BBVA Research

Eurozone Economic Watch

September 2018

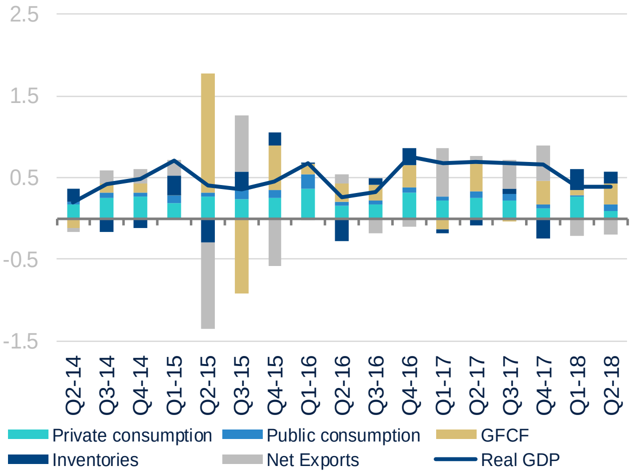
Creando Oportunidades

Eurozone: steady growth supported by domestic demand, with increasing concerns on global headwinds

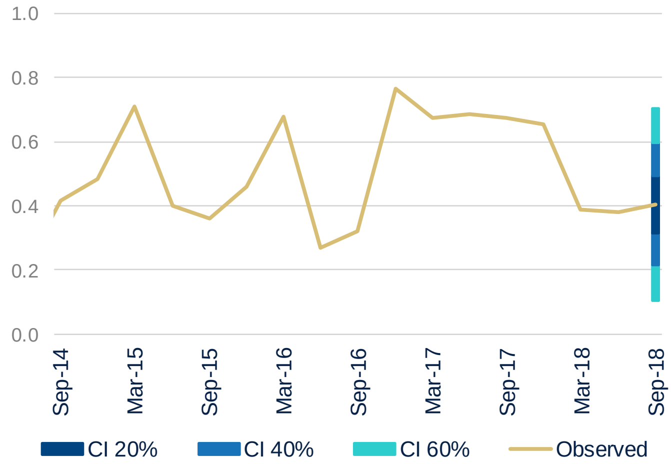
- The Eurozone GDP grew at a steady 0.4% q/q in 2Q18, as expected. Domestic demand remains robust but net exports weighed on growth.
- Hard data in July were mixed. Retails sales point to ongoing solid private consumption, which could be also underpinned by job creation. Industrial output fell, though firms' supply constraints and financial conditions should continue to support the recovery of investment.
- Worsening confidence seen in early year seems to have halted over the summer at levels consistent with still resilient but more moderate growth. However, some leading components, mainly related to export orders, are a warning sign about eventual negative effects from both increasing protectionism and stress in emerging economies for the coming quarters.
- Our MICA-BBVA model projects quarterly GDP growth to remain stable at 0.4% in 3Q18, consistent with our forecast of an annual growth of 2% in 2018.
- Headline inflation seems to have peaked during the summer and is likely to moderate slightly due to energy base effects. Core inflation remains steady at low levels, but we continue to expect a very gradual increase in coming quarters supported by the strength of domestic demand and ongoing labour market tightening.
- Downside risks are tilted to the downside, both domestic risks (Italy, Brexit) and external (emerging market turmoil and, mostly, uncertainty on protectionism).

Growth slowed at the beginning of the year due to global headwinds, but seems to have stabilized at around 0.4% q/q

GDP, contribution by components
(%, QoQ)



GDP and MICA forecasts
(%, QoQ)



