Europe Economic Outlook

Third quarter 2015
Europe Unit

- The eurozone's pace of recovery is holding up, despite some weakness among emerging markets and a more limited run in the euro's depreciation
- We expect a gradual upturn in inflation, although this will still be short of 2% in 2016
- The ECB will keep up its rate of bond purchases until September next year
- Greece has managed to avoid leaving the euro, although challenges still lie ahead. The Greek crisis will prompt debate over the future of the euro in the coming months

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Closing date: 30 July 2015

1 Editorial

The eurozone economy has been marked by the flow of news linked to the crisis in Greece in the past few months. Beyond this, **the economy has been growing at a rate that is generally in line with our forecasts, though with a mild downward bias**: our forecast scenario of a gradual recovery of activity during 2015 has been the case, but with marginally worse than expected figures in the first quarter and a less clear-cut acceleration than we would have liked to see over the first half of the year. The factors behind these doubts are fundamentally external ones: exports were weak at the start of the year and, although they have made a distinct recovery since then, which has been a reflection of the euro depreciation in the past few quarters, they have also been affected by somewhat weaker than expected growth among the emerging markets, dragged by China.

Yet **the mainstays of activity persist going forward: the neutral and very lax tone of fiscal and monetary policies respectively remains**, while the oil price will continue to support activity. With respect to monetary policy, the ECB has kept up its rate of bond purchases in line with expectations, and we expect it to adhere to the scheduled duration of its programme, up to September 2016. **With regard to oil, the recent falls in its price seem to be more influenced by supply-side factors** (the deal with Iran and the resilience of shale-oil production in the US) than demand-side, and our new path (which foresees prices of around USD61/bbl on average in 2015 and USD69/bbl in 2016) is 7% below our previous forecast. This could support consumption and investment in the eurozone.

Even so, **two factors relating to the external sector lead us to lower our forecast for 2016 slightly**: **greater than expected weakness in the Chinese economy** for this year and the next, which will weigh on other emerging markets and translate into lower external demand; and **the euro exchange rate**, which, although it has remained at low levels against the dollar with respect to 2014, seems to have bottomed-out and should thus not depreciate any further, as we were predicting before. To summarise, a less depreciated euro and less robust external demand have led us to reduce our growth forecast by 0.3pp for 2016, to 1.9%, which is quite a respectable level and still above the analyst consensus forecast. Turning to inflation, we do not see any material changes. We do not think that lower commodity prices will give rise to new deflation risks, although they will cause inflation levels for 2016 to remain some way off the ECB's implicit target.

Over the next few months the Greek crisis will remain the focus of attention in Europe, together with the debate that this might trigger over the future of the eurozone and which in fact is now being outlined. The agreement on a third bailout means that Grexit is now a more remote possibility and is positive in that it focuses the conditional aspect on structural reforms rather than on fiscal adjustments, although it does leave a lot of issues unaddressed, which means that a mishap is still a possibility. One such issue, and perhaps the most important, is the fact that the present Greek government has not assimilated the need for reforms and views and treats them as an imposition on the part of the creditors. If the authorities do not apply this programme to improving the supply-side conditions in the economy, it is hard to see how the country can achieve a sustainable growth path. Another outstanding issue is that of debt restructuring: even though the agreement in early July only envisages relief in terms of conditions without any nominal debt relief, and only from November, the IMF is pushing for the restructuring to be more generous, just as the Greek government has also requested. A radical restructuring does not appear to be key to making the debt sustainable, since most of the debt is currently in official hands, with very long maturities and at very low rates. This makes the debt servicing bill much lower than in other peripheral countries, which it will be for many years hence. Yet it is clear that without the participation of the IMF in the third bailout, its approval by the member states will be more difficult.

A spin-off of the negotiations with Greece has been the debate which has emerged over the future of the euro. Germany's defence of a Grexit at one point in the negotiations, albeit a temporary one, seems to have broken the taboo associated with the irreversibility of the euro, which could entail an unwelcome cost in future episodes of stress. This suggests a need to make inroads into greater integration in the eurozone more rapidly than has been suggested by the relatively slow pace that had been time-tabled previously, as is reflected in the announcements of proposals in this direction by the French government. In this context, the Five Presidents report programmed for discussion in the second half of the year with the December Council meeting in mind will be a good framework for debate that should give rise to more ambitious proposals in the medium term.

2 Moderation in world growth and a marked deceleration in the emerging economies

The growth figures for the major economies confirmed that **world GDP decelerated in 1Q15 by showing the weakest annual rate of growth since early 2014** (2.1% compared to an average of 2.8% for the two preceding quarters) **according to our estimates**. The available activity indicators predict **more dynamic growth in the world economy in 2Q15**, on the back of the recovery in the US (after the stagnation in GDP observed in the first few months of the year), eurozone strength and GDP growth in China of 7% YoY.

Over the forecast horizon, **the developed economies continue to share encouraging growth prospects, which will contribute to mitigate the impact on world activity and trade of the current slowdown among the key emerging economies**. Specifically, while in 2015, the developed nations have the potential to grow at their fastest pace since 2010, at a shade over 2% YoY, the major emerging markets could see weaker growth again for the fifth year in succession. The world GDP is likely to have grown at under 3% YoY in the first half of the year, thus justifying our **downward revision of growth for 2015 as a whole** (3.4%, which is 0.1pp below what we were predicting in April). **Looking to 2016, the world economy could pick up pace and attain growth of 3.8%**.

A hallmark of the global context in the last quarter has been **the manifestation of some of the risk events that we singled out three months ago** and, if they take a turn for the worse, this could bring the global economic recovery to a halt. The first of these involves the **bout of financial instability in China.** This was brought about by the sharp correction of its stock market, within a situation of trend deceleration in growth, which has drawn on substantial borrowing, and a process of financial liberalisation still underway. The second, which is equally significant, is the **Greek crisis**, and the constrains to reach an agreement that ensures that the country will face its financial commitments in the short term, as well as the sustainability of its debt via reforms to enhance the economy's capacity to grow in the long run.

The combination of these two risk events, together with the approach of the Fed's rate hike, has heightened financial disruption the world over, particularly in the form of greater volatility in stock and currency markets, with a heavier impact on the eurozone and Asia. In this regard, **the maintenance of loose monetary policies**, above all in the wake of the implementation of the ECB's public debt purchase programme, is proving decisive. Even so, the risk that we might see a further outbreak of financial volatility when the US rate hike cycle takes place remains high.

The strength of the US labour market and the transient nature of the recent correction of activity continue to suggest that the first fed funds rate hike is set to take place in September. As the Fed continues to say that monetary tightening will be very gradual and the global context has worsened on events in China and Greece, the market is discounting a pace of hikes, and therefore the level of the Fed funds rate in late 2016, substantially below FOMC forecasts. The need for the monetary normalisation process to take place makes the case for 2015 as the year when the first rate hike occurs. Nonetheless, the path of the hikes will be conditioned by the soundness of economic recovery and inflation expectations. We think that any further deterioration in the external environment of the US could delay the lift-off of the hike cycle, which in any event would take the Fed funds rate to a level of 1.50% at the end of 2016. If the Fed chooses a pattern of hikes which is more aggressive than the recovery suggests, the increases in financial volatility could be substantial; however, whatever happens, the room for manoeuvre of the central banks in the emerging economies to make further cuts in rates, which are at historically low levels in most of them, would be minimal given the risk of a reallocation of capital flows towards developed countries.

The **correction of oil price forecasts** due to both supply factors and the slowdown in demand in China could become a burden on the fledgling recovery in consumer prices and lead to heavier falls in industrial and import prices.

The direction of monetary policies, and developments regarding risk flashpoints and the commodities market will continue to set the course for capital flows and, therefore, financial variables. The expected divergence between the monetary policies of the Fed and the ECB, as well as uncertainty over the resolution of the Greek crisis, will continue to bolster the dollar's exchange rate against the euro in a scenario where the long-term yield spread between sovereign assets in the two areas will remain more favourable to the US.

Looking in more detail at the key areas, note the sharp slowdown in the **US** economy, with essentially stagnation of GDP in the first quarter, while the progress made in 2Q15 was only modest judging by the available indicator readings for activity and confidence. The worse than expected first half on balance warrants a **downward revision for growth for 2015 as a whole**, which could amount to 2.5%, or some 0.4pp below the level we forecast in April. The uncertainty over how the economic cycle will perform in the coming quarters has now been heightened bearing in mind the impact of the persistent dollar appreciation on exports, the weakness of private investment and the deterioration in the global situation. Even so, US GDP could grow by 2.8% in 2016.

China has become the focus of attention in the last quarter on account of the sharp correction to its stock market and the potential impact that this might have on both its domestic economic cycle and world growth. For the moment, the first half of the year has produced a 7% increase in GDP YoY, although the pace of the economy's growth is likely to ease up owing to the impact of the recent bout of financial tensions. Besides the negative effect on the confidence of private sector, there might also potentially be some reversal of consumption decisions as a result of the drop in households' financial wealth. More than anything though, **there is likely to be a deterioration in financing conditions for corporates**, which is associated with both the suspension of new placements and the loss of value of collateral backing bank loans. These are the factors responsible for the **downward revision in the growth forecast for China in 2015 and 2016 to 6.7% and 6.2% respectively** (0.3pp and 0.4pp lower than in our April scenario).

