28 February 2014 | 16 pages

Developed Markets
Western Europe

Euro Economics Weekly

ECB to Cut: Beware the (Early) Ides of March

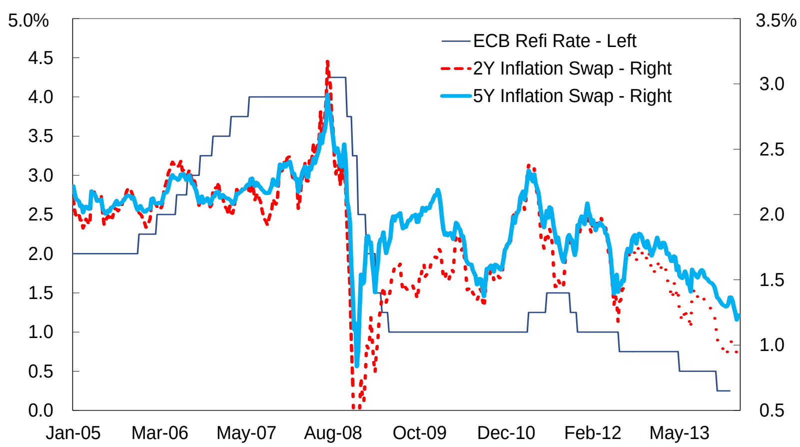
- **A 15bp refi rate cut to 10bp is our base case** – we argue that the evidence of persistently weak inflation and the associated risks in terms of economic activity as well as debt sustainability will likely prompt the ECB to lower its policy rate in March.
- **ECB's 2016 inflation mid-point to be well below target –** with inflation staying very low in 1Q-14, the risk of significant undershooting of the ECB's price stability objective (1.5% 2016 mid-point) and evidence of long-dated inflation expectations drifting lower, we believe that the ECB will likely cut its deposit rate to -10bp in June.
- **What else could the ECB announce in March or April? –** Ending/suspending/ reducing the sterilisation of the SMP and the publication of minutes are strong contenders, alongside a possible extension of the fixed rate full allocation period for MROs. Limited asset purchases (ABS of SME loans) are possible, but the hurdle for the ECB to embark on large scale QE looks very high to us at present.

Figure 1. Euro Area

	$/€	Euro Repo	10-yr Bunds	£/€	UK Bank Rate	10-yr Gilt-Bund	SKr/€	SEK Policy Rate	NOK/€	NOK Policy Rate	SFr/€	CHF Policy Rate	CHF Spread vsBunds
2Q 14	1.38	0.10	1.65	0.80	0.50	137	8.92	0.75	8.18	1.50	1.24	0.00	-67
4Q 14	1.40	0.10	1.80	0.79	0.75	163	8.80	0.75	7.97	1.50	1.25	0.00	-75

Source: Citi Research

Figure 2. Euro Area — ECB Refi Rate and Euro Inflation Swaps, Jan-05 to Feb-14



Sources: Bloomberg and Citi Research

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Low Inflation to Prompt a 15bp ECB Cut

To cut or not to cut?

A Reuters poll of economists showed that 52 out of 78 expect the ECB Governing Council (GC) will leave rates unchanged at the 6 March meeting. Market participants also expect the ECB to stay on hold, having been disappointed by the lack of any action in February. Recent comments from ECB governors (Italy's Visco and Austria's Nowotny) did not suggest that a rate cut is imminent as they do not see deflation risks at the moment, and considered the ECB's forward guidance effective in communicating that rates would be lowered if inflation surprised on the downside or in case of tensions in the money markets. To be sure, there is little sign of the latter currently despite the continued reduction in excess liquidity. The question therefore is whether the ECB will judge that despite incoming data confirming the ECB's expectation of a gradual recovery, the risk of inflation staying below target for an extended period of time needs to be addressed to avoid possible dis-anchoring of inflation expectations in the private sector.

We believe that the evidence calls for additional monetary policy stimulus and expect a cut in March

We think that a consensus will emerge in the GC that now is the time for additional monetary policy support for a number of reasons: i) the proportion of HICP items in deflation territory or experiencing rapid disinflationary tendencies remains elevated, ii) the inaugural three-year inflation forecast will likely show a mid-point of roughly 1.5%, well below the ECB's 'less but close to 2%' target, and iii) long-term inflation expectations are drifting lower. Therefore, we believe that the ECB will surprise the consensus and market participants, and cut its main refinancing rate by 15bp to 10bp, but will likely decide to leave the deposit rate at 0%.

But the risk of no action is significant in our view

Undoubtedly, there are some arguments for the ECB to stay put in March, ranging from the fact that survey activity data have continued to improve modestly, confirming the muted recovery story, that financial fragmentation is receding gradually, that the euro effective exchange rate average (7-25 Feb) is unchanged from the corresponding period last month (10-28 Jan) and that emerging market risk has not risen much compared to last month – with the exception of the situation in Ukraine. In addition, the German Constitutional Court's decision to refer the OMT to the European Court of Justice and renewed criticism from France about the strong euro could, for some GC members, be good reasons to play for time.

