The Outlook for European Economies

There is still great uncertainty surrounding Brexit and the current political situation, and the pace of recovery will slow going forwards

YASUHIRO ISHIMARU
CHIEF MANAGER
ECONOMIC RESEARCH OFFICE
T 03-3240-3204

The Bank of Tokyo-Mitsubishi UFJ, Ltd.
A member of MUFG, a global financial group

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1. Eurozone

(1) Current Economic Situation

The Eurozone economy is maintaining its trend of gradual recovery. In Q3, its real GDP growth rate was 0.3% QoQ, continuing an increasing trend. The figures by country reveal that the growth pace in Germany and Spain is decelerating, while in France and Italy it is accelerating (Table 1). Looking at the trend of countries who published a breakdown by expenditure, growth in Germany was supported by private consumption (0.4% QoQ) and government expenditure (1.0% QoQ). On the other hand, exports slowed by 0.4% QoQ. Meanwhile, Spain’s private consumption was robust (0.6% QoQ) on the back of improvements in the labour market, but fixed capital formation decelerated to 0.1% QoQ from 1.1% QoQ the previous quarter. In France, business investment slowed by 0.2% QoQ and private consumption remained relatively unchanged from the previous quarter. However, government expenditure accelerated to 0.5% QoQ. In general, investment and exports appear to be weak, whereas growth of private consumption remains robust.

(2) Outlook

The Eurozone’s real GDP growth is forecast to decelerate to 1.1% YoY in 2017, after reaching 1.5% YoY in 2016 (Table 1). This is due to the strong possibility that the UK’s decision to leave the EU will put downward pressure on growth; exports to the UK are expected to slow and business investment will be inhibited owing to high levels of uncertainty. Moreover, depending on the result of important elections in major countries taking place in 2017, there is the risk of a negative impact to the real economy as an unsettled political situation will worsen sentiment. However, it appears that private consumption will continue to underpin the economy on the back of a recovery in the labour market. It is probable that the steady trend of recovery will continue uninterrupted.

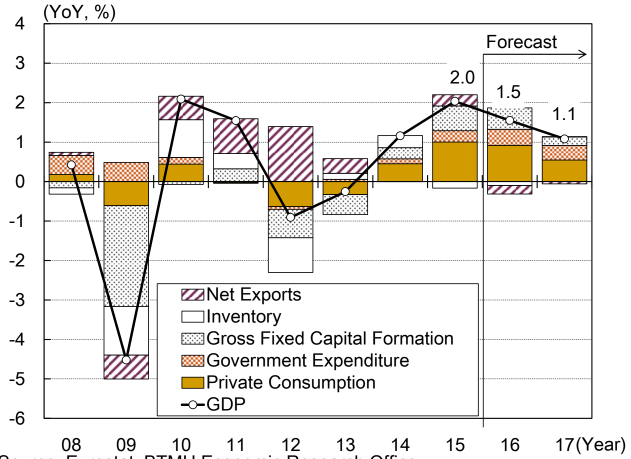
Table 1: Eurozone Real GDP

(QoQ, %)

	2015				2016		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Eurozone	0.8	0.4	0.3	0.5	0.5	0.3	0.3
Germany	0.2	0.5	0.2	0.4	0.7	0.4	0.2
France	0.6	0.0	0.4	0.3	0.6	-0.1	0.2
Italy	0.3	0.2	0.1	0.2	0.4	0.0	0.3
Spain	1.0	0.8	0.9	0.8	0.8	0.8	0.7
Portugal	0.6	0.3	0.1	0.3	0.2	0.3	0.8
Greece	0.7	0.0	-1.5	1.2	-0.6	0.3	0.5

Source: Eurostat, BTMU Economic Reserech Office

Chart 1: Eurozone Real GDP



Source: Eurostat, BTMU Economic Research Office

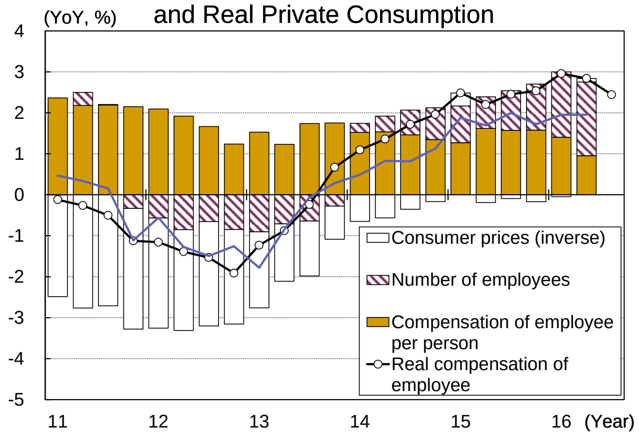
(3) Key Points

① Growth of private consumption is resilient due to labour market recovery

Currently, private consumption remains robust. Real retail sales maintained their growth, increasing 0.3% QoQ in Q3 from the previous quarter. The backdrop for this growth is favourable labour market conditions; compensation of employees per person continues to grow and the number of employees is rising at an increasing pace. Unemployment is following a declining trend, falling to 10.0% in Q3 – the same level as before the European debt crisis. Furthermore, low inflation owing to a fall in oil prices has pushed up real wages and supported private consumption (Chart 2).

