

Eurozone Economic Watch

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Economic Analysis

Europe

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Domestic demand strengthens growth, with very low inflation

The eurozone's short-term indicators are relatively positive, and point to 0.4% QoQ growth in the first quarter (even with a bias to the upside), which is somewhat more positive than the 0.2% in our base scenario. Confidence indicators continue to be positive, although in March they have not improved, which suggests that the second quarter may be somewhat weaker. This may be related to the crisis in Crimea or to doubts about growth in emerging markets. By large countries, Germany remains strong, Italy and Spain are getting better and France is looking weaker. When it comes to inflation, it should have troughed with March's 0.5% and we expect it to recover in April and in the second quarter overall. Even so, although we still see no high risks of deflation, it continues to be very low and far off the ECB's reference values.

The eurozone points to 0.4% QoQ growth in 1Q14. Inflation should lift slightly in 2Q14

- **Confidence indicators suggest that the growth rate gained traction at the beginning of the year, but doubts are appearing about whether it will last through the next quarter**

The European Commission's Economic Sentiment Index (ESI) continued rising significantly in March, its eleventh consecutive improvement, this time driven by services and staying above its historic average (Figures 3 and 4). The composite PMI index continues in clearly expansive terrain in both sectors, although at a slightly lower rate than in February (the highest level in nearly three years). In addition, the subcomponents in the indicators suggest that the improvement in activity will continue in April, given that new orders and backlogs of work continue rising, and the significant increase in consumer confidence may herald an improvement in private consumption in the next few months. In sum, both surveys suggest that the eurozone economy may already be growing at around its average growth of about 0.4%/0.5% QoQ in 1Q14.

- **Export recovery and signs of greater strength in internal demand**

Activity data available to date (still limited) point in the same direction as the confidence indicators. Exports were robust in January (0.6% above the average for 4Q13, after showing weakness in 2H13) and the heavy increase in orders from abroad presages good performance in 1Q14 (Figure 8). Despite industrial production moderating in January (-0.2% MoM, 0.1% over 4Q13 after rising 0.4% QoQ), national production indexes (Germany and Spain) anticipate a production uptick in February. In addition, the strength of global demand and the greater impetus in domestic demand ought to support the on-going recovery of capital and consumer goods production and to drive investment. Retail sales surprised again in February, showing an increase in the quarter so far of 0.8% over 4Q13 (-0.3% QoQ). Together with the stabilising job market, the moderation in inflation and the improvement in household confidence, they suggest that private consumption may continue growing at moderate rates (as it has done, at just 0.1% QoQ since 2Q13), although it might speed up slightly in the next few months (Figures 5 and 6).

In short, the information available is consistent with consolidating investment recovery and greater dynamism in domestic demand, although this will impact on greater growth in imports, so that the contribution of net exports may fall at the beginning of the year.

- **The MICA-BBVA model estimates growth of 0.4% QoQ in 1Q14**

When we introduce the data available to date (hard data are still limited), our short-term forecast model forecasts growth of around 0.4% QoQ in 1Q14 (after 0.2% QoQ in 4Q13, Figure 2).

- **Inflation softened in March, but we still expect the disinflation process to stop in 2Q14**

The calendar effect of the Easter holidays has shown in March in a moderation of inflation of 0.2pp, bringing it to 0.5% YoY, and it has also affected core inflation which fell 0.2pp to 0.8% YoY (Figures 11 and 12).

We continue to forecast that inflation will rise again in 2Q14, by around 0.4pp to 0.9% YoY, and that it will stay relatively stable until the last quarter of this year, when it might return to rates above 1% YoY. Core inflation is likely to go up in April, staying stable at around 1.1% for the rest of the year.

The resilience of core inflation in the last few months may help to dispel fears about the intensity and nature of the disinflation process and its possible negative effect on inflation expectations, although the April figure will be key in confirming this scenario. However, inflation will stay well below the ECB's target and the differences between central and peripheral countries will remain, with very low rates on the periphery and moderate rates in central European countries. Risks continue tilted to the downside, a result above all of the strength of the euro and the moderation in oil prices.

Germany: the figures point to higher, and more balanced, growth

- **The solidity of domestic demand may have taken over from net exports as the main underpinning for growth in 1Q14**

More recent data confirm our scenario of a solid recovery based on robust domestic factors and exports. Retail sales increased significantly, in both January and February (1.7% over 4Q13 after -0.3% QoQ in that quarter), in line with the improvement in consumer confidence indicators, as was the case in industrial production which, even discounting the construction sector, showed solid growth at the start of the year (1.2% over 4Q13 after 0.6% QoQ) (Figures 15 to 18). All this, together with the sound confidence and forward indicator data to March, points to this improvement continuing in the next few months, although at a gentler rate.

Orders from abroad and good export performance to February (1.1% over 4Q13, despite the correction from the January bounce) suggest that net exports will continue to support growth at the beginning of the year, although we expect a more moderate contribution (1.1pp in 4Q13) because of the greater movement in imports (Figures 19 and 20). As a whole, we forecast GDP growth of 0.6% in 1Q14 (Figure 14).

France: growth moderates at the beginning of the year

- **Support of domestic demand could flatten**

For the first quarter, the Bank of France estimates a slight growth of 0.2% QoQ (after 0.3% QoQ in 4Q13), although available data point to an even more moderate growth. Confidence indicators, whether national, PMIs or from the Commission, improved a little to March, although real data show a somewhat less optimistic panorama (Figures 27 to 30). On the one hand, industrial production fell in January for the second consecutive month leaving production at around -0.2% below its 4Q13 level. Household consumption data are not very bright either, with retail sales practically stagnant and consumption expenditure contracting significantly compared to 4Q13. In short, these data points to a lower contribution from domestic demand at the start of the year. Nevertheless, the heavy fall in imports should be reflected in a new positive contribution from net exports to quarterly growth (after the 0.2pp of 4Q13), although exports had not taken off by February (Figures 31 and 32).

Italy: recovery confirmed at the start of the year

- **Positive trend of exports and fragile internal demand**

On the basis of January data only, it is likely that the principal growth factor in 1Q14 will continue to be net exports: whilst imports remain flat, exports grew 1.3% over the previous quarter, and forward indicators (export orders) suggest that the trend may continue in the coming months (Figures 43 and 44). This is also reflected in a timid recovery in industrial production (0.6% over 4Q13) which by the end of last year had already returned to growth after ten consecutive quarters of contraction.

By contrast, retail sales continue to show weak internal demand, racking up seven QoQ falls in a row, and sticking to that trend at the beginning of the year, a vulnerability that may last over the next few months, as anticipated by the confidence indicators and in view of the disappointing unemployment figures (13%, the worst rate since 1977).

Spain: the Spanish economy grows and creates employment

- **Economic recovery gains traction**

The improvement in the Spanish economy since the summer of 2013 has been sustained by reduced financial stress, by less need for fiscal adjustment than in 2012, by the solid export sector and, finally, by structural reforms. These factors continue to have a positive impact on domestic demand (private, mainly) and to underpin the consolidating recovery (our MICA-BBVA model estimates an activity expansion rate of between 0.4% and 0.5% over 4Q13) throughout the 2014-15 period (+0.9% YoY and 1.9% YoY, respectively), which will also be accompanied by employment creation for the second consecutive quarter.

The composition of growth in 1Q14 may have been more balanced than at the end of 2013. As far as foreign demand is concerned, expectation indicators (industry export order-books) and expenditure indicators (trade balance and foreign sales by large corporations) both confirm that the flattening in goods exports recorded in 2H13 has begun to reverse (Figures 55 and 56). To the contrary, the trend of the indicators linked to services exports points to a slowdown, probably transitory, in their growth.

