Citi Research

Economics

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Developed Markets
Western Europe

Euro Economics Weekly

One Shock Away from Deflation

- Euro area core inflation has fallen to a record low of 0.8% YY in October. While the downtrend in place since early 2012 has been remarkable, we expect it to continue in 2014 and 2015. Ample spare capacity and the recent appreciation of the currency will likely exert major downside pressures on inflation in the next couple of years, while the internal devaluation process in several peripheral countries will likely cause mild but protracted negative inflation rates in some of them.
- We have revised down our euro area inflation forecasts for the next couple of years and we now expect it to average at 0.9% in 2014 and at 0.7% in 2015. After this week's rate cut, we would expect the ECB to react to further downward surprises to headline inflation over time, but at this stage, we expect policy rates unchanged in December and anticipate the refi rate to be kept at record lows until Q4-16.

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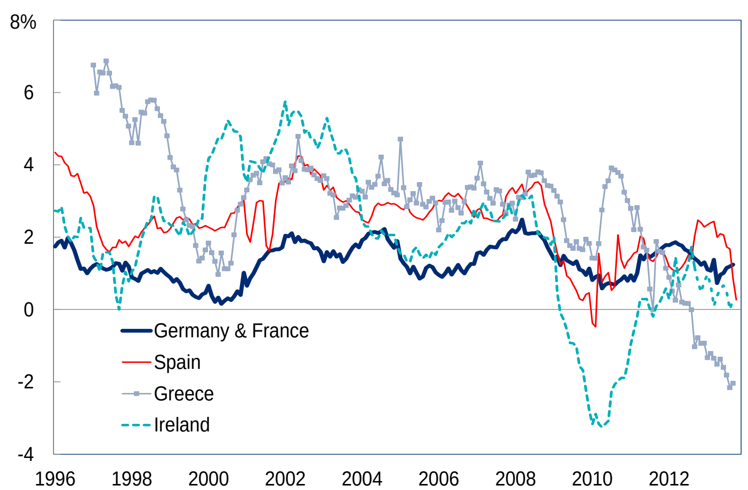
Figure 1. Citi Market Forecasts

	$/€	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	1.38	0.25	1.80	0.83	0.50	102	8.87	1.00	8.08	1.50	1.25	0.00	-82
2Q 14	1.40	0.25	1.80	0.82	0.50	127	8.94	1.00	8.01	1.50	1.25	0.00	-78

Source: Citi Research

Figure 2. Selected Euro Area Countries – Core HICP Inflation, 1996-Oct 2013



Sources: Eurostat, Haver Analytics and Citi Research

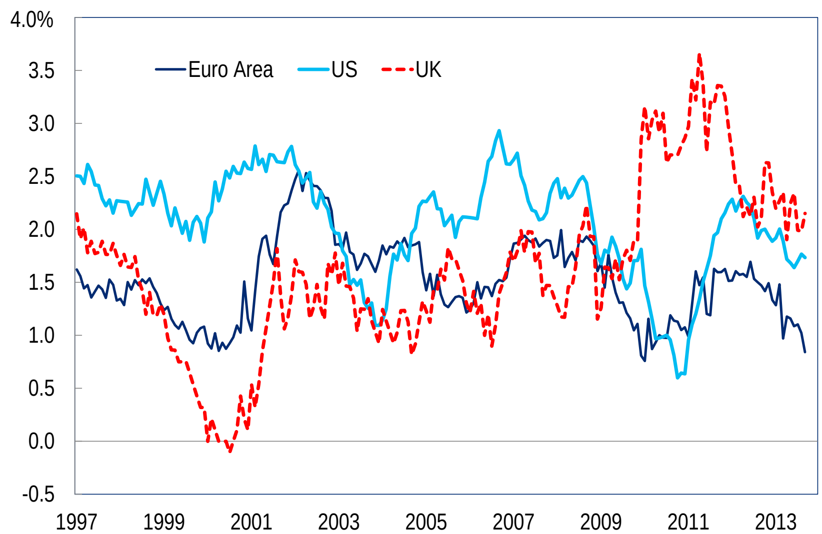
See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Euro Area: One Shock Away from Deflation

Surprisingly low Sep and Oct inflation readings have spurred ECB rate cut

Two consecutive weak and below-consensus inflation prints in September and October, together with a strengthening euro, have reignited concerns about deflationary risks in the euro area and have prompted the ECB to deliver a 25bp rate cut. Core inflation – ex-energy, food and tobacco – dropped to a record low of 0.8% YY in October[1], which is by far the lowest among several main advanced economies, except Japan (see Figure 3). We revisit our simple Phillips curve model to assess the impact of the recent EUR appreciation and ample economic slack on medium-term price dynamic. The model predicts euro area core inflation continuing to fall in 2014 and in 2015 and getting close to 0% YY by end-2015. We have revised our inflation forecasts and we now expect headline inflation to average at 0.9% in 2014 and to fall to 0.7% on average in 2015[2]. The ECB's new inflation projection (due out at the 7 December meeting) may yield slightly different results, but it looks likely to us that the 2015 mid-point inflation forecast will be lower than 2014 (current 2014 forecast at 1.3%). Given the symmetric approach to its inflation target, we would expect the ECB to react to further downward surprises to headline inflation over time, but at this stage, we expect the ECB to leave rates unchanged in December, and anticipate the refi rate to be kept at record lows until Q4-16.

Figure 3. Selected Advanced Economies – Ex-Food and Energy CPI Inflation, 1997-Sep-13



Sources: Haver Analytics and Citi Research

Inflation unlikely to fall further from October's 0.7% YY before year-end

In the space of four months, euro area headline inflation has dropped from 1.6% YY in July to 0.7% YY in October. The scale of the decline is not that unusual, especially since the move has been driven to a large extent by falling inflation in the more volatile components. Fresh food price tensions, which had been building up in late spring/early summer due to unfavourable weather conditions, were abruptly reversed in the last two months, shaving some 0.25pp off the headline rate. Favourable base effects coupled with falling petrol prices drove the annual inflation rate of the energy component down to a low of -1.7% YY in October, shaving some 0.35pp off the headline inflation rate in four months. Using oil prices futures as the main input, energy prices are expected to fall marginally again in November and December: the annual rate of the energy HICP component is likely to remain in negative territory, but it is unlikely to fall much further over the next six months, therefore providing a negligible contribution to short-term changes in the headline

[1] Ex-food, energy and tobacco inflation stood at 0.8% YY also in Jan and Feb 2010.

