BBVA Research

Eurozone Economic Watch

January 2020

Creating Opportunities

Eurozone | Slightly upward growth forecasts, but weakness persists

- More signs of stabilization in 4Q19. Exports gained some traction up to November, supported by better performance of those to UK and Asia while the deterioration of the industrial sector seems to have bottomed out. Retail sales slowed slightly, but continue to grow supported by low inflation and higher wages.
- Worsening confidence halted in 4Q19 driven by less negative manufacturing mood and some improvement in services expectations. These figures point to a limited contagion of lower exports to domestic demand.
- Our MICA-BBVA model projects subdued growth to extend in 4Q19 (around 0.2% QoQ) in line with our forecasts of annual GDP growth at 1.2% in 2019.
- Looking forward, we do not expect major changes in growth drivers: Solid domestic factors should be underpinned by accommodative monetary policy (ECB to keep interest rates unchanged) and mildly expansionary fiscal policy. This could partly offset the weak global demand while external headwinds ease in the short-term (US-China trade truce and Brexit).
- Eurozone growth forecasts are revised slightly upwards thanks to better incoming data, but we continue to expect some slowdown from the 1.2% in 2019 to 0.9% in 2020, before recovering gradually to 1.2% in 2021. Across countries, the weakness in Germany will persist dragged down by manufacturing, but growth divergence across countries will be reduced over the year.
- Both inflation and expectations increased in late 2019, in line with our view of a gradual upward trend in core inflation over the forecast horizon (1.2% in 2019, 1.3% in 2020 and 1.4% in 2021).
- Risks remain tilted to the downside, but ease somewhat: Lower probability of a hard Brexit or higher car tariffs in the short term, but could arise again during the year.

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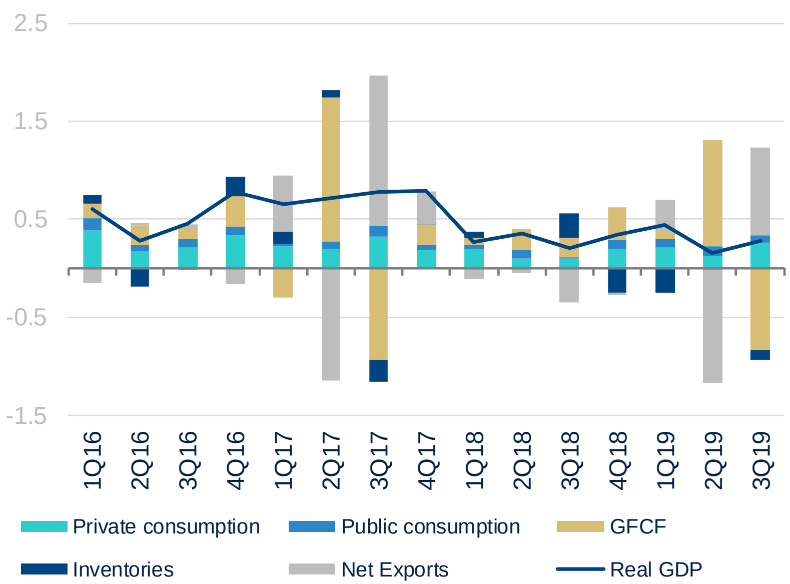
01

Short-term indicators

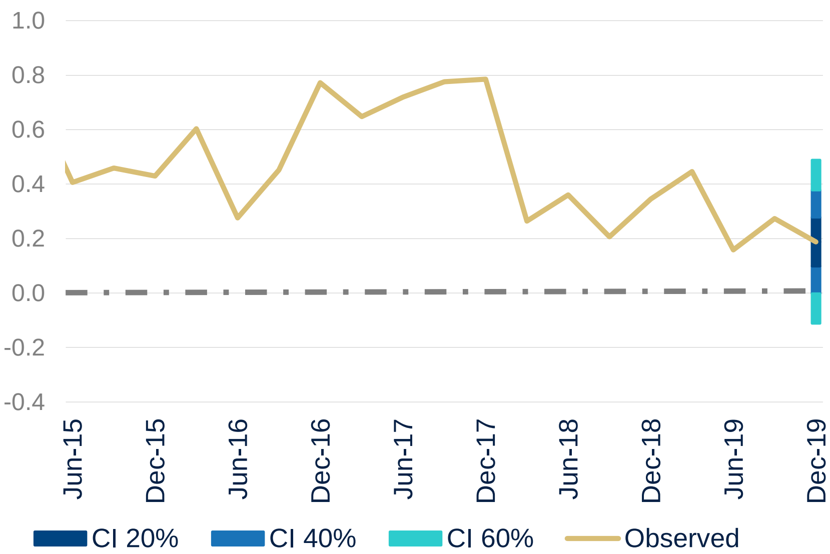
Eurozone growth in 3Q19 was revised slightly upwards to 0.3% QoQ driven by consumption and net exports, but weakness extended to 4Q19

