July 17, 2014
Issue No: 14/27

European Economics Analyst

Economics Research

Spain – stronger growth, financial conditions remain key

Spain has benefited from easier financial conditions…

Momentum in the Spanish economy has been rising. Economic performance has benefited from financial conditions easing more than we expected at the turn of the year. Indeed, Spain's leveraged national balance sheet has made its growth performance especially sensitive to easier financial conditions. Together with a decline in fiscal drag for next year, this leads us to revise up Spain's growth outlook from +0.9% to 1.2% for 2014 and from +1.2% to +1.6% for 2015. Yet, elsewhere in the Euro area, the 2Q conjunctural indicators have generally disappointed – particularly in Germany and France. Allowing for these indicators in a mechanical way leaves our outlook for annual area-wide GDP growth unchanged, at 1.0%yoy in 2014 and 1.5%yoy in 2015.

…that make a stretched national balance sheet less of a headwind for growth

Two years ago, our core view was that Spain's economic prospects required adjustments that would lead to weaker domestic demand and improved competitiveness as the economy was restructured towards the external sector. While these adjustments have indeed progressed (and have done so at the expense of growth), they have been less costly than expected owing to financial conditions easing somewhat more than we anticipated. The ECB has contributed to that process.

While fiscal risks exist, we expect continued adjustment

Two main risks apply to Spain's outlook: 1) Although its gradual fiscal adjustment is justifiable in the context of still weak demand, the size and persistence of the fiscal deficit imply some risk to sustainability. 2) Spain's political landscape is likely to become more fragmented over the next two years. This may see Spain's commitment to continued adjustment questioned. Nonetheless, we expect Spain to remain on its current adjustment path, while the ECB continues to ensure the feasibility of Spain's managed deleveraging. The ECB's latest policy measures will continue to facilitate those adjustments, even if Spain's stretched balance sheet prevents a sharper 'snap-back' in the pace of recovery.

Huw Pill
+44(20)7774-8736 huw.pill@gs.com
Goldman Sachs International

Kevin Daly
+44(20)7774-5908 kevin.daly@gs.com
Goldman Sachs International

Dirk Schumacher
+49(69)7532-1210 dirk.schumacher@gs.com
Goldman Sachs AG

Andrew Benito
+44(20)7051-4004 andrew.benito@gs.com
Goldman Sachs International

Lasse Holboell Nielsen
+44(20)7774-5205 lasseholboell.nielsen@gs.com
Goldman Sachs International

Antoine Demongeot
+33(1)4212-1343 antoine.demongeot@gs.com
Goldman Sachs International

Sebastian Graves
+44(20)7552-5748 sebastian.graves@gs.com
Goldman Sachs International

Spain – stronger growth, financial conditions remain key

Momentum in the Spanish economy has been rising. GDP growth has increased for the past five consecutive quarters, to 0.4%qoq in 1Q. The latest conjunctural indicators point to a small further gain in momentum in 2Q. Our interpretation of this news leads us to revise up our 2014 growth forecast from 0.9% to 1.2%yoy (Exhibit 1). This compares with a forecast for 0.4%yoy growth made in November last year.

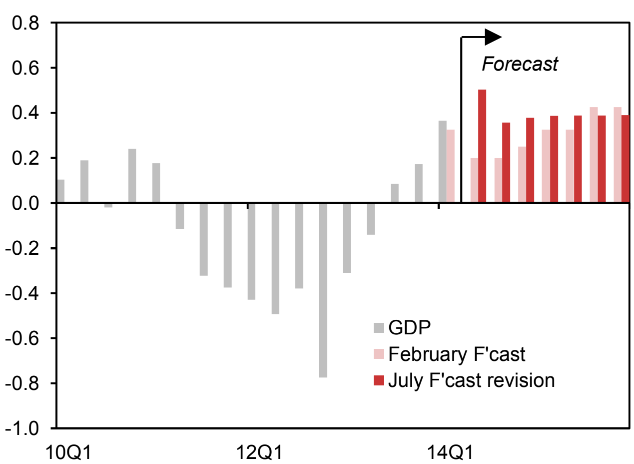
Elsewhere in the Euro area, the 2Q conjunctural indicators have generally disappointed – particularly in Germany and France. While these data do not (yet) lead us to change our underlying view of the German and French economies, we have revised down 2Q growth forecasts in a mechanical way. Overall, this leaves our outlook for annual area-wide GDP growth unchanged, at 1.0%yoy in 2014 and 1.5%yoy in 2015.

The revised view on Spain calls for a deeper assessment of its economy's prospects. Three scenarios could describe the growth profile in the remainder of the year in Spain, based on how one interprets the recent improvement in momentum:

- *Reduced uncertainty* has supported growth as levels of caution – induced by elevated uncertainty two years ago – have subsided. This boosts growth, particularly in the near term. On this view, the recovery continues but sequential (qoq) growth rates ease back somewhat from their 1Q/2Q rate.
- *Structural reforms* have raised supply capacity and have paid off quicker than expected. Reforms of the labour market and financial sector have contributed to the improvement in financial conditions and reduced uncertainty. On this view, further acceleration in activity occurs and growth rates continue to pick up steadily through the remainder of the year.
- *Easier financial conditions* since mid-2012 have also allowed a quicker stabilisation of domestic demand (Exhibit 2). This has a 'front-loaded' effect on growth which may raise growth persistently including through higher levels of business investment.