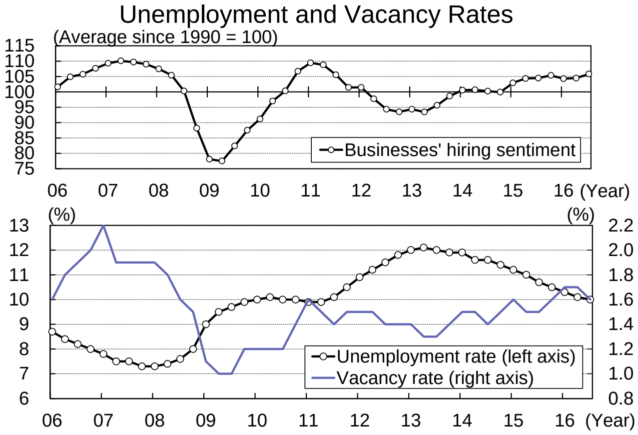
Due to a recovery in oil prices, it is unlikely that the upward effect of low inflation on real wages will continue in the coming months. However, the labour market will continue to improve. In addition to a rising trend in businesses' labour sentiment, it appears there is still room for the labour market to recover as the unemployment and vacancy rates have not yet recovered to the level they were at before the Global Financial Crisis (Chart 3). Therefore, it appears that the improved wage situation arising from a continued increase in labour will lead to resilient growth in private consumption in the future, which will underpin the economy.

Chart 2: Eurozone - Real Conpensation of Employee and Real Private Consumption



Note: "Real conpensation of employee" is the an estimated value of Q3.
Source: Eurostat, BTMU Economic Research Office

Chart 3: Eurozone - Hiring Sentiment and the Unemployment and Vacancy Rates



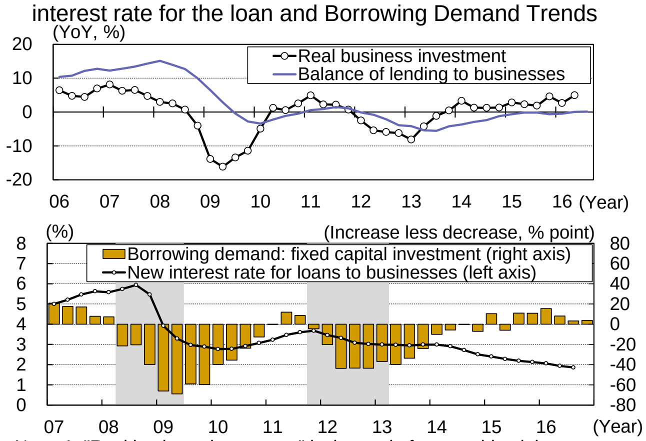
Note: 1. "Businesses' employment sentiment" is the average of the manufacturing, retail and services sectors.
2. "Vacancy rate" is the number of job vacancies divided by the sum of the number of job vacancies and the number of employees.
Source: The European Commission, Eurostat, BTMU Economic Research Office

② Uncertainty surrounding Brexit and the political situation weighs on investment demand

Currently, investment demand in the Eurozone is following a trend of steady growth, and borrowing demand related to businesses' fixed capital investment is picking up (Chart 4). Lending to businesses in the Eurozone has not increased significantly and there is room for discussion about the extent to which the effect of monetary easing by the ECB and the resulting decrease in lending rates is having on stimulating investment. Meanwhile, the capacity utilisation rate has risen to 82.3%, a high level compared with the long-term average. Potential demand has emerged, such as renewed investment, which was inhibited for a long time during the Global Financial Crisis and the European Debt Crisis. This potential demand will probably continue for the time being (Chart 5).

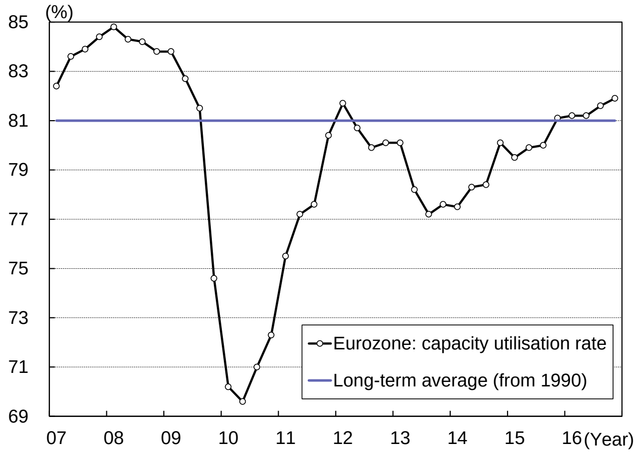
It is likely that uncertainty about the future will increase, especially uncertainty related to political risks, such as the UK's EU exit negotiations amongst other risks mentioned later. It appears that businesses' approach to investment will also become more cautious. The emergence of potential demand, such as renewed investment, will become a primary source of support, but growth of investment will remain low until around 2017.

