Bloomberg BRIEF

Economics Europe

NEWS ANALYSIS & COMMENTARY

TUESDAY
04.16.13
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ECONOMIC CALENDAR
(LONDON TIME)

COUNTRY	TIME	EVENT	SURVEY	PRIOR
IT	09:00	Trade Bal. (Euro) Feb.	--	-1619M
IT	09:00	Trade Balance EU Feb.	--	663M
NO	09:00	Existing Homes 1Q	--	-0.70%
UK	09:30	ONS Home Price (YoY) Feb.	2.40%	2.20%
UK	09:30	CPI (MoM) March	0.30%	0.70%
UK	09:30	CPI (YoY) March	2.80%	2.80%
UK	09:30	Core CPI (YOY) March	2.30%	2.30%
UK	09:30	RPI (MoM) March	0.40%	0.70%
UK	09:30	RPI (YoY) March	3.30%	3.20%
EC	10:00	CPI (MoM) March	1.20%	0.40%
EC	10:00	CPI (YoY) March	1.70%	1.70%
EC	10:00	CPI - Core (YoY) March	1.40%	1.30%
GE	10:00	ZEW (Current Sit.) April	14	13.6
GE	10:00	ZEW (Eco. Sentiment) April	41	48.5
US	13:30	CPI (MoM) March	0.00%	0.70%
US	13:30	CPI Ex Food (MoM) March	0.20%	0.20%
US	13:30	CPI (YoY) March	1.60%	2.00%
US	13:30	CPI Ex Food (YoY) March	2.00%	2.00%
US	13:30	Housing Starts March	930K	917K
US	13:30	Housing Starts (MOM) March	1.40%	0.80%
US	13:30	Building Permits March	943K	946K
US	13:30	Build. Permits (MOM) March	0.40%	4.60%
US	14:15	Ind. Prod. March	0.20%	0.70%
US	14:15	Cap. Utilization March	78.40%	79.60%

Slovenia Plea, ZEW, Draghi, Korea Move, Gold

EUROPE TODAY:
Chris Kirkham

■ **NEWS: Slovenian Premier Alenka Bratusek** asked for more time to repair public finances**. Russia** plans to discuss ideas at the G-20 for an early-warning mechanism to prevent Cyprus-like crises. **South Korea** unveiled a $15.4 billion supplementary budget to revive the economy.

■ **WHAT TO WATCH: German ZEW** investor confidence may have declined for the first time in five months. 10 a.m. **ECB's Draghi** briefs European parliament on the euro crisis. 2 p.m. **German** budget committee votes on Cyprus bailout. 10 a.m.

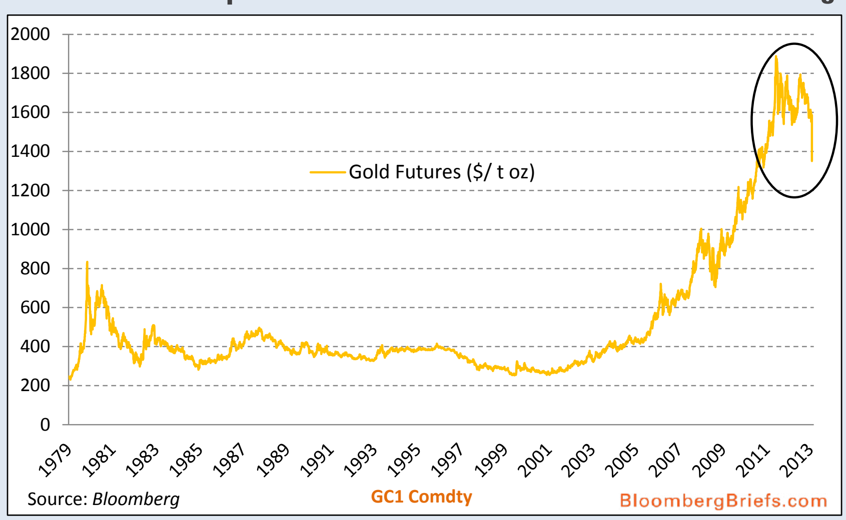
■ **ECONOMICS: U.K. inflation** was unchanged at 2.8 percent in March, economists say. 9.30 a.m. **Data: Italy** Feb. trade. 9 a.m. **Norway** 1Q existing homes. 9 a.m. **Euro-area** March CPI. 10 a.m. **Sales: Spain** to sell bills. 9.30 a.m. **Greece** to sell bills. **Central banks: SNB's Danthine** speaks in Geneva. 5.30 p.m. **BOE's King** speaks in Washington. 8 p.m. **BOE's Haldane** speaks in Washington. 10 p.m.

