

MACROECONOMIC ANALYSIS

Eurozone: very weak signs and minimal growth

Europe Unit

Weakness continues in the eurozone, after the negative surprise in the second quarter. The confidence indicators are still biased to the downside, and although on the whole they are in growth territory, they are much less positive than before the summer. The activity data has also been negative in the industrial sector: after the positive July production figure, production, new orders and exports all fell sharply in Germany in August (although industrial production has picked up a little in other countries). Consumption indicators are somewhat more hopeful. On balance, we are expecting very slow growth in the third quarter of 0.1% QoQ, so everything points to the year closing with GDP growth of 0.7%. Inflation is still very low, at 0.3%, and we expect it to accelerate in the next few months to 0.7%, while core inflation will stay at around its current levels of 0.8%. The ECB has not produced any surprises this month and continues to await the result of the second TLTRO auction in December. Nor has it provided much information about its ABS bond purchase programme. The economic policy debate at the moment hinges on fiscal policy, the announcements that Italy's deficit and, above all, France's are higher than expected, and pressure by the IMF (and not only the IMF) on Germany to stimulate its economy. The debate will be resolved within the next two or three months, although we are not expecting a significant change in the eurozone's fiscal stance next year.

Eurozone: the economy could grow slightly in 3Q14 despite the weakness

- **Confidence indicators deteriorate throughout the third quarter...**

In 3Q14, the Markit PMI composite index recorded a downwards correction from the second quarter (an average of 52.8 after of 53.4), revealing clear differences between confidence levels in the services and manufacturing sectors (Figures 3 and 4): while the first remains a stable trend, the second shows a marked fall, partly conditioned by the uncertainty caused by the geopolitical conflicts holding back the exports sector. The performance of the European Commission's economic sentiment index (ESI) is virtually identical. By subcomponents, the forward indicators for both surveys offer poor perspectives for the next few months, given that in September growth in new orders has been only marginal, and employment creation has halted. Even so, the confidence indicators are still suggesting modest GDP growth in 3Q14 (Figure 2), after the stagnation in the second quarter of the year.

- **... and activity indicators are still conditioned by the geopolitical environment**

The available activity indicators offer mixed signals in 3Q14: exports to July fell slightly and external orders have contracted again, a sign that the export sector could remain weak in 3Q14 (Figure 8), limited by the uncertainty of the conflict in Ukraine. July's strong industrial production figure was offset by the contraction in August (-1.8% MoM, -0.5% down compared to the 2Q14 average), after publishing national data which were particularly negative in Germany, and would endanger the recovery of investment. Retail sales to August, however, grew by 0.5%, a slightly higher rate than in 2Q14 (0.3% QoQ) despite the deterioration in consumer confidence, which could sustain private consumption in the third quarter (Figure 6).

- **The MICA-BBVA model estimates growth of 0.1% in 3Q14**

Incorporating the data available to date (real figures only exist to August), our short-term forecast model estimates moderate growth of 0.1% QoQ in 3Q14, after 0.0% QoQ in the previous quarter. With the last

two quarters posting poor results, for the year as a whole we expect 0.7% growth, down from our estimate three months ago of 1.1%.

- **Inflation moderates at 0.3% YoY, and core inflation drops 0.1% (to 0.8% YoY)**

The moderation in inflation was a response to the fall in energy product prices (in line with expectations) but also to lower growth in underlying component product prices, which was partially offset by a small fall in fresh food prices (Figures 11 and 12). Our forecasts indicate that inflation could jump throughout the last quarter to reach rates of around 0.7% YoY, driven by the change in prices in more volatile components, which will accelerate somewhat because of the disappearance of base effects. On the other hand, we expect core inflation to remain relatively stable, at around 0.8-0.9% YoY for the rest of the year.

Germany: deterioration in the industrial sector

- **GDP could grow moderately in 3Q14**

The most recent figures suggest that growth in Germany in 3Q14 will be marginal compared to the second quarter of the year (0.1% after -0.2% QoQ in 2Q14) (Figure 14). Due to the volatility of the data between July and August, it's not possible to establish a clear trend, but the bias in our forecast is to the downside. The external sector could be the main growth driver, given that, despite the poor figure in August, exports rose in July and August by 2% more than the 2Q14 average. By contrast, imports fell, probably partly hampered by companies' reluctance to invest, as heralded by the deterioration in the business expectations indicators over the last few months, due mainly to the uncertainty caused by the crisis in Ukraine and lower European demand. As a sign of the above, industrial production to August is contracting again from the previous quarter, when it fell 0.6% QoQ, although this might to a degree be a result of seasonal effects (Figure 17). Industrial orders are also falling. Retail sales, however, are picking up (0.8% above the 2Q14 average), encouraged by favourable unemployment figures, in line with the high levels of consumer confidence, even though these have cooled in recent months.

France: activity indicators unchanged

- **Minimal uptick in activity expected in the third quarter**

Real data available to August are a little better than the negative perspectives being offered by the various confidence indicators: both the national indicators, such as the PMIs, and the European Commission's indicator for 3Q14 are lower than in the second quarter, signalling, particularly, the fragility in the manufacturing sector (Figures 27 and 28). However, industrial production has risen by 0.7% compared to the 2Q14 average (which suffered the negative impact of three holidays falling on Thursdays in May), especially because of the uptick in construction production. Retail sales to May, meanwhile, rose by 0.7% compared to the second quarter and consumption spending increased slightly again (Figure 30), even though household confidence is still flat. The external sector made a negative contribution again in 3Q14, given that exports are still contracting and imports are edging up, which will translate into a moderate growth in GDP of 0.1/0.2% QoQ, after the stagnation in 1Q14 and 2Q14.

