

# Economic Watch

## Eurozone

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Economic Analysis

### Europe

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## Stable growth and inflation throughout the eurozone in 1Q14

The activity data available indicate that growth in the eurozone as a whole, including the periphery, remains stable or may have even strengthened slightly at the beginning of the year. In addition, growth is starting to be supported by the reactivation of domestic demand, while exports appear to be continuing to increase at a robust rate and are key for the recovery in investment. Inflation surprised to the upside in February, remaining stable at 0.8% YoY. Discounting a slight deceleration in March due to base effects, the disinflationary process is likely to run its course in 1Q14 and give way to relatively stable inflation in the coming months, although we still view the level as too low. Given this scenario, the ECB continues to expect a moderate recovery with stable inflation in the coming quarters (in line with our forecast), and this led it to maintain the tone of its monetary policy, with no additional standard measures (see our [ECB Watch](#)). The risks continue to be tilted to the downside, partly due to the continued strength of the euro derived from the monetary authority's stance.

## Eurozone: the economy will grow around 0.4% QoQ and the disinflationary process will run out of steam

- **Confidence indicators were again better in February in all sectors**

The European Commission's Economic Sentiment Index (ESI), was practically unchanged in February after the significant improvement it had been showing since mid-2013. It remains above its historical average so far this year, underpinned by better expectations in both the industrial and services sectors, which offset the deterioration in consumer confidence. Similarly, the composite PMI also improved again in February, this time driven by services, and indicates that the downturn at the end of last year was transitory, with the index remaining firmly in expansive terrain. In short, both surveys suggest that the eurozone economy may already be growing around its potential of approximately 0.4% QoQ in 1Q14. Furthermore, the subcomponents in both indicators suggest that improved activity is still benefiting from foreign orders (despite the strength of the euro), while the support from internal demand is gaining ground.

- **January activity data gave mixed signals, revealing a slightly more moderate scenario**

The (scanty) activity data available for January were a mixed bag and point to a slightly more moderate economic performance than the confidence indicators suggested at the beginning of the year. Retail sales surprised to the upside, with significant increases (1.6% MoM, 1% higher than 4Q13 after contracting 0.5% QoQ), in line with the improvement in consumer confidence over the last few months, supported by a more stable labour market (an unemployment rate of around 12% in the last year) and the moderation in inflation. This data suggests that household consumption should continue to show a degree of resilience in 1Q14.

There was a surprise to the downside with the mild decline in January's industrial production (-0.2% MoM, 0.1% over 3Q14 after rising 0.4% QoQ), pointing to a degree of moderation in industrial activity. Export data for January are not yet available, but the surveys indicate that the big increase in orders, including those coming from abroad, may have slowed at the start of the year (world growth is still strong despite a slight slowdown in February - see [BBVA-GAIN Flash](#) -, so it is likely that the strong euro is causing this behaviour), which could put a brake on sector growth and possibly result in a more moderate uptick in investment than we saw at the end of 2013.

- **The MICA-BBVA model forecasts higher growth in 1Q14 (+0.4% QoQ)**

When we input the data available to date (there are only hard data up to January), our short-term forecast model estimates growth of around 0.4% QoQ in 1Q14 (after 0.3% QoQ in 4Q13). Even so, we feel comfortable with our 1Q14 growth estimate of 0.2% QoQ, since the relative optimism of the confidence data has yet to be reflected in activity data, which have not yet really taken off.

- **Inflation is stable in February, while we still expect the disinflation process to come to an end in April**

The rise in services and non-energy industrial goods inflation in February offset the fall in energy prices, so headline inflation stayed at 0.8% YoY in February while core inflation should have gone up slightly after the 1% YoY increase in January. Nevertheless, we expect inflation to fall a little in March (around 0.1pp) because of the calendar effect of the Easter holidays, although partly offset by a slightly easier energy prices. In the next few months, we expect inflation to increase by around 0.3pp to about 0.9% YoY in 2Q14, and remain relatively stable until the final quarter of this year, when it could return to levels above 1% YoY.

Therefore the surprise to the upside in February offset in part the surprises to the downside of previous months, since core inflation was more resilient than expected. This could help to dispel fears about the intensity and nature of the disinflationary process and its possible negative effect on inflationary expectations. We still think it unlikely that disinflation will continue beyond March, and that a scenario of low and stable inflation rates around 0.9% YoY is more likely, given that internal demand recovery is taking hold. These are the values we have seen for inflation, excluding the impact of higher taxes on prices since 2Q13. Nevertheless, we continue to see downside risks, particularly derived from euro strength, while differences between countries will continue, with very low rates of inflation in the periphery and moderate rates in central European countries.

## Germany: the figures point to solid and more balanced growth

- **Retail sales and industrial production jump in January and confidence indicators remain optimistic about the coming months**

Retail sales increased significantly in January, consistent with the improvement in consumer confidence indicators, as did industrial production, which surprised to the upside, even discounting the construction sector, showing more growth at the start of the year (1.1% up on 4Q13, after 0.6% QoQ). These figures, together with forward indicators for February, point to this improvement continuing in the next few months, with private consumption and investment making a positive contribution to GDP growth.

As regards the PMI subcomponents, note the strong orders from abroad; together with balance of trade data to January, these indicate that net exports will continue supporting growth at the beginning of the year, although we expect a more moderate contribution (1.1pp in 4Q13) as a result of greater import momentum.

## France: real data are consistent with moderate growth, but confidence is slow in returning

- **Confidence and output indicators continue to contradict one another at the start of the year**

Based on January data, manufacturing production is growing timidly and retail sales are beating the 4Q13 average by 1.2%; this contrasts with the confidence indexes: the PMIs remained pessimistic at the beginning of the year, whereas the improving trend of the INSEE business-owners confidence index, that of the Bank of France and those of the EC, which were optimistic in 4Q13, has been interrupted, mainly due to weakness in services. The disappointing behaviour of the confidence indexes vs. hard data, as well as their decoupling from the same, was already visible in the latter part of last year, although the lack of confidence (linked not only to economic data but also to economic policy measures) could end up hampering economic activity in coming quarters, although the Bank of France is forecasting slight growth for 1Q14 (0.2% QoQ).

## Italy: recovery strengthens at the start of the year

- **Confidence indicators continue to improve in all sectors and begin to show in the real data**

The composite PMI has risen nearly five points since November, thanks to improved confidence, first in the manufacturing sector and, in February, to growth in services, backed up by activity data: after ten consecutive quarters of contraction, industrial production returned to growth in 4Q13 and the positive trend continued in January, remaining 0.6% above the average from 3Q13; retail sales, with data to December, continue to reflect the weakness of internal demand and recorded their seventh consecutive QoQ fall, although a much more moderate one. Even so, slight growth in GDP has been confirmed in 4Q13, mainly driven by investment and exports, after the stagnation in the previous quarter.

## Spain: risks to the upside in 1Q14

- **Resilient exports hand in hand with a reactivation of private domestic demand**

In the first quarter, average improved industrial confidence and manufacturing PMIs for January-February, together with progress in the capital goods IPI and solid performance on the part of exports could be heralding new growth in investment in machinery and equipment. When it comes to foreign demand, expectations (industrial exports backlog) and expenditure (exports of goods and services by large corporations) suggest that the slowdown in 2H13 could be starting to reverse. On the other hand, the positive trend in non-resident tourism-related indicators seems to be decelerating after the strong increase in 2013 (2.6% vs. 2012).

