

## Still in recession

*Euro-zone real GDP decreased sharply in Q4 2008, by -1.6%, after -0.3% in Q3. GDP is expected to contract strongly again in Q1 2009 (-1.9%), as well as in Q2 (-0.6%) and in Q3 (-0.2%) albeit more moderately assuming supportive public policies. Industrial production fell heavily in Q4 2008 (-5.3%) and should continue to decline over the forecast horizon, as implied by industrial business surveys. Private consumption is likely to diminish further: real income is expected to go down in the quarters ahead, and consumer surveys report low confidence over future economic conditions. The global economic recession, tighter credit-access and lower pressure on productive capacity will likely continue to undermine investment. Assuming the oil price at USD45/barrel (Brent) and an exchange rate fluctuating around USD1.35 per euro over the forecast horizon, euro-zone inflation is projected to decline to 0.6% in Q1 2009 (end-of-quarter, y-o-y) and to -0.2% in Q2 and Q3, benefiting from a positive base effect from lower food and energy prices. However, the euro-zone should not be near deflation since core inflation should remain clearly positive (around 1.5%).*

### Industrial production still declining

Euro-zone industrial production fell by about 5.3% in Q4 2008, reflecting the erosion of business confidence and sales expectations as well as the drop in domestic and foreign new orders.

The slowdown in global demand should continue to undermine euro-zone industrial activity in the quarters ahead. At the beginning of 2009, business climate indicators are still deteriorating and new orders diminishing, indicating that the recession in the industrial sector is deepening. Moreover, inventories are high despite the recent fall in production. Industrial production should decline further in the coming quarters (-7.0% in Q1 2009, -3.0% in Q2 and -2.0% in Q3).

### Further GDP contraction

In Q4 2008, euro-zone GDP contracted for the third consecutive quarter, by 1.6%, due to a fall in consumption, investment and net exports. Euro-zone members are with few exceptions experiencing their worst downturn in the last decades. Short-run indicators point to a worsening of economic activity in the coming quarters. However, the governments' fiscal packages and support policies should have the effect of progressively attenuating the strong contraction of economic activity, even though the scale of public intervention is heterogeneous across member countries.

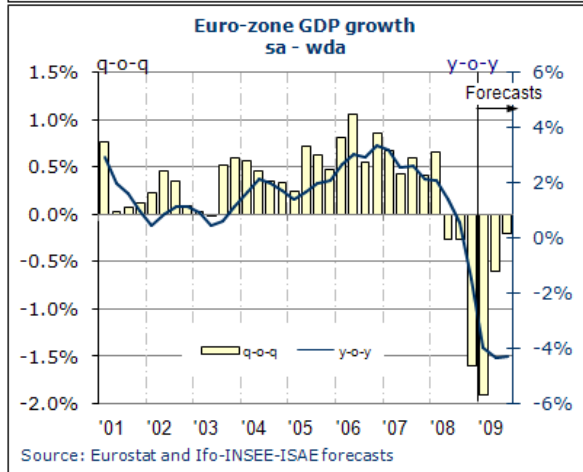
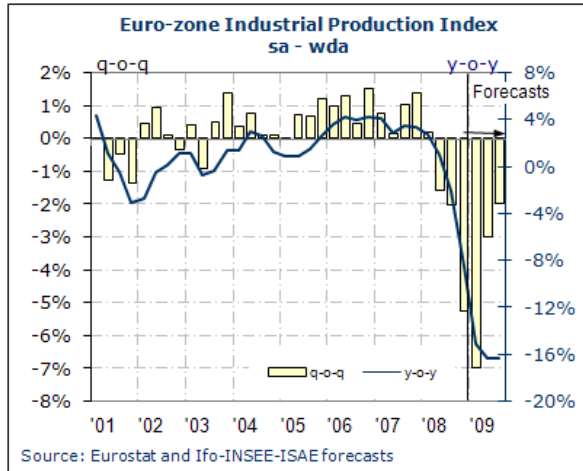
The situation on labour markets has further deteriorated due to the economic slump, as suggested by lower hiring prospects. At the same time, wage dynamics are likely to become negative. After a trend that was still positive in Q1 2009, thanks to the drop in inflation,

household purchasing power is expected to diminish in Q2 and Q3. Along with rising concerns over economic prospects, as displayed by consumer surveys, this fall in real income should weigh on household expenditure. Private consumption is expected to decline in Q1 2009 (-0.4%), then more moderately in Q2 (-0.2%) and Q3 (-0.1%).

