



BBVA Research

Eurozone Economic Watch

December 2018

Creando Oportunidades

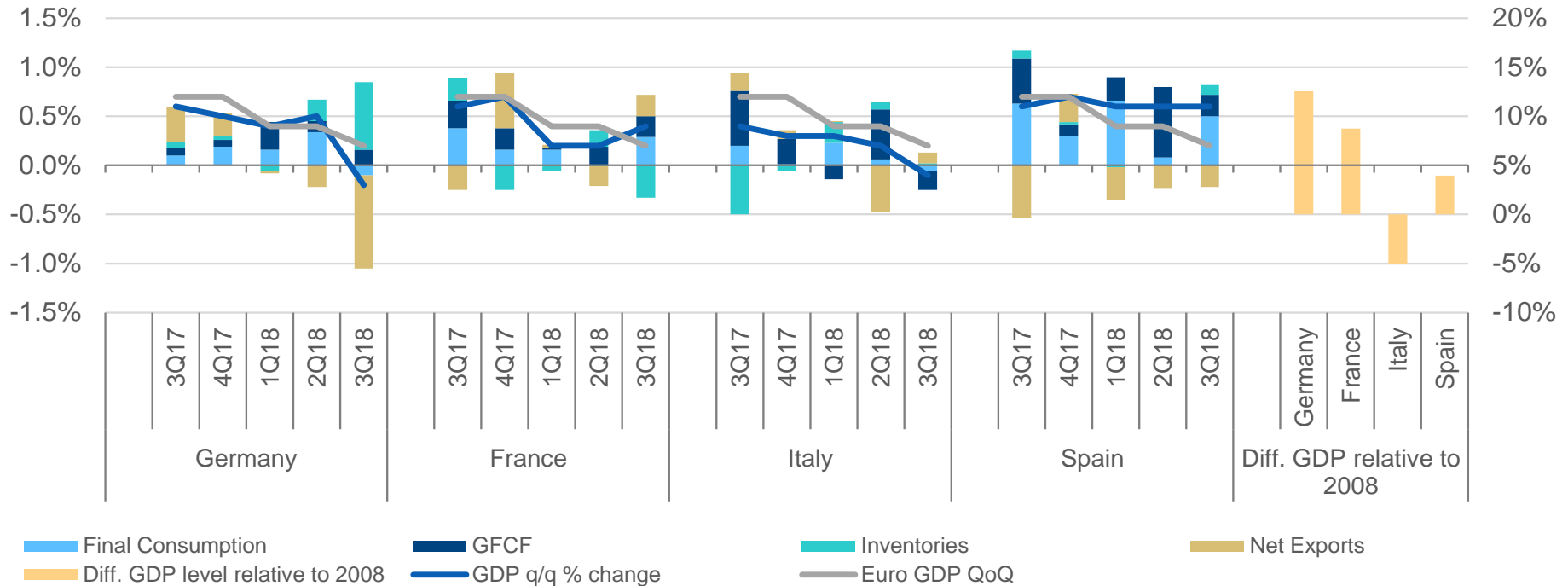
Eurozone | GDP growth still slows gradually, but high uncertainty could take its toll

- GDP growth could grow by around 0.4% QoQ in 4Q18 as one-off factors ease, but lower global demand and high uncertainty are also weighing on activity.
- Hard data improved in October to halt previous signs of a marked slowing, supported by the strength of domestic factors. The improvement of retail sales is driven by lower inflation and higher wages, while the strong recovery of capital goods production suggests that investment growth should continue in coming quarters. On the other hand, exports edged up again in October to maintain the upward trend so far this year, but failing to support activity as in the last two years.
- A further worsening of confidence has extended to the service sector, as high and protracted uncertainty could be weighing on spending, although the PMIs fall in December has been exacerbated by protests in France and still weak demand for autos. This contrasts with a broadly steady composite indicator in Germany and improving confidence in Spain, but more worrying signs stem from the weakness in Italy.
- Beyond recent volatility, the Eurozone recovery seems to loose steam gradually, putting a slight downward bias to our growth forecast of 2% in 2018 and 1.7% in 2019.
- The sharp fall of oil Brent will shape inflation down in coming months clearly below the ECB's target in early next year, while core inflation is likely to trend upward very gradually.
- The ECB ends net asset purchases this month, but remains cautious about the future.

Larger-than-expected slowdown in 3Q18 driven by one-off effects in Germany, but also by the Italian GDP contraction

Regulatory changes in the car industry partly explain the fall in output, especially in Germany, but also lower global demand. In contrast, growth rebounded in France and remained steady in Spain.

