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# Eurozone Economic Watch

July 2017



## Eurozone: Upward revision of GDP with a broad-based recovery

- ◆ **Hard data seem to be catching-up with confidence** figures. The **industrial recovery** strengthens over 2Q17 while **retail sales continue to grow** on the back of both employment gains and strong confidence.
- ◆ **Foreign trade figures remain strong**, benefiting from robust global demand during 1H17.
- ◆ Our **MICA-BBVA model** now suggests that **GDP growth could have improved again in 2Q17** (to around 0.7% QoQ), but we remain cautious on the sustainability of this strong pace above potential.
- ◆ **We revised upwards our GDP growth estimates for 2017** (by 0.3pp to 2.0%), based on stronger incoming data and the more broad-base recovery, even with some upward bias in the short run. **For 2018, we view some moderation** and maintain our previous forecast (1.7%).
- ◆ Stronger GDP **growth is widespread across the region**, with significant upward forecast revision in Italy, Spain and Germany supported by higher exports and investment.
- ◆ Lower oil prices and stronger euro led us to revise slightly down forecasts for headline inflation, while **core inflation is expected to increase very gradually** over 2017-18.
- ◆ **Both monetary and fiscal policies will continue to be supportive in coming quarters**, although some retrench on the monetary front is expected going forward. We still expect **QE's end by around mid-2018 and a first rate hike by the end of next year**.
- ◆ **Political risk has eased**, but some concerns prevails regarding the electoral cycle and Brexit negotiations. Global risks (geopolitical, China's imbalances) are still prevalent.

# Economic developments: Growth momentum stabilizes in 2Q17 at high levels

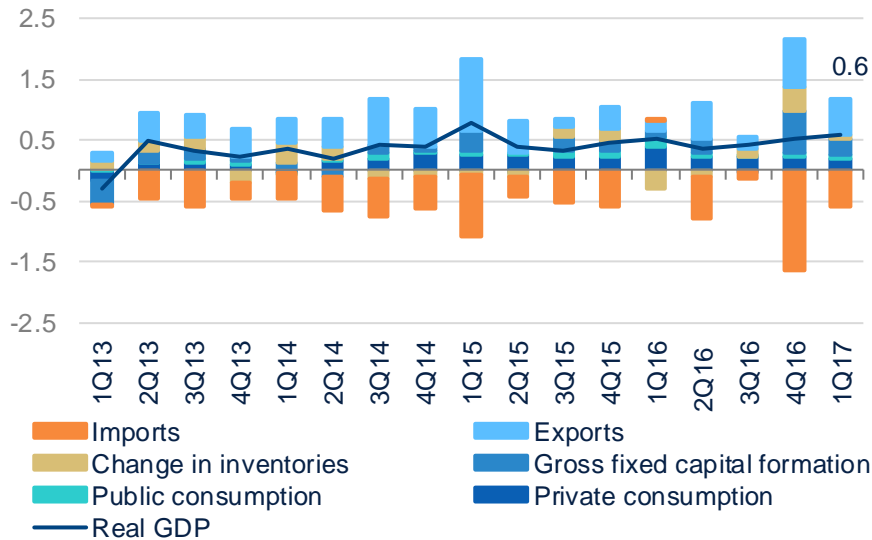
JULY 2017



# Growth momentum in the area stabilizes in 2Q17 at high levels

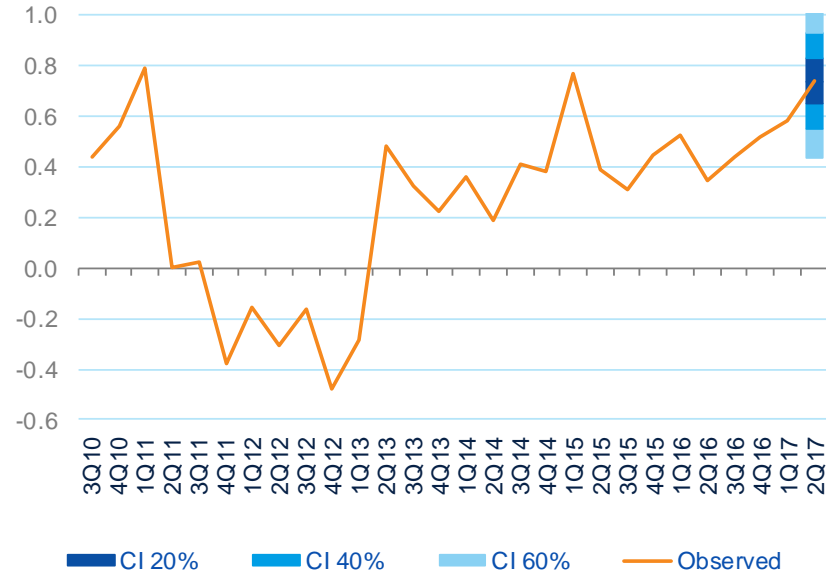
## GDP, Contribution by Components

(%QoQ, pp)



## GDP and MICA forecasts

(%QoQ)

