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Eurozone Economic Watch

May 2017



Eurozone: The outlook remains positive as political risks ease

- ◆ **The outlook** across sectors and major countries **continued to improved at the start of 2Q17**, while 1Q GDP growth figures were revised upwards and showed strength of both domestic and external demand
- ◆ **Confidence data remain very robust across major countries in April** driven by both manufacture and services. Meanwhile **consumer mood continues to increase** supported by the ongoing improvement of the labor market and the cyclical recovery
- ◆ **Foreign trade is strong** but **industrial production and retail sales** decelerated somewhat in 1Q
- ◆ Our **MICA-BBVA model** for short-term growth estimates a quarterly **GDP figure in the eurozone of 0.6% QoQ in 2Q17**, although data is still limited to April's confidence surveys
- ◆ **Inflation recovered** and reached 1.9% YoY in April **driven by energy and services, mainly due to calendar issues (later Easter this year)**. Core measures also accelerated (to 1.2% YoY) but remain subdued. Inflation fears seem to be still far away as annual wage inflation pressures remain subdued
- ◆ Despite a more upbeat outlook and while some of the political uncertainty at the start of the year begin to ease, **risks to short-term growth remain tilted to the downside**, and are mainly political (Italy, tough Brexit negotiations)

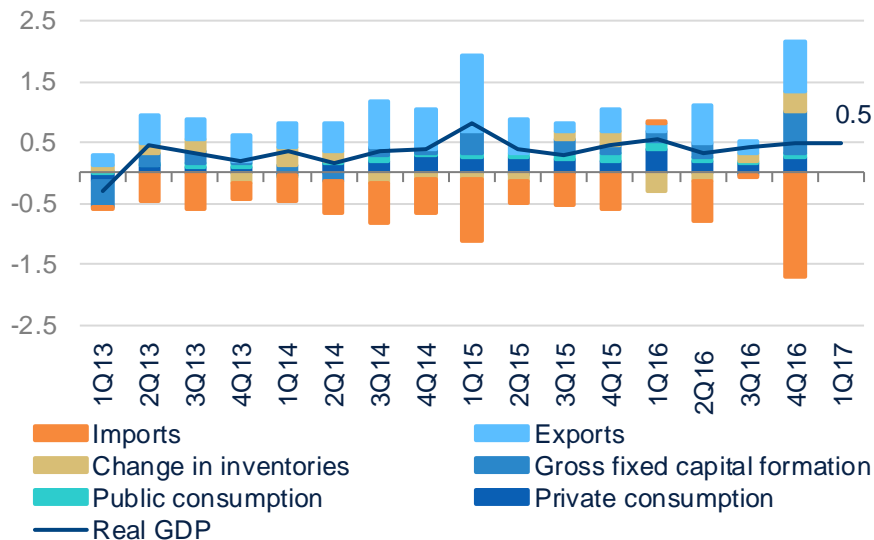
Economic developments

MAY 2017

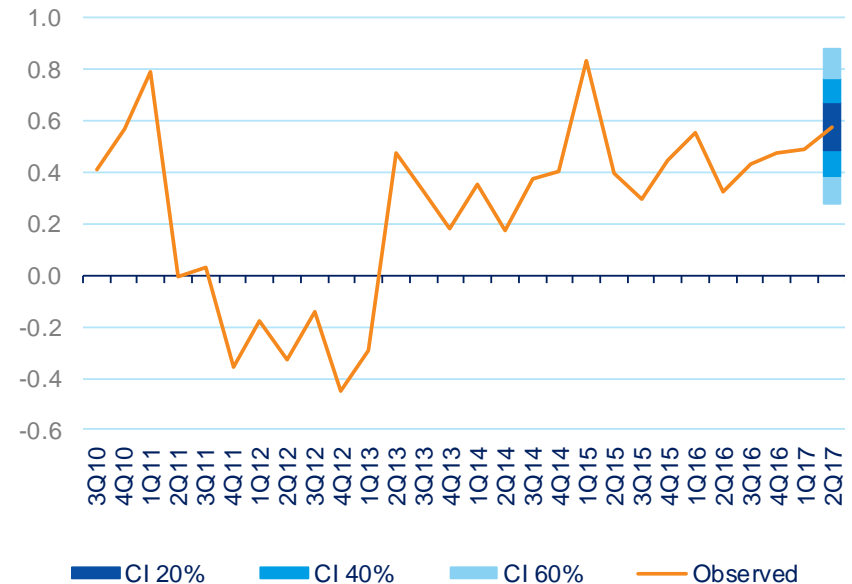


GDP growth stabilized at 0.5% QoQ in 1Q17 while soft data suggests higher momentum in 2Q17

GDP, Contribution by Components
(%QoQ, pp)



GDP and MICA forecasts
(%QoQ)



Source: Eurostat and BBVA Research

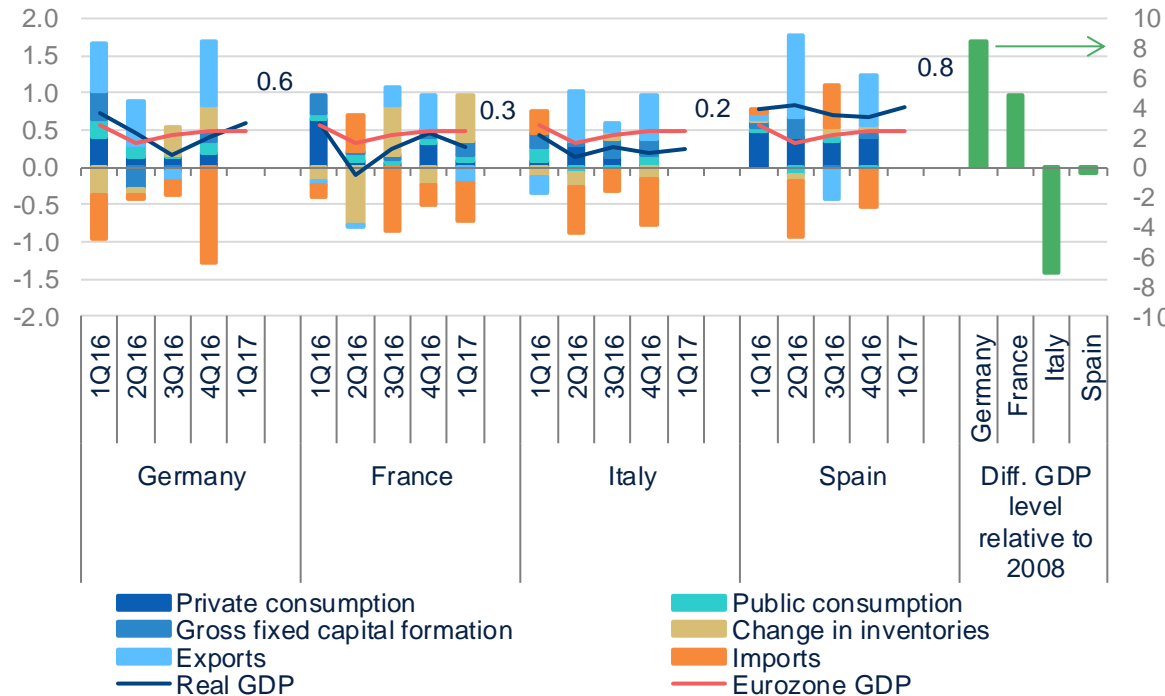
◆ **GDP grew by 0.5% QoQ in 1Q17, same pace from 4Q16** (although revised upwards by +0.1pp)

