10 October 2014 | 20 pages

Developed Markets
Western Europe

Euro Economics Weekly

France: Rejecting Austerity, For Now

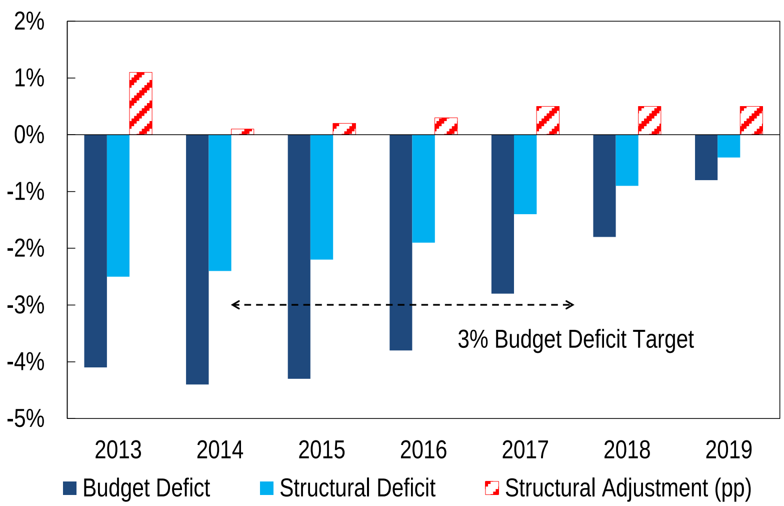
- **No to austerity** — The government's 2015 budget plan shows that it will not meet its previous consolidation objectives on the grounds of much lower-than-expected inflation and that the already-fragile economy would suffer too much if additional expenditure savings or revenue raising measures were to be implemented.
- **Re-submitted budget and clear reform agenda** — Provided that the government demonstrates its willingness to incorporate modest additional savings and provides more clarity on its structural reform agenda, we think that an EU fine will be avoided and that France will be granted two more years to meet the 3% deficit target.
- **Policy mix debate is only starting** — We do not believe that the euro area fiscal stance will change enough to add much to the recovery. Given the persistence of 'low-flation', we continue to expect the ECB to launch a QE programme later in 2014 year or in early 2015 given the serious damage that a triple-dip recession could inflict on the euro area project, let alone on debt sustainability perspectives.

Figure 1. Citi Forecasts

	$/€	Euro Repo	10-yr Bunds	£/€	UK Bank Rate	10-Yr Gilt Bund
4Q 14	1.21	0.05	0.75	0.76	0.50	177
2Q 15	1.15	0.05	1.25	0.73	1.00	178

Source: Citi Research

Figure 2. France – Targeted Budget Deficit and Structural Adjustment, % of GDP, 2013-19



Sources: French Finance Minister and Citi Research

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France's 2015 Budget Showdown

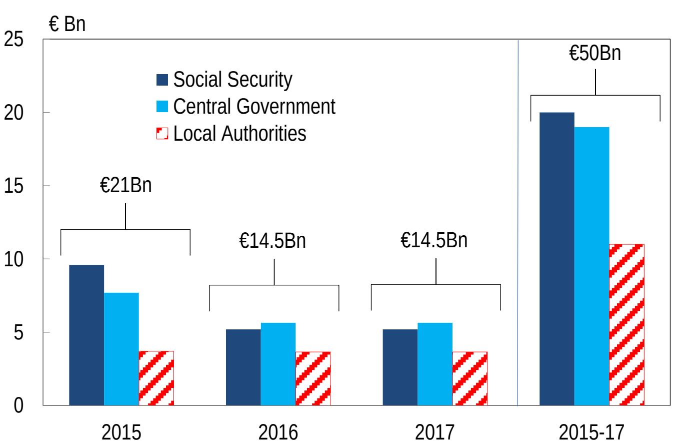
The French 2015 budget plan shows that it will not respect its previous fiscal consolidation objectives on the grounds that the already fragile economy would suffer too much if additional expenditure savings or revenue-raising measures were to be implemented. While there have been many precedents of non-compliance with pre-determined fiscal targets, the EU surveillance framework has been reinforced in the last few years, increasing the likelihood of financial sanctions being imposed unless opposed by a qualified majority of member states. This note reviews the key drivers behind the deviation from the pre-agreed budget deficit targets, asks what concessions could be demanded to grant Paris two more years to hit the 3% of GDP target and investigates what could happen in coming months in terms of sanctions or changes in the fiscal framework.

France – the 2015 budget plan

The updated fiscal trajectory envisages bringing the budget deficit to less than 3% of GDP two years later than planned, in 2017. The French government's 2014-19 fiscal trajectory, presented as part of the draft 2015 budget, is aimed at achieving a medium-term structural budget deficit objective of 0.5% of GDP in 2019. The 2015 budget deficit is expected to be 4.3% of GDP (compared to 3.0% in the April 2014 Stability Programme) and the structural deficit adjustment effort worth 0.2pp of GDP (compared to 0.8pp). For 2015-17, the government is planning to deliver a total of €50bn (around 0.8% of GDP) of expenditure savings. The government estimates that real public expenditure growth will be limited to 0.2% per year in 2015-17, compared to the 1.7% historical growth rate, describing the effort as "*unprecedented*". This strategy is designed to bring the ratio of public expenditure from 56.5% of GDP in 2014 to 54.5% of GDP in 2017. The government argues that these measures would allow a reduction in the structural budget deficit of around 0.5pp of GDP per year, making it compliant with the EU requirements.

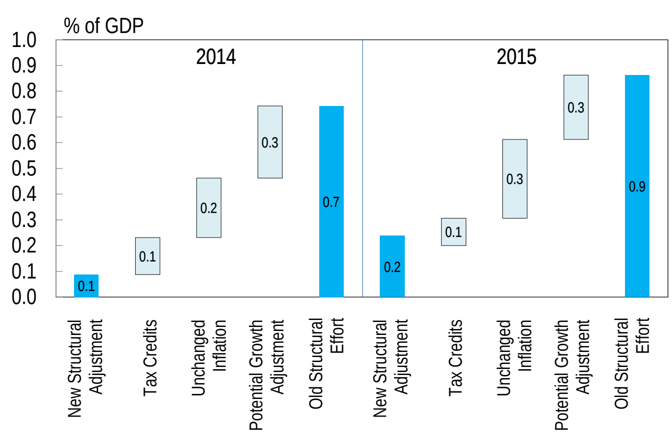
Breakdown of expenditure savings. The government is targeting €21bn of savings in 2015, with the remainder of the total €50bn effort equally split between 2016 and 2017 (see Figure 3). The largest share of the adjustment is to be obtained from the social security budget (€9.6bn: €3.2bn will come from the health budget and €6.4bn from benefits), followed by the central government and its agencies (€7.7bn) and local authorities (€3.7bn). Note that the government decided to front-load some of the expenditure savings by focusing on social security (45.7% of the 2015 effort compared to 40% of 2015-17).

