

## Euro-zone in recession

As forecast in the previous EZEO, GDP in the Euro-zone contracted by 0.2% in Q2. It is expected to continue declining in Q3 (-0.2%) and Q4 (-0.1%) as ongoing fiscal consolidation and the still high level of uncertainty will be taking their toll on domestic demand. In Q1 2013 GDP will stagnate on the back of a moderate acceleration in external demand. The recent decisions to increase the firepower of the ECB and to allow the ratification of the ESM in Germany have likely reduced market perception of Euro-zone related risks and could lead to a stabilization of market confidence in the coming months. Private consumption will continue contracting over the forecast horizon owing to purchasing power being depressed by the upsurge in inflation, by fiscal austerity measures and by unfavourable labour market conditions in most countries. Low capacity utilization, uncertain demand prospects and still tight credit conditions in some countries will protract the decline in investment over the forecast horizon. Under the assumption that the oil price stabilizes at USD 114 per barrel and that the euro/dollar exchange rate fluctuates around 1.30, inflation is expected to decrease slightly from 2.7% in September 2012 to 2.3% in December 2012 and 2.0% in March 2013. Risks remain tilted to the downside as "fiscal cliff" in the United States, sluggish global trade and continued turbulence in the Euro area may dent sentiment, but the action of the European authorities could restore confidence quickly.

### Expected contraction of industrial production

Business and consumer confidence have been steadily decreasing over the past months due to continued tensions in financial markets and fiscal consolidation in most member states. The latest readings of numerous leading indicators and the recent deceleration in world trade point to a further decline in economic activity in the Euro-zone in H2 2012. Accordingly, notwithstanding a temporary increase in July, industrial production is projected to contract by 0.4% in both, Q3 and Q4.

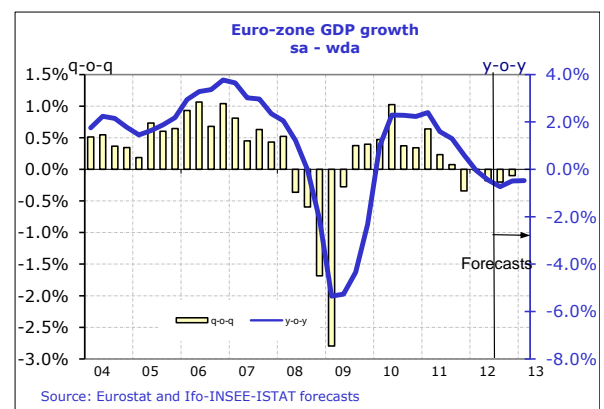
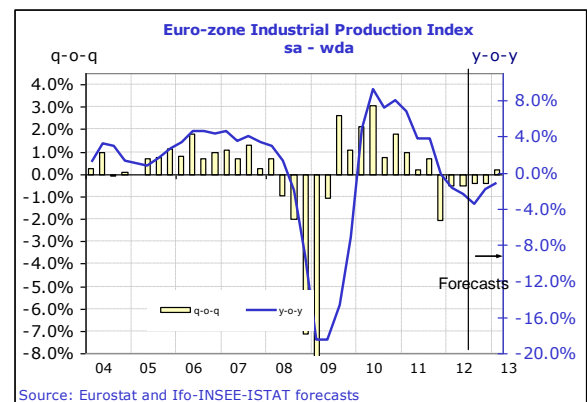
Thanks to demand from emerging economies gradually gaining momentum towards the end of the forecast horizon, industrial output is projected to expand modestly in Q1 2013 (+0.2%).

### GDP continues declining

After declining by 0.2% in Q2 2012, aggregate output in the Euro-zone is forecast to contract further in H2 2012. This development reflects a continuing downward pressure on domestic demand exerted by recently intensified austerity measures in several member states and the high level of economic uncertainty. Nevertheless, the gradual acceleration in demand from emerging markets thanks to monetary stimuli over the coming quarters will support exports and investment. Accordingly, GDP is projected to stagnate in Q1 2013.

Labour market conditions are currently slack and, given the weak economic prospects, are

likely to deteriorate further over the forecast horizon. This will limit nominal wage growth and, together with tax increases and cuts in social benefits in most Euro-zone countries, weigh on households' disposable income. Consequently private consumption is likely to continue declining over the forecast horizon.



