

EUROZONE

ECONOMIC WATCH

DECEMBER 2016



Key messages: gaining some momentum by year-end, though we remain cautious on the outlook for the coming months

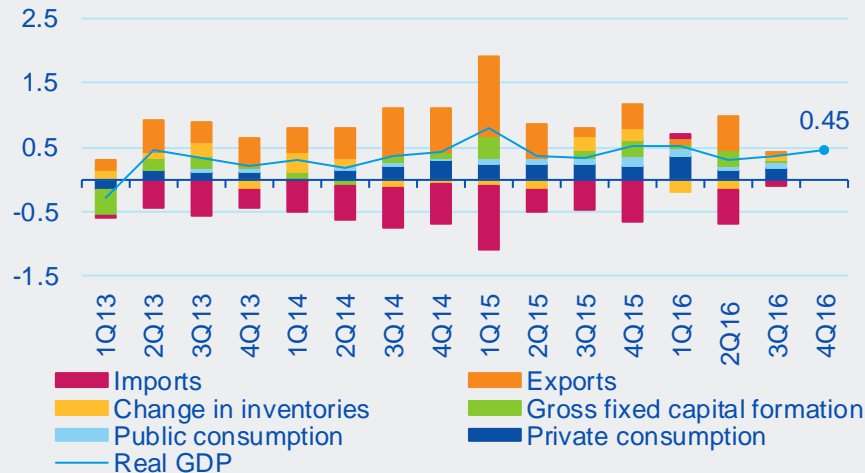
- **Improving confidence in 4Q16** across the board **proved the eurozone resilience** after political events since the summer, while leading components suggest **a slightly more optimistic outlook for coming months** supported by increasing export orders and the depreciation of the euro.
- Although **hard data are mixed so far**, the strength of consumption remains on track, but **concerns about the weakness of investment have not been dispelled**. Nonetheless, beyond data volatility up to October, positive underlying signs are taking root.
- Our **MICA-BBVA model**, with still limited data, **estimates quarterly GDP growth in the eurozone to gain some momentum to 0.4/0.5% QoQ in 4Q16**, after growth of 0.3% in the previous two quarters.
- **Inflation is picking up as expected**, given the energy prices' base effects, **but core measures remain subdued**. We continue to expect headline inflation to increase in coming months (to around 1% YoY in December), but to remain clearly below the ECB target in the medium-run.
- **The ECB extended QE up to the end of 2017, but lowered monthly asset purchases** (from €80 to €60bn) and included lower maturity assets in the purchase program.
- **We remain cautious and maintain our GDP growth projections** for the eurozone at 1.6% in 2016 (though it could be 1.7%) and 1.5% in 2017.
- **Risks remain tilted to the downside and are mostly political**, both at national and regional level, but derive also from financial sector fragilities and public debt sustainability in some countries.

ECONOMIC DEVELOPMENTS

GDP growth accelerates slightly in 4Q16...

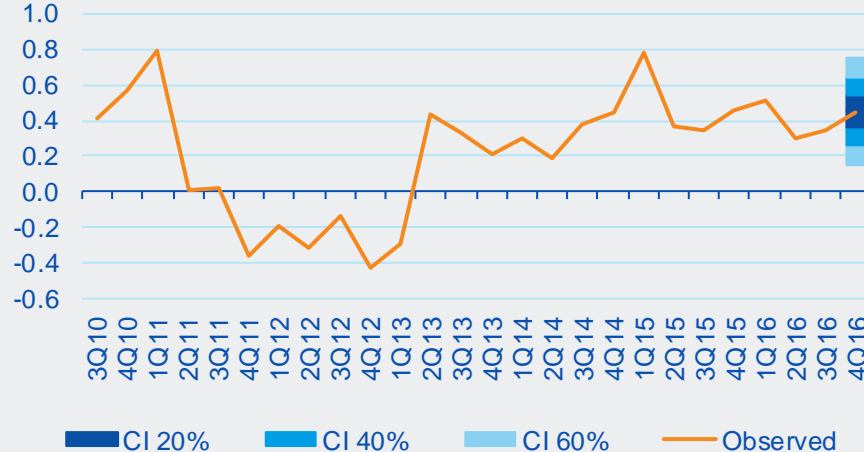
GDP, CONTRIBUTION BY COMPONENTS

(%QoQ, pp)



GDP AND MICA FORECASTS

(%QoQ)

