BBVA Research

Eurozone Economic Watch

October 2019

Creating Opportunities

Eurozone | Growth projections for 2020 revised down

- Disappointing hard data in 3Q19 so far, but slowing growth trend seems to be containing. Exports increased slightly up to August, supported by some recovery in UK sales while those to Asia decline. The deterioration of industrial output slows due to a slight improvement of durable consumer and capital goods. Slowing retail sales point to a more moderate 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, still consistent with our unchanged growth projection of 1.1% in 2019.
- Growth forecast for 2020 is revised down by 0.4pp to 0.8% driven by more evident negative effects from the worsening global outlook, especially on export-led countries, and higher uncertainty on foreign demand and investment. Further monetary policy easing, along with slightly expansive fiscal policy, could help to halt the worsening of confidence, underpin spending decisions and support a weaker euro.
- Across countries, GDP growth has been revised significantly downward in Germany (gloomier global outlook) and Spain (historical revision shows slower-than-expected domestic demand). More gradual slowdown is expected in France due to lower exposure to global headwinds and fiscal support, while Italy’s GDP remains virtually stagnant over the forecast horizon.
- We revised slightly downward expectations for both headline inflation (1.2% in 2019 and 1.1% in 2020) and the core rate (1.1% in 2019 and 1.2% in 2020), driven by a more moderate domestic demand and a more gradual improvement in the labour market, along with a limited pass-through from inputs to consumer prices.

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01

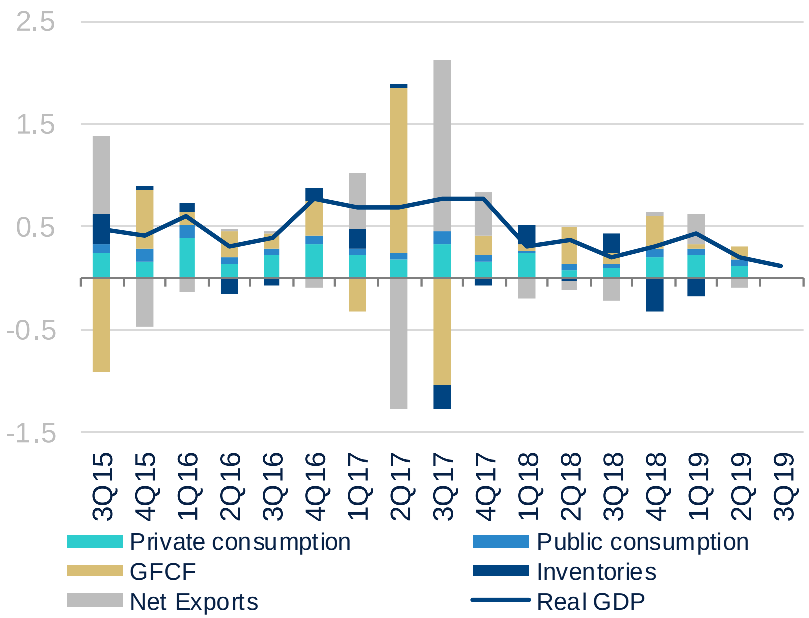
Economic developments

EZ weaker momentum to extend into 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)