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

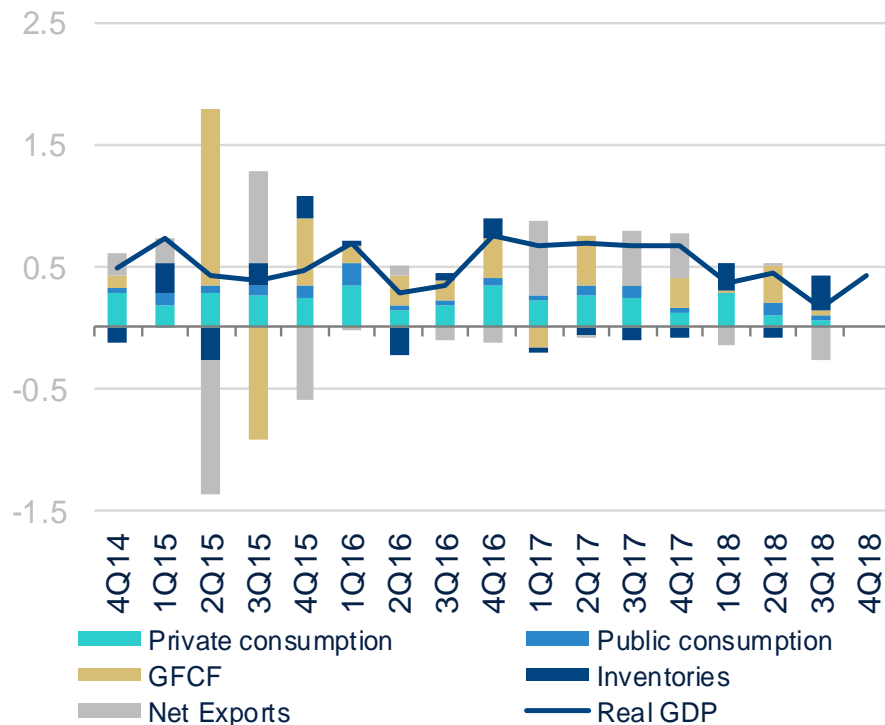


GDP growth around 0.4% QoQ in 4Q18, returning to the previous moderate pace

Although temporary factors are fading, there are more enduring drivers (lower global demand and confidence) preventing the rebound in activity. French riots could have also weighed on growth.

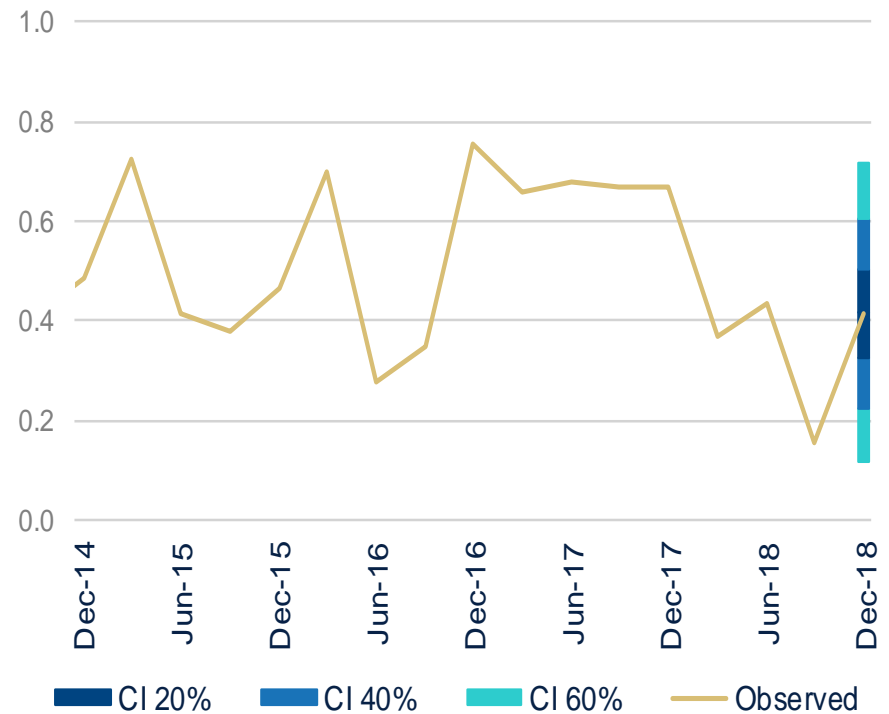
GDP, contribution by components

(%, QoQ)



GDP and MICA forecasts

(%, QoQ)