◆ **Consumption** as the main contributor to growth, followed by investment. A better global outlook is also supporting a **solid external demand**

◆ Our **MICA-BBVA** model, with only confidence data for April, suggests a **quarterly GDP growth of around 0.6% QoQ in 2Q17**

Growth picked up in Germany and Spain in 1Q while slowed down in France

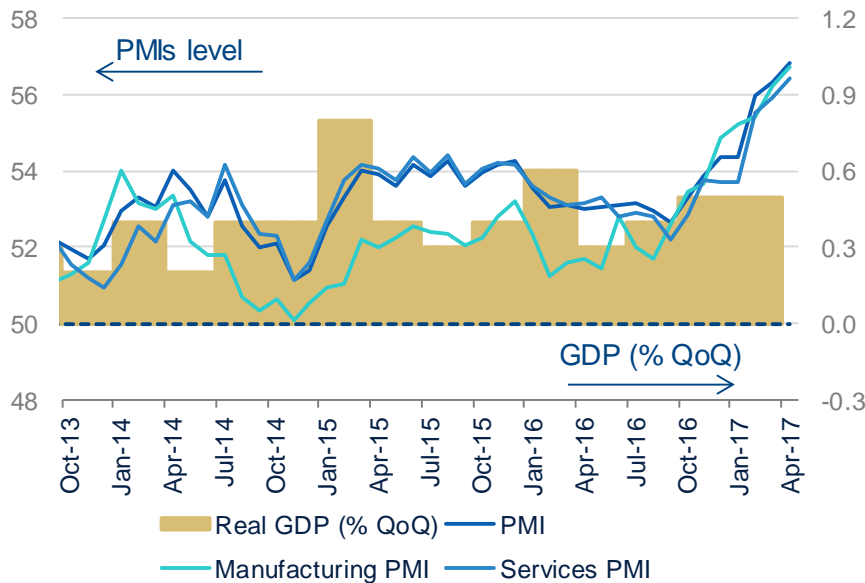
GDP, Contribution by components
(%QoQ, pp)



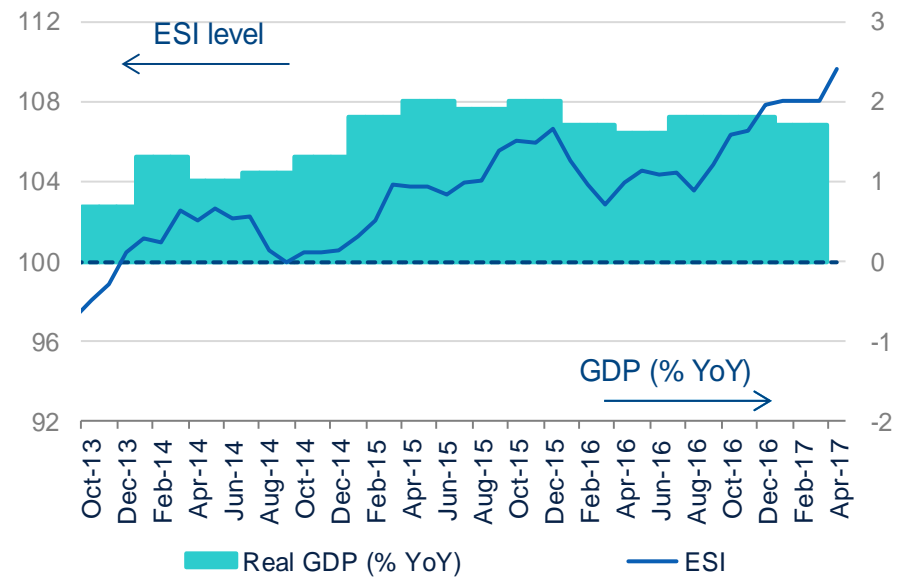
- ◆ In both **Germany and Spain GDP growth accelerated** to 0.6% and 0.8% QoQ, respectively at the start of 2017
- ◆ **French GDP growth slowed down** by 0.2pp to 0.3% QoQ in 1Q
- ◆ In **Italy the recovery fails to gain ground**, as GDP growth remained stable at 0.2% QoQ

Confidence across sectors suggests improving economic activity at the beginning of 2Q

PMI and GDP
(level, %QoQ)



ESI and GDP
(level, %YoY)

