

BBVA

RESEARCH

October
2016



Eurozone

Economic Watch

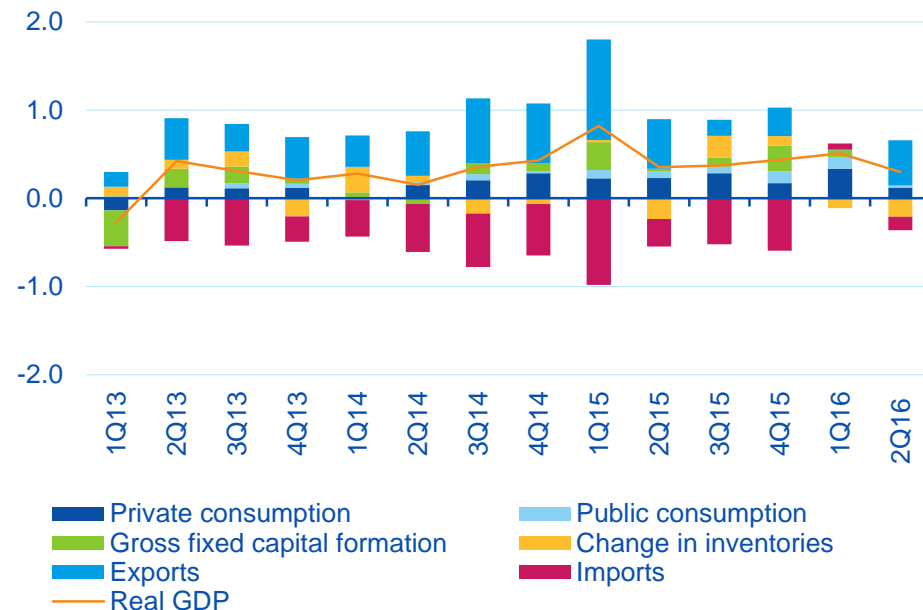
An improvement in the third quarter, with caution

- **Confidence data so far suggest some resilience of the Eurozone**, but the still weak global demand and the moderate euro appreciation so far this year could weigh on exports and the industrial sector.
- **Better-than-expected hard data in August offset July disappointing figures.** Retail sales continue to point to stronger private consumption. More importantly, the significant improvement in both industrial production and exports paint a more upbeat outlook for investment. Conversely, the dynamism of imports could prevent the positive contribution of net exports in 3Q16.
- Our **MICA-BBVA indicator estimates quarterly GDP growth in the eurozone to gain some momentum to +0.4% QoQ in 3Q16**, after growth of 0.3% in 2Q16.
- **Less negative energy inflation has pushed headline inflation up to positive rates in recent months, while core inflation remains subdued but stable.** Easing energy base effects from a year ago might increase inflation in coming months to rates slightly below 1% in December.
- The **ECB kept the monetary policy stance unchanged in September.** Despite recent favourable data, concerns on inflation remain. Before the year end, an extension of QE (+6 months) is very likely, combined with some technical adjustments to cope with the scarcity of German bonds.

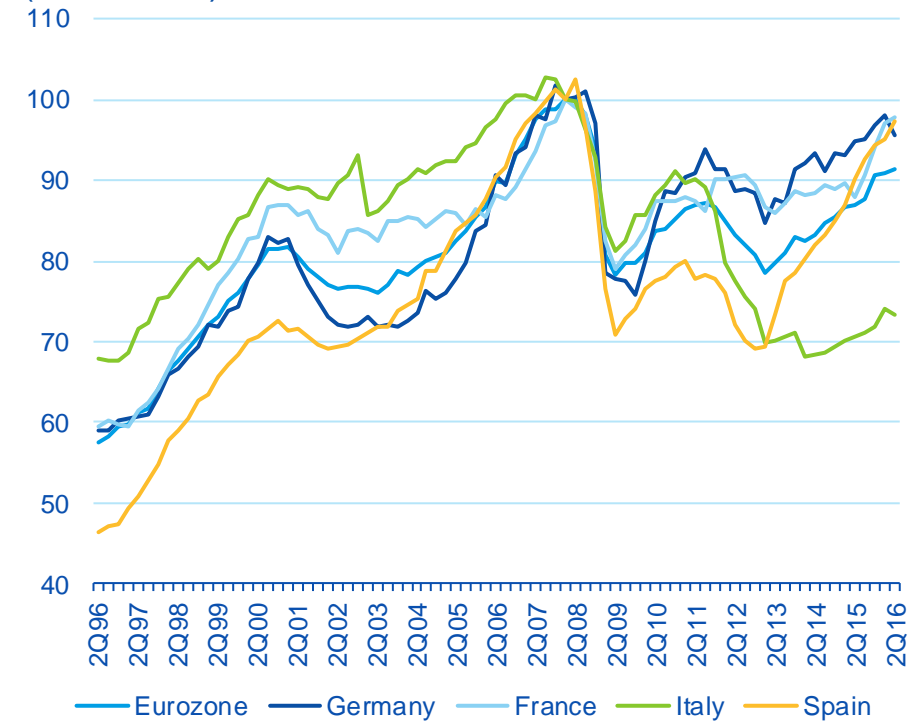
Uneven investment in 1H16 cast doubts on the pace of recovery, but investment in M&E remained solid

- During 2Q16 GDP growth reflected the lack of fixed investment and a poor contribution from both private and public consumption, that was only partially offset by a boost from external demand, particularly in Germany and Spain.
- Low growth in investment is the main concern, as the **accumulation of fixed capital weakened in 1H16**. Nonetheless and despite volatility, **machinery and equipment should remain as the main driver of investment growth this year**, coming mostly from periphery countries.