[2] We previously expected euro area inflation to average 1.3% in 2014 and 1.4% in 2015.

rate. Similarly, further outright food price declines are still possible, but their magnitude is likely to be more contained than in Sept and Oct. Assuming a small payback in core prices in November (we think part of the October weakness was related to some seasonal movements), we think that headline HICP inflation will probably bounce back to 0.9% YY in November before falling back again to 0.8% YY at the beginning of 2014.

But the recent fall in core inflation is noticeable, as starting point was already low

As one may expect, core inflation responds mainly to a degree of economic slack and exchange rate moves

Nevertheless, the downward trend in core inflation – in place, really, since the beginning of 2012 – has been quite remarkable as the starting point was already not particularly high. Note that, given the increasing amount of spare capacity in the euro area economy, we had already argued in last May that core inflation was likely to keep heading south to reach 1% by year-end[3]. However, the strengthening of the trade-weighted euro since last summer and an output gap likely to remain negative until 2015 suggest that the downtrend in core inflation still has some way to go.

Core inflation set to fall close to 0% by end 2015

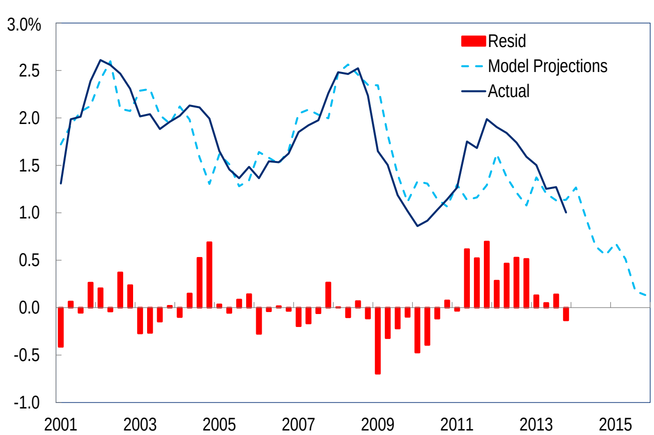
Our simple Phillips curve model estimates the changes in the annual core (ex-unprocessed food and energy) inflation rate as a function of the output gap (one quarter lagged) and of previous changes in the effective exchange rate (6 to 10 quarters lagged)[4]. We added to this basic formulation the lagged changes in energy and fresh food prices over the previous four quarters, in order to account for second round effects of these exogenous shocks on core prices. The estimated elasticity suggests that core inflation tends to fall (rise) by 0.1pp for each percentage points of negative (positive) output gap and to fall (rise) by 0.4-0.5pp for each 10% appreciation (depreciation) of the effective exchange rate after 6-to-10 quarters[5]. A 10% shock on energy HICP implies a 0.15pp shock on core inflation with a two-quarter lag, while the same shock on fresh food prices has an impact of 0.6pp with roughly the same time lag (see Figure 4).

Figure 4. Euro Area – Estimated Elasticities of Changes in Core Inflation (pp)

	Elasticity	Quarter Lags
1% change in Output Gap	0.12	1
10% change in TW-EUR	-0.38	6-10
10% change in Energy HICP	0.17	1-2
10% change in Fresh Food HICP	0.64	1-2

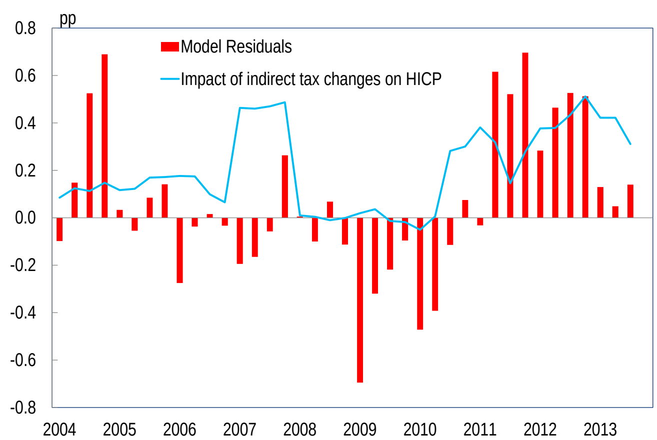
Source: Citi Research

Figure 5. Euro Area – Realised and Projected Core Inflation, 2001-2015F



Sources: Haver Analytics, Eurostat and Citi Research

Figure 6. Euro Area – Core Inflation Model Residuals and Indirect Tax Changes, 2004-2013



Sources: Haver Analytics, Eurostat and Citi Research

[3] See "Euro Economics Weekly – Euro Area Disinflationary Pressures", Citi Research, 10 May 2013

[4] The model is estimated on quarterly data over the period 1998-2013Q3. The dependent variable is the YY core inflation rate at time t minus the YY core inflation rate at time t-4.

[5] The estimated exchange rate elasticity is fairly similar to the one included in the ECB's euro-area wide model (see http://www.ecb.europa.eu/pub/pdf/scpops/ecbocp94.pdf).

The model predicts core inflation to keep falling to close to 0% by end-2015

The model has a relatively good in-sample fit, at least until 2011, when it failed to predict the increase in core inflation (see Figure 5). However, a good part of the model residuals in 2011-2012 can be attributed to higher indirect taxes which affected the core inflation rate in several euro area countries (see Figure 6). Going forward, the model predicts core inflation to continue falling from 1% YY in Q4 13 to just above 0% at the end 2015. This is based on the assumption that the output gap remains in negative territory, albeit narrowing from around -3% of GDP now to about -1.8% in Q4 15. We take Citi official forecasts for the trade-weighted euro as an input, envisaging an appreciation of 4.8% in 2013 and another one by 2.7% in 2014, before a small depreciation by 0.7% in 2015[6]. Given the aforementioned usual lag of the exchange rate pass-through, the recent currency strength will display its effects on core inflation only from H2 14. The ECB rate cut this week may at margin have affected the projected level for the euro, but we still think the expected path over the next couple of years remains similar.