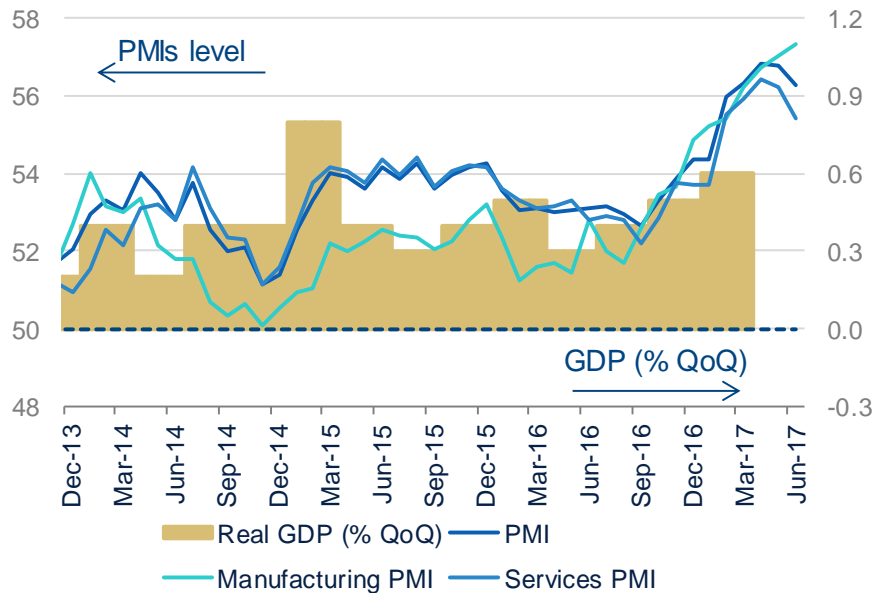


Source: Eurostat and BBVA Research

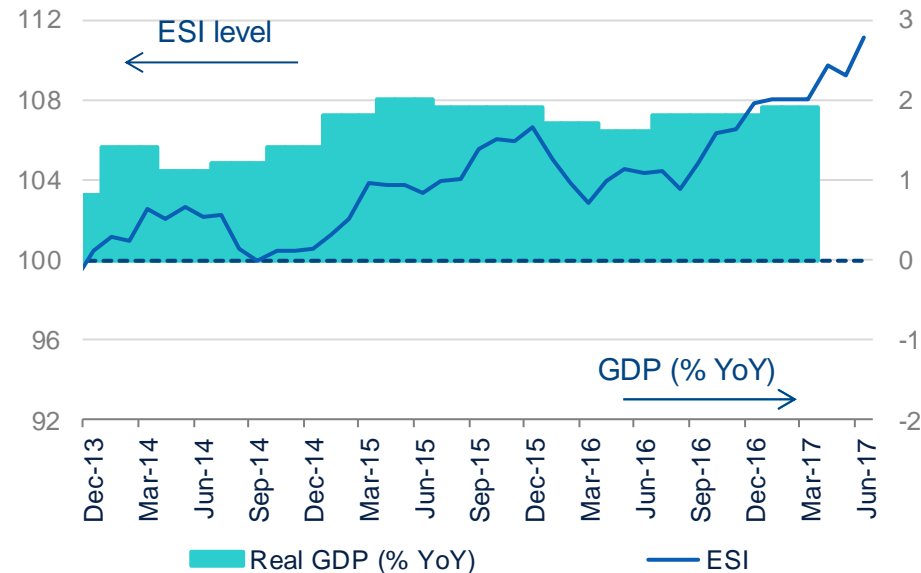
- ◆ GDP grew by +0.6% QoQ in 1Q17
- ◆ Investment remains the main contributor to growth
- ◆ Exports growth still supported by improving external demand
- ◆ Consumption expected to soften due to rising inflation
- ◆ Our MICA-BBVA model estimates a quarterly GDP growth rate of near +0.7% in 2Q17

