ECB's Coeuré Seeks Safety Margin Against Deflation

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Economics

Western Europe

Industrialised G7 Countries

Summary

ECB seeks safety margin against deflation – ECB's Coeuré noted that the ECB had "*acted because we wanted to keep a sufficient safety margin above zero percent inflation*".

ECB's Linde says path of least resistance would be rate cut rather than asset purchases – but both lower rates and asset purchases would be difficult.

ECB's Praet highlights issues with balance sheet recession – saying that the current situation "*has more signs of a balance sheet recession, which is a priori more of a deflationary environment than what we had in the 1960s*".

Bundesbank warns about blurred lines between monetary and fiscal policies – indicating on Monday that "*monetary policy runs the risk of becoming subject to financial and fiscal dominance*".

Bundesbank president says ECB Governing Council should not permanently supervise banks.

Dutch Central Bank expects one round of capital raisings after ECB tests.

Germany – coalition negotiations enter final phase. Please refer to ***Germany - What if Grand Coalition negotiations fail?*** for more details.

Italy – government to call confidence vote on 2014 Budget law today to quicken its approval, ahead of another crucial vote (on Silvio Berlusconi's impeachment) on Wednesday. The governing coalition, probably without the support of the new centre-right Forza Italia, should still be able to pass the law.

Spain – recovery to remain weak says Bank of Spain's Linde, noting however that the end of credit contraction is approaching, with still high risks on 2013 budgetary outcome.

Spain – central government deficit soared to 3.61% of GDP in Jan-Oct 2013, broadly unchanged vs. Jan-Sep 2013, but 0.2pp of GDP above Jan-Oct 2012. INE sees population shrinking by 0.5%-0.6% per year over the next decade.

Greece – narrowing divergence with troika on the 2014 fiscal gap. FinMin Stournaras said that the troika has agreed to a 2014 fiscal gap of €1bn (0.5% of GDP), instead of €3bn, thanks to new data showing improved tax revenues.

Portugal – Constitutional Court upheld extension of working week from 35 to 40 hours for state employees. More than 80% of public sector workers will experience a wage cut, says *Diario Economico*.

Slovenia – slightly better sentiment in Nov, after expectations of weak Q3 GDP.

Recent Research

Germany — What if Grand Coalition negotiations fail?

25 November 2013

We expect a Grand Coalition government between CDU/CSU & SPD to be formed, but there are risks. First, coalition negotiations between CDU/CSU and SPD party leaders could still fail. Second, the coalition agreement could be rejected by the SPD party base. We consider the first risk to be small, but attach significant uncertainty to the outcome of the SPD party referendum. Either of these two scenarios would result in further political uncertainty.

Ebrahim Rahbari

Euro Economics Weekly — Is This the End of Austerity?

22 November 2013

The fiscal tightening in the euro area this year has been about half that in 2012, with periphery countries (namely, Spain, Italy and Portugal) showing the largest swings, leaving their headline

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Today’s News in Detail

ECB seeks safety margin against deflation – ECB executive board member Benoit Coeuré said disinflation in Europe is likely to continue for now, but will not progress to deflation because the economy is recovering and inflation expectations remain anchored around 2%. Mr. Coeuré noted that the ECB had *"acted because we wanted to keep a sufficient safety margin above zero percent inflation*". Banque de France Governor Christian Noyer said on Monday that central bankers have to invent policies to achieve price stability if conventional monetary policy stops working. Mr. Noyer was quoted by Reuters on Monday giving a speech in Tokyo arguing that *"we see risks that low inflation will remain for some time*", adding that *"we will keep interest rates low for an extended period, or even lower if need be, for price stability*". Mr. Noyer was also quoted by Market News arguing that “*fragmentation in the euro area is decreasing*”, although the “*recovery remains weak and fragile*”. Comment: the ECB appears very keen to keep all its options open, with a growing number of governors acknowledging some downside risks to the ECB's target of 'below but close to 2%'. The problem of inflation being too low on average is that it would likely force countries in need of regaining competitiveness to experience a prolonged period of intense disinflation or even deflation, which would risk creating more problems, one of which would be to exacerbate the often difficult situation with respect to debt sustainability.