GDP (% QoQ), contribution by components (pp)

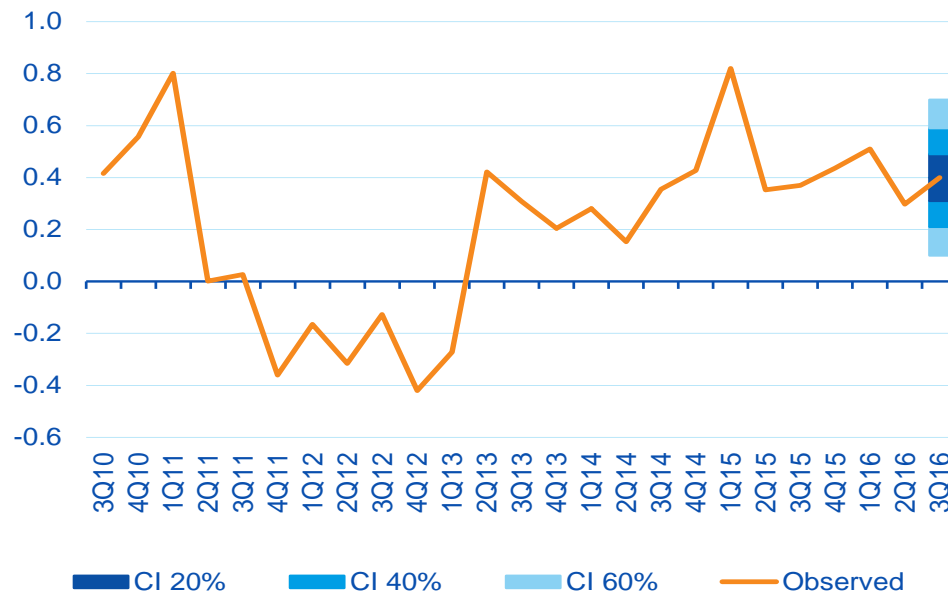


Investment in machinery & equipment by country (1Q08=100)



Economic momentum could improve in 3Q16

GDP and MICA forecasts (% QoQ)



Incoming data suggest a slight acceleration in GDP growth in 3Q16 (+0.4% QoQ after +0.3% in 2Q16)...

... supported by stronger private consumption...

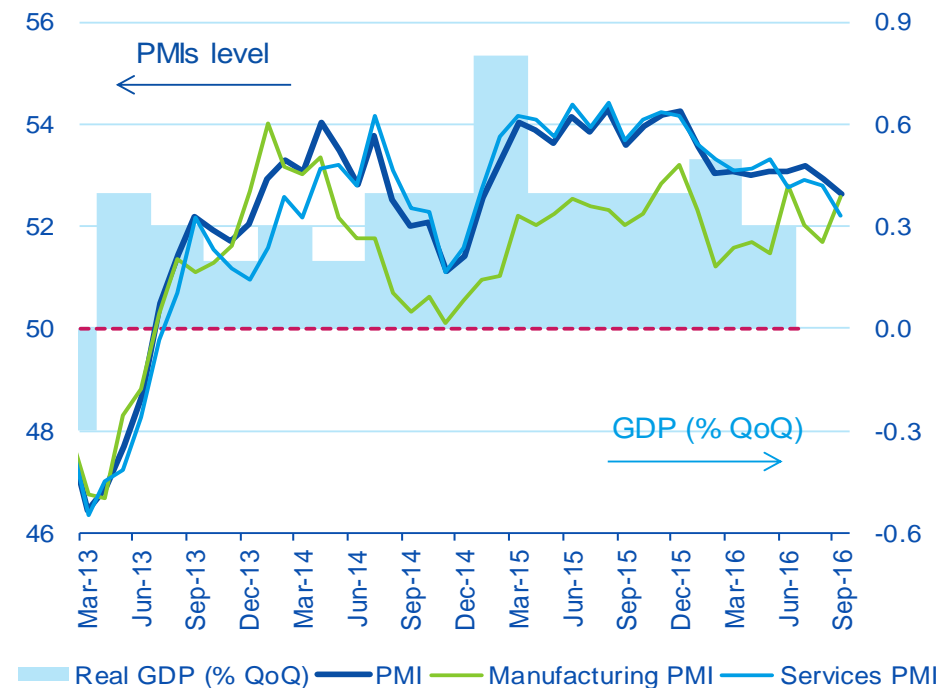
... and a mild rebound in investment that could be benefiting from increasing exports.

Source: Eurostat and BBVA Research

Mixed signals in confidence figures in 3Q16, but still resilient and in positive territory

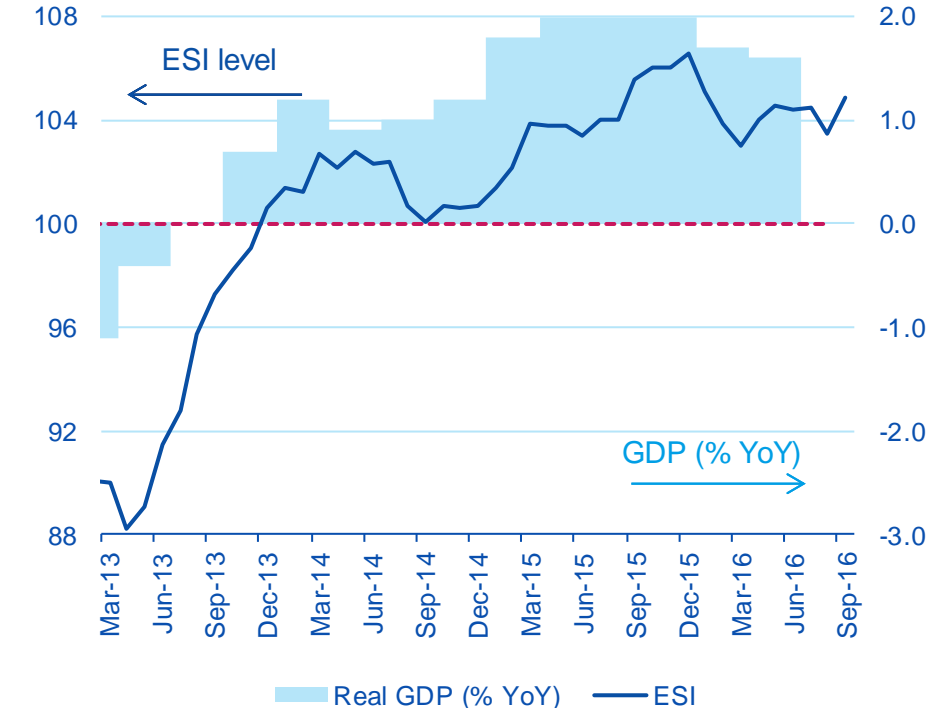
Although a rebound took place both in September's manufacture PMI and in ESI confidence, the mood reflected in services PMI in 3Q16 was less positive.