Our MICA-BBVA model projects subdued growth to extend in 4Q19 (around 0.2% QoQ) in line with our forecasts of annual GDP growth at 1.2% in 2019. Beyond recent volatility, average quarterly investment growth remained relatively steady last year, while exports were somewhat more resilient than anticipated.

GDP, CONTRIBUTION BY COMPONENTS
(% QOQ, PP)



GDP AND MICA FORECASTS
(% QOQ)

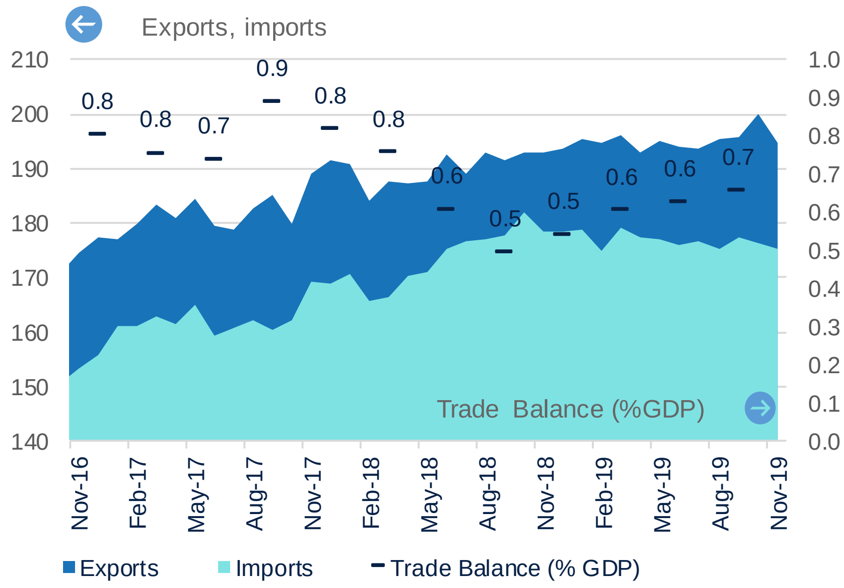


Source: Eurostat and BBVA Research

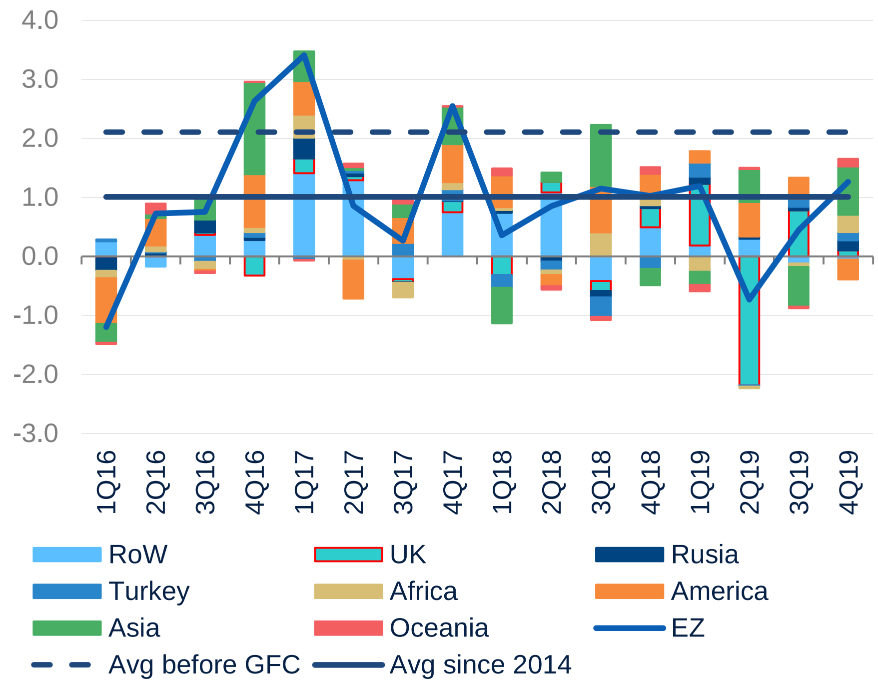
Exports gained some traction up to November, suggesting further net export support by year end

