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Eurozone Economic Watch

February 2018



Eurozone: Strong growth continues in 1Q18, but confidence seems to peak

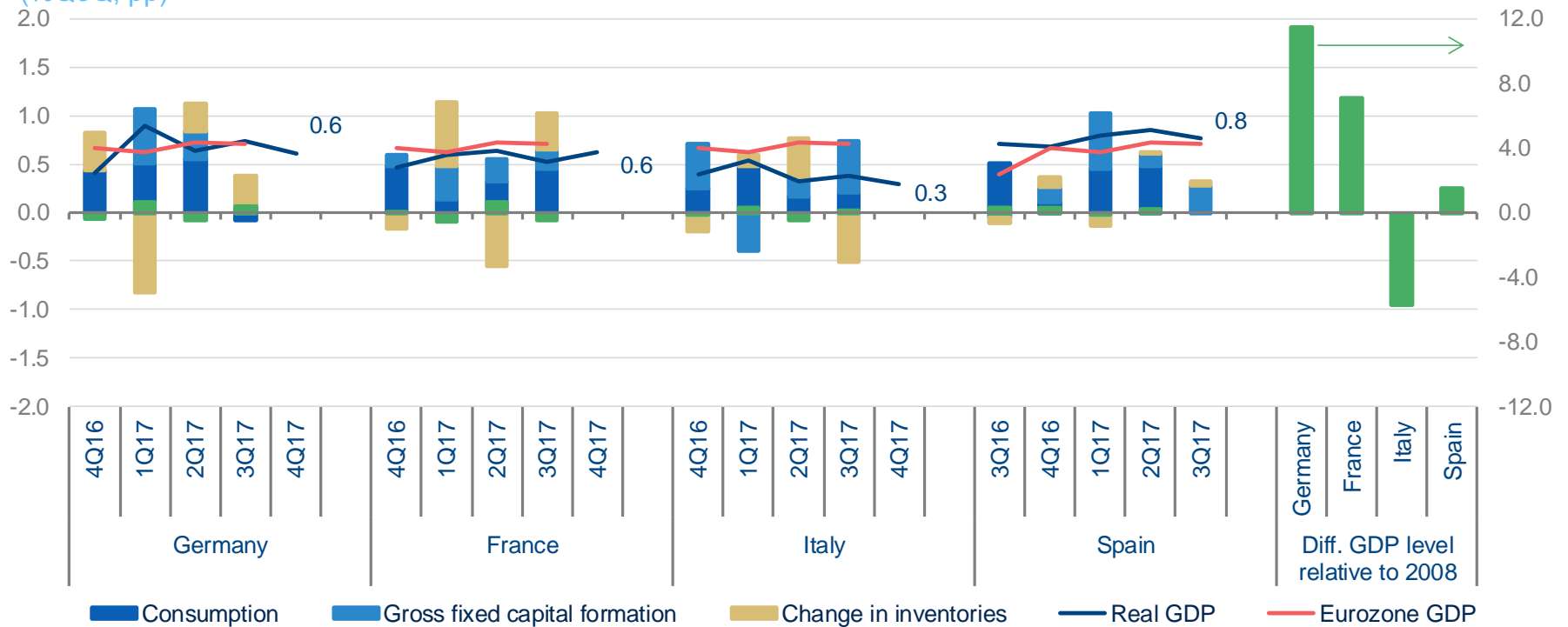
- ◆ **GDP growth moderated slightly in 4Q17**, but there was an upward revision to previous quarters. Available data suggests that **domestic demand could slow, but offset by increasing net exports**. GDP increased by **2.5% in 2017**, above potential for the third year in a row.
- ◆ Our **MICA-BBVA model** estimates a slight upturn in GDP growth to around **0.6/0.7% QoQ in 1Q18**, but we continue to see a moderation over the year ahead, to average a still strong growth of around 2.2% in 2018.
- ◆ **Hard data improved by year end** boosted by strong domestic fundamentals and steady global growth. Strong exports, despite the moderation in foreign orders, continued to support the recovery in the industrial sector and investment. There is some moderation in private consumption, but improving labour market and low inflation continue to support consumer confidence.
- ◆ **Sentiment indicators remain very strong** compared with their historical averages and leading components are consistent with resilient activity in coming months, **but February figures moderated markedly**, indicating that the optimistic mood might have reached a peak.
- ◆ **Headline inflation eased in January to 1.3% in the EZ**, and could decline a bit further in February due to energy base effects. **Core inflation surprised slightly upwards**, increasing to 1.2% YoY. Confidence surveys show some incipient signs of price pressures in coming months, in line with our forecast of a **gradual increase in core inflation over the year**.

Slight growth moderation in 4Q17 across countries, except in France, but strong recovery in 2017 as a whole

- **Growth in 2017 gained traction** in Germany (2.5% after 1.9% in 2016), France (1.9% after 1.1%) and Italy (1.5% after 1.1%), while the strong momentum remained in Spain (3.1% from 3.3%).
- **GDP has surpassed pre-crisis levels also in Spain** now (but not yet in Italy).

