

Economic prospects remain subdued

The euro-zone is still in recession. Real GDP dropped sharply in Q1 2009 by 2.5%, after a fall of 1.8% in Q4 2008. Economic prospects remain subdued, but the contraction of activity is likely to be less sharp in the coming quarters. Real GDP is forecasted to shrink by 0.6% in Q2 and by 0.4%, respectively, in Q3 and Q4. The fall of industrial production is likely to continue but at a progressively slowing pace: recent business surveys indicate slightly improving production growth expectations but the economic environment remains unsupportive. Private consumption is expected to fall by 0.6% in Q2, 0.4% in Q3 and 0.5% in Q4. While purchasing power could be stimulated by tax cuts associated with the massive fiscal packages, the deterioration of the labour market situation is dampening. Investment is expected to diminish further by 3.2% in Q2, 2.5% in Q3 and 1.4% in Q4. Firms' earning prospects are still depressed and credit conditions are likely to remain restrictive due to recession caused write-offs. On the assumption that the oil price stabilizes at USD 70 per barrel of Brent and that the dollar/euro exchange rate fluctuates around 1.40 over the forecast horizon, inflation should move to -0.1% in September and 1.0% in December.

The slide of industrial production should slow progressively

Industrial production in the euro-zone decreased strongly in Q1 2009 (-7.7%). The fall occurred in all large economies of the region – most notably in Germany – and reflected the massive slowdown of domestic and foreign demand, as announced by the deterioration of business surveys, as well as restrictive financial conditions

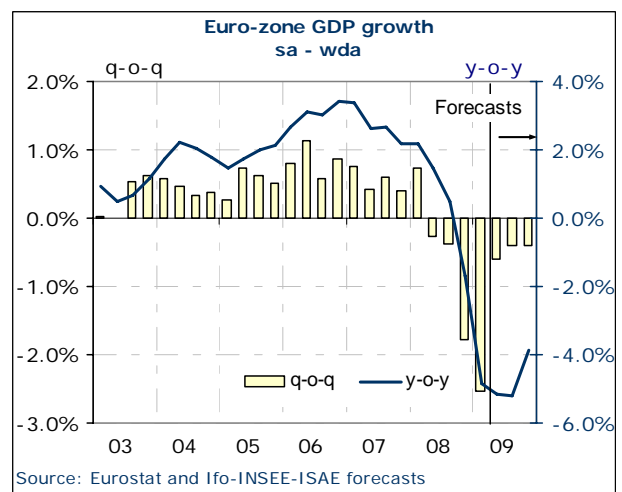
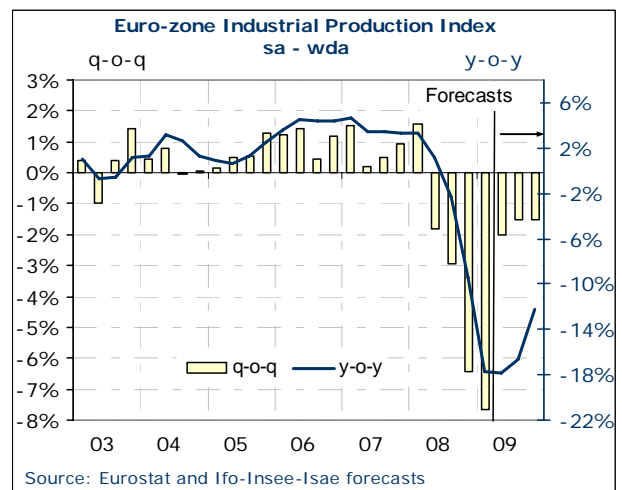
The fall of industrial production is expected to continue in the coming quarters, but at more moderate rates. Recent business surveys indicate a slight improvement of entrepreneurs' expectations, even if they are still expecting a decline in production. However, the current economic environment is still unsupportive. Industrial production is likely to decrease by 2% in Q2 and by 1.5%, respectively, in Q3 and Q4.

