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# Focus Europe

## Is there any alternative?

The sudden rise of the eurosceptic Alternative für Deutschland (AfD) party has been accompanied by much public attention and media coverage. This week we explore the implications for the German election. As swing voter potential is almost equally distributed between the coalition and the SPD, we think the AfD will make a grand coalition more likely in the federal elections in September.

As we expected, the "rebellion" of the left wing of the French socialist party — at least for the time being — has not had any impact on the fiscal strategy. The new Stability Programme (P-Stab) confirms Francois Hollande's recent message of (i) a sustained commitment to fiscal retrenchment and (ii) a shift in the consolidation efforts from 2014 onward from tax hikes to spending cuts.

With the final EU-IMF payment to Ireland due at year end, minds are turning to 'post-programme' support. We examine the options — including precautionary credit and OMT — but a decision is unlikely before the Q3 bank stress test.

The IMF published new economic forecasts in its semi-annual outlook this week. We take a closer look at how the IMF's long-run forecasts have changed across countries over recent years.

The Riksbank left rates on hold this month, but revised down its future profile of interest rates and inflation. We have thus changed our view, putting back the first tightening from early 2014 to the middle of the year.

France: Changes relative to the budget bill: higher headline deficit target – higher structural effort – slightly more spending cuts

| | Budget bill for 2013 (September 2012) | | | | Stability Program (April 2013) | | | |
|---|---|---|---|---|---|---|---|---|
| | Headline balance | Structural effort | of which: spending | of which: tax | Headline balance | Structural effort | of which: spending | of which: tax |
| 2012 | -4.5 | 1.4 | 0.3 | 1.1 | -4.8 | 1.3 | 0.2 | 1.1 |
| 2013 | -3.0 | 1.9 | 0.3 | 1.6 | -3.7 | 1.9 | 0.4 | 1.5 |
| 2014 | -2.2 | 0.5 | 0.4 | 0.1 | -2.9 | 1 | 0.6 | 0.3 |
| 2015 | -1.3 | 0.5 | 0.4 | 0.1 | -2 | 0.6 | 0.7 | 0 |
| 2016 | -0.6 | 0.4 | 0.4 | 0 | -1.2 | 0.5 | 0.5 | 0 |
| 2017 | -0.3 | 0.1 | 0.4 | -0.3 | -0.7 | 0.3 | 0.5 | -0.2 |

*Source: Deutsche Bank, French Treasury*

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## Economic Forecasts

| | Real GDP % growth[b] | | | CPI % growth[c] | | | Current a/c % GDP[d] | | | Fiscal balance % GDP | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2012E | 2013F | 2014F | 2012 | 2013F | 2014F | 2012E | 2013F | 2014F | 2012E | 2013F | 2014F |
| Euroland (top-down) | -0.6 | -0.6 | 1.0 | 2.5 | 1.6 | 1.6 | 1.2 | 1.7 | 1.6 | -3.2 | -3.0 | -2.6 |
| Germany[b] | 0.7 | 0.3 | 1.5 | 2.1 | 1.7 | 1.8 | 7.0 | 6.3 | 6.1 | 0.2 | -0.4 | -0.2 |
| France | 0.0 | -0.6 | 1.1 | 2.2 | 1.4 | 1.5 | -2.3 | -2.2 | -1.9 | -4.6 | -3.8 | -3.2 |
| Italy | -2.4 | -1.8 | 0.9 | 3.3 | 1.8 | 1.6 | -0.6 | 0.0 | 0.4 | -3.0 | -3.0 | -2.4 |
| Spain | -1.4 | -1.6 | 0.5 | 2.4 | 1.9 | 1.3 | -1.1 | 0.5 | 0.3 | -10.0 | -6.2 | -5.3 |
| Netherlands | -1.0 | -0.5 | 0.8 | 2.8 | 2.6 | 1.7 | 9.9 | 8.2 | 8.0 | -4.0 | -3.8 | -3.0 |
| Belgium | -0.2 | -0.3 | 1.0 | 2.6 | 1.4 | 1.6 | -1.4 | 0.5 | 1.0 | -3.0 | -3.2 | -3.0 |
| Austria | 0.8 | 0.8 | 1.6 | 2.6 | 2.3 | 2.0 | 1.8 | 2.2 | 2.4 | -3.0 | -2.7 | -2.4 |
| Finland | -0.2 | -0.3 | 1.0 | 3.2 | 2.3 | 2.2 | -1.8 | -0.8 | -1.0 | -1.9 | -1.6 | -1.4 |
| Greece | -6.4 | -4.5 | 0.5 | 1.0 | -0.3 | -0.1 | -3.0 | -2.0 | -1.0 | -6.8 | -5.2 | -4.1 |
| Portugal | -3.2 | -2.2 | 0.8 | 2.8 | 0.5 | 1.2 | -1.8 | 1.0 | 1.5 | -4.9 | -5.0 | -3.8 |
| Ireland | 0.9 | 0.5 | 1.7 | 1.9 | 1.2 | 1.4 | 4.9 | 3.5 | 4.0 | -7.8 | -7.9 | -6.4 |
| UK | 0.3 | 0.5 | 1.8 | 2.8 | 3.0 | 2.6 | -3.7 | -3.1 | -2.5 | -7.8 | -7.1 | -6.4 |
| Sweden | 1.2 | 1.3 | 2.3 | 0.9 | 1.0 | 1.5 | 7.2 | 6.5 | 6.0 | -0.7 | -0.5 | 0.0 |
| Denmark | -0.5 | 0.3 | 1.5 | 2.4 | 2.0 | 2.0 | 5.6 | 5.0 | 4.5 | -4.4 | -2.5 | -2.0 |
| Norway | 3.0 | 2.2 | 2.6 | 0.7 | 1.8 | 2.0 | 14.1 | 14.0 | 13.0 | 10.1 | 10.5 | 10.0 |
| Switzerland | 1.0 | 1.0 | 1.5 | -0.7 | 0.2 | 0.6 | 13.6 | 10.5 | 10.0 | 0.3 | 0.5 | 0.5 |
| Poland | 2.1 | 1.4 | 2.3 | 3.7 | 1.8 | 2.5 | -3.5 | -2.3 | -3.0 | -3.6 | -3.5 | -2.9 |
| Hungary | -1.7 | -0.2 | 1.6 | 5.7 | 2.6 | 3.1 | 1.6 | 1.2 | 0.5 | -2.1 | -2.7 | -2.6 |
| Czech Republic | -1.2 | 0.7 | 2.8 | 3.3 | 2.0 | 2.0 | -2.4 | -2.3 | -2.4 | -4.4 | -3.2 | -2.7 |
| US | 2.2 | 2.4 | 3.3 | 2.1 | 2.3 | 2.6 | -3.1 | -3.1 | -3.3 | -6.8 | -6.3 | -5.3 |
| China | 7.8 | 8.2 | 8.9 | 2.6 | 3.0 | 3.5 | 2.7 | 2.0 | 1.6 | -1.6 | -2.1 | -1.5 |
| Japan | 2.0 | 1.4 | 0.6 | 0.0 | 0.0 | 2.0 | 1.0 | 1.2 | 2.3 | -9.6 | -9.4 | -7.4 |
| World | 2.9 | 3.2 | 4.0 | 3.3 | 3.3 | 3.6 | | | | | | |

*(Sources: National statistics, national central banks, DB forecasts. (a) Euro Area and the Big 4 forecasts are frozen as of 13/12/12. All smaller euro area country forecasts are as of 13/12/12.Bold figures signal upward revisions. Bold, underlined figures signal downward revisions. (b) Annual German GDP is not adjusted for working days. (c) HICP figures for euro-area countries/UK (d) Current account figures for euro area countries include intra regional transactions.*

## Forecasts: Euroland GDP growth by components and central bank rates

| Euroland, % qoq | 12-Q1 | 12-Q2 | 12-Q3 | 12-Q4 | 13-Q1F | 13-Q2F | 13-Q3F | 13-Q4F | 2012 | 2013F | 2014F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP | -0.1 | -0.2 | -0.1 | -0.6 | -0.3 | 0.0 | 0.2 | 0.2 | *-0.6* | *-0.6* | *1.0* |
| Private Consumption | -0.2 | -0.5 | -0.2 | -0.5 | -0.1 | -0.2 | 0.1 | 0.1 | *-1.3* | *-0.6* | *0.4* |
| Gov. Consumption | -0.1 | -0.3 | -0.1 | 0.1 | -0.1 | -0.1 | -0.2 | -0.2 | *-0.4* | *-0.5* | *-0.3* |
| Investment | -1.4 | -1.6 | -0.8 | -1.2 | -0.5 | -1.0 | 0.2 | 0.5 | *-4.1* | *-2.7* | *2.1* |
| Stocks (contribution) | -0.1 | 0.0 | -0.3 | -0.1 | -0.1 | -0.1 | 0.0 | 0.0 | *-0.7* | *-0.3* | *0.3* |
| Exports | 0.5 | 1.7 | 0.9 | -0.8 | 0.4 | 0.8 | 0.9 | 0.9 | *2.7* | *1.9* | *4.1* |
| Imports | -0.4 | 0.6 | 0.1 | -0.9 | 0.3 | 0.0 | 0.8 | 0.9 | *-0.9* | *0.4* | *4.0* |
| Net Trade (contribution) | 0.4 | 0.5 | 0.4 | -0.1 | 0.0 | 0.4 | 0.1 | 0.0 | *1.6* | *0.7* | *0.2* |
| HICP inflation, % yoy | 2.7 | 2.4 | 2.6 | 2.3 | 1.9 | 1.6 | 1.6 | 1.6 | *2.5* | *1.6* | *1.6* |
| Core inflation, % yoy | 1.9 | 1.8 | 1.8 | 1.6 | 1.5 | 1.2 | 1.2 | 1.3 | *1.8* | *1.2* | *1.5* |
| EMU4 GDP, % qoq | | | | | | | | | | | |
| Germany | 0.5 | 0.3 | 0.2 | -0.6 | 0.1 | 0.4 | 0.4 | 0.3 | *0.7* | *0.3* | *1.5* |
| France | -0.1 | -0.1 | 0.2 | -0.3 | -0.3 | -0.1 | 0.0 | 0.2 | *0.0* | *-0.6* | *1.1* |
| Italy | -0.9 | -0.7 | -0.2 | -0.9 | -0.6 | -0.4 | 0.0 | 0.2 | *-2.4* | *-1.8* | *0.9* |
| Spain | -0.4 | -0.4 | -0.3 | -0.8 | -0.6 | -0.1 | -0.1 | 0.1 | *-1.4* | *-1.6* | *0.5* |
| Central Bank Rates (eop) | | | | | | | | | | | |
| ECB refi rate | 1.00 | 1.00 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | | | |
| BoE bank rate | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | | | |
| US fed funds target rate | 0.25 | 0.17 | 0.10 | 0.16 | 0.10 | 0.10 | 0.10 | 0.10 | | | |
| PBOC 1Y deposit rate | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 | 3.25 | | | |
| BoJ O/N call rate | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | | | |

*Source: Deutsche Bank*

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# Germany: Eurosceptic party *Alternative für Deutschland* on the rise?

- The eurosceptic party Alternative für Deutschland (AfD) held its official founding assembly in Berlin on April 14. On April 16, the AfD already scored 3% in a first election poll. The sudden rise of the AfD has been accompanied by public attention and media coverage.
- The party's election manifesto is three and a half pages short. The AfD calls for an orderly dissolution of the euro area. The programme neither provides any cost-benefit analysis of an EMU exit, nor does it outline any implementation strategy. For a party that considers itself a protest movement, the absence of any constructive element at this stage is not necessarily perceived as a critical issue.
- In the run-up to the federal elections in September, the AfD could lead to a more reticent stance of the incumbent CDU/CSU/FDP coalition on euro-area issues. As swing voter potential is almost equally distributed between the coalition and the SPD, we think the AfD will make a grand coalition more likely in the federal elections.
- It will likely be mostly exogenous factors that influence the AfD's success in federal elections – inter alia (1) whether the AfD can capitalise on a possible re-escalation of the euro crisis until September; (2) whether Angela Merkel's crisis management can squeeze the AfD out of the public's perception; and (3) possible reactions of other parties, which could attempt to stop voter migration by taking a more eurosceptic stance.

## Foundation convention, new structures and rapidly increasing membership

On April 14 the Alternative für Deutschland (AfD) held its official founding meeting in Berlin. Party structures and statues were defined and a board of spokespersons was elected. Party head Bernd Lucke used the general enthusiasm of the founding assembly to push through the election manifesto by acclamation – which means that there was neither a real discussion of content nor a general consideration of alternatives. Thus, the AfD could successfully mitigate the risk of factional disputes and party fragmentation in the next few months. Factional disputes and aggressive discussions regarding the programme were the main factors in the (IT-oriented) Pirates party losing ground in public acceptance throughout last year.

At the same time, the party has gained ground as regards the number of members: over 9,000 applications for membership have reportedly been registered so far. The applications are individually assessed in order to prevent any infiltration from the extreme right. The past few weeks have seen some member migration from *Freie Wähler* (Free Voters), another eurosceptic movement. The German eurosceptic environment seems to be consolidating.

Meanwhile, the coalition parties, first and foremost the CDU (center-right party), have started to react to the AfD. The general line of arguments is that (1) the AfD is not using constructive arguments and (2) all obvious faults of the euro area should not be taken as a reason to vote against the euro. As things stand today, the SPD (center-left) has decided not to issue any comments.