GDP, Contribution by Components

(%QoQ, pp)

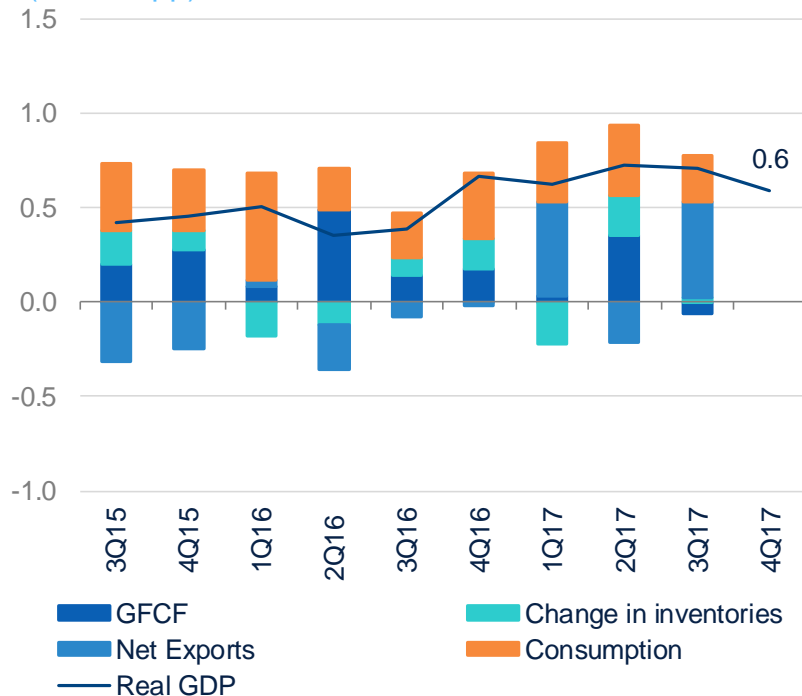


Growth is expected to remain broadly stable in 1Q18 at rates similar to those observed over the past four quarters

- GDP growth moderated slightly in 4Q17, after upward revisions in previous quarters. Domestic demand probably slowed, but net exports improved
- Our MICA-BBVA model points to a quarterly GDP growth of 0.6/0.7% QoQ in 1Q18

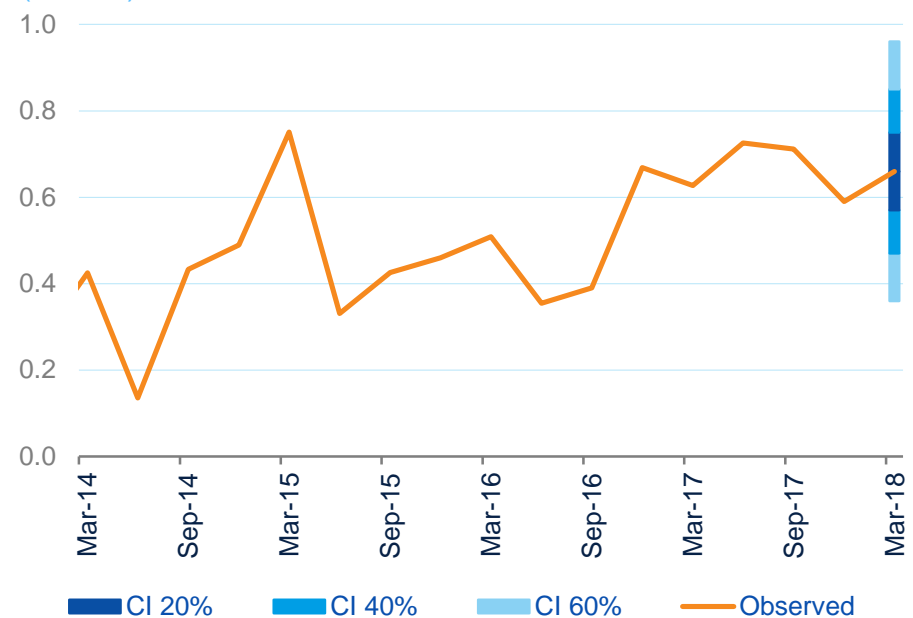
GDP, Contribution by Components

(%QoQ, pp)



GDP and MICA forecasts

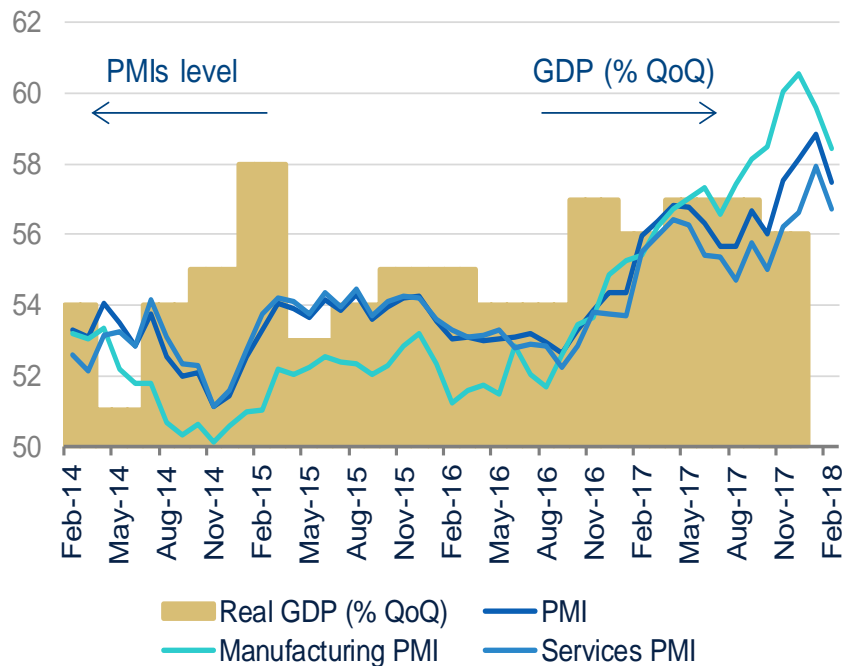
(%QoQ)



