

## A fragile pick-up

Euro-zone GDP stabilized in Q2 (-0.2 %), in contrast with the fall recorded in Q1 (-2.5 %), owing to the world trade rebound in Q2 and to a rise in consumption in the wake of governments' fiscal packages and scrappage bonus schemes for cars. Euro-zone growth is expected to pick-up but to remain fragile at the forecast horizon (+0.4 % in Q3, +0.2% in Q4 and Q1 2010). Private consumption is expected to grow by +0.2 % in Q3 but to diminish in Q4 (-0.1 %) and stagnate in Q1 2010, as the labour market is still deteriorating, inflation is rising and the boost to income provided by the stimulus plans is likely to wane in Q4. Investment should diminish further but at a slowing pace: production capacities are largely under-used and credit conditions are likely to remain restrictive despite the normalization of the monetary and financial markets. On the assumption that the oil price stabilizes at USD 70 per barrel of Brent and that the dollar/euro exchange rate fluctuates around 1.46 over the forecast horizon, inflation should rise to 1.0% in December 2009 and March 2010.

### Industrial production is stabilizing

Industrial production has been declining at a lower pace since Q2 (-2.7 %), and increasing in the automobile sector (+2.2 %) owing to the scrappage bonus for cars implemented in many countries at the beginning of the year. It reflects improving business confidence and sales expectations as well as - to a lesser extent, domestic and foreign new orders, yet from low levels.

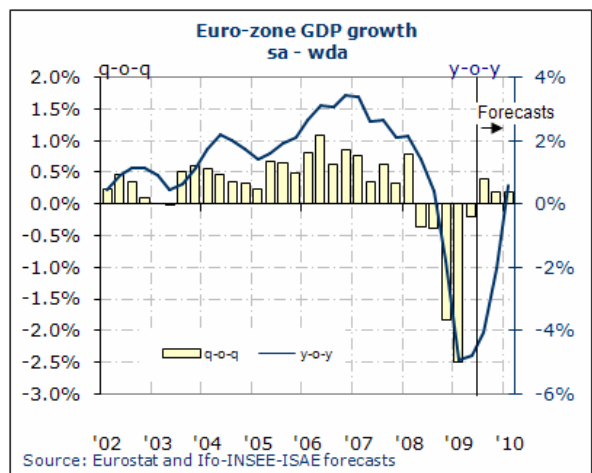
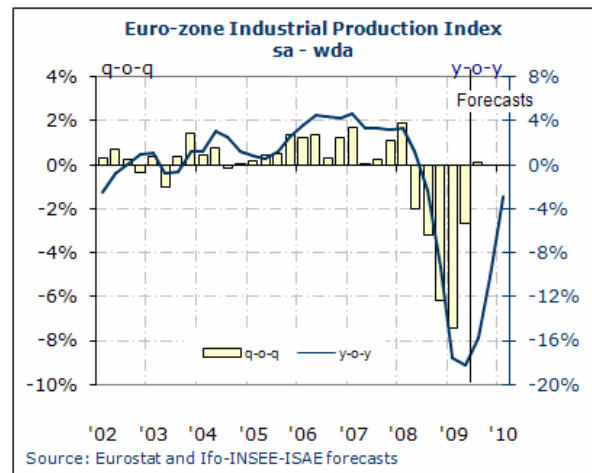
Industrial production is expected to stabilize in the coming quarters, with continued weakness of domestic demand still undermining euro-zone industrial activity in the quarters ahead. Accordingly, industrial production is expected to stagnate in the coming quarters (+0.1% in Q3 and 0.0% both in Q4 and Q1 2010).

### Activity is recovering on fragile grounds

Real GDP in the euro-zone contracted much less in Q2 (-0.2 %) than in Q1 (-2.5%). While investment kept declining, private consumption bounced back - owing to supportive fiscal packages and scrappage bonuses for cars. Foreign trade contributed positively to growth, as imports fell more strongly than exports.

Short-run indicators point to economic activity picking-up in the coming quarter. Public investments should support economic activity by the turn of the year, notably in the construction sector, even though the scale of public intervention varies across member countries.

Euro-zone employment has been affected by weaker GDP and should continue to contract over the next quarters, as suggested by deteriorating hiring prospects in business surveys.



