

Euro Economics Weekly

Removing Grexit from the Baseline Scenario

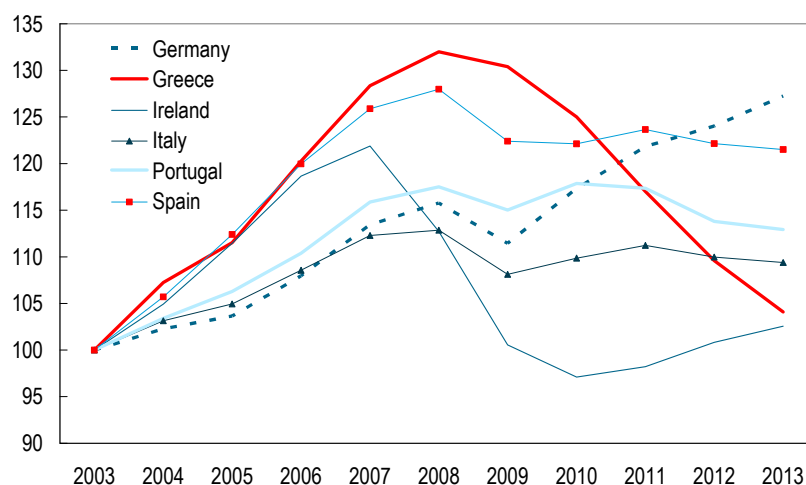
- Although we still see risks of Greece leaving the euro in the next few years, we have removed “Grexit” from our central scenario in 2014. The governing coalition looks somewhat less fragile than we previously thought and, with key legislative actions for 2013 behind us, we do not see major triggers for the coalition to break down in the near term. Despite a significant drop in living standards, social unrest that could destabilise the government remains contained so far, although risks of an abrupt eruption remain.
- Yet, the Greek public debt is still on an unsustainable path in our view, likely to approach 180% of GDP by end-2013, and the economy remains in recession. But the recent slightly better compliance with the fiscal targets and, in general, a better cooperative stance by the Greek government towards international lenders should make the lenders more open to some additional debt relief – in the form of OSI – later this year or in 2014.

Figure 1. Citi Market Forecasts

| | \$/€ | Euro Repo | 10-yr Bunds | £/€ | U.K. Bank Rate | 10-yr Gilt-Bund | SKr/€ | SEK Policy Rate | NOK/€ | NOK Policy Rate | SFr/€ | CHF Policy Rate | CHF Spread vs Bunds |
|-------|------|-----------|-------------|------|----------------|-----------------|-------|-----------------|-------|-----------------|-------|-----------------|---------------------|
| 3Q 13 | 1.27 | 0.50 | 1.40 | 0.87 | 0.50 | 66 | 8.58 | 0.75 | 7.46 | 1.50 | 1.26 | 0.00 | -75 |
| 3Q 14 | 1.25 | 0.25 | 1.50 | 0.87 | 0.50 | 91 | 8.53 | 0.75 | 7.33 | 1.75 | 1.27 | 0.00 | -85 |

Source: Citi Research

Figure 2. Selected Euro Area Countries — Per Capita GDP (2003 = 100), 2003-2013



Sources: IMF, Haver Analytics and Citi Research

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Removing Grexit from the Baseline Scenario

Grexit no longer base case scenario...

Although we still believe that the event of Greece leaving the euro area in the next few years remains a possibility, we have removed "Grexit" from our central scenario in Q1 14. We have argued since May 2012 that Grexit could happen either as a unilateral decision by Greece to return to its own currency or as a partly coordinated decision with its European creditors for it to leave the monetary union. We think the probability of both events occurring in the near future has receded. The domestic political environment is proving more stable than we thought and social unrest remains overall contained so far, despite ongoing economic depression.

...with further debt restructuring – of the official loans – likely in 2014

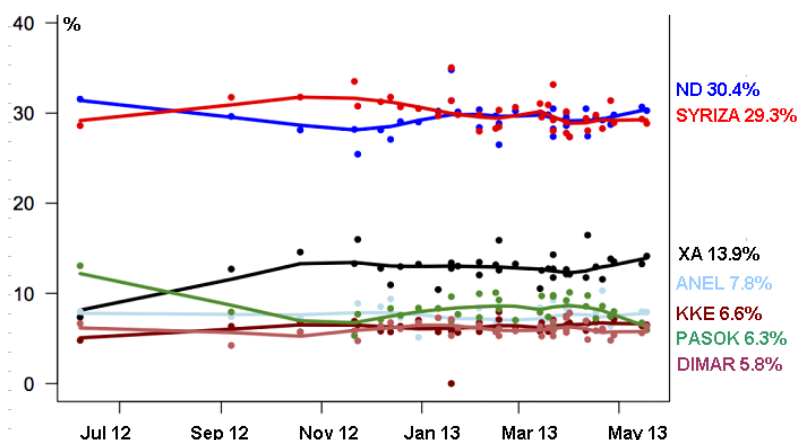
Moreover, fiscal numbers have been improving and they have been achieving (or even exceeding) the programme targets. Although some of the other targets are still not met (eg, privatizations), the Greek programme can more easily be deemed on-track now compared to the last three years. This makes a stalemate between Greece and its international creditors, eventually leading to a withdrawal of financial assistance and to the euro exit, a less likely scenario. Also, improved cooperation from Greece makes the official creditors (now holding around 80% of Greece's public debt) more open to conceding further debt relief perhaps in 2014, as comments from the head of the Eurogroup Dijsselbloem suggested this week.

Governing coalition surviving longer than expected, albeit still fragile

Main governing party New Democracy holding up in the polls...

