

German Constitutional Court Refers OMT to ECJ

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Summary

German Constitutional Court (GCC) has referred Outright Monetary Transactions (OMT) to the European Court of Justice but will issue its ruling on a court case against other EU support measures, including the ESM and Fiscal Compact, on March 18. Comment: this is a negative in our view, as it leaves open to question whether the OMT violates the EU treaty (although we acknowledge that the GCC cannot directly bind the ECB). Historically, the ECJ has tended to a more pro-European interpretation of the law, which makes it likely, in our view, that it will declare the OMT to be in line with European law.

ECB likely to deliver 15bp rate cut at the 6 March ECB meeting, in our view, because of the weakness of inflation in the next few quarters and the likely undershooting of the ECB's 'less but close to 2% objective' by 2016.

ECB's Liikanen on EM and Noyer on the euro – hoping that emerging-market turmoil “calms down” and noting it would be “normal” for the euro to weaken if the euro area recovery lagged the US.

SRM – Extra meetings needed to resolve disagreements.

Germany – Goods exports and imports fall in December, still leaving a positive contribution to Q4 GDP growth. **Dec industrial orders weaker than expected.**

BdF's Noyer stresses that more reforms are needed in France – the ‘Responsibility Pact’ is a step in the right direction, but many more will be needed to tackle “dwindling productivity”, “weak profit margins” and “economic rigidities”.

President Hollande's approval ratings weaken further in February – A TNS Sofres opinion poll showed that President Hollande's approval rating had fallen by 3 percentage points to 19%, with a 2-point drop to 23% in a CSA poll.

Italy – Renzi reveals proposal to abolish the Senate, reducing risks of hung parliaments at next elections.

Italy – rising calls for Renzi to replace PM Letta in a government reshuffle, Renzi says a decision may be taken on 20 February. If Renzi becomes PM, the probability of early elections in May reduces significantly.

Spain – independence is preferred option among Catalans with 48.1% support, a GESOP poll showed. 31% remain undecided.

Spain – industrial production fell by 0.3% MM in Dec, after a strong rise of 0.9% MM in Nov. IP fell by 0.2% QQ in Q4, after rising by 0.6% QQ in Q3.

Dutch Eurosceptics argue EU exit would lift GDP growth – Geert Wilders argued that Dutch GDP would be 10%-12% higher by 2035 if outside of EU.

Portugal – Fitch revises up 2014 GDP growth forecast to 0.8% (from 0.2%), but rating remains at BB+ with negative outlook due to the high public debt.

Greece – 2013 recession milder than the expected -4.0%, FinMin says.

Greece: Government to reverse some tax fines.

7 February 2014

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With thanks to Antonio Montilla

Economics

Western Europe

Industrialised G7 Countries

Recent Research

ECB: No Change, But Action Likely In March

6 February 2014

Unchanged today, but we now expect a March rate cut. The ECB disappointed market hopes of action today, keeping its interest rates, non-standard measures unchanged and not ending SMP sterilisation. But ECB President Draghi opened the door to action in March. We therefore bring forward the timing of the refi rate cut to March, looking for a 15bp cut in the refi rate (leaving the deposit rate at zero).

Ebrahim Rahbari | Guillaume Menuet

UK — MPC – All Eyes on the Inflation Report

6 February 2014

The MPC left Bank Rate and QE unchanged. The MPC are likely to unveil the next phase of forward guidance at next week's “Inflation Report”.

Inevitably, such a framework will be far less precise than the current forward

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Today's News in Detail

German Constitutional Court refers OMT case to European Court of Justice.

The German Constitutional Court, in a press release this morning, says that it will issue its ruling on a court case against European support measures, including the ESM and Fiscal Compact, on March 18. But the Court has separated the matters that relate to OMT and has referred “several questions” to the ECJ for a “preliminary ruling”. The GCC apparently sees substantial reasons that Outright Monetary Transactions (OMT) exceeds the ECB’s mandate and infringes the monetary financing prohibition, even though a limited interpretation of the OMT could make it conform to law. Comment: this is a negative in our view. The German Constitutional Court (GCC) has to our knowledge never referred a case to the ECJ and this leaves open to question whether the OMT violates the EU treaty (although we acknowledge that the GCC cannot directly bind the ECB). Historically, the ECJ has tended to a more pro-European interpretation of the law, which makes it likely, in our view, that it will declare the OMT to be in line with European law. Nevertheless, we think this will leave the OMT even less likely to be used (certainly until the ECJ makes its ruling).

