

Short-term indicators and
Updated Forecasts

Eurozone

NOVEMBER 2016



Key messages: resilience and unchanged projections

- **The moderate pace of economic growth continued in the eurozone** in 3Q16 (+0.3% QoQ), in a context of improved external demand in the quarter and showing resilience after the uncertainty experienced by mid-year.
- **Improving soft data so far in 4Q16 suggest that the recovery could gain some momentum**, though we remain cautious about it due to political uncertainties in coming months.
- **Inflation is picking up as expected**, given the energy prices' base effects, **but core measures remain subdued**. We continue to expect inflation to remain **clearly below the ECB target in the forecast horizon**.
- **Supportive economic policies and ECB with little room for further action**: the most likely option is the extension and fine tuning of QE, though this could be delayed to early 2017. **Fiscal policy will continue to be slightly supportive**, but with heterogeneity across countries.
- **Unchanged forecasts**: we maintain our GDP growth projection for the eurozone at 1.6% and 1.5% in 2016 and 2017, respectively. Nonetheless, some **changes** were made **at country level**, with **higher dynamism in Germany and Spain** offset by **lower prospects in France and Italy**.
- **Risks remain tilted to the downside and are related mostly to political issues**, both at national and regional level, but derive also from financial sector fragilities in some specific countries.

ECONOMIC DEVELOPMENTS: STEADY RECOVERY RESILIENT TO POLITICAL UNCERTAINTY

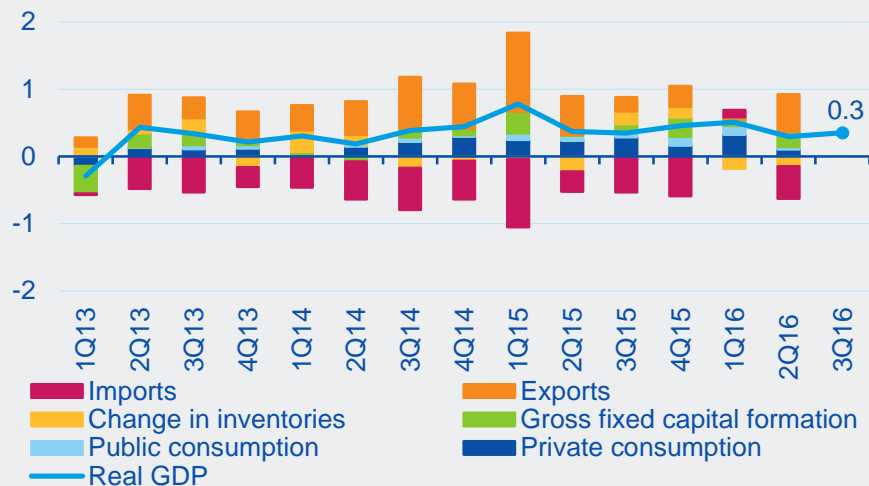
NOVEMBER 2016



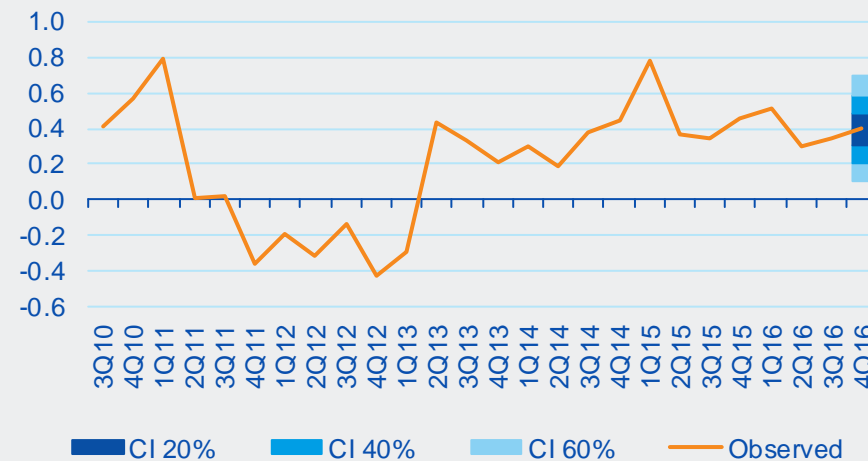
SECTION 1: ECONOMIC DEVELOPMENTS

GDP growth steady in 3Q. We expect it to remain broadly stable during coming quarters

GDP, CONTRIBUTION BY COMPONENTS
(%QoQ, pp)



GDP AND MICA FORECASTS
(%QoQ)

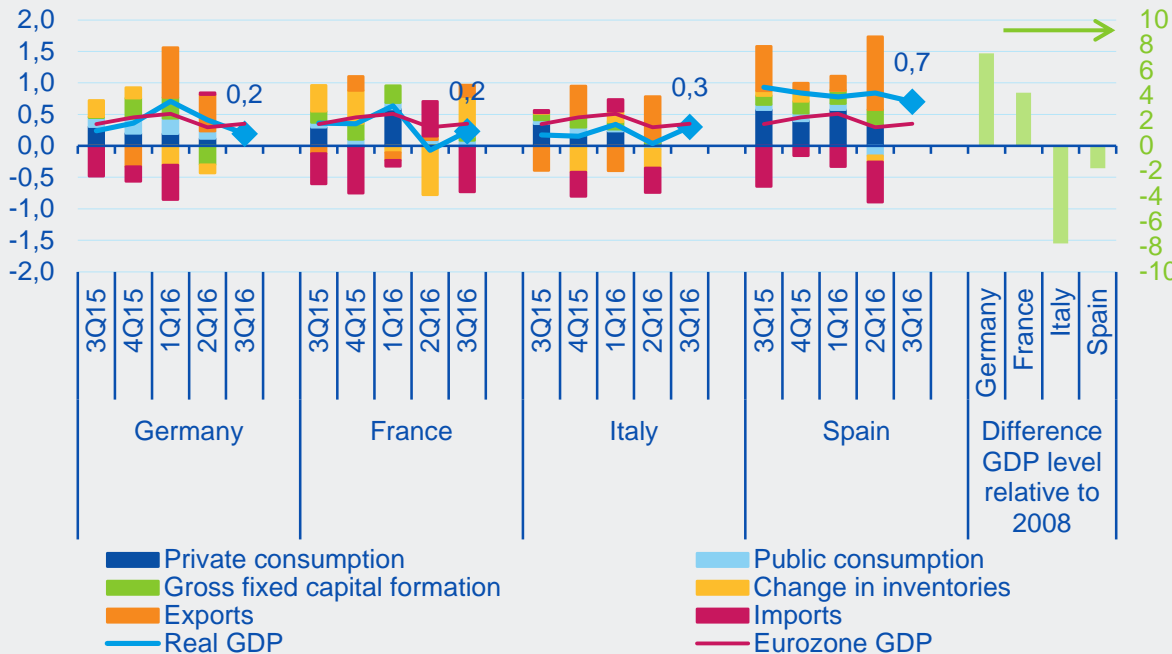


- **Flash estimate for GDP growth showed a stable recovery** in 3Q16, posting a +0.3% QoQ figure. Overall consumption will continue to be the main contributor to GDP growth
- **Machinery and equipment** is the main driver of investment growth together with inventories
- **Concerns are related to a weak fixed investment recovery**, but we are positive for 4Q16 figures
- Improving soft data in October suggest that the **recovery could gain some momentum in 4Q16**