On the side of private domestic demand, the recovery is expected to continue at a rate similar to 2H13. Expenditure indicators for household consumption and expectations improved in 1Q14, which points to a growth in private consumption similar to that of the previous quarter. Similarly, the uptick in both industrial confidence and manufacturing PMIs, together with positive movement in the capital goods IPI in the January-February average and sound goods export performance in January, allows us to forecast increased machinery and equipment investment, close to levels seen at the end of 2013 (see [Spain Economic Watch](#)).

Eurozone

National Accounts: 0.2% QoQ growth in 4Q13

Growth was underpinned by exports and investment. Our MICA-BBVA model forecasts growth of 0.4% QoQ in 1Q14, tilting our scenario slightly to the upside.

Chart 1
GDP (%QoQ) and contribution by components (pp)*

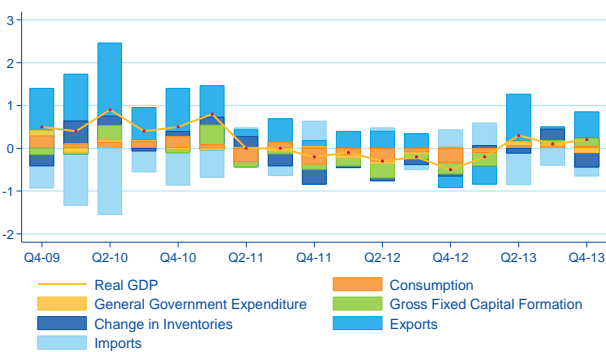
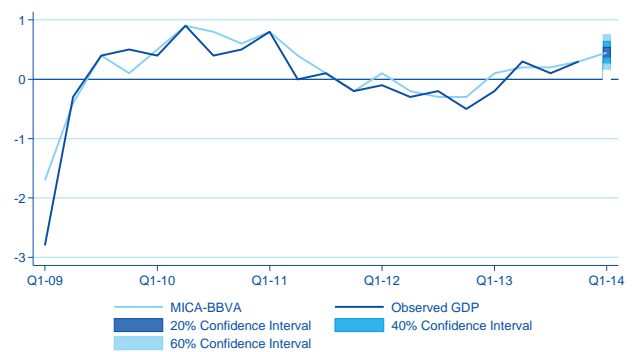


Chart 2
GDP growth (%QoQ) and MICA-BBVA forecast*



Confidence: growth could gain more impetus in 1Q14

ESI, the EC confidence indicator, continued to improve in all sectors in March, while the PMIs continue in expansive territory, albeit at a slightly lower level. This data confirms that the eurozone's recovery could be gathering momentum, and as always led by Germany.

Chart 3
PMI and GDP growth (%QoQ)*

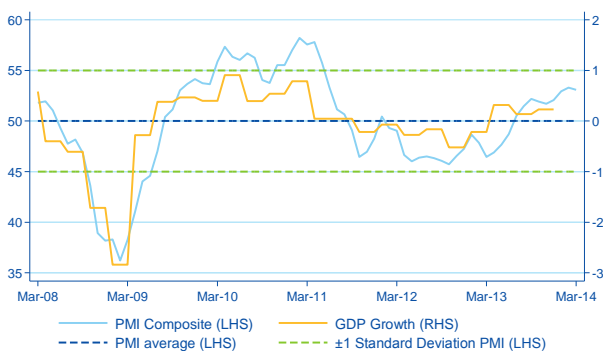
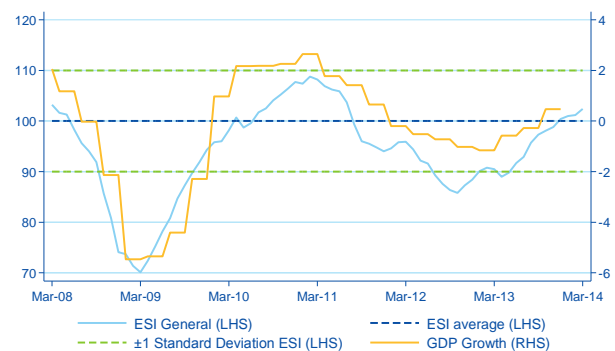


Chart 4
Confidence (ESI) and GDP growth (%YoY) **



Activity: retail sales increase again in January, but industry is stagnant

Retail sales, after closing 4Q13 with a contraction of 0.5% QoQ, increased considerably in January and fairly evenly across the member states. Industrial production growth moderated over 4Q13.

Chart 5
Industrial prod.(%YoY), manuf. new order and output PMI*

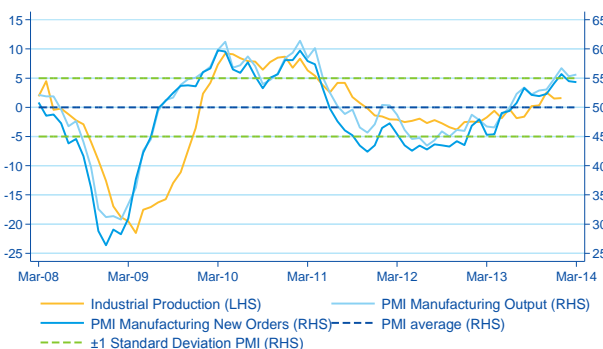
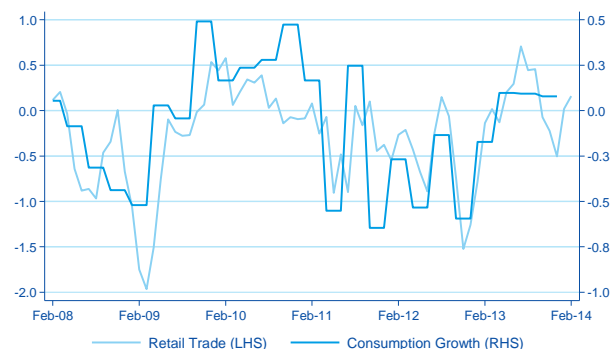


Chart 6
Retail trade (% 3m/3m) and consumption growth (%QoQ)*



*Source: HAVER ANALYTICS and BBVA Research

Foreign sector: heavy fall in imports points to net exports contributing once again to growth

Exports were robust in January (0.6% over 4Q13), but the vigour of imports could impact on a lower contribution of net exports.

Chart 7
Current account (% of GDP)*

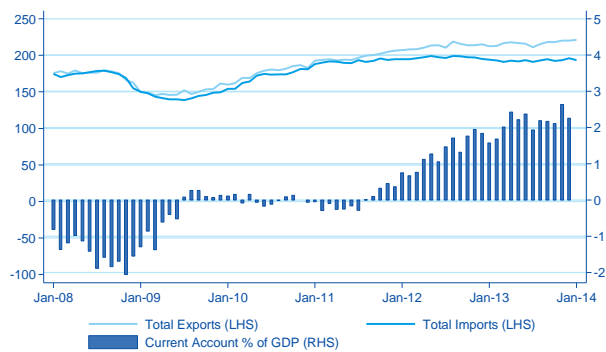
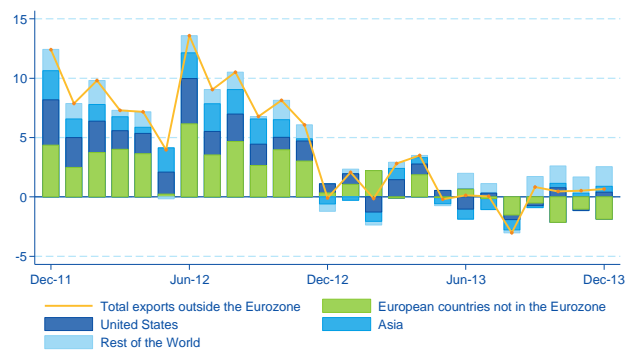


Chart 8
Exports by destination (contribution to %YoY)



Labour market: stable over the last year

Although we believe that a moderate recovery is underway, the unemployment rate is unlikely to drop in the short term due to the lag between output and employment, as well as the fact that idle capacity is still at high levels. Even so, wage costs went up in 4Q13.

