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European Economics

Waiting for the Credit Impulse to Kick in

MORGAN STANLEY RESEARCH
Europe

Morgan Stanley & Co. International plc

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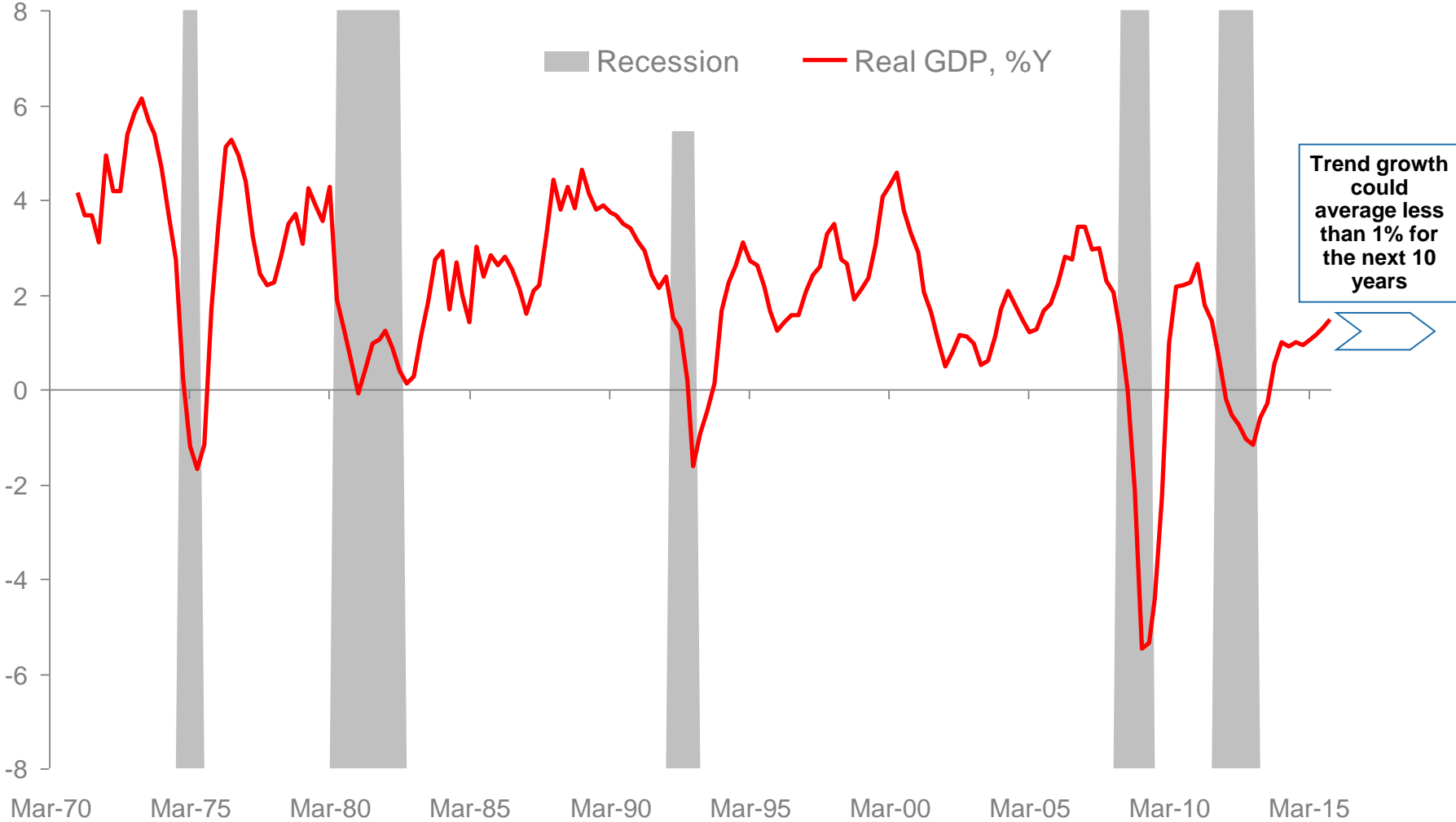
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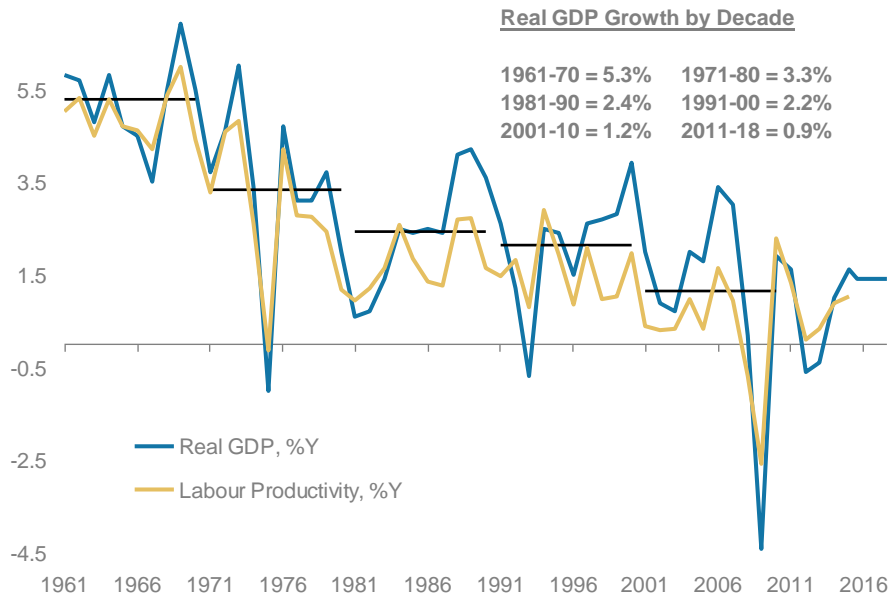
Europe at Risk of Secular Stagnation?



Source: OECD, Eurostat, Morgan Stanley Research

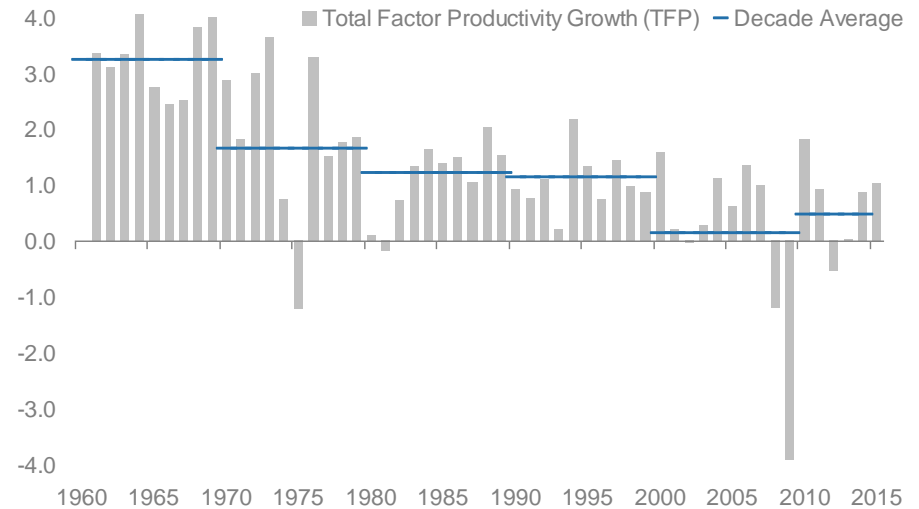
A Secular Deceleration in Growth and Productivity?

