

Economic Watch

Eurozone

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Economic Analysis

Europe

Miguel Jiménez González-Anleo
Chief Economist
mjimenezg@bbva.com

Agustín García Serrador
Senior Economist
agustin.garcia@bbva.com

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

Pablo Budde
pablo.budde@bbva.com

Massimo Trento
massimo.trento@bbva.com

The recovery gained momentum in the fourth quarter, spread across countries

The latest data from the euro area are slightly more positive, within the context of a very slow recovery. Although a month ago the forecast bias for the last quarter (0.3% q/q) was negative because October activity data had not been very positive and confidence had slowed, the latest data published last month suggest that this forecast will be met and it might even grow to 0.4%. The improvement has been widespread among core countries. Inflation was again lower than expected, but this time due to technical problems in the prices of services in Germany. We continue to consider unlikely the danger of deflation.

Eurozone activity data in line with the expected improvement in confidence, but inflation continues to surprise to the downside in December

- **Confidence indicators improved in December to levels consistent with moderate GDP growth in 4Q13**

The economic sentiment indicator from the European Commission (ESI) continues the upward trend observed since the middle of last year, supported by improved expectations of both industry and services. In addition, the composite PMI improved further in December, more than expected, offsetting the slight decline seen in the previous two months, so that it remains above the growth threshold of 50. Over the fourth quarter as a whole, the average level of both indicators (ESI and PMI) is similar to that observed in mid-2010, when the GDP in the euro area rose at around 0.4% q/q.

- **Activity data in November improved more than expected after disappointing October figures**

The most recent activity data, mostly relating to November, give a more optimistic picture of the European economy than the data published in October. On the one hand, the strong growth in industrial production in November (also widespread across countries) offset the falls in the previous two months, so that the level of production in October and November grew about 0.3% over Q3 (after stagnating in that quarter). In addition, industrial orders, especially export orders, suggest that the recovery of the industrial sector continues and could gain momentum in the coming months. On the other hand, the increase in retail sales in November was also higher than anticipated (offsetting the fall in the previous month), which, together with the stabilization of the labor market (unemployment rate at 12.1% since April) and the moderation of inflation, suggests that private consumption could have returned to contribute to GDP growth by year-end. Finally, the weakness in exports continued in the last months, although in October-November it rose by about 0.7% on 3Q13, while imports shrank again (-1.4% compared to 3Q13), so these data suggest that net exports could have returned to a positive contribution to quarterly GDP growth in the last quarter of 2013 (after draining 0.3pp in 3Q13).

- **The MICA-BBVA model estimates that the recovery continues in 4Q13 (+0.3%/0.4% q/q).**

Incorporating November hard data, our short-term forecast model estimates a growth rate of around 0.4% q/q in 4Q13 (after 0.1% q/q in 3Q13), just a little higher than we anticipated a month ago and contemplated in our latest set of forecasts (compatible with negative annual average growth of -0.4% in 2013 and +1.1% recovery in 2014). Across countries, German's GDP (seasonally and calendar adjusted) grew by 0.5% in 2013 as a whole, which, assuming no revision of the quarterly pattern until 3Q13, is consistent with growth of around 0.3% q/q in 4Q13. National data also suggest that the recovery will be widespread across the countries (0.2% q/q in France, although the Bank of France and Insee expect more, 0.1% q/q in Italy and 0, 3% q/q in Spain).

- **Inflation will slow down again in the first quarter**

Both headline and core inflation fell in December by 0.2pp to 0.8% y/y and 0.9% y/y, respectively. Behind this behavior was mainly the slowdown of inflation in services, which reflected the changes in the seasonality of holiday packages and hotels in Germany, resulting in a reduction of inflation in this country of 0.4pp to 1.2% y/y. In other countries, headline inflation remained relatively stable, although the increase in energy and food prices offset a slight slowdown in the growth rates of the underlying components. Our projections are for inflation to decline slightly over the first quarter (to rates around 0.7% y/y), partly reflecting a lower base effect from energy prices, not only the moderation in oil prices but also the strength of the euro. In addition, we see a more volatile performance of core inflation in coming months resulting from methodological changes, though on average we expect it to remain relatively stable. However, inflation rates will remain low but positive for a time, somewhat below 1% in the coming months (probably in the first half) to recover gradually after, so we believe that a strong disinflation process is unlikely.

Germany: high confidence and a rebound in industrial production and retail sales

- **Significant improvement in confidence indicators in 4Q13**

Confidence data remained at high levels in December, confirming the improvement in 4Q13. PMIs have been driven mainly by higher expectations of the manufacturing sector, while services data is still in expansionary territory (despite a reduction in December), indicating that domestic demand could remain resilient in 4Q13 (after a contribution of 0.6pp to quarterly GDP growth in 3Q13). It should be noted that the composite PMI remained at similar levels to those observed in mid-2011, when GDP grew by around 0.5% q/q. In the breakdown of the PMI by components it is worth mentioning the strength of export orders that, along with trade balance data up to November, suggest that net exports could again contribute positively to growth by year-end, after the negative contribution in 3Q13.

- **Retail sales and industrial production rebounded in November**

Retail sales rose sharply in November, in line with the improving indicators of consumer confidence, as well as industrial production, which surprised bouncing on a monthly basis after contracting for two consecutive months. Improving consumer expectations and industrial output in recent months suggest that actual indicators could continue to improve at the end of the fourth quarter.

- **The increase of 0.5% of GDP in 2013 suggests that the recovery is consolidating at a steady pace (about 0.3% q/q)**

Assuming that the growth rates of previous quarters are not revised, the advanced GDP estimated for 2013 as a whole implies a GDP growth of around 0.3% q/q in the fourth quarter, such that the pace of recovery would have remained constant in the second half of the year after the temporary rebound observed in 2Q13. Overall, these data are somewhat lower than those reported in our last Europe Economic Outlook report, because we expected a relatively constant quarterly improvement of around 0.4% q/q in 2H13.

France: hard data deny doubts about the recovery in Q4 shown by PMIs

- **The latest confidence data are positive, while PMIs are pessimistic**

National confidence data and PMIs show mixed signals in the fourth quarter. INSEE business confidence indicators (and consumer confidence) and the Bank of France, as well as the ESI continue their upward trend, albeit at a slower pace, especially because of the weakness of services. In contrast, the composite PMI deteriorated again in December because of the worsening of confidence in both sectors, which remained below the growth threshold.

- **But hard indicators are positive up to November**

Up to November, industrial production grew softly, and retail sales improved by 0.6% on 3Q13 average data, showing some improvement in the current quarter, in line with confidence indicators and our forecast of a slight increase.

Italy: slow exit from recession

- **Confidence indicators are stable at still weak levels, with differences across sectors**

After the bad confidence data for October and November, PMIs recovered in December due to improved expectations in the industrial sector, while the service sector outlook remains more pessimistic and consumer confidence continues below its historical average.

- **Positive trend in industrial production in November**

Industrial production has increased for the third consecutive month in November, in line with the improved confidence in the sector, and up by 1% above the average of 3Q13. Retail sales, with data until October, continue to shrink due to weak domestic demand. However, we continue to expect GDP to grow slightly in 4Q13, confirming a slow exit from recession after stagnating in the previous quarter.

Spain: towards sustained growth

- **Exports lose some momentum but domestic demand begins to recover**

Regarding foreign demand, firms expectations (foreign orders) and expenditure data (sales of large enterprises abroad) indicate that exports are likely to slow again in 4Q13, but remaining strong. In addition, data on foreign tourism seem to maintain their upward trend, confirming the strong increase observed throughout the year.

Some indicators of private demand (car registration and consumer confidence) show more signals that household consumption has improved in 4Q13, and the strong increase in November retail sales offset the fall in October. Overall, more positive data were noted in the labor market, as employment registered in Social Security increased and unemployment decreased at the same time (-1.4% q/q swda).

