

Economic Outlook

Europe

Second Quarter 2012
Economic Analysis

- **The eurozone economy will recover slowly** during the second half of the year.
- **The stark divergence between the core and periphery** is explained by financial stress and strong fiscal adjustment in the latter.
- **European authorities should clarify the institutional setting and policies** of the eurozone for the coming years.
- **Progress towards a fiscal union**, a fiscal strategy focused on structural deficits and stronger liquidity support for sovereigns would help to solve the crisis.

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Closing date: May 10, 2012

1. Editorial

The eurozone continues to be hit by a crisis in the periphery. After months of restraint, financial strains have re-emerged. Recent data shows that the eurozone economy has stagnated in the first half of the year, and we project that the recovery will come slowly through the second half and will continue at a moderate pace during 2013. The divergence between the core and the periphery will be large, mostly due to the ongoing financial stress and the sharp fiscal adjustment experienced by the latter. Apart from these two main negative drivers, growth will be supported by the ongoing progress in the rest of the world.

This scenario, though sluggish, is dependent on a progressive improvement of financial conditions over the second half of the year, which is uncertain, as risks related to the situation in Greece and to persistent doubts on other periphery countries remain. Avoiding such risks depends on the policy response to the crisis at area-wide and national level. There is ample room for improvement on that front.

The response to the eurozone crisis has been articulated over the past months at three levels, and in all three there is margin for further action:

- **Improvement of institutions to prevent future crisis:** The EU has approved a fiscal compact that reinforces fiscal discipline, and developed an early alert system to identify imbalances and ultimately suggest policy recommendations to correct them. However, this institutional setting would be much improved if there were clear advances towards a fiscal union, eventually leading to loss of national fiscal sovereignty in exchange of further debt pooling through eurobonds. These could be designed in a way that strong incentives to avoid excessive debt are maintained. The positive effect that would generate a clear roadmap towards such an institutional setting would contribute decisively to the resolution of the current crisis.
- **Liquidity support to sovereigns:** The ECB has provided ample liquidity for the banking sector, and thus indirectly to sovereigns, but not directly to clearly solvent sovereign countries facing liquidity problems. The role of the ESM as a provider of liquidity (becoming senior creditor) is subject to strict conditionality and lacks flexibility, while its resources are perhaps not large enough to cover contagion effects to large countries. In both cases there is room for a more pro-active intervention.
- **National reforms and fiscal austerity:** The cornerstone of the European strategy to recover market confidence for the periphery has been based on rapid fiscal consolidation and structural reforms in problematic countries. There have been substantial advances on that front in most of them. These reforms are essential, but the strategy has met a serious obstacle in the fiscal consolidation process. As the key problem in the periphery is the lack of competitiveness and the development of private imbalances, the focus on structural reforms is of utmost importance, although they take time to work through the economy. The excessive focus on a too quick fiscal consolidation process has led markets to doubt the sustainability of the strategy, as debt to GDP ratios cannot improve in a recession. One risk in this strategy, sometimes overlooked, is that support of structural reforms could fade in a recessionary environment. Hence, we think that complementing the current strategy with a growth compact makes sense. It is important to lay out European programs to support growth in countries implementing structural reforms with infrastructure investment, or setting incentives to revive the labour market, but resources seem to be scarce at present. It would help if countries that have fiscal margin and high savings stimulate their domestic market, though this depends on national choices. But one should not underestimate the advantages of addressing the fiscal consolidation process by setting fiscal targets for the correction of the structural deficit, rather than the overall deficit. This would help to avoid an overreaction to cyclical events and is in line with the long-term fiscal framework laid out in the fiscal compact.

All in all, Europe has so far reacted to events rather than leading them. This approach should be substituted by a roadmap to define the new institutional setting to which we are converging: A monetary union with low imbalances also at the national level, with some type of fiscal union, and with a common banking market, preferably with a European bank resolution setting. This goes much in line with the recent demand by ECB president M Draghi to clarify the eurozone future for the coming decade.

2. Global recovery, but risks reignite

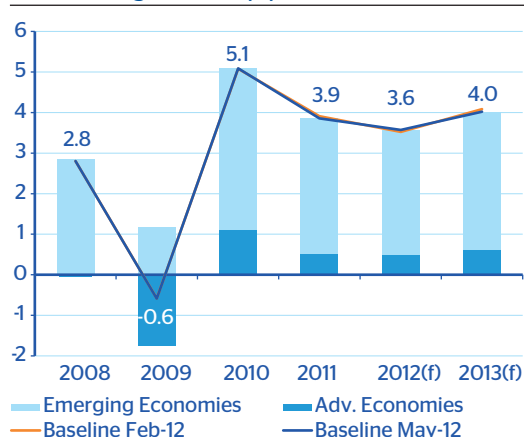
Global economic activity will gradually recover, with wider growth differentials across the main areas. But the risks to growth are tilted to the downside

After a gradual deceleration during 2011, especially in the last quarter, the global economy is starting to show signs of increased dynamism. Global growth in Q1-12 is expected to have been higher than in Q4-11, given stronger growth in Asia (ex China and including Japan) and Latin America and sustained –but modest– dynamism in the US. We estimate that global growth will continue improving and surpass 1% q/q at the end of 2012 (0.6% in Q4-11). This recovery will also be quite heterogeneous, amplifying the divergence in growth rates between the main economic areas. The increase in growth in 2012 will be more evident in Asia, given the rebound from natural disasters in Thailand and Japan (affecting regional supply chains) and the partial turnaround of policy tightening measures implemented until mid-2011. Also, growth in Latin America is likely to pick up, as Brazilian growth rates increase on the back of easier monetary policy and Mexico maintains growth over 3.5% helped by US demand, improved competitiveness and supportive funding conditions. On the other hand, the US will continue sustaining quarterly growth rates of around 0.6% in 2012 and 2013, significantly lower than in previous recoveries. Still, this will be better than a basically stagnant activity in the erozone in 2012, dragged by aggressive fiscal consolidation and persistently high financial stress in peripheral countries, after tensions eased temporarily in the first quarter.

Therefore, emerging economies will recover their growth differential vis-à-vis developed economies, of around 4pp, for the whole of 2012 and 2013. In turn, Europe and the US also will continue to increase their growth gaps in the next two years, even as we expect European authorities to continue taking decisive actions which will slowly lower financial tensions.

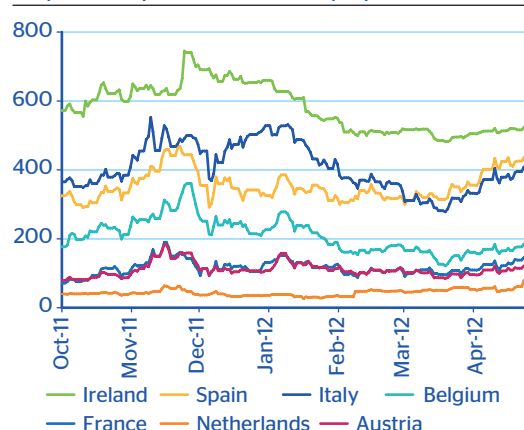
All in all, our economic outlook is not very different from this published in February. We expect global growth of 3.6% in 2012 and 4% in 2013, with emerging economies contributing around 80% of that increase in global activity (Chart 1). But, as mentioned before, this scenario is conditioned on the evolution of the crisis in Europe, and thus risks to these projections are still strongly tilted to the downside.

Chart 1
Global GDP growth (%q/q)



Source: BBVA Research

Chart 2
European sovereign risk premia
(10yr bond spreads to Germany, bps)



Source: Datastream and BBVA Research

In this context, monetary policies in advanced economies will continue to be very accommodative for an extended period, fulfilling the role of bridging the slump in activity towards the medium and long-run. However, the effectiveness of further intervention (conventional or not) is decreasing, while

at the same time the costs increase –including the risk of reduced central banks' independence and the collateral damage from unconventional measures. Thus, it is time for other policymakers and institutions in the US and Europe to decisively take up part of the burden of reviving growth from central banks, by implementing economic and institutional reforms and managing fiscal risks. While these measures take effect, central banks should continue supporting an adequate functioning of the monetary transmission mechanism.

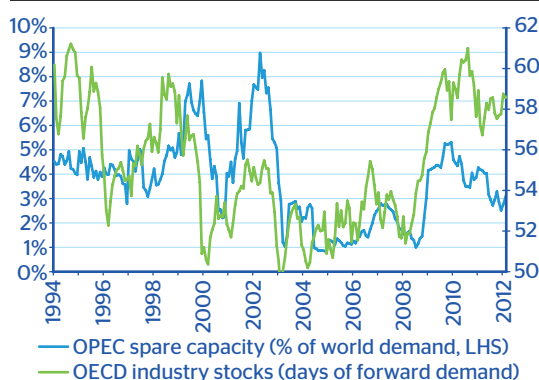
These easy monetary policies in advanced economies will bring about favorable financing conditions in emerging countries. There central banks will have to weigh the pressure from capital inflows and an uncertain external demand against inflationary risks (in part from oil prices) and strong domestic demand. The difference in inflation projections in Asia and Latin America –declining in the former but stable in the latter– will condition a different outlook for monetary policies. We expect the easing cycle to have ended in much of emerging Asia (except for, notably, China and India), and a cautious tightening bias in most of Latin America, apart from Brazil.

Current oil prices will have only a moderate impact on global growth. However, a big oil price spike constitutes a significant risk to growth

A threat to the global economy is a further increase in oil prices. The recent spike at the beginning of 2012 can be traced back in part to tightening fundamentals (demand and supply) but also to an increase in the geopolitical risk premium to around \$10-15 per barrel, given tensions around Iran and very reduced market buffers (oil inventories and producer's spare capacity (Chart 3). In our baseline scenario, we consider prices around \$120 per barrel of Brent oil for much of 2012, around 20% higher than in our February forecasts (Chart 4). In our view, this will only have a moderate negative impact on global growth, as central banks in advanced countries will view this as a temporary shock and their weak cyclical positions will prevent them from tightening monetary policy, one of the traditional channels of transmission to lower growth. Nevertheless, should the conflict in the Gulf escalate, there could be a very large spike in oil prices, and even if central banks still do not react, growth could be damaged through the associated increase in global risk aversion. We consider that the probability of an escalation of the conflict in the Gulf is relatively reduced, but it is a scenario that would have a significant impact on global growth should it materialize.

Chart 3

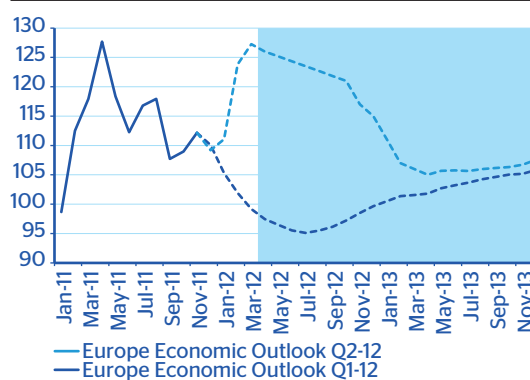
Oil market buffers: OPEC spare production capacity and OECD inventories



Source: Haver and BBVA Research

Chart 4

Oil Brent price (\$/barrel)



Source: BBVA Research

A new intensification of the European crisis is still the main global risk

Despite some progress in resolving the European crisis (Box 1), there are still important steps towards a clear roadmap to end the downturn. Undoubtedly, one of the most important actions in the last four months was the provision of long-term liquidity by the ECB. This allowed, at least until March, a significant reduction of liquidity risk in European banks, a timid opening of wholesale

funding markets and a compression of sovereign spreads in peripheral countries (Chart 2). But these positive effects proved temporary, as markets (i) detected some complacency on the part of policymakers as risk premia decreased in Q1-12, and (ii) both markets and policymakers doubted the ability of many peripheral countries to reach their fiscal targets and feared the fallout on growth of actually achieving them. Thus, since March, risk premia increased rapidly in Italy and Spain, in the latter to levels similar to the high tensions reached back in November (Chart 2).

In this context, we still see a new intensification of the European crisis as the main risk, with potentially very negative consequences for global growth. Increased tensions can come about from reform fatigue in peripheral countries coupled by bailout fatigue in core countries, in the context of electoral processes –and a referendum– in many European countries: France, Greece, Germany (two states), Ireland and the Netherlands are holding them in the first half of this year.

Box 1. Advances in European governance since February: Fiscal compact and ESM new resources

Fiscal Compact: The fiscal compact was signed by 25 European Union countries (all except the UK and the Czech Republic) in the European summit on March 1-2. It requires signatory states to incorporate fiscal rules in their legislation (preferably in their constitution) limiting the structural deficit to 0.5% of GDP. The compact has to be ratified before the end of the year and begin being applied from 2016. Temporary deviations from the structural deficit will be accepted under exceptional circumstances, although the definition of “temporary” is not made explicit, and the concept of “exceptional” is relatively lax (“unusual events outside the control of the country”, or “severe downturn” without talking about recession).

A deviation from the rule will kick in an automatic correction mechanism, defined by the country in line with the guidelines of the European Commission. If the country does not comply with the plan, it will be referred to the European Court of Justice (this is a novelty), which may impose a fine of up to 0.1% of GDP, which seems to be low compared with the theoretical fines within the Stability and Growth Pact, which can reach up to 0.5% of GDP.