Italy: GDP will fall again in the third quarter

- **Confidence and industrial production deteriorate**

The intense deterioration in all the confidence indicators throughout the third quarter is showing up in the activity data available to August. The PMIs have tumbled and are back in contractive territory, while the Commission's ESI indicator has reached a new record low, in particular because of fragility in the

manufacturing sector; industrial production continues to contract (-0.6% below the 2Q14 average) and retail sales, after nine quarters of falls, are still shrinking (data from July), proving the change in trend in consumer confidence which remitted in 3Q14 (Figure 41). Exports to July dropped 1.8% from the previous quarter's average and the fall in external orders, together with a smaller reduction in imports, suggest that the external sector will not contribute to GDP growth either in 3Q14 (Figure 38), which we estimate at around -0.1/-0.2% QoQ after the falls in the first half of the year (-0.1% and -0.2% QoQ in 1Q14 and 2Q14 respectively).

Spain: momentum continued in 3Q14

- **The rate of expansion in the economy continued at a healthy rate, with growth in both domestic and external demand**

The trend in the variables indicates that the Spanish economy's recovery extended into the third quarter of 2014 and the MICA-BBVA model for Spain forecasts GDP growth of around 0.5% QoQ (just under the 0.6% reached in 2Q14). On the side of private domestic demand, recovery continued, but at a slightly slower rate than in the first half. Although household income and expectations performed favourably, some spending indicators softened. Likewise, the changes in industrial confidence and production, in manufacturing PMIs and in trade flows, suggest rather less growth in machinery and equipment investment than in the previous quarter. In terms of external demand, the expectations and income indicators signal that, although the main trading partners are performing unevenly, exports of goods and non-tourism services continue to recover. In terms of the job market, although the employment figures for September beat expectations, they did not fully offset the weak start to the quarter. All in all, our estimates indicate that the number of affiliates paying Social Security grew by 0.5% QoQ (seasonally adjusted) in 3Q14, whereas the reduction in unemployment moderated more intensely, to -0.7% QoQ (also seasonally adjusted) from -1.9% the previous quarter (see [Spain Economic Watch](#)).

Eurozone

National accounts: zero growth in 2Q14, hampered 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 0.1% QoQ in 3Q14.

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

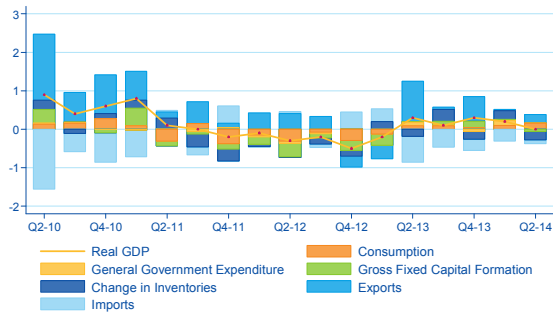
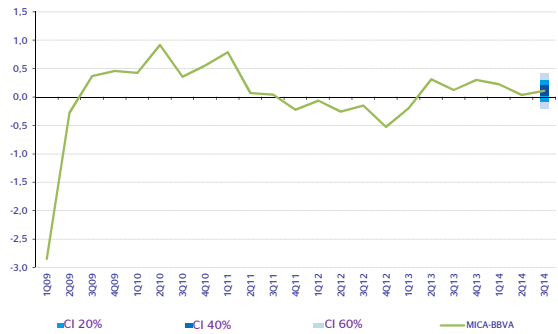


Figure 2
GDP growth (% QoQ) and MICA-BBVA forecast*



Confidence: the PMIs and the ESI both fall

PMIs fell in September, weighed down by weak manufacturing, and with the services sector showing signs of weakness. By countries, the German economy's recovery is proceeding at a rather slower rate, while France and Italy are in negative territory.

Figure 3
PMIs and GDP growth (% QoQ)*

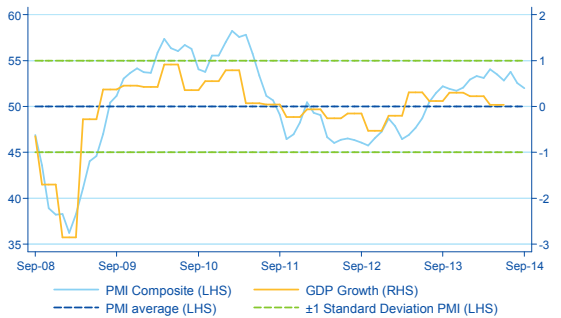
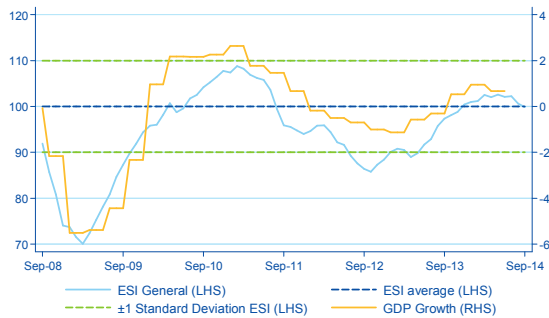


Figure 4
Confidence (ESI) and GDP growth (% YoY) **



Activity: mixed signals from the activity indicators

July's strong industrial production figure was offset by the contraction in August (-1.8% MoM, -0.5% down compared to the 2Q14 average). Meanwhile, retail trade improved in August, growing 0.6% 3Mo3M.

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

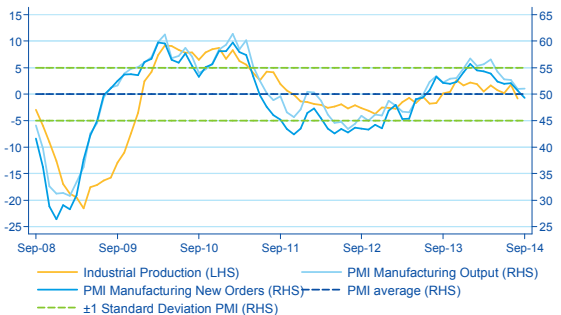


Figure 6
Retail sales (% 3Mo3M) and consumption growth (% QoQ)*



*Source: Haver Analytics and BBVA Research

Foreign sector: the trade surplus narrows in July

The eurozone's trade balance surplus narrowed in July due to a contraction in exports and increased imports. In annual terms, however, exports grew by 2.6% in July.