- **For the first time since the outburst of the crisis, positive signs are observed in the job market**

The number of Social Security affiliates increased by 0.6% q/q swda in 4Q13 (0.5% q/q swda excluding the loss of non-professional carers), which contrasts with the estimated decline of -0.3pp during 3Q13. This is the first non-seasonal increase in affiliation since the first quarter of 2008. This pace of job creation would have been supported by activities related to the public administration, which created 128,800 jobs from September to December, 54,600 more than in the same period of 2012.

However, even excluding this factor, the growth in affiliates in 4Q13 was positive (0.2% q/q swda).

Meanwhile, the reduction of registered unemployment intensified to -1.8% q/q swda in 4Q13 from 0.6% the previous quarter. Finally, hiring increased again between October and December (4.6% q/q), both permanent (1.1% q/q) and, especially, temporary (+4.9% q/q) hiring.

- **The economic recovery is underway in the 4Q13 (+0.3% q/q)**

Available data for 4Q13, indicate that, after exiting from the recession in the previous quarter, the economy might have gained some momentum by year-end. The MICA-BBVA model estimates a quarterly GDP growth of +0.3% q/q, in line with our baseline scenario, and therefore a fall in annual GDP of about 1.3% in 2013 as a whole.

Eurozone

National accounts: the positive contribution of domestic demand offsets weak exports

Quarterly GDP growth slowed by 0.2pp to 0.1% q/q in 3Q13. The MICA-BBVA model estimates a quarterly GDP growth between +0.3% and +0.4% q/q in 4Q13, in line with our scenario.

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

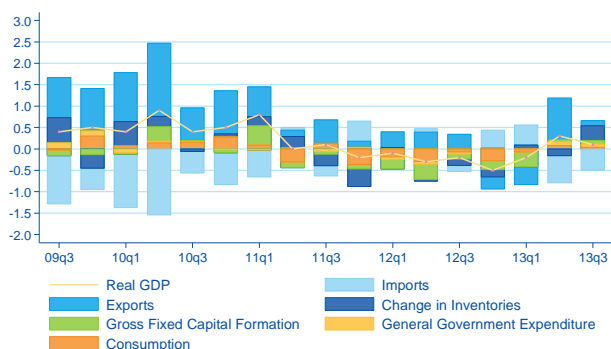
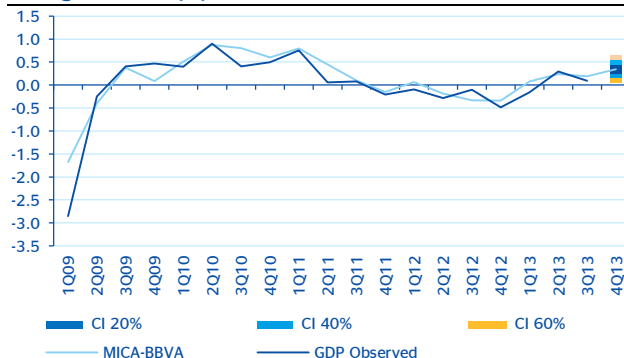


Chart 2
GDP growth (%q/q) and MICA-BBVA forecast**



Confidence: good December data suggest that the recovery gained momentum in 4Q13, with GDP growth at around 0.4% q/q

EC confidence indices (ESI) improve in December at a high rate and PMIs remained strong. These data confirm that the eurozone recovery might be taking some momentum, being led by Germany.

Chart 3
PMI and GDP growth (%q/q)*

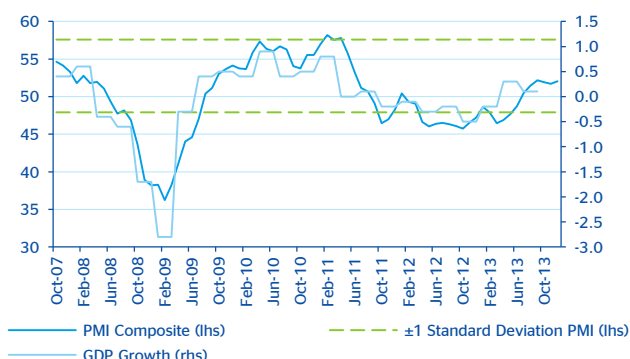
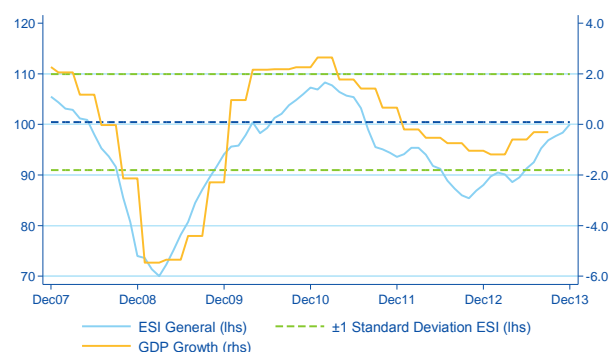


Chart 4
Confidence (ESI) and GDP growth (%y/y) **



Activity: data available up to November improved more than expected, in line with the anticipated improvement in confidence

Industrial production posted a strong improvement in November, bringing the index to 0.3% above the average of 3Q13. Retail sales increased strongly after falling in the previous two months, pointing to a recovery in private consumption.

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

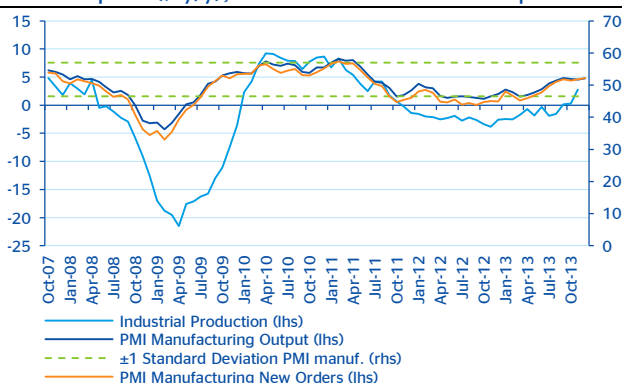
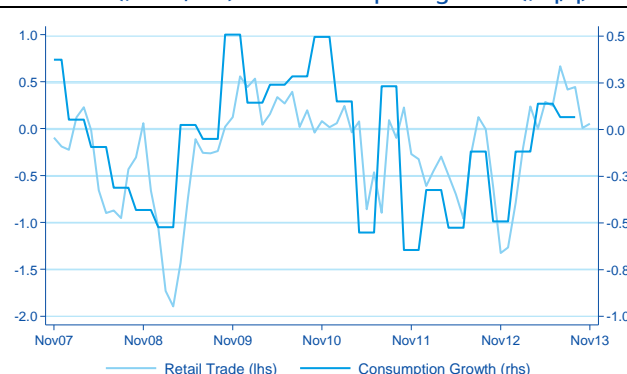


Chart 6
Retail trade (% 3m/3m) and consumption growth (%q/q)*



* Source: HAVER and BBVA Research

Foreign sector: weakness in exports continues, but the drop in purchases from abroad suggest that net exports will contribute to growth again

Weakness in exports continued in recent months, although in October-November they rose by about 0.7% on 3Q13, while imports fell again (-1.4% compared to 3Q13), suggesting that net exports could have returned to a positive contribution to quarterly GDP growth in the last quarter of 2013 (after draining 0.3pp in 3Q13).

