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May 23 , 2017

Election Time(s) in Europe

~Challenges on the way to economic recovery~

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

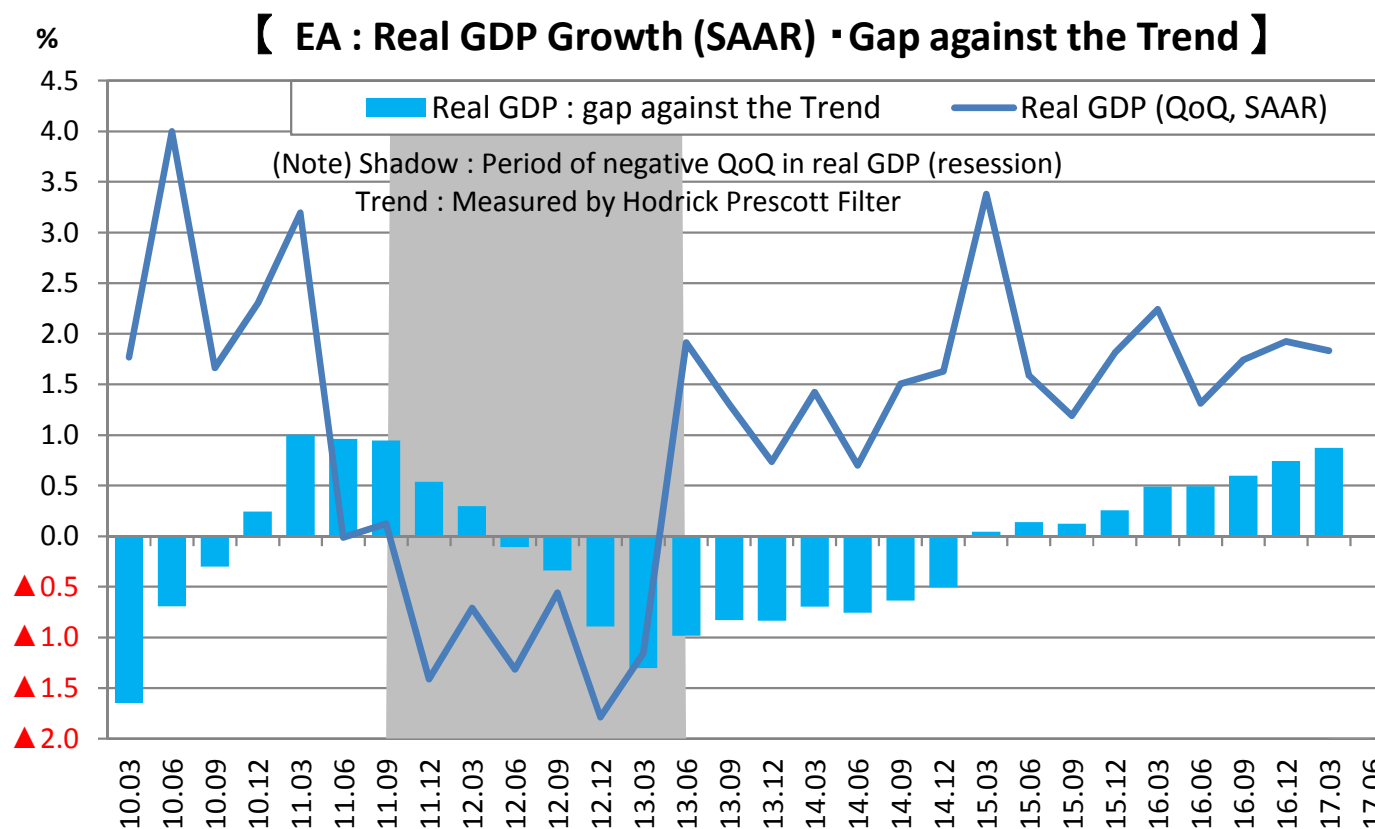


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GDP : Growing More than Potential

- ◆ 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?

