

Economic Watch

Europe

Madrid, September 10, 2013
Economic Analysis

Europe Unit

Miguel Jiménez González-Anleo
mjjimenezg@bbva.com

Agustín García Serrador
agustin.garcia@bbva.com

Francisco José Ortega Castaño
franciscojose.ortega.castano@bbva.com

Diego Torres Torres
diego.torres.torres@bbva.com

Massimo Trento
massimo.trento@bbva.com

Growth with some upward surprises

Recent data suggest that GDP could contract somewhat below our -0.4% forecast for 2013 published three months ago

- **GDP growth in 2Q13 was due to domestic demand, but also to the positive contribution from the foreign sector**

The eurozone's GDP grew by +0.3% q/q in 2Q13, slightly above expectations (BBVA Research and Consensus: +0.2% q/q), and also showed a more balanced growth pattern. As we anticipated three months ago, exports once again grew (1.6% q/q; BBVA Research: 1.4%) following the decline seen in previous quarters, and did so more than imports (1.4% q/q; BBVA Research: 1.0%), despite the latter reflecting the stronger dynamism of domestic demand, resulting in a +0.2pp contribution from net exports to GDP growth (BBVA Research: 0.2pp).

The main surprise with regard to our forecasts was the improved performance of all the components of domestic demand, especially investment and public spending. Investment rose +0.3% q/q following the strong declines registered in the previous quarters (see table), somewhat more than the improvement envisaged in our forecasts (-0.3% q/q after -2.2% q/q in 1T13), which already included the disappearance of the temporary adverse effects at the start of the year, and suggests a widespread improvement in all the components of investment, and not only construction-related investment (as confirmed by German data). Public spending also provided an upward surprise, growing 0.4% q/q (BBVA Research: -0.1% q/q) after remaining virtually stagnant in the previous two quarters. This could be due in part to the change in the orientation of fiscal policy, probably through its impact on expectations, rather than a direct effect. Lastly, private consumption also grew once again in 2Q13 at a relatively strong rate (0.3% q/q, BBVA Research: 0.2% q/q), supported by improved consumer confidence and a certain stabilization of the labor market so far this year. In short, despite the fact that the change in inventories subtracted -0.1pp from quarterly GDP growth, domestic demand once again supported growth (0.1pp; BBVA Research: 0.0pp), after depressing economic activity for two years.

- **The countries in central Europe led the recovery, although the recession eased significantly in the periphery**

GDP in both Germany and France rose sharply in 2Q13 with 0.7% q/q and 0.5% q/q growth, respectively, providing an upward surprise especially in the case of France (BBVA Research: 0.5% and 0%, respectively), while the recession eased significantly in Italy (-0.2% q/q after -0.6% q/q in 1Q13) and in Spain (-0.1% q/q after -0.5% q/q in 1Q13), in line with our scenario. The figures available so far suggest that the recovery is already on track in the countries of central Europe, while the periphery will have to wait until the end of the year for the consolidation of a rather weak growth.

- **These data, along with the upward revision of GDP in the previous quarters, have a positive knock-on effect for the year as a whole**

With the publication of the National Accounts data for 2Q13, the figures for the previous quarters have also been revised upwards and now show a lower GDP decline in both 4Q12 and 1Q13 (+0.1pp revision in both cases to -0.5% q/q and -0.2% q/q, respectively). These upwards revisions, together with the slight surprise in 2Q13, result in a positive knock-on effect on our forecast of around +0.2pp for 2013 as a whole published in the last Europe Economic Outlook in early August, and should our forecast for the second half of the year be confirmed, it would involve a GDP decline somewhat more moderate than our -0.4% forecast three months ago.

- **The MICA-BBVA model estimates that the recovery should consolidate in 2H13, although the hard indicators still have to confirm the significant improvement in confidence data**

Although the available data are still very limited, as the figures published consist mainly of confidence indicators to August, our short-term model (MICA-BBVA) suggests that the recovery is still underway at a relatively stable pace, and estimates a quarterly growth for 3Q13 of around 0.3% q/q / 0.4% q/q, practically in line with our scenario published in August.

Confidence data, both PMIs and the figures from the European Commission's survey, improved significantly in both July and August and confirm the upward trend seen in 2Q13, even suggesting a certain acceleration of economic activity in this quarter. In addition, leading indicators, such as industrial orders or stock of finished goods, anticipate that such an improvement in economic activity should continue in the latter part of the year and suggest not only a support from foreign demand, but also greater dynamism of domestic demand.