# Confidence indicators remain strong in 2Q17, despite some moderation in services' PMI

**PMI and GDP**  
(level, %QoQ)



**ESI and GDP**  
(level, %YoY)

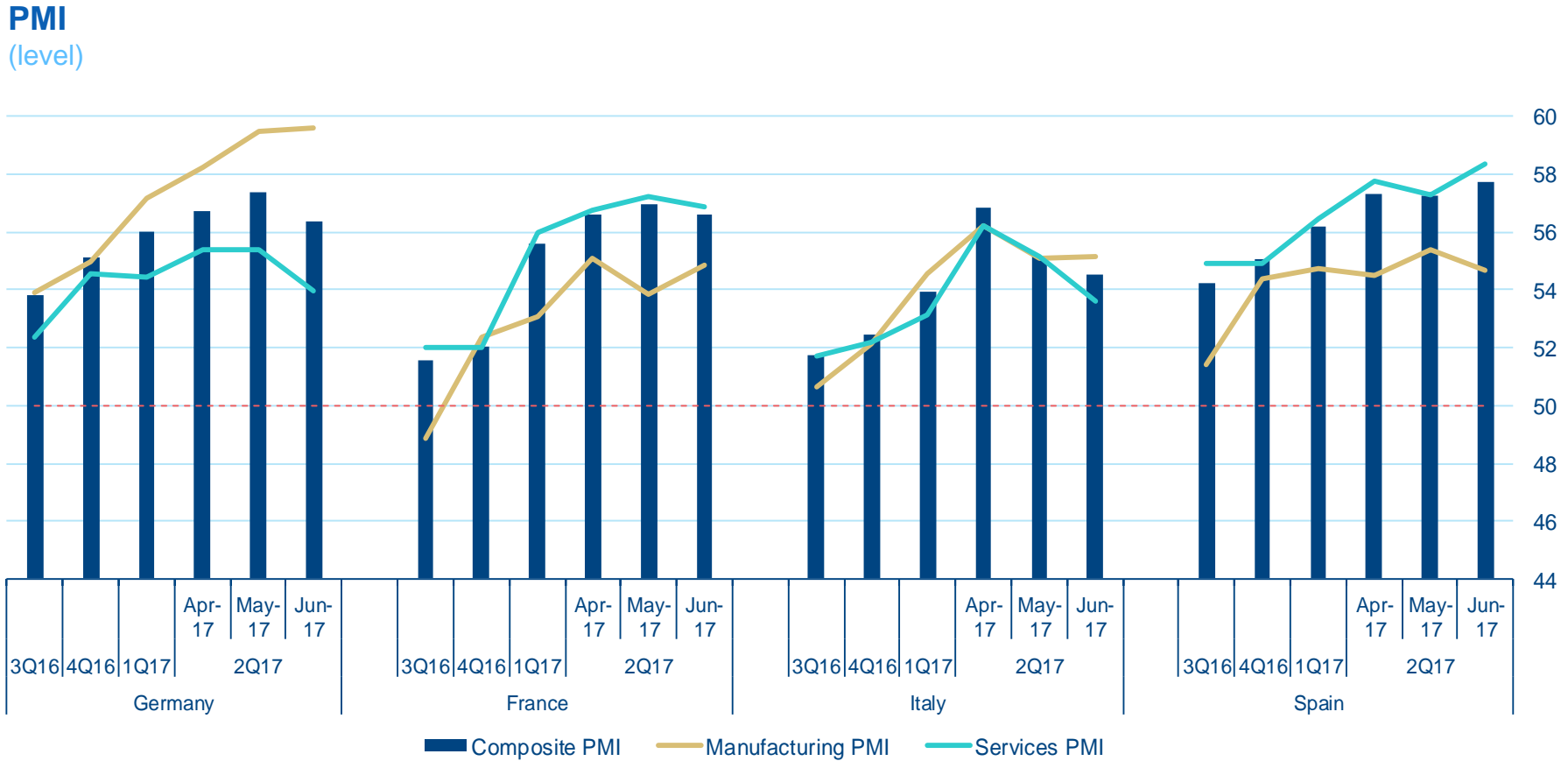


Source: Eurostat and BBVA Research

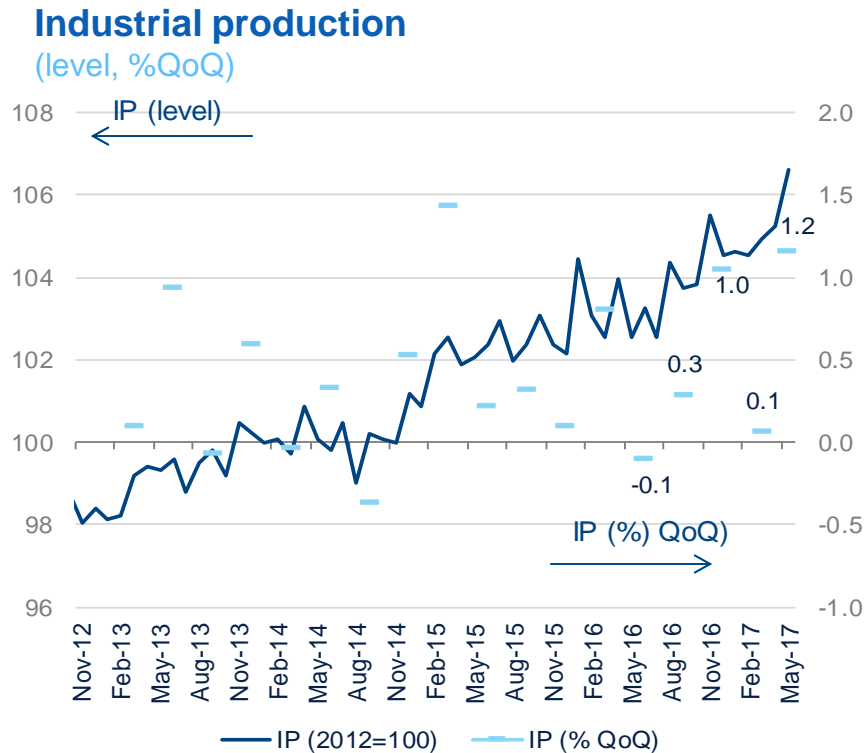
◆ Confidence data show continued gains in 2Q17, with an upbeat mood in manufacturing and some moderation of services

◆ Economic sentiment (ESI) increase was broad based in June and kept an upward trend towards post-crisis high

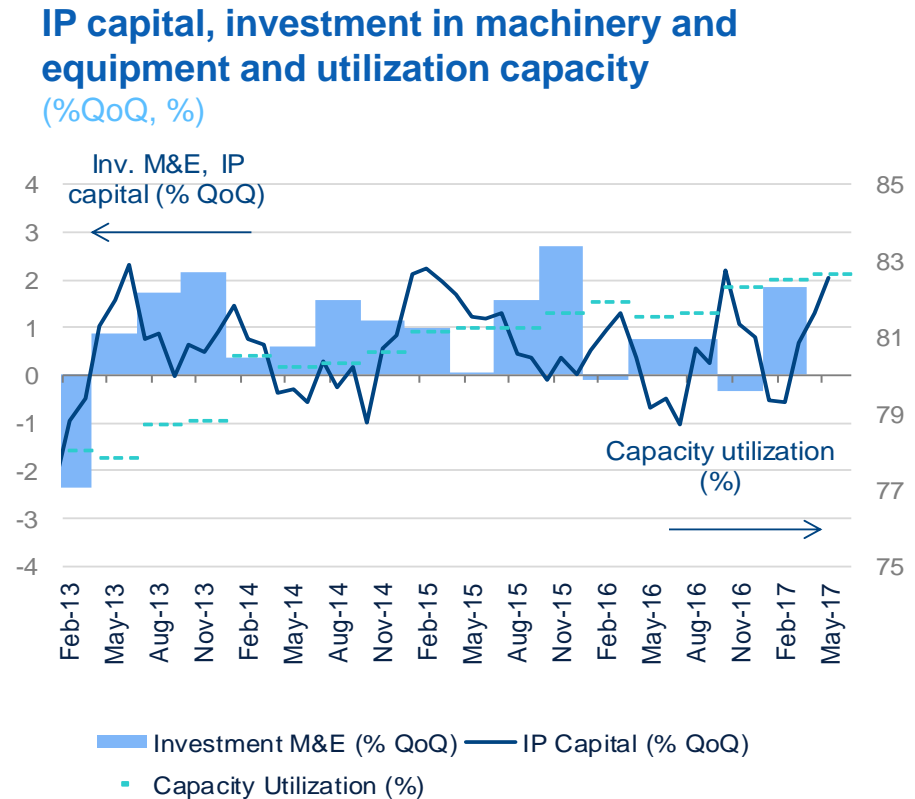
# Germany, Spain and France are leading the positive mood, but figures begin to stabilize



# The recovery of industrial production strengthens over 2Q17



Source: Eurostat and BBVA Research



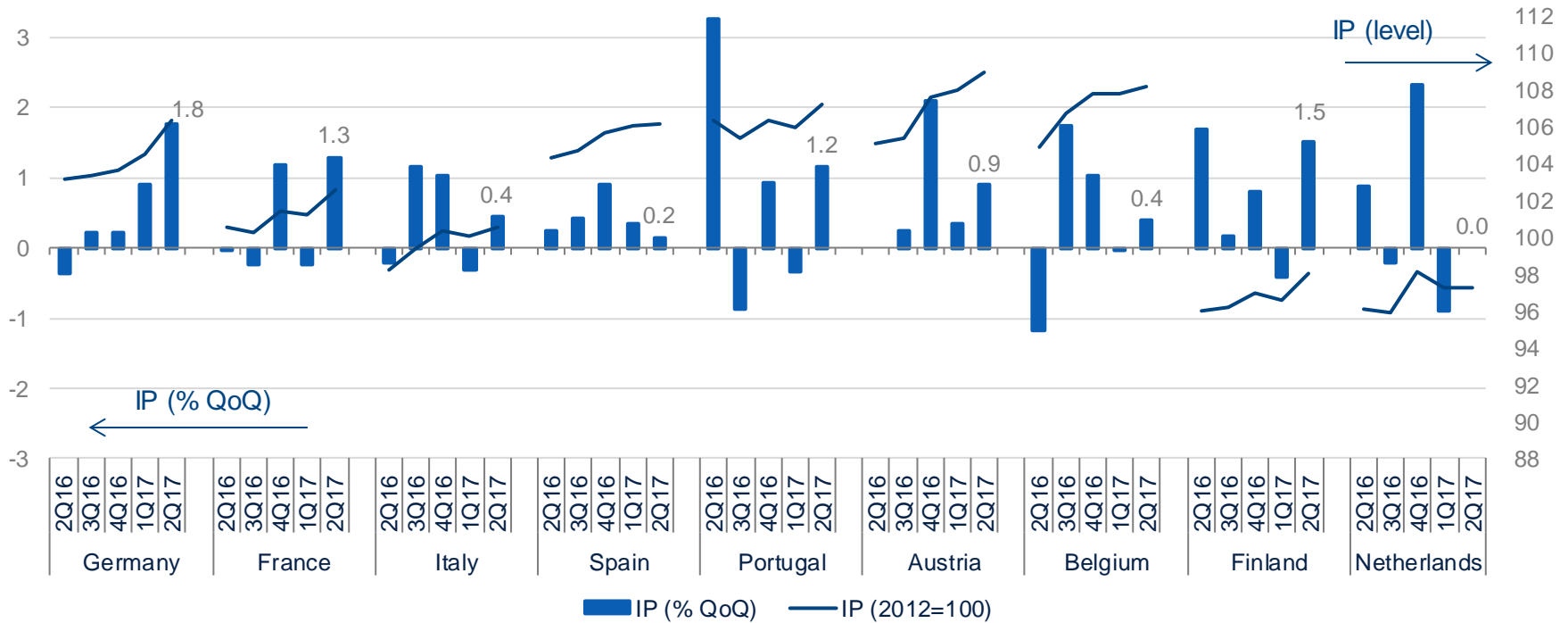
Source: Eurostat and BBVA Research

◆ **Industrial production surged 1.3% MoM in May** after 0.3% MoM in April (although revised downwards by -0.2 pp)

