

## Spain – Moody's Revises Rating Outlook to Stable

Summary | Today's News in Detail | Latest Issues of Sovereign Debt Update | Macroeconomic Forecasts | Recent Research

### Summary

**Spain – Moody's revises outlook from negative to stable, affirms Baa3 rating**, following similar moves from S&P and Fitch in the past month. Improving economic conditions and ongoing fiscal consolidation are main drivers.

**ECB — We expect the ECB to leave its key interest rates unchanged today, with the focus being the publication of new Eurosystem Staff Projections**, extending to 2015 for the first time. Given the outlook for muted inflationary pressure in the medium term, we believe that the ECB will reiterate its forward guidance, leaving the door open to additional accommodation in 2014.

**ECB will test banks based on their vulnerabilities**, according to ECB's Mersch, but final capital requirements for the adverse scenario of the stress test remain unspecified.

**Financial transactions tax proposal** given green light by EU Commission's legal service.

**Germany – FinMin Schäuble confident of bank resolution agreement before year-end.**

**French businesses turn more pessimistic about 2014** – 82% (+13ppt) of French employers are pessimistic about the possibility of recovery according to a Viavoice poll. 44% believe that 2014 “will be worse” than 2013.

**French PM announces €50bn of budgetary savings by 2017** – as part of the multi-annual budgetary strategy to be unveiled in the Autumn of 2014. The aim will be to save around €15bn per year, involving ministers in the process.

**Italy – High Court rules against the current electoral law**, reinstating a fully proportional electoral system if an electoral reform is not agreed in the next few weeks. Ruling may make early elections in the near term (i.e. spring 2014) somewhat less likely, but political instability is likely to remain high.

**Spain – industrial production falls by 0.8% MM in Oct**, after two consecutive monthly rises, consistent with still subdued level of survey indicators.

**Spain – Unemployment still the main concern**, according to the latest CIS barometer, together with corruption, fraud, and the economic situation. Optimism however improved in November, as 20.7% of respondents said the economy would improve in the next 12 months, the highest share since Feb 2012.

**Greece – government arrears continue to edge lower in Oct, but remain high at €6bn (3.2% of GDP).**

**Slovenia – Another jump to €5bn in banks' estimated recapitalisation needs**

5 December 2013

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Economics

Western Europe

Industrialised G7 Countries

### Recent Research

#### UK — Services PMI Still Points to Strong Growth

4 December 2013

Newswires report that the services PMI fell to 60.0 in November from 62.5 in October. This is the sixth highest monthly reading of the last 15 years and consistent with continued rapid output growth. We recently further lifted our above-consensus UK 2014 growth forecast to 3.2% from 3.0%, and we look for a similar pace of growth in 2015. The PMIs do not map exactly onto GDP growth. But, if anything, the PMIs and other business surveys suggest the UK economy will grow even faster than we expect.

Michael Saunders

#### Global Economic Outlook and Strategy — Prospects for Economies and Financial Markets in 2014 and Beyond

2 December 2013

In this "Prospects" edition, Citi's research team presents updated

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

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## Today's News in Detail

**Spain – Moody's revises outlook to stable, affirms Baa3 rating**, citing improved medium-term economic prospects, a faster than expected adjustment in the balance of payment, a gradual reduction of the large government deficit, reduced risk of a sudden stop and loss of market access, and a significant reduction in contingent liabilities for the sovereign emanating from the Spanish banking sector. The rating agency expects the strong export performance to continue, as competitiveness is supported by very low wage and price increases. In addition, Moody's expects fiscal deficit targets in 2013 (of 6.5% of GDP excluding financial sector support) and 2014 (of 5.8% of GDP) to be achievable, and for the budget deficit to decline more rapidly from 2015 onwards as *"the economy grows more robustly"*. The public debt ratio, however, is expected to peak at around 100% of GDP in 2016, on the back of large budget deficits and weak nominal GDP growth. Moody's noted that the sovereign rating would come under downward pressure if the economic improvement or the fiscal consolidation stalled. Comment: this is the third main rating agency raising its rating outlook on the Spanish sovereign in the last month, all of them citing the improvement in economic conditions, ongoing fiscal consolidation, and the advanced banking sector restructuring since 2012. While we agree that the rebalancing of the Spanish economy is definitely under way, we think the process is going to be long and major headwinds (private deleveraging, still large fiscal imbalances, ongoing adjustment in the housing sector, and tight financial conditions) are likely to prevent any significant economic growth in the next couple of years. We do not expect much cyclical improvement in the Spanish budgetary position in the next couple of years, even if growth resumes.

