

MACROECONOMIC ANALYSIS

Eurozone: less buoyant growth perspectives for this year

Europe Unit

The macroeconomic data for the eurozone published over the summer have been clearly negative. After the negative surprise of the second quarter GDP figure (zero growth instead of the expected 0.2% QoQ), the third quarter confidence indicators deteriorated noticeably, offset only by positive data from the industrial sector in July. The performance of the three major countries in the area is to blame for these poor figures, and everything leads us to think that growth this year will come in at around 0.8% to 0.9%, QoQ instead of the 1.1% we were forecasting two months ago. The crisis in Ukraine and domestic problems in Italy and France account for this performance. The ECB has responded with new measures (see [ECB Watch¹](#)) which are propitiating a depreciation of the euro, and a debate is shaping up in the EU as to the possibility of a slight fiscal softening; meanwhile, the results of the stress tests will be published at the end of October. The outcomes of all these events, plus economic and geopolitical developments outside the eurozone, ought to open the way to a clearer outlook by the end of the year, which will enable us to estimate the extent to which the European economy will continue on its slow path to recovery in 2015.

Eurozone: the confidence indicators deteriorate in the third quarter, after GDP stagnation in the second

- **The confidence indicators are pessimistic about the 3Q ...**

Both the European Commission's economic sentiment index (ESI) and Markit's composite PMI index flag up a weakening in activity in 3Q14 (Figures 3 and 4); the manufacturing sector continues to show the greatest signs of fragility, partly conditioned by the uncertainty caused by geopolitical conflicts which is curbing the export sector. Services, however, are more resilient and, according to the PMI services index, are improving slightly over the previous quarter (53.6 on average in 3Q14, up from 53.1 in 2Q14). The indicators' subcomponents suggest that activity will continue to be vulnerable in September, given that the new orders in the manufacturing sector (internal and external), business expectations and the backlog of jobs have all moderated, while employment has not risen, having done so for several months. In short, given the surprise to the downside in 2Q14, moderate GDP growth in the third quarter would be consistent with these survey results.

- **... and real indicators point to moderate growth**

Activity data available to date (for July) appear to have a slightly more optimistic tone. Exports were practically unchanged (-0.2% over the average for 2Q14) after falling in June, and the moderation in orders from outside the eurozone is a forewarning that weakness in exports could continue throughout 3Q14 (Figure 8). Industrial production at the beginning of the third quarter is showing an uptick, coming in at 0.4% above the 2Q14 average, particularly thanks to the improvement in the German indicators, although part of this might be a temporary pick up. Despite stabilisation in the job market and a still-low inflation, retail sales fell in July, after six months of modest growth, suggesting that private consumption has not taken hold.

1: See ECB Watch: <https://www.bbvaesearch.com/en/publicaciones/recent-data-push-the-ecb-to-act-again/>

- **Our MICA-BBVA model, although still awaiting significant data, estimates 0.2% growth in 3Q14**

With information currently available (real data only from July), our short-term model puts GDP growth at 0.2% QoQ in 3Q14 (figure 2), below the data input in our baseline (0.4% QoQ). Taken with the negative surprise of 2Q14, this leads us to believe that GDP growth for 2014 as a whole may be closer to 0.8 or 0.9% than the 1.1% figure we published in our last forecast at the end of July.

- **Inflation stable at 0.4% YoY in August, while core inflation edges up 0.1pp**

Inflation stood steady in August, once more thanks to services inflation, which offset the fall in energy prices, principally, and in food. By contrast, inflation excluding these products rose to 0.9% YoY, having remained stable the previous month at 0.8% YoY (Figures 11 and 12).

Our forecasts suggest that inflation will remain relatively stable throughout the third quarter before rising to annual rates of around 0.7% by the end of the year, driven by the changing prices of the more volatile components, which will accelerate somewhat because of the disappearance of base effects. On the other hand, we expect core inflation to remain practically unchanged at around 0.9% YoY for the rest of the year.

Germany: activity contracted more than expected in 2Q14

- **The 0.2% QoQ fall in GDP (compared to its 0.7% QoQ rise in 1Q14) was due to the performance of the external sector and investment**

Robust growth in construction production in the first quarter of this year, as well as a jump in investment, were mainly due to favourable weather conditions and thus lead us to expect a correction to the downside in 2Q. Rather less expected was, particularly, moderation in private consumption (0.1% instead of 0.8% QoQ), given that consumer confidence remained at very high levels. And investment in capital goods fell too (-0.4% QoQ), having grown in the previous two quarters, possibly affected by the uncertainties associated with the conflict between Ukraine and Russia, which were already on the horizon in the second quarter. Net exports also had a negative effect on growth, with exports growing less than imports throughout 2Q14. So far this quarter, there has been continued moderation in the confidence indicators (Figures 15 and 16), even though there was a strong uptick in July, both in exports and in industrial production, whereas retail sales fell 0.8% from their average in 2Q14. Everything suggests that the crisis in Ukraine is affecting economic confidence, so in principle there is nothing to make us think that the improvement in industrial variables in July will last for the rest of the quarter.

France: the stagnation of the French economy sets in

- **Zero growth for the second quarter in a row, held back by investment**

Even though household confidence is still not picking up, private consumption grew in the second quarter (0.5% QoQ) and the behaviour of retail sales in July (0.3% above the average for 2Q14) may be a foretaste that the trend will hold. Public sector consumption remains robust, while investment fell again for the second consecutive quarter (-1.1% QoQ, following -1% QoQ in 1Q14) and net exports continue to sap growth. In 3Q14, this rather pessimistic outlook is evident whether one looks at the national confidence indicators, the PMIs or the European Commission index, particularly in the manufacturing sector (Figures 27 and 28). The French economy seems to be affected by the lack of economic policy direction in the last few quarters, although the measures passed to restore competitiveness ("the responsibility pact"), together with the change in government at the end of the summer, which points to greater clarification, are likely to contribute to improving the economic climate in the coming months.

Italy: activity shrank in the first half

- **The negative contribution of investment and weak exports are curbing the recovery**

The improvement in all the confidence indicators in 2Q14, especially consumer confidence, has not finally been reflected in an improvement in activity, which in the second quarter contracted -0.2% QoQ (compared to -0.1% QoQ in 1Q14), 0.4pp below our forecasts. Net exports and the abrupt fall in investment (-0.9% QoQ) were the main burdens on the economy. So far in the third quarter, the European Commission's ESI confidence index has shown a significant turn downwards, and the PMIs have again moved into contractive mode (Figures 39 and 40). The first real data available (July's industrial production) do not appear to signal an immediate reversal of the negative trend, while export orders, lower than in 2Q14, indicate that the external sector will not be driving the recovery of activity in the next few months either.

