6 December 2013 | 16 pages

Developed Markets
Western Europe

Euro Economics Weekly

Why Is France Underperforming? And How To Fix It

- **Tackling competitiveness is key** — The competitiveness problems that France is experiencing are not unique: Italy and Finland are in the same position and probably need to be even more ambitious in their efforts to improve their competitiveness.

- **Ambitious reforms needed** — The government's reform agenda should be more ambitious, if only given the extent of the task to reduce the enormous size of its public sector. While short-term political considerations appear to be an obstacle to a Copernican revolution with respect to reducing public expenditure, voters seem to be willing for the administration to announce more than the typical half-measures.

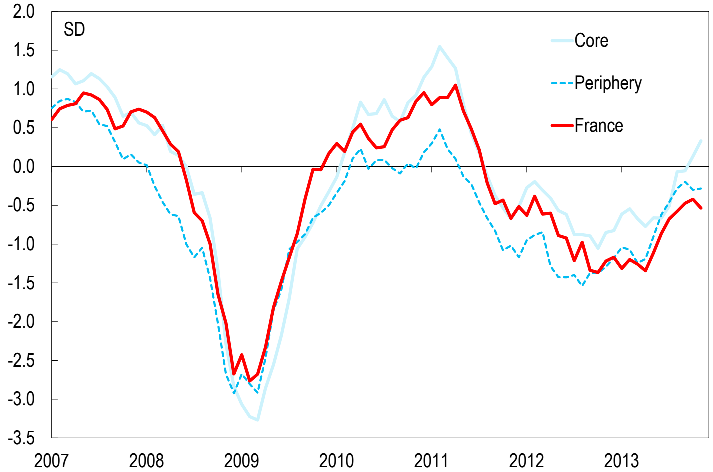
- **Opportunities after spring elections** — France's predicament is well-known and the reform agenda unveiled so far seem sufficient for the OAT/Bunds spread to stay tight. Faster than average GDP growth should be possible over time, assuming the need to enact structural changes is seen as an opportunity rather than a constraint.

Figure 1. Citi Market Forecasts

	$/€	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	1.39	0.00	1.70	0.80	0.50	137	9.10	0.75	8.05	1.50	1.25	0.00	-68
4Q 14	1.40	0.00	1.80	0.80	0.50	153	9.00	0.75	7.86	1.50	1.26	0.00	-73

Source: Citi Research

Figure 2. Selected Euro Area Countries – Aggregated Business Confidence Measures, January 2007 to November 2013



Note: Average of composite PMIs and Economic Sentiment Indicators. Core (DE, NL, AT), Periphery (IT, SP & IE)
Sources: Haver, European Commission and Citi Research

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Why is France Underperforming?

Doubts about the government's ability to reform, very high levels of public spending and taxation, together with weak corporate profits are key driver of underperformance, in our view

The French economy is recovering, albeit very slowly. GDP remains below its pre-crisis level and the output gap is continuing to widen. Nineteen months after his election, President Hollande's popularity ratings have never been so low and there are many questions about the government's ability to introduce ambitious reforms and cut public spending drastically to lower taxes by 2017. This note reviews the government's strategy to improve the country's competitiveness and the next likely steps on the road to structural reforms. It also raises the question of France's economic underperformance and investigates the reasons behind the anaemic investment backdrop. We conclude that addressing underperformance will be a long and arduous task, and worry that any delays in reforming could have serious consequences on the country's ability to deliver faster GDP growth by 2017.

Soft and hard data have remained disappointing

France is having a tough time: it is underperforming its neighbours and it suffered a rating downgrade, while facing negative Q3 GDP and rising unemployment

French survey data have been disappointing in the last few quarters. If one compares the performance of France's economic confidence against that of Germany, Italy, Spain, the Netherlands and Belgium — the other five largest economies of the euro area — it is clear that France is lagging (see Figure 2, front page). There has been some negative news for France lately, starting with a one-notch downgrade in its sovereign credit rating to AA with a stable outlook by S&P on November 8. The rating agency argued that the reforms "*will not substantially raise the medium-term growth prospects […] constraining the government's ability to consolidate public finances*". Third quarter GDP fell by 0.1% QQ (-0.6% SAAR), leaving GDP 0.2% higher than in Q3-12. Splits showed a nil contribution from domestic demand — for the sixth time in the last seven quarters — and a noticeable drop in export volumes. Unemployment rose to a 16-year high of 10.9% in Q3, and monthly data suggest that the government's promise of lowering unemployment by year-end is unlikely to be met, barring a surprisingly strong ramping up in the delivery of public sector subsidised jobs.

The balance of risks to 2014 GDP growth lie to the downside, in our view

Our forecast for 2014 envisages a modest pick-up in economic activity, with GDP growth averaging 0.9%. This is significantly lower than pre-crisis 10-year average real GDP performance of 2.3%. The balance of risks lies to the downside, in our view, given the sizeable amount of structural budget adjustment expected in 2014 (0.9pt of GDP) and low confidence. Our baseline scenario anticipates that French GDP growth will exceed 1.5% only from 2017.

France's competitiveness has been eroding steadily

France is losing competitiveness compared to its peers

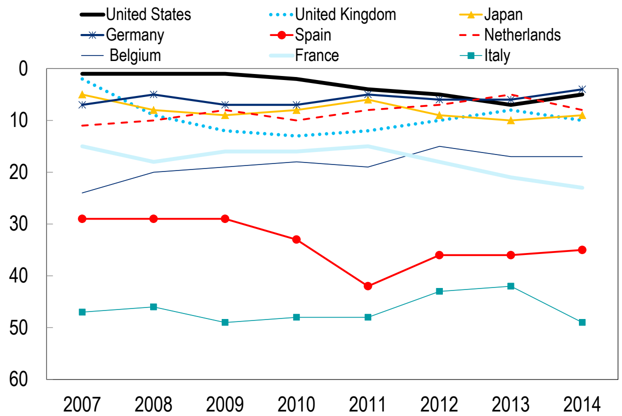
France has been losing competitiveness for some time, as evidenced by the increase in unit labour costs and steady erosion in its ranking versus its peer group. We refer to the Global Competitiveness Index[1] compiled for the World Economic Forum, measuring the micro- and macro-economic foundations of national competitiveness for 148 countries. Using a sample containing the G8 plus Netherlands and Belgium, we find that France has been the worst performer since 2011, having lost 8 places to #23 (see Figure 3). Over the same period, both the US and Italy lost one place to #5 and #49, respectively and Japan lost three places to #9. Conversely, the best performer has been Spain which gained 7 places to #35, followed by Belgium and the UK, both up two places to #17 and #10, respectively. Germany gained one place to #4 and the Netherlands were unchanged at #8.