Following intervention by the States and Central banks, the financial markets have improved but in a limited way. Risk aversion remains high and is not expected to weaken in the short-term. The resulting constraint on credit access, added to the drop in sales expectations and the low pressure on productive capacity are expected to foster a marked decline in equipment investment over the next three quarters. Similarly, construction investment should continue to suffer from the real-estate crisis. Consequently, investment is expected to fall (at rates of -5.0% in Q1 2009, followed by -3.0% in Q2 and -1.5% in Q3).

At the end of 2008, the clear contraction of activity and demand came along with the sharp drop in world trade in Q4 2008 (-6.3%, the biggest decline recorded over the last 40 years). The external demand of the euro-zone is expected to remain weak in the next three quarters, weighing on real GDP growth.

Accordingly, the euro-zone is likely to remain in recession during the first three quarters of 2009. Real GDP is expected to decrease sharply in Q1 2009 (-1.9%) then more moderately in Q2 (-0.6%) and in Q3 (-0.2%).

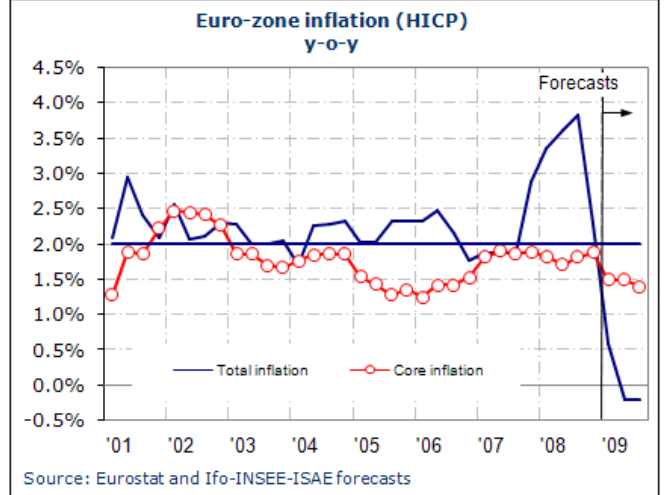


Core inflation should diminish as well, due to the past decline in oil prices, the impact of unemployment increases in the more labour-intensive service sector and lower pressure on productive capacity. However, the euro-zone should not be near deflation since core inflation should remain clearly positive. It should decrease to 1.5% in Q1 and Q2 2009 and to 1.4% in Q3, after 1.8% in Q4 2008 (end-of-quarter, y-o-y).

2009 forecasts, % changes, sa - wda

q-o-q	y-o-y	Q4 2008	Q1 2009 estimations	Q2 2009 forecasts	Q3 2009 forecasts	2008	2009 overhang
IPI	-5.3	-8.5	-7.0	-3.0	-2.0	-16.2	-15.6
GDP	-1.6	-1.5	-1.9	-0.6	-0.2	0.7	-3.8
Consumption	-0.3	-0.5	-0.4	-0.2	-0.1	0.3	-0.9
Investment	-4.0	-5.0	-5.0	-3.0	-1.5	-0.2	-11.7
Inflation*	2.3	2.3	0.6	-0.2	-0.2	3.2	0.4

Source: Eurostat and Ifo-INSEE-ISAE forecasts \* end-of-quarter  
Note: The IPI figures corresponds to the classification Nace Rév.1.1, base 2000 = 100



## Inflation declining

In Q1 (end-of-quarter, y-o-y), euro-zone inflation (HICP) should diminish strongly (+0.6%), due to the decline in oil prices since mid-July. Under the assumption of a Brent price of around USD45 over the forecast horizon and stable import prices of raw materials, euro-zone inflation should diminish further in June and September (-0.2%), benefiting from a positive base effect from lower food and energy prices.

## Methodological note

This quarterly publication is prepared jointly by the German Ifo institute, the French INSEE institute, and the Italian ISAE institute. The forecasts are produced with the help of tools shared by the three institutes, using time-series models based on business surveys by national institutes, Eurostat, and the European Commission.

Our joint two-quarter-ahead forecast covers euro-zone industrial production, GDP, consumption, investment, and inflation. Publication is timed to coincide with Eurostat's second release of quarterly national accounts.

Fuller economic analysis for each country (Germany, France, Italy) is available from:

- [Ifo Konjunkturprognose](#), Ifo
- [Conjoncture in France](#), INSEE
- [Abridged Quarterly Report](#), ISAE

### Contacts:

- Kai Carstensen +49 (0) 89 92 24 13 75
- Laure Turner +33 (0) 1 41 17 59 63
- Carmine Pappalardo +39 (0) 64 44 82 355

**Next release:**

**8 July 2009 (day of Eurostat GDP second release)**

**Next forecast horizon:**

**2009 Q4**