Spain: recovery in activity and in employment continue into 3Q14

- **Private sector domestic demand is growing more slowly than in the first half, while exports are recovering gradually**

The second quarter was characterised by a strongly expansive momentum in domestic demand, in both the private and public sectors, and a gradual improvement in Spanish exports. Thus, the progress made both in household consumption (+0.7% QoQ), and in investment in machinery and equipment (+2.1% QoQ) was once again noticeable. In terms of the structure of net foreign demand, there was a correction to the upside in exports of 1.3% QoQ, but the positive tone of domestic demand gave way to progress in imports (1.5% QoQ), causing a stagnation in net external demand. The outlook for the third quarter, with the information available to date, suggests a rather more balanced composition of growth. In terms of external demand, the expectations and expenditure indicators suggest that exports of non-tourism goods and services continue to gain ground (Figure 56). On the side of private domestic demand, we estimate that the recovery is losing some traction, after the higher upticks in the first half. Thus, indicators for consumer spending and household expectations are showing signs of deceleration in 3Q14, surprising in some cases to the downside. Likewise, the change in industrial confidence, manufacturing PMIs and trade flows heralds less growth in machinery and equipment investment than in the preceding quarter (see [Spain Economic Watch](#)).

Eurozone

National accounts: zero growth in 2Q14, held back by investment

By components, consumption makes a positive contribution, as do net exports, due to lower growth in imports. Our MICA-BBVA model foresees growth at around 0.2% QoQ in 3Q14.

Figure 1
GDP (% QoQ) and contribution by component (pp)*

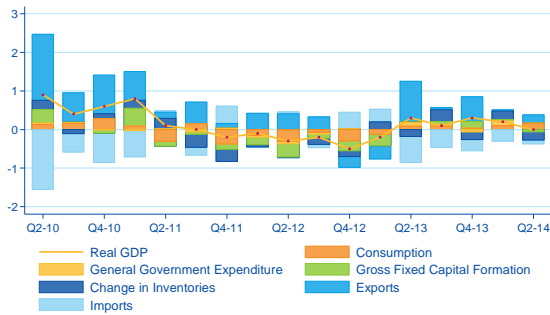
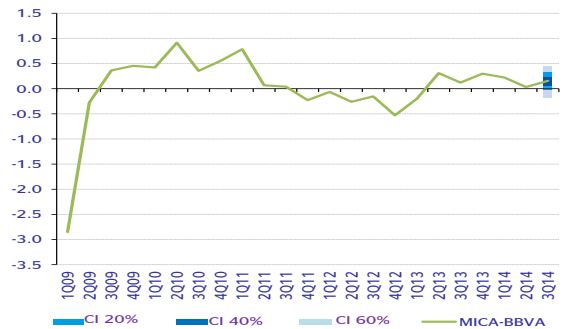


Figure 2
GDP growth (% QoQ) and MICA-BBVA forecast*



Confidence: the PMIs and the ESI both fall in August

PMIs fell in August, weighed down by weak manufacturing, but the services sector remained buoyant. By countries, the German economy's recovery is proceeding at a slightly slower rate, while France and Italy are in negative territory.

Figure 3
PMIs and GDP growth (% QoQ)*

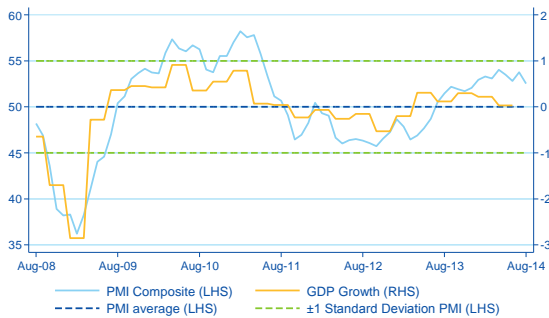
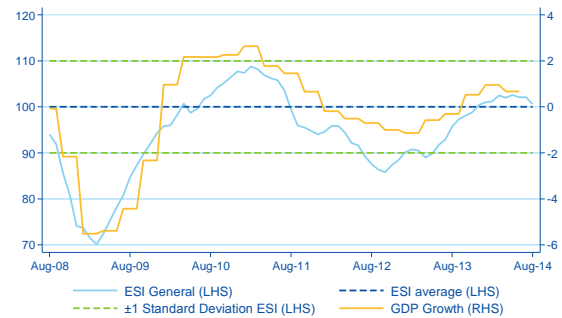


Figure 4
Confidence (ESI) and GDP growth (% YoY) **



Activity: mixed signals from the activity indicators

Industrial production was up in July even though the manufacturing sector's PMI confidence indicators are deteriorating. Meanwhile, the retail trade is weak, contracting in July.

Figure 5
Ind. Prod. (% YoY), PMI new orders and manufacturing prod.*

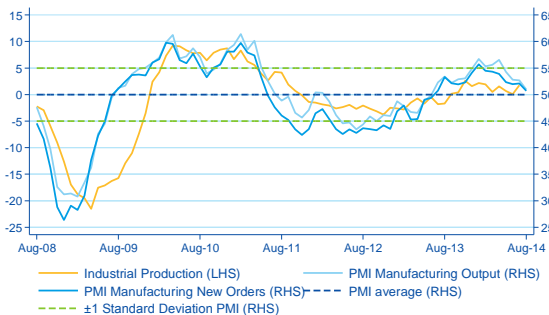


Figure 6
Retail sales (% 3Mo3M) and consumption growth (% QoQ)*



*Haver Analytics and BBVA Research

Foreign sector: the trade surplus reduces in July

The trade balance surplus of the euro area reduces in July due to a contraction in exports and increased imports. In yearly figures, however, exports grew by 2.6% in July.

Figure 7
Current account (% of GDP)*

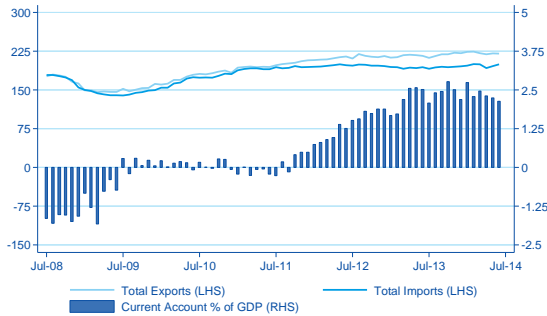
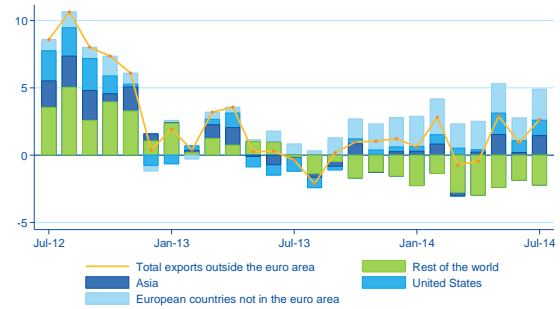


Figure 8
Exports by destination (contribution to % YoY)



Labour market: the year-long stability continues

Although we expect a moderate recovery is underway, the unemployment rate is unlikely to fall in the short term because of the lag between activity and employment, as well as the fact that idle capacity remains at high levels. Labour costs in the business sector increased by 1.4% YoY in 2Q14.