Broad-based weakening

A split of the main GCI subcomponents for France shows that the macroeconomic environment has been the area of most significant weakness, with a drop of 29 places to #73. Labour market and goods market efficiency are also areas of concern, with drops of 11 and 13 places to #71 and #45, respectively (see Figure 4).

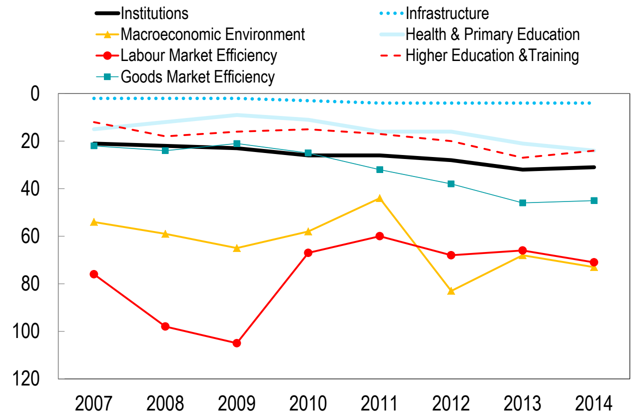
[1] http://www.weforum.org/issues/global-competitiveness

Figure 3. Selected Countries – Global Competitiveness Index (GCI), Annual Rankings from 2007 to 2014



Sources: World Economic Forum and Citi Research

Figure 4. France – Main Components of the GCI, Annual Rankings from 2007 to 2014



Sources: World Economic Forum and Citi Research

How is the French government addressing the issue?

Mitigating the cost of the 35-hour work week experiment

Since embarking on the 35-hour work week experiment in 2000 under the Jospin government, France has been losing competitiveness. After his election in 2012, President François Hollande announced that he would tackle the issue that had been one of the key points of contention between the two candidates in the final week of the campaign. Six months later, in November 2012, PM Jean-Marc Ayrault announced that the government was launching the National Pact For Growth, Competitiveness and Employment. Its main aim was to improve firms' cost competitiveness through the creation of a Competiveness and Employment Tax Credit (CICE) of €20bn (1% of GDP) for 2013-14. Note that to tackle non-cost competitiveness, parallel measures were launched, aiming to improve access for SME financing, support for innovation and exports, and cut red tape.

The most significant measure to date has probably been the CICE

On cost competitiveness, the government's thinking was that companies would gradually pass on lower production costs in their selling prices to households, eventually increasing their purchasing power. Non-wage labour costs will need to be tackled also. For 2014, the CICE is being beefed up to 6% of payroll taxes from 4% in 2013, implying a 3% average fall in companies' labour costs. The government estimates the cost of the CICE for 2014 to be €10bn to be covered by €6bn of VAT hikes and €4bn from expenditure savings. Going forward, the government retains the option of increasing the tax credit, but will need to finance it by identifying more expenditure saving measures and an increase in environmental taxation.

What does the French government's reform roadmap look like?

A multi-faceted approach to generate savings and boost potential growth

What are the fiscal-structural reforms that the government has launched or intends to deliver? Analysis of the French government's Economic Policy Strategy[2] shows that there are five priorities: **i**) reducing the government deficit, notably through the containment of expenditure growth, **ii**) creation of an independent fiscal council (High Council for Public Finances), **iii**) reform the pension system, **iv**) simplifying the tax system, **v**) reduction in the cost of labour. Additional measures with a bearing on growth and competitiveness, and therefore some indirect impact on the deficit reduction efforts include **i**) support to innovation and export capacity of firms, **ii**) measures to enhance competition and efficiency in network industries and some regulated sectors, **iii**) reform of the labour market and **iv**) support to youth employment.

[2] http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/dbp/fr_2013-10-15_dbp_en.pdf

What is the European Commission (EC)'s take on progress to date?

The EU is urging France to tackle its public finances, restore its competitiveness and combat unemployment

France was required to implement country-specific recommendations (CSR) as agreed by the EU Council on 9 July 2013, focusing on three key areas: **i**) ensuring the long-term sustainability of public finances while simplifying the tax system, **ii**) restoring competitiveness through measures to reduce production costs, improving the business environment and increasing competition and **iii**) combating unemployment and inequality on the labour market.

The Commission expressed some reservations about the policies implemented to date, urging Paris to deliver more

As part of the two-pack euro area regulations further strengthening the surveillance mechanisms, and because France is currently under an Excessive Deficit Procedure (EDP), the EC reviewed France's Economic Partnership Programme (EPP)[3]. Both the EC and Eurogroup President Jeroen Dijsselbloem have been fairly critical of France's lack of progress on many reform fronts. The EC document highlights a number of areas where more information is required including **i**) structural reforms, notably those referring to taxation, pension and health systems and **ii**) budgetary frameworks, which will be instrumental to correct the excessive deficit in a lasting manner, with a strong focus on the period up to 2015, the deadline for correcting the excessive deficit.

Figure 5. France's Economic Partnership Programme - Draft Opinion

Reforms	European Commission's Assessment
Spending Review	The Commission highlights that expected savings highlighted by the spending review have not been systematically quantified, adding that part of the measures announced so far limit and/or abolish tax and social security exemptions, a situation that will actually increase the tax burden rather than lower expenditure. The Commission adds that it remains to be seen to what extent the spending review will result in major reforms of government policies, the coverage of public sector activities and the delivery mode of public services.
Decentralisation	The decentralization reform aims at clarifying the responsibilities of local authorities and central government to increase the efficiency of local government expenditure (ie doing the same or ideally more, for less). The government has not quantified what savings are expected from the reform.
Healthcare spending	Little information is provided in the measures designed to improve the cost effectiveness of healthcare spending in the medium to long run.
Pension reform	On pension reform, the announced measures taken up to 2020 appear to be relying mainly on the revenue side, although the increase in social contributions for both employees and employers are expected to be offset by a reduction in family contributions. The Commission notes that the pension reform is expected to only halve the financing gap of the pension system by 2020, highlighting that the scope and specific rules of public sector worker schemes have not been reviewed. Finally, the Commission warns that the macroeconomic scenario used for the baseline could prove overly optimistic.
Tax simplification	Tax reform to simplify the system, increase its efficiency through cuts in tax expenditures and proposals to increase environmental taxation. The Commission noted that no measures are considered in the draft budgetary plan to reduce the debt bias in corporate taxation. It appears that amendments to the draft budgetary plan will increase the corporate tax statutory rate for large firms, going against the Council's recommendation to reduce statutory rates while broadening the tax base. On VAT, the Commission notes that there are no measures to bring the reduced rate closer to the standard rate, and notes the suspension of the green tax on heavy goods vehicle announced on 29 October.
Labour market	This is the area where the Commission noted positive steps to improve the functioning of the labour market and therefore increase France's growth potential. But it deplores that the negotiation on the unemployment benefit system has been postponed to 2014.

