

# Euro Economics Weekly

## Spain Is Becoming More German

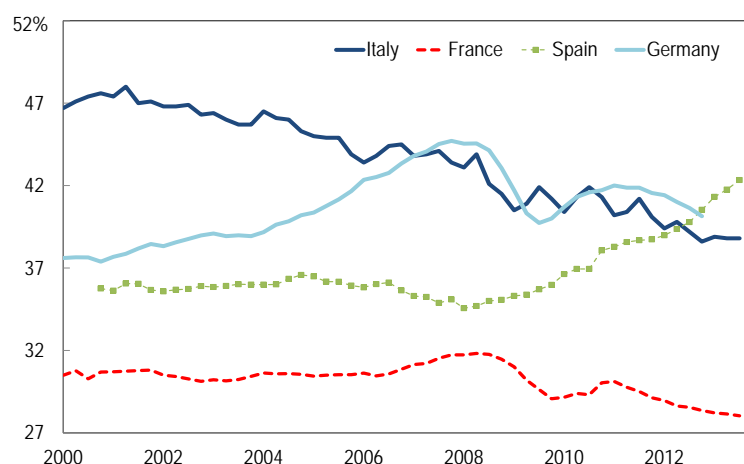
- We are raising our Spanish 2014 GDP growth forecasts to 0.9% (from 0.2%) and to 1.1% (from 0.8%) in 2015, on evidence that the recovery is already creating jobs, much earlier than in previous episodes. Corporates' balance sheets have improved on stronger profits and collapsing labour costs, while improving financial market conditions help offset the negative effects of ongoing private debt deleveraging. We expect job creation to support a pick-up in private consumption, although the acceleration in GDP will likely be capped by the ongoing housing adjustment and adverse demographic trends.
- Spain's recovery may be a template for upside growth surprises from nearby Portugal, though a larger fiscal drag in 2014 should delay the Portuguese recovery until 2015. On the other hand, we think Spain will likely continue to outperform Italy, because of the latter's more limited progress on structural reforms, ongoing political uncertainty and long-standing competitiveness issues.

Figure 1. Citi Market Forecasts

		Euro Repo	10-yr Bunds	£/€	UK Bank Rate	10-yr Gilt- Bund	SEK Policy Rate	NOK Policy Rate	CHF Policy Rate	CHF Spread vsBunds			
	\$/€					SKr/€			SFr/€				
2Q 14	1.39	0.00	1.70	0.80	0.50	158	8.71	0.75	8.12	1.50	1.24	0.00	-73
4Q 14	1.40	0.00	1.80	0.80	0.75	183	8.79	0.75	7.95	1.50	1.26	0.00	-77

Source: Citi Research

Figure 2. Selected Euro Area Countries – Non-Financial Corporations' Profit Share (Pct of Gross Value Added), 2000- Q3 13



Sources: Haver Analytics, Eurostat and Citi Research

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# Spain Is Becoming More German

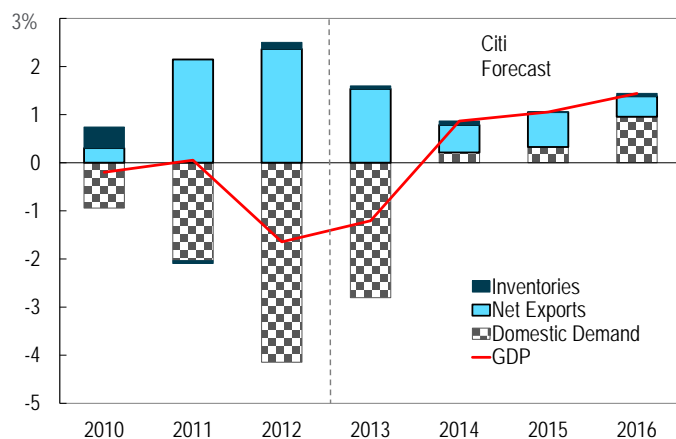
**Stronger GDP growth on earlier-than-expected net job creation**

This week's positive Q4 labour market data, recent Q3 flow of funds data and the latest business surveys suggest that the Spanish recovery is stronger and more broad-based than we previously thought. We are raising our GDP growth forecasts for this year to 0.9% (from 0.2% previously, above consensus of 0.7%) and to 1.1% (from 0.8%) for 2015. Despite still very high debt levels, we note that the financial position of the corporate sector has improved significantly over the past 4 quarters on the back of strong export-driven revenues and ongoing declines in labour costs, resulting in hefty profit growth. This is now translating into stronger business investment expansion and, crucially, into earlier-than-expected net job creation. Private consumption is expected to grow again in 2014 (by 0.7%), although at a still-mild pace due to a record-low saving rate, ongoing housing adjustment and negative population growth (see Figure 3). We expect Spanish GDP growth to outperform Italy over the next couple of years, reflecting its more advanced progress on the reform agenda and a much better competitive position.

**Acceleration in business surveys point to 0.3% QQ growth**

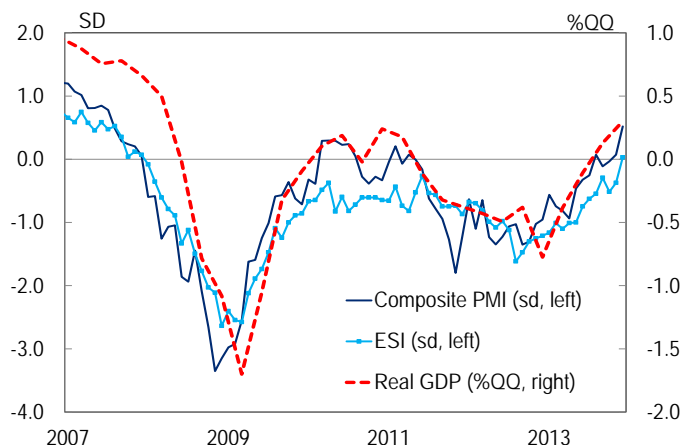
The recovery in Spain's business sentiment indicators accelerated at the end of 2013, with the EU Commission economic sentiment indicator (ESI) moving back to its long-run average in December for the first time since mid-2007, and the composite PMI to 0.5 standard deviations above average. This week's January [flash PMI estimates](#) for the euro area aggregate suggest the Spanish composite PMI will probably show another gain this month<sup>1</sup>. These survey levels are consistent with quarterly GDP growth of around 0.3%, in line with the probable Q4 outcome<sup>2</sup> (see Figure 4). Admittedly, hard data have been depicting a weaker picture for Q4: industrial output was probably flat QQ, growth of goods exports decelerated sharply up to November and real retail spending probably declined in the last quarter of 2013. However, we think there are fundamental reasons to believe that hard data will show further improvement in coming months.

