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BBVA Research

Eurozone Economic Watch

June 2018

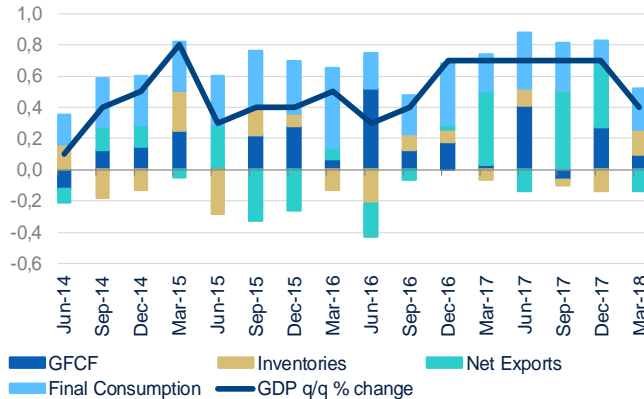
Creando Oportunidades

Growth moderation has continued in Q2 and headline inflation has shot up

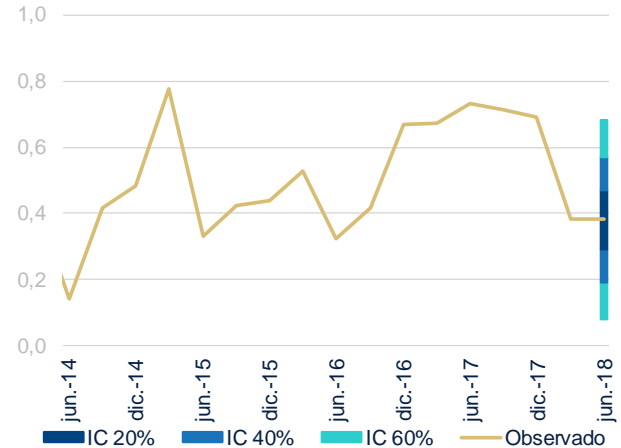
- The Eurozone GDP growth slowed down in 1Q18 more than expected, mostly driven by Germany and France, due to lower contribution from external demand.
- Our BBVA-MICA model points to a quarterly increase of 0.4% in 2Q18 GDP while it suggests a downward bias to our growth forecast of 2.3% for this year.
- Higher political uncertainty and protectionist measures may have weighed on overall confidence figures. In this context, hard data suffered accordingly in 1H18, with there were new declines in industrial output and almost flat retail sales during April. PMI's, however, have recovered somewhat in June.
- External trade has also moderated, mostly exports, adding to the doubts in trade policy emerging from the U.S.
- Inflation accelerated to 1.9% YoY (+0.6pp) due to the surge in energy prices, while core measure increased more gradually, as expected, to 1.3% YoY (+0.2pp) mostly coming from services. Higher oil prices and the euro depreciation has contributed to widening the gap between headline and core figures.
- The ECB is set to unwind its monetary stimulus, starting in September this year, while it has also strengthened its forward guidance on rates, holding them up until next summer.
- Overall, risks to the growth outlook remain tilted to the downside, characterized by renewed political concerns in various fronts, which add to increasing protectionism measures.

Growth slowed down in the first quarter of the year and seems to stabilize in 2Q18

GDP, contribution by components (% QoQ)