[>> Back to the Top](#)

**ECB — We expect the ECB to leave its key interest rates unchanged today, and the focus to be publication of new Eurosystem Staff Projections**, extending to 2015 for the first time (for more details see [ECB - Seen on Hold in December, but More Easing Likely in 2014](#)).

[>> Back to the Top](#)

**ECB will test banks based on their vulnerabilities.** Bloomberg reports that ECB Executive Board member Yves Mersch said that tests on the robustness of Europe's banks will likely use known weaknesses in the financial system as a starting point for the deeper analysis and for the stress test assumptions. He added that the capital requirement for the stress scenario had yet to be decided, but that it was crucial that the stock-taking exercise creates transparency, is credible, and brings back trust in European banks.

[>> Back to the Top](#)

**Financial Transaction Tax (FTT) given green light by Commission's legal service.** *Handelsblatt* reports that the European Commission's legal service has given a green light to its own Financial Transactions Tax proposal. This legal opinion is in contrast to an opinion published by the legal service of the European Council that considered the EC's FTT proposal partly inconsistent with the European Treaties. Comment: the FTT is noted in the provisional coalition agreement of the CDU/CSU and SPD in Germany and this legal opinion also suggests that it is not yet dead in the water. A revised proposal which narrows down the scope of the FTT is likely to come in the next few months.

[>> Back to the Top](#)

**German FM confident about bank resolution agreement before year-end.** Acting German Finance Minister Wolfgang Schäuble (who looks likely to remain FM in the German government if the Grand Coalition between CDU/CSU and SPD materialises) said in an interview with *Handelsblatt* that *"maybe it will still*

forecasts for economies, policy, commodity prices and sovereign ratings around the world for 2014 and beyond, along with Overview essays on EMU banking union, world trade growth, global imbalances, challenges facing emerging markets, political risks and long-run projections for the size of major economies.

[Willem Buiter](#) | [Guillermo Mondino](#) | [Nathan Sheets](#) | [Michael Saunders](#) | [Robert V DiClemente](#)

## Denmark — An Update on the Experience with Negative Interest Rates

2 December 2013

We reiterate our conclusion from Sep-12 that the negative deposit rate in Denmark has had the desired effect in Danish terms; it has been passed through to money market rates and (helped by ECB action) the pace of FX inflows has eased markedly. Technical issues with negative interest rates appear to have been manageable and evidence suggests that it has been perfectly possible to introduce negative rates in Denmark without major adverse side effects.

[Tina Mortensen](#)

## UK — YouGov Report Inflation Expectations Edge Down

2 December 2013

We report here the results of the November YouGov survey of inflation expectations among the general public. The survey was carried out during 20-22 November with a sample size of 2,023 people. The median for inflation expectations in the year ahead fell back to 2.7% in November from 3.2% in October and 2.5% in September. The median for inflation expectations in the longer term (next 5-10 years) fell to 3.7% YoY in November from 3.9% in October and 3.3% in September.

[Michael Saunders](#)

## UK — PMI and FLS Data

2 December 2013

Newswires report that the manufacturing PMI rose to 58.4 in November from 56.5 in October, well above the consensus (56.0) and indeed above any pre-release forecast. This is the fourth-

take some night sessions, but we want to have an agreement (on bank resolution) by the end of the year.” He added that a deal at the finance ministers’ meeting next week may be unlikely. Schäuble said that the German government wanted a “liability cascade to be clearly anchored and applied to the bank stress tests” next year. But Schäuble also admitted that there was a diversity of opinions when it came to the various resolution-related issues between European governments, including when to apply bail-in rules. He said that the German government wanted that the single resolution authority would be a “body in which national representatives sit” to decide on future bank resolutions, but he also added that “the formal decision could be taken by a European institution – for example, the council of finance ministers or the EU Commission”. He favoured that the resolution fund be privately funded by banks and that it have secure legal standing, even if that meant a limited Treaty change, and that in the meantime states may need to be liable. Comment: the interview summarises the German position on European bank resolution very clearly. It highlights that Germany continues to resist common backstops for bank resolution at this point and this suggests that if an agreement materialises by year-end, it will most likely only envisage a very small role for such backstops.

