BBVA Research

Eurozone Economic Watch

October 2019

Creating Opportunities

Eurozone | Weaker growth in 2H19 on worsening global trade, but now also on lower domestic demand

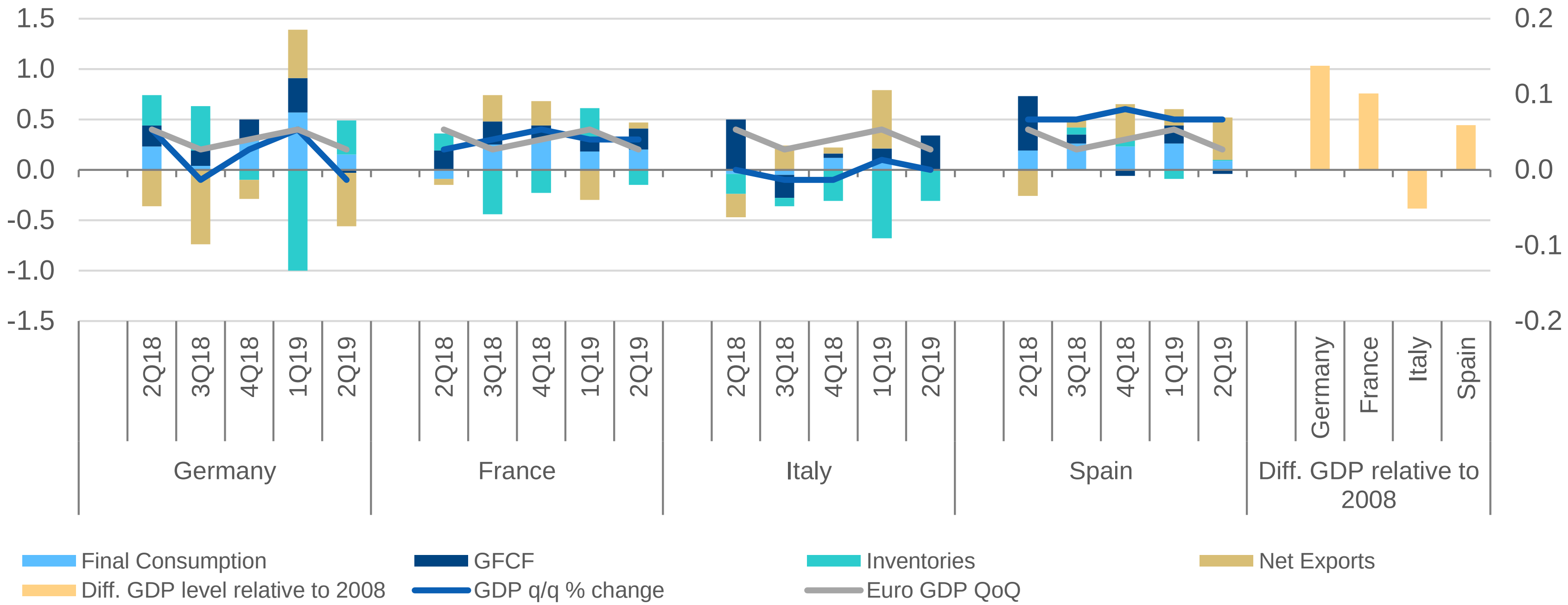
- EZ GDP growth slowed in 2Q19 dragged down by net exports, but also by the weakness of investment and the moderation in consumption despite a solid labour market, increasing wages, very low inflation and favourable financing conditions. The broadly steady growth in France and Spain contrasts with the slight contraction in Germany due to a larger exposure to foreign demand.
- Disappointing hard data in 3Q19 so far. Exports have slowed since mid-2018 affected by lower global demand, but those to other European countries have also declined strongly more recently, especially to the UK. Lower trade and higher uncertainty have pulled down the manufacturing sector. In addition, slowing retail sales point to more moderate growth of private consumption.
- Confidence surveys up to September rule out any improvement in manufacturing in the short-term, as foreign orders decline, with incipient signs of lowering hiring intentions. However, spillover effects to services still remain contained.
- Our MICA-BBVA model now projects Eurozone GDP to slow slightly further to around 0.1% QoQ in 3Q19. Recent data is still consistent with growth at 1.1% in 2019, but point to a further deceleration in 2020 (slightly below 1%).
- Core and inflation expectations entrench at very low levels while inflationary pressures are muted, leading the ECB to deliver a strong easing package amid heightened downward risks, especially related to a no-deal Brexit scenario and increasing trade constraints.