■ **GOVERNMENT: Romano Prodi,** a two-time Italian prime minister, will discover today whether he has a chance of becoming the next president.

■ **COMPANIES: A panel** led by U.S. CFTC chairman and U.K. Financial Conduct Authority CEO may issue a report today on how rates should be set.

■ **MARKETS: Gold** swung between gains and losses after the biggest bear market decline since 1983. **Options traders' bets** on yen volatility were set for the biggest two-day gain since March. *(All times are local for London.)*

Gold Price Slumps After China GDP Data as Bull Market Ending



The price of gold fell at the fastest pace since 1980 yesterday, raising investor concerns that the precious metal's decade-long bull run may be coming to an end. The spot price plunged more than $100 an ounce in a few hours yesterday after China's economic growth unexpectedly slowed in the first quarter and investors bet hedges against inflation were unneeded. — *Niraj Shah, Bloomberg Economist*

CRISIS WATCH

COMMENTARY BY DAVID POWELL, BLOOMBERG ECONOMIST

Malta's Banking Bill of Health Seems Clean Though Clarity on Liabilities May Be Required

The European Commission provided advance warning of the implosion of the Cypriot banking industry. That proved to be a reliable early indicator. The institution has given the Maltese banking industry a clean bill of health. That also appears to be an accurate assessment.

Depositors in Cypriot banks had warning of the potential for imminent disaster. Nearly one year ago, the authors of the EC study wrote: "The situation in the Cypriot banking sector also threatens the sustainability of the country's position… Any shock to the banking sector could thus have catastrophic consequences to the economy by compounding the challenges arising from Cyprus' internal imbalances." (For details, see: Commission Staff Working Document: In-Depth Review for Cyprus. European Commission, May 30, 2012.) *{http://ec.europa.eu/europe2020/pdf/nd/idr2012_cyprus_en.pdf}*

The institution is more upbeat on the banking industry of Malta than it was on that of Cyprus. Its staff recently wrote: "The majority of the very large financial sector is internationally-oriented with very little link to the domestic economy, and therefore does not pose large risks for domestic stability." (For details, see: Commission Staff Working Document: In-Depth Review for Malta. European Commission, April 10, 2013.) *{http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/ocp139_en.pdf}*

Bloomberg Brief recently drew a similar conclusion. Data on the size of the Maltese banking system is distorted by the presence of foreign banks. Luxembourg faces a similar situation to that of Malta. (See: Bloomberg Brief: Economics Europe, April 4, 2013).

The banks of Cyprus became too large for the state to honor its deposit guarantee without external assistance. The growth of the Maltese banking system, using the deposit-to-GDP ratio as a metric, would have to continue to expand at the same pace as it did between 2005 and 2012 for almost 20 years to reach the size of the Cypriot banking system.

The Malta Financial Services Authority has already taken steps to limit an endless increase in the potential liabilities of the government. "One of the objectives of the MFSA is to limit the related systemic risk involved in newly proposed set-ups," according to a press statement issued by the regulator on May 16, 2012. "The MFSA may therefore require applicants for a credit institution licence to seek modes of acceptable funding which are not covered by the Deposit Compensation Scheme (DCS)."

