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# Eurozone Economic Watch

November 2018

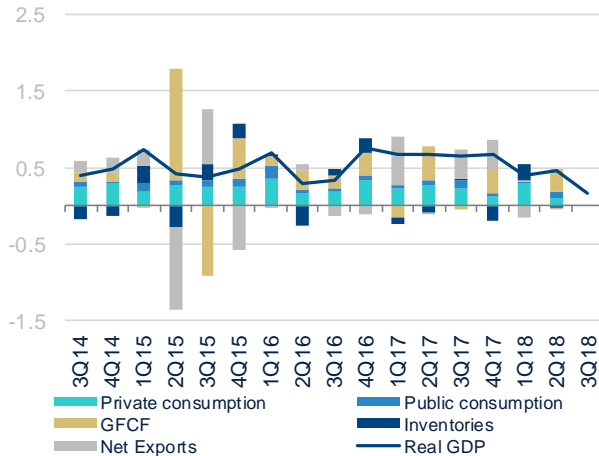
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## Eurozone: Growth to recover in 4Q18, but concerns about the slowdown next year are growing

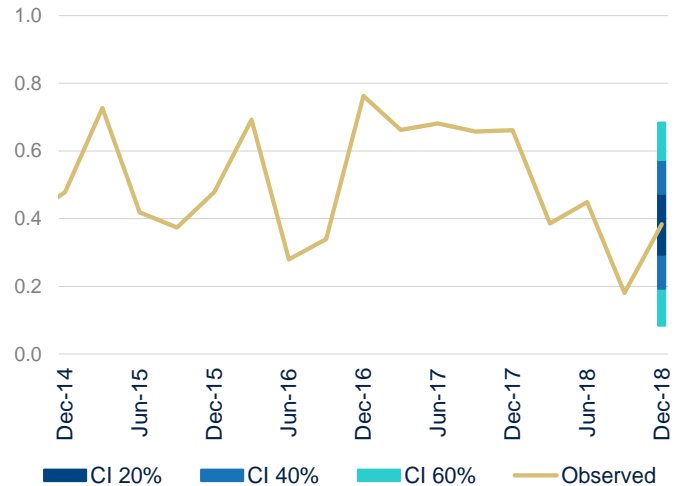
- Eurozone GDP growth slowed down more than expected in 3Q18, to 0.2% QoQ, with negative surprises in Germany and Italy.
- Hard data until September suggest that the significant deterioration of net exports might have weighed on growth. Domestic demand remained solid, except in Germany due to the disruption in the auto sector that impacted both investment and consumption.
- Confidence data in October declined further, mainly in the manufacturing sector. It is still in expansionary territory, but there are increasing concerns about the negative effects of heightened uncertainty on activity.
- Our MICA-BBVA model projects a slight growth upturn, but at a moderate pace (around 0.3% QoQ in 4Q18 after 0.4% on average in 1H18). This, along with disappointing figures in 3Q18, puts a small downward bias to our GDP growth forecast of 2% in 2018 and 1.7% in 2019.
- Political uncertainty surrounding Brexit and Italian fiscal policy is likely to increase in the remainder of the year.
- Higher energy prices have kept inflation around 2%, but underlying rates remain at low levels. We continue to expect a gradual upward trend in core inflation in coming months driven by higher input prices and the tightening of the labour market, more evident in some countries.

# Sharp slowdown in the Eurozone in 3Q18, partly transitory, but recent data suggest a return to a more moderate growth ahead