Figure 9
Unemployment rate (%) and employment expectations*

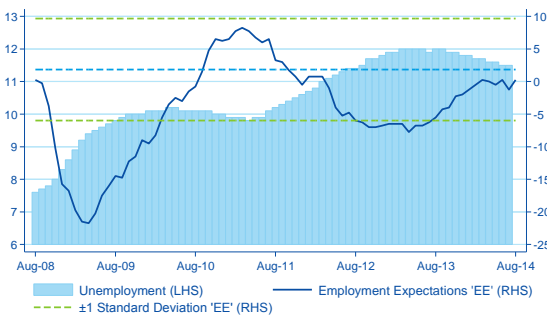
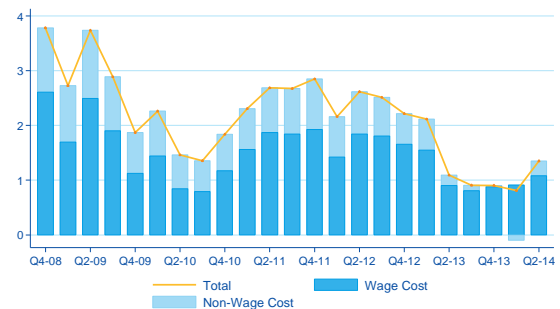


Figure 10
Labour costs in the corporate sector (% YoY)*



Prices: inflation in the eurozone stood steady

The eurozone inflation stood steady in August at 0.4% YoY. The increase in the price of services is offsetting the sharp decline in energy prices.

Figure 11
Inflation rate, headline and core (% YoY)*

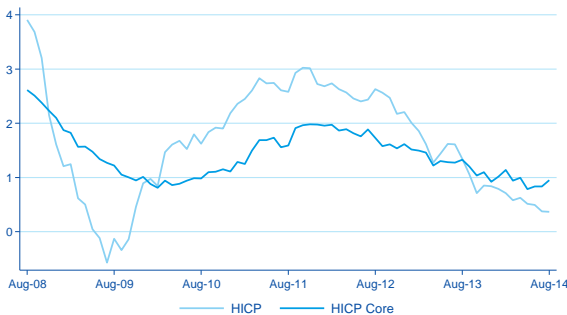
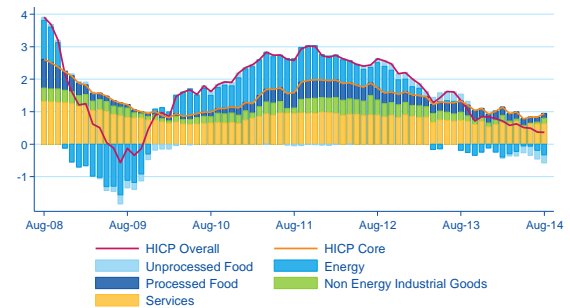


Figure 12
Inflation by component (contribution by %)*



* Sources: Haver Analytics and BBVA Research

Germany

National accounts: GDP shrinks in the second quarter

GDP contracted by -0.2% QoQ, mainly as a result of the external sector's performance and investment. Both private and public consumption rose slightly.

Figure 13
GDP (% QoQ) and contribution by component (pp)*

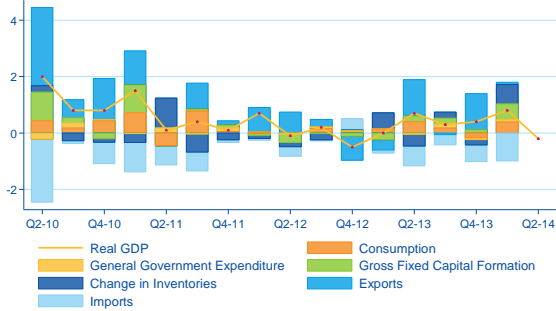
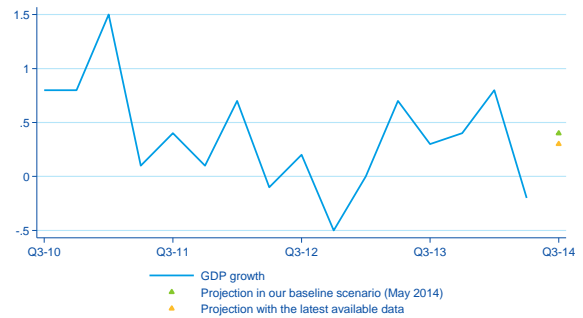


Figure 14
GDP (% QoQ) and forecasts*



Confidence: confidence indicators slow down

The composite PMI is slowing because of doubts in the manufacturing sector, while the services component remains high. Both the EC and domestic confidence indicators are flagging up increasing uncertainty.

Figure 15
PMI and GDP growth (% QoQ)*

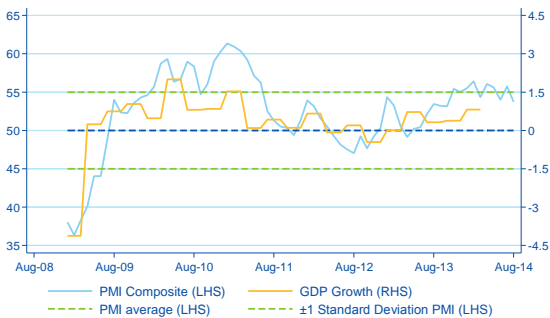
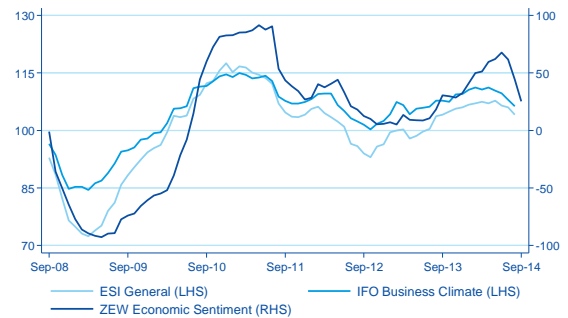


Figure 16
Confidence indicator (ESI, Ifo and ZEW)*



Activity: industrial production rises and retail sales fall in July

In July, industrial production rose by 1.6% from its average level in 2Q14, while retail sales fell by -0.8% from their average in 2Q14.