PMI and GDP (index, % QoQ)



Source: Eurostat and BBVA Research

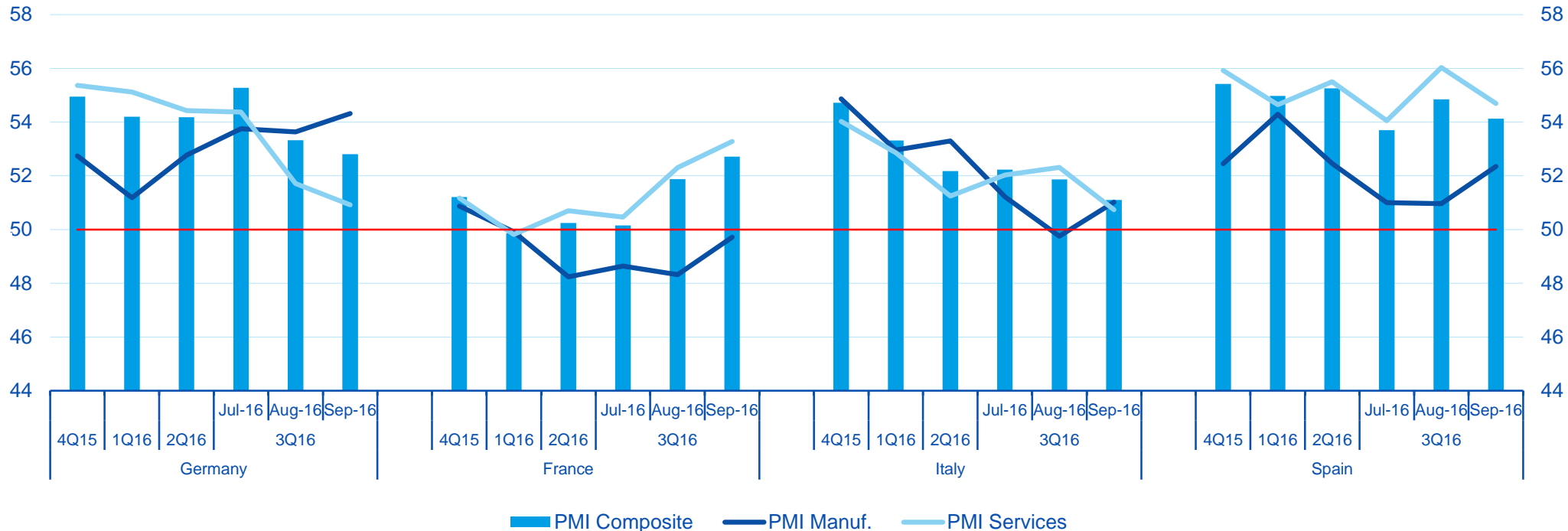
ESI and GDP (index, % YoY)



Source: Eurostat and BBVA Research

Manufacturing PMIs increased in all major countries in September, but services declined (except in France)

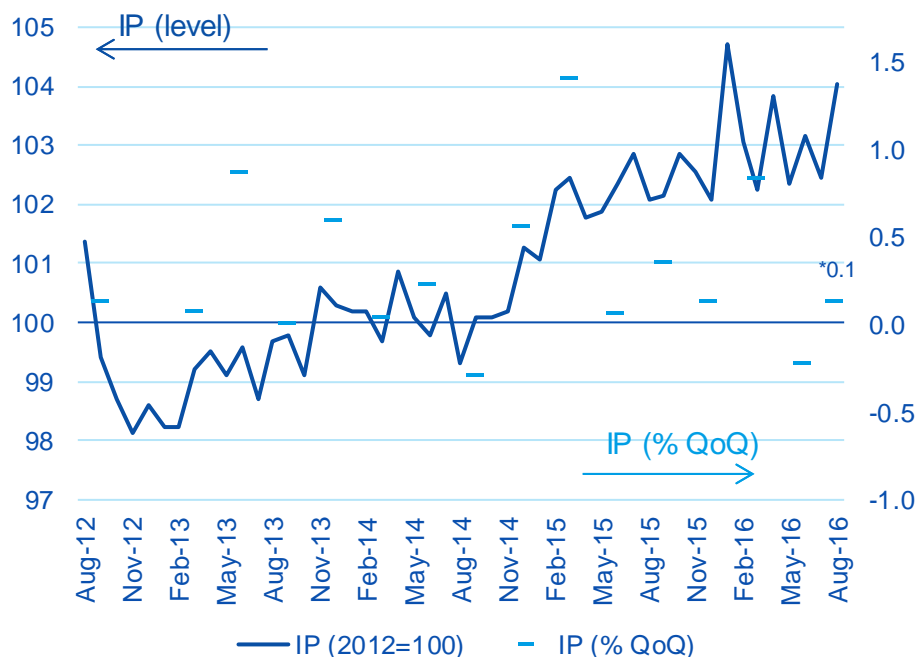
PMI (level)



Industrial output surged in August showing a mild recovery for 3Q16

- **Industrial production showed a 1.6% MoM expansion in August.** However, figures for the whole 3Q16 remain weak, with a meager increase of +0.1% QoQ so far after declining -0,2% QoQ in 2Q16.
- **Production of capital goods** also showed an increase in August and reduced concerns over the ongoing weak investment recovery.

