

EUROZONE GROWTH RECOVERING

The Eurozone recovery is expected to pick up in the first quarter of 2014 with a GDP growth rate of +0.4% (after +0.2% and +0.1% respectively in the previous two quarters). Growth is forecasted to decelerate slightly in the following two quarters. The recovery is expected to be broad based across sectors and countries and the consolidation of the upturn would be determined by a progressive improvement of domestic demand and a slightly positive contribution of the external sector. Private investment will continue to grow over the forecasting horizon due to the increase in activity and the need for new production capacity after the sharp adjustment phase determined by the financial crisis. However, prospects for consumption remain subdued owing to fiscal austerity measures in some member States combined with a continuing labor market slack and slow growth in real disposable income. Under the assumptions that the oil price stabilizes at USD 107 per barrel and that the euro/dollar exchange rate fluctuates around 1.38, the headline inflation is expected to increase marginally in the next two quarters, remaining well below the threshold of 2%.

Weaker external demand in emerging economies, especially in Asia, and an escalation of international tensions in Eastern Europe, which could determine a sharp rise in European gas prices and weight on households and firms' expenditure, are key downside risks related to this scenario.

Recovering industrial production

Recent business surveys for the Eurozone show a continuation of the upward trend. The European Commission surveys report output is increasing for all sectors but construction. In the latter sector, the deterioration of confidence indicators has stopped.

In January, industrial production surprised on the downside (-0.2%) mainly owing to mild weather during the winter that drastically weighted on production in the energy sector.

However, in line with survey indicators and the still positive statistical overhang (+0.2%), we still expect that industrial output will remain on a positive trail, fluctuating around 0.4% in the next three quarters.

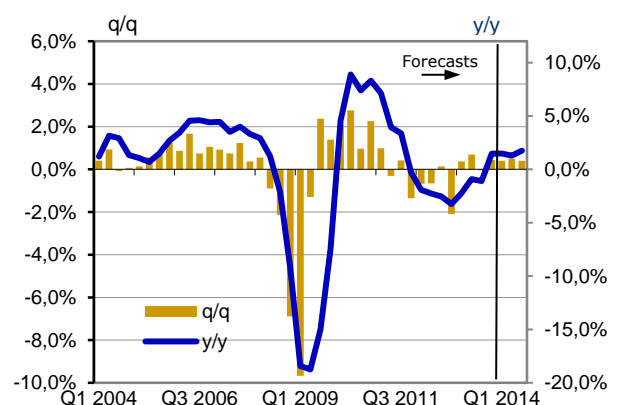
GDP on an upward trend

According to our forecast, the recovery in the Eurozone will continue over the forecast horizon driven mainly by a progressive improvement in domestic demand. It is worth mentioning that the recovery will be more balanced across sectors and countries than in the past few months.

All in all, GDP will increase by 0.4% in Q1 and then slightly decelerate in the following two quarters (+0.3% in both Q2 and Q3) partly reflecting a normalization in weather conditions (in particular in Germany).

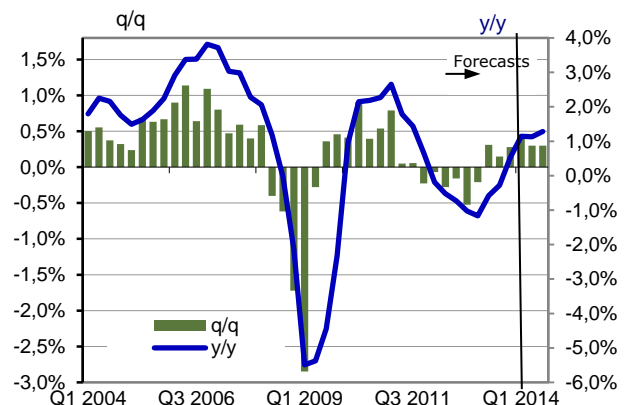
Prospects for private consumption remain subdued owing to a continuing labor market slack and slow growth in real disposable income. Although improving, the pace of the recovery will remain insufficient to significantly reduce the unemployment rate. This is expected to stay at record highs in the short term and to decrease only moderately going forward.

FIGURE 1 | Eurozone Industrial Production Index
sa-wda



Source: Eurostat and forecasts Ifo-Insee-Istat

FIGURE 2 | Eurozone GDP Growth
sa-wda



Source: Eurostat and forecasts Ifo-Insee-Istat

Thus, real disposable income will grow only marginally and private consumption growth in the Eurozone will remain subdued over the next three quarters (+0.2% in Q1, Q2 and Q3).

According to survey data, a lack of equipment is starting to limit manufacturing output. This factor, combined with better profit growth prospects, suggests that investment growth is likely to strengthen over the forecast horizon.

Accordingly, we expect that investment will remain vibrant over the next three quarters (+0.8%, +0.4% and +0.7%), with the deceleration in Q2 determined by the effect of the favorable weather conditions in the winter of 2013/2014.

Notwithstanding this general trend, construction investment will remain weak. Equipment investment, on the contrary, will expand at a faster pace over the forecast horizon, stimulated by improving confidence, positive external demand and a gradual stabilization of domestic-demand prospects.

Inflation increases only marginally

In Q1 2014 inflation hit a year-on-year growth of +0.7% after the +0.8% increase reported at the end of 2013. Under the assumptions that the oil price stabilizes at USD 107 per barrel and that the euro/dollar exchange rate fluctuates around 1.38 over the coming quarters, headline inflation is expected to increase marginally and to remain well below the 2% threshold (+0.8% and +0.9% respectively in Q2 and Q3).

This trend partly reflects impulses from the energy sector, while domestic price pressures are expected to remain subdued.

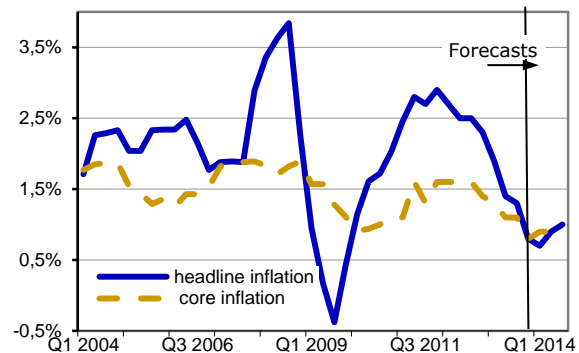
With weak demand and a persistently high unemployment, core inflation would not accelerate in spite of the recovery.

2014 forecasts, % changes, sa - wda

| q/q | y/y | Q1 - 2014 forecasts | Q2 - 2014 forecasts | Q3 - 2014 forecasts | 2014 overhang |
|-------------|-----|---------------------|---------------------|---------------------|---------------|
| IPI | | 0.4 | 0.5 | 0.4 | 1.5 |
| | | 1.5 | 1.3 | 1.8 | |
| GDP | | 0.4 | 0.3 | 0.3 | 1.0 |
| | | 1.1 | 1.1 | 1.2 | |
| Consumption | | 0.2 | 0.2 | 0.2 | 0.5 |
| | | 0.5 | 0.6 | 0.7 | |
| Investment | | 0.8 | 0.4 | 0.7 | 2.1 |
| | | 2.5 | 2.8 | 3.0 | |
| Inflation | | 0.7 | 0.8 | 0.9 | 0.8 |

Source: Eurostat and forecasts Ifo-Insee-Istat

FIGURE 3 | Eurozone Inflation (HICP) (y-o-y)



Source: Eurostat and forecasts Ifo-Insee-Istat

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:

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