Exports growth recovered from the sharp fall observed in 2Q19 thanks to better performance of sales to UK and Asia. Looking forward, weak foreign orders and subdued global trade point to a still weak external outlook in the short-term.

TRADE BALANCE
(EUR BN; % GDP)



EXPORTS BY DESTINATION
(% QOQ; PP)

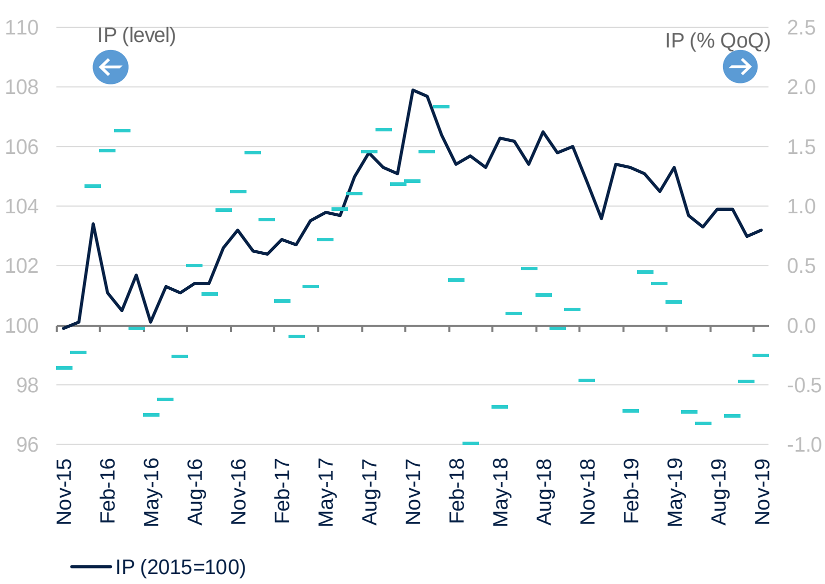


Source: Eurostat and BBVA Research

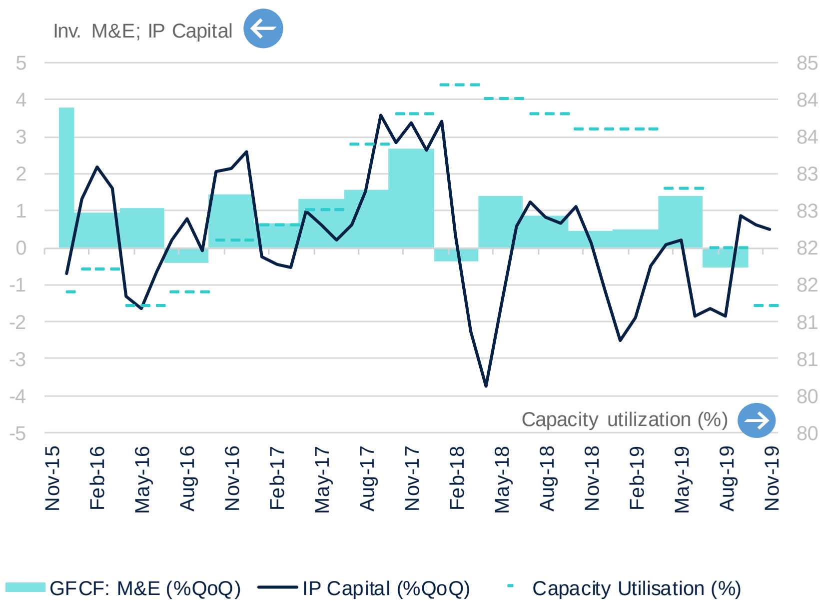
The deterioration in industrial sector eased in 4Q19, especially in intermediate goods, while production of consumer goods remains firm