We put forward three arguments to support our change of view on Grexit. **First**, the three-party coalition government is proving more resilient than we originally thought. The main governing party New Democracy (ND) has managed to maintain its support in polls at around 28%, neck and neck with anti-bailout opposition party Syriza, and relatively unchanged compared to last year's elections (see Figure 3). Actually, ND managed to improve its score slightly in the polls after the December deal with the international lenders, which allowed Greece to access a sizable amount of liquidity through new bailout loans (€52.3bn, or 29% of GDP, have been disbursed over the past five months, including €23bn as bank recap funds) and to receive some debt relief from the official creditors¹.

Figure 3. Greece – Opinion Polls, July12-May13



Source: Citi Research polling average of 36 surveys conducted by major Greek pollsters through May 18, 2013

¹ See ["The Greek Deal", 27 November 2012, Citi Research](#).

...although the junior coalition party PASOK has collapsed

Admittedly, while ND has been holding up in the polls, the other coalition parties have been sliding back, with the former governing party, the Socialist PASOK, down to 6.3% (from 12.3% in the June 2012 election) and surpassed by the far-right party Golden Dawn (13.9%). Were the governing coalition to break down in the next few months, the likelihood of the next government being a mainstream pro-European one is limited, in our view. But triggers that may overthrow the coalition in the near term seem less likely than in the past. The government recently passed a much-debated measure on the dismissal of some 15,000 civil servants by end-2015 (of which 4,000 by the end of 2013). Negotiations on this bill within the governing coalition were tough, but nowhere near the levels of brinkmanship seen on previous occasions for similarly contentious measures. Moreover, the next milestones to receive the next tranche of bailout money are far less controversial (anti-corruption measures, energy sector reform and households' indebtedness resolution law). And the next major troika review will not be until the discussion of the 2014 Budget in the autumn.

Social unrest has remained overall contained ...

Second, we note that although there are no signs of any material easing in the economic recession, social unrest has remained contained so far. In fact, consumer confidence has actually recovered somewhat relative to the historical lows of mid-2012². The significant improvements in equity prices and the sizable decline in consumer price inflation in recent months may have supported the slightly less negative sentiment among households, making a severe escalation of social unrest perhaps less likely in the near term than a few months ago.

... although it can always flare up given the dramatic fall in living standards

Admittedly, the limited evidence of social unrest does not mean that it is unlikely to happen. Triggers for such events are very difficult to predict, and the socioeconomic indicators are certainly not improving: the Greek population has experienced a reversal of their living standards to the level of a decade ago – per capita GDP is now back to 2003 levels – and the unemployment rate has now almost surpassed Spain's at 27% in February. Social discontent could still become more manifest in the future.

Fiscal data are finally achieving the targets

2012 fiscal targets have been met

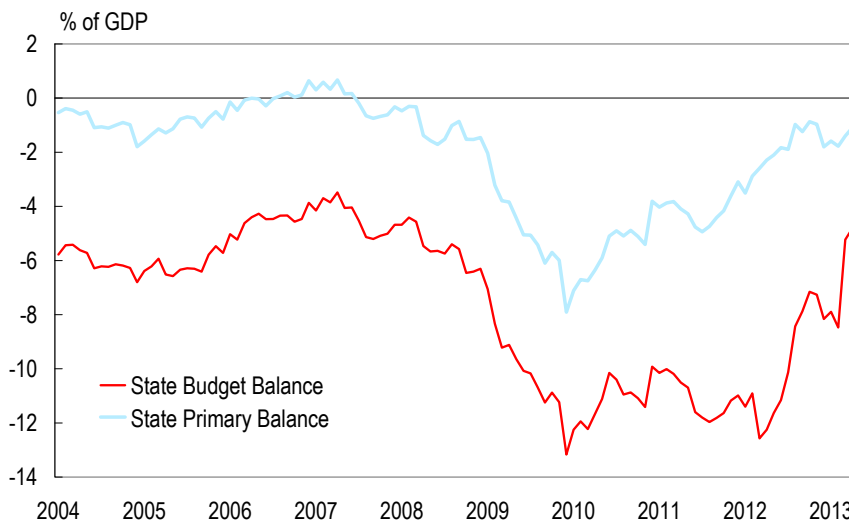
A **third** reason for changing our view on Grexit stems from recent developments on the fiscal front. Final 2012 data confirmed that the fiscal deficit last year was narrower than the original programme target, at 6.3% of GDP (net of the 4% of GDP effect of bank recapitalizations), compared to the projected 7.3% in March 2012. Admittedly, the better-than-expected performance mainly stemmed from lower interest spending (down from €15bn, or 7.2% of GDP in 2011, to €9.7bn or 5.0% of GDP in 2012) following the March PSI and the December debt buyback. The primary deficit, at 1.3% of GDP, stood broadly in line with the official forecast (of 1.5% of GDP).

And the trend seemed to continue in the first four months of 2013

Data for the first four months of 2013 suggest this trend has continued. The central government budget deficit stood at €2.4bn YTD in Apr 2013, against a €7.2bn deficit in the same period of 2012. While the YTD primary deficit was broadly similar to last year's (€300m) in April, the 12-month sum of the monthly primary balances showed a deficit of just €2bn in April (1% of GDP), down from 2.6% one year ago (see Figure 4). Moreover, revenues seem to be stabilizing, although at very low levels, in the past couple of months relative to a clear declining trend in the second half of 2012. The FinMin noted in the April budget press statement that revenues in the recent months had beaten the official targets for the first time.