Inflation is behaving badly

Inflation is the only needle on its compass

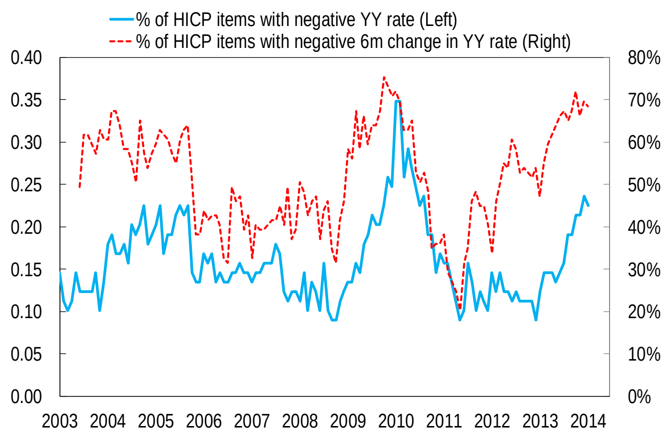
Nevertheless, for a central bank that, as its former President Jean-Claude Trichet used to say, has "*only one needle on [its] compass, and that is inflation*", the persistence of very low HICP annual growth readings calls into question whether the current monetary policy stance is accommodative enough to bring inflation back to its target over the medium- to long-term.

Disinflation still in full swing and not only restricted to the periphery

To gauge how the short-term inflation dynamics are evolving, we take a look at the share of HICP items with negative YY rates out of the total basket, and at the share of HICP items whose YY rate is showing a negative 6-month change. As shown in Figure 3, the January data remain in line with the 4Q-13 averages of 22% and 69%, respectively, confirming the intensity of disinflationary forces. From a euro area member state angle, we look at a "hard core", a "soft core" and a "periphery" measure of inflation rates at constant tax rates to filter the impact of recent tax changes[1]. The verdict remains the same (see Figure 4). The January figures are not meaningfully different from the 4Q-13 averages, showing that the very low inflation environment is not just a factor in the periphery, but also applies to the "soft core", which has opened a sizeable gap of 90bp compared to the "hard core".

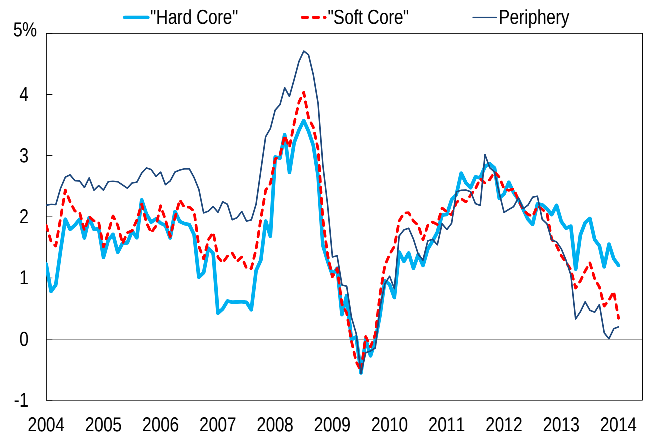
[1] Most EA governments implemented budgetary consolidation strategies relying heavily on tax hikes.

Figure 3. Euro Area – % HICP Items Displaying Negative YY Rates or Disinflationary Tendencies, Jan-03 to Jan-14



Sources: Eurostat and Citi Research

Figure 4. Selected Euro Area Countries – HICP At Constant Tax Rates, % YY, Jan-04 to Jan-14



"HC" = GE, AT, FI, LU; "SC" = FR, NL, BE; Periphery = IT, SP, GR, PT, SL, CY
Sources: Eurostat and Citi Research

Market and SPF expectations point to risk of lower inflation

Inflation swaps suggest that disinflation remains in full swing

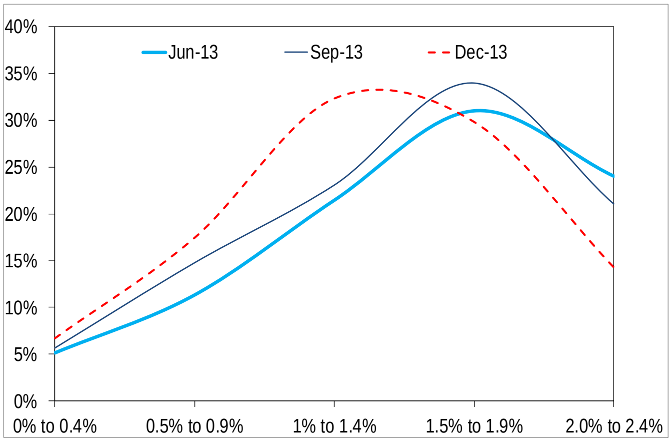
Do market participants share the view that disinflation could become a feature of the euro area for years to come? The answer from the euro inflation swaps market is an unequivocal 'YES'. Figure 2 (on the Front Page) tracks the 2- and 5-year inflation swaps measured on a weekly basis (average of daily closes) against the ECB refinancing rate. As of Friday 28 February, the 2-y inflation swap stood at 0.96% unchanged compared to its level on 6 February, while the 5-y inflation swap was 1.22%, 3bp lower. Compared to levels that prevailed at the time of the November rate cut, the 2- and 5-year inflation swaps are 8bp and 15bp lower, respectively. In our view, market participants are increasingly comfortable with the view that disinflation remains in full swing.

The SPF survey is beginning to incorporate some downside risks to long-dated inflation expectations

What about professional forecasters? The latest survey (published in the February ECB bulletin[2] and conducted between 16-24 January) highlights some noticeably lower inflation expectations for 2014 (1.1%) and 2015 (1.5%), revised down by 0.4ppt and 0.2ppt respectively compared to the October survey. Figure 5 on page 4 shows very clearly that the aggregate probability distribution for expected inflation in 2014 and 2015 has shifted toward a lower outcome. Computing the cumulative percentage of average annual inflation expectations of less than 1.4%, the measure stood at 78% for 2014 and 56.4% for 2015. When comparing aggregate probability distributions 2 years ahead (Dec-15), the 0% to 1.4% segment represents 45.7% of responses exceeding the 30.2% for the 1.5% to 1.9% segment. For the longer-term (5-year or 2018), the same conclusion holds, with 31.8% and 29.7% respectively. As Figure 6 on page 4 demonstrates, this is only the second time (even including the low inflation period of 2008-09) that this unusual situation has been apparent. We interpret these results as a clear sign that professional forecasters are beginning to incorporate some downside risks to their long-dated inflation expectations, despite the ECB arguing that those continued to be "firmly anchored".