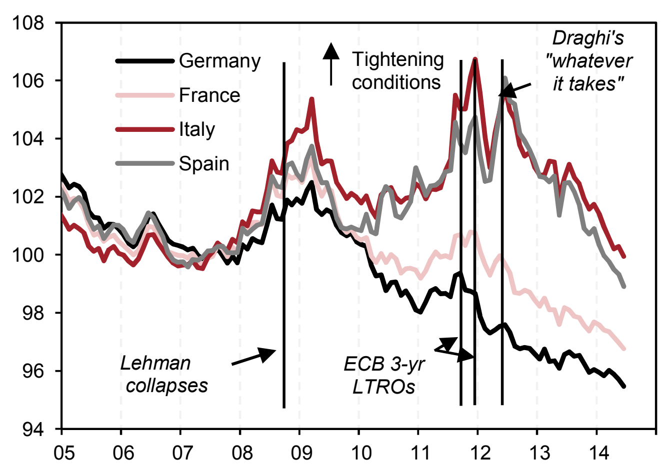
While by no means mutually exclusive, we attribute most of the stronger 2014 recovery to easier financial conditions. Specifically, funding costs for the Government, banks and, to a lesser extent, households and corporates, have fallen more than we expected at the end of last year. Economic performance has been more sensitive to financial conditions in Spain – compared with Italy, for example – owing to Spain's high level of leverage.

Exhibit 1: Upward forecast revisions, although momentum expected to ease in near term
Spain qoq growth rates



Source: INE, Goldman Sachs Global Investment Research.

Exhibit 2: Easing financial conditions are supporting the recovery



Source: Goldman Sachs Global Investment Research.

The fact that financial conditions have eased somewhat more in Spain than in Italy may capture Spain's record on structural reforms being somewhat better than that of Italy. Overall, this makes our revised forecasts most consistent with 'Scenario 3' above.

In our November and February forecasts we highlighted two other factors in addition to easier financial conditions that would support a 2014 recovery: reduced fiscal drag, and an improvement in foreign demand. We continue to believe these factors support the recovery but we do not attribute the stronger 2014 recovery to them.

We have also revised up our growth forecast for 2015. This owes primarily to reduced fiscal drag associated with the fiscal reforms announced on June 20. A growth forecast of 1.2%yoy in 2014, and 1.6%yoy in 2015 leaves our views marginally above consensus on 2014 growth and at consensus for 2015.

The near-term profile to growth will help reveal what factors are driving the recovery

We expect quarterly GDP growth rates to ease marginally into 2H2014, as the near-term boost to growth from easier financial conditions and lower uncertainty subsides somewhat. Should growth be maintained at current rates through the remainder of the year, then this would signal either:

- a near-term boost to activity from the easing in financial conditions and reduced uncertainty that is larger than allowed for; or
- a move to a stronger growth trajectory associated with a larger than expected pay-off from structural reforms.

With an output gap that we estimate at around -5%, there is plenty of 'room to grow'.[1] A large margin of spare capacity, together with the additional wage flexibility that has resulted from the 2012 labour market reform, weigh on inflation. Our November and February forecasts anticipated inflation turning negative in Spain over the summer. We continue to expect this to be the case, notwithstanding the somewhat firmer growth outlook. We expect consumer price inflation to rise to 0.7%yoy by spring next year on the back of the recovery.

Economic restructuring has improved the composition of output growth (away from construction) and the source of spending growth (towards external demand)

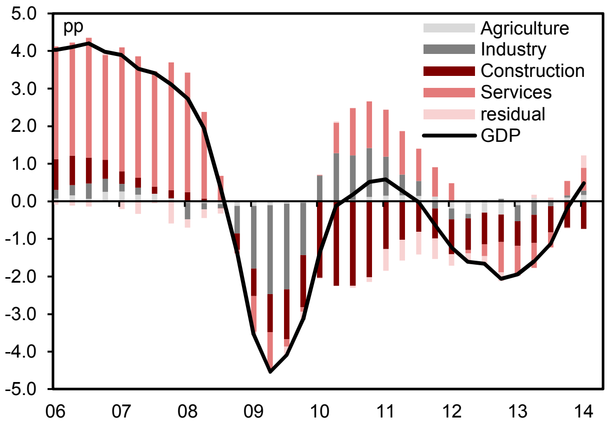
The drag from a weak construction sector likely to subside soon

Annual growth rose to 0.5% in 1Q with growth dominated by the services sector, where annual growth has risen to 0.8% (Exhibit 3).

Falling construction sector output has been the predominant drag on growth since the 2008 peak. That drag has not yet fully subsided, and indeed construction sector output fell by over 8% in the year to 1Q. Yet, as the sector's adjustment nears its completion and as the sector has itself shrunk (by almost one-half), its drag on aggregate output will decline further before it finally disappears. At that point, the growth that is already apparent elsewhere in the economy will translate into higher aggregate growth.

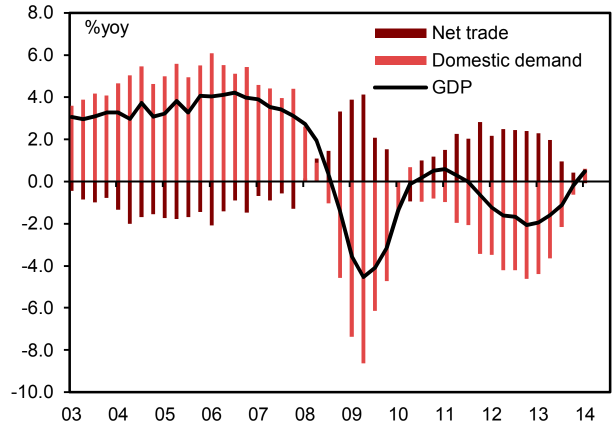
[1] *European Economics Daily*, 'An update on Euro area output gaps: significant slack remains, just not in Germany', April 17, 2014.

Exhibit 3: As the drag from a weak construction sector subsides growth in services will dominate
Rate of growth on a year ago



Source: INE, Goldman Sachs Global Investment Research.

Exhibit 4: As domestic demand growth has resumed, net trade contributions have reduced
Rate of growth on a year ago



Source: INE, Goldman Sachs Global Investment Research.

Activity has also re-oriented towards the external sector

Growth has also seen a re-orientation of demand towards external demand and away from domestic demand since the 2008 peak in spending (Exhibit 4).