Chart 4: Eurozone - Business Investment and the lending, interest rate for the loan and Borrowing Demand Trends



Note: 1. "Real business investment" is the total of non-residential construction investment and mechanical equipment investment
2. The shaded area shows periods of economic recession
Source: Eurostat, ECB, BTMU Economic Research Office

Chart 5: Eurozone - Capacity Utilisation Rate

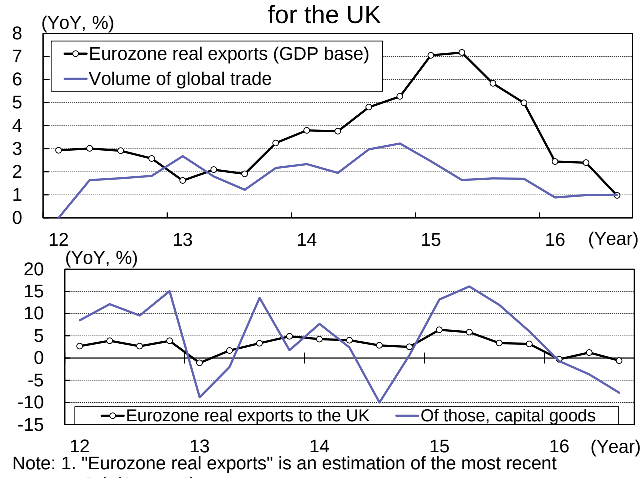


Source: European Commission, BTMU Economic Research Office

③ Exports are forecast to remain sluggish

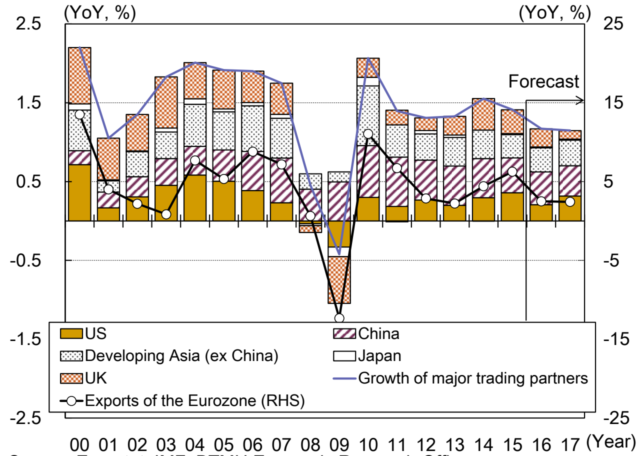
Exports weaken if the partner country's economy slows and the decrease of capital goods destined to the UK in Q3 has resulted in a deceleration in the current growth trend of Eurozone exports (Chart 6). Going forwards, the volume of global trade will pick up on the back of an economic recovery in the US. However, this will be countered by expectations of sluggish exports to the UK – a major export destination – which means the pace at which exports are increasing is forecast to slow (Chart 7).

Chart 6: Eurozone - Real Exports and Exports Destined for the UK



Note: 1. "Eurozone real exports" is an estimation of the most recent July/August data
2. "Real exports to the UK" is UK imports from the Eurozone
Source: Eurostat, CPB, BTMU Economic Research Office

Chart7：Exports of Eurozone



Source: Eurostat, IMF, BTMU Economic Research Office

④ Increased political risks due to the result of the US Presidential Election

Donald Trump's victory at the US Presidential Election showed voters' inherent dissatisfaction with established political parties, and there are concerns that this trend will spread to Europe. In particular, the French presidential election and the German general election taking place in spring and autumn next year respectively will act as a litmus test for the sustainability of the euro and the EU (Chart 8). The result of a poll in November by French polling company, Harris Interactive, suggests that the probability of Le Pen, leader of the Eurosceptic party National Front, remaining on the final ballot for president is high (Table 2).