Figure 3. France – Breakdown of Targeted Expenditure Savings, €Bn, 2015-17



Sources: French Finance Ministry and Citi Research

Figure 4. France – Government Structural Budget Deficit Adjustment Estimates, New vs. Old and Contributing Factors, 2014-15



Sources: French Finance Ministry and Citi Research

Adjusting the rhythm of fiscal consolidation. The French government is arguing that the budgetary consolidation effort is following the guidelines of its April 2014 Stability Programme, but that its rhythm must be adapted to the macroeconomic situation characterized by very slow real GDP growth and much lower-than-expected inflation, with the latter estimated to be 0.5% in 2014 and 0.9% in 2015 instead of the 1.3% projected last year for 2014.

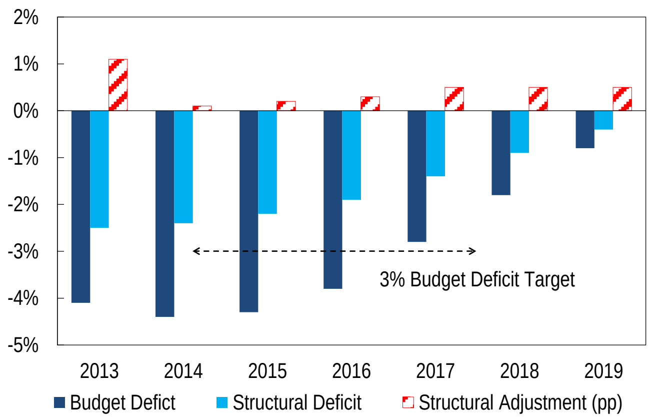
The government also makes the case that "*important technical changes*" to the calculation of budget deficits are obscuring the magnitude of effort (see Figure 4). In particular, the government notes that its policy of corporate tax credits is subtracting 0.1pp from the structural deficit adjustment effort following the methodology change required by the adoption of the ESA2010 national accounts, and that the choice of a lower (1.2% instead of 1.5%) and more prudent potential GDP growth trajectory is shaving some 0.3pp off the structural adjustment in both 2014 and 2015.

More importantly, the government stresses that much lower-than-expected inflation rates are diluting the government's effort to control nominal spending by a very sizeable amount. This is a genuine issue that the government estimates will reduce structural budget deficit reduction efforts by 0.2pp in 2014 and 0.3pp in 2015. Hence, because of methodological changes and lower inflation, the structural adjustment effort presented in the 2015 budget is very modest, worth 0.1pp and 0.2pp for 2014 and 2015, respectively, instead of the 0.8pp targets contained in the April Stability Programme.

Are the expenditure reduction objectives feasible?

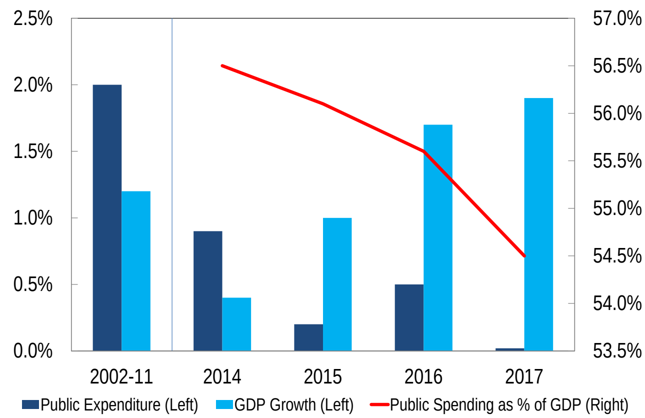
In his hearing by the public finances commission of the lower house, Didier Migaud, president of the High Council for Public Finances (HCFP) was asked to give the Council's assessment of i) potential GDP growth, ii) macroeconomic forecasts and iii) the multi-year (2014-19) fiscal trajectory compared to France's medium-term objectives (OMT) set by the EU. Mr. Migaud noted that the government had adopted the European Commission (EC)'s potential growth and output gap estimates instead of relying on its own forecasts, but warned that the persistence of a large output gap raised some questions about the likelihood of the French economy being in a position to grow as strongly in the foreseeable future as anticipated by the government's long-term forecasts. In addition, when reviewing assumptions related to 2015, he noted that the Court judged the 1% GDP growth forecast to be slightly on the optimistic side given recent weakness of business sentiment surveys.

Figure 5. France – Targeted Budget Balance and Structural Adjustment, % of GDP, 2013-19



Sources: French Finance Ministry and Citi Research

Figure 6. France – Targeted Real Public Expenditure and GDP Growth, %, 2014-17



Sources: French Finance Ministry and Citi Research

In associated documents, the HCFP highlighted that there were fragile elements to the macroeconomic scenario, warning about the possibility of less robust global demand than envisaged by the government, the possibility of a more subdued rebound in corporate investment given the low level of capacity utilisation, as well as the downside risks to consumer spending from the elevated jobless rate limiting the likelihood of a fall in the household savings ratio. On the positive side, the HCFP noted that the euro could depreciate further compared to the government's standard assumption of a stable exchange rate.

The HCFP also remarked that it had not received any document detailing how the government intended to take corrective action with respect to the lower-than-expected amount of structural budget deficit reduction (0.1pp for 2014 and 0.2pp for 2015) compared to the 0.8pp targets presented in the last update of the stability programme (see Figure 5). It concluded that the multi-annual budget deficit reduction plan was not compliant with pre-agreed EU targets. Finally, the HCFP warned that the structural budget deficit reduction objectives for 2015 could be at risk given the natural trend of progression in public sector pay trends, the room for manoeuvre by local authorities to increase spending and the lack of details about expenditure savings measures in terms of social security outlays.

While we believe the assumptions behind the modest increase in real government spending for 2015-16 are credible, we are more circumspect about the target of 0% growth in real public expenditure for 2017 (see Figure 6), which anticipates that the 1.8% increase in nominal outlays will largely match the projected increase in the inflation rate (1.75%). In what will be a legislative and presidential election year, this would represent an unparalleled achievement. Overall, we agree with the conclusion of France's High Council for Public Finances, which warns of significant risk of deviation from the already revised budget deficit targets and the possible consequences in terms of the already elevated stock of public sector debt.

What are the new budgetary rules saying?