As an indicator of rising competitiveness, Spain's export recovery has been impressive – rising 36% since the 2009 trough. That said, there has been little evidence of 'import substitution' in the form of a decline in imports relative to domestic demand.

While positive contributions to growth in the past five years have come from net trade as shrinking domestic demand has generally deducted from growth (Exhibit 4), the source of the positive recent surprise on growth has been that domestic demand has risen in recent quarters. We interpret this as reflecting balance sheet issues having weighed less on the outlook owing to easier financial conditions.

Overall then, the recent macro news for Spain has been positive. In the remainder of this review we assess two main risks to that recovery – concerning fiscal sustainability and deflation. We highlight why we do not view these risks as major drivers of our central case but also note the circumstances under which they may become more important.

Back-loaded fiscal adjustment weighs less on growth, even if it implies some fiscal risk from persistent deficits

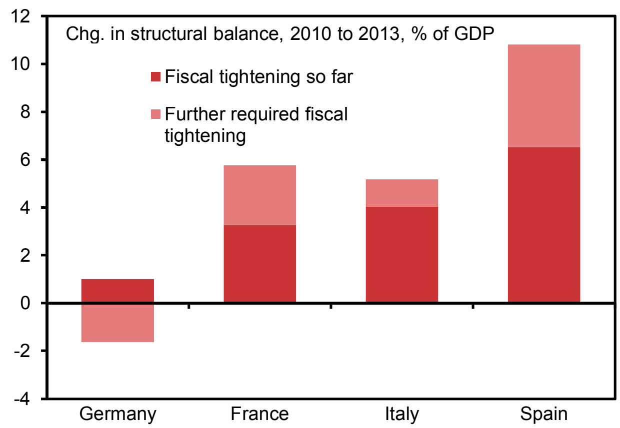
The public sector deficit was 7.1% of GDP in 2013 (including the cost of one-off financial sector interventions at 0.5% of GDP). Deficit targets are for 5.5% in 2014 and 4.2% in 2015. The European Council recently concluded that "additional efforts are needed to fully comply" with the Council's budgetary recommendations.

Even assuming fiscal targets are met, a persistent fiscal deficit together with little area-wide risk sharing implies some fiscal risk for debt sustainability and, ultimately, for growth. That said, we view a drawn-out fiscal adjustment as a more optimal path of adjustment given the sizable output gap.

The drawn-out fiscal adjustment has become feasible with Spain having regained some credibility partly through the costly fiscal consolidation and structural reforms enacted so far. Exhibit 5 shows that Spain's consolidation effort since 2010 has been significantly greater than applied by France or Italy.[2] The authorities' fiscal plans skew the remaining fiscal effort towards expenditure cuts, rather than tax rises (Exhibit 6).

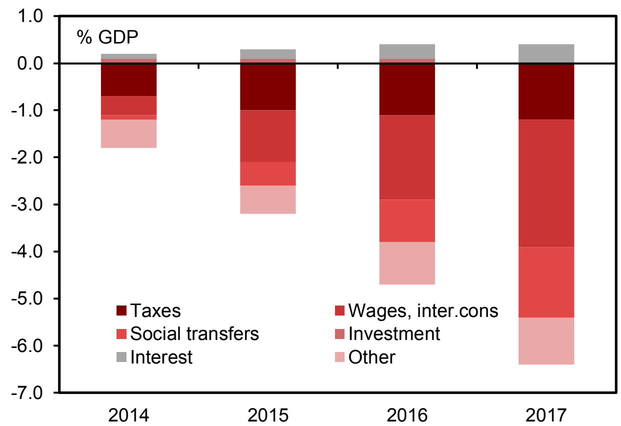
[2] *European Economics Analyst* 13/35, 'Fiscal policy less tight, but room for manoeuvre still slight', October 10, 2013

Exhibit 5: A pronounced fiscal adjustment still leaves significant further required tightening



Source: Eurostat, Goldman Sachs Global Investment Research.

Exhibit 6: Planned improvement in fiscal balances is skewed towards reductions in public spending
Contribution to change in public sector deficit



Source: Ministry of Economy, Goldman Sachs Global Investment Research.

The fiscal balances will benefit from the cyclical recovery. Nonetheless, the fiscal reform announced last month is likely to lower tax revenues by around 0.5% of GDP by 2016.[3] In the medium term, the cyclically-adjusted balance has a key bearing on how the fiscal balances evolve. Estimates of the cyclically-adjusted balance are highly uncertain. The IMF estimates that this deficit is large, at -4.7% of GDP in 2013, compared with the Government's estimate of -2.5%. Since our estimate of the output gap is relatively large, at -5.0%, it implies greater scope for the fiscal balances to improve in the medium term and implies an estimate of the cyclically-adjusted balance closer to that of the Government. Imprecision in such estimates implies some fiscal risk applies to the medium-term improvement in the fiscal outlook.

Recent fiscal announcements, including last month's fiscal reform, coincide with the electoral cycle (tax cuts are introduced in two stages beginning in January 2015 and then in 2016). Spain faces regional elections in May 2015 and a general election by November 2015. Provided the authorities do indeed make up for any budgetary shortfall on the other side of elections, then there may be a strong economic case for delaying further fiscal adjustment until the output gap is closed somewhat further.

The political landscape is likely to turn more fragmented…

That said, the political landscape in Spain is likely to look rather more fragmented after the next general election. The June European Parliament elections illustrated the fragmentation of Spain's traditional two-party system. While the People's Party (PP) obtained almost 45% of the vote in the 2011 general election – making for a strong majority Government in this Parliament – the European Parliament election results (and polling consistently in the past 18 months) has put its vote share at around 30%.

Recently-formed parties, the (left-wing) Podemos and the centrist UPyD have gained ground at the expense of the two traditional parties of PP and PSOE (Socialist Party). In recent polls, the leftist Podemos party has attracted almost 15% of the vote, despite only being formed ahead of the European elections. This support has come at the expense of PSOE and the (also left-wing) United Left. Regional parties have generally maintained their levels of support.