Figure 7
Current account (% of GDP)*

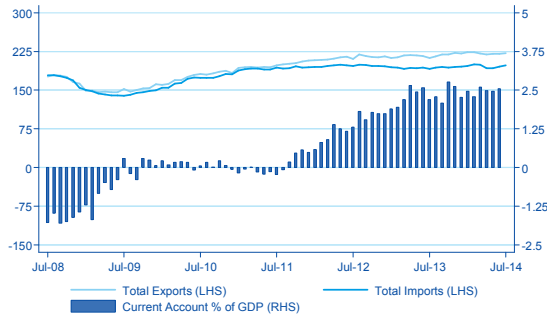
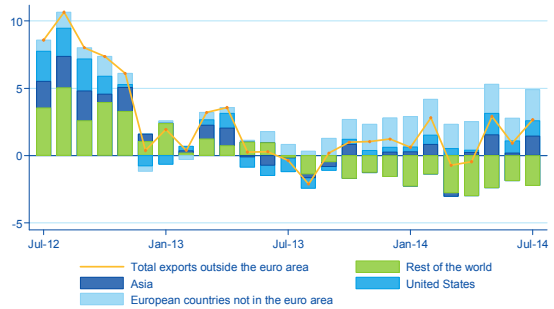


Figure 8
Exports by destination (contribution to % YoY)



Labour market: stable over the last year

Although we expect that 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*

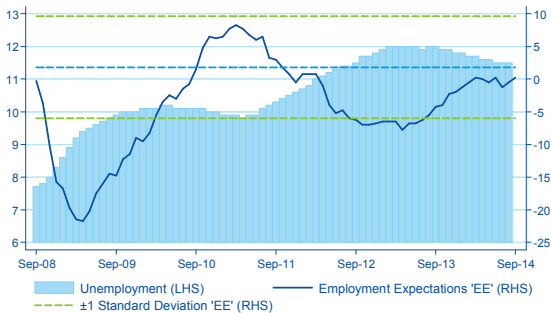
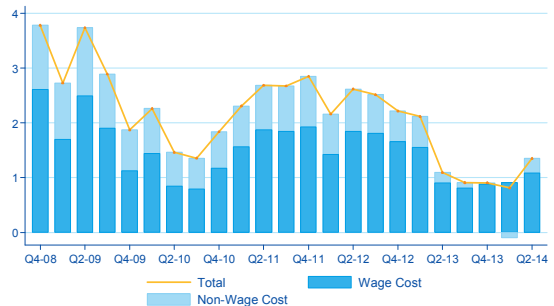


Figure 10
Labour costs in the corporate sector (% YoY)*



Prices: inflation moderates at 0.3% YoY, and core inflation falls 0.1pp

Inflation moderation in September was a result of the fall in prices in energy products, but also due to lower growth in prices in underlying component products.

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

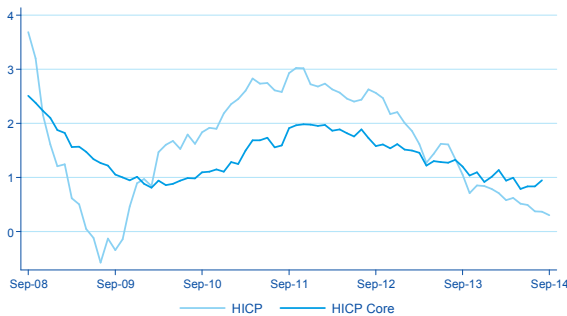
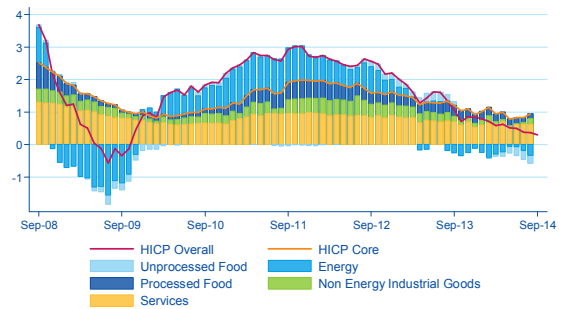


Figure 12
Inflation by component (contribution by %)*



* 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 performance of the external sector and of investment. Both private and public consumption rose slightly.

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

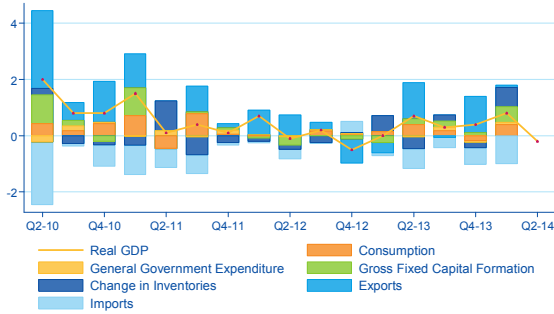


Figure 14
GDP (% QoQ) and forecasts*



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)*

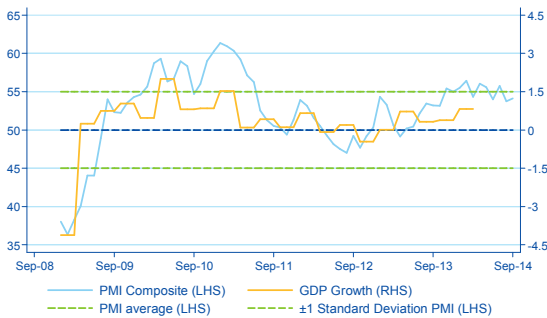
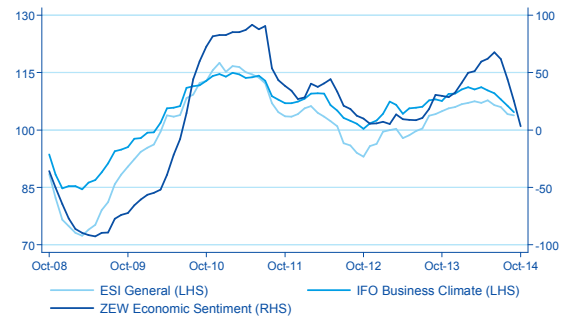


Figure 16
Confidence indicator (ESI, Ifo and ZEW)*



Activity: industrial production contracts and retail sales rise

In August, industrial production fell brusquely, after having risen in July. Compared with the previous quarter, industrial production to August fell -0.7%, in line with the manufacturing PMI. Retail sales rose in August by 0.8% 3Mo3M.