Figure 3. Spain – Composition of GDP Growth, 2010-2016F



Sources: Haver Analytics, INE and Citi Research

Figure 4. Spain – GDP Growth and Business Surveys, 2007-Dec 13



Sources: Haver Analytics, EU Commission and Citi Research

<sup>1</sup> This estimate is based on the calculation of the contribution of euro area countries other than France and Germany to the euro area aggregate PMI for which flash estimates are not published.

<sup>2</sup> The Bank of Spain's usually accurate estimate for GDP growth was published this week at 0.3% QQ.

## A story of strong corporate profitability

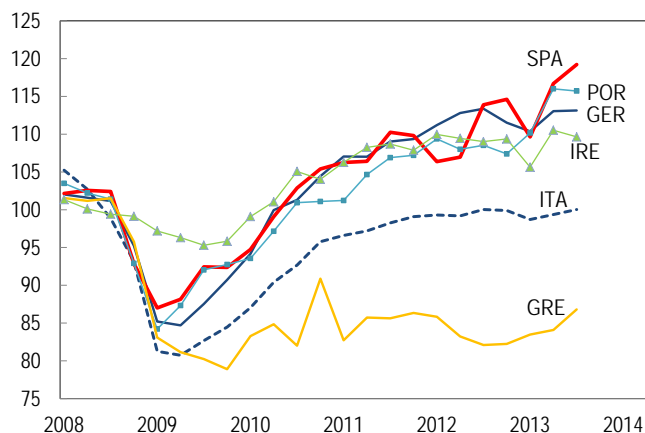
### Export growth is lifting corporate profit growth...

Our brighter outlook for Spain rests mainly on the acknowledgment of a marked improvement in the balance sheet position for Spanish non-financial corporations (NFC), despite their still high level of indebtedness. First, while still small as a share of GDP, Spanish exports have been rising strongly, outperforming most of other euro area countries over the past five years (see Figure 5). With external demand picking up, this is finally translating into better corporate revenues and accelerating profits at the economy-wide level.

### ...already strengthened by five years of falling labour costs

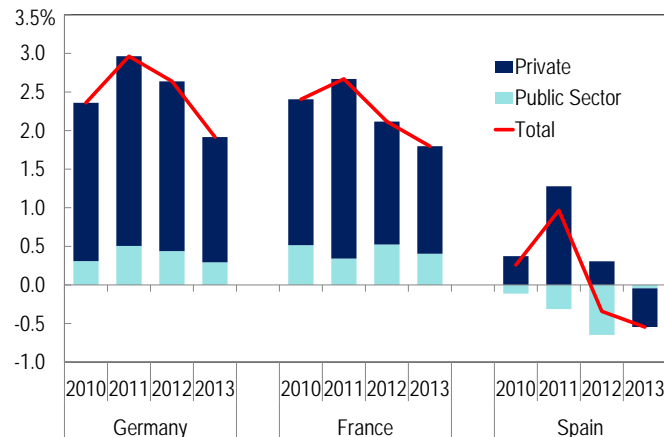
More crucially, the sharp reduction in labour costs over the past five years has boosted corporate profitability significantly, at first via large job shedding, but more recently also via a significant slowdown in wage growth. Wage moderation in Spain has been remarkable when compared with Spain's main euro area trading partners, like Italy France or even Germany (see Figure 6). Compensation per employee dropped by 0.3% in 2012 and by 0.5% on average in the first three quarters of 2013. While a large part of the overall decline in 2012 was driven by public sector wage cuts, compensation per employee has started to fall in a number of other sectors of the economy (-1.8% YY in 2013 in the private sector category including retail, transportation and accommodation services). We suspect that the 2012 labour market reform is probably contributing to recent wage moderation.

Figure 5. Real Exports of Goods and Services (2008=100), 2008-Q3 13



Sources: Haver Analytics, Eurostat and Citi Research

Figure 6. Spain – Germany, France and Spain – Compensation per Employee By Sectors (YY), 2010-2013



Sources: Haver Analytics, ECB and Citi Research

### Improvement in profitability similar to Germany in 2000-2007 period

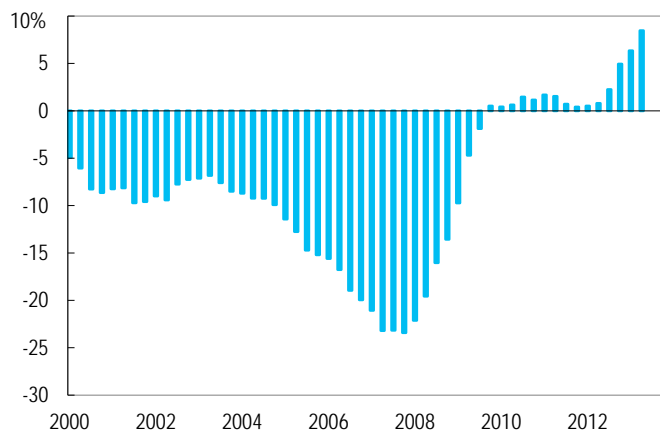
Mirroring the significant swing in labour costs, the profit share of NFC (as a percentage of their gross value added) has increased by 7.5ppt between 2008 and 2013 Q3. This is comparable with the rise in corporate profitability experienced by German firms between 2000 and 2008 (+7ppt), and it stands in clear contrast with the declining trend observable in Italy or France (see Figure 2 on the Front Page). Improved profits have been reflected in a much improved situation for the corporate sector financial balance (i.e., net lending/borrowing relative to the rest of the economy), which has switched to a surplus over the past four quarters for the first time since records began in 1999 (reaching 4.2% of GDP in Q3) (see Figure 7).

### Negative effects of deleveraging offset by improving financial markets

The level of corporate debt as percentage of GDP (at 131.7% in Q3 13) remains very high by historical and international standards, although it has declined by 13.5ppt relative to the peak in 2007. This would argue for savings to remain higher for longer, amid generally tight financing conditions, hence restricting investment and hiring. However, flow of funds data released this week showed that over the last few quarters rising equity valuations and better access to equity and debt security

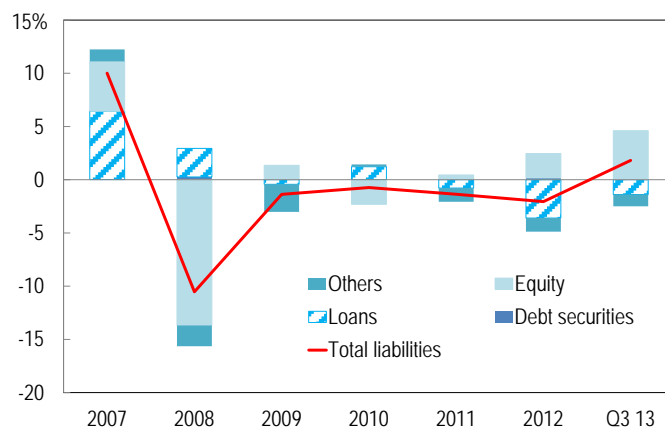
markets have offset the negative drag of negative credit flows, generating the first expansion in total corporate liabilities since 2007 (see Figure 8). In fact, the improved liquidity position of businesses and better asset valuations could have actually been one of the reasons behind the sharp acceleration in debt repayments observed since early 2013, as assets would have become more easily divested and associated liabilities more easily repaid.

