

A MODERATE RECOVERY

As projected, GDP in the Eurozone expanded by a meagre 0.1% in Q3 2013, as export growth fell sharply. Economic activity is expected to accelerate modestly over the forecast horizon (+0.2% in Q4 2013, +0.2% in Q1 2014 and +0.3% in Q2 2014) with a gradual shift in growth engines from external to domestic demand. Continued tight fiscal policy in many member states together with persistent labour-market slack conducing to a stagnant real disposable income will lead to limited private consumption growth. Investment is forecast to increase thanks to the gradual acceleration in activity and the need to renew production capacity after a marked phase of adjustment. Under the assumptions that the oil price stabilizes at USD 110 per barrel and that the euro/dollar exchange rate fluctuates around 1.36, headline inflation is expected to remain well below 2% (0.9% in Q1 2014 and 1.1% in Q2 2014). The major upside risk to this scenario is a stronger than expected investment growth, led by improved access to credit. A stagnation in private consumption triggered by continued labour market weakness and weaker external demand in emerging economies are key downside risks.

Stable industrial production in Q4 2013

The business surveys have picked up since mid-2013, despite a dip in October. After a decrease in Q3 (-0.1%), industrial production fell sharply in October, in part because of a working day effect in Germany not captured by working day adjustment procedures¹. Industrial production is expected to remain stable in Q4 2013, and to regain some momentum in Q1 and Q2 2014 (+0.7% and +0.8% respectively), on the back of brightening prospects for external and internal demand.

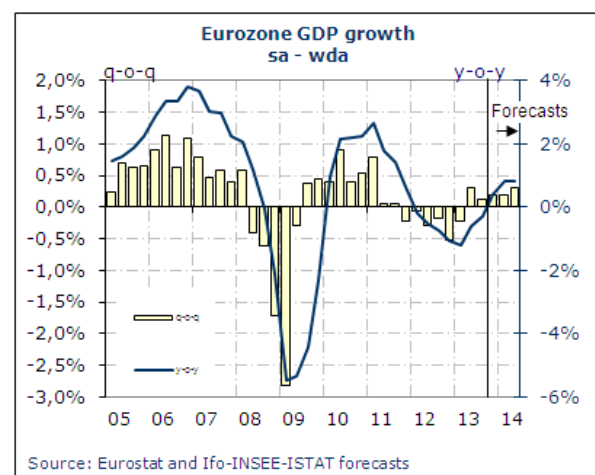
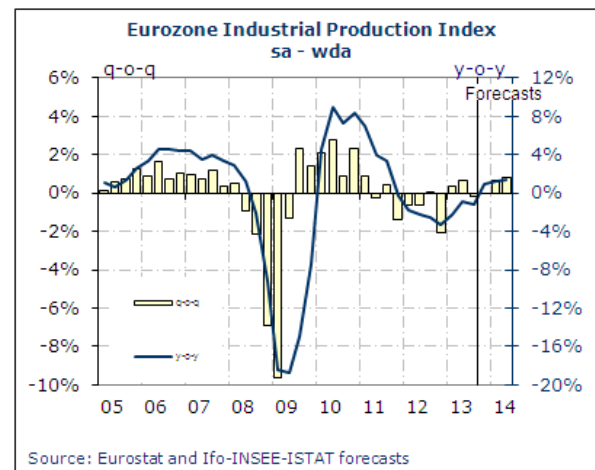
Moderate upswing in activity in 2014

In the third quarter of 2013, euro area GDP slowed down (+0.1% after +0.3% in Q2), mainly because of weaker export growth in most Eurozone economies. We forecast a moderate growth in Q4 (+0.2%), on the back of a rebound in France and a progressive strengthening of the recovery in Spain.

As suggested by the business surveys, activity is likely to continue to grow at a moderate pace in the first half of 2014, helped by a recovery in private investment and declining negative fiscal impulse from macroeconomic policies. Exports are expected to slowly gain momentum over the forecast horizon as growth picks up again in emerging economies (particularly China and Central European countries) and activity remains buoyant in the US, the UK, and Japan.

The gap between Eurozone countries growth, although persisting, is likely to contract again.

¹ The 3rd of October (day of German reunification) was a Thursday. Many workers took an additional day off on Friday the 4th.



