

# Europe Outlook

Second Quarter 2015



## Main messages

- 1 **Softened global recovery** with heightened differentiation and policy activism
- 2 **Eurozone recovery gain momentum** due to stronger than expected impact from QE and from lower oil prices, with broadly neutral fiscal policy
- 3 **All large countries exit the recession**, with stronger growth in Germany and Spain
- 4 **Inflation expectations in the eurozone remain low** but broadly stable
- 5 **Risks balance is now more neutral, but remains biased to the downside:** unresolved Greek and Russia/Ukraine crisis; less benign external environment

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# The global juncture: increasing financial tensions in DM and differentiation across EM

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Eurozone drivers: oil and ECB measures offset the downside risks

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The challenges continue: low potential, large imbalances

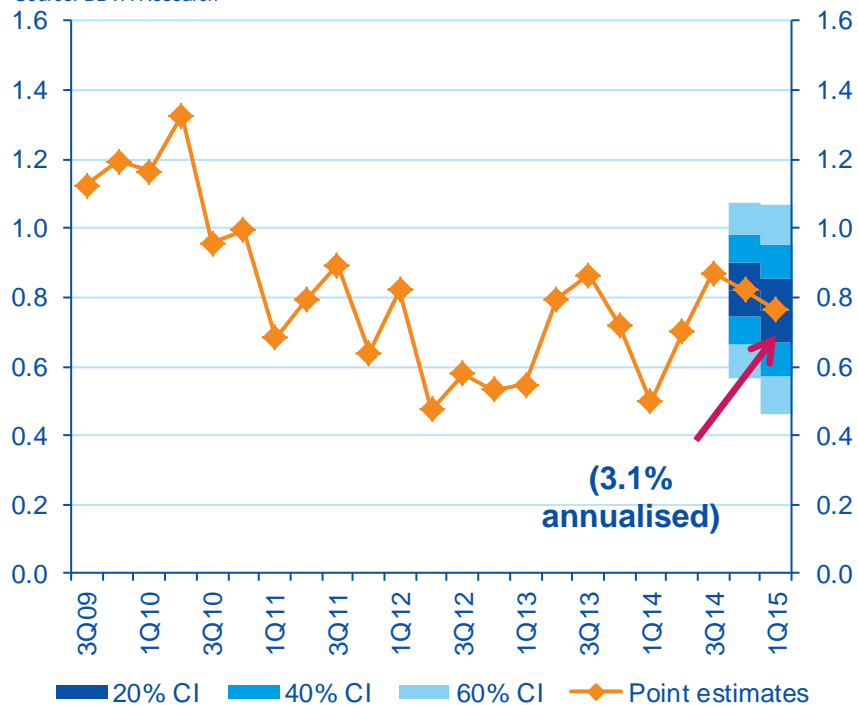
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# The global recovery loses ground at the beginning of 2015, mainly in EMs and the US, while inflation remains low

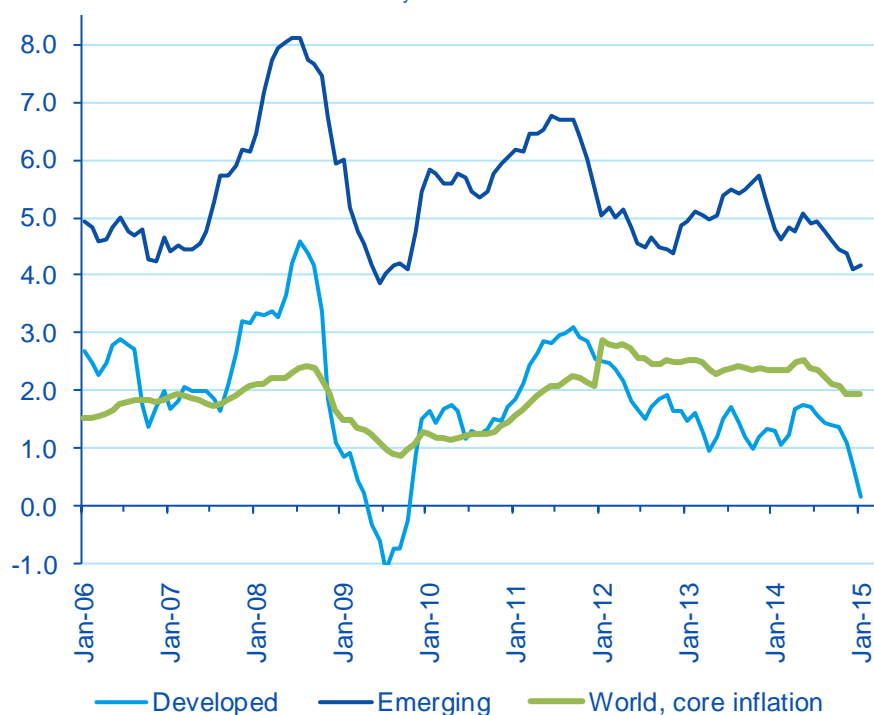
## World GDP growth forecasts based on BBVA-GAIN (% , QoQ)

Source: BBVA Research



## Inflation (% , YoY)

Source: BBVA Research based on Haver Analytics



# Main features of the World economy

## USA

- Strong domestic consumption...
- ...but slow global demand and USD appreciation
- Prolonged period of low inflation
- Fed's hike in September

## Europe

- Recovery gains momentum...
- ... supported by oil prices and QE
- Inflation expectations low but broadly stable
- Neutral fiscal policy

## LatAm

- Less benign global environment (China, commodity prices, Fed)
- Tighter policies and adverse politics

## EMs

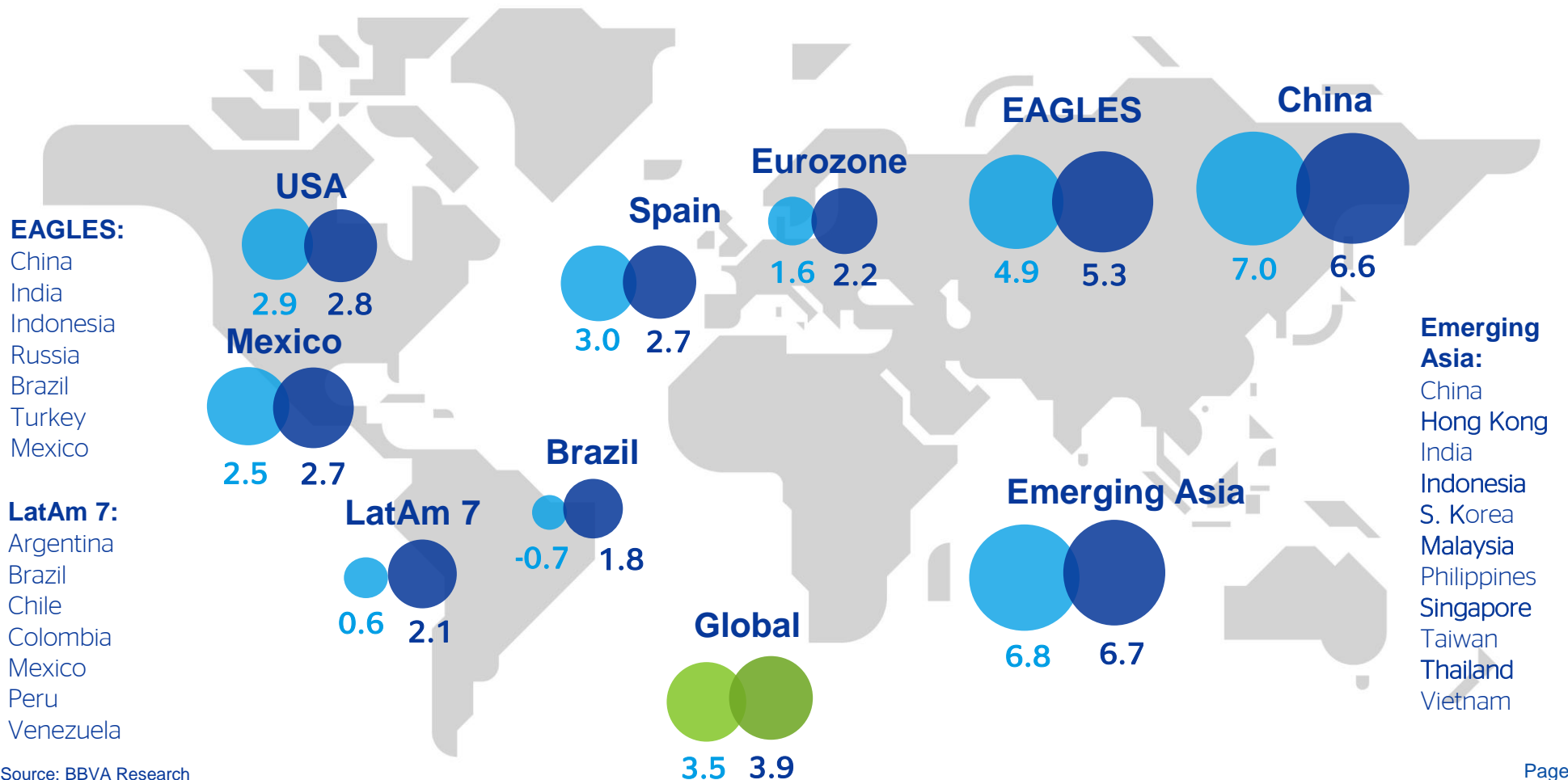
- Response to the Fed's rate hikes
- Less room for manoeuvre