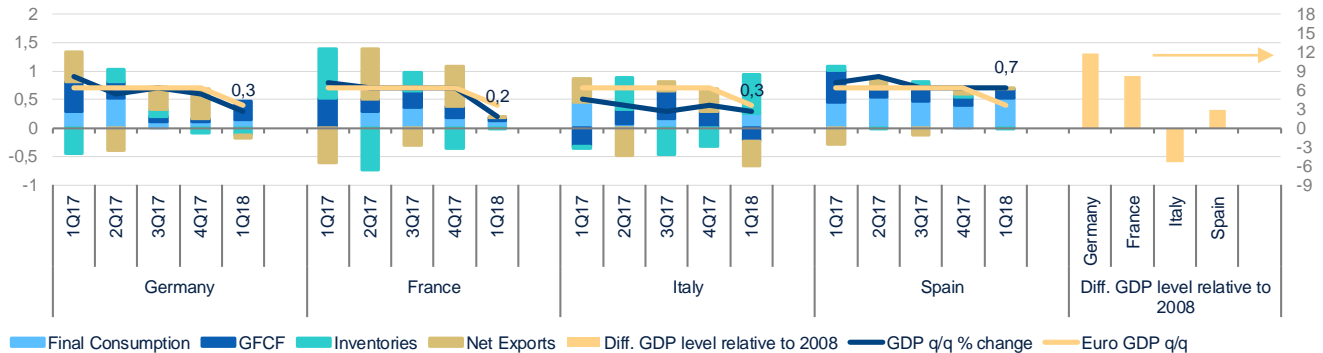
GDP and MICA forecasts (% QoQ)



GDP growth slowed more than expected to 0.4% QoQ in 1Q18 (after 0.7% in previous quarter), mainly due to lower contribution from net exports. For 2Q18, our BBVA-MICA model forecasts a similar pace of growth at around 0.4% QoQ

Germany and France are driving the moderation in growth

GDP and expenditure contribution by country (%QoQ; pp)

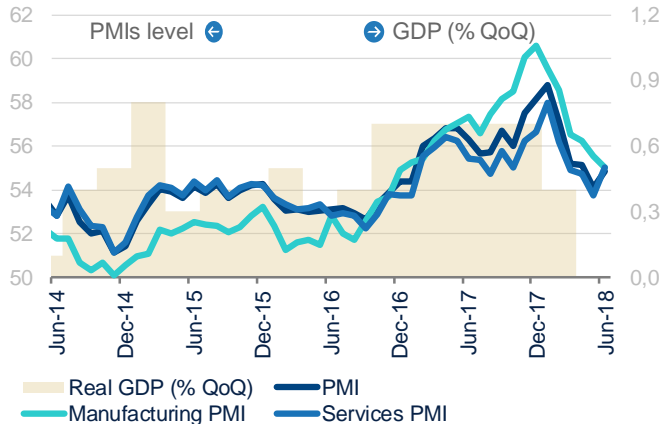


The deceleration was most significant in France, to 0.2% q/q, driven by net exports. For the Eurozone as a whole, export gains have resumed in every core country, while in contrast domestic demand still fuels economic activity.

Sentiment indicators improved in the services sector but not in manufacturing, according to preliminary June PMI's

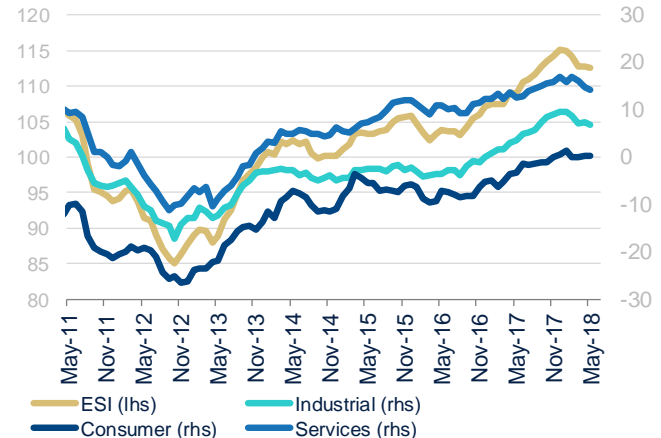
PMI and GDP

(level, %QoQ)