Chart 7
Current account (% of GDP)*

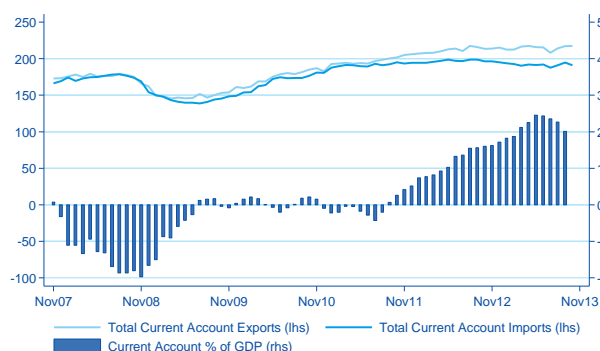
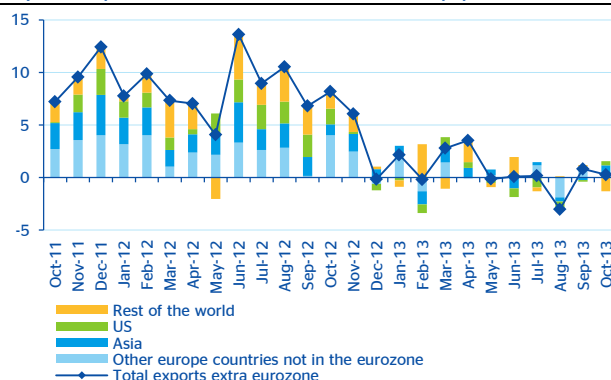


Chart 8
Exports by destination (contribution to %y/y)



Labour market: stable throughout the last year

Although we think that a mild economic recovery is on track, the unemployment rate is unlikely to decline in the short run, given the lag between activity and employment as well as the economic slack, remaining at high levels. As a result, wage costs are moderating.

Chart 9
Unemployment rate (%) and employment expectations*

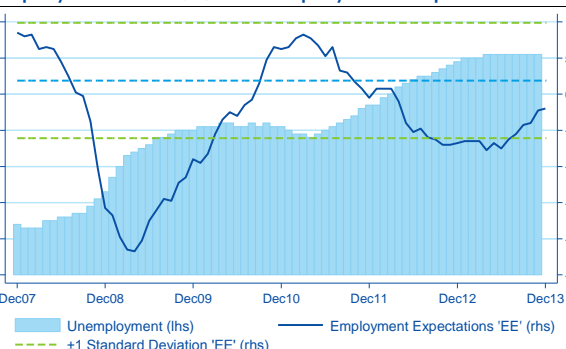
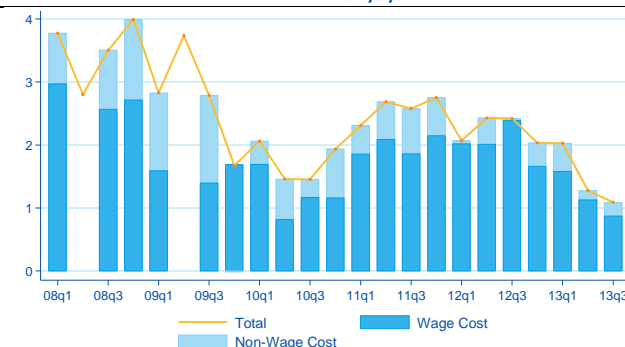


Chart 10
Labour cost in business sector (%y/y)*



Prices: inflation likely to moderate again during the first quarter

Both headline and core inflation fell in December by 0.2pp to 0.8% y/y and 0.9% y/y, respectively. Behind this behavior was mainly the slowdown of inflation in services, which reflected the changes in the seasonality of holiday packages and hotels in Germany.

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

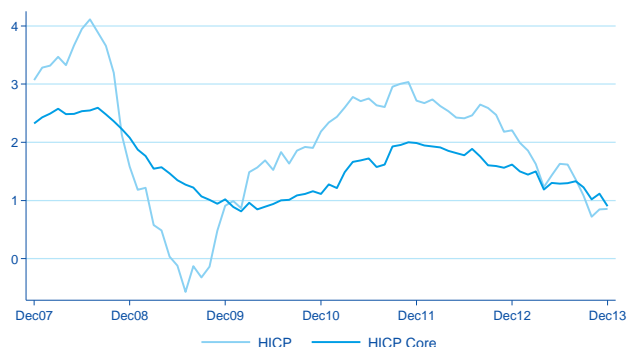
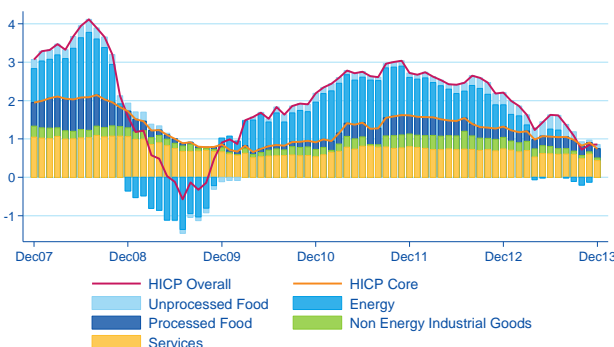


Chart 12
Inflation by components (contribution in %)*



* Source: HAVER and BBVA Research

Germany

National accounts: strong domestic demand, especially in domestic investment

GDP growth slowed in 3Q13, as net exports weighed negatively on activity and were not offset by the stronger contribution of domestic demand. The increase of 0.5% of GDP in 2013 suggests that the recovery is consolidating at a steady pace (at about 0.3% q/q)

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

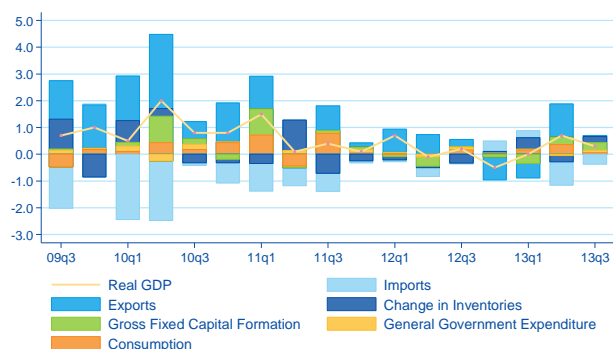
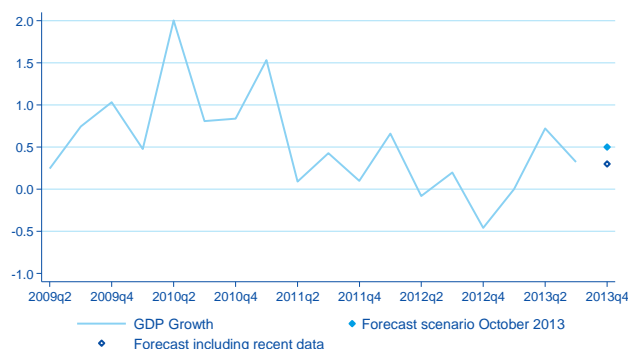


Chart 14
GDP (%q/q) and forecasts*



Confidence: confidence improved significantly in 4Q13, until mid-2011 levels

The strength of confidence is mainly due to higher expectations in the manufacturing sector. The composite PMI remains at levels well above the growth threshold in December and recorded strong improvements in both sectors in 4Q13.

Chart 15
PMI and GDP growth (%q/q)*

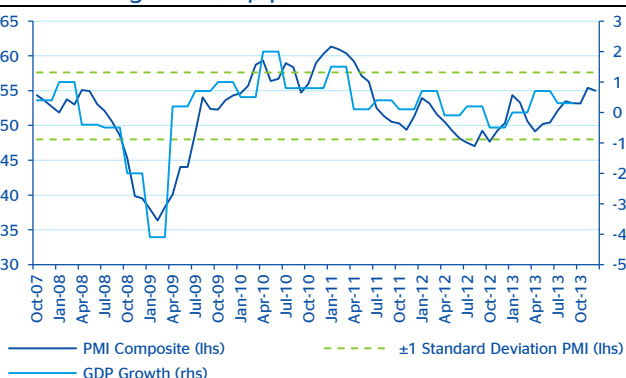
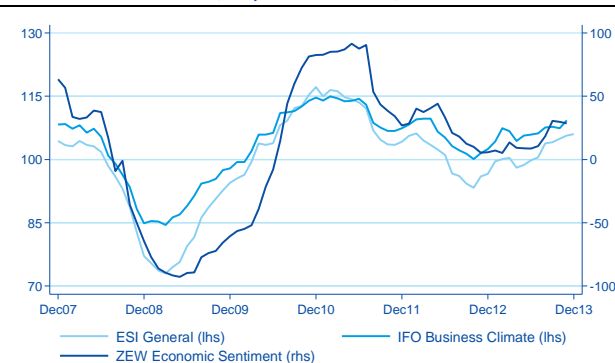


Chart 16
Confidence indicator (ESI, Ifo and ZEW)*



Activity: retail sales and industrial production rebounded in November

Retail sales and industrial production rebounded strongly in November after two months of contraction, in line with confidence indicators.