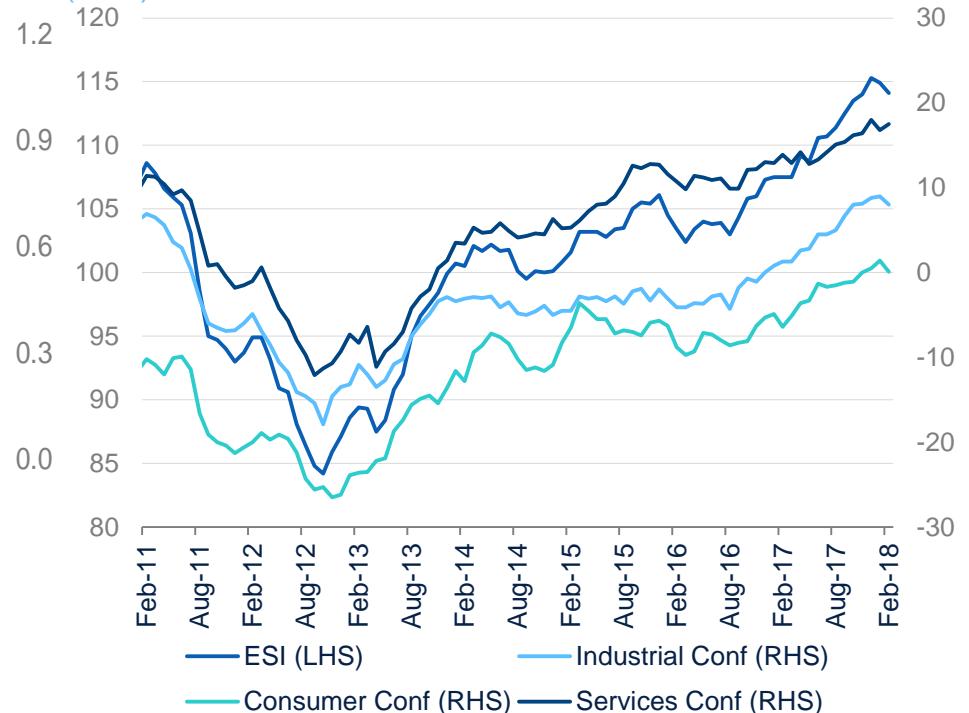
Confidence in 1Q18 has remained at very high levels so far, but showing some signs of stabilization

- Both PMI and ESI figures declined slightly in early 2018, suggesting that **the peak of growth could be behind us**
- Some **moderation signs in industrial confidence**, partly due to moderation in new orders, but services expectations improved

PMI and GDP
(level, %QoQ)



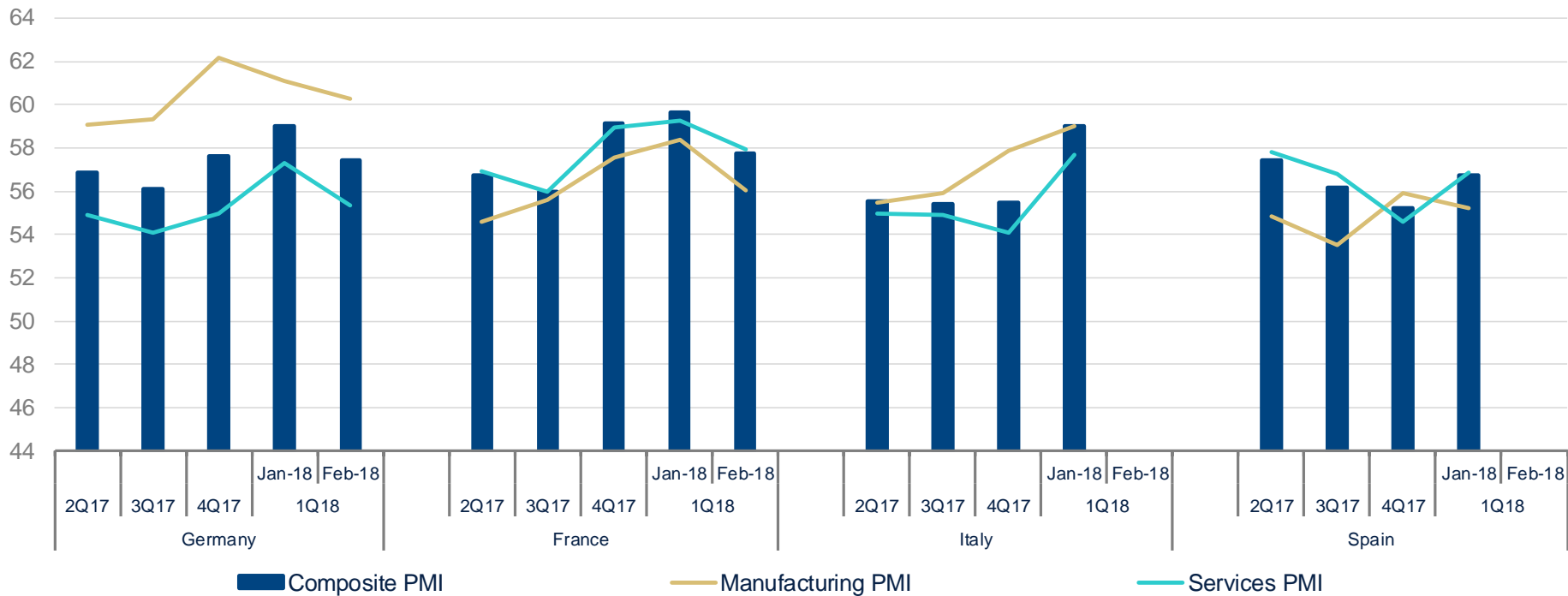
EC confidence survey
(level)



February PMIs in France and Germany point also to moderation

- At a country level, a retreat is seen in Germany and France in both manufacturing and services in February. Positive surprise in Italy in January, where the composite index reached an historical high.

