

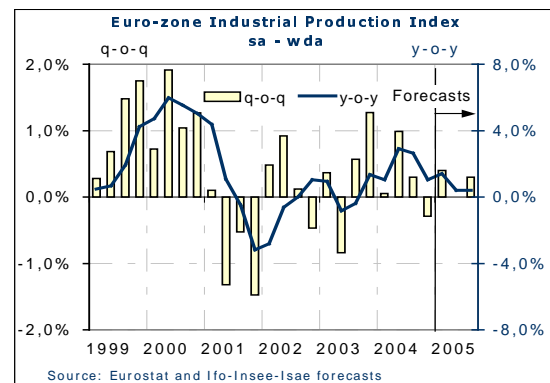
Subdued growth

After the weakening of H2 2004, the short-run prospects for euro-zone growth remain very moderate. Business survey results in France, Germany and Italy deteriorated at the beginning of the year, affected by the strong euro, the oil spikes and less buoyant global environment. Industrial production should experience a small rebound in Q1 2005 (0.4%), before remaining flat in Q2 and increasing modestly in Q3 (0.3%). Consumer expenditure is slow in responding to some positive impulses at work in the zone, as the personal income tax cuts adopted in some countries. Household expenditure is expected to rise by 0.4% in Q1, 0.3% in Q2 and 0.4% in Q3. A similar profile would characterise GDP (0.4% in Q1, 0.3% in Q2, 0.4% in Q3). On the assumptions that the dollar/euro exchange rate fluctuates within the range 1.30-1.34 and that the oil price eases from its current peaks and oscillates around \$47/barrel, inflation will probably be 2% in Q2 (the same as in Q1) and then ease slightly to 1.9% in Q3.

Weak industrial production

After the fall in Q4 2004 (-0.3%), caused by waning export support, industrial output could have rebounded in Q1 2005 (0.4%), mainly thanks to the German positive reading in January that sustains the average production of the quarter, despite the fall occurred in February in Germany and in France and the stagnation registered in the same month in Italy. The rise is likely to prove temporary, however, as the industrial climate remains downward-oriented, reflecting the appreciation of the euro, the oil price hikes and slightly less buoyant world demand. The Ifo-Insee-Isae business surveys took a turn for the worse at the beginning of the year, with the deterioration speeding up in February and March. On the basis of these indications, euro-zone industrial production is likely to experience a setback in the coming two quarters, staying basically flat in Q2 and rising only modestly in Q3 (0.3%).

continues to be sluggish, although with important cross-country differences. After the setback in the central quarters of 2004, consumption improved in Q4. Even keeping



2005 Forecasts, % changes, sa - wda

q-o-q y-o-y	Q4-2004	Q1 - 2005 estimates	Q2 - 2005 forecasts	Q3 - 2005 forecasts
IPI	-0,3 1,1	0,4 1,4	0,0 0,4	0,3 0,4
GDP	0,2 1,6	0,4 1,3	0,3 1,2	0,4 1,3
Consumption	0,6 1,4	0,4 1,1	0,3 1,4	0,4 1,7
Inflation	2,3	2,0	2,0	1,9

Source: Eurostat and Ifo-Insee-Isae forecasts

Sluggish GDP due to less external support and moderate domestic demand

Owing to the slowdown in exports and the fall in industrial production, GDP growth touched a new low (0.2%) in Q4 2004. Foreign demand for euro-zone goods and services is likely to slow down further in 2005, in view of the persistent strength of the exchange rate and some softening in the global environment. To offset this, there is still no convincing evidence of a significant recovery in domestic demand. Investment activity appeared to be in better shape in H2 2004 and may well have remained favourable in the early part of the current year. On the other hand, private consumption

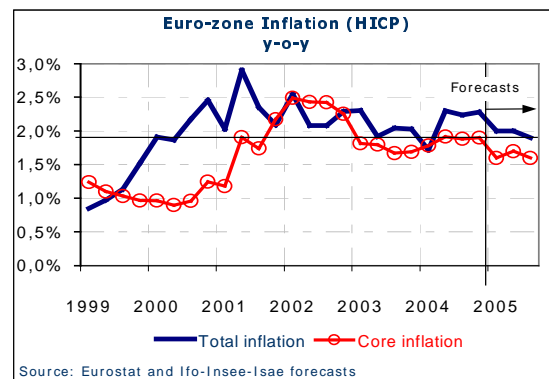
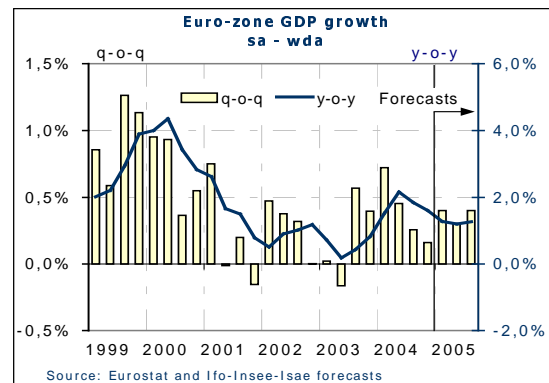
positive, household expenditure is expected to experience no further acceleration in the following three quarters of 2005. Worsening

confidence and the persistent weakness of the labour market are tending to restrain the favourable impulses coming from other factors, as the cuts in personal income tax adopted in some countries, the credit expansion to the household sector and the wealth effects induced by the housing market. Private consumption is expected to show rises of 0.4% in Q1, 0.3% in Q2 and 0.4% in Q3.

Under these demand conditions, euro-zone GDP should remain on a very moderate growth path during the first three quarters of the year, rising by 0.4% in Q1, 0.3% in Q2 and 0.4% in Q3.

Inflation would stabilise at 2% in Q2 and would ease to 1.9% in Q3

The external pressures on HICP inflation are expected to ease gradually. Oil price developments remain particularly uncertain. On the assumption of a decrease from the recent peaks of \$55/barrel, the Brent price could fluctuate around \$47/barrel in both Q2 and Q3 (compared with \$48 in Q1). Meanwhile, the dollar/euro exchange rate is assumed to fluctuate between 1.30 and 1.34. Inflation should remain stable at 2% (y-o-y) in both Q1 and Q2 and is expected to ease slightly below this level in the following quarter. This evolution would reflect, on the one hand, the impact on the consumer price index coming from the lagged and indirect effects of past oil hikes and, on the other hand, the benefits coming from the still high level of the euro exchange rate and the relatively weak domestic price pressures due to the low European growth. Core inflation should remain around 1.6% over the forecast horizon.



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 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: July 14, 2005 (day of Eurostat GDP second release)
Next forecast horizon: 2005 Q4