

February 15, 2019

Dear clients and colleagues,

The uncertainties that remain regarding global trade and geopolitical events make it hard to predict a sustainable rebound of financial markets. An organized Brexit would certainly be seen as a positive over a hard Brexit. Because of these uncertainties, investment decisions are being delayed and exports are softening. On the positive side, European balance sheets are in good shape, and the unemployment rate continues to decline. The consumer space in Europe had a challenging year in 2018 due to weak consumer confidence, unseasonal weather, the world cup and some protest movements. We believe that at some point household spending could neutralized some of these negative factors and support economic growth in the near term.

While Italy's economy fell into a technical recession at the end of Q4, other European countries are doing relatively well considering the many external uncertainties. For instance, Spain and France posted reasonable GDP growth of 0.7% and 0.3% respectively for the period. German household consumption even recorded a slight increase in Q4. In the case of France, this GDP figure is acceptable considering the negative impact of the yellow vest movement, which could have reduced GDP by 0.2%.

European household debt is well under control compare to the rest of the Western world, and that is a clear positive. According to the Institute of International Finance, the debt held by the average European household in proportion to GDP fell to 57.6% last September. This ratio represents the lowest score since 2006. As a comparison, US and UK household debt to GDP are at 75% and 86% respectively. Europeans are also in a very good situation when compared to Canada, Australia or even the Netherlands that are all above 100%. The debt amount taken into consideration in this calculation includes all secured and unsecured loans.

A relatively healthy job market combined with lower energy prices could incentivize consumer spending. The job market remains favourable with a 7.9% unemployment rate in the eurozone, the lowest since 2008. Fiscal measures recently adopted in conjunction with the yellow vest movement in France could also have a positive impact on consumer spending. In response to the protests, the French government proposed a series of measures to increase the purchasing power of its population, such as freezing energy taxes or allowing exceptional year-end bonuses to be tax-exempt.

The yellow vest movement, which had a negative impact on retail sales in Q4, is fading. At first, the majority of the population was in favour of the cause. Since then, the level of support has fallen sharply. The movement went from a peak of 3 million protestors last December to 84,000 a month ago to 51,000 last weekend. This is also confirm by the January retail sales figure which shows that the weaknesses is reverting.

The outlook for economic growth remains challenging. Thanks to an improvement in purchasing power and a resilient job market, household spending could provide some additional growth and help mitigate other negative factors.

Have a good weekend.

The Global Alpha Team