

## ECONOMIC OUTLOOK · Euro area growth outlook remains robust

### The euro area has started 2018 on the right foot.

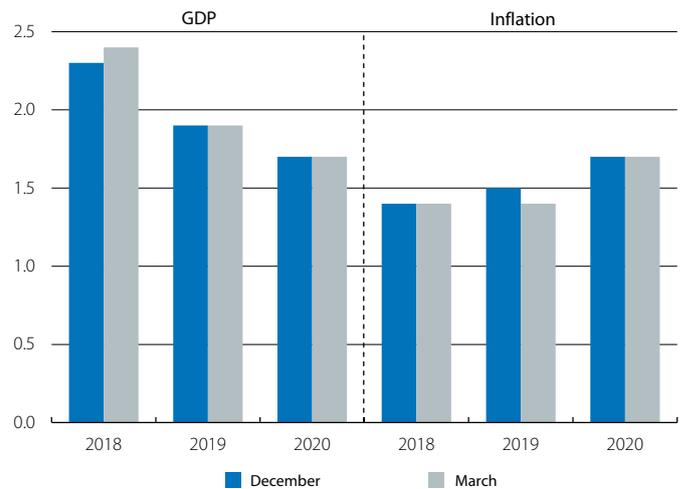
Q1 economic activity indicators confirm that the euro area is in a positive phase of the business cycle. Likewise, the ECB in its quarterly update of its macroeconomic projections, raised its 2018 forecast for euro area growth (+0.1 pp) to 2.4% and kept its forecast for 2019 at 1.9% – these are very similar figures to the CaixaBank Research forecasts of 2.5% and 2.0%, respectively. This revision is supported by macroeconomic fundamentals continuing to favour an expansion in the euro area over the medium-term. Specifically, domestic demand is expected to continue to benefit from the ECB’s accommodative monetary policy, as well as from the improved labour market conditions. Similarly, exports will remain robust on the back of the improved global growth prospects. However, despite the good pace of economic activity, inflation is expected to remain at moderate levels in 2018-19 (1.4% and 1.8%, respectively). On the other hand, March was also marked by political events. Firstly, Italy’s general elections resulted in a fragmented parliament where no single party or coalition achieved an absolute majority. M5S was the most voted party (32% of votes) but the Centre-Right bloc won the largest number of seats. This outcome prolongs political uncertainty in Italy and could extend Gentiloni’s time in office. Secondly, members of Germany’s Social Democratic Party (SPD) ratified the Grand Coalition agreement with Angela Merkel’s Conservative Party (CDU). Finally, the UK and EU reached an agreement on the Brexit transition period. Although the UK will leave the EU in March 2019, it will remain in the single market and customs union until December 2020. Although this transition agreement may be conditional on both parties reaching a final agreement, it does allow both sides to start negotiations on future trade relations and the Northern Ireland border issue.

**Q4 2017 euro area growth was more balanced.** Eurostat confirmed that economic activity in the euro area increased by 2.7% year-on-year (0.6% quarter-on-quarter) in Q4 2017. By component, domestic demand decreased its contribution to year-on-year GDP growth to 1.4 pp (1.9 pp in Q3 2017) due to more moderate private consumption growth. However, investment remained strong, and was up by 2.5% year-on-year (2.4% in Q3 2017). On the other hand, external demand increased its contribution to 1.3 pp (0.8 pp in Q3). In particular, exports of goods and services remained strong, and increased by 2.9% year-on-year (0.2 pp higher than the previous quarter) while the increase in imports was smaller (1.6% year-on-year compared with 2.0% in Q3).

**Business sentiment indicators point to a good pace of activity in the euro area in Q1 2018.** The composite PMI index for the euro area as a whole stood at 57.1 points in Q1 2018, a similar figure to that of Q4 2017 (57.2) and comfortably in the

### Euro area: ECB forecasts for GDP and inflation

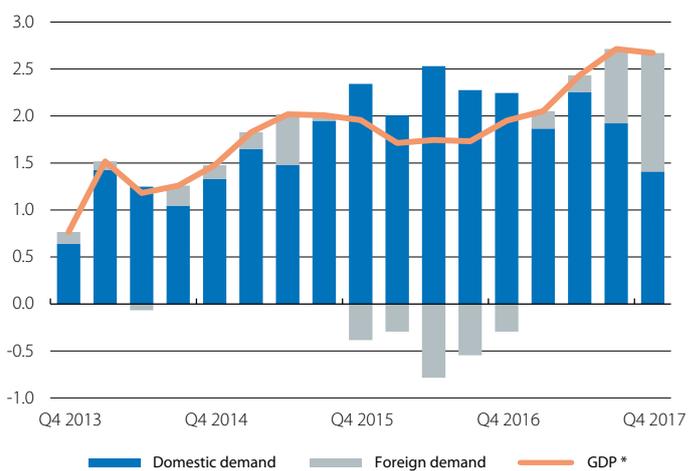
Annual change (%)



Source: CaixaBank Research, based on data from the ECB.