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

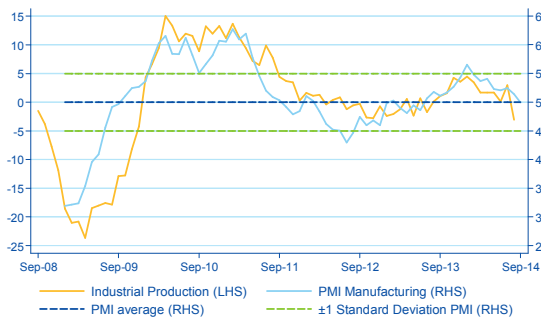
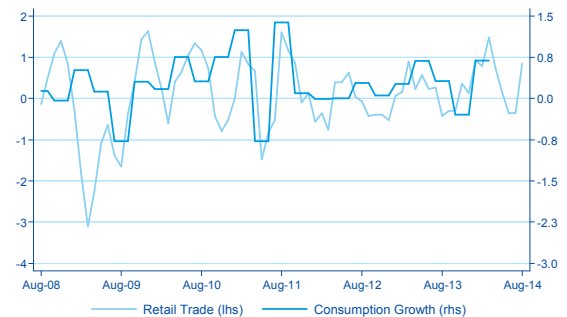


Figure 18
Retail sales (% 3Mo3M) and consumption growth (% QoQ)*



*Sources: Haver Analytics and BBVA Research

Foreign sector: goods exports rise over the previous quarter

Despite showing increasing volatility, goods exports to August rose by 2% from the previous quarter. Meanwhile, goods imports shrank -0.6 from 2Q14. Foreign orders continued their downwards trend into September.

Figure 19
Current account (% of GDP)*

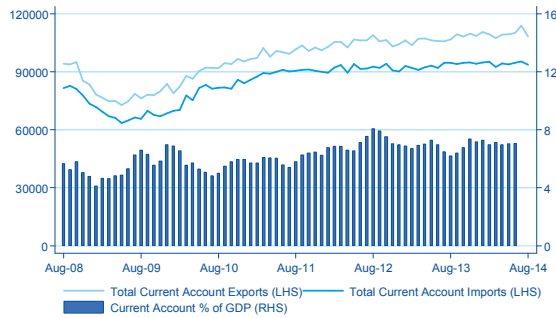
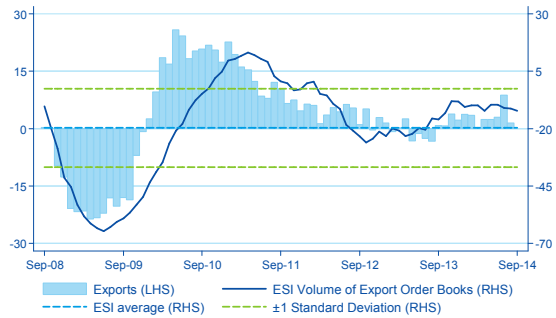


Figure 20
Export growth (% YoY) and volume of export orders*



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 0.4% YoY in 1Q14.

Figure 21
Unemployment rate (%) and employment expectations*

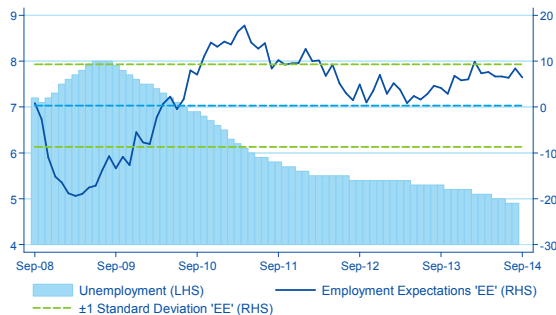
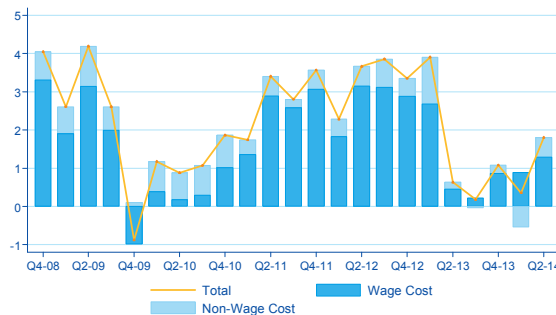


Figure 22
Labour costs in the corporate sector (% YoY)*



Prices: inflation unchanged in September

Preliminary estimates for harmonised inflation have remained stable at 0.8% YoY in September. A further fall in energy prices was offset by increases in food and services prices.

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

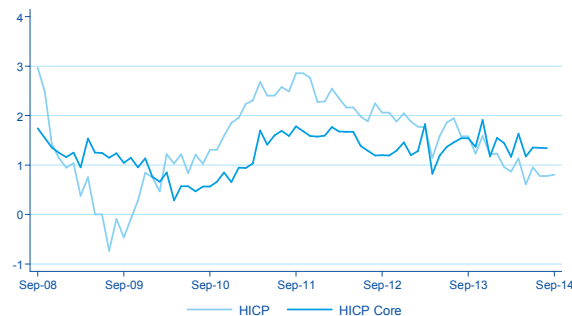
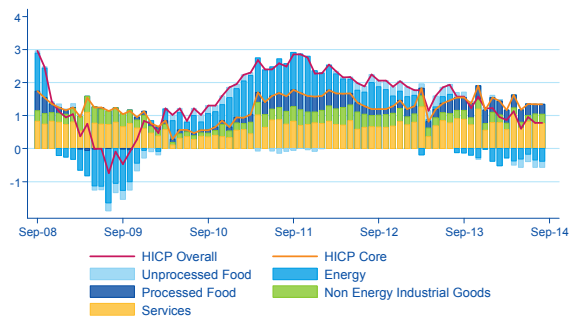


Figure 24
Inflation by component (contribution by %)*



* 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)*

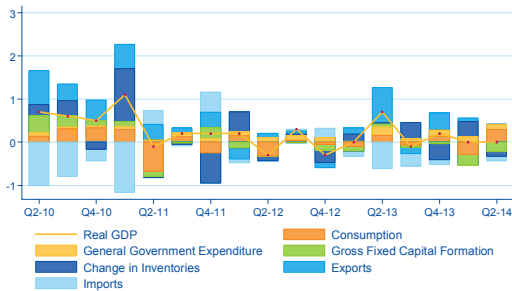


Figure 26
GDP (% QoQ) and forecasts*



Confidence: confidence continues to deteriorate

The composite PMI deteriorated, remaining in negative territory in September, while confidence as measured by the EC and the INSEE continues to fall. The PMI breakdown shows that, above all, it is the weakness in the manufacturing sector that is weighing on economic activity, although the services PMI is also in negative terrain.