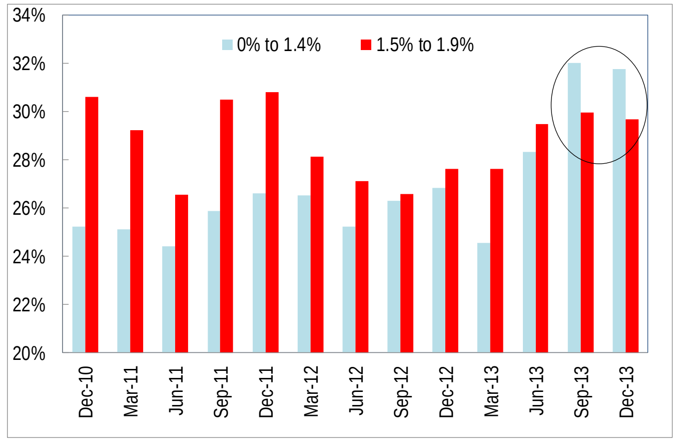
[2] Box 8, page 61, http://www.ecb.europa.eu/pub/pdf/mobu/mb201402en.pdf

Figure 5. Euro Area – Aggregate Probability Distribution of Average Annual Inflation Expectations for 2015



Sources: European Central Bank Citi Research

Figure 6. Euro Area – Aggregate Probability Distribution of Average Annual Longer-Term (5Y) Inflation Expectations



Source: European Central Bank Citi Research

The European Commission is also warning about the risk of low inflation for a protracted period

It seems that other institutions are more willing to acknowledge downside risks to inflation. In its latest forecast round, the European Commission included a box inquiring whether the driving forces behind the current disinflation in the euro area could be a temporary or a more persistent phenomenon[3]. The article notes that the recent downtrend is due to the "*fading away of temporary factors (indirect taxes and administered prices)*", but also related to cyclical and structural factors. In particular the box makes the point that the "*output gap elasticity of inflation appears to have increased again*", particularly in 'vulnerable' member states, while arguing that the Phillips curve estimate also suggests a "*gradually increasing role of inflation expectations in explaining price developments*". The box notes that the scenario of outright euro-area wide deflation would require "*a strong shock*", a point that we made in a recent publication (Euro Economics Weekly - The Euro Area Now and Japan Then: Separated by One Large Shock). The EC concluded that a "*protracted period of very low inflation increases the real value of both public and private debt and results in higher real interest rates, making the ongoing internal adjustment in a number of Member States more difficult and the deleveraging process more challenging*". We could not agree more.

Staff economic projections likely to be ratcheted down

The ECB will likely lower the 2014-15 inflation mid-points

So what will the European Central unveil for its new staff projections? In our view, these will likely show some ratcheting down in the 2014 and 2015 inflation mid-points. We estimate that the size of the downward adjustment will be around 0.2pt for both years to 0.9% and 1.1%, respectively. The 1.1% 2015 mid-point would likely represent the lowest reading for the 2 years ahead forecast since the 1.0% in March and June 2009 (see Figure 7). We believe that this likely downward revision of ECB staff projections for 2014-2015, together with indications of persistent disinflation, will weigh heavily in the balance in favour of the Governing Council deciding to lower its main refinancing rate.

The all-important 2016 inflation mid-point will likely be well below the ECB's price stability mandate

Just as importantly, the ECB Governing Council will also release an inaugural 3-year forecast for inflation (and GDP). We estimate that the mid-point for 2016 inflation will be around 1.5%, within a probable range of 0.6% to 2.4%. If the ECB wants to stress that its inflation mandate is symmetric, a significant undershooting of

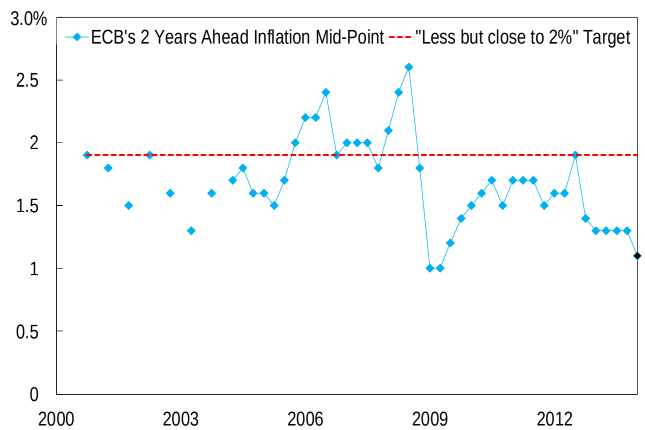
[3] European Commission Winter 2014 Forecasts, Box 1.4: Analysing current disinflationary trends in the euro area, page 39.

its 'less but close to 2% target' would likely require some monetary policy response, either in the form of strengthened forward guidance, or a refinancing rate cut. Note that the lower the mid-point, the larger the pressure on the ECB to act. We continue to think that the ECB will have to revise its inflation profile down again during the course of 2014 to take into account lower-than-projected inflation prints. We very much doubt that the annual rate of HICP will break above 1% before the second half of 2016 (see Figure 8).

