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Western Europe

Euro Economics Weekly

France a Year On: How Much Progress?

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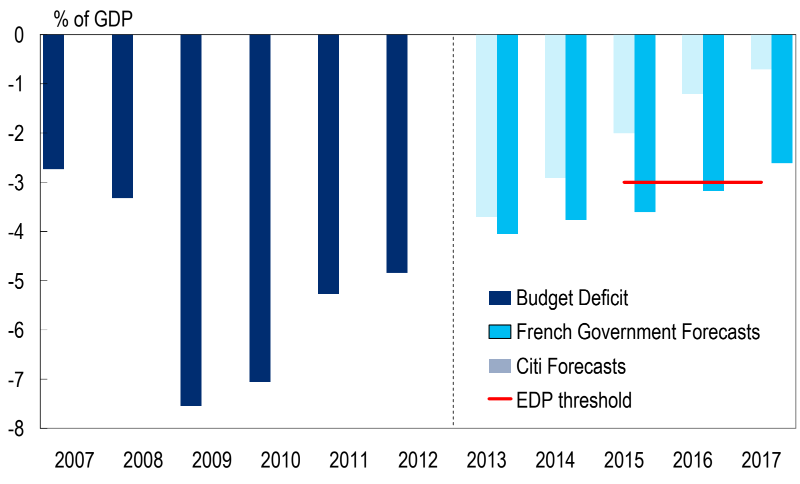
- We continue to worry that firms' weak profitability and persistent competitiveness issues will hinder the corporate sector's willingness to invest and hire. In terms of budgetary adjustments, we estimate that more efforts will be required in 2015 to exit the recently extended excessive deficit procedure. As structural reforms should help the economy add to its growth potential, low popularity ratings ought to be a source of motivation for reform, rather than a hindrance, in our view.

Figure 1. Citi Market Forecasts

	$/€	Euro Repo	10-yr Bunds	£/€	U.K. Bank Rate	10-yr Gilt-Bund	SKr/€	SEK Policy Rate	NOK/€	NOK Policy Rate	SFr/€	CHF Policy Rate	CHF Spread vs Bunds
4Q 13	1.36	0.25	1.50	0.86	0.50	66	8.80	0.75	7.76	1.50	1.26	0.00	-75
2Q 14	1.37	0.25	1.50	0.86	0.50	86	8.71	0.75	7.62	1.50	1.27	0.00	-90

Source: Citi Research

Figure 2. France – Nominal Budget Deficit Trajectory, 2007-17F



Sources:

Guillaume Menuet
+44-20-7986-1314
guillaume.menuet@citi.com

Giada Giani
+44-20-7986-3281
giada.giani@citi.com

Michael Saunders
+44-20-7986-3299
michael.saunders@citi.com

Ebrahim Rahbari
+44-20-7986-6522
ebrahim.rahbari@citi.com

Ann O'Kelly
+44-20-7986-3297
ann.okelly@citi.com

For all distribution enquiries regarding Citi Economics research, including access via Citi websites and via third party distribution channels, please contact michael.saunders@citi.com or jan.maguire@citi.com

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Guillaume Menuet

France a Year On: How Much Progress?

A year on, how is France doing in terms of growth, budget consolidation and reforms?

President François Hollande has been in office for a little more than a year. In our view, while stability of deposit base and relative healthiness of its banking system mean that credit availability will not be an obstacle to GDP growth, the missing ingredients are confidence and greater visibility with respect to the government's policies, but also the continuing focus on sizeable budget consolidation. Unless those issues are addressed, we fear that French growth will disappoint.

Cyclical dynamics remain poor, but stabilization is underway

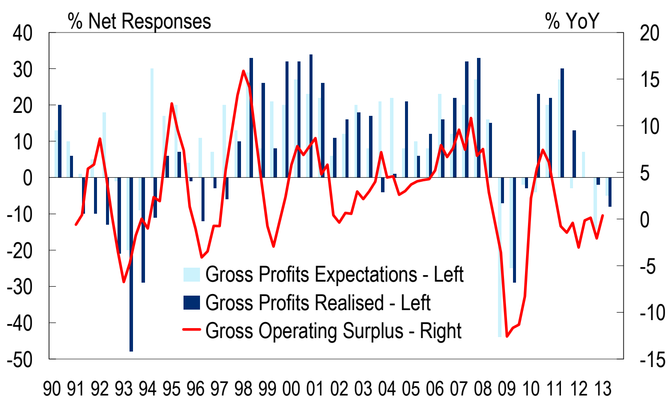
Is the worst behind us? Possibly, but the economy is not displaying much cyclicality

Politicians like to reassure voters and investors by claiming as early and as often as possible that the "*worst is behind us*", arguing that policy decisions already taken will lead to the desired results. President Hollande was no exception, believing that cyclical dynamics would eventually reassert themselves given all the efforts made at the EU level to deepen the monetary union. On the domestic front, his government had launched labour market reforms, having finally acknowledged that firms were suffering an excessively high cost of labour and low profit margins.

Weak corporate profitability remains an issue, weighing on firms' ability to invest and hire

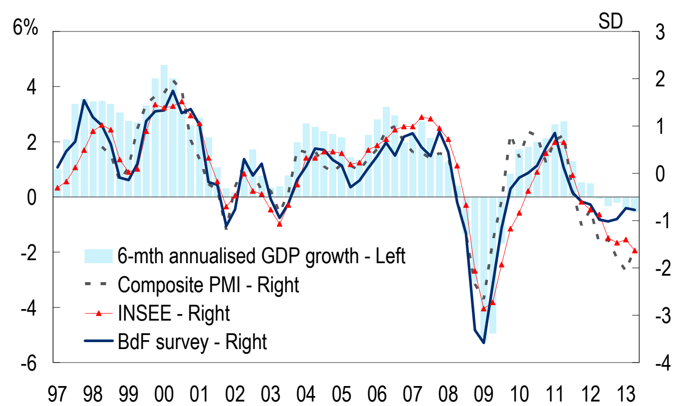
The launch of the Competitiveness Pact (aimed at addressing these issues) in the autumn of 2012 has not yet had a material impact on the corporate sector[1]. Profit margins remain under pressure, with INSEE's latest survey of industrial treasurers highlighting the still challenging picture in terms of revenue expectations (see Figure 3). It is not surprising, therefore, that manufacturers last April ratcheted down their expectation of a 4% contraction in investment compared to a January forecast of no change, coming on the heels of 7% and 12% gains in 2012 and 2011, respectively.