Chart 8: Major Political Trends in Europe

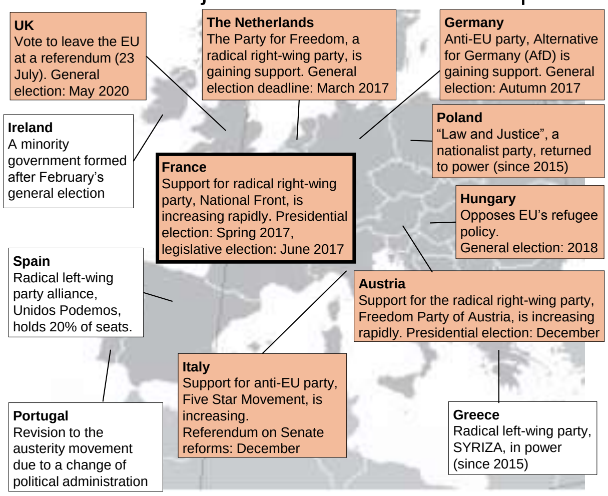


Table 2: European Major Political Parties and Candidates - Support Rate

Support Rate for Presidential Election Candidates	Support rate (%)	No. of seats in parliament (seats)			
France	Nov. poll	National Assembly			
Union for a Popular Movement (UMP): François Fillon	26.0	197			/577
National Front (FN): Le Pen	24.0	2			
Socialist Party (PS): Valls	9.0	285			
The Left Front Union: Mélenchon	15.0	15			
Support Rate for Political Parties					
Italy (the Chamber of Deputies and the Senate have equal authority)	Nov. poll	Senate		C. of Deputies	
Democratic Party (PD)	32.8	113	/320	310	/630
Five Star Movement (M5S)	27.3	35		91	
Lega Nord (LN) and autonomy	12.6	12		19	
Forza Italia (FZ)	12.4	42		50	
Area Popolare	3.3	29		30	
Germany (the Federal Diet has strong authority)	Nov. poll	Federal Diet			
Christian Democratic Union of Germany (CDU/CSU)	33.0	310			/631
Social Democratic Party of Germany (SPU)	22.0	193			
Alternative for Germany (AfD)	13.0	0			
Alliance '90/ The Greens (B90/Gr)	12.0	63			
The Left (Die Linke)	9.0	64			

(Source) Various, BTMU Economic Research Office

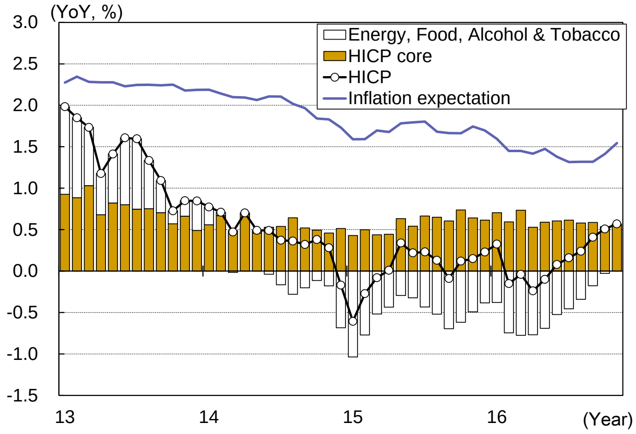
Regarding the German general election, the support rate for Alternative for Germany (AfD) is greater than 10%, and there is a strong possibility that they will gain a seat in the lower house for the first time. Furthermore, opinion polls of the five major pollsters show that the government's proposed constitutional reforms will probably be rejected at the referendum in December against a backdrop of dissatisfaction towards the current administration. If the reforms are rejected, there is a risk that the prime minister will resign and the political situation will become more fluid. It is possible that the uncertainty surrounding these important elections and the referendum will affect business and household sentiment along with Brexit, and will become a source of downward pressure on the economy as a whole.

(4) Prices and Monetary Policy

The Eurozone's consumer price inflation rate (HICP) is gradually accelerating due to the recovery in oil prices and the expected inflation rate shows signs of bottoming out (Chart 9). However, there is a limited sense of increase in the core inflation rate and the ECB has suggested their target of raising inflation to "below, but close to, 2%" will be met in the period from around the end of 2018 to the start of the following year.

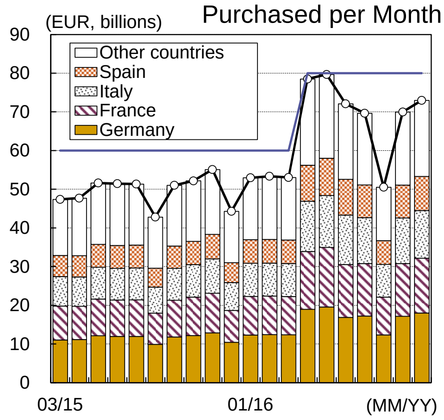
Under such circumstances, it is likely that the ECB will maintain its monetary easing policy in the future. In October, there were reports that it will start to scale back its asset purchase programme (APP). That being said, while a change to its monetary policy stance has not been revealed, the ECB has reviewed a change to the method of easing, taking into account insufficient funds for future assets subject to purchase. In fact, when we compare the cumulative purchase price of the Public Sector Purchase Programme (PSPP) (which accounts for 80% of the APP balance) up until now with the balance of government bonds which the ECB intends to purchase, approximately 60% of German bonds have been purchased. If buying continues at the present pace, it is calculated that the targeted bonds will run out in 10 months (Chart 10). Regarding the continuation of its policy on monetary easing, the APP will carry on until March 2017 and when the deadline is reached, it is forecast to be extended. However, it is likely that a technical modification to the current system will eventually be carried out.

