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IMF的介入...

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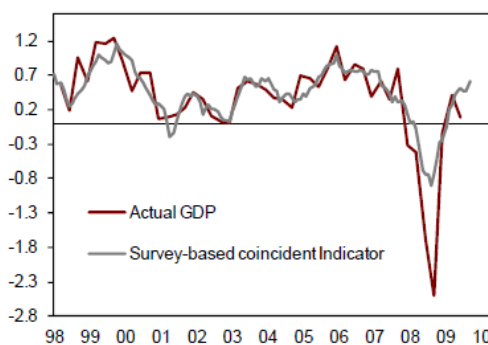
欧元区度过了亦喜亦忧的一周。一方面，发布的增长相关数据，尤其是PMI，表明欧元区2010年一季度的经济整体走势较为强劲——而且我们对一季度GDP环比增长0.4%的预测（未折年）面临上行风险。但另一面，欧元区的内部差异变得愈发明显，大部分边缘国家被甩在了后面。

欧洲央行行长特里谢终于在今早宣布，欧洲央行自2011年起的抵押政策将较原计划有所调整，其中包括按比例削减主权债券。

与此同时，随着欧洲高峰会议的临近，德国总理默克尔也明确表示，不到万不得已不会对希腊提供财政援助，而且即便是提供援助也是有条件的——即希腊必须同意加入由国际货币基金组织 (IMF) 牵头的计划。这似乎解决了长期以来困扰欧洲的一个问题，即在欧元区成员国陷入财政困境时，谁将施以援手。这是一条好消息——至少对欧洲的纳税人来说是这样。

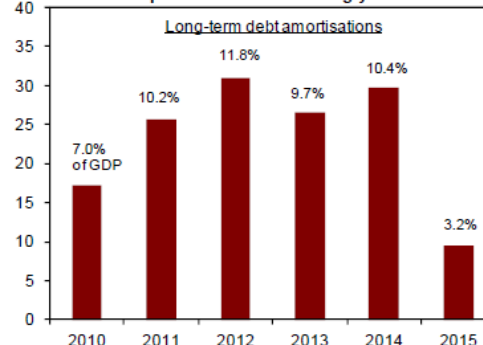
我们认为希腊不仅面临流动性危机，还遭遇了一个潜在的负债可持续性问题，因此我们认为应该对希腊进行援助，提供援助的时间如果不是在4-5月，那也应该在明年底之前。我们预计，最后会出台一项为期18个月援助金额达200亿欧元的IMF计划——这笔援助资金将由IMF和欧洲各国政府平摊。尽管这项计划将有助于缓解财务负担，但市场将持续面临较大的资金要求。计划实施的政策条件将十分严苛，并将取决于希腊的政治和社会结构。我们将概述计划可能包括的内容，并探讨它对市场的潜在影响。

PMI-based indicator points to +0.6%qoq GDP growth in Q1



Source: Eurostat, GS Global ECS Research

Greece's refinancing difficulties will persist over the coming years



Source: Greece Debt Management Office

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Here comes the IMF...

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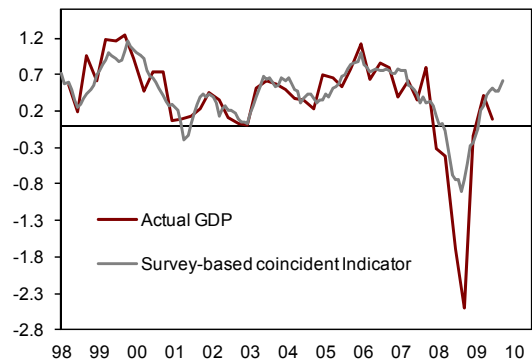
It has been a rather mixed week in the Euro-zone. Growth-related data releases, particularly the PMIs, suggested a robust ending to 2010Q1 for the Euro-zone as a whole—and some upside risk to our Q1 GDP forecast of +0.4%qoq non-annualised. But divergence is becoming increasingly evident, with much of the periphery falling behind.

Long overdue, the ECB's Trichet announced this morning a forthcoming revision of the ECB's collateral policy from the beginning of 2011, including via the introduction of a sliding scale of haircuts for sovereign securities.

Meanwhile, heading into the European Summit, German chancellor Merkel made clear that any financial assistance to Greece would be a very last resort and that any such help would be conditional on Greece agreeing on a program with the IMF. This seems to settle the long-running intra-European debate about who will bail out a Euro-zone member in financial trouble, which is good news—at least for Europe's taxpayers.

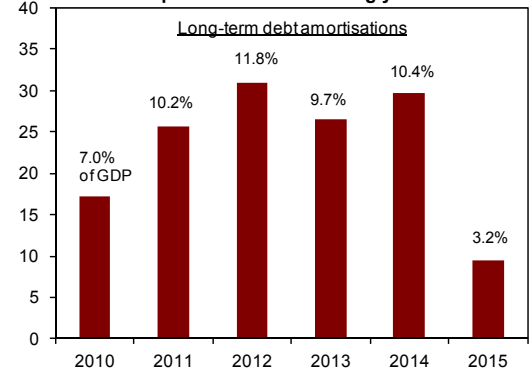
We think Greece is facing both a liquidity crisis and a potential debt sustainability problem, and we therefore expect that help will be needed, if not during April-May, then before the end of next year. We expect this to lead to an 18-month IMF program with financing of up to €20bn, split between the IMF and the European governments. While this would ease the financing burden, large financing requirements that the market will need to fill will persist. The program will come with draconian policy conditionality; implementation will depend on the political and social fabric in Greece. We outline what the program might look like and discuss the likely impact on markets.

PMI-based indicator points to +0.6%qoq GDP growth in Q1



Source: Eurostat, GS Global ECS Research

Greece's refinancing difficulties will persist over the coming years



Source: Greece Debt Management Office

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Week in review

It has been a busy week in Europe on both policy and data fronts. First and foremost, the ECB announced that it will extend its minimum credit threshold (currently BBB-) for collateral beyond the end of this year, and that it will also supplement it with a “*graded haircut schedule*”, some variant of which we have been proposing for several years now. Credit ratings also made the headlines when Fitch decided to downgrade Portuguese sovereign debt yesterday by one notch. This move did not come as a major surprise, however, given that the risks to Portugal’s economic and fiscal outlook have been elevated for some time now.

In terms of data, the March round of business surveys came in much stronger than we had expected, particularly in Germany. As usual, we will have to wait for a few more hard data prints before we can more comprehensively assess the repercussions for GDP but, based on sentiment alone, the latest readings impart some clear upside risks to our Q1 GDP forecast of +0.4%qoq. Finally, the Norges Bank kept policy rates on hold this month, as expected, but trimmed its projected rate path a bit more than we thought it would.

ECB extends collateral rules

ECB President Trichet announced this morning that the minimum credit threshold for collateral pledged at the ECB’s repo facility would remain at BBB- beyond the end of 2010, rather than rising back to A- as was originally planned. Moreover, in parallel, the ECB is set to introduce a “*graded haircut schedule*” to the collateral framework, the details of which will be announced at the next meeting of the Governing Council on April 8.

We have been arguing for some years now that ECB’s ‘grim trigger’ collateral policy is tantamount to placing a nuclear device in the hands of ratings agencies, because any downgrade that pushes a sovereign member’s debt below the minimum threshold immediately renders the whole stock of this asset ineligible for ECB liquidity.

