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Directorate-General for Economic and Financial Affairs

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European Economic Forecast

Autumn 2010

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EDITORIAL

The economic recovery in the European Union and the euro area is making progress. We see a welcome broadening of the basis for the recovery, with domestic demand coming to the fore, and the recovery increasingly becoming self-sustained. However, the growth spurt seen in particular in the second quarter of this year was exceptional and not likely to last. The overall pace of the recovery remains gradual and rather uneven across Member States.

The shock of the global crisis still casts its shadow over the EU economy. As argued last year, it will take time therefore for our economies to work through the inevitable financial and economic adjustment, thus muting the prospects for employment, consumption and investment over the forecast horizon. However, the challenges and pace of adjustment differ across Member States. The German economy is leading the recovery. At the same time, growth is expected to remain subdued in those Member States where formidable adjustment challenges remain due to domestic macroeconomic and structural imbalances accumulated prior to the crisis.

The level of uncertainty for our outlook continues to be very high. In particular, the risks to the global economic environment seem tilted to the downside. As the autumn 2010 European Economic Forecast (EEF) document is going to print, tensions in euro-area sovereign debt markets have re-emerged. Indeed, a replay of the negative feedback loop between rising sovereign risk premia, banks' ability to lend and economic growth prospects cannot be excluded. It goes without saying that such a scenario, if it was to materialise, would throw a spanner in the wheels of the recovery. But is it likely? We do not think so. First of all, in contrast to the situation at the beginning of the year, with the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF) we now have the instruments in place to take emergency measures should they become necessary. The recent decision to provide financial assistance to Ireland in the context of an EU-IMF programme shows that the Union can move swiftly when risks for financial stability in the EU and the euro area set in. Second, the health of the European banking sector in autumn 2010 has recovered compared to a year ago. The capital ratios of banks have improved, money markets are showing signs of normalisation, and lending to the private sector has started to pick up. Third, important measures have been taken in Member States perceived as vulnerable to correct fiscal imbalances, foster economic adjustment and so improve the prospects for growth. And finally, the European economy is now more solidly on the path of recovery than was the case in Spring.

Our autumn forecast highlights the importance of making progress on a four-point policy programme to achieve fiscal sustainability, financial sector repair and higher potential growth. First, determined implementation of fiscal adjustment is needed to put public finances back on sustainable footing. The thematic chapter on fiscal consolidation contained in this autumn's EEF shows that consolidation strategies can be designed as to minimise the inevitable short-term costs and maximise the longer-run gains on growth. Second, the banking sector needs further attention to strengthen its resilience to shocks where necessary and to ensure it is viable to meet increased credit demands and perform its allocation functions. Third, structural reform should be pursued with vigour to foster economic adjustment, revitalise economic growth in Europe and thereby help achieving fiscal consolidation. This is the focus of the second thematic chapter in this autumn forecast. And, finally, the international community, including in particular the G20, must keep the cooperative process of multilateral policy coordination towards strong, balanced and sustainable global growth on track and protectionist tendencies contained.



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OVERVIEW

Recovery gathered pace and broadened out in the first half of 2010...

The economic recovery in the EU, while still fragile and uneven across Member States, is proceeding at a somewhat faster pace than anticipated in the spring. Real GDP has surprised on the upside so far this year and particularly in the second quarter, when it picked up by an exceptional 1% (quarter-on-quarter) in both the EU and the euro area. This strong performance stemmed in large part from the ongoing export-driven industrial rebound, in line with the continued strong dynamics of global growth and trade in the first half of the year, most notably in emerging markets. Encouragingly, a revival in domestic demand, including private consumption and investment, also became evident, particularly in Germany. The spillover of some of this momentum into the second half of the year implies a significant upward revision to annual growth in 2010 compared to the spring forecast.

...but is expected to moderate as the global economy goes through a temporary soft patch and fiscal consolidation starts in the EU...

Looking ahead, the pace of GDP growth in the EU is set to moderate into mid-2011, as the global economy goes through a temporary soft patch, dampening EU export growth. The pace of economic activity eased already in the third quarter, reflecting also the fading of the temporary factors that kick-started the recovery, such as the exceptional stimulus measures and the positive impulse from inventory adjustments that were particularly important in shaping short-run dynamics in the EU and globally in recent quarters. Another factor that is set to weigh on growth prospects in the short to medium term is the fiscal consolidation phase that many Member States are embarking on to put the fiscal situation onto a sustainable footing.

...while financial markets gradually recover and provide support there is ...

On the side of financial markets, conditions in several segments have recovered somewhat from the acute tensions experienced last May. In particular, following decisive policy action, including the creation of the European Financial Stabilisation Mechanism and the European Financial Stability Facility, and continued support provided by the monetary policy authorities stress in sovereign-bond markets has generally eased, though some tensions have reappeared lately. For the banking sector, the publication of EU-wide stress tests showed that the system as a whole is resilient, despite some pockets of vulnerability. Moreover, lending activity to the private sector appears to have turned positive in line with past patterns. As the economic recovery gains firmer ground and concerns about fiscal sustainability are addressed, financial-market conditions should continue to gradually improve and provide support to the recovery. Yet, with balance-sheet adjustments remaining incomplete in several sectors/countries and lingering concerns about developments in certain market segments, the situation remains generally tenuous and uncertainty is rife.

... sluggish (post-crisis) recovery ahead, as the EU grapples with legacy headwinds.

Notwithstanding the strong performance earlier this year, the EU recovery so far is more muted than the average of previous upturns. This is in line with the pattern that has in the past characterised recoveries following financial crises. As argued since last autumn, the EU faces significant legacy headwinds that are set to restrain domestic demand while the economy transits to a new steady state in the coming years. These include the downsizing of construction sectors, which is still ongoing in a number of Member States; the increase in unemployment, which following financial crises tends to be accompanied by higher structural unemployment; the surge in government deficits and debt, which, as seen recently, can threaten overall

financial stability; and the adverse impact of the financial crisis on potential output, which is estimated to remain well below pre-crisis levels over the forecast horizon. The two thematic chapters in this autumn forecast document provide a timely treatment of the latter two issues, with an assessment of the likely impact of fiscal consolidation on economic growth and an examination of how to restore the EU's growth potential. In keeping with the renewed emphasis on these two issues (e.g. via the Europe 2020 strategy), the chapters also consider how fiscal adjustment and structural reforms can be used to underpin the sustainability of public finances and spur a more dynamic EU economy beyond the forecast horizon..

A broadening out of the recovery is materialising earlier than envisaged in the spring...

In terms of demand components, a broadening out of the recovery appears to be taking hold somewhat earlier than envisaged in the spring. The ongoing strength of export growth has brought forward the rebound of equipment investment, which is set to return to positive growth this year. The brighter prospects for equipment investment also reflect improved corporate profits and higher capacity utilisation rates. As for private consumption, the gradual strengthening has also been advanced, with a modest pick-up envisaged for this year. Further ahead, slowly improving labour markets, moderate income growth, subdued inflation and lower saving rates should underpin the gradual recovery of private consumption. However, the still ongoing deleveraging process in the corporate and household sectors, heightened risk aversion and the impact of fiscal consolidation are set to weigh on capital and consumer spending in the short term.

...leading to GDP growth of about 1¼% in 2010, somewhat lower in 2011 and about 2% in 2012

With private domestic demand gradually strengthening, the recovery is set to become increasingly self-sustaining over the forecast horizon. Overall, EU GDP growth is expected to remain rather subdued over the next three quarters, and to regain ground from the second half of 2011, when external demand growth also picks-up, to reach a pace of some ½% quarter-on-quarter in 2012. Taking into account the significant upward revision to this year's growth and the above mentioned developments, annual GDP growth should ease somewhat next year, from about 1¾% in 2010 in both the EU and the euro area to about 1½% in the euro area and more marginally in the EU, before recovering to some 2% in 2012. This implies that the EU economy starts this year to slowly close the sizeable output gap that opened up during the recession.

Increasing differences across EU countries, particularly between core and periphery...

The aggregate picture masks marked differences in developments across Member States. Some countries, in particular Germany, but also some smaller export-oriented economies have registered a solid rebound in activity, while others, notably some peripheral countries are lagging behind. Factors explaining the divergences include trade orientation, the product mix of exportables, degree of openness, exposure to the financial-sector disturbances and the existence of sizeable internal and/or external imbalances. Looking forward, the expectation remains for a differentiated pace of recovery within the EU, reflecting the challenges individual economies face and the policies they pursue. Lingering concerns about fiscal sustainability, especially in some euro-area Member States that remain under intense market scrutiny and differences in competitiveness positions appear among the most important challenges in this regard.

...reflecting heterogeneity in individual challenges

Among the largest economies, the upturn is set to be notably strong in Germany, where economic activity is expected to expand by 3.7% this year, more than double that of the euro area. Meanwhile France is just below the area average, Italy ½ pp. lower, and Spain is projected to remain in recession.

Outside the euro area, the very strong German performance is nearly matched by Poland, the only EU economy to have escaped a recession last year, while the recovery in the United Kingdom is expected to match only the moderate EU average. Among the smaller economies, the rebound is particularly pronounced for Slovakia (4.1%) and Sweden (4.8%), the latter two posting the highest growth rates in the EU. In contrast, GDP is projected to contract in Greece, Latvia, Romania, and mildly in Bulgaria and Ireland. By 2011, all EU countries, with the exception of Greece and Portugal, are expected to be out of recession. With the strong momentum in Germany pulling other countries, and a general gradual strengthening of domestic demand, GDP growth will tend to firm up in the course of 2011 and 2012 for most Member States.

Labour market conditions are stabilising, albeit with high unemployment levels prevailing,...

Labour-market conditions have started to stabilise in recent months. The second quarter of 2010 saw job losses come to an end in the EU, while employment remained stable in the euro area (at 0% q-o-q). Similarly, the unemployment rate has more or less held steady since the spring, at 9.6% in the EU and at around 10% in the euro area. The situation is, however, highly differentiated across countries, with the rate of unemployment ranging from 4-5% in the Netherlands and Austria to some 17-20% in Spain and the Baltics.

...and the outlook is for a gradual improvement though with a rather jobless recovery

Looking ahead and taking into account the usual lag between output and employment growth, the outlook is for a gradual improvement in labour markets over the forecast horizon. Employment is now projected to contract by around ½% in the EU and ¾% in the euro area in 2010, some ¼ pp. less than envisaged in the spring, with modest growth expected thereafter in both regions. The outlook for unemployment is brighter than in the spring, also owing to the resilience shown in some Member States, with declines of some ½ pp. expected over the forecast horizon in both regions. However, despite brightening since the spring, the outlook remains for a rather jobless recovery and (potentially persistent) high unemployment ahead at the aggregate level.

Economic slack keeps inflation in check

Consumer-price inflation has been on a moderate upward path so far this year, on the back of upward food and energy base effects, increasing global commodity prices and firming core inflation. Sizeable slack in the economy is nevertheless expected to keep both wage growth and inflation in check, partly offsetting expected increases in energy and commodity prices. HICP inflation is projected to average 2% in the EU both this year and next, before easing to about 1¾% in 2012, and in the euro area to rise from 1½% this year to 1¾% in 2011-12.

Public deficits start adjusting...

After having been severely hit by the crisis, albeit to different degrees across countries, public finances are starting to adjust. About half of EU Member States are expected to post lower general government deficits this year than in 2009. On account of stronger growth, the end of the temporary stimulus measures and the additional consolidation efforts announced since the spring, the general government deficit in the EU (excluding Ireland where a one-off operation led to a deficit of some 32%) is expected to fall from about 6½% of GDP this year to around 5% in 2011 and 4¼% in 2012, with a broadly similar pattern but at a somewhat lower level for the euro area. The adjustment seems to be mainly expenditure-based in both regions.

... while debt remains on an upward path

The debt ratio, in contrast, remains on an increasing path over the forecast horizon, reaching some 83% of GDP in the EU and 88% in the euro area by 2012. If not corrected in the years to come, the current trends in public debt

may jeopardise long-term fiscal sustainability given the combination of sustained large deficits, low(er) potential growth than in the past and, in the not too distant future, unfavourable demographic developments.

Continued high uncertainty...

Amid continued high uncertainty, the present outlook is faced with elevated risks, which go in both directions and appear to remain broadly balanced.

...with broadly balanced risks for both the growth...

As regards economic activity, the rebalancing of EU GDP growth towards domestic demand could prove stronger than assumed in the forecast with, for instance, the labour market surprising positively. Similarly, spillovers from the strong momentum in Germany to other Member States could materialise to a larger extent than currently expected. Moreover, policy measures to redress the fiscal situation could prove more effective than presently foreseen in dissipating market concerns (both in the EU and abroad) and thus further raising confidence among businesses and consumers. In contrast, a more pronounced slowdown in the global economy than included in the baseline is a risk to EU export growth. Related to this are risks from tensions in exchange rates and rekindled protectionist impulses. The fragility of financial markets, particularly of some sovereign-bond segments, remains a source of concern, with damaging negative feedback loops still possible. Finally, fiscal consolidation, given uncertainty on the timing of measures, may weigh more on domestic demand more than currently envisaged.

...and the inflation outlook

Turning to inflation, the recent rebound in oil and other commodity prices as well as increases in indirect taxes and administered prices constitute upside risks to the current projection. At the same time, the remaining slack in the economy, weak labour-market conditions and well-anchored inflation expectations are likely to contain inflationary pressures in the near term.

PART I

Economic developments at the aggregated level

1. THE EU ECONOMY: A GRADUAL AND UNEVEN RECOVERY

The economic recovery in the EU appears to be taking hold, with GDP growth surprising on the upside thus far in 2010, both in magnitude and composition. While activity is set to moderate towards the end of the year, the better than expected performance in the first half of 2010, and the spillover of some of this momentum into the second, imply a significant upward revision to annual growth compared to the spring forecast.

Further out, a number of forces are set to shape growth prospects. Whereas the projected softening of the global environment and fiscal consolidation are expected to have a dampening effect, especially next year, further improvements in financial-market conditions and the broadening out of the recovery are expected to support activity in 2011 and 2012. Indeed, with private demand gradually strengthening over the forecast horizon, the recovery is set to become increasingly self-sustaining. Developments across Member States remain uneven however, more so than in the spring, with the recovery advancing at a relatively fast pace in some, but lagging behind in others. This reflects differences in the scale of adjustment challenges across economies and ongoing rebalancing within the EU and euro area.

Overall, the EU economy is forecast to grow by around 1¼% in 2010-11 (with a slight easing next year) and by some 2% in 2012. Risks to this outlook appear broadly balanced, though uncertainty remains high.

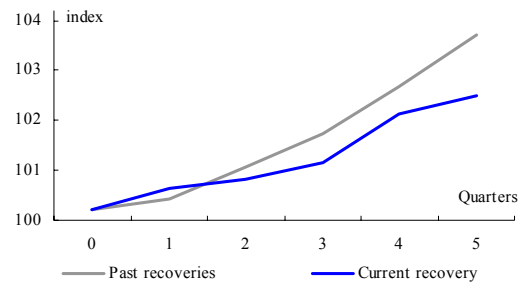
1.1. RECOVERY PROGRESSING

Autumn 2009 saw a resurgence of economic growth in the EU, thus bringing to an end the deepest and longest recession in the region's history. A year on and the economy appears to be on the mend; with the recovery progressing and even surprising on the upside in 2010 to date. Economic activity was especially strong in the second quarter, expanding by 1% or so (q-o-q) in the EU and euro area. This solid performance followed largely from an export-led rebound in industry, in line with the dynamics of global activity and trade. However, reflecting a softening in the latter and the fading of the temporary factors that kick-started the recovery, the pace of growth eased in the third quarter (to around ½% q-o-q in both regions).

While the nascent recovery of last autumn has gained some ground over the past year, the pick-up in economic activity has, on the whole, been rather modest. Indeed, apart from the initial rebound (which owed much to policy measures in the EU and abroad), this recovery is proving more muted than the average upturn (see graph I.1.1).⁽¹⁾ This is as expected, and in line with the characteristics of past recoveries following periods of financial

distress. Such recoveries tend to be slower, held back by weak private demand and tight credit conditions.⁽²⁾

Graph I.1.1: Comparison of recoveries, current against past average - GDP, euro area



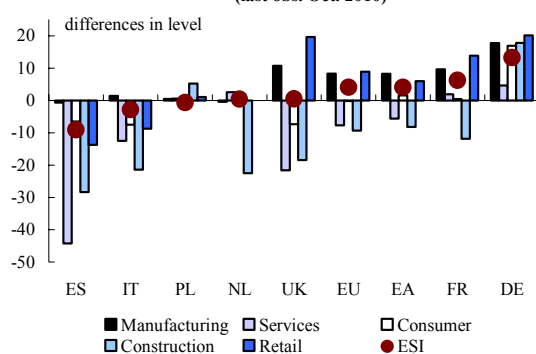
Note: Real GDP following the recessions of the mid 1970s, early 1980s and early 1990s

A priori expectations of a differentiated speed of recovery across Member States also seem to be holding up. While Germany and a number of smaller countries have seen a solid rebound in activity, others are lagging behind, notably some peripheral economies. Uneven progress at Member State level is not surprising given differences in the scale of adjustment challenges and ongoing rebalancing within the EU and euro area. As discussed last autumn, the economic and financial

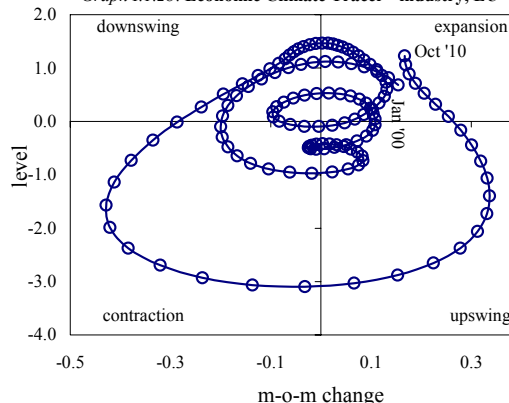
⁽¹⁾ The previous recoveries referred to are those of the mid-1970s, early 1980s and early 1990s.

⁽²⁾ See for example, Reinhart, C. and V. (2010) 'After the fall'. NBER Working Paper no. 16334, September; and IMF (2009) 'World Economic Outlook', April 2009.

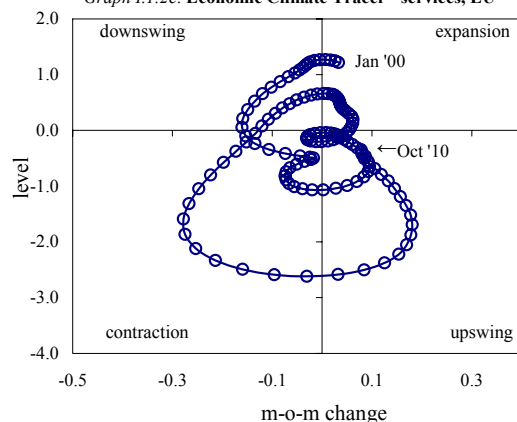
Graph I.1.2a: Economic Sentiment Indicator (ESI) and components: differences from long-term averages (last obs. Oct. 2010)



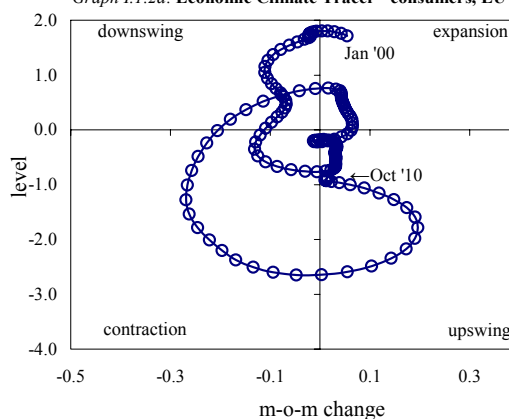
Graph I.1.2b: Economic Climate Tracer - industry, EU



Graph I.1.2c: Economic Climate Tracer - services, EU



Graph I.1.2d: Economic Climate Tracer - consumers, EU



crisis affected countries in different ways and to different degrees depending, inter alia, on the scale of exposure to risky assets and the size of the financial sector (e.g. the UK), the export dependency of the economy (e.g. Germany) and the current-account position (e.g. Hungary, the Baltics), and the extent to which house prices had been overvalued and construction industries oversized (e.g. Spain and Ireland).⁽³⁾

Although the crisis has had asymmetric effects across Member States, a common legacy has been the shadow cast on public finances and potential growth. With fiscal consolidation set to take hold over the forecast horizon and renewed emphasis on structural reforms via the Europe 2020 strategy, it seems timely to consider how these instruments can be used to underpin the sustainability of public finances and ensure a more dynamic EU economy. Accordingly, the two thematic chapters that accompany this autumn forecast look at these issues in more detail. The remaining sections of this chapter elaborate on the current situation and short-term outlook for the EU economy.

Broadly favourable developments so far

While the recovery this time round is set to be more gradual and more subdued than past upturns, the chain of events should be much the same. Recoveries of the EU economy are typically export-led: with a pick-up in exports feeding through to (equipment) investment; investment growth then leading to employment growth which, in turn, stimulates private consumption.⁽⁴⁾

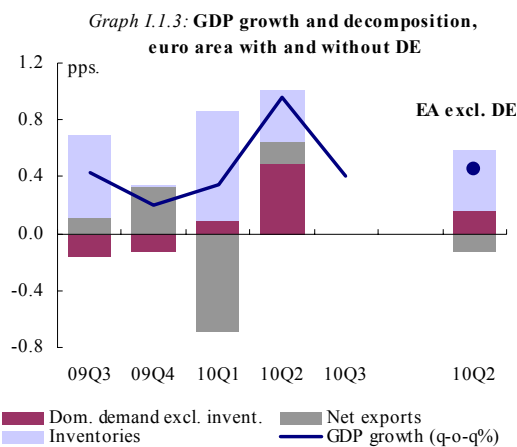
A year into the current recovery and available data show that export growth – the first stage of the traditional recovery pattern – has been solid for some time now. EU exports rose by a sizeable 4% q-o-q in the second quarter of 2010, with euro-area exports also up by 4¼%. Moreover, there are signs that the economy is entering the next phase of the typical recovery sequence, whereby the pick-up in exports spurs (equipment) investment demand. For instance, the second quarter saw some rebalancing of GDP growth towards domestic demand, with the broad-based nature of the latest survey

⁽³⁾ See chapter 1 in European Commission (2009) 'European Economic Forecast – Autumn 2009'.

⁽⁴⁾ See chapter 1 in European Commission (2010) 'European Economic Forecast – Spring 2010'.

readings suggesting a similar outcome in the third quarter (see graphs I.1.2a-d).

It appears then that the upswing phase of the EU business cycle has taken root, and somewhat earlier than envisaged at the time of the spring forecast. However, a closer look at the data reveals marked cross-country differences. Excluding Germany, where recent developments have been particularly dynamic, the aggregate picture is more tentative. That said, it is still indicative of a broadening out of the EU recovery.



All-in-all, the economic situation has brightened since the spring, with GDP growth in recent quarters surprising on the upside not only in magnitude, but also in composition.

1.2. LOOKING AHEAD

Turning to the growth prospects for the EU economy over the forecast horizon, which now extends out to 2012. Given the important role played by global growth and credit in recoveries following financial crises, the starting point in this respect is the outlook for the external environment and financial markets.⁽⁵⁾

Global recovery continues, though momentum softens ...

The solid export performance of the EU economy of late owes much to the strength of global activity and trade (excl. EU) in the first half of 2010. A softening in the pace of world growth is however in sight for the second half of the year, as support from the inventory cycle and stimulus measures wanes. High-frequency indicators suggest that this soft patch has already started to materialise. For example, the global Purchasing Managers' Index (PMI) for manufacturing recorded its highest reading in nearly six years in April 2010, but eased back subsequently, picking up again only recently. Similarly, CPB data show a slowing in the rate of industrial production growth at the global level from May on.

With momentum declining, global GDP growth (excl. EU) is projected to moderate somewhat in 2011-12, to around 4½% compared to some 5¼%

⁽⁵⁾ As discussed in IMF (2009) 'World Economic Outlook', April 2009.

Table I.1.1:

International environment

(Real annual percentage change)					Autumn 2010 forecast			Spring 2010 forecast	
(a)	2007	2008	2009		2010	2011	2012	2010	2011
Real GDP growth									
USA	20.7	1.9	0.0	-2.7	2.7	2.1	2.5	2.8	2.5
Japan	6.0	2.4	-1.2	-5.2	3.5	1.3	1.7	2.1	1.5
Asia (excl. Japan)	26.0	9.8	6.5	5.8	8.5	7.6	7.5	8.2	7.5
- China	12.7	13.0	9.0	8.7	10.5	9.2	8.9	10.3	9.4
- India	5.1	9.2	6.7	7.4	8.5	8.3	7.8	8.1	8.0
Latin America	8.6	5.8	4.2	-1.9	5.6	4.0	4.2	4.2	4.0
- Brazil	2.9	6.1	5.1	-0.2	7.4	4.8	5.1	5.7	4.5
MENA	5.0	5.6	4.8	2.1	3.8	4.0	4.0	4.2	5.3
CIS	4.3	7.8	4.9	-7.0	3.7	4.1	4.2	3.7	4.2
- Russia	3.1	8.1	5.6	-7.9	3.5	3.8	4.0	3.7	4.0
Sub-Saharan Africa	2.5	6.9	5.6	2.1	5.0	5.5	6.0	4.7	5.9
Candidate Countries	1.4	4.8	0.8	-4.8	6.3	5.1	4.3	4.1	4.3
World (incl. EU)	100.0	5.2	2.8	-0.7	4.5	3.9	4.0	4.0	4.0
World merchandise trade									
World import growth		6.6	3.0	-13.8	13.8	7.4	7.3	8.9	6.3
Extra EU export market growth		8.9	3.6	-11.0	13.7	7.9	7.3	9.8	6.5

(a) Relative weights in %, based on GDP (at constant prices and PPS) in 2009.

this year. Thus, the outlook is for a rather gradual recovery of the world economy, with growth expected to remain below pre-crisis levels over the forecast horizon. Developments across regions are set to differ markedly though.

For advanced economies, where temporary supports are fading and the bulk of countries are still grappling with the legacy of the crisis – namely weak labour markets, deleveraging on the part of households and firms, as well as large fiscal deficits – a more modest recovery is in prospect. US GDP is projected to grow by about 2¾% this year, but to fall back to just over 2% next year, before picking up again in 2012 (to some 2½%). In Japan, GDP growth is forecast at around 3½% in 2010, 1¼% in 2011 and 1¾% in 2012.

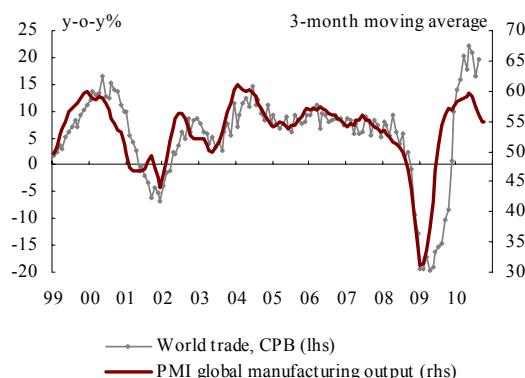
In emerging markets outside the EU and in developing countries, the outlook is decidedly brighter. Emerging economies are expected to perform strongly over the forecast horizon on the back of buoyant domestic demand, trade and commodity price developments. Emerging Asia, for instance, is projected to grow by some 8½% in 2010 and by 7½% in 2011-12. Within this region, China continues to lead the way, with GDP growth of 10½% foreseen for this year, and growth of around 9¼% expected in 2011 and 9% in 2012. Outside of Asia, the emerging economies of Russia and Brazil are projected to post solid growth in 2010, with activity set to gradually pick-up thereafter in Russia, but to fall back in Brazil.

World trade was also stronger in the first half of 2010 than anticipated at the time of the spring forecast. Having staged an impressive rebound in the latter part of 2009, trade volumes rose by 5¾% q-o-q in the first quarter of this year and by 3½% in the second (CPB estimates). That trade is now back at pre-recession levels is attributable to a number of factors, inter alia, the recovery of the global manufacturing sector, car-scrapping schemes and the inventory cycle, the reactivation of global supply chains and some improvement in trade financing conditions.⁽⁶⁾

Looking ahead, the global PMI for manufacturing and the OECD leading indicator for global developments have softened in recent months, suggesting some loss of momentum.⁽⁷⁾ With

economic activity across advanced and emerging economies also set to slow in the coming period, the outlook is for a deceleration in world trade growth (excl. EU) over the forecast horizon, from some 13½% in 2010 to close to 8% in 2011 and 7¼% in 2012.

Graph I.1.4: World trade and PMI global manufacturing output



The less buoyant external environment foreseen for the second half of this year and next can be expected to have a dampening effect on the export performance of the EU economy. Indeed, extra-euro-area exports have been on a broadly downward trend since the summer, as has the new export orders component of the Purchasing Managers' Index. The extent of the impact on individual Member States will differ depending on their geographical and product specialisation, as well as on their competitive position (see graphs I.1.5a-b). The impact could be quite pronounced for countries where the share of exports going to the US is high (e.g. Ireland and the UK), given the projected softening of the US economy in 2011, but less so for Member States whose exports are directed in large part towards emerging markets (e.g. Germany and Finland), where demand remains strong. For euro-area countries, part of the impact might also be offset via the exchange-rate channel, owing to lagged effects from the depreciation of the euro during the summer months.⁽⁸⁾ At the aggregate level, the share of the US in EU and euro-area exports has been falling in recent years, whereas the share of emerging Asia has been growing. Nonetheless, as outlined in box I.1.1, the strong influence of the US, not least through the trade channel, means that the EU / euro area is unlikely to escape unscathed from the expected slowdown in the US economy.

⁽⁶⁾ See the article 'Recent developments in global and euro area trade' in ECB (2010) 'Monthly Bulletin', August.

⁽⁷⁾ Indicator for the OECD region plus six large emerging markets.

⁽⁸⁾ The technical exchange-rate assumptions for 2010-12, as well as other external assumptions, are set out in box I.1.7.

Box 1.1.1: What impact will developments in the US and China have on the EU and euro area?

While the Chinese economy continues to grow at a brisk pace over the forecast horizon, the US economy is in for a soft patch in 2011. This box takes a look at the impact of slowing US demand on the euro-area economy via the trade channel, taking into account structural shifts in global trade as well as the role of Asia, and in particular China, as a partial counterbalancing force.

Emerging and developing economies⁽¹⁾ are taking an ever larger share in world growth and GDP (in PPP). They are expected to represent a larger share in world GDP than advanced economies for the first time ever in 2012. At the same time, the share of the US in world GDP has declined from an average of 24% over 1996-2003 to 21% in 2009 (for the EU, the figures are similar). These changes are also reflected in the changing composition of EU exports. Table 1 shows that exports to the US and, to a lesser extent, to other advanced economies have been shrinking as a share of EU (and euro-area) exports during the last decade. This contrasts with the growing role of China and oil-exporting countries.

Table 1:

Composition of EU merchandise exports outside the EU (%)

	USA	Developed	Oil exporters	China	Emerging rest
99-07	27.7	19.1	23.3	4.8	25.1
2008	21.1	16.6	30.3	6.6	25.4
2009	20.6	17.3	28.2	8.2	25.7
2010*	18.8	17.3	27.4	9.0	27.5

* based on data for the first 7 months

The three aggregates are respectively: developed economies excl. EU and US; oil exporters (MENA + CIS + Norway); other emerging economies.

While the share of the US in EU exports has diminished by one third since 1999, three factors point to the still-large influence of the US via the trade channel: first, the above calculations are based on goods only, while the share of the US is usually higher for EU exports of services. Secondly, the picture changes when considering the share in GDP. During the same period, openness has increased, thus exports to the US in terms of EU GDP have decreased only gradually from 1999 to 2007. The trade slump, however, accelerated this decrease in 2008 and 2009. Thirdly, Dees and Saint-Guilhem⁽²⁾ find evidence that "the increasing economic integration at the world level is likely to

have fostered second-round and third-market effects, making U.S. cyclical developments more global."

To illustrate the impact of changes in US demand on the outlook for the euro-area economy, Commission services have run different scenarios using the model QUEST III⁽³⁾. In scenario 1, a reduction in US domestic demand is offset by an equivalent increase in domestic demand in emerging Asia, with flexible exchange rates facilitating the adjustment. As a result, euro-area GDP would be little affected. In scenario 2, the offsetting demand boost and exchange rate flexibility from Asia is absent. In this scenario, euro-area GDP declines sharply in the first few years compared to baseline. The non-tradable sector performs better than the tradable, pulling total GDP gradually back towards the baseline scenario in subsequent years. This reflects the significant additional inflow of capital, which in particular boosts demand for non-tradable goods. However, in reality the shift in resources from tradable to non-tradable sectors would not happen smoothly, which is why scenarios with adjustment frictions (2a or 2b in Table 2) would be more likely to occur. While scenario 2a assumes frictions in the form of a temporary decline of average productivity in the non-tradable sector due to mismatches in resource allocation, scenario 2b additionally assumes unchanged interest rates in the euro area. On the other hand, the more benign scenario 2c presumes smooth adjustment with no negative productivity effect during the restructuring phase and no binding restrictions on monetary policy. This scenario requires a proper functioning of financial markets and additional flexibility in the EU economy and underlines the importance of the Europe 2020 strategy for structural reforms.

Table 2:

Simulation results (euro-area GDP deviation from baseline in pps following 1% lower domestic demand in the US)

scenario	Year					
	1	2	3	4	5	6
1	0.0	0.0	0.0	0.0	0.0	0.0
2a	-0.5	-0.1	0.0	0.0	0.0	0.0
2b	-1.1	-0.5	-0.2	-0.2	-0.2	-0.1
2c	-0.2	0.3	0.4	0.5	0.5	0.6

Shocks are calibrated such that US domestic demand declines 1% after 2 or 3 years, which implies domestic demand being only 0.5-0.6% below baseline in the first year.

Scenario 1: Growing demand from Asia
Scenario 2: Stagnant demand from Asia

It appears that the likelihood of the benign scenario 1, with the euro area being little impacted, depends on the policy choices made in Asia.

(1) In our definition, the world excluding the EU, candidate countries, USA, Japan, Canada, Norway, Switzerland, Australia and New Zealand.

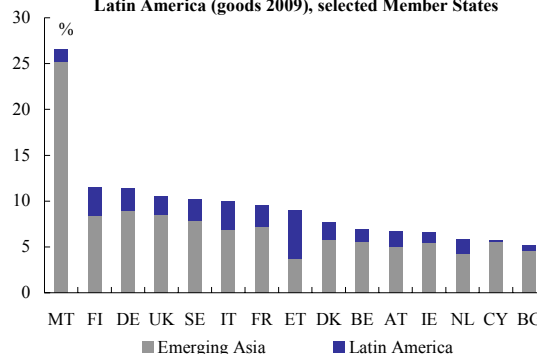
(2) S. Dees and A. Saint-Guilhem "The role of the United States in the global economy and its evolution over time", ECB Working Paper No 1034, 2009, (forthc. Empirical Economics).

(3) http://ec.europa.eu/economy_finance/research/macroeconomic_models_en.htm

Graph I.1.5a: Share of exports going to the US (goods 2009), selected Member States



Graph I.1.5b: Share of exports going to emerging Asia and Latin America (goods 2009), selected Member States



The export outlook for the EU and euro-area economies also depends on progress vis-à-vis demand rebalancing at the global level, with recent developments suggesting that external imbalances have started to widen again.

Regarding commodity price developments, oil and particularly metal prices have been firming since the start of the year, largely due to strong demand in China, whereas adverse weather conditions have driven up the price of some agro-commodities (see box I.1.6 for further details). Over the forecast horizon, commodity prices are generally projected to increase; rebounding sharply in 2010, though rising by considerably less thereafter given still significant spare capacity and inventories. Oil prices are now assumed to average USD 79.9/bl. in 2010, USD 88.9/bl. in 2011 and USD 90.8/bl. in 2012.

... while financial-market conditions gradually improve

Turning to developments on the financial front, markets have recovered somewhat from the sovereign-debt crisis of last May. Although progress has been unsteady, the past few months have seen equity-market indices edge-up and a normalisation in money-market rates, while corporate-bond spreads have, in the main, been on a broadly downward trend. On the back of policy measures – among them the establishment of the European Financial Stabilisation Mechanism and the European Financial Stability Facility – tensions in sovereign-bond markets themselves eased, though some stress has reappeared lately. As discussed in box I.1.2, investors have started to differentiate more clearly between sovereign issuers, with the result that benchmark yields have fallen significantly (reflecting their safe haven status), whereas government-bond yields remain

high in a number of euro-area Member States (notably Greece, Ireland and Portugal).

In the banking sector, the situation appears to be improving. For instance, the solvency position of banks has brightened since the spring, with the EU-wide stress test exercise carried out in July 2010 finding that the system as a whole is fairly resilient, despite some pockets of vulnerability.⁽⁹⁾ Banks have also reported strong profits in recent months, which should allow them to better cover potential future loan losses. Moreover, it seems that the rise in funding costs and difficulties in accessing funding markets experienced in the second quarter of the year, due to concerns about the sector's exposure to sovereign risk, eased in the third.

As for lending activity, the latest ECB Bank Lending Survey (October 2010) points to a stabilisation in the tightening of credit standards for enterprises over the coming period, and to an easing in standards for households. Lending to households has in fact been rising, albeit modestly, for some time in the euro area, though it is still declining for non-financial corporations. The pace of the latter is moderating however, with the turning point even in sight (see graph I.1.6d). As discussed last spring, recoveries in private sector credit growth typically lag economic upturns by at least a year.⁽¹⁰⁾ With developments so far largely in line with past patterns, support from the credit side to the real economy can be expected to materialise towards the end of this year.

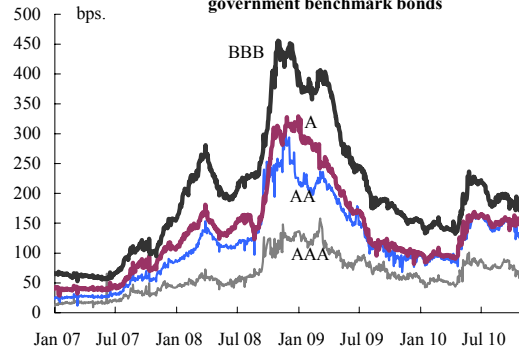
⁽⁹⁾ The detailed results can be found in CEBS (2010) 'Aggregate outcome of the 2010 EU wide stress test exercise coordinated by CEBS in cooperation with the ECB'.

⁽¹⁰⁾ See chapter 2 in European Commission (2010) 'European Economic Forecast – Spring 2010'.

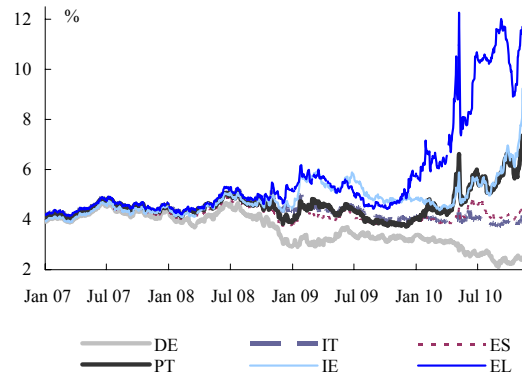
Graph I.1.6a: Stock-market performance



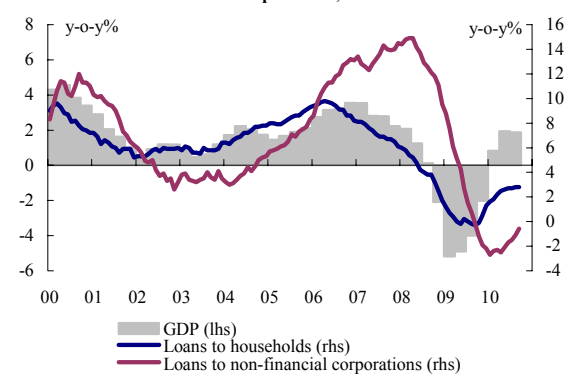
Graph I.1.6b: Corporate spreads over euro-area government benchmark bonds



Graph I.1.6c: Government-bond yields, selected Member States



Graph I.1.6d: Bank lending to households and non-financial corporations, euro area



When looking at the relationship between financial conditions and real activity, a useful indicator is the OECD's financial conditions index for the euro area.⁽¹¹⁾ This has been broadly stable since the spring, but given the lags involved, earlier improvements mean that aggregate financial conditions should support growth in the period ahead.

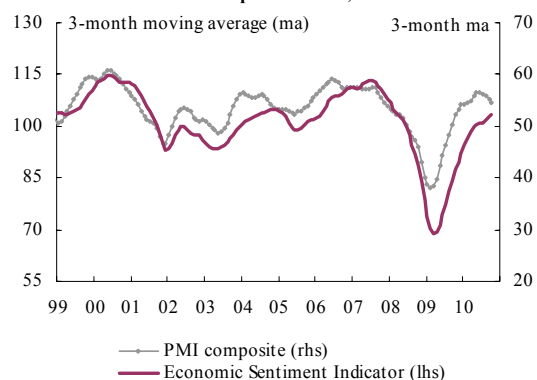
Overall, a further gradual improvement in financial conditions is expected over the forecast horizon, as economic activity strengthens and fiscal consolidation programmes are implemented. The road ahead is set to remain rough though, with periods of stress likely in light of still significant challenges.

EU recovery taking hold, but progress uneven ...

With the slowdown in global activity dampening export growth, and temporary supports running their course, near-term growth prospects for the

EU economy appear rather subdued. Economic activity in the EU and euro area softened in the third quarter of 2010, with high-frequency indicators pointing to a similar outcome in the fourth. For example, the composite Purchasing Managers' Index (PMI) eased further in October, though it remains in expansionary territory, as does the Commission's Economic Sentiment Indicator (ESI). Thus positive, but weaker, GDP growth of about ¼% q-o-q is projected for the fourth quarter in the euro area (slightly higher in the EU).

Graph I.1.7: Economic Sentiment Indicator and PMI composite index, EU



⁽¹¹⁾ This covers real interest rates, bond spreads, credit conditions, real exchange rates and household net wealth.

Box I.1.2: Interdependencies between financial-market segments

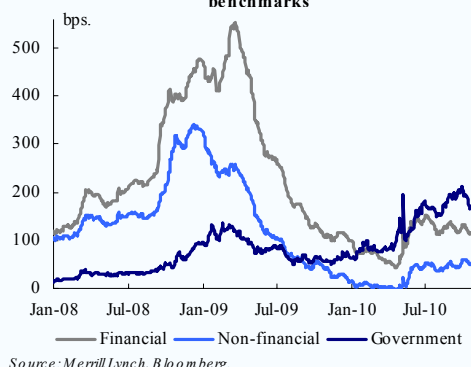
Developments in different segments of global financial markets are strongly interrelated. In particular, sovereign yields provide the benchmark interest rate, i.e. risk pricing reference, for the economy as a whole. Consequently, higher government bond yields tend to translate into higher financing costs for financial institutions, households and corporations, although the evidence on the strength of the linkage is mixed (see Box I.2.1 in chapter I.2).

Conversely, government bond yields may also be influenced by private sector developments. For example, during the financial crisis, many governments issued guarantees for bonds issued by banks, thereby keeping the financing costs of banks artificially low. However, these guarantees effectively transferred risk from the banking sector to the sovereign sector and created contingent liabilities for Member States. As a result, investors have started to price in this transferred risk into government bonds' premia and, on this basis, have differentiated more clearly between euro-area sovereign issuers.

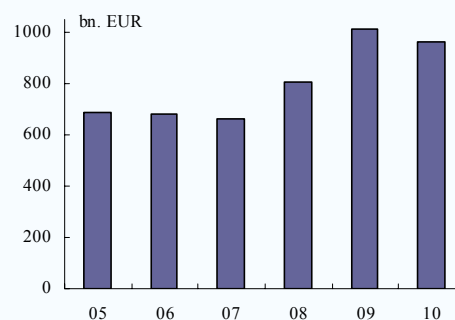
Since some sovereign bonds have started to be perceived as riskier than before, their yield spreads vis-à-vis the benchmark have widened. In parallel, the price of risk of financial assets has increased. Hence, the return on safe assets declined and spreads to riskier assets increased.

This transfer of risk has not only had an impact on sovereign bond yields. The new borrowing requirement of sovereigns has also translated into increased bond issuance. Higher volumes of sovereign issuance can lead to a crowding out of private sector financing, particularly in times of high risk aversion. It should be noted, however, that the extent of such crowding out (and widening of yield spreads) is also a function of perceived risk: for example, large international companies are often considered less risky than some sovereigns due to better diversified income sources and continue to thereby enjoy a relatively good standing on capital markets in times of more adverse conditions in financial markets.

Graph 1a: Euro-area yield spreads vis-à-vis benchmarks



Graph 1b: Euro-area government bonds issuance (as of September 30, 2010)

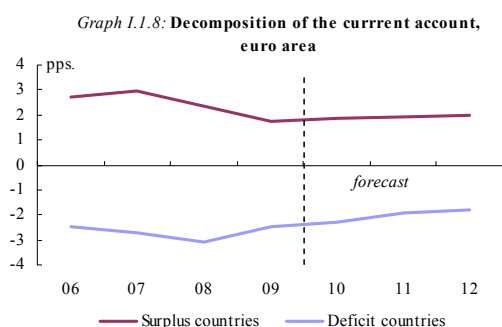


While activity is set to moderate towards the end of 2010, the better than expected performance in the first half of the year, and the spillover of some of this momentum into the second, imply a significant upward revision to annual growth compared to the spring forecast. For 2010 as a whole, GDP is now expected to grow by around 1¾% in both the EU and euro area. However, this aggregate picture masks divergent developments across Member States; for example, growth has been revised markedly up in Germany, but down in Greece.

Indeed, despite signs that some adjustment is starting to take place, imbalances within the euro

area remain significant. These partly reflect structural weaknesses, such as weaknesses in domestic demand (in surplus countries) and weak price and cost competitiveness (in deficit countries), often combined with high debt levels in the latter.⁽¹²⁾

⁽¹²⁾ See chapter 1 in European Commission (2010) 'European Economic Forecast – Spring 2010' and European Commission (2010) 'Quarterly Report on the Euro Area', Volume 9, No 1.



Note: Euro-area Member States are identified as surplus or deficit countries on the basis of their current-account position in 2006. This is kept unchanged over the entire period

As for GDP growth further out, a number of factors are set to shape prospects for the EU and euro area. On the one hand, indications that the recovery is broadening out and the expected gradual improvement in financial-market conditions bode well for real activity in 2011 and 2012. There is also a possibility that recent improvements in Germany could have knock-on effects for other Member States. Model-based estimates presented in box I.1.3 point to positive spillovers in this regard.

On the other hand, the less buoyant external environment can be expected to weigh on activity going forward. With Member States also embarking on retrenchment programmes in the period ahead (if not already), an additional factor to be considered is the impact of fiscal consolidation. As highlighted by the thematic chapter on this issue, the macroeconomic effect of

such consolidation depends on its composition and perceived credibility. Stylised simulations show that a permanent consolidation amounting to 1% of GDP, made up of spending cuts and tax rises proportional to their current budget shares, would lower GDP by about 0.3% in the first year, though the long-run impact is positive. They also show that growth-enhancing structural reforms can ease the burden of fiscal adjustment (see also the thematic chapter on structural reforms).

These various forces are expected to play out through the main components of EU / euro-area GDP. Some differentiation in their effect is however likely across Member States, reflecting, inter alia, differences in the export dependency of economies and the scale of structural and budgetary adjustment challenges.

Table I.1.2:

GDP growth forecast, additional features

EU	2010	2011	2012
Carry-over from preceding year	0.3	0.8	0.7
Y-o-Y in Q4	2.3	1.6	2.3
Annual average	1.8	1.7	2.0

Euro area	2010	2011	2012
Carry-over from preceding year	0.3	0.7	0.6
Y-o-Y in Q4	2.1	1.5	2.0
Annual average	1.7	1.5	1.8

Table I.1.3:

Main features of the autumn 2010 forecast - EU

(Real annual percentage change unless otherwise stated)				Autumn 2010 forecast (a)			Spring 2010 forecast	
	2007	2008	2009	2010	2011	2012	2010	2011
GDP	3.0	0.5	-4.2	1.8	1.7	2.0	1.0	1.7
Private consumption	2.1	0.7	-1.7	0.7	1.2	1.6	0.1	1.3
Public consumption	1.9	2.3	2.0	1.2	-0.2	0.0	1.0	0.1
Total investment	5.8	-0.8	-12.1	-0.6	2.8	4.2	-2.2	2.5
Employment	1.7	0.9	-1.9	-0.6	0.4	0.7	-0.9	0.3
Unemployment rate (b)	7.2	7.0	8.9	9.6	9.5	9.1	9.8	9.7
Inflation (c)	2.4	3.7	1.0	2.0	2.1	1.8	1.8	1.7
Government balance (% GDP)	-0.9	-2.3	-6.8	-6.8	-5.1	-4.2	-7.2	-6.5
Government debt (% GDP)	58.8	61.8	74.0	79.1	81.8	83.3	79.6	83.8
Adjusted current account balance (% GDP)	-1.0	-1.9	-1.0	-0.9	-0.5	-0.3	-1.4	-1.3
Contribution to change in GDP								
Domestic demand	2.8	0.7	-3.1	0.6	1.2	1.7	-0.1	1.2
Inventories	0.2	-0.3	-1.0	0.7	0.1	0.0	0.5	0.2
Net exports	-0.1	0.1	-0.1	0.6	0.4	0.3	0.6	0.3

(a) The European Commission autumn 2010 forecast is based on available data up to November 15, 2010.

(b) Percentage of the labour force. (c) Harmonised index of consumer prices, annual percentage change.

Box I.1.3: Spill-over effects from Germany to other EU Member States

The German economy accelerated sharply in spring 2010. GDP surged by a 2.3% q-o-q in the second quarter (9.6% annualised), the highest growth rate since German reunification. Beyond temporary catch-up effects in construction activity due to the cold winter, exports remained the engine driving the German upswing. However, the quicker-than-expected recovery also benefited substantially from a revitalised domestic economy, with both investment and private consumption displaying tangible positive growth contributions.

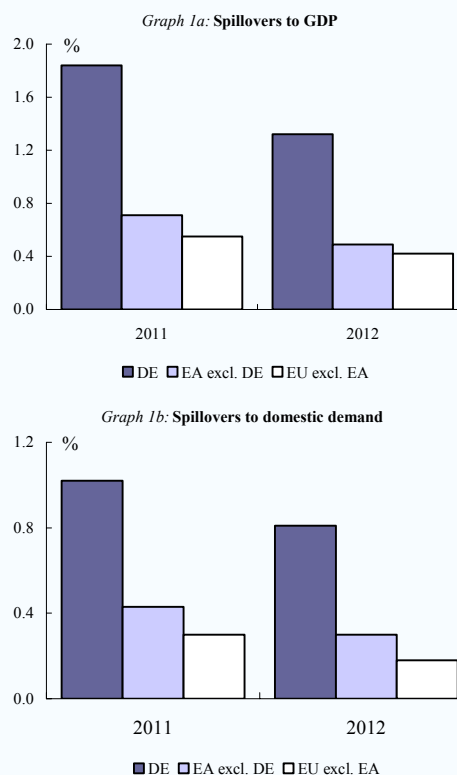
What are the growth implication of the stronger-than-expected performance of the German economy for the rest of the euro area and the EU? This box presents model-based estimates of the potential spillovers from upward GDP growth revisions in Germany to growth prospects in other Member States. The exercise uses a four-region version of the Commission's QUEST III model. The four regions are Germany, the rest of the euro area, the non-euro-area EU members, and the rest of the world.⁽¹⁾

Model-based estimates of spillovers

The first, direct, spill-over effect from GDP growth over a two-year horizon occurs via demand linkages. Growth in economic activity increases the demand for intermediate inputs, which are partly imported. It also increases income, consumption and investment, which partly impacts on imports as well. The model captures these trade linkages between Germany and its European neighbours. The second, indirect, channel includes the stance of monetary policy in response to developments affecting euro area aggregates and the reaction of common variables such as the euro exchange rate.

Graphs 1 and 2 show estimates of spill-over effects for the following illustrative scenario. Global demand raises German exports by 5%. The increase in exports comes via higher import demand in the rest of the world that is fully targeted to German exports. As a consequence, German domestic demand rises by 1% in the same year.⁽²⁾ The export demand shock lasts for two years, but due to endogenous price and policy responses their impact on demand and activity weakens in 2012. It is

assumed that policy interest rates in the euro area remain frozen in 2011 and public spending is held constant in real terms.



Given these assumptions, the aggregate spill-over effect from Germany to the rest of the EU and the euro area economy as a whole is substantial. The first-year output effect of 1.8% in Germany raises import demand by 2.7%. The stronger import demand translates into higher export demand for other euro-area countries (1.2%) and the non-euro-area EU economies (1.1%). In turn, this generates higher domestic demand (0.3-0.4%) and GDP (0.6-0.7%) in these countries. Overall, the estimated spill-over effect from a 1% increase in domestic demand in Germany translates into a 0.4% increase in domestic demand in other euro-area countries and 0.3% in non-euro-area EU economies in the first year.

The impact of the export demand shock on German GDP and, via the demand spillovers, on GDP in the rest of the EU, is strongest in the first year in which policy interest rates are assumed to remain constant. Nominal rates increase in the second year,

(Continued on the next page)

⁽¹⁾ For details on QUEST III and its application to policy analysis, see http://ec.europa.eu/economy_finance/research/macroeconomic_models_en.htm.

⁽²⁾ In the absence of monetary tightening, higher export demand itself contributes to the increase in domestic demand through the income effect from higher employment and the real interest rate reduction.

Box (continued)

to the extent that EU central banks react to inflationary pressure from higher demand. Given the assumed change in the monetary stance in 2012, real interest rates increase, and the euro and other EU currencies appreciate relative to the rest of the world in 2011-12. In addition, stronger demand-driven pressure on production costs and prices in EU economies in 2011 contribute to the appreciation of the real effective exchange rate. As a consequence of increasing interest rates and real appreciation, domestic and export demand weaken throughout the EU in 2012 compared to 2011, but they still remain above the original baseline.

Possible spillovers from stronger domestic demand in Germany

The extent to which stronger export and domestic demand in Germany could entail beneficial spill-over effects for the rest of the EU/euro-area depends strongly on four, interrelated, factors: trade (including its composition and competitiveness issues); financial and credit conditions; confidence and policy implications.

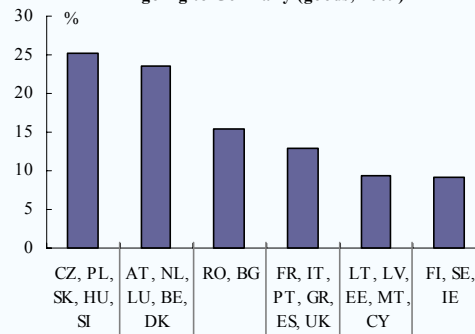
The model estimates presented in the previous section focussed on the first factor. The rest of the EU/euro area is set to benefit via the trade channel from higher domestic demand in Germany and associated higher imports. The import content of German exports and the German export share have increased in recent years. At the same time however, these trade linkages should not be overestimated. On average, only about 13% of French, Italian, Portuguese, Greek, Spanish and UK goods exports go to Germany (Graph 2).

Moreover, the extent to which individual countries can benefit from stronger German imports depends not only on their geographical proximity but also on their competitiveness position. All things being equal, positive spill-over effects via the trade channel are likely to be more pronounced for those countries which have preserved their competitiveness (e.g. Central and East European economies). They might be less significant for countries that have been suffering from competitiveness losses.

The overall impact of stronger domestic demand growth in Germany on the rest of the EU/euro area is also likely to depend on the nature and composition of this stronger demand. Arguably, spill-over effects could be larger in the case of stronger private sector demand, whereas stronger public sector demand would boost domestic growth to a larger extent, given the low import content of

public investment and because current public spending is to a large extent comprised of wages and benefits.

Graph 2: Member States' shares of exports going to Germany (goods, 2009)

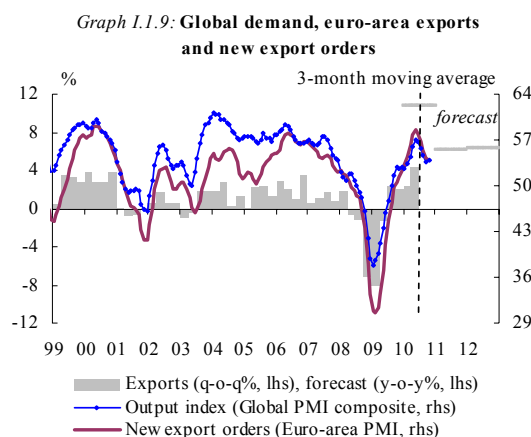


Improving financial-market conditions can be expected to reinforce transmission mechanisms between Germany and other countries. Survey evidence suggests that the attitude of banks to credit risks has improved. This change in risk preferences has partly fed through to actual lending behaviour.

The improved growth outlook for Germany can yield positive confidence effects impacting on the prospects of the EU economy as a whole. Such confidence effects are partially captured by the model but are difficult to measure and can have a pervasive impact on real-sector activity across Member States. Most recent data are suggestive of improving confidence, especially in services, a sector more directly affected by domestic demand developments than industry.

Finally, the size of spill-over effects will depend on the policy response. In particular, the monetary policy reaction to increased inflationary pressure on the back of higher domestic demand would dampen the spill-over effect.

Beginning with the outlook for exports, this demand component is expected to continue supporting the recovery going forward, albeit to a lesser extent than in the first half of this year. Mirroring developments in global activity and trade, export growth is projected to decelerate over the forecast horizon, to around 6½% in the EU in 2011-12 from over 10% this year; and to about 6¼% in the euro area from some 10¾%.



As discussed last spring, a pick-up in exports is a necessary, but not a sufficient, condition for a self-sustaining recovery in the EU.⁽¹³⁾ For this to come about, a strengthening of private demand is also needed. Hence, growth prospects for gross fixed capital investment and private consumption are of key importance at the current juncture.

⁽¹³⁾ See chapter 1 in European Commission (2010) 'European Economic Forecast – Spring 2010'

Overall investment spending is projected to rebound in 2011, by around 2¾% in the EU and 2¼% in the euro area, and to gain ground in 2012, picking up by some 4¼% and 3½% respectively. This reflects a relatively strong outlook for equipment investment, but a more muted one for construction.

Equipment investment is in fact set to return to positive growth this year, somewhat earlier than envisaged at the time of the spring forecast (with a particularly strong rebound foreseen for Germany, Italy and Luxembourg). Prospects for next year have also been revised up, by almost 2 pps. in the euro area, with growth of some 5¾% foreseen for 2012. In addition to the impetus from the export-led industrial rebound, this brighter outlook follows from improvements in the profit situation of firms and the capacity utilisation rate. The latter stood at around 77½% in the euro area in the fourth quarter of 2010, not far off its long-term average (just above 80%). Conversely, corporate deleveraging, along with fiscal consolidation, is set to act as a constraint on equipment investment growth over the forecast horizon, especially in Member States where the indebtedness level of firms prior to the crisis was high (e.g. Portugal). According to empirical research, balance-sheet adjustment in the corporate sector takes time, lasting on average eight years.⁽¹⁴⁾ This, together

⁽¹⁴⁾ Discussed in European Commission (2010) 'Quarterly Report on the Euro Area', Volume 9, No 3. The sample on which the findings are based includes the 27 EU Member States, the US and Japan, and covers the last three decades.

Table I.1.4:

Main features of the autumn 2010 forecast - euro area

(Real annual percentage change unless otherwise stated)				Autumn 2010 forecast (a)			Spring 2010 forecast	
	2007	2008	2009	2010	2011	2012	2010	2011
GDP	2.9	0.4	-4.1	1.7	1.5	1.8	0.9	1.5
Private consumption	1.7	0.4	-1.1	0.6	0.9	1.4	0.0	1.1
Public consumption	2.3	2.4	2.4	1.0	-0.1	0.2	0.9	0.3
Total investment	4.7	-0.8	-11.4	-0.8	2.2	3.6	-2.6	1.9
Employment	1.7	0.6	-2.0	-0.7	0.3	0.6	-1.0	0.1
Unemployment rate (b)	7.5	7.5	9.5	10.1	10.0	9.6	10.3	10.4
Inflation (c)	2.1	3.3	0.3	1.5	1.8	1.7	1.5	1.7
Government balance (% GDP)	-0.6	-2.0	-6.3	-6.3	-4.6	-3.9	-6.6	-6.1
Government debt (% GDP)	66.0	69.7	79.1	84.1	86.5	87.8	84.6	88.4
Adjusted current account balance (% GDP)	:	:	:	:	:	:	:	:
Contribution to change in GDP								
Domestic demand	2.4	0.5	-2.6	0.4	0.9	1.5	-0.3	1.0
Inventories	0.2	-0.2	-0.8	0.5	0.1	0.0	0.4	0.1
Net exports	0.3	0.1	-0.7	0.8	0.5	0.2	0.8	0.4

(a) The European Commission autumn 2010 forecast is based on available data up to November 15, 2010.

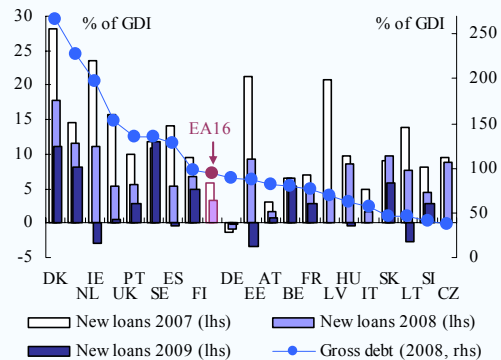
(b) Percentage of the labour force. (c) Harmonised index of consumer prices, annual percentage change.

Box 1.1.4: How much deleveraging has taken place?

The household and non-financial corporate sectors in many EU Member States accumulated high volumes of debt in the years prior to the financial crisis. Historical evidence suggests that financial crises are most often followed by a protracted period of sizeable balance sheet adjustments by the most heavily indebted economic actors.⁽¹⁾ Such a deleveraging process usually translates into reduced GDP growth over several years, due to subdued growth in investment and consumption. This box highlights the state of the deleveraging process in the EU household and non-financial corporate sectors, providing some measure of how far into the adjustment process Member States are, and to what extent deleveraging is weighing on economic growth.

Over the past decade, EU households have increased their borrowing steadily and since 2002, debt accumulation has even accelerated⁽²⁾, in parallel with rising real estate prices. The gross indebtedness of households, relative to gross disposable income (GDI), surged in the euro area from 75% in 2001 to 95% in 2008. As banks have tightened credit standards and net credit growth slowed sharply in the wake of the crisis, EU households' debt accumulation has slowed down. However, due to a corresponding slowdown in GDI, the average debt ratio in the euro area continued to rise slightly in 2009 (to 96%). This aggregate debt level remains low compared to other advanced economies such as the US and Japan. It masks, however, significant differences among Member States. Household debt ratios are particularly high in Denmark, the Netherlands, Ireland, the United Kingdom, Sweden, Portugal, Spain, Cyprus and Greece. In the course of 2009, households in, for example, Ireland, the UK and Spain have started to deleverage. In countries with less severe housing market corrections, there are so far no clear signs of debt reduction. The low level of interest rates and the increased use of variable interest rates have eased the debt-servicing burden⁽³⁾, which may also have reduced pressure to adjust debt levels, implying a significant risk of adjustment pressure when interest rates begin to rise.

Graph 1: Debt and deleveraging of households (gross disposable income=GDI)



A similar increase in indebtedness occurred in the non-financial corporate sector prior to the crisis. According to different measures, debt ratios have been moving up for more than a decade until peaking in early 2009, when worsening economic and tighter financing conditions led many firms to use their ample cash reserves to reduce leverage. Supported by a strong rebound in earnings and subdued investment, the net lending position of the non-financial corporate sector has become positive since mid-2009. Consequently, a gradual decline in debt ratios is underway. However, debt ratios remain quite high in historical terms, and relative to countries like the US. In the first quarter of 2010, the ratios of debt to GDP and gross entrepreneurial income were about 67% and 334% respectively in the euro area.

The deleveraging pattern is unevenly spread across Member States. While debt ratios are moving down in, for example, Belgium, Denmark and the United Kingdom, they were still trending higher – to different degrees – in, for example, France, Ireland, Portugal and Spain. Following the gradual recovery in equity markets, debt-to-equity ratios have on average in the euro area declined from their peak in the first quarter of 2009, but remain high (70% in the first quarter of 2010), and particularly so in Greece, Latvia and Ireland. Subdued issuance of new equity in Europe compared to bond issuance has not helped in making corporate balance sheets more robust.

All in all, it would seem that the deleveraging process in both sectors is still at an early stage. This slow start of to this process, compared to what historical evidence would suggest, may be partly explained by low interest rates and the related decline in the debt-servicing burden.

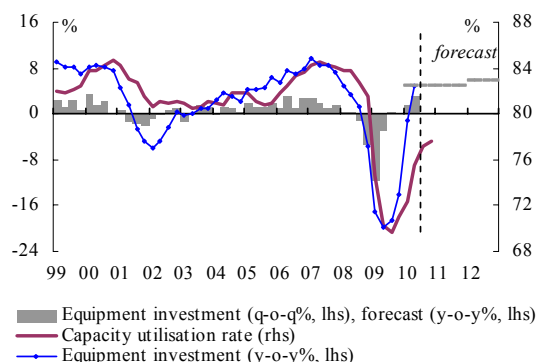
⁽¹⁾ See e.g. Tang, G. and C. Upper, Debt reduction after crises, *BIS Quarterly Review*, September 2010, pp. 25-38.

⁽²⁾ Notable exception was Germany, where debt relative to disposable income declined to about 90%, see e.g. *Quarterly Report on the Euro Area*, Vol. 9, No. 3, September 2010.

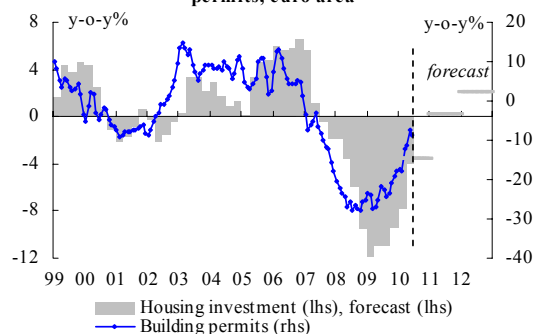
⁽³⁾ Since their peak in the third quarter of 2008, households' interest payments have declined substantially and represented now 2.1% of GDI in the EU in the first quarter 2010.

with the limited progress in this respect to date (see box I.1.4), suggests that equipment investment will face headwinds on this front for quite a while yet.

Graph I.1.10: Equipment investment and capacity utilisation in manufacturing, euro area

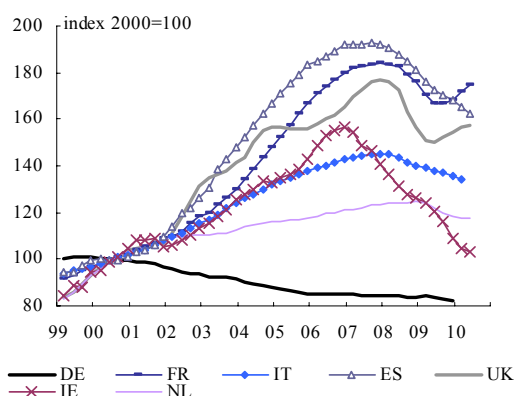


Graph I.1.11: Housing investment and building permits, euro area



Note: Forecast figures relate to overall construction investment

Graph I.1.12: Real house prices, selected Member States



As for construction investment, the residential component is projected to remain relatively subdued over the forecast horizon, picking up only gradually from next year on. While leading supply

indicators such as building permits have recovered somewhat of late (e.g. the number of permits issued in the EU was up by around 12% y-o-y in June 2010), the stock of unsold housing is set to act as a drag on investment activity for some time to come. Moreover, price corrections are still ongoing in a number of Member States, notably Ireland and Spain. Recent empirical work finds that this adjustment process tends to be fairly slow, with most countries taking two to four years to halve house-price imbalances (with the exception of Ireland, where the adjustment has been much more rapid).⁽¹⁵⁾ Finally, consolidation measures are expected to weigh on income growth, and thus on housing demand in the period ahead.

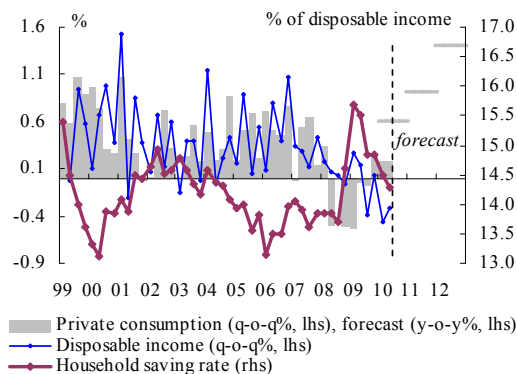
Similarly, fiscal consolidation is set to have a dampening effect on public investment spending over the forecast horizon, implying a weaker outlook for the non-residential component of construction investment.

Turning to private consumption, where the impetus from the export-led industrial rebound has also materialised earlier than expected in the spring. Indeed, a modest pick-up in consumer spending is now foreseen for this year. A gradual firming is expected thereafter; supported by a slowly improving employment outlook, moderate income growth and subdued inflation. The decline in the saving rate from its peak during the crisis also augers well in this respect. Going in the opposite direction, deleveraging on the part of households is set to weigh on private consumption growth over the forecast horizon. As outlined in box I.1.4, the process of balance-sheet repair is still at an early stage in many of the Member States with high household debt-levels in the pre-crisis period (e.g. Denmark and the Netherlands), though it seems more advanced in some, namely Ireland, Spain and the UK. Likewise, fiscal consolidation is expected to have a dampening effect on consumer spending, especially in 2011. To give an illustrative order of magnitude, the stylised 1% of GDP consolidation scenario mentioned previously would lower consumption by about 0.4% in the first year (see also the thematic chapter on fiscal consolidation).

Overall, private consumption in the EU is forecast to expand by about 1¼% and 1½% in 2011 and 2012 respectively (and by close to 1% and 1½% in the euro area).

⁽¹⁵⁾ For a detailed discussion on house price imbalances in the euro area, see European Commission (2010) 'Quarterly Report on the Euro Area', Volume 9, No 3.

Graph I.1.13: Private consumption, disposable income and saving rate, euro area



Public consumption growth on the other hand is projected to ease going forward as consolidation takes hold; from some 1% in the euro area this year, to slightly negative in 2011 and around ¼% in 2012 (flat in the EU). Compared to the spring forecast, the outlook for 2011 has been revised down in a number of Member States, including the peripheral and some emerging economies (e.g. Slovakia and the Czech Republic).

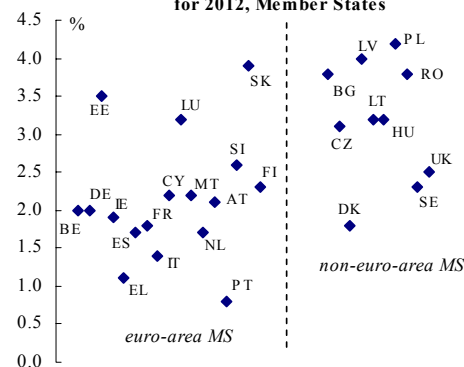
Another force set to constrain the recovery somewhat is the estimated adverse impact of the financial crisis on potential output, with growth rates in this respect possibly not returning to pre-crisis levels.⁽¹⁶⁾ As discussed in the thematic chapter on structural reforms, potential growth is expected to suffer from a much lower contribution from labour in the period ahead, owing to a rise in the structural rate of unemployment, as well as from smaller contributions from capital accumulation and total factor productivity. Potential output growth in the euro area is projected at around 1% over the forecast horizon, whereas prior to the crisis (2000-07), the rate was close to 2%.

As regards overall growth prospects for 2011 and 2012, drawing the above elements together, economic activity is expected to soften next year, to around 1¼% in the EU and 1½% in the euro

area; but to pick-up in 2012 in both regions, to some 2% and 1¼% respectively. Thus, real GDP is set to grow above potential over the forecast horizon, meaning that the negative EU / euro-area output gap should diminish in size, though it is not projected to close by 2012. While this picture is largely unchanged at the aggregate level for 2011, an increased differentiation in the speed of recovery is projected among Member States compared to the spring forecast.

In sum, the recovery of the EU economy appears to be taking hold. Indeed, the gradual strengthening of private demand over the forecast horizon, and reduced reliance on export growth, is indicative of a recovery that is becoming increasingly self-sustaining. That said, the EU economy still faces significant headwinds as it transits towards a new steady state. Moreover, developments across Member States remain uneven, with the recovery set to continue advancing at a relatively fast pace in some, but to lag behind in others. This reflects differences in the scale of adjustment challenges across economies and ongoing rebalancing within the EU and euro area.

Graph I.1.14: GDP growth forecast for 2012, Member States



... with labour-market conditions slowly improving ...

In keeping with the usual pattern – whereby labour-market developments follow those of GDP with a time lag of half a year or more – the labour-market situation has started to stabilise in recent months. The second quarter of 2010 saw job shedding come to an end in the EU, while employment remained stable in the euro area (at 0% q-o-q). Similarly, the unemployment rate has more or less held steady since the spring, at 9.6% in the EU and around 10% in the euro area.

⁽¹⁶⁾ For instance, growth rates of potential output may not return to pre-crisis levels on account of a permanent change in financing conditions and/or a sustained need for deleveraging. As a result, capital accumulation will be slower. The impact of this may be reinforced by parts of the capital stock becoming obsolete even faster. This, in turn, would adversely affect total factor productivity growth. For further details, see European Commission (2009) 'The impact of the financial and economic crisis on potential output', European Economy – Occasional Papers 49.

Box 1.1.5: The resilience of the euro-area labour market

While historical experience suggests that *activity rates* decrease (sometimes persistently) as economic growth recedes, the euro-area labour market has shown remarkable resilience during the recent recession: activity rates increased slightly, spurred by the older and female worker components. While the latter may be related to changes in the social attitude toward female employment, policy measures taken during the crisis to avoid early exit from the labour market may have played a role.

There are considerable differences in *unemployment* responses across countries. Unemployment in Germany and the Netherlands responded very mildly to the recession, with an apparent elasticity of the unemployment rate to growth from peak to trough of below 0.05 in both countries. A response more in line with standard "Okun-law" estimates was recorded in Italy and France (elasticities of 0.24 and 0.39 respectively), whereas major hikes in unemployment were recorded in Spain, Greece and Ireland (1.88, 0.79, and 0.55 respectively).

The factors that explain cross-country differences in labour-market performance include: (i) the sectoral composition of output; (ii) capacity utilisation and firm profitability at the start of the crisis; (iii) the characteristics of existing labour-market institutions; and (iv) policy measures taken to contain labour shedding. It appears that the countries most affected by house-price corrections experienced major employment losses and the largest increases in unemployment after the crisis (see table 1, which displays sectoral employment developments in selected euro-area countries). Conversely, in spite of a major drop in the demand for durable manufactured goods, countries with a relatively high share of manufacturing output (notably Germany) experienced more limited labour shedding. This could be related to stronger expectations of a labour-demand recovery in the manufacturing than in the construction sector. This may have motivated firms to use flexible working time arrangements, and governments to put in place, for the first time in some cases, short-time working schemes with a view to avoiding wasteful labour shedding.⁽¹⁾ In Germany, labour hoarding was mostly a voluntary response of firms with solid

financial positions. This followed a long period of employment restructuring, with emerging skill shortages before the crisis also playing a role. Thus, working-hour reductions were largely initiated by employers, rather than being the result of government-sponsored short-time working schemes.⁽²⁾

Table 1:

Sectoral employment growth in selected euro-area Member States

	EA	DE	IE	ES	FR	IT	NL
Peak to trough							
Manufacturing	-1.4	-0.4	-2.0	-3.3	-0.8	-1.1	-0.8
Construction	-1.7	0.1	-5.8	-4.9	0.0	-0.4	-0.5
Market services	-0.5	0.0	-1.0	-1.2	-0.6	-0.6	-0.7
Trough to 2010Q2							
Manufacturing	-1.0	-0.9	:	-0.6	-1.2	-1.4	-0.7
Construction	-0.9	0.1	:	-2.5	-0.4	0.4	-0.9
Market services	-0.1	0.1	:	0.1	0.0	0.1	-0.4

Looking forward, the question arises as to whether the current resilience of the euro-area labour market can be sustained. Answers are largely country-specific, depending inter-alia on possible further job destruction related to sectoral adjustment, the extent of job shedding in the public sector, and the phasing out of government-sponsored short-time working schemes. An analysis of job market flows could provide indications of unemployment prospects. In countries strongly affected by the bursting of house-price bubbles (e.g. Spain and Ireland) the increase in job destruction after the crisis (inflows into unemployment) was much larger than in other euro-area countries, especially Germany. Recent trends suggest a decline in unemployment in Germany and the Netherlands, due to a combination of reduced job destruction and increased job creation (outflows from unemployment).

Changes in job destruction appear to offset those in job creation in France and Italy, with France experiencing lower entry into unemployment but also lower exit rates, while Italy is exhibiting the opposite pattern. An analysis of labour-market flows⁽³⁾ suggests grimmer unemployment prospects in Spain, with a persistently high job destruction rate not compensated for by improvements in exit rates from unemployment.

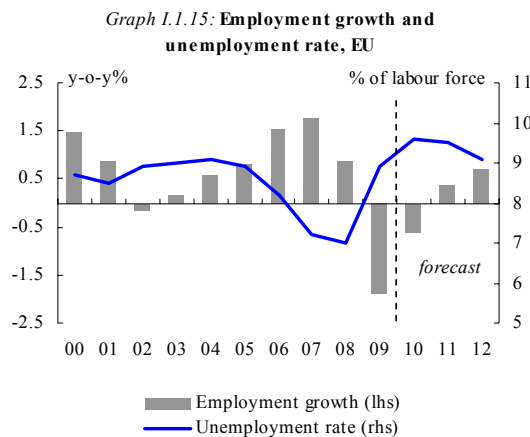
⁽¹⁾ For a description of these schemes see European Commission (DG ECFIN), Labour Market and Wage Developments in 2009, *European Economy* No 5.

⁽²⁾ Boysen-Hogrefe, J. and D. Groll, "The German Labour Market Miracle", *National Institute Economic Review*, October 2010, no. 214, pp. R38-R50.

⁽³⁾ For more details see A. Arpaia and N. Curci, "EU labour market behaviour during the Great Recession", *European Economy Economic Papers*, no. 405, 2010.

Survey indicators of firms' employment expectations point to moderate job creation going forward, as does the PMI employment index which crossed the 50-mark in the EU last April. Taken together with the strong upward revision to economic growth, it seems that the labour market may hold up somewhat better this year than previously expected. And indeed, employment is now projected to contract by about $\frac{1}{2}\%$ in the EU and $\frac{3}{4}\%$ in the euro area in 2010, some $\frac{1}{4}$ pp. less than envisaged at the time of the spring forecast. Modest growth is expected thereafter, of close to $\frac{1}{2}\%$ in 2011 and $\frac{3}{4}\%$ in 2012 in the EU (and of some $\frac{1}{4}\%$ and $\frac{1}{2}\%$ respectively in the euro area).

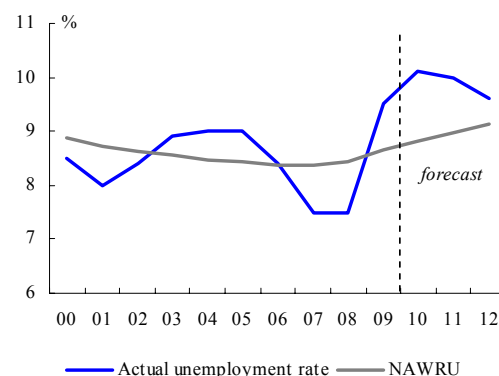
While the outlook is for a gradual improvement over the forecast horizon, labour-market conditions are set to remain relatively weak for a number of reasons. First, as noted above, there is usually a time lag of around 2-3 quarters between cyclical developments in activity and the labour market. Second, policy measures implemented in response to the recession are expected to be unwound, at least in part, over the coming quarters. Third, structural adjustment is still taking place across sectors and firms, with fiscal consolidation also expected to lead to some restructuring and job shedding in the public sector in a number of Member States in the period ahead.