So what do the EU new laws suggest should happen when a member state is not compliant with the reinforced budget rules? The process is referred to as the 'corrective arm' of the Stability and Growth Pact (see Figure 11). The complexities and length of the process are obvious, suggesting that getting anywhere close to imposing a fine on a recalcitrant member state is an arduous task. Countries such as France (but also Malta, Cyprus, Portugal, Slovenia, Ireland, Greece and Spain) that are under an Excessive Deficit Procedure (EDP) are given a deadline of six months (or three months for a serious breach) to take effective action to comply with a recommendation in accordance with Article 126 (7) of the Treaty. Following the expiry of the deadline, the Commission assesses whether sufficient action (or measures) has been taken to ensure adequate progress towards the correction of the excessive deficit situation. According to Regulation (EC) No 1467/97 and the Code of Conduct on the implementation of the Stability and Growth Pact, the assessment of effective action is based on whether the annual budgetary targets and the underlying improvement of its cyclically adjusted (or structural budget) balance, net of one-off and other temporary measures, as recommended by the Council, have been achieved.

The methodology for assessing effective action requires that the Commission first consider whether the Member State is compliant with the nominal target and the underlying improvement in the structural balance, as required in the EDP Recommendation. If this is the case, the EDP is held in abeyance.

A Member State that has taken effective action to address its excessive deficit, but where the impact on the public finances has been affected by exceptional events

outside its control, may see an extension of its deadline for correction and a revision of the recommendations to reflect the change in circumstances.

If a country is judged not to have done enough, the procedure can be escalated and the country will receive revised recommendations, which may include a new time line to address the excessive deficit. But the stepping up of the EDP may also result in the imposition or strengthening of sanctions in the form of a fine of 0.2% of GDP.

With continued non-compliance, the fine for euro area Member States may be increased to include a variable component and imposed annually as long as the country in question continues to fail to take effective action. Since the 2011 reforms, reverse qualified majority voting (RQMV) – whereby a qualified majority of Member States is needed to reject a Commission proposal for a Council decision – is used for the imposition of most sanctions.

Could France be treated leniently?

Given its political importance in the euro area, and the relatively good (albeit limited) track record of compliance with respect to the newly monitored country-specific recommendations (CSR), we believe it is unlikely that France will be fined.

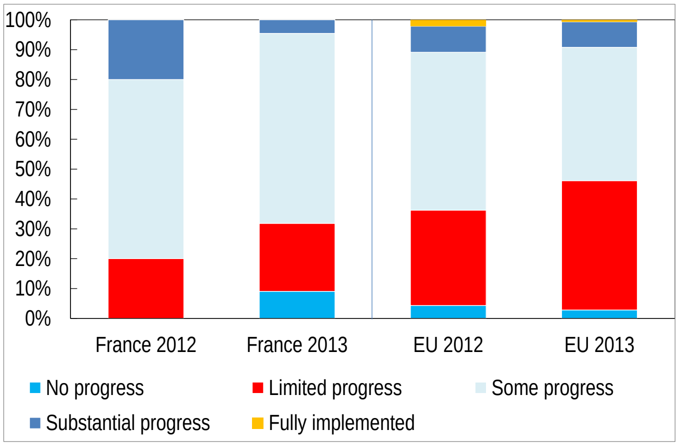
In a previous euro weekly "France: More Reforms to Jump Start Confidence? we had highlighted some of the progress made in France towards structural reforms, arguing that more changes had happened than many investors seemed to be willing to give it credit for.

We complement that analysis by referring to a methodology developed by the EC and presented in the ECFIN Economic brief, Issue 37, October 2014. The EC team built a synthetic indicator of EU-wide CSR implementation showing a score just over 40% based on the 2013 CSRs. The paper notes that implementation was i) weaker for the 2013 vintage of recommendations than the 2012, ii) appears to vary with the electoral cycle, and iii) is stronger in policy areas where market pressure requires an imminent policy response (banking sector reform) and/or where the recommendations are backed by an EU rule with enforcement powers (public finances).

We apply the same methodology (see Figure 7) to gauge the France's aggregate CSR implementation and find that it stands in the lower end of the range of the 'some progress' category (37.5% to 62.5%) with a reading of 41% in 2013 compared to 50% in 2012. Both metrics are higher than EU averages of 40.2% in 2013 and 43.1% in 2012, particularly the 2012 vintage (measured in Nov-13).

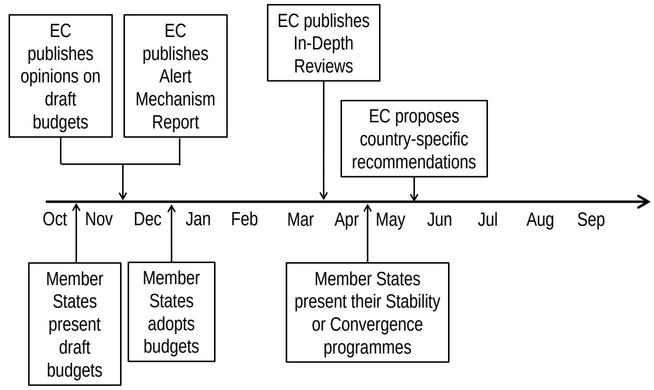
The paper makes an interesting point about implementation over time, suggesting that member states have "*picked the low-hanging fruit*" first, perhaps facing a more challenging set of CSRs in subsequent rounds of the European Semester. Another point made by the paper refers to some possible "*reform fatigue in combination with a perception of diminished urgency of reforms as market pressures have dissipated somewhat*". This assessment is based on an increase in the number of entries in the category of "*limited*" and "*no progress*" representing 46% of all assessments compared to 36% in 2012. In France's case this represents 7 entries in the 2013 vintage (32% of the total) compared to 20% in 2012. These findings are consistent with the analysis that we ran in July 2014 when we argued that investors were perhaps underestimating the underlying progress made by the French government about structural reform delivery.

Figure 7. France and EU: EC Assessment of Country-Specific Recommendations, 2012-13



Sources: European Commission and Citi Research

Figure 8. European Semester Timeline



Sources: European Commission and Citi Research

Two alternative scenarios

The ball is now in the EC's court. There are two main scenarios, in our view. The **first scenario** sees the EC concluding by the end of October that there is such a deviation from the pre-agreed consolidation path that a new 2015 budget draft needs to be resubmitted before the Commission can issue its verdict in the second half of November (see Figure 8). We believe that the outgoing EC will be reluctant to accept that lower-than-expected potential growth estimates should alleviate the need for the French fiscal effort to be consistent with the prescribed 0.5pp of GDP per year, given that it is subject to an excessive deficit procedure. As a result, it is likely, in our view, that the EC will request additional efforts, probably worth 0.3pp (€6bn) of GDP for 2015 in order to comply with the pre-agreed magnitude, while perhaps choosing to ignore the 2014 miss.