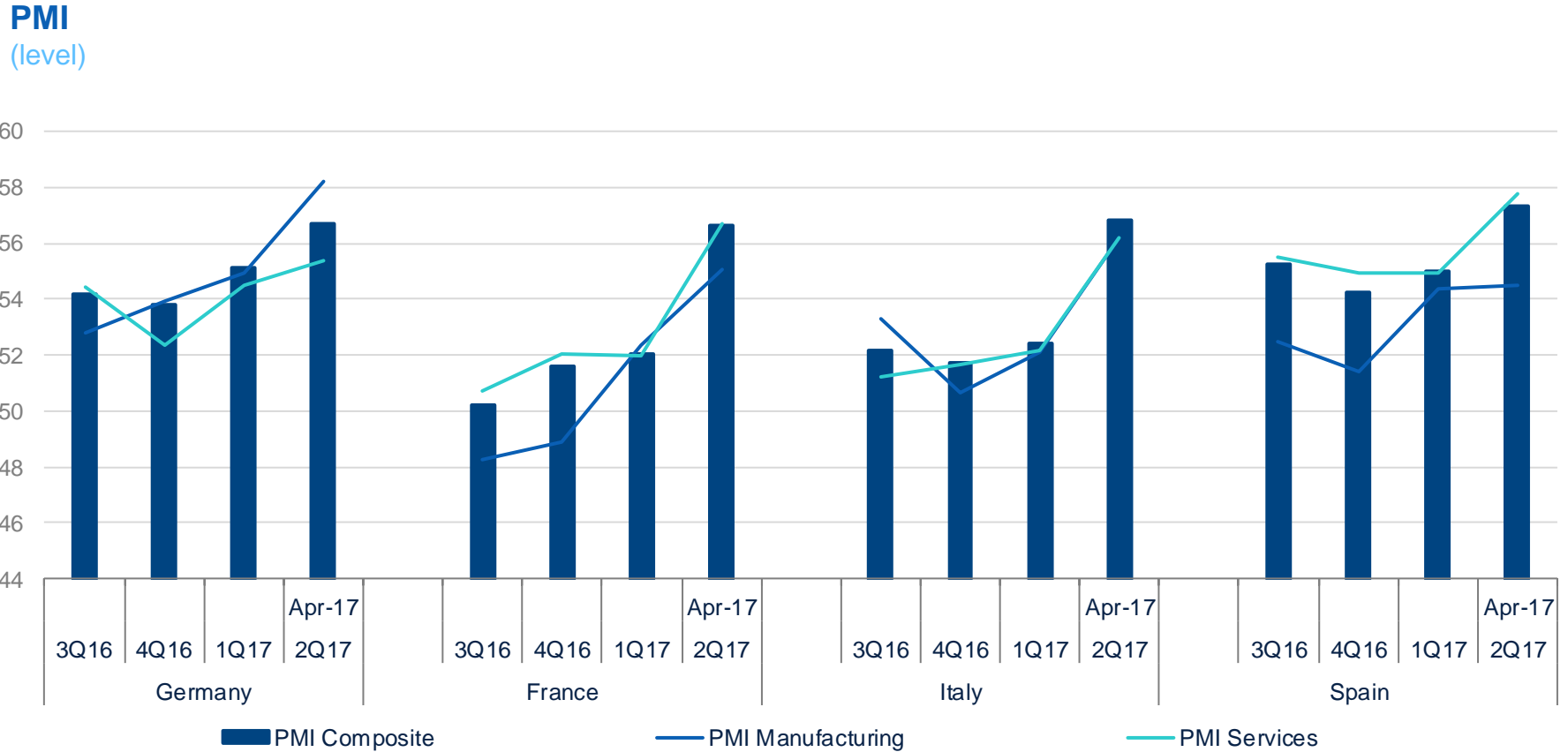


Source: Eurostat and BBVA Research

◆ Both **manufacture and services PMI continues to surprise to the upside** in April and **suggest improving economic conditions** for 2Q17

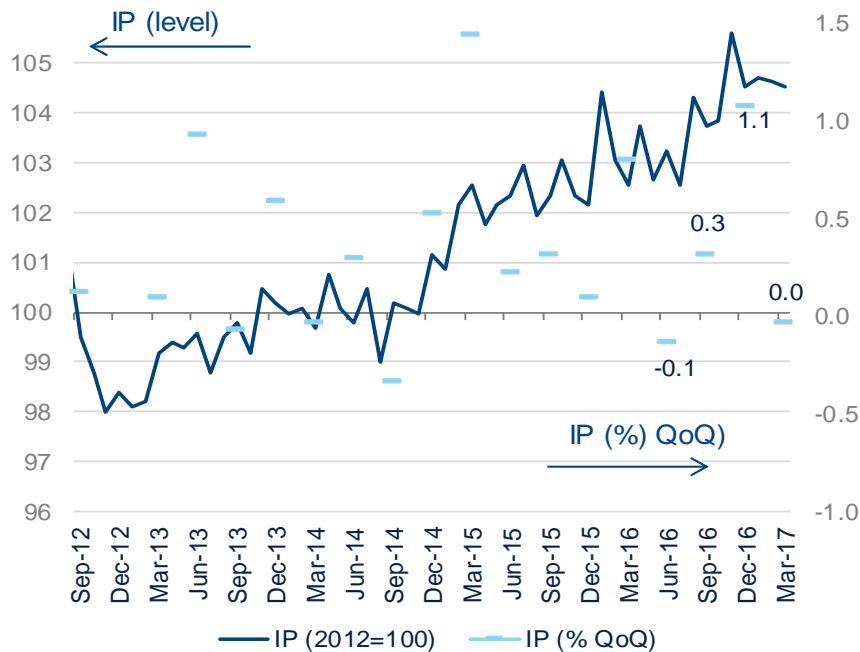
◆ **Consumer confidence show resilience** to different political event and **improved slightly** at the start of 2Q17

The positive mood is common to all major economies



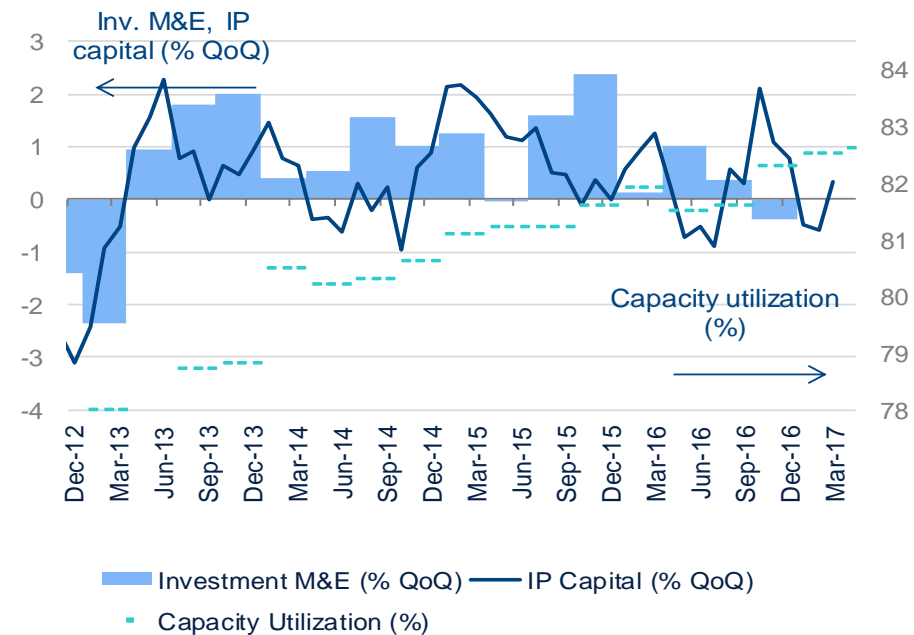
Industrial production stabilized in the first quarter of the year

Industrial production
(level, %QoQ)