Chart 9
Unemployment rate (%) and employment expectations*

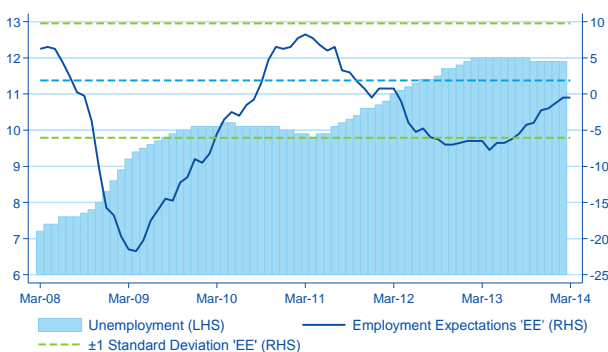
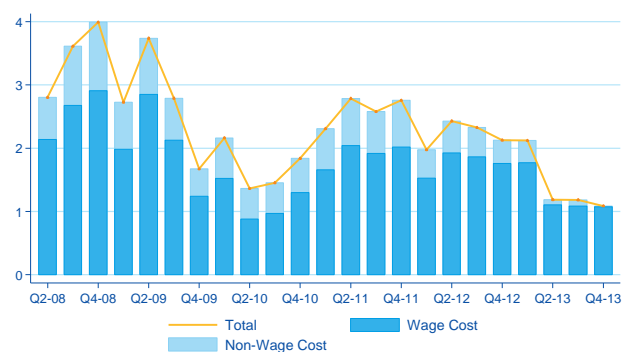


Chart 10
Labour cost in the business sector (%YoY)*



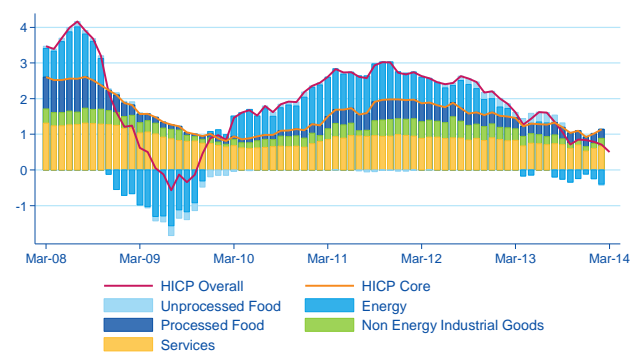
Prices: inflation moderated again in March as a result of seasonal factors

Inflation in the eurozone went down by 0.2pp to 0.5% YoY in March. The slowdown was due to seasonal factors and the fall in energy prices. Inflation should increase in the second quarter to 0.9% YoY.

Chart 11
Inflation rate, headline and core (%YoY)*



Chart 12
Inflation by components (contribution in %)*



* Sources: HAVER ANALYTICS and BBVA Research

Germany

National Accounts: net exports contributed positively to growth again, with a stable pace of recovery in investment

GDP growth went up in 4Q13 by 0.4% QoQ, thanks to the contribution of net exports (1.1pp after slipping -0.7pp in 3Q13) and of investment (+1.4% QoQ), which offset the strong negative contribution of inventories (-0.8pp).

Chart 13
GDP (%QoQ) and contribution by components (pp)*

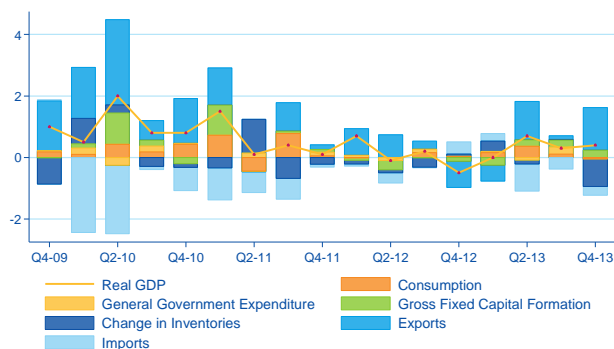


Chart 14
GDP (%QoQ) and forecasts*



Confidence: confidence remains at high levels in March

The strength of confidence was due, above all, to better expectations in the services sector. The composite PMI remained at levels well above the growth threshold and registered growth in both sectors in March.

Chart 15
PMI and GDP growth (%QoQ)*

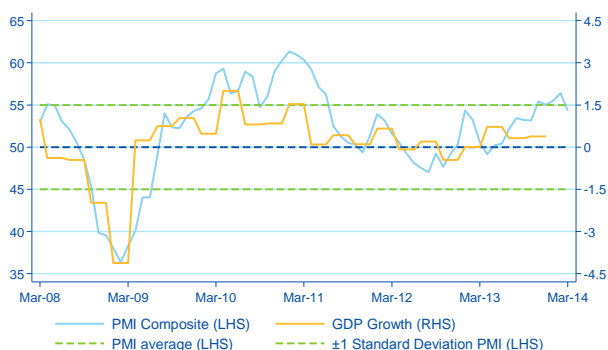
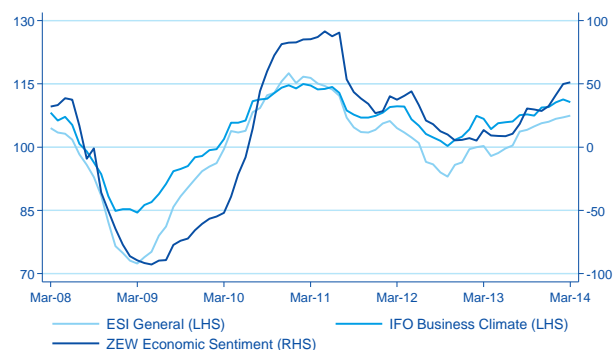


Chart 16
Confidence indicator (ESI, Ifo and ZEW)*



Activity: industrial production and retail sales improved

Retail sales continued to rise (+1.3% MoM) after a strong uptick in January, while industrial production retained its positive bias (+1.7% over 4Q13), in line with the confidence indicators and the continued increase in industrial orders.