## GDP, contribution by components (%, QoQ)



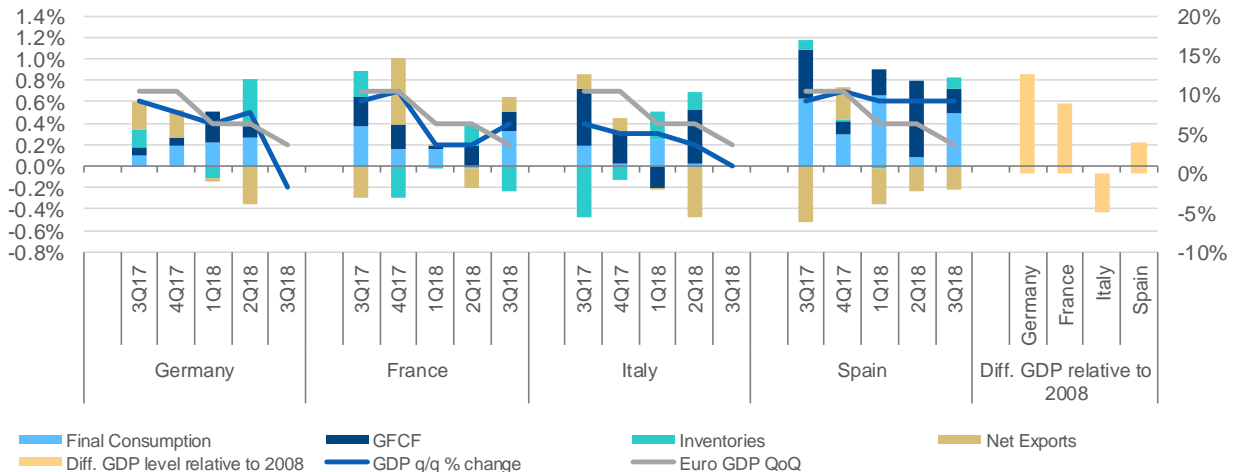
## GDP and MICA forecasts (%, QoQ)



Growth slowed down by 0.2pp to 0.2% QoQ in 3Q18. The disaggregation by component is not available yet but the deterioration of net exports might have weighed on growth. Domestic demand should remain solid, except in Germany due to the negative impact of the disruption in the auto sector linked to environmental regulations on both investment and consumption.

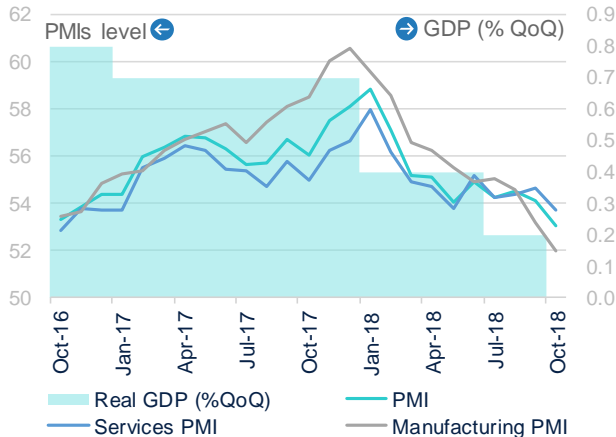
# Growth has eased across countries, with negative surprises in Germany and Italy

## GDP and expenditure contribution by country (%QoQ, pp)

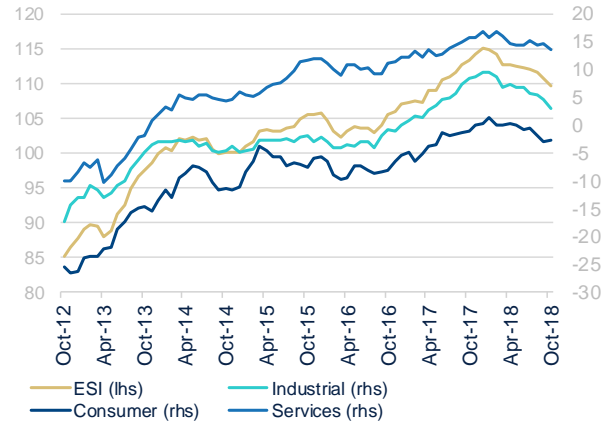


# PMIs extended their downward trend in October, raising concerns about the negative effect of heightened uncertainty on activity