Euro Area Growth Dynamics on a Downward Trend



Source: OECD, Morgan Stanley Research

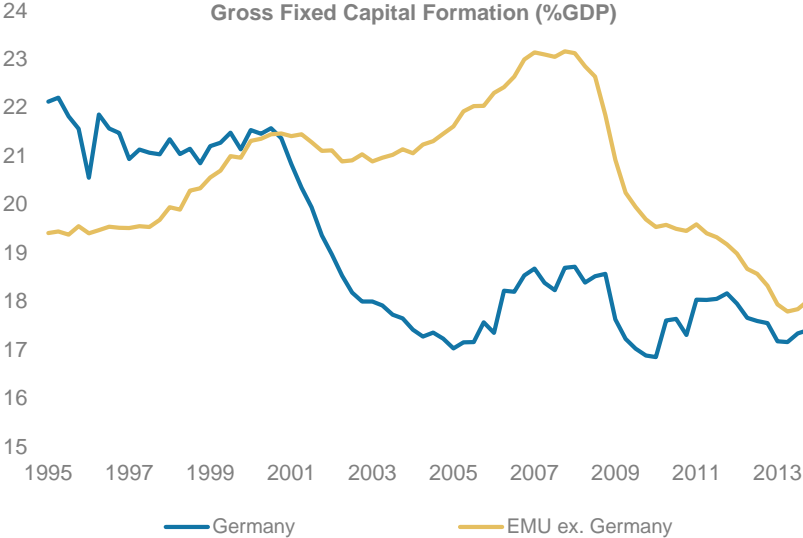
Secular Headwind: Falling TFP Growth



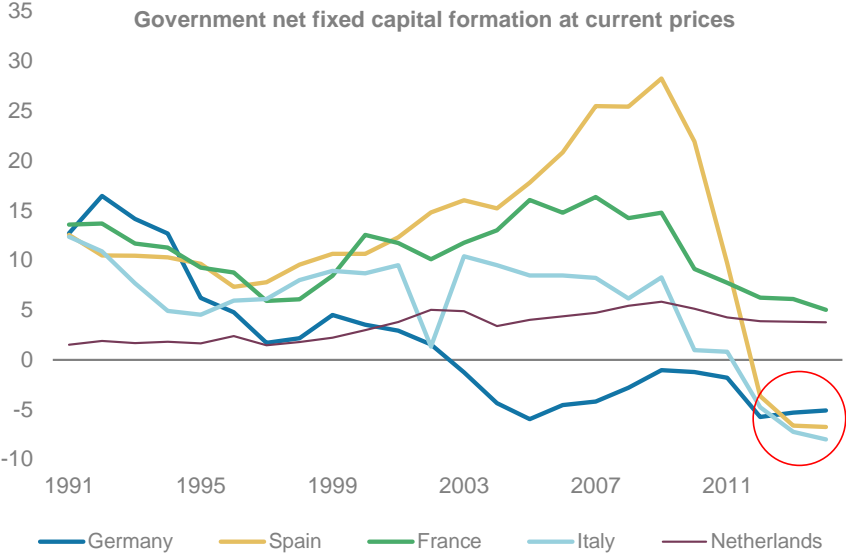
Source: European Commission, Morgan Stanley Research

Germany is underinvesting and has been for some time

Prolonged weakness in investment spending



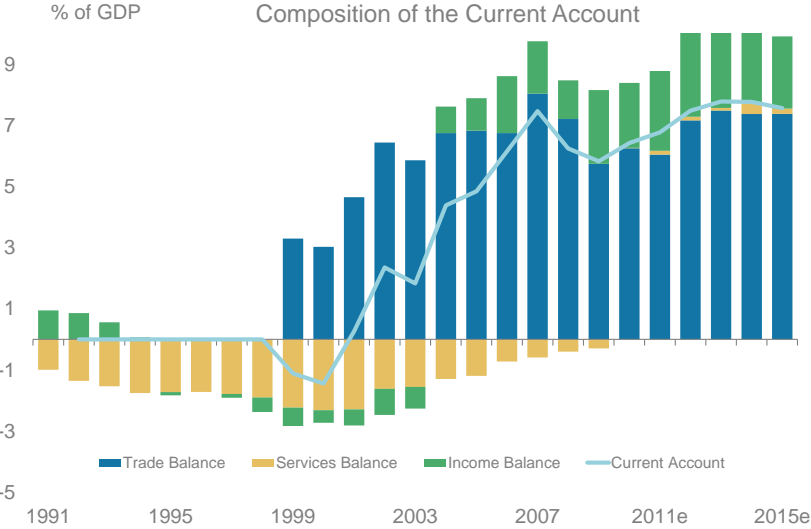
Public Infrastructure Deteriorating for Many Years



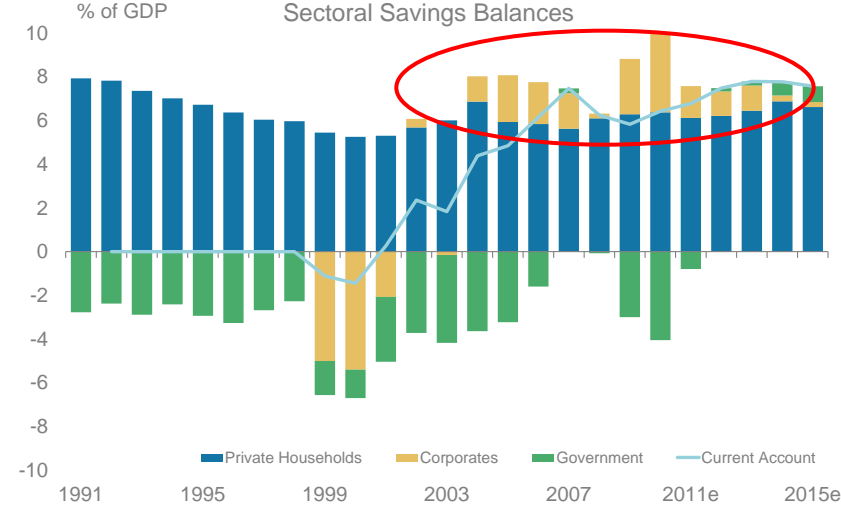
Source: Destatis, Ameco, Bundesbank, Morgan Stanley Research