Figure 3. France – Industry Profits Expectations and Gross Operating Surplus, 1Q-90 to 2Q-13



Sources: INSEE and Citi Research

Figure 4. France – GDP Growth and Sentiment Surveys, 1Q-97 to 2Q-13



Sources: INSEE, Haver, Banque de France and Citi Research

Smaller rate of GDP contraction ahead as surveys rebound from their recent lows

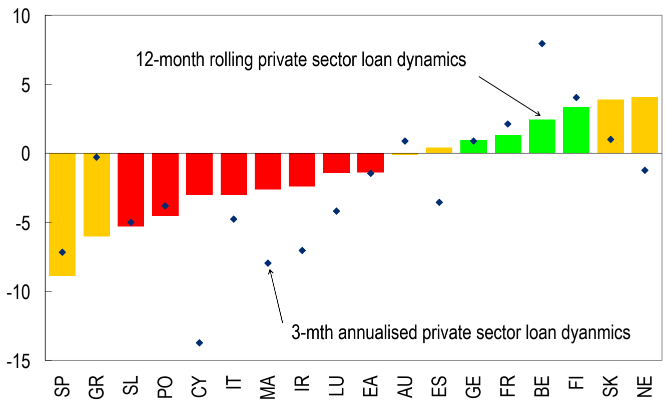
In the 12 months since President Hollande's election, the economy has contracted in three of the last four quarters, and the annualized rate of GDP looks set for a fifth successive quarterly drop. Sentiment surveys (see Figure 4) for 2Q-13 continue to suggest some contraction in economic activity: in June industrial confidence remains stuck at -0.7 standard deviation below its long-term average, consumer confidence has fallen to a new historical low (-2.3 sd) and economic sentiment hit a 15-quarter low of -1.6 sd.

[1] Only 43% of SMEs are planning to use the payroll tax credit offered by the government to reduce their labour costs, according to French employers' organisation CGPME representing small and medium-sized firms

The credit channel is not an impediment to economic activity

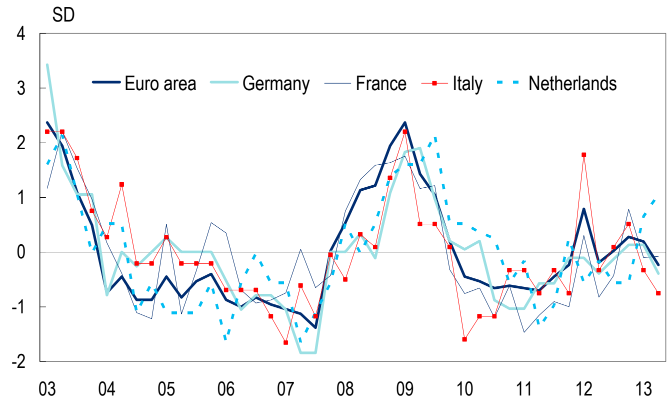
Yet, credit flows to the private sector remain positive, suggesting that the banking system remains in relatively good shape compared to the more challenging picture in other euro area member states (see Figure 5). The three-month annualized growth rate of loans to the non-financial corporate sector stood at 1.1% in May-13 (+0.7% YY), while the equivalent figure for household mortgages was 2.9% (+1.9% YY). Looking ahead, the decline in the perception of risk related to expectations of general economic activity suggests that the credit channel is unlikely to be a significant constraint on GDP growth, in our view (see Figure 6).

Figure 5. Selected Countries – Private Sector Credit Growth, May-13



Note: The orange colour code represents a gap of at least one percentage point between the two metrics to indicate positive momentum from a situation of negative credit growth and a negative momentum from a situation of positive credit growth.
Sources: ECB, National Central Banks, Haver and Citi Research

Figure 6. Selected Countries – Bank Lending Survey – Perception of risk: Expectations of General Economic Activity, Jan-03 to Jul-13



Sources: ECB, National Central Banks, Haver and Citi Research

Economy to flat-line for much of 2013, with muted rebound in 2014

France will have "*no growth*" in 2013, according to French President François Hollande. This opinion was also expressed by the French Statistics Institute INSEE in its latest Economic Outlook released in late June, pointing to a small rebound in GDP growth of 0.2% QQ in 2Q-13, but expecting little upward momentum in the second half, with 3Q and 4Q GDP estimates of 0.0% and 0.1% QQ, respectively. INSEE estimates that GDP growth will be negative to the tune of 0.1% in 2013, compared to the government's forecast of a 0.1% gain. In all likelihood, GDP growth will remain anemic in France for much of the second half of the year, leading to a low entry point for 2014, which will require a further downward revision in the government's 2014 baseline of 1.2% GDP growth, in our view.

We remain below consensus for 2013 and 2014, arguing that the lack of clarity in terms of the government's intentions with respect to taxation is hindering the recovery in domestic demand

Our French 2013 GDP forecast (which is not too different from those reviewed above) is unchanged, showing a likely fall in economic activity of 0.3%, and a similar sized drop in domestic demand. The tentative improvement in surveys since the start of the second quarter argues in favour of some stabilisation in GDP during the second half of the year compared to an average annualised contraction of 0.7% in 4Q-12 and 1Q-13. While the government is still pushing its modest reform agenda, opinion polls suggest that households would be willing to accept more radical changes, (particularly with respect to their pensions and various entitlements but also labour market laws) in exchange for greater clarity with respect to the overall level of taxation. Key risks going forward are the persistence of subdued profitability dynamics, together with negative business investment as firms struggle with weak domestic demand.