SECTION 1: ECONOMIC DEVELOPMENTS

Germany decelerated but France and Italy returned to growth in 3Q

GDP, CONTRIBUTION BY COMPONENTS
(%QoQ, pp)

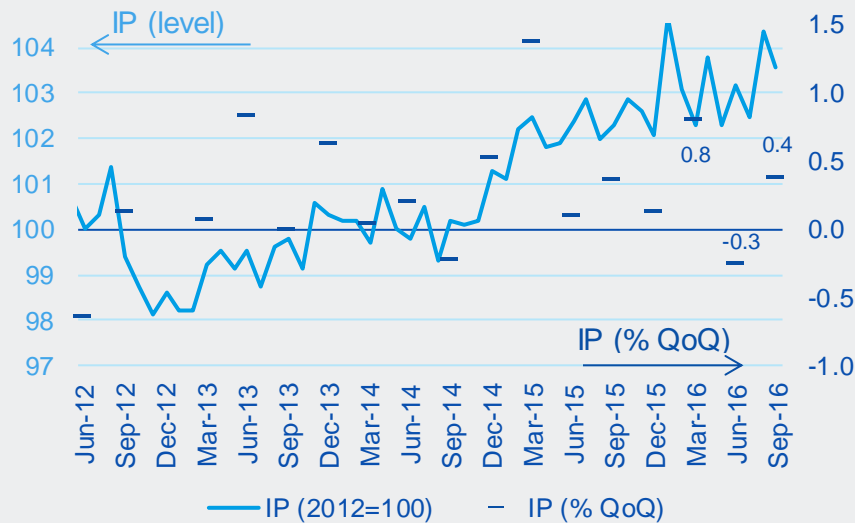


- **France and Italy returned to growth** in 3Q16 with GDP increasing 0.2% and 0.3% QoQ respectively. The former mainly driven by inventory investment (+0.3% QoQ) and public consumption (+0.4% QoQ), while private expenditure remained flat in the quarter
- In **Germany growth slowed further in 3Q16** (+0.2% QoQ), apparently due to lower contribution from external demand. Growth should be mainly driven by domestic demand components, despite a possible decline in machinery and equipment investment
- **Spain continues to outperform** the region showing a preliminary GDP increase of 0.7% QoQ in 3Q16

SECTION 1: ECONOMIC DEVELOPMENTS

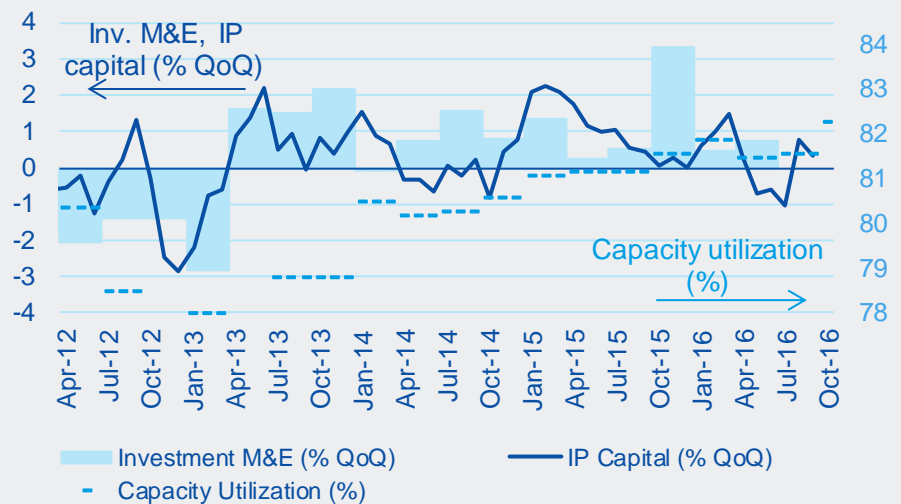
Industrial production recovered in 3Q despite high volatility

INDUSTRIAL PRODUCTION
(%QoQ, pp)



- Industrial production **declined in September** by 0.8% MoM after an increase of 1.8% MoM in August, **closing 3Q16 with an overall growth of 0.4% QoQ** (-0.3% in 2Q16)

IP CAPITAL, INVESTMENT IN MACHINERY AND EQUIPMENT AND UTILIZATION CAPACITY
(%QoQ, %)