² See ["Euro Economics Weekly: Watching for Positive Surprises: Favour GIPS over France"](#), Guillaume Menuet, 17 May 2013

Figure 4. Greece – State Budget and Primary Balance (12-Month Sum, Pct. of GDP), 2004-Apr13



Sources: Haver and Citi Research

Fiscal weaknesses remain, and the deficit may still exceed the 2013-2014 targets

To be sure, major weaknesses still impact the Greek government budget, including an inadequate tax collection mechanism, widespread tax evasion and a still high level of government arrears (at €7.9bn in April, or 4% of GDP, still higher than the €7.6bn one year ago). The IMF has recently criticised more openly than before the lack of progress on fighting tax evasion and structural change in the public budget, including the still-high reluctance to go ahead with public sector job cuts. We think that persistent economic weakness will cause some new deficit overshoots in 2013 and 2014, against official projections of a fiscal deficit of 4.1% of GDP and 3.3% of GDP, respectively (and a 0% and +1.5% of GDP primary balance). Moreover, the medium-term budget outlook remains uncertain as in order to reach the final target of a primary surplus of 4.5% of GDP by 2016, additional fiscal tightening measures worth 1.7% of GDP in 2015 and 2.1% of GDP in 2016 still have to be defined, according to the recent EU Commission review of the Greek programme published last week³.

More debt restructuring very likely to occur

The public debt remains on an unsustainable path...

Even though Grexit is no longer our baseline scenario, we have not changed our view on the unsustainability of the Greek public debt. Despite an overall 71pp of GDP in gross debt relief granted in 2012 (as estimated by the IMF in the January 2013 Review) and despite massive fiscal consolidation over the past three years, the Greek debt ratio is nowhere near a sustainable position yet. The debt ratio dropped to 156.7% of GDP in 2012, but it is bound to rise again to around 180% at the end of this year and close to 200% by 2014 according to our forecasts. The "snowball effect" added some 18pp of GDP to the debt-to-GDP ratio in 2012 and it is going to add about the same in 2013 (based on our forecasts). Despite a close-to-balance primary budget, the public debt remains on an unsustainable path in our view because of the weakness of the economy.

...requiring further debt restructuring, probably involving also a write-off of some bilateral loans

³ http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/ocp148_en.pdf

Figure 5. Greek Central Government Debt by Holders (€Bn), May 2013

| | |
|------------------|--------------|
| T-Bills | 18.9 |
| Bonds | 103.6 |
| PSI | 38.9 |
| Hold-outs | 5.2 |
| ECB/Eurosystem* | 51.8 |
| Others | 7.7 |
| Loans | 218.4 |
| Bilateral Loans* | 52.9 |
| EFSF* | 123.1 |
| IMF* | 24.9 |
| Others* | 17.5 |
| Total | 340.9 |

* in official hands (% of total) 264.9 (78%)

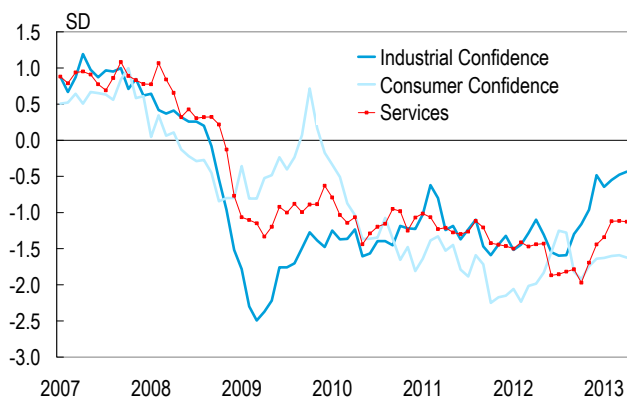
Source: Greek Ministry of Finance, Citi Research

Timing of the OSI not before the German elections, probably in 2014

Further debt restructuring seems inevitable in our view. But with 80% of public debt held in official hands, the sustainability of Greek public debt is now almost entirely dependent on political decisions by Greece's international lenders to offer additional relief in the form of OSI. With the large share of debt held in official loans or bonds at the ECB (see Figure 5), and with a zero primary deficit likely by the end of this year, Greece is spending about 3.0-3.5% of GDP annually to service the debt that is held by official sector lenders (other euro area countries, the ECB and the IMF). Various debt-relieving measures were agreed in December 2012 (among which a 100bp reduction in interest rate on bilateral loans and a 10-year interest rate moratorium and an extension of the loans maturity by 15 years). A similar mix, but probably also some principal write-off on bilateral loans, could be negotiated this time. There is also still a possibility that further PSI – affecting the hold-out bonds in the first PSI, amounting to some €4.5bn – will also be considered.

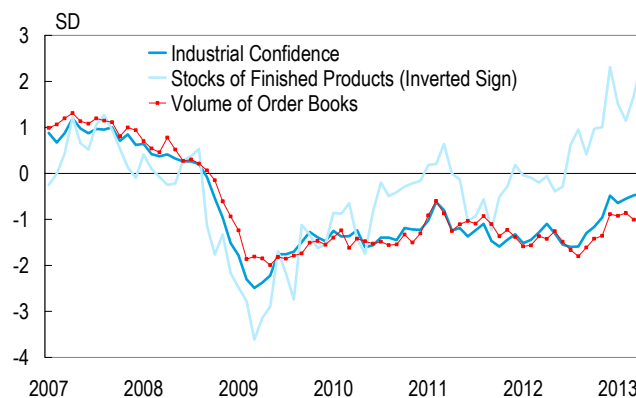
We think the discussion on further OSI will not be initiated ahead of the 22 September German elections, given the sensitivity of this issue within the German public. But German officials had already suggested last autumn that some form of debt write-off could be considered in the case of Greece. The improved performance in meeting the programme targets compared with earlier phases of the bailout, together with a cooperative stance by the current Greek government⁴, in our view should make official lenders more open to the idea of granting some additional debt relief to Greece at the end of 2013 or in 2014. Many statements praising Greece have been made by European politicians recently and hardly any criticism. Some of that is consistent with an aversion to shocks pre-German election, but we reckon a drastic change of course post-election looks difficult.