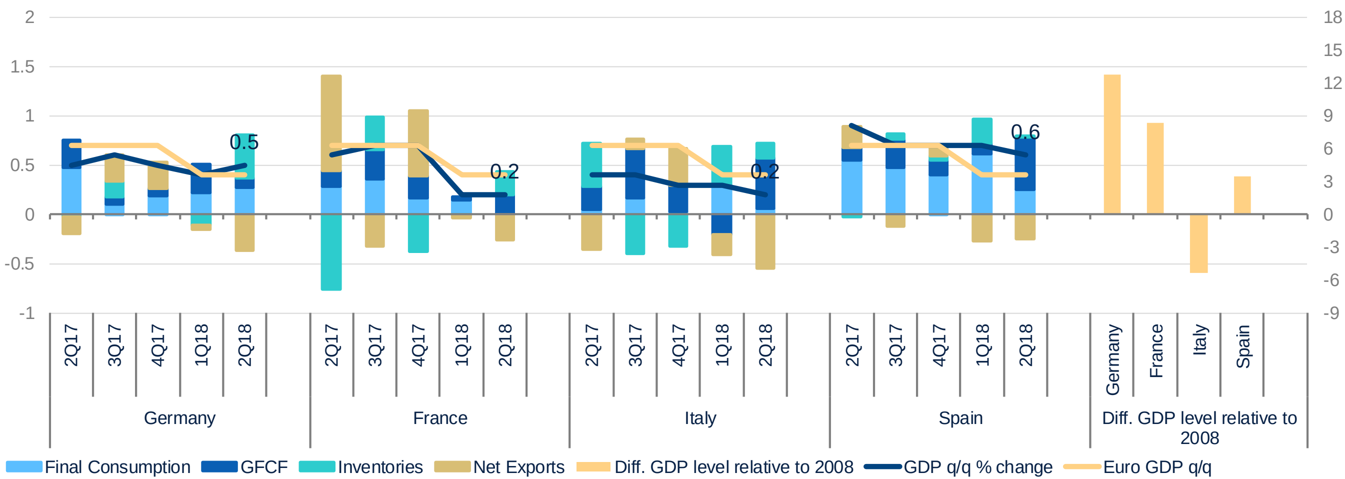
Quarterly GDP growth has been confirmed at 0.4% QoQ in 2Q18 underpinned by solid domestic demand (+0.6pp), as increasing investment and public consumption compensate for weaker private consumption. Net exports contributed negatively again (-0.2pp) due to a sharp rise in imports, likely linked to strong investment figures, and offset the slight recovery of exports.

Source: Eurostat and BBVA Research

Broad-based moderation across countries in 1H18, with differences stemming from the strength of their domestic demand

GDP and expenditure contribution by country

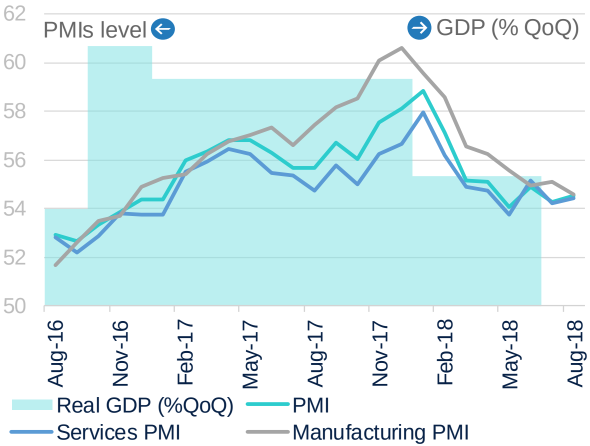
(%QoQ, pp)



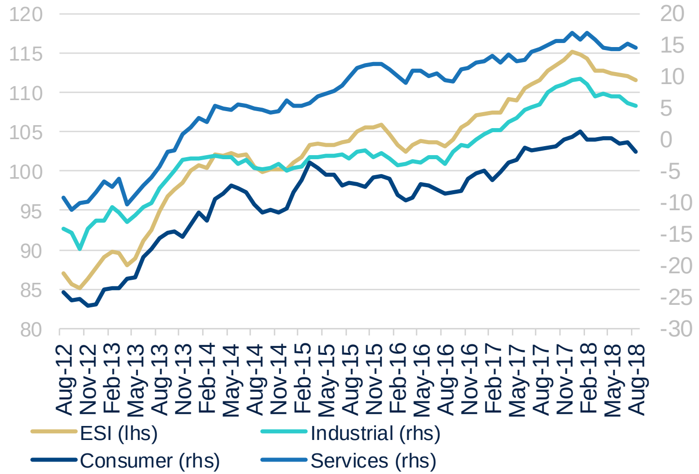
Source: Eurostat and BBVA Research

The worsening of confidence in early year seems to have halted at levels consistent with more moderate growth than a year ago

