

increase, whose impact could range between -0.3 and -0.4 pp.

Following the leap in Q2, the outlook for investment is likely to remain supportive over the forecast horizon, although at a lower pace. Credit conditions remain favorable, despite the recent tightening of monetary policy which is moving from an expansionary to a neutral stance. Investment is expected to decelerate slightly with respect to H1, growing by 1.5% in Q3 and by 1% both in Q4 2006 and Q1 2007.

All in all, real GDP is expected to grow by 0.7% in Q3 and by 0.6% in the final quarter of the year, posting the annual growth rate at 2.7%. In Q1 2007, a temporary slowdown will occur (0.3%), mainly due to the German tax hike.

Inflation set to ease in Q4 2006 before rebounding strongly in Q1 2007

The recent large fall in oil prices together with a slight appreciation of the euro, has led to a sharp slowdown in HICP inflation, with the growth of consumer prices decreasing from 2.4% in Q2 to 2.2% in Q3.

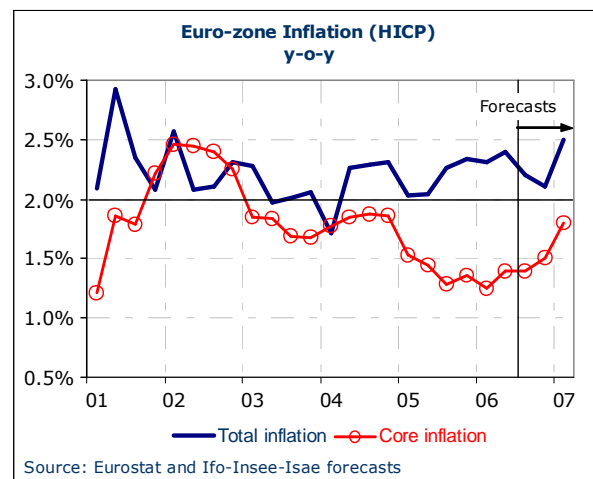
On the assumptions that oil price stabilises around 65\$/barrel and that the euro/dollar exchange continues to fluctuate between 1.27-1.30 within the forecast horizon, headline inflation is expected to decrease slightly to 2.1% in Q4 2006. The downward trend is bound to be temporarily interrupted at the beginning of next year due to the increase in the main German VAT rate, expected to raise the euro zone harmonized index by 0.3 percent. The HICP is likely to peak at 2.5% in Q1 2007.

The strengthening in domestic demand and the moderate pass-through from past energy and raw materials prices increases is set to be reflected in core inflation, edging up from 1.5% in Q3 to 1.6% in Q4 2006 and to 1.9% in Q1 2007 (but remaining stable net of the German VAT increase).

2006 Forecasts, % changes, sa - wda

q-o-q y-o-y	Q2-2006	Q3 - 2006 estimations	Q4 - 2006 forecasts	Q1 - 2007 forecasts	2006 forecasts
IPI	1.1 3.8	0.9 3.9	0.5 3.7	0.5 3.1	3.7
GDP	0.9 2.7	0.7 2.8	0.6 3.0	0.3 2.6	2.7
Consumption	0.3 1.7	0.4 1.5	0.5 1.9	0.0 1.2	1.7
Investment	2.1 4.8	1.5 5.1	1.0 5.7	1.0 5.7	4.8
Inflation	2.4	2.2	2.1	2.5	2.3

Source: Eurostat and Ifo-Insee-Isae forecasts



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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, investment 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:

Next forecast horizon:

**January 12, 2007 (day of Eurostat GDP second release)
 2007 Q2**