ECB's Praet and Makúch Offer Strong Hints About QE

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10 December 2014

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With thanks to Ann O'Kelly

Economics

Western Europe

Industrialised G7 Countries

Summary

ECB's Praet: gives strong hints of upcoming government bond QE, warns that the ECB must be "*particularly vigilant*" over the effect of oil prices on inflation. He confirmed that "*ECB lawyers, risk managers are working on stimulus tools*". Interestingly, Bloomberg reported that Mr. Praet had indicated that "*European institutions will have to take some risk*". On legal issues, Reuters reported that Mr. Praet said deliberations over including government bonds in a broader asset purchase programme "*will not be influenced by the case challenging the OMT*".

ECB's Makúch: overwhelming majority of governors supported QE – saying that *when the expectations change in a negative way, and they changed for inflation and GDP, the probability of such [non-standard] measures grows*".

EU: agrees on contributions to Single Resolution Fund (SRF), with French and German banks contributing €15bn each.

Greece: **PM aims to restore political stability by bringing presidential election forward.**

Greece: PM nominates Stavros Dimas as candidate for President. For more discussion, see *Greece: Snap Presidential Elections Highlight Political Uncertainty in Wake of Troika Decision To Extend Bailout.*

EU Economics Commissioner Moscovici: ways to go forward whatever the outcome of the Greek presidential election.

Germany: Chancellor pledges to create financial room for manoeuvre to limit inflation-induced tax rises, but sticks to balanced budget goal.

France: "Law on Growth and Activity" to be presented to cabinet today.

French IP and employment data disappoint.

Italy: IMF's Lagarde highlights three areas where more progress is needed.

Italy's EconMin Padoan says breaching of 3%-of GDP-deficit threshold won't create growth.

Italy: banks reduce central bank borrowing in November, by €2.6bn MM (1.5%) to €175bn (or 4.4% of banks' assets). Target2 liabilities rose by €13.5bn (7.4% MM) in November.

Spain: Government presents €53bn worth of projects under the Juncker investment plan, according to daily *El Pais*.

Portugal: real GDP growth may exceed 2% in 2015, says EconMin Antonio Pires de Lima, above the government forecast of 1.5%, Bloomberg reports.

Recent Research

Sweden — Long-term Inflation Expectations Drift Lower in December

10 December 2014

According to the quarterly survey among all market participants, Swedish inflation expectations slipped further on all horizons in December. Most noteworthy, long-term inflation expectations slipped 0.1pp to 1.72%, the lowest reading since 2Q 1999 and also widening the gap versus the 2% inflation target. This will clearly prove a concern for the Riksbank – recall that low actual inflation and falling inflation expectations from already depressed levels were key drivers behind the recent repo rate cuts. Today's outcome is an important element supporting the case for additional monetary easing. With the policy rate now at zero, the Riksbank has effectively used up its options for conventional monetary policy easing. We expect that the Riksbank's first options for further stimulus (if needed) would be forward guidance (with a 1.5%

Today's News in Detail

ECB Praet: gives strong hints of upcoming government bond QE – ECB chief economist Pieter Praet indicated in a speech in Washington on Tuesday that the "*Euro area cannot eliminate the job market slack before 2018*" and warned about the economy "*settling in a slow growth regime*". He again warned that the ECB must be "*particularly vigilant*" over the effect of oil prices on inflation. He confirmed that "*ECB lawyers, risk managers are working on stimulus tools*". Interestingly, Bloomberg reported that Mr. Praet had indicated that "*European institutions will have to take some risk*". Mr. Praet also noted that while the market was skeptical over the ECB's capacity for stimulus, the GC had "*calculated it needs the balance sheet back at 2012 levels to meet its price stability mandate*" and that it *"will do what is necessary*" to meet its mandate of price stability. Mr. Praet also highlighted the benefits of buying government bonds, ranging from a strong signaling effect, to broader portfolio effects and an inflation expectations effect. Finally on legal issues, Reuters reported that Mr. Praet said deliberations over the decision to include government bonds in a broader asset purchase programme "*will not be influenced by the case challenging the OMT*". Comment: more attention is now being directed to persistence of low core inflation and the probable absence of any meaningful wage spiral in coming years. We think that the remark about some risk taking is interesting, signaling that the need to improve monetary policy transmission supersedes considerations about balance sheet protection (buying at negative yields or taking on selected credit risk).

