BBVA | RESEARCH

# Europe Economic Outlook

Fourth quarter 2014
Europe Unit

- The eurozone's recovery is delayed, hindered by the Russia-Ukraine crisis and internal weakness in France and Italy.
- The measures adopted by the ECB contribute to the expansion of its balance sheet and the depreciation of the euro, but may not be sufficient to anchor price expectations.
- After the successful completion of the banking sector review, continuing the progress towards banking union, there should be no obstacles to fulfilling the demand for credit.
- Fiscal policy is at the centre of the debate, pending the Junker's plan, but additional national measures are unlikely to be taken.

# Index



**Closing date: 30 October 2014**

# 1 Editorial

**The obvious weakness in the eurozone's economic data in the last few months reveals a stagnant economy and a recovery that has not yet got off the ground**. Negative shocks have mainly affected the large countries in the region (Germany, France and Italy), more in the industrial sector than in services, and more in investment. Inflation remains very low, and, on top of the deflation risks, is making it difficult for the periphery to reduce imbalances. The factors underlying this delay in exiting the crisis are not easy to discern, but they probably include both external and domestic items.

On the one hand, **the international environment is complex**. **Geostrategic tensions** have tightened throughout the world and affect Europe most directly in the crisis between Ukraine and Russia; they are **responsible for the lack of investment in the second quarter, and for the poorer export data** from the third quarter onwards in Germany, because of the severe deceleration of the Russian economy and, to a lesser degree, as a result of tit-for-tat sanctions between Russia and the European Union. Growth in other developed countries is taking hold, above all in the United States and the United Kingdom (a major buyer of European products at the moment), but in some emerging markets further uncertainty is rising about the forecast acceleration of activity.

On the other hand, **from the domestic point of view, structural weaknesses are weighing on confidence and on the recovery**, particularly in France and Italy, where structural reforms are being carried out to improve competitiveness and growth potential, but at a slower rate than could be wished. The tenser political climate in certain countries in the area, the long transition towards installing the new European Commission and the manifest disagreements in recent months between governments of various countries about strategy are not helping to improve the climate of confidence either.

Despite these vulnerabilities, **factors supporting the recovery still exist**. The publication of the **banking stress tests** creates a more transparent outlook in the sector and enables a centralised, single supervisory function to be set up which, together with **the ECB's liquidity provision** policies, will ensure that supply restrictions are not an impediment to the provision of credit, which seems to be increasingly connected to demand-side conditions. On the other hand, the **euro's depreciation** against the dollar in recent months, linked to different economic cycles and monetary policies between the US and the eurozone, will lead to increased exports in 2015 and 2016, which will boost growth by several tenths of a pp. **Fiscal policy**, going by the budgets announced to date, **will in the main no longer be contractive in 2015**, so it should not be a drain on growth. Finally, it's worth to be mentioned the decline in oil prices as a favourable bias for global growth expectations, as long as it results from a positive supply shock.

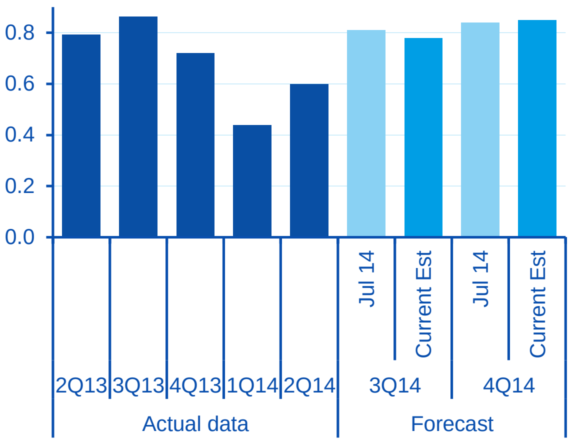
**The dilemma right now in the eurozone centres on the nature of the current weakness** – to what extent the stagnation we are seeing at the moment will be permanent or not – **and on the economic policies that should be followed**. Our perception is that the current delays are temporary and that the eurozone economy will recover in 2015, with 1.3% growth, following on from the 0.8% expected for 2014 (both forecasts have been revised downwards), but that risks to the downside have multiplied, since external uncertainty may continue in the coming months. We also believe that there is more uncertainty about whether investment and domestic demand generally are recovering again. That is why Mario Draghi and the International Monetary Fund are calling for constancy in structural reforms and for monetary easing, but also for a more expansive fiscal policy where there is scope for it - in Germany - which is the most controversial point.

The ECB has set up new measures designed to expand its balance sheet and implicitly to support the euro's depreciation, and if the measures currently in place (TLTROs, ABS bond purchases and covered bonds) do not achieve this, it is likely to embark on public debt purchasing (QE). Meanwhile, on the fiscal side, over and above the discussions between the European Commission, France and Italy about their budgets (with an impact of a few tenths), we do not expect significant fiscal measures in Germany. The fiscal debate, which will take place at the end of the year, will turn on the Juncker investment plan, where some details are missing, but which may provide further support if the stagnation is prolonged. In both cases - monetary and fiscal policy - discrepancies between countries are substantial, which does not help the recovery of confidence and poses a risk to the area.

# 2 Global recovery, slow and with downside risks

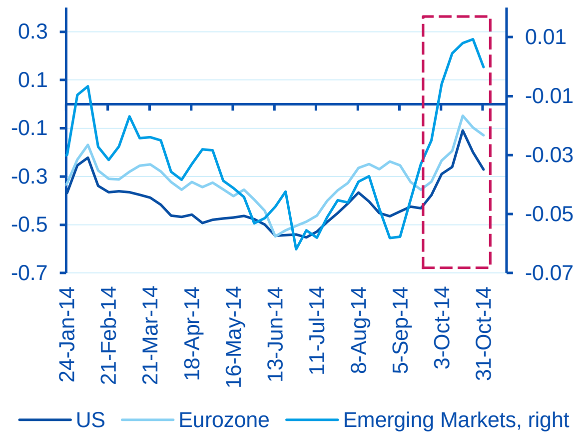
**Global growth has accelerated moderately in the last three months**. According to our calculations, global GDP expanded 0.6% QoQ in 2Q14 and the forecast based on our BBVA Research GAIN[1] indicator is +0.8% in 3Q14 (Figure 2.1). However, there is downside risk to these figures given that the industrial activity indicators and world trade in September could still moderate, and the effects of the financial volatility (Figure 2.2) on confidence could be more persistent than we expect. Also, there are the geopolitical risks associated with the situation in Syria and Iraq and the fragile agreement between Ukraine and Russia.

Figure 2.1
**Global GDP growth (% QoQ)**
**Forecasts based on BBVA GAIN**




Source: BBVA Research

Figure 2.2
**BBVA Research Financial Tensions Index**




Source: BBVA Research

In this context, **monetary policy will remain focused on supporting activity, while fiscal policy will be less restrictive in tone** in 2014-15 in both the US and the eurozone than in the recent past. Even in China, together with the budget consolidation at the local and regional government level it is felt that additional measures to support growth could be implemented if necessary by the central government. In the case of the more developed economies, the tone of fiscal policy is the result of both the discretionary decisions taken by the authorities, in some cases in Europe preoccupied by the short-term effects on growth of the rapid and intense fiscal consolidations, and by the room for manoeuvre afforded due to the more favourable funding conditions from sovereigns bonds. The latter is a direct consequence of central bank support, with their policies of anchoring expectations of interest rates and the provision of liquidity to the system.

Finally, **the fall in oil prices is a favourable factor for global growth expectations** to the extent that this is the result of a positive supply shock, especially for the **sustained increase in unconventional oil production**[2]. The diminished transfer of income from importers to producers gives more scope for the former to attend to their spending, saving and investment decisions, which is a much more positive situation for the economic scenario. All increases in productive capacity of a limited and growing demand resource, even for a more efficient use, help to put a brake on prices that in real terms are at similar levels to those of the oil crisis at the end of the 1970s.

1: Details on the methodology of BBVA Research GAIN available at: http://bit.ly/1nl5RIn
2: The recent fall in oil prices reflects not only the increased supply, but also USD appreciation and a moderation in expectations of demand, in both DMs and EMs.

These income transfers to consumer countries have their flip side in the producer countries of oil and, in general, raw materials, where prices are also falling due to the moderation of demand from Asia. These countries are posting decelerating activity and downward adjustments to perspectives for growth in 2015 as well, which is doubtless affecting some South American economies where we are seeing a delay in expected productive investments.

Altogether, **this cycle is still compatible with an improvement in GDP growth in the coming quarters, although at a slower rate than we were forecasting three months ago.** According to our calculations, global GDP will expand by 3.2% in 2014, the same as in 2013, and by 3.7% in 2015 (see Global Economic Outlook, Fourth Quarter 2014).

**US growth remains in line with our expectations, and could reach 2.5% in 2015.** After the unexpected and transitory drop in activity in 1Q14, the activity, spending and employment indicators have recovered to the extent that the pace of GDP growth could well be above 2.5% in the second half of the year, and thus average 2% for 2014 as a whole. In fact, in the light of the first estimation of 3Q14 GDP growth this forecast has a positive bias of around 0.2 pp. However**,** the role of the Fed, which emphasises caution before acting on the signs of improvement in the economy, continues to support our scenario of a cyclical recovery in the US underpinned by the solid creation of employment and the increase in household wealth. The Fed's scope for manoeuvre is favoured by the lack of inflationary tensions in a context of a stronger dollar and lower oil prices, together with moderate wage increases.

**Our outlook for China is unchanged, but with a downward bias due to the external environment**, and even assuming the possibility of economic policy support. In 3Q14 GDP growth continued to decelerate, to 7.3%, reflecting the moderation in domestic activity, particularly in the construction and real estate sectors, but partially offset by an unexpected and intense upturn in exports. We maintain our outlook for GDP growth at 7.2% in 2014, although we do not rule out that the final print could be a few basis points higher. Altogether, the risks to growth in China continue to be to the downside from 2015 onwards, precisely because of the brake on external demand that the situation in Europe might imply and the adjustment underway in the real estate sector in a context of high leverage and the introduction of measures to control its less regulated banking system.