Figure 17
Industrial production (% YoY) and manufacturing PMI*

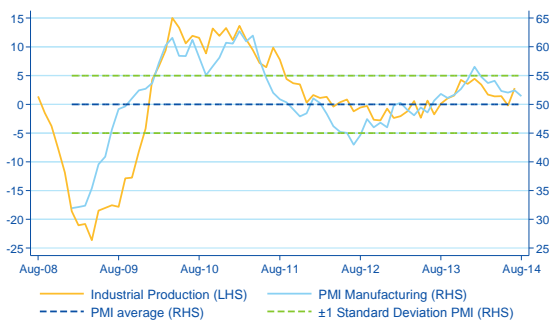
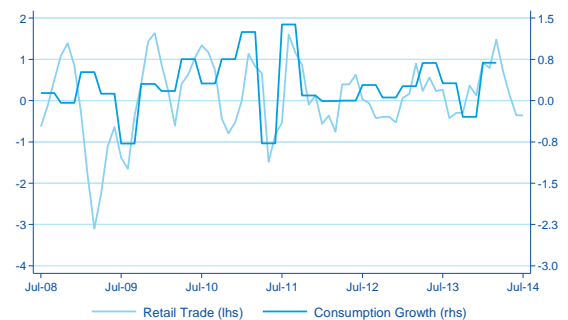


Figure 18
Retail sales (% 3Mo3M) and consumption growth (% QoQ)*



*Sources: Haver Analytics and BBVA Research

Foreign sector: exports up in July

Exports grew strongly in July, coming in 5.2% above their average in 2Q14. Imports, on the other hand, shrank, settling at -0.3% under their 2Q14 average. Foreign orders, which diminished slightly in earlier months, remained fairly stable in August.

Figure 19
Current account (% of GDP)*

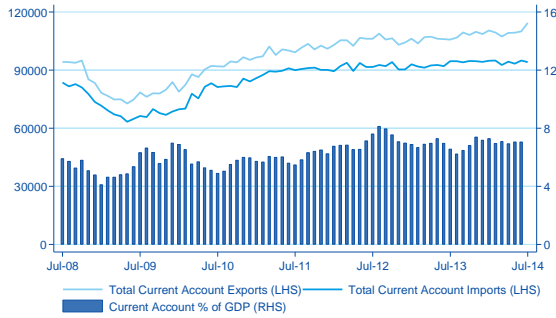
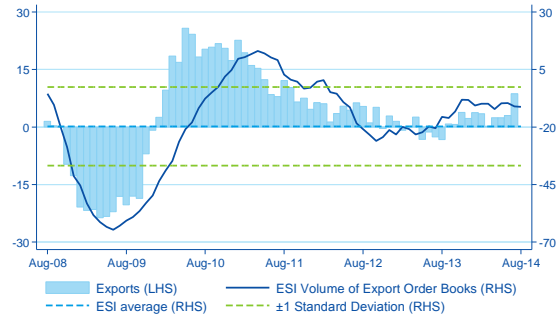


Figure 20
Export growth (% YoY) and volume of export orders*



Labour market: unemployment rate continues at record low

The unemployment rate remained at a record low (5.1%) in May, while growth in labour costs accelerated to 1.8% YoY in 2Q14 after a 0.4% YoY in 1Q14.

Figure 21
Unemployment rate (%) and employment expectations*

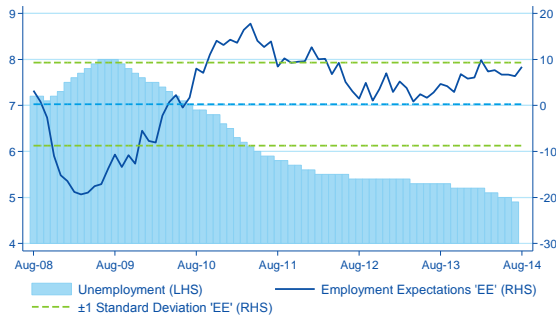
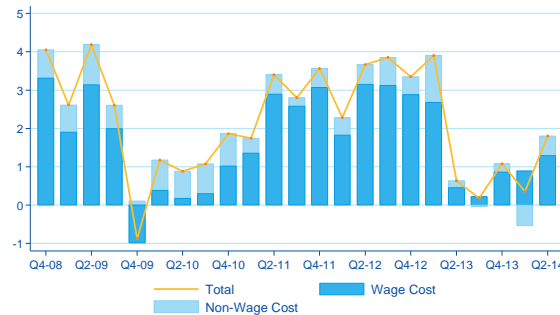


Figure 22
Labour costs in the corporate sector (% YoY)*



Prices: inflation stable in August

Harmonised inflation remained stable at 0.8% YoY in August. An additional fall in energy prices was offset by increases in food prices.

Figure 23
Inflation rate, headline and core (% YoY)*

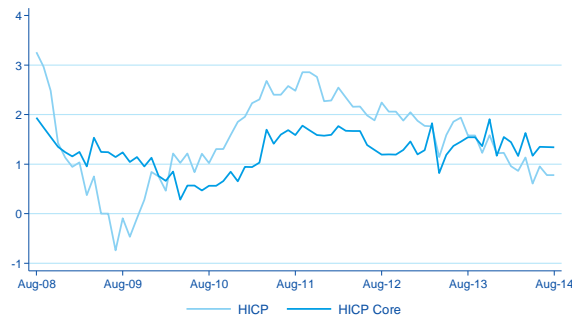
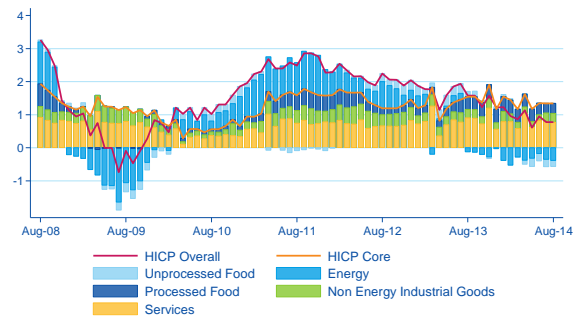


Figure 24
Inflation by component (contribution by %)*



* Sources: Haver Analytics and BBVA Research

France

National accounts: activity is still stagnant

French GDP recorded zero growth for the second quarter in a row. The performance of investment and net exports is holding back growth, while both private and public consumption are making positive contributions.