### Euro area: GDP

Contribution to year-on-year growth (pp)

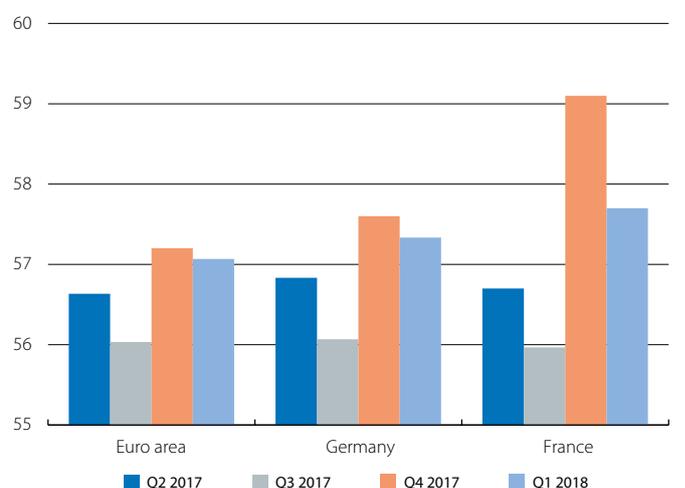


Note: \* Year-on-year change (%).

Source: CaixaBank Research, based on data from Eurostat.

### Euro area: Composite PMI

Level



Source: CaixaBank Research, based on data from Markit.

expansionary zone (above 50 points). Moreover, confidence remains high in the euro area. The economic sentiment index (ESI) produced by the European Commission reached 113.9 points in Q1 2018, a very similar figure to that of the previous quarter (114.3 points) and clearly above the 2017 average (110.7).

**Private consumption continues to drive the euro area's economic expansion**, as shown by the positive trend in euro area retail sales, that increased by 2.0% year-on-year in January, a similar rate to the Q4 2017 average (1.9% year-on-year). Similarly, consumer confidence remains high. In particular, the European Commission's consumer confidence indicator stood at 0.1 points in March, the same figure as the previous month and well above the 2017 average (-2.5). Together with continued improvements in the labour market and the low interest rate environment, this suggests that consumption will remain strong over the coming quarters.

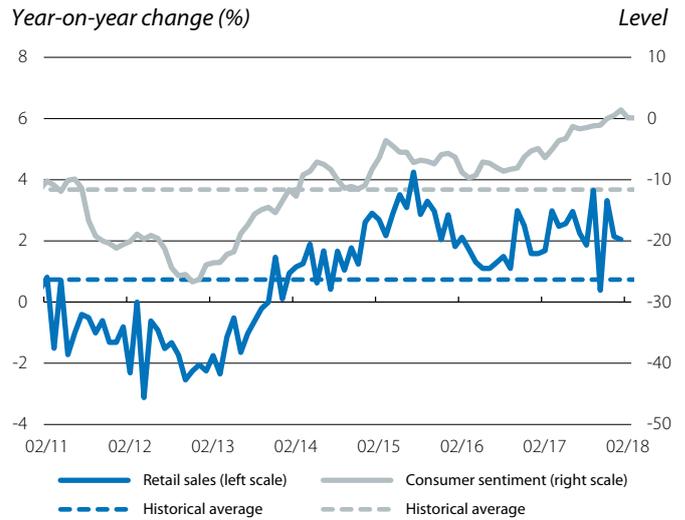
**The labour market continues to create jobs and support the economic recovery.** Employment in the euro area rose by 1.6% year-on-year in Q4 2017, bringing the total number of employees to 156.7 million, an all-time high. Employment growth was widespread across countries, with sharp increases in Portugal (3.2%) and Spain (2.6%) while rises were slightly more moderate in Germany, France and Italy (1.2% on average). These improvements confirm the dynamism of the euro area labour market and are gradually translating into higher wages. In particular, hourly labour costs in the euro area as a whole grew by 1.7% year-on-year in Q4 2017, a rate 0.1 pp higher than that of the previous quarter. By country, the increase in wages was particularly high in Portugal (4.7% year-on-year), Germany (1.9%) and France (1.8%). On the other hand, wage costs fell by 0.4% year-on-year in Italy.

**Inflation continues its upward trend.** The harmonised index of consumer prices (HICP) of the main euro area economies increased in March. In particular, the recovery in France's inflation to 1.7% (0.4 pp higher than the previous month's figure) was particularly substantial, and so was Germany's, where inflation rose to 1.5%, (+0.3 pp with respect to the previous month's figure) thanks to a larger contribution from the energy and food components. Over the coming months, and as the labour market enters a more mature phase of the business cycle, wages are expected to increase moderately, helping inflation to recover gradually and reach 1.8% in 2019.