The Long Road to a <3% of GDP Budget Deficit

Downside risks to official GDP growth in 2013 mean that the budget deficit is likely to overshoot the official baseline, in our view. France's Audit Court highlighted some risks to the 3.7%-of-GDP target for 2013, arguing that based on the government's 2013 GDP growth forecast of 0.1%, the deficit would likely be in a 3.7% to 4% of GDP range. Based on INSEE's forecast of a 0.1% GDP contraction, the Court estimates the deficit to be between 3.8% and 4.1% of GDP. While the expenditure side of the equation is likely to remain under control with the government expected to cancel more 'reserve credits', the largest shortfall is expected to come from revenues. The court's calculations point to a gap of up to €4bn in revenues, made up of a €1.5bn shortfall in VAT and a €2.5bn shortfall in corporate taxes. A larger contribution to the EU budget could also amount to around €1bn.

Figure 7. France – 2014E Revenues

	% of GDP	€ bn
Structural revenues increases	**0.3%**	**€ 6.0**
Compensation for expiry of 2013 one-offs	**0.4%**	**€ 8.0**
New Resources	**0.7%**	**€ 14.0**
Already announced		**€ 8.0**
VAT hike (CICE)		€ 6.0
Family benefits		€ 1.0
Reformatted 75% income tax		€ 0.5
Supplementary pensions		€ 0.5
To be introduced		**€ 3.5**
Basic state pension		-
Diesel taxes		-
Life insurance		-
Additional VAT changes		-
Corporate taxation		-
Tackling tax evasion		**€ 2.5**

Sources : French Parliament and Citi Research

Figure 8. France – Structural Deficit Trajectory (Pct. of GDP)

Structural deficit plans	2012	2013E	2014E	2015E	2016E	2017E
Latest (Jul-13)	-3.9%	-2.2%	-1.2%	-0.4%	0.0%	0.3%
Implied annual effort		1.7pp	**1.0pp**	**0.8pp**	**0.4pp**	**0.3pp**
SCP* (Apr-13)	-3.7%	-2.0%	-1.0%	-0.5%	0.0%	0.0%
Implied annual effort		1.7pp	1.0pp	0.5pp	0.5pp	-
LPFP* (Oct-12)	-3.6%	-1.6%	-1.0%	-0.5%	0.0%	0.0%
Implied annual effort		2.0pp	0.6pp	0.5pp	0.5pp	-

*SCP (Stability and Convergence Programme); LPFP refers to the organic public finance law.

Sources: Citi Research

Figure 9. France – 2014E Expenditures

	% of GDP	€ bn
Structural spending cuts	**0.7%**	**€ 14.0**
Nominal freeze in gov't outlays		**€ 7.0**
Other savings		**€ 6.0**
o/w contributions to local authorities		€ 0.8
o/w from central gov't, operators and local authorities		€ 1.5
o/w social security accounts		€ 0.5
o/w pensions		€ 2.0
o/w family benefits		€ 1.2
Still to be determined		**€ 1.0**

Sources: French Parliament and Citi Research

The government's estimate of a 2.2% structural deficit is 0.6pp of GDP wider than the LPFP estimate (see Figure 9). This amounts to a 'significant gap' that under the new fiscal framework adopted in 2012 needs to be addressed in the subsequent two years. As a result, the new trajectory of public finances incorporates some compensation for the 2012-13 overshoot in 2014-15. Note that the structural budget deficit reduction effort will also have to be extended into 2017.

The government's objective is to cut the structural budget deficit by 1% of GDP or around €20bn

The government has indicated that, in line with its newly submitted Stability and Convergence Programme (SCP), it would shrink its structural budget deficit by 1% of GDP in 2014. The effort would be heavily skewed towards expenditures instead of tax increases, through a 70%-30% split.

Given the already announced VAT rate hikes (starting January 2014) to finance the corporate payroll tax credit embedded in the Competitiveness Pact, the government appears reluctant to increase the fiscal pressure on households. PM Jean-Marc Ayrault has been very careful about its communication, arguing that the greater focus on expenditure control from 2014 onwards will limit the recourse to revenue raising measures. Yet, estimates from the Audit Court and the government's lower house budget expert, Socialist PM Christian Eckert, point to revenues increases in 2014 of at least €12bn, but more likely €14bn (Figure 7).

Around €6bn of revenues will come from new measures

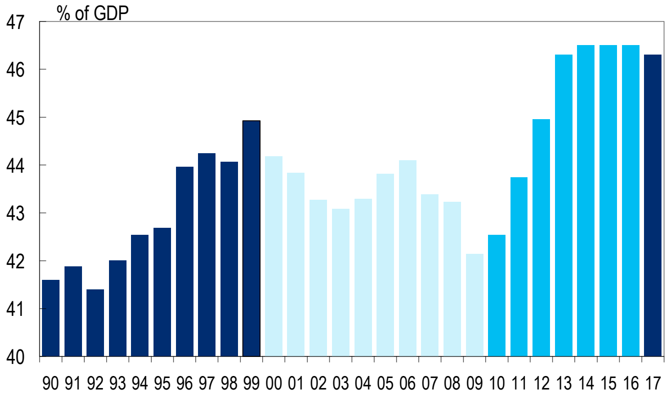
The SCP indicates that the total tax burden as percentage of GDP will increase by 0.3ppt to 46.5% in 2013 (fourth highest of the EU-27, Figure 10, next page), which would amount to €6bn of extra revenues, stemming from previously announced changes to family benefits (€1bn), the reformatted 75% income tax (€0.5bn) and higher contributions (€0.5bn) to supplementary pension schemes (Agirc-Arrco). Other options under discussion include an increase in contributions for the basic state pension system, higher taxes on diesel, as well as some contributions from largest life insurance portfolios. On top of this, the government needs to agree on revenue-raising measures worth 0.7% of GDP to compensate the phasing out or complete expiry of prior tax arrangements. Targeting corporate taxes appears to the

government's preferred option, mainly through a widening of the corporate tax base, as well as an intensification of the effort to combat tax evasion (€2-3bn), in addition to measures destined to curtail tax-avoidance schemes.