In addition to the fiscal rule, the summit also approved a provision by which countries with public debt over 60% of GDP will have that ratio decreased by a rate of 1/20th per year, although there are no explicit sanctions to countries that do not comply. On the other hand, sanctions related to the excessive deficit procedure (which will continue

to apply) will be implemented automatically unless a qualified majority of countries oppose it (66% of the vote). To date, sanctions only were applied if they were voted by a qualified majority. The new principle is that of reversed qualified majority voting, and greatly reinforces the Stability and Growth Pact.

ESM new resources: The March 30 summit officially confirmed the beginning of operations of the European Stability Mechanism (ESM) in July 2012 instead of mid-2013, as decided at the December summit. This mechanism will be permanent and will replace the EFSF, which participated in peripheral countries’ rescue plans. ESM funds increased from a total effective loan capacity of €500bn to €700bn on a temporary basis, since it can combine the ESM’s original €500bn with the €200bn already committed by the EFSF to Greece, Portugal and Ireland. The chosen option is the least ambitious of the three proposals by the European Commission which was considering adding (temporarily or permanently) €240bn of unused lending capacity by the EFSF to the €700bn described above. The summit also decided to accelerate the payment of ESM capital by countries in four installments through 2014.

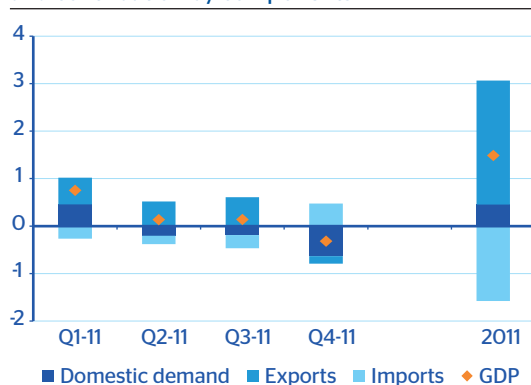
3. Europe: waiting for a definitive solution

Financial stress led to activity contraction in Q4-11...

Europe's economic activity clearly declined during the second half of 2011. The sharp increase in financial stress and sovereign debt spreads (Chart 2), falling confidence and global economic slowdown took their toll on economic activity in the eurozone as a whole in Q4-11. As pointed in our forecasts, these determinants were reflected in a -0.3% q/q fall in GDP, with a slump in domestic demand (-0.6 pp) and stagnant exports, while foreign demand contributed positively to growth (+0.3 pp) due to the collapse of imports (Chart 5). Furthermore, this drop in activity was widespread among the member states (except France), while the intensity of the contraction was more pronounced in peripheral countries (Chart 6).

Chart 5

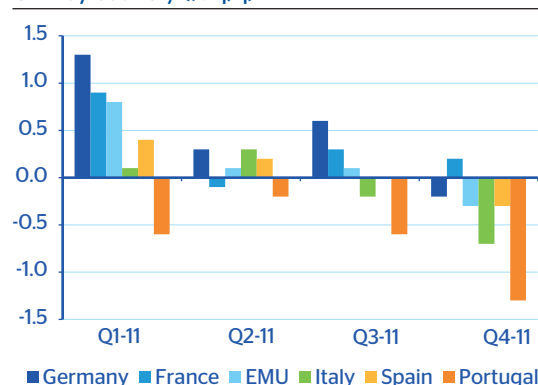
Eurozone: GDP growth (q/q and annual) and contribution by components



Source: Eurostat and BBVA Research

Chart 6

GDP by country (% q/q)



Source: Eurostat and BBVA Research

....prompting a reaction of economic policy since December, which helped stabilize activity in early months of the year

Given the increased uncertainty and risks of a financial accident in Europe, authorities took a series of measures since the end of the year, which helped stabilize the situation in early 2012, but did not provide a permanent solution to the crisis in the European periphery. To begin with, the ECB approved in early December the provision of unlimited long-term liquidity in two auctions (LTROs), which took place in December and February, flooding the market with liquidity. At the same time, it expanded the range of assets that can be used as collateral. In addition, the European Union adopted a fiscal compact to strengthen long-term fiscal discipline in member countries and decided to bring forward the implementation of the permanent rescue mechanism (European Stabilization Mechanism, ESM) and then reinforce it (Box 1). Finally, the European Union had to cope with the deterioration of the situation in Greece, and approved, together with the IMF, a second rescue package that incorporates a significant haircut to private bondholders (53.5% in nominal terms and 74% in net present value) which should, in principle, make Greek public debt sustainable.

This strategy has been complemented by a strengthening of fiscal consolidation and structural reforms in peripheral countries. Other small programme countries (Portugal and Ireland) have generally continued their reform plans successfully, and changes of government in Italy and Spain in late 2011 have led to stronger structural reforms and to additional steps towards adhering to the fiscal commitments demanded by European institutions.

This strategy has paid off partially, but remains subject to risks and uncertainties. It is evident that the ECB's intervention helped to channel wholesale funding to the banking sector and to ease credit conditions. Data from April's ECB survey of lending conditions shows that during Q2-12

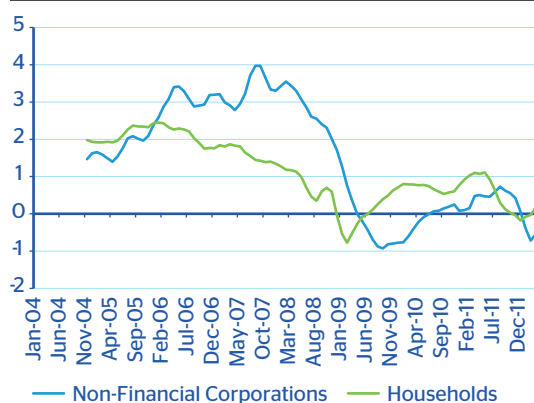
credit supply conditions could be less stringent than in the previous two quarters (when they were alarmingly tight), but private sector credit in the euro area remains virtually stagnant in early 2012 due to weak demand (Chart 7). The provision of liquidity also led to a fall in sovereign spreads in the first months of the year (Chart 2), largely because the banking systems in the European periphery channeled much of that liquidity to the purchase of domestic sovereign bonds (Chart 8). At the same time, in January confidence recovered together with economic activity.

However, as noted in our latest Europe Economic Outlook in February, liquidity provision by the ECB was only a temporary response to the crisis in the periphery and provided just a window of opportunity to improve their fundamentals, mainly linked to sovereign debt conditions.

But doubts persist, as measures taken are not sufficient to solve the crisis...

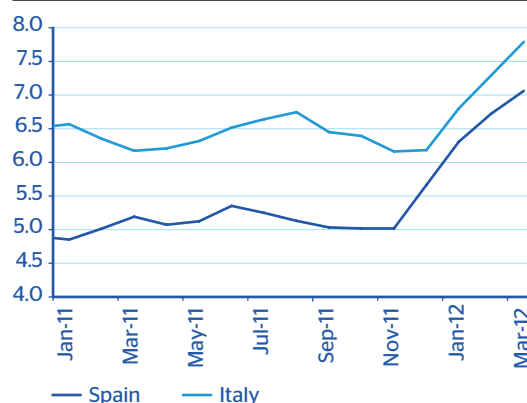
In this sense, the aforementioned measures were not sufficient for permanently calming markets. First, the second rescue package and debt restructuring in Greece has clarified the country's financing conditions in the short to medium-term and avoided an accident of possible contagion to the rest of the eurozone. But the outlook for the country continues to be exposed to risks that may materialize in coming quarters as the financing of the second programme remains subject to the conditions imposed by the troika, which will be difficult to implement in a country mired in a deep recession, with a fiscal deficit that is still high and dubious public and political support for further reforms. Given that the path of public debt is expected to remain above 100% until 2030 these risks fuel doubts about the sustainability of Greek debt (Chart 10).

Chart 7
Eurozone: Loans to private sector (3mma, s.a.)



Source: BBVA Research and ECB

Chart 8
Banks: Holding of euro area sovereign bonds (% of total assets)



Source: BBVA Research and ECB

Second, the fiscal compact approved by the vast majority of EU countries is subject to implementation risks (referendum in Ireland, the threat of renegotiation by France). Despite representing a significant shift toward greater control of national budgets, it includes some provisions that allow deviations from the structural deficit limit in exceptional circumstances. These exceptions of budget rules could depict the fiscal compact as not being strong enough to justify a more forceful action by Germany or the ECB to solve the crisis. In addition, the fiscal compact contains no elements that suggest a roadmap to a fiscal union that can complement the monetary union and reform programs in the European periphery with some kind of pooling of sovereign debt.

Third, the liquidity firewall approved is greater than that provided through the EFSF, but it falls short of some of the proposals made by the European Commission. The already approved €500bn of new funding (in addition to the €200mm already committed to existing rescue plans) it could be complemented with the new contributions to IMF resources (\$430bn, approximately €330bn), but the beneficiaries of these funds will not necessarily be European countries, and their use would

be subject to strong and uncertain conditionality. Overall, although the liquidity firewall may be sufficient to avoid a possible contagion to Spain or Italy by covering their financing needs, it does not do so convincingly, since it does not exceed those needs comfortably (Chart 9) and may be subject to risks of implementation and compliance as experienced in the case of EFSF. Furthermore, the implicit assumption that ESM loans would be senior to existing private bondholders could seriously undermine its role of attracting private funds to increase sovereign funding.

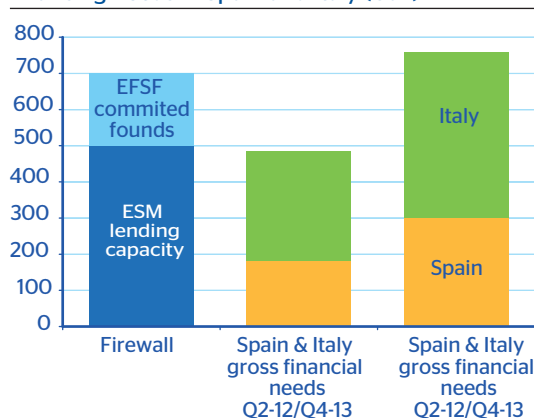
In short, European authorities have not used the window of opportunity given by the ECB's provision of long-term liquidity to finalize a roadmap for a clear and credible solution to the crisis in Europe. Instead, some authorities even sent doubtful signals about the need to continue working on the solution of the crisis given the reduction of tensions in sovereign debt markets.

...and hence tensions in peripheral Europe resurfaced since March

The result of this process is that, once the short-term effect of the two liquidity auctions evaporated, financial tensions resurfaced, with an increase in Spanish and Italian sovereign spreads (Chart 2), a capital flight to German public debt (which has seen its long-term interest rates dropping to record lows), widespread falls in European stock markets and a reversal in confidence gains seen in the first months of the year. These problems have also been compounded by market doubts about the sustainability of Spanish debt, linked to difficulties to devise and implement specific fiscal consolidation measures at the regional level, and to lingering markets doubts about the Spanish financial system. In addition, there is a growing feeling that the accelerated fiscal consolidation strategy in peripheral countries can lead to a recession that would be difficult to revert in the medium-term, threatening the sustainability of public debt in those countries. Finally, the senior status in the Greek public debt held by the ECB during the restructuring carried out in Q1-12 has made investors fear that if another restructuring process occurs, the same criteria would apply. The market reasoning is that debt of peripheral countries held by the ECB is rising after the liquidity auctions, increases the potential impact of a restructuring on private debt, as the same reduction in debt ratios has to be achieved by a decreasing share of debt in private hands.

Chart 9

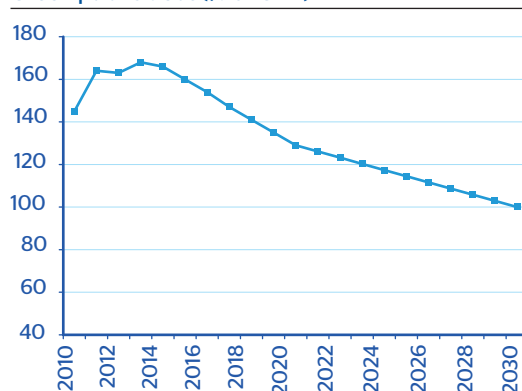
European sovereign firewall and financing needs in Spain and Italy (€bn)



Source: BBVA Research and Bloomberg

Chart 10

Greek public debt (% of GDP)



Source: BBVA Research and IMF

Renewed financial strains, along with the risks associated with fiscal consolidation in the periphery, have put on the table the debate about the need to accompany fiscal consolidation with a growth strategy. The latter has played a prominent role in elections that have taken place recently in several European countries. ECB President, Mario Draghi, also highlighted this issue, and requested a clarification of the situation of the euro for the next ten years.

The essence of this strategy, however, is not yet well defined, and will be discussed by the European authorities in May and June. A first possibility is to reconsider fiscal consolidation paths in a coordinated way (or else there are risks of being singled out by markets), easing the deficit reduction targets and extend the target beyond 2013 (the required date for most countries in the region), while redefining the fiscal targets in terms of structural deficits (consistent with the spirit of the fiscal compact) complemented with explicit, comprehensive, detailed and multi-year reduction plans. This way, sound public finances could be achieved without a large damage to short-term growth. At the same time, this provides time to peripheral countries to reap benefits from the ongoing long-term structural reforms. A second idea is to increase investment in infrastructure at European level, redistributing the EU structural funds and easing the criteria for using them, or increasing the capital of the European Investment Bank. Both the European Commission and the Italian government have already made proposals in this regard. A third interpretation, the strictest one, defended by Germany, limits the growth strategy to deepening structural reforms, although these generate benefits in the medium to longer-term rather than in the short-term. Beyond the debate on strict growth measures, proposals have been also made by French candidate Hollande to introduce Eurobonds or allowing a much more active role of the ECB in supporting sovereign debt.