Unemployment prospects over the forecast horizon largely reflect the above employment trends. Thus, the unemployment rate is projected to gradually fall, from around $9\frac{1}{2}\%$ this year in the EU to just over 9% by 2012. Likewise, a $\frac{1}{2}$ pp. decline is expected in the euro-area rate, from about 10% to $9\frac{1}{2}\%$. This outlook is also brighter than the spring forecast due to the resilience shown in some Member States to date. For example, the German unemployment rate is projected to be the same this

year as in 2008, in sharp contrast to the situation in Spain, where the unemployment rate is expected to be around $8\frac{3}{4}$ pps. higher than two years ago. As discussed in box I.1.5, such cross-country divergences in labour-market performance follow from, inter alia, the sectoral composition of output, capacity utilisation and firm profitability at the outset of the crisis, the characteristics of labour-market institutions and the policy response.

Graph I.1.16: Actual and structural unemployment rates, euro area



While the labour-market situation is expected to improve overall, a rather jobless recovery still seems in sight, with (potentially persistent) high unemployment. The unemployment rate in the EU and euro area is in fact set to stay above the structural rate (NAWRU i.e. the non-accelerating wage rate of unemployment) over the forecast horizon. However, recalling the thematic labour-market chapter that accompanied the 2009 autumn forecast, EU labour markets have become more flexible and resilient on the back of reforms enacted over the last decade, implying that increases in unemployment could be less persistent than in the past.⁽¹⁷⁾

... and inflation remaining subdued ...

On the nominal side, consumer-price inflation has risen moderately in 2010 so far, on the back of upward food and energy base effects, as well as increasing global commodity prices. As already mentioned, oil and metal prices have been firming for some time now, while the sharp pick-up in the price of some agro-commodities during the summer has given rise to fears of a generalised hike in food prices, akin to the crisis of 2008. However, as discussed in box I.1.6, market

⁽¹⁷⁾ See chapter 2 in European Commission (2009) 'European Economic Forecast – Autumn 2009'.

conditions are very different now compared to two years ago. For instance, food stocks are much higher at present. The headline rate of inflation currently stands at 2.2% in the EU and 1.8% in the euro area (September 2010), whereas the core rate (i.e. HICP inflation excluding energy and unprocessed food) is some $\frac{3}{4}$ pp. lower in both regions.

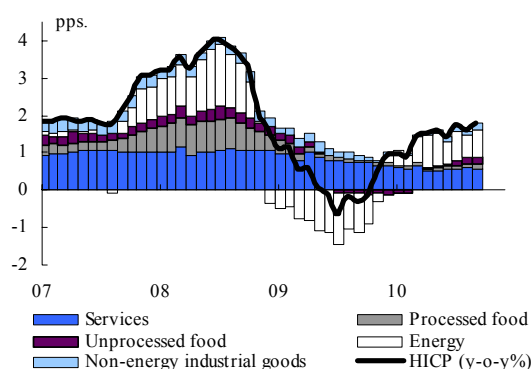
Since turning positive in the spring, producer-price inflation has also been on a broadly upward trend. Industrial prices in the euro area were up by 4.2% y-o-y in September, due to a combination of base effects and increases in the price of energy and intermediate inputs.

On the wage front, the two main indicators for the euro area have shown some divergence of late, though the overall picture is one of relatively muted wage growth. While the annual growth rate of hourly labour costs slowed in the second quarter of the year, to 1.6% from 1.9% in the first, nominal compensation per employee accelerated (rising by 2% compared to 1.5% in the previous quarter). With continuing labour-market slack set to dampen upward pressures somewhat, wage growth is projected to remain moderate over the forecast horizon. Partly because of this, but also because of improving labour productivity, unit labour cost growth is expected to turn negative this year, with only a modest rebound foreseen thereafter, to around $1\frac{1}{4}\%$ in the EU and to almost 1% in the euro area in 2012. The outlook in this respect is generally more muted for peripheral economies, reflecting the steps being taken to restore lost competitiveness.

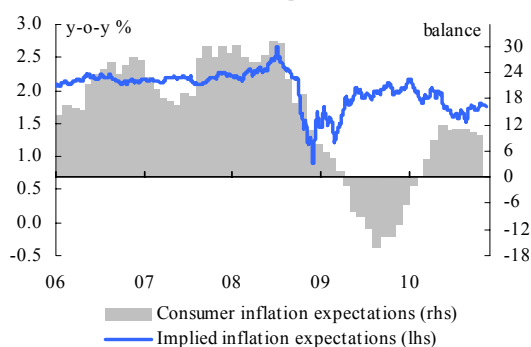
Weighing up these developments, inflation prospects appear rather subdued. The remaining slack in the economy, along with fairly moderate wage and unit-labour cost growth are expected to keep inflation in check going forward, notwithstanding slightly higher commodity prices and increases in indirect taxation and administered prices in some Member States. The latter come on the back of fiscal consolidation efforts, for example, the VAT rate in the UK is due to rise from 17.5% to 20% in January 2011 as part of the Government's adjustment programme.

Inflation expectations offer further support to this outlook, remaining well-anchored according to standard measures (see graph I.1.8).

Graph I.1.17: Contributions to inflation, euro area

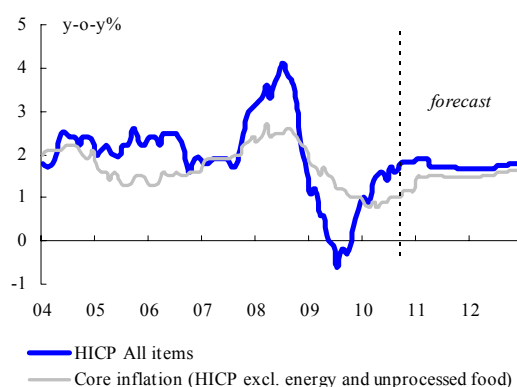


Graph I.1.18: Inflation expectations, euro area



Note: Implied expectations derived from inflation-indexed government bonds, 10 year horizon

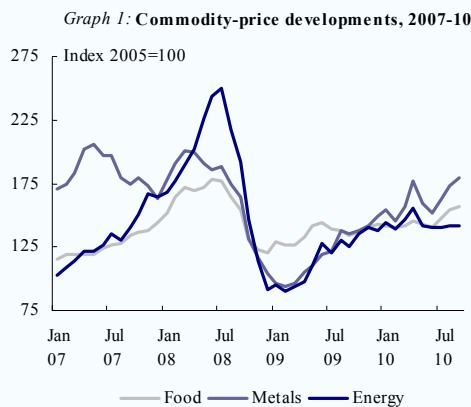
Graph I.1.19: Headline and core inflation, euro area



All-in-all, HICP inflation is projected to average 2% in the EU this year and next, easing to around $1\frac{3}{4}\%$ in 2012 on account of some softening in the UK. In the euro area, the headline rate is expected to pick-up from $1\frac{1}{2}\%$ in 2010 to about $1\frac{3}{4}\%$ in 2011-12. Likewise, core inflation is set to increase over the forecast horizon, as services inflation firms.

Box 1.1.6: Commodity price developments – how does the recent rebound compare to the previous spike in 2006-08?

In 2006-08 nominal prices of food and metals increased by around 70%, while those of oil more than doubled. Apart from buoyant economic growth, the food-price boom was driven by a combination of adverse weather conditions and the diversion of some food commodities to the production of biofuels. Moreover, government policies (including export bans and prohibitive taxes) brought global stocks of many food commodities down to levels not seen since the early 1970s. The weakening and/or reversal of these push-factors coupled with the financial crisis that erupted in September 2008 and the subsequent global economic downturn, induced sharp price declines across most commodities (see graph 1).



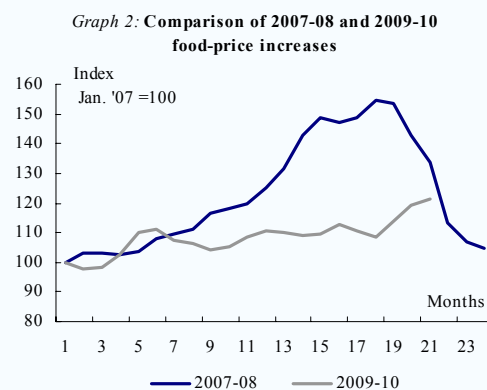
Commodity prices bottomed out in February 2009 and rebounded quickly thereafter. The pattern of commodity prices over the past two years contrasts with previous global downturns and recoveries, especially given the severity of the global recession. According to the IMF (WEO April 2010) commodity prices rebounded more quickly due to strong growth in energy-intensive emerging Asian economies, smaller increases in stocks, and the US dollar depreciation together with continued accommodative monetary policy in advanced economies.

Oil prices (Brent) have largely remained within a relatively narrow range of 70-80 USD per barrel since the fall in 2009. According to supply and demand estimates by the IEA, high OPEC spare capacity and OECD inventories as well as non-OPEC supply gains suggest that upward price pressures should remain moderate for some time.

In contrast to oil prices, *non-energy commodity prices* have been more volatile and have shown marked increases in recent months. Metal prices have nearly doubled since their trough in February 2009. The sharp recovery was mostly driven by rising Chinese demand. Large idle capacity and softening demand growth from China (although less than initially expected) are expected to limit future price increases (perhaps with the exception of rare earth commodities).

Agricultural commodity prices have fallen less during the downturn and have recently become less responsive to changing global economic conditions. Supply conditions have been the dominant determinant of agricultural price developments. During the summer of 2010, some agricultural commodities, including wheat, suffered adverse supply shocks, leading to sharp price increases. This has had some knock-on impacts on possible substitutes such as rice, barley and maize. Yet, the spillovers to most other agricultural commodities have so far been relatively limited.

The spike in the prices of several food commodities over the summer of 2010 was reminiscent of the 2008 food crisis. However, the current food price spike is smaller in size (see graph 2), less broad-based across commodities, and is driven by different factors compared to 2008. It is tightly linked to supply side shocks in specific grains, rather than broader global commodity price pressures and export restrictions. In addition, the stocks are much higher than they were in 2008. Nevertheless, prices of some grains are nearing their previous heights and there are increasing risks that low-income countries will again have major difficulties in coping with higher food prices.



... while public finances start to adjust

As noted earlier, a common legacy of the recent recession in the EU has been the shadow cast on public finances. That said, the deterioration in the budgetary position has been more marked in certain countries (i.e. the peripheral and some emerging economies, e.g. Latvia and Lithuania, along with the UK) than in others (such as Sweden). A year into the recovery and some adjustment seems to be taking place on the fiscal side, with around half of EU Member States set to post a lower general government deficit this year than in 2009. A notable exception in this respect is Ireland.⁽¹⁸⁾

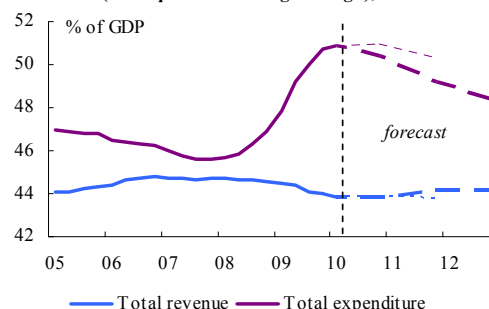
Net of the one-off intervention in Ireland, the general government deficit in the EU is projected to fall from some 6½% of GDP this year to just over 5% in 2011. This represents a downward revision compared to the spring forecast (of roughly ¾ pp. in 2010 and 1½ pps. in 2011), mainly due to stronger than expected economic activity this year and the additional consolidation measures (mostly on the expenditure side) adopted since, including the budget proposals for 2011 in most countries. A further decline in the deficit, to about 4¼%, is foreseen for 2012 as the recovery gains ground. This downward trend is also evident in the euro area, where a deficit of some 6% of GDP is expected this year, falling to around 4½% in 2011 and slightly below 4% in 2012.⁽¹⁹⁾ The picture here is also somewhat brighter than in the spring.

In terms of the components, a more pronounced decline in the expenditure-to-GDP ratio is now projected in the EU, while the revenue ratio is expected to slowly converge towards its pre-crisis level from 2011 on.

With the stimulus measures taken by several Member States to promote investment, support households' purchasing power, help enterprises and sustain labour markets (in line with the European Economic Recovery Plan) coming to an end, and the consolidation phase increasingly

taking hold, the fiscal stance is set to turn restrictive in 2011 in the EU and euro area. In other words, fiscal conditions will act as a drag on GDP growth.

Graph I.1.20: Total revenue and expenditure (four-quarter moving average), EU



Note: The solid dashed lines represent the current forecast, whereas the light dashed lines refer to the spring 2010 forecast

Turning to government debt, the debt-to-GDP ratio is projected to remain on an upward path over the forecast horizon. The pace of the increase is set to moderate somewhat though, largely on the back of less negative primary balances going forward (see table I.1.5).⁽²⁰⁾ In the EU, the gross debt ratio is projected to rise to a level of over 83% of GDP by 2012; and to almost 88% in the euro area.

Table I.1.5:

Euro-area debt dynamics

(% of GDP)	average 2003-07	2008	2009	2010	2011	2012
Gross debt ratio ¹	68.6	69.7	79.1	84.1	86.5	87.8
Change in the ratio	-0.4	3.6	9.4	5.0	2.4	1.3
Contributions ² :						
1. Primary balance	-0.9	-1.0	3.4	3.5	1.6	0.8
2. "Snow-ball" effect	0.2	1.4	5.1	1.1	0.6	0.4
Of which:						
Interest expenditure	3.0	3.0	2.8	2.9	3.0	3.2
Growth effect	-1.4	-0.3	3.0	-1.3	-1.2	-1.5
Inflation effect	-1.4	-1.3	-0.7	-0.4	-1.2	-1.2
3. Stock-flow adjustment	0.3	3.2	0.9	0.5	0.2	0.1

Notes:

¹ End of period

² The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects

⁽²⁰⁾ Note that the exceptional magnitude of the stock-flow adjustment in 2008 largely reflects the sizeable financial sector rescue interventions. Public money amounting to about 2.1% of EU GDP has been injected into this sector in the form of recapitalisation since 2008. These measures affect government debt, but not the deficit. Moreover, guarantees to the financial sector of around 24½% of EU GDP have been approved by the European Commission, of which 6% of GDP has actually been granted so far. Impaired asset relief and liquidity support to the banking sector, similar in nature to guarantees, amount to almost 4% of GDP (approved). Guarantees represent contingent liabilities which affect the government deficit (and debt) only once they are called on.

With high debt ratios projected at the aggregate level and for many Member States, debt could also act as a drag on economic activity in the period ahead. According to research findings, high levels of debt relative to GDP are associated with significantly lower growth outcomes in both advanced and emerging economies.⁽²¹⁾ As discussed in the fiscal consolidation chapter, there are three main channels through which this effect can come about; namely higher savings on the part of households, the financing of deficits via distortionary taxation and increases in government risk premia.

1.3. UNCERTAINTY REMAINS HIGH

While the recovery of the EU economy appears to be taking hold, uncertainty at the current juncture is high. The growth outlook presented here is thus subject to non-negligible risks. These risks go in both directions, but appear broadly balanced for 2010 and 2011-12.

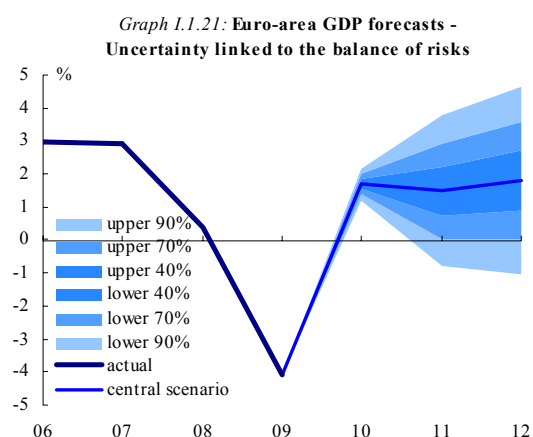
On the upside, the rebalancing of GDP growth away from exports and towards domestic demand could prove stronger than assumed in the baseline. Additional support in this respect may come from the labour market, should it continue to positively surprise – as it has done for some time now. The materialisation of these risks would add to the self-sustainability of the economic recovery in the EU. Likewise, the spillover expected from the pick-up in activity in Germany to other Member States could turn out to be larger than envisaged at present, further strengthening the recovery.

Another upside risk relates to the policy measures being taken, or yet to be implemented, to tackle high fiscal deficits and debt. These may prove more effective than assumed to date in dissipating market concerns, as well as in boosting confidence among business and consumers. As a result, domestic demand could be stronger than expected. Indeed, research findings suggest that in countries where perceived sovereign risk is high, the contractionary effect of fiscal consolidation is milder, consistent with the notion that confidence or credibility effects help alleviate the negative impact of consolidating.⁽²²⁾

On the downside, softening global demand in the second part of this year – beyond that allowed for in the baseline – poses a risk for EU export growth. Also on the external front, tensions regarding exchange-rate developments and global imbalances may trigger an increase in protectionist measures, thus weighing on the global recovery.

Moreover, the relatively fragile financial-market situation remains a concern. Tensions in sovereign-bond markets have reappeared in some euro-area countries of late, with the potential for broader effects. For instance, renewed turbulence in sovereign-debt markets, or stress in systemic banks, could give rise to adverse feedback loops between the two. In addition, any softening of bank profits (e.g. due to a decline in net interest earnings) could undermine credit provision, with adverse consequences for economic activity. The possibility of a crowding-out of private sector debt by sovereign-debt issuance also cannot be ruled out. A further downside risk relates to the fiscal consolidation underway in a number of Member States. In so far as the nature and timing of such measures is uncertain, they may weigh more on domestic demand in the short term than currently envisaged.

Graph I.1.21 quantifies the various risks in terms of the possible deviation of output growth from the central forecast. It shows the impact that different combinations of risks could have on euro-area GDP growth in 2010-12, the outcomes being weighted by the probability of their occurrence.



⁽²¹⁾ See Reinhart, C.M. and Rogoff, K.S. (2010) 'Growth in a time of debt', American Economic Review, May 2010, Vol. 100, No. 2.

⁽²²⁾ For a detailed discussion, see IMF (2010) 'World Economic Outlook', October 2010.

Regarding the inflation outlook, risks also appear broadly balanced over the forecast horizon. On the one hand, higher oil and other commodity prices could pose an upside risk to the outlook, as could increases in indirect taxation and administered prices, to the extent that they are larger than anticipated at present. On the other hand, the remaining slack in the economy should keep inflationary pressures subdued going forward.

1.4. ECONOMIC CHALLENGES

The outlook presented in this autumn forecast points to the scale of the economic challenges policymakers need to address in order to sustain the recovery and ensure a return to a balanced growth path. As characteristics and priorities vary across Member States, country-specific challenges are discussed in the accompanying country chapters.

At the aggregate level, one economic challenge stands out as particularly urgent at this time, that of the need to tackle sovereign-debt tensions and break the negative feedback loop between developments in sovereign-bond markets, the banking sector and economic growth. Doing so requires action on each of these fronts.

Starting with sovereign-debt markets, a first challenge is to secure the long-term sustainability of public finances, with the crisis of last May and recent developments pointing to a need for some countries to deal with large fiscal deficits and debt in a credible way in the near term.

On the banking front, the challenge is to ensure the soundness of the system so that it is in a position to withstand any future stress and meet increased credit demand, and thus support economic activity.

As for growth, the main challenge is to mitigate the adverse impact of the financial and economic crisis on potential output, along with ensuring a more dynamic EU economy; inter alia, by undertaking the necessary restructuring and structural reform of product and labour markets under the Europe 2020 strategy. Measures aimed at raising employment and productivity will be indispensable for growth prospects and the sustainability of public finances further out, and could positively affect expectations in the short term. They should also help prevent a return to the hysteresis experienced by Europe in the past.

A final challenge relates to adjustment within the euro area, with the reappearance of tensions in sovereign-bond markets and the differentiation in the speed of recovery across Member States reinforcing the need to correct persisting imbalances.

Box 1.1.7: Some technical elements behind the forecast

The overall cut-off date for taking new information into account in this update of the Commission's macroeconomic outlook was 15 November. The forecast also incorporates validated public finance data from Eurostat's News Releases 157/2010, dated 22 October 2010 and 170/2010, dated 15 November 2010.

External assumptions

This forecast is based on a set of external assumptions, reflecting market expectations at the time of the forecast. To shield the assumptions from possible volatility during any given trading day, averages from a 10-day reference period (between 1 and 12 November) were used for exchange and interest rates, and for oil prices.

Exchange and interest rates

The technical assumption as regards exchange rates was standardised using fixed nominal exchange rates for all currencies. This technical assumption leads to implied average USD/EUR rates of 1.33 in 2010 and 1.39 in 2011-12. The average JPY/EUR rates are 116.54 in 2010 and 113.25 in 2011-12.

Interest-rate assumptions are market-based. Short-term interest rates for the euro area are derived from futures contracts. Long-term interest rates for the euro area, as well as short- and long-term interest rates for other Member States are calculated using implicit forward swap rates, corrected for the current spread between the interest rate and swap rate. In cases where no market instrument is available, fixed spread vis-à-vis euro-area interest rates is taken for both short- and long-term rates. As a result, short-term interest rates are expected to be 0.8% on average in 2010, 1.4% in 2011 and 1.7% in 2012 in the euro area. Long-term interest rates are assumed to be 2.7% on average in 2010, 2.6% in 2011 and 2.8% in 2012.

Commodity prices

Commodity price assumptions are also, as far as possible, based on market conditions. According to futures markets, prices for Brent oil are projected to be on average 79.9 USD/bl. in 2010, 88.9 USD/bl. in 2011 and 90.8 USD/bl. in 2012. This would correspond to an oil price of 60.1 EUR/bl. in 2010, 64.0 EUR/bl. in 2011 and 65.3 EUR/bl. in 2012.

Budgetary data

Data up to 2009 are based on data notified by Member States to the European Commission on 1 October and validated by Eurostat on 22 October 2010 for all Member States but Greece. Data for Greece were validated on the 15 November 2010 and Eurostat has lifted the reservation on Greek data expressed in its News Release 55/2010 of 22 April 2010. Eurostat and the Hellenic Statistical Authority have addressed all of the issues identified in the last reservation during a series of EDP methodological visits.

As usual, government deficit data notified by the UK for the years to 2009 have been slightly amended for consistency with Eurostat's view on the recording of UMTS licences proceeds.

For the forecast, measures in support of financial stability have been recorded in line with the Eurostat decision of 15 July 2009.⁽¹⁾ Unless reported otherwise by the Member State concerned, capital injections known in sufficient detail have been included in the forecast as financial transactions, i.e. increasing the debt, but not the deficit. State guarantees on bank liabilities and deposits are not included as government expenditure, unless there is evidence that they have been called on at the time the forecast was closed. Note, however, that loans granted to banks by the government, or by other entities classified in the government sector, usually add to government debt.

For 2011, budgets adopted or presented to national parliaments and all other measures known in sufficient detail are taken into consideration. For 2012, the 'no-policy-change' assumption used in the forecasts implies the extrapolation of revenue and expenditure trends and the inclusion of measures that are known in sufficient detail.

The general government balances that are relevant for the Excessive Deficit Procedure may be slightly different from those published in the national accounts. The difference concerns settlements under swaps and forward rate agreements (FRA). According to ESA95 (amended by regulation No. 2558/2001), swap- and FRA-related flows are financial transactions and therefore excluded from the calculation of the government balance. However, for the purposes of the excessive deficit

⁽¹⁾ Eurostat News Release N° 103/2009.

(Continued on the next page)

Box (continued)

procedure, such flows are recorded as net interest expenditure.

Calendar effects on GDP growth and output gaps

The number of working days may differ from one year to another. The Commission's annual GDP forecasts are not adjusted for the number of working days, but quarterly forecasts are.

However, the working-day effect in the EU and the euro area is estimated to be limited over the forecast horizon, implying that adjusted and unadjusted growth rates differ only marginally. The calculation of potential growth and the output gap does not adjust for working days. Since the working-day effect is considered as temporary, it should not affect the cyclically-adjusted balances.

Euro-area enlargement with Estonia

Following the Council Decision (2010/416/EU) of 13 July 2010 on the adoption by Estonia of the euro on 1 January 2011⁽¹⁾, in line with past practice, all forecast numbers (i.e. for 2010-12) for the euro-area aggregate include Estonia. For the sake of comparability, all reference forecast numbers from the spring (2010-11) and all historical numbers for the euro-area aggregate have been recalculated and refer to EA-17 aggregate. Consequently, all the graphs in Chapter 1 displaying annual data for the euro area present the EA-17 aggregate for historical and forecast years.

⁽¹⁾ Council Decision (2010/416/EU) of 13 July 2010 in accordance with Article 140(2) of the Treaty on the adoption by Estonia of the euro on 1 January 2011, OJ L 196, 28.7.2010, p. 24.

New methodology for output gap calculations

Following the decision of the Economic Policy Committee in December 2009, DG ECFIN has replaced the previously used Hodrick-Prescott (HP) method for detrending TFP with a new Kalman filter (KF) based approach which exploits the link between TFP and capacity utilisation. This step has been taken to address a number of problems with the HP filter method, especially its tendency to produce imprecise estimates at the end of the sample period, most notably close to turning points. The new KF method is expected to address some of the shortcomings with the existing approach. In particular, it should lead to more precise trend TFP estimates which are less frequently revised over time.

As in the previous approaches, the new method breaks a TFP series into a trend and a cyclical component. Its non-standard element is an additional equation that serves to extract information on the TFP cycle that is present in the data on over or underutilisation of resources in the economy. The industry capacity utilisation index and the economic sentiment indicator (industry and services) are used for this purpose, both series collected as part of the European Commission's Business and Consumer Survey Programme. The econometric equations are estimated using Bayesian techniques. More details on the applied theoretical model as well as on the estimation practicalities can be found in Francesca D'Auria, Cécile Denis, Karel Havik, Kieran Mc Morrow, Christophe Planas, Rafal Raciborski, Werner Röger & Alessandro Rossi, (2010) "The production function methodology for calculating potential growth rates and output gaps", *European Economy Economic Paper*, no 420.

2. THE IMPACT OF FISCAL CONSOLIDATION ON EUROPE'S ECONOMIC OUTLOOK

European governments will have to make significant fiscal retrenchments in the coming years. The crisis has drastically reversed the favourable economic and financial conditions that prevailed until 2007 and made clear that windfalls accumulated during good times have not been sufficiently used to create room for manoeuvre when times turned bad. Very sizeable budgetary consolidation will be necessary in most Member States to bring public debt again on a declining path.

The major concern at the present juncture is what the impact of these consolidation measures will be on economic growth. Given the uncertainty about the underlying strength of the economy, it is feared that output losses caused by large scale fiscal retrenchments could derail the recovery. Economic conditions matter, as model simulations indicate that fiscal multipliers are larger when more households are credit-constrained and when the zero lower bound on nominal interest rates is binding. A withdrawal of stimulus measures and a rapid introduction of fiscal consolidation measures would thus be more costly if credit conditions remain tight and/or monetary policy is constrained by the interest rate floor.

However, prolonging stimulus measures to support the recovery and delaying consolidations is difficult for governments that now face punitive sovereign-bond spreads. Financial market pressures force governments to announce far-reaching consolidation plans. Model simulations presented in this chapter indicate that fiscal consolidations that are credible and perceived as permanent lead to short-term falls in GDP and employment but these effects are significantly smaller than multipliers for temporary fiscal policy changes. The impact on GDP can be larger at the zero interest rate floor. But reducing government debt levels can give positive GDP and employment effects in the longer run, as lower debt-servicing costs will create fiscal space for reducing distortionary taxes. The short and long run output effects depend crucially on the fiscal instrument used, and, hence, on the composition of the adjustment. Consolidations can be designed so as to minimise the short term costs and maximise the long run gains. Consolidations that reduce pension transfers by raising the retirement age can reverse the upward trend in age-related expenditure and simultaneously increase the labour force and raise potential output.

2.1. INTRODUCTION

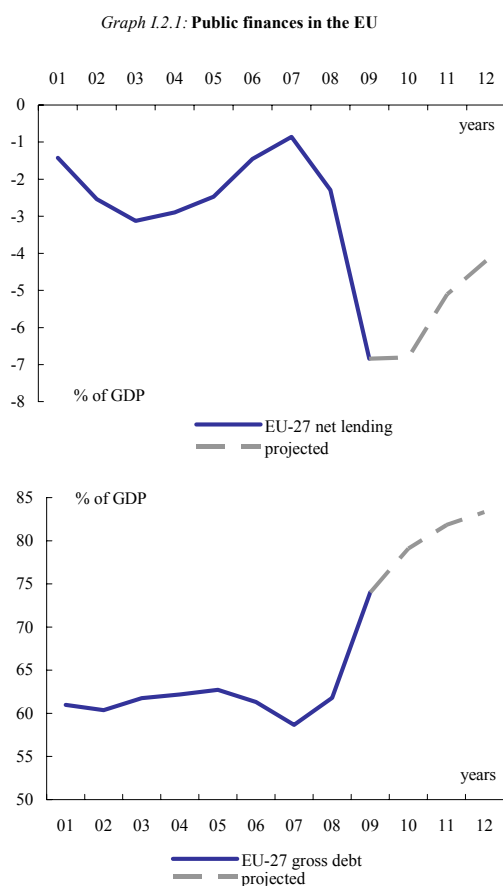
Public finances in the European Union have deteriorated sharply in recent years. The aggregate government budget deficit in the EU-27 increased markedly in the crisis, from less than 1% of GDP in 2007 to almost 7% of GDP in 2009. This has led to a strong rise in the debt-to-GDP ratio for the EU27, to more than 80% of GDP projected in 2011 (see Graph I.2.1). With high primary budget deficits and rising interest expenditure, debt-to-GDP ratios are projected to increase further. Mechanical projections for the debt ratios based on unchanged-policy assumptions suggest that debt-to-GDP ratios could rise to above 100% of GDP by the end of the decade if no action is taken, which would leave Member States ill-prepared for the future costs of aging populations. These concerns about the long run sustainability of public finances in certain countries have fed tensions in government bond markets and led to steep

increases in sovereign-bond yields for the Member States concerned.

The dramatic deterioration in public finances is partly cyclical and the consequence of the 'normal' operation of so-called automatic stabilisers. One can expect this to be reversed when the economy recovers, although the financial crisis has had ongoing negative effects on potential growth and this could put further pressure on public finances.⁽²³⁾ But the deterioration in underlying fiscal positions dates back to well before the crisis. In many countries, credit and asset price booms had led to improvements in fiscal positions in the years preceding the crisis, and this partly obscured the deterioration in underlying positions. The failure to fully account for the direct and indirect effects of strong asset prices on fiscal positions led

⁽²³⁾ "Impact of the current economic and financial crisis on potential output", *European Economy Occasional Paper* 49, June 2009; "Economic Crisis in Europe: Causes, Consequences and Responses", *European Economy* 7, 2009.

to a distorted and overly optimistic assessment of the true fiscal stance in these 'good' years. When the bubble burst and the crisis unfolded, tax revenues fell sharply and the dramatic increase in budget deficits became apparent.



Crisis-related stimulus measures also contributed to the deterioration in fiscal positions, but account for a relatively small share. EU Member States implemented countercyclical fiscal measures under the common framework provided by the European Economic Recovery Plan (EERP), launched by the European Commission back in December 2008. On average the fiscal stimulus in 2009 amounted to slightly more than 1% of GDP in the EU27 and slightly less than that in 2010, with a considerable dispersion of package sizes across Member States. The discretionary stimulus measures were called for as automatic stabilisers were considered insufficient to stem the collapse in demand following the financial crisis and conventional monetary policy was constrained by the zero lower bound. Discretionary fiscal policy was deemed to be more effective in the economic crisis due to two specific conditions: the significant tightening of

credit conditions, and the zero lower bound on nominal interest rates.⁽²⁴⁾

There is no broad consensus about the efficacy of discretionary fiscal policy. Empirical evidence from structural VAR approaches shows that much uncertainty exists about the size of spending and tax multipliers, with estimates ranging from small or even negative numbers to values larger than one. Structural general equilibrium models show output effects can be large for temporary stimuli when the zero lower bound is binding.⁽²⁵⁾ Table I.2.1 shows fiscal multipliers for temporary shocks in the Commission's QUEST model.⁽²⁶⁾ Multipliers can be large, in particular for spending shocks and targeted transfers, and are higher in the presence of credit-constrained households and at the zero interest rate floor. This is a robust finding in macroeconomic models, as results from a model comparison exercise of various structural models used by policymaking institutions showed.⁽²⁷⁾ There is considerable agreement across models on both the absolute and relative sizes of different types of fiscal multipliers. More generally, the fiscal multiplier is found to be larger 1) for direct government spending and targeted transfers (as opposed to tax cuts and general transfers); 2) if the share of liquidity-constrained (or 'rule of thumb') and/or credit-constrained consumers is larger; 3) if monetary policy supports fiscal policy by

⁽²⁴⁾ For an analysis of fiscal policy in the presence of credit constrained households and a binding zero lower bound on nominal interest rates, see Roeger W., in 't Veld J.(2009), "Fiscal Policy with Credit Constrained Households", *European Economy Economic Paper no.357*.

⁽²⁵⁾ See e.g. Christiano L., Eichenbaum, M., Rebelo, S. (2009), When is the Government Spending Multiplier Large?, NBER Working paper 15394.; Eggertson, G. B. (2009), What fiscal policy is effective at zero interest rates. Federal Reserve Bank of New York Staff Report Nr. 402; Erceg, C.J., Linde, J.,(2010). Is there a Fiscal Free Lunch in a Liquidity Trap?, CEPR Discussion Paper no. 7624. Woodford, M.(2010), Simple Analytics of the Government Expenditure Multiplier. NBER Working paper no 15714.

⁽²⁶⁾ The version of the QUEST-III model used in this chapter consists of two regions (EU27 and the rest of the world), and contains tradables and non-tradables sector, housing, and a public sector. The household sector is disaggregated into 1. liquidity-constrained ('rule of thumb') households, who consume their disposable income, 2. credit-constrained households that optimise utility but face a collateral constraint linked to their housing value, and 3. unconstrained households who fully engage in financial markets (Roeger and in 't Veld, 2010). For references, see: http://ec.europa.eu/economy_finance/research/macroeconomic_models_en.htm

⁽²⁷⁾ Coenen, G., C. Erceg, C. Freedman, D. Furceri, M. Kumhof, R. Lalonde, D. Laxton, J. Linde, A. Mourougane, D. Muir, S. Mursula, C. de Resende, J. Roberts, W. Roeger, S. Snudden, M. Trabandt, J. in 't Veld (2010). Effects of Fiscal Stimulus in Structural Models. IMF Working Paper WP/10/73.

Table I.2.1:
Fiscal multipliers temporary shocks

	EU alone			Global stimulus		
	Without credit constraints	With credit constraints	With credit constraints and zero interest rate floor	Without credit constraints	With credit constraints	With credit constraints and zero interest rate floor
Investment subsidies	1.5	1.6	2.0	2.0	2.1	2.6
Government investment	0.9	0.9	1.1	1.0	1.1	1.2
Government purchases	0.8	0.8	1.0	0.9	1.0	1.2
Government wages	1.1	1.3	1.4	1.2	1.3	1.5
General transfers	0.2	0.4	0.5	0.2	0.5	0.6
Transfers targetted to credit-constrained hh.	-	0.7	0.9	-	0.8	1.0
Transfers targetted to liquidity-constrained hh.	0.7	0.7	0.9	0.8	0.9	1.1
Labour tax	0.2	0.4	0.6	0.3	0.5	0.6
Consumption tax	0.4	0.5	0.7	0.5	0.6	0.8
Property tax	0.0	0.1	0.2	0.0	0.2	0.2
Corporate income tax	0.0	0.0	0.0	0.0	0.0	0.1

Note: First year impact on EU GDP (% diff. from baseline) for a temporary one year fiscal stimulus of 1% of baseline GDP.

accommodating stimulative fiscal actions through holding interest rates constant for some period of time (this effect is reinforced by the presence of credit-constrained households and also stronger in case of more persistent stimulus as long as monetary policy remains accommodative); 4) if economies are less open (unless the stimulus is global); 5) under a fixed exchange rate; 6) if the stimulus is temporary rather than permanent.

Very sizeable budgetary consolidation will be necessary in many Member States to bring public finances back on a sustainable path. This raises concerns about the impact on growth and a possible derailment of the recovery. The continuing relevance of credit constraints and a binding zero lower bound on interest rates would imply larger multipliers now than under 'normal' conditions and hence larger negative GDP effects from a withdrawal of stimulus measures and a rapid fiscal consolidation.⁽²⁸⁾ However, the distinction between temporary and permanent stimulus is important, as permanent fiscal expansions have significantly lower impact multipliers and negative output effects in the long run.⁽²⁹⁾ If consolidation measures are not credible but are perceived as temporary fiscal contractions, then the impact on GDP can be as large as for temporary shocks. But the objective of fiscal consolidation programmes is to achieve permanent reductions in government deficits and debt, and if measures are credible they can generate expectation effects of lower future tax liabilities and boost spending by households and firms, mitigating the negative impact of the fiscal contraction. This indicates the importance of

credibility of the permanent nature of fiscal consolidations. If measures are part of a credibly permanent consolidation plan, the short term impact on economic growth cannot be gauged from a simple reversal of stimulus multipliers, but could be significantly less detrimental, as will be discussed in this chapter.

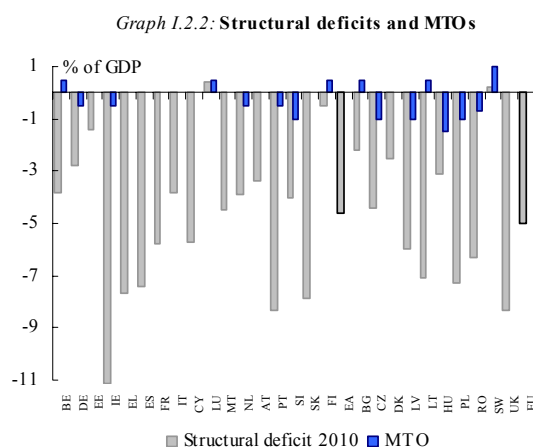
2.2. THE REQUIRED FISCAL CONSOLIDATION EFFORTS IN MEMBER STATES

There are significant differences in fiscal positions across Member States and the fiscal efforts required to bring positions back on a sustainable path will therefore also vary. In the short to medium run, under the Excessive Deficit Procedures the deadlines for correction and required structural efforts have been differentiated across Member States, taking into account country-specific circumstances. In particular, some Member States, whose margin of budgetary manoeuvre as determined by fiscal and macro-financial risks is considered to be large (such as Germany), have been encouraged to still run a fiscal stimulus in 2010, while others have been urged to start consolidating during the same year. Even when EDP final targets have been met, Member States are committed to gradually bring their deficits in line with the medium-term objectives for budgetary policy, which could be a small deficit or surplus (depending on agreed parameters, essentially, the level of debt and the projected cost of ageing). Graph I.2.2 below shows the structural deficits projected for 2010 and the MTOs set for each of the Member States. The difference between these two shows the structural effort that Member States are required to make. On average for the EU as a whole, the structural effort amounts to almost 5% of GDP. Measures foreseen over the current forecast horizon go some way

⁽²⁸⁾ Non-conventional monetary policy measures may independently support growth, but their impact on the size of fiscal multipliers is not a priori clear.

⁽²⁹⁾ Roeger W., in 't Veld J. (2010), "Fiscal stimulus and exit strategies in the EU: a model-based analysis", European Economy Economic Papers no. 426. See also Coenen et al. (2010), p.20-22.

towards meeting this target, but an equally large effort will be required in the following years.



2.3. MACRO-ECONOMIC EFFECTS OF HIGHER DEBT

In many EU Member States government debt-to-GDP ratios are on a strongly increasing path. The economic and budgetary effects of ageing populations will put further upward pressure on future debt developments. This raises concerns about the long run sustainability of public finances. This section discusses the possible macroeconomic effects of higher government debt.

A much-cited study by Reinhart and Rogoff (2010) shows evidence of a link between growth and debt when debt-to-GDP levels are high.⁽³⁰⁾ The authors use an extensive database of forty-four countries and about 200 years of observations. They find that the growth impact of government debt is negligible for levels of debt below a threshold of 90% of GDP, but above that threshold median growth rates fall by 1%, and average growth falls considerably more. Kumar and Woo (2010) also find higher debt has negative consequences for subsequent growth, based on growth regressions on a panel of advanced and emerging economies.⁽³¹⁾ The causal interpretation of this correlation has been questioned, and it has been argued it partly reflects the fact that countries with low growth are more likely to have encountered debt sustainability problems.⁽³²⁾ But even if the relationship is bidirectional, concerns about the

impact of higher debt on future growth cannot easily be dismissed.⁽³³⁾

There are three main channels through which government debt can affect long term growth: 1) an effect on national savings/interest rates; 2) an effect of distortionary taxes; 3) an effect on risk premia.

Savings/interest rates

The Ricardian equivalence proposition (Barro, 1974) states the conditions under which government debt would *not* have an effect on the level of output in the long run.⁽³⁴⁾ This proposition essentially states that no such link exists with infinitely-lived consumers (or finitely-lived consumers with highly developed bequest motives) with only non-distortionary (lump-sum) taxes and a zero probability that the government defaults on its debt. Under these conditions households will anticipate that taxes on government debt will eventually have to be paid. Government debt then only affects the composition of spending (i.e. lower private consumption) but not the level of output. However, to the extent that the abovementioned conditions are violated in the real world, government debt can have an effect on real economic activity.

One departure from Ricardian equivalence relates to the assumption of infinitely-lived households (or bequest motives of households caring about the well-being of their children). In an overlapping generations environment (where households leave no bequests to their descendants), government debt will be associated with a less than fully offsetting decline in private consumption and, hence, an effect on interest rates and on the level of output. However, for realistic life expectancies the effect on the interest rate in an OLG framework is negligible.⁽³⁵⁾ In QUEST model simulations, simulated either as an infinitely-lived-agent model

⁽³⁰⁾ Reinhart, C. M., Rogoff, K. S., 2010. "Growth in a Time of Debt", *American Economic Review*, May 2010, Vol. 100, No. 2, pp. 573-578.

⁽³¹⁾ Kumar, M., Woo, J., 2010. "Public Debt and Growth", IMF Working Paper WP/10/174, July.

⁽³²⁾ Iron, J., Bivens, J., 2010. "Government Debt and Economic Growth", Economic Policy Institute Briefing Paper 271.

⁽³³⁾ Reinhart, C. M., Rogoff, K. S., 2010. "Debt and growth revisited", VoxEU.org, 11 August 2010.

⁽³⁴⁾ Barro, R. J. (1974), "Are Government Bonds Net Wealth?", *Journal of Political Economy*, Vol. 82 (6), pp. 1095-1117.

⁽³⁵⁾ Kumhof, M., Laxton D. (2009), "Fiscal Deficits and Current Account Deficits", IMF WP/09/237, show there is no difference in the interest rate response between a 50 year OLG model and an infinitely-lived-agent model. Significant interest rate effects emerge from OLG models only with very short time horizons, but this leads to counterfactual implications of very high marginal propensity to consume out of financial wealth. Empirical estimates suggest values in the range between 0.02 and 0.04 which is roughly in the range of models with planning horizons above 50 years.

or as an OLG model with a realistic life expectancy of 50 years, the savings channel of government debt is negligible.⁽³⁶⁾

Distortionary taxation

Another departure from the Ricardian equivalence proposition relates to the assumption of lump-sum taxation. Financing of deficits via *distortionary taxes* leads to a negative impact of debt on GDP. Higher government debt implies higher interest charges and government revenue will need to be higher (for given expenditure levels) to service this debt. The larger the distortions of taxes are, the larger the negative effect on potential GDP. In the QUEST model the distortions are largest for corporate profit taxes, due to their negative impact on capital accumulation. Labour taxes distort employment decisions and have a negative impact on potential output. Property taxes on housing discourage residential investment but have no direct negative impact on other factors of production and have smaller negative long run output effects. Taxes on consumption (VAT) are least distortionary in the model.

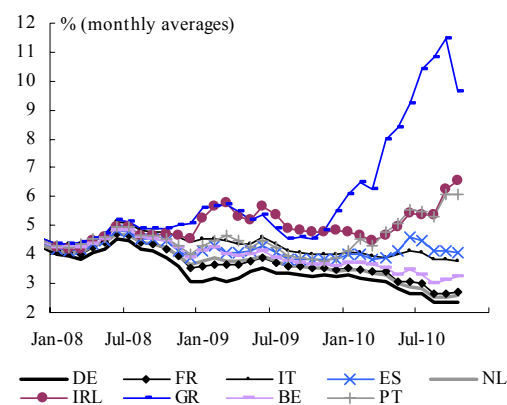
The servicing costs associated with higher debt also have distributional consequences which depend on the tax instrument used. Labour income taxes mostly hit workers, and constrained 'rule of thumb' households with no other sources of income will be most affected. Corporate profit taxes hurt capital owners most, but also reduce employment and affect workers. Consumption taxes depress consumption of all income groups.

Risk premia

Empirical evidence suggests that higher government debt is associated with an increase in real interest rates on government bonds. Laubach (2009) reports an effect ranging from a 1 to 6 basispoints increase in interest rates on government bonds for a 1 pp. increase of the government debt-to-GDP ratio.⁽³⁷⁾ There is

however no consensus on whether this increase is confined to government bonds or whether it affects the general level of interest rates in the respective country. It may well be that for countries which rely heavily of foreign financing of investment an increase in government debt could lead to a general increase in the risk premium for the currency and raise interest rates for both government and private bonds. However, evidence for the US shows that an increase in Treasury debt held by the public leads to a decline in yield spread of AAA corporate debt over Treasuries.⁽³⁸⁾ This suggests that an increase in government debt may raise the sovereign spread but reduces the spread between government and corporate bonds.⁽³⁹⁾

Graph I.2.3: 10y government bond yields, by country



Graph I.2.3 shows 10-year government bond yields of selected member states. The spreads of sovereign Greek and Irish bonds to German bonds have widened in recent months, as concerns about long run sustainability of public finances in these countries mounted. But the correlation with the level of gross debt is not clear cut, as Graph I.2.4 shows. Greece has the highest gross debt-to-GDP ratio in the euro area and faces the highest spread, but Belgium and Italy have similar or larger debt ratios than Ireland and Portugal while facing considerably lower spreads. Structural problems,

⁽³⁶⁾ In the model simulations presented here only a fraction of households has an infinite planning horizon. Liquidity constrained households have a zero planning horizon and credit (or collateral) constrained households have an effective planning horizon of about 10 years. However, what matters is that savers (no matter how large their share in the total population) have an infinite planning horizon. Mankiw, N.G. (2000), The Savers-Spenders Theory of Fiscal Policy, *American Economic Review* 90(2): 120-25.

⁽³⁷⁾ Laubach, T., 2009. "New evidence on the interest rate effects of budget deficits and debt". *Journal of the European Economic Association*, 7(4): 858-85.

⁽³⁸⁾ Krishnamurthy, A. and A. Vissing-Jorgensen, 2007. The Demand for Treasury Debt, NBER Working paper 12881.

⁽³⁹⁾ Model simulations reported in this chapter include an endogenous risk premium term to government bonds rates that is calibrated such that a 1 pp. increase in the debt-to-GDP ratio leads to a 3 bps. increase in government bond rates, roughly in the middle of the range estimated by Laubach (2009).

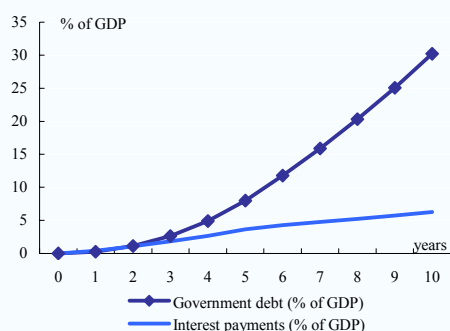
Box 1.2.1: Impact of sovereign risk premia

Many governments now face punitive sovereign bond spreads and can no longer delay extensive consolidations. These spreads, if persistent, can have serious implications for public finances and GDP.

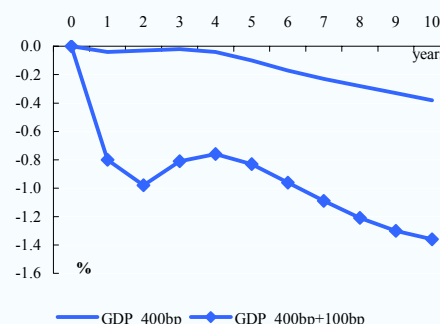
Graph 1a and 1b show a stylised model simulation of a sovereign risk premium of 400 bps. over a period of ten years, without policy reaction. This leads to a gradual increase in government interest payments, a deterioration in the government deficit, an accumulation of debt, and, with part of the interest payments flowing abroad (wealth transfer), a deterioration in the current account.⁽¹⁾

expenditure and/or increase taxes. In model simulations, a debt stabilisation rule triggers an increase in labour taxes that gradually stabilises the government debt ratio in the long run. The increase in distortionary labour taxes reduces consumption and employment. GDP falls 0.4% below baseline after ten years (Graph 2a and 2b). The rise in taxes cannot avoid the debt-to-GDP ratio increasing by more than 10 pps. Although the trade balance improves as imports decline, the current account deteriorates due to higher government interest payments to foreign holders of government debt.

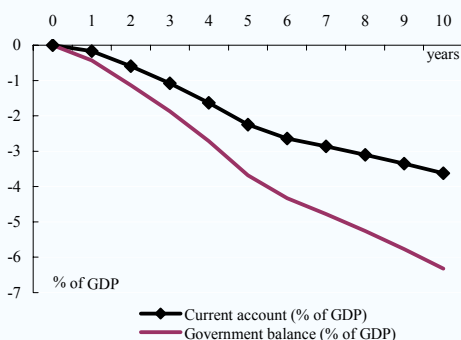
Graph 1a: Impact sovereign risk premium



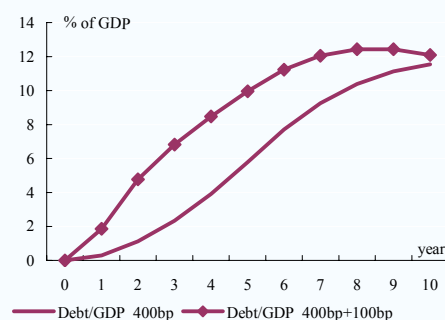
Graph 2a: Impact of risk premia



Graph 1b: Impact sovereign risk premium (2)



Graph 2b: Impact of risk premia (2)



A permanent rise in debt servicing costs will elicit a response and force governments to cut back

⁽¹⁾ The model is calibrated as a small euro area economy with government debt at 80% of GDP, with an average maturity of 5 years, and 70% of debt held abroad. The scenario simulated assumes a 400 bps. sovereign spread lasting for 10 years, after which period it is gradually phased out (with an autoregressive coefficient of 0.9). In the first scenario no fiscal reaction is assumed.

There is no conclusive evidence on how sovereign-risk premia affect private sector borrowing rates. So far there appears little evidence of the sovereign risk premia spreading to the private sector and raising yields on corporate bonds. Evidence for the US suggests that an increase in government debt reduces the spread between government and corporate bonds. This would suggest that corporate-bond rates are not directly affected by increases in sovereign spreads. However, expectations of future defaults may lead

(Continued on the next page)

Box (continued)

to a general reassessment of risks and bring about a general economy-wide increase in risk premia. That would cause much larger GDP losses, as illustrated in the alternative scenario in Graph 2a and 2b in which the sovereign risk premium is assumed to spill over to private sector borrowing

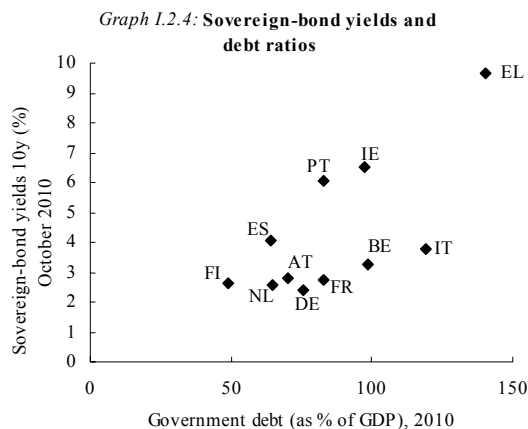
costs and lead to a wider economy-wide risk premium of 100 bps. In that case, there is a sharp fall in consumption and investment, and GDP declines by 0.8% in the first year and is 1.4% lower after a decade.

lower growth expectations and state guarantees to the banking system also shape markets' assessments of long run sustainability of public finances. The box discusses the impact of higher sovereign risk premia on public finances and GDP.

the effects for individual revenue and expenditure instruments. Scenarios are presented as standardised reductions in the ex-ante government deficit-to-GDP ratio by 1 pp. In each scenario this is achieved by an adjustment in the respective instrument that equals ex-ante 1% of (baseline) GDP.⁽⁴⁰⁾ With the gradual de-cumulation of government debt, lower interest payments create space for reductions in labour taxes, and this raises employment and boosts GDP in the medium and long run.

Expenditure measures

On the expenditure side, the main difference is between productive and unproductive spending. Government investment has a productivity-raising effect and a permanent reduction leads to the largest GDP losses, both in the short and long run. Transfers are unproductive in the model and only serve distributional purposes. Reducing such transfers – and lowering distortionary labour taxes in the medium/long run – leads rapidly to positive output effects in the model. However, cuts in transfers hit proportionally more those constrained 'rule of thumb' households who are more dependent on such transfers and have limited access to financial markets. Consumption of those households declines sharply. An example of a transfer shock is a reduction in pension benefits, but an alternative option of pension reform that raises the retirement age is discussed in Box I.2.2. Government purchases have no productivity-raising effect and a reduction in this instrument has only a short-term negative GDP effect when it is compensated by cuts in labour taxes in the medium/long run.



2.4. THE MACRO-ECONOMIC IMPACT OF FISCAL CONSOLIDATIONS

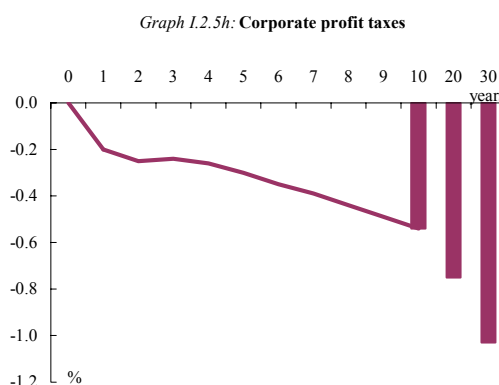
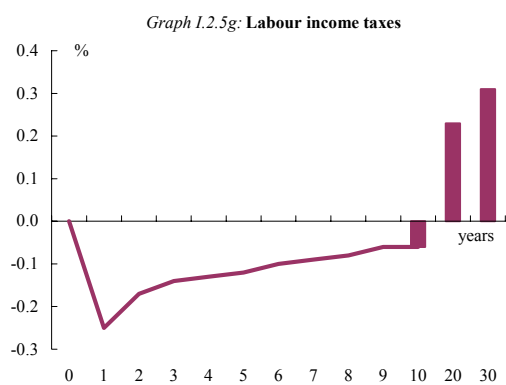
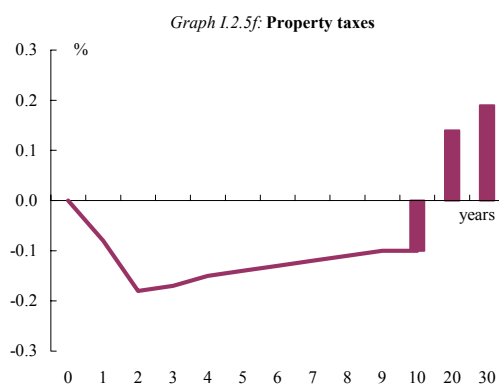
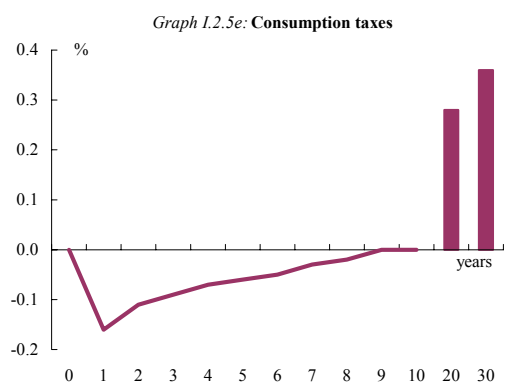
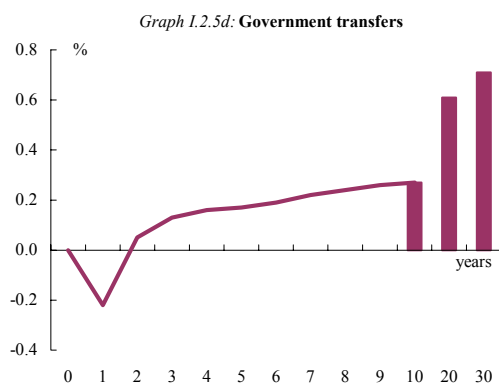
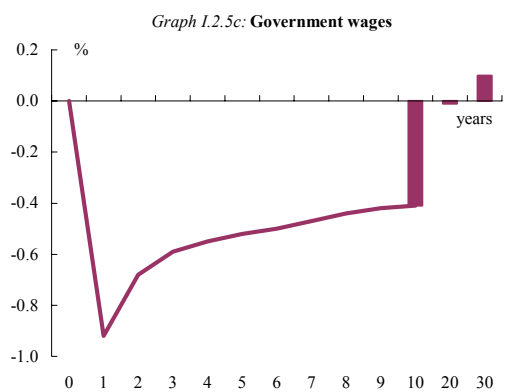
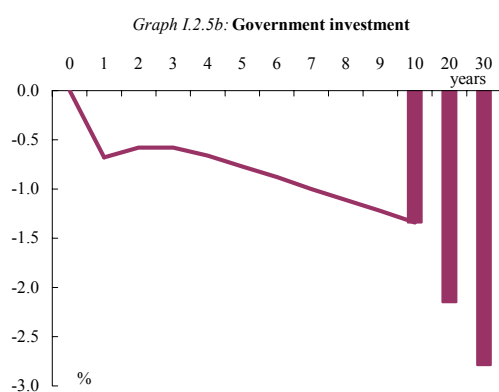
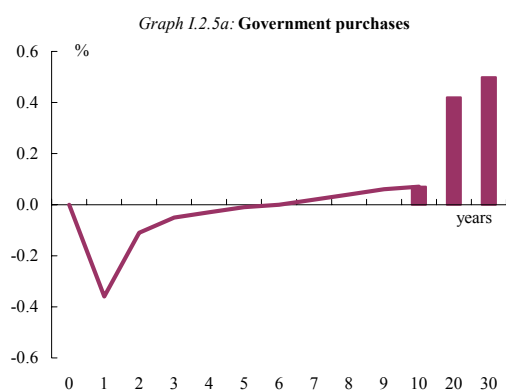
This section explores the macroeconomic effects of permanent consolidations, using the Commission's QUEST model. First, permanent changes in individual revenue and expenditure instruments are considered separately to highlight their different impacts on the economy. The effects of a credible general 'across-the-board' fiscal consolidation is then compared to an alternative where credibility is lacking and agents do initially not believe consolidation measures are permanent. The effect of the zero interest rate floor is considered, as well as the effects in case of a synchronised global consolidation. Finally, targeted consolidations combining expenditure cuts with tax cuts are shown.

2.4.1. By expenditure and revenue instrument

The impact of fiscal consolidations depends crucially on their composition. Graph I.2.5 shows

⁽⁴⁰⁾ At first consolidations in the EU only are considered. The model assumes a continuing relevance of credit constraints in the economy. The labour tax rule that stabilises debt in the model is turned off in the first 15 years and then targets a 25 pps. lower debt-to-GDP ratio, consistent with a 1% of GDP permanent reduction in the government deficit and the assumptions on nominal growth rates in the model. The sovereign risk premium declines by 75 bps. in the long run.

Graph I.2.5: GDP impact of 1% of GDP fiscal consolidation



Box 1.2.2: Pension reform: raising the retirement age

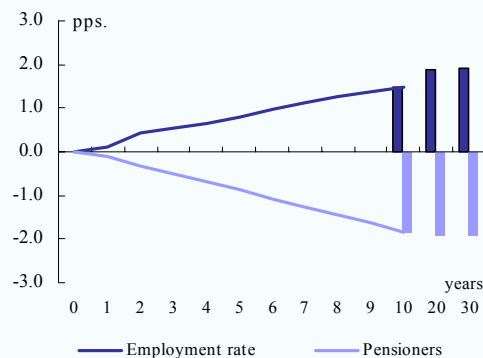
Expenditures on age-related support will increase significantly over the coming years. Based on current policies, for the EU27, age-related expenditure (pension provision, health care and long-term care) is set to increase by 4½% of GDP between 2010 and 2060. These growing costs will put further pressure on the long run sustainability of fiscal balances.

Reforms in the area of pension provisions are therefore considered priority for fiscal consolidation and long-term sustainability. Reforms that reduce pension benefits by cutting average replacement rates will decrease transfer payments to households, and yield positive output effects in the medium term, as shown in Graph 1.2.5.d. An alternative option of pension reform is raising the statutory retirement age, and this is the path taken by many member states (e.g. in Germany from 65 to 67, in France from 60 to 62). Such reforms can have both favourable public finance implications and positive labour market effects. By reducing the number of people entitled to a state pension, they reduce public transfers paid to households and, as more workers stay longer in employment, raise social security contributions. The improvement in public finances helps to bring down government debt and lower government interest payments will then create additional fiscal space in the future that could be used for reducing distortionary taxes. By extending working lives the reforms increase the labour force, put downward pressure on wages and raise the employment rate. This can give a direct boost to potential output and raise growth over a prolonged period.

A model simulation can illustrate the effects of lifting the retirement age. In this scenario the number of pensioners are gradually reduced by 10%, roughly corresponding to an increase in the age of retirement by two years, phased in over a 10-year period. After a decade the pension rate has fallen by almost 2 pps. The reform puts downward pressure on wages and raises employment. The employment rate increases by 1½ pps. after 10 years, and almost 2 pps. in the long run.⁽¹⁾ There is initially a negative impact on consumption of constrained households as wages decline, but the positive employment effect raises

permanent income, and consumption of non-constrained households rises. Aggregate consumption and corporate investment are higher after ten years. Government budget balances improve due to lower transfer payments and the debt-to-GDP ratio declines by 14 pps., and more than 30 pps. in the long run. The scenario assumes average productivity is not affected by the reform. A larger share of older workers in the labour force may reduce average labour productivity, but it is unlikely that this effect would eliminate the long run GDP gains from this reform.

Graph 1: Employment and pensioners rate



Graph 2: GDP

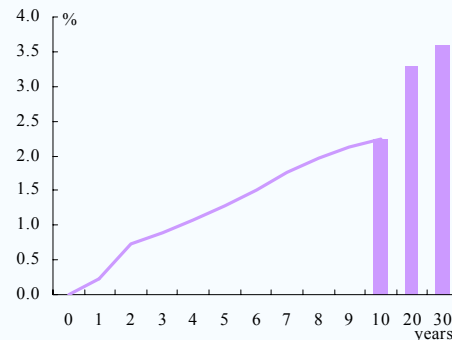


Table 1:

Macro-economic impact raising retirement age

	After 10 years	After 40 years
GDP	2.2	3.6
Employment	2.1	3.0
Pensioners	-9.6	-10.0
Consumption	2.1	5.6
Investment	4.2	2.9
Transfers	-6.1	-7.2
Real wages	-0.4	-0.3
Gov balance (% of GDP)	3.3	1.1
Gov debt (% of GDP)	-14.8	-37.1

Note: reduction in number of pensioners of 10%, phased in over 10 years

⁽¹⁾ Note that this is not based on any exogenous assumption on the un/employment status during the extended working lives, and indeed, during the transition there may be a small increase in the share of unemployment benefit recipients.

Lowering government wages however has a direct impact on aggregate GDP as defined in the national accounts.⁽⁴¹⁾ Public sector wage cuts put downward pressure on wages in the private sector (spillover) and the reduction in incomes leads to a fall in consumption. This again particularly hits constrained households who depend on current disposable income for their consumption expenditure and their consumption falls. Lower wages in the private sector help to boost competitiveness though, and this, as well as expectations of lower future taxes, raises employment. These effects gradually increase value added in the private sector and more than offset the reduction in the public sector in aggregate GDP.⁽⁴²⁾

Revenue measures

Raising taxes has generally negative short and long term output effects, but in these scenarios tax increases are compensated in the long run by reductions in labour taxes as the debt burden declines. Thus the scenarios show the dynamic adjustment to partial tax shifts from labour taxes, to the extent that this is made possible by lower debt in the steady state.

Short term effects of tax increases depend partly on adjustment costs in capital and labour. An increase in corporate profit tax may, with relatively high adjustment costs on capital, only have a relatively small short term impact but GDP losses build up over following years as investment is depressed and the capital stock declines. It generates the largest long run GDP loss of all tax-based consolidations. A consolidation through labour taxes also yields an initial GDP loss. In the long run, however, labour taxes can be reduced due to the fiscal space that becomes available as a result of the reduction in government debt, and GDP eventually turns positive. Taxes on consumption and housing property are less distortionary in the model. Increasing these taxes, compensated by future reductions in labour taxes,

yields smaller short term negative impacts, with GDP falling by around 0.2% below base. Output gradually recovers and in the long run there are positive output gains.

Tax increases also have different distributional consequences. Increases in labour taxes hit the consumption of constrained 'rule of thumb' households proportionally harder. Increases in consumption taxes affect all households, but constrained households are not able to smooth their consumption in anticipation of lower future taxes and are more affected. Property taxes reduce residential investment of credit-constrained and unconstrained households and lead to a permanently lower housing stock. GDP as defined in national accounts falls, as output of services of owner-occupied dwellings declines. In the medium to long run this is offset by an increase in production due to the reduction in labour taxes.

2.4.2. Across-the-board expenditure- and revenue-based consolidation scenario

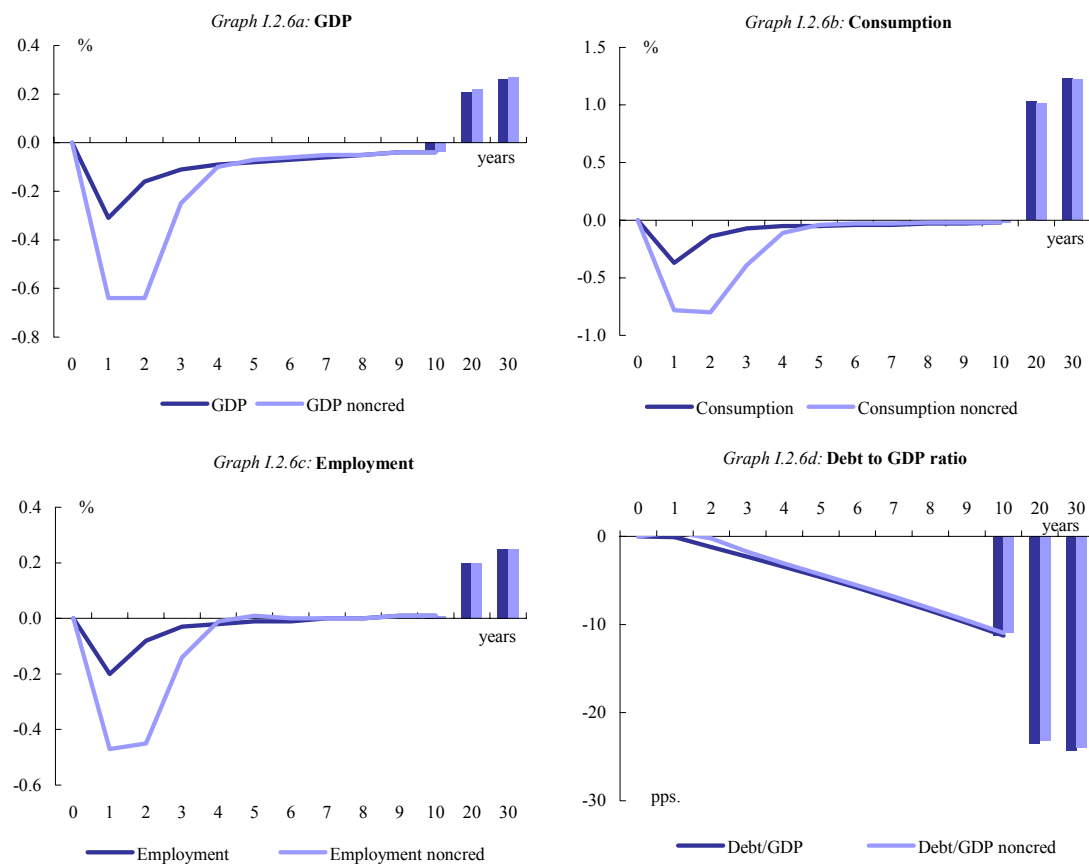
The previous section looked at individual instruments, this section describes the macroeconomic effects and the dynamic adjustment to an across-the-board consolidation, through an adjustment in spending and taxes, roughly proportionally to their respective shares in the government budget.⁽⁴³⁾

The combined reduction in spending and increase in taxes lowers output on impact, by approximately 0.3% in the first year (Graph I.2.6). It leads to a gradual decline in the stock of debt, and the costs of servicing this debt also fall. The additional fiscal space that this creates is used to gradually reduce labour income taxes, offsetting the initial increase in taxes that was part of the consolidation package. In the long run, labour taxes are lower than in the no-consolidation baseline, and this boost employment and output.

⁽⁴¹⁾ Output of general government is valued at costs and a government wage cut implies a decrease of value-added and GDP not only in nominal terms, but, in the absence of other productivity measures for government services, also in volume terms. This is a pure accounting effect on the definition of GDP and does not in itself reflect any reduction in government services (Roeger and in 't Veld, 2010). Using alternative productivity measures can partly overcome this effect, but these have not yet been widely implemented.

⁽⁴²⁾ See also the simulations reported in Box I.2.3 of German fiscal consolidation measures, which rely heavily on reducing the government wage bill.

⁽⁴³⁾ On the expenditure side cuts in transfers of 0.15% of (baseline) GDP, government wages 0.1%, government employment 0.1%, government purchases 0.1% and in government investment 0.05%, and on the revenue side increases of 0.2% of GDP in labour taxes and VAT each, and 0.05% in corporate profit taxes and house property taxes. The tax rule targets a 25 pps. lower debt-to-GDP ratio in the long run, similar as described above.

Graph 1.2.6: Impact of 1% of GDP across-the-board fiscal consolidation (credible vs. non-credible)

Consumption falls in the short run as incomes decline because of cuts in public sector wages (which also puts downward pressure on private sector wages), public sector employment and transfers. Higher taxes on labour income (in the short run) and taxes on consumption further depress consumption spending. But while employment initially declines, lower wages gradually stimulate employment growth in the private sector as competitiveness improves, and consumption also gradually recovers. The current account improves as imports decline due to lower domestic demand and exports increase.

Consolidations when lacking credibility

The scenarios shown here assume the measures are part of a credible permanent consolidation plan, which is believed by agents to permanently reduce government debt and leads to anticipations of a lower tax burden in the future. Consolidation measures that lack this credibility can have more detrimental effects, as suggested by the difference between the impact of permanent government spending shocks shown in the previous section and

the multipliers for temporary fiscal shocks reported in Table 1.2.1. The second scenario shown in Graph 1.2.6 assumes that the consolidation measures lack credibility in the first two years and are instead perceived as temporary. Only after the second year do the measures gain credibility and agents start to believe the consolidation is permanent. This initial credibility gap leads to GDP losses in the first two years that are more than twice as large, while the long term positive effects are delayed till later.⁽⁴⁴⁾ This indicates the importance of designing fully credible consolidation measures. Consolidations that are not perceived as permanent but expected to be reversed at a later stage may have significantly larger output and employment costs. As a consequence, enacting legislation or changes in legislation that will take effect even several years down the road could be very useful to maximise the benefits from often painful reforms.

⁽⁴⁴⁾ A multiplier of 0.7 is roughly the average of fiscal multipliers of temporary shocks in spending and tax components. See Table 1.2.1

Box 1.2.3: Country-specific effects of consolidations and the German package

The scenarios discussed in this chapter treat the EU27 as one aggregate region. However, there is a generally agreed need for differentiation across Member States. As shown in section 1.2.2, there are significant differences in the order of magnitude of the required structural consolidation effort across Member States. The macro-economic effects of a given fiscal consolidation will also be different across countries. Model simulations described in this chapter give an indication of likely macroeconomic impacts of consolidations, but the scenarios are of an illustrative nature, stylised with a constant permanent profile, and based on simulations of a model of the EU and the rest of the world as aggregate regions. One important aspect in which consolidations in a single Member State differ from the scenarios shown here is the potential monetary policy response. Monetary policy is not likely to be able to support a consolidation in a single euro-area member state to the same degree, and the impact will thus be more closely related to those shown here at the zero interest rate floor. However, one has to keep in mind that there is a euro-area-wide need for fiscal consolidation and this argument relates more to the extent that fiscal retrenchments will be asymmetric. The degree of openness is another important factor behind differences in fiscal multipliers. Small open economies will have a smaller negative GDP impact as the reduction in demand will have a larger effect on imports. In the model version simulated here it is assumed government debt is held by domestic residents, which is for individual euro-area member states certainly not a valid assumption. The fact that a large share of government debt is held abroad means there are current account implications, as illustrated in Box 1.2.1. However, the costs of consolidations will still have to be borne by domestic residents.

To illustrate the effects of consolidation plans in an individual Member State, Graph 1 below shows results from a QUEST model simulation of the German consolidation measures.⁽¹⁾ The German federal government announced in June 2010 a fiscal consolidation package which aims at cutting the federal deficit by 1.3% of GDP by 2014. The consolidation package has both expenditure and revenue elements, but the emphasis is on lower

government spending: the largest share of the intended EUR 32.1 bn deficit reduction by 2014 shall come from lower expenditure. The package is split over 4 years, but frontloaded with 60% of the volume to be implemented in 2011-12.⁽²⁾

The items on the expenditure side take predominantly the character of lower government employment, government wages and unemployment benefits. These measures reduce the disposable income of and the demand from liquidity-constrained households. The measures have however a positive supply-side effect, reducing reservation wages in the private sector and raising labour supply. The reduction of government consumption has a direct negative impact on aggregate demand, but all these measures also reduce expected future tax liabilities. Most revenue-side items take the form of lump-sum taxes – equivalent to a reduction of lump-sum transfers – for non-constrained intertemporally optimising households that own the firms and receive the firms' profits. In particular it is assumed that taxes imposed on the nuclear energy sector are non-distortive as it only taxes rents accruing to firms from extending the time of operation of existing nuclear plants. Lump-sum taxes affect households' wealth without distorting their investment and consumption decisions. Only the planned bank levy is modelled as a distortionary measure that is passed on to firms and households, raising financing costs and leading to a fall in corporate and housing investment. Based on the amount of outstanding bank credit, firms are assumed to pay 60% and households 40% of the EUR 2 billion extra revenue.

The consolidation package achieves a lasting fiscal consolidation. The government deficit declines by 1.0% of GDP by 2014 and public debt by 9% of GDP after 10 and 21% of GDP after 20 years. The consolidation has positive output effects in the medium to long run. Real output is 0.1% above the no-consolidation baseline after 10 years and 0.8% after 20 years. The positive medium and long term effects of consolidation come with costs in the short to medium term but the negative GDP impact is small. In fact, the 2.5% reduction in public wages has a direct impact on GDP as measured in national accounts of almost 0.2%, and this is a pure accounting effect, not related to any reduction in government services.

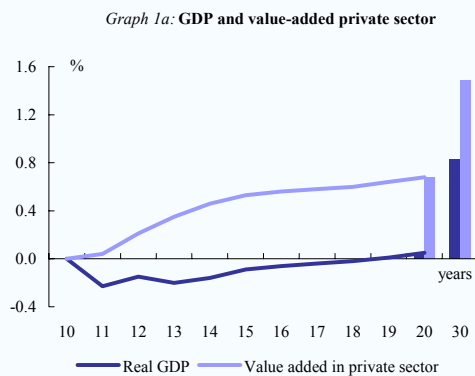
⁽¹⁾ A three-region version of the model to used here (Germany, rest of euro area, rest of world). For more details, see Roeger W., in 't Veld J., Vogel L. (2010), "Fiscal Consolidation in Germany". *Intereconomics*, (forthcoming).

⁽²⁾ It should be noted that in 2010 there is still a sizeable fiscal stimulus.

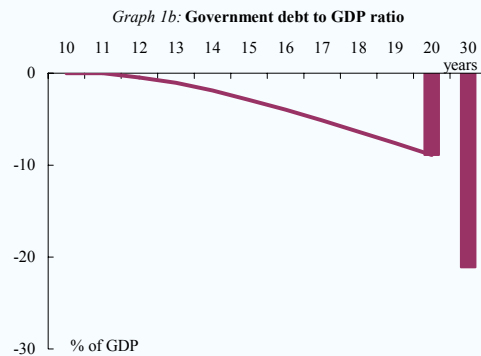
(Continued on the next page)

Box (continued)

Graph 1: Impact of German consolidation measures



Value-added in the private sector increases on impact. The reduction in public employment, public wages and reservation wages puts downward pressure on real wages and the resulting wage moderation leads to falling production costs and lower product prices. Employment is shifted from the public sector to the private sector. The average multiplier of the consolidation on real GDP is around 0.4-0.5 in the first year (2011) and drops to around 0.2 in 2014, not dissimilar to the multiplier reported in the chapter for the EU as a whole.



Germany's competitiveness improves and net exports increase as a consequence, which further improves the country's current account. In the context of intra-euro-area current-account imbalances, improving Germany's trade competitiveness increases the pressure on other euro-area economies to follow with fiscal consolidation and structural reforms.

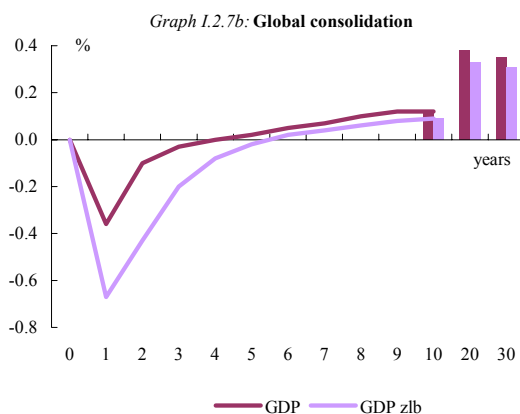
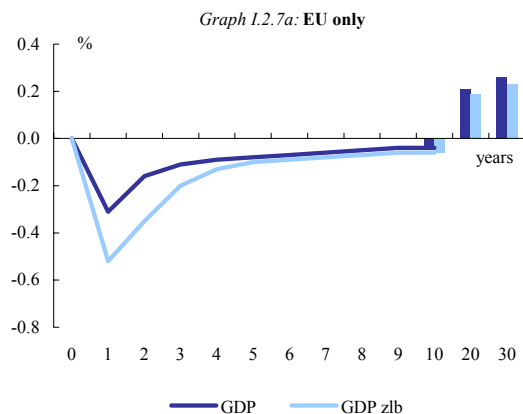
Consolidation when interest rates are near zero interest rate floor

It is assumed in the above scenario that monetary policy operates in normal fashion, and central banks cut interest rates in response to negative output and inflation gaps. However, at present policy rates in the euro area and in many other economies are near the zero interest rate floor. If monetary policy is constrained by this zero lower bound for nominal interest rates the impact on

GDP can be larger. The left hand panel of Graph I.2.7 illustrates this for the same across-the-board consolidation package as described above, when policy rates are near the zero lower bound.⁽⁴⁵⁾ The GDP impact in the first year rises from 0.3 to 0.5. This suggests fiscal consolidations could be more

⁽⁴⁵⁾ In this scenario, the Taylor type interest rate reaction function is switched off for one year and gradually reactivated in following periods. As noted earlier, even at the zero interest rate floor, central banks can still resort to non-conventional monetary policy measures.

Graph I.2.7: Impact of 1% of GDP fiscal consolidation: effect of zero interest rate floor and synchronisation



painful in the short term when policy rates are near the zero interest rate floor.