## Asia

- Activity slowdown
- Room for both fiscal and monetary policy

# World growth: subdued with heightened differentiation

● 2015 ● 2016



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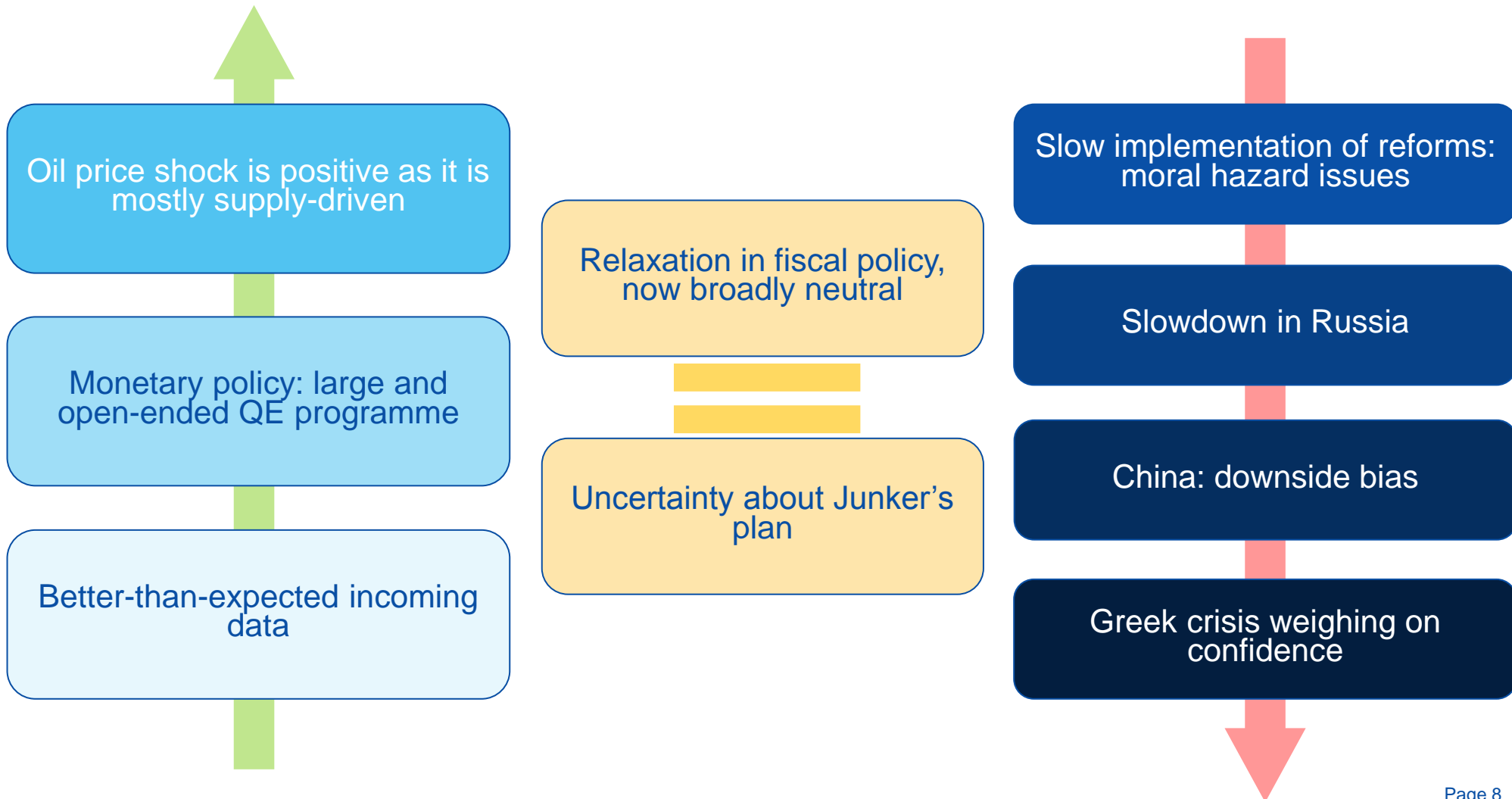
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# Drivers of growth

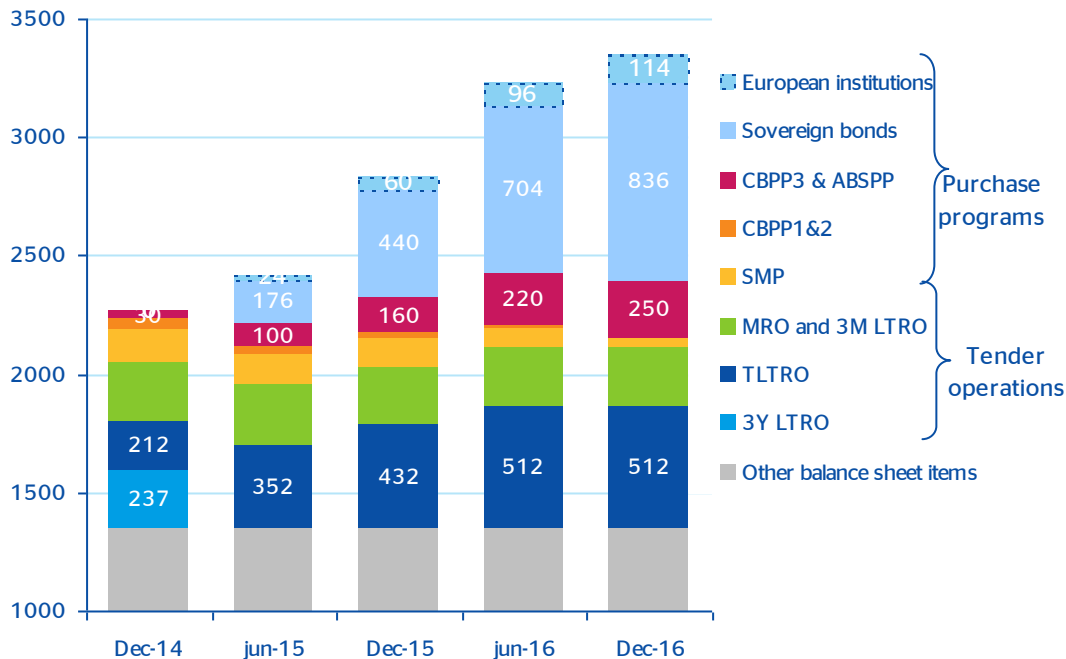




# The ECB announced a larger-than-expected QE...

## ECB's expected balance sheet: breakdown by components (EUR bn)

Source: Bloomberg and BBVA Research



**Open ended:** Monthly purchases €60bn to expand the ECB balance sheet by about €1.1 trillion (CBPP and ABSPP)

**Purchases of private assets:** CBPP and ABSPP, currently running at about €13 billion a month (250 EUR bn).

**Purchases of European institutions' bonds:** 12% (114 bn EUR). Risk-sharing.

**Purchases of government bonds:** around EUR 836 bn EUR. Risk-sharing 8% (EUR 67 bn)

# ... that will strengthen the recovery

## QE channels

Portfolio rebalancing channel.  
Weaker euro

Signaling channel (QE + FWG).  
Still limited impact on relevant interest rates

Reduced uncertainty about financial markets  
and the economy

Impact? Likely lower than US and UK  
(Bank-based financial system / Later implementation)

Impact  
from  
purchase  
of 1% of  
GDP

US GDP: 0.1/ 0.6pp

UK GDP: 0.1/ 0.2pp

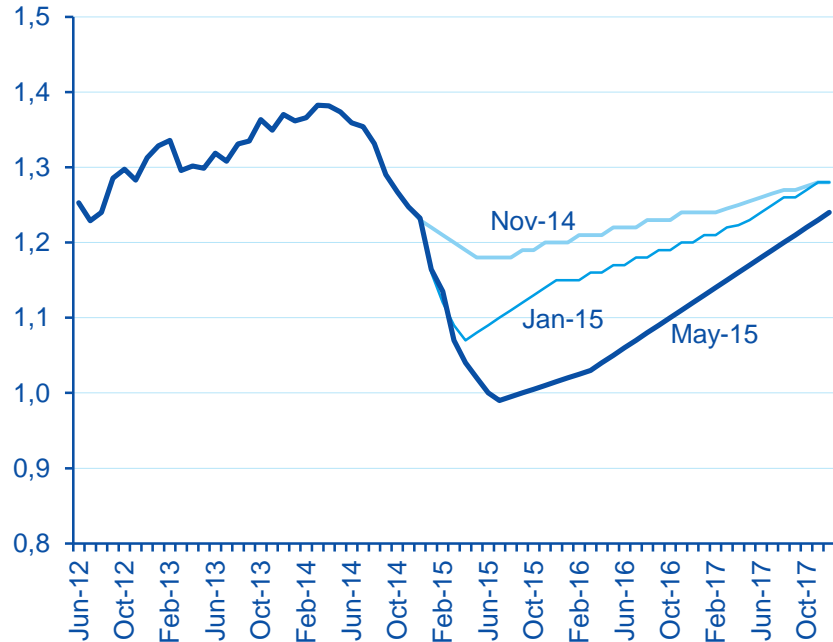
	Low growth	Baseline	Dif. GDP level 4Q (pp)
2015	1.2 (0.4QoQ)	<b>1.6</b> (0.5QoQ)	<b>0.6</b>
2016	1.6 (0.4QoQ)	<b>2.2</b> (0.6QoQ)	<b>1.2</b>

Source: ECB , Weale et al. March 2015, and BBVA Research

# A larger than expected weaker euro

Exchange rate (EURUSD)

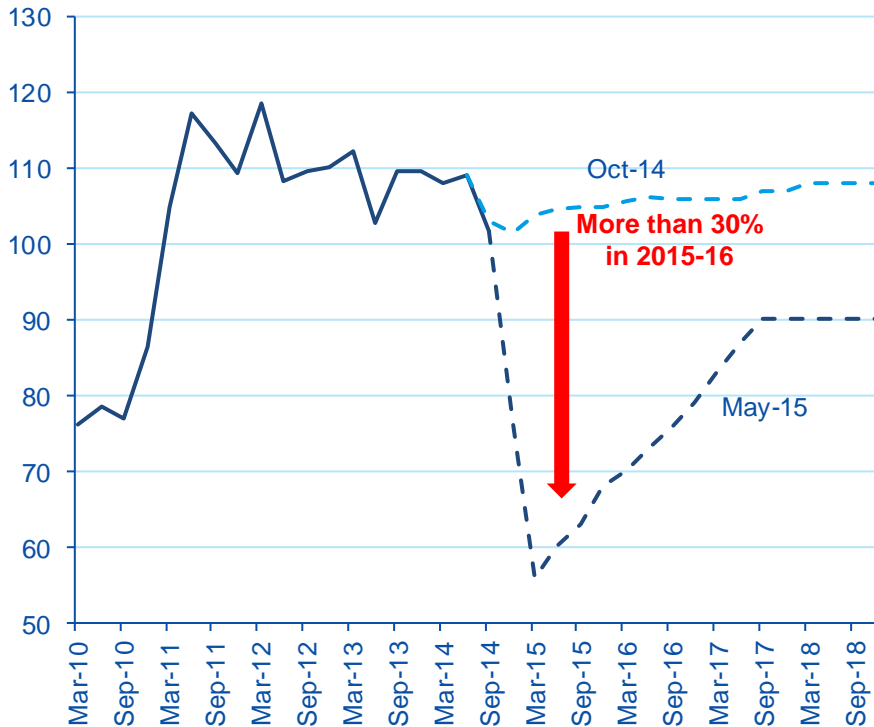
Source: BBVA Research



# The fall in oil prices is positive for growth, and joins to improved confidence

**Oil price** (Brent, USD/b)

Source: BBVA Research



Lower oil prices will boost GDP growth in 2015 and 2016...



