

Slogging through a weakening world economy

After displaying some resilience at the beginning of 2008, the euro zone is set to lose momentum gradually under the influence of a worsening international environment. Industrial production, after a rebound in Q1 (0.7%), will slow down in Q2 (0.5%) and Q3 (0.4%). Erosion of households purchasing power will moderate the pace of consumption growth (0.4% in Q1 and Q2, 0.3% in Q3), while business uncertainties and less conducive credit conditions will damp down investment in Q2 (0.5%) and Q3 (0.4%), following a still positive Q1 (0.7%). Overall, GDP is expected to slow down progressively in the coming quarters (0.5% in Q1, 0.4% in Q2, 0.3% in Q3). Provided that the oil price stabilizes within the range US\$ 97-100 per barrel of Brent and assuming a dollar/euro exchange rate around 1.50, inflation is estimated to decelerate slightly in Q2 (3.2%) and Q3 (3.1%).

Industrial production set to moderate

In Q1 2008, the industrial business surveys' downward tendency levelled out well above the long-term average. In Germany, the improvement in industrial confidence was driven by the recovery in order books, while in France it was supported by the enhancement in entrepreneurs' assessment of production outlook. The development of industrial activity is again diverging in Italy, eroding the gains observed during 2007.

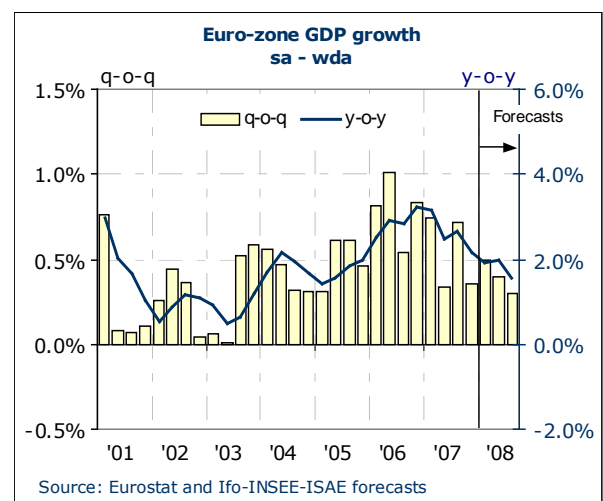
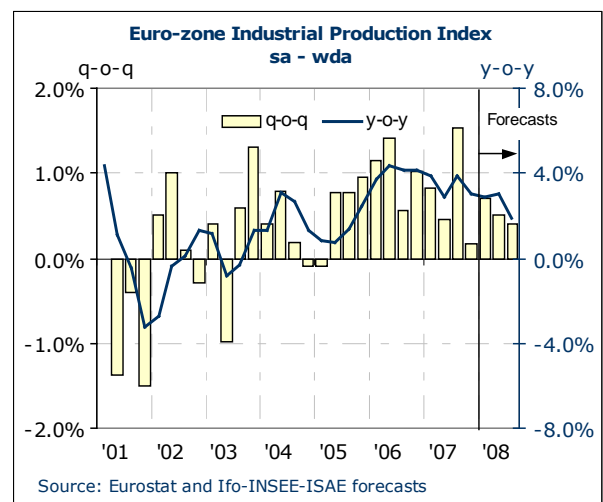
After a recovery at the beginning of 2008, industrial production growth is however expected to moderate in the coming quarters. The slowdown in world trade and the uncertainties concerning the duration of the financial turmoil should continue to affect entrepreneurs' confidence. Moreover, the slackening of orders from the United States would be only partially dampened by the East Asian demand for capital goods. Industrial production is forecast to grow by 0.7% in Q1, 0.5% in Q2 and 0.4% in Q3.

Decelerating GDP growth

Real GDP growth slowed down to 0.4% in Q4 2007, from 0.7% in Q3. Over the forecast horizon, we expect a slight further deceleration due to the losing momentum of domestic demand.

After the setback in Q4 2007 (-0.1%), growth in private consumption is expected to remain moderate in the coming quarters. Despite the positive performance of the labour market, purchasing power is being negatively affected by rising food and energy prices. Consumer confidence stabilized in the euro area at a low level and it currently stands below its long-term average. Overall, private consumption is

expected to grow by 0.4% in both Q1 and Q2 and by 0.3% in Q3 2008.



Recent figures are indicating that the investment growth cycle in the euro zone has

peaked. Firms' expenditure on capital goods is likely to be hindered by the persisting uncertainty stemming from the financial turbulence and less conducive credit conditions. The downturn in building permits in several euro-zone countries is signalling weaker support from the construction component. Investments are still expected to expand at a positive pace in Q1 (0.7%), supported by the demand for capital goods in Germany, and to weaken afterward (0.5% in Q2, 0.4% in Q3).

Overall, real GDP is forecast to grow by 0.5% in Q1 2008, followed by 0.4% in Q2 and 0.3% in Q3, when the appreciation of the euro will probably hamper the external competitiveness of European exports.

stable at around 1.8%, as no significant second-round effects are expected and the diffusion of past food and oil inflation would still remain low and gradual.

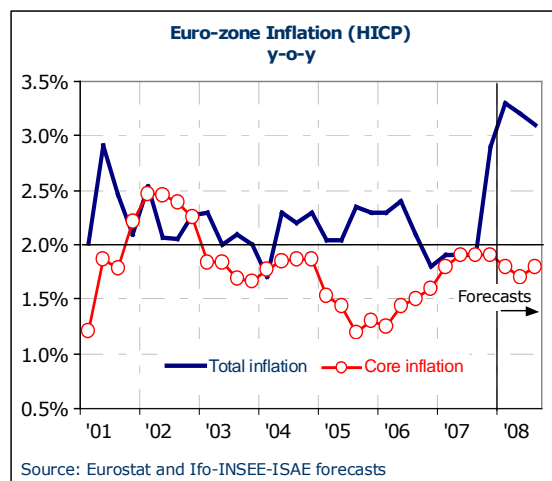
2008 Forecasts, % changes, sa - wda

q-o-q y-o-y	Q4-2007	Q1 - 2008 estimations	Q2 - 2008 forecasts	Q3 - 2008 forecasts
IPI	0.2 3.1	0.7 2.9	0.5 2.9	0.4 1.9
GDP	0.4 2.2	0.5 1.9	0.4 2.0	0.3 1.6
Consumption	-0.1 1.1	0.4 1.5	0.4 1.2	0.3 1.0
Investment	0.8 3.2	0.7 2.6	0.5 3.1	0.4 2.4
Inflation	2.9	3.3	3.2	3.1

Source: Eurostat and Ifo-INSEE-ISAE forecasts

Inflation slightly above 3%

The inflation rate in the euro zone accelerated from 2.9% in Q4 2007 to 3.3% on average in Q1 2008, which is likely to be the peak. The increase reflects the sharp rises in commodity prices and their direct impact on energy and food components of the HICP. Assuming that oil prices keep on hovering between US\$ 97-100 per barrel over the forecast horizon and the US\$/euro exchange rate stabilises around 1.50, inflation should slow down moderately in the coming quarters. The annual increase would decelerate to 3.2% in Q2 and 3.1% in Q3. This evolution would reflect the weakening of external pressures coming from the stabilisation of oil prices, strengthened by a positive baseline effect due to the upward trend observed in oil prices last spring, while food prices would continue to rise. Core inflation would remain



Source: Eurostat and Ifo-INSEE-ISAE forecasts

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

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Next release:

July 9, 2008 (date of Eurostat's second release of quarterly national accounts)

Next forecast horizon:

2008 Q4