Consolidations when globally synchronised

The scenarios described above relate to consolidations in the European Union alone. However, at present many countries around the world face the need to consolidate and are embarking on a simultaneous fiscal retrenchment. The negative spill-over effects of this could further raise the costs of fiscal retrenchments. The right hand panel in Graph I.2.7 illustrates this. The GDP impact of the same 1% of GDP consolidation rises in the first year from 0.3 to 0.4 in case not only the EU embarks on consolidation, but if this is done across the world (global consolidation). The effects become even larger when central banks are constrained by the zero interest rate floor. In this case the GDP impact rises from 0.5 to 0.7. The larger impact effect is due to two factors. First, the fiscal consolidation abroad reduces demand for EU exports and this has a negative impact on EU GDP. Second, in case of only the EU consolidating, the depreciation vis-à-vis the (non-consolidating) rest of the world can play a cushioning role in the short term. In case of a synchronised global consolidation, the absence of such a cushioning exchange rate depreciation implies a larger short term GDP impact.

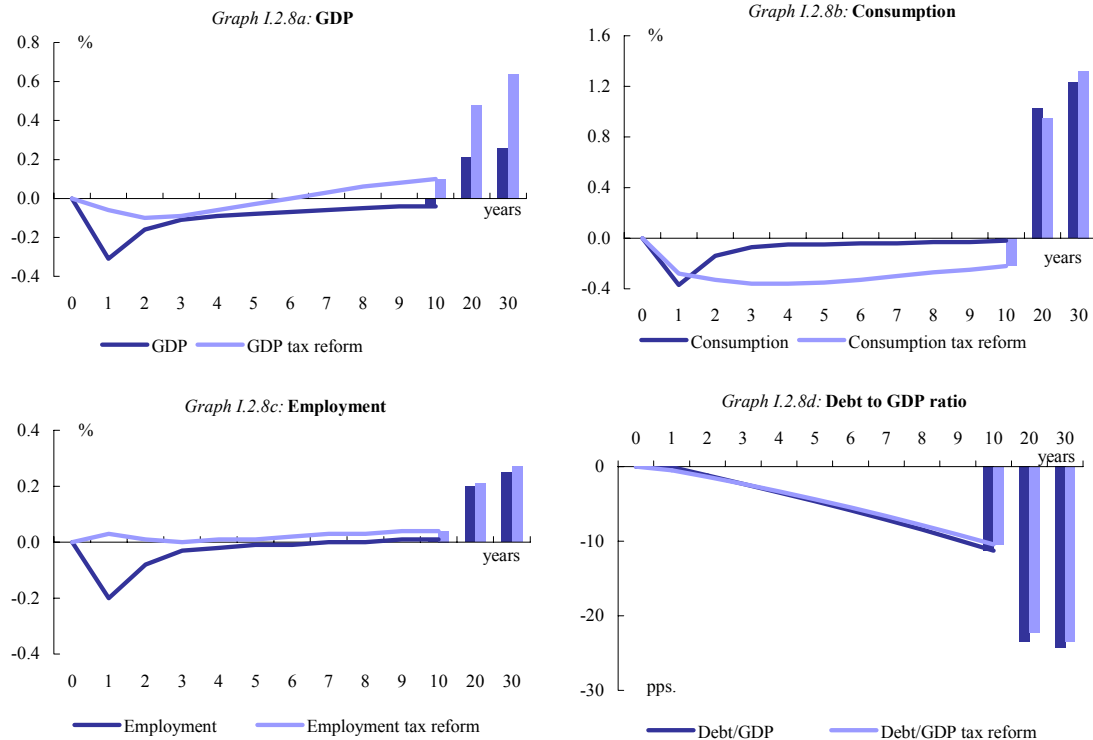
In the medium/long run the positive demand spillovers from the rest of the world boost EU GDP by more. The second channel mentioned above also reverses the effects. The depreciation in the case of the EU acting alone has only a short term mitigating output effect, but a negative effect on output in the medium term. Hence, the short term pain is larger, but the medium and long term effects are more positive under a global consolidation.

2.4.3. Fiscal consolidations combined with tax reform

The differences in short and long run effects of different instruments indicate a consolidation package can be designed that minimises the short term losses in GDP and maximises the long run gains. Such a package could consist of reductions in unproductive spending (purchases, transfers) and increases in the least distortionary taxes (consumption, housing), while at the same time reducing the most distortionary taxes (on labour and capital). This would combine the positive effects of structural reforms raising potential output with the necessary fiscal retrenchment.

Graph I.2.8 shows an example of such a package which combines selective tax increases and expenditure cuts with reductions in distortionary taxes, and compares this to the 'across-the-board' consolidation scenario described in the previous section.⁽⁴⁶⁾ Reducing tax distortions boosts employment and helps to minimise the short term output costs of the consolidation. The decline in private consumption is more persistent, as consumption taxes are raised by more to finance the labour tax cut, but positive employment effects boost incomes and mitigate the impact on consumption in the medium run. The fall in GDP is short-lived and output rises above baseline in following years. Corporate investment increases as corporate profit taxes are reduced, raising capital accumulation and boosting potential output. This scenario illustrates that composition matters: well designed measures that combine expenditure cuts with tax cuts can reduce the negative effects of fiscal consolidations on GDP and raise output by more in the long run.

⁽⁴⁶⁾ On the expenditure side cuts in transfers of 0.3% of (baseline) GDP, government wages, employment and purchases of 0.1% each, and on the revenue side increases of 0.5% of GDP in consumption and property taxes and reductions of 0.3% each in labour and corporate profit taxes.

Graph 1.2.8: Impact of 1% of GDP fiscal consolidation combined with tax reform

2.5. CONCLUSIONS

European governments will be undertaking extensive fiscal consolidations the coming years to reverse persistently high primary deficits and trend increases in debt-to-GDP ratios. Some countries face now already punitive sovereign-bond spreads and are forced to take immediate and rapid action. Model simulations presented in this chapter show fiscal consolidation measures are likely to have negative GDP and employment effects in the short run. But these effects can become positive in the medium run by reducing government interest payments and creating space for future tax reductions and so raise potential output.

The challenge policy makers now face is to design consolidation measures in such a way as to minimise the short run costs and maximise the long run gains. Model simulations suggest four broad lessons. First, full credibility of the permanent nature of the consolidation plans is important. If economic agents were to believe measures were to be reversed in the future, output losses could be considerably larger. This indicates consolidations should be part of a wider agenda that deals convincingly with long run sustainability of public finances, external imbalances and promoting long run growth potential. Enacting

changes in legislation, even if only taking effect several years down the road, could help maximise the benefits from often painful reforms. Second, if monetary policy is able to support the economy by reducing interest rates in response to the fiscal retrenchments this could significantly reduce the negative short term impact on output and employment. In this context, it is also important that the financial system is working properly so as to pass the effects of low policy rates through to lending rates and other credit conditions. Third, the composition of consolidation measures should focus on those measures that maximise long run output effects. Reductions in unproductive spending, such as government purchases and transfers, yield generally the largest long term gains in GDP, but measures that rely too much on instruments like cuts in transfers can have distributional consequences and may undermine the long-run credibility of consolidation packages. If one were to resort to revenue measures, the focus should be on shifting the burden towards less distortionary taxes, like consumption and property taxes. Finally, consolidations should address the underlying fiscal problem of increasing age-related expenditure. Pension reform that raises the retirement age can achieve these objectives by reducing transfer payments and simultaneously increase potential output.

Box I.2.4: Non-Keynesian effects of fiscal consolidations

The simulations reported here show fiscal consolidations can have positive output effects in the long run, but they generally have contractionary effects in the short run. The possibility that fiscal consolidations may in certain cases have expansionary effects already *in the short run* has attracted some attention among economists. The impetus was given by Giavazzi and Pagano (1990), who, looking at the fiscal consolidations that occurred in Denmark in 1983-86 and in Ireland in 1987-89, documented in both cases an acceleration in growth just after governments put in place measures that drastically reduced budget deficit. This has given rise to a literature on so-called non-Keynesian effects of fiscal consolidations.⁽¹⁾

Theoretical considerations

Certain theoretical considerations can rationalise non-Keynesian effects. A permanent consolidation that credibly reduces public sector borrowing may lead to an increase in aggregate consumption already in the short run if it generates expectations of permanently lower future distortionary taxes and lead to an expected increase in permanent incomes, and if the share of unconstrained consumers is sufficiently high. For these confidence and wealth effects the role of consumers' expectations becomes crucial in determining the impact of fiscal consolidations on the short-run behaviour of consumption and such impact, in turn, could be affected by the size of consolidations and by the state of public finances.⁽²⁾ A different strand of research focuses instead on the effects of fiscal policy on business investment and concentrates on the supply side, in particular on how profits are affected through the impact of fiscal policy on real wages in the private sector. Fiscal consolidations may lead to higher expected profits and higher

investment by reducing the tax burden on firms and inducing wage moderation.⁽³⁾ Finally, for those countries that face punitive sovereign bond spreads, credible fiscal retrenchments can help to convince financial markets that governments are serious in putting public finances back on a sustainable path. Elimination of such risk premia may have positive growth effects in the short run.

In the model simulations reported in this chapter, these channels are present and explain why GDP effects of consolidations are smaller than for temporary fiscal shocks and turn positive in the medium run. Confidence effects play a role for non-constrained households who anticipate higher future incomes, but other households are constrained and cannot smooth their consumption in this way. Consolidation can exert downward pressure on wages and this may boost profits and investment spending. But on the whole, these effects are not strong enough to offset in the simulations the immediate negative impact of the fiscal consolidation on GDP, and do not generate a non-Keynesian effects in the short run. Although an effect on sovereign risk premia is present in the simulations, debt decumulates only gradually, delaying the significance of this effect. But if consolidations were to eliminate risk premia that had arisen due to higher indebtedness, as described in Box I.2.1, then exogenous changes in such risk premia would yield larger GDP gains in the model.

Empirical evidence

There is a large empirical literature investigating episodes of expansionary fiscal consolidations. Different methodologies have been adopted in these case studies, but most studies have focussed on changes in the primary cyclically-adjusted budget balance to identify discretionary consolidation periods.

A number of results are common to almost all studies:

1) There have been episodes of fiscal consolidations that coincided with expansionary effects.

⁽¹⁾ Giavazzi, F., Pagano, M., 1990. "Can severe fiscal contractions be expansionary? Tales of two small European countries", in O. Blanchard and S. Fischer (eds.), *NBER Macroeconomics Annual 1990*, 75-111.

⁽²⁾ E.g. if the dead-weight loss of taxation increases significantly with the extent of taxation, this could give rise to non-linearities. See Blanchard, O. (1990). 'Comment on Giavazzi and Pagano', in *NBER Macroeconomics Annual 1990*, O. Blanchard and S. Fischer, eds., Cambridge Mass., MIT Press; See also Bertola, G., Drazen, A. (1993). 'Trigger points and budget cuts: explaining the effects of fiscal austerity', *American Economic Review*, 83, 1170-88; Sutherland, A. (1997). 'Fiscal crises and aggregate demand: Can high public debt reverse the effects of fiscal policy?', *Journal of Public Economics*, 65, 147-62.

⁽³⁾ Alesina, A., S. Ardagna, R. Perotti, and F. Schiantarelli, (2002), 'Fiscal policy, profits, and investment', *American Economic Review*, 92, 571-89.

(Continued on the next page)

Box (continued)

2) Such coinciding expansionary effects are more likely for consolidations leading to a permanent reduction in debt ('successful').

3) But the policy environment in which fiscal consolidations are undertaken matters. In particular, monetary policy, exchange rate and wage policies accompanying consolidations have played cushioning roles.⁽¹⁾

Several papers find composition matters, with expenditure cuts rather than tax increases having a higher probability of showing expansionary effects. Other studies found that fiscal adjustments with expansionary effects are more likely when the size of consolidation is large (Giavazzi and Pagano, 1996). There are also studies that emphasise the initial state of public finances, with consolidations more likely to have non-Keynesian effects when they occur in countries and periods where debt-to-GDP ratios are high (Alesina and Ardagna, 1998, Perotti, 1999). This may suggest risk premia effects play a role.

Although these empirical studies can shed light on several features of fiscal consolidation episodes, there are a number of reasons why the results arising from such cross-country empirical analyses need to be interpreted with caution. First, there are problems in measuring and defining fiscal consolidation episodes. In particular, relying on deficit-based measures tends to exclude fiscal reforms with a limited impact on current budget balances but potentially large effects on long-term public finances and on permanent income, such as pension reforms. Second, it is difficult to take properly into account other relevant factors, such as developments in monetary and exchange rate policies, which might have driven positive short run growth effects. Third, when interpreting the

links between fiscal policy and economic activity spurious relations and simultaneity issues are to be taken into account (e.g. independent cyclical developments, especially when fiscal consolidations are undertaken in weak phases of the cycle), and reversed causality (the expectation of a recovery – stronger in the trough of the cycle – may increase the likelihood of public finance consolidation). Finally, there is the possibility that results are driven to some extent by a sample selection bias. Most of the episodes of fiscal consolidations that, once started, have been aborted due to very adverse growth consequences are by definition missing from the samples used in cross-country analyses. Methodological problems have been highlighted in IMF World Economic Outlook (2010), which compares the standard CAPB-based approach with an analysis based on accounts and records of what countries actually did. With the action-based approach the authors find a deficit cut of 1% of GDP typically reduces GDP by ½%, in line with model simulation results shown in this chapter.

Relevance at current juncture

It is clear from this literature that, although generally fiscal consolidations have had contractionary output effects, there have been exceptions to this rule. The question though is whether cushioning factors can play a role at the current juncture. Historically, expansionary episodes have often been associated with real depreciations, achieved either through monetary policy actions or through wage moderation that improved competitiveness. A decline in the exchange rate could cushion the short term impact on growth, but this is not a channel that can be relied upon at present given the synchronisation of consolidation efforts globally and the general uncertainty that surrounds global exchange rate developments. Monetary policy is at the current juncture constrained by the zero interest rate floor, which *increases* GDP effects of fiscal changes. Simultaneous structural reforms could however play an important supporting role. The case of Denmark in the 1980s illustrates the role of wage moderation. Fiscal consolidation coincided with not only wide-ranging financial liberalisation, but also with the abolition of automatic indexation, which led to an improvement in competitiveness. This suggests consolidations that are accompanied by comprehensive structural reforms in labour and product markets that boost domestic demand and improve competitiveness can help to soften the negative impact of fiscal consolidations.

⁽¹⁾ See e.g. Giavazzi, F. and M. Pagano, (1996), 'Non-Keynesian effects of fiscal policy changes: International evidence and the Swedish experience', *Swedish Economic Policy Review*, 3, 3, 67-103; McDermott, C.J., Westcott, R.F. (1996), 'An empirical analysis of fiscal adjustment', *IMF Staff papers* 43, 725-53; Perotti, R., (1999), 'Fiscal policy in good times and bad', *Quarterly Journal of Economics*, 114, 1399-1436; Giudice, G., A. Turrini and J. in 't Veld (2007), 'Non-Keynesian Fiscal Adjustments? A Close Look at Expansionary Fiscal Consolidations in the EU', *Open Economies Review*, 18 (5), 613-630; Afonso, A. (2010), "Expansionary fiscal consolidations in Europe: new evidence", *Applied Economics Letters*, 17(2), 105-9; Alesina A.S. and S. Ardagna, (2009). 'Large changes in fiscal policy: taxes versus spending'. *NBER Working Paper* no. 15438; IMF, World Economic Outlook, October 2010.

3. RESTORING GROWTH POTENTIAL IN THE EU: THE ROLE OF PRODUCT AND LABOUR MARKET REFORMS

Historical evidence shows that economic recoveries after financial crises tend to be slow and sluggish; typically, the need for financial deleveraging, demands for higher risk premia, inevitable fiscal consolidation to restore sustainable public finances and persistent labour market weaknesses weigh on growth for a prolonged period of time. All these factors must be expected to impact on potential growth in the EU over the coming decade. Without bold reforms, a medium-term scenario presented in this chapter projects the average potential growth rate over the period 2011-2020 to be around 1½% in the EU27. This is significantly lower than the rates observed in the EU in the past two decades, which already were much lower than those recorded in the US. Over the forecast horizon (until 2012), potential growth in the EU27 is expected to particularly suffer from the lower utilisation of labour, manifest in a rise in structural unemployment, and slow capital accumulation due to historically low investment rates in the wake of the crisis. This goes hand-in-hand with slow total factor productivity growth, only gradually recovering from the crisis and converging to the lacklustre pre-crisis path.

The chapter then discusses the potential of different structural reforms to boost long-run growth performance as well as their capacity to support the ongoing recovery. A stylised comprehensive reform scenario, which combines effects of several structural reforms, demonstrates that reforms can generate significant gains in terms of additional output and employment, a small part of which materialises already relatively soon following their implementation. It emphasises that while some reforms indeed carry non-negligible short-run budgetary or adjustment costs, positive effects of others come with a relatively short delay. Overall, it needs to be recognised, however, that the short-run effects of structural reforms are ambiguous. In practise, the magnitude of reform effects will be closely tied to the credibility of reform announcements and capability of Member States to accelerate their reform agendas. In addition, the existing diversity among the EU countries regarding their macro-structural bottlenecks calls for a differentiated approach when designing appropriate reform agendas.

3.1. INTRODUCTION

The economic and financial crisis has caused a significant drop in the level of potential output. According to the estimates of the European Commission (2009)⁽⁴⁷⁾, the loss of potential output in the EU accumulates to around 4% in the medium run. The present forecast does not suggest that these losses can be quickly recovered as the crisis leaves a heavy legacy on trend growth.

Historical evidence suggests that economic recoveries after financial crises tend to be slow and sluggish. The typical factors weighing on growth, such as the need for financial deleveraging and fiscal consolidation, demands for higher risk premia, and persistent weaknesses in the labour market, must be expected to be at work again. From a supply-side perspective, potential growth in the EU27 is expected to particularly suffer from

the lower use of labour and slower capital accumulation over the forecast horizon (2010-12); as the evidence presented below will suggest, in the absence of policy change the average potential growth rate over the period 2011-20 may only amount to about 1½%.

Growth-enhancing structural reforms are thus now needed more than ever to address the existing "bottlenecks" to growth and stimulate the adjustment capacity of the economy. A substantial part of their effects typically materialises only over the medium- to long-run. Many reforms involve fairly long implementation lags due to administrative, institutional or policymaking constraints. Once implemented, the effects of reforms often trickle gradually into the real economy, as it takes several years before the economy converges to the new steady state. Some reforms may even have a negative impact on economic activity in the short-run due to adjustment costs of resource reallocation in the economy. Last but not least, there may also be upfront budgetary costs of certain growth-

⁽⁴⁷⁾ European Commission (2009), "Impact of the current economic and financial crisis on potential output", European Commission Occasional Papers, No. 49, June 2009, European Commission, Brussels.

enhancing reforms that need to be borne in the short-run.

Some structural reform measures, nevertheless, have a material impact already within the short term. While some reforms indeed carry short-run budgetary or adjustment costs, positive effects of others come with a relatively short delay and can have non-negligible macroeconomic effects already in the early period after their implementation. Structural reforms also contribute to generating favourable expectations of future growth and facilitate the necessary fiscal consolidation. The magnitude of these effects is, however, closely tied to the credibility of the reform announcements and depends on the capability of Member States to accelerate their reforms agenda, together with implementation lags.

This chapter explores the potential of structural reforms in product and labour markets to affect the growth outlook in the EU over the following decade, putting emphasis on their time profile and capacity to contribute to the ongoing recovery. It is structured in the following way. The next section discusses the main growth drivers in the EU and the outlook for potential growth in the short- to medium-run in the EU and the euro area in the absence of policy changes. Section 3 then provides a broad assessment, largely based on multipliers from modelling simulations, of the potential short- to medium-run effects of structural reforms and section 4 concludes.

3.2. GROWTH PROSPECTS IN THE EU IN THE SHORT TO MEDIUM RUN

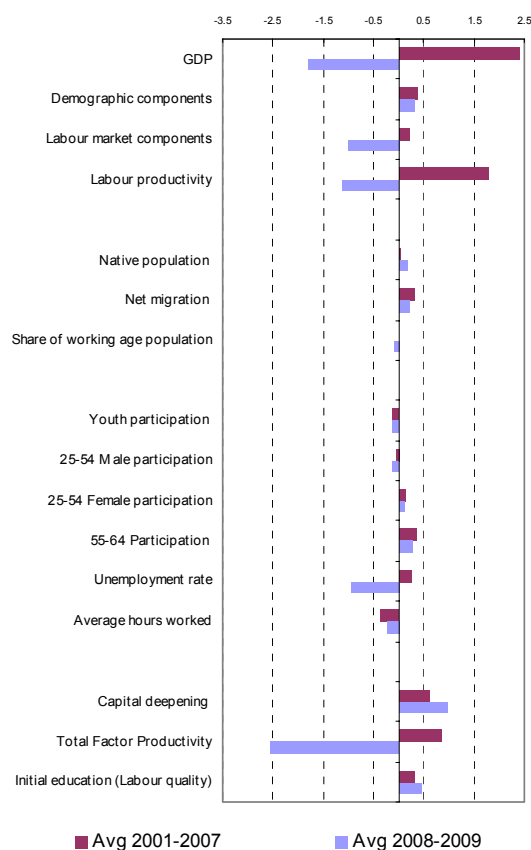
The lacklustre growth performance in the EU over the past decade suggests that there are various structural weaknesses, market distortions and "bottlenecks", which hold back the potential for growth in Europe. Standard growth accounting reveals that before the crisis (2001-07) labour productivity was the main driving force behind growth, while improved labour utilisation and the increase in working-age population only accounted for around one fourth of total growth; in particular, decreasing labour market participation of youth and prime-age men and a reduction in hours worked per persons were dragging growth down in the EU27 (see graph I.3.1). The crisis led to a contraction of GDP, with a sharp increase in unemployment and a drop in total factor

productivity (TFP), mostly explained by the strong decrease in capacity utilisation.

Over the 2010-15 period, the crisis is anticipated to impact potential growth via both productivity growth and labour utilisation. Regarding productivity, the crisis might adversely affect the pace of capital accumulation as the timing and extent of the recovery in investment activity hinges upon the need for rebuilding of capital stocks, the prospects for global and domestic demand and the size of capital costs. The negative effect of slower capital accumulation can be magnified by the fact that the depreciation rates of the capital stock might increase due to the ongoing economic restructuring which will make some capital vintages obsolete. Total factor productivity (TFP) might also be affected by the crisis to the extent that the long-run drivers of TFP such as physical investment or R&D and innovation are affected. For example, investment may suffer further from a timid recovery, changes in attitudes towards risk leading to the tightening of credit conditions. As investments in private R&D are markedly pro-cyclical, the crisis might result in a slowdown in the pace of technological progress. A slow process of industrial restructuring caused either by credit constraints, possibly due to delayed adjustments in the banking sector, or by entrenched structural rigidities, can also hurt the growth rate of TFP growth by locking resources in relatively unproductive activities.

Labour utilisation is expected to be affected as a result of the crisis through reductions in average hours worked and labour participation as well as an increase in the rate of structural unemployment (NAIRU). Past experiences show that rises in NAIRU during and in the aftermath of crises tend to be persistent. Lasting increases in capital costs, arising from the shifts in attitudes towards risk brought about by the financial turmoil, have a potential to raise the NAIRU permanently as firms would increase their mark-up to recoup the higher cost of capital. Moreover, long unemployment spells may cause a permanent destruction in human capital, leading to an irreversible rise in the NAIRU (the so-called 'hysteresis effect') and further losses in potential output growth in the medium-term.

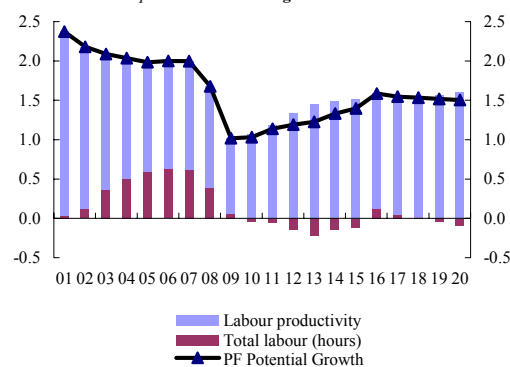
Graph I.3.1: Growth decomposition in the EU27



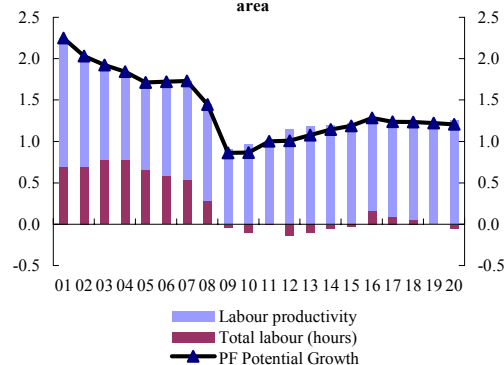
Graph I.3.2.a displays the potential growth prospects in EU27, *in absence of policy changes*, according to a macroeconomic scenario. As explained in detail in Box I.3.1, potential growth corresponds to a concept of sustainable trend growth compatible with supply-side conditions, correcting for the short-term cyclical fluctuations in actual GDP growth. As suggested by Graph I.3.2.a potential growth in the EU27 is expected to be particularly low (1.1%) over the forecast horizon (2010-12). The situation is expected to be even more lacklustre in the euro area, with broadly similar but more acute patterns. It is likely to suffer from the lower use of labour, which is attributable to the significant rise in NAIRU but also the further decline in average hours worked per worker and the slow contraction of working-age population. It will also be affected by the slower capital accumulation due to historically low investment rate in the wake of the crisis. This would be combined with slow total factor productivity growth, gradually recovering from the crisis but still converging to the weak pre-crisis path.

Beyond the forecast horizon, in absence of resolute policies, potential growth is likely to remain weak: over the period 2011-20, the average potential growth rate is projected to be around 1½% in the EU27. This is significantly lower than the rates observed in the EU in the past two decades, which were, moreover, much lower than those recorded in the US. This is accounted for by the pronounced underutilisation of labour in the wake of the crisis, combined with the contraction of labour due to population ageing at the end of the period and fairly slow productivity growth in the EU27. The picture for productivity growth will be particularly gloomy for the euro area, as the former will stand at around 1¼% on average. Most countries have been strongly affected by the crisis, through both capital accumulation and labour utilisation, and are expected to record a reduction of their labour resources at the end of the decade owing to the population ageing.

Graph I.3.2a: Potential growth in EU-27



Graph I.3.2b: Potential growth decomposition in Euro area



The crisis has significantly affected the future growth prospects for the EU. Nonetheless, experiences from past economic and financial crises indicate that policy responses matter greatly. For example, the deep recessions which started in

1991 in Sweden and Finland were relatively short lived and did not result in a reduction in potential output growth.

This was *inter alia* thanks to significant restructuring of their economies. On the other hand, an insufficiently resolute policy reaction to the financial crisis, combined with mounting competitive pressures from emerging economies, contributed to the slowdown in long-run potential growth in Japan in the course of 1990s.

3.3. THE IMPACT OF REFORMS ON GROWTH: HOW MUCH AND WHEN CAN THEY DELIVER?

The following discussion focuses on reforms in labour and product markets. Obviously, future growth prospects will also be shaped by other types of policies such as the regulatory efforts in financial markets and the progress in financial market repair, policies to meet the climate change targets or policies aimed at promoting social cohesion. As regards financial market policies, the growth effects of the ongoing efforts to redesign the regulatory environment (e.g. enhanced supervision, improved prudential regulation for banks and insurance company) are ambiguous. Progress on financial repair and improvements in the functioning of financial markets can have very significant implications for short- to medium-run growth through reductions in risk premia on capital; on the other hand, stricter regulation could increase the cost of capital in historical comparison; thus, the net impact is still unclear.

The efforts to meet the climate change targets can also generate costs and reduce, at least temporarily, growth. However, recent ECFIN analysis demonstrates that a well-designed "green" growth agenda might alleviate the costs associated with reducing the carbon emissions.⁽⁴⁸⁾ With respect to the link between growth and equity, despite an intensive debate in the economic

literature (see for example Benabou, 1997⁽⁴⁹⁾), there is no conclusive evidence on the growth effects of cohesion policies, partially owing to the multiple and complex channels at work. It is not possible to exclude that there will be some trade-off between equity and efficiency and hence growth, at least in the short- to medium-run. However, that may not be inevitable given that there are many countries with relatively low income disparities among the 20 richest countries in terms of GDP per capita.

3.3.1. Macroeconomic effects of structural reforms

This section explores the macroeconomic effects of different structural reforms, both in terms of their potential to stimulate long-run growth and their dynamics. It builds on simulations undertaken with the QUEST III model.⁽⁵⁰⁾ These are complemented with findings from empirical literature. It is important to recall that the modelling results focus on the EU as a whole and do not consider the specific situations of individual EU countries. In practice, policies will operate against the backdrop of a large diversity among the EU countries in terms of their main economic challenges to growth. The different starting conditions across Member States will inform different policy priorities, which will crucially influence the design of concrete reform agendas and potential effects of specific reforms.

While the strategy of reforms should be tailor-made for each country, this section only discusses some relevant reform ingredients that could be considered and on which model simulations are available. It focuses on some specific types reforms and, by no means, covers the full variety of growth-enhancing reforms in the labour markets, product markets and the wide array of measures to promote knowledge and innovation. The following discussion deals with the potential impact of some structural reforms without attempting to make conclusions on

⁽⁴⁸⁾ See Conte Andrea, Ariane Labat, Janos Varga and Ziga Zarnic (2010). "What is the Growth Potential of Green Innovation? An Assessment of EU Climate Policy Options", European Economy. Economic Papers. 413. The paper shows that the negative long-run impact on output of reducing carbon emissions e.g. through imposition of carbon taxes or emission trading schemes, can be eliminated if the raised resources are effectively recycled into reductions in the tax burden on labour and increasing R&D spending, including "green" stimulating production of clean technologies.

⁽⁴⁹⁾ Benabou Roland (1997). "Inequality and Growth," NBER Working Papers 5658, National Bureau of Economic Research.

⁽⁵⁰⁾ QUEST III is an estimated dynamic stochastic general equilibrium model which was developed in DG ECFIN and is used for policy analysis. For a description of the semi-endogenous growth version of the model, which is used in this chapter, see Roeger Werner, Janos Varga and Jan in 't Veld (2008). "Structural Reforms in the EU: A simulation-based analysis using the QUEST model with endogenous growth." European Economy. Economic Papers. 351.

Box I.3.1: Potential growth: the concept and its components

In a standard production function framework, potential GDP can be represented by a combination of factor inputs (labour and capital), multiplied with the technological level or total factor productivity (TFP)⁽¹⁾. Given that potential output is an unobserved variable, it is necessary to clearly define the *potential use* of each factor of production and the trend (i.e. normal) level of *efficiency* of factor inputs.

First, **labour input** is defined in terms of total hours worked. Determining the trend of labour input involves several steps. We start from the actual population of working age. We obtain the trend labour force by mechanically detrending (using an HP filter) the participation rate. In a next step, we calculate trend un/employment to be consistent with stable, non-accelerating, (wage) inflation (NAWRU). Finally, we obtain trend hours worked (potential labour supply) by multiplying trend employment with the trend of average hours worked. One of the advantages of this approach is that it generates a potential employment series which is relatively stable whilst at the same time also providing for year-to-year changes closely linked to long-run demographic and labour market developments in areas, such as the actual working age population, trend participation rates and structural unemployment.

⁽¹⁾ D'Auria, F., Denis, C., Havik, K., Mc Morrow, K., Planas, C., Raciborski, R., Röger, W., and A. Rossi (2010), "The production function methodology for calculating potential growth rates & output gaps", Economic Papers 420, July 2010, European Commission.

Second, with respect to **capital**, this task of defining potential factor use is straightforward since the maximum potential output contribution of capital is given by the full utilisation of the existing capital stock in an economy. Since the capital stock is an indicator of overall capacity, there is no justification to smooth this series in the production function approach. In addition, the unsmoothed series is relatively stable for EU economies since net investment in any given year, which is quite volatile – represents only a tiny fraction of the capital stock. In terms of the measurement of the capital stock, the perpetual inventory method is used which requires an initial assumption regarding the size of the capital / output ratio.

Third, potential output embeds a **trend efficiency component**, also called trend TFP. Potential output refers to the level of output which can be produced with a "normal" level of efficiency of factor inputs. This trend efficiency level is measured using a bivariate Kalman filter model which exploits the link between the TFP cycle and the degree of capacity utilisation in the economy.

Finally the production function allows for deriving future potential output growth from the growth in individual factor inputs. Potential output growth is calculated as the sum of trend TFP growth, potential labour supply growth weighted by the share of labour in total value-added, and the increase in total capital stock multiplied by 1 minus the labour share. Medium term projections are made by forecasting the individual components relevant for calculating total trend hours, the trend component of TFP and the investment to potential output ratio.

a desired composition of reform packages to be implemented.

Overall, the model simulations and econometric estimates confirm that structural reforms deliver important benefits in terms of increased output (see table I.3.2). While the reforms reported in the table should not be interpreted as any sort of "priority list", a broad assessment of these results indicates that both labour and product market

reforms will have an important role in boosting potential output in the coming decade.⁽⁵¹⁾

⁽⁵¹⁾ The stylised nature of the policy shocks in these simulations makes the comparison of the effects of

On the product market side, reforms leading to reductions in final goods market mark-ups (e.g. services), to smarter network industry regulation and to reductions in administrative

individual reform measures difficult. A possible way of making different types of shocks (with different units) broadly comparable is to apply the structural reform multipliers to the actual cross-country dispersions or, similarly, to reflect the existing scope for improvement vis-à-vis a specific benchmark, i.e. performance gap. The results shown in Table I.3.1, therefore, provide, where possible, two measures to ease the comparison: (i) the effects of improving the policy settings by one standard deviation of the dispersion in the EU (OECD) and (ii) the effects of reducing the performance gap in the EU vis-à-vis the three best performing EU countries in the given policy area by 1/3. These measures thus give a rough idea of a "realistic" room for improvement of the indicators.

burden will improve allocative efficiency in the economy. Structural reforms that promote knowledge and innovation, albeit being essential for boosting potential growth, imply important reallocation of resources in the economy and yield output gains only in the long-run. Moreover, they often require substantial initial investments. Amongst the surveyed labour market reforms, measures to increase labour supply via activation measures, including reductions in the long-term benefit replacement rate, and tax reforms that reduce the tax burden on labour, especially the low-skilled, could bring about significant GDP increases. While the major share of gains from structural reforms typically materialises in the longer-run, there are reform measures that potentially yield benefits already relatively rapidly. This can be seen from graph I.3.3, which shows the time profiles of the selected reforms measures based on different assumptions on the speed of their implementation, ranging from periods of two to ten years. Taking into account the necessary implementation gaps demonstrates that, in practise, the short-term impact of reforms crucially hinges upon a swift implementation.

The results in graph I.3.3 indicate that product market reforms, particularly those increasing the level of competition in the services sector or network industries, can deliver benefits already over a relatively short horizon. Also, removal of the existing regulatory and administrative barriers for businesses is likely to generate non-negligible gains. Some of these reforms have relatively limited budgetary costs which improves their attractiveness in face of the existing budgetary constraints. However, slow implementation will considerably delay the growth effects of these measures. Labour market reforms are crucial to support the reduction of the high unemployment levels and to prevent unemployment from becoming structural. Their benefits could start materialising within a reasonable timeframe, but significant short-run adjustment costs and even temporary increases in unemployment cannot be fully excluded. They, moreover, have important distributional effects with a possibly prolonged decline in real wages. On the other hand, the positive impact of reforms could potentially be supported by confidence-boosting and signalling effects. Overall, it needs to be emphasised that, contrary to their long-run benefits, short-run effects of structural reforms are sometimes ambiguous and should not be overestimated. In particular, the existing approaches to estimating

the impact of reforms might not fully capture all the short-run costs associated with reforms.

Both product and labour market reforms typically aim at improving allocative efficiency, implying an upward shift in the level of output. Thus, they tend to raise growth rates only temporarily, albeit over a considerable period of time. Permanent increases in output growth rates, through improvements in TFP growth, typically rely on an increased pace in generating and exploiting knowledge and innovations. As stressed above, permanent increases in TFP growth will be essential to counter the secular declining trend in growth of labour productivity.

A closer look at effects of measures to promote knowledge and innovation, ...

Policies promoting innovation and human capital formation have a capacity to permanently increase potential growth rates. Nevertheless, their short-run effects tend to be very small and could even be slightly negative. This is due to the substantial structural adjustment that they unleash in the economy, as well as the associated budgetary costs. The model simulations show that measures to boost R&D through tax credits or wage subsidies to research personnel start generating fruits only in the very long-run, i.e. at least a decade.

Similarly, policies to upgrade human capital by improving the educational composition of the labour force deliver very substantial long-run growth dividends but take a very long time to materialise. Increases in public spending on education have some short-run positive demand effects which are comparatively higher than other non-productive government spending due to the high return on this type of investment. In this context, efficiency of education spending is important.

For example, St. Aubyn et al. (2009) suggest that the strength of the link between the resources used in tertiary education and broader economic outcomes, like productivity, crucially depends on efficiency of spending.⁽⁵²⁾ Moreover, policies that increase efficiency are highly relevant in view of the existing severe budgetary constraints in most

⁽⁵²⁾ St. Aubyn, M., Pina, A., Garcia, F., and J. Pais (2009), "Study on the efficiency and effectiveness of public spending on tertiary education", European Economy, Economic Paper 390.

Table I.3.1:

Performance gaps on some relevant policy variables

	Levels of policy variables			Performance gaps with		MEMO: Past developments in relevant variables	
	EU27	average 3 best EU	MEMO: US	3 best in EU	MEMO: US	Period	Change
Public spending on R&D (% GDP) ⁽¹⁾	0.6	0.8	0.7	0.2	0.1	00-07	+0.0 p.p.
Final goods market mark-up ⁽²⁾	24.2	17.8	20.5	6.4	3.7	early 90s -99	+7 p.p. ⁽³⁾
Benefit replacement rate (from 1 year) ⁽⁴⁾	49.0	35.0	24.0	14.0	25.0	01-07	-3.3 p.p.
Labour taxes ⁽⁵⁾	38.6	26.7	29.0	11.9	9.6	00-08	-0.4 p.p. ⁽⁶⁾

Notes and sources: (1) Eurostat; (2) Based on markup estimates for 10 EU countries from Roeger et al. (2007), "An overview of the EU KLEMS Growth and Productivity Accounts", European Economy, Economic Papers (290); (3) Mark-ups in the services sector (roughly equivalent to the final goods sector in QUEST) reported in Badinger (2007); (4) OECD data, IT and GR excluded; (5) Simulations on tax shifts are based on the gaps in the labour tax rates across the EU; (6) Computed on the basis of implicit tax rate on labour. Note that the increases in public R&D spending are arbitrarily calibrated in the scenarios.

Member States. Educational policies take very long time before they can significantly affect the skill levels of the workforce as a whole. But underinvestment in these types of productive expenditures could undermine the future competitiveness and growth performance of the European economy, also in view of increasing global competition and substantial investments that are being undertaken by the main competitors.

The generation and exploitation of innovations can also be effectively boosted by improvements in framework conditions (e.g. improved market entry, more favourable business environment, more effective IPR regime or availability of venture capital). Measures that deliver better framework conditions can, in many cases, be implemented quickly and with limited budgetary costs.

...product market reforms ...

Product market reforms generally have high potential to boost output and employment. They often comprise measures to strengthen the business environment by improving regulatory conditions or reducing administrative burdens on companies, to facilitate market entry in specific shielded sectors, to allow for effective exit from markets, to put in place efficient pro-competitive frameworks or to improve the availability of credit for businesses. Increased competitive pressures and (threat of) entry of new firms typically boosts productivity; it improves the allocation of resources, both between different sectors towards those with better growth perspectives and within sectors, and induces internal restructuring at firm level leading to higher productive efficiency. Some of these effects start unfolding already in a relatively short time horizon after their implementation while full benefits are typically linked to the progress in sectoral restructuring which is a long-run phenomenon. Looking at aggregate product market regulation indexes,

Mourougane and Vogel (2008)⁽⁵³⁾ report that correlations between changes in structural unemployment and product market reforms are significant already in the first years following their introduction.

Some of these measures also have comparatively limited – budgetary, administrative or political – costs. For example, unlike in the case of labour market reforms, costs of product market reforms are usually concentrated on a relatively narrow group of economic agents, which limits their political costs. Product market reforms may also increase the incentives of firms to innovate.⁽⁵⁴⁾ Moreover, there are possibly spillovers between product market and labour market reforms. For example, Blanchard and Giavazzi (2003)⁽⁵⁵⁾ take a political economy perspective and argue that product market reforms can help implement labour market reforms as they tend to reduce opposition to the latter by reducing the rents to be distributed between the workers and firms. The simulations suggest that measures to increase competition in product markets which lead to reductions in price-cost mark-ups deliver important output gains. These gains materialise rather quickly and are accompanied by increases in employment and real

(53) Mourougane, Annabelle and Lukas Vogel, 2008, "Speed of Adjustment to Selected Labour Market and Tax Reforms," OECD Economics Department Working Papers 647, OECD, Economics Department.

(54) While it seems that high levels of market power are associated with weak incentives to innovate, the effect of competition on innovation is theoretically ambiguous. Recent literature suggests that the relationship between mark-ups and innovation is non-linear and has an inverted U-shape with too low or too high levels of competition thwarting innovation. See Aghion P. Bloom N. Blundell R. Griffith R. Howitt P. (2002). Competition and Innovation: An Inverted U Relationship. National Bureau of Economic Research Working Paper No. 9269, October.

(55) Blanchard, Olivier and Francesco Giavazzi (2003). "Macroeconomic Effects Of Regulation And Deregulation In Goods And Labor Markets," The Quarterly Journal of Economics, MIT Press, vol. 118(3), pages 879-907, August.

Table I.3.2:
GDP effects of structural reforms

Policy impulse	Source	Unit of the stylised shock	GDP effects of stylised reform simulations				Measures to compare reforms (effects after 10 years)	
			2 years	5 years	10 years	20 years	Reduction by one s.d.	Reducing 1/3 of performance gap vis-à-vis 3 best in EU27
Knowledge and innovation								
R&D tax subsidy	QUEST III	0.1% GDP	0.0	-0.1	0.0	0.1	0.0	0.0
Wage subsidy to R&D	QUEST III	0.1% GDP	-0.1	-0.1	0.0	0.1	0.0	0.0
Increase of the share of medium skilled workers	QUEST III	1 p.p.	0.0	0.0	0.1	0.2	1.2	0.6
Increase of the share of high skilled workers	QUEST III	1 p.p.	0.0	0.1	0.1	0.3	0.2	0.1
Product markets								
Reduction of mark-up (final goods sector)	QUEST III	-1 p.p.	0.3	0.4	0.5	0.6	0.9	1.0
Reduction of mark-up (intermediate goods sector)	QUEST III	-1 p.p.	0.2	0.3	0.3	0.3	1.1	0.4
Reduction in administrative burden	QUEST III	-10%	0.5	0.6	0.6	0.6		
Reduction in entry barriers (high-tech firms)	QUEST III	-10%	0.0	0.0	0.0	0.0	0.0	0.0
Reduction of tangible capital costs	QUEST III	-50 b.p.	0.1	0.3	0.5	0.9		
Reduction of intangible capital costs	QUEST III	-50 b.p.	-0.1	-0.1	0.0	0.1		
Decrease in network industry regulation	OECD	-0.1 index p.		0.6	0.3		5.7	
Labour markets								
Reduction in benefit replacement rate	QUEST III/OECD	- 5 p.p.	0.8	1.3	1.5/1.0	1.7/1.5	3.6/2.0	0.6
Wage mark up reduction	QUEST III	(1)	0.4	0.7	0.8	0.9		
Tax shift from labour to VAT	QUEST III	1% GDP	0.1	0.2	0.2	0.3	0.5	0.5
Tax shift from low to high skilled labour	QUEST III	1% GDP	0.1	0.2	0.2	0.2	0.4	0.4
Decline in average tax wedge	OECD	- 10 p.p.			3.3	5.2		
Reduction in employment protection legislation	OECD	-1 index p.		0.3	0.4		0.2	

Note: The effects based on QUEST III simulations shows GDP multipliers of structural reforms assuming that the policy shock is implemented immediately. OECD results are based on a simulation framework based on estimated coefficients (see Dougherty et al., forthcoming).

(1) The shock to wage mark-up is calibrated in such a way that it yields a 1 p.p. increase in employment rate in the medium-term.

Source: European Commission and OECD.

wages. For example, reducing mark-ups in the model's final goods sector (roughly corresponding to the services sector in the real economy) by 1 pp. increases GDP by around ½% by 2020 (to put this into perspective, average mark-ups in the EU are roughly 4 pps. above those in the US, with the largest room for improvement in the services sector). In reality, though, policy measures are likely to translate with (possibly non-negligible) time lags into higher levels of competition and, in turn, reductions in mark-ups. Similarly, policy initiatives to cut red tape, especially for SMEs, are shown to bring significant output gains, which could materialise rapidly. These measures typically reduce the overhead costs that firms need to bear. A 10% drop in administrative burden on companies, modelled as a reduction in fixed costs, boosts GDP by 0.6%.⁽⁵⁶⁾

Reductions in entry barriers for (high-tech) start-ups strengthen the adaptive capacity of the economy, facilitate structural change and, at the

same time, allow for technological upgrading.⁽⁵⁷⁾ However, due to the required reallocation of resources, some of which are shifted from production to research activities, there can be an initial drop in output and the gains of these measures come with a very long lag. Further measures that improve the framework conditions for innovative firms are those that ease access to financing, i.e. through better access to venture capital (modelled as a reduction in risk premium on intangible capital). Also these measures deliver benefits with a significant delay. On the other hand, they have a potential to quickly increase R&D intensity.

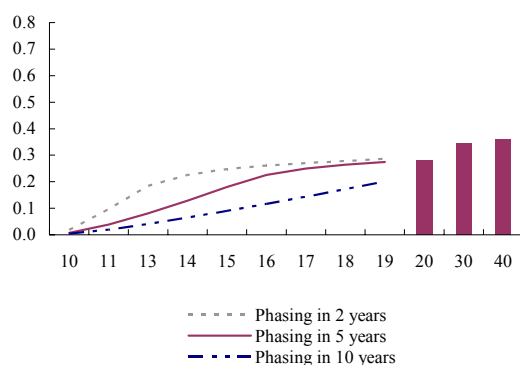
... and labour market reforms.

The effects of labour market reforms generally materialise through improvements in labour utilisation, either due to increased labour supply or reduced structural unemployment. For instance, policies that promote active inclusion in the labour market, foster real and nominal wage flexibility and cut labour taxes contribute to increasing labour supply, reducing structural unemployment and boosting competitiveness and adjustment capacity.

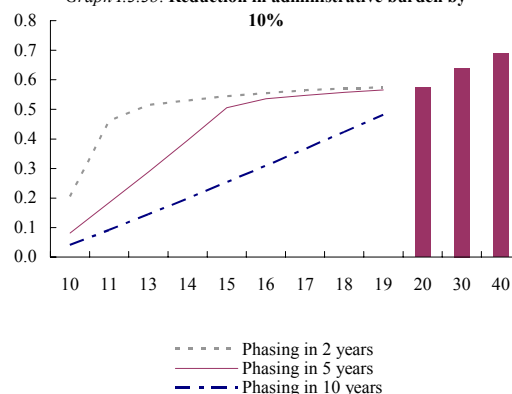
⁽⁵⁶⁾ Some of the regulatory reforms, which essentially depend on an adoption of a legal act, can be brought to life without prolonged implementation lags. On the other hand, reductions in administrative burden can come through introducing e-government projects which could imply relatively important costs of setting up the necessary infrastructure. As these costs are not considered in the simulations, the short- to medium-run output effects could be biased upwards.

⁽⁵⁷⁾ Aghion et al. (2007) argue that financial frictions (for start ups) are at least as important as labour market rigidities for explaining productivity differences between countries.

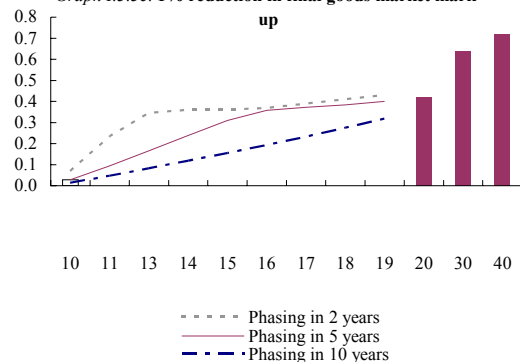
Graph I.3.3a: 1 p.p. reduction in net replacement ratio



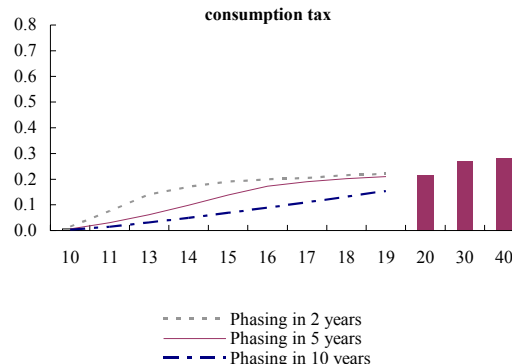
Graph I.3.3b: Reduction in administrative burden by 10%



Graph I.3.3c: 1% reduction in final goods market mark-up



Graph I.3.3d: 1% of GDP shift from labour tax to consumption tax



Labour market activation policies also support the protection of the most vulnerable groups threatened by long-term exclusion from the labour market. The modelling approach of cutting the unemployment benefit replacement rate is only illustrative of a wider and more complex set of policies aiming at activating labour supply. An integrated flexicurity approach helps to reduce moral hazard associated with more generous social security systems. In theory, an increase in unemployment benefits is positively correlated with unemployment, especially its duration, as it tends to increase reservation wage, workers' wage bargaining power and reduce job search intensity. But the generous provision of unemployment benefits could be compatible with low unemployment and high labour supply, provided that it is accompanied by effective active labour market policies (ALMP), in particular efficient job search support and work incentives to ensure a balance between rights and duties and to eliminate potential adverse impacts on unemployment. A declining profile of benefits over time and strict job-search conditionality of benefits can provide proper incentives. The success of some Northern European countries is to a large extent attributed to reforms which

underlined the more active approach in labour market policies with a clear job search and employment focus⁽⁵⁸⁾. By providing (re)training and efficient job placement services, ALMP could also favour the mobility of labour across firms, sectors and regions. There are also strong complementarities between different labour market institutions⁽⁵⁹⁾, for example between the generosity of unemployment benefits (including their time profile and conditionality) and the level of employment protection legislation (EPL).

The impact of these reforms on productivity is not straightforward. As labour market reforms increasing labour supply typically result in a drop of the capital-to-labour ratio, they tend to temporarily lower productivity growth. On the other hand, smoothly functioning labour markets allow for better matching between workers and jobs, which improves average productivity levels and prevents losses in human capital due to long

⁽⁵⁸⁾ Andersen T. and M. Svarer (2008), Flexicurity in Denmark, CESifo Dice Report, Vol. 6, No. 4, CESifo GmbH.

⁽⁵⁹⁾ See for example Coe, D. and D. Snower (1997): „Policy Complementarities: The Case for Fundamental Labor Market Reform”, IMF Staff Papers, 1997, 44(1), March, 1-35.

Table I.3.3:

Description of the stylised reform scenario

Product markets and knowledge & innovation	Labour markets
Increase public R&D by 0.1% GDP through tax credits	Tax shift from labour to VAT (1/3 gap)
Reduce mark-ups (1/3 gap)	Reduce benefit replacement rate (1/3 gap)
Reduce administrative burden by 10%	

unemployment spells. The simulations show that labour market measures which increase participation and labour demand can deliver high benefits (Table I.3.2). They consider in particular measures that increase labour supply through reducing the reservation wage (e.g. by tightening eligibility criteria), or strengthen labour demand through reducing the mark-ups of wages over the reservation wage (e.g. by reinforced matching of skills and jobs or reforms in wage-bargaining or wage-setting frameworks) or decreasing tax burden on labour (in general or specifically low-skilled labour). This is partially given by the fact that there exists an important scope for improving policy settings in a number of Member States. The estimates of OECD (2010)⁽⁶⁰⁾ also suggest an important long-run impact of adjusting the levels of EPL, which reduces the segmentation of the labour market and facilitates the adjustment processes in the economy. Pension reforms that increase the effective retirement age or reduce the replacement rates also have a favourable impact for the functioning of the labour market as well as long-run sustainability of public finances (for a more detailed discussion see the discussion in the previous chapter in box I.2.2 in Chapter 2).

Part of the effects of labour market reforms materialises already in first two to three years after their implementation, although their full benefits come after much longer time (see graph I.3.3).⁽⁶¹⁾ These measures can in principle be implemented relatively quickly as long as there exist political determination and, ideally, broad social consensus on their necessity. Therefore, it is plausible to consider the trajectories in graph I.3.3, which assume phasing in of reforms over two or possibly five years.

While the model simulations do not point to significant short-run costs of these reforms, it must be acknowledged that some labour market reforms may have considerable upfront budgetary costs (e.g. spending on ALMPs or uncompensated labour tax reductions) and other adjustment costs in the early stages after their adoption.⁽⁶²⁾ In particular, measures that increase the adjustment capacity of labour markets can lead, in the short-run, to a temporary drop in real wages (Blanchard and Giavazzi, 2003) or an increase in unemployment. Indeed, the model simulations confirm that these measures generally result in a reduction in real wages, especially for the lower-skilled workers, which take a long time to recover. Despite boosting long-run competitiveness and output growth, wage moderation policies thus can suppress demand in the short-run and generate a slowdown in economic activity. These findings are in line with empirical evidence assembled in IMF (2004), which also suggests that labour market reforms can have a significant negative impact on growth in the short run. However, despite a temporary increase in unemployment, they relatively quickly turn positive and succeed in reducing the unemployment rate. Tax reforms were found to bring a rather immediate benefit, boosting growth and reducing unemployment.

3.3.2. Potential gain of reforms – an aggregated stylised scenario

Using the stylised simulation results discussed in the previous section, this section explores the possible magnitude of aggregated gains from structural reforms. It presents a stylised reform scenario combining reforms from the main policy areas, which have a potential to stimulate both employment growth and productivity growth. The description of reform policies included in the reform scenario is shown in Table I.3.2.

The results of this exercise clearly demonstrate that progress with an integrated package of

⁽⁶⁰⁾ Dougherty, S., S. Barnes, P. Briard, R. Bouis and M. Eris (2010), "The GDP Impact of Structural Reform: A Simulation Framework", OECD Economics Department Working Papers, forthcoming.

⁽⁶¹⁾ Mourougane and Vogel (2008) find a high and statistically significant correlation between structural unemployment and reforms reducing tax wedge already shortly after their implementation. The correlations for other labour market reforms are considerably lower (e.g. EPL) or reach their maximum later (e.g. average replacement rates).

⁽⁶²⁾ See for example Deroose, S. and A. Turrini (2005), "The Short-term Budgetary Impact of Structural Reforms. Evidence from a Panel of EU Countries", CEPR Discussion Paper, 5217.

structural reforms can bring substantial dividend. But obviously, such a scenario should be seen as purely stylised and illustrative and cannot serve as a blueprint for a reform policy agenda.

The scenario combines QUEST III multipliers of different reforms to obtain the growth dividend of reform. Such an approach can be justified by the broadly linear nature of the simulation results. However, it does not capture potential synergies or trade-offs between specific reforms; indeed, there may be economic or political economy trade-offs between some reforms, which should be taken into account when designing reform agendas.

The results are to a large extent dependent on the assumptions about the extent and pace of structural reforms, as the magnitude of economic benefits is obviously conditional on the policy efforts made. The scenario assumes that reform gains momentum across the EU countries and important progress will be achieved across all the main policy areas. It feeds in significant increases in knowledge-oriented expenditures as well as bold reforms in product and labour markets. It generally assumes that the EU, on average, proceeds to close $\frac{1}{3}$ of the performance gap in specific policy areas with the three best EU performers. It is assumed that implementation of reforms starts in 2011. In order to capture the gradual implementation of growth-enhancing policies, the gap in the policy variables is reduced gradually within a period of five years.

The policy assumption of closing a third of the performance gaps with three "best performers" in the EU appears reasonably ambitious and realistic at the same time broadly achievable in historical comparison; the existing performance gaps for the policy variables included in this scenario are provided in Table I.3.3

As Table I.3.3 documents, the reform efforts necessary to partially close the performance gaps have been witnessed in the past (e.g. net replacement ratios). On the other hand, (public) spending on R&D or education has not increased substantially in the past and future increases would clearly need to reflect a political decision on (re)allocation available budgetary resources. Similarly, the tax burden on labour (measured as implicit tax rate on labour) has stayed relatively stable over the past decade. As regards mark-ups in the services sector, the past evidence is more mixed but indicates that the implied reductions,

while significant, might not be excessive. For example, Badinger (2007)⁽⁶³⁾ estimated that mark ups in the services sector increased from 30% to 37% in the course of 90s, which points to important obstacles to competition in this sector.

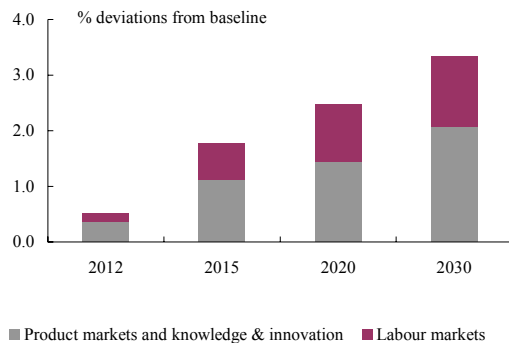
The scenario developed in this chapter assumes that progress in completing the Single Market and improvements in the business environment could help reduce mark-ups in the services sector by 2 pps. and lower administrative burden for companies by 10%.⁽⁶⁴⁾ It further assumes that labour market reforms stimulate labour supply and increase incentives to work; this is implemented in the model via a reduction in long-run net replacement ratios by 5 pps.⁽⁶⁵⁾ Moreover, tax reforms are assumed to shift part of tax burden, in an order of roughly 2.5% of GDP, from labour to consumption taxes. Finally, the scenario feeds in an arbitrarily selected increase in public spending on R&D of 0.1% GDP which would bring the EU spending to 0.7%, i.e. the current level recorded in the US.

⁽⁶³⁾ Badinger, Harald (2007), "Has the EU's Single Market Programme Fostered Competition? Testing for a Decrease in Mark-up Ratios in EU Industries," Oxford Bulletin of Economics and Statistics, Department of Economics, University of Oxford, vol. 69(4), pages 497-519, 08.

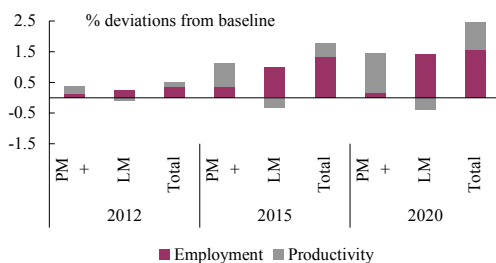
⁽⁶⁴⁾ This assumption is arbitrary and does not rely on estimates of a "performance gap" as there are no reliable estimates of the extent of administrative burden and the scope for its reductions available. Efforts to cut red tape feature high on policy agendas of EU countries. In January 2007, the Commission adopted an action programme aimed at reducing administrative burdens on businesses in the EU by 25% in 2012. The EU and Member States have made some progress towards this benchmark though it difficult to devise a quantitative measure. The scenarios therefore assume that these efforts will be continued and that it will be possible to reduce administrative burden by up to 10% between 2011 and 2020.

⁽⁶⁵⁾ In policy terms, it is in essentially the long-run replacement rates that should be a concern of reforms to make work pay. The long-run unemployment benefit replacement rates play a key role in determining job-search intensity. In the short-run, unemployment benefits play an important social role as they allow the unemployed to search for a suitable job and hence the short-run replacement rates rather reflect the extent to which dismissed workers are supported in the periods of job transitions. As the model features only average replacement ratio, the shock is scaled appropriately.

Graph I.3.4a: GDP effects of structural reforms



Graph I.3.4b: GDP effects - contributions from productivity and labour input



PM + K&I = Product market and knowledge & innovation
LM = Labour market

The model simulation results suggest that a comprehensive package of policy measures aimed at reforming product markets, labour markets and promoting R&D and innovation generates significant gains. A non-negligible part of these gains accrues already soon after the start of the implementation of the reform package. The level of GDP in the EU increases by around ½% in the second year compared to the baseline and the output gains rise to around 1½% in 2015 and close to 3½% in 2030 (table I.3.4).

Around 15% of the long-run dividends thus materialise in the second year after the implementation of the reform package.⁽⁶⁶⁾ Employment gains would also be substantial: rising from around ½% in 2012 to a level of 1½% in 2015 and onwards. Not surprisingly, a dominant part of employment gains is due to labour market reforms with product markets and particularly R&D and innovation measures contributing only modestly. Table I.3.3 shows the contribution of individual reform measures as specified in the scenario.

⁽⁶⁶⁾ These figures need to be treated with caution as the short-run effects of reforms are rather uncertain as discussed above and the simulations might not fully account for the possible short-run costs.

Table I.3.4:

Macroeconomic effects of individual structural reforms

	2012	2015	2020	2030
GDP effects				
Reduction of mark-up	0.2	0.7	0.9	0.6
Reduction in administrative burden	0.1	0.3	0.3	0.6
R&D tax subsidy	0.0	0.0	0.0	0.1
Reduction in benefit replacement rate	0.1	0.3	0.5	1.7
Tax shift from labour to VAT	0.1	0.3	0.5	0.3
Total	0.4	1.5	2.2	3.3
Employment effects				
Reduction of mark-up	0.2	0.4	0.2	0.1
Reduction in administrative burden	-0.1	-0.1	-0.1	-0.1
R&D tax subsidy	0.0	0.0	0.0	0.0
Reduction in benefit replacement rate	0.1	0.5	0.8	0.8
Tax shift from labour to VAT	0.1	0.4	0.6	0.7
Total	0.3	1.2	1.5	1.4

Output as well as employment gains are driven by product market and labour market reforms. In the initial stages, a somewhat larger share of output increases would come from product market reforms (graph I.3.4). In the medium- to long-run the contribution from product market and labour market reforms would roughly be equal. The contribution from knowledge-oriented measures would be slightly negative in the first decade and turn positive only in the long-run. Not surprisingly, the employment gains are predominantly due to labour market reforms. Increased employment due to labour market reforms induces a drop in productivity as the capital-to-labour ratio decreases, partially counteracting the productivity-enhancing effects of product market reforms. Consequently, the overall effects of the reform package initially materialise to a large extent through increased labour utilisation with productivity improvements taking hold only in the later stages.

3.4. CONCLUSIONS

The growth performance in the EU over the past decade has been lacklustre, suggesting that there are various structural weaknesses or market distortions that hold back the potential for growth in Europe. Potential growth is expected to be particularly low (close to 1% on average) over the forecast horizon in the EU27. The situation is expected to be even more lacklustre in the euro area. The driving forces would be the lower use of labour – owing to the rise in NAIRU and a further decline in average hour worked – and a slower capital accumulation due to historically low investment rate in the wake of the crisis. This would be combined with slow total factor productivity growth, gradually recovering from the crisis but still converging to the weak pre-crisis path. Beyond the forecast horizon, in absence of

resolute policies, potential growth is likely to remain weak: over the period 2011-20, the average potential growth rate is projected to be only around 1½% in the EU27. This is significantly lower than the rates experienced in the EU in the past twodecades. This is accounted for by the underutilisation of labour in the wake of the crisis, combined with the contraction of labour due to population ageing at the end of the period and fairly slow productivity growth in the EU27.

Structural reforms can boost GDP level in the long-run and have a potential to boost growth performance as well if they succeed in unlocking the innovation potential. Their capacity to support

the ongoing recovery over the forecast horizon is much more uncertain due to the important short-run budgetary or adjustment costs of some reforms, the likely delay in their implementation due to political and institutional reasons and the gradual propagation of their effects in the real economy. However, empirical evidence presented in this chapter tends to indicate that some structural reforms may have some positive impact on the economic activity in the short-run, provided that they are implemented without unnecessary delays, which may more than offset the negative short-run effect usually associated with implementation of reforms.

PART II

Prospects by individual economy

Member States

1. BELGIUM

Gradual recovery in an uncertain environment

An open economy recovering from the crisis thanks to a revival of exports

Real GDP growth is expected to be positive again in 2010 after contracting sharply by 2.8% in 2009, in the context of the global economic and financial crisis. In the second quarter of 2010, it increased by 1% q-o-q, after having stagnated in the first quarter. This strong performance was partly due to a rebound in construction activity after the bad weather conditions, which had negatively affected this sector at the beginning of 2010. Activity also benefited from a strong increase in net exports, thanks to the spectacular economic recovery in Germany – Belgium's main trading partner. However, a moderation of GDP growth is foreseen from the second half of 2010, due to a smaller support of inventory building and weaker export performance compared to the first half of the year. Exports may be expected to slow down as economic growth subdues in Belgium's main trading partners in the wake of the phasing out of stimulus measures and the need for fiscal consolidation in many EU countries. Furthermore, weaker-than-expected world trade developments could have negative spillovers in Europe and Belgium, and a resumption of tensions on the financial markets might also play a dampening role.

Gradual recovery ahead

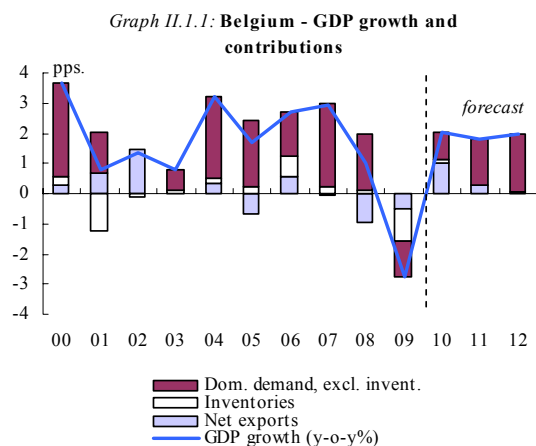
Due to the above-mentioned strong rebound and still relatively good prospects for the second half of the year, GDP growth in 2010 should reach 2%, which is better than foreseen in the Commission spring 2010 Forecast. Growth this year should be supported by positive contributions from both net exports and domestic demand.

In general terms, however, domestic demand will remain relatively subdued in 2010 because: (i) companies will prefer to absorb existing excess capacity, which acts as a deterrent to new investment; and (ii) limited growth in real disposable income – due to still increasing unemployment, less buoyant wage growth and a pick-up in HICP inflation (to 2.3%) – will have a dampening impact on consumption.

On the other hand, better prospects on employment contribute to the improvement in consumer

confidence, so that private consumption growth will reach positive territory, together with a sharp decline of 1.7 pps. in the savings rate (to 16.6%).

GDP is projected to expand by 1.8% in 2011 and by 2% in 2012, which is higher than the euro-area average. Private consumption is expected to grow less than GDP in 2011 on the back of a moderate increase in disposable income, while the savings rate remains stable. Higher growth in private consumption is expected for 2012 as job creation accelerates.



Capacity utilisation rates have reached their average historical levels (79%) during the third quarter of 2010 and profitability has kicked in again, so once companies become more confident that the recovery is sustainable, they are expected to accelerate their investment plans, especially in 2012. The high growth in total investment expected for 2011 is linked to a projected acceleration of government investment due to the local elections in 2012, as observed on previous occasions.

In 2009, housing investment in Belgium declined less than in the euro area, since there were much more limited excesses in the residential real estate market and also because of the temporary reduction in the VAT rate for residential construction. In 2010, housing investment is forecast to continue to contract, albeit at a slower pace. Nevertheless, at the end of 2010, the slowdown in the housing market now seems to be over and house prices are tending to rise again.

The competitive position weakened in recent years and little improvement is expected...

After a sharp decline in exports and imports, the recovery in 2010 is being export-led. For 2011 and 2012, high export and import growth are still foreseen. However the contribution of net trade to GDP growth will be lower.

It is not sure, however, whether Belgium will be able to fully benefit from a rebound of the world economy. Over the past years, there has been a structural loss of market share for Belgian exports for both goods and services.⁽⁶⁷⁾ Since 2005, unit labour costs (ULC) have increased more in Belgium than in the euro area, mainly as a result of the slowdown in productivity growth in Belgium and higher wage increases compared to the three neighbouring countries.

More generally, export performance also seems to be suffering from an adverse geographical and product market orientation. Indeed, exports are mainly oriented towards other euro-area countries, whose imports have been less dynamic than world trade. In addition, Belgium's product specialisation, in goods with relatively low technology content, has appeared less advantageous than for the euro area as a whole. Looking forward, the demand for those products may continue to underperform, while price competition is likely to become even stronger, posing challenges to the sustainability of export growth and firms' profitability.

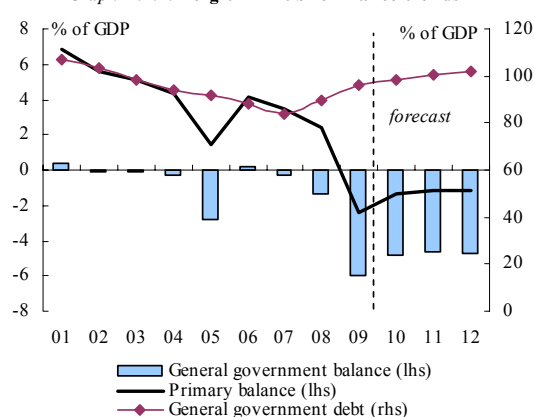
The rapid rise in ULC in 2009 and stabilisation in 2010 are mainly due to the cyclical profile of productivity and the effect of wage indexation, reacting with a lag to higher inflation in 2008 and a fall in 2009. After a decrease in 2009, labour productivity is expected to grow again over the forecast period, though only moderately. The slowdown in productivity growth together with the increase in wages, will cause ULC to rise again in 2011-12.

...while labour utilisation is set to remain low...

The impact of the economic recession on domestic employment was relatively contained. A temporary decline in hours worked – thanks to the temporary unemployment schemes – and labour productivity per hour fulfilled a buffer function. Hours worked

and productivity are expected to increase again over the forecast period. Employment would rise again from 2010 onwards, by 0.4% in 2010 and 0.3% in 2011, while a slightly faster growth is expected in 2012 (0.6%). The number of unemployed is expected to increase faster than the increase in the labour force in 2010 and 2011, causing a further rise in the unemployment rate before it starts decreasing again in 2012 (to 8.7%). In the longer term, the major risk is that part of the cyclical rise in unemployment becomes a structural increase (known as the hysteresis effect).

Graph II.1.2: Belgium - Public finance trends



...and the fiscal position remaining a source of concern in the aftermath of the crisis

By its action – which was in line with the initiatives taken at European and international level – the Belgian government did much to cushion the impact of the crisis on the Belgian economy by avoiding the collapse of the financial system and by taking measures to reduce the most immediately harmful impacts of the crisis on enterprises and households. However, this had an important effect on Belgium's budgetary situation, which had been progressing substantially until 2007.

The general government deficit, which increased to 6% of GDP in 2009 due to the automatic stabilisers and to a lesser extent recovery measures in the aftermath of the crisis, is expected to start decreasing again, although not very dynamically as yet.

Despite higher than previously expected GDP growth in 2010, the deficit will not come out below the target specified in the Stability Programme (4.8%). This is due to the counterbalancing effect of both positive and

⁽⁶⁷⁾ As calculated by the growth differential between Belgian export markets and Belgian exports.

negative factors. On the positive side, the evolution of the deficit benefitted from a decrease in interest rates (stable interest payments in 2010), and the extra revenues from banks of about 0.1% of GDP (dividends, interests paid on loans, contributions to the deposit guarantee fund) and higher VAT receipts due to higher private consumption. On the other hand, corporate tax receipts have turned out to be lower than foreseen, and the speeding-up in the enrolment⁽⁶⁸⁾ of personal income taxes still has a negative effect in 2010.

Our forecast is based on the no-policy-change assumption, whereby no consolidation measures will be taken. In reality – as there is currently only a caretaker government – there is not yet a new budget for 2011 under preparation. Should this situation continue, no new expenditure decisions can be made in 2011 and the budget is likely to rely on the “provisional twelfth” rule, which would lead to a somewhat better outcome than projected.

Under the no-policy-change assumption, the headline deficit should decrease to 4.6% of GDP in 2011, as VAT income will increase (partly due to the phasing out of VAT reducing measures) and

income taxes will be higher as a result of the reversal effect of the faster enrolment in the previous year. For 2012, the deficit is expected to worsen again slightly, mainly due to higher interest payments and the lack of consolidation measures specified so far, while the effect of ageing will come in at a faster pace.⁽⁶⁹⁾

The government gross debt ratio is projected to increase over the forecast period, although to a slightly lower extent than forecast in spring due to lower interest rate assumptions in 2010 and 2011. In 2010 it will reach 98½%, while in 2011 and 2012 it will surpass 100%.

The main challenges for Belgium's public finances are the correction of the excessive deficit, the reduction of the government gross debt ratio and the improvement of the long-term sustainability of public finances. Budgetary consolidation accompanied by labour market reforms, boosting employment, should address these challenges.

⁽⁶⁸⁾ The government decided in 2009 to fasten the settlement of income taxes. As the federal government usually has to refund money, this measure lowers revenues.

⁽⁶⁹⁾ Age-related expenditure will increase by 0.4% of GDP in 2012 compared to 2009.

Table II.1.1:

Main features of country forecast - BELGIUM

	2009			92-05	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	339.2		100.0	2.1	2.9	1.0	-2.8	2.0	1.8	2.0
Private consumption	177.8		52.4	1.6	1.8	1.5	-0.3	1.4	1.3	1.9
Public consumption	83.7		24.7	1.6	2.1	2.3	0.6	1.4	1.2	1.4
Gross fixed capital formation	72.3		21.3	2.2	6.5	2.9	-5.3	-1.1	2.6	2.9
of which : equipment	30.0		8.8	2.4	9.4	3.1	-9.8	0.1	4.0	4.5
Exports (goods and services)	247.5		73.0	4.8	4.4	1.7	-11.6	9.6	5.7	6.0
Imports (goods and services)	238.2		70.2	4.5	4.7	3.0	-11.1	8.5	5.5	6.1
GNI (GDP deflator)	342.3		100.9	2.1	3.0	1.5	-3.3	2.0	1.8	2.0
Contribution to GDP growth :										
Domestic demand				1.7	2.7	1.9	-1.2	0.9	1.5	1.9
Inventories				0.1	0.2	0.1	-1.0	0.1	0.0	0.0
Net exports				0.4	0.0	-1.0	-0.5	1.0	0.3	0.1
Employment				0.7	1.6	1.7	-0.4	0.4	0.3	0.6
Unemployment rate (a)				8.4	7.5	7.0	7.9	8.6	8.8	8.7
Compensation of employees/head				2.9	3.4	3.6	1.8	1.5	2.3	2.3
Unit labour costs whole economy				1.5	2.1	4.4	4.3	-0.1	0.7	1.0
Real unit labour costs				-0.4	-0.2	2.4	3.2	-1.8	-1.2	-0.9
Savings rate of households (b)				-	-	17.0	18.3	16.6	16.6	16.8
GDP deflator				1.9	2.3	1.9	1.1	1.7	2.0	1.9
Harmonised index of consumer prices				1.9	1.8	4.5	0.0	2.3	1.9	1.9
Terms of trade of goods				-0.4	0.3	-2.9	3.5	-2.2	0.0	-0.1
Trade balance (c)				3.1	1.6	-1.6	0.1	-0.4	-0.2	-0.3
Current account balance (c)				4.5	3.9	1.1	2.0	1.7	2.0	2.0
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				4.3	3.6	0.6	1.6	1.4	1.7	1.8
General government balance (c)				-2.2	-0.3	-1.3	-6.0	-4.8	-4.6	-4.7
Cyclically-adjusted budget balance (c)				-2.4	-1.6	-2.1	-4.6	-3.7	-3.7	-4.1
Structural budget balance (c)				-	-1.6	-2.2	-4.0	-3.8	-3.7	-4.1
General government gross debt (c)				113.2	84.2	89.6	96.2	98.6	100.5	102.1

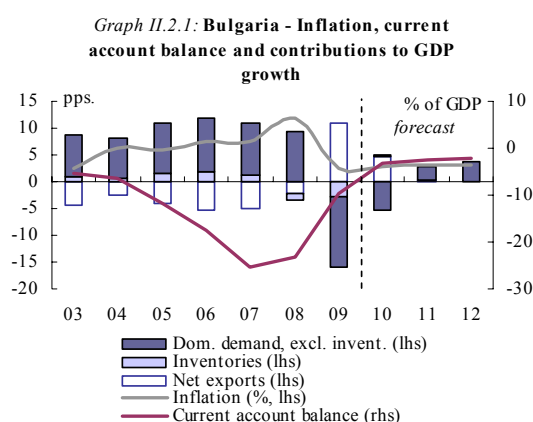
(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

2. BULGARIA

Growth drivers reverse but external imbalances keep unwinding

Domestic demand keeps dragging economic recovery in 2010

Bulgaria entered into recession relatively late compared with its neighbours. Economic activity contracted by 4.9% in 2009 and the deterioration continued into the first quarter of 2010, when the recession is expected to have bottomed out. Growth resumed in the second quarter and will gain momentum by the end of the year. This underlying growth profile would result in broadly flat real GDP for 2010 as a whole. The main driving forces behind the economic turnaround include a continued strong export pick-up and replenishing of inventories, while domestic demand is expected to contract. Despite the healthy export demand, industrial output remained at low levels. In addition, retail trade and construction are still depressed, while credit growth is only minimal.



All components of domestic demand are expected to have continued to contract in 2010. The highest, albeit sharply decelerating, decline is again expected in gross fixed capital formation. Private and government consumption expenditure will be lower for the year as well, declining by 3.6% and 2.4%, respectively. The overall tight credit market conditions, falling FDI inflows and continuing household and corporate sector balance sheet adjustments are some of the main factors behind the enduring negative domestic demand dynamics in 2010.

Net exports are expected to have been the main growth driver in 2010. Together with a build up in inventories, these should almost compensate for

the negative contribution of domestic demand. Indeed, in the first half of 2010, exports of goods to non-euro-area and third countries were very high and close to their pre-crisis peaks, while exports of goods to some of the main EU trading partners such as Germany, Greece, and some other Member States in the region (i.e. Romania, Hungary and the Czech Republic) reached all-time highs. As a result of exports picking up faster, earlier and stronger than imports, the current-account deficit will continue to decline, reaching 3¼% of GDP in 2010.

By end-March 2010 the accumulated budget deficit increased to 2.4% of the full-year GDP projection under the impact of lower tax revenue (as a result of the changing growth composition as well as higher VAT and excise tax refunds) and increased social expenditures. In April-September, however, total expenditures decelerated and were 1.1% lower y-o-y at the end of the third quarter, while the contraction of total revenues gradually narrowed to 6.3% y-o-y. As a result, the budget deficit is expected to improve from 4.7% of GDP in 2009 to 3.8% of GDP in 2010. Thanks to its strong fiscal position prior to the crisis, Bulgaria is one of the few EU countries which plan to correct their excessive deficit by 2011. This will be achieved without substantial increases in the tax burden (except for the increases in social security contributions and excise tax rates to comply with EU requirements) or cuts in wages and pensions.

Rebound of domestic demand in 2011

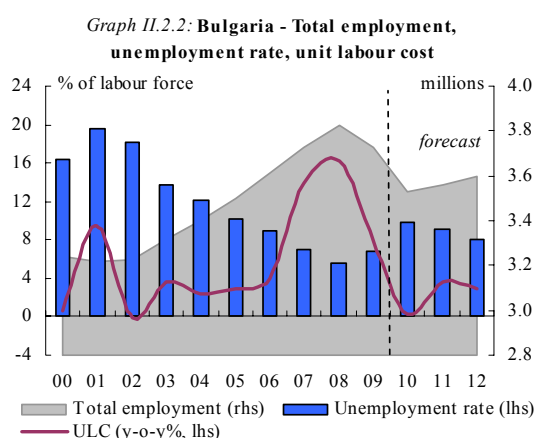
After the economy's stagnation in 2010, the recovery is set to accelerate and gradually become broad-based in 2011 and 2012, with real GDP growth reaching 2.6% and 3.8%, respectively, underpinned by both external demand as well as a pickup of domestic demand. With the growth contribution of domestic demand turning positive again and outpacing by far that of net exports, growth drivers are expected to reverse and return to a more traditional pattern for Bulgaria.

The shift from external to domestic demand as the main growth driver will stimulate imports. After collapsing by 21.5% in 2009, imports of goods and services are expected to have turned mildly positive in 2010 and to start growing faster in 2011-12. Import growth is, however, projected to

trail behind that of exports, resulting in a positive contribution of net exports to growth over the forecast period.