Chart 9: Eurozone inflation



Notes: "Inflation expectation" is 5-year, 5-year EUR inflation swap rate.
Source: Eurostat, Bloomgerg BTMU Economic Research Office

Chart 10: Public Sector Purchase Programme - Amount Purchased per Month



Likelihood the ECB's public sector purchase programme will continue (as of 30 Nov 2016)

(EUR, billions)

	Germany	France
①Sovereign bonds eligible for purchase by ECB	450	858
② ECB's aggregate purchases	273	217
③ : ①−②	176	642
④Average monthly purchases since purchase amount increased	17	14

(Months)

	Germany	France
Timescale for continued purchasing ③÷④	10	47

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

2. UK

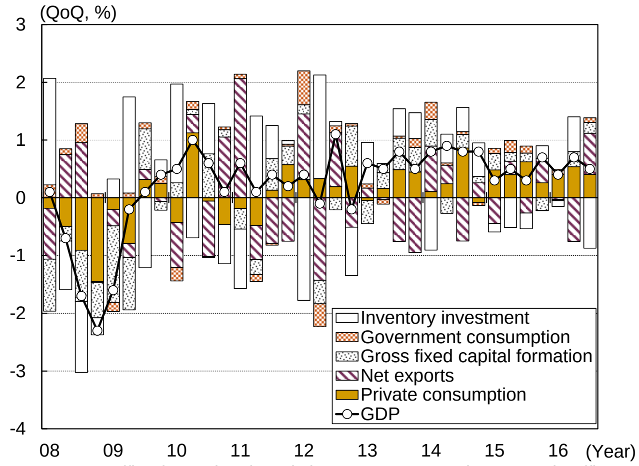
(1) Current situation

The uncertainty surrounding the future of the UK economy continues due to the decision to leave the EU which was made at a referendum in June. However, a sharp deterioration of the economy has been avoided up until now. Although the real GDP growth rate in Q3 decelerated from the previous quarter to 0.5% QoQ, resilient growth continued (Chart 11). Robust private consumption supports the economy against a backdrop of good labour market conditions.

Among the most recent economic indicators, the number of those showing a weak trend is increasing and it is thought that the economy is decelerating (Table 3). In addition to faltering manufacturing and construction output, the growth of house sales has fallen since the first half of the year. The number of people in work continues on an upward trend, but the pace of growth is decelerating somewhat. Additionally, the volume of exports and the trend of expenditure by foreign tourists to the UK are see-sawing and positive effects from the depreciation of the pound cannot be confirmed. While the significant worsening of consumer and business confidence directly after the referendum has improved, it has still not recovered to the level it was at before the referendum.

It is still difficult to forecast the process of leaving the EU. At the start of November, the British Supreme Court reached the verdict that the procedure to leave the EU must be approved by parliament. Prime Minister Theresa May intends to invoke Article 50 by March next year without parliamentary consent, but this plan is dependent on the verdict of the appeal by the Supreme Court in January. It cannot be denied that the progress of invoking Article 50 will be significantly delayed depending on the length and complications of the Parliamentary discussion and it is likely that the continued uncertainty will be a factor in the downward pressure on sentiment.

Chart 11: UK Real GDP



Source: UK Office for National Statistics, BTMU Economic Research Office

Table 3: UK Main Economic Indicators

2016	Average Jan to Jun	Jul	Aug	Sep	Oct
Industrial production (MoM, %)	0.5	0.1	-0.4	-0.4	—
Real retail sales (MoM, %)	0.5	2.0	0.2	0.1	1.9
Number of employees (Compared with previous 3-month period, %)	0.3	0.5	0.3	0.2	—
Real construction production (MoM, %)	-0.4	0.7	-1.1	0.3	—
Number of property sales (MoM, %)	4.7	1.3	0.1	-0.1	1.0
Volume of exports (MoM, %)	-0.5	6.6	0.2	-0.8	—
Expenditure by foreign tourists (MoM, %)	-0.3	-2.2	3.3	-4.8	—

Source: UK Office for National Statistics, BTMU Economic Research Office

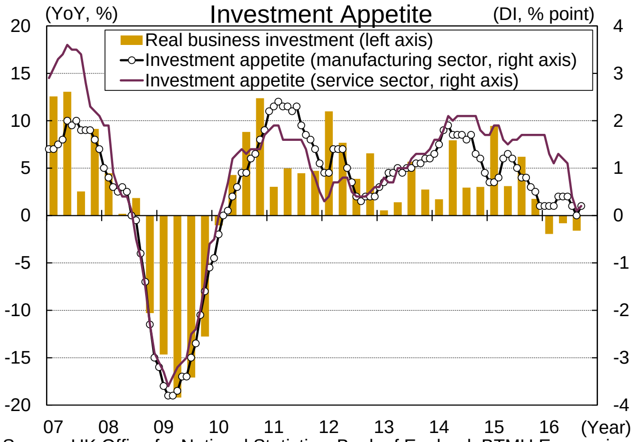
(2) Outlook

Downward pressure on the economy is forecast to increase further in the coming months. Looking at investment appetite in the corporate sector, the manufacturing industry has been sluggish since the end of last year, and the service sector has become considerably more cautious since the referendum (Chart 12). Since the start of 2016, growth of real corporate investment has already slowed compared with the previous year and there is a large possibility that it will decelerate further in the future. Consumer confidence is sluggish and the rise of the inflation rate has become a factor in the downward pressure on households. The pressure from import inflation is growing on the back of significant pound depreciation since the referendum; in October, the price of imported raw materials was 14.1% YoY, the highest growth since 2011 (Chart 13). The rise in consumer prices is expected to accelerate due to the spread of inflationary pressure from imports to the UK, and it seems that the decline in real purchasing power of households will inhibit consumption going forwards.

