lending Remains Weak, Especially for SMEs	Michael Saunders	May 31, 2013
UK - CBI Report Weaker Sales Growth	Michael Saunders	May 29, 2013
UK - YouGov Report Inflation Expectations Edge Down Again	Michael Saunders	May 23, 2013
UK - GDP Split Not Encouraging For Growth Prospects	Michael Saunders	May 23, 2013
UK - Data and IMF Review	Michael Saunders	May 22, 2013
<b>UK Economics Weekly</b>		
Are We Nearly There Yet?	Michael Saunders	May 31, 2013
Disinflation Opens the Door to Guidance	Michael Saunders	May 24, 2013
Inflation Report Does Not Signal End of Easing	Michael Saunders	May 17, 2013
Options for Forward Guidance	Michael Saunders	May 10, 2013
Upside Inflation Risks Receding	Michael Saunders	May 3, 2013
Reinhart and Rogoff Were (Partly) Right	Michael Saunders	Apr 26, 2013

Source: Citi Research

## Appendix A-1

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