Finally, **economic growth in the EMS will slow for the fifth consecutive year**, as a consequence of the deceleration in growth in China and lower commodity prices. These economies – with all the differences between them - are facing an uncertain scenario, with lower demand from China and the approaching increase in the US interest rates, which make financing themselves more expensive. In the coming months, the economic policies dilemmas faced by the EMs will become more evident, as they try to support the domestic cycle while balancing risks of de-anchoring inflation and the lack of external funding, particularly in the more financially integrated economies and those with greater imbalances (See Global Economic Outlook 3Q15).

3 Eurozone: domestic factors are conducive to growth, external drivers less so

Since the publication of our last set of forecasts **three months ago, there have been no substantial changes to the outlook for the European economy, which has been dominated by the Greek crisis. The tone of modest recovery has generally persisted, although there have been certain differences in terms of the exogenous factors** which determine activity levels, and these have already shown through in the figures for the first half of the year, above all on the external side, all of which **leads us to revise our forecasts for both this year and the next down slightly**.

Growth for 1Q15 was 0.1pp worse than forecast, even though the recovery progressed at a modest and stable pace that was based on domestic demand strength. The negative note was the slowdown in the progress of exports, which, rather more than had been expected, was evidence of the deceleration in global demand at the start of the year. The second quarter figures suggest that the recovery should continue to move ahead at this steady speed, meaning annualised rates of a little over 1.5%.

In the past few months, some of the factors which underlie economic growth have taken a turn for the worse, particularly external ones, with the materialisation of the risk of a **deceleration of the emerging economies, especially China**. Added to this, there has been **less of a depreciation of the euro than we had predicted** at the time, even though the weakness it has been showing since the middle of last year will continue to work in favour of export sales. In Europe, **the resurgence of the Greek crisis has added to the financial tensions, although the spill-over to other periphery countries has been limited** thanks to the improvement in European governance over earlier years and the measures set in train by the ECB. For the time being, the situation has been brought back to normality with a third bailout for Greece in the offing, even though we can expect few quarters of uncertainty over both negotiations and the implementation of reforms, as well as, in a wider context, over the future of the European integration project, which could hit confidence and investment harder than expected.

The **other factors** which shape growth **continue to be positive. Fiscal and monetary policy will continue to support the recovery of activity**, with the debate once again emerging over the flexibility of the fiscal adjustment (with fresh proposals for fiscal expansion in Italy), while the quantitative easing programme is already producing a modest rise in inflation expectations and encouraging real interest rates to come down and (tied in with the liquidity provision via the TLTROs) the re-establishment of credit.

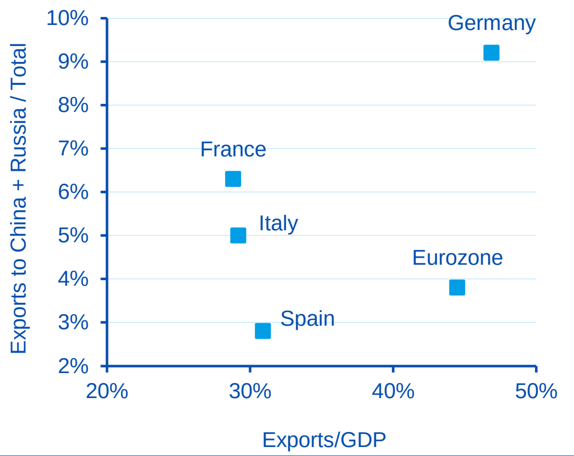
Certain tailwinds are also still blowing a little more strongly, such as the **smaller than expected rise in the oil price**, which seems to be largely due to a supply shock (the end of sanctions on Iran and productivity gains in shale oil production in the US), although this is also on account of a certain dip in demand. This should help to shore up growth a little more, above all by giving a further boost to household disposable income and bringing down energy costs for businesses. The recovery is also being reflected in an improvement in labour market conditions that is both slightly earlier and to a greater degree than expected, which, together with what we said above, means that confidence among economic agents is holding up. All of this suggests a recovery which is a bit more gradual than we were predicting three months ago for Europe (Section 4), although we still expect growth of around 2% for next year, which will allow GDP to reach pre-crisis levels.

Some of the negative factors mentioned above could become risks if the situation deteriorates, above all the Greek crisis, while the Russian-Ukrainian situation remains unresolved. Although the contagion of a potential Grexit is limited, and might be even further reduced via preventive measures, it could mean greater stress that affects activity. Meanwhile, another risk comes from external demand, particularly from emerging markets, which might prove smaller than expected.

The external environment has become a little more negative, added to which there is the euro's greater resilience to depreciation…

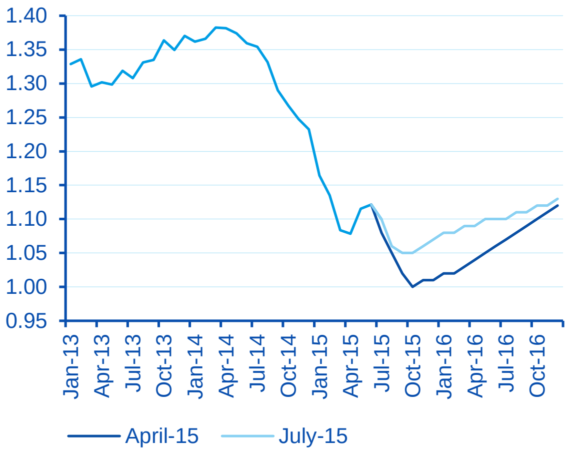
As described in section 2, the **global scenario has become slightly worse in the past three months, fundamentally due to the slowdown among the emerging economies in spite of the gradual improvement among their developed counterparts**. Notable among the factors behind the loss of momentum in the emerging markets are: i) the fall in commodity prices, which, among others, will affect Latin America; ii) the toughening of financial conditions, which is tied in with the Fed's expected normalisation process and the increase in the level of certain risks, and iii) the ongoing slowdown of growth in China. Added to the latter is the foreseeable adverse effect of the recent fall of the local stock market on the real economy, which all means a **downward revision of growth in China of 0.3pp and 0.4pp in 2015 and 2016** respectively. Although the direct impact of this revision on the eurozone is moderate (around 0.2pp in 2016) and entails clear differences across member states (Figure 3.1), the balance of risks still has downward bias on the external side, above all if the Chinese economy ultimately drags down other economies in Asia or Latin America.

Figure 3.1
Exports to China and Russia



Source: Eurostat and BBVA Research

Figure 3.2
EURUSD exchange rate



Source: BCE and BBVA Research

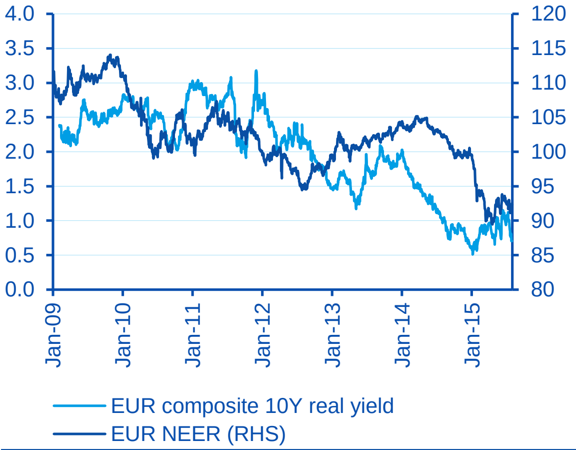
On top of this easing up of global demand, **there is the resilience which the euro has been showing** recently, which contrasts with our forecast three months ago of a larger depreciation (Figure 3.2) and could be attributable to a smaller than initially expected impact of QE on the exchange rate, though also to the increased doubts over a potential delay in the lift-off of the Fed's monetary policy normalisation, and also to loosening by other central banks. Thus, although the euro will continue to support recovery, having depreciated by around 14% since QE was announced and by 23% over the past 12 months, it will do so to rather less of a degree than we were anticipating in our previous forecast. **Since April, the exchange rate has held relatively stable (at close to USD1.10) and we now expect less room to run on the downside over the rest of the year, then a timid appreciation in 2016**, which implies that the euro will be around 5% stronger over the rest of this year and 2016 with respect to our previous scenario, and this could remove around 0.2pp from GDP growth in 2016.

The impact of these factors accounts for practically all of the downward revision of growth for the eurozone in 2016 (Section 4), with differing impacts in individual countries that will lead to more uniform growth rates than in previous years of around 2% (annualised rates), with the exception of Italy. The countries with the largest industrial sector weights and/or which have more openness externally (Germany or the Netherlands) will be the most affected, as has already been illustrated by the fall in exports to China and Russia, which already led to a significant slowdown in activity early this year.