Entrusting decisions with such consequences to ratings agencies is inappropriate even in normal times, but in the current environment, where fragile Euro-zone banks have absorbed large amounts sovereign debt issuance with the comfort that they can use it to secure ECB liquidity, the consequences of a sudden eligibility cut-off would be especially dire. In Greece, government debt alone accounts for roughly 10% of bank assets, and an ECB rejection of this debt would risk an outright collapse of the Greek financial system.

In this context, we have maintained that a more reasonable eligibility policy would be one where assets that breach the minimum credit requirements are penalised with incremental haircuts. The ECB’s announcement this morning suggests that it has finally come to appreciate the merits of this more accommodative sliding scale of eligibility, and we look forward to seeing the details of how the ECB plans to structure and implement such a system.

Fitch downgrades Portugal

Although Greece currently stands to benefit most from a more flexible ECB collateral policy, it is becoming more and more likely that other fiscally-strained peripheral countries will soon test the bounds of sovereign eligibility. Yesterday, Fitch changed Portugal’s sovereign

Table 1: Portugal's sovereign credit ratings

	Moody's	S&P	Fitch
Current rating	Aa2	A+	AA-
Previous rating	Aa2	AA-	AA
Date of last change	N/A	21/01/2009	24/03/2010

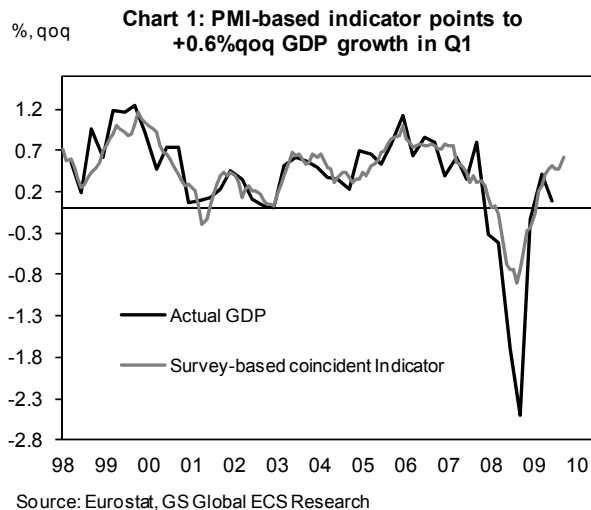
Source: Bloomberg

debt rating for the first time since 1998, downgrading it from AA to AA-. As it stands, Portugal still holds high investment-grade ratings from all the major agencies (Table 1), and has a comfortable buffer from the BBB- threshold where any current and future penalties might kick in. Still, future downgrades are not unlikely, and apart from Greece, Portugal will be the next key peripheral EMU country to watch in the sovereign space.

The Portuguese economy has underperformed its Euro-zone peers by a wide margin over the past decade (growing an average of 0.9% a year compared with 1.4% for the Euro-zone as a whole), and its recovery prospects over the coming years are not particularly bright. Against this weak growth backdrop, the government’s latest fiscal plan is perhaps too back-loaded, with only a 1ppt reduction in the deficit envisioned for 2010 (from -9.3% to -8.3%), and an expected rebound in revenues accounting for the entirety of this near-term consolidation. Therefore, as in Greece, the sustainability of Portugal’s public finances will hinge on a strict adherence to budget targets in the medium term, and on a pick-up in growth, which is far from guaranteed. We therefore expect the Portuguese government to remain in the crosshairs of ratings agencies for some time to come.

Business surveys bode well for Q1

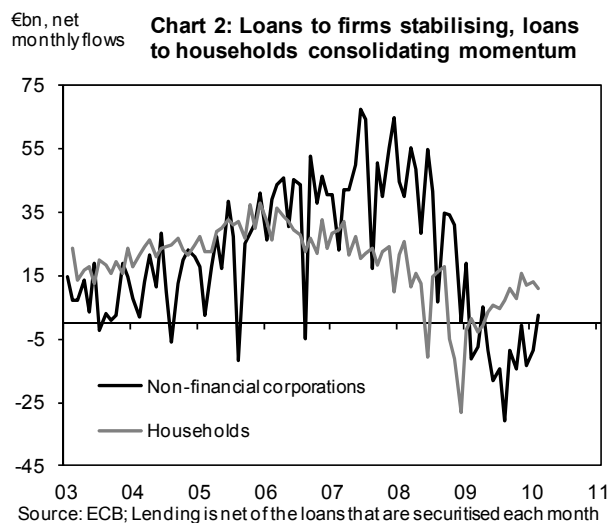
The latest round of business sentiment indicators for March underline a message we have been reiterating for some now: the Euro-zone recovery is firmly on track (with upside risks to Q1), although divergence at both the sectoral and regional level continues to characterise the European economic landscape.



First, at the regional level, Germany, which stagnated in Q4, is now re-emerging as the EMU frontrunner in Q1. This momentum is most clear in industrial sectors: the manufacturing PMI, on the heels of a 3.5 gain last month, surged ahead again in March from 57.2 to 59.6 (its second-strongest print ever). The Ifo, which covers a larger sample of industrial firms, also registered an increase of similar magnitude, rising from 95.2 to 98.1.

Business sentiment in France and Italy, on the other hand, was relatively less buoyant. The French manufacturing PMI rose from 54.9 to 56.3, but a chunk of this was make-up for the decline last month. We do not yet have March PMI readings for Italy, but the ISAE business survey edged up only slightly (83.8 to 84.1).

In terms of sectoral divergence, the outperformance of manufacturing relative to services continues across countries. The German services PMI improved in March from 51.9 from 54.7, but has been fluctuating, with no clear pattern, between 50 and 55 since August of last year. The French services index continued its somewhat mysterious decline since peaking at 60.9 last November, and now stands at 53.0. Additional signs of service sector



softness came from the French consumer spending report, which fell for the second consecutive month.

In all, we expect these divergences to persist for some time as domestic demand (which has a higher content of services) continues to lag behind external demand (where industrial goods dominate). In aggregate, however, the latest round of surveys are consistent with GDP growth of +0.6%qoq in Q1 (Chart 1), and, together with the strong IP data in January, present clear upside risks to our forecast of +0.4%qoq.

Slow but steady recovery in bank lending

The monthly report on liquidity developments in the Euro-zone showed that bank lending continues to be consistent with traditional cyclical patterns at this stage of the recovery. More specifically, lending to nonfinancial corporations is still lagging lending to households, but the February readings were the first sign that this gap is beginning to close (Chart 2).

Indeed, lending to nonfinancial firms registered its first net increase since April 2009 (albeit a minor €2.2bn), and looks set to stabilise or even increase further in the coming months. Lending to households rose at a similar pace to the previous six months, and is now firmly on an upward underlying trend.

That said, liquidity creation in the Euro-zone is still fairly sluggish, with overall M3 flat on the month and down 0.4%mom. As the recovery becomes more entrenched, however, we should also see this broader aggregate beginning to turn positive.

Norges Bank: On hold with a dovish twist

As expected, the Norges Bank kept its key policy rate on hold at 1.75% at its March meeting, and trimmed its rate forecasts.