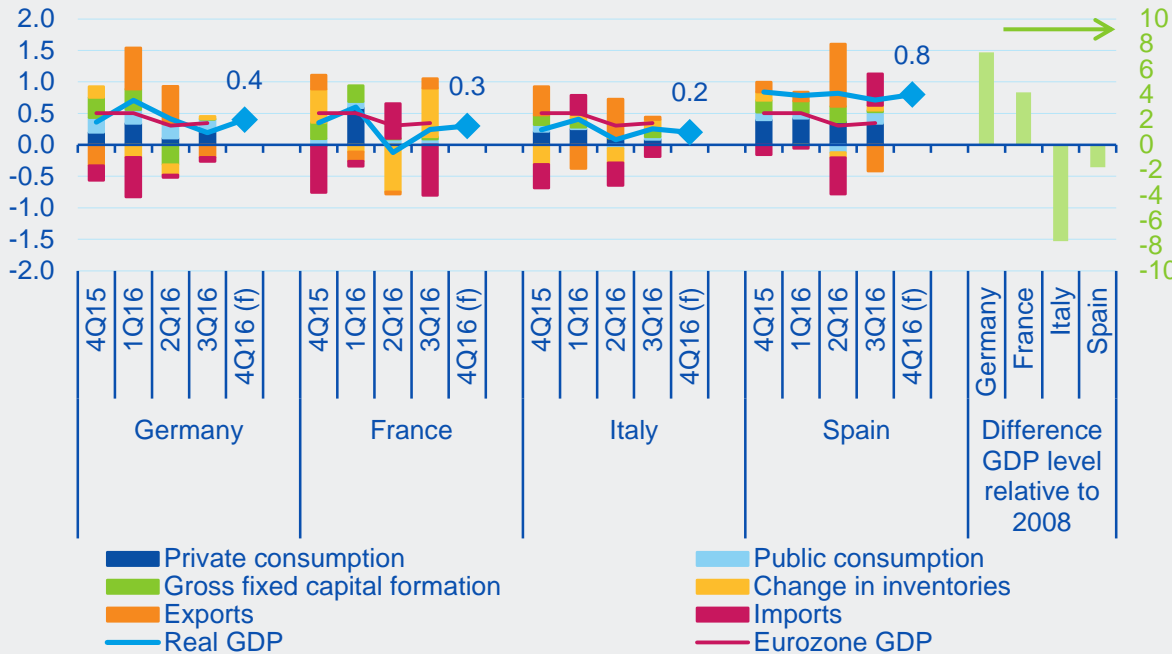


- **GDP growth stable in 3Q16**, (0.3% QoQ) thanks to stronger consumption and despite low investment and a negative contribution from net exports
- Early indicators, still scarce, suggest that the **economy could be gaining traction in 4Q** as the eurozone has shown resilience to increased uncertainty
- **Domestic demand continues to support growth** thanks to the strength of the labor market and favorable policies, **while some tailwinds blow again** (improving global demand and euro depreciation)

ECONOMIC DEVELOPMENTS

... underpinned by an acceleration in Germany and France by year end, while growth could slow in Italy

GDP, CONTRIBUTION BY COMPONENTS (%QoQ, pp)

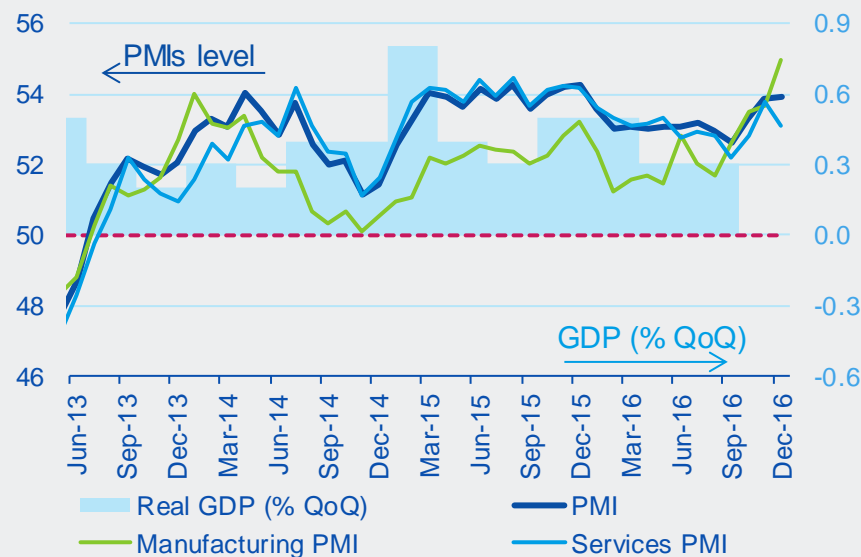


- Data for 4Q16 point to a **GDP growth acceleration in Germany** (BBVAe: 0.4% QoQ after 0.2% QoQ) on the back of improved net exports, **and France** (BBVAe: 0.3% QoQ after 0.2% QoQ)
- In contrast, **Italy growth could slow again in 4Q16** (BBVAe: 0.2% QoQ after 0.3% QoQ in 3Q16)
- **Spain continues to outperform** GDP growth in the region (BBVAe: 0.8% QoQ) driven by both private consumption and external demand

ECONOMIC DEVELOPMENTS

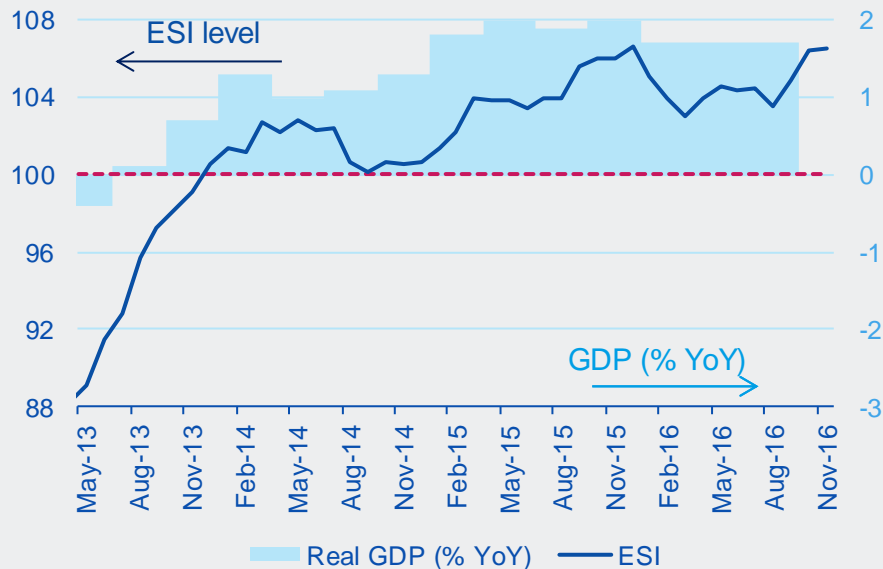
Confidence improved in 4Q across sectors, showing resilience to political uncertainty

PMI AND GDP
(index, %QoQ)



- Confidence data **so far continue to show the economy's resilience** to increasing uncertainty since the summer, with manufacturing increasing strongly driven by expectations on global demand and a weaker euro

