

## Economic growth remains on stable path

*Real GDP in the euro-zone decelerated slightly in Q3 2006 (0.5%) after the strong increase registered in H1. The prospects for economic growth remain however positive. Real GDP is expected to rise by 0.7% in Q4 2006, followed by 0.3% in Q1 2007 and 0.5% in Q2. Industrial production should continue to expand, but at lower rates, owing to the expected slackening in world trade. Domestic demand is bound to exhibit resilience. Consumption should remain robust after a temporary slowdown in Q1 2007 associated with the German VAT hike. Investment should expand at a constant but still strong rate. On the technical assumption that oil prices stay within a range of USD 60-65 per barrel of Brent and that the dollar/euro exchange rate fluctuates around 1.30, consumer price inflation is expected to jump, reflecting the VAT rise in Germany, to 2.1% in Q1 2007 before decreasing to 1.7% in Q2.*

### Industrial production retains stable but lower growth rates

Industrial production in the euro-zone increased by 0.8% in Q3 2006, after the remarkable rise of 1.2% in Q2. The expansion of production was largely driven by the strong impulse in Germany. In Italy, industrial production also recorded a slight positive performance whereas by contrast it experienced a setback in France. Recent readings of business surveys reflect some heterogeneity in the area. While in Germany the business climate has further improved, in France and in Italy it has been stable.

Industrial production in the euro-zone is expected to expand again but at lower growth rates in the coming quarters, mainly because of a slackening in world trade. Production should decelerate in Q4 2006 to a rate of 0.5%, and then evolve with a flat profile at rates of 0.4% in Q1 2007 and 0.5% in Q2.

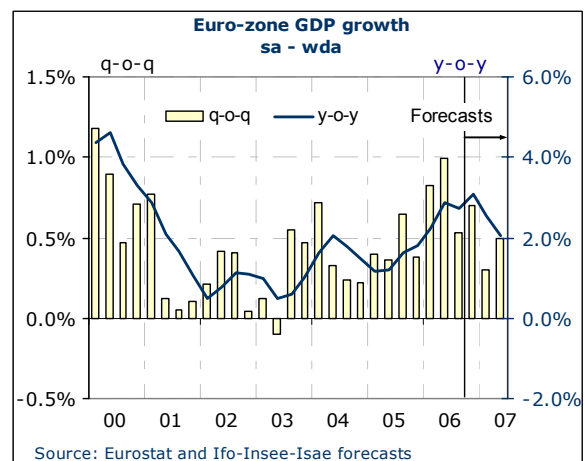
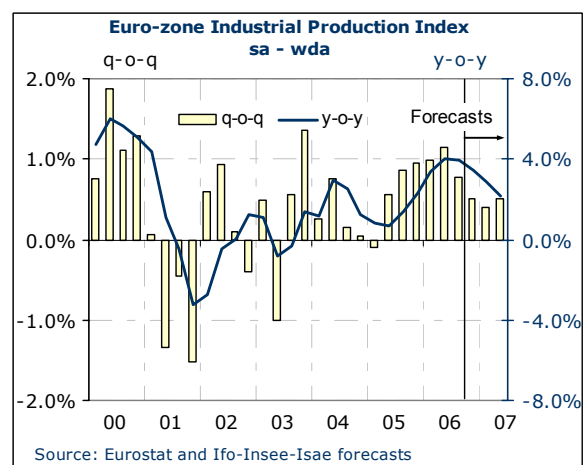
### Real GDP growth with temporary dent

Real GDP slightly decelerated in Q3 2006 (+0.5%) after the very positive pace registered in H1; nevertheless, growth prospects remain sanguine. Domestic demand is likely to keep on growing robustly, thereby dampening the slowdown in net exports that comes along with the moderation of world economic expansion.

Perspectives of private consumption remain positive thanks to the continuous improvement of the labour market. Employment has steadily increased, which fosters household income, despite slack wage dynamics. A dampening effect may come at the beginning of 2007 because of the VAT rise in Germany. Yet, recent readings of consumer confidence indicators

seem supportive to a quick return of consumption to a robust trend in the course of 2007.

Private consumption is expected to raise by 0.6% in Q4 2006, followed by 0.0% in Q1 2007 - a temporary setback essentially attributable to the German VAT hike - and 0.4% in Q2.