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ECB's Makúch: overwhelming majority of governors supported QE – Slovakia's central bank governor Jozef Makúch said on Tuesday that "*regarding the Governing Council vote [last week], I will repeat what has been said, that the overwhelming majority of governors supported the QE*". Mr. Makúch also remarked that "*always, when the expectations change in a negative way, and they changed for inflation and GDP, the probability of such [non-standard] measures grows*". Comment: Mr. Makúch is arguing that the very sizeable downward revision in both real GDP growth and inflation in both 2015 (-1.0pp combined) and 2016 (-0.5pp) effectively crystallises the need for additional policy action. And if one were to add the impact of the fall in oil prices to the baseline, the drop in inflation reading would exceed the increase in real GDP from the potential increase in disposable income.

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EU agrees on contributions to single resolution fund (SRF) – The *Financial Times* reports that EU finance ministers on Tuesday agreed on the contributions to the Eurozone's Single Resolution Fund (SRF). The SRF is to be built up to €55bn over eight years. According to the agreement, German and French banks will contribute €15bn each (compared to a previous proposal under which French banks would have paid €2bn more than German banks). The final agreement also includes more exceptions for medium-sized banks and allows up to 30 per cent of the contributions to be met through funding pledges backed by collateral, rather than cash. However, the agreement would still imply that the Fund will have 70 percent of its resources available in cash.

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Greece: PM aims to restore political stability by bringing presidential election forward – The *Financial Times* reports that the Greek PM Samaras said in a brief television appearance, that he decided to bring forward the presidential election to restore political stability, noting that "*the presidential vote had become*

CPIF threshold), coupled with a cut in the repo rate to -25bp in the next five-six months. This is our base case.

Tina Mortensen

Euro Area — Greece: Snap Presidential Elections Highlight Political Uncertainty in Wake of Troika Decision To Extend Bailout*

9 December 2014

Greek PM Samaras called an early Presidential election for December 17 in the wake of likely bailout extension by two months until end-February. The final round of a potential three-stage presidential vote would take place on Dec 29. The current coalition government has the support of 155 MPs, 25 short of the majority needed to elect a new president. If the current parliament fails to elect a new President, early parliamentary elections will be triggered, probably in the 2nd half of January. An average of recent polling trends suggest that far-left Syriza would win parliamentary elections, even though perhaps without a majority in parliament. A potential follow-up bailout programme is to be negotiated by mid-February, and its conclusion could therefore depend on the outcome of a potential parliamentary election. However, the new developments highlight major political uncertainties in Greece that were already there in any case rather than raising them.

Ebrahim Rahbari | Tina M Fordham

UK — UK Production, Interest Rate and Mortgage Data

9 December 2014

The ONS report that manufacturing output fell 0.7% MM in October. We note, however, that these data are often volatile and also are often revised. Business surveys (which are not so weak) often give a better real-time guide to the underlying trend in output growth than the ONS data. Second, the BoE reports that key household fixed mortgage rates fell to new record lows in November. The sharp recent drop in mortgage rates, plus the boost to real incomes from lower oil prices, probably will give a powerful further stimulus to the economy in coming months. Third,

an excuse for blackmail over early elections" and adding that "*even though we have stabilised the economy and have finally returned to growth, clouds have gathered in Greece over political stability and there is uncertainty abroad about Greece's prospects*".