Another focal point is how close to 1.9% the Q4-16 estimate will be

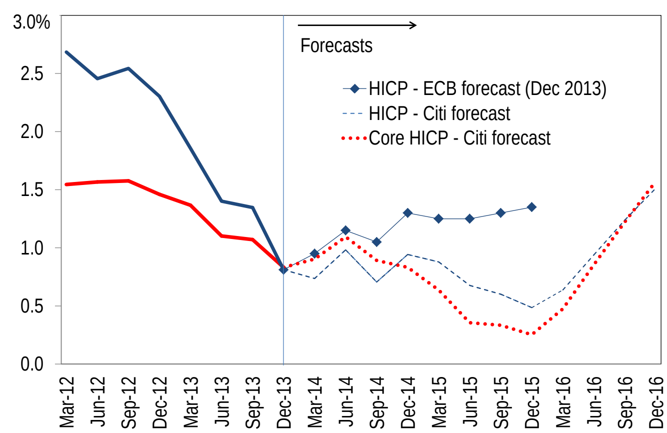
What is difficult to work out at this stage is whether the quarterly mid-point for inflation in Q4-16 will be close enough to 1.9% YY for some Governing Council members to argue that the current policy stance is sufficiently accommodative to engineer a return to target over the medium to long-term – the ECB's new reference period that superseded the previous reference to 'over the medium term'.

Figure 7. ECB Inflation Mid-Points and Target



Sources: European Central Bank and Citi Research

Figure 8. Euro Area Inflation – ECB and Citi Forecasts, Mar-12 to Dec-16



Sources: European Central Bank and Citi Research

Most likely ECB announcements on 6 March

A 15bp rate cut in the refi rate is our base case

So how is the ECB likely to react to the new available information gathered since the February meeting? A flash February HICP inflation print of 0.8% (albeit above the 0.7% consensus) continues to highlight some downside risks compared to the quarterly profile of YY HICP rate released by the ECB in December (see Figure 8). Together with January private sector credit and money supply figures continuing to remain very weak, we believe that the absence of a 'safety' margin and the evidence of some long-dated inflation expectations drifting lower will prompt the ECB to announce a 15bp rate cut in the refi rate.

Forward guidance would require that downside risks to price stability are addressed by monetary policy loosening

We judge that there have been enough indications since the February meeting for some Governing Council members to suggest that the ECB's reaction function has not changed. In the last few weeks, ECB's Coeuré and Coene talked about inflation scenarios. ECB Executive Board member Benoit Coeuré reiterated that "*if we see any downside risk to medium-term price stability, then we would have to act, that has been very clear*" in a testimony to European Parliament committee in Brussels. Separately, Belgium's central bank governor Luc Coene had remarked that "*a 0.7% January inflation rate is not in itself a sufficient element to decide that we absolutely have to do something*", adding "*it depends on what you expect inflation will be thereafter*". Mr. Coene explained that the ECB was analysing two scenarios: one where the negative price development in the periphery amounted to "*an adjustment to a new equilibrium*", and another "*where it is a real development of deflationary tendencies*". What these comments illustrate, in our view, is that the debate will

likely be intense, but that the "low or lower" monetary policy stance leaves the door firmly open to a cut. It is conceivable, of course that the ECB could decide to play for more time again, waiting for additional information to help it address some key uncertainties. But we think that the weight of evidence, including from the credit side (continued contraction in private sector credit, very weak growth in M3 and limited upward momentum in M1), is sufficient for the Governing Council to act in line with the forward guidance statement.

What else could the ECB announce in March or April?

The ECB could also announce other decisions. We put them in three groups: the first two have a good chance of being activated this month or in April, the next two are more distant prospects (2H-14), while the fifth is not part of our baseline.

- **Ending/suspending/reducing sterilisation of the SMP**: since the Bundesbank has indicated that it would be acceptable to end sterilization, we believe that this decision could be taken quickly. An intermediate step might be the suspension of the 7-day liquidity absorption tender until July 2015, matching the window of the fixed rate full allocation for main refinancing operations (MROs). Reserve requirements could be lowered further, and the collateral list adjusted again.
- **Publication of Minutes**: we think that this is one of the easiest decisions that the ECB could take, and its timing is only conditional on the Governing Council agreeing to the fine print regarding its format/structure. The publication of minutes would likely enhance the ECB's communication strategy and help anchor short-end rates fairly effectively, in our view.
- **Asset purchases**: according to AFME, there were €123bn of ABS of SME loans outstanding in 2Q-13, 71% or €88bn of which were originated in the periphery[4] The pool of assets is not particularly large, suggesting that some relaxation in the valuation haircut of 26% could be a better solution in the short-term.
- **Another LTRO**: we doubt that this tool will be used again soon. But it would likely be very convenient again if some degree of stress returns to the bank funding market around the tail end of the comprehensive assessment period and/or in the event of sovereign stress resurfacing. A one-year fixed-rate LTRO looks the more likely option, in our view, but the ECB would probably need to ensure that it leads to a pick-up in loans to the private sector, particularly to SMEs.
- **QE**: the hurdle for the ECB to initiate pro-rata purchases of euro-area government bonds appears very high to us. We do not expect the ECB will implement major QE unless it concludes that inflation will stay very low (probably below 1%) and slack will remain ample even 2-3 years ahead.

We look for a small rate cut in March, and continue to anticipate the ECB having to do more in June (-10bp deposit rate)

Conclusions

To be sure, a 15bp rate cut in the refi rate would only likely have a small impact, and it is not clear yet whether the Governing Council has managed to iron out differences about which are the ideal levers to pull in order to react to contingencies such as downside inflation and higher money market rate risks. However, we think that the evidence of persistently weak inflation and the associated risks in terms of economic activity and debt sustainability will likely prompt the ECB to lower its policy rate in March. We also expect some announcements on the liquidity policy and the publication of minutes in March or April. We still believe that more will need to be done with rates and keep our base case of a -10bp deposit rate in June.

[4] Spain = €44.2bn (35.9%), Italy = €30.3bn (24.6%), Greece = €7.3bn (5.9%), Portugal = €6bn (4.9%).

