

Growth recovers mildly, amid persistent weakness

After six consecutive quarters of decline, GDP in the Eurozone increased by 0.3% in Q2 2013. Economic activity is projected to expand further over the forecast horizon (+0.1% in Q3, +0.3% in Q4 2013 and +0.4% in Q1 2014) mainly on the back of the expected pick-up in external demand as well as fiscal policy gradually becoming less contractionary. However, the recovery is likely to be very modest, as fiscal austerity measures and structural reforms currently undertaken by member states will continue to hamper the expansion of domestic demand. The unfavourable labour market conditions will keep on weighing on the development of real disposable income and private consumption will therefore recover only slowly. Aggregate investment is forecast to expand, albeit still at a rather low rate over the forecast horizon. This profile will be mainly driven by the increasing needs to replace depreciated capital as well as the robust foreign-demand growth. Under the assumptions that the oil price stabilizes at USD 111 per barrel and that the euro/dollar exchange rate fluctuates around 1.35, inflation is expected to remain well below 2% (1.5% in Q4 2013 and 1.4% in Q1 2014). The major downside risks to this scenario arise from possible renewed escalations of the debt crisis and from a stronger than expected deceleration in some emerging markets.

A slow GDP recovery

In Q2 2013 Eurozone GDP recorded its first quarter of positive growth (+0.3%) since Q4 2011. This was mainly driven by foreign demand. However, domestic demand also contributed positively to the expansion of economic activity thanks to the pick-up of private consumption in Germany and France as well as an increase in equipment investment.

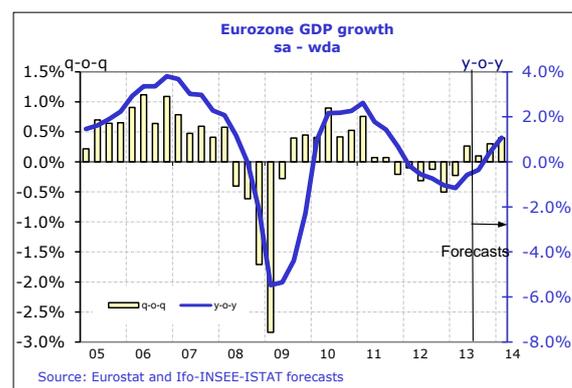
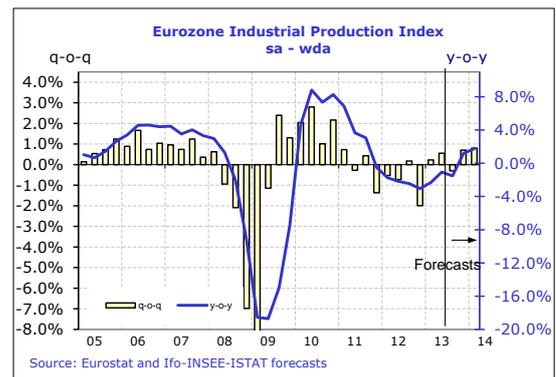
Business and consumer confidence point towards a further increase in GDP over the forecast horizon (+0.1% in Q3, +0.3% in Q4 2013 and +0.4% in Q1 2014). However, the recovery is likely to be modest, supported mainly by the expected acceleration in demand from major advanced countries (USA, UK and Japan) and China as well as the gradual improvement in domestic demand. The latter will remain weak as it continues suffering from fiscal consolidation as well as some drag from high unemployment and tight credit conditions, associated with the structural rebalancing ongoing in many Eurozone economies.

A correction in industrial production is expected in Q3 after the rebound in Q2 2013 (-0.3% after +0.6%), as indicated by the drop recorded in July. In the following quarters industrial production is forecast to accelerate (+0.7% in Q4 2013 and +0.8% in Q1 2014), as pointed out by business surveys.