Chart 17
Industrial prod. (%YoY) and manufacturing PMI*

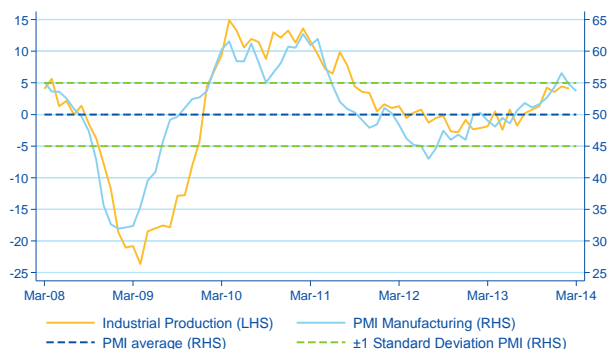
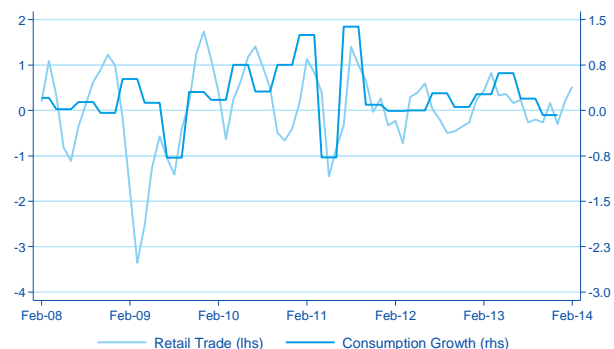


Chart 18
Retail trade (% 3m/3m) and consumption growth (%QoQ)*



*Sources: HAVER ANALYTICS and BBVA Research

Foreign sector: exports maintain their positive bias of the last few months

Robust rise in exports in 4Q13 (+1.1% QoQ). Orders from foreign markets presage that the trend will continue in upcoming months. In January both exports and imports went up strongly.

Chart 19
Current account (% of GDP)*

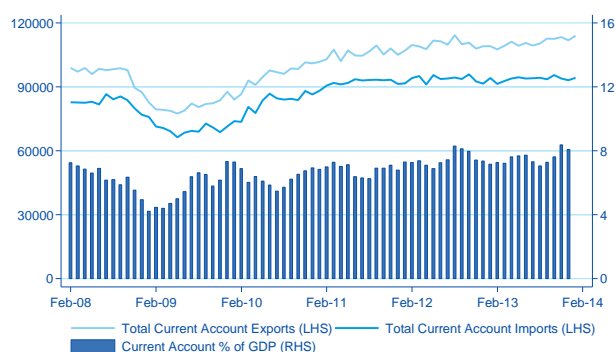
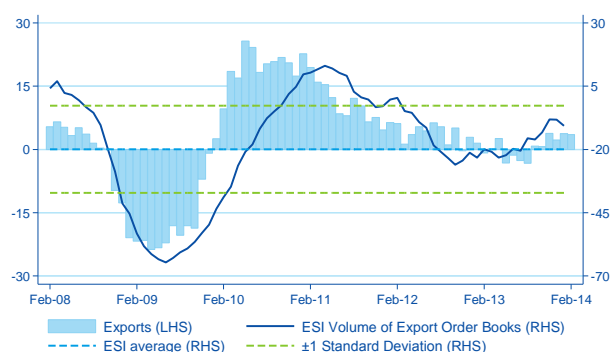


Chart 20
Export growth (%YoY) and volume of export order books*



Labour market: the unemployment rate stays at all-time lows

The unemployment rate fell again to its historic low (5.1%) in February. This could give rise to upward pressure on wages in the next few months, as has already been reflected in the 0.9% QoQ increase in labour costs in 4Q13.

Chart 21
Unemployment rate (%) and employment expectations*

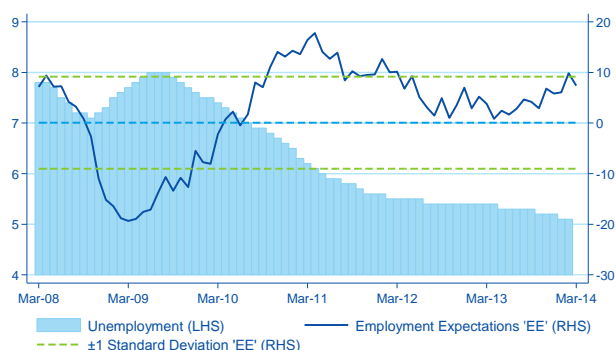
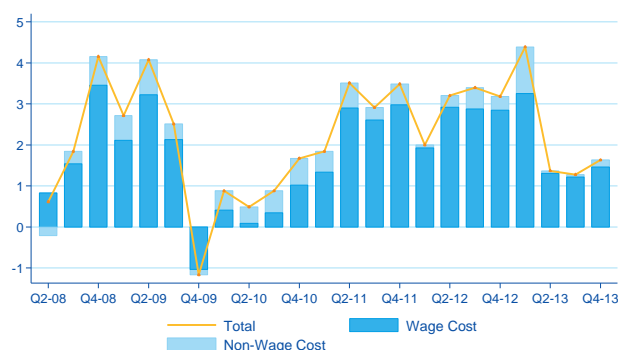


Chart 22
Labour cost in the business sector (%YoY)*



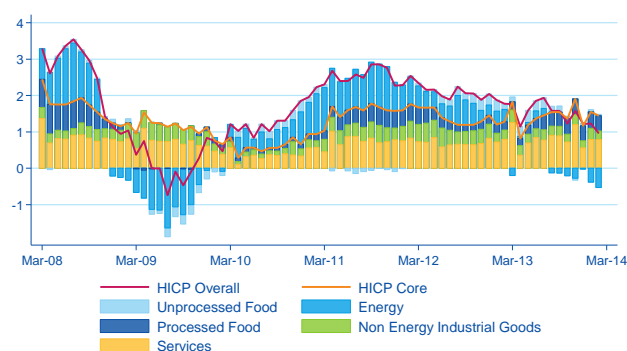
Prices: inflation slows again in March

Harmonised inflation has dropped another decimal point to 0.9% YoY in March (flash), mainly because of the fall in food prices and services.

Chart 23
Inflation rate, headline and core (%YoY)*



Chart 24
Inflation by components (contribution in %)*



* Sources: HAVER ANALYTICS and BBVA Research

France

National accounts: domestic demand is supporting growth

GDP expanded 0.3% QoQ in 4Q13, after the stagnation seen in 3Q13, due to the recovery of net exports and improved private consumption (0.5%) and investment (0.6% QoQ), although inventories are a burden on growth (-0.3pp).

Chart 25
GDP (%QoQ) and contribution by components (pp)*

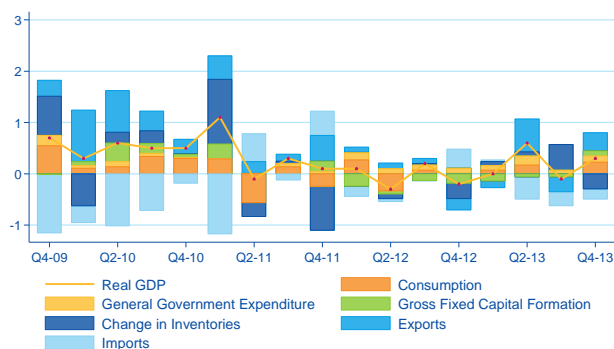
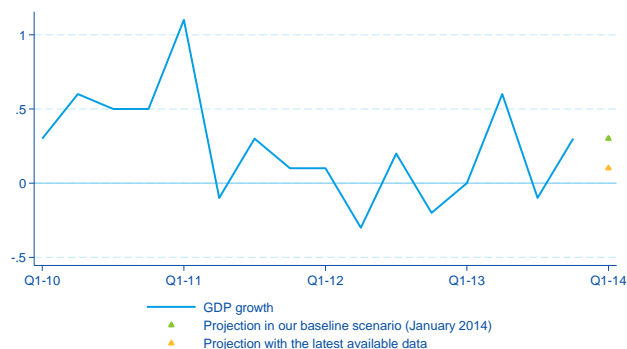


Chart 26
GDP (%QoQ) and forecasts*



Confidence: March indicators are optimistic again about recovery

PMIs left negative territory in March, returning to levels of (weak) growth, especially in manufacturing, after four months of negative results, although without a quantitative sign. The INSEE, the European Commission and BdF confidence indicators remain virtually unchanged.