Figure 7. Spain – Non-Financial Corporations' Financial Balance (Pct of NFC Gross Value Added), 2000-Q3 13



Sources: Haver Analytics, INE and Citi Research

Figure 8. Spain – Change in Non-Financial Corporation Liabilities, 2007-Q3 13



Sources: Haver Analytics, INE and Citi Research

#### Stronger financial position bodes well for higher investment spending and hiring

Therefore, Spanish non-financial corporations probably have more cash (thanks to higher profits) and also better access to financing (via higher equity valuations and despite ongoing credit contraction), if they need to start investing and hiring again. The investment rate (as pct. of value added) has dropped to a new record low in 2013, supporting the case for some rebound in investment activity (see Figure 9). In fact, coinciding with rising capacity utilisation rates, business investment has already posted three quarterly gains (of around 2.0% QQ on average) in the first three quarters of 2013 and the positive trend is expected to continue in 2014.

#### Q3 13 employment posts first QQ gain (in SA terms) since 2008

#### An earlier-than-expected recovery in the job market

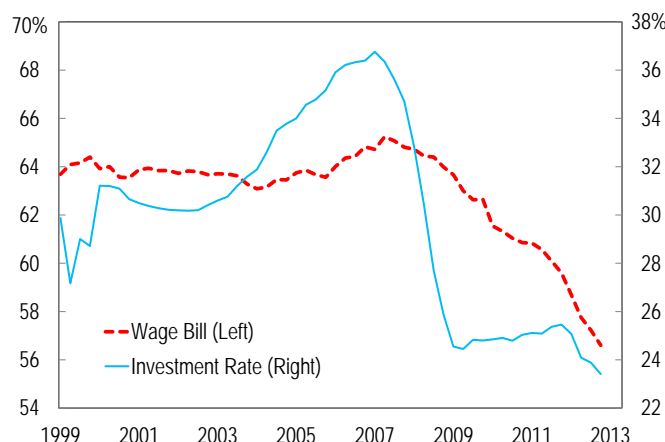
The rationale for expanding the workforce could be even more compelling as extensive job-shedding of the past five years may well imply that even modest expansions of output require new hiring<sup>3</sup>. This is unusual by historical standards for Spain, since during previous recessions employment growth has usually lagged GDP dynamics by a few quarters. In the 1993 cycle, for example, it took eight quarters for employment to post the first quarterly growth rate after the first positive print in QQ real GDP occurred. In 2010, positive GDP growth readings for five quarters (albeit small) did not even manage to lift job growth into positive territory. In contrast, Labour Force Survey (LFS) data released this week showed that the current recovery could be different, with a much quicker turnaround in the labour market. Data showed that employment dropped by only 0.4% QQ in Q4 in non-seasonally adjusted terms (smallest Q4 quarterly decline since 2008): we compute this translates into a QQ gain of around 0.3% in seasonally adjusted terms. This is occurring just one quarter after GDP turned positive in Q3 last year (+0.1% QQ in Q3).

<sup>3</sup> See "Euro Economics Weekly: Italy and Spain Look Well Positioned For Job Growth", Citi Research 25 October 2013.

**Unemployment has already started to fall  
also due to a shrinking labour force**

LFS data this week also showed that the unemployment rate (NSA) has probably already peaked, stabilising at 26.0% in Q4. This is the first time unemployment has not increased in Q4 since 2004. We compute that in seasonally adjusted terms the unemployment rate dropped from 26.5% in Q3 to 26.1% in Q4. The number of unemployed (NSA) in absolute terms was lower than a year earlier for the first time since Q2 07. It is important to note, though, that the stabilisation in the jobless rate has been driven both by better employment dynamics, as well as by a steep decline in the labour force. This reflects the shrinkage of the working-age population and a marginal decline in the participation rate. The number of persons unemployed dropped by 69K in Q4 13 relative to Q4 12 and this was the result of a decline in the labour force by 268K (of which a 211K fall in working age population and an increase by 57k in those within the working age group that were not actively looking for a job) and employment losses of 199k (see Figure 10).

Figure 9. Spain – Non-Financial Corporations' Investment Rate and Wage Bill (As Pct. of Gross Value Added), 1999-Q3 13



Sources: Haver Analytics, INE and Citi Research

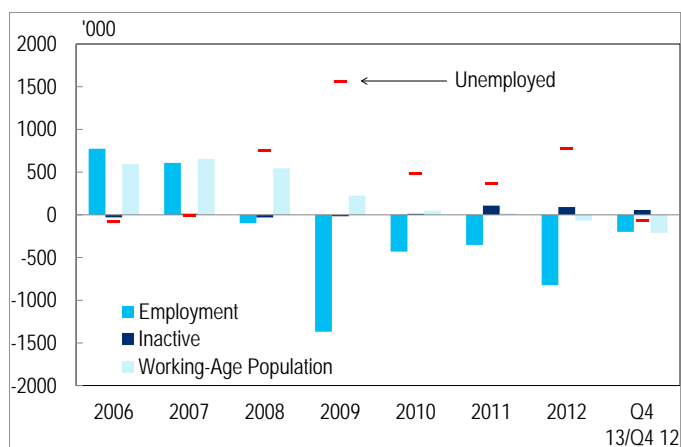
**Unemployment rate expected to fall  
faster than expected previously**

Looking forward we expect employment growth to continue, supported by ongoing wage moderation (negotiated wage growth has been stable at around 0.6% YY in the past 12 months) and labour shortages probably soon becoming an issue. Moreover, the negative impact on employment from public sector job cuts should start fading soon, as the Q4 LFS showed the number of public sector employees has now returned below 2005 levels. A reversal of the recent small decline in the participation rate is probably to be expected, as the labour market improves, but the fall in the working-age population will probably persist for some time. This will likely help to lower the unemployment rate sooner and faster than we previously expected (to 25.6% on average in 2014 and to 24.6% in 2015).

**Net job creation set to make private  
consumption recovery sustainable**

Positive employment growth, together with a much reduced fiscal drag, should allow an expansion in 2014 household nominal disposable income for the first time since 2009, even with wage growth remaining very subdued. The swing in real disposable income would be even larger, as inflation is expected to continue subsiding into slightly negative territory. This should provide a stimulus for private consumption, which we now expect to expand by 0.7% in 2014 and by 0.8% in 2015. For a fairly large economy (and relatively closed compared with smaller euro area economies like Ireland or Portugal), Spain needs a pick-up in private consumption to get any meaningful improvement in GDP growth. This will likely result in a rebound in imports from the extremely compressed levels of the past five years and hence a much smaller contribution from net exports to GDP growth.