[3] Methodological changes in the calculation of GDP in September 2014 will lower the calculated deficit through a 'denominator effect' and may see the 2013 deficit in-line with the 6.5% deficit target (excluding the cost of financial interventions). If the Spanish authorities also raise their 2014 growth forecast, this would also support the expected 2014 fiscal balance.

We have argued that Spain's fiscal adjustment since the crisis and its delivery on reforms were not primarily a result of the stability of its politics, but instead owed mainly to the severity of its economic imbalances.[4] While politics in Spain may look more fragmented next year, the sense of realism about having to adjust to past imbalances, together with the fact that populist 'euro-scepticism' is largely absent from its politics, should ensure Spain remains on its adjustment path.

…and, although political tensions with Catalonia may rise, we expect a settlement to be found

Political risks also apply as a result of tensions between the national Government in Madrid and that in Catalonia. These tensions have a long history but have been aggravated by the crisis. Catalonia has proposed a referendum on whether it should form an independent state, although that is likely to be ruled as unconstitutional. We expect a negotiated settlement to be found in the following way.

Tensions will become more visible as we approach the November 9 date for the proposed Catalan referendum. But the President of the Catalan government has stated that he will not hold an illegal referendum. This suggests that, if the referendum is confirmed to be against the Constitution, as we expect, then it should become clear that the referendum will not take place.

The Madrid administration, meanwhile, has indicated that it would be prepared to discuss additional autonomy for Catalonia provided a claim for independence is withdrawn. We expect Madrid to indicate more clearly that it is prepared to make concessions towards greater Catalan autonomy. If the Madrid government failed to do that, then elections in Catalonia could be held as a legal, 'de facto' referendum on independence.

Overall, this settlement would mark progress relative to the current stand-off.

Fiscal risks posed by low inflation are exaggerated by Spain's front-loaded external adjustment

In the past we have assessed the fiscal risk posed by low inflation.[5] Low inflation implies low nominal GDP growth, raises deficit ratios and generally worsens debt sustainability. The key judgment regarding the size of risk concerns whether low inflation – which in Spain is currently at zero – reflects a front-loaded adjustment owing to reforms or not. Low inflation will generally hurt but the revival of the economy supported by underlying adjustment will help the fiscal situation.

We interpret low inflation in Spain as partly a form of front-loaded adjustment associated with its 2012 labour market reform and greater pay flexibility. That leads us to believe that the fiscal risks from low inflation are contained.

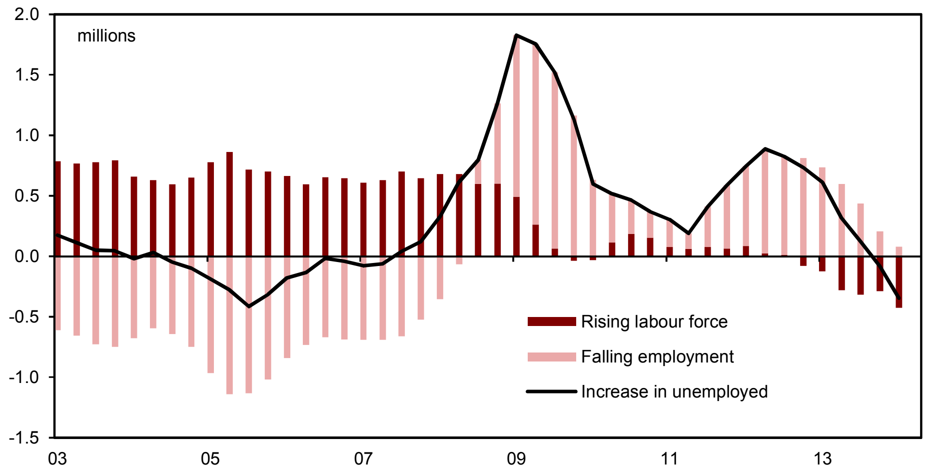
Both risks to fiscal sustainability – from political factors and from low inflation – therefore depend on some key judgements. While we expect both risks to become more "apparent" – as the political landscape fragments somewhat and as inflation turns negative in coming months – we also expect both risks to be held in check by ongoing adjustments and Spain's political commitment to its adjustment path.

---

[4] *European Economics Daily*, 'Italy versus Spain: Economics, not Politics', March 18, 2014

[5] *European Economics Analyst* 14/10, 'Debt, deflation and external adjustment in the Euro area', March 13, 2014

Exhibit 7: The fall in unemployment in the past year owes to a declining labour force
Change in unemployment on a year ago



Source: INE, Goldman Sachs Global Investment Research.

Spain and the wider Euro area economy

Two years ago, our analysis viewed the Spanish economy as the mirror image of Germany. Spain was among the Euro area's major debtor economies, while Germany was the major creditor economy. Reflecting those starkly different balance sheet positions, the adjustments required of the Spanish economy were the mirror image of those required in Germany. For Spain, the most realistic path to reduced external borrowing involved weaker domestic demand and improved external competitiveness including through restructuring its economy towards a larger external sector.

The economy has largely followed that path. While starkly different balance sheet positions between Spain and Germany persist, ECB policies, including through Mr Draghi's 'whatever it takes' intervention, have meant that Spain's stretched balance sheet has not depressed activity as much as it otherwise would have done. Spain has been among the major beneficiaries of the ECB's strategy since the financial turmoil of summer 2012, precisely because of its high level of leverage. ECB policies have made debt refinancing easier and facilitated Spain's managed deleveraging.[6]

With its improved growth and external trade position, Spain has become more 'representative' of the Euro area average – at least in terms of its 'flows' such as growth, and trade position.