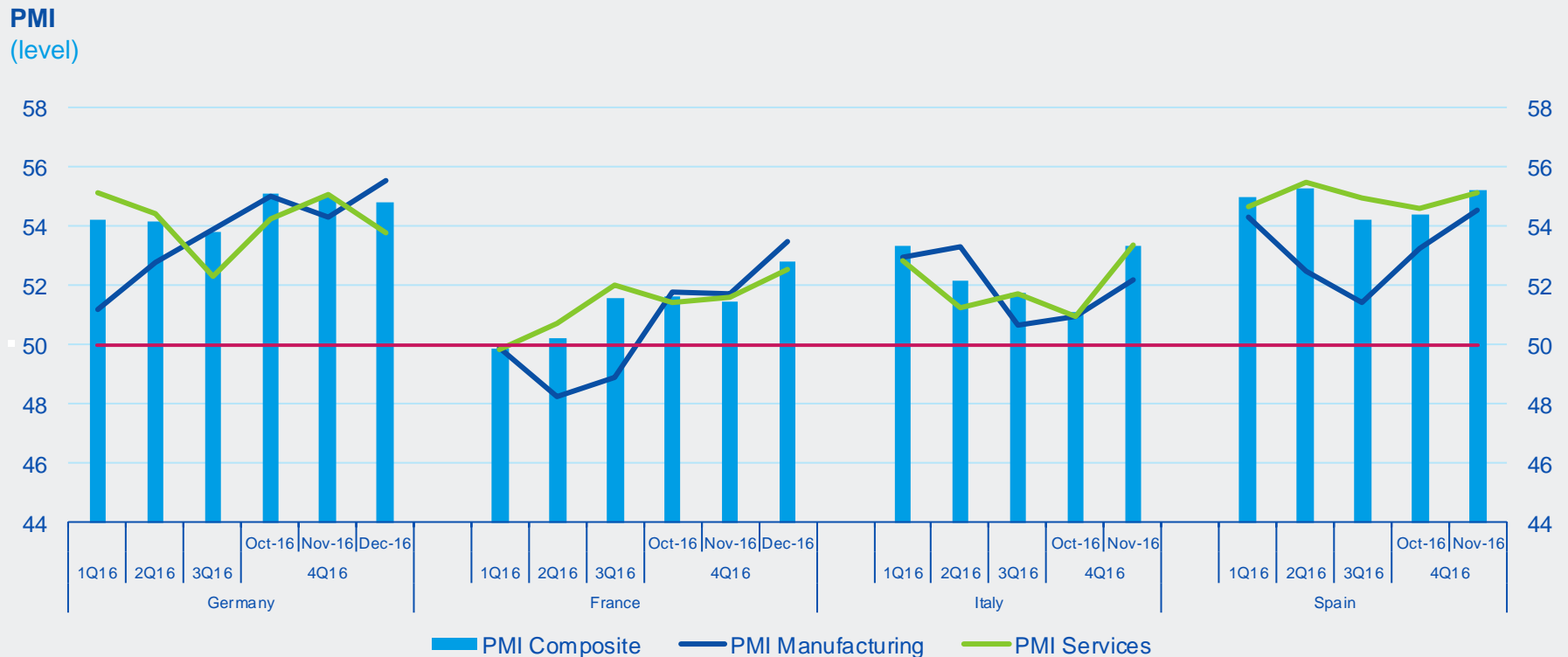
ESI AND GDP
(index, %QoQ)



- But **we remain cautious** as political events in coming months could end up weighing on confidence

ECONOMIC DEVELOPMENTS

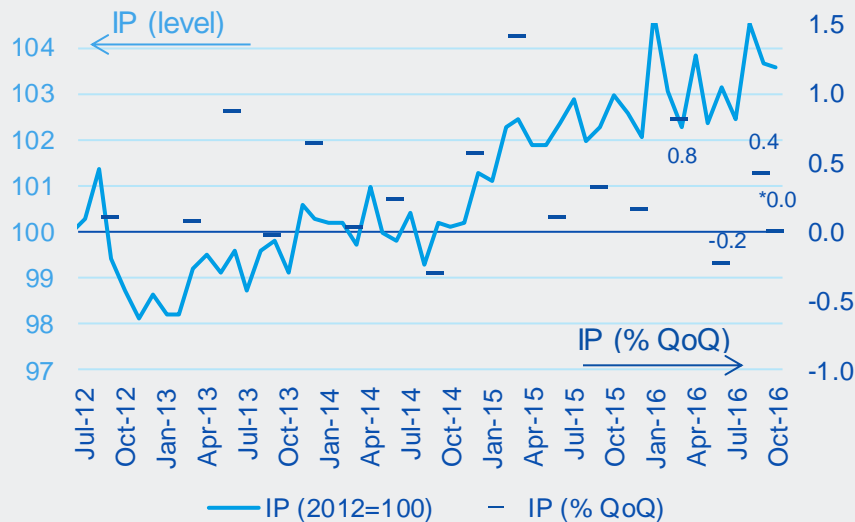
Manufacturing and services' PMIs improved in all core countries in 4Q, although German services slowed in December



ECONOMIC DEVELOPMENTS

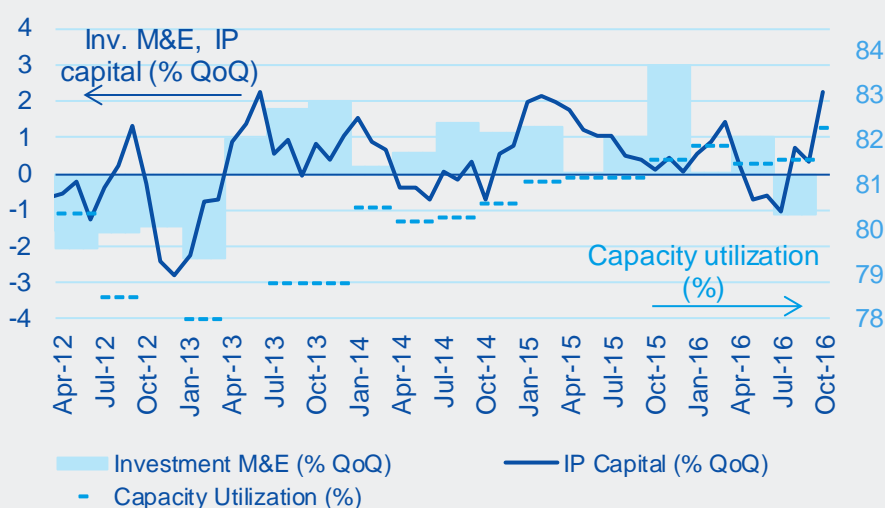
Stable industrial output in October, though capital goods' production accelerated at the beginning of 4Q ...