… in a context of a tightening of financial conditions and heightened volatility

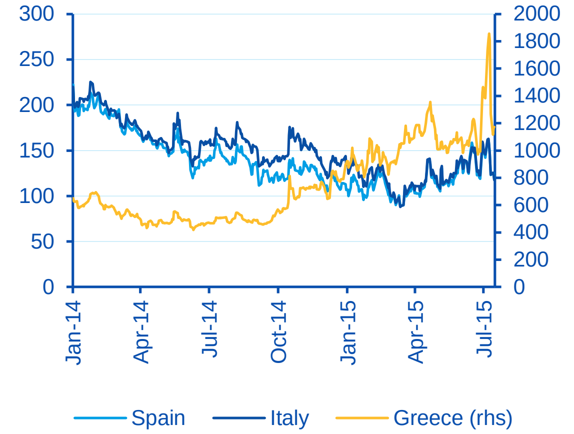
Financial conditions have become tougher in the eurozone in recent months **as a result of the combination of higher yields on long-term interest rates and euro appreciation** (in effective terms) (Figure 3.3). The rise in interest rates at the long end was especially sharp at the start of the quarter, with the rate on the German Bund spiking above 80 basis points from levels of close to zero in the first quarter of the year. This upturn was largely due to a correction from abnormally low levels after the scenario of deflation had clearly faded, but there are also technical and liquidity-related factors which ought to explain the abruptness of the movement. Rate rises in the eurozone have allayed fears of negative interest rates (which had spread to the long end of the curve in the previous quarter and a number of countries within the area), while this has produced a bandwagon effect on interest rates in other geographical areas. The tightening of financial conditions is an element for the ECB to keep a watch on, so it does not constitute any brake or hindrance as regards economic recovery.

Figure 3.3
EMU: interest rate (%) and nominal effective exchange rate



Source: Bloomberg and BBVA Research

Figure 3.4
10Y bond yields (bp)



Source: Bloomberg and BBVA Research

The risk of Grexit has been a temporary burden on risk premiums and stock markets. Risk premiums on the periphery have increased (Figure 3.4) and lows have been left behind, but there have not been any major upturns despite the high risk of Greece leaving the euro. Bank risk flipped up too, in line with sovereign risk. Stock market falls were significant (also coinciding with the sharp correction of the Chinese stock exchange), although they bounced back after a deal was reached with Greece. In the final analysis, it can be said that in recent months financial assets have recorded high volatility in the eurozone, although without settling at extreme levels indicative of either financial stress or the creation of speculative bubbles.

Liquidity conditions for the banking system are still very encouraging, because of both funding facilities via the ECB and issuance on wholesale markets, where activity is **on the road to recovery after the brakes were slammed on over the weeks when tension over Greece was at its height**.

The launching of the third bailout is keeping Greece in the euro, although uncertainty will linger in the coming months

Events moved faster in the Greek crisis in June and early July after almost six months of deadlocked negotiations. After all but clinching a deal at the end of June on reforms to be implemented to conclude the second bailout programme, and to obtain the final tranche of aid and thereby head off a default with the IMF in late June, **the Greek government called a referendum, in which the choice which it was championing won** (a NO to the conditions proposed by the creditors). **It nonetheless failed to avert a default with the IMF and the imposition of capital controls** via a freezing of liquidity provision to the banks through ELA. After this victory, and to **avoid Grexit, the country accepted new conditions at the beginning of July** (which were even harsher than those rejected in the referendum) **in exchange for the launch of a third bailout** over three years of EUR85bn, **which is currently being negotiated.** This includes the recapitalisation of the banking system, to be determined by the European regulator in an assessment after the summer. Meanwhile the capital controls are being maintained.

The new situation has some positive aspects: **Grexit has been avoided**, at least for the moment, despite pressure from Germany at certain points during the negotiations. Furthermore, the **new agreement is more centred on structural reforms** (labour market, reform of the legal system, markets for goods and services) than on greater fiscal adjustment (even though this does not disappear). This matters because at the heart of Greece's problems is one issue that fundamentally concerns supply, and this way there is recognition that **it needs to make further progress in improving its productive structure**.

Even so, **several doubts still linger**, for which reason the possibility of an eventual **Grexit cannot be ruled out**:

- The **Greek government continues to withhold its support for the reforms**, which it considers are an imposition that it has been forced to accept to avoid leaving the euro. Without any genuine adoption of the programme of reforms, implementation of the changes is unlikely to be handled properly.
- The matter of **debt restructuring is still unresolved** and will be negotiated after the initial review of the third programme, which takes us up to the end of the year. The Greek government and the IMF are in favour of a haircut, yet this has been ruled out in the agreement, and the lightening of the debt burden will once more be effected by means of a further reduction of interest rates, the extension of loan maturities and grace periods. This ought not to represent any obstacle to recovery, as the sustainability of the debt has not been compromised in the short or medium term, with almost all of it in official hands and an interest-to-GDP ratio which is lower than in other periphery countries (thanks to the low rates and very long repayment periods which have been applied). **This is clearly a political issue though, and could complicate the IMF's involvement in a third bailout**.
- **The negotiations** over the details of the third bailout **will not be easy**, due to the first point mentioned above, as well as the political climate in Greece (where there seems to be a rift within the governing party and elections are highly likely in September or October), and because the economy slipped back into recession during the first half of 2015, given the paralysis of activity by a government more focussed on negotiations and the lack of confidence in connection with a potential Grexit. **The date set for the agreement (20 August) will not be easy to meet and an additional bridging loan could become necessary**.

Thus, even though Grexit has been averted for the time being, the likelihood of it still happening has not disappeared. Such an event would have a certain spill-over effect on the other eurozone countries in the short term, which poses a risk to European growth, although this should be limited, since: i) the macroeconomic situation of the other countries has been turned around more than was the case in 2012 (positive growth and smaller budget and external imbalances); ii) the banking union process is more established, and iii) the ECB's instruments for enforcing containment remain in the frame.

The lower oil price reinforces domestic factors

The dive in the oil price since the middle of last year appears to have been interrupted in the second quarter this year in line with our earlier forecasts, although **we now expect a more gradual rise for the Brent price**. This is due to the fact that we foresee **lower global demand, although this is mostly because of supply factors**. First, the ending of sanctions on Iran will lead to an increase in the short-term supply, while over a longer timeframe this will emanate from gains in productivity within the shale oil industry in the US.

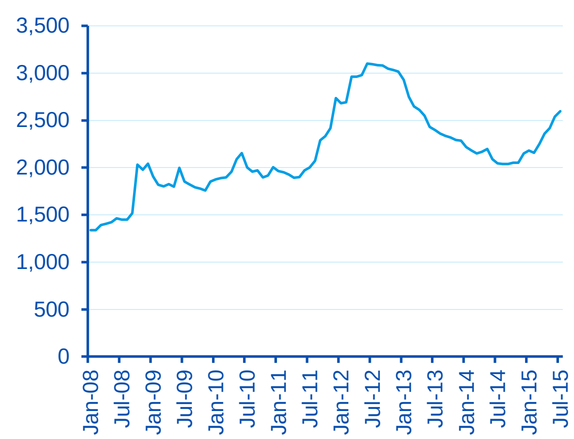
We have consequently revised our course for the oil price in 2015 down slightly to USD60.90/bbl for Brent (which is -1.3% against our previous forecast of three months ago) and to USD69.00/bbl in 2016 (-7.4% after revision). If we add to this the fact that we now expect a somewhat stronger euro, this would translate into euro oil prices around 4% and 10% lower in 2015 and 2016 respectively than we predicted three months ago, and we estimate that these **could boost growth in 2015-16 by between 0.1pp and 0.2pp** via greater household disposable income, since they would also **reduce inflation by around 0.2pp in 2016**. The lower energy price for businesses would also feed through into higher profits (given the strength of domestic demand) and contribute to encouraging investment decisions, which are key to the second phase of recovery in 2016.

The ECB: resolute about implementing QE and ready for any contingencies

After almost five months since the start of bond purchasing (the APP), the **ECB has bought up a total of EUR300bn in line with the monthly target that it set in advance** (EUR60bn a month) (Figure 3.5). In May and June, the target was slightly exceeded (by EUR3bn in each month), which is something that can be interpreted as indicative of a bit of advance buying, given the lower liquidity levels in the summer months. As might have been expected, the purchases focus very much on government bonds (80%), while those of private assets (ABSs and CBs) are practically at token levels. With respect to geographical distribution, the purchasing virtually echoes each country's share in the ECB's capital (as had already been announced). The average maturity of purchases, however, has been uneven among countries, with longer terms for those bonds of periphery countries that have been purchased (9.7 years), compared to an average of 7.5 years for core countries. These are in any case long terms, averaging 8 years (Figure 3.6). In brief, it is evident that the **purchases of public sector bonds have proved to be the genuinely effective method for the ECB to achieve a significant expansion of its balance sheet**, given that the fourth TLTRO auction only saw moderate take-up (EUR73.8bn, which was barely 21% of estimated potential demand).