EC confidence survey

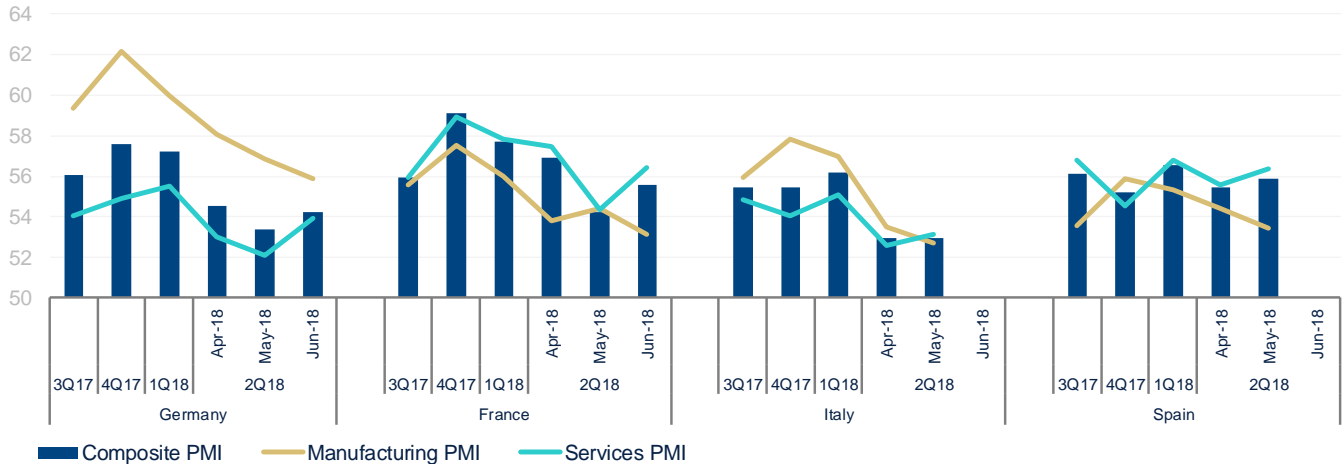
(level)



EZ PMIs recovered somewhat in June and signal stronger business activity in the services sector, though manufacturing activity remained subdued. Optimism thus improves after indicators were hit in May by uncertainty surrounding both domestic and global factors (e.g. political and trade protectionism).

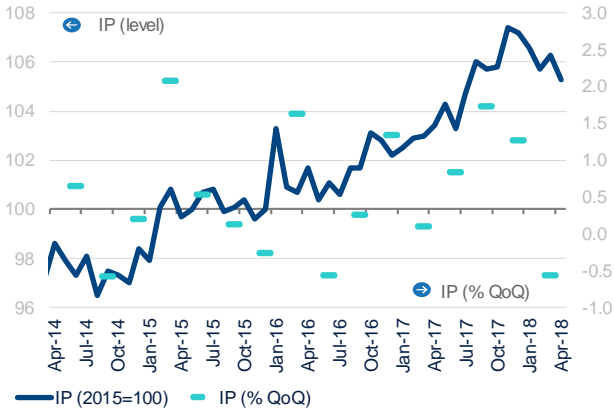
Composite PMIs have declined in all major countries in early 2Q, though they have recovered in France and Germany in June

PMI survey (level)

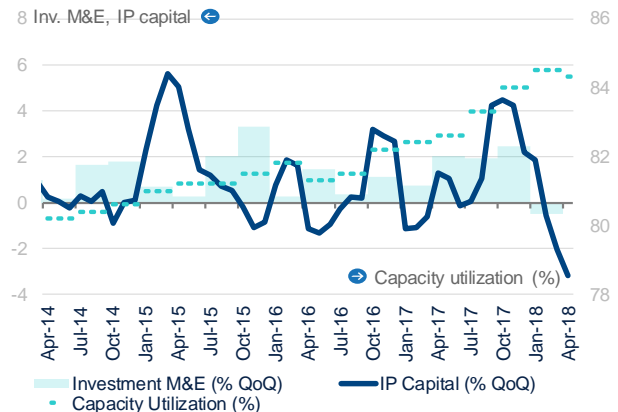


Industrial production continued its downward adjustment in April

Industrial Production (level, %QoQ)