Shifting the budgetary consolidation efforts from revenues to expenditure

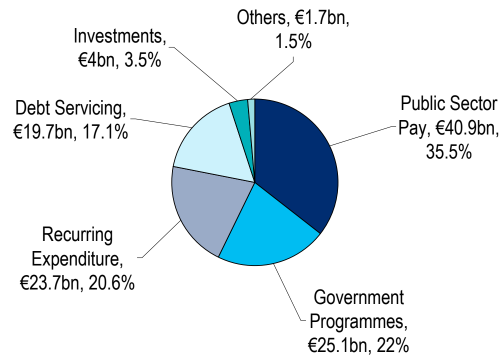
In a recession, relying on tax revenues to reduce budget deficits is widely acknowledged as being the least negative strategy in terms of its GDP impact from a short-term perspective[2]. But the opposite argument holds over the longer-term, requiring governments to adjust their budgetary consolidation strategy to focus on the more politically sensitive topic of entitlement reduction. The government has announced that it would find €14bn of expenditure savings for the 2014 budget, of which €9bn would come from central government, its operators and agencies as well as local authorities, with the remaining €5bn from the social security accounts.

Figure 10. France – Total Tax Burden



Sources: INSEE, Finance Ministry and Citi Research

Figure 11. France – Central Government Outlays, Jan-Apr 2013



Sources: Budget Ministry and Citi Research

French public sector pay to be frozen again…

An effective way of reducing government outlays would be to freeze wages of public sector employees, as they represents a little more than a third of central government outlays (see Figure 11). Public Affairs Minister Marylise Lebranchu indicated in June that public sector employees would not obtain any wage revaluation for the fourth year running in 2014 because of budgetary constraints. She noted that any broad-based increase would likely be conditional on a "*return of growth and gains in competitiveness*".

…and subsidies to be cut

As part of the 2014 budget discussions, the French government is studying a €3bn cut over 2014-15 from the current €46.5bn pot of 660 subsidies, loans, guarantees, advances and discounts given to firms, with a 50/50 split between budgetary savings and the curtailment of tax breaks (see Figure 8, previous page). French business daily La Tribune reported the government would decide on 17 July, which of the 12 most effective (gauged in terms of enhancing firms' competitiveness) programmes would survive in 2014, as recommended by a report for industry minister Arnaud Montebourg.

Our budget deficit trajectory envisages a deficit below 3% only in 2017

In all likelihood, France's 2013 budget deficit will be closer to the 4% of GDP mark than the government's 3.7% target, in our view. The government's nominal budget deficit trajectory relies on an optimistic baseline of a 1.2% increase in 2014 GDP, and 2% GDP growth from 2015 onwards. We argue that a disappointing GDP

[2] In its latest economic outlook, the INSEE estimates that the fiscal consolidation measures will lower France's GDP baseline by 0.8% in 2013 after 0.7% in 2012. Compared to structural budget deficit cutting measures of around 1.7% of GDP, the elasticity is 0.47. Given the greater shift towards expenditure reduction in 2014 and 2015, we prefer to rely on a budget elasticity of 0.5.

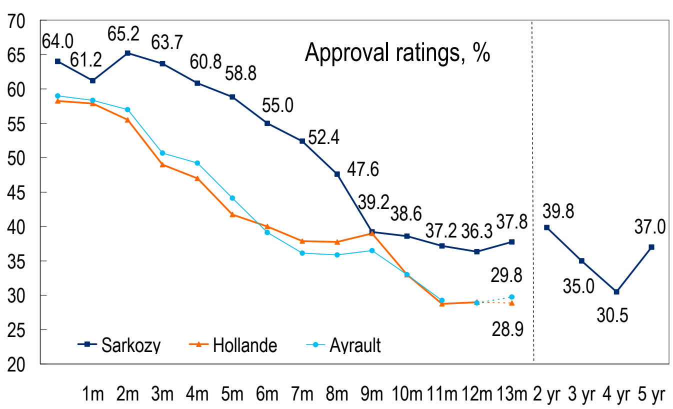
performance in the remainder of 2013 and a low entry point for 2014 would make hitting the 3% of GDP budget deficit target in 2015 an arduous task. We forecast that the budget deficit will likely be 4.0% in 2013, 3.8% in 2014, 3.6% in 2015 and 3.2% in 2016.

Timid attempts at reform so far

The government is very unpopular and voters do not believe in the effectiveness and fairness of policies

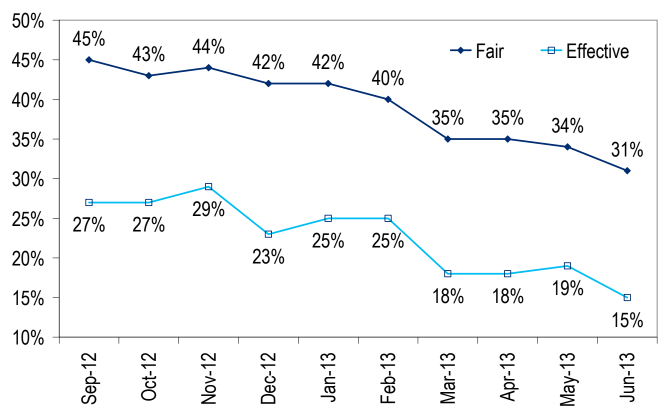
Voters appear disillusioned by the government's management of the economy at large (see Figure 13) and have repeatedly expressed their frustration by choosing opposition MP candidates in each of the recent by-elections. A rolling average of monthly surveys from the main six polling institutes shows some stabilization at a very low level in the percentage of positive opinions expressed by voters about both President Hollande and Prime Minister Jean-Marc Ayrault (see Figure 12). If the pattern of the Sarkozy presidency were to be repeated, gains of between two and three points could be envisaged in the next 12 months, particularly if the government were to push through with a more ambitious structural reform agenda.