Despite some improvement in confidence surveys, there are no strong signs of improvement in the short-term, increasing concerns on the effect of more structural factors mainly related to the car sector and disruptions in global value chains. Lower capacity utilization also point to a weak investment ahead.

INDUSTRIAL PRODUCTION
(LEVEL; % QOQ)



IP CAPITAL EQUIPMENT, INVESTMENT AND CAPACITY UTILIZATION
(% QOQ; %)

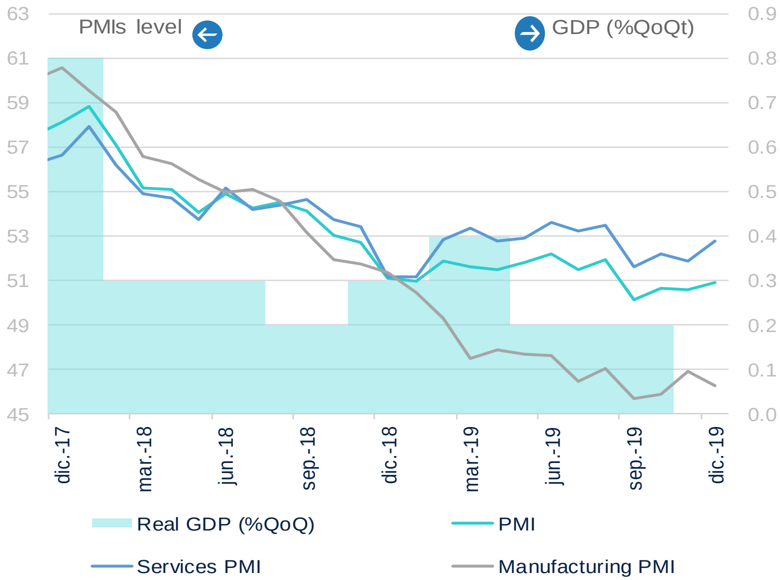


Source: Eurostat and BBVA Research

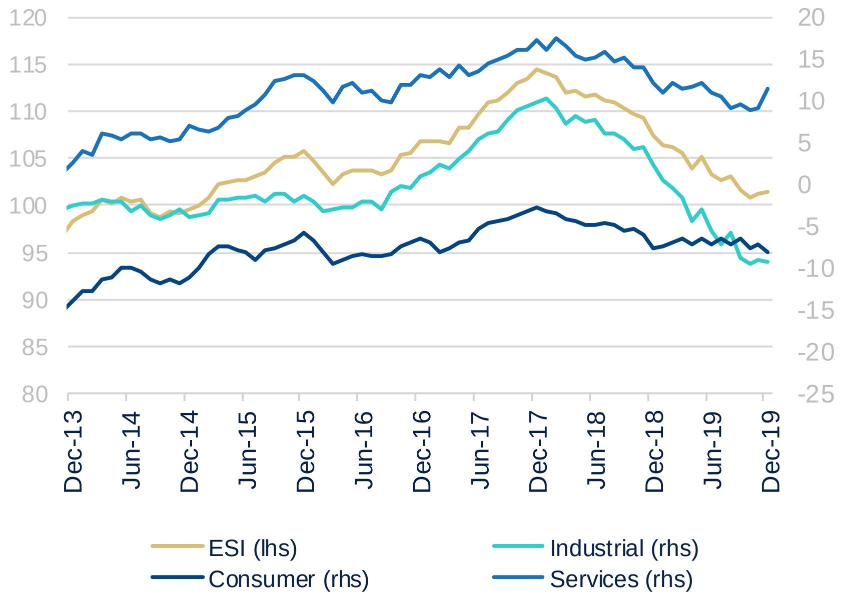
Worsening confidence halted in 4Q19 driven by a less negative manufacturing mood and some improvement in services expectations

Weak foreign orders continue to weigh on manufacturing, also reflected in lower hiring intentions. However, recent data point to a limited contagion to services and consumers' confidence. German ZEW indicators for January show an increase in optimism after the US-China trade truce.