Figure 6. Greece – Economic Sentiment By Main Sectors (St. Dev. Around Mean), 2007-Apr13



Sources: EU Commission and Citi Research

Figure 7. Greece – Industrial Confidence (St. Dev. Around Mean), 2007-Apr13



Sources: EU Commission and Citi Research

⁴ The recent improvement in investor confidence towards Greece, if sustained, may also support this decision, as it bodes well for some privatisation deals to be finally concluded (as the sale of a major stake in the state-owned gaming company has recently suggested).

Recovery not close, economic rebalancing long and painful process

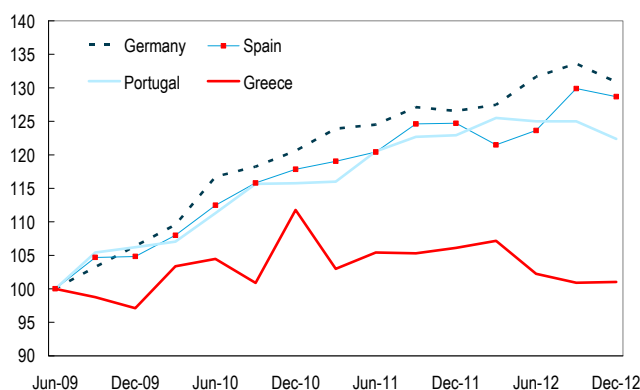
Recent improvement in confidence indicators does not signal the recovery is near, in our view

Despite this slightly better outlook on the political and fiscal fronts, the Greek economy remains mired in deep recession. According to IMF data, per capita GDP will be 21% lower this year than the peak in 2008 – a similar drop to Ireland between 2007 and 2010 (see Figure 2 on the front page). Despite the improvement in some confidence indicators, we think the economy is nowhere near a turning point (see Figure 6). The EU Commission sentiment indicator has risen substantially since last autumn (from 2.7 to 1.6 standard deviations below its long-run average), but most of the improvement in the headline index has been driven by higher expectations rather than better assessments of the current conditions. In particular, the industrial confidence indicator (which enters into the calculation of the overall economic sentiment) gained mainly just because of businesses' assessments of their finished product stock levels have fallen to record-low levels (which is normally seen as a sign of imminent output rebound but could also reflect other effects, see Figure 7). In fact, hard data, perhaps with the only exception of car registrations, have not really mirrored the improvements in confidence sentiment indicators.

Export performance has been very poor signaling limited competitiveness gains so far

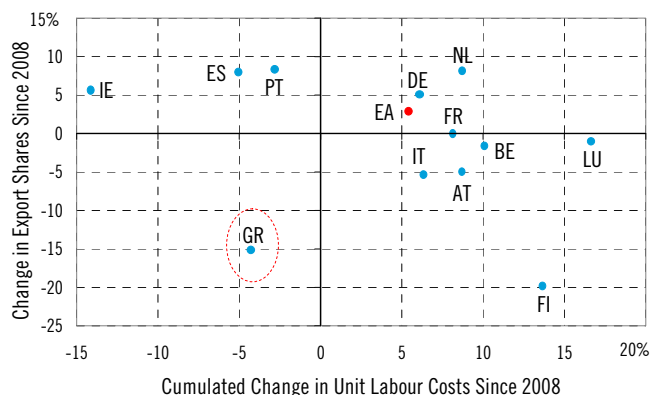
On a more medium-term basis, we think the Greek economy has not yet rebalanced enough to be able to generate GDP growth. Unit labour costs have been falling significantly (in Q3 12 ULC were down by around 20% from the peak in Q3 10) mainly because of wage declines, but the improvement in exports has so far been limited, especially when compared with other periphery countries (see Figure 8). As the ECB noted in the latest monthly bulletin, Greece stands out among the euro area countries in that its sizable fall in ULC has not been matched yet by any improvement in export market shares (actually these have continued to fall see Figure 9).

Figure 8. Selected Euro Area Countries – Real Exports of Goods and Services (Q2 09 = 100), Q2 09- Q4 12



Sources: Haver, Eurostat and Citi Research

Figure 9. Euro Area – Unit Labour Costs and Export Market Shares, 2008-2012



Sources: ECB Monthly Bulletin, May 2013

Prolonged sub-par inflation will have to occur to foster competitiveness

The internal devaluation process will be a key driver of this rebalancing process. Wage disinflationary pressures have started to be reflected into meaningfully lower consumer prices – CPI inflation has turned negative since March. But the process of regaining competitiveness will probably require a few years of very low or negative inflation rates. For example, the price level for restaurants and accommodation – possibly an important driver of Greece's potential gains in competitiveness given the important share of the tourism sector on GDP – remains broadly in line with the EU-27 average; this CPI component has grown below the EU-27 average only since last year. Moreover, we think it is not just an issue of regaining price

**Recession likely to persist more than
official forecasts**

competitiveness. An import-substitution process has probably also to take place for a larger share of domestic demand to be met by domestic output compared to the past. These rebalancing processes will likely take a very long time to complete.

Fiscal tightening will probably get less pronounced in 2014-16, especially if the expected OSI also reduces the government financing needs over for the next couple of years. But repairing the private sector's balance sheets will still be a major headwind on GDP growth, in our view, with likely little help from exports given the still small share of exports in GDP (still below 30%). Some support may come from initiatives taken at the EU level such as increasing the European social funds disbursements (by keeping the co-financing at the minimum) and some FDI inflows which seem to be starting to return to Greece (although from extremely low levels). But overall we expect real and nominal GDP to continue contracting at a fast pace.