Irrespective of the above, one logistical challenge remains: Parties can run for federal elections only in those German states (Bundesländer) where they have founded a state association. So far, the AfD has founded five state associations: in Bavaria, Hamburg, North Rhine-Westphalia, Rhineland-Palatinate and Saxony-Anhalt. The party aims to have founded all 16 state associations by May 10. They will have to register at the federal election office by June 17 at the latest in order to run for federal elections in September. By July 15 the party must collect supporting signatures in order to run for election: the party cannot compete in those German states where it has not been able to collect a number of supportive signatures higher than 0.1 percent of the electorate, or 2,000 signatures – whichever is lower. As of today the chances look good that the party will be able to collect the necessary number of signatures in each state where it has set up a state section.

## The manifesto: Three and a half pages short but sufficient for a protest movement

The party's election manifesto is three and a half pages of assertions on (1) currency policy, (2) European policy, (3) the rule of law and democracy, (4) public finance and taxes, (5) pensions, (6) energy policy and (7) integration policy. The section on currency policy is the central part of the programme. In this section, the AfD calls for, amongst other things,

- an orderly dissolution of the euro area,
- the relaunch of national currencies or the creation of smaller currency/monetary associations,
- Germany's veto of future ESM loans in order to achieve a change of the European Treaties that will enable every country to leave the euro,
- an immediate stop to secondary market interventions by the ECB,
- the bearing of any bailout-cost by banks, hedge funds and big private investors before the taxpayer is involved.

Regarding other policy areas, the AfD generally favours (1) giving power back to national governments in the European context, (2) strengthening elements of direct democracy and (3) bolstering the values of ownership and self-responsibility.

Most of the provisions in the manifesto remain rather vague. For example, the manifesto does not outline an exact strategy on how the euro area should be dissolved. Bernd Lucke and other representatives of the party have addressed these points in public statements and op-eds so far: As regards the logistics of their objectives, they favour the introduction of parallel currencies. They do not address any of the accompanying challenges that an economy with two currencies would bring for the euro area – e.g. capital controls, shadow economy and scarcity of import products in the countries concerned. Broader consequences – such as major distortions in the European single market and potential damage to the real economy in case of a major appreciation in exiting strong countries – such as Germany – are not tackled either.

Moreover, the programme does not provide any cost-benefit analysis of a euro exit. The overall tenor is "*better a terrible end than unending terror*." The AfD does not argue about absolute costs but about unspecified opportunity costs.

Moreover, the AfD does not outline how its other policy goals should be financed. For a party that considers itself a protest movement, the absence of any constructive element is not necessarily an existential threat, as seen in other euro-area countries.

## Intensive media exposure

Media exposure is essential for the AfD as it does not yet have the financial resources for campaigning and it still needs to become better known. The German media has reacted with considerable interest so far. Recent right-wing suspicions and accusations that the party could not distance itself from right-wing extremist parties came to a peak at the end of March but have muted in the meanwhile.

There are three reasons that could explain why the AfD has attracted such media interest:

- Apart from discussions in academic journals, any debate on the benefits and costs of the EMU has generally been muted due to the general pro-European consensus in parliament and among the so-called social partners (e.g., labor unions, business associations, social aid/welfare groups). Initially euro-rescue measures were described as “without alternative” by the German government. In this context, there have often been expectations that a eurosceptic movement could be founded soon.
- The established parties in Germany have been facing a constant loss of membership over the past two decades. There has been ongoing debate about where a political milieu might arise that could be a new intellectual home for the bourgeois-conservative camp.
- The rise of eurosceptic powers in the rest of the euro area has increased the public’s awareness of political risks.

## Polls: AfD scores 3%

On April 16, the AfD scored 3% in an initial poll by INSA Institute (mandated by the German tabloid BILD-Zeitung). Whether that result is simply a reflection of the increased public attention that the party had in the run-up to its convention on April 14 and/or whether it can persist remain to be seen. In the same poll, the CDU and the FDP (liberal) still have a comfortable majority (39% + 5%) ahead of the SPD and the Greens (26% + 15%).

Against this background, two other polls of interest recently analysed the AfD’s voter potential, and they provide further insights into swing voter potential.

- According to a recent poll by *Infratest Dimap* (mandated by German weekly Welt am Sonntag) dated April 7, 24% of the respondents indicated that they could imagine voting for the AfD in the federal elections. 7% of respondents answered "Yes, for sure". 17% of respondents answered "Yes, perhaps". (CDU/CSU voters: 19%; SPD: 21%; Greens: 14%; Left Party: 29%; FDP: n/a; undecided/non-voters: 31%)
- In another poll by *Forschungsgruppe Wahlen* (mandated by ZDF Politbarometer) dated April 12, 17% of respondents stated they would vote for a party at the federal elections that favoured an EMU exit. (CDU/CSU voters: 11%; SPD: 18%; Greens: 8%; Left Party: 20%; FDP: n/a; undecided/non-voters: 26%).

These voter potential analyses do not provide any hard indications of the real election outcome. For example, the Pirates party occasionally scored well above 30% in similar polls when they reached their zenith of public attention last year, but would likely score considerably lower in real voter polls now. Still, these figures provide an initial indication of the potential for swing voters. Interestingly, despite the right-wing connotation of the party, there is also a considerable amount of voters of the SPD and the Left that indicated they could imagine switching sides.

The Allensbach Institute has published another poll that sheds some light on the potential voters of the AfD. While the share of Germans that would like to return to the Deutschmark has constantly decreased from 61% in 2002 to 37% in 2013, 80% of potential AfD voters regard a return to the Deutschmark as important or highly important. The AfD is most successful in the 30-60 age bracket. Some 51% of its potential voters have a "Hauptschulabschluss", or Secondary General School Certificate (German population: 39%), while 11% have a university degree (25%). The poll was conducted before the founding assembly, when only 22% of the German population was aware of the AfD.

Internet affinity of the AfD merits a closer look as well. The party launched its official website in the social network *facebook* on 6 April – and it is already highly frequented and has led to intensive discussions on the content. So far, the AfD has already gathered 24,000 'friends' while more than 18,000 users are involved in forum discussions. (By comparison: CDU: 36,100, 806 involved in discussions. SPD: 36,850, 5,460. FDP: 20,300, 1,702. Linke: 20,750, 1291). Every time users comment on the party's goals, the personal contacts of these users are informed of their comments. Since 10 March, the AfD has a higher level of users involved in discussions than the Pirates Party (5,000), which itself is perceived to have high internet affinity. Social networking could become a crucial factor in increasing the public's awareness of the AfD throughout Germany.

## Political consequences will only evolve over time

While the first poll results and the swing voter potential show rising recognition of the party, there remains the question of what the political impact of the AfD could be.

In the run-up to federal elections, the AfD could lead to a more reticent stance of the incumbent coalition on euro-area issues.

- The governing coalition will most likely emphasise that voters opting for the AfD would basically increase the probability of a grand coalition that could push through decisions on the euro area even faster than today.
- Chancellor Merkel could take a central role in this debate as she could capitalise on the broad acceptance of her crisis management: According to a recent *Politbarometer Poll*, 70% of all respondents in Germany regard Merkel's crisis management as "rather good".

Apart from that, the positioning of the eurosceptic MPs in the CDU faction in parliament is critical: They could practice party loyalty to provide a more cohesive picture of the party. Alternatively, the CDU could give these MPs a more prominent role to create identification anchors for eurosceptic voters. The vote on the Cyprus package on April 18 shows that resistance to the bailout policy has decreased in the CDU fraction. There were only 10 dissenting votes in comparison to last year's approvals of the second package for Greece (13), the ESM treaty (16) and financial aid for Spain (13). This could be a reflection of decreased public interest and support for eurosceptic MPs of the CDU, as the AfD now offers a new pool in which to gather. That in turn could have lowered incentives for individual MPs to distinguish themselves with eurosceptic stances. More likely, however, the lower number of dissenters is due to the sizeable bailing-in of private creditors, thus meeting a key demand of critics of previous rescue packages.

Irrespective of the above, the polls might foster public discussion of Germany's role in the euro area. That, in turn, could prompt the established parties towards sending stronger messages regarding the advantages of the common currency and the direction in which EMU and the EU should evolve.

Looking at the potential results of the federal elections in September, it could make a grand coalition more likely, as swing voter potential is almost equally distributed between the ruling coalition and the SPD. That is particularly true if the AfD managed to cross the 5% hurdle to enter the Bundestag. But also if the AfD's current level of voters remained static, swing voters from the CDU could endanger the re-election of the current coalition.

## Outlook

The AfD seems to have left behind the risks that are its own responsibility and that could endanger the existence of the party. The risk of fragmentation has been mitigated so far as the AfD has a general election manifesto that should provide enough content for a protest movement. The risks associated with the financing of campaigns (or lack thereof) have become less important thanks to high media coverage, though this interest could peter out if the new party does not present greater detail on its programme and/or if the absence of critical events prevents the AfD from further developing its profile.

From now on, it will likely be mostly exogenous factors that influence the AfD's success in federal elections – inter alia:

- whether the AfD can capitalise on a possible re-escalation of the euro crisis before September
- the possibility of Angela Merkel's crisis management squeezing the AfD off the public's radar screen
- possible reactions of other parties that could attempt to stop voter migration from the coalition by taking a more eurosceptic stance.

Europe
France

Economics

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# French stability program: Paris toes the line

- A cabinet meeting this week has approved the new "Stability program" covering 2013-2017 (i.e. the remainder of Hollande's tenure) which is now going to be transmitted to the European Commission. The program confirms the message from Hollande's statement last week (see Focus Europe last Friday) on i) sustained commitment to fiscal retrenchment and ii) a shift from 2014 onward in the consolidation efforts from tax hikes to spending cuts. As we expected, the "rebellion" of the left wing of the socialist party - at least for the time being - has not had any impact on the fiscal strategy. However, as usual the program at this stage lacks the granularity that the budget bill for 2014 - to be released in September - and the negotiations with the unions (on pension and unemployment benefits reforms), due to conclude by year end, will provide.

## P-stab confirms Hollande's message last week: no strategic shift on fiscal policy

The new Stability Program ("P-stab" in the French acronym) re-states the magnitude of the discretionary budgetary effort for 2013, at 1.9% of GDP, already inscribed in the budget bill for 2013 voted in December of last year, heavily skewed towards tax hikes (1.5% of GDP). The difference in the headline deficit targets for this year (from 3.0% of GDP to 3.7%) comes from the sum of i) a base effect of 0.2 pp from the drift in the 2012 budget; ii) 0.3 pp cyclical impact from the downward revision in the GDP growth forecasts (from 0.8% to 0.1%, with the usual elasticity of c.0.4) and iii) 0.2 pp from a deterioration in tax base dynamics that goes beyond the usual cyclical effect.

France would then comply with the European reference value and bring its headline deficit under 3.0% of GDP (to 2.9%) in 2014 instead, thanks to an additional structural effort of 1.0% of GDP, conditional on GDP growth of 1.2% next year. This confirms that, unlike the Euro area in aggregate which reached the peak of fiscal retrenchment in 2011/2012, in the French case 2013 will be the top of the structural adjustment effort and a sizeable fiscal drag will still significantly affect domestic demand next year. Even in 2015 the fiscal drag will still be a headwind to reckon with, since the government projects a fiscal stance (i.e. discretionary change in the structural balance) of 0.7% of GDP for that year.

We find the new P-stab more credible on the underlying macroeconomic scenario than the April 2012 version.

First, the Treasury has revised down its estimate of French potential growth, from 1.7% over 2011-2016 to 1.4% on average, which in our view better reflects the "scarring" effect of the current slump (slower capital accumulation, higher unemployment depleting human capital).

Second, the April 2012 P-stab expected a return to a 2.0% growth pace from 2014 onward (and a very optimistic 1.75% in 2013), while this time the "2% cruise speed" would not be reached before 2015.

Third, as we mentioned in FE last Friday, the government has aligned its growth forecasts for 2013 and 2014 with the European Commission's winter projections (0.1% and 1.2% respectively). While we find these forecasts optimistic, the absence of any divergence with Brussels on the macro scenario will help secure a benign assessment of the program by the EC and may provide for some room for manoeuvre in 2014 vis-a-vis the European partners if the 3% target is not met amidst adverse cyclical conditions.

A mechanical consequence of revising down potential GDP growth is that the output gap was also revised down. This means that a smaller fraction of the headline deficits can be ascribed to adverse cyclical conditions. Accordingly the level of the structural deficit for 2011 was revised up from 3.7% in the April 2012 P-stab to 4.9% in the new version (this had already been done in the budget bill for 2013). With a higher starting point for the structural deficit and a less optimistic scenario for GDP growth, the headline deficit targeted for 2017 now stands at 0.7% of GDP (a zero balance was targeted by 2016 already in the previous P-stab, the last year for which a comparison can be done between the two programs). Still, the overall structural effort - i.e. the cumulated change in the cyclically-adjusted balance over the overlapping hoizons of the programmes) is nearly unchanged at 5.1/5.3% of GDP).

The bottom line is that the new P-stab - constructed by a centre-left administration - does not contain any relaxation in discretionary fiscal policy relative to the previous one, designed by Sarkozy's centre-right government.

