



BBVA Research

Eurozone Economic Watch

May 2019

Creando Oportunidades

Eurozone | Growth gained momentum in 1Q19, but trending to more moderate pace amid increasing downward risks

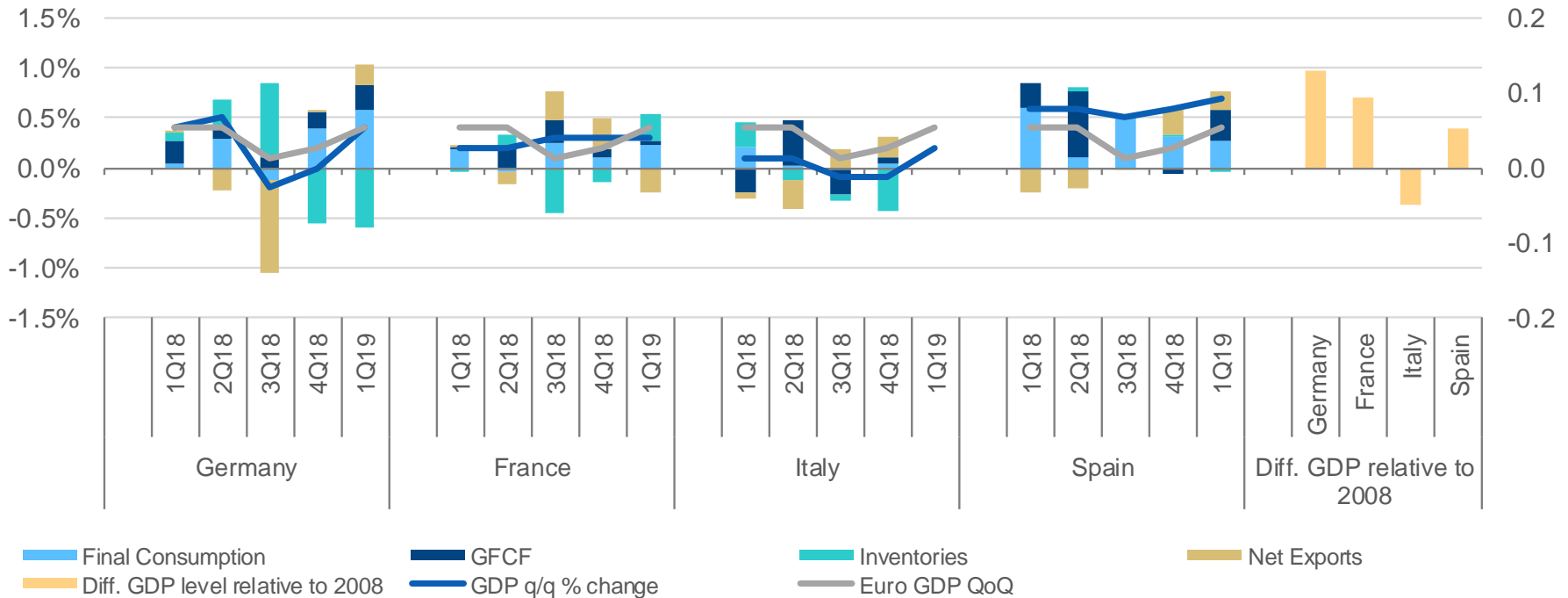
- Growth in the Eurozone surprised on the upside during 1Q19, especially in Italy and Germany, likely related to fading negative one-off effects in previous quarters and the positive effect on mild winter. Beyond volatility, there are signs of a more protracted weakness in the industrial sector linked to structural factors (automobiles) and slowing global demand.
- Hard data up to March point to domestic demand as the main driver of growth, while the support of net exports should be small with differences across countries. Retail sales grew at steady robust rate, supported by the resilience of consumers' mood and improving labour market. The better performance of exports to other EU countries offset the decline of those to Asia, raising doubts about foreign support and the sustainability of the improvement in the industrial sector.
- Soft data up to May show some stabilization but at lower levels than in 1Q19 and indicate that growth could lose some steam in 2Q19. Higher uncertainty is taking its toll also on services sentiment.
- Our MICA-BBVA model now projects Eurozone GDP to slow slightly to around 0.3% QoQ in 2Q19. This combined with positive surprise in 1Q19 could lead to a slight upward bias to our forecast of growth at 1% in 2019, but we remain cautious due to gloomier leading indicators and trade threats.
- Core inflation increased in April due to the effect of Easter on service prices, but it is likely to remain very subdued. In addition, inflation expectations continue to slip, so the ECB will remain very cautious and debating further measures if necessary.
- Risks are tilted to the downside, mostly related to political events. The risk of a no-deal Brexit is increasing while US trade disputes are heightening, not only with China but also with the EU.

