ifo INSTITUTE
Leibniz Institute for Economic Research
at the University of Munich

Istat
Istituto Nazionale
di Statistica

KOF Swiss Economic Institute

Eurozone
economic
outlook

June 26th, 2019

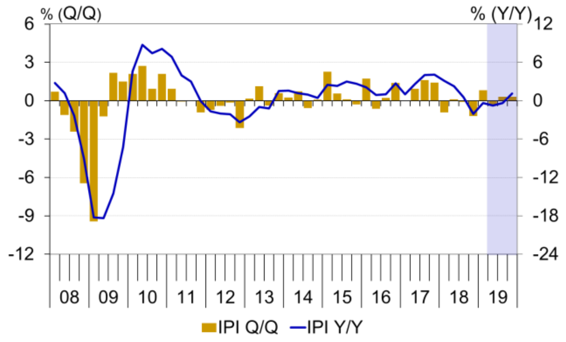
Eurozone GDP growth moderates

- *After an expansion of 0.4% in the first quarter 2019 GDP growth is expected to slow down slightly in the second quarter due to weaker industrial production but it should pick up slightly afterwards (+0.4%).*
- *Annual headline inflation weakens again after Easter special effects fade out.*
- *The outlook is subject to downside risks such as an escalation of trade conflicts and a hard Brexit.*

GDP surprisingly resilient in Q1 2019

Despite ongoing trade conflicts, political uncertainties and declining world trade, GDP in the euro area expanded in the first quarter of 2019 by 0.4% (after 0.2% in Q4 2018). GDP growth was mainly driven by internal demand. Private consumption expenditures grew by 0.5% and gross fixed capital formation by 1.1% especially in the construction sector. In line with the declining world trade, euro area exports and imports decelerated in Q1, while net trade still contributed positively. Among the largest member states, Germany recovered strongly (+0.4%) in Q1 after stagnating in Q4 2018. France and Spain registered positive growth rates of 0.3% and 0.7% respectively and Italy interrupted the negative trend in the two previous quarters (+0.1%).

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

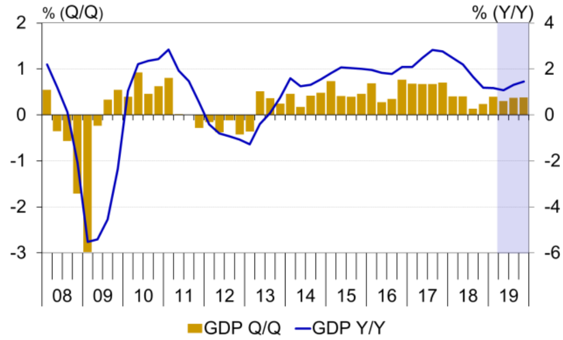


Source: Eurostat and Ifo-Istat-KOF Forecasts

The economic sentiment indicator (ESI) slightly recovered from the decreases registered in the previous months. The sentiment in the manufacturing sector is slightly above its long-term average, whereas services and consumer confidence are above average. The construction confidence indicator has been decreasing lately, albeit from a very high level.

Industrial production increased unexpectedly strongly by 0.9% in Q1 compared to Q4, especially for durable and non-durable consumer goods. Energy production stagnated due to mild weather in Q1 and production in capital goods was weak in line with moderate manufacturing sentiment. In April industrial production fell by 0.5%, especially for capital and durable consumer goods. Industrial production is expected to decrease slightly in Q2 and then pick up in the subsequent quarters (+0.3% for both Q3 and Q4 2019).

FIGURE 2 | Eurozone GDP Growth
Seasonally and working day adjusted



Source: Eurostat and Ifo-Istat-KOF Forecasts

GDP growth in the euro area is forecast to slow down in the second quarter (+0.3%) but should pick up slightly afterwards, resulting in a steady expansion by 0.4% in the following quarters.