We project inflation to fall on average to 0.9% in 2014 and to 0.7% in 2015

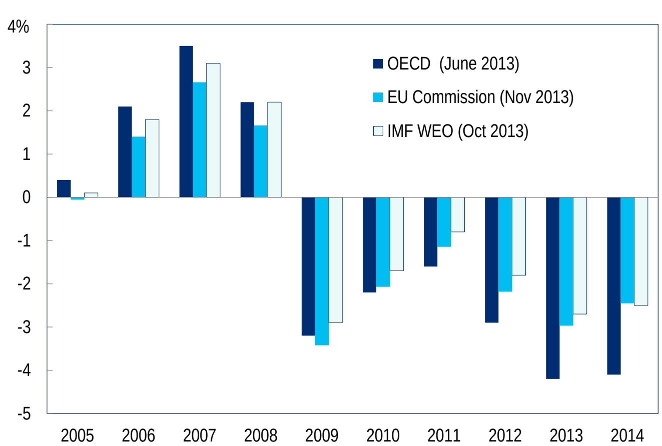
Combining this core inflation forecast with the projections for the energy and fresh food components (and also taking into account the already-announced indirect tax changes), we expect euro area headline inflation to fall from an average of 1.4% in 2013 to 0.9% in 2014 and to decline further to 0.7% in 2015 (averaging 0.4% YY in Q4 15).

Uncertainty around real-time output gap estimates

Output gap real-time estimates differ significantly among forecasters

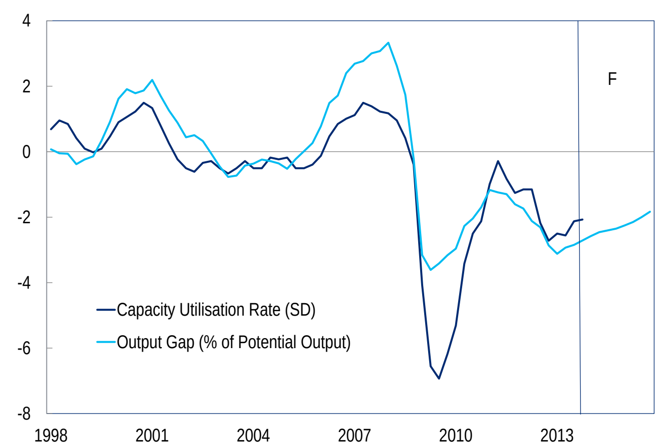
This inflation forecast crucially relies on an assumption for the output gap, that is on the difference between actual and potential GDP – the latter notoriously very difficult to estimate, especially in real time. Our output gap assumption of close to -2.0% of GDP in 2015 is not far from other estimates: the EU Commission autumn forecasts released this week estimate the 2015 output gap for the euro area at -1.5% (from -2.5% in 2014) and the IMF October WEO put it at -1.9%. The OECD, which has a more benign view of where potential GDP growth stands in the euro area, estimated the output gap at -4.1% in 2014 (see Figure 7).

Figure 7. Euro Area Output Gap (Pct. of Potential GDP), 2005-2014F



Sources: Haver Analytics and Citi Research

Figure 8. Euro Area – Measures of Economic Slack, 1998-2015F



Sources: EU Commission, Haver Analytics and Citi Research

But capacity utilisation rates convey a similar message on the ample degree of spare capacity at present

Other measures of economic slack are currently depicting a fairly similar picture as the output gap: the capacity utilisation rate in the industrial sector remains about 2 standard deviations below its long-run average, albeit on a slightly improving trend (see Figure 8). However, it has to be said that in the last few years the output gap

[6] See "Global Economic Outlook and Strategy - October 2013", Willem Buiter et al, 23 October 2013, Citi

and the capacity utilisation rate have signaled quite different degrees of spare capacity in the eurozone (albeit generally of the same sign), confirming the difficulty of accurately estimating the degree of resource underutilisation and hence of downward price pressures.

Labour costs are also falling, following rather than leading the consumer price move

Moreover, our core inflation model does not take into account any effect of labour costs on price dynamics. This reflects the fact that in the past wages and unit labour costs (ULC) have tended to lag (or at best being coincident with) the inflation dynamic, mainly because of the high degree of wage indexation in many European countries. Nevertheless, it is hard to argue that current wage inflation could pose upside pressures on consumer prices: private sector labour costs have decelerated to a record low of 1.2% YY in Q2 13. With the unemployment rate at historically high levels, we think that the wage dynamic will remain subdued and possibly move alongside HICP dynamic in coming quarters rather than represent a potential source of upward inflation risks.

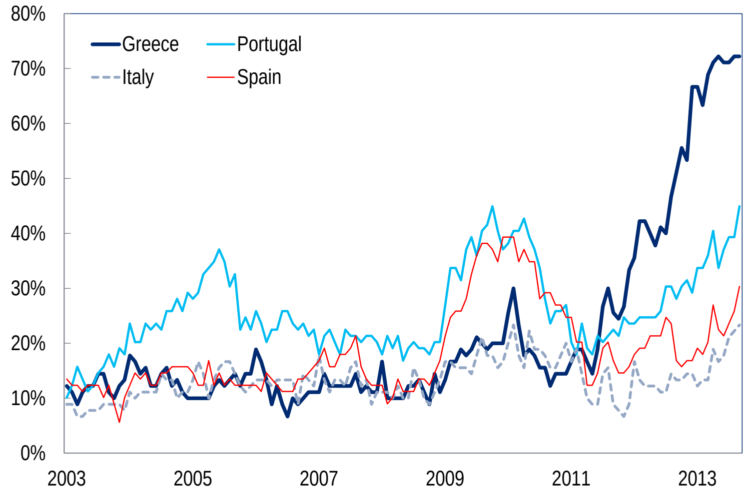
Deflation in the euro periphery?

Downward trend in core inflation largely driven by peripheral countries

Another way of looking at future drivers of euro area inflation is to consider the country breakdown of the euro area HICP. As we discussed in the past, we reckon the ongoing internal devaluation process of the euro periphery will likely be a major source of disinflationary pressure for the euro area as a whole. [7] Greece, Portugal, Ireland and Spain (about 20% of the euro area) accounted for 0.6pp to the euro area annual HICP rate on average in the 2002-2007 period, running inflation rates considerably above the average of the other euro members. These countries at present all display below-average inflation rates and their contribution to euro area annual inflation rate was only 0.05pp in the first nine months of 2013 (falling to just 0.01pp in September). If Italy (18% of the euro area) is added to the group (we believe that Italy is also likely to experience disinflationary pressures in coming years due to the need to regain competitiveness), disinflationary forces at the euro area level would become conspicuous. This is unless German and French core inflation readings were to exceed materially the 2% threshold under which they have generally remained in the past ten years (see Figure 2 on the Front Page). In fact, recently inflation has been falling also in Germany (to 1.3% YY in October) and in France (probably below 1% in October), not just in the periphery.

