

July, 12th 2016**RECOVERY CONTINUES AMID HUGE
POLITICAL RISKS**

UK referendum increased uncertainty about the economic growth prospects in the Eurozone: while the short run impact on the activity of the area, via the trade channel, should be limited until the fourth quarter of 2016, the medium term effect strongly depends upon future agreements between UK and EU countries. In this setting, Eurozone real gross domestic product is estimated to increase by 0.3% in Q2, slightly accelerate to 0.4% in Q3 and then slowdown to 0.3% in Q4. The average GDP growth for 2016 is set to be 1.6%. Consumption is expected to remain the prime driver, thanks to improving labour market conditions and subdued inflation. Investment is set to gain momentum over the forecast horizon, sustained by the further easing of financing terms and improved prospects. Under the assumption that Brent oil price remains stable at \$49 per barrel, and the Dollar/Euro exchange rate fluctuates around 1.12 dollar per euro, inflation is expected to moderately pick-up during the rest of the year bringing the annual average to +0.3%.

Industrial production is set to increase in H2

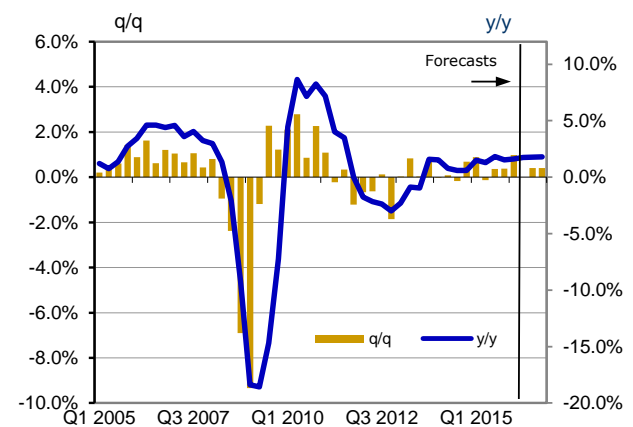
Industrial production strongly accelerated in Q1 2016 (+1.0%), based on a solid expansion in capital goods, but proved to be mixed April and May. Industry confidence improved in Q2, but production is expected to be flat in Q2. In the second half of the year, industrial production is set to continue to expand at a slower pace with the effect of Brexit weighing on economic activity and keeping uncertainty elevated. All in all, industrial production is forecast to be stable in Q2 and increase by 0.4% in Q3 and Q4 leading the 2016 average to +1.7%.

Real GDP growth consolidates

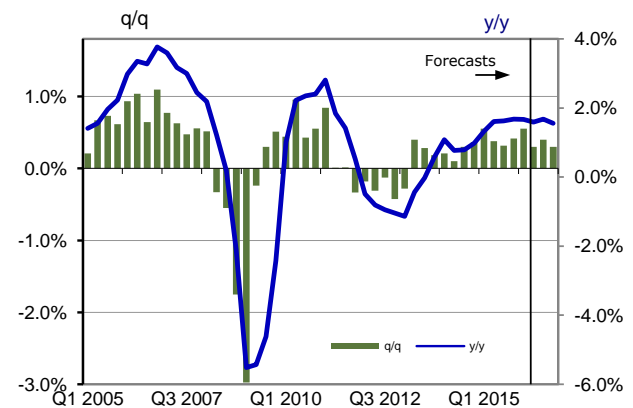
Real gross domestic product in Q1 grew more than expected (+0.6%) driven by unforeseen improvements in consumption and investment. The contribution of net exports was negative for the third quarter in a row. Among major member states, Spain showed the strongest GDP growth (+0.8%), followed by Germany (+0.7%) and France (+0.6%). Italy's growth was moderate, although positive and in slight acceleration (+0.3%).