[>> Back to the Top](#)

**French businesses turn more pessimistic about 2014** – 82% of French employers are pessimistic about the possibility of the French economy recovering according to a Viavoce poll published in French business daily *Les Echos* on Thursday. This amounts to a 13ppt increase compared to the last survey conducted in October. 44% of respondents believe that 2014 “will be worse” than 2013 when GDP growth is likely to have been almost flat (+0.2%). However, 65% remain optimistic about their own prospects, a fall of 3ppt. Comment: A negative 3Q GDP print of 0.1% QQ, together with continuous suggestions about a reform of taxation likely did some damage to business confidence. With France underperforming its neighbours in terms of business confidence, we doubt that the government’s forecast of a 1.5% rebound in business investment will materialise.

[>> Back to the Top](#)

**French PM announces €50bn of budgetary savings by 2017** – *Les Echos* report that PM Jean-Marc Ayrault indicated on RTL radio that the government would deliver substantial savings as part of the multi-annual budgetary strategy for 2015-17 to be unveiled in the Autumn of 2014. The aim will be to save around €15bn each year, replicating the method adopted in the 2014 budget. Ministers are being incentivized to identify some savings in their own budgets to avoid the Prime Minister’s office imposing some cuts. Comment: the next step of the necessary overhaul of French government spending will be painful, now that most of the hanging fruit has been harvested in the 2014 budget. More problematic perhaps is the government’s unwillingness to indicate what strategy will be implemented to deliver those savings, most likely to avoid further damage to its popularity ratings ahead of the municipal and European elections in H1-14.

[>> Back to the Top](#)

**Italy – High Court rules against the current electoral law.** In a much-awaited ruling, the Constitutional Court ruled yesterday that two main features of the current electoral law (the majority bonus to the party gaining more votes and inability for voters to express candidate preference within the party list) are against the Constitution and should be abolished. The case against the electoral law – in place since 2005 – was referred to the High Court by a group of private citizens. The rejection of the current system (commonly named “porcellum”) reinstates a fully proportional electoral system, which was in place in Italy before 1991. Comment: the current electoral law has been extensively criticised on many fronts as one of the main causes for political instability (as the inconclusive electoral result of February’s national elections showed). Yet, political forces

highest figure since BoE independence in mid-1997, and fits in with other signs that the UK economy will continue to grow rapidly. Also out today, the BoE report that the amount borrowed by banks from the BoE under the Funding for Lending (FLS) scheme surged to £5.5bn in Q3 from £2.6bn in Q1 and £1.1bn in Q2, bringing the total borrowed since mid-2012 to £23.1bn.

Michael Saunders

## Euro Economics Weekly — Is Deflation Good or Bad for the Eurozone Periphery?

29 November 2013

The unweighted average of Greece, Ireland, Italy, Portugal and Spain is now flirting with deflation. The fall in domestic price pressures is driven by large output gaps, falls in energy prices, and relatively less loose monetary policy than in other major economies. Given a strong euro and low inflation in the rest of the Eurozone and most other advanced economies, low inflation or outright deflation may also be needed to regain export competitiveness in periphery countries.

Ebrahim Rahbari | Guillaume Menuet | Giada Giani | Michael Saunders | Ann O’Kelly

## UK Economics Weekly — Policy Post-Guidance

29 November 2013

With the economy recovering strongly, we expect the jobless rate to hit the 7% threshold in late 2014. Whatever the exact timing, markets probably cannot rely on guidance to anchor rate expectations much beyond 6-7 quarters or so. This note aims to sketch out the MPC’s options once the 7% jobless threshold is hit. We expect the MPC will seek to return real rates to roughly zero (ie lifting Bank Rate to about 2%) in 2015-16, but will keep Bank Rate below a neutral level for some time.

Michael Saunders | Ann O’Kelly

## ECB — Seen on Hold in December, but More Easing Likely in 2014

28 November 2013

We expect the ECB to leave its key rates unchanged on Dec 5. The focus will be new Staff Projections, extending

have not been able to find an agreement on a new system for the past two years and, while the ruling may increase the pressure to find a solution, the positions of the main parties are still far apart. More importantly, a slimmer government majority (after the departure of Silvio Berlusconi's Forza Italia from the coalition) reduces the scope for the constitutional changes necessary to reform the electoral system. If no electoral reform is agreed in the next few weeks (before the ruling becomes binding), the next general elections in Italy may be held with a pure proportional system, likely to increase further political uncertainty and instability. While the ruling may make early elections in the near term (i.e., spring 2014) somewhat less likely, opposition parties Five Star Movement (M5S) and Forza Italia called for an immediate return to the ballot boxes as they deem the current Parliament unrepresentative to agree a new electoral reform.