Figure 1: Change from the budget bill: higher headline deficit target –higher structural effort – slightly more spending cuts

| | Budget bill for 2013 (September 2012) | | | | Stability Program (April 2013) | | | |
|---|---|---|---|---|---|---|---|---|
| | Headline balance | Structural effort | of which: spending | of which: tax | Headline balance | Structural effort | of which: spending | of which: tax |
| 2012 | -4.5 | 1.4 | 0.3 | 1.1 | -4.8 | 1.3 | 0.2 | 1.1 |
| 2013 | -3.0 | 1.9 | 0.3 | 1.6 | -3.7 | 1.9 | 0.4 | 1.5 |
| 2014 | -2.2 | 0.5 | 0.4 | 0.1 | -2.9 | 1 | 0.6 | 0.3 |
| 2015 | -1.3 | 0.5 | 0.4 | 0.1 | -2 | 0.6 | 0.7 | 0 |
| 2016 | -0.6 | 0.4 | 0.4 | 0 | -1.2 | 0.5 | 0.5 | 0 |
| 2017 | -0.3 | 0.1 | 0.4 | -0.3 | -0.7 | 0.3 | 0.5 | -0.2 |

*Source: French Treasury, Deutsche Bank*

The tightening - and more precise definition - of the European fiscal rulebook is showing in the P-Stab. For countries which have not reached their Medium Term Objective (which will be France's case in 2013-2016) primary spending in volume, corrected for new measures on the income side and excluding unemployment benefits, must increase less than potential GDP (as estimated by the European Commission), while the gap must be large enough to allow a structural adjustment of at least 0.5 pp per year. In the French case, this creates a ceiling - just respected in the P-stab - at 0.2% per annum for expenditure growth as defined above. The other new rule derived from the 6-pack, where the distance between the actual debt to GDP ratio and the 60% threshold needs to be reduced by one twentieth per annum, doesn't create any additional pressure on France (a structural adjustment of 0.2% per annum, i.e. well below the pace inscribed in the P-stab, would suffice).

Since the changes to the fiscal surveillance system, the room for manoeuvre for governments in designing their P-stabs has diminished significantly in our view. In a pessimistic approach, one could argue that this increases the "science fictional" aspects of these programs. Indeed, once the main parameters are set (initial position, GDP forecasts by the European Commission - which are non-binding but create a benchmark - and EC's estimates of potential GDP), there are actually very few different "roadmaps" governments can choose from. The risk is then that P-stabs become mere formal exercises. We do not share this view. Even if they are not directly binding in the domestic political system, P-stabs are important public messages from governments which, for sheer consistency, cannot significantly change tack between the programme and the budget bill without incurring a significant political cost.

What are the possible criticisms Paris could incur from the European Commission? We would mention one avenue in particular: granularity on spending cuts.

The government went beyond the commitment from the budget bill for 2013 to shift the structural efforts towards spending cuts. Indeed, in the pluri-annual strategy annexed to the budget bill for 2013, the cumulated effort over 2012-2017 on expenditure stood at 2.2% of GDP. This has been upgraded to 2.9% of GDP in the new P-stab. Still, the Commission may question the content of the actual cuts. Indeed, the P-stab - as usual - is quite vague on the measures. On the benefits side, the program mentions the imminent reform of the pension system (to be negotiated this autumn) but without spelling out its characterics beyond the objective of achieving a "financial rebalancing at short, medium and long terms". There is also a mention of the renegotiation before the end of the year of the unemployment benefits system, but again without any details. This discretion is politically understandable. Indeed, we think that it would be toxic for the government to "pre-announce" the content of controversial reforms of the welfare state in a document which is part of the European surveillance mechanism. This would be fodder for the radical left which is already prompt to blame any structural reform on "diktats from Europe". Still, this means that in the current form of the government's fiscal plans, much of the spending restraint would come from fairly vague "efficiency gains" via a comprehensive review of state programs (Public Action Modernisation, MAP in the French acronym). Note that in any case we do not expect "revolutions" on public spending in France in the next few years. As we suggested in Focus Europe last Friday, given the not-so-redistributive nature of the French welfare state, building strong political coalitions in favour of sweeping changes is very difficult.

In general though, we think that through this P-stab Paris is seeking to appear as a "good pupil" in terms of respect of the letter and spirit of the new European surveillance mechanism, at a time when it is negotiating a one-year delay in the completion of the 3% target. In any case, we cannot find any trace in this document of the debate currently taking place within the socialist party on the fiscal stance. Paris continues to advocate the full-use of automatic stabilisers so as not to chase headline deficit target when growth disappoints, but this is now we think a consensual approach in the Euro area. Paris in the P-stab did not "cross the Rubicon" of revising the pace of structural consolidation.

The socialist party held a "National Council" (the party's parliament) last Saturday. To appease the left-wing, the Prime Minister call the "peoples of

Europe to mobilise themselves against the most conservative governments", while the party's secretary general - who does not belong to the cabinet - called on a "confrontation with Mrs Merkel". In a nutshell, the government toes the current European line but gives lip service to a change in this line. This is an ambiguous strategy, but probably the only one currently open to Paris without facing both market distrust and further disconnect from public opinion. In our view, both Francois Hollande and Angela Merkel may have a domestic interest, in the short run, in faking a public disagreement. Still, beyond the rhetoric and a lot of political manoeuvering, the bottom line remains, we think, that the French government remains committed to the necessary macroeconomic adjustment.

Eurozone | Economics

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# Ireland: Plotting a course for 'exit'

- Ireland continues to enjoy its status as the crisis "success story". This year has seen a number of 'credit enhancements', from the restructuring of promissory notes to an extension of the EFSF/EFSM loan maturities. Ireland's recently re-launched 10Y bond is yielding 3.75%, an all-time low.
- With the final EU-IMF payment due in December 2013, minds are turning to 'post-programme' support. With an estimated EUR20bn liquidity buffer, Ireland could try to go it alone. Troika caution might urge precautionary credit line support through a transition period. Beyond year-end, Ireland could only continue to benefit from the ECB OMT umbrella if it is under an ECCL programme.
- The most significant event before the end of the programme is a second bank stress test (PCAR2) in Q3 2013. The outcome of PCAR2 could have economic and political ramifications. Decisions on post-programme support will likely wait until the stress test result is published.
- One of the notable features of Ireland's post-crisis adjustment has been social cohesion. This week's refusal by public sector workers to accept a revised pay deal could threaten this stability. The political cost of fiscal consolidation may be rising.

## The crisis 'success story'

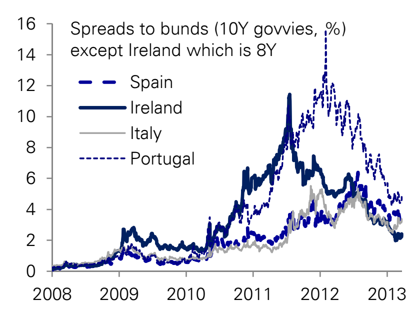
All going well, Ireland will be the first euro crisis country to reach the end of its lending programme. The final tranche payment from the EU-IMF programme will be in December 2013 (the final payment for Portugal is in mid 2014).

Ireland has been consistently viewed as the crisis 'success' story. From the peak in mid-2011, sovereign yields have fallen markedly. The recently issued 10Y benchmark sovereign bond is currently yielding 3.75%, a all-time low for Irish bonds, even pre-crisis.

Ireland's capacity for success started early in the programme. The first step was a bank stress in March 2011. The outcome was credible and affordable. Of the EUR35bn of funds allocated for bank recapitalization within the EUR85bn EU-IMF programme, only EUR16bn was required. The remainder seeded a liquidity buffer.

From the start of the programme, Ireland has maintained strong compliance with the terms of the MoU. Unlikely Portugal, which has been granted two extensions of its deficit correction timeline, the Troika has not had to revise the Irish programme. The fiscal deficit has repeatedly and consistently come in below expectations while the economy outperformed its crisis periphery peers and the banking sector deleveraging was achieved.

Figure 1: Irish sovereign yields are down dramatically




Source: Deutsche Bank, Blomberg Finance LP

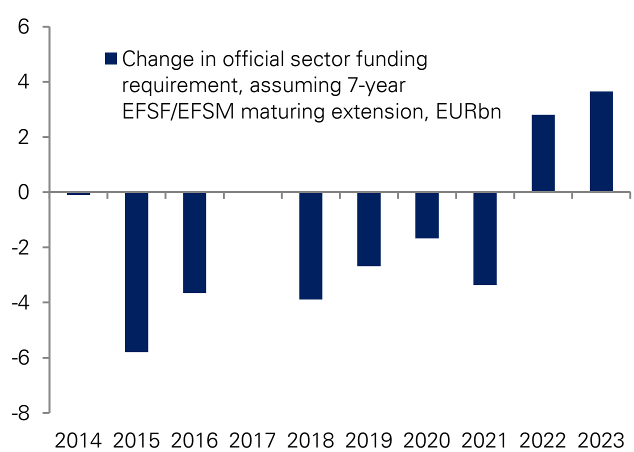
## Credit enhancements underline the success story

The Irish story has benefited from several 'credit enhancements' in recent months.

First, after a protracted negotiation, Ireland announced a restructuring of the promissory notes. The promissory notes were an instrument the State used to finance the failed Anglo Irish bank (renamed IBRC, Irish Bank Resolution Corporation). In February 2013, IBRC was liquidated and taken directly onto the Central Bank of Ireland balance sheet. This allowed the debit and credit entries associated with the ELA, backed by the promissory notes as collateral, to be cancelled. The liquidation also allowed the Irish government to replace the promissory notes with a basket of regular Irish government bonds with a longer average maturity than the promissory notes (34 years versus about 8 years). The transaction reduces sovereign funding needs by EUR20bn over the next 10 years. There are also benefits for the fiscal deficit due to lower financing costs[1].

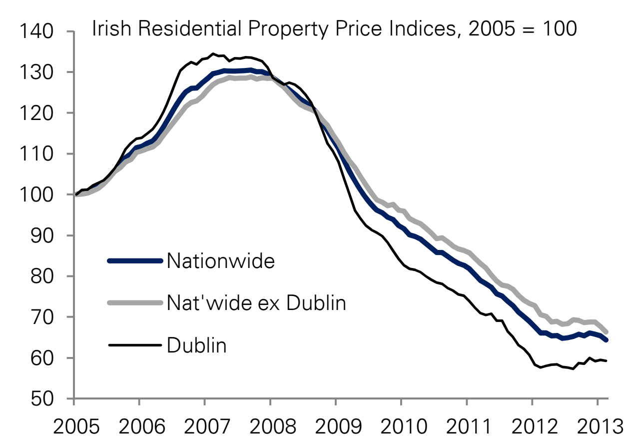
Second, European Finance ministers recently confirmed that, dependent on a successful conclusion to the next (ninth) review of the Irish loan programme, the EFSF and EFSM loans will have their average maturity extended by 7 years. This creates a smoother refinancing profile for the sovereign and greater certainty and value for shorter term private sector holdings of public debt.

Figure 2: Extending the maturity of Ireland's EFSF/EFSM loans improves the intermediate funding profile




Source: Deutsche Bank

Figure 3: Irish house prices have broadly speaking stopped falling, in particular in Dublin where NAMA's property portfolio is heavily exposed




Source: Deutsche Bank, Central Statistics Office

Third, the ELG (Eligible Liabilities Guarantee) bank liability guarantee has now ended. Bank bonds issued under the guarantee are grandfathered. Once these bonds have matured, a contingent liability worth 11.4% of GDP (IMF estimate) will have been removed from the sovereign balance sheet. Cessation of the expensive guarantee is also a positive for bank profitability, the lack of which is one of the Troika's prevailing concerns. We expect the bulk of ELG fees to fall in 2013 as the fee structure was particularly punitive to short term funding. Additionally, the government sold a portion of its CoCos in the banks for

[1] See "Irish promissory note saga comes to an end", Focus Europe, 8 February 2013 and "IBRC liquidation", Fixed Income Special Report, 8 February 2013.

EUR1bn and the Irish Life insurance company, which had been taken into public ownership for a period, was sold for EUR1.3bn.

Fourth, fear that the bad bank, NAMA, will be loss-making over its rough 10-year life-cycle are subsiding. NAMA (National Asset Management Agency) paid about EUR31bn for EUR74bn of assets. NAMA senior bonds are a contingent liability on the sovereign balance sheet worth 17.1% of GDP (IMF estimate). Encouragingly, in its first 3 years, the Agency has generated cash flow from asset sales and income of EUR11bn and is on course to repay EUR7.5bn of its debt by the end of this year. With income now secured on the property portfolio, on a monthly basis NAMA earns about EUR300m. The Irish property market has broadly stabilized, led by Dublin, which is where the majority of NAMA's Irish assets are located. What is currently not clear is how NAMA's outlook and strategy might change with the liquidation and transfer of assets from IBRC (which has loans to smaller customers).

## Ireland's post-programme options including precautionary credit lines and OMT

Ireland may be — or is close to being — implicitly eligible for OMT purchasing, but ongoing eligibility beyond the end of this year depends on Ireland applying for an ECCL programme.

As the conclusion of the disbursement phase of the EU-IMF lending programme approaches at the end of 2013, minds are turning towards programme 'exit'. The question is, will the private market fully finance Ireland from the start of what is called the "post-programme" period?

Within the disbursement phase, the country is monitored intensely and disbursement is conditional on successful quarterly Troika reviews. Ireland will continue to be monitored closely.

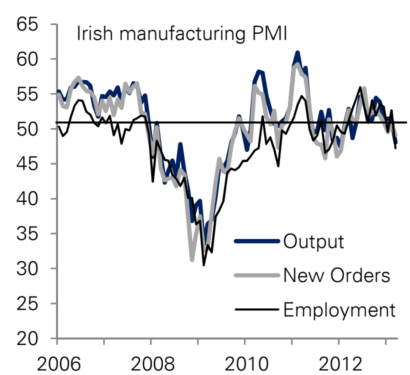
The IMF will continue to monitor as long as outstanding borrowings are in excess of 200% of quota. The IMF loan to Ireland represented 1548% of its IMF quota. It will be 2021 before IMF monitoring ends.