German underinvestment drives current account surplus, capital exports

Trade surplus boosted by overseas income & services balance



C/A surplus driven by corporate & government balances



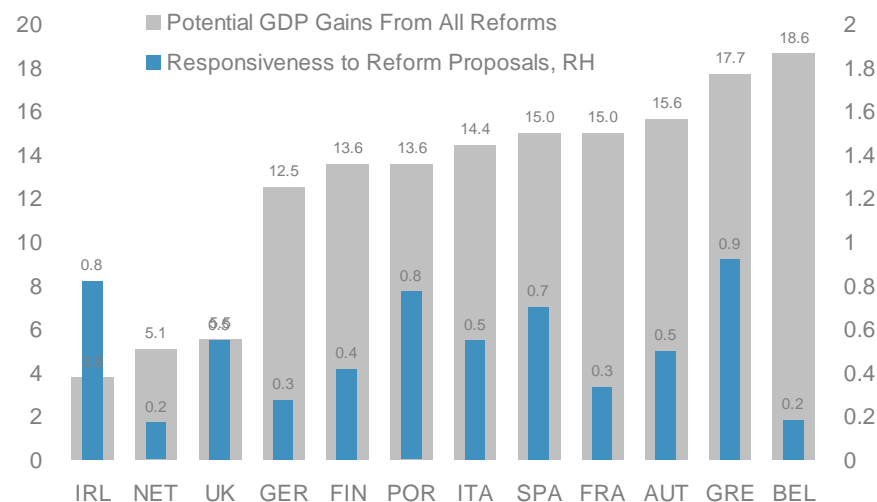
Source: Deutsche Bundesbank, Morgan Stanley Research

Europe's Growth Potential Is Limited, Unless Additional Reforms Are Pushed Through

Medium-Term & Potential Growth Rates at a Glance

	2014e	2015e	2016-18e	Potential*
EU-15	1.2	1.5	1.7	1.0
EMU	0.8	1.2	1.5	0.8
Austria	0.9	1.3	1.7	1.5
Belgium	1.2	2.0	1.6	1.0
Denmark	0.8	1.6	1.6	1.2
Finland	-0.5	0.1	1.2	0.4
France	0.4	1.0	1.5	1.1
Germany	1.5	1.6	1.4	1.5
Greece	0.1	1.3	1.3	0.6
Ireland	3.8	3.4	2.5	2.0
Italy	-0.2	0.8	0.8	0.3
Netherlands	0.6	1.1	1.2	0.5
Portugal	0.9	1.7	0.9	0.7
Spain	1.4	2.2	1.5	1.0

Possible Boost to Growth from Structural Reforms and Responsiveness to Reform Proposals



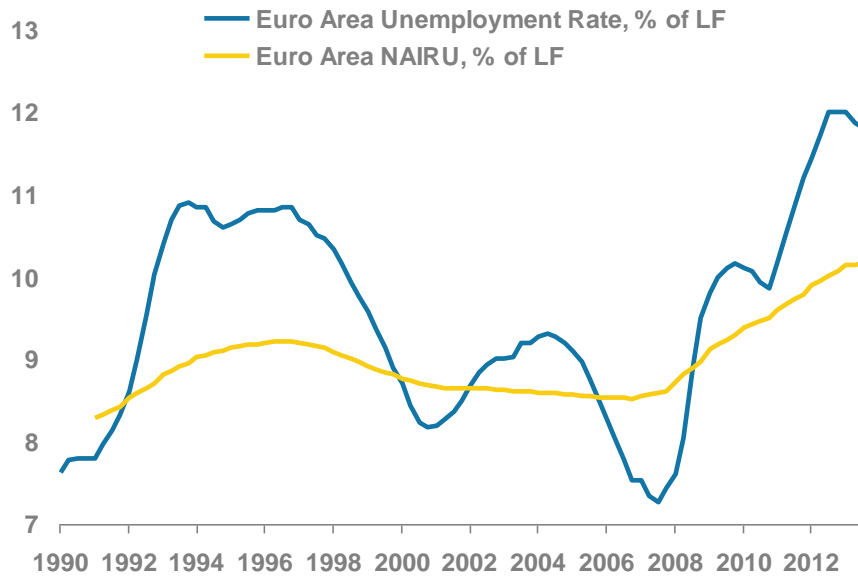
Source: OECD, Morgan Stanley Research

*Potential refers to the estimate of the European Commission or the OECD for 2015. Especially for former crisis countries, these will be subject to a high degree of uncertainty and subjectivity. In our view, the negative estimates by the EC are unlikely to reflect the long-term growth potential of these countries adequately. Hence, we use OECD estimates instead.

Source: European Commission, OECD, Morgan Stanley Research forecasts

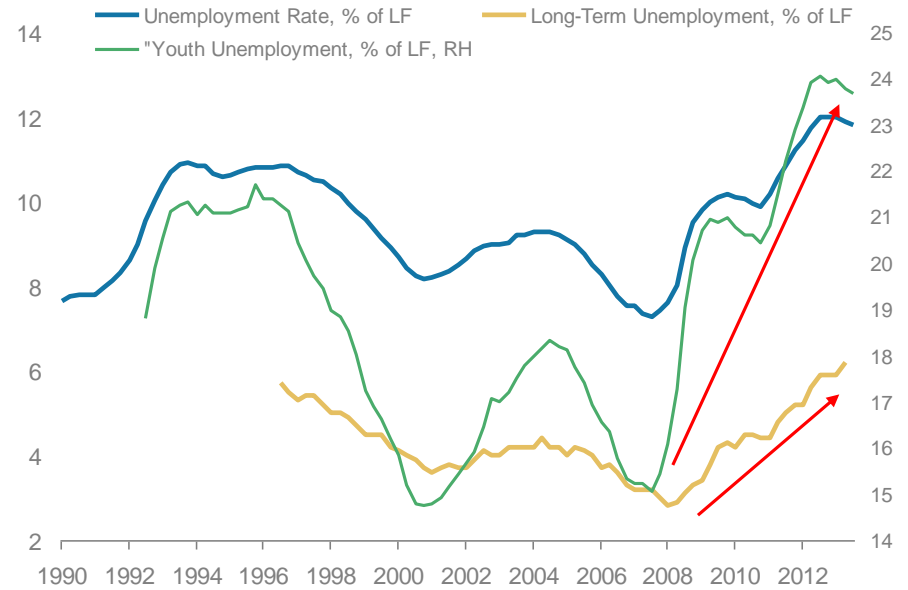
Labour Market Shows a Worrying Rise in Long-Term and Youth Unemployment

Crisis Has Caused Structural Unemployment to Rise to About 10% of the Labour Force