Key Economic Indicators (3 March – 7 March 2014)

		Forecast	Last
During the Week		Forecast	Last
08:00	UK: Halifax House Prices, Feb		
Monday 3 March		Forecast	Last
07:30	Sweden: Manufacturing PMI, Feb	55.3	56.4
08:00	Italy: Budget Balance, 2013	3.0% of GDP	2012: 3.0% of GDP
08:00	Norway: Manufacturing PMI, Feb	52.1	52.8
09:00	Norway: Credit Indicator C2, Jan	6.0% YY	6.0% YY
09:00	Italy: GDP and Debt, 2013		
09:00	Euro Area: Manufacturing PMI, Feb Final	53.0	54.0
09:30	UK: Manufacturing PMI, Feb	56.3	56.7
09:30	UK: Personal Borrowing, Jan		
	Italy: State Sector Borrowing Requirement, Feb YTD	€9.3 Billion	Jan-Feb 2013: €15 Billion
Tuesday 4 March		Forecast	Last
08:00	Spain: Registered Unemployment, Feb	22K MM	113K MM
09:30	UK: Mergers & Acquisitions involving UK Companies, 4Q		
10:00	Euro Area: Industrial Producer Prices, Jan		
16:30	Ireland: Exchequer Return, Feb		
Wednesday 5 March		Forecast	Last
07:30	Sweden: Services PMI, Feb	55.1	55.9
08:30	Sweden: Industrial Production, Jan	0.4% MM	-1.0% MM
08:30	Sweden: Services Production, Jan	0.5% MM	-1.5% MM
09:00	Euro Area: Services PMI, Feb Final	51.7	51.6
	Composite PMI, Feb Final	52.7	52.9
09:30	UK: Services PMI, Feb	58.0	58.3
10:00	Euro Area: GDP Details, 4Q	0.3% QQ, 0.5% YY	0.1% QQ, -0.3% YY
10:00	Euro Area: Retail Sales, Jan	1.5% MM, 0.2% YY	-1.6% MM, -1.0% YY
11:00	Ireland: Unemployment Rate, Feb		
Thursday 6 March		Forecast	Last
06:30	France: LFS Mainland Unemployment Rate, 4Q	10.6%	10.5%
	Mainland Unemployment Change, 4Q`	15K	31K
08:30	Sweden: Average House Prices, Feb		
08:30	Netherlands: Consumer Prices, Feb		
10:00	Greece: Unemployment Rate, Dec		
11:00	Germany: Incoming Orders, Jan	0.4% MM, 7.5% YY	-0.5% MM, 5.5% YY
12:00	UK: MPC Interest Rate Announcement	Unchanged at 0.5%	0.5%
12:45	Euro Area: ECB Outcome – Press Conference at 13:30	15bp Refi Rate Cut to 0.10%	0.25%
Friday 7 March		Forecast	Last
06:30	Switzerland: Unemployment Rate, Feb		
07:45	France: State Budget Balance, Jan		
07:45	France: Trade Balance, Jan		
08:15	Switzerland: Consumer Prices, Feb		
08:15	Switzerland: Industrial Production, 4Q		
09:00	Norway: Manufacturing Production, Jan	-0.4% MM	1.7% MM
09:00	Italy: Producer Prices, Jan		
09:30	UK: BoE/GfK Inflation Attitudes Survey, Feb		
11:00	Germany: Industrial Production (inc Construction), Jan SWDA	0.9% MM, 4.3% YY	-0.6% MM, 2.9% YY
11:00	Ireland: Industrial Production, Jan		

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area

Mar 3 | 09:00 | London Time

Manufacturing PMI, Feb Final — Forecast: 53.0 — Prior: 54.0

The flash estimate showed the manufacturing PMI was down quite sharply in Feb, interrupting a string of four back-to-back gains. The level of the index however remains well in expansionary territory. The February weakness is attributable to Germany and France and may have been partly affected by adverse weather conditions. The weighted average move in Germany and France was slightly more negative than the move in the euro area index, suggesting that other countries (Spain and Italy) may have shown a less marked decline.

Mar 5 | 09:00 | London Time

Services PMI, Feb Final — Forecast: 51.7 — Prior: 51.6

Composite PMI, Feb Final — Forecast: 52.7 — Prior: 52.9

The services PMI remained roughly unchanged in Feb, failing to continue the catching up trend relative to the higher manufacturing PMI. The composite PMI – which averages output indicators for the manufacturing and the service sector – was down only slightly in Feb, which suggests that the weakness in the headline manufacturing index (down by 1.0pt MM) was not that large in the output sub-component. Italy and Spain (to be published for the first time with the final PMI report) likely to report a similar small drop to Germany and France. The level of the composite PMI –at 52.7 – in the past has been consistent with annualised quarterly GDP growth of 1½ % over the same quarter.

Mar 5 | 10:00 | London Time

GDP, 4Q Final — Forecast: 0.3% QQ, 0.5% YY — Prior: 0.1% QQ, -0.3% YY

The preliminary estimate for 4Q GDP showed accelerating quarterly growth, to 0.3% QQ, after the temporary slowdown to +0.1% QQ in Q3. The final report will likely show that domestic demand growth has continued to improve (to +0.3% QQ, from 0.2% QQ), while a slowdown in import growth (+0.3% QQ) and a pickup in export growth (1.3% QQ), should have caused a positive contribution of net exports to QQ GDP growth (+0.4pp). Inventories should have subtracted the same amount, leaving overall GDP growth at 0.3% QQ. More recent indicators suggest that there is some room for acceleration in GDP dynamic in 1Q 14 relative to the end of last year.

