Election Time(s) in Europe
~Challenges on the way to economic recovery~

~ A View upon European Economy by a Japanese Institutional Investor ~

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GDP: Growing More than Potential

- Real GDP (1Q/’17): +1.8%(SAAR). Deflation gap has been narrowing
  - Real economy has been expanding more than potential (mid-1%'s) since ’15.
  - Output gap: Negative gap has been narrowing (OECD: ▲1.2% in ’17). Positive?

Source: Eurostat
CPI : Picking Up with Disparity

- ’17/4 : CPI (YoY) +1.9%, Core (ex. Food & Energy) +1.2%
  - Although some noise by seasonal adjustment elevated the recent level, inflation pressure has been trending up. Disparity among members : Not narrowed much
  - Pullout of monetary accommodation would uncover the downward adjustment pressure in weaker economies together with bad debt issues.

Source: Eurostat
Leverage: In the Course of Adjustment

- Private debt / GDP: Under B/S adjustment pressure
  - Still adjustment pressure exists, presumably centered in countries such as Portugal, Italy, Ireland, Greece & Spain.
NPL: Peaked-out but Stay High in Some Area

- Non-performing Loan Ratio: Well-tamed but still high in some countries
  - Those in Greece, Portugal, Italy and Ireland are still higher than 15%, although Ireland marked a large drop recently. It has moved higher in Portugal.

(Note) No data for Greece as of '15/06.

Source: EBA
**Target 2 : Covered Support through ECB**

- Liquidity supply through ECB: Swelled. From stronger to weaker
  - Outstanding balance of Target 2 started to swell again since ’14/6
  - Interbank market has not been effectively functioning.

![Graph of ECB Target2 Balances](source: ECBm, Eurosystem)

![Graph of ECB Target2 Balances Change (’14/6–’17/3)](source: ECB, Eurosystem)
Credit Derivatives: Very Large in Europe

- B/S of credit derivatives across national boarder: 75% in Europe

Credit Derivatives: Very Large in Europe

CDS Cross-border transaction amount by location

- US, 21%
- Japan
- Others
- Europe, 75%

Source: BIS

※ As of the end of 2016.
※ Nominal amount outstanding.
※ Based on transactions with reporting dealers.
GSIFIs : Too Big to be Rescued

- Big Banks in Europe: Very large relative to GDP in some countries
  - (UK, Switzerland) & France: Large banks’ assets are very large vs. nominal GDP
  - Regardless of Bank Union, basically each sovereign government has the initial responsibility about prudence of each bank.
Government Bonds : Less Correlated Now

◆ Causality relations in Euro Government Bonds Market : Lowered
  – Causality in volatilities : Down. Waiting for another financial risk to be correlated and/or market is focusing upon country-specific situation in the election season?
  – “ The next financial crisis would be a catalyst for solid Euro Bank Union”

(Note) The result of the Granger causality test with 10 year bond index (26 weeks volatility, local currency).

Y → X : The null hypothesis is not rejected for case Y does not Granger cause X at 1%.
Y → X : The null hypothesis is not rejected for case Y does not Granger cause X at 5%.

Source : Datastream
“Italia und Germania”

Friedrich Overbeck (1828)
Neuen Pinakothek in München
(image from DIE PINAKOTHEKEN)
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