Part of the 'two-pack' legislation recently passed verifies that euro area member states that have received financial assistance will continue to be monitored on a six-monthly basis until 75% of EU loans (EFSF, EFSF, ESM) have been repaid. Considering that the average maturity of Ireland's EFSF and EFSM loans are 11.7 and 12.4 years before the 7-year extension, Ireland will be monitored for some time to come.

In terms of sovereign financing in the "post-programme" period, there are several options.

First, Ireland could choose to go into the post-programme period within any financial backstops. For such a strategy to be successful, markets would need to have high confidence in Ireland's economic, fiscal and banking adjustment trajectories. Unlike its crisis periphery peers, Irish GDP is growing. The current account surplus was 4.9% of GDP in 2012 having been a deficit of 5.7% of GDP in 2008. The fiscal deficit is declining and has repeatedly outperformed the Troika targets. Reliance on central bank funding is declining, although arguably banking remains the weak link. Ideally, the next bank stress test (PCAR, Prudential Capital Adequacy Review) will substantially address residual concerns here.

Figure 4: Irish manufacturing PMI has lost some momentum recently

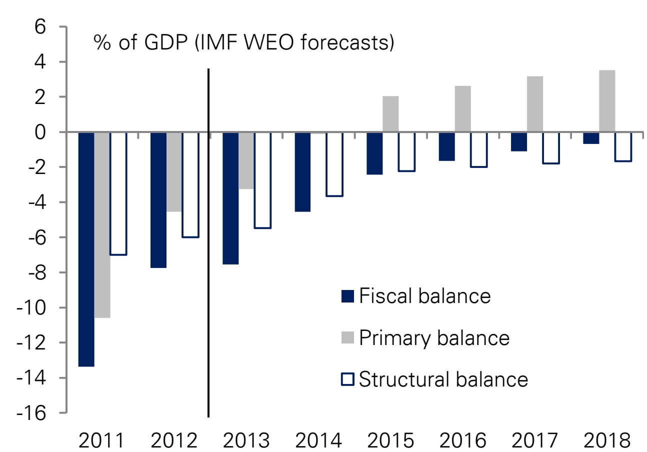



*Source: Deutsche Bank, Markit*

Ireland would need a large liquidity buffer to cover remaining adjustment uncertainty. According to the latest IMF report, Ireland will have an exchequer cash position at the end of 2013 of EUR20.2bn. This would be sufficient to finance Ireland through 2014 and a portion of 2015. Such a substantial cash buffer makes the 'go it alone' strategy a possibility.

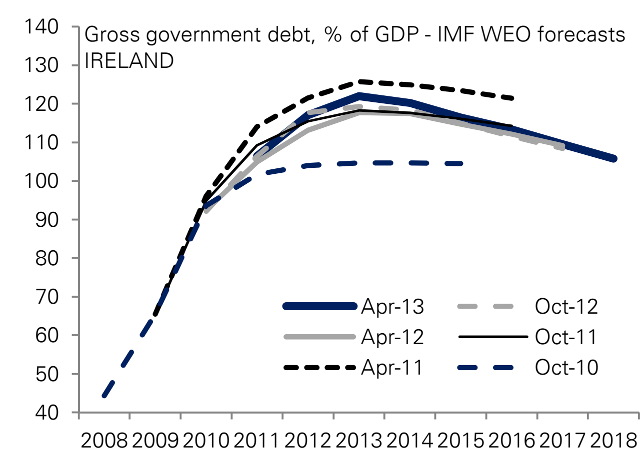
Second, Ireland could agree precautionary lending facilities with the Troika. With a strong vested interest in sustainable exit, both the EU and IMF may request that, at least initially, a country moving off a full financial assistance programme be backstopped by precautionary facilities.

Figure 5: Ireland's fiscal deficit may be high relative to the other crisis peripherals, but it is declining at a faster rate than dictated by the Troika programme




Source: Deutsche Bank, IMF

Figure 6: Despite some downward revisions to medium-term GDP expectations, Ireland's public debt trajectory has been stable over recent vintages of Troika forecasts




Source: Deutsche Bank, IMF

The benefit of precautionary support is that Ireland would have a financial backstop should market funding turn challenging, even if temporarily. The drawback is that it could likely entail new economic conditionality.

From a European perspective, conditionality depends on whether Ireland could access the Precautionary Conditional Credit Line (PCCL) or Enhanced Conditions Credit Line (ECCL).

There is no 'new' conditions attached to a PCCL. A country would merely have to continue to comply with the PCCL eligibility criteria. A PCCL country must be respecting and continue to respect its excessive deficit procedure (EDP) requirements and any excessive imbalance procedure (EIP) requirements. The two criteria that could raise questions for Ireland are (a) the "absence of bank solvency problems that would pose systemic threats to the stability of the euro area banking system" and (b) a "sustainable general government debt". A credible PCAR with zero capital requirement could resolve these concerns.

An ECCL, on the other hand, is open to countries that do not comply with the qualification criteria for the PCCL but whose "general economic and financial situation remains sound". Unlike PCCL, additional corrective measures would have to be agreed. The objective of the measures would be to rebalance the economy to satisfy the PCCL qualification criteria.

The EU precautionary support facilities are modeled on those of the IMF. The IMF's Precautionary and Liquidity Line (PLL), like the PCCL, has tougher qualification criteria. The alternative is the Flexible Credit Line (FCL). It is not automatic that the IMF asks for countries to transition off full programmes via precautionary facilities.

The third option is OMT (Outright Monetary Transactions). The prospects of a member state benefiting from ECB purchases has arguably already a positive impact on market conditions, in Ireland and across the peripheral space. The reality, however, is that OMT is not separable from Option 2.

The eligibility criteria for OMT depends on whether a country is currently under a full financial assistance programme (i.e., Greece, Ireland and Portugal) or not.

1. For any future cases, the country must be under "strict and effective conditionality" attached to either a full EFSF/ESM financial assistance programme or an ECCL, "provided that they include the possibility of EFSF/ESM primary market purchases".

2. For the three current cases, the EFSF/ESM primary market purchases element is not required but the ECB will consider OMT when the country is "regaining" access to the bond market. This has been clarified since. The OMT will not be used as a tool "to support countries in their return to the market". Rather, the beneficiary country must have access to the market, defined as "being able to issue along the yield curve, being able to issue to a fairly broad category of investors, and being able to issue certain quantities" (Mario Draghi, ECB press conference, March 2013).

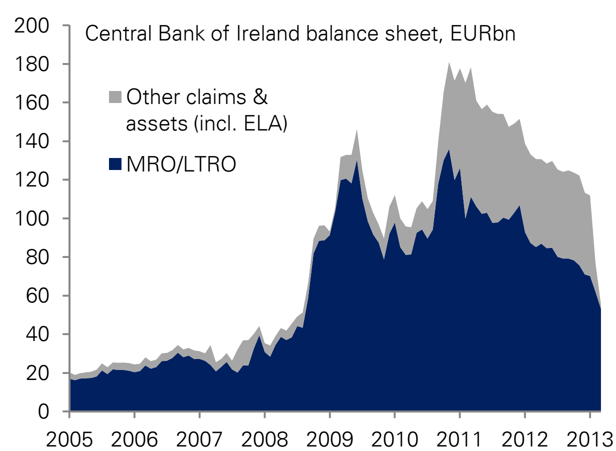
In Ireland's care, the window to benefit from OMT expires when the full programme expires at the end of 2013. To benefit from the OMT umbrella in the post-programme period Ireland will have to sign an ECCL and potentially accept new economic conditions to avail of OMT in the 'post-programme period (note, the no-conditions PCCL does not make a member state eligible for OMT).

Figure 7: Despite harsh macro rebalancing under the programme, Ireland has managed consistent GDP growth, if below original Troika expectations

| Review | 2011 | 2012 | 2013 | 2014 | 2015 | Cum. |
|---|---|---|---|---|---|---|
| Original prog. | 0.9 | 1.9 | 2.5 | 3.0 | 3.0 | 11.3 |
| 1st/2nd reviev | 0.6 | 1.9 | 2.4 | 2.9 | 3.0 | 10.8 |
| 3rd review | 0.6 | 1.9 | 2.4 | 3.0 | 3.0 | 10.9 |
| 4th review | 1.1 | 1.0 | 2.3 | 2.7 | 3.0 | 10.1 |
| 5th review | 0.9 | 0.5 | 2.0 | 2.7 | 2.9 | 9.0 |
| 6th review | 0.7 | 0.5 | 1.9 | 2.6 | 2.8 | 8.5 |
| 7th review | 1.4 | 0.4 | 1.4 | 2.5 | 2.8 | 8.5 |
| 8th review | 1.4 | 0.4 | 1.1 | 2.2 | 2.8 | 7.9 |
| 9th review | 1.4 | 0.7 | 1.1 | 2.2 | 2.7 | 8.1 |
| DB Forecasts | 1.4 | 0.5 | 0.5 | 1.7 | 2.2 | 6.4 |

Source: Deutsche Bank, CSO, IMF

Figure 8: Irish bank reliance on ECB funding has declined




Source: Deutsche Bank, Central Bank of Ireland

Following the two successful bond syndications since the start of 2013, the second eligibility criterion is arguably close to being met. Perhaps only another one or two successful auctions with broad participation would be required to satisfy the terms.

Meeting the eligibility criteria is not sufficient for the ECB to purchase bonds. The purpose of OMT is to address “severe distortions” in the government bond market that threaten the monetary transmission mechanism. These distortions “in particular” come from “unfounded” fears of euro break-up, but the ECB is leaving the drivers sufficiently open so as to give its some flexibility. As Draghi said in a speech on 15 April, OMT aims to “eliminate the pricing of unwarranted tail risks”, allows the ECB to “cope with extraordinary risk premia” such as potentially “self-fulfilling expectations of catastrophic events”.

It is difficult to imagine currently that Ireland would qualifying for OMT purchases on the basis of “extraordinary risk premia”. It would take an extraordinary deterioration in events.

We do not know whether the ECB will publicly announce that a member state satisfies the eligibility criteria for OMT *prior* to an ‘extraordinary risk’ event being priced or whether the ECB will only test eligibility once markets fear (price) an extraordinary risk event. Nor is it obvious that the ‘extraordinary risk’ event need directly involve the member state that might benefit from OMT.

Conceivably, a country could be pre-approved for OMT if the two eligibility criteria above are met. Having the ECB validate the eligibility criteria takes it one step closer to intervention, making the irrational and extraordinary risk event even less likely to occur. Such a validation would not only be positive for the country in question. But were this to be Ireland in the relative near-term, by moving the OMT one step closer to reality, it could reinforce the positive spillovers for other crisis periphery countries.

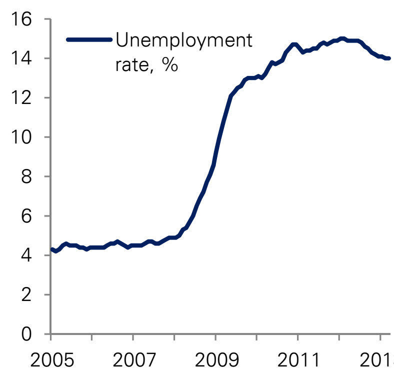
Ireland may already be implicitly eligible for OMT intervention; if not, it is arguably close to being eligible. But unless Ireland agrees to an ECCL precautionary credit line, Ireland will lose its OMT eligibility beyond year-end.

Whether Ireland needs ECCL depends on external and internal events. Externally, the key is how the EU manages the debt crisis and ‘shares the burden’ of banking crisis. Internally — and connected — is the next bank stress test.

The most significant event between now and the post-programme period will be the next Irish bank stress test or PCAR (Prudential Capital Adequacy Review). This is due to be completed by end Q3 2013. The outcome of the PCAR may have significant bearing on Ireland’s needs in the post-programme period.

This is consistent with a recent unattributed quote on Reuters from a public policy official with knowledge of the situation that Ireland is unlikely to decide what strategy to take into the post-programme period until “after the summer” (Reuters, 12 April 2013).

Figure 9: Irish unemployment rate is declining, primarily due to participation




Source: Deutsche Bank, CSO

## PCAR: The last hurdle?

For both Ireland and the Troika, there is no incentive to make decisions on the specifics of post-programme support until the results of the new bank stress test (PCAR2) are known. On current plans, these are due by end Q3 2013, though a coordination on timing with the Europe-wide EBA and SSM entry stress tests may be required.

Being a bank-based crisis and having spent roughly 40% of GDP on banks over the course of the crisis in one form or another, stress testing the banks and demonstrating a sufficiently capitalized banking system would enhance confidence in the banking system and help to re-open market financing sustainably for the Irish sovereign. The Troika is aware of this and has made a second PCAR exercise part of the conditionality of the programme before it ends.

Ireland's initial PCAR in March 2011 was deemed by the market to be credible. We have argued that the credibility came from three factors:

(a) The baseline and stress scenarios were credible and the economic scenarios were translated into credible assumptions pre-provision profits, the probability of default (PD) and loss-given-default (LGD). The involvement of independent assessors was part of the credibility.

(b) The Irish stress test was built on a tougher capital target over a longer period than its EBA counterpart. PCAR also included additional capital buffers and the costs of significant bank deleveraging.