Figure 10. Spain – Changes in Unemployment, Employment and Labour Force ('000), 2006-Q4 13

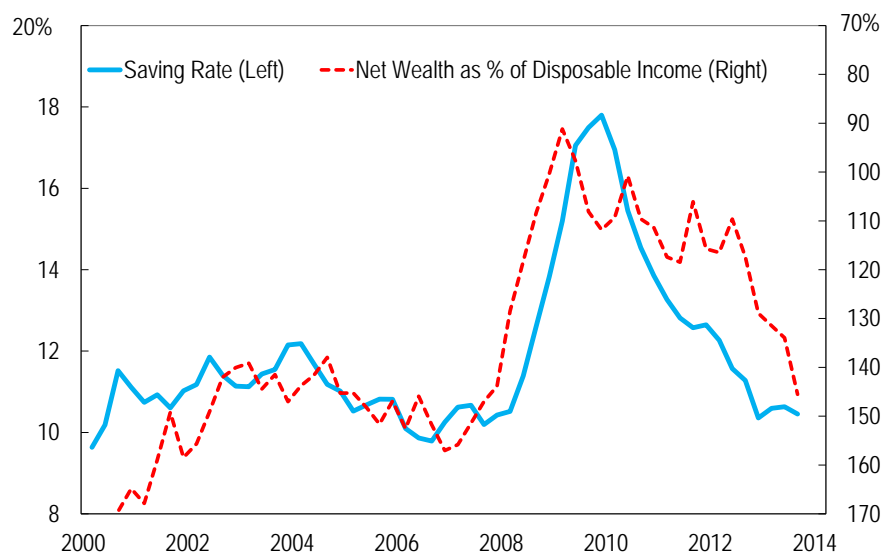


Sources: Haver Analytics, INE and Citi Research

### Recovery in private consumption to lag overall GDP

We still expect the recovery in private consumption to lag overall GDP. As we argued recently<sup>4</sup>, still high debt levels, falling housing prices and a record-low household saving rate leave little room for any consumption pick-up to exceed income. However, rising financial asset prices are likely to mitigate these negative effects: the ratio of household net financial wealth to disposable income has bounced back close to pre-crisis levels in the four quarters ending in Q3 13. This indicator is usually quite good in tracking households' consumption/saving behaviours, suggesting that the saving rate may remain at these subdued levels for few more quarters (see Figure 11).

Figure 11. Spain – Households' Net Financial Wealth and Saving Rate, 2000-Q3 13



Sources: Haver Analytics, INE and Citi Research

### Ongoing housing adjustment and a weak fiscal position likely to prevent growth from accelerating further

Finally, we think the recovery will remain capped by the ongoing adjustment in housing<sup>5</sup>, adverse demographic trends and a still fragile fiscal situation, which may eventually impose some further tightening (although unlikely before the next general elections in autumn 2015). The government is expected to announce an overhaul of the Spanish tax system in the next couple of months and PM Rajoy said this week that both corporate and income taxes will be cut in 2015, with possibly some offsetting higher indirect taxes. However, we think the room for meaningful tax rebates remains limited as the structural fiscal deficit is still quite large (above 4% of GDP, according to recent IMF and EU Commission estimates), tax elasticity to GDP growth is lower than pre-crisis trends and tax revenue as a pct. of GDP is among the lowest in the euro area<sup>6</sup>.

### Is Spain the template for the rest of the euro area periphery?

### Portugal may be surprising on the upside like Spain; Italy and Greece probably not

The extent to which the stronger-than-expected Spanish recovery could be a template for the other periphery countries is only partial. We think Portugal may be the country most likely to experience a similar economic recovery to Spain as export

<sup>4</sup> See ["Euro Economics Weekly: Spain: 2014 Outperformer?"](#), Citi research 13 December 2013.

<sup>5</sup> House prices are expected to stabilise only in late 2014/15 as we think that the still large stock of unsold properties will likely keep construction investment in negative territory both this year and the next.

<sup>6</sup> See ["Euro Economics Weekly: Is This the End of Austerity?"](#), Citi Research 22 November 2013.

growth has been almost as strong as in Spain and there have already been signs of an improvement in the labour market. We remain more pessimistic on the growth outlook for 2014 for Portugal relative to Spain mainly because we factor in the planned fiscal tightening measures worth 2.3% of GDP included in the 2014 Budget. Moreover, we think a much higher (and rising) public debt ratio relative to Spain (approaching 130% of GDP in 2013 vs. 100% in Spain) still represents a risk factor on growth, but we acknowledge that risks to Portuguese GDP forecasts are probably tilted to the upside. On the other hand, we think Italy and Greece will continue to lag — the former because of the relative absence of reform and long-standing competitiveness issues, the latter because the export rebound is still at a very early stage despite significant wage declines and still elevated uncertainty related to political developments.

Figure 12. Spain — Economic Forecasts, 2013-15F

		2013F	2014F	2015F
Real GDP	YoY	-1.2%	0.9%	1.1%
Final Domestic Demand	YoY	-2.9	0.2	0.3
Private Consumption	YoY	-2.4	0.7	0.8
Government Consumption	YoY	-1.0	-0.3	-0.9
Fixed Investment	YoY	-5.9	-0.7	0.4
Exports	YoY	5.7	6.2	4.6
Imports	YoY	0.8	5.0	2.9
CPI	YoY	1.5	-0.2	-0.1
Unemployment Rate	%	26.4	25.6	24.6
Current Account	€bn	10.5	10.1	14.7
	% of GDP	1.0	1.0	1.4
General Govt. Balance	€bn	-70.6	-59.9	-50.5
	% of GDP	-6.9	-5.8	-4.8
Primary Balance	% of GDP	-3.4	-2.2	-1.1
General Govt. Debt	% of GDP	93.9	99.7	103.5

F Citi forecast. YoY Year-to-year growth rate. Fiscal deficits include the effect of financial support for banks in 2013 (€2.8bn). Sources: INE, Haver Analytics, Eurostat and Citi Research forecasts