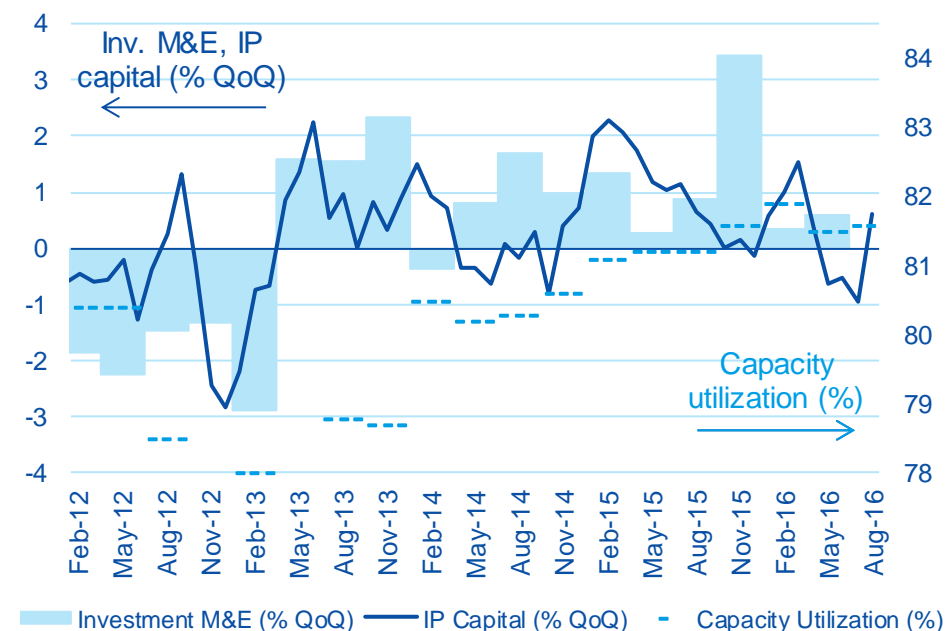
Industrial production (% QoQ)



* July and August with respect to three previous months

Source: Eurostat and BBVA Research

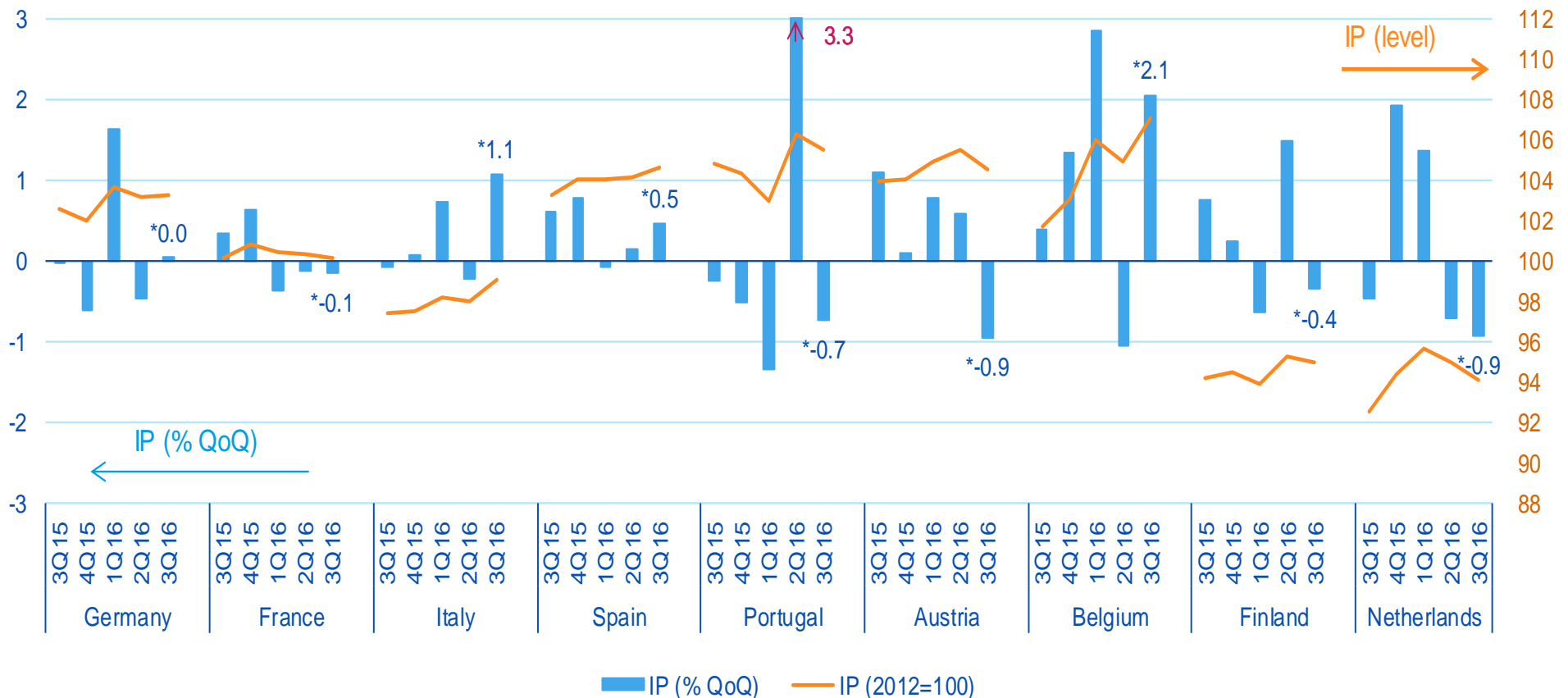
IP Capital (% QoQ), investment in machinery and equipment (% QoQ) and utilization capacity (%)



Source: Eurostat and BBVA Research

With heterogeneity across countries, industrial output growth remains subdued for 3Q16

Industrial production (% QoQ)



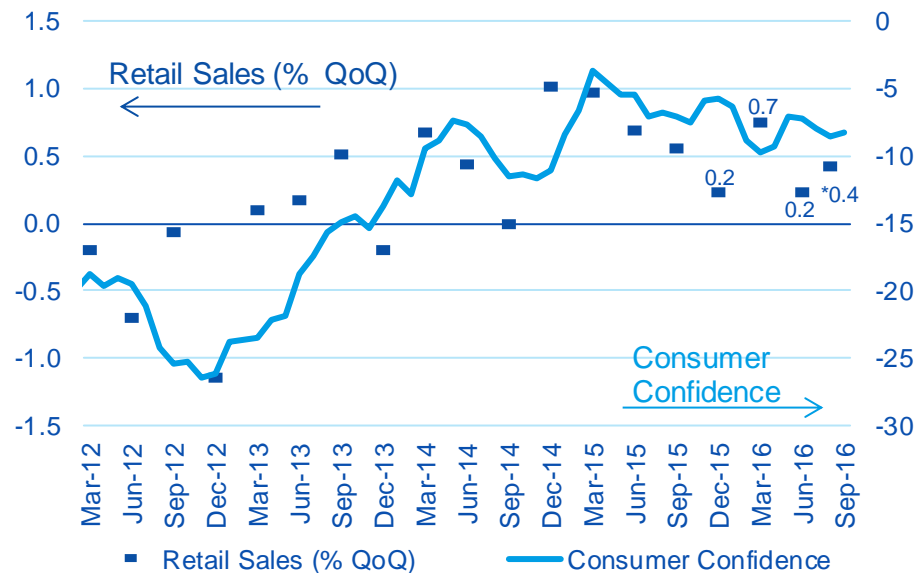
* 3Q16 calculated using July data for Austria and Belgium, and with July and August data for Germany, France, Italy, Spain, Portugal, the Netherlands and Finland