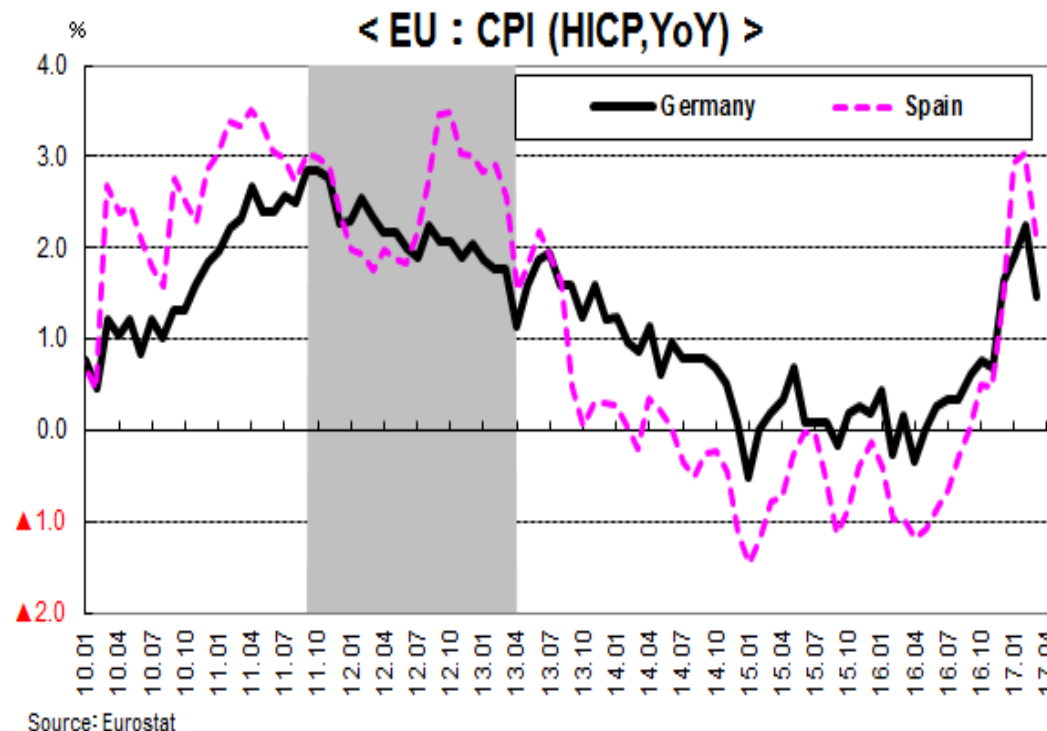
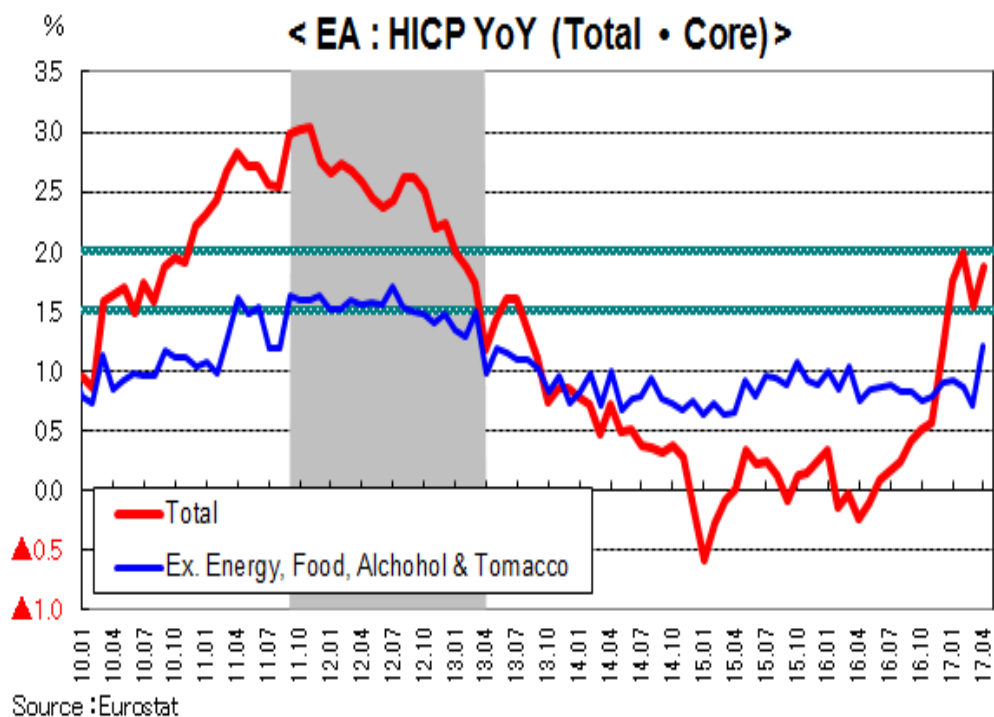