That said, growth at around trend rates does little to absorb the margin of spare capacity that has opened up from Spain's past 'double-dip' recession – a point that also applies for the Euro area as a whole. In both cases the margin of spare capacity has weighed on inflation but is reflected in especially high unemployment in Spain.[7]

With growth around trend rates, unemployment is likely to stay elevated. We expect unemployment to fall back from its current rate around 25% but at a modest pace (falling to 23% by mid-2016) and partly on account of a falling participation rate. The recent pattern has seen a declining labour force account for most of the reduction in unemployment, alongside a stabilisation in employment (Exhibit 7). The declining labour force – which fell by 425,000 or 1.8% in the year to 1Q – places the onus on productivity gains as the source of growth.

---

[6] *European Economics Analyst* 14/07, 'Balance sheet adjustment with expansion – Italy versus Spain', February 20, 2014

[7] *European Economics Analyst* 14/12, 'Persistent labour market slack implies low rates, but not deflation', March 27, 2014.

What ECB strategy implies for Spain

Spain remains a leveraged version of the Euro area as a whole. Indeed, this leverage helps explain why it has been a larger beneficiary of ECB policy that has eased financial conditions, including by lowering peripheral sovereign spreads. Spain's 'idiosyncratic risk' has also been reduced by a track record of meaningful reforms that have addressed weakness in its financial sector and labour market.

Recognising Spain's leveraged position is also important given the slow progress that has been made on banking union. Above all, progress has been slower than expected regarding those elements of banking union that involve risk-sharing and/or mutualisation of legacy problems with centralised funds.[8] Nonetheless, the fact that Spain itself has already undertaken a reform of its financial sector – effectively, the model for this year's area-wide AQR and stress tests – has contributed to lowering its idiosyncratic risk.

Looking ahead, what will ECB strategy – and its recently-announced Targeted LTRO ("TLTRO") policy – imply for Spain? There are three main effects in our view:

- *Maintaining ample liquidity* – we expect excess liquidity in money markets to stand at around €150-300bn in 2015H1, thereby playing an important role in anchoring short-term rates around zero and ensuring the risk-free curve remains flat, given the ECB's negative deposit rate.[9] While this matters for all Euro area countries, it matters especially for Spain owing to its high leverage.
- *Providing term funding and effects on banks* – colleagues from the GS banks' equity research team expect TLTROs to largely replace the funding made available through the 3-year LTROs that mature by end-February 2015.[10] An environment of low risk-free rates should continue to support demand for peripheral assets so that any asset sales from peripheral banks facing a shortfall of term funding do not disrupt financial markets persistently.
- *Supporting bank lending especially towards companies otherwise facing credit constraints* – we are more sceptical that the policy will be successful along this dimension. That credit demand is starting to rise in Spain is positive for the outlook for lending volumes and for the size of subsidy banks will receive through the TLTRO.[11] Yet, actively supporting credit supply – especially towards small and medium-sized enterprises – seems less likely. Banks maintaining net lending volumes will likely respond by rolling-over existing loans to businesses and, where lending is raised, directing that towards lower risk, larger corporates. Spain's is a creditless recovery.

Andrew Benito

[8] *European Economics Analyst* 14/25, 'Banking union at two: Cautious optimism and a cautionary tale', July 3, 2014

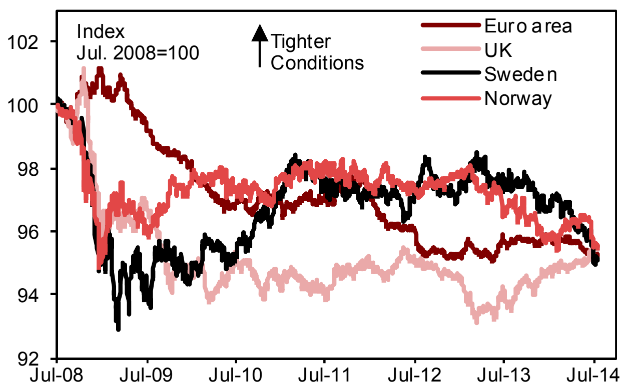
[9] *European Economics Daily*, 'ECB announcements, excess liquidity and Eonia', June 18, 2014

[10] *Europe – Banks* 'TLTRO, bottom-up: Take-up could top €700bn – but most of it not until 2015/16', July 1, 2014.

[11] *European Economics Analyst* 14/21, 'ECB credit easing and the investment outlook', June 5, 2014

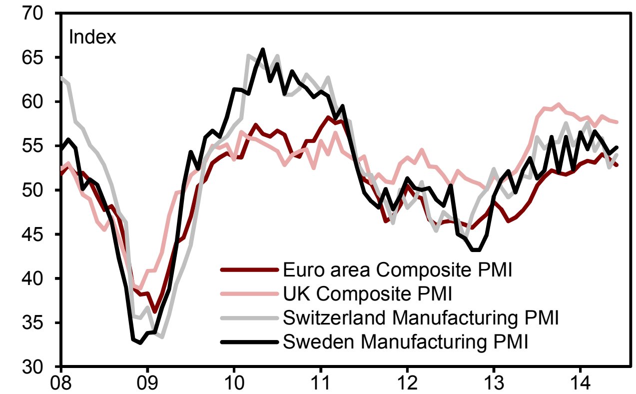
Key European Indicators

Financial conditions have eased notably in Scandinavia recently
European financial conditions



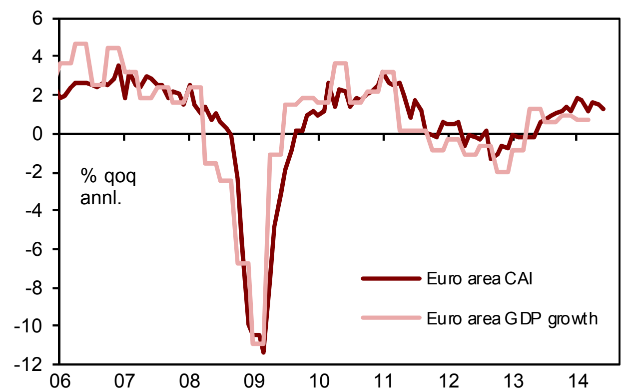
Source: Goldman Sachs Global Investment Research.