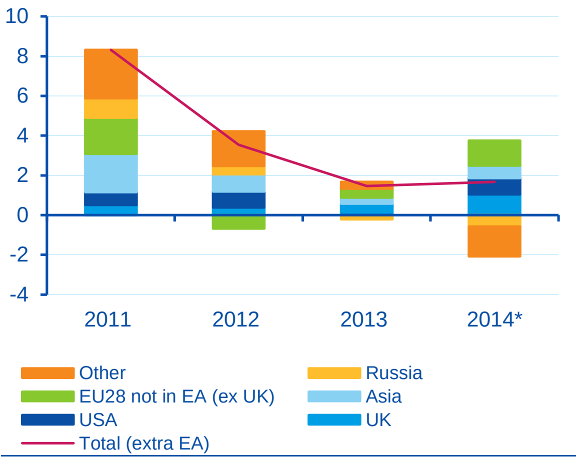
China is facing the task of managing the present deceleration of economic growth while reducing its financial risks and rebalancing growth in favour of domestic demand**.** In this scenario, the authorities will remain disposed to intervene so that the deceleration does not intensify more than is desirable, and growth does not fall below the targets set. Thus we would not be surprised to see additional monetary policy easing (with cuts in the reserve ratio or liquidity injections), expansive central government fiscal policy (albeit with consolidation at the local government level) and on-going structural reforms.

Finally, and beyond the weakness in the eurozone commented in the following sections, **in general terms we are maintaining our outlook of stronger growth in 2015 vs. 2014 in the other areas**. In Japan we are still expecting a slight acceleration in GDP growth from 1.1% in 2014 to 1.3% in 2015, although the downside risks are accumulating given the considerable impact of the higher tax rate on consumption. In South America, our forecasts reflect the negative impact of a less favourable external context, which is also making itself felt in terms of domestic expenditure, particularly investment.

# 3 Eurozone: The recovery is delayed, although the fundamentals are still positive

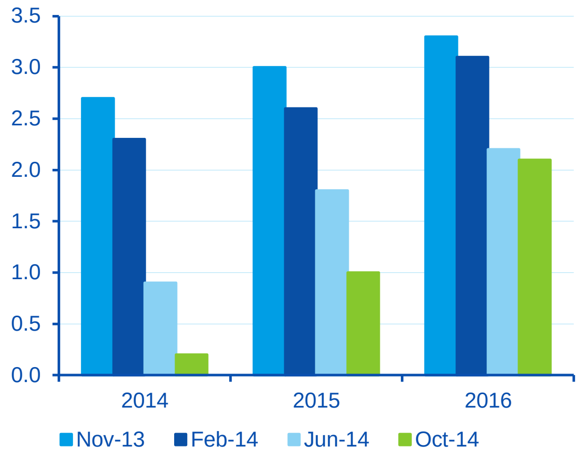
**All the economic data on the situation in the eurozone published during the summer was disappointing**: growth in the second quarter was practically stagnant and less than expected, the confidence indicators deteriorated swiftly in July and August, with activity indexes flagging up significant weakness, above all in the industrial sector. **The reasons for this delay in the recovery**, which we already knew would be slow because of high levels of debt accumulated by agents, **are the Ukraine-Russia crisis**, which is weighing heavily on confidence, investment and exports; **and a lack of dynamism in domestic demand** for which it is difficult to account. The fact that, as well as Germany (more affected by the Russian crisis), France and Italy are the countries which have disappointed most leads to the reflection that it is the lack of confidence on the part of these countries' economic agents, linked to the delay in the reforms, which is the greatest brake on the recovery. **The fundamentals for growth** – modest but positive global progress, a fiscal policy which has stopped siphoning off growth, abundant liquidity and, most recently, depreciation in the exchange rate and compliance with steps towards banking union in line with forecasts – **are still in place and ought to support gradual growth throughout 2015, although it is obvious that the delay in the recovery is creating doubts as to whether the eurozone is perhaps immersed in a lengthy semi-stagnation** because of high levels of debt on the part of public and private agents in several countries in the area, or uncertainty about economic policy, due to both the absence of structural reforms and the insufficiently expansive direction of macroeconomic policies. This second hypothesis is more of a risk scenario than our baseline position.

Figure 3.1
**EMU: exports by area (% YoY)**




Source: BBVA Research

Figure 3.2
**Russia: annual GDP growth forecasts (%)**




Source: Focus Economics

## Where is the eurozone's recent weakness coming from?

Poorer-than-expected growth in the second quarter and the data published to date for the third and fourth (see breakdown in the next section of this report) have affected the main economies in the region, Germany, France and Italy, particularly hard. **In Germany, the component responsible for the shock** in the national accounts figure for the second quarter **was investment**, partly explained by the higher-than-expected growth in construction in the first quarter thanks to the good weather (which then fell back more than expected in the second), but also – and this is more important – **because the crisis between Ukraine and Russia had an impact on confidence** and therefore on investment, even before sanctions were put in place at the end of July. Over the summer this drop in confidence has been much more apparent, with all the indexes falling since the beginning of the year further than the subsequent real activity data themselves. **During the summer months there was also a very clear weakness in industrial and export indicators**; already affected by exports to Russia, they were also impacted by mutual sanctions and, above all, by the rapid deceleration of growth there (and by the severe depreciation of the ruble, by about 20%).

**In the case of Italy and France** there was also a negative shock in the second quarter (particularly in Italy, 0.4pp down to -0.2% QoQ) while the deterioration in confidence indicators occurred in parallel with Germany, although to a much lesser extent since the starting point was much lower. The evidence appears to indicate that **the negative shock was based above all on domestic demand**, particularly in investment.

**Spain and Ireland have maintained high rates of growth**, without shocks in the case of Spain, which is growing at an annualised rate of around 2%, although rather less strongly in recent months, while Ireland is forging ahead at over 3%. The data from **Portugal is** less positive, **growing in line with expectations but under 1%**, and in Greece, which despite probably showing positive growth rates for the first time since 2008 has a weaker outlook for the end of the year. Both **the Netherlands** (the fifth biggest economy in the eurozone) **and Finland came out of recession in the second quarter, while Belgium and Austria have positive growth rates** (just moderate). The star performer in the European Union is the United Kingdom, growing at rates close to 3%.

## The rate of reform in France and Italy is slow, but significant progress is being made

One of the factors most frequently mentioned as being linked to the delay in France and Italy's recovery is the lack of structural reforms, which may be generating a lack of confidence in growth perspectives and by extension in private investment in these two countries, in contrast with the measures taken in the last three years by the other countries in the periphery, put under more pressure from the financial markets and subject to programmes by virtue of the aid received from the Troika.

**The lack of reforms in the last few years when compared with others is certainly the case, but the situation has begun to change in recent months, with significant initiatives in both countries**, particularly in the following areas:

- In France, tax reductions have been introduced for the labour factor and for companies; a plan to cut public spending between 2015 and 2017 by EUR50bn exists (most of it still to be specified) and there is a planned tax cut of EUR40bn. More recently, the government has announced a plan of structural reforms in the services sector (partial liberalisation of shop opening hours and of professional services), to be published in detail in December.
- In Italy, the political reform will allow governments to be more stable, by introducing an electoral law with majoritarian features and a cut in the Senate's powers to block legislative action at a very advanced stage (given its semi-constitutional nature, will not be definitively passed until the first quarter of 2015). Furthermore, the Italian parliament has passed the first stages of a labour market reform suppressing key articles in the labour legislation encouraging the duality of that market, although the details will be legislated by government decree throughout 2015. In addition, social security quotas will be waived for new job contracts for three years, which has had a positive impact on hiring. Other measures, such as the Spending Review, to analyse potential areas for reductions in public spending, and the reform of the justice system to speed up civil procedures, have yet to be outlined.

**These initiatives**, which are slow to apply, **have not yet had an effect on confidence or on activity, but they ought to play an important role as they materialise over 2015**.

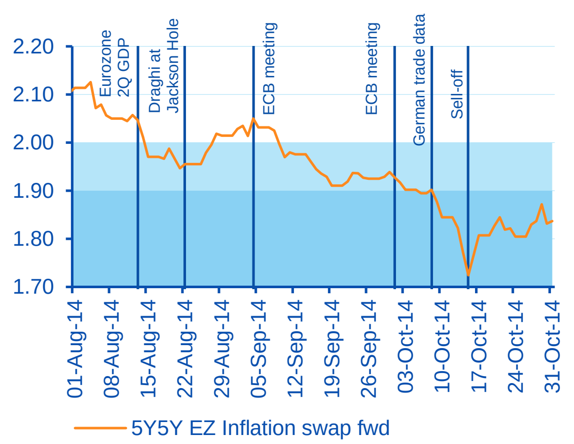
## Negative impact of the Russia-Ukraine crisis in a context of improved global growth in coming quarters

There are two external factors which make a big difference to the forecasts for the next two years: global demand, which in principle will change little; and the crisis with Russia, whose impact is difficult to establish.

**Our forecast for growth outside the eurozone has not changed significantly** from three months ago, **although the risks are to the downside** as a result of the increasing uncertainty about growth in some emerging markets, and particularly because of the tensions springing from the crisis between Ukraine and Russia. In recent months growth in exports has centred above all on the developed countries (Figure 3.1), and specifically on European countries outside the eurozone, and here the UK's growth has played an important role.

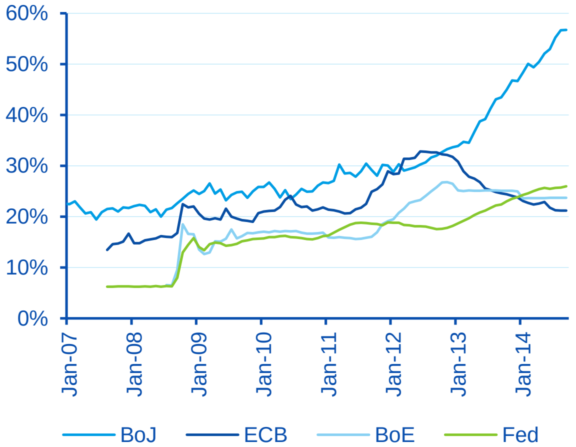
**The negative effect on European growth of the crisis with Russia** is visible in three channels: one, which in principle is small, **derives from tit-for-tat sanctions between Russia and the eurozone**, which translates as shrinking trade in particular sectors with a limited scope. A second channel derives from the **reduction in Russia's growth** (which has suffered a downwards correction of 2.5pp between November 2013 and October 2014 to virtual stagnation (Figure 3.2) and which has a direct impact on exports from the eurozone of around 0.2pp. The third channel, which is more difficult to quantify, is the **increased uncertainty because of the crisis, which has had the effect, mentioned above, on investment** in the second and third quarters in Germany, and which could continue to hamper the recovery.

