

Ongoing recession

The Eurozone plummeted into recession in H2 2008. Short-run indicators point to a worsening outlook in the final part of the year. The trend should still be negative in H1 2009, hopefully at a more moderate pace if supportive policies adopted in the area start to have some effect. Industrial production, on a downward path since several months, should drop in Q4 (-2.3%) and fall again in Q1 and Q2 2009 (-1.3% and -0.7%). Despite the positive influence of lower inflation, consumption should diminish for a couple of quarters (-0.2% in Q4 2008 and -0.1% in Q1 2009) and stabilise in Q2 2009. Tighter credit and falling demand weigh on investment which could fall by -2.5% in Q4 2008, and by -1.6% and -1.2% in Q1 and Q2 2009. Overall, GDP should contract at the forecast horizon (-0.6% in Q4 2008, -0.4% in Q1 2009 and -0.2% in Q2 2009). On the assumption that the Brent price will fluctuate in the range US\$ 45-50 and the US\$/euro exchange rate will hover around 1.40, inflation should significantly ease, moving to 1.2% in March and 0.6% in June 2009.

Industrial production falls in Q4

Recent readings of business surveys depict a sharp decline in industrial activity. The eurozone manufacturing sector started Q4 on a deteriorating path (-1.2% in October) due to deep contractions in both France and Germany. In Italy, a more moderate drop actually followed the plunge posted in September.

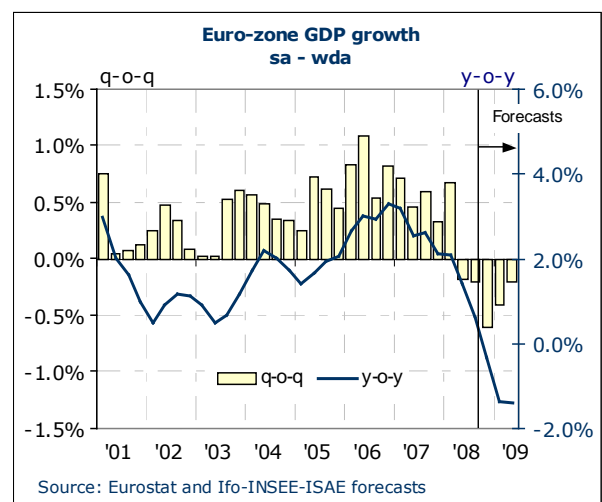
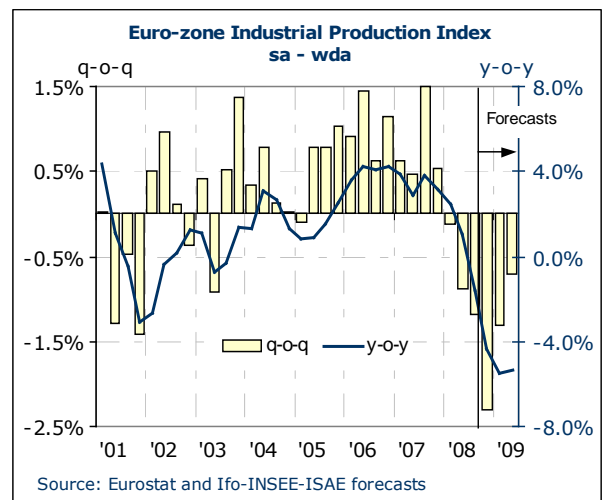
Business surveys signal production is going to remain negatively tilted in the short-run: the eurozone economic sentiment reached its record low. IP is expected to fall markedly in Q4 by 2.3% (-0.7% on average in 2008) and to decline further by -1.3% and -0.7% in Q1 and Q2 2009. Reduction of production is driven by rise in uncertainty and risk aversion, tighter credit conditions affecting domestic demand and lack of foreign demand.