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

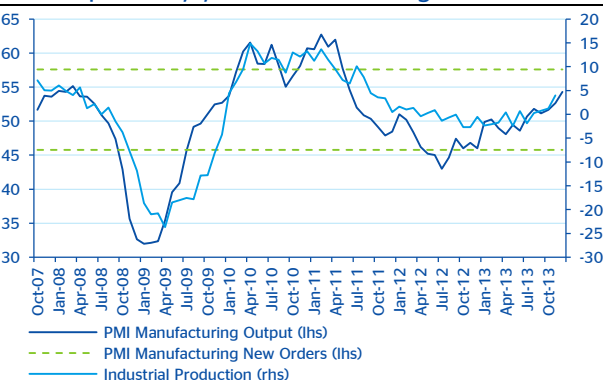
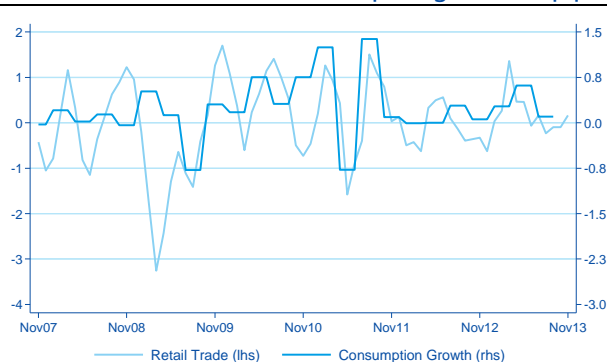


Chart 18
Retail trade (% 3m/3m) and consumption growth (%q/q)*



* Source: HAVER and BBVA Research

Foreign sector: exports maintained the positive trend in recent months

Exports increased again in November for the fourth consecutive month. Thus, the level of exports increased at around 1.8% over 3Q13 (0.4% q/q).

Chart 19
Current account (% of GDP)*

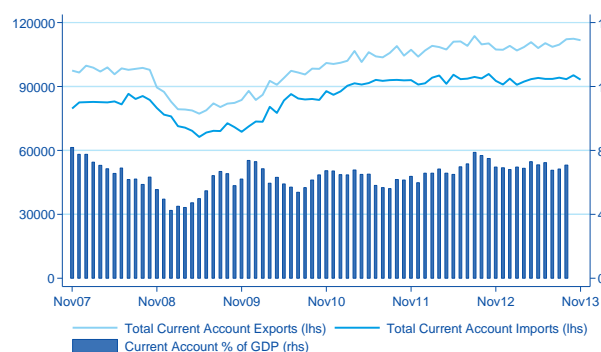
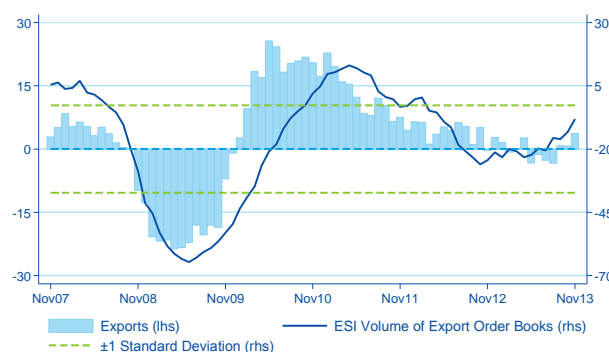


Chart 20
Export growth (%y/y) and volume of export order books*



Labour market: unemployment rate at historically low levels

The unemployment rate remained broadly stable in the last three months at 5.2%. This could put some upward pressures on wages in coming months, although wage costs moderated sharply in Q2.

Chart 21
Unemployment rate (%) and employment expectations*

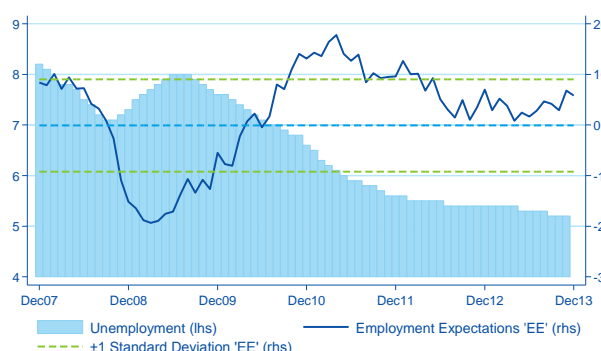
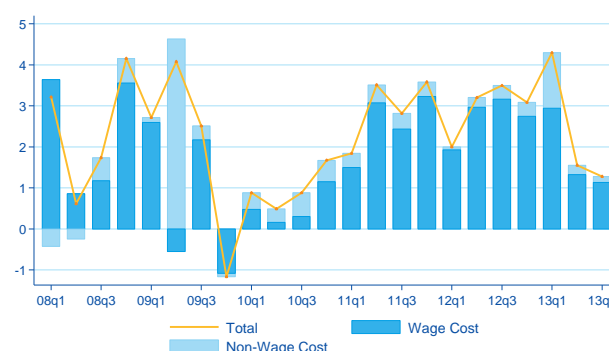


Chart 22
Labour cost in business sector (%y/y)*



Prices: slowdown in inflation in December, but due to technical changes

Harmonized inflation fell 0.4pp to 1.2% y/y in December, reflecting changes in the seasonality of holiday packages and hotels, that led to a sharp fall in inflation in services of 1.3pp to 1% y/y

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

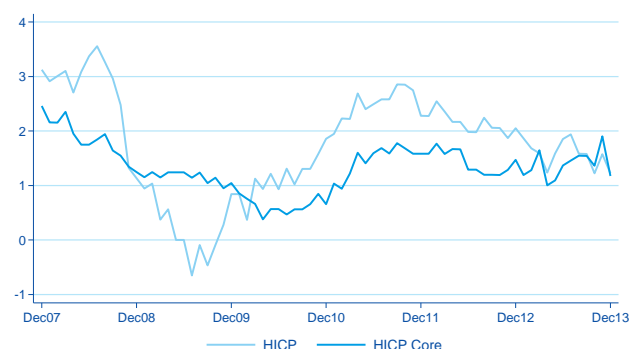
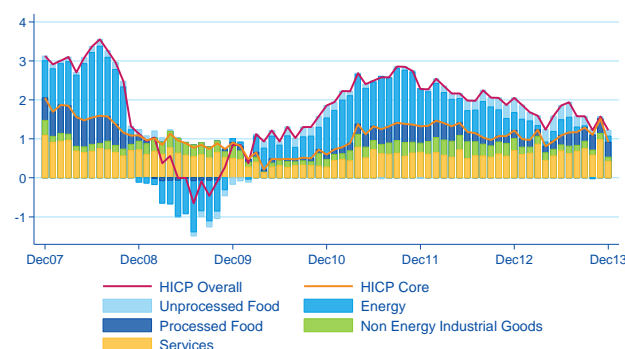


Chart 24
Inflation by components (contribution in %)*



* Source: HAVER and BBVA Research

France

National accounts: domestic consumption was not enough to offset declining investment