The best metric to assess the potential liabilities of the state linked to the banking system may be the ratio of deposits to GDP. That figure stands at 259 percent for Cyprus and 173 percent for Malta. The number divides the size of the deposit base, excluding the holdings of monetary financial institutions and central government, in February, the latest reporting period, by nominal gross domestic product of 2012. This measure of the deposit base is used because, according to the EU webpage, guarantee schemes in Europe exclude the holdings of financial institutions and public authorities.

The measure has some problems. The ECB's webpage indicates its monetary aggregates "include only positions of residents in the euro area which are held with MFIs located in the euro area."

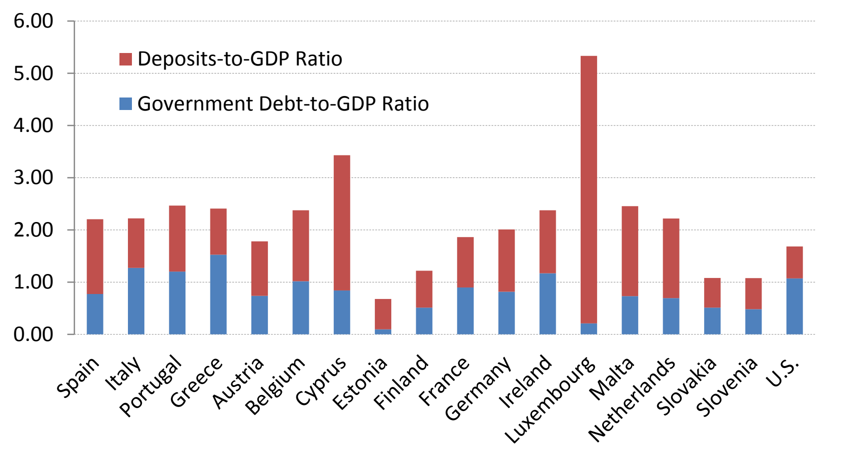
It fails to capture deposits from non-residents of the euro area. In the case of Malta, deposits from euro-area residents total about 19.5 billion euros and those from non-euro-area residents total about 22.1 billion euros.

Foreign deposits are likely to create fewer potential liabilities for the state than those of euro-area residents in the event of a crisis. For example, 1 billion euros in deposits from non-euro-area residents is likely to consist of fewer accounts with larger balances than 1 billion euros in deposits from euro-area residents. Malta is unlikely to be the deposit destination of choice for savers from around the world with balances of less than 100,000 euros. A breakdown of the non-resident deposits into the categories of monetary financial institutions, non-financial corporations, households, etc. is unavailable.

In addition, deposits from non-euro-area residents are more likely to be held by foreign banks than those of euro-area residents. In the event of a crisis, European policy makers would be unlikely to force the taxpayers of Malta to guarantee the deposits of foreigners in foreign banks.

Comparisons between Cyprus and Malta continue to appear misplaced, though detail on the composition of foreign deposits in the latter would provide clarity on the potential liabilities of the state.

Banking System of Cyprus Larger Than That of Malta



Source: *Bloomberg*

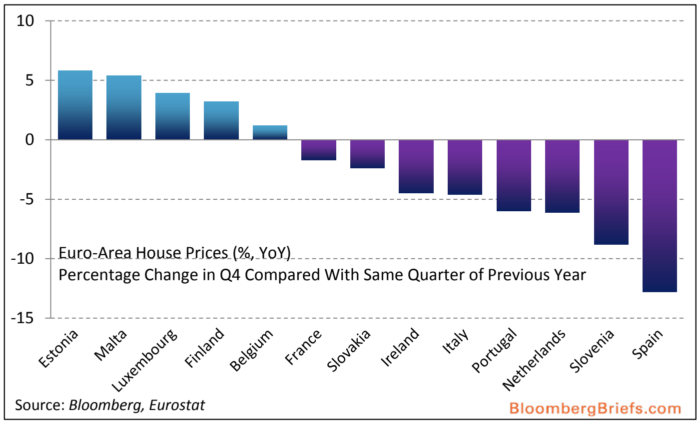
CRISIS MONITOR

NIRAJ SHAH, BLOOMBERG ECONOMIST

Falling house prices in the euro area may impede the economic recovery. Home values dropped 1.8 percent year over year in the fourth quarter, with property prices in France, Italy and Spain sliding the most. The declines may curtail consumption as household wealth declines and stymies lending. The IMF may revise down its euro-area growth forecasts today, having previously forecast a contraction of 0.2 percent this year and growth of 1 percent next year.