Figure 3.3
**EMU: inflation swaps (%)**




Source: Bloomberg and BBVA Research

Figure 3.4
**Central Banks balances (% of GDP)**



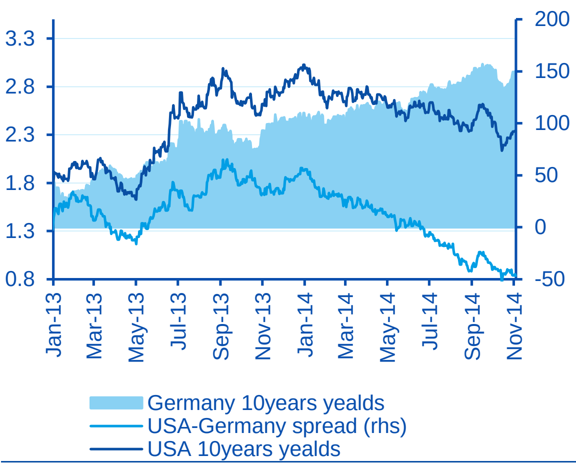

Source: Bloomberg and BBVA Research

## In response to this deterioration in the cycle, the ECB has continued to announce monetary easing measures…

In the third quarter of 2014 the divergence between the eurozone and the United States was manifest, not only in cyclical terms, but above all in the area of monetary policy. While growth in the United States has surprised to the upside in the last two quarters, in the eurozone negative shocks piled up, with near-stagnant activity and further deterioration in long-term inflation expectations (Figure 3.3).

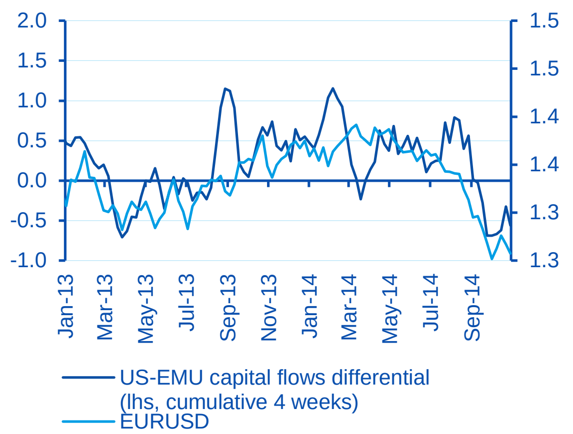
Thus the Federal Reserve in the United States announced at its October meeting that it had brought its asset purchasing programme (QE) to an end as a first step in its monetary normalisation process (which is still dependent on the data). However, the ECB was forced to take additional measures scarcely three months after announcing the last package of measures, in response to cyclical deterioration. **In September the ECB surprised with a further (marginal) cut in the refi rate** (taking it to 0.05%), this time reaching minimums (Zero Lower Bound, ZLB) and trying to incentivise at the bound the taking of liquidity in the September TLTRO auction, **as well as announcing a programme of private asset purchases (asset-backed securities) for a duration of at least two years** and a third covered bonds purchase programme. The ECB is not setting an explicit numerical target for asset purchases, but has let it be known that **with these measures it is aiming for significant balance sheet expansion** (Figure 3.4), as an instrument for increasing inflation expectations. However, this goal is becoming increasingly difficult to achieve, since the first liquidity (TLTRO) auction in September was lower than expected and the deterioration in growth expectations is also contributing to dampen expectations for forthcoming auctions. Furthermore, even with the asset purchase programmes, uncertainty persists about the ECB's capacity to reach its desired target[3]: both markets are of limited size and the attraction of selling some of these assets to the ECB seems meagre (particularly for financial institutions, as it is perceived solely as a financing instrument). So, in our opinion, in an environment with persistent risks to the downside, the likelihood that the ECB ends up conducting a bond purchase programme (QE) is increasingly significantly.

Figure 3.5
**10-year bond yields (%)**




Source: Bloomberg and BBVA Research

Figure 3.6
**US-EMU capital flows differential**

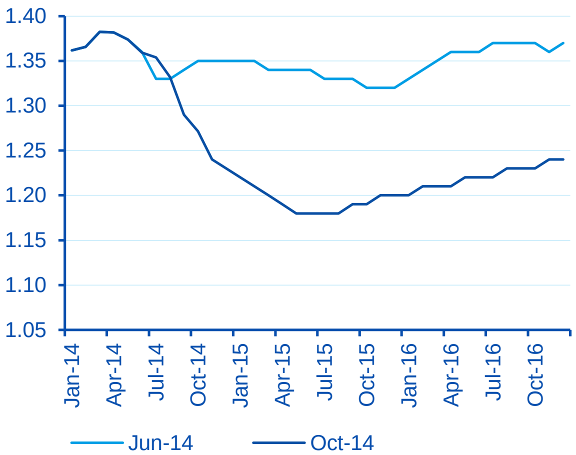



Source: Bloomberg, EPFR and BBVA Research

**On the debt market, yields have fallen to very low levels**, particularly in Europe, but also in the US (Figure 3.5). This is the result of a combination of shrinking expectations of eurozone growth, the increasing likelihood that the ECB will announce a bond purchase programme and the safe-haven effect of capital towards assets perceived as lower risk, in an environment in which volatility has started to edge up and geopolitical risks are still present. In our opinion, yields on German bonds will continue to be anchored for some time around their current levels (in the area of or below 1%) while risks to the downside persist in Europe and the likelihood of QE is present or rising.

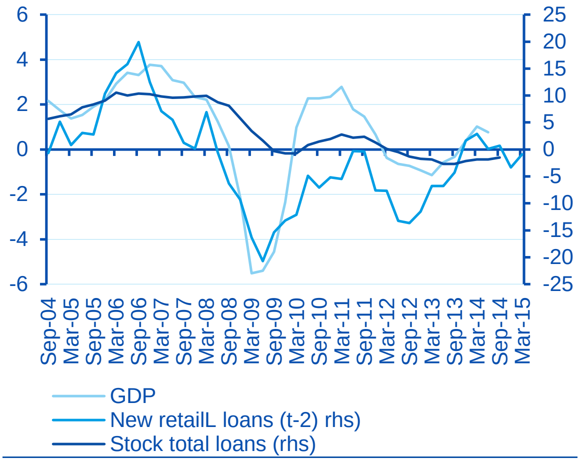
3: Although the rate of covered bonds purchases in the first two weeks was healthy, with aggregate purchases worth EUR4.7bn, it seems unlikely that this rate will hold. The ABS purchase programme will not start until early November.

Figure 3.7
**EUR/USD exchange rate**




Source: BBVA Research

Figure 3.8
**EMU: GDP and credit (% YoY)**




Note: retail credit is the sum of loans up to EUR1mn to households and companies
Source: BCE, Eurostat and BBVA Research

## … which has depreciated the euro and ought to be a stimulus for growth in the eurozone

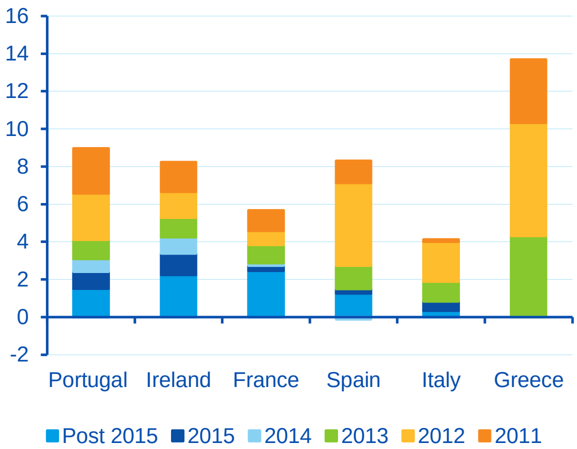
In the FX market, **the euro's depreciation has been aligned with the fundamentals and risks associated with each geography**, and is a sign of a greater forecast differential in growth between the United States and the eurozone, together with the fact that monetary policy in both areas is moving in different directions, with the Federal Reserve in "exit mode" and the ECB trying to expand its balance sheet with new measures. Along the same lines, movements in capital flows are also confirming the preference of investors for US rather than European assets. In fact, in recent months there has been a reversal of the capital inflows which had been entering Europe since mid-2012 (Figure 3.6). Since last August so far, portfolio flows have been showing heavy outflows from Europe and inflows towards the United States. In the next few months, we expect the better fundamentals of the US economy to continue rewarding the dollar against the euro. In fact, **in view of the fragile European recovery, we now forecast a greater depreciation of the euro, which may be long-lasting** (Figure 3.7). The effect on growth of the exchange rate's new direction could be around 0.3pp of GDP in 2015 and 0.4-0.5pp in 2016, and 0.2pp and 0.3pp on inflation respectively. These effects are subject to a high degree of uncertainty, naturally, given the difficulty of estimating both the path of the euro and the impact of that route.

## The balance sheets review marks the completion of one of the key phases of banking union

The other milestone event in the last few months has been the publication of the results of the asset quality review (AQR) and the stress tests on the European banking sector, thus completing one of the main stages in reaching a fully functioning banking union. **The overall assessment of these was positive**, since this exercise: i) provides significantly increased transparency enabling investors, analysts and the market in general to have a more reliable picture of the European banking sector; ii) demonstrates that the European banking sector can resist an adverse economic scenario; and iii) indicates capital shortfalls that can easily be remedied (EUR9.5bn), demonstrating that the exercise has been a success, leading to capital expansions and provisioning before the results were published.