Mar 5 | 09:00 | London Time

Retail Sales, Jan — Forecast: 1.5% MM, 0.2% YY — Prior: -1.6% MM, -1.0% YY

We forecast a rebound in retail spending in Jan, after an unexpectedly large drop in Dec. Retail sector sentiment indicators have been pointing to a decent acceleration in retail activity in recent months.

Germany

Mar 6 | 11:00 | London Time

Incoming Orders, Jan — Forecast: 0.4% MM, 7.5% YY — Prior: -0.5% MM, 4.4% YY

After December's small decline in German manufacturing orders, we expect the January figures to show a small increase. Order assessments in the ifo survey registered another improvement in February and the underlying trend remains robust. However, a slow tone in some of the recent global data as well as the fact that the December orders included an above average amount of large orders points to a small increase in January at best. With the expected increase in January, orders would be up 7.5% YY (as the previous year was weighed down by an unusually cold winter) and would leave the orders 0.9% above the 4Q average which in turn was 1.2% above the 3Q average.

Mar 7 | 11:00 | London Time

Ind. Production (inc Construction), Jan SWDA — Forecast: 0.9% MM, 4.3% YY — Prior: -0.6% MM, 2.9% YY

After a decrease in IP in December (even though construction output rose), we expect industrial production to rise in January. The decline in December was in part driven by calendar effects, and orders in recent months and business sentiment in general have continued to be robust. With the expected reading in January, IP would be 1.2% above the 4Q average (which was 0.9% higher than in 3Q).

France

Mar 6 | 06:30 | London Time

ILO Mainland Unemployment Rate, 4Q — Forecast: 10.6% — Prior: 10.5%

Mainland Unemployment Change (000s) — Forecast: 15K — Prior: 31K

We look for another uptick in the mainland unemployed rate to 10.6%, which will likely mark the peak in this cycle, equalling its 4Q-97 level. Employment expectations improved somewhat during the fourth quarter, but early indications are that the trend is losing momentum in early 2014 despite encouraging noises from the government about the 'Responsibility Pact' and better 4Q GDP readings. The current situation highlights the urgency of implementing significant structural reforms designed to lower the GDP growth threshold at which the economy begins to generate faster jobs growth.

Italy

Mar 5 | 08:00 | London Time

Budget Balance, 2013 — Forecast: 3.0% of GDP — Prior (2012): 3.0% of GDP

The first release of the data on the general government budget balance should show a fiscal deficit unchanged relative to 2012 right at the threshold of the 3% of GDP, above which the Excessive Deficit Procedure would have to be re-initiated (Italy exited the EDP in spring 2013).

Mar 3

State Sector Borrowing Requirement, Feb YTD — Forecast: €9.3 Billion — Prior (Jan-Feb 2013): €15 Billion

The state cash budget deficit in the first two months of 2014 should have performed better than in the same period of 2013, in partly due to one-off cash disbursement last year (ie. €2bn of financial support for MPS) and in part because of weaker cyclical factors.

Spain

Mar 4 | 08:00 | London Time

Registered Unemployment, Feb — Forecast: 22K MM — Prior: 113K MM

We expect the number of registered jobless claimants to rise by 22K in Feb, mainly driven by seasonal factors. The underlying trend should continue to show a marginal reduction in registered unemployment (we estimate by -0.6% MM), as observed since Aug 2013. Registered unemployment , however, in recent quarters has been less representative of the developments in the labour market than the labour force survey (due to changes in the criteria to access jobless benefits and rising long-term unemployment).Total unemployment (as measured by the labour force survey) stood at 5.9mln in 4Q 13, against 4.7mln jobless claimants.