The outcome of the debate on new growth initiatives is very uncertain, but probably will not lead to radical changes in the fiscal compact, or on the current institutional framework in Europe (role of the ECB or ESM). It is more likely that limited new funds are collected for infrastructure investment, and perhaps fiscal plans will be renegotiated for some member states. In principle, these initiatives are unlikely to significantly change the market's doubts about the periphery.

Box 2. Macroeconomic imbalances: Developments and correction over 2011

Last February the European Commission introduced and adopted the “Macroeconomic Imbalance Procedure (MIP)” under the framework of the “Six Pack”. The MIP includes a scoreboard consisting of 10 indicators with the aim to identify potential risks and to pinpoint excessive imbalances already built-in. The main objective is to establish a framework of economic surveillance so as to avoid unsustainable economic trends, extending the scope from fiscal variables (the main focus of the Stability and Growth Pact) to private sector imbalances. Hence, the variables included relate to private sector (private debt, credit growth, housing prices), the external sector (current account, net foreign debt), competitiveness (real effective exchange rate, unit labour costs, changes in the exports share), and unemployment rate.

Table 1 presents these variables for the main eurozone countries, in addition to the public deficit and debt, as defined in the MIP with the latest information available for 2011. The variables defined by the European Commission are not the latest observations but in some cases averages over the recent past, in some cases up to three years. The alert mechanism also establishes a set of thresholds based on statistical performance to highlight potential problems.

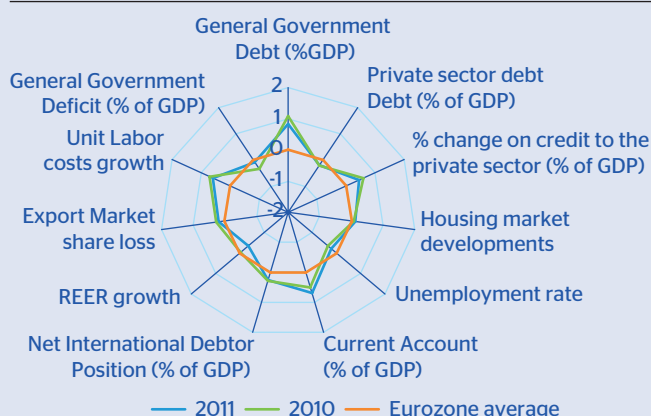
In addition to those variables, we also present graphs that highlight the divergences across eurozone countries (see charts) by normalizing those variables around the eurozone average (which is represented by a round circle at value zero), and we compare the evolution of these indicators along 2011 vs. 2010 in selected economies. Each unit in

the graphs represents a standard deviation of the variable around the average.

It can be observed that the divergence across countries is relatively large for some variables, especially those related to external debt and the current account, revealing differences in competitiveness. In 2011 the current account balance shows a strong convergence to the average in the case of Portugal and Spain, accompanied by the correction of competitiveness indicators such as the unit labor costs and the real effective exchange rate. The performance in the export share loss is, in relative terms, better than that of other eurozone members. However, the performance on those variables that represent levels of cumulated imbalances, such as the international investment position (net foreign debt) naturally evolves much more slowly and will take longer to reveal signs of correction. In the same vein, debt levels, both public and private, are also showing a small rate of convergence towards the average. Flow variables such as credit measured as percentage of GDP, are adjusting rapidly, especially in those economies where rapid increases were recorded in the past, such as Spain and Ireland. Housing prices are also in a downward trend in these two countries and in Portugal, while in other members the adjustment is milder. Finally, the adjustment process is taking place at the expense of further deterioration in the labor market in the periphery, where unemployment rates continue to record maximum highs.

Chart 11

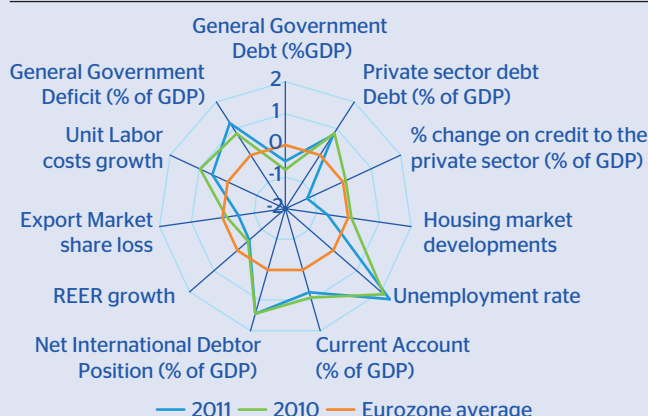
Italy: macroeconomic imbalances



Note: Standard deviation with respect to the normalized eurozone
Source: (1), (3) y (7) National sources, (2) ECB, (4), (5) (6) y (8) Eurostat, (9) OECD y (10) IFS through HAVER and BBVA Research

Chart 12

Spain: macroeconomic imbalances



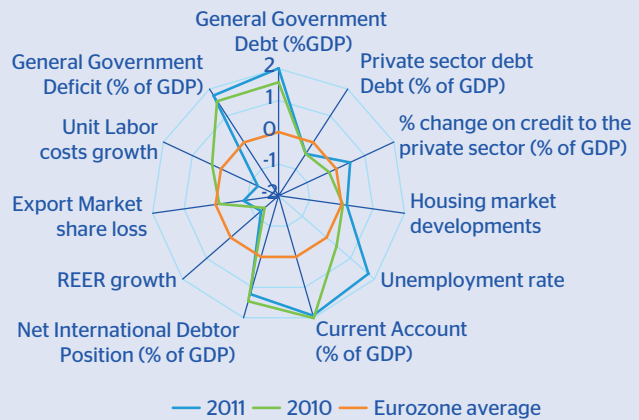
Note: Standard deviation with respect to the normalized eurozone
Source: (1), (3) y (7) National sources, (2) ECB, (4), (5) (6) y (8) Eurostat, (9) OECD y (10) IFS through HAVER and BBVA Research

Chart 13
Portugal: macroeconomic Imbalances



Source: National sources, ECB, Eurostat, OECD and IFS through HAVER and BBVA Research

Chart 14
Greece: macroeconomic Imbalances



Source: National sources, ECB, Eurostat, OECD and IFS through HAVER and BBVA Research

Table 1
European Commission 10 Indicators Scoreboard for selected EU members

	Domestic sector						External sector			Competitiveness indicators			
	Private sector debt	Private sector credit flow	General government debt	House prices relative to consumption deflator	Unemployment rate	International Investment position	Current account		Real effective exchange rate	Nominal Unit Labor Cost	Export market share	# missed thresholds	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)		(8)	(9)	(10)		
Thresholds	> 160% of GDP	> 15% of GDP	60% of GDP	+15% y.o.y	3 year moving average +10%	Last	-35% of GDP	3 year backward moving average -4% / +6% of GDP	Last	3 year % change +/- 5% for EZ / +/-11% for non EZ	3 year % change 9% for EZ / +/-12% for non EZ	5 year % change -6%	
Germany	124.3	-2.5	81.2	0.6	5.7	5.6	36.4	5.9	5.7	-7.8	4.1	-11.1	3
France	220.7	1.8	86.0	1.2	9.8	10.0	-10.0	-1.8	-2.2	-5.6	8.1	-19.9	4
Italy	162.3	1.6	120.1	-0.2	9.1	9.6	-21.8	-3.0	-3.2	-5.0	8.3	-15.2	3
Spain	280.9	-10.3	68.5	-2.2	22.9	23.8	-92.1	-5.1	-3.5	-4.6	8.0	-5.4	5
Greece	136.8	1.9	165.3	n/a	19.5	20.5	-79.2	-11.1	-9.8	-2.6	-1.8	0.0	4
Portugal	253.9	-0.6	107.8	-2.3	13.9	15.0	-103.6	-10.1	-6.4	-2.6	3.8	-11.1	6
Ireland	373.5	-16.1	108.2	-4.7	14.7	14.6	-101.9	-1.4	0.1	-12.1	-8.3	-19.8	6
Belgium	235.2	-2.0	98.0	-1.6	7.3	7.3	77.6	-0.7	-0.8	-3.5	7.3	-11.8	3
Austria	172.8	-2.0	72.2	0.2	4.1	4.1	-5.6	2.9	1.9	-3.8	10.9	-11.9	4
Finland	146.7	0.4	48.6	1.3	7.6	7.5	14.0	1.2	-0.7	-6.8	5.8	-31.0	2
Netherlands	245.4	0.9	65.2	-6.8	4.7	5.0	37.2	5.9	9.1	-7.1	5.2	-5.0	3

Note: Last refers to the latest observation available on quarterly basis

Sources: Haver through (1) (3) (6) and (7) National sources (2) ECB (4) (5) and (8) Eurostat (9) Eurostat or OECD and (10) IFS and BBVA Research

4. Economic outlook: Sluggish and heterogeneous recovery with high downside risks

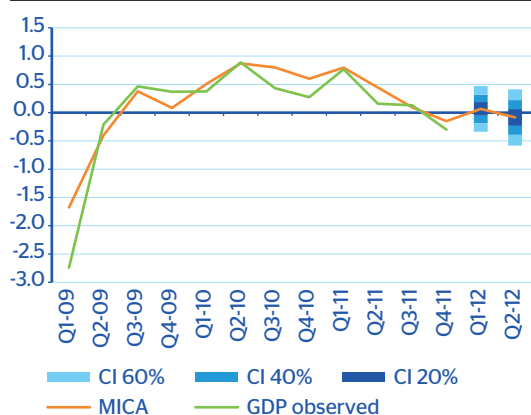
Data available for Q1-12 points to an improvement in economic activity

The relief of financial stress, in contrast to our expectations three months ago, supported a significant improvement in confidence in January, although February and March data were somewhat disappointing (Chart 16). Hard data available up to February also outlined a somewhat more upbeat situation. Although fiscal consolidation dragged down domestic demand, retail sales suggest that private consumption could have been more resilient in the first quarter than in Q4-11, while industrial production rose more than anticipated, mainly supported by foreign demand. However, uncertainty about the resolution of the European crisis remains very high, clearly weighing on demand expectations in coming months and, therefore, adversely affecting firms' plans of both investment and hiring. This has been reflected in a further deterioration of the labour market in early 2012, with an increase in the unemployment rate to 10.8% in February. In addition, tightening conditions, coupled with weak domestic demand, have resulted in the stagnation of credit provision to the private sector.

In short, considering all this information our short-term model (MICA) estimates GDP growth at about 0.1% q/q in Q1-12 (Chart 15), but our scenario does not exclude the probability of a stagnation or even a slight contraction in activity. On the other hand, the most recent surge of financial strains has been reflected in a sharp deterioration of confidence in April, pointing to a drop in economic activity in Q2-12, although it is still too early to draw conclusions with such limited set of information. Our MICA model suggests that GDP could contract by around -0.1% q/q in Q2-12, in line with that provided in our projections.

Chart 15

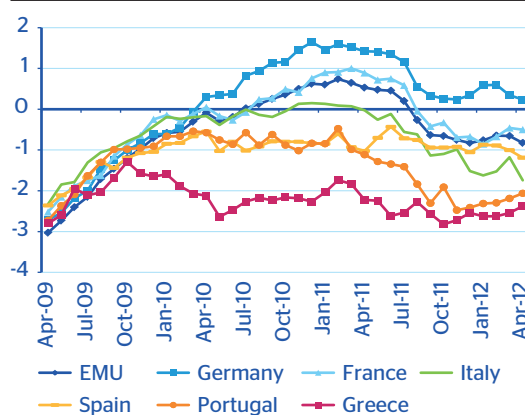
Eurozone: MICA-BBVA and GDP observed (% q/q)



Source: Eurostat and BBVA Research

Chart 16

EC Economic sentiment (standardized)



Source: European Commission and BBVA Research

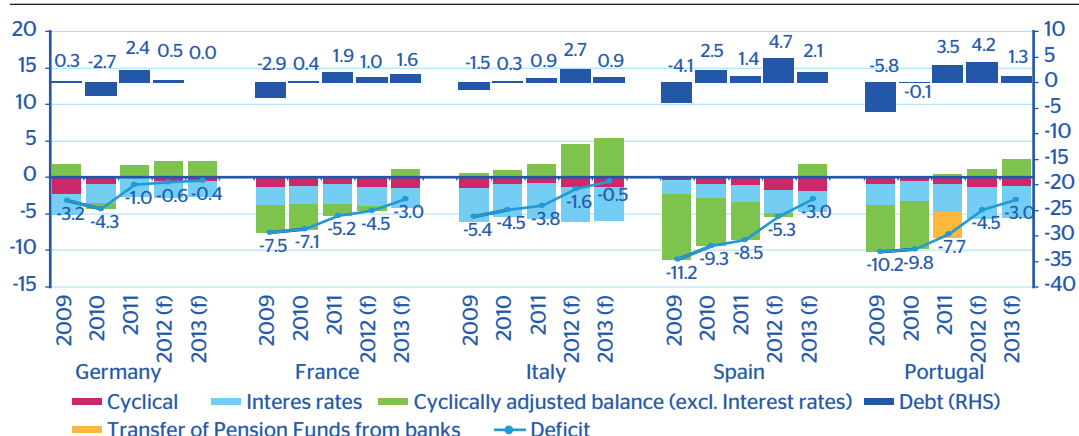
Drivers affecting economic developments in the eurozone have not changed significantly from those three months ago

Regarding fiscal consolidation, there are no additional measures announced that could have altered our assessment about the impact of fiscal adjustment on growth in 2012 and 2013 (Chart 17). Peripheral countries have reinforced their fiscal effort to meet the targets (Portugal, Italy and Spain), while in countries such as Germany the adjustment will be lower than expected as its public

accounts are already very close to be balanced. As a result, the fiscal adjustment in the eurozone as a whole should be similar to that of 2011, when the deficit declined by 2.1pp to 4.1% of GDP. However, this process will continue to weigh on economic growth in the eurozone, as shown in Box 3, and has not been offset by the gain from greater stability in financial markets, with monetary policy being the only source of support to economic activity.