PMI AND GDP
(LEVEL; % QOQ)



EC CONFIDENCE SURVEY
(LEVEL)

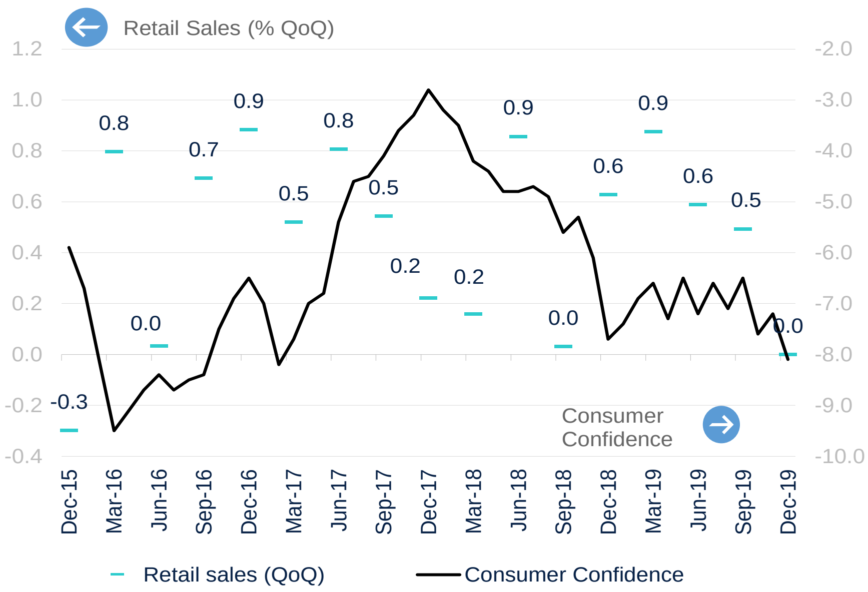


Source: Eurostat and BBVA Research

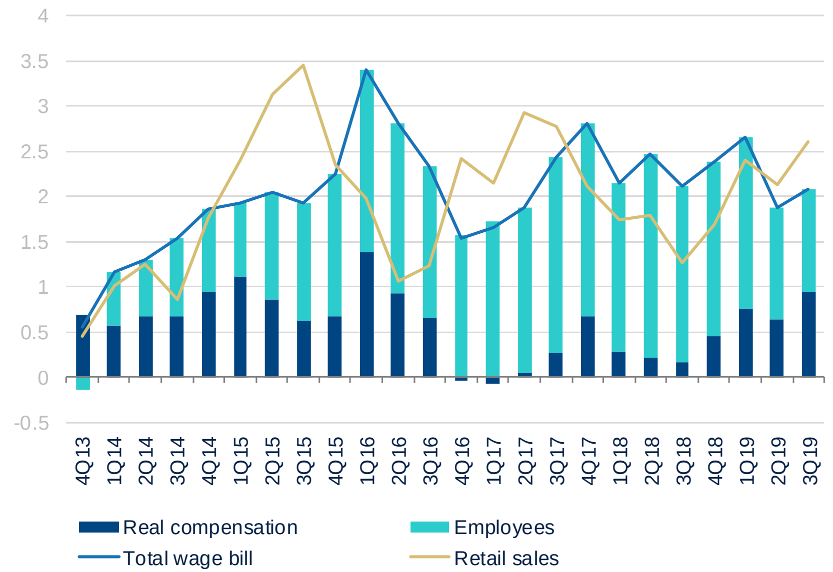
Retail sales slowed slightly up to November, but continues to grow in a context of low inflation and higher wages

Underlying this moderation in retail sales seems to be a halt in labour gains and weaker consumer sentiment that triggered higher saving rates over last year.