Business sentiment has flattened off in recent months
European business sentiment



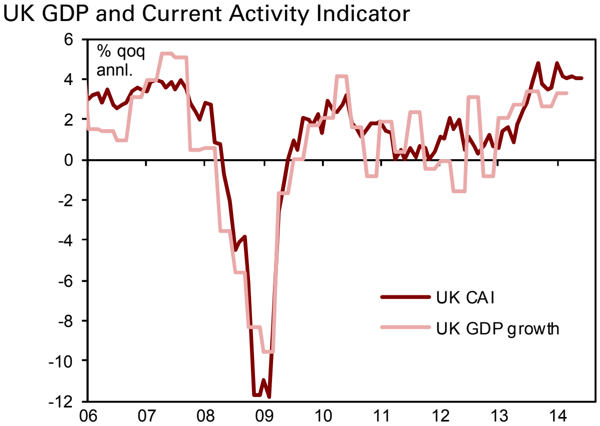
Source: Markit, SVME, Swedbank, Goldman Sachs Global Investment Research.

Our Euro area *Current Activity Indicator* points to growth of 1.2% annualised…
Euro area GDP and Current Activity Indicator



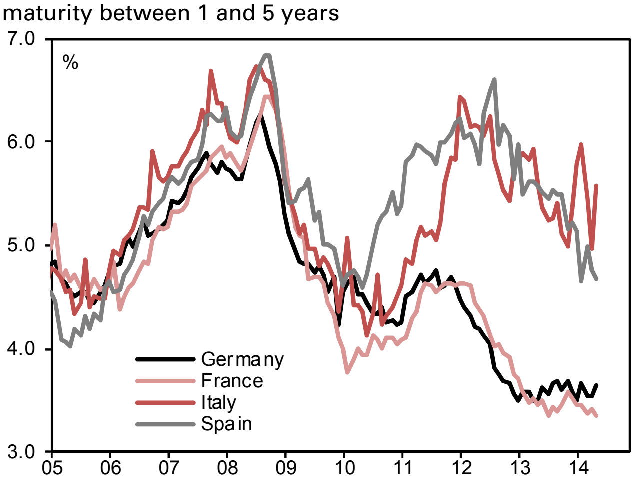
Source: Goldman Sachs Global Investment Research.

…and our UK *Current Activity Indicator* is consistent with growth of 4.0%qoq annualised
UK GDP and Current Activity Indicator



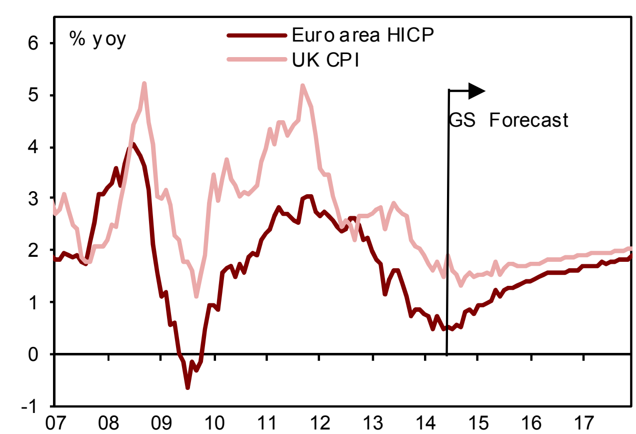
Source: Goldman Sachs Global Investment Research.

Bank lending rates to companies remain divergent, but have been trending downwards in Italy and Spain
% pa, interest rates on business loans up to €1mn with maturity between 1 and 5 years



Source: Goldman Sachs Global Investment Research.

We expect Euro area inflation to remain low in the coming months and UK inflation to fall further
Inflation forecasts



Source: Eurostat, ONS, Goldman Sachs Global Investment Research.

Main Forecasts

Economic Forecasts

	GDP (Annual % change)			Consumer Prices (Annual % change)			Current Account (% of GDP)			Budget Balance (% of GDP)		
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
Euro area	-0.4	1.0	1.5	1.3	0.6	1.1	2.4	2.9	3.1	-3.0	-2.7	-2.1
Germany	0.5	2.0	2.0	1.6	0.9	1.7	7.0	6.8	5.9	-0.5	-0.5	0.0
France	0.4	0.6	1.1	1.0	0.6	0.9	-1.4	-1.2	-1.0	-4.3	-4.0	-3.5
Italy	-1.8	0.3	1.1	1.3	0.4	0.7	0.1	0.1	0.1	-3.1	-2.8	-2.3
Spain	-1.2	1.2	1.6	1.5	0.1	0.8	0.9	2.9	3.6	-6.4	-5.2	-4.6
UK	1.7	3.4	3.0	2.6	1.6	1.6	-4.5	-4.2	-3.9	-6.4	-5.0	-3.5
Switzerland	2.0	2.0	2.2	-0.2	0.3	1.3	13.6	13.9	13.1	0.0	0.1	0.2
Sweden	1.6	2.5	3.4	0.0	0.0	1.3	6.2	5.2	5.1	-1.1	-1.3	-0.5
Denmark	0.4	1.4	1.8	0.5	0.8	1.6	5.7	5.6	6.1	-2.1	-2.7	-3.7
Norway*	2.1	2.8	3.2	2.1	1.9	1.8	12.9	15.7	16.7	-	-	-
Poland	1.6	3.4	3.3	0.9	0.4	1.8	-1.3	-2.3	-3.5	-4.2	4.5	-3.0
Czech Republic	-0.9	2.6	2.4	1.4	0.6	1.6	-1.4	-1.2	-1.6	-2.1	-2.8	-2.8
Hungary	1.2	2.2	2.0	1.7	0.1	2.8	3.0	1.5	1.0	-2.9	-3.0	-3.0

*Mainland GDP growth

Source: Goldman Sachs Global Investment Research.