Figure 12. France – Approval Ratings of President and Prime Minister, from the start of the 5-year mandate



Sources: CSA, TNS-Sofres, BVA, Ifop, Ipsos, LH2, OpinionWay and Citi Research

Figure 13. France – Judgment of the Government's Economic Policy, Sep-12 to Jun-13



Sources: BVA, Le Monde and Citi Research

A large majority would favour bolder moves to tackle structural issues and would be willing to accept some changes

A BVA poll for Le Monde[3] recently reaffirmed that a large majority of French voters would like the government to go further in its reform agenda: 74% favoured bolder moves to tackle structural issues that have been holding back the economy. 80% of respondents criticised politicians for never having displayed the courage to undertake the necessary reforms, focusing instead on their re-election instead of putting the interest of the country first. Voters are increasingly vocal on the subject, and particularly on pensions[4], wishing that the government would chose the path of deeper reforms instead of the strategy of sometimes cosmetic adjustments that must be repeated with regular frequency. Two key drivers of this positioning are in our view the poor economic backdrop and the realisation that other euro area member states are grasping the reform nettle.

[3] Les français et l'avenir #1, http://www.bva.fr/gene/expe/download.php?sequence=sondage_fiche_e834cd56f7342a161b1e49f140b6816d;

[4] An IPSOS poll published in Les Echos in May-13 showed that 63% of voters want an in-depth overhaul of the French pension system, that 66% think the pay-in period should be extended beyond the current 41.5 years requirement and that 61% say the legal retirement age should be raised. Despite strong backing for a "deep overhaul that spares no issue", 76% of those questioned said they did not trust Hollande's government to make the pension system sustainable.

Elections loom large on the horizon, starting with the municipal elections in March, followed by the EP in May 2014

The near-term election calendar is also one important factor impacting the government's willingness to push through with the structural reform agenda, in our view. Given the high level of discontent expressed by the public about the government's policies and the multiplication of judicial investigations about allegations of political corruption, the government is focusing its communication strategy on the pursuit of fiscal responsibility ahead of the municipal (9 & 16 March 2014) and European parliamentary (22 May 2014) votes. On Tuesday 2 July, President Hollande dismissed his environment minister Delphine Batho on the grounds that she had refused to retract earlier comments that the 7% fall in her ministry's budget credits meant it was "a bad budget". President Hollande had little choice but to finally make an example against insubordination from cabinet members on the sensitive topic of 2014 budgetary discussions in our view.

Conclusions

Low confidence readings, weak GDP growth and depressed profits suggest unemployment will continue to increase during 2014

France's recession is expected to end in the second half of 2013. But our prognosis remains that 2014 will again likely disappoint in terms of GDP performance, and we very much doubt that 2% GDP growth could be achieved before 2017. We continue to be worried that firms' weak profitability metrics and persistent competitiveness issues will hinder the corporate sector's ability to invest and hire. On a positive note, the relative better health of the banking system suggests that the credit channel will not be an impediment to economic recovery.

More budgetary efforts will likely be required, particularly in 2015, for France to meet its new objective of a 3% budget deficit

Investors' focus is rapidly shifting to the sizeable efforts that will be required as part of the 2014 budgetary adjustments. For the first time in more than forty years, central government expenditure excluding debt servicing and pensions is set to decline, indicating a break from the past in terms of public finance management: this is a welcome development. But taxes will also likely continue to rise a little in 2014, and probably in 2015, challenging the government's promises of delivering some stability in the fiscal pressure and weighing on business confidence. One solution would be to find more savings from the social security accounts, and continue to shrink the size of the public sector, including regional and local administrations. We estimate that more budgetary efforts will be required in 2015, in order for France to meet its revised objective of exiting the excessive deficit procedure.

Voters' preference for a more ambitious reform agenda should be heeded soon, in our view, to help confidence rebound

What we have seen so far in terms of reforms has been limited, both in terms of the labour market and corporate competitiveness. Early signs are that pension reform will follow the same pattern, and the implementation of the services directive will probably wait a while longer. The reform agenda is where we think the government should push more strongly, with voters (as well as some more reform-minded trade unions) having expressed repeatedly their desire for more ambitious policies designed to solve problems rather than implement partial fixes. Low popularity ratings should be seen as a source of motivation for reform, rather than a hindrance, in our view.

Key Economic Indicators (8 July – 12 July 2013)