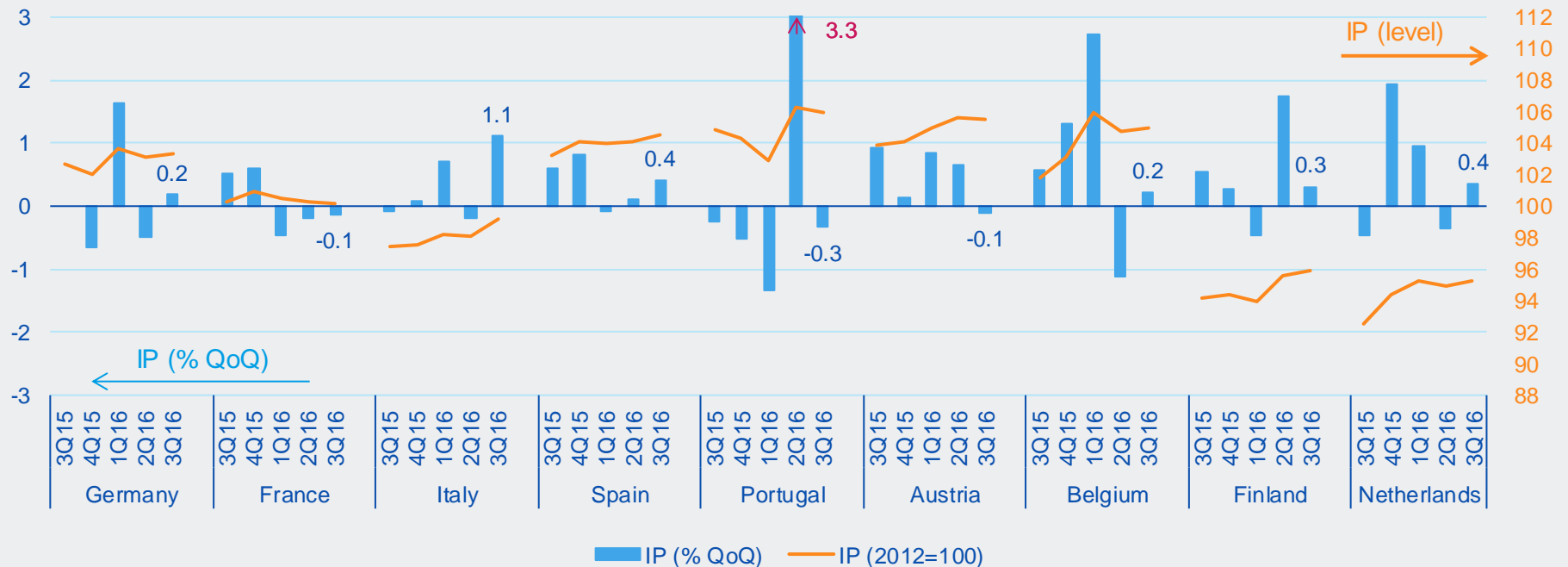


- The **recovery in 3Q16 was widespread across sectors**, mainly in the production of **capital goods** (+0.4% QoQ) and **consumer durables** (+0.1% QoQ), suggesting a recovery in equipment and machinery investment

SECTION 1: ECONOMIC DEVELOPMENTS

Industrial output growth for 3Q was observed across most countries

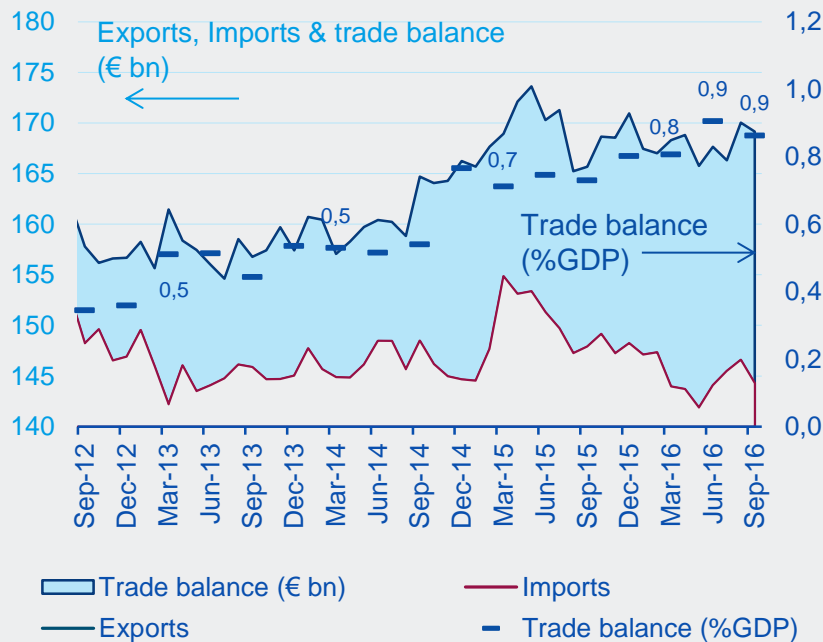
INDUSTRIAL PRODUCTION (%QoQ, pp)



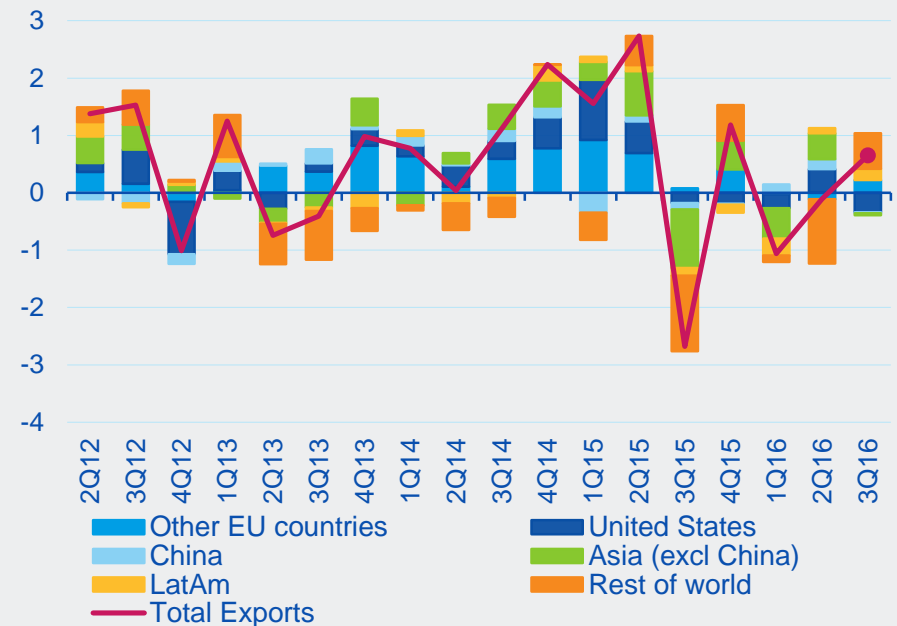
SECTION 1: ECONOMIC DEVELOPMENTS

Exports rebounded slightly in 3Q while imports suggest some improvement in domestic demand

TRADE BALANCE
(€ bn, %GDP)



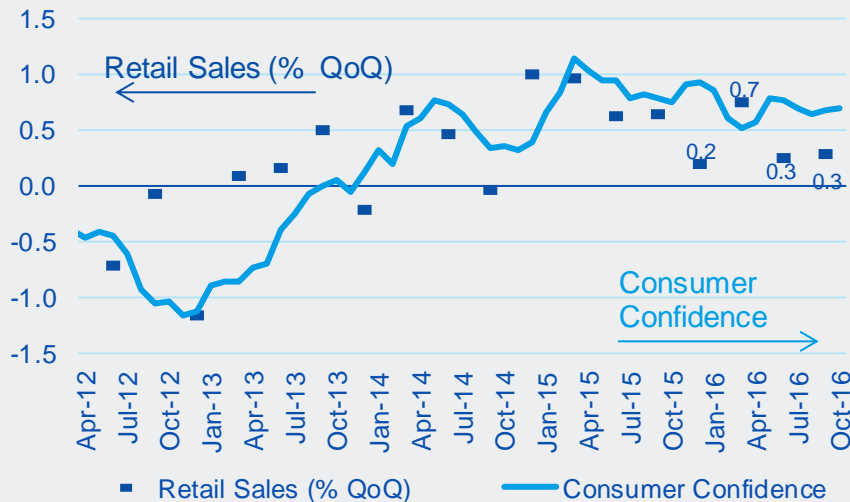
EXPORTS CONTRIBUTION BY DESTINATION
(%QoQ, pp)