EZ GDP growth slowed in 2Q19 driven by the slight contraction in Germany, despite broadly steady growth elsewhere

Increasing divergence in economic performance across countries reflects the different exposure to the external sector. The volatility on German growth in 1H19 could be distorted by changes in original Brexit deadline in March

GDP AND EXPENDITURE CONTRIBUTION BY COUNTRY

(% QOQ, PP)



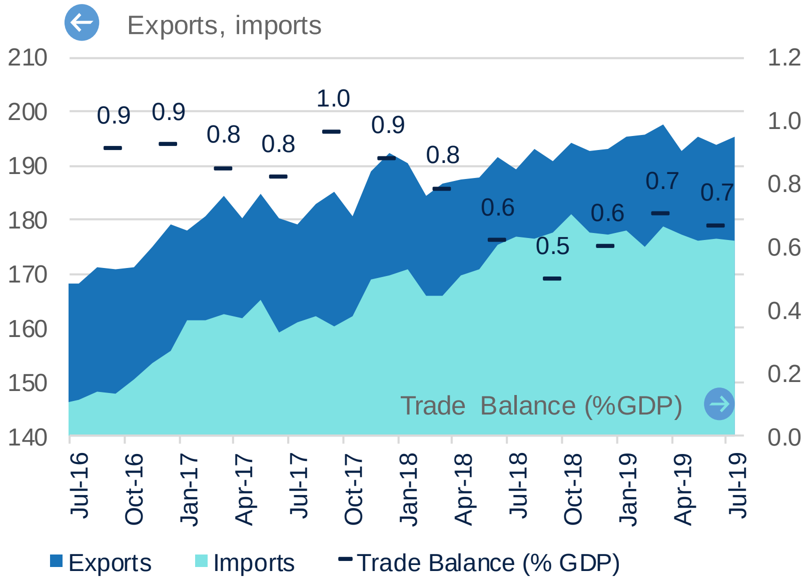
Source: Eurostat and BBVA Research

Exports increased in July, but fell sharply in 2Q19 dragged by sales to other EU countries, especially the UK. Gloomier outlook is likely to persist

Exports have slowed since mid-2018 affected by lower global demand, but those to other European countries have also declined strongly more recently, especially to the UK, while they are some signs of recovery in exports to the US and China

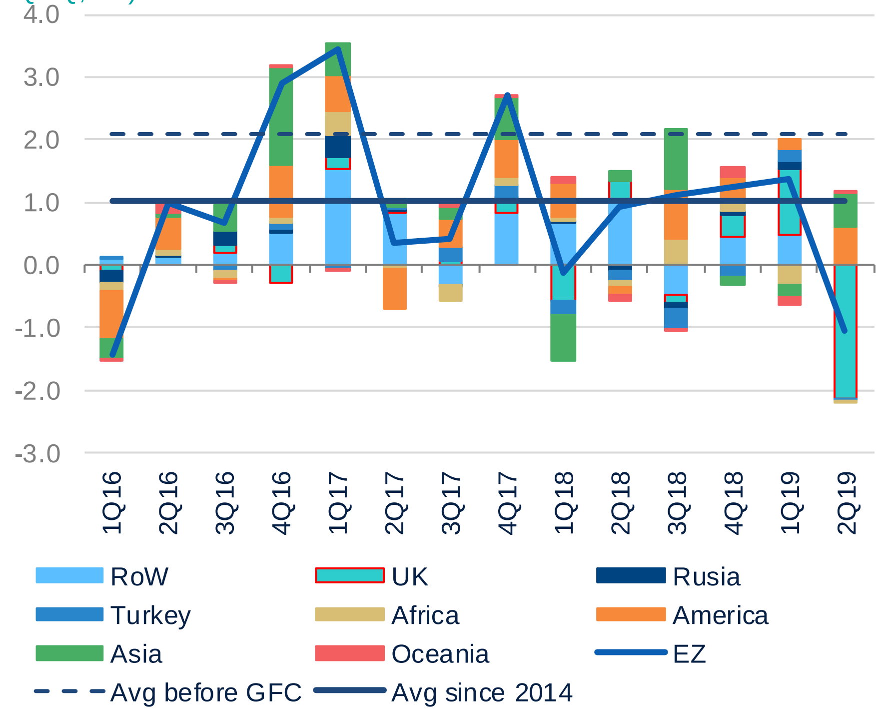
TRADE BALANCE

(EUR BN; % GDP)



