

October, 6th 2015

Recovery driven by domestic demand

Real domestic product in the Eurozone expanded by 0.4% in Q2, in line with our previous forecast. In the second half of 2015, real GDP is expected to expand at a moderate pace (+0.4% in Q3 and +0.5% in Q4). Primarily driven by domestic demand, growth is set to accelerate from +0.9% in 2014 to +1.6% in 2015. Improving labour market conditions are expected to maintain growth of consumption expenditure at a solid pace, with the latter expanding by +1.8% in 2015. Investment is expected to accelerate, but only slowly, mainly because construction investment remains a drag in many countries. On average, total investment is set to grow by 1.7% in 2015. Assuming a fixed oil price at 48\$ per barrel and a stabilization of the €/€ exchange rate at 1.12 in the coming quarters, inflation is expected to increase only moderately and reach +0.5% in Q1 2016.

Industrial production is recovering

After growing sharply in two consecutive quarters, industrial production (excluding construction) decreased by 0.2% in Q2. Industrial production bounced back in July (+0.6% m-o-m). In addition, in September the European Commission surveys confirmed the expansionary momentum in the area.

Over the forecast horizon, industrial production is expected to expand moderately in Q3 (+0.3%) and then accelerate in the successive two quarters (+0.5% each). On average, industrial production is set to expand by +1.5% in 2015.

Toward a solid GDP expansion

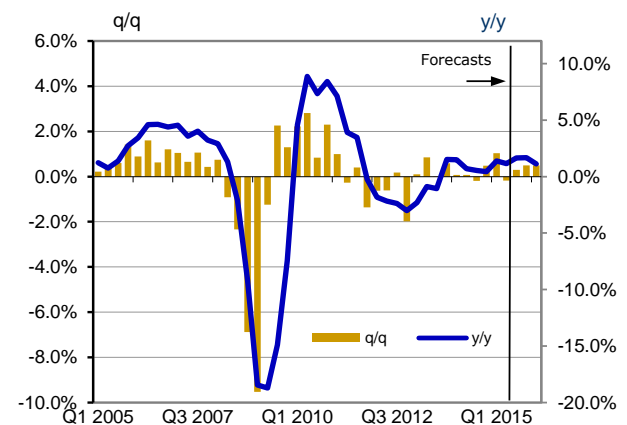
Eurostat's second release of GDP growth in Q2 2015 confirmed expectations of a moderate but solid expansion in the second quarter of 2015 (+0.4% after +0.5% in Q1). In Q2, both private (+0.4%) and public consumption (+0.3%) expanded at a solid pace, while investment disappointed (-0.5%). Exports (+1.6%) grew faster than imports (+1.0%); the contribution of net exports to real GDP growth was positive (0.3 pp).

Over the forecast horizon, domestic demand is set to remain on a positive pattern mainly because of solid consumption dynamics. External demand is expected to slightly weaken in the second half of 2015 given the uncertainty surrounding the outlook for emerging markets and especially China.

Improvements in the labour market are boosting personal income with beneficial effects on consumption. Over the forecast horizon, this momentum is expected to be maintained. Many indicators and surveys suggest a positive trend of consumption in the coming months. After growing by +0.4% in Q3 and Q4, consumption is expected to expand by 0.5% in Q1 2016.

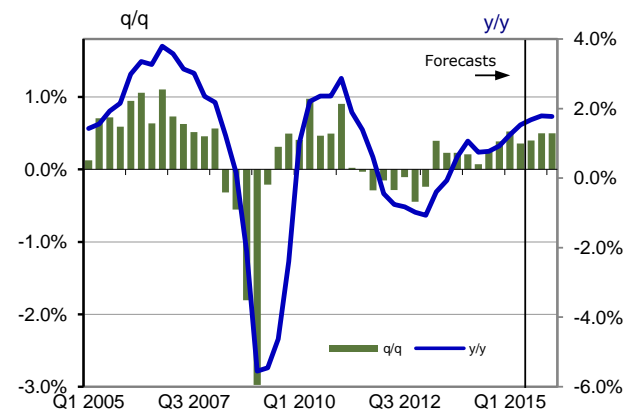
Investment is still lagging behind mainly because of the renewed decrease of construction investment in Italy and France. Corporates investment in equipment is increasing slowly because of weak domestic demand in

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 forecasts Ifo-Insee-Istat

the recent past and uncertainty about external demand in the future. As a whole, investment should only slowly accelerate, reaching +1.7% as an average over the year 2015. A sensible acceleration is not expected before the beginning of next year when investment is anticipated to speed up to +0.8% in Q1 2016.

Gross domestic product is set to expand in Q3 at a similar pace as in Q2 (+0.4%) and accelerate thereafter to +0.5% in the following two quarters. Real GDP is set to grow by +1.6% in 2015.

Inflation slowly crawling above zero

Oil price reduction in the recent months kept headline inflation at a very low rate, despite the uptick in core inflation. The increase of core inflation to close to 1% in September was mainly driven by services. Provided that the exchange rate and oil price stay constant at 1.12 dollar per euro and 48\$ per barrel respectively, inflation is anticipated to rise only slowly above zero, namely +0.2% in Q4 2015 and +0.5% in Q1 2016. On average, the price change in 2015 is forecasted to be nil.

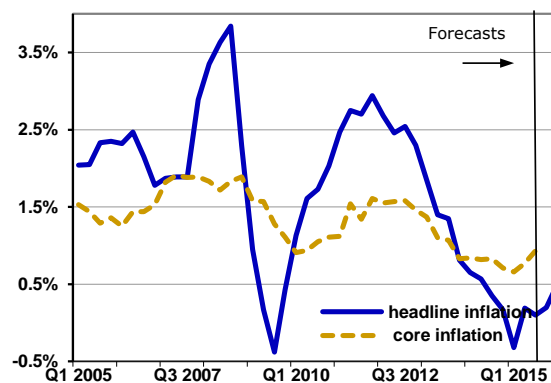
Risks

On the downside, short term developments in the emerging markets, especially in China, is a major risk for the Eurozone outlook. A marked deceleration of the European economies is however highly unlikely. Investment behaviour has proven to be feeble since the beginning of the crises. A renewed optimism after years of contraction in capital accumulation could boost growth more than expected. Such a development represents an upward risk.

TABLE 1 | Forecasts 2015

	Q3/2015		Q4/2015		Q1/2016		2015 Year average
	q/q	y/y	q/q	y/y	q/q	y/y	
IPI	0.3	1.7	0.5	1.7	0.5	1.1	1.5
GDP	0.4	1.7	0.5	1.7	0.5	1.8	1.6
Consumption	0.4	1.8	0.4	1.6	0.5	1.7	1.8
Investment	0.3	1.8	0.5	1.7	0.8	1.0	1.7
Inflation	0.1		0.2		0.5		0.0

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:

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Next release: January 12th, 2016 | Next forecast horizon: 2016 Q2