Chart 17

General government deficit and estimated structural adjustment



Source: Eurostat and BBVA Research

In addition to continuing stress in financial conditions, the recapitalization process of the banking sector to attain a capital ratio of 9% in June 2012 is also ongoing and is a growth driver. However, banks' results show that many of them have already been recapitalized and there is no evidence that the deleveraging is taking place in a disorderly manner or is affected credit restrictions more than anticipated. In particular, the impact of recapitalization is in line with our estimation published in the Europe Economic Outlook Q4-11, according to which the impact, while significant, is modest on both credit and activity. Thus, we do not expect the effect to be much larger over Q2-12, especially as a result of extraordinary liquidity measures implemented by the ECB.

Regarding monetary policy, the ECB's statement in early 2012 incorporated an upward bias in the short-term inflation outlook, driven by rising oil prices, improved confidence, as well as more positive developments in sovereign debt markets. However, the ECB reversed this bias in its latest meeting in May as a result of renewed financial strains and lower risks associated with commodity prices. In this context and assuming a sluggish recovery over H2-12, we expect the refi rate to remain unchanged at 1% over the forecast horizon, while a rate cut is unlikely unless downside risks to growth materialize. Regarding liquidity provisions, we think that the ECB is likely to extend the three-month full allotment tenders until the end of the year at its next meeting. In addition, the ECB is not buying sovereign bonds through the SMP programme, but officials reiterate that this scheme is still active. We think that these purchases will not be reactivated unless there is a substantial deterioration in financial markets, and thus the ECB continues to put much pressure on governments to fulfill their commitments.

Regarding the main source of growth for the eurozone economy, foreign demand, no major unanticipated changes have occurred in the last three months, as the recent slowdown in global growth, especially in China, was broadly offset by the slight depreciation of the euro observed since H2-11. Given the doubts about the eurozone recovery, the euro is likely to continue depreciating moderately in the remainder of the year.

Finally, the recent rise in Brent oil prices, stemming from geopolitical strains in the countries of North Africa and Middle East, has emerged again as a relevant economic driver and has fed fears about the recovery in the eurozone for several reasons. First, this could negatively affect economic growth. We do not think that this increase in oil prices is a pure supply shock, but it rather responds to a temporary and speculative demand shock amid fears of disruptions in oil supply, thus having a

small impact on economic growth. However, and secondly, the effect on consumer inflation could be a bit stronger, by around +0.5pp in 2012. This implies that annual inflation rate in the eurozone will remain above the ECB's target throughout 2012 (Box 4).

Taking into account all these drivers, our forecasts continue to envisage a slight contraction of GDP in the eurozone in H1-12 to be followed by sluggish growth in H2-12, with the moderate recovery possibly being stronger over 2013, supported by improved financial conditions and a lower fiscal adjustment.

Obviously, these projections depend to a large extent on the management of the European crisis in coming months. In particular, we assume that both European authorities and national governments will continue to advance in the adoption and implementation of measures that will lead to easing sovereign spreads in H2-12, narrowing pressures on the sustainability of public finances in the periphery and, therefore, also on the terms of funding for other sectors. In addition, the adjustments of macroeconomic imbalances proceed, such as the private sector deleveraging and the restructuring of the banking sector, while the structural reforms should strengthen the fundamentals that underpin a return to growth.

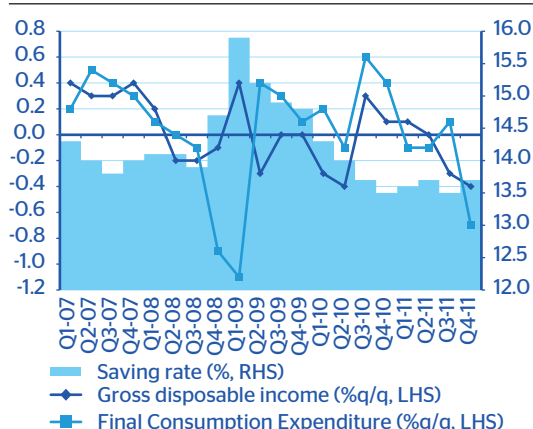
For 2012, the eurozone economy will contract slightly, with GDP falling by around -0.2%

Taking into account all the aforementioned developments, we have slightly revised upwards our forecast for GDP growth in 2012 to -0.2%, from a -0.5% fall estimated three months ago, although the probability of recession remains high, at around 60%. In particular, the reason for this revision can be found in the easing of financial strains in early 2012, which occurred earlier and to a larger degree than anticipated (+0.3pp), which triggered an improvement of economic data for Q1-12 (+0.2pp). However, the rising Brent oil prices, which came in by about 20% higher than in our previous forecasts (Char 4), will drag down activity (-0.2pp). Despite these facts, our projections continue contemplating very weak economic activity, couple by high volatility in financial markets.

The recession will be evident mainly in the evolution of domestic demand. Private consumption will fall moderately as a result of lower households' disposable income and consumer confidence, which is being reflected in an increase of the saving rate for precautionary reasons (Chart 18). This drop in households' spending along with slowing global demand and falling corporate profits (Chart 19) will also drag down investment throughout 2012, for which we expect a significant contraction. Unlike past crises, when there was room for expansionary policies, the ongoing fiscal consolidation will also result in a fall of public consumption. Therefore, exports will continue to be the only source of growth, but will slow sharply after reaching pre-crisis levels and will not have a very dynamic impact on other economic sectors. The latter has already been observed during the last two years, when the strong exports' recovery was not reflected in the rebound of investment, characteristic of previous recoveries, which could be a sign not only of poor demand expectations, but also of the impact of higher funding costs combined with excess production capacity. However, the projected drop in imports will result in an positive contribution of foreign demand (+0.8pp), partly offsetting the negative contribution of domestic demand (-1.0pp). Against this background, since labour indicators react with a lag of two to four quarters to changes in activity, our projections assume that the labour market will continue to deteriorate in 2012, with a fall in employment of -0.5% and an increased unemployment rate to about 11%.

Chart 18

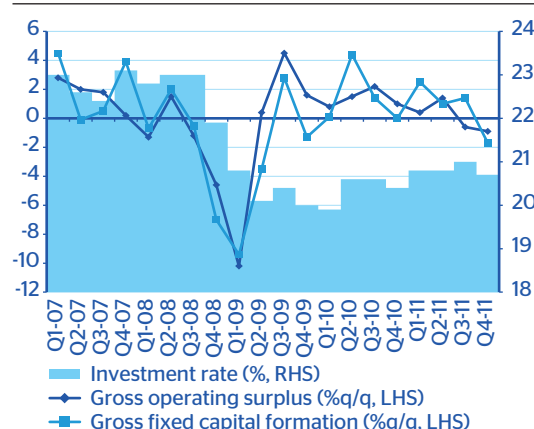
Eurozone: Households' quarterly accounts



Source: Eurostat and BBVA Research

Chart 19

Eurozone: Firms' quarterly accounts



Source: Eurostat and BBVA Research

These developments will largely be widespread in all member states (Table 2), although divergences persist. While northern European countries (Germany and France) will slow significantly but still registering positive growth rates, activity in peripheral countries will contract sharply (Portugal, Greece, Italy and Spain). These divergences should be mainly due to different macroeconomic adjustments underway, which significantly affect domestic demand, while exports will remain the basis of growth in all member states. However, depending on the degree of openness by country, investment could be stronger in those with a comparative advantage in trading with emerging economies, as Germany.

The recovery is expected to strengthen somewhat in 2013

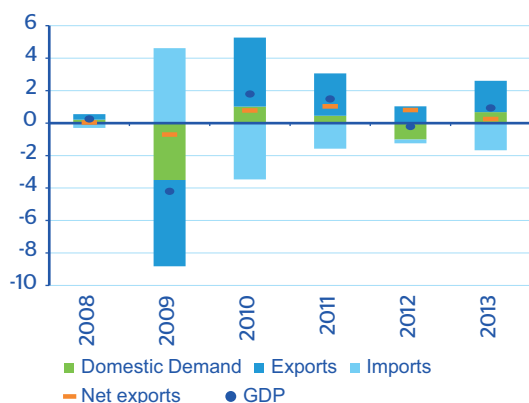
The slow recovery projected for the eurozone as a whole from H2-12 hardly affects the annual average growth of 2012, but will result in a moderate growth of around +1% in 2013, still below the potential growth rate, as is usually the case after a deep financial crisis. Our forecasts suggest that all components of domestic demand will return to moderate growth rates, making a positive contribution of +0.7pp. Therefore, the pattern of growth will be more balanced, with net exports contributing to growth +0.3pp. Across countries, the consolidation of the recovery will also take place at different speeds, with German and French GDP expanding by more than +1%, while the economies in the periphery will almost stagnate.

Risks to the economic outlook continue to be biased downwards

Risks to economic activity are varied, but all depend on possible events leading to a worsening of financial conditions. A major risk is that fiscal targets in the periphery are not being fulfilled due to a larger deterioration than anticipated of cyclical conditions. If authorities react by taking new fiscal measures, a vicious circle of adjustment and recession could take shape. A second risk is the intensification of financial tensions linked to liquidity problems of some governments or financial institutions, with possible contagion effects. In principle, the European authorities and the ECB have sufficient instruments to deal with such events, but a slow or inadequate response may aggravate the effects of contagion. There are also political risks arising from the possible failure to approve the fiscal compact (in France, referendum in Ireland), or linked to the deteriorating political situation in Greece following the difficulties in forming a government after May 6 elections (which could lead to new elections in June). Finally, the risks from the external environment (raw material prices and global demand slowing faster than expected) are not ruled out. However, there are also upside risks, such as a quick reaction from the European authorities in coming months, with a decisive action focused on economic growth and moving towards a more complete fiscal union. But overall, the risks are clearly skewed to the downside.

Chart 20

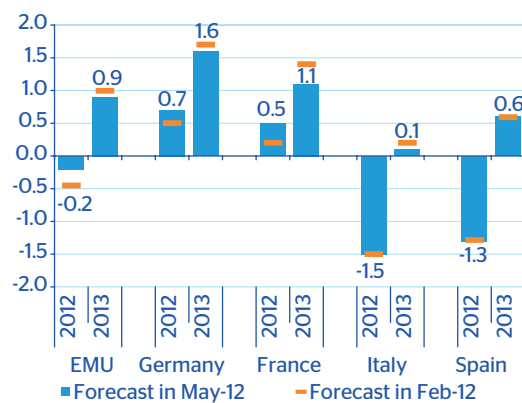
Eurozone: Contribution to annual GDP growth (pp)



Source: Eurostat and BBVA Research

Chart 21

Eurozone: Growth forecasts by country



Source: BBVA Research

Box 3.**Tracking the underlying drivers in the eurozone economy: Negative financial and fiscal shocks in Q4**

The detailed breakdown of GDP growth in Q4-11 showed a more negative picture than anticipated, as both internal demand and exports fell, while lower imports mitigated the fall in GDP. One important issue when looking at the evolution of GDP and its components are the driving factors explaining the evolution of activity. This helps to interpret what is going on exactly in the economy and to potentially design a better policy response to situations such as the current one.

To that end we have extended the version of our DSGE model with a banking sector presented in previous issues of our publication (see Europe Economic Outlook, August 2011 for a description and the motivation for using this type of models) by incorporating fiscal shocks. The introduction of fiscal policy was obviously necessary, as one of the key elements in explaining current events in the eurozone is the relatively rapid fiscal consolidation strategy. A diagram describing the mechanisms of the model is included below (Chart 23). After estimating the model, we calculate the relative importance of the different shocks in the model in explaining the evolution of GDP in different quarters, i.e. we present the historical decomposition of shocks.

