

ECB Cuts Rates, Announces Several Liquidity Measures

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

Summary

ECB hopes that banks will not resist attraction of cheap funding – the ECB cut interest rates, extended the fixed-rate full allotment procedure, suspended the weekly sterilisation of the Securities Market Programme (SMP) and introduced a new instrument called the **targeted long-term refinancing operation (TLTRO)** aimed at improving bank lending to the euro area private sector, excluding household loans for house purchases, over a window of two years. Mr. Draghi indicated that the Governing Council had been unanimous in approving the package.

ECB's Knot and Hansson on Thursday's policy announcement – indicating the ECB package was “*strong*” and specifically aimed at dealing with too-low inflation and limited loan availability to firms.

Germany – IP rises by 0.2% MM in April, in line with our forecast, reversing part of the March setback, suggesting the underlying trend in the euro area's industrial powerhouse remains robust.

Germany – trade surplus close to record highs in April as exports rebound, imports remain flat.

Germany – Bundesbank cuts inflation forecasts, raises GDP outlook. Inflation is seen going back to ECB's target only by 2016 also in Germany.

Italy – turnover in service sector rises by 0.2% YY in Q1 14, posting the first annual increase since Q3 11.

Spain – government to approve a €6.3bn stimulus package today, to foster R&D investment, of which €3.6bn (0.3% of GDP) to be government financed.

Spain – Industrial production bounces back in April, rising by 1.6% MM (above our expectations of 0.6% MM), highest MM rise since Aug 2012.

Greece – unemployment rate drops to 26.8% in March, from an upwardly revised 26.9% in February, standing one full percentage point lower than the peak, but still highest in EU.

Greece – house prices to fall by another 15%, Fitch report says.

Portugal – government approves pension cuts for 2015 budget.

Belgium – government formation talks and GDP forecasts. Walloon parties are scheduled to start government coalition talks according to PM Elio di Rupo. Belgian GDP growth seen at 1.4%, before accelerating to 1.8% in 2015.

The Danish National Bank (DNB) has announced that it maintains all of its interest rates unchanged - see [Denmark - Unchanged Rates from DNB](#).

UK - REC Survey Suggests Labour Market Still Tightening

6 June 2014

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With thanks to Antonio Montilla and Ann O'Kelly

Economics

Western Europe

Industrialised G7 Countries

Recent Research

ECB — Door firmly open to additional stimulus and QE in late 2014

5 June 2014

Mario Draghi announced that the Governing Council (GC) had cut all its interest rates, effective 11 June 2014. The ECB narrowed the interest rate corridor to 50bp, with a 35bp cut in the marginal lending rate to 40bp, and 10bp cuts in both the refinancing and the deposit rates to 15bp and -10bp, respectively. The ECB noted that the negative rate would also apply to banks' average reserve holdings in excess of the minimum reserve requirements, and other deposits held in the Eurosystem - a guideline will be published by 7 June.

Guillaume Menuet

Denmark — Unchanged Rates from DNB

6 June 2014

The Danish National Bank (DNB) has

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Today's News in Detail

ECB hopes that banks will not resist attraction of cheap funding – the ECB Governing Council (GC) presented “a package of measures to provide additional monetary policy accommodation and to provide lending to the real economy”. The ECB cut interest rates, extended the fixed-rate full allotment procedure, suspended the weekly sterilisation of the Securities Market Programme (SMP) and introduced a new instrument called the **targeted long-term refinancing operation (TLTRO)** aimed at improving bank lending to the euro area private sector, excluding household loans for house purchases, over a window of two years. Mr. Draghi indicated that the GC had been unanimous in approving the package. Comment: these announcements amount to a significant amount of additional stimulus. But we doubt it will be enough to prevent a continued inflation undershoot. Given our baseline of headline inflation easing further in the summer (averaging 0.3% in 3Q-14) and that disinflationary headwinds from poor credit availability and the strong euro persist, we expect the ECB to do more by relying on non-standard measures. We still expect the ECB to launch a fully-fledged QE, possibly in Dec-14.

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ECB's Knot and Hansson on Thursday's policy announcements – Dutch central bank Governor Klaus Knot indicated in an email statement that the ECB package was “strong”, and was specifically aimed at dealing with the two most important challenges: namely too-low inflation and limited loan availability to firms. Estonia central bank Governor Ardo Hansson noted that it “*may be years rather than months*” before euro-area inflation will start rising fast in an interview with public broadcaster Eesti Rahvusringhaeaeling according to Bloomberg. Comment: we agree that the TLTROs are a welcome development for the euro area banking system, potentially adding a significant amount of liquidity. We also share the view that inflation will stay low for an extended period of time and expect the ECB to deliver additional monetary policy stimulus later in 2014, with the door firmly open to a QE programme.