[7] See "Euro Economics Weekly – Euro Area Disinflationary Pressures", Citi Research, 10 May 2010

Figure 9. Selected Euro Area Countries – Percentage of Items in the HICP Basket With Negative YY Inflation Rate, 2003-Sep 2013



Sources: Eurostat, Haver Analytics and Citi Research

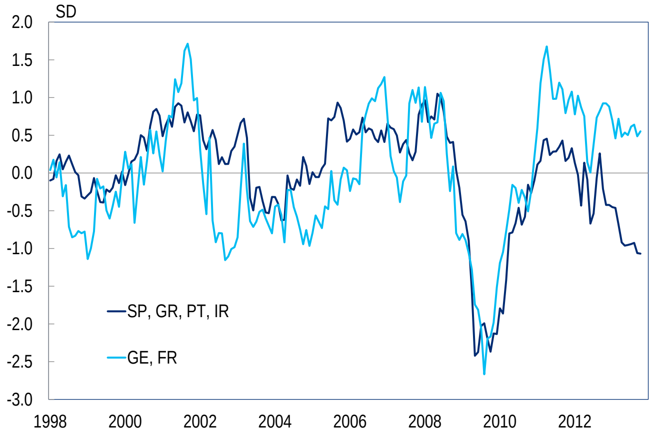
Greece and Ireland show the possibility of outright price declines as part of the internal devaluation process

The magnitude of the internal price adjustment is difficult to predict as it depends on many factors, including different degrees of price rigidity across different economies and the extent of real output losses relative to potential output. For example, in Ireland, arguably the most flexible of the periphery economies, the internal devaluation started already in 2009, much earlier than elsewhere. It was quite abrupt (core inflation averaged -2.5% in 2010), but eased relatively quickly (although core inflation remains close to zero now). Conversely, in Greece core inflation turned negative only in late-2012, alongside a negative output gap in the order of 12-13% of GDP (more than double Ireland's in 2010).

Downward price rigidities not so widespread, as large shares of the CPI baskets already in negative territory in some periphery countries

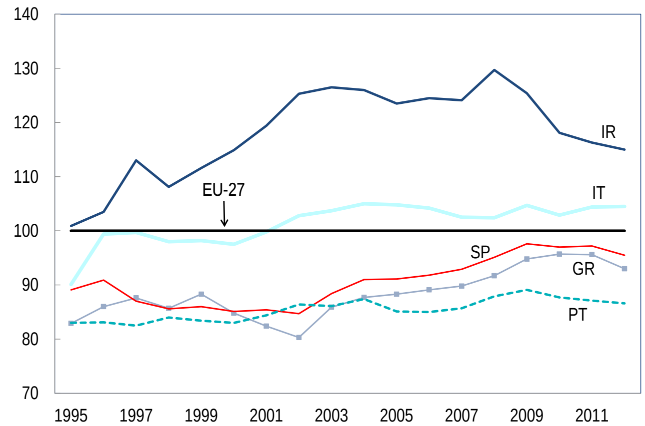
However, the case for widespread and large deflation in several peripheral countries remains debatable in our view. We do not expect output gaps in Spain, Italy or even Portugal of a magnitude similar to Greece's over the next few years. But recent structural reforms in product and labour markets in these countries (especially in Spain) should help reduce price stickiness and nominal rigidities, making these countries closer to Ireland than Greece. Nominal price rigidity may already not be a major issue. Looking at the most detailed HICP breakdown (90 items), data show that 25% of the Italian HICP basket has a negative inflation rate, 30% in Spain, and 45% in Portugal. In Greece this share has shot up to 70% in Sept, from 40% only 12 months ago (see Figure 9). This suggests that downward price rigidities may be less widespread than generally expected and that price declines, once initiated, may quickly transfer through a large number of HICP items. Moreover, households' price expectations in Spain, Greece, Portugal and Ireland are clearly lower than in Germany or France at present, although this may reflect the current lower level of inflation rather than genuinely lower price expectations for the future (see Figure 10).

Figure 10. Euro Area – Core vs. Periphery Households Price Expectations Over Next 12 Months, 1998-Oct 2013



Sources: EU Commission and Citi Research

Figure 11. Selected Euro Area Countries – Price Levels of Private Household Consumption (EU-27= 100), 1995-2012



Sources: Eurostat and Citi Research

Price and wage levels are still lower in the periphery than in the core, limiting the scope for widespread and sizable deflation

On the other hand, one argument against broad-based deflation in the periphery is that price and wage levels in all these countries, except for Ireland, are already below (in some cases by a large margin) the European average (see Figure 11). Despite above-average inflation rates in pre-crisis years, the Spanish and Greek average price levels remain some 10% lower than the euro area and Portugal's is even lower. The Italian price level is broadly in line with the euro area, possibly leaving more room for a downward adjustment in prices. Regaining price competitiveness probably does not require large negative inflation rates, but a mildly deflationary or close-to-zero inflation scenario would help to achieve the objective.

Upside price pressure can still come from higher indirect taxes …

All in all, we believe that underlying inflation rates in Italy, Spain and Portugal, and to some extent Greece, are likely to continue subsiding from already record-low levels, probably falling to zero and into mildly negatively territory over the next couple of years. This will be a major source of disinflationary pressure at the euro area aggregate level. Upside risks to this scenario could still stem from the fact that governments will remain under pressure to reign in budget deficits via higher indirect taxes. The standard VAT rate has been already brought to 23% in Portugal, Greece and Ireland, but still stands at 21% in Spain and at 22% in Italy, leaving some room for further hikes.