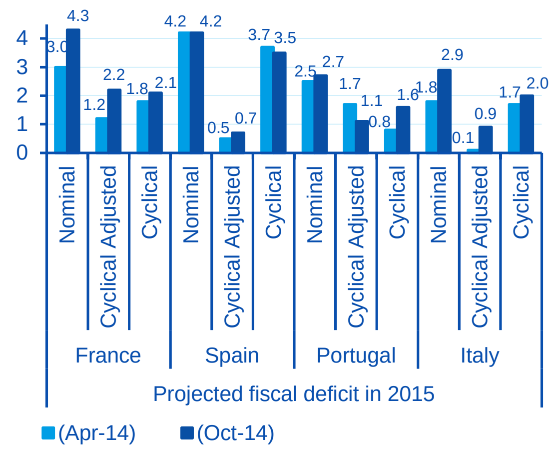
Furthermore, **these results ought to contribute to the increased efficacy of the measures taken by the ECB and, in particular, help to re-establish the transmission channels for monetary policy**, supporting the aim of the TLTRO to increase credit to the private sector. However, the impact of these injections of liquidity may possibly be less than we expected three months ago (in both new credit operations and in the impact on GDP), due in part to the growing number of signals pointing to weak demand for credit (discounting the still-existing supply shortages). Even so, the most recent data are already pointing to greater momentum in the behaviour of credit flows – despite the context of deleveraging in the private sector – particularly those being spent on household consumption (+8.4% YoY in 3Q14) and loans up to EUR1mn lent to non-financial companies (+0.9% YoY in 3Q14), which should support the recovery of domestic demand in the forecast horizon. Nevertheless, these data also suggest that weak recovery, above all in investment, will stretch into the last quarter of the year (Figure 3.8).

Figure 3.9
**Adjustment of structural public deficit 2010-15 (% GDP)**




Source: BBVA Research

Figure 3.10
**EMU: GDP and credit (% YoY)**




Source: European Commission and BBVA Research

## Permanent stagnation or straightforward delay in the exit from the crisis?

Recent weakness in the eurozone has generated debate on the nature of the recovery and the required economic policy response. On the one hand, there are doubts about whether the tardy exit from the crisis is the mirror of an outlook of secular stagnation, associated with insufficient stimulus measures, or whether it is simply a delay in the withdrawal from the crisis situation as a result of external geostrategic conflicts (and internal political ones), preventing the recovery of confidence. **This debate is linked to a parallel one on economic policy measures**, well framed by the President of the ECB, Mario Draghi, when he proposed, starting last summer, to continue taking measures on three fronts: monetary policy, structural reforms and fiscal policy. Despite the controversies over the details of these, there appears to be a consensus on the need to emphasise the first two fronts, while differences of opinion exist about fiscal policy, which has to find a balance between supporting the recovery of demand and keeping public debt at reasonable levels.

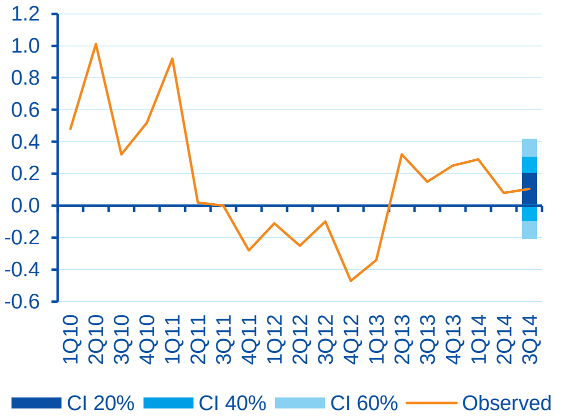
The stance of fiscal policy in 2015 is going to be practically neutral or slightly contractive, but in any event much less contractive than in previous years (Figure 3.9). France and Italy are negotiating a lower fiscal adjustment with the European Commission, although the discrepancies are regarding tenths of a percentage point (Figure 3.10). The calls from several fronts (including the International Monetary Fund) to use the fiscal margin in the countries which can handle it (that is, Germany) do not seem to be producing an effective fiscal expansion. The scope of the Juncker plan for reviving investment in Europe remains to be seen; budgeted at EUR300bn over the next three years, it has yet to be defined, above all to establish to what degree it represents an additional stimulus to public and private investment, or whether it is merely a reorganisation of existing resources. At the least, the Juncker plan ought to set a recapitalisation sum for the European Investment Bank, which could have some effect, although difficult to quantify, in the medium term. In the final months of the year the new measures will be announced on this matter, and the outlook as to the persistence of the current stagnation in the eurozone may also be clarified.

# 4 Outlook: moderate growth in 2014 and 2015

## Growth lost momentum in the previous two quarters, contrary to expectations…

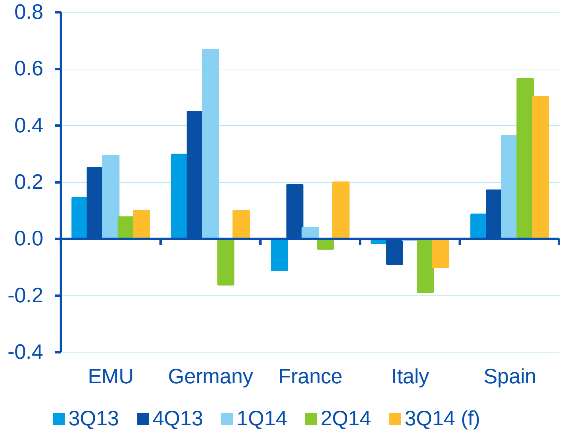
**The eurozone's economic recovery showed more signs of weakness** in 2Q14 than we had been expecting three months ago (0.1% QoQ after 0.3% in 1Q14; BBVA Research: 0.2% QoQ for 2Q14), essentially owing to some of the downside risks materialising, both outside (geopolitical) and within (the sluggishness of structural reform in France and Italy and political problems in several countries in the zone), which had a crushing effect on the confidence of economic agents. The Ukraine crisis proved particularly **stifling for business confidence,** leading to a **drop in investment** (-0.9% QoQ after 0.3% QoQ in 1Q14; BBVA Research: 0.5% for 2Q14), mainly in Germany (-2.3% QoQ in 2Q14), though also in France (-1.1% QoQ) and Italy (-0.9% QoQ). Despite the weaker consumer confidence, financial conditions held relatively stable in a context of a mild improvement in the labour market and low inflation, which spurred progress in private consumption to relatively stable rates, in line with forecasts, while public consumption also added to growth. All told, **the share of domestic demand slipped back to zero** following the contribution of 0.4pp the previous quarter. **External demand, however, helped growth along slightly** (0.1pp), exports proving somewhat more resilient than predicted despite the geopolitical tensions, and buoyed by both demand from the developed economies and a weakening euro from early 2Q14.

Figure 4.1
**EMU: MICA-BBVA and real GDP (% QoQ)**




Source: Eurostat and BBVA Research

Figure 4.2
**EMU: GDP growth by countries (% QoQ)**




Source: Eurostat and BBVA Research

**Our short-term MICA-BBVA model suggests that the weakness in recovery should continue in 2H14**, with GDP growth forecast for 3Q14 of 0.1% QoQ, on a par with the 2Q14 rate (Figure 4.1). The only figures available for 4Q14 are those for October confidence, with these pointing to a gentle upturn in growth to rates comparable with those seen coming into the year (0.2% QoQ). **In country terms the bleaker economic outlook in 2H14 is across the board, though with marked differences among them**. Thus, except for Spain, where the recovery should have stabilised in 3Q14 with the growth rate virtually holding steady (0.5% QoQ after 0.6% in 2Q14), the pace is expected to have eased off in Germany (0.1% QoQ) and France (0.2% QoQ), whereas in Italy business activity could have contracted again (-0.1% QoQ) (Figure 4.2). Political woes and the slow progress in structural reform in both France and Italy are acting as more of a drag on the economy than we were expecting three months ago, and could slow the pace of the exit from the crisis.

## … and leads us to revise downwards our forecasts for both 2014 and 2015

Although most of the factors underlying the situation in the European economy have not changed (expansionary monetary policy and more neutral fiscal policy), the more muted growth already noted in 2Q14 and predicted now for the second half of the year, tied in with a continuation of the factors explained above (geopolitical, extra-eurozone climate and those of an idiosyncratic hue) have led us to revise our growth forecasts substantially downwards for both this year and next. **For 2014 we now expect an average annual GDP growth of 0.8%** (-0.3pp on our previous report), **in the main due to far more moderate investment growth than predicted**, although, thanks to stubborn private consumption and less fiscal belt-tightening, internal demand is still the key driver for growth this year. **For 2015 we are also revising our growth forecast to 1.3%** (from 1.9%), although this is largely **due to the base effect of lower growth in 2H14** (-0.4pp). **We still expect relatively robust growth rates throughout 2015**, underpinned by the fall in the euro in the wake of the measures taken by the ECB, as well as additional steps in the next few quarters associated with balance-sheet expansion by the bank, which should be reflected in a re-establishment of the transmission channels for monetary policy, with a greater increase in credit to allow investment recovery.

## The gradual recovery of private consumption continues…

As we forecast three months ago, private consumption growth remained stable in 2Q14 and we expect this trend to have been repeated in 3Q14. Although consumer confidence has dipped again in recent months, **consumption is still above its historical average, held up by the steady improvement in the labour market** since late 2013. Both retail sales, available up to August, and the upturn in new car registrations should show that private consumption has held at growth rates of 0.3% QoQ in 3Q14. Looking ahead to the end of 2014, however, both employment trend prospects and future financial conditions indicate that growth is not set to pick up in the last quarter of the year to pre-crisis rates (around 0.5% QoQ).

For the forecast horizon the mainstays shoring up private consumption will continue to gain in strength, with employment edging up this year, real wages on the rise against a backdrop of low inflation and improved access to consumer credit. This ought to translate into higher disposable income for households in 2014 and 2015 (0.8% and 1.1% respectively), meaning that private consumption could climb by about 1.3% in 2015 after the figure of 0.7% expected in 2014, practically in line with our earlier forecasts.