Figure 27
PMIs and GDP growth (% QoQ)*

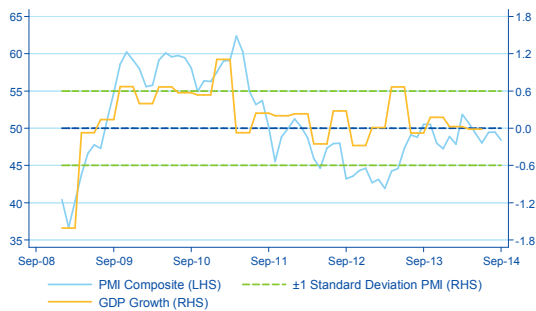
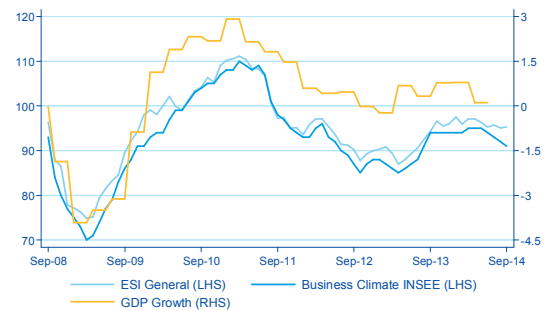


Figure 28
Confidence indicator (ESI and INSEE)*



Activity: industrial production stable, while retail trade improves

Industrial production remained stable in August, staying at its average level of 1Q14. In line with the manufacturing PMI, manufacturing production shrank slightly. However, retail sales have improved in recent months, expanding by 1% 3Mo3M.

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

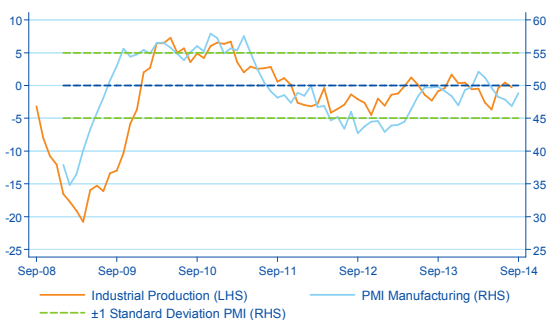
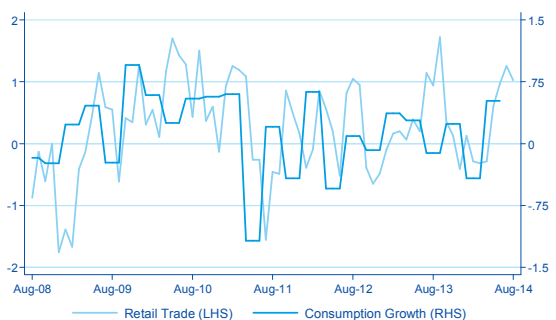


Figure 30
Retail sales (% 3Mo3M) and consumption growth (% QoQ)*



*Sources: Haver Analytics and BBVA Research

Foreign sector: both exports and imports shrink in August

Both exports (-1.3% MoM) and imports (-0.6% MoM) of goods slid again in August. However, while exports dropped -1% compared to 2Q14, imports rose 1.1% over 2Q14.

Figure 31
Current account (% of GDP)*

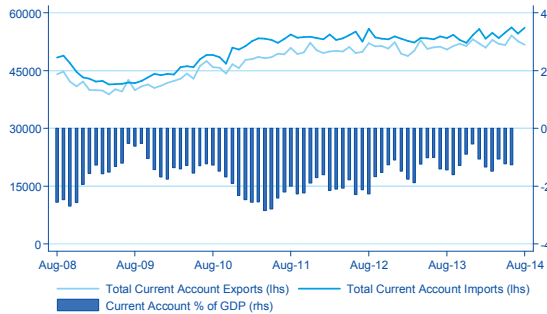
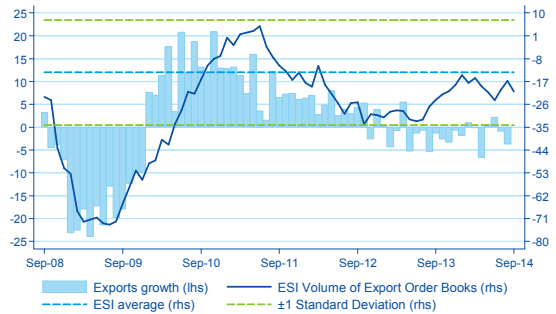


Figure 32
Export growth (% YoY) and volume of export orders*



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*

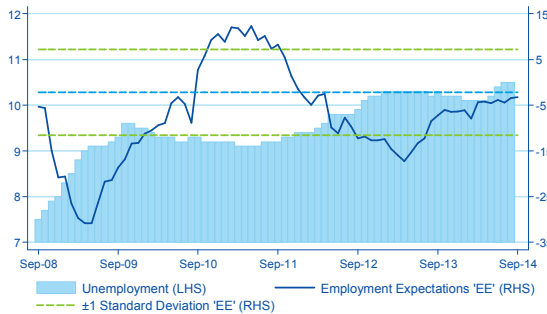
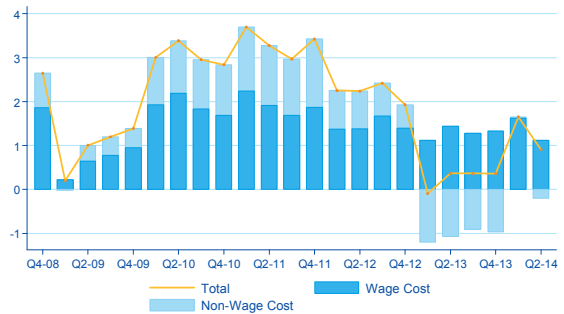