◆ **Production of capital and durable consumer goods added to high capacity utilization** and suggest that the recovery in investment is on track

# The increase in industrial output has been broad-based across countries

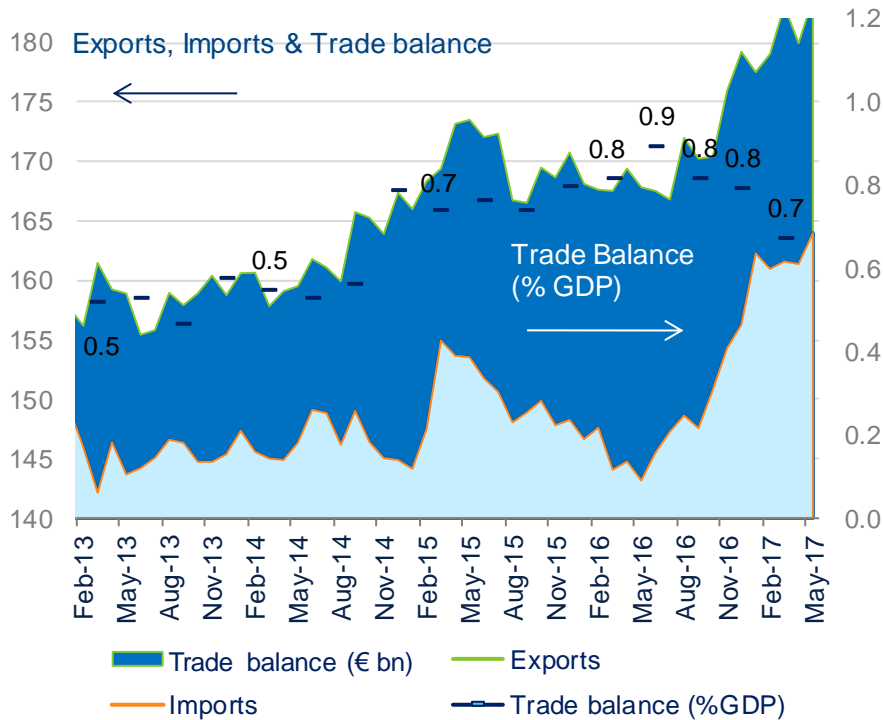
**Industrial production**  
(%QoQ, level)