EXPORTS BY DESTINATION

(% QOQ; PP)



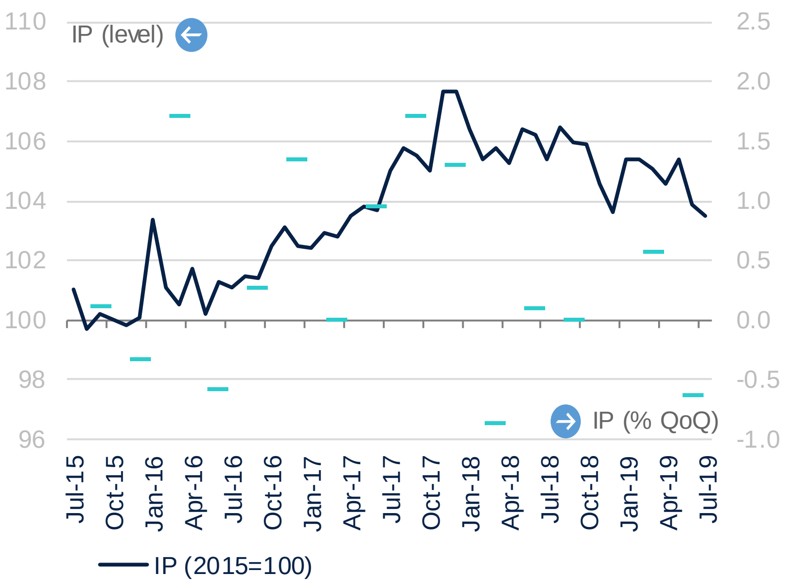
Source: Eurostat and BBVA Research

The deterioration of the industrial production intensifies in recent months, despite the slight improvement of durable consumer and capital goods in July

Lower global trade and increasing uncertainty are weighing on the manufacturing sector, also affected in Europe by structural problems in the automotive sector and Brexit. This increases concerns about the sustainability of investment

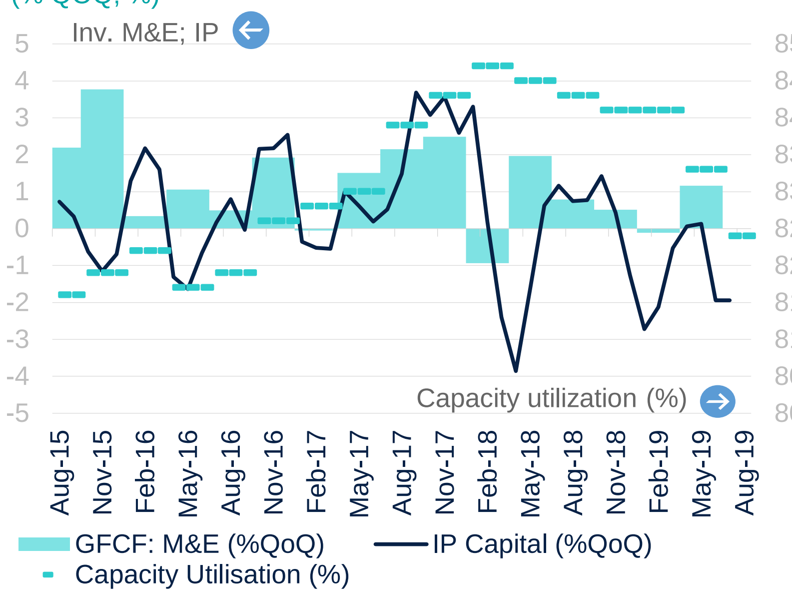
INDUSTRIAL PRODUCTION

(LEVEL; % QOQ)



IP CAPITAL EQUIPMENT, INVESTMENT AND CAPACITY UTILIZATION

(% QOQ; %)