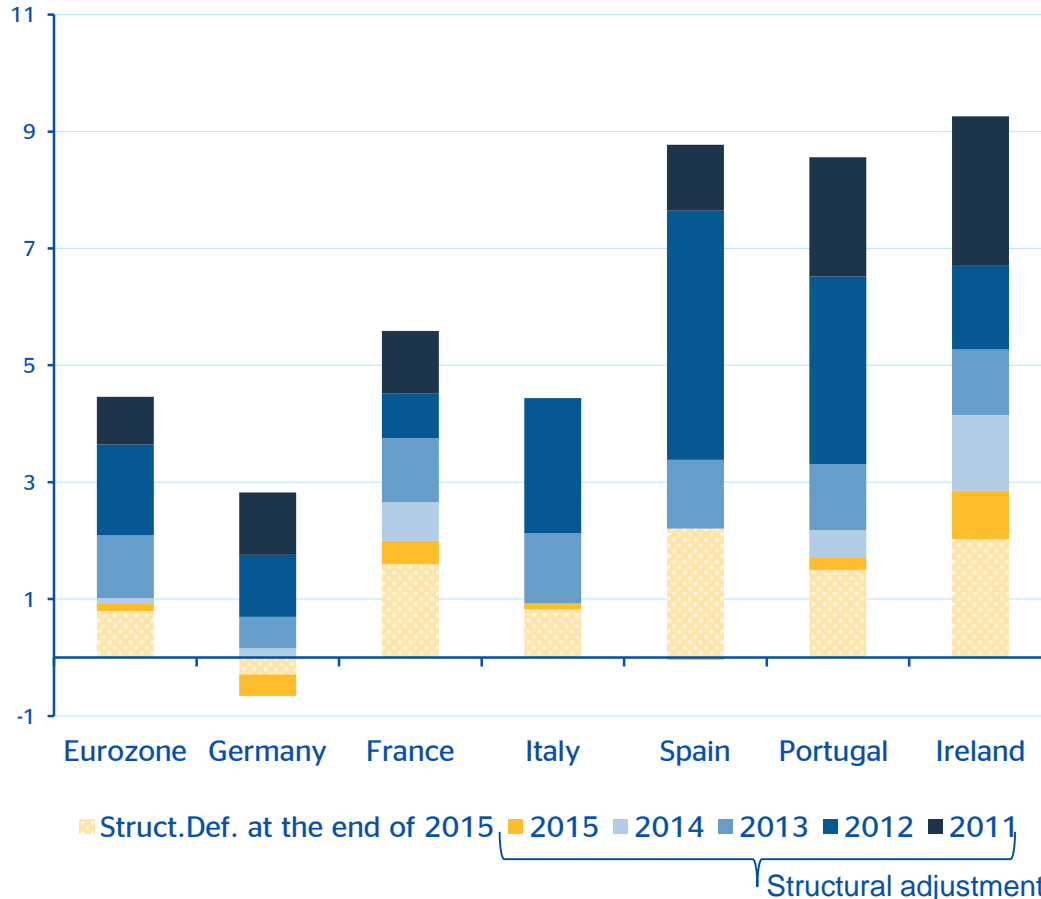
**0.2-0.5%**

... supporting household spending, also underpinned by employment

# Fiscal policy more favourable than in previous years

## Structural deficit adjustment 2010-2015 (% GDP)

Source: BBVA Research and IMF



Broadly neutral fiscal policy in 2015

European Commission more careful not to force pro-cyclical adjustments

Uncertainty about Juncker's Plan: Impact of up to 0.5% per year in 2015-17 if successful

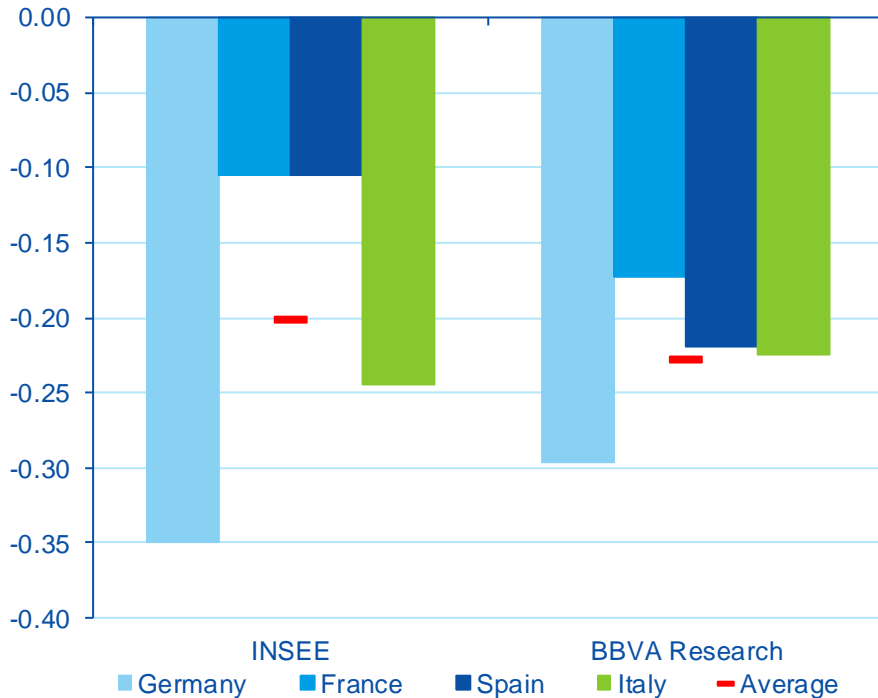
# Softened global recovery, mainly in EMs and the slowdown in China

Russia: most of the impact through trade channel

Downward bias in China and downside revision in Latam

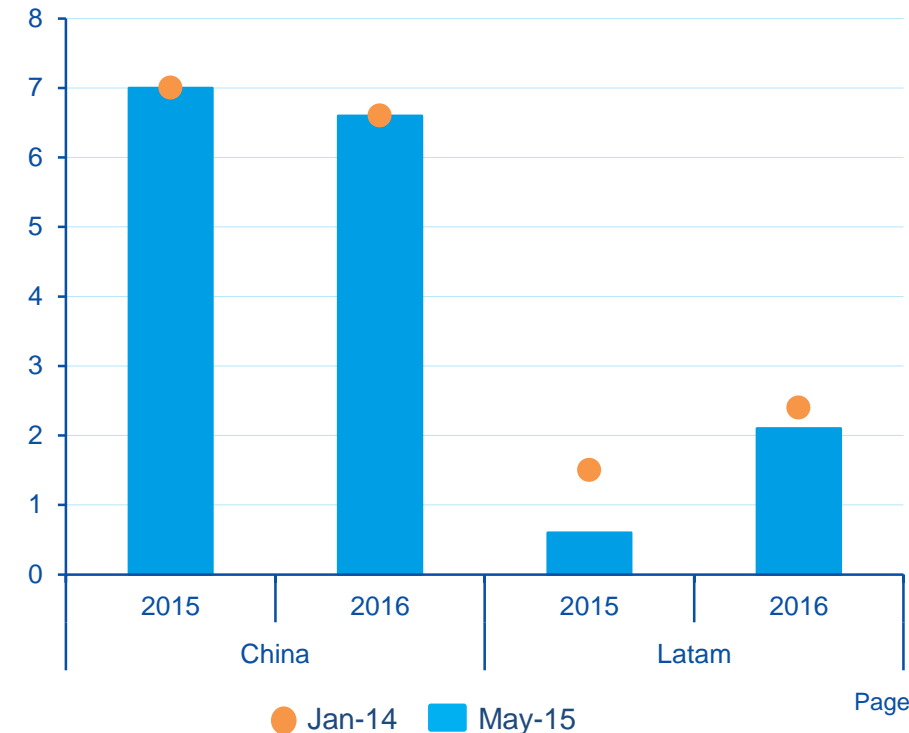
## Direct effect of a negative shock of 4% of GDP in Russia on the GDP of member states (pp)

Note: INSEE estimates the impact of a negative shock of GDP in the Central and Eastern European Countries [http://www.insee.fr/en/indicateurs/analys\\_conj/archives/dec-2014-D1E.pdf](http://www.insee.fr/en/indicateurs/analys_conj/archives/dec-2014-D1E.pdf)  
Source: INSEE and BBVA Research



