

European Economy Continues to Improve

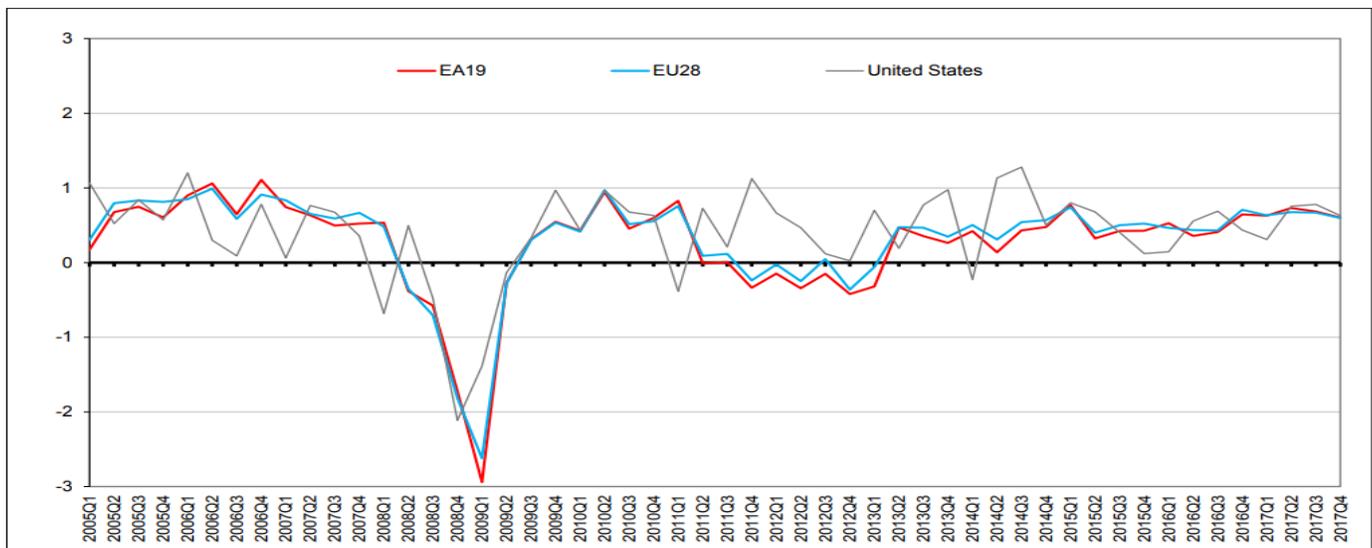
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The European economy is in its fifth year of growth. In 2017, euro area (EA19) GDP grew 2.3% and the EU (EU28) 2.4%, versus 1.8% and 2.0% respectively in 2016. Of the core countries, the largest GDP contributors were Germany and France. And Spain and the Netherlands showed the highest percentage increases in growth. EU28 unemployment was better at 7.1% in February (compared with 8.0% a year ago), its lowest rate since before the 2008 financial crisis. Italy and its banking system have been improving, but continued gains could be mitigated by inconclusive national elections this past month. At present, Italy has no majority government and coalition talks remain at an impasse.

As a top GDP-ranked EA19 member, Spain continues to be a standout economy. In the past three years, it outperformed core European sovereigns with 3% plus GDP growth rates. Economic progress and improving banking fundamentals outweigh the political risk of an independent Catalonia, a minority (though efficient) government, and the ECB's slow unwind of its asset purchase program. Spanish banks are stronger given years of restructuring and consolidation which has aided capital formation and the reduction of legacy non-performing loans. This past summer, Spain's banking system was tested by the failure of Banco Popular. However, the bank underwent a "textbook bail-in" and was quickly taken over by Banco Santander. EU resolution rules proved successful as the bank collapse had no systemic impact. Spain's sound credit profile was enhanced by one-notch ratings upgrades this year. S&P and Fitch each moved to A- and Moody's to Baa1. S&P maintained a positive outlook.

Like the United States, core European sovereigns are highly rated. Seven of the 10 AAA-rated countries in the world comprise Germany, Luxembourg, Netherlands, Switzerland, Norway, Denmark and Sweden. Europe tends to lag U.S. economic activity (see below), but of late it has performed similarly. **We expect Europe to post continued economic gains in 2018 despite populist politics and waning ECB support.**

(source: Eurostat quarterly data)



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