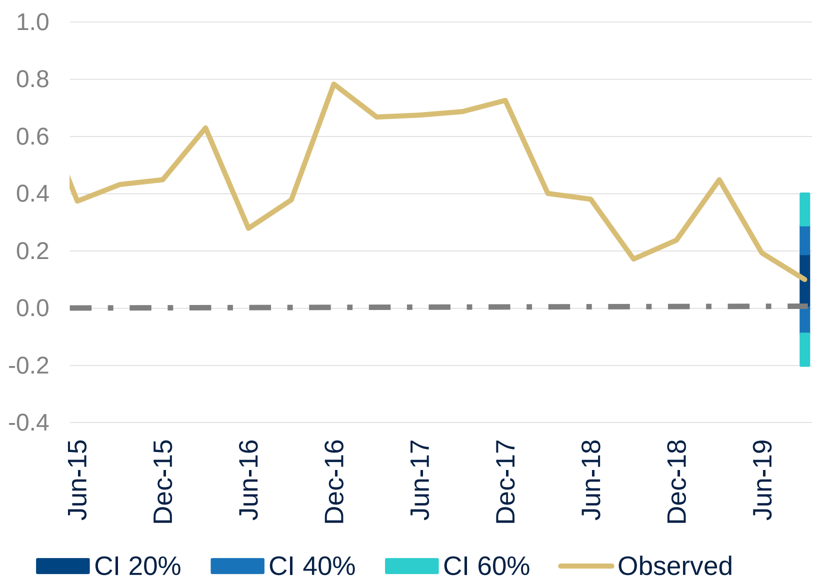
GDP, CONTRIBUTION BY COMPONENTS

(% QOQ, PP)



GDP AND MICA FORECASTS

(% QOQ)



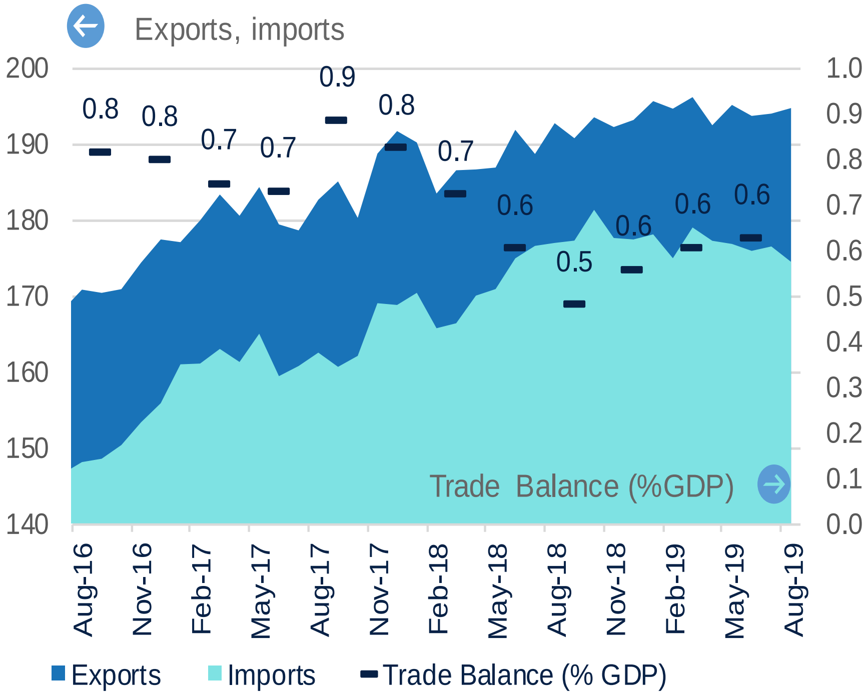
Source: Eurostat and BBVA Research

Exports increased slightly up to August, supported by some recovery in UK sales after falling sharply in previous months, but those to Asia decline

Uncertainty on Brexit and global trade tensions would continue to weigh on exports from 2Q19, growing at very subdued pace (beyond volatility). However, this weakness, along with declining imports, points to a slight positive contribution of net exports in 3Q19