Investment and private consumption will return to positive growth next year and accelerate later on in 2012, when balance sheet adjustments of the corporate and household sectors are at a more advanced stage. Supporting factors would be some credit easing, improved outlook as well as higher employment by the end of the forecast period. The increase in infrastructure investment, mainly due to the absorption of EU funds, is expected to play a stabilising role and might partially compensate for subdued corporate investment and construction.

With the rebound of real GDP growth in 2011 and imports rising once again, projected gains in competitiveness stemming from further deceleration in nominal wages and the only partial recovery in employment will prevent the trade deficit from widening again. After the massive correction of external imbalances in 2009-10, the current-account deficit is expected to remain broadly unchanged or to slightly decline further over the rest of the forecast period. Given the monetary regime in place, the sustainability of this adjustment will depend crucially on the supply-side response and the ability of the economy to shift from the non-tradable to the tradable sector.



The labour market worsened considerably, as the downturn led to a 2.7% fall in employment in 2009 and an increase in unemployment, mainly affecting labour-intensive sectors, in particular construction. Total employment is projected to have registered a steeper decline in 2010 and to start increasing only in 2011. The subsequent gains in employment over the forecast period are expected to help recover less than one-third of the crisis-induced

losses. After decelerating considerably in 2009, real wage growth is set to decline further in 2010-12. As a result of the significant fall in employment against the backdrop of stagnating output, productivity is expected to rebound strongly in 2010. The adjustment in competitiveness should continue over the rest of the forecast period, albeit at a slower pace, whereby real wage growth is projected to be broadly in line with productivity gains.

HICP inflation should remain subdued over the forecast period at around 3% on average. However, once the global recovery gains momentum, the prices of oil and other commodities in international markets could be a further source of pressure. In addition, core inflation is set to remain above the euro-area average over the forecast period, reflecting a certain degree of price rigidity in product markets.

With domestic demand still contracting in 2010 and recovering only gradually towards the end of the forecast period, a further moderate correction of the current-account deficit is projected. This, together with increasing capital inflows linked to enhanced absorption of EU funds, should bring the economy's net borrowing position vis-à-vis the rest of the world to slightly below ½% of GDP by 2012. However, given the challenges to competitiveness in recent years, it remains to be seen how sustainable these adjustments will be and how far they will go. The country's gross external debt, at above 100% of GDP, remains high, despite the fact that the current-account deficit has been fully financed through FDI.

Risks to this baseline scenario are broadly balanced. Foreign capital inflows may turn out to be larger than expected, either through a partial recovery in FDI, or through higher EU funds absorption, which would support domestic demand and the recovery in investment. On the negative side, given the worsening of fiscal balances, the country might be in a less favourable position to withstand persistent negative dynamics or further adverse shocks, should they materialise. At the same time, a milder-than-expected pick up in external and domestic demand would result in a less pronounced rebound of economic activity. In addition, within the context of tight credit market conditions, the servicing of the economy's high external debt might crowd out domestic investment and spending. In the event of external financing

conditions become even tighter, the current-account deficit could narrow more rapidly, but at the expense of a slower economic recovery.

Catching up is expected to slowdown

While the recovery might be slightly stronger than in other EU countries, growth in 2011-12 will remain well below the pre-crisis average, thus temporarily slowing the catching-up process. Given the projected lower contribution of FDI-driven investment to economic growth and the protracted recovery of domestic demand, the economic adjustment would have to involve a shift towards a more export-oriented growth pattern. In addition, real convergence could be enhanced by improved competitiveness and structural reforms to boost potential growth, i.e. in the sectors of healthcare, education, pensions and public administration.

Returning to a sounder budgetary position in 2011-12

The changing growth composition has adversely affected the government revenue, while the functioning of the automatic stabilisers and the accumulation of arrears has led to expenditure overruns. The planned gradual fiscal consolidation in 2011-12 mostly relies on revenue increases

induced by the expected economic recovery and the freezing of many public expenditure items such as public sector wages and pensions, as well as cuts in some current non-interest and capital expenditure. Under a no-policy-change assumption, the general government budget deficit would be contained at 3.8% in 2010, while in 2011 and 2012 it would decline to slightly below 3% and 2% of GDP, respectively. General government gross debt is expected to increase moderately from 18¼% of GDP in 2010 to 20¾% of GDP in 2012, but still to remain one of the lowest in the EU.

The risks to the budgetary projections in 2010-12 are broadly balanced. The 2010 budget execution could turn out better than expected if some recent improvements in revenue collection and expenditure restraint continue until the end of the year. The 2011 fiscal outcome, however, could be negatively affected if some downward risks to the underlying growth scenario materialise. On the revenue side, the impact of some revenue-raising measures may be lower than expected. On the expenditure side, social spending could increase further, while the envisaged cuts in items such as capital expenditure could affect the economy's medium term potential and growth prospects.

Table II.2.1:

Main features of country forecast - BULGARIA

	2009			92-05	Annual percentage change					
	bn BGN	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	68.5	100.0	1.8	6.4	6.2	-4.9	-0.1	2.6	3.8	
Private consumption	45.3	66.0	2.6	9.0	3.4	-3.5	-3.6	2.2	3.8	
Public consumption	11.1	16.3	-2.1	0.3	-1.0	-6.5	-2.4	0.6	0.9	
Gross fixed capital formation	16.7	24.4	-	11.8	21.9	-29.0	-9.8	3.7	5.4	
of which : equipment	-	-	-	-	-	-	-	-	-	
Exports (goods and services)	32.8	47.8	-	6.1	3.0	-10.3	10.5	5.6	6.2	
Imports (goods and services)	38.2	55.8	-	9.6	4.2	-21.5	0.7	4.9	5.8	
GNI (GDP deflator)	65.5	95.5	-	6.2	8.6	-5.3	0.2	2.9	4.1	
Contribution to GDP growth :										
Domestic demand			-	9.4	8.5	-13.1	-5.2	2.3	3.7	
Inventories			-	0.9	-0.7	-2.7	0.5	0.1	0.0	
Net exports			-	-3.8	-1.5	10.9	4.6	0.3	0.1	
Employment			-	3.2	2.6	-2.7	-5.2	0.7	1.1	
Unemployment rate (a)			-	6.9	5.6	6.8	9.8	9.1	8.0	
Compensation of employees/head			-	17.4	20.3	7.8	6.8	5.7	5.5	
Unit labour costs whole economy			-	13.8	16.2	10.4	1.4	3.7	2.8	
Real unit labour costs			-	4.2	7.2	6.1	-1.0	1.1	0.3	
Savings rate of households (b)			-	-	-	-	-	-	-	
GDP deflator			46.0	9.2	8.4	4.1	2.4	2.6	2.5	
Harmonised index of consumer prices			-	7.6	12.0	2.5	2.9	3.2	3.1	
Terms of trade of goods			-	-1.3	-2.5	0.6	2.8	0.2	-0.4	
Trade balance (c)			-8.2	-23.6	-24.3	-11.7	-6.8	-6.5	-6.5	
Current account balance (c)			-5.2	-20.1	-20.6	-8.4	-3.3	-2.5	-2.3	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-5.1	-20.0	-21.3	-6.6	-1.7	-0.8	-0.6	
General government balance (c)			-	1.1	1.7	-4.7	-3.8	-2.9	-1.8	
Cyclically-adjusted budget balance (c)			-	-0.3	-0.1	-3.6	-2.1	-1.4	-0.9	
Structural budget balance (c)			-	2.8	-0.1	-3.6	-2.2	-1.4	-0.9	
General government gross debt (c)			-	17.2	13.7	14.7	18.2	20.2	20.8	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Note : Contributions to GDP growth may not add up due to statistical discrepancies.

3. THE CZECH REPUBLIC

Gradual recovery alongside consolidation effort

Former sound economic performance interrupted by the crisis

The Czech economy enjoyed buoyant economic growth of around 6% on average in 2004-07. However, given its high degree of trade openness at the onset of the crisis, with exports representing more than 75% of GDP, the plunge in external demand had a large detrimental effect on the Czech economy. In parallel, tighter credit conditions for households and non-financial corporations, dwindling inflows of foreign capital and uncertain growth prospects triggered a sizeable decline in investment.

In line with the gradually improving global economic environment, real GDP growth turned positive in the third quarter of 2009, supported by rebounding exports, fiscal stimulus measures and monetary easing. Despite the large shock to the real economy and severe stress in global financial markets, the Czech banking sector has remained strong. This reflects the good liquidity situation of Czech credit institutions and low dependence on cross-border lending.

A moderate economic recovery ahead

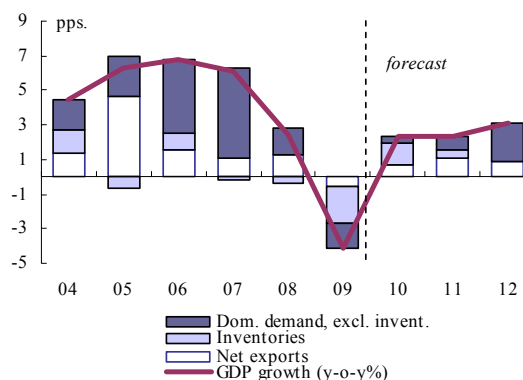
The economic performance of the Czech Republic in the first half of 2010 was influenced by several factors. Firstly, the unexpectedly vigorous growth of its trading partners, Germany and Slovakia in particular (representing more than 40% of Czech export markets), supported a rebound in Czech export performance. Secondly, the contribution of domestic demand turned positive on the back of significantly higher inventory accumulation and relatively robust growth in private consumption. The Czech economy is expected to keep these growth dynamics in the second half of 2010, also supported by a recovery in private investment and continuing inventory accumulation. In 2011, economic growth is nevertheless expected to slow down slightly, reflecting the impact of the consolidation measures planned in the 2011 budget and the expected deceleration of growth performance in the Czech Republic's main trading partners. Looking further ahead, somewhat more resilient growth is expected in 2012, fuelled mainly by stronger pick-up in households' consumption expenditure, investments and renewed trade dynamics. Overall, real GDP is

projected to increase by 2.4% in 2010 and 2.3% in 2011, and to gather pace in 2012 with growth of 3.1%. While positive, these figures are much lower than those of the boom phase.

Given the improving conditions on the labour market, coupled with positive growth of disposable income, household consumption is expected to increase by 1.3% this year. A slight deceleration is projected for 2011, reflecting in particular the planned reduction in the public sector wage bill and cuts in social expenditure. However, these are to be partly offset by a further decrease in the unemployment rate and positive real wage growth in the private sector.

Investment activity continued to decrease in the first three months of 2010, with a steep decline of more than 5% compared to the last quarter of 2009. This coincides with negative credit growth in the business sector. Nevertheless, a strong rebound is expected for the rest of this year. This will be mainly driven by a temporary boom in investment into photovoltaic power plants. The main reason for the exceptionally high investment in this sector is that generous conditions in the form of a state-guaranteed price for electricity produced from solar energy will expire at the end of this year. Overall, investment is projected to decline by 1.8% in 2010. A modest rebound in private investment is expected in 2011, reflecting the current growth in capacity utilisation; the projected investment recovery is also expected to be sustained by the current pick-up in new orders in industry.

Graph II.3.1: The Czech Republic - GDP growth and contributions



Turning to the external side, the Czech Republic is expected to benefit from a rebound in external demand. The contribution of net trade to growth is expected to reach 0.7 pp. in 2010. The dynamics of exports are projected to slow in 2011 as external conditions worsen slightly, while imports will be contained by somewhat weaker domestic demand. One of the underlying assumptions of the forecast is that the Czech Republic will gradually return to the pre-crisis pattern of gaining share on its export markets, although to a lesser extent. The current-account deficit is projected to fall slightly from its peak in 2010 close to 2% of GDP over the forecast horizon (with a concurrent slight deterioration of income balance) and is not expected to pose any significant problem for the macroeconomic stability of the Czech Republic.

The forecast is subject to several risks. In particular, any unexpected developments concerning the pace of recovery in the country's main trading partners might result in potentially large changes in export performance in both directions. A stronger-than-expected impact of consolidation measures envisaged in 2011 might have negative implications especially for household consumption expenditure.

Labour market gaining some momentum

Following the crisis in 2009, the Czech labour market experienced one of the highest increases in the unemployment rate in the EU, rising from 4.4% in 2008 to 6.7% in 2009. However, the unemployment rate seems already to have peaked in the first quarter of 2010 and is expected to reach 7.3% for this year. Nevertheless, conditions on the labour market are expected to be slightly worsened in 2011 by fiscal austerity measures, in particular by cuts in the public sector wage bill. This will be implemented partly via a reduction in the number of public sector employees at the central government level. Labour demand in the private sector will also remain fragile. Unemployment is therefore projected to decline only moderately, to around 7% in 2011. Further improvement is expected in 2012, supported by stronger domestic economic activity and improvement in external conditions.

Furthermore, the government currently envisages several labour market reforms with the aim of increasing its flexibility. If properly designed and implemented, these could contribute to limiting the

risks of post-crisis hysteresis effects and help to lower long-term unemployment.

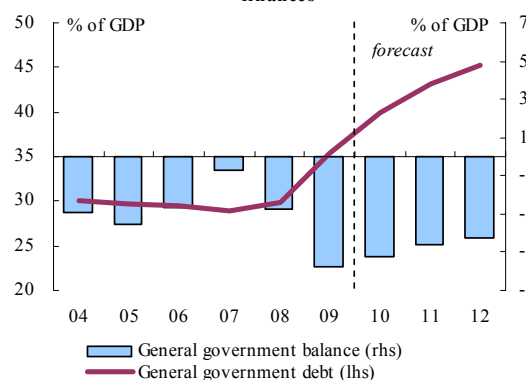
Inflation driven by administrative changes in 2011

Following a sharp one-off increase in 2008, HICP inflation decelerated substantially in 2009, to 0.6%, also due to a decline in core inflation during the economic downturn. The gradual economic recovery is set to drive inflation to about 1.2% in 2010. In the following years, price pressures will be contained by the generally low pressures stemming from the demand side, moderate wage growth and the likely further appreciation of the Czech currency. Nevertheless, some pro-inflationary pressures will stem from the expected increase in electricity prices as a result of the above-mentioned state guaranteed price for solar energy and an increase in natural gas prices. At the same time, food commodity prices are set to continue to rise in 2011. Overall, HICP inflation is projected to rise to 2.1% in 2011, whereas the core inflation is expected to be rather subdued. For 2012, improving domestic demand will result in only a slight increase in the inflation rate to 2.2%, also due to lower expected contribution of administrative and regulatory changes when compared with 2011.

Further steps towards correcting the fiscal imbalances

The situation of the Czech public finances is expected to improve over the forecast horizon, due largely to the relatively significant consolidation efforts made by the government.

Graph II.3.2: The Czech Republic - Public finances



Most of the fiscal stimulus measures implemented in 2009 to support the economy during the crisis were withdrawn at the end of the year; the

government started fiscal consolidation by adopting a package of measures focused predominantly on the revenue side (increases in VAT, excise duties and social contributions).

Budgetary execution in 2010 has so far developed broadly in line with plans, with a few exceptions. These occurred mainly on the revenue side: the central budget revenue from income taxes and social contributions appears to be lower than expected. Central government expenditure has broadly followed the budgetary plans but higher-than-expected deficits in local governments and social security funds are likely to add some ½ pp. to the general government deficit in 2010. Faced with these revenue shortfalls and expenditure slippages, the government took additional consolidation measures in the course of the year, amounting to around 0.5% of GDP. These mainly included cuts in central government operational expenditure. On the other hand, better than expected developments in sovereign risk premia took place throughout 2010, resulting in lower interest expenditure than originally planned. Consequently, the general government deficit is projected to decrease to 5.2% of GDP in 2010.

The consolidation effort is set to continue in 2011, focusing predominantly on the expenditure side. Expenditure growth is projected to be significantly

lower than nominal GDP growth, resulting in a reduction of the expenditure-to-GDP ratio by around 1 pp. Revenue growth, while lower than in 2010, will broadly mirror nominal GDP growth. The forecast takes into account the consolidation measures taken into account in the budget submitted to the Parliament. The main consolidation measures for 2011 include cuts in the public sector wage bill, cuts in some social benefits, reduction of government subsidies to construction savings and further cuts in current expenditure by the public sector. In 2011, the general government deficit is expected to fall to 4.6% of GDP. The deficit is likely to decrease further in 2012, as the government plans to continue fiscal consolidation in line with the recommendations under the excessive deficit procedure. While the overall expenditure ceilings have already been set, concrete measures on the expenditure and revenue side are not yet known. Therefore, under the no-policy-change assumption, the government deficit is forecast to decrease further to 4.2% of GDP in 2012, on the back of accelerating economic activity.

Consolidation measures will furthermore contribute to reducing the pace of public debt increase. The debt-to-GDP ratio was 35½% GDP in 2009 and is expected to reach approximately 45% of GDP in 2012.

Table II.3.1:

Main features of country forecast - THE CZECH REPUBLIC

	2009			92-05	Annual percentage change					
	bn CZK	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	3625.9	100.0	2.7	6.1	2.5	-4.1	2.4	2.3	3.1	
Private consumption	1836.9	50.7	3.8	5.0	3.6	-0.2	1.3	1.1	2.5	
Public consumption	799.0	22.0	1.0	0.5	1.1	2.6	0.6	-2.2	0.8	
Gross fixed capital formation	814.0	22.5	4.8	10.8	-1.5	-7.9	-1.8	3.1	3.7	
of which : equipment	311.8	8.6	8.5	16.9	-0.6	-19.0	-0.8	3.5	4.0	
Exports (goods and services)	2507.0	69.1	10.4	15.0	6.0	-10.8	12.1	7.3	7.6	
Imports (goods and services)	2305.5	63.6	13.2	14.3	4.7	-10.6	12.0	6.3	7.0	
GNI (GDP deflator)	3411.3	94.1	-	3.9	5.2	-5.6	2.4	2.0	2.8	
Contribution to GDP growth :										
Domestic demand			3.4	5.2	1.6	-1.5	0.4	0.8	2.2	
Inventories			0.3	-0.1	-0.4	-2.1	1.2	0.4	0.0	
Net exports			-1.0	1.1	1.3	-0.6	0.7	1.1	0.9	
Employment			-	2.7	1.2	-1.1	-0.5	0.2	0.3	
Unemployment rate (a)			-	5.3	4.4	6.7	7.3	7.0	6.7	
Compensation of employees/head			-	6.3	6.3	0.3	2.5	2.9	4.7	
Unit labour costs whole economy			-	2.9	5.1	3.5	-0.3	0.7	1.8	
Real unit labour costs			-	-0.5	3.2	1.0	0.2	-0.6	-0.1	
Savings rate of households (b)			-	-	10.1	8.9	8.7	8.3	8.0	
GDP deflator			6.9	3.4	1.8	2.5	-0.6	1.4	1.9	
Harmonised index of consumer prices			-	3.0	6.3	0.6	1.2	2.1	2.2	
Terms of trade of goods			-	1.2	-2.3	3.0	-1.9	-0.3	0.1	
Trade balance (c)			-3.6	3.4	2.7	4.5	5.0	5.6	6.4	
Current account balance (c)			-3.5	-2.6	-0.8	-1.2	-1.9	-1.5	-1.1	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-3.7	-2.0	0.3	0.6	-0.1	0.0	0.0	
General government balance (c)			-	-0.7	-2.7	-5.8	-5.2	-4.6	-4.2	
Cyclically-adjusted budget balance (c)			-	-3.0	-4.6	-5.0	-4.5	-3.9	-3.9	
Structural budget balance (c)			-	-3.0	-4.6	-5.4	-4.4	-3.7	-3.8	
General government gross debt (c)			-	29.0	30.0	35.3	40.0	43.1	45.2	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

4. DENMARK

Domestic demand drives the recovery

The recovery remains on track...

After contracting by 5.2% in 2009, the Danish economy has rebounded strongly, with real GDP growth expected to reach 2.3% in 2010. The recovery has been driven mainly by domestic demand and a strong inventory rebound. Government interventions to cushion the negative effect of the crisis on the labour market and on confidence contributed to the rather swift turnaround.

The recovery is expected to lose some momentum in the second half of this year. Real GDP growth is then forecast to revert to a more moderate path, with annual rates of 1.9% in 2011 and 1.8% in 2012.

...supported by domestic demand...

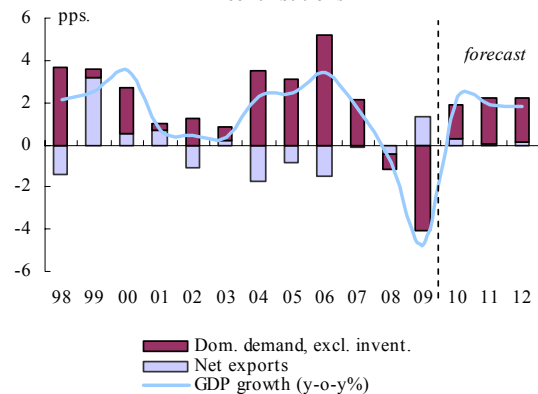
Income tax cuts have lifted household real disposable income in 2010 (which fell in 2009) and have started to feed into private consumption, which is expected to increase by about 2% per year until 2012. The household saving rate, which increased in 2008-10, is set to revert gradually towards pre-crisis levels. Consumer confidence has improved markedly since the end of last year and already exceeds its long-term average.

The improvement in investment is forecast to be gradual. Following the slump in 2009, investment growth is expected to remain negative in 2010 as government stimulus measures will not fully compensate for lacklustre private investment. Investment growth rates will be close to 2% in 2011 and 3% in 2012. Rising capacity utilisation and the restoration of corporations' profitability following the sharp contraction in 2009 will lend particular support to higher investment in equipment. The situation on the Danish housing market is also expected to improve gradually over the next two years. After the slump in 2009 and this year, housing investment is projected to be flat in 2011 and to turn positive only in 2012.

Gradual fiscal consolidation will lead to a decline in the growth rate of government expenditure. Following a 1½% rise this year, government expenditures are forecast to shrink slightly in 2011 and rise only modestly in 2012 as the government has announced its firm intention to keep a tight lid

on expenditures and to prevent spending overruns. In particular, amendments to the way municipalities are financed and their expenditures are controlled should help to ensure a closer match between budgeted and disbursed amounts.

Graph II.4.1: Denmark - GDP growth and contributions



...and an improving global economy

Denmark has benefitted from the recent improvement in the external economic environment. The rapid and robust recovery in Germany and Sweden, Denmark's main trading partners, bodes well for the export sector, and in particular for producers of intermediate goods that feed into international value chains. The agricultural and pharmaceutical sectors, although less exposed to cyclical fluctuations, are also likely to face higher demand. Overall, despite a decreasing trend over the medium-term, the merchandise trade balance is expected to remain positive. At the same time, Denmark's competitive maritime transport sector will provide a platform for a strong rebound in services exports, as world trade volumes continue to pick up after the crisis.

On the back of a positive trade balance and increasing revenues on foreign investments, the current-account surplus is substantial and projected to remain around 4% of GDP over the entire forecast horizon, i.e. close to the 2009 level. However, the current-account surplus masks the increasing divergence between the declining merchandise and the rising services trade balances. In particular, the apparent deterioration in Denmark's cost competitiveness position vis-à-vis its main trading partners is weighing on goods

exports. Relatively weak total labour productivity growth over the past decade and sharp wage increases during the boom years have led to soaring unit labour costs. The fall in unit labour costs forecast for 2010, due to wage moderation and a rebound in productivity, will be insufficient to counterbalance the sharp rise recorded in 2009. Moreover, with the gradual improvement in the economy over the coming years, wage growth is expected to approach historical averages in 2011 and 2012. These projected productivity and wage developments will exert upward pressure on unit labour costs over the forecast horizon and hence hold back the restoration of Denmark's external cost competitiveness.

Against this backdrop, further euro appreciation – and thus of the Danish krone – might have additional negative short-term effects on the export sector, even though the well-diversified export product mix reduces the sensitivity of exports to exchange rate fluctuations.

Inflation is set to decelerate

Measures introduced earlier this year – higher indirect taxes, penalising the consumption of high energy and unhealthy products (tobacco, high-sugar-content soft drinks, high-fat foods, etc.), a rise in several environmental taxes and a reduction in the number of transactions under the reduced VAT rate – will have a significant impact on headline inflation. Inflation is forecast to rise from 1.1% in 2009 to 2.2% in 2010 with the effect of higher indirect taxes assumed to contribute more than ½ pp. to headline inflation in 2010. As the tax effect on inflation will peter out in the course of 2011, inflation will fall marginally and stabilise around 2% in 2011-12.

Overall, services inflation is assumed to be the most important contributor to the headline rate, also as a result of relatively lower competition in the services sector. Core inflation is set to increase to almost 2% in 2011 from 1½% this year, before receding slightly in 2012.

Unemployment is forecast to decrease in 2011

The Danish labour market has performed far better than expected at the onset of the crisis. Unemployment has increased from 3½% in 2008 to just below 7% in 2010 but is expected to peak at the end of 2010. Although the rise in unemployment has been substantial, the flexible

Danish labour market system and active labour market policies are expected to limit the risk of a rise in long-term and structural unemployment.

Population ageing, with fewer people in the working age group, will reduce the size of the labour force already this year. The composition of the labour force will also change, with a growing share of people with lower employment rates, such as older and younger workers as well as workers of foreign origin. Looking forward, demographic trends might put pressure on the labour market in the years ahead.

Public finances still expansionary in 2010...

The fiscal consolidation and structural reforms implemented before the onset of the crisis provided the authorities with room for manoeuvre to support the economy during the crisis through expansionary fiscal policy and financial sector stabilisation measures.

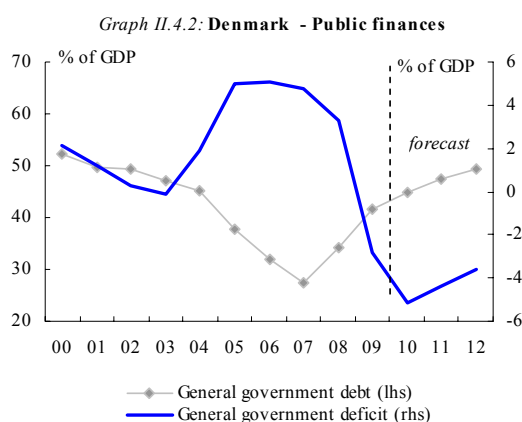
The budget deficit is forecast to increase to about 5% of GDP in 2010, as automatic stabilisers are allowed to work freely, stimulus measures from the 2010 fiscal bill are implemented and the tax cuts from the latest tax reform lower income taxes, negatively affecting revenue.

...but consolidation is set to start from 2011

As the recovery gets under way in 2011 and the extraordinary high level of public investments normalises, the government expenditure ratio is expected to decline. The recovery should also trigger an increase in government revenues as some of the financing elements from the 2010 tax reform, including increased green taxes and business taxes, become operational and the growth in private consumption leads to higher revenue from indirect taxes.

On top of the phasing out of the temporary measures introduced to counter the negative effects of the crisis, the Danish government has secured parliamentary support for a set of fiscal consolidation measures designed to decrease the budget deficit to below 3% of GDP by 2013. The consolidation measures are set to work from 2011 to 2013, and include spending adjustments, suspension of automatic adjustments of the thresholds for income taxes, postponement of income tax cuts and the reduction in the duration

of the unemployment benefit period from four to two years.



On the back of the fiscal consolidation measures and the phasing out of temporary support measures, the government budget deficit is

projected to decline to 3½% of GDP and gross debt is expected to increase to 49% of GDP by 2012 (gross debt had reached a low of 27% of GDP in 2007). The impact on interest payments will be small, since new debt can be issued at low interest levels.

Risks are balanced

In a generally uncertain global economic environment, this central scenario is subject to both upside and downside risks. A faster-than-expected reduction in the still robust household savings rate would result in stronger consumption growth. Although the recovery of the Danish economy rests essentially on domestic demand, the contribution from trade is important: a worse-than-expected evolution of world trade or a stronger effective exchange rate of the krone could have a significant negative impact on GDP growth (and vice versa in case of positive surprises).

Table II.4.1:

Main features of country forecast - DENMARK

	2009			92-05	Annual percentage change					
	bn DKK	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	1656.1		100.0	2.3	1.6	-1.1	-5.2	2.3	1.9	1.8
Private consumption	813.6		49.1	2.1	3.0	-0.6	-4.5	2.0	1.9	2.3
Public consumption	496.3		30.0	2.2	1.3	1.6	3.1	1.6	-0.1	0.4
Gross fixed capital formation	300.8		18.2	4.5	0.4	-3.3	-14.3	-3.8	2.3	2.8
of which : equipment	109.7		6.6	4.5	4.9	-3.5	-13.2	-1.5	3.9	4.5
Exports (goods and services)	792.8		47.9	5.0	2.2	2.4	-10.2	6.4	5.0	5.6
Imports (goods and services)	726.5		43.9	6.3	2.6	3.3	-13.2	6.6	5.3	5.9
GNI (GDP deflator)	1700.1		102.7	2.6	0.8	-0.9	-4.7	2.5	1.8	1.8
Contribution to GDP growth :										
Domestic demand				2.5	1.9	-0.6	-4.3	0.8	1.3	1.7
Inventories				0.1	0.3	-0.6	-2.0	1.2	0.5	0.0
Net exports				-0.3	-0.1	-0.4	1.2	0.2	0.1	0.1
Employment				0.5	2.8	1.9	-3.1	-1.4	0.3	0.3
Unemployment rate (a)				5.8	3.8	3.3	6.0	6.9	6.3	5.8
Compensation of employees/head				3.5	3.6	3.6	2.4	3.5	3.1	3.1
Unit labour costs whole economy				1.7	4.8	6.8	4.7	-0.3	1.4	1.5
Real unit labour costs				-0.2	2.4	2.8	4.3	-2.6	-0.9	-0.7
Savings rate of households (b)				-	-	5.0	7.7	10.6	10.4	9.7
GDP deflator				1.9	2.3	3.9	0.4	2.4	2.3	2.2
Harmonised index of consumer prices				1.9	1.7	3.6	1.1	2.2	2.1	2.0
Terms of trade of goods				0.9	-2.8	1.0	3.0	-0.1	-0.1	-0.2
Trade balance (c)				3.8	-0.5	-0.6	1.9	2.1	1.9	1.5
Current account balance (c)				2.1	1.4	2.7	3.6	4.5	4.2	4.0
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				2.2	1.4	2.7	3.5	4.5	4.2	3.9
General government balance (c)				0.3	4.8	3.2	-2.7	-5.1	-4.3	-3.5
Cyclically-adjusted budget balance (c)				0.4	3.1	3.1	0.9	-2.7	-2.9	-3.0
Structural budget balance (c)				-	3.1	3.1	0.9	-2.5	-2.9	-3.0
General government gross debt (c)				57.7	27.3	34.1	41.5	44.9	47.5	49.2

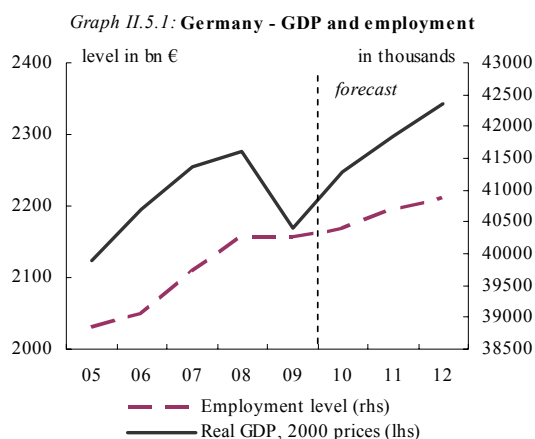
(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

5. GERMANY

Rebalancing under way as the upswing keeps momentum

Sound fundamentals support a speedy and broad-based recovery

The German economy has recovered remarkably swiftly and vigorously from the crisis, posting six consecutive quarters of above-potential growth. In spring 2010, real GDP advanced by over 2%, the highest rate since unification followed by a further gain of $\frac{3}{4}\%$ in the third quarter. The value of exports is back to pre-crisis levels. Employment growth has been only temporarily dented by the downturn. Capacity utilisation has almost returned to its long-term average. Most of the output loss incurred during the crisis has been already reversed. Moreover, the initially predominantly export- and inventory-driven recovery has given way to a broad-based upswing, with private consumption and investment contributing more strongly to growth in the second quarter than net exports.



This swift recovery can be explained by a number of factors. First and foremost, Germany was hit by the economic crisis primarily in the form of an exogenous, temporary trade shock, whereas its economic fundamentals were essentially sound after an extended period of structural adjustments. Unlike other countries, Germany had not experienced any domestic housing, asset or credit boom prior to the crisis. Moreover, major structural reforms had been carried out in the 2000s, rendering the German labour market more flexible, improving competitiveness and strengthening the profitability of companies. As a result, the German economy has been able to fully benefit from the incipient global recovery.

It is not being held back by the need to address domestic imbalances or to repair private and public balance sheets. Finally, with its specialisation in capital goods, the German export sector was particularly well placed to benefit from the demand boom in emerging markets.

Even though export dynamics are assumed to slow down after the growth spurt in 2010, the economic upswing is expected to largely maintain its momentum. Fiscal consolidation will start in 2011, but is likely to imply only a limited moderation of growth. With a buoyant labour market and favourable financing conditions, domestic demand can be expected to react much more dynamically to the export-led upswing than was previously the case. This would also lead to a more balanced growth composition and imply a steady decline in the current-account surplus.

Private consumption and investment sustain growth momentum

Apart from a temporary soft patch in the second half of 2009 following the expiry of the car scrappage premium, private consumption was an important stabilising factor during the crisis, benefiting from past employment gains, higher wage growth and household relief measures as part of the fiscal stimulus. A vibrant labour market and a steady decline in unemployment will continue to boost private consumption, as will a pick-up in wage growth and still-contained inflation. The household saving rate is not expected to rise any further, given that its drop in the wake of the post-unification consumption boom has largely been reversed. Hikes in social security contributions and other fiscal consolidation measures are projected to moderate private consumption growth only temporarily in the beginning of 2011.

Rebounding strongly in 2010, investment is projected to remain buoyant in the coming years. Corporate spending on equipment is catching up from the severe slump in 2009. Many companies had put investment plans on hold during the crisis. Given the stronger-than-expected rebound, many of these projects are now being implemented. Structural shifts in demand associated with the crisis, for example in the car industry, require additional investment in the modernisation of production facilities. The sharp rise in capacity

utilisation has also increased the need to extend existing capacities. Capital formation also benefits from relatively favourable financing conditions and the strong financial position of the corporate sector. The expiry of favourable depreciation rules for companies at the end of 2010 is set to give an extra push to equipment investment, followed, though, by a correction in the beginning of next year.

A decline in real interest rates in Germany and lower capital exports from Germany after the end of asset and housing booms abroad should further help overcome the protracted period of weak domestic investment. This could also buoy housing investment, especially as many alternative investment opportunities have become relatively less attractive in the aftermath of the crisis. The favourable labour market outlook and rising household incomes should further support stronger housing investment in the future. With both household and corporate savings projected to moderate somewhat over the forecast horizon, this pick-up in housing and corporate investment would also imply a gradual reduction in the current-account surplus.

Lower growth contribution from net exports

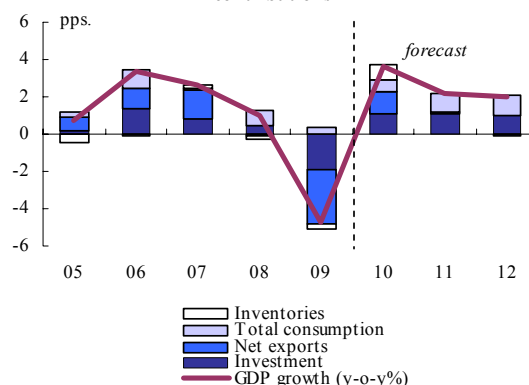
The swift turnaround of the German economy after the crisis is largely due to the quick recovery of world trade and the strong competitiveness of Germany's export sector. Strong export growth in 2010 has laid the basis for improved capacity utilisation, resilience of the labour market and more dynamic private consumption and investment growth going forward. Some moderation of export growth is projected for 2011 and 2012, reflecting still relatively weak demand from some key trading partners which are exiting the crisis more slowly and a certain normalisation of the situation after the sharp post-crisis bounce-back in global trade.

Given the rising import content of German exports and a noticeable pick-up in domestic demand, imports are projected to grow faster than exports in 2011-12. As a result, the growth contribution of net exports would move close to zero and the balance of trade in goods and services would gradually approach a surplus of around 4¼% by 2012.

Given the importance of the export sector, the continued recovery of world trade will remain

crucial to sustain the upswing of the German economy, including domestic demand. A sharper-than-expected deceleration of foreign demand, disruptive exchange rate developments or a surge in protectionist tendencies pose downside risks to the current growth outlook and could imply a setback to the ongoing recovery.

Graph II.5.2: Germany - GDP growth and contributions



Buoyant labour market becoming potentially tight

The German labour market remained remarkably resilient to the crisis with only a slight fall in employment and a modest pick-up in unemployment. To a large extent this has been due to enhanced working-time flexibility at company level and the increased use of short-time work schemes. In addition, past labour market reforms and several years of wage moderation have arguably reduced the level of structural unemployment in Germany and have facilitated more dynamic employment growth, especially in some lower-wage and service sectors. Consequently, employment and unemployment dynamics in Germany have very quickly and seamlessly returned to pre-crisis trends, with the unemployment rate having falling below its pre-crisis level already by mid-2010.

The strong growth outlook for 2011 and 2012 will translate into further falls in unemployment – approaching a rate of 6% towards the end of the forecast horizon – and further employment creation. Especially in 2010 and – to a lesser extent – also in 2011, the rise in headcount employment will be mitigated by a rebound in average working hours.

In the light of negative demographic trends and overall stagnation in terms of educational

outcomes, the projected strong labour demand could lead to shortages at least in certain sectors and especially for high-skilled workers. Considerable regional differences in unemployment rates also contribute to an increased tightness in the German labour market. This will imply stronger wage pressure, but can also become an increasingly important bottleneck to growth and constitutes a non-negligible risk factor for the growth outlook. Increased labour market tightness could also entail a shift to more capital-intensive production and thereby underpin the expected surge in investment.

Wage growth picking up, while inflation remains contained

In line with stronger economic growth and a progressively tightening labour market, wage growth is projected to accelerate. In 2010, higher per-capita wage growth is still, to a large extent, driven by higher average working hours with underlying wage agreements remaining fairly moderate. Recent wage agreements, however, also point to a pick-up in collectively-agreed wage rates from 2011 onward. As a result, nominal unit labour costs are projected to rise by around 1% per year in 2011 and 2012.

HICP inflation is projected to pick up from 2011 onwards but to remain relatively contained at around 1¼% and 2% in 2011 and 2012. Higher inflation in 2011 reflects in particular a hike in energy prices due to lagged effects from higher oil prices in 2010 and higher electricity prices. Rising wage pressures and a progressive closing of the output gap are also expected to contribute to somewhat higher inflation in 2012.

Strong upswing – but growth bottlenecks are looming

As argued above, the economic upswing in Germany is supported by sound economic fundamentals and the lack of any major domestic imbalances and balance sheet problems. Further stabilisation of the banking sector – especially in light of new regulatory requirements – and completing the restructuring of the *Landesbanken* remain important near-term challenges, especially with a view to ensure adequate access to finance for the household and corporate sectors.

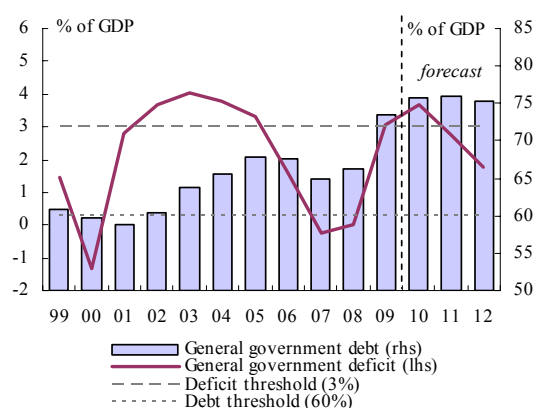
Emerging shortages in the labour market are prone to become a major bottleneck to growth in the

medium term. Further rises in participation and employment rates, especially among women and older workers, would help counter negative demographic trends. Moreover, improvements in access to, and quality of, education as well as an increase in higher educational attainment rates would contribute to providing a pool of high-skilled workers sufficient to underpin Germany's comparative advantage in high-value-added industries. This could also help reverse the trend of falling productivity growth in Germany

Government deficit rises in 2010 but less than expected

The general government deficit is projected to increase further to 3¾% of GDP in 2010, still driven by the measures undertaken to support the economic recovery. While some of the discretionary measures undertaken in 2009 have already expired (e.g. car-scrapping premium), others have continued in 2010 generating an even stronger budgetary impact. For example, the reduced contribution rate to health-care insurance, initially introduced as of mid-2009, will reveal its full impact only in 2010. Moreover, some measures have come into effect with a lag, e.g. additional infrastructure investment, or have only been introduced as of 2010, e.g. tax deductibility of contributions to health-care and long-term care insurance. In addition, the German authorities introduced new fiscal measures as of 2010 (around ¼% of GDP), including increased child allowance and child benefit, modification of parts of the corporate tax reform, changes to the inheritance tax and a reduced 7% VAT rate on hotels and restaurants. The impact of one-off measures – deficit-increasing financial market stabilisation measures and deficit-decreasing revenue from the UMTS auction – is likely to balance out.

Graph II.5.3: Germany - Public finances



Fiscal consolidation under way as of 2011

Germany's post-crisis budgetary situation benefits from the remarkably robust labour market and the broad-based rebound of the German economy. Moreover, as of 2011, the German government is to start fiscal consolidation at federal level, as implied by the new constitutional budgetary rule, which prescribes a structural deficit ceiling of 0.35% of GDP for the Federal government from 2016 onwards and balanced structural budgets for the Länder as of 2020.

In 2011, the general government deficit is forecast to diminish to below 3% of GDP benefiting from more favourable cyclical conditions and federal fiscal consolidation measures (around ¼% of GDP), the expiry of certain stimulus measures (around ¼% of GDP) and health-care reform (around ½% of GDP), including a 0.6 pp. increase in the contribution rate to finance rising health-care costs. Based on the no-policy-change assumption, the forecast does not take into account measures that have not yet been fully specified. The major 2011 measures encompass reduced social benefits for long-term unemployed, cuts in public sector wages, as well as a new tax on the nuclear energy sector and an air traffic charge.

The deficit is set to decline further in 2012, to below 2% of GDP, also on the back of the expiry of certain stimulus measures, e.g. additional investment. Gross debt is projected to increase from 73¼% of GDP in 2009 to 76% of GDP in 2011, also due to the asset transfer from one of the Landesbanken into a bad bank.⁽⁷⁰⁾ Establishment of further bad banks might additionally burden Germany's public finances in the short- and medium-term. The debt-to-GDP ratio will fall to 75¼% of GDP in 2012, mainly due to a favourable denominator effect.

The envisaged federal consolidation appears to be largely growth-friendly – e.g. previously agreed increases in the R&D and education expenditure have been ring-fenced. However, the increase in the health-care insurance contribution rate would add to the already high tax wedge. Reconciling fiscal adjustment with raising potential growth, including by further improving the composition of government budgets, will therefore constitute a challenge for public finances in the years ahead.

⁽⁷⁰⁾ The establishment of the "bad-bank" for one of the *Landesbanken* is assumed to have a direct impact on the debt. This treatment follows the practice currently used by the German statistical authorities. The forecast does not take into account the effects of another "bad-bank" establishment due to the lack of sufficient details.

Table II.5.1:

Main features of country forecast - GERMANY

	2009			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-05	2007	2008	2009	2010	2011	2012
GDP	2397.1		100.0	1.5	2.7	1.0	-4.7	3.7	2.2	2.0
Private consumption	1411.1		58.9	1.3	-0.2	0.7	-0.2	0.1	1.4	1.6
Public consumption	472.1		19.7	1.3	1.6	2.3	2.9	2.9	1.0	0.9
Gross fixed capital formation	422.7		17.6	0.9	4.7	2.5	-10.1	6.0	6.0	5.1
of which : equipment	154.7		6.5	1.9	11.1	4.0	-22.3	9.9	10.3	8.2
Exports (goods and services)	978.8		40.8	6.4	7.6	2.5	-14.3	14.7	6.6	6.7
Imports (goods and services)	860.3		35.9	5.5	5.0	3.3	-9.4	13.4	7.2	7.6
GNI (GDP deflator)	2430.9		101.4	1.6	2.3	0.8	-4.9	3.6	2.2	2.0
Contribution to GDP growth :										
Domestic demand				1.2	1.0	1.3	-1.5	1.7	2.1	2.1
Inventories				-0.2	0.2	-0.2	-0.3	0.8	0.0	0.0
Net exports				0.5	1.5	-0.1	-2.9	1.2	0.1	-0.1
Employment				0.1	1.7	1.4	0.0	0.3	0.7	0.4
Unemployment rate (a)				8.6	8.4	7.3	7.5	7.3	6.7	6.3
Compensation of employees/f.t.e.				2.2	0.9	2.0	0.2	2.0	2.6	2.8
Unit labour costs whole economy				0.7	-0.1	2.4	5.2	-1.2	1.0	1.2
Real unit labour costs				-0.6	-1.9	1.3	3.7	-1.4	-0.2	-0.1
Savings rate of households (b)				-	-	17.6	17.2	17.4	17.2	17.0
GDP deflator				1.3	1.8	1.0	1.4	0.2	1.2	1.3
Harmonised index of consumer prices				-	2.3	2.8	0.2	1.1	1.8	2.0
Terms of trade of goods				0.3	0.7	-1.5	6.1	-3.2	-0.1	-0.3
Trade balance (c)				4.2	8.2	7.3	5.6	6.1	6.0	5.8
Current account balance (c)				0.8	7.6	6.7	5.0	4.8	4.6	4.3
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				0.8	7.7	6.7	5.0	4.8	4.6	4.3
General government balance (c)				-2.6	0.3	0.1	-3.0	-3.7	-2.7	-1.8
Cyclically-adjusted budget balance (c)				-2.7	-0.6	-0.7	-1.0	-2.8	-2.2	-1.4
Structural budget balance (c)				-	-0.6	-0.3	-0.9	-2.8	-2.2	-1.4
General government gross debt (c)				58.3	64.9	66.3	73.4	75.7	75.9	75.2

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

6. ESTONIA

Post-crisis acceleration of growth

Robust growth since end-2009...

Following seven consecutive quarters of decline, the Estonian economy turned to positive quarterly growth at the end of 2009 and reached positive annual growth rates by mid-2010. Quarterly growth was particularly robust in the second quarter of 2010, when it reached 1.9% (seasonally and working day adjusted), the fastest since early 2007, while annual growth reached 4.7% in the third quarter of the year, according to the latest available information. The prospects of euro adoption in 2011, confirmed in July 2010, have been clearly supportive for overall confidence in the Estonian economy.

So far the main contribution to growth has come from external trade, as Estonia's main export partners – in particular Sweden, but also euro-area economies, the other Baltics and Russia – have been growing more strongly than previously expected. The flexible nature of the Estonian economy and the availability of factors of production allowed Estonia to benefit promptly from this rebound. The adjustment in costs that took place in 2009 also contributed to the improved competitiveness of the economy, allowing Estonia to increase its share in global trade.

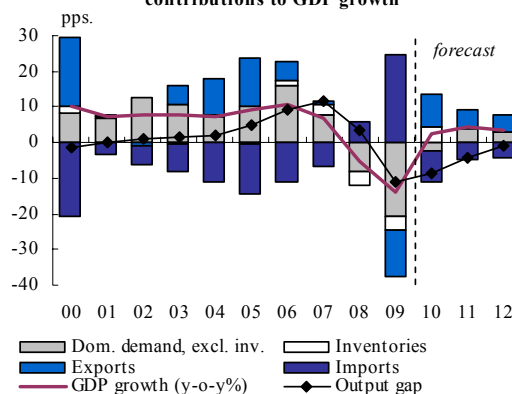
While exports provided the main growth stimulus, domestic demand continued to act as a drag on the economy until mid-2010, with the exception of stocks. The latter, extensively run down during crisis years, were rebuilt to support expanding external demand, contributing strongly to overall growth in the first half of 2010. Resumption of growth in fixed investment has been uneven, with a firmer recovery in investment in equipment. On the other hand, government investment was lower than expected in the first half of 2010.

...is expected to continue in the short term, with stronger demand contributing to some reversal in the current account...

External demand is expected to remain one of the principal determinants of growth in 2011 and 2012, with exports growing broadly in line with demand growth in Estonia's main export markets.

Private consumption is projected to start supporting the recovery towards the end of 2010, even though the full-year contribution will likely remain negative. While positive annual growth is expected to resume in 2011-12, it will remain significantly below levels observed in pre-crisis years. Nevertheless, private consumption is set to benefit from demand that has been postponed due to high precautionary saving during the crisis, in particular in 2009, while growth in household disposable income is expected to turn positive from 2011. The household saving rate, while decreasing, should remain positive over the forecast horizon, contrary to the pre-crisis trend, as households continue to repay accumulated liabilities. Uncertainty around the saving behaviour of households constitutes one of major risks to the forecast, both on the upside and on the downside.

Graph II.6.1: Estonia - Output gap and contributions to GDP growth



As with private consumption, fixed investment is set to reach positive year-on-year growth by the end of 2010. The growth in investment is expected to accelerate in 2011 and remain robust in 2012. Increasing external and domestic demand can be satisfied partly by redeploying existing capacity: although the utilisation rate reached its long-term average by the third quarter of 2010, surveys still point to availability of spare capacity. However, it is likely that some available capacity, which will not be suitable to support the new growth phase given ongoing shifts in the output mix, will need to be replaced. This implies an acceleration in equipment investment in the short term, in particular for new product lines. The extent to which fixed investment rebounds following the enormous contraction in 2008-2009 depends

largely on financial sector confidence and lending policy, as well as on the firming of the economic outlook, thus constituting another uncertainty in the forecast.

Recovery in both external and internal demand has led to a pickup in import growth rates. This trend is expected to continue in 2011 and 2012, reducing somewhat the high level of current-account surplus recorded in 2009. Moreover, recovering profitability of companies in foreign ownership will lead to a larger income account shortfall, with a significant part of these profits being reinvested.

Overall this is expected to lead to annual GDP growth higher than what was predicted in the previous forecast, at 2.4% in 2010, accelerating to 4.4% in 2011 and at 3.5% in 2012. This growth acceleration reflects a re-employment of available production capacity, both capital and labour, but also new investment.

...but can it be sustained in the medium and long term?

The current growth acceleration largely relates to the closure of the significant negative output gap that emerged as a result of a combination of the global financial crisis and reversal of the domestic cycle. The negative output gap is estimated to be over 10% of GDP in 2009, twice the level reached during the recession in the late 90s. However, the question remains of how much spare potential is left in the economy, given that part of the existing production capacity may no longer be usable after the crisis and the readjustment of the economy.

The crisis also probably impacted on the level of potential growth. The extent to which the current high level of unemployment becomes structural will be a significant determinant of potential growth in the medium and long term. In addition, the contribution to potential growth from capital accumulation, while gradually rising, will remain substantially lower than during the peak years of the previous cycle, including due to servicing accumulated liabilities. The contribution to growth from improvements in technology, which was likewise very high during the peak years of the cycle, is highly uncertain looking forward. Overall, this implies that potential growth will stay rather subdued in Estonia in the coming years, reaching barely a third of its pre-crisis rate in the medium term.

Further challenges: labour market...

After peaking at 20.4% in early 2010, unemployment (15-64) started to decline very rapidly to 19.2% by the spring and 15.7% at end-September. Job creation has been high since March 2010, highlighting the flexibility of the labour market and the quality and speed of job intermediation. The fall in unemployment is expected to decelerate during the winter months, before gaining pace again later in 2011, in line with the projected acceleration in growth. In 2009, nominal hourly wages contracted by around 3% for the whole economy, while hourly wages in public administration declined by around 5%. This decline has, however, reversed in 2010 and moderate nominal wage growth can be expected in both 2011 and 2012.

Efforts are being made to further raise the effectiveness of active labour market policies, in particular: job mediation and job search guidance efforts; measures to support job creation and recruitment; and measures to preserve or restore employability. Nevertheless, structural unemployment is set to continue to rise in Estonia over the forecast horizon, potentially leading to premature wage pressures. In addition, the availability of employment opportunities in other EU countries could lead to a fall in the economically active population, exposing bottlenecks as labour demand rises.

...and rising prices

After a very low consumer price increase (0.2%) in 2009, HICP inflation has been on an upward trend since the beginning of 2010. While initially the increase mostly related to surges in energy prices, including hikes in excise duties from July 2009 and January 2010, food prices have also started to increase since early 2010. The latter reflected not only a rise in global food prices, but increasingly also a magnified domestic response to global trends, possibly related to corporate intentions of restoring profit margins after substantial losses, small market size and the prevalence of short-term contracts. Furthermore, growing food exports to Russia, following adverse weather conditions there in summer 2010, have reduced domestic supply in Estonia.

Overall, global commodity price developments and more limited domestic price pressures are expected to lead to inflation of 2.7% in 2010, which is expected to accelerate to 3.6% in 2011 before

moderating to 2.3% in 2012. Domestic factors are set to play an increasingly prominent role in price developments in 2011 and 2012. Given the history of relatively high inflation in Estonia prior to the last downturn, there is a risk that current inflation developments may affect expectations and, hence, weigh on private consumption and recovery.

Public finances: uneven pattern in coming years but overall sound

As a result of adverse economic developments in 2008 and 2009, tax revenue fell, while general government expenditure as a share of GDP increased by over 10 pps. in two years, reaching a high of 45% of GDP in 2009. Comprehensive fiscal consolidation, implemented especially from the second half of 2009, helped to limit the deterioration of public finances and was achieved through a combination of permanent measures, which constituted around two-thirds of total consolidation, and some temporary measures to deal with the more extreme – but also temporary – effects of the crisis. As the economy improves, some of these temporary measures will start to expire. This in particular relates to the resumption of state contributions to the funded mandatory pension scheme and to lower dividends from state-owned companies in 2011 and 2012, compared to their level in 2009 and 2010. However, this

reversal is not expected to lead to a pronounced deterioration in public finances.

The near-term fiscal outlook is markedly affected by sizeable sales of so-called "Kyoto units"⁽⁷¹⁾. These transactions, signed in the course of 2010, considerably improve the outlook for public finances in that year, while environmental investments funded by the sales will have an opposite impact in 2011 and 2012. Without the impact of those sales, the headline general government deficit would have been fairly stable over the forecast period, at 2.0% of GDP in 2010, 1.6% in 2011 and 2.1% in 2012.

The outlook for the general government debt level, which increases to 11.7% of GDP in 2012, reflects an assumption that the deficit will be fully financed by new borrowing, although in practice part of the deficit could be financed through running down existing reserves.

⁽⁷¹⁾ An Assigned Amount Unit (AAU) is a tradable 'Kyoto unit' or 'carbon credit' representing an allowance to emit greenhouse gases. AAUs are issued up to the level specified in Annex 1 Party to the Kyoto Protocol. Due to the initial comparison basis, Estonia received a higher quota amount than needed given the current structure of the economy, and is able to sell the surplus of the CO₂ quota allocated for the 2008-2012 commitment period.

Table II.6.1:

Main features of country forecast - ESTONIA

2009				Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-05	2007	2008	2009	2010	2011	2012
GDP		13.9	100.0	-	6.9	-5.1	-13.9	2.4	4.4	3.5
Private consumption		7.2	51.9	-	8.6	-5.4	-18.4	-0.9	2.5	3.1
Public consumption		3.0	22.0	-	3.9	3.8	0.0	-1.5	1.1	0.9
Gross fixed capital formation		3.0	21.6	-	6.0	-15.0	-32.9	-6.6	12.8	6.4
of which : equipment		1.0	7.0	-	7.4	-11.6	-44.0	3.0	17.0	7.0
Exports (goods and services)		9.0	64.7	-	1.5	0.4	-18.7	14.3	6.6	6.3
Imports (goods and services)		8.1	58.6	-	7.8	-7.0	-32.6	15.0	6.6	6.2
GNI (GDP deflator)		13.5	97.7	-	5.0	-3.5	-11.1	2.8	1.2	3.0
Contribution to GDP growth :	Domestic demand			-	7.6	-7.9	-20.9	-2.2	4.0	3.1
	Inventories			-	3.0	-4.2	-3.4	4.2	0.0	0.0
	Net exports			-	-5.4	5.7	11.3	0.4	0.4	0.4
Employment				-1.6	0.8	0.2	-9.9	-4.7	2.9	1.9
Unemployment rate (a)				-	4.7	5.5	13.8	17.5	15.1	13.6
Compensation of employees/f.t.e.				-	24.6	10.1	-3.3	0.2	2.2	3.5
Unit labour costs whole economy				-	17.4	16.2	1.2	-6.7	0.7	1.9
Real unit labour costs				-	6.2	8.4	1.2	-6.7	-1.9	-0.3
Savings rate of households (b)				-	-	3.4	13.3	9.3	7.1	6.7
GDP deflator				-	10.5	7.2	-0.1	-0.1	2.7	2.2
Harmonised index of consumer prices				-	6.7	10.6	0.2	2.7	3.6	2.3
Terms of trade of goods				-	4.6	-0.2	-2.6	-2.1	0.1	-0.2
Trade balance (c)				-	-17.2	-12.2	-3.9	-4.7	-4.1	-4.1
Current account balance (c)				-	-17.2	-8.8	4.5	4.1	1.4	0.9
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-16.2	-7.7	7.8	9.2	5.4	4.6
General government balance (c)				-	2.5	-2.8	-1.7	-1.0	-1.9	-2.7
Cyclically-adjusted budget balance (c)				-	-0.9	-3.8	1.7	1.5	-0.7	-2.5
Structural budget balance (c)				-	-1.3	-4.0	-0.2	-1.4	-1.1	-1.9
General government gross debt (c)				-	3.7	4.6	7.2	8.0	9.5	11.7

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Note : Contributions to GDP growth may not add up due to statistical discrepancies.

7. IRELAND

Painful but necessary adjustment to facilitate gradual recovery

Domestic real estate boom turned into financial sector crisis

Ireland is currently undergoing a period of unavoidable and severe adjustment after the crisis brought to an end the build-up of imbalances during the preceding boom years. These had been marked by high domestic demand-driven growth on the back of an unsustainable housing boom, financed through rapid credit growth. This also entailed a sharp expansion in banks' balance sheets and high private sector indebtedness.

A light touch regulatory framework tolerated a concentration of lending to residential construction and property development resulting in an over-exposure of some Irish banks to these sectors. The rapid credit expansion also led to high dependence of Irish banks on international wholesale financing, implying vulnerabilities on the liabilities side of banks' balance sheets.

A sharp adjustment in the Irish real estate market started after the 2006 peak and has since spread to the wider economy. This development has been amplified by the decline in global demand and especially by the recession in the main trading partners (euro area, US and UK) of the very open Irish economy, as well as by the international financial crisis. Between the end of 2007 and the end of 2009, employment fell by nearly 12% and real GDP declined by over 14%, despite being buoyed by net exports. The crisis has also led to a dramatic deterioration in the Irish public finances, with a double-digit general government deficit emerging and feeding into a steep increase in the debt ratio from its low pre-crisis level despite considerable consolidation efforts.

Moreover, in the course of 2010, the extent to which Irish banks' excessive exposure to the construction sector has weakened them after the bursting of the real estate market bubble led to drastic valuation losses has become increasingly visible. Starting in 2008, the Irish authorities had put in place several measures to support the sector, including a blanket guarantee, large capital injections, the full nationalisation of one bank, and the establishment of the National Asset Management Agency (NAMA), a "bad bank" to deal with banks' property-related impaired assets. The need to support the vulnerable financial sector

has greatly exacerbated the deterioration in the public finances. Uncertainty about the total cost of the support and its implications for the sustainability of public finances led to increasing nervousness in bond markets in the second half of 2010, reflected in soaring Irish sovereign-bond spreads. In response, the Irish authorities presented in late November their detailed and comprehensive four-year fiscal consolidation plan to stabilise debt developments and reduce the deficit to 3% of GDP by 2014. While inevitably imposing some pain, this plan aims at restoring confidence – a prerequisite for the return to sustainable growth – and will thereby shape economic developments over the forecast horizon.

Strong exports lead return to economic growth

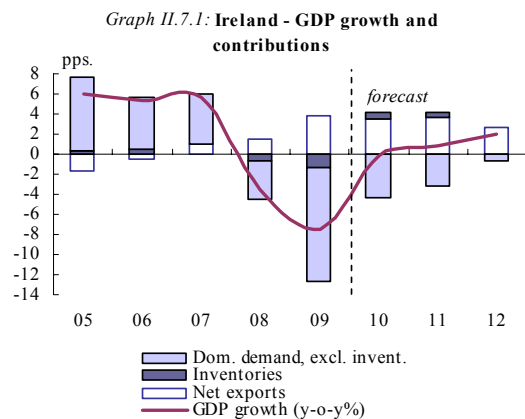
In 2010, a further small decline in GDP is expected. Thereafter, the economy is projected to return to moderate growth, with some acceleration expected in 2012. By historical standards (which are inflated by Ireland's successful catching up process and the unsustainable real estate boom), the projected growth is very modest. This reflects the drawn-out adjustment process, during which domestic demand is expected to continue to act as a drag on growth, while exports should continue to drive the recovery.

Following the historic drop in household consumption in 2009, further moderate declines are expected over the forecast horizon. Households' deleveraging efforts should continue to weigh on their demand throughout the forecast period, while the declines in consumption would also reflect reductions in disposable income on account of subdued labour market developments in 2010-11. Albeit partly offset by positive confidence effects, fiscal consolidation measures should also have a dampening impact.

Gross fixed capital formation is expected to have further declined by around one fifth in 2010. It should see another smaller reduction in 2011 and stabilise in 2012. While softening, the ongoing drastic downsizing of the construction sector is only expected to come to an end in 2012, also on the back of planned further reductions in public investment. This should be progressively offset by a moderate pick-up in equipment and machinery

investment once confidence has been restored and prospects improve.

Net exports are expected to make strong positive contributions to growth throughout the forecast horizon. In 2009, Irish exports had declined only modestly, mainly reflecting their composition, notably a large share of a-cyclical chemicals, notably pharmaceuticals, in goods exports. In the first half of 2010, they benefitted strongly from the pick-up in global trade and should expand by around 5¼% for the year as a whole. On the back of continued growth in export markets and the ongoing recovery of past competitiveness losses through domestic price and wage adjustments, exports should continue to grow markedly in 2011–12. Imports should be held back by subdued domestic demand developments over the forecast horizon, implying strong growth contributions from the external sector and a return to a moderate current-account surplus by the end of the forecast horizon.

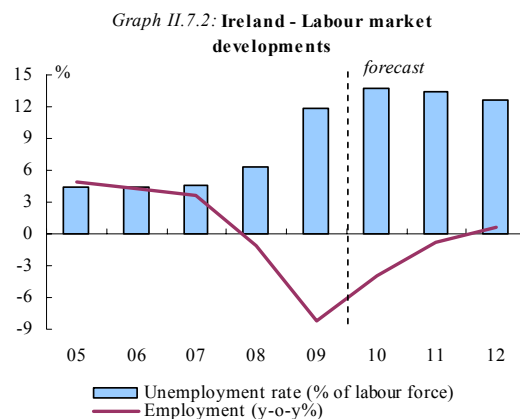


Considerable risks to the outlook remain. On the external side, Ireland's position as a price-taker in international markets implies that export prospects are strongly influenced by exchange rate developments especially vis-à-vis USD and GBP (36% of Irish goods exports in 2009 went to the US and the UK). Domestically, there is uncertainty on how quickly and strongly positive confidence effects of fiscal consolidation could kick in, eventually supporting domestic demand. Further, a domestic upturn is conditional on the ability of a viable banking sector to extend credit to the economy. Subdued lending activity on account of slower-than-expected restructuring in the sector could have a detrimental impact on investment. At the same time, a faster-than-assumed pace of sectoral adjustment might provide support to consumption and investment demand.

Correction of imbalances key for recovery

While the government's four-year strategy clearly sets out plans to consolidate the public finances, the pace of recovery will also depend on the speed of correction of other imbalances accumulated in the past. Notably, the forecast assumes progress in the domestic rebalancing of economic activity from construction to more productive sectors, in the clean-up of household and corporate balance sheets as well as further regaining of competitiveness.

At the peak of the housing market cycle in 2006, the construction sector accounted for over 13% of total employment, nearly double the average share in the euro area. The shrinking of the construction sector and the wider recession have been reflected in a large decline in employment, which has hit young and low-skilled workers hardest. The rise in the unemployment rate has been limited by a marked fall in the participation rate and the return to net outward migration after over a decade of significant inflows. Even after the projected peak in the unemployment rate at close to 13¼% in 2010, further sizeable net emigration is expected over the forecast horizon. The export-led recovery and capital-intensive production in key export sectors imply a very gradual improvement in labour market conditions, lagging more than usual next year's expected return to positive economic growth.



Price and wage adjustment supports competitiveness and export-led growth

During the domestic boom, Ireland suffered significant losses in competitiveness, as reflected in a strong rise in unit labour costs since 2002. The Irish price level was among the highest in the euro area in recent years. A downward adjustment of

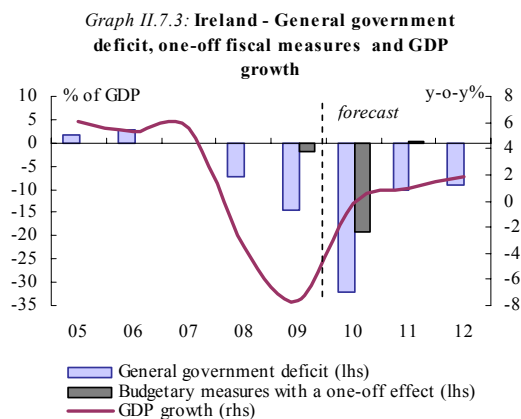
prices is underway; at around -1½% for the GDP deflator and HICP, disinflation continued in 2010. While inflation is projected to return to positive territory in 2011-12, it should remain subdued in the absence of strong demand pressures. Nominal wage adjustment is also taking place, led by corresponding cuts in the public sector now feeding through to the private sector. Wage developments are projected to be very moderate in 2011-12, thereby helping to recover past competitiveness losses and facilitating sectoral adjustment.

Balance-sheet adjustments are likely to continue to weigh on domestic demand over the next few years. After the steep increase in 2009, the household saving rate is expected to decline only gradually over the forecast horizon. While confidence should improve and reduce precautionary savings, the highly indebted household sector's need for further deleveraging following the end of the housing boom will prevent a more marked drop. Further deleveraging and restructuring in the banking sector will also be necessary following past excessive exposure to the construction sector and over-reliance on international wholesale funding. While this might weigh on credit supply in the short term, the non-financial corporate sector's demand for investment credit should also remain subdued over the same period. The measures put in place by the government, including guarantees and NAMA, should help facilitate a further orderly restructuring.

Ambitious but realistic consolidation plans

The Irish public finances have been hit hard by the economic and financial crisis. The sharp deterioration of the general government balance from a small surplus in 2007 to a double-digit deficit ratio in 2009 reflects several factors: a shift away from tax-rich domestic demand driven growth; the rigidity of the expenditure plans given the sharp decline in revenue; as well as a large cost of one-off financial rescue measures.

The large consolidation packages adopted since mid-2008, amounting to some 9% of GDP in 2009-10, have barely halted the deterioration of the underlying general government balance. The deficit ratio reached 14.4% of GDP in 2009 and is estimated at 32.3% in 2010. These figures include significant one-off costs largely related to banking sector support measures. Excluding net-deficit



increasing one-offs of 2% of GDP in 2009⁽⁷²⁾ and around 19% in 2010 the deficit would have been 12.4% of GDP and 13.2%, respectively. In 2010, capital injections into Anglo Irish Bank and two smaller building societies in the form of promissory notes account for almost 20% of GDP. While the full amount of promissory notes is included in the government deficit and debt in 2010, the actual borrowing needs related to the notes are spread over a period of 10 years. The four-year plan published in late November includes detailed measures for 2011 and broad measures for 2012-14. The budget that will be submitted to parliament on 7 December will include a consolidation package of almost EUR 6 billion (3.7% of GDP). Based on this, the deficit is expected to narrow to some 10¼% of GDP next year which is somewhat higher than that projected by the national authorities due to the assumption of less favourable nominal GDP growth. Consistent with the preliminary view of Eurostat on the matter⁽⁷³⁾, this figure reflects zero interest paid on the promissory notes issued to banks in 2011-12 to restore their capital positions. Three-quarters of the measures for 2011 are on the expenditure side, including cuts in capital expenditure (1.1% of GDP), savings on purchases (0.6%), lower social transfers (0.5%) and a reduction in public sector employment (0.2%). A reform of personal income tax system is initiated accounting for most of the measures on the revenue side (0.8% of GDP). The disposal of non-financial assets is estimated to have a one-off deficit-reducing effect of 0.3% of GDP in 2011.

⁽⁷²⁾ One-off measures for 2009 include a deficit-increasing capital injection into Anglo Irish Bank (2.5% of GDP) and a deficit-reducing transfer of pension fund assets to the general government (0.6%).

⁽⁷³⁾ See: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/methodology/advice_member_states

In 2012, the deficit ratio is projected to decrease to 9.1% of GDP taking into account broad consolidation measures of 2.2% of GDP. The expenditure ratio should decline by 1½ pps. of GDP taking into account a nominal freeze of expenditure and rates together with consolidation measures of 1.2% of GDP across main expenditure items. Despite further tax revenue increasing measures amounting to 0.9% of GDP, the revenue-to-GDP ratio is expected to only see a minor improvement given still negative domestic demand, lower fees from the bank

guarantee scheme and a smaller dividend from state bodies after frontloading in 2011. A sharp increase in the gross-debt-to-GDP ratio from 65% in 2009 to 97% in 2010 reflects the large primary deficit, including bank rescue measures, rising interest expenditure and falling nominal GDP. In particular, promissory notes contribute almost 20 pps. to the increase in the debt ratio in 2010. However, the government deficit and debt is subject to further risks related to banking sector recapitalisation needs. Gross debt is projected to rise to 114% of GDP by 2012.

Table II.7.1:

Main features of country forecast - IRELAND

	2009			92-05	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	159.6	100.0	6.8	5.6	5.6	-3.5	-7.6	-0.2	0.9	1.9
Private consumption	81.0	50.7	5.6	6.3	-1.8	-7.2	-1.4	-1.8	-1.0	
Public consumption	31.4	19.7	4.8	7.3	2.8	-4.1	-2.2	-5.7	-0.8	
Gross fixed capital formation	24.7	15.5	8.3	2.8	-14.3	-31.1	-21.1	-10.0	0.0	
of which : equipment	6.8	4.3	8.1	17.2	-17.4	-22.5	-7.0	-3.2	3.8	
Exports (goods and services)	144.8	90.7	11.7	8.2	-0.8	-4.1	5.7	4.5	4.5	
Imports (goods and services)	120.4	75.4	11.1	7.8	-2.9	-9.7	2.3	0.9	2.5	
GNI (GDP deflator)	132.6	83.1	6.4	4.4	-3.5	-11.4	-2.7	-0.3	0.3	
Contribution to GDP growth :										
Domestic demand			5.3	4.9	-3.9	-11.3	-4.4	-3.2	-0.6	
Inventories			0.0	0.0	-0.7	-1.4	0.7	0.4	0.0	
Net exports			1.7	1.1	1.5	3.8	3.4	3.7	2.6	
Employment			3.8	3.7	-1.1	-8.2	-4.0	-0.8	0.6	
Unemployment rate (a)			8.2	4.6	6.3	11.9	13.7	13.5	12.7	
Compensation of employees/head			5.3	5.4	3.4	0.0	-1.9	0.5	0.1	
Unit labour costs whole economy			2.3	3.4	5.9	-0.6	-5.6	-1.3	-1.2	
Real unit labour costs			-1.4	2.3	7.5	3.6	-3.9	-1.6	-1.9	
Savings rate of households (b)			-	-	9.3	16.3	16.3	15.8	15.1	
GDP deflator			3.7	1.1	-1.5	-4.0	-1.7	0.4	0.8	
Harmonised index of consumer prices			-	2.9	3.1	-1.7	-1.5	0.4	0.6	
Terms of trade of goods			-0.3	-2.0	-5.9	4.9	-0.1	0.0	0.0	
Trade balance (c)			20.4	10.5	13.2	20.3	22.9	25.1	26.7	
Current account balance (c)			0.6	-5.5	-5.6	-3.1	-1.1	1.5	2.7	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			1.0	-5.6	-5.9	-3.4	-1.1	1.4	2.6	
General government balance (c)			0.6	0.0	-7.3	-14.4	-32.3	-10.3	-9.1	
Cyclically-adjusted budget balance (c)			0.3	-1.7	-7.3	-11.8	-30.2	-9.1	-8.9	
Structural budget balance (c)			-	-1.7	-7.3	-9.8	-11.1	-9.3	-8.9	
General government gross debt (c)			54.3	25.0	44.3	65.5	97.4	107.0	114.3	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

8. GREECE

Rebalancing growth amidst ongoing fiscal consolidation

Economic adjustment is supported by restrictive fiscal policy

A decade of expansionary fiscal policies resulted in the build-up of unsustainably high fiscal (high general government deficit and gross debt stock, rising interest payments) and macroeconomic (high current-account deficit and external debt, outflow of income) imbalances.

Following the escalation of the debt crisis in spring 2010 and the setting-up of the three-year Economic Adjustment Programme, Greece adopted comprehensive fiscal consolidation measures. They are expected to have a dampening impact on domestic demand in 2010 and the first half of 2011. However, successful and credible fiscal adjustment efforts should boost confidence and improve sentiment. Credibility gains are expected to compensate for the economic cost of adjustment and lead to the beginning of a recovery in the second half of 2011. Sustained fiscal consolidation would support the much needed rebalancing of the economy towards a higher positive contribution to growth of the external sector.

Recession deepens as the downward adjustment in domestic demand accelerates...

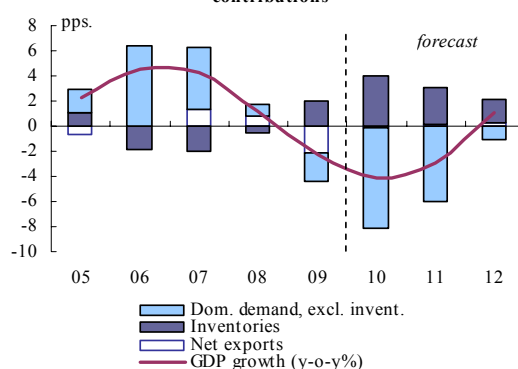
The recent downward revision of annual real GDP data for 2009 (almost -2½% compared with -2% previously) will have an adverse impact on real GDP dynamics in 2010. Moreover, the sharp drop in domestic demand (investment and private consumption in particular) in the first nine months of 2010 points to a significant contraction in economic activity. Despite the recovery in the third quarter, negative average exports growth so far also weighs on this year's economic performance.

Market pressures and high spreads have been keeping up the cost of and limiting private sector access to financing. Credit expansion has been decelerating on the back of tighter credit conditions and high household indebtedness. High-frequency and leading indicators suggest that the economy will lose further steam in the current year, before the recovery kicks in during the second half of 2011. For the year as a whole, economic activity is set to contract by -4¼% in

2010. In the short term, fiscal tightening will have a strong contraction impact on economic activity, on the back of cuts in public wages, an increasing tax burden and ensuing declining disposable income and public spending.

Real GDP is expected to further decline by 3% in 2011 – mainly due to carry-over effects – while growth is expected to turn around positively during the second half of the year, with the recovery gaining further momentum in 2012. The contraction of economic activity, reflected in weakening labour demand from the retail, wholesale and construction sectors, is weighing heavily on employment which is set to fall by more than 5% over the forecast horizon. Reduced employment opportunities in the private sector, along with the recruitment freeze and cuts in short-term contracts in the public sector will push the unemployment rate up to just below 15% in 2012. Negative employment growth and declining wages should weigh on disposable income over the medium-term, dampening real demand. The households saving rate would turn positive already in 2010. As a result, private consumption is projected to contract by around 4% in 2010 and further 4¼% in 2011, before returning to a moderately positive growth rate at the end of the forecast horizon.

Graph II.8.1: Greece - GDP growth and contributions



Gross fixed capital has been falling since the beginning of 2009, on the back investment retrenchment in both housing and equipment. Public investment activity is expected to remain particularly depressed in 2010 and 2011, as a result of continued fiscal consolidation efforts. Tighter credit conditions and subdued domestic demand

should lead to a further strong decline in 2010, before a gradual q-o-q improvement takes course in the second half of 2011.

...while the recovery is entirely driven by the external sector

The contraction in domestic demand will be sustained over the forecast horizon, mirrored also by shrinking imports. Total exports, which started to recover already in 2010, will be further enhanced in 2011-12 by labour cost developments and favourable external demand factors. Exports of goods should rise by around 5½% in 2011 and increase further in 2012, while exports of services – in particular world trade sensitive merchant shipping and tourist receipts – should recover at a similar pace. All in all, the contribution of net exports to GDP growth should be highly positive in 2010-12, due to both the accelerating pick-up in exports and the ongoing contraction in imports.

The risks to this baseline scenario are broadly balanced. On the positive side, the resurgence of both consumer and business confidence and the gradual improvement of liquidity and capitalisation of Greek banks may help to sustain credit expansion at modest levels, which could underpin private consumption and foster investment. In addition, the contribution of net exports to GDP growth may turn out to be stronger than projected, should the impact of ongoing and planned structural reforms materialise more swiftly. On the negative side, the contraction in imports may prove to be more transitory and less pronounced than expected (especially towards the end of the forecast horizon). If tighter credit conditions persist, external financing to the private sector could prove less buoyant and so the servicing of Greece's high external debt might crowd out domestic spending.

Despite high (tax-driven) inflation...

Inflationary pressures have built up in the course of 2010, fuelled by the VAT-rates rises in March and July and the increase in excise duties on alcohol, tobacco and fuel. Based on price developments in the first ten months of the year, annual inflation in 2010 should exceed 4½% on average. The large impact of taxes on inflation, in the context of a severe recession, calls for strong and frontloaded structural reforms targeting the existing inflexibilities in domestic markets. Looking forward, both headline and core inflation

should decline, as base effects and tax effects fade out, and slack in the economy and wage moderation start feeding through.

...external imbalances are decreasing at a fast pace and competitiveness is starting to recover

Higher-than-expected tax-driven inflation has not produced any evidence so far of an adverse wage-price spiral that could push labour costs higher. In fact, the competitiveness losses accumulated in recent years will start to be reversed over the forecast horizon, mainly due to a faster-than-expected labour market adjustment. This will spur labour reallocation and hasten real wage adjustment. The wage cuts in the public sector, their expected spill-over effect in the private sector and the moderate recent private sector minimum wage agreements (the minimum wage will be frozen in 2010 and will increase by 1.5% in July 2011 and 1.7% in July 2012) are expected to push unit labour cost down, after a long period of rapid growth. Private sector average wages are projected to respond accordingly to the strong downturn and the fall in employment, thus contributing to partial recovery of the competitiveness losses.

Developments in the external sector have already kick-started a partial correction of the external deficit in 2010. Further improvement over the medium term is expected, driven by accelerating exports growth and falling imports. The current-account deficit is expected to decline to 8% of GDP in 2011 and to move closer to 6% of GDP in 2012, down from 10½% of GDP in 2010. Expected competitiveness gains and the benefits from ongoing structural reforms may result in an even faster adjustment of the current-account balance.

Ongoing fiscal consolidation to be further strengthened in 2011

The 2009 general government deficit notified by the Greek authorities in November 2010 stands at 15½% of GDP, 1¼ pps. higher than the previous notification made in April 2010. Eurostat has lifted the reservations on Greek deficit and debt figures expressed in October 2009 and April 2010⁽⁷⁴⁾ and

⁽⁷⁴⁾ Eurostat (news release 149/2009) has expressed a reservation on the data reported by Greece on 21 October 2009, due to significant uncertainties over the figures notified by the Greek statistical authorities. A further

validated the data⁽⁷⁵⁾. This upward revision has been higher-than-anticipated. The major elements of the revision concerned the sector reclassification of public enterprises and their inclusion in general government, the significantly worse-than-expected fiscal position of the social security sector and the accounting of off-market swaps. At the same time, general government gross debt in 2009 was revised upward by 11¾% of GDP, reaching almost 127% of GDP.