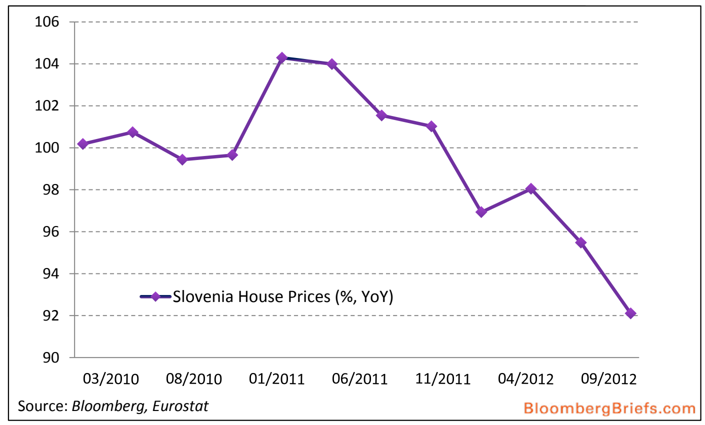
Euro Area

CLICK HERE FOR DETAILS <<



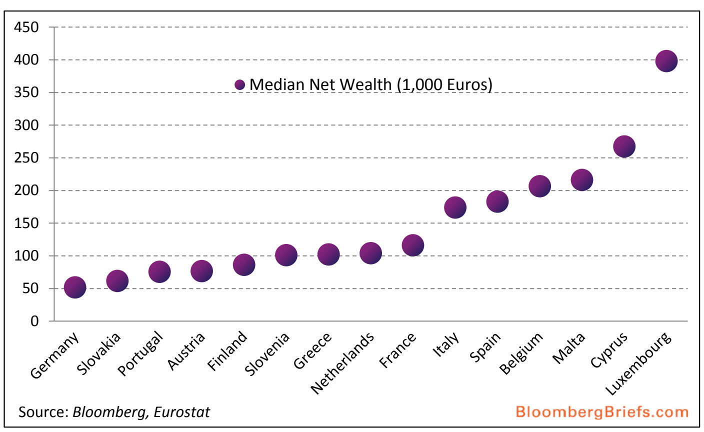
House prices fell on an annual basis in eight of the 13 countries that provided data for the fourth quarter. Price changes varied by 18.6 percentage points between the best and worst performing countries in the region. Values slumped 12.8 percent in Spain as a result of fiscal austerity and an overhang of newly built properties. Estonia and Malta were among five nations where prices rose on the year by 5.8 percent and 5.4 percent, respectively.

Slovenia



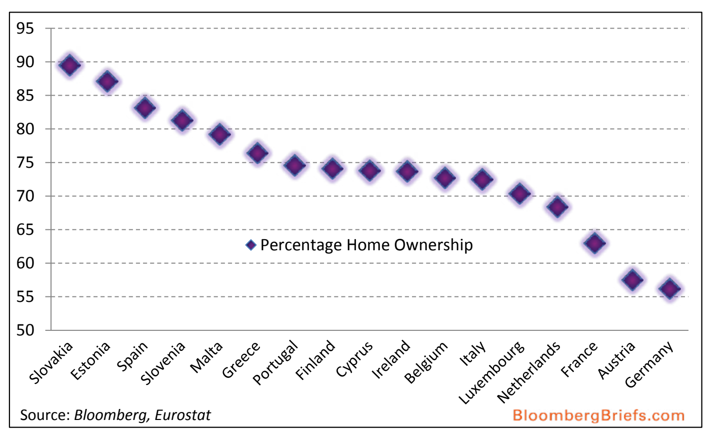
Slovenian home prices fell 8.8 percent last year, the second-largest decline in the region. A slumping property market may exacerbate the banking industry's woes by undermining the value of the collateral against which mortgage loans were made. The European Commission estimates almost a quarter of corporate loans are non-performing.