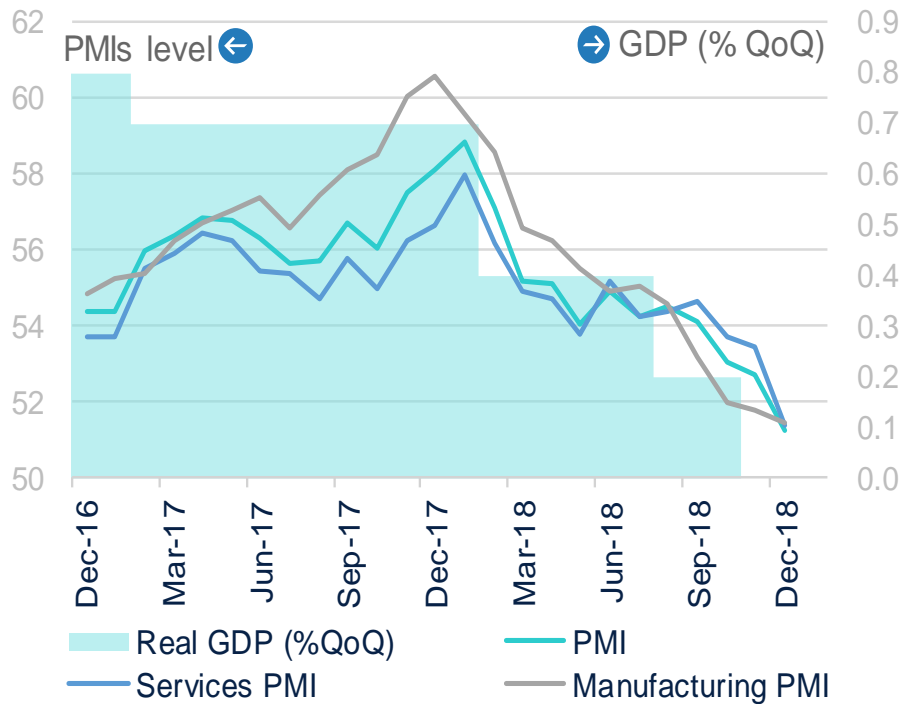


Further worsening of confidence extended to the service sector, as high and protracted uncertainty could end weighing on spending

PMIs extended their downward trend in December, mainly due to the sharp fall in services' confidence, while the deterioration in manufacturing seems to hold back.

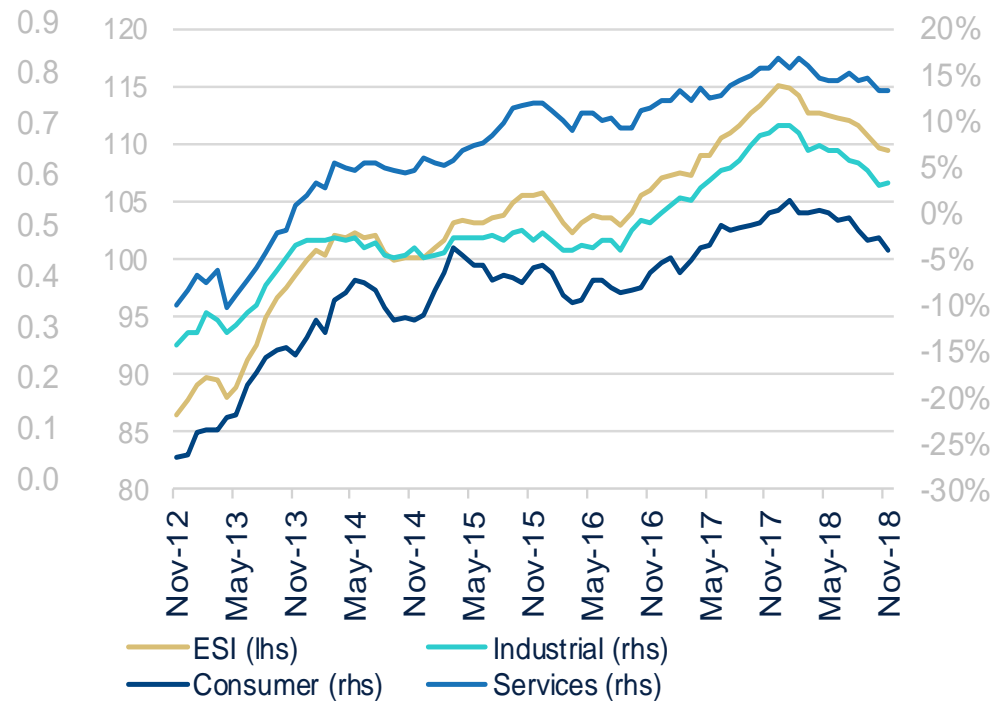
PMI and GDP

(level, %QoQ)



EC confidence survey

(level)

