

## MACROECONOMIC ANALYSIS

# Eurozone: increasing uncertainty weighs on growth

Europe Unit

The euro zone continues to grow at a modest pace, thanks to the resilience of domestic demand. The strength of private consumption over last few quarters was joined by a certain recovery in investment at the end of 2015, despite the worsening of confidence and the moderation of global demand. However, concerns remain and risks are tilted to the downside, especially if the tensions in financial markets and the doubts about economic policy in some European countries persist. Against this scenario and with inflation back in negative figures, the ECB took further action to tackle the potential second-round effects.

The actual activity data were surprisingly positive in January and suggest that domestic demand will continue to support moderate growth...

Recovery of the eurozone stabilized in the second half of last year, against the expected slight acceleration, because the lower global demand finally weighed on exports and offset the momentum of domestic demand. More positive news came from increased investment in the last quarter of the year; this together with the increase in public consumption, linked to the management of the refugee crisis (especially in Germany), offset the moderation in private consumption.

January retail sales suggest that the moderation in household consumption in 4Q15 may have been temporary, after increasing for the second consecutive month and regrow to robust rates (0.8% over the 4Q15 average) supported by some fundamentals that continue to be strengthened by falling oil prices and the improving labour market. Industrial production data also gave out more positive signals for investment, after surprising in January with a strong overall growth by components and, above all, by the consolidation of the increase in intermediate goods (about 4% annualized) and the rebound of capital goods. However, it remains to be seen whether the consolidation of growth in domestic demand is sufficient to offset the lower sales momentum abroad, following the moderation in global growth and the sharp depreciation of the euro recorded over the last year. However, with exports virtually stagnant during the second half of 2015, the new decrease in orders from abroad along with the dynamism of imports, suggest that net exports will continue to weigh on growth in the coming quarters.

... although the worsening of confidence so far this year does not yet dispel doubts about the strength of recovery

The sharp rise in global and idiosyncratic uncertainty and the escalation of tensions in financial markets was noticeable in a widespread deterioration of confidence among agents, although this was heavier in the industrial sector, as both the manufacturing PMI and the EC indicator fell by about 2 points to 51.2 and -4.4, respectively. More in line with the indications of actual data on the strength of domestic demand, the drop confidence in services was more moderate (about 1 point on the services PMI). Despite the correction in confidence (following the sharp increase observed late last year), agents continue to be confident, at similar levels to those observed in early 2015, when the eurozone GDP progressed at a quarterly rate of 0.4% / 0.5% QoQ.

## The MICA-BBVA model estimates growth of 0.4% QoQ in 1Q16

With all this information, which is still limited to actual data from January and based on confidence for February, our MICA-BBVA model estimates growth of about 0.4% QoQ in the first quarter of the year; this is an acceleration compared to fourth quarter of 2015, but is more moderate than our forecast three months (0.5%) ago. Together, the data 4Q15 and what is expected for 1Q16 would indicate growth for the whole of 2016 of around two tenths less than our forecast of 1.8%, which still considers that the recovery will gain some traction throughout the year to average around 0.5% QoQ, supported by monetary and fiscal policies more favourable to growth and by low oil prices.

## Negative inflation until the summer owing to falling oil prices, while the moderation in core inflation slows

Inflation surprised to the downwards in February, not as much because it fell back into negative figures (-0.2% YoY), which it was anticipated because of the sharp drop in oil prices, but by the moderation of core inflation (by 0.2 to 0.8% YoY) feeding fears about possible second-round effects. According to confidence surveys, companies continue to pass on to consumers the decreases in prices of raw materials. Although the effect should be limited if consumption remains robust in a context of reduced corporate margins and gradual improvement in the labour market, in March meeting the ECB took further steps to address the problem as soon as possible (see [ECB Watch](#)).

The evolution of oil prices will continue to be the main determinant of how inflation behaves in the coming months. A further, steeper drop in inflation could occur in coming months and negative rates recorded during the second quarter (when we expect oil prices bottom out) and only gently pick up after the summer (to around 0.5% YoY at the year-end).

## Germany: despite the recent drop in confidence, actual data for January point to robust growth in 1Q16

- In 4Q15, growth was more disappointing than expected when it stabilized at 0.3% QoQ, –caused especially by its vulnerability to moderation in global demand– with a drop in exports that resulted in a significant negative contribution of net exports (-0,5pp). This was offset by increased domestic demand (0.8pp), in particular in government spending (1% QoQ from 0.5%) and investment (1.5% QoQ).
- Exports fell again in January, while foreign orders fell anew in February and this trend is unlikely to reverse in the coming months, and its effect may be seen mainly in the manufacturing sector.
- However, the bleaker outlook of the qualitative indicators contrasts with the strong real activity data available for January, more in line with the strength of confidence in the services sector, sustained by strong domestic demand. Thus, industrial production across all components rebounded in January (3.3% on 4Q15), but especially in investment goods and consumer goods. Meanwhile, retail sales consolidate the momentum already observed in December, accelerating their growth to 0.8% and reversing the moderation recorded in 4Q15 (0.5% QoQ after 0.8% of 3Q15).
- Despite the mixed signals of the most recent indicators, we expect growth to gain some traction in 1Q16 (in line with our scenario of 0.5% QoQ) or even make a surprising upturn in the light of the real indicators. In any case, the indication extracted from the information as a whole is that it seems difficult that further growth will be sustainable, as lower global demand will continue, although the pace of growth this year will also be underpinned by the increase in both consumption and public spending.

## France: doubts remain about the sustainability of the recovery, but it may be moving at a relatively stable pace

- In 4Q15, activity grew at the steady rate of 0.3% QoQ (revised upwards by 0.1 pp), despite the negative impact of the terrorist attacks on private consumption and the negative effect of net exports, driven mainly by consumption and public and private investment.
- As in the eurozone, the strength of the actual data in January contrasts with the more pessimistic signals of the confidence surveys, suggesting that the economy has shown some resilience to the tensions of the financial markets, but also because of the disappearance of the negative effect on the data of the terrorist attacks late last year. Thus, spending on household consumption grew again to robust rates in January to stand at around 0.9% above the average for 4Q15 (-0.5% QoQ), while industrial production increased significantly to reverse the declines observed in November and December and maintain a stable growth (0.7% QoQ), while the construction sector continues to show signs of incipient recovery.
- By contrast, data from the January trade balance showed a sharp drop in exports of both goods and services in January, indicating that weaker external demand will continue to burden growth, and that, despite the weak euro, the French economy continues to suffer from certain problems of competitiveness.
- In light of all this data, our forecasts point to a moderate and relatively stable growth rate in 1Q16 (0.3% QoQ), somewhat below what we expected three months ago. It may gain some momentum throughout the year supported by a recovery in investment encouraged by the favourable financial conditions and private consumption resulting from increased disposable income in households, despite the little leeway for fiscal policy.