For 2010, the official general government deficit estimate stands at around 9½% of GDP (EUR 22.3 bn), 1½% of GDP above the original target of 8% of GDP (EUR 18.5 bn). About one third of the shortfall is explained by propagation effects of Eurostat revisions of the 2009 fiscal statistics. The remaining two-thirds would be explained by revenue underperformance of some 1¾% of GDP (EUR 4 bn) compared with the initial revenue target. At the same time, additional sizable

spending retrenchment has been undertaken as compared to the May programme targets⁽⁷⁶⁾.

The 2011 budget (as submitted to Parliament on 18 November) foresees additional measures amounting to 2½% of GDP, which should be sufficient to reach the 2011 deficit target of 7½% of GDP. This would bring total fiscal consolidation measures in 2011 – including those agreed in May – to 5¾% of GDP. About two-thirds of the agreed new measures are on the expenditure side, and most of them are structural in nature. They include cuts in unproductive and untargeted spending, a reduction in short term contracts in the public sector, better targeting of universal household subsidies, and better management and use of state assets, particularly in the collection of arrears.

Taking into account the consolidation measures for 2012 agreed under the Economic Adjustment Programme in May (but no additional ones) and on the back of the discontinuation of one-off measures to be implemented in 2011, the headline deficit should exceed 7½% of GDP in 2012. Debt would increase from 126¾% of GDP in 2009 to 156% of GDP in 2012.

reservation was expressed on 22 April 2010 (news release 55/2010).

⁽⁷⁵⁾ Eurostat has lifted the reservation on Greek data (news release 170/2010 of 15 November 2010). Eurostat and the Hellenic Statistical Authority have addressed all of the issues identified in the last reservation during a series of EDP methodological visits.

⁽⁷⁶⁾ Subject to a positive compliance assessment by the Council, the third loan disbursement under the Economic Adjustment Programme is planned for December (IMF) and mid-January (euro-area Member States).

Table II.8.1:

Main features of country forecast - GREECE

	2009			92-05	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	233.1		100.0	3.0	4.3	1.3	-2.3	-4.2	-3.0	1.1
Private consumption	174.4	74.8	3.1	3.1	3.2	-1.8	-4.1	-4.3	0.5	
Public consumption	45.4	19.5	2.6	9.2	1.0	7.6	-9.0	-8.5	-6.0	
Gross fixed capital formation	40.1	17.2	4.3	5.3	-7.6	-11.4	-17.4	-7.5	-2.6	
of which : equipment	17.9	7.7	8.6	21.9	6.2	-12.2	-13.0	-7.3	-3.1	
Exports (goods and services)	44.3	19.0	6.3	5.8	4.0	-20.1	0.6	5.1	6.0	
Imports (goods and services)	69.5	29.8	5.8	9.8	4.0	-18.6	-12.0	-6.4	-1.5	
GNI (GDP deflator)	226.7	97.3	2.8	3.3	1.0	-1.8	-4.3	-3.1	1.0	
Contribution to GDP growth :										
Domestic demand			3.4	4.9	0.9	-2.2	-8.0	-6.0	-1.0	
Inventories			-0.1	1.3	0.8	-2.1	-0.1	0.1	0.3	
Net exports			-0.4	-2.0	-0.5	2.1	3.9	2.9	1.8	
Employment			1.2	1.7	0.2	-0.7	-2.8	-2.6	0.1	
Unemployment rate (a)			9.9	8.3	7.7	9.5	12.5	15.0	15.2	
Compensation of employees/head			7.9	6.2	6.8	2.3	-1.8	-0.2	0.1	
Unit labour costs whole economy			6.0	3.7	5.7	3.9	-0.4	0.1	-0.9	
Real unit labour costs			-0.2	0.6	2.4	2.7	-3.2	-1.4	-1.3	
Savings rate of households (b)			-	-	-	-	-	-	-	
GDP deflator			6.3	3.1	3.2	1.2	3.0	1.5	0.4	
Harmonised index of consumer prices			-	3.0	4.2	1.3	4.6	2.2	0.5	
Terms of trade of goods			0.0	0.8	-3.3	1.0	1.0	0.1	-0.6	
Trade balance (c)			-15.2	-19.7	-20.5	-16.4	-13.1	-11.1	-10.3	
Current account balance (c)			-6.3	-15.7	-16.4	-14.0	-10.6	-8.0	-6.5	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-13.5	-15.0	-12.9	-9.5	-6.7	-5.1	
General government balance (c)			-6.5	-6.4	-9.4	-15.4	-9.6	-7.4	-7.6	
Cyclically-adjusted budget balance (c)			-6.5	-7.7	-10.5	-15.2	-7.4	-4.1	-4.7	
Structural budget balance (c)			-	-7.5	-9.7	-14.2	-7.7	-5.3	-6.0	
General government gross debt (c)			97.7	105.0	110.3	126.8	140.2	150.2	156.0	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

9. SPAIN

Prospects for a slow recovery while external imbalances recede

The economy is stabilising after the sharp adjustment in 2008-09

Robust growth between the mid-90s and 2007 (above 3½% per year on average) was accompanied by growing imbalances: unsustainable private sector indebtedness, excessive expansion of residential investment, large and persistent cost competitiveness losses and wide external deficits. The financial crisis struck the Spanish economy at a time when a gradual adjustment of these imbalances appeared to have started. The correction became sharp, leading to a severe economic contraction between the second quarter of 2008 and the end of 2009. GDP fell by a cumulative 4.7% over this period and only stopped falling at the beginning of 2010.

The counterpart to the end of the credit boom was sudden shifts in sectoral balance sheets. The household saving rate increased sharply and the sector moved from being a net borrower until mid 2008 to being a large net lender in the second quarter of 2010. The net borrowing position of the corporate sector also shrank very rapidly. Conversely, the impact of the crisis and the discretionary stimulus turned the pre-crisis government surpluses into a large net borrowing position. The external deficit halved to less than 5% in the second quarter of 2010 from the 2007 peak, due mainly to a sharp import retrenchment.

Overall, the economy appears to have stabilised in 2010 – with still shrinking construction activity compensated for by the contribution of other sectors – but it has not yet embarked on a robust recovery path. For the year as a whole, GDP is projected to fall by ¼%, following a contraction of 3.7% in 2009. Private consumption was buoyant in the first two quarters of 2010, partially driven by front-loading of consumption in anticipation of the VAT-rate increase on 1 July. Construction investment is projected to continue to contract at a rapid pace, reflecting the ongoing adjustment in housing investment. However, equipment investment is set to recover due to favourable developments in private consumption and exports in the first half of this year.

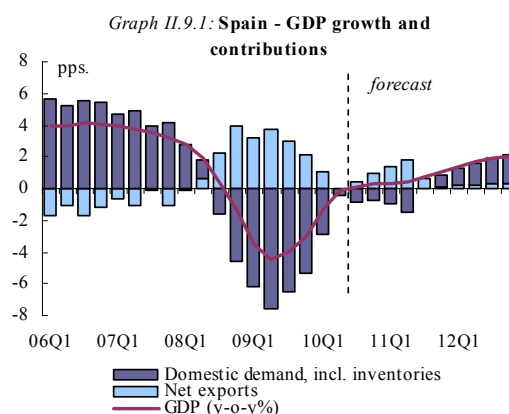
As a result, domestic demand should drag GDP growth down by 1¼ pps. this year, compared to a negative contribution of almost 6½ pps. last year.

A better-than-expected external demand situation is underpinning a vigorous recovery in exports. However, higher imports, driven by the significant increase in domestic demand in the first half of 2010 and higher oil prices, are expected to lead to a fall in the contribution of net external demand to GDP to 1 pp., from 2.7 pps. in 2009.

Further adjustment needs and policy action set the scene for the future

The need for further adjustment and deleveraging will shape the economy over the coming years. Household and corporate debt has broadly stabilised since the beginning of 2008, albeit at high levels. Low interest rates are facilitating debt servicing. Net external debt also remains high, but it has been refinanced smoothly. While financial asset prices have recovered, thus supporting private sector wealth, house prices are still declining, although at a slower pace and with much regional differentiation.

With the adjustment in the labour market taking place principally on the employment side, productivity accelerated during the crisis (in contrast to other countries), sustaining profitability once the wage adjustment followed belatedly. Wage growth has moderated significantly in the first semester of 2010.



Spain has experienced a period of market tensions in the context of increasing financial market fragilities. In response, the government has accelerated and expanded its fiscal consolidation and structural reform agendas. In May 2010, Spain adopted a consolidation package, which

frontloaded the fiscal consolidation efforts foreseen in the February 2010 update of the Stability Programme. In June 2010, it implemented a labour market reform aimed at reducing the duality of the labour market and increasing flexibility for firms. The wide-ranging restructuring process in the savings banks sector, supported by the Fund for Orderly Bank Restructuring ('FROB'), was stepped up and a new governance regime for savings banks was introduced. Other important reform items are being discussed in parliament or are under preparation – such as reforms of pensions, collective bargaining, product markets and innovation. Once fully implemented, the combined effects of these reforms should lift potential growth and employment and facilitate the reallocation of the excess resources that poured into the construction sector during the boom years.

The fiscal consolidation package and the results of the comprehensive stress test of banks in July 2010 helped to decouple Spain from the group of euro-area Member States considered most vulnerable by financial markets. However, government bond spreads against the German benchmark widened again in mid-October/early November in the wake of increasing market tensions.

A slow recovery in 2011-12 will support limited job creation

Looking forward, the continuing deleveraging process, very high unemployment and the short-term demand impact of fiscal consolidation are all expected to lead to more muted GDP growth than in some other euro-area countries. GDP is forecast to grow by ¾% in 2011 and by 1¾% in 2012.

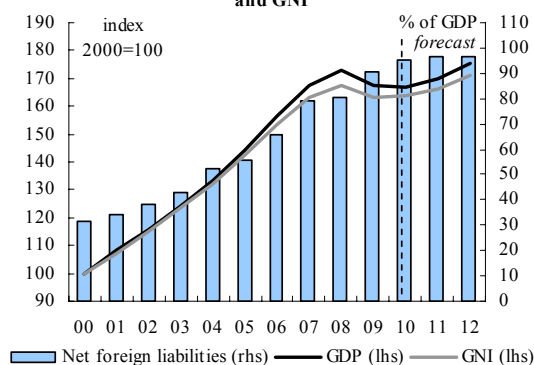
The contribution of domestic demand to growth is projected to remain slightly negative in 2011, before turning positive in 2012. Specifically, private consumption is set to grow modestly in 2011, and to accelerate moderately in 2012 as disposable income picks up and the repair of household balance sheets will have advanced further. The projected evolution of consumption takes into account the impact of the fiscal austerity measures in 2011 on disposable income and the fact that both demand for, and access to, credit are expected to remain more restrained than in the past. The household savings ratio is expected to continue to fall gradually over the forecast horizon

from the peak of 18.1% reached in the last quarter of 2009, but to remain above pre-crisis levels.

Gross fixed capital formation is expected to continue to decline in 2011, due to the ongoing reduction of capacity in the construction sector and significant cuts in public investment, which are only partially offset by a mild recovery in equipment investment amidst improving economic prospects. Although the stock of unsold dwellings is expected to remain large in some regions, production capacity in housing construction at the national level is forecast to stabilise by 2012. In addition, non-residential construction is expected to recover on the back of improving economic prospects, thus partly offsetting the projected fall in infrastructure investment. All in all, construction investment should grow moderately in 2012. This would allow the rate of growth of total gross capital formation to turn positive in 2012.

Net exports are projected to continue contributing positively to growth over the forecast period, in particular in 2011. Against a backdrop of negative domestic demand growth, imports are expected to expand only slowly in 2011, before rebounding in 2012. As the downsizing of domestic demand during the crisis is likely to be partly structural and lasting, the share of imports in GDP is expected to remain lower than in the years preceding the crisis. Growth of exports is projected to continue to outpace that of imports, with Spanish exporters expected to maintain their market shares. However, the softening of world demand growth and the limited correction of past cost-competitiveness losses is expected to reduce the dynamism of exports relative to 2010.

Graph II.9.2: Spain - Net external debt, GDP and GNI



After having contracted in 2010, employment is forecast to stabilise in 2011 and to increase

moderately in 2012. The unemployment rate is set to rise further, to 20% of the labour force in 2011, before falling to around 19% in 2012. The full implementation of the recent labour-market reform is expected to reduce the degree of labour market segmentation and to contribute to reducing structural unemployment over time.

A further narrowing of the current-account deficit is expected to lead to a levelling off of net external debt

The long period of large external deficits has added to net external liabilities, which surpassed 90% of GDP in 2009. The servicing of these liabilities will continue to absorb a non-negligible share of income. The primary income deficit, including net current transfers, is expected to continue to increase and to reach 3% by 2012. Overall, the current-account deficit is set to narrow to 4¾% of GDP in 2010 and to 3¾% in 2011-12, supporting a levelling-off of net external debt.

Unit labour costs set to decrease further in 2011 and inflation to remain moderate

The crisis has shown that inadequate wage bargaining mechanisms, including indexation clauses, prevent nominal wages from adjusting in a timely manner, even when job losses and unemployment rise sharply. The relaxation of employment protection legislation for permanent contracts and the possibility to opt out of collective bargaining agreements, introduced with the recent reform of the labour markets, could however exert a constraining effect on wage growth in the future. The pace of growth of real compensation per employee is projected to fall to 1¾% in 2010, after recording 3¾% growth in 2009 in the midst of the crisis, but it is expected to increase again by 2012.

Productivity growth in Spain has been sluggish during the last decade (½% on average in the period 1998-2008), partly as a result of the allocation of a large amount of resources to investment in the construction sector and to some low-productivity services. The recent apparent surge in productivity growth is mainly due to the sharp contraction in these activities rather than to improvements in the structural drivers of total factor productivity. By the end of the forecast period, productivity is expected to fall back to a growth rate of around ½%, pointing to the need for efforts to enhance innovation and investment by firms, strengthen human capital and foster

competition. Due to these diverging patterns of wage and productivity developments, unit labour costs are projected to decline only marginally in 2011 and to return to positive growth in 2012.

After the slightly negative rate recorded in 2009, inflation is projected to exceed 1½% on average in 2010, mainly driven by a temporary surge in energy prices and increases in indirect taxes. Notwithstanding the uncertainty related to the prices of oil and other commodities in international markets, headline inflation is forecast to remain close to 1½% over the forecast horizon on the back of gradually rising core inflation.

Significant but balanced risks to the baseline scenario

Private consumption could receive an extra impulse if the household saving rate, which is still at historically high levels, fall faster than expected as a result of low interest rates. The effective implementation of the recently adopted structural reforms could spur economic dynamism and bolster confidence. The swift adoption of other reforms under preparation could pave the way for a better performance of the economy by reducing the transmission of inflation shocks to wages and by producing a better alignment between wages and productivity. On the other hand, the still-subdued employment prospects and high unemployment rate might erode confidence and lead households to hold back on expenditure. Further substantial and protracted falls in house prices could lead to a deeper-than-expected adjustment in construction, dent household wealth and sap consumer confidence. With net exports providing a major contribution to short-term growth, worse-than-expected growth in external demand would weigh heavily on economic activity. Finally, downside risks stemming from a reappearance of stress in financial markets remain present.

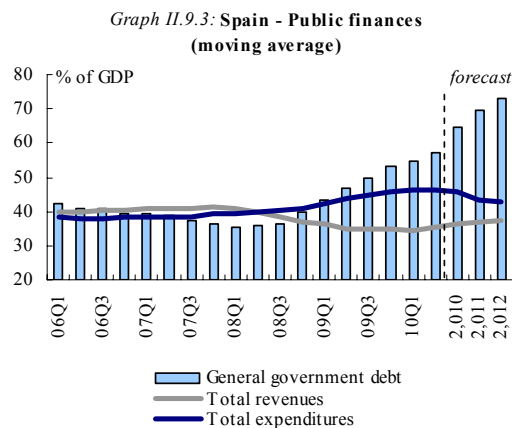
Safeguarding the long-term sustainability of public finances

The departure from the highly tax-rich growth composition of the boom and increased social protection needs stemming from the crisis resulted in a sharp deterioration in the public accounts in 2008-09.

The frontloading of fiscal consolidation is expected to start to deliver a significant correction

this year. In 2010, total revenues are estimated to increase by 1¼ pps. of GDP. This figure includes

GDP, mostly due to cuts in public investment and government public consumption. The deficit is projected at 9¼% of GDP in 2010, down from 11.1% of GDP in 2009.



the reversal of discretionary and one-off revenue-decreasing measures amounting to ½ pp. of GDP in 2009. For the rest, the increase in revenues is driven notably by higher indirect taxes, in particular resulting from the recent increase in the tax rates on consumption (VAT). Total expenditures are set to fall by more than ½ pp. of

For 2011, the Draft Budget Law targets a deficit of 6% of GDP. Total revenues are expected to rise by nearly ¾ pp. of GDP, through both direct and indirect tax revenues. Total expenditures are set to decrease by 2 pps. of GDP, mostly as a result of reduction in public investment and containment of public consumption.

The deficit is projected to fall just below 6½% of GDP in 2011, slightly over the government projection, due mainly a less favourable GDP growth scenario than seen in the 2011 Draft Budget. The government has committed itself to the implementation of additional measures if deviations from the expected budgetary execution are observed. The 2011 budget tightens the procedures to enforce the respect of targets by sub-national entities. Based on the customary unchanged-policy assumption, the 2012 budget deficit is forecast to be 5½% of GDP. Government debt is set to increase to 73% of GDP by 2012.

Table II.9.1:

Main features of country forecast - SPAIN

	2009			92-05	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP		1053.9	100.0	3.1	3.6	0.9	-3.7	-0.2	0.7	1.7
Private consumption		596.4	56.6	3.0	3.7	-0.6	-4.2	1.1	0.9	1.6
Public consumption		222.8	21.1	3.7	5.5	5.8	3.2	0.0	-1.3	-0.3
Gross fixed capital formation		253.0	24.0	4.3	4.5	-4.8	-16.0	-7.9	-3.1	2.7
of which : equipment		59.7	5.7	4.6	10.4	-2.5	-24.8	3.0	3.7	6.0
Exports (goods and services)		246.4	23.4	7.6	6.7	-1.1	-11.6	9.1	5.5	5.6
Imports (goods and services)		269.0	25.5	8.4	8.0	-5.3	-17.8	4.5	1.4	4.5
GNI (GDP deflator)		1029.5	97.7	2.8	2.9	0.4	-3.3	0.2	0.5	1.6
Contribution to GDP growth :										
Domestic demand				3.5	4.5	-0.7	-6.4	-1.2	-0.4	1.5
Inventories				0.0	-0.1	0.1	0.0	0.0	0.0	0.0
Net exports				-0.4	-0.8	1.5	2.7	1.0	1.1	0.3
Employment				2.2	2.8	-0.5	-6.6	-2.3	-0.3	1.1
Unemployment rate (a)				13.7	8.3	11.3	18.0	20.1	20.2	19.2
Compensation of employees/f.t.e.				4.0	4.8	6.4	4.1	1.0	0.7	1.3
Unit labour costs whole economy				3.1	4.0	4.9	1.0	-1.1	-0.3	0.6
Real unit labour costs				-0.9	0.7	2.4	0.4	-1.1	-1.3	-0.8
Savings rate of households (b)				-	-	13.4	18.0	15.8	14.6	13.7
GDP deflator				4.1	3.3	2.4	0.6	0.0	1.1	1.4
Harmonised index of consumer prices				-	2.8	4.1	-0.2	1.7	1.5	1.4
Terms of trade of goods				0.4	0.1	-2.3	4.1	-3.7	0.4	0.4
Trade balance (c)				-4.8	-8.6	-7.8	-4.2	-4.3	-3.5	-3.2
Current account balance (c)				-3.3	-10.0	-9.6	-5.5	-4.8	-3.8	-3.6
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-2.4	-9.6	-9.2	-5.1	-4.3	-3.3	-3.1
General government balance (c)				-2.4	1.9	-4.2	-11.1	-9.3	-6.4	-5.5
Cyclically-adjusted budget balance (c)				-2.2	1.3	-4.2	-9.2	-7.4	-4.9	-4.8
Structural budget balance (c)				-	1.3	-3.9	-8.6	-7.4	-4.9	-4.8
General government gross debt (c)				55.6	36.1	39.8	53.2	64.4	69.7	73.0

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

10. FRANCE

Consolidation to start in earnest

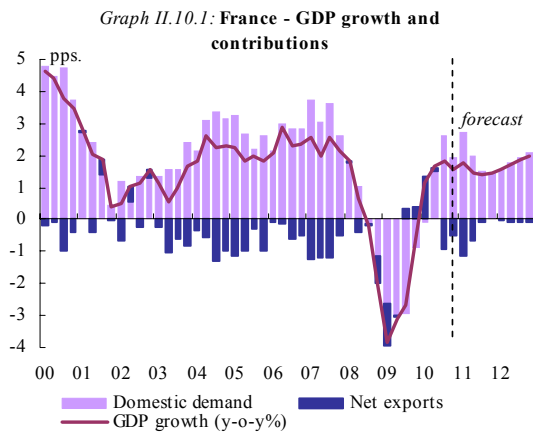
Domestic demand picked up in the second and third quarters of 2010

The French economy came out of the recession in the second quarter of 2009 thanks both to a rebound in exports and to improved domestic consumption as the recovery plan got underway. The plan, which amounted to around 1¼% of GDP for 2009-10, supported purchasing power and households' consumption. Some measures had a very high multiplier: the car scrapping premium sustained private consumption significantly, also on the back of one-off social transfers, which supported households' disposable income. All in all, both private consumption and disposable income growth remained positive throughout 2009 and the first three quarters of 2010. Cash-flow support to businesses probably kept numerous companies afloat and limited the impact of the downturn on the French production system. Nevertheless, investment was subject to a strong correction which only stopped in the second quarter of 2010 after 8 consecutive quarters in negative territory.

On the latest developments, activity accelerated in the second quarter of 2010, when GDP increased by 0.7% q-o-q, the best performance since early 2007. It slowed in the third quarter, growing by 0.4%. Economic expansion was exclusively driven by domestic demand, as in the second quarter. Destocking began to fade, after large negative contributions of stocks to growth in the previous six quarters. Total investment edged up in the second quarter and continued to support activity, thanks to a rebound in business investment and a stabilisation of investment in housing. Private consumption was also on the rise in line with disposable income thanks to improvements in the labour market, deceleration in taxes and more moderate prices. At the same time, net trade was a drag on growth, with imports outpacing exports both in the second and the third quarter.

In the final quarter of 2010, GDP is set to grow by 0.4%, implying an annual growth rate of 1.6% for the year. The composite index for business climate in France, which is based on survey data from industry, services, construction and retail trade is above its long-term average and suggests a continued pace of expansion for the coming quarters. In particular in the industry and services

sectors, business climate indicators improved again in October and are now above their long-term average.



The overall impact on the economy of the strikes against the pension reform would be marginal. Indeed, they were concentrated in the oil distribution and transport sectors and were not followed by all workers. This situation is not comparable with the 1995 benchmark, in which with 22 days of strike without “service minimum” had a 0.2 pp. impact on quarterly GDP.

Modest recovery in exports

French exports benefited from the pick-up in world demand and posted positive growth rates from the third quarter of 2009, strengthening in 2010 with quarterly growth of 4.4%, 2.6% and 2.5% in the first three quarters. This recovery was led by Asian markets and investment in intermediary goods. In addition, French exports benefited from the very good show of Germany in the second quarter.

Limited economic expansion in 2011; recovery to gain strength in 2012

Economic expansion is again expected to rely on both private consumption and investment in 2011. Past experience with deep financial crises has shown that there will be no major acceleration of growth so soon after the trough: domestic demand will not be dynamic enough to strongly support economic expansion.

Private consumption growth is expected to remain positive in 2011 but should not come back to

pre-crisis rates of expansion: rather, it is set to remain subdued in line with the evolution of disposable income growing by around 1½% as compared to 2½% in the past. In more detail, the temporary measures that supported income in 2009/10 will be phased out. In particular, the car-scrapping scheme is expected to expire by the end of 2010. Consolidation measures included in the draft budget law will also have an adverse effect on purchasing power. Tax increases on households will have a 0.3 pp. impact on revenue growth (mainly through reductions in tax expenditures). The slowdown of compensation of public employees, through a reduction in employment and a limited increase in salaries, will also contribute to the weakness of households' disposable income, especially given the size of public employment in France.

Total investment is not expected to pick up strongly and sustain growth in a significant way. After being hit hard during the crisis, corporate investment has gradually increased and eventually returned to positive growth rates in mid 2010. However, the combination of a slowdown in world trade and weak domestic demand brings about rather limited production expectations. Concomitantly, the latest available information shows that the production capacity utilisation rate is still well below its long term average. Productive investment is therefore projected to be limited and should mainly concentrate on replacement investment. It is also worth highlighting that from the supply side, investment prospects are equally subdued. The need for firms to strengthen their balance sheets in a context of high indebtedness and low self-financing capacity suggests little room for a surge in productive investment. In addition, while financing conditions are less tight, they are not yet favourable. In particular, interest rates have fallen but spreads on corporate bonds have increased and credit conditions remain stricter than before the crisis. Finally, fiscal policy will not be as supportive as it was during the crisis with most of the consolidation measures targeted to enterprises.

As regards investment in construction, the sector has stabilised after putting a heavy and continuous drag on growth for the last two years. The upturn in permits and construction starts together with the slight contraction of stocks of unsold homes seem to indicate a gradual recovery of housing investment. In addition, public investment will stabilise after declining in 2010. All in all, growth

in construction investment is expected to be positive as of 2011.

Concerning developments of the external sector in 2011, the growth of international demand for French products might almost halve if the projected slowdown of import appetite in the French trading partners finally materializes.

In general, unlike in the past, domestic demand will not be strong enough to dynamically support economic activity and consolidation measures will somewhat limit the expansion. GDP growth is thus expected to grow moderately in 2011 by 1.6%. In 2012, quarterly GDP growth is projected to be slightly above potential as the large output gap closes gradually. Economic activity is expected to expand by close to 2% on average, supported by domestic demand.

Several uncertainties surround this scenario. In particular, inventory levels are judged to be lower than their long-term average and businesses could run down stocks less extensively or even restock, which would be more favourable to growth. On the other hand, GDP growth could be hindered by further market share losses.

World demand: start me up?

While France's relatively low degree of trade openness has helped it to weather the storm, because of the lack of structural adjustment means that the French economy has not fully benefited from the pick-up of world trade. The combination of a rather sustained domestic demand, feeding in turn relatively dynamic imports, and continuously declining market shares, leads to increasing external imbalances and a sluggish recovery. In 2010, while world trade was booming, net trade was only a small contributor to growth. The geographic specialisation of France's exports could explain part of this performance, as 70% of its exports go to European economies, which grew and are expected to grow at a much slower pace than emerging economies and Asia.

Net trade has hampered French growth in a significant way over the last few years. This can be explained on the basis of a series of weaknesses on the supply side. A decomposition of French exports clearly points to the medium-high technology positioning of French products, which, together with relatively low investment in R&D and underperformances as regards the education

system, is placing the country in a situation of innovation follower. Against this background, French exporters have reduced their profit margins in order to contain the loss in terms of price competitiveness. However, compressed profit margins have been insufficient to limit the rapid loss of market shares, given the pressure on prices from competitors in emerging economies. In addition, France's net exports are held back by the size and the number of exporting firms. For a large majority of firms, exports represent a very limited share of their turnover, compared with German companies for example.

Increasing labour utilisation – key for a sustainable recovery

With the strong deterioration in economic activity, the French labour market adjusted sharply. Since the first quarter of 2010, employment has started to rise again gradually. Mirroring what happened during the crisis, job creations have been so far limited to temporary employment ("interim"). Job creation is set to continue throughout the forecast horizon but at a slow pace (0.5% and 0.7% respectively in 2011 and 2012). Indeed, growth prospects are not good enough to trigger a significant improvement in the labour market. In addition, subsidized contracts would no longer support public employment as observed during the crisis. The unemployment rate is likely to decrease slowly until the end of 2012, not yet reaching its pre-crisis level.

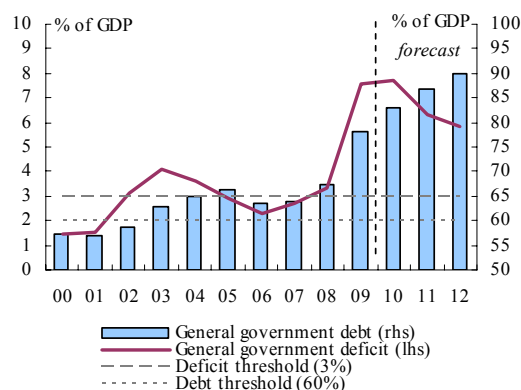
The employment rate will remain low at around 65% in 2012. This could add to the historically insufficient utilisation of labour, which is one of the main bottlenecks of the French economy. Poor labour-market functioning in France manifests itself in a rather low participation rate at both ends of the age spectrum (young and older workers), a high unemployment rate, and a low number of average hours worked. During the crisis, the unemployment rate of the young has jumped from an already high level compared to European standards (24.4% in 2009 from 19.4% in 2007, vs. 15.4% in the EU as a whole). This may be linked to insufficient wage differentiation at the lower end of the wage scale as a result of the minimum wage. Additionally, it seems that many employers are currently actively encouraging early retirement. Furthermore, tax cuts on overtime hours could incite employers to favour overtime over new recruitment and thus limit job creation. On the other hand, the pension reform is expected to have

a gradual but positive impact on the total labour force and employment in the coming years.

Deficit decline but level still high

In 2010, the budget deficit is projected to almost stabilise compared to 2009 at around 7¼% of GDP. The balance of discretionary measures in 2010 is broadly neutral: the positive impact of the phasing-out of the recovery plan (some ¾% of GDP) is projected to offset the new discretionary measures adopted in the 2010 budget, among which the reform of the local business tax (lowering revenues by around ½% of GDP) and the decrease of VAT in the catering sector (around 0.1% of GDP).

Graph II.10.2: France - Public finances



The deficit is expected to improve in 2011 to around 6¼% of GDP based on the budgetary retrenchment presented by the French authorities in the Draft Budget for 2011, slightly above the target contained therein (6% of GDP) notably due to higher social benefits coupled with a more subdued increase in tax revenue. The measures consist mainly of tax increases and would lead to a rise in the tax burden by around ¾% of GDP. On the expenditure side, the phasing out of the remaining measures taken in the context of the recovery plan, together with a freeze in value terms of spending at the central government level (excluding pensions for civil servants and interest payments) and the reform of the pension system, would improve the deficit by around ½% of GDP. Those measures would more than offset the budgetary impact of the public loan (the so-called "*Investissements d'avenir*", notably consisting in public investment), which would deteriorate the 2011 budget deficit by around 0.1% of GDP (and public debt by around ¼% of GDP).

The general government deficit would continue its decreasing trend in 2012. Social benefits would be held in line with the economic recovery and some discretionary measures would contribute to improving the deficit; these include the reform of the pension system and some tax increases presented in the Draft Budget for 2011 with a budgetary impact in 2012. The impact of the public loan would be the same as in 2011. This deficit projection would still be significantly above the government's target of 4.6% included in the pluriannual budget. Indeed, the improvement of the 2012 deficit projected by the French authorities is foreseen to be backed by additional measures that still need to be further specified and could therefore not be taken into account in the Commission's services forecast. In addition, the economic environment in 2012 anticipated by the French authorities would be more conducive to improving the situation of public finances.

The debt-to-GDP ratio would continuously rise over the forecast horizon due to the high expected deficits; it would reach almost 90% of GDP in 2012. The increase in debt-service requirements,

already the second budgetary spending at the central government level, right after public spending on education, could crowd out more productive expenditure necessary to further stimulate growth. This underlines the need for fiscal consolidation.

The consolidation strategy announced by the French authorities is backed by some structural reforms, targeting long-term sustainability and the overall budgetary framework. The reform of the pension system would balance pension accounts in 2018. In particular, it includes a gradual lift of the minimum retirement age from the current 60 to 62, as well as an increase in the age at which a full pension can be received (from the current 65 to 67). As regards the budgetary framework, the French authorities have notably announced measures aiming at better monitoring and reaching the objective set for healthcare spending. A constitutional reform aimed at compelling each newly appointed government to set out a five-year consolidation path and to commit to a deadline for reaching a balanced budget in structural terms, was also announced.

Table II.10.1:

Main features of country forecast - FRANCE

	2009			92-05	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	1907.1		100.0	2.0	2.4	0.2	-2.6	1.6	1.6	1.8
Private consumption	1112.8		58.3	2.1	2.6	0.5	0.6	1.5	1.4	1.7
Public consumption	469.8		24.6	1.5	1.5	1.7	2.7	1.5	0.4	0.4
Gross fixed capital formation	392.1		20.6	2.2	6.0	0.5	-7.1	-1.7	2.4	3.5
of which : equipment	99.3		5.2	3.1	9.1	3.5	-9.6	2.8	3.1	4.5
Exports (goods and services)	439.6		23.0	5.2	2.5	-0.5	-12.4	9.5	5.9	6.2
Imports (goods and services)	476.6		25.0	5.3	5.6	0.6	-10.7	8.2	5.7	5.7
GNI (GDP deflator)	1922.8		100.8	2.0	2.6	0.1	-2.8	1.7	1.7	1.8
Contribution to GDP growth :										
Domestic demand				1.9	3.1	0.8	-0.6	0.9	1.4	1.8
Inventories				0.0	0.2	-0.3	-1.9	0.6	0.3	0.0
Net exports				0.0	-0.9	-0.3	-0.2	0.1	-0.1	0.0
Employment				0.6	1.6	0.7	-1.2	0.0	0.5	0.7
Unemployment rate (a)				10.0	8.4	7.8	9.5	9.6	9.5	9.2
Compensation of employees/f.t.e.				2.7	2.3	2.4	1.6	2.0	1.7	1.8
Unit labour costs whole economy				1.3	1.5	2.9	3.0	0.3	0.5	0.7
Real unit labour costs				-0.3	-1.0	0.3	2.5	-0.1	-1.1	-0.8
Savings rate of households (b)				-	-	15.1	16.0	15.9	15.7	15.7
GDP deflator				1.6	2.5	2.6	0.5	0.5	1.6	1.5
Harmonised index of consumer prices				1.8	1.6	3.2	0.1	1.7	1.6	1.6
Terms of trade of goods				0.0	1.5	-1.2	2.3	-3.5	0.5	-0.2
Trade balance (c)				0.4	-2.1	-2.8	-2.2	-3.0	-3.0	-3.0
Current account balance (c)				0.6	-2.2	-2.7	-2.9	-3.3	-3.4	-3.5
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				0.6	-2.1	-2.7	-2.8	-3.8	-3.1	-3.0
General government balance (c)				-3.4	-2.7	-3.3	-7.5	-7.7	-6.3	-5.8
Cyclically-adjusted budget balance (c)				-3.7	-3.7	-3.5	-5.8	-6.0	-4.6	-4.4
Structural budget balance (c)				-	-3.8	-3.6	-5.8	-5.8	-4.6	-4.4
General government gross debt (c)				57.1	63.8	67.5	78.1	83.0	86.8	89.8

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

11. ITALY

Back to moderate growth

An export-led recovery in 2010

Over the forecast horizon, the Italian economy is expected to return to the moderate growth rates experienced before the crisis. The structural weaknesses behind the unsatisfactory productivity growth over the last decade are also set to weigh on the economy's ability to recover swiftly from the severe output loss recorded during the recession. After falling by more than 6% over 2008-09, Italy's real GDP expanded by around ½% in quarterly terms in the first two quarters of 2010; according to preliminary estimates, GDP growth eased to ¼% in the third quarter and is projected to keep the same pace in the last quarter of the year. Overall, Italy's real GDP is forecast to grow by 1.1% in 2010.

The industrial sector, which drove the contraction in output from late 2008 to mid-2009, is leading the ongoing moderate recovery of the Italian economy, mainly thanks to the rebound in exports. Despite the deceleration in global demand anticipated for the second half of the year, export volumes are set to rise by almost 8% in 2010 as a whole, with exports of goods expected to be significantly more dynamic than those of services. Import volumes of goods are also projected to increase in 2010 due to the mild upturn in domestic demand, especially in investment in equipment, while imports of services are set to decline. As a result, net exports provide a positive contribution to GDP growth in 2010.

The upturn in external demand in the first half of 2010 supported investment in equipment, which also benefited from tax incentives. In the second half of the year, however, the anticipated less buoyant external environment and the expiry of the tax incentives at the end of June are set to dampen growth in machinery investment. Investment in construction is projected to remain subdued, due to the protracted weakness of the property market and the planned contraction in government capital spending.

Private consumption stagnated in the first half of 2010. Expenditure on durable goods, which had until the end of 2009 benefited from incentives to the purchase of energy-efficient goods, in particular vehicles, has been declining. The still fragile labour market situation is set to weigh on

private consumption for the rest of the year, despite improved financial market conditions and a slight overall increase in real disposable income.

Real GDP growth continues to be moderate in 2011-12

In 2011, real GDP is forecast to grow at the same pace as in 2010, while in 2012 it is expected to accelerate to 1.4%, around ½ pp. below the euro-area average.

Exports are again expected to be the main growth driver in 2011-12. However the outlook for exports, given their geographical orientation, mainly depends on growth prospects in euro-area partners and thus prevents Italy from fully reaping the benefits of the more vigorous growth prospects in emerging markets. As imports are assumed to grow slightly less than exports in 2011-12, on the back of the still slow dynamics of domestic demand, net exports are projected to make a positive contribution to real GDP growth in both years.

The export channel is expected to support investment in equipment, which will also benefit from improved profitability conditions. However, capacity utilisation in industry, which plummeted at the worst of the crisis and is anticipated to continue recovering slowly throughout the forecast horizon, as well as the further need for balance-sheet adjustments, notably for small and medium-sized enterprises, may limit the scope for new investment plans. Investment in construction is projected to return to moderate positive growth in 2011-12. While investment in residential building is expected to pick up under the assumption of an improved housing market and better credit conditions, government infrastructure spending is bound to remain constrained by the planned consolidation of public finances.

A slow recovery in labour market conditions and a moderate increase in real disposable income are expected to improve private consumption prospects only gradually in 2011-12.

Risks to the outlook for the Italian economy appear broadly balanced. On the upside, global demand could prove stronger than anticipated, with further positive spillovers, first on investment and then

also on employment and private consumption. On the downside, possible renewed tensions and uncertainty in financial markets might affect economic agents' confidence.

Real GDP growth prospects are set to be only marginally affected by the consolidation strategy planned over the forecast horizon, as its direct negative impact on domestic demand is expected to be partly offset by positive confidence effects. The full implementation of the planned consolidation will help to prevent a surge in Italy's sovereign risk premium and its likely negative impact on the cost of capital for the entire economy.

Current-account deficit narrows gradually

Italy's losses in competitiveness over the decade before the crisis determined a steady worsening of the current-account balance, which moved from a surplus to a deficit. An increase in the deficit in the balance of primary income with the rest of the world, mainly due to the collapse in capital revenue inflows, further deteriorated the current-account balance in 2008-09.

In 2010, the merchandise trade balance is expected to move from a small surplus to a moderate deficit because of worsened terms of trade, mainly related to the rebound in energy prices. By contrast, the services balance is set to reduce its deficit, thanks to falling imports. Notwithstanding the resulting overall deterioration in the external balance of goods and services, the current-account deficit is forecast to remain stable, thanks to a less negative balance of primary incomes. In 2011-12, the external balance of goods and services is assumed to record a lower deficit, thanks to slightly more favourable terms of trade. As the balance of primary incomes is not anticipated to change significantly, the current-account deficit is set to decline to 2½% of GDP by 2012.

A short-lived rebound of productivity

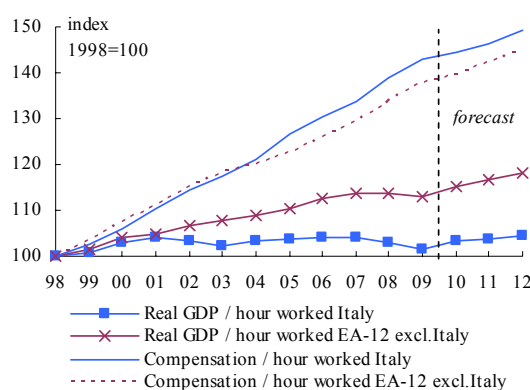
Throughout the crisis, firms chose to hoard labour, through a wider use of the wage supplementation scheme (CIG), whereby employees stop working or reduce hours worked but keep their job at reduced pay. The effect of this scheme is visible when comparing full-time equivalent employment with headcount employment: according to national accounts figures, the number of full-time equivalent employees declined by 2.7% in 2009,

significantly more than the fall in headcount employees (1.3%). In 2010, the requests to access the scheme continued to rise. However, the composition shifted from ordinary benefits to special ones supporting longer-term inactivity spells and workers otherwise ineligible by reason of sector, firm size or type of employment contract.

As in 2009 the contraction in real GDP was much sharper than the fall in employment, the decline in labour productivity already underway since 2008 intensified. As the crisis has been affecting the labour market with some lag, further job losses are expected in 2010. The gradual recovery in output is thus assumed to translate first into a rebound of productivity, then into an expansion of hours worked, and only at a later stage in additional headcount employment, which is set to start rising marginally in 2011 and accelerate in 2012. Productivity is then forecast to rise only mildly in 2011-12, in line with its pre-crisis trend.

Reflecting the more moderate decline in headcount employment and a shrinking labour supply in response to the depressed labour market conditions, the unemployment rate increased only gradually over 2009, peaked at 8.5% between March and May 2010 and started declining during the summer. It is set to remain slightly above 8% across the forecast period on account of the still moderate recovery in headcount employment.

Graph II.11.1: Italy vs. euro area - Productivity and compensation per hour worked



Wage growth per full-time employee outpaced inflation in 2009, also because of contract renewals incorporating past inflation trends. The newly-reformed bargaining framework started to be applied extensively in 2010. Contractual wages are thus set to increase in line with projected inflation excluding imported energy goods, while

the weak labour market conditions and productivity developments are poised to leave little scope for further increases at the level of firms or sectors. As a result, unit labour costs are expected to remain broadly constant in 2010 and increase moderately in 2011-12, after the significant rises recorded over the last decade due to stagnating labour productivity and wage increases slightly above the euro-area average. The projected unit labour cost dynamics over the forecast horizon would allow Italy to avoid further deterioration in competitiveness vis-à-vis the rest of the euro area.

After declining markedly in 2009, HICP inflation picked up in the first half of 2010, due to the fading out of favourable base effects from energy prices. In 2010 as a whole, it is projected to rise to 1.6% on average, while core inflation is forecast to remain considerably above the euro-area average due to a more sustained dynamics of service and non-energy goods prices. Under the assumption of higher oil prices and moderately recovering domestic demand, HICP inflation is then expected to increase broadly in line with the euro-area average in 2011-12.

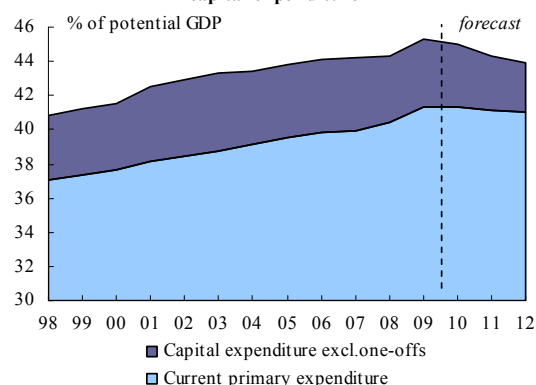
Fiscal consolidation leads to lower deficits in 2011 and 2012

After closing at 5.3% in 2009, the deficit-to-GDP ratio is projected to decline to 3.5% by 2012. This forecast incorporates both the 2009-11 consolidation package adopted in summer 2008 and the 2011-13 consolidation package adopted in May 2010, including the planned expenditure restraint at the lower government levels, but with a less optimistic ex ante assessment of the effectiveness of some of the measures to combat tax evasion.

In 2010, the deficit is expected to fall slightly to 5.0% of GDP. Revenues are set to grow moderately, broadly in line with nominal GDP. Indirect taxes are expected to pick up strongly, mainly thanks to the larger-than-anticipated proceeds of a measure adopted in 2009 that prohibits the offsetting of tax dues with unaudited tax credits above 15 000 euro. Direct taxes are bound to follow the recovery at a slower pace, due to the negative impact of falling interest rates in 2009 on withholding taxes on bank and postal saving interests. Capital tax revenues are projected to decline substantially this year, on the back of the expiry of one-off measures that boosted 2009 revenues by $\frac{3}{4}$ pp. of GDP.

In 2010, primary expenditure in nominal terms is expected to stabilise at the 2009 level, while its current component is estimated to grow by just 1%, as against the $4\frac{1}{2}\%$ average annual growth over the previous decade. Public wage dynamics are assumed to remain moderate thanks to the measures to freeze wages and restrict recruitment in the public sector, as part of the expenditure-restraint strategy adopted with the summer 2008 package. Also as part of that strategy, intermediate consumption is expected to fall slightly in nominal terms, after two years of sizeable increases. Social transfers are assumed to grow more moderately than in 2009 as some temporary recovery measures expire. Capital spending is set to fall substantially in 2010, after the rise recorded in 2009, again related to the recovery measures. Finally, interest expenditure in 2010 still benefits from historically low short-term interest rates and is thus anticipated to remain broadly stable.

Graph II.11.2: Italy - Current primary and capital expenditure



In 2011, the deficit-to-GDP ratio is expected to fall to 4.3%. The May 2010 consolidation package entails around $\frac{1}{2}$ pp. of GDP of expenditure savings. Two-thirds of these savings are to be borne by the sub-national governments. The remaining expenditure restraints fall on: public sector wages, which will be frozen to their 2010 level; intermediate consumption, through cuts to departmental spending and pharmaceutical supplies; and pension expenditure, thanks to the postponement by a few months of the transition to retirement for eligible workers. The package also foresees around $\frac{1}{4}$ pp. of GDP of revenue increases, one-third of which to be raised through motorway tolls and the rest through intensified fight to tax evasion. This forecast incorporates only some of the additional revenues from tax evasion, i.e. those stemming from the measures that appear most likely to yield immediate effects.

Moreover, some 0.2 pp. of GDP lower reduction in the deficit compared with the national plans is due to an estimated lower nominal GDP growth.

In 2011, total revenues are expected to rise by just over 2% y-o-y, i.e. less than nominal GDP. As a result, the revenue-to-GDP ratio is set to decrease relative to 2010. Indirect taxes are set to increase at a faster pace than private consumption, thanks to the new measures to fight tax evasion. Income taxes paid by households are projected to grow very moderately, also due to the planned postponement of some self-assessed tax payments from 2011 to 2012, while corporate income taxes are set to increase only marginally as some one-off taxes on corporate assets expire in 2010.

Public expenditure in 2011 is set to increase significantly less than revenues and nominal GDP, thanks to the planned restraint in most primary components. This entails a 1 pp. reduction in the expenditure-to-GDP ratio relative to 2010. On the current side, the wage bill is bound to fall by almost 1% y-o-y, while intermediate consumption is expected to increase only slightly. Social benefits are set to rise by around 3%, as additional resources have been earmarked for the wage supplementation scheme (CIG). On the capital side, the retrenchment of public investment and subsidies is set to continue, also as a consequence

of the planned cuts to local authorities' spending. The contraction in capital spending, however, is magnified by the one-off sale of broadband licences, worth around 0.2% of GDP, adopted by the government with the budget 2011-13. Interest expenditure is set to rise as from 2011, also due to the still increasing debt.

The deficit is projected to go down further to 3.5% of GDP in 2012. Revenues are expected to grow slightly more than nominal GDP, thanks to the additional payment of personal income taxes postponed from 2011. Indirect taxes are instead projected to rise in line with the assumed growth in their tax bases. As a result, the revenue-to-GDP ratio is expected to rise slightly. Expenditure developments are expected to remain quite subdued, mainly thanks to persistent wage moderation which, combined with the envisaged continued restriction to recruitment in the public sector, is assumed to keep the total wage bill unchanged. Capital expenditure is projected to decrease further in 2012, though at a slower pace. The expenditure-to-GDP ratio is thus set to fall further.

After rising to 116% in 2009, the debt-to-GDP ratio is projected to rise to almost 119% in 2010. The debt ratio is set to continue increasing in 2011, peak at around 120% and start declining in 2012.

Table II.11.1:

Main features of country forecast - ITALY

	2009			92-05	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	1520.9		100.0	1.4	1.5	-1.3	-5.0	1.1	1.1	1.4
Private consumption	911.5		59.9	1.3	1.1	-0.8	-1.7	0.4	0.9	1.0
Public consumption	327.8		21.6	0.8	0.9	0.8	0.6	-0.4	0.0	0.1
Gross fixed capital formation	287.6		18.9	1.5	1.7	-4.0	-12.1	2.4	1.6	3.1
of which : equipment	118.8		7.8	2.2	3.1	-5.0	-17.7	9.5	3.2	4.8
Exports (goods and services)	364.5		24.0	4.4	4.6	-3.9	-19.1	7.9	5.6	5.7
Imports (goods and services)	370.6		24.4	3.9	3.8	-4.3	-14.5	6.8	4.3	4.6
GNI (GDP deflator)	1494.6		98.3	1.5	1.0	-2.2	-5.2	1.3	1.2	1.5
Contribution to GDP growth :										
Domestic demand				1.2	1.2	-1.1	-3.4	0.6	0.8	1.2
Inventories				0.1	0.1	-0.3	-0.4	0.2	0.0	-0.1
Net exports				0.1	0.2	0.1	-1.2	0.2	0.3	0.3
Employment				0.3	1.0	-0.4	-2.6	-1.4	0.4	0.9
Unemployment rate (a)				9.6	6.1	6.7	7.8	8.4	8.3	8.2
Compensation of employees/f.t.e.				3.3	2.4	3.7	2.1	2.3	1.5	1.8
Unit labour costs whole economy				2.3	1.9	4.6	4.7	-0.1	0.7	1.2
Real unit labour costs				-0.8	-0.7	1.8	2.5	-0.9	-0.9	-0.6
Savings rate of households (b)				-	-	14.7	14.0	14.1	14.3	14.0
GDP deflator				3.1	2.6	2.8	2.1	0.7	1.6	1.7
Harmonised index of consumer prices				3.0	2.0	3.5	0.8	1.6	1.8	1.9
Terms of trade of goods				-0.4	1.5	-2.8	7.6	-2.4	0.3	-0.1
Trade balance (c)				1.7	0.2	-0.1	0.1	-0.7	-0.3	0.0
Current account balance (c)				0.4	-1.8	-3.1	-3.2	-3.2	-2.7	-2.4
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				0.5	-1.7	-3.1	-3.1	-3.0	-2.5	-2.2
General government balance (c)				-4.7	-1.5	-2.7	-5.3	-5.0	-4.3	-3.5
Cyclically-adjusted budget balance (c)				-4.6	-3.0	-3.3	-3.5	-3.7	-3.5	-3.3
Structural budget balance (c)				-	-3.1	-3.5	-4.1	-3.8	-3.6	-3.3
General government gross debt (c)				111.7	103.6	106.3	116.0	118.9	120.2	119.9

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

12. CYPRUS

Economic recovery constrained by domestic and external imbalances

The recession has bottomed out...

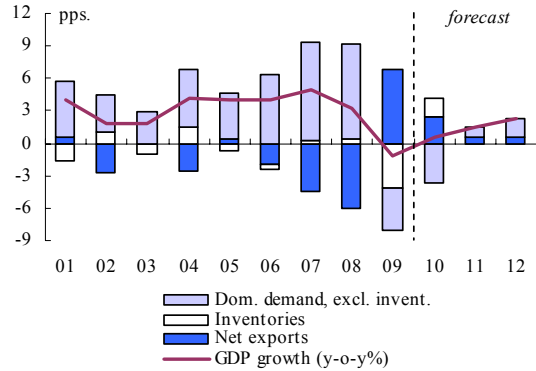
The global economic and financial crisis hit Cyprus through a slump in external demand. After five quarters of contracting activity, moderate growth resumed in the first half of 2010. Assuming that current trends continue, the economy will grow by ½% this year.

Domestic demand, hitherto the key driver of growth, continued to shrink in the first half of the year. High household indebtedness, together with tighter lending conditions, a worsening labour market outlook and negative confidence effects, resulted in a further decline in private consumption, albeit at a slower pace than in 2009. Public consumption, which was expansionary in 2009 driven by fiscal stimulus measures in line with the European Economic Recovery Plan (EERP), is estimated to have levelled off. With lacklustre foreign demand for housing and the restructuring of corporate balance sheets, investment is set to remain on a correction path.

Given high import elasticities, contracting domestic demand was reflected in shrinking imports. In contrast, the improvement of the external environment led to a pick-up in export growth, especially in financial and business services. In particular, banks benefited from inflows of deposits, largely owing to unfavourable conditions in Greece. The growth contribution of the tourism sector was marginal, as receipts were similar to last year's levels. Overall, the recovery from the crisis brought a welcome adjustment of the external imbalance. The current-account deficit is estimated to have narrowed from a historical high of 17¾% of GDP in 2008 to about 6% in 2010.

The recession has taken a heavy toll on public finances. The government deficit was 6% of GDP in 2009 from a surplus the previous years, on the back of the fading away of the asset boom, a less tax-rich composition of growth and the expansionary stance of fiscal policy. The deficit is estimated to stabilise close to this level in 2010, while the debt ratio is on a rising trend and expected to exceed the 60% of GDP reference value.

Graph II.12.1: Cyprus - GDP growth and contributions



Cyprus' labour market also suffered from the recession, with losses concentrated in construction and tourism. In the first two quarters of 2010, the unemployment rate rose to an average of 6.8% from 5.2% in 2009. A turnaround since the spring of the current year may signal that the worst has passed.

...but growth prospects remain subdued

The economic recovery that started in 2010 is set to continue into 2011 and to gain momentum in 2012, moving towards a more balanced composition of growth. Domestic demand is projected to expand moderately, driven by recovering private consumption, on the back of rising consumer confidence and an improving labour market outlook. However, the construction sector is set to experience some further downsizing in the years ahead. Both foreign and domestic demand for dwellings should remain subdued, due to strong growth of prices in recent years and the high indebtedness of domestic households. While other construction, including infrastructure projects, should support investment, it is unlikely that this would be sufficient to fully offset the impact of the fall in housing demand on total construction investment. Likewise, equipment is set to remain on a downward trend.

As regards the external sector, imports are projected to recover and to resume growth in line with domestic demand, after two years of correction. Exports of goods and services, mainly financial and business services, are set to pick up with the rebound in global trade and an improved

outlook in Cyprus' main trading partners. All in all, the contribution of net exports to GDP growth is expected to be positive over the forecast period.

The Cypriot labour market is expected to improve gradually over the forecast period, in line with strengthening economic activity. Thus, employment is projected to rise while unemployment should ease from its peak at the end of the current year. Nevertheless, moderate growth prospects are set to weigh on further inflows of low-skilled foreign workers, hitherto employed primarily in labour-intensive activities.

Overall, the balance of risks appears to be neutral. Total demand may strengthen beyond expectations should growth of Cyprus' major trading partners surprise on the upside. Furthermore, improved confidence and wage growth could lead to higher private consumption. Investment, for its part, may be sustained by the implementation of various announced construction and infrastructure projects. On the other hand, risks associated with adverse spillovers from Greece, particularly in view of the large exposure of the financial sector to the Greek market, are not negligible. At the same time, a tightening of credit conditions, coupled with high indebtedness of private agents, could delay the rebound in consumption. Furthermore, in a context of low growth in both real and nominal terms, the rising external debt could become more severe.

Imbalances weigh on recovery

Within this economic outlook, the challenge for the Cypriot economy is to return to a balanced growth path, leading to further correction of the external imbalance in a context of higher potential growth.

The downturn in economic activity was accompanied by a significant reduction in the current-account deficit of almost 11½ pps. of GDP in 2008-10. This improvement occurred despite the parallel deterioration in the fiscal position by 6¾ pps. Overall, this implies an improvement in private sector's savings of about 18¼ pps., after five years of rising indebtedness and rapid credit expansion. The substantial savings of the private sector are reflected in subdued consumption and shrinking investment and consequently, lower growth.

However, even at around 6% of GDP, the current-account deficit is still relatively large and

likely to constrain economic growth over the medium-term. High public sector dissavings need to be financed by either foreign debt or higher domestic private savings. Thus, the adjustment of the current-account deficit would require either higher cost of debt-financing or higher private sector savings. The latter would imply lower output growth by crowding out private consumption or investment. In the medium term, the deficit is set to continue to improve but at a moderate rate.

Developments in Cyprus' competitiveness, especially regarding wage developments, will be crucial in determining how sustainable the adjustment of the external imbalance will be. In particular, nominal compensation per employee is projected to increase by about 3% annually on average over the forecast period, which exceeds projected productivity growth. Even in case of no or negligible wage increases in the forthcoming sectoral collective agreements, particularly in the public sector, the wage drift and indexation mechanism (Cost of living allowance; COLA), which adjusts wages to inflation over the previous 6 months, would exert upward pressure on wage levels. Productivity growth is expected to remain subdued in line with moderate activity and rising employment. As a result, unit labour costs should rise modestly, although by more than the average in the euro area. All in all, the gap between wage growth and productivity gains is undermining the competitiveness of the Cypriot economy.

Inflation is projected to rise over the forecast horizon in line with prices of imported oil, on which Cyprus is highly dependent, and the gradual recovery of domestic demand. Core inflation is likely to remain above the euro-area average, mainly reflecting domestic cost pressures.

Fiscal deficit in need of correction

Public finances in Cyprus have deteriorated substantially as a result of the crisis and discretionary fiscal stimulus measures, as well as rather large composition effects due to a much less tax-rich GDP growth pattern. As the economy shifts to a more export-oriented pattern, growth composition would likely be less tax-intensive, thus complicating consolidation efforts.

The budget deficit appears to have stabilised in 2010 at a level similar to last year, since a marginal increase in revenues is set to be fully

offset by a rise in expenditures. On the one hand, the slowdown of activity and reduced corporate profitability appears to weigh on tax receipts. In particular, direct tax revenues declined further, dragged down by lower income-tax receipts. Only social contributions posted positive growth, possibly benefiting from the rise of contribution rates adopted in the first half of the 2009. On the other hand, current expenditure continued to rise, despite the fall in interest payments, on the back of increases in the public wage bill, social outlays and subsidies. Given that revenues benefited from a one-off factor of almost $\frac{3}{4}$ pp. of GDP, associated with the profit on an interest swap agreement and a transfer of higher-than-usual Central Bank profits, the budgetary outcome could have been worse on the basis of underlying fiscal trends.

For 2011, the Draft Budget Law targets a deficit of almost $5\frac{1}{2}\%$ of GDP, on the basis of an estimated deficit for 2010 of just below 6% of GDP. On the revenue side, the draft budget does not incorporate any additional measures, apart from the phasing-out of the tax-relief, which was part of the stimulus measures and the harmonisation of excise duties on petroleum products, in effect since last

July. Nevertheless, these effects are partly offset by a reduction in other current revenues. On the expenditure side, the draft budget aims at savings through a reduction of operational expenditure, as well as restraint in public investment and employment. However, these elements are fully offset by a rise in the public wage bill, interest payments and in social outlays.

The present projection is for a deficit of $5\frac{3}{4}\%$ of GDP for 2011. This incorporates a more prudent assessment of revenue prospects, given a less tax-rich growth composition, and on the expenditure side, given past trends on key items such as the wage bill and social transfers. Measures which are still under discussion with an uncertain outcome, or with no information on the modalities or the timing of implementation are not incorporated in this forecast.

Based on the customary no-policy-change assumption, the deficit is set to remain at $5\frac{3}{4}\%$ of GDP in 2012, as gradually rising revenues are offset by higher expenditures. With still moderate growth and an increasing deficit, the debt-to-GDP ratio will rise and reach about $68\frac{1}{2}\%$ by 2012.

Table II.12.1:

Main features of country forecast - CYPRUS

	2009			92-05	Annual percentage change					
	mio EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	16960.1		100.0	4.3	5.1	3.6	-1.7	0.5	1.5	2.2
Private consumption	11649.8		68.7	-	9.4	8.4	-3.0	-1.5	2.1	2.2
Public consumption	3378.0		19.9	-	0.3	6.2	5.8	0.3	1.3	2.0
Gross fixed capital formation	3464.7		20.4	-	13.4	8.6	-12.0	-12.9	-3.8	-1.5
of which : equipment	926.4		5.5	-	11.9	19.7	-19.5	-12.0	-4.0	1.0
Exports (goods and services)	6669.9		39.3	-	6.1	-2.1	-11.8	3.6	3.5	3.8
Imports (goods and services)	7654.4		45.1	-	13.3	8.0	-19.8	-1.5	2.1	2.4
GNI (GDP deflator)	16655.9		98.2	4.1	3.9	2.8	3.2	0.8	0.8	1.8
Contribution to GDP growth :										
Domestic demand				-	8.8	8.6	-3.7	-3.7	1.0	1.7
Inventories				-	0.3	0.4	-4.1	1.8	0.0	0.0
Net exports				-	-4.0	-5.3	5.8	2.4	0.5	0.6
Employment				-	3.2	2.8	-0.7	-0.9	0.2	0.8
Unemployment rate (a)				-	4.0	3.6	5.3	6.8	6.6	5.9
Compensation of employees/head				-	3.0	3.5	5.2	2.7	3.1	3.2
Unit labour costs whole economy				-	1.1	2.7	6.3	1.3	1.8	1.8
Real unit labour costs				-	-3.4	-2.1	6.3	-1.2	-1.3	-0.7
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				3.2	4.6	4.8	0.0	2.5	3.2	2.5
Harmonised index of consumer prices				-	2.2	4.4	0.2	2.8	3.3	2.5
Terms of trade of goods				-	0.6	-2.5	2.7	-1.2	1.3	0.2
Trade balance (c)				-	-29.7	-32.2	-24.8	-24.5	-24.3	-24.4
Current account balance (c)				-	-11.7	-17.7	-8.5	-6.1	-5.7	-5.4
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-11.7	-17.6	-8.2	-5.8	-5.4	-5.1
General government balance (c)				-	3.4	0.9	-6.0	-5.9	-5.7	-5.7
Cyclically-adjusted budget balance (c)				-	2.5	-0.3	-5.5	-5.1	-5.0	-5.4
Structural budget balance (c)				-	2.5	-0.3	-5.7	-5.7	-5.0	-5.4
General government gross debt (c)				-	58.3	48.3	58.0	62.2	65.2	68.4

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

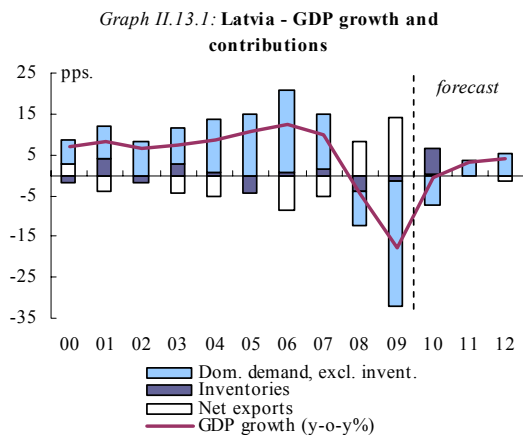
13. LATVIA

Export driven recovery gains momentum

Growth returns sooner than expected

Following a very steep contraction in 2009, the Latvian economy recorded three consecutive periods of quarter-on-quarter growth in 2010 and technically went out of recession. In annualised terms, output is recovering at a faster pace than previously expected, although the growth rate in 2011 and 2012 will remain significantly below pre-crisis levels and the unemployment rate will stay in the double-digit zone for years ahead.

Exports rose significantly, helped by a global trade resurgence and strong demand from all major trade partners. Reduced labour costs and favourable movements in the real effective exchange rate also supported the country's export-driven recovery. Domestic demand remained relatively weak in the first half of 2010, but spillovers from export gains influenced consumption and investment indicators in the third quarter, notably through the rebound in imports and retail trade. The basket of growth contributors is expected to be more balanced in future, although exports will maintain a leading role for some time.



On the supply side of the economy, industry, and to a smaller extent the agricultural sector, were leading the way to recovery while construction output continued to deteriorate at staggering rates in the first half of 2010. The service sector reported a rather mixed picture across different sub-sectors with overall modest improvement as key statistics about ports and railways were still on the downside.

Consumer, investment confidence improves

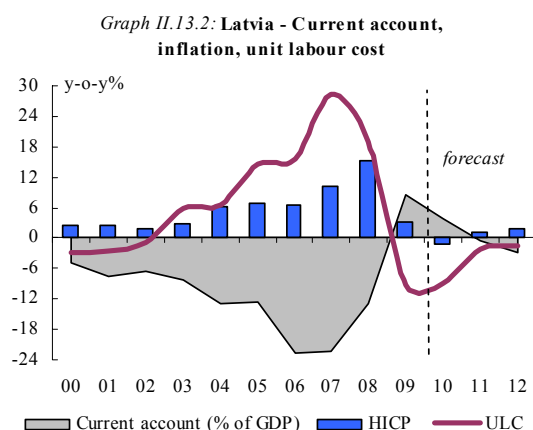
Consumer and business confidence improved in the course of 2010, but with some moderation in the autumn, possibly reflecting uncertainties over the composition of the new government and the forthcoming budgetary consolidation. After a steep fall in households' incomes in 2009, driven by lower wages and employment as well as a high debt burden, consumer behaviour shifted to a lower saving propensity than the one recorded at the height of the crisis. Private consumption regained momentum through 2010 as industrial activity picked up substantially and contraction effects from the fiscal consolidation were largely offset by improved confidence. In the medium run, consumer demand will be supported by job creation effects as well as gradual moves towards the pre-crisis model of a higher spending propensity, although at an aggregate level this will be somewhat offset by less favourable demographics. In the meantime, increased energy prices, with a high seasonal impact in the winter period, are expected to limit households' purchasing power and to offset the risks of a very quick return to demand driven growth, which could lead to inflationary pressures and a loss of competitiveness. Fiscal policies will be also of key importance for avoiding such risks and reducing uncertainty.

In the corporate sector, the steep rise in sales orders moved capacity utilisation rates close to pre-crisis levels in many industries. Nevertheless, investments remained relatively weak in view of the debt repayment efforts, more conservative bank lending policies, and lingering uncertainties in relation to political developments and fiscal reforms. However, many export-oriented manufacturers are looking to upgrade production capacities and investment demand is expected to pick up substantially in 2011, supported by more favourable conditions in the banking sector.

Labour market weighs on potential growth

The recent shock to the labour market will have lasting effects on potential growth and social policies as significant structural adjustments are needed in order to overcome deficiencies. Unemployment declined to 19.4% in the second quarter of 2010 from an all-time high of 20% in

the first quarter of the year, according to the Eurostat seasonally adjusted statistics. The projected economic recovery will continue to support job creation although the process will to a large extent be restrained by the need of export oriented firms to prioritise productivity gains in order to remain competitive. Therefore employment indicators are likely to rise at a much slower pace than production output. Nevertheless, the combination of a decreasing and ageing population, as well as migration flows, will have contractionary effects on the labour force and relatively small job creation rates could still have a big positive effect on unemployment in the medium run, which could be further strengthened by policy actions to eradicate bottlenecks in the labour market. The current estimates show that unemployment could decline by about 1½ pps. per year but this scenario suggests that the job losses in 2008-09 will only be recovered over a much longer period, running beyond 2015.



Inflation risks surface again

After a year-long deflationary episode driven by the collapse of domestic demand and restructuring, the annualised price index (HICP) rose by 0.3% in September and 0.9% in October 2010, due mainly to higher import prices. Adjustments to the state regulated energy prices will continue to weigh on the annualised rates until the spring of 2011, along with the recent recovery of domestic demand and further inflationary impacts fuelled by international agricultural prices. Although inflation is expected to accelerate, it should remain below the EU average in 2011 and around the EU average in 2012. Nonetheless, prices are highly sensitive to both external factors and changes to domestic demand given existing bottlenecks, making inflation a key challenge in maintaining

external competitiveness. The implementation of a further significant fiscal consolidation should be an effective tool for containing inflation risks.

External balance signals new readjustment

The current-account balance remained in positive territory in 2010, pushed by booming merchandise exports and large net inflows in income transfers. Exports of goods were still rising faster than imports but the growth rates' margin contracted significantly in relation to 2009. Moreover, the current account is now forecast to move back to deficit as early as 2011 in contrast with earlier expectations that the surplus will stay for several years. The overall performance in the current account will also depend on the income statements of foreign owned companies, where the losses booked in 2010 have a positive effect on net income transfers, but the ongoing economic recovery could reverse the impact as early as 2011. While the current account is not expected to lead to significant external imbalances in the near future, authorities need to keep focusing on the country's competitiveness in order to extend this favourable outlook to the medium and long run.

The financial account remained in deficit in the first half of 2010 but the stock of foreign reserves continued to increase helped by the EU/IMF financing. The net inflow of FDI was very weak during the same period, while gross FDI inflows showed signs of improvement. Given that the latter remain far below the pre-crisis benchmarks, there is a good chance of rebound as uncertainties on the country prospects diminish.

Fiscal consolidation at the crossroads

As, so far, the implementation of the 2010 budget seems satisfactory overall, this should allow the authorities to comply comfortably with the 8.5% of GDP deficit ceiling. After three quarters, tax revenues are better than expected, mostly thanks to value added tax. The final deficit outcome remains subject to uncertainties, given potential overruns and a possible acceleration of spending by the end of the year, including efforts for full absorption of EU structural funds. Some unsettled commitments, arrears and financial sector costs may also lead to a somewhat higher 2010 ESA outcome, although about 1% of GDP is already included in the forecast deficit of 7.7% of GDP.

For 2011, the forecast of 7.9% of GDP does not include new fiscal measures since the draft budget will only be adopted by the government on 7 December 2010 and its measures are still under discussion. Hence, as was the case last year, the forecast represents a baseline before consolidation. Thanks to a better than expected macroeconomic environment, the consolidation need for 2011 has been revised significantly downwards in consultation with the lenders, from 3.0-3.5% of GDP identified in June 2010, to slightly more than 2% of GDP. If adopted, this should lead to a 2011 deficit below 6% of GDP. It should be noted that the figures mentioned for 2011 and 2012 (and the forecasts) exclude the impact of financial sector measures, for which the temporal distribution is still difficult to predict at this stage.

In the short run, the main risks relate to consolidation fatigue, given the magnitude of the adjustment already implemented over the past two years (15% of GDP), and the possible impact of the fiscal consolidation on the economy. The latter is expected to be at least partially offset by more sustained investment which is still withheld in view of uncertainties on the ambition of the fiscal course. Over the next two years, risks relate to

financial sector measures and possible arrears or unbudgeted social needs. Financial sector measures may affect the fiscal balance in ESA terms, as already happened with the upward revision of the 2009 deficit in October (10.2% of GDP instead of 9%, mostly due to a methodological change related to one capital injection). Given current trends, the adjustment need to bring the 2012 deficit below 3% of GDP, taking account of potential financial sector costs, remains large.

Estimates on public debt developments are subject to significant uncertainty. On the one hand, risks relating to the financial sector, while more limited than originally expected, are still difficult to quantify and their temporal distribution remains unclear. On the other hand, a significant part of the amounts committed by bilateral lenders will now be treated as credit facilities and may not be fully drawn. In addition, the ongoing work towards the definition of a strategy on the management of state-owned firms could possibly lead to the privatisation of some non-core assets. Overall, public debt would evolve in a more favourable way than previously envisaged, with a peak below 60% of GDP.

Table II.13.1:

Main features of country forecast - LATVIA

	2009			92-05	Annual percentage change					
	mio LVL	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	13082.6		100.0	1.8	10.0	-4.2	-18.0	-0.4	3.3	4.0
Private consumption	8053.8		61.6	-	14.8	-5.2	-24.1	-0.5	3.2	4.0
Public consumption	2566.8		19.6	-	3.7	1.5	-9.2	-4.0	-2.6	-2.0
Gross fixed capital formation	2806.8		21.5	-	7.5	-13.6	-37.3	-24.8	9.5	15.0
of which : equipment	-		-	-	-	-	-	-	-	-
Exports (goods and services)	5741.7		43.9	-	10.0	2.0	-14.1	8.6	6.0	6.4
Imports (goods and services)	5935.3		45.4	-	14.7	-11.2	-33.5	7.6	6.0	8.5
GNI (GDP deflator)	14081.2		107.6	1.5	9.7	-2.0	-10.8	-4.8	-1.0	2.7
Contribution to GDP growth :										
Domestic demand				-	13.5	-8.4	-30.7	-7.1	3.5	5.3
Inventories				-	1.6	-4.1	-1.5	6.5	0.0	0.0
Net exports				-	-5.1	8.2	14.2	0.2	-0.1	-1.3
Employment				-1.7	3.6	0.9	-13.6	-5.6	0.5	0.6
Unemployment rate (a)				12.5	6.0	7.5	17.1	19.3	17.7	16.2
Compensation of employees/head				-	35.1	15.7	-11.7	-4.0	0.7	1.8
Unit labour costs whole economy				-	27.2	22.0	-7.0	-9.0	-2.1	-1.5
Real unit labour costs				-	5.8	6.6	-5.6	-6.2	-2.7	-2.5
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				30.3	20.3	14.4	-1.5	-3.0	0.6	1.0
Harmonised index of consumer prices				-	10.1	15.3	3.3	-1.3	1.1	1.8
Terms of trade of goods				-	7.2	-1.8	-2.9	0.0	0.1	0.0
Trade balance (c)				-13.8	-23.9	-17.7	-7.1	-7.7	-7.8	-8.9
Current account balance (c)				-4.6	-22.3	-13.1	8.6	3.9	-0.5	-2.9
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-2.2	-20.4	-11.6	11.1	6.4	1.9	-0.6
General government balance (c)				-	-0.3	-4.2	-10.2	-7.7	-7.9	-7.3
Cyclically-adjusted budget balance (c)				-	-4.4	-6.2	-7.2	-5.1	-6.5	-7.0
Structural budget balance (c)				-	-4.4	-6.2	-7.8	-6.0	-7.1	-7.6
General government gross debt (c)				-	9.0	19.7	36.7	45.7	51.9	56.6

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

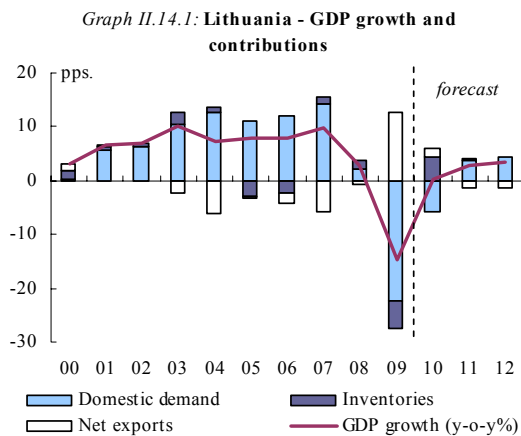
14. LITHUANIA

Recovery gathers momentum and becomes broad based

Gradual recovery in 2010, supported by export growth

Lithuania is recovering from a deep economic recession. After contracting by nearly 15% in 2009, economic activity is projected to expand by about 0.4% in 2010.

Growth has been driven by external demand as exports expanded across sectors throughout 2010. Positive export developments have been supported by improved cost competitiveness, aided by strong wage disinflation. Moreover, the main export partners – in particular Germany, the other Baltic states and Russia – have been growing more strongly than previously expected. Inflation fell significantly to around 1% in 2010 and wage adjustment continued (-5.4% in the second quarter of 2010) while the current account recorded a surplus for the second year in a row.

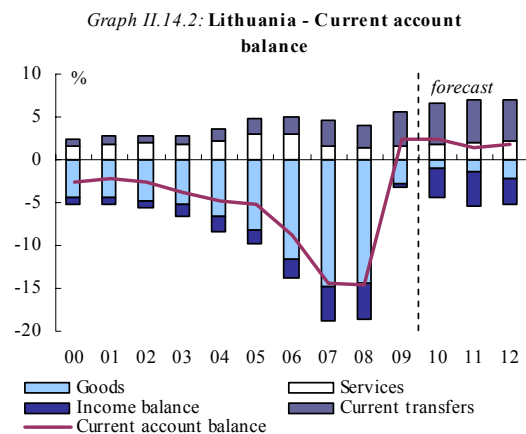


On the other hand, sluggish private domestic demand is dampening the economic recovery as credit growth remains negative, wages have been reduced in both private and public sectors, social benefits have been cut and indirect taxes increased; all significantly reducing household disposable income. The unemployment rate is expected to peak in 2010 at close to 18%. Non tradable sectors have been most strongly affected. Youth unemployment is particularly high and reached 37% in the second quarter of 2010, resulting in a fresh emigration surge. However, investment has been showing some signs of recovery and depleted inventories are being rebuilt. The absorption of EU structural funds has also picked up.

Recovery broadens to domestic demand and gathers pace in 2011

Real GDP growth is expected to accelerate in 2011 as strong export dynamics progressively spur investment and ultimately consumption.

After contracting for two years in a row, domestic demand is projected to rebound in 2011, reflecting an upturn in private investment on the back of a more favourable business outlook and improved credit flows. At the same time, the real estate market seems to have bottomed out in 2010. Moreover, public investment should remain strong amid continued commitment to frontloading of EU co-financed projects, related in particular to infrastructure and energy efficiency enhancing investments. The labour market is expected to improve progressively, especially during the second half of 2011. Consumer spending is set to expand, supported by employment and wage growth, though less strongly than private investment, as households' disposable income continues to be affected by the ongoing fiscal consolidation. Skill mismatches seem to have emerged in some sectors, which may put upward pressure on private wages over the forecast horizon.

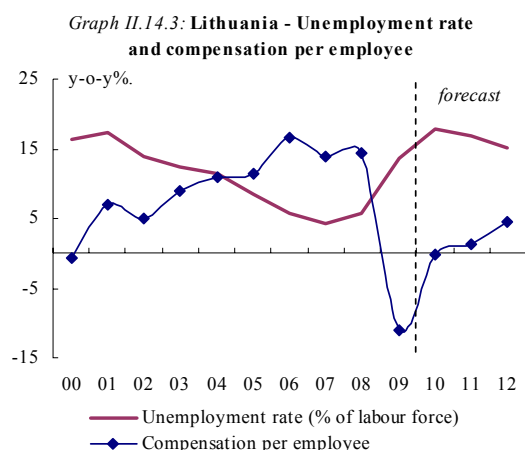


The external balance is likely to contribute negatively to growth in 2011. Export growth is projected to remain robust against the backdrop of a broadly stable global economy outlook, while imports are set to pick up gradually in line with the ongoing recovery in domestic demand. Consequently, the trade deficit is expected to widen and exert a dampening impact on output.

growth. On the other hand, the current-account balance is set to remain positive due to continuing inflows of EU funds and private sector transfers.

Inflation should increase to 2.3% in 2011 as oil and other commodity prices on international markets are expected to increase further. Higher food prices and excise duty increases on tobacco and fuel (as from the beginning of 2011) as well as the expiry of the reduced VAT rate on heating (currently planned in September 2011) will also add to inflation dynamics. The extent of second-round effects, related to the pass-through of higher production costs to consumer prices, however, remains uncertain. Core inflation is projected to accelerate only very gradually over the forecast horizon, albeit from very low levels, as domestic demand gathers momentum.

Following its peak of close to 18% of the labour force, unemployment is set to moderately decrease over the forecast horizon, in part due to high emigration. The major challenge will be to ensure that unemployment does not become structural. Labour market mismatches need to be tackled and the restructuring of the economy from non-tradable to tradable sectors, including the diversification towards higher-value added production processes, facilitated to underpin future growth prospects.



Further expansion in 2012

On the back of the improved wage and business outlook as well as more favourable credit flows, real GDP is projected to grow at a robust pace, close to its long-term trend. This expansion is projected to rely on domestic demand as the trade balance deficit widens further.

Domestic demand is set to strengthen towards the end of the forecast horizon as positive expectations underpin private investment as well as employment prospects. Public investment growth is also expected to remain positive, while increases in disposable income triggered by brighter wage and employment outlooks should support consumption. Over the medium-term, growth prospects will crucially depend on the depth and speed of the ongoing economic restructuring.

