News & Views

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Improving data eases eurozone breakup fears

An improving European economic and investment outlook is helping to calm fears of an impending eurozone collapse, says Newton portfolio manager Jon Day.

Political uncertainty triggered by the UK's decision to leave the European Union (EU) and fears over a raft of forthcoming national elections in Europe have led some commentators to predict the imminent demise of the eurozone.[1]

With Greece also currently locked in talks with EU and IMF officials over ways to ease its ongoing debt crisis, ahead of a €7bn debt repayment in July,[2] market uncertainty remains a key theme among many European investors.

However, some portfolio managers doubt the euro currency or the EU itself face any immediate threat of collapse, instead pointing to early signs of eurozone recovery, such as recent modest GDP growth[3] and the historic resilience of EU nations such as Italy in times of stress.

The recent Dutch election has also helped ease some concern about the rise of populism in Europe. Despite fears of a major political upset in the election, the centre-right VVD party comfortably beat the anti-immigration Freedom party of Geert Wilders.[4]

Green shoots

Commenting on the current eurozone environment, Newton global bond portfolio manager, Jon Day, says: "While there are some genuine investor concerns on Europe, we do see signs the regional economy is picking up. Ironically, without some of the current background political uncertainty, most investors would probably be quite comfortable with the latest European economic outlook.

"Despite some fairly gloomy predictions it could be argued that, with the exception of bond markets, a lot of the European assets currently being affected by political risk actually look quite cheap. And while Europe remains politically volatile, volatility itself can also provide opportunities - because the underlying risks which drive it often turn out to be less extreme than markets initially fear."

In early March the euro rose 0.7%, hitting a weekly high of US$1.0615,[5] while the German Bund reached its highest level since February on news European Central Bank (ECB) President Mario Draghi had declared victory on deflation. He said the ECB no longer had a "sense of urgency" on doing more to bolster eurozone growth and inflation via its quantitative easing programme.[6]

Against this improving economic backdrop, Day believes the political risk inherent in upcoming elections in France and Germany is also less stark than in the 2016 UK referendum on EU

[1] *Financial Times:* 'Brexit stirs eurozone break-up fears for fund managers', 1 July 2016.
[2] *Financial Times:* 'Greece bailout: what is expected from the latest talks?' 28 February 2017.
[3] *Financial Times:* 'Eurozone's economic recovery picks up speed', 31 January 2017.
[4] *BBC News:* 'Dutch election: Wilders defeat celebrated by PM Rutte', 16 March 2017.
[5] *Financial Times:* 'Euro roses as Draghi claims victory over deflation and softens QE tone', 10 March 2017.
[6] *Reuters:* 'Sterling falls broadly after ECB strikes more optimistic tone', 9 March 2017.

membership and the US election, though he cautions that further political upset cannot be entirely ruled out.

“While upsets can happen I’m more relaxed about political risk in 2017 than last year because the two major political events of 2016 - the Brexit vote and the Trump election in the US - were very much binary 50:50 decisions and, as we saw in the Dutch election, the European elections are much less clear cut,” he says.

European outlook

Commenting on Greece and the wider market outlook for Europe, Day believes the Greek debt crisis remains manageable - providing European finance ministers and/or the IMF continue to support its restructuring efforts. While he sees no immediate threat to the euro, Day does, however, feel the eurozone could be seriously tested if Europe were to enter a new recession.

“Given improving economic data, the euro looks safe for the foreseeable future but it is what happens in the next recession that is likely to be decisive, given the underlying structural issues some eurozone members face.

“Recent history suggests we will probably see a recession in Europe at some point within the next 10 years and without real economic improvement the eurozone could face that from a very weak position, particularly if unemployment were to rise substantially,” he concludes.

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