The **second scenario** assumes that the EC accepts the methodology change presented by the French government, and that the flexibility existing in the current budgetary rules allows for the proposed delay in fiscal consolidation. We very much doubt that such a conclusion could be reached, as it would likely open the door to other countries submitting 'non-compliant' budgets in future. We would be surprised if France's proposal for a two-year delay in bringing its budget deficit below 3% of GDP could be accepted without clear guarantees about the timing and form of structural reforms to be implemented to match EU Council recommendations.

What happens next?

The proposed 2015 budget would fall substantially short of the previously agreed targets in terms of structural budget deficit reduction. Therefore, assuming that the version submitted to the EC by Oct 15 does not contain any supplementary measures to narrow the budget deficit, we expect the outgoing EC will ask for some amendments to be made. A press report by *Le Figaro* on Oct 7 suggested that the EC is considering asking the government to identify €8bn (or 0.4% of GDP) of supplementary savings or tax revenues by Oct 31, as well as a clearly measurable structural reform programme (partly focusing on the labour market) by year-end. The same paper also reported that the French government is working on "Plan B".

It does not seem likely that the French government will adjust its stance in the next few weeks, perhaps hoping to force the issue, perhaps with the backing of Italian Prime Minister Matteo Renzi, immediately after the Oct 23-24 EU Council meeting

when discussions about the economic situation will take centre stage. At the EU Jobs Summit in Milan on Wednesday Oct 8, President Hollande reiterated his call for some “*adjustment in the pace of budgetary consolidation in light of the deteriorating growth picture*”.

A refusal by France to resubmit an amended budget would open up a tense period of negotiations between Paris and Brussels. We would expect the European Commission’s hard stance to be supported by most member states from the core euro area countries, as well as some from the euro area periphery that will expect the same rules to apply to all.

However, eventually, we believe that a compromise is likely, with France being granted an extra two years as it wishes, as long as the government can demonstrate that it can go beyond the already announced structural reform plan (currently focusing on some relaxation in the threshold for worker representation in firms, some simplification in labour laws and a challenging pledge to open up closed professions).

As part of a likely quid-pro-quo, we list below some of the options that the French government would likely be willing to consider. We rank them in what we see as a decreasing order of likelihood:

- Additional expenditure savings focusing on social security (means-testing of family benefits, healthcare/hospitalisation costs, drugs prices, less generous refunds).
- VAT rate hike of two percentage points (1pp generates around €6.5bn or 0.3% of GDP), with a large part of the proceeds going to cut employees’ social security contributions further.
- Labour market reforms, further relaxation of the 35-hour week framework, introducing more flexibility in terms of hiring and firing.
- Reform of the unemployment benefit system: less generous and adjusted over time to encourage job offer acceptance as part of the upcoming re-negotiation between social partners in 2016.
- Supplementing the already announced €4bn of asset sales to pay off debt.
- Revisiting the 2013 pension reform.

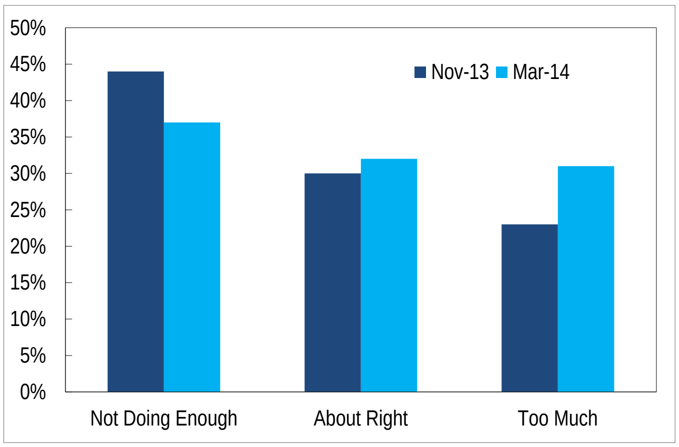
Will the political situation allow it?

One of the key issues in France at present is the lack of visibility about the reform agenda, its sequencing and the government’s strategy. The lack of appetite from leading politicians for reform is surprising, in our view, given the multitude of opinion polls suggesting that a majority of French voters support spending cuts. For instance, some 41% of voters indicate that the government is not doing enough when asked to pass judgment on the €50bn 2015-17 expenditure savings programme, with around 31% thinking the effort is adequate and only 27% that it is excessive (see Figure 9). When quizzed about the reform of closed professions (78%), the regions (67%) and the labour market (63%), voters told BVA polling institute that they were overwhelmingly in favour.

Low popularity ratings for the government (see Figure 10) and growing voter discontent with the erosion of France's social model (itself a by-product of economic policy and reform inertia from the mainstream parties in the last few decades) could make it difficult for Mr. Hollande and Mr. Valls to adjust the 2015 budget without a

fight. Yet, the PM's strong focus on supply-side reforms and his well publicised desire to implement "*pro-business*" policies should make it easier, in our view, for France and Brussels to find some common ground about quickening the pace of a clearly defined structural reform programme in exchange for more time to meet the fiscal targets. It is possible that a deal of this kind could even be supported by some of the mainstream opposition party key figureheads who are currently jockeying for position ahead of upcoming primaries, and are often advocating more cuts in spending to shrink the size of the state in the economy.

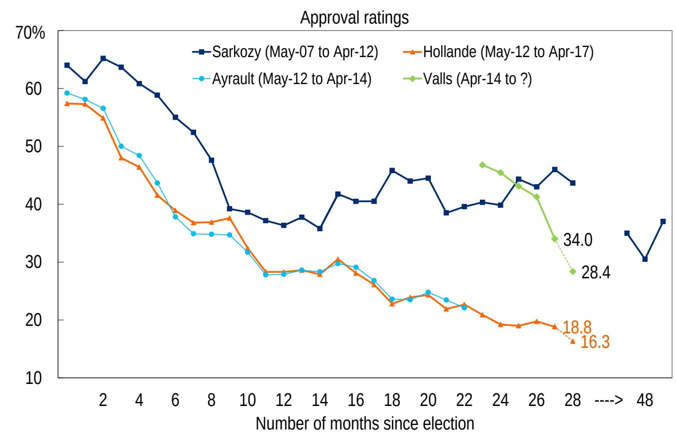
Figure 9. France – Opinion Polls on the €50bn 2015-17 Expenditure Savings Programme, %



Note: the Nov-13 poll was conducted by BVA and the Mar-14 by EY

Sources: European Commission and Citi Research

Figure 10. France – Popularity Ratings (Percentage of Positive Opinions), May-12 to Sep-14



Sources: Ifop, BVA, TNS-Sofres, Harris Interactive, YouGov, CSA, Ipsos, OpinionWay and Citi Research

Yet, the French government remains in a combative mood. French Finance Minister Michel Sapin remarked on Sunday October 5 than the "*treaties apply to all*" and that France is not asking to change the deficit rules, but that Europe needs "*debate about the proper monetary and budgetary policy mix*" to support growth. Mr. Sapin added that the government had "*clearly*" ruled out raising new taxes or identifying additional savings measures in 2015. Mr. Sapin also stressed that the Commission cannot reject a budget as its task is to give recommendations, adding that only the national parliament is sovereign with respect to its budgetary decisions.