**Grexit still a plausible scenario in the
next few years**

On the political front, while we do not see a concrete trigger in the near term that would bring down the governing coalition, the government's fragility, the drop in support for the mainstream party PASOK, and the pick-up in support for non-mainstream parties, are still worrisome developments. Greek support for NEAPs (New, Extreme and Alternative Parties) is the highest in the EU⁵. A struggling economy and dropping living standards, in our view, still makes Grexit a plausible scenario in the next few years, probably more plausible than many expect.

⁵ See Mid-year Outlook: Rising Geopolitical Risks and the New UltraVox Populi Will Carry On Into 2013. August 2, 2012 and 2013 Global Political Outlook: Another Annus Politicus Ahead? December 21, 2012

Key Economic Indicators (27 May – 31 May 2013)

| Monday 27 May | | Forecast | Last |
|------------------|---|----------------------|----------------------|
| 08:30 | UK: Bank Holiday | | |
| 08:30 | Netherlands: Producer Confidence, May | | |
| 08:30 | Sweden: Retail Sales, Apr | 0.6% MM | -0.4% MM |
| 09:00 | Norway: Unemployment Rate, Mar | 3.5% | 3.5% |
| Tuesday 28 May | | Forecast | Last |
| 07:00 | Germany: Import Prices, Apr | | |
| 07:00 | Switzerland: Trade Balance, Apr | | |
| 07:45 | France: Consumer Confidence, May | 85 | 84 |
| 08:15 | Switzerland: Unemployment, 1Q | | |
| 08:30 | Sweden: Producer Prices, Apr | | |
| 08:30 | Sweden: Trade Balance, Apr | | |
| 11:00 | Ireland: Retail Sales, Apr | | |
| | Spain: Budget Balance, Apr | | |
| Wednesday 29 May | | Forecast | Last |
| | Germany: HICP, May Flash | 0.3% MM, 1.6% YY | -0.5% MM, 1.1% YY |
| | National CPI, May Flash | 0.3% MM, 1.4% YY | -0.5% MM, 1.2% YY |
| 08:00 | Spain: Real Retail Sales, Apr | -6.1% YY WDA | -8.8% YY WDA |
| 08:55 | Germany: Unemployment, May | +8K, Rate: 6.9% | +4K, Rate: 6.9% |
| 08:30 | Sweden: GDP, 1Q | 0.2% QQ | 0.0% QQ |
| 08:30 | Sweden: Household Lending, Apr | 4.6% YY | 4.6% YY |
| 09:00 | Italy: Business Confidence, May | 89.1 | 87.6 |
| 09:00 | Euro Area: M3, Apr | 3.1% YY, 2.8% 3-M YY | 2.6% YY, 3.0% 3-M YY |
| 10:00 | OECD <i>Economic Outlook</i> released | | |
| 11:00 | UK: CBI Retail Survey, May | | |
| Thursday 30 May | | Forecast | Last |
| 06:45 | Switzerland: GDP, 1Q | | |
| 07:00 | UK: Nationwide House Prices, May | | |
| 08:00 | Spain: HICP Flash, May | 1.7% YY | 1.5% YY |
| 08:00 | Spain: GDP Details, 1Q | -0.5% QQ, -2.0% YY | -0.8% QQ, -3.2% YY |
| 09:00 | Italy: Producer Prices, Apr | | |
| 09:00 | Norway: Retail Sales, Apr | 0.6% MM | 0.0% YY |
| 10:00 | Euro Area: Economic Sentiment, May | 88.7 | 88.6 |
| 11:00 | Ireland: Quarterly Unemployment Survey (QNHS), 1Q | | |
| 17:00 | France: Jobseekers – Net Change, Apr | 30.0K | 36.9K |
| | Total Jobseekers, Apr | 3,254.6K | 3,224.6K |
| Friday 31 May | | Forecast | Last |
| 00:01 | UK: GfK Consumer Confidence, May | | |
| 07:00 | Germany: Retail Sales, Apr | 1.1% MM | -0.3% MM |
| 07:45 | France: Consumer Spending, Apr | -0.8% MM, 0.0% YY | 1.3% MM, 1.2% YY |
| 07:45 | France: Producer Prices, Apr | -0.2% MM, 1.6% YY | 0.0% MM, 1.9% YY |
| 08:00 | Denmark: GDP, 1Q Preliminary | | |
| 08:00 | Switzerland: KOF Economic Barometer, May | | |
| 09:00 | Norway: Credit Indicator C2, Apr | 6.0% YY | 6.1% YY |
| 09:00 | Norway: Registered Unemployment Rate, May | 2.4% | 2.6% |
| 09:00 | Italy: Unemployment Rate, Apr | 11.6% | 11.5% |
| 09:30 | UK: Personal Borrowing, Apr | | |
| 10:00 | Italy: HICP, May Preliminary | 1.3% YY | 1.3% YY |
| 10:00 | Euro Area: HICP Flash Estimate, May | 1.4% YY | 1.2% YY |
| 10:00 | Euro Area: Unemployment, Apr | | |
| | Spain: Current Account, Apr | | |