Our MICA-BBVA model estimates GDP growth of around 0.4% QoQ. The improvement in output and employment (social security affiliations have had a six-month run of consecutive increases to February, seasonally adjusted) is supported by the reductions in financial tensions and fiscal consolidation, in a solid export sector and the positive impact of some reforms. These reforms continue to have a positive impact on improved domestic demand (private, especially) and justify that recovery will strengthen throughout 2014 and 2015. Although our forecast scenario for 2014 (0.9%) has remained relatively unchanged for a year, the data indicate that the recovery in domestic demand and employment is somewhat more robust than we expected at the time. As a result, and for the first time since the crisis began, there are upside risks to our growth forecasts (see [Spain Economic Watch](#)).

Eurozone

National Accounts: 0.3% QoQ growth in 4Q13

Growth was underpinned by exports and investment. Our MICA-BBVA model forecasts growth of 0.4% QoQ in 1Q14, tilting our scenario slightly to the upside.

Chart 1  
GDP (%QoQ) and contribution by components (pp)\*

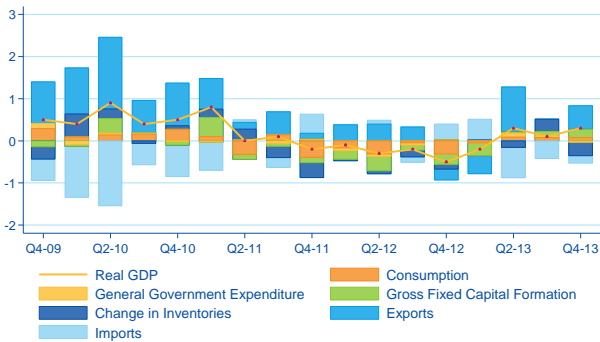
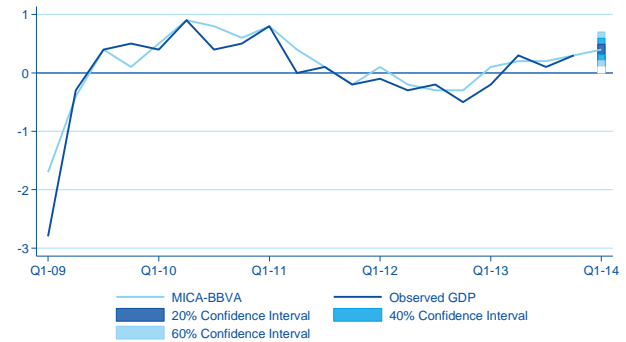


Chart 2  
GDP growth (%QoQ) and MICA-BBVA forecast\*\*



Confidence: growth could gain more vigour in 1Q14

ESI, the EC confidence indicator, continued to improve in all sectors in February, while the PMIs maintain their pace of expansion, outperforming expectations. This data confirms that the eurozone's recovery could be gathering momentum, and as always led by Germany.

Chart 3  
PMI and GDP growth (%QoQ)\*

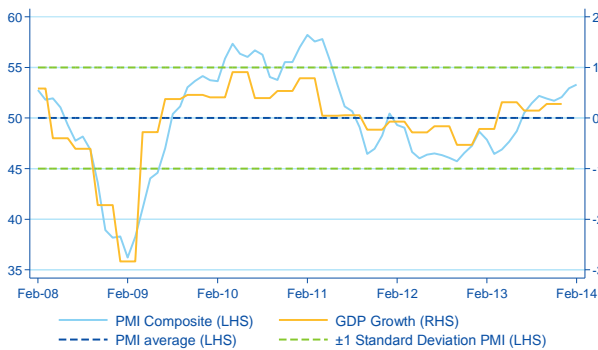
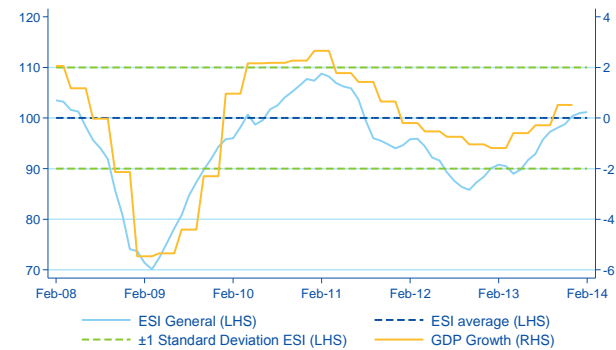


Chart 4  
Confidence (ESI) and GDP growth (%YoY) \*\*



Activity: retail sales increase again in January, but the industry is stagnant

Retail sales, after closing 4Q13 with a contraction of 0.5% QoQ, increased considerably in January and fairly evenly across the member states. Industrial production growth moderated over 4Q13.

Chart 5  
Industrial prod.(%YoY), manuf. new order and output PMI\*

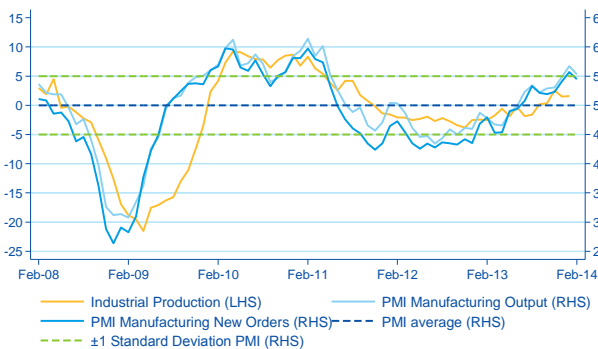
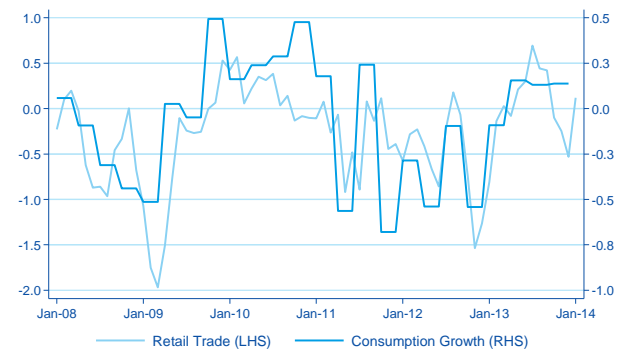


Chart 6  
Retail trade (% 3m/3m) and consumption growth (%QoQ)\*



\*Source: HAVER y BBVA Research

## Foreign sector: heavy fall in imports points to net exports contributing once again to growth

Exports fell again in December, with the average for the last quarter remaining unchanged from 3Q13, while imports dropped 1.8% over 3Q13, indicating that net exports may make a positive contribution in 4Q13

Chart 7  
**Current account (% of GDP)\***

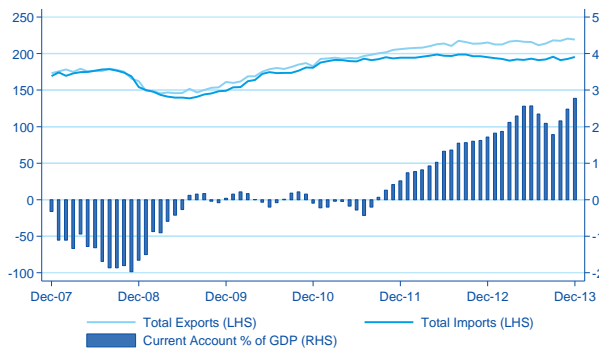
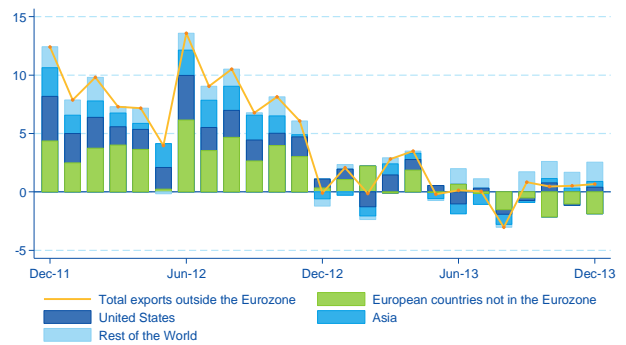


Chart 8  
**Exports by destination (contribution to %YoY)**



## Labour market: stable over the last year

Although we believe that a moderate recovery is underway, the unemployment rate is unlikely to drop in the short term due to the lag between output and employment, as well as the fact that idle capacity is still at high levels. As a consequence, wage costs are softening.