GDP growth surprised on the upside in 1Q19, gaining momentum across the Eurozone...

The stronger growth was underpinned by domestic demand, both private consumption and investment, while net exports weighed on activity except in Germany

GDP and expenditure contribution by country

(%QoQ, pp)

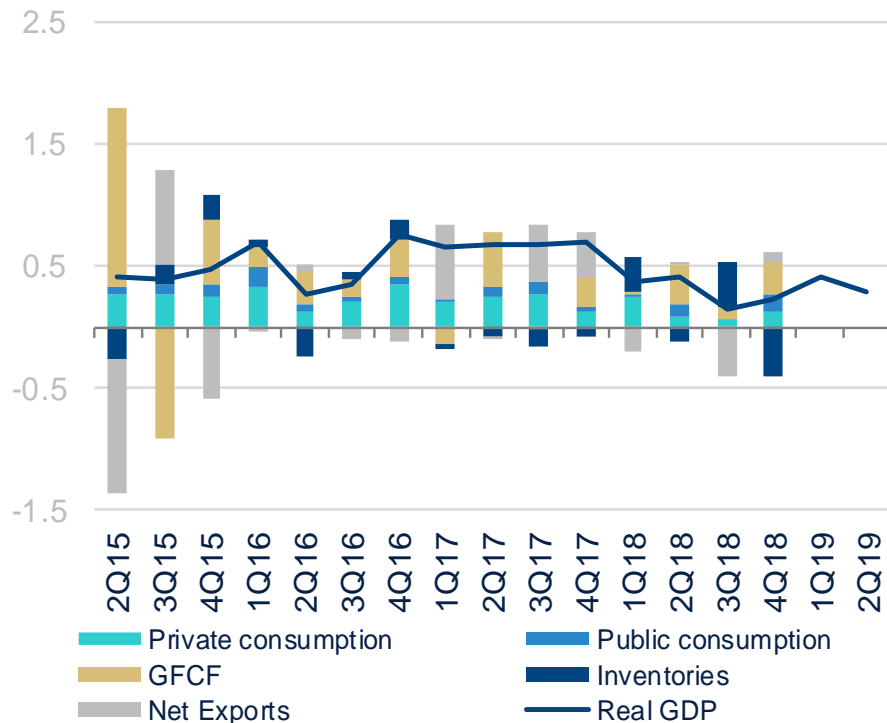


... but economic momentum seems to trend to a more moderate pace

Our MICA-BBVA model now projects GDP to slow slightly to around 0.3% QoQ in 2Q19. Better-than-expected performance in 1H19 would put a slight upward bias to our growth forecast at 1% in 2019, but we remain cautious due to gloomier leading indicators and increasing uncertainty over the trade outlook