(c) PCAR was backed with a capital commitment of up to EUR35bn from the EUR85bn EU-IMF programme (EUR17.5bn of which was being committed from Irish resources).

PCAR1 showed that the Troika could achieve a credible outcome. To date, little if anything is known about the specifics of PCAR2.

We have several concerns with PCAR2.

First, the PCAR1 was calibrated on the Basel II regime for bank capital. Although Basel III does not start until 2019, most European banks are moving to fully-loaded (i.e., including transitional deductions) Basel III ratios already, and our bank analysts expect Europe to be at an average of 9-10% CET1 ratio at the end of this year. With PCAR2 coming 2.5 years after PCAR1, for the sake for credibility, the Troika should be ushering the Irish banks towards Basel III compliance. Issues such as the treatment of deferred tax assets (DTA) could create capital challenges.

Second, a new personal insolvency regime has now launched which could seem individuals discharged from insolvency in as little as 3 years compared to the 12 year period under the old regime. The pace of deterioration of mortgage arrears has slowed over the last few quarters and it is not obvious that arrears assumptions are much different from the base case in PCAR1. The question is whether the new insolvency regime significantly alters household repayment behaviour. It could take a few quarters of the new system to bed down, leaving some uncertainties. Meanwhile Ireland's retail loan arrear levels remain significantly above other markets in Europe.

Third, tracker mortgage books remain an outstanding structural drag on the profitability of Irish banks. Tracker mortgages (interest charges directly linked to ECB rates) are loss-making represent about 55% of outstanding Irish mortgages. Last year our banks analysts previously estimated that tracker mortgages were a drag on bank profitability going forward. Further ECB rate cuts would exacerbate the problem.

Fourth, it is not clear what the capital backstop is for the new PCAR. With the majority of the banking system in State hands, going to private investors for a capital raising is not possible across the board. Having used less than half the original EUR35bn capital envelop in the original PCAR, the Troika could simply point to those 'spare resources'. This would necessarily atrophy the sovereign's liquidity buffer. There are CoCos, but we doubt these could trigger as part of a stress test. In any case, these are mostly government owned. There is also the not insignificant political cost of injecting more funds into the

Figure 10: GIIPS main macro balances: With the exception of the fiscal deficit — which had to overcome a large cyclical deterioration — Ireland compares favourably

| | 2012 | 2013F | 2014F |
|---|---|---|---|
| **Real GDP growth, %** | | | |
| Greece | -6.4 | -4.5 | 0.5 |
| Ireland | 0.9 | 0.5 | 1.7 |
| Italy | -2.4 | -1.8 | 0.9 |
| Portugal | -3.2 | -2.2 | 0.8 |
| Spain | -1.4 | -1.6 | 0.5 |
| **Output Gap, % of potential GDP*** | | | |
| Greece | -7.7 | -10.6 | -9.5 |
| Ireland | -1.8 | -1.8 | -1.0 |
| Italy | -3.4 | -4.5 | -3.9 |
| Portugal | -3.9 | -5.1 | -4.5 |
| Spain | -4.5 | -5.4 | -4.2 |
| **Current account, % of GDP** | | | |
| Greece | -3.0 | -2.0 | -1.0 |
| Ireland | 4.9 | 3.5 | 4.0 |
| Italy | -0.6 | 0.0 | 0.4 |
| Portugal | -1.8 | 1.0 | 1.5 |
| Spain | -1.1 | 0.5 | 0.3 |
| **Fiscal Balance, % of GDP** | | | |
| Greece | -6.8 | -5.2 | -4.1 |
| Ireland | -7.8 | -7.9 | -6.4 |
| Italy | -3.0 | -3.0 | -2.4 |
| Portugal | -4.9 | -5.0 | -3.8 |
| Spain | -10.0 | -6.2 | -5.3 |
| **Public debt, % of GDP** | | | |
| Greece | 162.6 | 176.9 | 177.8 |
| Ireland | 116.0 | 121.2 | 119.8 |
| Italy | 127.0 | 131.7 | 131.5 |
| Portugal | 120.0 | 125.6 | 127.2 |
| Spain | 85.4 | 92.0 | 96.5 |

*Source: Deutsche Bank, * from IMF WEO database* banks, although after Cyprus the relative cost of injecting more equity (or triggering CoCo conversion) versus deposit bail-in are likely to be changing. ESM direct recapitalization is not available yet and the timeline for delivery is not known; given the core country messaging on 'legacy assets', Irish access is in any case highly uncertain. One way or another, recapitalizing the banks creates a political headache.

Fifth, as our bank analysts have covered previously (see Irish Banking Quarterly, 18 Feb 2013), regional dynamics are extremely important in Ireland. Dublin appears to be in recovery, in terms of the economy and housing market performance. However, rural areas, with high volumes of vacant housing, pose more of a risk. We lack detail on provisioning levels (and consistency between banks) on these areas, and think that PCAR2 would be more credible to the market if regional dynamics are taking into account as part of the stress test. For the moment, exposures to these areas remain uncertain.

The best possible outcome from PCAR2 would be a credible exercise with a zero capital requirement. Second best would be a credible exercise with a modest capital requirement that can be met in both economically and politically sustainable ways, that is, does not do much damage to Ireland's liquidity buffer or to the stability of a government that has so far shown strong commitment to delivering the terms and conditions of the loan programme.

## Croke Park Agreement: A negative turn of events

One of the notable features of Ireland's post-crisis adjustment has been social cohesion. This week's rejection by public sector workers of a revised pay deal could threaten this stability. This could complicate the government's decisions on bank recapitalization, should it be required, and on precautionary aid, if it entails new conditionality.

The government imposed substantial pay cuts on the public sector at the end of 2009 of between 5 and 10%. To maintain good working relations, in mid 2010 the government agreed with the public sector unions to maintain pay levels until 2014 and avoid involuntary redundancies in exchange for a pledge of no industrial action and a constructive approach to government efforts to secure public sector efficiency gains. This agreement was known as the Croke Park Agreement (CPA).

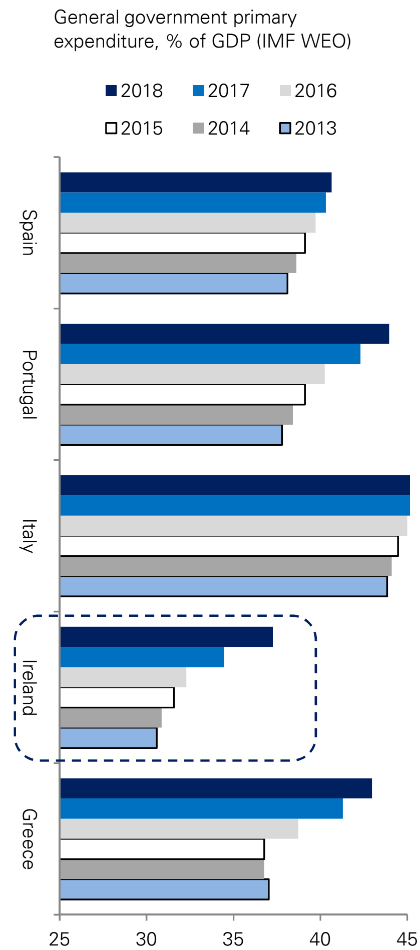
The CPA implementation body calculates that the Exchequer pay bill fell from EUR17.5bn in 2009 to EUR14.4bn in 2012, a decline of EUR3.1bn. Within this, the implementation body estimates that EUR800m of savings were generated under the CPA.

Following concerns that the benefits of the CPA might be overstated and to keep the medium-term fiscal adjustment on track, the government re-opened the CPA last year with the hope of extending it another year to 2015 and achieving a further EUR1bn of annual savings, EUR300m of which were to materialize in 2013.

The main elements of the re-negotiated deal includes: an increase in minimum weekly working hours; a progressive reduction in overtime pay rates; reduced Sunday pay rates; longer periods of service to trigger pay increments; and additional pay cuts for higher earning public workers (earning in excess of EUR65,000). The new conditions were due to begin from July 2013.

The deal was put to a members vote by the public sector unions. This week it was announced that a majority of members had rejected the deal.

Figure 11: Trouble with the pay deal, but primary expenditure is better than in Ireland's GIIPS peers




Source: Deutsche Bank, IMF

The government has yet to decide what to do in response. The Deputy Prime Minister and leader of the Labour Party, the junior coalition partner, refused to rule out legislating the new pay conditions. Perhaps attempts will be made to re-cast the deal, but time is short and the Troika is banking on significant savings already from this deal in 2013.

The housing tax begins in July and social benefits are likely to see further declines in the budget later this year. All considered, the political cost of fiscal consolidation could be rising.

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# Euro sovereign events: what to watch

The following is a list of key events to watch over the next several weeks and months – events that could have bearing on how the euro sovereign debt crisis evolves.

## April

- 19-21 April: IMF/World Bank Spring Meetings.
- 22 April: Dutch parliament to debate Cyprus bailout.
- 22 April: EMU – data on government deficit and debt (2012).
- 23 April: Dutch parliament to vote on Cyprus bailout.
- 23 April: Spain auction. Bills.
- 24 April: ESM Board of Governors due to make a decision on the Cyprus bailout, to which it will contribute EUR9bn.
- 24 April: ECB Vice President Constancio to present ECB Annual Report to European Parliament Economic and Monetary Affairs Committee.
- 25 April: Eurogroup President Dijsselbloem to speak to European Parliament Economic and Monetary Affairs Committee.
- 25 April: German Chancellor Merkel to meet Slovenian President Pahor in Berlin.
- 24 April: ECB Bank Lending Survey for Q1.
- 24 April: Italy auction. Bonds.
- 26 April: Spain to present new fiscal projections.
- 26 April: Italy auction. Bills.
- 29 April: (prelim) EMU – Business climate indicator for the Euro area (April '13).
- 29 April: Italy auction. Bonds.

## May

- 2 May: ECB Governing Council meeting, followed by the interest rate announcement and press conference.
- 3 May: European Commission to release spring macroeconomic forecasts.
- 7 May: Slovenia 'golden fiscal rule' vote. Originally due on 11 April the vote by Slovenian parliament on the addition of the euro area 'golden fiscal rule' was postponed until 7 May. There had been disagreements upon when the rule should take effect, with the centre-left parties calling seeing 2015 as to early

- 9 May (latest): Slovenia Stability Programme. Slovenia is due to submit to the European Commission its 2013 Stability and National Reform programmes, which will provide fuller details on plans for much needed reforms for the country. The Slovenian PM announced that the stability programme would be submitted by 9 May 'at the latest' - the programmes are submitted by EU countries in April, although delays to early May are not unusual. The European Commission should reply with its recommendation at the end of May.
- 9 May: Spain auction. Bonds.
- 10 May: Italy auction. Bills.
- 10 May: G7 finance ministers and central bankers meeting.
- 13-14 May: Eurogroup/ECOFIN meetings. The agenda is expected to include: the Commission's spring forecasts; Financial and macroeconomic stability developments in the euro area, including monitoring of individual Member States; and the Macro-imbalances procedures – in depth reviews euro area countries. The Eurogroup will be hoping to approve a EUR6bn tranche payment to Greece ahead of the 20 May bond redemption.
- 13 May: Italy auction. Bonds.
- 14 May: (prelim) EMU Industrial production (March '13).
- 14 May: Spain auction. Bills.
- 15 May: (prelim) EMU – First estimate of GDP Euro area and EU (Q1 2013).
- 20 May: Redemption of EUR5.6bn of Greek sovereign debt, in large part held in the ECB Securities Markets Programme (SMP).
- 21 May: Spain auction. Bills.
- 22 May: European Council – EU leaders' summit. Informal summit, agenda still open but will include tax evasion.
- 23 May: Spain auction. Bonds.
- 24 May: Germany GDP Q1 2013 details on components.
- 26 May: Germany state election in Schleswig-Holstein.
- 28 May: Italy auction. Bonds.
- 29 April: EU to issue Annual Economic Policy Recommendations.
- 29 May: Italy auction. Bills.
- 30 May: (prelim) EMU – Business climate indicator for the Euro area (May '13).
- 30 May: Italy auction. Bonds.

## June

- 6 June: ECB Governing Council meeting, followed by the interest rate announcement and press conference.
- 11/12 June: Hearing at the German Constitutional Court on the constitutional complaints against the ECB's secondary market programmes and Germany's participation in ESM. The judgment will be held later in summer. It will most likely be in line with the constructive approach of former judgments that provided that (1) the Court will not

comment on the ECB's monetary policy and (2) any major decision taken by intergovernmental mechanisms such as EFSF and ESM needs to be legitimized by the German legislative.

- 12 June: (prelim) EMU Industrial production (April 2013).
- 14 June: Spain – Public debt according to the Excessive Deficit Procedure (Q1 2013).
- 17-18 June: G8 leader summit.
- 20-21 June: Eurogroup/ECOFIN meetings. The agenda is expected to include: the European semester - discussion on Stability and Convergence programmes and euro area specific recommendations, including implications of the spring forecast for excessive deficit procedures and possibly excessive imbalance procedures for euro area countries; and the latest reviews of the Greek, Irish, Portuguese and Spanish loan programmes.
- 27-28 June: European Council – EU Leader's summit. Country specific recommendations on economic policy.

## July

- July: IMF World Economic Outlook Update.
- 4 July: Governing Council meeting of the ECB in Frankfurt.
- 12 July: (prelim) EMU Industrial production (May '13).
- 24 July: EMU – Bank Lending Survey (Q2 2013).
- 30 July: (prelim) EMU – Business climate indicator for the euro area.