Source : Eurostat



CPI : Picking Up with Disparity

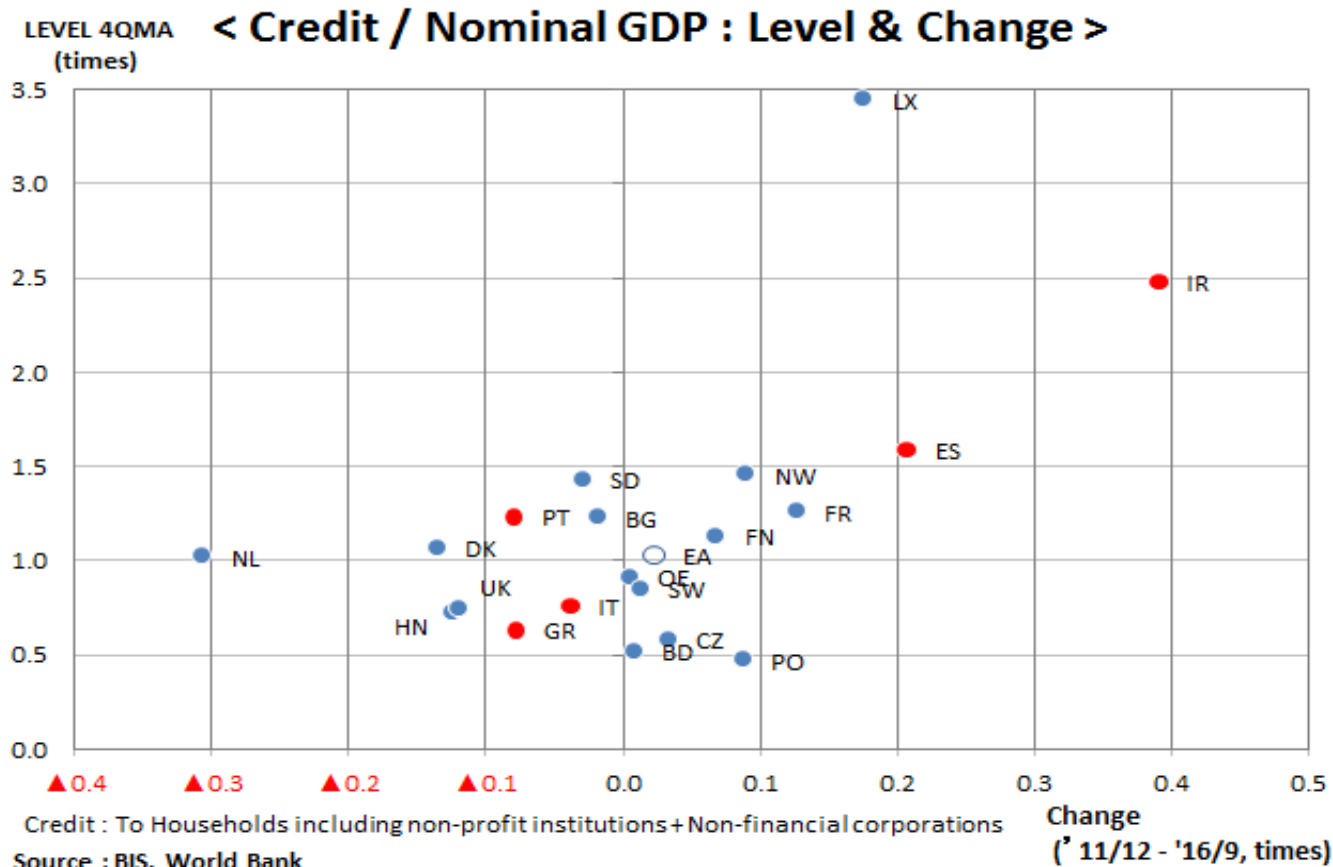
- ◆ '17/4 : CPI (YoY) +1.9%, Core (ex. Food & Energy) +1.2%
 - Although some noise by seasonal adjustment elevated the recent level, inflation pressure has been trending up. Disparity among members : Not narrowed much
 - Pullout of monetary accommodation would uncover the downward adjustment pressure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





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.