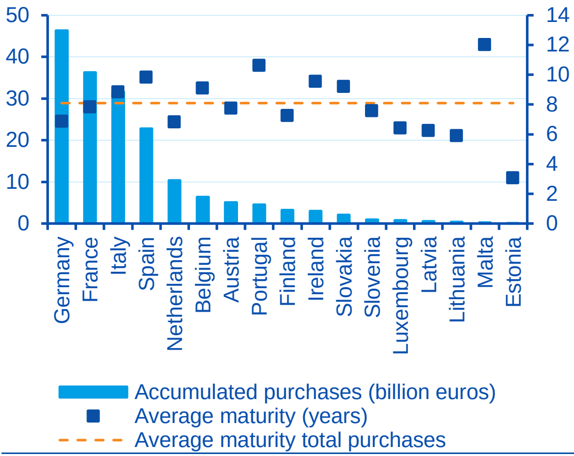
The ECB remains adamant in its message that it intends to implement the approved measures in full, which is reinforced by letting it be known that it is ready to take further measures (or to avail itself of the flexibility provided for it by the purchasing programme). Thus, in spite of the recovery of inflation expectations and inflation figures in these recent months, the ECB has not shown any sign of making an early exit from its QE programme. In our opinion, such caution is more than justified in view of the downward biases regarding growth, low levels of inflation in the eurozone and uncertainty over the impact which the Fed rate hikes could provoke in markets. In fact, on the subject of inflation, we will once again have to watch out for movements in energy prices and how these have an impact on medium- and long-term inflation prospects. **We are therefore standing by our forecast of the bond purchase programme being maintained until September 2016**.

Figure 3.5
ECB balance sheet (EUR bn)



Source: ECB and BBVA Research

Figure 3.6
EBC bond purchase



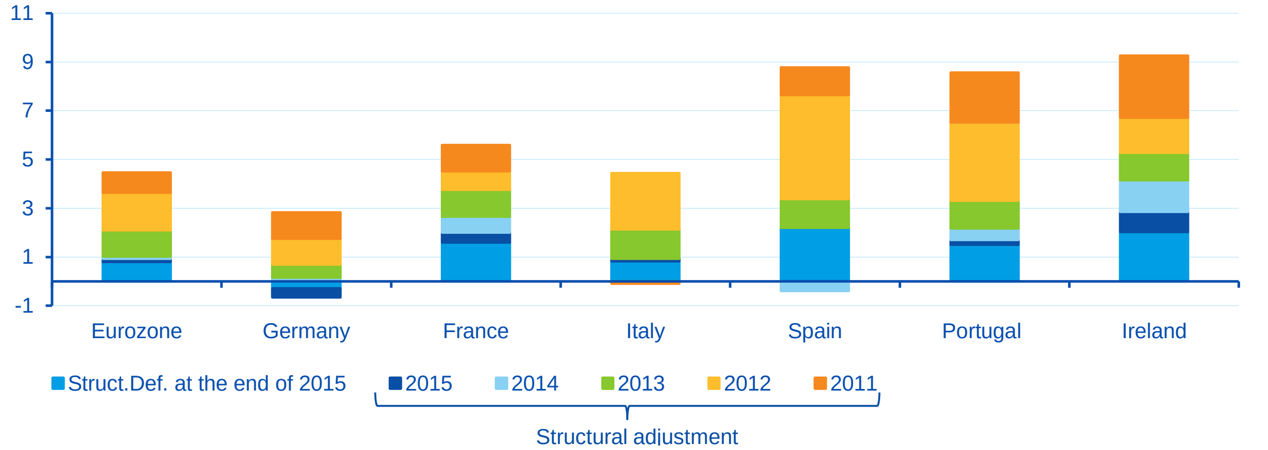
Source: ECB and BBVA Research

Fiscal policy remains neutral, while the debate continues over adjustment flexibility in exchange for reforms

Fiscal policy will not put a brake on growth in 2015, as the fiscal adjustment will be marginal and very similar to that observed last year, which was already far smaller than those carried out in the three preceding years. Figure 3.7 shows the structural balance adjustments planned for several countries in the eurozone which exhibit this trend. **In the past quarter, the approach of relaxing the fiscal effort gained traction (above all, if this was being made due to cyclical factors) in exchange for structural reforms being carried out.** This came with the approval last March of France and Italy's consolidation plans, which meant postponing the meeting of the target in France's case and omitted the requirement of applying further adjustments in the case of Italy.

In Italy, over the past three months news has been generated on the fiscal front. On the one hand, the freezing of public sector wages has been declared unconstitutional, which could add about 0.4pp to the deficit in 2015, taking it to 3% of GDP. Despite the fact that this implies a reduction of the fiscal margin included in the rules (0.5% of GDP), **the prime minister has proposed cutting taxes by** EUR50bn up to 2018 (of which EUR18bn is likely to have been carried out in 2014-15) **and for the moment the European Commission has not shown itself to be very unwilling as regards the suggestion, in the light of the new rules on increasing flexibility** and despite Italy's high level of public debt. In the short term, with the QE programme underway and low interest rates on debt (and if some kind of debt relief is finally adopted in the case of Greece), this window of opportunity (the slowing down of adjustment) could be exploited to incentivise reforms that both ensure greater growth in the medium to long term and facilitate the sustainability of public debt, above all when some of the current stimuli start to be withdrawn.

Figure 3.7
Structural deficit adjustment 2010-15 and structural balance in 2015 (% of GDP)



Source: IMF and BBVA Research

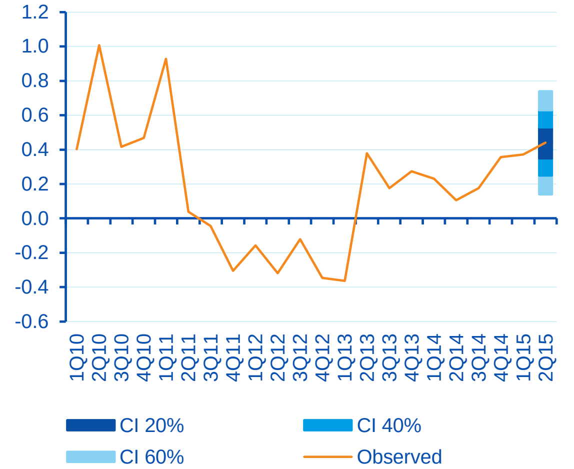
4 Outlook: the pace of recovery is firming up

Domestic factors continue to support growth in 2Q15

After the sound improvement in domestic demand in early 2015, from both private consumption and investment, the latest information suggests that domestic components are likely to have continued to support the recovery in the second quarter, albeit a little less convincingly than in 1Q15. The external sector, however, should have made a positive contribution to growth again after the disappointing performance by exports as the year got underway.

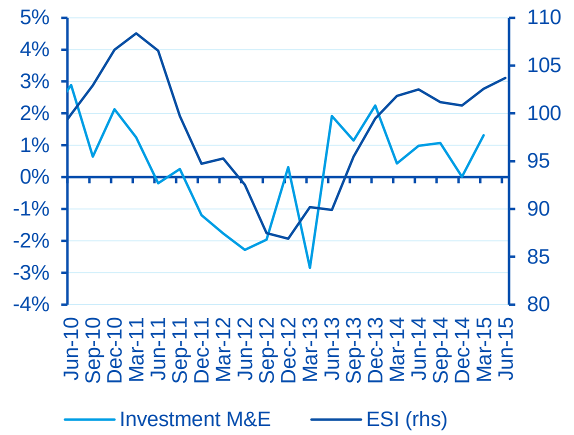
With all the confidence figures and two-thirds of the real data available**, our MICA-BBVA short term model estimates quarterly GDP growth of 0.4% QoQ in 2Q15 for the eurozone** (Figure 4.1), which would mean that it has held steady with respect to the previous quarter (0.4% in 1Q15). Across countries, Spain is likely to have led the way in the recovery process with growth of 1% QoQ, followed by Germany with 0.5% QoQ, while Italy should have grown at around 0.4% QoQ and expansion in France probably dampened to a rate of 0.3% QoQ.

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



Source: Eurostat and BBVA Research

Figure 4.2
EMU: M&E investment and ESI confidence



Source: Eurostat and BBVA Research

Private consumption recovery is confirming its credentials as the key driver of domestic demand

Since the middle of last year, eurozone private consumption growth has held relatively steady at around 0.5% QoQ. The main spending indicators suggest that household consumption ought to have eased up a fraction in 2Q15. Thus it is that, despite the solid restoration of consumer confidence on the back of the gradual improvement in the labour market, retail sales are growing less robustly than in 1Q15 and car registrations have ground to a halt, which would appear to indicate that private consumption offers growth rates of close to 0.4% QoQ for 2Q15, after 0.5% QoQ in 1Q15.

On the forecast horizon, **household consumption outlook continues to be encouraging,** thanks to expectations of a progressively better labour market and moderate inflation, which will translate into higher disposable income. As a result, **consumption should gather momentum in 2015 (1.7%, after 1% in 2014) and stick to roughly these growth rates in 2016**.