Source: Citi Research

The Commission's verdict – good start but must do more

On balance, the array of fiscal and structural reforms presented by the French government to the Commission and the Council in its Economic Partnership Programme is judged to be partly adequate to support an effective and lasting correction of the excessive deficit. But more details will need to be provided. We argue that the government's muddled message on taxation is creating uncertainty about the long-term strategy, which can only be damaging for business confidence in the short-term. While the government's focus on reducing labour costs is the right one in our view, the lack of clarity on what may happen beyond 2015 is problematic. The government's reluctance to discuss further structural reforms appears related to the mid-term municipal elections (municipal polls on 23 & 30 March 2014) and the European Parliament elections (25 May).

[3] http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/other_documents/2013-11-15_fr_-_epp_en.pdf

Low confidence and weak profits curtail investment spending

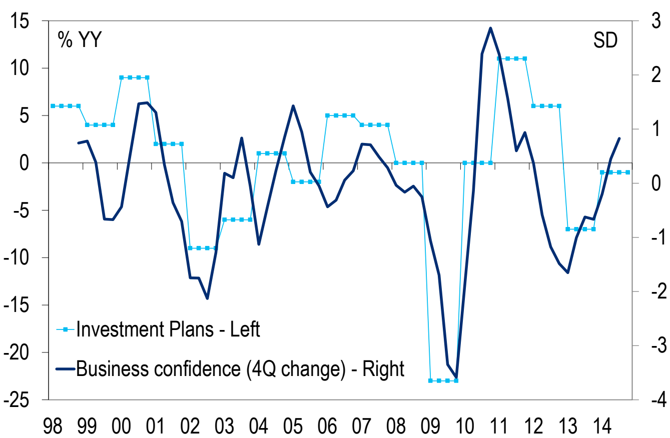
Weak confidence is holding back the economy

Despite the government communicating on its structural reform programme and signs of a modest cyclical upswing, businesses remain skeptical about recovery. A Viavoice poll for Les Echos released on 5 December showed that 82% of employers are pessimistic about economic activity in 2014, up 13 ppt compared to October. 44% of respondents believe that 2014 "*will be worse*" than 2013 when GDP growth is likely to have been almost flat (+0.2%). Note, however, that 65% of business owners are optimistic about their own prospects, a fall of only 3ppt. We believe that the main problem is that pervasive general pessimism restrains investment.

Improving business confidence points to modest recovery in investment plans

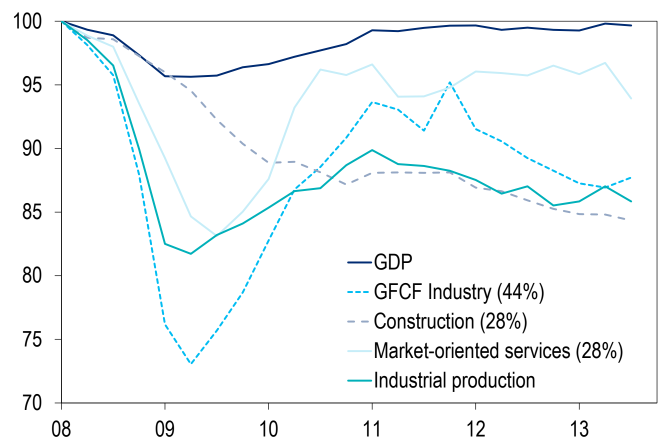
Yet, in absolute terms, business confidence has risen noticeably during the last few quarters, having troughed at -1.4 standard deviation below its long-term average at the end of 2012. The four-quarter gain in business confidence[4] amounts to 0.8sd, which historically has been associated with a pick-up in industrial investment intentions, averaging around 3% in the following year (see Figure 6). But results of the last INSEE industrial investment survey indicate that investment intentions remain subdued at best: industrialists are pencilling in a 1% increase in their investment plans for 2014 after a projected 7% contraction in 2013 and an increase of 6% in 2012, implying virtually no change in the last three years.

Figure 6. France – Business Confidence (3-quarter lead) and Industrial Investment Intentions, 1Q-1998 to Q4-2014



Sources: INSEE, Haver, European Commission and Citi Research

Figure 7. France – GDP, Industrial Production and Non-Financial Gross Fixed Capital Formation by Sector, (Q1-08 = 100), Q1-08 to Q3-13



Sources: INSEE and Citi Research

So why are industrialists so timid about capex?

So why are industrialists so timid about capex, despite the fact that industrial gross fixed capital formation has fallen by 12.3% in real terms since French real GDP peaked in 1Q-08? A simple answer could be that industrial production has fallen by around the same magnitude (14.2%), while capacity utilisation is also 7.2 percentage points lower (see Figure 7). This sharp adjustment proved calamitous for industrial sector jobs as almost 400,000 were lost in the reference period. Given the often-discussed argument that the French industrial capital stock suffers from obsolescence[5], and that the relatively high cost of labour might favour some substitution toward capital spending, we believe it more likely that the timidity of industrialists with respect to capex plans stems from the combination of a challenging corporate profit backdrop and some lack of visibility.

[4] Average of the standardised series of INSEE business confidence, the composite PMI and the BdF survey.

[5] The manufacturing industry in France since 2008: what has changed? INSEE, Special Topic, Economic Outlook, Dec-12.