Rising unemployment should lead to nominal wage moderation. As a consequence, household purchasing power is expected to decline further in the coming quarters, in a context of rising inflation. Private consumption would still benefit in Q3 from fiscal packages and sectorial policies, notably in Germany, but their effect is expected to wane in Q4. Moreover, the ending of the "cash-for-clunkers" scheme in Germany is likely to contribute to slow down consumption

in Q4 and Q1 2010. All in all, private consumption growth should moderate in the euro-zone (+0.2 % in Q3, -0.1 % in Q4 and +0.0 % in Q1 2010).

Although monetary conditions substantially eased during past months, credit constraints persist, adding to record low pressures on production capacity. Consequently, investment in equipment should remain depressed in the coming quarters. Construction investment is expected to recover slowly in the wake of the real-estate market normalization and the effect of the public spending programs. Total investment is therefore expected to only level off in the quarters ahead (-0.8 % in Q3, followed by -0.4 % in Q4 and +0.0 % in Q1 2010).

Overall, the euro-zone would emerge from recession, but the pace of the recovery would be losing momentum at the forecast horizon, due to the weakness of internal demand growth drivers. GDP growth would be of +0.4 % in Q3 and +0.2 % in Q4 and Q1 2010. The annual contraction in 2009 would amount to -4.1 %.

The sustainability of exports' recovery, the impact of public investment projects and its timing, and the calendar of corporate restocking are the main uncertainties surrounding this scenario.

## Inflation should be positive again in December

In Q3 (end-of-quarter, y-o-y), the euro-zone inflation (HICP) slightly decreased (-0.3 %). Under the hypothesis of a *Brent* price around \$70 and a dollar/euro exchange rate fluctuating around 1.46 over the forecast horizon, the euro-zone inflation would become positive

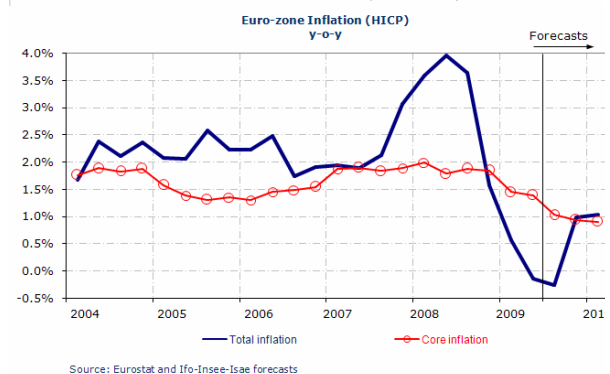
(+1.0 %) at the end of the year, owing to the rise in Brent price that was at \$40 in December 2008. The contribution of energy prices should become positive at the end of the year.

Core inflation is expected to slow down to 0.9 % in Q1 2010 but to remain clearly positive. The high level of unemployment expected in 2010 would moderate wage growth and affect the prices of services requiring an intensive labour force. Moreover, the decrease in producer prices of consumption goods in the first half of 2009 should continue to weigh on manufacturing prices up to March 2010.

2009/2010 forecasts, % changes, sa - wda

q-o-q y-o-y	Q2 - 2009	Q3 - 2009 estimations	Q4 - 2009 forecasts	Q1 - 2010 forecasts	2009 forecasts
IPI	-2.7 -18.2	0.1 -15.7	0.0 -10.1	0.0 -2.9	-16.1
GDP	-0.2 -4.8	0.4 -4.0	0.2 -2.0	0.2 0.6	-4.1
Consumption	0.1 -1.0	0.2 -0.8	-0.1 -0.4	0.0 0.1	-0.8
Investment	-1.5 -11.4	-0.8 -10.8	-0.4 -7.9	0.0 -2.7	-10.7
Inflation*	-0.1	-0.3	1.0	1.0	0.3

Source: Eurostat and Ifo-INSEE-ISAE forecasts, \* end-of-quarter



## 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 in:

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

### Contacts:

Kai Carstensen +49 (0) 89 92 24 1266  
 Laure Turner +33 (0) 1 41 17 59 63  
 Roberta De Santis +39 (0) 64 44 82 320

### Next release:

**January 7, 2010 (date of Eurostat's second release of quarterly national accounts)**

### Next forecast horizon:

**2010 Q2**