INDUSTRIAL PRODUCTION
(%QoQ, pp)



- Industrial production **dropped 0.1% MoM in October** after falling by 0.9% MoM in September, **remaining flat with respect to 3Q16** (0.4% QoQ)

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



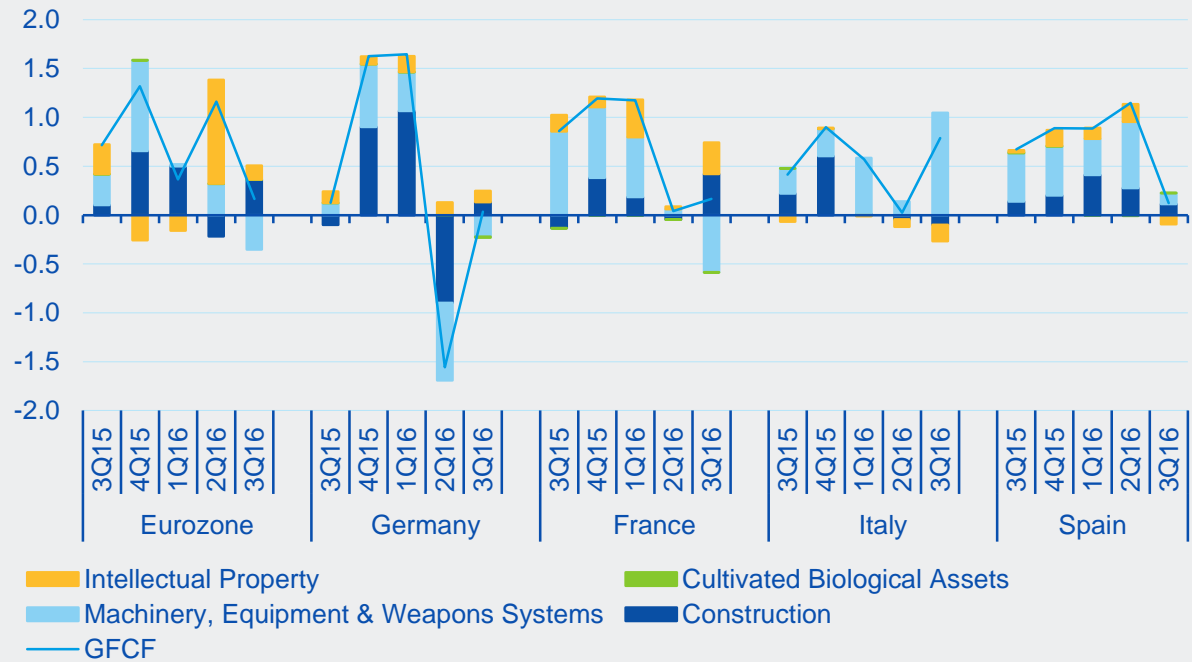
- Strong production of **capital and durable consumer goods** along with **high capacity utilization** suggest some recovery in equipment and machinery investment over 4Q16

*October with respect to three previous months
Source: Eurostat and BBVA Research

ECONOMIC DEVELOPMENTS

... which should foster investment towards year-end after a break in 3Q

GROSS FIXED CAPITAL FORMATION, CONTRIBUTION BY COMPONENT (%QoQ, pp)

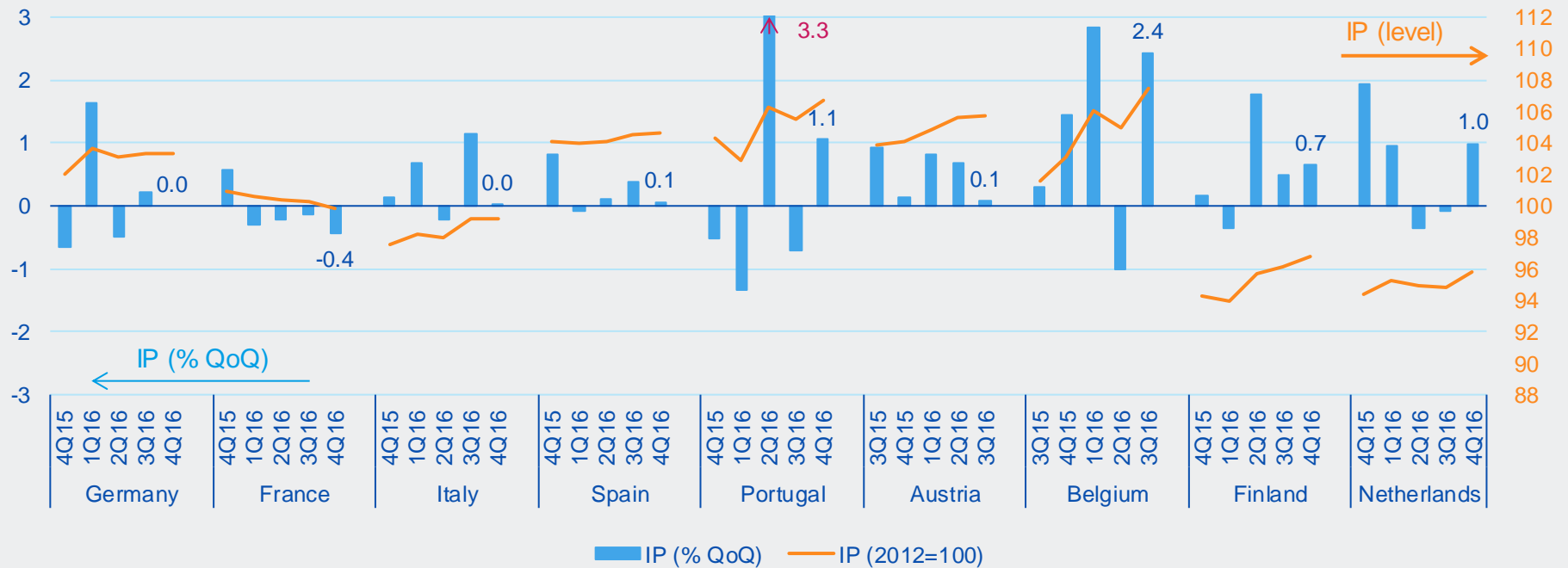


- **Mixed figures of Machinery and Equipment (M&E) in core countries**, with a lower decline and an acceleration in Germany and Italy during 3Q ...
- ... while a deceleration and weakening of M&E in Spain and France was observed
- **Construction accelerates** in Germany and France, while falls in Italy during 3Q

