Citi Research
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Western Europe

Euro Economics Weekly

New ECB LTRO? Not Like Waiting for Godot

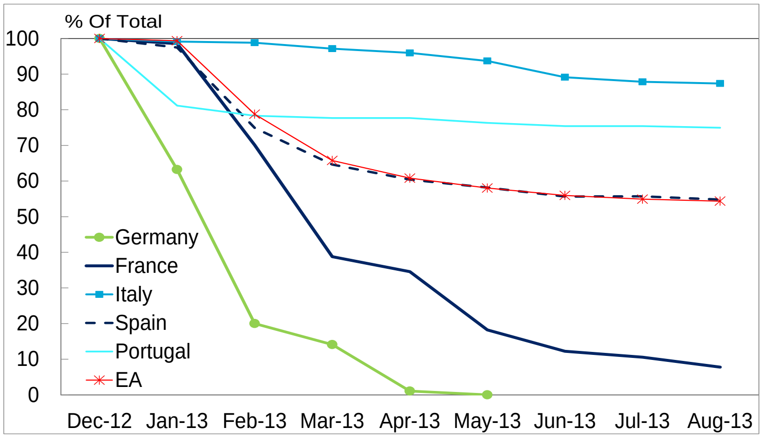
- Despite some suggestions that the ECB is not yet willing to commit to offering another LTRO, we believe that the case is compelling enough to expect some announcement over the next 3 to 6 months, possibly as early as December. In our view, the only issues that still need to be resolved by the Governing Council are the exact timing and length of the facility as well as its interest rate characteristics.
- A two-year facility seems the most likely option, not only because it would coincide with the supposed length of ECB forward guidance, but also as it should bridge the Feb-15 second LTRO expiry and cover the 12-month bank recapitalization window that will follow the ECB's AQR and EBA stress tests results in 3Q-14.
- We review recent developments since the September Governing Council meeting and argue that the ECB is under no pressure to alter its very accommodative monetary policy stance at the October 3 meeting. With inflation pressures contained, a slow recovery and negative private sector credit dynamics, we expect the refi rate to remain stable at 0.5% until the end of 2016.

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
4Q 13	1.37	0.50	1.80	0.83	0.50	102	8.68	1.00	7.77	1.50	1.25	0.00	-85
2Q 14	1.36	0.50	1.80	0.82	0.50	127	8.85	1.00	7.70	1.50	1.25	0.00	-77

Source: Citi Research

Figure 2. Remaining 3-year LTRO Funds As Percentage of Initial Take-Up, Dec-12 to Aug-13



Sources European Central Bank, National Central Banks and Citi Research

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LTRO: Now You See It, Now You Don't

The ECB is under no pressure to alter its very accommodative monetary policy stance

We review recent developments since the September Governing Council meeting and argue that the ECB is under no pressure to alter its very accommodative monetary policy stance. With inflation pressures contained, a slow recovery and negative private sector credit dynamics, we expect the refi rate to remain stable at 0.5% until the end of 2016. We also analyse the excess liquidity situation and conclude that the ECB is likely to offer another LTRO in the next 3 to 6 months. We anticipate that the chosen tenure will be a two-year maturity in order to cover the expiry of the Feb-15 LTRO and encompass the bank recapitalization window that will follow from the ECB's Asset Quality Review (AQR) and EBA stress tests.

What has changed since the last ECB meeting?

We anticipate the GC will leave its key interest rates unchanged again, and reiterate that its monetary policy stance will "*remain accommodative for as long as necessary*"

The ECB Governing Council (GC) meets on Wednesday 2 October in Paris — the change of date stems from the fact that Thursday, 3 October, is a holiday in Germany. We anticipate the Governing Council will leave its key interest rates unchanged again, and reiterate that its monetary policy stance will "*remain accommodative for as long as necessary*", in line with the forward guidance provided in July and reiterated at the August and September meetings. Hence the introductory statement should make a reference to the fact that the Governing Council will expect the "*key ECB interest rates to remain at present or lower levels for an extended period of time*".

The hard data are suggesting that the recovery remains fragile

Overall, the hard data are suggesting that the recovery remains fragile. Industrial production numbers for July were disappointing, showing a 1.3% MM fall compared to the second quarter average. Together with some temporary softness in euro area manufacturing new orders (-0.3% lower in July than the 2Q average) and a flat retail sales performance, our forecast for 3Q GDP growth stands at 0.6% (annualized) only half the rate of the 1.2% recorded in 2Q. It is therefore not surprising to have heard various GC members qualify the pace of the recovery as being "*very slow*" and ECB President Draghi to qualify it as being "*very green*". Mr. Draghi also noted that unemployment in the euro area remains far too high. Our interpretation of these recent statements is that the GC continues to express dovish views, perhaps paying more attention to the degree of slack in the economy.

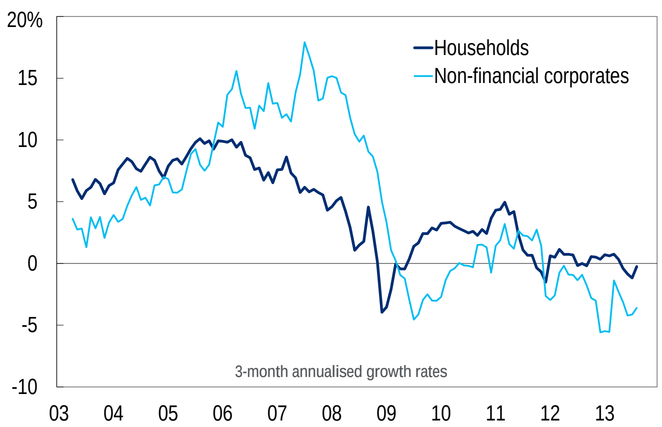
However, survey signals have been more positive

However, survey signals have been more positive. The flash composite September PMI surprised to the upside, with a 0.6-point gain to 52.1, comfortably exceeding the 51.8 consensus forecast. This fifth successive monthly increase marked the fastest rate of expansion in private sector activity since June 2011. The composite PMI survey (and other leading indicators such as M1 and ZEW) suggests that economic activity is accelerating slightly at the end of the third quarter. And with survey details suggesting that incoming orders are improving, we believe that the modest recovery scenario will be confirmed, underpinning a positive (and most likely higher) 4Q GDP.