Germany



While Eurostat provided no fourth-quarter data for Cyprus, Germany or Greece, prices in Germany may have increased last year. Property consultancy BulwienGesa, used by the Bundesbank, says apartment prices rose 5.9 percent in 2012. The divergence between Germany and other nations may narrow some of the differentials in wealth revealed by an ECB study that showed Germany was the poorest of the three nations in terms of household wealth.

Ownership



Slovenia has a homeownership rate of 81.3 percent compared with 56.2 percent in Germany. About 28 percent of households own their homes with a mortgage in the euro area, while 43 percent own their residences outright. An additional 18 percent rent in the private sector while social housing accounts for the remaining 11.4 percent.

CHINA WATCH

GUEST COMMENTARY BY JIANGUANG SHEN OF MIZUHO SECURITIES

Stabilizing Growth Remains Priority for Chinese Government Officials

China's economic growth weakened to 7.7 percent last quarter, lagging behind economists' forecasts, from 7.9 percent in the fourth quarter. The slowdown suggests the recovery since late last year has lacked broad-based support. Government infrastructure spending, the key pillar of the economy, has not so far been strong enough to push for more upbeat growth.

Contributions from investment eased to 2.3 percentage points in the quarter from 3.9 points in the prior period, as the government failed to compensate for a slowdown in domestic investment, under pressure from excess capacity. Capacity utilization ratios were low in sectors such as solar and wind power, shipbuilding, steel and cement. The bankruptcy of Suntech in March is an example of the challenge that lies ahead for manufacturing.

Consumption contributed 4.3 percentage points to headline GDP growth in the quarter, versus 4.1 points in the previous period, confirming household consumption has been resilient following rising wages in recent years. Even so, luxury consumption and services have been dampened by the government's anti-corruption and frugality drive.

Net exports contributed 1.1 percentage points to growth. However, we believe exporters over-reported in the period to gain tax rebates and evade capital controls. After adjusting for this, GDP growth may have been even weaker than 7.7 percent.

We anticipate more aggressive fiscal spending on infrastructure. Indeed, the government spending spree has accelerated since the national congress in March when key appointments were announced.

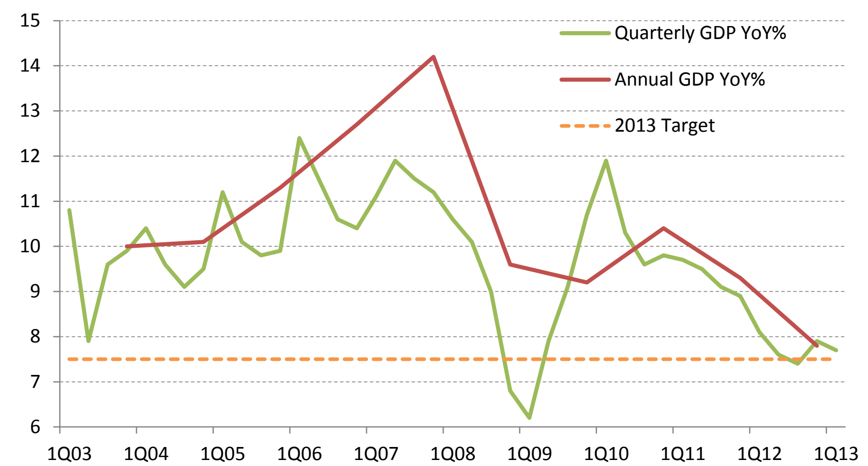
Inflation does not appear to be as big a threat as feared by the PBOC, so the need for tightening should be reduced. Still, as money supply growth, at 15.7 percent in March, is already significantly above the government target of 13 percent, as total social financing is undergoing restructuring and as house prices are rising, it is likely monetary policy will be constrained. Lacking more substantial support from the private sector and external demand, we forecast growth will moderate to 7.6 percent this quarter, leading to a 7.7 percent expansion for 2013.