## PMI and GDP (level, %QoQ)



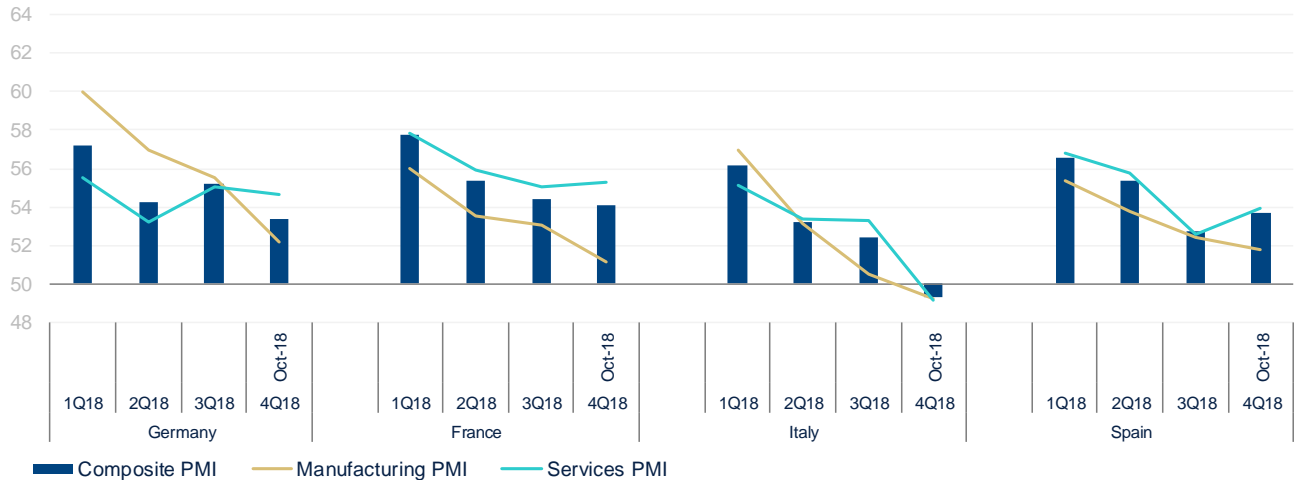
## EC confidence survey (level)



Despite being higher than their flash estimates, final PMIs in October signal further declines in both the manufacturing and the service sectors. More importantly, leading indicators –mainly business confidence and new orders- are reaching multi-year lows, as uncertainty surrounding Brexit talks and US-China trade negotiations could be affecting confidence and investment.

# The resilience of confidence in the service sector in large EZ countries contrasts with that of manufacturing, except in Italy

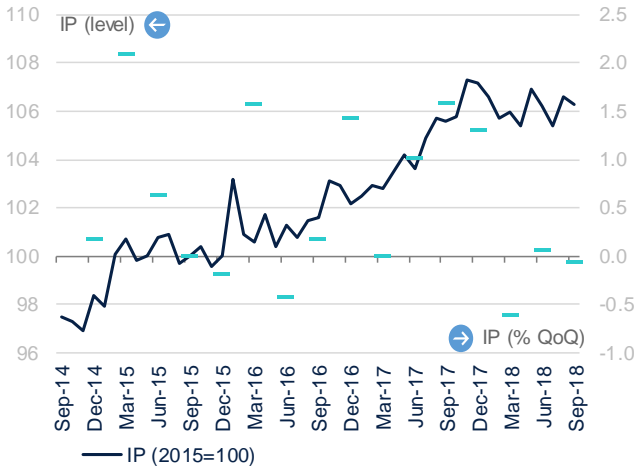
## PMI Survey (level)