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Germany – IP rises by 0.2% MM in April, in line with our forecast, reversing part of the setback recorded in March (-0.6% MM, revised lower from -0.5% MM). The April reading is broadly in line with Q1 average. Excluding construction, industrial output was up by 0.4% MM, entirely offsetting the March drop. Comment: the underlying trend in the euro area's industrial powerhouse remains robust, despite the fact that industrial orders weakened sharply in March and construction is bound for a breather after a very large increase in 1Q.

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Germany – exports rebound, imports remain flat in April. Exports rose by 3.0% MM in April, rebounding after two consecutive large monthly declines (of -1.4% and -1.7% MM in Feb and Mar, respectively). Imports were roughly flat on the month (-0.1% MM), after falling by 1.1% MM in March. The trade surplus jumps to €17.7bn, close to the record-peak levels (a trade surplus slightly in excess of €18bn was recorded only in four times in recent history (Sep-09, Nov-09, Aug-08 and Sep-13)).

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Germany – Bundesbank cuts inflation forecasts, raises GDP outlook. The German central bank reduced its projection for German inflation in 2014 to 1.1%, from 1.3% expected in December, while it sees inflation in the largest euro area economy picking up to 1.5% in 2015 and 1.9% in 2016. The downward revision in inflation was coupled with an upward revision in the growth outlook: GDP is seen rising by 1.9% this year (from 1.7% expected in Dec-13), by 2.0% in 2015 and by

just announced that it maintains all of its interest rates unchanged; hence, the CD-rate stays at 0.05%, the lending rate at 0.2%, the discount rate at 0% and the current account rate at 0%. Currency reserve data showed that the DNB did minor-scale intervention of DKK 0.8bn in May to fend off DKK weakness versus the EUR. As the EUR/DKK continues to trade on the weak side of the central parity and we only saw a marginal depo rate cut from the ECB yesterday, today's outcome should come as no surprise. In other words, the DNB is making the ECB do the work for it.

[Tina Mortensen](#)

UK — REC Survey Suggests Labour Market Still Tightening

6 June 2014

The REC survey on jobs suggests that labour demand remains high and that the labour market continues to tighten. The overall index of demand for staff edged down from 67.1 in April to 66.3 in May (like the PMIs, a figure above 50 implies an increase) but remains more than one standard deviation above average.

[Michael Saunders](#)

Sweden — Mfg. Prod. Rebounds in April, But Weak Order Intake a Concern

4 June 2014

According to monthly statistics, the trend in manufacturing production continues to stay weak, but this is partly being offset by ongoing recovery in the service sector.

[Tina Mortensen](#)

Euro Area — Inflation Surprises Once Again to the Downside

3 June 2014

Euro area HICP inflation dropped to 0.49% YY in May, from 0.72% in April, once again below consensus expectations (of 0.6% YY). Euro area inflation has surprised to the downside in four out of five months since the start of the year. The cumulated negative surprises since last October now stand at 0.6pp. The negative surprises have stemmed equally from the core and periphery countries, with Germany actually reporting the biggest misses

1.8% in 2016. Comment: both the inflation and the GDP forecasts from the Bundesbank are somewhat less optimistic than our view on Germany, for which we expect GDP growth to exceed 2% both in 2014 and in 2015.

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Italy – turnover in service sector rises by 0.2% YY in Q1 14, posting the first annual increase since Q3 11. This is the first time ISTAT reports data on total services turnover. Comment: the marginal improvement in services activity is consistent with the rise of the services PMI above the 50 threshold in the past four months, although the level remains quite subdued, at 51.6 in May.

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Spain – Government to approve a €6.3bn (0.6% of GDP) stimulus package today, aimed to “*increase competitiveness and productivity*”, PM Mariano Rajoy announced last week. The stimulus package in reality is split between €2.7bn to be financed by the private sector and €3.6bn (0.3% of GDP) as the actual fiscal “*stimulus*” from the government’s budget. The plan aims to encourage investment in research and development and to help the “*re-industrialisation*” of the country. Mr Rajoy also noted that the government will expand the car subsidy scheme (PIVE).

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Spain – Industrial production bounced back in April, rising by 1.6% MM (above our expectations of 0.6% MM), highest MM growth rate since Aug 2012, and after a 0.4% MM decline in March. On an annual basis, output (WDA) increased by 4.3% (vs. +0.9% in Mar). By main industrial grouping, industrial production expanded strongly in durable consumer goods (2.8% MM), capital goods (2.3%), and energy (1.8%), INE reported. Comment: the result is consistent with recent improvements in survey data (manufacturing PMI at 52.7 in Apr, 0.5 sd. above its long-term average). Going forward, rises in both new and existing orders suggest that further growth of output is likely in the coming months.