PMI survey (level)

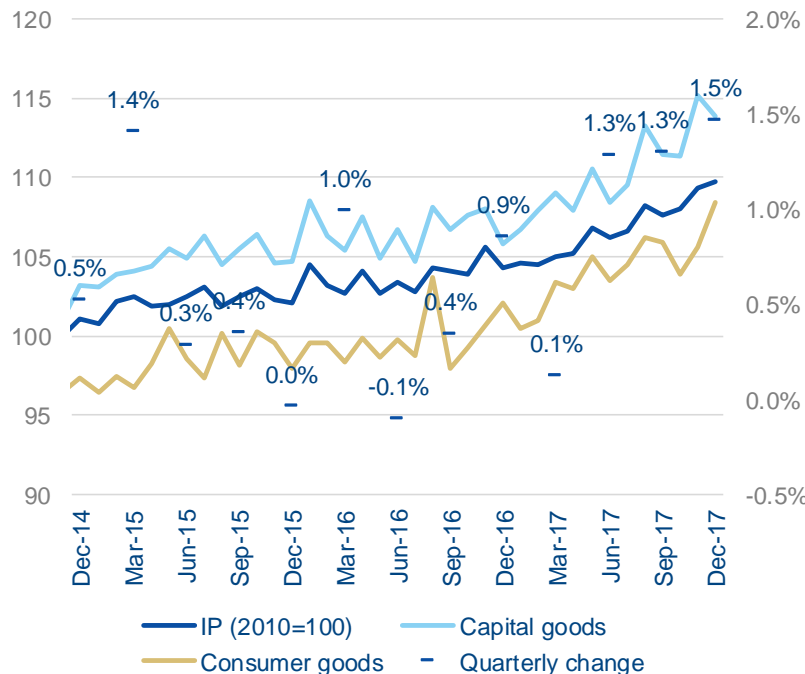


Industrial production accelerated in 2017 (2.9% after 1.5% in 2016), but has grown at more stabilized rates in recent quarters

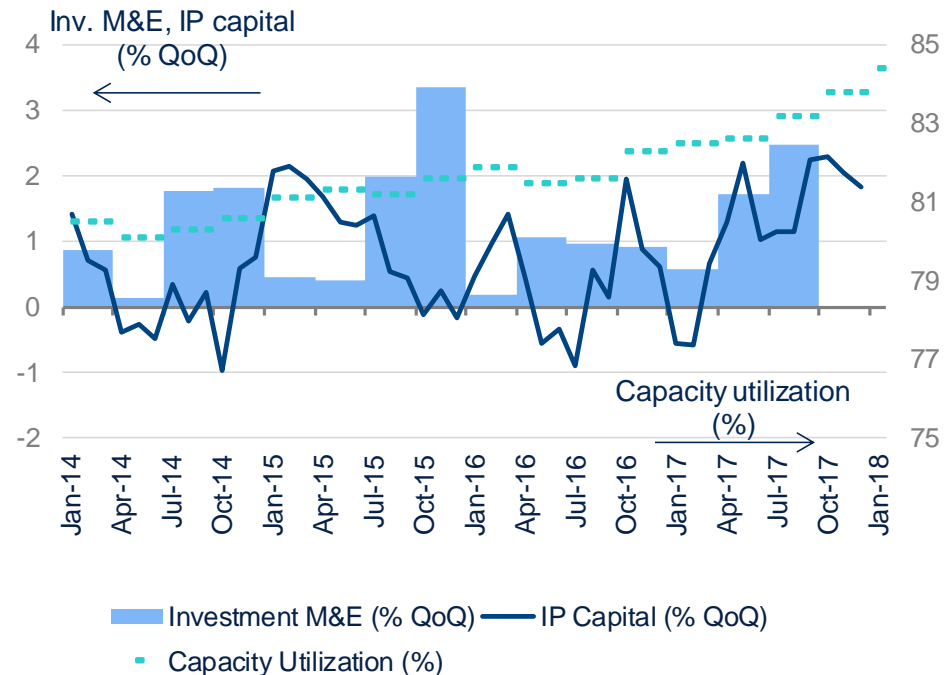
- IP has grown at around 1.4% QoQ in recent quarters, supported in particular by export orders

- The production of durable and capital goods, along with high capacity utilization, points to a favourable investment outlook

Industrial production
(level, %QoQ)