# Despite the rebound in August and the modest decline in September, industrial output was flat in 3Q18

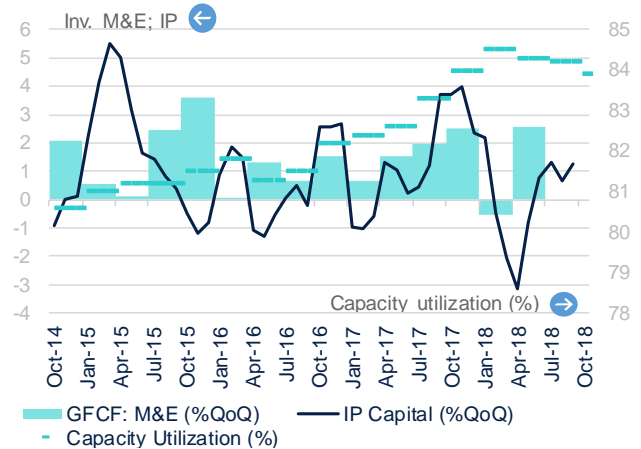
## Industrial production

(Level, % QoQ)



## IP capital equipment, investment in M&E and capacity utilization

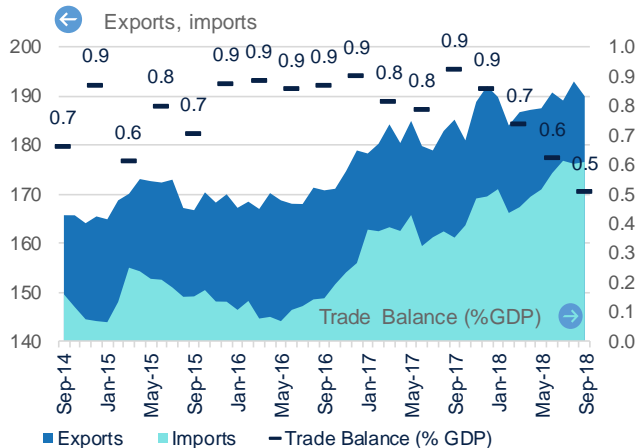
(%QoQ; %)



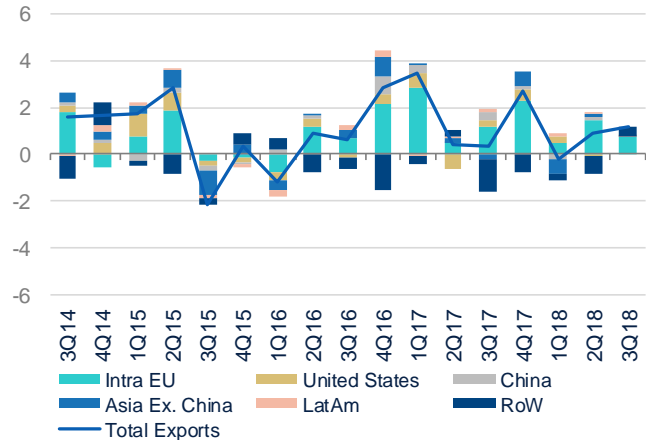
Industrial output stagnated in 3Q18 as the falls of durable consumer and intermediate goods offset the rebound in capital goods and energy. Uncertainty surrounding auto tariffs and the probability of a hard Brexit are conditioning the investment outlook, while new EU regulations on car emissions have had an impact on the automobile sector, especially in Germany.

# Exports disappointed in September, but accelerated slightly in 3Q18 overall.

## Trade balance (€bn; %GDP)



## Exports by destination (%YoY; pp)

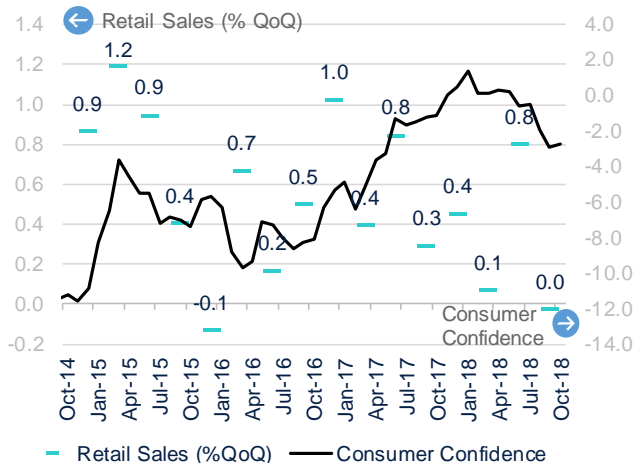


Exports declined in September (-1,6% m/m), offsetting partly the rebound in August. Global demand support remains, but is moderating, while concerns arise from China's lower demand beyond the negative transitory effect of the change in the regulation of car emissions.