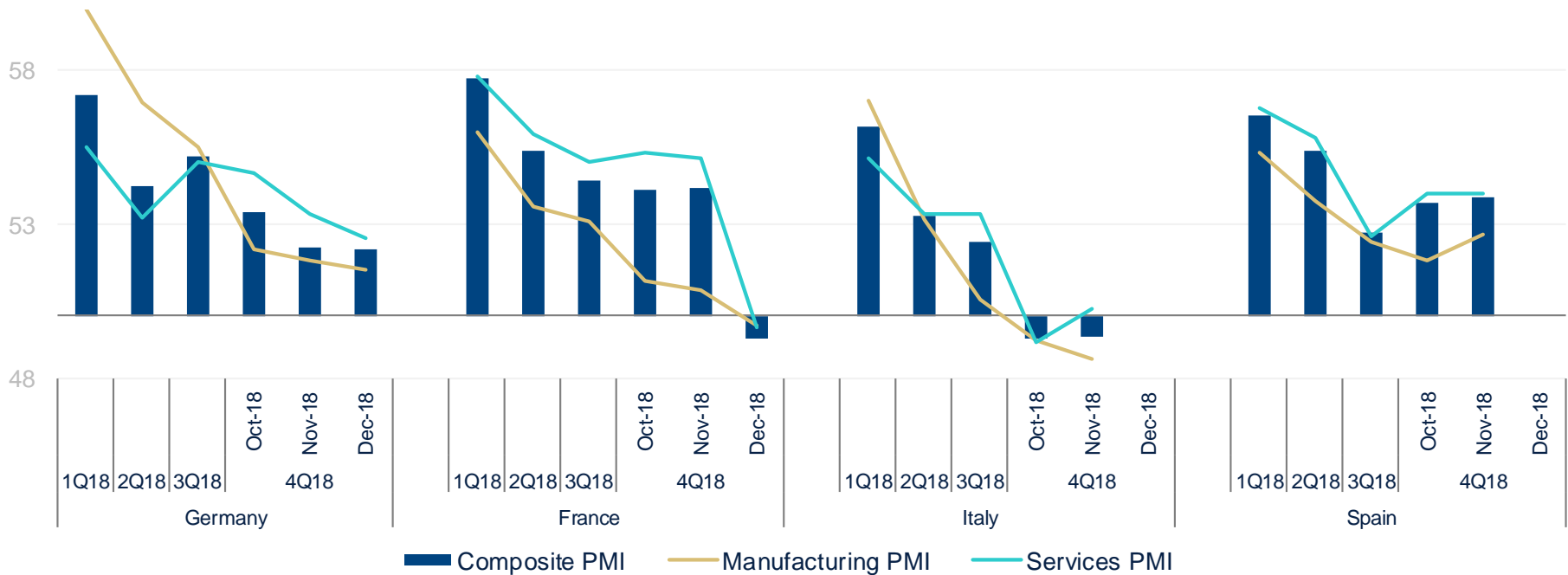


The PMIs fall in December is likely exacerbated by protests in France and still weak demand for autos

The sharp fall in French PMIs contrasts with a broadly steady composite indicator in Germany and improving confidence in Spain. More worrying signs stem from the weakness in Italy.

PMI Survey

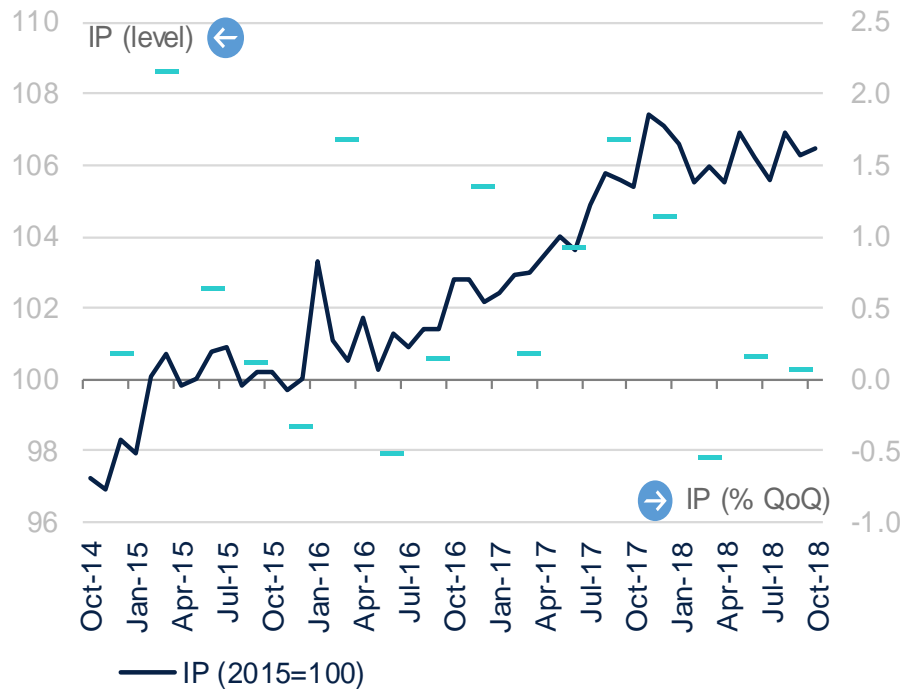
(level)