Loans to the private sector (adjusted for securitization) weakened further

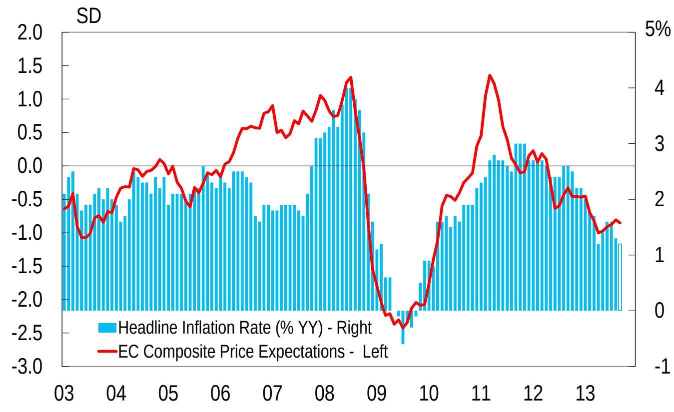
Turning to the credit picture, the annual rate of change of loans to the private sector (adjusted for securitization) weakened further to -1.5% YY in August from -1.4% in July. On a flow basis, bank loans to the private sector contracted again, with a negative reading of €7.2bn. This was less than the €21bn average contraction in the three months to July, owing to a positive contribution from loans to households of €4.4bn. This offset the sizeable €11.6bn contraction in loans to non-financial corporates, itself slightly smaller than the €15.7bn average drop in the three months to July. Note that both series of mortgage lending and loans to non-financial corporates remain negative (see Figure 3). The recent data supports our scenario of a credit less recovery (see "Loan Dynamics: Renaissance by Year-End", 13 September 2013).

Figure 3. Euro Area – Private Sector Bank Lending, Split By Sector, Jan-03 to Aug-13



Sources: European Central Bank and Citi Research

Figure 4. Euro Area – Headline Inflation Rate and Composite Price Expectations, Jan-03 to Sep-13



Sources: Eurostat, European Commission and Citi Research

We expect headline HICP to have been stable at 1.3% YY

Inflation data for September was not available at the time of writing, but we expect the euro area headline HICP to have edged lower to 1.2% YY. As we do not detect any significant upside risks to the near-term trajectory of headline inflation rates, we would expect the Governing Council to conclude again that the "*risks to the outlook for price developments are expected to be still broadly balanced*". As a reminder, the ECB staff projections updated in September showed a 0.1ppt uptick to 1.5% in the 2013 inflation mid-point, but left the 2014 estimate unrevised at 1.3% (see Figure 4).

The ECB is under no pressure to alter its monetary policy stance.

Overall, the tentative economic recovery scenario and persistently negative credit picture suggest that price developments should remain consistent with the ECB's price stability mandate. With the average monthly level of the 1Y1Y Eonia some 2bp lower than at the same time last month, and a delay in the Federal Reserve tapering we argue that the ECB is under no pressure to alter its monetary policy stance.

Monitoring money market rates closely

Short-dated money market rates are being pushed higher by the gradual reduction in excess liquidity

Money market rates are important for the ECB in the sense that they reflect a gauge of the central bank's credibility with respect to its message that rates will remain low or lower for an extended period of time. They also affect the economy, for instance mortgages rates in Spain based on Euribor rates. At the same time, short-dated money market rates are being pushed higher at least in part by the gradual reduction in excess liquidity, but also given some contagion from other countries and a small increase in the likelihood of rate hikes in the future. This situation is the product of the early repayment of funds from banks as part of the two three-year long-term refinancing operations (LTRO), reflecting a combination of deleveraging strategies, reduced financial market fragmentation and better confidence in the banking system at large[1].

Central bankers have been keen to stress that the tool bag contains many instruments

ECB central bankers have been keen to stress that their tool bag contains many instruments that the GC might have to reply upon in due course, if it decided that the monetary policy stance required adjusting. More specifically, ECB President Draghi indicated that with respect to non-standard measures, "*we are ready to use any instrument, including another LTRO if needed, to maintain short-term money*

[1] It seems to be the case that banks are repaying part of their LTRO money as the remaining duration gradually declines towards the one-year threshold from where it is treated worse in calculations of liquidity coverage ratios.

market rates at a level which is warranted by our assessment of inflation in the medium term". Asked about the possibility of the central bank giving banks another chance for those loans, Austrian central bank Governor Ewald Nowotny said: "*It is certainly important to show all that we have in the way of instruments, which are flexible*."

There is little need for the ECB to change anything in its communication strategy

Assuming that the market continues to trade with the 1Y1Y EONIA rate around or below the 50bp main refinancing rate, as it does currently, there is little need in our view for the ECB to change anything in its communication strategy (see Figure 5). It will likely therefore stick to the current forward guidance framework and will make references to the panoply of non-standard measures available for the Governing Council to choose from if it judges that its monetary policy stance is not being transmitted adequately.