Chart 9  
**Unemployment rate (%) and employment expectations\***

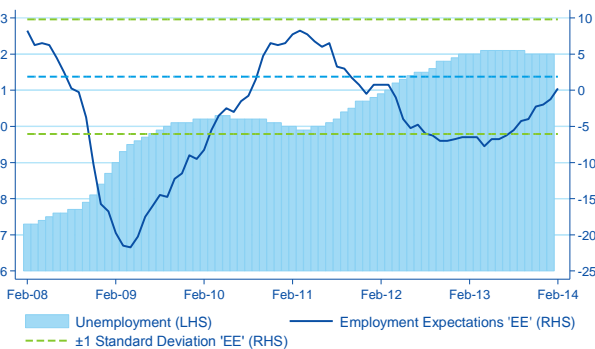
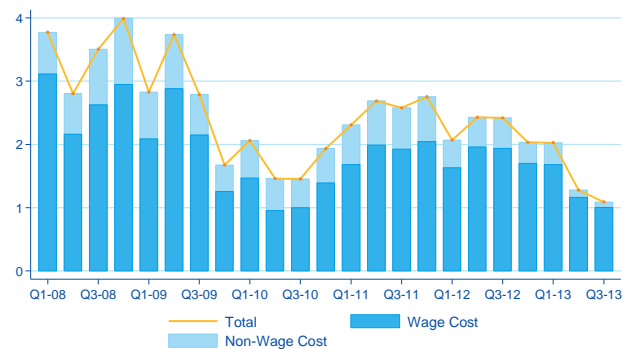


Chart 10  
**Labour cost in the business sector (%YoY)\***



## Prices: inflation surprised to the upside in February, by remaining stable

Flash headline inflation remained unchanged in February at 0.8% YoY. The main reason for this behaviour was the slowdown of inflation in non-energy industrial goods and the fall in energy prices.

Chart 11  
**Inflation rate, headline and core (%YoY)\***

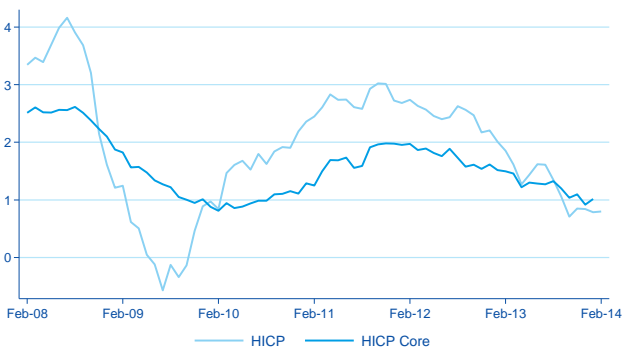
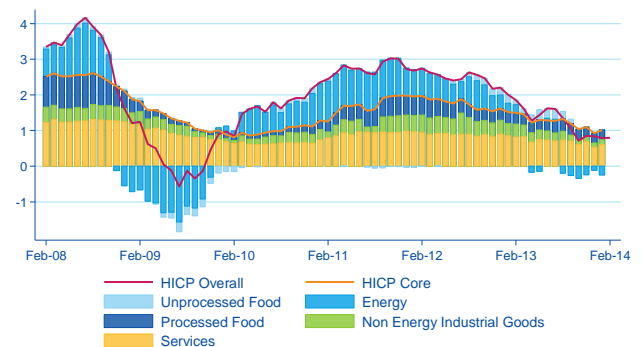


Chart 12  
**Inflation by components (contribution in %)\***



\* Sources: HAVER & BBVA Research

## Germany

### National Accounts: net exports contributed positively to growth again, with a stable pace of recovery in investment

GDP growth went up in 4Q13 by 0.4% QoQ, thanks to the contribution of net exports (1.1pp after slipping -0.7pp in 3Q13) and of investment (+1.4% QoQ), which offset the strong negative contribution of inventories (-0.8pp).

Chart 13  
GDP (%QoQ) and contribution by components (pp)\*

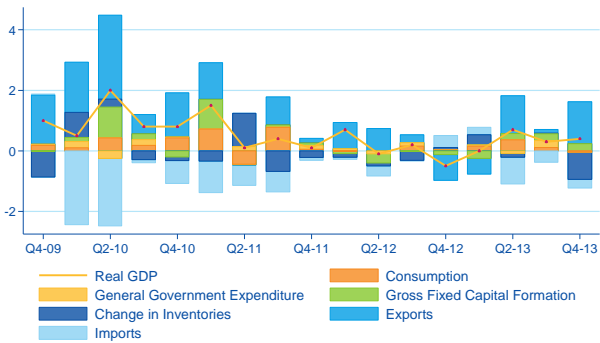
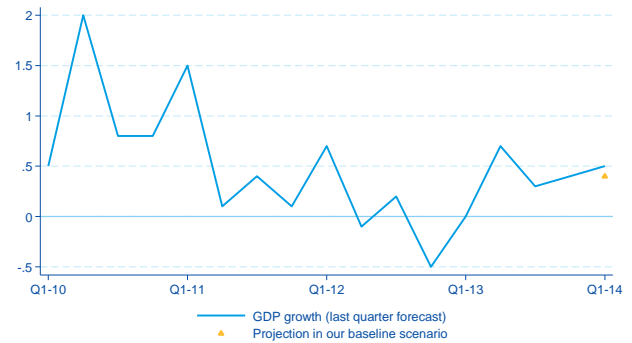


Chart 14  
GDP (%QoQ) and forecasts\*



### Confidence: confidence increased across the board in February

The strength of confidence was due above all to better expectations for the manufacturing sector. The composite PMI remained at levels well above the growth threshold in December and registered growth in both sectors in February.

Chart 15  
PMI and GDP growth (%QoQ)\*

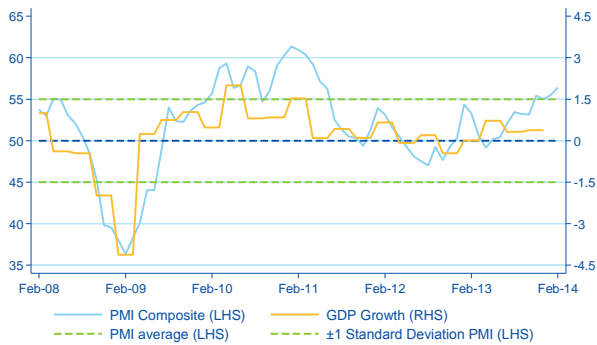
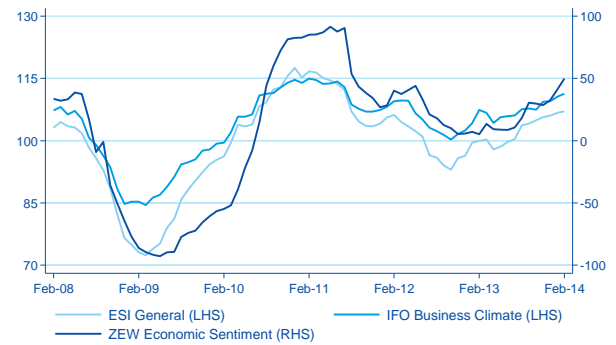


Chart 16  
Confidence indicator (ESI, Ifo and ZEW)\*



### Activity: industrial production and retail sales improved

Retail sales had a strong uptick in January (+2.5% MoM) after falling for three quarters in a row, while industrial production maintained its positive bias, in line with the confidence indicators and the continued increase in industrial orders.