## … thanks to the slowly improving labour market…

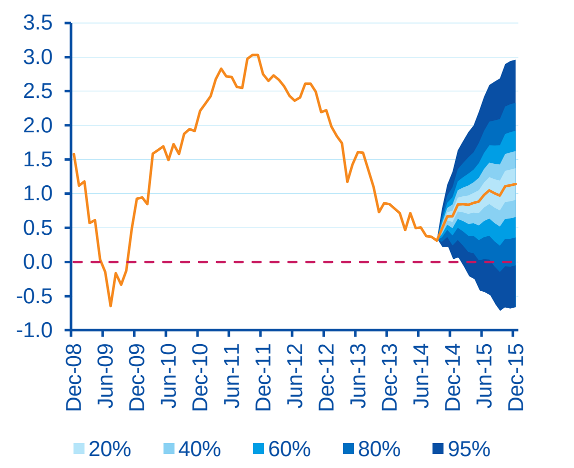
The slow but steady improvement in the labour market from 4Q13 is mainly due to the rise in employment for the third quarter running (0.2% QoQ in 2Q14, after 0.1% seen in 1Q14 and 4Q13), which, added to the relative stability of the labour force, produced an annual paring down of the unemployment rate by around 0.5pp to 11.5% in August. The rate of economic growth considered in our scenario assumes that **the moderate level of job creation will continue in the coming quarters** (at the same pace of about 0.1-0.2% QoQ), meaning that over the whole of 2014 it could rise by around 0.5% (-0.8% in 2013), supposing slightly better productivity (0.3%), and this would be reflected in a fall in the average annual unemployment rate of around 0.3pp to 11.6%. For 2015 the mild pick-up in activity (to 0.4% QoQ per quarter) will be primarily backed by a recovery in investment, which will feed through into a further upturn in productivity that should limit job creation (0.6%) and be mirrored in a more gradual drop-off in the unemployment rate (11.4%).

## … and to still too low inflation

Headline inflation continued to fall back slightly in the last three months, reaching 0.4% YoY for Q3 as a whole (after 0.6% YoY in 2Q14 and 0.7% in 1Q14), though at a slower rate than was observed over last year (from 1.9% YoY in 1Q13 to 0.8% YoY in 4Q13), and remains at very low levels. This slowdown in recent months came with the fall in the prices of the most volatile components (chiefly energy and unprocessed food), while core inflation (taking out energy and fresh food) held virtually stable at 0.9% YoY over the entire third quarter, as we were expecting.

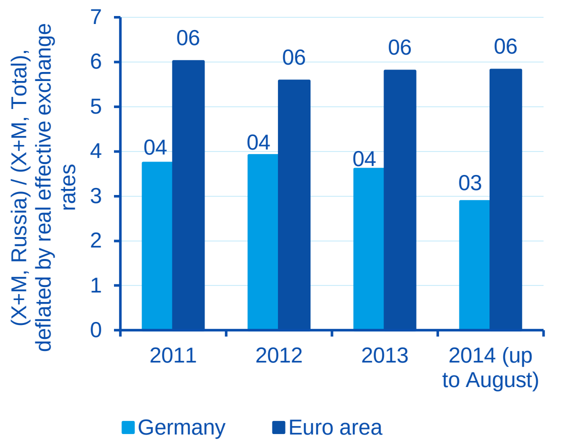
Within the forecast horizon, **inflation will remain clearly below the ECB target, rising very slowly and gradually** as, although the recovery is expected to start gaining a certain amount of traction in the coming quarters, price dynamics will remain **limited by a negative output gap, a high rate of cyclical unemployment and the absence of wage pressure**. All in all, the figures are in line with an average annual inflation scenario of 0.5% in 2014 and 1% in 2015, one-tenth less for each year with respect to our previous estimate. As for core inflation, our forecasts suggest that this will stay relatively constant at around 0.8% YoY for the remainder of the year, and then rally slightly over next year, reaching rates of about 1.1% YoY in late 2015.

Figure 4.3
**EMU: HICP inflation (% YoY)**




Source: Eurostat and BBVA Research

Figure 4.4
**Trade with Russia (% of total X+M)**




Source: Haver analytics and BBVA Research

Despite this downward revision, our scenario continues to give a very low probability to a deflation episode (a little over 10%) (Figure 4.3). We nonetheless still see **downside risks in the short term**, above all justified if current oil prices remain low, but also if the recovery of domestic demand fails to take off in line with expectations. Further depreciation of the euro, however, which could arise from differences in the progress of the economy and monetary policy in the eurozone and the United States, would partly offset the fall in commodity prices and produce upward pressure on the prices of imported products.

## The return of confidence and credit are still key to investment recovery and achieving sound growth…

The negative investment surprise in 1H14 was significantly affected by the uncertainty associated with geopolitical events and the sustainability of the pace of demand recovery, both globally and in Europe, all of which was combined with the fact that profit margins are still no better. Nonetheless, **some of the factors that might have been behind the drop-off in investment**, such as the geopolitical tensions in Europe or the uncertainty over the pace of world recovery, **should gradually ebb away over the next year**. The return to normal capacity utilisation by companies, together with greater ease of access to funding and its lower cost, ought to be reflected in a pick-up in the rate of investment growth, although this will be at a more modest clip than was expected three months ago.

The negative investment surprises throughout the year have led us to revise our growth estimates down for 2014 and 2015, mainly owing to a strong base effect. We now forecast that investment will grow at around 0.6% in 2014, thereafter accelerating to roughly 2% in 2015.

## … and thus the role of exports continues to be vital

**The rebound in exports in the 2Q14 came as a welcome surprise, and we expect the positive growth rates to be maintained throughout the rest of the year** (around 1.2% QoQ after the figure of 1.3% for 2Q14), buoyed by a more conducive exchange rate and because the United States and the United Kingdom, which are key trading partners, continue to exhibit good growth prospects. So far this year, exports to these two countries have significantly contributed to the good performance of exports, largely offsetting the marginal negative impact of the Ukraine crisis on foreign trade (Figure 3.1). In Germany, bilateral trade with Russia is being slightly more affected than in the eurozone as a whole, falling some seven tenths while the trade in the eurozone has remained at 2013 levels. (Figure 4.4)

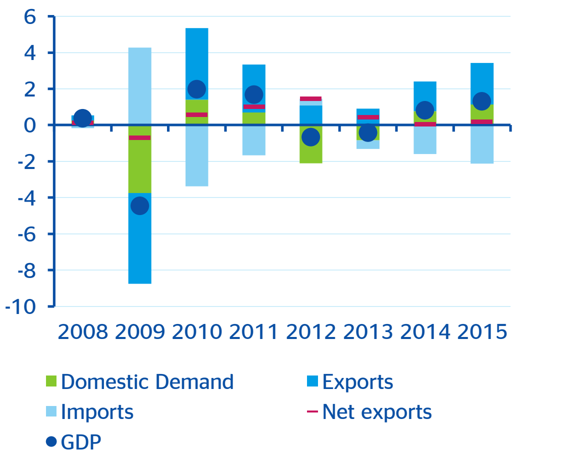
Adding in this brighter outlook and the further depreciation forecast for the euro, **we are revising our export growth forecasts upwards** to 3.7% for 2014 and 5.1% in 2014, from the earlier estimates of 3% and 4.6% respectively. Imports performed equally well, also surprising in a positive sense in 2Q14, and for the remainder of 2014 we are expecting buying linked to investment and intermediate goods, as well as more dynamic private consumption, to boost import growth rates (around 1.6% QoQ following 1.3% in 2Q14, 4.1% in 2014 and 5.2% in 2015). Thus the contribution of net exports to GDP growth for the eurozone as a whole will gradually become less substantial in relative terms (0pp in 2014 and 0.2pp in 2015) (Figure 4.5).

## We project more moderate growth in the three major economies, whereas growth for peripheral countries should top that in the eurozone

The divergence among eurozone economies has been maintained in the first half of the year. This situation has however been reversed, as certain peripheral countries (Spain, Ireland and, to a far lesser extent, Portugal) are now growing at sustained rates and the major economies (Germany, France and Italy) have displayed clear signs of weakness this year. We have therefore revised growth for these last three countries downwards (Figure 4.6) to 1.3%, 0.4% and -0.6% in 2014 and in the region of 1.4%, 1.1% and 0.8% in 2015 (on average some five-tenths below our previous estimates, in both cases). The peripheral countries are set to grow at a shade above the eurozone average in 2014 and 2015. For Portugal we are going for 0.9% in 2014 and 1.5% in 2015; and in Spain’s case, 1.3% and 2% respectively.

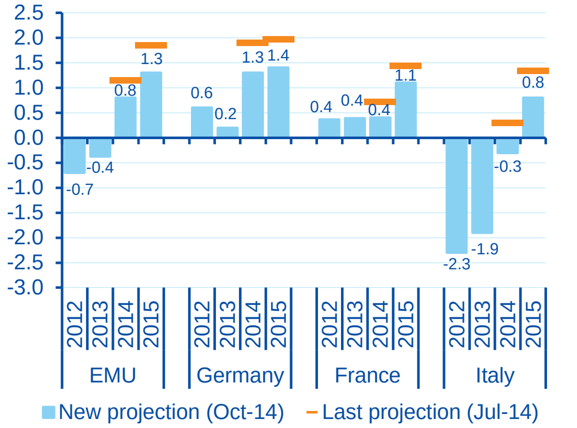
With respect to how growth breaks down, in Spain and Portugal domestic demand has ceased to be a burden on activity and will become the key driver in 2014 and 2015, as in Germany and France, whereas foreign demand will contribute less and less to growth. On the other hand, in Italy domestic consumption will continue to be a drain on growth, though at a more modest level. (See the following in-depth analysis of the member states).

Figure 4.5
**EMU: Contribution to YoY growth (pp)**




Source: Eurostat and BBVA Research

Figure 4.6
**EMU: growth forecast by countries (%)**




Source: Eurostat and BBVA Research

# Eurozone member states: detailed analysis

## Germany: the geopolitical crisis has affected the economy, but the strength of the domestic fundamentals will continue to support robust growth in 2015

GDP: +1.3% in 2014, +1.4% in 2015

**Recent data:** the first half of the year was conditioned by the impact of temporary factors on output in the construction industry, which had a significant effect on investment volatility in the sector, but the German economy should continue to grow in the third quarter, albeit at a slow pace (0.1% QoQ compared to 0.2% QoQ in 2Q14). The recovery of investment is now expected to be weaker, given the slowdown in the economies of the country's main trading partners and the conflict in the Ukraine, which have both had negative impacts on output and business confidence, especially in the case of exporters, who have seen their foreign orders shrink. Despite the historically low unemployment, consumer confidence waned in 3Q14 and retail sales increased only slightly, so that any increase in consumer spending is likely to have been modest. Meanwhile, exports and imports may have grown at similar rates, cancelling out any net contribution from trade after two quarters in which it had drained growth (-0.2 in 1Q and 2Q).