Source: Eurostat and BBVA Research

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



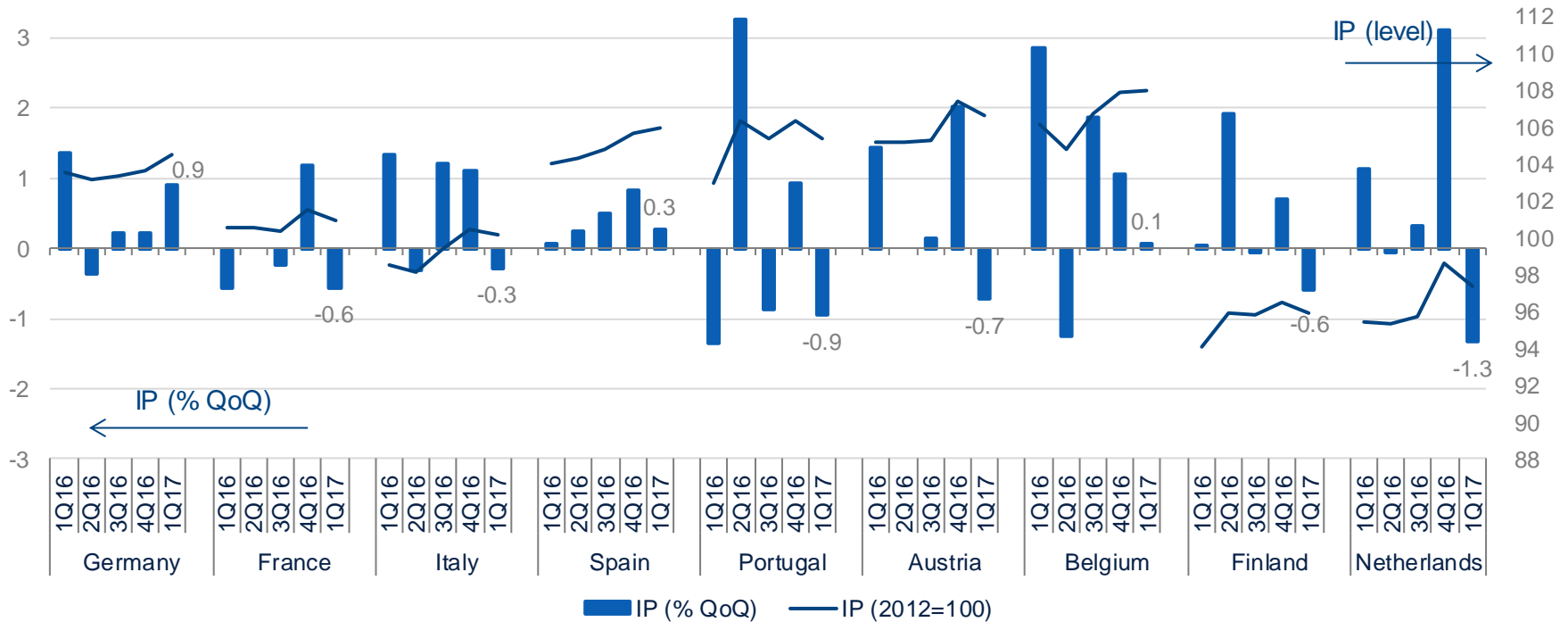
Source: Eurostat and BBVA Research

Industrial production **flattened in 1Q**, driven by a **decline in energy output and a moderation in non-durable consumer goods...**

... but **production of durables, intermediate and capital goods recovered** at the end of 1Q

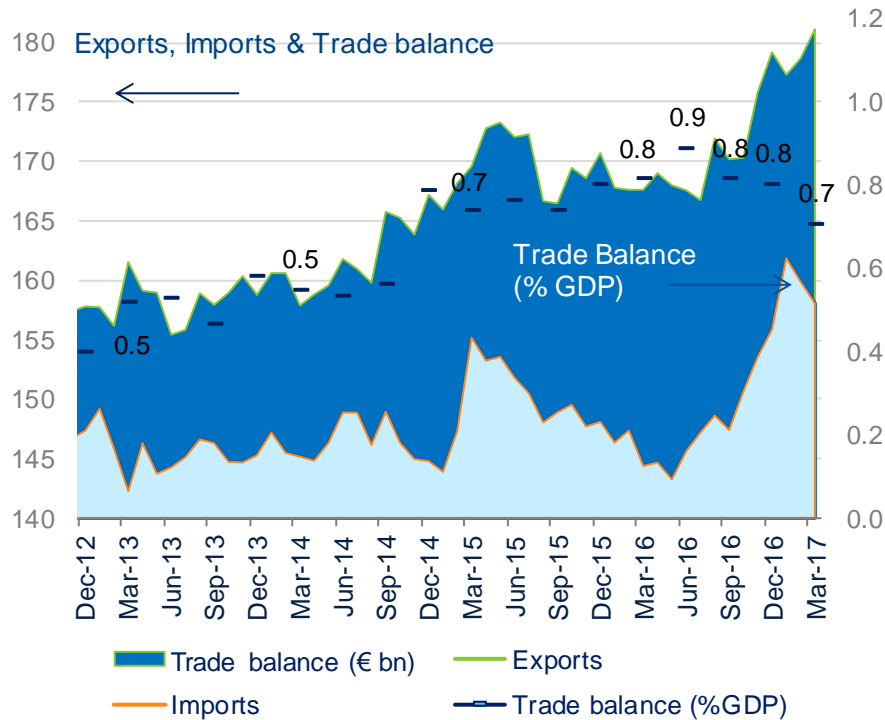
By country, performance of industrial output was mixed in 1Q, improving only in Germany, Spain and Belgium

Industrial production
(%QoQ, level)

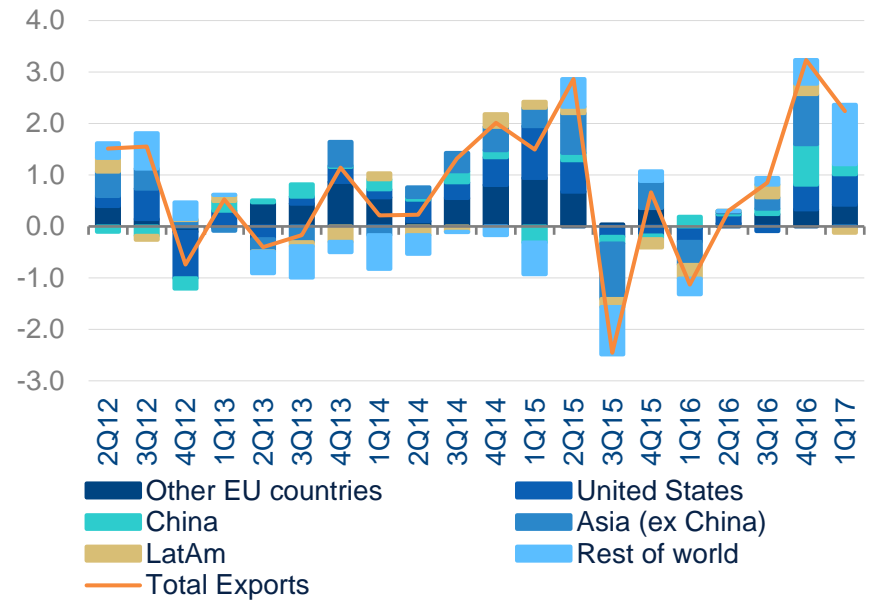


Exports surged in March and continued to signal an improving global demand

Trade balance
(€ bn, %GDP)