The results of the model updated with Q4-11 data reveal that, not surprisingly, the underlying factors behind the fall in activity, especially of private consumption and investment, are the negative effect of the fiscal adjustment (that explains around 55% of the drop in GDP) and the intensification of financial tensions (around 25%), along with macroeconomic shocks (around 20%, mainly due to the fall of total factor productivity and the demand for consumer goods). The lax monetary policy was the only factor supporting activity (offsetting around 0.1pp of quarterly GDP fall in Q4-11). In Chart 22, it is also apparent that the role of fiscal policy was important in mitigating the decline in activity over 2008-10. It was procyclical before that period, and it is procyclical now when it is exacerbating the fall in output. The decomposition also shows that negative financial shocks eased by end-2010 thanks to the ECB's non-standard measures, but escalated again in late 2011. The ECB reaction in December with the

3-years LTROs will likely maintain the size of the financial shock below the level reached in 2009-10 in early 2012.

The model also incorporates different shocks related to the banking system, i.e. banks' balance sheet, loan-to-value of credit for both households and firms, mark-up in interest rates of credit to private sector and the mark-down charged to interest rates of deposits. Among these shocks, the negative impact of the higher loan-to-value ratio required to firms (21% of the drop in GDP) is noticeable, probably reflecting increased risk aversion as well as a tightening of supply restrictions in funding markets, that also led to the higher mark-up applied to interest rate of loans both to household and firms (4%). In addition, banks' recapitalization efforts also ended up negatively affecting economic activity (as discussed in the European Economic Outlook, November 2011). These findings are consistent with both the evolution of credit and with results from the Bank Lending Survey conducted by the ECB (Chart 24 and 25), which show that the decline in credit magnitudes is not only due to very subdued credit demand but also due to the tightening of credit standards.

To sum up, these results are in line with the expected short-run negative impact of fiscal consolidation on economic growth, which has not been offset by gains in financial conditions, while the only positive support to economic activity continues to derive from the lax monetary policy stance. Looking forward, the strong liquidity provision by the ECB along with the accommodative monetary policy should support an increasingly emerging demand for credit as the economy recovers over the second half of the year. The fiscal shock is likely to continue exerting negative pressures in GDP, while bank recapitalization will also detract from growth. The entire batch of measures taken at European level since late 2011 (fiscal compact, liquidity firewall, Greek debt restructuring) should help ease financial stress as observed over the first quarter of this year. However, the financial strains have resumed recently driven by fears about the vulnerability of both Italy and Spain. Still, downside risks to this scenario remain high.

Chart 22
Eurozone: output, trend and shocks

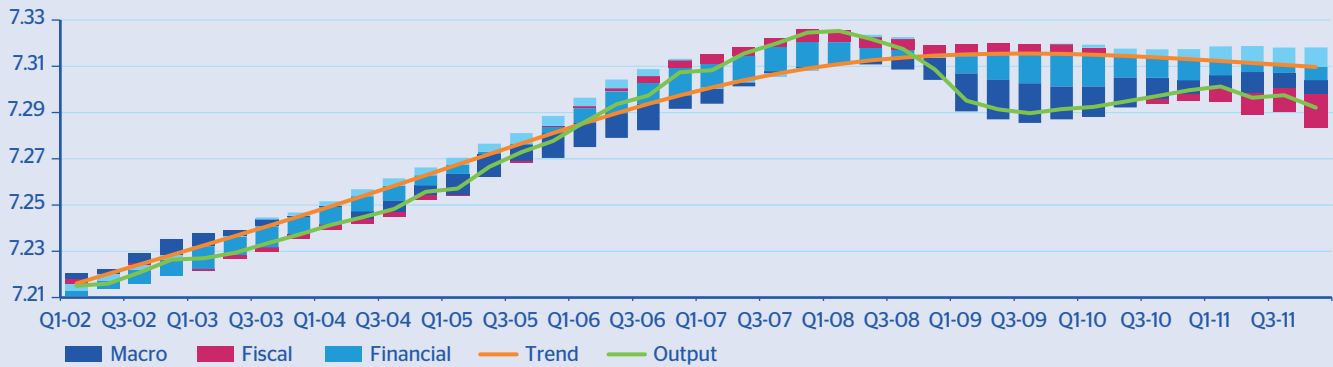


Chart 23
DSGE-BBVA model: structure and transmission channels

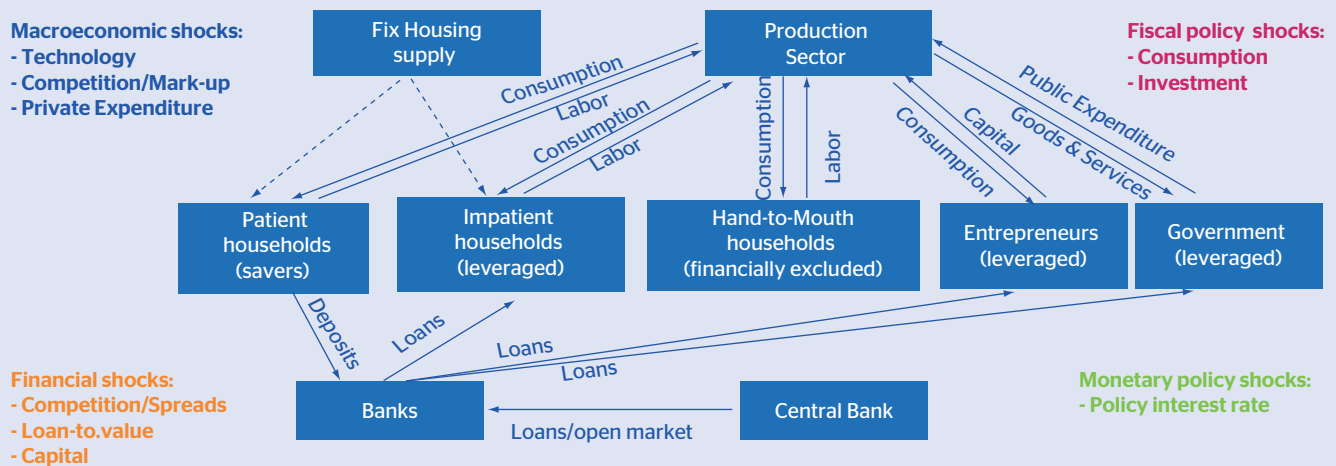


Chart 24
Credit standards for the next 3 months (weighted net %)

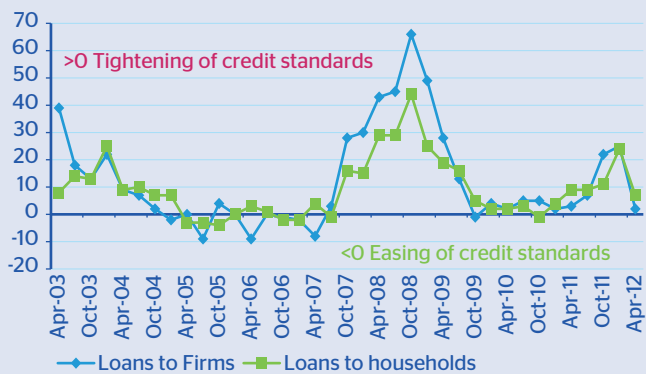
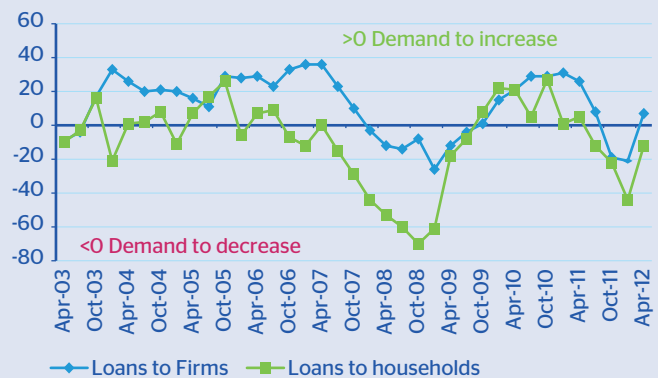


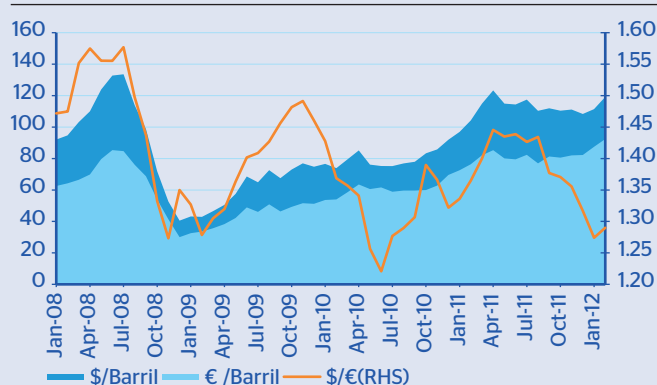
Chart 25
Demand for credit, next 3 months (weighted net %)



Box 4. Slow moderation of inflation in 2012, approaching the ECB's target only in Q4-12

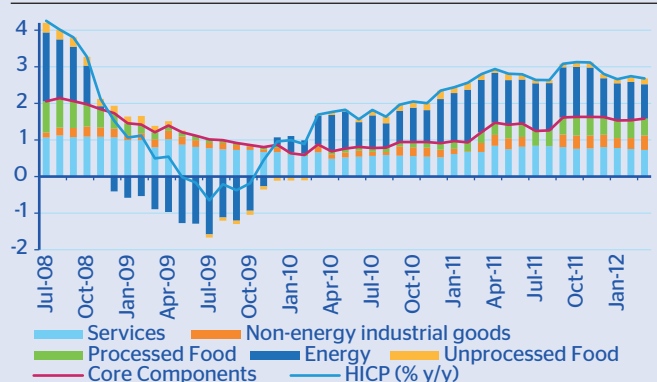
During the last two quarters, the inflation rate in the eurozone was determined by the price evolution of the most volatile components, primarily of those related to energy, and to a lesser extent of food prices, both attributed to higher prices of commodities. In the meanwhile, core inflation remained stable at 1.9% y/y. While the increase in food commodity prices came as a response to the adverse winter weather, geopolitical tensions in Northern Africa and the Middle East were the factors leading to a sharp rise in oil prices during the first quarter. The Brent crude oil price was up 12.4% y/y to \$125/barrel, in contrast to an anticipated fall of nearly 7% according to our previous scenario. The latter factor, together with the depreciation of the euro of approximately 7% (from 1.37 to 1.27) resulted in a nearly 21% increase of the Brent crude oil price in euros (Chart 26). This significantly offset the base effect we expected three months ago for Q1-12 (after the average rise of nearly 30% y/y observed during 1H11). Therefore, headline inflation remained relatively stable in the first quarter at 2.7% y/y (as compared to our forecast of 2.2% y/y and 1.9% y/y for the core), slowing down only slightly from the 2.9% y/y recorded in Q4-11 (Chart 27).

Chart 26
Brent oil prices and euro exchange rate



Source: Datastream and BBVA Research

Chart 27
Annual HICP inflation rate: Contribution by component



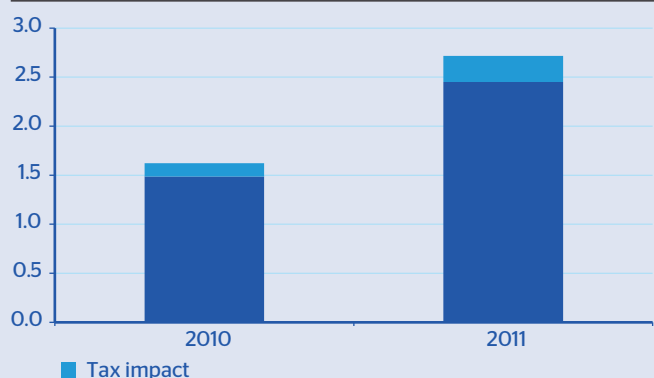
Source: Eurostat and BBVA Research

Another factor explaining these relatively high inflation rates, related to the weakness of domestic demand, is the tax increases as part of the fiscal consolidation efforts in Europe. According to data published by Eurostat, in the eurozone as a whole, this effect added 0.3pp to the average annual rate of inflation in 2011 (2.7%, Chart 28). Specifically, these tax increases translate partially into a permanent increase of consumer prices, with effects on the annual rate of inflation that will last for a year. Therefore, some of the increases carried out in 2010 (Ireland in January, Greece in March and July, Portugal and Spain in July) were reflected in 2011. Likewise, some of those carried out throughout 2011 (Portugal and Greece in January, Ireland in July, Italy in September) will continue to have an impact during 2012. Both France and Ireland have made changes to their VAT rates in 2012, with the introduction of a reduced tranche in France and an increase of 2pp in the standard rate in Ireland.

All these developments had an impact on the revision of our forecast for inflation for 2012 and 2013. The new path of oil prices incorporated into the current scenario assumes that, on average, they would be 20% higher in 2012 than we expected three months ago, and they would start to moderate in Q4-12, and will converge to the previous path by mid-2013 (nearly 5% higher) (Chart 4). It is important to mention that, from our standpoint, this increase in oil prices has responded fundamentally to a transitory demand shock as a result of fears of a potential restriction in oil supply and, therefore, with a more limited impact on both inflation and growth than in the event of a pure supply shock. According to the SVAR model (Model 1) presented in the Europe Economic Outlook Q2-11 which enables us to identify shocks of a different nature, this new path would imply an increase of inflation of approximately +0.5pp. It is also essential to analyze the different channels through which an increase in crude oil prices is eventually transmitted to consumer prices. For this reason, we also use other models (see Europe Economic Outlook Q1-11) to estimate the direct impact of this increase through the energy component of the HICP index (up +0.4pp), as well as the indirect effects derived from its use as an intermediate good in manufacturing processes. Moreover, the higher-than-expected inflation, together with the recent evolution of commodities prices, could lead to an upward revision of the medium-term inflation expectations, and could possibly intensify the pressures on salary increases and, therefore, trigger second round effects on inflation. Even though our models estimate that all the above mentioned impacts are significant, the direct effect is the one which most influences the revision of our forecast, since both the indirect effects and the second round effects could be partially offset: the former, with a reduction of firm benefits aiming to mitigate the weakness of domestic demand, while the latter appears

unlikely given the continued unraveling of the labor market and the uncertainty regarding the economic recovery. According to our model (Model 2), the impact of both the indirect effects and the second round effects would be approximately +0.2pp, with the joint effect of this new trajectory of oil prices translated to an increase in inflation of nearly +0.6pp for 2012 (Chart 29) and of +0.1pp for 2013.