Potential ECB responses to rising money market rates

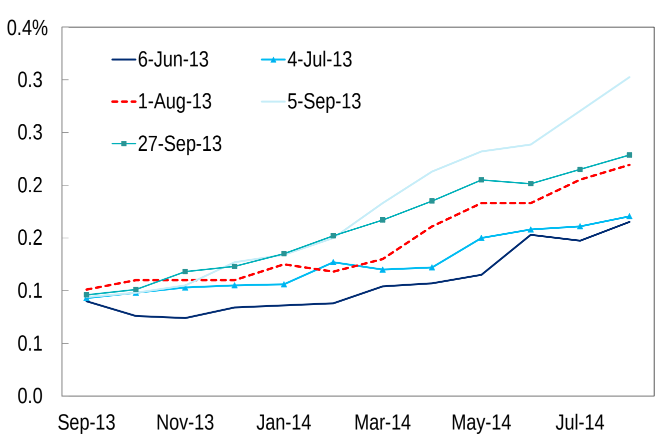
Recent acceleration in the repayment of LTRO funds and the prospects of Fed tapering have forced central bankers to answer more questions on the subject

The issue of whether the ECB will offer another LTRO has been on the market's radar for some time. However, recent acceleration in the repayment of LTRO funds and the prospects of Fed tapering have forced central bankers to answer more questions on the subject (see Figure 6). Earlier this week, President Draghi argued that the trend of reduced excess liquidity was a sign of normalization, suggesting that the banking system's reduced reliance on ECB funding is a positive development. Yet, he underscored that the GC "*will remain particularly attentive to the implications that these developments may have on the stance of monetary policy*". This statement illustrates that the ECB is worried that money market rates could rise to levels which could skew the balance of risks on inflation to the downside.

We believe that ECB would likely propose another LTRO

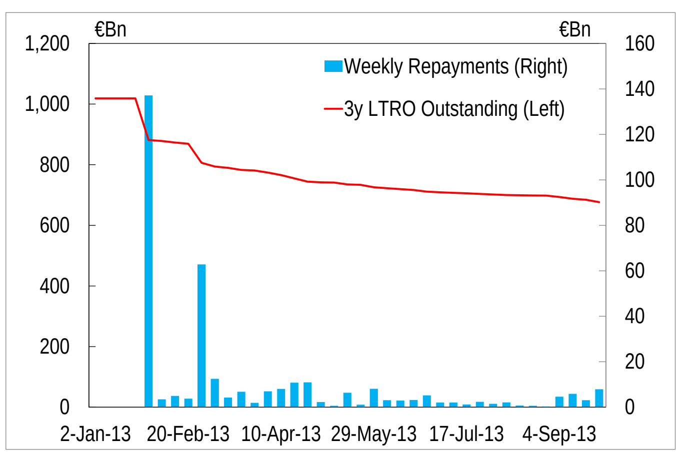
Assuming a further rapid fall in the excess liquidity position[2] that pushes up money market rates, and that the Fed becomes more comfortable with tapering, while the euro area recovery remains fragile and credit growth continues to be negative, we believe that ECB would likely propose another LTRO.

Figure 5. EONIA Forwards – ECB Meeting Dates, Jun-13 to Sep-13



Sources: Bloomberg and Citi Research

Figure 6. LTRO – Outstanding and Weekly Repayment, Jan to Sep-13



Sources: European Central Bank and Citi Research

[22] President Draghi indicated at the September press conference: "*I remember some time ago I mentioned a figure of €200 billion as the threshold, but in fact it is really context-dependent. It depends on the context; it depends on the degree of fragmentation that we have. The ECB's Monthly Bulletin speaks of a figure between €200 billion and €100 billion, but in general the threshold depends on the state of fragmentation*".

How is the LTRO repayment schedule going?

Gauging how dependent the various eurosystems remain to ECB liquidity

We now turn to the LTRO usage statistics in order to gauge how dependent the various national eurosystems remain on ECB liquidity. Data up to August show that the German eurosystem was the first to completely repay its LTROs funds once the option to do so could be exercised. As Figure 2 on the Front Page illustrates, Germany extricated itself from reliance on LTRO funding by May 2013. The French banking system is very close to being in the same position, with only 8% of estimated residual LTRO money. At the rate of repayment seen in the last three months, we estimate that France will be in the Germany group by around November 2013. Belgium and Luxembourg are closely bunched together at 26% and 28%, respectively. Spain stands in the middle of the pack with a ratio of around 55%, very close to the 54% euro area average. Much higher up in the dependency scale, we find Portugal with 75%, Finland with 84% and finally Italy with 87%.

Figure 7. Estimates of LTOs Absorption by Country

	1st LTRO			2nd LTRO			TOTAL		
	€ bn	% ot EA	% of MFIs assets	€ bn	% ot EA	% of MFIs assets	€ bn	% ot EA	% of MFIs assets
Belgium	12.0	3.9	1.0	22.6	5.2	1.9	34.6	4.6	3.0
Finland	2.1	0.7	0.3	1.4	0.3	0.2	3.5	0.5	0.6
France	43.6	14.0	0.5	46.4	10.6	0.5	90.0	12.0	1.0
Germany	29.4	9.4	0.3	26.6	6.1	0.3	56.0	7.5	0.6
Lux	1.1	0.4	0.1	1.8	0.4	0.2	3.0	0.4	0.3
Ireland	5.2	1.7	0.4	11.2	2.6	0.9	16.4	2.2	1.3
Italy	92.2	29.6	2.2	127.5	29.1	3.0	219.7	29.3	5.2
Portugal	5.0	1.6	0.9	14.1	3.2	2.5	19.1	2.5	3.4
Spain	33.5	10.7	0.9	163.0	37.1	4.5	196.5	26.2	5.5
Neth	0	0	0	20.6	4.7	0.8	20.6	2.7	0.8
Others	87.2	28.0	0.0	3.5	0.8	0.0	90.7	12.1	0.0
EA	311.4	100.0	0.9	438.8	100.0	1.3	750.2	100.0	2.3

