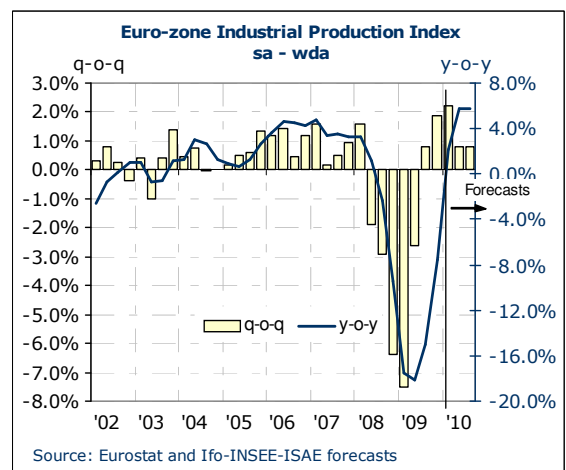


## Weak domestic demand undermines growth

*In the Euro-zone, real GDP was stable in Q4, after accelerating in Q3. Domestic demand barely grew, with consumption stagnating and investment contracting by 1.3%. Only net exports contributed positively to growth. Accordingly, the perspectives for the Euro Area remain modest. Real GDP is forecasted to rise by 0.2% in Q1 and by 0.3% and 0.2% in Q2 and Q3 respectively. Fading fiscal stimuli, still restrictive credit conditions, and labour market slack will hamper growth over the forecast horizon. After picking up to 2.2% in Q1 driven by external demand, IPI growth is expected to soften in Q2 and Q3 (0.8% in both quarters). Private consumption is likely to stagnate in Q1 and only slightly increase in Q2 and Q3. Investment is projected to diminish by 0.5% in Q1, due to bad weather conditions, and to rise by 0.3% in Q2 and 0.2% in Q3. Under the assumption that in the coming two quarters oil prices will stabilize around the Q1 level (77 dollar/barrel) and that the dollar/euro exchange rate will slightly depreciate from 1.39 in Q1 to 1.37 in Q3, external price pressures are likely to cause a moderate acceleration of inflation (1.6% at Q2-end).*

### Industrial production softens after Q1 rebound

Driven by external demand, industrial production picked up in the last quarter of 2009 as well as in January 2010. Although business surveys signal the continuation of a positive trend in the following months, a setback is expected after the surge in activity recorded in January due to some deceleration of world trade and the still weak domestic demand. The positive carry-over from the acceleration at the beginning of 2010 will anyway deliver a robust rebound in Q1, with an IPI increase of 2.2%. For subsequent quarters, we forecast a slowdown in manufacturing production: the growth rate of IPI will stabilize at 0.8% in both Q2 and Q3 2010.

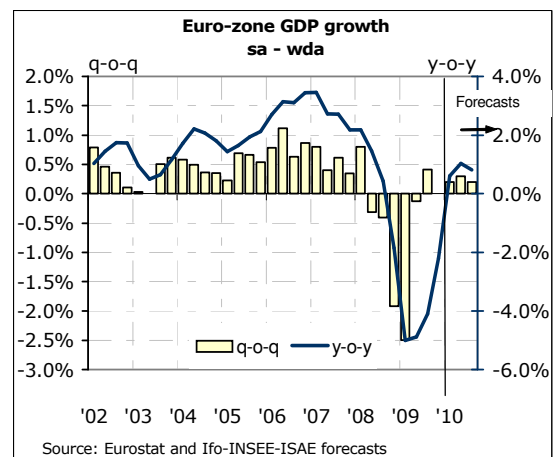


### Moderate pace in GDP growth

In the Euro-zone, real GDP was stable in Q4, after accelerating by 0.4% in Q3. Domestic demand barely grew, with consumption stagnating and investment contracting by 1.3%, while a positive contribution came from net exports.

Perspectives for private consumption remain modest. Slack labour market conditions will continue to weigh on households' disposable income, while the fading of fiscal measures will affect expenditures. Consumption is thus forecasted to stagnate in Q1 and marginally increase (0.1%) in Q2 and Q3.

Investment is likely to decrease further in Q1 (-0.5%), due to the negative impact on construction of unfavourable weather conditions in the Northern part of Europe. Postponement of projects that should have been realized in Q1



would cause a pick up in the construction sector in Q2. This trend could be offset by still moderate growth in equipment investment, hampered by low capacity utilisation and credit-market constraints. The growth rate of total investment is expected to come in at 0.3% in Q2 and 0.2% in Q3.

Facing persistently weak domestic demand, economic activity in the Euro-zone will be mainly boosted by external demand, which will however rise at a lower speed than in the last period. All in all, real GDP is forecasted to expand at rates of 0.2% in Q1, 0.3% in Q2, and 0.2% in Q3 2010.

A potential risk to this scenario is due to the deteriorated fiscal situation in several countries and a renewed instability in financial markets induced by the Greek crisis and fears of contagion spreading to other economies.

### Stable inflation over the forecast horizon

Euro-zone inflation rose in March to 1.5%, i.e. 0.6 p.p. higher than in February. The increase can be attributed, to a large extent, to energy price developments that have reflected the rise of oil prices during the last month. In the meantime, inflationary pressures from underlying components have remained subdued, due to weak consumer demand.

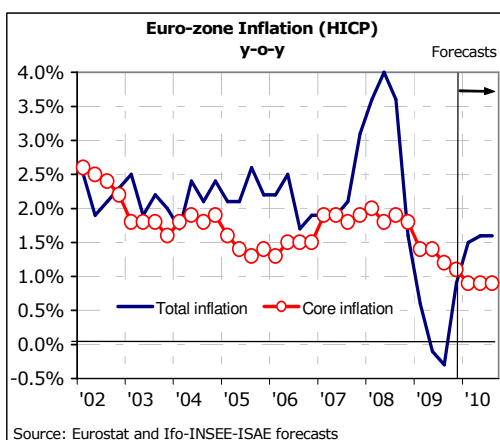
Under the assumption that oil prices will stabilize around the Q1 level (77 dollar/barrel) and that the dollar/euro exchange rate will depreciates slightly from 1.39 in Q1 to 1.37 over the next two quarters, external price pressures could cause a moderate acceleration of inflation, while domestic fundamentals should continue to weigh down on the price trend.

HICP inflation is expected to increase to 1.6% in June and in September; core inflation is projected to stay subdued over the forecast horizon, reflecting sluggish demand and unfavorable labor market conditions.

2010 Forecasts, % changes, sa - vda

q-o-q y-o-y	Q4-2009	Q1 - 2010 forecasts	Q2 - 2010 forecasts	Q3 - 2010 forecasts
IPI	1.9 -7.5	2.2 2.2	0.8 5.8	0.8 5.8
GDP	0.0 -2.2	0.2 0.5	0.3 0.9	0.2 0.7
Consumption	0.0 -0.6	0.0 -0.1	0.1 -0.1	0.1 0.2
Investment	-1.3 -8.8	-0.5 -4.3	0.3 -2.4	0.2 -1.3
Inflation	0.9	1.5	1.6	1.6

Source: Eurostat and Ifo-INSEE-ISAE forecasts



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

#### Contacts:

- Nikolay Hristov +49 (0) 89 92 24 1225
- Olivier Redoules +33 (0) 1 41 17 60 05
- Roberta De Santis +39 (0) 64 44 82 320

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

**Next forecast horizon:** 2010 Q4