The return to confidence is key to consolidating investment

After a very volatile first half in 2014, that was partly associated with geo-political events, the remarkably steady increase in investment over the latter half of the year and the first quarter of 2015 points to a sustainable recovery over the forecast horizon (Figure 4.2). Despite the Greek crisis flaring up again and more doubts appearing in connection with the slackening of external demand, confidence remains at a high level, while the factors that underlie investment decisions continue to gain in strength. Comparatively robust domestic demand, added to lower commodity-related costs, indicate that profits should climb in the coming quarters. On top of this, corporate capacity utilisation is now at historically high levels within a scenario of benign financing conditions. All of this leads us to **revise our investment growth forecasts up for 2015 as a whole by 0.4pp to 1.9%. For 2016, we continue to envisage a considerable upturn, to 3.9%**, although this is approximately 0.4pp less than we were expecting three months ago, due to both a base effect and the ultimate impact that doubts could have on investment decisions which relate to the moderation of external demand, as well as uncertainty over the handling of the Greek crisis.

A marginal fiscal adjustment on an aggregate level should help public sector consumption to support growth in 2015-16

The latest data on budget implementation show encouraging progress, and the economy should be on track to hit the new official targets. Nonetheless, the room for manoeuvre to achieve these targets has diminished if we compare this with our forecasts of three months ago, mainly as far as these concern Italy, where there could be a substantial impact from the fact that one of the central measures to be applied in the 2015 budget was declared unconstitutional (the freezing of public sector wages, which has been effective since 2010), as well as with respect to the somewhat less encouraging economic progress in the eurozone in 2H15. Despite this, the fiscal adjustment will be marginal. According to our estimates, the **fiscal deficit for the eurozone overall should continue to come down in 2015 and 2016 to 2.2% and 1.8% of GDP respectively** (i.e. 0.1pp and 0.2pp more with respect to our previous estimates), after 2.4% in 2014. Bearing in mind that fiscal policy is practically neutral, **public sector consumption should manage to grow at around 0.8% in both 2015 and 2016** (after 0.7% in 2014).

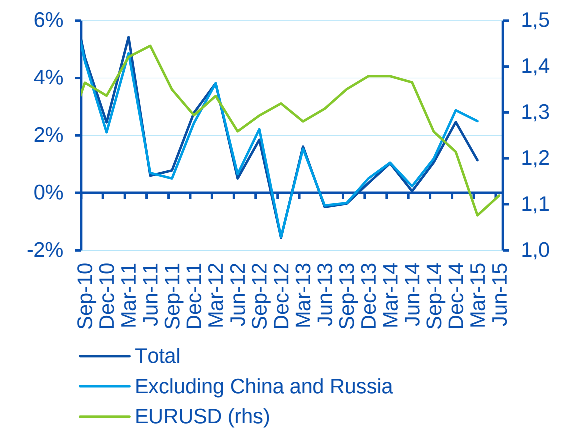
The slowdown in global demand and rising imports are limiting the contribution to growth of net external demand

Last year, exports kept up solid growth (3.7%), driven by the euro's depreciation and by lower domestic prices. In 1Q15, the loss of momentum by exports was a little disappointing, above all because it apparently did not do justice to the rise in manufacturing orders from abroad and thus suffered more than expected from the slowdown in the emerging economies (Figure 4.3). Although we expect **something of a recovery for exports, a rather less cheerful global outlook and a euro exchange rate that is proving a bit more resilient than we thought** (Section 3) **prompt us to revise export growth down** by 0.8pp for 2015 and 2016, to 4.4% and 5.1% respectively.

Imports increased a little more than expected in 2014 (4%), which was in keeping with what was a decent performance by domestic demand. For our forecast horizon, **the pick-up in private consumption, added to the steady improvement in investment-related procurement, will mean that imports will continue to gather pace in 2015 and 2016,** growing at 4.8% and 5.6% respectively.

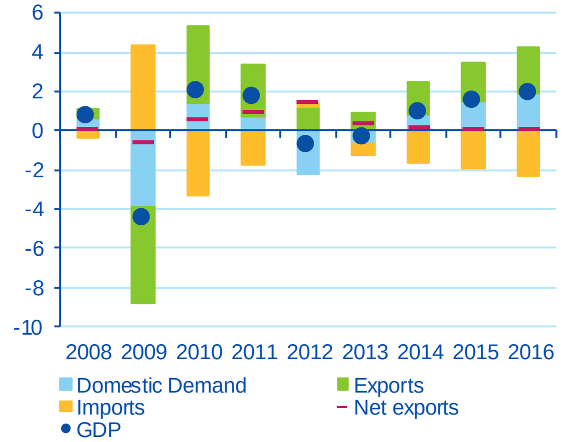
All-in-all, external demand should make a virtually negligible contribution to GDP growth in both 2015 and 2016.

Figure 4.3
EMU: exports (% QoQ) and exchange rate



Source: Eurostat and BBVA Research

Figure 4.4
EMU: contribution to annual GDP growth (pp)



Source: Eurostat and BBVA Research

Widespread recovery across the eurozone

Giving due consideration to all the factors mentioned in the previous section, **we are revising our central scenario downwards slightly (-0.1pp) to 1.5% in 2015, basically on account of the more muted tone than was expected, which has been noted in the first half of the year, and since we can see that the momentum of the global and eurozone economies is not going to lead to any offsetting effect in the second half**. The revision becomes distorted, mainly by a larger contribution from domestic demand (+0.2pp to 1.5pp) that arises from the lower oil price, which will mean lower costs for businesses and low inflation, as well as from better financial conditions, which should provoke economic agents to decide to consume and invest. Nevertheless, this improvement is not likely to make up for developments regarding the external sector which, owing to a slowdown in exports, should cease to make any contribution to growth (0.3pp down on our last forecast). We expect this to extend over the forecast horizon, given the less encouraging outlook for global demand (Section 2), and **we are also revising down our growth forecast for 2016, by 0.3pp to 1.9%**, which basically should continue to rely on the contribution from domestic demand (+1.9pp) (Figure 4.4).

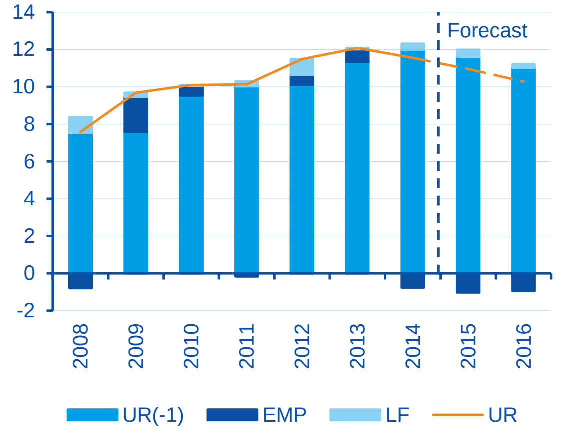
After the fine performance across the board by the eurozone economies at the start of the year, we predict that sound growth will continue on the periphery, while this will be more modest in France and Italy in the coming quarters, although our scenario sees more even rates of progress among the constituent countries over 2016, with the exception of Italy, at around annualised rates of 2%. Within our outlook, Spain will take up the baton from Germany as the economy that exhibits the largest growth in 2015-16. On the other hand, Italy will grow at a moderate rate in 2015 after three years of negative rates, while the French economy should speed up its growth from this year. For a more in-depth analysis, see the countries table further below.

The improvement in the labour market continues

During the first half of the year, the general pattern which had already been noted over 2014 persisted, with a 0.3pp reduction in the unemployment rate to 11.1%, due to the fact that employment continued to rise at a relatively steady rate (around 0.2% QoQ since early 2014), while the labour force remained fairly stable.

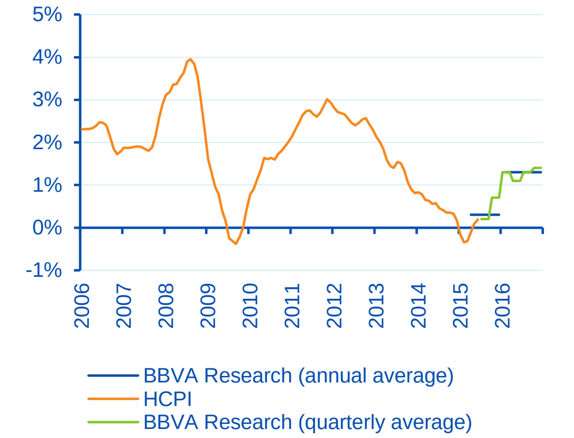
Over the forecast horizon **we expect this improvement to continue, with employment growth of approximately 1% a year**, which will be reflected in a further fall in the unemployment rate to 10.4% on average for 2016, after 11.6% in 2014 (Figure 4.5).

Figure 4.5
EMU: unemployment and breakdown by component (%)



Source: Eurostat and BBVA Research

Figure 4.6
EMU: observed and forecast inflation



Source: Eurostat and BBVA Research

Inflation will flip up at the end of 2015, although it will remain clearly below the ECB target in 2016

After the low figure registered in January (-0.6% YoY), headline inflation picked up gradually to 0.2% YoY in June, which is a bit more than we were predicting three months ago. The principal cause of this mild surprise was the slowdown in the fall of energy prices, although the upturn among foods was influential too, while core inflation, on the other hand, held relatively stable at around 0.7-0.8% YoY in the second quarter, which was in line with our scenario.