**PORTUGAL**

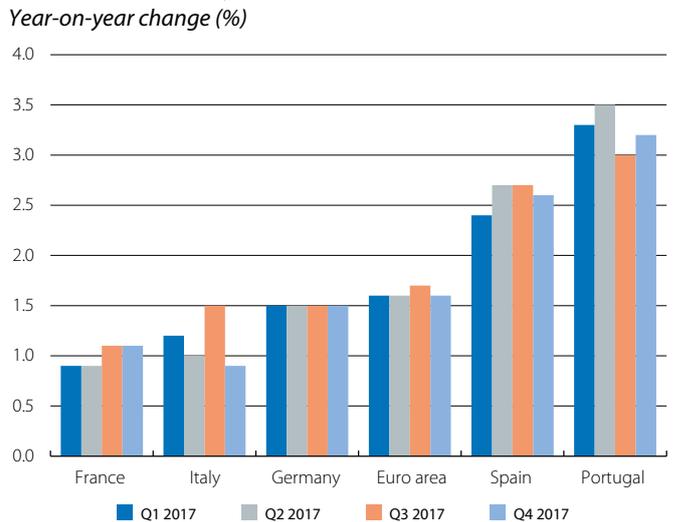
**Portugal's growth remains solid.** The Portuguese economy continued to enjoy solid GDP growth in Q4 2017 with growth of 2.4% year-on-year (0.7% quarter-on-quarter). This brought the total figure for 2017 to 2.7%, the highest growth rate since 2000 (1.6% in 2016). By components, private consumption remains one of the main drivers of this growth, even though it grew at a more moderate pace (2.0% year-on-year vs. 2.6% in Q3 2017). Similarly, investment grew by a solid 5.3% year-on-

**Euro area: consumption indicators**



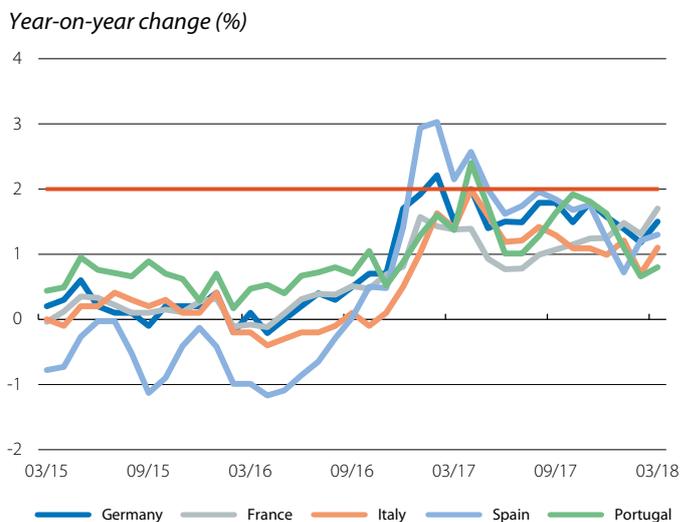
Source: CaixaBank Research, based on data from Eurostat and the European Commission.

**Euro area: employment across countries**



Source: CaixaBank Research, based on data from Eurostat.

**Euro area: Harmonised CPI across countries**



Source: CaixaBank Research, based on data from Eurostat and national sources.

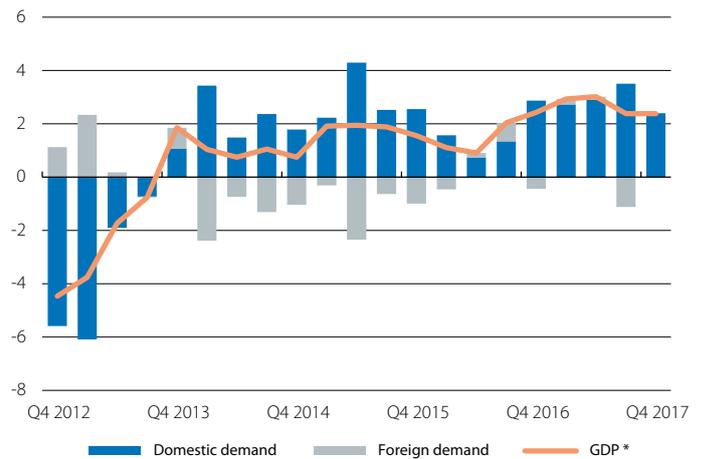
year, although this rate is lower than the exceptionally high figures posted over the past three quarters (10.3% on average). On the other hand, exports of goods and services growth accelerated to 7.2% year-on-year (6.2% in Q3). These data confirm that Portugal's economic growth is becoming more balanced, with domestic demand being the main driver of growth but exports also performing well. For 2018, the outlook remains positive. CaixaBank Research expects real GDP growth to be 2.4% in 2018 and 2.3% in 2019. The Bank of Portugal is forecasting a similar scenario. In particular, its March Economic Bulletin the Central Bank maintained its GDP growth forecasts for 2018 at 2.3% and for 2019 at 1.9%. Both domestic demand (particularly investment) and foreign demand are expected to support growth.