Figure 34
Labour costs in the corporate sector (% YoY)*



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)*

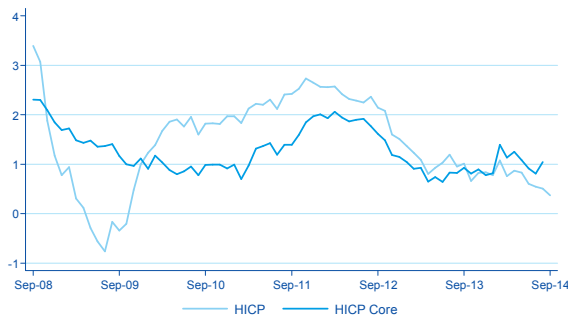
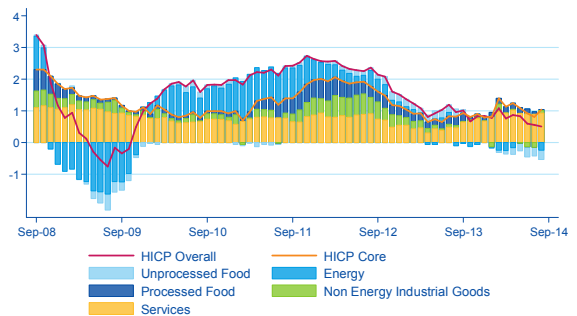


Figure 36
Inflation by component (contribution by %)*



* 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)*

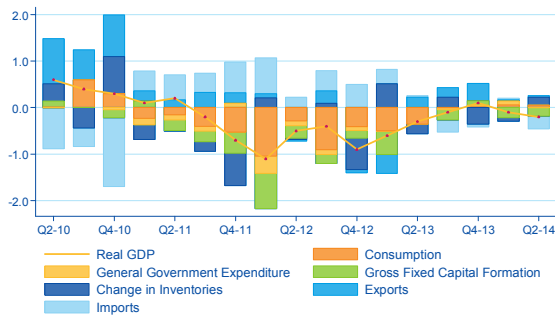


Figure 38
GDP (% QoQ) and forecasts*



Confidence: the confidence indicators fall in September

The September composite PMI continued in 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)*

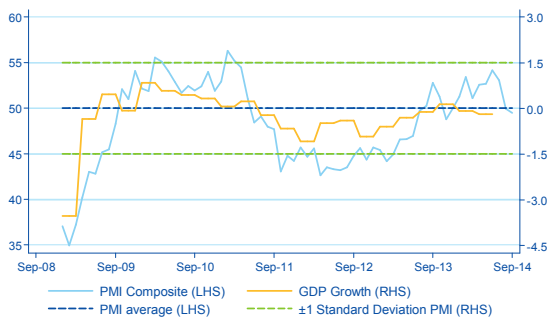
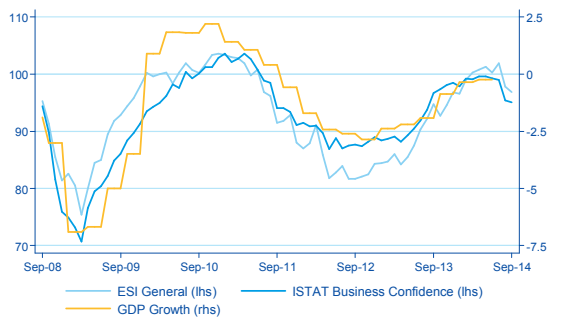


Figure 40
Confidence indicator (ESI and ISTAT)*



Activity: the industrial sector and retail sales, in line with the generally weak situation

After the negative surprise in July, industrial production rose a little in September and the manufacturing PMI improved. Nevertheless, retail sales remain stagnant, contracting by -0.2% QoQ in 2Q14.

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

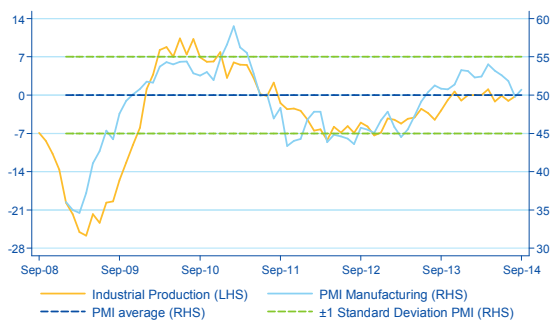
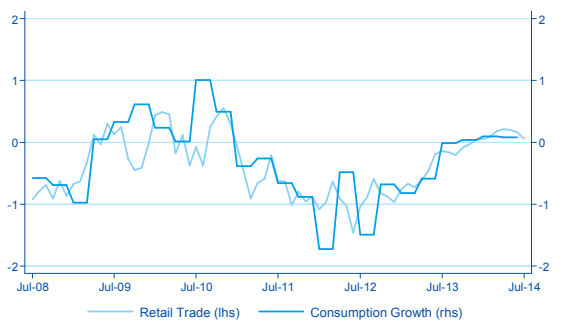


Figure 42
Retail sales (% 3Mo3M) and consumption growth (% QoQ)*



*Sources: Haver Analytics and BBVA Research

Foreign sector: exports and imports shrink

Exports contracted -1.6% MoM in July, but less so than imports, which shrank by -2.5% MoM. The volume of export orders fell in September.