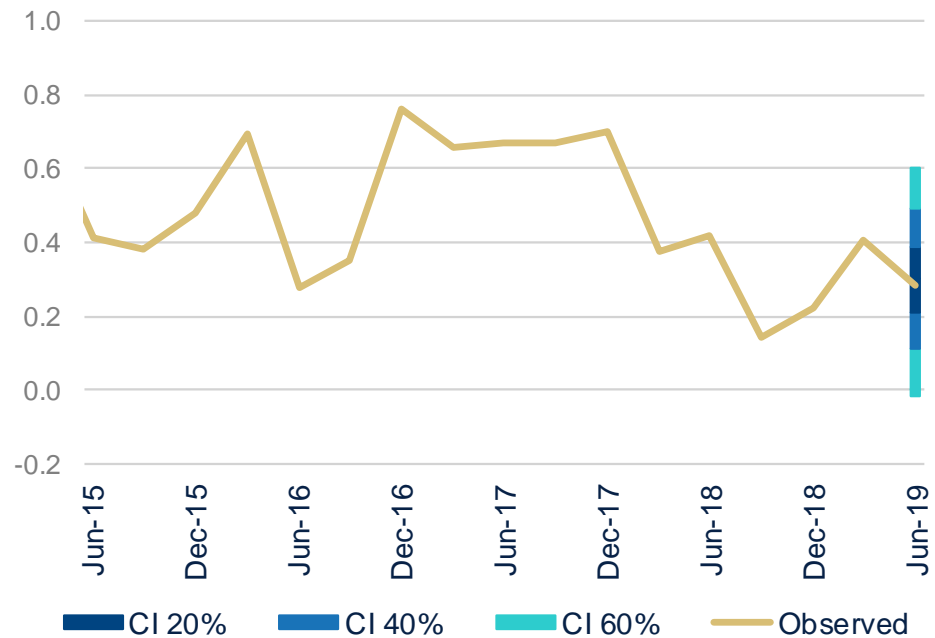
GDP, contribution by components

(%, QoQ)



GDP and MICA forecasts

(%, QoQ)

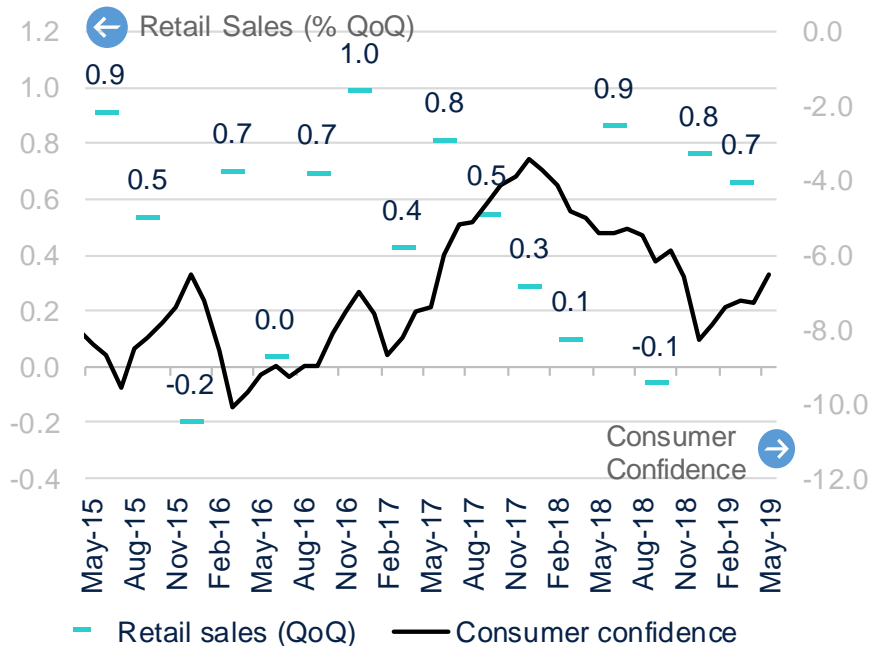


Robust growth of retail sales in 1Q19 and the resilience of consumer confidence suggest private consumption will remain the main driver of growth

Retail sales grew steadily at 0.7% QoQ over last year, supported by the improvement in the labour market and low inflation. But despite the resilience of consumer mood, it is unlikely that private consumption gain further momentum ahead

