

ANDBANK RESEARCH

Global Economics &
Markets

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That's how you have
to really look at the
Eurozone!!

(At the end
of the day,
nothing
bad)



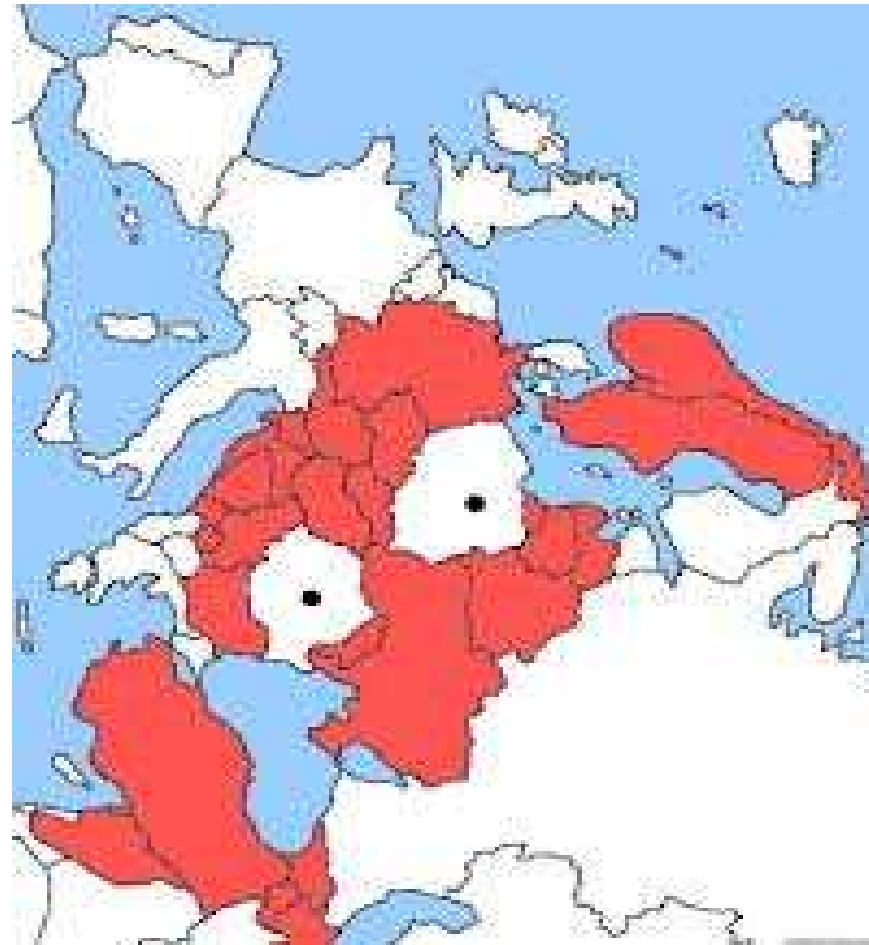
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Eurozone – Everything you need to know

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Private Bankers

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Although many, in a clear exercise of temporal myopia, insist in looking at the Eurozone from this perspective...



Eurozone & the Euro

The data do not point to the drama. Other factors behind the Euro's fall

□ Eurozone PMI's ease but are still in expansionary territory.

- ✓ Eurozone Sep final Composite PMI at 52.0 vs prior 52.5. September Services PMI at 52.4 vs prior 53.1.
- ✓ The biggest expansion was noted in Ireland and Spain (60.0 and 55.3, respectively), but both countries saw activity easing to three month lows.
- ✓ Germany surprised on the upside, with the composite number at two-month highs of 54.1.
- ✓ Italy continued to struggle, with the composite PMI registering 10-month lows of 49.5 after services PMI weakened.
- ✓ In France, the composite number came in at three-month lows of 48.4 after services PMI continued its downtrend.

□ EUR

- ✓ Behind the recent decline in the Euro are the negative interest rates, that are forcing some central banks to rethink how much of their foreign reserves must be hold in Euros.
- ✓ Central banks cut their Euro holdings in Q2, with estimated sales worth around \$40 bn.
- ✓ This could indicate that negative rates are becoming a factor that could influence the rebalancing of reserves. The 2-year interest rate in the German government bonds stands at -0.06% and the 5-year stands at 0.08%.

The ECB

We have now discovered who is really the boss... and what can't be done

- ❑ ECB's plan to buy ABS draws sharp criticism from Germany. One factor that will continue to limit the ECB's movements:
 - ✓ Weidman on Oct, 3:
 - *"There is a danger that the ECB would buy low-quality loan securitization, at inflated prices"*.
 - *"The credit risks taken by private banks would be transferred to the central bank and therefore taxpayers without getting anything in return"*.
 - *"ECB policy risks being held hostage by politics"*
 - *"The ECB's mandate is narrower than buying government bonds, preventing the ECB from government financing"*.
 - *"With government and borrowing costs already super low, such a policy would have limited effect"*.
 - ✓ Former ECB board member Stark, also made some warnings:
 - *"the ECB is giving into financial market expectations and political pressure from France and Italy rather than showing leadership"*.
 - Stark also pointed to the *"incalculable risks with this ABS program"*.
- ❑ ECB's balance sheet declines from Draghi's call for increase its size.
 - ✓ The ECB's balance sheet stays at €2.05T in the week of October, 3. Down €10B from the last week of September, when president Draghi said he could lift the size from levels in early 2012 (when it was above €3T).
 - ✓ The size has increased in the 3Q14 by €25.6B (at this pace, it will take 10 years to reach the €3T). This simply will not happen, if not accompanied by a clear upturn in the economy before.

