Association of Three Leading European Economic Institutes

Eurozone economic outlook

July 4, 2013

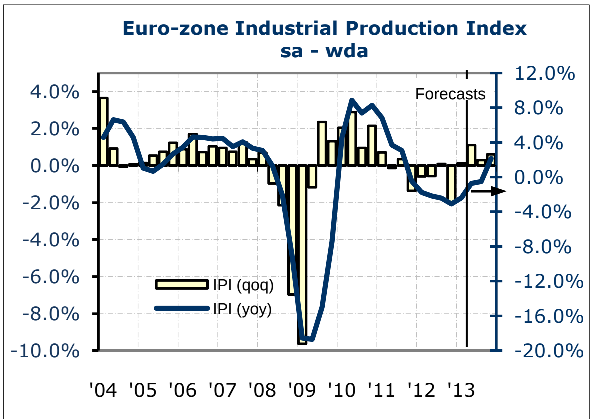
Recovery amid challenges

In the Eurozone, activity contracted by 0.3% in Q1 2013, falling for the sixth consecutive quarter. However, GDP growth is expected to turn slightly positive in Q2 2013 (+0.1%), with a mild acceleration over the following quarters (+0.2% in Q3 and +0.3% in Q4). The driving forces of the upturn will be a progressive improvement in exports and a marginal recovery of domestic demand in the second half of the year. Nevertheless, fiscal consolidation and ongoing deleveraging in corporate and banking sectors of several Eurozone economies will continue to weigh on economic growth. Labor market conditions will remain unfavorable, placing an additional burden on disposable income and private consumption. Due to tight credit conditions and weak prospects for internal demand, gross fixed investment is also expected to remain weak. Exports growth and the need to replace an ageing capital stock will lead to a modest investment recovery in Q3 and Q4 2013 (+0.1% and +0.4% respectively). Under the assumption that Brent oil price remains stable at USD 103 per barrel in Q3 and Q4 and the euro/dollar exchange rate fluctuates around 1.30, inflation is projected to 1,3% in Q4. This reflects diminishing pressures from global commodity prices and weak international and internal demand. This forecast assumes that financial tensions in Europe do not escalate and a gradual unwinding of the monetary policy stimulus in the United States.

Industrial production increasing

Business and consumer confidence in most Eurozone countries has improved slightly since December 2012. Therefore, after a modest expansion in Q1 2013 (+0.1%), industrial production is projected to increase over the forecast horizon. This is mainly due to the expected acceleration in external demand.

In the second quarter, industrial production will benefit from inventory rebuilding and increase significantly in Q2 (+1.1%). Thereafter industrial output is expected to maintain a positive trend in Q3 (+0.3%) and Q4 (+0.6%).

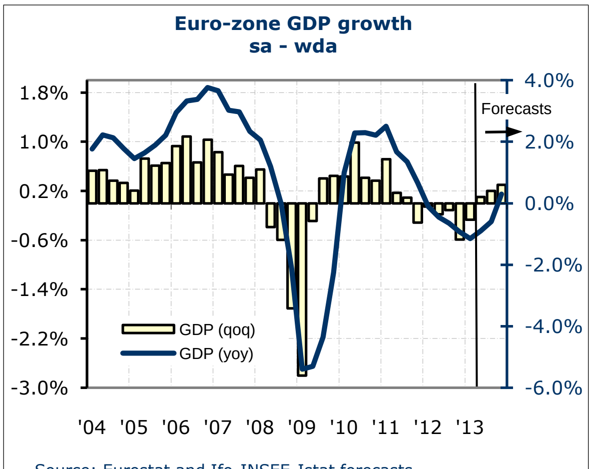


Source: Eurostat and Ifo-INSEE-Istat forecasts

GDP recovers sluggishly

Tensions on Eurozone financial markets have progressively stabilized until mid-May when the US Federal Reserve Bank announced the future unwinding of the Quantitative Easing policy spurring a spell of market volatility and a slight increase of the bond yields. However, the average spread over German bunds remains at significantly lower level than a year ago.