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Greece: PM nominates Stavros Dimas as candidate for President – Bloomberg reports that Greek PM Samaras nominated Stavros Dimas as presidential candidate in the election taking place on December 17. Dimas, who is 73 years old, is a former Greek Foreign Minister (from November 2011 until May 2012) and EU Commissioner and currently a vice president of the New Democracy party of PM Samaras. The government has 155 MPs currently and at least 180 are needed to elect a new President. According to the article, the government's best chances may lie in trying to convince some members of the Independent Greeks Party or independents in the Greek parliament (some of whom are conservatives) to support the presidential candidate. Panos Kammenos, leader of Independent Greeks, has said that his party will not support any candidate for the presidency, but last week one MP left the Independent Greeks caucus, reportedly based on a disagreement on whether he could support a presidential candidate. For more discussion, see ***Greece: Snap Presidential Elections Highlight Political Uncertainty in Wake of Troika Decision To Extend Bailout.***

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EU's Moscovici: ways to go forward whatever the outcome of the Greek presidential election – Bloomberg reports that the EU Commissioner for Economic and Financial Affairs Moscovici said in Brussels on Tuesday that "*whatever the decision of the Greek Parliament, there are ways to go forward*", adding that Prime Minister Samaras appears to know where he is going with his decision to speed up the parliament's election of the next Greek president. Responding to press questions, Moscovici expressed some surprise at the market reaction, saying that "*the markets should feel more secure compared to their reaction today*" but also noting that "*the markets are always very sensitive to political uncertainty*". Moscovici said that the EU is following the situation carefully and that it appreciates the huge efforts the government of Greece has made to strengthen and improve the economy.

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Germany: Chancellor pledges to create financial room for manoeuvre to limit inflation-induced tax rises – The *Financial Times* reports that German Chancellor Merkel in a speech to the annual party conference of her CDU party pledged to create "*financial room to manoeuvre*" to ease the effects of so-called 'cold progression', when inflation pulls taxpayers into higher tax brackets. Reducing the effects of the 'cold progression' has been a long-standing demand of the economic wing of her party. However, Merkel's pledge came a day after she refused to commit to a timetable for tax reductions and she also noted that any action would be contingent on still being able to balance the budget. Regarding the planned balanced budget for 2015, Merkel said that "*we have stopped living on credit. We are thinking of our children and grandchildren [who would otherwise have bigger debts]*". Merkel also said that the EU's Stability and Growth Pact are not an expression of "*German fussiness*" but of concern for "*credibility*". After her speech, Merkel was elected party leader for the eighth time, with 96.7% of the vote (in 2012, she had 97.9% cent of the vote).

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France: "Law on Growth and Activity" to be presented to cabinet today.– Economic Minister Emmanuel Macron is scheduled to present a reform bill to the cabinet today, allowing shops to open more often on Sundays, to resolve disputes over redundancies more quickly and deregulate closed professions and

the PRA report that the share of new mortgage loans with high LTVs and high income multiples fell slightly in Q3. The signs that macroprudential policy is biting are likely to lessen any pressure on the MPC to use tighter monetary policy to rein in the riskier parts of lending.

Michael Saunders

Norway — Norges Bank Forecast: Stable Interest Rate, Lower Rate Path

8 December 2014

At the 11-Dec monetary policy meeting, we expect Norges Bank to keep the key policy rate stable at 1.50%, as indicated in the September conditional interest rate path (signals nil probability of a rate cut). However, as Norges Bank historically has been cautious in periods of heightened uncertainty, we expect the Bank to retake a dovish bias by lowering its interest rate path slightly, hence, opening the door for near-term easing in case downside risks to economic growth materialize. Ahead, our base case is for an unchanged key policy rate throughout 2015, but with the uncertain outlook for the global economy and Norwegian oil investments (with the plunge in oil prices increasing downside risks), a rate cut next year cannot be ruled out. For comparison, market pricing discounts more than a 50% probability of a rate cut before year-end, and sees a 50bp lower sight deposit rate by mid-2015.

Tina Mortensen

UK — BoE Article On Household Balance Sheets

8 December 2014

The latest BoE Quarterly Bulletin contains a regular annual survey of household balance sheets, carried out for the BoE by NMG Consulting, and based on a survey of 6,000 households. There are several points of interest. First, fewer households are worried about housing costs and debt levels. Second, households' decisions to borrow do not seem to be based on overly optimistic assessments of the interest rate outlook – or at least, no more optimistic than markets. Third, the BoE report that fewer households than a

cut red tape for construction. The objective is to "*remove the locks that burden our economy*" said Mr. Macron according to Reuters. Comment: despite a significant degree of popular support for this law, the government will likely be challenged in parliament by some of the left wing MPs in our view. We believe, passing the legislation without meaningful changes will be crucial in order to demonstrate the government's ability to reform and obtain a few more years (to 2017) to bring the budget deficit below the 3% of GDP.