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area

| | | | |
|-----------------|--|---------------------------------------|--------------------------------|
| May 29 10:00 | M3, Apr | Forecast: 3.1% YY, 2.8% 3-M YY | Prior: 2.6% YY, 3.0% YY |
| London Time | After troughing at 2.6% YY, we expect a small uptick in M3 annual growth rate in April. In our view, seasonally adjusted loans to the non-financial sector will likely remain unchanged on a MM basis, after March's small increase (+0.1% MM) ended a string of nine consecutive monthly declines. | | |
| May 30 10:00 | Economic Sentiment, May | Forecast: 88.7 | Prior: 88.6 |
| London Time | Economic sentiment likely remained broadly unchanged in May, after dropping by 1.5 points (0.1 standard deviations) in April. We think some improvement has probably occurred in the industrial sector, reversing the weakness experienced in April, but the services and the consumer sectors are likely to have edged lower. | | |
| May 31 10:00 | HICP, May Flash Estimate | Forecast: 1.4% YY | Prior: 1.2% YY |
| London Time | After a surprisingly low inflation print in April, we expect some payback to occur in May, as holiday-related prices reverse the sharp drop they recorded after Easter in early April. However, inflation is unlikely to go back near the 2% YY level for the remainder of this year. | | |

Germany

| | | | |
|-----------------|---|-----------------------------------|------------------------------------|
| May 28 07:45 | HICP, May Flash | Forecast: 0.3% MM, 1.6% YY | Forecast: -0.5% MM, 1.1% YY |
| | National Consumer Prices, May Flash | Forecast: 0.3% MM, 1.4% YY | Forecast: -0.5% MM, 1.2% YY |
| London Time | Consumer prices are expected to have rebounded modestly in May, with unfavourable base effects pushing the headline rate upward. Structurally, underlying inflation pressures will be increasing in Germany given the uptrend in wage dynamics resulting from a much stronger labour market than in the rest of the euro area. | | |
| May 29 07:45 | Unemployment Change (000's), May | Forecast: 8K | Prior: 4K |
| | Unemployment Rate, May | Forecast: 6.9% | Prior: 6.9% |
| London Time | As in most euro area economies, unemployment expectations in Germany have been weakening since the start of 2013. In the last three months, the unemployment upticks have averaged around 5K. Given the muted performance of the German economy in 1Q-13 and the soft patch in business sentiment in the past few months, we anticipate a slightly larger increase in the total number of jobless in May. | | |
| May 31 07:45 | Retail Sales, Apr | Forecast: 1.1% MM | Prior: -0.3% MM |
| London Time | Retail sales are expected to have rebounded in April, based on indications of a much improved retail situation reading from the Ifo survey and continued positive dynamics in various indicators of consumer confidence. | | |

France

| | | | |
|-----------------|--|------------------------------------|--------------------------------|
| May 28 07:45 | Consumer Confidence Indicator (May) | Forecast: 85 | Prior: 84 |
| London Time | We look for a one-point gain in consumer confidence in May, after an unchanged reading in April. While the labour market situation is not showing any signs of improvement, households appear to believe a little more in the President's ability to turn the situation around, with tentative signs of a rebound in his record-low level of popularity. Generally, a noticeable fall in headline inflation during the previous month helps confidence rise. | | |
| May 30 17:00 | Jobseekers – Net Change, Apr (000s) | Forecast: 30.0K | Prior: 36.9K |
| | Jobseekers, Apr (000s) | Forecast: 3,254.6K | Prior: 3,224.6K |
| London Time | We anticipate a modest slowdown in the pace of unemployment increases in April, but expect a 30K uptick, consistent with the 29.1K six-month average increase. Although the government is ramping-up the creation of subsidised jobs to have a chance of meeting its ambitious year-end targets, the persistently muted level of private sector employment expectations does not suggest any improvement in the very near-term. | | |
| May 31 07:45 | Consumer Spending, Apr | Forecast: -0.8% MM, 0.0% YY | Prior: 1.3% MM, 1.2% YY |
| London Time | While car registrations improved noticeably in April, we suspect that the collapse in retail sentiment last month, coupled with noticeable drop in households' capacity to save probably reflected a sizeable correction in consumer spending. Retail sales point to downside risks to our forecast. We believe that household spending will likely contract for the third successive quarter in 2Q, contributing to an extension of the mild recession. | | |
| May 31 07:45 | Producer Prices, Apr | Forecast: -0.2% MM, 1.6% YY | Prior: 0.0% MM, 1.9% YY |
| London Time | The continued downtrend in Brent prices, raw materials and commodity prices points to a further slide in producer prices in April. We forecast that prices declined by around 0.2% MM, driving the headline rate to its lowest level since June and July 2012. As base effects start to become less favourable, the near-term outlook points to some stabilisation below 2% for the remainder of 2013. | | |

Italy

| | | | |
|-----------------|---|--------------------------|-----------------------|
| May 29 09:00 | Business Confidence, May | Forecast: 89.1 | Prior: 87.6 |
| London Time | Business sentiment likely bounced back in May, after a one-point decline in April, probably supported by buoyant equity prices and the interest rate cut from the ECB. The index however remains at 1.3 standard deviations below its long-run average, suggesting the contraction in industrial activity is likely to continue in the next few months. | | |
| May 31 09:00 | Unemployment, Apr | Forecast: 11.6% | Prior: 11.5% |
| London Time | Unemployment likely ticked higher in April, after stabilising in the previous two months at 11.5%. Employment will likely continue to shrink reflecting very negative GDP growth. On a quarterly basis unemployment will likely come at 11.6% on average in 1Q13, up from 11.2% in 4Q12. | | |
| May 31 10:00 | HICP, May P | Forecast: 1.3% YY | Prior: 1.3% YY |
| London Time | Thanks primarily to favourable base effects and to the recent sharp fall in oil prices, the annual HICP inflation rate declined substantially in April from 1.8% to 1.3% – lowest reading since Feb-10. Core inflation also dropped by 0.2pp to 1.3% YY. We expect only a small fraction of the April weakness to be reversed in May, with core HICP inflation moving back to 1.4% YY, but further declines in fuel prices will likely offset this effect. The headline HICP inflation rate is expected to remain stable at 1.3%. We think the underlying trend remains mildly on the downside, although the planned 1-pp VAT rate hike in July (if implemented) will likely lift the headline YY rate during the summer. | | |

