

January 8th, 2019

Eurozone growth dampened

- Economic growth is forecast to moderate over the forecast horizon (+0.3% for each quarter) with domestic demand expected to be the main driver even if with a decelerating path.
- Annual headline inflation is expected to be around the ECB target of 2% in the last quarter of 2018 (year over year) and then to decline again in the following quarters.
- The risks are still balanced but they are moving to the downside due to uncertainties related to economic and political factors.

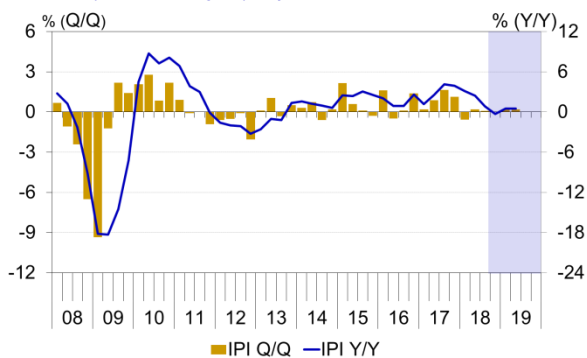
Global economy is losing momentum

In Q3 the economic performance of the main advanced and emerging economies was disappointing. US GDP growth slowed marginally with respect to the previous quarter but remained above its potential. The emerging market deceleration was accompanied by a generalized tightening in financial conditions suggesting that the slowdown may continue. According to the OECD latest outlook, global GDP growth is losing momentum. The Central Planning Bureau data showed that in the first three quarters of 2018 international merchandise trade in volume was less dynamic than in the previous year.

GDP evolves at a moderate pace

Euro area GDP increased by 0.2% q-o-q in Q3 2018 (+0.4 in Q2) recording the lowest growth rate since the second quarter of 2014. The deceleration was mainly due to temporary production cuts in the German car industry that weighted on the Euro area external balance contribution to growth (-0.3 p.p.). Among the largest member states, Germany and Italy displayed a negative growth rate (respectively -0.2% and -0.1% q-o-q) while France's growth rebounded and Spain's expansion carried on at a steady pace.

FIGURE 1 | Eurozone Industrial Production Index
Seasonally and working day adjusted

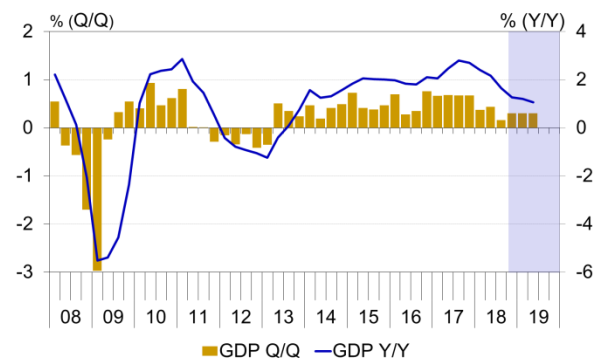


Source: Eurostat and Ifo-Istat-KOF Forecasts

The deceleration has continued as suggested by the economic sentiment indicator (ESI) which is on a slowing trend starting from the end of 2017 (broadly stable in November). While consumer confidence decreased significantly, the sentiment remained stable in all sectors but increased slightly in the manufacturing sector reflecting managers' more optimistic production expectations. On the contrary, their assessment of export order books weakened.

Industrial production increased by +0.1% in Q3 compared to the previous quarter and by +0.2% in October (m-o-m) with the production of capital goods registering the highest growth rate (+1.0% in October m-o-m). Industrial production is expected to remain stable in Q4 then picking up in the first part of 2019 (+0.2% for both Q1 and Q2 2019).

FIGURE 2 | Eurozone GDP Growth
Seasonally and working day adjusted



Source: Eurostat and Ifo-Istat-KOF Forecasts

Over the forecast horizon, the Euro Area economy is expected to pick up slightly resulting in a steady expansion of GDP by +0.3% in each quarter.