Investment increased modestly in Q3 2006, after the strong upturn in Q2. Prospects for investment are still positive, as firms expectations about returns remain promising and credit conditions should stay at a relative convenient level. However, investment dynamics is strongly affected by the different phases of the cycle in the various countries. The acceleration is likely to continue especially in Germany, while a slowdown may emerge in France. All in all, investment is expected to retain stable growth rates, exhibiting an increase of 0.8% in Q4 2006, which is followed by 1.0% in the next two quarters.

Real GDP should grow by 0.7% in Q4 2006, followed by 0.3% in Q1 2007 and 0.5% in Q2. Domestic demand provides the main stimulus to growth, while the contribution of external trade is minor. Overall, real GDP is expected to increase by 2.7% in 2006, the highest figure since 2001.

### German VAT affects inflation

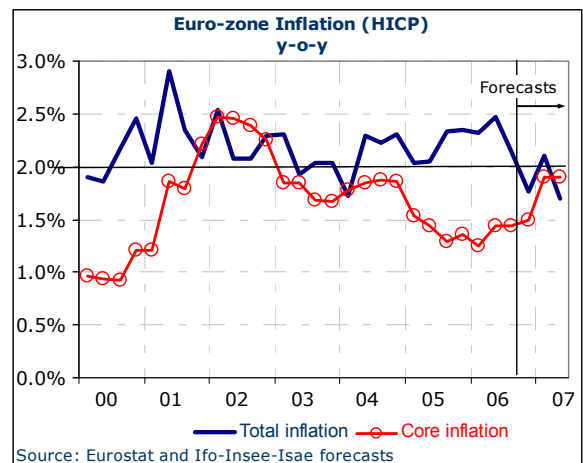
After the significant drop in oil prices in Q3 2006 and the appreciation of the euro in Q4, consumer price inflation fell to 1.8% in the last quarter. The price development in 2007 is mainly influenced by the German VAT increase, which became effective in January 2007 and is expected to shift the euro-zone HICP by 0.3%. On the assumption that oil prices stay within a range of USD 60-65 per barrel of Brent and that the dollar/euro exchange rate fluctuates around 1.30 over the forecast horizon, headline inflation is bound to jump to 2.1% in Q1 2007

and then fall back to 1.7% in Q2. The strong decline in Q2 should be of temporary nature as it mainly reflects a base effect resulting from the oil price hike to USD 70 per barrel in Q2 2006. Core inflation, which is – according to the definition of Eurostat – also affected by the German VAT increase, should rise from 1.5% in Q4 to 1.9% in H1 2007.

**2007 Forecasts, % changes, sa - wda**

q-o-q y-o-y	Q3-2006	Q4 - 2006 estimations	Q1 - 2007 forecasts	Q2 - 2007 forecasts	2006 estimations
IPI	<b>0.8</b> 3.9	<b>0.5</b> 3.5	<b>0.4</b> 2.9	<b>0.5</b> 2.2	3.7
GDP	<b>0.5</b> 2.7	<b>0.7</b> 3.1	<b>0.3</b> 2.5	<b>0.5</b> 2.0	2.7
Consumption	<b>0.7</b> 1.8	<b>0.7</b> 2.4	<b>0.0</b> 1.7	<b>0.4</b> 1.8	1.9
Investment	<b>0.6</b> 4.6	<b>0.8</b> 4.9	<b>1.0</b> 4.7	<b>1.0</b> 3.4	4.8
Inflation	2.1	1.8	2.1	1.7	2.2

Source: Eurostat and Ifo-Insee-Isae forecasts



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### Methodological note

This publication is jointly produced by the German Ifo institute, the French Insee institute and the Italian Isae institute. The forecasts are built up with the help of different forecasting tools shared by the three institutes, using time series models based on business surveys by national institutes, Eurostat and the European Commission.

A joint two-quarter-ahead forecast will be made on a quarterly basis for industrial production, GDP, consumption, investment and inflation for the euro-zone. The release of the forecast coincides with the quarterly national accounts second release by Eurostat.

More in-depth economic diagnoses for each country (Germany, France, Italy), can be found in:

- [Ifo Konjunkturprognose](#), Ifo
- [Conjoncture in France](#), Insee
- [Abridged Quarterly Report](#), Isae

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**Next release:**

**Next forecast horizon:**

**April 12, 2007 (day of Eurostat GDP second release)  
 2007 Q3**