BBVA Research

# Eurozone Economic Watch

## Higher growth forecasts for 2018-19

January 2018

# Eurozone: Higher growth forecasts for 2018-19

- Our **MICA-BBVA model** estimates a broadly stable pace of growth for GDP in 4Q17, at around 0.6/0.7% QoQ. **Hard data rebounded in November** after disappointing figures in the previous month, with industrial output and retail sales growing at a solid pace.
- **Confidence figures soared again by the end of the year** and reached historical high levels. The **increasing optimism is widespread** across sectors and countries, signaling a more positive outlook for early 2018.
- **Inflation eased in December** (-0.1pp to 1.4% a/a) due to energy base effects with **core inflation stable** at 1.1% a/a. Inflationary pressures remain subdued so far.
- **We revised up growth forecasts for 2018** to 2.2% (+0.4pp) on account of the **strengthening of domestic factors** and a better global outlook. The projection moderates slightly to 1.8% in 2019.
- On the back of higher expectations for oil prices, **we revise our inflation forecasts upward** to 1.5% in 2018 (+0.3pp), but maintain our view of a **gradual increase in core prices.**
- **Economic policies will remain supportive** while political uncertainty has eased. We continue to expect a **gradual monetary normalization** with a QE ended over 4Q18, while the **fiscal policy stance will remain broadly neutral or slightly expansionary.**
- **Lower risks, but some remain latent:** uncertainty remains attached to political events (government negotiations in Germany, elections in Italy).

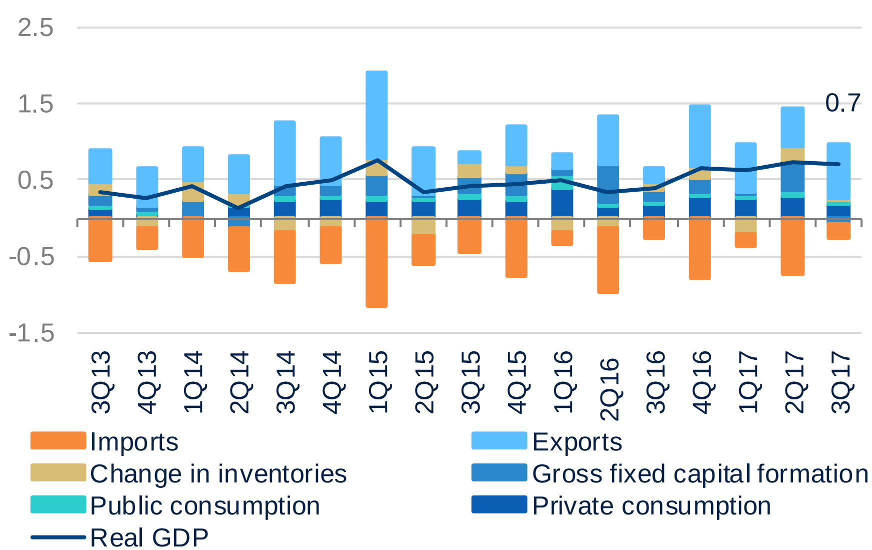
BBVA Research

# Economic developments:
## Firmer and sustained growth across components and countries

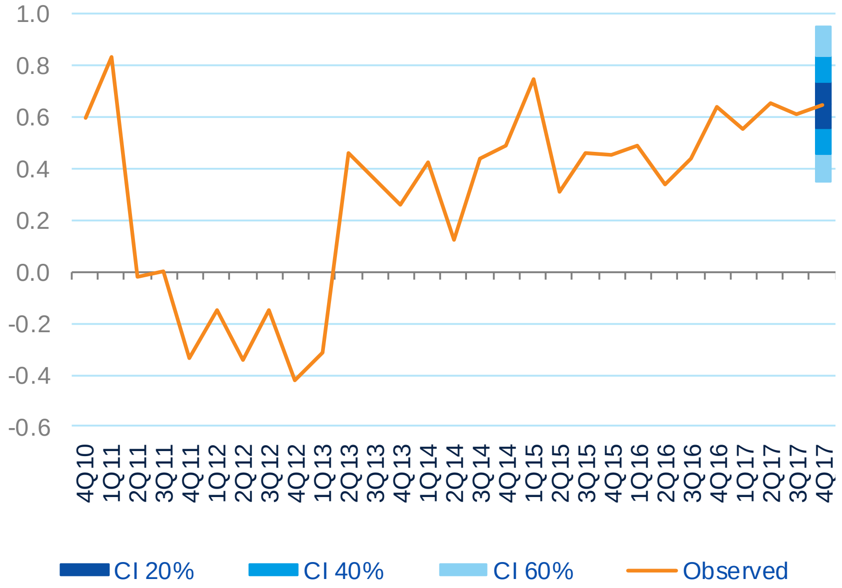
January 2018

# Growth pace likely to remain stable at high levels in 4Q17…

## GDP, Contribution by Components
(%QoQ, pp)




## GDP and MICA forecasts
(%QoQ)

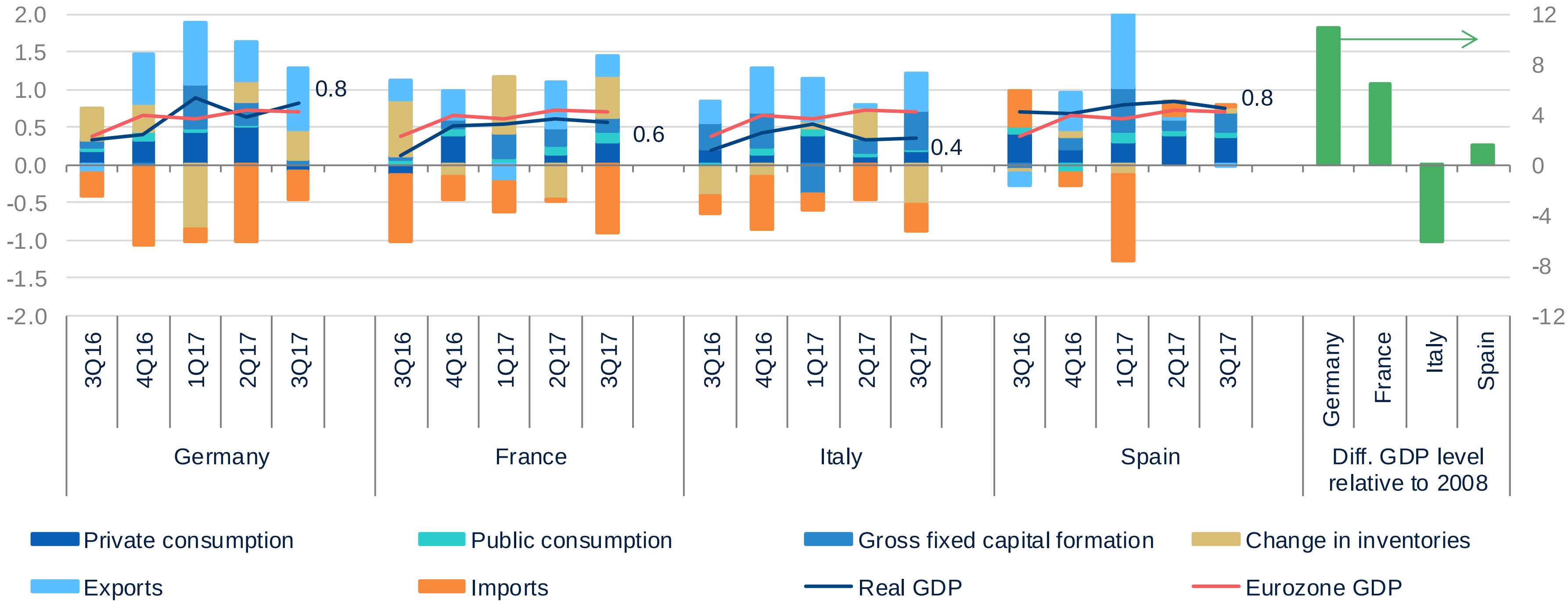



Source: Eurostat and BBVA Research

- **Consumption still resilient** thanks to rising incomes and employment
- **Investment resumed in 3Q17**, but **favorable financial conditions and higher confidence** should continue to support capital accumulation in coming quarters
- Our **MICA-BBVA** model suggests a quarterly GDP growth of around 0.6/0.7% in 4Q17