Note: 1st LTRO estimated by change in LTRO outstanding in NCBs balance sheet between Nov-11 and Dec-11. 2nd LTRO correspond to change between Feb-12. For Greece, the estimated total change was negative: outstanding LTRO moved from €60.8bn in Nov-11 to €60.9bn in Dec-11 and €36.81bn in Mar.
Source: Citi Research

Figure 8. Amount Still Outstanding to be Repaid €Bn, Dec-12 to Aug-13

	BE	FI	FR	GE	IR	IT	POR	SP	NE	EA
Dec 12	34.6	3.5	90.0	56.0	16.4	219.7	19.1	196.5	20.6	750.2
Jan 13	23.9	3.5	88.7	35.4	14.9	217.8	15.5	191.5	19.7	745.4
Feb 13	13.9	3.5	63.1	11.2	9.0	217.1	15.0	147.2	8.7	590.8
Mar 13	10.9	3.5	34.9	7.9	0.0	213.5	14.8	127.0	8.7	493.3
Apr 13	9.9	3.5	31.1	0.6	0.0	210.8	14.8	118.7	8.7	456.3
May 13	9.2	3.1	16.4	0.0	0.0	205.9	14.6	114.3	8.7	435.3
Jun 13	9.2	3.0	11.0	0.0	0.0	195.8	14.4	109.3	8.1	419.8
Jul 13	9.2	3.0	9.5	0.0	0.0	193.0	14.4	109.5	8.1	412.0
Aug 13	9.1	3.0	7.0	0.0	0.0	192.0	14.3	107.7		407.7

Note that the balance for Ireland is at zero, but we suspect that this is related to the ELA deal in February.
Source: Citi Research

The higher the dependency ratio of a national eurosystem on ECB liquidity, the more stress its banking system is likely to experience as the deadline for repayment approaches, in our view

The higher the dependency ratio of a national eurosystem on LTRO liquidity, the more stress its banking system is likely to experience as the deadline for repayment approaches, in our view. With the Italian banking system having reinvested most of the LTRO money in purchases of BTPs, there is a risk that the sudden erosion of demand at auction will cause some upward risk to the Italian sovereign yields. While the threat of OMT is likely to keep Italian spreads capped for a while, we believe the average cost of funding could drift higher if a sizeable portion of the country's issuance is not absorbed by the domestic banking system.

When could the ECB announce a new LTRO? And what kind?

Announcing another LTRO in the next few weeks would probably make some investors wonder what the ECB knows that they do not

Announcing another LTRO in the next few weeks could send a negative signal with some investors wondering what the ECB knows that they do not, and could lead to increased volatility. We think that the GC is more focused on the upcoming AQR than on the possibility of an extra LTRO in the next couple of meetings, even if the pace of repayments has increased in the last few weeks — probably also because of quarter-end. There is also a risk that by announcing a facility too early, the take-up could be low and show the ECB as running out of ammunition. We would argue that the attractiveness of a potential LTRO is likely to be determined by its length (at least one year, possibly two) and specifications relative to the interest rate (fixed-rate or at the average rate of the main refinancing operations over the life of the respective operation).

The signal could come at some point in next quarter or two

We doubt that there would be enough stress for now in the system for the GC to agree on a fresh 3y LTRO in the very near term. Rather, we think that the ECB is more likely to signal at some point over the next few months that it will offer a new 2-year LTRO facility to be launched in the first half of 2014. Its aim would be to at least cover the Feb-15 second three-year LTRO expiry. We suspect that the timing of any announcement would likely be contingent on some agreement having been reached with the relevant parties about the length of the recapitalization period for the banking system (probably 12 months, as in the last EBA stress test), addressing some market concerns of funding difficulties for some of the more vulnerable institutions after the results of the AQR and ECB bank stress tests in Q3 2014.

A two-year LTRO could be based on different interest rate modalities

The modalities of a 2-year LTRO could perhaps include a fixed rate for the first year and a refinancing rate reference value for the second year if some members of the GC threatened to veto a two-year fixed rate as going beyond the intended (we suspect 18 months, but not disclosed) horizon of forward guidance.

Short of designing an LTRO which is too compelling to ignore, there will be varying degrees of dependence on ECB funding

We believe that another LTRO is probably only a matter of time. However, we suspect that the ECB will be keen to avoid a situation where it could be accused of favouring one banking system over another. Unfortunately, short of designing an LTRO so attractive that all banks to bid for large amounts of liquidity, there will be varying degrees of dependence on ECB funding. One possibility to get around the problem would be for the ECB to announce further loosening to certain parts of the collateral pool on the provision that the liquidity obtained in this third LTRO would make its way to SMEs, perhaps by forcing banks to agree to certain lending targets ex-ante — mirroring the BoE's Funding for Lending Scheme. The EIB could be involved by extending some guarantees designed to offset the extra risk related to the temporary expansion of the collateral list or the lower haircuts on existing assets.

Conclusions

We don't expect much from the ECB at the Paris meeting when forward guidance will be confirmed

Given the tentative economic recovery scenario and persistently negative credit picture, the GC will keep its assessment that price developments should remain consistent with its price stability mandate. As a result, we expect key rates to be left unchanged and the forward guidance statement to be reiterated, confirming the current accommodative policy stance.