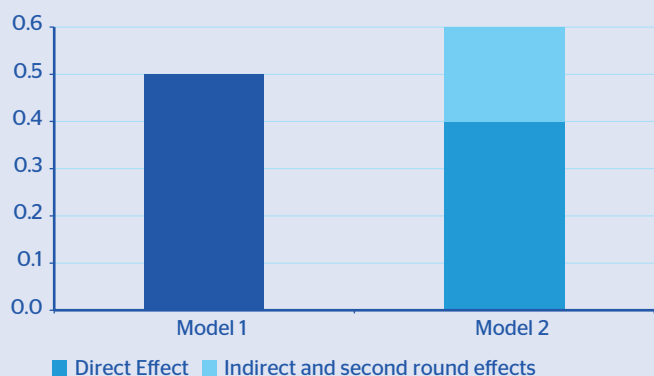
Chart 28
Impact of tax hikes



Source: Eurostat and BBVA Research

On the other hand, though part of the tax increases were already included in our previous forecasts, we now have more evidence of the impact on last year's inflation of those increases carried out in 2010 and 2011. Specifically, this type of announced measures (some adopted throughout 2011 and others in 2012) could lead to an increase in inflation of approximately +0.2pp in 2012. However, as we highlighted in the case of indirect effects of the increase of oil prices, the impact of the increase of taxes could be partially absorbed to the extent that companies decide to assume it in response to the weakness of domestic demand.

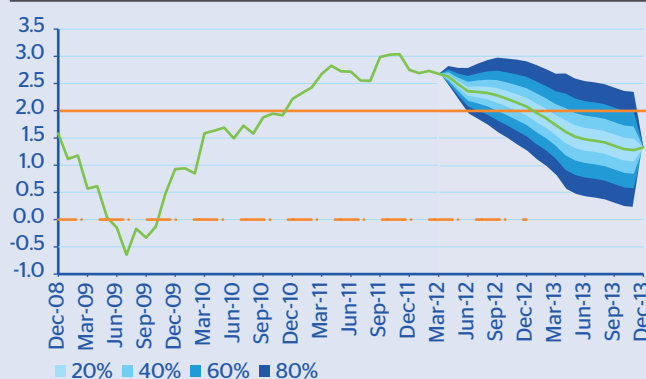
Chart 29
Oil price effects



Source: BBVA Research

Taking into account all this information, we have revised upwards our headline inflation forecast by +0.6pp to 2.4% by 2012, thus expecting the rate to remain clearly above the ECB target for practically the entire year, though it will flatten to reach 2% in Q4-12. As for core inflation, our forecasts suggest that it will continue relatively stable around 1.9% in the coming months, and will moderate towards 1.6% in H2-12. For 2013, we expect both headline and core inflation to stand at 1.5%. In particular, the probability that headline inflation will be below the ECB target at the end of Q1-13 is approximately 60% (Chart 30).

Chart 30
Inflation (% y/y)



Source: Eurostat and BBVA Research

According to this scenario, we continue to see risks to short-term inflation from greater increases of crude prices should geopolitical tensions intensify, as well as from potential rises in taxes and/or administered prices aiming at reaching the fiscal targets. However, they will be partially offset by the downward biases stemming from the weakness of domestic demand, which will be more significant determining factors for the medium-term.

Table 2

Eurozone member states: a closer view**Eurozone: After a mild recession in 2012, the economy will recover slowly in 2013**

GDP:	-0.2%	in 2012	+0.9%	in 2013	HICP:	+2.4%	in 2012	+1.5%	in 2013
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Latest official data for Q4-11: GDP fell in Q4 (-0.3%), in line with expectations, with only external demand leading to positive growth, though the trade volume slowed down. All components of domestic demand made negative contributions to growth.

Incoming data for Q1 and Q2: In recent months, industrial production remained flat, interrupting the large falls observed in Q4-11 (average of -0.6% q/q up to February over Q4-11, when it declined by -2.0% q/q), but the decline in new orders points to a gloomy outlook in coming months. Manufacturing confidence improved slightly during Q1, but reverted clearly to below 50 in April. For the services sector the prospects are not much better, as the PMI sub-index remains in contractionary territory and EC indicator turned very negative in April. Thus, investment is not expected to lead to expansion in activity. There was a clear improvement of consumption at the beginning of the year, as confidence and retail sales suggest, but labour market conditions and fears weigh on domestic demand, with unemployment steadily and gradually increasing since Q4-2011. Regarding the trade balance, exports increased at steady rates up to February, while import gains responded mainly to higher commodity prices. Our short-term GDP forecast model (MICA-BBVA) suggests that GDP could have increased by around 0.1% q/q in 1Q, but could contract again by -0.1% q/q in 2Q.

Outlook for 2012 and 2013: Overall, we expect negative growth for 2012, on a very weak domestic demand, with the weak first half of the year determining the downturn, while in the second half economic activity would start improving. For 2013, we anticipate a moderate rebound with positive contributions from both domestic and external demand.

Inflation outlook: As regards price developments, after a sticky inflation during Q1 at 2.7%, the rate eased slightly to 2.6% in April, driven by the lower growth of energy prices, while our forecasts suggest that core inflation should have remained broadly stable at 1.9% y/y. We now expect inflation to slow further in coming months, but to remain above target during 2012, while averaging 1.5% in 2013 (see Box 4).

Public sector: The general government deficit in the eurozone has shown an important adjustment in 2011, from -6.2% to -4.1%. Fiscal balances improved in all countries with respect to the previous year except Ireland. Portugal and Germany have recorded the largest adjustments. Debt is estimated at 87.3% and it is expected to reach its peak by 2013 at 89.3% and then gradually be reduced.

Germany: Domestic demand to take the lead

GDP:	+0.7%	in 2012	+1.6%	in 2013	HICP:	+2.0%	in 2012	+1.5%	in 2013
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Latest official data for Q4-11: Broadly expected mild contraction in Q4-2011 (-0.2%), on weak external demand, and with only investment contributing positively to growth. Unlike the eurozone and other member states, the upturn in 2011 was mainly driven by domestic demand, as fundamentals strengthened further over last year.

Incoming data for Q1 and Q2: There was an improvement observed over the first quarter in services. Industrial production rebounded at the end of Q1, after being markedly affected by the impact of adverse winter weather in construction in February, although excluding the latter, manufacturing output could have remained flat in Q1. Industrial orders, mostly from abroad, showed signs of weaknesses in the beginning of the year, reflecting subdued activity in the eurozone, but they improved more than expected by the end of Q1. Consumer spending, after being nearly flat in Q4 and losing ground the first two months of Q1, bounced back in March, as reflected in retail sales data. Despite the short-lived rebound in confidence in March, German consumers turned more pessimistic at the beginning of Q2. In addition, although exports have grown recently, export orders have been falling and imports continue rising on the back of stronger domestic demand. Confidence data, available for the current quarter, further points to deterioration in industrial activity and to weaker services sector at the beginning of Q2. GDP is expected to have turned marginally positive in Q1 (+0.1% q/q).

Outlook for 2012 and 2013: We have revised slightly upwards our GDP forecast for 2012 to 0.7% q/q, with the positive contribution stemming from domestic demand (+0.8). Private consumption might remain resilient, supported by a healthy labour market that should be reflected in an increase of households' disposable income. Investment is likely to grow at a more moderate pace, as uncertainty remains high and capacity utilization is already above its historical average, while public investment might also decline due to the end of temporary stimulus. Net exports will turn slightly negative (-0.1%), mostly due to the robustness of imports, after their positive contribution in 2011 (+0.9%). We also expect domestic demand to continue supporting growth in 2013.

Inflation outlook: HICP Inflation has eased and reached 2.2% in April, moderating slowly as a result of rising oil prices. Core inflation has hovered in Q1 between 1.6% and 1.8%, indicating that there are no clear signs of potential indirect or second round effects. For 2012 as a whole, we now expect a stronger inflation rate, at 2.0%, while for 2013 we foresee a rate as low as 1.5%.

Public sector: The deficit for 2011 came in at -1% of GDP, compared to a targeted -2.5%, reflecting the expiration of one-off measures taken in 2010, withdrawal of stimulus and consolidation measures, together with better than expected tax revenues associated to a good performance in economic activity. Excluding one-off measures the structural adjustment is estimated to be at around 1.5pp. For 2012 the adjustment is expected to be more moderate.

Continued on the next page

Table 2

Eurozone member states: a closer view (cont.)**France: Resilient to downturn also in 2012, after escaping contraction in Q4**

GDP:	+0.5%	in 2012	+1.1%	in 2013	HICP:	+2.2%	in 2012	+1.6%	in 2013
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Latest official data for Q4-11: France, in contrast to most eurozone countries, but in line with expectations, managed to maintain positive growth during Q4-11 at +0.2% q/q, with positive contributions from both external and domestic demand, only offset by the negative contribution of the change in inventories. However, the strong rebound in investment came from one-off measures, as firms brought forward car purchases to avoid higher taxes.

Incoming data for Q1 and Q2: During Q1-12, services and industry have resisted better the downturn, showing some growth, while the construction sector became weaker. Exports came in stronger than in Q4-11, but so did imports. As a result, we expect flat GDP in Q1-12. Soft data for Q2 so far are disappointing for investment, but positive for private consumption, bringing in a mixed picture for domestic demand.

Outlook for 2012 and 2013: For 2012 we have revised slightly upwards our projections, and we now see GDP growth of 0.5% (versus 0.2% previously), with the contribution almost equally distributed between domestic and external demand. Overall, the deceleration from 2011 (1.2pp) should reflect mostly the weakness of domestic demand, with unemployment increasing and weighing on households' disposable income, while the high levels of uncertainty combined with tightened credit conditions might take their toll on investment. GDP growth would pick up to 1.1% in 2013, supported mostly by domestic factors.

Inflation outlook: HICP inflation accelerated slightly in Q4-11, reflecting not only higher oil prices but also the anticipation of the increase in the reduced rate of VAT at the beginning of 2012. Over Q1-12, both headline and core inflation remained broadly stable at 2.6% and 2% y/y respectively. Taking into account both higher oil prices and tax hikes, we have revised upwards our HICP inflation forecast by 0.6pp to 2.2% in 2012. The weakness of the labour market might put a brake on wage claims and thus we do not expect inflationary pressures to emerge during the year.

Public sector: France improved on its 2011 fiscal goals, reaching a 5.2% deficit against a target of 5.7%. This implies a structural adjustment of 2pp of GDP. This year's target for the overall balance is set at -4.5% of GDP.

Italy: In recession, with only flat GDP growth expected in 2013

GDP:	-1.5%	in 2012	+0.1%	in 2013	HICP:	+3.1%	in 2012	+1.9%	in 2013
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Latest official data for Q4-11: Economic activity contracted sharply in Q4-11, for the second quarter in a row, driven by domestic factors, while net export support was determined by the strong fall in imports, with more worrying signs coming from the stagnation of exports.

Incoming data for Q1 and Q2: Industrial output fell strongly in Q1, while new orders do not point to an improvement in the short-run. Indicators from services are also gloomy, with PMIs in contraction and EC confidence falling sharply in April. Consumption indicators improved in Q1, after having deteriorated towards the end of 2011. We expect GDP to fall by -0.6% q/q in Q1.

Outlook for 2012 and 2013: Despite a more moderate decline of GDP expected for H2-12, the large fiscal consolidation measures are already weighing on activity, and thus we maintain our forecast of a GDP fall of around -1.5% this year. Private consumption is expected to slump, as a result of a decline in households' disposable income due to the labour market deterioration, tax hikes and higher inflation. The downward trend observed in investment is projected to persist over 2012, while public consumption is set to contract in order to meet the fiscal targets. Overall, the contraction in activity could be softened by a positive contribution of net exports, but mainly due to sharp fall projected for imports. For 2013, we expect a flat GDP growth.

Inflation outlook: HICP inflation remained high in Q1-12 (3.8% y/y in March), after the significant increase observed in September (from 2.3% to 3.6% y/y) resulting from VAT hikes (+1pp to 21%). Together with higher energy inflation, this has led us to revise our forecast for this year upwards by 0.9pp to 3.1%. We do not factor in potential further VAT increases in October, which have not been decided yet. As both higher oil prices and tax hikes should be temporary, we continue to expect inflation to moderate next year due to the weakness of domestic demand.