Chart 17  
Industrial prod. (%YoY) and manufacturing PMI\*

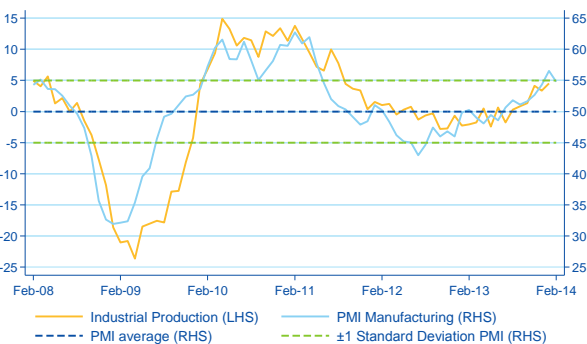
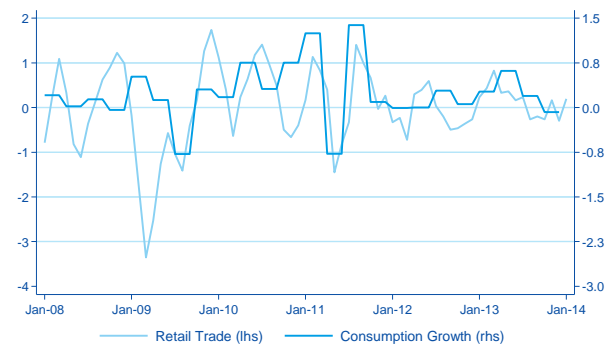


Chart 18  
Retail trade (% 3m/3m) and consumption growth (%QoQ)\*



\*Sources: HAVER y BBVA Research

## Foreign sector: exports maintain their positive bias of the last few months

Robust rise in exports in 4Q13 (+1.3% QoQ). Orders from foreign markets presage the trend will continue in upcoming months. In January both exports and imports went up strongly.

Chart 19  
Current account (% of GDP)\*

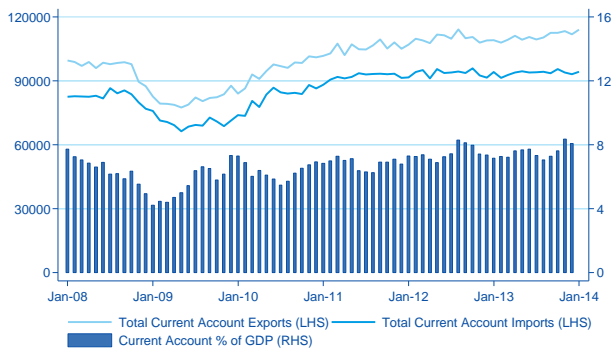
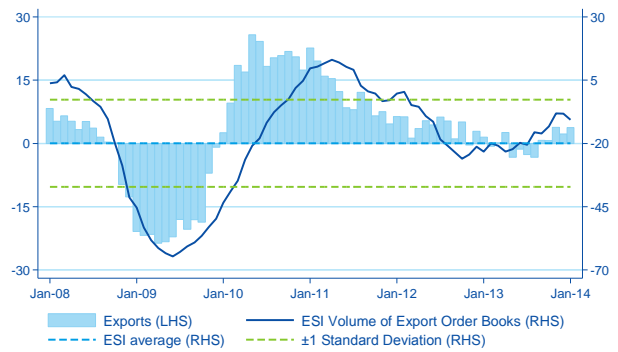


Chart 20  
Export growth (%YoY) and volume of export order books\*



## Labour market: the unemployment rate stays at all-time lows

The unemployment rate has fallen again to its historic low (5.0%) in January. This could give rise to upward pressures on wages in the next few months, as has already been reflected in the 0.9% QoQ increase in labour costs in 4Q13.

Chart 21  
Unemployment rate (%) and employment expectations\*

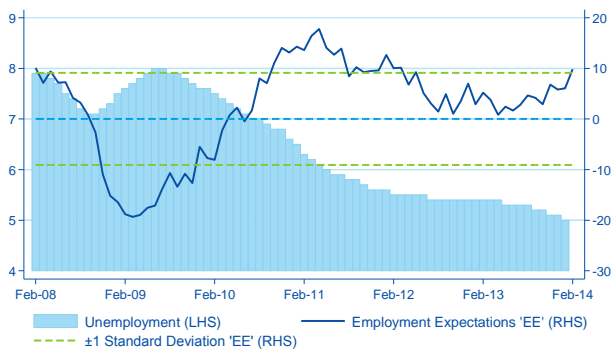
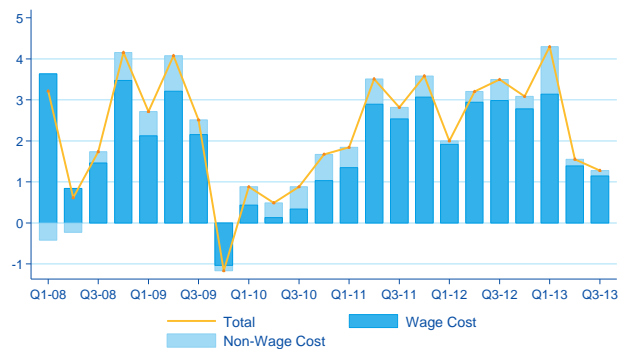


Chart 22  
Labour cost in the business sector (%YoY)\*



## Prices: inflation slows again in February

Harmonised inflation has dropped another 2 decimal points to 1% YoY in February (flash), mainly because of the fall in energy prices

Chart 23  
Inflation rate, headline and core (%YoY)\*

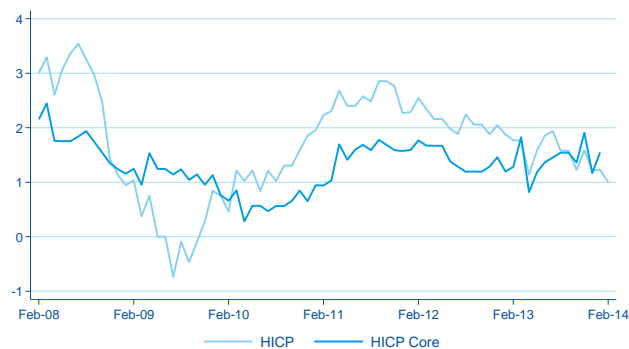
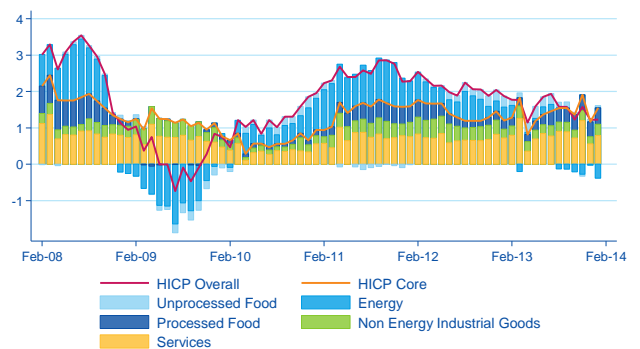


Chart 24  
Inflation by components (contribution in %)\*



\* Sources: HAVER y BBVA Research



## France

### National accounts: domestic demand is supporting growth

GDP expanded 0.3% QoQ in 4Q13, after the stagnation seen in 3Q13, due to the recovery of net exports and improved private consumption (0.5%) and investment (0.6% QoQ).