Over the forecast horizon, domestic demand is expected to remain the main driver of the Eurozone expansion while the net contribution of external demand, conditioned by the difficulties in the economy of the emerging economies, is still set to be a drag on the expansion. Improvement in the labour market, both in terms of employment and earnings, and subdued price dynamics keep supporting disposable income and thus private consumption expenditure. In Q2 consumption would appear to have marginally slowed down (+0.3%), as the effects of temporary factors faded away. Over the rest of the year, consumption is foreseen to return to its recent trend rate (+0.4%) with an overall expansion in 2016 of 1.7%.

Investment was strong in Q1 (+0.8%), but is expected to decelerate in Q2 (+0.5%) along with the general slowdown in economic activity.

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

Productive investment is likely to be buoyed up by steady improvements in activity and financial situation of businesses and is set to strengthen in the second semester. Furthermore, the new ECB Corporate Sector Purchase Programme should continue easing already favourable financing conditions. Accordingly, investment is expected to gradually accelerate to +0.6%, then to +0.7% respectively in Q3 and Q4, amounting to an annual investment growth rate of 3.1%. Machinery, transport and ICT equipment are expected to generate the bulk of this result, while construction investment is expected to stabilise in France and Italy.

All in all, GDP is expected to expand by 0.3% in Q2 and to grow by 0.4% in Q3. In Q4 the Brexit effects are likely to manifest via the trade channel and GDP is set to decelerate its speed to +0.3%. The average for 2016 would then be 1.6%, slightly weaker than in 2015 (+1.7%).

Inflation eventually on an upward path

Since early 2015, headline inflation in the Eurozone has remained very low due to the weak global demand and the past fall in oil prices. Growth in the Eurozone has since recovered, but oil prices are still lower than a year ago. The acceleration in economic activity and the fading of the statistical effect of the oil price fall suggest a gradual increase in inflation. Assuming the Brent price stabilises at 49 dollars per barrel and the exchange rate fluctuates around 1.12 dollar per euro, headline inflation is expected to turn positive in Q3 (+0.4%) and further accelerate in Q4 (+0.7%), so that the average price increase in 2016 is set to be 0.3%.

Risks

A sharp increase in uncertainty in the management of the Brexit and the future agreements with the EU could trigger turbulence in the financial markets, reduce confidence and hence put new investment on hold. These effects are very difficult to quantify at this early stage.

On the upside, a general reduction in uncertainty linked to the above mentioned risks, together with a better than expected dynamics in the US economy and in emerging countries would constitute a brighter picture for the Eurozone, boosting both domestic demand and exports.

TABLE 1 | Forecasts 2016

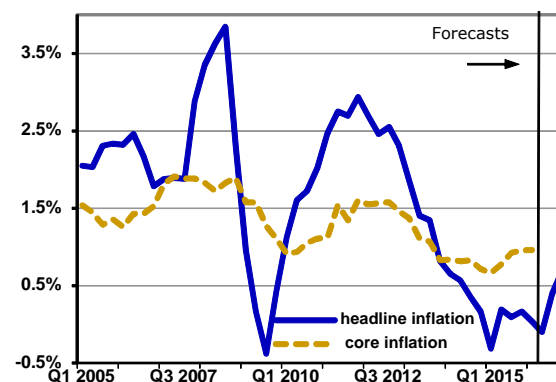
% Change, seasonal and working day adjusted

	Q2/2016		Q3/2016		Q4/2016		2016 Year average
	q/q	y/y	q/q	y/y	q/q	y/y	
IPI	0.0	1.7	0.4	1.8	0.4	1.8	1.7
GDP	0.3	1.6	0.4	1.7	0.3	1.6	1.6
Consumption	0.3	1.7	0.4	1.6	0.4	1.7	1.7
Investment	0.5	3.3	0.6	3.4	0.7	2.7	3.1
Inflation		-0.1		0.4		0.7	0.3

Source: Eurostat and Ifo-Insee-Istat forecast

FIGURE 3 | Eurozone Inflation

Harmonised Index of Consumer Price (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: October 11th, 2016 | Next forecast horizon: 2017 Q1