PMI and GDP
(level, %QoQ)



EC confidence survey
(level)

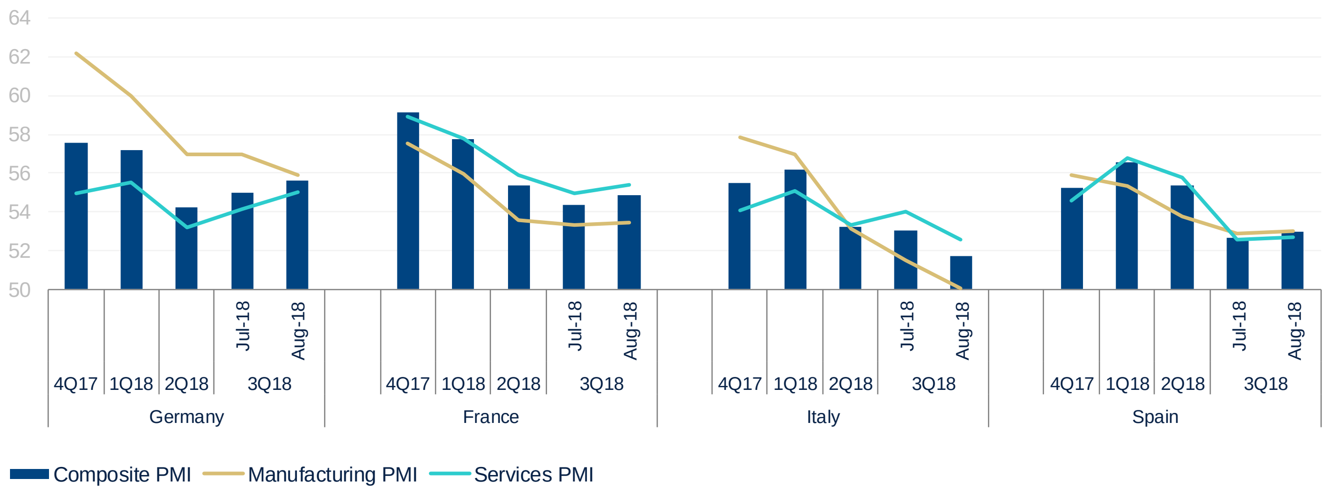


Confidence has stabilized during the summer and points to a steady quarterly growth of around 0.4% for 3Q18 (after strong 0.7% QoQ on average in 2017). However, the worsening of some leading components, mainly related to export orders, raise concerns about the negative effects in coming from both protectionism and financial stress in emerging economies.

Source: Eurostat, European Commission and BBVA Research

Services PMIs remain more resilient to trade uncertainty and have helped to stabilize confidence across large countries (except in Italy)

PMI Survey
(level)



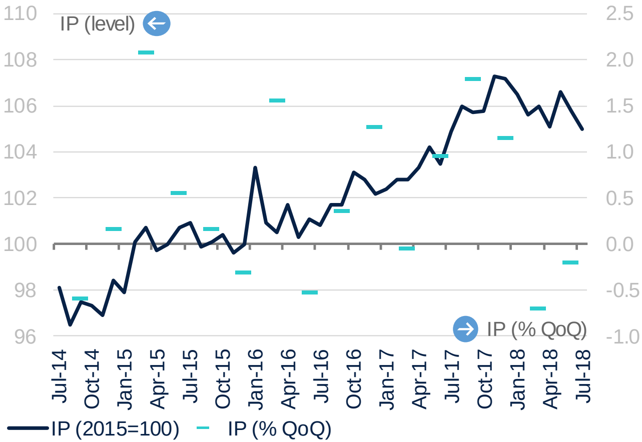
Confidence levels remain robust with the sole exception of Italy, where the manufacturing index recorded the worst reading in two years (50.1). Overall, the service sector keeps performing somewhat better than in Q2, favored by supportive domestic drivers and accommodative policies.

