CANACCORD Genuity
Wealth Management

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Weekly Note

Investment Team

Robert Jukes
Global Strategist
T: 44.207.523.4594
robert.jukes@canaccord.com

Michael Quach
Senior Research Analyst
T: 44.207.523.4528
michael.quach@canaccord.com

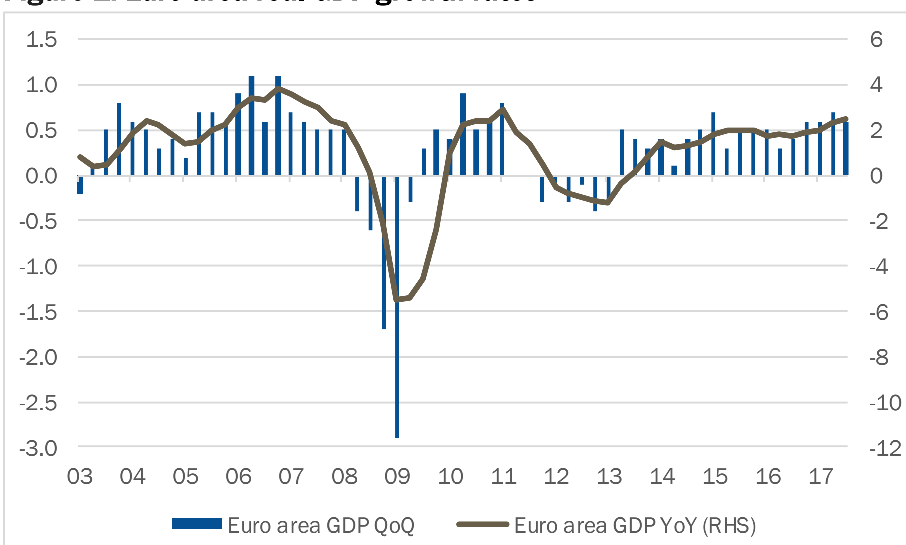
Ian LeCroy
Research Analyst
T: 416.867.2643
ian.lecroy@canaccord.com

Boom Bang-a-Bang

This year, Europe has transformed from one of the most troubled developed economies to one of the most celebrated. Parts of the region are positively booming on the incredibly supportive monetary policy and unemployment is beginning to normalize in even the hardest hit regions of Greece, Portugal and Spain. The latest estimate on economic growth for the euro area shows the region expanding by 0.6% quarter-on-quarter (QoQ) and by 2.5% year-on-year (YoY) in the third quarter of this year. This would represent 18 consecutive quarters of economic growth, which is within touching distance of the twenty consecutive growth quarters recorded from mid-2003 till early 2008 and the fastest annualized growth rate since the first quarter of 2011. There may be short-term political challenges ahead for the region, Brexit, Italian elections next year, and the business of forming a government in Germany, but there is nothing fundamental holding the region back from continued success.

That is, the positive economic momentum is likely to continue given the improvements in the underlying economic fundamentals and the prospect of an on-going supportive monetary policy. Figure 1 highlights the positive economic momentum in the euro area with the bars showing the QoQ growth and the line indicating the annualized growth rate on the right-hand scale.