Source: Eurostat and BBVA Research

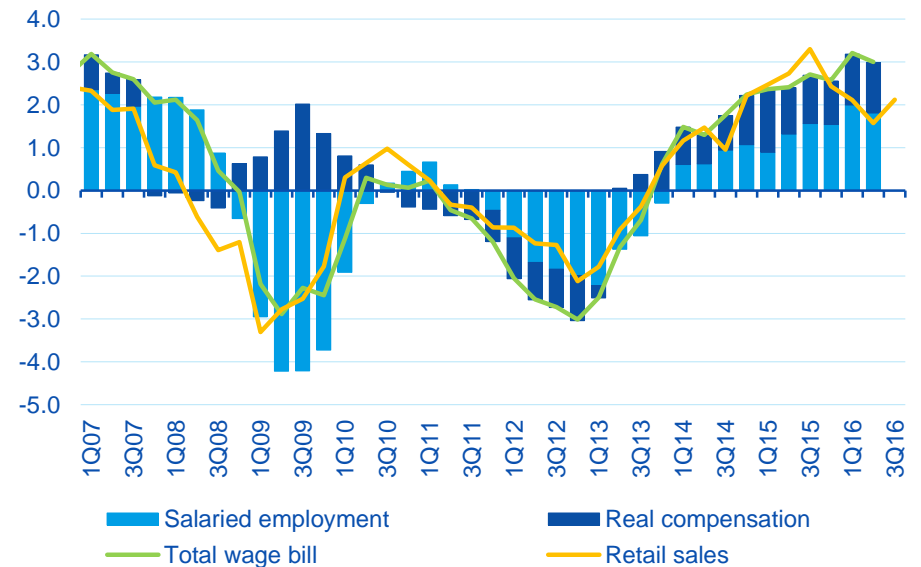
Retail sales stagnated in August but remained robust over 3Q16

Retail sales did not show any variation in August after a increase of +0.3% MoM in July, but continues to suggest a positive contribution to private consumption in 3Q16 (so far +0.4% QoQ).

Retail sales (% QoQ) and consumer confidence



Retail sales and total wage bill (% YoY)*



* July and August with respect to three previous months

Source: Eurostat and BBVA Research

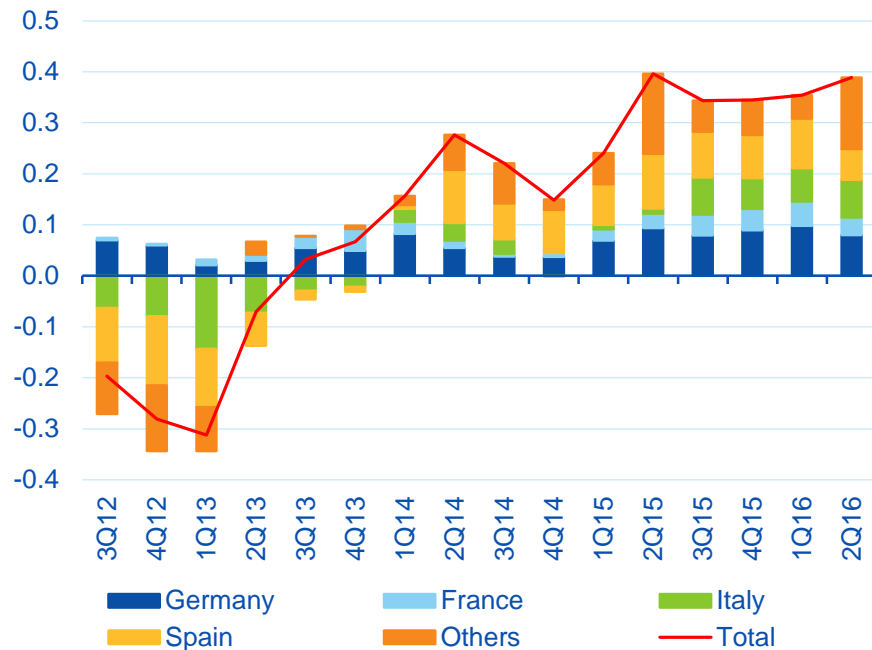
* 3Q16 calculated using data for July and August

Source: Eurostat and BBVA Research

Employment grew at steady pace over the past year

- Slightly lower employment growth contribution from core countries in 2Q16, but higher from the periphery.
- Despite a strong overall employment growth during last quarters, **composition** has recently **tilted to higher self-employment**.

Job growth contribution by country (pp, % QoQ)



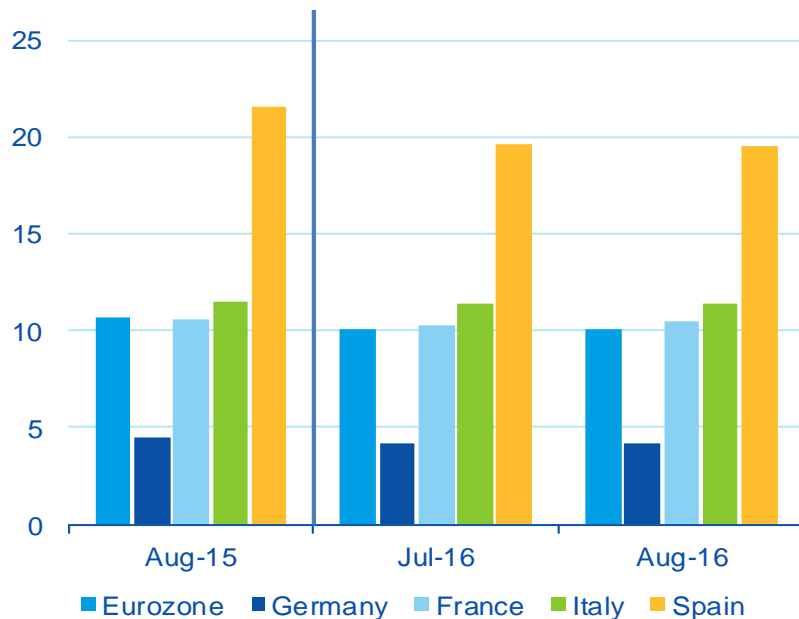
Job growth contribution by category (pp, % QoQ)