Interest Rate Forecasts

%			3 Month Horizon		6 Month Horizon		12 Month Horizon	
		Current	Forward	Forecast	Forward	Forecast	Forward	Forecast
Euro area	3M	**0.2**	**0.2**	**0.1**	**0.3**	**0.1**	**0.3**	**0.1**
	10Y	**1.2**	**1.2**	**1.4**	**1.3**	**1.6**	**1.4**	**1.9**
UK	3M	**0.6**	**0.6**	**0.5**	**0.9**	**0.5**	**1.4**	**0.8**
	10Y	**2.6**	**2.7**	**2.8**	**2.8**	**3.0**	**2.9**	**3.1**
Sweden	3M	**0.5**	**0.4**	**0.6**	**0.5**	**0.6**	**0.6**	**0.8**
	10Y	**1.7**	**1.8**	**2.1**	**1.8**	**2.3**	**1.9**	**2.5**
Switzerland	3M	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.3**
	10Y	**0.6**	**0.6**	**0.8**	**0.7**	**1.0**	**0.7**	**1.3**
US	3M	**0.2**	**0.3**	**0.3**	**0.3**	**0.3**	**0.7**	**0.3**
	10Y	**2.5**	**2.6**	**2.8**	**2.7**	**3.0**	**2.9**	**3.3**
Canada	3M	**1.2**	**1.3**	**1.6**	**1.3**	**1.6**	**1.4**	**1.7**
	10Y	**2.2**	**2.3**	**2.5**	**2.3**	**2.8**	**2.4**	**3.0**
Australia	3M	**2.6**	**2.6**	**2.6**	**2.5**	**2.7**	**2.7**	**2.9**
	10Y	**3.4**	**3.5**	**3.8**	**3.5**	**4.0**	**3.6**	**4.3**
Japan	3M	**0.1**	**0.1**	**0.3**	**0.1**	**0.3**	**0.1**	**0.3**
	10Y	**0.5**	**0.6**	**0.7**	**0.6**	**0.8**	**0.7**	**0.9**

Close: July 16, 2014, mid-rates for major markets. We are currently using September 2014, December 2014 and June 2015 contracts for 3-month forward rates.

Source: Goldman Sachs Global Investment Research.

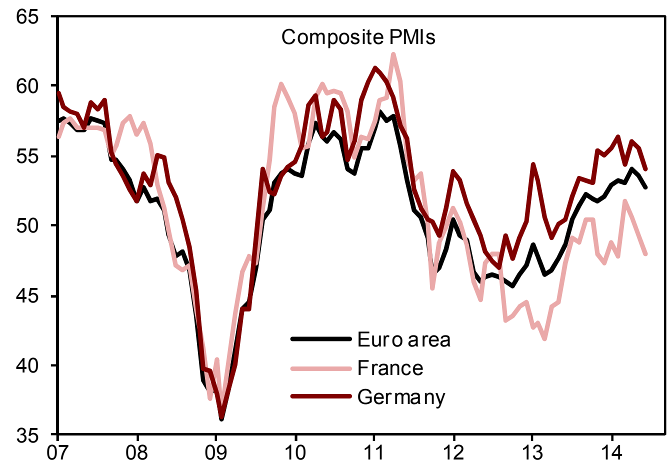
European Calendar

Focus for the Week Ahead

Flash PMIs for July are released on Thursday. We expect a small decline in the Euro area Composite PMI, from 52.8 to 52.6, mainly owing to the decline in Manufacturing new orders seen in June.

The first release of **UK 2Q GDP** data occurs on Friday. Our Tracking Estimate points to growth of +0.8%qoq. Our CAI points to growth of around +1.0%qoq, indicating that the preliminary estimate will likely be revised higher over time.

Euro area Composite PMI has eased since April



Source: Markit, Goldman Sachs Global Investment Research.

Economic Releases and Other Events

Country	Time (UK)	Economic Statistic/Indicator	Period	Forecast* mom/qoq	Forecast* yoy	Previous mom/qoq	Previous yoy	EMEA-MAP Relevance
Fri 18th Jul								
—	—	—	—	—	—	—	—	—
Mon 21st Jul								
Switzerland	08:00	M3 - YoY % Change	Jun	—	—	—	+7.6%	—
Tue 22nd Jul								
Switzerland	07:00	Trade Balance	Jun	—	—	CHF 2.77bn	—	—
United Kingdom	09:30	PSNB (nsa)	Jun	—	—	£13.3bn	—	—
United Kingdom	11:00	CBI Industrial Trends Survey	Jul	—	—	11.0	—	—
Wed 23rd Jul								
France	07:45	Business Confidence	Jul	—	—	92.0	—	—
United Kingdom	11:00	CBI Distributive Trades Survey	Jul	—	—	4.0	—	—
Euro area	15:00	Consumer Confidence	Jul	—	—	–7.5	—	—
Thu 24th Jul								
Spain	08:00	Unemployment Rate	Q2	—	—	+25.9%	—	—
France	08:00	PMI - Composite	Jul (Flash)	—	—	48.1	—	—
France	08:00	PMI - Manufacturing	Jul (Flash)	—	—	48.2	—	—
France	08:00	PMI - Services	Jul (Flash)	—	—	48.2	—	—
Germany	08:30	PMI - Manufacturing	Jul (Flash)	—	—	52.0	—	—
Germany	08:30	PMI - Services	Jul (Flash)	—	—	54.6	—	—
Germany	08:30	PMI - Composite	Jul (Flash)	—	—	54.0	—	—
Sweden	08:30	Unemployment Rate	Jun	—	—	+7.8%	—	—
Euro area	09:00	PMI - Manufacturing	Jul (Flash)	—	—	51.8	—	—
Euro area	09:00	PMI - Services	Jul (Flash)	—	—	52.8	—	—
Euro area	09:00	PMI - Composite	Jul (Flash)	52.6	—	52.8	—	—
United Kingdom	09:30	Retail Sales - Ex Autos	Jun	+0.3%mom	+4.6%	–0.5%mom	+4.7%	—
Italy	10:00	Consumer Confidence	Jul	—	—	107.0	—	—
Fri 25th Jul								
Germany	07:00	GFK Consumer Confidence	Aug	—	—	8.9	—	—
Germany	09:00	IFO Business Survey	Jul	—	—	109.7	—	—
Euro area	09:00	M3 - YoY % Change	Jun	—	—	—	+1.0%	—
United Kingdom	09:30	GDP	Q2	+0.8%qoq	—	+0.8%qoq	+3.0%	—
United Kingdom	09:30	Services Output	May	—	—	+0.3%mom	+3.1%	—