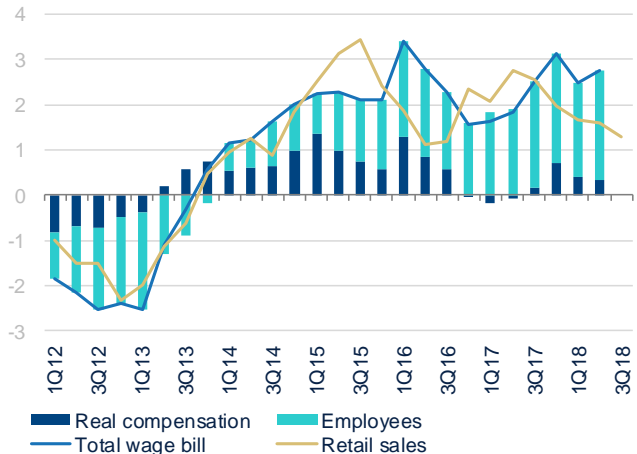


# Retail sales stagnated in September. The trend is still solid but has loosened some steam over the past year

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



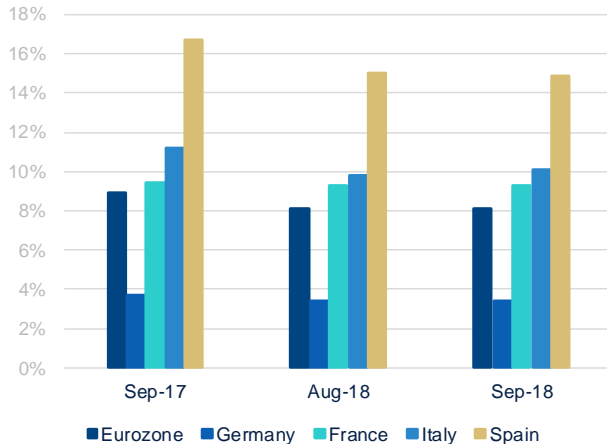
## Retail sales and total wage bill (%YoY; pp)



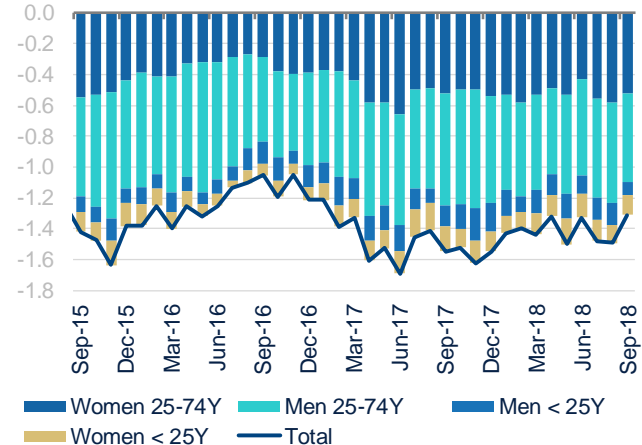
Retail sales flattened in 3Q18 as a whole, which was expected after the sharp increase in the previous quarter. The improvement in the labour market, the gradual increase in wages and slowing energy prices should continue to underpin private consumption in coming quarters.