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Greece – unemployment rate drops to 26.8% in March, from an upwardly revised 26.9% in February. Employment expanded by 0.3% MM, taking the annual rate to just -0.3% YY – the least negative pace of annual contraction in employment since Q1 09. The labour force was still falling at a slightly higher pace (-0.8% YY), contributing to the drop in the unemployment rate. The jobless rate now stands one full percentage point lower than the peak reached six months ago, although it remains the highest in the EU and extraordinarily high by historical standards.

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Greece – house prices to fall by another 15%, Fitch reports says. House prices in Greece will drop an additional 15 percent in the medium term, *Ekathimerini* says reporting a Fitch report. The rating agency estimates that total house price decline since the peak in 2008 will amount to 45%.

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Portugal – government approves pension cuts for 2015 budget. *Diario Economico* reports that the government cabinet meeting approved yesterday one of the measures to be part of the 2015 budget aimed at further reining in public spending. As presented in the Fiscal Strategy Document in April, the current extraordinary levy (CES) applied to pensions will be substituted with a lower but permanent tax on pensions amounting to 2.0%-3.5% to be applied on pensions above €1000/month. The current extraordinary levy (CES) is still being reviewed by the Constitutional Court and a ruling is expected in the next few weeks.

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relative to consensus in the most recent months, although Italy displays the largest cumulative negative surprise since last October

Giada Giani

Norway — Upside Surprise in Unemployment

3 June 2014

Although there are early signs that registered unemployment (Norges Bank's preferred measure) might be reaccelerating again, we find it too early to conclude that momentum has turned for the worse. Hence, we do not expect today's data to have any significant bearing on Norges Bank's view on the outlook for the labour market; in the March Monetary Policy Report, the Bank forecast the registered unemployment rate at 3% for full-year 2014, which compares with a year-to-date-average of 2.75%.

Tina Mortensen

Euro Economics Weekly — Negative Deposit Rate: Limiting Risks, Limited Upside

30 May 2014

We expect the ECB to lower the Refi rate and to set a negative Deposit rate for the first time at the June meeting. In our view, these actions will lead to modest reductions in interbank rates, government bond yields, and credit spreads and will also modestly weaken the euro, even though many of these effects may be priced in by now.

Ebrahim Rahbari | Guillaume Menuet | Giada Giani | Michael Saunders | Antonio Montilla

UK Economics Weekly — Inflation Downtrend Probably Over

30 May 2014

We suspect the recent sharp downtrend in CPI inflation and consensus inflation forecasts is now basically over. Underlying inflation has not weakened recently and the BoE agents' survey (like other surveys) shows a steady uptrend in domestic cost and capacity pressures. We also expect the RPI-CPI wedge to widen sharply over the next or two, with RPI inflation likely to average close to 4% YoY in 2015-16.

Michael Saunders | Ann O'Kelly

Belgium – government formation talks and GDP forecasts. Walloon parties are scheduled to start government coalition talks according to PM Elio di Rupo whose French-speaking Socialist Party has agreed to hold preliminary discussions with the centrist CdH. Flemish Liberals and Christian Democrats are blocking Brussels government talks according to Bloomberg. Separately, the Federal Planning Bureau maintained its forecast for Belgian GDP growth of 1.4% this year, while anticipating economic growth to accelerate to 1.8% in 2015 on better prospects for domestic demand. Household consumption growth is forecast to accelerate from 1.3% in 2014 to 1.7% in 2015, while gross fixed capital formation is anticipated to expand by 1.6% in 2014 and 3.2% in 2015. Net exports are still seen contributing 0.2ppt to 2014 GDP, and 0.1ppt to 2015 GDP. Comment: forming governments always takes time in Belgium given the large number of possible combinations of parties. Discussions are taking place at the regional government level first, with the federal negotiations to start afterwards. We continue to expect a shorter period of negotiations than in 2010, anticipating some deal to be reached before year-end. We are slightly less optimistic than the FPB about GDP growth, looking for gains of 1.3% in 2014, and a 1.5% in 2015.

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Latest Issues of Sovereign Debt Update

All Eyes on ECB: Rates at 12:45, the Rest at 13:30

5 June 2014

ECB meeting: Rate cuts, liquidity measures, lower staff forecasts. EC says Lithuania ready to adopt euro. EA final May PMIs revised down. No further G7 sanctions on Russia. France aims for billions in savings from local authority reform, 1Q ILO unemployment rate stable at 9.7%. Italy's state sector borrowing requirement improves again. Spain's govt increases cushion to lower 2015 income taxes. Greece's privatisation projects. Ireland's tax take improves. Slovenia: challenge to early election.