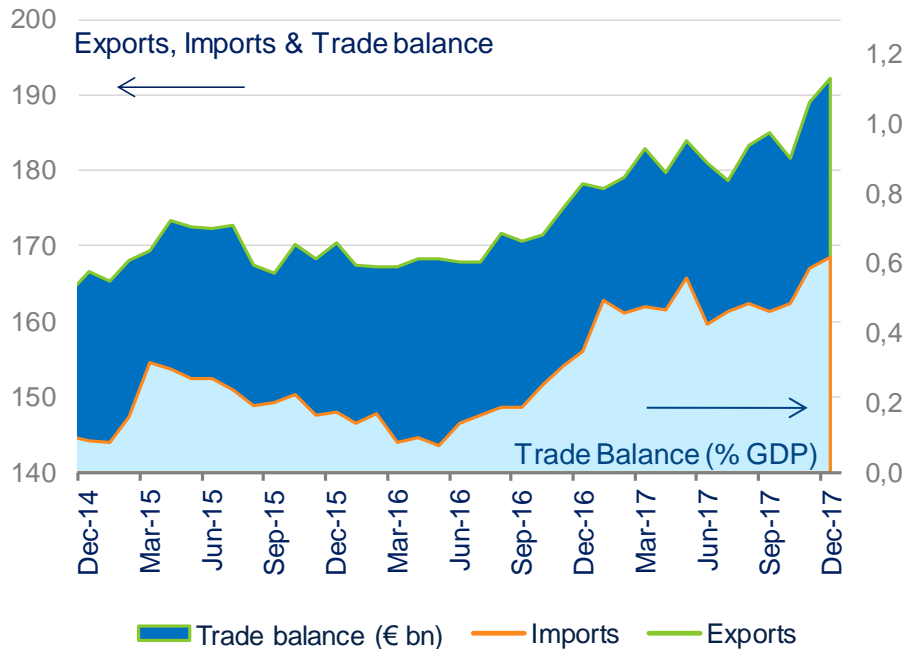
IP capital equipment, investment in M&E and capacity utilisation
(%QoQ, %)



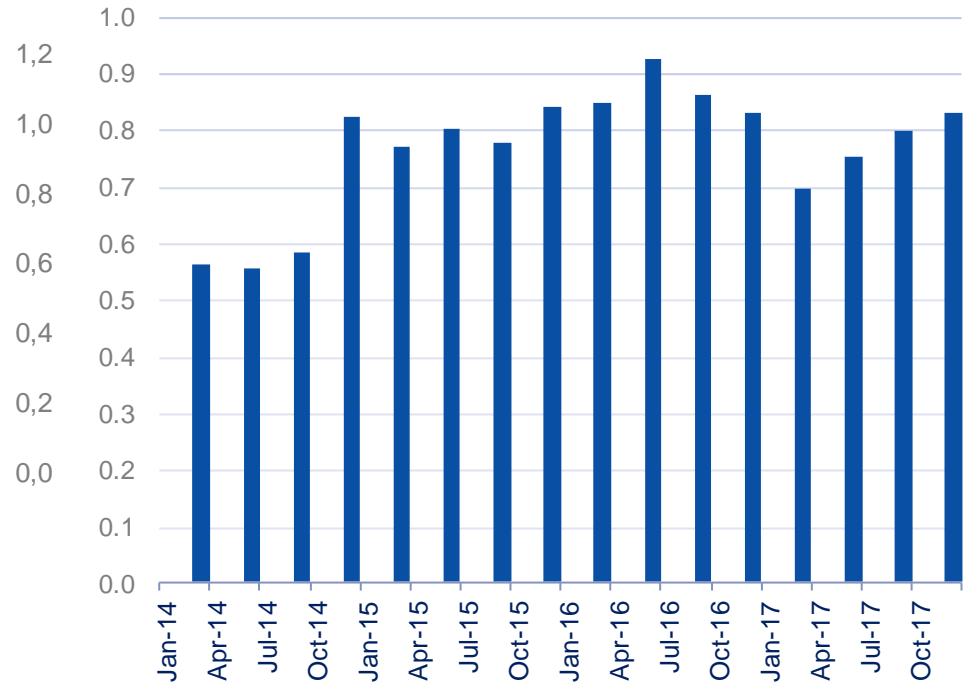
Export growth consolidated in 2017 despite the appreciation of the euro

- Exports ended the year on a solid gear (+2.9% QoQ in 4Q17) in a context of sustained global growth
- The trade balance remained stable at around 0.8% of the GDP in 4Q17

Trade balance
(€ bn)



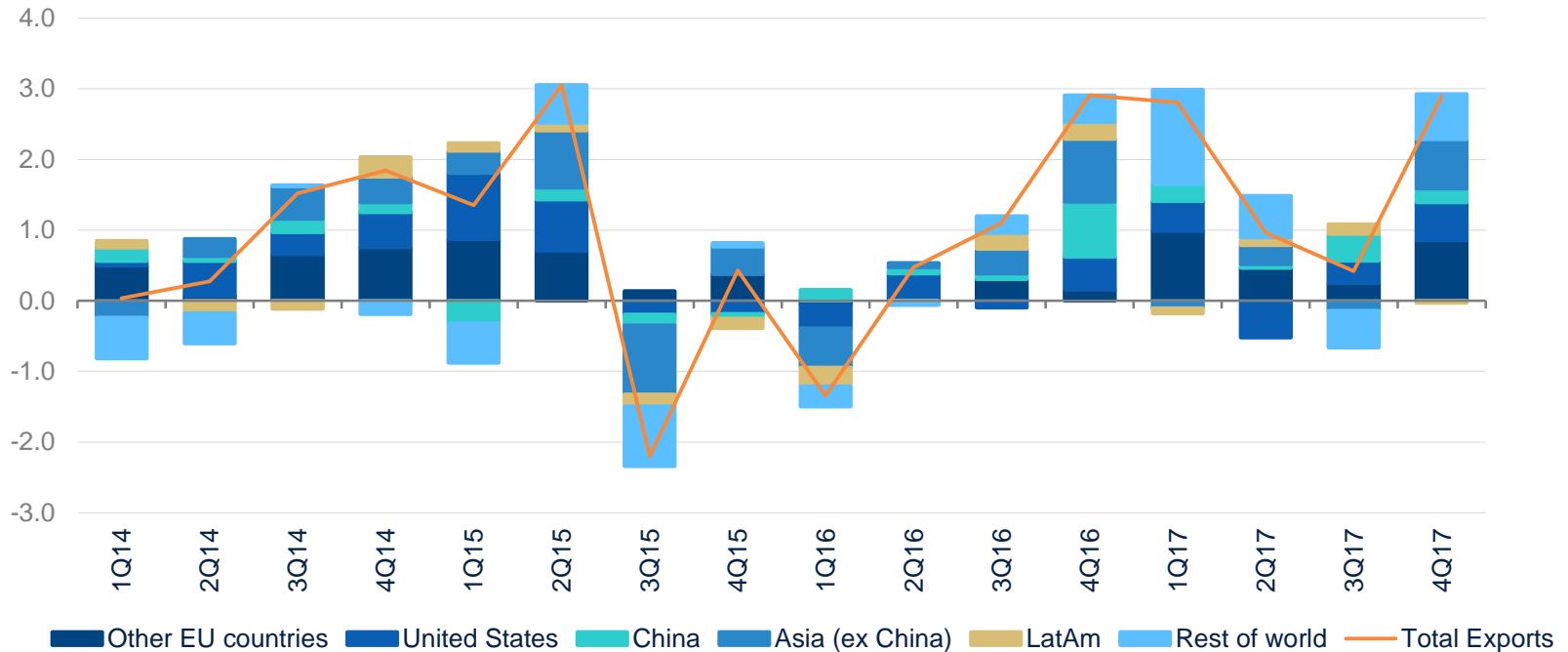
Trade balance
(%GDP)