Economic data releases in calendar are subject to change at short notice.
Complete calendar available via GS360 — https://360.gs.com/gs/portal/events/econevents/.
* In the case of the PMIs, the Forecast is simply the Flash estimate where available (Flash PMIs are published by Markit for the Euro area, Germany and France 1-2 weeks before the end of the reference month).

Source: Bloomberg, Goldman Sachs Global Investment Research.

Disclosure Appendix

Reg AC

We, Huw Pill, Kevin Daly, Dirk Schumacher, Andrew Benito, Lasse Holboell Nielsen, Antoine Demongeot and Sebastian Graves, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

Disclosures

Global product; distributing entities

The Global Investment Research Division of Goldman Sachs produces and distributes research products for clients of Goldman Sachs on a global basis. Analysts based in Goldman Sachs offices around the world produce equity research on industries and companies, and research on macroeconomics, currencies, commodities and portfolio strategy. This research is disseminated in Australia by Goldman Sachs Australia Pty Ltd (ABN 21 006 797 897); in Brazil by Goldman Sachs do Brasil Corretora de Títulos e Valores Mobiliários S.A.; in Canada by either Goldman Sachs Canada Inc. or Goldman, Sachs & Co.; in Hong Kong by Goldman Sachs (Asia) L.L.C.; in India by Goldman Sachs (India) Securities Private Ltd.; in Japan by Goldman Sachs Japan Co., Ltd.; in the Republic of Korea by Goldman Sachs (Asia) L.L.C., Seoul Branch; in New Zealand by Goldman Sachs New Zealand Limited; in Russia by OOO Goldman Sachs; in Singapore by Goldman Sachs (Singapore) Pte. (Company Number: 198602165W); and in the United States of America by Goldman, Sachs & Co. Goldman Sachs International has approved this research in connection with its distribution in the United Kingdom and European Union.

European Union: Goldman Sachs International authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, has approved this research in connection with its distribution in the European Union and United Kingdom; Goldman Sachs AG and Goldman Sachs International Zweigniederlassung Frankfurt, regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht, may also distribute research in Germany.

General disclosures

This research is for our clients only. Other than disclosures relating to Goldman Sachs, this research is based on current public information that we consider reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. We seek to update our research as appropriate, but various regulations may prevent us from doing so. Other than certain industry reports published on a periodic basis, the large majority of reports are published at irregular intervals as appropriate in the analyst's judgment.

Goldman Sachs conducts a global full-service, integrated investment banking, investment management, and brokerage business. We have investment banking and other business relationships with a substantial percentage of the companies covered by our Global Investment Research Division. Goldman, Sachs & Co., the United States broker dealer, is a member of SIPC (http://www.sipc.org).

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients and our proprietary trading desks that reflect opinions that are contrary to the opinions expressed in this research. Our asset management area, our proprietary trading desks and investing businesses may make investment decisions that are inconsistent with the recommendations or views expressed in this research.

The analysts named in this report may have from time to time discussed with our clients, including Goldman Sachs salespersons and traders, or may discuss in this report, trading strategies that reference catalysts or events that may have a near-term impact on the market price of the equity securities discussed in this report, which impact may be directionally counter to the analyst's published price target expectations for such stocks. Any such trading strategies are distinct from and do not affect the analyst's fundamental equity rating for such stocks, which rating reflects a stock's return potential relative to its coverage group as described herein.

We and our affiliates, officers, directors, and employees, excluding equity and credit analysts, will from time to time have long or short positions in, act as principal in, and buy or sell, the securities or derivatives, if any, referred to in this research.

The views attributed to third party presenters at Goldman Sachs arranged conferences, including individuals from other parts of Goldman Sachs, do not necessarily reflect those of Global Investment Research and are not an official view of Goldman Sachs.

Any third party referenced herein, including any salespeople, traders and other professionals or members of their household, may have positions in the products mentioned that are inconsistent with the views expressed by analysts named in this report.

This research is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Clients should consider whether any advice or recommendation in this research is suitable for their particular circumstances and, if appropriate, seek professional advice, including tax advice. The price and value of investments referred to in this research and the income from them may fluctuate. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Fluctuations in exchange rates could have adverse effects on the value or price of, or income derived from, certain investments.

Certain transactions, including those involving futures, options, and other derivatives, give rise to substantial risk and are not suitable for all investors. Investors should review current options disclosure documents which are available from Goldman Sachs sales representatives or at http://www.theocc.com/about/publications/character-risks.jsp. Transaction costs may be significant in option strategies calling for multiple purchase and sales of options such as spreads. Supporting documentation will be supplied upon request.

All research reports are disseminated and available to all clients simultaneously through electronic publication to our internal client websites. Not all research content is redistributed to our clients or available to third-party aggregators, nor is Goldman Sachs responsible for the redistribution of our research by third party aggregators. For research, models or other data available on a particular security, please contact your sales representative or go to http://360.gs.com.

Disclosure information is also available at http://www.gs.com/research/hedge.html or from Research Compliance, 200 West Street, New York, NY 10282.