Eurozone economic outlook

January, 12th 2015

EXPANDING AT A SLOW PACE

In Q4 2014, economic activity is expected to confirm the moderate expansion rate registered in Q3 (+0.2%). In Q1 and Q2 2015, GDP is expected to expand modestly by 0.3%, mainly driven by domestic demand. The recovery in the labour market is expected to be gradual and private consumption is sustained by modest wage dynamics and low inflation. The latter was further cut down by the recent drop in the oil price, resulting in a moderate increase of real disposable income. Investment is forecast to recover, sustained by the acceleration of internal and external demand, helped by more favourable financing conditions. Under the assumptions that the oil price stabilizes at 56 US$ per barrel and that the dollar/euro exchange rate fluctuates around 1.21, headline inflation is expected to bottom out in Q1 2015 and then slowly increase in Q2. Key upside risks are a further depreciation of the euro and a greater fall in oil prices that is expected to provide a stronger stimulus to internal and external demand. On the downside, risks are related to the outcome of the parliamentary elections in Greece and its possible consequences on the stability of the Eurozone.

Moderate expansion in industrial production

After the contraction in the third quarter 2014, industrial production posted a slight increase in October (+0.1%).

Both European Commission survey and Markit PMI point to a continued expansion of output over the next few months at a low pace.

In line with this overview, industrial production is expected to expand by 0.2% in Q4 2014, then to slightly accelerate in the first half of 2015 (+0.3% per quarter).

Mild growth for GDP

In Q3 2014 GDP grew by 0.2%, mainly driven by private consumption and, only modestly, by public consumption. Foreign trade balance contribution to GDP was negative while investment was neutral.

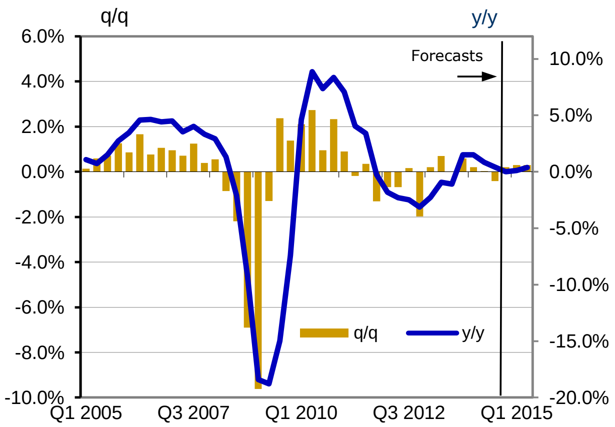
In the last quarter of 2014, the Eurozone economy is expected to have expanded at 0.2% with the average annual growth rate for 2014 at +0.8%, as in last October Eurozone economic outlook.

For the first half of 2015, the fall in oil price is expected to support private consumption whereas the appreciation of the dollar *vis-a-vis* the euro will enhance external trade, resulting in a moderate acceleration of the GDP to +0.3% in both quarters.

In this context, investment is set to pick up moderately. After a modest 0.1% in Q4 2014, investment is forecast to grow by 0.2% in Q1 2015 and 0.3% in Q2 2015. This expansion would stem from an improvement of demand expectations and the end of the construction crisis in Spain and France.

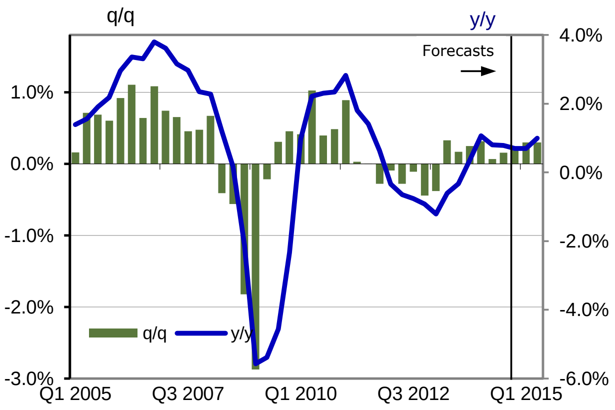
The mild recovery projected in the first half of 2015 will have a limited impact on employment growth. Wages are also expected to expand slowly, in spite of the introduction of a minimum wage in Germany.

FIGURE 1 | Eurozone Industrial Production Index
sa-wda



Source: Eurostat and Ifo-Insee-Istat forecasts

FIGURE 2 | Eurozone GDP Growth
sa-wda



Source: Eurostat and Ifo-Insee-Istat forecasts

However, low inflation and more gradual fiscal consolidation in the major advanced countries are expected to stimulate households' purchasing power.

In this environment, consumption is forecast to evolve at the same speed as GDP, namely 0.2% in Q4 2014 and 0.3% per quarter in the first half of 2015.

Inflation bottoming out in Q1 2015

Since end-2011 inflation is on a downward trend and reached a 5-year low in December 2014 at -0.2% y-o-y. The sharp fall of oil price in November and December accelerated the trend prevailing since mid-2014. In parallel, the depreciation of the euro only partially compensated this price decrease.

Under the technical assumptions of a stable exchange rate at 1.21 US$/€ and 56 US$/per barrel of Brent, inflation is expected to remain near zero in the first quarter 2015 (+0.1% y-o-y) driven by a still negative outlook for manufactured goods together with the effect of the oil price reduction in late 2014.

The acceleration in the economic activity forecast for H1 2015 is expected to have a very limited effect on prices, which should continue to grow only slightly: inflation is expected to be at +0.2% y-o-y in Q2 2015.

Risks

Upside risks are represented, both by a further depreciation of the euro and a greater fall in oil prices that is expected to provide a stronger stimulus to internal and external demand. On the downside, risks are related to the outcome of the parliamentary elections in Greece and its implication for the Eurozone stability.

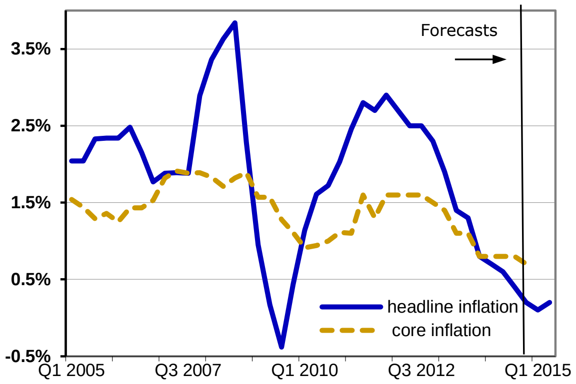
TABLE 1 | Forecast 2014/2015

% Change, seasonal and working day adjusted

	Q4/2014		Q1/2015		Q2/2015		2014
	q/q	*y/y*	*q/q*	*y/y*	*q/q*	*y/y*	*Year average*
IPI	**0.2**	0.0	**0.3**	0.1	**0.3**	0.4	0.7
GDP	**0.2**	0.7	**0.3**	0.7	**0.3**	1.0	0.8
Consumption	**0.2**	1.2	**0.3**	1.3	**0.3**	1.4	0.9
Investment	**0.1**	-0.4	**0.2**	-0.6	**0.3**	0.4	0.7
Inflation		0.2		0.1		0.2	0.4

Souce: Eurostat and Ifo-Insee-Istat forecast

FIGURE 3 | Eurozone Inflation (HICP) (y-o-y)



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:

- **Ifo Konjunkturprognose, Ifo** Atanas Hristov +49 (0) 89 92 24 1228
- ***Conjoncture* in France, Insee** Aurélien Fortin +33 (0) 1 41 17 59 63
- **Istat** Marco Fioramanti +39 06 46 73 36 25

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