## Italy: weak growth in early 2016, supported by domestic demand

- In 4Q15 the gradual slowdown of GDP growth continued to 0.1% QoQ from 0.4% a year ago. Nevertheless, beyond the volatility of the data on accumulation of inventories, domestic demand has been gradually gaining weight, although while net exports burdened growth during the whole of 2015, foreign sales grew towards the end of the year and showed more resistance than in other countries in the eurozone.
- The available data for the first quarter are very limited. The economic sentiment indicator fell in January and February, but is still clearly above the historical average, while industrial production rose significantly in January, indicating that the sector is on the path of robust growth (1.3% 4Q15) after stagnating in the 4Q15.
- The Italian economy suffered financial tensions earlier this year and the doubts about its financial sector are not yet completely cleared up; this may have weighed on the progress of the economy earlier this year. All in all, we expect that GDP growth might gain some traction and rise to about 0.2% QoQ, slightly less than expected earlier this year. Nevertheless, the Italian economy may one be that most benefits from the new measures of the ECB, which would help the recovery to gain some momentum in the remainder of the year.

## Spain: despite the uncertainty, the growth rate was maintained at the start of 2016, accompanied by job creation

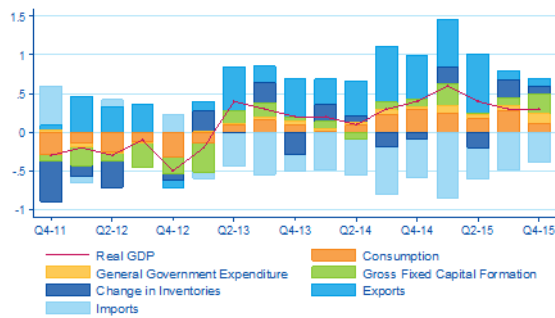
- In 4Q15, domestic demand was the main support of the activity with a 0.6pp contribution to growth, highlighting the solid progress of both household consumption and private production investment. Exports slowed (0.9 pp to 0.9%), but less than imports (2.8pp to 0.3% QoQ), resulting in a positive contribution to growth of net external demand (0.2pp).
- Although confidence indicators for households and industry fell again in February, moderation of optimism was lower than that observed earlier this year. Unemployment expectations explain the fall in the consumer confidence, while the outlook on the orders portfolio and inventory explain the developments in industrial confidence.
- The consumer spending and employment variables indicate that consumption continues to lead the recovery (with similar rates as at the end of 2015), while production and industrial confidence again overtake the slower growth in investment in machinery and equipment. Data on foreign sales and expectations point to a continuation of the sluggishness of goods exports, along with a slowdown in services in 1Q16.
- Despite the uncertainty of economic policy, the MICA-BBVA model estimates GDP growth at around 0.8% QoQ in 1Q16 which, if confirmed, will be a stabilization of the rate of expansion, in line with our scenario. Growth will continue in the coming quarters supported by external factors (cheaper oil prices and, above all, the ECB's monetary policy) and internal factors, such as changes that have taken place in the production structure as well as the expansionary stance of fiscal policy (for details see [Spain Economic Watch](#)).

**Euro zone**

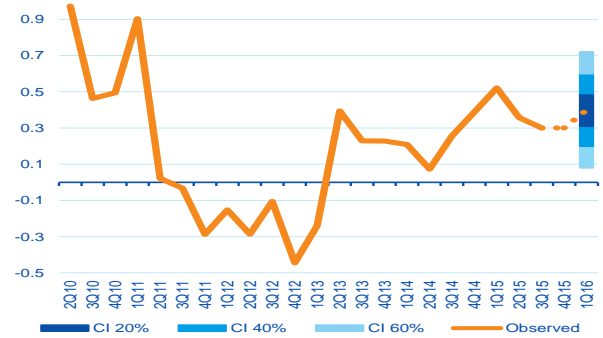
**National accounts: modest growth in 4Q15 (0.3% QoQ)**

Domestic demand contributed +0.5pp, driven by investment growth (+1.3% QoQ). Private consumption decelerated (+0.2% QoQ), while the public spending increased (+0.6% QoQ). Net exports drained -0.3pp from growth

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



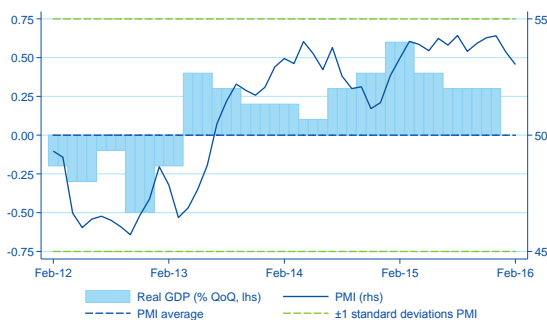
**Graph 2**  
**GDP growth (% QoQ) and MICA-BBVA forecast\***



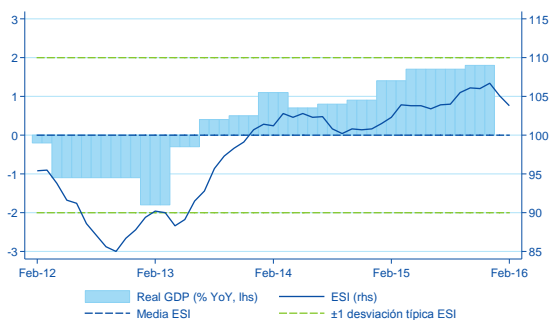
**Confidence: the PMI and ESI continued to fall in February**

The PMI fell in February, both in services and especially in manufacturing, together with the ESI sentiment, which fell 1.3pp to 103.8 points, burdened by weak household confidence

**Graph 3**  
**PMIs and GDP growth (% QoQ) \***



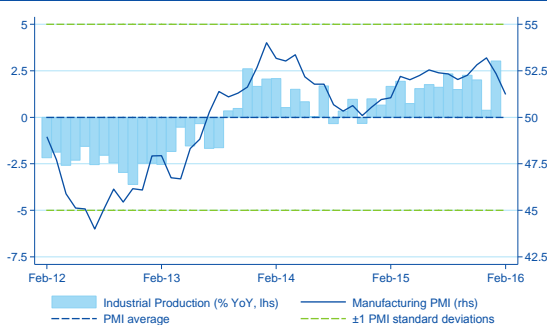
**Graph 4**  
**Confidence (ESI) and GDP growth (% YoY) \***



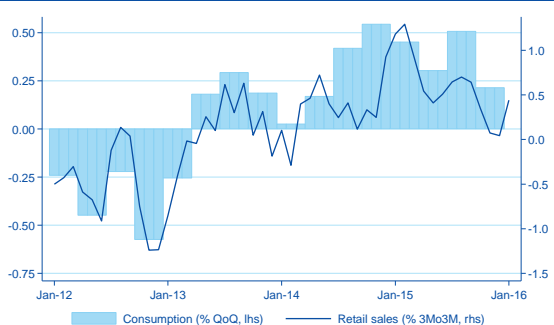
**Activity: industrial production and retail sales rose in January**

In January, industrial production bounced up (+2.1% MoM) and stood 1.7% above the 4Q15 average (0.4% QoQ), while retail sales increased more than expected in January (+0.4% MoM) and stand at 0.9% above 4Q15 (0.1% QoQ)