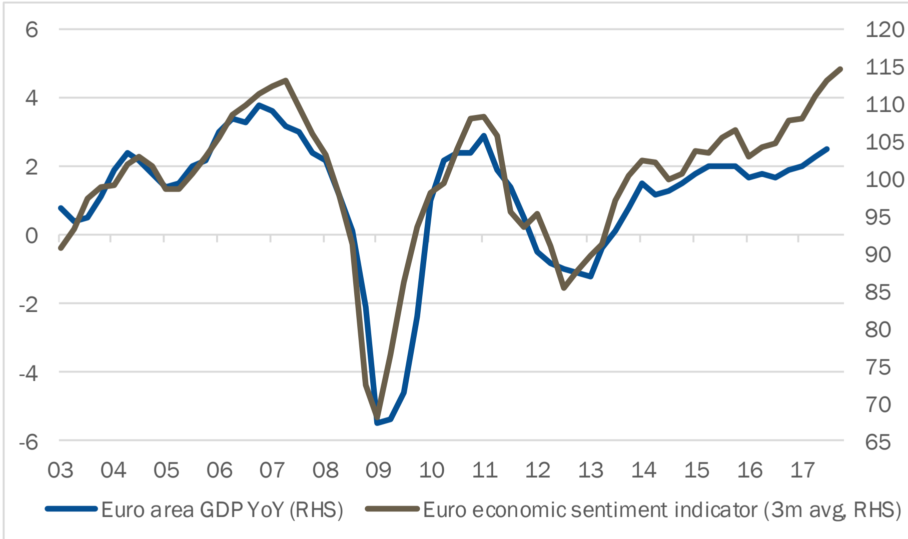
Figure 1: Euro area real GDP growth rates



Source: Datastream, Canaccord Genuity Wealth Management

The euro area economic sentiment indicator continued to rise by 0.5 points to 114.6 in November, which is the highest level since October 2000. The indicator is the weighted average of the industrial, the services, the construction and the retail trade confidence indicators. Figure 2 highlights the close correlation between the economic sentiment indicator and the real GDP growth rate. The upward momentum in the sentiment indicator last month, which was driven by improved confidence among consumers and in the construction sector while the industrial and services confidence remained unchanged, is likely to lead to further gains in the economic growth rate in the fourth quarter.

Figure 2: Positive economic momentum in the euro area



Source: Datastream, Canaccord Genuity Wealth Management

One of the key drivers of the improvement in consumer confidence within the euro area are households' more optimistic assessment of future employment. To a lesser degree the rise has been driven by households' assessment of the future general economic situation and their future financial situation. Figure 3 highlights the improvement in the employment within the region and more importantly, the uptrend in the employment expectations by manufacturing and service firms, which has historically led the growth in employment.

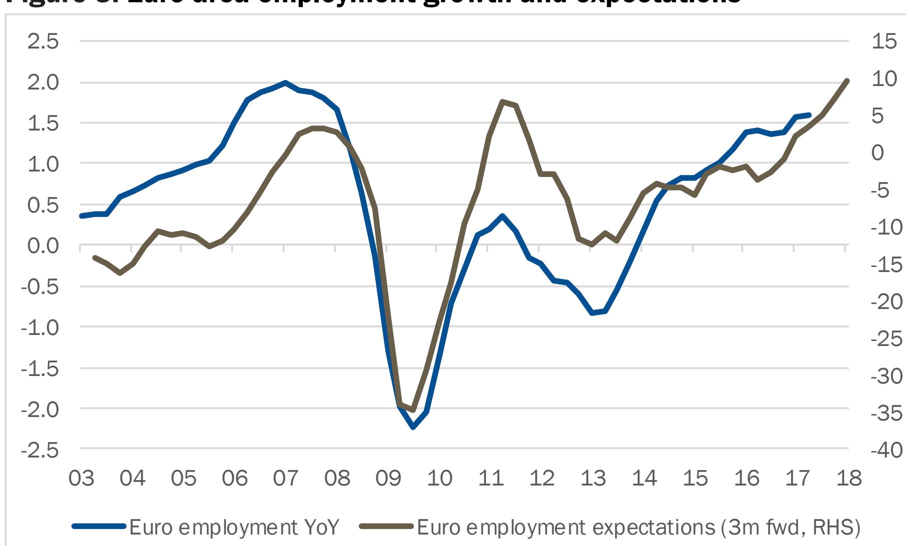
Indeed, employment expectations saw significant upward revisions in retail trade and industry in November with both indicators reaching their highest levels in more than 30 years. Employment plans in the construction sector also improved reaching a 10-year high. At the start of the year, 1 in 4 adults were unemployed in Greece, as of September this year it was 1 in 5, which is still too high, but the improving trend is clear. Europe remains underemployed relative to the peak of the previous cycle, so there is plenty of capacity to be taken up before the authorities start getting too concerned about wage inflation.