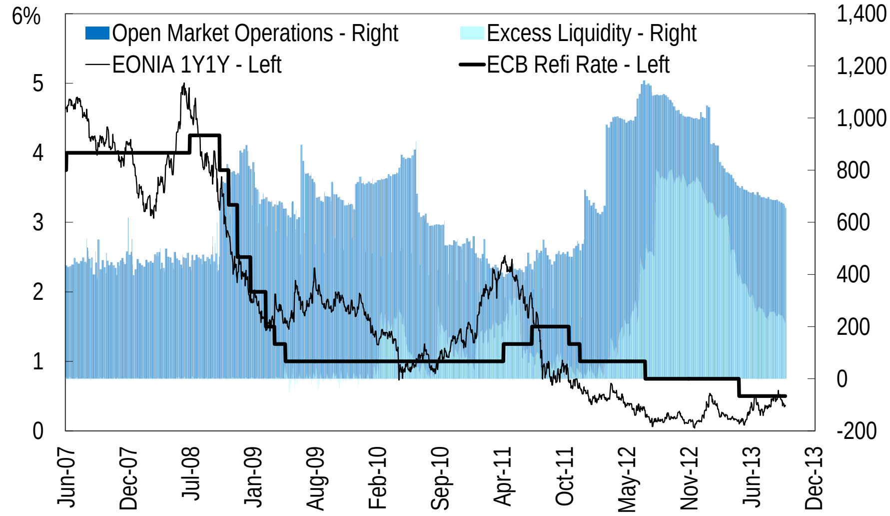
Waiting for the LTRO is unlikely to be like waiting for Godot, although some important details are still missing

We do not think that investors will find themselves in a position similar to that of Vladimir and Estragon in Samuel Beckett's play "Waiting for Godot" in which they wait in vain for his arrival. Despite some suggestions that the ECB is not yet willing to commit to offering another LTRO, we believe that the case is compelling enough to expect some announcement in the next three to six months. In our view, the only issues that still need to be resolved are the exact timing, and length of the facility as well as its interest rate characteristics.

A two-year facility seems to be the most likely option, coinciding with the ECB's forward guidance framework and upcoming bank recapitalization period

A two-year facility seems the most likely option, not only because it would coincide neatly with the supposed length of the ECB's forward guidance framework, but also because it should bridge the February 2015 second LTRO expiry and cover the 12-month bank recapitalization window that will follow the ECB's AQR and EBA stress tests results in the third quarter of 2014. LTRO repayment figures suggest that the degree of monetary fragmentation in the euro area might be reducing slowly, but that there are still clear differences between the core/semi-core and the periphery banking systems where full weaning off ECB liquidity support will probably require significant recapitalization efforts.

Figure 9. Euro Area – Open Market Operations, Excess Liquidity, and Interest Rates, Jun-07 to Sep-13



Sources: Bloomberg and Citi Research

A rate cut and a narrower rate corridor could represent an alternative policy options

An alternative to the LTRO option could be to narrow the corridor between the marginal lending rate and the refinancing rate as part of a decision to lower the refinancing rate by a further 25bp, leaving the deposit rate at 0%. This would likely be as a result of a significant downward trend in headline inflation and could be an option for the ECB to combat an excessively strong euro backdrop. However, we believe that some members of the GC would have strong reservations about this strategy having already highlighted the risks associated with an already exceptionally low level of rates.

Key Economic Indicators (30 September – 4 October 2013)

During The Week		Forecast	Last
08:00	UK: Halifax House Prices, Sep		
Monday 30 September		**Forecast**	**Last**
07:00	Sweden: Registered Unemployment Rate, Sep	4.9%	4.8%
07:00	Germany: Retail Sales, Aug	1.2% MM, 0.9% YY	-0.5% MM, -0.1% YY
07:45	France Producer Prices, Aug		
08:00	Denmark: GDP, 2Q Final		
09:00	Italy: Producer Prices, Aug		
09:00	Norway: Credit Growth Indicator C2, Aug	6.1% YY	6.2% YY
09:00	Norway: Retail Sales, Aug	0.6% MM	-1.3% MM
09:30	UK: Personal Borrowing, Aug		
10:00	Portugal: GDP Details, 2Q Final		
10:00	Italy: HICP Flash, Sep	1.3% YY	1.2% YY
10:00	Euro Area: HICP Flash, Sep	1.2% YY	1.3% YY
	Spain: Current Account, Jul		
	Greece: Retail Sales, Jul		
Tuesday 1 October		**Forecast**	**Last**
07:00	Sweden: PES Unemployment Rate, Sep		
07:30	Sweden: Manufacturing PMI, Sep	51.9	52.2
08:00	Norway: Manufacturing PMI, Sep	51.2	53.0
08:55	Germany: Unemployment, Sep	-9K	7K
09:00	Italy: Unemployment Rate, Aug	12.0%	12.0%
09:00	Euro Area: Manufacturing PMI, Sep Final	51.1	51.4
09:30	UK: Manufacturing PMI, Sep		
10:00	Euro Area: Unemployment Rate, Aug	12.1%	12.1%
	Italy: State Sector Borrowing Requirement, Sep	€77 Billion FYTD	Jan-Sep 2012: €45.9 Billion
Wednesday 2 October		**Forecast**	**Last**
08:00	Spain: Registered Unemployment, Sep		
09:30	UK: Government Debt and Deficit, Sep 2013		
10:00	Euro Area: Industrial Producer Prices, Aug		
11:00	Ireland: Unemployment Rate, Sep		
12:45	Euro Area: ECB Meeting, Paris. Outcome at 12:45 – Press Conference at 13:30		
16:30	Ireland: Exchequer Return, Sep		
Thursday 3 October		**Forecast**	**Last**
07:30	Sweden: Services PMI, Sep	53.2	53.7
09:00	Euro Area: Services PMI, Sep Final	52.1	50.7
	Composite PMI, Sep Final	52.1	51.5
09:30	UK: Services PMI, Sep		
10:00	Euro Area: Retail Sales, Aug	0.2% MM, -1.4% YY	0.1% MM, -1.0% YY
Friday 4 October		**Forecast**	**Last**
07:00	Germany: Producer Prices, Aug	0.3% MM, 1.7%YY	0.0% MM, 1.5% YY
08:30	Sweden: Services Production, Aug	0.4% MM	-0.2% MM
10:00	Euro Area: Industrial Producer Prices, Aug		
11:00	Ireland: Industrial Production, Aug		