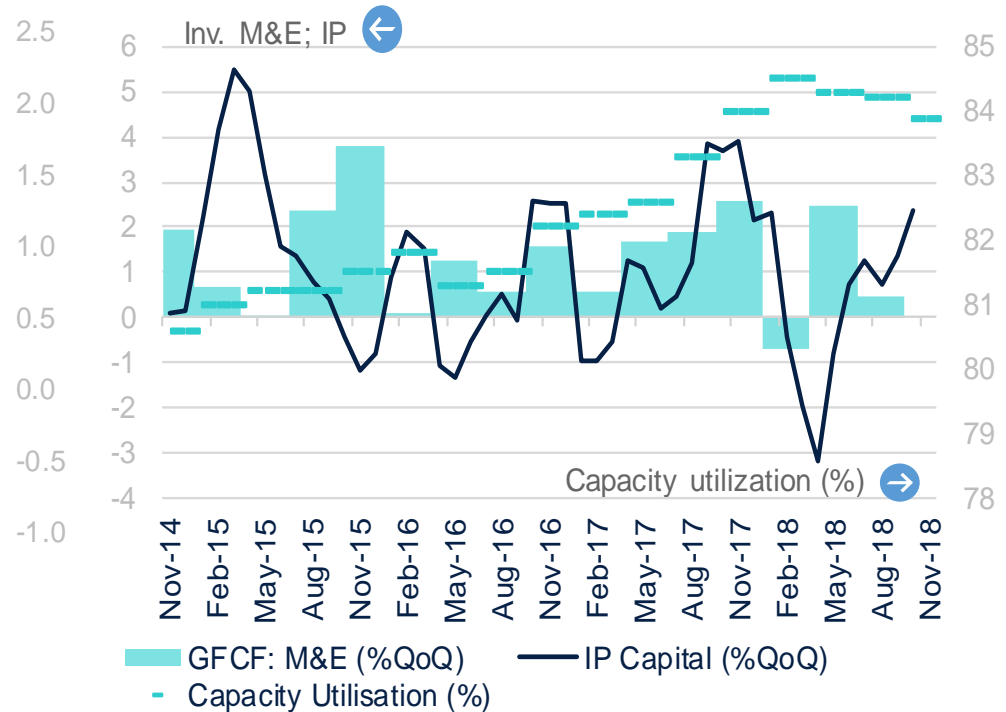
Industrial production grew in October to offset previous declines, supported by strong growth in capital goods' output

Strong capital output along with increasing production in both intermediate and durable consumer goods point to ongoing investment recovery in coming quarters amid declining idle capacity.

Industrial production (Level, % QoQ)



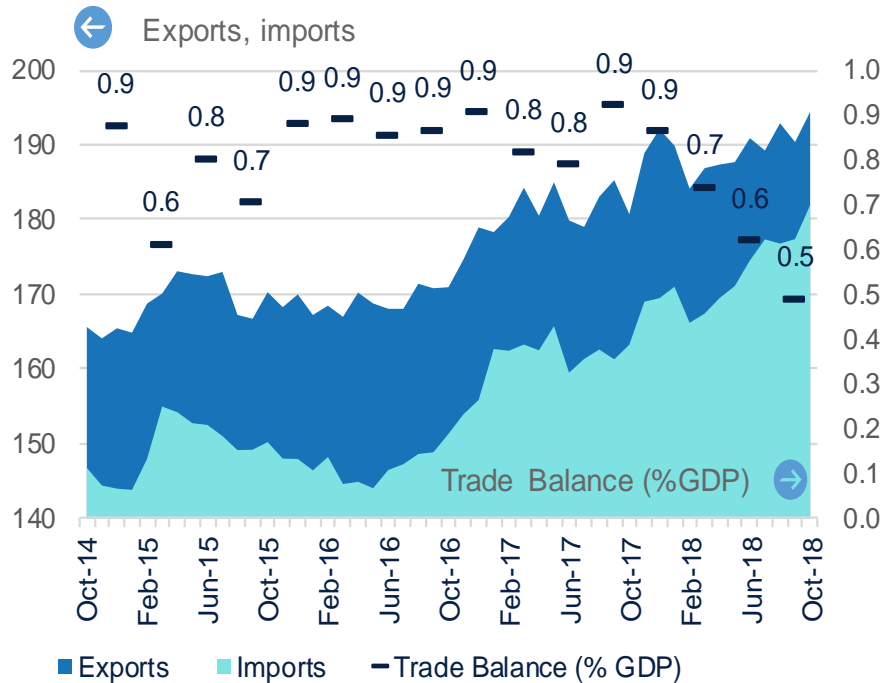
IP capital equipment, investment in M&E and capacity utilization (%QoQ; %)