Chart 25  
GDP (%QoQ) and contribution by components (pp)\*

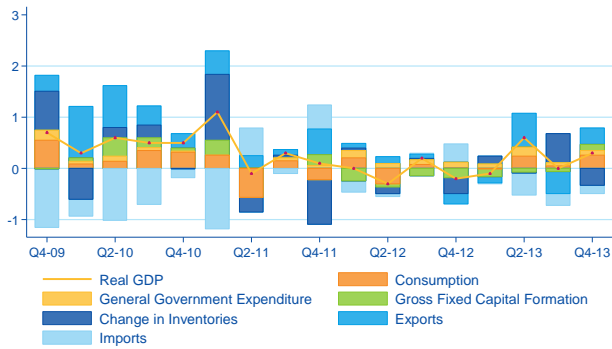


Chart 26  
GDP (%QoQ) and forecasts\*



### Confidence: increasing fears about the sustainability of the recovery

PMIs remained in negative terrain in February, far from the threshold 50, confirming weakness in all productive sectors, although without a quantitative symmetry. The INSEE and BdF Confidence indicators, as well as those of the EC, remain virtually unchanged.

Chart 27  
PMI and GDP growth (%QoQ)\*

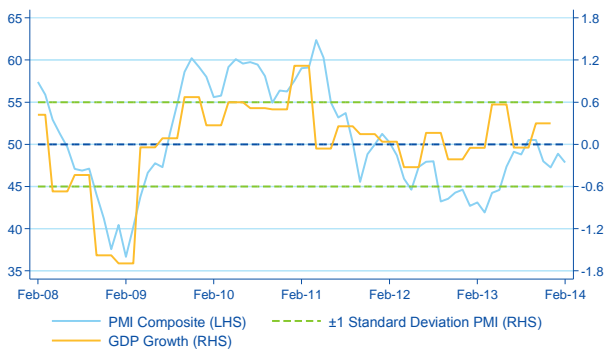
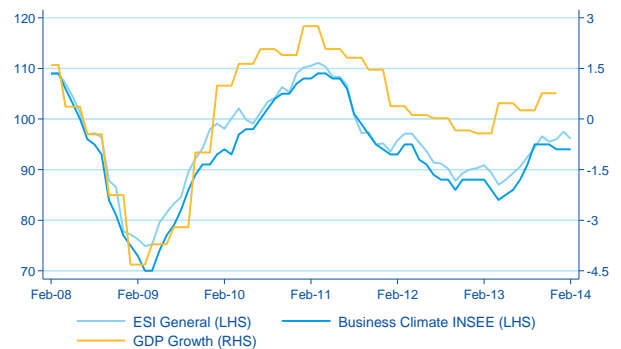


Chart 28  
Confidence indicator (ESI and INSEE)\*



### Activity: industrial production improves, retail trade remains weak

Retail sales bounced up in January, after falling by 0.4% in 4Q13 vs. 3Q13, and industrial production declined slightly, although the improving trend in manufacturing seen since October continued, after having fallen 1.4% QoQ in 3Q13.

Chart 29  
Industrial prod. (%YoY) and manufacturing PMI\*

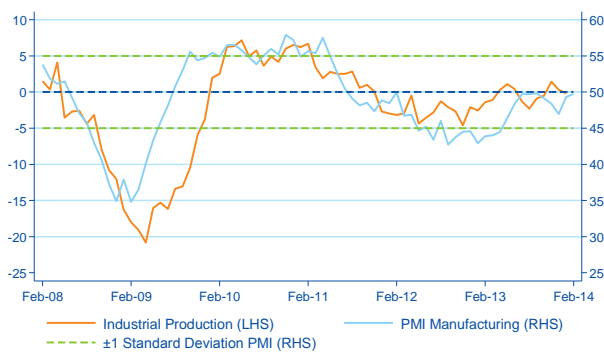


Chart 30  
Retail trade (% 3m/3m) and consumption growth (%QoQ)\*



\*Sources: HAVER y BBVA Research

## Foreign sector: exports continue to fall at the beginning of 2014

After slipping -0.3% in 4Q13, exports fell again in January, keeping the impact of net exports on growth negative.

Chart 31  
Current account (% of GDP)\*

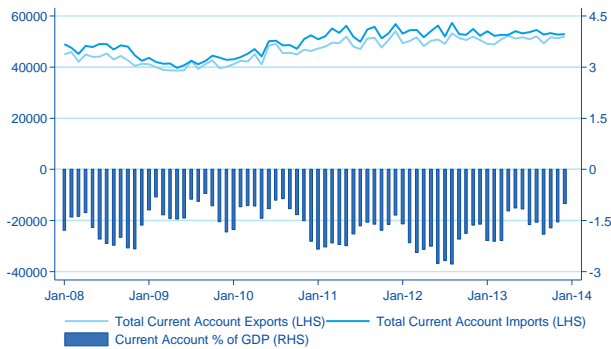
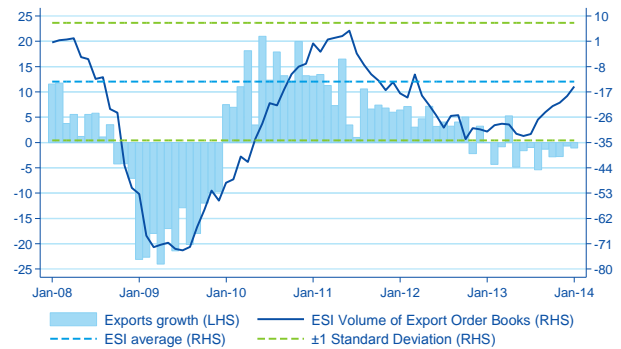


Chart 32  
Export growth (%YoY) and volume of export order books\*



## Labour market: a degree of stabilisation in the last few months

The unemployment rate stabilised at around 11% last year after having risen approximately 0.2pp per quarter over the course of the year before. Labour costs declined considerably in the first half of the year as a result of the drop in non-wage costs.

Chart 33  
Unemployment rate (%) and employment expectations\*

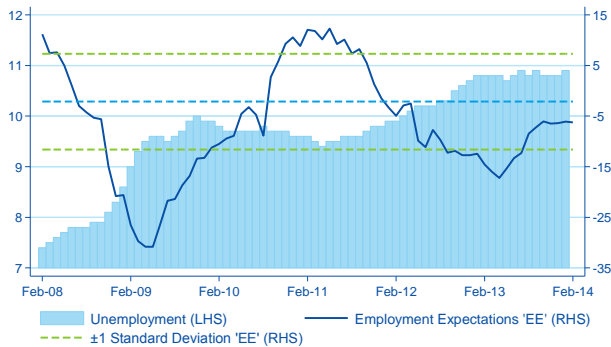
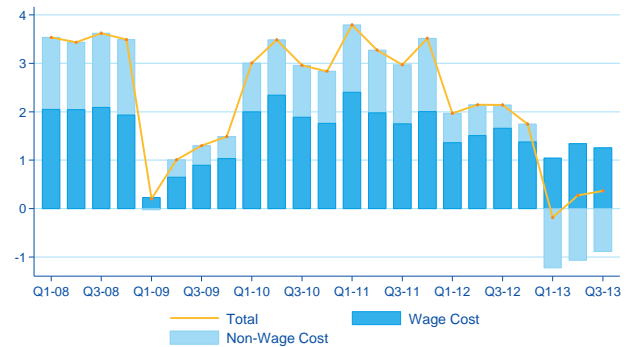


Chart 34  
Labour cost in business sector (%YoY)\*



## Prices: inflation creeps back over 1% YoY in February

Harmonised inflation increased to 1.1% YoY in February, mainly because of increased prices for services. Core inflation also went up to 0.7% YoY.