The Bank now expect rates to end this year between 2.25% and 2.50% (we had thought that it would lower its rate projection only to 2.50%), and to reach 3.50% by the end of 2011. The main reason for this lower rate path is the rally in foreign interest rates and the stronger NOK, with weaker demand and wage/price growth also playing a role.

We remain comfortable with our view that Norges Bank will eventually hike rates by more than it and the market currently predict. Norges Bank's new growth forecasts are more conservative than ours (particularly in 2011); and its external demand forecasts are weaker. The Bank also uses market forwards as its estimate of how foreign rates will evolve; we think the market is underestimating the pace of likely rate hikes in a number of Norway's trading partners, particularly the UK and Sweden.

Nick Kojucharov

The Greek crisis: Why and when the IMF will be involved, and what a support package might look like

Germany and France clarified today that financial support for Greece will be made available only as a very last resort, and only with the IMF involved in a leading role that would include both financing and policy conditionality. Whether or not Greece can close the April-May financing gap using only commercial funding, we expect the IMF to be involved before the end of the year to tackle the more fundamental problems ahead of the 2011-14 payments hump. We outline here what we think will be a very large 18-month IMF program, which will come with a set of draconian policy measures as a conditionality. Whether the effort will lead to a restoration of debt sustainability will depend on the willingness and ability of Greece's political leadership to undertake (and for its population to accept) some very substantial cuts in living standards during the next three years.

Greece faces both a liquidity and a 'solvency' crisis

Greece faces both an imminent liquidity crisis and significant debt sustainability problems in what is often labelled a potential sovereign 'solvency' crisis. The liquidity crisis relates to the government's financing requirements between now and mid-May, including redemption and coupon payments of €8.6bn in April and €10.8bn in May, coming on top of €8bn in other financing needs for the budget deficit and short-term roll-overs during those two months. On our numbers, the Greek government will have to raise a minimum of €8bn-€10bn to overcome these payments humps. The debt sustainability problem relates to the fact that, in order to halt the present acceleration in the debt to GDP ratio (which implies large and increasing transfers of interest payments to foreign creditors), the government will need both to implement draconian fiscal measures during the next three years and undertake unprecedented structural reforms to generate a return to positive GDP growth—a combination that is likely to test the political and social fabric to its limit. To the extent the government could finance itself at below present market rates, the stress on the sustainability issue would ease somewhat.

It is not clear that European policy-makers fully appreciate the scale of the problems: The IMF reported on July 20, 2009 that "*the authorities continue to target a fiscal deficit of 3.7 percent of GDP in 2009,*" while the IMF staff's own forecast had been moved up to 6.2% of GDP. Yet, at the most recent IMF Board discussion of

Greece on July 26, the Greek government representative stated that "*my authorities do not share the staff's assessment of tail risks. Fiscal consolidation is underway...*" Two months later, the Greek government more than doubled its forecast for the 2009 deficit to 12.7% of GDP on an accrual basis. This is still the present government's number for the 2009 deficit, although the government reported on February 9 that the 2009 deficit on a cash basis had come in at 16% of estimated GDP. The IMF has observed that in Greece "*cash fiscal data show consistently weaker results than accrual SGP data, which is inadequately explained*¹."

The present government has been—and apparently continues to be—reluctant to acknowledge the underlying severity of the crisis. The fiscal measures for 2010, aimed at reducing the deficit by 4% of GDP, were agreed only in three incremental instalments as the European Commission, the IMF, other European governments, the rating agencies and independent economists expressed concern about the underlying assumptions, and hence about the net effects of the measures on the fiscal accounts. We estimated that the first set of measures would deliver a deficit reduction of about 2% of GDP; the second set of measures would provide an additional 0.5% of GDP or so, while the third and most recent package would top it all up to the original target of 4% of GDP. (We still doubt that the deficit will drop to 8.7% of GDP this year because we expect a sharper drop in GDP.) Reflecting the severity of the situation and the apparent

Table 1: Greek government financing calendar (2010)

€ bn	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	TOTAL
Financing needs													
Long-term debt redemptions		0.3		8.2	8.5				0.2				17.2
T-bill redemptions	3.5			3.9			2.0			1.3			10.5
Interest payments	0.3		1.8	0.4	2.3	0.1	3.3	2.0	0.8	1.1	0.1	0.1	12.2
Budget deficit*		1.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	21.6
TOTAL	3.8	1.8	3.9	14.4	12.8	2.1	7.3	4.0	3.0	4.3	2.1	2.1	61.5
Funds raised													
Long-term debt issues	2.0	8.0	5.0										15.0
T-bill issues	3.7												3.7
Budget surplus	0.6												0.6
TOTAL	6.3	8.0	5.0										19.3

* Italicised numbers denote monthly estimates of deficit flows based on full-year deficit of 8.7% of GDP.

Source: Bloomberg, GS estimates

1. IMF Staff Report for the 2009 Article IV Consultation; June 30, 2009.

foot-dragging, the government's funding costs have accelerated sharply and CDS spreads have widened. In a sign of possible continued denial, Greek officials still suggest that speculation—and not fundamentals and slow policy reactions—has driven up funding costs, when indeed (statistically) bond spreads have led CDS spreads, and not the other way around, as documented in the *Financial Times*, and agreed by Germany's Bafin. Meanwhile, German chancellor Merkel said as recently as today in the German parliament that Greece is not suffering from a “solvency” crisis.

Financing the liquidity crisis

On our numbers, the Greek government needs to raise €8bn-€10bn before the end of April to get through the last leg of the April-May payments hump. However, on March 20, the director general of the Greek debt management office, Petros Christodoulou, was quoted as saying that the government will have just €7bn of cash left at the end of March, suggesting that the cash situation is tighter than our estimate, and that they might need to raise funds before April 10.

It has been clear all along that the European partners are extremely reluctant to provide financial help to Greece, and that the preference would be for the Greek government to finance itself to the extent possible in the commercial market. That this is also the Greek government's strategy was confirmed earlier this week by the finance ministry, although repeated statements from Athens have called for some sort of non-financial support that would lower the financing costs. PM Papandreou has said that Greece ought to be able to borrow at the same cost as other Euro-zone sovereigns, without specifying whether this means a zero or an average spread over Germany. Repeated statements of political support from European leaders have failed to drive Greece's funding costs because investors have been looking for more concrete support.

The issue of what role the IMF might play has been hotly debated. Arguments for involving the IMF include the necessity of policy conditionality, an area in which the IMF holds undisputed expertise, and the need not to transfer tax payments across the Euro-zone (the ‘no bail-out’ clause.) The arguments against involving the IMF beyond technical assistance have been political, focusing on an argument that the Euro-zone should be able to handle its ‘own’ problems internally. (What ‘own’ exactly refers to—and how far one should interpret this internal aspect of the currency union—among sovereign nations is not clear.) Earlier this week, PM Papandreou's patience seemed to be running low when he issued what appears to be an ultimatum to his European counterparties by saying that if (unspecified) help—presumably to bring down the borrowing cost—is not provided at the European Summit today and tomorrow, then he would turn to the IMF for financing. Meanwhile, German chancellor Merkel said this morning that official help to Greece would be provided only as a last resort and only with IMF involvement.