Risks related to this baseline scenario seem balanced. On the one hand, stronger-than-expected growth in global trade would support Lithuanian's exports, facilitating the structural shift towards the tradable sector. An improved business outlook might also trigger stronger-than-projected capital inflows, which would further underpin output growth. On the other hand, downside risks relate to slower-than-expected improvement in the labour market, insufficient fiscal consolidation as well as setbacks to financial stability.

Fiscal outlook

Fiscal measures amounting to around 8% of GDP in 2009 and 3.7% in 2010 helped limit the public sector deficit, which is expected to narrow to 8.4% in 2010 after reaching 9.2% of GDP in 2009. The measures have partly corrected for the high pre-crisis growth of expenditure and the subsequent sharp fall in revenues as the domestic bubble collapsed in 2009, reinforced by the global economic crisis. Revenue collection in the first eight months of 2010 has exceeded the government's expectations, even though central government revenue is nearly 5% lower than in the same period in 2009. In July 2010 the government extended some temporary expenditure-reducing measures. These include reduced wages for politicians, lawyers and government officials (extended for one more year, until the end of 2011) as well as reduced transfers of contributions to the second pillar pension funds (extended until the economic situation improves). Moreover, maternity benefits have been significantly reduced and some sickness leave benefits are to be permanently paid by the employers rather than the social security fund. However, some other expenditure items, including interest payments, healthcare spending, capital expenditure, and social benefits have increased in 2010.

On the whole, fiscal risks are increasing as consolidation fatigue is reinforced by the electoral

cycle and some temporary fiscal consolidation measures are set to expire in the coming years. The 2011 budget relies on strong revenue growth to meet budgetary targets. The draft 2011 budget adopted by the government targets a deficit of 5.8% of GDP in 2011, in line with the excessive deficit procedure. In the budget, the government expects better tax compliance and improved efficiency of state-owned enterprises. Measures to ensure the effectiveness of these goals remain to be specified. Tax changes are limited to increases in excise duties on tobacco and fuel according to EU legislation, and some increases in non-tax revenue, which mainly relate to a higher inflow of EU structural funds. The personal income tax rate for the self-employed is to be reduced from 15% to 5% as of 2011. The 2011 draft budget foresees a 4.6% nominal increase in government expenditure

compared to the 2010 budget due to higher debt service costs and increased social expenditure. General government investment is also planned to decrease. A contingency provision, in case the budgetary revenue falls short of expectations, has been included in the draft budget. It requires a supplementary budget that would ensure that the 5.8% of GDP target is met.

In 2012, some of the temporary consolidation measures including government wages and reduced social benefits, in particular pensions, will expire. Hence, on the basis of the customary no-policy-change assumption, the general government deficit is expected to narrow to 7.0% of GDP in 2011 and 6.9% in 2012. Government debt is expected to increase from over 37% of GDP in 2010 to around 48% in 2012.

Table II.14.1:

Main features of country forecast - LITHUANIA

	2009			92-05	Annual percentage change					
	bn LTL	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	91.5	100.0		1.2	9.8	2.9	-14.7	0.4	2.8	3.2
Private consumption	63.0	68.8		-	12.1	3.7	-17.7	-5.9	2.9	4.0
Public consumption	20.1	21.9		-	3.2	7.3	-1.9	-1.3	0.0	2.5
Gross fixed capital formation	15.7	17.1		-	23.0	-5.2	-40.0	-8.5	13.0	8.5
of which : equipment	3.7	4.0		-	21.9	-17.1	-49.8	0.0	15.0	10.0
Exports (goods and services)	50.0	54.6		-	3.0	11.6	-12.7	11.0	6.3	6.6
Imports (goods and services)	51.3	56.1		-	10.7	10.3	-28.4	7.8	8.1	8.4
GNI (GDP deflator)	91.8	100.4		-	8.0	3.5	-10.1	0.1	2.7	4.2
Contribution to GDP growth :										
Domestic demand				-	14.2	2.3	-22.2	-5.8	3.8	4.5
Inventories				-	1.3	1.4	-5.3	4.5	0.1	0.0
Net exports				-	-5.7	-0.7	12.7	1.6	-1.2	-1.2
Employment				-0.9	2.8	-0.7	-6.8	-5.6	1.1	2.1
Unemployment rate (a)				9.5	4.3	5.8	13.7	17.8	16.9	15.1
Compensation of employees/head				-	13.9	14.3	-11.1	-0.2	1.2	4.4
Unit labour costs whole economy				-	6.5	10.4	-2.8	-6.1	-0.4	3.3
Real unit labour costs				-	-1.8	0.5	0.9	-7.1	-2.2	0.8
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				40.2	8.5	9.8	-3.7	1.1	1.8	2.5
Harmonised index of consumer prices				-	5.8	11.1	4.2	1.2	2.3	2.8
Terms of trade of goods				-	0.9	3.6	-5.9	1.2	0.1	0.4
Trade balance (c)				-	-15.0	-13.0	-3.1	-1.1	-2.2	-3.2
Current account balance (c)				-	-15.1	-13.1	2.6	2.6	1.3	1.0
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-12.9	-11.2	7.0	6.9	5.4	4.9
General government balance (c)				-	-1.0	-3.3	-9.2	-8.4	-7.0	-6.9
Cyclically-adjusted budget balance (c)				-	-3.6	-5.5	-7.0	-6.5	-6.0	-6.5
Structural budget balance (c)				-	-3.0	-5.5	-7.4	-7.1	-6.6	-7.1
General government gross debt (c)				-	16.9	15.6	29.5	37.4	42.8	48.3

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

15. LUXEMBOURG

Strong rebound but future prospects remain exceptionally uncertain

After a severe recession, economic activity is picking up strongly

The recession has been severe in Luxembourg but the recovery is rather robust too: from peak to trough (from the second quarter of 2008 to the second quarter of 2009), real GDP fell by 8.0%. Since then, it has recovered around two-thirds of the loss, rising by 5.4% y-o-y in the second quarter of 2010. Like in most other member states, the fall in GDP in 2009 was chiefly caused by a collapse in investment (-19%) and in exports (-8% of which -20% for exports of goods), partially compensated by a correlative drop in imports (-10% of which -22% for imports of goods). Similarly, the recovery in 2010 is essentially being generated by investment and exports, which are expected to rise by about 8½% and 10% respectively, while imports should increase by about 12%. Private consumption, which slowed down from 4.8% in 2008 to 0.3% in 2009, probably as a side-effect of the strong rise in unemployment and the deterioration in consumer confidence, is strengthening again and should increase by more than 2% in 2010. In total, real GDP should grow by about 3¼% this year after falling by 3.7% in 2009.

This rather strong growth momentum is expected to continue in 2011-12 as domestic demand will strengthen and external trade will probably remain rather supportive. In total, real GDP growth should decelerate somewhat in 2011 and slightly reaccelerate in 2012, following the general trend of the EU, while remaining in the neighbourhood of 3%. Although such growth rates are substantially higher than those currently expected for most other Member States, they are also significantly below the average rates recorded in Luxembourg before the crisis. In a longer perspective, future prospects are very unclear for the Luxembourgish economy. The financial sector, which has been the country's main growth engine in recent decades and now represents almost 30% of total value added, seems to have withstood the crisis rather well, but the future of financial activity at the world level is exceptionally uncertain. Moreover, the sector is extremely internationalised in its ownership and activities, which makes it particularly sensitive to developments abroad.

Employment has been exceptionally resilient but unemployment will not decline much in the coming years

Employment performed particularly well during the recession and its resilience surprised even the most optimistic observers. It decelerated strongly from the very high growth rates recorded in 2008 (4.8% over the year) to about 0.1% y-o-y in the autumn of last year but it never decreased in absolute value and, in yearly average, it still rose by 0.9% in 2009 – the highest figure in the whole EU-27, where it declined by 1.9% on average. This massive labour hoarding was probably due to a large part to the reluctance of firms to lay off people whom they had found difficult to hire during the boom years, but it was also helped by a systematic recourse to short time working encouraged by the government. Employment is growing strongly again, by about 2¼% a year in recent months. It is expected to rise by about 1¾% this year and to continue to accelerate over the forecast period, growing by 2% in 2011 and slightly more in 2012.

Unemployment has risen significantly in recent years, from about 4.2% of the active population in the spring of 2008 to around 6% in the first half of 2010. It strongly accelerated in the autumn of 2008 but began to slow down in the course of 2009; it has been broadly stable since the beginning of this year. However, the strong job creation expected over the forecast period will probably not result in a significant decline in unemployment. Indeed, unemployment has an increasingly structural character in Luxembourg (even though its large increase since 2008 is clearly a consequence of the recession). Evidence of this is the fact that it hardly declined during the good years 2004-07 despite the very strong employment growth recorded at that time: it took employment to rise by more than 3½% a year for unemployment to decrease marginally and relatively briefly, from the beginning of 2007 to the spring of 2008. Like in the previous boom period, job creation is thus expected to most benefit non-resident workers, whose number has once again been rising faster than national employment in recent months (by more than 2½% a year, compared with about 2% for residents' employment).

Inflation is picking up but should remain moderate

Inflation was negative from February to October 2009 due to the large drop in energy prices; the yearly average fell to 0%, but it resumed rising at the end of the year. It reached 2.8% on average over the first three quarters of 2010 and will probably amount to the same figure for the year as a whole. Inflation is projected to decelerate slightly in 2011 and more strongly in 2012, reaching about 2% and 1½% respectively, provided the factors behind the acceleration observed this year, in particular, the surge in the prices of oil and other basic commodities, weaken as expected. Wages had risen by 3.5% a year on average during the good years 2004-07. They slowed down to 2.0% on average in 2008 and 2009 and are expected to rise by a similar amount in 2010-11. They should slightly accelerate in 2012 due to an indexation threshold foreseen at the end of 2011 and the projected acceleration in job creation.

The government balance deteriorated substantially but the deficit remains contained

The general government balance, which had amounted to a surplus of 2.9% in 2008, turned into a 0.7% deficit in 2009, the lowest deficit recorded in 2009 in the EU, in large part thanks to the

favourable situation of public finance before the crisis. The deficit will increase to about 1¼% of GDP this year because, partly as a result of the delayed impact of the crisis, government revenues are still forecast to rise more slowly than expenditure even though they are recovering after a slight decline in 2009. In 2011, the deficit is projected to decrease to about 1¼% as a result of the consolidation package decided by the government in the spring of this year. Revenues, in particular taxes paid by households, should accelerate, while expenditure will slow down after three years of strong growth (about 8.5% a year on average from 2008 to 2010). Government investment, notably, is planned to decrease by about 2½% of GDP next year. In 2012, at unchanged policy, the deficit is forecast to stabilise at around 1¼% of GDP.

The public debt, which amounted to 14.5% of GDP in 2009, it is expected to rise to around 20% of GDP at the end of the forecasting period, which is still one of the lowest in the EU. The increase is essentially a result of the financing of the deficits of the central government. The social security system, on the other hand, should continue to run substantial surpluses, which, like in the past, will be used to increase its reserves, the amount of which is now estimated at more than 30% of GDP.

Table II.15.1:

Main features of country forecast - LUXEMBOURG

	2009		92-05	Annual percentage change						
	mio EUR	Curr. prices		% GDP	2007	2008	2009	2010	2011	2012
GDP		38044.7	100.0	4.3	6.6	1.4	-3.7	3.2	2.8	3.2
Private consumption		12955.9	34.1	2.5	3.3	4.8	0.3	2.2	1.6	2.1
Public consumption		6349.1	16.7	4.2	2.8	2.7	4.5	3.7	3.2	3.5
Gross fixed capital formation		6576.1	17.3	4.4	17.9	1.4	-19.2	8.7	7.6	7.3
of which : equipment		1627.3	4.3	3.3	23.9	3.3	-38.0	12.5	10.0	8.5
Exports (goods and services)		63774.0	167.6	7.5	9.1	6.6	-8.2	9.9	7.6	6.1
Imports (goods and services)		51260.3	134.7	7.3	9.3	8.5	-10.3	11.8	8.8	6.7
GNI (GDP deflator)		26773.8	70.4	2.7	12.8	-5.4	-9.7	4.1	3.1	3.5
Contribution to GDP growth :	Domestic demand			2.8	5.0	2.2	-3.2	3.2	2.8	3.0
	Inventories			0.0	-0.9	-0.1	-0.8	0.4	0.2	0.0
	Net exports			1.6	2.5	-0.6	0.3	-0.5	-0.2	0.2
Employment				3.3	4.5	4.7	0.9	1.7	2.0	2.1
Unemployment rate (a)				3.1	4.2	4.9	5.1	5.5	5.6	5.6
Compensation of employees/head				3.3	3.7	2.1	1.8	2.2	2.0	2.5
Unit labour costs whole economy				2.4	1.6	5.4	6.7	0.8	1.2	1.4
Real unit labour costs				-0.6	-2.0	1.2	7.1	-1.8	-1.3	-0.9
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				3.0	3.7	4.2	-0.4	2.7	2.5	2.3
Harmonised index of consumer prices				-	2.7	4.1	0.0	2.8	2.1	1.6
Terms of trade of goods				-0.4	3.4	0.5	-0.9	-1.5	-1.0	-0.5
Trade balance (c)				-11.1	-8.8	-10.4	-7.8	-10.5	-12.8	-14.3
Current account balance (c)				11.1	10.1	5.3	6.7	8.4	9.4	9.9
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-	-	-	-	-	-
General government balance (c)				2.2	3.7	3.0	-0.7	-1.8	-1.3	-1.2
Cyclically-adjusted budget balance (c)				-	1.7	2.3	1.7	0.4	0.8	0.6
Structural budget balance (c)				-	1.7	2.3	1.7	0.4	0.8	0.6
General government gross debt (c)				6.4	6.7	13.6	14.5	18.2	19.6	20.9

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

16. HUNGARY

Recovery firming up, yet fiscal challenges remain

The crisis impact was severe in 2009

In autumn 2008, Hungary was hit markedly hard by the global financial crisis, culminating with the loss of market access. As the government implemented its adjustment programme supported by a joint EU-IMF financial package, the situation stabilized and market access was regained in July. Nonetheless, credit conditions tightened significantly, as banks struggled to deleverage. Declining real wages and growing unemployment in the context of large exposure to foreign currency debt and the depreciating forint boosted precautionary savings in the household sector and depressed consumption. Firms trimmed investment back reflecting uncertainty about future demand and ample unused capacity. In the event, economic activity declined by around 6¾% in 2009, despite a large positive contribution from net exports (mostly as a result of the sharp decline in imports).

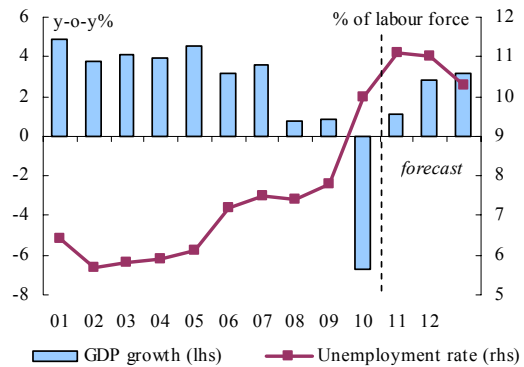
A moderate recovery is underway

Since early in 2010, financial market conditions have continued to improve, uncertainty about the recovery has gradually subsided, and investor confidence has picked up, as shown by several new flagship investments by large multinationals (benefiting in particular the auto industry, with car production capacity now set to expand to match that of Slovakia).

The pick-up in economic activity has been supported mostly by recovering exports reflecting better than expected global trade demand. The healthy performance of the German manufacturing sector has in particular led to an upward revision for GDP growth, now expected to reach 1.1% in 2010.

In contrast to exports, domestic consumption has remained predictably subdued. High unemployment and, more recently, higher interest costs on Swiss franc-denominated mortgages due to the depreciation of the Hungarian forint have kept a lid on disposable income and consumption.

Graph II.16.1: Hungary - GDP growth and unemployment rate



Looking forward

The dichotomous nature of the recovery that has taken place so far will be mediated by the effects of several recently announced policy measures. Household consumption is expected to receive a boost from the personal income tax (PIT) reform instituting a combination of a 16% flat tax with substantial tax credits for those with children. The positive current income effect of the lower PIT taxes for most wage earners is nevertheless likely to be tempered by: (i) the fact that the tax cut mainly supports those households with higher wages and a lower marginal propensity to consume; (ii) the fact that roughly 40% of taxpayers are childless and without a high enough income to benefit from the tax reform⁽⁷⁷⁾; and (iii) likely higher precautionary savings in response to the diversion of pension contributions without clear prospects of compensation and concerns about increasing public debt in the long term.

Unemployment will also start to modestly decline over the course of 2011. Labour supply (especially for high-skilled individuals) is expected to be boosted by the declining labour tax wedge, while employment and, especially, investment will receive a further boost from the corporate income tax cut and from the significant FDI projects announced in the autumn of 2010.

At the same time, the temporary levies that have been announced in order to bring the budget deficit below the 3% of GDP threshold may have an

⁽⁷⁷⁾ Calculations by the Fiscal Council published on November 8, 2010.

unfavourable impact on investment and consumption. The financial sector levy is likely to dampen credit to corporations and to households. The further extra levies on energy, telecoms and retail may have a negative impact on the business environment through increased institutional uncertainty, and are also likely to keep inflation above target (as the incipient recovery increases firms' pricing power).

Temporary improvement of the fiscal stance

In the autumn notification, the 2009 budget deficit was revised up to 4.4% of GDP from the previous estimate of 4% of GDP mainly due to higher than expected investments. The revised outcome is well above of the target of 3.9% of GDP for that year. Although the central government cash deficit of 3.5% of GDP was better than expected, this largely reflects factors that have no impact in national accounts terms (such as the advance payments of dividends and late payments of certain tax refunds).

In 2010, the headline budget deficit target of 3.8% of GDP is expected to be met, despite expenditure slippages of 1½% of GDP and revenue shortfalls of 1% of GDP compared to the budget. These slippages partly reflect (i) a lack of tight expenditure control, (ii) a larger than foreseen participation in the Pathway to Work Programme, (iii) a sharper than expected drop in revenues as a result of the economic downturn in 2009, as well as (iv) unfavourable court decisions. Moreover, a corporate income tax cut and the abolishment of some smaller tax items lowered revenues by ¼% of GDP. Beside the cancellation of budgetary reserves of ½% of GDP, the new government implemented deficit-decreasing measures of close to 2% of GDP.⁽⁷⁸⁾ In June, it introduced a first consolidation package comprising an extra levy on financial institutions of 0.7% of GDP and saving measures of 0.4% of GDP. In October, it decided on additional extra levies of 0.6% of GDP on selected sectors and to divert for 14 months (through the end of 2011) to the public pension fund the part of pension contributions normally transferred to the private pension pillar. The latter

decision is expected to result in additional revenue of 0.2% of GDP in 2010.

In 2011 the headline deficit is expected to increase to around 4¾% of GDP). On the revenue side, this forecast incorporates (i) the personal income tax cut of 1.8% of GDP compared to 2010 and (ii) the additional revenue loss of ¼% of GDP stemming from the corporate income tax cut implemented from mid-2010, partly offset by (iii) the temporary diversion of the pension contributions of 1.3% of GDP. Moreover, this forecast assumes that the extra levies of 1.3% of GDP introduced in 2010 will be maintained and takes into account the positive impact of the economic recovery. On the expenditure side, the forecast includes: (i) a decrease in real terms of the public sector gross wage bill and of the social benefits;⁽⁷⁹⁾ (ii) lower local government sector investment by 0.3% of GDP relative to 2010 (an electoral year); and (iii) a budgetary reserve of 0.4% of GDP. In addition, the absorption of the EU funds is expected to be accelerated, resulting in higher co-payments, but this will partly offset investments from own resources. On the other hand, the draft budget does not include plans for significant structural reforms (e.g. in the public transport sector, price subsidies, the local government sector or social benefits) and therefore no savings are expected from this source. Moreover, in contrast to the draft budget, our forecast also does not include the possible effects of the recent opening of the option to switch from the private pillar back to the public pension scheme. Assuming a 20% take-up of this offer, as in the draft 2011 budget, the headline deficit would be lower by 2% of GDP, and thus close to the deficit target in the draft budget of 2.94%. The public debt could decline by around 1% of GDP since about half of the private pension funds' assets are invested in Hungarian government bonds.⁽⁸⁰⁾

Deteriorating medium-term fiscal outlook

In 2012 the headline deficit is forecast to increase again above 6% of GDP mainly due to the phasing-out of the temporary divergence of the pension contributions, the planned decrease of the extra levy on the financial institutions to around

⁽⁷⁸⁾ Lower than budgeted interest expenditure and one-off revenue from the switch of people from the second pillar to the first pillar of the pension system also lowered the deficit by ½% of GDP. The currently higher expected economic growth in 2010 vs. the forecast in the budget hardly results in higher budgetary revenues since it mainly reflects the boom of relatively tax-poor net exports.

⁽⁷⁹⁾ In part this reflects the expected savings from the restructuring of the public work scheme and the elimination of the complementary salary in the public sector.

⁽⁸⁰⁾ The transfer of the other assets will increase the public sector wealth and decrease the net public debt but not automatically the gross public debt.

1/3% of GDP and the further personal income tax cut of 0.8% of GDP adopted by Parliament. These deficit increasing effects are only partly counterbalanced by the forecast impact of accelerating economic growth.

Thereafter, a further significant deterioration of the government balance is expected in light of the further personal and corporate income tax cuts of 1.3% of GDP and the phasing out of the extra

levies on selected sectors introduced in autumn 2010, which raises concerns about the sustainability of the public finances and the debt outlook even though the tax reforms could have some positive effects on the longer term growth.⁽⁸¹⁾

Overall, after decreasing in 2009, the structural deficit will increase substantially over the forecasting period.

⁽⁸¹⁾ Our forecast for the path of the debt ratio does not incorporate any assumption on the possible use of the government's reserves to pay off public debt.

Table II.16.1:

Main features of country forecast - HUNGARY

	2009			92-05	Annual percentage change					
	bn HUF	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	26054.3		100.0	2.9	0.8	0.8	-6.7	1.1	2.8	3.2
Private consumption	13901.8		53.4	-	0.2	0.4	-7.8	-3.2	2.8	3.2
Public consumption	5792.7		22.2	0.9	-7.3	1.0	-0.2	-0.9	-0.1	1.2
Gross fixed capital formation	5441.6		20.9	4.6	1.7	2.9	-8.0	-1.9	4.3	5.5
of which : equipment	2010.0		7.7	-	-	-	-	3.2	7.0	9.3
Exports (goods and services)	20175.3		77.4	12.5	16.2	5.7	-9.6	13.5	9.0	10.0
Imports (goods and services)	18817.2		72.2	12.7	13.3	5.8	-14.6	11.5	9.5	10.6
GNI (GDP deflator)	24750.7		95.0	-	-0.8	1.3	-5.3	0.9	2.8	3.2
Contribution to GDP growth :										
Domestic demand				2.8	-1.2	1.0	-6.0	-2.3	2.3	3.1
Inventories				0.2	-0.1	-0.2	-4.7	1.2	0.3	0.0
Net exports				-0.1	2.1	0.0	4.0	2.2	0.2	0.1
Employment				-	-0.3	-1.3	-2.8	-0.8	0.1	0.8
Unemployment rate (a)				-	7.4	7.8	10.0	11.1	11.0	10.3
Compensation of employees/f.t.e.				-	6.7	7.0	-2.2	1.3	3.1	4.8
Unit labour costs whole economy				-	5.6	4.8	1.9	-0.5	0.4	2.4
Real unit labour costs				-	-0.3	0.0	-2.4	-3.1	-2.3	0.2
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				12.8	5.9	4.8	4.4	2.7	2.8	2.2
Harmonised index of consumer prices				-	7.9	6.0	4.0	4.7	3.9	3.7
Terms of trade of goods				-	-0.1	-1.1	1.0	-0.5	-0.4	-1.1
Trade balance (c)				-4.5	-0.2	-0.6	3.5	4.9	4.4	3.5
Current account balance (c)				-	-7.0	-6.9	-0.4	0.8	0.4	-0.4
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-6.2	-6.0	1.3	2.4	2.1	1.3
General government balance (c)				-	-5.0	-3.7	-4.4	-3.8	-4.7	-6.2
Cyclically-adjusted budget balance (c)				-	-6.4	-5.0	-2.3	-1.9	-3.7	-6.2
Structural budget balance (c)				-	-5.6	-4.6	-2.2	-3.1	-5.9	-6.7
General government gross debt (c)				-	66.1	72.3	78.4	78.5	80.1	81.6

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

17. MALTA

A stronger than expected recovery

A stronger than expected rebound in the first half of 2010...

The recession in Malta started at the end of 2008 and lasted three quarters. Its total impact in terms of real GDP contraction over 2009 was one of the mildest in the euro area, at 2.1% compared to 4.1% for the euro-area average. The decline in exports, together with the sharp retrenchment of investment, mainly machinery and housing construction, and the depletion of inventories were the key drivers of the decline in real GDP in 2009. However, the high import-intensity of exports and investment led to the fall in imports being steeper than that in exports. Furthermore, private and government consumption had a broadly neutral impact on GDP developments in 2009.

The first half of 2010 witnessed a stronger than expected rebound in economic activity. Year-on-year real GDP growth until the second quarter is estimated to reach 4%, mainly resulting from a strong rebound in external demand. The steep increase in exports, primarily of machinery, was only partly offset by the increase in imports, of mainly industrial supplies. Domestic demand, however, remained more subdued.

...is expected to soften in the latter part of the year

The slower growth of real GDP in the second quarter this year – 0.1% q-o-q compared to 1.4% in the first quarter – may be indicative of a slowdown in the momentum of economic recovery. Real GDP growth in 2010 as a whole is in fact forecast to expand by 3.1%, as the positive contribution of net trade is expected to moderate in the second half of the year. This is due to a less buoyant external environment outlook for the latter part of the year, also related to the phasing out of the recovery measures in a number of EU member states, and a stronger euro than in the first half of the year.

Domestic demand is expected to pick up strongly during the course of the year. This is mainly due to a sharp increase expected for public investment, partly financed from EU grants, in the latter half of the year. Notwithstanding a moderate increase in real disposable income as a result of weak wage growth and higher energy prices, private

consumption is forecast to start growing again, mainly due to the more favourable labour market conditions already seen in the second quarter this year. Government consumption is expected to rebound, also due to the temporary recovery measures adopted with the 2010 Budget.

In 2011-12, domestic demand is expected to continue to be the main contributor to real GDP growth. Investment growth is again expected to be particularly strong. Increases in machinery and non-residential construction will underpin private investment, while residential construction is set to pick up in 2012. However investment dynamics are likely to be driven by public investment resulting from the expected increased absorption of EU grants, as mentioned earlier. As households' disposable income and consumer confidence are expected to improve further due to the anticipated better labour market conditions, private consumption growth is set to accelerate. As a result of the pick up in both consumption and investment, imports are expected to grow faster than exports, with the contribution of net trade expected to turn slightly negative.

Also, labour market conditions are improving faster than expected...

Labour market conditions improved significantly in the first half of this year. Employment was seen to grow faster than labour supply, which has led to a decline in the unemployment rate from its peak of 7.2% at the end of 2009 down to 6.2% in September this year. Employment is expected to expand by 1.1% this year, and to rise at a slightly higher rate in 2011-12. Malta's unemployment rate is expected to fall to 6.5% on average in 2010, remaining broadly stable in the coming two years on the back of an increase in labour supply in line with that in employment.

Yearly wage growth in Malta averaged 4.3% over the last decade. For 2010, wage growth is expected to remain relatively subdued, picking up towards the end of the year and becoming more dynamic in 2011 in line with employment developments. A further acceleration is anticipated for 2012, also explained by the anticipated higher pressure from the cost-of-living adjustment mechanism (COLA).

Labour productivity is set to rebound in 2010 following the strong economic recovery experienced in the first half of the year and a lagged adjustment of employment to economic growth. Productivity gains are expected to moderate over the forecast horizon in line with past trends. Against this background, unit labour costs are expected to fall in 2010, after the steep rise recorded in 2009, and to increase again by an average of 2% over 2011-2012.

...with inflation expected to be energy-driven

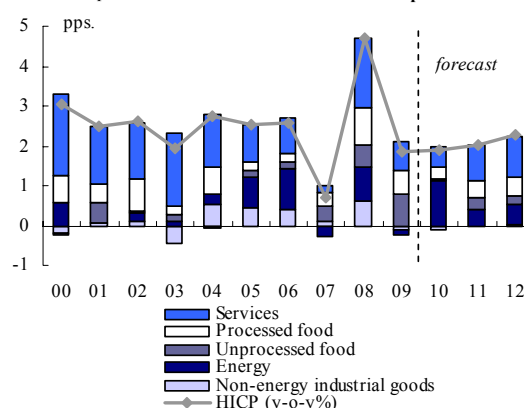
HICP inflation is expected to average 1.9% in 2010, remain broadly stable in 2011 and increase to 2.3% in 2012, as private consumption accelerates.

After decelerating in 2010, food inflation is again expected to become an important contributor to HICP inflation, given the assumed increase in global food commodity prices over the forecast horizon. An increase in excise duties on alcohol and tobacco is also expected to have a relatively strong impact on processed food inflation.

Services inflation is expected to be one of the driving factors behind the rise in inflation in the final months of the current year and throughout the forecast horizon, partly reflecting improved demand conditions as well as the announced increase in the rate of VAT for hotel and private accommodation from 5% to 7% as from 2011.

Various factors are at play in driving energy inflation over the forecast horizon. Dynamic energy prices have highly characterised HICP inflation in Malta in recent years. Besides the changes in international oil prices, the gradual removal of electricity and, more recently, gas subsidies, has resulted in the energy component substantially contributing to the changes in HICP inflation. The recent commitment by the government to keep electricity tariffs in 2011 fixed at the 2010 rate will help to partly compensate for the expected pick up in fuel prices, which are affected by the announced increase in excise duty. In 2012, energy inflation is expected to be driven again by electricity given the expected reversal of the measure implemented in 2011.

Graph II.17.1: Malta - HICP and its components



The need to restore public finances

Malta maintained a relatively sound budgetary position in the years following EU accession in 2004. The general government deficit, however, widened markedly in 2008 to 4.8% of GDP, mainly due to some exceptional expenditure-increasing items related to the liquidation of the shipyards and temporary subsidies to the energy provider. The deficit ratio narrowed in 2009 to 3.8% of GDP, mainly due to the expiry of the above-mentioned exceptional expenditure items, lower public investment and one-off tax receipts resulting from a tax amnesty.

In 2010, the deficit is expected to widen to 4.2% of GDP, mainly due to growth of current primary expenditure outpacing that in tax collection. On the expenditure side, compensation of employees is set to increase moderately, helped by favourable base effects related to the liquidation of the shipyards. By contrast, intermediate consumption is projected to increase markedly, mainly because of the additional temporary recovery measures in the 2010 budget. Social transfers other than in kind are projected to keep increasing at a fast pace due to the dynamics of age-related entitlements. Capital spending is also expected to increase substantially mainly thanks to public investment projects in environment and infrastructure and support to private investment, partly financed with the EU funds.

Tax revenue is expected to remain relatively moderate in 2010. Indirect taxes are affected by still weak consumption dynamics. The overall moderate increase in wages and the one-off effect of the tax amnesty in 2009 are both anticipated to weigh on direct tax dynamics in 2010. Finally, social contributions are set to increase by more

than the economy-wide wage bill after the buoyant outturn recorded in the first half of the year.

The deficit is projected to narrow substantially in 2011, to 3.0% of GDP. Part of the deficit reduction (around ½ pp. of GDP) is related to the expiry of some temporary support measures adopted with the 2010 Budget. Another ½ pp. of GDP improvement is due to the assumed strict implementation of the 2011 budget. Finally, an expected marked acceleration in tax collection related to the ongoing economic recovery explains the remaining ¼ pp. of GDP adjustment. Meanwhile, the forthcoming restructuring of Air Malta may entail additional government expenditure and thus represents an upward risk for the 2011 deficit forecast.

Regarding expenditure, current primary expenditure is expected to decelerate in 2011, mainly due to the expiry of some recovery measures, the assumed moderation in public wages and the projected efficiency gains. After the rebound anticipated for 2010, capital expenditure is set to continue to increase strongly due to the expected improvement in EU funds absorption. On

the revenue side, direct taxes are set to accelerate on the back of both improved corporate profitability as well as higher households' income. Indirect taxes will benefit from the increase in excise duties adopted with the 2011 budget and the acceleration in private consumption, while social contributions are set to increase more moderately.

In 2012, based on a no-policy-change assumption, the deficit is anticipated to widen again to 3.3% of GDP mainly due to the projected lower impact of one-off measures and still-substantial increases expected in capital spending, although partly financed with EU funds. Current primary expenditure and current revenues are set to grow at a similar pace.

After increasing by nearly 7 pps. of GDP in 2008-09, the debt-to-GDP ratio is expected to continue on an upward path over the forecast horizon, increasing from 68.6% to around 71% by 2012. This is partly explained by the need to finance the rescue loan provided to Air Malta that implies an increase of more than ¾ pp. of GDP in the debt ratio as from 2010.

Table II.17.1:

Main features of country forecast - MALTA

	2009				Annual percentage change					
	mio EUR	Curr. prices	% GDP		92-05	2007	2008	2009	2010	2011
GDP		5749.7	100.0	3.5	3.7	2.6	-2.1	3.1	2.0	2.2
Private consumption		3636.0	63.2	-	0.9	4.4	0.0	1.0	1.6	2.1
Public consumption		1246.7	21.7	-	0.0	12.8	-0.7	2.4	0.4	1.9
Gross fixed capital formation		848.6	14.8	-	5.9	-27.5	-16.3	9.6	8.2	3.3
of which : equipment		-	-	-	-	-	-	-	-	-
Exports (goods and services)		4265.1	74.2	-	2.7	-3.0	-7.6	19.0	6.3	6.2
Imports (goods and services)		4234.7	73.7	-	-0.8	-2.9	-10.6	18.1	6.5	6.3
GNI (GDP deflator)		5369.3	93.4	2.8	4.3	2.4	-4.9	4.1	2.5	2.6
Contribution to GDP growth :	Domestic demand			-	1.9	-0.8	-2.7	2.4	2.3	2.3
	Inventories			-	-1.6	3.3	-2.5	0.1	0.0	0.0
	Net exports			-	3.4	0.0	3.1	0.6	-0.3	-0.1
Employment				1.0	3.2	2.6	-0.5	1.1	1.2	1.4
Unemployment rate (a)				6.5	6.4	5.9	7.0	6.6	6.6	6.5
Compensation of employees/head				5.0	2.0	3.7	2.3	0.6	2.0	3.0
Unit labour costs whole economy				2.5	1.5	3.8	3.9	-1.4	1.2	2.1
Real unit labour costs				-0.1	-1.4	1.5	1.6	-4.3	-1.4	-0.4
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				2.6	3.0	2.2	2.3	3.0	2.7	2.5
Harmonised index of consumer prices				-	0.7	4.7	1.8	1.9	2.0	2.3
Terms of trade of goods				-	-0.2	1.1	-1.8	4.9	1.3	0.7
Trade balance (c)				-18.3	-17.9	-21.4	-16.5	-14.8	-14.9	-15.2
Current account balance (c)				-	-6.2	-5.6	-6.1	-3.9	-2.9	-2.2
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-5.2	-5.1	-4.8	-2.1	-0.9	-0.2
General government balance (c)				-	-2.3	-4.8	-3.8	-4.2	-3.0	-3.3
Cyclically-adjusted budget balance (c)				-	-2.4	-5.0	-2.9	-3.9	-2.9	-3.5
Structural budget balance (c)				-	-3.0	-5.3	-3.5	-4.5	-3.3	-3.5
General government gross debt (c)				-	61.7	63.1	68.6	70.4	70.8	70.9

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

18. THE NETHERLANDS

A slow-paced recovery sets in

The recovery that started in the second half of 2009...

The Dutch economy has been recovering from the global financial and economic crisis since the second half of 2009, initially mainly as a result of the favourable developments in world trade. As one of the most open economies in the European Union, the Netherlands benefitted from a strong rebound in exports, which entailed a very positive contribution of net exports to GDP growth. On the other hand, domestic demand growth remained weak throughout 2009. Lagged effects of the financial and economic crisis continued to impact both private consumption and investment. The latter was also affected by the low capacity utilisation rate.

Domestic demand turned around sharply in the second quarter of 2010, resulting in the economic recovery gaining significant momentum, with quarter-on-quarter GDP growth of 0.9%. Domestic demand in the second quarter benefited from a strong upswing in the inventory cycle and a rebound of investment, in particular in equipment. Net exports however, put a drag on growth, as imports significantly outperformed exports in both the first and the second quarter of 2010.

Despite the significantly positive contribution of domestic demand to GDP growth in the first half of 2010, private consumption growth remained subdued. The decrease in real disposable income in 2009 in combination with lagged negative wealth effects, both in financial and non-financial assets and residual negative confidence effects prevented households from increasing consumption. A surge in households' energy consumption in the first quarter, related to the relatively low temperatures, briefly interrupted this negative pattern.

...is expected to become more moderate in the coming period

The outlook points to a moderation of economic growth, as a result of an expected slowdown in the external environment, combined with a planned restrictive fiscal policy stance starting in 2011. With respect to the latter, the government will end the stimulus package that was implemented in

response to the crisis and enact a strong budgetary correction throughout the government's term of office up to 2015. The plans of the new government are expected to have a non-negligible impact on economic activity, especially on government and private consumption and investment.

With the rebound in investment in the first half of 2010 being mainly based on replacement investment and no urgent need as yet to increase capacity, the strength of its recovery is expected to be more moderate over the forecast period than may be assumed by the strong surge in the second quarter of 2010.

The less buoyant outlook for world trade and the projected appreciation of the euro are expected to have a dampening impact on Dutch exports. This should largely counterbalance an improvement in Dutch competitiveness coming from the downward adjustment of unit labour costs in 2010. All in all, net exports are foreseen to moderately contribute to economic growth in 2011-12. In line with the net contribution of exports, the current account is foreseen to improve again to a surplus of around 8% of GDP in 2012.

Private consumption is not expected to take over the role as growth driver

Following the normal sequence of events in the aftermath of a recession, a significant rebound of net exports followed by a robust increase in investment would be followed by rising private consumption. The outlook for private consumption however, does not point to a buoyant recovery. Private consumption growth is expected to remain subdued throughout the forecast period. Recent wage agreements already point to a strong and rapid decrease in wage growth. For the short to medium run, the government envisages a policy of wage moderation in the public sector, which may also have some spill-over effects on private sector wage dynamics. Additionally, only limited support for private consumption is expected to come from labour market developments, in spite of the latter having outperformed expectations in the recession.

However, a positive impetus on private consumption in the short run may come from the decision by the previous government to unblock

savings by employees, which are held on a blocked bank account, and total around EUR 4 bn. This effect is however expected to be rather small and to affect mainly 2010. Furthermore, in the short run, private consumption could benefit from an increase in consumer confidence and the fading out of negative wealth effects. Wealth and confidence effects can have a strong impact on private consumption, as was witnessed during the crisis, when gross disposable income turned only slightly negative in 2009, but private consumption fell by 2.5%.

The moderate growth of the Dutch economy, combined with subdued wage growth and a modest outlook for private consumption, is expected to keep core inflation at relatively low levels in the next two years, at 1.2% and 1.3% in 2011 and 2012, respectively. As regards HICP, energy prices are expected to positively contribute to inflation as the oil price in euro is assumed to be on the up throughout the forecast period. Processed food prices including alcohol and tobacco are expected to be positively influenced by the planned increase in taxes on tobacco in 2011, but its overall effect is expected to be limited. Overall, HICP inflation is projected to increase from 1% in 2010 to 1.5% and 1.6% in 2011 and 2012, respectively.

This scenario is subject to both positive and negative risks. On the positive side, developments in the labour market could turn out to be more favourable and/or growth in emerging economies stronger than foreseen. However, on the negative side, lower than expected global demand may pose risks to the growth outlook. Furthermore, risks to the stability of the financial sector have not yet fully disappeared.

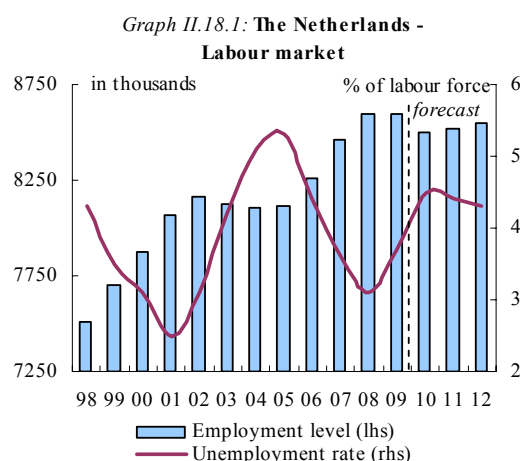
Labour market continues to surprise on the upside, but no strong rebound expected

The Dutch labour market has weathered the crisis relatively well. Despite the severe economic crisis, the unemployment rate increased by only 0.6 pp. to 3.7% in 2009, thereby remaining one of the lowest in the EU. Data on unemployment developments at the start of the second half of 2010 point towards a stabilisation of the unemployment rate at around 4½%.

One of the main elements explaining the relatively limited increase in unemployment over the past years stems from the demand side. At the dawn of the crisis, the labour market in the Netherlands was

extremely tight, with the number of unfilled vacancies matching the number of unemployed. In these circumstances, it proved to be very difficult for employers to attract and retain qualified personnel. When demand decreased in the recession, employers were reluctant to fire personnel, which led to a strong policy of labour hoarding. On the labour supply side, the effects of the crisis on the unemployment rate were also mitigated through the effect of discouraged workers. This effect most notably affected young persons who decided to continue studying.

After a decrease of employment in 2010, it is not expected that employment will pick up in line with the recovery of the economy, as corporations will first increase the hours worked by their employees, for instance by reversing the measures that were introduced during the crisis, such as the part-time working scheme. A second element supporting the view of a modest recovery in employment in the coming years stems from the consolidation policy of the new Dutch government aiming to reduce the size of government, which is expected to have a negative impact on employment growth. On the other hand, the discouraged worker effect is expected to diminish, also on the back of a positive, although moderate, expected growth in employment starting in 2011 and continuing in 2012.



Combining all factors described above, the unemployment rate, after recording a further increase in 2010 to 4.5%, will only very slowly diminish in the coming years. Unemployment is expected to come out at 4.4% and 4.3% in 2011 and 2012 respectively.

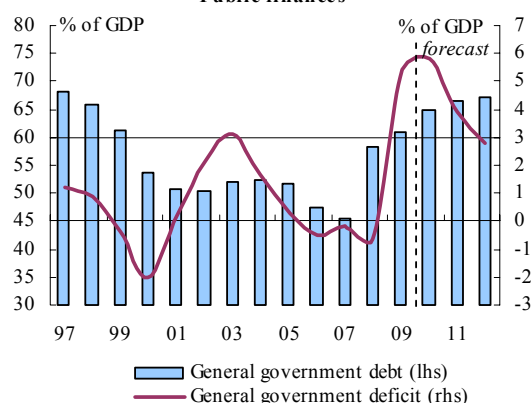
Strong consolidation leads to improvement in the general government balance

The Dutch public finances deteriorated sharply as a result of the economic downturn and a surplus of 0.6% of GDP in 2008 turned into a deficit of 5.4% of GDP in 2009. In 2010, the deficit is expected to deteriorate further to a deficit of 5.8% of GDP. The most important reason for the further deterioration, besides the continuation of the stimulus package, is the impact of various lagged effects of the economic crisis, in particular the expected further increase in unemployment.

The new government has committed itself to a significantly frontloaded consolidation of public finances. This consolidation effort is mainly concentrated on government administrative expenditure, subsidies, international cooperation and income transfers. A strong improvement in the general government balance is foreseen in 2011, with the deficit decreasing to 3.9% of GDP from 5.8% of GDP in 2010. This sizeable improvement is partly the result of the consolidation measures already presented in the Budget for 2011, amounting to ½% of GDP as well as the start of the consolidation plans foreseen in the new coalition agreement amounting to ¼% of GDP in 2011. For the remainder the improvement is primarily the result of the ending of the stimulus

package already decided by the previous government in the Budget for 2011, a positive contribution of cyclical conditions and somewhat higher gas revenues. For 2012, the government foresees a further consolidation effort of ½% of GDP, leading to an additional improvement in the general government balance, which is forecast to record a deficit of 2.8% of GDP.

Graph II.18.2: The Netherlands - Public finances



The government gross debt ratio, which reached the 60% Treaty reference value in 2009, partly as a result of the significant interventions in the financial markets, is expected to further increase to around 67% of GDP in 2012.

Table II.18.1:

Main features of country forecast - THE NETHERLANDS

	2009			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-05	2007	2008	2009	2010	2011	2012
GDP		572.0	100.0	2.6	3.9	1.9	-3.9	1.7	1.5	1.7
Private consumption		262.6	45.9	2.1	1.8	1.1	-2.5	0.2	0.7	0.9
Public consumption		162.7	28.4	2.6	3.5	2.5	3.7	1.7	0.1	-0.4
Gross fixed capital formation		108.9	19.0	2.9	5.5	5.1	-12.7	-4.3	3.2	4.2
of which : equipment		31.3	5.5	4.2	8.6	4.9	-19.0	2.5	5.4	7.2
Exports (goods and services)		395.9	69.2	6.2	6.4	2.8	-7.9	10.3	6.0	6.9
Imports (goods and services)		354.6	62.0	6.2	5.6	3.4	-8.5	10.4	5.2	6.9
GNI (GDP deflator)		556.5	97.3	2.8	2.9	-1.7	-4.7	3.8	2.2	2.2
Contribution to GDP growth :										
Domestic demand				2.3	2.8	2.2	-2.8	-0.3	1.0	1.0
Inventories				0.0	0.1	-0.1	-0.9	1.3	-0.5	0.0
Net exports				0.3	1.0	-0.2	-0.2	0.7	1.0	0.6
Employment				1.1	2.2	1.2	-1.2	-1.1	0.2	0.3
Unemployment rate (a)				4.7	3.6	3.1	3.7	4.5	4.4	4.3
Compensation of employees/f.t.e.				3.5	3.4	3.6	2.2	1.7	2.3	2.1
Unit labour costs whole economy				1.9	1.7	3.0	5.1	-1.1	1.0	0.7
Real unit labour costs				-0.4	-0.1	0.6	5.3	-1.8	-0.5	-0.9
Savings rate of households (b)				-	-	12.0	13.4	14.9	14.7	14.7
GDP deflator				2.4	1.8	2.4	-0.2	0.7	1.5	1.6
Harmonised index of consumer prices				2.2	1.6	2.2	1.0	1.0	1.5	1.6
Terms of trade of goods				0.5	-0.1	-0.1	-0.8	-1.3	0.0	0.0
Trade balance (c)				5.8	7.6	7.3	6.7	6.8	7.7	8.1
Current account balance (c)				5.6	8.4	4.8	3.4	5.2	6.8	7.9
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				5.3	8.2	4.4	3.1	4.7	6.5	7.7
General government balance (c)				-1.6	0.2	0.6	-5.4	-5.8	-3.9	-2.8
Cyclically-adjusted budget balance (c)				-1.5	-0.8	-0.3	-3.4	-4.1	-2.3	-1.5
Structural budget balance (c)				-	-0.8	-0.3	-3.4	-3.9	-2.2	-1.5
General government gross debt (c)				62.4	45.3	58.2	60.8	64.8	66.6	67.3

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

19. AUSTRIA

Steady recovery facilitating fiscal consolidation

Rebound in 2010 driven by exports

Having stagnated in the first quarter of 2010, GDP grew by 1.2% and 0.9% q-o-q in the second and third quarters respectively, reflecting the improved situation in the world economy. Growth was driven, on the one hand, by net exports benefiting from stronger economic activity in Germany (Austria's main trading partner) and, on the other hand, by the return of gross fixed capital formation to positive growth in spring 2010 after seven quarters of decline. Industrial production reacted strongly to the rebound in world trade and dynamic external demand. Austria was the first country in the EU in which capacity utilisation in the manufacturing sector surpassed its long-term average after the crisis. However, the negative trend in construction investment continued to prevail. Moderately growing private consumption was a stabilising factor, as households took advantage of additional elements of the 2009 tax reform (in particular, relief for families with children and tax cuts for the self-employed).

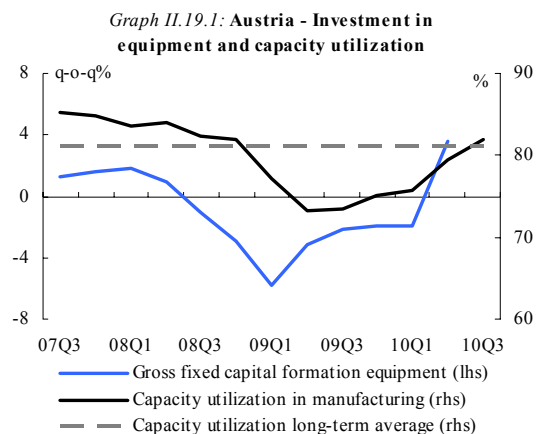
Overall real GDP growth is expected to reach around 2% in 2010. It is expected that the main contribution to growth will come from net exports, although there are signs that the momentum may be slowing. In spite of the continued growth of investment in equipment since the second quarter of this year, the latter will still fall in annual average terms in 2010 because of a substantial negative carry-over from the previous year. A small positive contribution is expected from the inventories cycle.

2011 and beyond: shift towards domestic demand forces

GDP is forecast to grow by about 1.7% in 2011 and 2.1% in 2012. Whereas the recovery in 2010 relied heavily on external demand, growth in the remaining forecast years is predicted to be more broad-based. Investment in machinery and equipment is set to return to positive yearly growth against the background of the revival in industrial production and rising capacity utilisation, and underpinned by an improvement in corporate balance sheets. The advanced depreciation allowance, introduced as a part of the fiscal stimulus package, is likely to encourage companies to invest in new production facilities, while also

replacing old capital stock vintages. However, the continued decline in the number of building permits suggests that investment in construction will remain subdued.

In 2011, private consumption may be affected by the withdrawal of the temporary stimulus measures and phasing in of the fiscal consolidation measures described below. However, as the household saving rate is expected to edge down somewhat and positive developments in the labour market should boost consumer confidence, only a slight deceleration in private consumption growth is forecast for 2011. It is assumed that public consumption growth will come to a halt in 2011 in the context of the fiscal consolidation efforts, but will resume thereafter.



Foreign demand is expected to soften quite significantly in line with slower growth in world trade. In particular, the projected deceleration of Germany's goods imports is of key importance to Austria, as one-third of the country's exports are destined for its northern neighbour. In addition, Italy and Switzerland, respectively Austria's second and third most important trading partners, are facing moderate domestic demand growth. Last but not least, demand from the Central and Eastern European Countries, whose importance as Austria's trading partners grew significantly in the last decade, is also expected to slacken. Nevertheless, as the trade balances on both goods and services are expected to gradually improve during the forecast period, the current-account

surplus is likely to return to its pre-crisis level of about 4% of GDP in 2012.

Moderate inflation and wage growth

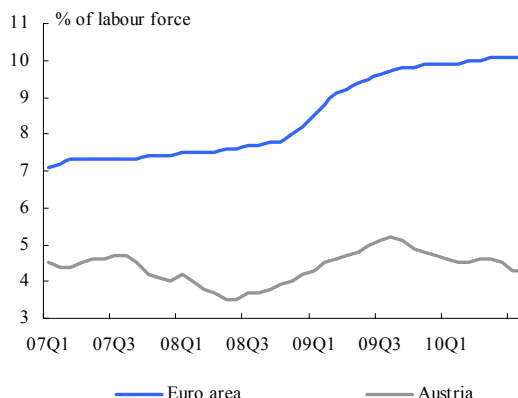
Consumer prices rose by 1.6% on average in the first three quarters of 2010 and were mainly driven by higher energy prices. Some dampening effects have come from slower wages growth than in the previous year. Overall, inflation is forecast at 1.7% in 2010. In 2011, the inflation rate is expected to rise slightly above 2% on the back of the increase in the taxes on fuel and cigarettes agreed on by the government coalition partners as part of the consolidation package. Inflation is likely to fall once again below 2% in the following year. It is assumed that oil prices will continue to exert upward, yet diminishing, pressure throughout the forecast period. The profile for industrial goods prices is expected to remain flat. Overall, inflation should be driven somewhat more by services prices as wages pick up slightly and previous energy prices increases are translated into costs.

Improvement in the labour market

In the wake of the crisis, employment fell by almost 1% in 2009, pushing the unemployment rate up to almost 5% (from around 4% a year earlier). Short-time work and extended training in particular helped rein in job losses that otherwise would have been more severe in view of the scale of the contraction in activity. More recently, labour market developments surprised on the positive side, especially in comparison to other euro-area countries. Annual employment growth resumed in March 2010. Despite labour supply growing in parallel, the unemployment rate has been declining steadily. With 4.3% in August 2010, Austria registered the lowest unemployment rate in the EU.

Total employment is likely to grow by just under 1% in the three forecast years, resulting in the unemployment rate gradually decreasing from about 4.5% in 2010. One factor adding uncertainty to the forecast is that foreign labour supply may rise with the expiry in 2011 of the seven-year-long transition period during which access by citizens of the new EU Member States to the Austrian labour market was restricted. However, there are conflicting views as to what impact this change would have.

Graph II.19.2: Austria - Unemployment rate



Fiscal consolidation helped by business cycle

The general government deficit rose to 3½% of GDP in 2009, as a result of the free operation of automatic stabilisers and the stimulus packages adopted by the Austrian authorities (in the context of the European Economy Recovery Plan). In 2010, the deficit is set to widen further, rising above 4% of GDP, mainly due to discretionary measures. In particular, parts of the 2009 tax reform, namely relief for families with children and tax cuts for the self-employed, came into force only in 2010 and are expected to burden the budget by about ¼% of GDP. The accelerated depreciation provision, adopted in January 2009, will also weigh somewhat on the budget in 2010.

Fiscal consolidation, facilitated by the favourable economic developments, is set to begin in 2011, and is projected to result in a narrowing of the deficit to around 3.6% of GDP in 2011 and 3.3% in 2012. At the end of October 2010, the government coalition partners came to an agreement on the measures to be introduced in order to bring Austrian public finances back on a sustainable path. The agreed consolidation package, involving both revenue and expenditure measures, is scheduled to be approved by the Parliament towards the end of the year.

The biggest item in the above-mentioned consolidation package on the revenue side is a bank levy (0.2% of GDP), designed in response to the latest global financial crisis and intended to collect a contribution from financial institutions to the costs of stabilising the financial sector borne by the Austrian authorities. Its effect will be mitigated, however, by the withdrawal of a fee on loans. Another substantial element in the package is a rise in the fuel tax and in the tax on cigarettes (combined effect of around 0.2% of GDP). Apart

from this, the set of agreed measures comprises inter alia: introduction of a tax on airline tickets, a rise in the tax on property sales by private foundations, an increase in registration fees for less environment-friendly vehicles, the total effect of which should have only a modest budgetary impact. There are still some remaining items from the 2008/2009 stimulus package operating in 2011 (e.g. accelerated depreciation provision), but their combined effect is forecast to be less than 0.1% of GDP.

Whereas the measures on the revenue side of the consolidation package are well defined, there is still some uncertainty as to what measures will be taken on the expenditure side. This forecast is based on the assumption that the package will mainly contain cuts in family allowances (equivalent to about 0.1% of GDP) and pension entitlements (0.1% of GDP) as well as some saving in the area of long-term care (less than 0.1% of GDP).

The effect of these expenditure measures will coincide with a drop in spending on labour market relief as the short-time work scheme is being phased out (0.1% of GDP). However, the consolidation effort will partly be offset by additional spending on education, R&D and energy-saving renovation of buildings (0.1% of

GDP) agreed by the government coalition partners in the consolidation package. Nevertheless, the general government deficit figures for 2011 and 2012 might turn out lower, should the package to be adopted by the Parliament in December 2010 contain more consolidation measures on the expenditure side.

Gross government debt went up by 5 pps. in 2009, reaching 67.5% of GDP. Apart from the increase in the deficit and the decline in GDP growth, a significant stock-flow adjustment, primarily reflecting bank-rescue operations, contributed to the rise in the debt-to-GDP ratio. Throughout the forecast period, the debt ratio is projected to rise continuously, from almost 70.5% of GDP in 2010 to over 73% of GDP in 2012.

Risks and uncertainties in the short-term outlook mainly derive from external developments, notably the pace of the recovery in Austria's major trading partners, the euro exchange rate and oil prices. From the domestic side, further positive surprises from business conditions and the labour market may lead to mutually reinforcing stronger consumption and investment possibly adding to price pressure. On the other hand, any adverse (external) shock may be amplified by domestic fiscal restraint weighing on private sector confidence and spending.

Table II.19.1:

Main features of country forecast - AUSTRIA

	2009			92-05	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	274.3		100.0	2.2	3.7	2.2	-3.9	2.0	1.7	2.1
Private consumption	149.0		54.3	1.7	0.7	0.5	1.3	0.9	0.8	0.9
Public consumption	54.6		19.9	2.0	2.1	4.0	0.4	0.8	0.0	0.5
Gross fixed capital formation	58.0		21.1	1.4	3.9	4.1	-8.8	-2.6	2.7	2.9
of which : equipment	22.0		8.0	1.5	6.6	7.5	-14.5	-2.3	4.7	5.3
Exports (goods and services)	138.6		50.5	6.1	8.6	1.0	-16.1	9.0	6.3	6.5
Imports (goods and services)	126.2		46.0	5.0	7.0	-0.9	-14.4	6.4	5.6	5.5
GNI (GDP deflator)	271.4		98.9	2.2	3.6	2.0	-3.6	1.9	1.7	2.1
Contribution to GDP growth :										
Domestic demand				1.7	1.6	1.8	-1.1	0.1	1.0	1.2
Inventories				0.0	0.7	-0.6	-1.0	0.3	0.0	0.0
Net exports				0.5	1.3	1.1	-1.8	1.6	0.7	0.9
Employment				0.5	1.5	1.6	-1.6	0.7	0.7	0.8
Unemployment rate (a)				4.2	4.4	3.8	4.8	4.4	4.2	4.0
Compensation of employees/f.t.e.				2.7	3.0	3.2	2.3	1.6	2.2	2.1
Unit labour costs whole economy				0.9	0.8	2.7	4.8	0.3	1.2	0.8
Real unit labour costs				-0.6	-1.2	0.8	3.9	-0.3	-0.4	-0.5
Savings rate of households (b)				-	-	16.5	16.0	16.1	15.7	15.9
GDP deflator				1.6	2.1	1.9	0.8	0.6	1.6	1.3
Harmonised index of consumer prices				1.9	2.2	3.2	0.4	1.7	2.1	1.8
Terms of trade of goods				-0.1	-0.5	-2.1	2.1	-2.1	-0.2	-0.3
Trade balance (c)				-2.2	0.4	-0.2	-0.8	-0.4	-0.3	0.1
Current account balance (c)				-0.5	4.0	3.7	2.6	3.0	3.5	4.1
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-0.6	4.1	3.7	2.7	3.0	3.5	4.1
General government balance (c)				-2.6	-0.4	-0.5	-3.5	-4.3	-3.6	-3.3
Cyclically-adjusted budget balance (c)				-2.5	-1.6	-1.8	-2.3	-3.4	-2.9	-2.9
Structural budget balance (c)				-	-1.6	-1.8	-2.3	-3.4	-2.9	-2.9
General government gross debt (c)				64.7	59.3	62.5	67.5	70.4	72.0	73.3

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Note : Contributions to GDP growth may not add up due to statistical discrepancies.

20. POLAND

Restrained rebound turns into solid, domestic-demand driven recovery

Moderate recovery as some growth factors peter out

In the crisis year 2009, Poland was the only country in the EU to record positive growth (1.7%). The rebound after the crisis has however been much less pronounced than in other Member States with the rate of growth picking up by 1.8 pps. between 2009 and 2010. The subdued rebound is the mirror image of the strong performance seen in 2009. In particular, the low degree of openness to trade, which shielded Poland from the effects of the slump in external trade in 2009, now limits the effects of the brisk rebound in international trade. Fiscal stimulus measures, which supported growth during the crisis, are being replaced by fiscal retrenchment in view of the deteriorating fiscal position. Last but not least, improved market sentiment has led to the appreciation of the Polish currency and much more import-rich growth, contrasting with the sharp depreciation and import contraction of 2009.

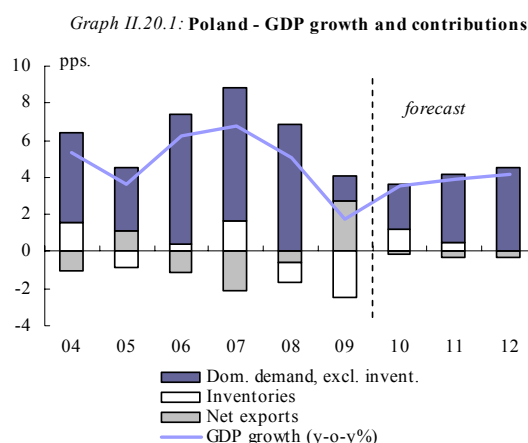
In the first half of 2010, real GDP grew by 3.3% y-o-y, increasingly driven by private consumption and restocking. After a sharp drop in the first quarter of 2010, investment rebounded, strongly supported by a sizeable inflow of EU funds, increasing capacity utilisation levels and improved profitability, despite constrained credit supply. Improving labour market prospects underpinned private consumption. Rebounding external demand fuelled the domestic manufacturing sector and strengthened the turnaround in the inventories cycle. The overall contribution of net exports to growth was, however, neutral as the appreciating currency resulted in accelerating import demand. Overall, real GDP is expected to increase by 3.5% in 2010.

Continued improvement in 2011 and 2012 on the back of strengthening domestic demand

The recovery is expected to strengthen further in 2011 and 2012. Real GDP is projected to increase by 3.9% in 2011 and 4.2% in 2012. The main drivers of this recovery are: a gradually improving labour market, rebounding consumer and business confidence, and increased foreign capital inflows.

Public investment is set to accelerate further as several infrastructure projects are expected to be finalised before the Euro 2012 football championships. Government plans to consolidate public finances by cutting investment will however curb the investment growth rate. Private gross fixed capital formation is forecast to speed up considerably in 2011 after two years of sluggish growth. In particular, the corporate sector is set to invest again, as capacity utilisation reach long-term averages, large and medium sized companies hoard cash and there are tentative signs of credit supply picking up in the low cost environment. Real disposable income and consumption will benefit from the improving situation of the labour market and returning consumer confidence, though the increase in indirect taxes will somewhat limit this positive impact. Overall, private consumption growth will gradually increase over the forecast horizon, though it will remain below pre-crisis levels.

The impact of external trade on growth is likely to be slightly negative, as accelerating domestic demand may stimulate imports, outweighing the effects of ongoing strong export growth.



The recovery is expected to strengthen further in 2012, reflecting both external and domestic factors: continued recovery of the world economy and a further increase in FDI; improvement of the labour market situation and robust wage growth stimulating households' demand with additional boost from Euro2012 football championship; and

further acceleration in private investment on the back of projected loosening of credit conditions.

The current-account deficit, which temporarily tightened to 1.9% of GDP in 2009, is expected to widen again to 3.7% of GDP over the forecast horizon. It reflects in particular the projected rebound in domestic demand and transfers due to improved profitability of foreign-owned companies.

This scenario is subject to broadly-balanced upside and downside risks. On the upside, a stronger rebound in global demand and risk appetite would boost exports and investments. On the downside, a delayed loosening of credit conditions could hamper investment and consumption in the quarters ahead. In addition, delayed consolidation of public finances could affect market sentiment adversely, and increase the costs of borrowing for the private sector also.

Inflation gradually picks up in the medium term

The effects of the depreciating domestic currency petered out and the rate of HICP inflation decreased from 4% in 2009 to below 2% by mid-2010. It is expected to rebound moderately exceeding 2½% towards end of 2010, fuelled by elevated food and energy prices. In 2011 it is forecast to grow further to 2.9%, reflecting developments in non-core components of the index and a rise in administered prices and indirect taxes.

The rapid slowdown in wage growth in 2009, despite relatively modest productivity increases, resulted in limited ULC rises during the crisis. Going forward, labour productivity is expected to increase stronger over the forecast period, while wage growth in 2010 and 2011 will remain subdued, not least due to a freeze in public sector wages, curbing ULC growth until 2011. However, a limited supply of labour in the outer year of the forecast horizon and contained wage pressure during the crisis are expected to result in an accelerating wage growth in the private sector in 2012, which is likely to fuel core inflation and affect unit labour costs.

Increasing unemployment masks resilient labour market performance

After 6 years of continuous decline, the 2009 crisis resulted in only a moderate rise in the unemployment rate, amid increasing labour supply

benefiting inter alia from recent structural reforms. The sharper-than-anticipated downward adjustment of real wages mitigated the effects of the downturn on employment. Thus, employment kept growing during the crisis (by 0.5% between the first quarter of 2008 and the first quarter of 2010), especially in the services sector (except transportation), while manufacturing and agriculture experienced substantial falls in employment.

Overall, employment growth is expected to remain in positive territory (0.7%) in 2010. Hiring is muted due to the effect of labour hoarding during the crisis. Increasing labour market participation will result in unemployment peaking at 9.5% in 2010.

Going forward, employment growth is projected to accelerate gradually, leading to a moderate decrease in the unemployment rate to 8.5% in 2012. Against this improved outlook and mounting demographic pressures, further reforms favouring dynamic employment creation and higher labour market participation focusing on the extreme ends of the age distribution would help sustain a permanent recovery of domestic demand without undermining the competitiveness of the economy.

Slow consolidation of public finances

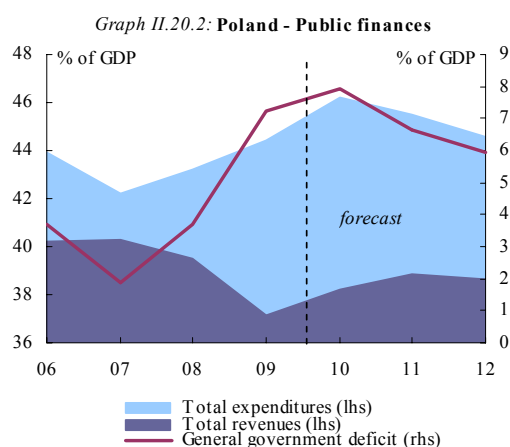
The Polish public finances have deteriorated considerably during the economic and financial crisis which hit Poland in 2008-09. A substantial stimulus package helped Poland to stay on a growth track; however, it resulted in a sizeable increase in the headline deficit from 3.7% in 2008 to 7.2% of GDP in 2009. In 2010, despite higher than projected growth and a few consolidation measures, the headline deficit is expected to reach almost 8% of GDP. This further deterioration can be explained mainly by lower revenues from Corporate Income Tax (due to the authorisation to carry over the losses accumulated during the crisis to the subsequent years), higher consumption and investment expenditure by local government entities and higher interest expenditure.

In 2011, the headline deficit relative to GDP is expected to fall by around 1⅓ pps. This improvement is due to consolidation measures enacted by the government which are expected to amount to about 1% of GDP. It also benefits from a positive growth outlook. The revenue ratio is

forecast to increase, driven by the strong growth in tax revenues (a 1 pp. VAT rate increase and rebound in income taxes driven by further acceleration in GDP growth and stronger public investment). The expenditure ratio is set to drop, mainly due to a nominal freeze in public sector wages (with the exception of teachers) and a relatively slow increase in social transfers, related to an expected improvement in labour market situation.

A further deficit reduction of about ½ pp. is forecast for 2012. Under the no-policy change scenario the deficit forecast mainly improves on the back of close-to-potential GDP growth. Further increases in tax revenues and social contributions are expected to be accompanied by a considerable slowdown in public investment expenditure growth and limited growth in social transfers.

Given a small negative output gap, the structural deficit does not deviate considerably from the headline deficit and is relatively high in comparison to other EU Member States.



Despite the liquidity management reform planned to be introduced in 2011 and ambitious privatisation plans, general government debt is forecast to continue to rise from 55½% of GDP in 2010 to over 57% in 2011 and close to 60% in 2012, driven by persistently high deficits. Projected debt figures are, however, subject to uncertainty because of the high volatility of exchange rate and the ensuing valuation effects of the large foreign-denominated part of the debt. Finally, interest expenditure, also strongly contingent on the external factors, may turn out to be higher than projected.

Table II.20.1:

Main features of country forecast - POLAND

	2009			92-05	Annual percentage change					
	bn PLN	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP		1343.7	100.0	4.5	6.8	5.1	1.7	3.5	3.9	4.2
Private consumption		820.7	61.1	4.3	4.9	5.7	2.0	2.8	3.2	4.0
Public consumption		247.8	18.4	3.3	3.7	7.4	2.0	3.5	-0.2	0.3
Gross fixed capital formation		285.2	21.2	6.8	17.6	9.6	-1.1	0.1	8.4	9.2
of which : equipment		103.7	7.7	-	22.3	13.0	-9.1	-6.0	9.0	13.0
Exports (goods and services)		530.3	39.5	11.0	9.1	7.1	-6.8	10.0	6.9	7.7
Imports (goods and services)		529.3	39.4	11.6	13.7	8.0	-12.4	10.2	7.5	8.2
GNI (GDP deflator)		1296.2	96.5	4.5	5.6	6.8	0.1	3.4	3.9	4.3
Contribution to GDP growth :										
Domestic demand				4.6	7.2	6.9	1.4	2.4	3.7	4.5
Inventories				0.1	1.7	-1.1	-2.5	1.2	0.5	0.0
Net exports				-0.3	-2.1	-0.6	2.7	-0.1	-0.3	-0.3
Employment				-	4.4	3.8	0.4	0.7	1.3	1.4
Unemployment rate (a)				15.1	9.6	7.1	8.2	9.5	9.2	8.5
Compensation of employees/head				16.9	4.9	8.9	2.9	3.7	4.0	5.9
Unit labour costs whole economy				-	2.6	7.5	1.6	0.8	1.3	3.0
Real unit labour costs				-	-1.3	4.3	-1.9	-0.8	-1.4	0.2
Savings rate of households (b)				-	-	3.7	11.2	8.5	7.9	7.5
GDP deflator				12.9	4.0	3.1	3.6	1.7	2.7	2.8
Harmonised index of consumer prices				-	2.6	4.2	4.0	2.6	2.9	3.0
Terms of trade of goods				0.2	2.0	-2.1	4.4	-1.6	-1.0	-0.6
Trade balance (c)				-2.9	-4.0	-4.9	-1.0	-1.6	-2.0	-2.5
Current account balance (c)				-1.9	-5.1	-4.8	-1.9	-2.7	-3.3	-3.7
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-1.3	-4.1	-4.1	-0.3	-0.3	-0.5	-1.2
General government balance (c)				-	-1.9	-3.7	-7.2	-7.9	-6.6	-6.0
Cyclically-adjusted budget balance (c)				-	-3.1	-4.8	-7.0	-7.4	-6.1	-5.5
Structural budget balance (c)				-	-3.1	-4.8	-7.3	-7.3	-6.1	-5.5
General government gross debt (c)				-	45.0	47.1	50.9	55.5	57.2	59.6

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

21. PORTUGAL

Fiscal consolidation and private sector deleveraging

In the spotlight of sovereign debt markets

In the first half of 2010, the economy recovered, following a severe recession that hit the country during the global economic and financial crisis. This growth spurt was due to a strong turnaround in domestic demand, in particular private and public consumption, and mildly positive contributions from external trade. Private consumption arguably benefited from low interest rates and anticipatory effects of the VAT rate increase, which has taken effect on 1 July 2010. Positive growth rates in the first half of the year merely slowed down the shedding of jobs, as investment activity remained subdued. With the continued weakness of the labour market, unemployment became more entrenched.

The recession, the subsequent deterioration in labour market conditions, and the halt in fiscal consolidation attempts observed up to early 2008 have taken a heavy toll on public finances. This spring, Portugal along with some other Member States came under increased scrutiny from sovereign debt markets, and increases in government bond yields put additional pressure on public finances. In an attempt to alleviate this pressure, the Portuguese authorities announced fiscal plans in May and September that were more ambitious than those set out in the March 2010 Stability Programme, with the new fiscal targets being underpinned by consolidation measures, part of which implemented in mid 2010.

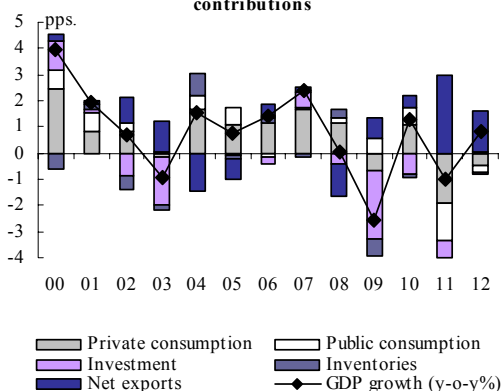
The underlying growth trend remains weak

The intensified fiscal consolidation, while having an important impact on raising confidence levels and lowering yield spreads, shapes the short-term outlook for economic growth through their immediate impact on private and public consumption expenditures. At the same time, a high level of private sector indebtedness will force households and companies to undertake balance sheet corrections. In order to attenuate the high external indebtedness, economic activity needs to be rebalanced by strengthening exports and investment activity and restraining public and private consumption.

Fiscal consolidation shapes short-term outlook

Real GDP is expected to increase by 1¼% in 2010 and to decline by about 1% in 2011. In 2012, GDP is forecast to recover at a rate of ¾%. The growth pattern in 2010 is shaped by the strong activity recorded in the first half of this year and the expected subsequent drop in GDP in the second semester due to the impact of the VAT hike and cuts in social transfers that came into effect in July. Fiscal consolidation will continue to weigh on private consumption once the new fiscal measures come into effect in January. In addition, private households are expected to continue their balance sheet repair amidst a subdued labour market outlook and tightened financial conditions. As a consequence, private consumption is expected to decrease substantially in both 2011 and 2012.

Graph II.21.1: Portugal - GDP growth and contributions



Figures for GDP components in 2010 and 2011 are distorted by the import of two submarines in 2010, which raises government consumption and imports but not aggregate GDP. In 2011, real government consumption is forecast to fall by about 6¾% in 2011 and by a further 1¼% in 2012. Gross fixed capital formation is projected to continue its longstanding downward trend until the end of 2011, weighed down by weak domestic demand and deleveraging by the corporate sector. A mild recovery in machinery and equipment investment and business construction is, however, expected for 2012 as accelerating exports are likely to require additional production capacity. Housing investment, in contrast, should continue to decline during the forecast period.

Stronger exports in line with the expected recovery in Portugal's export markets and a deceleration in imports due to the contraction in domestic demand should lead to significant reductions of the deficits in the trade and current-account balances. Servicing external liabilities will continue to absorb a significant share of income over the medium-term, mirrored in the deficit in the primary income balance, which is expected to increase from 3½% of GDP in recent years to 4% of GDP in 2012. As a result, the gap between gross domestic product and gross national income should continue to widen.

Labour market conditions weigh on wage growth...

Unemployment recorded a sharp increase when the economic and financial crisis unfolded at the end of 2008 and has since become entrenched with more than half of the unemployed now being out of work for longer than one year. At the same time, the NAIRU has increased to record levels. Labour market conditions are expected to improve only towards the end of 2012, on the back of the recovery in private investment activity. Employment is forecast to decrease in each year between 2010 and 2012. Against this background and in the wake of a reduction in nominal public sector wages, private sector wage growth is expected to be moderate in the forecast period, thereby containing unit labour costs and improving price competitiveness.

...and dampen price developments

HICP headline inflation reached 2% y-o-y in September 2010, partly as a result of the VAT hike in July. A further increase is to be expected when another VAT increase comes into effect at the beginning of 2011. HICP is forecast to increase by 1½% in 2010 and to further accelerate to 2¼% in 2011, before it falls back in 2012. After a strong increase in 2009, unit labour costs are expected to stagnate or even slightly decline in the forecast period.

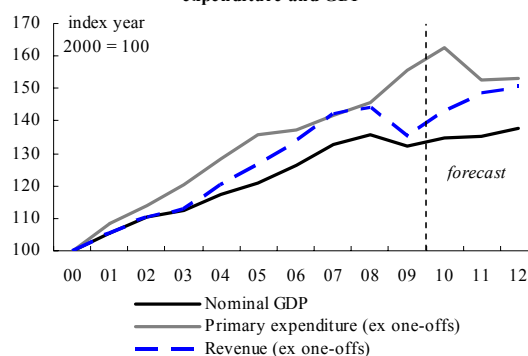
There are upside and downside risks to the forecast. On the positive side, an earlier-than-expected improvement of labour market conditions could mitigate the contractionary short-term impact of the fiscal consolidation and trigger a faster recovery of domestic demand. On the negative side, any unfavourable development would not only put public finances at immediate

risk, but higher risk premia on the bond market could also raise the funding costs of domestic banks and negatively impact on the provision of credit to the private sector.

Challenge of fiscal consolidation in a low GDP growth environment

In 2010, the government deficit is expected to be 7.3% of GDP, down from 9.3% of GDP in 2009. The lower 2010 deficit outcome is due to higher revenue, reversing the sharp falls recorded in 2009. The revenue increase partly reflects some household consumption buoyancy as well as discretionary measures taken in the middle of the year, especially a one percentage point increase in all VAT rates and, to a lesser extent, increases in direct taxes. In addition, the 2010 budgetary outcome will benefit from a one-off revenue item worth 1.5% of GDP, linked to the transfer of a private pension fund to the government sector, which takes responsibility for the payment of future pensions. This transaction reduces the 2010 deficit but is neutral in terms of fiscal sustainability insofar as the one-time payment to the government is the actuarial value of future pension payments.

Graph II.21.2: Portugal - Government revenue and expenditure and GDP



Yet, in 2010, the higher revenue-to-GDP ratio has been accompanied by a rising expenditure-to-GDP ratio. Despite some deceleration following the large increase in 2009, primary expenditure is estimated to have grown in excess of nominal GDP, with social transfers accounting for a significant part of that increase. Large non-recurrent purchases of military equipment in 2010 also contributed to the higher spending and interest expenditure edged up too.

A sizeable fiscal consolidation effort will be implemented in 2011, based on several fiscal

measures to reduce spending and increase revenue. Measures on the expenditure side include an average cut of 5% in government wages, reductions in government employment, cuts in social transfers such as unemployment benefits and family allowances, and a freeze of essentially all other social outlays. Additional measures are targeted at reining in spending in a number of other areas, including, for instance, the health sector, and transfers to state-owned enterprises or public investment. Consolidation efforts on the revenue side consist mainly of an additional rise of 2 pps. in the standard VAT rate. In addition, revenue proceeds will reflect the carry-over effect of the tax hikes of mid-2010.

In all, with such a large fiscal consolidation effort, the 2011 deficit may come to under 5% of GDP, also taking into account the fact that the fading of the large one-off revenue recorded in 2010 will limit the deficit reduction in 2011. The current fiscal outlook hinges, on the one hand, upon the assumption that the ambitious expenditure plans outlined in the 2011 Budget Law will largely materialise and, on the other hand, upon a GDP outlook which is only mildly more subdued than the contraction of 0.7% underlying the tax projections of the 2011 Budget. Thus, there are risks to this fiscal scenario. Notably, should the macroeconomic outlook turn out to be bleaker than

currently expected, fiscal prospects will be affected by lower tax revenues. Indeed, given the uncertainty on a number of external and financial variables, it cannot be excluded that the evolution of demand stays below the present scenario.

Based on unchanged policies, the government deficit is expected to remain essentially constant in 2012. Revenue is expected to continue to be affected by the weak economic momentum, while expenditure is projected to grow in excess of sluggish nominal GDP. In particular, interest spending is expected to increase rapidly. Measures put in place in earlier years to rein in spending are expected to work towards expenditure containment, but they will not yield a marked fall in the primary-spending-to-GDP ratio in a context of rather low nominal GDP growth.

Government debt is projected to attain 92% of GDP in 2012, up from 83% of GDP in 2010. The rising debt levels should lead to a rapid increase in interest spending, which is expected to be the fastest-growing spending item and a major factor hindering improvements in the government balance in the coming years.