**Graph 5**  
**Industrial production (% YoY) and manufacturing PMI\***



**Graph 6**  
**Retail trade (% 3M/3M) and growth in consumption (% QoQ)\***

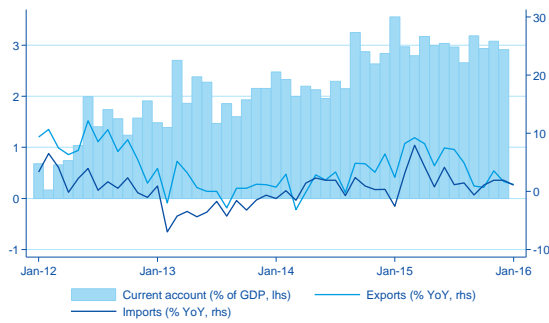


\*Sources: HAVER and BBVA Research

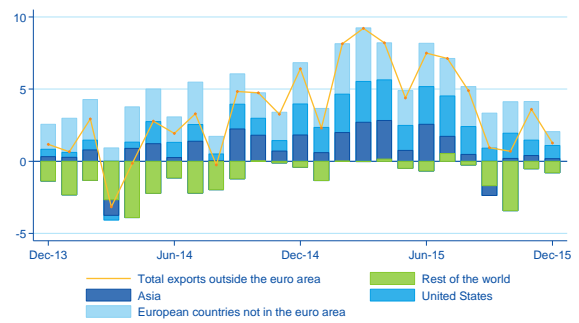
**External sector: exports fell in January, after a small increase in 4Q15**

Exports fell by -1.9% MoM, more than expected, although this drop could be partly driven by the drop in prices. Additionally, imports dropped somewhat less, 1.3% MoM

**Graph 7**  
**Current account (% of GDP)\***



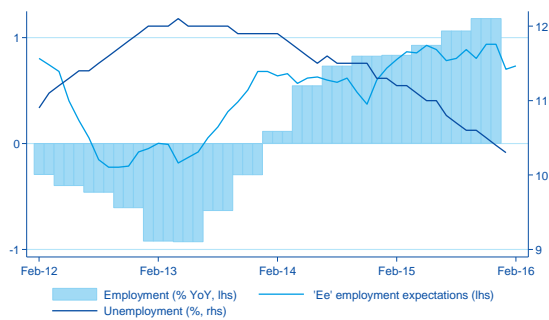
**Graph 8**  
**Exports by destination (contribution to % YoY)\***



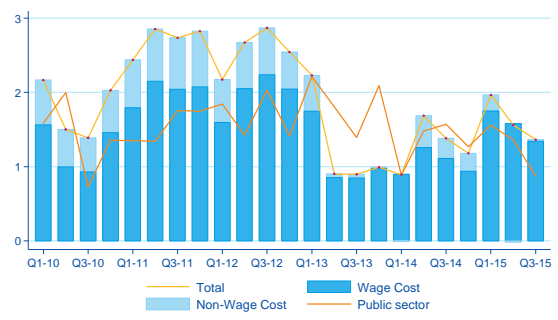
**Labour market: unemployment falls by 0.1 points to 10.3% in January**

In January, the unemployment rate decreased to 10.3%, although with differences between countries, and employment increased in 4Q15 at a steady rate (0.3% QoQ). Labour costs in the business sector moderated in 3Q15 (1.1% YoY after 1.6% YoY)

**Graph 9**  
**Unemployment rate (%) and employment expectations\***



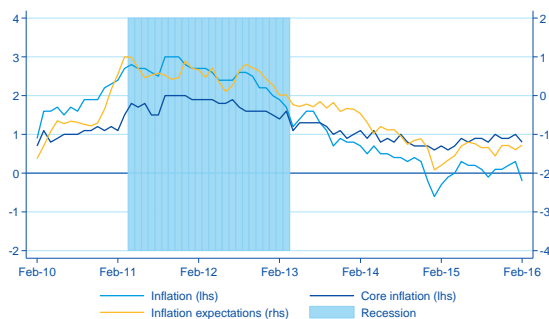
**Graph 10**  
**Labour costs in the business sector (% YoY)\***



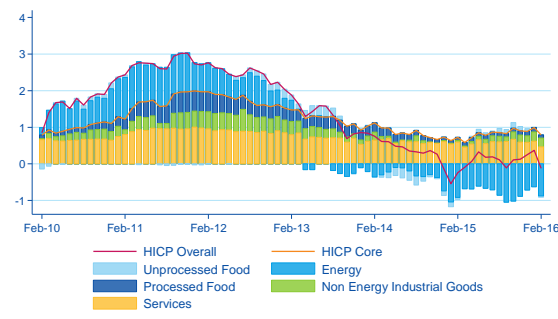
**Prices: Negative inflation in February and the moderation of core inflation**

Inflation declined by 0.5pp to -0.2% YoY in February, due to the intensification of falling energy prices, but also by the moderation of core inflation (-0,2pp) to 0.8% YoY

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



**Graph 12**  
**Inflation by components (contribution in %)\***



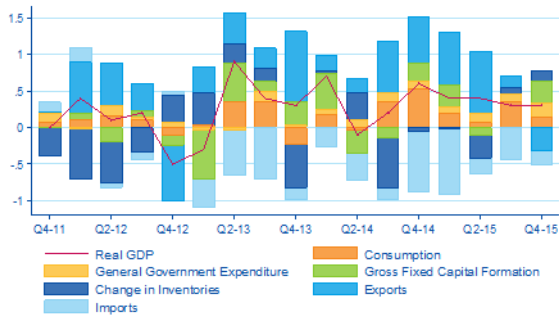
\* Sources: HAVER and BBVA Research

**Germany**

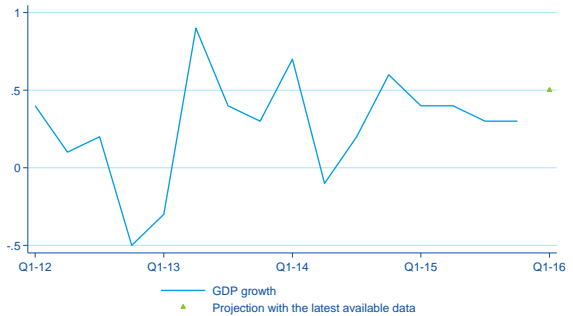
**National accounts: modest growth continues in 4Q15 (0.3% QoQ)**

The main driver of GDP growth in 4Q15 was again domestic demand (+ 0.8pp, after + 0,6pp in 3Q15). External demand contributed negatively to growth 4Q15 (-0,5pp) after contributing negatively also in 3Q15 (-0,3pp)

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



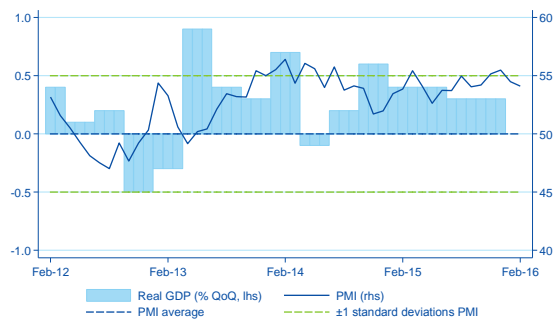
Graph 14  
**GDP (% QoQ) and forecasts \***



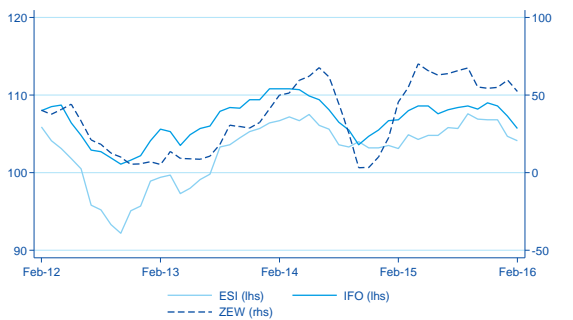
**Confidence: the PMI and ESI worsened in February**