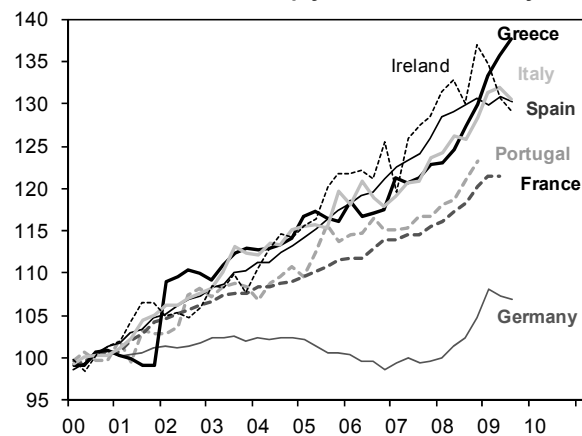
On the back of such an agreement, we see several routes for Greece to fill its liquidity needs through May. We continue to believe that a default during this spring is a very low probability, although it has to be recognised that the closer the deadline gets, the greater the risk of some sort of hiccup and administrative mistake that might delay payments:

- The government may raise €8bn-€10bn in the commercial market before April 10, either through a tender and/or a private placement. (However, time is running low because of various holidays in Europe and elsewhere in the coming weeks.)
- The government raises some part of the necessary cash in the market, and then returns to the EU partners (and IMF) for help for the remaining amount, say €5bn. This would trigger program negotiations with the IMF, making fast disbursements somewhat complicated. The European partners would then likely provide a short-term bridge loan to Greece, linking funds to the first IMF disbursement a few months down the road.

Financing the ‘solvency’ crisis

Whether or not the IMF comes in to help with the April-May payment hump, we think that it will become involved eventually—and most likely around mid-year—because Greece suffers from serious debt sustainability issues, resembling a sovereign solvency crisis. To illustrate, on our numbers, to achieve just a stabilisation of public debt to GDP (at 120% of GDP) over the medium term would require an unprecedented combination of sizeable primary fiscal surpluses (on the order of 3.0%-3.5% of GDP, compared with a primary deficit of about 3.5% of GDP this year) and real GDP growth of at least 1% in spite of a declining working age population and a significantly tighter policy stance. And even if this could be achieved, it would imply annual transfers of about 4% of GDP (in the form of interest payments) to foreign creditors in perpetuity, hence requiring a non-interest current account surplus of the same magnitude over the cycle—a tall task for a country that has reported a trade (goods and services) deficit in every single year for many decades.

Index 2000=100
Chart 1: Greek unit labour costs have increased sharply relative to Germany

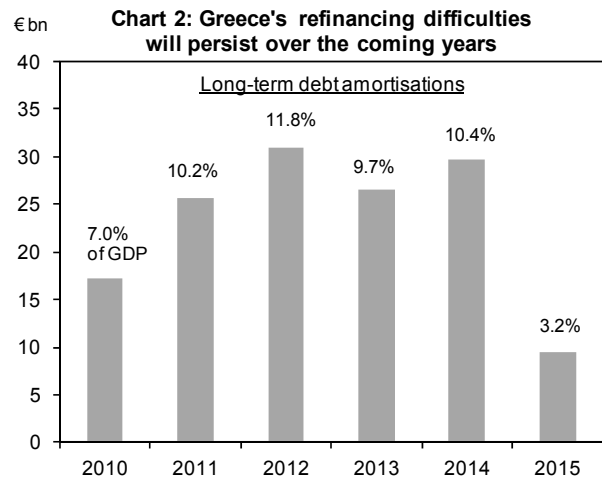


Source: ECB

From this it is clear that the path to restoring fiscal sustainability will be threefold:

- **Substantial fiscal adjustments:** This year's primary budget deficit is projected to decline by 4.2% of GDP (to achieve the targeted 4% decline in the nominal deficit), through a planned increase in revenues by 2.6% of GDP and a cut in primary spending by 1.6% of GDP. Assuming that this is achieved for this year, then the government will need to introduce further measures for 2011 and 2012 to bring the deficit below 3% of GDP, as planned. Such measures would include a further boost to revenues to a tax level of more than 45% of GDP (compared with 39% last year), the highest in the last few decades, and permanent spending cuts of the same order of magnitude. (In addition, the government will have to hope that its chronic gap between the cash and accrual deficits—typically on the order of a couple of percent of GDP—will vanish by better tax compliance—over and above what has already been included in the budget—and that slippages on the spending side will be eliminated.)
- **Simultaneously, Greece needs to restore growth** in order to make the process both fiscally and politically sustainable. This will be an uphill battle because the working age population will start declining this year. Moreover, Greek unit labour costs have increased by almost one-third relative to German ULCs over the past ten years—a process that caused Greek export prices to increase by about 20% more than its competitors' export prices, and Greece to lose about 25% of its market share abroad during its time in the Euro-zone. This illustrates an overvalued exchange rate, which—without the possibility of a 'quick-fix' FX devaluation—promises a long and gradual adjustment process to engineer the necessary 'internal devaluation'.
- Lastly, Greece needs lower funding costs to make its debt sustainable, and that needs to be achieved while the ECB is likely to gradually normalise the base rate. In other words, Greece needs lower spreads in coming years, while global liquidity is likely to become gradually less ample. The market may provide lower spreads if investors regain trust in the policy process and investment opportunities in Greece, and hence longer-term debt sustainability. However, this would have to take place while Greece taps the market to a substantial extent, and in competition with others with big funding needs.

Given the complexity of bringing about the necessary substantial fiscal tightening while maintaining the social peace—and while engineering a sustainable growth recovery—it seems an unlikely scenario that investors would substantially change their assessment of debt sustainability and lower the required premium for lending to Greece. On present information, it seems more likely that Greece would need help from the official sector to bring down its borrowing costs. This raises the prospect



Source: Greece Debt Management Office

of asking the IMF for a program—if not during April, then during the summer before the big financing needs return next year.

Outlines of an IMF program for Greece

Greece is a member of the IMF, with a personal quota of SDR823mn (about €1.0bn or \$1.3bn), giving the Greek government the right to request help from the Fund. The typical IMF program runs about 18 months and would provide financing for that period, with quarterly disbursements conditional on numerical targets for key macroeconomic aggregates and structural benchmarks in the shape of measures the government needs to take and/or pass through parliament. If a country borrows more than 600% of its quota, then the IMF will require additional “consultation criteria”, which would include tighter monitoring of other variables, e.g., inflation or private-sector wage developments, which the government cannot influence directly but which—if they were to move outside a pre-agreed corridor—would trigger additional consultations with the IMF and possibly additional policy measures. High access to IMF resources will also imply quarterly reviews of performance under the program.

We expect a big IMF program, which would lower financing costs:

If the IMF were to be brought in around mid-year, then the program would most likely be designed to help the Greek government through its payments in 2010H2 and 2011. The ideal (and ‘normal’) practice of the IMF program being ‘fully funded’ (i.e., financing is committed to fill the entire financing gap during the program period) is not likely in the case of Greece because of the size of the hole. As a compromise, we suspect that the IMF (with bilateral co-financing) might provide about half the funding for the government's medium-term debt amortizations during this period, or about €20bn. If that were all to come from the IMF, it would be a whopping 2,000% of quota, the biggest program in IMF history that we are aware of. It is therefore more likely that the IMF would limit itself to something in line with previous mega-programs of

1,000%-1,200% of quota, i.e., €10-12bn, with an additional €8bn-€10bn provided by European countries. Under standard IMF rules, the government would pay 1.25% for borrowing up to 200% of quota, then 2.25% for borrowing up to 300% and 3.25% for borrowing above that. Presumably, the Europeans would charge a similar rate for their lending.