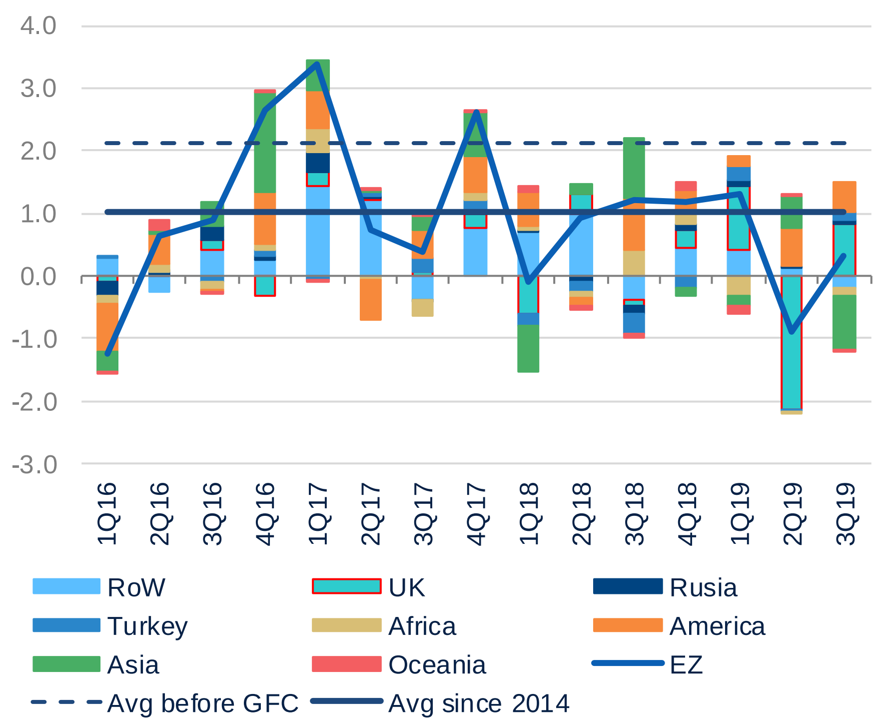
TRADE BALANCE

(EUR BN; % GDP)



EXPORTS BY DESTINATION

(% QOQ; PP)



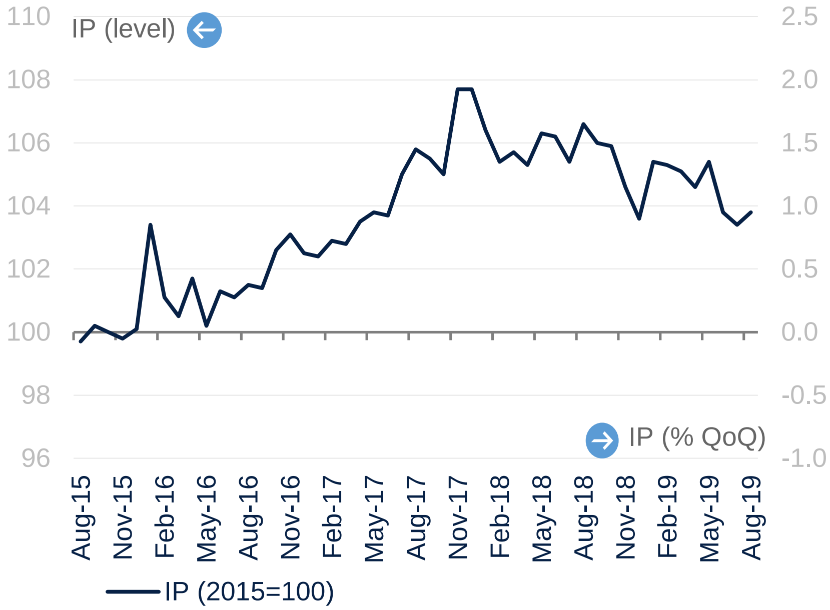
Source: Eurostat and BBVA Research

The deterioration of the industrial output in recent months is contained by the slight improvement of durable consumer and capital goods up to August

Lower global trade and higher uncertainty are weighing on the manufacturing sector, also affected by structural problems in the car sector and Brexit, increasing doubts on the sustainability of investment