ECONOMIC DEVELOPMENTS

Flat industrial output in core countries during 4Q with the exception of France, but confidence suggests an improvement in coming months

INDUSTRIAL PRODUCTION
(%QoQ, pp)

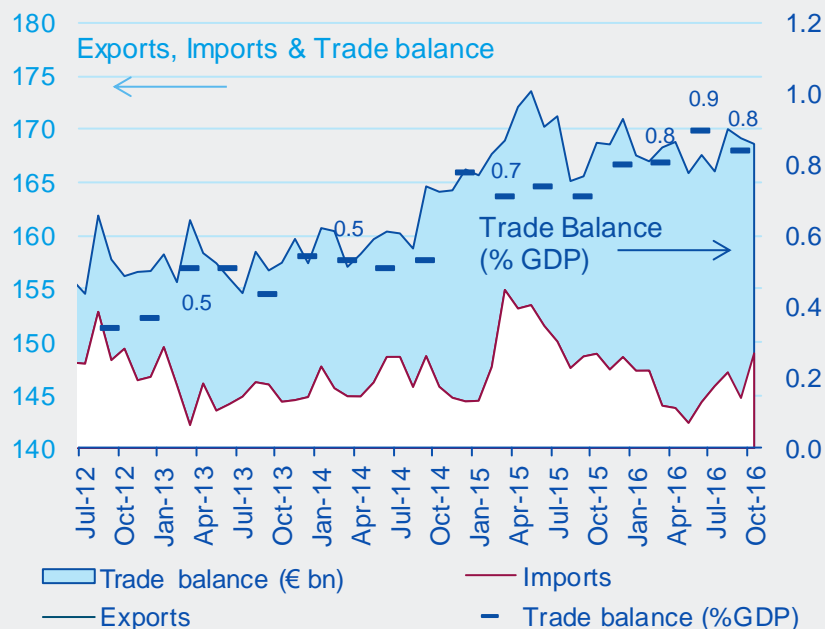


*4Q16 calculated using October data
Source: Eurostat and BBVA Research

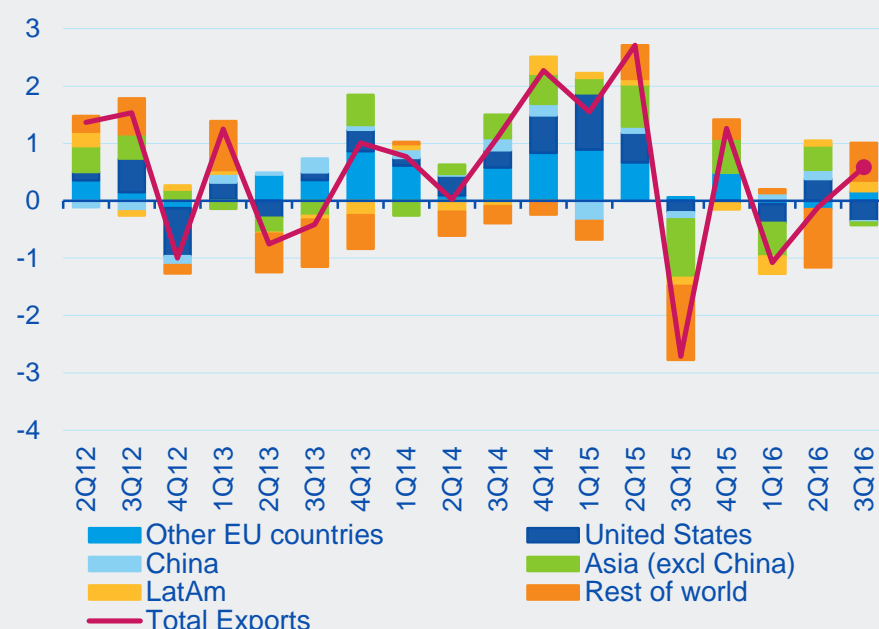
ECONOMIC DEVELOPMENTS

Exports slowed in October, but looking through volatility they are improving in the second half of the year

TRADE BALANCE
(€ bn, %GDP)



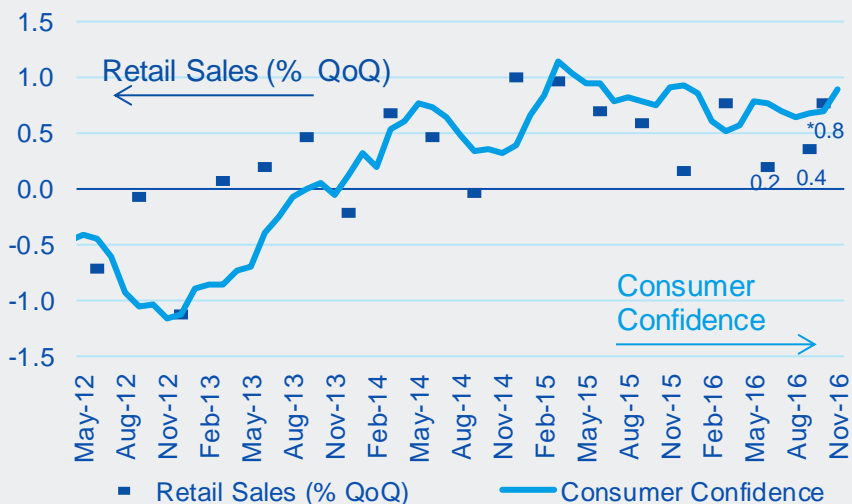
EXPORTS CONTRIBUTION BY DESTINATION
(%QoQ, pp)