## GDP growth in China and Latam (% YoY)

Source: BBVA Research



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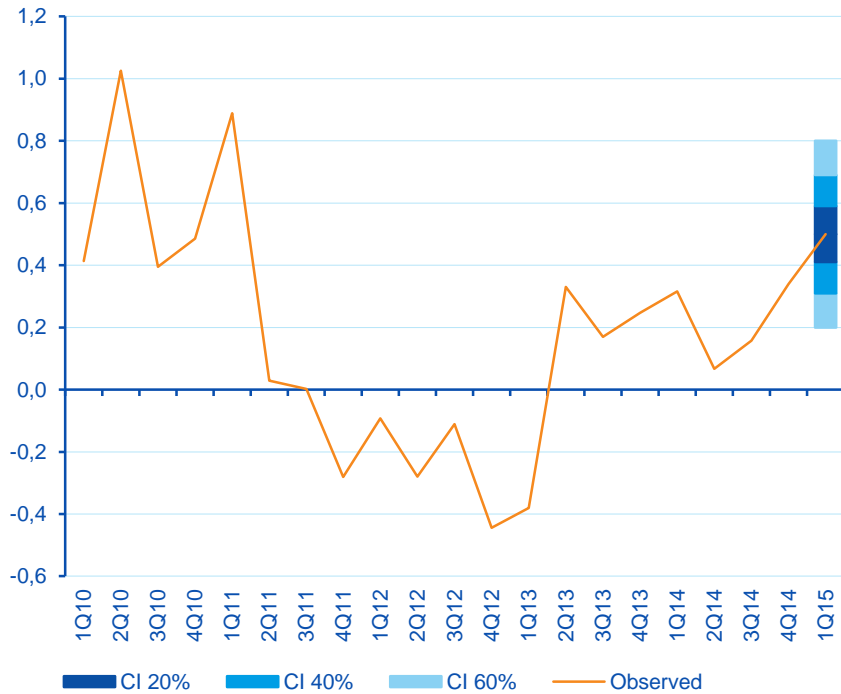
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Country breakdown

# The recovery is evolving better than expected, with more growth in Germany and Spain than France or Italy

## MICA-BBVA GDP short term model (% QoQ)

Sources: Haver and BBVA Research



GDP growth (QoQ)	2Q14	3Q14	4Q14	1Q15 (f)
<b>Eurozone</b>	0.1%	0.2%	0.3%	0.5%
<b>Germany</b>	-0.1%	0.1%	0.7%	0.6/0.7%
<b>France</b>	-0.1%	0.3%	0.1%	0.3%
<b>Italy</b>	-0.2%	-0.1%	0.0%	0.2/0.3%
<b>Spain</b>	0.5%	0.5%	0.7%	0.9%

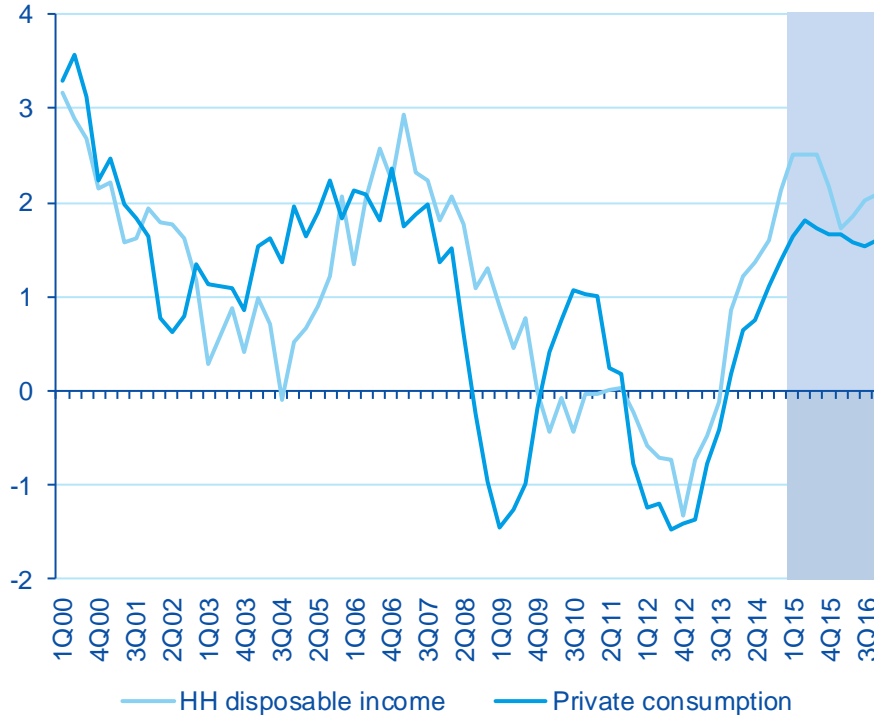
Source: Eurostat and BBVA Research



# Strong private consumption in 2015

## Eurozone: private consumption and real labour income (% YoY)

Source: Eurostat and BBVA Research



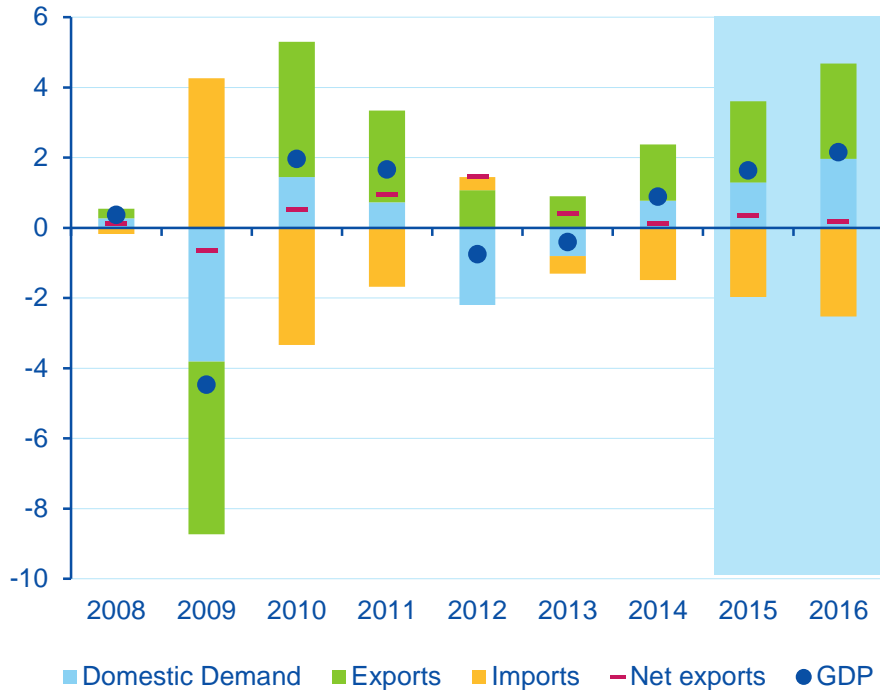
Real labour income increased by 1.7pp (1.6%) in 2014 driven by employment (1.4pp) and low inflation (0.6pp), despite low wages (-0.3pp)

Confidence recovery is finally supporting domestic demand, especially consumption

# Forecast: growth will be higher than 1.5% in 2015

## EMU: annual GDP growth contributions (pp)

Sources: Eurostat and BBVA Research



	2013	2014	2015 (f)	2016 (f)
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### Activity

REAL GDP (% YoY)	-0.4	0.9	1.6	2.2
Private consumption	-0.6	1.0	1.7	1.6
Public consumption	0.2	0.7	0.5	0.9
Investment	-2.4	1.0	1.5	4.4
Domestic demand (contr. %)	-0.9	0.8	1.3	2.0
Exports	2.1	3.7	5.2	5.9
Imports	1.2	3.8	4.9	6.1
Net exports (contr. %)	0.4	0.1	0.3	0.2

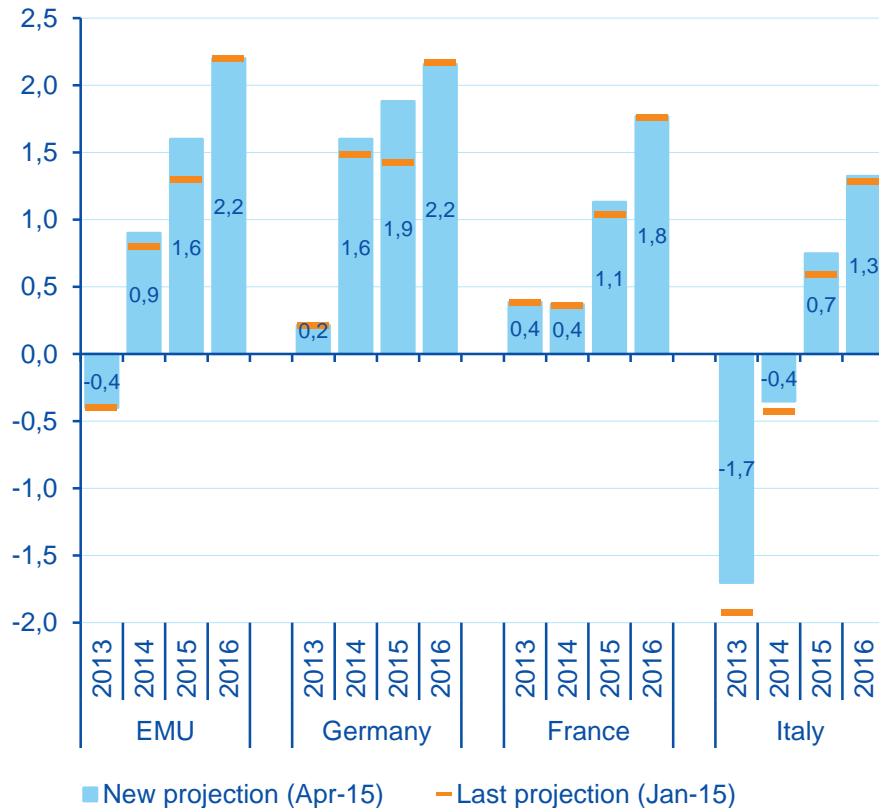
Current account balance(% GDP)	2.2	2.3	2.8	2.8
Public deficit (% GDP)	-2.9	-2.5	-2.1	-1.6
CPI, % average	1.4	0.4	0.1	1.3