For the remainder of the year, inflation is likely to remain unchanged or to edge up in 3Q15, and it will not be until 4Q15 that a bigger upturn becomes noticeable, to around 1%, owing to the disappearance of the base effect from energy prices (after the sharp fall in late 2014). Meanwhile, core inflation should also stay at current levels in the next few months. All of this prompts us to **revise our forecast for average inflation in 2015 up to 0.3% YoY and to leave our prediction of an upturn to 1.3% in 2016 unchanged,** which is a level some way below the ECB's target (still at rates of under 1.5% at the end of next year), although the low point should have been left behind and the risk of deflation has diminished (Figure 4.6). Nonetheless, the recent developments in commodity prices, particularly oil, impart a downward bias to the course of inflation in the short term.

Eurozone member states: detailed analysis

Germany: despite betraying signs of the global economic slowdown, the strength of domestic fundamentals should manage to underpin relatively stable growth of around 2%

(GDP: +1.5% in 2015, +1.9% in 2016)

Recent data: after a start to the year that was worse than initially expected, the most recent figures suggest that the economy will gain a bit of traction in 2Q15 (+0.5% QoQ, after +0.3% QoQ). Industrial production and exports should continue to encourage investment in the second quarter. Low inflation and household confidence, which is at high levels as a result of heartening progress by the labour market, should give rise to increased private consumption, as is suggested by the retail sales figures. Nonetheless, this rise in domestic demand will serve to lift imports, for which reason the contribution of net exports to growth ought to continue to be minimal, despite something of a recovery in exports in 2Q15.

Outlook for 2015 and 2016: domestic fundamentals will be key to how growth progresses in the German economy. The moderate inflation rate, together with the sound health of the labour market, ought to produce a significant rise in consumption in 2015 and relatively stable growth in 2016. The uncertainty prompted by the resurgence of the crisis in Greece and the thus far unresolved geo-political conflicts (Russia-Ukraine) could bring about the postponement of investment plans, which would in turn be conducive to more moderate growth in 2015. On the other hand, the slowdown in global demand, chiefly from the emerging economies, in combination with a more resilient euro than we were expecting three months ago, will be reflected in more modest sales abroad. As a result, net exports could ultimately come to drain activity in 2015 and make no contribution to growth in 2016, which, on top of the disappointing figures from the beginning of the year, would lead to a 0.4pp downward revision of growth for this year to 1.5%, as well as one of 0.3pp for 2016, to 1.9%.

Fiscal policy: the slight downward revision of growth for the German economy would imply minor adjustments to the forecast for the fiscal variables, with a fiscal surplus of 0.3% of GDP in 2015 (0.2pp less than was predicted three months ago) and a small fiscal deficit of 0.1% in 2016. Under this scenario, public debt will continue to come down to about 71% of GDP in 2015 and 70% in 2016.

France: growth will be more even in 2016, with investment taking over from the strong support provided by consumption

(GDP: 1.3% in 2015, 1.7% in 2016)

Recent data: after the fine start to the year, the key confidence and activity indicators suggest more moderate growth in 2Q (0.3% QoQ, after 0.6% QoQ in 1Q15). The economic confidence indicators, both on a national level as well as those of the Commission, point to a poor quarter for industrial production and do not presage any signs of a recovery for investment. The PMIs, which confirm the weakness of the recovery in the manufacturing sector, conversely indicate progress in the services sector and therefore a bit of strength in domestic spending, which is probably also suggested by the sound performance of retail sales. The low inflation and buoyancy of household confidence should continue to underpin private consumption, with family spending practically stable in recent months. Although the minor correction in the trade deficit confirms that exports have improved, we can expect the contribution of net exports to growth to continue to be negative.

Outlook for 2015 and 2016: our scenario envisages a slightly more moderate recovery than for the eurozone as a whole, where growth will continue to be driven mainly by consumption this year, both public and private. The stabilisation of the labour market, together with low inflation, should spur on household consumption, while the slowdown of the fiscal adjustment ought to allow public consumption to continue to advance at relatively stable rates of around 2% QoQ (seasonally adjusted annualised rates), although support of this kind will tend to fade away in 2016. Investment is still failing to show clear signs of recovery after stabilising, but the improved confidence since the start of the year, the strength of domestic spending, the timid reforms in progress and the consolidation of eurozone recovery, in conjunction with better financial conditions, should between them allow there to be a notable lift-off in investment in 2016, which will take over after a slowdown in consumption. On the other hand, the deceleration of the emerging economies should have less of an impact on the French economy, given that it is less open (than Germany or the countries in northern Europe) and almost half of its exports go to other member states. Nonetheless, a good performance by exports will not be enough for the external sector to make a positive contribution to growth, because the improvement in domestic demand, especially investment, will pave the way for an increase in imports and this will outweigh the recovery of exports. In spite of this, we are revising 2015 growth upwards by 0.2pp to 1.3%, above all due to the base effect of the upturn in activity in 1Q15, while we are only cutting the forecast for 2016 by 0.1pp, to 1.7%.

Fiscal policy: the latest data on budget execution is confirming our forecasts, so we are standing by the prediction that the deficit for the public authorities in 2015 will be 3.6% of GDP, which is a shade under the shortfall of 3.8% estimated by the government. The structural adjustment for this year (0.4pp) is based on the measures established in the responsibility pact last year, which mainly relate to a significant effort to make savings which will more than make up for the reduction in taxes and employer’s contributions which companies face. For 2016, the deficit should continue to come down, reaching a level of 3%, and this is likely to be attributable in equal proportions to the cyclical improvement for the economy (0.3pp) and a new fiscal adjustment (0.3pp). In line with this scenario, public debt should arrive at 97.3% of GDP in 2015, and top off at 97.5% in 2016.

Italy: oil and ongoing reforms are encouraging a bigger role for domestic demand in recovery

(GDP: +0.7% in 2015, +1.3% in 2016)

Recent data: the Italian economy could have managed to keep up its pace of growth in 2Q15 (0.4% QoQ, after +0.3% QoQ in 1Q15), with the latest available figures pointing to a recovery of private consumption. In spite of the slowness of improvement in the labour market (the unemployment rate is still high, at 12.4%), low inflation and less fiscal pressure on incomes at the low end continue to be reflected in the rally in confidence among households, whose propensity to consume is having a positive impact on retail trade. The improvement in economic confidence suggests that the rise in industrial production and export orders ought to encourage investment, while net exports should start to make a positive contribution to growth, given the steady rate of growth of exports.

Outlook for 2015 and 2016: our forecasts envisage moderate growth for the whole of 2015, which should gather momentum next year (0.7% and 1.3%, respectively). 2015's growth should be based not only on the contribution from exports, but also the gradual recovery of investment and private consumption as a result of the high confidence levels, tax cuts and low inflation. The weight of the external sector in growth should lose significance as the progressive recovery of domestic demand will give rise to a sustained increase in imports. The first signs of the structural reforms that were announced, and are aimed at improving the business climate, should emerge in 2015 and be confirmed next year with an expansion of investment, thanks also to the better financing conditions as a result of the ECB's measures.

Fiscal policy: although the latest fiscal data are still encouraging, the declaration that the measure which involved freezing public sector wages with effect from 2010 is unconstitutional could have a negative effect on the deficit this year. Given that the impact could be close to +0.4pp, our new fiscal forecast puts the deficit at 3% of GDP in 2015 and 2.4% next year, which would in any event not prevent the government from keeping inside the limit of 3%. The central concern is actually still the high volume of public debt (132.1% of GDP in 2014), which, according to our forecasts, should peak in 2015 (134.8%) and then descend to 133.4% in 2016. These forecasts take account of the privatisation scheme for public companies which the government has been pursuing since the end of 2013 (although with longer delays than had been expected), so as to comply with the Fiscal Compact rule on debt reduction from 2018.

Spain: growth has reached its peak speed, supported by domestic and external factors

(GDP: +3.2% in 2015, +2.7% in 2016)

Recent data: the Spanish economy moved ahead by 1% QoQ in 2Q15, 0.1pp more than in the preceding quarter. With respect to composition, partial short-run indicators suggest that both domestic and net external demand should have made positive contributions to quarterly growth (0.9pp and 0.1pp respectively). The private sector accounts for most of domestic demand's recovery as, on the one hand, the rise in disposable income and net households financial wealth, the positive trend in consumer confidence and the expansion of consumer credit are all likely to have encouraged household spending, while on the other hand the greater traction of exports and growth of domestic demand were probably the factors underpinning the fine performance by machinery and equipment investment.