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area			
Sep 30 10:00	*HICP, Sep P*	Forecast: 1.2% YY	Prior: 1.3% YY
London Time	The HICP annual inflation rate probably edged lower by 0.1pp to 1.2% in September. Together with the April reading, this would be the lowest level of inflation for the euro area since Feb-2010. A much weaker-than-expected reading in Spain (HICP inflation down from 1.6% YY to 0.5% YY) will likely have been the main driver for the lower rate in the euro area. In general, price pressures remain very muted, with core inflation likely to print at 1.1% YY in Sept, unchanged relative to August.		
Oct 1 09:00	*Manufacturing PMI, Sep F*	Forecast: 51.1	Prior: 51.4
London Time	The flash estimate showed the Sep manufacturing PMI edged lower, reporting the first monthly drop in five months. The index level remains broadly in line with its long-term average, suggesting activity in the industrial sector is probably expanding, but at a still quite muted pace. Subdued readings are likely to be recorded also by periphery countries, Italy and Spain, now that the manufacturing PMI has caught up with the levels in core countries, especially Germany (at around 51).		
Oct 1 10:00	*Unemployment Rate, Aug*	Forecast: 12.1%	Prior: 12.1%
London Time	The August unemployment rate likely remained unchanged for the fourth consecutive month at the record-high level of 12.1%. The recent stabilisation is likely to be a temporary one, in our view, reflecting positive seasonal hiring in Mediterranean countries, rather than an underlying improvement in the labour market. We expect the unemployment rate to edge higher again in 4Q.		
Oct 3	*Services PMI, Sep F*	Forecast: 52.1	Prior: 50.7
09:00	*Composite PMI, Sep F*	Forecast: 52.1	Prior: 51.5
	The services PMI bounced back sharply in September, according to the flash estimate, by 1.4 points relative to August and posting the sixth consecutive gain. The composite PMI – which averages activity indicators for the manufacturing and the service sectors – also posted a decent gain (+0.7 points) in September, although slightly smaller than in previous three months. We expect these readings to be confirmed in the final reports. The level of the composite PMI – at around 52.0 – in the past has been consistent with annualised quarterly GDP growth of 1%-1¼ %.		
Oct 3 10:00	*Retail Sales, Aug*	Forecast: 0.2% MM, -1.4% YY	Prior: 0.1% MM, -1.0% YY
London Time	We forecast a modest rise in retail spending in Aug, consolidating the small positive reading in July (+0.1% MM). Retail sector sentiment indicators have been lagging behind improvements in confidence in other sectors, suggesting that the growth dynamic of euro area domestic demand remains quite poor.		
Germany			
Sep 30 07:00	*Retail Sales, Aug*	Forecast: 1.2% MM, 0.9%YY	Prior: -0.5% MM, -0.1%MM
London Timer	We expect retail sales (excluding cars) in Germany to rise after two consecutive monthly falls (even though the fall in July was revised upwards to -0.5% MM from -1.4% MM originally). Consumer confidence remains upbeat, unemployment is low and stable and wages are increasing, suggesting that retail sales are unlikely to trend downwards.		
Oct 1 08:55	*Unemployment, Sep*	Forecast: -9K	Prior: 7K
London Time	Most labour indicators in Germany suggest that it is stable currently and we expect a small downtick in unemployment in September only on small seasonal factors. Vacancies are stable (while they had been falling slightly until recently), but survey unemployment expectations have ticked up a little recently. On a trend basis, immigration and robust pay growth (which immigration also contains) should limit the scope for unemployment rates to fall much further even as the German economy gains some more traction.		
Oct 4 07:00	*Producer Price Index, Aug*	Forecast: 0.3% MM, 1.7% YY	Prior: 0.0% MM, 1.5% YY
London Time	Import prices continue to fall, as a strong euro and weak commodity prices more than compensated for robust pay increases. In August, we expect a small increase as the downward pressures fade, notably on the commodity price side, but still leaving producer prices almost exactly flat compared to a year ago.		
Italy			
Sep 30 10:00	*HICP, Sep P*	Forecast: 1.3% YY	Prior: 1.2% YY
London Time	HICP inflation may have edged higher in Sept, driven by the end-of-summer rebound in clothing prices, after the summer sales. Favourable base effects in the energy component may have partly offset this effect, keeping overall inflation subdued. The planned VAT rate hike in October – as it seems likely to be implemented – will likely lift inflation back to 1¾% YY by year-end.		
Oct 1 09:00	*Unemployment Rate, Aug*	Forecast: 12.0%	Prior: 12.0%
London Time	The unemployment rate has declined by 0.2pp between May and July, probably on the back of slightly better employment in holiday-related activities. We expect it to have stabilised in August, while probably to edge higher again in September.		
Oct 1	*State Sector Borrowing Requirement, Sep*	Forecast: €77bn	Prior (Jan-Sep 2012): €45.9bn
	The YTD state budget deficit likely widened further in September relative to last year, as the repayment of government arrears (round €4bn only in September) is contributing to lift the state sector's cash needs. While the comparison with 2012 may be particularly unfavourable, because of several one-off deficit-reducing measures in 2012 at the peak of the sovereign debt crisis, the 2013 YTD cash deficit is the worst since records began in 1998. While some of the cash items are not going to affect the accrual deficit, we think these data suggest that the government's fiscal deficit in 2013 is likely to exceed the target of 3% of GDP (probably by around 0.5pp).		