Across destination, exports to all major regions gained traction by year end, except to China

- Strong and steady **global growth should continue to support exports over 2018**, as suggested by new export orders

Exports contribution by destination
(%QoQ, pp)

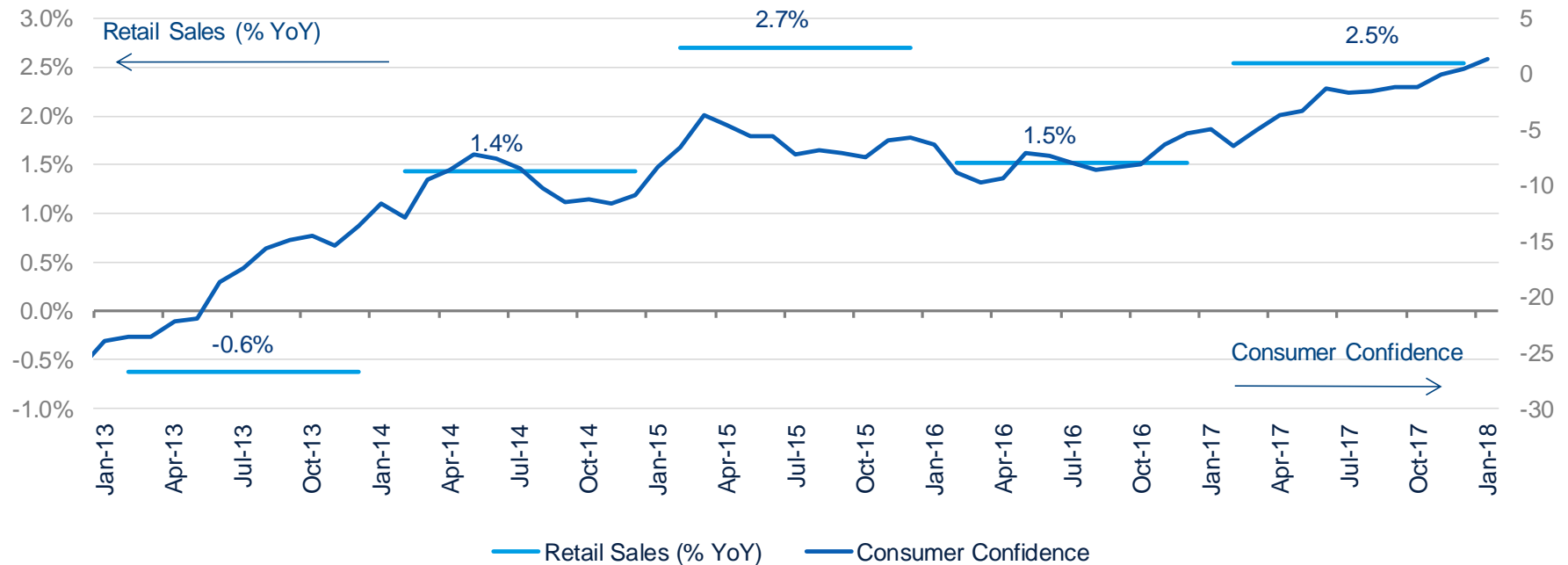


Retail sales slowed in 4Q17, but remain solid

- Despite the significant acceleration of retail sales in 2017 (2.5% from 1.5%), they moderated over 2H17 to more sustainable rates.
- High consumer confidence suggests that private consumption should continue to be a key growth driver in coming quarters.