Outlook for 2015 and 2016: the available figures mean that it is increasingly likely that there might be a mild slowdown in the growth rate in the next few months, bearing in mind the flagging of the tailwinds which drove growth on during the first half. This temporary shift in gear is proving less abrupt than was forecast in May, and so the decent first half economic climate indicators, economic policy and the change in the external situation all make it advisable to raise the 2015 growth forecast marginally to 3.2% (+0.2pp) and to hold the estimate for 2016 at 2.7%. Such growth should be enough to create one million jobs over the period and to bring down the unemployment rate to the neighbourhood of 20%. The expansion of activity will rely on both domestic and external factors. Externally, the downward revision of growth expectations for the world economy and the smaller expected depreciation for the euro will be partly offset by the greater predicted oil price restraint. At home, the support from fiscal and monetary policies, together with the structural improvement of the fundamentals, will bring about solid growth of domestic demand which will in turn prompt a steep rise in imports, leading to a practically negligible contribution to growth from net external demand.

Fiscal policy: the public administrative bodies are using the opportunity provided by the recovery and improved financing costs to implement a mildly expansive fiscal policy in 2015. Even so, in a scenario where there are no changes in economic policy, the tone of fiscal policy will be virtually neutral in 2016. Total spending by the public administrative bodies as a percentage of GDP will continue to shift over the next two years, largely on account of the expected improvement in the labour market, which will bring down the total spent on unemployment benefit, as well as because of the reduction in financing costs. On the public revenues side, the economic cycle continues to make a positive contribution to revenues collected from taxes on production and employer's contributions, but the tax cuts are also giving rise to a structural fall in revenues. In this respect, the bringing forward to July 2015 of the reduction in personal income tax (IRPF), which was initially scheduled for January 2016, will barely have any effect on activity, meaning that the cost of the tax cut (of around EUR1.5bn) will be passed through to tax collection levels. Overall, the cyclical boost over 2015-16 will not be enough to compensate up for the effect of the expansive policies implemented, and so, in the absence of a new round of fiscal consolidation measures, the public deficit is expected to be slightly above the stability target in the next two years. The imbalance in the national accounts is thus expected to be reduced by 1.2pp of GDP in 2015 to 4.5%, and by 1.5pp in 2016 to 3.0% of GDP (compared to targets of 4.2% and 2.8% respectively).

5 Tables

Table 5.1
Eurozone forecasts (% YoY)

	2012	2013	2014	2015	2016
GDP at constant prices	**-0.8**	**-0.3**	**0.9**	**1.5**	**1.9**
Private consumption	-1.3	-0.6	1.0	1.7	1.7
Public consumption	-0.1	0.2	0.6	0.8	0.8
Gross Fixed Capital Formation	-3.5	-2.3	1.2	1.9	3.9
Inventories (*)	-0.7	0.0	-0.1	0.0	0.0
Domestic Demand (*)	**-2.2**	**-0.7**	**0.9**	**1.5**	**1.9**
Exports (goods and services)	2.9	2.1	3.7	4.4	5.1
Imports (goods and services)	-0.6	1.3	4.0	4.8	5.6
External Demand (*)	**1.4**	**0.4**	**0.0**	**0.0**	**0.0**
Prices and Costs					
CPI	2.5	1.4	0.4	0.3	1.3
CPI Core	1.8	1.3	0.9	0.8	1.2
Labour Market					
Employment	-0.5	-0.7	0.8	1.0	0.9
Unemployment rate (% of labour force)	11.3	12.0	11.6	11.0	10.4
Public Sector					
Surplus (+) / Deficit (-) (% GDP)	-3.6	-2.9	-2.4	-2.2	-1.8
Public debt (% GDP)	89.1	90.9	91.9	93.2	92.9
External Sector					
Current Account Balance (% GDP)	1.2	1.8	2.1	2.6	2.5

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

Table 5.2
Macroeconomic Forecasts: Gross Domestic Product

(End of period, YoY rate)	2012	2013	2014	2015	2016
United States	2.3	2.2	2.4	2.5	2.8
Eurozone	-0.8	-0.3	0.9	1.5	1.9
Germany	0.6	0.2	1.6	1.5	1.9
France	0.3	0.7	0.2	1.3	1.7
Italy	-2.8	-1.7	-0.4	0.7	1.3
Spain	-2.1	-1.2	1.4	3.2	2.7
UK	0.7	1.7	3.0	2.5	2.3
Latin America *	2.8	2.5	0.8	0.3	1.2
Mexico	4.0	1.4	2.1	2.5	2.7
Brazil	1.8	2.7	0.2	-1.5	0.5
EAGLES **	5.7	5.6	5.2	4.8	5.2
Turkey	2.1	4.1	2.9	3.0	3.9
Asia Pacific	5.7	5.9	5.7	5.7	5.6
Japan	1.8	1.5	-0.1	1.3	1.2
China	7.8	7.7	7.3	6.7	6.2
Asia (exc. China)	4.1	4.5	4.3	4.9	5.1
World	3.4	3.4	3.4	3.4	3.8

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 30 July 2015.
Source: BBVA Research and IMF

Table 5.3
Macroeconomic forecasts: Inflation

(Annual average, YoY rate)	2012	2013	2014	2015	2016
United States	2.1	1.5	1.6	0.5	1.8
Eurozone	2.5	1.4	0.4	0.3	1.3
Germany	2.1	1.6	0.8	0.5	1.4
France	2.2	1.0	0.6	0.3	1.2
Italy	3.3	1.3	0.2	0.2	1.1
Spain	2.4	1.4	-0.2	-0.2	1.3
UK	2.8	2.6	1.5	0.1	1.5
Latin America *	7.8	9.2	12.6	15.7	26.3
Mexico	4.1	3.8	4.0	2.9	3.3
Brazil	5.4	6.2	6.3	8.7	6.1
EAGLES **	5.2	5.2	4.6	4.9	4.3
Turkey	8.9	7.6	8.9	7.5	7.5
Asia Pacific	3.9	4.1	3.4	2.6	3.0
Japan	0.0	1.6	2.7	1.0	1.6
China	2.6	2.6	2.1	1.6	2.0
Asia (exc. China)	4.8	5.2	4.4	3.5	3.9
World	4.5	4.2	3.9	3.9	5.0

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 30 July 2015.
Source: BBVA Research and IMF

Table 5.4
Macroeconomic forecasts: Current Account

(Annual average, % GDP)	2012	2013	2014	2015	2016
United States	-2,8	-2,4	-2,9	-3,1	-2,7
Eurozone	1,5	2,2	2,1	2,6	2,5
Germany	6,8	6,5	7,6	7,7	7,2
France	-1,5	-1,4	-0,8	-0,9	-0,8
Italy	-0,5	0,9	1,9	2,1	2,4
Spain	-0,3	1,4	0,8	1,3	1,4
UK	-3,7	-4,5	-5,9	-5,3	-4,7
Latin America *	-1,6	-2,5	-2,8	-3,1	-2,5
Mexico	-1.3	-2.1	-2,1	-2,2	-2,0
Brazil	-2,4	-3,4	-4,5	-3,9	-3,1
EAGLES **	0,9	0,5	0,7	0,5	0,8
Turkey	-6,1	-7,9	-5,7	-5,0	-5,4
Asia Pacific	1,1	1,3	1,8	2,1	1,8
Japan	1,0	0,7	0,5	1,0	0,8
China	2,6	2,0	2,1	2,5	2,8
Asia (exc. China)	-0,1	0,8	1,5	1,7	1,0

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 30 July 2015.
Source: BBVA Research and IMF

Table 5.5
Macroeconomic Forecasts: Government Balance

Annual average, % GDP	2012	2013	2014	2015	2016
United States	-6.8	-4.1	-2.8	-2.8	-2.5
EMU	-3.6	-2.9	-2.4	-2.2	-1.8
Germany	0.1	0.1	0.7	0.3	-0.1
France	-4.8	-4.1	-4.0	-3.6	-3.0
Italy	-3.0	-2.9	-3.0	-3.0	-2.4
Spain	-6.6	-6.3	-5.7	-4.5	-3.0
UK	-8.3	-5.7	-5.7	-4.1	-3.5
Latin America *	-2.4	-2.5	-4.3	-3.8	-3.2
Mexico	-2.6	-2.3	-3.2	0.0	0.0
Brazil	-2.5	-3.1	-6.7	-6.7	-5.8
EAGLES **	-1.3	-2.0	-2.6	-3.4	-2.9
Turkey	-2.1	-1.2	-1.6	0.0	0.0
Asia Pacific	-2.7	-3.0	-2.9	-3.1	-2.9
Japan	-7.6	-9.2	-7.9	-7.0	-6.5
China	-1.1	-1.5	-1.8	-2.5	-2.5
Asia (exc. China)	-3.9	-4.1	-3.7	-3.6	-3.2

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Brazil, China, India, Indonesia, Mexico, Russia and Turkey.
Forecast closing date: 30 July 2015.
Source: BBVA Research and IMF