Overall, the data indicate the priority for policy makers is still stabilizing growth, though this has become a challenge. First, growth continues to weaken even with rapid credit growth. Second, inflationary pressure remains subdued while property prices are hard to curb. Third, investment remains strong as the government pushes forward structural reforms.

In addition, the surging capital flow across the border, discrepancy between official export figures and actual external conditions and excess capacity are reasons for concern. These contradictions suggest favorable fiscal policy is only a short-term solution for China's economic problems. The nation requires more profound structural reforms to get back on a sustainable path of development.

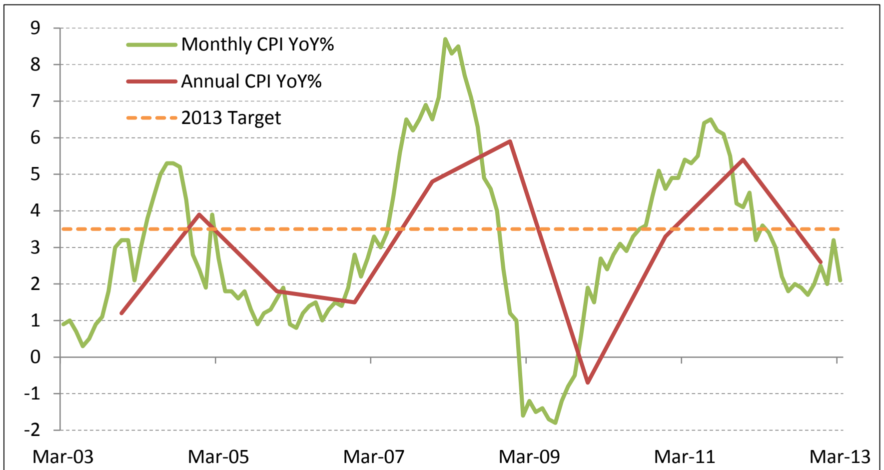
Jianguang Shen is an economist for Mizuho Securities Asia in Hong Kong.

GDP Growth Slowed in First Quarter



Source: *Bloomberg*
CNGDPYOY Index, GDPNTTLY Index BloombergBriefs.com

Slower CPI Reduces Need for Monetary Tightening



Source: *Bloomberg*
CNCPIYOY Index, CNCPI1 Index BloombergBriefs.com

TWEETS OF THE DAY

For simple solutions to follow tweets about companies, industries and markets on the Bloomberg terminal run ***TWTR<GO>***

Andrew Sentance @asentance
UK rebalancing? Little evidence from balance of payments. 2012 deficit = 3.7% of GDP. Only 74 & 88/89 was higher!
pic.twitter.com/c9swi6n8pw

Axel Merk @AxelMerk 15h
#ECB's Draghi, in resisting #QEn, said two weeks ago all this money printing by other central banks isn't working. #gold appears to agree

Gavyn Davies @gavyndavies
Like reports of Mark Twain's death, the death of inflation targeting has been greatly exaggerated - on.ft.com/Zh9GGx

Yiannis Mouzakis @YiannisMouzakis
#Greece passes troika's review, gets €2.8B tranche. Next one of €6B covers maturities of €5.6B of ECB/NCBs held bonds
pic.twitter.com/4AMfwZuKUs

Megan Greene @economistmeg
If Dijsselbloem were German, he'd have been forced to resign over this. They take falsifying academics v seriously! bit.ly/Ypj9s9
Expand

Peter Brandt @PeterLBrandt
Big hint on historical oversold condition in metals. Markets stay grossly oversold short time, markets can be overbought forever.
Retweeted by Axel Merk

TOP STORIES

BLOOMBERG NEWS {TOPE <GO>}

Ireland Packs $38 Billion Parachute to Exit Bailout

Ireland is racing to exit its rescue program by the end of this year armed with 29 billion euros to insulate the country against a renewed flare up in the European debt crisis.

