

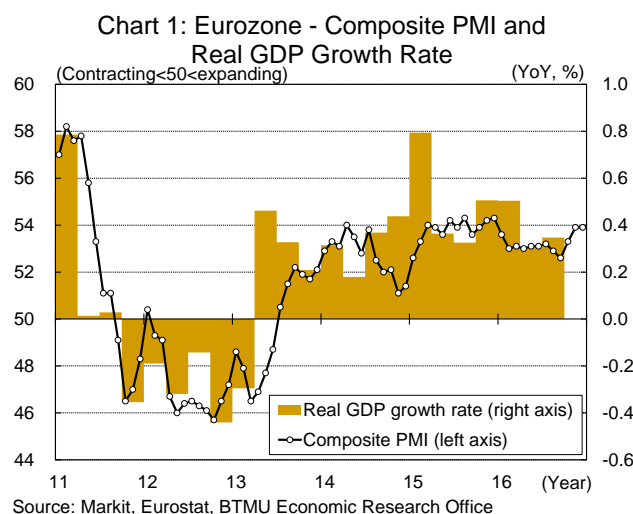
The European Economy Experienced Resilient Growth in 2016, but Political Trends Pose a Risk in 2017

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The Eurozone's business sentiment continued to improve. In December, the Eurozone's composite Purchasing Managers' Index was 53.9, maintaining a high level on the back of a recovery in the manufacturing sector in France and Germany (Chart 1). Industrial production fell by 0.1% in October month-on-month (MoM). However, it is forecast to improve in December because manufacturing new orders, a leading indicator of manufacturing activity, showed a solid increase in Germany and the pace of the decrease in new orders in Italy has slowed. Moreover, in the household sector, consumer confidence has improved for four consecutive months and growth of real retail sales increased 1.1% MoM in October. These figures suggest that real GDP growth remained robust in the final quarter of 2016.



Meanwhile, November's inflation rate was 0.6% year-on-year (YoY), continuing to fall short of the ECB's target. The ECB Governing Council decided to continue its monetary easing measures at a meeting on 8th December (Table 1, Chart 2). Specifically, the deadline for the Asset Purchase Programme (APP) was extended from March 2017 to December 2017, and the parameters of asset purchases were broadened. Regarding the pace of purchasing, the ECB decided that it will decrease its monthly net asset purchasing from EUR80 billion to EUR60 billion from April 2017, contrary to market consensus to maintain the status quo. However, at a press conference after the meeting, the President of the ECB, Mario Draghi, emphasized that the decrease in purchases is not "tapering". He also clarified the ECB's continued stance on monetary easing, stating that "net asset purchases are intended to

continue until the end of December 2017, or beyond, if necessary” and that the ECB “will act by using all the instruments available within its mandate”. Concern about the lack of assets available for purchase – particularly German bonds – will continue to rise in the coming months. Therefore, it appears that the ECB wished to avoid the decreased pace of its net asset purchasing being interpreted as it taking steps towards ending its monetary easing measures.

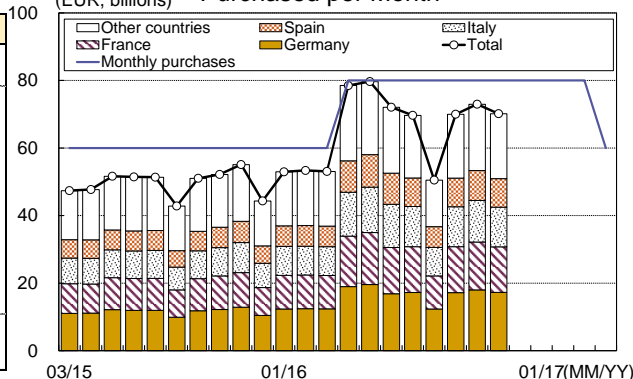
In 2017, there are several major political events: the UK Supreme Court will reach a decision in January about whether or not a parliamentary vote will be necessary in triggering Article 50, in spring, a general election will be held in the Netherlands and the French presidential election will also take place in Spring. In addition, the Italian Prime Minister, Matteo Renzi, has resigned following a referendum in December, and there are concerns that a general election will take place before the end of the parliamentary term in May 2018. It is unlikely that such political events will shake the EU/euro system, but it will be necessary to monitor the considerable impact on the real economy from unsettled financial markets and an erosion of business and household sentiment owing to increased uncertainty.

Table 1: Decisions of ECB's Governing Council - 8 December Meeting

Policy measures	Contents
• Key ECB interest rates	Unchange
• Asset Purchase Programme	Extend the deadline: Mar 2017→Dec 2017 Reduce monthly asset purchases: • EUR80→EUR60 billion (from Apr 2017) Expand bonds eligible for purchase (if necessary): • Decrease the minimum remaining maturity from 2 years to 1 • Permit purchase of securities with a yield to maturity below the interest rate on the deposit facility (-0.4%)
• Securities lending programme	Enhance accessibility (accept cash as collateral)

Source: ECB, BTMU Economic Research Office

Chart 2 : Public Sector Purchase Programme - Amount Purchased per Month



Note: The difference between "planned purchase amount" and "total" is due to the purchasing of covered bonds, ABS and government bonds
 Source: ECB, Bloomberg, BTMU Economic Research Office

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