Consequences for fiscal policy and markets

Overall, France's ability to deliver some reforms (with respect to clearly identified CSRs) and its desire to reach a deal on a more appropriate policy mix, suggest to us that some compromise will be able to be reached with the Commission and the EU Council, albeit probably only after some weeks of tense negotiations as the EU wants to demonstrate the effectiveness of the enhanced fiscal rules.

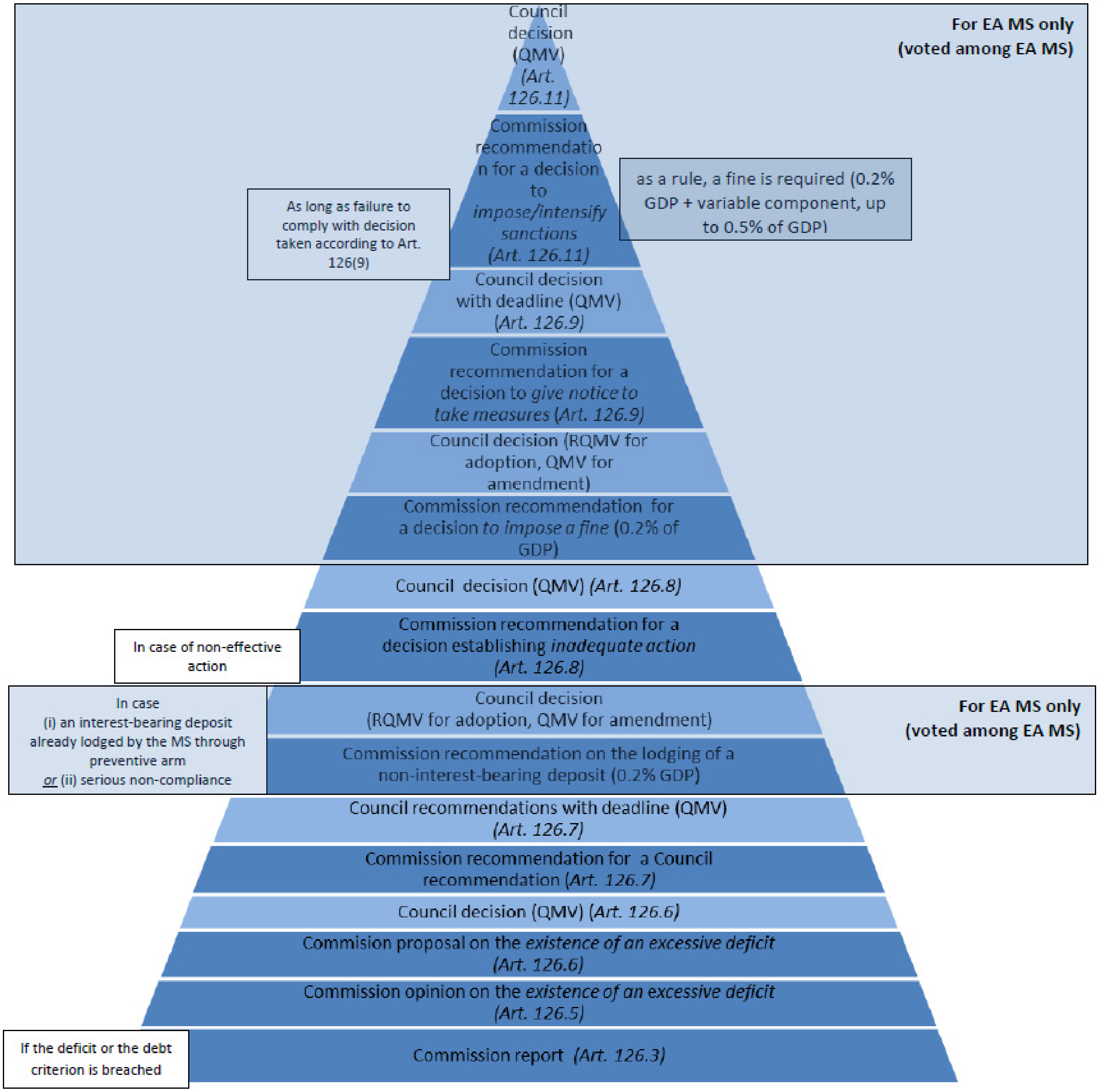
Hence, we think that, provided that the French government demonstrates its willingness to incorporate such structural changes, France should avoid being fined, and will likely obtain more time to bring its deficit below 3% of GDP. Other countries also under an excessive deficit procedure might well also offered a similar arrangement as evidence of a widespread slowdown in economic activity materialises with the publication of weak Q3 GDP data by mid-November.

At the margin, some relaxation in budgetary austerity could make the ECB less willing to deliver more stimulus if the aggregate policy mix were to become more supportive of economic activity. But we do not believe that the aggregate euro area fiscal stance will change by a sizeable enough margin to add meaningfully to the

recovery (see Euro Area: What Are The Prospects For Fiscal Easing?). Hence, we continue to believe that, with the likelihood of 'low-flation' becoming more persistent, together with evidence of growing downside risks to what is an uneven and fragile picture of muted economic activity, the Governing Council of the ECB will soon conclude that more needs to be done to meet its medium-term price stability target.

We expect the ECB to announce a change in the composition of its balance sheet by adding government securities to its programme of private sector asset purchases in late 2014 or early 2015. A full blown QE programme targeting €1tr of asset purchases might not be enough on its own to steer the euro area towards a sustainable recovery and ultimately address the problems of low inflation, but some fiscal relaxation across the euro area would certainly help boost domestic demand. We argue that France's rejection of pro-cyclical austerity and calls for further weakening of the euro are welcome developments at this juncture, given the serious damage that a triple-dip recession could inflict on the euro area project, let alone on debt sustainability perspectives.