Source: Markit and BBVA Research

Industrial output dipped significantly in July, except in France, raising concerns about the effect of increasing uncertainty on activity

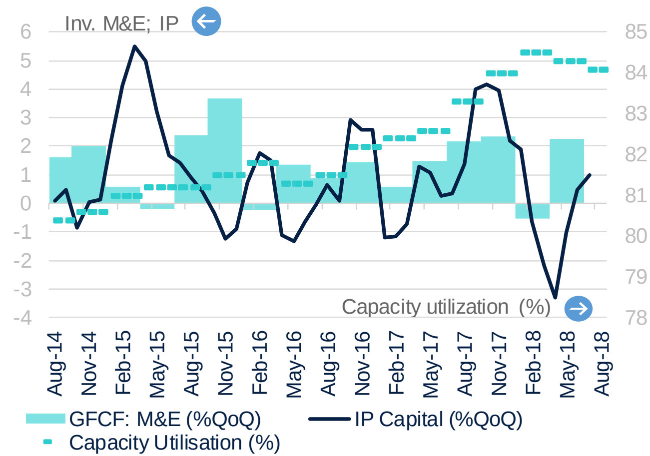
Industrial production

(Level, % QoQ)



IP capital equipment, investment in M&E and capacity utilisation

(%QoQ; %)

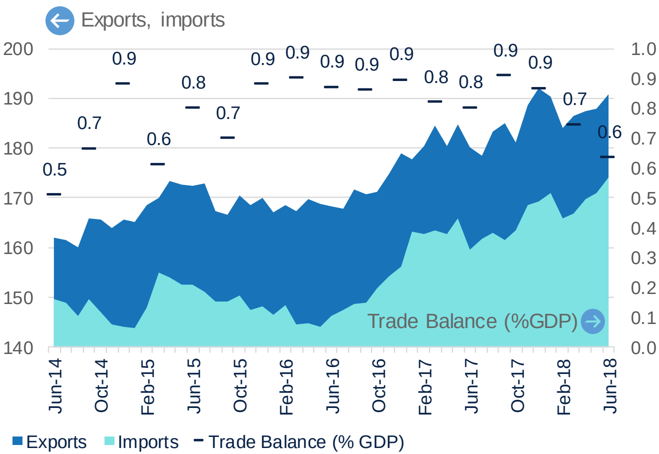


IP declined significantly in July (-0,8 m/m) posting negative readings in Germany (-1.8% m/m), Italy (-1.8% m/m) and Spain (-0.3%). Despite high uncertainty, financial conditions are accommodative and domestic demand remains strong, so we expect these negative figures to partly revert in the months ahead.

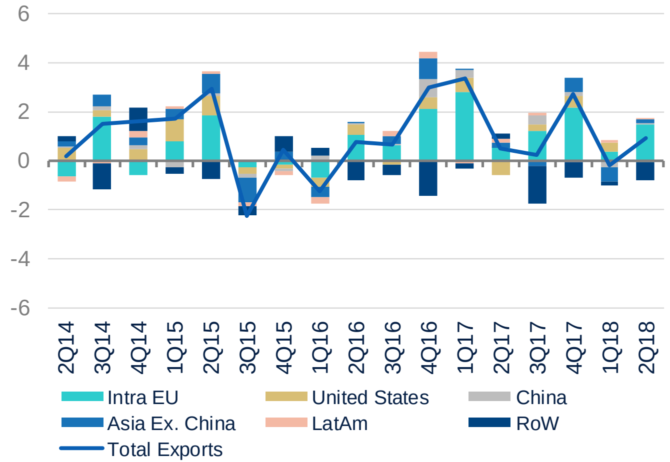
Source: Eurostat and BBVA Research

Exports increased slightly in 2Q18 supported by EU demand

Trade balance
(€bn; %GDP)



Exports by destination
(%YoY; pp)