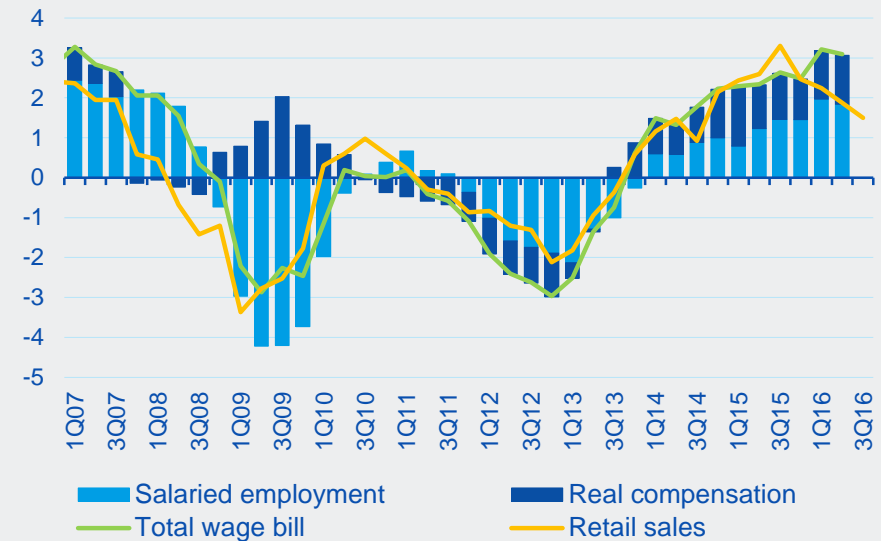
SECTION 1: ECONOMIC DEVELOPMENTS

Retail sales grew moderately in 3Q despite recent monthly declines

RETAIL SALES AND CONSUMER CONFIDENCE
(%QoQ, pts)



RETAIL SALES AND TOTAL WAGE BILL
(%YoY)



- **Retail sales grew 0.3% QoQ in 3Q16** despite monthly declines in September and August figures (both -0.2% MoM)
- **Weakness** is observed in non-food consumption and durables

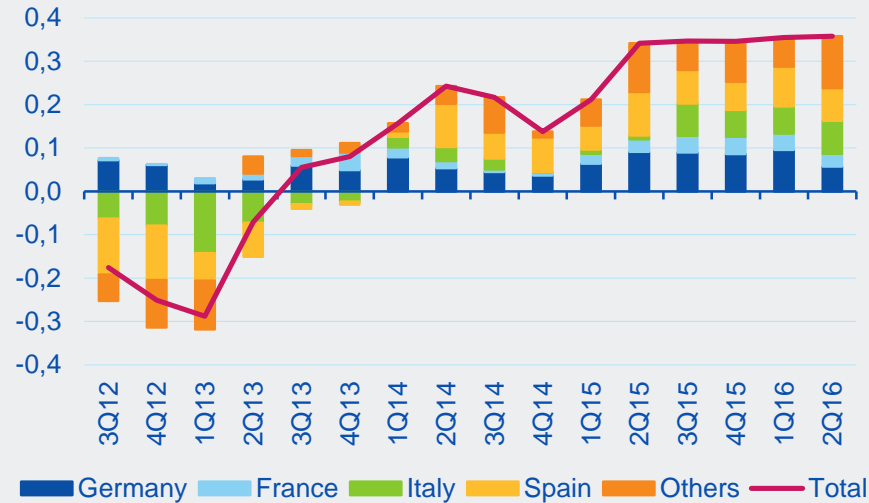
- Nonetheless, overall **3Q16 data** continues to **suggest a positive contribution to private consumption**, similar to previous quarter, **which adds to stable confidence**

SECTION 1: ECONOMIC DEVELOPMENTS

Employment grew at a steady pace over the past year, while the labour force growth accelerated

JOB GROWTH CONTRIBUTION BY COUNTRY

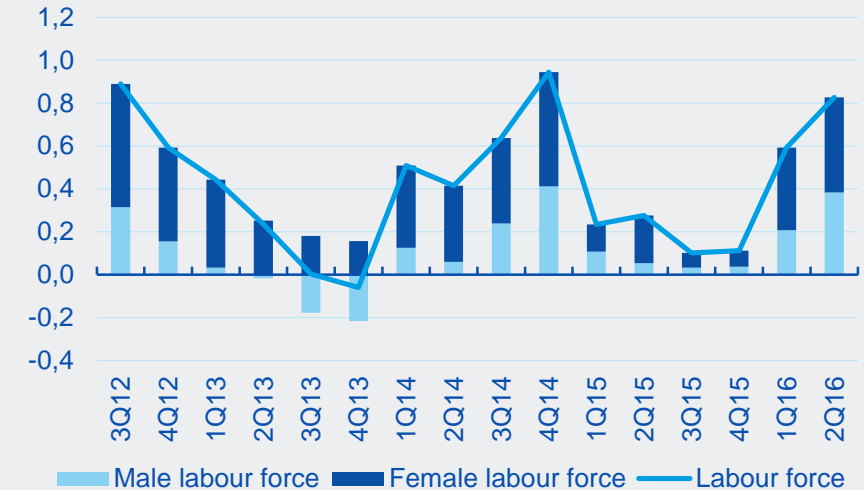
(pp, %QoQ)



- Slightly lower employment growth contribution from core countries in 2Q16, but higher from the periphery
- The composition has recently tilted to higher self-employment

LABOUR FORCE GROWTH BY GENDER CONTRIBUTION

(pp, %QoQ)

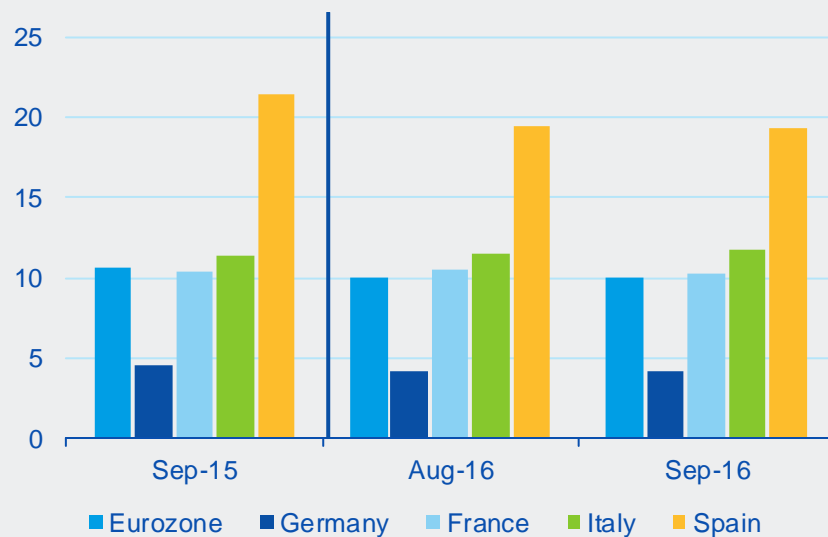


- Nonetheless, in a recovery environment, higher growth of labour force was observed during 1H16