Figure 25
GDP (% QoQ) and contribution by component (pp)*

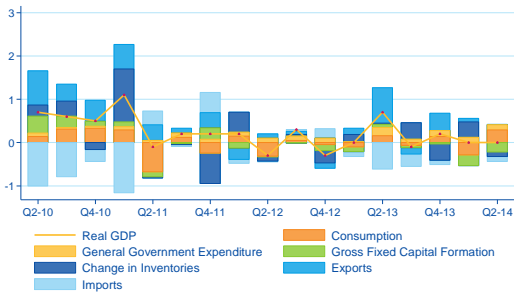
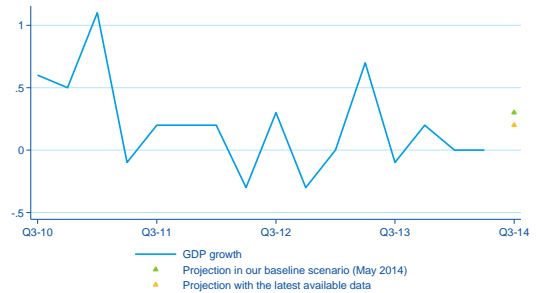


Figure 26
GDP (% QoQ) and forecasts*



Confidence: confidence falls further

The composite PMI remained in negative territory in August, while confidence as measured by the EC and the INSEE continues to deteriorate. The PMI breakdown shows that, above all, it is the weakness in the manufacturing sector that is weighing on economic activity.

Figure 27
PMIs and GDP growth (% QoQ)*

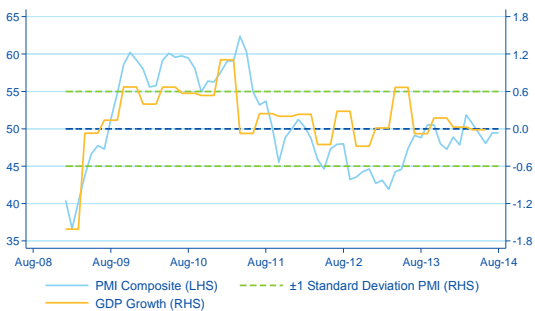
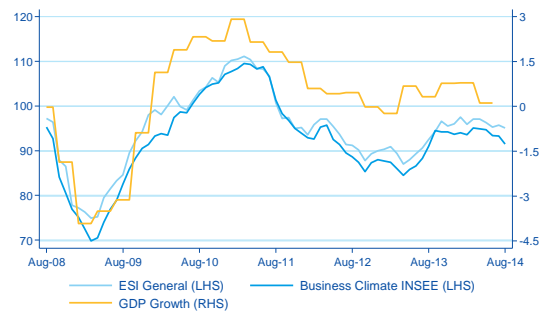


Figure 28
Confidence indicator (ESI and INSEE)*



Activity: industrial production stable, while retail trade improves

In YoY terms, industrial production remains virtually unchanged, increasing by 0.2%, although the manufacturing PMI indicates that the manufacturing sector is contracting. However, retail sales have improved in recent months, expanding by 1.3% 3Mo3M.

Figure 29
Industrial production (% YoY) and manufacturing PMI*

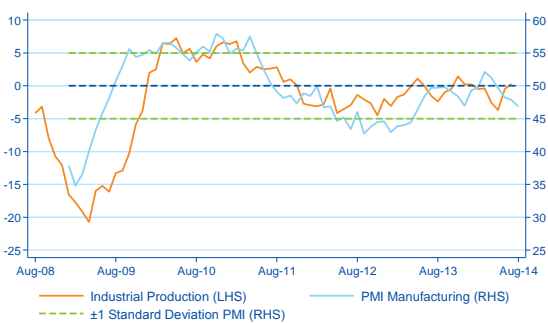
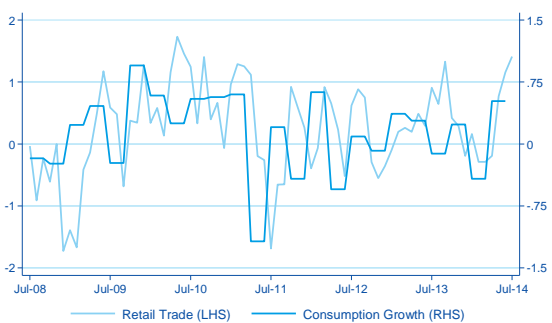


Figure 30
Retail sales (% 3Mo3M) and consumption growth (% QoQ)*



*Sources: Haver Analytics and BBVA Research

Foreign sector: exports discreetly up in 2Q14

Exports grew 0.3% in 2Q14, after 3 consecutive months of losses, and imports are rising at the same rate (-0.9% QoQ in 1Q14), which we would expect to result in a weak contribution from net exports.

Figure 31
Current account (% of GDP)*

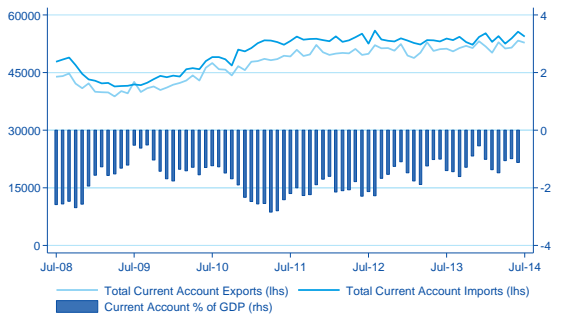
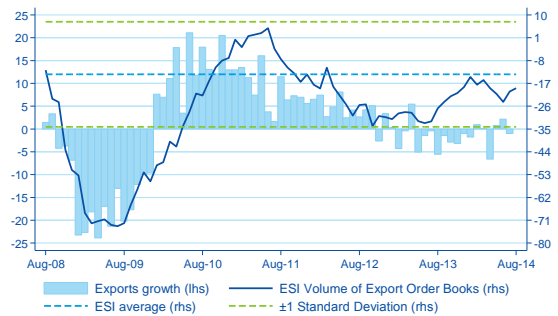


Figure 32
Export growth (% YoY) and volume of export orders*



Labour market: a degree of stabilisation in recent months

The unemployment rate stabilised at around 10.3% last year, after having increased by about 0.2pp every quarter the year before. Meanwhile, the overall labour cost accelerated in 2Q14 by 0.9% YoY.

Figure 33
Unemployment rate (%) and employment expectations*

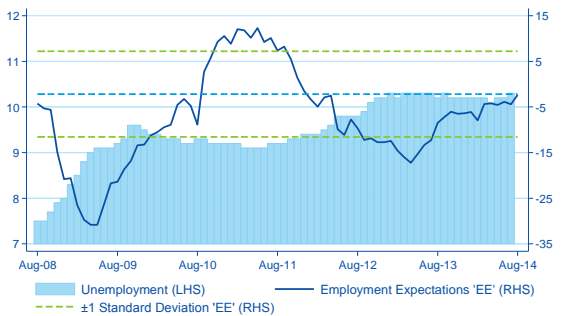
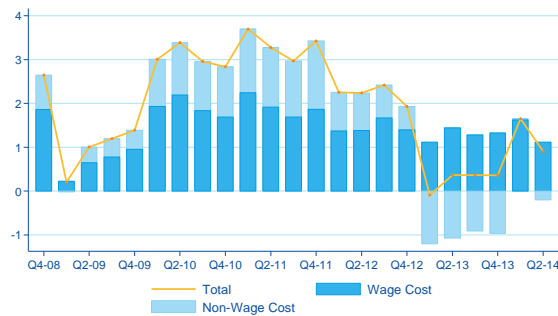


Figure 34
Labour costs in the corporate sector (% YoY)*



Prices: inflation decelerates again slightly in August

Harmonised inflation fell in August to 0.5% YoY, 0.1pp below the July figure (0.6% YoY).