… and perhaps lower than estimated elasticity to very negative output gaps

Other upside risks could also come from smaller inflation elasticity to the output gap than historical estimates suggest due to highly different levels of spare capacity across the euro economies. If one allows for some non-linearity in the response of the inflation rate to very large output gaps, then the heterogeneity of degrees of spare capacity across euro area countries – ranging from marginally negative in Germany to minus 12-13% in Greece – may imply an overall lower inflation sensitivity to economic slack. But equally, a non-linear relationship between inflation and the output gap could be a source of downside risk, as inflation in some periphery countries may start falling abruptly when the negative output gap reaches a certain level.

ECB's Crucial 2015 inflation projection

ECB 2015 inflation forecasts are crucial to assess their next move…

The inflation outlook will likely be crucial in shaping the next ECB's next moves. Mr Draghi stressed this week that the ECB expects a protracted period of low inflation, without providing a view on what "protracted" and "low" exactly mean. The 2015 mid-point inflation forecast of the ECB Staff Projections (to be released on 5 December) will be key to determine the potential for further monetary

accommodation and it remains uncertain whether the new forecast will be below 1%, as our model suggests. The EU Commission autumn forecasts released this week projected euro area inflation flat-lining at 1.5% in 2014 and falling only marginally to 1.4% in 2015, with an output gap of -1.5%. The ECB September Staff projections had already a lower mid-point forecast for 2014 than the Commission, at 1.3%, and recent euro appreciation could shave a few decimal points off the mid-point for 2014 and 2015[8].

…and may not show inflation as low as we project

On the other hand, the ECB has always been quite critical over the usage of real-time estimates of output gap as input for inflation forecasts, due to the aforementioned uncertainty in estimating potential GDP growth in real time and due to instable and non-linear relationship between output gap and inflation in the euro area.[9] This may limit the extent of further downward pressures on core inflation seen by the ECB over the next couple of years.

Lower-than-expected inflation may still remain a potential source of further ECB actions

Nevertheless, in our view there is little doubt that a sizeable output gap will be a feature of the next couple of years and that the internal devaluation process in peripheral countries will remain a significant factor impacting the euro area aggregate inflation rate. Given the symmetric approach to its inflation target, we would expect the ECB to react to further downward surprises to headline inflation over time, but at this stage, we expect the ECB to leave rates unchanged in December, and anticipate the refi rate to be kept at record lows until Q4-16.

[8] However, the exchange rates used in the December forecasts will be those prevailing in the first two weeks of November, already lower than the October peak due to increasing ECB rate cut expectations and actually the rate cut this week.

[9] See for example "Recent evidence on the uncertainty surrounding real-time estimates of the euro area output gap" in ECB Monthly Bulletin, November 2011.

Key Economic Indicators (11 November – 15 November 2013)

		Forecast	Last
Monday 11 November		**Forecast**	**Last**
09:00	Italy: Industrial Production, Sep	0.4% MM	-0.3% MM
09:00	Norway: Consumer Prices, Oct	0.1% MM, 2.4% YY	0.5% MM, 2.8% YY
	EU: EcoFin Meeting of EU-28 Finance Ministers on Budget		
Tuesday 12 November		**Forecast**	**Last**
00:01	UK: RICS House Price Survey, Oct		
07:00	Germany: HICP Final, Oct	-0.2% MM, 1.2% YY	0.0% MM, 1.6% YY
07:30	France: Bank of France Business Sentiment, Oct	98	97
08:30	Sweden: Consumer Prices, Oct	0.2% MM, 0.3% YY	0.4% MM, 0.1% YY
09:00	Italy: HICP, Oct Final	0.0% MM, 0.7% YY	1.8% MM, 0.9% YY
09:30	UK: Producer Input Prices, Oct	-0.8% MM, 0.0% YY	-1.2% MM, 1.1% YY
09:30	UK: Producer Output Prices, Oct	-0.1% MM, 0.9% YY	-0.1% MM, 1.2% YY
09:30	UK: Consumer Prices, Oct	0.2% MM, 2.3% YY	0.4% MM, 2.7% YY
	Retail Prices, Oct	0.2% MM, 2.8% YY	0.4% MM, 3.2% YY
Wednesday 13 November		**Forecast**	**Last**
08:00	Spain: HICP, Oct Final	0.1% YY	0.5% YY
08:30	Netherlands: Trade Balance, Sep		
08:30	Netherlands: Retail Sales, Sep		
09:30	UK: LFS Unemployment Jul-Sep	-22,000 QQ, 7.7% Rate	-18,000 QQ, 7.7% Rate
	Claimant Count Unemployment, Oct	-25,000 MM, 4.0% Rate	-41,700 MM, 4.0% Rate
09:30	Italy: General Government Debt, Sep		
10:00	Euro Area: Industrial Production, Sep	-0.4% MM	1.0% MM
10:30	UK: Bank of England's *Inflation Report*		
Thursday 14 November		**Forecast**	**Last**
06:30	France: GDP, 3Q Flash	0.1% QQ, 0.3% YY	0.5% QQ, 0.4% YY
07:00	Germany: GDP, 3Q Flash	0.4% QQ, 0.7% YY	0.7% QQ, 0.5% YY
07:45	France: Balance of Payments, Sep		
07:45	France: Consumer Prices, EU Harmonized, Oct	-0.1% MM, 0.8% YY	-0.2% MM, 1.0% YY
07:45	France: Nonfarm Payrolls, 3Q		
08:15	Switzerland: Producer & Import Prices, Oct		
08:30	Sweden: Unemployment, Oct	7.4%	7.5%
08:30	Netherlands: GDP, 3Q Flash	0.0% QQ, -1.0% YY	-0.1% QQ, -1.9% YY
09:00	Euro Area: ECB Monthly Bulletin		
09:00	Italy: GDP, 3Q Flash	-0.1% QQ, -1.9% YY	-0.3% QQ, -2.1% YY
09:30	UK: Retail Sales, Oct	0.0% MM, 3.1% YY	0.6% MM, 2.2% YY
10:00	Cyprus: GDP, 3Q Flash		
10:00	Euro Area: GDP, 3Q Flash	0.2% QQ, -0.2% YY	0.3% QQ, -0.5% YY
11:00	Portugal: GDP, 3Q Flash		
	Greece: Unemployment Rate, Aug		
	Greece: GDP, 3Q		
14:00	Euro Area: Eurogroup Meeting of EA Finance Ministers (Brussels)		
Friday 15 November		**Forecast**	**Last**
	EU: EcoFin Meeting of EU-28 Finance Ministers (Brussels)		
09:00	Italy: Trade Balance, Sep		
09:00	Norway: Trade Balance, Oct		
10:00	Euro Area: HICP, Oct Final	0.7% YY	1.1% YY
10:00	Italy: Current Account, Sep		