Retail sales and consumer confidence

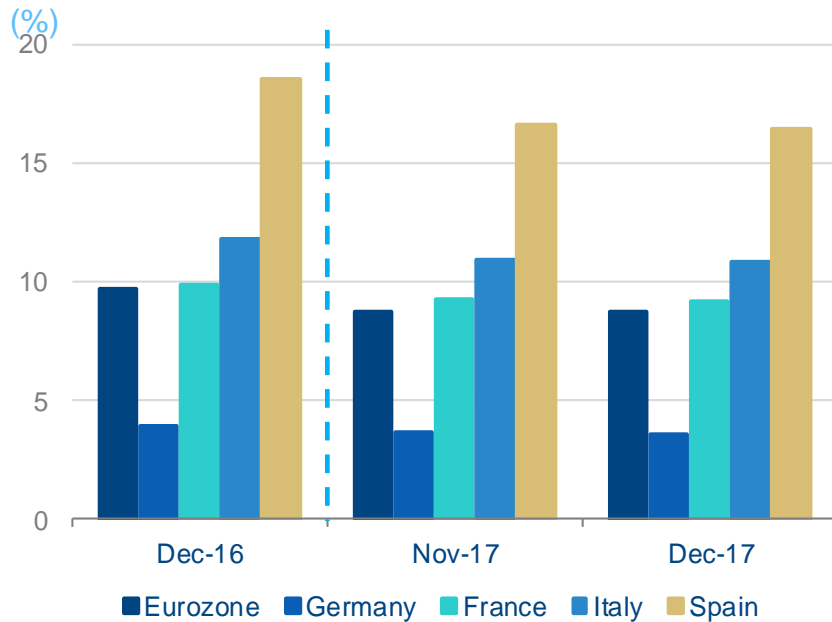
(%YoY, pts)



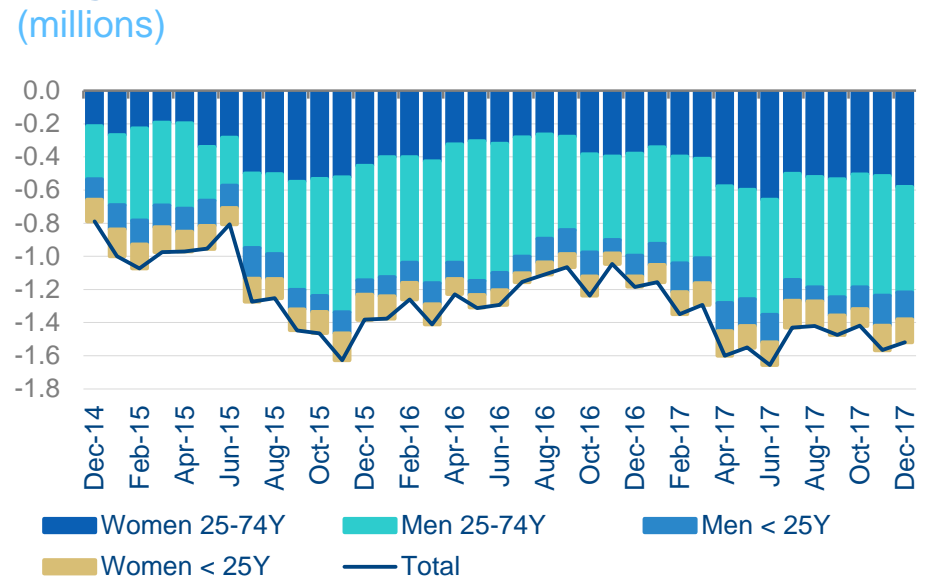
The labour market improved further in 2017 across the board

- The EZ jobless rate declined to 8.7% in December, which is one percentage point less than a year ago
- Broad decline across all working groups, but much more moderate for younger

Unemployment rate by country



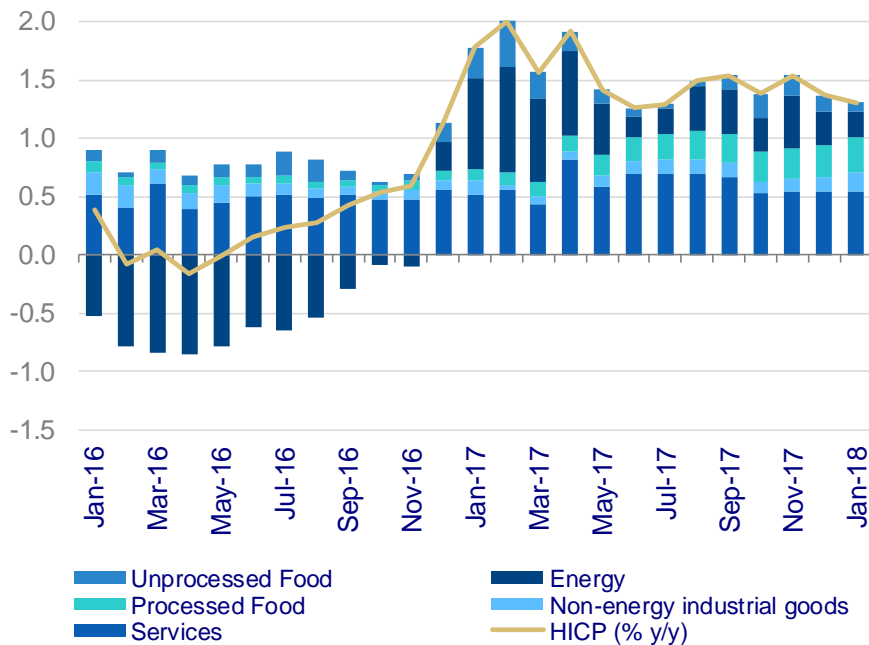
Annual unemployment change by gender & age