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ECB’s Liikanen on EM and Noyer on the euro – European Central Bank Governing Council member Erkki Liikanen said on Finland’s MTV television that inflation expectations remain subdued, adding that he hopes emerging-market turmoil initiated by the Fed’s tapering of bond purchases “calms down”. BdF Governor Christian Noyer remarked that the current situation “*had nothing to do with deflation*”, adding that it would be “*normal*” for the euro to weaken if the euro area recovery lagged that of the US, according to Bloomberg. Both central bankers noted that ECB interest rates were expected to stay low or lower for an extended period of time. Comment: we believe that the weakness of inflation in the next few quarters and the likely undershooting of the ECB’s ‘less but close to 2% objective’ by 2016 will lead to a [15bp rate cut at the 6 March ECB meeting](#).

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SRM – Extra meetings needed to resolve disagreements. Bloomberg reports that the European Parliament called on EU finance ministers to hold an emergency meeting ahead of the next EU meeting on Feb 18 to avoid any further delay in the negotiations on the Single Resolution Mechanism (SRM). Guy Verhofstadt, the head of the EP’s Liberal Democrats called for EU FMs to make a new proposal, likening the current SRM proposal to a “*Trabant*” (a car produced by the former East Germany) when “*a McLaren or a Ferrari*” was needed to resolve bank crises quickly. The article reports that talks between EP legislators and Greece, which holds the rotating presidency of the EU, had stalled, as EP representatives complained that Greece had not been given any mandate to negotiate. Meanwhile, Herbert Reul, who was the chief negotiator for Chancellor Merkel’s coalition negotiations in Germany last year, criticised EP President Martin Schulz for “*heating up the opposition*” in the EP and saying that he was not showing any signs of working constructively on a deal. Comment: the EP is criticising the current SRM proposal for making resolution decisions too complex, and for not building up joint resolution funds quickly enough, and these criticisms are justified, in our view, and shared by a number of EU countries. However, it remains to be seen whether the common position of the EU governments can change substantially, which will mostly depend on Germany. In general, we expect the European Parliament and the governments to come to some form of an agreement before the parliament’s term ends in May this year, even though that agreement will probably still only be a starting point for further changes in coming years.

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Germany – Goods exports and imports fall in December. Both exports and

guidance framework aimed to be. In future, the MPC are likely to put more emphasis on a range of guides to labour market slack, and this may well include the concept of under-employment – that is, people who would like to work more hours than currently or get an extra job.

Michael Saunders

UK — PMI Edges Down, Still Points to Solid Growth

5 February 2014

Newswires report that the services PMI edged down to 58.3 in January from 58.8 in December. This index is 0.8 standard deviations above the 1997-2013 average, a period in which services output has risen by 3.0% YY on average. So this points to continued solid growth, at least matching the solid pace recorded in Q3 and Q4 (both 3.2% QoQ SAAR). Against this backdrop, we do not expect the MPC will cut the jobless threshold at the upcoming meeting.

Michael Saunders

Sweden — Riksbank Forecast: Stable Interest Rate and Path

5 February 2014

We expect the Riksbank to maintain the repo rate and its rate path unchanged at the upcoming 13 Feb meeting. Hence, the Bank is expected to continue to signal a 16% chance of another near-term rate cut and initial tightening early next year. With improving growth metrics and indications that unemployment is likely to decline soon, we reckon the Dec interest rate cut probably is the last in this easing cycle.

Tina Mortensen

Euro Area — Assessing Vulnerabilities to an EM Slowdown

3 February 2014

Exports of goods to EM countries as pct of GDP are highest in Belgium, Netherlands, Germany, Austria, Italy, Greece and Switzerland. Of course, any adverse effects on growth from an EM slowdown may be cushioned in part by a real income boost if prices of imported commodities weaken, but this effect is relatively even across economies.

Michael Saunders

imports in Germany fell in December (by 0.9% and 0.6%, respectively), whereas consensus expectations had been for a similar-sized increase. However, previous data for exports were revised upwards (to a 0.7% MM increase in November vs 0.3% initially), leaving exports in Oct-Dec 1.6% above the Q3 average. Imports on the other hand were revised downwards to a 2.3% decrease in November (originally -1.1%), leaving them flat in Q4 over Q3. Comment: the data suggest that net exports may have contributed to GDP growth in Q4 (the first reading is due on Feb 14), even though the national account data in real terms (which also include trade in commercial services) can differ substantially from the nominal data for goods only.