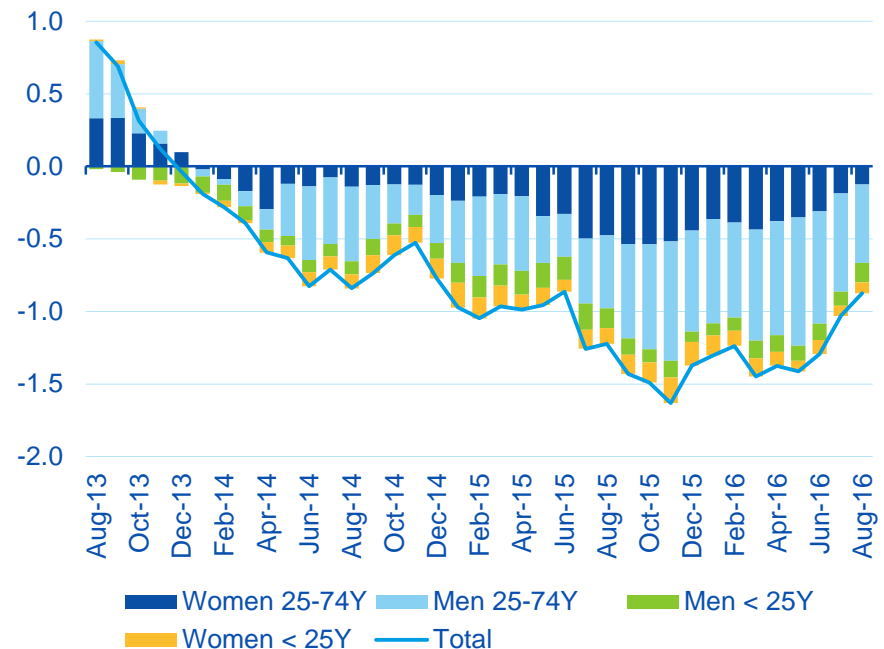
Unemployment rate has stabilized in recent months

Although the **jobless rate continues to fall at a low pace**, driven mostly by Spain, a **slower decline in unemployed was observed in August among the experienced population**, mainly for women.

Unemployment rate by country (%)

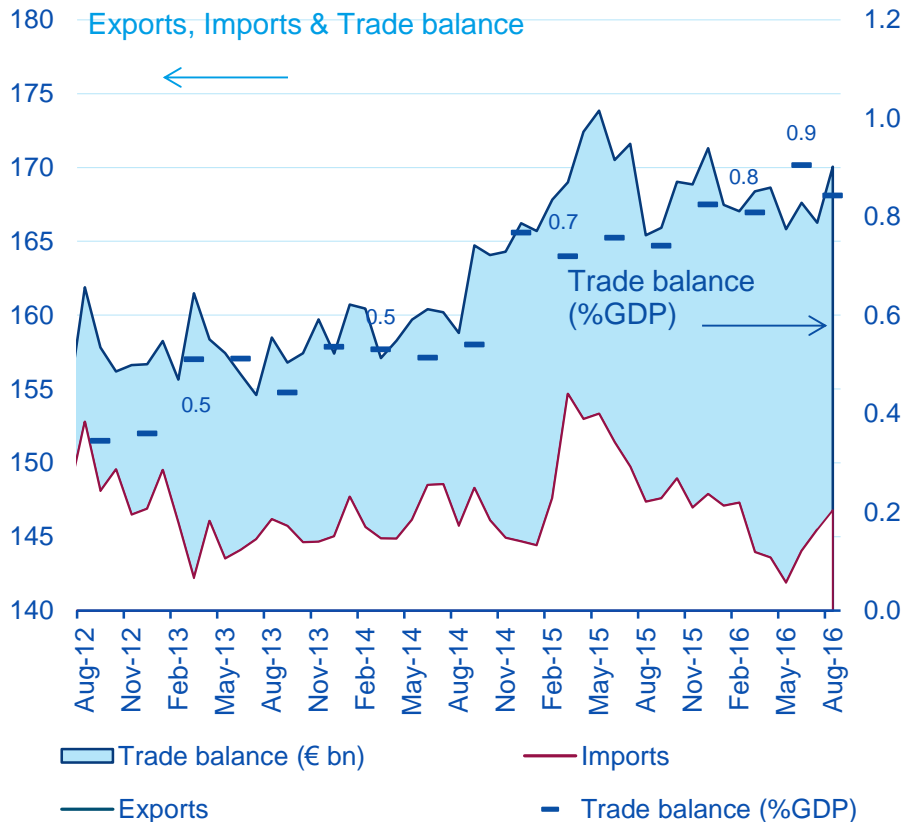


Annual unemployment change by gender & age (millions)