ECONOMIC DEVELOPMENTS

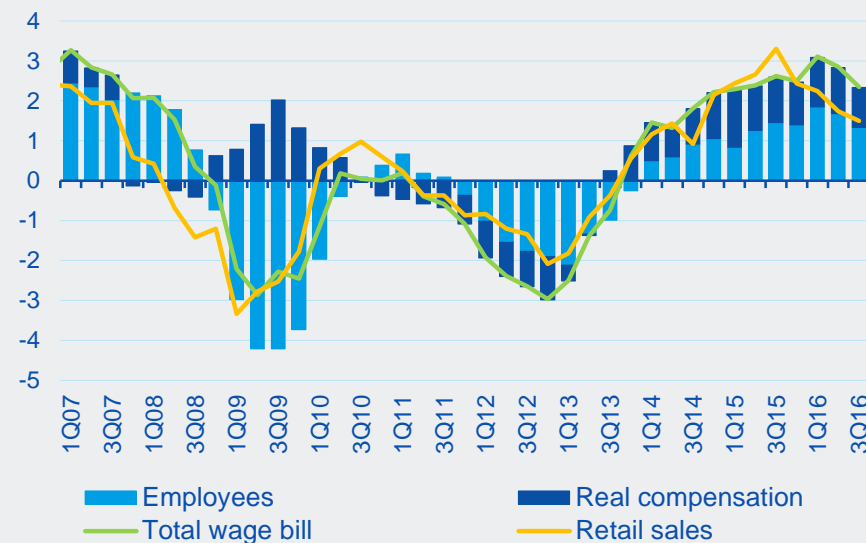
The rebound of retail sales in October points to private consumption remaining as the main driver of growth

RETAIL SALES AND CONSUMER CONFIDENCE
(%QoQ, pts)



- **Retail sales increased strongly in October** (0.8% QoQ) and reverted the moderation observed in the previous two quarters (around 0.3% QoQ)

RETAIL SALES AND TOTAL WAGE BILL
(%YoY)



- **Consumer confidence rose in November to its highest this year**, which together with labour market gains should support household spending despite increasing inflation

*October with respect to three previous months
Source: Eurostat and BBVA Research

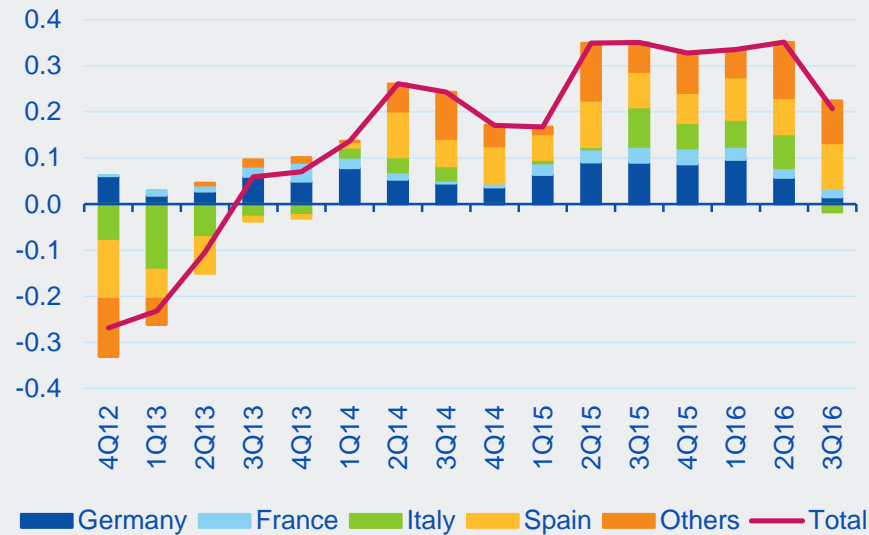
Source: Eurostat and BBVA Research

ECONOMIC DEVELOPMENTS

Employment growth slowed in 3Q mainly driven by weaker public and private services ...

JOB GROWTH CONTRIBUTION BY COUNTRY

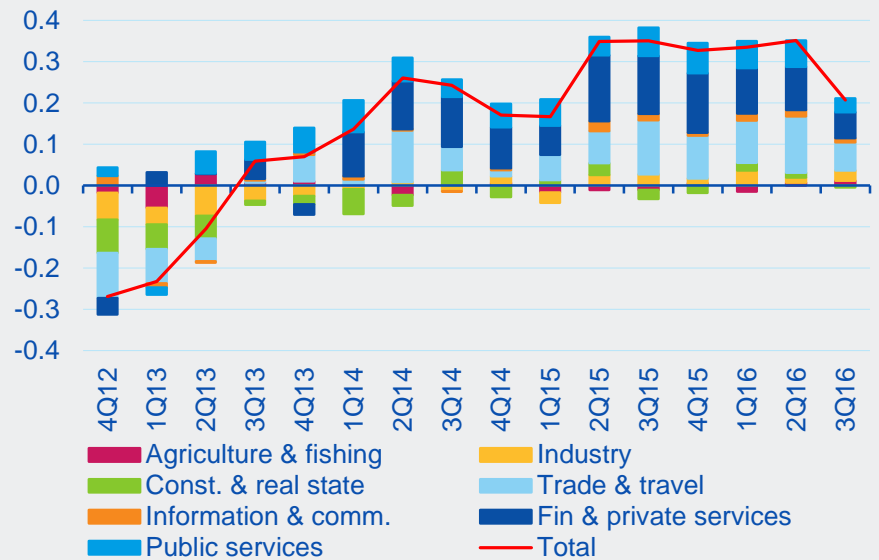
(pp, %QoQ)



- Lower employment growth contribution from Germany and Italy in 3Q16, but higher from Spain

JOB GROWTH CONTRIBUTION BY SECTOR

(pp, %QoQ)