Economic Indicators

Spain

Oct 2 08:00 London Time — *Registered Unemployment, Sep ('000)* — Forecast: 72K MM — Prior: 0K MM

Registered unemployed usually rebounds in September, due to the end of the summer hiring season and we estimate most of the expected rise in September to be driven by seasonal factors. Registered unemployment, however, has recently been less representative of the developments in the labour market than the labour force survey, due to changes in the criteria to access jobless claims and probably to the rising share of long-term unemployed (not eligible any more for jobless claims). Total unemployment (as measured by the labour force survey) stood at 5.9mln in 2Q 13, against 4.7mln jobless claimants.

Sweden

Sep 30 07:00 London Time — *Registered Unemployment Rate, Sep* — Forecast: 4.9% — Prior: 4.8%

Weekly figures suggest that registered unemployment continued to trend very gradually higher in September. Registered unemployment suggests that the lower unemployment according to the LFS labour force survey during the summer is partly temporary.

Oct 1 07:30 London Time — *PMI Manufacturing, Sep* — Forecast: 51.9 — Prior: 52.2

The PMI recovered in August, but continues to stand below its long-term average of 54.4. Improving international sentiment is expected to support ongoing recovery in the Swedish PMI ahead. However, in line with the minor setback for the German PMI (fell 0.5pp to 51.3) and the euro area PMI (slipped 0.3pp to 51.1), we also expect a minor decline in the Swedish PMI in September. Such an outcome would also be in line with the setback in NIER manufacturing sentiment in September.. Ahead, we expect the manufacturing sector to gradually recover, supporting economic recovery. Hard data (production and exports), though, have been weak during the first half of this year, but should accelerate somewhat in the second half of the year. Goods exports, though, remained weak in July.

Oct 3 07:30 London Time — *PMI Services, Sep* — Forecast: 53.2 — Prior: 53.7

The Service Sector PMI corrected lower in August following the nearly 12-point rise in the previous month (the largest on record in the index's history). The series, however, is very volatile and one gets a more precise picture by looking at three-month moving averages. On this basis, the services PMI has hovered around 50 for the past year, and stood at 51.7 in Jun-Aug 2013. Services sentiment according to NIER has increased steadily since late 2012 and jumped 4.9 points to above the historical average in September. Meanwhile, the picture is mixed for the domestic sectors as confidence in the retail sector dropped 3.9 points to 97.9, and the situation in the construction sector remains subdued. Services production was weak in 2Q, but is expected to recover during the second half of the year.

Oct 4 08:30 London Time — *Services Production, Aug* — Forecast: 0.4% MM — Prior: -0.2% MM

Service-sector production was weak in 2Q, and weakness continued in the beginning of the third quarter. Meanwhile, services sentiment has improved both according to NIER (for private services, but confidence in retail trade actually fell back in September) and the PMI. Hence, we expect production to rise in August, reversing the decline from July and June.

Norway

Sep 30 9:00 London Time — *Credit Growth Indicator, Aug* — Forecast: 6.1% YY — Prior: 6.2% YY

The latest lending survey showed that household credit demand increased in 2Q, in line with the monthly credit growth indicator for households which averaged 7.5% YY in 2Q vs. 7.3% in 1Q. With moderating gains in the housing market, household credit demands are likely to slow in 3Q. The latest lending survey also showed a pick-up in credit demand from non-financial enterprises, reflecting easier credit standards, but banks expected demand to be approximately unchanged in 3Q. The monthly development in corporate credit growth has been in a downward trend since Jun-12 (picked up slightly in May-Jun, but has come down since then). In August, we expect credit to households and non-financial enterprises to remain in the area of 7.1% YY and 4.0% YY, respectively. Meanwhile, credit to municipalities should fall slightly further (7.9% YY in Jul).

Sep 30 9:00 London Time — *Retail Sales, Aug* — Forecast: 0.6% MM — Prior: -1.3% MM

Retail sales and overall domestic spending on goods dropped markedly in July, questioning any improvement in private spending momentum this quarter following the moderation in 2Q. As the weakness in sales in July appears somewhat exaggerated, we expect August to show a solid rebound. Solid income growth and recovering employment still suggest firmer consumption going forward.

Oct 1 9:00 London Time — *Manufacturing PMI, Sep* — Forecast: 51.2 — Prior: 53.0

We expect the Norwegian PMI to correct slightly lower again in September. This would be better in line with indications from other business surveys, which signal slightly below-trend growth ahead. We note that the PMI is not closely watched by Norges Bank as there often are problems with the seasonal adjustment procedure. Also, the 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.