**Outlook for 2014 and 2015:** we continue to foresee a moderate recovery in the German economy, supported by an improvement in domestic demand. However, we have revised our growth forecasts down by 0,6pp for both 2014 and 2015 to 1.3% and 1.4% respectively, in view of the unwelcome surprise of 2Q14, the slowdown in Europe and the effects of geopolitical tensions. The continuing improvement in the labour market should ensure that household consumption holds up, and investment could grow at healthy rates, albeit more slowly than was forecast three months ago. As a consequence, rising imports driven by strong domestic demand should practically cancel out the contribution to growth from net exports.

**Fiscal policy:** we expect the central government to balance its books (0% of GDP) in both 2014 and 2015, following the slight surplus seen in the preceding two years. Furthermore, the structural balance should once again show a surplus (of around 0.5% of GDP in 2014 and 2015). Meanwhile, public debt will fall to approximate 74.4% of GDP in 2014 and then 72% in 2015.

## France: recovery has been slow in coming, but it should finally arrive in 2015 thanks to an almost neutral fiscal policy accompanied by a more favourable composition of growth

GDP: 0.4% in 2014, 1.1% in 2015

**Recent data:** after stagnating in 1Q14 and 2Q14 we expect the economy to pick up only slowly in the third quarter (0.2% QoQ). Based on the information available to date, confidence and business indicators continue to send mixed signals. On the one hand, both national and Commission business confidence surveys and PMIs indicate considerable fragility in manufacturing industry, while consumer confidence again dipped in 3Q14, but on the other, industrial output improved up to August, pointing to a recovery in investment, while retail sales and household consumer spending also rose. Meanwhile, the French trade deficit persists and net exports are unlikely to contribute to growth in the third quarter.

**Outlook for 2014 and 2015:** although we have not changed our position with regard to the fundamentals underlying the slow recovery of the French economy, we have revised our growth forecast downwards by 0.3pp for both 2014 (0.7%) and 2015 (1.1%) in view of the negative surprise in 2Q14. The recovery will continue to be based on the contribution of domestic factors supported by government spending, which is expected to increase faster than initially expected, given the relaxation of fiscal policy, and by private consumer spending, which will increase at minimal rates. Investment will continue to suffer from the weakness of the construction industry in 2014 and from uncertainty over the eurozone. However, we expect it to recover gradually in 2015, thanks to continued tax credit and stillfavourable financing terms. Exports and imports look set to grow at similar rates, and we therefore expect net exports to make a neutral contribution to growth in both years.

**Fiscal policy:** the recently presented French budget confirms the deviation from the deficit target agreed with the Commission (3.8% of GDP), and the government has established a goal of 4.4% (in line with our scenario) in the face of the worsening macroeconomic scenario. The deficit should fall minimally to 4.1% in 2015, which would represent a very limited structural adjustment of just 0.1pp in 2014 and 0.4pp in 2015. However, the budget contains measures to cut both taxes and spending, which should foster confidence and provide support for recovery. Public debt could rise to 95.3% of GDP in the year as a whole, and to 96.9% next year.

### Italy: the recovery will be delayed until 2015 and will be very slow, in the expectation that the government will finally implement the structural reforms announced

GDP: -0.3% in 2014, +0.8% in 2015

**Recent data:** the first half of the year saw a clear increase in all confidence indicators, but this was not reflected in any actual improvement in the economy. The cyclical weakness of the Italian economy continued in 3Q14, accompanied by a slowdown in the eurozone as a whole. The decline in output mainly affects investment, which remains weak, reflecting both the very moderate change in consumer spending and the limited support offered by exports. In recent months, business confidence returned to the levels seen at the beginning of the year, falling most sharply in manufacturing industry, while household consumption was held back by increasing pessimism among families, mainly due to the high rate of joblessness and in spite of tax cuts for those on low incomes. Furthermore, the positive contribution made by net exports has gradually faded as foreign demand cools. All of these data suggest that GDP could contract again in 3Q14 (-0.1% QoQ on top of -0.2% QoQ).

**Outlook for 2014 and 2015:** economic recovery will arrive more slowly than expected three months ago. Net exports will again contribute to growth, but their share will be smaller than foreseen in our recent predictions, due to the slowdown in exports. The government’s plans for reform are intended to stimulate fragile domestic demand by improving business confidence: investment will continue to contract in 2014, but it should recover next year and private consumption may pick up as family disposable incomes rise due to a stronger labour market. Meanwhile, public spending will continue to be shackled by budget restrictions. To sum up, we foresee a contraction in the economy as a whole in 2014 and limited growth in 2015 (-0.3% and 0.8% respectively).

**Fiscal policy:** fiscal policy is still conditioned by the downturn in the business cycle. According to our forecasts based on available budget implementation data, the deficit will be 3% of GDP in 2014 (in line with the new official forecasts), two decimal points above the level observed one year ago and three points above our most recent forecast, as a result of a sharper fall in revenues than in spending. The government has proposed a sharp cut in taxes in 2015 (approximately EUR18bn or 1.1% of GDP), which will be financed largely by cuts in public spending and by tightening up on tax fraud, leaving the deficit for the year as a whole on 2.6%, which is 0.4pp above the official forecast announced an April after negotiations with Brussels. The high volume of public debt (127.9% of GDP in 2013) will continue to be the main concern, as we forecast that it will continue to rise to 131.6% in 2014 and will peak at 132.9% in 2015.

### Spain: growth supported by internal and external factors

GDP: +1.3% in 2014, +2.0% in 2015

**Recent data:** the rate of growth in the economy practically stabilised at 0.5% QoQ in 3Q14. With regard to its make-up, partial indicators show that both domestic demand and exports would have made positive contributions to quarterly growth. Meanwhile, consumption indicators point to a small slowdown in the rate of growth in household spending, and in investment in machinery and equipment. Public spending is expected to fall in the third quarter, after the spike seen in the first half of the year. Both exports and imports will continue to recover, and net foreign demand will make a positive contribution to quarterly growth.

**Outlook for 2014 and 2015:** the economy will grow by 1.3% in 2014, speeding up to 2.0% in 2015, although this is 0.3pp less than we expected in the last edition of this report. The main reason for this downward revision is the change in the outlook for eurozone growth. The recovery should still be supported by both external and internal factors. The world economy will continue to expand, and together with the depreciation of the euro this will allow a robust increase in Spanish exports. At the domestic level, the recovery in the fundamentals, progress with the correction of imbalances, the drop in the oil price and the stimuli provided by fiscal and monetary policy will underpin rising domestic demand.

**Fiscal policy:** the tax cut proposed by the government is expected to provide a boost for growth without endangering compliance with stability targets thanks to the cyclical improvement expected in certain revenue and expenditure items. Economic recovery and the lower cost of borrowing are expected to have positive effects on tax receipts and on the outlays represented by unemployment benefits and interest payments in 2014. As a result, the deficit will fall to around 5.5% of GDP by the end of 2014, in line with the budgetary stability target established by the government. According to our forecasts, the contractive tone in fiscal policy will disappear in 2015. The tax cuts will shrink the government's structural revenues, but this effect will be offset in the short run by the cyclical boost to tax revenues. Based on the policies announced to date, therefore, it is expected that the deficit for 2015 will be close to the stability objective (4.2% of GDP).

# 5 Tables

Table 5.1
**Eurozone forecasts (% YoY)**

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| **GDP at constant prices** | **2.0** | **1.7** | **-0.7** | **-0.4** | **0.8** | **1.3** |
| Private consumption | 0.8 | 0.2 | -1.3 | -0.6 | 0.7 | 1.3 |
| Public consumption | 0.8 | -0.2 | -0.2 | 0.2 | 0.9 | 0.4 |
| Gross Fixed Capital Formation | -0.6 | 1.5 | -3.2 | -2.4 | 0.6 | 1.8 |
| Inventories (*) | 0.9 | 0.3 | -0.7 | -0.1 | 0.1 | 0.0 |
| Domestic Demand (*) | **1.4** | **0.7** | **-2.1** | **-0.8** | **0.8** | **1.1** |
| Exports (goods and services) | 10.8 | 6.7 | 2.6 | 2.1 | 3.7 | 5.1 |
| Imports (goods and services) | 9.6 | 4.4 | -1.0 | 1.2 | 4.1 | 5.2 |
| External Demand (*) | **0.6** | **1.0** | **1.4** | **0.4** | **0.0** | **0.2** |
| **Prices and Costs** | | | | | | |
| **CPI** | 1.6 | 2.7 | 2.5 | 1.4 | 0.5 | 1.0 |
| **CPI Core** | 1.0 | 1.7 | 1.8 | 1.3 | 0.9 | 1.0 |
| **Labour Market** | | | | | | |
| **Employment** | -0.5 | 0.4 | -0.7 | -0.8 | 0.5 | 0.6 |
| **Unemployment rate (% of labour force)** | 10.1 | 10.1 | 11.3 | 11.9 | 11.6 | 11.4 |
| **Public Sector** | | | | | | |
| **Surplus (+) / Deficit (-) (% GDP)** | -6.1 | -4.1 | -3.6 | -2.9 | -2.8 | -2.6 |
| **Public debt (% GDP)** | 83.7 | 85.8 | 89.0 | 90.9 | 94.5 | 94.4 |
| **External Sector** | | | | | | |
| **Current Account Balance (% GDP)** | 0.0 | 0.1 | 1.4 | 2.3 | 2.2 | 2.1 |

(*) Contribution to GDP growth.
Source: BBVA Research

Table 5.2
**Macroeconomic Forecasts: Gross Domestic Product**

| (End of period, YoY rate) | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| **United States** | 1.6 | 2.3 | 2.2 | 2.0 | 2.5 |
| **Eurozone** | 1.6 | -0.6 | -0.4 | 0.8 | 1.3 |
| Germany | 3.7 | 0.6 | 0.2 | 1.3 | 1.4 |
| France | 2.1 | 0.4 | 0.4 | 0.4 | 1.1 |
| Italy | 0.6 | -2.4 | -1.8 | -0.3 | 0.8 |
| Spain | -0.6 | -2.1 | -1.2 | 1.3 | 2.0 |
| **UK** | 1.1 | 0.3 | 1.7 | 3.0 | 2.7 |
| **Latin America *** | 4.1 | 2.6 | 2.4 | 0.9 | 1.8 |
| Mexico | 4.0 | 3.7 | 1.3 | 2.5 | 3.5 |
| Brazil | 2.7 | 1.0 | 2.5 | 0.2 | 1.3 |
| **EAGLES **** | 7.0 | 5.4 | 5.3 | 4.9 | 5.3 |
| Turkey | 8.8 | 2.1 | 4.1 | 2.5 | 3.9 |
| **Asia Pacific** | 6.1 | 5.2 | 5.2 | 5.0 | 5.2 |
| Japan | -0.5 | 1.5 | 1.5 | 1.1 | 1.3 |
| China | 9.3 | 7.7 | 7.7 | 7.2 | 7.0 |
| Asia (exc. China) | 3.8 | 3.5 | 3.4 | 3.5 | 3.9 |
| **World** | 4.1 | 3.4 | 3.2 | 3.2 | 3.7 |