Source: Eurostat, OECD, Morgan Stanley Research

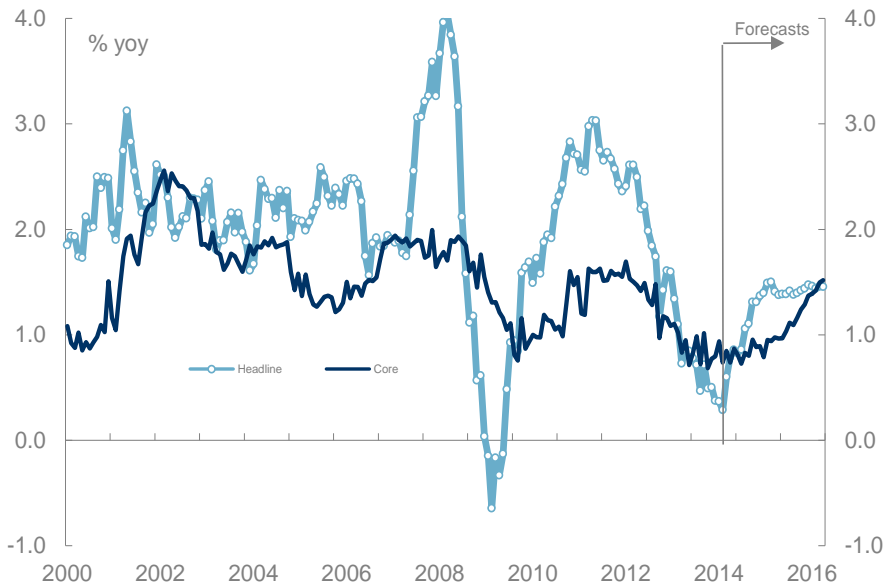
Secular Headwind: Rising Unemployment



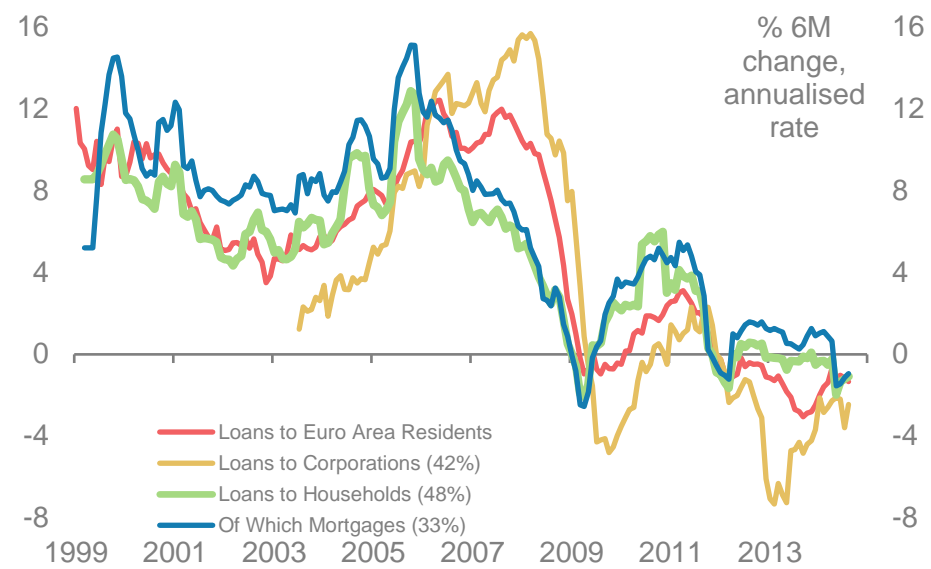
Source: Eurostat, Morgan Stanley Research

Inflation likely to have troughed, deleveraging continues but at a slower pace

A protracted period of very low inflation

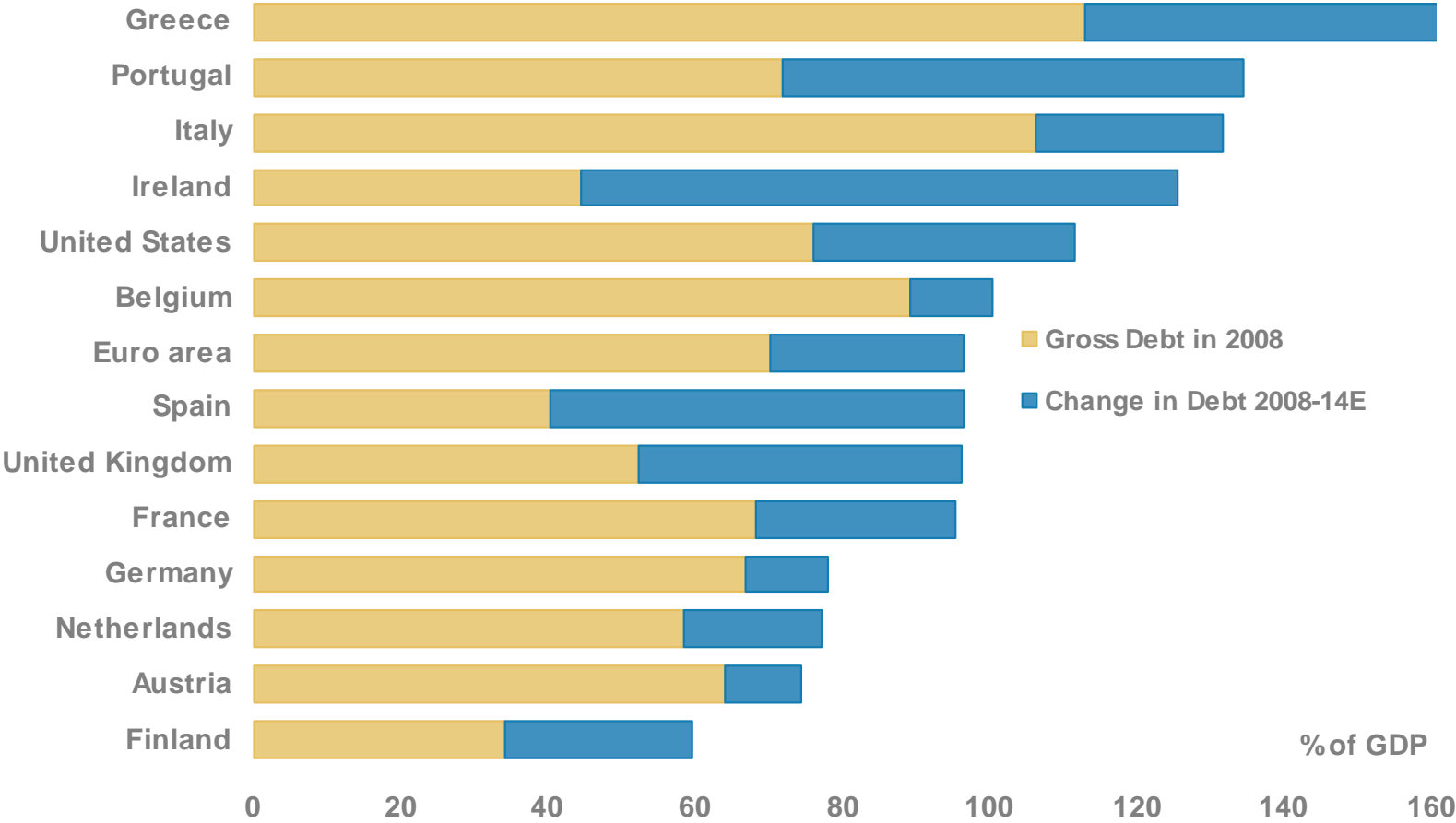


Bank lending falling, deleveraging continuing



Source: ECB, Eurostat, European Commission, Morgan Stanley Research

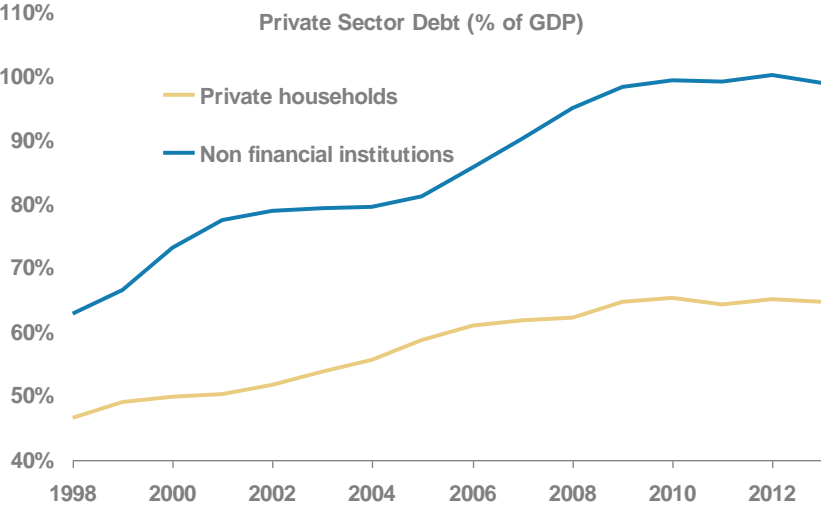
Headwind #2: A growing public sector debt overhang