Domestic demand improving gradually

Given the moderate recovery lying ahead, labour market conditions are expected to remain subdued over the forecast horizon. Employment is projected to stabilize gradually,

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and productivity is forecast to continue to pick up slowly as it has done since the beginning of 2013. Nominal wages are likely to increase moderately over the forecasting period, though unemployment rates will remain at record-high levels, and fiscal policies are expected to become a little less restrictive. The decrease in purchasing power should thus ease over the forecasting period. Consumption should pick up slightly (+0.1% for Q4 2013 and Q1 2014, +0.2% in Q2 2014) as households are expected to gradually reduce their precautionary savings with business and employment prospects improving.

Bank lending conditions have stopped tightening in the Eurozone since the start of 2013. In addition, the gradual upswing in activity and the need to renew production capacity after a marked phase of adjustment are expected to sustain the recovery in equipment investment. In the construction sector, the drop in investment is projected to slow down. Total investment, despite the subdued public component, is thus expected to moderately gain momentum over the forecast horizon (+0.2% in Q4 2013, +0.3% in Q1 2014 and +0.4% in Q2).

Inflation to remain stable at a low level

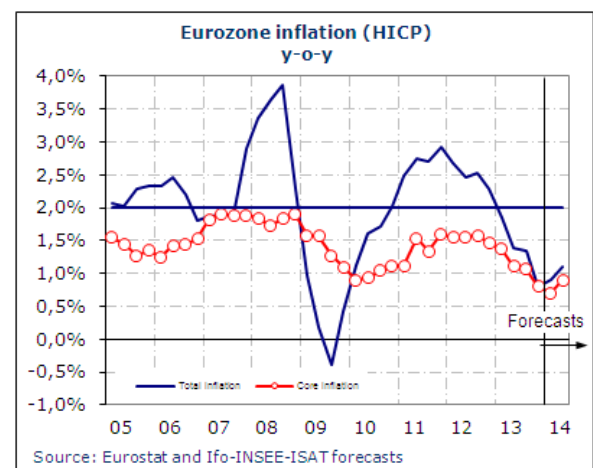
After peaking at 2.9% year-on-year in Q4 2011, headline inflation has fallen to 0.8% in Q4 2013. It is expected to reach 0.9% in Q1 2014 and rise slightly to +1.1% year-on-year in Q2 2014, sustained by energy prices, under the assumption that the Brent price remains stable at \$110 while the USD/Euro exchange rate fluctuates around 1.36, and under the effect of the gradual exit from year-on-year figures of the drop in energy prices that occurred in spring 2013.

Core inflation is forecast to remain stable at a low level (0.8% in Q4 2013, 0.9% in Q2 2014), dampened by the high unemployment rates in most Eurozone countries.

2013 Forecasts, % changes, sa - wda

q-o-q y-o-y	Q4 - 2013 forecasts	Q1 - 2014 forecasts	Q2 - 2014 forecasts	2013 average
IPI	0.0 0.9	0.7 1.3	0.8 1.4	-0.9
GDP	0.2 0.4	0.2 0.8	0.3 0.8	-0.4
Consumption	0.1 0.2	0.1 0.4	0.2 0.5	-0.5
Investment	0.2 -1.0	0.3 1.3	0.4 1.4	-3.1
Inflation*	0.8	0.9	1.1	1.3

Source: Eurostat and Ifo-Insee-Istat forecasts, * quarterly average



Methodological note

This quarterly publication is prepared jointly by the German IFO institute, the French INSEE institute, and the Italian ISTAT institute. The forecast results are based on consensus estimates building on common methods by the three institutes. They are based on time-series models using auxiliary indicators from business surveys by national institutes, Eurostat, and the European Commission. The joint three-quarter forecast covers Eurozone industrial production, GDP, consumption, investment, and inflation.

Further economic analysis for each country (Germany, France, Italy) is available by:

- [Ifo Konjunkturprognose](#), Ifo
- [Conjoncture in France](#), INSEE
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Nikolay Hristov +49 (0) 89 92 24 1225
 Étienne Chantrel +33 (0) 1 41 17 59 63
 Roberta De Santis +39 06 46733620

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