## August

- 1 August: Governing Council meeting of the ECB in Frankfurt.
- 13 August: (prelim) EMU Industrial production (June '13).
- 14 August: EMU – First estimate GDP of the Euro area and EU (Q2 2013).

## September

- 4 September: (prelim) EMU – Second estimate GDP of Euro area and EU (Q2 2013).
- 5 September: Governing Council meeting of the ECB in Frankfurt.
- 5-6 September: G20 Leaders' Summit.
- 12 September: (prelim) EMU Industrial production (Jul 2013).
- Mid-September: Germany state election in Bavaria.
- 22 September: German Federal election.
- September: Austria parliamentary election.

## October

- 2 October: Governing council meeting of the ECB in Frankfurt.

- 11-13 October: Annual meetings of the World Bank Group and the International Monetary Fund.
- 14 October: (prelim) EMU Industrial production (Aug 2013).
- 30 October: (prelim) EMU – Bank Lending Survey (Q3 2013).
- October: Portuguese local election.

## November

- 7 November: Governing Council meeting of the ECB in Frankfurt.
- 13 November: (prelim) EMU Industrial production (Sep '13).
- 14 November: EMU – First estimate of GDP in the Euro area and EU (Q3 2013).
- November: Germany – state election in Hessen.

## December

- 4 December: (prelim) EMU – Second estimate GDP of the Euro area and EU (Q3 2013).
- 5 December: Governing Council meeting of the ECB in Frankfurt.
- 12 December: (prelim) EMU Industrial production (Oct '13).
- 19-20 December: European Council – EU leaders' summit.

## 2014

- 1 January: Latvia may join the Euro area.
- 1 January: ECB begins supervision of Eurozone banks.

Global | Economics

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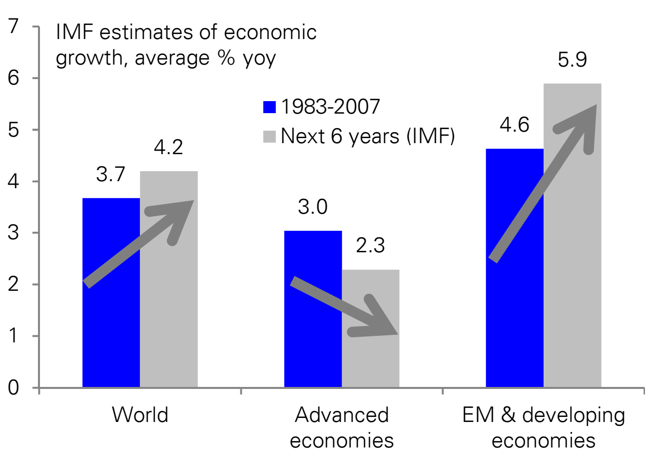
# IMF long-run forecasts revised down


- The IMF published new economic forecasts in its semi-annual World Economic Outlook this week. There are two things we'd like to do in this note – first, compare the IMF's forecasts with our own, and second, take a closer look at how the IMF's long-run forecasts have changed across countries over recent years. While the IMF has revised down its view of long-run growth for most countries since the onset of the Great Recession, there are some interesting aspects to this worth investigating.


## The IMF's new near-term forecasts

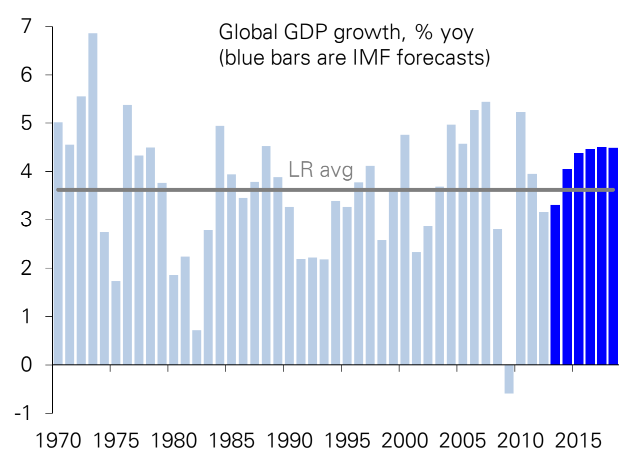
First, let us consider the IMF's near-term forecasts. The IMF sees global growth of 3.3% for this year and 4% next, almost identical to our forecasts of 3.2% and 4%. The IMF's numbers are below its previous estimates, published six months ago, of 3.6% and 4.1%, respectively. An interesting point is that the IMF expects annual global growth to be some 0.5pp stronger on average over the coming six years than it was during the 25-year run up to the Great Recession – a period during which global growth was generally buoyant.

Figure 1: IMF's EM versus DM growth forecasts




Source: Deutsche Bank, IMF

Figure 2: IMF forecast for world growth similar to ours



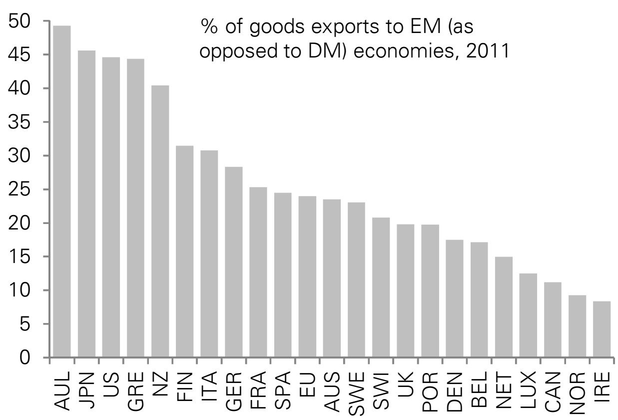

Source: Deutsche Bank, IMF, Haver Analytics

However, an important consideration is what part of the world is generating this forecast improvement. Figure 1 above left splits IMF world growth forecasts into advanced versus developing economies. In the 25Y run up to the Great Recession, the average for developing economies was around 4.5% versus the IMF's forecast for the next 6Y of almost 6%. For the same periods advanced economies are expected to weaken from 3% to just 2.3%, respectively.

So while the world in aggregate should be stronger over the next few years, if we and the IMF are right, it might not feel like that for advanced economies – particularly those in Europe. Take the European Union for example – exports are highly targeted towards other advanced economies. According to the IMF's Direction of Trade database, in 2011 around 75% of EU goods exports went to advanced economies versus 25% to emerging economies. But which countries in the EU could benefit more/less from stronger growth in EM as a result of higher direct trade exposures?

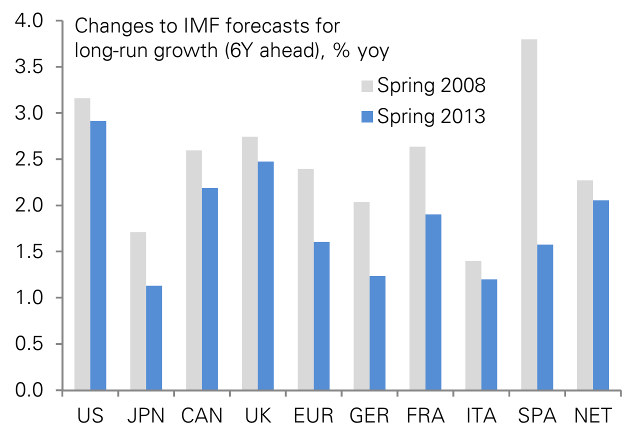
Within the EU Belgium, the Netherlands, Luxembourg, Ireland, Denmark and Norway stand out as having particularly low exposures to developing economies – with the proportion of goods exports to EM sub-20% (and, in the case of Ireland and Norway, below 10%). The UK is at the higher end of this group but still below the EU average at a little under 20%. Those with higher exposures include Germany, Italy and Finland, all around the 30% mark (Greece stands out with an even higher proportion due to exports to Central & Eastern Europe). However, the EU figures are dwarfed by the US, which - on account of its sizable exposure to LatAm - has a far more favourable balance between DM and EM goods exports (55%/45%). Japan and Australia have similar exposures thanks to their proximity to Asian markets.

Figure 3: DM exposure to EM




Source: Deutsche Bank, IMF, Haver Analytics

Figure 4: IMF DM long-run growth versus five years ago




Source: Deutsche Bank, IMF

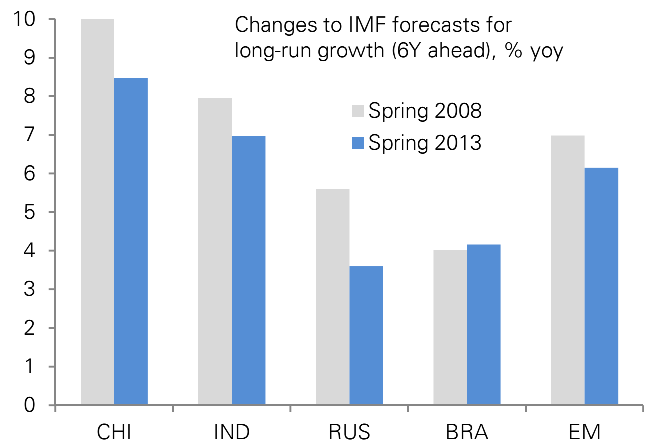
## Looking further out

This greater exposure to faster-growing emerging economies may be a reason that the IMF's long-run forecasts for growth in the US are higher than those for many other developed economies (including any other G7 economy and the largest five euro area countries). To see this, Figure 4 above right looks at the IMF's long-run (i.e. six years ahead – the furthest out the IMF forecasts) growth views. This shows US real GDP growth running at around 2.9% by 2018, not far off twice the rate that the euro area is expected to grow by the end of the IMF's forecast horizon.

We had found the IMF's view on UK long-run economic growth as being too high – in its Autumn numbers it saw end-forecast growth at 2.7%, but that has since been revised down to less than 2.5% (even this looks challenging, in our view – the UK has seen one of the smallest downward revisions). Some other interesting observations include that regarding Germany, where growth is seen by the IMF as being low – similar to Italy (around the 1.2% mark) – by the end of the forecast horizon. We are more surprised here by the Italian number; our Italian economist Marco Stringa believes that the trend rate of growth in Italy – even under the assumption that Monti's structural reforms are eventually passed – may still be sub-1% (and sub-0.5% without structural reforms).

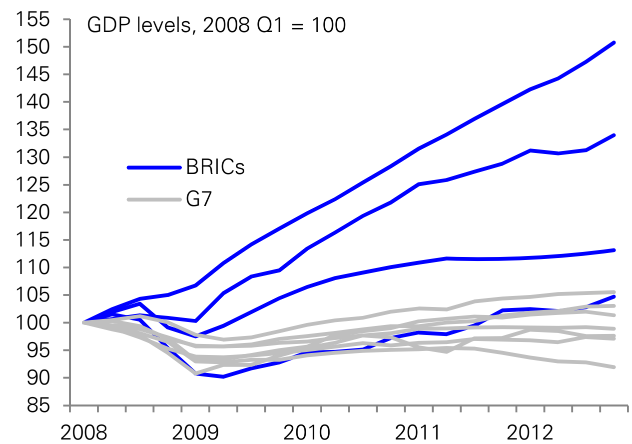
Long-run EM growth generally has been revised down by 0.8pp by the IMF over the past five years, from 7% to 6.2%. Among the BRIC economies, Russia has seen the sharpest fall (5.6% to 3.6%) while China and India have also been revised down substantially (by 1.5pp and 1pp respectively to 8.5% and 7%). Brazil's long-run growth has been left unscathed, even rising modestly from 4% to 4.2%. At the same time G7 growth has been revised down 0.4pp to 2.3%. While the gap may have narrowed, EM is still forecast to grow at two and a half times the rate of G7 economies (the same multiple as five years ago).

Figure 5: IMF EM long-run growth versus five years ago




Source: Deutsche Bank, IMF

Figure 6: EM versus DM GDP since the recession




Source: Deutsche Bank, Haver Analytics

Our final chart, Figure 6 above right, illustrates why the IMF has been so optimistic on EM long-term growth versus DM, despite revising down the former by more than the latter (in percentage point terms). It shows the performance of the G7 versus the BRICs since the start of the Great Recession.

## Focus on the UK

As we discussed briefly above, UK economic growth has been revised down but by less than we think might eventually be required. The IMF still sees growth of 2.5% for the UK in the long-run, down from around 2.75% in its Spring 2008 WEO. On the IMF's forecasts the UK has outperformed in terms of revisions – i.e. it has been lowered by 0.27pp over that period versus a downward revision in global growth of 0.42pp. Among the G7, euro area big 4 and BRIC economies, only the US, Italy and Brazil have outperformed the UK in terms of long-run growth revisions over the past five years.

We remain dubious about how strongly the UK can grow over the long term (the recent productivity puzzle has raised questions about the sustainable rate of economic growth), but this could be supported by the government's plans to reduce the structural deficit – to around zero by the end of the OBR's forecast horizon (2017-18). While Reinhart and Rogoff's research on the impact of public sector debt on economic growth has been questioned this week (see *Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff*, Herndon, Ash & Pollin, April 15 2013), lowering the debt burden and spending share of the state should mean less crowding out of the more efficient private sector. Debt levels will still be high five years from now, but they will be on their way down and as the government reduces the pace of tightening economic growth should eventually improve.