SECTION 1: ECONOMIC DEVELOPMENTS

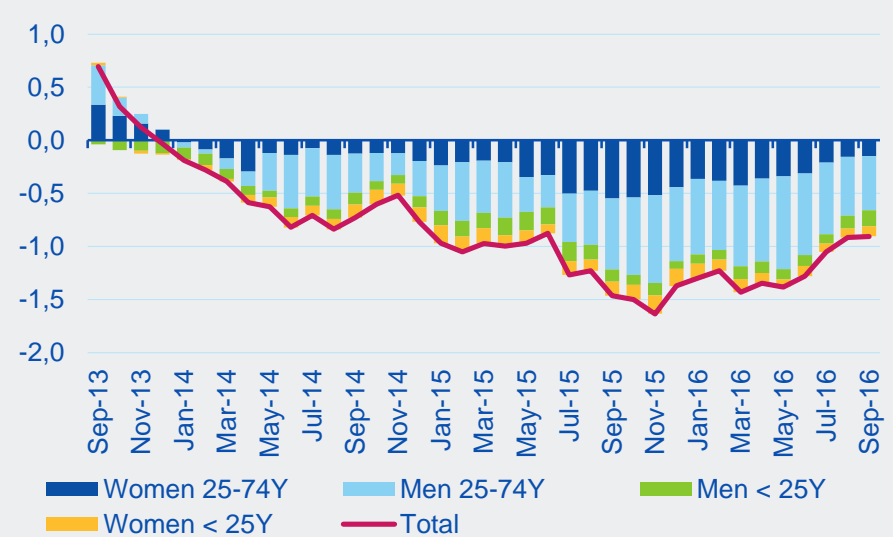
Unemployment rate has stabilized in recent months, but continues to decline in Spain

UNEMPLOYMENT RATE BY COUNTRY (%)



- **Jobless rate continues to fall at a low pace**, driven mostly by Spain

ANNUAL UNEMPLOYMENT CHANGE BY GENDER & AGE (millions)

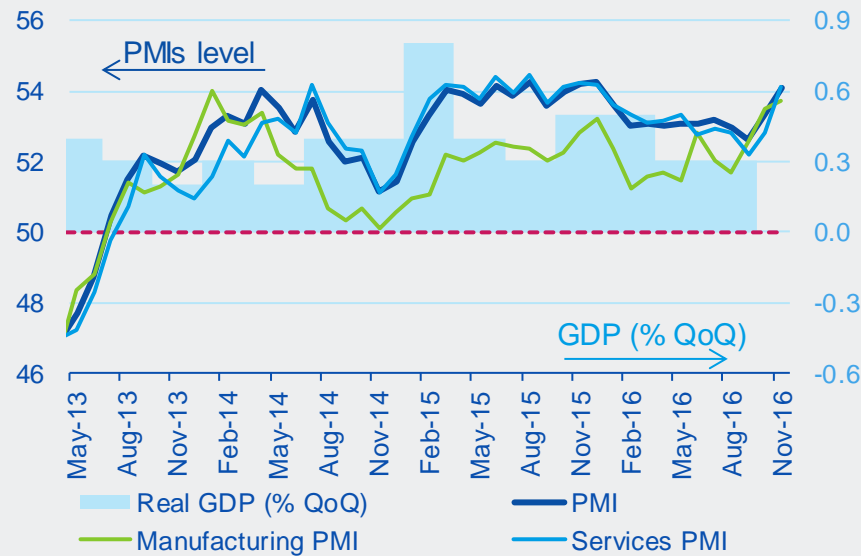


- But a **slower decline in unemployed was observed in 3Q16** among the experienced population, mainly women

SECTION 1: ECONOMIC DEVELOPMENTS

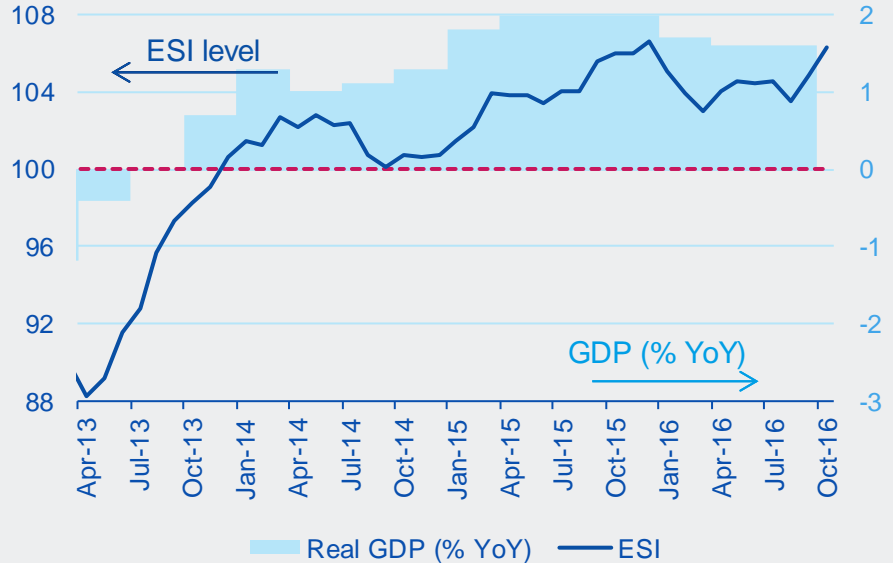
Confidence figures accelerated in October, suggesting some momentum building for 4Q

PMI AND GDP
(index, %QoQ)



- Confidence data **so far continue to show the eurozone's resilience** to increasing uncertainty since the summer