Figure 35
Inflation rate, headline and core (% YoY)*

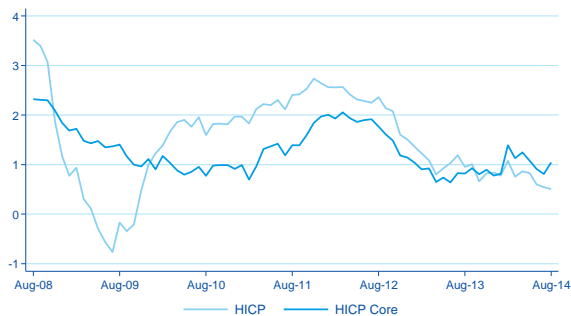
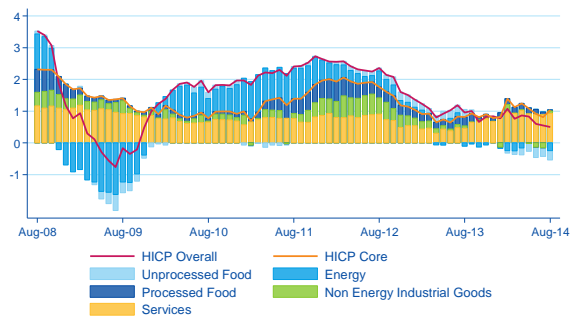


Figure 36
Inflation by component (contribution by %)*



* Sources: Haver Analytics and BBVA Research

Italy

National accounts: with the fall of GDP in 2Q14, Italy goes back into recession

GDP surprised negatively by falling -0.2% QoQ in 2Q14. This was essentially due to the negative contribution of net exports. Domestic demand ceased to hold back activity after thirteen consecutive quarters.

Figure 37
GDP (% QoQ) and contribution by component (pp)*

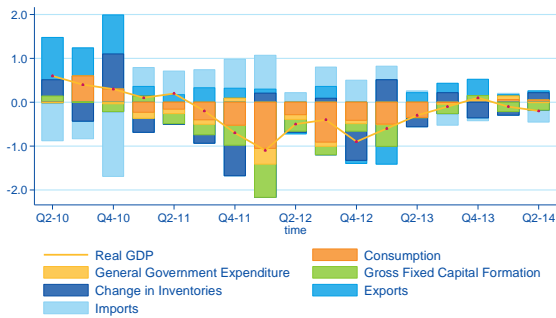
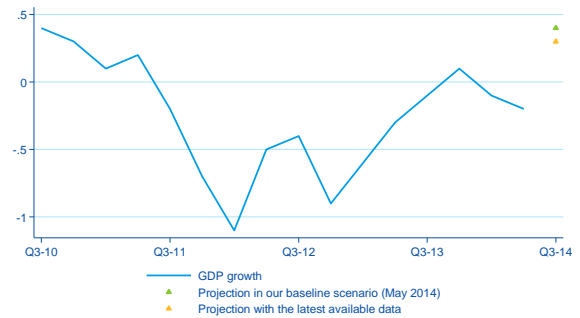


Figure 38
GDP (% QoQ) and forecasts*



Confidence: confidence indicators fall in August

The August composite PMI entered negative territory, as did the EC and ISTAT confidence indexes, a reflection of the weakness of the Italian economy.

Figure 39
PMIs and GDP growth (% QoQ)*

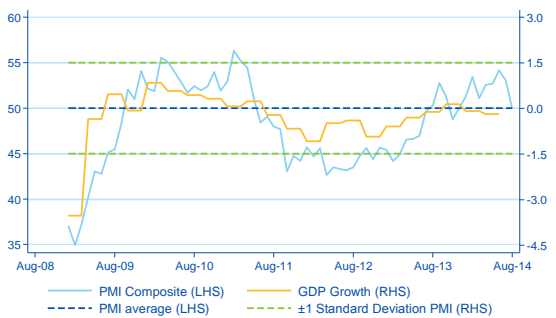
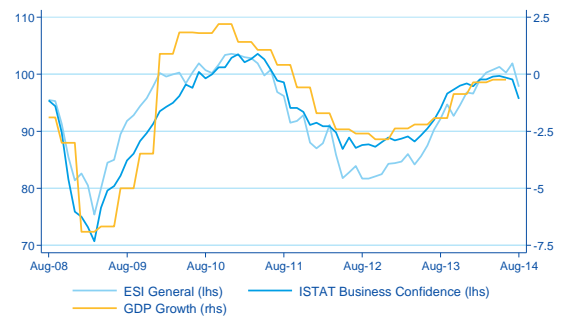


Figure 40
Confidence indicator (ESI and ISTAT)*



Activity: the industrial and retail sales sectors, matching the weak situation

July's industrial production data surprised negatively and is in line with the poor manufacturing PMI figure. At the same time, retail sales are stagnant, contracting -0.2% QoQ in 2Q14.

Figure 41
Industrial production (% YoY) and manufacturing PMI*

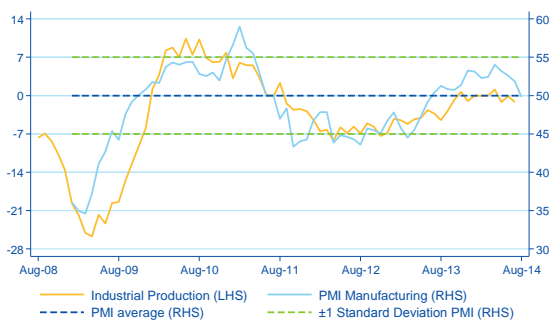


Figure 42
Retail sales (% 3Mo3M) and consumption growth (% QoQ)*



*Sources: Haver Analytics and BBVA Research

Foreign sector: net exports moderate their contribution to growth in 2Q14

Exports improved to May, after growing +0.3% QoQ in 1Q14, but less than imports. Net exports continue to be the principal short-term growth factor for Italy, although they will contribute less than in 1Q14.