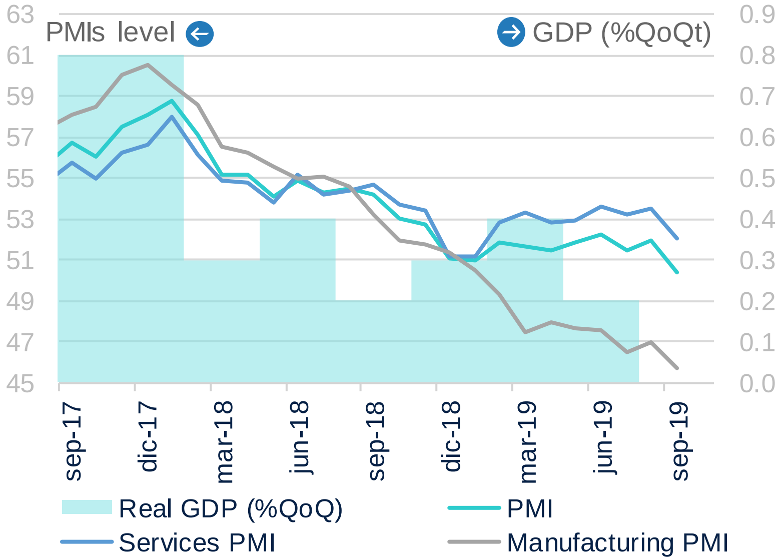
Source: Eurostat and BBVA Research

Confidence surveys up to September rule out any improvement in manufacturing in the short-term, but contained spillover effects to services

Leading indicators, especially foreign orders, point to a more protracted weakness in the industrial sector, with incipient signs about lower hiring intentions. However, service expectations remain still resilient at expansionary territory across countries

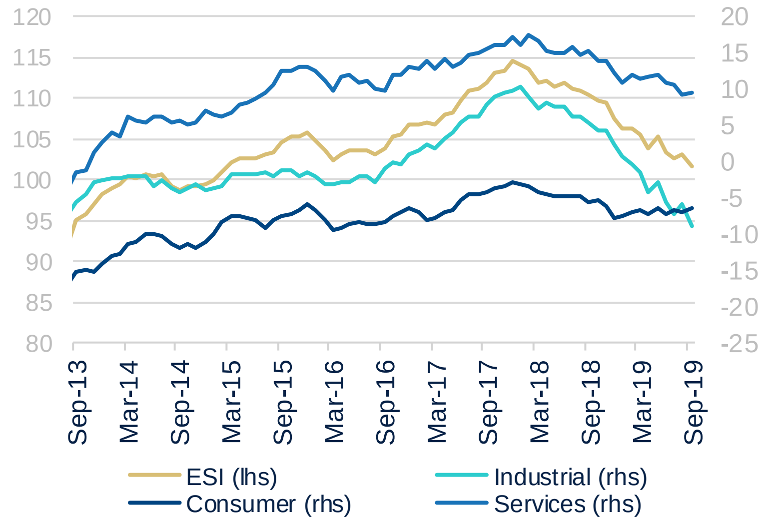
PMI AND GDP

(LEVEL; % QOQ)



EC CONFIDENCE SURVEY

(LEVEL)