The labor market remained strong as the number of persons employed increased by 0.3% in Q1. In April, the unemployment rate decreased further to 7.6%, its lowest level since late 2008. Favorable labor market conditions together with wage increases will continue to support household consumption. Private consumption expenditures are expected to increase by 0.3% in Q2 and by +0.4% in the subsequent two quarters.

Although capacity utilization decreased markedly in Q2 2019 its level is still very high. Investment dynamics should stay robust amid favorable financing conditions and strong construction confidence. Gross fixed capital formation is projected to increase in Q2 by 0.3% accelerating in Q3 and Q4 2019 (+0.5%).

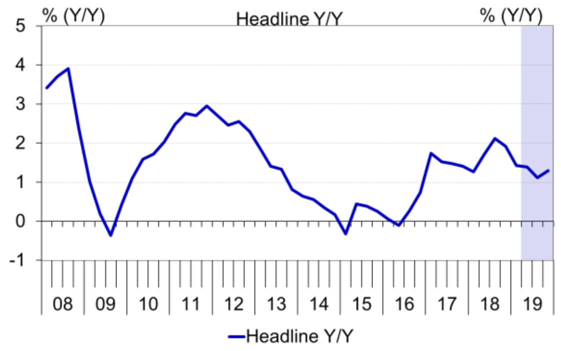
Inflation dynamics have slowed down

The European Central Bank (ECB) has recently signaled its intention to keep the policy interest rates unchanged at their present levels at least until the summer of 2020 or even cut them further if economic conditions do not improve. In addition, it also launched new TLTROs to keep supporting credit growth.

Since the middle of May 2019 the oil price decreased markedly. According to Eurostat's data, the euro area HICP index recorded at 1.2% in May after 1.7% in April. Besides the dampening effects of falling energy prices this drop can be attributed to the vanishing of the Easter effect, which occurs when the Easter holidays fall into a different month than in the previous year. This has one-off effects on different prices compared to the previous year, i.e. package holidays. In the coming months, inflation dynamics are forecast to slow down to 1.1% in the third quarter and to increase slightly afterwards to 1.3%. The inflation forecast is based on the technical assumption that the Brent oil price remains stable at 63 USD per barrel and that the euro/dollar exchange rate stays at 1.12 over the forecast horizon.

FIGURE 3 | Eurozone Inflation

Harmonized Index of Consumer Price (HICP), y-o-y growth rates



Source: Eurostat and Ifo-Istat-KOF Forecasts

Downside risks still prevail

The outlook for the euro area is surrounded by many downside risks, especially towards autumn 2019 as decisions on the Brexit approach. In addition, the USA will decide about the introduction of car tariffs on the EU and Japan, which would have substantial negative effects on euro area GDP.

Table 1 | Forecast Overview

	Q2 19		Q3 19		Q4 19		2019
	q/q	*y/y*	q/q	*y/y*	q/q	*y/y*	
Industrial Production	-0.3	*-0.8*	0.3	*-0.4*	0.3	*1.1*	-0.1
Gross Domestic Product	0.3	*1.1*	0.4	*1.3*	0.4	*1.5*	1.3
Private Consumption Expenditures	0.3	*1.3*	0.4	*1.5*	0.4	*1.6*	1.4
Gross Fixed Capital Formation	0.3	*3.4*	0.5	*3.3*	0.5	*2.4*	3.5
Headline Inflation	1.6	*1.4*	0.0	*1.1*	0.4	*1.3*	1.3

Change in % seasonal and working day adjusted

Source: ifo-Istat-KOF Forecasts

Methodological note

This quarterly publication is prepared jointly by the German ifo Institute, the KOF Swiss Economic Institute, and the Italian Statistical Institute Istat. 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:

- **ifo Institute** Pauliina Sandqvist +49 89 92 24 1239
- **Istat** Roberto Iannaccone +39 06 46 73 73 02
- **KOF Swiss Economic Institute** Stefan Neuwirth +41 44 632 2553