

July, 4<sup>th</sup> 2014

## THE MODERATE RECOVERY CONTINUES

The Eurozone growth is expected to recover in Q2 2014 with GDP increasing by +0.3% (after +0.2% in the previous quarter). Growth rates are forecasted to remain at this level in Q3 and Q4. The recovery is expected to be broad based across sectors and countries. The consolidation of the upturn will be mainly driven by progressive improvements in domestic demand and a marginal contribution by the external sector. Private investment will continue to grow over the forecast horizon stimulated by the rise in production activity and increasing demand for new production capacity after the sharp adjustment following the financial crisis. However, consumption prospects remain subdued owing to the continuing labor market slack and the slow growth in real disposable income. Under the assumptions that the oil price stabilizes at USD 114 per barrel and that the dollar/euro exchange rate fluctuates around 1.36, the headline inflation is expected to increase only marginally over the next two quarters, remaining well below the threshold of 2%. Key downside risks to this scenario comprise increases in the savings rate of private households owing to deleveraging, a weaker external demand from emerging economies, especially from Asia and Latin America, as well as an escalation of international tensions in Eastern Europe and of the military conflict in Iraq and Syria.

## Solid recovery in industrial production

Recent consumer and business surveys for the Eurozone show a continuation of the recent upward trend. The European Commission's surveys indicate output is increasing for all sectors but construction. For the latter, confidence indicators decreased slightly in the last months, but remain higher than the 2013 average.

In April, the substantial expansion in the industrial production index (+0.8%) implies a rebound over the previous months, mainly due to mild weather (compared to the year before). Industrial production is expected to rise by +0.6% in Q2 compared to +0.2% in Q1. For the remainder of the year, industrial output growth is expected to remain on a positive trail, fluctuating around +0.4%, as indicated by the sound increases in intermediate goods production in the last few months.

## Mild GDP growth

The recovery in the Eurozone is forecasted to continue over the remainder of the year mainly by a progressive and persistent improvement in domestic demand. Compared to 2013 the recovery is expected to be more balanced across sectors and countries.

All in all, we expect GDP growth to increase to +0.3% in Q2 from +0.2% in the previous quarter and to stabilize at this growth rate in Q3 and Q4. Accordingly, GDP growth for the Eurozone should reach +1.0% in 2014, still below potential output expansion. The acceleration in Q2 will be mainly driven by a normalization of net exports that significantly weighted on the recovery in Q1.

FIGURE 1 | Eurozone Industrial Production Index

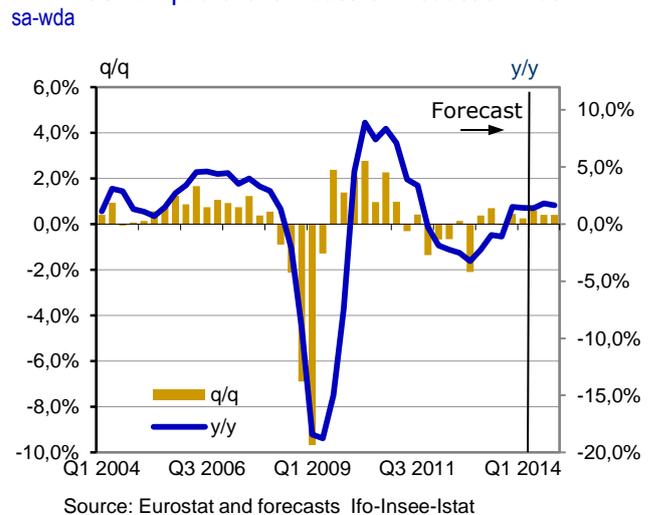


FIGURE 2 | Eurozone GDP Growth



The labor market slack and the slow growth in real disposable income will shape the private consumption outlook that is expected to remain subdued. The moderate pace of the recovery will not be sufficient to significantly lower the unemployment rate, which is expected to stay at record highs in the short term and to decrease only moderately over the forecast horizon.

Consequently, real disposable income in the Eurozone will increase only marginally and private consumption growth should remain weak over the next three quarters (+0.2% in Q2, Q3, and Q4).

According to survey data, a lack of equipment is starting to limit manufacturing output. In combination with better profit growth prospects, this suggests investment growth to strengthen over the forecast horizon.

Accordingly, we expect that investment will be vibrant over the next three quarters (+0.4%, +0.6% and +0.6%), with a temporary deceleration in Q2 due to some normalization of construction investments. This is related to the favorable weather conditions for the northern Eurozone economies experienced in the winter of 2013/2014.

Equipment investment 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, while construction investment stays weak.

### Inflation increases only marginally

In Q2 2014 inflation hit a year-on-year growth of +0.6% which is a further reduction from the +0.7% reported in Q1. Under the assumptions that the oil price stabilizes at USD 114 per barrel and that the dollar/euro exchange rate fluctuates around 1.36 over the coming quarters, headline inflation is expected to remain at its current low levels in Q3 (+0.6%), before marginally increasing in Q4 (+0.8%).

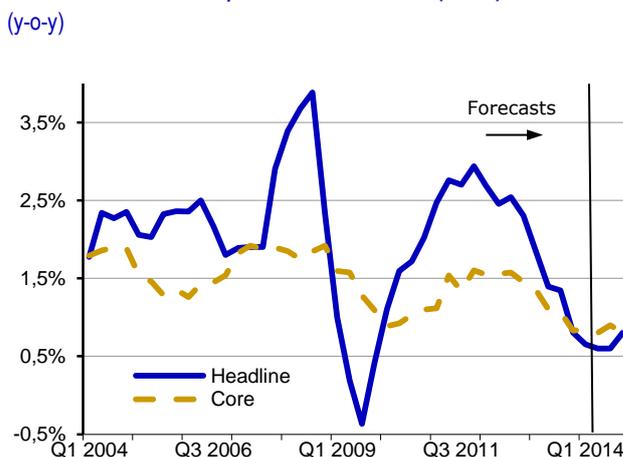
This trend partly reflects impulses from energy and food prices, while domestic price pressures are expected to remain subdued: due to the weak demand and a persistently high unemployment, core inflation will not significantly rise in spite of the recovery.

### 2014 Forecasts, % changes, sa - wda

q/q	y/y	Q2 - 2014 forecasts	Q3 - 2014 forecasts	Q4 - 2014 forecasts	2014 forecasts
IPI		<b>0.6</b>	<b>0.4</b>	<b>0.4</b>	1.6
		1.4	1.8	1.7	
GDP		<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	1.0
		0.9	1.0	1.1	
Consumption		<b>0.2</b>	<b>0.2</b>	<b>0.2</b>	0.7
		0.6	0.7	0.8	
Investment		<b>0.4</b>	<b>0.6</b>	<b>0.6</b>	2.1
		2.1	2.3	2.0	
Inflation		0.6	0.6	0.8	0.7

Source: Eurostat and forecasts of Ifo-Insee-Istat

FIGURE 3 | Eurozone Inflation (HICP)



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 macroeconomic forecast 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 and Italy) is available by:

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**Next release: October 2<sup>nd</sup>, 2014 | Next forecast horizon: 2015 Q1**