However, in this scenario, the Greek government would still need to raise from commercial sources about €20bn to meet long-term amortizations (Chart 2), and another €10bn-€20bn to finance the deficit and short-term roll-overs during the 18-month IMF program. The conditions for such financing would remain uncertain, although the IMF's stamp of approval would certainly help. The forthcoming changes to the ECB collateral requirement would only be helpful for Greece if they were to imply smaller haircuts than presently applies; a somewhat unlikely outcome in our view.

IMF conditions would likely be draconian. When the IMF designs its policy conditionality, it will try to address the debt sustainability issues outlined above. First, there is the issue of restoring fiscal sustainability, then the issue of re-creating growth and, finally, there are a number of outstanding issues relating to the strength of Greece's public institutions:

- On fiscal consolidation, we believe that the government's 2010 budget is as tough as one could ask for, so the focus would be on 2011. Here we imagine that the IMF would aim at bringing the deficit down from 9%-10% of GDP this year (i.e., after accounting for a sharply lower GDP this year than currently expected by the government) to about 6% of GDP next year. This would require another tightening of the primary fiscal account by 3.0%-3.5% of GDP, probably distributed evenly on the revenue and expenditure sides. Tax hikes would probably focus on the relatively easy-to-collect items, i.e., indirect taxes, including VAT hikes. Spending cuts would surely focus on the public-sector wage bill, with a targeted decline of maybe 10%-15%, distributed between redundancies and nominal wage cuts.
- The IMF would also ask for far-reaching structural reforms. On our numbers, the Euro is at least 25%-30% overvalued for Greece (one-third of which applies to the entire Euro-zone), and without the possibility of devaluing, regaining Greek competitiveness would require an 'internal devaluation' of at least 20%-25%. This would need to happen either via lower nominal wages across the economy (particularly in the tradeable sectors) or via stronger productivity gains. Neither is feasible over an 18-month period, but consultation criteria for a reduction in private-sector nominal wages might be included, as well as strategies for liberalising labour and product markets to boost productivity. In our judgement, this might be the single most complicated part of the necessary adjustment program.
- Lastly, institutional reforms would be requested, including with respect to tax collection, public procurement and statistics. The IMF would need to become comfortable with the persistent discrepancy between the fiscal accounts on an accrual and cash basis. Most extra-budgetary funds would likely be shut down and consolidated to increase transparency. Also, while the government's planned reform to make the statistical office independent is welcome, more would need to be done to secure proper transfer of information from other agencies, including the finance ministry, to secure better quality statistics. Finally, many public enterprises would need to be privatised and their drainage on public finances curtailed.

Thoughts on how the market might react

Historically, agreement on an IMF program brings about lower borrowing costs for a country as investors recognise the benefit of having tougher adjustments and structural reforms imposed. However, IMF programs typically come with up-front currency devaluations to quickly restore competitiveness. We have very few examples of IMF programs with 'internal devaluations', and in the most recent one, Latvia, financial markets were so small and illiquid that they may not serve as a useful guide. Also, Latvia may not be illustrative in terms of the population's acceptance of long and grinding measures to restore competitiveness via 'internal devaluations'; the mega-crisis in the Baltics following the collapse of the Soviet Union might put the present Latvian crisis in a different perspective than would be the case in Greece—as might the pre-crisis years of very strong growth in Latvia. In the final analysis, an IMF program would help lower funding costs and provide the government with additional time to undertake necessary reforms—but the population would still need to accept the lowering of their living standards that comes with the adjustment program.

For the rest of the Euro-zone, an IMF program in Greece would imply that the potentially open-ended 'bail-out threat' would evaporate, which ought to ease the potential fiscal burden on core-Europe while adding some stress on other peripheral spreads. Our long-held key theme of Euro-zone divergence would surely be further strengthened, but IMF involvement in Greece (with its policy conditionality) would facilitate the ECB's planned gradual exit strategy. The effect on the Euro would depend on whether the market thinks that the IMF program would be successful in engineering internal devaluations and restore competitiveness to German levels (which would be long-term bullish the Euro)—or whether the market sees the IMF's arrival as the beginning of a period of unprecedented policy adjustment, causing years of zero or negative growth, debt restructuring and decline (in which case, the news would be bearish for the Euro.)

The next three months may provide several of the answers to these questions.

Erik F. Nielsen

Hungary and the IMF

Hungary was the first country in the EU to request help from the IMF following the rapid decline in demand for emerging market debt and an increased differentiation in investors' perception of sovereign risk. A high stock of external debt and substantial currency mismatches, especially on households' balance sheets, as well as high refinancing needs, made Hungary especially vulnerable to a shift in global sentiment.

The IMF program was agreed under the fast-track Emergency Financing Mechanism procedures; nevertheless, the IMF Board approved the program nearly four weeks after the first official mention of the Fund's readiness to assist the country. The Stand-By Arrangement, originally for 17 months, was agreed on November 6, 2008. The IMF agreed to provide SDR10.5bn (€12.5bn or US\$15.7bn), which amounts to 1,015% of the Hungarian quota at the IMF. Together with the European Union (€6.5bn or about US\$8.4bn) and the World Bank (€1bn or about US\$1.3bn) funding, the total financing package reached €20bn (or about US\$25.8bn). Reflecting the continued threat of a crisis, the program was extended to 23 months and is scheduled to expire on October 5 this year.

The key objectives of the program and its conditions were to:

- **Implement a substantial fiscal adjustment to ensure lower government financing needs in the future and reduce public debt.** Appropriate measures included structural spending reforms in the pension system, social transfers, and subsidies; tax reform shifting the tax burden from labour to consumption to lift labour participation and potential growth over the medium term. So far, the deficit targets under the program were achieved through the pre-agreed reforms and strict expenditure control.
- **Maintain adequate liquidity and strong capitalisation of the banking system.** The measures included liquidity support, strengthening the supervision and bank resolution frameworks, as well as tightening of forex loan regulations to discourage further lending in Euros and Swiss Francs.

- **Augment the international reserves of the NBH to provide sufficient cover for external obligations,** even in adverse market conditions. This is a 'classic' role of any Stand-By Arrangement, which at its core is designed to prevent a balance of payments crisis.

To achieve these objectives, the program includes appropriate conditions for completing each program review and disbursing further tranches of the loans.

- The main condition of the program is fiscal adjustment, implemented by imposing **deficit targets and a ceiling on the total debt stock** of the central government; supplemented by the standard criterion of non-accumulation of external payment arrears.
- **Accumulation of external reserves** to create a buffer against refinancing risk, measured against a floor for the reserve level.
- A number of **structural benchmarks**, that is, pre-agreed structural reforms supporting the key objectives of the program, including, among others, a submission of a bank support package law to parliament, passage of a fiscal sustainability law, and the strengthening of the bank resolution framework and financial supervision.
- In addition, program monitoring includes an **inflation consultation clause**, which requires that the Hungarian authorities consult their policies with the IMF if the inflation rate exits a pre-agreed band.