# … while the positive outlook is widespread across large countries

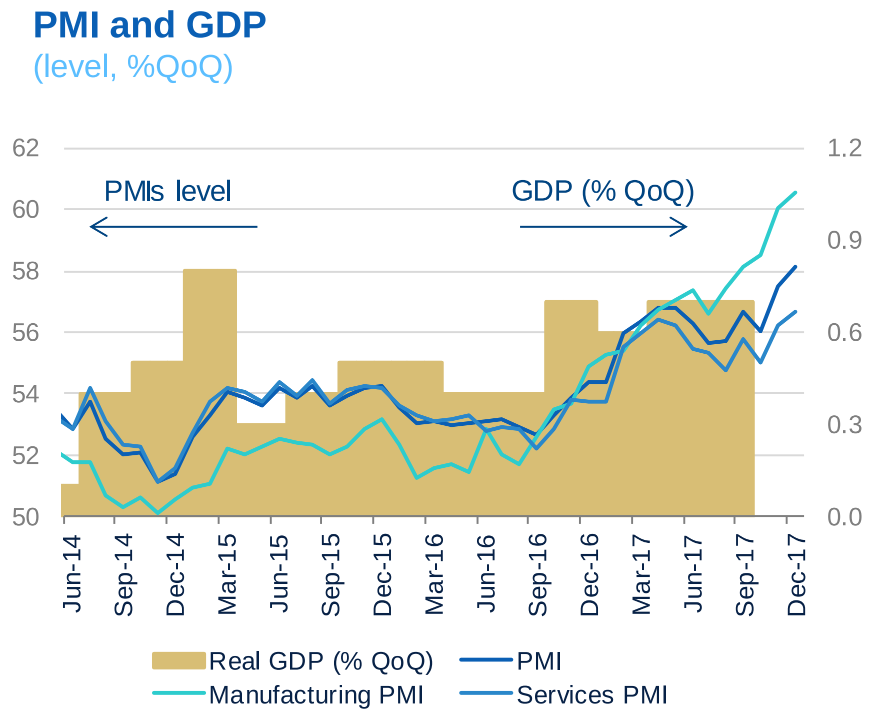
## GDP, Contribution by components
(%QoQ, pp)

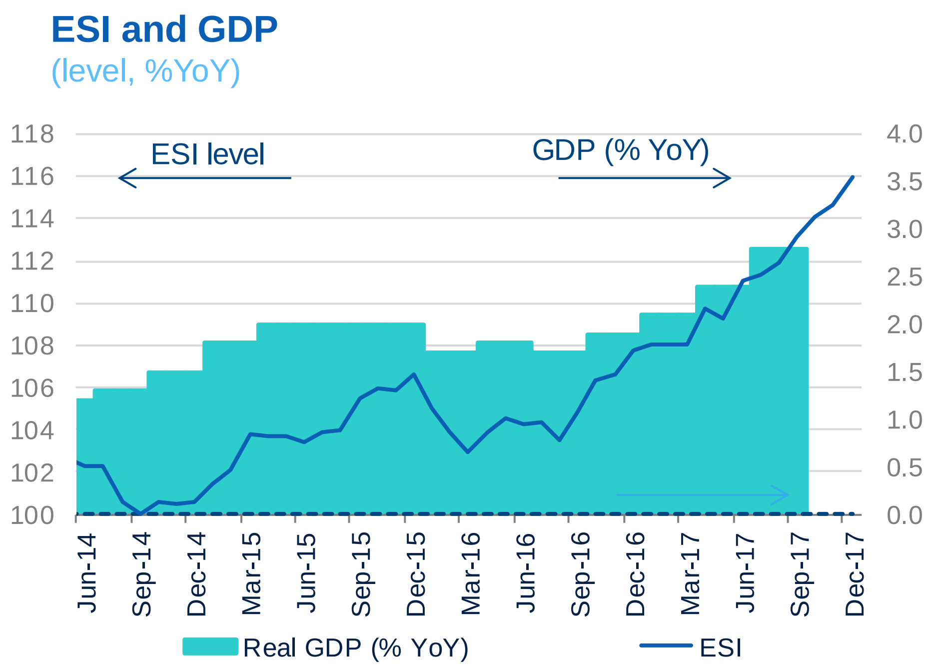



Source: Eurostat and BBVA Research

- **Germany accelerates** from stronger external demand and grows at +0.8% QoQ in 3Q17
- **Activity remains stable in France** for the third quarter in a row **and improves in Italy** underpinned by better investment figures and export gains
- **Spain's strong private consumption** remains fuelling growth (+0.8% QoQ), **despite high uncertainty**

# Continued optimism, with confidence soaring to record highs in 4Q



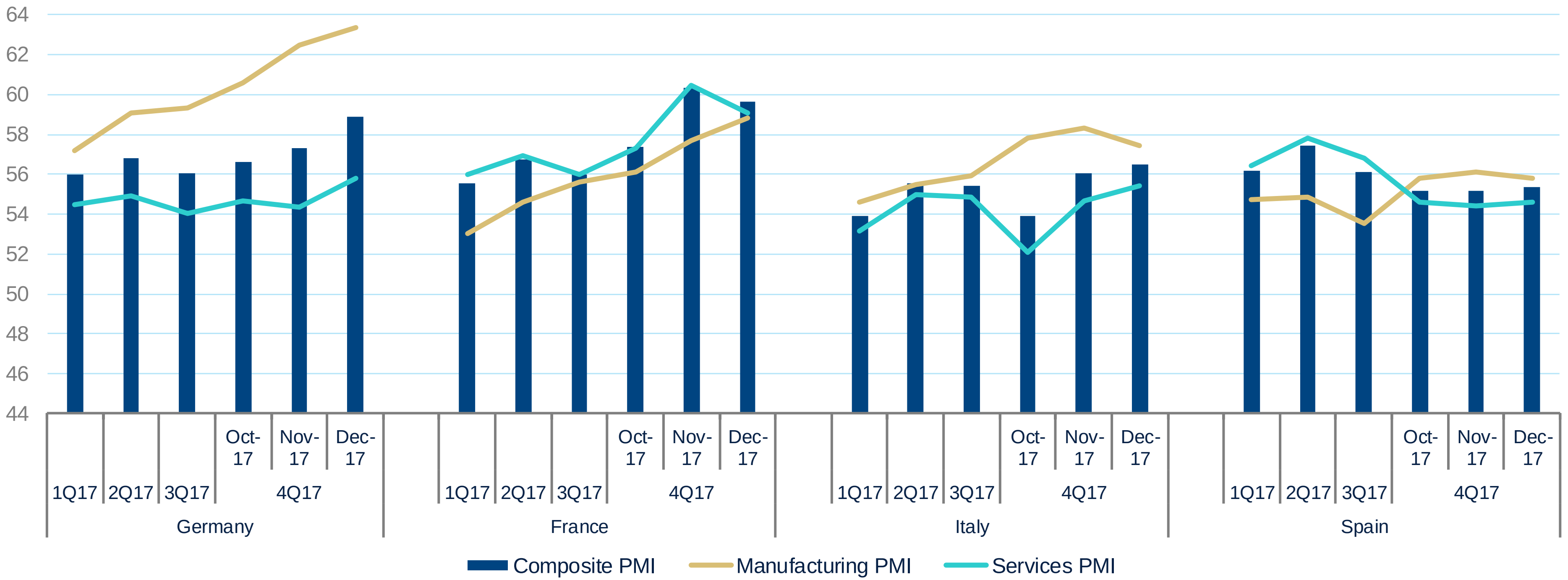




Source: Eurostat and BBVA Research

- **Confidence levels improved** significantly during 4Q17, reaching **record levels**
- **Optimism is broad-based** although mainly in manufacturing, driven by new orders
- The **Economic Sentiment Index reached an all time high** in December in almost all countries

# PMI: Confidence gains still suggest further growth momentum across the board

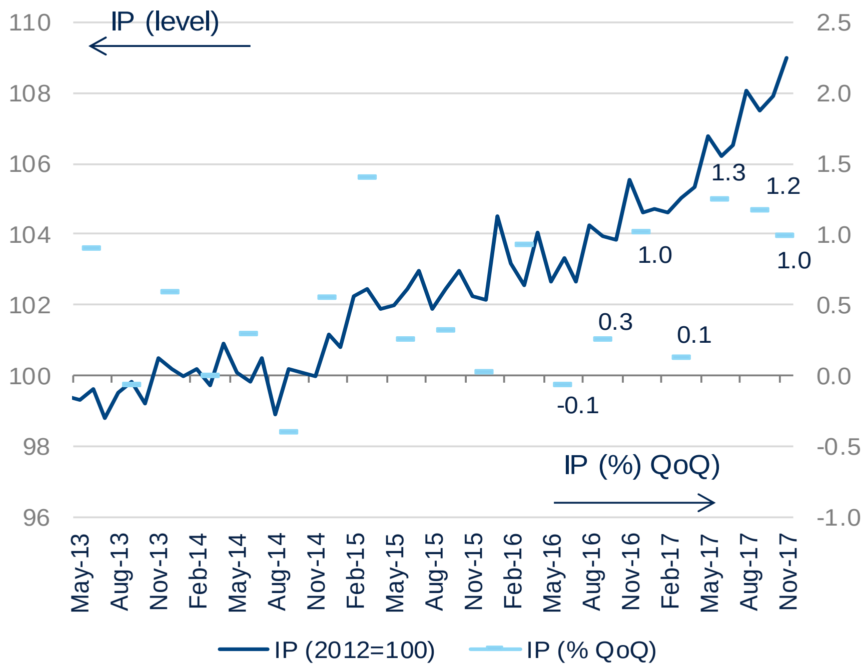
## PMI survey
(level)