Chart 35  
Inflation rate, headline and core (%YoY)\*

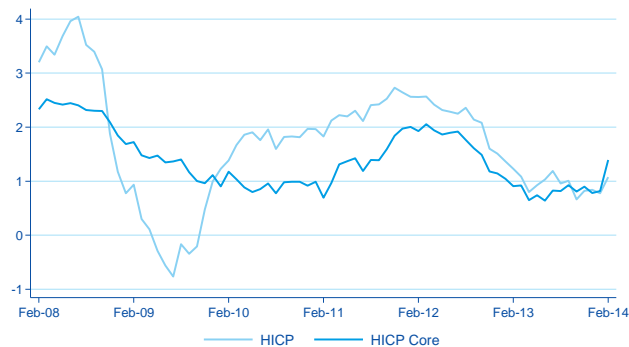
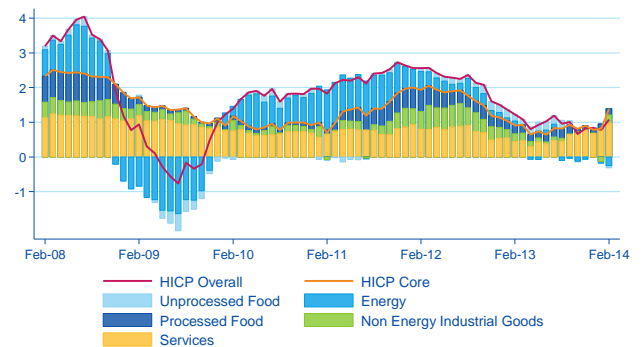


Chart 36  
Inflation by components (contribution in %)\*



\* Sources: HAVER y BBVA Research

## Italy

### National accounts: slowly coming out of recession

GDP went up in 4Q13; external demand has continued supporting growth (0.3pp) while internal demand has been less of a drain on growth, mainly thanks to the improvement in the investment component (+0.9% QoQ).

Chart 37  
GDP (%QoQ) and contribution by components (pp)\*

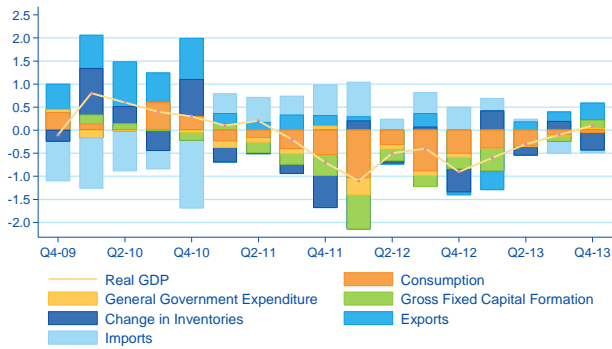
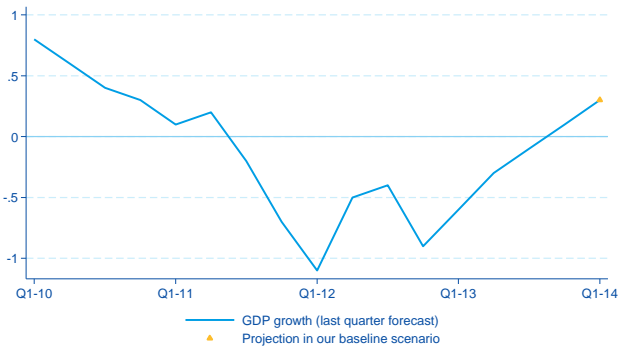


Chart 38  
GDP (%QoQ) and forecasts\*



### Confidence: stabilising in recent months

The composite PMI data improved in January, reaching expansive terrain, thanks to more favourable expectation in the industrial sector, while it remains somewhat weaker in the services sector: there was a sharp improvement in national business's confidence indicators and those of the EC in February.

Chart 39  
PMI and GDP growth (%QoQ)\*

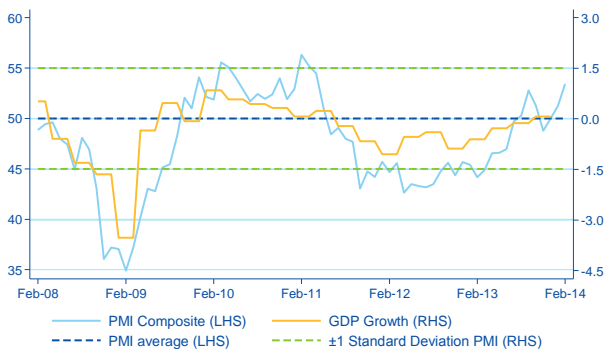
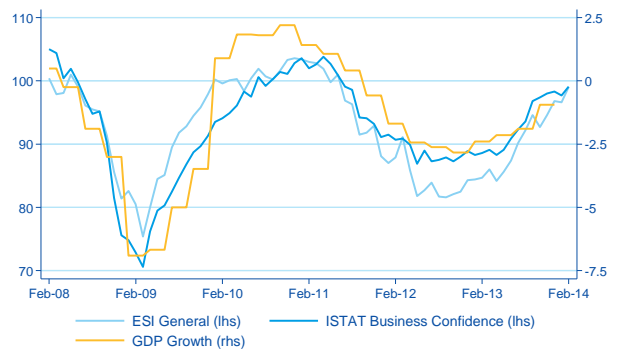


Chart 40  
Confidence indicator (ESI and ISTAT)\*



### Output: positive bias for the industrial sector

Industrial production has again increased in January, after recording a rise of 0.7% over the average for 3Q13; meanwhile, the seventh consecutive quarter of retails sales contraction confirms the weakness of domestic demand.

Chart 41  
Industrial prod. (%YoY) and manufacturing PMI\*

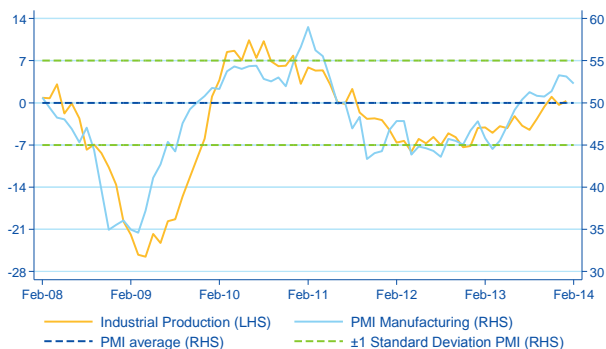
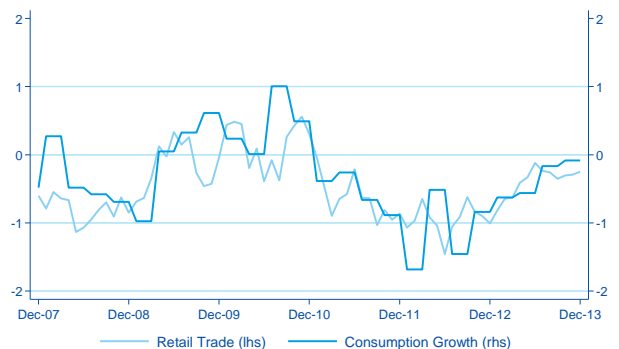


Chart 42  
Retail trade (% 3m/3m) and consumption growth (%QoQ)\*



\*Sources: HAVER y BBVA Research

## Foreign sector: net exports are the main growth factor in the short term

The latest export order volume data (December) confirm that they grew again in 4Q13 (0.9% QoQ), after the gains in 3Q13 (+0.7% QoQ)

Chart 43  
Current account (% of GDP)\*

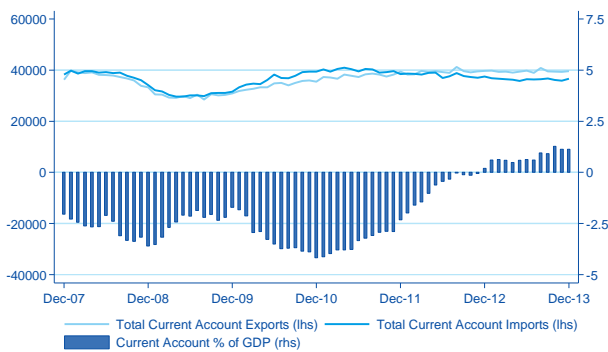
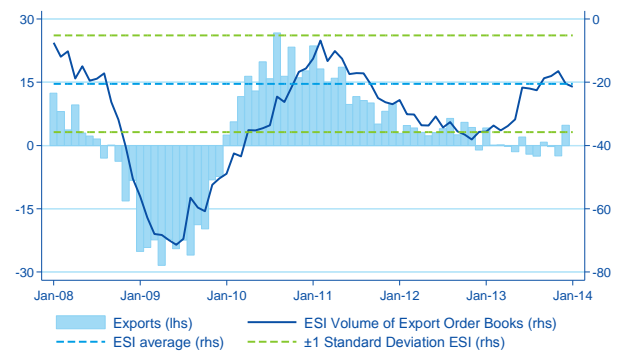


Chart 44  
Export growth (%YoY) and volume of export order books\*



## Labour market: unemployment continues to rise, with labour costs softening

The unemployment rate continues at very high levels, the worst figure ever, 1.1pp up on a year ago, and employment outlooks worsen. Labour costs still increased at a fast pace in 3Q13.