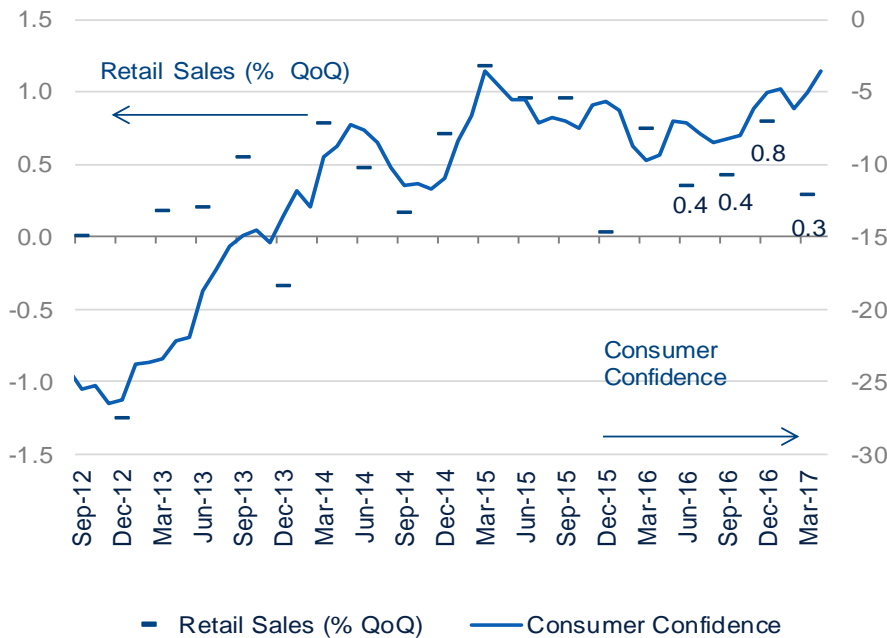


Exports contribution by destination
(%QoQ, pp)

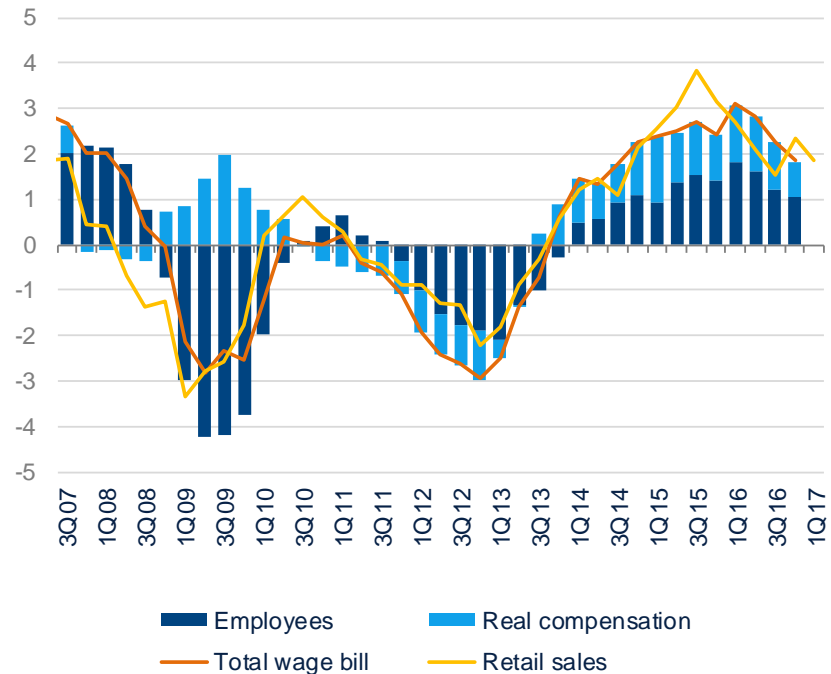


Retail consumption moderated somewhat in 1Q but confidence showed improving mood

Retail sales and consumer confidence
(%QoQ, pts)



Retail sales and total wage bill
(%YoY)



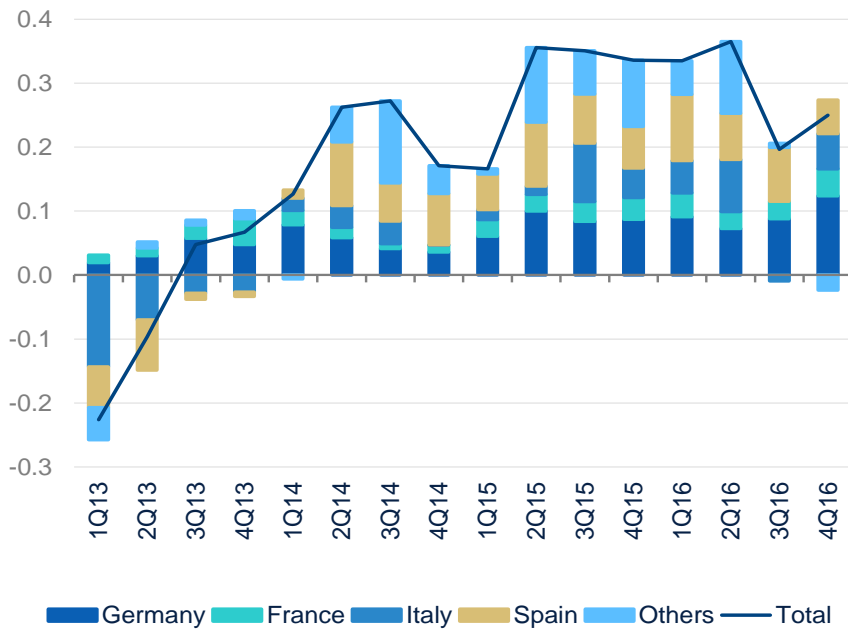
Source: Eurostat and BBVA Research

◆ **Retail sales increased 0.3% MoM in March** after 0.5 MoM in February, decelerating in 1Q17 (to 0.3% QoQ from 0.8% QoQ in 4Q16)

