

Gradually moving out of recession

In Q4 2012, activity in the Eurozone contracted by 0.6% (-0.1% in the previous quarter). The decrease in exports put a drag on GDP growth while domestic demand remained on a negative trend. However, in the first quarter of 2013, the business climate has slightly improved. As a result, Eurozone activity is expected to turn positive in the second quarter: 0.0% in Q1, +0.1% in Q2 and +0.2% in Q3. Exports are projected to accelerate, as demand from emerging markets will expand at an increasing pace, reflecting monetary and fiscal easing. Furthermore, GDP growth in the United States is also expected to be buoyant and support Eurozone exports. This acceleration in external demand together with a gradual easing of financial tensions will support a stabilization of investment. Private consumption is projected to decline in Q1 before stabilizing in Q2 and Q3 as a result of a decline in inflation and more gradual fiscal consolidation despite the persistent increase in unemployment. Under the assumption that the oil price stabilizes at USD 110 per barrel and the euro/dollar exchange rate fluctuates around 1.30, inflation is expected to decrease from 1.8% in Q1 2013 to 1.5% in Q3 2013. This forecast assumes that financial tensions in Europe do not escalate. It is subject to various risks, including the evolution of the political situation in the Eurozone.

Industrial production is expected to stabilize

After reaching a low point in October 2012, the business climate has picked up significantly in the Eurozone, especially in Germany. Therefore, the decline of industrial production in Q1 2013 (-0.5%) is expected to be smaller than in Q4 2012 (-2.1%).

In the following quarters, the expected acceleration in external demand and the stabilization of domestic demand should trigger a modest recovery of industrial production, which is projected to be stable in Q2 before growing slightly in Q3 (+0.3%).

GDP expands modestly

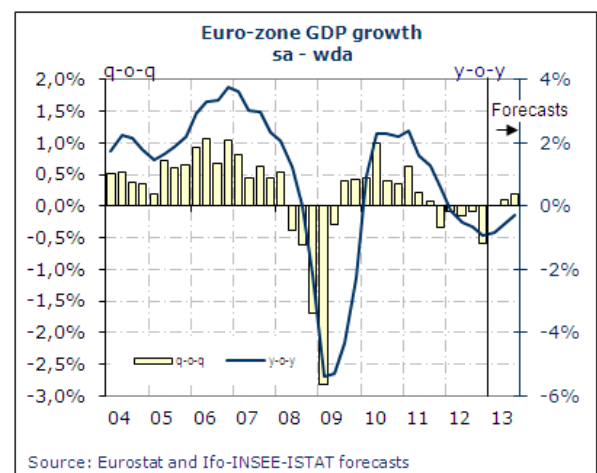
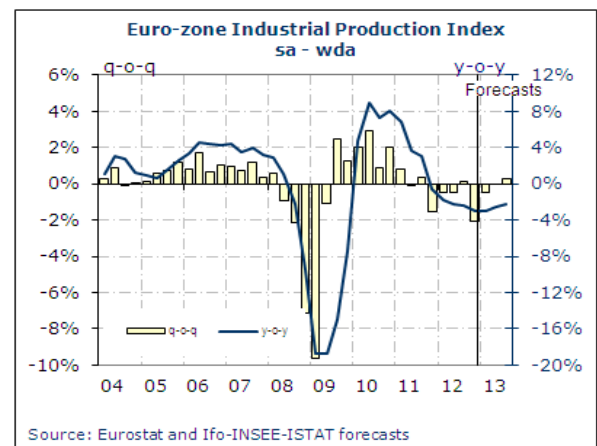
Activity in the Eurozone contracted sharply in Q4 2012 (-0.6% after -0.1%). For the first time in three years, exports fell (-0.8%). Furthermore, consumption and investment continued to fall at the same pace as in previous quarters.