		Forecast	Last
Monday 8 July		**Forecast**	**Last**
06:45	Switzerland: Unemployment Rate, Jun		
07:00	Germany: Trade Balance, May		
07:30	France: Bank of France Business Sentiment, Jun	96	94
08:15	Switzerland: Industrial Production, 1Q		
08:30	Sweden: Industrial Production, May	0.1% MM	-0.5% MM
09:30	Euro Area: Sentix Investor Confidence, Jul	-11.0	-11.6
11:00	Germany: Industrial Production, May	1.6% MM, 1.6% YY	1.8% MM, 1.0% YY
	Greece: Consumer Prices, Jun		
Tuesday 9 July		**Forecast**	**Last**
00:01	UK: RICS House Price Survey, Jun		
08:15	Switzerland: Retail Sales, May		
09:30	UK: Trade Balance – Goods & Services, May	£-3.0 Billion	£-2.6 Billion
09:30	UK: Industrial Production, May	0.0% MM, -1.8% YY	0.1% MM, -0.6% YY
	Manufacturing Output, May	0.0% MM, -1.9% YY	-0.2% MM, -0.5% YY
14:00	Eurogroup Meeting, Brussels		
Wednesday 10 July		**Forecast**	**Last**
	EcoFin Meeting, Brussels		
07:00	Germany: HICP, Final, Jun	0.1% MM, 1.9% YY	0.3% MM, 1.7% YY
07:00	Sweden: Registered Unemployment Rate, Jun	4.3%	4.0%
07:45	France: Balance of Payments, May		
07:45	France: Industrial Production, May	-1.5% MM, -0.9% YY	2.2% MM, -0.5% YY
	Manufacturing Output, May	-1.8% MM, -1.5% YY	2.6% MM, -0.2% YY
08:30	Netherlands: Industrial Production, May		
09:00	Italy: Industrial Production, May	-0.2% MM, -5.3% YY	-0.3% MM, -4.6% YY
09:00	Norway: Consumer Prices, Jun	-0.4% MM, 2.0% YY	0.1% MM, 2.0% YY
	CPI-ATE, Jun	-0.2% MM, 1.5% YY	0.3% MM, 1.4% YY
	Greece: Unemployment Rate, Apr		
	Greece: Industrial Production, May		
Thursday 11 July		**Forecast**	**Last**
07:45	France: HICP, Jun	0.2% MM, 1.1% YY	0.1% MM, 0.9% YY
	Consumer Price Index, Jun	0.2% MM, 1.0% YY	0.1% MM, 0.8% YY
	CPI Ex Tobacco Index, Jun	125.81	125.57
08:30	Sweden: Consumer Prices, Jun	0.0% MM, 0.0% YY	0.2% MM, -0.2% YY
	CPIF, Jun	-0.1% MM, 0.9% YY	0.2% MM, 0.7% YY
09:00	Euro Area: ECB Monthly Bulletin		
10:00	Euro Area: House Price Index, 1Q		
11:00	Ireland: Consumer Prices, Jun		
Friday 12 July		**Forecast**	**Last**
08:00	Spain: HICP, Final, Jun	2.2% YY	1.8%
09:00	Italy: HICP, Final, Jun		
09:30	UK: Construction Output, May		
10:00	Euro Area: Industrial Production, May	0.2% MM, -1.0% YY	0.4% MM, -0.6% YY
11:00	Ireland: Trade Balance, May		

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area

Jul 8 09:30 London Time — ***Sentix Investor Confidence, Jul*** — **Forecast: -11.0** — **Prior: -11.6**

We look for a third successive uptick in investor confidence in June, ending the quarter on a three-month high. We estimate that the greater uncertainty related to the Fed's tapering announcements and worries about a Chinese slowdown may dampen expectations slightly, but that the recovery in PMIs and better confidence with respect to the euro area periphery will boost current conditions a little more.

Jul 12 10:00 London Time — ***Industrial Production, May*** — **Forecast: 0.2% MM, -1.0% YY** — **Prior: 0.4% MM, -0.6% YY**

Industrial output probably posted another gain in May, the fourth consecutive one, reversing the weakness in activity observed around the end of last year. German data are likely to remain stronger than in other large euro area countries. If our forecast is correct, this would leave the IP index 1.2% above 1Q average, boding well for 2Q GDP growth.

Germany

Jul 8 11:00 London Time — ***Industrial Production, May*** — **Forecast: 1.6% MM, 1.6% YY** — **Prior: 1.8% MM, 1.0% YY**

We expect German industrial production to continue its gradually strengthening momentum in May, following improvements in businesses' assessments and expectations in previous months, only capped by the poor weather towards the end of the month, which will probably weigh even more on next month's IP.

Jul 10 07:00 London Time — ***HICP, Jun Final*** — **Forecast: 0.1% MM, 1.9% YY** — **Prior: 0.3% MM, 1.7% YY**

We expect the flash estimate for German HICP inflation to be confirmed. HICP inflation has now retraced most of the fall since the beginning of the year, but the recent rise probably owes much to rising food prices, as rainy weather and floods have hit food harvests.

France

Jul 8 07:30 London Time — ***Bank of France Business Sentiment, Jun*** — **Forecast: 96** — **Prior: 94**

We see some room for a 2-point gain in business confidence in June against a backdrop of declining stocks of finished goods and increases in foreign orders. Nevertheless, the industrial sector reading would remain some 0.6 standard deviation below its long-term average. Industrial production is contracting at a much slower rate, with employment expectations beginning to stabilise and downward price pressures diminishing.

Jul 10 07:45 London Time

Industrial Production, May	**Forecast: -1.5% MM, -0.9% YY**	**Prior: 2.2% MM, -0.5% YY**
Manufacturing Output, May	**Forecast: -1.8% MM, -1.5% YY**	**Prior: 2.6% MM, -0.2% YY**

Business confidence weakened in May according to the Banque de France survey, which has been a useful gauge of industrial production in recent months. Both the recent output measure and capacity utilisation readings fell in May, suggesting a sizeable unwind of the April uptick. The steady improvement in the manufacturing PMI since the January 2013 cycle low points to further gains in IP during the second quarter, highlighting some upside risks to our -0.1% QQ 2Q GDP forecast.

Jul 11 07:45 London Time

CPI – EU Harmonised, Jun	**Forecast: 0.2% MM, 1.1% YY**	**Prior: 0.1% MM, 0.9% YY**
Consumer Price Index, Jun	**Forecast: 0.2% MM, 1.0% YY**	**Prior: 0.1% MM, 0.8% YY**
CPI Ex Tobacco Index, Jun	**Forecast: 125.81**	**Prior: 125.57**

Consumer prices are expected to remain on an upward trajectory in June, finishing the quarter on a three-month high. While core inflation measures are forecast to be stable in June, remaining very close to the April cycle lows, we anticipate some uptrend in food prices related to the challenge weather and a small uptick in energy prices. Headline inflation rates are forecast to fluctuate in a 0.8% to 1.2% range in 2H-13.