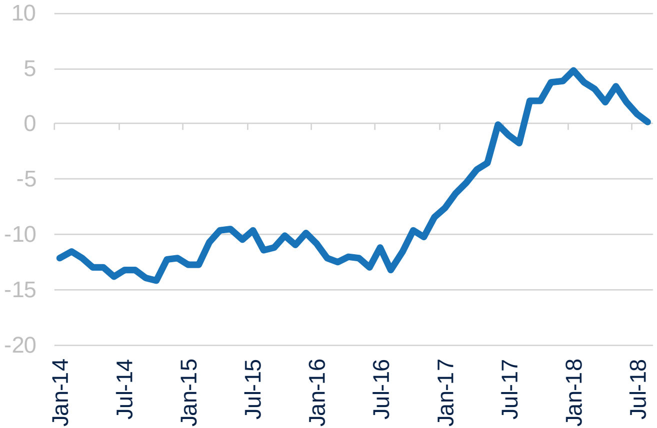


Exports picked up in Q2 (+0.6% q/q) after a weak record at the beginning of the year, but remain a drag to quarterly growth due rising imports (+1.1% q/q). The trade balance has narrowed so far this year, but the surplus with the US widened significantly over the quarter (26%).

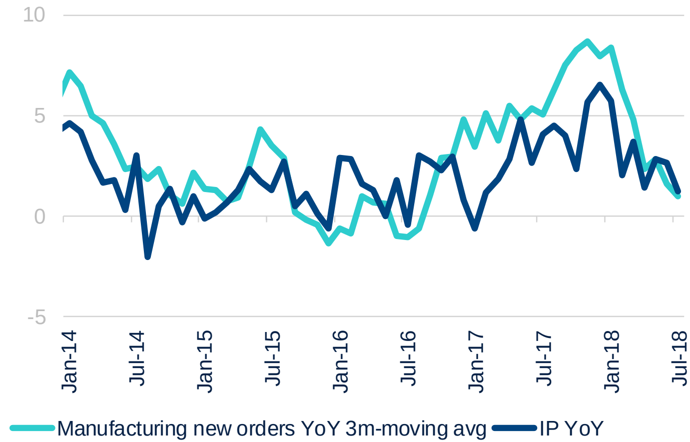
Source: Eurostat and BBVA Research

But export orders have weakened across the board

ESI, industry: volume of export orders
(Level)



Germany: manufacturing new orders, IP
(%YoY 3m-moving avg; %YoY)



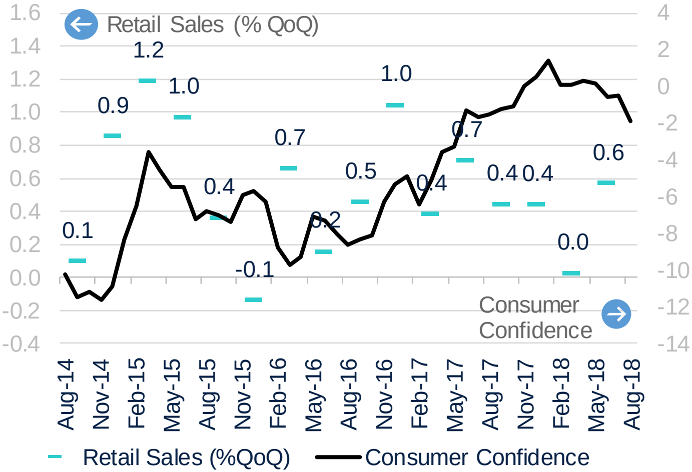
New export orders have declined in recent months affected by a lower dynamism of foreign demand. Despite the fact that new emission tests could have temporarily dented auto orders, the decline goes beyond the usual volatility of the indicator and has intensified over the summer.

