



September, 20<sup>th</sup> 2017

## Strong Expansion Continues

Growth in the euro area continued to consolidate. GDP in the second quarter accelerated (+0.6% in Q2 2017 compared to +0.5% in Q1). Leading and coincident economic indicators remained positively oriented and the economic growth is expected at the same pace in Q3 and Q4 2017 as in Q2 (+0.6%), before a slight deceleration in Q1 2018 (+0.5%). The main force behind this expansion should be investment, which will benefit from favourable financing conditions and from the improvement in bank lending conditions. Moreover consumption is expected to continue to expand slowly but steadily (+0.4% over the forecast horizon), supported by favourable labour market conditions and increasing wages. The positive outlook for the global economy is likely to support external demand, although hampered by the competitiveness losses due to the recent appreciation of the euro. Over the forecast horizon, core inflation is projected to increase modestly.

### Global economy continues to expand

The positive outlook for the global economy is confirmed over the forecast horizon, with world GDP expected to expand at a similar pace over the forecast horizon as in Q2 2017 (+0.9%). World trade is projected to increase as well (+4.6% in 2017). However, external demand is not likely to generate additional stimuli for the euro area due to the recent appreciation of the euro as well as the expected slightly weaker economic growth in the United States and no acceleration of Chinese economy.

### Expansion on a strong and stable path for the Eurozone

Growth in the euro area continued on a strong and stable path: the estimate of GDP in Q2 confirmed its acceleration (+0.6% compared to +0.5% in Q1). The main drivers of GDP growth in Q2 2017 were private consumption and gross fixed capital formation. The contribution of the external balance to GDP growth was slightly positive.

Coincident and leading business cycle indicators for the euro area remained positively oriented and confirm a positive outlook for the second half of 2017.

**TABLE 1 | Forecasts 2017**

% Change, seasonally and working day adjusted

	Q3/2017		Q4/2017		Q1/2018		2017 Year average
	q/q	y/y	q/q	y/y	q/q	y/y	
IPI	0.6	3.1	0.6	2.8	0.5	3.1	2.4
GDP	0.6	2.4	0.6	2.4	0.5	2.4	2.3
Consumption	0.4	1.8	0.4	1.6	0.4	1.7	1.6
Investment	0.9	2.8	0.9	2.5	0.7	3.4	2.8
Inflation		1.4		1.4		1.1	1.5

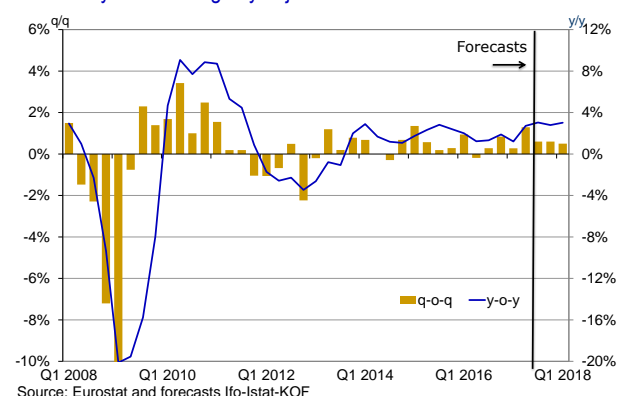
Source: Ifo-Istat-KOF forecast

In July 2017 seasonally adjusted industrial production (IPI) increased by +0.1% (+3.2% year-on-year) in the euro area compared with a decrease by 0.6% in June 2017. The forces behind this increase are production of

capital goods, durable consumer goods and intermediate goods. In August, the Economic Sentiment Indicator increased slightly with modest improvements in the manufacturing sector. Managers' views on order books marginally deteriorated in August, especially on exports. The weak growth registered in July and the sentiment indicators signal a high likelihood of somewhat slower growth in industrial production during the forecast horizon (+0.6% in Q3 and Q4 2017 and +0.5% in Q1 2018) compared to Q2 2017 (+1.2%).

Favourable conditions in the labour market and the increasing trend in wages are expected to support the expansion of private consumption, which is in line with the improvement in consumer confidence registered in August. However, growth in private consumption is forecast to expand at a slightly slower pace than in Q2 2017 (+0.5%) through the forecast horizon (+0.4% in Q3 and Q4 2017 and Q1 2018), reflecting the slight erosion in the purchasing power of households due to the upward trend in inflation.