# The unemployment rate remained broadly unchanged in September

## Unemployment rate by country (%)



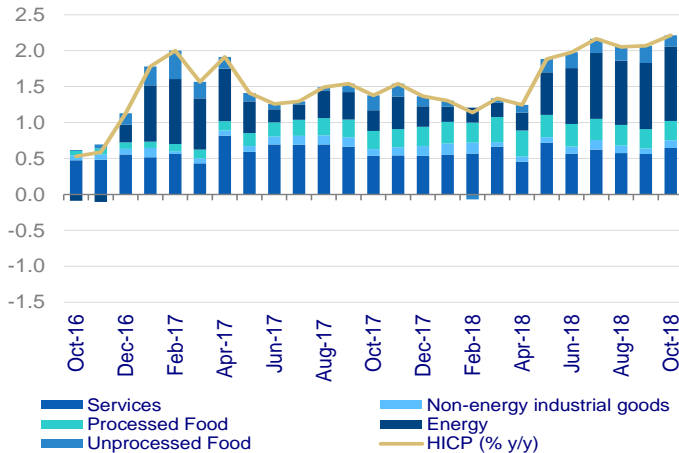
## Annual unemployment change by gender and age (millions)



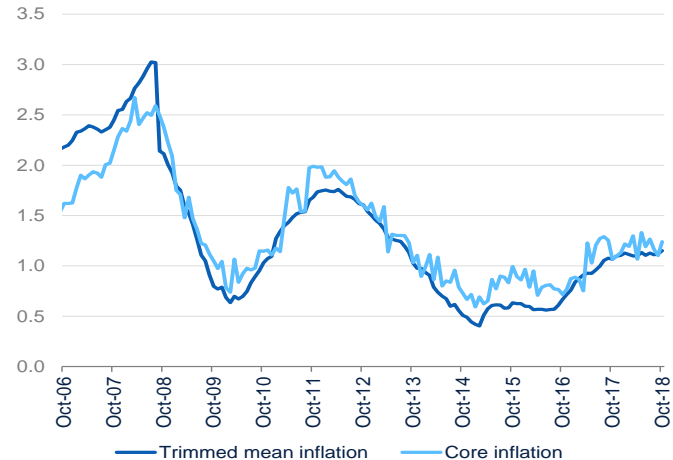
The unemployment rate remained steady at 8.1% in September for a third month in row, interrupting the downward trend over the last five years. Despite significant differences across countries, the tightening of the labour market should result in upward wage pressures in coming quarters.

# Higher energy prices could keep inflation around 2% for the rest of the year, but core inflation remains at low levels

## Inflation contribution of components (%YoY, pp)



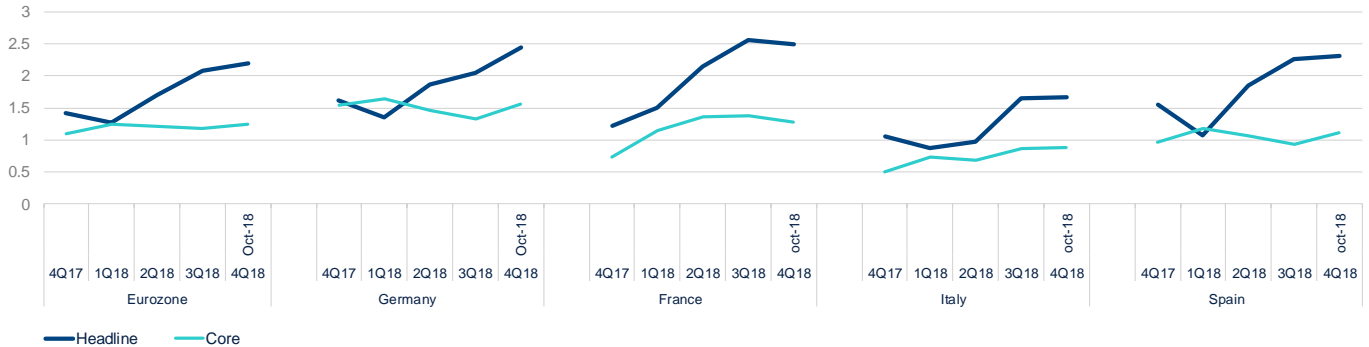
## Core and trimmed-mean inflation (%YoY; pp)