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French IP and employment data disappoint: data released by INSEE showed that industrial production contracted by 0.8% MM in October (-1.0% YY), implying a 0.8% drop compared to the Q3 average. Final salaried employment figures were revised down, showing that some 55,200 jobs were lost in the third quarter instead of the 34,100 preliminary estimate. Non-farm private sector payrolls declined by 0.6% YY, the worst reading for four quarters. Jobs losses accelerated in the construction sector, industry and services. Comment: These latest employment statistics highlight the need for further loosening of regulations and labour laws in France.

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Italy: IMF's Lagarde highlights three areas where more progress is needed – IMF Managing Director Christine Lagarde highlighted three key weakness that the Italy government should address to achieve GDP growth and reduce unemployment, in a speech at Milan's Bocconi University on Tuesday. Mrs. Lagarde stressed that reducing "*the labour tax wedge in Italy to the average European level could lower youth unemployment by some four to eight percentage points*", noted that the inefficient judicial system remained "*a major factor behind Italy's weak business environment*" and called for "*insolvency regimes*" to help businesses, households and banks clean up their balance sheets. Reuters also reported that she had welcomed the ECB's pledge to purchase euro zone sovereign assets if needed.

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Italy: breaching the 3%-of-GDP threshold for the fiscal deficit won't create growth, EconMin Pier Carlo Padoan said on Tuesday, as *"it would produce a negative reaction on the [money] markets and reverse the trend on the [cost of servicing] the debt and that would come at a cost we cannot afford",* daily Ansa reports. Mr Padoan added that economic growth is the only way to bring down Italy's public debt, which can only be achieved by a combination of structural reforms that attack obstacles, stimulation of private investment and continued budget consolidation in a growth-friendly way. Comment: we expect the government deficit to remain at the 3%-of-GDP threshold in 2015, exceeding the budget target of 2.6% of GDP.

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Italy: banks reduce central bank borrowing in November – Bank of Italy data showed that loans to Italian banks related to monetary policy operations fell by €2.6bn MM (1.5%) in November, to €175bn (or 4.4% of banks' assets), and after rising by 2% MM and 6% MM in October and September, respectively. On an annual basis, Italian banks have reduced central bank borrowing by 23.2%. In addition, the data showed Target2 liabilities rising by €13.5bn (7.4% MM) in November, after falling by €15.5bn MM in October.

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Spain: government presents €53bn worth of projects under Juncker plan – Daily *El Pais* reports the Spanish government presented projects amounting to €53bn to the European Fund for Strategic Investments (EFSI). The amount is slightly below the €60bn figure cited by EconMin Luis de Guindos earlier this week. Mr. De Guindos noted that Spain was ready to help with expanding the plan's budget, but the government requires further details in terms of who will

year ago would have to take some action to improve their finances if interest rates rise. We agree with this general message that household balance sheets are not highly fragile. .

Michael Saunders

Euro Economics Weekly — The Eurozone Investment Collapse And The Juncker Plan

5 December 2014

Eurozone investment trends are very weak and the outlook for Eurozone investment remains subdued. Investment weakness is probably both suffering from, as well as contributing to, poor overall growth prospects in the Eurozone. The EU's planned investment Offensive or 'Juncker plan' promises to boost Eurozone investment incrementally by cumulatively at least €315bn in 2015-17. In our view, this target seems very ambitious, as the public funding component is small and the appetite for private investors to finance the incremental funding needs uncertain. However, there is an intriguing possibility that additional national contributions to the EFSI could be a 'backdoor' route to modest fiscal easing in the Eurozone, which could address the plan's shortcomings of a lack of capital and the possibility of crowding out private investments.

Ebrahim Rahbari | Guillaume Menuet | Michael Saunders | Antonio Montilla | Ann O'Kelly

UK Economics Weekly — What Does The Oil Price Plunge Mean for the UK?