**Key Economic Indicators (27 January – 31 January 2014)**

<b>Monday 27 January</b>		<b>Forecast</b>	<b>Last</b>
08:30	Netherlands: Producer Confidence, Jan		
09:00	Germany: Ifo Business Climate, Jan	108.3	109.3
17:00	France: Jobseekers – Net Change, Dec	+5.0K	+17.8K
	Total Jobseekers, Dec	3,298.0K	3,293.0K
	Euro Area: Eurogroup Meeting, Brussels		
<b>Tuesday 28 January</b>		<b>Forecast</b>	<b>Last</b>
	EU: EcoFin Meeting, Brussels		
07:00	Germany: Import Prices, Dec	0.3% MM, -2.0% YY	0.1% MM, -2.9% YY
07:45	France: Consumer Confidence, Jan	87	85
08:30	Sweden: Trade Balance, Dec		
08:30	Sweden: Producer Prices, Dec		
08:30	Sweden: Retail Sales, Dec	0.5% MM	0.9% MM
09:00	Italy: Consumer Confidence, Jan	96.7	96.2
09:30	UK: GDP, 4Q Preliminary Estimate	0.7% QQ, 2.7% YY	0.8% QQ, 1.9% YY
09:30	UK: Service Sector Output, Nov	0.3% MM, 2.4% YY	0.1% MM, 2.1% YY
10:00	Italy: Contractual Wages, Dec		
11:00	Ireland: Retail Sales, Dec		
<b>Wednesday 29 January</b>		<b>Forecast</b>	<b>Last</b>
07:00	UK: Nationwide House Prices, Jan		
07:00	Germany: GfK Consumer Confidence, Feb		
08:00	Spain: Retail Sales, Dec	4.2% YY	2.0% YY
08:30	Sweden: Household Lending, Dec	5.0% YY	4.9% YY
09:00	Italy: Business Confidence, Jan	98.4	98.2
09:00	Norway: LFS Unemployment Rate, Nov	3.4%	3.3%
09:00	Euro Area: M3, Dec	1.7% YY, 1.6% 3-M YY	1.5% YY, 1.7% 3-M YY
14:00	Belgium: GDP, 4Q Flash	0.4% QQ, 0.9% YY	0.3% QQ, 0.4% YY
19:00	US: FOMC Outcome		
<b>Thursday 30 January</b>		<b>Forecast</b>	<b>Last</b>
08:00	Switzerland: KOF Economic Barometer, Jan		
08:00	Sweden: Consumer Confidence, Jan	105.4	105.4
08:00	Sweden: Manufacturing Confidence, Jan	106.0	106.6
08:00	Spain: GDP, 4Q Flash	0.3% QQ	0.1% QQ
08:55	Germany: Unemployment, Jan	-10K MM SA, +297K MM NSA	-15K MM SA, +67K MM NSA
09:30	UK: Personal Borrowing, Dec		
10:00	Euro Area: Economic Sentiment, Jan	100.8	100.0
13:00	Germany: HICP, Jan Flash	-0.4% MM, 1.4% YY	0.4% MM, 2.1% YY
	National CPI, Jan Flash	-0.4% MM, 1.5% YY	0.4% MM, 1.4% YY
<b>Friday 31 January</b>		<b>Forecast</b>	<b>Last</b>
00:01	UK: GfK Consumer Confidence, Jan		
07:00	Germany: Retail Sales, Dec	0.1% MM, 2.5% YY	0.8% MM, 0.8% YY
07:45	France: Consumer Spending, Dec	0.6% MM, 1.9% YY	1.4% MM, 1.5% YY
07:45	France: Producer Prices, Dec		
08:00	Spain: HICP, Jan Flash	0.3% YY	0.3% YY
09:00	Italy: Unemployment Rate, Dec	12.7%	12.7%
09:00	Norway: Registered Unemployment Rate, Jan	2.9%	2.6%
09:00	Norway: Retail Sales, Dec	0.3% MM	0.5% MM
09:00	Norway: Credit Indicator C2, Dec	6.0% YY	6.0% YY
10:00	Greece: Retail Sales, Nov		
10:00	Euro Area: HICP Flash, Jan	0.9% YY	0.8% YY
10:00	Euro Area: Unemployment Rate, Dec	12.1%	12.1%
	Spain: Current Account, Nov		

Sources: National statistical offices, central banks and Citi Research



## Economic Indicators

### Euro Area

Jan 29 09:00	<b>M3, Dec</b>	<b>Forecast: 1.7% YY, 1.6% 3-M YY</b>	<b>Prior: 1.5% YY, 1.7% 3-M YY</b>
London Time	Base effects are likely to push the annual growth rate in broad money higher in December, to 1.7% YY, even assuming that the monthly dynamic (adjusted for seasonality) may have remained subdued around year-end. Most importantly, the annual growth rate in private sector loans should have eased its contraction to -1.9% YY in December, from -2.3% in November – first improvement since Sept-11. We still expect a contraction in flows of new loan to non-financial corporations (-0.3% MM). We expect private sector deleveraging, especially in the euro periphery, to continue in coming months, resulting in more debts being paid back, amid improved businesses' liquidity position.		
Jan 30 10:00	<b>Economic Sentiment, Jan</b>	<b>Forecast: 100.8</b>	<b>Prior: 100.0</b>
London Time	The overall economic sentiment indicator probably continued to rise in January, moving above its long term average for the first time since July 2011. A rebound in confidence for the service sector and consumers has likely led the rise in January, as these indices in recent months had been lagging behind the gains recorded by industrial sentiment. At current levels, historically the ESI has been consistent with annual GDP growth of around 1.5%, pointing to some upside risks to our current baseline scenario of growth in the region of 1% on average in 2014.		
Jan 31 10:00	<b>HICP, Jan P</b>	<b>Forecast: 0.9% YY</b>	<b>Prior: 0.8% YY</b>
London Time	Inflation has probably continued to hover around the 0.8%-0.9% annual rate in January, with some risks of a 1% YY print. The rise in the annual rate likely stemmed from the impact of the VAT rate hikes in France, as well as a payback in German inflation after the subdued HICP reading in December. These factors should push core inflation temporarily higher to 0.9% YY in January, from 0.7% in December, but we expect it to decline again in coming months (with a local trough seen in March due to favourable base effects around the late timing of Easter relative to last year).		
Jan 31 10:00	<b>Unemployment Rate, Dec</b>	<b>Forecast: 12.1%</b>	<b>Prior: 12.1%</b>
London Time	The unemployment rate likely remained unchanged for the ninth consecutive month in December. The unemployment rate has stabilised since the beginning of 2013, as a result of a declining trend in Germany, offset by still rising jobless rates in Italy (+0.8pp up to November), Netherlands (+0.9pp) and to a lesser extent Spain (+0.3p). The French jobless rate was broadly unchanged in 2013.		