Table 5.6
Financial variables

Macroeconomic Forecasts: Official Interest Rates (End of period)	2012	2013	2014	2015	2016
United States	0.25	0.25	0.25	0.50	1.50
Eurozone	0.75	0.25	0.05	0.05	0.05
China	6.00	6.00	5.60	4.60	4.60
Macroeconomic Forecasts: 10-year government bond yield (Annual average)					
United States	1.8	2.3	2.5	2.3	2.6
Germany	1.6	1.6	1.2	0.6	1.0
Macroeconomic Forecasts: Exchange Rates (Annual average)					
USD-EUR	0.78	0.75	0.75	0.92	0.91
EUR-USD	1.29	1.33	1.33	1.09	1.10
GBP-USD	1.59	1.56	1.65	1.53	1.65
USD-JPY	79.8	97.5	105.8	123.3	131.7
USD-CNY	6.31	6.20	6.14	6.18	6.22

Forecast closing date: 30 July 2015.
Source: BBVA Research and IMF

Table 5.7

Germany: GDP growth and inflation forecasts (% YoY)

	2009	2010	2011	2012	2013	2014	2015	2016
Private consumption	0.2	0.5	2.3	0.6	0.9	1.2	2.0	1.8
Public consumption	3.0	1.3	0.7	1.2	0.7	1.2	1.4	0.9
Gross Fixed Capital Formation	-9.9	4.6	7.5	0.0	-0.4	3.3	1.9	3.8
Inventories (*)	-1.6	1.4	0.1	-1.4	0.1	-0.3	0.0	0.0
Domestic Demand (*)	-3.0	2.8	2.9	-0.8	0.7	1.3	1.7	1.9
Exports	-14.3	14.2	8.2	3.5	1.7	3.7	4.1	5.2
Imports	-9.6	12.6	7.3	0.4	3.2	3.4	5.2	6.0
Net exports (*)	**-2.6**	**1.1**	**0.7**	**1.4**	**-0.5**	**0.4**	**-0.2**	**0.0**
GDP	**-5.6**	**3.9**	**3.7**	**0.6**	**0.2**	**1.6**	**1.5**	**1.9**
Inflation	0.2	1.2	2.5	2.1	1.6	0.8	0.5	1.4

(*) Contribution to growth.
Source: BBVA Research

Table 5.8

France: GDP growth and inflation forecasts (% YoY)

	2009	2010	2011	2012	2013	2014	2015	2016
Private consumption	0.3	1.8	0.4	-0.2	0.5	0.7	1.9	1.4
Public consumption	2.5	1.2	1.1	1.6	1.7	1.5	1.7	1.0
Gross Fixed Capital Formation	-9.0	1.9	2.1	0.3	-0.4	-1.2	-0.3	3.3
Inventories (*)	-1.1	0.3	1.1	-0.6	0.2	0.2	0.0	0.0
Domestic Demand (*)	-2.5	2.0	2.1	-0.3	0.8	0.7	1.5	1.7
Exports	-11.0	8.6	7.1	2.6	1.8	2.4	4.9	5.0
Imports	-9.3	8.5	6.5	0.8	1.8	3.9	5.1	4.7
Net exports (*)	**-0.3**	**-0.1**	**0.0**	**0.5**	**0.0**	**-0.5**	**-0.2**	**0.0**
GDP	**-2.9**	**1.9**	**2.1**	**0.2**	**0.7**	**0.2**	**1.3**	**1.7**
Inflation	0.1	1.7	2.3	2.2	1.0	0.6	0.3	1.2

(*) Contribution to growth.
Source: BBVA Research

Table 5.9

Italy: GDP growth and inflation forecasts (% YoY)

	2009	2010	2011	2012	2013	2014	2015	2016
Private consumption	-1.5	1.2	0.0	-4.0	-2.8	0.3	0.6	0.8
Public consumption	0.4	0.6	-1.8	-1.2	-0.3	-1.0	-0.3	0.0
Gross Fixed Capital Formation	-10.0	-0.6	-1.7	-9.4	-5.8	-3.2	0.6	3.0
Inventories (*)	-1.2	1.3	0.2	-1.1	0.3	0.0	0.0	0.0
Domestic Demand (*)	-4.2	2.1	-0.5	-5.6	-2.5	-0.6	0.5	0.9
Exports	-17.9	11.3	6.1	2.0	0.7	2.4	3.5	4.3
Imports	-12.7	12.1	1.2	-8.3	-2.2	1.7	2.9	3.4
Net exports (*)	**-1.3**	**-0.4**	**1.2**	**2.8**	**0.8**	**0.2**	**0.3**	**0.4**
GDP	**-5.5**	**1.7**	**0.7**	**-2.8**	**-1.7**	**-0.4**	**0.7**	**1.3**
Inflation	0.8	1.6	2.9	3.3	1.3	0.2	0.2	1.1

(*) Contribution to growth.
Source: BBVA Research

Table 5.10

Portugal: GDP growth and inflation forecasts (% YoY)

Rate YoY	2009	2010	2011	2012	2013	2014	2015	2016
Private consumption	-2.3	2.4	-3.6	-5.5	-1.5	2.2	2.2	1.7
Public consumption	2.6	-1.3	-3.8	-3.3	-2.4	-0.3	-0.4	0.4
Gross Fixed Capital Formation	-7.6	-0.9	-12.5	-16.6	-6.7	2.5	4.7	3.7
Inventories (*)	-1.1	1.0	-0.6	-0.3	0.0	0.4	0.0	0.0
Domestic Demand (*)	**-3.8**	**2.1**	**-6.4**	**-7.6**	**-2.5**	**2.1**	**2.0**	**1.8**
Exports	-10.2	9.5	7.0	3.4	6.4	3.3	5.2	4.9
Imports	-9.9	7.8	-5.8	-6.3	3.9	6.4	5.3	4.3
Net exports (*)	**0.8**	**-0.2**	**4.6**	**3.6**	**0.9**	**-1.2**	**-0.1**	**0.2**
GDP	**-3.0**	**1.9**	**-1.8**	**-4.0**	**-1.6**	**0.9**	**2.0**	**2.0**
Inflation	**-0.9**	**1.4**	**3.6**	**2.8**	**0.4**	**-0.2**	**0.7**	**1.2**

(*) Contribution to growth.
Source: BBVA Research

Table 5.11

Spain: GDP growth and inflation forecasts (% YoY)

	2009	2010	2011	2012	2013	2014	2015	2016
Private consumption	-3.6	0.3	-2.0	-2.9	-2.3	2.4	3.3	2.5
Public consumption	4.1	1.5	-0.3	-3.7	-2.9	0.1	1.3	0.6
Gross Fixed Capital Formation	-16.9	-4.9	-6.3	-8.1	-3.8	3.4	5.2	5.8
Equipment and other products	-23.5	5.1	0.8	-9.0	5.6	12.2	6.5	6.4
Construction	-16.5	-10.1	-10.6	-9.3	-9.2	-1.5	4.8	4.8
Housing	-20.6	-11.6	-12.8	-9.0	-7.6	-1.8	2.6	7.1
Other construction	-11.8	-8.5	-8.6	-9.6	-10.5	-1.3	6.5	3.1
Inventories (*)	-0.2	-0.1	0.0	-0.1	0.1	0.2	-0.2	0.0
Domestic Demand (*)	**-6.4**	**-0.5**	**-2.7**	**-4.3**	**-2.7**	**2.2**	**3.0**	**2.7**
Exports	-11.0	9.4	7.4	1.2	4.3	4.2	4.7	7.1
Imports	-18.3	6.9	-0.8	-6.3	-0.5	7.6	4.5	7.5
Net exports (*)	**2.8**	**0.5**	**2.1**	**2.2**	**1.4**	**-0.8**	**0.1**	**0.0**
GDP	**-3.6**	**0.0**	**-0.6**	**-2.1**	**-1.2**	**1.4**	**3.2**	**2.7**
Inflation	**-0.3**	**1.8**	**3.2**	**2.4**	**1.4**	**-0.2**	**-0.2**	**1.3**

(*) Contribution to growth.
Source: BBVA Research

Table 5.12

UK: GDP growth and inflation forecasts (% YoY)

	2009	2010	2011	2012	2013	2014	2015	2016
Private consumption	-3.1	0.4	0.1	1.1	1.7	2.5	2.9	2.2
Public consumption	1.0	0.0	0.0	2.3	-0.3	1.6	1.2	0.2
Gross Fixed Capital Formation	-14.4	5.9	2.3	0.7	3.4	8.6	5.8	5.5
Inventories (*)	-0.6	1.5	-0.2	0.1	0.2	0.4	0.0	0.0
Domestic Demand (*)	**-5.0**	**2.8**	**0.3**	**1.5**	**1.7**	**3.6**	**3.1**	**2.5**
Exports	-8.2	6.2	5.6	0.7	1.5	0.5	4.3	4.7
Imports	-9.8	8.7	1.0	3.1	1.4	2.4	5.5	4.8
Net exports (*)	**0.7**	**-0.9**	**1.4**	**-0.8**	**0.0**	**-0.6**	**-0.5**	**-0.2**
GDP	**-4.3**	**1.9**	**1.6**	**0.7**	**1.7**	**3.0**	**2.5**	**2.3**
Inflation	**2.2**	**3.3**	**4.5**	**2.8**	**2.6**	**1.5**	**0.1**	**1.5**

(*) Contribution to growth.
Source: BBVA Research

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