

The Gradual Recovery Continues, but Downside Risks Remain

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Europe's economy maintains a gradual recovery. With regard to business and consumer confidence, the Purchasing Managers' Index (composite) and Consumer Confidence Index for the Eurozone remain mostly stable. Although confidence in the UK worsened in July directly after the UK's decision to leave the EU (Brexit), it has been recovering (Table 1). Real economic indicators show that growth of industrial production in the Eurozone remains resilient at 1.8% y/y in August and real retail sales also continued to increase in August, especially the non-food sector such as household equipments. In the UK, the pace of industrial production decelerated to 0.7% y/y in August from 2.1% y/y due to a reaction to the rapid growth of the mining industry in July; however, it maintains a gradually increasing trend. The adverse effect of Brexit on the growth rate of real retail sales has not been identified clearly up until now. At a press conference after the ECB Governing Council's meeting on 20th October, Mario Draghi – president of the ECB – said that the current situation “confirms a continued moderate but steady recovery of the euro area economy” and gave this as a basis for continuing with the current monetary policy. Markets suggest a possibility that the concerning short-term economic effects of Brexit will not increase in scale.

Table 1: Eurozone and UK - Main Economic Indicators Before and After Brexit

| | | Before Brexit | | Referendum | After Brexit | | | |
|-----------|-------------------------------------|---------------|-------|------------|--------------|--------|-----------|---------|
| | | April | May | June | July | August | September | October |
| Euro Area | PMI: composite | 53.0 | 53.1 | 53.1 | 53.2 | 52.9 | 52.6 | 53.7 |
| | Consumer confidence | - 9.3 | - 7.0 | - 7.2 | - 7.9 | - 8.5 | - 8.2 | - 8.0 |
| | Industrial production, y/y % | 2.0 | 0.4 | 0.7 | - 0.5 | 1.8 | - | - |
| | Real retail sales y/y % | 1.6 | 1.8 | 1.9 | 1.8 | 0.6 | - | - |
| | HCPI, y/y % | - 0.2 | - 0.1 | 0.1 | 0.2 | 0.2 | 0.4 | - |
| | Nominal effective ex.rate, 2015=100 | 102.7 | 103.0 | 102.6 | 102.8 | 103.1 | 103.3 | 104.4 |
| UK | PMI: composite | 51.9 | 53.0 | 52.4 | 47.5 | 53.6 | 53.9 | - |
| | Consumer confidence | 0.8 | - 1.6 | - 1.2 | - 9.2 | - 7.5 | - 1.7 | - |
| | Industrial production, y/y % | 2.2 | 1.2 | 1.4 | 2.1 | 0.7 | - | - |
| | Real retail sales y/y % | 4.1 | 5.4 | 3.9 | 6.0 | 6.6 | 4.1 | - |
| | HCPI, y/y % | 0.3 | 0.3 | 0.5 | 0.6 | 0.6 | 1.0 | - |
| | Nominal effective ex.rate, 2015=100 | 92.9 | 94.7 | 92.9 | 86.8 | 85.6 | 86.0 | 81.8 |

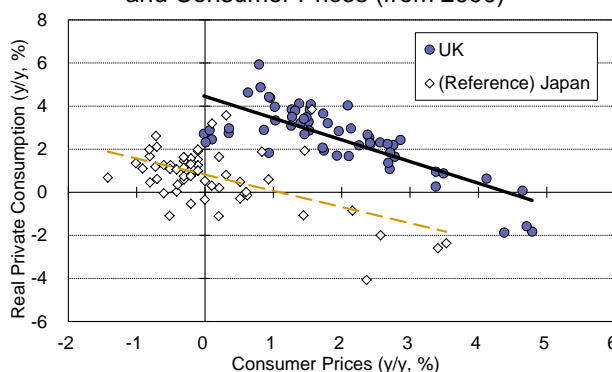
Note: "Nominal effective exchange rate" is the average rate. October's average rate is calculated up to 25th October.

Source: Markit, European Commission, Eurostat, BoE

Concerns surrounding risks of a softening of the economy – in particular, that of the UK – still cannot be dismissed. In the UK, one of these concerns is the swift depreciation of the pound

after Brexit. Downward pressure on the pound continues due to the UK's decision to leave the EU and heightened concerns that the UK is headed towards a "hard Brexit" which would have a strong, negative effect on the UK's economy. Historically, there has been a clear, negative correlation between the inflation rate and real private consumption in the UK. It appears that the decrease of households' real purchasing power due to an increase in prices is causing suppressed private consumption (Chart 1). Growth of UK consumer prices accelerated from 0.6% y/y in August to 1.0% y/y in September, and the effect of pound depreciation on import inflation is expected to strengthen in the future. Pound depreciation will push down on the UK economy by curbing private consumption. It is necessary to continue to monitor any risks this will have on the Eurozone economy as well.

Chart 1: Correlation between UK Private Consumption and Consumer Prices (from 2000)



Note: The period from Q4 2008 to Q3 2009 has been excluded as it is strongly effected by the Global Financial Crisis.
 Source: Japan Cabinet Office, Japan Ministry of Internal Affairs and Communications, Office for National Statistics

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