Source: Eurostat and BBVA Research

# Across countries, Germany will continue to lead France and Italy

## GDP forecast by country (%)

Sources: Eurostat and BBVA Research

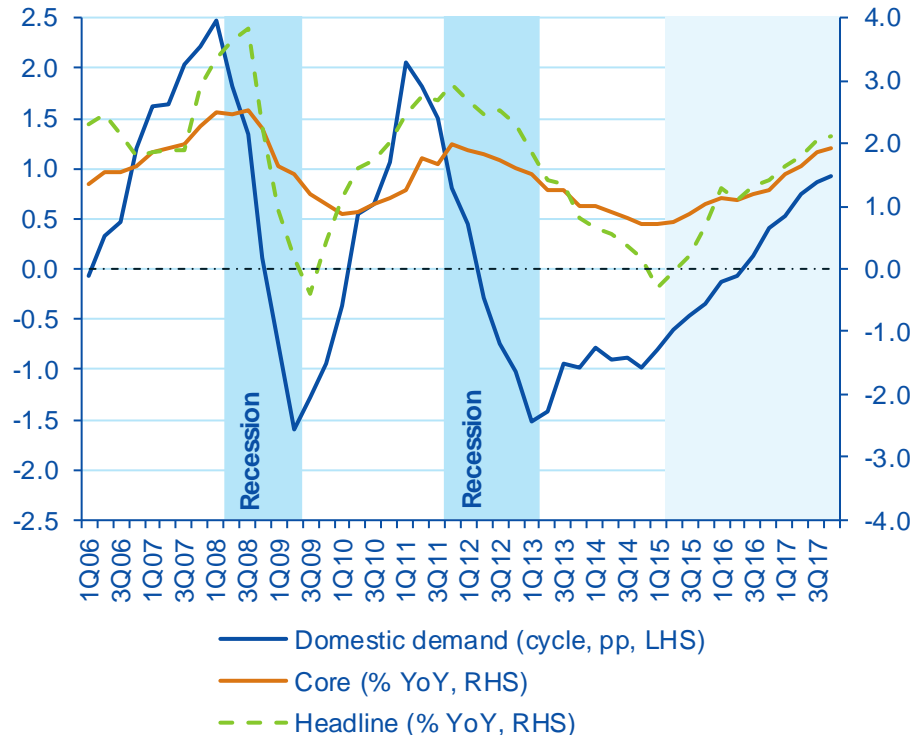


- Germany: strong growth will continue to be driven by domestic demand
- France: the pace of recovery depends on continued structural reforms and reinforcing competitiveness
- Italy: finally out of recession in 2015, though the recovery is slow and mainly exports driven

# Inflation very low in 2015, below the ECB target in the forecast horizon

## Eurozone: demand and inflation

Source: Eurostat and BBVA Research



Very low inflation due to slow recovery of domestic demand

Negative inflation due to energy prices that will continue to shape inflation in 2015...  
...but the through should be behind us

Lower risk of deflation

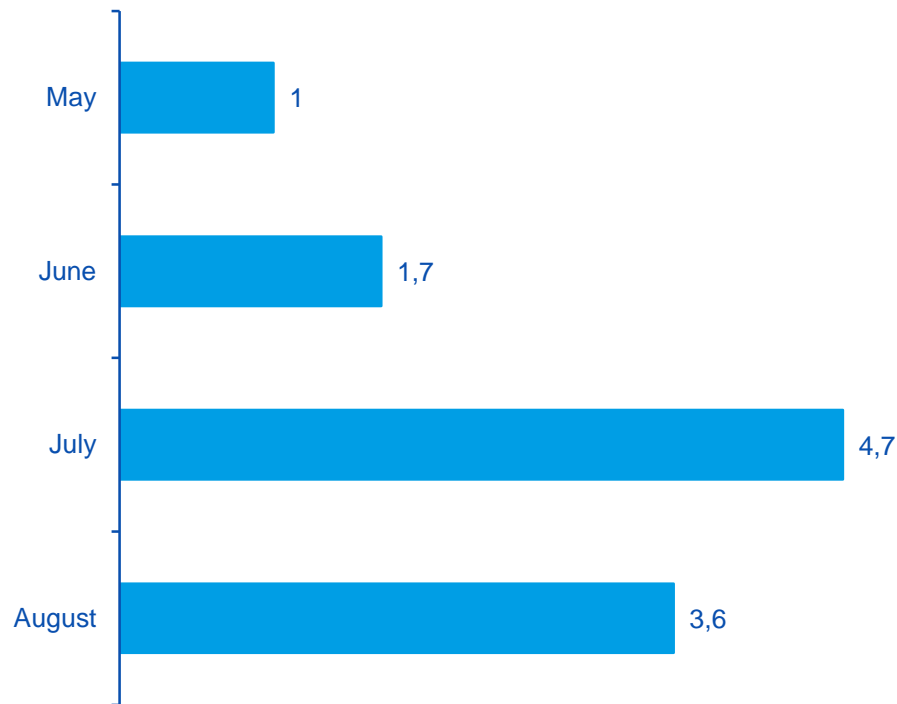
# Europe faces important challenges and risks



# Greece in the spotlight

## Greece: Forthcoming repayments of sovereign debt (EUR bn)

Source: BBVA Research.



Slow progress in negotiations and strong liquidity strains

Some progress on VAT, privatization, housing tax

Important differences on pension and labour market reform

The impact of a risk scenario (default and/or Grexit) on the rest of Europe would be manageable

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**The challenges continue: low potential, large imbalances**

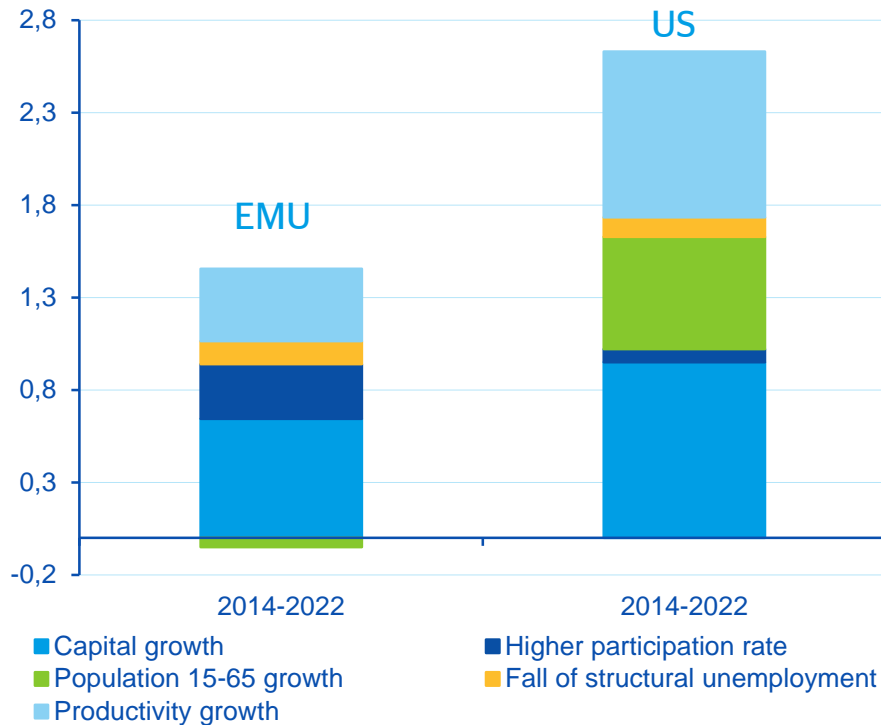
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# Low potential growth in the EZ vs the US

**US and EZ projected potential GDP growth (pp)**

Sources: Eurostat and BBVA Research



Lower potential well below that in the US

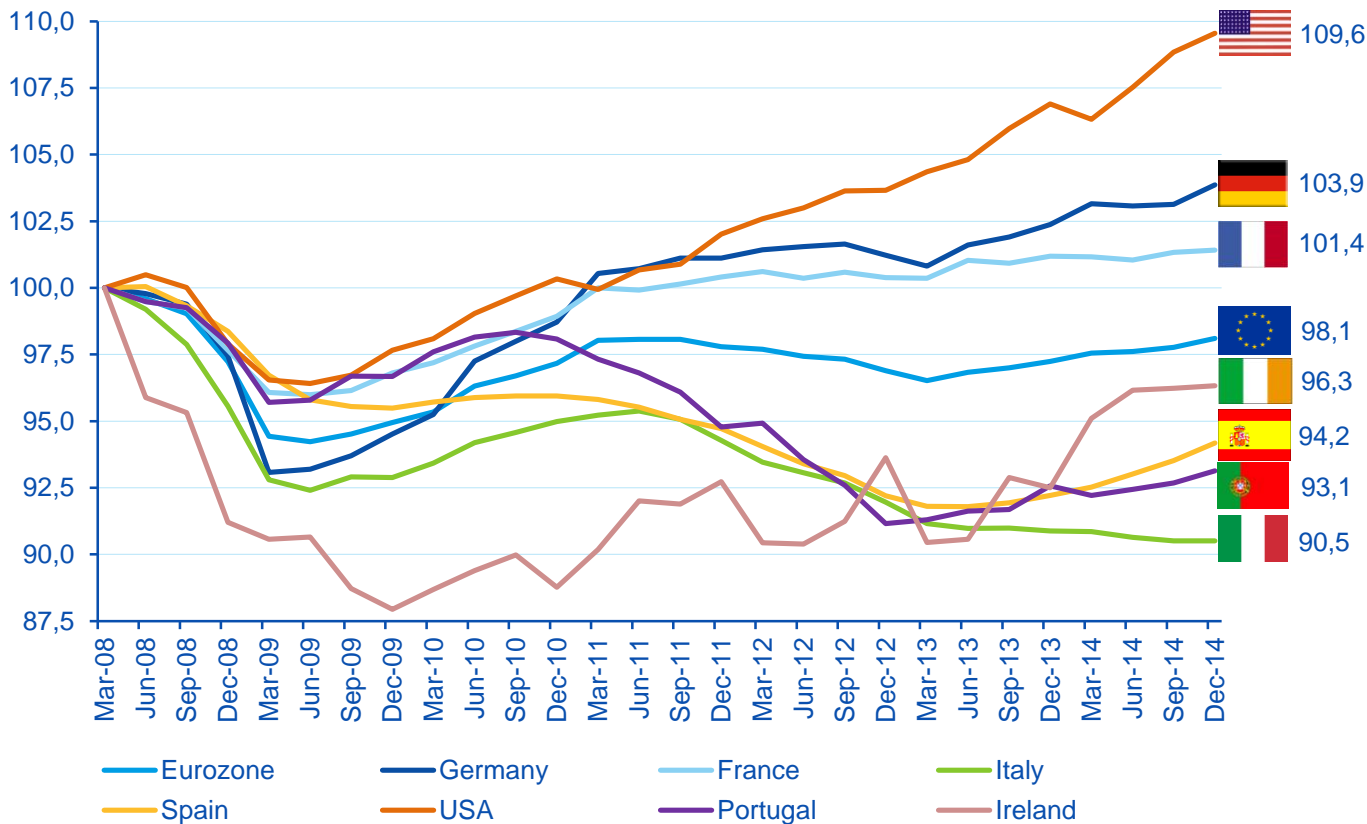
Slower population dynamics and productivity growth are the main reasons of the gap