## Association of Three Leading European Economic Institutes

The development of private construction and equipment investment will be hampered by the still high uncertainty about the economic outlook and the low level of capacity utilization. In addition, financial tensions will keep on weighing on the financing conditions faced by firms while credit standards will remain tight as banks try to maintain a high capital ratio.

Nevertheless, the recent decision of the ECB to buy unlimited sovereign bonds in the secondary market within its Outright Monetary Transactions program as well as several recent changes in the European fiscal framework may lead to an improvement of market confidence. This, together with the expected gradual brightening of prospects for external demand, will support a mild recovery in private investment.

Besides, public investment is projected to contract in the course of fiscal consolidation. Overall, aggregate investment will continue declining over the forecast horizon (-1.2% in Q3, -0.7% Q4 and -0.2% in Q1 2013).

### Inflation decreases slowly

In September, headline inflation rose to 2.7% year on year, up from 2.6% in August, mainly due to the recent increase in oil and food prices.

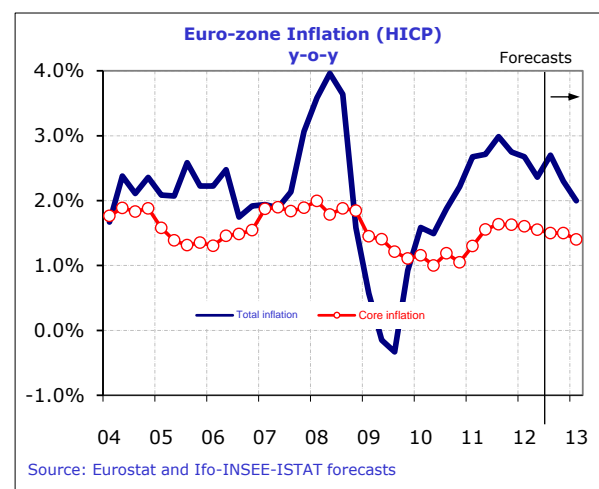
Over the forecast horizon inflation is expected to moderately decrease, reaching 2.3% at the end of the year and 2.0% in March 2013. The inflationary pressures will continue to stem mainly from the transmission of past increases of energy and food prices. This reflects the assumption that the Brent oil price stabilizes around US\$ 114 per barrel over the coming

quarters while the US\$/euro exchange rate fluctuates around 1.30.

#### 2012 Forecasts, % changes, sa - wda

q-o-q y-o-y	Q2-2012	Q3 - 2012 forecasts	Q4 - 2012 forecasts	Q1- 2013 forecasts	2012 forecasts
IPI	-0.5 -2.4	-0.4 -3.4	-0.4 -1.8	0.2 -1.1	-2.3
GDP	-0.2 -0.5	-0.2 -0.7	-0.1 -0.5	0.0 -0.5	-0.4
Consumption	-0.4 -0.9	-0.2 -1.3	-0.2 -0.9	-0.1 -0.8	-1.0
Investment	-1.5 -3.7	-1.2 -4.4	-0.7 -4.5	-0.2 -3.5	-3.7
Inflation*	2.4	2.7	2.3	2.0	2.5

Source: Eurostat and Ifo-INSEE-ISTAT forecasts; \* end-of-quarter



Source: Eurostat and Ifo-INSEE-ISTAT forecasts

Core inflation is forecast to decrease from 1.6% in Q2 2012 to 1.4% in Q1 2013 owing to high unemployment and weak domestic demand keeping inflationary pressures moderate.

### Methodological note

This quarterly publication is prepared jointly by the German IFO institute, the French INSEE institute, and the Italian ISTAT institute. The forecast methods are shared by the three institutes. They are based on time-series models using business surveys by national institutes, Eurostat, and the European Commission. The joint three-quarter forecast covers euro-zone industrial production, GDP, consumption, investment, and inflation. Publication is timed to coincide with Eurostat's third release of quarterly national accounts.

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

- [Ifo Konjunkturprognose](#), Ifo
- [Conjoncture in France](#), INSEE
- [ISTAT](#)

Nikolay Hristov +49 (0) 89 92 24 1225  
 Nicolas Jegou +33 (0) 1 41 17 59 63  
 Roberta De Santis +39 (0) 64673 3620

**Next release: January 4, 2013 (date of Eurostat's third release of quarterly national accounts)**

**Next forecast horizon: 2013 Q2**