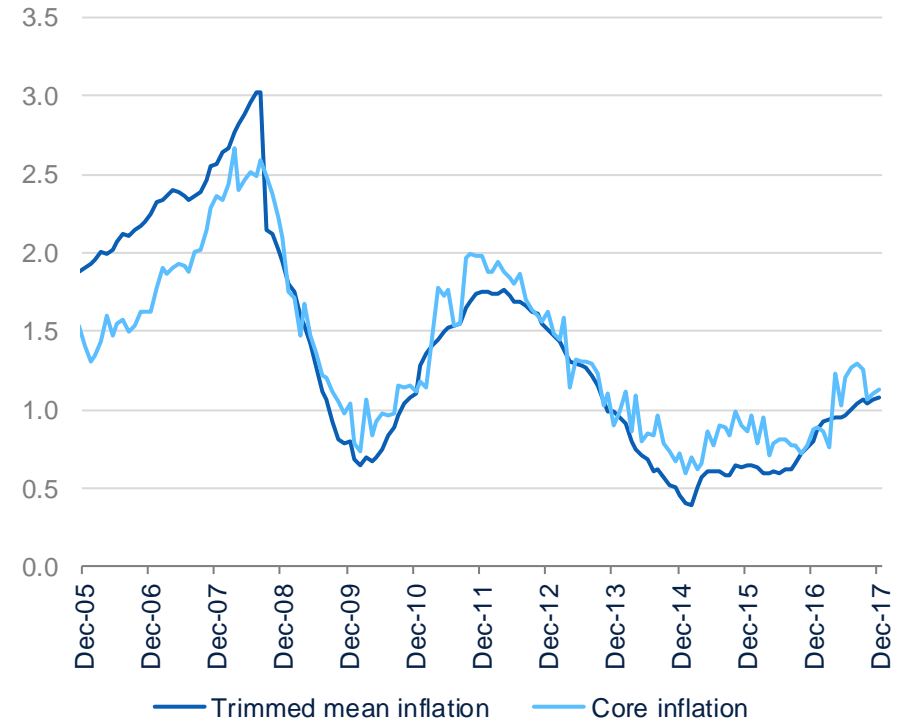
Headline inflation declined in January, but with a slight upward surprise in core inflation (1.2% YoY)

- Lower inflation in energy and fresh food in recent months. **Energy base effects should fade from February onwards**
- The increase in core inflation in January reflected **higher prices of both non-energy industrial goods and processed food**

Inflation and contribution of components
(%YoY, pp)



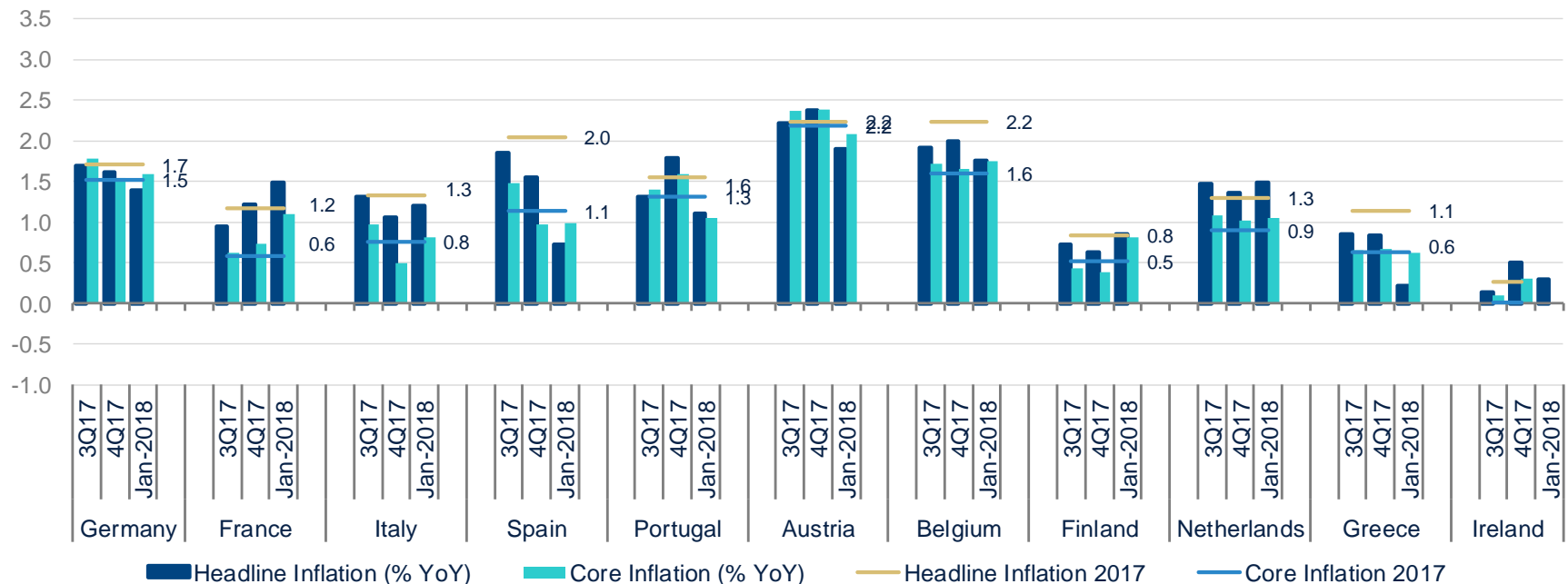
Core and trimmed-mean inflation
(%YoY)



Increasing core inflation across countries in January, expect in Germany

- According to preliminary data, HICP increased in January in Italy (+1.1% after +1.0%), remain muted in France (+1.2%) and declined in Spain (+0.7% after +1.2%) and Germany (+1.4% after +1.6%)

Headline and core inflation (%YoY)



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