At present, it is not just the growth of import prices which is accelerating; the growth of export prices is also accelerating. This is due to the continued fall in the pound amongst other factors. FX-denominated export prices generally remain the same; whereas GBP-denominated export prices are rising. Looking forward, it is unlikely that FX-denominated export prices will fall significantly, and the upward pressure on the number of exports due to effect of pound depreciation has limited scope. This is because production costs are expected to rise owing to an increase in domestic prices.

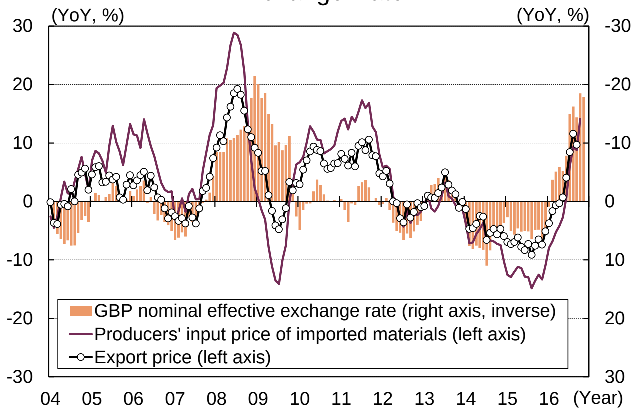
The real GDP growth rate is forecast to hit a comparatively high growth of 1.9% YoY in 2016, but this is expected to decelerate to 0.8% YoY in 2017.

Chart 12: UK - Real Business Investment and Investment Appetite



Source: UK Office for National Statistics, Bank of England, BTMU Economic Research Office

Chart 13: UK Import and Export Price and the GBP Exchange Rate



Source: UK Office for National Statistics, Bank of England, BTMU Economic Research Office

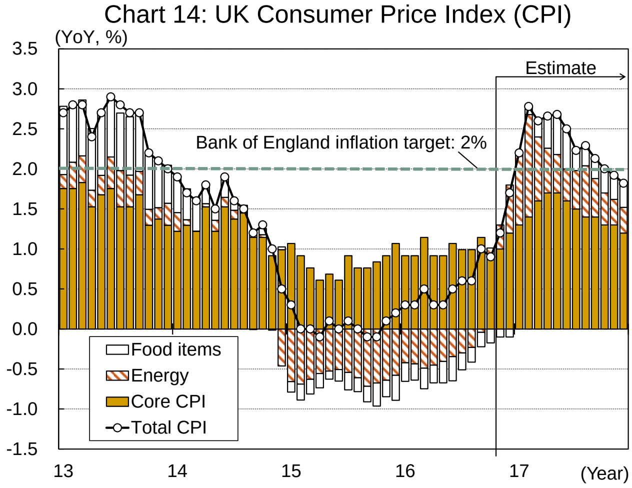
(3) Monetary policy

Since the end of 2015, the inflation rate has followed an upward trend. In September, the Consumer Price Index was 0.9% YoY, falling slightly from 1.0% YoY the previous month. However, this is expected to accelerate further in the coming months owing to the continued recovery of oil prices and the ripple effects of pound depreciation (Chart 14). It is likely that CPI will greatly exceed the BoE's target of 2.0% in the first half of 2017.

Under these circumstances, the BoE kept its policy rate at 0.25% at its Monetary Policy Committee meeting on 3rd November. At its meeting in August, where it lowered the policy rate for the first time in 7.5 years, the BoE carried out an additional rate cut in line with its outlook, but it updated its outlook after taking into consideration the increase of inflationary risks (Table 4). Looking forward, the monetary policy management will guard against downside risks to the economy and an accelerated inflation rate. It may deal with this by tightening and easing monetary policy.

The feeling of economic deceleration will strengthen in accordance with the inflation rate, which will rise until around mid-2017, and the BoE will be urged to gently steer monetary policy in the future. Subsequently, the inflation rate is expected to be below 2.0% YoY due to the base effect of pound depreciation and a rebound in oil prices, and is forecast to relieve downward pressure on the economy to some extent. In the medium term, the BoE will judge the balance of the economy and the risk of inflation and is expected to continue to hold its policy rate.