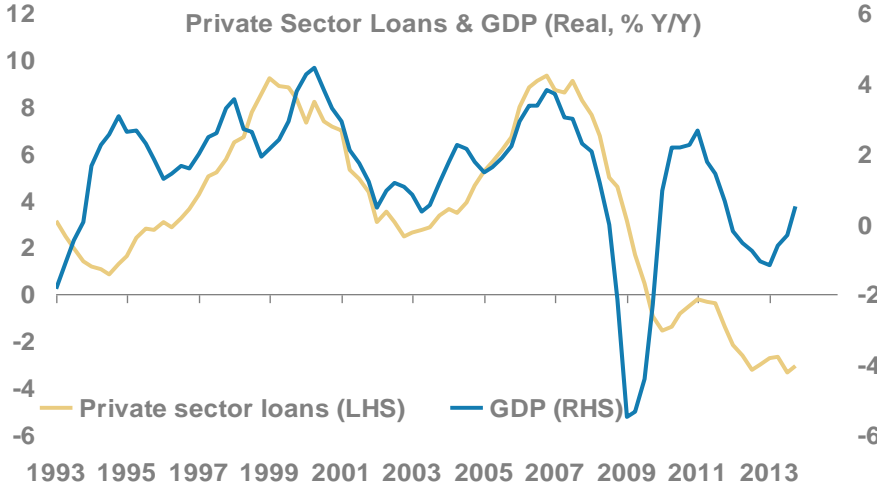
Source: EU Commission, IMF, OECD Morgan Stanley Research estimates