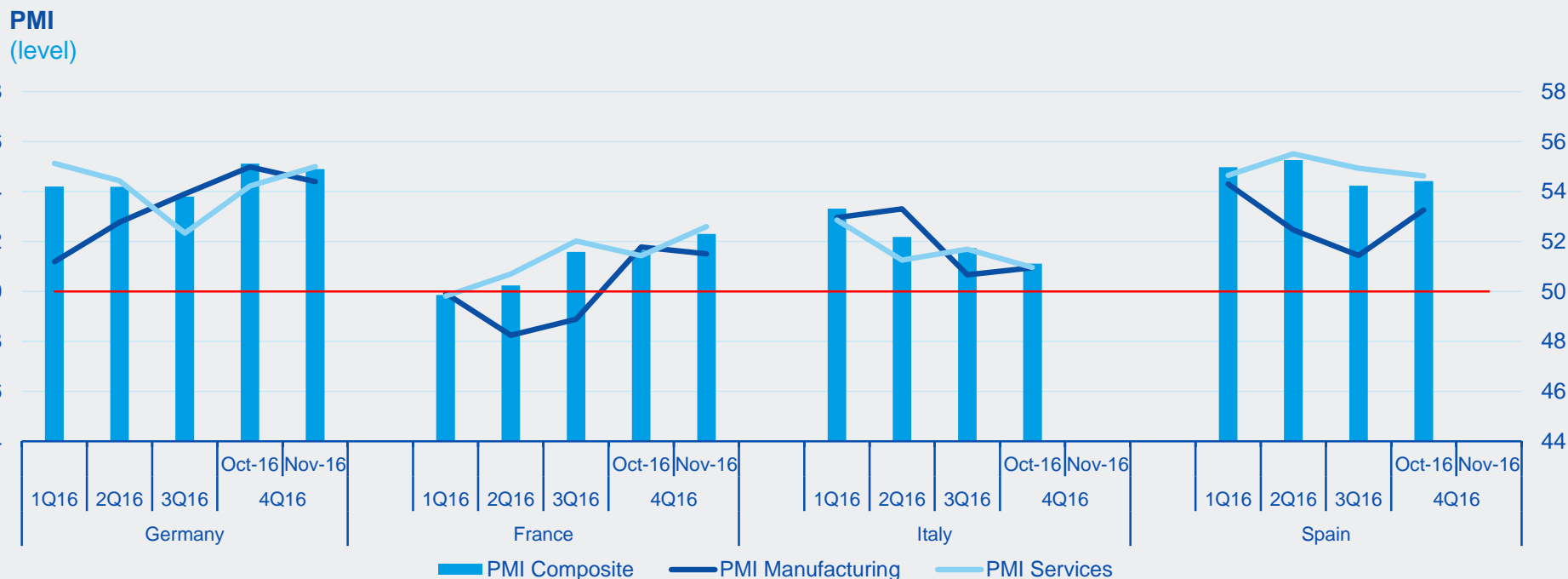
ESI AND GDP
(index, %QoQ)



- But **we remain cautious** as political events in coming months -Italy's constitutional referendum, on-going *Brexit*, a charged political calendar for 2017- could end up weighing on confidence

SECTION 1: ECONOMIC DEVELOPMENTS

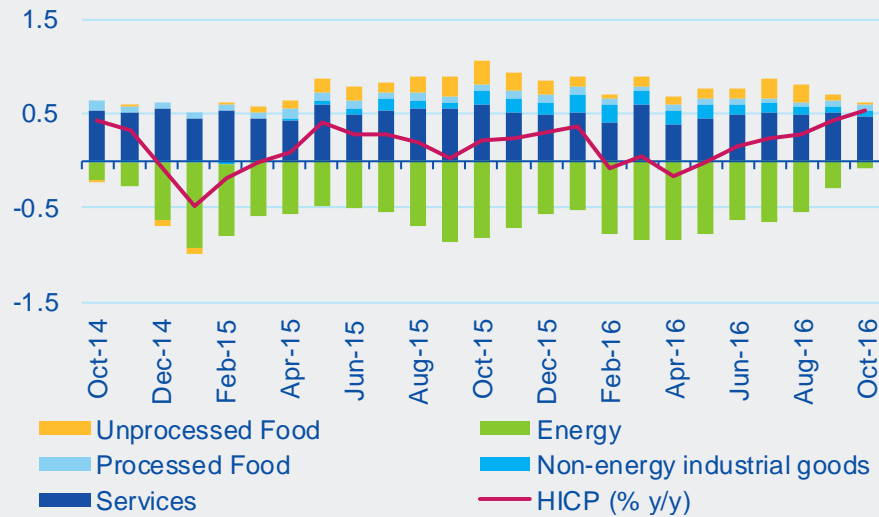
Manufacturing PMIs have increased in all core countries so far in 4Q, with a mixed performance in services



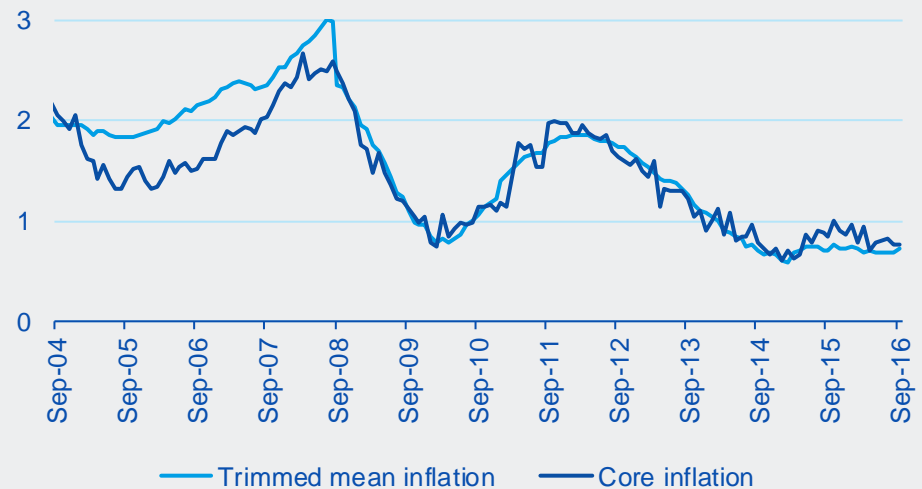
SECTION 2: UPDATED FORECASTS

Headline inflation accelerated slightly in October driven by energy price base effects

INFLATION AND CONTRIBUTION OF COMPONENTS
(%YoY, pp)



INFLATION AND TRIMMED MEAN
(%YoY)



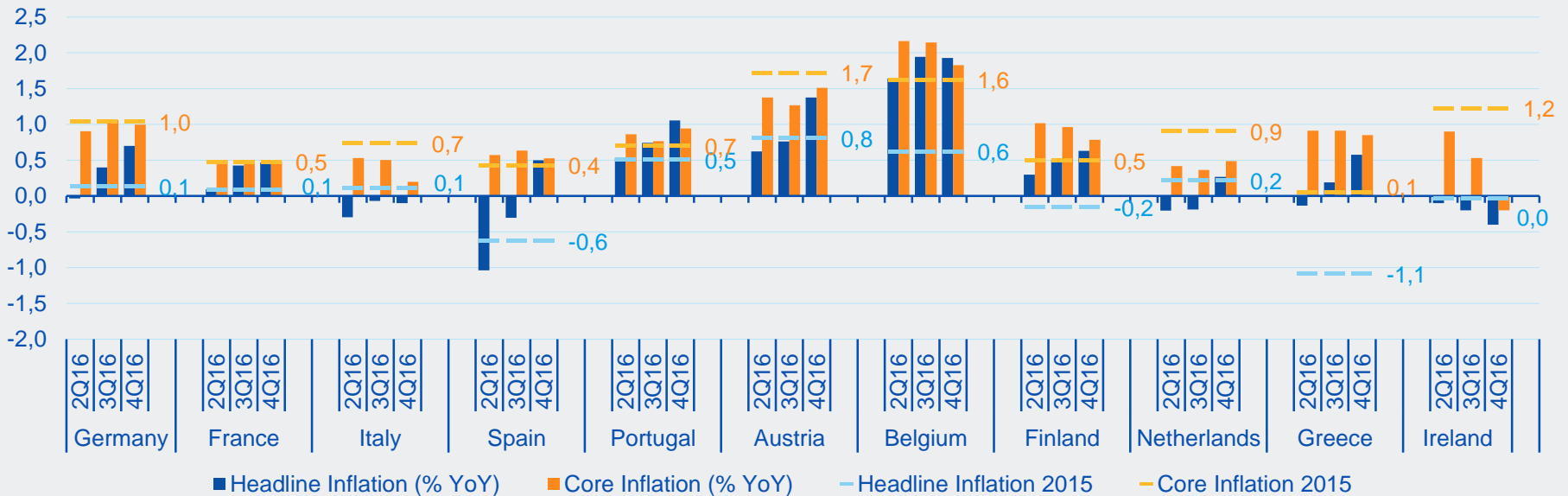
- Eurozone **HCPI** came out as expected at **+0.5% YoY in October**, slightly accelerating (+0.4% YoY in September), but the **core measure remained stable** at 0.8% YoY

