

October, 6<sup>th</sup> 2014

## GROWTH PROSPECTS REMAIN SUBDUED

In Q3 2014, economic activity is expected to increase, but only moderately, as geopolitical concerns are still strong and seem to affect investors' confidence. GDP is projected to increase by 0.2% in the third and fourth quarter, and expand by 0.3% in Q1 2015. This masks increasing asymmetries across euro area economies. The recovery is expected to be mainly driven by a gradual improvement in domestic demand conditions. Private investment is expected to restart over the forecast horizon triggered by improved liquidity conditions and lower cost of capital, after the sharp adjustment following the financial crisis. The rise in production activity and increasing demand for new production capacity will be the main factor underpinning the recovery. Consumption prospects remain positive, albeit subdued, as the recovery in the labor market is projected to be gradual. Under the assumptions that the oil price stabilises at USD 97 per barrel and that the dollar/euro exchange rate fluctuates around 1.28, the headline inflation is expected to increase only marginally over the next two quarters, remaining significantly below the threshold of 2%. Key downside risks to this scenario comprise the effective recovery of investment and the 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 a greater impact of international tensions in Eastern Europe and the Middle East, might also be a drag on the exports and investment.

### Slight rebound in Industrial Production

In the face of rising geopolitical uncertainties, and after a disappointing Q2 2014 in terms of activity, recent consumer and business surveys for the Eurozone have deteriorated. They are however still compatible with a mild output growth in the Eurozone.

In line with expectations, industrial production in the Eurozone bounced back in July (+1.0% after -0.3% in June and -1.0% in May). The negative results reported in May and June were mainly due to calendar effects, with most countries experiencing bridge days in Q2 2014. For the next three quarters, industrial output growth is forecasted to return to a moderate positive pace (+0.2% in Q3 2014 and Q4 2014, +0.3% in Q1 2015).

### Low growth in sight

GDP growth is expected to remain weak in Q3 2014 and Q4 2014 – with geopolitical uncertainty inducing a wait-and-see position by economic agents –, before increasing slightly in Q1 2015. The recovery is however characterised by regional asymmetries, driven by growth in Spain and Germany.

After the stagnation recorded in Q2, GDP growth is forecasted to increase to +0.2% in Q3 and Q4 and to reach +0.3% in Q1 2015. Accordingly, GDP growth for the Eurozone is expected to be +0.8% in 2014, still below potential output expansion.

According to the current levels of business and consumer surveys, consumption and investment are expected to expand moderately in Q3 2014 (+0.1% and +0.3% respectively).

FIGURE 1 | Eurozone Industrial Production Index  
sa-wda

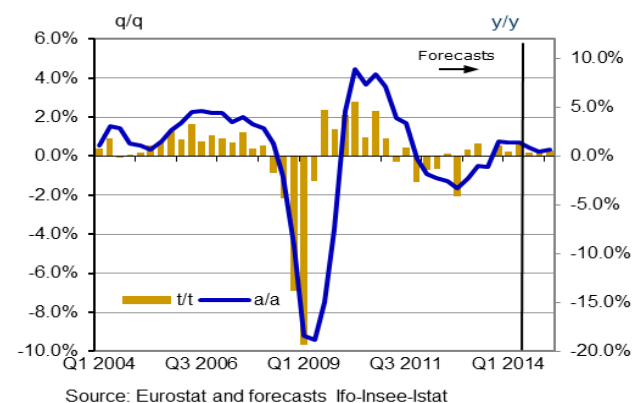
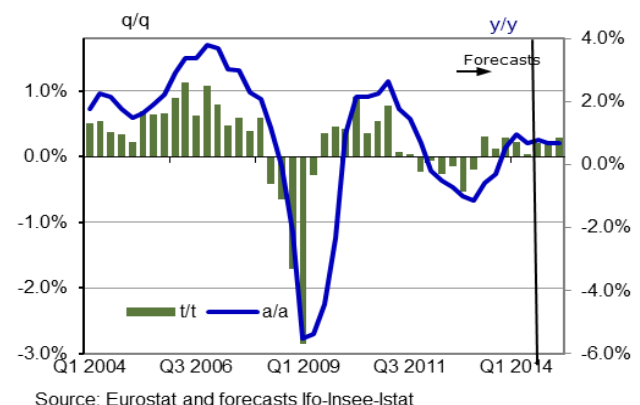


FIGURE 2 | Eurozone GDP Growth  
sa-wda



During the next two quarters, the recovery in the labor market is expected to continue, albeit at pace too low to significantly allow a marked decline in the unemployment rate. As wages continue to grow – especially in real terms with inflation remaining subdued –, real disposable income will support consumption in the Eurozone. The expansion of consumption will therefore slightly pick up, growing by +0.2% in Q4 2014 and by +0.3% in Q1 2015.

On the back of a gradual improvement of domestic demand prospects, positive external demand and increasing capacity utilisation, investment growth will raise over the forecast horizon (+0.4% in Q4 2014, +0.5% in Q1 2015)

However, the acceleration of investment will be mainly driven by business equipment, while construction spending is expected to remain weak over the forecast horizon.

### Inflation increases only marginally

In September 2014, inflation hit a year-on-year growth of +0.3% which is a further reduction from the +0.6% reported in Q2 2014. Under the assumptions that the oil price stabilises at USD 97 per barrel and that the dollar/euro exchange rate fluctuates around 1.28 over the coming quarters, the headline inflation is expected to increase marginally in Q3 (+0.3%), Q4 2014 (+0.5%) and Q1 2015 (+0.6%).

This trend partly reflects impulses from energy and food prices, while domestic price pressures are expected to remain subdued: given the relatively weak demand and a persistently high unemployment, core inflation is not expected to rise.

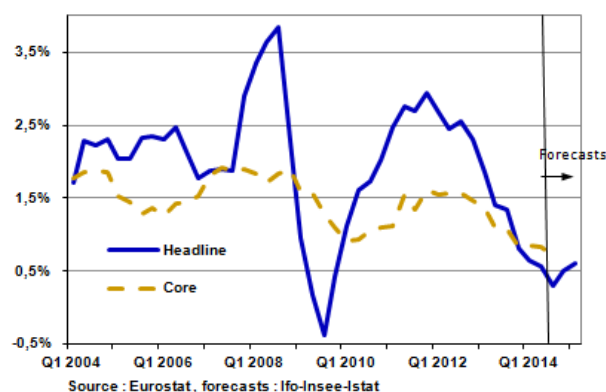
Forecasts, % changes, sa - wda

| q/q<br>y/y  | Q3 - 2014<br>forecasts | Q4 - 2014<br>forecasts | 2014<br>forecasts | Q1 - 2015<br>forecasts |
|-------------|------------------------|------------------------|-------------------|------------------------|
| IPI         | 0.2<br>0.9             | 0.2<br>0.5             | 0.9               | 0.3<br>0.7             |
| GDP         | 0.2<br>0.8             | 0.2<br>0.7             | 0.8               | 0.3<br>0.7             |
| Consumption | 0.1<br>0.7             | 0.2<br>0.8             | 0.7               | 0.3<br>0.9             |
| Investment  | 0.3<br>1.1             | 0.4<br>0.6             | 1.2               | 0.5<br>0.9             |
| Inflation   | 0.3                    | 0.5                    | 0.5               | 0.6                    |

Source : Eurostat and forecasts of Ifo-Insee-Istat

FIGURE 3 | Eurozone Inflation (HICP

(y-o-y)



Source : Eurostat, 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: January 12<sup>th</sup>, 2015 | Next forecast horizon: 2015 Q2**