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Economic Watch

Europe

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Economic Analysis

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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: Quaterly GDP growth (%) and domestic components

				2Q13	
	3Q12	4Q12	1Q13	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 recovety is gaining momentum across sectors

Chart 1
EMU: Confidence data

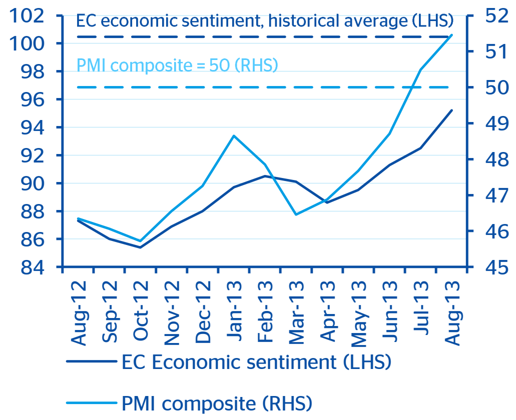
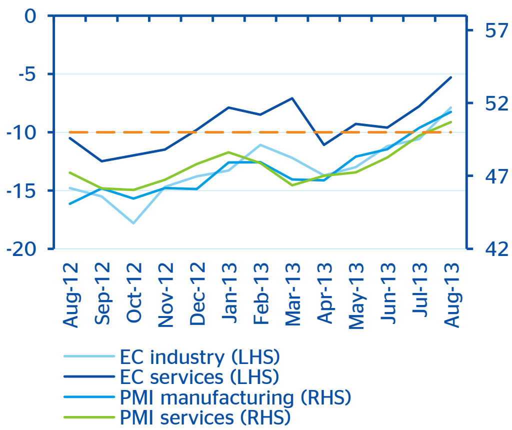


Chart 2
EMU: Confidence data



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

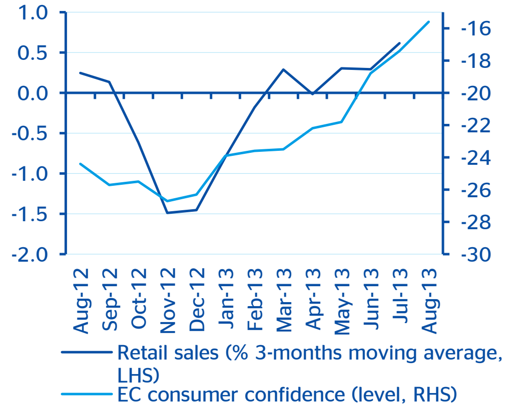
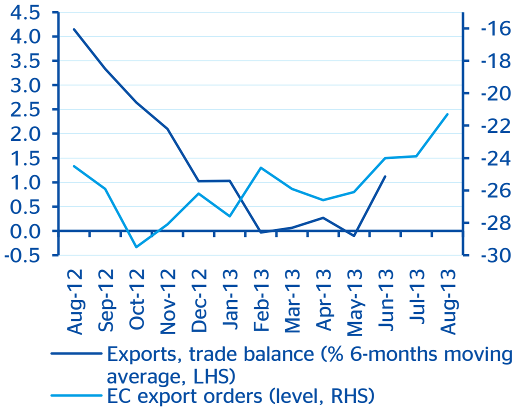


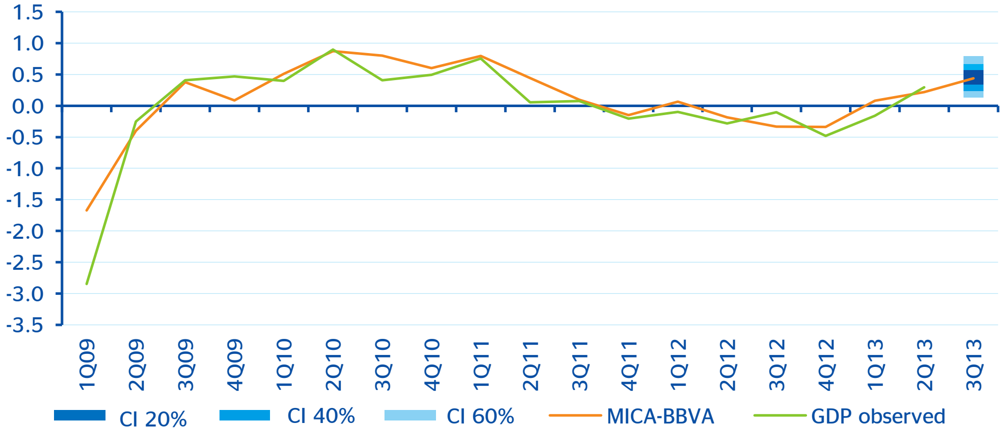
Chart 4
EMU: exports



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
Quaterly GDP growth and MICA-BBVA forecast



Source: Eurostat and BBVA Research

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