



January 8<sup>th</sup>, 2020

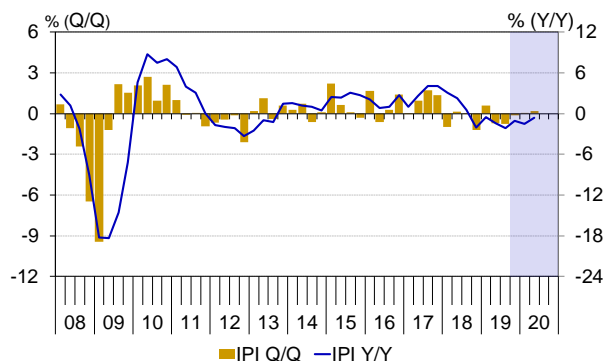
## Eurozone growth at moderate pace

- The sectoral divide between falling industrial production and resilient turnover in services persists. However, business survey indicators convey first signals of optimism in manufacturing. Economic growth is projected to slightly increase its pace to moderate growth rates of 0.3% over the forecast horizon.
- Private consumption will continue to drive growth. In the first half of 2020, industrial production and investment are expected to pick up after a negative performance in Q4 2019.
- Annual inflation remains low in 2019, with a moderate acceleration in the first half of 2020.
- New risks to the outlook emerge from tensions between the US and Iran and strikes in France, while longer-standing risks about Brexit and trade tensions between the US and China have eased somewhat.

### Eurozone growth remained sluggish

The expansion of GDP in the euro area continued to be sluggish in Q3 (+0,2%, as in Q2). The main driver was private consumption. Reflecting weak external demand, the contribution of net exports was slightly negative. Industrial production kept falling and is now on a downward trend since Q1 2018. The slow-down in China and the weakness in the automotive sector weighed especially on capital and intermediate goods producers. This is particularly relevant for the German economy, which only recovered slightly in Q3 (+0,1%) from negative growth in Q2 (-0,2%). France and Spain, which have a higher share of services and consumer goods production, performed better, while the Italian economy remained weak.

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



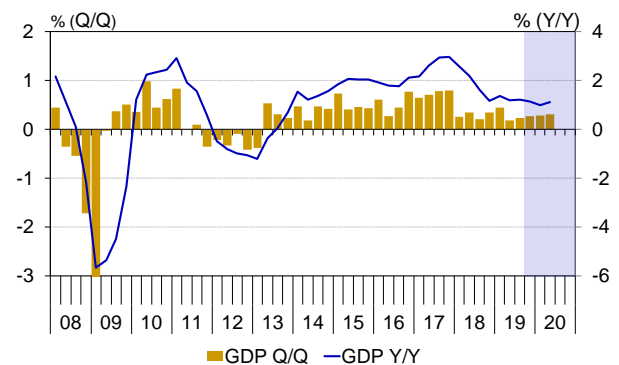
Source: Eurostat and Ifo-Istat-KOF Forecasts

According to leading indicators, the outlook stabilized in the recent months. The consumer sentiment indicator by the European Commission signals little change, but the sentiment indicator related to manufacturing seems to have bottomed out - after a deterioration since the beginning of 2018. Markit's purchasing manager's index

confirms this broad picture. Its manufacturing sub-index stabilized during Q4 2019.

However, industrial production still declined in September and October, with monthly changes of -0,1% and -0,5%. After a quarter-on-quarter change of -0,8% in Q3, industrial production is likely to fall again slightly in Q4 (-0,2%), before it is expected to rally moderately with +0,1% and +0,2% in Q1 and Q2 2020.

**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 increase slightly faster than in Q3. In Q4 2019 and the first two quarters of 2020 it is expected to be +0.3%. For the year 2019, this results in an increase of GDP by 1.2% compared to the year 2018.

Private consumption is likely to continue to be the main driver of GDP growth, as labor markets remain resilient to the downturn in industrial production. Private consumption is expected to expand with steady quarterly rates of 0.3% over the forecast horizon. Government consumption will also add to growth, as fiscal policy in the euro area is projected to become more expansionary in 2020. After high levels, capacity utilization has decreased in the manufacturing sector, but it is still slightly above the

long-term average over the last 20 years. First signs of an ease of tension in the trade war between the US and China as well as increased certainty about Brexit may stimulate external demand.

In a similar way as industrial production, gross fixed capital investment is projected to slightly decline in Q4 (-0.1%), before it will expand with +0.3% and +0.4% in Q1 and Q2 2020.

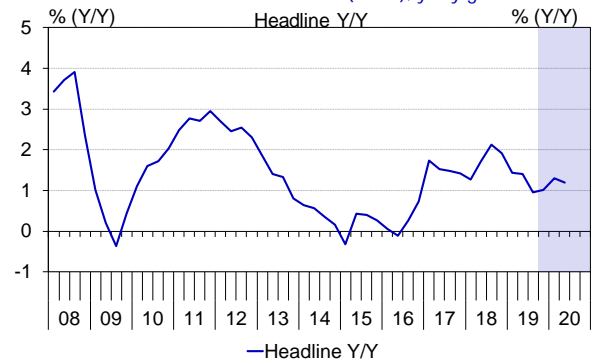
### Inflation remains moderate

Due to the reduction of energy prices, headline inflation, measured as annual changes in the Harmonized Index of Consumer Prices (HICP), came down to relatively low levels since the beginning of 2019. It stood at a modest rate of +1.0% in November. Core inflation, which excludes the effects of energy and unprocessed food prices, increased in November to +1.5%, due to increasing price pressures for services. These stem most likely from past changes of the accounting of package holidays in Germany.

Headline inflation is expected to be steady at +1.0% in Q4 2019, which results for the year 2019 in an inflation rate of +1.2%. In 2020, inflation is projected to accelerate to +1.3% in Q1, before it will somewhat slow down to +1.2% in Q2, due to basis effects of past energy price fluctuations. The inflation forecast is based on the technical assumption that the Brent oil price remains stable at 65 USD per barrel and that the dollar/euro 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

### Risk landscape is changing

While some older factors of uncertainty seem to have eased somewhat, new risks are emerging. There is now more clarity about Brexit. With the re-election of Boris Johnson as prime minister in the UK in December, Brexit is very likely to be executed on January 31<sup>st</sup>. This reduces uncertainty. From 2021 onwards, new modalities in the relationship between the remaining members of the EU and the UK need to be negotiated, with a still uncertain outcome. Moreover, there are first signs of an ease in trade tensions between the US and China; but there remains the risk of a further escalation. Within the euro area, a new risk has emerged in France. Strikes - above all in public transportation - since December 2019 may lead to a weaker growth performance. Last, the escalating tensions between the US and Iran bear the potential for further conflict, economic repercussions, and fluctuations in energy prices.

Table 1 | Forecast Overview

	Q4 19		Q1 20		Q2 20		2019
	q/q	y/y	q/q	y/y	q/q	y/y	
Industrial Production	-0.2	-1.1	0.1	-1.6	0.2	-0.6	-1.3
Gross Domestic Product	0.3	1.1	0.3	1.0	0.3	1.1	1.2
Private Consumption Expenditures	0.3	1.4	0.3	1.3	0.3	1.4	1.3
Gross Fixed Capital Formation	-0.1	6.3	0.3	6.2	0.4	0.9	6.8
Headline Inflation	0.2	1.0	-0.4	1.3	1.5	1.2	1.2

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 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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