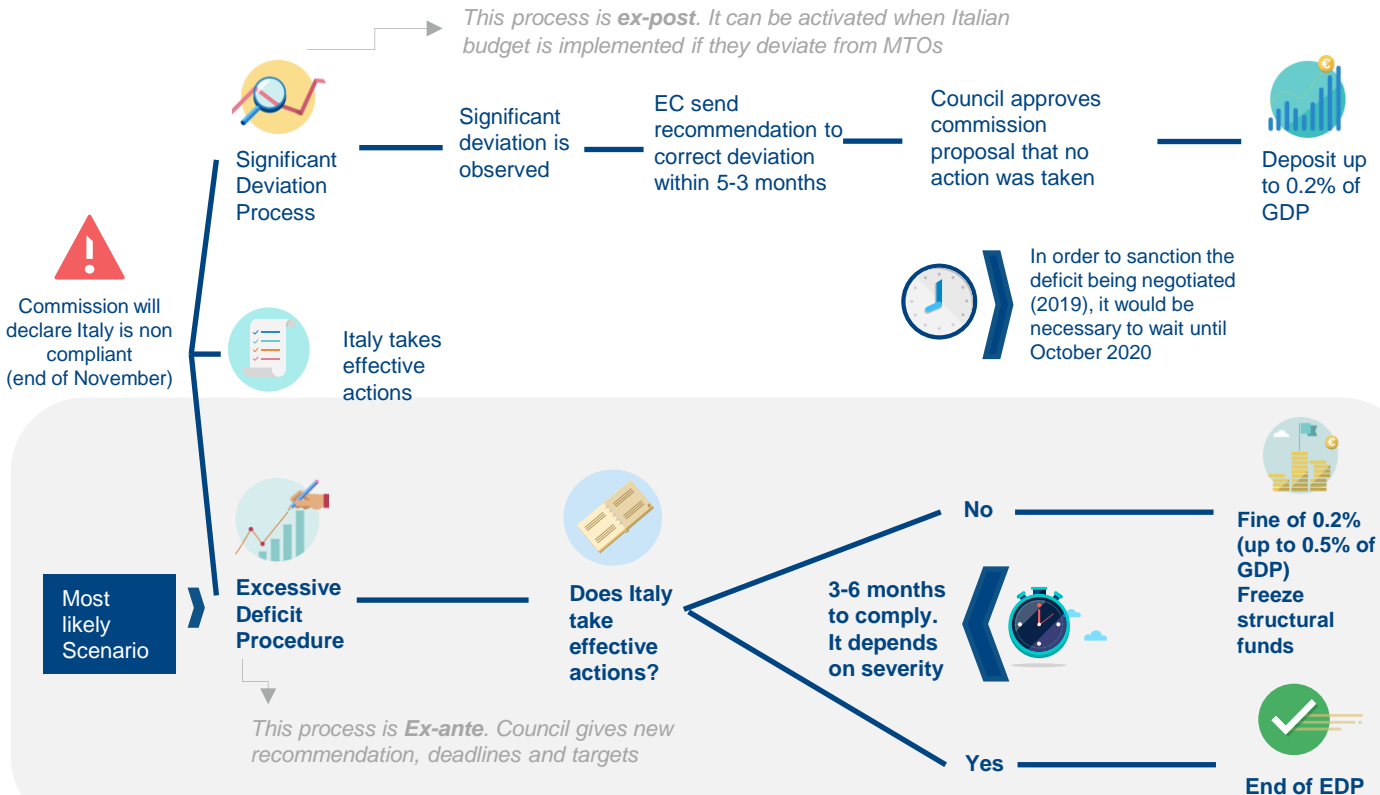
Inflation edged up slightly in October (0.1pp to 2.2% YoY) due to higher energy prices, together with core inflation (+0.1pp to 1.2% YoY), driven by higher prices for services and non-energy industrial goods.