Figure 11. EU Economic Governance: The Corrective Arm of the Stability and Growth Pact



Sources: European Commission and Citi Research
http://ec.europa.eu/economy_finance/economic_governance/images/corrective_arm.jpg

Figure 12. Key Economic Indicators (13 October – 17 October 2014)

Monday 13 October		Forecast	Last
14:00	Euro Area: Informal Eurogroup, Luxembourg		
	US: Columbus Day Holiday		
Tuesday 14 October		**Forecast**	**Last**
	EU: EcoFin meeting, Luxembourg		
07:45	France: HICP, Sep	-0.3% MM, 0.4% YY	0.5% MM, 0.5% YY
	Consumer Prices, Sep	-0.4% MM, 0.3% YY	0.4% MM, 0.4% YY
	CPI Ex Tobacco Index, Sep	126.11	126.38
07:45	France: Balance of Payments, Aug		
08:00	Spain: HICP, Sep Final	-0.3% YY	-0.5% YY
08:15	Switzerland: Producer and Import Prices, Sep		
08:30	Sweden: Consumer Prices, Sep	0.5% MM, 0.0% YY	-0.1% MM, -0.2% YY
	CPIF, Sep	0.6% MM, 0.7% YY	0.0% MM, 0.5% YY
09:00	Italy: Consumer Prices, Sep Final		
09:30	Italy: General Government Debt, Aug		
09:30	UK: Consumer Prices, Sep	0.2% MM, 1.4% YY	0.5% MM, 1.5% YY
	CPI Ex Food, Drink, Tobacco, Energy, Sep	0.3% MM, 1.8% YY	0.5% MM, 1.9% YY
	Retail Prices, Sep	0.4% MM, 2.4% YY	0.4% MM, 2.4% YY
	RPIX – Excludes Mortgages, Sep	0.4% MM, 2.5% YY	0.4% MM, 2.5% YY
09:30	UK: Producer Input Prices, Sep	-0.1% MM, -6.4% YY	-0.6% MM, -7.2% YY
09:30	UK: Producer Output Prices, Sep	0.1% MM, -0.2% YY	-0.1% MM, -0.3% YY
	Ex Food, Drink, Tobacco, Energy, Sep	0.1% MM, 1.0% YY	0.1% MM, 0.9% YY
10:00	Germany: ZEW Current Situation, Oct	15.4	25.4
	ZEW Economic Sentiment, Oct	3.9	6.9
10:00	Euro Area: Industrial Production, Aug	-1.8% MM	1.0% MM
Wednesday 15 October		**Forecast**	**Last**
07:00	Germany: HICP, Sep Final	0.0% MM, 0.8% YY	0.0% MM, 0.8% YY
	National CPI, Sep Final	0.0% MM, 0.8% YY	0.0% MM, 0.8% YY
08:30	Netherlands: Retail Sales, Aug		
09:00	Norway: Trade Balance, Sep		
09:30	Italy: GDP Details (ESA 2010), 2Q	-0.2% QQ, -0.2% YY	-0.1% QQ, -0.4% YY
09:30	UK: LFS Unemployment, 3-Month Average, Jun-Aug	-143,000 QQ, 6.1%% Rate	-145,000 QQ, 6.2% Rate
	LFS Unemployment Rate, Single Month, Aug	5.9%	5.9%
	Claimant Count Unemployment, Sep	-35,000 MM, 2.8% Rate	-37,200 MM, 2.9% Rate
	Average Earnings Ex Bonus, 3-Month Average, Aug	0.9% YY	0.7% YY
	Spain: Current Account, Jul		
	Ireland: 2015 Budget		
Thursday 16 October		**Forecast**	**Last**
06:45	Switzerland: SECO Economic Forecasts		
08:30	Netherlands: Unemployment, Sep		
08:30	Sweden: LFS Unemployment Rate, Sep	7.6% NSA, 8.0% SA	7.4% NSA, 8.0% SA
09:00	Italy: Trade Balance, Aug		
10:00	Euro Area: Consumer Prices, Sep Final	0.3% YY	0.4% YY
10:00	Euro Area: Trade Balance, Aug		
Friday 17 October		**Forecast**	**Last**
07:00	EU-27: New Car Registrations, Sep		
09:30	UK: EU Government Debt and Deficit Returns, Sep		
10:00	Euro Area: Construction Output, Aug		
11:00	Euro Area: Eurostat releases first GDP estimates according to ESA 2010		
	Italy: Current Account, Aug		

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

Figure 13. Economic Indicators – Comments: Euro Area, Germany, France, Italy, and Spain

Euro Area			
Oct 14	*Industrial Production, Aug*	Forecast: -1.8% MM	Prior: 1.0% MM
10:00			
London Time	Based on the very weak country data available so far, we project euro area industrial output plummeted by 1.8% MM in Aug, more than reversing the Jul gain. If correct, our forecast would imply that the Jul-Aug average for the IP index is 0.5% lower than 2Q average, suggesting a likely QQ decline in industrial output in 3Q.		
Oct 16	*HICP F, Sept*	Forecast: 0.3% YY	Prior: 0.4%YY
10:00			
London Time	Headline inflation is likely to be confirmed at 0.3% YY in June, in line with the flash estimate and reaching a new cyclical low. Core inflation (ex-food and energy) dropped to 0.7% YY in Sept, reversing the temporary pick-up to 0.9% in August. September should represent the cyclical trough in the headline rate, but core inflation should remain at these levels, or possibly subside further, in coming months. This will likely produce a further undershooting relative to the ECB's latest inflation projections.		
Germany			
Oct 14	*ZEW Current Situation, Oct*	Forecast: 15.4	Prior: 25.4
10:00	*ZEW Economic Sentiment, Oct*	Forecast: 3.9	Prior: 6.9
London Time			
	We expect the German ZEW index of financial market analysts to continue to decline in October for both the current conditions component and the economic sentiment index. For the current conditions index, we expect another large decline, after September had already seen the largest decline since August 2011, but even so, the index would still remain more than 0.5 std above its long-term average. For the economic conditions index, we expect a smaller decline, but it would be the tenth consecutive monthly decline and would leave the index 0.5 std below its long-term average. Incoming data have been mixed, but we expect the weak data to have a disproportionate effect on the sentiment readings.		
Oct 15	*HICP, Sep Final*	Forecast: 0.0% MM, 0.8% YY	Prior: 0.0% MM, 0.8% YY
07:00	*National CPI, Sep Final*	Forecast: 0.0% MM, 0.8% YY	Prior: 0.0% MM, 0.8% YY
London Time			
	We expect the final readings for German inflation in September to confirm the flash readings for both the national definition and the HICP at 0.8%. For the time being, inflation in Germany seems to have stabilised at below, but close to 1%. For now, the CPI on the national definition remains at its lowest level since January 2010 (the HICP was weaker in May 2014), and the decline in recent months is mostly accounted for by reductions in energy prices.		
France			
Oct 14	*CPI – EU Harmonised, Sep*	Forecast: -0.3% MM, 0.4% YY	Prior: 0.5% MM, 0.5% YY
07:45	*Consumer Price Index, Sep*	Forecast: -0.4% MM, 0.3% YY	Prior: 0.4% MM, 0.4% YY
London Time	*CPI Ex Tobacco Index, Sep*	Forecast: 126.11	Prior: 126.38
	We expect consumer prices to decline again in September, pushing the headline YY rates to new cycle lows. Manufactured goods prices are expected to fall by 1.3% YY in September, matching their July low, while services price inflation is anticipated to rebound because of unfavourable base effects. Volatile components such as food and energy prices are expected to contribute negatively to headline inflation, with food price inflation including tobacco likely to be unchanged compared to the -0.9% YY recorded in August. Energy prices are forecast to have declined by around 1.8% YY. As a result, we anticipate a further decline in core CPI inflation to a new cycle low of 0.7% YY in September. Our near-term inflation trajectory envisages a very modest YY increase in both the HICP and CPI rates worth around 0.1pp.		
Italy			
Oct 15	*GDP, 2Q F*	Forecast: -0.2%QQ; -0.2% YY	Prior: -0.1% QQ; -0.4%YY
09:30			
London Time	The national statistical office (ISTAT) will release the quarterly series with the new ESA2010 national account methodology up to 2Q 14. Despite an upward revision of the level of nominal GDP (by 3.8% in 2013), the quarterly profile is likely to remain broadly unrevised. 2Q 14 GDP is likely to be confirmed down by 0.2% QQ, after -0.1% QQ in 1Q 14, confirming the Italian economy remains stuck in recession.		
Spain			
Oct 14	*HICP, September F*	Forecast: -0.3%	Prior: -0.5%
08:00			
London Time	According to the flash estimate, inflation stood at -0.3% YY in Sep, slightly rising from -0.5% YY in Aug (lowest since Oct 2009). Base effects and rising electricity prices have likely lifted the YY rate in the energy component from -0.9% YY in Aug to -0.6% YY in Sep, contributing to lift the headline rate. Fresh food price inflation also likely became less negative in Sep (we estimate it at -0.9% YY vs. -2.9% YY in Aug). On the other hand, core inflation (excluding fresh food and energy) has probably remained broadly unchanged (-0.1% YY in Aug). Overall, we expect inflation to remain close to zero on average in 2014.		