In addition to Hungary, other countries in Europe have requested IMF assistance, with the scale of IMF support larger in Latvia, Iceland and Romania. Other programs now in place are in Latvia (1,200% of the quota), Iceland (1190%), Romania (1,111%), Ukraine (800%), Bosnia and Herzegovina (600%), Serbia (560%), and Belarus (420%). Further east, there are also programs in Armenia (580% of the quota) and Georgia (495%).

Magdalena Polan

Hungary - Timeline of events under the fast-track Emergency Financing Mechanism procedures

Date	Event	Days passed
Oct. 13, 2008	First official mention of a possible IMF engagement	-
Oct. 26, 2008	First agreement with the Hungarian government on the broad outline of policies under the program	+13 days
Oct. 28, 2008	Staff-level agreement on the exact shape of the program	+15 days
Nov. 6, 2008	IMF Board approves the program and makes the first tranche of the loan available	+24 days

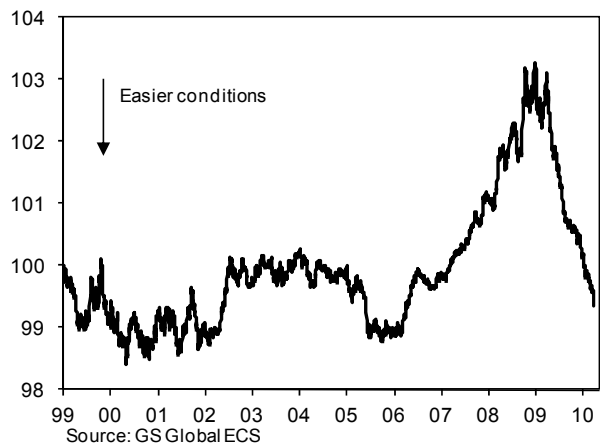
Source: International Monetary Fund

Weekly Indicators

After having peaked in the immediate aftermath of the financial crisis, the *GS Euroland Financial Conditions Index* has eased significantly and is now back below August 2007 levels. More than half of this easing can be explained by the fall in corporate bond yields. The fall in short-term rates as a result of easing by the ECB has also contributed, in addition to the rally in equity markets.

Euro-zone data releases in February surprised to the downside, on balance, and our Surprise index ticked down on both a monthly and a 3-month smoothed basis.

Index, 1999=100 **Euro-zone financial conditions**



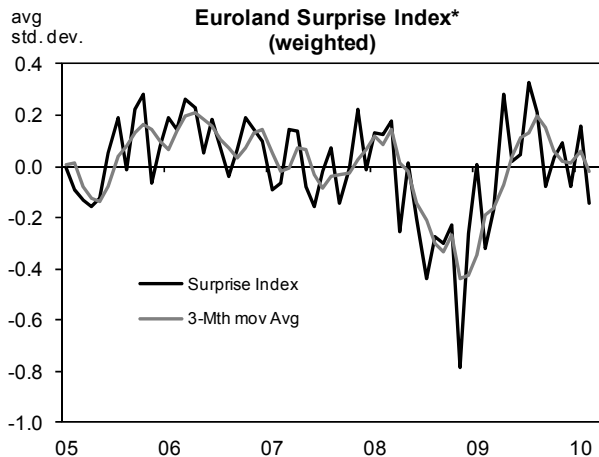
Real Euro TWI



Euro/US\$



Euroland Surprise Index* (weighted)



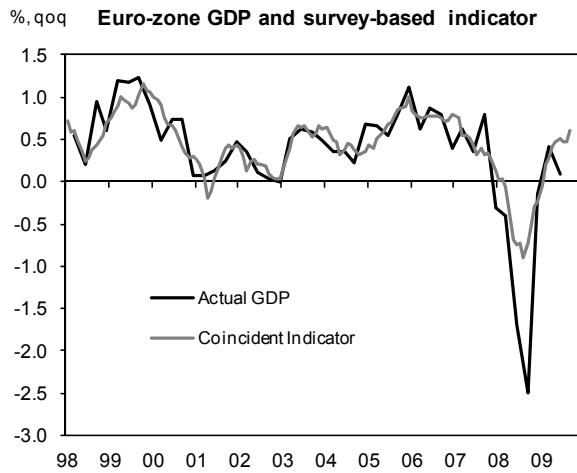
*excluding US non-farm payrolls
Source: GS Global ECS Research

Indicator	Latest Reading	Month	Consistent with (qoq) growth of:
Services PMI	53.7	Mar	0.4
Composite PMI	55.5	Mar	0.6
German IFO	98.1	Mar	0.7
Manufacturing PMI	56.3	Mar	0.8
French INSEE	94.0	Mar	0.2
Belgian Manufacturing	-6.5	Mar	0.5
EC Cons. Confidence	-17.4	Feb	0.2
EC Bus. Confidence	-12.7	Feb	0.3
Italian ISAE	84.1	Mar	0.2
Weighted* Average			0.5

* Weights based on relative correlation co-efficients

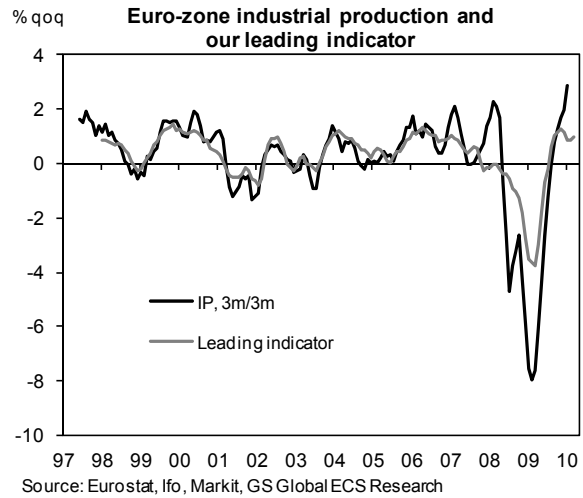
GS Leading Indicators

Our survey-based GDP indicator is now pointing to a +0.5%qoq expansion in Q1.



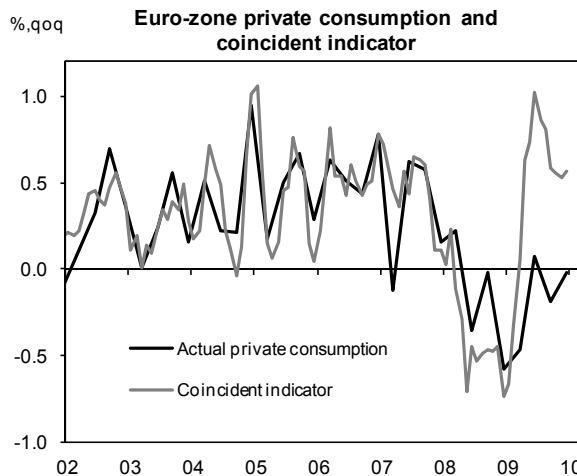
Source: Eurostat, GS Global ECS Research

Our leading indicator, calibrated on IP, is showing sustained industrial momentum.