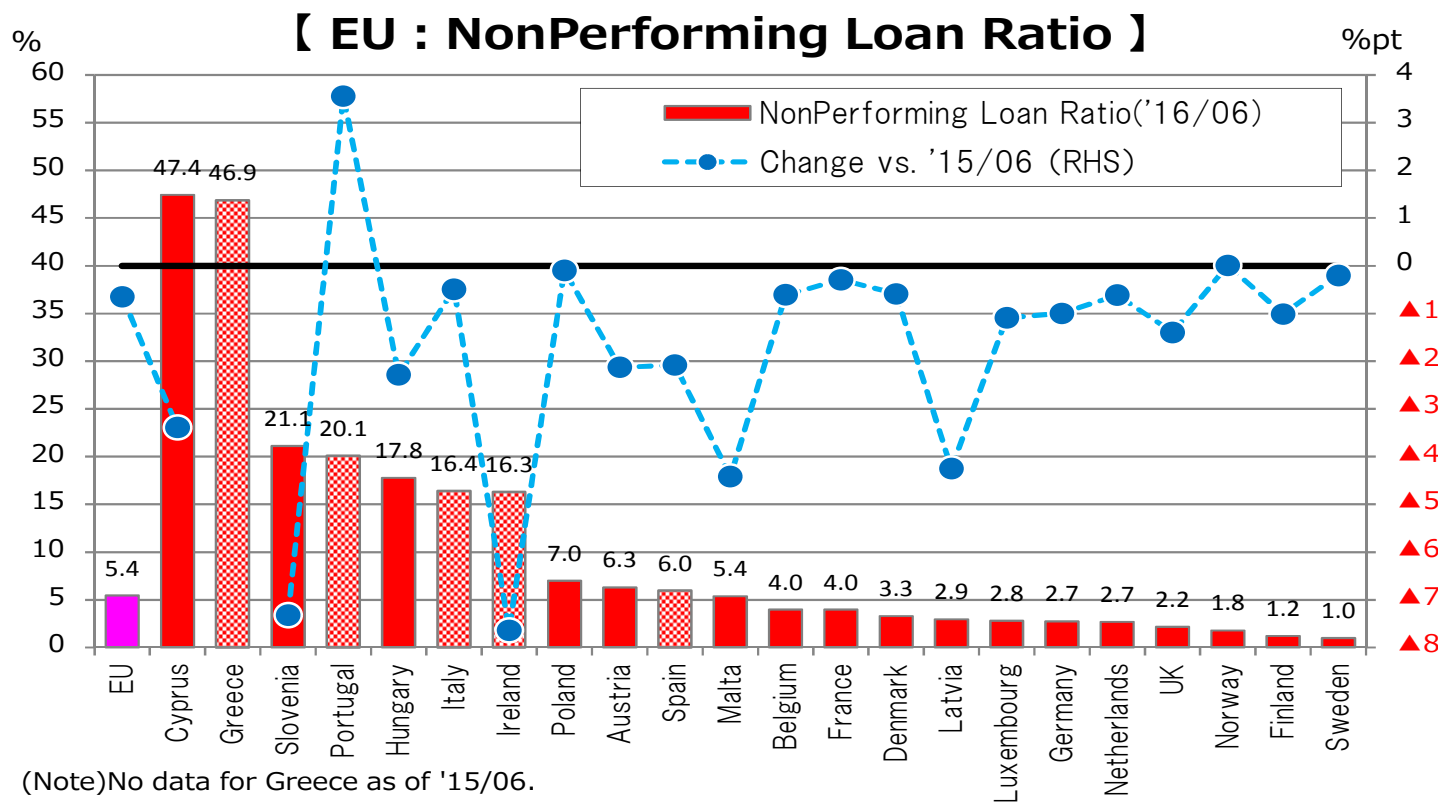


EA	Euro Area
BD	Germany
FR	France
IT	Italy
ES	Spain
NL	Netherlands
BG	Belgium
OE	Austria
GR	Greece
FN	Finland
IR	Ireland
PT	Portugal
LX	Luxembourg
UK	UK
SW	Switzerland