More need for deleveraging in the private sector

No meaningful deleveraging yet

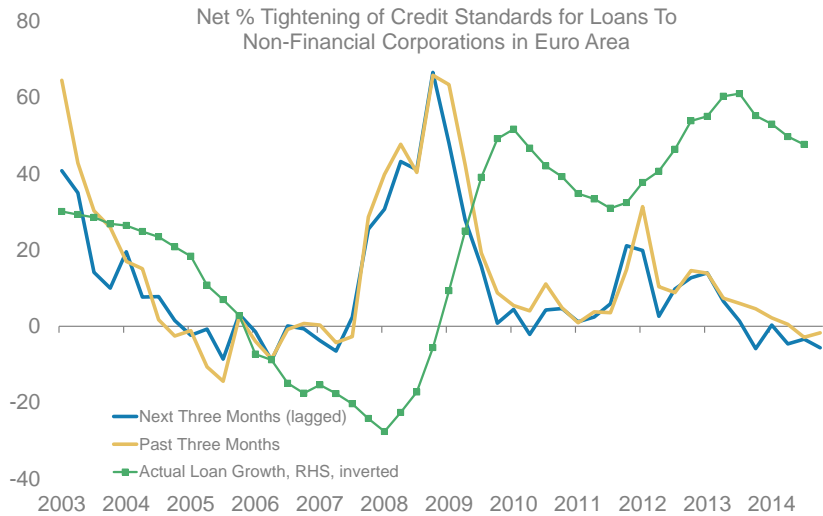


GDP recovered while credit fell further

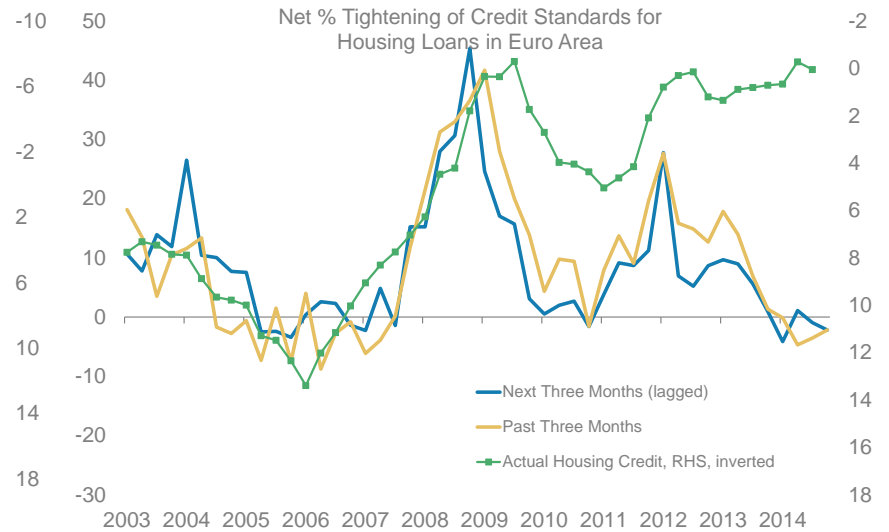


Credit Conditions and Loan Demand at a Glance

Credit Conditions and Loans - Corporates

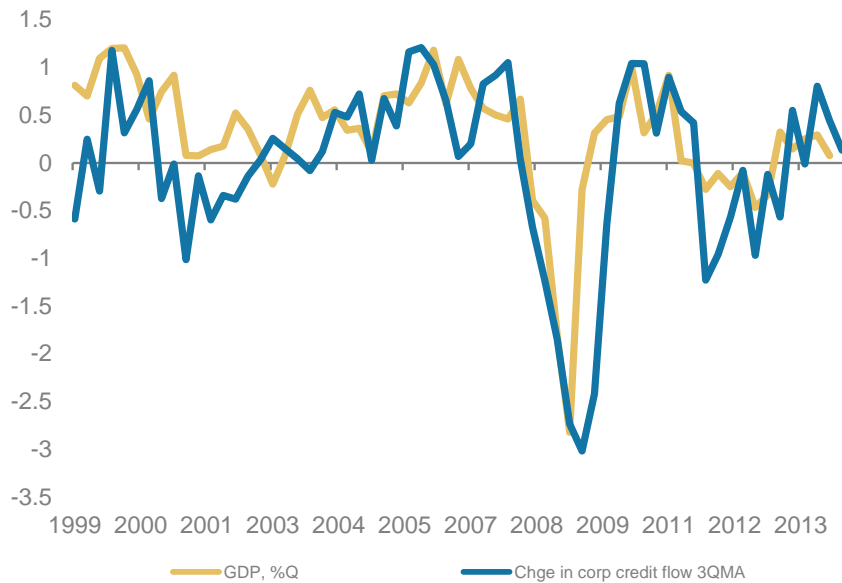


Credit Conditions and Loans - Housing



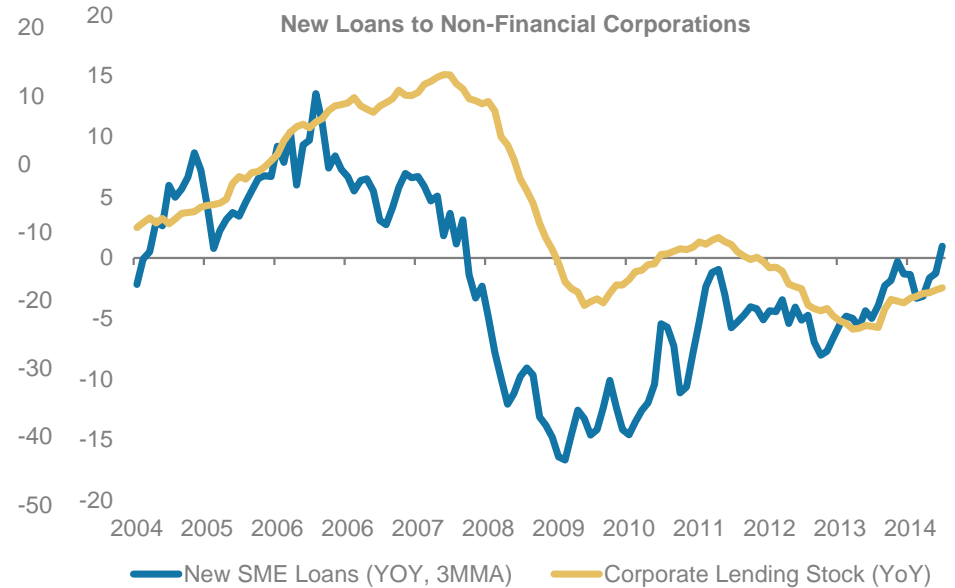
Gauging the impact of the credit impulse

Lagged Credit Impulse Positive, But Weakening Now



Source: ECB, Eurostat, Morgan Stanley Research

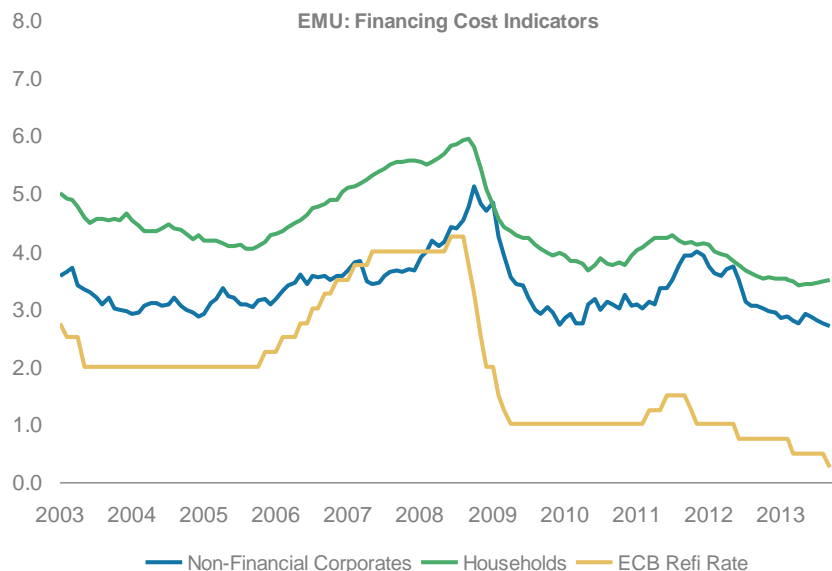
New SME Loans Growth Recovering



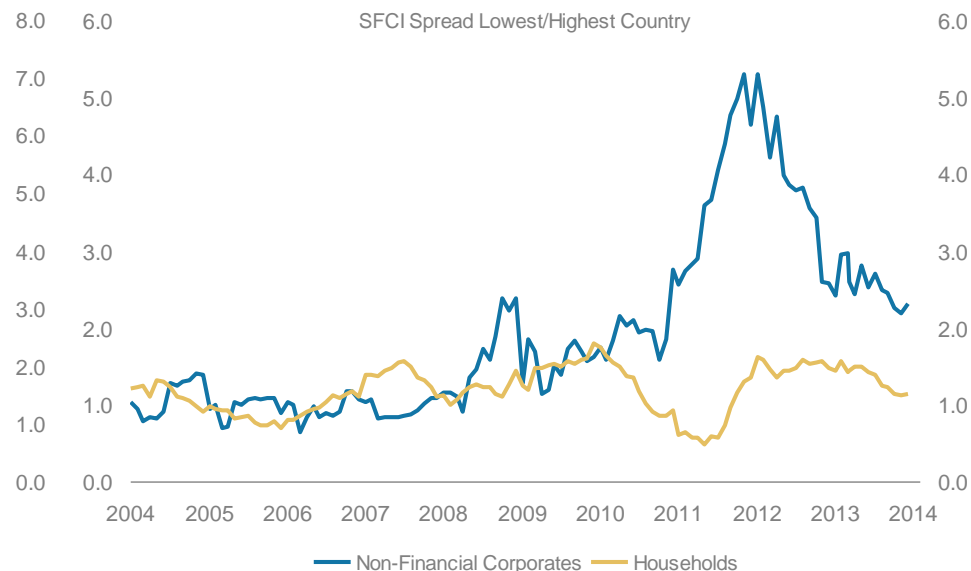
Source: EU Commission, Morgan Stanley Research

Tracking financial fragmentation in the euro area

Financing conditions remain rather tight ...



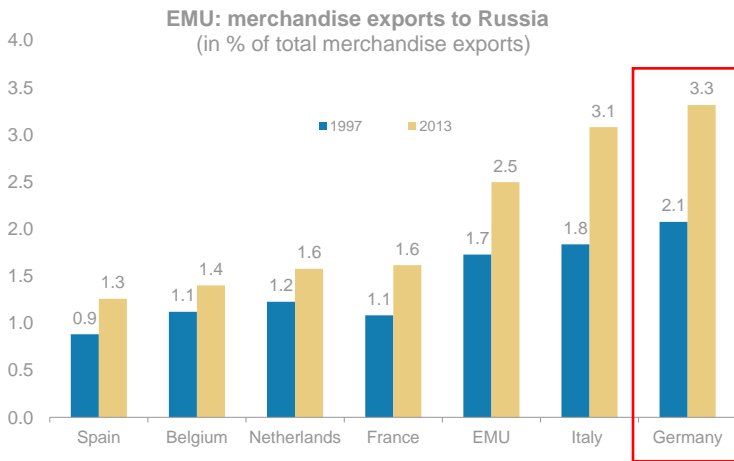
... even though fragmentation has been falling