Economic Indicators

| | | | |
|-----------------|---|-------------------------------------|----------------------------------|
| Spain | | | |
| May 29 09:00 | Real Retail Sales, Apr | Forecast: -6.1% YY (WDA) | Prior: -8.8% YY (WDA) |
| London Time | Retail spending dropped by 1% MM in March, and we expect a small payback in April. However, we think the underlying trend remains weak although not as weak as at end-2012, at the time of the VAT rate hike and public sector wage cuts, when retail spending dropped by 5.6% QQ. | | |
| May 30 08:00 | HICP, May F | Forecast: 1.7% YY | Prior: 1.5% YY |
| London Time | After the sharp decline in headline HICP inflation from 2.6% to 1.5% in April, we think a small payback is likely in May, as base effects turned less favourable and some payback in holiday-related prices is to be expected. The underlying price trends remain weak, especially if one considers that inflation is boosted at present by the 3-pp VAT rate introduced in September 2012, probably lifting the headline rate by almost 1pp. | | |
| May 30 09:00 | GDP Details, 1Q | Forecast: -0.5% QQ, -2.0% YY | Prior: -0.8% QQ, -3.2% YY |
| London Time | The contraction in 1Q GDP was somewhat less deep than in 4Q (-0.8% QQ), but the recession has definitely continued at the beginning of the year. We expect GDP details to show that domestic demand contracted sharply, but probably at around half the pace of 4Q12 (probably we estimate by -1.0% QQ). Net exports continued to contribute positively to GDP growth, primarily because of falling imports. | | |
| Sweden | | | |
| May 27 08:30 | Retail Sales, Apr | Forecast: 0.6% MM | Prior: -0.4% MM |
| London Time | Following four consecutive gains, retail sales fell back slightly in March. Still, retail sales have been off to a strong start this year with average activity up 1.6% QQ in 1Q. The overall gain is driven by durable goods sales and food consumption, and is well in line with the significant improvement seen in consumer confidence since the turn of the year. Given the ongoing recovery in consumer confidence, we expect retail sales to increase again in April. | | |
| May 29 08:30 | GDP, 1Q | Forecast: 0.2% QQ | Prior: 0.0% QQ |
| London Time | According to monthly data, production both in manufacturing and construction was weak during the first quarter. In addition, goods exports fell substantially and we have seen a decreasing number of hours worked. Meanwhile, retail sales have shown decent growth and with a large decrease in goods imports, net foreign trade should contribute positively to growth in the first quarter. On balance, our model points to a 0.2% QQ gain, marginally below the Riksbank's forecast of 0.3% QQ. | | |
| May 29 08:30 | Household Lending, Apr | Forecast: 4.6% YY | Prior: 4.6% YY |
| London Time | Lending to households ticked slightly higher in February to 4.6% YY, but has otherwise gradually moderated from 9.3% YY in early 2010 and 5.0% YY a year ago. The largest part of households' loans consists of housing loans (63%), which in Feb had an annual growth rate of 4.7%, down from 5.2% YY a year ago and 10.5% YY in early 2010. Hence, it appears that the tightening in mortgage regulation is having the intended effect on household borrowing (an 85% loan-to-value mortgage cap was introduced in Oct-10). In late-Nov, the FSA proposed a 15% risk weight floor for mortgages as another measure to contain household indebtedness (170% of disposable income at present). | | |
| Norway | | | |
| May 27 09:00 | LFS Unemployment Rate, Mar | Forecast: 3.5% | Prior: 3.5% |
| London Time | The LFS jobless data suggest that unemployment levelled out in the beginning of the year, following the sharp deterioration in the final quarter of 2012, where the seasonally-adjusted jobless rate jumped to the highest level in two years of 3.6% in December, up 0.5pp from September. Meanwhile, employment continues to expand, albeit at a much more moderate pace than during 2012. | | |
| May 30 09:00 | Retail Sales, Apr | Forecast: 0.6% MM | Prior: 0.0% MM |
| London Time | Following a weak trend last autumn, momentum in private spending appears to be improving again. Even though spending was basically flat in March, it follows four months of solid gains. In turn, retail sales gained a strong 1.9% QQ in 1Q, the strongest quarterly gain since 2Q-07. With supportive fundamentals in place, consumption growth should stay robust ahead (firm labour market, solid real disposable income, low interest rates and strong house price gains). In other words, it appears that the weak tendency in 4Q was temporary. | | |
| May 31 09:00 | Registered Unemployment Rate, May | Forecast: 2.4% | Prior: 2.6% |
| London Time | Norway's labour market remains relatively firm. In line with the seasonal pattern, we expect May's registered jobless rate to fall 0.2pp to 2.4%. | | |
| May 31 09:00 | Credit Growth Indicator, Apr | Forecast: 6.0% YY | Prior: 6.1% YY |
| London Time | The latest lending survey from Norges Bank showed that household credit demand surprisingly declined in 1Q, contradicting the monthly credit growth indicator for households, which remained stable at 7.2% YY in Jan-Mar. With ongoing strong developments on the housing market, we do not expect household credit growth to slow near-term. We also note that the survey has not been very accurate in terms of actual credit growth. The latest lending survey also showed a pick up in credit demand from non-financial enterprises, reflecting easier credit standards. The monthly development in corporate credit growth has been on a downward trend over the past nine months and is currently running at 3.8% YY. Ahead, banks expect demand to continue to increase in 2Q despite lending standards being tightened. In turn, we expect credit to households to remain in the area of 7% YY in April, and credit to municipalities will probably also stay largely unchanged. Meanwhile, the downward trend in credit to non-financial enterprises probably continued in April. | | |