RETAIL SALES AND CONSUMER CONFIDENCE
(% QOQ, LEVEL)



RETAIL SALES AND WAGES
(% YOY, PP)

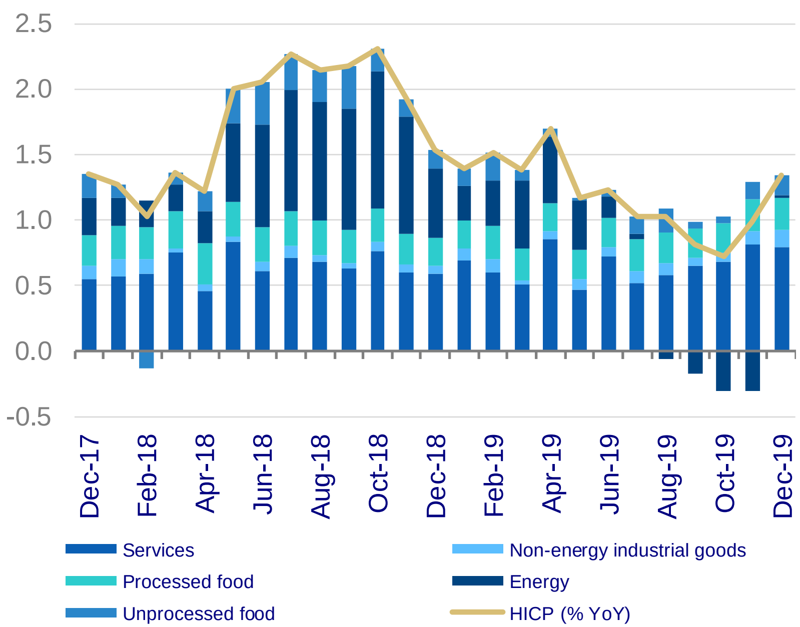


Source: Eurostat and BBVA Research

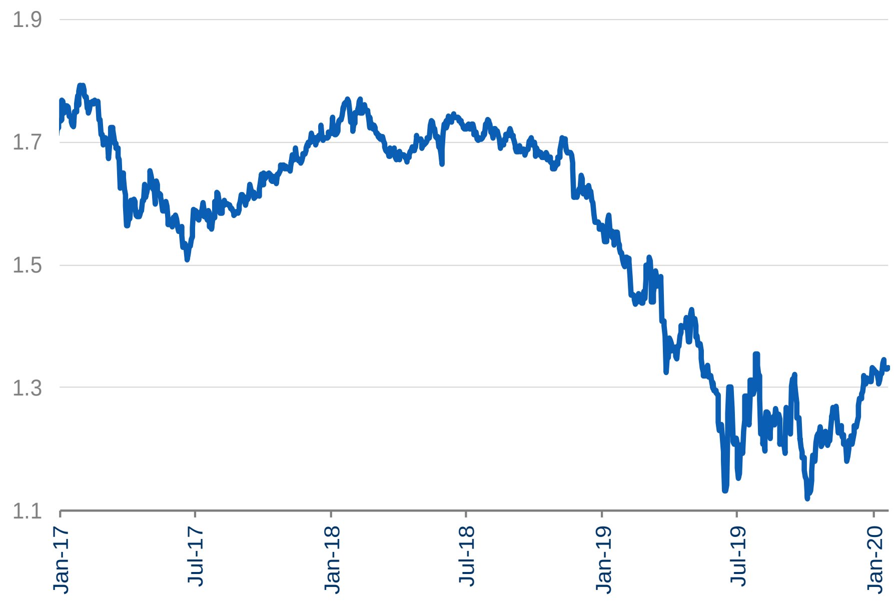
Inflation rose to 1.3% in December driven by energy prices, while core inflation remains steady at 1.4%

Positive surprises in core inflation in 4Q19 seem to consolidate, as service inflation remains steady after the sharp rebound in November. These figures are consistent with our projection of a very gradual increase of core inflation in coming months, also reflected in slightly higher inflation expectations.