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area			
Nov 13 10:00 London Time	*Industrial Production, Sep*	Forecast: -0.4% MM	Prior: 1.0% MM
	With negative readings out from Germany and France, industrial output likely declined in Sept, after a fairly strong rebound in Aug. If our forecast is correct, IP would have fallen by 0.1% QQ in Q3, after rising by 0.7% QQ in Q2, and the YY rate would stabilise at -1.0%. This would confirm that a slight deceleration occurred in the pace of economic activity in Q3.		
Nov 14 10:00 London Time	*GDP, Q3 Flash*	Forecast: 0.2% QQ; -0.2% YY	Prior: 0.3% QQ; -0.5% YY
	After the first quarterly gain in seven quarters in Q2, euro area GDP growth likely remained positive but slightly weaker in Q3, posting a +0.2% QQ gain, with possible risks of an even lower print of 0.1%. This growth rate of 0.1-0.2% on a quarterly basis is consistent with the euro area composite PMI being at around 51.5 – the prevailing level in Q3 and the level of the latest print for October. This leaves little room for further acceleration in GDP dynamic in Q4, in our view.		
Nov 15 10:00 London Time	*HICP, Oct F*	Forecast: 0.7% YY	Prior: 1.1% YY
	Inflation surprised significantly to the downside in Oct for a second consecutive month, according to the HICP flash estimate. A reversal of fresh food price tensions seen during the summer together with falling fuel prices have contributed to the headline decline. But core inflation has also dropped to 0.8% YY – lowest rate since record begun in 1993. This partly reflected base effects as VAT rate hikes in Oct 2012 in Spain and in the Netherlands exited the annual comparison, revealing a lower underlying inflation trend. A small rebound in Nov, perhaps to 0.9% YY, is likely but we think inflation is likely to remain extremely subdued.		
Germany			
Nov 12 07:00 London Time	*HICP, Final, Oct*	Forecast: -0.2% MM, 1.2% YY	Prior: 0.0% MM, 1.6% YY
	We expect the final readings for German inflation in October to confirm the flash readings for both the national and the harmonised measures. The flash readings showed a decline of -0.2%MM after two months of unchanged prices, which have lowered inflation to 1.2%YY, as energy prices continue to fall and food price increases are moderating.		
Nov 14 07:00 London Time	*GDP, 3Q Flash*	Forecast: 0.4% QQ, 0.7% YY	Prior: 0.7% QQ, 0.5% YY
	We expect German GDP to rise by 0.4%QQ in Q3, after the 0.7%QQ reading for Q2 growth. Data have been mixed this quarter with some weakness in retail sales and exports, while IP registered another sizable increase and sentiment readings remain supportive for both consumers and businesses.		
France			
Nov 12 07:30 London Time	*Bank of France Business Sentiment, Oct*	Forecast: 98	Prior: 97
	The business sentiment indicator has been treading water throughout the summer, only gaining one point since June. The latest manufacturing PMI print for October suggests that France is struggling compared to its peers, being the only one with Greece to record a sub-50 reading. We expect that the strengthening of the euro effective exchange rate since the spring will continue to limit the recovery in manufacturing order books, making further gains in confidence harder throughout the fourth quarter. We suspect that confidence in the services sector will continue to lag.		
Nov 14 06:30 London Time	*Gross Domestic Product, 3Q P*	Forecast: 0.1% QQ, 0.3% YY	Prior: 0.5% QQ, 0.4% YY
	The flash estimate of 3Q GDP is likely to show a noticeable slowdown in the rate of economic expansion compared to the 0.5% QQ uptick in 2Q-13. The contribution of domestic demand to GDP is expected to be nil, with no momentum in household expenditure, while a small uptick in public expenditure will likely be offset by a slight drop in gross fixed capital formation. We look for a modest contribution from net trade, worth around 0.1ppt, and a neutral contribution from inventories after two successive quarterly upticks. In light of the recent survey prints, the balance of risks around our 0.3% QQ 4Q GDP forecast lies slightly to the downside.		
Nov 14	*CPI – EU Harmonised, Oct*	Forecast: -0.1% MM, 0.8% YY	Prior: -0.2% MM, 1.0% YY
07:45	*Consumer Price Index, Oct*	Forecast: -0.1% MM, 0.6% YY	Prior: -0.2% MM, 0.9% YY
London Time	*CPI Ex Tobacco Index, Oct*	Forecast: 125.48	Prior: 125.6
	French headline inflation rates are expected to ease further in October, with the national reading forecast to fall by 0.3ppt to a 47-month low of 0.6%. Lower food prices are likely to be the largest driver of the inflation slowdown, followed by energy prices. Core inflation is not anticipated to ease much in October, and a similar dynamics should hold for the remainder of 2013, before the January 2014 VAT rate hike begins to drive headline inflation higher. Overall, the fourth quarter is likely to witness the lowest inflation prints since 4Q-09.		
Netherlands			
Nov 14 08:30 London Time	*Gross Domestic Product, 3Q P*	Forecast: 0.0% QQ, -1.0% YY	Prior: -0.1% QQ, -1.9% YY
	We forecast that the Dutch economy stabilised in the third quarter, expecting the first non-negative GDP print since 2Q-12 and only the second since 1Q 2011, some ten quarters earlier. Business confidence has rebounded noticeably in the third quarter and remains on an improving trajectory at the start of 4Q. On the household front, the improvement has been more modest, indicating some continued contraction in disposable income growth related to increasing fiscal pressure from changes in the deductibility of mortgage interest payments. GDP growth is forecast to grow modestly in 2014, to the tune of 0.3%, for the first time in three years.		