In February, the composite PMI index and the Commission index worsened again, in both manufacturing and in services; national indicators show similar evolutions, both ZEW and IFO deteriorated

Graph 15  
**PMIs and GDP growth (% QoQ) \***



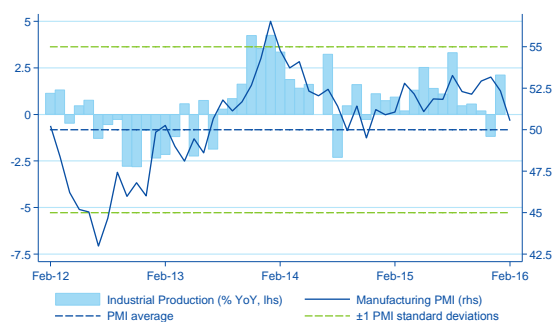
Graph 16  
**Confidence indicator (ESI, Ifo and ZEW) \***



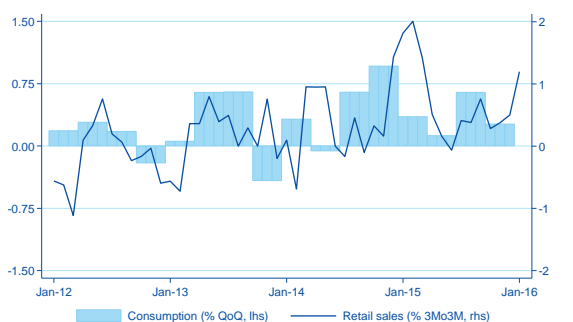
**Activity: rebound in industrial output and retail sales rise in January**

Industrial production grew strongly in January (+3.3% MoM), and currently stands at 3.1% above the average for 4Q15. Retail sales rose by 0.7% MoM and open 1Q16 1.2% above the average of 4Q15

Graph 17  
**Industrial production (% YoY) and manufacturing PMI\***



Graph 18  
**Retail trade (% 3M/3M) and growth in consumption (% QoQ)\***

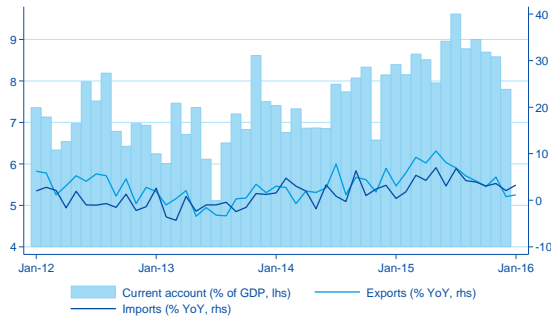


\* Sources: HAVER and BBVA Research

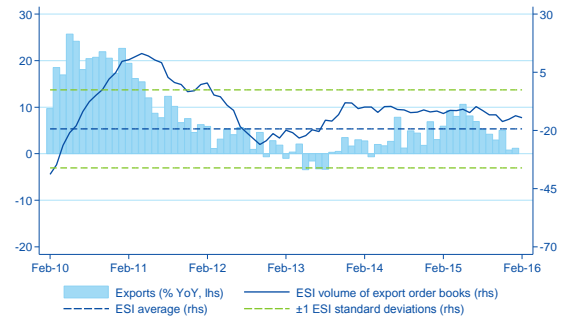
**External sector: exports continue to decline in early 2016**

Exports fell by 0.5% MoM in January, reaching -0.9% below the average for 4Q15. Meanwhile, imports increased by 1.2% MoM in January to 0.5% above 4Q15

**Graph 19**  
**Current account (% of GDP)\***



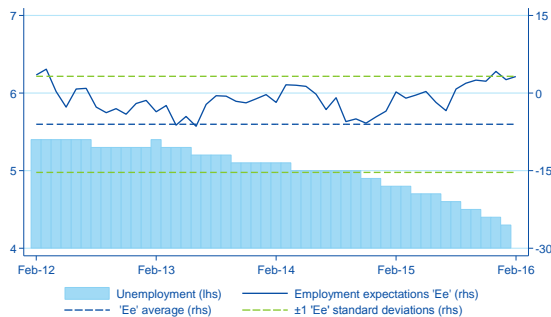
**Graph 20**  
**Exports growth (% YoY) and volume of export orders\***



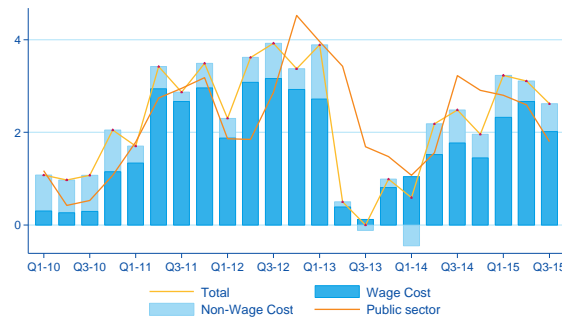
**Labour market: unemployment remains at record lows**

The unemployment rate is again at a record low (4.3%) in January, while growth in labour costs moderated to 2.4% YoY in 3Q15 after 3.1% YoY in 2Q15

**Graph 21**  
**Unemployment rate (%) and expectations of employment\***



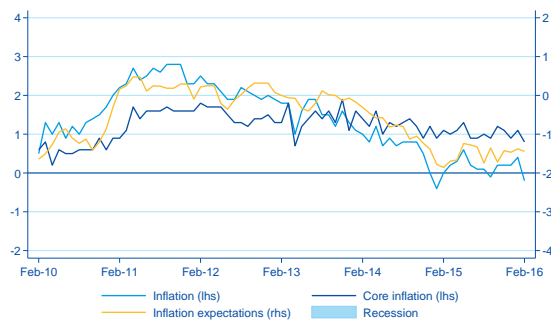
**Graph 22**  
**Labour costs in the business sector (% YoY)\***



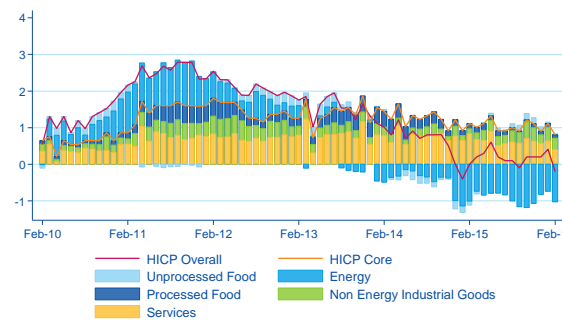
**Prices: Inflation fell (-0.2% YoY) in February**

In February, inflation fell by 0.6 points to -0.2% YoY. This is mainly explained by the larger drop in energy prices and the slower increase in food and service prices