Figure 43
Current account (% of GDP)*

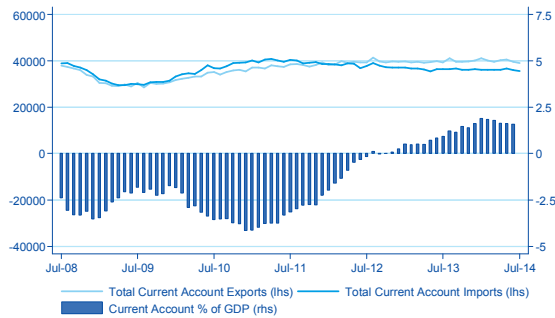
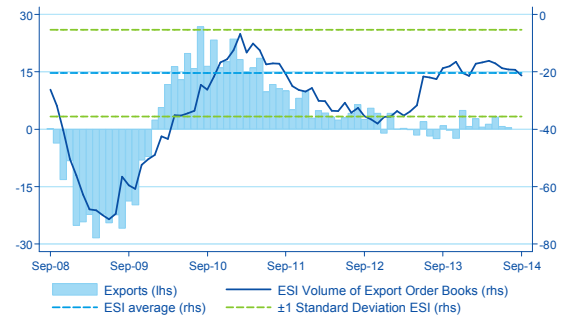


Figure 44
Export growth (% YoY) and volume of export orders*



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 increased by 1.2% YoY in 2Q14, slightly below the eurozone average (1.4% YoY).

Figure 45
Unemployment rate (%) and employment expectations*

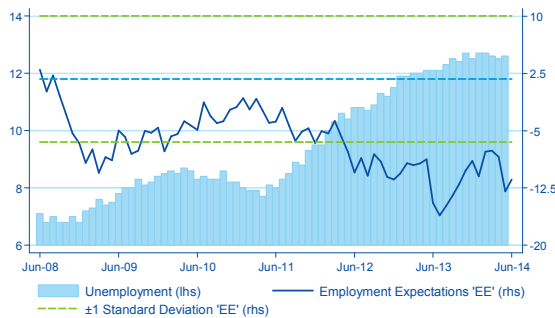
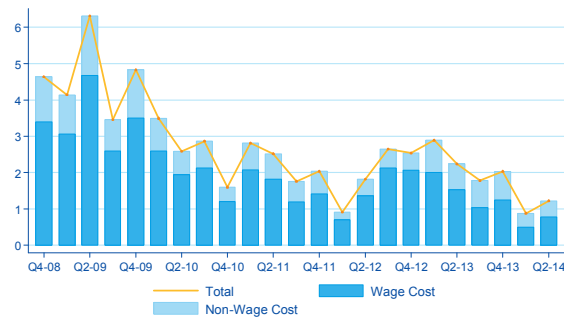


Figure 46
Labour costs in the corporate sector (% YoY)*



Prices: inflation holds at -0.2% YoY in September

Consumer prices fell (-0.2% YoY) in September according to harmonised indicators. Core inflation also decelerated by 0.1pp (+0.3% YoY).

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

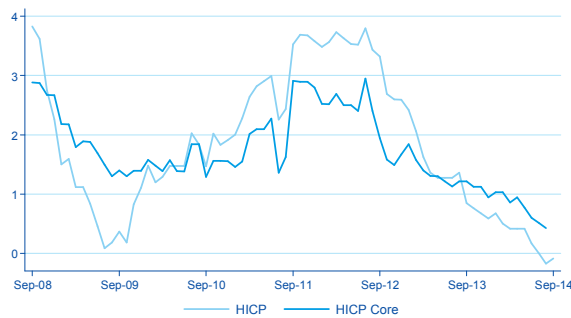
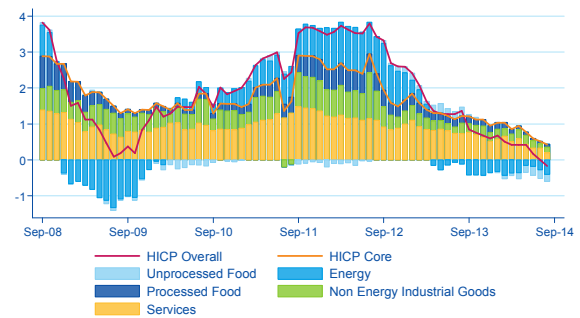


Figure 48
Inflation by component (% contribution)*



* 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)*

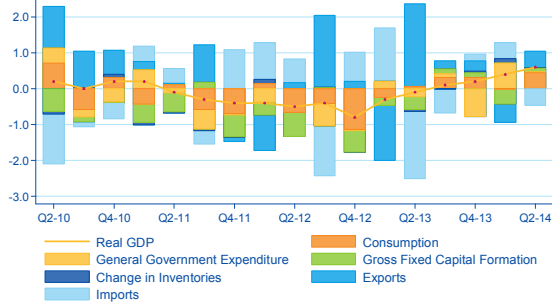
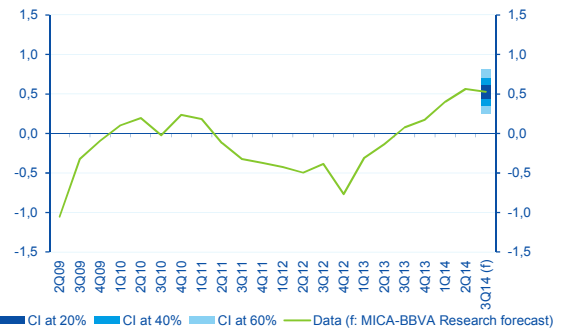


Figure 50
GDP Growth (% QoQ) and MICA-BBVA forecast*



Confidence: confidence levels high in the third quarter

The ESI and PMI indexes have cooled their positive tendencies in 3Q14, but remain high, with the PMIs clearly above the growth threshold, particularly in services and with consumer confidence in positive mood.