Domestic demand remains subdued

Given the ongoing adjustment to the weak past activity and a subdued recovery lying ahead, labour market conditions are expected to

improve only to a limited extent over the forecast horizon.



This will put a drag on nominal wage developments. Accordingly, the evolution of purchasing power will remain restrained, even though the effects of tax increases and cuts in social benefits will gradually diminish and inflation is projected to remain low in the coming quarters. Consumption is forecast to stagnate in Q3 2013 before recovering slightly

Association of Three Leading European Economic Institutes

in the following two quarters (+0.1% in Q4 2013 and +0.2% in Q1 2014).

Equipment investment will continue to recover at a moderate pace, driven by the rebound in external demand and the increasing need to replace depreciated capital. Furthermore, assuming no renewed escalation of the sovereign debt crisis, the financing conditions faced by firms in peripheral countries will likely improve, albeit very slowly. On the other hand, while construction investment is projected to continue falling, the decline should gradually slow down. Total investment is thus forecast to moderately gain momentum over the forecast horizon (+0.1% in Q3, +0.2% in Q4 2013 and +0.4% in Q1 2014).

Inflation to stabilize at a low level

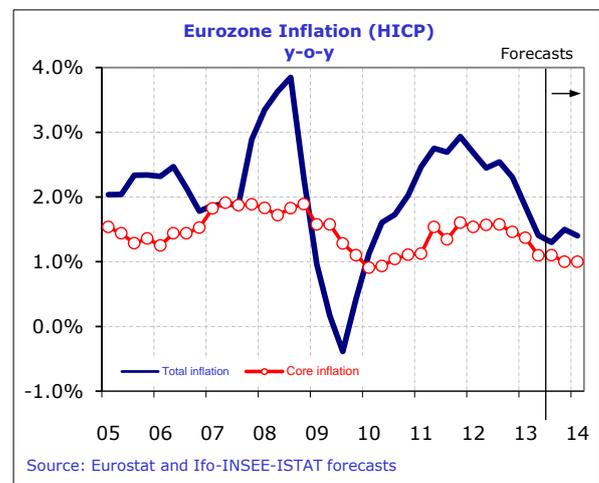
After peaking at 2.9% year on year in Q4 2011, headline inflation has fallen to 1.3% in Q3 2013. It is expected to remain relatively stable around over the forecast horizon as nominal wage increases are likely to remain weak and domestic demand is forecast to recover only modestly. Core inflation is also forecast to decrease only marginally, from 1.1% in Q2 2013 to 1.0% in Q1 2014.

Nevertheless, owing to the recent increase in food prices and the legislative development in Italy on the VAT rate, the inflation rate should slightly increase in Q4 2013 (+1.5%). Under the hypothesis that the Brent oil price stabilizes around USD 111 per barrel while the USD/Euro exchange rate fluctuates around 1.35, inflation should be back to 1.4% in the following quarter.

2013 Forecasts, % changes, sa - wda

| q-o-q y-o-y | Q2-2012 | Q3 - 2013 forecasts | Q4 - 2013 forecasts | Q1- 2014 forecasts |
|----------------|-------------|------------------------|------------------------|-----------------------|
| IPI | 0.6 -1.1 | -0.3 -1.5 | 0.7 1.2 | 0.8 1.8 |
| GDP | 0.3 -0.6 | 0.1 -0.4 | 0.3 0.4 | 0.4 1.1 |
| Consumption | 0.1 -0.7 | 0.0 -0.6 | 0.1 -0.1 | 0.2 0.4 |
| Investment | 0.2 -3.8 | 0.1 -3.3 | 0.2 -1.9 | 0.4 0.8 |
| Inflation | 1.4 | 1.3 | 1.5 | 1.4 |

Source: Eurostat and Ifo-INSEE-ISAE-ISTAT 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
- [ISTAT](#)

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

Next release: January 3, 2014 (date of Eurostat's third release of quarterly national accounts)

Next forecast horizon: 2014 Q2