Source: Eurostat and BBVA Research

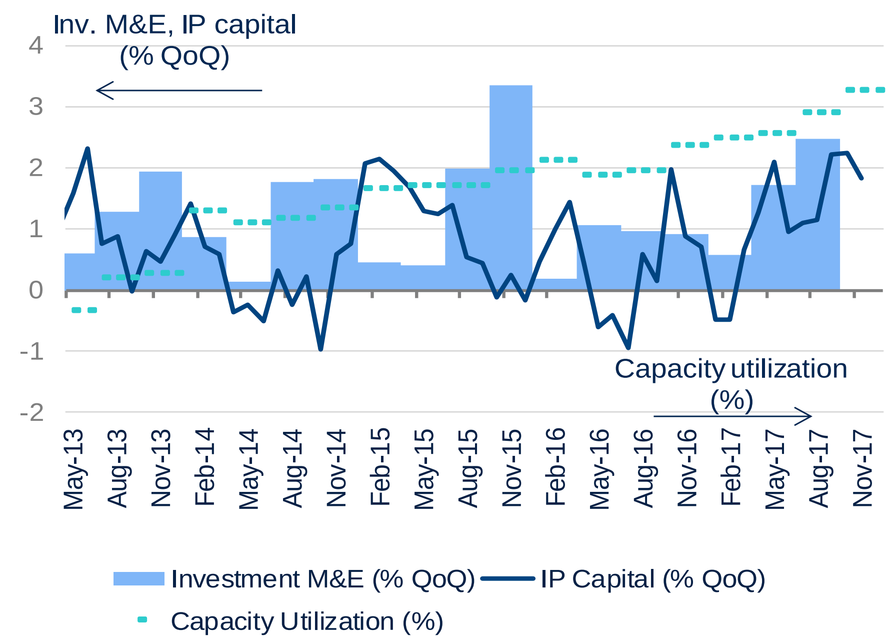
# Industrial production bounces back in November and will end the year at a solid clip

### Industrial production
(level, %QoQ)




Source: Eurostat and BBVA Research

### IP capital, investment in machinery and equipment and utilization capacity
(%QoQ, %)

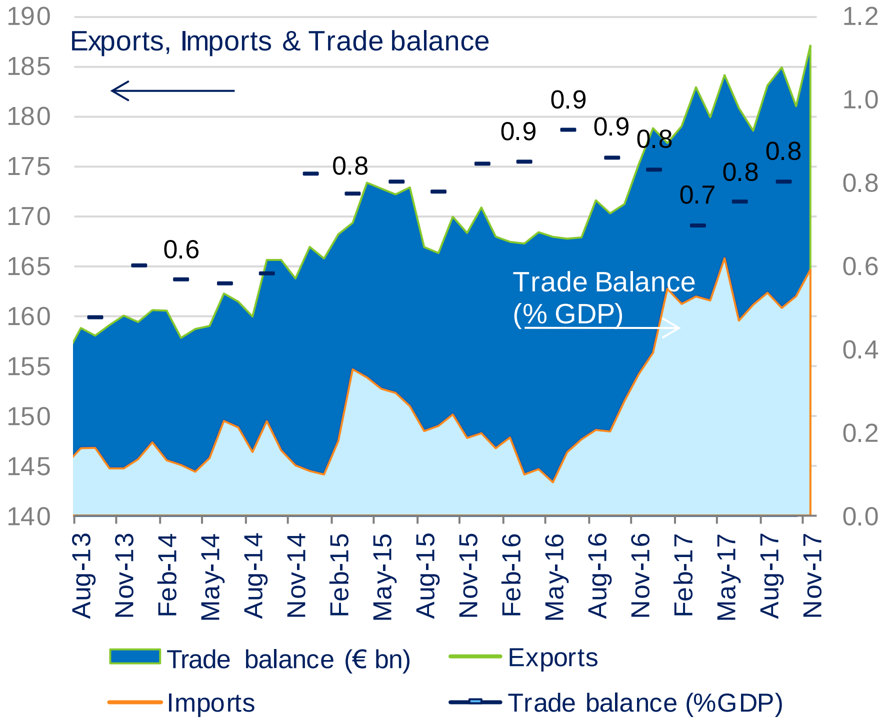



Source: Eurostat and BBVA Research

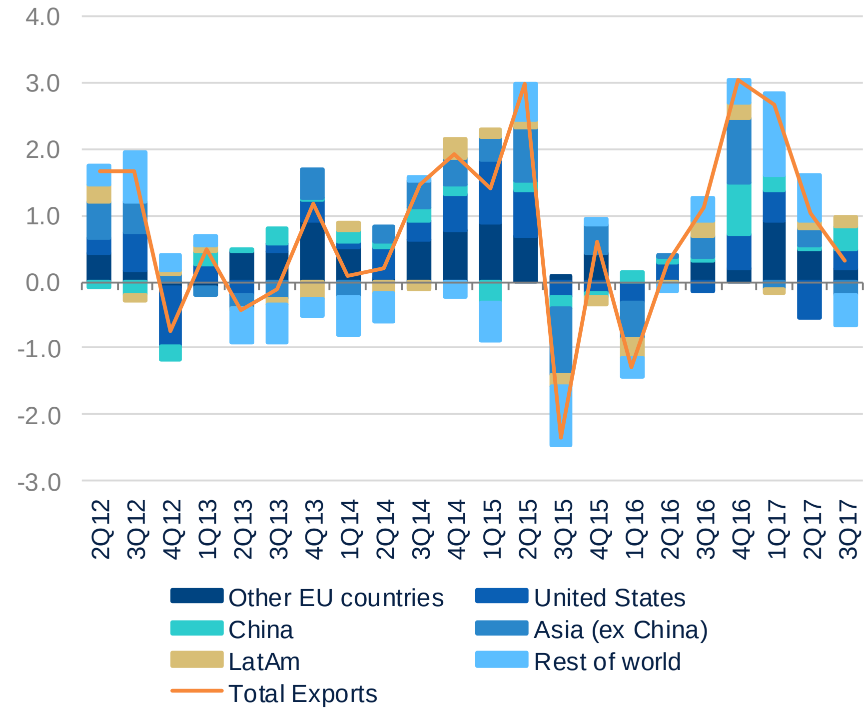
- **November pick-up in output** was at 1% m/m
- **Industrial production improves** ahead of expectations and records an **annual growth of +2.7%**
- **Investment spending is gaining traction from stronger demand**, allowing a recovery of the industrial sector