The improvements recorded by the survey indicators supports a moderate acceleration of GDP over the forecast horizon (+0.1% in Q2, +0.2% in Q3 and +0.3% in Q4). The end of the recession in Q2 will be mainly driven by the acceleration in external demand from the US and emerging countries.



Source: Eurostat and Ifo-INSEE-Istat forecasts

Consumption still weak

Fiscal austerity measures and labor market deterioration continue to weigh on household disposable income. Real purchasing power is projected to keep on falling, despite a decline in inflation.

Accordingly, private consumption is expected to stagnate in Q2 and Q3 and to increase marginally in Q4 (+0.1%).

The growth rate of gross fixed investments is projected to remain negative in Q2 (-0.3%). However, the expected acceleration in external demand and the need to renew production capacity after the crisis-related marked adjustment phase should help investment.

Furthermore, although financing conditions remain tight in some Eurozone countries, they are expected to improve gradually due to the easing of tensions on the sovereign debt market. Overall, investment will modestly rebound in Q3 (+0.1%) and recover more rapidly in Q4 2013 (+0.4%).

Inflation easing

In Q2, headline inflation continued to moderate to 1.4%, down from 1.9% in Q1. This reflects diminishing pressures from global commodity prices and weak international and internal demand.

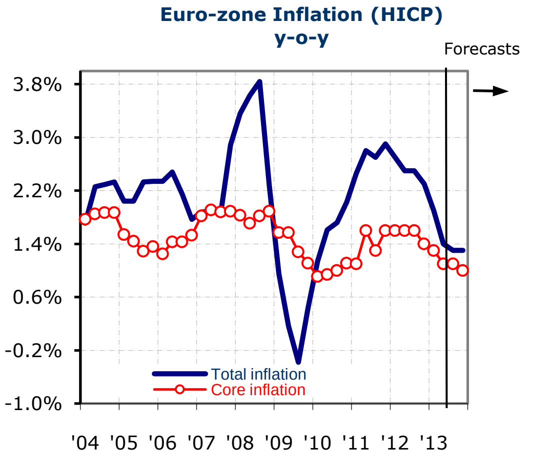
Due to subdued demand conditions, core inflation is projected to fall from 1.3% in Q1 to 1.0% in Q4. Under the assumption that oil price stabilizes at USD 103 per barrel for Brent in Q3 and Q4 and that the euro/dollar exchange rate fluctuates around 1.30, headline inflation is projected to fall to 1.3% in Q4.

Furthermore, the base effect of relatively high energy prices in H1 2012, as well as of past increases in indirect taxes are also expected to contribute to the slowdown in inflation.

2013 Forecasts, % changes, sa - wda

q-o-q / *y-o-y*	Q2 - 2013 forecasts	Q3 - 2013 forecasts	Q4 - 2013 forecasts	**2013 average**
IPI	**1.1** / -0.8	**0.3** / -0.5	**0.6** / 2.1	**-0.4**
GDP	**0.1** / -0.9	**0.2** / -0.6	**0.3** / 0.3	**-0.6**
Consumption	**0.0** / -0.7	**0.0** / -0.6	**0.1** / 0.1	**-0.6**
Investment	**-0.3** / -4.4	**0.1** / -3.6	**0.4** / -1.7	**-3.9**
Inflation	1.4	1.3	1.3	**1.4**

Source: Eurostat and Ifo-INSEE-Istat forecasts



Source: Eurostat and 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 methods are shared by the three institutes. They are based on time-series models using business surveys by national institutes, Eurostat, and the European Commission. The joint two-quarter-ahead forecast covers Eurozone industrial production, GDP, consumption, investment, and inflation. Publication is timed to coincide with Eurostat's third release of quarterly national accounts.

Further economic analysis for each country (Germany, France, Italy) is available by:

- Ifo Konjunkturprognose, Ifo
- Conjoncture in France, INSEE
- ISTAT

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Next release: October 7, 2013 (date of Eurostat's third release of quarterly national accounts)
Next forecast horizon: 2014 Q1