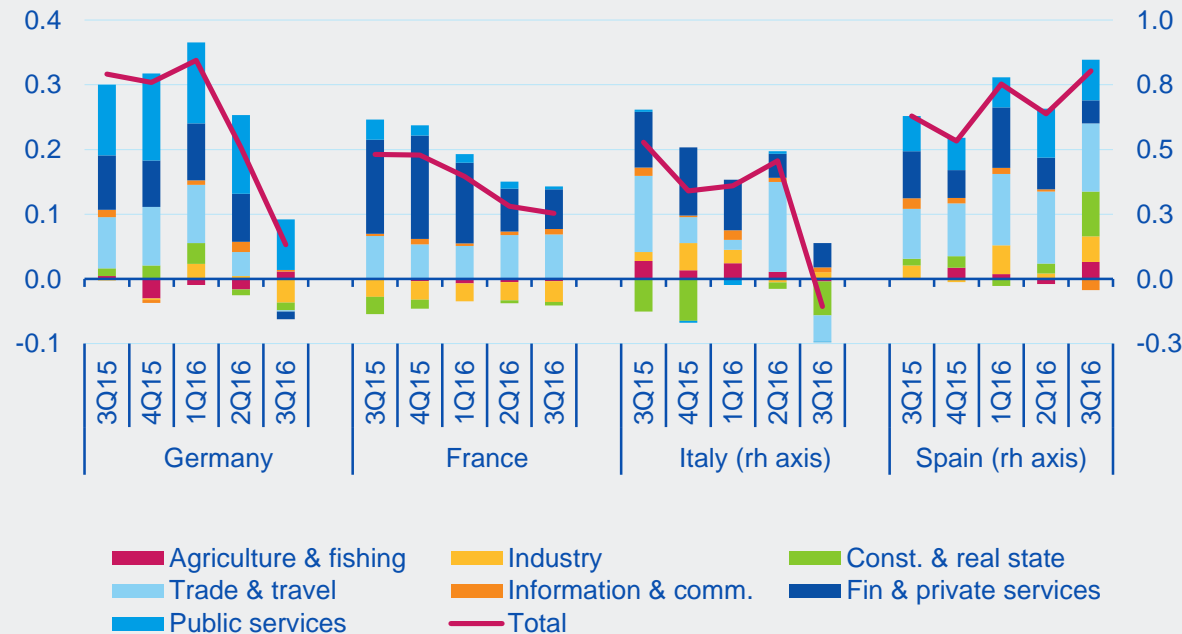
- By sector, lower contributions from public and private services, which add to trade and travel activities

ECONOMIC DEVELOPMENTS

... with weakness mostly in Germany and Italy, while job creation continued in France and Spain

JOB GROWTH CONTRIBUTION BY SECTOR

(pp, %QoQ)

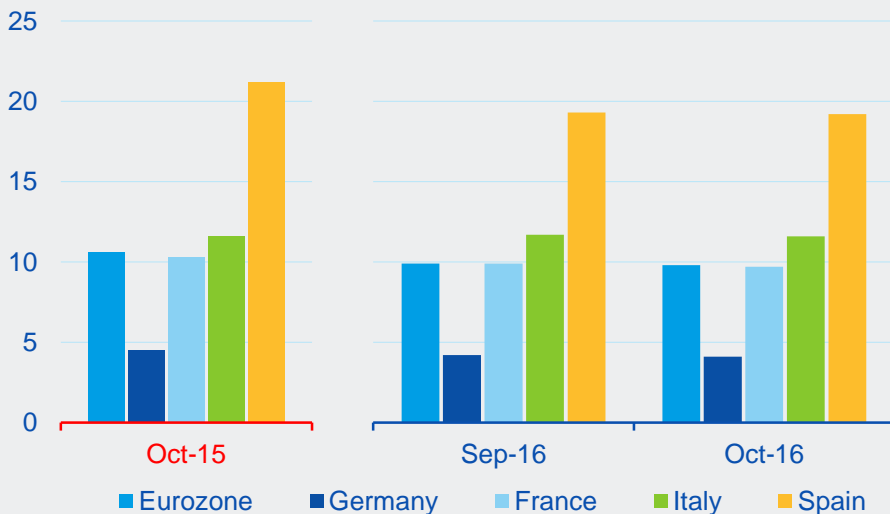


- **Public employment** explained all job growth in **Germany**, offsetting the decline of private employment growth
- **Job destruction in Italy** in 3Q driven by construction, trade and travel activities
- Employment growth in **France and Spain** still supported by services

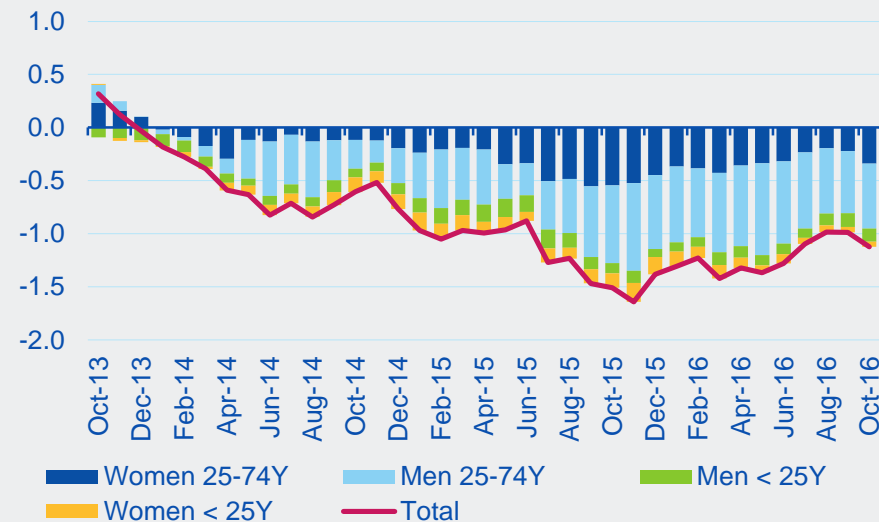
ECONOMIC DEVELOPMENTS

Unemployment continued to decline at the beginning of 4Q, after some stabilization by mid-year

UNEMPLOYMENT RATE BY COUNTRY (%)



ANNUAL UNEMPLOYMENT CHANGE BY GENDER & AGE (millions)