# Where do we stand after the crisis?

## GDP (Q1-2008=100)

Sources: Eurostat, Haver and BBVA Research



# Heat map of macroeconomic imbalances

	<b>Public Debt</b> % of GDP Q4-2014	<b>Public Deficit*</b> % of GDP 2014	<b>Unemploy- ment rate</b> %AP Latest	<b>Current Account</b> % of GDP 2014	<b>Net International Investment Position</b> % of GDP 2014	<b>Real effective exchange rate</b> 3-yr % chg. Q4-2014	<b>Nominal Unit Labour Cost</b> 3-yr % chg. Latest	<b>Household Debt</b> % of GDP Latest	<b>Non-Financial Corporations Debt</b> % of GDP Latest
GER	74,7	0,7	4,8	7,6	36,4	-0,3	1,7	55,1	49,4
FRA	95,2	-4,0	10,6	-1,0	-16,4	-1,2	1,2	54,8	96,4
AUT	84,5	-2,4	5,3	0,8	2,1	1,9	2,5	50,9	77,9
BEL	106,5	-3,2	8,5	1,8	54,7	-0,5	0,1	56,5	135,1
NED	68,8	-2,3	7,1	10,3	65,8	0,8	1,9	117,1	113,8
ITA	132,1	-3,0	12,7	1,9	-27,7	0,2	1,6	42,8	69,1
SPA	97,7	-5,8	23,2	0,8	-93,5	-1,0	-0,2	74,6	109,9
POR	130,2	-4,5	14,1	0,6	-111,6	-1,8	-6,4	79,7	106,1
GRC	177,1	-3,5	25,7	0,9	-121,9	-5,6	0,8	64,4	69,7
CYP	107,5	-8,8	16,3	-5,1	-165,1	-1,4	-2,1	123,1	220,9
SLV	80,9	-4,9	9,4	5,8	-44,7	1,2	-4,2	29,6	81,0
SLK	53,6	-2,9	12,3	0,1	-70,0	1,3	2,2	29,2	44,2
DEN	45,2	1,2	6,2	6,2	41,8	-1,2	1,3	133,0	88,4
SWE	43,9	-1,9	7,9	7,8	-4,0	-3,7	0,4	83,4	145,4

Colour criterion:

Higher than 130	Lower than -6	Higher than 16	Lower than -6	Lower than -100	Greater than 6	Greater than 9	Greater than 110	Greater than 140
110/130	-6/-5	13/16	-6/-4	-100/-50	4/6	6/9	90/110	120/140
90/110	-5/-4	10/13	-4/-2	-50/0	2/4	3/6	75/90	100/120
60/90	-4/-3	7/10	-2/0	0/20	0/2	0/3	60/75	80/100
Lower than 60	Higher than -3	Lower than 7	Greater than 0	Greater than 20	Lower than 0	Lower than 0	Lower than 60	Lower than 80

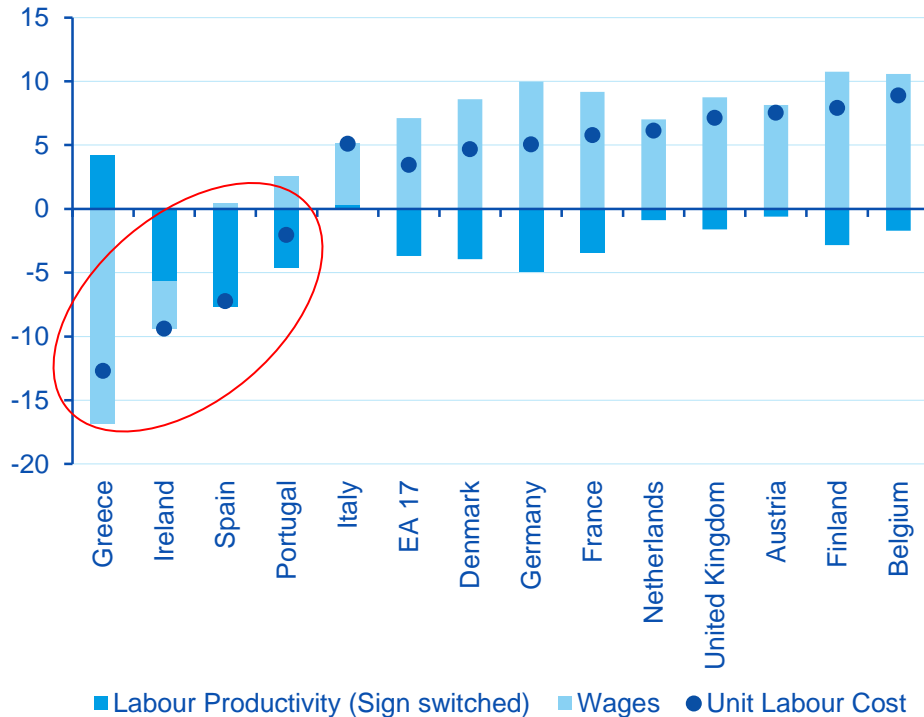
Excluding aid to the financial sector

Source: Eurostat, BCE, Haver and BBVA Research

# Unit labor costs and current account deficits have adjusted in the periphery

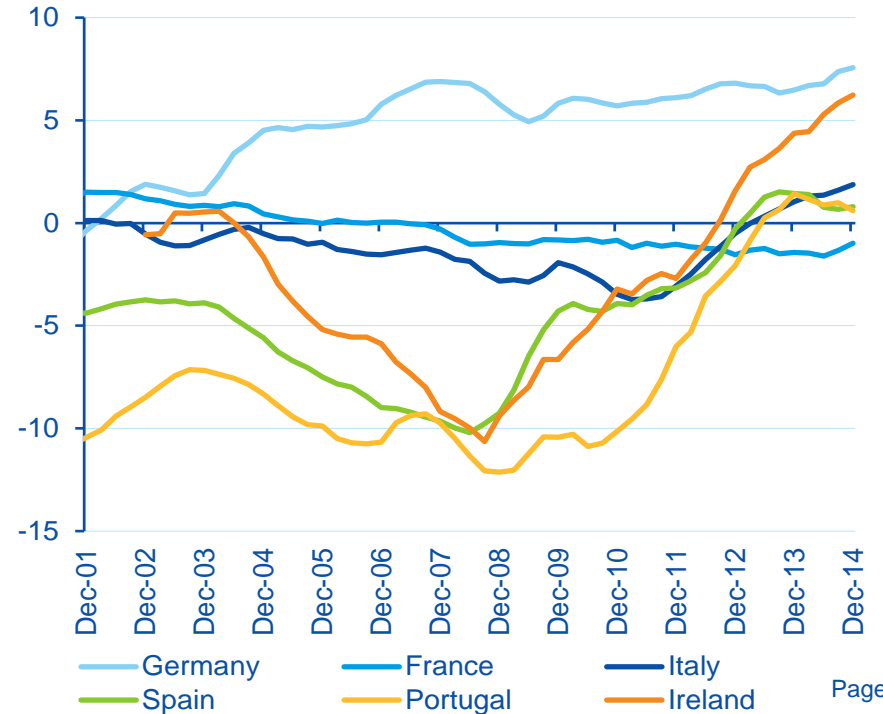
**Unit labour costs adjustment, 2009-2013 (%)**

Sources: Haver y BBVA Research



**Current account (% GDP)**

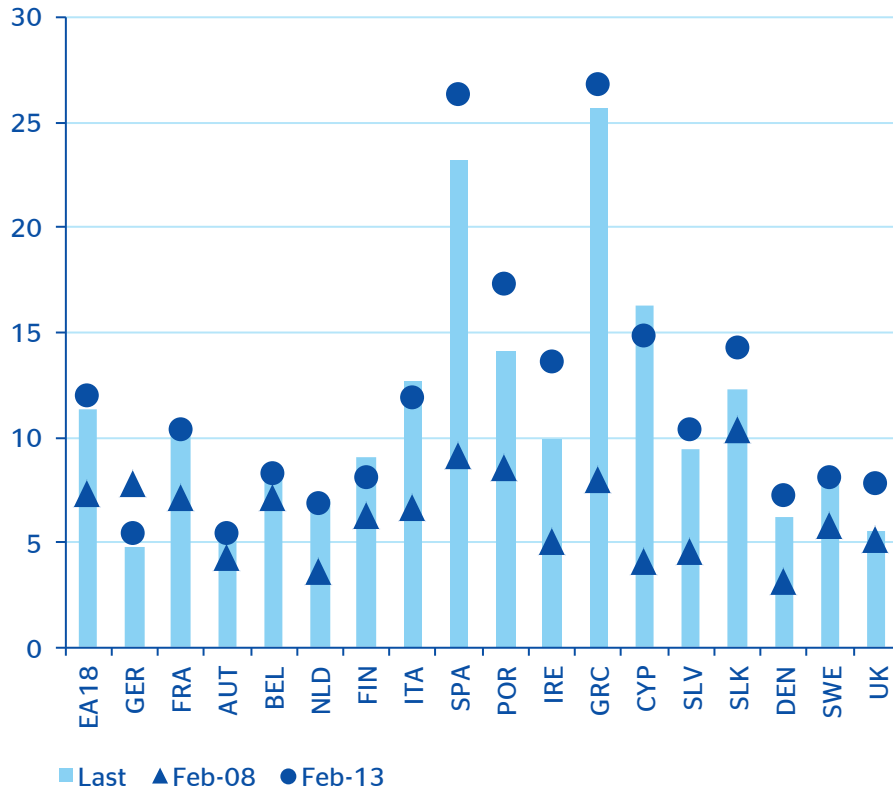
Sources: Eurostat and BBVA Research



# The high unemployment remains the main problem of economic policy

## Unemployment since the beginning of the crisis (%)

Sources: Haver and BBVA Research



The unemployment rate is well above that of 2008 (except in Germany)