# Foreign trade figures improved in November but at a slower pace

## Trade balance
(€ bn, %GDP)



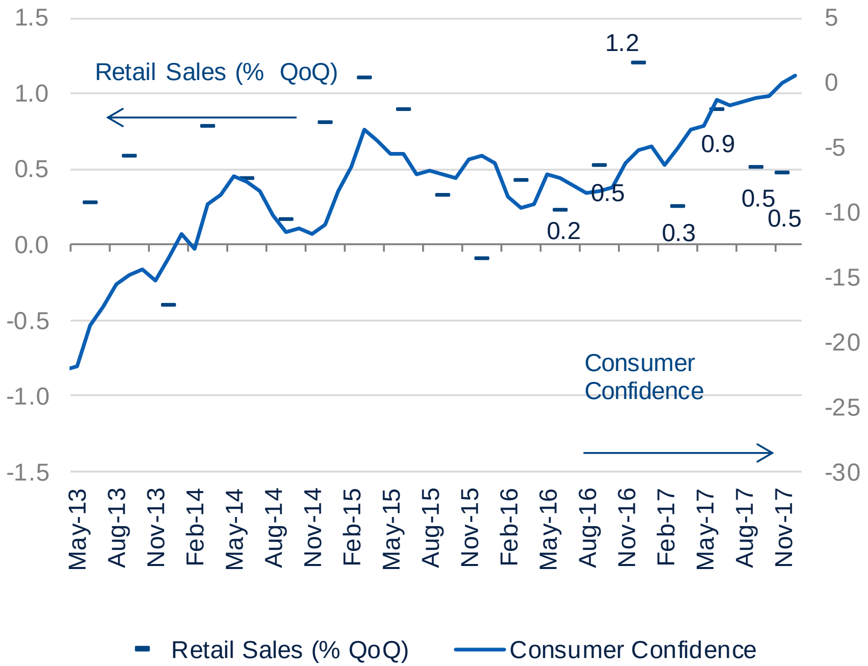

## Exports contribution by destination
(%QoQ, pp)



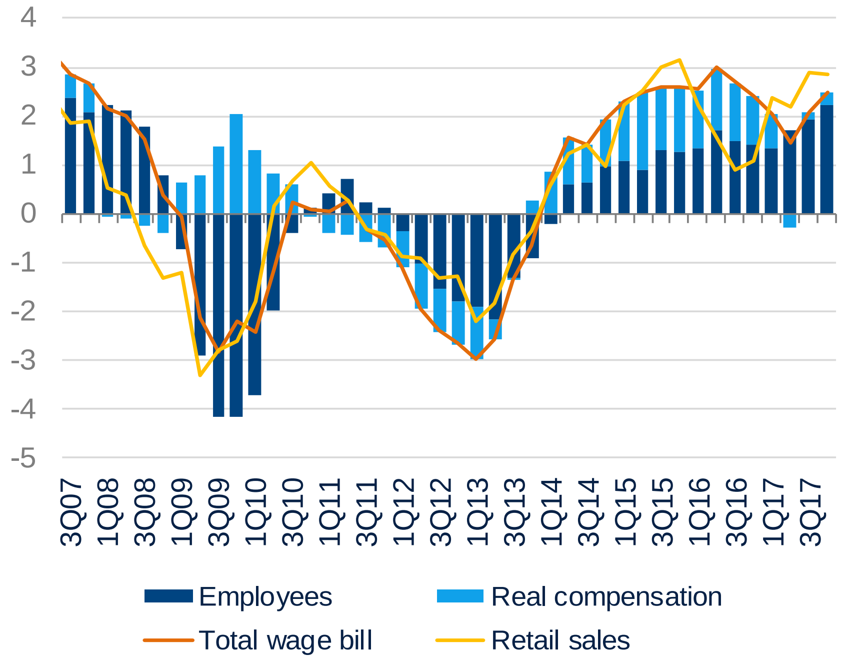

Source: Eurostat and BBVA Research

# Retail sales growth continued resilient backed by rising incomes, employment gains and higher confidence

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




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



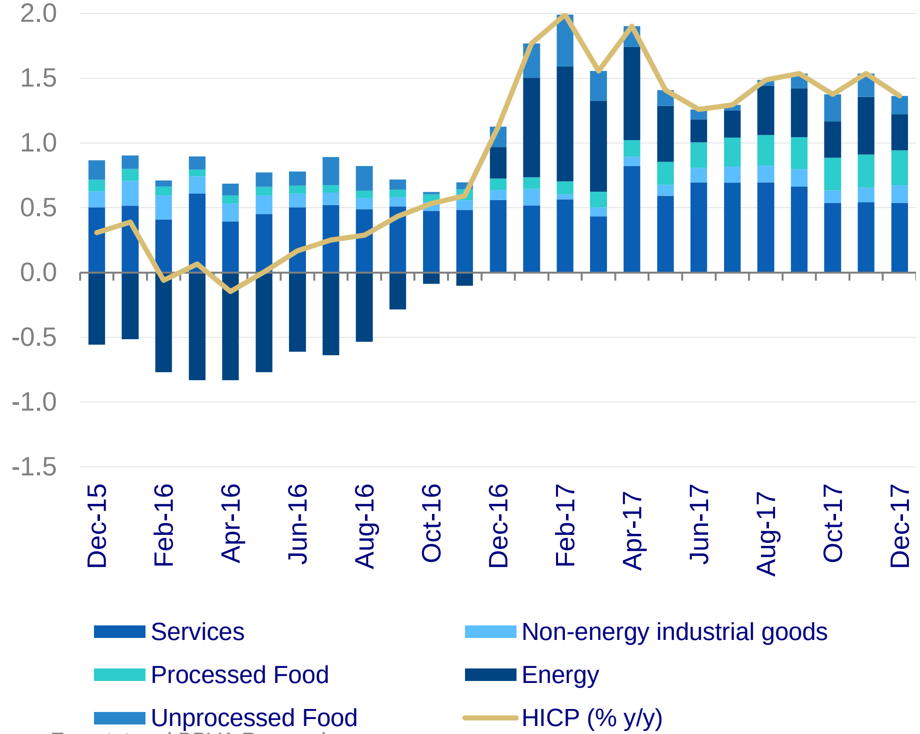

Source: Eurostat and BBVA Research

- **Retail sales surprised to the upside in November (+1.5% m/m)**, offsetting the marked slowdown from the previous month (-1.1% m/m)
- Overall, **household consumption has been** favoured by improving labour conditions

# Headline inflation declined in December due to the energy base effect, but core inflation remained unchanged

## Inflation and contribution of components

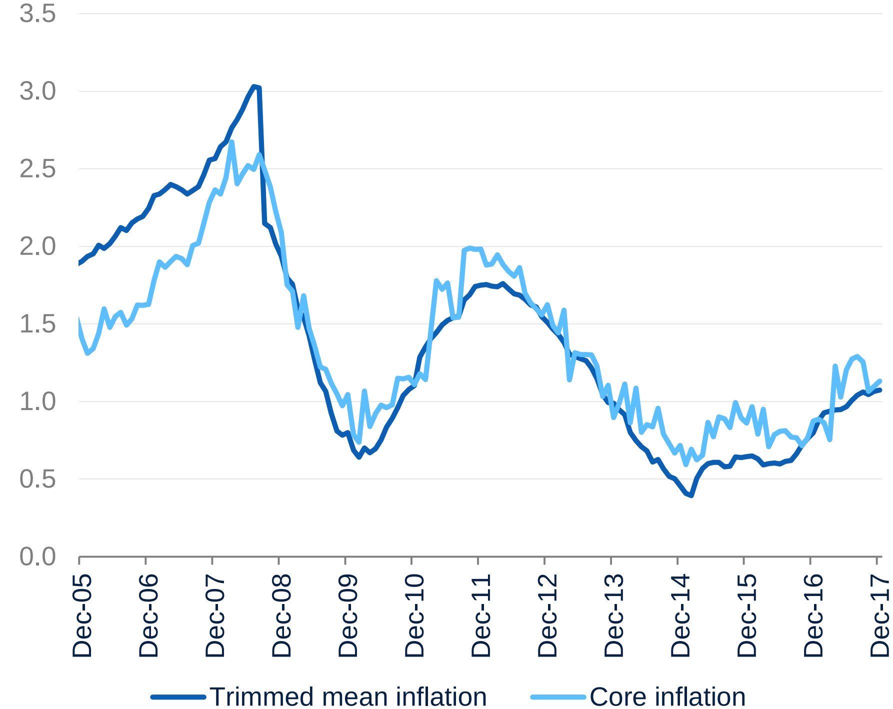
(%YoY, pp)




Source: Eurostat and BBVA Research

## Core and trimmed-mean inflation

(%YoY)

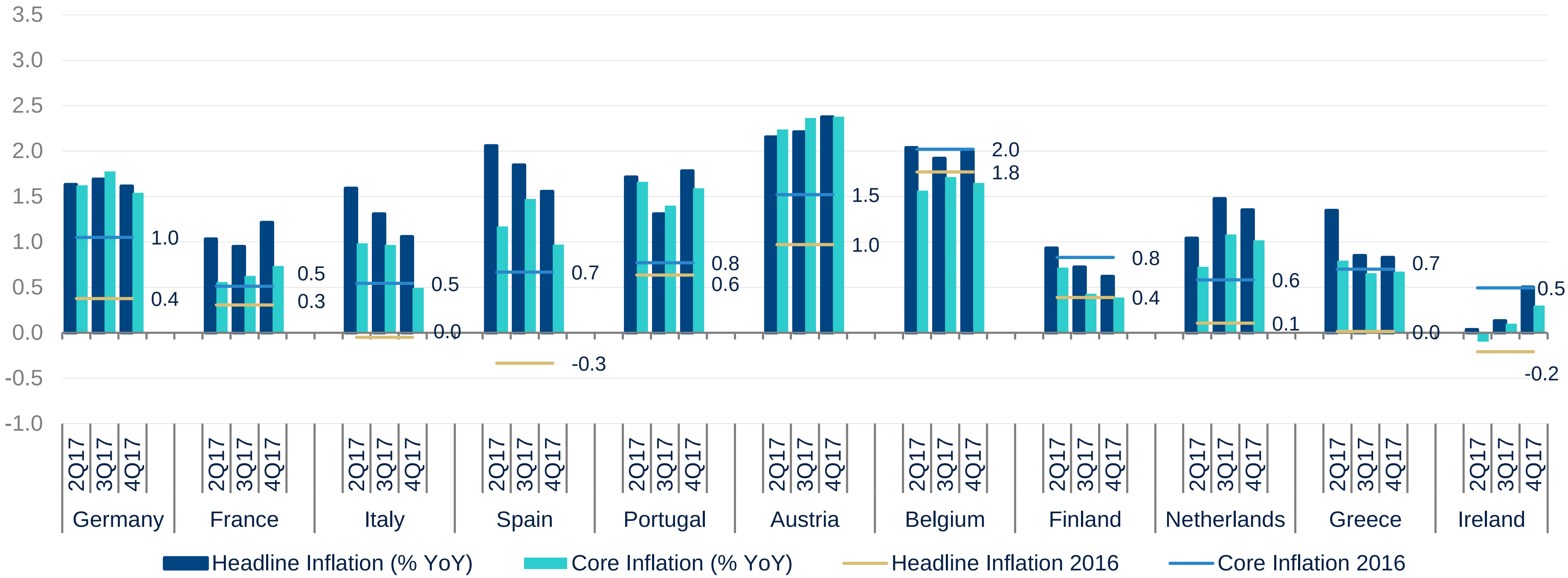



- **Headline inflation declined in December** 0.1pp to 1.4% but with inflationary pressures still subdued
- **In 2017 inflation averaged an annual increase of 1.5%** while core figure posted a milder pick-up at 1.1%
- Headline **inflation could declined further until February due to energy base effects to recover afterwards**. Core prices are expected to continue its ongoing gradual increase

# Inflation figures declined in the majority of countries in December while core measures kept mostly unchanged

## Headline and core inflation

(%YoY)




Source: Eurostat and BBVA Research

- **December HICP declined among most countries in the Euro area:** slashes were observed in Spain (+1.2% YoY after +1.8%), Germany (+1.6% YoY after +1.8%) and Italy (+1.0% YoY after +1.1%). While **in France inflation remained unchanged** at +1.2% annual figure.