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

ECB Sources: Next ECB Rate Cut May Not Be The Last

4 June 2014

Next ECB rate cut may not be the last - ECB sources. BIS head says negative rates may not make EA banks lend more. EA HICP surprises again to the downside. EPP slightly widens lead in update to EU Parliament election results. Italy's unemployment rate stabilises. Spain's fiscal reform to be approved by 13 June, says PM. Spain: consumer confidence highest since mid-2007, services PMI remains strong. Portugal's PM warns on effects of recent Constitutional Court ruling on 2015 budget target.

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

EC Recommends More Fiscal Tightening in France and Italy

3 June 2014

ECB's Nowotny on negative ECB interest rates. ECB's former Chief Economist Stark says interest rate cuts "cosmetic". Merkel suggests EU Council vote on EU Presidency. EC recommends closing EDP on 6 countries. EC's recommendations for France, Italy, Spain and Germany. Moody's says EU election result credit positive for Italy, credit negative for France, Greece.

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

ECB Reportedly to Cut Rates and Announce LTRO

2 June 2014

ECB to cut rates and announce LTRO says FT, LTRO to target SMEs say Spiegel and FAZ. ECB's Constancio and Visco: "we are ready to act". BoE and ECB support revival of EU securitisation market. Choice of EU president remains

Scandi Economics Update — Norges Bank's Regional Network Report in Focus

5 June 2014

Sweden - Markets are closed for a national holiday.

Norway – Norges Bank's Regional Network Report – Minor decline in manufacturing production for April.

Denmark – DNB rate announcement.

[Tina Mortensen](#)

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contentious. Germany may revise up 2014 net borrowing. BoE & BuBa call for new loss-absorbing capital standard for banks. Spain's Rajoy announces €6.3bn stimulus. Portugal's Constitutional Court rejects budget measures. Slovenia's president sets 13 July date for election.

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

ECB and BoE to Publish Joint Paper on Securitization

30 May 2014

ECB and BoE to publish follow-up paper on securitisation today. German retail sales weak in April after very strong 1Q increase. Spain's fiscal reform to be discussed at Cabinet on June 13. Spain's HICP inflation slows to 0.2% YY in May. Portugal's government still waiting for Constitutional Court ruling.

[Ebrahim Rahbari](#) | [Guillaume Menuet](#) | [Antonio Montilla](#)

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Macroeconomic Forecasts

Europe — Monthly Inflation Profiles for Selected Countries

5 June 2014

Updated monthly inflation forecasts for Euro Area, Italy and Spain

[Ann O'Kelly](#) | [Michael Saunders](#) | [Guillaume Menuet](#) | [Giada Giani](#) | [Ebrahim Rahbari](#)

European Economic Forecast Highlights — May 2014

22 May 2014

This companion to Global Economic Outlook and Strategy - May 2014 gives more detailed forecasts for the main European countries to end 2015. Figures 20-21 give annual forecasts to 2018 for growth, inflation, current balance, fiscal balance, primary balance and government debt.

[Ann O'Kelly](#) | [Michael Saunders](#) | [Guillaume Menuet](#) | [Giada Giani](#) | [Ebrahim Rahbari](#)

Global Economic Outlook and Strategy — May 2014

21 May 2014

This publication contains updated forecasts for a wide range of economies, interest rates and currencies by the Citi economists and strategy teams. We expect the ECB to loosen policy at the June meeting, with a lower refi rate, negative deposit rate and a probable extension of the full allocation fixed rate MRO window until 2016. We look for further easing subsequently, with QE in 4Q. The BoJ remains likely to loosen further but is unlikely to act before the autumn — and maybe even later.

[Willem Buiter](#) | [Guillermo Mondino](#) | [Michael Saunders](#) | [Kiichi Murashima](#) | [David Lubin](#)

Emerging Markets Macro and Strategy Outlook - Is the rally safe?

23 May 2014

Late last year, we identified three forces that would shape the outlook for EM economies and asset prices in 2014. The first was the outlook for capital flows to EM; the second was the outlook for China; and the third was the outlook for EM exports. As things stand, none of these three forces are generating much in the way of bad news for EM. Yet we think there are reasons to doubt that this benign environment for EM can be sustained. This isn't the same as saying the rally is about to end. But we think the factors governing the EM rally are not well-entrenched.

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

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Appendix A-1

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