- **We expect increases in inflation during coming months**, to rates slightly below 1% towards December, while energy base effects will continue to ease

SECTION 2: UPDATED FORECASTS

The acceleration of inflation in 3Q was shared in most countries but in general remains subdued

HEADLINE AND CORE INFLATION (%YoY)



- By countries, HCPI inflation picked up in Spain (+0.5% YoY) and Germany (+1.0 YoY) in October, while it remained stable in France (+0.5% YoY)

UPDATED FORECASTS: MODEST GROWTH OUTLOOK FOR 2016-17 UNCHANGED

NOVEMBER 2016



SECTION 2: UPDATED FORECASTS

Growth drivers for the eurozone

Lower tailwinds: disappearance of the effect of the depreciation of the euro and low oil prices

Global outlook still uncertain

Fruitless debate on fiscal stance to relieve an exhausted monetary policy

Political risks in a jam-packed election calendar next year

Brexit

Improving confidence since mid-year

Resilience of internal demand despite of higher uncertainty and lower tailwinds

Economic policies will continue to support the recovery: especially monetary policy along with a more favorable fiscal stance

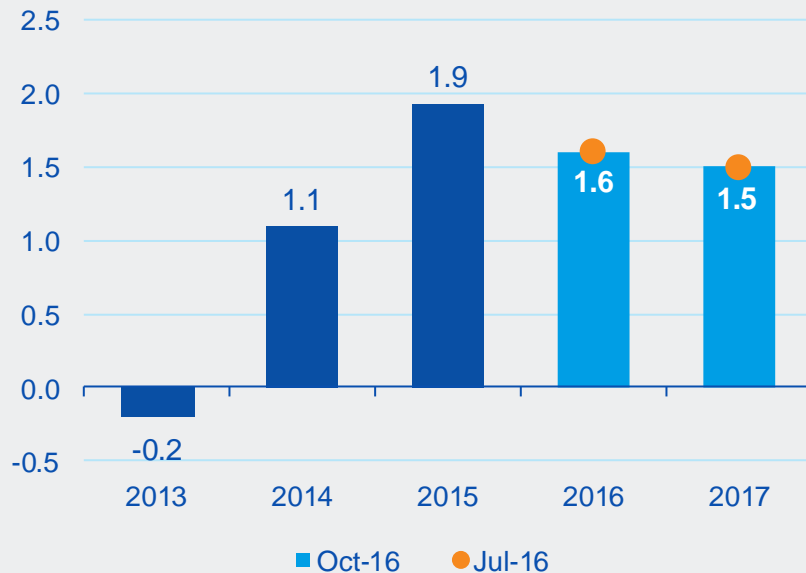
Gradual improvement in world trade

SECTION 2: UPDATED FORECASTS

Eurozone: unchanged forecasts, at around 1.5%

GDP GROWTH AND FORECAST

(%)



- **Domestic demand remains as the main driver of growth**, still supported by monetary policy and, to a lesser extent, fiscal policy

MAIN MACROECONOMIC INDICATORS

(%YoY, %GDP)

	2014	2015	2016 (f)	2017 (f)
Real GDP	1.1	1.9	1.6	1.5
Private consumption	0.8	1.7	1.6	1.4
Public consumption	0.6	1.4	1.7	1.1
Investment	1.5	2.9	2.2	2.4
Domestic demand (cont. pp)	1.1	1.7	1.7	1.5
Exports	4.4	6.1	2.4	2.8
Imports	4.8	6.1	2.9	3.2
Net exports (cont. pp)	0.0	0.2	-0.1	-0.1
Current account (% GDP)	2.4	3.1	3.4	3.2
Budget balance (% GDP)	-2.6	-2.1	-1.9	-1.8
HICP (avg. %YoY)	0.4	0.0	0.2	1.4

- Our assessment ponders a **downward bias** by year-end due to **political uncertainty, banking system blues and Brexit** effects

SECTION 2: UPDATED FORECASTS

ECB: An extension of QE remains as the most likely scenario

BBVA EZ INFLATION MONITOR

(index)



What happened

ECB dismissed rumors of tapering
The decision of **an extension of QE** has been postponed to **December**