BBVA Research

# Updated forecasts:

## Stronger and more balance growth taking root with still subdued inflation

January 2018

# Growth drivers for the Eurozone

### Strengthening domestic factors

Improving labour market
Increasing profits share
Favorable lending conditions

### Increasing global demand

Stronger exports and investment

### Lower political uncertainty

Somewhat clearer political landscape, but uncertainty persists

### Supportive economic policies

Very gradual ECB's exit
Slightly expansionary fiscal policy

### Inflation remains weak and broadly stable

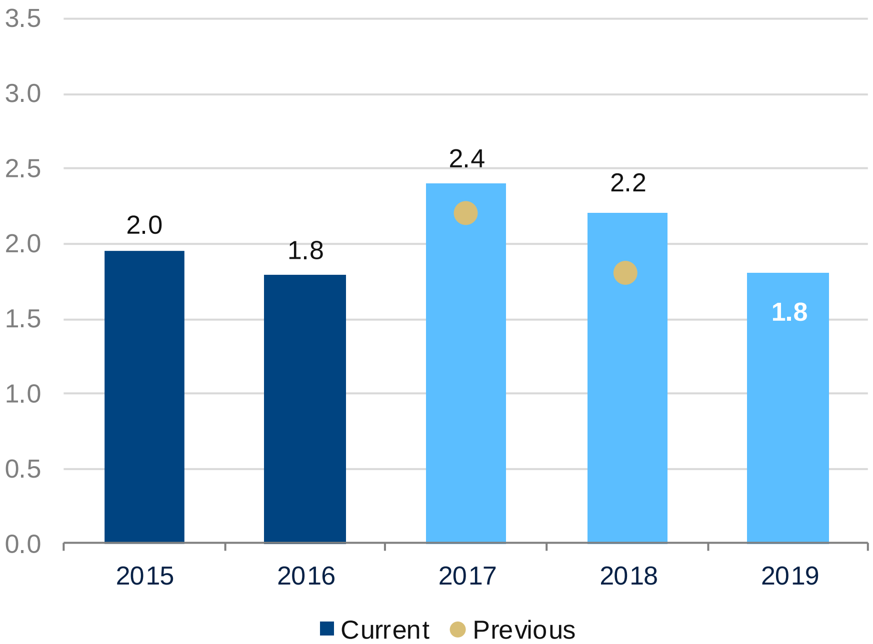
Inflationary pressures remain contained, although some push down factors are fading

### Risks remain contained, but latent

German government negotiations; Italian elections and policies of new government.

# Eurozone: stronger and more balanced growth taking root

## GDP growth and forecast
(%)




Source: Eurostat and BBVA Research

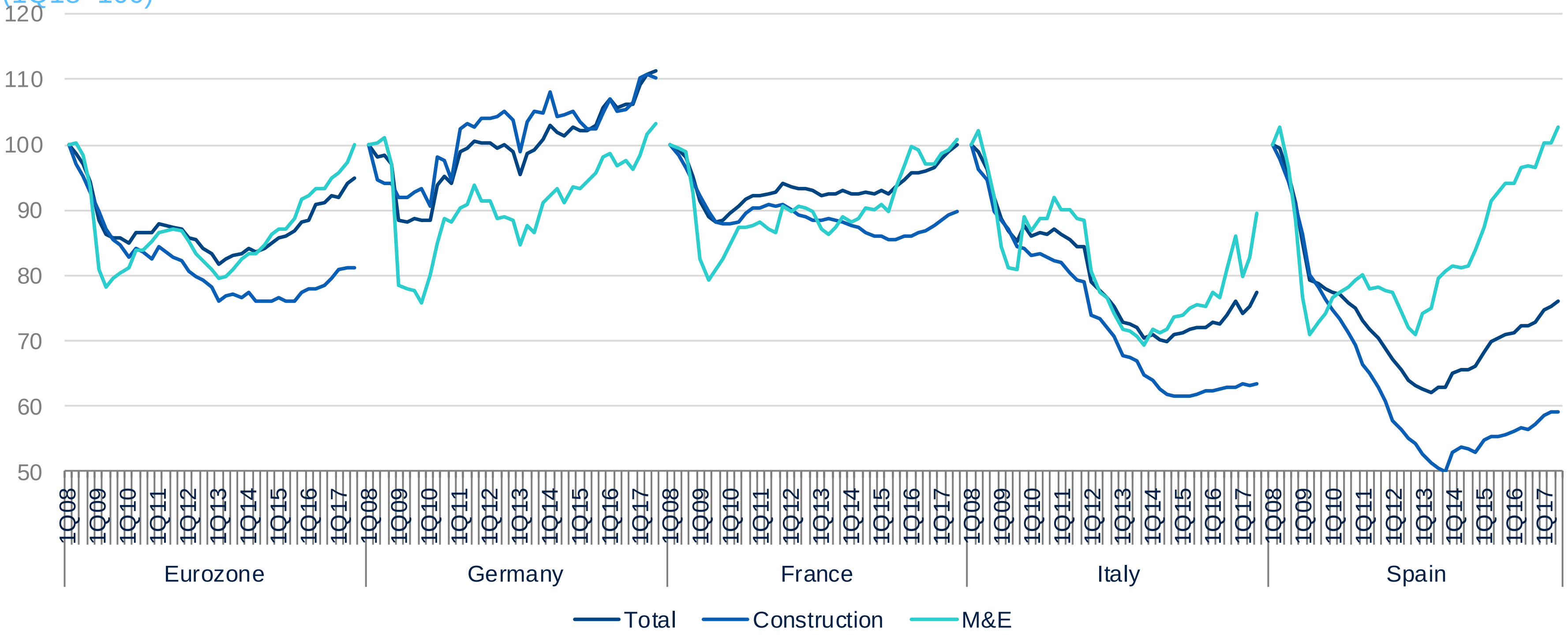
## Main macroeconomic indicators
(% YoY, %GDP)

| | 2016 | 2017 (e) | 2018 (f) | 2019 (f) |
|---|---|---|---|---|
| **Real GDP** | **1.8** | **2.4** | **2.2** | **1.8** |
| **Private consumption** | 2.0 | 1.8 | 1.7 | 1.6 |
| **Public consumption** | 1.7 | 1.1 | 1.2 | 1.1 |
| **Investment** | 4.5 | 4.1 | 4.1 | 3.3 |
| **Domestic demand (cont. pp)** | **2.3** | **2.2** | **2.1** | **1.8** |
| **Exports** | 3.3 | 4.7 | 3.7 | 3.6 |
| **Imports** | 4.7 | 4.6 | 3.9 | 4.1 |
| **Net exports (cont. pp)** | **-0.5** | **0.2** | **0.1** | **0.0** |
| **Current account (% GDP)** | 3.3 | 3.3 | 3.2 | 3.0 |
| **Budget balance (% GDP)** | -1.5 | -1.1 | -0.9 | -0.8 |
| **HICP (avg. %YoY)** | 0.2 | 1.5 | 1.5 | 1.6 |

- We **revise up our forecasts** driven by **stronger domestic demand** and a less noisy political outlook
- **Investment still benefits** from reduced idle capacity, increased profits and lower policy uncertainty
- Domestic **consumption to remain resilient** on the back of better job market prospects
- **Hard data points to a growth moderation over coming quarters,** although we remain optimistic due to the very high confidence and export growth
- **Inflation remains stable,** but we expect a gradual increase driven by higher oil prices going forward

# Investment remains on track, slowly regaining pre-crisis levels

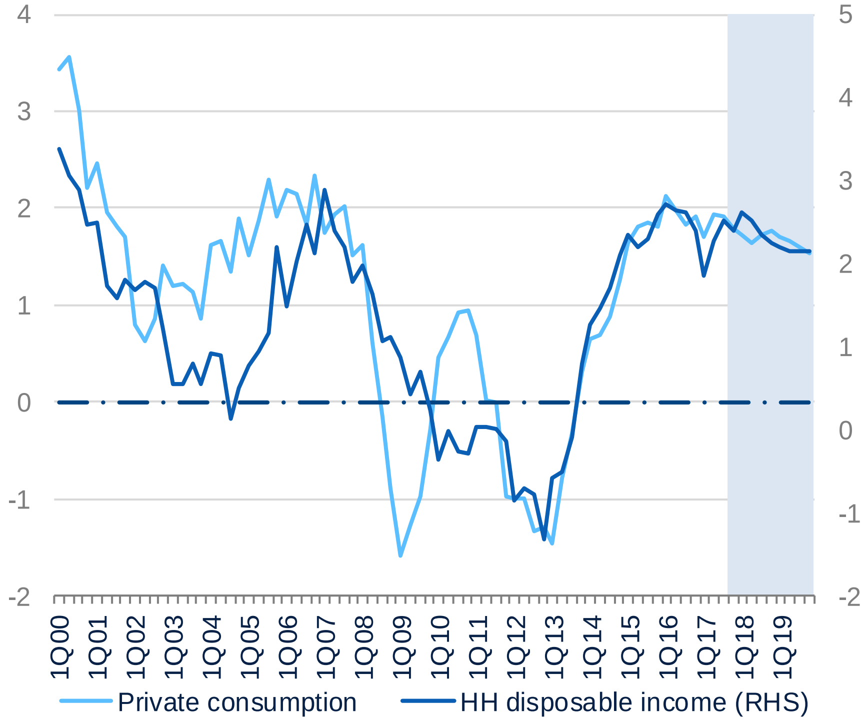
**Investment by country**
(1Q18=100)