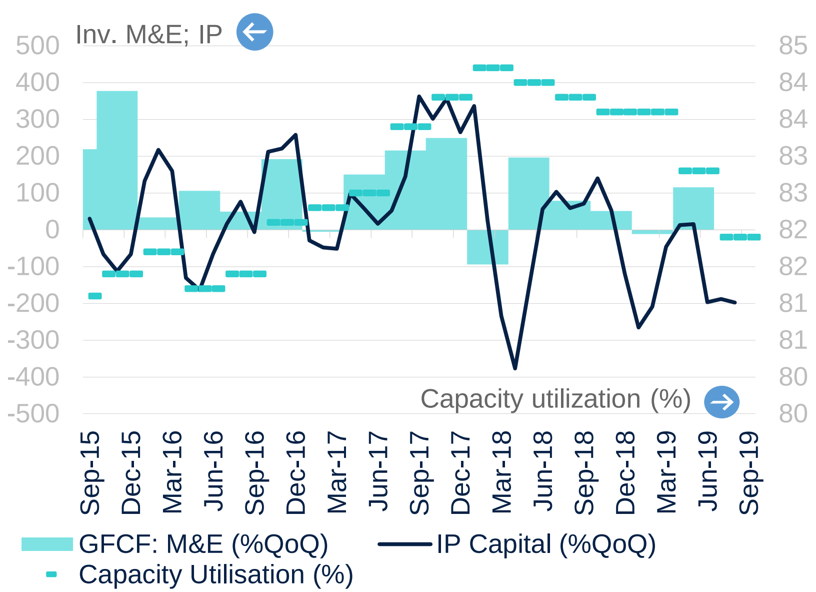
INDUSTRIAL PRODUCTION

(LEVEL; % QOQ)



IP CAPITAL EQUIPMENT, INVESTMENT AND CAPACITY UTILIZATION

(% QOQ; %)

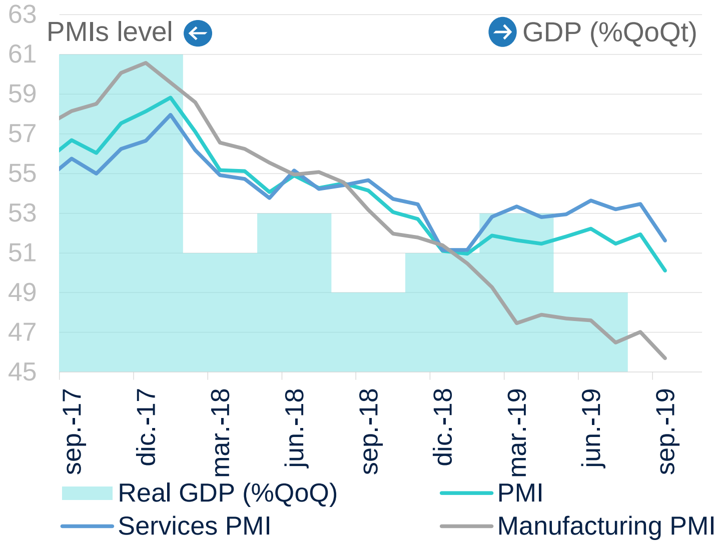


Source: Eurostat and BBVA Research

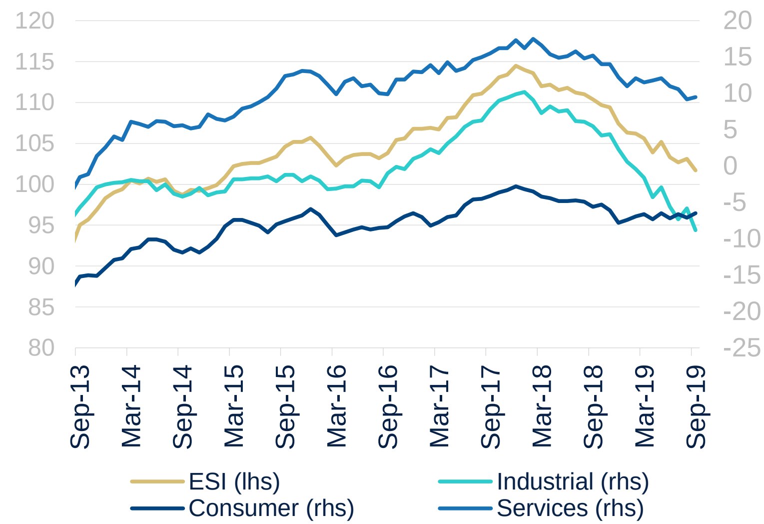
Confidence surveys up to September rule out any improvement in manufacturing in the short-term, but contained spillover effects to services