The National Treasury Management Agency said last week the country has that cash ready after selling bonds this year. The money is enough for Ireland to pay its way for at least a year after leaving the safety of the bailout it has relied on for the past 2 ½ years.

"There's this idea that we are heading toward a dark cliff edge without a parachute," said Eoin Fahy, an economist at Kleinwort Benson Investors. "That's really not the case at all given we have so much cash in hand."

— By Dara Doyle

Barclays to RBS See Long-Term Inflation Bets Rising

U.K. inflation that economists say exceeded the Bank of England's target for the 40th month in a row in March has Barclays to Morgan Stanley predicting bond investors will extend their protection against rising prices.

The 30-year break-even rate, a gauge of inflation expectations, is increasing relative to its 10-year counterpart, rebounding after the gap between the two shrank to parity this month for the first time since 2008. Gilts analysts say demand for the longer maturities will pick up after the 10-year rate rose to the most in 4 1/2 years last week. U.K. index-linked gilts returned 9.1 percent this year, the best-performing inflation-protected securities in the G-7 nations.

Inflation bets have climbed since BOE Governor Mervyn King said consumer-price increases are likely to stay above the 2 percent target until 2016.

— By David Goodman

Slovenia Needs More Time to Repair Public Finances

Slovenian Prime Minister Alenka Bratusek said the government needs more time to repair public finances as an asset-sale plan failed to quell concern that the euro-area nation will be next to seek a rescue.

Bratusek called fiscal-consolidation plans of the previous government "ridiculous" and said assumptions in this year's budget were too optimistic. Slovenia's default risk rose to a six-month high before a debt sale tomorrow and bond yields hovered close to records even after the premier announced plans to sell shares in state-owned companies.

"The situation in the budget is more serious than I thought" when in opposition, Bratusek said last night. "The situation is not good, but we will take measures to improve it."

— By Scott Rose and Boris Cerni

Putin Calls for Stimulus Plan as Minister Sounds Alarm

Russian President Vladimir Putin urged the government to come up with a plan to revive the flagging economy after a minister warned that a recession is possible as companies cut investment and export demand wanes.

Putin told Prime Minister Dmitry Medvedev to devise steps to aid "shoots" of growth. While not the main scenario, Russia risks sliding into a recession without stimulus, Economy Minister Andrei Belousov said last week after cutting his growth forecast.

The economy is growing at the weakest pace since 2009 as Europe's debt crisis curbs exports and the government scales back spending. GDP will rise 2.4 percent this year, says the Economy Ministry. The slowdown is hurting incomes, Putin told Medvedev.

— By Agnes Lovasz

GLOBAL FOCUS

Asia

■ **South Korea** unveiled a 17.3 trillion won ($15.4 billion) supplementary budget to support exporters and revive the economy. The package will boost growth by 0.3 percentage point and create 40,000 jobs.

■ **The Reserve Bank of Australia** reiterated that the inflation outlook gives it room to reduce borrowing costs to a record even as earlier cuts boost demand.

■ **Sri Lanka** left interest rates unchanged for a fourth month to support economic growth and contain inflation. The central bank kept its reverse repurchase rate at 9.5 percent and the repurchase rate at 7.5 percent.

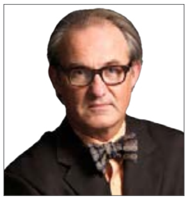
■ **China,** the largest foreign lender to the U.S. government, boosted its holdings of Treasuries in February to the most in 15 months, while No. 2 Japan sold the debt for a fourth month.

U.S.

■ **A gauge** of traders' inflation expectations dropped to this year's low before a report forecast to show consumer prices stagnated.