Chart 27
PMI and GDP growth (%QoQ)*

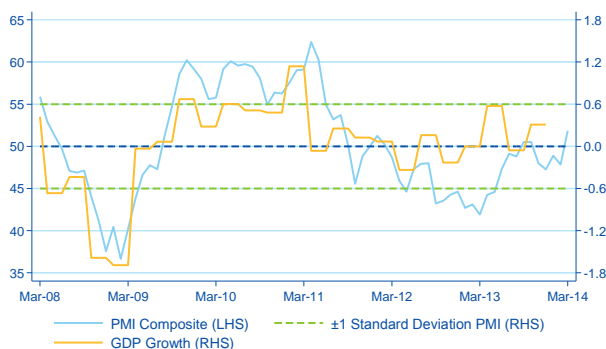
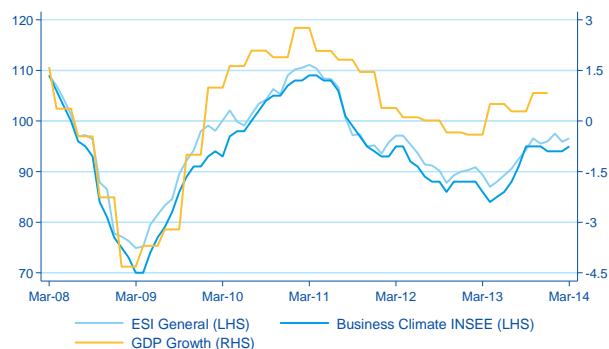


Chart 28
Confidence indicator (ESI and INSEE)*



Activity: both industrial production and retail trade continue weak

Retail sales increased in February (+0.4% MoM), but stayed virtually flat compared to 4Q13 (-0.2% QoQ); industrial production declined slightly, although manufacturing maintains the improving trend seen since October, after having fallen 0.9% QoQ in 3Q13.

Chart 29
Industrial prod. (%YoY) and manufacturing PMI*

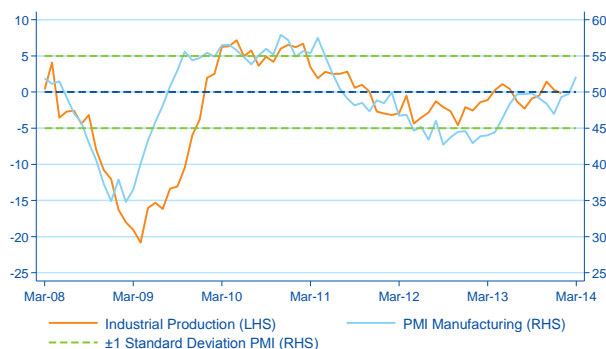
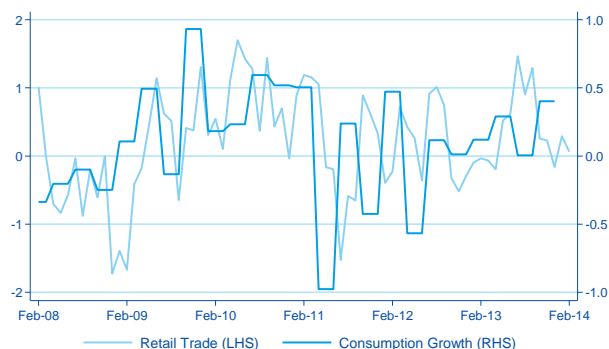


Chart 30
Retail trade (% 3m/3m) and consumption growth (%QoQ)*



*Sources: HAVER ANALYTICS and BBVA Research

Foreign sector: exports continue to fall at the beginning of 2014

Exports did not start taking off until February, but the heavy fall in imports should be reflected in a positive contribution of net exports to quarterly growth.

Chart 31
Current account (% of GDP)*

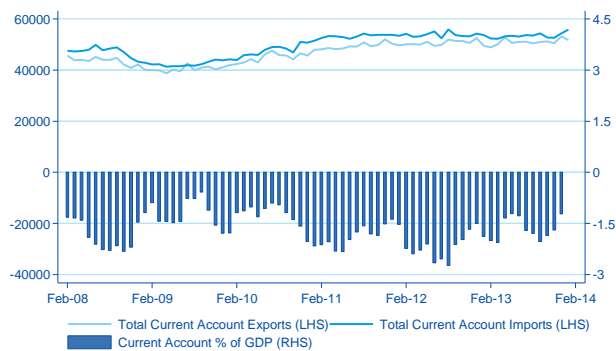
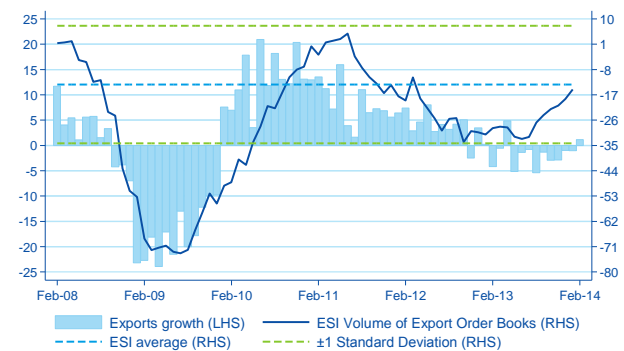


Chart 32
Export growth (%YoY) and volume of export order books*



Labour market: a degree of stabilisation in the last few months

The unemployment rate stabilised at around 11% last year after having risen approximately 0.2pp per quarter over the course of the year before. Labour costs declined considerably during 2013 as a result of the drop in non-wage costs.

Chart 33
Unemployment rate (%) and employment expectations*

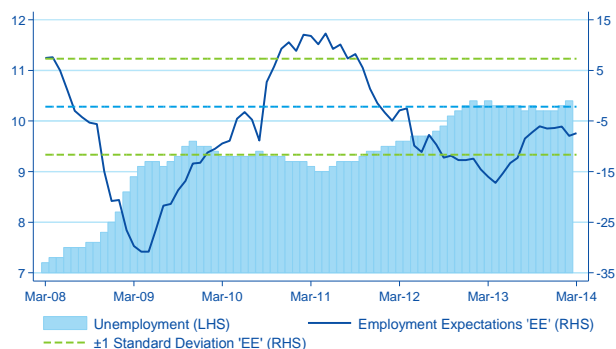
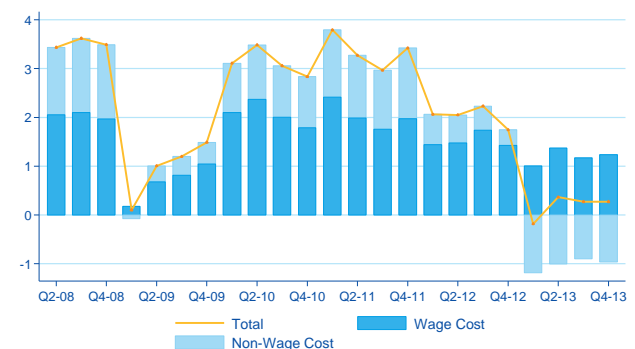


Chart 34
Labour costs in business sector (%YoY)*



Prices: inflation creeps back over 1% YoY in February

Harmonised inflation increased to 1.1% YoY in February, mainly because of increased prices for services. Core inflation also went up to 0.7% YoY.