### Germany

Jan 27 09:00	<b>Ifo Business Climate, Jan</b>	<b>Forecast: 108.3</b>	<b>Prior: 109.3</b>
London Time	We expect a slightly stronger reading for the ifo business climate in December, owing to a small increase in the current conditions indicator and an unchanged expectations index. Both indices remain more than one standard deviation above their long-term averages, but their momentum has somewhat faded in recent months.		
Jan 28 07:00	<b>Import Prices, Dec</b>	<b>Forecast: 0.3% MM, -2.0% YY</b>	<b>Prior: 0.1% MM, -2.9% YY</b>
London Time	We expect German import prices to rise in December. Even with the increase, German import prices would still be falling in year-on-year terms (by 2%), as the euro remains strong, and export prices of other euro area countries and commodity prices weak.		
Jan 30 08:55	<b>Unemployment, Jan</b>	<b>Forecast: -10K MM SA, +297K MM NSA</b>	<b>Prior: -15K MM SA, +67K MM NSA</b>
London Time	German unemployment is very stable at low levels and we expect that to be reflected in the January numbers where seasonally-adjusted unemployment is likely to tick down slightly and non-seasonally-adjusted figures should show a large seasonal increase, but still leaving the (seasonally adjusted) unemployment rate at a very low 6.9% according to the domestic definition.		
Jan 30 13:00	<b>HICP, Jan Flash</b>	<b>Forecast: -0.5% MM, 1.4% YY</b>	<b>Prior: 0.4% MM, 2.1% YY</b>
London Time	<b>National CPI, Jan Flash</b>	<b>Forecast: -0.4% MM, 1.5% YY</b>	<b>Prior: 0.4% MM, 1.4% YY</b>
London Time	We expect the flash readings for German inflation in January to tick up to 1.4% for the HICP definition and 1.5% for the national definition. In recent months, base effects have created a discrepancy between the HICP and the national definition readings which should be history from January. Overall consumer price inflation in Germany remains weak, but should start to pick up very slowly amid rising core inflation.		
Jan 31 07:00	<b>Retail Sales, Dec</b>	<b>Forecast: 0.1% MM, 2.5% YY</b>	<b>Prior: 0.8% MM, 0.8% YY</b>
London Time	Growth in German retail sales (excluding cars) in November was revised down from a strong 1.5% MM to 0.8% MM, leaving the Oct-Nov average still down on 3Q. The 2013 release for private consumption also suggested sluggish but positive growth in 4Q. We therefore expect a small increase in December, which would lift the YY increase on base effects.		

### France

Jan 27 17:00	<b>Jobseekers – Net Change, Dec (000s)</b>	<b>Forecast: +5.0K</b>	<b>Prior: +17.8K</b>
London Time	<b>Jobseekers, Dec (000s)</b>	<b>Forecast: 3,298.0K</b>	<b>Prior: 3,293.0K</b>
London Time	We look for a 5,000 increase in the number of registered jobseekers in December, taking the total figure very close to the 3mn mark. We continue to expect the mainland jobless rate to peak in 2Q-14 at 10.7%, compared to 10.5% in 3Q-13, helped by a modest rebound in economic activity and a significant contribution from government-sponsored schemes. Employment expectations in the private sector are improving steadily, returning to their long-term averages, as is the number of job vacancies, up to a 17-month high of nearly 250k, up 50k from June/July lows.		
Jan 28 07:45	<b>Consumer Confidence Indicator, Jan</b>	<b>Forecast: 87</b>	<b>Prior: 85</b>
London Time	Consumer confidence has been treading water in the last four months, with the headline measure ending 2013 some 1.8sd below its long-term average. We believe that the change of tone by President Hollande in his New Year address, focusing on competitiveness, sizeable expenditure savings and a clear step on the road to more structural reforms will help support business confidence and higher economic activity in the coming months. The main near-term risk to our forecast is the impact on household sentiment from the VAT rate hike on January 1.		

## Economic Indicators

### France Continued

Jan 31 07:45 London Time	<b>Consumer Spending, Dec</b>	<b>Forecast: 0.6% MM, 1.9% YY</b>	<b>Prior: 1.4% MM, 1.5% YY</b>
Ahead of the January 1, 2014 VAT rate hike, we expect consumer spending to have risen by 0.6% in December, boosted by household purchases of big-ticket items (car registrations rose 3.2% QQ in 4Q). As a result, consumer spending is forecast to have risen by almost 2% in the final two months of 2013 (+0.9% QQ), despite flat-lining household confidence. Hence, the contribution from household expenditure to GDP is expected to be significant. However, we would expect some payback in the first quarter of 2014, dampening the GDP growth trajectory somewhat.			

### Italy

Jan 28 09:00 London Time	<b>Consumer Confidence, Jan</b>	<b>Forecast: 96.7</b>	<b>Prior: 96.2</b>
Consumer sentiment has started to deteriorate again since last October, after several monthly gains, mainly on expected worsening of the personal financial situation. We expect this trend to have partially reversed in January, as inflation continues to subside, boosting real incomes, and the effects of the fiscal tightening should have continued to abate.			
Jan 29 09:00 London Time	<b>Business Confidence, Jan</b>	<b>Forecast: 98.4</b>	<b>Prior: 98.2</b>
Business sentiment probably gained marginally in January, in line with the clear slowdown in the pace of improvement of the past couple of months. The level remains some 0.2 standard deviations below long-run average, suggesting only marginally positive GDP growth in 4Q/1Q.			
Jan 31 09:00 London Time	<b>Unemployment Rate, Dec</b>	<b>Forecast: 12.7%</b>	<b>Prior: 12.7%</b>
The unemployment rate may have remained unchanged in December, after a 0.2pp increase in November. The economic recovery in Italy has been lagging behind the rest of the euro zone, and GDP has probably posted positive quarterly growth only in 4Q 13. This implies employment creation may not be experienced before mid-2014. YY employment growth has actually deteriorated further since the summer.			

### Spain

Jan 29 08:00 London Time	<b>Retail Sales, Dec</b>	<b>Forecast: 4.2% YY</b>	<b>Prior: 2.0% YY</b>
We expect MM growth rate in real retail sales to have eased in December (to 0.7% MM) after the strong pickup of 2.0% MM in November. On an annual basis, positive strong base effects (retail sales fell by 1.5% MM in Dec-12) should bring the annual rate (WDA) up to 4.2% YY, highest reading since Aug 2007. Falling inflation has provided some boost to real disposable income and spending. We expect private consumption to post positive QQ growth in 4Q as well as in 2014.			
Jan 30 09:00 London Time	<b>GDP, 4Q P</b>	<b>Forecast: 0.3% QQ</b>	<b>Prior: 0.1% QQ</b>
We expect the preliminary 4Q GDP reading (+0.3% QQ, highest quarterly rate since 1Q 08) to confirm the end of recession in the Spanish economy, after two years of QQ contractions. Private consumption likely rose marginally in 4Q, amid falling inflation, less fiscal tightening, and first signs of employment growth. Recent gains in business confidence together with improvements in firms' financial position should keep business investment rising in 4Q. On the other hand, net exports' contribution to real growth likely was zero in 4Q (after deducting 0.1pp in 3Q), reflecting a weakening in both exports and imports.			
Jan 31 09:00 London Time	<b>HICP, Jan P</b>	<b>Forecast: 0.3% YY</b>	<b>Prior: 0.3% YY</b>
We expect the annual HICP inflation rate to remain unchanged at 0.3% YY in January. Fuel prices were down slightly in January, reflecting lower oil prices, however the announced increase in the electricity tariffs (by 2.3% MM) should still move HICP energy inflation up (to 0.6% YY from 0.2% YY in Dec). On the other hand, we expect further easing in food price inflation as well as on-going weakness in core prices. Still ample spare capacity however will probably push core inflation lower in coming months, likely to negative territory. We expect HICP inflation to average -0.2% YY over 2014.			