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



**Graph 24**  
**Inflation by components (contributions in %)\***



\* Sources: HAVER and BBVA Research

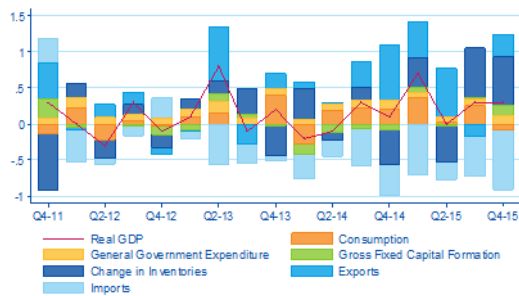


**France**

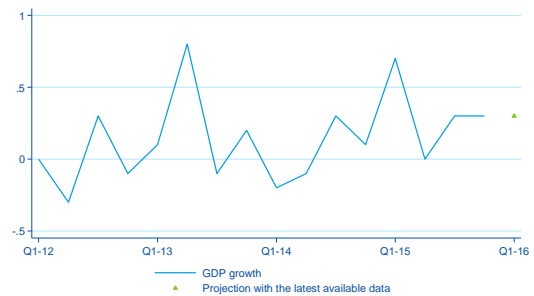
**National Accounts: GDP growth revised + 0.1pp upward (+ 0.3% QoQ) in 4Q15**

The fall in consumption (-0.2% QoQ from +0.5% QoQ) is partly compensated by public consumption that slightly accelerates its growth rate to +0.5% QoQ. Investment (+0.7% QoQ after +0.1% QoQ) accelerated, together with the contribution of inventories (+0.7pp and 3Q15). However, net exports subtracted somewhat less from growth (-0,5pp after -0,7pp in 3Q15)

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



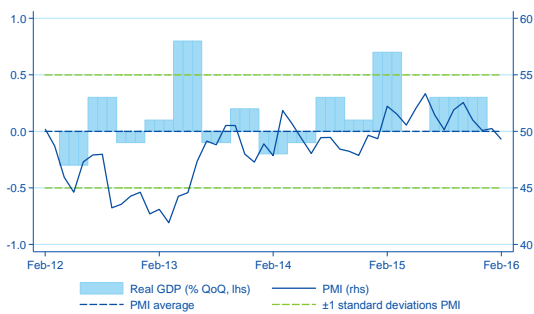
**Graph 26**  
**GDP (% QoQ) and forecasts \***



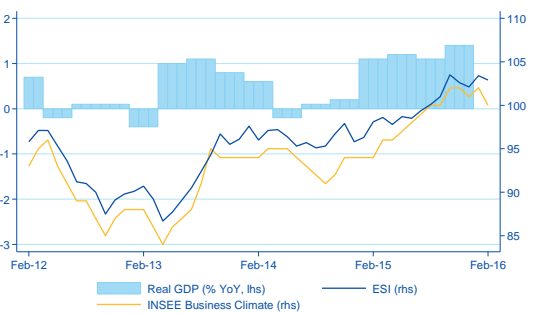
**Confidence: worsening in February**

The composite PMI again contracted, as did the ESI and the national indicators, which also pointed towards declining confidence.

**Graph 27**  
**PMIs and GDP growth (% QoQ) \***



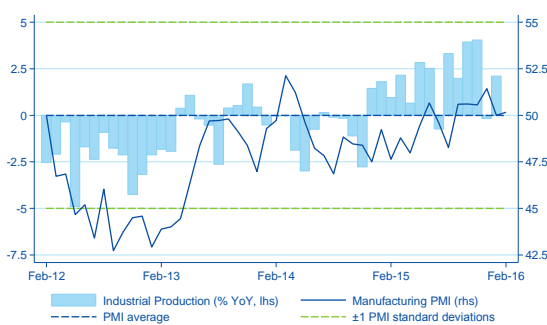
**Graph 28**  
**Confidence indicator (ESI, and INSEE) \***



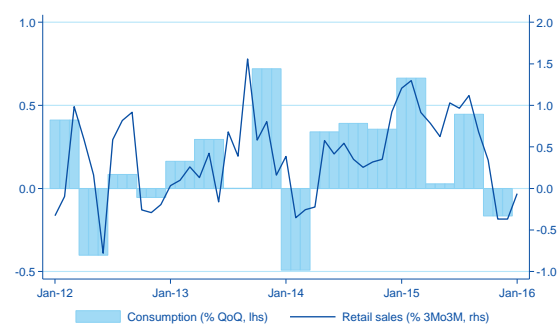
**Activity: industrial production increased and retail sales held steady in January**

With the January figure (+1.3% MoM), the industrial production index increased +0.8% above the 4Q15 average, while retail sales remained unchanged in January, but opened 1Q16 +0.7% QoQ above 4Q15

**Graph 29**  
**Industrial production (% YoY) and manufacturing PMI\***



**Graph 30**  
**Retail trade (% 3M/3M) and growth in consumption (% QoQ)\***

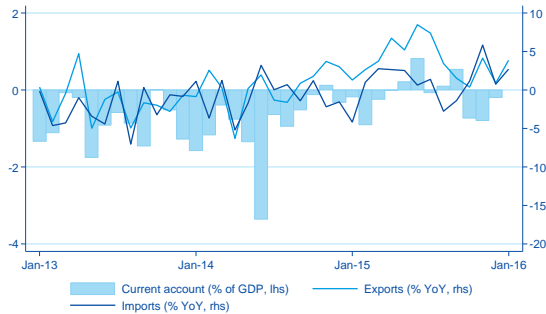


\* Sources: HAVER and BBVA Research

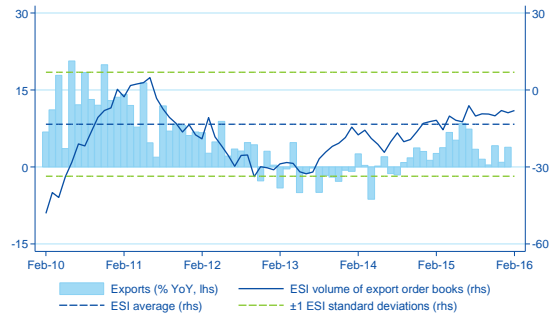
**External sector: exports fell in January**

Following the increase in November and December, exports fell in January (goods -3% MoM and services -4.1%) and more than imports, meaning that net exports will continue to weigh on growth

**Graph 31**  
**Current account (% of GDP)\***



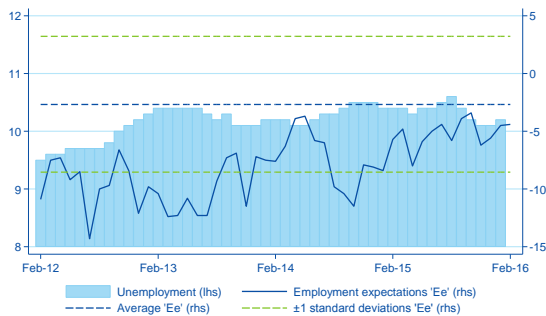
**Graph 32**  
**Exports growth (% YoY) and volume of export orders\***



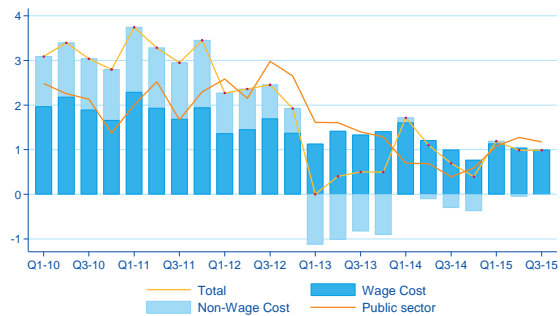
**Labour market: the unemployment rate increased in January**

The unemployment rate increased by 0.1 to 10.2% in January. Meanwhile 3Q15 labour costs grew at the same pace as in 2Q15 (1.1% YoY).