Chart 14: UK Consumer Price Index (CPI)



Source: UK Office for National Statistics, BTMU Economic Research Office

Table 4: Bank of England's Changes to their Outlook

	August	November
Economy	• The growth rate forecast is very low.	• Likely that the growth rate in the short term will be higher than earlier forecasts.
Prices	• The inflation rate is forecast to exceed the target of 2%.	• It is predicted that the future inflation rate will exceed the predication made in August.
Monetary Policy	• Even though the inflation rate will temporarily exceed the target, monetary easing is appropriate in stimulating the economy • If the economy moves in line with current predictions, there will be a further rate cut this year.	• There is a limited tolerance for above-target inflation • Monetary easing and tightening will both be used in response to changes in the future economic outlook

(Source) Bank of England, BTMU Economic Research Office

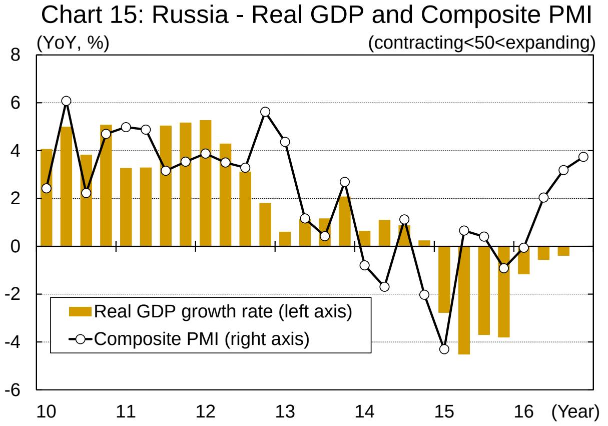
3. Russia

(1) Current situation

The Russian economy is still in a recessionary phase, but it is slowly coming to an end. In Q3, the real GDP growth rate was -0.4% YoY; the pace of decline decelerated for a third consecutive quarter (Chart 15). In October, the Purchasing Managers' Index was 53.7, rising to a level well over 50, which marks the boundary between the growth and decline of business activities. As such, the economy is thought to be on a path of recovery.

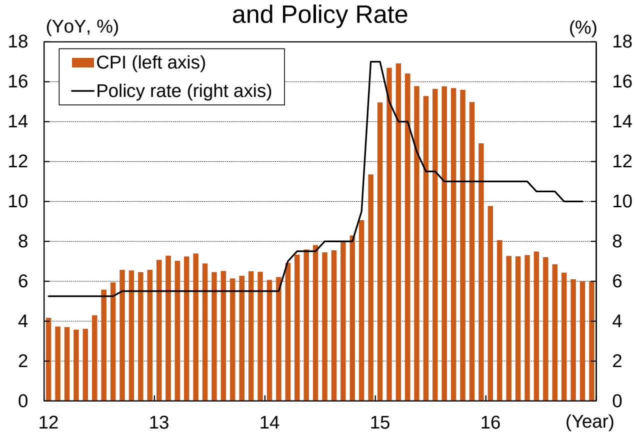
The stabilisation of the rouble along with the fall in inflation has led to an easing of downward pressure on the economy. The impact of the swift depreciation of the rouble and the sudden rise in food prices lasted a year from the latter half of 2014 until mid-2015. In October, the Consumer Price Index was 0.6% YoY, falling to same level which was recorded at the start of 2014 (Chart 16). The Bank of Russia (CBR) carried out rate cuts in June and September owing to a calmer inflation trend and the policy rate was cut to 10.0%. The policy rate remains at a high level, but it is thought that the easing of monetary policy tightening is contributing to some extent to the downturn of the economy.

Chart 15: Russia - Real GDP and Composite PMI



Note: "Composite purchasing managers' index (PMI)" is the monthly value in October, the most recent data
Source: Russian Federal Service for State Statistics, Markit, BTMU Economic Research Office

Chart 16: Russia - Consumer Price Index (CPI) and Policy Rate



Source: Russian Federal Service for State Statistics, Central Bank of Russia, BTMU Economic Research Office

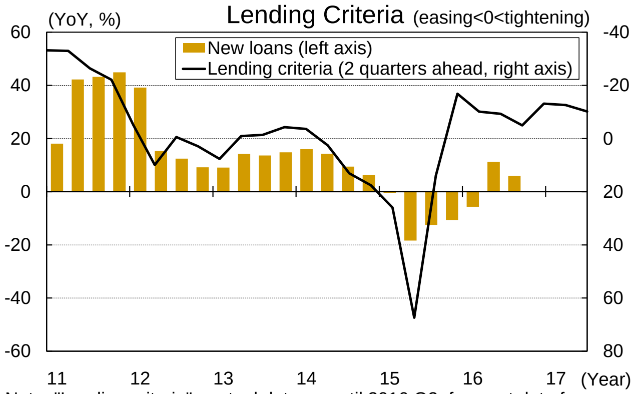
(2) Outlook

In 2017, oil prices will follow a gradual, upward trend, which will be established above US$50 per barrel. This will be a factor in the stabilisation of the rouble – the currency of an oil-producing country. Real purchasing power is forecast to recover due to a continued decrease in the inflation rate and there is scope for additional rate cuts on the monetary policy front. Financial institutions are relaxing their lending criteria, which will also support the spread of the effects of monetary easing (Chart 17).