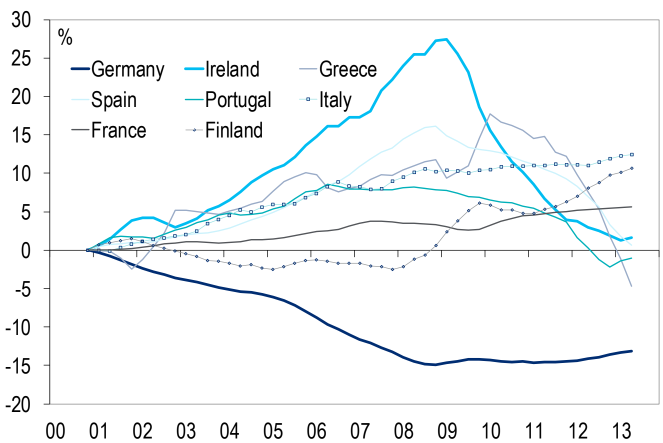
Unit labour costs have risen steadily in France since 2000, undermining corporate profits

While the weak profitability of the French corporate sector had been an issue for some time, the stronger focus on competitiveness led the government to take action in Q4 2012 with the CICE. We expect that the payroll tax cut will start to feed through to the ULC calculations soon, helping France improve its position, being currently the third highest increase within the euro area (see Figure 8). This is partly explained by a continued increase in wages exceeding productivity growth.

Profitability has been French industry's Achilles' heel

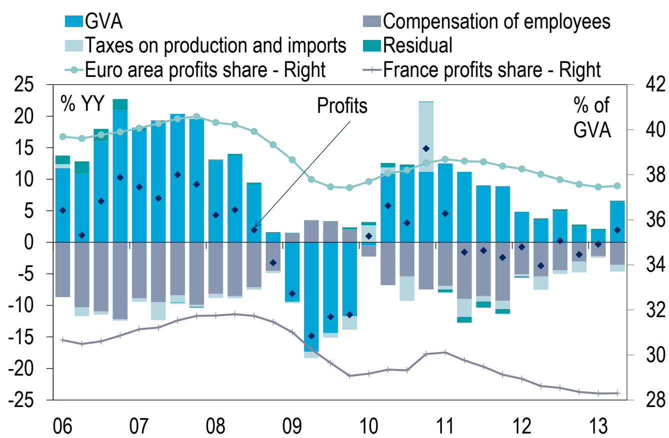
Recent trends show that corporate profits are rebounding modestly, with a 2% YY gain in firms' gross operating surplus in Q2-13 (see Figure 9). The decomposition of the main drivers of corporate profits shows that while gross value added is growing at 1.7% YY (vs. 1.0% in Q2-12), its fastest rate since Q1-12, the growth rate of compensation of employees has slowed to 1.4% YY (vs. 2.2%), and that of taxes on production and imports has slowed to 3.3% YY (vs. 7.2%). It appears that the French corporate sector is one of the few enjoying some recovery in corporate profits, albeit at a much less rapid pace than the 5.3% and 6.6% recorded in Portugal and Spain, respectively. Hence, on the condition that positive profitability dynamics can be maintained in the foreseeable future, we believe that some recovery will materialise in corporate investment. What remains to be addressed, however, is the record low profit margin of the French corporate sector, currently estimated around 28.3% of gross value added, almost 10 percentage points below the euro area average (vs. 39.1% in Germany).

Figure 8. Selected Countries – Unit Labour Costs, Cumulative change since Q4 2000, Q1-01 to Q2-13



Sources: European Central Bank and Citi Research

Figure 9. France – Non-Financial Corporate Profits and Contributions , 1Q-2006 to Q4-2014



Sources: INSEE and Citi Research

What will happen to France in 2014? Is there a new growth model?

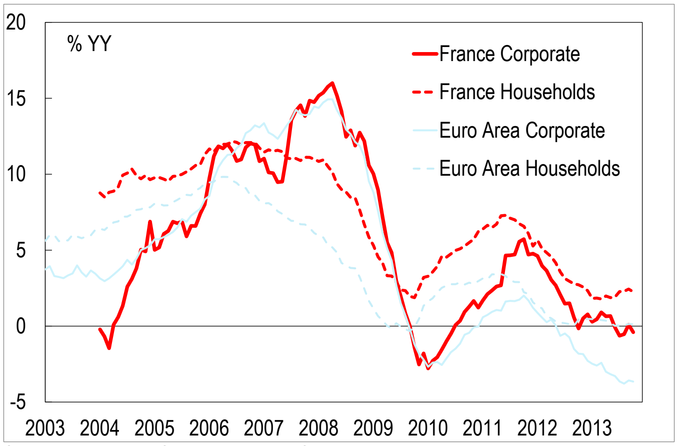
Economic growth was essentially reliant on credit and household consumption

Contrary to the situation of a credit crunch in most euro area member states, France has been used to rely on increases in household indebtedness and consumer expenditure to support economic activity. To be sure, the flow of bank loans to the private sector remained positive even during the six quarters of negative GDP growth (Q3-08 to 4Q-09) and more recently in Q4-12 and Q1-13, owing mainly to households' appetite for housing debt obtained at very low fixed rates (see Figure 10). We doubt that this situation can be sustained in the coming years, with house prices gradually coming off their peaks (3% lower than in Q3-11).

So what happens next?

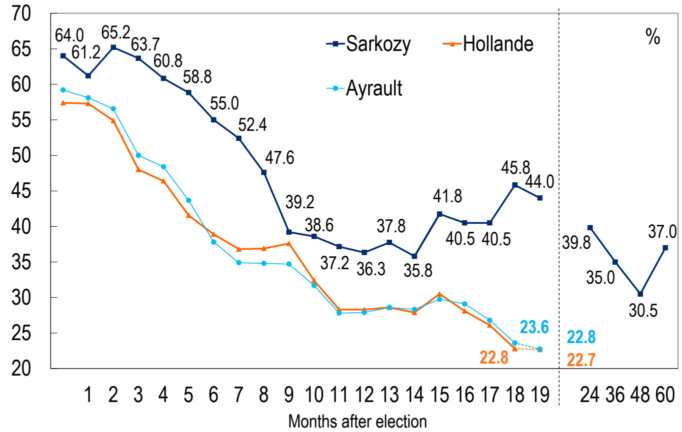
So what happens next? We believe that the corporate sector and exports will be the only sources of outperformance, given the central government's belt-tightening exercise and the households' limited appetite for leverage at a time when fiscal pressure is increasing.