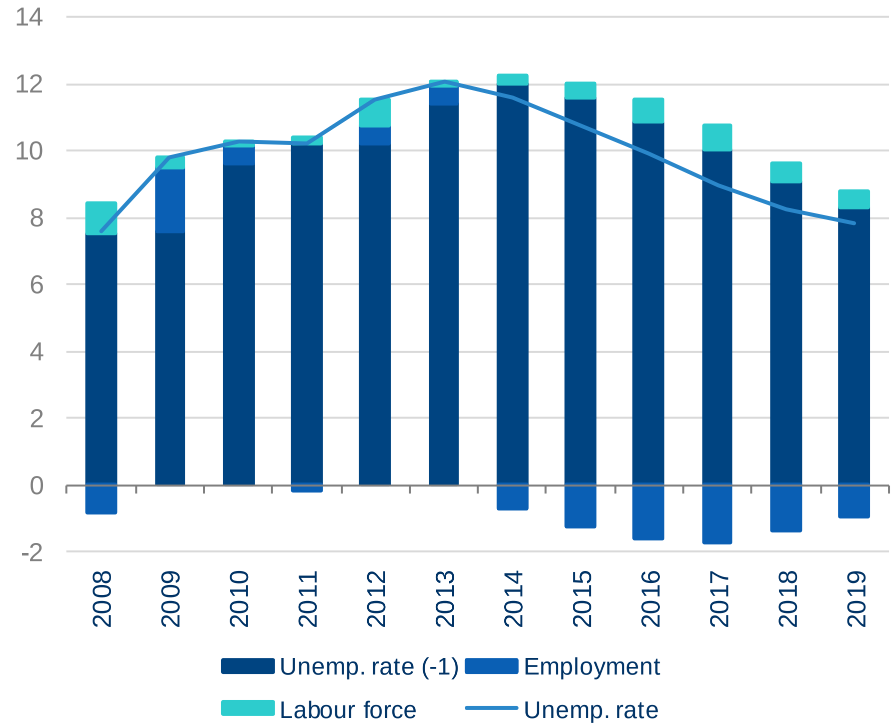

Source: Eurostat and BBVA Research

# Solid consumption in 2018-19 despite still moderate wage growth

## Private consumption and real labour income (% YoY)




## Unemployment rate and contributions (%, pp)

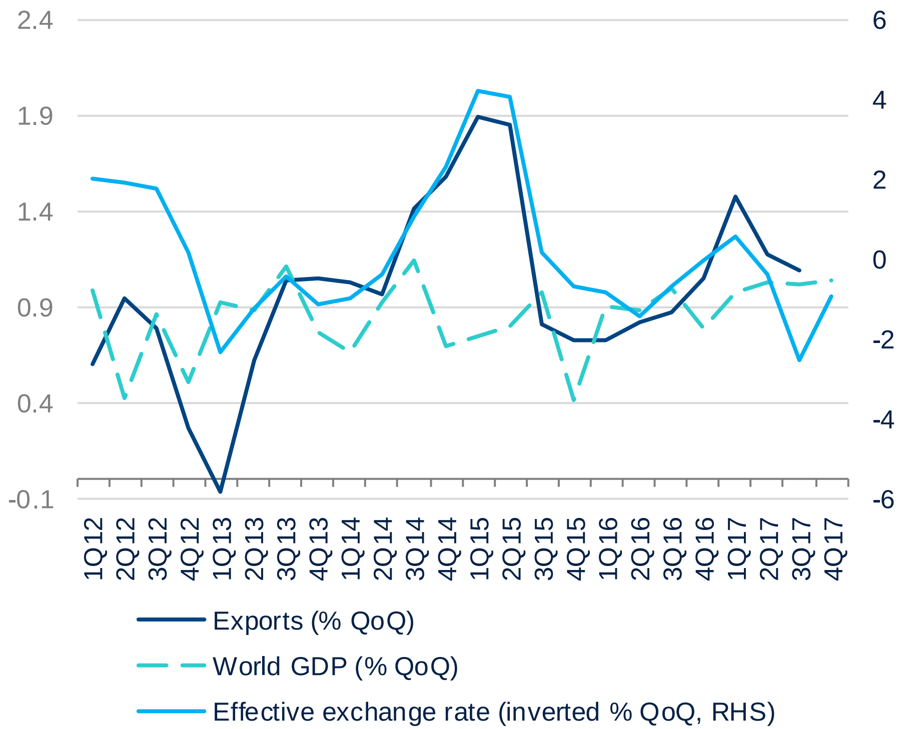



Source: Eurostat and BBVA Research

- Private consumption has shown **strong growth** and adds to **buoyant confidence levels**
- Real **disposable income to slightly moderate** on higher inflation expectations
- Unemployment rate **expected to keep its downward trend**

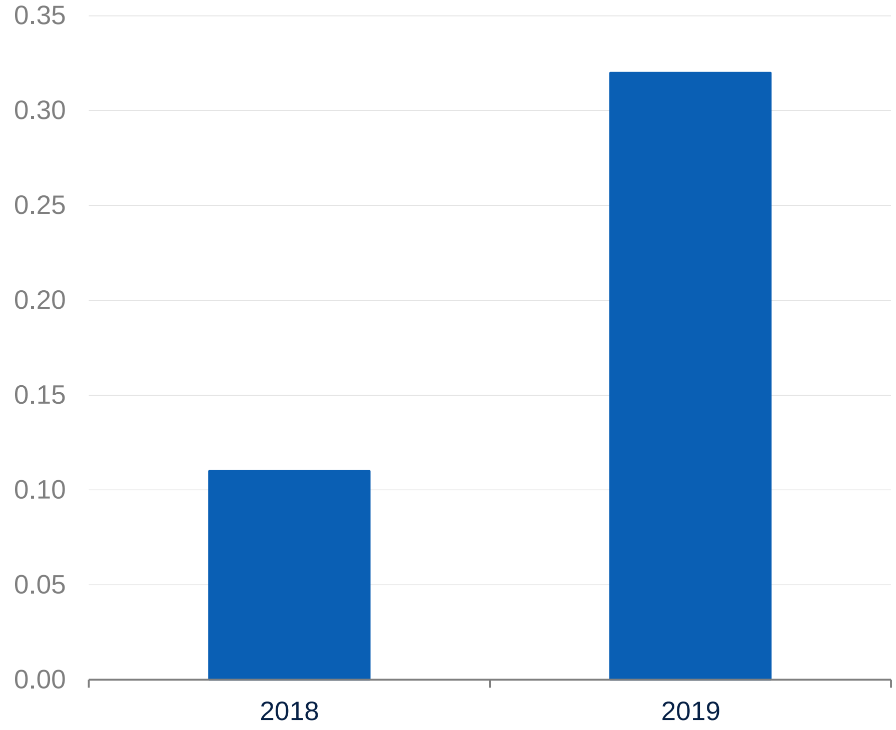
# Strong global demand boosts exports, while the impact from euro appreciation is still limited

## Exports, EURUSD and World GDP




Source: Eurostat and BBVA Research

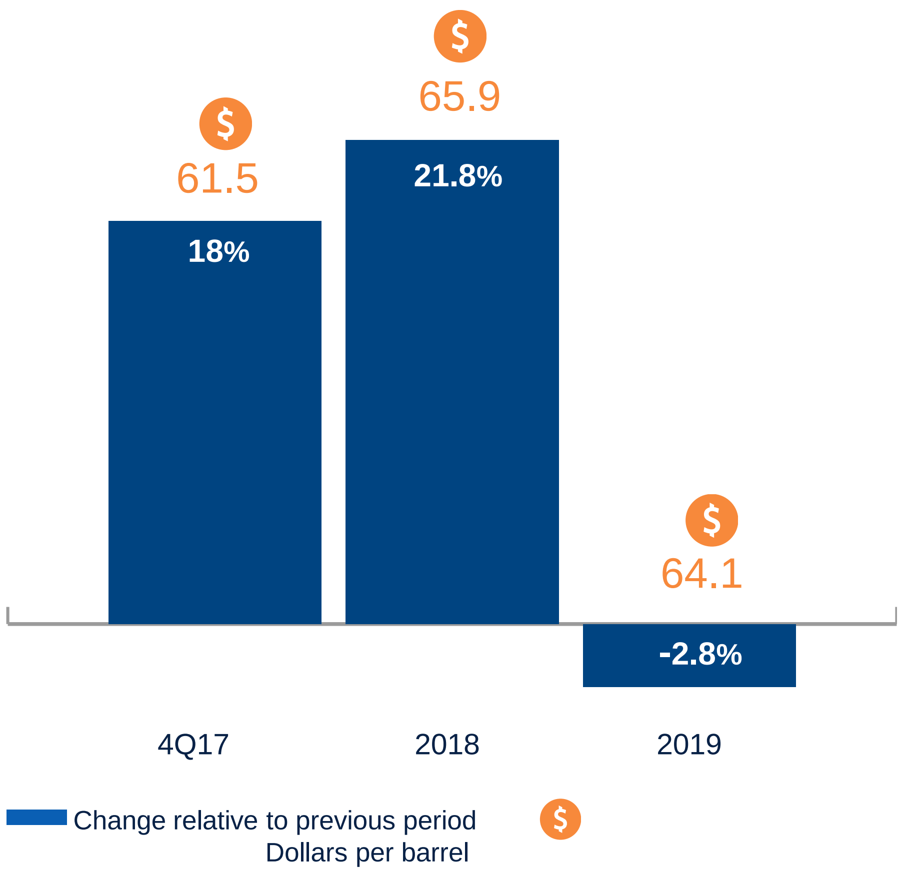
## Effect of higher Chinese growth on Eurozone GDP growth (pp)