Germany

**The credo remains intact. In my view, a healthy principle.
Recall that from healthy principles we can only get healthy things.**

❑ Germany holds firm on fiscal rigor and is not alone in its stance:

- ✓ Germany is unlikely to deviate from fiscal rigor despite reports that it is considering possible growth-friendly measures.
- ✓ Estonia is a tenacious advocate of budgetary discipline, while Germany's insistence on fiscal discipline wins applause across the Nordic area and central and eastern, Europe.
- ✓ German MPs from the coalition government discussed economic issues early in the month, but there was no attempt to question the government pledge to cut the fiscal deficit to zero next year.
- ✓ Germany's position is guided by German Finance Minister Schaeuble's maxim that *"growth and jobs are not generated by rising deficits"*.

❑ Germany considers original remedies for sluggish growth:

- ✓ Signs of economic stagnation is prompting debate within Berlin about how it can support growth without diluting fiscal policy.
- ✓ German officials are discussing (1) business-friendly policy measures and (2) a limited boost to public spending to help investments and consumption.
- ✓ Some of the ideas on the table include (1) Using proceeds for next year's auctions of mobile-phone frequencies to subsidize investment in a new internet network and (2) using legal incentives to encourage German companies to invest more. The Economics Ministry said that in no way these measures represent a stimulus program.

France

Ironies of life. Ready to take the punishment from a Frenchman

- ❑ French Commissioner Moscovici, ready to fine France if necessary:
 - ✓ EU commissioner-designate for economic policy, said that he was ready to step up disciplinary action against Paris for not respecting EU budget rules.
 - ✓ The comments were made to the European Parliament's economic and monetary affairs committee that must approve him for the job.
 - ✓ Recall there has been criticism of Moscovici's appointment because some of France's problems came when he held the French finance minister role until six months ago.

- ❑ France - EU likely to reject France's 2015 budget:
 - ✓ Several Eurozone officials said that the European Commission is likely to reject France's 2015 budget draft at the end of October and ask for a new one.
 - ✓ It would be the first time the EU executive exercises its power to demand changes to a budget draft under new prerogatives that EU countries granted the Commission in 2013.
 - ✓ The Commission is likely to step up the disciplinary procedure against France before fines while at the same time granting it the extra two years to bring down its budget within EU limits.

Italy

Finally, interesting shifts. Slow but, after all, structural reforms.

□ Italy - Renzi wins backing on labor market reforms

- ✓ Renzi prepared confidence vote on labor reform and he has won backing. He planned to introduce changes on the sensitive question of the Labor Statute (article 18), which protects permanent workers guaranteeing they can have their jobs back if they are unfairly sacked.
- ✓ Renzi won his confidence vote on labor market reform by a margin of 165 to 111 after following hours of drama in Italy's upper house.
- ✓ Renzi's political battle is far from over, because the reform plans still need to get through the lower house. Then, the government must rewrite and implement the new legislation, so it is unlikely to be finalized before the middle of 2015.
- ✓ An awkward question because Renzi is pressed to prove he is making headway on reforms, but there is doubt he will be able to deliver changes quickly enough to stave off further economic pain.
- ✓ We are optimistic as we begin to see interesting changes. Slow but, after all, long overdue structural reforms and much needed.

□ Italy - PM Renzi vows Italy will abide by EU deficit rules:

- ✓ Renzi reiterated Italy's commitment to abiding by the EU's 3% debt-to-GDP rule.
- ✓ Renzi has been pushing for more flexibility in the way the EU enforces budget rules.
- ✓ He said it will not follow France's lead, but respected its right to take such a step to bolster economic prospects.

Peripherals

Overall, in the right direction.

- ❑ Ireland - Irish central bank significantly upgrades growth outlook.
 - ✓ The Irish central bank raised the 2014 GDP growth forecast to 4.5% vs 2.5% previously forecast.
- ❑ Ireland – Berlin backed Ireland’s request to restructure the Irish EU/IMF loan package.
 - ✓ The Irish government is expected to issue its first 15-year bond later this year to take advantage of cheap borrowing rates to raise the cash to pay off the IMF loan.
 - ✓ Berlin’s positive vote backing this new scheme was a significant step in Ireland’s bid to repay €18B of its €22.5B loan from the IMF, which would be refinanced on financial markets by lower interest rates.
 - ✓ The scheme will save Ireland an estimated €2.1B in interest payments based on borrowing costs of 1.88% for 10-year bonds compared to the 5% that the IMF is charging for shorter term loans.
- ❑ Greece - Crucial week for government with draft budget & vote of confidence
 - ✓ The coalition government presents the draft budget for 2015, predicting a primary surplus for 2015 very close to the 3% target demanded by the troika without new austerity measures.
 - ✓ In fact, the draft 2015 budget aims to cut taxes and ease austerity measures in an effort to boost flagging popularity amid speculation that it may face snap elections next year.
 - ✓ It said that despite the tax cut the government has indicated it will only post a minor budget deficit - equivalent to just 0.2% of GDP next year.
 - ✓ Athens fail to reach a deal with the troika over the latest review of the bailout program. The Troika is leaving Athens after the first round of talks and will return after the ECB’s results of the stress tests

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