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

Key Economic Indicators (7 October – 11 October 2013)

During The Week		Forecast	Last
07:00	Germany: Insolvencies, Jul (by 11 Oct)		
Monday 7 October		**Forecast**	**Last**
09:00	Norway: Industrial Production, Aug		
09:30	Euro Area: Sentix Investor Confidence, Oct		
Tuesday 8 October		**Forecast**	**Last**
00:01	UK: RICS House Price Survey, Sep		
	UK: British Chambers of Commerce Quarterly Economic Survey, Sep		
06:45	Switzerland: Unemployment, Jul		
07:00	Germany: Trade Balance, Aug		
07:30	France: Bank of France Business Sentiment, Sep		
07:45	France: Trade Balance, Aug		
08:00	Spain: Industrial Production, Aug		
08:15	Switzerland: Retail Sales, Aug		
08:15	Switzerland: Consumer Prices, Sep		
09:00	Italy: Deficit to GDP YTD, 2Q		
11:00	Germany: Incoming Orders, Aug		
	Greece: Consumer Prices, Sep		
14:00	US: IMF Releases *World Economic Outlook*		
Wednesday 9 October		**Forecast**	**Last**
08:00	Spain: Business Confidence, 4Q		
08:30	Netherlands: Industrial Production, Aug		
09:30	UK: Industrial Production, Aug		
	Manufacturing Output, Aug		
09:30	UK: Trade Balance – Goods & Services, Aug		
11:00	Germany: Industrial Production, Aug		
13:30	US: IMF Releases its *Global Stability Report* and later the *Fiscal Monitor* (at 16:30)		
Thursday 10 October		**Forecast**	**Last**
	G-20 Finance Ministers & Central Bank Governors Meet in Washington, DC (Oct 10-11)		
07:45	France: Industrial Production, Aug		
08:30	Sweden: Consumer Prices, Sep		
08:30	Sweden: Industrial Production, Aug		
08:30	Netherlands: Consumer Prices, Sep		
09:00	Euro Area: ECB Monthly Bulletin		
09:00	Italy: Industrial Production, Aug		
09:00	Norway: Consumer Prices, Sep		
	Greece: Industrial Production, Aug		
12:00	UK: MPC Outcome		
Friday 11 October		**Forecast**	**Last**
	US: IMF/World Bank Annual Meetings (Washington, DC, Oct 11-13)		
07:00	Germany: Consumer Prices, Final, Sep		
07:45	France: Balance of Payments, Aug		
08:00	Spain: HICP Final, Sep		
09:00	Italy: Consumer Prices, Final, Sep		
09:30	UK: Construction Output, Aug		

Sources: National statistical offices, central banks and Citi Research

Title	Author	Date
Euro Area – Sovereign Debt Crisis Update		
Coeuré Says Forward Guidance is to Limit Market Volatility	European Economics Team	Sep 27, 2013
French 2014 Budget Unveiled	European Economics Team	Sep 26, 2013
ECB Downplays Near-Term LTRO Option	European Economics Team	Sep 25, 2013
Draghi Stresses Need for Very Accommodative Policy Stance	European Economics Team	Sep 24, 2013
Merkel's Victory Paves Way for Political Continuity	European Economics Team	Sep 23, 2013
Euro Area		
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
European Economic Forecast Highlights - August 2013	Ann O'Kelly	Aug 22, 2013
Germany - Is the Current Coalition Heading For Four More Years?	Ebrahim Rahbari	Aug 19, 2013
Euro Economics Weekly		
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
Greece — More Drama, Fewer Systemic Risks	Giada Giani	Aug 30, 2013
Enhanced Forward Guidance, ECB-Style	Guillaume Menuet	Aug 23, 2013
Euro Area Recovery? Not Strong Enough	Giada Giani	Aug 16, 2013
What do the US Pickup and China Slowdown Mean for Euro Area Growth?	Ebrahim Rahbari	Aug 9, 2013
Low(er) ECB Rates: For How Long?	Guillaume Menuet	Jul 26, 2013
German Exports — Down But Not Out	Ebrahim Rahbari	Jul 19, 2013
On Italy's Fiscal Woes and Euro Area's Dismal Labour Market	Giada Giani	Jul 12, 2013
France a Year On: How Much Progress?	Guillaume Menuet	Jul 5, 2013
Small steps towards banking union: the ECB should be pleased	Guillaume Menuet	Jun 28, 2013
Slovenia: ESM Assistance for Bank Recap Would Make Sense	Guillaume Menuet	Jun 21, 2013
Spain's External Rebalancing	Giada Giani	Jun 14, 2013
Financial Conditions Neutral, At Best, on Growth	Giada Giani	Jun 7, 2013
Chief Economist Publications		
Global Economic Outlook and Strategy - September 2013	Willem Buiter	Sep 25, 2013
Scandi		
Scandi Economics Update	Tina Mortensen	Sep 27, 2013
Sweden - Surprise Drop in Sentiment in September	Tina Mortensen	Sep 25, 2013
Norway - Stable Rates, Easing Bias Removed And Earlier Rate Hike	Tina Mortensen	Sep 19, 2013
Switzerland		
Switzerland - Economy Continues to Grow Solidly	Michael Saunders	Sep 3, 2013
UK		
UK - Retail Sales Fall Back, Trend Remains Solid	Michael Saunders	Sep 19, 2013
UK - MPC Minutes – No Rate Protest	Michael Saunders	Sep 18, 2013
UK - CPI Inflation Edges Down, RPI-CPI Wedge Rising	Michael Saunders	Sep 17, 2013
UK - UK Data and Household Rate Expectations	Michael Saunders	Sep 6, 2013
UK - No Change from the BoE	Michael Saunders	Sep 5, 2013
UK Economics Weekly		
Change to Rate View	Michael Saunders	Sep 20, 2013
Scenarios for the Jobless Rate	Michael Saunders	Sep 13, 2013
Housing is Recovering, Not Bubbling	Michael Saunders	Sep 6, 2013
Assessing Vulnerabilities to the EM Slowdown	Michael Saunders	Aug 30, 2013
Is Guidance Failing?	Michael Saunders	Aug 23, 2013
The Upturn and Unemployment	Michael Saunders	Aug 16, 2013
Four More Years!	Michael Saunders	Aug 9, 2013

Source: Citi Research

Appendix A-1

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