GDP contracted -0.1% q/q in 3Q13, after the rebound observed in 2Q13, due to a sharp negative net export contribution. We expect GDP to grow slightly in 4Q13, but with a downward bias (around 0.2% q/q, while the Bank of France and INSEE expect more)

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

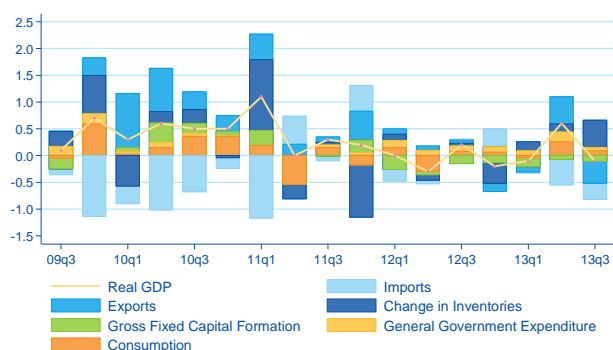
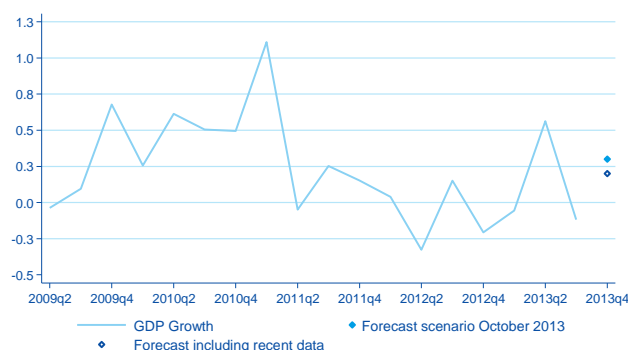


Chart 26
GDP (%q/q) and forecasts*



Confidence: doubts about the recovery identified by PMIs contrast with other confidence indicators

The PMIs confirmed the weakness of all productive sectors, which is below the threshold of 50 points. INSEE and Bank of France business confidence indicators as well as the EC confidence indicator continue their upward trend

Chart 27
PMI and GDP growth (%q/q)*

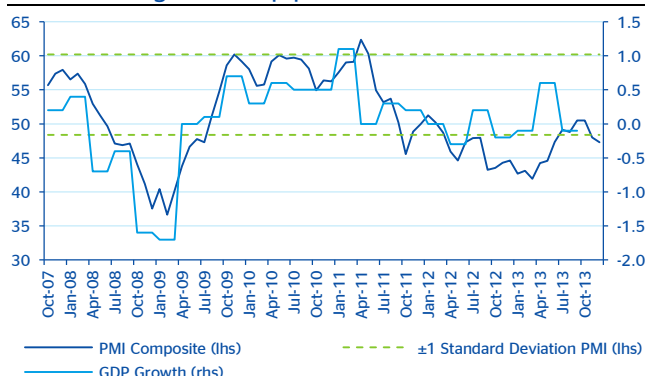
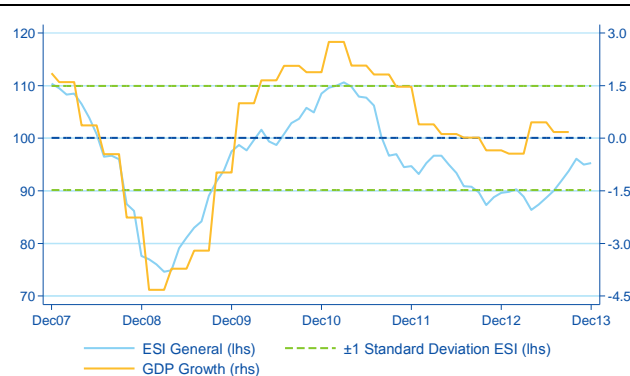


Chart 28
Confidence indicator (ESI and INSEE)*



Activity: November data contrast with the weak signals of PMIs

Up to November, industrial production grew slowly, and retail sales improved by 0.6% on 3Q13 average data, showing some improvement in the current quarter

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

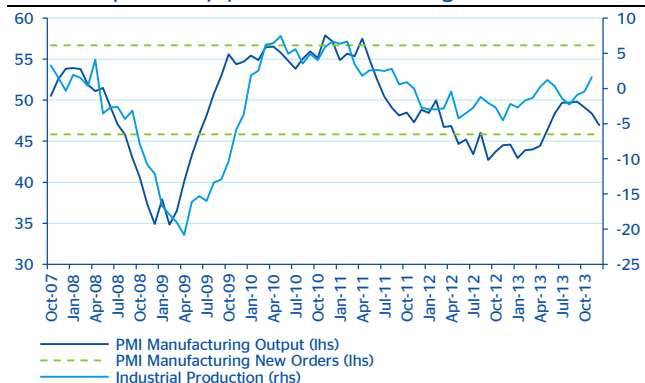
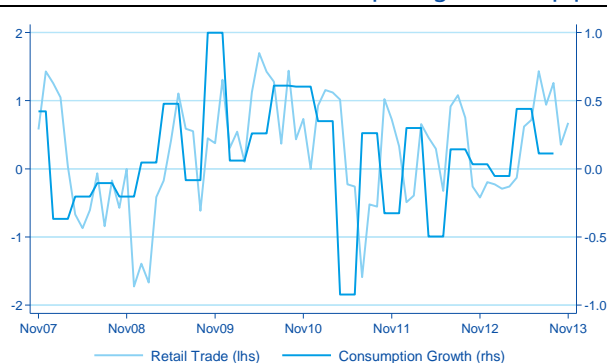


Chart 30
Retail trade (% 3m/3m) and consumption growth (%q/q)*



* Source: HAVER and BBVA Research

Foreign sector: the decline in exports up to November continues

After declining by -1.3% q/q in 3Q13, exports continued to fall -0.9% so far this quarter, while imports maintained a more stable performance, increasing the negative impact of net exports to growth.

Chart 31
 Current account (% of GDP)*

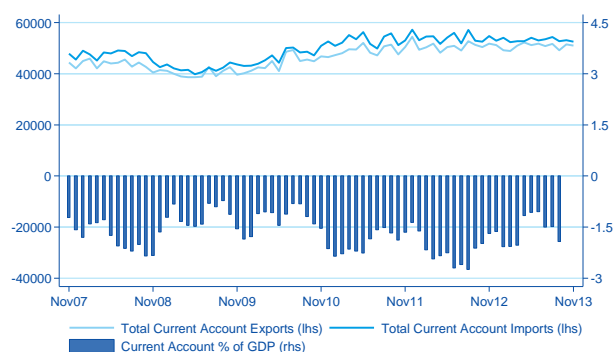
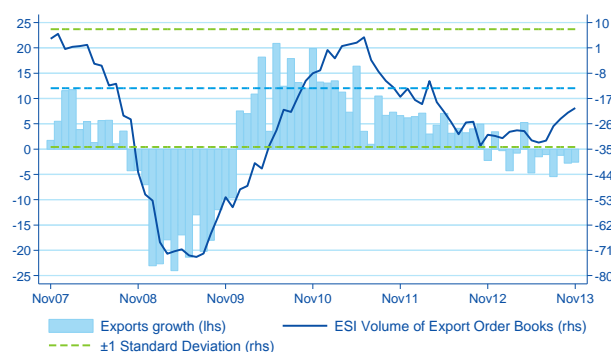


Chart 32
 Export growth (%y/y) and volume of export order books*



Labour market: some stabilization in recent months

The unemployment rate stabilized at around 11% in the past year after increasing by around 0.2pp per quarter over the previous year. Labour cost's increase slowed sharply during the first half of the year driven by falling non-wage costs.