**Public deficit at its lowest level for decades.** In 2017, Portugal's public deficit (excluding the recapitalisation of Caixa Geral de Depósitos) totalled EUR 1.765 billion, a figure equivalent to 0.9% of GDP and 0.5 pp below the government's target (1.4%). This figure is also 1.1 pp lower than the 2016 deficit (2.0%) and results from higher revenue (6.2%) boosted by the recovery in economic activity and employment, as well as contained expenditure (1.5%). However, as requested by Eurostat, the capital transfer of EUR 3.944 billion (equivalent to 2.0% of GDP) to the state-owned bank Caixa Geral de Depósitos (CGD) must be included in the official deficit figure for 2017. This brings the deficit to 3.0% of GDP. Thanks to Portugal's good economic performance, we expect the public deficit to remain contained at 1.2% of GDP in 2018. As a result, public debt will continue to fall. We predict that this will go from 125.7% of GDP in 2017 to almost 123% of GDP by the end of this year.

**Strong growth in new credit, supported by the economic recovery.** Although growth in new housing loans for households slowed down slightly in January to 13.3% year-on-year, this is still a strong rate and indicative of the recovery in demand for real estate. Consumer credit also performed well, increasing by 16.2% year-on-year (20.2% in January 2017). Loans for SMEs (2.4% year-on-year) and large firms (70.1%) also rose again after three years of decline, in spite of the deleveraging being carried out by the private sector.

**Portugal: GDP**

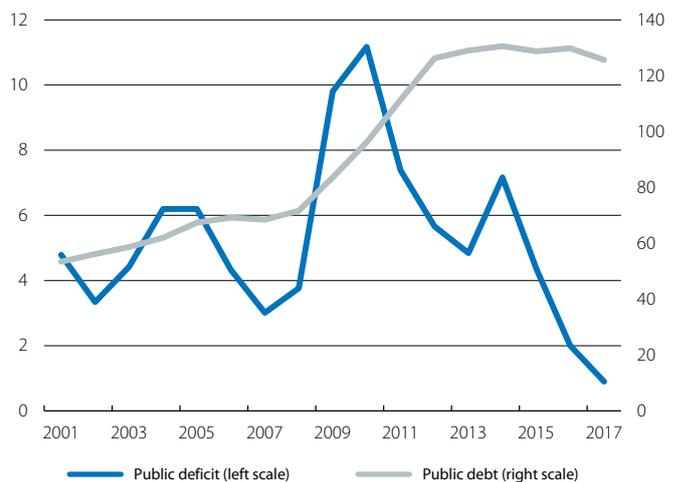
Contribution to year-on-year growth (pp)



Note: \* Year-on-year change (%).  
Source: CaixaBank Research, based on data from the National Statistics Institute.

**Portugal: public deficit and debt**

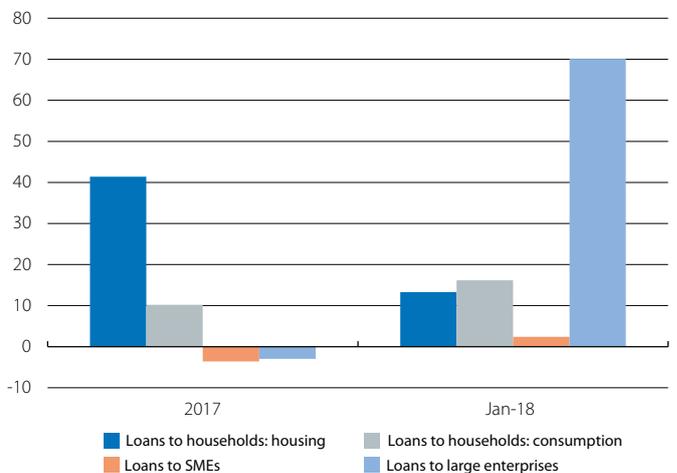
(% of GDP)



Source: CaixaBank Research, based on data from the National Statistics Institute.

**Portugal: new loans granted**

Year-on-year change (%)



Note: Loans to households exclude refinancing.  
Source: CaixaBank Research, based on data from the Bank of Portugal.