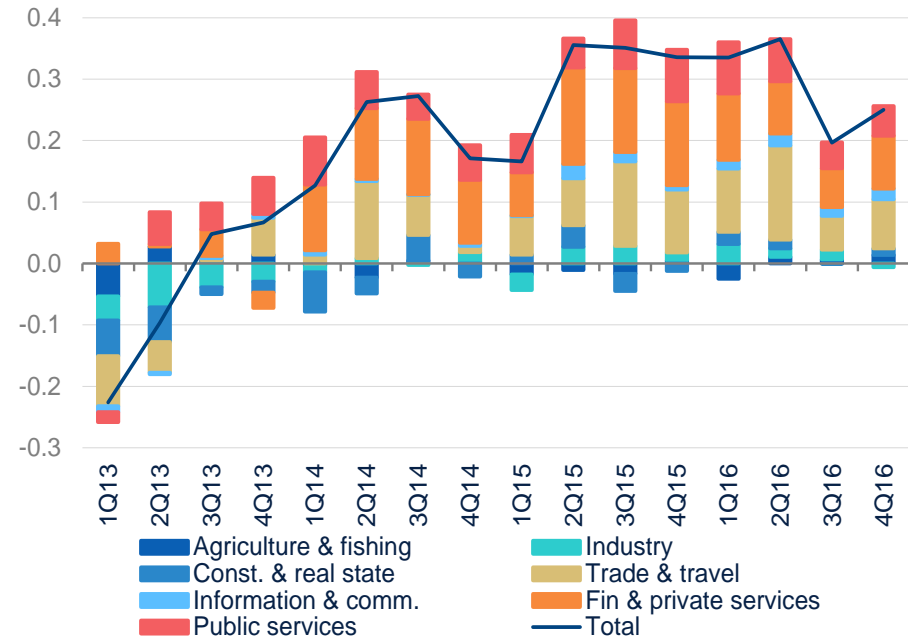
◆ **Consumer confidence continued to improve** offsetting signs of erosion in real wages

Employment growth is coming mainly from core countries and from services, trade and travel activities

Eurozone: Job growth contribution by country
(%QoQ, pts)



Eurozone: Job growth contribution by sector
(millions)



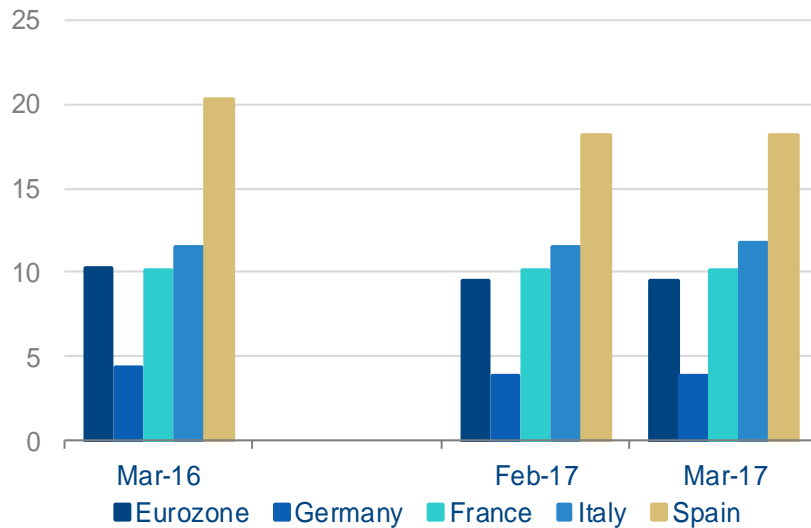
Source: Eurostat and BBVA Research

◆ **Employment growth contribution mostly from Germany and Italy** in 4Q16

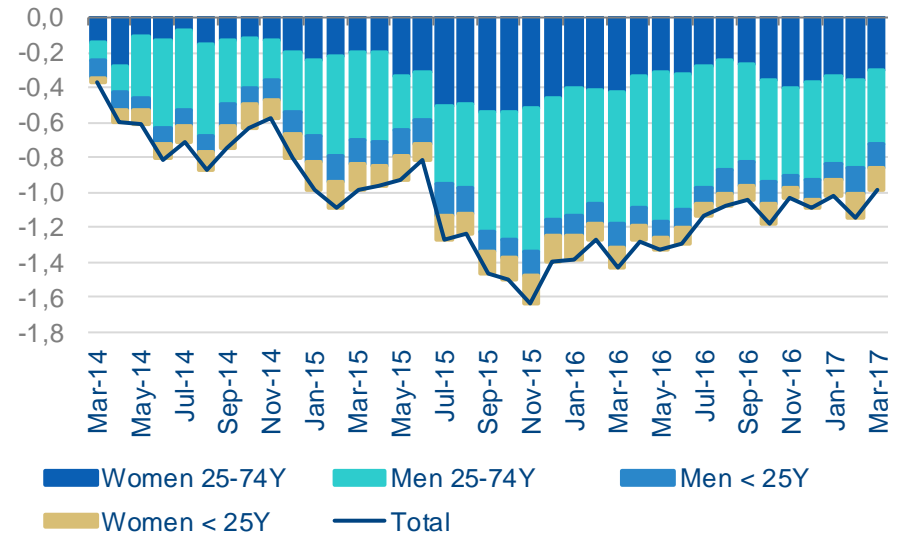
◆ By sector, **contributions** came from public and private **services**, which add to **trade and travel** activities

The unemployment rate kept steady in March

Unemployment rate by country
(%)



Annual unemployment change by gender & age
(millions)



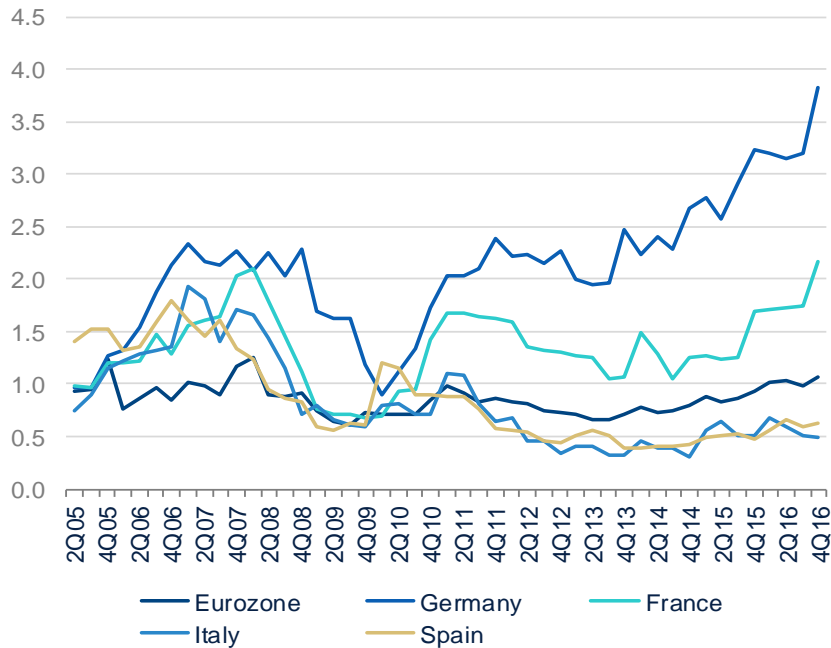
Source: Eurostat and BBVA Research

◆ **Jobless rate remained steady at 9.5% in March**, while the annual decline of 0.7pp is driven mostly by Spain and Germany