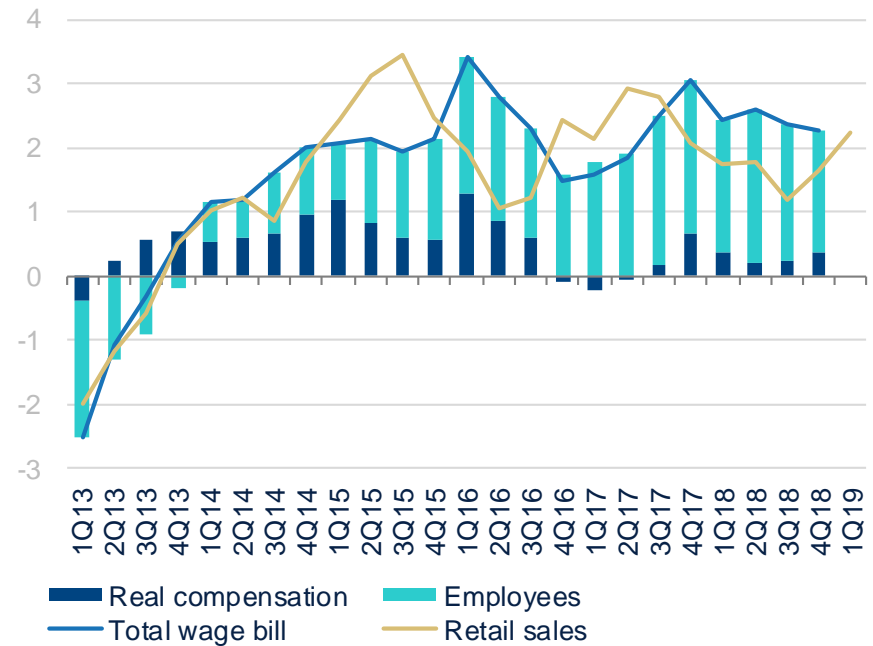
Retail sales and consumer confidence

(%QoQ, level)



Retail sales and total wage bill

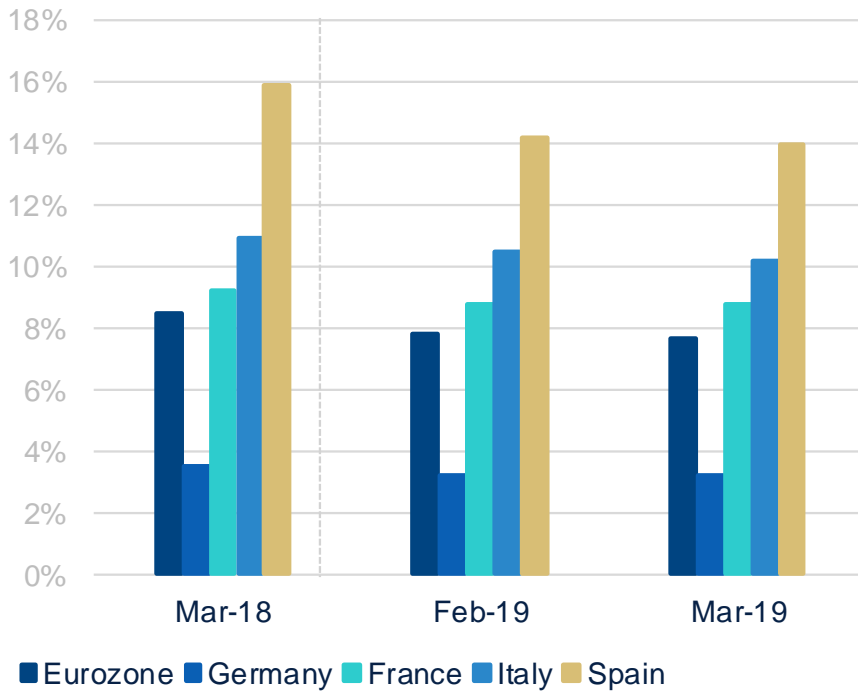
(%YoY; pp)