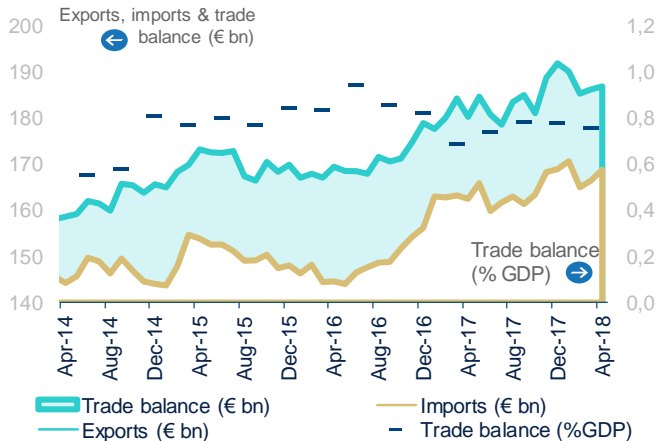
IP capital equipment, investment in M&E and capacity utilisation (%QoQ; %)



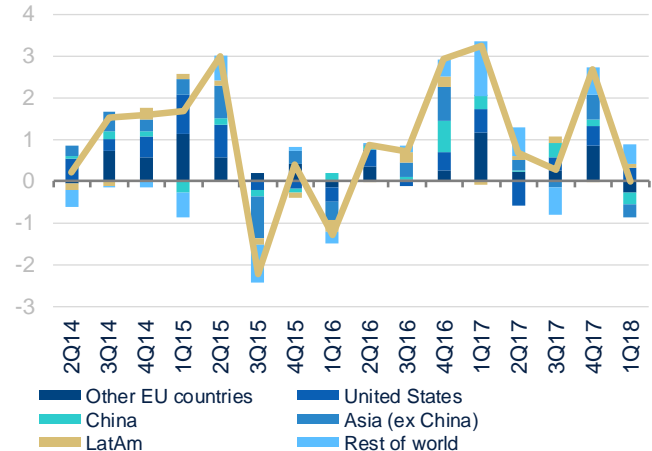
Industrial output fell in April by 0.9% MoM driven by a lower production of energy (-5.0% MoM) and durable goods (-2.2% MoM). In this context, investment in machinery and equipment (M&E) and capital goods production have shown declines since the turn of the year

External trade was characterized by both higher dynamism from imports and moderate exports in April

Trade balance (€bn, %GDP)



Exports by destination (%QoQ; pp)

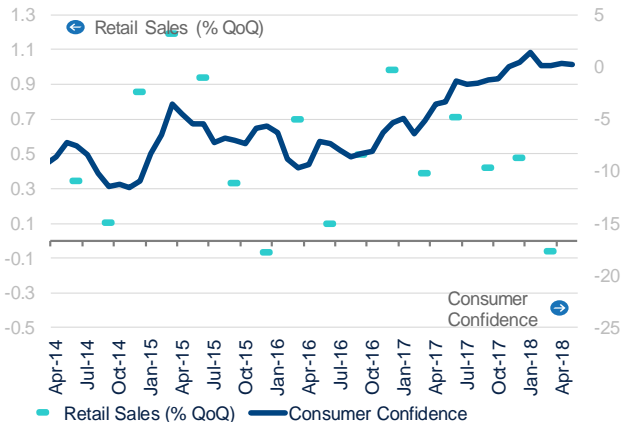


As of April, the trade surplus broadened by almost 10% compared to last year, while the surplus with the US has increased by around 17% to €45.4bn. Exports in Q1 stagnated after the very strong growth at the end of 2017.