Chart 35
Inflation rate, headline and core (%YoY)*

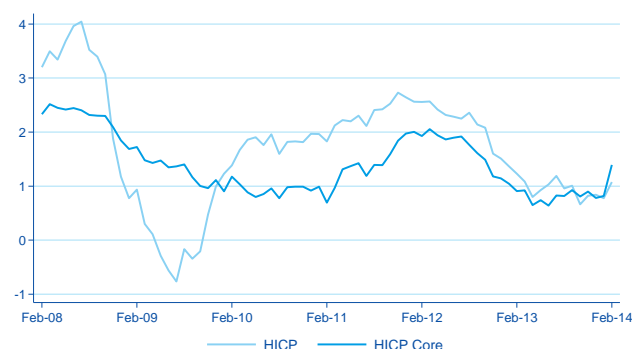
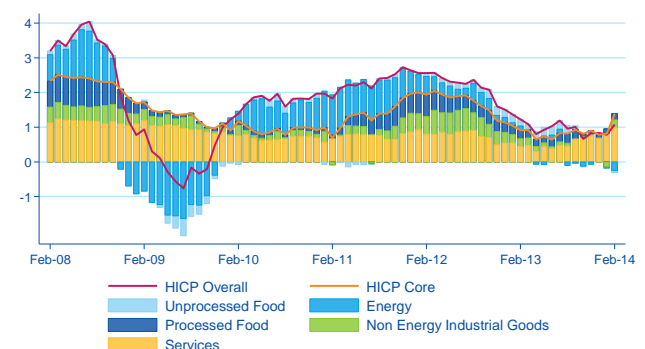


Chart 36
Inflation by components (contribution in %)*



* Sources: HAVER ANALYTICS and BBVA Research

Italy

National accounts: slowly coming out of recession

GDP went up in 4Q13; external demand has continued to support growth (0.3pp) while internal demand has been less of a drain on growth, mainly thanks to the improvement in the investment component (+0.9% QoQ).

Chart 37
GDP (%QoQ) and contribution by components (pp)*

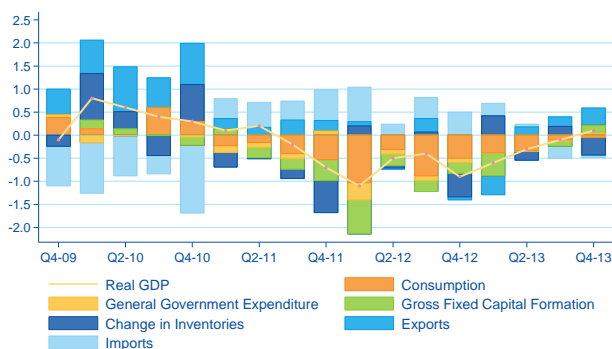
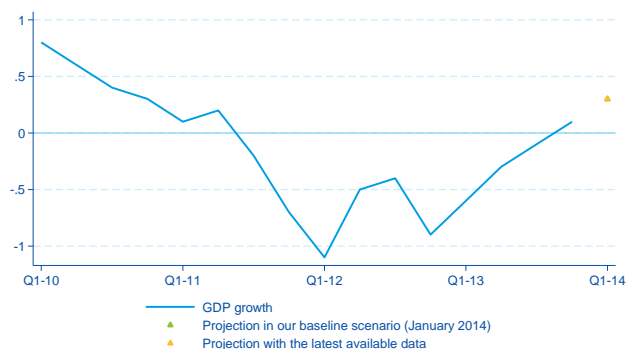


Chart 38
GDP (%QoQ) and forecasts*



Confidence: optimism increases in March

The composite PMI data was stable in March in expansive territory, but growing less than in February, mainly because of negative expectations in the services sector; national business confidence indicators and the EC indicator have returned to strong improvements in March.

Chart 39
PMI and GDP growth (%QoQ)*

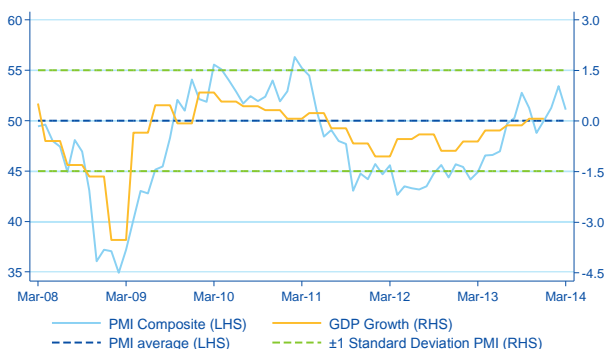
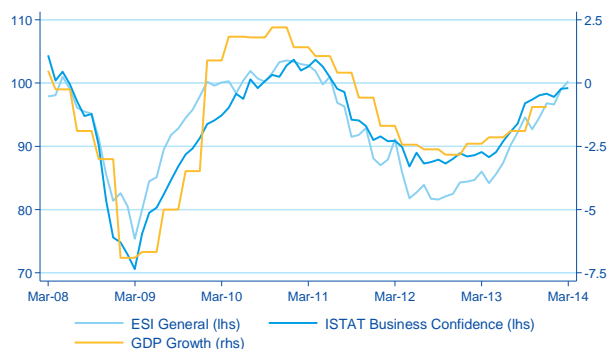


Chart 40
Confidence indicator (ESI and ISTAT)*



Activity: positive bias for the industrial sector and weakness in retail trade

Industrial production has again increased in January, after recording a rise of 0.7% over the average for 3Q13; meanwhile, the seventh consecutive quarter of retail sales contraction confirms the weakness of domestic demand.

Chart 41
Industrial prod. (%YoY) and manufacturing PMI*

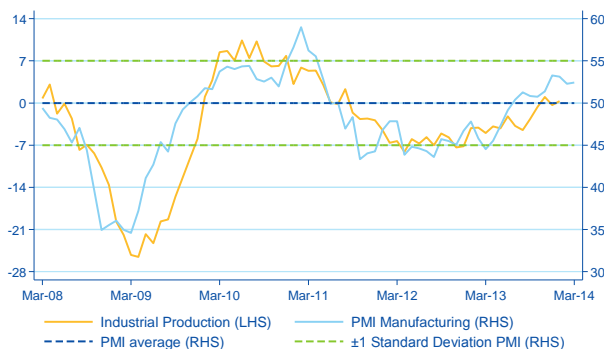
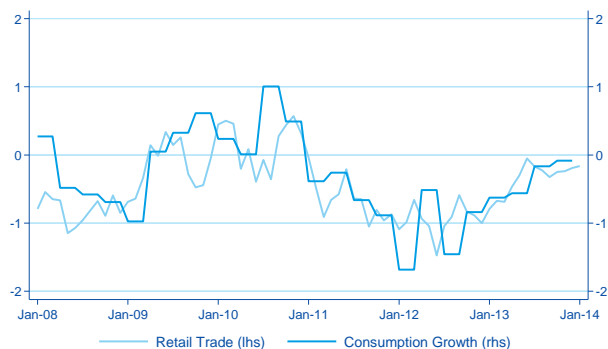


Chart 42
Retail trade (% 3m/3m) and consumption growth (%QoQ)*



*Sources: HAVER ANALYTICS and BBVA Research

Foreign sector: net exports are the main growth factor in the short term

After growing in 4Q13 (0.9% QoQ) and the strong uptick in December, exports fell in January, but so did imports, confirming forecasts pointing to net exports as the principal growth factor in the short term for Italy.