Economic Indicators

Italy Nov 11	*Industrial Production, Sep*	Forecast: 0.4% MM	Prior: -0.3% MM
09:00 London Time	Despite the improvement in survey-based indicators, industrial output likely fell by around 1% QQ in Q3, about the same pace of contraction seen in Q2. We expect a small gain to have occurred in Sep, on the back of the manufacturing PMI and business confidence having moved to levels consistent with a modest expansion in output.		
Nov 14 09:00	*GDP, Q3 Flash*	Forecast: -0.1% QQ; -1.9% YY	Prior: -0.3% QQ; -2.1% YY
London Time	In contrast with other peripheral countries, Italian GDP likely continued to contract in Q3, albeit at a slower pace than in previous quarters. Exports have failed to show much of a recovery so far, with goods export values up by just 0.4% YY in the first eight months of the year. The decline in domestic demand is easing, mainly, we think, due to a less restrictive fiscal policy. While a positive GDP print is likely in Q4, we do not expect an acceleration in GDP dynamic in 2014.		
Spain Nov 13	*HICP, Oct F*	Forecast: 0.1% YY	Prior: 0.5% YY
08:00 London Time	Inflation declined strongly in October to 0.1% YY (lowest since Oct-09), according to the flash estimate, well below expectations (consensus 0.4%). The breakdown details will likely confirm a further slowdown in core inflation (from 0.9% YY in Sep to 0.3% YY in Oct, in our view) as well as a continuation of fresh food price declines seen in Sept (after upward tensions during the summer, probably weather-related). In addition, energy inflation is likely to remain in negative territory, despite the recent increase in electricity prices (of 3.1%), due to falling fuel prices. We project inflation remaining below 1% YY also in 2014.		
Sweden	*CPI, Oct*	Forecast: 0.2% MM; 0.3% YY	Prior: 0.4% MM; 0.1% YY
Nov 12	*CPIF, Oct*	Forecast: 0.2% MM; 1.0% YY	Prior: 0.4% MM; 0.9% YY
08:30 London Time	With headline CPI barely in positive territory and a modest 0.9% Y/Y gain in core CPI (hence reversing upward tendencies during the summer), inflation pressures continue to look very subdued in Sweden. Modest wage growth, persistently falling import prices and ongoing SEK strength (from a historical perspective) suggest inflation will stay well below the 2% target also in the foreseeable future. This clearly highlights the Riksbank's dilemma of rising house price and accelerating credit growth vs. low inflation and capacity use.		
Nov 14	*Unemployment Rate, Oct*	Forecast: 7.4%	Prior: 7.5%
08:30	*Unemployment Rate, SA, Oct*	Forecast: 7.9%	Prior: 8.0%
London Time	Unemployment is basically trending sideways, while employment continues to increase. Given weak GDP growth in recent quarters, this is a bit of a surprise. Meanwhile, leading indicators suggest that the employment upturn could be accelerating. Developments on the labour market are basically in line with the Riksbank's forecast, with employment in September 0.1-0.2pp above the Bank's 3Q forecasts, but largely in line with its 4Q projection.		
Norway			
Nov 11	*CPI, Oct*	Forecast: 0.1% MM; 2.4% YY	Prior: 0.5% MM; 2.8% YY
9:00	*CPI-ATE, Oct*	Forecast: 0.0% MM; 1.7% YY	Prior: 0.4% MM; 1.7% YY
London Time	Following the acceleration in inflation during spring and summer, September saw a markedly downward – and much larger-than-expected – correction. The massive slowdown largely related to a correction in the components, which provided a boost to inflation in previous months (i.e. clothing, shoes and food). With core inflation undershooting Norges Bank's forecast by half a percentage point and now again being well below the 2.5% target (1.7% Y/Y vs. 2.5% Y/Y in August), this will likely have some dovish implications for monetary policy. We note, though, that the Central Bank at the October meeting said that it will look *"through these monthly variations in CPI inflation to some extent in its assessment of the inflation outlook"*.		
United Kingdom			
12 Nov	*Consumer Prices (Oct)*	Forecast: 0.2% MM; 2.3% YY	Prior: 0.4% MM; 2.7% YY
9:30	*CPI Ex Food, Drink, Tobacco, Energy (Oct)*	Forecast: 0.4% MM; 1.9% YY	Prior: 0.4% MM; 2.2% YY
London Time	*Retail Prices (Oct)*	Forecast: 0.2% MM; 2.8% YY	Prior: 0.4% MM; 3.2% YY
	RPIX – Excludes Mortgages (Oct)	Forecast: 0.2% MM; 2.9% YY	Prior: 0.4% MM; 3.2% YY
	A sharp drop in petrol prices, down about 3% MoM, probably caused CPI and RPI inflation to tick lower in October. However, the YoY rates may edge up a little in November as recently-announced energy price hikes take effect. The Autumn Statement may include measures to cap energy prices and, if so, this could introduce downside risks to inflation for 2014.		
12 Nov 9:30	*Producer Input Prices (Oct)*	Forecast: -0.8% MM; 0.0% YY	Prior: -1.2% MM; 1.1% YY
London Time	With commodity prices weakening in the last few months and sterling higher, we expect that input prices will fall for the third month in a row and the fifth month out of seven. Weakness in input prices will probably help bring CPI and RPI inflation lower in coming months.		
12 Nov	*Producer Output Prices (Oct)*	Forecast: -0.1% MM; 0.9% YY	Prior: -0.1% MM; 1.2% YY
9:30	*Output Prices Ex Tax (Oct)*	Forecast: -0.1% MM; 1.1% YY	Prior: 0.0% MM; 1.3% YY
London Time	*Excluding Food, Drink, Tobacco, Energy (Oct)*	Forecast: -0.1% MM; 0.5% YY	Prior: -0.1% MM; 0.7% YY
	Surveys suggest that manufacturers' pricing intentions are weak and with the downtrend in commodity prices over recent months, output price inflation is likely to slide further. The core series for output prices ex food, drink, tobacco and energy has been flat over the last six months (ie a zero inflation rate), the weakest trend since 2004.		

