

The Eurozone GDP would appear to have increased by +0.4% in Q4 2016 and is expected to keep growing at the same pace over H1 2017. The economic activity should be driven by steady growth in private consumption and public spending. Favourable labour market conditions as well as increasing nominal wages are expected to buoy up disposable income, despite an upturn in inflation which slowly erodes purchasing power. Moreover, investment should become slightly more dynamic, based on the continuously good financing conditions. The global economy recovery, from both advanced economies and emerging countries, should also foster external demand.

Positive external stimuli

In Q3 2016 the global economy expanded at the highest rate for several quarters. Among the developed countries, the US reported the strongest expansion. Positive fiscal stimuli in Japan, China and India and the halt in economic decline in Russia added to the positive global trend. Through to mid-2017, net foreign trade should hinder GDP growth less strongly than in 2016, as increasing demand from the US and emerging countries should stimulate exports.

Moderate growth in aggregate activity

So far the economy in the Eurozone has been resilient to high levels of political uncertainty arising from the results of the referendums in the UK and Italy. After a deceleration in Eurozone GDP in Q2 2016 (+0.3% after +0.5% in Q1 2016), output still increased moderately in Q3 2016 (+0.3%). Mainly, industrial production kept expanding at +0.4% in Q2 and Q3 2016. Consumption, both private and public, was the main driver of the output expansion in Q3 2016, despite rather low growth in private consumption (+0.3% after +0.2% in the previous quarter). Investment almost stalled in Q3 2016 (+0.2% after +1.2%). Moreover, foreign trade was lacklustre and did not provide a significant contribution to GDP growth.

TABLE 1 | Forecasts 2016

% Change, seasonally and working day adjusted

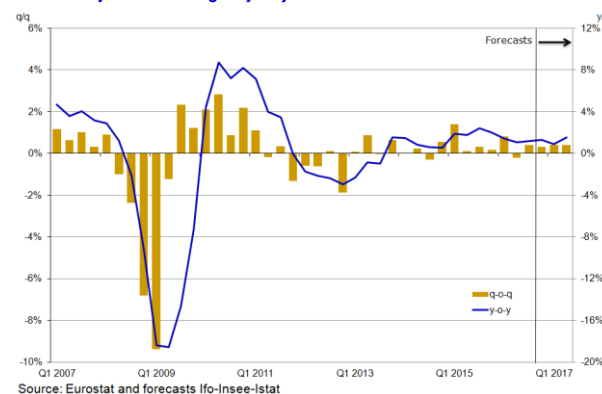
quarter-on-quarter year-on-year	Q4 - 2016 forecasts	Q1 - 2017 forecasts	Q2 - 2017 forecasts	2016 Year average
IPI	0.3 1.2	0.4 0.8	0.4 1.5	1.2
GDP	0.4 1.6	0.4 1.5	0.4 1.6	1.6
Consumption	0.4 1.6	0.4 1.4	0.4 1.5	1.7
Investment	0.7 2.4	0.8 2.9	0.6 2.3	2.9
Inflation	0.7	1.5	1.5	0.2

Source : Eurostat and Ifo-Insee-Istat forecast

In Q4 2016 industrial production would appear to have continued to grow, albeit at a slightly lower rate compared to Q3 2016 (+0.3%). Thereafter, it is forecast to pick up slightly in Q1 and Q2 2017 (+0.4%). Growth in

private consumption is forecast to have increased moderately in Q4 2016 (+0.4%) and it is expected to keep this pace of expansion through to mid-2017. This forecast is in line with an increase in consumer confidence, according to the latest available data. For H1 2017, a rise in employment should continue to foster household consumption through a steady increase in disposable income. Growth in nominal wages is also anticipated to be dynamic. An expected rise in inflation rates over the forecasting period should slowly erode real incomes but should still allow for growth in purchasing power. Public spending is forecast to keep growing at its actual pace.