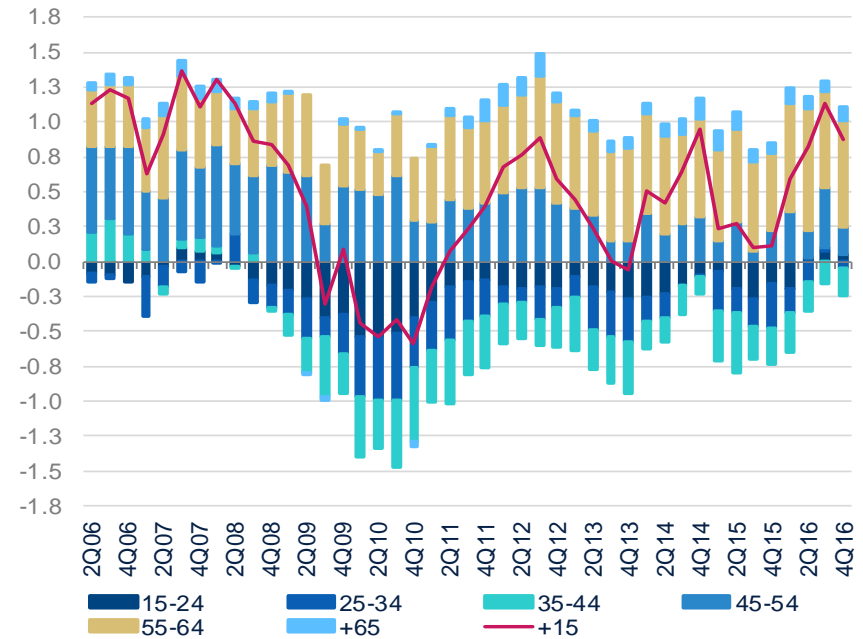
◆ **Unemployment decline** is observed mostly among the **experienced population**

Vacancy-unemployment ratio signals an improving job market, adding to strong labor force growth among experienced cohorts

Job vacancy to unemployment ratio
(Index, 1Q05=1)



Labor force contribution by cohort
(% YoY)



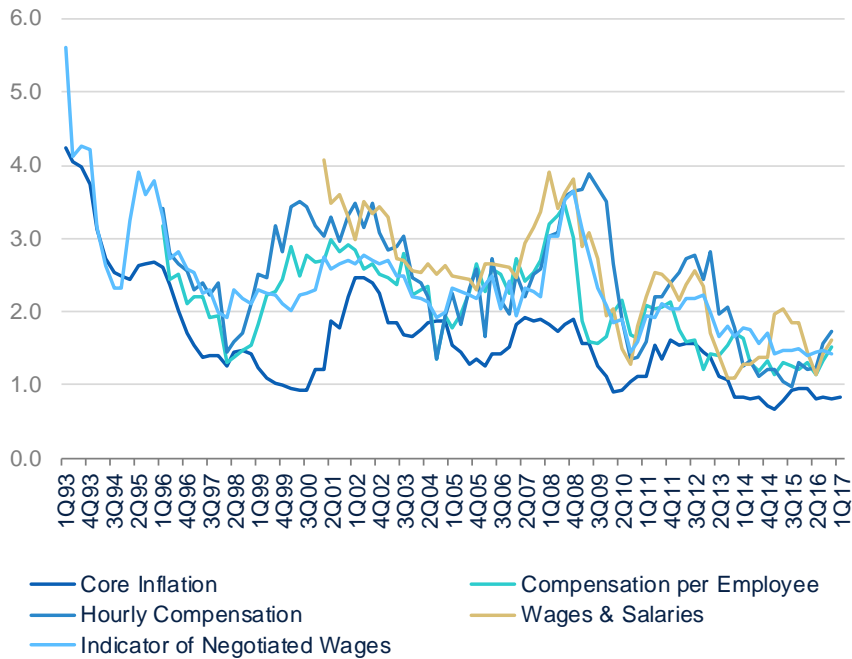
Source: Eurostat and BBVA Research

◆ At aggregate levels the **vacancy-to-unemployment** ratio is recovering at **different speeds by country**

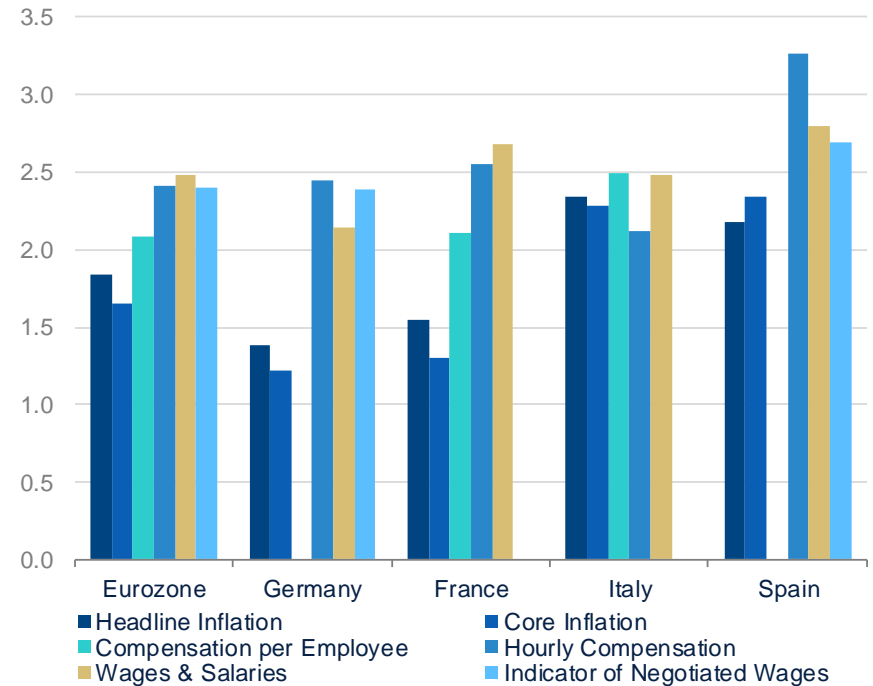
◆ **Increasing labor force** signals higher willingness to job-search and availability while the **decline in younger cohorts supply stabilized**

Annual wage growth remains subdued despite better labor market conditions

Eurozone: CPI inflation and wage measures
(% YoY)