Chart 43
Current account (% of GDP)*

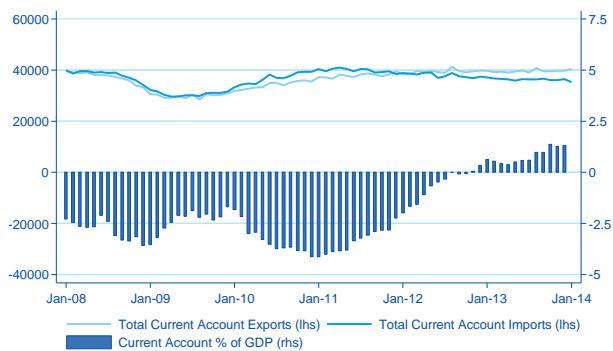
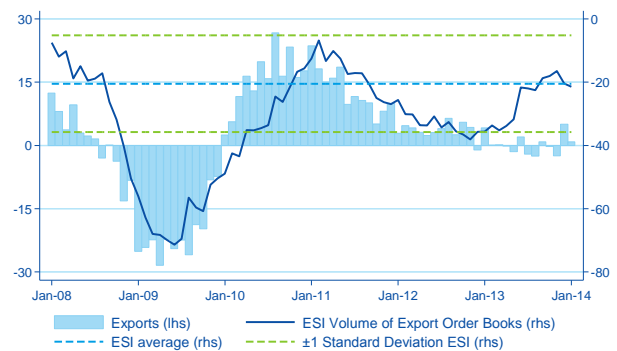


Chart 44
Export growth (%YoY) and volume of export order books*



Labour market: unemployment continues to rise, with labour costs softening

The unemployment rate continues at very high levels, the worst figure ever, 1.1pp up on a year ago, and employment outlooks worsen. Labour costs still increased at a fast pace in 4Q13.

Chart 45
Unemployment rate (%) and employment expectations*

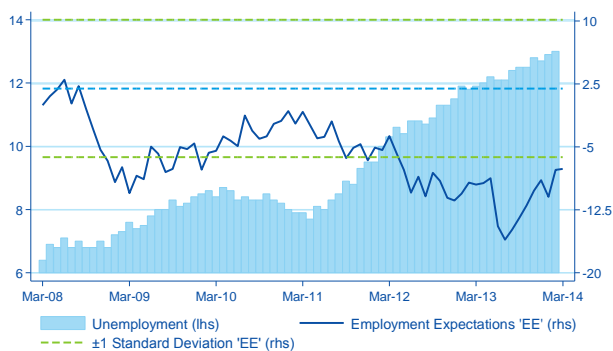
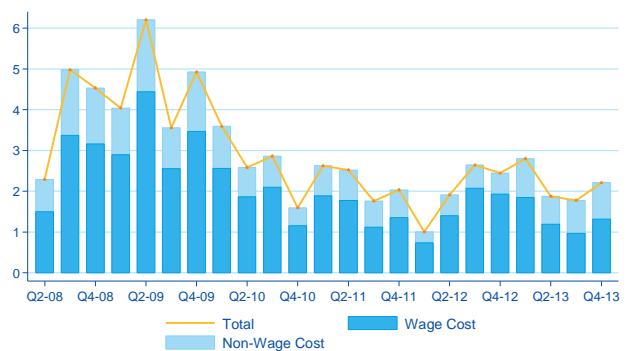


Chart 46
Labour costs in the business sector (%YoY)*



Prices: inflation slows again to 0.3% in March

Inflation slowed rapidly from the middle of last year, but stayed steady at 0.7% YoY in 4Q13 due to the fall in energy prices and less growth in service prices, and continues slowing in March.

Chart 47
Inflation rate, headline and core (%YoY)*

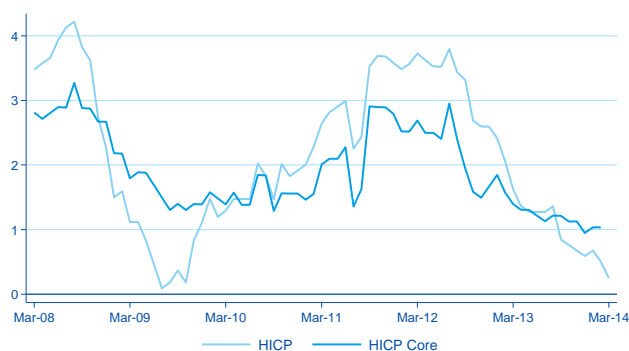
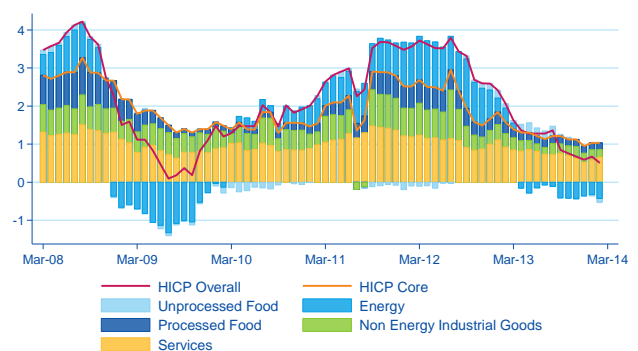


Chart 48
Inflation by components (contribution in %)*



* Sources: HAVER ANALYTICS and BBVA Research

Spain

National accounts: exports hold firm and private domestic demand starts to recover

The economy grew +0.2% QoQ in 4Q13. The improvement is thanks, above all, to solid exports and the recovery of private demand.

Chart 49
GDP (%QoQ) and contribution by components (pp)*

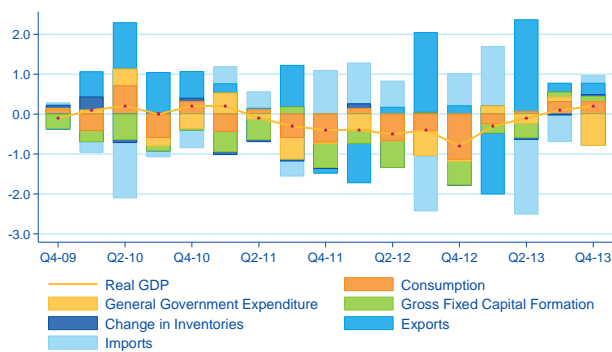
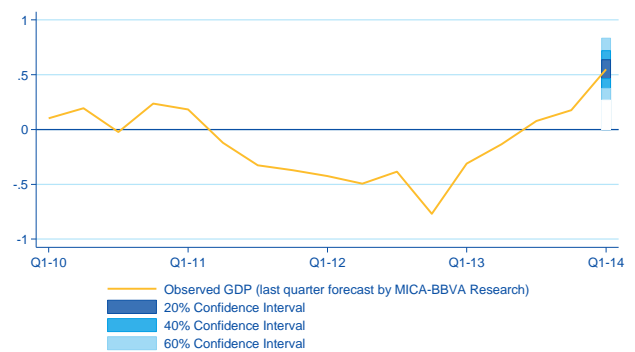


Chart 50
GDP growth (%QoQ) and MICA-BBVA forecast*



Confidence: outlook improves in the first quarter

The ESI and PMI indexes picked up over 4T13, with PMIs well above the growth threshold in 1Q14, particularly in services and with the consumer confidence index trending positively.