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Brazil, China, India, Indonesia, Mexico, Russia and Turkey.
Forecast closing date: 30 October 2014.
Source: BBVA Research and IMF

Table 5.3

### Macroeconomic forecasts: Inflation

| (Annual average, YoY rate) | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| **United States** | 3.1 | 2.1 | 1.5 | 1.9 | 2.2 |
| **Eurozone** | 2.7 | 2.5 | 1.4 | 0.5 | 1.0 |
| **Germany** | 2.5 | 2.1 | 1.6 | 0.9 | 1.5 |
| **France** | 2.3 | 2.2 | 1.0 | 0.7 | 0.9 |
| **Italy** | 2.9 | 3.3 | 1.3 | 0.3 | 0.7 |
| **Spain** | 3.2 | 2.4 | 2.4 | 0.0 | 1.0 |
| **UK** | 4.5 | 2.8 | 2.6 | 1.5 | 1.6 |
| **Latin America *** | 7.0 | 6.3 | 7.8 | 13.1 | 14.2 |
| **Mexico** | 3.4 | 4.1 | 3.8 | 4.0 | 3.4 |
| **Brazil** | 6.6 | 5.4 | 6.2 | 6.3 | 6.2 |
| **EAGLES **** | 6.6 | 5.1 | 5.3 | 4.8 | 4.6 |
| **Turkey** | 6.5 | 8.9 | 7.5 | 8.8 | 7.0 |
| **Asia Pacific** | 4.9 | 3.4 | 3.5 | 3.4 | 3.6 |
| **Japan** | -0.3 | 0.0 | 0.4 | 2.2 | 1.5 |
| **China** | 5.4 | 2.6 | 2.6 | 2.2 | 2.3 |
| **Asia (exc. China)** | 4.6 | 4.0 | 4.2 | 3.9 | 3.7 |
| **World** | 5.2 | 4.2 | 4.09 | 4.2 | 4.4 |

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Brazil, China, India, Indonesia, Mexico, Russia and Turkey.
Forecast closing date: 30 October 2014.
Source: BBVA Research and IMF

Table 5.4

### Macroeconomic forecasts: Current Account

| (End of period, % GDP) | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| **United States** | -3.0 | -2.8 | -2.4 | -2.7 | -2.6 |
| **Eurozone** | 0.1 | 1.4 | 2.3 | 2.2 | 2.1 |
| **Germany** | 6.1 | 7.1 | 6.8 | 6.7 | 7.1 |
| **France** | -1.0 | -1.5 | -1.4 | -1.7 | -1.6 |
| **Italy** | -3.1 | -0.5 | 1.0 | 0.9 | 0.9 |
| **Spain** | -3.7 | -1.2 | 0.8 | 1.2 | 2.1 |
| **UK** | -1.7 | -3.7 | -4.2 | -4.1 | -3.8 |
| **Latin America *** | -1.0 | -1.6 | -2.5 | -2.4 | -2.1 |
| **Mexico** | -1.1 | -1.3 | -2.1 | -1.6 | -1.9 |
| **Brazil** | -2.1 | -2.4 | -3.7 | -3.7 | -3.7 |
| **EAGLES **** | -0.1 | -0.4 | -0.3 | 0.1 | 0.3 |
| **Turkey** | -9.9 | -7.6 | -7.0 | -6.0 | -6.0 |
| **Asia Pacific** | 1.5 | 1.1 | 1.4 | 1.7 | 1.7 |
| **Japan** | 2.0 | 1.0 | 0.7 | 1.2 | 1.3 |
| **China** | 1.9 | 2.3 | 2.0 | 2.5 | 2.8 |
| **Asia (exc. China)** | 1.5 | 0.5 | 1.3 | 1.3 | 1.2 |

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Brazil, China, India, Indonesia, Mexico, Russia and Turkey.
Forecast closing date30 October 2014.
Source: BBVA Research and IMF

Table 5.5
### Macroeconomic Forecasts: Government Balance

| End of period, % GDP | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| **United States** | -8.7 | -6.8 | -4.1 | -3.1 | -2.7 |
| **EMU** | -4.1 | -3.6 | -2.9 | -2.8 | -2.6 |
| **Germany** | -0.9 | 0.1 | 0.1 | 0.0 | 0.0 |
| **France** | -5.1 | -4.9 | -4.1 | -4.4 | -4.1 |
| **Italy** | -3.5 | -3.0 | -2.8 | -3.0 | -2.6 |
| **Spain *** | -9.1 | -6.8 | -6.6 | -5.5 | -4.2 |
| **UK **** | -7.6 | -8.3 | -5.8 | -5.7 | -4.3 |
| **Latin America ***** | -2.2 | -2.3 | -2.7 | -3.9 | -3.7 |
| **Mexico** | -2.7 | -2.6 | -2.3 | -3.6 | -3.5 |
| **Brazil** | -2.6 | -2.5 | -3.7 | -4.0 | -3.6 |
| **EAGLES ******* | -2.3 | -2.9 | -3.0 | -3.4 | -3.3 |
| **Turkey** | -1.4 | -2.1 | -1.2 | -2.2 | -1.6 |
| **Asia Pacific** | -2.8 | -2.9 | -2.9 | -2.9 | -2.7 |
| **Japan** | -9.8 | -8.7 | -8.4 | -7.2 | -6.4 |
| **China** | -1.1 | -2.1 | -1.9 | -2.5 | -2.5 |
| **Asia (exc. China)** | -3.9 | -3.5 | -3.5 | -3.2 | -2.9 |

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Brazil, China, India, Indonesia, Mexico, Russia and Turkey.
Forecast closing date30 October 2014.
Source: BBVA Research and IMF

Table 5.6
### Financial variables

| Macroeconomic Forecasts: Official Interest Rates (End of period) | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| **United States** | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 |
| **Eurozone** | 1.10 | 0.75 | 0.25 | 0.05 | 0.05 |
| **China** | 6.56 | 6.00 | 6.00 | 6.00 | 6.00 |
| **Macroeconomic Forecasts: 10-year government bond yield (Annual average)** | | | | | |
| **United States** | 2.8 | 1.8 | 2.4 | 2.6 | 3.1 |
| **Germany** | 2.6 | 1.5 | 1.6 | 1.2 | 1.0 |
| **Macroeconomic Forecasts: Exchange Rates (Annual average)** | | | | | |
| **EUR-USD** | 0.72 | 0.78 | 0.75 | 0.75 | 0.84 |
| **USD-EUR** | 1.39 | 1.29 | 1.33 | 1.33 | 1.19 |
| **GBP-USD** | 0.62 | 0.63 | 0.64 | 0.61 | 0.64 |
| **JPY-USD** | 79.8 | 79.8 | 97.6 | 104.7 | 115.3 |
| **CNY-USD** | 6.46 | 6.31 | 6.20 | 6.14 | 6.02 |

Forecast closing date: 30 October 2014 .
Source: BBVA Research and IMF

Table 5.7
**Germany: GDP growth and inflation forecasts (% YoY)**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|
| **Private consumption** | 0.4 | 0.2 | 0.5 | 2.3 | 0.6 | 0.9 | 1.2 | 1.3 |
| **Public consumption** | 3.4 | 3.0 | 1.3 | 0.7 | 1.2 | 0.7 | 1.1 | 0.9 |
| **Gross Fixed Capital Formation** | 0.6 | -9.9 | 4.4 | 7.4 | 0.1 | -0.6 | 3.2 | 3.3 |
| **Inventories (*)** | -0.1 | -1.5 | 1.3 | 0.0 | -1.4 | 0.1 | 0.0 | 0.0 |
| **Domestic Demand (*)** | 0.9 | -2.9 | 2.7 | 2.9 | -0.8 | 0.7 | 1.5 | 1.5 |
| **Exports** | 1.3 | -14.3 | 14.2 | 8.2 | 3.5 | 1.7 | 3.4 | 4.1 |
| **Imports** | 1.8 | -9.6 | 12.6 | 7.3 | 0.4 | 3.2 | 4.3 | 4.9 |
| **Net exports (*)** | **-0.1** | **-2.7** | **1.2** | **0.8** | **1.4** | **-0.5** | **-0.1** | **0.0** |
| **GDP** | **0.8** | **-5.6** | **3.9** | **3.7** | **0.6** | **0.2** | **1.3** | **1.4** |
| **Inflation** | 2.8 | 0.2 | 1.2 | 2.5 | 2.1 | 1.6 | 0.9 | 1.5 |

(*) Contribution to growth.
Source: BBVA Research

Table 5.8
**France: GDP growth and inflation forecasts (% YoY)**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|
| **Private consumption** | 0.4 | 0.3 | 1.8 | 0.4 | -0.4 | 0.3 | 0.2 | 1.1 |
| **Public consumption** | 1.1 | 2.5 | 1.2 | 1.0 | 1.7 | 2.0 | 1.7 | 0.5 |
| **Gross Fixed Capital Formation** | 0.7 | -9.0 | 1.9 | 2.1 | 0.3 | -0.8 | -0.6 | 1.1 |
| **Inventories (*)** | -0.3 | -1.2 | 0.3 | 1.1 | -0.6 | -0.2 | 0.0 | 0.0 |
| **Domestic Demand (*)** | 0.4 | -2.5 | 2.0 | 2.1 | -0.3 | 0.3 | 0.4 | 0.9 |
| **Exports** | 0.1 | -11.0 | 8.6 | 7.1 | 1.2 | 2.4 | 2.6 | 3.2 |
| **Imports** | 1.0 | -9.2 | 8.5 | 6.5 | -1.2 | 1.9 | 2.5 | 2.6 |
| **Net exports (*)** | -0.3 | -0.3 | -0.1 | 0.0 | 0.7 | 0.1 | 0.0 | 0.1 |
| **GDP** | 0.1 | -2.9 | 1.9 | 2.1 | 0.4 | 0.4 | 0.4 | 1.1 |
| **Inflation** | 3.2 | 0.1 | 1.7 | 2.3 | 2.2 | 1.0 | 0.7 | 0.9 |