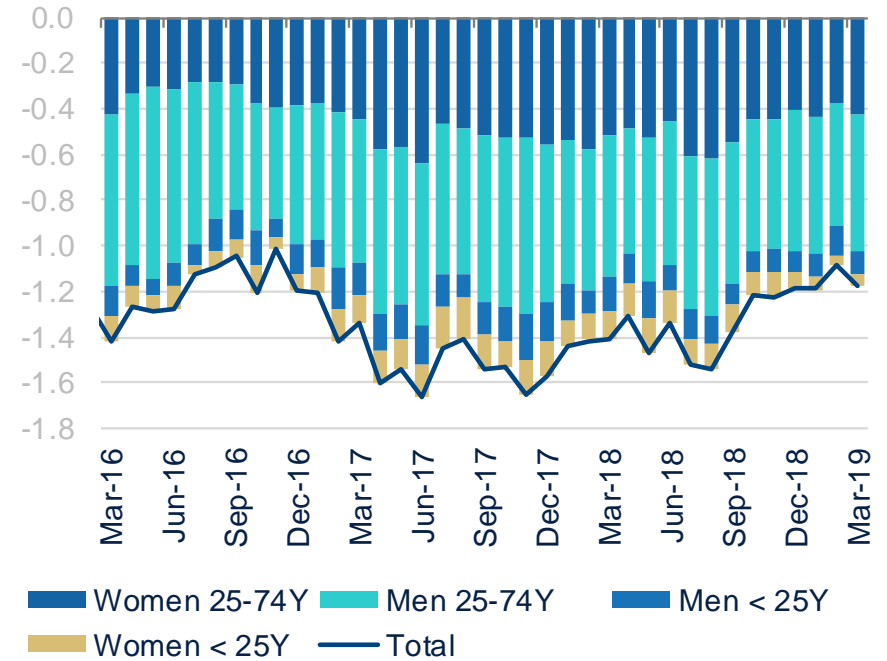
Despite activity slowdown, the steady growth in employment resulted in a declining unemployment rate to 7.7% in March

Unemployment in the Eurozone drops by 0.1pp, mainly due to better performance in Italy and (to a lesser) extent in Spain

Unemployment rate by country (%)



Annual unemployment change by gender and age (Million)

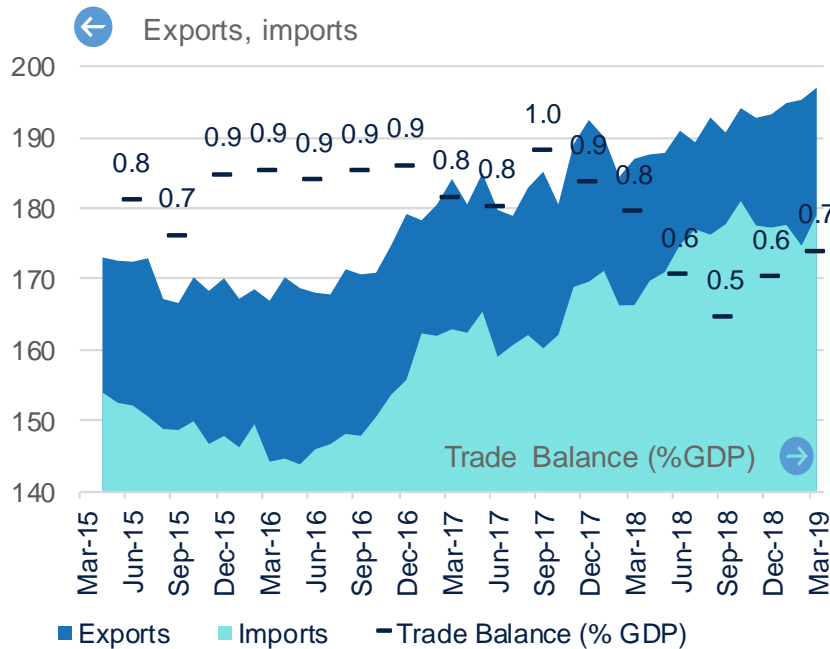


Exports grew again in March and have maintained a stable pace since mid-2018

Exports to other EU countries offset the moderation of those to China and the fall of sales to other Asian countries. There are increasing concerns on the trade war and thus on demand from Asia