INFLATION AND CONTRIBUTION BY COMPONENTS
(% YOY, PP)



INFLATION SWAPS 5Y5Y
(% YOY)



Source: Eurostat, Bloomberg and BBVA Research

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02

Updated forecasts

Eurozone: Slightly upward revision of growth forecasts driven by better than expected incoming data. No significant changes on drivers

MAIN MACROECONOMICS INDICATORS

(% YoY, % GDP)

	2018	2019 (f)	2020 (f)	2021 (f)
Real GDP	**1.9**	**1.2**	**0.9**	**1.2**
Private consumption	1.4	1.3	1.2	1.2
Public consumption	1.1	1.5	1.5	1.3
Investment	2.4	6.9	1.9	2.0
Domestic Dem. (cont. pp)	**1.5**	**2.0**	**1.3**	**1.3**
Exports	3.3	2.4	2.1	2.7
Imports	2.7	4.6	3.3	3.1
Net Exports (cont. pp)	**0.4**	**-0.8**	**-0.4**	**-0.1**
Current account (% GDP)	**3.1**	**2.6**	**2.4**	**2.3**
Budget balance (% GDP)	**-0.5**	**-0.8**	**-1.0**	**-1.1**
HICP (avg. %YoY)	**1.8**	**1.2**	**1.1**	**1.5**

Source: BBVA Research

- Growth is stabilizing at low levels supported by the resilience of domestic demand
- The economic dynamism will increase from mid-2020, partly due to higher exports and lower uncertainty
- Fiscal stimulus (around 0.3pp of GDP in 2019) will extend in 2020. The Green Deal will mobilize at least €1tr over next 10 years through public and private leverage.
- The growth divergence across countries will be reduced over the year, mostly due to a better performance in Germany
- Inflation will remain very low despite the strong monetary stimulus and tightening labour market
- The risk of recession has decreased in the short-term, but threats of a disorderly Brexit or higher US auto tariffs could return

Germany: Industrial activity is gradually bottoming out, but weakness persists. Higher public consumption adds to households spending

MAIN MACROECONOMICS INDICATORS

(% YoY, % GDP)

	2018	2019 (f)	2020 (f)	2021 (f)
Real GDP	**1.5**	**0.6**	**0.7**	**1.2**
Private consumption	1.2	1.6	1.2	1.1
Public consumption	1.4	2.0	2.2	1.9
Investment	3.5	2.6	0.4	1.4
Domestic Dem. (cont. pp)	**2.0**	**1.1**	**1.0**	**1.2**
Exports	2.3	1.0	0.9	2.0
Imports	3.7	2.3	1.8	2.3
Net Exports (cont. pp)	**-0.4**	**-0.5**	**-0.3**	**0.0**
Current account (% GDP)	**7.5**	**7.1**	**6.6**	**6.4**
Budget balance (% GDP)	**1.9**	**1.3**	**0.5**	**0.4**
HICP (avg. %YoY)	**2.0**	**1.3**	**1.2**	**1.6**

Source: BBVA Research

- Mixed signs in manufacturing over 2H19, but increasing optimism on the back of lower uncertainty on trade (US-China truce and Brexit). Still, structural problems would prevent a rebound in the short-term.
- Favourable financing conditions, global stabilization and the pick-up in emerging Europe should bolster a gradual recovery in investment over the forecast horizon
- Slightly more expansionary fiscal policy in 2020 should also contribute to underpin activity, while a new investment and green package has been announced for the next decade
- Consumption will be resilient supported by solid labour market and low inflation
- Global risks ease, but the threat of US car tariffs remains, and domestic political uncertainty increases after worsening relations in the government coalition

France: Steady growth due to the resilience of domestic demand

MAIN MACROECONOMICS INDICATORS

(% YoY, % GDP)

	2018	2019 (f)	2020 (f)	2021 (f)
Real GDP	**1.7**	**1.3**	**1.2**	**1.3**
Private consumption	0.9	1.2	1.3	1.2
Public consumption	0.8	1.2	1.1	1.2
Investment	2.8	3.4	1.9	1.6
Domestic Dem. (cont. pp)	**1.0**	**1.5**	**1.3**	**1.4**
Exports	3.5	1.9	1.6	2.3
Imports	1.2	2.4	1.9	2.4
Net Exports (cont. pp)	**0.7**	**-0.2**	**-0.1**	**0.0**
Current account (% GDP)	**-0.7**	**-0.7**	**-0.6**	**-0.5**
Budget balance (% GDP)	**-2.6**	**-3.1**	**-2.4**	**-2.3**
HICP (avg. %YoY)	**2.1**	**1.3**	**1.1**	**1.4**