Chart 45  
Unemployment rate (%) and employment expectations\*

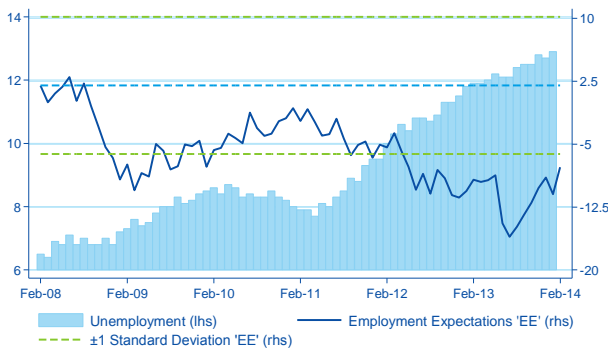
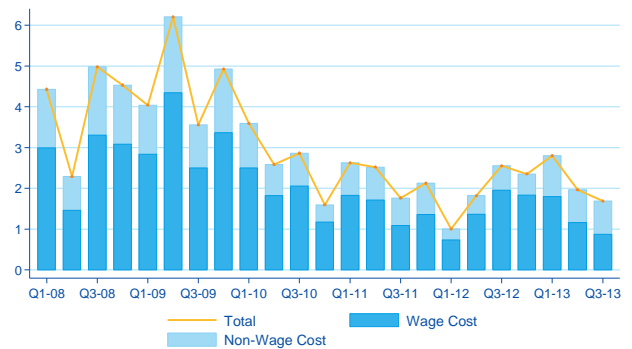


Chart 46  
Labour cost in business sector (%YoY)\*



## Prices: inflation slows again to 0.4% in February

Inflation slowed rapidly from the middle of last year, but stayed steady at 0.7% YoY in 4Q13 due to the fall in energy prices and slower growth in service prices, with continued moderation in February.

Chart 47  
Inflation rate, headline and core (%YoY)\*

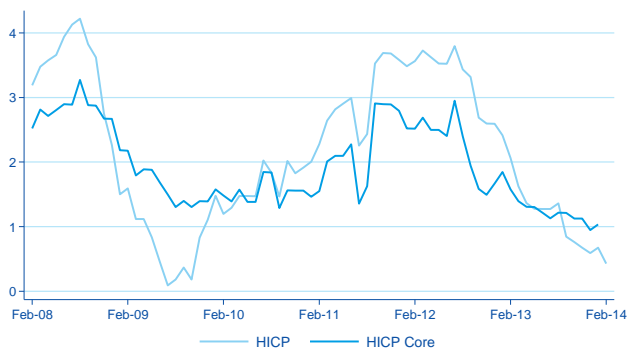
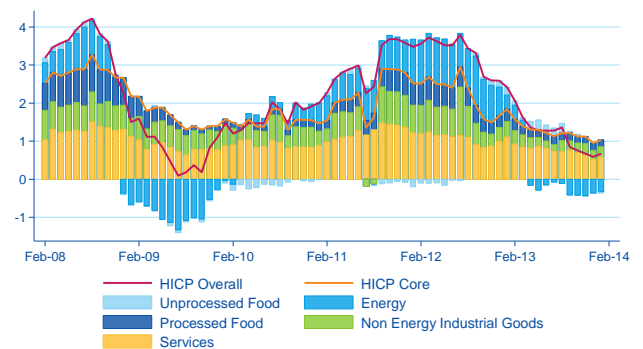


Chart 48  
Inflation by components (contribution in %)\*



\* Sources: HAVER y BBVA Research

## Spain

### National accounts: exports hold firm and private domestic demand starts to recover

The economy grew +0.2% QoQ in 4Q13. The improvement is thanks, above all, to solid exports and the recovery of private demand.

Chart 49  
GDP (%QoQ) and contribution by components (pp)\*

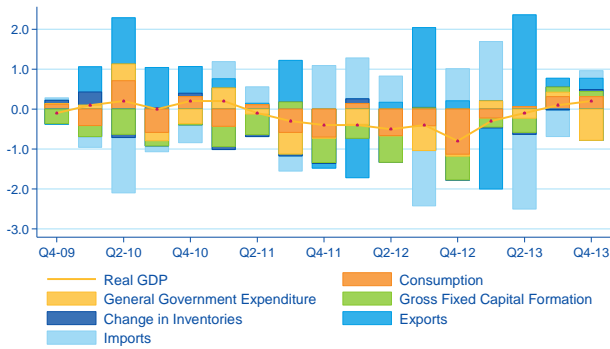
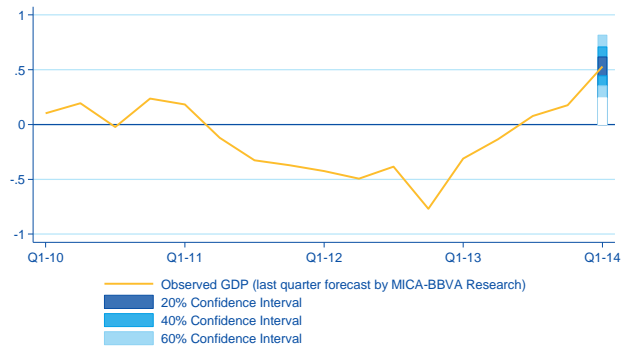


Chart 50  
GDP growth (%QoQ) and MICA-BBVA forecast\*



### Confidence: outlook improves

The ESI and PMI indexes fell slightly in February, but stayed at high levels, with PMIs well above the growth threshold in 1Q14, particularly in services.

Chart 51  
PMI and GDP growth (%QoQ)\*

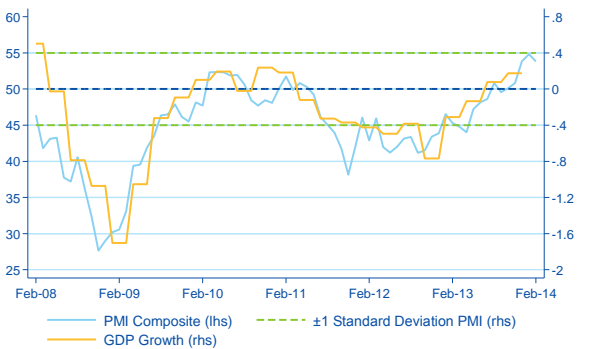
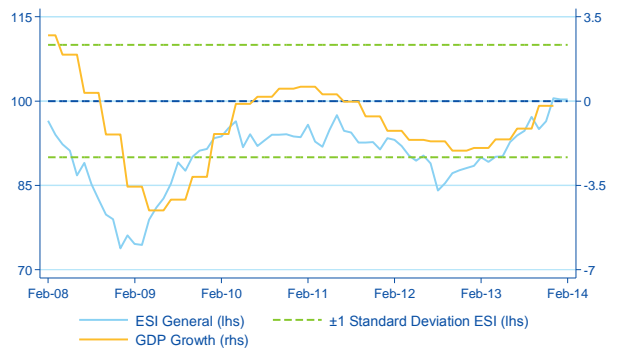


Chart 52  
Confidence (ESI) and GDP growth (%YoY) \*



### Activity: domestic demand recovery is still fragile

Some consumer expenditure indicators continued to show signs of stabilising, although the unfavourable variation in retail sales in October confirms that the recovery is still fragile.