**Graph 33**  
**Unemployment rate (%) and expectations of employment\***



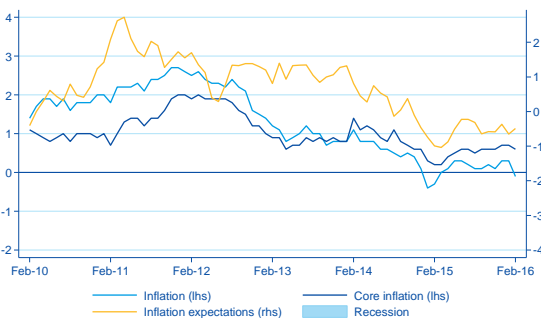
**Graph 34**  
**Labour costs in the business sector (% YoY)\***



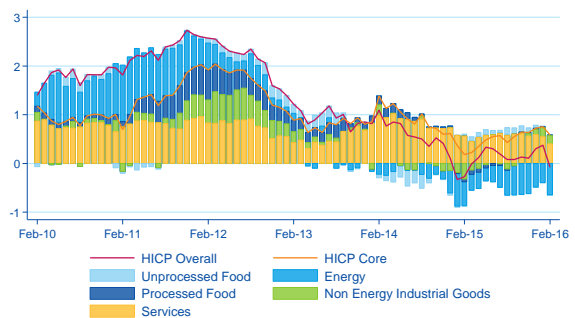
**Prices: In February, inflation was again negative**

In February, the harmonized inflation rate fell by 0.4 points to -0.1% YoY, the largest decline in the price of energy and manufactured goods. Also food prices are slowing along with the price of services

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



**Graph 36**  
**Inflation by components (contribution in %)\***



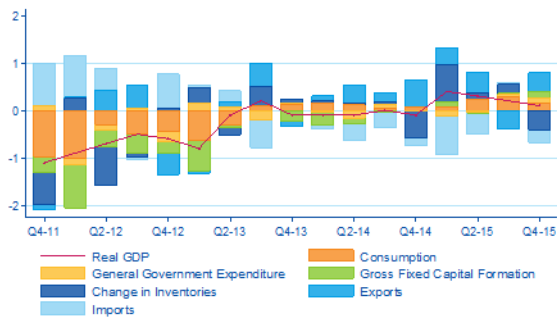
\* Sources: HAVER and BBVA Research

**Italy**

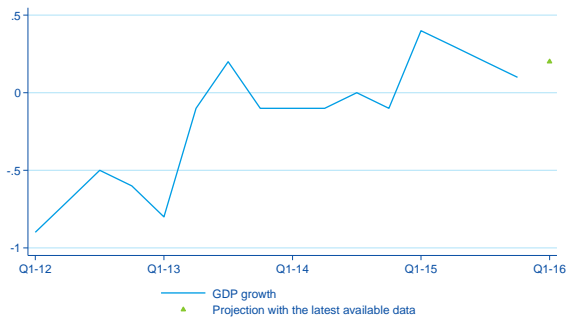
**National Accounts: the recovery lost momentum at the end of 2015 (0.1% QoQ)**

Private consumption showed a growth rate of +0.3% QoQ, public consumption accelerated by 0.6% QoQ and investment grew by +0.8% QoQ. External demand contributed positively (+0.1pp)

Graph 37  
**GDP (% QoQ) and contribution by components (pp)\***



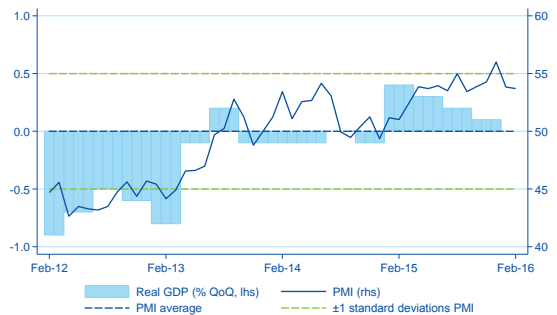
Graph 38  
**GDP (% QoQ) and forecasts \***



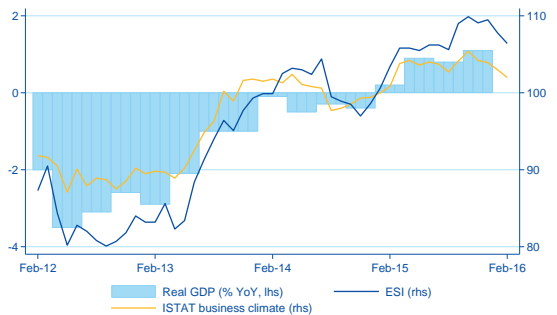
**Confidence: in February PMIs and ESI were moderated by the manufacturing sector**

The composite PMI fell slightly in February, weighed down by manufacturing, while service remained virtually stable. The ESI was moderated by the drop in confidence in manufacturing and households, which was confirmed by the ISTAT indicator

Graph 39  
**PMIs and GDP growth (% QoQ) \***



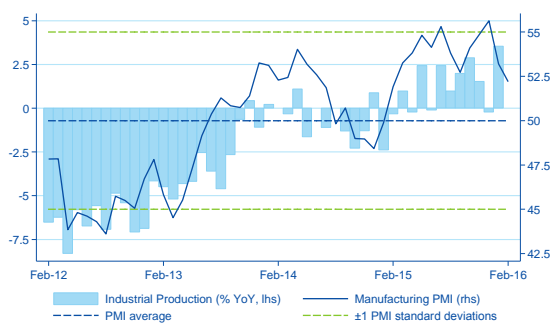
Graph 40  
**Confidence indicator (ESI, and ISTAT) \***



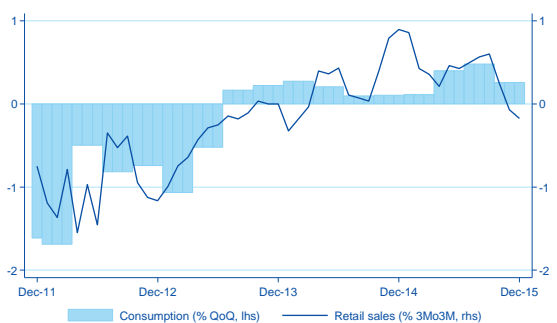
**Activity: industrial production rebounded in January and retail sales did not take off**

Following declines in November and December, the industrial production index increased in January (+1.9% MoM) reaching +1.3% above the average of 4Q15. Retail sales fell in December (-0.1% MoM) and -0.5% QoQ to below 3Q15