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ECB’s Linde says path of least resistance would be rate cut rather than asset purchases – Bank of Spain Governor Luis Maria Linde commented in Madrid on Monday that both lower rates and asset purchases would be difficult for the ECB, but that the first option would be easier than the second. Mr. Linde was quoted by Bloomberg saying that he does not see the “*ECB raising interest rates in coming months*”, arguing instead that the “*ECB is signalling that rates will remain low for a long time*”. Comment: coming from one of the governors believed to belong to the dovish camp, these remarks suggest that the ECB believes that it has done enough for the time being, with respect to standard measures. The appetite for asset purchases would likely be very low, in our view, unless deflationary risks were to increase significantly, accompanied with a likely un-anchoring of price expectations.

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ECB’s Praet highlights issues with balance sheet recession – ECB chief economist Peter Praet noted last week at a Banque de France seminar that the current situation “*has more signs of a balance sheet recession, which is a priori more of a deflationary environment than what we had in the 1960s*”. According to Reuters, he added that “*this is a very different context for the correction of expectations [about income] which is more of a debt overhang*”. Comment: the reference to debt overhang problems and deflationary risks illustrate some change of focus from the ECB in the communication of its chief economist, suggesting that the central bank is seeing more risks of a prolonged period of subdued price pressures, threatening its objective of bringing the headline inflation rate back to its ‘below but close to 2% target’.

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Bundesbank warns about blurred lines between monetary and fiscal policies – Bundesbank president Jens Weidmann indicated on Monday that “*monetary policy runs the risk of becoming subject to financial and fiscal dominance*”. He noted that central bankers “*cannot have enough arms now – arms with which they are to pull all the levers*”. Asked whether he was worried about the recovery faltering, Mr. Weidmann replied that “*I do not see any need to*

fiscal deficit roughly unchanged relative to 2012. Conversely, fiscal efforts have been stepped up in some core countries. This likely explains most of the recent improvements in periphery domestic demand and periphery-core convergence in economic activity indicators.

Giada Giani | Guillaume Menuet | Michael Saunders | Ebrahim Rahbari | Ann O'Kelly

UK Economics Weekly — Will Weak Investment Scupper the Recovery?

22 November 2013

Investment has been very weak in this recession/recovery cycle. Recent weakness in investment probably will not stop the economy growing rapidly in 2014-15, and indeed pent-up demand — especially in housebuilding — probably will help support GDP growth. Nor will recent weakness in investment create early capacity and inflation presures. However, the economy’s long-term growth prospects probably will depend critically on whether investment does recover significantly in the next couple of years.

Michael Saunders | Ann O'Kelly

Scandi Economics Update — Waning Optimism among Norwegian Consumers and Businesses

26 November 2013

Sweden — New study on household indebtedness.

Norway — Consumer confidence falls in 4Q — Companies have turned gloomy on the economic outlook — NHO confirms its forecast of 2.0% Y/Y mainland GDP growth in 2014 — Norges Bank’s expectation survey.

Tina Mortensen

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revise the forecast of a gradual recovery". Comment: the multi-tasking role which has largely been forced on central banks during the crisis has blurred the frontier between monetary policy and fiscal policy, but was largely unavoidable as the central bank had to react to a severe balance sheet recession. Confidence about the recovery suggests that there will be limits to how much more stimulus the hawks will be willing to allow, although they will likely be outvoted again if inflation were to surprise to the downside in coming quarters.

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Bundesbank president says ECB Governing Council Shouldn't Permanently Supervise Banks. Bloomberg reports that Bundesbank President Jens Weidmann said that the ECB Governing Council should be responsible for banking supervision only temporarily, as the decision-making body for monetary policy should not be in charge of supervising banks in order to avoid possible conflicts of interest. Weidmann said that a change in the European treaties was needed to allow an ECB body other than the Governing Council to have decision-making authority for supervisory matters, and that if "*this avenue was not taken"*, an independent supervisory institution would become necessary. Weidmann also reiterated previous comments that "*sovereign bonds should be adequately risk-weighted, and exposure to individual sovereign debt should be capped, as is already the case for private debt*", as "*large and undiversified exposure is what makes sovereign default a potentially systemic event*". Weidmann rejected the mutualisation of debt, as it would lead to further demands for the same.