Even so, it has begun to decrease earlier than in other recoveries

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# Germany: growth gains momentum

	2013	2014	2015 (f)	2016 (f)
<b>Activity</b>				
<b>REAL GDP (% YoY)</b>	<b>0.2</b>	<b>1.6</b>	<b>1.9</b>	<b>2.2</b>
Private consumption	0.9	1.2	1.9	1.8
Public consumption	0.7	1.1	1.2	0.9
Investment	-0.4	3.4	2.2	4.0
Domestic demand (contr. %)	<b>0.7</b>	<b>1.2</b>	<b>1.7</b>	<b>1.9</b>
Exports	1.7	3.8	4.6	5.6
Imports	3.2	3.3	4.9	6.0
Net exports (contr. %)	<b>-0.5</b>	<b>0.4</b>	<b>0.2</b>	<b>0.2</b>
<b>External sector</b>				
Current account balance (% GDP)	6.7	7.5	7.6	7.9
<b>Public finances</b>				
General Govt. Balance (% GDP)	0.1	0.6	0.5	0.3
<b>Prices</b>				
CPI, % avg.	1.6	0.8	0.3	1.4

Source: Eurostat and BBVA Research

Private consumption begins to grow at rates consistent with the favorable labor market conditions

Uncertainty caused by geopolitical conflicts could lead companies to continue delaying their investment plans to 2016

Net exports will play a minor role in contributing to growth

# Germany: strong domestic fundamentals

## Deviation from the EA18 average

Source: BBVA Research and Eurostat

+18.2pp

**GDP** per working age population

Positive divergence with the average of the area is gradually broadening

-2.5pp

**Public consumption / GDP** ratio

Increasing public investment would help correct the current account surplus

+9.9pp

**Employment** rate

Unemployment rate reached a historic low in March (4.7%)



# France: recovery will move up in 2015

	2013	2014	2015 (f)	2016 (f)
<b>Activity</b>				
<b>REAL GDP (% YoY)</b>	<b>0.4</b>	<b>0.4</b>	<b>1.1</b>	<b>1.8</b>
Private consumption	0.3	0.6	1.5	1.4
Public consumption	2.0	1.9	1.0	1.0
Investment	-0.8	-1.6	0.0	3.5
Domestic demand (contr. %)	<b>0.3</b>	<b>0.7</b>	<b>1.0</b>	<b>1.7</b>
Exports	2.4	2.7	4.4	5.5
Imports	1.9	3.8	3.8	5.1
Net exports (contr. %)	<b>0.1</b>	<b>-0.3</b>	<b>0.1</b>	<b>0.1</b>
<b>External sector</b>				
<b>Current account balance (% GDP)</b>	-1.4	-2.3	-2.2	-2.2
<b>Public finances</b>				
<b>General Govt. Balance (% GDP)</b>	-4.1	-4.0	-3.6	-3.0
<b>Prices</b>				
<b>CPI, % avg.</b>	1.0	0.6	0.1	1.1

Source: Eurostat and BBVA Research

The recovery in 2015 and 2016 will be based on domestic factors, especially consumption

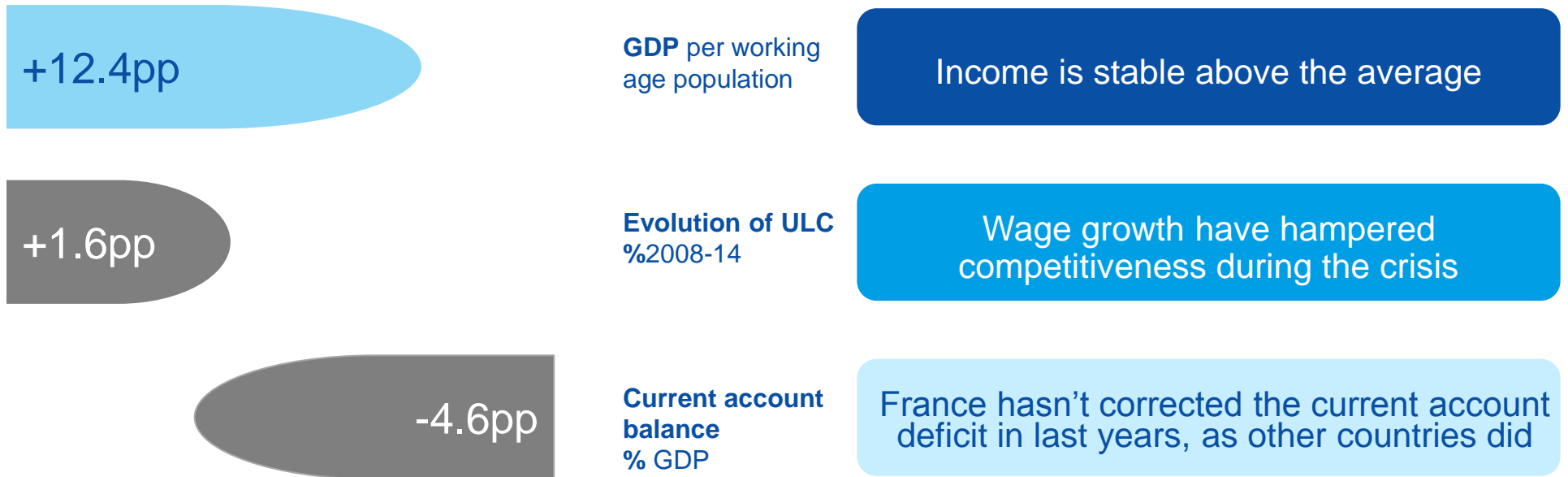
The delay in the deficit adjustment should also help

The loss of competitiveness is the main issue in the medium term

# France: fiscal targets loosening to help economy recover

## Deviation from the EA18 average

Source: BBVA Research and Eurostat



# Italy: out of recession in 2015

	2013	2014	2015 (f)	2016 (f)
<b>Activity</b>				
<b>REAL GDP (% YoY)</b>	-1.7	-0.4	0.7	1.3
Private consumption	-2.8	0.3	0.6	0.8
Public consumption	-0.3	-0.9	-0.5	0.0
Investment	-5.8	-3.2	-0.2	3.0
Domestic demand (contr. %)	-2.5	-0.6	0.1	0.9
Exports	0.7	2.4	4.5	4.9
Imports	-2.2	1.6	2.7	4.0
Net exports (contr. %)	0.8	0.3	0.6	0.4
<b>External sector</b>				
<b>Current account balance (% GDP)</b>	1.0	1.8	2.0	2.6
<b>Public finances</b>				
<b>General Govt. Balance (% GDP)</b>	-2.8	-3.0	-2.6	-2.0
<b>Prices</b>				
<b>CPI, % avg.</b>	1.3	0.2	0.0	0.9

Source: Eurostat and BBVA Research

We continue to expect a slow recovery in 2015 (0.7%), driven by exports

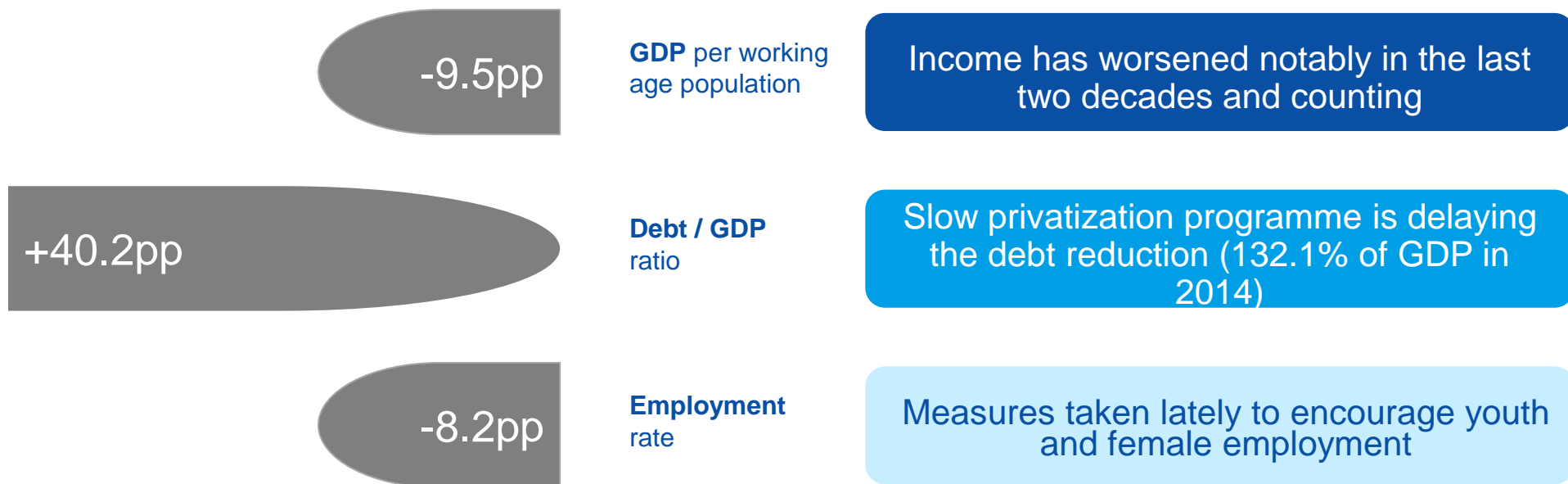
Investment will still be affected by uncertainty linked to the slow pace of reforms

