

## ***Eurozone economy robust amid simmering political risk***

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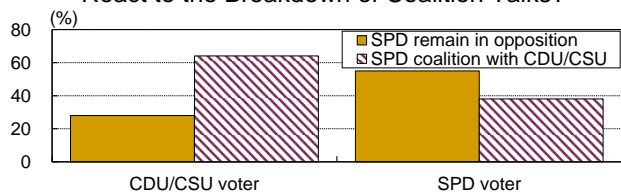
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There is at present a strong current of political uncertainty in Europe which is set to continue into 2018. In Germany, a core EU country, coalition talks between the Christian Democratic Union and Christian Social Union (CDU/CSU) and Social Democratic Party (SPD) are not expected to be straightforward. In addition to policy differences, a large proportion of SPD party members and voters believe that the party should remain in opposition (chart 1) because the coalition system is viewed as a factor in the recent decline of the party's strength. Destabilisation of the political situation will be unavoidable if inconclusive talks result in the formation of a minority government (this has not happened immediately after an election since WWII), or another election, which would raise the possibility of further CDU/CSU seat reductions. Furthermore, in addition to the ongoing issue of Catalan independence in Spain, the Italian general election is planned for March 2018, and the Northern League and Five Star Movement are drawing attention with their intent to exceed the EU budget deficit target.

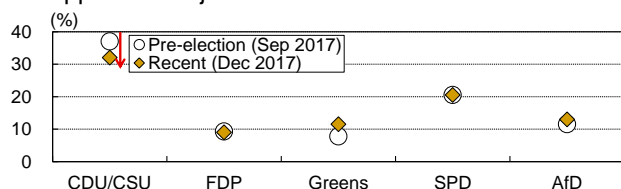
However, like recent Brexit developments, this kind of political uncertainty does not necessarily place significant downward pressure on the economy, and Eurozone business sentiment is improving. The composite PMI continues to rise, reaching a high of 58 in December following expansion of manufacturing export orders, and consumer confidence has been improving for five consecutive months (table 1). Looking at economic indicators for October, industrial production increased slightly by 0.2% month on month (MoM), and real retail sales and exports were weak. However, bearing in mind the continued increase in German manufacturing orders, which is a leading indicator for production, it is difficult to foresee a slowdown of production into December. There is no marked change in employment and income conditions, which support private consumption, and the unemployment rate has dropped to 8.8%. The Eurozone economy looks likely to remain robust for the remainder of 2017, and loose monetary policy is forecast to continue into 2018 against a backdrop of low inflation, with blind spots due to regional factors unlikely.

This kind of political divergence is a global trend which is seen in Asia for example, home to the Korean peninsula and in the US, where there is a strong sense of uncertainty over the direction of the Trump administration. One factor supporting the economy is the fact that the markets are not disrupted by this, having grown accustomed to political risk. Though the situation should be monitored as normal, it looks likely that political uncertainty and a robust economy will continue to coexist in Europe too.

Chart 1: German Opinion Poll: How Should the SPD React to the Breakdown of Coalition Talks?



Support for Major German Parties Pre/Post Election



Source: Infratest dimap, BTMU Economic Research Office

Table 1: Eurozone Key Economic Indicators

	2017							
	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Real GDP (QoQ, %)	0.7		0.6		-			
Industrial production (MoM, %)	1.3	-0.5	0.3	1.5	-0.5	0.2	-	-
German manufacturing orders (MoM, %)	1.2	0.8	-0.4	4.1	1.2	0.5	-	-
Real retail sales (MoM, %)	0.4	0.4	0.0	-0.2	0.8	-1.1	-	-
Total exports (MoM, %)	2.3	-1.8	-1.3	2.6	1.1	-2.4	-	-
Unemployment rate (%)	9.2	9.0	9.0	9.0	8.9	8.8	-	-
Negotiated wages (YoY, %)	1.4		1.4		-			
German negotiated wages (YoY, %)	2.3	2.3	2.0	2.2	2.1	2.1	-	-
Headline inflation (HCIP) (YoY, %)	1.4	1.3	1.3	1.5	1.5	1.4	1.5	-
Composite PMI	56.8	56.3	55.7	55.7	56.7	56.0	57.5	58.0
Consumer confidence (balance)	-3.3	-1.3	-1.7	-1.5	-1.2	-1.1	0.1	0.5

Note: Where no country is named, figures are for the Eurozone  
 Source: Eurostat, Deutsche Bundesbank, Markit, European Commission  
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