Graph 41  
**Industrial production (% YoY) and manufacturing PMI\***



Graph 42  
**Retail trade (% 3M/3M) and growth in consumption (% QoQ)\***

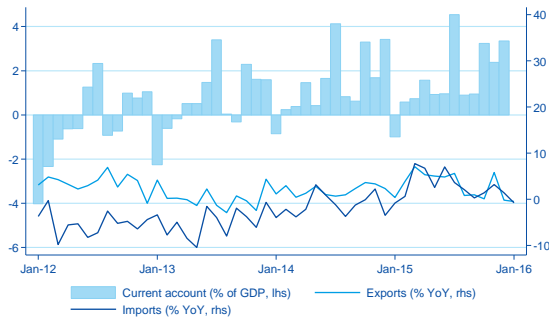


\* Sources: HAVER and BBVA Research

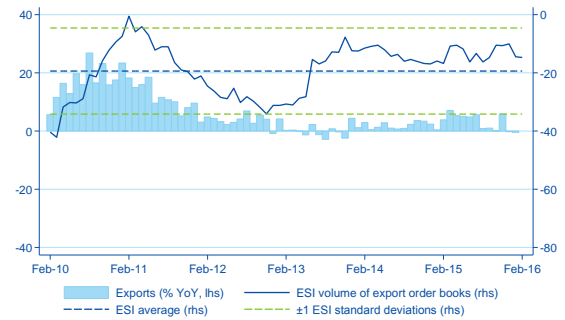
**External sector: exports increased in 4Q15**

Exports rose in December and remained firmer in 4Q15 than in other countries in the eurozone; the rise, together with more moderate import growth, supported growth in the last quarter of last year

Graph 43  
**Current account (% of GDP)\***



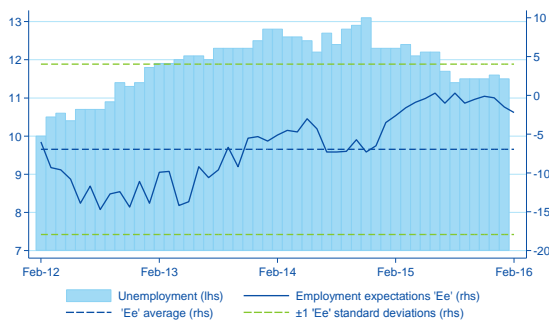
Graph 44  
**Exports (% YoY) and volume of export orders\***



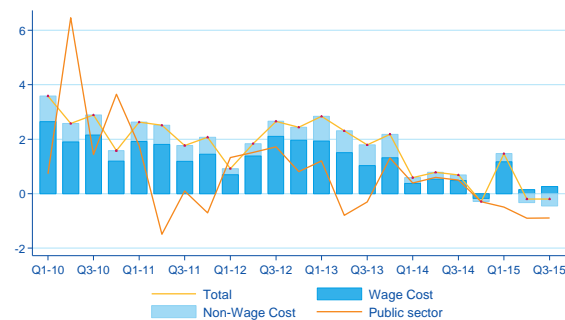
**Labour market: unemployment continued to decline slowly**

The unemployment rate fell by 0.1 to 11.5% in January. Labour costs fell by 0.4% YoY in 3Q15 (after -0.6% YoY in 2Q15).

Graph 45  
**Unemployment rate (%) and expectations of employment\***



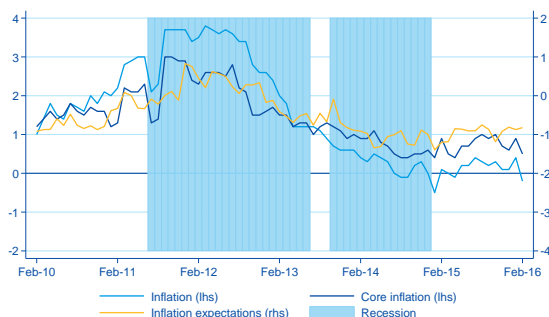
Graph 46  
**Labour costs in the business sector (% YoY)\***



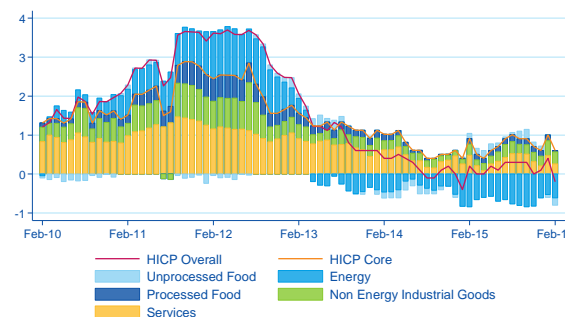
**Prices: negative inflation rates in February**

The harmonized inflation rate fell to -0.2% YoY in February (January: +0.4% YoY) owing to a smaller increase in the price of services and a further drop in energy. Hidden inflation, moderated by 0,5 to 0.4% YoY as a result

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



Graph 48  
**Inflation by components (contribution in %)\***



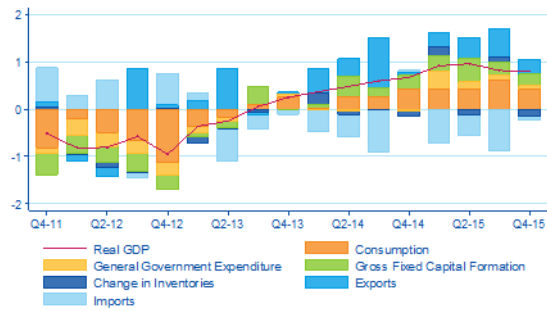
\* Sources: HAVER and BBVA Research

**Spain**

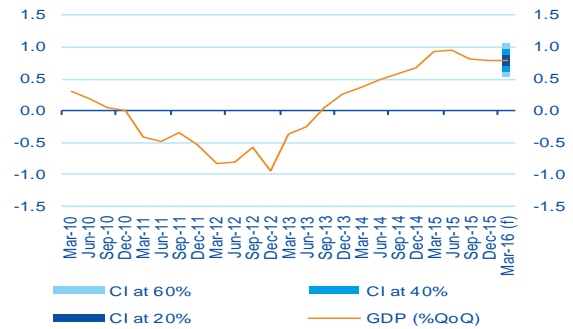
**National accounts: GDP growth stabilized in 4Q15 (0.8% QoQ)**

Domestic demand was the main support of the activity with a 0,6pp contribution to growth, highlighting the solid progress of both household consumption and investment. Exports slowed (0.9pp to 0.9%), but less than imports (2.8pp to 0.3% QoQ), resulting in a positive contribution of net external demand (0.2pp)

Graph 49  
**GDP (% QoQ) and contribution by components (pp)\***



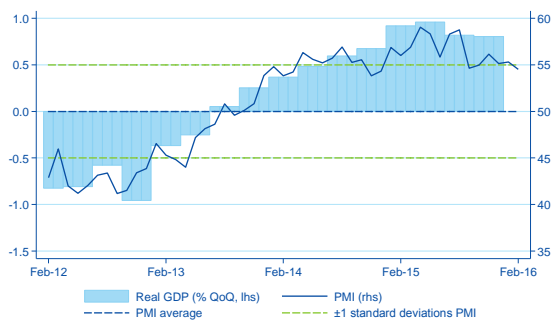
Graph 50  
**GDP growth (% QoQ) and MICA-BBVA forecast\***