### Belgium

Jan 29 14:00 London Time	<b>GDP, 4QP</b>	<b>Forecast: 0.4% QQ, 0.9% YY</b>	<b>Prior: 0.3% QQ, 0.4% YY</b>
Net exports are expected to contribute to a sizeable increase in Belgian 4Q GDP, which we forecast will show a 0.4% QQ gain. We expect some payback in terms of domestic demand contributions to GDP growth (-0.1ppt) after an unexpectedly robust 0.4ppt in 3Q. In our <i>Euro Economics Weekly</i> of 17 Jan 2014, we raised the 2014 Belgian GDP forecast to 1.2%, arguing that cheap financing costs, better investment prospects and better sentiment make Belgium well positioned to benefit from a pick-up in external demand.			

### Sweden

Jan 28 08:30 London Time	<b>Retail Sales, Dec</b>	<b>Forecast: 0.5% MM</b>	<b>Prior: 0.9% MM</b>
Retail sales rebounded strongly in November; activity in October and November combined was 1.2% above the 3Q level (3Q: 0.5% QQ, 2Q: 0.6% QQ, 1Q: 1.4% QQ). Current levels of consumer and retail confidence support an upward trend in private consumption, and fiscal policy measures are expected to support spending going into 2014.			
Jan 29 08:30 London Time	<b>Household Lending, Dec</b>	<b>Forecast: 5.0% YY</b>	<b>Prior: 4.9% YY</b>
Lending to households was stable at 4.9% YY in November, staying above the growth pace a year ago (4.5% YY). The largest part of households' loans consists of housing loans (63%), which in October had an annual growth rate of 5.2% (4.6% YY a year ago and down from 10.5% YY in early 2010). Given the rebound on the housing market (house prices have increased throughout most of 2013), we see a clear risk that household lending could pick up further ahead. Although this is well in line with the Riksbank's expectations (forecast a pick-up to around 5%-5.5% YY), we reckon the board would be more comfortable with a slowdown in lending growth.			

## Economic Indicators

### Sweden Continued

Jan 30 08:00 London Time	<b>Consumer Confidence, Jan</b>	<b>Forecast: 105.4</b>	<b>Prior: 105.4</b>
	Consumer confidence is now at highest levels since March 2011, and although short-term indicators point to further upward pressure on the housing market, we expect a consolidation in January. We note, though, that household confidence according to SKOP rose slightly in January. Further ahead, rising home prices and an improving labour market should continue to support confidence. Current levels of consumer confidence suggest that private consumption will accelerate this year.		
Jan 3 08:00 London Time	<b>Manufacturing Confidence, Jan</b>	<b>Forecast: 106.0</b>	<b>Prior: 106.6</b>
	Following strong gains in recent months (confidence at highest level since Jun-11), we expect manufacturing confidence to fall slightly back in January. A lower PMI reading in December supports this. Meanwhile, the stronger-than-expected gain in the European PMI is an upside risk to our forecast. However, NIER normally tends to react with a slight lag compared to PMI, so an effect is more likely in the February data. We note that hard data in Sweden has now slowly started to catch up with sentiment data		

### Norway

Jan 29 09:00 London Time	<b>LFS Unemployment Rate, Nov</b>	<b>Forecast: 3.4%</b>	<b>Prior: 3.3%</b>
	The Labour Force unemployment rate is expected to inch up a notch to 3.4% in November (Oct-Dec 3m average). Over the past year, unemployment has held fairly stable, while employment growth has recovered despite the slowdown in economic activity since spring. The stable development in the jobless rate hence reflects an increasing labour force. Looking ahead, we expect unemployment to remain around the current level in 2014 while employment should continue to grow at the current rate. Note that Norges Bank's preferred unemployment measure is registered unemployment which was stable at 2.6% in December. The Central Bank expects registered unemployment to rise slightly in coming quarters.		
Jan 31 09:00 London Time	<b>Registered Unemployment Rate, Jan</b>	<b>Forecast: 2.9%</b>	<b>Prior: 2.6%</b>
	Registered unemployment increased by slightly above 500 persons in December, marginally less than in previous years (675 persons in Dec 2011 and Dec 2012). Norges Bank forecasts an increase in unemployment from 2013 to 2014 (from 2.75% to 3.0%). In line with the seasonal pattern, we expect the registered jobless rate to climb in January.		
Jan 31 09:00 London Time	<b>Retail Sales, Dec</b>	<b>Forecast: 0.3% MM</b>	<b>Prior: 0.5% MM</b>
	Norwegian retail sales and domestic spending on goods recovered slightly in November, but the data still suggest that goods consumption probably stayed weak in the final quarter of 2013. In Oct-Nov, the level of retail sales is 0.2% below the 3Q average, and it will require a strong growth gain in December to lift the quarterly growth rate above nil in 4Q. As in recent quarters, we expect that service consumption and consumption abroad likely will offset some of the weakness in retail sales in 4Q, but overall private spending is likely to remain weak in the final quarter of 2013. In other words, we see downside risks to Norges Bank's 0.4% Q/Q 4Q forecast.		
Jan 31 09:00 London Time	<b>Credit Growth Indicator, Dec</b>	<b>Forecast: 6.0% YY</b>	<b>Prior: 6.0% YY</b>
	The 4Q lending survey showed that household credit demand slipped in the fourth quarter, mirroring developments in the monthly credit growth indicator for households, which fell 0.1pp to 7.1% YY in 4Q (Oct-Nov average). With moderating gains in the housing market, household credit demands are likely to slow further in 4Q. Meanwhile, the latest lending survey showed about stable credit demand from non-financial enterprises, and this is unlikely to change in the first quarter of 2014. The monthly development in corporate credit growth has been moderating since mid-2012, from 7.5% YY in June 2012 to 3.8% YY in November 2013, likely reflecting stricter lending conditions from banks and high activity on the bond market. In December, we expect credit to households and non-financial enterprises to remain in the area of 7.0% YY and 3.8% YY, respectively. Meanwhile, credit to municipalities should fall slightly further (7.4% YY in Nov).		

### United Kingdom

Jan 28 09:30 London Time	<b>GDP, 4Q, Preliminary Estimate</b>	<b>Forecast: 0.7% QQ, 2.7% YY</b>	<b>Prior: 0.8% QQ, 1.9% YY</b>
	Partial data so far show solid growth in industrial production, but a modest gain in retail sales and little change in construction output. We suspect some of these monthly activity readings understate the economy's momentum but, unless the services output data released at the same time are very strong, we suspect growth will fall a little short of the 0.8% QQ pace seen in 3Q.		
Jan 28 09:30 London Time	<b>Service Sector Output, Nov</b>	<b>Forecast: 0.3% MM, 2.4% YY</b>	<b>Prior: 0.1% MM, 2.1% YY</b>
	Business surveys point to solid output growth, and so we look for a gain in line with the average of the prior four months. Such a figure would put the average level of output in October and November 0.5% above the 3Q level.		