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Dutch Central Bank expects one round of capital raisings after ECB tests. Bloomberg quotes the Dutch central bank director Jan Sijbrand, who will likely be the deputy chair of the ECB's bank supervisory board, saying that there could only be one round of recapitalizations of banks after both the ECB asset quality review and stress test are completed. Sijbrand noted that there was still a "*debate"* about how to handle the results of the asset quality review, notably to avoid an "*uncontrolled process*". He added that the AQR should be conducted on at least 50% of each bank's assets and that the Dutch Central Bank was carrying out a review of Dutch banks' commercial real estate loans before, and separate from, the ECB AQR. He also said that there was also an ongoing debate about whether the respective supervisory team should be led by a supervisor from the bank's home country or a different country, noting that he himself preferred to have supervisors from another country in charge.

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Germany: coalition negotiations enter final phase. FAZ reports that CDU/CSU and SPD negotiated for 11 hours on Monday to discuss the first draft of the coalition agreement. The newspaper quoted unnamed sources that the atmosphere was good and that the plan was for the coalition agreement to be completed mostly on Wednesday. Negotiations continue this morning from 8am and a number of issues remained unresolved, including the final nature of the national minimum wage (the starting date, level and the scope of exceptions), pension reform, car levies and double citizenship - see ***Germany - What if Grand Coalition negotiations fail?***

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Italy – government to call confidence vote on 2014 Budget law. After being outvoted in two minor amendments to the draft budget, yesterday the Italian government decided to suspend the discussion on the budget draft in the relevant parliamentary Committee and to submit the current draft to the Senate today for a vote of confidence. The Minister for the relationship with Parliament, Franceschini, said the vote was necessary not only to guarantee a quick approval for the budget law but also to verify the parliamentary majority supporting the government, after the split within the centre-right coalition party.

The newly formed centre-right political party, Forza Italia (FI), headed by Silvio Berlusconi, is reportedly pondering whether to vote against the draft bill, *de facto* formalising its move into the opposition ranks. The government last night reached an agreement on one of the most controversial issues of the budget law, the modification of the property tax (currently named IMU). The government reportedly aimed at having the budget law approved before the vote on Mr. Berlusconi's impeachment scheduled for tomorrow. Comment: two crucial votes – on the budget and on Berlusconi's expulsion from the Senate – for the fragile government coalition led by Enrico Letta, possibly generating more political instability.

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Spain – Bank of Spain: recovery to remain weak – Bank of Spain Governor Luis Maria Linde said yesterday that while the Spanish economy is starting to show some improvements relative to last year, the government should remain prudent to avoid complacency as risks have not disappeared and "*impulses for a sustained recovery are still weak*". Mr Linde noted however that Spain is approaching the end of credit contraction and Spanish banks can view the upcoming ECB comprehensive analysis with "*some calm*". In terms of fiscal policy, Mr Linde highlighted that while he sees the 2013 fiscal target as achievable, the uncertainty surrounding the budgetary outcome is still high, in particular regarding revenue performance. Finally, Mr Linde noted that he sees no risk of deflation in Spain in coming years. Comment: in our view the rebalancing of the Spanish economy is definitely gathering pace, but we think the process is going to be long and major headwinds (private deleveraging, still large fiscal imbalances, on-going adjustment in the housing sector, and tight financial conditions) are likely to prevent any significant economic growth in the next couple of years. After HICP fell into negative territory in Oct-13 (to -0.1%YY), we expect inflation to remain subdued in Spain in 2014.

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Spain – Central government deficit continues to soar. State Secretary for budget and expenditure, Maria Fernandez Curra, suggested yesterday that Spain's central government posted a deficit of 3.61% of GDP in Jan-Oct 2013, rising from 3.58% of GDP in Jan-Sep 2013. The deficit is also higher relative to the same period last year (3.33% of GDP), and is now only 0.2ppts of GDP below the 2013 deficit target for the central government (of 3.8% of GDP). Final data on the central government budget execution will be released later today. FinMin Cristobal Montoro reiterated yesterday that there will be a selective reduction of taxes in 2015. Comment: the figures highlight the hurdles for the Spanish government to meet the fiscal deficit target (6.5% of GDP for the general government and 3.8% of GDP for the central government) in 2013. The main problem remains a poor revenue performance. Even if growth resumes, we do not expect much cyclical improvement in the Spanish budgetary position in the next couple of years.