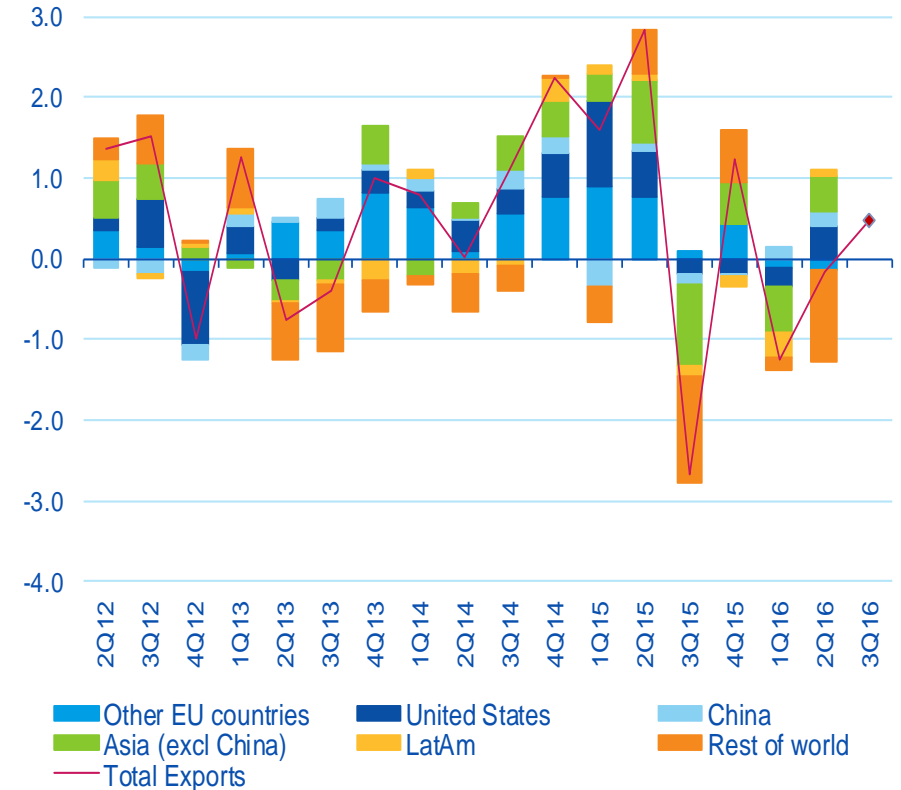


Exports rebounded in August amidst high volatility in foreign demand

Trade balance (€ bn, % GDP)



Exports (% QoQ) contribution by destination (pp)



Source: Eurostat and BBVA Research

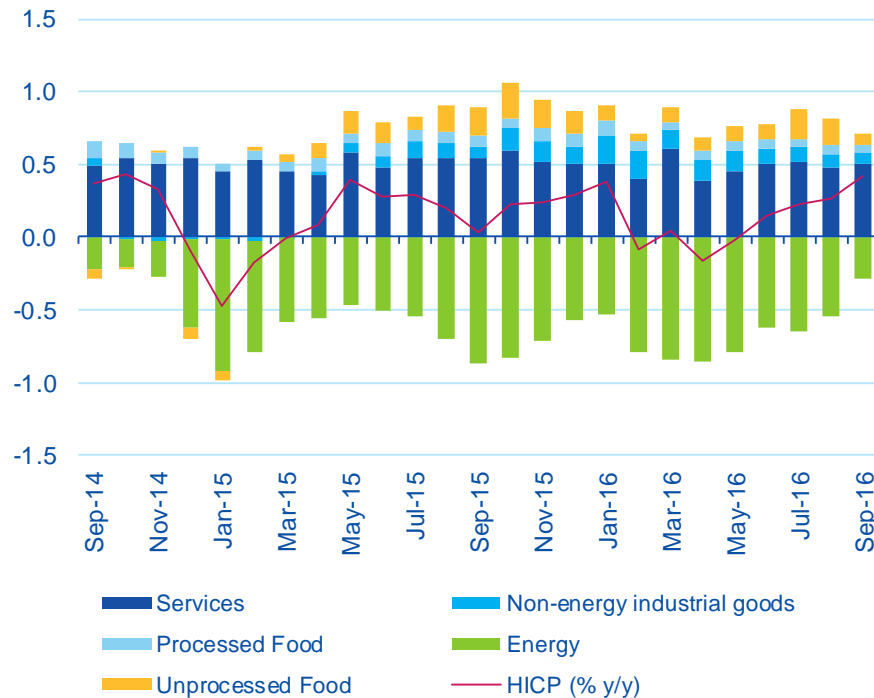
* 3Q16 calculated using data for July and August

Source: Eurostat and BBVA Research

Headline inflation accelerates in September driven by energy prices

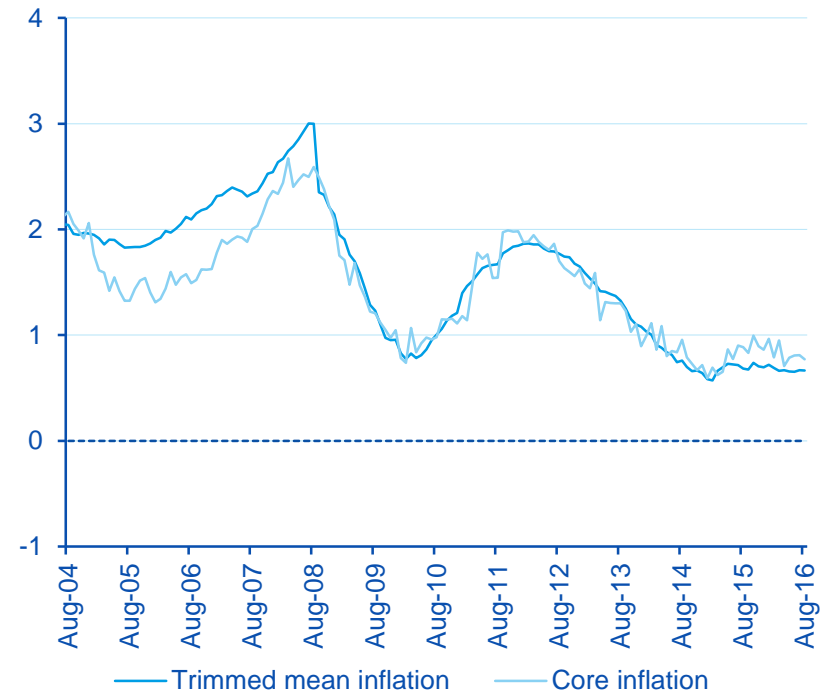
Energy base effects continue to fade, increasing headline inflation to +0.4% YoY in September (+0.4% MoM), and should continue towards rates slightly below +1.0% YoY by the end of 2016. The core measure remained stable at around 0.8% YoY in 2016 so far.