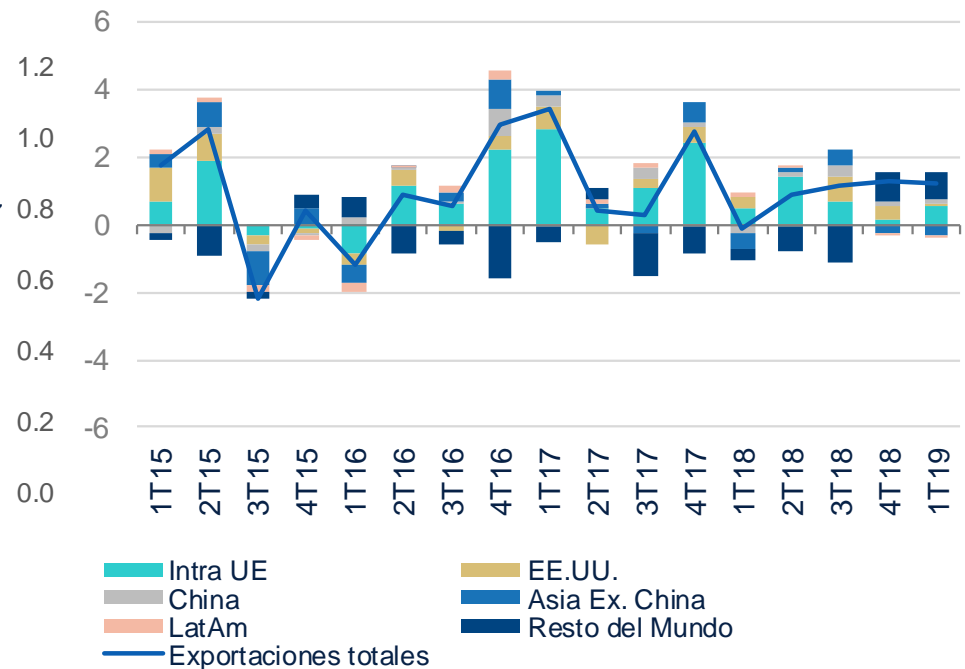
Trade balance

(€bn; %GDP)



Exports by destination

(%YoY; pp)

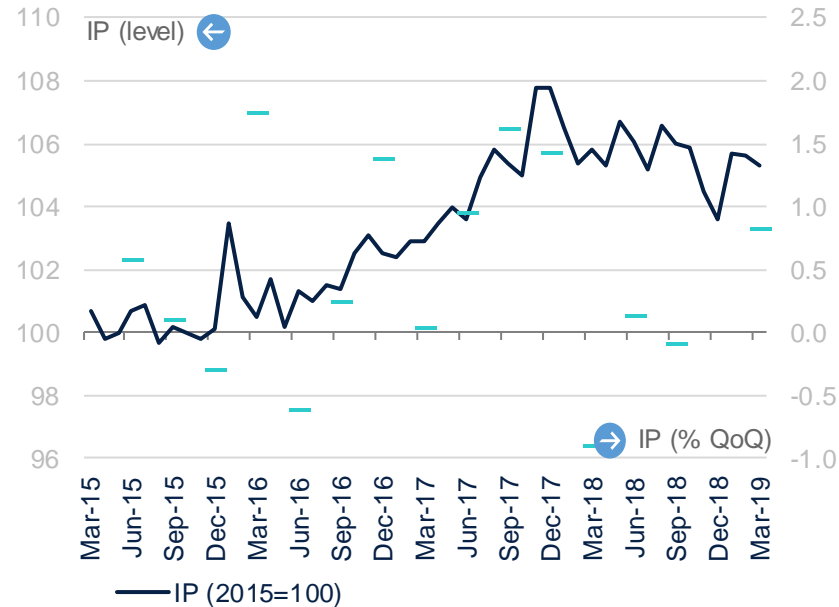


The downward trend in industrial production seems to have halted...

Beyond volatility, industrial production increased in 1Q19 after falling in 2H18, driven by the rebound in capital and durable goods. This suggests that investment could increase further in coming quarters.