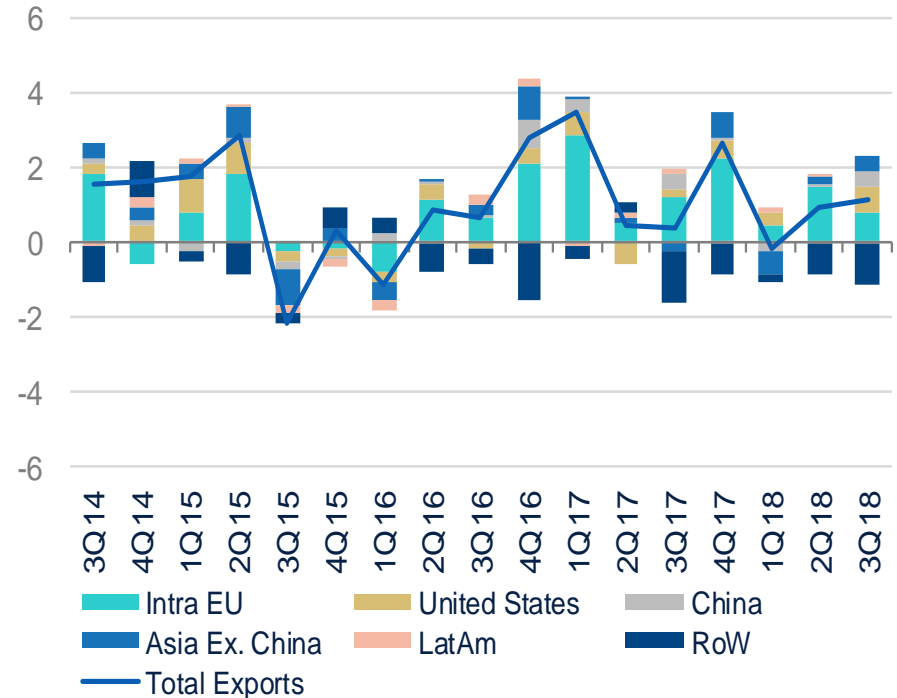
Exports edged up again in October to maintain the upward trend so far this year, although failing to support activity as in the last two years

Net exports are likely to weigh on growth again in coming quarters due to larger increase of imports supported by the strength of domestic demand.

Trade balance
(€bn; %GDP)



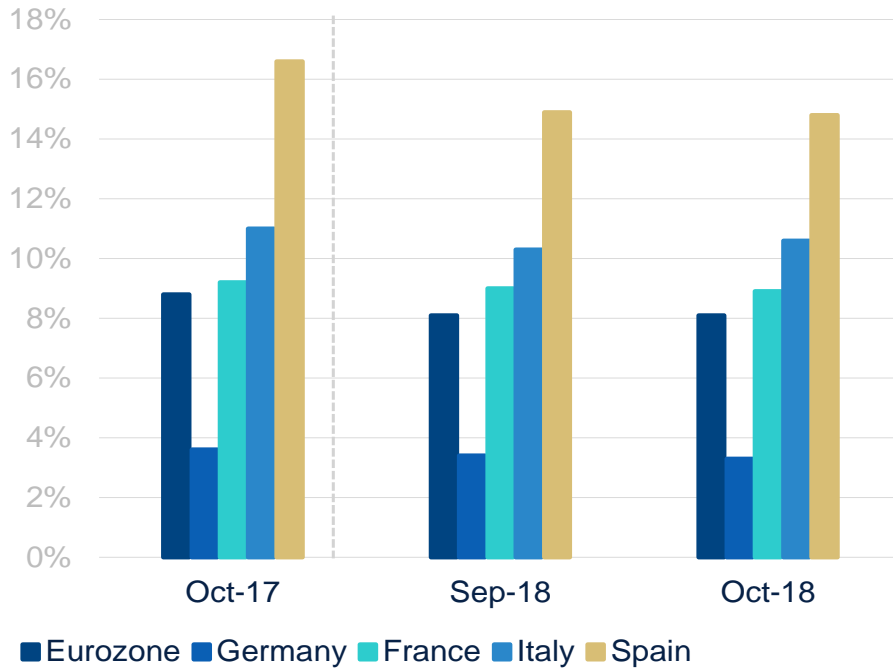
Exports by destination
(%YoY; pp)



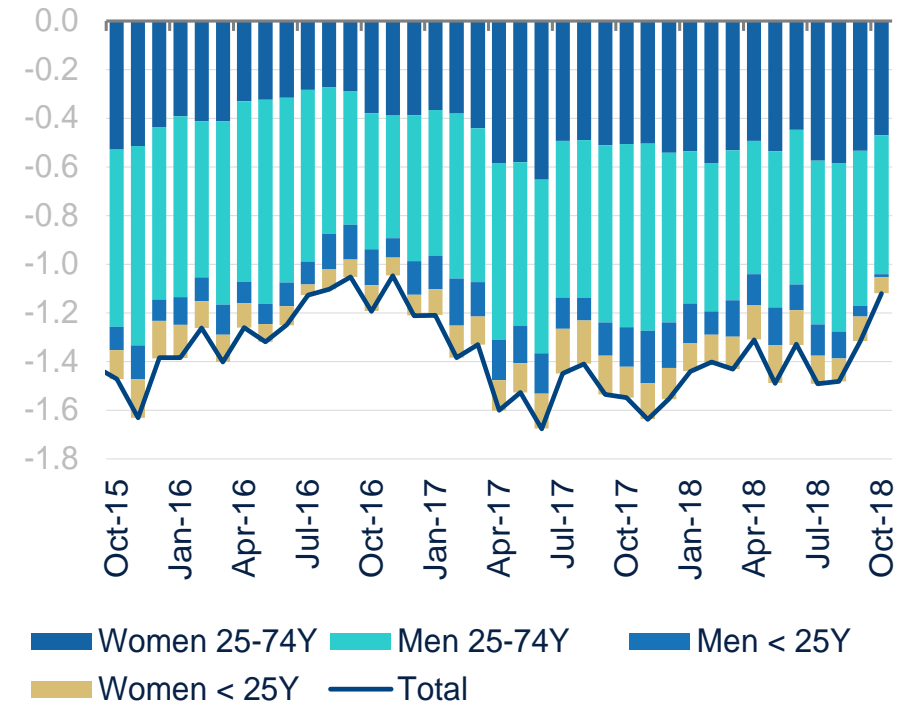
The unemployment rate remained broadly unchanged in October