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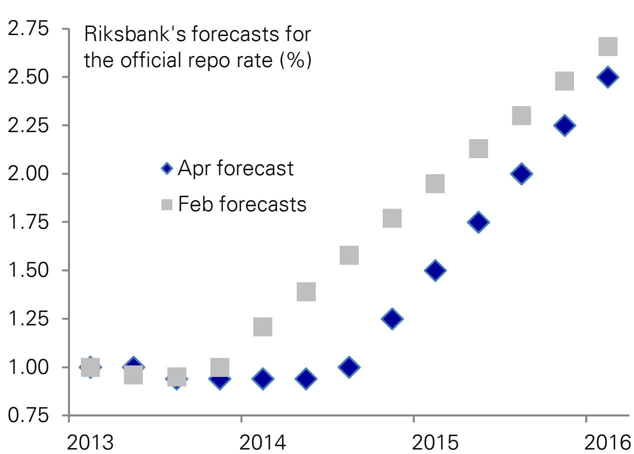
# Sweden: Rate rises put back

- The Riksbank left its key repo rate on hold at its policy meeting this month, but revised down notably the profile of interest rate moves and inflation going forward. As at the February meeting, both Ekholm and Svensson voted for a lower repo rate now (-25bp and -50bp respectively) and a lower profile for rates going forward.
- Following this month's decision and new repo rate profile from the Riksbank, we have changed our view on the first tightening in policy – rather than seeing a rise in early 2014 we have put this back to the middle of next year. Even then, compared to the Riksbank's own forecast for policy rates this would be an early move.

## Forecast revisions: growth and inflation

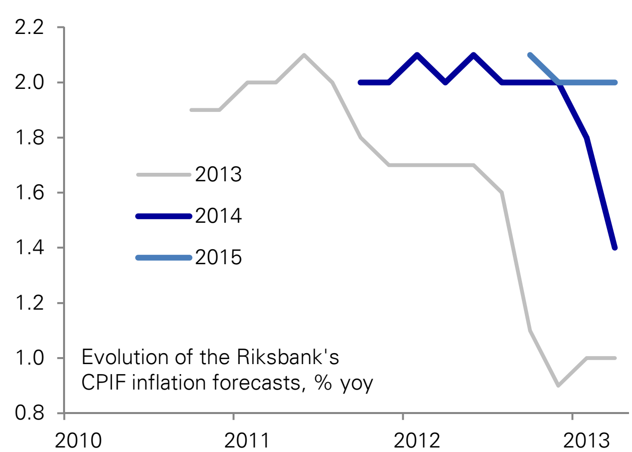
The Riksbank's revisions to its forecasts for both interest rates and inflation come amid a revision up to the GDP profile. Growth is seen at 1.4% this year (similar to our own view of 1.3%), up from the Riksbank's previous forecast published in February of 1.2%. Growth rates in 2014 and 2015 are expected to rise to 2.7% and 3.5% respectively (2015 having been revised up from 3.1%). Part of the reason the Riksbank has revised up its view on economic growth reflects the recent positive string of survey evidence: economic tendency, manufacturing and consumer confidence all up at their highest since the end of last summer, and the key activity indices within the PMI manufacturing survey (i.e. output and orders) back above the 50 mark. As the Riksbank said in its statement, "growth prospects are gradually brightening".

Figure 1: Revisions to Riksbank rate forecast




*Source: Deutsche Bank, Riksbank*

Figure 2: Inflation forecast revised down




*Source: Deutsche Bank, Riksbank*

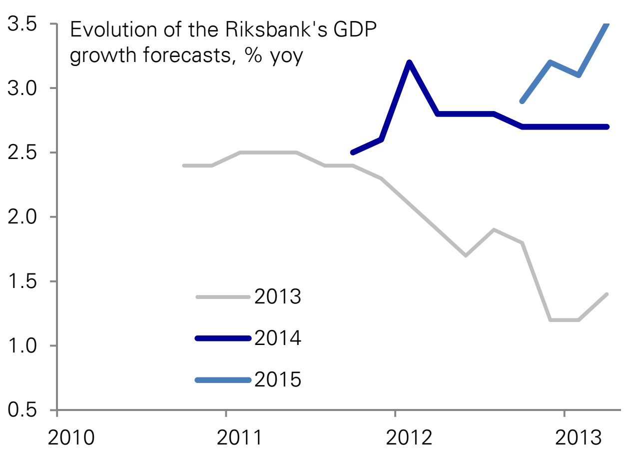
At the same time, inflation is seen as being lower than before. This year's CPIF inflation rate (CPI with a fixed interest rate) is forecast to be 1%, unchanged from the Riksbank's previous forecast, while next year's is down to 1.4% -

notably lower than the 1.8% forecast just two months ago. Headline inflation has been lowered for this year, and is not seen rising back to the 2% target until the very end of next year (it does so partly because of the impact on the mortgage rate of the Riksbank taking back monetary easing), while CPIF is not expected to breach its target at all during the Riksbank's 3Y forecast horizon.

## Outlook for the repo rate

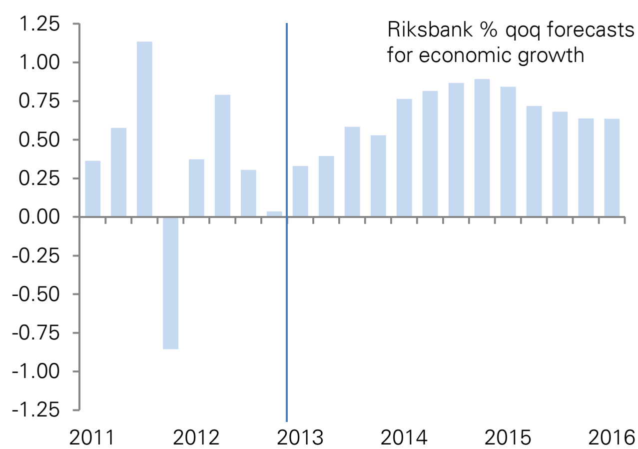
It is for this reason (and the need to support the economy through the recovery, according to the statement) that the Riksbank revised down its forecasts for the repo rate. In its forecasts the repo rate is seen at 0.94% for a full year between Q3 2013 and Q2 2014 – roughly implying a one-in-four chance of rates being cut further during this period. While rates were seen falling to a similar level in the February set of forecasts, they did not remain low for so long. Indeed, the Riksbank's repo rate forecast of 0.94% by Q2 2014 is almost 50bps lower than February's forecast of 1.39%.

Figure 3: Growth "gradually brightening"




Source: Deutsche Bank, Riksbank

Figure 4: Latest Riksbank forecast profile for growth




Source: Deutsche Bank

Clearly, this raises the risks to our existing view of rates being lifted in around a year's time from now. The Riksbank is grappling with the balancing act of, on the one hand, the idea of lowering rates to bring inflation up to its target and reduce unemployment more quickly, but on the other, holding rates at their current level and raising them in the future to limit "the risk of imbalances [notably in housing and household debt] building up".

As a result, while we do not expect the Riksbank to ease policy further, we do think it will take longer than our previous view to tighten policy. As such, we have put our forecast back for the first rise in interest rates to just inside the second half of 2014 (July 2014). Any tightening in policy looks set to be slow – the Riksbank forecasts increases of 25bps per quarter from 2014 Q4 onwards.

# Financial Forecasts

## Euro Area

The changing ECB rhetoric over the last couple of months suggests the risk of a refi rate cut is rising. Our baseline remains no further rate cuts, but we will be watching this week's data closely, in particular the flash PMI data and the Bank Lending Survey. Weaker-than-expected results could tip the balance.

## UK

Despite a change in the Bank's remit (the government underlined its view that the Bank may miss its 2% target in the near term for the greater good of growth or financial stability) the MPC left policy unchanged in April. We do not expect further QE but do not see the first hike in rates until the end of 2014.

## Switzerland

The SNB opted to keep its EUR/CHF floor at 1.20 at its March meeting, but lowered the outlook for inflation. Next meeting: 20 Jun.

## Sweden

After the Riksbank's rate cut in December the risks remain for further action. However, household debt concerns should prevent this. Next meeting: 3 Jul.

## Norway

We have pushed back our view of the first tightening until the early 2014, but Norges Bank is still likely to be one of the first to hike. Next meeting: 8 May.

## Denmark

We expect Danish official rates to be raised gradually in the event of FX outflows going forward.

## Poland

The NBP has cut by 100bps YTD and is now in wait-and-see mode. Recent communication has been poor, but we see this as the end of the easing cycle.

## Hungary

The NBH has cut rates by 200bp with inflation below target and the MPC more focused on growth. Further falls in inflation should allow 150bps more cuts.

## Czech Republic

The CNB has said that rates are to remain at the current low level over a long horizon. Any further monetary policy stimulus is to come via FX intervention.

### Financial Forecasts

| Euro Area | Latest | Jun 13 | Sep 13 | Mar 14 |
|---|---|---|---|---|
| Refi rate | 0.75 | 0.75 | 0.75 | 0.75 |
| 3m Libor | 0.13 | 0.25 | 0.25 | 0.35 |
| 10Y govt bond | 1.27 | 1.65 | 1.75 | 2.00 |
| EUR/USD | 1.31 | 1.26 | 1.23 | 1.20 |
| **UK** | Latest | Jun 13 | Sep 13 | Mar 14 |
| Bank Rate | 0.50 | 0.50 | 0.50 | 0.50 |
| 3m Libor | 0.50 | 0.51 | 0.52 | 0.60 |
| 10Y govt bond | 1.67 | 2.25 | 2.45 | 2.90 |
| GBP/USD | 1.53 | 1.45 | 1.43 | 1.41 |
| EUR/GBP | 0.86 | 0.87 | 0.86 | 0.85 |
| **Switzerland** | Latest | Jun 13 | Sep 13 | Mar 14 |
| 3m Libor Tgt | 0.00 | 0.00 | 0.00 | 0.00 |
| EUR/CHF | 1.22 | 1.25 | 1.25 | 1.25 |
| **Sweden** | Latest | Jun 13 | Sep 13 | Mar 14 |
| Repo rate | 1.00 | 1.00 | 1.00 | 1.25 |
| EUR/SEK | 8.52 | 8.20 | 8.00 | 7.80 |
| **Norway** | Latest | Jun 13 | Sep 13 | Mar 14 |
| Deposit rate | 1.50 | 1.50 | 1.50 | 1.75 |
| EUR/NOK | 7.59 | 7.30 | 7.20 | 7.10 |
| **Denmark** | Latest | Jun 13 | Sep 13 | Mar 14 |
| Lending rate | 0.30 | 0.30 | 0.40 | 0.50 |
| EUR/DKK | 7.46 | 7.46 | 7.46 | 7.46 |
| **Poland** | Latest | Jun 13 | Sep 13 | Mar 14 |
| 2w repo rate | 3.25 | 3.25 | 3.25 | 3.25 |
| EUR/PLN | 4.11 | 4.10 | 3.95 | 3.80 |
| **Hungary** | Latest | Jun 13 | Sep 13 | Mar 14 |
| Base rate | 5.00 | 4.25 | 3.50 | 3.50 |
| EUR/HUF | 298 | 320 | 325 | 330 |
| **Czech Rep.** | Latest | Jun 13 | Sep 13 | Mar 14 |
| Repo rate | 0.05 | 0.05 | 0.05 | 0.05 |
| EUR/CZK | 25.9 | 26.5 | 26.5 | 26.0 |
| **Memo** | | | | |
| **Japan** | Latest | Jun 13 | Sep 13 | Mar 14 |
| O/N Call Rate | 0.10 | 0.10 | 0.10 | 0.10 |
| 3m Tibor | 0.23 | 0.30 | 0.30 | 0.30 |
| 10Y govt bond | 25.9 | 26.5 | 26.5 | 26.0 |
| USD/JPY | 99.3 | 96.0 | 98.0 | 100.0 |
| **US** | Latest | Jun 13 | Sep 13 | Mar 14 |
| Fed Funds Tgt | 0.125 | 0.125 | 0.125 | 0.125 |
| 3m Libor | 0.28 | 0.35 | 0.35 | 0.35 |
| 10Y govt bond | 1.70 | 2.00 | 2.50 | 3.00 |