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

Key Economic Indicators (3 June – 7 June 2013)

| Monday 3 June | | Forecast | Last |
|------------------|--|-------------------|-------------------|
| 07:30 | Sweden: PMI, May | 49.3 | 49.6 |
| 08:00 | Norway: PMI, May | 50.1 | 48.9 |
| 09:00 | Euro Area: Manufacturing PMI, May Final | | |
| 09:30 | UK: Manufacturing PMI, May | | |
| | Italy: Budget Balance, May | | |
| Tuesday 4 June | | Forecast | Last |
| 08:00 | Spain: Unemployment, May | | |
| 08:30 | Sweden: Service Production, Apr | -0.4% MM | -0.9% MM |
| 10:00 | Euro Area: Industrial Producer Prices, Apr | | |
| Wednesday 5 June | | Forecast | Last |
| 07:00 | Finland: GDP, 1Q | | |
| 09:00 | Euro Area: Services PMI, May Final | | |
| | Composite PMI, May Final | | |
| 09:30 | UK: Services PMI, May | | |
| 10:00 | Euro Area: Retail Sales, Apr | | |
| 10:00 | Euro Area: GDP Details, 1Q | | |
| 11:00 | Portugal: GDP Details, 1Q | | |
| 4:00 | Belgium: GDP Details, 1Q | | |
| Thursday 6 June | | Forecast | Last |
| 06:30 | France: Unemployment, 1Q | | |
| 08:15 | Switzerland: Consumer Prices, May | | |
| 08:30 | Netherlands: Consumer Prices, May | | |
| 10:00 | Cyprus: HICP, May | | |
| 11:00 | Germany: Incoming Orders, Apr | | |
| | Greece: Unemployment Rate, Mar | | |
| 12:00 | UK: MPC Outcome | | |
| 12:45 | Euro Area: ECB Outcome (Press Conference at 13:30) | | |
| Friday 7 June | | Forecast | Last |
| 07:00 | Germany: Labour Cost Index, 1Q | | |
| 07:00 | Germany: Trade Balance, Apr | | |
| 08:00 | Spain: Industrial Production, Apr | | |
| 08:30 | Netherlands: Industrial Production, Apr | | |
| 09:00 | Norway: Manufacturing Production, Apr | -1.2% MM, 2.3% YY | -0.7% MM, 3.2% YY |
| 09:30 | UK: Trade Balance – Goods & Services, Apr | | |
| 09:30 | UK: New Construction Orders, 1Q | | |
| 09:30 | UK: BoE/GfK Inflation Expectations, May | | |
| 10:00 | Cyprus: GDP Details, 1Q | | |
| 11:00 | Germany: Industrial Production, Apr | | |
| | Greece: GDP Details, 1Q (NSA, YY %) | | |

Sources: National statistical offices, central banks and Citi Research

| Recent Research Publications | Author | Date |
|--|------------------|--------------|
| Euro Area | | |
| | Giada Giani | May 24, 2013 |
| European Economic Forecast Highlights - May 2013 | Ann O'Kelly | May 23, 2013 |
| Euro Area - ECB Cuts Refi Rate By 25bp, Does Not Rule Out More To Come | Giada Giani | May 2, 2013 |
| ECB - Rate Cut Likely in May or June | Jürgen Michels | Apr 4, 2013 |
| Euro Economics Weekly | | |
| Watching for Positive Surprises: Favour GIPS over France | Guillaume Menuet | May 17, 2013 |
| Euro Area Disinflationary Pressures | Giada Giani | May 10, 2013 |
| Italy and Spain — "We Will Die of Austerity Alone" | Giada Giani | May 3, 2013 |
| Muted Profits Dynamics Point to Sub-Par Recovery Prospects | Guillaume Menuet | Apr 26, 2013 |
| ECB to Cut Rates First, SME Support Later | Jürgen Michels | Apr 19, 2013 |
| Italy's Credit Crunch | Giada Giani | Apr 12, 2013 |
| France: Could Low Popularity Slow the Structural Reform Drive? | Guillaume Menuet | Apr 5, 2013 |
| Chief Economist Publications | | |
| Global Economic Outlook and Strategy - May 2013 | Willem Buiter | May 22, 2013 |
| Spain | | |
| Spain - Registered Unemployment and Sector Accounts Data | Giada Giani | Apr 2, 2013 |
| Norway | | |
| Scandi Economics Update | Tina Mortensen | May 24, 2013 |
| Norway - Stable Interest Rate at 1.50%, No Change to Outlook | Tina Mortensen | May 8, 2013 |
| Sweden | | |
| Sweden - Sharply Undershooting Inflation in April | Tina Mortensen | May 14, 2013 |
| UK | | |
| UK - YouGov Report Inflation Expectations Edge Down Again | Michael Saunders | May 23, 2013 |
| UK - GDP Split Not Encouraging For Growth Prospects | Michael Saunders | May 23, 2013 |
| UK - Data and IMF Review | Michael Saunders | May 22, 2013 |
| UK - BoE Inflation Report | Michael Saunders | May 15, 2013 |
| UK - Carney Speech: Implications for the UK | Michael Saunders | May 2, 2013 |
| UK Economics Weekly | | |
| Inflation Report Does Not Signal End of Easing | Michael Saunders | May 17 2013 |
| Options for Forward Guidance | Michael Saunders | May 10 2013 |
| Upside Inflation Risks Receding | Michael Saunders | May 3 2013 |
| Reinhart and Rogoff Were (Partly) Right | Michael Saunders | Apr 26, 2013 |
| Will the BoE Do a BoJ? | Michael Saunders | Apr 19, 2013 |
| Source: Citi Research | | |

Appendix A-1

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