The other key driver of the positive economic momentum in the euro area has been the improvement in exports growth. Euro exports grew by 5.2% YoY in the third quarter of this year from 3.2% YoY growth in the third quarter of 2016. Moreover, export order books rose in November to its most optimistic reading since September 2007. As highlighted in Figure 4, the growth in exports is likely to continue given the strong uptrend in the exports order book.

Meanwhile, the latest estimates showed headline inflation for the region at 1.5% in November (from 1.4% in October). Core inflation (excluding energy and food) came in unchanged at 1.1% last month. The European Commission's November forecasts are for headline inflation of 1.5% in 2017, 1.4% in 2018 and 1.6% in 2019. The lack of strong inflationary pressures is supportive of an ongoing accommodative monetary policy. In relation to GDP growth, the European Commission is projecting growth of 2.2% in 2017, 2.1% in 2018 and 1.9% in 2019. Policy makers are likely to want to run the economy hot for longer than normal in order to alleviate some of the damage done through the European debt crisis.

Of course, there are political risks in Europe - Germany has yet to form a government, the Italians head to the polls next year for a general election, and Brexit will likely provide a dark cloud for the next year or two because European negotiations always go to the wire, and sometimes beyond. None of these risks, however, are threats to economic growth in the next year or two and in many ways, the success of the European growth recovery further reduces the potential for bad outcomes.

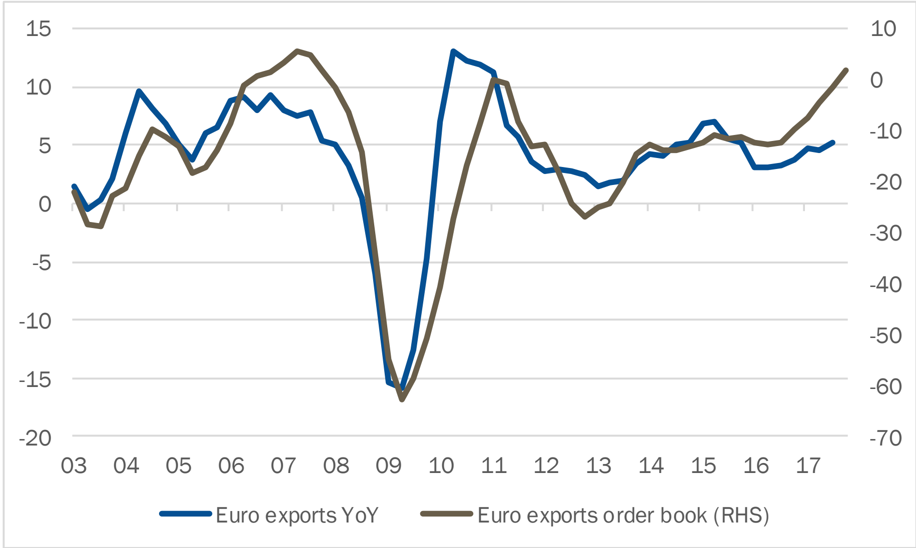
Figure 3: Euro area employment growth and expectations



Source: Datastream, Canaccord Genuity Wealth Management

It is hard not to like the recovery potential in the European block, and investors in the region should not underestimate the potential for a continued currency revaluation on the back of that. Indeed, we would not be surprised to see the Euro trading at 1.25-1.30 next year against the US dollar, and that against the backdrop of a stronger US dollar more generally. Europe has had a good year of economic recovery and equity market strength, next may be just as impressive as this economy shakes off the blues and starts to go Boom bang-a-bang, in true Eurovision style.

Figure 4: Export order books strongest since September 2007



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