Chart 51
PMI and GDP growth (%QoQ)*

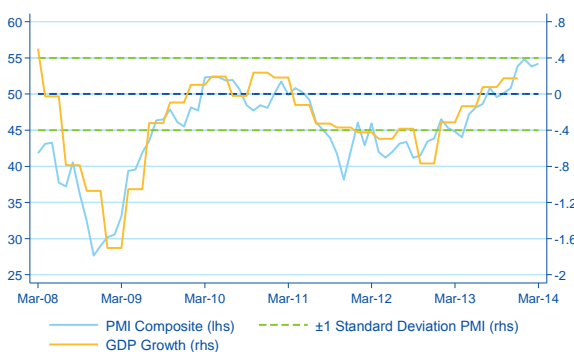
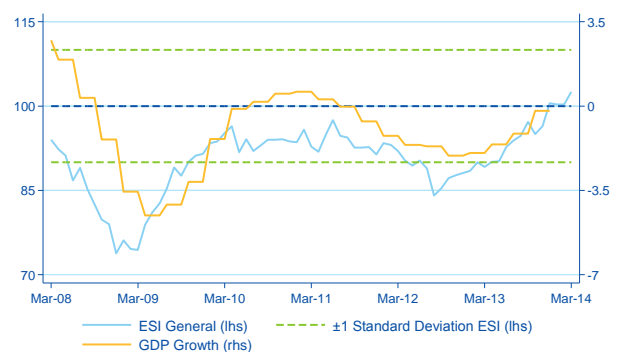


Chart 52
Confidence (ESI) and GDP growth (%YoY) *



Activity: industrial production surprises to the upside and retail trade stagnates

Some consumer expenditure indicators continued to show signs of stabilising, and although retail sales stagnated in February, industrial production has grown.

Chart 53
Industrial prod. (%YoY) and manufacturing PMI*

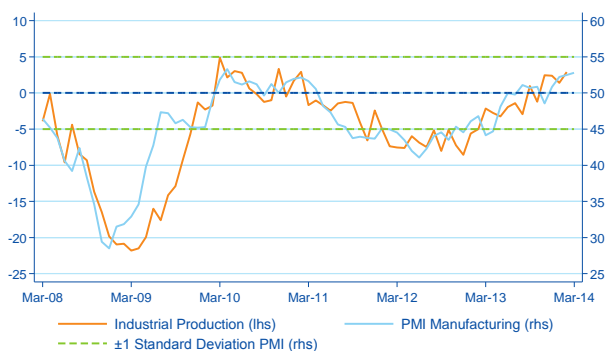
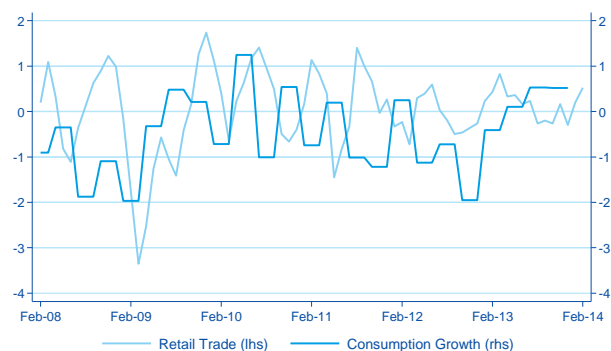


Chart 54
Retail trade (% 3m/3m) and consumption growth (%QoQ)*



*Sources: HAVER ANALYTICS and BBVA Research

Foreign sector: exports improve at the beginning of the quarter

Growth in January and companies' expectations (export order books) indicate that the slowdown in exports over the last few months has started to reverse at the beginning of 2014.

Chart 55

Current account (% of GDP)*

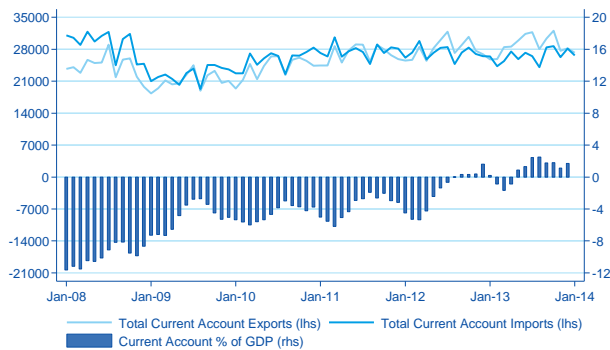
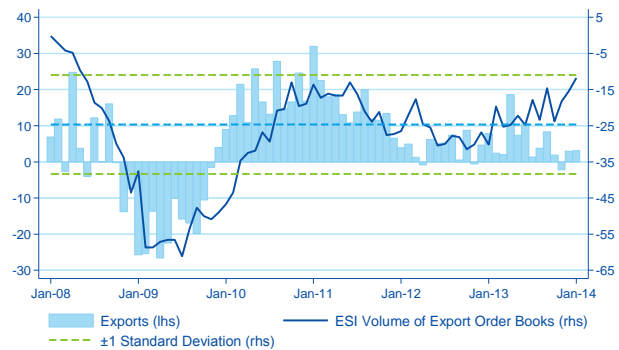


Chart 56

Export growth (%YoY) and volume of export order books*



Labour market: the positive signs continue

Social security affiliations have had a seven-month run of consecutive increases to March. Meanwhile, registered unemployment has clocked up ten consecutive months of falls, which gave rise to the third quarterly reduction in registered unemployment.

Chart 57

Unemployment rate (%) and employment expectations*

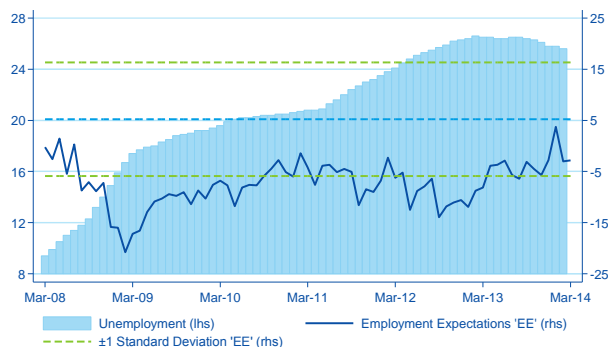
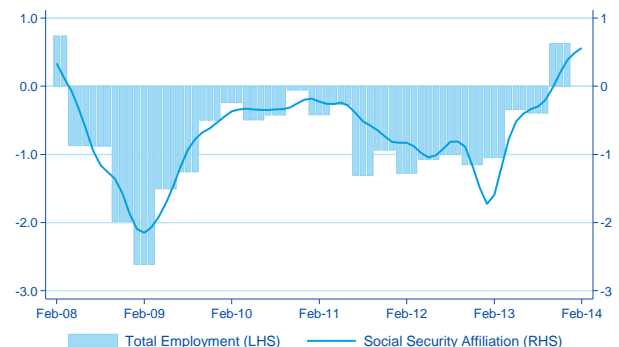


Chart 58

Employment growth: N.A. and social security (% 3m/3m)*



Prices: prices fall in March due to the base effect of the date of Easter

Headline inflation fell 0.2pp to -0.2% YoY in March, due mainly to the base effect of the date of Easter, but also because of the fall in food prices. Core inflation moderation and should come in at 0.0% YoY.

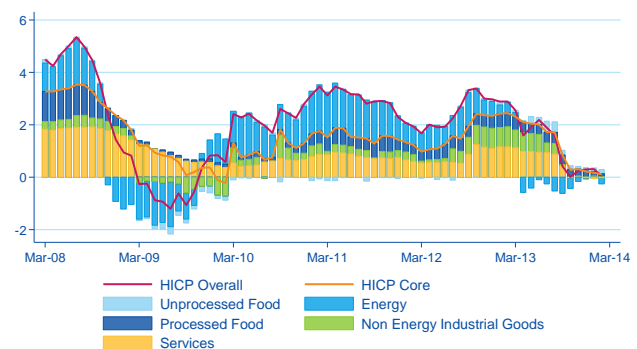
Chart 59

Inflation rate, headline and core (%YoY)*



Chart 60

Inflation by components (contribution in %)*



* Sources: HAVER ANALYTICS and BBVA Research

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