Germany – industrial orders weaker than expected in December. German industrial orders for December were down 0.5% MM (up 6.0% YY), in line with our forecast, but weaker than the consensus expectation of a 0.2% MM increase. November data were revised up at the same time to a 2.4% MM/7.2% YY increase from a 2.1% MM/6.8% YY original reading. The press release noted that despite the reduction in December, the share of large orders in December was above average for a December. It also highlighted that the positive trend in orders generally continued, and was mostly driven by foreign orders currently, with euro area demand showing more and more positive signs. Comment: the weak reading in December should mostly be seen as a partial payback for the strong November reading, which was distorted by a large number of large orders. The Q4 average of industrial orders is still up by 1.1% over the Q3 average, highlighting a pretty robust underlying trend.

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BdF's Noyer stresses that more reforms are needed in France – Banque de France Governor Christian Noyer in a lengthy interview with *Les Echos* notes that President Hollande's 'Responsibility Pact' is a step in the right direction, adding around 1 percentage point to GDP growth over two or three years. However, Mr. Noyer warned that many more steps will be needed to tackle "dwindling productivity", "very weak profit margins" and "economic rigidities". Mr. Noyer remarked that the public administration would need to be streamlined, as part of the government's target of bringing the budget deficit to less than 3% of GDP in 2015. Comment: improving the competitiveness of the French economy will take some time, with more efforts necessary in terms of the flexibility in both the private and public sector with respect to employment practices.

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President Hollande's approval ratings weaken further in February – A TNS Sofres opinion poll for *Le Figaro* Magazine showed that President Hollande's approval rating had fallen by 3 percentage points to 19%. In a further CSA poll also released on Friday in *Les Echos*, Mr. Hollande's popularity was reported to have declined by two points to 23%. PM Ayrault was stable at 23%. When quizzed about the President's 'Responsibility Pact', 69% of respondents approved, but 89% thought it would be hard for employers to create hundreds of thousands of jobs. Comment: it seems that the government's failure to trigger a fall in the unemployment rate is weighing on their popularity ratings, while President Hollande's decision to embrace supply-side economics likely cost him some support in the left without convincing many of the conservatives.

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Dutch Eurosceptics argue EU exit would lift GDP growth – Geert Wilders, a Eurosceptic politician, argued on Thursday that the euro area's fifth largest economy would see substantially higher growth to the tune of 10%-12% higher by 2035 if the Netherlands quit the European Union, making reference to an earlier report called "*Nexit: assessing the economic impact of the Netherlands leaving the EU*" commissioned by his party. Finance Minister and Eurogroup head Jeroen Dijsselbloem retorted that quitting the EU would be "very unwise"

Euro Economics Weekly — The Euro Area Now and Japan Then: Separated by One Large Shock

31 January 2014

The euro area is not currently in deflation. But, with very low inflation, ample slack and sluggish growth, we believe the euro area is — like mid-90s Japan — potentially just one major adverse shock away from deflation. To be sure, there are some differences but, in our view, the commonalities outweigh the differences. It is not inevitable that the euro area will be hit by a similar shock but, if it is, then — like Japan — the region could well be tipped into deflation.

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

UK Economics Weekly — Is Growth Credit-Led?

31 January 2014

Sceptics of our strong growth forecast often argue that the rebound is a credit-led bubble and hence inherently fragile. We disagree. The household debt/income ratio — and indeed, the overall private sector debt/GDP ratio — continues to fall. More broadly, the period of balance sheet retrenchment probably is ending. Corporate liquidity is the best for over 50 years, and this is likely to feed through to solid job growth, higher pay growth and a business investment recovery in coming quarters.

Michael Saunders | Ann O'Kelly

Scandi Economics Update — Production and Orders Data set the Agenda

7 February 2014

Sweden — Ongoing upward trend in house prices — FinMin steps up criticism of biggest Swedish banks after raising shareholders reward — Industrial and service sector production for Dec (out at 8.30 UK time).

Norway — Government rejects FSA recommendation on mortgage cap — Moderate gain expected in Dec manufacturing production.

Denmark — Government rules out mortgage bank support.

Tina Mortensen

given the country's crucial trade links with the rest of the EU. A recent Maurice de Hond poll published on January 20 showed that some 45% of the Dutch are in favour of EU membership, with 37% opposed. Mr. Wilders' far-right VVD Freedom Party would win 29 seats in the 150-seat parliament if an election were held now, while the Liberal and Labour parties, which are in a coalition government, would win 19 and 14 seats, respectively. Comment: With the next parliamentary elections not scheduled before March 2017, this rhetoric is targeted at voters in the upcoming European parliamentary elections when populist and anti-euro parties are expected to do well.

