

Slowdown confirmed

Euro-zone real GDP expanded on a strong note in Q1 2008 after the disappointing performance in Q4 2007. However, the acceleration clearly overstated the underlying trend. Real GDP growth is forecast to slowdown considerably in the coming quarters, expanding at rates of 0.0% in Q2 and 0.3% in both Q3 and Q4. Industrial production is loosing momentum, thereby reflecting the continuous downward tendency of business surveys due to worsening expectations. Private consumption is expected to grow by 0.2% in Q2 and 0.3% in both Q3 and Q4. Real disposable income growth is likely to remain weak as increases in nominal wages are eroded by high inflation rates. Investment is expected to expand on a modest path, with rates of -0.3% in Q2, a correction of the sharp increase in Q1, and 0.3% in both Q3 and Q4. On the assumption that oil prices stabilize at USD 135 per barrel of Brent and that the dollar/euro exchange rate fluctuates around 1.57 over the forecast horizon, inflation should peak at 4.0% in Q3, before easing gradually to 3.5% in Q4.

Industrial production looses momentum

Industrial production in the euro zone increased in Q1 2008 by 0.6%, after 0.2% in Q4 2007. In Germany production grew markedly. Also in Italy the rise of production quickened, whereas France posted a more modest growth rate. Despite the good performance of industrial production at the beginning of the year, the downward tendency of business surveys observed in recent months has continued almost area-widely, reflecting expectations of a slowdown in the coming quarters.

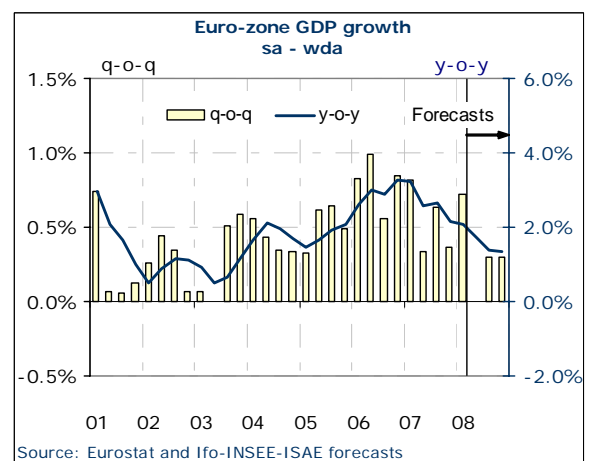
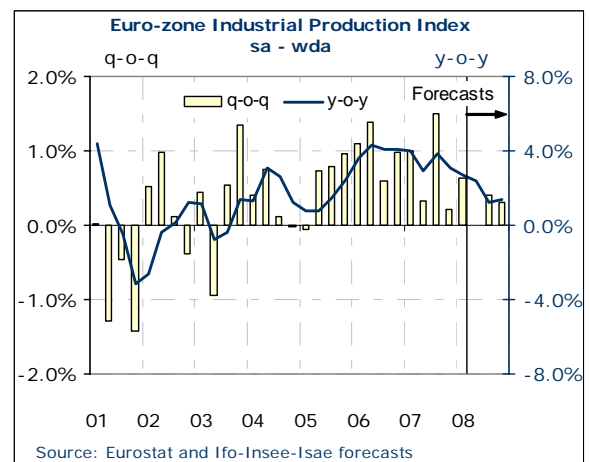
Industrial production is expected to decelerate over the year, stagnating in Q2 in response to the strong increase in Q1, and expanding at 0.4% in Q3 and 0.3% in Q4. The slack expansion of production is attributed to the unsupportive economic environment associated with a slowdown in domestic and foreign demand, less convenient financial conditions, high energy prices and the unfavourable dollar/euro exchange rate.

Darkening growth prospects

Euro-zone real GDP picked up in Q1 2008 rising by 0.7%, after a disappointing 0.4% in Q4 2007. The expansion was mainly driven by economic growth in Germany that was exceptionally high. Economic growth in France and Italy was also stronger than in Q4, even if more moderate than in Germany, while in Spain it was markedly poor.