5 December 2014

We calculate that the drop in oil prices from the 2013 average level will cut the aggregate fuel bill (ex-taxes) of households and consumers by about £14bn (0.8% of GDP) per year. Roughly £4½bn of this will come through directly to consumers via lower prices for petrol and diesel transport fuel, £6bn will come through indirectly to households and businesses via lower costs for transport services (notably air travel, sea travel and freight) with the remaining feeding through via lower industry costs (including the wider use of oil for non-energy purposes). CPI inflation is likely

manage the fund and who will determine priorities. In addition, Mr. De Guindos noted that investments should not count towards fiscal deficits under the Excessive Deficit Procedure (EDP). According to *El Pais*, up to €25b of the total amount requested will be assigned for the energy sector.

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Portugal: real GDP growth may exceed 2% in 2015, says EconMin Antonio Pires de Lima, above the government forecast of 1.5%, Bloomberg reports. The EconMin argued that lower oil prices (e.g. 20% below the €96.7 a barrel estimated in the 2015 budget) will have a positive impact to the economy, noting that Portugal's trade account and capital account could have a surplus of 4% of GDP instead of 2%. The EconMin added that a lower currency will also boost exports more than previously anticipated, while further ECB stimulus will keep interest rates low.

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Latest Issues of Sovereign Debt Update

Greek PM Calls Presidential Election for December 17

9 December 2014

Greek PM calls snap presidential election. Eurogroup approves 2-month extension for Greece. ECB's weekly asset purchases. Coeuré says dissent at ECB meeting on communication, not on stance. Nowotny says GC focusing on govt bonds QE. Dijsselbloem on incentives for structural reform. Merkel rules out cooperation with euro-sceptic AfD. Eurogroup on 2015 French budget. Spain: house prices, bank plans for TLTRO. Dutch CB lowers GDP forecast. Portugal's economic conditions improving - Dijsselbloem.

Ebrahim Rahbari | Guillaume Menuet | Antonio Montilla

ECB QE Programme Could Exceed €1tn

8 December 2014

ECB QE programme could exceed €1tn. ECB: Nowotny says QE decision in 1Q15, Weidmann says monetary policy too expansive for Germany, Coene concerned over lasting low inflation, Visco warns that current oil prices may lead to negative CPI. Merkel urges Germany and France to do more. French PM Valls urges voters to back reforms. S&P lowers Italy's rating. Spain's fiscal watchdog asks for sanctions on some regions. Rajoy says Spain's growth could exceed 2%. Greek parliament adopts 2015 budget bill.

Guillaume Menuet | Antonio Montilla | Ebrahim Rahbari

ECB Strengthens Dovish Tone Despite Lack of Unanimity

5 December 2014

ECB's dovish statement sends strong signal of action in early 2015. ECB sources suggest at least two executive board members opposed language change. EC considers shelving planned bank reform. BaFin head as Chair of new Single Resolution Board? German factory orders stronger than expected. France: Hollande's popularity creeps up. Renzi and Merkel likely to meet in Jan. Spain's IP falls in Oct. Belgian trade unions to strike over austerity plans. Greek govt wants only short extension of bailout.

Guillaume Menuet | Ebrahim Rahbari | Antonio Montilla

ECB to Modify Language to Cement Expectation of Action in Q1

4 December 2014

ECB language change expected at today's meeting to cement expectations of more action. EA Nov final composite PMI revised down, while Oct retail sales rise 0.4% MM. Germany's junior coalition party SPD to put EU-Canada trade deal to below 1% YoY in the December data. The mix of cheaper oil and cheap money is likely to ensure that GDP growth again overshoots consensus in 2015, fuelled by strength in household real incomes, consumer spending and business investment .