Chart 33
 Unemployment rate (%) and employment expectations*

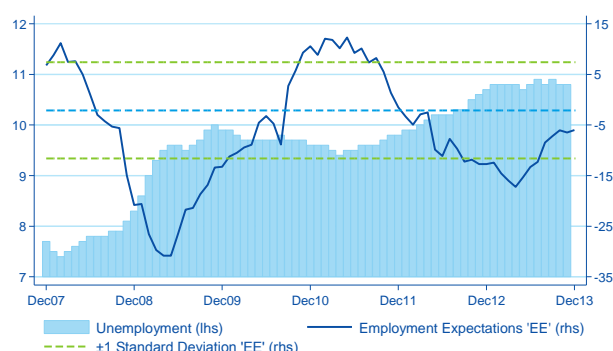
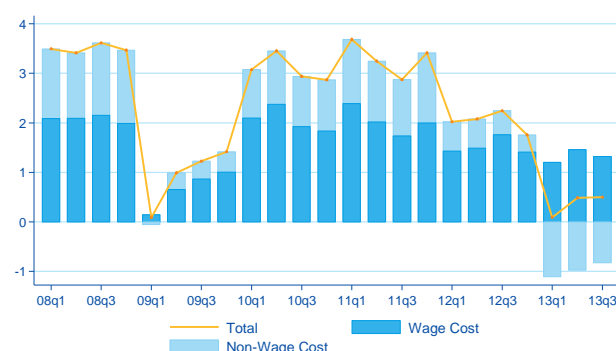


Chart 34
 Labour cost in business sector (%y/y)*



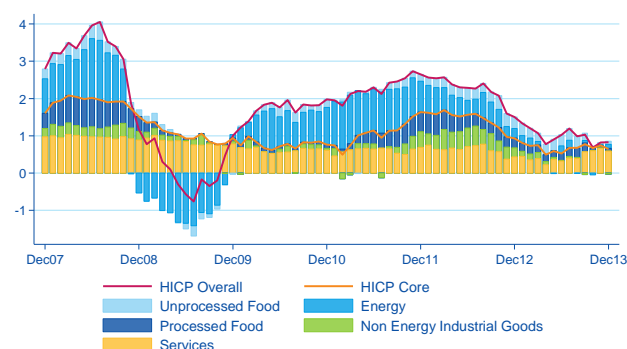
Prices: inflation remains below 1% y/y

Harmonized inflation remained stable at 0.8% y/y in December, while core inflation fell to 0.6% y/y. The slowdown in inflation over the year mainly responded to the moderation of the most volatile products (energy and unprocessed food).

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



Chart 36
 Inflation by components (contribution in %)*



* Source: HAVER and BBVA Research

Italy

National accounts: slow exit from recession

GDP stagnated in 3Q13, with both private consumption and investment weighing negatively on growth. We continue to expect a slight growth in 4Q13 (around 0.1% q/q).

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

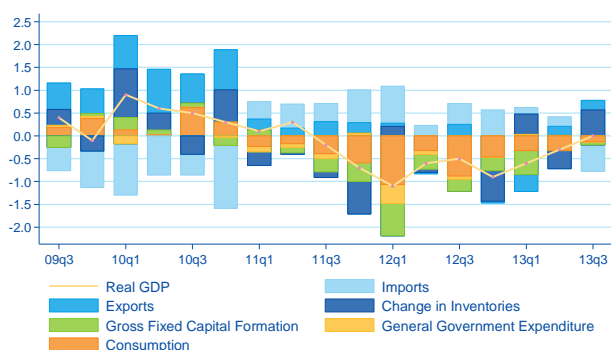
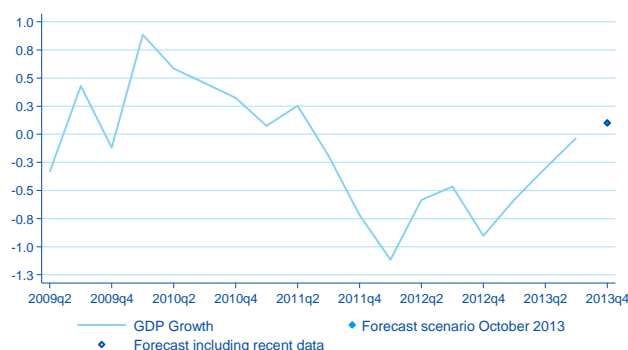


Chart 38
GDP (%q/q) and forecasts*



Confidence: stabilized in recent months

The composite PMI improved in December reaching neutral ground (50), after falling in October and November, reflecting more favorable expectations in the industrial sector, while the service sector continued to worsen; other confidence indicators remained practically stable.

Chart 39
PMI and GDP growth (%q/q)*

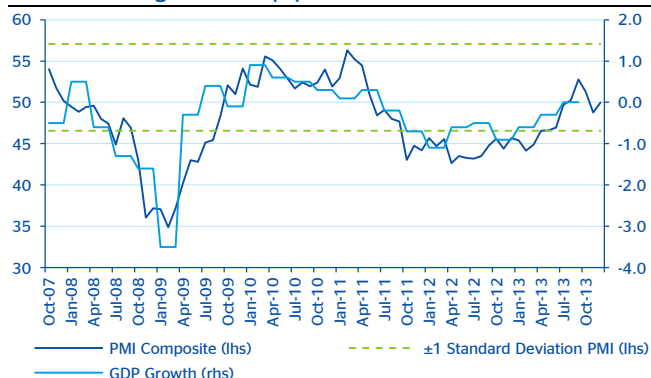
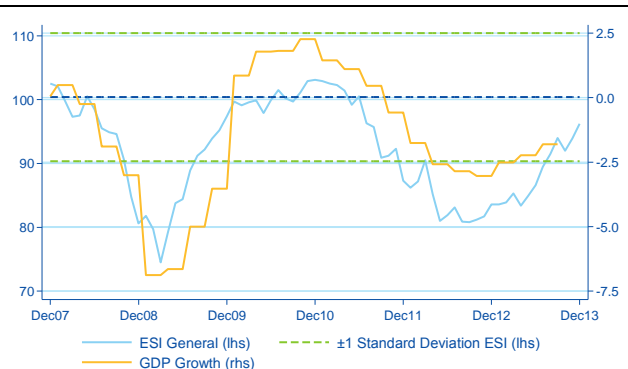


Chart 40
Confidence indicator (ESI and ISTAT)*



Activity: positive trend in industrial production

Industrial production has increased for the third consecutive month in November, in line with the improved confidence in the sector, and up by 1% above the average of 3Q13

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

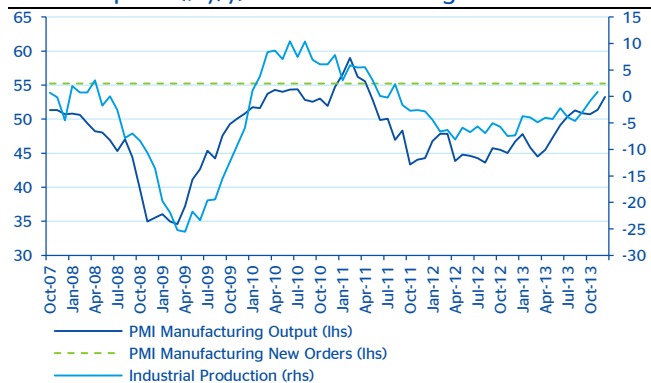
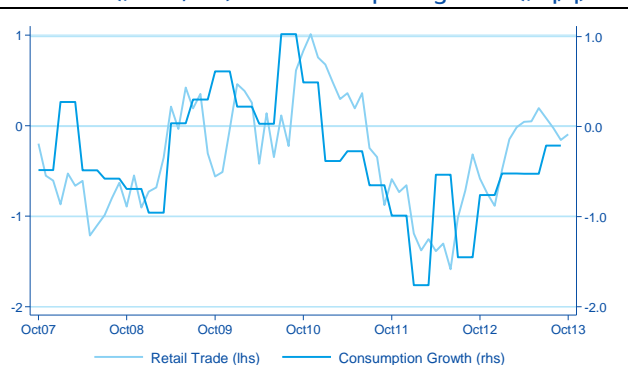


Chart 42
Retail trade (% 3m/3m) and consumption growth (%q/q)*



* Source: HAVER and BBVA Research

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

The last data of export order books (December) suggest that exports are likely to stagnate or decline in 4Q13, following the improvements observed in 3Q13 (0.7% q/q), since up to November they have fallen to -0.7% over the previous quarter.