Private consumption expanded modestly in Q1, mainly hampered by weak real disposable income growth. A recovery of consumption in the coming quarters is unlikely to arise. Although, the situation on the labour market remains favourable, the decline of unemployment is loosing momentum. Furthermore, the gains from slightly accelerating nominal wages

are swept off by high inflation rates. Finally, consumer confidence has deteriorated area-widely reflecting the worsening of households' concerns. Private consumption is therefore expected to expand by a modest 0.2% in Q2 and 0.3% in both Q3 and Q4.



Investment accelerated in Q1 2008, rising by a brisk 1.6%. The shift of investment in Germany was - also due to seasonal effects - surprisingly sharp, while investment growth somewhat softened in France and Italy. The expansion of investment is likely to moderate considerably in the coming quarters as the demand outlook becomes dimmer, pressures on productive capacity are easing and external financing conditions are deteriorating. Moreover, the construction component of investment is depressed by the real-estate downturn observed in an increasing number of euro-zone countries. Investment is expected to decline by 0.3% in Q2 – a correction of the sharp rise in Q1 – followed by a modest rise of 0.3% in both Q3 and Q4.

Overall real GDP in the euro zone is forecast to stagnate in Q2, and to grow by no more than 0.3% in Q3 and Q4, respectively. The contribution to growth stemming from domestic demand slacks off substantially, while that of net exports is expected to turn out negative in the light of a gradual slowdown of world economic expansion.

Inflation continues to rise

Euro-zone headline inflation continued to accelerate from 3.4% in Q1 to 3.6% in Q2, which is the highest rate since the introduction of the single currency. The increase reflects the sharp rises in commodity prices and their direct impact on energy and food components of the HICP. Under the assumption that the oil price will stabilize at 135 USD per barrel of Brent and that the dollar/euro exchange rate will fluctuate around 1.57 over the forecast horizon, inflation is expected to reach a peak in Q3 (4.0%), before it gradually lowers to 3.5% in Q4 due to

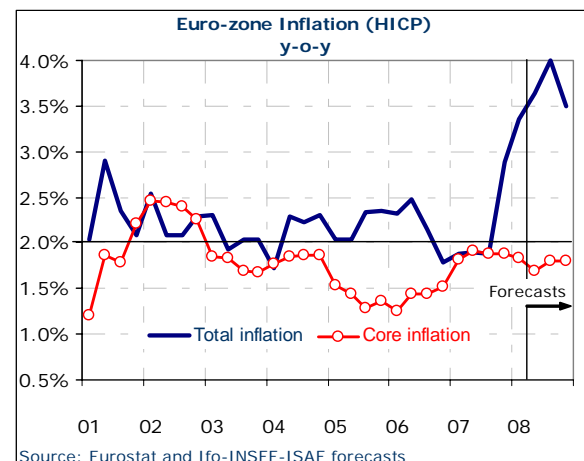
a favourable base effect. Average HICP inflation should be 3.6% in 2008, and thus well above the ECB's 2% reference value for price stability.

Core inflation is expected to increase slightly in H2 to 1.8%, from 1.7% in Q2. This forecast is based on the assumption that second-round effects on wages will not materialise, but that there will be some indirect pass-through on core prices, which, however, will be partially offset by a demand slowdown and a delayed effect of the euro exchange rate appreciation.

2008 Forecasts, % changes, sa - wda

q-o-q y-o-y	Q1-2008	Q2 - 2008 estimations	Q3 - 2008 forecasts	Q4 - 2008 forecasts	2008 forecasts
IPI	0.6 2.7	0.0 2.4	0.4 1.3	0.3 1.4	1.9
GDP	0.7 2.1	0.0 1.7	0.3 1.4	0.3 1.3	1.6
Consumption	0.2 1.2	0.2 0.8	0.3 0.6	0.3 1.0	0.9
Investment	1.6 3.5	-0.3 3.1	0.3 2.7	0.3 1.9	2.8
Inflation	3.4	3.6	4.0	3.5	3.6

Source: Eurostat and Ifo-INSEE-ISAE forecasts



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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

Contacts:

Kai Carstensen +49 (0) 89 92 24 1266
Benoît Ourliac +33 (0) 1 41 17 59 63
Carmine Pappalardo +39 (0) 64 44 82 355

Next release:

Next forecast horizon:

October 8, 2008 (day of Eurostat GDP second release)
2009 Q1