Figure 10. France – Bank Lending to Households and Non-Financial Corporates, Jan-03 to Oct-13



Sources: European Central Bank and Citi Research

Figure 11. France – Approval Ratings of President and Prime Minister, May-12 to Dec-13



Sources: Various French polling institutes and Citi Research

Is the government ready to launch a deeper overhaul of taxation?

Fostering an export and investment rebound would require an extensive overhaul of the tax system. This objective was formally announced by Prime Minister Jean-Marc Ayrault at the end of November, leading to widespread calls from the business sector for the government to be ambitious. It is hard to envisage that such a proposal will be successful without being accompanied by a multi-annual effort on curbing government spending, since in our view the likely focus on greater progressivity in taxation would most certainly trigger an increase in the tax burden of the wealthier households, including a significant part of the middle class.

No escape from underperformance without structural change

The principle of economic reforms is that a country assumes ownership of a programme designed to improve its competitiveness and its growth prospects. We argue that in the last decade, the political class has been more reactive than proactive to the need for change. But transforming the French economy is a necessity in order to improve its growth prospects in the medium term. Yet, our impression is that the European Commission is often the principal engine of change, while governments often do their best to ignore its recommendations.

Conclusions

Tackling competitiveness problems will require a significant reduction in fiscal pressure, but changes are hard to make before important mid-term elections

At a time when a number of countries have embraced the reform agenda (Spain, Portugal, Ireland), France is in danger of being left behind if it does not find solutions to improve its competitiveness. The government's poll ratings are disastrous, and President Hollande's popularity ratings are even worse than those of his PM. Record high fiscal pressure is largely to blame, in our view. A significant reform of the role of the public sector will be unavoidable, even if the government were to pledge only a freeze in nominal general government outlays rather than an outright fall. We presume that such a strategy will likely be unveiled after the spring municipal (23 & 30 March) and European parliamentary (25 May) elections, when the results are likely to be very challenging for all mainstream parties.

Tax cuts will be the only viable long-term solution to rebalance the economy away from household spending towards exports and investment

As the current administration could soon be fighting for its political survival, we expect that the government will be pencilling in some tax cuts, most likely targeting households towards the end of its mandate, having focused on stabilising and then lowering corporate taxation in the first half of its tenure. Yet, a pre-condition for this scenario is an extensive overhaul of the role of the public sector, requiring the identification of areas where expenditure can be reduced while minimising the drag on economic activity. If this is done successfully, France would recover and likely outperform.

Key Economic Indicators (9 December – 13 December 2013)

Monday 9 December		**Forecast**	**Last**
06:45	Switzerland: Unemployment Rate, Nov		
07:00	Germany: Trade Balance, Oct		
07:00	Germany: Labour Costs, 3Q		
07:30	France: Bank of France Business Sentiment, Nov	98	99
08:15	Switzerland: Retail Sales, Oct		
09:30	Euro Area: Sentix Investor Confidence, Dec		
10:00	Greece: GDP Details (NSA, YY), 3Q		
10:00	Cyprus: GDP Details, 3Q		
10:00	Malta: GDP, 3Q		
11:00	Portugal: GDP Details, 3Q		
11:00	Germany: Industrial Production, Oct	0.9% MM, 3.4% YY	-0.9% MM, 0.9% YY
	Euro Area: EuroGroup Meeting, Brussels		
Tuesday 10 December		**Forecast**	**Last**
00:01	UK: RICS House Price Survey, Nov		
	EU: EcoFin Meeting, Brussels		
07:00	Germany: Insolvencies, Sep		
07:45	France: Industrial Production, Oct	0.8% MM, 1.1% YY	-0.5% MM, -0.9% YY
	Manufacturing Output, Oct	1.0% MM, 1.1% YY	-0.7% MM, -1.6% YY
08:30	Netherlands: Industrial Production, Oct		
08:30	Sweden: Industrial Production, Oct	0.3% MM	0.0% MM
09:00	Norway: Consumer Prices, Nov	0.1% MM, 2.4% YY	0.1% MM, 2.4% YY
	CPI-ATE, Nov	0.1% MM, 2.0% YY	0.2% MM, 1.9% YY
09:00	Italy: Industrial Production, Oct	-0.1% MM	0.2% MM
09:30	UK: Industrial Production, Oct	0.5% MM, 3.4% YY	0.9% MM, 2.2% YY
	Manufacturing Output, Oct	0.5% MM, 2.9% YY	1.2% MM, 0.8% YY
09:30	UK: Trade Balance – Goods & Services, Oct	£-2.7 Billion	£-3.3 Billion
10:00	Italy: GDP Details, 3Q	-0.1% QQ, -1.9% YY	-0.3% QQ, -2.1% YY
10:00	Greece: Industrial Production, Oct		
Wednesday 11 December		**Forecast**	**Last**
06:30	France: Nonfarm Payrolls, 3Q	-0.1% QQ, -0.7% YY	-0.2% QQ, -0.9% YY
07:00	Germany: HICP, Nov Final	0.2% MM, 1.6% YY	-0.3% MM, 1.2% YY
	National Consumer Prices, Nov Final	0.2% MM, 1.3% YY	-0.2% MM, 1.2% YY
07:45	France: Balance of Payments, Oct		
10:00	Greece: Unemployment Rate, Sep		
Thursday 12 December		**Forecast**	**Last**
07:45	France: HICP, Nov	0.1% MM, 0.9% YY	-0.1% MM, 0.7% YY
	Consumer Price Index, Nov	0.1% MM, 0.8% YY	-0.1% MM, 0.6% YY
	CPI Ex Tobacco Index, Nov	125.48	125.44
08:30	Switzerland: Swiss National Bank Monetary Policy Assessment		
08:30	Sweden: Consumer Prices, Nov	-0.1% MM, 0.1% YY	-0.2% MM, -0.1% YY
	CPIF, Nov	0.0% MM, 0.8% YY	-0.2% MM, 0.6% YY
08:30	Sweden: LFS Unemployment Rate, Nov	7.2% NSA, 7.9% SA	7.3% NSA, 7.9% SA
08:30	Netherlands: Retail Sales, Oct		
09:00	Euro Area: ECB Monthly Bulletin		
09:00	Italy: Consumer Prices, Nov Final		
10:00	Euro Area: Industrial Production, Oct	0.3% MM	-0.4% MM
11:00	Ireland: Consumer Prices, Nov		
	Slovenia: Result announced of Banks' Asset Quality Review and Stress Test		
Friday 13 December		**Forecast**	**Last**
08:00	Spain: HICP Final, Nov	0.3% YY	0.0% YY
08:15	Switzerland: Producer and Import Prices, Nov		
08:30	Netherlands: Trade Balance, Oct		
08:30	Sweden: Average House Prices, Nov		
09:30	Italy: General Government Debt, Oct		
09:30	UK: Construction Output, Oct		
10:00	Euro Area: Employment, 3Q		
11:00	Ireland: Goods Trade Balance, Oct		