SD	Sweden
NW	Norway
DK	Denmark
PO	Poland
CZ	Czech
HN	Hungary



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.



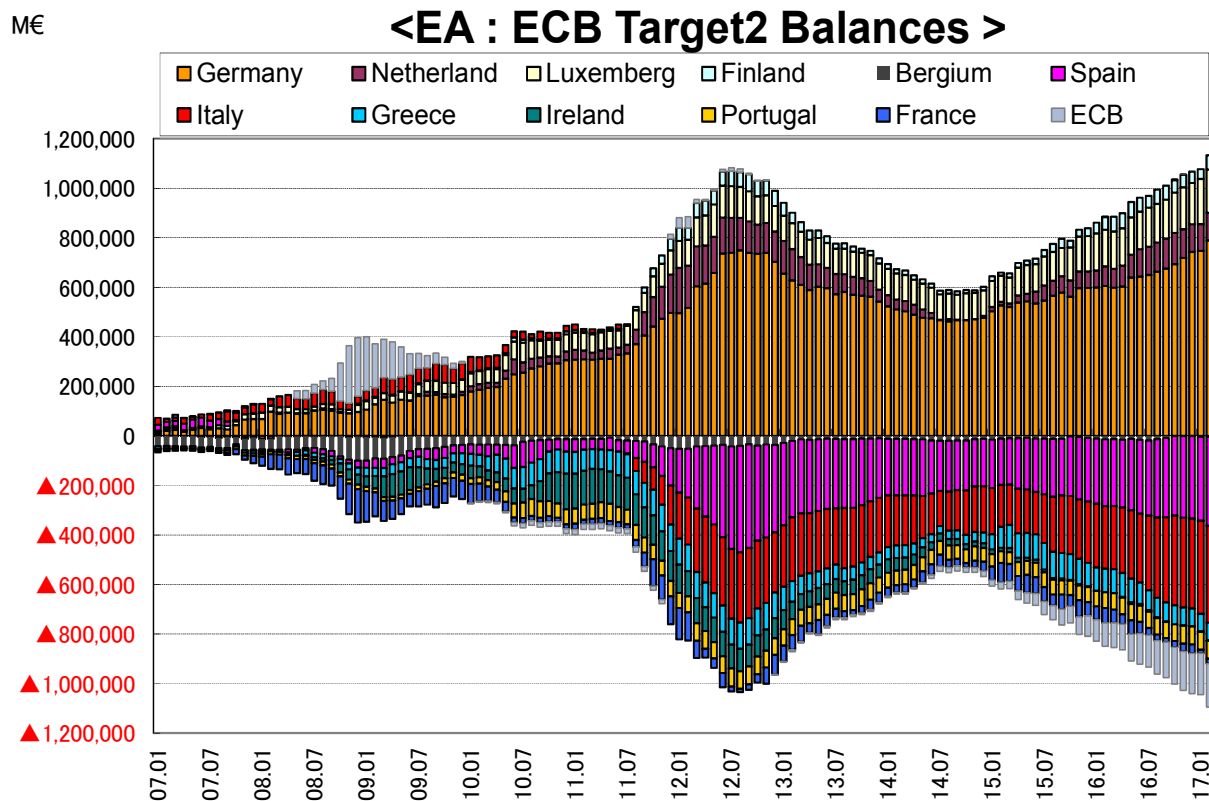
(Note) No data for Greece as of '15/06.