(*) Contribution to growth.
Source: BBVA Research

Table 5.9
**Italy: GDP growth and inflation forecasts (% YoY)**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|
| **Private consumption** | -1.1 | -1.5 | 1.2 | 0.0 | -4.1 | -2.7 | 0.0 | 0.5 |
| **Public consumption** | 1.0 | 0.4 | 0.6 | -1.8 | -1.5 | -0.7 | 0.0 | -0.3 |
| **Gross Fixed Capital Formation** | -3.2 | -10.0 | -0.6 | -1.7 | -7.5 | -5.4 | -2.1 | 1.5 |
| **Inventories (*)** | -0.1 | -1.2 | 1.2 | 0.2 | -0.8 | -0.1 | 0.0 | 0.0 |
| **Domestic Demand (*)** | -1.3 | -4.1 | 2.0 | -0.5 | -5.0 | -2.8 | -0.4 | 0.6 |
| **Exports** | -3.2 | -17.9 | 11.3 | 6.1 | 1.6 | 0.9 | 2.0 | 3.8 |
| **Imports** | -4.0 | -12.7 | 12.1 | 1.2 | -8.2 | -2.6 | 1.6 | 3.4 |
| **Net exports (*)** | 0.2 | -1.4 | -0.3 | 1.2 | 2.6 | 0.9 | 0.2 | 0.3 |
| **GDP** | -1.1 | -5.5 | 1.7 | 0.7 | -2.3 | -1.9 | -0.3 | 0.8 |
| **Inflation** | 3.5 | 0.8 | 1.6 | 2.9 | 3.3 | 1.3 | 0.3 | 0.7 |

(*) Contribution to growth.
Source: BBVA Research

Table 5.10
### Portugal: GDP growth and inflation forecasts (% YoY)

| Rate YoY | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|
| **Private consumption** | 1.4 | -2.3 | 2.4 | -3.6 | -5.2 | -1.4 | 1.6 | 1.3 |
| **Public consumption** | 0.4 | 2.6 | -1.3 | -3.8 | -4.3 | -1.9 | -0.5 | -0.8 |
| **Gross Fixed Capital Formation** | 0.4 | -7.6 | -0.9 | -12.5 | -15.0 | -6.3 | 1.3 | 2.8 |
| **Inventories (*)** | 0.2 | -1.1 | 1.0 | -0.6 | 0.1 | 0.0 | 0.3 | 0.0 |
| **Domestic Demand (*)** | 1.3 | -3.8 | 2.1 | -6.4 | -6.9 | -2.4 | 1.4 | 1.1 |
| **Exports** | -0.3 | -10.2 | 9.5 | 7.0 | 3.1 | 6.4 | 4.0 | 5.7 |
| **Imports** | 2.5 | -9.9 | 7.8 | -5.8 | -6.6 | 3.6 | 5.5 | 4.6 |
| **Net exports (*)** | -1.1 | 0.8 | -0.2 | 4.6 | 3.6 | 1.0 | -0.6 | 0.4 |
| **GDP** | 0.2 | -3.0 | 1.9 | -1.8 | -3.3 | -1.4 | 0.9 | 1.5 |
| **Inflation** | **2.7** | **-0.9** | **1.4** | **3.6** | **2.8** | **0.4** | **0.0** | **0.7** |

(*) Contribution to growth.
Source: BBVA Research

Table 5.11
### Spain: GDP growth and inflation forecasts (% YoY)

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|
| **Private consumption** | -0.6 | -3.7 | 0.2 | -1.2 | -2.8 | -2.1 | 2.1 | 1.8 |
| **Public consumption** | 5.9 | 4.1 | 1.5 | -0.3 | -3.7 | -2.9 | 1.0 | 0.9 |
| **Gross Fixed Capital Formation** | -3.9 | -16.9 | -4.9 | -6.3 | -8.1 | -3.8 | 0.6 | 4.3 |
| **Equipment and other products** | -2.9 | -23.9 | 4.3 | 5.3 | -3.9 | 2.2 | 8.0 | 6.5 |
| **Construction** | -5.8 | -16.6 | -9.9 | -10.8 | -9.7 | -9.6 | -3.9 | 2.9 |
| **Housing** | -9.1 | -20.4 | -11.4 | -12.5 | -8.7 | -8.0 | -3.6 | 4.9 |
| **Other construction** | -1.6 | -12.2 | -8.4 | -9.2 | -10.6 | -10.9 | -4.2 | 1.4 |
| **Inventories (*)** | 0.1 | -0.2 | 0.3 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Domestic Demand (*)** | **-0.4** | **-6.4** | **-0.5** | **-2.7** | **-4.3** | **-2.7** | **1.6** | **2.0** |
| **Exports** | -0.8 | -11.0 | 9.4 | 7.4 | 1.2 | 4.3 | 3.7 | 5.3 |
| **Imports** | -5.6 | -18.3 | 6.9 | -0.8 | -6.3 | -0.5 | 4.8 | 5.5 |
| **Net exports (*)** | **1.6** | **2.8** | **0.5** | **2.1** | **2.2** | **1.4** | **-0.3** | **0.1** |
| **GDP** | **1.1** | **-3.6** | **0.0** | **-0.6** | **-2.1** | **-1.2** | **1.3** | **2.0** |
| **Inflation** | **4.1** | **-0.3** | **1.8** | **3.2** | **2.4** | **1.4** | **0.0** | **1.0** |

(*) Contribution to growth.
Source: BBVA Research

Table 5.12
### UK: GDP growth and inflation forecasts (% YoY)

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|
| **Private consumption** | -0.5 | -3.1 | 0.4 | 0.1 | 1.1 | 1.6 | 2.2 | 2.3 |
| **Public consumption** | 2.2 | 1.0 | 0.0 | 0.0 | 2.3 | 0.7 | 1.0 | 0.1 |
| **Gross Fixed Capital Formation** | -4.7 | -14.4 | 5.9 | 2.3 | 0.7 | 3.2 | 8.0 | 6.3 |
| **Inventories (*)** | -0.5 | -0.6 | 1.5 | -0.2 | 0.1 | 0.1 | 0.1 | 0.0 |
| **Domestic Demand (*)** | **-1.4** | **-5.0** | **2.8** | **0.3** | **1.5** | **1.7** | **3.0** | **2.6** |
| **Exports** | 1.6 | -8.2 | 6.2 | 5.6 | 0.7 | 0.5 | -1.1 | 3.5 |
| **Imports** | -1.8 | -9.8 | 8.7 | 1.0 | 3.1 | 0.5 | -1.2 | 3.0 |
| **Net exports (*)** | **1.1** | **0.7** | **-0.9** | **1.4** | **-0.8** | **0.0** | **0.0** | **0.1** |
| **GDP** | **-0.3** | **-4.3** | **1.9** | **1.6** | **0.7** | **1.7** | **3.0** | **2.7** |
| **Inflation** | 3.6 | 2.2 | 3.3 | 4.5 | 2.8 | 2.6 | **1.5** | **1.6** |

(*) Contribution to growth.
Source: BBVA Research

**DISCLAIMER**

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

## This report has been produced by the Europe Unit:

*Chief Econmist for Developed Economies*
Rafael Doménech
r.domenech@bbva.com
+34 91 537 36 72

Europe
Miguel Jiménez
mjimenezg@bbva.com
+34 91 537 37 76

Agustín García Serrador
agustin.garcia@bbva.com
+34 91 374 79 38

Diego Torres Torres
diego.torres.torres@bbva.com
+34 91 374 05 12

Pablo Budde
pablo.budde@bbva.com

Massimo Trento
massimo.trento@bbva.com

## BBVA Research

*Group Chief Economist*
Jorge Sicilia Serrano

*Developed Economies Area*
Rafael Doménech Vilariño
r.domenech@bbva.com

*Spain*
Miguel Cardoso Lecourtois
miguel.cardoso@bbva.com

*Europe*
Miguel Jimenez González-Anleo
mjimenezg@bbva.com

*US*
Nathaniel Karp
Nathaniel.Karp@bbva.com

*Emerging Markets Area*
Alicia García-Herrero
alicia.garcia-herrero@bbva.com

*Cross-Country Emerging Markets Analysis*
Alvaro Ortiz Vidal-Abarca
alvaro.ortiz@bbva.com

*Asia*
Le Xia
le.xia@bbva.com

*Mexico*
Carlos Serrano Herrera
carlos.serranoh@bbva.com

*LATAM Coordination*
Juan Manuel Ruiz Pérez
juan.ruiz@bbva.com

*Argentina*
Gloria Sorensen
gsorensen@bbva.com

*Chile*
Jorge Selaive Carrasco
jselaive@bbva.com

*Colombia*
Juana Téllez Corredor
juana.tellez@bbva.com

*Peru*
Hugo Perea Flores
hperea@bbva.com

*Venezuela*
Oswaldo López Meza
oswaldo.lopez@bbva.com

*Financial Systems and Regulation Area*
Santiago Fernández de Lis
sfernandezdelis@bbva.com

*Financial Systems*
Ana Rubio
arubiog@bbva.com

*Financial Inclusion*
David Tuesta
david.tuesta@bbva.com

*Regulation and Public Policy*
María Abascal
maria.abascal@bbva.com

*Recovery and Resolution Strategy*
José Carlos Pardo
josecarlos.pardo@bbva.com

*Global Coordination*
Matías Viola
matias.viola@bbva.com

*Global Areas*

*Economic Scenarios*
Julián Cubero Calvo
juan.cubero@bbva.com

*Financial Scenarios*
Sonsoles Castillo Delgado
s.castillo@bbva.com

*Innovation & Processes*
Oscar de las Peñas Sanchez-Caro
oscar.delaspenas@bbva.com

## Contact details:

**BBVA Research**
Paseo Castellana, 81 – 7th floor
28046 Madrid (Spain)
Tel.: +34 91 374 60 00 and +34 91 537 70 00
Fax: +34 91 374 30 25
bbvaresearch@bbva.com
**www.bbvaresearch.com**