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

PMI AND GDP
(LEVEL; % QOQ)



EC CONFIDENCE SURVEY
(LEVEL)

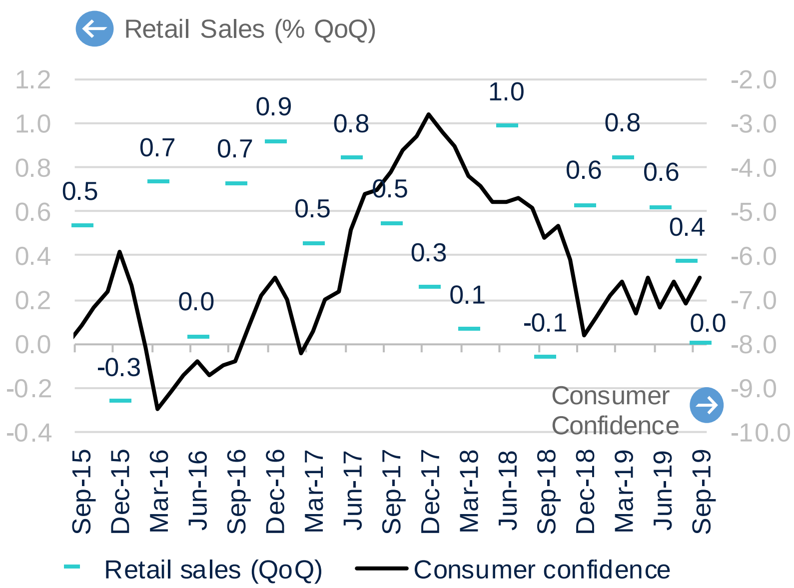


Source: Eurostat and BBVA Research

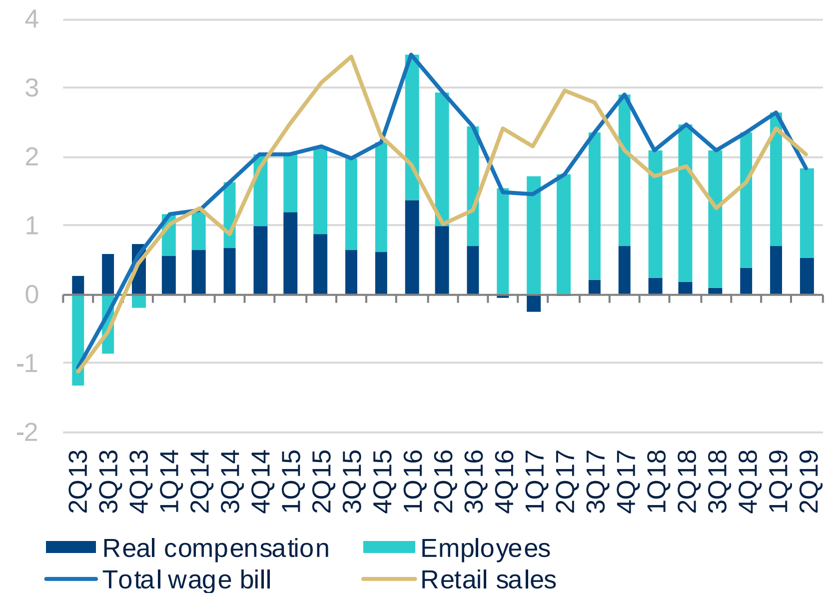
Slowing retail sales point to a moderate growth in private consumption, mainly due to precautionary reasons despite improving labour conditions

Consumers' confidence seems to have 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)