# Headline inflation increased across countries driven by energy prices, but differences in core inflation continue to increase

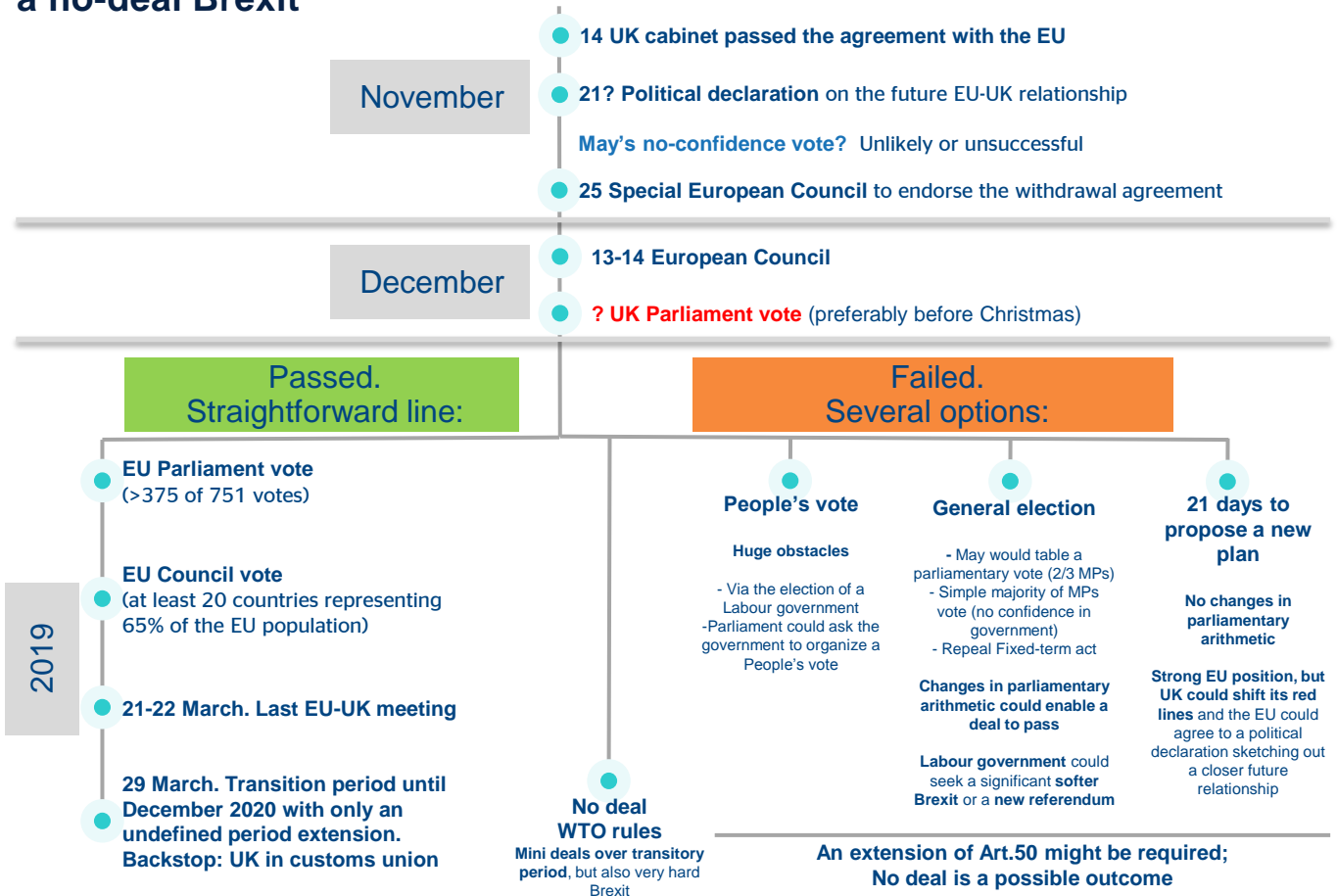
## Headline and core inflation (% YoY)



# What can we expect from the EU on Italy?



# Higher political uncertainty: UK political hurdles increase the chances of a no-deal Brexit



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