Chart 53  
Industrial prod. (%YoY) and manufacturing PMI\*

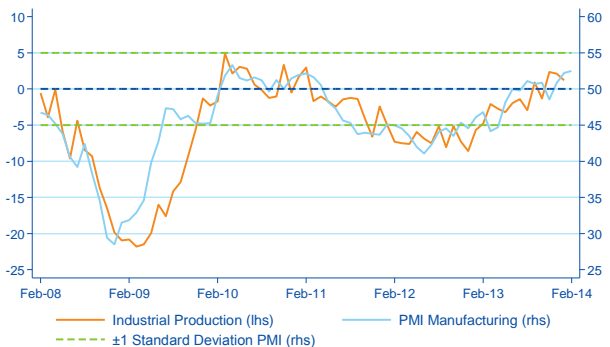
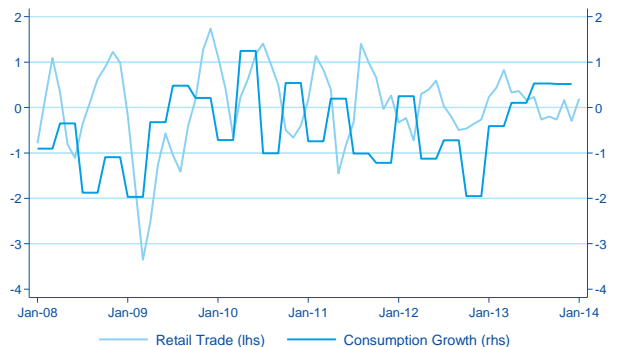


Chart 54  
Retail trade (% 3m/3m) and consumption growth (%QoQ)\*



\*Sources: HAVER y BBVA Research

## Foreign sector: exports lose some of their momentum in 4Q13

Corporate expectations (export orders) indicate that the slowdown of exports in the last few months has probably started to reverse at the beginning of 2014.

Chart 55  
**Current account (% of GDP)\***

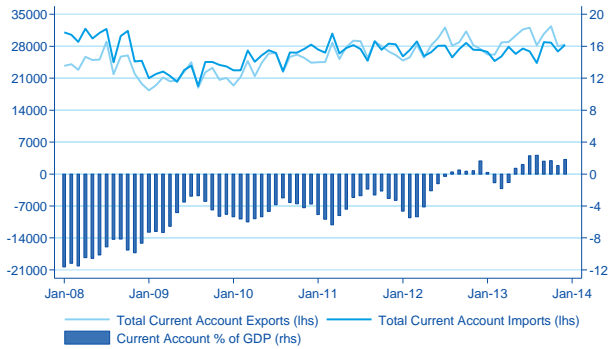
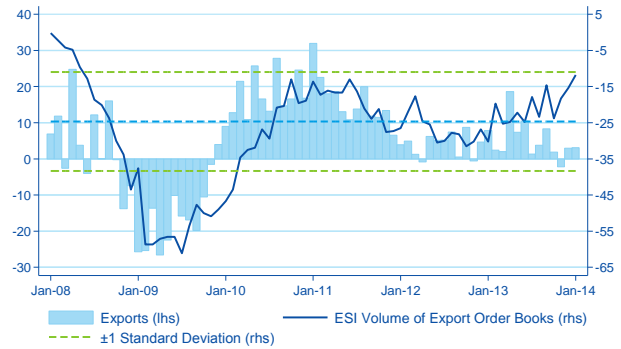


Chart 56  
**Export growth (%YoY) and volume of export order books\***



## Labour market: the positive signs continue

Social security affiliations have had a 6-month run of consecutive increases to February. Meanwhile, registered unemployment has clocked up ten consecutive months of falls which, if confirmed in March, would give rise to the third quarterly reduction in registered unemployment.

Chart 57  
**Unemployment rate (%) and employment expectations\***

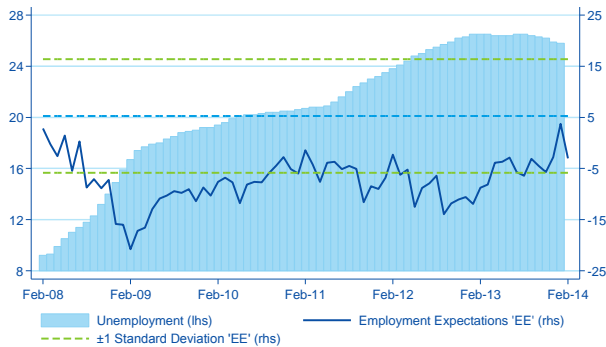
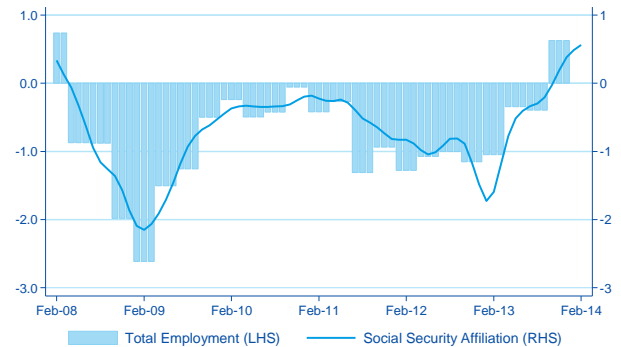


Chart 58  
**Employment growth: N.A. and social security (% 3m/3m)\***



## Prices: inflation slows again

Headline inflation fell 0.3pp to 0.0% YoY in February due to easier energy prices. Core inflation slowed but is still in positive terrain (-0.1pp down, to 0.1% YoY)

Chart 59  
**Inflation rate, headline and core (%YoY)\***

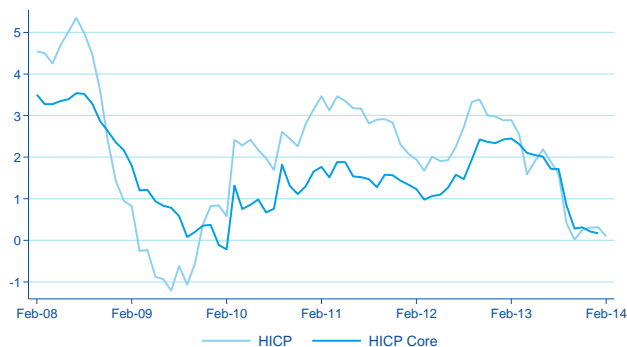
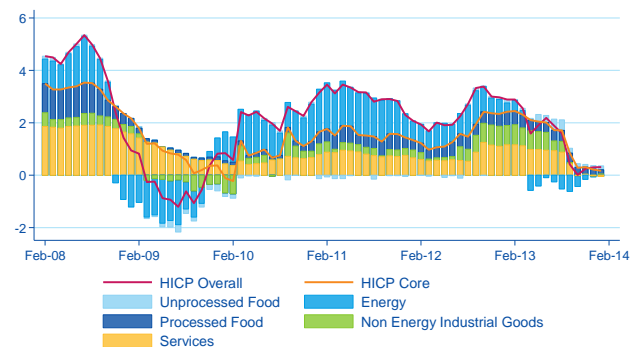


Chart 60  
**Inflation by components (contribution in %)\***



\* Sources: HAVER y BBVA Research

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