Figure 43
Current account (% of GDP)*

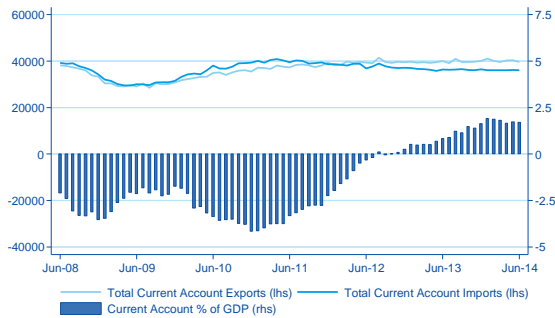
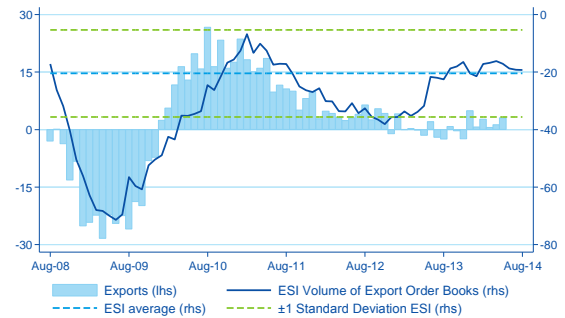


Figure 44
Export growth (% YoY) and volume of export orders*



Labour market: unemployment steady at record highs, and labour costs rise

The unemployment rate remained at very high levels, close to the worst figure on record, and 1.1pp more than a year ago, with employment prospects deteriorating. Labour costs were increasing by 1,2% YoY in 2Q14, slightly below Eurozone average (1.4% YoY).

Figure 45
Unemployment rate (%) and employment expectations*

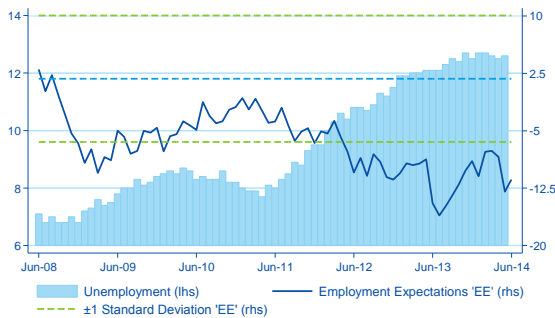
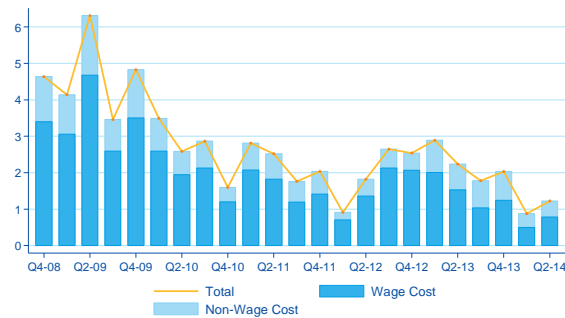


Figure 46
Labour costs in the corporate sector (% YoY)*



Prices: inflation decelerates 0.2pp down to -0.2% YoY in August

Consumer prices fell (-0.2% YoY) in August according to harmonised indicators. Core inflation also decelerated 0.1pp (+0.5% YoY).

Figure 47
Inflation rate, headline and core (% YoY)*

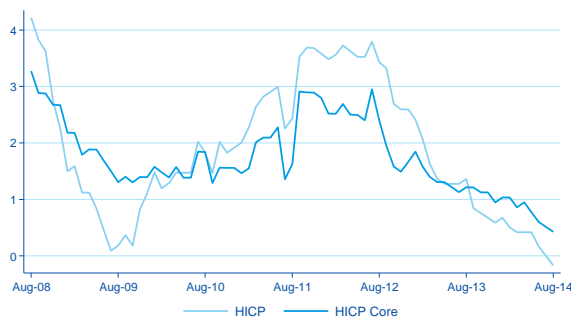
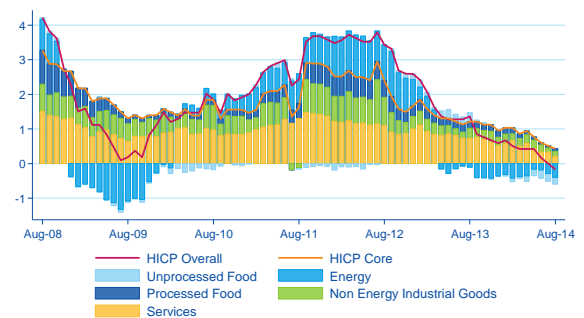


Figure 48
Inflation by component (% contribution)*



* Sources: Haver Analytics and BBVA Research

Spain

National accounts: GDP growth takes root

GDP grew 0.6% QoQ in the second quarter, supported, above all, by private consumption and, to a lesser degree, by investment. Net exports made virtually no contribution because of the uptick in imports, and neither did public sector consumption.

Figure 49
GDP (% QoQ) and contribution by component (pp)*

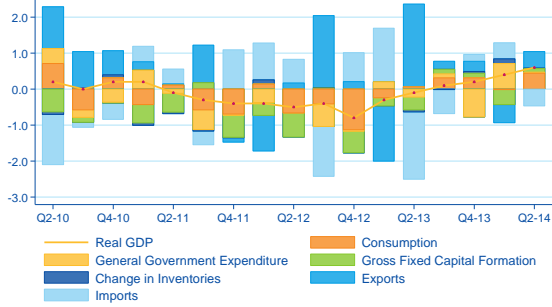
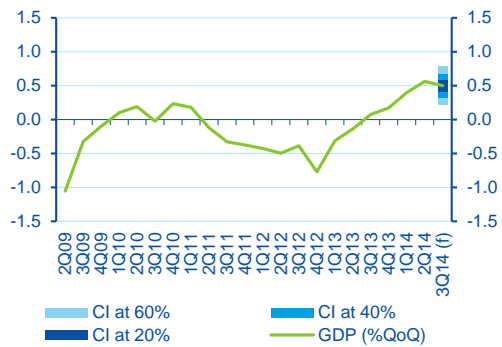


Figure 50
GDP Growth (% QoQ) and MICA-BBVA forecast*



Confidence: confidence levels remain high in the third quarter

The ESI and PMI indexes remained at high levels in August, with the PMIs clearly above the growth threshold, especially in services, and with consumer confidence in a positive trend.

Figure 51
PMIs and GDP growth (% QoQ)*

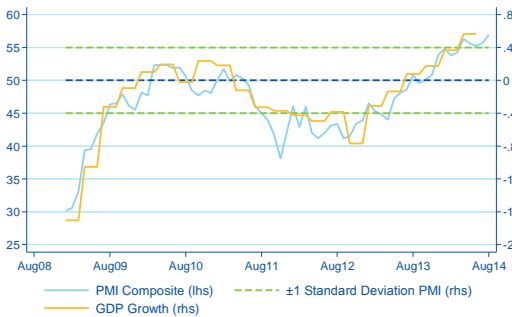
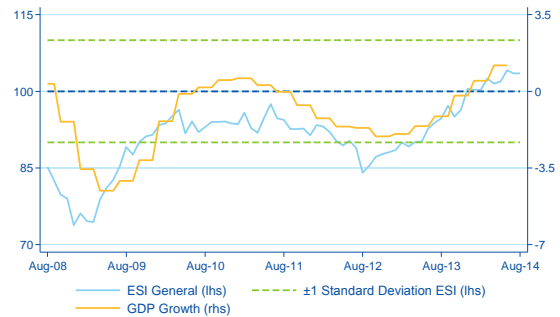


Figure 52
Confidence (ESI) and GDP growth (% YoY) *



Activity: improvements in industrial production and retail trade have stopped

In July, both the industrial production and the retail sales indexes have interrupted their growth, in comparison with 2Q14, and leading and confidence indicators suggest that growth will be somewhat more moderate in the third quarter.