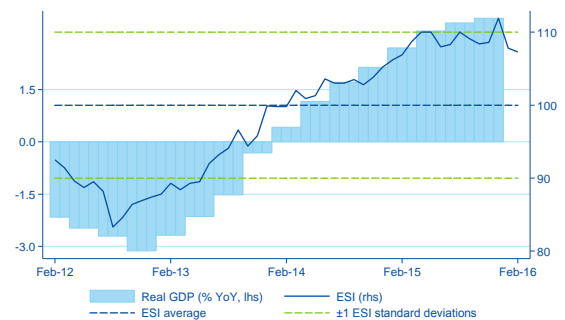
**Confidence: slight drop in confidence**

Confidence indicators for households and industry fell again in February, but optimism fell less than at the beginning of this year. Unemployment expectations explain the fall in consumer confidence, while the outlook on the orders portfolio and inventory explain the developments in industrial confidence

Graph 51  
**PMIs and GDP growth (% QoQ) \***



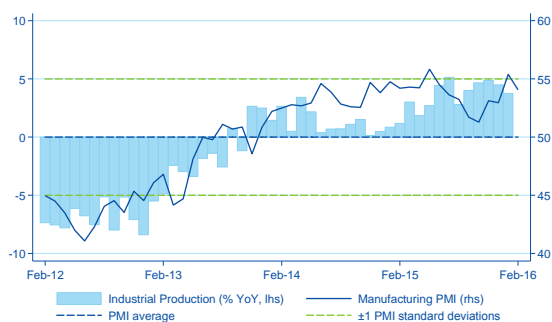
Graph 5  
**Confidence (ESI) and GDP growth (% YoY) \***



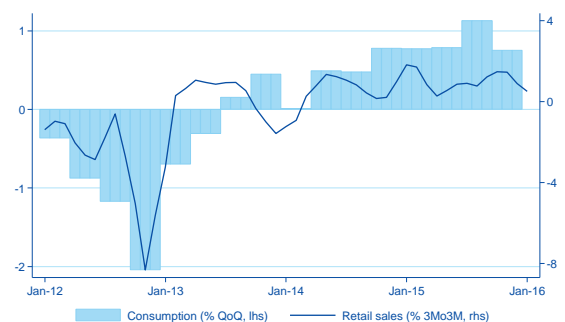
**Activity: moderation of the IPI and retail sales in January**

Industrial activity declined marginally in January (-0.1% MoM), but the positive trend continued in the non-energy components. Retail sales grew by 0.4% MoM for the second consecutive month, albeit less than expected

Graph 53  
**Industrial production (% YoY) and manufacturing PMI\***



Graph 54  
**Retail trade (% 3M/3M) and growth in consumption (% QoQ)\***

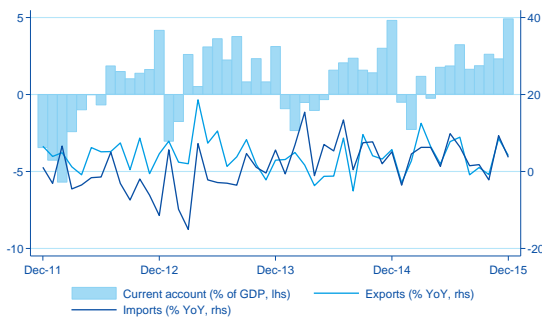


\* Sources: HAVER and BBVA Research

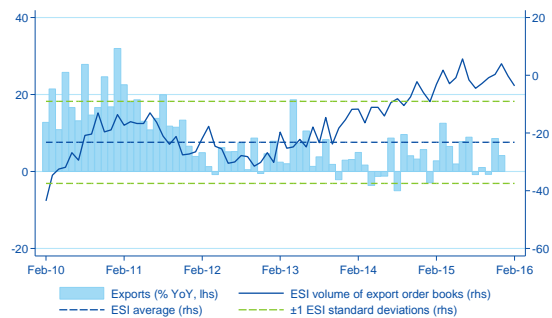
**External sector: sluggishness in exports of goods and slowdown in services**

Nevertheless, the variables relating to foreign tourism (tourist arrivals and spending) indicate that this demand component will again grow at a similar pace to that seen in the first nine months of 2015, following the sharp increase experienced in 4Q15

Graph 55  
**Current account (% of GDP)\***



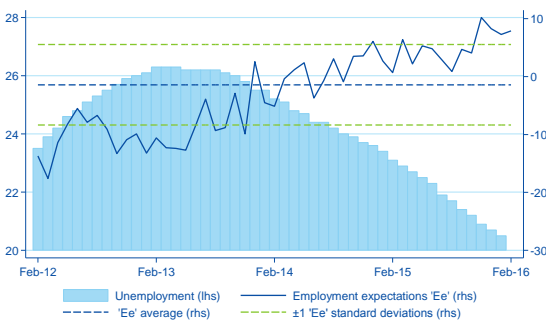
Graph 56  
**Exports growth (% YoY) and volume of export orders\***



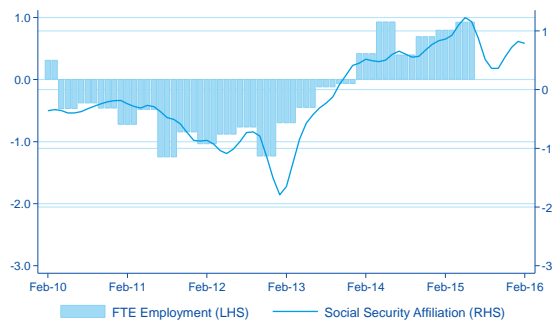
**Labour market: improvement continues as 2016 gets under way**

Affiliation to social security continued to grow in February and points to a stabilization in the pace of job creation (in 4Q15 0.7% QoQ). Meanwhile, unemployment continued its downward trend in the second month of 2016

Graph 57  
**Unemployment rate (%) and expectations of employment\***



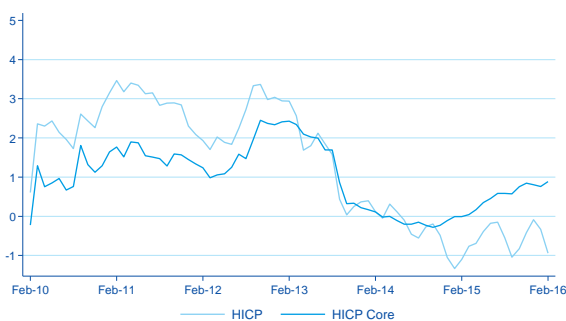
Graph 58  
**Employment growth: QNA and Social Security (% QoQ)\***



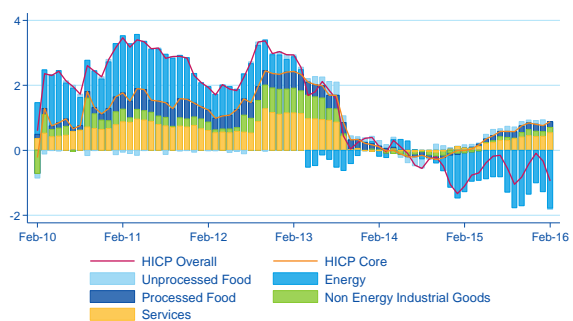
**Prices: inflation fell again in February, but core inflation improved**

The increased fall in general inflation (-0.5pp to -0.8% YoY) was due to lower energy and food prices, partly offset by the general increase in the components of core inflation (+ 0.1pp to 1% YoY)

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



Graph 60  
**Inflation by components (contribution in %)\***



\* Sources: HAVER and BBVA Research

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