Table II.21.1:

Main features of country forecast - PORTUGAL

	2009			92-05	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	168.1	100.0		2.2	2.4	0.0	-2.6	1.3	-1.0	0.8
Private consumption	111.9	66.6		2.4	2.5	1.8	-1.0	1.6	-2.8	-0.7
Public consumption	35.8	21.3		2.4	0.5	0.8	2.9	3.0	-6.8	-1.3
Gross fixed capital formation	32.7	19.4		2.0	2.6	-1.8	-11.9	-4.1	-3.2	-0.4
of which : equipment	10.1	6.0		3.4	7.9	3.7	-14.4	-3.0	-3.4	0.6
Exports (goods and services)	46.9	27.9		5.9	7.6	-0.3	-11.8	9.1	5.6	6.4
Imports (goods and services)	59.7	35.5		6.0	5.5	2.8	-10.9	5.8	-3.2	1.5
GNI (GDP deflator)	162.4	96.6		2.0	2.2	-0.3	-2.5	1.1	-1.2	0.7
Contribution to GDP growth :										
Domestic demand				2.6	2.3	0.9	-2.7	0.9	-4.0	-0.8
Inventories				0.2	-0.1	0.3	-0.6	-0.1	0.0	0.0
Net exports				-0.6	0.2	-1.2	0.8	0.5	3.0	1.6
Employment				0.5	0.0	0.5	-2.6	-0.9	-0.7	-0.3
Unemployment rate (a)				5.9	8.1	7.7	9.6	10.5	11.1	11.2
Compensation of employees/head				6.0	3.6	2.7	3.6	1.7	-1.3	0.7
Unit labour costs whole economy				4.2	1.2	3.1	3.5	-0.5	-1.1	-0.4
Real unit labour costs				0.1	-1.6	1.1	3.3	-1.2	-2.3	-1.4
Savings rate of households (b)				-	-	7.8	11.0	10.5	9.9	10.2
GDP deflator				4.1	2.8	2.0	0.2	0.7	1.3	1.0
Harmonised index of consumer prices				3.6	2.4	2.7	-0.9	1.4	2.3	1.3
Terms of trade of goods				0.4	0.4	-2.2	5.1	-1.8	0.2	-0.4
Trade balance (c)				-10.3	-10.9	-12.9	-10.1	-10.8	-8.5	-7.6
Current account balance (c)				-7.8	-10.2	-12.5	-10.4	-10.7	-8.0	-6.7
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-5.6	-8.9	-11.0	-9.3	-9.5	-6.7	-5.3
General government balance (c)				-3.9	-2.8	-2.9	-9.3	-7.3	-4.9	-5.1
Cyclically-adjusted budget balance (c)				-4.0	-3.1	-3.0	-8.2	-6.7	-3.8	-4.3
Structural budget balance (c)				-	-3.2	-3.8	-8.0	-8.3	-4.1	-4.3
General government gross debt (c)				55.0	62.7	65.3	76.1	82.8	88.8	92.4

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

22. ROMANIA

Economy not out of the woods yet

Domestic demand prolongs the recession

After a major slump in economic growth in 2009 (-7.1%), the Romanian economy remains mired by weak domestic demand in 2010. The long duration of the recessionary period is mainly due to the unsustainable developments in the economy before the international crisis. The economic boom in the pre-crisis period – with real GDP growth averaging 6.8% in 2004-08 – was underpinned by strong domestic demand. The latter was fuelled by a pro-cyclical policy of generous increases in public wages and pensions, and also by bank lending, most of which in foreign currency. As a result, Romania entered the recession with a budget deficit of 5.4% of GDP and a current-account deficit of 12.7%. This vulnerable position created additional stress in local financial markets and limited the scope for any government stimulus to prop up the economy.

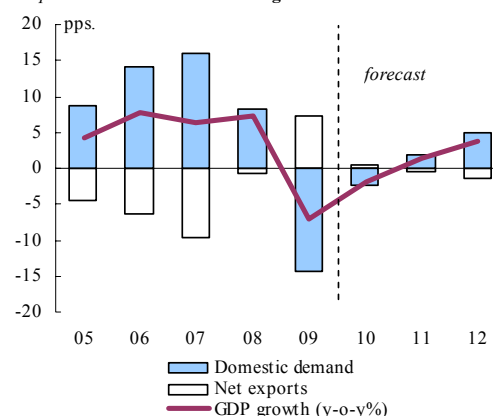
With the onset of the crisis, Romania asked for medium-term financial assistance in the form of a multilateral loan package totalling EUR 20 bn from the EU, the IMF, the World Bank, the EIB and the EBRD. This assistance is still ongoing and loan disbursements are conditional on implementing an adjustment programme which aims to bring down the budget deficit, promote structural reforms and restore stability in financial markets. The key economic reforms include a new pension system, a unified wage law for the employees in the budgetary sector and a fiscal responsibility law to ensuring the long-term sustainability of public finances. Thanks to the programme, pressures on the exchange rate have been reduced, financial stress has eased, and the international reserves position has improved.

Industrial activity decoupled from weak domestic environment

Real GDP growth is expected to decline by 1.9% in 2010, mainly due to faltering domestic demand. Private consumption recovered somewhat in the second quarter, but fell again after the increase in the standard VAT rate, cuts in public wages and layoffs in the budgetary sector. Retail sales plummeted and consumer sentiment stands at historically low levels. Government spending is also falling in order to keep in line with the targets agreed in the context of the multilateral assistance

programme. Investment spending has been hard hit by the political uncertainty and the still high risk premia associated with the country and the region. This is likely to have an impact on the rate of potential growth of the economy in the short-term as its productive capacity has been reduced and will take some time to recover. On the other hand, industrial activity is benefitting strongly from the recovery in the main trading partners, and seems to be sheltered from the weak domestic environment. Exports increased robustly in the first half of this year, with imports rising in tandem but at a slower rate. The current-account deficit is projected to deteriorate somewhat this year to 5.5% of nominal GDP, from 4.5% in 2009, primarily due to lower workers' remittances. Still, this ratio represents a substantial improvement from the double-digit rates recorded in 2006-08.

Graph II.22.1: Romania - GDP growth and contributions



The economy is expected to turn around in 2011, with real GDP forecasted to increase by 1.5%. After falling severely in 2009 and 2010, investment should pick up vigorously by 4.2% and is expected to be a main driver of growth as companies re-adjust their production lines to meet the increased external demand. Exports have maintained their strong momentum throughout 2010, and together with the jump in industrial orders, this development is expected to re-assure companies even if risk spreads remain somewhat elevated. Moreover, increased absorption of substantial EU funds would provide a fillip for infrastructure investment. After having declined considerably in 2009 (-10.6%) and 2010 (projected to decline by 1.6%), household consumption will pick-up marginally next year by 1.8%, as wages re-adjust upwards. It will however be suppressed

by the continuing fiscal retrenchment and the high debt-service-to-income ratio, which is also leading to high non-performing loans (ratio close to 12% as at September). After having an overall positive impact in 2009 and 2010, net exports are expected to have a negative contribution to growth next year as imported capital goods increase, feeding into investment growth. As Romanians living abroad benefit from improving labour market conditions abroad, workers' remittances should pick-up again in 2011. The current-account deficit is projected to stabilise at 5.6% of GDP.

The economy is then expected to close the output gap faster in 2012 as it grows by 3.8%, above its medium-term potential growth rate of around 3%. By then, wages are projected to accelerate from their very low levels (compared to its main trading partners), especially in the industrial and professional sectors. This development will in turn have a positive impact on restoring household balance sheets and will lead to a higher growth rate in private consumption. Growth will thus be more broad-based, with domestic demand again playing a decisive role in uplifting the economy. Government consumption will however remain subdued as the government is expected to continue with fiscal consolidation.

Higher unemployment and declining wages ...

The protracted economic recession led to higher unemployment in 2010 and a substantial correction in wage growth. The unemployment rate has been declining somewhat since the second quarter, but most of this could be statistical as those who lose their unemployment benefit do not seem to have an incentive to register for work. The unemployment rate is projected to average 7.4% in 2010, up from 6.8% last year, and then to diminish slowly in 2011-12. The recovery in total employment will be delayed – employment growth is expected to be negligible in 2011, after negative growth this year – due to the lack of flexibility in the labour market and also because of further layoffs in the public sector. Improving labour market legislation remains a key challenge as the country grapples with its huge informal economy, low employment and activity rates, and strong emigration. In the meantime, growth in average gross monthly earnings went into negative territory in the third quarter after the 25% cut in public wages, but are expected to increase as from next year as layoffs will leave some space for upward wage adjustment in the public sector.

... while inflation increased on the back of the VAT increase

The purchasing power of households has been hit not just by the reduction in gross wages, but also by the elevated levels of inflation. The declining trend in inflation since mid-2008 was halted by the 5pps increase in the main VAT rate in July. VAT and higher food prices will push CPI inflation towards 8% by year-end, compared to 4.6% last year. In view of these inflationary pressures, the National Bank of Romania maintained its policy rate at 6.25% since May 2010. Annual inflation is projected to be within the central bank's targeted tolerance band of 3% +/-1 pp. in end-2011 and throughout 2012.

Fiscal consolidation to continue, but substantial risks of reversing measures remain

The fiscal situation deteriorated further in the first months of 2010, due mostly to substantial revenue underperformance. During the multilateral financial assistance review in May 2010 it appeared that the 2010 deficit target of 6.4% of GDP would be missed by around 3 pps. of GDP under unchanged policies. The 2010 government deficit target was revised upward to 7.3% of GDP to accommodate for a deterioration in economic conditions. To reach the revised target, the authorities took additional consolidation measures including a temporary 25% reduction in public wages, a 15% reduction in social spending excluding pensions and an increase in the main VAT rate from 19% to 24%. In addition, the authorities decided to cut spending on goods and services by 10% and early retirements were frozen from 1 June 2010 until after the pension reform is in effect (1 January 2011). Social contributions and personal income tax bases were broadened and the authorities also committed to further reduce personnel in the last part of the year, on top of cuts in the first half of 2010 exceeding 25000 jobs. The fiscal consolidation measures have put Romania on track to achieve the deficit target of 7.3% of GDP for 2010. However, Romania continues to be plagued by recurring arrears, particularly in the health sector. Despite the fact that 2 billion RON were given to the sector to pay back arrears in September, trends would suggest a new build-up of arrears at the end of the year due to structural problems (the health fund can make expenditure commitments exceeding its budget which translates into arrears). The authorities have reallocated funds within the budget to pay the new accumulated arrears and would use any budget

over performance to this effect. They have also agreed to measures within the multilateral financial assistance programme to prevent a further accumulation of arrears in the health sector in the future.

The 2011 budget deficit is forecast to decrease further to 4.9% of GDP given the carry-over from the 2010 fiscal consolidation measures and the additional savings on the expenditure side decided by the authorities. The latter include a reduction in energy subsidies, a freeze in pensions in nominal terms, a further reduction in public employment by continuing to apply the policy of only replacing 1 of 7 departing workers, implementation of further health-sector reforms, and an improvement

in revenue and expenditure controls. For 2012, under the no-policy-change assumption, the budget deficit is forecast to decrease to 3.5% of GDP.

While the forecast assumes that the authorities do not reverse the fiscal consolidation measures taken in July 2010 there are substantial risks that can endanger the fiscal consolidation path. In particular, there is heavy pressure on the authorities to reverse the fiscal consolidation measures implemented in July 2010 and to revert to policies of unsustainable spending. While this may provide some short-term stimulus in terms of domestic demand, it will come at a cost of severely reduced growth potential in the medium- to long-run.

Table II.22.1:

Main features of country forecast - ROMANIA

	2009			92-05	Annual percentage change					
	bn RON	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	491.3	100.0	2.2	6.3	7.3	-7.1	-1.9	1.5	3.8	
Private consumption	308.3	62.8	4.7	11.9	9.0	-10.6	-1.6	1.8	3.9	
Public consumption	89.0	18.1	1.1	-0.1	7.2	0.8	-3.9	-1.0	1.7	
Gross fixed capital formation	126.0	25.6	8.2	30.3	15.6	-25.3	-9.9	4.2	7.3	
of which : equipment	55.0	11.2	11.2	28.3	10.9	-32.7	-5.4	6.3	7.3	
Exports (goods and services)	153.4	31.2	11.0	7.8	8.3	-5.5	17.0	6.0	6.1	
Imports (goods and services)	182.5	37.2	12.7	27.3	7.9	-20.6	12.9	6.4	8.3	
GNI (GDP deflator)	481.9	98.1	2.1	6.1	8.1	-6.2	-2.2	0.9	3.8	
Contribution to GDP growth :										
Domestic demand			5.7	15.9	11.9	-14.8	-4.2	2.0	4.5	
Inventories			-1.7	0.0	-3.5	0.4	1.8	0.0	0.5	
Net exports			-1.6	-9.6	-1.0	7.3	0.5	-0.5	-1.3	
Employment			-2.6	0.4	0.0	-2.0	-0.8	0.1	0.6	
Unemployment rate (a)			6.6	6.4	5.8	6.9	7.5	7.4	7.0	
Compensation of employees/head			65.1	22.0	31.9	10.5	1.8	3.3	4.2	
Unit labour costs whole economy			57.2	15.2	22.9	16.6	2.9	1.9	1.0	
Real unit labour costs			-1.6	1.5	6.6	13.4	-3.2	-2.6	-4.0	
Savings rate of households (b)			-	-	-	-	-	-	-	
GDP deflator			59.8	13.5	15.3	2.8	6.3	4.6	5.1	
Harmonised index of consumer prices			-	4.9	7.9	5.6	6.1	5.5	3.2	
Terms of trade of goods			0.8	10.6	3.2	0.1	0.0	1.0	0.5	
Trade balance (c)			-7.4	-14.3	-13.6	-5.8	-4.6	-4.4	-5.0	
Current account balance (c)			-	-13.6	-11.4	-4.5	-5.5	-5.6	-6.2	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-4.9	-13.0	-11.0	-4.0	-5.1	-5.1	-5.7	
General government balance (c)			-	-2.6	-5.7	-8.6	-7.3	-4.9	-3.5	
Cyclically-adjusted budget balance (c)			-	-5.1	-8.9	-8.6	-6.1	-3.5	-2.6	
Structural budget balance (c)			-	-5.0	-8.4	-9.0	-6.3	-3.5	-2.6	
General government gross debt (c)			-	12.6	13.4	23.9	30.4	33.4	34.1	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

23. SLOVENIA

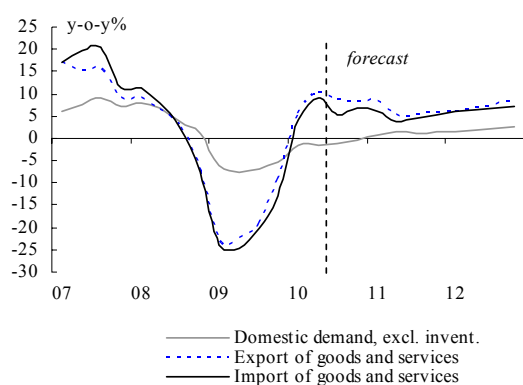
An export-driven recovery held back by low investment

With a weak presence in high growth markets, the pace of the export-led recovery in Slovenia is set by demand in the country's main EU and Western Balkan trade partners. Accordingly, growth is expected to be moderate and to ease somewhat heading into 2011. Faster growth is also being hampered by the tight credit conditions in the indebted corporate sector and slow adjustment in the construction sector, which may take until late 2011 or 2012 to complete.

A moderate rebound

Slovenia has seen real GDP fall more abruptly and for longer than fellow euro-area countries. By mid 2010, six consecutive quarters of economic turbulence left real GDP around 9% below the peak reached in the third quarter of 2008. In 2009, gross capital formation was the biggest contributor to negative growth, as both construction and investment in equipment went into freefall. Pronounced destocking throughout the year also dragged growth down. Despite declining trade, a smaller fall in merchandise exports compared to imports helped to attenuate the recession.

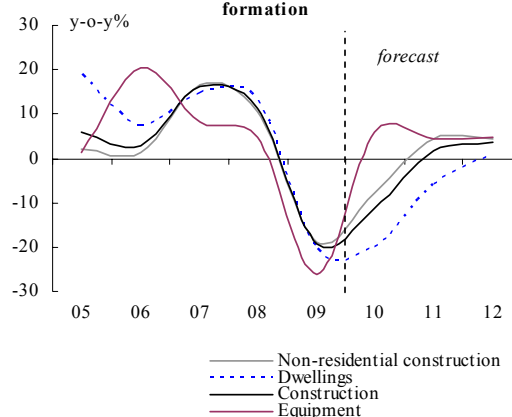
Graph II.23.1: Slovenia - Domestic and foreign demand



Domestic demand has remained depressed into 2010, with gross fixed capital formation still declining in the first half of the year. While the drag on growth from private consumption has persisted, destocking has given way to renewed inventory accumulation. The strengthening pull from external demand belatedly brought the recovery to life in the second quarter of 2010, when real GDP grew by 1.1% q-o-q. Merchandise exports, particularly to the EU, are the engine of

growth here, while the trade surplus in services has in fact narrowed.

Graph II.23.2: Slovenia - Gross fixed capital formation



Extrapolating these trends, net exports are expected to contribute 1.2 pps. to real GDP growth in 2010, while gross fixed capital formation and household consumption continue to subtract from growth. Underlying these figures on the supply side, there is a healthy recovery in high and medium-technology manufacturing and certain services, undercut by a continuing decline in the construction sector, particularly in residential housing. These trends are, overall, likely to contribute to the improvement in the trade balance in 2011-12.

Domestic demand is expected to contribute 1 pp. to real GDP growth in 2011, as revived private consumption and equipment investment outweigh the drag from construction and public consumption. As private consumption strengthens in 2012, the contribution of domestic demand is projected to rise further.

Uncertain prospects in the construction sector

Notwithstanding efforts to increase exports of construction services, the highly indebted construction sector, notably civil engineering and housing, is likely to account for a significantly reduced share of GVA in Slovenia's post-crisis economy. The onset of the crisis coincided with the end of major civil engineering projects, notably highways, while housing construction underwent a sustained decline in the second half of 2009 and has yet to bottom out. The number of new

dwellings sold is down by half while the corresponding prices remain far closer to their peak. Under current market conditions, indebted construction firms would only be able to sell their stocks of finished housing units by adjusting prices, so they prefer to await a rebound in demand. Banks appear to be facilitating this situation by allowing loans to roll over rather than forcing further price adjustments to take place. In this context, orderly deleveraging is not a foregone conclusion.

Slovenia's net borrowing is set to decline further, from 1.3% of GDP in 2009 to 0.7% in 2010, as a result of some continued balance sheet repair in the corporate sector, improved absorption of EU funds and low interest rates. Except for the latter, these trends are forecast to be stable over 2011 and 2012, sustained by the minor improvement in the external balance of goods and services. Household finances are expected to remain sound, due to low indebtedness and traditionally high savings rates.

Inflation, which declined markedly over 2009, is running at a higher rate in 2010, largely due to successive hikes of excise duty rates on energy products, alcohol and tobacco, and high prices in utilities services. These temporary factors, which should fall out of the calculation in 2011, account for most of the inflation differential vis-à-vis the euro-area average in 2010. In 2011-12, the reversal of price falls in non-energy industrial goods and gradually increasing cost-pressures in the service sector are expected to sustain HICP around 2%.

A flat labour market

Considering the severity of the output shock, employment has remained rather resilient during the recession, with labour productivity taking a large part of the adjustment. Subsidies for temporary lay-offs and reduced working hours were a supportive factor. These are expiring but adverse effects are expected to be contained as the number of beneficiaries has already declined substantially. Furthermore, the labour market has, according to early indications, adapted well to the 2010 minimum wage increase, which applied to fewer people than initially expected due to earlier job losses in the relevant wage bracket.

Employment fell in the first half of the year, albeit at a diminishing rate, and further slight declines in the second half of the year can be expected due to continued difficulties in construction and some

bankruptcies, leaving employment for 2010 as a whole lower than in 2009.

As regards the projected employment dynamics in 2011-12, the upturn is expected to mirror the downturn, in that increased output will initially raise labour productivity, with employment growth occurring with a considerable lag. Moreover, ongoing employment losses in construction, many of them affecting foreign workers, are unlikely to be completely reversed if, as expected, the sector's share in gross value added settles at a more sustainable level.

Wage growth in 2010 is forecast to be somewhat higher than might be expected at the current stage of the cycle, due to the minimum wage increase, the continuing composition effects from job losses in low paid sectors and occupations, and higher wages for employees returning to work or full hours after a spell on one of the wage subsidy schemes. As these temporary factors recede, wages are expected to moderate somewhat in 2011, before picking up again in 2012 as the economic recovery gathers pace. Wage increases will be concentrated in the private sector due to the planned restraint in the public sector. After edging downwards in 2010, unit labour costs are expected to rebound as wages growth overtakes productivity growth in 2011.

This baseline scenario could prove optimistic or pessimistic depending on the strength of foreign demand, particularly in the EU. Similarly, the gathering pace of domestic recovery over the forecast horizon is contingent on the construction sector completing its adjustment. Significant economic dislocation and financial contagion could emerge if the orderly unwinding of high corporate debts, not least in the construction sector, cannot be accomplished.

From containment to consolidation

For 2010, the government has adopted measures to restrain primary expenditure growth, confirming its intention to pursue an expenditure-based fiscal consolidation. These measures include an agreed postponement of public sector wage increases and a halving of the usual indexation of social benefit rates, including pensions. Last June, in light of worsening economic and budgetary developments since the adoption of the budget, the government adopted additional consolidation measures in

excise duties, investment and capital transfers in a supplementary budget.

The general government deficit is estimated to stabilise at around 5.8% of GDP in 2010. This exceeds the national target of 5.6%, largely because of lower projected growth in indirect taxes. The primary balance is expected to improve by ¼% of GDP. Revenues are expected to be boosted by higher excise duties and current and capital transfers while expenditures are driven higher mainly by growth in intermediate consumption and the number of recipients of social transfers – particularly new pensioners in anticipation of the pension reform. These developments drive up both the revenue and expenditure ratios in 2010.

For 2011, public sector wage restraint will continue, with, in addition, a freeze on promotions and less generous wage indexation. Indexation of social transfer rates, including pensions, will be further reduced. Nevertheless, the projected reduction of the general government deficit to 5.3% of GDP is somewhat less than that planned by the government (4.8% of GDP). In addition to the lower starting base for indirect taxes from 2010, the Commission services' forecast incorporates the expectation that public employment will be reduced by less than the extent

planned and that departures into retirement will continue above trend until the pension reform enters into force.

In 2012, increased domestic demand is expected to support revenue growth, while on the expenditure side, this forecast does not take account of the announced but not yet adopted consolidation measures, due to the usual no-policy-change assumption. Notably, any prolongation of the freeze in promotions to 2012 is still to be agreed and the less generous indexation in public wages and social transfer rates, including pensions, currently only applies until 2011.

The gross government debt ratio is expected to rise to 40.7% of GDP in 2010, up from 35.4% in 2009, driven by the primary deficit and the increasing interest burden. The debt ratio is projected to grow further, reaching 47½% in 2012, as a result of persisting primary deficits. The government expects to finance the announced recapitalisation of the country's foremost banking group and international obligations out of funds deposited with banks in 2009. As the deposits are already reflected in the government gross debt, these operations are not anticipated to further increase debt over the forecast horizon.

Table II.23.1:

Main features of country forecast - SLOVENIA

	2009			92-05	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP		35.4	100.0	3.5	6.9	3.7	-8.1	1.1	1.9	2.6
Private consumption		19.6	55.4	3.7	6.7	2.9	-0.8	-0.5	0.8	1.8
Public consumption		7.2	20.3	3.0	0.7	6.2	3.0	0.9	-0.3	1.0
Gross fixed capital formation		8.5	23.9	6.7	12.8	8.5	-21.6	-4.4	2.9	4.1
of which : equipment		2.9	8.3	9.8	8.2	4.9	-26.2	6.0	4.4	4.7
Exports (goods and services)		20.6	58.1	4.8	13.7	3.3	-17.7	8.1	5.9	7.2
Imports (goods and services)		20.1	56.8	6.5	16.7	3.8	-19.7	6.3	5.0	6.5
GNI (GDP deflator)		34.7	98.1	3.4	5.9	3.1	-7.4	1.6	1.7	2.4
Contribution to GDP growth :	Domestic demand			4.1	7.1	5.0	-6.1	-1.2	1.0	2.1
	Inventories			0.4	1.9	-0.8	-4.0	1.1	0.2	0.0
	Net exports			-1.0	-2.0	-0.4	2.0	1.2	0.6	0.5
Employment				-	3.0	2.8	-1.9	-2.3	-0.2	0.6
Unemployment rate (a)				-	4.9	4.4	5.9	7.2	7.2	6.6
Compensation of employees/head				-	6.4	7.0	1.6	3.1	2.8	3.3
Unit labour costs whole economy				-	2.6	5.9	8.5	-0.4	0.7	1.3
Real unit labour costs				-	-1.5	1.8	5.1	-0.6	-0.6	-0.2
Savings rate of households (b)				-	-	15.5	15.9	16.0	15.5	15.3
GDP deflator				18.2	4.2	4.0	3.2	0.2	1.3	1.5
Harmonised index of consumer prices				-	3.8	5.5	0.9	2.1	2.0	2.2
Terms of trade of goods				0.8	0.6	-1.8	4.7	-2.9	-0.7	-0.8
Trade balance (c)				-2.8	-4.9	-7.2	-2.1	-2.1	-2.0	-1.9
Current account balance (c)				-0.2	-4.5	-6.8	-1.3	-0.7	-0.6	-0.8
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-0.4	-4.7	-6.7	-1.4	-0.4	-0.2	-0.2
General government balance (c)				-	0.0	-1.8	-5.8	-5.8	-5.3	-4.7
Cyclically-adjusted budget balance (c)				-	-3.0	-5.0	-3.9	-4.0	-3.8	-3.8
Structural budget balance (c)				-	-3.0	-5.0	-3.9	-4.0	-3.8	-3.8
General government gross debt (c)				-	23.4	22.5	35.4	40.7	44.8	47.6

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

24. SLOVAKIA

An externally-driven recovery

Buoyant growth interrupted by the crisis

Given its large degree of openness to, with exports representing over 80% of GDP in 2008, Slovakia was strongly exposed to the contraction in external demand in 2008 and 2009. At the same time, also because of the extremely uncertain outlook at that time, investment plunged by 20%. Moreover, firms simultaneously reduced their inventories at an unprecedented pace, which acted as an "accelerator" of the contraction. As a result, real GDP fell by 4.8%.

In order to sustain domestic demand and in line with the European economic recovery plan, the Slovak government let the automatic stabilisers operate freely. It also adopted several anti-crisis measures totalling roughly ½% GDP in 2009. These policies helped to retain household consumption a slight positive growth in 2009.

Despite the large shock to the real economy and severe stress in global financial markets, the Slovak banking sector has remained solid. This reflects the good liquidity situation of credit institutions and low dependence on cross-border lending.

More subdued GDP growth following strong rebound in 2010

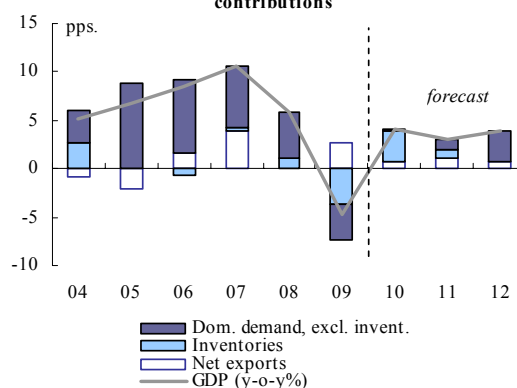
In 2010, real GDP is projected to increase by around 4%, following an unexpectedly strong rebound in economic activity, especially in Germany, Slovakia's largest trading partner, in the first half of 2010. Economic growth is expected to be more subdued in 2011, taking into account consolidation measures envisaged in the budget for that year and the expected deceleration of Slovakia's main trading partners, returning again to an average annual rate close to 4% in the final year of the forecast period.

Given the rapidly deteriorating labour market conditions in 2009-10, household consumption expenditure is expected to turn negative in 2010, as suggested by continuously deteriorating consumer sentiment indicators over the last months. For 2011, an increase of 1.5% is expected, reflecting improvements on the labour market combined with more sustained growth in real wages and a decline in households' savings rate.

On the other hand, some of the implemented consolidation measures, in particular the reduction of the wage bill in the public sector, will dampen disposable income of households.

After an unprecedented slump in 2009, investment growth is expected to return to positive territory as soon as 2010 (1.7%) given the need to replace fixed capital in the follow-up of the crisis, and to further accelerate to 5.1% in 2011. In the short term, the current low capacity utilisation and rather subdued industrial confidence will pose some drag on private investment growth. Nevertheless, for both 2011 and 2012, it is assumed that a better drawing of EU funds, together with a revival of highway projects and gradually improving global economic prospects, will have an overall positive impact on investment growth. Moreover, on the back of a sharp pick-up in exports, for 2010 and to a lesser extent 2011, strong re-stocking is assumed, following the drop in 2009 which contributed substantially to the contraction in real GDP.

Graph II.24.1: Slovakia - GDP growth and contributions



Turning to the external side, Slovakia is expected to benefit from a rebound in external demand, fuelled in particular by the strong growth performance of the German economy in the first half of 2010. With external conditions slightly worsening in 2011, both export and import growth are projected to decelerate. Net trade is forecast to contribute to growth by over ½ pp. this year and 0.9 pp. on average in 2011-12. One of the underlying assumptions is that Slovakia will also continue to gain export market shares also in 2011-12, albeit at a slower pace than in 2010.

The baseline scenario is subject to a number of risks. In particular, any unexpected developments in the pace of recovery in the country's main trading partners might result in potentially large changes in export performance in both directions. From the domestic demand side, a stronger-than-expected impact of consolidation measures for 2011 might have implications, especially for households' consumption expenditure.

Persistent underperformance of the labour market

After several years of above-potential economic growth, the unemployment rate in Slovakia declined significantly, but at its low point of 9.5% in 2008 it was still one of the highest in the EU. The reaction of the Slovak labour market to the downturn in 2009 was strong and almost immediate: the unemployment rate is now expected to reach about 14½% in 2010, despite improving economic conditions, which points to fragile labour demand from the private sector in the aftermath of the crisis. The situation is expected to improve progressively in 2011, although fiscal austerity measures, in particular cuts in the public sector wage bill which will be implemented partly via a reduction in the number of public sector employees at the central government level, will weigh on the labour market, albeit marginally. More substantial improvement is foreseen in 2012, coupled with the general increase in economic activity. However, a number of persistent structural problems in the labour market, which has the highest rate of long-term unemployed among all the EU Member States, and professional-skill mismatches, which led to significant labour shortages at the end of the previous expansion, could hamper the adjustment.

HICP inflation driven also by administrative changes in 2011

After years of modest increases in price levels, HICP inflation further decelerated in 2009 to 0.9%, following the economic downturn. Gradual economic recovery is set to drive inflation in 2010 only modestly, to around 1%, also taking into account the decrease in excise duties on diesel fuels implemented at the beginning of 2010. In the following years, although the generally low pressures stemming from the demand side and moderate wage growth are projected to contain price pressures, increases in the VAT rate and excise taxes as part of the fiscal package will result

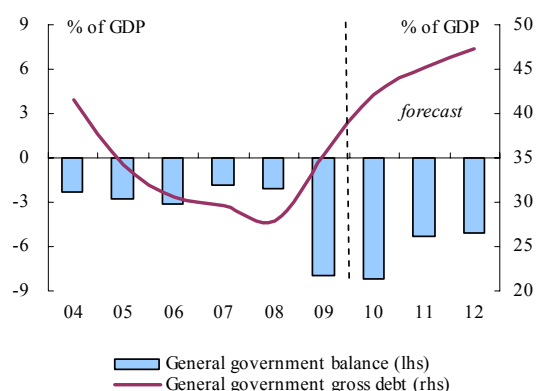
in HICP inflation rising by 3.2% in 2011, whereas core inflation is expected to be rather subdued. Inflation in 2012 will decelerate as the effects of the administrative measures wear off, but will be sustained by improving household consumption.

Strong emphasis on the consolidation of public finances

The vulnerable state of the public finances, caused by years of procyclical fiscal policies, when strong economic performance had been accompanied by an increasing structural deficit, has been fully revealed during the economic downturn. In 2009, when Slovakia's economic activity plunged by an unprecedented 4.8%, the general government deficit reached 7.9% of GDP. A drop in tax revenues and full operation of automatic stabilisers were the main reasons behind the significant deterioration. Nevertheless, other factors such as the subsidising of loss-making companies and the inefficient healthcare sector also contributed to an increase in the headline deficit.

In view of the worsening state of the public finances, the government adopted the 2010 budget, which included several consolidation measures, focusing principally at the reduction of the general government expenditure on goods and services and capital. However, given lower-than-projected revenues, higher-than-planned expenditures and unexpected events (e.g. floods), the deficit is projected to remain high in 2010 at 8.2% of GDP.

Graph II.24.2: Slovakia - Public finances



The newly elected government, which took office in July 2010, set the deficit reduction as one of its major targets and announced a set of discretionary measures amounting to 2.5% of GDP in 2011. The 2011 draft budget adopted by the government assumes an adjustment effort somewhat more on

the expenditure side, through measures aimed at reducing the public wage bill, expenditures in goods and services and at increasing the efficiency of the health sector and capital expenditures. The measures on the revenue side include hiking VAT by 1 pp. to 20%, increases in excise taxes (i.e. beer, tobacco, etc.), broadening of bases for personal income tax and social contributions and extra non-tax revenues such as receipts from sale of emission allowance quotas and special fees of electricity distributors. Implementation of these measures is expected to lead to a significant reduction in the general government deficit to 5.3% of GDP in 2011. As so far no specific measures have been announced for 2012, the deficit is projected to reach around 5% of GDP under the no-policy-change assumption.

While the general government debt is projected to

remain at relatively low levels (42%, 45% and 47% of GDP in 2010, 2011 and 2012 respectively) the speed of the increase is non-negligible. A projected increase in the debt-to-GDP ratio of almost 20 pps. in 2008-12 would be close to the reduction achieved in 2000-08. Unsuccessful consolidation could signify a further increase in public debt.

In order to improve the budgeting process, the current government intends to introduce a number of changes to the existing fiscal framework. If thoroughly implemented, these measures (which could notably include binding expenditure ceilings and better specification of rules for budgeting of local governments and its monitoring) could significantly improve the quality of the budgetary framework and increase the credibility of government's budgetary plans.

Table II.24.1:

Main features of country forecast - SLOVAKIA

	2009			Annual percentage change							
	bn EUR	Curr. prices		% GDP	92-05	2007	2008	2009	2010	2011	2012
GDP		63.1	100.0	-		10.5	5.8	-4.8	4.1	3.0	3.9
Private consumption		38.4	60.9	-		6.8	6.2	0.3	-0.5	1.5	3.1
Public consumption		12.6	20.0	-		0.1	6.1	5.6	0.7	-4.5	0.5
Gross fixed capital formation		13.0	20.6	-		9.1	1.0	-19.9	1.7	5.1	6.4
of which : equipment		4.9	7.8	-		4.3	1.7	-27.8	1.9	6.7	7.2
Exports (goods and services)		44.5	70.6	-		14.3	3.1	-15.9	14.7	7.9	8.0
Imports (goods and services)		44.8	71.0	-		9.2	3.1	-18.6	13.7	6.6	7.2
GNI (GDP deflator)		62.1	98.4	-		11.1	6.1	-3.2	4.4	2.5	3.5
Contribution to GDP growth :		Domestic demand		-		6.3	4.8	-3.8	0.2	1.0	3.2
		Inventories		-		0.3	1.1	-3.6	3.3	0.9	0.0
		Net exports		-		3.9	0.0	2.6	0.7	1.0	0.7
Employment				-		2.1	2.8	-2.4	-2.8	0.3	0.8
Unemployment rate (a)				-		11.1	9.5	12.0	14.5	14.2	13.4
Compensation of employees/head				-		8.4	7.1	4.8	3.2	3.7	4.5
Unit labour costs whole economy				-		0.2	4.0	7.5	-3.7	1.0	1.4
Real unit labour costs				-		-1.0	1.1	8.7	-4.1	-1.7	-1.1
Savings rate of households (b)				-		-	-	-	-	-	-
GDP deflator				-		1.1	2.9	-1.2	0.5	2.8	2.5
Harmonised index of consumer prices				-		1.9	3.9	0.9	0.7	3.2	2.8
Terms of trade of goods				-		-1.1	-1.9	-0.6	-0.7	0.3	0.0
Trade balance (c)				-		-1.8	-1.6	1.5	1.7	2.9	3.5
Current account balance (c)				-		-5.1	-6.9	-3.4	-2.9	-1.9	-1.7
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-		-4.7	-5.9	-2.9	-1.7	-0.1	0.1
General government balance (c)				-		-1.8	-2.1	-7.9	-8.2	-5.3	-5.0
Cyclically-adjusted budget balance (c)				-		-3.5	-4.0	-7.3	-7.9	-5.0	-5.1
Structural budget balance (c)				-		-3.5	-4.2	-7.5	-7.9	-5.0	-5.1
General government gross debt (c)				-		29.6	27.8	35.4	42.1	45.1	47.4

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

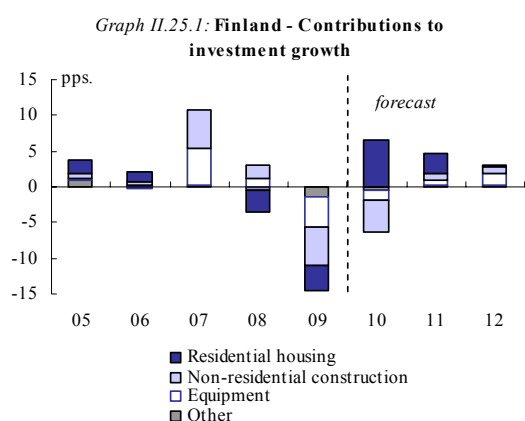
25. FINLAND

Strong domestic demand boosting recovery

Recovery gathering strength in 2010

While GDP declined in 2009 by 8%, led by the collapse of foreign demand, the economy has generally preserved its solid fundamentals. The global crisis had a relatively small negative effect on the health of the Finnish financial sector, the labour market proved resilient and consumer confidence recovered rapidly to levels even exceeding the pre-crisis peak. The sizeable fiscal stimulus of over 3% of GDP extending over 2009 and 2010 also boosted economic activity.

GDP growth remained subdued in the first quarter of 2010 and was also affected by an exceptionally cold winter and a strike closing major Finnish seaports for several weeks. In contrast, GDP grew rapidly in the second quarter of the year on the back of a recovery in foreign trade and robust domestic demand. The economic crisis only had a temporary disruptive effect on the real-estate market. Real-estate prices have already recovered to above pre-crisis levels and housing construction is booming after a temporary drop during the crisis. Compared with last year, investment in housing shot up by about a third in the second quarter of 2010, having returned to the high levels of construction activity seen prior to the global crisis. Since the other main investment categories were still contracting in the second quarter, the overall slight growth in investment was solely driven by housing.



The labour market has remained resilient in the face of longer-term effects from population ageing

The crisis has had a more limited impact on the labour market than was initially expected based on past experiences. Annual average unemployment is forecast to peak at 8½% of the labour force in 2010, which is a 2 percentage point increase from the low-point in 2008. During the crisis in 2009, temporary lay-offs and various schemes to reduce working time were widely used, amounting to about 2% of the labour force, which limited the increase in unemployment. In 2010, reduced working time arrangements have been largely reversed, with the majority of the affected employees having moved back to full time employment. During the economic crisis, the activity rate of the labour force also declined notably, as people increasingly opted for studies or domestic work, when labour market conditions deteriorated.

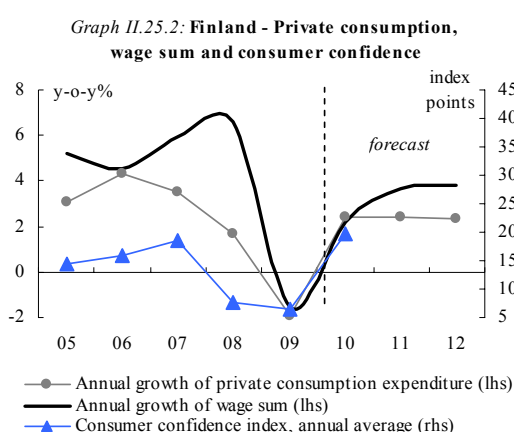
Finland will be one of the first Member States to be affected by population ageing. Reflecting the retirement of a large baby-boom generation, the working age population is projected to decline by about 140,000 people in 2010-2020, representing over 5% of the current labour force. Beyond 2020, this demographic shift will level off. The impact on the labour market will already become evident over the current forecast period. Labour shortages and wage pressures will probably increase in some sectors, even though unemployment would remain relatively high due to existing labour market mismatches.

Strong recovery going forward, led by domestic demand and exceptional growth in housing investment

Given that the economy has already gained momentum over the course of 2010, and forward looking indicators show strong consumer and business confidence coupled with solid macroeconomic fundamentals, economic growth is expected to exceed the EU average over the forecast period. The difference with the EU average is forecast to narrow in 2012, as GDP growth in Finland moderates to rates closer to potential, which is suppressed by the adverse demographic trends.

Past economic crisis episodes in Finland have been followed by an export-led recovery. In contrast, the current recovery process will be more balanced, with domestic demand growing fast as well. While foreign trade has also rebounded in 2010 from the exceptionally sharp drop in 2009 (when export volumes declined by about 20%), the contribution to growth from foreign trade is forecast to be broadly neutral over 2011-12, as buoyant domestic demand also drives rapid growth in imports. Apart from the global economic cycle, the main Finnish export industries (metal engineering, electronics, and forestry products) are affected by longer term global production shifts. The traditionally high share of industry in the Finnish economy and in employment has already been declining over the past decade, while that of services has increased. While the globalisation trends imply a shift in goods production to cheaper locations, it is compensated for by higher value-added jobs remaining in Finland (headquarters, R&D, sales) which is recorded in foreign trade as services exports. The current account is forecast to maintain a surplus position of about 1½% of GDP in 2010-12.

During the acute phase of the economic crisis, consumers' purchasing power was strongly supported by tax cuts and by relatively generous wage increases settled by previous centralised wage agreements. Nevertheless, the aggregate wage sum, which accounts for the contraction in employment and hours worked, shrank in 2009, although it has already rebounded during 2010.



Additionally, given that over 90% of Finnish mortgage loans are linked to variable interest rates, indebted households are currently benefitting fully from the exceptionally low interest rate environment. The apparently strong financial position of households, coupled with a healthy

banking sector and some regional housing shortages, is driving the real-estate market towards a new peak, both in terms of price levels and housing supply. Household indebtedness has already risen to a historically high level of over 100% of annual disposable income. Nevertheless, it is still around the average for euro-area countries. The relatively high household indebtedness level, coupled with variable interest rates and the currently booming real-estate market, implies a vulnerability going forward if the base interest rates were to rise substantially.

The main risk factor for Finland's economic prospects is the global economic- and trade outlook. The Finnish economy has traditionally been highly dependent on the strength of external demand. Adverse developments in the exporting industries would also have a significant and immediate impact on the domestic sectors, notably by affecting consumer and corporate confidence.

Moderate wage growth and inflation

Wage increases, largely negotiated at sector level, are set to remain moderate in response to the economic crisis. Nevertheless, the growth of unit labour costs is projected to turn positive in 2011, with wage growth forecast to somewhat exceed labour productivity growth in 2011-12.

Consumer price inflation is forecast to pick up slightly from 1½% in 2010. In 2011, the increase in energy tax is projected to add somewhat less than ½ pp. to headline inflation, affecting prices in several product categories. Changes in excise duties on several food categories are expected to have a more limited effect in 2011. HICP inflation is forecast to remain slightly above the euro-area average in both 2011 and 2012.

Public finances set to improve on the back of the recovery and a moderate fiscal consolidation in 2011 and 2012

General government net lending relative to GDP deteriorated substantially – by over 6½ pps. – in 2009, turning a surplus of 4.2% of GDP in 2008 into a deficit of 2.5% of GDP in 2009. This deterioration reflected the operation of automatic stabilisers and the relatively large fiscal stimulus. Since a substantial fiscal stimulus of about 1% of GDP was given in 2010, the deficit is set to widen further, to 3.1% of GDP. Fiscal policy is set to turn restrictive from 2011 onwards, as the government

has decided to raise energy and some product taxes, which amount to some 0.5% of GDP in 2011 and 0.1% of GDP in 2012. Additionally, the government, in cooperation with social partners, has already decided on changes to pension, health, and unemployment insurance contribution rates, improving the general government balance by 0.1% of GDP in 2011 and 0.4% in 2012.

Expenditure growth is also expected to moderate as some of the investment projects coming from the earlier stimulus package run out and local governments (accounting for a third of general government expenditure) are likely to react to financing constraints by making savings in their budgets. Both the central and local governments

are continuing to implement long term programmes to boost public sector productivity, which should also yield some savings in personnel costs. Even though the general government debt level is currently increasing relatively quickly, debt servicing costs are being countered by exceptionally low effective interest rates on Finnish sovereign debt. The forecast assumes a normalisation of interest costs in 2012 towards the long term average, adding to expenditure growth. Overall, the deficit is forecast to narrow to 1.6% of GDP in 2011 and further to 1.2% of GDP in 2012. Driven largely by central government borrowing, the general government debt ratio is forecast to increase from about 43.9% of GDP in 2009 to 53.0% by 2012.

Table II.25.1:

Main features of country forecast - FINLAND

	2009			92-05	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	171.3		100.0	3.0	5.3	0.9	-8.0	2.9	2.9	2.3
Private consumption	94.0		54.9	2.5	3.5	1.7	-1.9	2.4	2.4	2.3
Public consumption	43.0		25.1	1.0	1.1	2.4	1.2	0.4	0.6	0.7
Gross fixed capital formation	33.4		19.5	2.2	10.7	-0.4	-14.7	0.4	4.8	3.0
of which : equipment	8.8		5.1	1.9	17.9	3.9	-14.2	-4.9	2.6	5.2
Exports (goods and services)	64.0		37.4	9.0	8.2	6.3	-20.3	6.5	6.1	4.8
Imports (goods and services)	59.8		34.9	7.0	7.0	6.5	-18.1	5.1	5.8	4.8
GNI (GDP deflator)	171.4		100.0	3.3	4.4	1.4	-8.5	2.9	2.8	2.2
Contribution to GDP growth :										
Domestic demand				1.9	4.2	1.3	-3.9	1.5	2.4	2.0
Inventories				0.3	0.3	-0.7	-1.8	0.7	0.2	0.1
Net exports				1.0	0.9	0.3	-1.7	0.7	0.2	0.1
Employment				0.3	2.2	1.6	-2.8	-0.1	0.9	0.9
Unemployment rate (a)				11.4	6.9	6.4	8.2	8.3	7.8	7.2
Compensation of employees/head				2.9	3.7	5.1	1.9	2.4	2.7	2.8
Unit labour costs whole economy				0.2	0.5	5.8	7.7	-0.6	0.7	1.5
Real unit labour costs				-1.3	-2.4	3.9	6.8	-1.8	-1.8	-0.6
Savings rate of households (b)				-	-	7.9	11.5	11.3	10.0	9.4
GDP deflator				1.5	3.0	1.8	0.9	1.3	2.6	2.1
Harmonised index of consumer prices				1.6	1.6	3.9	1.6	1.6	2.1	1.8
Terms of trade of goods				-0.8	0.0	-3.3	-0.2	-2.3	0.3	-0.5
Trade balance (c)				7.9	5.1	3.7	2.1	2.4	2.3	2.2
Current account balance (c)				4.2	4.2	3.5	1.3	1.3	1.6	1.4
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				4.1	4.3	3.6	1.3	1.4	1.7	1.5
General government balance (c)				0.0	5.2	4.2	-2.5	-3.1	-1.6	-1.2
Cyclically-adjusted budget balance (c)				0.0	2.4	2.4	0.6	-0.6	0.4	0.6
Structural budget balance (c)				-	2.4	2.4	0.6	-0.5	0.4	0.6
General government gross debt (c)				47.5	35.2	34.1	43.8	49.0	51.1	53.0

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Note : Contributions to GDP growth may not add up due to statistical discrepancies.

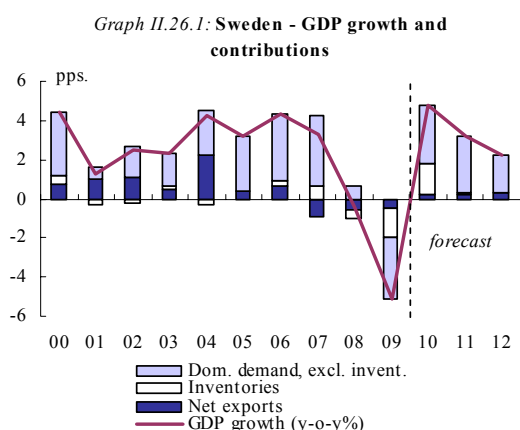
26. SWEDEN

Broad-based recovery helps to bring public finances back to surplus

The economy bounces back after recession

After a period of anaemic growth following the sharp recession of 2008-09, the recovery of the Swedish economy accelerated in the first half of 2010. Real GDP growth reached 1.9% (q-o-q s.a.) in the second quarter after 1.5% in the first quarter. While a significant part of the acceleration was due to the turning of the inventory cycle, all domestic demand components contributed to GDP growth. Notably, investment activity recovered much earlier and stronger than previously foreseen, despite remaining spare capacity in industry.

Indicators for the third quarter point to continued strong momentum in the second half of 2010. Industrial production and new orders strengthened during the third quarter and business and consumer surveys indicate high levels of optimism in all sectors, in particular services. Following already strong figures for August, retail sales surged ahead in September at an annual real rate of 5.5%. In particular, consumer durables sales increased at an annual rate of 9.5% in September, a pace not seen since 2007. Consumer optimism is underpinned by a decisive turnaround in the labour market and continued increases in equity and house prices. On current trends, real GDP growth for 2010 as a whole looks set to reach 4³/₄%.



Recovery to continue at a slowing pace

The recovery is expected to continue in 2011-12, but at a slower pace. The improving labour market outlook should support household consumption. Investment should continue to expand, as spare capacity is gradually absorbed and also helped by

continued optimism in the construction sector. Stronger investment is also supported by a significant improvement in corporate profitability, which is explained by a stabilisation of financial markets, the recovery of productivity and continued wage restraint.

At the same time, several headwinds are likely to be felt over the forecast period, notably a continued normalisation of the monetary policy stance, less support from fiscal policy, and slower exports growth, with the strengthening of the Swedish krona likely to exert a certain drag in the near future. Since its trough in early 2009, the Swedish currency has gained around 20% on a trade-weighted basis. Overall, net exports are likely to contribute only marginally to real GDP growth over the forecast period. Also taking into account a more neutral contribution from inventories, annual real GDP growth is forecast to reach 3¹/₄% and 2¹/₄% in 2011 and 2012, respectively.

Risks to growth appear broadly balanced

It cannot be excluded that private consumption in Sweden will grow faster than foreseen, given the current upsurge in consumer confidence. While the household saving rate has come down from its peak of 2009, it is still at a high level relative to the pre-crisis period. The wealth effect from rising house and stock prices could prove stronger, in particular since survey data indicate that households foresee house prices continuing to rise over the coming year. Moreover, with public finances under control, consumers may expect further fiscal stimulus increasing their disposable income. On the other hand, as was evident in the recent recession, Sweden's strong export dependence makes it vulnerable to any set-back in global trade. With uncertainty about prospects in some important trading partners' economies, Swedish exports could expand at a slower pace than predicted.

There is also some uncertainty with regard to the size of the output gap and, related to that, the likely pace of monetary policy tightening. On the one hand, reforms undertaken by the government aimed at making work pay should have stimulated increased labour force participation. On the other hand, the recession led to a sharp increase in

unemployment, which has only been partly reversed. It is therefore possible that there will be persistent negative effects on labour supply as a result of the recession. Uncertainty regarding the magnitude of these factors makes it more difficult than usual to assess how fast the economy can grow without stoking inflation.

The strong recent dynamics of household debt and house prices represents a further source of uncertainty in the near future. So far, low interest rates and a benign outlook for the labour market have underpinned strong demand for housing, which has translated into rising house prices (by around 10% over the last year). With household indebtedness exceeding 160% of disposable income and continuing to rise, households have probably become more sensitive to changes in interest rates, in particular since most mortgages are at variable interest rates. A continuation of current price and mortgage debt trends for an extended period would increase the risk of an abrupt correction.

Inflation likely to remain below target

While core inflation remained high throughout the recession, as productivity continued to decline and a weakening Swedish currency fed through to higher import prices, ample spare capacity and a strengthening krona have since had a dampening effect. The short-term outlook is one of continued subdued inflation. The wage bargaining round covering a large majority of Swedish wage earners, which was conducted earlier in 2010 (before the turnaround in the labour market had taken hold), yielded modest nominal wage increases. This should help to keep unit labour costs under control over the forecast horizon. However, the wage agreements signed covered a somewhat shorter period than the usual three years, with many contracts expiring already in early 2012. If the labour market continues to improve as forecast, the next round of wage negotiations will take place in tighter labour market conditions. This could lead to some upward wage pressure towards the end of the forecast period. Overall, annual HICP inflation is expected to remain below the 2% target level throughout the forecast period, but should gradually rise from 1.4% in 2011 to 1.9% in 2012.

Current-account surplus to remain large

While the current-account surplus is forecast to narrow somewhat over the forecast horizon,

decreasing from 7.3% of GDP in 2009 to 6.1% of GDP in 2012, the forecast implies that the long series of uninterrupted large current-account surpluses recorded since the mid-1990s looks set to continue in the near future. Over the last decade, all sectors have contributed to the surplus. The public sector's 1% surplus target over the cycle is expected to remain in place for at least the coming ten years. The household sector's savings rate is forecast to come down from its peak in 2009, but to remain in surplus over the forecast period, as is the corporate sector's surplus.

Flexibility of labour market put to the test

As a result of the recession, the situation in the Swedish labour market deteriorated significantly, with unemployment rising from an average level of 6.2% in 2008 to above 9% in early 2010. The manufacturing sector bore the brunt of labour-shedding, whereas the public sector and the private service sector fared much better. With the strong recovery in GDP growth in the first half of 2010, employment has started to grow again and seasonally adjusted unemployment has fallen to 8.2% in September 2010. The relatively large improvement in employment at this early stage of the recovery is somewhat surprising given the degree of labour hoarding during the crisis. It contrasts with past experience of "job-less growth" in the aftermath of the previous recession earlier in the decade. Companies' hiring plans as expressed in business surveys also bode well for continued employment growth in the near term. As the recovery continues, unemployment is projected to fall further to 8.0% and 7.5% in 2011 and 2012, respectively.

A key challenge is to prevent bottlenecks from arising in some sectors while unemployment remains high in other sectors. According to a recent business survey, a large number of companies in the construction sector are already having difficulties finding staff with the required qualifications. At the same time, some segments of the population, such as immigrants and people with poor education, are finding it difficult to gain a foothold in the labour market. Preventing structural unemployment from rising depends crucially on the flexibility of the labour market and on how well the skills of job-seekers match the requirements of employers.

Fiscal balance back in surplus in 2012

Due to a combination of cyclical effects and discretionary fiscal measures, public finances swung from a surplus of 3.6% of GDP in 2007 to a deficit of around 1% of GDP in 2009 and 2010. Stronger GDP growth together with the clear improvement in the labour market situation should contribute to bringing public finances almost back to balance by 2011, in spite of additional stimulus measures of about 0.4% of GDP announced in October as part of the 2011 Budget Bill. The announced measures consist mostly of lower taxes for pensioners and additional resources for local governments. With unemployment still high, the deficit relatively contained and a strong recovery underway, it is possible that further measures may be considered in the Spring Budget Bill, although the government has stated that it is aiming to

return to surpluses as fast as possible. As the recovery continues into 2012, the fiscal balance is expected to further improve and show a surplus of 1% of GDP that year.

The return of deficits, combined with negative or slow nominal GDP growth, halted the previous trend towards a lower government debt ratio, with the debt ratio rising from 38% in 2008 to 42% in 2009. With the economic recovery and the improvement in the government balances, gross debt should resume its downward path over the forecast period. This development is expected to be further supported by a resumption of the government's privatisation programme, with proceeds from this expected to reach about 0.8% of GDP per year as of 2011. The gross public debt ratio is forecast to fall to around 37½% in 2012.

Table II.26.1:

Main features of country forecast - SWEDEN

	2009			92-05	Annual percentage change					
	bn SEK	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	3108.0	100.0		2.7	3.3	-0.4	-5.1	4.8	3.3	2.3
Private consumption	1515.9	48.8		1.9	3.7	-0.1	-0.8	3.4	2.7	2.0
Public consumption	863.7	27.8		0.7	0.7	1.3	1.7	1.0	0.9	0.5
Gross fixed capital formation	555.5	17.9		2.7	8.9	1.7	-16.0	5.9	8.1	4.7
of which : equipment	206.9	6.7		5.4	12.9	5.9	-27.5	5.0	10.0	5.8
Exports (goods and services)	1507.5	48.5		7.5	5.7	1.4	-12.4	10.8	6.9	5.9
Imports (goods and services)	1294.0	41.6		5.7	9.0	2.9	-13.2	12.1	7.7	6.1
GNI (GDP deflator)	3161.3	101.7		3.0	4.3	0.7	-6.5	4.3	3.4	2.3
Contribution to GDP growth :										
Domestic demand				1.6	3.6	0.6	-3.1	3.0	3.0	2.0
Inventories				0.1	0.7	-0.5	-1.5	1.6	0.1	0.0
Net exports				1.0	-1.0	-0.5	-0.5	0.2	0.2	0.3
Employment				-0.1	2.5	0.9	-2.0	1.0	0.9	0.8
Unemployment rate (a)				7.6	6.1	6.2	8.3	8.3	8.0	7.5
Compensation of employees/head				4.0	5.0	1.3	1.3	2.3	2.6	3.0
Unit labour costs whole economy				1.2	4.1	2.6	4.7	-1.4	0.2	1.6
Real unit labour costs				-0.5	1.4	-0.6	2.7	-3.4	-1.7	0.0
Savings rate of households (b)				-	-	14.0	15.6	13.7	12.4	11.2
GDP deflator				1.6	2.8	3.2	2.0	2.1	1.9	1.5
Harmonised index of consumer prices				1.8	1.7	3.3	1.9	1.8	1.4	1.9
Terms of trade of goods				-1.1	1.7	-1.2	1.9	0.0	0.0	-1.0
Trade balance (c)				6.2	4.6	3.8	3.5	3.5	3.3	3.0
Current account balance (c)				4.2	8.6	8.9	7.3	6.6	6.5	6.1
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				3.9	8.5	8.7	7.2	6.5	6.4	6.0
General government balance (c)				-2.0	3.6	2.2	-0.9	-0.9	-0.1	1.0
Cyclically-adjusted budget balance (c)				-1.4	1.1	1.2	2.0	0.2	0.2	1.0
Structural budget balance (c)				-	1.1	0.9	2.0	0.2	0.2	1.0
General government gross debt (c)				60.7	40.0	38.2	41.9	39.9	38.9	37.5

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

27. THE UNITED KINGDOM

External demand and private investment to support recovery

Recovery gaining momentum but into continuing headwinds

The UK recovery started late and slowly relative to most peers but has quickened considerably in 2010 with growth in the second and third quarter well above trend. However, although a return to recession seems improbable, the impact of fiscal consolidation, coupled with a fading of temporary factors which have contributed strongly in 2010, make it unlikely that growth will remain this high for very long.

A few questions will act as central determinants of the UK's progress towards recovery. A first is the impact of the required cuts in public spending, particularly whether the positive effects of strengthened confidence in the soundness of public finances and lower interest rates dominate the negative shock to aggregate demand. A second, closely connected, is the ability of monetary policy to support demand and offset the fiscal squeeze. A third is the exchange-rate-driven rebound in net exports which, although seeming for some time to be just around the corner, has not yet materialised. A fourth is private sector investment. An eventual investment rebound seems inevitable given the huge drop in 2009, strengthening corporate balance sheets and improving credit availability, but timing remains uncertain. A fifth uncertainty, perhaps the largest, is the size of the output gap and hence the potential for a sustained growth spurt as spare capacity is taken up. While traditional measures suggest a large amount of spare capacity, persistent inflation and survey evidence of high capacity utilisation at the firm level point the other way. On balance, evidence favours a positive conclusion on these dilemmas, especially now the big political decisions on budgetary consolidation have been taken, but the uncertainty around each is indicative of the size of the upside and downside risks to UK performance.

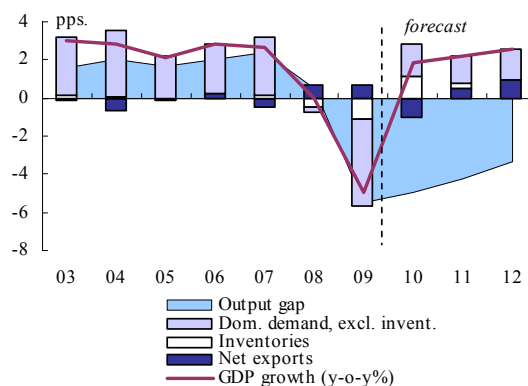
GDP figures a nice surprise

The UK recovery began slowly but steadily in the last quarter of 2009 with two quarters of 0.4% growth, slightly below the long-term trend. This gave way to a surprise 1.2% spurt in the second quarter of 2010, with further unexpected strength in the following quarter yielding 0.8% growth. The third-quarter output was 2.8% higher than the

previous year, the first above-trend year-on-year growth of the recovery. Although recent figures have been distorted by activity delayed by poor weather in the first quarter, underlying growth appears strong.

Quarterly growth is forecast to slow in 2011 as various headwinds remain. A reduced contribution from stock building, falling government expenditure and the impact of the January 2011 VAT rise are likely to hold back demand. On the production side, a slowing of the rapid expansion in construction, which has accounted for a third of growth so far this year, looks imminent. However, a gradual re-employment of spare capacity focused on an improvement in net exports will support GDP throughout the forecast period, leading to a marginal acceleration in 2012. Overall, GDP growth of around 1.8% is expected for 2010, followed by 2.2% in 2011 and 2.5% in 2012.

Graph II.27.1: The United Kingdom - Output gap and contributions to GDP growth



Domestic demand will grow slowly in 2011 and 2012, with modest consumption growth and rebounding private sector investment offsetting falling government spending. In the external sector, after subtracting around 1pp from growth in 2010, net exports will contribute positively in 2011-12. Export growth will accelerate as sterling's relative stability since the 2008 depreciation increases confidence among exporters that the currency's weakness will persist. This will encourage incumbents to build market share and new entrants to join the fray. Import growth will be moderated by substitution away from imported goods and weak consumption growth, although the high import content of some exported goods will

be an upward influence. The second-quarter figures suggest that the turning of the inventories cycle has been faster than expected, implying that some of 2010's growth was brought forward from 2011 and 2012. Stock building will therefore make a small contribution to growth in 2011 and none in 2012.

The outlook for private consumption remains muted. The fact that recent weakness in disposable income growth has shown through more in lower household savings than in falling consumption implies that households are prioritising consumption over the paying down of debt and building of precautionary saving which appear necessary in the long run. Consumption growth is thus unlikely to be pulled into negative territory by a flight to prudence by households. Equally, any future strength in disposable incomes will not be fully reflected in consumption as consumers backfill deferred savings. Consumption growth should therefore remain steady but fairly weak. There will be some uplift to consumption in the fourth quarter of 2010 from consumers anticipating purchases to beat the VAT rise. However, given that the largest impact of this effect tends to be increased purchases of household durables and cars, the effect is likely to be smaller this time around with many households already having made these infrequent purchases in anticipation of the January 2010 VAT increase.

Corporate investment has begun to recover after 2009's collapse. Given that UK investment was low by international standards even before the recession, an eventual rebound at least to pre-recession levels seems inevitable. There are positive signs, including improving credit conditions, the growing corporate cash pile and the expected shift towards tradeables which should require new investment. Capacity tells a more ambiguous story. Production function output gap measures show significant spare capacity, implying much slack to be taken up before new investment becomes necessary. However, firm-level surveys of capacity utilisation show a much tighter picture. If this discrepancy is explained by firm closures during the recession, a positive shock to investment appears more likely as markets re-expand. However, high unemployment and low wage growth imply a continued incentive for a labour-heavy factor mix in new output. While the arguments are finely balanced, private sector investment growth looks

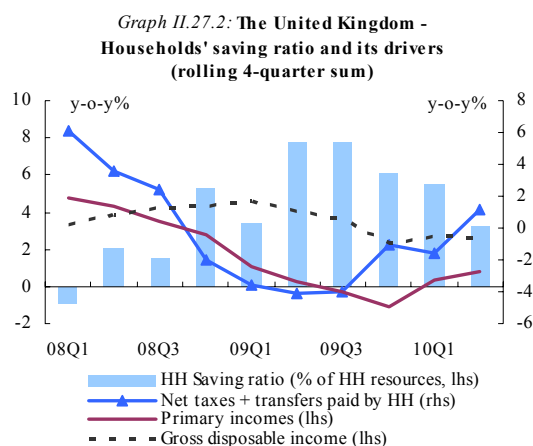
set to accelerate rapidly enough to offset big cuts on the government side.

Private sector job creation partially offsetting public sector cuts

Unemployment in the UK has stayed relatively stable with the ILO rate at 7.7% in June to August 2010. A feature of this rate is however the rise in part-time employment. There were 350,000 more part-time workers in June to August 2010 than in the same period in 2009, with an increase of 150,000 in the numbers saying they worked part-time because they could not find full-time work. The claimant count fell steadily from January 2010 before stabilising since June; it currently stands at just under 1.5 million. Inactivity increased from the previous year but has fallen in the intervening months to 23.3% of the working age population. With planned public sector job cuts of around half a million over the next four years, private sector job creation may not be sufficient to drive large falls in unemployment. Migration adds additional uncertainty, with insufficient statistical evidence to draw firm conclusions on whether a large number of migrant workers have returned home. Although better employment performance could ordinarily be expected given strengthening GDP, employment growth is likely to lag the overall recovery. Rapid falls in labour productivity during the recession are more likely to be explained by under-utilisation of employed labour than by real productivity losses, implying potential for catch-up without much employment growth. A reversal of forced shifts into part-time employment may act in the same direction.

Households' finances to be tighter

In 2009 household income was supported by higher benefits and lower taxes. However, this is likely to suffer a squeeze as VAT rises and public spending and welfare cuts loom. Pay growth between the third quarter of 2009 and the same period in 2010 was 2%. With a freeze in public sector pay and increasing competition for vacancies from public sector job cuts, pay will stay weak. Contrary to previous UK recessions, the savings rate will dip in the short-term as weak disposable income forces consumers to prioritise consumption.



Easy monetary stance, weak credit growth

The Bank of England has maintained extremely loose monetary policy with the main policy rate at 0.5% and GBP 200 bn (14% of GDP) of quantitative easing. Growth in lending to non-financial corporations has remained negative. Weak corporate lending had previously been linked to reduced bank willingness to lend. However indicators, not least the corporate sector's growing cash pile, suggest weak credit demand may be the most significant factor, with the large corporations which conduct the bulk of UK fixed investment having the option of bypassing banks by issuing corporate bonds. Credit availability no longer appears a central constraint on the recovery.

Inflation: long awaited falls from spare capacity by 2012

Inflation has consistently surprised on the upside, remaining above the 3% top end of the Bank of England's target range. The 2011 VAT increase will prevent significant falls during 2011, although weak consumption should ensure less than total pass through. As high inflation persists, the assumption that it is driven by temporary factors becomes harder to maintain. However, there are good reasons to believe it will fall substantially in 2012 once the 2011 VAT rise has passed through the annual comparison. Spare capacity is the main one, particularly if temporary restraints on capacity utilisation imposed by higher working capital costs begin to lift. Second, input cost pressures, from sterling's depreciation and commodity prices, look likely, based on previous lag structures, to moderate significantly in 2011. Unemployment should also restrain unit labour costs keeping inflation around 2¾% in 2011 and 1½% in 2012.

Ambitious expenditure-led consolidation plans

Following the large deterioration in the budgetary position in 2009/10⁽⁸²⁾, in 2010/11 the government launched an ambitious plan to put the public finances back on a sustainable path. The deficit is expected to fall from 11.5% of GDP in 2009/10 to around 6.0% of GDP by 2012/13, with the adjustment frontloaded. The structural deficit should fall by an annual average of around 1½% of GDP during the forecast period. The consolidation is driven by unprecedented restraint in discretionary expenditure. These plans, which the forecast assumes will be adhered to, are backed by departmental spending limits for 2011/12 to 2014/15. More details are expected shortly with the publication of departmental business plans.

The deficit in 2010/11 is projected at 9.9% of GDP, around ¼ pp. lower than forecast in the June 2010 Budget, primarily due to stronger-than-expected growth in 2010. In 2010/11, the primary deficit is expected to fall by 2½% of GDP, though the reduction in the total deficit – at 1½% of GDP – will be smaller because of higher debt servicing costs. The reduction in the deficit in 2010/11 is driven by a nominal revenue increase of 6½%, almost a third of which is due to the increase in VAT in January 2010 to its pre-stimulus level and the further increase from January 2011 from 17½% to 20%. Expenditure growth is projected to decelerate to around 3½%, in part reflecting a deceleration in cyclical expenditure. Front-loading of capital expenditure to 2008 and 2009 should also contribute to lower investment spending in 2010/11 by almost 1.0% of GDP. Moreover, the cuts in discretionary expenditure that were announced after the March Budget should reduce the deficit in 2010/11 by 0.4% of GDP. Overall, the discretionary measures in 2010/11, including the reversal of stimulus measures, will reduce the deficit by around 1½% of GDP.

Table II.27.1:
General government projections on a financial year basis

	2008/09	2009/10	2010/11	2011/12	2012/13
	Actual		Forecast		
General government balance ¹	-6.9	-11.5	-9.9	-7.9	-6.0
Structural budget balance	-5.8	-9.0	-7.9	-6.2	-4.7
General government gross debt	55.9	71.3	79.0	84.0	86.4

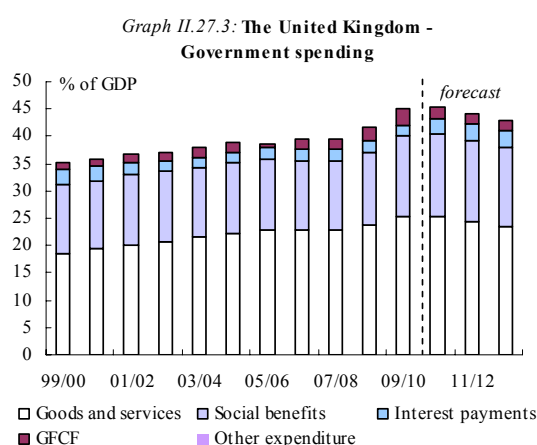
¹ Data adjusted for the consistent recording of UMTS licence proceeds.

In 2011/12 and 2012/13, the deficit is forecast to drop by around 2 pps. of GDP each year. Discretionary tightening is expected to reduce the deficit by around 2¼ pps. of GDP in 2011/12 and

(82) The UK financial year runs from April to March.

1½ pps. of GDP in 2011/12. The effect of the improvement in cyclical conditions on the deficit is expected to be partly muted by the economic rebalancing from private consumption to export activity, which should depress the elasticity of government revenue to GDP growth. More than three-fifths of the discretionary fiscal tightening in 2011/12 and 2012/13 is planned to come through a reduction in expenditure, including a cut in departmental budgets – excluding those for health and overseas aid – of 19% in real terms on average over a four-year period, a two-year public sector pay freeze, and a reduction in welfare benefits.

The VAT increase in January 2011 will boost revenues by around 0.8% of GDP in 2011/12. Higher social security contribution rates and a new bank levy will each increase tax intakes in 2011/12 by 0.2% of GDP, but these will be partly offset by an increase in personal income tax allowances. Reductions in corporation tax are also expected to reduce receipts by 0.2% of GDP from 2012/13.



The UK's debt ratio at end-2010/11 is projected at 79% of GDP, up by around 7¾ pps. on account of the high primary deficit. In 2012/13, the debt ratio of 84% of GDP is set to overtake the EU average.

Table II.27.2:

Main features of country forecast - THE UNITED KINGDOM

	2009			92-05	Annual percentage change					
	bn GBP	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	1392.6		100.0	2.8	2.7	-0.1	-5.0	1.8	2.2	2.5
Private consumption	908.5		65.2	3.1	2.2	0.4	-3.3	1.1	1.6	1.6
Public consumption	327.4		23.5	1.7	1.3	1.6	1.0	2.3	-0.8	-2.0
Gross fixed capital formation	204.3		14.7	3.9	7.8	-5.0	-15.1	2.8	3.5	6.5
of which : equipment	68.5		4.9	5.0	12.3	-5.2	-22.1	4.6	5.7	8.9
Exports (goods and services)	386.2		27.7	6.0	-2.6	1.0	-11.1	5.5	8.3	8.9
Imports (goods and services)	419.3		30.1	6.8	-0.8	-1.2	-12.3	8.6	5.7	5.2
GNI (GDP deflator)	1422.8		102.2	3.0	3.5	0.4	-4.7	1.9	2.5	2.6
Contribution to GDP growth :										
Domestic demand				3.0	3.0	-0.3	-4.5	1.7	1.4	1.6
Inventories				0.1	0.1	-0.4	-1.1	1.1	0.3	0.0
Net exports				-0.3	-0.5	0.6	0.7	-1.0	0.5	0.9
Employment				0.7	0.7	0.7	-1.6	-0.1	0.4	0.5
Unemployment rate (a)				6.7	5.3	5.6	7.6	7.8	7.9	7.8
Compensation of employees/head				4.2	5.0	1.5	2.1	2.7	2.8	4.0
Unit labour costs whole economy				2.1	3.0	2.3	5.8	0.8	1.0	2.0
Real unit labour costs				-0.4	0.0	-0.7	4.3	-1.8	-1.1	0.5
Savings rate of households (b)				-	-	2.0	6.3	4.5	3.7	4.0
GDP deflator				2.6	3.0	3.0	1.4	2.7	2.0	1.5
Harmonised index of consumer prices				1.9	2.3	3.6	2.2	3.2	2.6	1.4
Terms of trade of goods				0.1	1.3	-0.5	0.3	-0.1	-1.2	0.2
Trade balance (c)				-3.2	-6.4	-6.4	-5.9	-6.4	-6.3	-5.8
Current account balance (c)				-1.7	-2.6	-1.6	-1.3	-2.2	-1.5	-0.2
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-1.6	-2.4	-1.4	-1.0	-2.0	-1.3	0.0
General government balance (c)				-2.8	-2.7	-5.0	-11.4	-10.5	-8.6	-6.4
Cyclically-adjusted budget balance (c)				-3.1	-3.7	-5.2	-9.0	-8.3	-6.9	-5.1
Structural budget balance (c)				-	-3.7	-4.7	-8.7	-8.3	-6.9	-5.1
General government gross debt (c)				43.7	44.5	52.1	68.2	77.8	83.5	86.6

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Candidate Countries

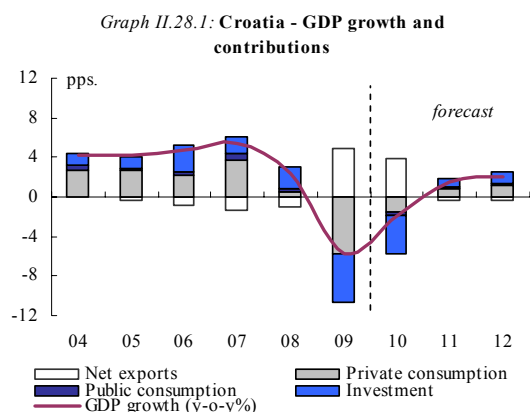
28. CROATIA

Recovery in the offing after two years of recession

A severe recession in 2008-10

The recession in Croatia started in the spring of 2008 when economic activity began to contract on a seasonally adjusted basis. The level of output fell by 8.7% over the two-year period to the second quarter of 2010. Although most of this contraction occurred before mid-2009, GDP still declined by 2.5% between the second quarter of 2009 and the second quarter of 2010.

Before the downturn, Croatia had enjoyed growth above 4% per year driven by domestic demand, fuelled by large capital inflows and strong credit growth. But the global financial and economic crisis hit the economy hard, particularly in 2009, when GDP dropped by 5.8%. Investment declined by almost 25% in the course of the recession. The sharp decline in domestic demand was partly offset by improving net exports (see graph II.28.1) as imports declined more than exports. The current-account deficit narrowed from around 9% to 3% of GDP. Employment reacted relatively slowly to the decline in output. But in the first half of 2010 the unemployment rate surged to a level above 12% of the labour force. Inflation has dropped by about 5 pps. over the past two years to around 1%.



The economy at a turning point

Recent data indicate that the recession bottomed out around mid-2010 and that a recovery has begun. Most notably, industrial production has started to show an upward trend. Retail trade has also increased on a year-on-year basis. Net exports, which had already softened the recession,

are apparently continuing to contribute positively to GDP growth in the second half of this year. Exports rose in annual terms in the first two quarters of the year whereas imports continued to fall. Physical indicators of tourism in the 2010-season have been strong. There are signs of an upturn in consumer confidence. Private consumption is getting some impetus from the gradual lifting of the so-called "crisis tax" which was imposed in 2009. A turnaround in household sentiment and spending is also suggested by a modest revival in bank lending to this sector. Although investment activity, in particular in construction, continues to be very subdued, the available data point to a slow expansion of overall economic activity in the third quarter.

The upturn is likely to remain moderate

Although economic activity seems to be gathering some momentum, it is unlikely that the economy will return to pre-recession growth rates, at least in the short term. The weak labour market continues to exert downward pressure on incomes and spending. Not only is employment still falling, but average gross wages in the private sector have embarked on a declining trend over the past year. The high level of indebtedness of households and companies and their need to deleverage are weighing on domestic demand. Credit availability is likely to remain relatively restricted. Investor confidence has taken a severe beating during the recession and will take some time to recover. The export performance is falling short of growth in major export markets. Overall, these headwinds are bound to restrain the recovery.

The banking sector has demonstrated resilience during the crisis and is well-capitalised and profitable. Maintaining soundness in the financial sector will be crucial for a sustained recovery. The quality of loan portfolios has continued to decline in 2010, reflecting in particular a strong rise in non-performing loans and continuing liquidity problems in the non-financial corporate sector. The government's credit programmes through the Croatian Bank for Reconstruction and Development have shown mixed results so far and may not provide the hoped-for boost to overall lending to the corporate sector. The levels of interest rates in lending to households and firms remain relatively high in view of financial market

conditions. Together with the general credit restraint, this will continue to hold back business and consumer spending.

The government has announced a set of public investments projects, but they have not yet been budgeted for. Their eventual impact on overall investment activity remains uncertain, not least in view of the existing budgetary constraints. For the same reason, the recovery is expected to get only limited support from government spending. Nevertheless, public consumption is projected to make a positive – though small – contribution to growth over the forecast period. The still-rising number of unemployed will lead to higher disbursement of unemployment benefits into 2011. An increased number of pensioners will also result in higher transfer payments. Furthermore, public wages are set to show some increase next year.

Net exports provided a significant offset to faltering domestic demand during the recession. This will still show in the annual GDP data for 2010 as imports are relatively slow to recover at the beginning of the upturn (see Graph II.28.1). But given the structure of the economy, imports are bound to pick up soon as the recovery takes hold. Although export growth is set to continue, it will probably happen at lower rate than in 2010 since import growth among trading partners is projected to soften. Furthermore, Croatia is currently losing market share and this is likely to continue over the next two years. Going forward, net exports are therefore projected to exert a small drag on growth, as was the case prior to the recession.

Annual GDP will still register a significant decline in 2010 (-1.8%) since output contracted until mid-year on a seasonally adjusted basis. Subsequently, the recovery is projected to result in annual average growth rates of 1.5% in 2011 and 2.1% in 2012. Private consumption and investment, including a renewed build-up of inventories, will emerge as the main drivers of this modest growth performance. Upside risks to this forecast are mainly related to a faster-than-projected economic recovery in the EU. The approaching accession to the EU may also provide some additional impetus to the economy through, inter alia, stronger net FDI inflows. But more importantly, there are significant downside risks related to the speed of private sector deleveraging and dependence on external financing. Furthermore, the delay in fiscal consolidation may

hurt both investment and consumption via higher borrowing costs.