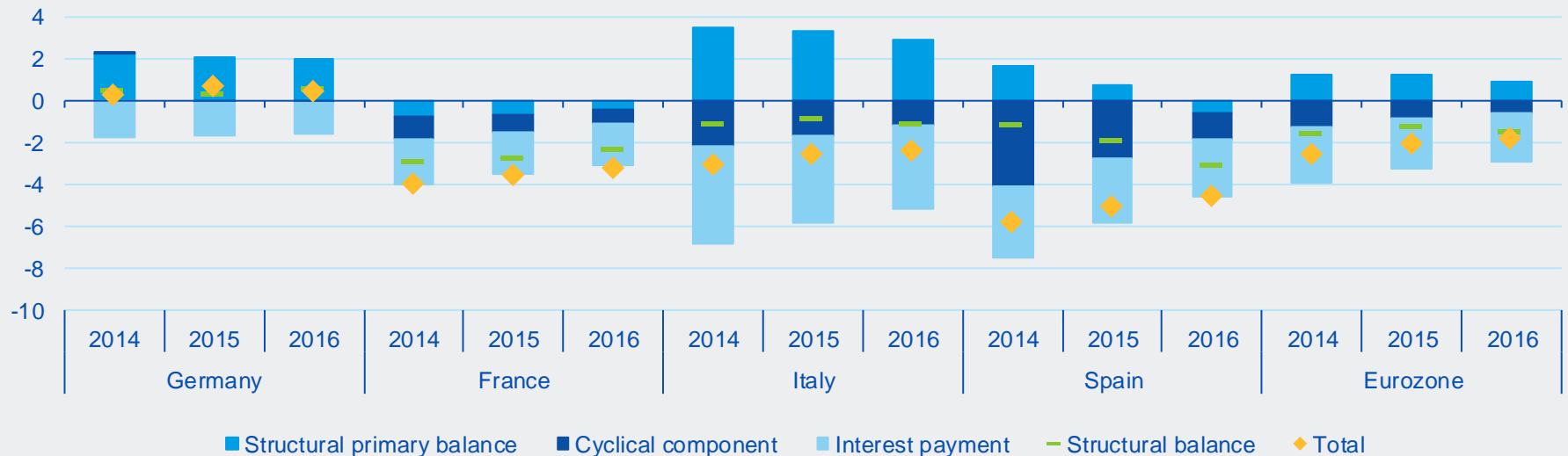
Next steps

Expected extension of QE until September 2017 added to technical adjustments to cope with the scarcity of risk free (German) bonds.

SECTION 2: UPDATED FORECASTS

Fiscal policy will continue to be supportive, but with high heterogeneity across countries

FISCAL BALANCE BREAKDOWN (%GDP)



- **France will continue to consolidate** fiscal accounts during 2016-17, while **Germany** committed to slightly expansionary measures **despite high room for fiscal maneuver**

- **Italy** is **postponing consolidation efforts** and increasing fiscal stimulus for 2016-17, while **Spain is expected to adjust more slowly** to a less supportive stance

SECTION 2: UPDATED FORECASTS

Germany: strengthening recovery in 2016, but uncertainty prevails in 2017

MAIN MACROECONOMIC INDICATORS (%YoY, %GDP)

	2014	2015	2016 (f)	2017 (f)
Real GDP	1.6	1.5	1.8	1.5
Private consumption	1.0	1.9	1.5	1.4
Public consumption	1.2	2.8	3.6	1.9
Investment	3.4	1.1	2.3	2.4
Domestic demand (cont. pp)	1.3	1.3	1.9	1.6
Exports	4.0	4.6	2.2	2.5
Imports	4.0	5.0	2.9	3.2
Net exports (cont. pp)	0.3	0.1	-0.1	-0.1
Current account (% GDP)	7.4	8.5	8.9	7.9
Budget balance (% GDP)	0.3	0.7	0.5	0.3
HICP (avg. %YoY)	0.8	0.1	0.3	1.6

- **Upward revision in 2016**, as public consumption offset a more moderate investment...
- ... but higher uncertainty could weigh on confidence and private spending in coming quarters
- **Resilient private consumption** supported by labour market and wage growth
- **Subdued global demand** will continue to put a brake on exports and investment by year end and in 2017

SECTION 2: UPDATED FORECASTS

France: relatively stable growth due to the worsening of domestic factors

MAIN MACROECONOMIC INDICATORS (%YoY, %GDP)

	2014	2015	2016 (f)	2017 (f)
Real GDP	0.7	1.2	1.2	1.3
Private consumption	0.7	1.5	1.6	1.5
Public consumption	1.2	1.4	1.5	1.2
Investment	-0.4	0.9	2.6	2.0
Domestic demand (cont. pp)	1.1	1.5	1.7	1.5
Exports	3.4	6.0	1.0	3.2
Imports	4.8	6.4	2.4	3.5
Net exports (cont. pp)	-0.5	-0.3	-0.5	-0.2
Current account (% GDP)	-1.1	-0.2	-0.7	-0.8
Budget balance (% GDP)	-4.0	-3.5	-3.3	-2.7
HICP (avg. %YoY)	0.6	0.1	0.2	1.3

- Stable and weak growth beyond volatility over last year, but **the economy is failing to escape the cycle of modest growth**
- **Uncertainty** driven by **upcoming elections** should weigh over business confidence
- In this context, **investment growth is expected to be lower**, which adds to an ongoing fiscal adjustment
- Overall, **private consumption should remain as the main contributor** to GDP growth in coming quarters

SECTION 2: UPDATED FORECASTS

Italy: weak growth on the back of political and banking sector worries, which add to uncertainty in Europe

MAIN MACROECONOMIC INDICATORS
 (%YoY, %GDP)

	2014	2015	2016 (f)	2017 (f)
Real GDP	-0.3	0.6	0.7	0.9
Private consumption	0.6	0.9	1.1	0.8
Public consumption	-1.0	-0.7	0.5	0.3
Investment	-3.3	0.6	1.9	1.8
Domestic demand (cont. pp)	-0.3	1.0	1.0	0.8
Exports	2.9	4.1	1.2	2.4
Imports	3.0	5.8	2.2	2.1
Net exports (cont. pp)	0.0	-0.3	-0.2	0.1
Current account (% GDP)	1.9	1.7	2.9	2.8
Budget balance (% GDP)	-3.0	-2.6	-2.4	-2.3
HICP (avg. %YoY)	0.2	0.1	-0.1	1.1

- **Growth continues supported by overall consumption**, but will remain subdued
- **Political uncertainty linked to the constitutional referendum and banking sector worries** weighed on domestic demand, mainly private consumption
- **Subdued investment** in the forecast horizon curbed by expectations of sluggish recovery
- **Net exports will again contribute to growth next year**, but will be less supportive than in other peripheral countries

SECTION 2: UPDATED FORECASTS

Spain: upward revision to GDP, but the economy will slow down in the coming quarters

MAIN MACROECONOMIC INDICATORS (%YoY, %GDP)

	2014	2015	2016 (f)	2017 (f)
Real GDP	1.4	3.2	3.3	2.5
Private consumption	1.6	2.9	3.3	2.3
Public consumption	-0.3	2.0	1.2	1.8
Investment	3.8	6.0	4.1	3.4
Domestic demand (cont. pp)	1.9	3.3	3.0	2.3
Exports	4.2	4.9	5.5	3.5
Imports	6.5	5.6	5.1	3.1
Net exports (cont. pp)	-0.5	-0.1	0.2	0.2
Current account (% GDP)	1.0	1.4	1.3	1.7
Budget balance (% GDP)	-5.7	-5.0	-4.6	-3.6
HICP (avg. %YoY)	-0.2	-0.5	-0.3	1.7

- Incoming data **confirmed the upward bias to GDP growth forecasts** in both 2016 and 2017. Domestic demand will continue to support the recovery ...
- ...with **still strong investment**, mainly in machinery and equipment. Net exports with positive contribution to growth in a context of subdued external demand
- Risks remain related to ongoing **fiscal consolidation and political uncertainty**, related to both idiosyncratic factors and *Brexit*

Short-term indicators and Updated
Forecasts

Eurozone

November
2016



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