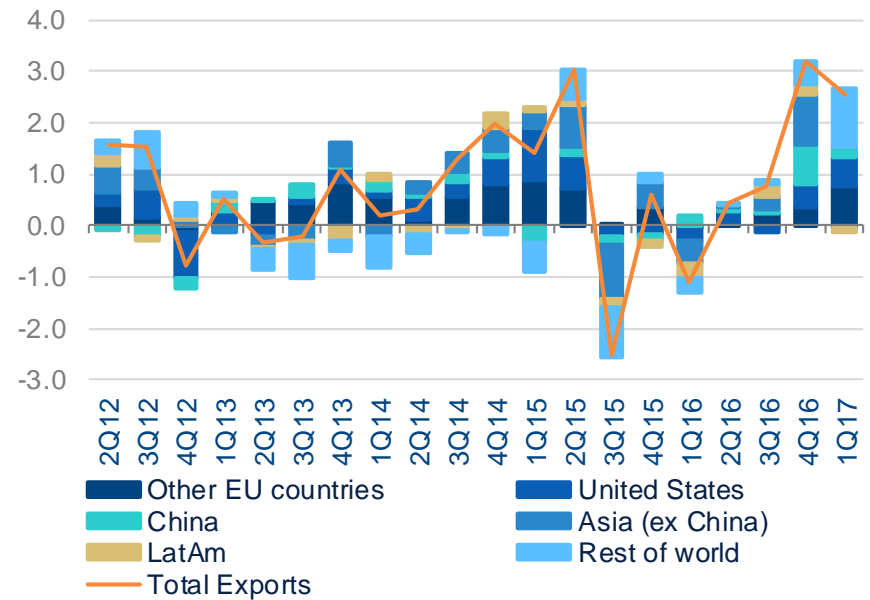


# Exports slowed down in May, but overall 2Q figures remain positive

**Trade balance**  
(€ bn, %GDP)

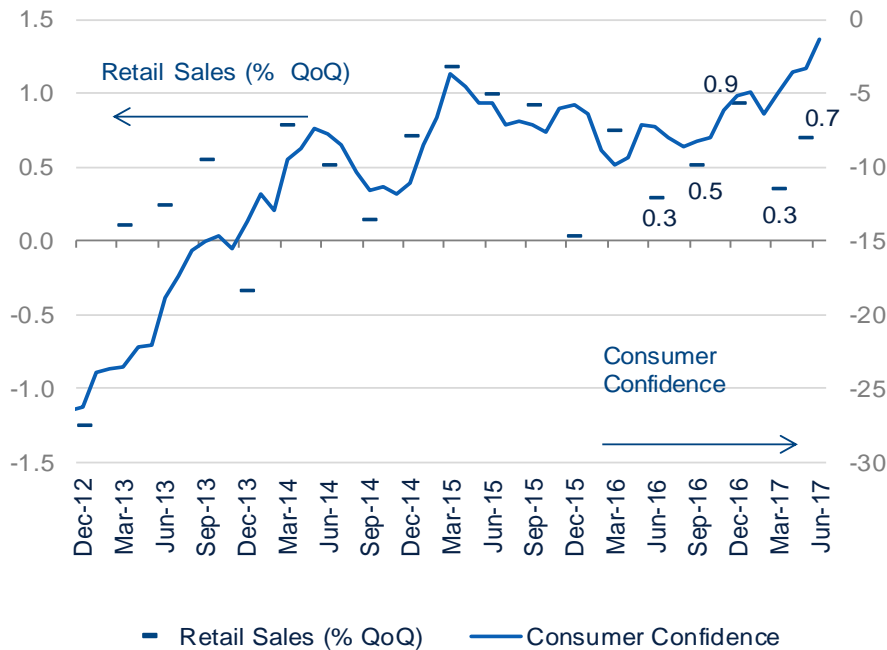


**Exports contribution by destination**  
(%QoQ, pp)

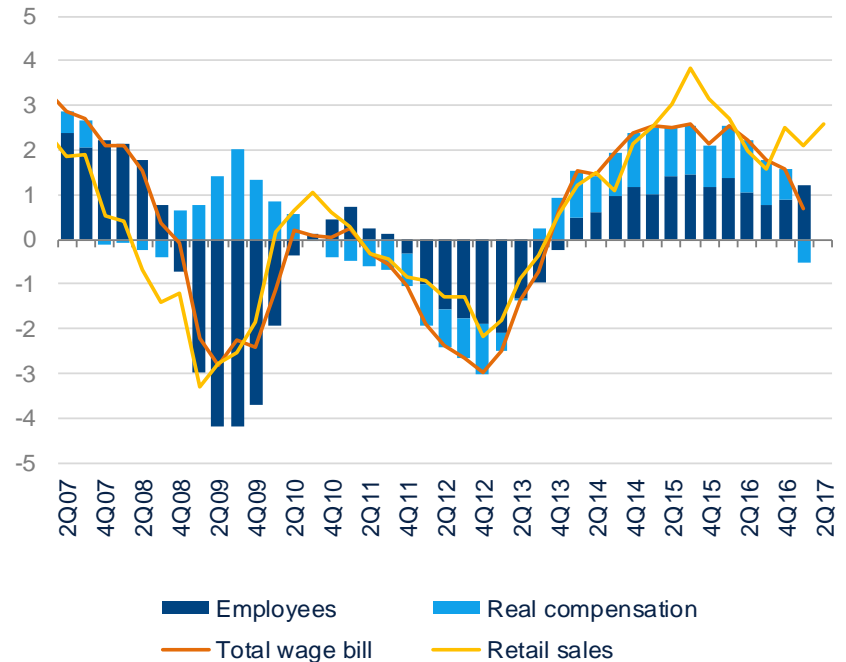


# Retail sales accelerated in May, pointing to resilience of consumption

**Retail sales and consumer confidence**  
(%QoQ, pts)



**Retail sales and total wage bill**  
(%YoY)



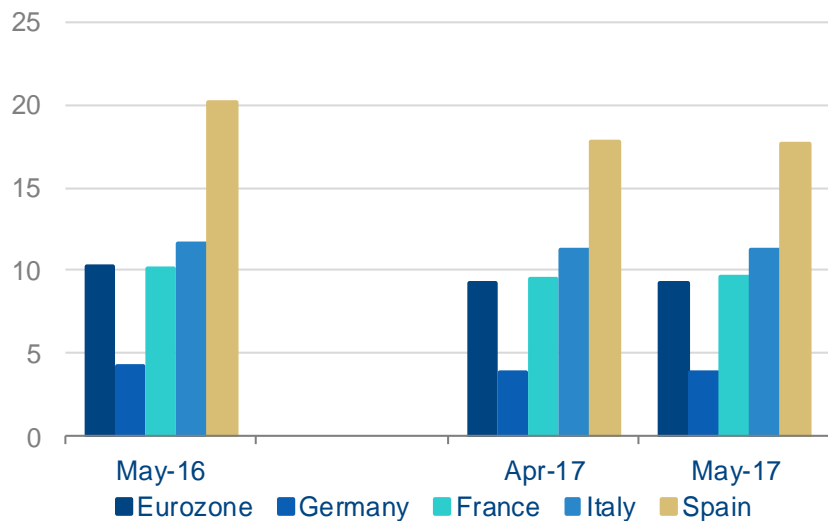
Source: Eurostat and BBVA Research

◆ **Retail sales accelerated in May (0.4% MoM; +0.3pp), while consumer confidence continued to improve**

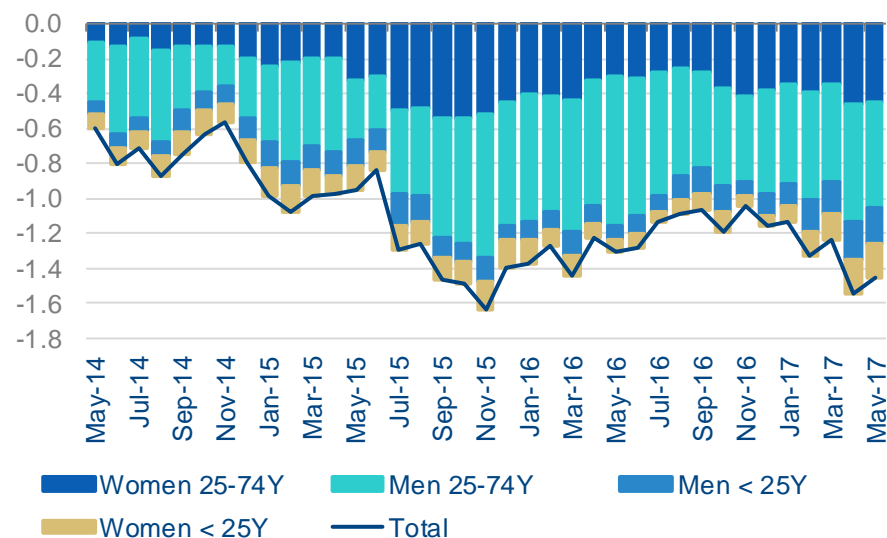
◆ **Employment gains seems to be offsetting the moderation of real wages, giving room to some resilience of private consumption**

# The unemployment rate remained steady in May

**Unemployment rate by country (%)**



**Annual unemployment change by gender & age (millions)**



Source: Eurostat and BBVA Research

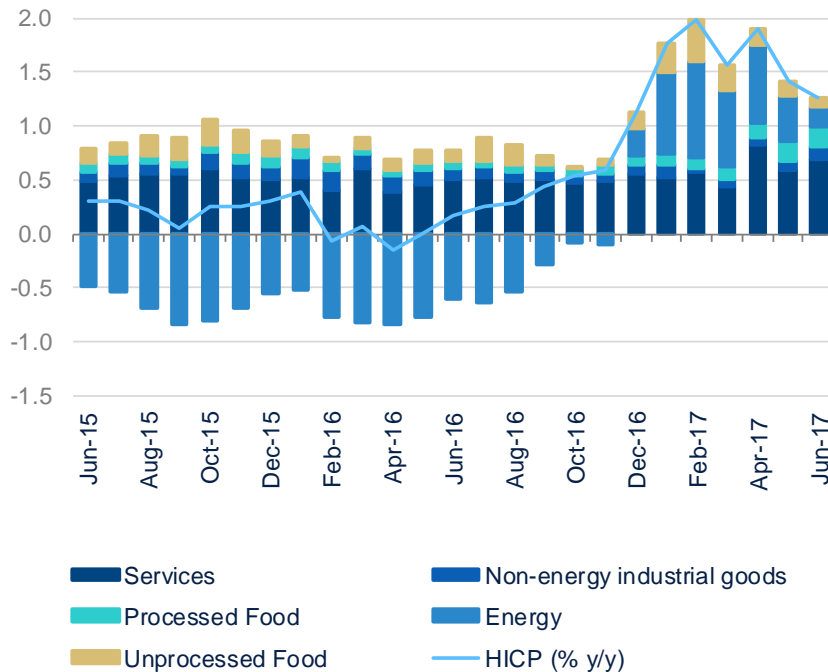
◆ **The jobless rate remained steady at 9.3% in May with a annual decline of 0.9pp**