Chart 43
Current account (% of GDP)*

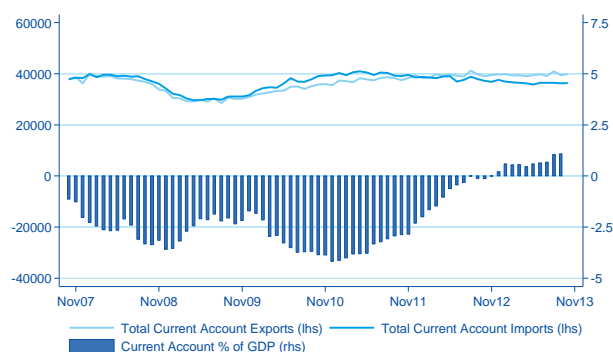
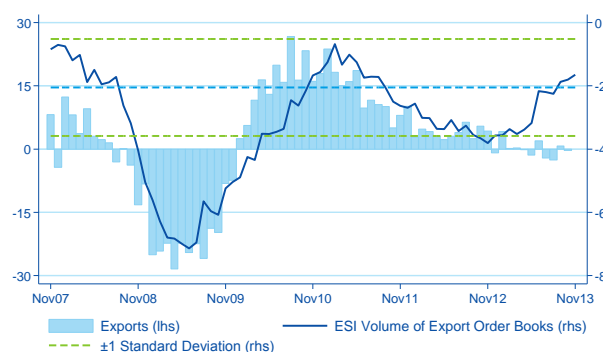


Chart 44
Export growth (%y/y) and volume of export order books*



Labour market: unemployment increasing, with more moderate rises of labour cost

The unemployment rate has risen to 12.7%, 1.4 percentage points higher than a year ago and the worst figure since 1977, despite favorable employment expectations. Labour cost was still increasing at strong rates in Q2.

Chart 45
Unemployment rate (%) and employment expectations*

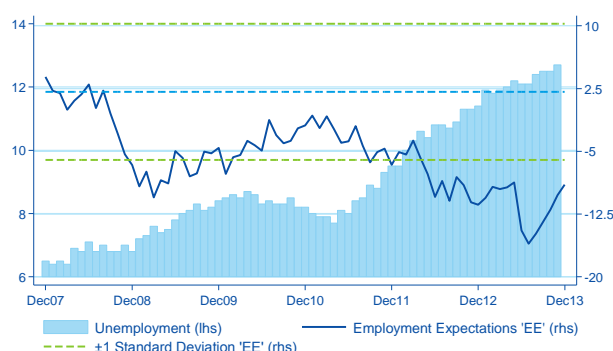
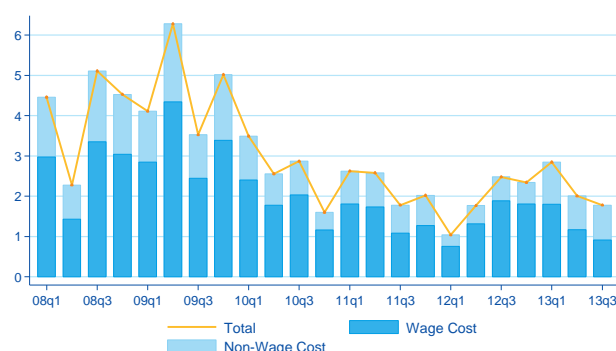


Chart 46
Labour cost in business sector (%y/y)*



Prices: inflation stabilizes at 0.7% in December

Inflation eased fast since mid-year, but remained stable at 0.7% y/y in December due to falling energy prices and slower growth in prices of services.

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

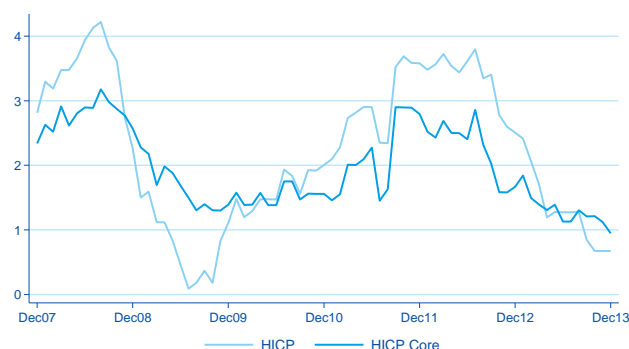
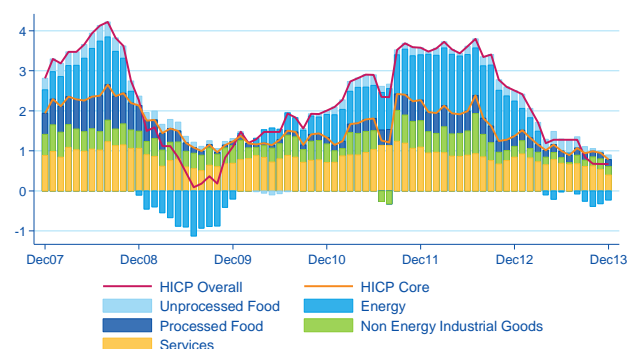


Chart 48
Inflation by components (contribution in %)*



* Source: HAVER and BBVA Research

Spain

National accounts: exports lose some momentum but domestic demand begins to recover

The economy grew at +0.1% q/q in 3Q13, leaving behind a long recession mainly due to robust exports and revival of private demand. The MICA-BBVA model estimates for 4Q13 a quarterly GDP growth of +0.3% q/q

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

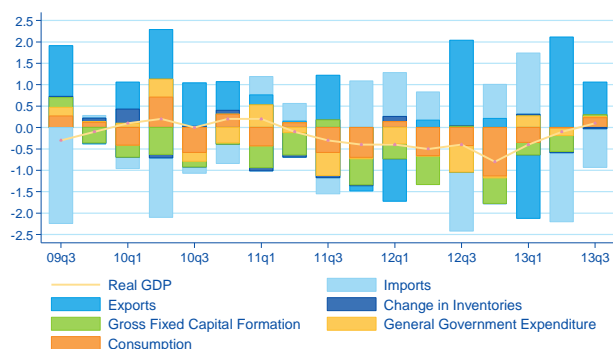
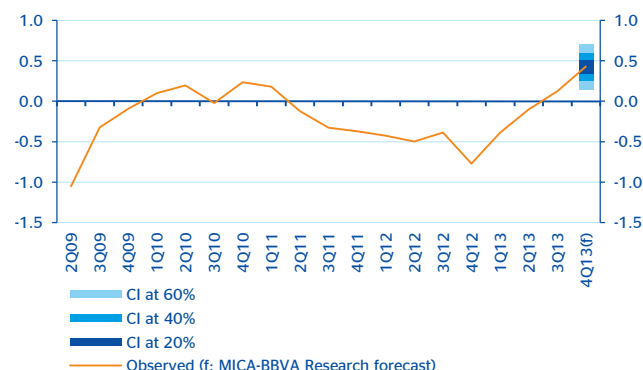


Chart 50
GDP growth (%q/q) and MICA-BBVA forecast*



Confidence: latest data consistent with higher GDP growth in 4Q13

The ESI and PMI indices increased significantly in December, with PMIs well above the threshold for growth in 4Q13.