Economic Indicators

United Kingdom (Continued)

13 Nov 9:30 London Time	*LFS Unemployment (Jul-Sep)* *Claimant Count Unemployment (Oct)*	Forecast: -22,000 QQ; 7.7% Rate Forecast: -25,000 MM; 4.0% Rate	Prior: -18,000 QQ; 7.7% Rate Prior: -41,700 MM; 4.0% Rate
	The LFS jobless measure is a 3-month average and, while this has been fairly stable in recent months, the single month LFS jobless figures have bounced around quite a lot, with readings of 8.0% in April and May, 7.4% in June, 7.7% in July and 8.0% in August. As the low June figure will drop out of the three-month average this month, the headline rate probably will not fall further and may even rise (if the September figure is similar to those of July and August). Claimant count unemployment probably will continue to fall rapidly, partly reflecting tighter benefit eligibility.		
14 Nov 9:30 London Time	*Retail Sales Volumes (Oct)*	Forecast: 0.0% MM, 3.1% YY	Prior: 0.6% MM; 2.2% YY
	The weather in October was relatively mild, with the average temperature in Central England 1.7 degrees celsius above the 30-year average for October. The correlation between clothing sales and average temperature is firmly negative over August-October, with warmer weather hitting sales of winter clothing, and hence we expect that softer clothing sales will cap retail sales this month.		

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

Key Economic Indicators (18 November – 22 November 2013)

Monday 18 November		Forecast	Last
09:00	Euro Area: Current Account, Sep		
10:00	Euro Area: Trade Balance, Sep		
Tuesday 19 November		**Forecast**	**Last**
07:00	EU-27: New Car Registrations, Oct		
09:00	Italy: Industrial Orders, Sep		
09:00	Norway: GDP, 3Q Flash		
10:00	Germany: ZEW Economic Expectations, Nov		
10:00	Euro Area: Construction Output, Sep		
	Greece: Current Account, Sep		
Wednesday 20 November		**Forecast**	**Last**
07:00	Germany: Producer Prices, Oct		
08:30	Netherlands: Consumer Confidence, Nov		
09:30	UK: MPC Minutes		
	Spain: Trade Balance, Sep		
14:00	Belgium: Consumer Confidence, Nov		
Thursday 21 November		**Forecast**	**Last**
07:00	Switzerland: Trade Balance, Oct		
08:30	Netherlands: Consumer Spending, Sep		
08:30	Netherlands: Unemployment, Oct		
09:00	Italy: Contractual Wages, Oct		
09:00	Euro Area: Flash PMIs, Nov		
09:30	UK: Public Sector Net Borrowing, Oct		
11:00	UK: CBI Industrial Trends Survey, Nov		
15:00	Euro Area: Consumer Confidence, Nov Flash		
Friday 22 November		**Forecast**	**Last**
07:00	Germany: GDP Details, 3Q		
08:15	Sweden: Business & Consumer Confidence Surveys, Nov		
09:00	Germany: ifo Business Climate, Nov		
09:00	Italy: Retail Sales, Sep		
14:00	Belgium: Business Confidence, Nov		

Sources: National statistical offices, central banks and Citi Research

Title	Author	Date
Euro Area – Sovereign Debt Crisis Update		
French Sovereign Rating Cut to AA	European Economics Team	Nov 8, 2013
ECB: Possibly Dovish, Not Acting	European Economics Team	Nov 7, 2013
EC Slightly Revises Down 2014 GDP Growth Forecast	European Economics Team	Nov 6, 2013
Italian and French Officials Warn about Strong Euro	European Economics Team	Nov 5, 2013
Spain – Fitch Revises Rating Outlook to Stable	European Economics Team	Nov 4, 2013
Euro Area		
ECB - Aiming for Low Real Rates	Guillaume Menuet	Nov 7, 2013
ECB Preview - Expect Dovish Tone, Leaving Door Open to a Cut in December	Guillaume Menuet	Nov 5, 2013
Euro Area - ECB AQR: More Detail, but not on Public Backstop	Ebrahim Rahbari	Oct 23, 2013
Euro Area - Under No Pressure to Act, ECB Stays Put and Gives Little Away	Guillaume Menuet	Oct 2, 2013
European Economic Forecast Highlights - October 2013	Ann O'Kelly	Sep 27, 2013
German Elections Outcome - Big Merkel Win, Grand Coalition Government Most Likely	Ebrahim Rahbari et al	Sep 23, 2013
German elections - Four More Years – A Multi-Asset View	Ebrahim Rahbari et al	Sep 12, 2013
Euro Area - ECB Reiterates Forward Guidance, with Some Dovish Hints	Giada Giani	Sep 5, 2013
Euro Economics Weekly		
Why the ECB Should Worry About the Strong Euro	Ebrahim Rahbari	Nov 1, 2013
Italy and Spain Look Well Positioned For Job Growth	Guillaume Menuet	Oct 25, 2013
Portugal – What After June 2014?	Giada Giani	Oct 18, 2013
Will the ECB's Comprehensive Assessment of Banks be the Euro Area's TARP Moment?	Ebrahim Rahbari	Oct 11, 2013
Italy – Political and Banking Fragility	Giada Giani	Oct 4, 2013
New ECB LTRO? Not Like Waiting for Godot	Guillaume Menuet	Sep 27, 2013
Housing Not Yet Turning Around	Ebrahim Rahbari	Sep 20, 2013
Loan Dynamics: Renaissance by Year-End	Guillaume Menuet	Sep 13, 2013
Germany — Four More Years	Ebrahim Rahbari	Sep 6, 2013
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
Chief Economist Publications		
Global Economic Outlook and Strategy - October 2013	Willem Buiter	Oct 23, 2013
Scandi		
Scandi Economics Update	Tina Mortensen	Nov 8, 2013
Denmark - DNB Keeps Key Lending Rate Stable at 0.20%	Tina Mortensen	Nov 7, 2013
Norway - Momentum in Manufacturing Production is Slowing	Tina Mortensen	Nov 7, 2013
Switzerland		
Switzerland - Economy Continues to Grow Solidly	Michael Saunders	Sep 3, 2013
UK		
UK - Strong Trends In Car Sales And IP	Michael Saunders	Nov 6, 2013
UK - Services PMI Suggests Britain is Booming	Michael Saunders	Nov 5, 2013
UK - Strong GDP Data	Michael Saunders	Oct 25, 2013
UK Economics Weekly		
UK Economics Weekly - Leaders and Laggards in the Recovery	Michael Saunders	Nov 1, 2013
Growth Dividend For The Public Finances	Michael Saunders	Oct 25, 2013
We Stick to 3% Growth Forecast for 2014	Michael Saunders	Oct 18, 2013
Why Is the UK Suddenly Doing So Well?	Michael Saunders	Oct 11, 2013
Fiscal Red Ink Receding	Michael Saunders	Oct 4, 2013

Source: Citi Research

Notes

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Appendix A-1

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