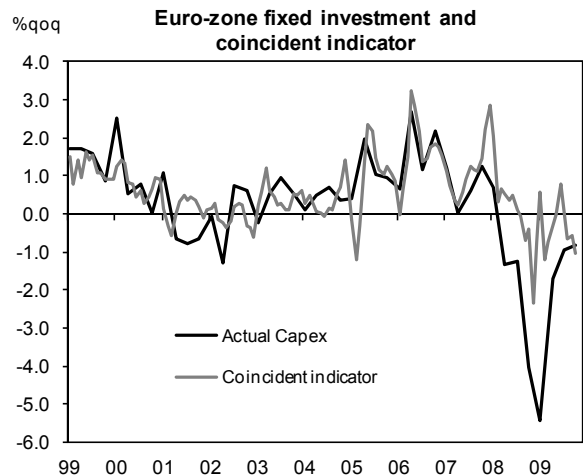
Source: Eurostat, Ifo, Markit, GS Global ECS Research

Our consumption indicator suggests improving prospects for consumption growth.



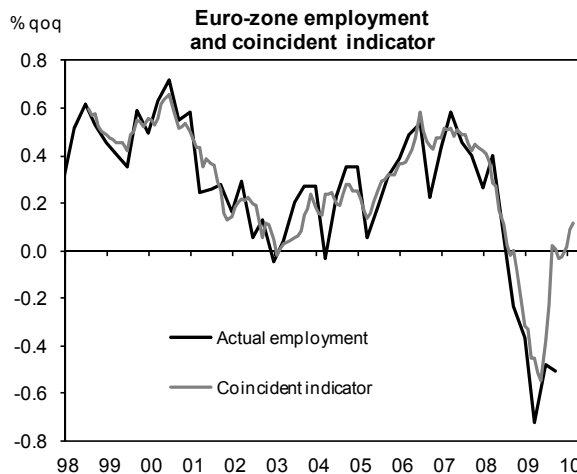
Source: Eurostat, GS Global ECS Research

Our capital expenditure indicator points to continued weakness in investment.



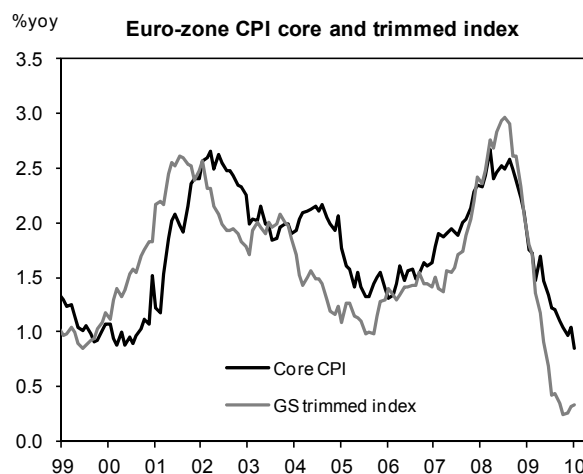
Source: Eurostat, GS Global ECS Research

Our labour market model suggests a stabilisation in employment.



Source: Eurostat, Markit, Labour office, GS Global ECS Research.

The GS trimmed index indicates further easing in Euro-zone core CPI.



Source: Eurostat, GS Global ECS Research

Main Economic Forecasts

	GDP			Consumer Prices			Current Account			Budget Balance		
	(Annual % change)			(Annual % change)			(% of GDP)			(% of GDP)		
	2009	2010(f)	2011(f)	2009(f)	2010(f)	2011(f)	2009(f)	2010(f)	2011(f)	2009(f)	2010(f)	2011(f)
Euroland	-4.0	1.2	1.9	0.3	1.1	1.6	-0.6	-0.4	-0.3	-6.0	-6.5	-6.1
Germany	-4.9	1.9	2.1	0.2	1.0	1.5	3.9	3.5	3.4	-3.9	-4.7	-4.4
France	-2.2	1.8	2.3	0.1	0.9	1.4	-2.1	-0.3	1.3	-8.7	-8.9	-7.5
Italy	-4.9	1.0	1.6	0.8	1.3	1.8	-4.3	-3.5	-2.8	-5.4	-5.3	-4.9
Spain	-3.6	-0.6	1.1	-0.3	1.4	2.0	-4.7	-2.2	-1.3	-11.9	-10.2	-8.9
Netherlands	-4.0	1.4	1.8	1.0	0.8	1.6	5.8	1.0	1.5	-5.0	-6.0	-4.5
UK	-4.8	1.8	3.4	2.1	2.2	1.5	-1.8	-0.6	0.1	-10.3	-10.6	-8.4
Switzerland	-1.5	1.7	1.9	-0.5	0.8	1.2	5.5	5.0	5.5	-0.7	-1.4	-1.3
Sweden*	-4.7	2.0	3.6	-0.3	1.4	2.7	7.4	8.1	9.1	-2.1	-3.4	-
Denmark	-4.6	1.5	2.2	1.1	1.6	1.7	4.1	4.6	4.5	-2.0	-4.6	-3.7
Norway**	-1.4	2.1	2.3	2.2	1.6	2.3	13.8	17.2	17.9	—	—	—
Poland	1.5	3.0	4.5	3.5	1.9	2.3	-1.2	-3.5	-4.4	-6.0	-7.0	-5.0
Czech Republic	-4.1	1.9	3.0	1.0	1.5	2.5	-1.0	-0.1	-0.9	-6.6	-5.4	-5.1
Hungary	-6.2	-0.4	2.8	4.2	3.7	2.5	-1.1	-1.4	-2.0	-4.0	-4.5	-4.0

*CPIX **Mainland GDP growth, CPI-ATE

Quarterly GDP Forecasts

% Change on Previous Quarter	2009				2010				2011			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Euroland	-2.5	-0.1	0.4	0.1	0.4	0.4	0.3	0.3	0.5	0.6	0.5	0.5
Germany	-3.5	0.4	0.7	0.0	0.6	0.5	0.4	0.3	0.6	0.7	0.6	0.6
France	-1.4	0.3	0.2	0.6	0.4	0.6	0.5	0.6	0.6	0.7	0.5	0.5
Italy	-2.7	-0.5	0.6	-0.2	0.4	0.3	0.4	0.4	0.5	0.4	0.4	0.4
Spain	-1.6	-1.1	-0.3	-0.1	0.1	0.1	-0.4	-0.1	0.4	0.6	0.7	0.7
Netherlands	-2.3	-1.1	0.5	0.3	0.3	0.4	0.5	0.4	0.4	0.5	0.4	0.5
UK	-2.6	-0.6	-0.4	0.3	0.5	0.8	0.9	0.9	0.8	0.7	0.8	0.8
Switzerland	-1.0	-0.1	0.5	0.7	0.4	0.4	0.3	0.4	0.5	0.5	0.6	0.6
Sweden	-0.9	0.0	-0.1	-0.6	1.2	0.8	0.8	0.9	0.9	0.9	0.9	0.9
Denmark	-1.3	-2.6	0.5	1.0	0.6	0.4	0.4	0.4	0.6	0.6	0.8	0.7
Norway*	-0.9	0.1	0.3	0.3	0.6	0.7	0.9	0.8	0.9	1.0	1.0	0.9
Poland	0.3	0.7	0.6	1.2	0.8	0.6	0.7	1.0	1.2	1.2	1.3	1.5
Czech Republic	-4.1	-0.3	0.6	0.7	0.5	0.4	0.3	0.6	0.8	1.0	0.9	0.9
Hungary	-2.3	-1.4	-1.2	-0.4	0.4	0.4	0.3	0.4	1.0	0.8	0.8	0.8

*Mainland GDP

We, Erik F. Nielsen, Magdalena Polan and Nick Kojucharov, hereby certify that all of the views expressed in this report accurately reflect personal views, which have not been influenced by considerations of the firm's business or client relationships.