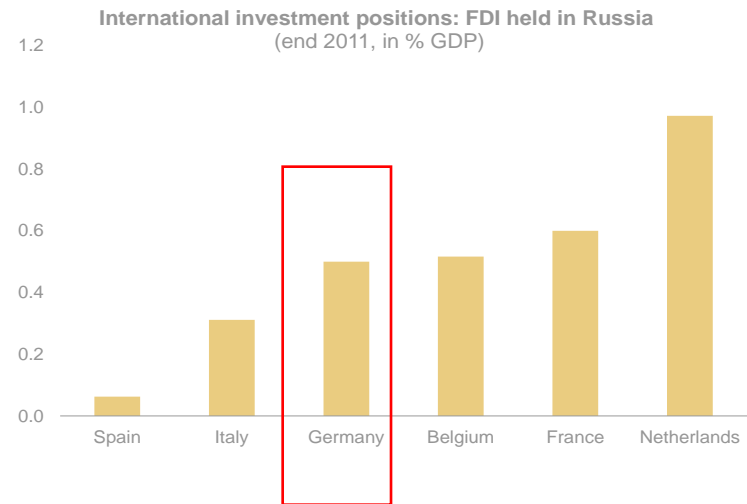
- Our **Synthetic Financing Cost Indicator (SFCI)** provides an estimate of overall financing costs for non-financial corporates and households in the euro area at monthly frequency both for the euro area as a whole and for selected euro area countries. The SFCI allows us to track aggregate financing costs for each sector over time and also to assess the divergence of these costs across countries.
- For **non-financial corporates (NFCs)**, we weigh together the marginal costs of bank borrowing, capital market funding and equity capital remuneration. The weights for each source of funding are derived using the flow of funds statistics. For the cost of funding we use MFIs' lending rates to NFCs, new business, all maturities; the dividend yield on Eurostoxx50 to capture the cost of equity funding; and the average yield on corporate credit index (rated BBB and above) constructed by our credit strategy team.
- For **households**, we only look at bank lending. Here the weights for each maturity and type of the loan are derived using outstanding lending of MFIs to households: consumer credit, housing loans, and other loans. The maturity ranges considered are: loans with maturities smaller than 1 year, between 1 and 5 years, and greater than 5 years. The weights represent the current financing structure.
- While our SFCI estimates the overall financing costs in the euro area, these estimates are **not fully fledged measures of the overall financial conditions** in the euro area. To derive those in a so-called Financial Conditions Index (FCI), financing volumes and non-price bank lending standards would need to be included (see ECB Monthly Bulletin, August 2012). Hence these indicators should be seen as work in progress.

Risks from rising geopolitical tensions with Russia?

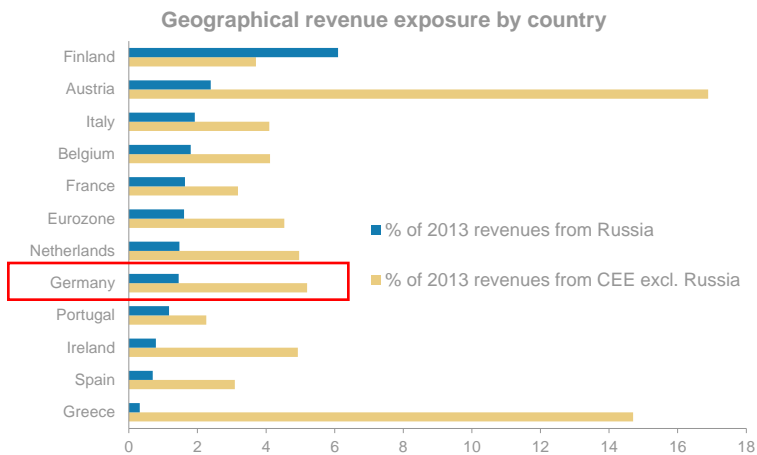
Above average exposure via merchandise trade ...



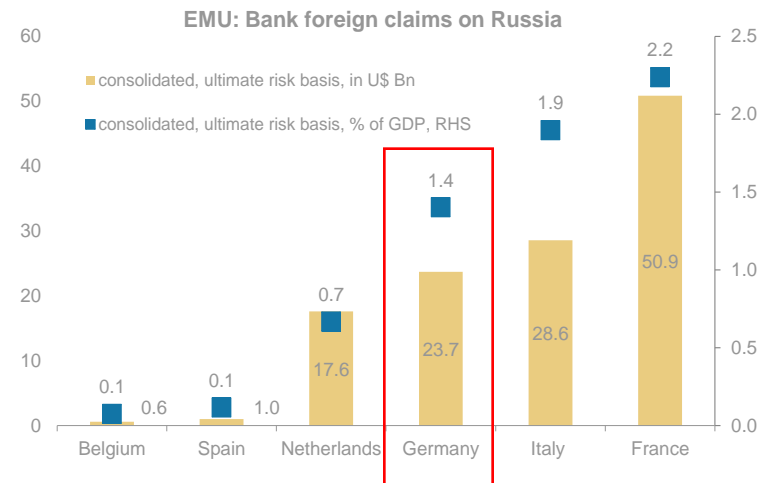
... but FDI exposure on par with other core countries



Foreign affiliate sales another key channel

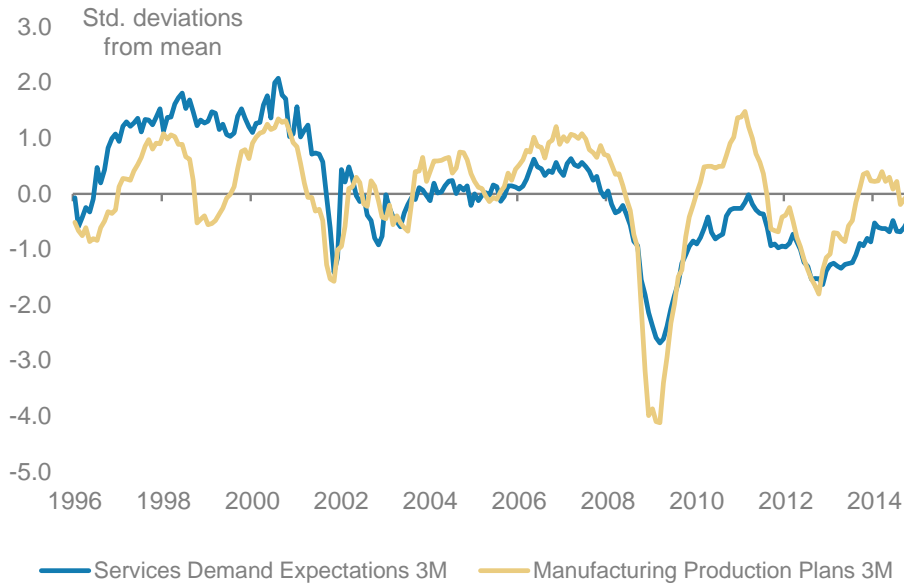


Banks' exposure more limited for Germany



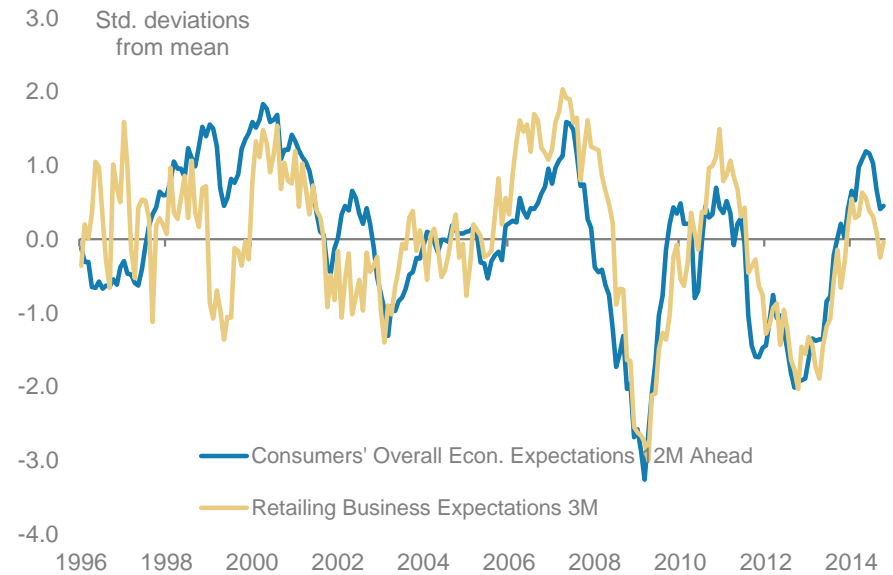
Sentiment indicators still in the doldrums