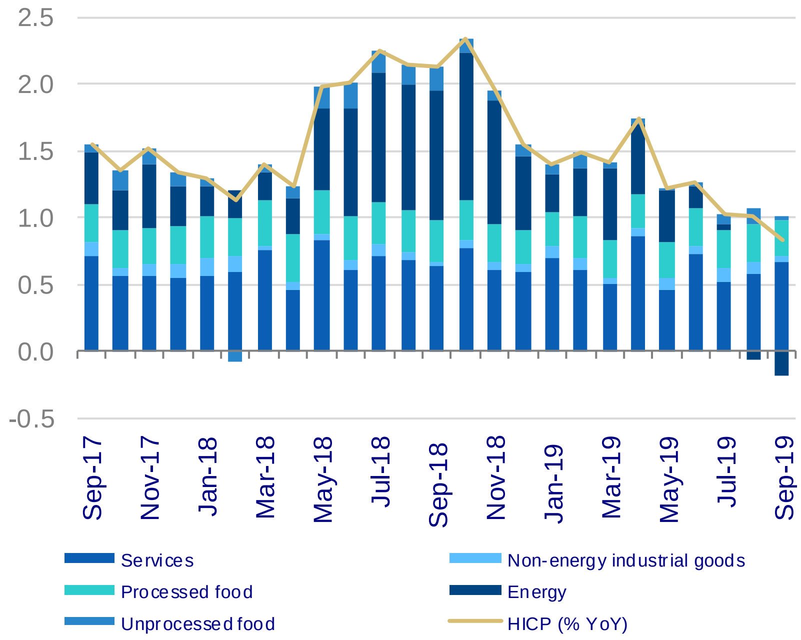


Source: Eurostat and BBVA Research

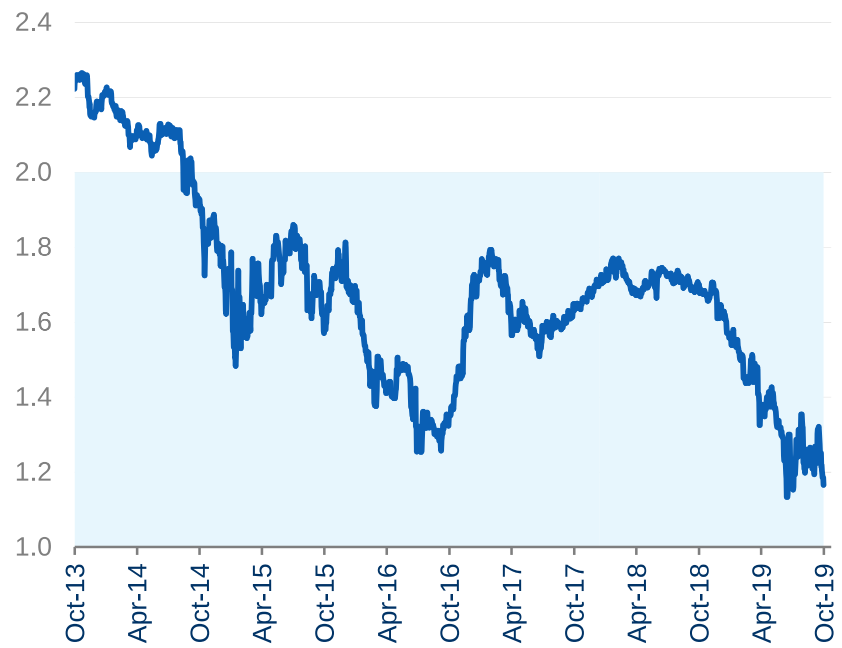
Lower headline inflation due to falling energy prices and the moderation price of fresh food. Core and inflation expectations remain at low levels…

Core inflation remains relative stable beyond increasing volatility due to the seasonality of holiday packages. A very gradual increase is expected due to the 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 some 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 deposit 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** (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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02

Updated forecasts

Eurozone: Worse growth prospects due to the more negative global environment and high uncertainty