Inflation (% YoY) and contribution of components (pp)



Source: Eurostat and BBVA Research

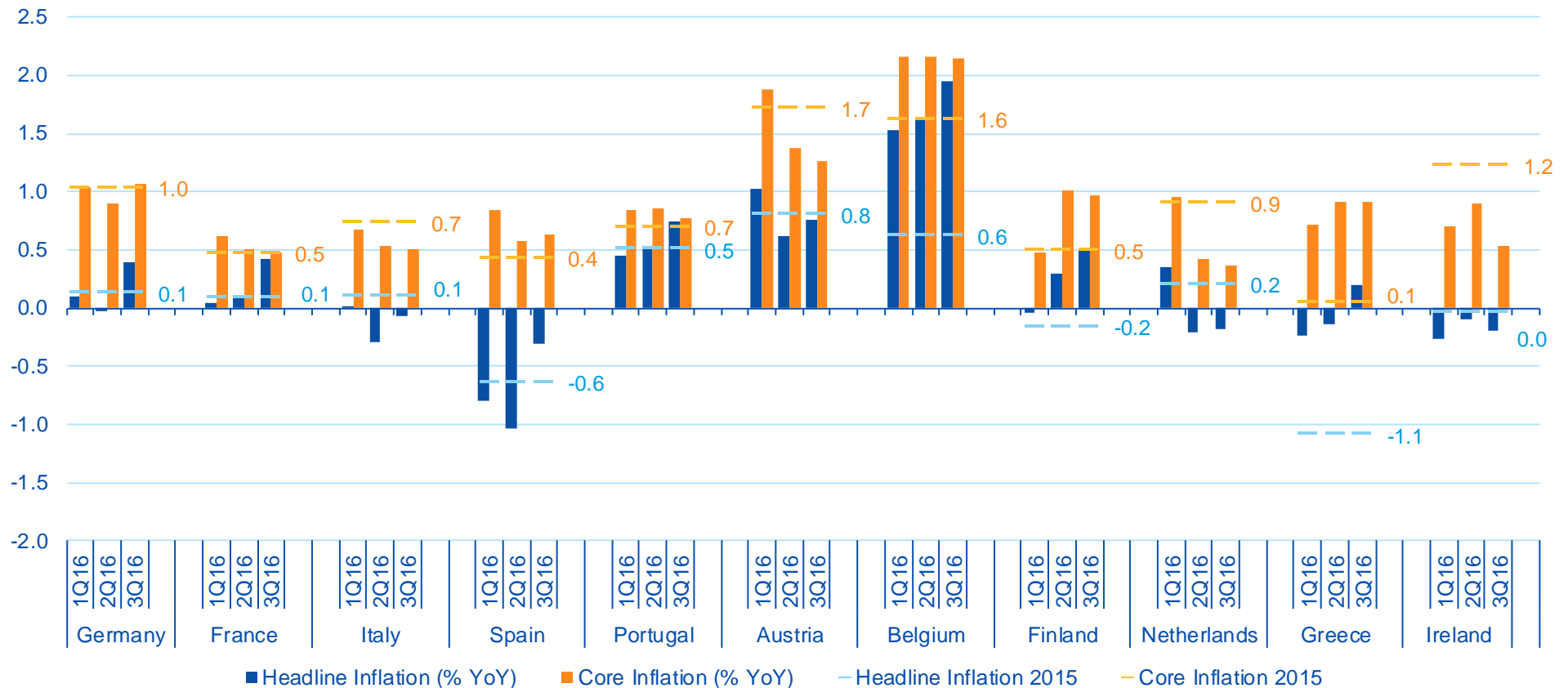
Inflation and trimmed mean (% YoY)



Source: Eurostat and BBVA Research

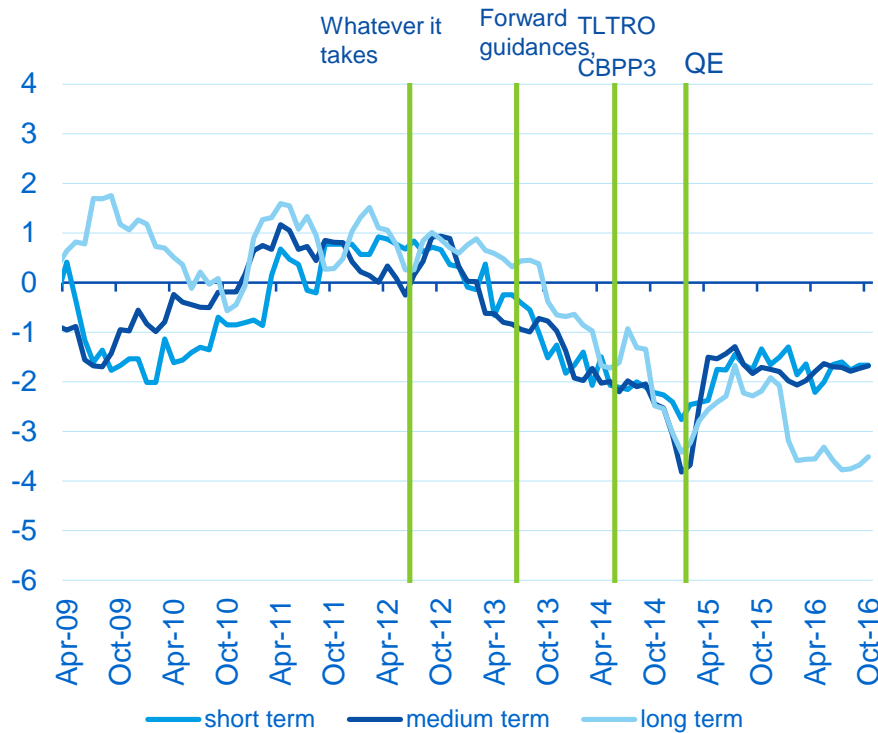
Inflation has been picking slightly up in most countries during 3Q16

Headline and core inflation (% YoY)



ECB: all options are on the table, but we expect an extension of QE by 6 months in December

BBVA EZ Inflation Monitor Index



Source: Reuters and BBVA Research

What happened

ECB on hold and not delivering new announcement over stimulus as no changes are made to the 2016-17 baseline scenario. Concerns on inflation remain.

Committees evaluating options available in a context of higher concerns over solvency of some european banks.

Before year ends

Expected extension of QE until September 2017 added to technical adjustments to cope with the scarcity of risk free (German) bonds.

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