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area			
Dec 12 10:00 London Time	***Industrial Production, Oct***	**Forecast: 0.3% MM**	**Prior: -0.4% MM**
	We project a small rebound for industrial activity in October, offsetting the September drop. Survey-based indicators like the PMI suggest a modest but yet positive growth rate for industrial output in 4Q, after a drop of 0.2% QQ in 3Q.		
Germany			
Dec 9 11:00 London Time	***Industrial Production, Oct***	**Forecast: 0.9% MM, 3.4% YY**	**Prior: -0.9% MM, 0.9% YY**
	We expect industrial production in Germany in October to reverse the decline in September. The YY growth rate would noticeable pick up as a result, but mostly due to base effects as last year's October reading was very weak. Survey indicators and incoming orders continue to suggest a positive trend for IP, even though it also remains volatile on a monthly basis.		
Dec 11 07:00 London Time	***HICP, Nov Final***	**Forecast: 0.2% MM, 1.6% YY**	**Prior: -0.3% MM, 1.2% YY**
	National Consumer Prices, Nov Final	**Forecast: 0.2% MM, 1.3% YY**	**Prior: 0.2% MM, 1.2% YY**
	We expect the final readings for German inflation in November to confirm the flash readings for both the national and the harmonised measures. In November, the HICP and the national version diverged due to base effects that are due to a change in the baskets used (mainly holiday accommodation and package holidays) that affected the national CPI and HICP differently. These base effects should work in the opposite direction in December and disappear thereafter.		
France			
Dec 9 07:30 London Time	***Bank of France Business Sentiment, Nov***	**Forecast: 98**	**Prior: 99**
	We expect a small one-point drop in business sentiment in November, ending the series of three successive upticks since July. Recent surveys of manufacturing sentiment have shown a downward bias lately, with the PMI down to a six-month low of 47.8 and the INSEE industrial confidence survey treading water. We doubt that confidence will be sufficiently elevated going into 2014 to generate much of an upswing in corporate investment, at a time when firms are still struggling with their profit margins.		
Dec 10 07:45 London Time	***Industrial Production, Oct***	**Forecast: 0.8% MM, 1.1% YY**	**Prior: -0.5% MM, -0.9% YY**
	Manufacturing Production, Oct	**Forecast: 1.0% MM, 1.1% YY**	**Prior: -0.7% MM, --1.6% YY**
	Capacity utilisation has risen by two points since the August lows and the order books assessment is improving according to the latest BdF surveys. With INSEE reporting a significant increase in the stock of finished goods, industrialists must have been ramping up production. Yet, manufacturing output has been disappointing in the past three months. As a result, we pencil in a significant bounce in output for October.		
Dec 11 06:30 London Time	***Non-Farm Payrolls, 3Q F***	**Forecast: -0.1% QQ, -0.7% YY**	**Prior: -0.2% QQ, -0.9% YY**
	Some 17K jobs were lost in 3Q, according to the flash estimate, and nearly 100K vs. 3Q-12. The adjustment has been particularly severe in the industrial sector (-16.5k and -59k, respectively), and in construction (-6k and -30k), highlighting problems of external competitiveness and early signs of a buyers' strike in property. With domestic demand showing signs of stabilising, and employment expectations rising towards their long-run average, we expect some gains in the service sector employment and look for net job creation for the first time since 2011.		
Dec 12 07:45 London Time	***CPI – EU Harmonised, Nov***	**Forecast: 0.1% MM, 0.9% YY**	**Prior: -0.1% MM, 0.7% YY**
	Consumer Price Index, Nov	**Forecast: 0.1% MM, 0.8% YY**	**Prior: -0.1% MM, 0.6% YY**
	CPI Ex Tobacco Index, Nov	**Forecast: 125.48**	**Prior: 125.44**
	Headline inflation is forecast to increase by two decimal points to 0.9% for the HICP measure and 0.8% for the national series. Core inflation is likely to have crept up to 1.1% for the national reading, driven by gains in services prices. Volatile components such as food and energy are likely to have contributed to the uptick, partly due to unfavourable base effects. The important event for French inflation will be in January 2014 when the VAT rate hike agreed as part of the 2012 budget will finally be introduced. We expect only limited pass-through to the CPI.		
Italy			
Dec 10 10:00 London Time	***Industrial Production, Oct***	**Forecast: -0.1% MM**	**Prior: 0.2% MM**
	With the manufacturing PMI still lingering at around 51 and other survey-based indicators below their long-run average, we think industrial output has little room to improve in 4Q 13, after falling by 0.9% QQ in 3Q (similar to 2Q). Weakness in October imports (-1.3% MM) also suggest industrial output remained weak in October. We expect some modest gains in Nov-Dec, to show only a small QQ rise in 4Q IP.		
Dec 10 10:00 London Time	***GDP, Q3 F***	**Forecast: -0.1% QQ; -1.9% YY**	**Prior: -0.3% QQ; -2.1% YY**
	In contrast with other peripheral countries, Italian GDP continued to contract in 3Q, albeit at a progressively slower pace than in previous quarters. Exports have failed to show much of a recovery so far, with goods export values flat in 3Q relative to 2Q and down by .8% YY. The decline in domestic demand has probably eased in 3Q, mainly, we think, due to a less restrictive fiscal policy. While we think a positive GDP print is still likely in 4Q, we do not expect an acceleration in GDP dynamic in 2014.		
Spain			
Dec 13 08:00 London Time	***HICP, Nov F***	**Forecast: 0.3% YY**	**Prior: 0.0% YY**
	According to the flash estimate, inflation bounced back slightly in November to 0.3% YY, above expectations (consensus 0.1%), after a reading of 0.0% YY in October, mainly explained by unfavourable base effects in the energy component. The breakdown details will likely show further easing in the rate of decline in the energy CPI, despite still falling fuel prices. We expect that still ample spare capacity and subdued commodity prices probably kept core inflation subdued in Nov (at around 0.3% YY). In addition, we expect the drop in fresh food prices of the past couple of months (after upward tensions during the summer) to have eased in Nov. We project inflation remaining very low also in 2014.		