Source: Eurostat and BBVA Research

Retail sales have slowed somewhat until July, but suggest an ongoing resilient household expenditure

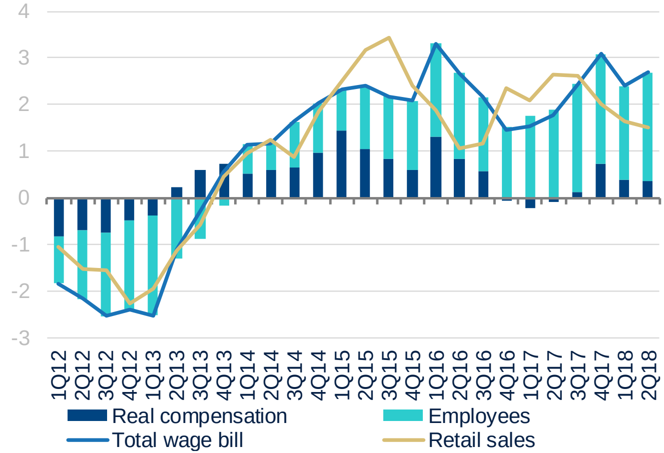
Retail sales and consumer confidence

(%QoQ, level)



Retail sales and total wage bill

(%YoY; pp)

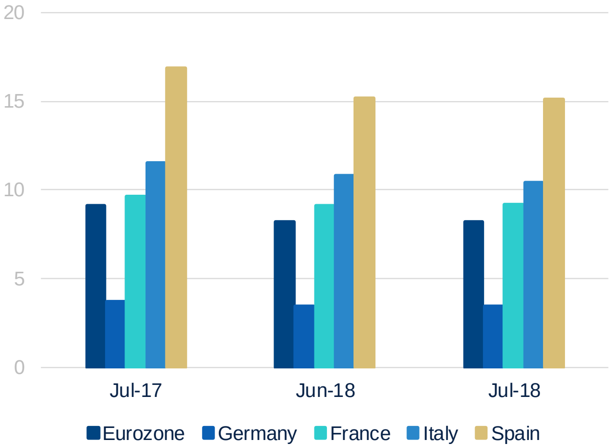


Retail sales declined slightly in July after rebounding in 2Q18. Beyond volatility, these figures so far continue to suggest that household expenditure remains solid but somewhat more moderate than a year ago. Despite higher inflation, job creation and the incipient wage increase could support household disposable income.

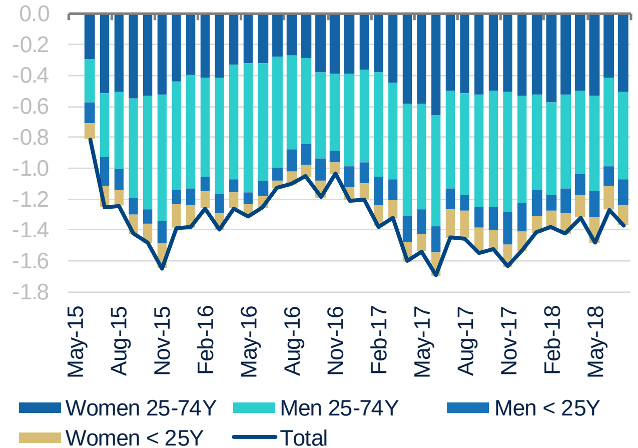
Source: Eurostat and BBVA Research

The downward trend of the unemployment rate halted paused over the summer to remain steady at 8.2% in July

Unemployment rate by country
(%)



Annual unemployment change by gender and age
(millions)

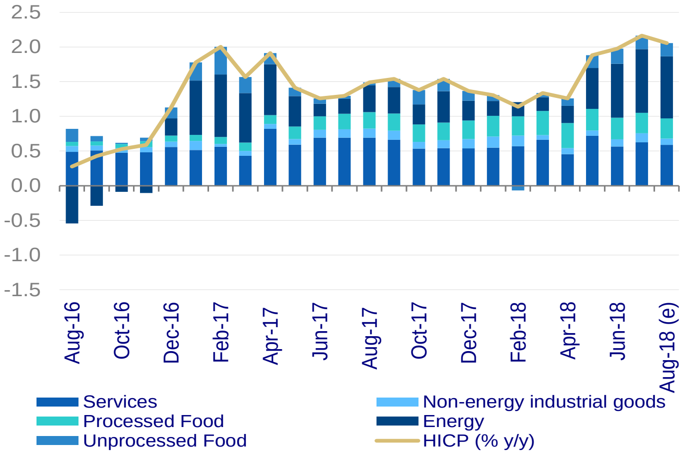


The labor market keeps gradually recovering in the whole of the Eurozone, although differences persist between core and peripheral countries. Sentiment indicators have captured rising fears of unemployment in some countries, but past reforms and strong economic fundamentals should keep fostering the labor market.

