

Euro Area: Sovereign Debt Crisis Update

- **Sources suggest ECB is studying the possibility of reducing haircuts on ABS securities** to make it cheaper for financial institutions to borrow against some €1tn of asset-backed bonds, Bloomberg reports. We expect that the Governing Council will provide more information on the collateral framework at the September 6 meeting.
- **ECB's Asmussen on the ECB's bond buying programme** — ECB Executive Board Member Asmussen said on Monday that the bank's new bond-buying plan will not finance governments, and that the programme will only support countries that follow a strict framework of reforms.
- **France 2013 budget** — FM Moscovici announced that France's budget deficit would be below 3% of GDP in 2013, but did not make any references to the GDP growth forecast other than it would be "*solid and realistic*". PM Ayrault declined to repeat the 1.2% 2013 GDP growth forecast when speaking on French TV on Monday evening, but remarked that it "*may be necessary to reduce that a bit*."
- **France and Germany — Even closer cooperation.** France and Germany announced after the meeting of their respective finance ministers that they would aim to coordinate euro zone proposals through the launch of a bilateral working group ahead of the October 18-19 EU council.
- **Spain** — PM Rajoy to have bilateral meetings in coming weeks with Hollande and Merkel. GDP growth in 2010 and 2011 revised down, while Q2 GDP has been confirmed at -0.4% QQ.
- **Greece** — Troika report on Greece to be released in late September at the earliest. PM Samaras briefs Greek President today and the other two coalition leaders tomorrow on his meetings last week with Merkel and Hollande. Extension would lessen recession, according to Greek government officials.
- **Netherlands** — According to Reuters, the Dutch Liberal party and the Socialists are neck and neck ahead of the Sep 12 parliamentary elections.
- **Ireland** — Unemployment benefits being cut for those refusing to take up training, job interviews or employment opportunities.

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■ **Sources suggest ECB studying the possibility of reducing haircuts on ABS securities**

- According to Bloomberg, the European Central Bank (ECB) is looking at ways to make it cheaper for financial institutions to borrow against some €1tn of asset-backed bonds by lowering the discounts or haircuts when repo-ing assets with the ECB. Sources familiar with the discussions are reported as suggesting that bonds that have weathered the crisis better should be given lower haircuts than others, enabling banks to obtain additional liquidity. Bloomberg also indicated that the ECB is pushing global banking regulators to relax draft liquidity rules so that lenders can use some asset-backed securities and loan debt in a buffer they must hold against a possible credit squeeze.

Comment: Avoiding an intense credit squeeze is of paramount importance to the ECB given the crucial intermediation role that financial institutions play in the euro area for the provision of loans. Hence, we expect that the Governing Council will do more on this aspect at the ECB's September 6 meeting. Please refer to our Euro Economics Weekly: [Eventful September Ahead](#), for more details about our expectations related to some easing of the Collateral Framework.

■ **ECB's Asmussen on the ECB's bond buying programme**

- ECB Executive Board Member Jörg Asmussen said on Monday that the bank's new bond-buying plan will not finance governments, and that the programme will only support countries that follow a strict framework of reforms. He confirmed that the ECB would only act within its mandate and buy bonds with short maturities and that the ECB was still working on the technical and operations details. **Comment:** This speech was mainly for domestic consumption, in our view, attempting to allay fears in Germany that the ECB is flirting dangerously close to the limits of its mandate. While ECB President Draghi is expected to present the bond buying programme next week, there is a significant probability that its activation will not begin until the latter part of September, given the need for a German Constitutional Court ruling on September 12 and the need for a formal request for financial assistance by a member state.

■ **France 2013 budget**

- French Finance Minister Pierre Moscovici announced that France's budget deficit would be below 3% of GDP in 2013, but did not make any references to the GDP growth forecast other than it would be "*solid and realistic*". French PM Jean-Marc Ayrault declined to repeat the 1.2% 2013 GDP growth forecast when speaking on French TV on Monday evening, but remarked that it "*may be necessary to reduce that a bit*". *Le Monde* wrote that the government could perhaps reduce slightly its 1.2% GDP forecast for 2013 versus the IMF's 0.8% and 0.5% for the consensus. President Hollande appears to be struggling to convince voters about his ability to solve the crisis, with *Le Monde* reporting on an upcoming IPSOS poll which reportedly suggests that the President's popularity declined by 11 points in August to 45%. **Comment:** Some downward revision to the 2013 GDP forecast seems unavoidable, given the weakness of GDP growth in the past few quarters. With unemployment reported to have increased by 41,300 or 1.4% in July to just short of 3 million, its highest level in 13 years, the labour market picture is not consistent with such a level of growth.