Weaker contraction of GDP

Real GDP in the euro-zone contracted sharply in Q1 2009 by 2.5%. While private consumption only fell modestly – thanks to the support of the "wreckage bonus" for cars in France or Germany – investment dropped again strongly. The contribution of net exports to growth was also negative. Although economic prospects remain depressed, the contraction of activity is likely to be less sharp than at the beginning of the year.

Private consumption is expected to diminish further in the coming quarters. The situation on the labour markets has severely deteriorated due to the economic slump, which weighs on disposable income. Moreover, consumer surveys still point to worries over future

economic conditions, especially a rising fear of becoming unemployed.



The deterioration in the job market could be tempered by a slight stimulus coming from tax cuts that have been implemented in combination with the fiscal packages. All in all, private consumption should contract at rates of -0.6% in Q2, -0.4% in Q3 and -0.5% in Q4.

The fall of investment is likely to continue in the coming quarters. Earning prospects of firms are still dampened and production capacity is largely under-utilized. Moreover, credit conditions set by banks should remain restrictive due to recession caused write-offs. Finally, construction investment still suffers from the ongoing slump in national real estate markets. Investment should fall by 3.2% in Q2, 2.5% in Q3 and 1.4% in Q4.

Overall, real GDP in the euro-zone is forecasted to shrink at rates of -0.6% in Q2 and -0.4%, respectively, in Q3 and Q4. The weaker decline in activity is due to the positive impact of the massive policy stimulus and an expected gradual stabilization of the world economy over the forecast horizon. Real GDP is estimated to decrease by 4.8%, on average, in 2009.

Inflation should be positive again in December

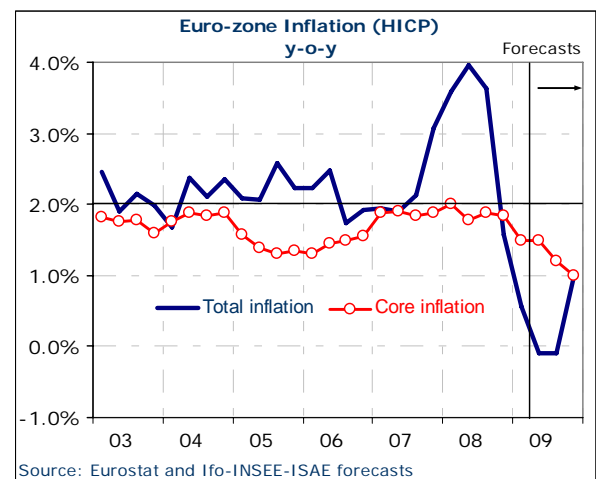
Euro-zone headline inflation continued to decelerate from 0.6% in March to -0.1% in June, which is the lowest rate since the introduction of the single currency. The decrease of inflation was triggered by the base effect of lower commodity prices than a year before, which had a direct impact on the energy and food components of the HICP. On the assumption that the Brent oil price will stabilize at 70 USD and that the dollar/euro exchange rate will hover around 1.40, headline inflation is

expected to remain at -0.1% in September and to increase to 1.0% in December. The rise of inflation at the end of the forecast horizon is due to the positive base effect arising from a higher oil price compared to the year-end 2008. Core inflation affected by weak demand and labour market deterioration is forecasted to decrease from 1.5% in June to 1.2% in September and 1.0% in December.

2009 Forecasts, % changes, sa - wda

q-o-q y-o-y	Q1-2009	Q2 - 2009 forecasts	Q3 - 2009 forecasts	Q4 - 2009 forecasts	2009 forecasts
IPI	-7.7 -17.7	-2.0 -17.8	-1.5 -16.6	-1.5 -12.2	-16.1
GDP	-2.5 -4.9	-0.6 -5.2	-0.4 -5.2	-0.4 -3.9	-4.8
Consumption	-0.5 -1.3	-0.6 -1.5	-0.4 -1.9	-0.5 -1.9	-1.7
Investment	-4.1 -10.2	-3.2 -11.9	-2.5 -13.2	-1.4 -10.7	-11.5
Inflation*	0.6	-0.1	-0.1	1.0	0.3

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



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:

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

Next forecast horizon:

2010 Q1