Despite significant differences across countries, the tightening of the labour market should result in upward wage pressures in coming quarters.

Unemployment rate by country (%)



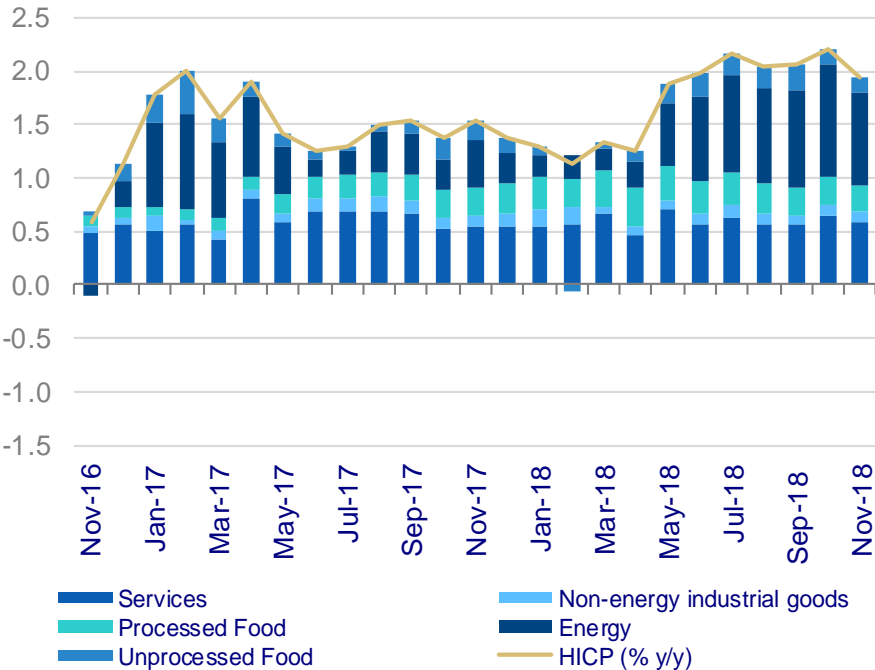
Annual unemployment change by gender and age (millions)



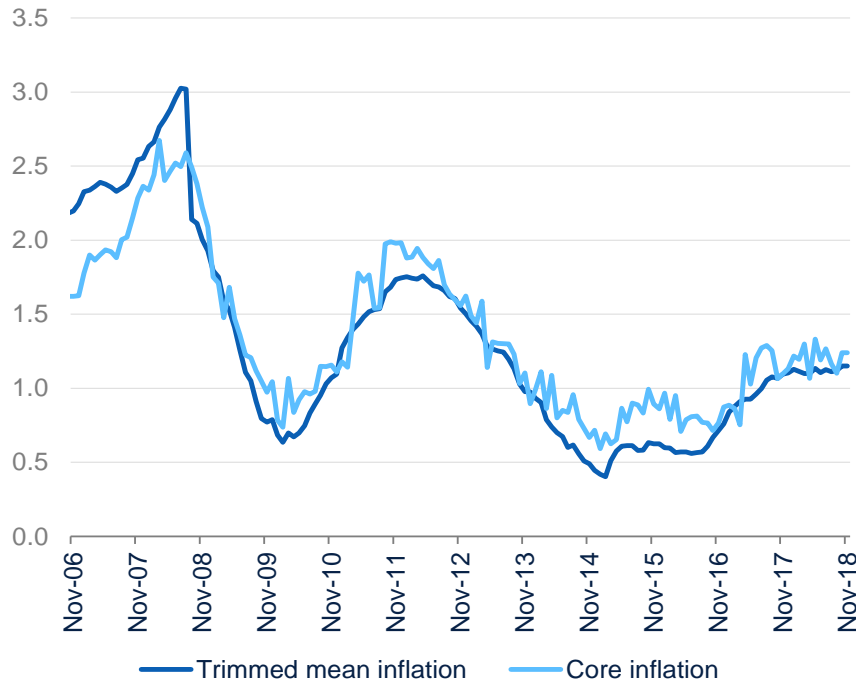
Slowing headline inflation driven by lower oil prices and steady core inflation at low levels

The sharp fall of oil Brent will shape inflation down in coming months clearly below the ECB's target in early next year, while core inflation is likely to trend upward very gradually.