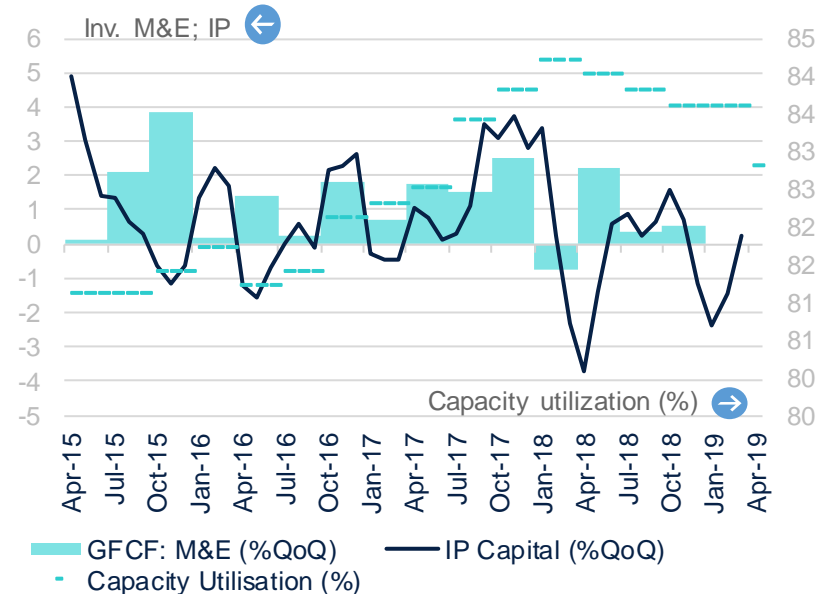
Industrial production

(Level, % QoQ)



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

(%QoQ; %)

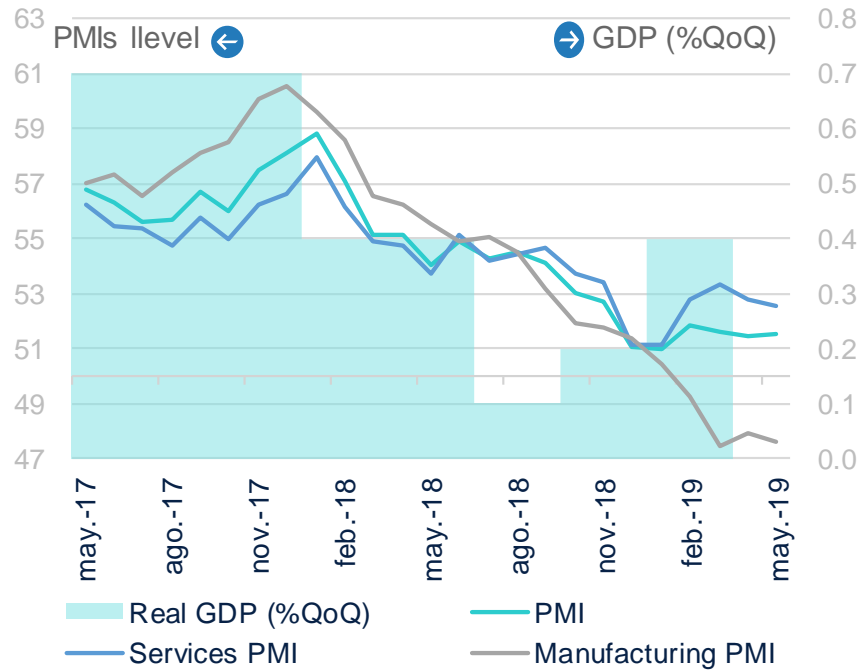


... but manufacturing confidence suggests that the weakness on the sector will persist, possibly spreading onto services

The EC and PMI surveys suggest that the decline in manufacturing confidence could have reached bottom, while higher uncertainty is taking its toll also on expectations on the service sector