However, it is highly likely that it will take some time for the inflation rate to fall to the CBR's target of 4.0% YoY, and a large policy rate cut is unlikely. Furthermore, in order for Russia's balance of payments to reach equilibrium, oil prices will need to be around US$70 per barrel, and there is a strong possibility that fiscal tightening will be a source of downward pressure on the economy. According to the budget proposal, there will be a slight increase in federal government expenditure compared with last year. Expenditure is forecast to fall at a comparable rate as it did in 2016, on a real basis which takes into account inflation (Chart 18).

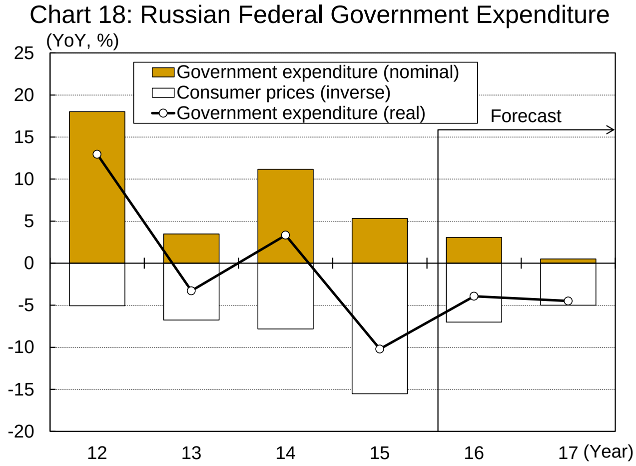
After decelerating by 0.5% YoY last year, the real GDP growth rate will enter positive territory for the first time in three years, but the growth rate is expected to remain at a gentle pace of recovery: 0.8% YoY.

Chart 17: Russian Banks' New Loans and Lending Criteria



Note: "Lending criteria" - actual data up until 2016 Q2, forecast data from a survey of banks for Q3 and Q4.
Source: Russia Federal Service for State Statistics, BTMU Economic Research Office

Chart 18: Russian Federal Government Expenditure



Source: Ministry of Finance of the Russian Federation, Russian Federal Service for State Statistics, BTMU Economic Research Office

Europe Economic Outlook

	Real GDP (YoY, %)			HCPI/CPI (YoY, %)			Current Accunt Balance (bil. US$)		
	2015 Actual	2016 Forecast	2017 Forecast	2015 Actual	2016 Forecast	2017 Forecast	2015 Actual	2016 Forecast	2017 Forecast
Eurozone	2.0	1.5	1.1	0.0	0.2	1.2	358.3	341.8	310.8
Germany	1.7	1.5	1.2	0.1	0.3	1.3	283.9	286.0	250.0
France	1.3	1.2	1.1	0.1	0.3	1.0	-4.9	-40.9	-23.0
Italy	0.7	0.7	0.8	0.1	0.0	0.9	29.3	46.6	33.8
UK	2.2	1.9	0.8	0.1	0.7	2.3	-153.1	-134.6	-104.6
Russia	-3.7	-0.5	0.8	15.6	7.1	5.7	69.0	24.0	49.0

(YoY, %)

	Eurozone			UK		
	2015 Actual	2016 Forecast	2017 Forecast	2015 Actual	2016 Forecast	2017 Forecast
Nominal GDP	3.2	1.7	2.2	2.6	3.5	3.4
Real GDP	2.0	1.5	1.1	2.2	1.9	0.8
Domestic Demand	1.7	1.8	1.1	2.6	1.8	0.3
Net Exports	0.3	-0.2	-0.1	-0.4	0.1	0.5
Private Consumption	1.8	1.7	1.0	2.6	2.7	1.0
Government Expenditure	1.4	1.9	1.8	1.5	1.3	0.8
Gross Fixed Capital Formation	3.2	2.7	1.1	3.4	1.0	-1.5
Inventory	-0.2	-0.1	0.0	-0.2	-0.1	0.1
Exports	6.5	2.2	2.2	4.5	2.5	1.0
Imports	6.4	3.0	2.5	5.4	2.1	-0.7

Note: 1. Eurozone includes Belgium, Germany, Ireland, Greece, Spain, France, Italy, Cyprus, Luxembourg, Malta, The Netherlands, Austria, Portugal, Slovenia, Slovakia, Finland, Estonia and Latvia.
2. "Domestic Demand", "Net exports" and "Inventory" are conribution.

For further details, please contact the Economic Research Office, Bank of Tokyo-Mitsubishi UFJ

Chief Manager, Yasuhiro Ishimaru Tel: 03-3240-3204

Written by Yuka Maehara yuka_maehara@mufg.jp

Shin Takayama shin_takayama@uk.mufg.jp