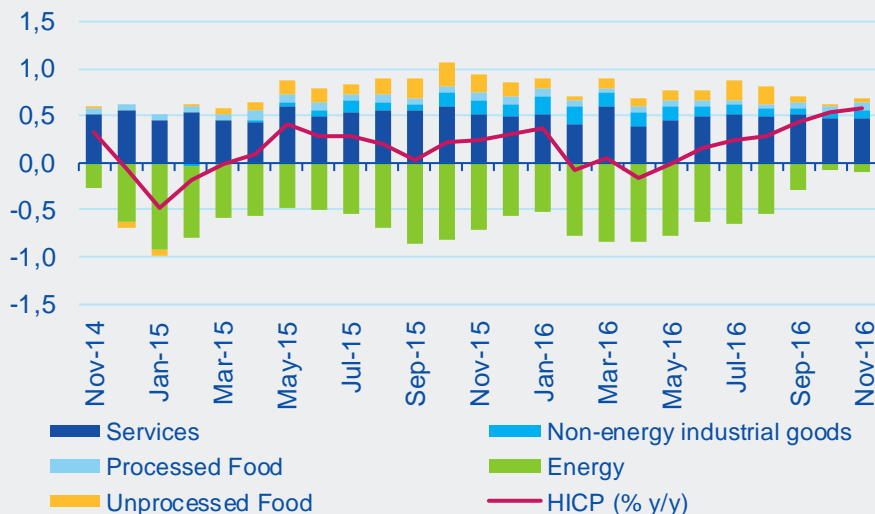
- **Jobless rate continues to fall at a low pace**, driven mostly by Spain

- **Unemployed decline** is observed mostly among the experienced population

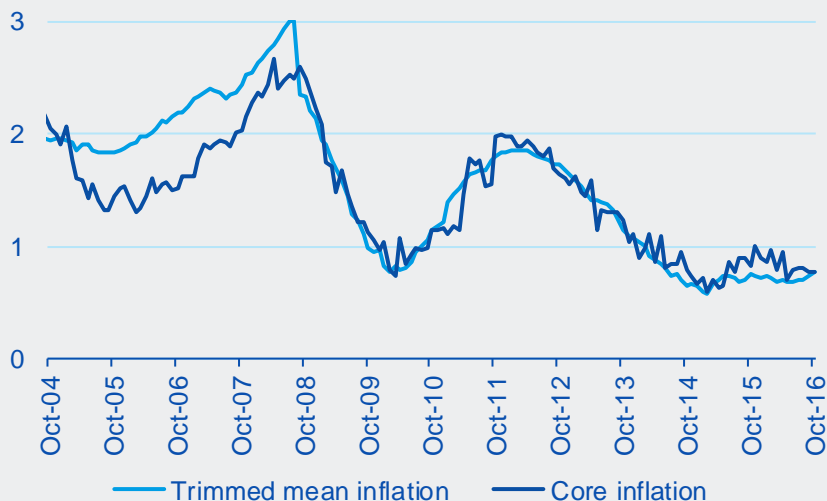
ECONOMIC DEVELOPMENTS

Headline inflation accelerated slightly in November but the core measure remained subdued at low levels

INFLATION AND CONTRIBUTION OF COMPONENTS
(%YoY, pp)



INFLATION AND TRIMMED MEAN
(%YoY)



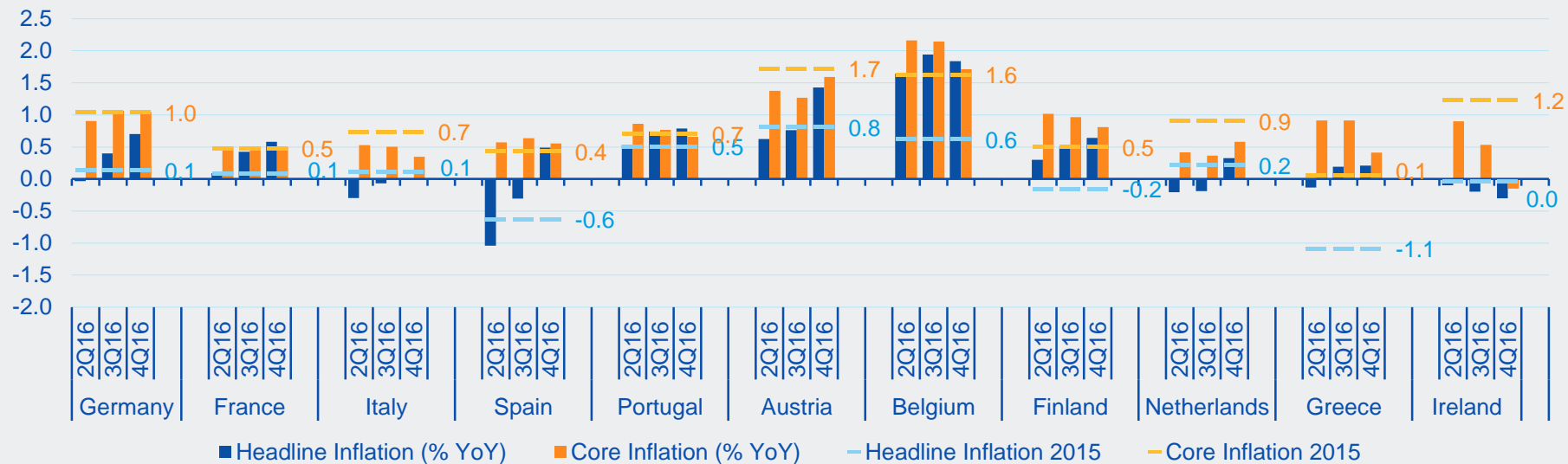
- Eurozone **HCPI** came out as expected at **0.6% YoY in November**, slightly accelerating (0.5% YoY in October), and marked the highest figure since April 2014

- The **core measure remained stable** at 0.8% YoY
- **We expect increases in inflation during coming months**, while energy base effects will continue to ease

ECONOMIC DEVELOPMENTS

Inflation is picking up in most countries in 4Q16

HEADLINE AND CORE INFLATION (%YoY)



- By country, HCPI inflation picked up in **France** (0.7% YoY) and **Italy** (0.1% YoY) in November, while it remained stable in **Spain** (0.5% YoY) and **Germany** (0.7% YoY)

*4Q16 calculated using October and November data
Source: Eurostat and BBVA Research

EUROZONE

ECONOMIC WATCH

DECEMBER 2016



Disclaimer

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

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

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

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

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

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

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.