Public sector: Last years' fiscal goals (-3.9% deficit) were met, with the deficit reaching -3.8% of GDP. In spite of the recent revision of this and next year's targets to -1.6% and -0.5%, from a previous -1.5% and 0%, the Italian economy is expected to bring a structural adjustment of 2.8 pp of GDP with the already announced measures. Budget execution data up to April are showing signs of improvement with respect to last year. The measures to be applied later this year will help to meet the targets.

Continued on the next page

Table 2

Eurozone member states: a closer view (cont.)

Portugal: Outlook remains negative, but somewhat improved

GDP:	-2.7%	in 2012	+0.6%	in 2013	HICP:	+3.3%	in 2012	+1.3%	in 2013
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Latest official data for Q4-11: Economic activity dropped by -1.3% q/q in Q4-11, slightly less than what we expected (-1.6% q/q), owing to the strong negative contribution of domestic demand to growth (-4.5pp).

Incoming data for Q1 and Q2: GDP growth is expected to have remained in clear negative territory in Q1-12, as dropping domestic demand more than offset the positive contribution of net exports. Activity has not yet recovered, though there is some improvement over Q4-11, especially in confidence. Industry orders have been falling, while services are somewhat stronger showing a less negative trend. Exports remain the main strength of the economy, but unemployment has risen faster than expected. Together with the fiscal consolidation efforts, it is having a negative impact on domestic demand. As a result, our MICA-BBVA model for short-term growth in Portugal suggests growth at -0.6% q/q in Q1.

Outlook for 2012 and 2013: For the medium term, economic developments will be shaped by additional fiscal measures and imbalances correction in the private sector, while uncertainty could increase due to a stronger conditionality coming from a potential second bailout. We foresee a considerable negative GDP growth in 2012, followed by a mild recovery in 2013, with external demand always driving growth.

Inflation outlook: HICP annual inflation has remained at very high rates over last year (3.6% in 2011) as a result of the impact of tax increases in 2010 and 2011. However, these effects should be disappearing throughout this year, and taking into account a depressed domestic demand, inflation is expected to slow to 3.3% in 2012 and 1.3% in 2013. Nevertheless, uncertainty to this outlook remains high, as further tax and/or administered price hikes could be adopted in order to meet fiscal targets.

Public sector: On the fiscal front, Portugal made a structural adjustment of as much as 3.5% of GDP in 2011 net of one-offs, while the deficit target of 5.9% of GDP in 2011 was undershot to 4.2% partly due to the transfer of pension funds' assets to the state (of 3.5% of GDP). The deficit target of 4.5% of GDP for 2012 remains within reach, requiring an additional consolidation of around 4% of GDP, with a focus on the expenditure side.

Spain: Recession in 2012 and slow recovery in 2013, with risks tilted to the downside

GDP:	-1.3%	in 2012	+0.6%	in 2013	HICP:	+1.9%	in 2012	+0.7%	in 2013
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Latest official data for Q4-11: Data available from the last two quarters confirms that the economy has entered in technical recession. The disaggregation of GDP in Q4-11 (-0.3% q/q) revealed a weakness of domestic demand significantly larger than expected.

Incoming data for Q1 and Q2: Although some doubts inherited on economic policy were removed during the first months of the year (i.e. increased credibility regarding the achievement of the fiscal objectives, ambitious labour reform and restructuring of the financial system), we maintain our view about the precariousness of the drivers of the economy in the short term. The most recent indicators point to a new fall of domestic demand in Q1-12, and therefore of imports, which shows that the growth pace (estimated at -0.3% q/q) would continue to be marked by increased external support.

Outlook for 2012 and 2013: Our baseline scenario keeps suggesting a correction of the accumulated imbalances during the current crisis. Thus, we expect a negative growth of -1.3% in 2012 as a whole, while we see a slow recovery of the economy in 2013. However, the negative impact of higher spreads in public debt, the absence of transparency in the measures taken by the autonomous regions and the doubts on the speed of the implementation together with the costs of the restructuring of the financial system increase the risks of a higher contraction this year.

Inflation outlook: The decelerating path of inflation was interrupted in Q1-12, due to the rise of oil prices, with headline and core inflation relatively stable around 2.0% and 1.2% respectively. For 2012, we expect an inflation rate at 1.9%, while in 2013 we foresee a much lower rate, as a consequence of weakening domestic demand and of the base effects on energy prices.

Public sector: On the fiscal front, the 2.5pp deviation from the fiscal target of 2011 was confirmed, with the deficit at 8.5% of GDP, thus increasing the pressure for the necessary fiscal adjustment in 2012 (of 3.2pp) to reach the goal of 5.3% of GDP. The composition of the budget measures, concentrated on direct taxation and on investment spending, does not minimize the negative impact of the adjustments on growth. In addition, budget execution data shows that the major part of the public consumption adjustment should take place by mid-2012.

Source: BBVA Research

Box 5. United Kingdom: No clear recovery in sight

Economic activity in the United Kingdom remains stressed by the eurozone crisis resolution and the fiscal consolidation process. The Monetary Policy Committee (MPC) members are facing a dilemma as growth remains subdued and inflation above target.

Economic activity unexpectedly fell into recession in Q1...

The British economy showed a modest increase of 0.7% in 2011 and this year started with uncertainty. In 2011 the external demand was the main driver of growth as at the domestic level households faced an environment of high inflation, tax rises and low nominal wage growth, leading to a decline in disposable income. This year, the British economy declined in Q1 by -0.2% q/q entering into technical recession after the decline by -0.3% q/q in Q4. This figure may be revised upwards, as soft and leading indicators have been showing a more upbeat performance. PMI data for Q1 showed improvements in all three sub-sectors; consumer confidence mildly improved and retail sales remains volatile. The labour market stabilized and unemployment has remained unchanged at 8.4% since the end of last year. There are some risks that this gloomy news may bring down agents' expectations under the current scenario marked by additional fiscal consolidation and unemployment at records highs. External developments, mainly dominated by the eurozone crisis will be the key for the economic recovery.

... and envisaged to be volatile in 2012

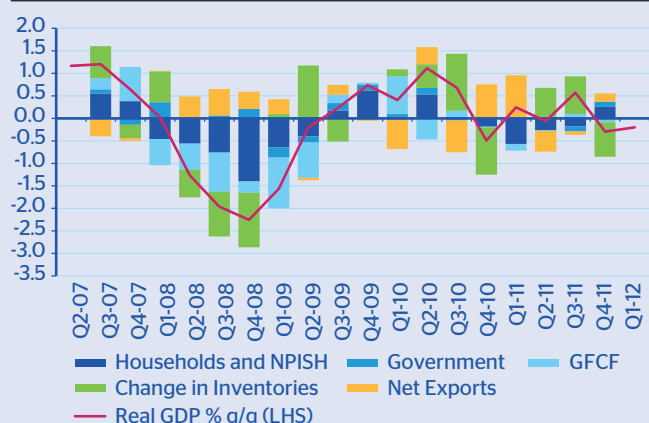
In view of worse-than-expected economic activity at the beginning of the year and amidst ongoing uncertainty, we have revised the profile for the year, but we maintain the overall picture. We expect a moderate growth of 0.5% in 2012 and 1.4% in 2013. The quarterly profile is expected to behave somewhat erratically as several events will take place: an additional holiday in Q2 and the Olympic Games, which will be hosted in London, and will presumably lead to a peak in demand in Q3.

The main determinants for this year's economic activity performance will be the continuing risks in major trading partners (the eurozone), strains in bank funding markets and the ongoing fiscal consolidation, which is having a somewhat higher impact on private consumption than initially foreseen through weaker expectations.

Private consumption will improve as disposable income recovers due to lower inflation

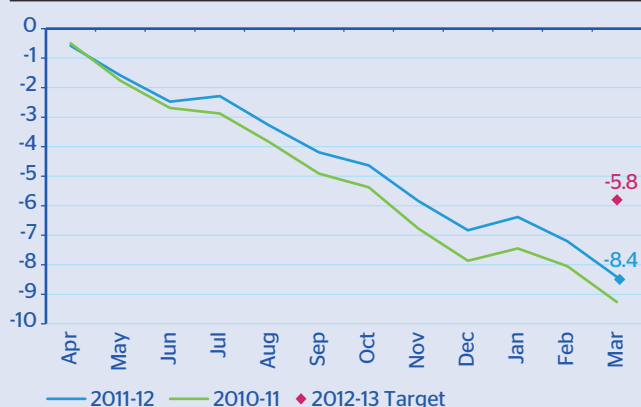
The outlook on private consumption remains highly uncertain. Although unemployment has remained stable at 8.4% since November according to ILO statistics, prospects for 2012 point to further increases as the private sector is struggling to create sufficient jobs to offset the public sector cuts. At the same time, wage growth has been very moderate. In contrast, the fall in inflation this year, although milder than initially expected, will lead to an increase in real disposable income, while household confidence is showing signs of recovery. As a result, we expect private consumption to show a moderate recovery of 0.4% in 2012, after falling -1.2% last year.

Chart 31
UK: Contribution to GDP q/q growth



Source: ONS and BBVA Research

Chart 32
UK: Public sector net borrowing as % of GDP



Source: ONS and BBVA Research

Investment is expected to pick up this year, but to remain subdued. Public consumption continues to show some resilience and has been increasing, although at a moderate pace, but it is expected to slow down further in coming years in line with fiscal adjustment plans to bring the budget back to balance by 2015-16. Budget execution data for the recently finished fiscal year showed little improvement with respect to last year, but the target was met. Looking ahead, the adjustment for this year is not so aggressive compared to eurozone counterparts and growth boosting measures are expected to bring in to play some positive effect on economic activity.

The external sector will be the main support for growth

In spite of the eurozone decline other markets such as the USA and emerging countries are providing support to the external sector. But the high dependency on industrial countries as main trading partners will become a toll in export activity in coming quarters. Trade with the eurozone, which accounts for more than 50% of UK exports, will be weak, and exports will be further hit by the recent (though moderate) appreciation of the pound. Overall, we expect a slowdown of exports from an estimated 4.6% in 2011 to a 3.1% this year. In contrast, imports are expected to perform better this year in line with the slight recovery in household's disposable income. Overall, the contribution to growth from

the external sector will be the main driver of growth for the UK.

Inflation rates are moderating, but still higher than expected due to energy prices

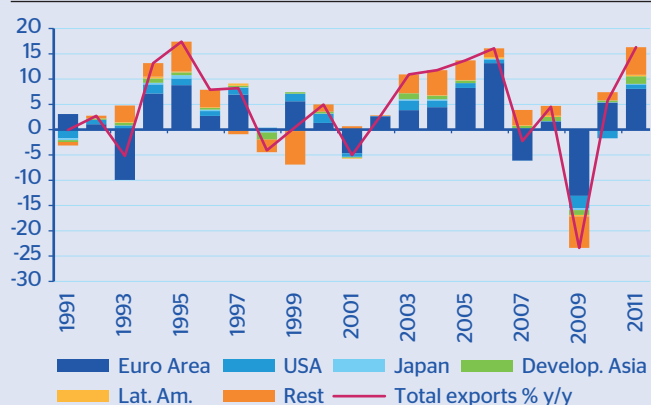
Inflation in 2011 averaged 4.5% partly to an increase in VAT by 2.5pp in January, and decelerated to 3.6% by January 2012, remaining relatively stable since then. We expect it to moderate further over 2012, although the oil price increase, which led to higher-than-expected rise in producer prices, and the recent increase in QE could curb the downward trend, and together with the pound appreciation could slow the pace of reversion. Overall, we expect inflation to average around 3.0% in 2012.

Monetary Policy Committee dilemma: increasing divergences

The weakness of activity along with persistent inflation makes it difficult to assess a possible extension of the QE programme. In May the latest tranche of the purchase programme announced at February's meeting will be completed, and the likelihood of an additional increase is uncertain given the divergent views among Monetary Policy Committee members. We still expect rates to remain at 0.5% all through 2012.