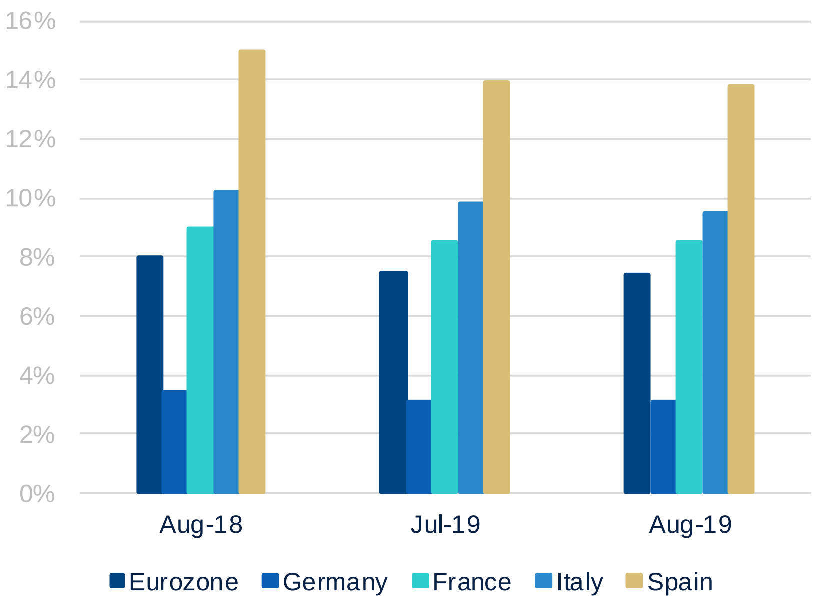


Source: Eurostat and BBVA Research

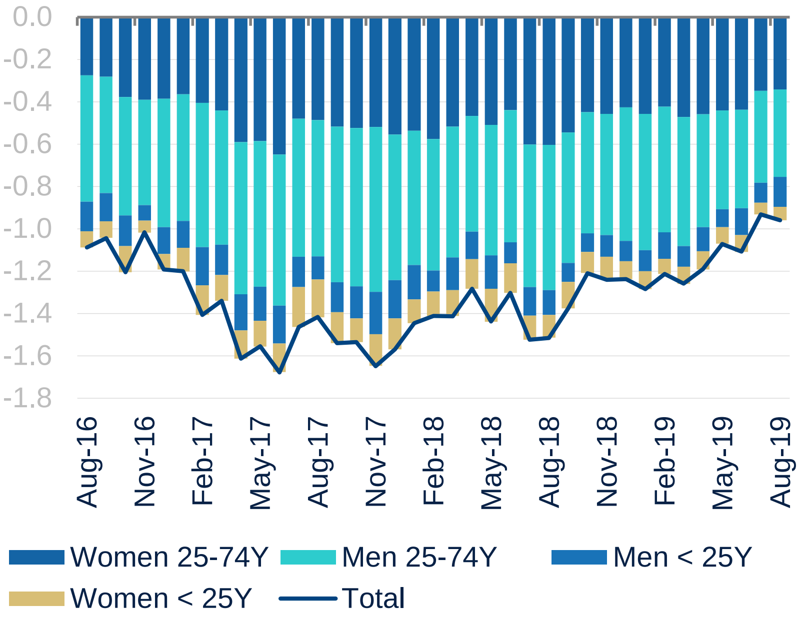
Labour market conditions continue to improve, but at lower pace across countries despite significant and persistent differences

Slowing activity and protracted uncertainty were also reflected in a lower employment growth and a more gradual decline in the unemployment rate in recent months

UNEMPLOYMENT BY COUNTRY
(%)



ANNUAL UNEMPLOYMENT CHANGE BY GENDER AND AGE
(MILLIONS)