In Q3, the number of persons employed increased by 0.2% in the euro area registering the highest levels of employment ever recorded. In October, the unemployment rate remained stable at 8.1% compared to September. The favorable labor market conditions together with the wage increase both

support a rebound of consumption in the next quarter. Private consumption expenditures are expected to increase by +0.3% in Q4 before picking up to +0.4% in the following two quarters.

Despite the slight decrease registered in Q4 2018 the current level of capacity utilization in the manufacturing industry remains high indicating that investments will recover from the previous weak development (+0.2% in Q3). Gross fixed capital formation is projected to increase in Q4 by +0.5% and then slightly decelerate in Q1 and Q2 2019 (+0.4%).

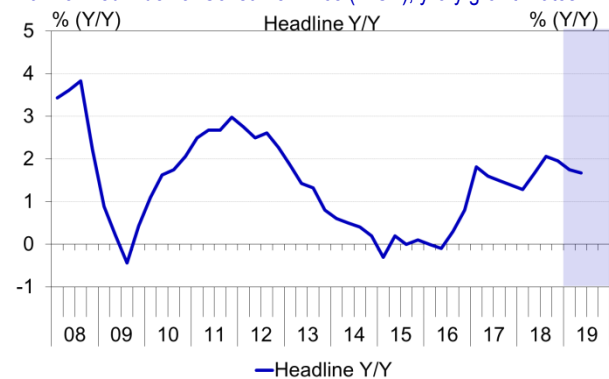
Energy prices drive inflation

The ECB decided to keep the policy interest rates unchanged and expects them to remain at their present levels. It also, as announced, ended net purchases under the asset purchase programme (APP) in December 2018. The decision has been already discounted by the markets and it is expected to not display major effects on inflation in the next months. In addition, the recent oil price fall is expected to give a negative contribution to overall prices. According to Eurostat's flash estimate, the euro area HICP index fell to 1.6% in December and on average for the fourth quarter stood at 2.0%. In the coming months a deceleration is expected (+1.9% and +1.8% respectively in the first and second quarter of 2019) as the base effects from past energy price increases start to fade. The inflation forecast is based on the technical assumption that the Brent oil price remains

stable at 57 USD per barrel and that the exchange euro/dollar exchange rate stays at 1.15 over the forecast horizon.

FIGURE 3 | Eurozone Inflation

Harmonized Index of Consumer Price (HICP), y-o-y growth rates



Source: Eurostat and Ifo-Istat-KOF Forecasts

Risks moving to the downside

The risks surrounding the Eurozone outlook are moving to the downside. Uncertainties related to political factors (i.e. Brexit), "trade wars", vulnerabilities in emerging markets and financial market volatility threaten economic and financial prospects for 2019. Moreover, the impact of the monetary policy normalization proceeding in US on the World economy is still difficult to assess

Table 1 | Forecast Overview

	2018	Q4 18		Q1 19		Q2 19	
		q/q	y/y	q/q	y/y	q/q	y/y
Industrial Production	1.5	0.0	-0.2	0.2	0.5	0.2	0.5
Gross Domestic Product	1.9	0.3	1.3	0.3	1.2	0.3	1.1
Private Consumption Expenditures	1.3	0.3	1.1	0.4	0.9	0.4	1.1
Gross Fixed Capital Formation	3.0	0.5	2.3	0.4	2.6	0.4	1.5
Headline Inflation	1.8	0.5	2.0	-0.2	1.9	1.3	1.8

Change in % seasonal and working day adjusted

Source: ifo-Istat-KOF Forecasts

Methodological note

This quarterly publication is prepared jointly by the German ifo Institute, the KOF Swiss Economic Institute, and the Italian Statistical Institute Istat. The forecast results are based on consensus estimates building on common macroeconomic forecast methods by the three institutes. They are based on time-series models using auxiliary indicators from business surveys by national institutes, Eurostat, and the European Commission. The joint three-quarter forecast covers Eurozone industrial production, GDP, consumption, investment, and inflation. Further country-specific and global economic analysis is available by:

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