MAIN MACROECONOMICS INDICATORS
(% YoY, % GDP)

	2017	2018	2019 (f)	2020 (f)
Real GDP	**2.7**	**1.9**	**1.1**	**0.8**
Private consumption	1.8	1.4	1.2	1.2
Public consumption	1.5	1.1	1.4	1.5
Investment	3.8	2.3	2.5	1.1
Domestic Dem. (cont. pp)	**2.2**	**1.5**	**1.2**	**1.2**
Exports	5.7	3.5	2.2	1.5
Imports	5.0	2.7	2.7	2.6
Net Exports (cont. pp)	**0.5**	**0.5**	**-0.1**	**-0.4**
Current account (% GDP)	**3.1**	**3.1**	**2.6**	**2.4**
Budget balance (% GDP)	**-1.0**	**-0.5**	**-0.9**	**-1.2**
HICP (avg. %YoY)	**1.5**	**1.8**	**1.2**	**1.1**

Source: BBVA Research

- Brexit and the problems in the auto sector, on top of trade tensions, have affected economic activity…
- … and have contributed to a particularly large fall of exports to the rest of Europe and UK
- Monetary easing and slightly expansive fiscal policy will support growth next year
- Increasing divergence in growth performance across countries depending on their exposure to the external sector
- Inflation will remain low (1.2% in 2019; 1.1% in 2020)
- The risk of recession has increased

Germany: Significant downward growth revision for 2019-20 on worsening exports and investment, despite higher public spending

MAIN MACROECONOMICS INDICATORS
(% YoY, % GDP)

	2017	2018	2019 (f)	2020 (f)
Real GDP	**2.8**	**1.5**	**0.5**	**0.6**
Private consumption	1.6	1.2	1.3	1.2
Public consumption	2.4	1.4	1.9	1.6
Investment	3.1	3.5	2.1	0.9
Domestic Dem. (cont. pp)	**2.5**	**2.0**	**1.2**	**1.1**
Exports	5.5	2.3	0.6	0.7
Imports	5.7	3.7	2.3	1.8
Net Exports (cont. pp)	**0.3**	**-0.5**	**-0.7**	**-0.5**
Current account (% GDP)	**8.0**	**7.4**	**6.8**	**6.1**
Budget balance (% GDP)	**1.0**	**1.7**	**0.9**	**0.3**
HICP (avg. %YoY)	**1.6**	**2.0**	**1.3**	**1.2**

Source: BBVA Research

- Weak global trade and cautious firms are weighing markedly on exports and investment, which have brought the economy to the brink of recession
- Increasing contagion signs to the service sector and labour market, but still resilient.
- Higher public spending could help to support confidence of both households and firms, but not enough to prevent a marked lower contribution of domestic demand
- This along with a larger drag of net exports led us to revise growth downwards by 0.3pp to 0.5% in 2019 and by 0.6pp to 0.6% in 2020
- Debate on further fiscal stimulus is gaining ground, but the debt rule is unlikely to be broken if the outlook does not get any worse

France: Gradual slowdown ahead due to lower exposure to global headwinds and fiscal measures supporting domestic demand

MAIN MACROECONOMICS INDICATORS
(% YoY, % GDP)

	2017	2018	2019 (f)	2020 (f)
Real GDP	**2.4**	**1.7**	**1.3**	**1.2**
Private consumption	1.6	0.9	1.1	1.2
Public consumption	1.5	0.8	1.0	1.2
Investment	5.0	2.8	2.2	1.8
Domestic Dem. (cont. pp)	**2.5**	**1.0**	**1.2**	**1.3**
Exports	4.0	3.5	2.5	1.7
Imports	4.1	1.2	2.1	1.9
Net Exports (cont. pp)	**-0.1**	**0.7**	**0.1**	**-0.1**
Current account (% GDP)	**-0.8**	**-0.7**	**-0.5**	**-0.5**
Budget balance (% GDP)	**-2.9**	**-2.6**	**-3.2**	**-2.6**
HICP (avg. %YoY)	**1.2**	**2.1**	**1.2**	**1.1**