[>> Back to the Top](#)

**Spain – Industrial production fell in October by 0.8% MM** (below our forecasts), after a rise of 0.2% MM in September. On an annual basis, output (WDA) fell by 0.8% (vs. +0.8% in September), driven by strong negative base effects. Comment: the Oct monthly decline in industrial activity is in line with relatively feeble survey data (manufacturing PMI stood at 50.9 in Oct, roughly unchanged from 50.7 in Sep). Overall, we still expect industrial output to post marginally positive growth in 4Q, and for GDP to rise by another 0.1%QQ.

[>> Back to the Top](#)

**Spain – Unemployment still the main concern**, according to the latest barometer survey of the Centre for Sociological Studies (CIS), together with corruption, fraud, and the economic situation. The poll (which was conducted in October) showed that 88.3% of respondents believe the economic situation is “bad” and “very bad” in Spain, while 69% consider it will get worse or remain the same in 2014. Optimism, however, improved in November, as 20.7% of those polled said the economy would improve in the next 12 months, up by 2.6ppts MM, and the highest level since Feb 2012. Unemployment remains the main concern of 77% of those polled, followed by corruption and fraud (31.8%), and the economic situation (31.3%). Comment: Unemployment (at 26.0% in Q3 13) is likely to remain the main concern of the Spanish population in the next few years. We expect unemployment to rise to 27% in 2014 (from an expected 26.6% in 2013).

[>> Back to the Top](#)

**Greece – government arrears continue to edge lower in Oct, but remain high at €6bn (3.2% of GDP)**, down marginally from €6.1bn in Sept, and from €8.8bn in October 2012. Comment: The pace of reduction in government arrears has been slower than envisaged by the troika at the beginning of the year (calling for a reduction to zero of government past due debts with the private sector).

[>> Back to the Top](#)

**Slovenia - Another jump to €5bn in banks' estimated recapitalisation needs**

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Reuters reported that senior EC officials talked about a necessary injection into the banking system of between €4bn and €5bn, which seems to be in line with a recently approved government proposal to put aside cash of €4.7bn for this purpose (implying an additional €3.5bn to the €1.2bn deposited in commercial banks' accounts during the summer). The larger recapitalisation need likely reflects: a lower transfer price, a further decrease in banks' capital adequacy ratio, a further increase in the non-performing loans (claims) ratio and most likely also a more realistic picture of loan quality in an adverse stress test scenario. Comment: Moreover, this all is accompanied by a higher target for the new level of banks' capital adequacy, beyond initial targets of around 12% – most likely to around 16%. However, the answers to each particular point will be published on 13 December. This will influence the government's need for cash in the near

to 2015. The outlook for muted inflationary pressure calls for reiteration of forward guidance, leaving the door open to more accommodation in 2014. We believe that non-standard measures will be insufficient on their own given rising disinflationary risks. Hence we also pencil in a 25bp rate cut in the refi rate to 0% and a 10bp cut in the deposit rate to -0.1% around Jun-14.

Guillaume Menuet

## Scandi Economics Update — Will Norges Bank Yet Again Surprise on the Dovish Side?

### Western Europe

**Norway** — Norges Bank: Steady rates, lower rate path, and recommendation of countercyclical capital buffer.

**Sweden** — Service production expected to recover in October.

**Sweden** — Riksbank revises its communication policy.

**Sweden** — Statistics Sweden's opinion poll confirms opposition lead.

**Sweden** — NDO sets up Scientific Advisory Council.

**Denmark** — DNB Governor: No limit to negative rates.

Tina Mortensen

[>> Back to the Top](#)



term, though it is likely that part of the recapitalisation costs will be shared with new owners, at least in the case of the NKMB. It will be interesting to see the requested time schedule for the recapitalisation as it could be a guide for the whole euro area AQR and stress tests next year.

[>> Back to the Top](#)

## Latest Issues of Sovereign Debt Update

### EC Calls for More Budget Cuts in Italy

4 December 2013

EC asks Italy for budget cuts to meet structural adjustment. EU countries lean towards EC as bank resolution authority. ECB's Nowotny says don't change sovereign debt regulations ahead of stress test. French PM says tax reform will not increase fiscal pressure. EU's Rehn says tax increases hurting French growth. French government popularity drops again. Spain's composite PMI above 50-mark. Greece: Syriza says it will be in power in 2014. Portugal: Troika wants a Plan B.