Economic Indicators

Slovenia			
Dec 12	***Results of Bank Asset Quality Review (AQR) and Stress Test***		
London Time	Reuters reports that senior EU Commission 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 finance of €4.7bn for this purpose.		
Sweden			
Dec 10	***Industrial Production, Nov***	**Forecast: 0.3% M/M**	**Prior: 0.0% MM**
08:30			
London Time	The September production and order data confirmed the overall picture of ongoing weakness in the Swedish industrial sector, with limited near-term prospects of clear recovery, despite improving sentiment indicators (PMI). There are glimpses of light, though, as momentum appears to be improving, albeit very gradually; following a very weak first half of the year, activity in the sector was up 1.2% QQ in 3Q. However, the order intake remains on a downward trend. Ahead, the well above-50 PMI readings in recent months, including the well-above 50 readings for the orders as well as the production index, point to ongoing recovery in industrial production (the NIER survey also support such development). On balance, we expect the manufacturing sector to recover gradually ahead.		
Dec 12	***Consumer Price Index, Nov***	**Forecast: -0.1% MM; 0.1% YY**	**Prior: -0.2% MM; -0.1% YY**
08:30	***CPIF, Nov***	**Forecast: 0.0% MM; 0.8% YY**	**Prior: -0.2% MM; 0.6% YY**
London Time			
	With headline CPI in negative territory again and a modest 0.6% YY gain in core CPI (hence reversing upward tendencies during the summer), inflation pressures continue to look very subdued in Sweden. Modest wage growth, persistently falling import prices and ongoing SEK strength (from a historical perspective) suggest inflation will stay well below the 2% target also in the foreseeable future. This clearly highlights the Riksbank's dilemma of rising house price and accelerating credit growth vs. low inflation and capacity use. For comparisons, the Riksbank's October forecasts look for a 0.4% YY gain in CPI and a 1.1% YY gain in CPIF.		
Dec 12	***LFS Unemployment Rate, NSA, Nov***	**Forecast: 7.2%**	**Prior: 7.3%**
08:30	***LFS Unemployment Rate, SA, Nov***	**Forecast: 7.9%**	**Prior: 7.9%**
London Time			
	Unemployment is basically trending sideways (in seasonally-adjusted terms), while employment continues to increase. Given weak GDP growth in recent quarters, this is a bit of a surprise. Meanwhile, leading indicators suggest that the employment upturn could be ongoing. Developments on the labour market are somewhat stronger than the Riksbank's forecast (jobless rate spot on, but employment growth well above – 1.9% YY in Oct vs. 4Q forecast of 1.1% YY).		
Dec 13	***Average House Prices, Nov***		
08:30			
London Time	The housing market outlook has continued to strengthen gradually, driven by falling mortgage interest rates, higher income and rising share prices. Home prices have climbed by about 2.5% so far this year, and indications are that this trend likely will continue ahead; for sure, a combination of a low supply of homes, an improving labour market and rising income support such a development. Meanwhile, November has historically been a weak month in terms of house price increases and sales, and this year looks like no exemption; there are already signs that activity is slowing down with several brokers reporting significantly lower sales in November.		
Norway			
Dec 10	***Consumer Price Index, Nov***	**Forecast: 0.1% MM; 2.4% YY**	**Prior: 0.1% MM; 2.4% YY**
09:00	***CPI-ATE, Nov***	**Forecast: 0.1% MM; 2.0% YY**	**Prior: 0.2% MM; 1.9% YY**
London Time			
	Although inflation has undershot Norges Bank's forecast in recent months (of around 0.4-0.5pp), the data still strengthens the impression that core inflation is unlikely to return to the low levels seen during 2012 and the first half of 2013. Reflecting weaker-than-expected inflation, lower interest rate expectations abroad and a weaker economic outlook, Norges Bank lowered its conditional interest rate path at the December meeting, completely removing any probability of a rate hike next year (a weaker NOK acted partly as an offset). Initial tightening is now not seen until mid-2015, one year later than indicated in September.		
United Kingdom			
Dec 10	***Industrial Production, Oct***	**Forecast: 0.5% MM, 3.4% YY**	**Prior: 0.9% MM, 2.2% YY**
09:30	***Manufacturing Output, Oct***	**Forecast: 0.5% MM, 2.9% YY**	**Prior: 1.2% MM, 0.8% YY**
London Time			
	We expect another solid gain in industrial production and manufacturing output, consistent with recent business surveys. A figure in line with our forecast would leave the level of industrial production already 0.8% above the 3Q average, hence setting the stage for a solid gain in 4Q GDP.		
Dec 10	***Trade Balance – Goods & Services, Oct***	**Forecast: £-2.7 Billion**	**Prior: £-3.3 Billion**
09:30			
London Time	We expect the trade deficit to fall a bit after quite high readings in recent months, with exports picking up – consistent with recent business surveys. The trade deficit in Jan-Sep has fallen to £21.4bn this year from £26.2bn last year, but the 3Q data showed a sharp rise – and the deficit may not fall much in the year ahead given the strong upturn in domestic demand.		

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

Key Economic Indicators (16 December – 20 December 2013)