Source: BBVA Research

- Short-term indicators suggest that private consumption and investment remains relatively firm.
- Fiscal support, low inflation and rising wages should continue to underpin household spending and service sector.
- Investment would moderate slightly, but still supported by favourable financing conditions and lower uncertainty.
- Less exposure to global headwinds, but concerns stem from German slowdown and threat on auto tariffs despite France halts digital tax until the end of the year.
- Net exports could continue to weigh on activity, but mainly due to higher imports.
- The protracted strike against the pension reform is a risk for the outlook.

Italy: Very low growth to extend to 2020, putting pressure on public accounts and the fragility of the coalition government

MAIN MACROECONOMICS INDICATORS
(% YoY, % GDP)

	2018	2019 (f)	2020 (f)	2021 (f)
Real GDP	**0.7**	**0.2**	**0.4**	**0.7**
Private consumption	0.8	0.5	0.6	0.5
Public consumption	0.4	0.4	0.3	0.3
Investment	3.0	2.5	0.3	1.0
Domestic Dem. (cont. pp)	**0.9**	**-0.1**	**0.6**	**0.6**
Exports	1.3	2.0	1.0	1.9
Imports	2.4	1.2	1.7	1.8
Net Exports (cont. pp)	**-0.3**	**0.3**	**-0.2**	**0.1**
Current account (% GDP)	**2.6**	**3.0**	**2.4**	**2.5**
Budget balance (% GDP)	**-2.2**	**-2.2**	**-2.4**	**-2.4**
HICP (avg. %YoY)	**1.2**	**0.7**	**0.7**	**1.2**

Source: BBVA Research

- Slowing domestic demand was offset in 2019 by stronger support from external demand due to better than expected exports as well as moderating imports.
- Still high unemployment and worsening confidence will continue take its toll on private consumption. The recovery of domestic demand will reflect the easing drag of inventories last year.
- Net exports support could ease over the forecast horizon
- Weaker Government coalition and low growth could rise concerns on public finance sustainability and financial stress at any time
- The lack of structural reforms points to a protracted very low growth ahead.

Spain: Slowdown could halt in 2020 as domestic demand and exports seem to have bottomed out, while fiscal policy would be pro-cyclical

MAIN MACROECONOMICS INDICATORS
(% YoY, % GDP)

	2018	2019 (f)	2020 (f)	2021 (f)
Real GDP	**2.4**	**1.9**	**1.6**	**1.9**
Private consumption	1.8	1.2	1.4	1.6
Public consumption	1.9	2.2	1.7	1.8
Investment	5.3	2.7	2.6	4.5
Domestic Dem. (cont. pp)	**2.6**	**1.7**	**1.7**	**2.1**
Exports	2.2	2.0	2.6	3.4
Imports	3.3	1.6	3.0	4.5
Net Exports (cont. pp)	**-0.3**	**0.2**	**-0.1**	**-0.3**
Current account (% GDP)	**1.8**	**1.7**	**1.2**	**0.9**
Budget balance (% GDP)	**-2.5**	**-2.4**	**-2.2**	**-2.0**
HICP (avg. %YoY)	**1.7**	**0.7**	**1.0**	**1.5**

Source: BBVA Research

- Growth has stabilized at 0.4% QoQ in 2H19, slightly above expectations, and will stay around this rate in early 2020.
- Consumption and investment is recovering; the export sector might have hit bottom, but several sectors remain negatively affected by regulatory changes (automobile, residential construction) and the tourism sector continues to slow down.
- Some improvement is expected from mid-2020 on, conditioned on the easing of uncertainty and the recovery in the Eurozone.
- Spain will continue to grow above the average of the Eurozone, but structural reforms are key to reduce unemployment and increase potential growth.
- The balance of risks is tilted to the downside, despite lower external risks (global trade and Brexit).

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