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

### ECB Methodology for Bank Supervision – Details by End-Jan, says Constancio

3 December 2013

ECB to make methodology announcement on bank supervision by end-Jan, says Constancio. ECB's Knot on principle of risk-weightings for all instruments. French voters want government to shrink size of public sector. Italy can beat the consensus, says FinMin. Spain may need further labour market reform, says EU's Rehn. Spanish government makes withdrawal from reserve fund to pay pensions. Spanish unemployment falls in November. Citi's latest economic forecasts for euro area and global.

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

### Moody's Upgrades Greece One Notch to Caa3

2 December 2013

Greece's sovereign rating goes up a notch to Caa3, says Moody's. Germany: polls suggest SPD voters would approve coalition agreement - but only SPD party members can vote in referendum. ECB's Coeure says QE not warranted, EC's Rehn sees long period of low inflation. French labour market reforms - Sundays in focus. Belgium to lower VAT on energy. Spain's current account surplus widens. Spain's government approves law on bank capital. Slovenia: milder YY GDP contraction in 3Q than expected.

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

### S&P Cuts Dutch Rating to AA+, Raises Spanish Outlook

29 November 2013

S&P says Netherlands no longer AAA, but revises Spain's outlook to Stable. ECB seen on hold in Dec. Germany's FinMin rules out tax increases. French unemployment falls for second time. Italy's President asks for confidence vote on new governing coalition. Italy: credit to private sector falls again. Spain: House prices fall in 3Q but at slower pace. Portugal: economic sentiment improves. Greece: no deal with troika before Eurogroup meeting. Greek bank deposits and bank credit keep falling.

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

### ECB's Constancio – Negative Deposit Rate Only in Extreme Situations

**28 November 2013**

ECB negative deposit rate only in extreme situation, says Constancio. ECB supervisor-to-be Nouy promises rigorous stress tests. ECB sees systemic risk measures return to pre-crisis levels. Germany: CDU, CSU and SPD party leaders present coalition agreement. French unemployment to fall steadily soon, says government. Berlusconi expelled from Italian Senate. Bank of Italy capital shares re-evaluation approved. Portugal's pension reform envisages raising retirement age.

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

## **ECB Ponders a Sort of “Funding for Lending” LTRO**

**27 November 2013**

ECB considers LTRO linked to bank lending. ECB's Liikanen on Eurosystem's capacity to find solutions, ECB's Coeure on inflation, ECB's Mersch on liquidity. Germany: coalition deal (almost) reached. French President seeks Spain's support for growth plan at Dec EU Summit. Italy passes 2014 Budget. Spain's state budget deficit rises, Spain's banks to increase capital. Belgium's CB head calls for improved competitiveness. Ireland not eligible for OMT, says Asmussen. Portugal passes 2014 Budget.

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

[>> Back to the Top](#)

## **Macroeconomic Forecasts**

### **Global Economic Outlook and Strategy — Prospects for Economies and Financial Markets in 2014 and Beyond**

Global, Americas, GEMS, Pan Asia, EMEA, Asia, Western Europe, North America, Latin America, Australia

**2 December 2013**

In this "Prospects" edition, Citi's research team presents updated forecasts for economies, policy, commodity prices and sovereign ratings around the world for 2014 and beyond, along with Overview essays on EMU banking union, world trade growth, global imbalances, challenges facing emerging markets, political risks and long-run projections for the size of major economies.

[Willem Buiter](#) | [Guillermo Mondino](#) | [Nathan Sheets](#) | [Michael Saunders](#) | [Robert V DiClemente](#)

### **Emerging Markets Macro and Strategy Outlook — Prospects for 2014 and beyond**

GEMS, Asia, Latin America, CEEMEA, Global

**2 December 2013**

Three questions are likely to dominate investors' thinking about EM in 2014. The first is about the future of capital flows to EM: will Fed 'tapering' and the prospect of US monetary tightening cause sustained outflows from EM? The second is about EM's export recovery: will EM's recent export slump ever reverse? And the third is about China: will 'China risk' re-emerge as a threat to EM growth? These three questions were very broadly discussed among investors during the course of 2013, and so in a sense 'nothing's new' as we go into the New Year. Overall we find it difficult to come up with optimistic answers to any of these questions, and so we think it makes sense to be quite cautious about the environment facing emerging markets.

[Guillermo Mondino](#) | [David Lubin](#) | [Johanna Chua](#)



# Appendix A-1

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