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Italy – Renzi reveals proposal to abolish the Senate. After forging an agreement on electoral reform, PD leader Renzi yesterday provided details of his proposal to change Italy's bicameral system and reduce the risk of hung parliaments at the next election. Under the proposal, senators would no longer be elected, would not be called to cast the confidence vote for appointing governments and would not vote for budgets. Representatives of the local authorities (mayors and presidents of the regions) would be sitting in the new Senate, they would not receive a salary and they would vote only on European matters and for the election of the President of the Republic. Renzi said the proposal has the support of the main political parties. Comment: allowing for just one House of Parliament to appoint new governments is the necessary condition for any electoral law to guarantee a clear-cut electoral result and hence guarantee better governability in Italy. The proposal requires a change in the Constitution and a broad parliamentary majority, implying a fairly long approval process (definitely too long for it to be ready for possible early elections in May).

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Italy – rising calls for Renzi to replace PM Letta in a government reshuffle.

Several local media report that the new PD leader Matteo Renzi may be ready to take on the premiership and replace PM Letta in a government reshuffle, as factions within his party would reportedly like to see a clear change of government strategy. Renzi, who so far had denied any intention to force a government reshuffle, yesterday said a decision on whether to ask for a change at the helm will be taken on 20 Feb. Comment: if Renzi becomes PM, the probability of early elections in May reduces significantly. Uncertainty however remains on whether Renzi favours a government reshuffle now, ahead of very sensitive EU elections in May, or prefers to search for voters' official backing and force an early election in May (jointly with the EU Parliament elections).

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Spain – Poll suggests independence as preferred option among Catalans.

According to a GESOP poll released yesterday, 48.1% of Catalans would favour the region becoming a new State (vs. 24.4% thinking otherwise). 84.7% of those wanting a new State would like Catalonia to be independent. 40.7% of all respondents support independence, broadly unchanged relative to last month's poll, while 31% are still undecided (+5.7ppts relative to last month). The poll was carried out between Jan 28 and Jan 31. Catalonia's political parties have agreed to hold a referendum on independence on 9 November 2014 based in two questions: "Do you want Catalonia to be a State?" and if so "Do you want that State to be independent?" Comment: at this stage the polling data suggest that a majority of Catalans would favour more autonomy for the region, but a smaller share would vote for independence. In our view, these preferences are likely to change as the campaign ahead of the referendum will shed light on the pros and cons of an independent Catalonia, including the region's EA and EU membership.

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Spain – Industrial production fell in December by 0.3% MM, after a strong

rise of 0.9% MM in November. On an annual basis, output (WDA) increased by 1.7%, down from 2.4% in Nov. IP fell by 0.2% QQ in Q4. Comment: the marginal decrease in output mainly reflected a payback after a strong reading in Nov. We continue to expect industrial production to post positive growth in Q1, amid data suggesting a pickup in external demand, as well as strong survey-based activity indicators (PMI manufacturing currently at highest level since Apr 2010).

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Portugal – Fitch revises up 2014 GDP growth forecast to 0.8% (from 0.2%), and expects GDP to accelerate to 1.5% in 2015, on stronger export expectations. Credit rating remains at BB+ with a negative outlook due to the still high level of public debt. Fitch said Portugal would be better off if it requested a precautionary credit line after the end of the current bailout programme in May.

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Greece – 2013 recession milder than -4.0%, FinMin Stournaras said, speaking in Frankfurt yesterday. The FinMin also said as new data from the budget execution come in, it seems that the primary surplus of 0.4% of GDP for 2013 will be largely outperformed. GDP data for Q4 13 will be published on February 14. Comment: we expect the annual pace of contraction in GDP to have eased substantially in Q4 13, from -3.1% YY in Q3 to -1.6% in Q4, leaving an annual average contraction of -3.4% for 2013.

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Greece – government to reverse some tax fines. Ekathimerini reports that PM Samaras has asked the Finance Ministry to reverse the tax regulations that have generated anger among taxpayers, accountants, property owners, farmers and entrepreneurs. Changes to the capital gains tax on property transactions are also to be considered, according to the newspaper. Comment: the weakening popularity of the main ruling party, Samaras' New Democracy, and rising support for the main opposition party, left-wing SYRIZA, is forcing the government to reduce to the minimum any unpopular decision ahead of crucial EU and municipal elections next May.

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Latest Issues of Sovereign Debt Update

ECB To Stay On Hold For Now

6 February 2014

No change in ECB rates expected today - we believe the Governing Council will prefer to wait for March macroeconomic forecasts. Euro area retail sales post surprisingly large fall in Dec. Deficit of German regions falls to €0.5bn in 2013. French President Hollande aims to speed launch of Responsibility Pact. Support for Spain's ruling PP continues to fall. Greece: maturity extension and 50bp interest rate cut on bilateral loans, reports Bloomberg, but denials by Germany and EU Commission.