◆ **The unemployment fall is observed mostly among the experienced population**

# Headline inflation eased in June, despite increasing prices in services

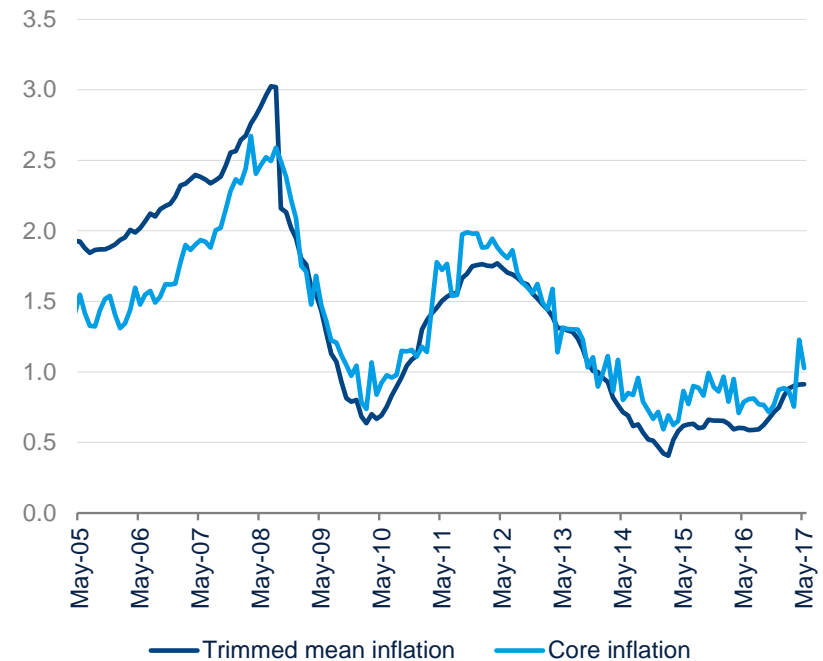
**Inflation and contribution of components**

(%YoY, pp)



**Inflation and trimmed mean**

(%YoY)



Source: Eurostat and BBVA Research

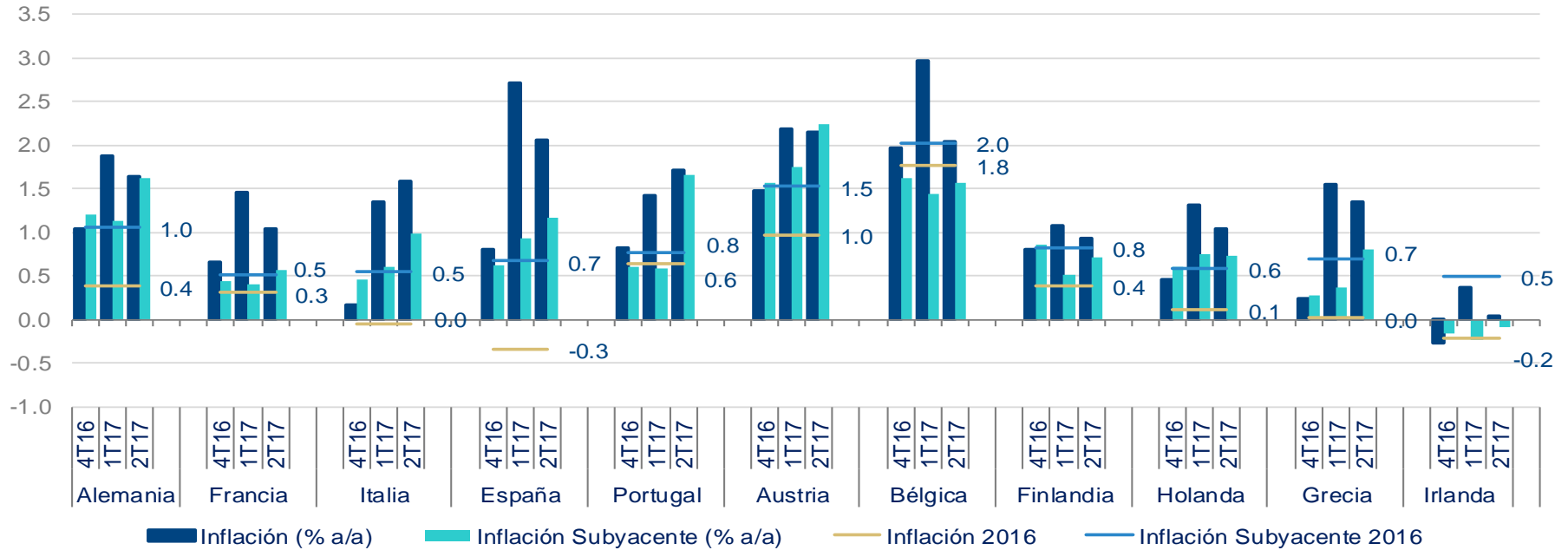
◆ **Harmonized inflation slightly moderated in June by 0.1pp to 1.3% YoY, driven by deceleration in energy prices**

◆ **Nonetheless, services prices accelerated by 0.3pp to 1.6% YoY**

◆ **In this context, core inflation increased 0.2pp to 1.2%**

# Though increasing, core inflation remains subdued across countries

Headline and core inflation (%YoY)



Source: Eurostat and BBVA Research

◆ By country, June HCPI headline inflation moderated in **Spain** (1.6% after 2.0% YoY), **Italy** (1.2% after 1.6% YoY), **France** (0.8% after 0.9% YoY) while slightly increased in **Germany** (1.5% after 1.4% YoY)