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

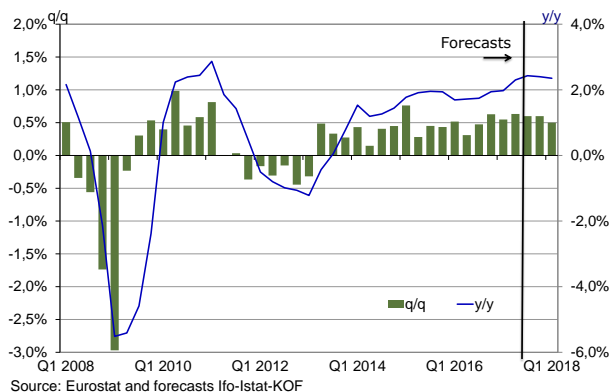


Gross fixed capital formation increased in Q2 2017 (+0.9%) after a rather low growth rate in Q1 (-0.3%). Construction investment increased in Q2 2017 (+1.2%), in line with improved construction confidence. Moreover the production capacity utilization still displays an

upward trend. Both would provide further support to business investment together with favorable financing conditions and improved bank lending conditions.

Investment in Q3 and Q4 2017 is expected to grow at the same pace as in Q2 2017 (+0.9%), before slightly slowing down in Q1 2018 (+0.7%).

**FIGURE 2 | Eurozone GDP Growth**  
Seasonally and working day adjusted



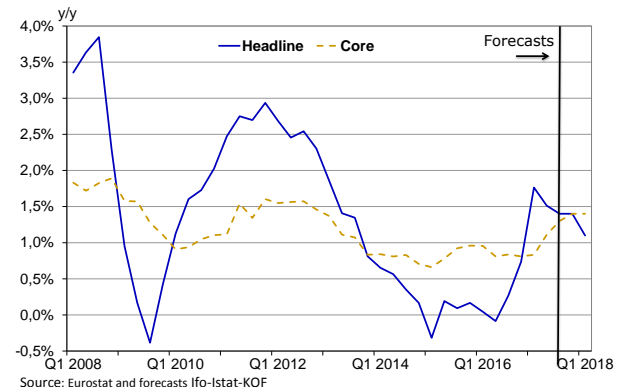
Overall, the euro area economy is expected to grow at a similar pace as in Q2 2017 over the forecast horizon. GDP is forecast to increase by +0.6% in Q3 and Q4 2017, before slightly decelerating at +0.5% in Q1 2018. GDP in 2017 is expected to rise by +2.3% compared to 2016.

### Inflation decelerates

The harmonized index of consumer prices (HICP) increased by +1.5% year-on-year in Q2 2017. Over the forecasting period the HICP is expected to grow at a slower pace than in Q2 2017: +1.4% both in Q3 and Q4 2017 and +1.1% in Q1 2018. The marked slowdown in headline inflation in the first quarter of 2018 is due to a base effect of energy prices, which will be significantly lower than in the first quarter this year. The outlook for headline inflation is based on the assumption of the Brent oil price remaining stable at \$51.70 per barrel and

the USD/Euro exchange rate fluctuating around 1.18. Core inflation (+1.2% in Q2 2017) should modestly increase over the forecast horizon: +1.3% in Q3 2017 and +1.4% in both Q4 2017 and Q1 2018, in line with an upward trend in wages.

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



### Risks

At the international level, uncertainty surrounds economic growth in the United States, whose expansion has been revised downwards in the most recent forecasts due to adjusted assumptions on future fiscal expansion. Uncertainty should be amplified by the political tensions between the United States and North Korea. In the euro area, the recent appreciation of the euro represents a risk factor for economic growth due to its potential negative impact on the trade balance of the euro area. The still high level of non-performing loans (NPL) in the balance sheets of banks in some euro area countries could also negatively affect economic growth by undermining bank lending conditions.

### Methodological note

This quarterly publication is prepared jointly by the German ifo Institute, the KOF Swiss Economic 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 country-specific and global economic analysis is available by:

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