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European Calendar

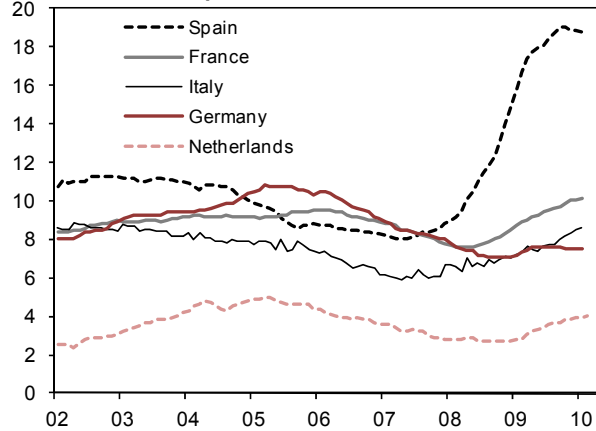
Focus for the Week Ahead

Unemployment rate (Wed). Labour markets throughout the Euro-zone are slowly beginning to stabilise, but further increases in unemployment are still in order this year. For the Euro-zone as a whole, we expect the unemployment rate to have ticked up from 9.9% to 10.0% in February.

Euro-zone flash inflation estimate (Wed). We expect headline inflation in the Euro-zone to remain stable at +0.9%yoy in March. Core prices should ease further but we won't receive the full component breakdown until a few weeks later.

Polish MPC meeting (Wed). We do not expect a change in rate or bias at the forthcoming meeting of the Polish MPC. The MPC will also discuss how much of the National Bank of Poland's 2009 profit should be transferred to the government.

Unemployment rates will continue to creep up across the Euro-zone



Source: Eurostat.

Economic Releases and Other Events

Country	Time (UK)	Economic Statistic/Indicator	Period	Forecast		Previous		EMEA MAP Relevance
				mom/qq	yoy	mom/qq	yoy	
Friday 26th								
France	07:45	Consumer Confidence	Mar	-32	—	-33	—	3
Sweden	08:30	Trade Balance	Feb	—	—	+SEK7.5bn	—	2
Norway	09:00	Unemployment Rate	Mar	—	—	+3.2%	—	4
USA	12:30	GDP - Third Estimate	Q4	+5.9%	—	+5.9%	—	—
USA	12:30	GDP Price Index	4Q	+0.4%	—	+0.4%	—	—
USA	12:30	PCE Core Price Index (Q/Q Annualized)	Q4	+1.6%	—	+1.6%	—	—
USA	13:55	U. of Michigan Consumer Sentiment - Final	Mar	—	—	—	—	—
Monday 29th								
Germany	—	Consumer Prices - Provisional (nsa)	Mar	flat	+0.6%	+0.4%	+0.6%	0
Hungary	08:00	Unemployment Rate	Feb	—	—	+10.8%	—	3
Sweden	08:30	Retail Sales	Feb	—	—	+0.8%	+3.3%	3
Euroland	10:00	Consumer Confidence	Mar	-16	—	-17	—	4
Euroland	10:00	Business Confidence	Mar	-11	—	-13	—	4
USA	12:30	Personal Income	Feb	-0.1%	—	+0.1%	—	—
USA	12:30	Personal Consumption	Feb	—	—	+0.5%	—	—
USA	12:30	PCE Core Price Index	Feb	—	—	Flat	—	—
Hungary	13:00	Monetary Policy Meeting	—	+5.5%	—	+5.8%	—	—
USA	14:30	Dallas Fed Manufacturing Survey	Mar	—	—	-0.1%	—	—
Tuesday 30th								
Spain	07:00	Harmonised inflation flash estimate	Feb	—	+1.1%	—	+0.9%	0
Hungary	08:00	Producer Prices	Feb	—	—	—	-0.6%	0
Norway	09:00	Retail Sales	Feb	+0.6%	—	-0.4%	—	2
USA	13:00	S&P Case Shiller Home Price Index	Jan	—	—	145.9	—	—
USA	14:00	Consumer Confidence	Mar	—	—	46.0	—	—
Wednesday 31st								
Poland	—	Monetary Policy Meeting	—	+3.5%	—	+3.5%	—	—
Hungary	07:30	Current Account Balance	Q4	+EUR0.7bn	—	+EUR0.7bn	—	2
Germany	08:55	Unemployment (Change)	Mar	20,000	—	7,000	—	2
Italy	09:00	Harmonised CPI	Mar	+0.9%	+0.8%	+0.0%	+1.1%	0
Italy	10:00	Unemployment Rate	Feb	—	—	+8.6%	—	—
Euroland	10:00	Unemployment Rate	Feb	+10.0%	—	+9.9%	—	5
Euroland	10:00	Harmonised inflation flash estimate	Feb	—	+0.9%	—	+0.9%	0
Switzerland	10:30	KOF Leading Indicator	Feb	1.9	—	1.9	—	4
USA	12:15	ADP Employment Change	Mar	—	—	—	—	—
Poland	13:00	Current Account Balance	Q4	—	—	—	-EUR1,264m	2
USA	13:45	Chicago Purchasing Managers' Index	Mar	—	—	62.6	—	—
USA	14:00	Factory Orders	Feb	—	—	+1.7%	—	—
Thursday 1st Apr								
Hungary	—	PMI Manufacturing	Mar	—	—	55.9	—	—
Sweden	07:30	PMI Manufacturing	Mar	—	—	61.5	—	5
Poland	08:00	PMI Manufacturing	Mar	—	—	52.4	—	—
Norway	08:00	PMI Manufacturing	Feb	51.0	—	49.4	—	3
Switzerland	08:30	PMI Manufacturing	Mar	57.0	—	57.4	—	4
Czech Republic	08:30	PMI Manufacturing	Mar	—	—	54.3	—	—
Euroland	09:00	PMI Manufacturing	Mar - F	56.3	—	54.2	—	5
Italy	09:00	Industrial Production	Feb	+0.2%	—	+2.6%	+0.1%	5
USA	12:30	Initial Jobless Claims	—	—	—	—	—	—
USA	14:00	ISM Survey	Mar	—	—	56.5	—	—
USA	14:00	Construction Spending	Feb	—	—	-0.6%	—	—
USA	15:00	Treasury 3, 10, 30-yr TIPS Announcement	—	—	—	—	—	—
USA	21:00	Lightweight Motor Vehicles Sales	Mar	—	—	10.4M	—	—
USA	21:00	Domestic Motor Vehicles Sales	Mar	—	—	7.9M	—	—
Friday 2nd								
Czech Republic	08:00	Minutes of MPC Meeting	Mar-25	—	—	—	—	—
USA	12:30	Civilian Unemployment Rate	Mar	—	—	+9.7%	—	—
USA	12:30	Non-Farm Payroll Employment	Mar	275,000	—	-36000	—	—
USA	12:30	Average Earnings	Mar	—	—	+0.1%	—	—

Economic data releases are subject to change at short notice in calendar. ¹ Consensus from Bloomberg. Complete calendar available via the Portal — <https://360.gs.com/gs/portal/events/econevents/>.