# Updated forecasts: Stronger growth boosted by global demand and investment

APRIL 2017



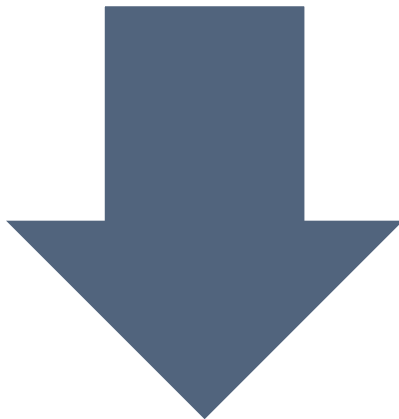
## Growth drivers for the Eurozone



**Further progress in global demand, along with lower oil prices**

**Industrial recovery on track, with investments benefiting from lower policy uncertainty**

**Economic policies still supportive: accommodative monetary stance and slightly expansionary fiscal stance**



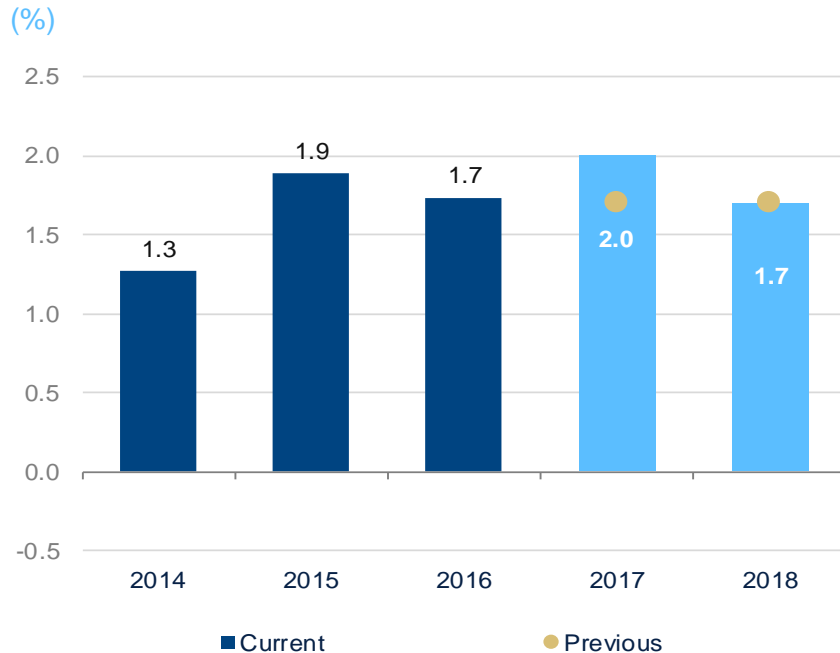
**More appreciated euro could weigh on exports**

**Ongoing adjusting imbalances in both public and private sector**

**Political uncertainty remains in some countries in the region (elections cycle, Brexit)**

# Eurozone: GDP growth revised upwards in 2017 on stronger domestic and global demand along with lower political uncertainty

## GDP GROWTH AND FORECAST (%)



Source: Eurostat and BBVA Research

## MAIN MACROECONOMIC INDICATORS

(% YoY, %GDP)

	2015	2016	2017 (f)	2018 (f)
<b>Real GDP</b>	<b>1.9</b>	<b>1.7</b>	<b>2.0</b>	<b>1.7</b>
Private consumption	1.8	2.0	1.5	1.5
Public consumption	1.3	1.8	1.2	1.2
Investment	3.0	3.4	4.3	3.1
Domestic demand (cont. pp)	1.7	2.1	2.2	1.6
Exports	6.0	2.9	5.1	3.2
Imports	6.1	4.2	5.8	3.4
Net exports (cont. pp)	0.2	-0.4	-0.1	0.0
<b>Current account (% GDP)</b>	3.2	3.3	3.0	2.9
<b>Budget balance (% GDP)</b>	-2.1	-1.5	-1.2	-1.1
<b>HICP (avg. %YoY)</b>	0.0	0.2	1.6	1.4

- ◆ Stronger exports and investment, while consumption should softened
- ◆ Lower inflation due to softer oil prices, but core inflation is still expected to increase gradually

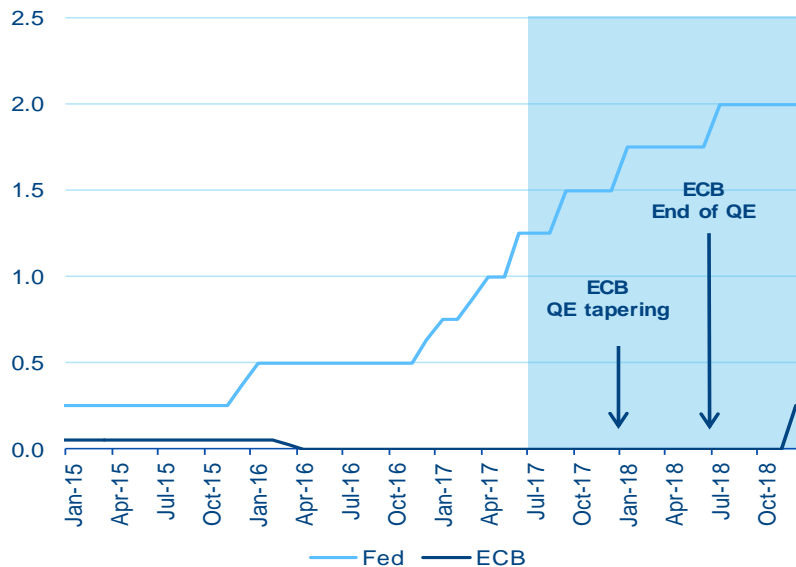
- ◆ Easing tailwinds in coming quarters (higher oil prices, stronger euro, stable global growth) underpin our forecast of a slight growth moderation next year



# The ECB will continue to adjust its policy stance carefully as economic outlook improves

## FED AND ECB INTEREST RATE

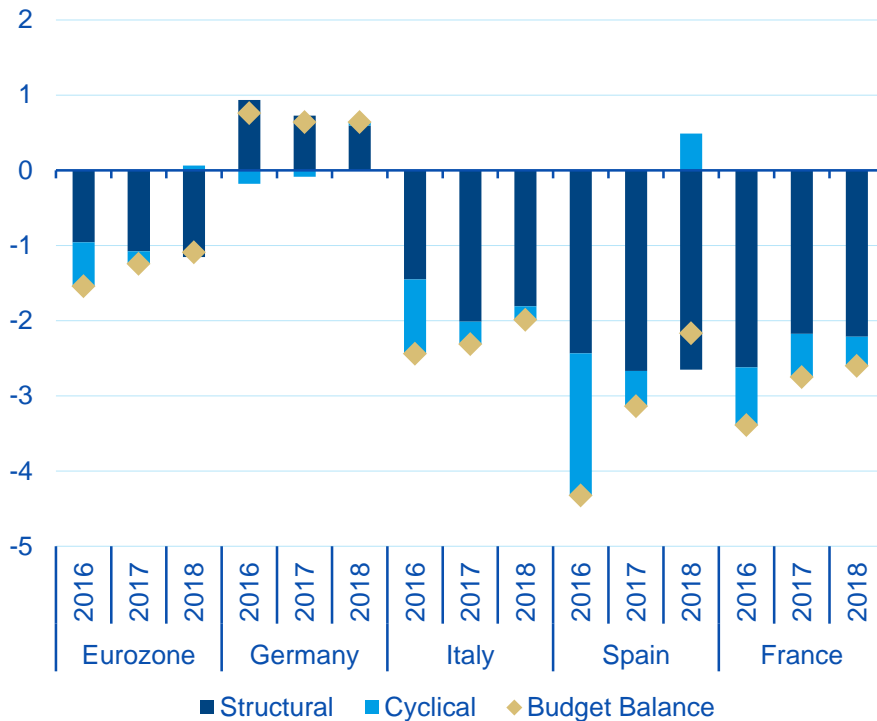
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- **No changes** in our baseline scenario, despite discussions regarding the **removal of the easing bias in the last ECB minutes**
- **The ECB is not in a hurry** and normalization is expected to **be orderly and prudent**
  - Carefully **monitoring of core inflation developments**
  - Tapering to start by early 2018, while **QE to end by mid-2018**
  - First **rate hike by end 2018**
  - **Communication strategy will be key to avoid non-desirable market reactions**