Italy

Jul 10 09:00 London Time — ***Industrial Production, May*** — **Forecast: -0.2% MM, -5.3% YY** — **Prior: -0.3% MM, -4.6% YY**

Another fall is expected in industrial output in May, following an almost-uninterrupted series of monthly declines since last summer (January 2013 only positive reading since last August). Despite some improvements in confidence indicators, their levels (eg. manufacturing PMI at 47.3) are still consistent with a contraction in industrial output, although at moderating pace.

Spain

Jul 12 08:00 London Time — ***HICP, Jun F*** — **Forecast: 2.2% YY** — **Prior: 1.8% YY**

HICP YY inflation rose to 2.2% in June, after reaching a local trough of 1.5% YY in April. The breakdown is likely to show that unfavourable base effects in the energy component contributed to push the headline rate higher, together probably with some price increases in the food sector. Base effects in energy should work in the opposite direction in July, when we expect the annual inflation rate to fall back again below the 2% mark. After that we expect inflation falling significantly into year-end, probably well below 1% YY.

Norway

Jul 10 08:00 London Time

Consumer Prices, Jun	**Forecast: -0.4% MM; 2.0% YY**	**Prior: 0.1% MM; 2.0% YY**
CPI-ATE, Jun	**Forecast: -0.2% MM; 1.5% YY**	**Prior: 0.3% MM; 1.4% YY**

Core consumer prices have been soft since mid-2010, showing no signs of any real upward trend shift despite relatively high wage growth and an economy operating at around normal capacity. This partly reflects persistent declines in prices of imported goods, but domestic inflation has also stayed surprisingly benign. However, core inflation rose quite noticeably in April, reaching the highest growth pace since March 2012. Although a large part of the rise reflected base effects, we still see signs of a slight acceleration ahead.

Economic Indicators

Sweden			
Jul 8	***Industrial Production, May***	**Forecast: 0.1% MM**	**Prior: -0.5% MM**
08:30			
London Time	Monthly sentiment data point to ongoing improvement in industrial production in the near-term; the PMI rebounded further in June (by 1.6 points to 53.5) and both the orders and production indices were well into expansionary territory. This is well in line with the gain in NIER manufacturing confidence, however, this indicator points to only a very mild recovery. Meanwhile, the orders data from April fell substantially (offsetting the strong gain in March), pointing to a weak development for production in May. In trend terms, momentum remains weak; industrial production in 1Q was only 0.2% above the 4Q average, which saw a 2.7% QQ contraction (April level 0.1% above 1Q average).		
Jul 10	***Registered Unemployment Rate, Jun***	**Forecast: 4.3%**	**Prior: 4.0%**
07:00			
London Time	In line with the seasonal pattern, registered unemployment is seen up in June. In trend terms, however, unemployment has now been trending upwards since mid-2012, largely driven by an increasing labour supply (fell back markedly in May, though). One important reason is government measures to reduce sick leave and early retirement. Stronger incentives to work (due to the earned income deduction) have probably also played a part. Another reason is higher labour force participation by people above the official retirement age of 65.		
Jul 11	***Consumer Prices, Jun***	**Forecast: 0.0% MM; 0.0% YY**	**Prior: 0.2% MM; -0.2% YY**
08:30	***CPIF, Jun***	**Forecast: -0.1% MM; 0.9% YY**	**Prior: 0.2% MM; 0.7% YY**
London Time			
	Inflation pressure continues to be very low and most indications are that inflation will remain low during the next 1-2 years. Although having weakened somewhat of late, we expect the krona (in KIX-terms) to remain strong in a historical perspective, which will help limit inflation ahead. Rising energy and commodity prices have kept inflation up in recent years, but looking ahead we will probably see negative contributions to inflation from these factors both this and next year. The rate of pay increases is now also slowing compared to 2013, which will also contain inflation		
United Kingdom			
Jul 9	***Trade Balance – Goods & Services, May***	**Forecast: £-3.0 Billion**	**Prior: £-2.6 Billion**
09:30			
London Time	The trade deficit fell markedly in April, to £2.6bn from £3.2bn in March, as imports weakened. We expect a slightly higher deficit this month. The trend in the deficit has been fairly stable at around £3bn per month since mid-2012.		
Jul 9	***Industrial Production, May***	**Forecast: 0.0% MM, -1.8% YY**	**Prior: 0.1% MM, -0.6% YY**
09:30	***Manufacturing Output, May***	**Forecast: 0.0% MM, -1.9% YY**	**Prior: -0.2% MM, -0.5% YY**
London Time			
	Manufacturing output has bounced around quite a lot from month to month recently, with MM changes of at least 1% either way in eight of the past 12 months, but has made little progress overall. Surveys suggest that the trend in output remains flattish and hence we expect no move either way this month although – given recent trends – another volatile number certainly cannot be ruled out.		

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

Economic Indicators

Key Economic Indicators (15 July – 19 July 2013)