Source: BBVA Research

- Private consumption is gaining momentum, benefiting from fiscal support, lower inflation along with improving labour market and increasing wages
- Investment slows only gradually as higher uncertainty is partly offset by lower business tax burden and public investment
- Slowing growth in 2019 reflects a significant lower contribution of net exports, but mainly due to higher imports
- Less exposure to global headwinds, but concerns stem from recession risks in Germany
- Public deficit likely to decline below 3% of GDP in 2020 after fading one-off measures for competitiveness and employment
- Growth forecast unchanged for 2019, but revised down by 0.3pp to 1.2% in 2020

Italy: Very low growth to extend to 2020 as the slight domestic demand recovery will be offset by fading external support

MAIN MACROECONOMICS INDICATORS
(% YoY, % GDP)

	2017	2018	2019 (f)	2020 (f)
Real GDP	**1.8**	**0.7**	**0.1**	**0.3**
Private consumption	1.5	0.6	0.3	0.5
Public consumption	0.3	0.2	0.0	0.3
Investment	4.5	3.2	0.9	0.5
Domestic Dem. (cont. pp)	**1.5**	**0.8**	**-0.3**	**0.5**
Exports	6.4	1.4	2.4	1.1
Imports	5.8	1.8	1.3	1.7
Net Exports (cont. pp)	**0.3**	**-0.1**	**0.4**	**-0.2**
Current account (% GDP)	**2.7**	**2.6**	**2.7**	**2.3**
Budget balance (% GDP)	**-2.4**	**-2.1**	**-2.0**	**-2.2**
HICP (avg. %YoY)	**1.3**	**1.2**	**0.7**	**0.9**

Source: BBVA Research

- Slowing domestic demand still offset in 2019 by stronger support from net exports due to better than expected exports as well as moderating imports
- The new government commits with EU rules and sets out a new deficit target at 2.2% of GDP, preserving some social measures and preventing an automatic VAT hike. Doubts stem from optimistic official growth forecast and higher revenues from tax evasion
- In 2020, easing political uncertainty should support a timid recovery in domestic demand…
- … but partly be offset by fading external support
- The lack of structural reforms points to a protracted very low growth ahead

Spain: Recovery will continue, but at a slower pace

MAIN MACROECONOMICS INDICATORS
(% YoY, % GDP)

	2017	2018	2019 (f)	2020 (f)
Real GDP	**2.9**	**2.4**	**1.9**	**1.6**
Private consumption	3.0	1.8	0.8	1.3
Public consumption	1.0	1.9	2.0	1.7
Investment	5.9	5.3	2.3	3.0
Domestic Dem. (cont. pp)	**3.0**	**2.6**	**1.3**	**1.7**
Exports	5.6	2.2	2.0	2.9
Imports	6.6	3.3	0.2	3.4
Net Exports (cont. pp)	**-0.1**	**-0.3**	**0.6**	**-0.1**
Current account (% GDP)	**2.5**	**1.8**	**1.6**	**1.4**
Budget balance (% GDP)	**-3.0**	**-2.5**	**-2.3**	**-1.9**
HICP (avg. %YoY)	**2.0**	**1.7**	**0.7**	**1.1**

Source: BBVA Research

- GDP growth revised down (-0.4pp to 1.9% in 2019 and -0.3pp to 1.6% in 2020) due to historical revision of the national accounts, the negative trend in some demand components (as the impact of several stimuli fade out) and the further global deterioration
- On top of global factors, local issues skew the balance of risks to the downside: political uncertainty, possibility of more interventionist policies and regulatory changes
- Lower external support could be partly offset by gaining momentum in domestic demand over the forecast horizon
- The economy is better prepared now than in other episodes to face a lower growth environment (lower private debt, sound financial system, no additional imbalances are perceived during the economic recovery)

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