# Slightly expansionary fiscal policy in the eurozone, but with heterogeneity across countries

**FISCAL BALANCE: STRUCTURAL AND CYCLICAL**  
(% GDP)



- The improvement in fiscal balances for 2017-18 would be driven mainly by the cyclical recovery
- Fiscal policy slightly expansionary in the eurozone as a whole, Germany and Italy in 2017
- Neutral fiscal policy in Spain
- The exception is France, as about half of the fiscal consolidation planned for this year would be the result of discretionary measures of about 0.3pp of GDP

## Germany: higher growth based on both investment and exports

### MAIN MACROECONOMIC INDICATORS

(% YoY, %GDP)

	2015	2016	2017 (f)	2018 (f)
<b>Real GDP</b>	<b>1.5</b>	<b>1.8</b>	<b>1.9</b>	<b>1.8</b>
Private consumption	1.9	1.9	1.3	1.3
Public consumption	2.8	4.0	1.8	1.6
Investment	1.1	2.0	3.2	2.8
Domestic demand (cont. pp)	<b>1.3</b>	<b>2.1</b>	<b>1.8</b>	<b>1.8</b>
Exports	4.6	2.5	4.0	3.1
Imports	5.0	3.7	4.3	3.3
Net exports (cont. pp)	<b>0.1</b>	<b>-0.3</b>	<b>0.1</b>	<b>0.1</b>
<b>Current account (% GDP)</b>	<b>8.6</b>	<b>8.3</b>	<b>7.8</b>	<b>7.1</b>
<b>Budget balance (% GDP)</b>	<b>0.7</b>	<b>0.8</b>	<b>0.6</b>	<b>0.6</b>
<b>HICP (avg. %YoY)</b>	<b>0.1</b>	<b>0.4</b>	<b>1.7</b>	<b>1.6</b>

- **GDP growth forecast revised upwards for this year and the next**, from 1.7% to 1.9% and from 1.6% to 1.8%, respectively
- **Investment-led growth** supported by **strong trade figures and financial conditions**
- Nonetheless, the inflation upturn should weight in the **softening of private consumption**
- **Public expenditure expected to decelerate** after transitory fiscal impulse and less expansionary fiscal policy next year

## France: modest but more balanced growth

### MAIN MACROECONOMIC INDICATORS

(% YoY, %GDP)

	2015	2016	2017 (f)	2018 (f)
<b>Real GDP</b>	<b>1.0</b>	<b>1.1</b>	<b>1.5</b>	<b>1.5</b>
<b>Private consumption</b>	1.4	2.1	1.3	1.5
<b>Public consumption</b>	1.1	1.2	1.3	1.1
<b>Investment</b>	0.9	2.7	2.9	2.5
<b>Domestic demand (cont. pp)</b>	<b>1.5</b>	<b>1.9</b>	<b>1.7</b>	<b>1.6</b>
<b>Exports</b>	4.0	1.9	2.9	3.5
<b>Imports</b>	5.5	4.2	3.2	3.3
<b>Net exports (cont. pp)</b>	<b>-0.5</b>	<b>-0.8</b>	<b>-0.2</b>	<b>-0.1</b>
<b>Current account (% GDP)</b>	-0.4	-0.9	-1.4	-1.1
<b>Budget balance (% GDP)</b>	-3.6	-3.4	-2.8	-2.6
<b>HICP (avg. %YoY)</b>	0.1	0.3	1.2	1.1

- **GDP growth in 2017 revised slightly upwards** from 1.4% to 1.5%.
- **Investment and inventories**, boosted by improving confidence (as the reform process starts), strong trade and environment of low rates.
- **Private consumption will decelerate markedly this year** pulled by lower growth of household real disposable income.
- **Restrictive fiscal measures** in 2017 should drag public expenditures.

# Italy: better outlook for 2017, despite political and financial vulnerabilities

## MAIN MACROECONOMIC INDICATORS

(% YoY, %GDP)

	2015	2016	2017 (f)	2018 (f)
<b>Real GDP</b>	<b>0.7</b>	<b>1.0</b>	<b>1.3</b>	<b>1.2</b>
<b>Private consumption</b>	1.6	1.3	1.1	1.0
<b>Public consumption</b>	-0.7	0.6	0.5	0.4
<b>Investment</b>	1.4	3.1	3.2	2.6
<b>Domestic demand (cont. pp)</b>	<b>1.2</b>	<b>1.1</b>	<b>1.3</b>	<b>1.1</b>
<b>Exports</b>	4.1	2.6	3.9	3.0
<b>Imports</b>	6.7	3.1	4.2	2.7
<b>Net exports (cont. pp)</b>	<b>-0.5</b>	<b>-0.1</b>	<b>0.0</b>	<b>0.1</b>
<b>Current account (% GDP)</b>	1.5	2.6	2.2	2.1
<b>Budget balance (% GDP)</b>	-2.7	-2.4	-2.3	-2.0
<b>HICP (avg. %YoY)</b>	0.1	-0.1	1.5	1.4

- **GDP growth for 2017 revised upwards** from 1.0% to 1.3% driven by **higher expectations of consumption and investment growth**.
- Nonetheless, **private consumption should gradually moderate** due to higher inflation.
- **Domestic demand still lags behind** the performance in **the Eurozone**.
- Despite a null contribution of net external sector, **exports will continue to benefit from improved global demand**.
- **Uncertainty remains high** -mostly related to next elections and financial vulnerabilities- and **continued to be a handicap to recovery**.

# Spain: cyclical factors point to stronger than expected growth

## MAIN MACROECONOMIC INDICATORS

(% YoY, %GDP)

	2015	2016	2017 (f)	2018 (f)
<b>Real GDP</b>	<b>3.2</b>	<b>3.2</b>	<b>3.3</b>	<b>2.8</b>
<b>Private consumption</b>	2.8	3.2	2.7	2.4
<b>Public consumption</b>	2.0	0.8	0.8	1.9
<b>Investment</b>	6.0	3.1	4.4	4.8
<b>Domestic demand (cont. pp)</b>	<b>3.3</b>	<b>2.8</b>	<b>2.6</b>	<b>2.7</b>
<b>Exports</b>	4.9	4.4	7.0	4.9
<b>Imports</b>	5.6	3.3	5.3	5.2
<b>Net exports (cont. pp)</b>	<b>-0.1</b>	<b>0.4</b>	<b>0.7</b>	<b>0.1</b>
<b>Current account (% GDP)</b>	1.4	1.9	2.0	1.9
<b>Budget balance (% GDP)</b>	-5.1	-4.3	-3.1	-2.2
<b>HICP (avg. %YoY)</b>	-0.5	-0.2	1.9	1.7

- Recent economic data point towards a **slightly better than expected short-term outlook**. GDP growth to reach 3.3% in 2017 (+0.3pp) and to 2.8% in 2018 (+0.1pp)
- No major changes on fundamentals. **Private consumption and investment have recovered**, while exports remain resilient.
- **Fiscal stance expected to be neutral** in coming years.
- Domestic risks seem to be subdued as **policy uncertainty has gone down** and there are no signs of wage pressures.

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