Source : EBA

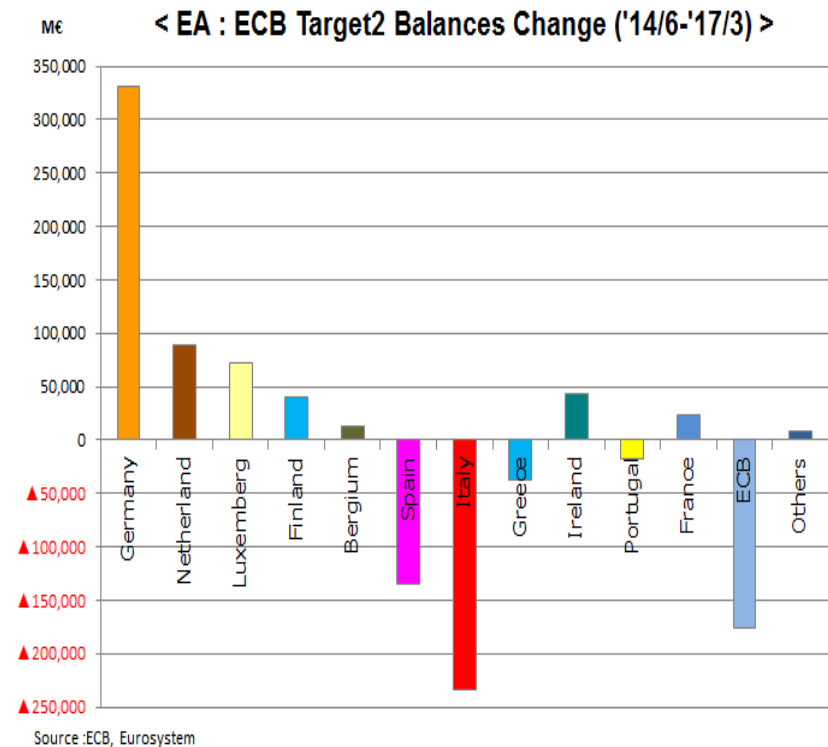


Target 2 : Covered Support through ECB

- ◆ 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.