Inflation contribution of components (%YoY, pp)



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



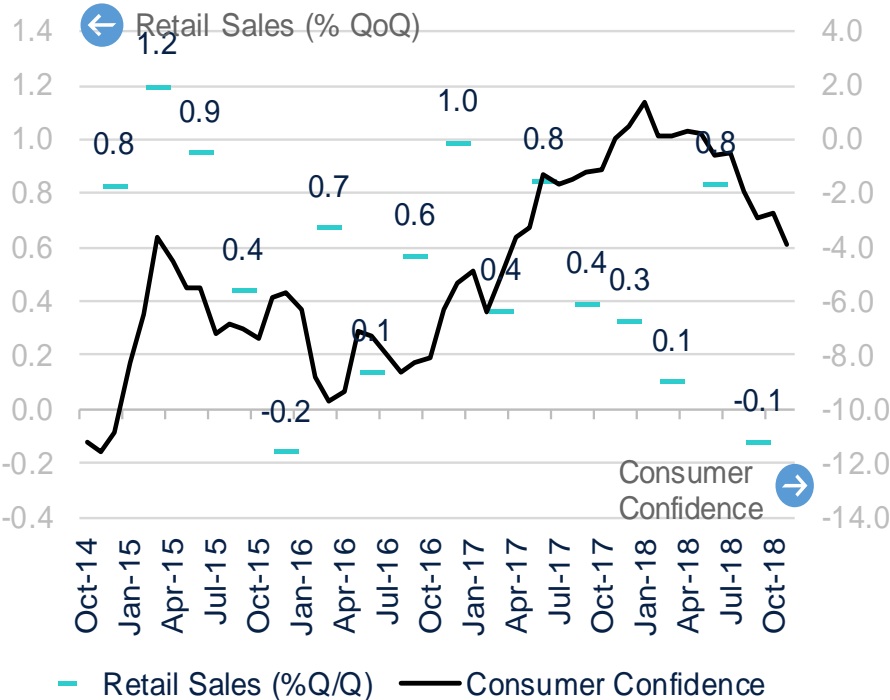
Source: Eurostat and BBVA Research

Retail trade increased in October to halt the markedly slowing in recent quarters

Lower inflation and higher wages will continue to support households' spending, although likely at a more moderate pace due to worsening consumers' confidence.

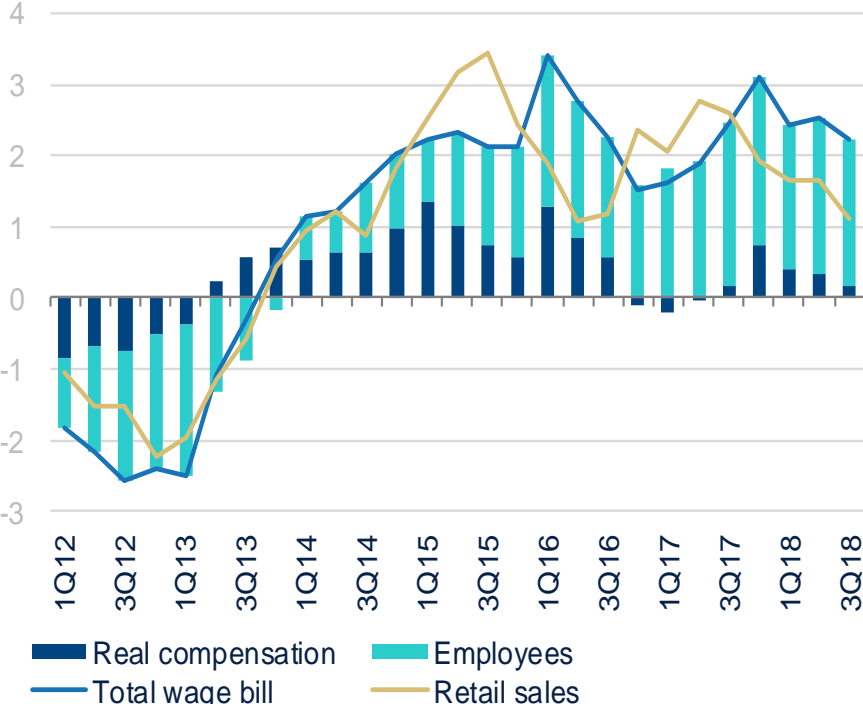
Retail sales and consumer confidence

(%QoQ, level)



Retail sales and total wage bill

(%YoY; pp)



Source: Eurostat and BBVA Research



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