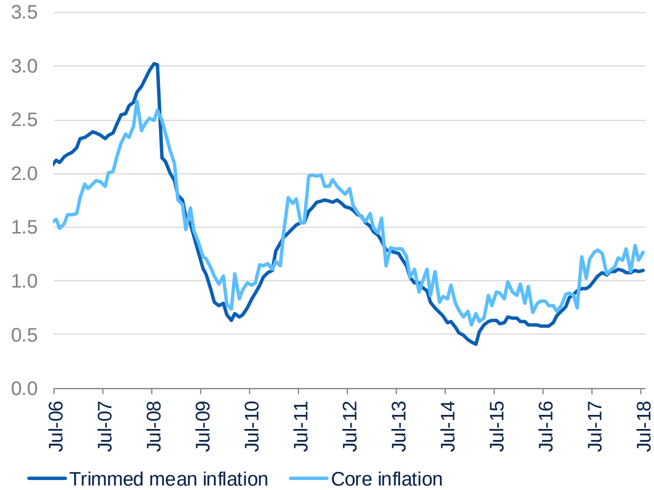
Source: Eurostat and BBVA Research

Headline inflation should have peaked in July after the strong boost from energy prices, while core inflation remains at low levels

Inflation contribution of components
(%YoY, pp)



Core and trimmed-mean inflation
(%YoY; pp)

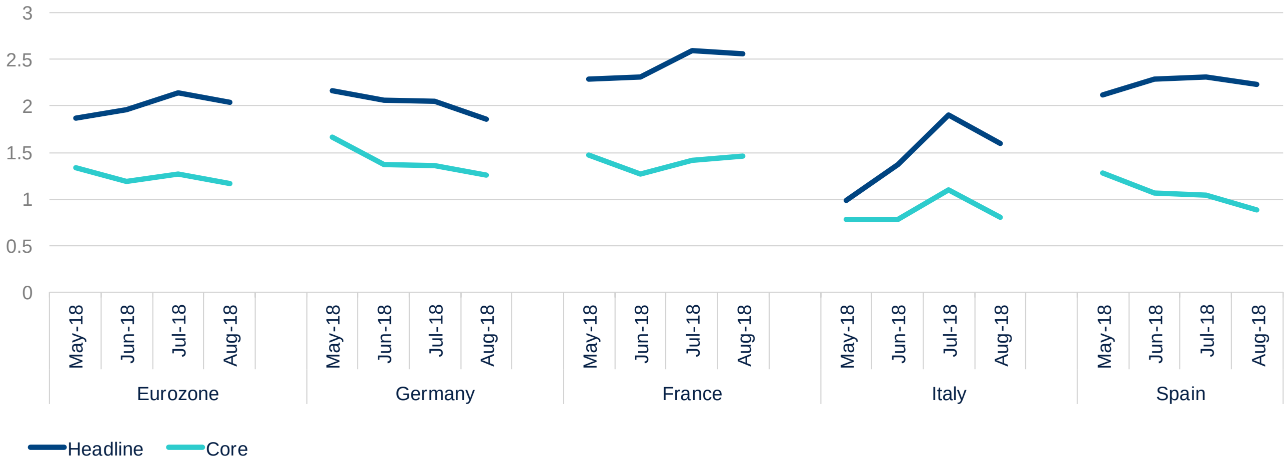


Headline inflation flexed down to 2% in August still boosted by higher oil prices and the recent weakness of the euro, while core inflation has remained broadly stable at low levels (slightly above 1%) over the year, despite incipient signs of inflationary pressures stemming from input prices and a tighter labour market.

Source: Eurostat and BBVA Research

Energy prices have pushed up inflation above 2% across the board, but differences on inflationary pressures by country remain

Headline and core inflation
(% YoY)



Source: Eurostat and BBVA Research

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