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

Figure 14. Economic Indicators – Comments: Sweden and United Kingdom

Sweden			
Oct 14	*Consumer Prices, Sep*	Forecast: 0.5% MM, 0.0% YY	Prior: -0.1% MM, -0.2% YY
08:30	*CPIF, Sep*	Forecast: 0.6% MM, 0.7% YY	Prior: 0.0% MM, 0.5% YY
London Time			
	Inflation eased somewhat in August, partly due to a strong comparison month in August last year. With the August reading, actual core inflation has been in line with or above consensus expectations for five consecutive months, supporting our view that Sweden is past the period of ultra-low inflation readings, which dominated at the outset of the year. In September, we expect higher prices on clothing and footwear after the summer sales to lift inflation (our forecast is similar to the Riksbank's). We expect inflation to accelerate slightly further in 4Q, but see CPIF a bit lower than the Riksbank forecast. Declining food prices in August and the recent decline in the oil price imply downside risks to our forecast.		
Oct 16	*LFS Unemployment Rate, Sep*	Forecast: 7.6% NSA, 8.0% SA	Prior: 7.4% NSA, 8.0% SA
08:30			
London Time	Unemployment on the LFS measure continues to be sticky, but another strong reading for employment (2.0% YY) points to underlying strength in the Swedish labour market. Ongoing gains in the labour force explain the diverging trends. These gains are driven by strong growth for the working age population, due to high immigration. Given accelerating population growth, we reckon the decline in unemployment most likely will be very gradual. With the downward trend in registered unemployment according to the unemployment offices' statistics, we continue to expect unemployment on the LFS measure to start trending lower in the near term as well.		
United Kingdom			
Oct 14	*Consumer Prices, Sep*	Forecast: 0.2% MM, 1.4% YY	Prior: 0.5% MM, 1.5% YY
09:30	*Ex Food, Drink, Tobacco, Energy, Sep*	Forecast: 0.3% MM, 1.8% YY	Prior: 0.5% MM, 1.9% YY
London Time	*Retail Prices, Sep*	Forecast: 0.4% MM, 2.4% YY	Prior: 0.4% MM, 2.4% YY
	RPIX – Ex Mortgages, Sep	Forecast: 0.4% MM, 2.5% YY	Prior: 0.4% MM, 2.5% YY
	We expect another subdued inflation figure – the ninth in a row with YY inflation below 2% – and indeed a figure in line with our forecast would put the YY CPI inflation rate at the lowest since the mid-2009 low (1.1% YY). Two notable features are that food prices are likely to fall further, while petrol prices also fell slightly in recent weeks.		
Oct 14	*Producer Input Prices, Sep*	Forecast: -0.1% MM, -6.4% YY	Prior: -0.6% MM, -7.2% YY
09:30			
London Time	Input prices have fallen by 10% since early 2013, reflecting both the appreciating pound and weakness in global commodity prices. We anticipate little change this month, with the pound having fallen back in the last couple of months. Even so, input prices will probably remain well down from a year ago.		
Oct 14	*Producer Output Prices, Sep*	Forecast: 0.1% MM, -0.2% YY	Prior: -0.1% MM, -0.3% YY
09:30	*Output Prices Ex Tax, Sep*	Forecast: 0.1% MM, 0.0% YY	Prior: -0.1% MM, -0.1% YY
London Time	*Ex Food, Drink, Tobacco, Energy, Sep*	Forecast: 0.1% MM, 1.0% YY	Prior: 0.1% MM, 0.9% YY
	Surveys suggest that manufacturers' expectations for their selling prices remain weak, and we anticipate another soft figure. The YY rate for output prices has been negative in the past two months, the first negative readings since 2009.		
Oct 15	*LFS Unemployment, 3-M Avg, Jun-Aug*	Forecast: -143,000 QQ, 6.1% Rate	Prior: -145,000 QQ, 6.2% Rate
09:30	*LFS Unemployment, Single Month, Aug*	Forecast: 5.9% Rate	Prior: 5.9% Rate
London Time	*Claimant Count Unemployment, Sep*	Forecast: -35,000 MM, 2.8% Rate	Prior: -37,200 MM, 2.9% Rate
	Average Earnings Ex Bonus, 3-M Avg, Aug	Forecast: 0.9% YY	Prior: 0.7% YY
	Business surveys suggest that firms' hiring intentions remain very strong and as a result we expect the jobless rate will continue to fall rapidly. A figure in line with our forecast would put the jobless rate down by 1.6 percent from a year ago, the sharpest drop since 1989. The number of job vacancies is likely to continue to rise rapidly.		