Source : ECB, Eurosystem



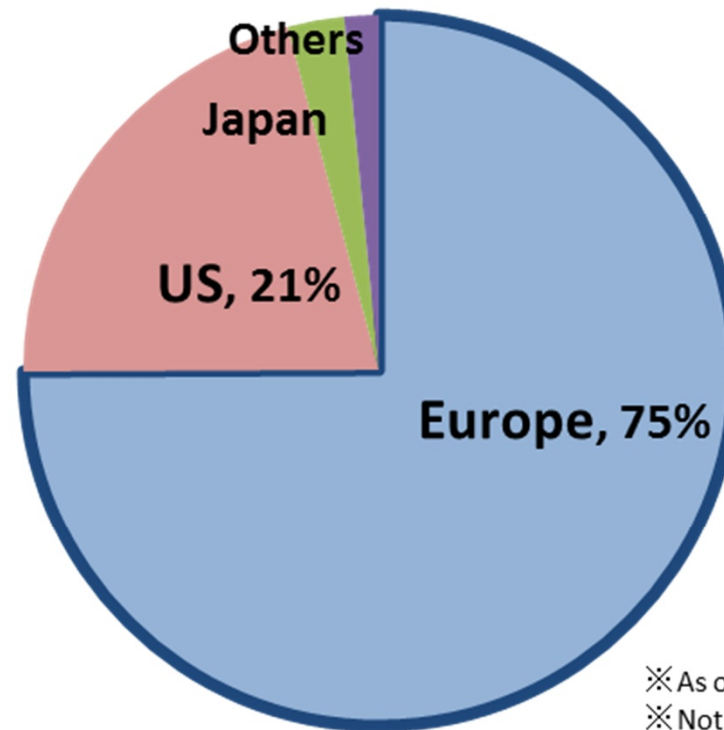
Source : ECB, Eurosystem



Credit Derivatives : Very Large in Europe

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

< CDS Cross-border transaction amount by location >



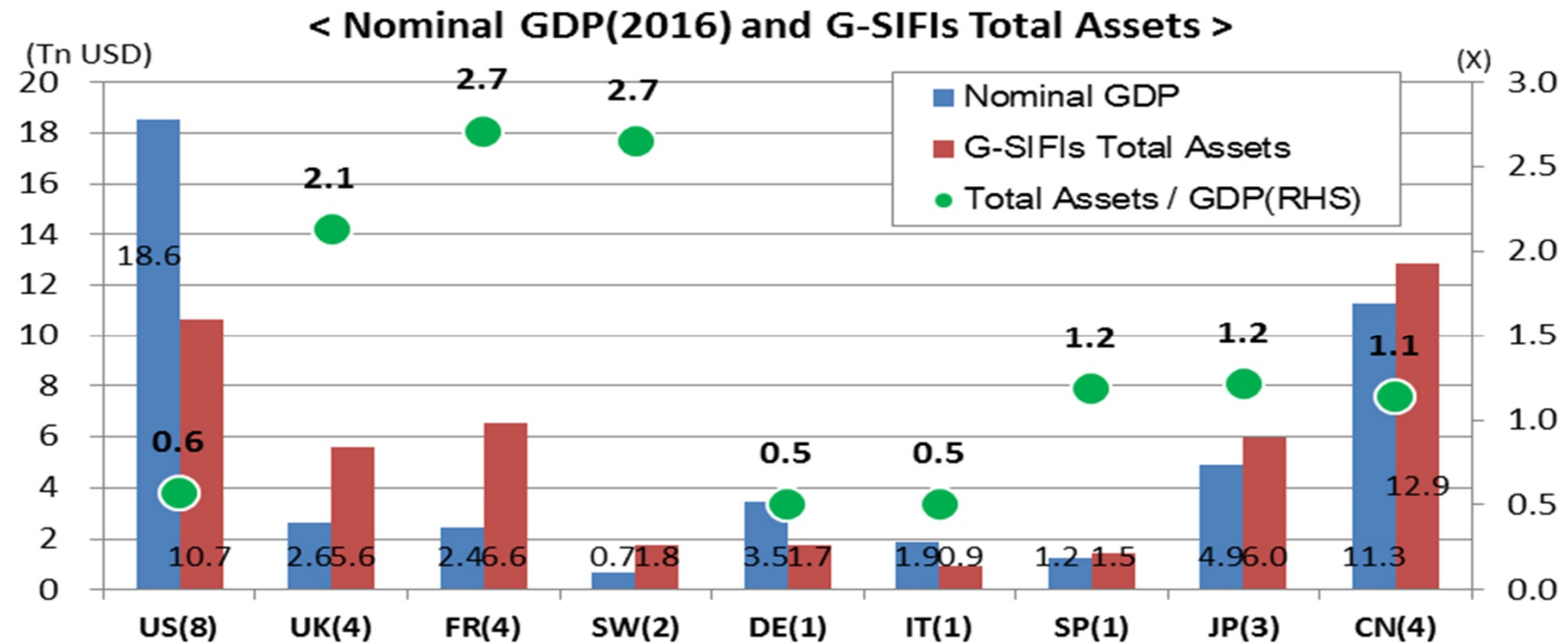
Source: BIS

- ⊗ As of the end of 2016.
- ⊗ Notinal amount outstanding.
- ⊗ Based on transactions with reporting delaaers.



G-SIFIs : 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.



