

April, 12th 2016

Consumption supports the recovery

In a lacklustre international environment, the Eurozone is expected to remain resilient and continue to recover at a moderate pace. Real gross domestic product is estimated to increase by 0.4% quarter-on-quarter in the first three quarters of 2016. The driving force behind this development is a dynamic domestic demand. An upturn in household purchasing power is expected to support private consumption, stimulated by the past drop in oil prices. The massive influx of refugees, mainly in Germany, is expected to raise public consumption and transfers. Total investment is forecast to grow at an accelerating pace in the first three quarters of 2016, driven by rising capacity utilisation and low borrowing costs. Under the assumption that Brent oil price remains stable at \$40 per barrel, and the Dollar/Euro exchange rate fluctuates around 1.12, inflation is expected to be negative in Q2 before picking up slightly in Q3.

Industrial production increases in Q1

Industrial production in the Eurozone gained momentum in the end of 2015 – it expanded by 0.4% in Q4 after a moderate growth of 0.2% in Q3. Moreover, industrial production was very buoyant in January, so it is foreseen to accelerate sharply quarter-on-quarter in Q1 2016, growing by 0.9%. Business climate in industry, however, has slightly weakened and external demand, notably from China, whose slowing economic activity hampers the exports of the advanced economies, is likely to be lacklustre. All in all, industrial production is forecast to grow more moderately, by 0.3% in Q2 and by 0.5% in Q3.

Real GDP expands at moderate rates

In Q4 2015, gross domestic product of the Eurozone increased in the same moderate fashion as in the previous quarter (+0.3%). The expansion in gross capital investment was robust (+1.3%), notably in motor vehicles, while private consumption slowed down (+0.2%); it decreased in France and was sluggish in Germany and Italy. In addition, the weakened demand from the emerging countries, in particular China and South-East Asia, acted as a drag on exports, which increased only modestly (+0.2%).

Over the forecasting horizon, domestic demand is set to boost economic activity, mainly driven by solid private and public consumption. Household real disposable income is expected to benefit from the ongoing improvement in employment and the recent drop in oil prices. As a result, private consumption is forecast to grow in the first three quarters of 2016 by 0.5% per quarter. Due to the massive influx of refugees since 2015, mainly in Germany, government spending on consumption and transfers should also provide a positive impulse.

FIGURE 1 | Eurozone Industrial Production Index
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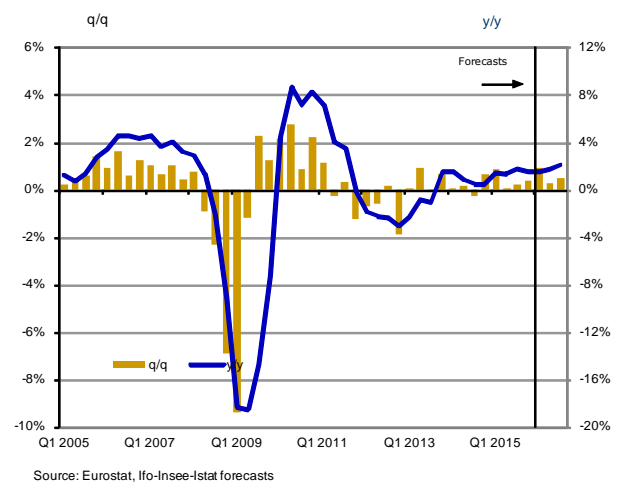
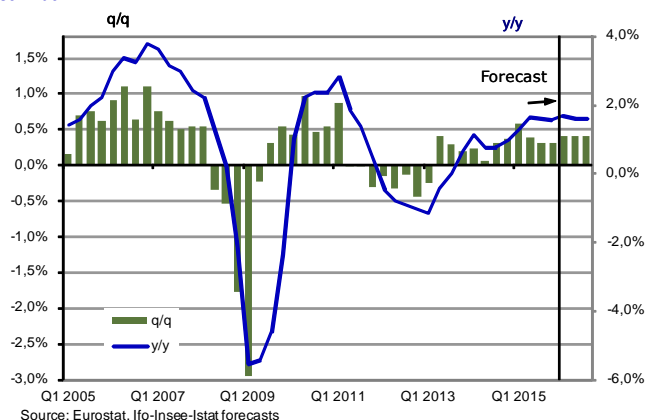