Michael Saunders | Ann O'Kelly

Euro Area — See You In January Says Draghi, Downplaying Lack Of Unanimity

4 December 2014

Dovish statement as expected — the Governing Council (GC) decided to introduce some of the language used by President Draghi in previous speeches (size, pace, composition), with a stronger language also used about balance sheet expansion objectives Much lower GDP & inflation trajectory in 2015-16 — the proxy for 2-year-ahead nominal GDP growth (real GDP+ HICP) fell to 1.7% (lowest since Sep-09) and the 3-year-ahead projection was lowered to 2.8%, 50bp below its average in the last three rounds Oil price vigilance to avoid unwarranted tightening — the GC indicates that "we will be particularly vigilant as regards the broader impact of recent oil price developments on medium-term inflation trends" Legality of achieving mandate trumps unanimity — Mr. Draghi remarked that "not pursuing its price stability mandate would be illegal". We continue to believe that the GC will announce a QE programme at its next monetary policy meeting on Jan 22

Guillaume Menuet

Norway — Investment Survey Implies Drop in Oil Investments in 2015, But Estimate Revised Up

4 December 2014

Following strong annual gains in previous years, Statistics Norway's 4Q 2014 investment survey suggests the growth pace of oil investment activity looks set to moderate quite a bit ahead. For 2014, investment is seen at NOK 218.6bn (down 8.7bn vs. Sep-estimate). While setting a near-record high in nominal terms, the 2014 estimate still implies moderating growth (expected level is "only" 4.6% above the actual 2013 outcome). The 3rd estimate for

party vote in 2015. French FinMin details €3.6bn savings for 2015 budget. Italy's Senate adopts Jobs Act. Spain's consumer confidence falls in Nov. Unnamed EU official says Greece may get technical extension of bailout.

Ebrahim Rahbari | Guillaume Menuet | Antonio Montilla

Franco-German Ministers' Meeting Yields No New Measures

3 December 2014

Little that is new after Berlin meeting of French and German Finance and Economy Ministers. Bundesbank's Weidmann says oil-price drop amounts to mini-stimulus programme. German EconMin Gabriel says EA does not need short-term stimulus. French govt would suffer extreme defeat if election held today - CSA poll. Renzi says new electoral law could come into force from 2016. Spain's services PMI fall sharply. Greek PM Samaras calls on Greeks to ignore Syriza.

Ebrahim Rahbari | Guillaume Menuet | Antonio Montilla

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Macroeconomic Forecasts

European Economic Forecast Highlights, December 2014

3 December 2014

This companion to the December issue of Global Economic Outlook and Strategy - Prospects for Economies and Financial Markets in 2015 and Beyond gives more detailed forecasts for the main European countries to 4Q16. Figures 21-22 give annual forecasts to 2018 for growth, inflation, current balance, fiscal balance, primary balance and government debt and Figure 23 shows the change in forecasts from last month. Figure 24 shows forecast unemployment to 2019, and Figures 25-27 compare our forecasts with those of other institutions.

Ann O'Kelly | Michael Saunders | Guillaume Menuet | Ebrahim Rahbari | Tina Mortensen

Europe — Europe: Monthly Inflation Profiles for Selected Countries

2 December 2014

Updated monthly inflation forecasts for Euro Area, Germany, France, Italy, Spain, UK, Sweden and Switzerland.

Ann O'Kelly | Michael Saunders | Guillaume Menuet | Ebrahim Rahbari | Tina Mortensen

Global Economic Forecasts — December 2014

3 December 2014

This file shows summary forecasts as published in Citi's Global Economic Outlook and Strategy

Michael Saunders

Global Economic Outlook and Strategy — Prospects for Economies and Financial Markets in 2015 and Beyond

1 December 2014

In this "Prospects" edition, Citi's research team presents updated forecasts for economies, interest rates, FX rates, commodity prices and sovereign ratings around the world for 2015 and beyond. Overview essays discuss the drift into secular stagnation, whether globalization is stalling, political issues for 2015, emerging market strains, advanced economy "low-flation" and long-run projections for the size of major economies. We are cutting 0.1 percent off our global growth forecast for 2015 and 0.2 percent off for 2016, and expect only a modest pickup in global growth in 2015, led by advanced economies. Major monetary policy divergence is likely, with QE by the ECB and BoJ, widespread near-term monetary easing across emerging markets, but (in late-2015)

expected oil investment for 2015 implies a substantial decline, albeit slightly more moderate than suggested in September; investment costs are estimated at NOK 188.6bn next year (NOK 3.3bn up vs. Sep-estimate), equivalent to a 13.7% decline (in nominal terms) versus the estimated 2014 outcome. On the monetary policy outlook, today's report should, in isolation, be broadly neutral. With the very weak NOK, we expect NB will appear dovish at next week's monetary policy meeting, but refrain from cutting interest rates.