Giada Giani | Ebrahim Rahbari | Guillaume Menuet

Euro Area PMI Hints at Accelerating GDP in 1Q14

5 February 2014

Rise in Jan EA composite PMI suggests a pickup in GDP growth in 1Q. ECB reshuffles responsibilities of Executive Board members. EBRD to start investing in Greece, Portugal, Cyprus. Greece's 2013 primary surplus may reach 0.8% of GDP, possibly resolving troika stumbling block. Greece's opposition Syriza party would seek debt write-off of 60% of GDP, if elected.

Giada Giani | Ebrahim Rahbari | Guillaume Menuet

Greece: Third Bailout Not To Be Agreed Until Mid-Year

4 February 2014

Third Greek bailout not to be agreed until mid-year. Little new at ECB's AQR press conference. Draghi to seek Bundesbank support to end SMP sterilisation. ECB's Lautenschläger on SSM at EU Parliament. Juncker as main centre-right candidate for EC president. German Foreign Min on EU treaty renegotiation. French spending review and corporate tax talks. Italy's 4Q GDP growth and state sector cash balance. Spain's manufacturing PMI, registered unemployment. Slovakia's solid fiscal revenue in Jan.

[Ebrahim Rahbari](#) | [Guillaume Menuet](#) | [Giada Giani](#)

ECB Liquidity Policy under the Spotlight

3 February 2014

Bundesbank favours end to sterilization operations, says Dow Jones. ECB's Coeuré says tools exist to ease, even if policy rate close to ZLB. EBA gives more stress test details. Eurogroup President to be full time role? EU's Rehn says reforms may become precondition for deficit deadline extensions. Spain's Rajoy repeats pledge of 2015 tax cuts. Spain's current account surplus widens. EU lenders prepare for third Greek bailout programme, says Spiegel. Greek stress tests delayed again to early Feb.

[Ebrahim Rahbari](#) | [Guillaume Menuet](#) | [Giada Giani](#)

ECB's Coeuré on Declining Fragmentation

31 January 2014

ECB's Coeuré on clear signs of declining financial fragmentation. ECB asks banks for data on restructured loans. ECB lending survey confirms supply-side improvement. Germany: tax receipts up, retail sales and inflation weaker than expected. French PM launches household income tax reform. Belgian budget deficit shrinks but misses target. Italy's Lower House starts voting on electoral reform bill in secret ballot. Spain's HICP remains subdued. Portugal's IP jumps, retail sales slow.

[Guillaume Menuet](#) | [Giada Giani](#) | [Ebrahim Rahbari](#)

ECB's Noyer Warns About A Strong Euro

30 January 2014

Noyer: stronger euro contrary to ECB price stability goal. EC's bank reform proposal. ECB's new Supervisory Board meets. Banks in Europe lose market share in property lending. German Cabinet approves pension reform. Banks' exposure to govt debt falls faster in Spain than in Italy. Italian business confidence rises. Spain's bank bailout programme completed. Spain's shadow economy at 25% of GDP. 4Q GDP in Spain and Belgium. Greek corporate deposits rebound. Moody's on Portugal. Slovenia update.

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Macroeconomic Research

European Economic Forecast Highlights — January 2014

23 January 2014

This companion to Global Economic Outlook and Strategy - January 2014 gives detailed quarterly forecasts for the main European countries to end 2015 and annual forecasts to 2018 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 — January 2014

22 January 2014

We are pushing up our global growth forecasts this month, and now look for global GDP growth (at current exchange rates) to rise from 2.5% in 2013 to 3.3% in 2014 and 3.4% in 2015, up by 0.1pp for 2013, 0.2pp for 2014 and 0.1pp for 2015 from our previous forecast. This year will, we expect, mark a return to sustained above-average global growth rates, whereas global growth has been below average for three consecutive years (2011-13) and indeed in five of the last six years.

[Willem Buiter](#) | [Nathan Sheets](#) | [Michael Saunders](#) | [Robert V DiClemente](#) | [Kiichi Murashima](#)

Emerging Markets Macro and Strategy Outlook — The ‘Fragile 5’: A Progress Report

GEMS, Asia, CEEMEA, Global, Latin America – 24 January 2014

The ‘F5’ - Brazil, India, Indonesia, South Africa and Turkey - were at the heart of EM's underperformance in 2013, but investors have become more discriminating lately: the IDR, BRL and INR have been the best-performing EM currencies since the start of the year, while the ZAR and TRY have been the worst. We don't pretend to have a full ‘theory’ of how investors should discriminate among these economies over the next few months, but some trends are becoming clear.

[Guillermo Mondino](#) | [David Lubin](#) | [Johanna Chua](#)

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Appendix A-1

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