		Forecast	Last
Monday 15 July		**Forecast**	**Last**
08:15	Switzerland: Producer and Import Prices, Jun		
08:30	Netherlands: Trade Balance, May		
08:30	Netherlands: Retail Sales, May		
09:00	Norway: Trade Balance, Jun		
Tuesday 16 July		**Forecast**	**Last**
07:00	EU-27: New Car Registrations, Jun		
08:30	Sweden: Riksbank Minutes		
09:00	Italy: Trade Balance, May		
09:30	Italy: General Government Debt, May		
09:30	UK: Consumer Prices, Jun	-0.1% MM, 3.0% YY	0.2% MM, 2.7% YY
	CPI Ex Food, Drink, Tobacco, Energy, Jun	-0.2% MM, 2.4% YY	0.4% MM, 2.2% YY
	Retail Prices, Jun	0.1% MM, 3.5% YY	0.2% MM, 3.1% YY
	RPIX – Excludes Mortgages, Jun	0.1% MM, 3.5% YY	0.2% MM, 3.1% YY
09:30	UK: Producer Input Prices, Jun	-0.7% MM, 3.7 %YY	-0.3% MM, 2.2% YY
09:30	UK: Producer Output Prices, Jun	0.0% MM, 1.9% YY	0.0% MM, 1.2% YY
	Excluding Food, Drink, Tobacco, Energy, Jun	0.0% MM, 1.0% YY	0.1% MM, 0.8% YY
10:00	Euro Area: HICP, Final, Jun		
10:00	Euro Area: Trade Balance, May		
10:00	Germany: ZEW Economic Expectations, Jun		
Wednesday 17 July		**Forecast**	**Last**
09:30	UK: Claimant Count Unemployment, Jun	-5,000 MM, 4.5% Rate	-8,600 MM, 4.5% Rate
	LFS Unemployment, Mar-May	-46,000 QQ, 7.8% Rate	-5,000 QQ, 7.8% Rate
09:30	UK: MPC Minutes		
10:00	Euro Area: Construction Output, May		
10:00	Italy: Current Account, May		
Thursday 18 July		**Forecast**	**Last**
08:30	Netherlands: Consumer Confidence, Jul		
08:30	Netherlands: Unemployment, Jun		
09:00	Euro Area: Balance of Payments, May		
09:30	UK: Retail Sales Volumes, Jun	0.0% MM, 1.5% YY	2.1% MM, 1.9% YY
Friday 19 July		**Forecast**	**Last**
	G-20: Meeting of Finance Ministers & Central Bank Governors, Moscow		
07:00	Germany: Producer Prices, Jun		
09:00	Italy: Industrial Orders, May		
08:30	Netherlands: Consumer Spending, May		
09:30	UK: Public Sector Net Borrowing – PSNB ex, Jun	£11.8 Billion Deficit	Year Ago: £11.8 Billion Deficit
	Fiscal Year To Date, Apr-Jun	£25.4 Billion Deficit	Year Ago: £8.8 Billion Deficit
	Greece: Current Account, May		

Sources: National statistical offices, central banks and Citi Research

Figure 14. Recent Research Publications

Title	Author	Date
Euro Area – Sovereign Debt Crisis Update		
ECB Embraces Forward Guidance	Guillaume Menuet /Giada Giani	Jul 5, 2013
Portugal remains in focus ahead of ECB press conference	Guillaume Menuet /Giada Giani	Jul 4, 2013
Portugal's Government Coalition Breaking Down	Guillaume Menuet /Giada Giani	Jul 3, 2013
Portugal FinMin's resignation illustrates 'austerity fatigue'	Guillaume Menuet /Giada Giani	Jul 2, 2013
No QE in sight from the ECB	Guillaume Menuet /Giada Giani	Jul 1, 2013
Euro Area		
ECB - Unanimous Governing Council Enacts Forward Guidance	Guillaume Menuet	Jul 4, 2013
Euro Area - Portugal Political Crisis	Giada Giani	Jul 4, 2013
European Economic Forecast Highlights - June 2013	Ann O'Kelly	Jun 20, 2013
Euro Area - ECB to reassess its monetary policy stance after the summer	Guillaume Menuet	Jun 6, 2013
Euro Economics Weekly		
Small steps towards banking union: the ECB should be pleased	Guillaume Menuet	Jun 28, 2013
Slovenia: ESM Assistance for Bank Recap Would Make Sense	Guillaume Menuet	Jun 21, 2013
Spain's External Rebalancing	Giada Giani	Jun 14, 2013
Financial Conditions Neutral, At Best, on Growth	Giada Giani	Jun 7, 2013
ECB: Focus on Collateral Rules rather than Direct Purchases	Guillaume Menuet	May 31, 2013
Removing Grexit from the Baseline Scenario	Giada Giani	May 24, 2013
Watching for Positive Surprises: Favour GIPS over France	Guillaume Menuet	May 17, 2013
Euro Area Disinflationary Pressures	Giada Giani	May 10, 2013
Italy and Spain — "We Will Die of Austerity Alone"	Giada Giani	May 3, 2013
Chief Economist Publications		
Global Economic Outlook and Strategy - June 2013	Willem Buiter	Jun 19, 2013
Ireland		
Ireland - Back in Recession	Michael Saunders	Jun 28, 2013
Scandi		
Scandi Economics Update	Tina Mortensen	Jul 5, 2013
Norway - Strong Payback for Mfg Production, but Momentum Stays Strong	Tina Mortensen	Jul 5, 2013
Sweden - Service Production Rebounds in May, but Momentum Stays Weak	Tina Mortensen	Jul 5, 2013
UK		
UK - MPC Set the Stage for Guidance	Michael Saunders	Jul 4, 2013
UK - BCC Survey Shows Better Growth, Plenty of Slack	Michael Saunders	Jul 2, 2013
UK - Stronger PMI, Credit Remains Weak	Michael Saunders	Jul 1, 2013
UK - Update on UK-EU Price Level Disparities	Michael Saunders	Jul 1, 2013
UK - YouGov Report Stable Inflation Expectations	Michael Saunders	Jun 28, 2013
UK - GDP Revisions Show Bigger Economic Shortfall	Michael Saunders	Jun 27, 2013
UK Economics Weekly		
The MPC's Declaration of (Monetary) Independence	Michael Saunders	Jul 5, 2013
Carney's Challenge	Michael Saunders	Jun 28, 2013
Selloff Reinforces the Case for Forward Guidance	Michael Saunders	Jun 21, 2013
Growing, But Not (Yet) Really Recovering	Michael Saunders	Jun 14, 2013
A Nation of Workers	Michael Saunders	Jun 7, 2013
Are We Nearly There Yet?	Michael Saunders	May 31, 2013
Disinflation Opens the Door to Guidance	Michael Saunders	May 24, 2013

Source: Citi Research

Appendix A-1

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