Tina Mortensen

UK — Autumn Statement

3 December 2014

The Chancellor admitted that this year's deficit is overshooting. The independent OBR believe that this deficit overrun is temporary, hence reinforcing the Chancellor's political inclination to avoid nearterm restraint. Third, the specific AS measures are aimed at providing stimulus where possible and limiting fiscal headwinds, while appeasing voters. We expect the Stamp Duty reforms will be highly popular with voters overall. The key losers will be a narrowly-based group that do not have many votes: banks, multinationals and people buying houses of price above £950,000. Fourth, we expect that GDP growth will overshoot the OBR's forecast in 2015 but that the deficit will probably overshoot slightly. Fifth, the UK's medium-term fiscal outlook remains very uncertain, given the likelihood that the 2015 election creates a doubly hung parliament and hence ushers in a multi-party coalition or minority government.

Michael Saunders

Scandi Economics Update — Will Inflation Expectations Fall in the Swedish Prospera Survey?

10 December 2014

Sweden — Long-term inflation expectations are very important for the Riksbank. According to the latest Prospera survey, inflation expectation stood at 1.8% on a 5-year horizon. The risk is that today's survey will show lower inflation expectations in line with the latest development in NIER inflation

tightening by the Fed and BoE. We forecast further major USD appreciation, breaching €1.10/$ and ¥125/$ in 2015, with levels of €1.00/$ and ¥135/$ likely over the next 2-3 years.

Willem Buiter | Guillermo Mondino | Michael Saunders

Emerging Markets Macro and Strategy Outlook — Prospects For 2015 And Beyond

1 December 2014

EM's prospects in 2015 will be governed by familiar themes: i) China's slowdown and its consequences; ii) the impact of falling commodity prices; and iii) the prospect of US monetary tightening. EM will face a challenging, though not insurmountable, year. After all, returns from (and flows into) EM were positive in 2014 in spite of a wide set of challenges. Weaker commodity prices in EM the last few quarters have had a notable effect on macroeconomic performance across the group of EM commodity exporters; so it is now possible to argue that a principal dividing line in EM is between manufacturing-based economies and commodity-based ones. On balance we expect EM spreads to widen by 15bp next year but with significant volatility, and with particular difficulty for quasi-sovereigns. In local markets, our themes are broadly negative on EMFX and more constructive on duration.

Guillermo Mondino

Foreign Exchange Forecasts — EUR/USD Parity Breach – November 2014

21 November 2014

The multi-year USD rally looks set to have legs as divergence in economic performance and monetary policies continues. We see 10-20% more USD upside vs. G10 currencies over the next couple of years. EUR/USD should find support in the low 1.20s short term but cut through, like a hot knife in butter, medium to long term. We expect parity to be approached and maybe breached over two years. BoJ QE acceleration announced on 31 October surprised the market and pushed USD/JPY sharply higher. We may get near term consolidation sometime given how overbought the USD is. But portfolio rebalancing and ongoing money base expansion should push USD/JPY towards 125-135 longer term. EM currencies are likely more protected by carry and lack of local quantitative easing. We expect USD gains of 5-6% vs. EM over 6-12m.

Jeremy Hale

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expectations (out at 7.00 UK time).

Sweden — Foreign minister Wallström yesterday said that she can envisage the SocDem cooperating with other parties than the Greens.

Sweden — The FSA publishes its semi-annual Financial Stability Report. In its June report, it concluded that the financial system was resilient, but banks' dependence on market funding and high household debt continued to be two major risks.

Norway — In November, we look for core inflation to tick 0.1pp lower to 2.4% YY (out at 9.00 UK time). With a new Monetary Policy Report out tomorrow, today's inflation data will not influence the new conditional interest rate path.

Tina Mortensen

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Appendix A-1

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