## Euroland Data Monitor

| | B'berg code | Q2 2012 | Q3 2012 | Q4 2012 | Q1 2013 | Nov 2012 | Dec 2012 | Jan 2013 | Feb 2013 | Mar 2013 | Apr 2013 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Business surveys and output** | | | | | | | | | | | |
| *Aggregate* | | | | | | | | | | | |
| PMI composite | | 46.4 | 46.3 | 46.5 | 47.7 | 46.5 | 47.2 | 48.6 | 47.9 | 46.5 | |
| *Industry* | | | | | | | | | | | |
| EC industrial conf. | EUICEMU | -10.9 | -15.4 | -15.8 | -12.5 | -14.9 | -14.2 | -13.8 | -11.3 | -12.5 | |
| PMI manufacturing | | 45.4 | 45.1 | 45.9 | 47.5 | 46.2 | 46.1 | 47.9 | 47.9 | 46.8 | |
| Headline IP (% pop) | EUITEMUM | -1.9 | 0.2 | -8.0 | -0.5 | -0.6 | 0.7 | -0.6 | 0.4 | | |
| Capacity Utilisation | EUUCEMU | 79.8 | 78.0 | 76.9 | 77.2 | | | | | | |
| *Construction* | | | | | | | | | | | |
| EC construction conf. | EUCOEMU | -27.2 | -29.7 | -33.0 | -29.5 | -34.1 | -33.3 | -28.5 | -29.7 | -30.3 | |
| *Services* | | | | | | | | | | | |
| EC services conf. | EUSCEMU | -3.1 | -9.2 | -9.3 | -6.6 | -9.3 | -8.6 | -7.7 | -5.3 | -6.7 | |
| PMI services | | 46.9 | 47.1 | 46.9 | 47.6 | 46.7 | 47.8 | 48.6 | 47.9 | 46.4 | |
| *National Sentiment* | | | | | | | | | | | |
| Ifo | GRIFPBUS | 107.2 | 102.3 | 101.4 | 106.1 | 101.5 | 102.5 | 104.3 | 107.4 | 106.7 | 106.5 |
| INSEE | INSESYNT | 93.0 | 90.0 | 87.3 | 89.0 | 88.0 | 89.0 | 87.0 | 90.0 | 90.0 | |
| **Consumer demand** | | | | | | | | | | | |
| EC consumer survey | EUCCEMU | -19.5 | -23.8 | -26.2 | -23.7 | -26.7 | -26.3 | -23.9 | -23.6 | -23.5 | |
| Retail sales (% pop) | RSSAEMUM | -3.0 | 0.1 | -6.0 | 1.1 | 0.2 | -0.7 | 0.9 | -0.3 | | |
| New car reg. (sa, % yoy) | | -6.7 | -12.5 | -14.6 | -11.4 | -15.3 | -13.4 | -14.1 | -8.8 | -11.4 | |
| **Foreign sector** | | | | | | | | | | | |
| Foreign orders | EUI3EMU | -24.6 | -27.4 | -27.8 | -26.6 | -29.1 | -27.3 | -29.0 | -24.5 | -26.4 | |
| Exports (sa val. % pop) | | 3.1 | 5.7 | -6.1 | 3.7 | 1.0 | -2.0 | 1.9 | 0.1 | | |
| Imports (sa val. % pop) | | -4.6 | 0.1 | -7.9 | 0.0 | -1.3 | -2.0 | 2.9 | -2.1 | | |
| Net trade (nsa EUR bn) | XTTBEZ | 23.2 | 26.7 | 32.5 | 5.6 | 13.1 | 10.3 | -4.7 | 10.4 | | |
| **Labour market** | | | | | | | | | | | |
| Unemployment rate (%) | UMRTEMU | 11.3 | 11.5 | 11.8 | 12.0 | 11.8 | 11.8 | 12.0 | 12.0 | | |
| Change in unemployment | | 618.0 | 386.7 | 449.3 | 309.2 | 104.0 | 54.0 | 222.0 | 33.0 | | |
| Employment (% yoy) | | -0.7 | -0.6 | -0.7 | | | | | | | |
| **Prices, wages and costs** | | | | | | | | | | | |
| Prices (% yoy) | | | | | | | | | | | |
| Harmonised CPI | ECCPEMUY | 2.5 | 2.5 | 2.3 | 1.9 | 2.2 | 2.2 | 2.0 | 1.8 | 1.7 | 1.4 |
| Core HICP (Eurostat)) | CPEXEMUY | 1.6 | 1.6 | 1.5 | 1.4 | 1.4 | 1.5 | 1.3 | 1.3 | 1.5 | 1.1 |
| Harmonised PPI | PPTXEMU | 2.4 | 2.4 | 2.1 | 0.8 | 2.0 | 1.8 | 1.2 | 0.8 | | |
| Oil Price (USD) | EUCRBRDT | 108.5 | 109.7 | 110.3 | 112.6 | 109.4 | 109.6 | 113.0 | 116.2 | 108.5 | |
| EUR/USD | EUR | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 | |
| *Inflation expectations* | | | | | | | | | | | |
| EC household survey | EUA8EMU | 23.1 | 25.4 | 25.6 | 19.8 | 26.0 | 23.7 | 21.8 | 18.7 | 18.8 | |
| EC industrial survey | EUI5EMU | 2.6 | -0.4 | 1.6 | 0.4 | 0.7 | 2.5 | 2.3 | 0.6 | -1.8 | |
| *Unit labour cost (% yoy)* | | | | | | | | | | | |
| Unit labour cost | | 1.6 | 2.0 | 1.6 | | | | | | | |
| Labour productivity | | 0.3 | -0.1 | -0.2 | | | | | | | |
| Compensation. | | 1.8 | 1.9 | 1.4 | | | | | | | |
| Hourly labour costs (sa) | | 2.3 | 2.2 | 1.9 | | | | | | | |
| **Money (% yoy)** | | | | | | | | | | | |
| M3 | ECMAM3YY | 2.7 | 3.0 | 3.7 | 3.3 | 3.7 | 3.5 | 3.5 | 3.1 | | |
| M3 trend (3m cma) | ECMA3MTH | | | | | 3.7 | 3.6 | 3.3 | | | |
| Credit - private | ECMSCDXE | -0.4 | -1.1 | -1.3 | -1.2 | -1.5 | -0.8 | -1.1 | -1.2 | | |
| Credit - public | ECMSCDGY | 9.0 | 9.0 | 7.8 | 4.1 | 8.3 | 5.8 | 4.5 | 3.6 | | |

*Quarterly data in shaded areas are quarter-to-date. Monthly data in the shaded areas are forecasts.(1) % pop = % change this period over previous period. Quarter on quarter growth rates are annualised.*
*Source: Deutsche Bank forecasts, Eurostat, Ifo, INSEE, Reuters, European Commission, National statistical offices.*

## The Week Ahead: Euro Zone

- In the euro area, there is a host of survey data due this week – German IFO (Wed), French INSEE (Tue), Belgian BNB (Wed) – which will provide a steer on business confidence while French (Fri) & Italian (Tue) consumer confidence will showcase economic sentiment. The key flash PMI's are also due for release this week.
- In terms of hard data, Italian retail sales (Tue) and the Spanish Q1 unemployment rate (Thu) are scheduled for release this week.

## Key Data & Events

| Day | Time (GMT) | Release | DB Forecast | Consensus | Previous |
|---|---|---|---|---|---|
| Mon | 14.00 | Euroland consumer confidence prelim (Apr) | | -24.0 | -23.5 |
| Tue | 06.45 | French INSEE business confidence (Apr) | | | 90.0 |
| | 06.45 | French personal production outlook (Apr) | | | 0.0 |
| | 06.45 | French production outlook indicator (Apr) | | | -42.0 |
| | 06.45 | French recent output trend index (Apr) | | | -17.0 |
| | 06.45 | French quarterly manufacturing survey (Q1) | | | -27.0 |
| | 07.00 | French PMI manufacturing, flash (Apr) | | | 44.0 |
| | 07.00 | French PMI services, flash (Apr) | | | 41.3 |
| | 07.30 | German PMI manufacturing, flash (Apr) | | 49.3 | 49.0 |
| | 07.30 | German PMI services, flash (Apr) | | 51.3 | 50.9 |
| | 08.00 | Italian retail sales (Feb) | | | -0.5% (-3.0%) |
| | 08.00 | Euroland PMI manufacturing, flash (Apr) | | 46.7 | 46.8 |
| | 08.00 | Euroland PMI services, flash (Apr) | | 46.5 | 46.4 |
| | 08.00 | Euroland PMI composite, flash (Apr) | | | 46.5 |
| | 08.00 | Italian consumer confidence (Apr) | | | 85.2 |
| Wed | - | Spanish house price index (Q1) | | | 02.2% (-9.8%) |
| | 07:00 | Spanish mortgages on houses (Feb) | | | (-12.4%) |
| | 07:00 | Spanish mortgages – capital loaned (Feb) | | | (-20.0%) |
| | 07.00 | Spanish PPI (Mar) | | | 0.2% (2.1%) |
| | 08.00 | German IFO - business climate (Apr) | 106.5 | 106.5 | 106.7 |
| | 08.00 | German IFO - current assessment (Apr) | | 109.5 | 109.9 |
| | 08.00 | German IFO - expectations (Apr) | | 103.4 | 103.6 |
| | 13.00 | Belgian BNB business confidence (Apr) | | | -15.0 |
| Thu | 07.00 | Spanish unemployment rate (Q1) | | | 26.0% |
| Fri | 06.45 | French consumer confidence (Apr) | | | 84.0 |
| | 08.00 | Euroland M3 (Mar) | | (3.2%) | (3.1%) |
| | 08.00 | Euroland M3 3mmca (Mar) | | | (3.3%) |

***dbCalendar:*** *For more forward-looking calendars of data and events, as well as various tools to analyse data surprises, go to our new online calendar: http://gm-secure.db.com/dbCalendar*

### Mon, 22
EU's Barroso to speak in Brussels – 07.30 GMT
ECB's Coeure to speak in Vienna – 11.00 GMT
EU's Rompuy to speak in Brussels – 14.30 GMT
ECB's Noyer to speak in New York – 17.00 GMT

### Wed, 24
ECB's Mersch to speak in Germany – 12.30 GMT
ECB's Constancio to speak in Brussels – 13.00 GMT

### Thu, 25
EU's Rehn to speak in Brussels – 07.30 GMT
ECB's Asmussen to speak in London – 07.55 GMT
ECB's Constancio speak in Brussels – 12.00 GMT
ECB's Coeure to speak in Brussels – 12.30 GMT

### Fri, 26
ECB's Asmussen to speak in Frankfurt – 07.15 GMT

*Source: Various National Statistical Offices, Bloomberg Finance LP, Reuters, S&P MMS, DB Global Markets Research. Growth rates in parentheses are year-on-year, while those without parentheses are this period over last period. * signifies provisional release day (or time if asterisk beside time)*

## The Week Ahead: Rest of Europe & the USA1

- In the US, all eyes will be on the advance estimate of Q1 real GDP data. As for the surveys, consumer confidence and consumer sentiment will provide some insight into the outlook for consumer spending going forward. Elsewhere, durable goods and a host of housing market data are due for release this week.
- In the UK, focus will be on Q1 GDP preliminary estimate as the economy stands on the verge of a possible 'triple dip' – we expect a flat reading. In addition public sector borrowing data is also due for the final month of 2012-13.

## Key Data & Events

| Day | Time (GMT) | Release | DB Forecast | Consensus | Previous |
|---|---|---|---|---|---|
| Mon | 07.00 | Danish consumer confidence (Apr) | | | -2.1 |
| | 07.00 | Danish retail sales (Mar) | | | 0.3% (-4.0%) |
| | 14.00 | US existing home sales (Mar) | 5.0m | 5.0m | 5.0m |
| Tue | 06.00 | Swiss trade balance (Mar) | | | CHF2.1bn |
| | 07.30 | Swedish unemployment rate (Mar) | | | 8.5% |
| | 08.00 | Polish retail sales (Mar) | | 17.0% (0.4%) | -2.6% (-0.8%) |
| | 08.00 | Polish unemployment rate (Mar) | | 14.4% | 14.4% |
| | 08.30 | UK PSNB (Mar) | | | GBP4.4bn |
| | 08.30 | UK PSNCR (Mar) | GBP22.0bn | | -GBP1.5bn |
| | 10.00 | UK CBI industrial trends survey (Apr) | | | 17.0 |
| | 13.00 | US house price index (Feb) | | 0.7% | 0.6% |
| | 14.00 | US new home sales (Mar) | 400.0k | 419.0k (1.9%) | 411.0k (-4.6%) |
| | 14.00 | US Richmond fed (Apr) | | | 3.0 |
| Wed | 10.00 | UK CBI distributive trades survey (Apr) | | | 0.0 |
| | 12.30 | US durable goods (Mar) | 0.0% | -2.9% | 5.7% (3.8%) |
| | 12.30 | US durable goods ex transport (Mar) | 1.0% | 0.7% | -0.5% (1.4%) |
| Thu | 07.30 | Swedish PPI (Mar) | | | -0.40% (-3.70%) |
| | 08.30 | UK GDP flash estimate (Q1) | 0.0% (0.2%) | 0.1% (0.3%) | -0.3% (0.2%) |
| | 12.30 | US Initial jobless claims (Apr - 20) | | 351.0k | 352.0k |
| Fri | 07.00 | Swiss KOF economic barometer (Apr) | | 1.1 | 1.0 |
| | 07.00 | Hungarian unemployment rate (Mar) | | 11.7% | 11.6% |
| | 07.15 | Swedish consumer confidence (Apr) | | | 2.8 |
| | 07.15 | Swedish economic tendency indicator (Apr) | | | 95.4 |
| | 07.30 | Swedish trade balance (Mar) | | | SEK7.1bn |
| | 12.30 | US GDP deflator adv (Q1) | 1.6% | 1.4% | 1.0% (1.8%) |
| | 12.30 | US GDP adv (Q1) | 3.0% | 3.0% | 0.4% (1.7%) |
| | 13.55 | US consumer sentiment (Apr) | 75.0 | 73.5 | 78.6 |

***dbCalendar:*** *For more forward-looking calendars of data and events, as well as various tools to analyse data surprises, go to our new online calendar: http://gm-secure.db.com/dbCalendar*

### Mon, 22
Fed's Dudley & EU's Rehn to speak in New York
BoE's Tucker to speak in New York – 18.30 GMT

### Tue, 23
National Bank of Hungary to announce interest rate decision – 1200 GMT

### Thu, 25
National Bank of Poland to publish minutes of its April rate setting meeting

### Fri, 26
SNB's Jordan to speak in Berne – 08.00 GMT

*The list of data and events for the US is not comprehensive. Please see the web-based week ahead for a more complete list*

*Source: National Statistical Offices, Bloomberg Finance LP, Reuters, S&P MMS, DB Global Markets Research*

*The list of data and events for the US is not comprehensive. Please see the web-based week ahead for a more complete list*

# Appendix 1

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