Manufacturing and services see better times ahead



Source: European Commission, Morgan Stanley Research

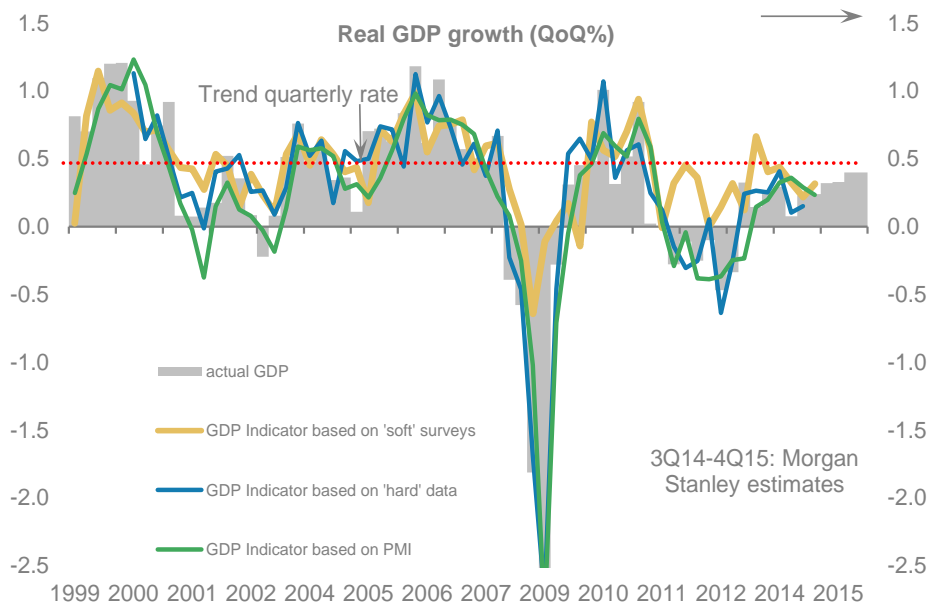
And so do consumers and retailers now as well



Source: European Commission, Morgan Stanley Research

Recovery continues but fails to gain more momentum

Quarterly GDP profile and latest tracking estimate



Source: Eurostat National Business Surveys, Morgan Stanley Research

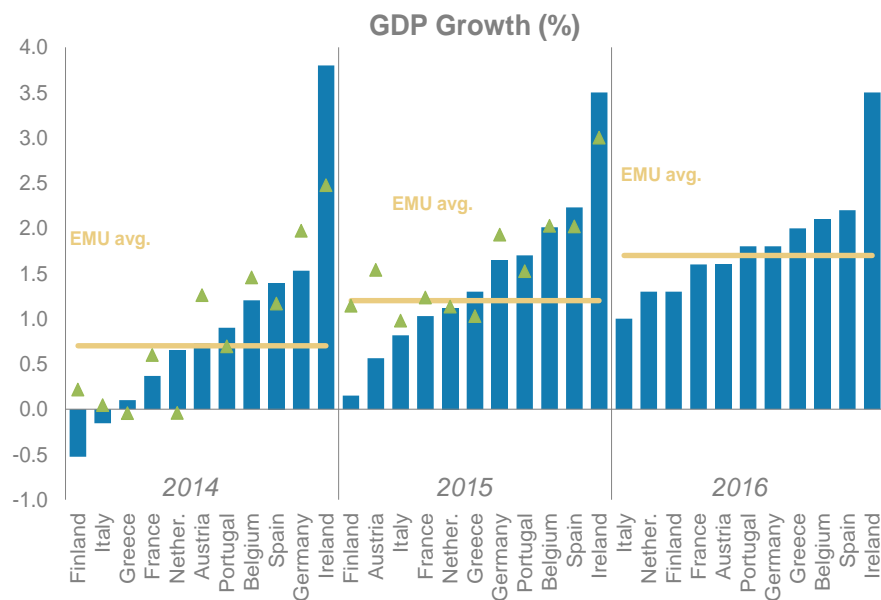
Main euro area macro forecasts, 2012-16E

	2013A	2014E	2015E	2016E
Real GDP	-0.4	0.8	1.2	1.7
Private Consumption	-0.6	0.8	1.1	1.2
Government Consumption	0.2	0.8	0.6	0.7
Gross Fixed Investment	-2.8	1.2	2.1	3.2
Contribution to GDP Growth (%)				
Final Domestic Demand	-0.8	0.8	1.1	1.4
Net Exports	0.5	-0.1	0.1	0.2
Inventories	0.0	0.0	0.0	0.1
Employment	-0.8	0.2	0.3	0.5
Unemployment Rate (% of Labour Force)	11.9	11.5	11.3	11.0
Real Disposable Income	-0.5	0.9	0.4	0.4
Personal Saving Rate (% of Disp. Income)	13.2	13.2	12.6	12.4
Inflation (HICP)	1.4	0.6	1.2	1.4
Core Inflation (HICP, Eurostat)	1.1	0.9	1.0	1.3
Unit Labour Costs	1.2	0.9	0.7	0.3
Current Account Balance (% of GDP)	2.4	2.5	2.6	2.5
General Government Balance (% of GDP)	-3.0	-2.7	-2.3	-1.9
Primary Government Balance (% of GDP)	-0.1	0.3	0.4	0.6
General Government Debt (% of GDP)	92.7	93.6	93.7	93.3
Net Government Debt (% of GDP)	68.5	N/A	N/A	N/A
ECB Policy Rate (Refi, %, EOP)	0.25	0.05	0.05	0.05

Source: National Statistics, Eurostat, Morgan Stanley Research
E = Morgan Stanley Research estimates.

A differentiated European Growth Landscape

Growth Rotates towards Reformers in the Periphery



Source: ECB, Eurostat, Morgan Stanley Research

European GDP Growth Forecasts at a Glance

	2013e	2014e	2015e	2016e
EU-15	0.0	1.2	1.5	1.9
EMU	-0.4	0.8	1.2	1.7
Austria	0.3	0.9	1.3	1.8
Belgium	0.2	1.2	2.0	2.1
Denmark	0.4	0.8	1.6	1.9
Finland	-1.2	-0.5	0.1	1.3
France	0.4	0.4	1.0	1.6
Germany*	0.4	1.5	1.6	1.8
Greece	-3.9	0.1	1.3	2.0
Ireland	0.2	3.8	3.4	3.5
Italy	-1.8	-0.2	0.8	1.0
Netherlands	-0.7	0.6	1.1	1.3
Portugal	-1.4	0.9	1.7	1.8
Spain	-1.2	1.4	2.2	2.2
Sweden	1.6	1.5	2.6	3.3
UK	1.7	3.1	2.7	2.5

Source: EU Commission, Morgan Stanley Research

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