Chart 33

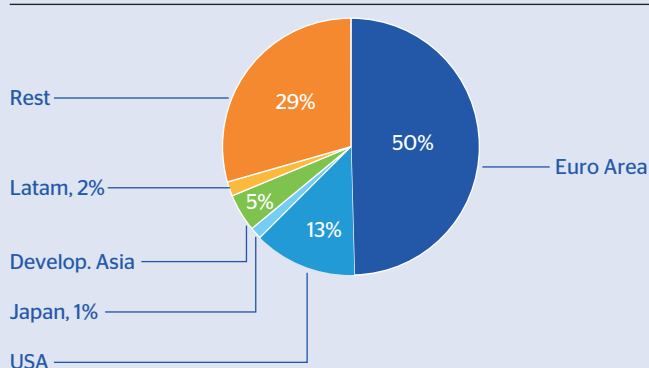
UK: Contribution to export growth by region



Source: ONS and BBVA Research

Chart 34

UK: Export breakdown



Source: IMF and BBVA Research

5. Tables

Table 3

Eurozone forecasts

(YoY)	2009	2010	2011	2012	2013
GDP at constant prices	-4.2	1.8	1.5	-0.2	0.9
Private consumption	-1.2	0.8	0.2	-0.4	0.6
Public consumption	2.6	0.5	0.1	-0.6	0.3
Gross Fixed Capital Formation	-12.0	-0.7	1.6	-2.6	1.4
Inventories (*)	-0.8	0.5	0.0	-0.1	0.0
Domestic Demand (*)	-3.5	1.0	0.5	-1.0	0.7
Exports (goods and services)	-12.7	11.1	6.3	2.4	4.3
Imports (goods and services)	-11.6	9.4	4.0	0.6	4.1
External Demand (*)	-0.7	0.8	1.0	0.8	0.3
Prices and Costs					
CPI	0.3	1.6	2.7	2.4	1.5
CPI Core	1.3	1.0	1.7	1.8	1.5
Labour Market					
Employment	-1.8	-0.5	0.3	-0.5	0.0
Unemployment rate (% of labour force)	9.6	10.1	10.2	10.9	11.0
Public Sector					
Surplus (+) / Deficit (-) (% GDP)	-6.4	-6.2	-4.1	-3.0	-2.0
Public debt (% GDP)	79.6	85.5	87.3	89.3	89.2
External Sector					
Current Account Balance (% GDP)	0.2	0.2	0.4	0.8	1.2

(*) Contribution to GDP growth

Source: BBVA Research

Table 4

Macroeconomic Forecasts: Gross Domestic Product

(YoY growth rate)	2009	2010	2011	2012	2013
United States	-3.5	3.0	1.7	2.3	2.2
EMU	-4.2	1.9	1.5	-0.2	0.9
Germany	-5.1	3.6	3.1	0.7	1.6
France	-2.6	1.4	1.7	0.5	1.1
Italy	-5.1	1.8	0.5	-1.5	0.1
Spain	-3.7	-0.1	0.7	-1.3	0.6
UK	-4.4	2.1	0.7	0.5	1.4
Latin America *	-0.6	6.6	4.5	3.8	4.1
Mexico	-6.1	5.4	3.9	3.7	3.0
EAGLES **	4.0	8.4	6.7	5.8	6.4
Turkey	-4.9	9.2	8.5	2.7	5.6
Asia Pacific	4.2	8.1	5.7	5.7	6.1
China	9.2	10.4	9.2	8.3	8.7
Asia (exc. China)	1.0	6.6	3.4	4.1	4.4
World	-0.6	5.1	3.9	3.6	4.0

* Argentina, Brazil, Chile, Colombia, Peru, Venezuela

** Brazil, China, India, Indonesia, Korea, Mexico, Russia, Taiwan, Turkey

Forecast closing date: April 30, 2012

Source: BBVA Research

Table 5

Macroeconomic Forecasts: Inflation (Avg.)

(YoY growth rate)	2009	2010	2011	2012	2013
United States	-0.4	1.6	3.1	2.5	2.2
EMU	0.3	1.6	2.7	2.4	1.5
Germany	0.2	1.1	2.3	2.0	1.5
France	0.1	1.5	2.1	2.2	1.6
Italy	0.8	1.5	2.8	3.1	1.9
Spain	-0.3	1.8	3.2	1.9	0.7
UK	2.2	3.3	4.5	3.0	1.9
Latin America *	6.9	9.0	10.0	9.3	10.0
Mexico	5.3	4.2	3.4	3.9	3.6
EAGLES **	2.8	5.3	6.3	4.8	4.6
Turkey	6.3	8.6	6.7	9.6	7.1
Asia Pacific	0.3	3.6	4.8	3.5	3.5
China	-0.8	3.3	5.4	3.5	3.8
Asia (exc. China)	1.1	3.7	4.3	3.4	3.2
World	2.2	3.5	5.1	4.4	4.0

* Argentina, Brazil, Chile, Colombia, Peru, Venezuela

** Brazil, China, India, Indonesia, Korea, Mexico, Russia, Taiwan, Turkey

Forecast closing date: April 30, 2012

Source: BBVA Research

Table 6

Macroeconomic Forecasts: Current Account (% GDP)

	2009	2010	2011	2012	2013
United States	-2.7	-3.3	-3.3	-3.0	-3.3
EMU	0.2	0.2	0.4	0.8	1.2
Germany	5.6	5.7	5.8	5.2	4.9
France	-1.5	-1.7	-2.3	-1.9	-1.5
Italy	-2.0	-3.5	-3.2	-2.2	-1.5
Spain	-4.8	-4.5	-3.5	-1.9	-0.4
UK	-1.7	-3.3	-1.9	-1.7	-1.1
Latin America *	-0.3	-0.8	-0.8	-1.3	-1.9
Mexico	-0.7	-0.3	-0.8	-1.3	-1.4
EAGLES **	2.4	2.0	0.9	0.4	0.5
Turkey	-2.2	-6.4	-10.0	-8.8	-8.5
Asia Pacific	3.5	3.3	2.0	1.5	1.8
China	5.2	5.2	2.8	2.5	2.8
Asia (exc. China)	2.3	2.0	1.4	0.9	1.1

* Argentina, Brazil, Chile, Colombia, Peru, Venezuela

** Brazil, China, India, Indonesia, Korea, Mexico, Russia, Taiwan, Turkey

Forecast closing date: April 30, 2012

Source: BBVA Research

Table 7

Macroeconomic Forecasts: Government Deficit (% GDP)

	2009	2010	2011	2012	2013
United States	-9.9	-8.9	-8.7	-7.6	-5.0
EMU	-6.4	-6.2	-4.1	-3.0	-2.0
Germany	-3.2	-4.3	-1.0	-0.6	-0.4
France	-7.5	-7.1	-5.2	-4.5	-3.0
Italy	-5.4	-4.5	-3.8	-1.6	-0.5
Spain	-11.2	-9.3	-8.5	-5.3	-3.0
UK	-11.5	-10.1	-8.2	-5.9	-5.8
Latin America *	-2.8	-2.0	-2.0	-1.8	-1.1
Mexico	-2.6	-3.5	-2.8	-2.8	-2.8
EAGLES **	-3.9	-2.5	-2.2	-2.3	-2.1
Turkey	-5.5	-3.6	-1.4	-2.0	-1.7
Asia Pacific	-4.8	-3.7	-3.8	-3.7	-3.2
China	-2.8	-2.5	-1.1	-1.8	-1.8
Asia (exc. China)	-6.1	-4.5	-5.6	-5.0	-4.1

* Argentina, Brazil, Chile, Colombia, Peru, Venezuela

** Brazil, China, India, Indonesia, Korea, Mexico, Russia, Taiwan, Turkey

Forecast closing date: April 30, 2012

Source: BBVA Research

Table 8

Financial Variables

Official Interest Rates (End period)	2009	2010	2011	2012	2013
United States	0.25	0.25	0.25	0.25	0.25
EMU	1.00	1.00	1.00	1.00	1.00
China	5.31	5.81	6.56	6.06	6.56
10-year Interest Rates (Avg.)					
United States	3.2	3.2	2.8	2.3	2.6
EMU	3.3	2.8	2.6	2.0	2.7
Exchange Rates (Avg.) (US Dollar per national currency)					
United States (EUR per USD)	0.72	0.76	0.72	0.78	0.77
EMU	1.39	1.33	1.39	1.28	1.30
UK	1.56	1.55	1.60	1.60	1.66
China (RMB per USD)	6.83	6.77	6.46	6.25	5.94

Forecast closing date: April 30, 2012

Source: BBVA Research

Table 9

Germany: GDP growth and inflation forecasts

YoY rate	2008	2009	2010	2011	2012	2013
Private consumption	0.5	0.0	0.6	1.4	0.7	1.4
Public consumption	3.1	3.3	1.7	1.4	0.5	0.5
Gross Fixed Capital Formation	1.0	-11.4	5.2	6.6	1.3	3.9
Inventories (*)	0.0	-0.9	0.6	0.0	0.0	0.0
Domestic Demand (*)	1.0	-2.3	2.2	2.2	0.7	1.6
Export	2.1	-13.6	13.4	8.4	3.7	5.3
Import	3.0	-9.2	11.5	7.5	4.4	5.9
Net export (*)	-0.2	-2.8	1.4	0.9	-0.1	0.0
GDP	0.8	-5.1	3.6	3.1	0.7	1.6
Inflation	2.8	0.2	1.2	2.5	2.0	1.5

(*) Contribution to growth

Source: BBVA Research

Table 10

France: GDP growth and inflation forecasts

YoY rate	2008	2009	2010	2011	2012	2013
Private consumption	0.2	0.2	1.4	0.3	0.3	1.1
Public consumption	1.2	2.3	1.2	0.8	-0.1	0.4
Gross Fixed Capital Formation	0.1	-8.8	-1.4	2.6	0.0	1.8
Inventories (*)	0.3	-1.3	0.5	1.0	0.0	0.0
Domestic Demand (*)	0.1	-2.4	1.3	1.8	0.2	1.1
Export	-0.6	-12.2	9.3	4.6	3.6	5.1
Import	0.6	-10.6	8.3	5.3	2.6	4.6
Net export (*)	-0.3	-0.2	0.1	0.0	0.2	0.1
GDP	-0.2	-2.6	1.4	1.7	0.5	1.1
Inflation	3.2	0.1	1.7	2.3	2.2	1.6

(*) Contribution to growth

Source: BBVA Research

Table 11

Italy: GDP growth and inflation forecasts

YoY rate	2008	2009	2010	2011	2012	2013
Private consumption	-0.8	-1.6	1.2	0.2	-1.7	-0.5
Public consumption	0.6	0.8	-0.6	-0.9	-1.6	-0.9
Gross Fixed Capital Formation	-3.8	-11.7	1.7	-1.2	-4.5	0.2
Inventories (*)	0.0	-1.1	1.2	-0.6	0.0	0.0
Domestic Demand (*)	-1.2	-4.3	2.1	-0.9	-2.3	-0.5
Export	-2.8	-17.7	11.4	6.3	1.5	2.8
Import	-2.9	-13.6	12.4	1.0	-1.4	0.9
Net export (*)	0.0	-1.2	-0.4	1.4	0.8	0.6
GDP	-1.2	-5.5	1.8	0.5	-1.5	0.1
Inflation	3.5	0.8	1.6	2.9	3.1	1.9

(*) Contribution to growth

Source: BBVA Research

Table 12

Portugal: GDP growth and inflation forecasts

YoY rate	2008	2009	2010	2011	2012	2013
Private consumption	1.3	-2.3	2.1	-3.9	-6.2	-1.4
Public consumption	0.3	4.7	0.9	-3.9	-2.3	-1.4
Gross Fixed Capital Formation	-0.3	-8.6	-4.1	-11.4	-12.8	-0.6
Inventories (*)	0.0	-1.1	0.1	-0.5	0.0	0.1
Domestic Demand (*)	0.9	-3.6	0.9	-6.2	-6.8	-1.2
Export	-0.1	-10.9	8.8	7.4	2.5	4.7
Import	2.3	-10.0	5.4	-5.5	-7.9	1.6
Net export (*)	-1.0	0.6	0.5	4.6	3.9	1.2
GDP	-0.1	-2.9	1.4	-1.6	-2.9	0.0
Inflation	2.7	-0.9	1.4	3.6	3.3	1.3

(*) Contribution to growth
Source: BBVA Research

Table 13

Spain: GDP growth and inflation forecasts

YoY rate	2008	2009	2010	2011	2012	2013
Private consumption	-0.6	-4.3	0.8	-0.1	-2.0	-0.9
Public consumption	5.9	3.8	0.2	-2.2	-8.0	-5.6
Gross Fixed Capital Formation	-4.7	-16.5	-6.2	-5.1	-7.4	-1.0
Equipment and other products	-2.8	-22.0	5.3	1.5	-4.5	2.9
Construction	-5.7	-15.4	-10.1	-8.1	-9.2	-3.2
Housing	-9.1	-22.0	-9.8	-4.9	-6.6	-1.6
Other construction	-1.6	-7.7	-10.4	-11.2	-11.8	-4.9
Inventories (*)	0.1	0.0	0.0	0.0	0.0	0.0
Domestic Demand (*)	-0.5	-6.5	-1.0	-1.8	-4.5	-1.8
Export	-1.0	-10.2	13.5	9.1	4.0	8.9
Import	-5.1	-16.9	8.9	-0.1	-6.2	1.6
Net export (*)	1.4	2.8	0.9	2.5	3.1	2.4
GDP	0.9	-3.7	-0.1	0.7	-1.3	0.6
Inflation	4.1	-0.3	1.8	3.2	1.9	0.7

(*) Contribution to growth
Source: BBVA Research

Table 14

UK: GDP growth and inflation forecasts

YoY rate	2008	2009	2010	2011	2012	2013
Private consumption	-1.5	-3.5	1.2	-1.2	0.4	1.3
Public consumption	1.6	0.0	1.5	0.1	1.0	-0.9
Gross Fixed Capital Formation	-4.8	-13.4	3.1	-1.2	3.3	7.8
Inventories (*)	-0.4	-1.0	0.9	0.6	-0.9	-0.3
Domestic Demand (*)	-1.9	-5.5	2.6	-0.3	0.1	1.5
Export	1.3	-9.5	7.4	4.6	3.1	2.8
Import	-1.2	-12.2	8.6	1.2	2.0	2.8
Net export (*)	0.8	1.1	-0.5	1.0	0.3	0.0
GDP	-1.1	-4.4	2.1	0.7	0.5	1.4
Inflation	3.6	2.2	3.3	4.5	3.0	1.9

(*) Contribution to growth
Source: BBVA Research

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