The growth potential is very low but could recover, should fiscal and labour market reforms underway be completed

# Italy: reforms needed to increase the growth potential

## Deviation from the EA18 average

Source: BBVA Research and Eurostat



# Spain: growth revision to the upside in 2015

	2013	2014	2015 (f)	2016 (f)
<b>Activity</b>				
<b>REAL GDP (% YoY)</b>	-1.2	1.4	3.0	2.7
Private consumption	-2.3	2.4	3.1	2.4
Public consumption	-2.9	0.1	0.8	0.6
Investment	-3.8	3.4	5.7	6.4
Domestic demand (contr. %)	-2.7	2.2	3.0	2.7
Exports	4.3	4.2	6.1	7.5
Imports	-0.5	7.6	6.5	7.8
Net exports (contr. %)	1.4	-0.8	0.0	0.1
<b>External sector</b>				
<b>Current account balance (% GDP)</b>	1.4	0.1	0.9	1.0
<b>Public finances</b>				
<b>General Govt. Balance (% GDP)</b>	-6.3	-5.7	-4.4	-3.0
<b>Prices</b>				
<b>CPI, % avg.</b>	1.4	-0.2	-0.2	1.4

Source: Eurostat and BBVA Research

Both in 2015 and in 2016, activity will grow steeply, supported by internal and external factors

The recovery in the fundamentals and the change in tone of fiscal policy will contribute to the sustained recovery in domestic demand

The contribution of net external demand to growth will be virtually nil

# Spain: the labour market is improving, but challenges remain

## Deviation from the EA18 average

Source: BBVA Research and Eurostat



# Portugal: domestic fundamentals underpinning growth

	2013	2014	2015 (f)	2016 (f)
<b>Activity</b>				
<b>REAL GDP (% YoY)</b>	-1.6	0.9	2.1	1.9
Private consumption	-1.5	2.1	2.2	1.7
Public consumption	-2.4	-0.3	-0.8	0.4
Investment	-6.7	2.5	3.9	4.2
Domestic demand (contr. %)	-2.5	2.1	1.9	1.8
Exports	6.4	3.4	5.9	5.0
Imports	3.9	6.4	5.2	4.8
Net exports (contr. %)	0.9	-1.2	0.2	0.1
<b>External sector</b>				
Current account balance (% GDP)	1.4	0.6	1.3	1.5
<b>Public finances</b>				
General Govt. Balance (% GDP)	-4.5	-3.7	-2.5	-2.4
<b>Prices</b>				
CPI, % avg.	0.4	-0.2	0.2	1.0

Source: Eurostat and BBVA Research

Strong private consumption will be the main driver of growth

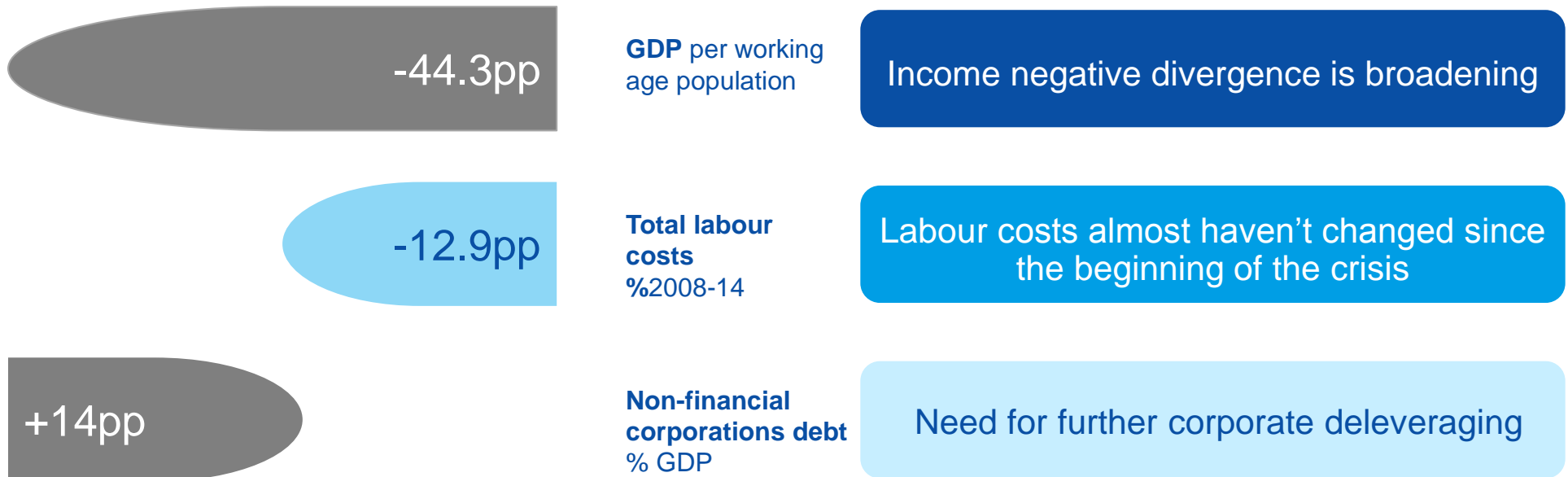
High level in business confidence indicators will be reflected in ongoing recovery of investment

Exports will recover and contribute to growth, though marginally

# Portugal: main challenges: improve competitiveness further and reduce overhang of corporate debt

## Deviation from the EA18 average

Source: BBVA Research and Eurostat





# UK: strong growth in 2015-16, but slowing due to lower support from fiscal and monetary policy

	2013	2014	2015 (f)	2016 (f)
<b>Activity</b>				
<b>REAL GDP (% YoY)</b>	1.7	2.8	2.5	2.3
Private consumption	1.7	2.5	2.4	2.2
Public consumption	-0.3	1.7	0.2	-0.4
Investment	3.4	7.8	4.5	5.6
Domestic demand (contr. %)	1.7	3.3	2.3	2.3
Exports	1.5	0.6	4.9	5.0
Imports	1.4	2.2	4.0	4.4
Net exports (contr. %)	0.0	-0.5	0.2	0.1
<b>External sector</b>				
Current account balance (% GDP)	-4.5	-5.5	-5.1	-4.8
<b>Public finances</b>				
General Govt. Balance (% GDP)	-5.7	-5.7	-4.4	-3.4
<b>Prices</b>				
CPI, % avg.	2.6	1.5	0.3	1.7

Source: Eurostat and BBVA Research

Strong domestic demand will continue to be the main support for growth...

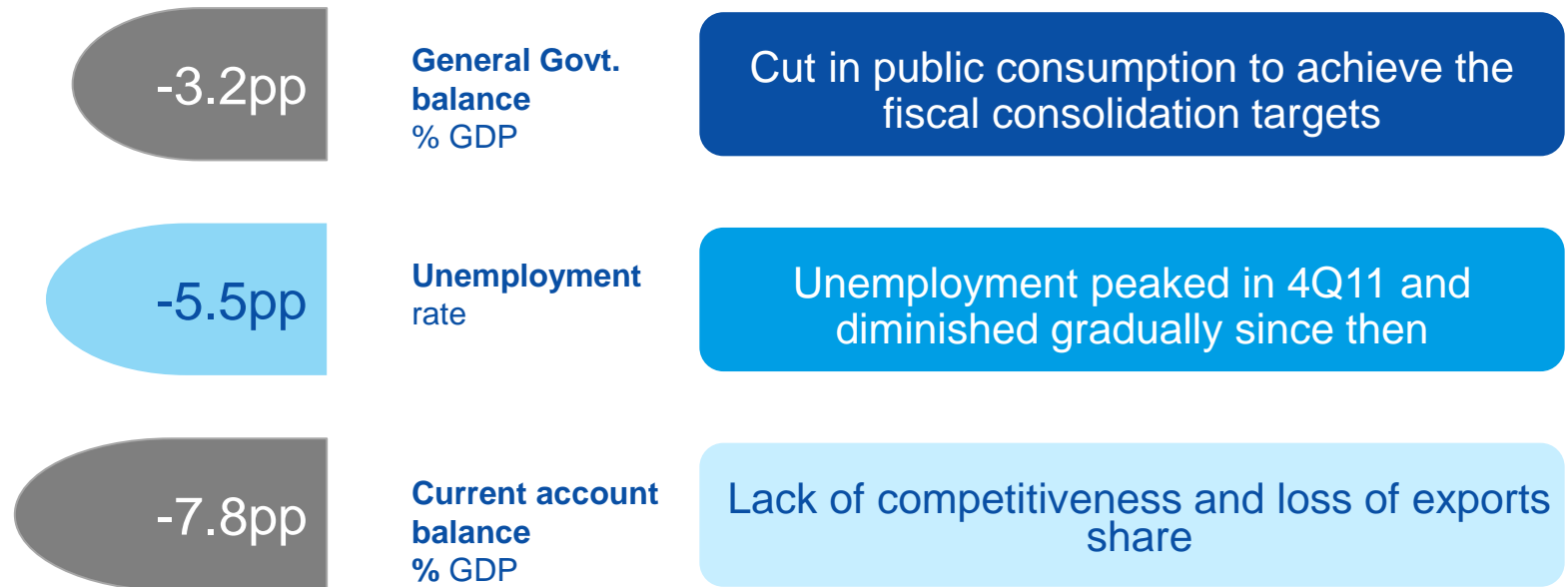
... while net exports will again make a small positive contribution

Domestic demand, the pace of inflation and the impact of Fed decisions on the pound will determine the date of the first hike of BoE Bank Rate

# UK: job creation relatively strong, with composition changes towards more productive workers

## Deviation from the EA18 average

Source: BBVA Research and Eurostat



# Europe Outlook

Second Quarter 2015