Spain – Population to continue shrinking by 0.5%-0.6% per year over next decade. According to the demographic projections of the National Institute of Statistics (INE), the Spanish population would decrease by 0.5% YY in 2013, continuing the downward trend that began in 2012 (fall of 0.2% YY). INE projects population declining by 2.6 million (or by 5.6%) to 44 million in the next 10 years, as a result of population aging (a reduction in the birth rate from 11.3% in 2008 to 7.6% in 2022 and an increase in the death rate from 8.4% in 2008 to 9.2% in 2022) and a continuation of migration outflows similar to those observed in 2013 (net flow of -299,607 people vs. +310,642 in 2008). Comment: the sizable shift from hefty population growth in pre-crisis years (due to native demographic trends and high immigration flows) to population declines will significantly reduce potential GDP growth in Spain in the next decade.

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Greece – narrowing divergence with troika on the 2014 fiscal gap, FinMin Stournaras said. The FinMin said that the troika has agreed that next year's fiscal gap amounts to just €1bn (0.5% of GDP), rather than the original estimate of €3bn, thanks to new data showing improved tax revenues. The government had originally estimated a fiscal gap of €0.5bn.

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Portugal – Constitutional Court upheld extension of working week for state employees. The measure was approved by the Portuguese government last summer and it envisages raising the working week for state employees from 35 to 40 hours. The measure is part of the government reform of public administration, which aims to reduce disparities between public and private sector employees. The High Court judge who reported on the matter said that the measure would increase the cost efficiency of the state administration. Note that another budget measure (the reduction in civil servant pensions) has been referred to the Court this week by the President of the Republic, and is awaiting a review.

Portugal – more than 80% of public sector employees will experience a wage cut, equivalent to the removal of some 600k employees from the state payroll, *Diario Economico* reports, based on simulation of the new measures included in 2014 Budget. The wage reduction will apply to wages starting from €675 per month, and will range from a minimum of 2.5% to 12.5%. Wage cuts already implemented in 2011 applied only to wages in excess of €1,500 per month. Comment: Portugal had one of the most well-paid (relative to general income level) public sector workforces in Europe (exceeded only by Ireland), hence the focus on reducing public sector pensions and wages. The measure, however, is at risk of not complying with the Constitution. However, if passed, it will contribute to a renewed significant slowdown in total wage growth and unit labour costs at the aggregate level.

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Slovenia – GDP dynamics are likely to slightly worsen in 3Q13 due to domestic demand.

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We expect GDP to decrease by 0.5% QQ sa in 3Q13 after -0.3% a quarter ago. While this is likely to lead to a slightly larger YY contraction of -2.3% from -2.2% a quarter ago, it should be less than the -2.8% reading from a year ago. Confidence indicators and recent monthly data suggest the export-driven recovery continues (backed by better order books and export expectations), with solid investment activity (supported by higher utilization of production capacities in manufacturing), while consumption is likely to be the main headwind. We forecast a 0.4% QQ drop in 4Q13 and close to zero growth in 2014, which should result in a milder YY contraction of 0.9% in 2014 after -2.3% in 2013 and -2.4% in 2012. 3Q13 GDP data will be published on Friday, 29 November.

Slovenia's economic sentiment measure improved slightly in November, having fluctuated in a narrow band since March.

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The survey showed divergent trends with better industrial and construction confidence, largely stable service sector and worse consumer and retail confidence. The latter seem to be most negatively influenced by recent political woes and on-going wait for the banking sector resolution. Comment: industrial confidence improved marginally after four months, supported by better order books and production expectations. This should be supportive of our forecast of acceleration in industrial production to 0.5% YY swda in 4Q13 from -1.3% in 3Q13. The better assessment of export order books is in line with recent improvement in euro area and German manufacturing PMIs and points to acceleration of export growth to 5%-7% YY from around 3% YY in July-August

2013. Construction confidence suggests some stabilization of construction output around 5% YY after -3.8% YY in 3Q13 and -17% in 1H13. The overall sentiment reading still suggests a milder GDP contraction compared to -2.7% YY in 1H13 and hence, is supportive of our GDP growth forecast.