- **Even closer cooperation between France and Germany** - France and Germany announced after the meeting of their respective finance ministers Pierre Moscovici and Wolfgang Schäuble that they would aim to coordinate euro zone proposals through the launch of a bilateral working group ahead of the October 18-19 EU council. Earlier this week, Schäuble said that he and Moscovici talk on the phone once a week and meet in person at least every other week. He added that the working group now being established *"is proof just how close our cooperation is"*. *Les Echos* wrote that the group, to be jointly headed by the head of the French Treasury Ramon Fernandez and Germany deputy finance minister Thomas Steffen, would focus on the following topics: Greece, Spain, banking supervision and European integration. **Comment:** Closer cooperation between France and Germany would be welcomed by most financial market participants, in our view, after the rather frosty start that immediately followed the election of French President François Hollande.
- **Spanish bilateral meetings in coming weeks:** French President François Hollande will travel to Madrid on August 30 for talks with Spanish Prime Minister Mariano Rajoy according to the French president's office. Rajoy has said he will host Merkel in the Spanish capital the following week, on September 6. **Comment:** We suspect that these discussions will focus on the framework to provide financial assistance to Madrid, once the details for the ECB's framework have been communicated, and on the conditionality to which Mr Rajoy would have to commit, even if it will likely be relatively light given the efforts already made by Spain.
- **Spain downward revisions to GDP growth and Q2 details** - Spain's National Statistics Institute said on Monday that it had revised down GDP growth in 2010 and 2011 to -0.3% and +0.4% compared to previous estimates of -0.1% and +0.7%, respectively. The 2nd release of Spanish GDP for Q2 by INE today confirmed the initial estimate of a drop of 0.4% QQ. After the GDP revisions of yesterday, the YY change came in at -1.3% (it was -1.0% YY in the initial release). As expected domestic demand was a drag on growth (deducting 3.9ppts from YY growth) with gross fixed capital formation down 9.4%, while household and government consumption were contracting by 2.2% and 3.0%, respectively. However, net exports supported GDP growth (adding 2.6ppts to YY growth). On a QQ basis, private consumption fell 1.0%, with government consumption down 0.7% QQ, and gross fixed capital formation fell 3.0% QQ. Exports rose 1.6% QQ, while imports fell 1.5% QQ. **Comment:** Exports were somewhat stronger than we had anticipated and government consumption fell by less. Private consumption and fixed investment on the other hand fell somewhat further than in our forecast. We continue to anticipate a substantial deterioration of the rate of GDP growth in the next quarters, as private deleveraging continues and fiscal tightening bites. The downward revisions to 2010 and 2011 will likely have an impact on consensus numbers for 2012 and 2013.
- **Troika report on Greece to be released in late September at the earliest:** An EU Commission spokesperson indicated on Monday that with the third mission to Athens since early July to begin on 7, 8, or 9 Sep, and set to last a few weeks, the publication of the report is expected in late September or early October. *Le Figaro* wrote that the Troika report, which is a precondition for the release of the €31.5bn October tranche, could be ready between the end of Sep and early October ahead of the Eurogroup meeting on 8 October

- **Greek PM to meet President today and the other two coalition leaders tomorrow.** According to *Ekathimerini*, Greek PM Samaras is expected to brief the country's president Karolos Papoulias today on his talks with German Chancellor Merkel and French President Hollande last week. On Wednesday, Mr Samaras is expected to meet with the other two leaders of the Coalition government. The PM's talks with the President and the leaders of the other two coalition parties follow talks on Monday between the finance minister Stournaras and other Government ministers to try to finalise the package of measures to deliver €11.5bn worth of savings plus an extra €2bn in cuts to make up for an expected shortfall from reduced tax revenues and social security contributions.
- **Extension would lessen recession, according to Greek government officials.** According to Greek government officials cited by Reuters, if Greece were granted the two-year extension it is currently seeking to deliver on the programme's targets, the country's economy would contract by only 1.5% in 2013 and would grow by 2.0% in 2014. However, if the Government goes ahead with plans to carry out all of the adjustment over the 2012-14 period, the economy will most likely contract by 4.5% in 2013 and will not start to recover until 2015. Greek Government officials also told Reuters that a two-year extension of the bailout programme would create a financing gap of less than €18bn, which the country could cover by issuing short-term debt rather than by asking its creditors for more money.
- **Dutch elections** - PM Mark Rutte, leader of the Dutch Liberal Party, indicated in a televised debate between the heads of the four parties leading in the polls that the Netherlands would not pay another cent towards Greece unless it stuck to the agreements to show it wants to stay in the euro.
- **Ireland: Unemployment benefits cut for those refusing to take up training, job interviews or employment opportunities.** Last April the Department of Social Protection introduced a measure allowing jobseeker payments to be cut by up to €44 per week where people refuse training offers, job interviews or offers of employment. Since then, 1,275 job seeker payments have been reduced.
Comment: This is a new initiative for Ireland: previous legislation allowed unemployment benefit to be withdrawn completely from a claimant, but not reduced. Because a claimant could then be left destitute, the legislation was rarely used. The new legislation forms part of an attempt to improve Ireland's response to unemployment (currently at 14.8%) which has been fragmented and passive, with little coordination between government departments and unemployment benefits not well linked to training or job search. Under the Troika's programme of structural reforms, the Department of Social Protection is tasked (among other things) with "*the introduction of one-stop shops*", "*increasing the number of unemployed referred to training courses and employment supports*" and reporting to the Troika "*on continued progress on implementing an improved data collection system to enable ongoing evaluation of activation and training policies.*"

Appendix A-1

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