■ **The Fed** could pay more than $77 billion a year in interest on the excess cash reserves it holds for commercial banks if rates follow the highest path forecast by policy makers. The annual interest costs by the end of 2015 could range from $4.3 billion to $77.7 billion.

■ **Builders** probably began work on U.S. homes in March at the second-fastest pace in almost five years, a sign one of the bright spots of the expansion is making further progress, economists said before a report today.



KEENE'S CORNER

Nathan Sheets and **Thomas Fitzpatrick** of Citigroup on constructive moves in Europe and slamming the fist on the table in Japan with Tom Keene.

Q: Is anything going to get done at the IMF meetings this week?
SHEETS: Those meetings are helpful in that they give senior people in the international community an opportunity to exchange thoughts and compare notes. But it's very unusual for there to be something significant achieved. I'd be surprised if anything notable came out of it.

Q: I've heard this hot air for 15 years. Whether it's the President of the Bank of France, or Olli Rehn, when are these guys finally going to talk about Slovenia five-year CDS blowing out like they did this week?
SHEETS: My feeling is that over the last year we have seen several steps forward, we saw them deal with Greece in a constructive way. So far so good. The Greeks are making some progress finally. The ECB has intervened in major ways to help support sovereigns and banks. But on the other hand, the way they handled Cyprus was very, very --

Q: It's outrageous! They're making it up as they go along. They're forced under market pressure and they're taking steps that took the U.S. years, decades. There's an argument to be made, they have made progress. The problem is where's the growth going to come from? They're deep in this recession.
SHEETS: You're hitting the nail on the head. The problem there is they're only able to make progress when there's huge market pressure. When the markets aren't on they don't take the necessary steps to implement the structural reforms. And other measures that over time will deliver the growth that we're talking about.

Q: Japan is not the United States. They're putting their round peg in the square hole, but it's a lot smaller isn't it?
SHEETS: Kuroda has slammed his fist on the table and said we will defeat deflation in Japan. And of course, bonding to that, he has put together a sizeable program. And one of the things that we're watching very carefully is how much of that liquidity finds its way abroad. And what are the global implications for treasury markets, U.S. equity markets, and the European financials?

Q: Do you just still see a weaker Japanese yen? That's the only way they can adjust after these shocks?
SHEETS: Given the size of this program, I think the risks are certainly skewed toward a weaker yen.

Q: Tom, what's the chart say?
FITZPATRICK: Actually in terms of the chart, we think it's a game changer. If you go back to 1995 after the Kobe earthquake and the stresses that came from the strong yen, they put in an intervention program. And in that intervention program they encouraged people to put money outside. We went from 80 to 147 in three years. This set up is very similar. If anything, this is more aggressive. They're telling Japanese investments, we're going to give you negative real yields.

Q: 140 dollar/yen? When? Thursday?
FITZPATRICK: Not by Thursday, it's going to take a period of time. We're very bullish the dollar on the two to three year period. We had looked at dollar yen as 98 to 100 this year, when we went into this year. But with this game changer we think that extends out. So we're thinking by 2015. So it's not today or tomorrow, but by 2015, given the dynamics of the dollar and given what we're seeing and what Japan has done, we think, we could be close.

Q: The swirl that we see here, what's Europe going to do with their real economy? We're at a tipping point here where it's fancy talk about finances versus the European real economy.
FITZPATRICK: They need deep structural reforms to increase the level of productivity and to reinvigorate their economies over the medium term. So there's a lot of work to be done. But that's a painful process. And I think it's going to require either some monetary stimulus from the ECB which we haven't seen or a weaker euro which we're also not seeing.

Q: Perhaps a bigger mystery right now and moving markets. China. What's its economy doing?
SHEETS: China's GDP has surprised us on the downside. And perhaps most importantly, consumption has surprised us on the downside. China's got to go through a rebalancing process from investment to stronger consumption and today's data were a step back from that perspective.

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