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Latest Issues of Sovereign Debt Update

Portugal – Pension Cuts Sent to Constitutional Court

25 November 2013

Portugal's President sends public pension cuts to Constitutional Court. ECB's Coeuré sees long period of low rates, Asmussen warns about activism. Ongoing debate on ECB Minutes. ECB and ESRB sovereign debt risk weight plans. Germany's coalition talks remain difficult. Buba deputy head expects some banks to fail ECB test. French tax reform talks begin. No changes to Italy's 2014 Budget, says FinMin. Spain on track says IMF. Greece: IMF says new fiscal measures to be less than in the past.

Giada Giani | Guillaume Menuet | Ebrahim Rahbari

France's Poor Recovery Momentum

22 November 2013

France: weak PMIs and protests underscore poor recovery momentum. Draghi says safety margin over zero inflation is key. Buba's Weidmann on liquidity, BdF's Noyer on readiness to act. Germany's Constitutional Court won't rule on OMT before year-end. Italy's €12bn state asset sales. Rajoy on Spain's 2014 tax overhaul. Moody's on Spain's banking sector after programme end. Portugal: troika undecided on what comes after programme end, EC says fiscal measures needed in 2015-17. Greece's draft budget.

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ECB Eyes Limiting Negative Deposit Rate at -10bp

21 November 2013

ECB mulls limiting negative deposit rate to -10bp. ECB's Constancio: no technical discussions about QE. ECB's Asmussen favours publishing Minutes, voting records. Buba's Weidmann against talk of more action. Dijsselbloem not convinced by "reform contracts". Germany's minimum wage proposals. Italy's 2014 Budget still with parliament. Spain's strong exports. Greece: no agreement with Troika, budget to go to parliament. Ireland: lack of precautionary credit line does not exclude OMT, says FM.

Giada Giani | Ebrahim Rahbari | Guillaume Menuet

ECB's Asmussen Wary of Negative Deposit Rate

20 November 2013

ECB's Asmussen "very careful" of cutting the deposit rate into negative territory. ECB's Praet says negative output gap possible until 2017. EU and Japan want to conclude free-trade agreement soon. Germany's CDU/CSU not afraid of early elections. French budget minister wants to support business and lower public spending. Italy: crucial reform of Parliament to be tabled tomorrow. OECD expects Spanish unemployment to peak in 2013. Greek banks ask for lower Core Tier 1 capital adequacy index of 8%

Giada Giani | Ebrahim Rahbari | Guillaume Menuet

ECB Members Suggest Reluctance to Further Nearterm Easing

19 November 2013

ECB GC members suggest nearterm reluctance for more easing. ECB's Mersch on set-up for stress tests. ECB allows simplified NPL definitions for first phase of assessment. Bundesbank says easy money policy justified. 2015 revamp of

French tax system says PM. Italy: Renzi wins PD party's pre-primaries. Italy's spending review to save 2% of GDP by 2016, says draft. Spain's aid programme on track, says Troika. Spain's NPL at new high in Sep. Portugal to access ECCL after bailout end, says Fitch.

Ebrahim Rahbari | Guillaume Menuet | Giada Giani

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Macroeconomic Research

European Economic Forecast Highlights — October 2013

24 October 2013

This companion to Global Economic Outlook and Strategy gives detailed quarterly forecasts for the main European countries to end 2014, together with annual forecasts to 2017 for growth, inflation, current balance, fiscal balance, primary balance and government debt.

Ann O'Kelly | Michael Saunders | Guillaume Menuet | Giada Giani | Ebrahim Rahbari

Global Economic Outlook and Strategy — October 2013

23 October 2013

Our global growth forecasts are unchanged this month, at 2.5% for 2013 and 3.2% for 2014 (at current exchange rates). We make a marginal (0.1pp) upward revision to our 2014 euro area forecast — led by upgrades to Portugal and Spain. The exact timing of the start of Fed tapering is highly uncertain, but we now expect that tapering will be pushed back to March, with asset purchases not ending fully until late 2014. The ECB is likely to introduce a new LTRO in Q1, with extra BoJ easing in 2014.

Willem Buiter | Nathan Sheets | Michael Saunders | Robert V DiClemente | Kiichi Murashima

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Appendix A-1

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