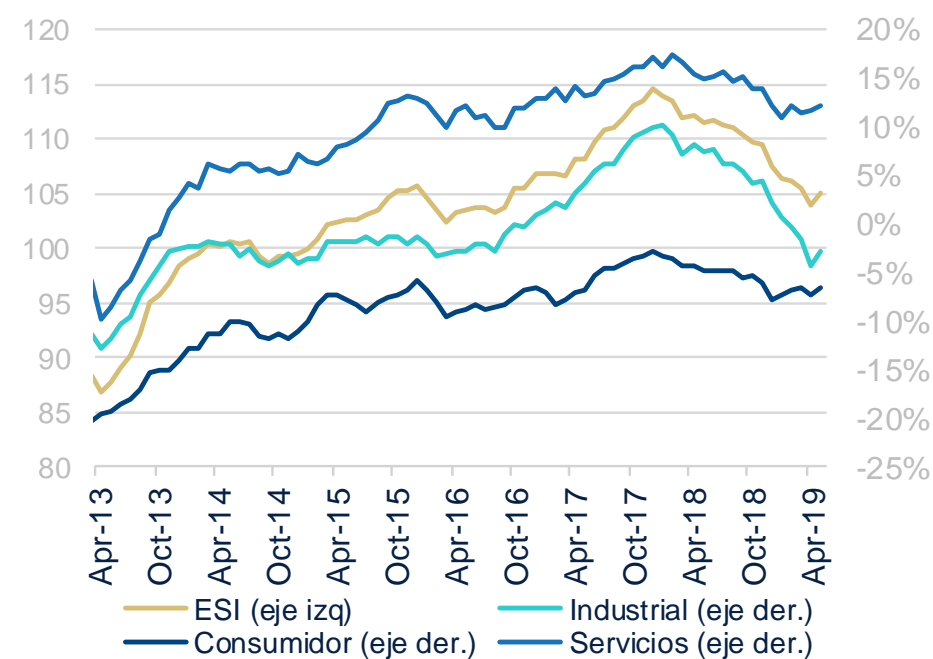
PMI and GDP

(level, %QoQ)



EC confidence survey

(level)

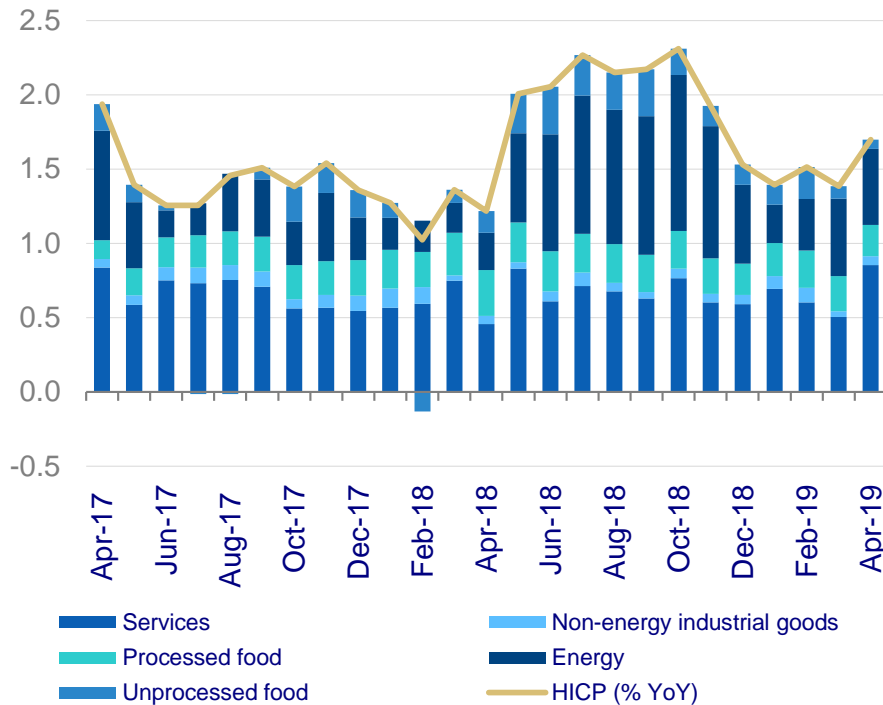


Core inflation increased in April driven by the Easter effect on service prices, but it will remain at low levels

Beyond volatility, core inflation is likely to remain at very low levels, while headline inflation will be shaped by energy prices. In addition, inflation expectations continue to slip despite higher oil prices

Inflation contribution of components

(%YoY, pp)



Inflation swaps 5y5y

(%YoY)





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