Retail sales have also slowed despite continued job creation and stable consumer confidence

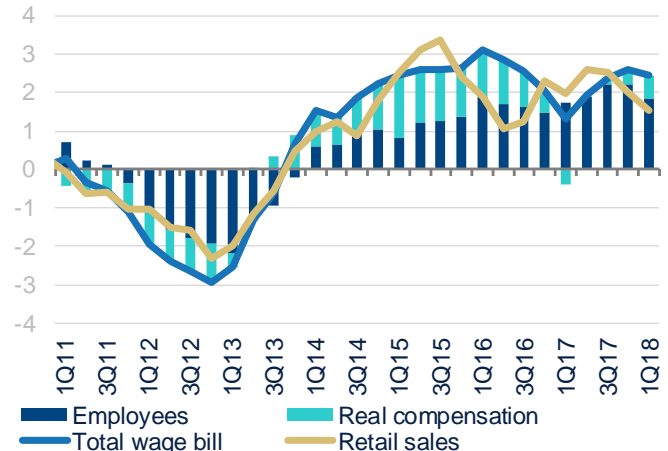
Retail sales and consumer confidence

(%QoQ; pts)



Retail sales and total wage bill

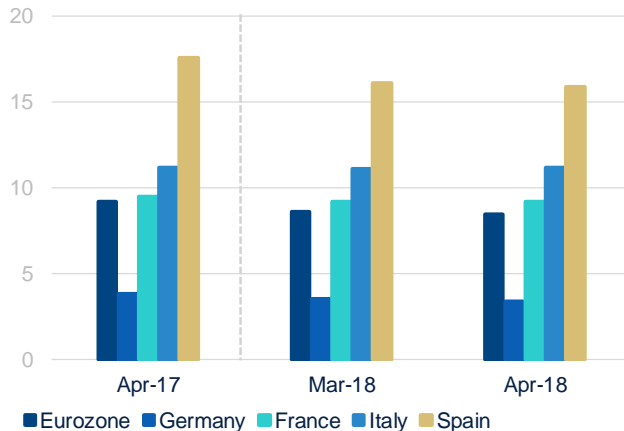
(%YoY; pp)



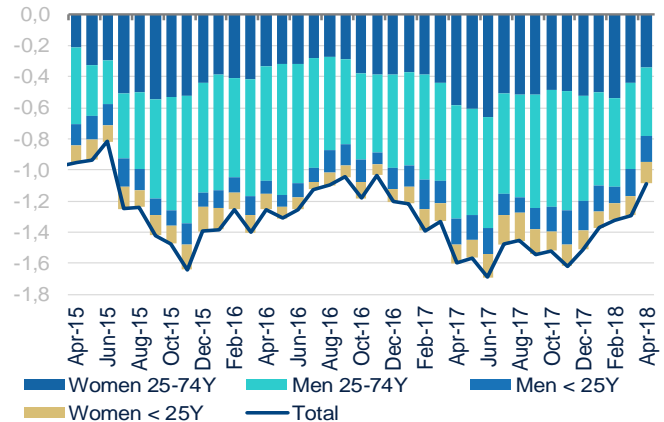
Retail sales showed almost flat in April (+0.1% MoM). Consumer confidence remains high despite a worsening growth outlook. Meanwhile, job creation continued to support household incomes. In this context, higher inflation and preemptive savings -due to higher uncertainty- could have weighed over recent retail sales figures.

The labor market remains dynamic although the unemployment rate is diminishing at a slower pace

Unemployment by country (%)



Annual unemployment change by gender and age (millions)

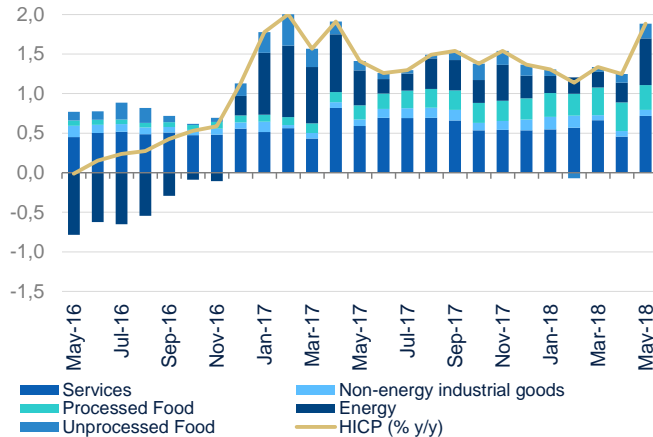


The unemployment rate remained broadly flat in April, declining by a minor 0.1% to 8.5% (0.7pp reduction in the past year). At the country level, the main improvement comes from Spain, while skill shortages are increasingly being reported in Germany