During The Week		**Forecast**	**Last**
07:00	Germany: Import Prices, Nov (by Dec 30)		
11:00	Ireland: GDP, 3Q (between 12-31 Dec)		
Monday 16 December		**Forecast**	**Last**
09:00	Norway: Trade Balance, Nov		
09:00	Italy: Trade Balance, Oct		
09:00	Euro Area: Flash PMIs, Dec		
10:00	Euro Area: Trade Balance, Oct		
11:00	UK: CBI Industrial Trends Survey, Dec		
Tuesday 17 December		**Forecast**	**Last**
07:00	EU-27: New Car Registrations, Nov		
08:00	Spain: Labour Costs, 3Q		
08:30	Sweden: Riksbank Monetary Policy Decision		
09:30	UK: Consumer Prices, Nov		
	Retail Prices, Nov		
09:30	UK: Producer Prices, Nov		
10:00	Euro Area: HICP, Nov Final		
10:00	Euro Area: Labour Cost Index, 3Q		
10:00	Germany: ZEW Economic Expectations, Dec		
Wednesday 18 December		**Forecast**	**Last**
07:00	Sweden: PES Unemployment Rate, Nov	4.5%	4.5%
08:00	Sweden: Business & Consumer Surveys, Dec		
09:00	Germany: ifo Business Climate, Dec		
09:30	UK: LFS Unemployment, Aug-Oct		
	Claimant Count Unemployment, Nov		
09:30	UK: MPC Minutes		
10:00	Euro Area: Construction Output, Oct		
10:00	Italy: Current Account Balance, Oct		
11:00	UK: CBI Reported Sales, Dec		
19:00	US: FOMC outcome		
Thursday 19 December		**Forecast**	**Last**
06:45	Switzerland: SECO Economic Forecasts, Dec		
08:30	Netherlands: Consumer Confidence, Dec		
08:30	Netherlands: Unemployment, Nov		
09:00	Euro Area: Balance of Payments, Oct		
09:00	Italy: Contractual Wages, Nov		
09:30	UK: Retail Sales Volumes, Nov		
10:00	Greece: Unemployment Rate, 3Q		
14:00	Belgium: Consumer Confidence, Dec		
Friday 20 December		**Forecast**	**Last**
00:01	UK: GfK Consumer Confidence, Dec		
07:00	Germany: GfK Consumer Confidence, Jan		
07:00	Germany: Producer Prices, Nov		
07:45	France: Industrial Confidence, Dec		
08:00	Denmark: GDP, 3Q Details		
08:30	Sweden: Producer Prices, Nov		
08:30	Netherlands: Consumer Spending, Oct		
09:00	Norway: Unemployment Rate, Dec		
09:30	UK: Public Sector Net Borrowing (Ex RM, APF & Fin. Intervention), Nov		
09:30	UK: Balance of Payments, 3Q		
09:30	UK: GDP Details, 3Q (3rd Release)		
09:30	UK: Service Sector Output, Oct		
10:00	Italy: Retail Sales, Oct		
10:00	Greece: Current Account, Oct		
15:00	Euro Area: Consumer Confidence, Dec Flash		

Sources: National statistical offices, central banks and Citi Research

Title	Author	Date
Euro Area – Sovereign Debt Crisis Update		
'Secret' Meeting on Bank Resolution in Berlin Today	European Economics Team	Dec 6, 2013
Spain – Moody's Revises Rating Outlook to Stable	European Economics Team	Dec 5, 2013
EC Calls for More Budget Cuts in Italy	European Economics Team	Dec 4, 2013
ECB Methodology for Bank Supervision – Details by End-Jan, says Constancio	European Economics Team	Dec 3, 2013
Moody's Upgrades Greece One Notch to Caa3	European Economics Team	Dec 2, 2013
Euro Area		
ECB - Ready to Act, But Likely Conditional on Lower Inflation Path	Guillaume Menuet	Dec 5, 2013
European Economic Forecast Highlights - December 2013	Ann O'Kelly	Dec 5, 2013
ECB - Seen on Hold in December, but More Easing Likely in 2014	Guillaume Menuet	Nov 28, 2013
Germany - What if Grand Coalition negotiations fail?	Ebrahim Rahbari	Nov 25, 2013
ECB - Aiming for Low Real Rates	Guillaume Menuet	Nov 7, 2013
ECB Preview - Expect Dovish Tone, Leaving Door Open to a Cut in December	Guillaume Menuet	Nov 5, 2013
Euro Area - ECB AQR: More Detail, but not on Public Backstop	Ebrahim Rahbari	Oct 23, 2013
Euro Area - Under No Pressure to Act, ECB Stays Put and Gives Little Away	Guillaume Menuet	Oct 2, 2013
European Economic Forecast Highlights - October 2013	Ann O'Kelly	Sep 27, 2013
German Elections Outcome - Big Merkel Win, Grand Coalition Government Most Likely	Ebrahim Rahbari et al	Sep 23, 2013
German elections - Four More Years – A Multi-Asset View	Ebrahim Rahbari et al	Sep 12, 2013
Euro Area - ECB Reiterates Forward Guidance, with Some Dovish Hints	Giada Giani	Sep 5, 2013
Euro Economics Weekly		
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
Will the ECB's Comprehensive Assessment of Banks be the Euro Area's TARP Moment?	Ebrahim Rahbari	Oct 11, 2013
Italy – Political and Banking Fragility	Giada Giani	Oct 4, 2013
New ECB LTRO? Not Like Waiting for Godot	Guillaume Menuet	Sep 27, 2013
Housing Not Yet Turning Around	Ebrahim Rahbari	Sep 20, 2013
Loan Dynamics: Renaissance by Year-End	Guillaume Menuet	Sep 13, 2013
Germany — Four More Years	Ebrahim Rahbari	Sep 6, 2013
Chief Economist Publications		
Global Economic Outlook and Strategy - Prospects for Economies and Financial Markets in 2014 and Beyond	Willem Buiter	Dec 2, 2013
Scandi		
Norges Bank Postpones Initial Tightening a Year (to Mid-2015)	Tina Mortensen	Dec 6, 2013
Denmark - An Update on the Experience with Negative Interest Rates	Tina Mortensen	Dec 2, 2013
UK		
UK - Autumn Statement: Steady as She Goes	Michael Saunders	Dec 5, 2013
UK - Services PMI Still Points to Strong Growth	Michael Saunders	Dec 4, 2013
UK - YouGov Report Inflation Expectations Edge Down	Michael Saunders	Dec 2, 2013
UK - PMI and FLS Data	Michael Saunders	Dec 2, 2013
UK - FLS Support For Mortgages Scaled Back	Michael Saunders	Nov 28 2013
UK - Solid Growth in Consumption and Investment	Michael Saunders	Nov 27 2013
UK - Strong CBI Survey	Michael Saunders	Nov 21 2013
UK - Fiscal Deficit On Course For Large Undershoot	Michael Saunders	Nov 21 2013
UK Economics Weekly		
Policy Post-Guidance	Michael Saunders	Nov 29, 2013
Will Weak Investment Scupper the Recovery?	Michael Saunders	Nov 22, 2013
The Recovery and Unemployment	Michael Saunders	Nov 15, 2013
The Opposite of Stagflation	Michael Saunders	Nov 8, 2013
UK Economics Weekly - Leaders and Laggards in the Recovery	Michael Saunders	Nov 1, 2013
Growth Dividend For The Public Finances	Michael Saunders	Oct 25, 2013

Source: Citi Research

Appendix A-1

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