Figure 53
Industrial production (% YoY) and manufacturing PMI*

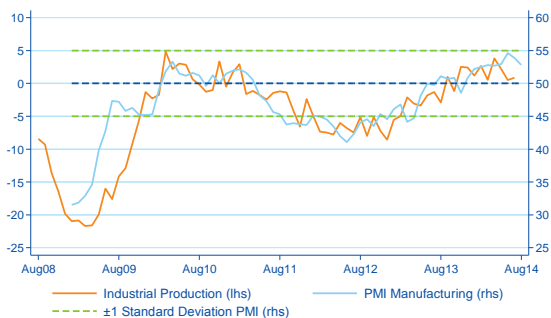
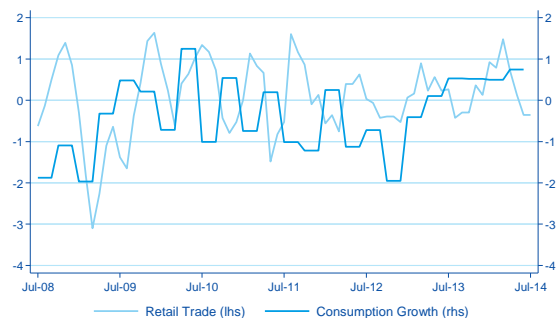


Figure 54
Retail sales (% 3Mo3M) and consumption growth (% QoQ)*



*Sources: Haver Analytics and BBVA Research

Foreign sector: exports recover gradually

In 2Q14, we saw the expected correction to the upside of goods exports (+1.4% QoQ) which, together with progress in services (+1.2% QoQ), resulted in a 1.3% QoQ expansion in sales outside the eurozone.

Figure 55
Current account (% of GDP)*

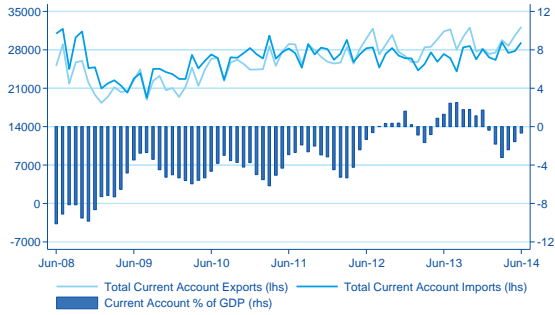
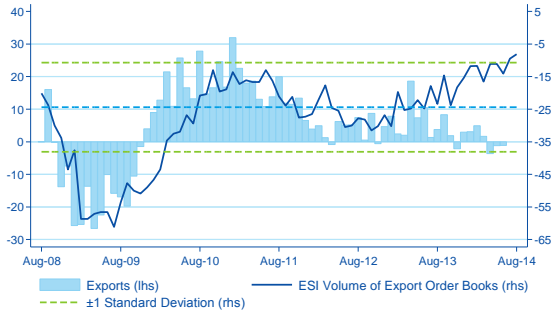


Figure 56
Export growth (% YoY) and volume of export orders*



Labour market: improvement slackens its pace from the first half

The number of workers paying social security has increased for eleven consecutive months to August, although at a slower rate than in the second quarter of the year.

Figure 57
Unemployment rate (%) and employment expectations*

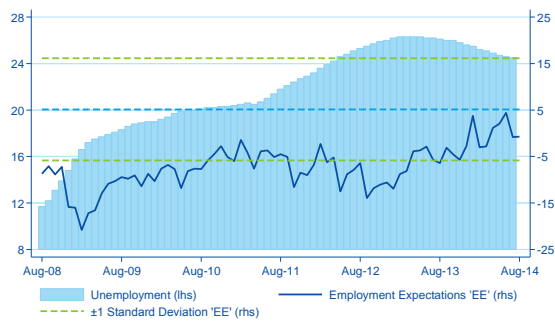
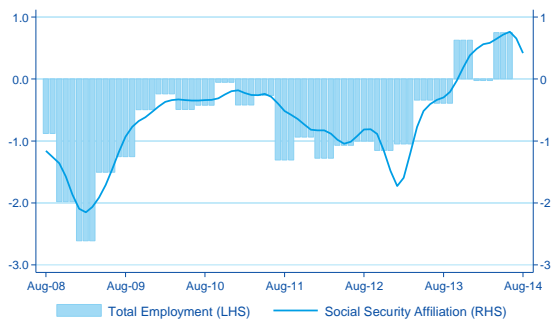


Figure 58
Job growth: New self-employed and social security contributors (% QoQ)*



Prices: consumer prices fall

The expected descent of inflation was due principally to the fall in energy prices and the absorption of the base effect on food prices. In line with expectations, core prices remained static.

Figure 59
Inflation rate, headline and core (% YoY)*

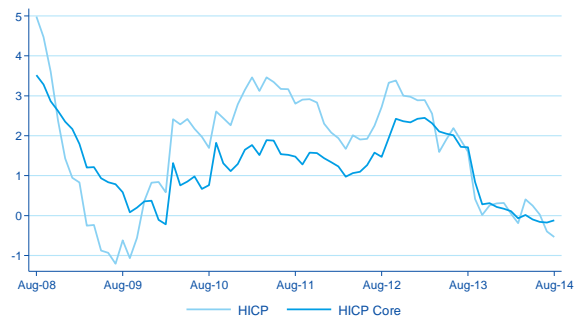
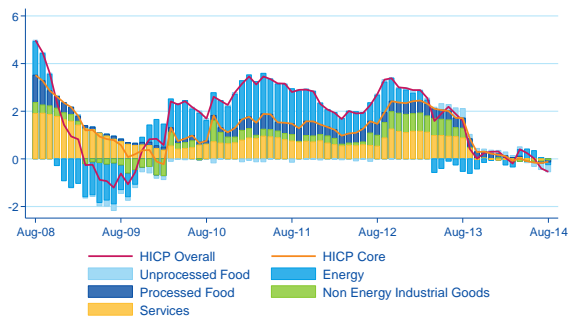


Figure 60
Inflation by component (contribution by %)*



* Sources: Haver Analytics and BBVA Research

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