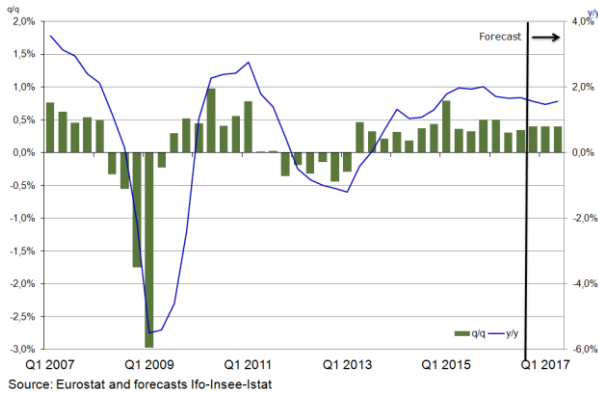
FIGURE 1 | Eurozone Industrial Production Index
Seasonally and working day adjusted



Furthermore, growth in capital formation is expected to accelerate increase as investment from both households and businesses should be dynamic. With an increasing number of construction permits, household investment is expected to gain momentum after having stalled in Q3 2016. It should be particularly buoyant in Germany, France and Italy. Moreover, spare production capacity kept decreasing; it reached its lowest level in the last eight years in Q3 2016. Therefore, investment by firms should grow solidly. The expected increase in external demand should also support investment. For households and firms, financing conditions remain very favorable. In spite of the recent increase in sovereign bond yields, the levels of private interest rates should remain very low. After the disappointing Q3 2016 (+0.2%), total

investment is expected to rebound over Q4 2016 (+0.7%) and Q1 2017 (+0.8%) before slowing down slightly (+0.6% in Q2 2017).

FIGURE 2 | Eurozone GDP Growth
Seasonally and working day adjusted



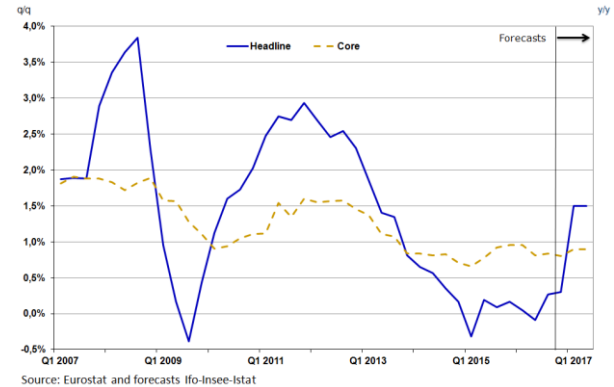
All in all, the moderate recovery in the output of the Eurozone area is expected to continue. GDP is forecast to have increased by +0.4% in Q4 2016 and should keep this pace in Q1 and Q2 2017. This development should be mainly driven by stable growth in private consumption and public expenditures.

Inflation to pick up again

The harmonized index of consumer prices (HICP) picked up at +0.3% (year-on-year) in Q3 2016, after a slight contraction (-0.1%) in Q2 2016. Over the forecasting period, the growth of HICP is expected to increase to +0.7% in Q4 2016 and +1.5% in Q1 and Q2 2017. This momentum stems from the energy component which is

no longer downward oriented as energy prices have stabilized. The projection of headline inflation is based on the assumption of the Brent oil price remaining stable at \$56 per barrel and the Euro/Dollar exchange rate fluctuating around 1.05. Core inflation is expected to keep growing at a similar pace over the forecast horizon, compared to 2016 rates, with about +0,9% year-on-year.

FIGURE 3 | Eurozone Inflation
Harmonised Index of Consumer Price (HICP), year-on-year growth rates



Risks

Political uncertainty remains high due to the unclear future actions of the next US government, the questions about the realization of Brexit and the consequences of the referendum in Italy. With elections being held in France, Germany, and the Netherlands, political uncertainty is not expected to decrease. All of the above events may have an adverse effect on firms' investment decisions.

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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