Annual inflation shot up to 1.9% in May due to rising oil prices and the euro depreciation, with no surprises in the core rate

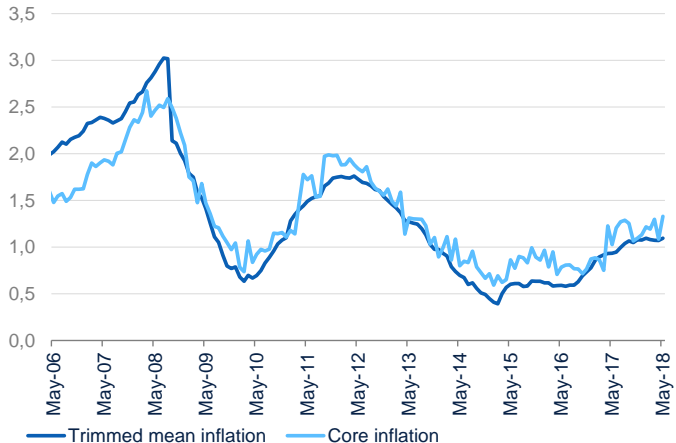
Inflation and contribution by components

(%YoY; pp)



Core and trimmed-mean inflation

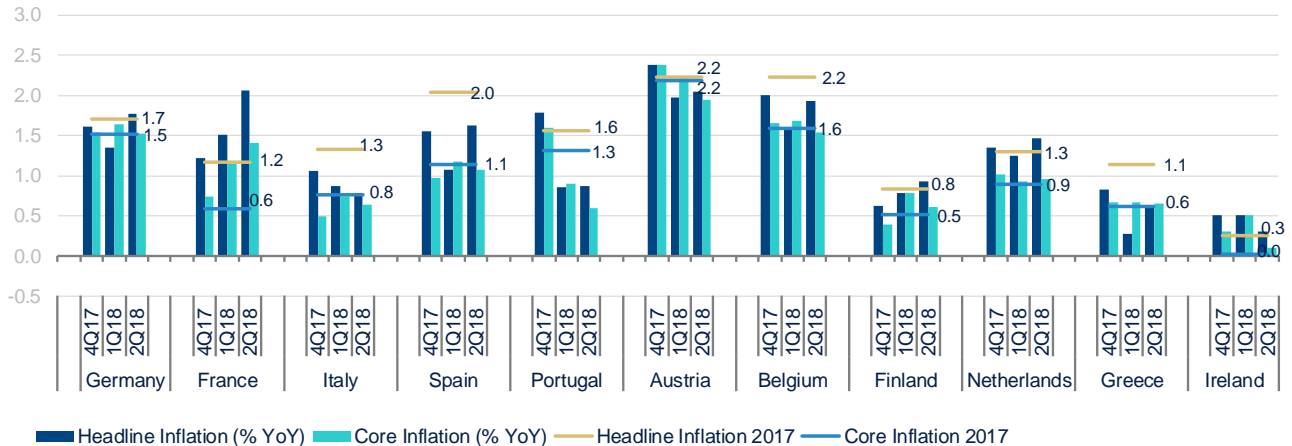
(% YoY)



Headline inflation has increased a bit more than expected, mostly due to higher prices for energy (+3.5pp to +6.1% y/y). Core inflation evolved as expected (+0.2% to +1.3%), with a slight surprise in services (+0.6pp to +1.6%)

As expected, headline inflation edged up in most countries, while core measures experienced a more gradual increase

Headline and core inflation (% y/y)



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