However, we should be cautious and wait for the quantitative data to confirm these signs. For the time being, retail sales in the eurozone as a whole continue to show certain resilience of private consumption, supported by improved consumer confidence and the stabilization of the labor market.

However, some national data available for July, especially German data, show a less promising outlook for the start of 3Q13, with industrial output and exports contracting, due in part to the marked improvement seen in the previous months. Although they are consistent with the consolidation of recovery, they do not point to an acceleration of economic activity.

In short, including the latest data and maintaining the profile of our forecasts for 2H13 (0.3% q/q in 3Q12 and 0.2% in 4Q13), the 0.4% decline in GDP forecast for the eurozone in 2013 could be a couple tenths lower.

- **But the risks continue to be tilted to the downside, although a derailing of economic activity does not seem likely**

The reasons for this somewhat stronger than expected upturn in GDP already in 2Q13 seem to be both the easing of the fiscal policy targets decided in spring and the maintenance of an expansive monetary policy by the ECB, and these factors will likely continue in the coming quarters. In particular, at the ECB meeting held last week, the board was quite cautious in its interpretation of the positive surprises provided by the latest economic data, and now expects a somewhat less severe contraction for 2013

(-0.4% vs. -0.6% forecast in June) and 1% growth in 2014, without changing its view of a slow and gradual recovery in 2H13. The ECB's forecasts still consider that inflation will remain relatively stable and clearly below the target for the rest of this year and next year, in line with our forecasts (1.5% in 2014 and 1.4% in 2014). In short, their stance was quite dovish, which suggests an accommodative monetary policy within the forecast horizon, especially taking into account the poor performance of credit to the private sector.

However, several issues must still be addressed over the coming quarters that could play a determining role in the consolidation of recovery. Firstly, the boost provided to banking union needs to be maintained, as it is important for reducing the financial fragmentation affecting the eurozone. Secondly, the slowdown in emerging economies and its possible impact on European recovery should be moderate, in line with expectations, so that exports continue to be a source of growth within the forecast horizon. Lastly, the crisis in the periphery, especially in Portugal and Greece, which will possibly require new sources of external finance, should be managed in such a way that it generates no contagion effects in other countries.

Table 1
EMU: Quarterly GDP growth (%) and domestic components

| | 3Q12 | 4Q12 | 1Q13 | 2Q13 | |
|---------------------------------------|-------------|-------------|-------------|------------|---------------|
| | | | | Observed | BBVA Research |
| GDP | -0.1 | -0.5 | -0.2 | 0.3 | 0.2 |
| Private consumption | -0.1 | -0.5 | -0.2 | 0.2 | 0.1 |
| Public consumption | -0.2 | 0.1 | 0.0 | 0.4 | -0.1 |
| Investment | -0.4 | -1.2 | -2.2 | 0.3 | -0.3 |
| Change inventories ⁽¹⁾ | -0.2 | -0.2 | 0.4 | -0.1 | 0.0 |
| Domestic demand ⁽¹⁾ | -0.3 | -0.7 | -0.1 | 0.1 | 0.0 |
| Exports | 0.6 | -0.5 | -1.0 | 1.6 | 1.4 |
| Imports | 0.2 | -0.9 | -1.1 | 1.4 | 1.0 |
| Net exports ⁽¹⁾ | 0.2 | 0.1 | 0.0 | 0.2 | 0.2 |

⁽¹⁾ Contributions to quarterly GDP growth
Source: Eurostat and BBVA Research

The significant gain in confidence data in 3Q13 suggests that the recovery is gaining momentum across sectors