FIGURE 2 | Eurozone GDP Growth
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Investment is also expected to contribute to the vigour of domestic demand. Facing a persistently low inflation, the European central bank has continued to set its monetary policy on an expansive tone: new measures were announced in December 2015 and March 2016. Therefore borrowing rates are expected to remain low over the forecasting period, favouring an increase in outstanding corporate loans. A pickup in the corporate margin rate, partly due to the drop in oil prices, and a rise in capacity utilisation should also result in a more dynamic growth of investment in equipment in the coming quarters, even if production expectations and order books from the tendency surveys slightly weakened in Q1.

Against a backdrop of economic recovery in the Eurozone and slowdown in activity in its main trading partners, net exports are expected to hamper growth in H1 2016. The positive effect of the depreciation of the Euro should start to recede, while the buoyancy of domestic demand is expected to drive up imports.

Overall, real gross domestic product is set to expand in the first three quarters of 2016 at +0.4%, slightly faster than in H2 2015 (+0.3%).

Inflation should not increase before Q3

Since early 2015, headline inflation in the Eurozone has remained very low, fluctuating between -0.2% and +0.3%. The low level of inflation is mainly due to the slump in oil prices. Core inflation, however, has picked up slightly since the start of 2015. Assuming that the price of a barrel of Brent stabilises at \$40 and the dollar/euro exchange rate fluctuates around 1.12, headline inflation is expected to be negative in Q2 (-0.1%), before slightly picking up in Q3 (+0.3%).

Risks

On the downside, short-term developments in the emerging markets, especially in China, are a major risk for the Eurozone outlook. Were exports orders to the emerging countries to prove stagnant or even falling, uncertainty could further increase and growth could be weaker than foreseen.

On the upside, although the savings ratio is expected to increase due to the improvement in household purchasing power, European households, especially in France, could consume a higher than expected share of the “revenue windfalls” due to the fall in commodity prices. Moreover, public expenditures could be set on a more expansive pace than foreseen, notably in Germany.

TABLE 1 | Forecasts 2016

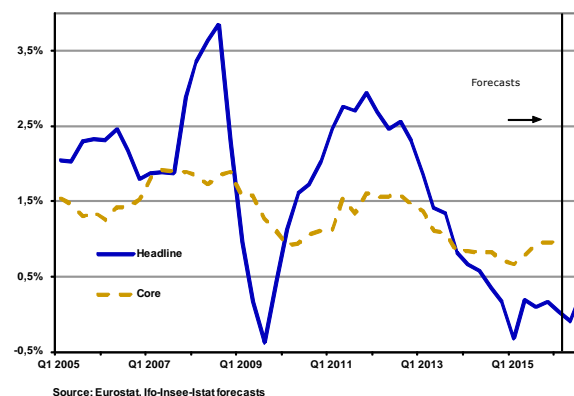
% Change, seasonal and working day adjusted

q/q	y/y	Q1 - 2016 forecasts	Q2 - 2016 forecasts	Q3 - 2016 forecasts	2016 overhang	
IPI	0.9	1.6	0.3	1.8	2.1	1.8
GDP	0.4	1.4	0.4	1.4	1.5	1.4
Consumption	0.5	1.5	0.5	1.7	1.7	1.6
Investment	0.5	2.4	0.6	2.9	3.2	2.6
Inflation	0.0	0.0	-0.1	0.3	0.3	0.1

Source: Eurostat, Ifo-Insee-Istat forecasts

FIGURE 3 | Eurozone Inflation

Harmonised Index of Consumer Price (HICP), y-o-y



Source: Eurostat, Ifo-Insee-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 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: July 12th, 2016 | Next forecast horizon: 2016 Q4