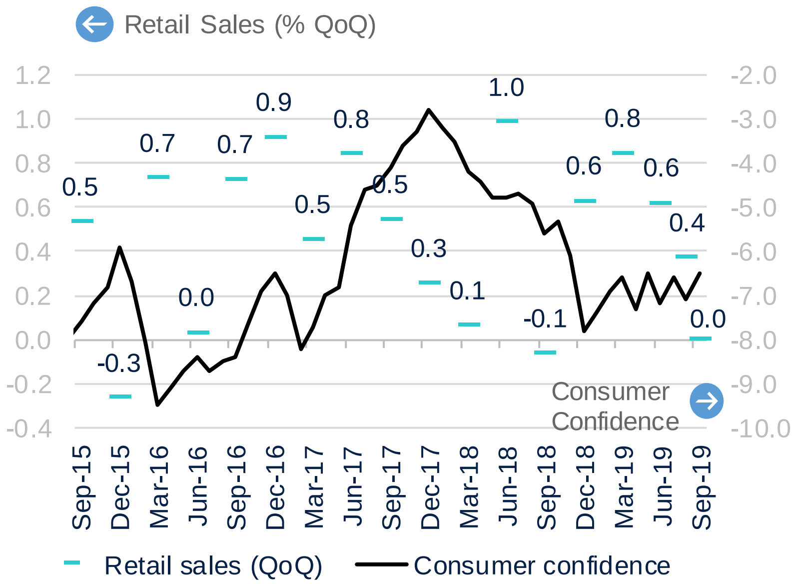


Source: Eurostat and BBVA Research

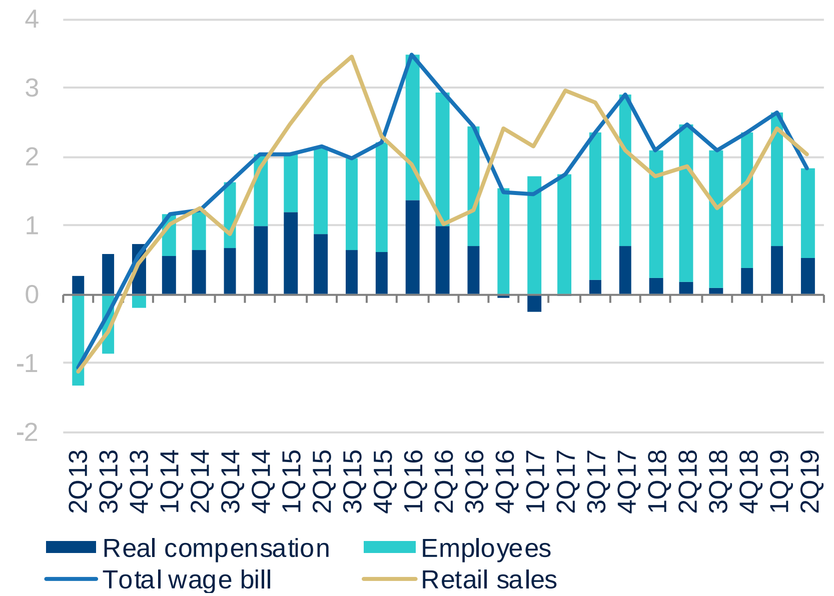
Slowing retail sales points to a moderate growth in private consumption, mainly due to more cautious consumers despite improving labour conditions

Consumers' confidence seems to be stabilized in recent months, but protracted high uncertainty is likely to trigger a more precautionary stance despite ongoing job creation, increasing wages and very low inflation

RETAIL SALES AND CONSUMER CONFIDENCE
(% QOQ, LEVEL)



RETAIL SALES AND WAGES
(% YOY, PP)

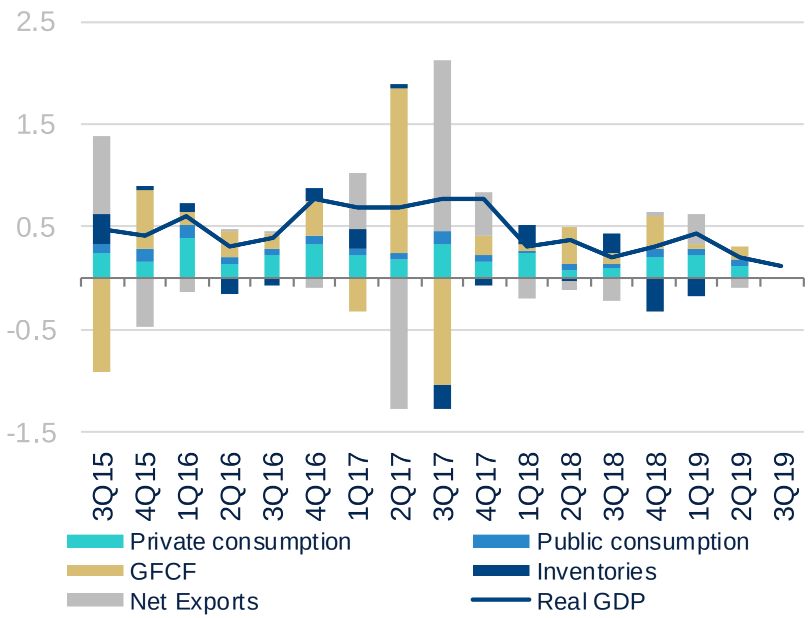


Source: Eurostat and BBVA Research

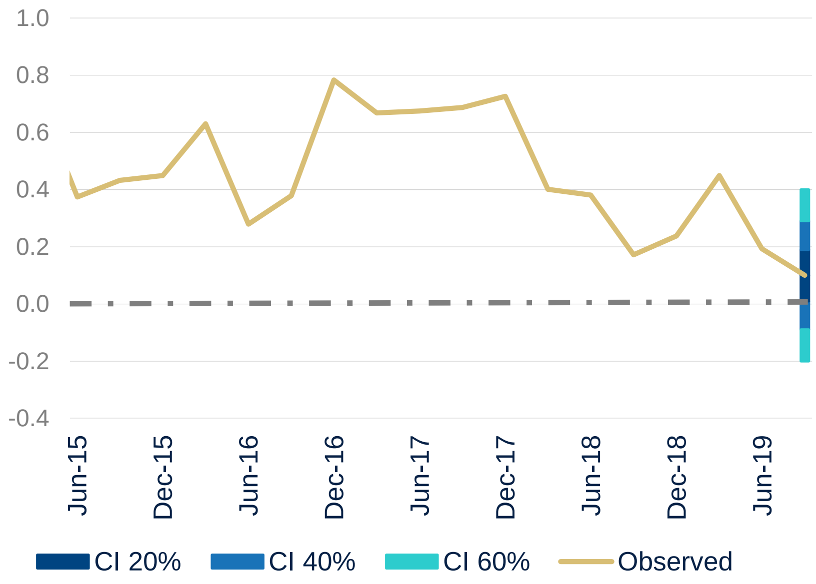
EZ weaker momentum to extend in 2H19 by the frailty in the industrial and external sector, but also the moderation in domestic demand