Economic Indicators

Sweden			
Mar 3 07:30 London Time	*Manufacturing PMI, Feb*	Forecast: 55.3	Prior: 56.4
	PMI jumped 4.2 points to 56.4 in January, above the long-term average (54.4). Although sentiment indicators now are at high levels, hard data has only just partly started to recover. In turn, we expect industrial production and export data to pick up strength early this year. Meanwhile, the current turbulence in emerging markets, will probably weigh on sentiment in coming months.		
Mar 5 07:30 London Time	*Service PMI, Feb*	Forecast: 55.1	Prior: 55.9
	Services sector PMI surprisingly fell 1.8pp to 55.9 in January. The series, however, is very volatile and one gets a more precise picture by looking at three-month moving averages. On this basis, services PMI moved up to 56.9 in the three-month period Nov13-Jan14 – the highest since mid-2011. Service sector sentiment according to NIER has increased steadily since late 2012, with sentiment both in private services and retail trade above the historic average. Meanwhile, production data have only just started to catch up with sentiment data; actual service production was up a meagre 0.1% QQ in 4Q (+0.4% MM in 3Q and -0.5% MM in 2Q). We expect the service sector to recover further ahead.		
Mar 5 08:30 London Time	*Industrial Production, Jan*	Forecast: 0.4% MM	Prior: -1.0% MM
	As expected, we saw a payback in industrial production in December following the strong increase in November, a gain largely explained by a 57% rise for telecom products (likely reflecting a deviation in the seasonal pattern). Excluding this temporary effect, industrial production continued to recover moderately in December. However, a large gap versus sentiment indicators continues to persist. Although the production data is very volatile and industrial production barely expanded in the fourth quarter, a recovery still seems to be on the way.		
Mar 5 08:30 London Time	*Services Production, Jan*	Forecast: 0.5% MM	Prior: -1.5% MM
	The trend in services production has been weak during the past year, and although we are seeing signs of improvement, we have not yet seen the strong pick up suggested by sentiment data. In 4Q, service production printed a meagre 0.1% MM gain (+0.4% MM in 3Q and -0.5% MM in 2Q). We expect the service sector to recover further ahead.		
Mar 6 08:30 London Time	*Average House Prices, Feb*		
	House prices in 4Q were up by 1.1% QQ and 4.1% YY. Hence, house prices have increased gradually during 2013, and short-term indicators point to ongoing upward pressures in the near term. Ahead, we expect house prices gradually to level out next year as the Riksbank starts hiking rates combined with macroprudential measures restraining lending. Given the Riksbank's strong focus on financial stability (although the Swedish FSA has been assigned the main responsibility for macro-prudential policy), a stronger momentum in the housing market clearly is a headache for the Bank. However, key to watch are developments in household lending; in December, growth in loans to households held steady at 4.9% YY. Meanwhile, with ongoing gains in housing starts (up by 28% YY in 2013), this suggests that the moderate re-acceleration in lending growth last year could become more pronounced this year. However, with the focus back on inflation, we do not expect a continued moderate increase in housing and lending will fuel an immediate rate hike.		
Norway			
Mar 3 08:00 London Time	*Manufacturing PMI, Feb*	Forecast: 52.1	Prior: 52.8
	We expect the Norwegian PMI to correct slightly lower in December. This would be better in line with indications from other business surveys, which on average signal slightly around trend-pace growth ahead (RNR points to below-trend growth while the BTS signals slightly above-trend growth). We note that the PMI is not closely watched by Norges Bank as there often are problems with the seasonal adjustment procedure. Also, PMI covers a very small sample compared to e.g. Norges Bank's own Regional Network Report and the quarterly manufacturing survey from Statistics Norway.		
Mar 3 09:00 London Time	*Credit Growth Indicator, Jan*	Forecast: 6.0% YY	Prior: 6.0% YY
	The 4Q lending survey showed that household credit demand slipped in the fourth quarter, mirroring developments in the monthly credit growth indicator for households, which fell 0.1pp to 7.1% YY in 4Q. With moderating gains in the housing market, household credit demands are likely to slow further in the near term. Meanwhile, the latest lending survey showed about stable credit demand from non-financial enterprises, and this is unlikely to change in the first quarter of 2014. The monthly development in corporate credit growth has been moderating since mid-2012, from 7.5% YY in June 2012 to 3.7% YY in Dec-13, likely reflecting stricter lending conditions from banks and high activity on the bond market. In January, we expect credit to households and non-financial enterprises to remain in the area of 7.0% YY and 3.7% YY, respectively. Meanwhile, credit to municipalities should fall slightly (7.8% YYYY in Dec).		
Mar 7 09:00 London Time	*Manufacturing Production, Jan*	Forecast: -0.4% MM	Prior: 1.7% MM
	Momentum in manufacturing production has turned markedly weaker since mid-2013, with the quarterly growth pace easing from 2.1% QQ in 2Q to 0.5% QQ in 3Q and -0.7% QQ in 4Q. Ahead, we note that latest manufacturing Business Tendency Survey (from Statistics Norway) was surprisingly upbeat; the sentiment indicator increased for a third consecutive quarter to the highest level since early-2012, lifted by an improving orders inflow and firmer production expectations. Hence, this suggests that the short-term trend in actual production should improve ahead. However, following the strong gain in December, we expect to see a minor reversal in January.		
United Kingdom			
Mar 3 09:30 London Time	*Manufacturing PMI, Feb*	Forecast: 56.3	Prior: 56.7
	The manufacturing PMI has been roughly stable since August, and we expect little change either way this month. Recent figures remain well above the longrun average (51.3) and hence are consistent with solid gains in manufacturing output.		
Mar 5 09:30 London Time	*Services PMI, Feb*	Forecast: 58.0	Prior: 58.3
	The services PMI has drifted a little lower in recent months, from very high levels, and we expect another solid reading this month. Such a figure would be consistent with continued above-trend growth in GDP.		

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

Economic Indicators

Key Economic Indicators (10 March – 14 March 2014)

Monday 10 March		Forecast	Last
07:30	France: Bank of France Business Sentiment, Feb		
07:45	France: Industrial Production, Jan		
08:00	Spain: Industrial Production, Jan		
08:15	Switzerland: Retail Sales, Jan		
09:00	Norway: Consumer Prices, Feb		
09:00	Italy: Industrial Production, Jan		
09:30	Euro Area: Sentix Investor Confidence, Mar		
	Spain: Budget Balance, Dec		
	Euro Area: Eurogroup Meeting, Brussels		
Tuesday 11 March		Forecast	Last
	EU: EcoFin Meeting, Brussels		
07:00	Germany: Trade Balance, Jan		
07:00	Germany: Labour Cost Index, 4Q		
07:00	Sweden: PES Unemployment Rate, Feb		
08:30	Sweden: Consumer Prices, Feb		
09:00	Italy: GDP Details, 4Q		
09:30	UK: Industrial Production, Jan	0.2% MM, 2.9% YY	0.4% MM, 1.8% YY
	Manufacturing Output, Jan	0.3% MM, 3.3% YY	0.3% MM, 1.5% YY
10:00	Greece: GDP Details, 4Q		
10:00	Cyprus: GDP Details, 4Q		
11:00	Portugal: GDP, 4Q		
Wednesday 12 March		Forecast	Last
06:30	France: Non-Farm Payrolls, 4Q Final		
08:00	Spain: HICP, Feb Final		
08:30	Netherlands: Industrial Production, Jan		
09:30	UK: Trade Balance – Goods & Services, Jan	£-2.0 Billion	£-1.0 Billion
10:00	Euro Area: Industrial Production, Jan		
11:00	Portugal: Consumer Prices, Feb Final		
Thursday 13 March		Forecast	Last
00:01	UK: RICS House Price Survey, Feb		
07:45	France: Consumer Prices, Feb		
08:00	Spain: Retail Sales, Mar		
08:30	Netherlands: Retail Sales, Jan		
08:30	Sweden: Unemployment, Feb		
09:00	Italy: Consumer Prices, Feb Final		
09:00	Euro Area: ECB Monthly Report		
10:00	Greece: Unemployment Rate, 4Q		
Friday 14 March		Forecast	Last
07:00	Germany: Consumer Prices, Feb Final		
08:15	Switzerland: Producer and Import Prices, Feb		
08:30	Netherlands: Trade Balance, Jan		
09:30	Italy: General Government Debt, Jan		
09:30	UK: Construction Output, Jan		
10:00	Euro Area: Employment, 4Q		