Chart 51
PMI and GDP growth (%q/q)*

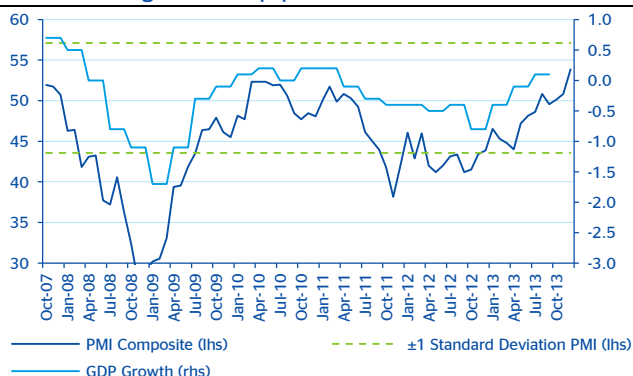
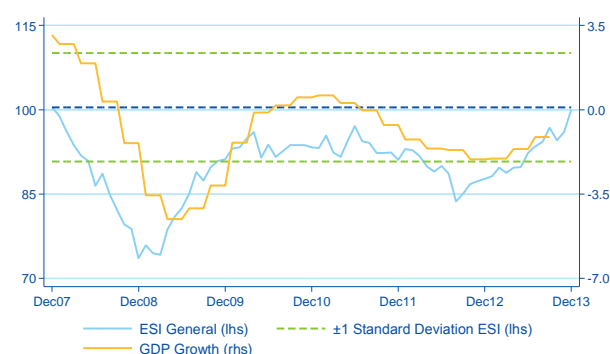


Chart 52
Confidence (ESI) and GDP growth (%y/y) *



Activity: the recovery of domestic demand is still fragile, but strong retail sales in November

Some indicators of consumer spending continued to show signs of stabilization and the strong increase in November retail sales offset the fall in October.

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

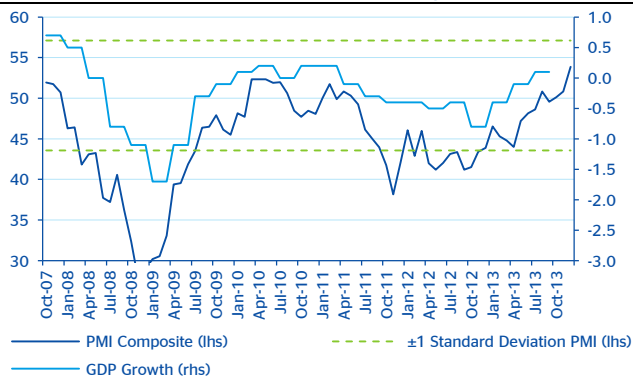
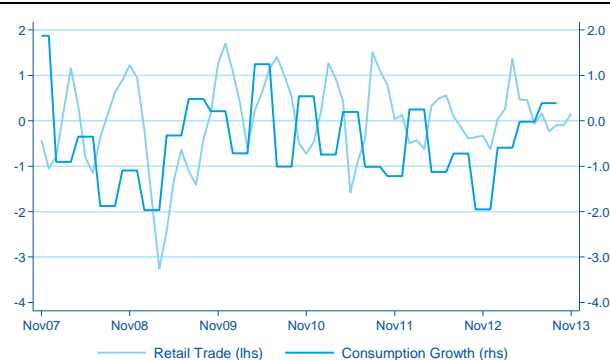


Chart 54
Retail trade (% 3m/3m) and consumption growth (%q/q)*



* Source: HAVER and BBVA Research

Foreign sector: exports lose some momentum in 4Q13

Firms' expectations (export orders) indicate that exports are likely to slow again in 4Q13.

Chart 55
Current account (% of GDP)*

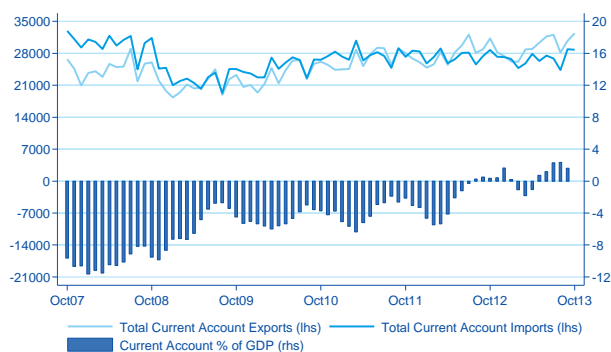
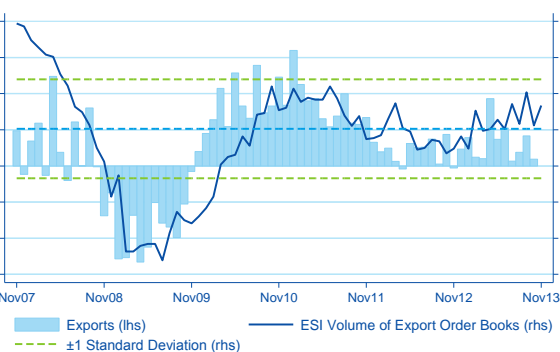


Chart 56
Export growth (%/y) and volume of export order books*



Labour market: positive signs for the first time since the outburst of the crisis

The affiliates to the Social Security grew by 0.6% q/q (seasonally adjusted), which contrasts with the estimated decline of -0.3pp during 3Q13. Meanwhile, the reduction of registered unemployment intensified to -1.8% /q swda in 4Q13 from 0.6% in the previous quarter.

Chart 57
Unemployment rate (%) and employment expectations*

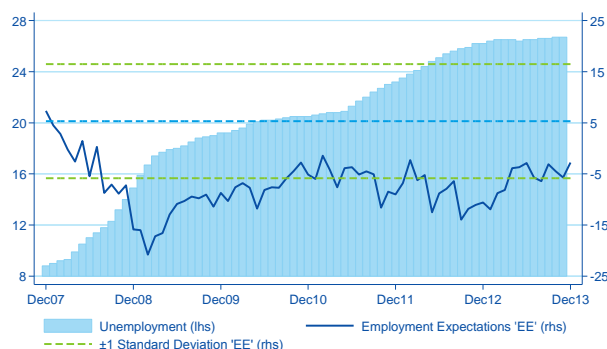
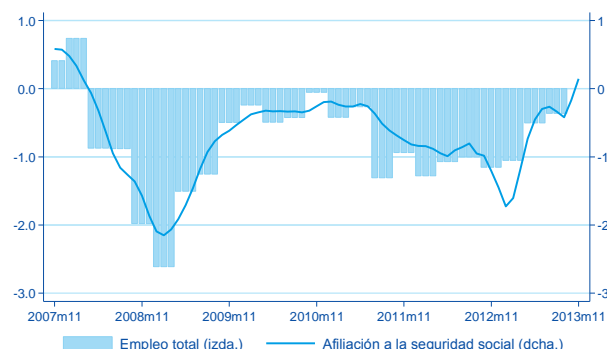


Chart 58
Employment growth: N.A. and social security (% 3m/3m)*



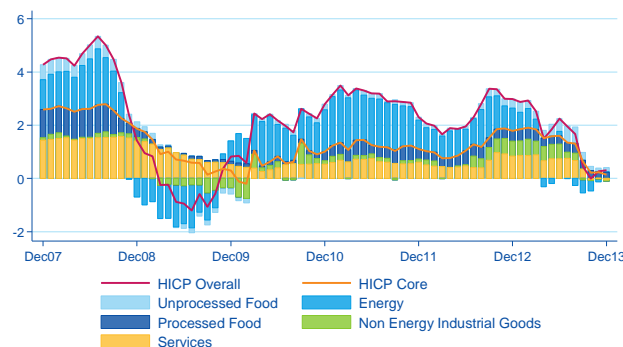
Prices: inflation remains in positive territory in December

Headline inflation rose by 0.1pp to 0.3% y/y in December due to the evolution of the residual component (energy and unprocessed food). The moderation in core inflation (by 0.1pp to 0.2% y/y) responded mainly to the partial progress of the winter sales campaign.

Chart 59
Inflation rate, headline and core (%/y)*



Chart 60
Inflation by components (contribution in %)*



* Source: HAVER and BBVA Research

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