- Stronger growth in China **could add around 0.2pp** to Eurozone GDP growth in 2018-19
- **External support should underpin a strong growth in the Eurozone** -above potential- for a relatively long period of time

# Higher commodity prices, but contained

**Price of oil**
(Dollars per barrel, %)

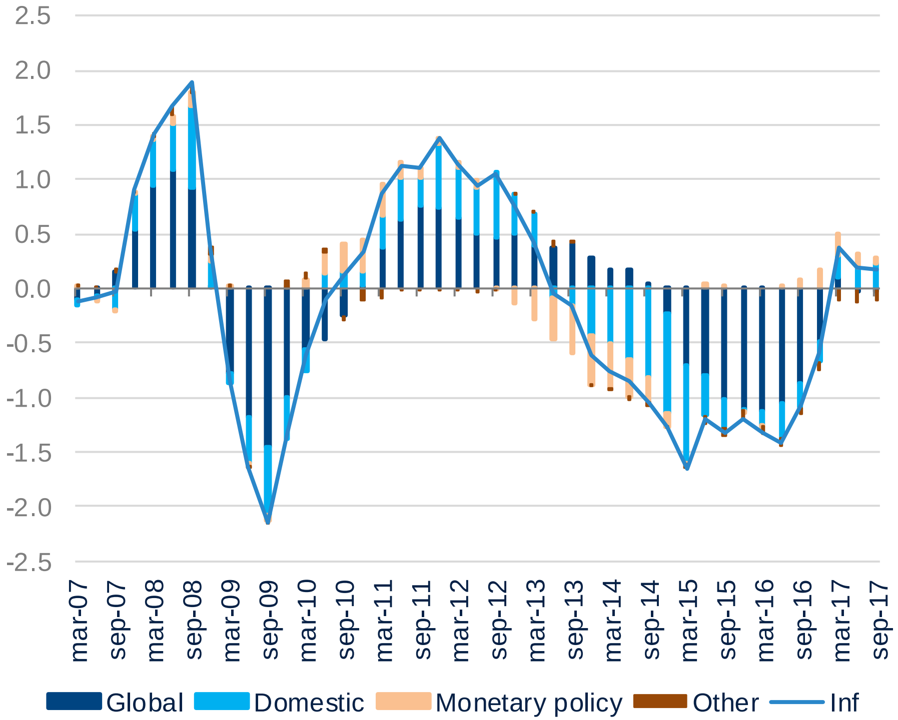



- Higher oil prices reflect greater global demand, which would account for 60% of the increase
- However, they also reflect supply factors, linked to geopolitical risks and the inventories correction
- The increase will push up inflation in the short term, but with limited impact on activity
- We still expect prices to move to $60 per barrel in the medium term, due to increased competition and structural changes in the energy sector

Source: BBVA Research

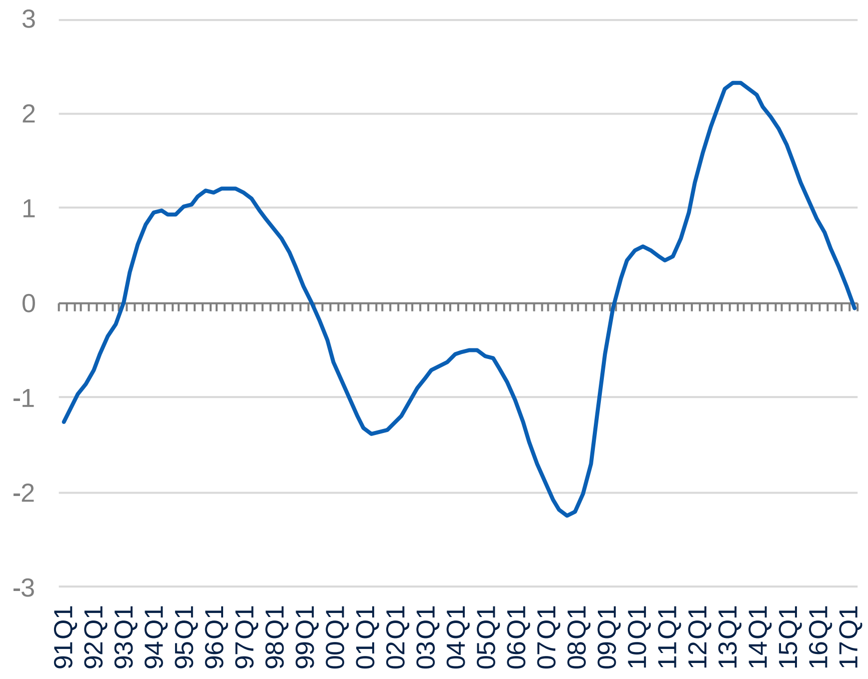
# Global and domestic shocks have driven low inflation in the past, but are now gradually fading

## Eurozone: historical decomposition of inflation (pp)




Source: BBVA Research

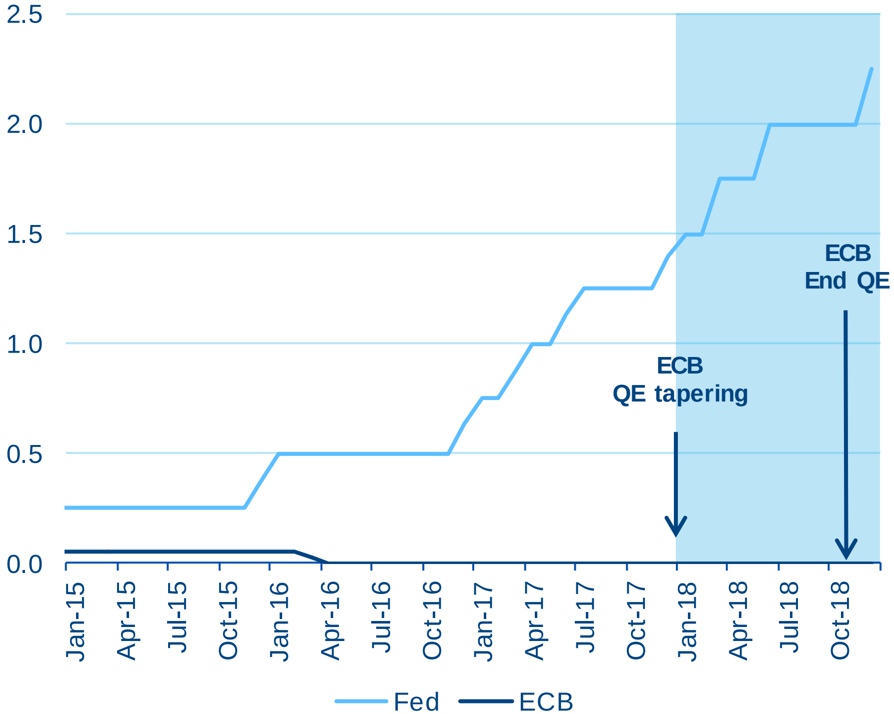
## Eurozone: unemployment gap (pp)




- Both **global and domestic shocks have ceased to weigh negatively on inflation** over the past year, which also benefits from the **positive contribution from ECB's measures**
- There has been more economic slack in recent years, but **now the gap has clearly narrowed**