Sources: National statistical offices, central banks and Citi Research

Title	Author	Date
Euro Area – Sovereign Debt Update		
Inflation Keeps Subsiding in February	European Economics Team	Feb 28, 2014
Mersch Says ECB is Reviewing All Policy Options	European Economics Team	Feb 27, 2014
EC Forecasts Revise Growth Up and Inflation Down	European Economics Team	Feb 26, 2014
ECB's Visco and Coeuré on Possible Policy Action(s)	European Economics Team	Feb 25, 2014
ECB Waiting for More Information in March	European Economics Team	Feb 24, 2014
Euro Area		
European Economic Forecast Highlights - February 2014	Ann O'Kelly	Feb 27, 2014
Euro Area - Bank Credit Data Understate Credit Flows to Non-Financial Firms	Ebrahim Rahbari/Antonio Montilla	Feb 27, 2014
Euro Area - German Constitutional Court Leaves OMT in Limbo	Ebrahim Rahbari	Feb 7, 2014
ECB: No Change, But Action Likely In March -	Ebrahim Rahbari	Feb 6, 2014
Euro Area - Assessing Vulnerabilities to an EM Slowdown	Michael Saunders	Feb 3, 2014
ECB Preview - ECB Likely to Resist Pressure to Act at February Meeting	Guillaume Menuet	Jan 31, 2014
Euro Area - Inflation Surprises Once Again to the Downside in January	Giada Giani	Jan 31, 2014
Euro Area - Bank Lending Survey Confirms Supply-Side Improvement	Guillaume Menuet	Jan 30, 2014
Euro Area - Weak Money Supply But Stabilisation In Credit Dynamics	Guillaume Menuet	Jan 29, 2014
European Economic Forecast Highlights - January 2014	Ann O'Kelly	Jan 23, 2014
Euro Area - Composite Flash PMIs — Strong Start To 2014	Guillaume Menuet	Jan 23, 2014
Euro Economics Weekly		
German Inflation: Lower For a Little Longer	Ebrahim Rahbari	Feb 21, 2014
Could Eurozone Politics Return to the Fore?	Giada Giani	Feb 14, 2014
ERS: An Alternative Solution to OMT?	Guillaume Menuet	Feb 7, 2014
The Euro Area Now and Japan Then: Separated by One Large Shock	Ebrahim Rahbari	Jan 31, 2014
Spain Is Becoming More German	Giada Giani	Jan 24, 2014
Belgium: Politics the Likely Main Wild Card in 2014	Guillaume Menuet	Jan 17, 2014
Germany 2014 Outlook: Recovery And Rebalancing	Ebrahim Rahbari	Jan 10, 2014
2014 Outlook: GDP Risks, Credit Dynamics and Inflation Update	European Economics Team	Jan 6, 2014
Spain: 2014 Outperformer?	Giada Giani	Dec 13, 2013
Why Is France Underperforming? And How To Fix It	Guillaume Menuet	Dec 6, 2013
Is Deflation Good or Bad for the Eurozone Periphery?	Ebrahim Rahbari	Nov 29, 2013
Is This the End of Austerity?	Giada Giani	Nov 22, 2013
Recovery Watch: SME Lending is Key	Guillaume Menuet	Nov 15, 2013
One Shock Away from Deflation	Giada Giani	Nov 8, 2013
Why the ECB Should Worry About the Strong Euro	Ebrahim Rahbari	Nov 1, 2013
Italy and Spain Look Well Positioned For Job Growth	Guillaume Menuet	Oct 25, 2013
Portugal — What After June 2014?	Giada Giani	Oct 18, 2013
Chief Economist Publications		
Global Economic Outlook and Strategy - February 2014	Willem Buiter	Feb 26, 2014
Scandi		
Scandi Economics Update	Tina Mortensen	Feb 28, 2014
Sweden - Minutes: Dovish Riksbank Board, with Extensive Inflation Focus	Tina Mortensen	Feb 26, 2014
Norway - Stronger-Than-Expected 4Q Mainland GDP	Tina Mortensen	Feb 12, 2014
UK		
UK - UK ECI Highest Since Late 1980s	Michael Saunders	Feb 27, 2014
UK - YouGov Reports Lower Inflation Expectations	Michael Saunders	Feb 27, 2014
UK - Strong Investment Recovery Boosting Growth	Michael Saunders	Feb 26, 2014
UK - No Sign of Adverse Weather Effects in BBA and CBI Data	Michael Saunders	Feb 25, 2014
UK Economics Weekly		
Still Bullish on UK Growth	Michael Saunders	Feb 21, 2014
What Does the "Next Phase of Forward Guidance" Amount To?	Michael Saunders	Feb 14, 2014
How Vulnerable Is the UK to EM Strains?	Michael Saunders	Feb 7, 2014
Is Growth Credit-Led?	Michael Saunders	Jan 31, 2014
After Forward Guidance…"Fuzzy Guidance"	Michael Saunders	Jan 24, 2014

Source: Citi Research

Notes

Appendix A-1

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