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

## Economic Indicators

### Key Economic Indicators (3 February – 7 February 2014)

During The Week		Forecast	Last
08:00	UK: Halifax House Prices, Jan		
Monday 3 February		Forecast	Last
07:30	Sweden: Manufacturing PMI, Jan		
08:00	Norway: Manufacturing PMI, Jan		
09:00	Euro Area: Manufacturing PMI, Jan Final		
09:30	UK: Manufacturing PMI, Jan	47.5	57.3
	Italy: Budget Balance, Jan		
Tuesday 4 February		Forecast	Last
08:00	Spain: Unemployment, Jan		
10:00	Italy: HICP, Jan Flash		
10:00	Euro Area: Industrial Producer Prices, Dec		
Wednesday 5 February		Forecast	Last
07:30	Sweden: Services PMI, Jan		
08:30	Sweden: Average House Prices, Jan		
09:00	Euro Area: Services PMI, Jan Final		
	Composite PMI, Jan Final		
09:30	UK: Services PMI, Jan	59.0	58.8
10:00	Euro Area: Retail Sales, Dec		
Thursday 6 February		Forecast	Last
06:45	Switzerland: SECO Consumer Confidence, Jan		
07:00	Switzerland: Trade Balance, Dec		
07:45	France: Survey on Industrial Investment, Jan		
11:00	Germany: Incoming Orders, Dec		
12:00	UK: MPC Meeting Outcome		
12:45	Euro Area: ECB Meeting Outcome – Press Conference at 13:30		
Friday 7 February		Forecast	Last
07:00	Germany: Trade Balance, Dec		
07:45	France: Trade Balance, Dec		
07:45	France: Budget Balance, Dec YTD		
08:00	Spain: Industrial Production, Dec		
08:15	Switzerland: Retail Sales, Dec		
08:30	Netherlands: Industrial Production, Dec		
08:30	Sweden: Industrial Production, Dec		
08:30	Sweden: Services Production, Dec		
09:00	Norway: Industrial Production, Dec		
09:30	UK: Trade Balance – Goods & Services, Dec		
09:30	UK: Industrial Production, Dec		
	Manufacturing Output, Dec		
11:00	Germany: Industrial Production, Dec		

Sources: National statistical offices, central banks and Citi Research

Title	Author	Date
<b>Euro Area – Sovereign Debt Update</b>		
Market Awaits Moody's Rating Review of France	European Economics Team	Jan 24, 2014
Draghi and Coeuré Cautiously Optimistic about Growth	European Economics Team	Jan 23, 2014
IMF Revises EA GDP Up, But Warns About Deflation Risk	European Economics Team	Jan 22, 2014
IMF Revises EA GDP Up, But Warns About Deflation Risk	European Economics Team	Jan 21, 2014
Greece – Election s Risk Increases Significantly	European Economics Team	Jan 20, 2014
<b>Euro Area</b>		
European Economic Forecast Highlights - January 2014	Ann O'Kelly	Jan 23, 2014
Euro Area - Composite Flash PMIs – Strong Start To 2014	Guillaume Mennet	Jan 23, 2014
ECB - Door firmly open to easing to address two contingencies	Guillaume Mennet	Jan 9, 2014
ECB January 9 Meeting Preview - Many issues to attend to, but no decisions expected yet	Guillaume Mennet	Jan 3, 2014
ECB - Ready to Act, But Likely Conditional on Lower Inflation Path	Guillaume Mennet	Dec 5, 2013
European Economic Forecast Highlights - December 2013	Ann O'Kelly	Dec 5, 2013
ECB - Seen on Hold in December, but More Easing Likely in 2014	Guillaume Mennet	Nov 28, 2013
Germany - What if Grand Coalition negotiations fail?	Ebrahim Rahbari	Nov 25, 2013
ECB - Aiming for Low Real Rates	Guillaume Mennet	Nov 7, 2013
ECB Preview - Expect Dovish Tone, Leaving Door Open to a Cut in December	Guillaume Mennet	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 Mennet	Oct 2, 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
<b>Euro Economics Weekly</b>		
Belgium: Politics the Likely Main Wild Card in 2014	Guillaume Mennet	Jan 17, 2014
Germany 2014 Outlook: Recovery And Rebalancing	Ebrahim Rahbari	Jan 10, 2014
2014 Outlook: GDP Risks, Credit Dynamics and Inflation Update	European Economics Team	Jan 6, 2014
Spain: 2014 Outperformer?	Giada Giani	Dec 13, 2013
Why Is France Underperforming? And How To Fix It	Guillaume Mennet	Dec 6, 2013
Is Deflation Good or Bad for the Eurozone Periphery?	Ebrahim Rahbari	Nov 29, 2013
Is This the End of Austerity?	Giada Giani	Nov 22, 2013
Recovery Watch: SME Lending is Key	Guillaume Mennet	Nov 15, 2013
One Shock Away from Deflation	Giada Giani	Nov 8, 2013
Why the ECB Should Worry About the Strong Euro	Ebrahim Rahbari	Nov 1, 2013
Italy and Spain Look Well Positioned For Job Growth	Guillaume Mennet	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 Mennet	Sep 27, 2013
Housing Not Yet Turning Around	Ebrahim Rahbari	Sep 20, 2013
Loan Dynamics: Renaissance by Year-End	Guillaume Mennet	Sep 13, 2013
Germany — Four More Years	Ebrahim Rahbari	Sep 6, 2013
<b>Chief Economist Publications</b>		
Global Economic Outlook and Strategy - January 2014	Willem Buiter	Jan 22, 2014
<b>Scandi</b>		
Scandi Economics Update	Tina Mortensen	Jan 24, 2014
Norway - Banks Expect Lending Margins to Narrow in 1Q 2014	Tina Mortensen	Jan 16, 2014
Sweden - Volatile Components Drive Inflation Higher in December	Tina Mortensen	Jan 14, 2014
<b>UK</b>		
UK - Change of UK Rate View	Michael Saunders	Jan 22, 2014
UK - CBI Report Continued Strong Output Growth	Michael Saunders	Jan 21, 2014
UK - Interesting Paper by David Miles	Michael Saunders	Jan 20, 2014
UK - Retail Sales Surge	Michael Saunders	Jan 17, 2014
<b>UK Economics Weekly</b>		
What Will the MPC Say When Unemployment Hits 7%?	Michael Saunders	Jan 17, 2014
Inflation Convergence and Divergence	Michael Saunders	Jan 10, 2014
2014 Outlook — Recovery and the New Normal	Michael Saunders	Jan 8, 2014
UK Economics Weekly - Looking Back...the Economic Surprises of 2013	Michael Saunders	Dec 13, 2013
Balancing Prudence, Politics and Growth	Michael Saunders	Dec 6, 2013
Policy Post-Guidance	Michael Saunders	Nov 29, 2013

Source: Citi Research

**Notes**

**Notes**



**Notes**

## Appendix A-1

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