MICA-BBVA model projects GDP to slow to around 0.1% QoQ in 3Q19, but uncertainty remains very high due to trade issues and Brexit (mainly in exports and manufacturing). Recent data is still consistent with an annual growth at 1.1% in 2019, but point to a further deceleration in 2020 (slightly below 1%)

GDP, CONTRIBUTION BY COMPONENTS
(% QOQ, PP)



GDP AND MICA FORECASTS
(% QOQ)

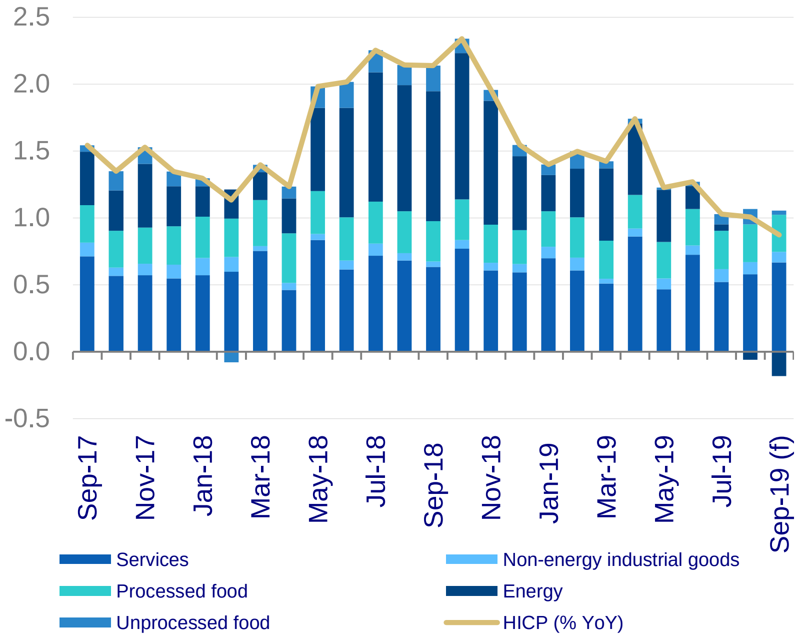


Source: Eurostat and BBVA Research

Lower headline inflation due to falling energy prices and the moderation price of fresh food. Core and inflation expectations remain at low levels…

Core inflation remains relative stable beyond increasing volatility due to the seasonality of holiday packages. A very gradual increase is expected due to some moderation of domestic demand and a more gradual improvement in labour conditions along with a limited pass-through from inputs to consumer prices

INFLATION AND CONTRIBUTION BY COMPONENTS
(% YOY, PP)



INFLATION SWAPS 5Y5Y
(% YOY)

Source: Eurostat, Bloomberg and BBVA Research

… leading the ECB to deliver a strong easing package amid heightened downward risks

The ECB left the door open to further easing measures, but also provided a strong message to the EU governments to use fiscal policy. This package is expected to have a limited effect on activity and prices, but would help to support confidence and prevent tighter financial conditions

Policy instruments	ECB's decisions September 2019
Policy rates	**Cut in depo rate by -10bp to -0.50%;** **Door open to more cuts** ("at present levels, or lower")
Deposit tiering	**Two-tiered system** for bank deposits based on a **6x multiple of excess reserves**; (Swiss model). (starting 30 October 2019). The **remuneration rate of the exempt tier and the multiplier can be changed** over time
Forward guidance	**Reinforced forward guidance** (current rates or lower and QE until inflation sustainably goes close to target, looking also to underlying inflation).
QE	**New open-ended QE programme of €20 bn per month**. The **same composition of assets**. The **new guidance** put together **QE exit to first rate hikes**
TLTROs	**Sweetened conditions for TLTRO-III** (lower cost by -10bp, longer maturities from 2 to 3 years and possibility of early repayments during the third year)

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