Chart 1

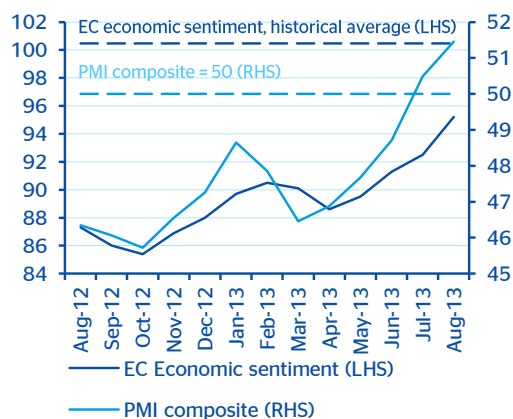
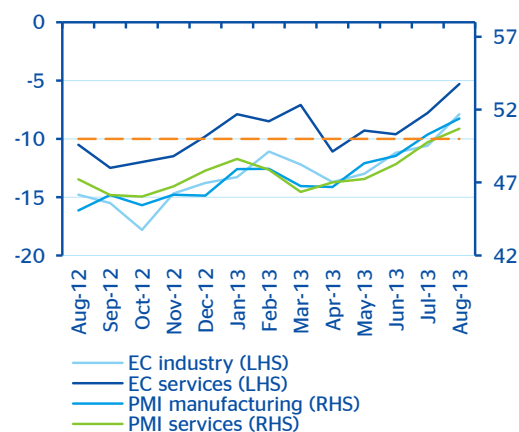
EMU: Confidence data


Chart 2

EMU: Confidence data


Source: European Commission, Markit Economics and BBVA Research

Hard indicators, although still limited, point to an incipient recovery in private spending, while exports continue to support economic growth

Chart 3

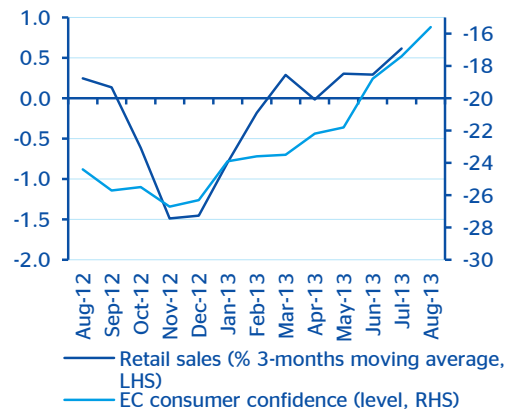
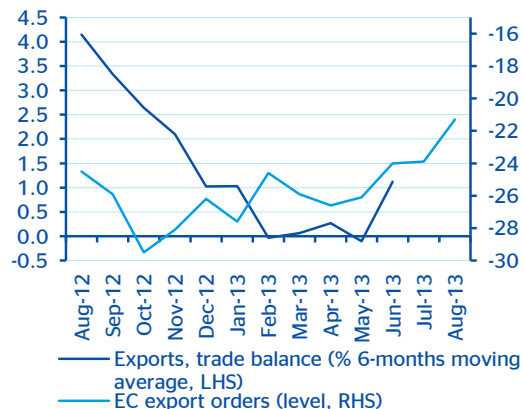
EMU: households consumption


Chart 4

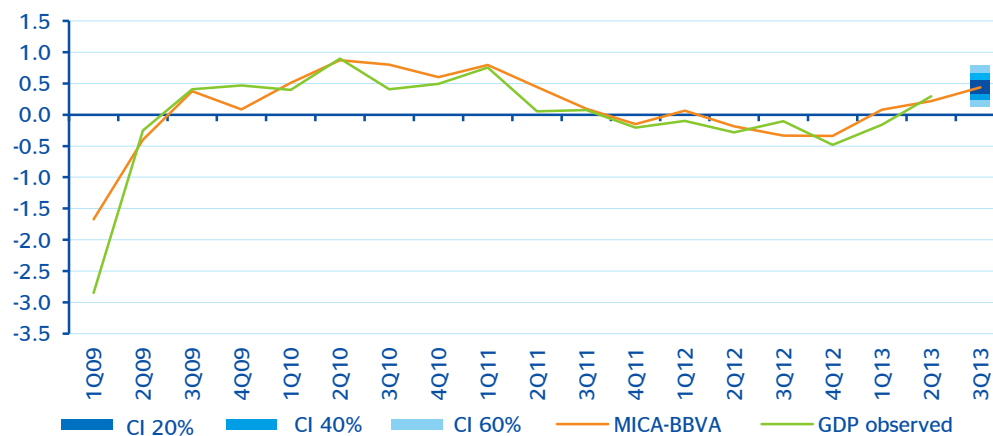
EMU: exports


Source: Eurostat, European Commission and BBVA Research

Our MICA-BBVA model, still limited to soft data, projects a consolidation of the recovery. GDP is forecasted to grow by +0.3%/+0.4% q/q in 3Q13

Chart 5

Quarterly GDP growth and MICA-BBVA forecast



Source: Eurostat and BBVA Research

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances; investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.