Source : World Bank, Bloomberg

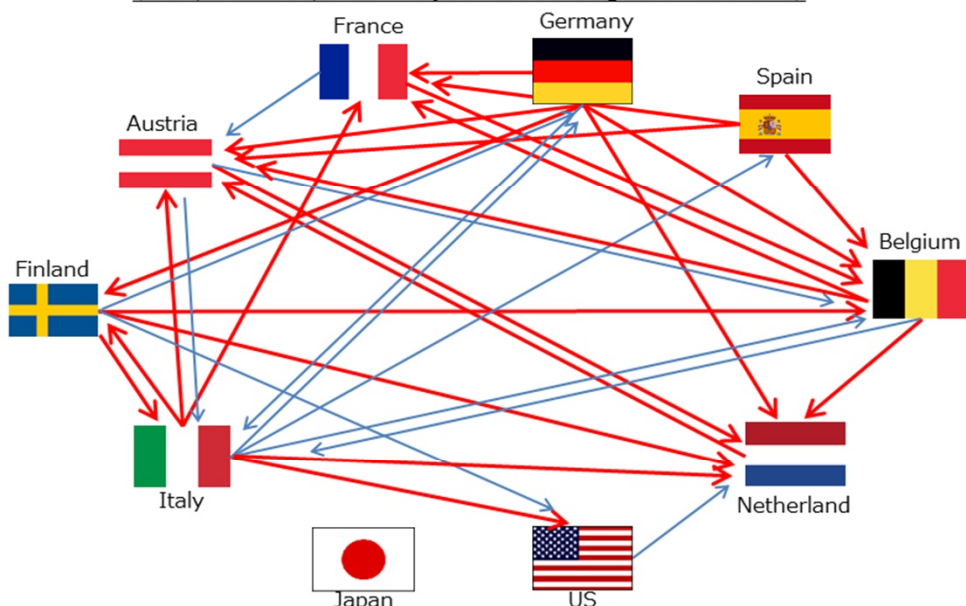
Note: The figures in () show the number of G-SIFIs in each country



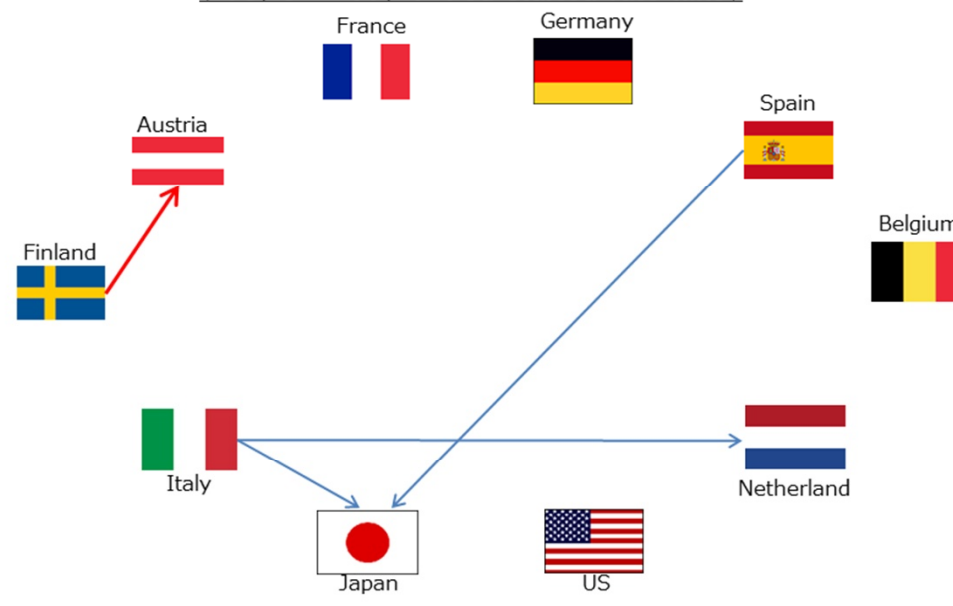
Government Bonds : Less Correlated Now

- ◆ 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”

【Causality in Volatilities : Euro Area Bonds】
 ('10/1~'13/2: European sovereign debt crisis)



【Causality in Volatilities : Euro Area Bonds】
 ('15/9~'17/4: Fed started rate hike)



(Note)The result of the Granger causality test with 10 year bond index(26 weeks volatility, local currency).
 $Y \rightarrow X$:The null hypothesis is not rejected for case Y does not Granger cause X at 1%.
 $Y \rightarrow X$:The null hypothesis is not rejected for case Y does not Granger cause X at 5%.

(Note)The result of the Granger causality test with 10 year bond index(weekly, local currency).
 $Y \rightarrow X$:The null hypothesis is not rejected for case Y does not Granger cause X at 1%.
 $Y \rightarrow X$:The null hypothesis is not rejected for case Y does not Granger cause X at 5%.

Source : Datastream

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“Italia und Germania”



“Italia und Germania”
Friedrich Overbeck (1828)
Neuen Pinakothek in München
(image from
DIE PINAKOTHEKEN)



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