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

Figure 15. Key Economic Indicators (20 October – 24 October 2014)

During The Week		Forecast	Last
07:00	Germany: Import Prices, Sep (by Oct 28)		
07:00	Germany: Retail Sales, Sep (by Oct 31)		
Monday 20 October		Forecast	Last
07:00	Germany: Producer Prices, Sep		
08:30	Netherlands: Consumer Confidence, Oct		
09:00	Euro Area: Monthly Balance of Payments, Aug		
09:00	Italy: Industrial Orders, Aug		
14:00	Belgium: Consumer Confidence, Oct		
Tuesday 21 October		Forecast	Last
07:00	Switzerland: Trade Balance, Sep		
08:30	Netherlands: Consumer Spending, Aug		
09:30	UK: Public Sector Net Borrowing, Sep		
10:00	Euro Area: General Government Deficit and Debt, 2013 (2nd Notification)		
	Greece: Current Account, Aug		
Wednesday 22 October		Forecast	Last
09:30	UK: Bank of England Minutes of Oct 9 Meeting		
Thursday 23 October		Forecast	Last
	EU: European Council, Brussels		
07:45	France: Manufacturing Confidence, Oct	97	96
	Own-Company Production Outlook, Oct	2	-5
08:00	Spain: Labour Force Survey, 3Q		
09:00	Norway: Norges Bank Interest Rate Decision		
09:00	Euro Area: Flash PMIs, Oct		
09:30	UK: Retail Sales Volumes, Sep		
09:03	UK: BBA Mortgage Advances, Sep		
10:00	Euro Area: Quarterly Data on Gen. Govt. Deficit and Debt, 2Q		
11:00	UK: CBI Quarterly Industrial Trends Survey, Oct		
15:00	Euro Area: Consumer Confidence, Oct Flash		
Friday 24 October		Forecast	Last
	EU: European Council, Brussels		
07:00	Germany: GfK Consumer Confidence, Nov		
08:00	Spain: Producer Prices, Sep		
09:00	Italy: Retail Sales, Aug		
09:30	UK: Service Sector Output, Aug		
09:30	UK: GDP, 3Q Preliminary Estimate		
10:0	Italy: Contractual Wages, Sep		
11:00	Italy: Consumer Confidence, Oct		
17:00	France: Job Seekers – Net Change, Sep	14K	-11.1K
	Jobseekers – Total, Sep	3,427.3K	3,413.3K
During The Weekend			
	Europe & UK: Clocks go back one hour (night of Oct 25/26)		
11:00	Euro Area: ECB releases final results of Comprehensive Assessment of 130 Banks		

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

Figure 16. Recent Research

Euro Area - Sovereign Debt Update		
German GDP Growth Forecasts Slashed	European Economics Team	Oct 10, 2014
ECB: Up to €1trn of Purchasable Private Assets	European Economics Team	Oct 9, 2014
French Government Working on Plan B for 2015 Budget	European Economics Team	Oct 8, 2014
German Industrial Output Slumps in August	European Economics Team	Oct 7, 2014
Noyer and Weidmann Warnings on ECB's ABS Programme	European Economics Team	Oct 6, 2014
Euro Area		
ECB - ECB: 'Let's See' First, But Leaves Door Open To QE	Ebrahim Rahbari	Oct 2, 2014
Global Economic Forecasts - September 2014	Michael Saunders	Oct 1, 2014
Euro Area - ECB Preview: Will all be revealed on Oct 2?	Guillaume Menuet	Sep 25, 2014
European Economic Forecast Highlights, September 2014	Ann O'Kelly	Sep 25, 2014
Italy - Growth and Inflation keep undershooting expectations	Giada Giani	Sep 25, 2014
Euro Area - ECB Cuts Rates and Announces Asset Purchase Programme	Guillaume Menuet	Sep 4, 2014
Euro Area - Euro Area: What Are The Prospects For Fiscal Easing?	Ebrahim Rahbari	Sep 3, 2014
Euro Area - Inflation Hit a New 5-Year Low	Giada Giani	Aug 29, 2014
Euro Area - ECB Preview: Will Draghi Highlight Downside Risks to Inflation?	Guillaume Menuet	Aug 28, 2014
Euro Area - ECB Draghi Notes Fall in Inflation Expectations	Guillaume Menuet	Aug 26, 2014
Euro Area - PMIs Suggest Very Little Room for Economic Rebound in H2 14	Giada Giani	Aug 21, 2014
Euro Area - SPF Survey: Downward Drift In 2014-15 Inflation Expectations	Guillaume Menuet	Aug 14, 2014
Euro Area: NFC Net Borrowing Falling More Slowly	Antonio Montilla	Aug 12, 2014
Euro Economics Weekly		
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
How Might Russia Developments Affect The Eurozone Economy?	Ebrahim Rahbari	Aug 1, 2014
France: More Reforms to Jump Start Confidence?	Guillaume Menuet	Jul 25, 2014
Public Debt Sustainability: Has It Really Been Restored?	Giada Giani	Jul 18, 2014
Why Banking Union Matters: Then and Now	Ebrahim Rahbari	Jul 11, 2014
Is The Euro Area Recovery at Risk of Faltering?	Guillaume Menuet	Jul 4, 2014
Weak Pay Trends Imply Further Inflation Undershoot	Giada Giani	Jun 27, 2014
A Great Rotation towards Eurozone Portfolio Assets?	Ebrahim Rahbari	Jun 20, 2014
Labour Market Slack	Giada Giani	Jun 13, 2014
ECB TLTRO: Ambitious But Probably Not Enough, QE Lies Ahead	Guillaume Menuet	Jun 6, 2014
Chief Economist Publications		
Global Economic Outlook and Strategy - September 2014	Willem Buiter	Sep 24, 2014
Scandi and Swiss		
Scandi Economics Update	Tina Mortensen	Oct 10, 2014
Norway - Core Inflation Picks Up in September, but Less Than Expected	Tina Mortensen	Oct 10, 2014
Denmark - A Unilateral Interest Rate Cut is Moving Closer	Tina Mortensen	Oct 9, 2014
Norway - An Expansionary Budget	Tina Mortensen	Oct 8, 2014
Sweden - Riksbank: A Dove Leaves the Nest	Tina Mortensen	Oct 7, 2014
UK		
UK - Mixed Trends in Latest BCC Survey	Michael Saunders	Oct 9, 2014
UK - Services PMI Indicates Continued Solid Growth	Michael Saunders	Oct 3, 2014
UK - PMI Weakens, Productivity Remains Flat	Michael Saunders	Oct 1, 2014
UK - GDP Revisions Highlight Domestic Demand Surge	Michael Saunders	Sep 30, 2014
UK Economics Weekly		
Still Bullish on UK Growth	Michael Saunders	Oct 3, 2014
Stubborn Fiscal Red Ink	Michael Saunders	Sep 26, 2014
After the "No" Vote	Michael Saunders	Sep 19, 2014
More Questions Regarding Scottish Independence	Michael Saunders	Sep 12, 2014
Resolving The Labour Market Puzzles	Michael Saunders	Sep 5, 2014

Source: Citi Research

Appendix A-1

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