Figure 51
PMIs and GDP growth (% QoQ)*

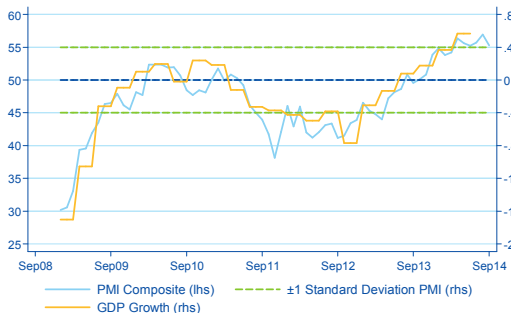
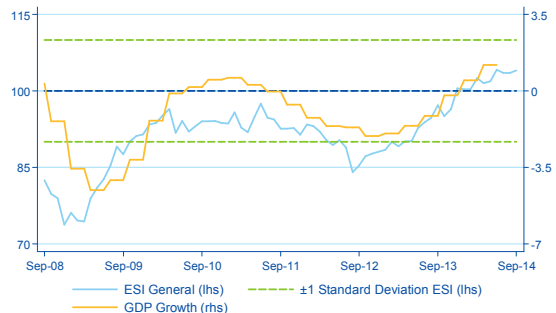


Figure 52
Confidence (ESI) and GDP growth (% YoY) *



Activity: the trend in activity remains positive, but is decelerating

To August, the industrial production indicator fell and the measure for retail sales continued upward, compared with 2Q14 (-0.6% and +0.8% respectively), while the forward and confidence indicators point to an improvement in both sectors.

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

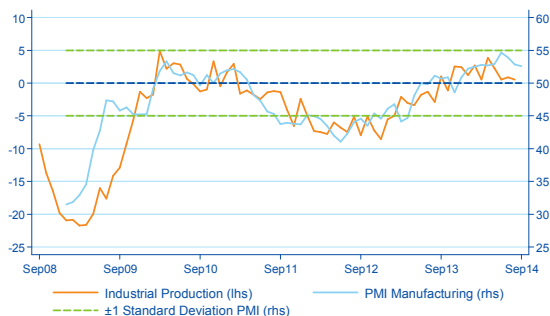
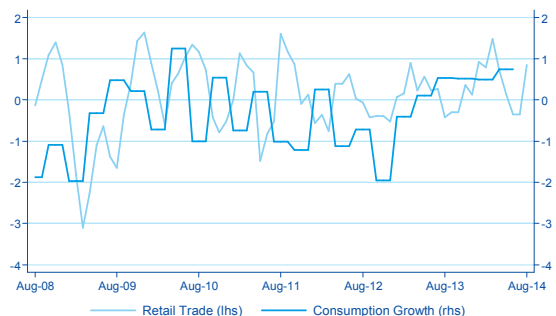


Figure 54
Retail sales (% 3Mo3M) and consumption growth (% QoQ)*



*Sources: Haver Analytics and BBVA Research

Foreign sector: exports recover in 3Q14

Exports of goods and non-tourism services continued to recover, despite the uneven performance on the part of Spain's main trading partners, and expectations and income indicators expect this positive trend to continue

Figure 55
Current account (% of GDP)*

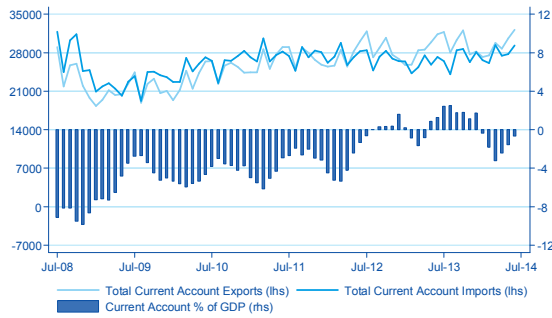
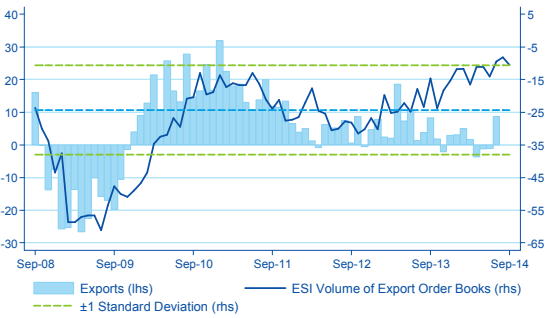


Figure 56
Export growth (% YoY) and volume of export orders*



Labour market: jobs registered slacken in 3Q14

Workers paying social security increased by 0.5% QoQ in the third quarter and the reduction in official unemployment was 0.7% QoQ, less than in 2Q14 (-1.9% QoQ)

Figure 57
Unemployment rate (%) and employment expectations*

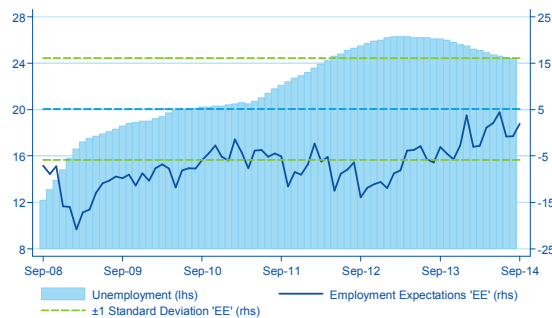
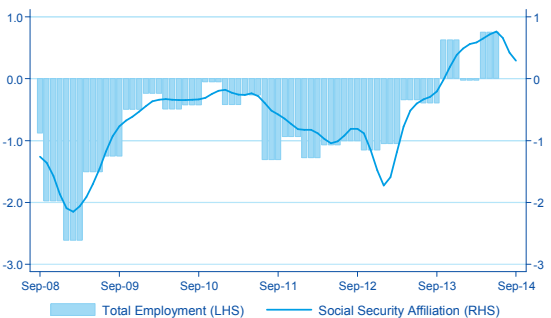


Figure 58
Employment growth: New workers and social security contributors (% QoQ)*



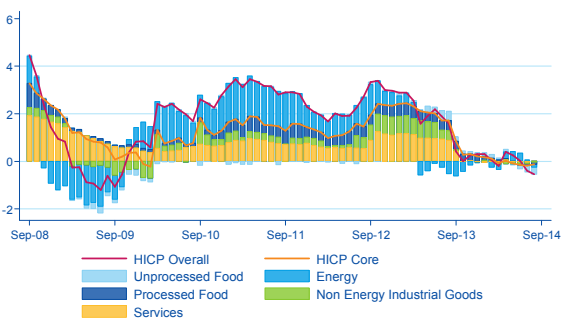
Prices: the fall in prices moderates in September

The forward CPI indicator confirmed the expected moderation in the YoY fall in consumer prices, due mainly to the absorption of base effects on food prices.

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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