Activity in the Eurozone is expected to return to growth in the second quarter of 2013. GDP should be stable in Q1 before increasing slightly by 0.1% in Q2 and 0.2% in Q3 2013.

This improvement is in large part driven by the acceleration in exports. Indeed, demand from emerging markets is likely to accelerate over the forecast horizon on the back of fiscal and monetary policy becoming more expansionary. In addition, despite significant fiscal retrenchment, most leading indicators point to robust GDP growth in the United States at the beginning of 2013.

This expected acceleration of exports should support investment. After several quarters of

marked decline, equipment investment will start to recover in Q3 2013.



However, this upturn in investment is expected to be gradual. Financing conditions remain tight in Italy and Spain. In these countries, interest rates on loans granted to businesses remain well above those in Germany or France. Our

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forecast assumes that financial market uncertainties will not lead to a resurgence of tensions on sovereign bond markets.

Furthermore, as a result of the ongoing fiscal consolidation, public investment in the Eurozone is expected to remain weak. Overall, investment is projected to fall in Q1 (-0.5%) and Q2 (-0.1%) and increase in Q3 (+0.3%).

Sluggish consumption

The past weakness of activity is likely to take a further toll on the labour market, and employment is expected to keep on decreasing. These conditions reduce the bargaining power of employees, and nominal wages are unlikely to increase above inflation. Additionally, fiscal consolidation measures in most countries weigh on household disposable income. Nonetheless, the moderation in inflation should also help sustain households' purchasing power. Overall, private consumption is projected to fall in Q1 (-0.1%) and stabilize thereafter.

Inflation keeps falling

The drop in headline inflation has been sharp since the start of 2012, and inflation stands at 1.7% in March. Under the assumption that the oil price stabilizes at USD 110 per barrel and that the euro/dollar exchange rate fluctuates around 1.30, this decrease should continue and inflation should reach 1.5% in Q3 2013.

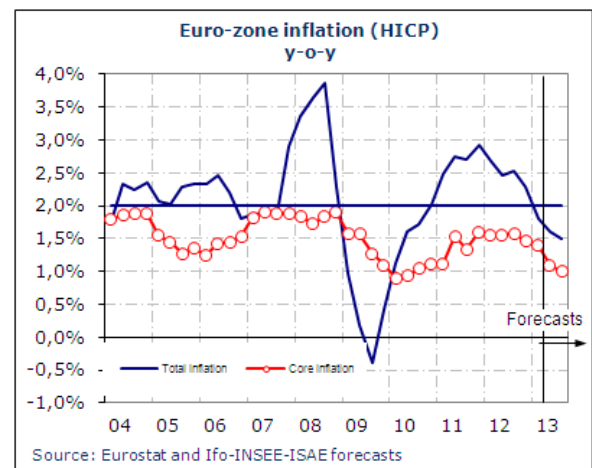
Given the weakness in domestic demand, inflationary pressures should be limited and core inflation should slip back to 1.0% in Q3 2013, after 1.4% in Q1. The year-on-year increase in energy prices should also slightly

decrease. Conversely, the sharp rises in commodity prices at the end of 2012 should filter through to food prices.

2013 Forecasts, % changes, sa - wda

q-o-q	Q1 - 2013	Q2 - 2013	Q3 - 2013	2013
y-o-y	forecasts	forecasts	forecasts	overhang
IPI	-0,5	0,0	0,3	-2,0
	-2,9	-2,5	-2,3	
GDP	0,0	0,1	0,2	-0,3
	-0,8	-0,6	-0,3	
Consumption	-0,1	0,0	0,0	-0,7
	-1,2	-0,7	-0,6	
Investment	-0,5	-0,1	0,3	-2,1
	-4,1	-2,6	-1,5	
Inflation*	1,8	1,6	1,5	1,4

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



Source: Eurostat and Ifo-INSEE-ISAIE forecasts

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 Eurozone 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
- [I STAT](#)

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

Next forecast horizon: 2013 Q4