Strong contraction of GDP at the turn of the year

In Q3, eurozone GDP contracted by 0.2% for the second consecutive quarter, due to a fall in investment and net exports. Short-run indicators point to a worsening of economic activity in the next quarters.

Following stagnation in Q3, household consumption is expected to decline at the turn of the year, despite positive support to purchasing power coming from lower inflation. A decline in overall investment is expected in the forecast horizon, with some moderation of the negative trend in 2009. Rising uncertainty about future economic conditions is likely to prompt households to increase savings. Deteriorating labour market developments, anticipated by the fall in entrepreneurs' hiring

intentions, should further weigh on household expenditure.



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Private consumption should decline by 0.2% in Q4, by 0.1% in Q1 2009 and is expected to stagnate in Q2 2009.

Tighter credit conditions, decreasing sales and a decline in capacity utilisation are leading firms to curb investment expenditure. Construction investment should keep decreasing following the real-estate slump in several eurozone countries.

Contraction in GDP is forecasted to be strong in Q4 (-0.6%). A more moderate fall could occur in subsequent quarters (-0.4% in Q1, -0.2% in Q2). The reduced deterioration expected for H1 2009 is related to the assumption that supportive public policies, adopted in the area as well as in the rest of the world, will help restore some confidence and bring markets back to more normal conditions. The degree of improvement is however still surrounded by uncertainties concerning the amount and the timing of the various governments' expenditure programs.

Inflation should decline significantly

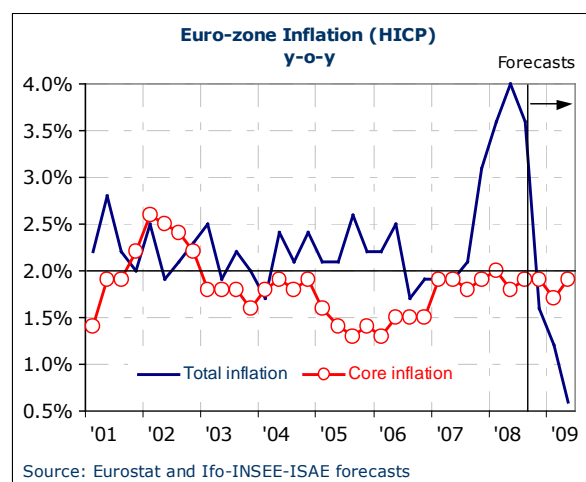
The strong fall in the oil price since July has led to a marked decline of headline inflation. In H2 2008 HICP decelerated sharply, moving from a peak of 4% in June-July to 1.6% in December. On the assumption that the Brent price will fluctuate between 45 and 50 USD and that the dollar/euro exchange rate will hover around 1.40, inflation is expected to fall significantly over the forecast horizon, declining to 1.2% in March 2009 and to 0.6% at the end of Q2. The main contribution to lower inflation should come from the fall in energy prices, reinforced by the favourable base effect related to last year's oil

price surge. Weak demand and labour market deterioration will begin to weigh on core inflation. The latter could fluctuate around 1.8%, close to H2 2008 values.

2009 Forecasts, % changes, sa - wda

q-o-q y-o-y	Q3-2008	Q4 - 2008 estimates	Q1 - 2009 forecasts	Q2 - 2009 forecasts	2008 estimations
IPI	-1.2 -1.6	-2.3 -4.5	-1.3 -5.6	-0.7 -5.4	-0.7
GDP	-0.2 0.6	-0.6 -0.3	-0.4 -1.4	-0.2 -1.4	1.0
Consumption	0.0 0.0	-0.2 -0.4	-0.1 -0.4	0.0 -0.3	0.3
Investment	-0.6 0.8	-2.5 -2.7	-1.6 -5.5	-1.2 -5.8	1.1
Inflation*	3.6	1.6	1.2	0.6	3.3

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



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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:

April 7, 2009 (date of Eurostat's second release of quarterly national accounts)

Next forecast horizon:

2009 Q3