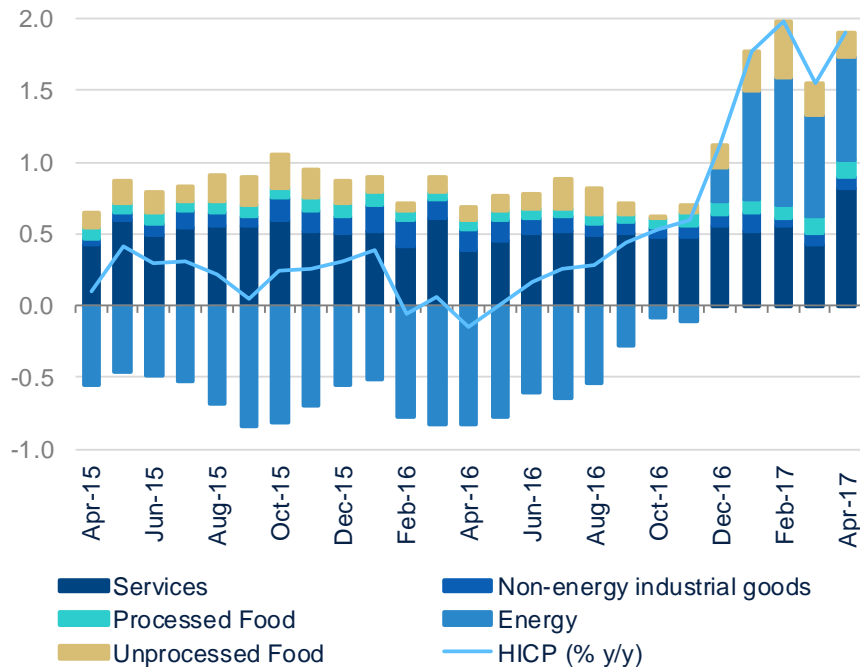
Average growth of CPI and wage measures*
(% YoY)



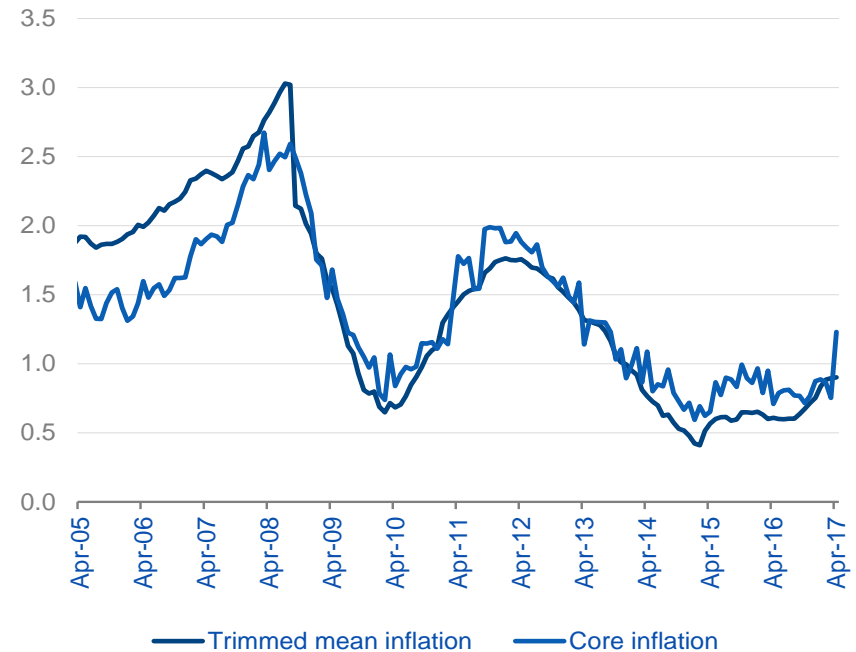
Source: Eurostat and BBVA Research
*Based on different individual samples of quarterly data

Headline and core inflation increased in April driven by services, mainly reflecting the change in the Easter calendar

Inflation and contribution of components
(%YoY, pp)



Inflation and trimmed mean
(%YoY)



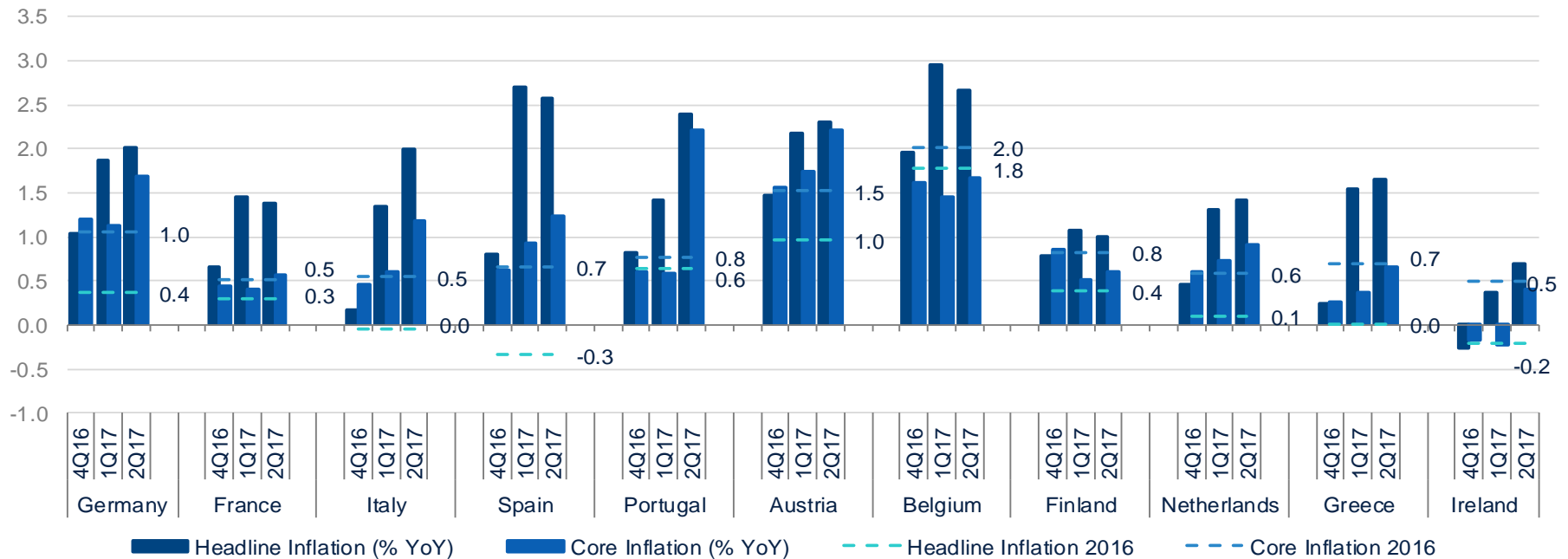
Source: Eurostat and BBVA Research

◆ **Harmonised inflation accelerate in April by 0.4pp to 1.9% YoY** (March: 1.5% YoY), driven by higher prices in energy and services, **mainly due to Easter's calendar effect**

◆ In this context, **core inflation also accelerated to 1.2%** (after 0.7% YoY), but is likely to return to around 1% YoY in May

Although increasing core inflation remains subdued across countries

Headline and core inflation
(%YoY)



Source: Eurostat and BBVA Research

◆ By country, April **HCPI inflation increased in Germany** (2.0% after 1.5% YoY), **Italy** (2.0% after 1.4% YoY) and **Spain** (2.6% after 2.1% YoY), **remained steady in France** (1.4% YoY)

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