# The ECB keeps the gradual normalization of monetary policy

**Fed and ECB interest rate**
(pb)



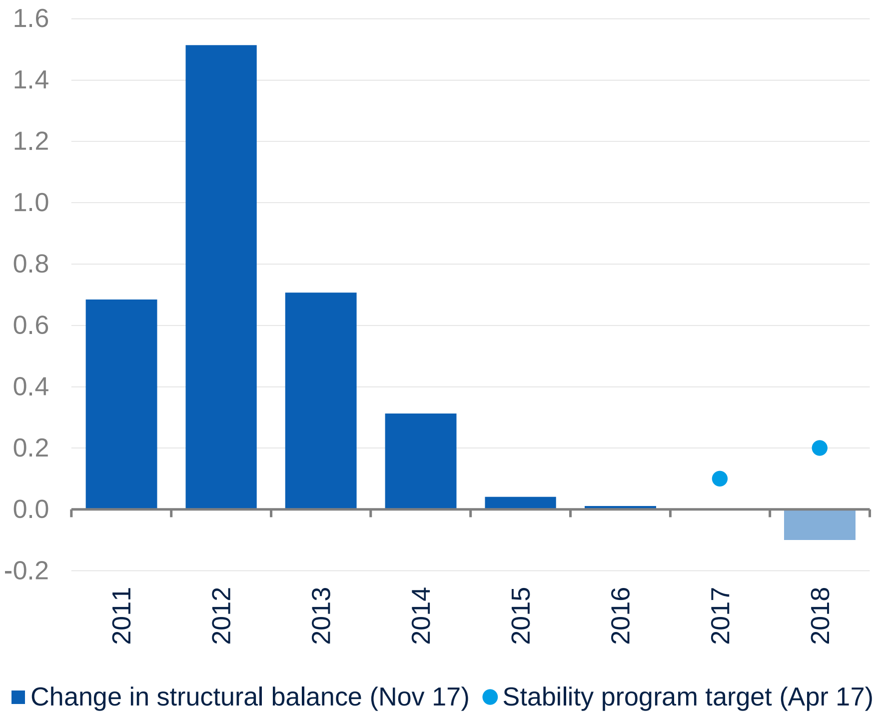

- **No changes** in our baseline scenario
- **The ECB is increasing confidence in the outlook**, but normalization is expected to **be orderly and prudent**
  - **Changes in forward guidance** possibly by March/April
  - Tapering by early 2018, but **QE extended to September 2018**
  - **No interest rate increases before 2019**
  - Focus: avoid a sudden jump in long-term rates

  **No changes** in our baseline scenario
- **Still uncertainty:**
  - Changes in the governing council
  - Macro: possible surprises in inflation and in economies' reaction to hither interest rates
  - Markets: long-term rates and steepness of the curve

Source: Fed, ECB and BBVA Research

# Draft budgetary plans for 2018 envisage a broadly neutral fiscal stance, but adjustments efforts will be below mid-term targets

**Annual change in structural balance**
(% of GDP)




- A broadly neutral –or slightly expansionary- **fiscal stance for 2018**
- **Cyclical improvements** add to still low interest rates
- Expectations of both a **lower growth of primary expenditures and interest burdens,** although public investment is expected to increase in 2018
- **Revenues are expected to decline,** due to adjustment measures and shortfalls for 2018

Source: European Commission and BBVA Research

# Germany: favorable domestic and external demand are underpinning stronger growth

**MAIN MACROECONOMIC INDICATORS**
(% YoY, %GDP)

| | 2016 | 2017 (e) | 2018 (f) | 2019 (f) |
|---|---|---|---|---|
| **Real GDP** | **1.9** | **2.6** | **2.4** | **1.8** |
| **Private consumption** | 1.9 | 2.3 | 1.9 | 1.6 |
| **Public consumption** | 3.7 | 1.2 | 1.4 | 1.4 |
| **Investment** | 2.9 | 4.4 | 4.3 | 3.1 |
| **Domestic demand (cont. pp)** | **2.2** | **2.4** | **2.4** | **1.8** |
| **Exports** | 2.4 | 4.8 | 4.4 | 3.5 |
| **Imports** | 3.8 | 5.1 | 4.4 | 3.9 |
| **Net exports (cont. pp)** | **-0.4** | **0.2** | **0.3** | **0.1** |
| **Current account (% GDP)** | 8.2 | 7.9 | 7.8 | 7.5 |
| **Budget balance (% GDP)** | 0.8 | 0.9 | 1.0 | 1.0 |
| **HICP (avg. %YoY)** | 0.4 | 1.7 | 1.8 | 1.8 |

- Recent data and 3Q17 **figures suggest that growth pace will prevail** in coming quarters
- GDP growth **forecast revised upwards for this year** from 1.8% to 2.4%
- A **well balanced investment and consumption** will lead growth. Private consumption fueled by confidence and labour market gains
- A **better global outlook** will continue to support strong trade figures and investment
- **Public expenditure** expected to **grow steadily** given a broadly unchanged fiscal policy stance
- Inflation upturn should weight in the **softening of private consumption**

Source: Eurostat and BBVA Research

# France: reforms and the better external environment are positively weighing on the outlook

**MAIN MACROECONOMIC INDICATORS**
(% YoY, %GDP)

| | 2016 | 2017 (e) | 2018 (f) | 2019 (f) |
|---|---|---|---|---|
| **Real GDP** | **1.1** | **1.9** | **1.9** | **1.6** |
| **Private consumption** | 2.1 | 1.2 | 1.7 | 1.5 |
| **Public consumption** | 1.2 | 1.5 | 1.4 | 1.2 |
| **Investment** | 2.7 | 3.6 | 3.1 | 2.7 |
| **Domestic demand (cont. pp)** | **1.9** | **2.5** | **2.0** | **1.6** |
| **Exports** | 1.9 | 3.1 | 3.8 | 3.3 |
| **Imports** | 4.2 | 4.6 | 3.7 | 2.9 |
| **Net exports (cont. pp)** | **-0.8** | **-0.6** | **-0.1** | **0.0** |
| **Current account (% GDP)** | -0.9 | -1.1 | -1.3 | -1.3 |
| **Budget balance (% GDP)** | -3.4 | -2.9 | -2.7 | -2.7 |
| **HICP (avg. %YoY)** | 0.3 | 1.1 | 1.3 | 1.5 |

- Recent data showed more positive. **Private consumption** surprised to the upside in 3Q17 and adds to higher **inventory investment**
- **We revised up GDP growth in 2018** from 1.7% to 1.9%, while the reforms have favored a positive environment for investment and growth
- **Investment growth is improving** on the back of lower policy uncertainty, reduced taxes and higher infrastructure expenditures
- A **better global outlook will underpin exports growth,** but higher imports will weight on the net contribution of trade
- Private **consumption to benefit from labour gains,** higher confidence and subdued inflation

Source: Eurostat and BBVA Research

# Italy: better prospects for 2018, despite political and financial vulnerabilities

**MAIN MACROECONOMIC INDICATORS**
(% YoY, %GDP)

| | 2016 | 2017 (e) | 2018 (f) | 2019 (f) |
|---|---|---|---|---|
| **Real GDP** | **1.1** | **1.6** | **1.5** | **1.3** |
| **Private consumption** | 1.5 | 1.5 | 1.2 | 1.1 |
| **Public consumption** | 0.5 | 0.8 | 0.4 | 0.4 |
| **Investment** | 3.0 | 3.2 | 3.8 | 2.7 |
| **Domestic demand (cont. pp)** | **1.2** | **1.5** | **1.4** | **1.3** |
| **Exports** | 2.6 | 5.1 | 3.5 | 2.8 |
| **Imports** | 3.3 | 5.5 | 3.7 | 2.9 |
| **Net exports (cont. pp)** | **-0.2** | **0.0** | **0.0** | **0.0** |
| **Current account (% GDP)** | 2.7 | 2.6 | 2.1 | 2.0 |
| **Budget balance (% GDP)** | -2.5 | -2.1 | -1.8 | -1.5 |
| **HICP (avg. %YoY)** | -0.1 | 1.4 | 1.4 | 1.7 |

- Solid and stable growth figures, **led by exports and the ongoing recovery of investment**
- We **revise upwards GDP growth forecasts** from 1.3% to 1.5% in 2018 driven by the impact of a better regional outlook over investment
- **Private consumption should gradually moderate** due to higher inflation
- Despite a null contribution of net external demand, **exports will continue to benefit from improved global growth**
- **Policy uncertainty** remains latent -given March elections- and continue to be a handicap for the **enhancement of potential growth**

Source: Eurostat and BBVA Research

# Spain: unchanged outlook amid high policy uncertainty

## MAIN MACROECONOMIC INDICATORS
(% YoY, %GDP)

| | 2016 | 2017 (e) | 2018 (f) | 2019 (f) |
|---|---|---|---|---|
| **Real GDP** | **3.3** | **3.1** | **2.5** | **2.3** |
| **Private consumption** | 2.9 | 2.5 | 2.2 | 1.9 |
| **Public consumption** | 0.8 | 1.2 | 1.8 | 1.9 |
| **Investment** | 3.3 | 5.0 | 3.7 | 4.4 |
| **Domestic demand (cont. pp)** | **2.5** | **2.6** | **2.4** | **2.3** |
| **Exports** | 4.8 | 5.1 | 4.4 | 5.2 |
| **Imports** | 2.7 | 3.9 | 4.4 | 5.8 |
| **Net exports (cont. pp)** | **0.7** | **0.5** | **0.2** | **0.0** |
| **Current account (% GDP)** | 1.9 | 1.8 | 1.9 | 1.7 |
| **Budget balance (% GDP)** | -4.3 | -3.1 | -2.3 | -1.7 |
| **HICP (avg. %YoY)** | -0.2 | 2.0 | 1.6 | 1.7 |

- Recent economic data **reinforce our view to keep the outlook unchanged**
- **GDP growth moderation will continue** in 2018 and 2019, with forecast at 2.5% and 2.3%, respectively
- **External fundamentals are still favourable** and support a relatively strong recovery, but **domestic demand is expected to moderate**
- **A neutral fiscal stance** in coming years
- **Domestic risks** seem still related to political uncertainty, fiscal adjustment and wage pressures

Source: Eurostat and BBVA Research

BBVA | Research

# Eurozone Economic Watch

## Higher growth forecasts for 2018-19

January 2018

# 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.