Current-account deficit to widen again

As a result of the recession, the high external deficits underwent severe adjustments. Reduced capital inflows and sharply lower domestic demand resulted in much lower trade and current-account deficits. In 2010, the latter is projected to fall to 2.8% of GDP, compared to 9.2% two years earlier. At this stage of the business cycle, the external balances are not only benefitting from still declining imports, but also from the turnaround to growth in exports of goods and services. As for the upcoming years, total exports are expected to continue to increase, albeit a somewhat slower rate than in 2010. However, import growth is projected to slightly outpace export growth. This widens the current-account deficit to 3.7% of GDP for 2011 and to 4.7% for 2012. The risks around this projection are significant. On the one hand, the declining trend in unit labour costs could improve international competitiveness to an extent which is not factored into the projected export performance. On the other hand, the pent-up demand for foreign goods and services could also lead to a stronger than expected increase in imports.

Inflation pressures to remain low

The recession was associated with a disinflationary process which lowered inflation to around 1% by mid-2010. It was primarily driven by the growing slack in the use of resources transmitted to price- and wage-setting. Additional reasons were the sharp declines in energy and food prices following the spikes in 2008. Notwithstanding the rebound in energy prices, disinflation has continued in 2010 helped by declining gross average wages. Core inflation has even turned slightly negative.

Inflation pressures are expected to remain low over the forecast horizon in spite of the upturn in economic activity. Cost push pressures from the domestic side should be insignificant as unit labour costs will continue to decline. There will be some pass-through from higher import prices, particularly from energy and energy-related prices. Much of this will be transmitted via increases in administratively-set prices. The recent rise in agricultural raw materials can also be expected to find its way into the consumer basket. The forecast projects an uptick in consumer price inflation from

around 1% to around 2% over the next two years. The stability-oriented monetary policy framework should help to prevent a significant re-acceleration of inflation over the medium term.

Labour market improving with a lag

The unemployment rate has increased from an annual average of 9.1% in 2009 to 12.4% in the second quarter of 2010. As employment continues its declining trend in the second half of the year, the annual average for 2010 is projected to reach 12.5%. The labour market is only expected to see a turnaround towards increasing employment in the course of 2011. However, as the labour force is projected to decline even faster than employment, the unemployment rate will show a small decrease. As the recovery takes a stronger hold in 2012, the unemployment rate should fall more significantly, to around 11%. In spite of the high level of unemployment, wages are likely to show some downward "stickiness" – more in the public sector, less in the private sector.

A sharply higher fiscal deficit

The recession put public finances under severe pressures and necessitated adjustments to the

original budget plans in the course of 2009 and 2010. Last year, the government adopted three budget revisions. This year, a significant budget revision was adopted in August, taking into account weaker-than-expected economic activity and providing for some limited fiscal measures. As a result, the planned general government deficit increased by almost 2 pps. of (the revised) GDP.

The forecast projects a deficit corresponding to 5.7% of GDP in 2010. There is little chance that the fiscal deficit will narrow significantly over the next two years. The upcoming parliamentary elections constitute a major hurdle for near-term rebalancing. It is projected that the deficit will widen somewhat in 2011 before falling back to around the current level in 2012 when the recovery will boost tax revenues more decisively. General government debt is set to increase sharply from around 35% in 2009 to almost 50% in 2012.

Table II.28.1:

Main features of country forecast - CROATIA

	2009			92-05	Annual percentage change					
	bn HRK	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	333.1	100.0	-	-	5.5	2.4	-5.8	-1.8	1.5	2.1
Private consumption	189.6	56.9	-	-	6.2	0.8	-8.5	-2.5	1.3	2.0
Public consumption	65.7	19.7	-	-	3.4	1.9	0.2	-0.9	0.8	0.4
Gross fixed capital formation	82.3	24.7	-	-	6.5	8.2	-11.8	-12.0	2.0	4.3
of which : equipment	-	-	-	-	-	-	-	-	-	-
Exports (goods and services)	120.2	36.1	-	-	4.3	1.7	-16.2	5.1	3.8	4.2
Imports (goods and services)	131.3	39.4	-	-	6.5	3.6	-20.7	-3.7	4.0	4.6
GNI (GDP deflator)	319.8	96.0	-	-	5.8	1.7	-6.8	-1.6	1.3	1.9
Contribution to GDP growth :										
Domestic demand			-	-	6.1	3.0	-8.2	-4.9	1.4	2.3
Inventories			-	-	0.8	0.4	-1.2	-0.7	0.4	0.2
Net exports			-	-	-1.4	-1.1	3.6	3.9	-0.3	-0.4
Employment			-	-	3.5	1.1	-1.8	-4.3	-0.2	1.0
Unemployment rate (a)			-	-	9.6	8.4	9.1	12.5	12.3	11.2
Compensation of employees/head			-	-	4.0	7.1	2.2	-0.4	0.4	0.6
Unit labour costs whole economy			-	-	2.0	5.7	6.5	-3.0	-1.3	-0.5
Real unit labour costs			-	-	-2.0	-0.6	3.1	-3.1	-2.5	-2.1
Savings rate of households (b)			-	-	-	-	-	-	-	-
GDP deflator			-	-	4.0	6.4	3.3	0.2	1.2	1.6
Harmonised index of consumer prices			-	-	2.7	5.8	2.2	1.1	1.8	2.0
Terms of trade of goods			-	-	-	-	-	-	-	-
Trade balance (c)			-	-	-22.0	-22.8	-16.3	-15.0	-15.8	-16.7
Current account balance (c)			-	-	-7.6	-9.2	-5.4	-2.8	-3.7	-4.7
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-	-7.5	-9.1	-5.3	-	-	-
General government balance (c)			-	-	-2.5	-1.4	-4.1	-5.7	-6.1	-5.6
Cyclically-adjusted budget balance (c)			-	-	-	-	-	-	-	-
Structural budget balance (c)			-	-	-	-	-	-	-	-
General government gross debt (c)			-	-	32.9	28.9	35.3	40.9	45.9	49.9

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

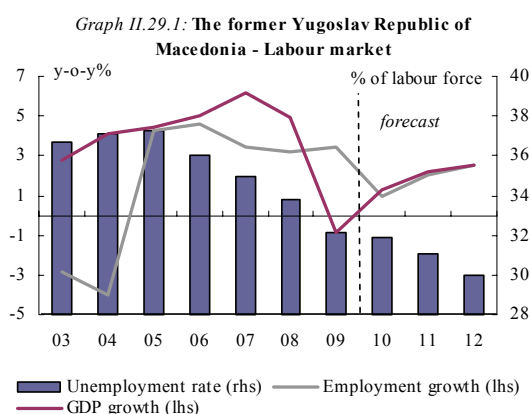
29. THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

From a mild recession to a modest recovery

External demand supported recovery so far ...

After a rather moderate output decline in 2009 and the first quarter of 2010, economic activity appears to have gained momentum in the second quarter, registering year-on-year output growth of 0.4%. However, due to a weak first quarter, output in the first half of 2010 was still about ¼% lower than a year before. The main positive contribution to growth came from exports, while all domestic demand components were lower than a year before, in particular investment, which in real terms is reported to be some 20% lower than in the first half of 2009. However, imports declined in line with domestic demand, which prevented a significantly sharper output decline. Private consumption declined by more than 3% in the first half of 2010, despite slightly increasing private transfers rising to nearly 19% of GDP and increased public transfers which also helped to stabilise domestic income and demand. On the supply side, public administration and financial services were the main growth-supporting sectors, while manufacturing and agriculture had the biggest negative growth contribution. The financial sector's lending slowed down markedly in 2009 but resumed in 2010. However, due to a minimal exposure to toxic assets, the direct impact of the financial crisis has remained minor so far.

Consumer-price inflation accelerated to 2.7% in October, bringing average headline inflation to 1.3% during the first ten months of 2010. Energy prices, which rose by 8.8% during this period, were important contributors to the price acceleration.



After a rather resilient labour market performance in 2009, the available data points to significant deterioration. Employment declined by about 1% y-o-y, compared to an increase in employment by 3.5% in 2009. The number of unemployed continued to decline, however, as a result of a shrinking labour force, the unemployment rate nevertheless increased slightly, from 31.9% in the second quarter of 2009 to 32.1 in the second quarter of 2010. About 20% of the unemployed are between 15-24 years old. Unemployment in this age group remained largely unchanged at some 55%. Nominal wage growth slowed to 0.3% in the second quarter.

The exchange rate of the Denar has remained largely unchanged against the euro at a level of 61.4 MKD/EUR.

In the near term, domestic sources for growth will be key ...

In the second half of 2010, economic activity is expected to gain momentum, benefitting not only from improved consumer confidence but also from a recovery of export markets. Thus, despite a weak first half year, annual GDP growth could increase to slightly above 1% in 2010. In the remaining forecast period, the global demand dynamics is expected to decelerate, leaving the generation of output growth mainly to domestic factors. The forecast expects a moderate acceleration in private consumption, driven by improved consumer confidence and stable private transfers from abroad. Investment, and in particular construction, should benefit from improved access to foreign financing, which could help to alleviate domestic financing constraints and would allow long delayed infrastructure investments to be realised. Overall, in 2011-12, output growth is likely to accelerate, albeit at a modest pace, reaching slightly above 2% in 2011 and about 2½% in 2012.

Overall, real disposable income is expected to remain fairly stable, benefitting from relatively low inflation and the stabilising impact of workers' remittances. In recent years, workers' remittances and other private capital inflows have increased to more than 18% of GDP. During the forecast period, these inflows are expected to return to previous levels of some 15% of GDP, reflecting the more difficult labour market situations in host

countries. As long as international prices for energy and raw materials remain moderate, inflation will probably remain low during the forecast period. This should support the real income of households. Labour income is likely to stagnate in the near future because of low growth of employment and wages. During recent years, employment growth has been rather high at around 3% annually. However, a significant share of those additional jobs appears to be the result of a stricter registration procedure and do not necessarily reflect newly created employment. In view of the likely still difficult international environment in 2011-12, the country's potential for creating employment or raising real wages will remain limited. Improving the country's labour income is thus closely linked to improving productivity by modernising and deepening the capital stock.

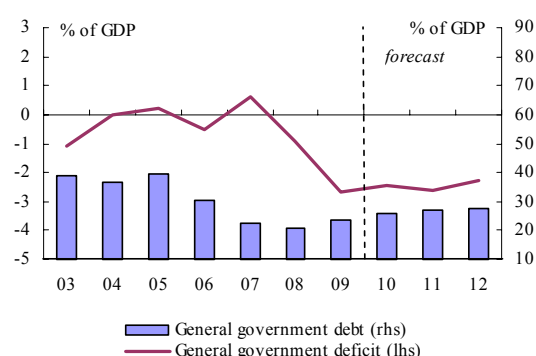
The current-account deficit is likely to deteriorate, albeit at a moderate pace, reflecting stronger domestic demand, in particular consumption, but also increased investment.

Public finances are likely to remain under control

Based on the country's track-record of respecting fiscal targets, the forecast expects public sector deficits to decline from 2¾% of GDP in 2009 to

2½% in 2010 and to 2¼% of GDP in 2012. The budget for 2011 and programmes for 2012 envisage a significant increase in public spending. Accelerating domestic activity and improved efficiency in tax collection should help to achieve those targets. The forecast expects that in case of spending constraints, the authorities will reduce capital spending, as has happened in the past on similar occasions. However, the quality of public spending might deteriorate further.

Graph II.29.2: The former Yugoslav Republic of Macedonia - Public finances



Continued fiscal deficits and rather low nominal GDP growth will lead to a marked rise in public sector debt, reaching some 28% of GDP by 2012.

Table II.29.1:

Main features of country forecast - THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

	2009			Annual percentage change						
	bn MKD	Curr. prices	% GDP	92-05	2007	2008	2009	2010	2011	2012
GDP	409.1		100.0	-	6.1	5.0	-0.9	1.3	2.2	2.5
Private consumption	312.0		76.3	-	8.1	7.4	-3.1	1.0	2.0	2.5
Public consumption	78.5		19.2	-	-0.3	10.6	-5.4	0.5	1.5	2.0
Gross fixed capital formation	81.9		20.0	-	17.1	5.4	0.5	-6.0	7.0	8.0
of which : equipment	35.8		8.8	-	16.7	-1.1	-	-	-	-
Exports (goods and services)	160.3		39.2	-	11.8	-6.3	-8.8	13.0	6.0	6.5
Imports (goods and services)	248.8		60.8	-	16.1	0.8	-9.1	5.7	5.6	6.6
GNI (GDP deflator)	403.5		98.6	-	1.6	8.7	-0.9	1.3	2.2	2.6
Contribution to GDP growth :										
Domestic demand				-	9.3	8.7	-3.4	-0.3	3.1	3.9
Inventories				-	1.8	0.2	0.0	0.0	0.0	0.0
Net exports				-	-4.9	-3.9	2.5	1.6	-1.0	-1.4
Employment				-	3.5	3.2	3.4	1.0	2.0	2.5
Unemployment rate (a)				-	34.9	33.8	32.2	31.9	31.1	30.0
Compensation of employees/head				-	-	12.9	1.7	2.1	3.4	5.1
Unit labour costs whole economy				-	-	11.0	6.1	1.8	3.2	5.1
Real unit labour costs				-	-	0.3	5.8	-0.1	-0.1	1.7
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				-	4.3	10.7	0.2	1.9	3.3	3.4
Harmonised index of consumer prices				-	2.3	8.3	-0.8	1.7	2.3	2.5
Terms of trade of goods				-	8.8	-3.4	-8.6	1.9	1.0	0.5
Trade balance (c)				-	-20.4	-26.1	-23.2	-22.2	-22.1	-22.4
Current account balance (c)				-	-7.3	-12.7	-6.1	-3.3	-4.1	-5.3
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-	-	-	-	-	-
General government balance (c)				-	0.6	-0.9	-2.7	-2.5	-2.6	-2.3
Cyclically-adjusted budget balance (c)				-	-	-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-	-	-
General government gross debt (c)				-	23.4	20.7	23.9	25.6	26.8	27.6

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

30. ICELAND

Domestic debt overhang impedes economic recovery

Iceland went into a long and deep recession...

Following the banking sector crisis in October 2008, economic activity and domestic demand started to drop sharply, leading to a marked fall in real GDP of 6.8% in 2009. The recession was strongly driven by a 50% drop in investments, which was particularly pronounced in the construction and the services sector, and a 16% decline in private consumption.

The economy contracted further in the first half of 2010, when real GDP fell by 7.3% y-o-y. Moreover, the quarterly growth rate (in seasonally adjusted terms) deteriorated from -1.2% in the first quarter to -3.1% in the second quarter, also indicating that the recession has not yet bottomed out.

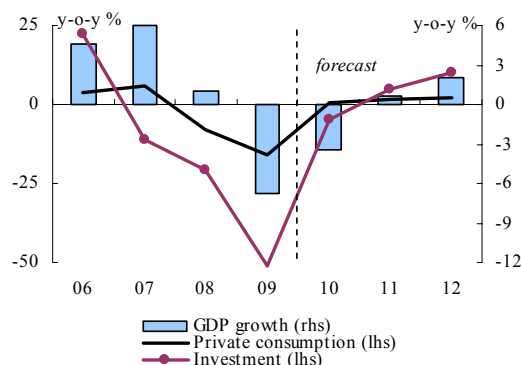
...and a swift recovery is impeded by a huge private sector debt overhang,...

The recession is expected to have reached bottom some time during the second half of 2010, later than initially expected. However, high frequency indicators provide mixed evidence as to whether a recovery process has started. Prospects for a marked pick-up in domestic demand appear weak. Household and corporate sector confidence is likely to remain undermined by a significant private sector debt overhang. Currently, a significant share of private households is suffering from sharp increases of inflation-indexed and forex debt. Also the corporate sector is suffering from financial problems and many firms would need to repair their balance sheets to be able to plan and finance new investment projects. At the same time, while general principles of debt restructuring have been adopted, the process has been slow due to its complexity. Many households appear to have been reluctant to make use of existing debt restructuring schemes, possibly in the expectation of a more generous debt relief. Corporate debt restructuring may only re-gain pace once remaining legal uncertainties have been solved, in particular on the treatment of corporate sector loans following Constitutional Court decisions on the illegality of foreign-exchange indexed loans. To this end, the government is currently preparing a legislative package.

...subdued disposable incomes ...

The scope for household consumption growth will remain constrained. The level of unemployment, although declining, is projected to stay far above pre-crisis levels. Disposable incomes are unlikely to increase strongly over the short term. In the upcoming wage negotiations, many unions are likely to demand higher wages to partly compensate for sharp real wage declines during the recession. But wage demands are generally expected to remain relatively modest under the current circumstances. Also, social partners seem to prefer a multi-annual agreement which may include a modest wage rise in the first years. Moreover, indirect tax increases and announced cuts on social transfers and family support will continue to put a lid on disposable incomes. Some limited support for private consumption growth could result from further withdrawals from individual pension savings.

Graph II.30.1: Iceland - GDP, consumption and investment growth



...as well as uncertainties with respect to firm's investment plans.

There is some evidence that investment activity in energy-intensive sectors have been stronger than initially estimated. Survey results and strong imports of investment goods also point to potentially stronger investments. On the other hand the forecast assumes that corporate sector debt problems and uncertainties with regard to government tax policies will continue to have a bearing on firm's investment plans. Once corporate sector debt restructuring gains pace and uncertainty about tax measures vanishes, investment activity is likely to unfold slowly.

A boost to investment could potentially come from large projects in the energy and aluminium sectors. However, it seems that these large investment projects are being further delayed due to technical, financial and political problems. The forecast projects that a pick-up in private investments growth is only to be expected in the second half of 2011 at the earliest. At the same time, public investments are projected to decline in the context of the government's fiscal consolidation programme.

The global outlook has somewhat improved. Stronger economic growth in Iceland's main trading partner countries will improve the conditions for a strengthening of external demand. At the same time, the growth of a large share of merchandise exports will continue to be subject to technical constraints (fishing quotas, capacity of aluminium smelters). The growth of services exports remains limited by a relatively short tourism season. Net exports are projected to add only small contributions to GDP growth over the forecast period.

Overall, the forecast projects a further contraction of GDP of around 3.5% for 2010 a whole, largely driven by a further annual decline in investments. The fall in domestic demand is partly compensated for by a positive, though small, contribution of net exports. For the 2011-12, the forecast projects a very mild recovery, mostly driven by domestic demand with stronger investment growth.

Inflation risks are balanced...

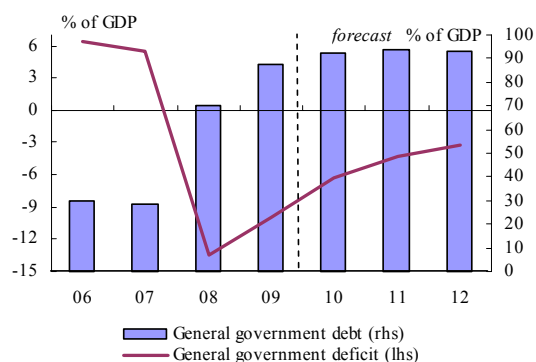
Annual inflation gradually came down to 6.6% in January 2010, from its peak of 18.6% in January 2009. It temporarily accelerated slightly to 8.5% in March on the back of increases in energy prices, indirect taxes and government fees, but continued to decelerate to 3.3% in October. Inflation expectations have stabilised and inflation risks appear relatively balanced over the forecast period. Relatively high unemployment, limited wage increases, low disposable income and domestic demand as well as the recent strengthening of the ISK are all expected to support the process of disinflation. The policy regime with a strong focus on exchange rate stabilisation is assumed to continue over the forecast period, limiting risks of higher inflation through pass-through effects. On the other hand, some mild price pressures could result from further tax increases, price rises by utility companies, potential wage pressures in the

tradable sectors and a recovery of the real estate market in some areas. Overall, the forecast projects annual average inflation to decline to around 2-2.5% in 2011-12.

...and the trade balance will remain in surplus...

External deficits have shrunk markedly following the recession. The sharp contraction in domestic demand and depreciation of the exchange rate (around 50% during the crisis) contributed to a substantial improvement in the trade balance. The forecast projects a slight reduction of the trade surplus as of 2011, as even a slowly growing economy will imply growing imports due to the high dependency rate while export growth will remain constrained, reflecting the low degree of diversification. In line with these trends, the current-account deficit is set to widen somewhat over the forecast period.

Graph II.30.2: Iceland - Public finances



...but labour markets continue to struggle with relatively high, though falling, unemployment

The crisis had led to a marked increase in unemployment and a sharp drop in the number of employed compared to pre-crisis levels, although elements of flexibility seem to have provided a degree of cushion, such as a reduced level of hours worked, increased part-time work and real wage flexibility. Net emigration has also prevented a stronger increase in the jobless rate. Nonetheless, the recession continued to impact on labour market performance in 2010, when the level of employment continued to fall and the unemployment rate increased in each of the first three quarters compared to the previous year quarters. Therefore, the forecast projects the level of employment to fall and the unemployment rate (LFS) to increase in 2010. The forecast projects

that employment levels will respond to an increase in economic activity in 2011 and 2012 with some time lag. This, together with a gradual fall in the number of unemployed will bring the unemployment rate down to around 6% at the end of the forecast period. However, this is still far above the average pre-crisis rate.

Public finance consolidation continues...

Public finances suffered a marked deterioration in the wake of the October 2008 crisis. Following budget surpluses in earlier years, the general government balance turned into huge deficits in 2008 and 2009, prompting the government to launch a series of fiscal adjustment measures in the context of the IMF programme which continued into 2010. The 2010 budget comprised a series of revenue enhancing measures (VAT, excise duties, energy taxes, social contributions) as well as cuts in current and capital spending. Budget implementation in the first half of 2010 has been largely in line with the plan; delays in implementing spending cuts were compensated by higher one-off revenues and lower interest costs. The forecast projects that the 2010 deficit target for the general government budget will be broadly achieved.

...but the 2011 budget is based on optimistic assumptions

The 2011 budget can be considered as an expression of the government's commitment to continued fiscal consolidation. In order to achieve a primary surplus, the budget contains fiscal measures equivalent to around 2.5-3% of GDP, including freezes on wages and transfers and significant cuts in spending, which may however be difficult to implement. Moreover, the budget is based on optimistic growth and revenue assumptions. A budget revision is currently in the pipeline and is likely to lead to a higher budget gap, unless the government introduces additional spending cuts or tax increases, posing further challenges. Against this background, and on the basis of less optimistic assumptions, the forecast assumes a reduction of the fiscal balance by around 2 pps. in 2011. The general government debt ratio is set to gradually increase to above 90% by the end of 2012. Fiscal risks are primarily related to significant financial sector contingent liabilities.

Table II.30.1:

Main features of country forecast - ICELAND

	2009			92-05	Annual percentage change					
	bn ISK	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	1500.8		100.0	3.4	6.0	1.0	-6.8	-3.5	0.7	2.1
Private consumption	765.4		51.0	3.6	5.6	-7.9	-16.0	-0.5	1.5	1.9
Public consumption	396.9		26.4	3.0	4.1	4.6	-1.7	-3.0	-3.0	-2.0
Gross fixed capital formation	207.9		13.9	7.7	-11.1	-20.9	-50.9	-5.0	5.0	10.0
of which : equipment	101.9		6.8	9.6	-28.3	-34.4	-62.9	-49.9	5.0	10.0
Exports (goods and services)	794.8		53.0	4.0	17.7	7.1	7.4	2.0	2.4	3.0
Imports (goods and services)	663.2		44.2	6.7	-0.7	-18.2	-24.1	1.6	3.2	3.1
GNI (GDP deflator)	1344.6		89.6	3.2	6.3	-13.5	3.2	-6.4	0.9	2.6
Contribution to GDP growth :										
Domestic demand				4.7	0.5	-9.6	-21.1	-	0.6	1.7
Inventories				-	-	-	-	-	-	-
Net exports				-1.3	6.1	10.7	14.7	0.4	0.1	0.4
Employment				1.4	4.5	0.8	-6.0	-0.6	0.5	1.0
Unemployment rate (a)				3.4	2.3	3.0	7.2	7.8	7.3	6.3
Compensation of employees/head				6.4	8.0	2.8	-2.5	2.3	2.5	2.9
Unit labour costs whole economy				4.3	6.5	2.6	-1.7	5.4	2.3	1.8
Real unit labour costs				0.5	0.8	-8.3	-9.8	-1.3	0.4	-0.4
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				3.8	5.7	11.9	8.9	6.8	1.8	2.2
Harmonised index of consumer prices				-	3.6	12.8	16.3	5.5	2.5	2.3
Terms of trade of goods				-	-	-	-	-	-	-
Trade balance (c)				-2.0	-6.9	-0.5	6.0	6.2	5.9	6.1
Current account balance (c)				-5.6	-16.4	-22.1	-2.2	-4.5	-4.9	-4.6
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-5.6	-16.6	-22.2	-2.3	-4.5	-4.9	-4.6
General government balance (c)				-	5.4	-13.5	-9.9	-6.2	-4.2	-3.2
Cyclically-adjusted budget balance (c)				-	-	-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-	-	-
General government gross debt (c)				-	28.5	70.5	87.8	91.5	93.5	92.8

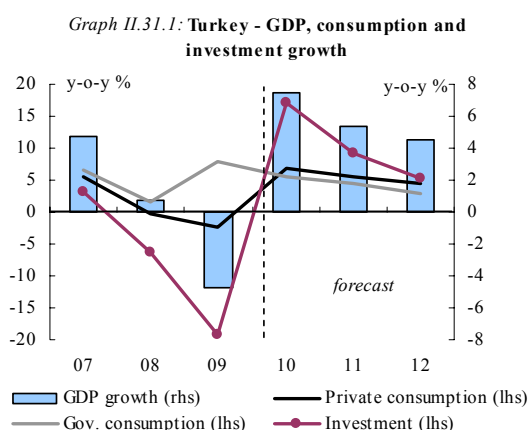
(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

31. TURKEY

Robust growth driven by domestic demand

Return to positive and robust growth

The Turkish economy is recovering strongly after having severely contracted in 2009. GDP tumbled by 4¾% last year, a sharp contrast to the 6% average annual growth rate in 2004-08. The global financial crisis hit the economy hard, thereby reducing fixed investment and external demand dramatically. Fiscal and monetary stimuli, combined with a healthy banking sector, helped to cushion the blow.



In Turkey's case, the crisis had a silver lining as it highlighted the economy's enhanced resilience to external shocks.

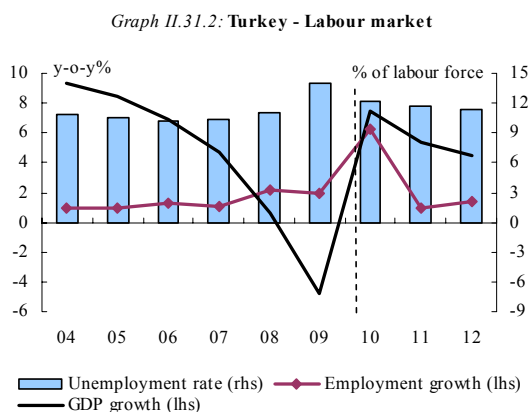
The Commission foresees a return to positive and robust annual growth in 2010. Exports growth may suffer from a more gradual recovery in Turkey's chief export markets, but GDP growth could be close to 7½% in 2010, helped – in particular in the first half of the year – by strong base effects. Monthly data point to a loss of momentum in the economy in the third quarter of 2010. Seasonally adjusted industrial output rose only 1.2% on the quarter – the smallest increase seen in the recovery so far, the unemployment rate stopped falling (sticking at 12%) and the current-account deficit did not show its usual seasonal improvement. However, some pause-for-breath was expected after the rapid recovery of the previous five quarters. Ultimately, a lasting global recovery would be instrumental in sustaining the upturn in growth.

Due to strong base effects, which in part reflect the severity of the 2009 downturn

The trough of the current cycle came in the first quarter of 2009 when GDP tumbled by 14.5% y-o-y. The economy has since shown steady improvement and grew by 11% in the first half of 2010, helped by stimulus measures and a solid banking sector. Growth in the second half of the year is expected to slow down, in line with the subsiding of base effects. While fixed investment is booming and recouping the losses of previous years, all components of domestic demand are expected to show positive year-on-year growth in 2010 (in part due to strong base effects) and to continue to drive growth, though at a more moderate pace, over the forecasting period. In contrast to emerging European peers, Turkish banks are relatively less reliant on external funding (the sector's loan-to-deposit ratio is well below 100%), and have only experienced limited asset quality deterioration.

And consumption and investment as the driving forces behind the recovery

Labour market developments, credit growth, capacity utilisation, and consumer and business confidence point to a gradual recovery in consumption in 2010. The jobless rate rose to 14% in 2009 from 11% in 2008, but decreased to 12% in the first half of 2010. Disposable income is benefiting substantially. Both consumer and business confidence indices seem to confirm that a recovery in consumption is underway.



Meanwhile, credit growth started to increase in the fourth quarter of 2009, albeit from very low levels,

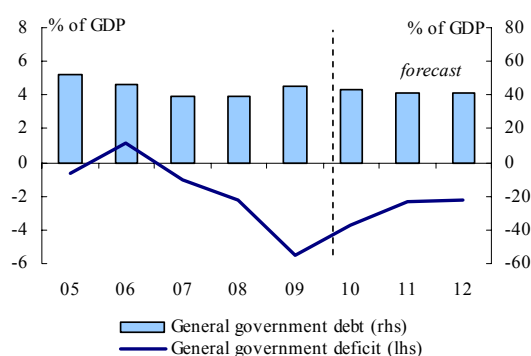
and was even above the double-digit credit growth of the previous year. The banking data indicate that business lending is growing significantly faster than consumer lending, pointing to strong investment growth. A recovery in investment is therefore expected to be significantly stronger than in the other expenditure categories.

Industrial production trends and Turkey's Purchasing Managers' Index (PMI) confirm the positive picture. Industrial production surprised on the upside in the first ten months of 2010, as it rose at double digit rates. The most recent PMI increases indicate a marked improvement of business conditions and significant growth of new orders in the Turkish manufacturing sector. Aside from the structural boosts to growth, activity is still being supported by a very expansionary monetary policy, while the tightening in fiscal policy has been overwhelmingly focused on raising indirect taxes rather than curbing spending growth, and any move on the latter is unlikely until next year's general election is out of the way.

Fiscal rebalancing may be challenging...

Compared to the fiscal consolidation that took place in 2001-08, the budgetary performance has deteriorated markedly in 2009. The general government budget deficit increased to 5½% of GDP from 2½% in 2008, while the public debt stock rose from 39½% of GDP to 45½%. The main contributors to the deterioration of the deficit were the acceleration of public spending, in particular of transfers to social security institutions, which recorded a deficit of 3% of GDP, and the impact of the various stimulus packages.

Graph II.31.3: Turkey - Public finances



Most of these stimulus measures have already been withdrawn. In addition, the strengthening economy has been positively affecting budget revenues. It is

therefore forecast that the budget deficit will narrow to around 3½% of GDP in 2010 and 2½% of GDP in 2011 and 2012. However, only a credible, strong and binding fiscal rule may lead to the forecasted fiscal outcome.

Downside risks may also stem from increased expenditures. The government's Pre-accession Economic Programme for 2011-13 points to real expenditures remaining high even as growth returns. A specific concern is that the government might ramp up spending ahead of 2011 parliamentary elections in a bid to shore up support. Such a ramp-up would likely pressure interest rates and dent investor confidence, thereby slowing or even undermining the recovery.

... while monetary policy may affect the recovery prospects

The conduct of Turkey's monetary policy is complicated by strong capital inflows from the much slower growing developed economies. With the ongoing Turkish Lira appreciation and the current-account deficit widening markedly, the central bank may be reluctant to place further upward pressure on the exchange rate by raising interest rates.

The country's dramatic economic contraction in the fourth quarter of 2008 and the first half of 2009 year spurred the central bank to cut the total overnight rates by 1025 bps to an all-time-low of 6½% in the first quarter of 2010.

The near doubling in inflation between October 2008 and October 2010 – from 5 to 9% – may urge the bank to back away from overly relaxed monetary policies. However, this is unlikely as long as core inflation remains relatively subdued, below 4% by October 2010. Food-price inflation constitutes the main risk factor. Against this backdrop, inflation is expected to be close to 8½% by December 2010, exceeding the central bank's inflationary end-year target of 6½%. A key question is how the inflationary developments will be reflected in monetary policy, in particular in 2011-12. In addition, any major cutback in investors' appetite for emerging market assets may negatively affect Turkey's recovery prospects.

External imbalances widening again

The correction in external accounts represented the silver lining of the recession. The positive

terms-of-trade shock resulting from collapsing oil prices combined with the decline in domestic demand and imports led to a major contraction of the trade and current-account deficits, from 5¾% in 2008 to 2¼% in 2009.

The forecast expects an increase of the current-account deficit to 5½% of GDP in 2010 due to stronger domestic demand and higher energy prices. With the recovery underway, the

current-account deficit is likely to widen further in 2011-12. However, the outlook for exports remains somewhat mixed. Exports declined by 5% in 2009 and are forecast to increase by 5% in 2010. Of particular importance is the automotive sector, Turkey's top export earner. Roughly three-quarters of vehicles manufactured in Turkey are exported to Europe. Special schemes supporting car sales in EU markets, which have now expired, brought forward future sales.

Table II.31.1:

Main features of country forecast - TURKEY

	2009			92-05	Annual percentage change					
	bn TRY	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	917.1	100.0	4.4	4.4	4.7	0.7	-4.7	7.5	5.5	4.5
Private consumption	659.2	71.9	4.3	4.3	5.5	-0.3	-2.3	6.8	4.5	3.0
Public consumption	121.9	13.3	4.1	4.1	6.5	1.7	7.8	5.5	4.2	1.0
Gross fixed capital formation	188.8	20.6	6.0	6.0	3.1	-6.2	-19.2	9.2	9.2	5.2
of which : equipment	98.4	10.7	-	-	-	-	-	22.6	10.0	4.5
Exports (goods and services)	212.5	23.2	9.3	9.3	7.3	2.7	-5.4	5.1	6.7	7.1
Imports (goods and services)	225.6	24.6	10.4	10.4	10.7	-4.1	-14.4	14.4	6.3	5.0
GNI (GDP deflator)	907.0	98.9	4.4	4.4	4.8	0.6	-4.9	7.1	6.6	4.6
Contribution to GDP growth :										
Domestic demand			4.9	4.9	5.3	-1.5	-	-	5.9	3.5
Inventories			0.0	0.0	0.6	0.3	-	1.4	0.1	0.9
Net exports			-0.5	-0.5	-1.3	1.9	-	-3.0	-0.3	0.2
Employment			0.8	0.8	1.1	2.2	2.0	6.2	0.9	1.4
Unemployment rate (a)			8.0	8.0	10.3	11.0	14.0	12.2	11.7	11.3
Compensation of employees/head			52.0	52.0	12.7	8.6	3.5	3.1	7.0	4.9
Unit labour costs whole economy			46.8	46.8	8.9	10.3	10.8	1.8	2.3	1.7
Real unit labour costs			-2.6	-2.6	2.5	-1.5	5.2	-7.7	-2.9	-2.7
Savings rate of households (b)			-	-	-	-	-	-	-	-
GDP deflator			50.8	50.8	6.2	12.0	5.4	10.3	5.3	4.5
Harmonised index of consumer prices			-	-	8.8	10.4	6.3	8.5	6.5	5.5
Terms of trade of goods			-0.5	-0.5	2.2	-3.2	2.5	-2.0	-4.6	-3.0
Trade balance (c)			-5.0	-5.0	-7.3	-6.8	-3.8	-9.1	-9.9	-10.2
Current account balance (c)			-1.6	-1.6	-5.9	-5.7	-2.3	-5.5	-6.6	-7.1
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-	-	-	-	-	-	-
General government balance (c)			-	-	-1.0	-2.2	-6.7	-3.7	-2.8	-2.2
Cyclically-adjusted budget balance (c)			-	-	-	-	-	-	-	-
Structural budget balance (c)			-	-	-	-	-	-	-	-
General government gross debt (c)			-	-	39.4	39.5	45.4	42.8	42.1	42.0

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Other non-EU Countries

32. THE UNITED STATES OF AMERICA

A return to a new normal?

After the fiscal stimulus and inventory building: a return to a new normal?

Real GDP growth was strong in the last quarter of 2009 and the first quarter of 2010, at 1.2% and 0.9% q-o-q respectively. However, this largely reflected inventory rebuilding, which contributed respectively 0.7 pp. and 0.6 pp. to growth in these quarters. In the second and third quarter of 2010, growth was more subdued, at 0.4% and 0.5% q-o-q respectively. Despite the official ending of the recession in June 2009 (according to the National Bureau of Economic Research), the economy remains historically weak in the absence of a strong pick-up in private demand.

Private consumption has been growing modestly over recent quarters, due to weak labour income growth and the ongoing process of deleveraging by households. The recovery of investment in equipment and software has been the bright spot, supported by improved profitability as well as replacement demand, which was postponed during the recession. On the other hand, the housing market remains fundamentally weak. The end of the tax credit for first-home buyers brought residential investment forward to the second quarter (6% q-o-q), at the expense of the third (-8% q-o-q). While export growth was healthy, imports outpaced exports by far in the second and third quarters. As a result, the current-account deficit, which narrowed to 2.7% of GDP in 2009 from 5.2% in 2007, is widening again on a quarterly basis (from a low of 2.4% of GDP in the second quarter of 2009 to 3.4% in the second quarter of 2010).

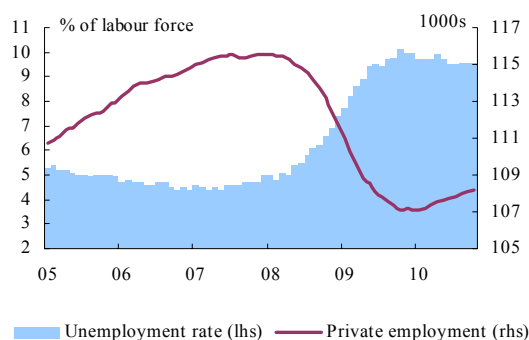
The recovery in employment has been very shallow, with private payrolls increasing by only 1.1 million during the first ten months of 2010. This makes up only a small share of the private job losses during the recession (-7.5 million). Notwithstanding weak employment growth, the unemployment rate has moved sideways since the start of 2010, due to a continued decline in labour force participation. The weak momentum in the economy has led to an unusually low inflation rate, which has caught the attention of the monetary authorities. Headline inflation was 1.1% in September, while core inflation fell to 0.8% – the lowest in many years.

The fiscal deficit of the general government peaked at 12.2% of GDP in the second quarter of 2009 and has since remained very large. Notwithstanding receipts growing twice as fast as expenditures (6.8% y-o-y vs. 3.3% y-o-y), the deficit was still 11.2% of GDP in the second quarter of 2010.

Developments in labour and housing markets crucial to the recovery

The persistent weakness in the labour market is one of the most important headwinds to the recovery. Unemployment insurance claims remain stubbornly high and the duration of unemployment is at a record level. The latter may point to a structural element in unemployment, which may be linked to sectoral shifts and the extension of unemployment benefits coverage. In addition, the ongoing problems in the housing market could hamper labour mobility. More than a fifth of homeowners have mortgage loans which are higher than the worth of their houses. As a result unemployed workers cannot easily relocate to places where prospects of finding a job are better.

Graph II.32.1: US - Labour market developments



The weakness of the housing market has been highlighted by the sharp drop in housing starts and sales, following the withdrawal of the homebuyers' tax credit in spring 2010. In autumn 2010, a legal investigation started on whether banks that foreclose on bad loans failed to review documents properly or submitted false information to evict delinquent borrowers. This caused some banks to temporarily suspend foreclosures. The main risk in this respect is that it postpones the clearing of the overhang of the housing supply, and as a result

causes further delays in the recovery in the housing market.

Policies will also play a crucial role

Monetary and fiscal policies have kick-started and accelerated the recovery from the crisis. A balance now has to be found between unwinding the large stimulus and continuing support to the economy. On the monetary side, the Fed has maintained the target range for the federal funds rate at 0-0.25% since late 2008. In April 2010 the Fed started to wind down some of its extraordinary liquidity measures. However, in view of signs of weakness in the economy, the Fed decided in August to maintain the size of its balance sheet by reinvesting the proceeds of maturing mortgage and agency debt holdings into US treasuries, bringing the gradual shrinking of its balance sheet to a halt.

At its 3 November 2010 meeting, the Fed launched a new round of quantitative easing ("QE2"), as progress towards its objectives of full employment and price stability had been disappointingly slow. The Fed plans to buy USD 600 bn of longer-term Treasury securities by the middle of 2011, at a pace of USD 75 bn a month. Through this operation, the Fed aims at lowering long-term interest rates and encouraging investment in stocks and corporate bonds. Moreover, it boosts the amount of money in the economy and should raise inflation expectations as a result. As a side effect, *ceteris paribus*, the exchange rate of the dollar weakens.

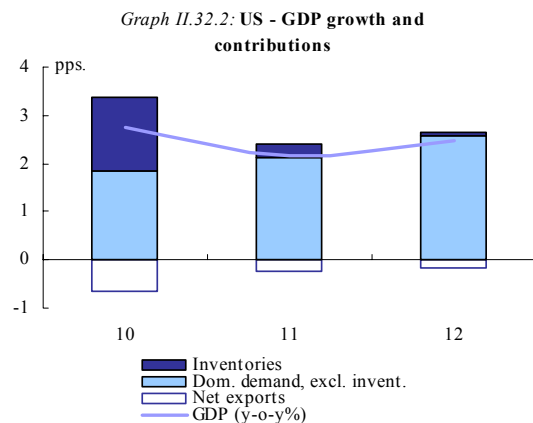
Fiscal policy has given the needed support to the economy, but this comes at a cost. The fiscal deficit of general government remains very large. In the short-term, a decision is needed on the so-called Bush tax cuts, which refer to income tax cuts enacted in 2001 and 2003 and are set to expire at the end of this year. While even a temporary extension of the tax cuts will make it very difficult for the government to reach its medium-term fiscal goal – stabilising the fiscal deficit at 3% of GDP by 2015 – letting all the tax cuts expire would be undesirable in view of the faltering recovery. This forecast assumes an extension for middle-income earners.

The composition of growth improves over the forecast horizon

Economic recoveries following financial crises are typically slow, because balance sheets have to be

rebuilt. Deleveraging by households, the financial sector and the government (following unprecedented fiscal stimulus) takes time and implies a drag on growth in the forthcoming years.

Real GDP growth is expected to slow down to just above 2% in 2011 and then to reaccelerate to 2½% in 2012. Inventory building will contribute more than half of the GDP growth in 2010 and fade away afterwards. Domestic demand will fill the gap, with its growth contribution increasing from 1.8 pps. in 2010 to 2.6 pps. in 2012. Employment growth will be positive again in 2011, but only in 2012 it will be strong enough (at 1.1%) to bring the unemployment rate down to 9%. The acceleration in GDP as well as the expiration of stimulus measures will bring the fiscal deficit down to 7¼% in 2012, from about 11% in 2009 and 2010.



Slow growth of income and employment imply that private consumption growth will remain fairly subdued, accelerating to close to 2% in 2012 after 1½% in 2010 and 2011. Consumption will get some support from a gradual decline in the savings rate. Growth in investment in equipment is expected to remain healthy, but no longer buoyant, in view of the low capacity utilisation (at 72.4% in September, 6½ pps. below its 1992-2006 average). The housing supply is expected to remain substantial due to the large amount of homes that have yet to be foreclosed. At the same time, housing demand is expected to remain soft due to the weakness in the labour market. As a result, housing prices are likely to fall further. Finally, due to surprisingly strong import growth, the growth contribution from net exports will be negative this year (-0.7 pp.). Going forward, the contribution will be less negative (at -0.2 pp. in 2011 and 2012). Partly due to unfavourable terms-of-trade effects – under the technical assumption

of fixed nominal exchange rates – the current-account deficit will widen further in 2011-12. From 2.7% of GDP in 2009, it will increase to 3½% this year and 4% in 2011 (4¼% in 2012).

The output gap will shrink over the forecast period, from -2.3% in 2010 to -1.2% in 2012. This will keep a lid on consumer price inflation, which will shrink to 1.1% in 2011 (partly due to carry-over effects) and return to 1½% in 2012.

Risks are tilted to the downside

In the aftermath of the crisis, risks are tilted to the downside.

On the upside, stronger-than-expected external demand could give additional support to growth. The main upside risk is the possibility of a fast

reduction in domestic fiscal uncertainty, in particular with relation to a timely decision on the extension of the income tax cuts. A clear path for medium-term fiscal consolidation would also support confidence. Such a reduction in uncertainty could help business confidence, which could lead to a faster recovery in hiring.

Downside risks mirror the upside ones. Global risks such as exchange rate volatility and increased protectionism would affect US growth in a negative way. The same is true for lingering domestic uncertainty, specifically regarding short- and medium-term fiscal policy plans. A high rate of long-term unemployment might hamper the recovery in employment. Finally, the recovery in the housing market could turn out to be slower than expected, for example as a result of the present problems with foreclosures.

Table II.32.1:

Main features of country forecast - THE UNITED STATES

	2009			92-05	Annual percentage change					
	bn USD	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	14119.0		100.0	3.3	1.9	0.0	-2.7	2.7	2.1	2.5
Private consumption	10001.3		70.8	3.6	2.4	-0.3	-1.2	1.6	1.6	1.9
Public consumption	2411.5		17.1	1.5	1.4	2.9	1.9	1.2	1.2	1.5
Gross fixed capital formation	2219.8		15.7	5.4	-1.4	-5.1	-15.5	3.2	4.8	6.3
of which : equipment	1099.6		7.8	7.4	3.3	-3.8	-18.6	13.7	8.8	5.6
Exports (goods and services)	1578.3		11.2	5.5	9.3	6.0	-9.5	11.8	8.4	7.4
Imports (goods and services)	1964.7		13.9	8.1	2.7	-2.6	-13.8	14.1	8.0	6.9
GNI (GDP deflator)	14265.3		101.0	3.5	0.5	-0.5	-3.2	3.0	2.1	2.4
Contribution to GDP growth :										
Domestic demand				3.7	1.6	-0.7	-3.3	1.8	2.1	2.6
Inventories				0.1	-0.2	-0.5	-0.6	1.5	0.3	0.1
Net exports				-0.5	0.6	1.2	1.2	-0.7	-0.2	-0.2
Employment (*)				1.4	0.9	-0.7	-5.0	-0.5	0.8	1.1
Unemployment rate (a)				5.4	4.6	5.8	9.3	9.6	9.4	9.0
Compensation of employees/head				3.8	3.9	3.1	2.2	2.1	1.0	0.5
Unit labour costs whole economy				1.8	2.9	2.4	-0.2	-1.1	-0.3	-0.8
Real unit labour costs				-0.3	-0.1	0.2	-1.1	-2.0	-1.1	-2.0
Savings rate of households (b)				-	-	6.9	8.7	8.2	7.8	7.2
GDP deflator				2.2	2.9	2.2	0.9	0.9	0.8	1.3
General index of consumer prices				-	2.8	3.8	-0.4	1.6	1.1	1.5
Terms of trade of goods				-0.3	0.2	-5.8	6.3	-2.3	-1.4	0.1
Trade balance (c)				-3.8	-6.0	-6.0	-3.7	-4.8	-5.3	-5.5
Current account balance (c)				-3.2	-5.1	-4.7	-2.7	-3.4	-4.0	-4.2
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-3.1	-5.3	-5.6	-4.0	-3.4	-4.0	-4.2
General government balance (c)				-2.5	-2.8	-6.2	-11.2	-11.3	-8.9	-7.9
Cyclically-adjusted budget balance (c)				-	-	-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-	-	-
General government gross debt (c)				64.4	62.4	71.5	84.7	92.2	98.4	102.1

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

(*) Employment data from the BLS household survey.

33. JAPAN

Weak growth ahead

The economy made a strong start in 2010. GDP grew by 1.6% q-o-q (5.0% y-o-y) in the first quarter of the year. By that time the economy had recouped almost half of the output losses which had hit Japan during the crisis (between the second quarter of 2008 and the first quarter of 2009 the output loss was 8.8%). The second quarter of 2010 inaugurated a much more gradual pace of recovery. GDP growth accelerated in the third quarter of 2010 (0.9% q-o-q), but growth was mainly driven by temporary factors. The recovery is likely to take a pause in the final quarter of 2010, as a payback for strong consumption in the third quarter is expected. In addition weaker leading indicators also suggest a setback.

Private investments likely to take the baton from net exports and consumption

Net exports and private consumption are now significantly higher than in early 2009, as these factors drove the strong recovery in the year up to the first quarter of 2010. Net exports contributed more than 3 pps. to growth in the five quarters up to the second quarter of 2010 combined. But both components are expected to contribute less to growth in the future. In the final quarter of 2010, inventories also might deduct from growth.

Private consumption grew by 3.3% y-o-y in the first quarter of 2010. Private consumption in the third quarter of 2010 was well above the level of the first quarter of 2009 and even higher than at the previous peak in the first quarter of 2008. Given the negative income trend since early 2008 and the already low household saving rate in 2007 it looks unlikely that consumption can strongly support GDP growth further. The strong consumption growth in the third quarter was driven by special factors like the recent hike in the child allowance and tax-incentives for car purchases. Against this backdrop, durable goods consumption was up by 11.1% q-o-q and by 24.8% y-o-y, which is unlikely to recur. Consumption is expected to become negative in the final quarter of 2010 as these fiscal incentives for durable goods purchases and weather conditions cease to have an impact. Looking ahead, and against the backdrop of the strong yen, which will affect the GDP path with a lag, net exports are expected to contribute only marginally to growth in 2011.

The outlook for private investments is relatively more favourable. In the second half of 2009, private investment as a share of GDP was weaker than at the trough of the previous cycle in 2002. Non-residential investments finally started to grow in the fourth quarter of 2009 while residential investments went up only in the first and third quarter of 2010 so far.

With Japanese companies profiting from falling unit-labour costs, sound balance sheets, solid profits, easy financing conditions and strong external demand, in particular from Asia, it is plausible that non-residential investments will be a major source of growth in the coming quarters. As a result, non-residential investments might contribute more to growth than private consumption in 2011. This also implies that confidence-instilling measures, the business climate, the tax environment as well as the fiscal outlook, will become more important for the growth outlook, as they have a large impact on business investment.

Residential investment declined almost 30% since the crisis started. Given easier financing conditions for households and increasing wages, residential investments are expected to grow moderately in the remainder of 2010 and in 2011. After 19 years of decline there are indications that residential property prices are bottoming out, at least in some important segments of the market. Also, Japanese residences normally have a life-span of only 20-30 years and therefore must be replaced at a higher rate than elsewhere. This implies a relatively large potential catch-up for investment after an extended period of low building activity.

Fiscal policy – the big unknown

The government's agenda, increased entitlements and age-related spending make a moderate growth in government consumption likely. The government's intention to finance increased spending in some areas with the elimination of wasteful spending has proven to be impossible. The elimination of wasteful spending simply did not generate enough savings.

In spring the urgency of fiscal consolidation had increased, after turbulence in the sovereign debt markets occurred in a number of countries around

the world. The government announced a fiscal adjustment package and promised not to increase debt issuance in the next three fiscal years. The government also vowed to halve the primary balance until Fiscal Year 2015, to around 3.2% of GDP. In the plan, all additional spending was expected to be financed by additional savings or by increased revenues. This implied that windfall profits by higher tax receipts or unused funds were to be used to speed up fiscal consolidation.

Such concerns seem to have been put on the backburner again after the economic recovery slowed markedly this summer and concerns about the short-term economic prospects increased. In September 2010 the government put forward a new stimulus package worth JPY 915 billion (less than 0.2% of GDP). On 26 October the Cabinet approved a second and much larger stimulus programme, which has yet to pass the Diet. This package is worth JPY 5.09 trillion (almost 1% of GDP), although the real additional spending element might be closer to JPY 3.8 trillion. The package will be mainly funded via a supplementary budget using greater-than-forecast tax revenues, savings from debt servicing and unspent money from the current budget. The rest of the money will come from cost cuts and frontloading of public works projects. The bulk of the spending is targeted at revitalising regional economies, developing infrastructure, supporting SMEs and upgrading medical and social welfare services. The government does not plan to issue new bonds to cover the cost. If the package finally passes the Diet, it would likely boost public spending significantly in the first half of 2011. Public spending further ahead would be somewhat lower, so that the medium-term net effect would be less significant.

Because it is politically uncertain whether or not the package will pass the Lower House and the Upper House (approval is needed for the implementation laws) and what the eventual shape of the package will be, this package was not taken into account in this forecast. GDP growth in 2011 could be stronger by almost $\frac{1}{2}$ pp. however, if the package were implemented.

Supportive labour market

In 2012 growth is expected to accelerate. Private consumption will be stronger than in 2011 on the back of rising wages and increasing confidence. Net exports will make a slightly larger contribution

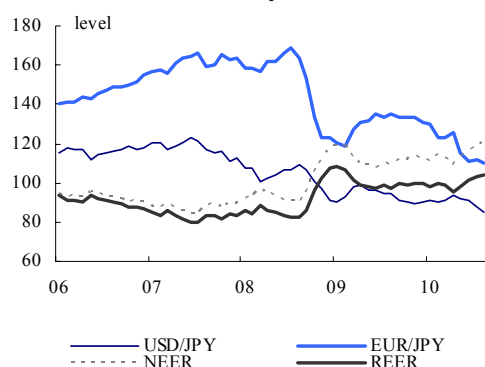
to growth and private investments will continue to grow.

The Japanese labour market has recently strengthened somewhat. In September 2010 the number of employees increased by 0.7% y-o-y, the highest since January 2009. The biggest gain occurred in education and in medical services and health care (+ half a million new jobs in the last year). However, the number of self-employed workers and family workers declined by 300 000 since September 2009. Although the working age population is currently shrinking at an annual rate of about 0.6%, there is still room for an increase in the labour force.

Deflation has proved to be more resilient than widely assumed several months ago. With the output gap gradually closing and monetary aggregates expanding, on balance it appears likely that deflation will ease somewhat in 2011 and will be overcome in 2012.⁽⁸³⁾

Risks around the forecast for the Japanese economy are tilted to the downside. Much will depend on the gyrations of the yen and on the impact on the competitiveness of Japanese exports.

Graph II.33.1: Japan - Exchange rate developments



The profits of export-oriented companies could be undermined and that could have a negative effect on investments. It could also accelerate the relocation of production sites, although the near-term effect of such a development on production and exports is not one-sided. The access to the Chinese market has grown more important for Japan. This implies downside risks in case of tensions between the two countries.

⁽⁸³⁾ However, the rebasing of the CPI calculation scheduled for August 2011 might result in lower 2011 CPI.

Economic developments in other Asian countries pose a downside risk as any significant slowing of growth in Asia would have an immediate impact on Japanese exports.

There are several other downside risks. A sudden increase in long-term interest rates in case investors lose confidence in the long-term fiscal sustainability of Japan could make debt servicing more expensive, although this is unlikely to materialize in the forecast horizon. A sudden deterioration in the financing conditions could cause investments to develop less than forecasted. Wages could increase less than forecasted as unemployment is still relatively high by Japanese standards and employers might continue to replace regular workers with lower-paid temporary workers. The relatively high unemployment of young people combined with the ongoing retirement of relatively well paid employees born in the baby boom years in the late 1940s and early 1950s might contribute to a more anaemic wage growth than thought and could negatively affect consumption. Such a development would also further prolong deflation and deteriorate sentiment.

There are also upside risks. Income growth in large emerging markets could bring about a sharp increase in demand for durable goods such as cars or electronic goods, in which Japan is a leading

supplier. Ample cash combined with easy financing conditions could result in investments growing faster than assumed in case profit opportunities improve. Another upside risk would stem from a depreciated yen relative to other Asian currencies. This would have positive effects for Japanese trade and would also imply a positive wealth effect and increasing income from the vast Japanese investments in Asia.

Residential investments could bounce back more strongly than expected, as sentiment and affordability improve. Government policy to promote more environment-friendly housing could play a role in increasing residential investment.

Last but not least, consumption could benefit from rising property income and relatively high real yields due to the zero -bound and deflation. This could well lift consumption growth above the limited growth foreseen for 2011. Given the shrinking working age population and the declining labour force, even a relatively minor improvement in employment could have a significant impact on the unemployment rate and therefore bring about somewhat higher-than-anticipated wage growth.

Table II.33.1:

Main features of country forecast - JAPAN

	2009			Annual percentage change						
	bn JPY	Curr. prices	% GDP	92-05	2007	2008	2009	2010	2011	2012
GDP	474306.5		100.0	1.1	2.4	-1.2	-5.2	3.5	1.3	1.7
Private consumption	282660.9		59.6	1.3	1.6	-0.7	-1.0	2.3	1.0	1.1
Public consumption	93613.7		19.7	2.5	1.5	0.3	1.5	1.4	0.8	0.9
Gross fixed capital formation	97956.8		20.7	-0.7	-1.2	-2.6	-14.0	-0.2	2.6	3.0
of which : equipment	-		-	-	-	-	-	-	-	-
Exports (goods and services)	59472.0		12.5	5.3	8.4	1.6	-23.9	24.7	4.8	5.1
Imports (goods and services)	58043.0		12.2	4.1	1.6	1.2	-16.7	10.9	5.4	4.3
GNI (GDP deflator)	487225.7		102.7	1.3	2.9	-1.3	-5.8	3.0	1.3	1.7
Contribution to GDP growth :										
Domestic demand				0.9	0.9	-0.9	-3.5	1.3	1.1	1.3
Inventories				0.0	0.3	-0.4	-0.4	0.0	0.0	-0.1
Net exports				0.2	1.1	0.1	-1.3	2.1	0.2	0.3
Employment				-0.1	0.4	-0.3	-1.6	-0.6	-0.2	0.1
Unemployment rate (a)				4.0	3.9	4.0	5.1	5.1	4.9	4.8
Compensation of employees/head				0.1	-1.1	-0.4	-2.9	0.7	1.1	1.2
Unit labour costs whole economy				-1.2	-3.0	0.4	0.8	-3.3	-0.4	-0.4
Real unit labour costs				-0.6	-2.3	1.3	1.8	-1.4	-0.6	0.1
Savings rate of households (b)				-	-	9.3	8.5	8.4	9.0	8.9
GDP deflator				-0.6	-0.7	-0.8	-0.9	-1.9	0.2	-0.4
General index of consumer prices				-	0.0	1.4	-1.4	-0.9	-0.7	0.0
Terms of trade of goods				-1.6	-4.3	-10.9	13.6	-6.2	-0.5	-0.7
Trade balance (c)				2.5	2.4	0.8	0.9	1.6	1.4	1.4
Current account balance (c)				2.8	4.8	3.2	3.5	3.8	3.7	3.7
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				2.7	4.7	3.1	3.4	3.8	3.7	3.7
General government balance (c)				-5.3	-2.4	-2.1	-6.3	-6.5	-6.4	-6.3
Cyclically-adjusted budget balance (c)				-	-	-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-	-	-
General government gross debt (c)				131.5	187.7	194.7	188.9	192.3	195.9	199.0

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

34. CHINA

World locomotive powering ahead

Strong performance in 2010

Following a growth rate of 9.1% in 2009, GDP in the first three quarters of 2010 was up by 10.6% y-o-y, with growth slightly decelerating in annual terms from 11.9% in the first quarter to 9.6% in the third quarter.

In the first three quarters of 2010, growth was primarily driven by private consumption and investments, with the GDP contribution of net exports diminishing, compared to the first three quarters of 2009. In the first three quarters, nominal retail sales increased by 18.3% on the year. When deflated by the corresponding rise in consumer prices (2.9%), this implies a real growth rate of private consumption of around 15%, very close to the one observed in 2009. As the nominal trade surplus in the first nine months declined by USD 14.9 bn to USD 120.6 bn, the contribution of net exports to growth must have declined somewhat (China publishes a real figure for overall GDP and no nominal or real figures for GDP components).

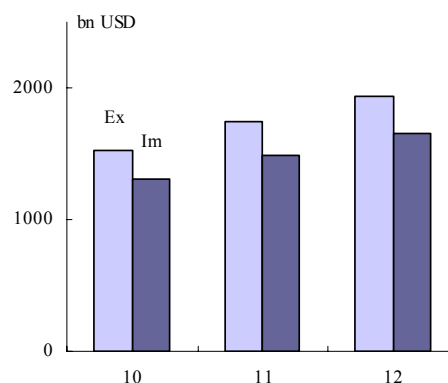
Growth in fixed asset investments rose by 24% y-o-y. Investment in real estate was up by 36.5% on the year (in the first ten months of 2010). As a result, there was renewed concern about a possible bubble scenario in this market. According to China's National Bureau of Statistics, real estate prices were up by 8.6% y-o-y in October compared to a rise of 12.8% in May, although there is anecdotal evidence suggesting that house price developments in large cities like Shanghai have been much more volatile than implied by Chinese statistics. However, since May, it seems that prices have started to decline moderately in some cities as a consequence of the policy measures introduced by the central government in late April.

In the first ten months of 2010, exports were up by 32.7% y-o-y, while imports rose by 40.5% (in value terms). China's imports of petrol were up by 19.5% on the year in volume terms and by 61.2% in value terms. China's trade surplus in the first ten months of 2010 reached USD 147.8 billion (down by 6.7% on the same period of 2009).

In the first ten months of 2010, EU imports from China were up by 33.3% on the year, while EU

exports to China rose by 32.2% and the EU remains China's largest trade partner. The EU's bilateral trade deficit with China reached USD 117.1 bn (compared to USD 150.5 bn for the US). While the EU and the US run a large trade deficit with China, East Asian countries and Australia run a trade surplus with China, and this surplus is continuing to rise. In 2009 exports to China accounted for more than 10% of GDP in South Korea and Taiwan, and this share is increasing (compared with less than 1% of GDP of the EU and the US).

Graph II.34.1: China - Forecast trade in goods



In the remaining months of 2010, export growth is likely to decelerate primarily due to the expected slowdown in the US. Import growth is also likely to continue to slow down as China's companies had used the low prices of commodities early this year to build up inventories.

At the end of the third quarter of 2010, China's holdings of foreign exchange reserves reached USD 2648.3 bn compared to USD 2454.3 bn at the end of the second quarter, the highest nominal quarterly rise ever registered. Since the trade surplus in this period was USD 65.6 bn, a substantial part of the increase in reserves was due to the inflow of hot money in the expectation of RMB appreciation. However, so far RMB appreciation against the US dollar has been only moderate. Since the 19 June announcement by China's central bank on the increased flexibility of the RMB exchange rate, on a nominal effective basis, the RMB has even depreciated by around 6%.

China's current-account surplus, which had reached USD 426.1 billion in 2008, declined to USD 284 billion, i.e. 6% of GDP in 2009 and to 4.8% of GDP in the first half of 2010. In light of the accumulating foreign exchange reserves, China is recording an increasingly large investment income, which, combined with the ongoing rise in the trade surplus, will drive the current-account surplus up again in the second half of 2010.

Developments on the price front are not in line with the targets which the central bank has set itself. Due primarily to food and commodity prices, consumer prices – which were originally projected to peak in May – edged up to 3.3% y-o-y in July and to 4.4% y-o-y (0.7% m-o-m) in October, increasing the risk that consumer price inflation for the year 2010 as a whole will be higher than the declared target of 3%. There is increasing evidence that official statistics are underestimating real price developments.

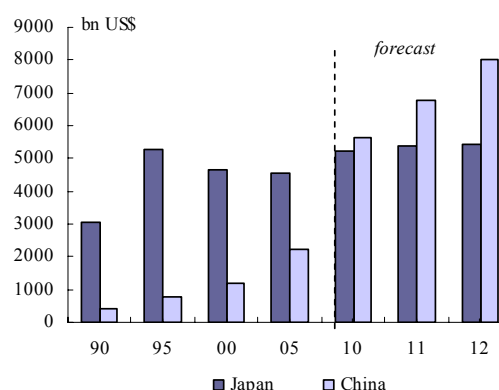
Monetary policy, which had turned very loose in 2009 (broad money supply M2 was up by 27.7% on the year end of 2009) has become less accommodative since early January.⁽⁸⁴⁾ However, with money supply M2 up by 18.96% y-o-y in September and new credits up by RMB 6.9 trillion on the year in October (compared to a target of RMB 7.5 trillion for the year as a whole), the People's Bank of China (PBoC) on 15 November raised the reserve requirement ratio for all banks by another 50 basis points (and by 100 basis points for some large lenders). Since increasingly loose monetary policy in the United States has already started to increase hot capital inflows into China, the PBoC faces a considerable challenge: while increasing price pressures demand further monetary tightening, further interest rate hikes could induce even stronger inflows of hot speculative capital.

Annual growth figures likely to come in slightly weaker in the short and medium-term

In the period from 2007 to 2012, China's contribution to global GDP growth is likely to be the highest in the world⁽⁸⁵⁾. In the fourth quarter of this year China is likely to show lower growth rates as a consequence of the fading of the stimulus measures, the weaker-than-expected

expected US recovery, the moderate monetary tightening initiated by the PBoC and the measures taken in the real-estate sector to avoid the building up of a generalised bubble. China's GDP growth rate is now likely to reach 10½% in 2010 and to decelerate moderately to around 9% in both 2011 and 2012.

Graph 11.34.2: Nominal GDP Japan vs China



Chinese household consumption declined to 35% of GDP in 2010 from roughly 50% 30 years ago, when Beijing embarked in an ambitious programme of market reforms. Private consumption is likely to remain resilient and the contribution of investment to GDP growth is expected to decline somewhat compared to the extremely high contribution in 2009 and 2010. With the strong focus of the stimulus package on the promotion of investments, the share of consumption in GDP has been declining further, while the share of investment has reached an unsustainable level (around 50% of GDP).

On the fiscal side, the general government deficit in 2009 (2.3% of GDP) was lower than the official target of 3% of GDP. In the current year, the deficit is likely to fall to around 1% of GDP. A downside risk is that the financing of many crisis measures via the banking system might cause the ratio of NPLs to rise in the medium-term and require a bail-out of banks by the central government. Local governments might also end up with fiscal problems, if projects yield less than what was optimistically anticipated.

Another domestic downside risk is a potential bursting of the housing bubble in some cities, (although on the basis of public Chinese statistics this risk is hard to quantify). Finally, external developments such as hot capital inflows or a stronger than currently anticipated slowdown in

⁽⁸⁴⁾ Since then, the PBoC has raised the reserve requirement ratio for banks by a total of 200 basis points.

⁽⁸⁵⁾ In the second quarter of 2010, China surpassed Japan as the second-largest economy measured at market exchange rate.

some important advanced economies could negatively impact China's economic performance.

The rebalancing of China's growth model

One of the main challenges to the growth outlook in China in the medium-term is the rebalancing of the economy. The large current-account surplus testifies China's imbalanced growth.

The high (nominal) current-account surplus reflects imbalances in the savings and investment composition of Chinese growth, where investment fuels export-led growth and where the rate of national savings is high. This is due to Chinese households trying to compensate for the country's thin social safety net, limited options to finance major expenditures such as education, and few investment options other than bank deposits. A rebalancing of the economy would require an ongoing improvement of the social welfare system (old age pensions, medical care, and unemployment) and of the education system, especially in the rural areas. Savings by the corporate sector and in particular by many state-owned enterprises are also high, due to the

lack of coherent taxation of those enterprises. In order to avoid a misallocation of resources and to deepen financial intermediation, further financial liberalisation is needed.

In 2009, China implemented some measures in these areas, for example introducing 9-year-free compulsory education and the three-year programme to extent provision of basic health care also into the countryside. These fostered household consumption to some extent. However, compared with the huge spending implied by the November 2008 stimulus package, the amounts earmarked for social issues remain relatively small.

In the absence of a more ambitious approach to social security and financial sector reform and a liberalisation of the service sector, China's growth trajectory looks more and more unsustainable in the medium-term. Against this background, the new 12th Five-Year-Plan starting in 2011 will be of paramount importance.

Table II.34.1:

Main features of country forecast - CHINA

	2009			Annual percentage change						
	bn CNY	Curr. prices	% GDP	92-05	2007	2008	2009	2010	2011	2012
GDP	34050.7	100.0		10.2	13.0	9.0	9.1	10.5	9.2	8.9
Private consumption	12113.0	35.6		-	-	-	-	-	-	-
Public consumption	4439.7	13.0		-	-	-	-	-	-	-
Gross fixed capital formation	164463.5	48.3		-	-	-	-	-	-	-
of which : equipment	-	-		-	-	-	-	-	-	-
Change in stocks as % of GDP	-	-		-	-	-	-	-	-	-
Exports (goods and services)	12016.1	35.3		-	36.9	11.9	-22.7	22.0	11.7	9.6
Final demand	-	-		-	-	-	-	-	-	-
Imports (goods and services)	10059.2	29.5		-	11.2	6.3	-18.4	25.5	11.7	10.8
GNI (GDP deflator)	-	-		-	-	-	-	-	-	-
Contribution to GDP growth :										
Domestic demand				-	-	-	-	-	-	-
Stockbuilding				-	-	-	-	-	-	-
Foreign balance				-	-	-	-	-	-	-
Employment				1.1	0.8	0.6	0.7	-	-	-
Unemployment (a)				3.3	4.0	4.2	4.3	4.4	4.2	4.0
Compensation of employees/head				-	-	-	-	-	-	-
Unit labour costs				-	-	-	-	-	-	-
Real unit labour costs				-	-	-	-	-	-	-
Savings rate of households				-	-	-	-	-	-	-
GDP deflator				-	7.4	7.3	2.6	2.8	3.0	2.9
Private consumption deflator				-	-	-	-	-	-	-
Index of consumer prices (c)				5.6	4.8	5.9	-0.7	3.3	3.3	3.7
Trade balance (b)				2.7	9.3	8.3	5.1	3.8	3.7	3.4
Current account balance (b)				2.1	11.0	10.1	6.1	5.0	4.8	4.6
Net lending(+) or borrowing(-) vis-à-vis ROW (b)				-	-	-	-	-	-	-
General government balance (b)				-1.5	0.6	-0.4	-2.3	-1.0	0.0	0.5
General government gross debt (b)				-	-	-	-	-	-	-

(a) urban unemployment, as % of labour force. (b) as a percentage of GDP. (c) national indicator.

35. EFTA

Faring well

Liechtenstein, Norway and Switzerland are covered in this section, whereas Iceland's outlook can be found in the section on candidate countries.

EFTA countries have weathered the crisis relatively well, with the exception of Iceland. During the crisis EFTA economies were actively supported through fiscal stimulus packages which are due to be unwound during the forecast years, albeit at different pace across countries. Government spending in the EFTA states is expected to be more restrained in the forecast years and domestic demand to be mostly driven by the private sector. While in Norway higher household spending is expected, Switzerland is relying on increased investments to drive growth in domestic demand.

The traditionally positive contribution to growth from external trade is likely to resume. Growth in both exports and imports is projected to rebound significantly for all EFTA countries, and mostly in the case of Switzerland. High unemployment rates continue to be the common challenge to all EFTA economies. Although remaining well below EU levels, these are likely to remain significantly above pre-crisis levels in the forecast years. The outlook for the forecast period shows moderate growth in Switzerland⁽⁸⁶⁾ and Norway.

GDP growth driven by consumer spending in Norway...

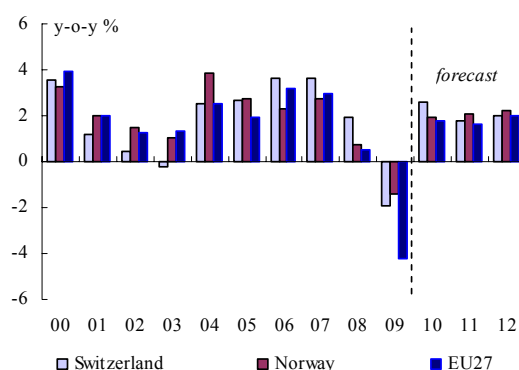
Real GDP contracted by 1.4% in 2009, with domestic demand shrinking through all its components (except government spending) and external trade also contributing to the contraction. The return to growth in 2010 is forecast at 1.9%. The challenge for Norway will be to maintain its growth momentum as the fiscal stimulus fades away towards the end of the forecast period. The expansionary fiscal policy exercised during the crisis is expected to become much more restrained in the coming years. The fiscal stance is expected to turn less expansionary from 2011 onwards as the fiscal stimulus package is envisaged to be halved compared with this year.

GDP growth is likely to accelerate somewhat in 2011, to 2.1% and 2.2% in 2012. The rebound of

growth is mostly driven by domestic demand. The decline in investments in Norwegian mainland industries that started in 2009 is expected to continue into 2010. Investment in the mainland industries is expected to increase in 2011 and onwards, though investment levels should still stay well below the (record high) levels of 2008. Even though investments in petroleum fell somewhat in the first half of this year, on an annual basis they are set to increase slightly this year and to remain stable during the forecast period.

Export growth should be driven by services and traditional goods, such as wood products, industrial machinery and transport equipment rather than Norway's oil exports. Oil production is expected to fall slightly in the forecast period. As this decrease is more than offset by the export of traditional goods, exports are likely to grow by around 1.3% this year and further to around 1.5% by the end of the forecast period. However, as import growth is expected to outpace the growth of exports, the external net contribution to GDP growth should be decreasing towards the end of the forecast period albeit remaining (slightly) positive.

Graph II.35.1: EFTA vs EU27 GDP growth



Households continue to spend...

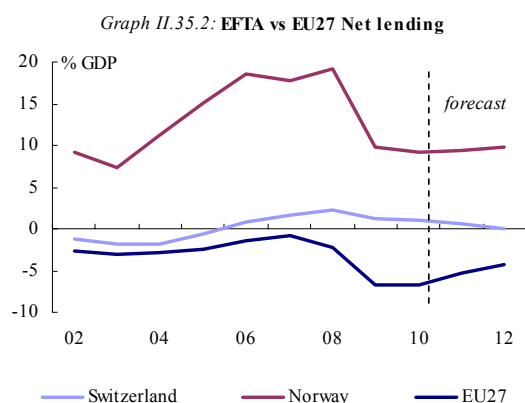
Household consumption, which accounts for around 55% of GDP in mainland Norway, is likely to grow again in the forecast period. Low interest rates, increased incomes, increased wealth and better prospects all contributed to stabilise household consumption in 2009, after having declined for a year. A return to growth of

⁽⁸⁶⁾ Switzerland's outlook includes Liechtenstein.

consumer spending of around 3.7% annually is expected in 2010 and growth should remain above 3% throughout the forecast period, despite planned higher policy interest rates. However, the relatively highly indebted Norwegian households could pose a downside risk to household spending. Taken together, the fact that the vast majority of the loans depend on flexible interest rates, in combination with the gradual withdrawal of fiscal stimulus measures, could negatively impact consumer's spending capacity and limit consumer spending.

Norway's housing market on a solid foundation...

House prices are expected to continue to increase in 2010 and 2011. The improvement in the housing market is expected to contribute to increased investments, thus turning the decline of the past two years into a possible upswing in the next two years.



Inflation remains moderate...

Consumer inflation declined to an annual average of 2.3% in 2009 and strengthening of the NOK is expected to contribute to putting a lid on inflation, resulting in rates around 1.8% this year. In the remainder of the forecast period the inflation rate will likely remain just below 2%. The recent slump in the Norwegian economy is partly responsible for a fall in wage growth. Wage growth is expected to slow down further in the forecast period which should also limit the pressure from the labour market.

...while unemployment remains low

Unemployment in Norway is relatively low as compared to the EU. However, it is expected to rise slightly this year to around 4% of the total

work force. In the next two years unemployment should ease to 3.5% by the end of 2012.

Current account remains positive...

Norway's current account is expected to remain positive throughout the forecast period. Although the trade surplus narrowed in 2009, as a result of lower oil prices, it is likely to widen again this year driven by higher oil prices. In 2011-12, the current account should further benefit from this development supported by a surplus of the service's balance.

Switzerland's economy is rebounding

Switzerland's economy is rebounding from the worst recession in over three decades with the global economic slump hitting its exporters hard. While the economy contracted by 1.9% in 2009 it is expected to pick up strongly this year. GDP growth is forecast at 2.6% in 2010, decelerating to 1.8% in 2011, due to decreasing growth in government spending. GDP growth should remain around that level in 2012 at 2.0% of GDP. Overall external trade has turned from a positive net contribution into a negative contribution in 2009, but is expected to turn positive again in 2010. After stabilisation in 2012, the external sector is foreseen to post a slight positive contribution to growth again in 2012 mostly due to strongly increasing exports.

With increasing saving rates and low consumer confidence, household consumption dropped in 2009 but is expected to resume moderately in 2010 and 2011. Growth in public investment is also expected to be modest in the forecast years despite increased government focus on infrastructure investments. In 2009, exports of goods, a key economic factor for Switzerland, declined by 11.5% whilst imports of goods were down by 5.4%.

Exports are picking up again in Switzerland

Exports rebounded strongly in the second quarter of this year, mostly due to strong growth in pharmaceutical and machineries exports to Asia, where Switzerland's exports are likely to gain a growing market-share. Real growth in exports of goods and services is expected to continue strongly this year and more moderately in 2011-12. However, there is a latent downside risk to the services sector in relation to the eroding bank

secrecy. Overall, imports will grow in a similar way, albeit slower than exports, and subsequently, the net external contribution to Swiss GDP growth should be slightly positive towards the end of the forecast period.

Swiss inflation...

The Swiss National Bank is expected to maintain the course of its expansionary monetary policy in 2011 and 2012. The key interest rate, the three-month Swiss-franc Libor, is likely to be kept low, at around 0.25% this year. For next year and 2012 a small rise of the key interest rate rise is likely, still leaving it however below 1% (this would still represent an expansionary monetary stance). Recent robust domestic credit growth does not seem too alarming, as the private sector is not burdened by high debt levels. Inflation continues to be low, especially on the core measures, which are close to deflation in the second half of 2010. For the forecast years, inflation is expected to remain low. Inflation rates are expected to remain close to 1%, with a slight increase towards the end of the forecast period.

In 2009 Switzerland began to intervene in the currency markets, buying up large amounts of euros between March 2009 and June 2010. However, the interventions merely slowed down

the appreciation of the Franc somewhat, leaving the Swiss Franc in its relatively strong position towards the euro. For the forecast period the National Bank is likely to continue fighting concerns about deflation and the strong Franc, using all available means, including currency interventions.

Low unemployment...

The unemployment rate is slightly on the rise and will be around 4.2% by the end of 2010, which has not happened since the mid-nineties. For 2011 unemployment is expected to remain high to decrease to a level of around 3.0% in 2012. Wage growth is expected to diminish significantly in the same period, adding a decreasing impact on inflation subsequently.

Swiss current account

The current-account surplus improved to around 12.7% of GDP in 2009. The trade and services balances should continue to record decreasingly large surpluses during the forecast years. The income balance is forecast to deflate gradually from the estimated surplus that it bounced back to in 2009. Overall, the current account is forecast to remain significant positive, at an annual average of around 10% of GDP in 2010-12.

Table II.35.1:

Main features of country forecast - EFTA

	Iceland			Norway			Switzerland		
(Annual percentage change)	2010	2011	2012	2010	2011	2012	2010	2011	2012
GDP	-3.5	0.7	2.1	1.9	2.1	2.2	2.6	1.8	2.0
Private consumption	-0.5	1.5	1.9	3.7	3.5	3.7	1.8	1.3	1.8
Public consumption	-3.0	-3.0	-2.0	2.7	1.8	1.7	0.6	0.6	0.2
Gross fixed capital formation	-5.0	5.0	10.0	-2.8	0.9	0.9	2.2	2.4	2.1
of which : equipment	-49.9	5.0	10.0	-2.1	0.9	0.9	1.5	2.5	2.1
Exports (goods and services)	2.0	2.4	3.0	1.3	1.6	1.5	10.7	3.5	5.1
Imports (goods and services)	1.6	3.2	3.1	-1.0	2.4	2.3	10.0	6.3	6.4
GNI (GDP deflator)	-6.4	0.9	2.6	-0.4	2.2	2.3	-2.1	1.5	1.7
Contribution to GDP growth :									
Domestic demand	-	0.6	1.7	1.6	2.1	2.2	1.6	1.3	1.4
Inventories	-	-	-	-	-	-	-	-	-
Net exports	0.4	0.1	0.4	0.8	0.1	0.1	1.5	-0.8	0.2
Employment	-0.6	0.5	1.0	-0.3	1.8	2.8	2.7	2.1	2.2
Unemployment rate (a)	7.8	7.3	6.3	4.0	3.7	3.5	4.2	3.2	3.0
Compensation of employees/head	2.3	2.5	2.9	2.4	3.4	4.4	3.8	3.3	4.4
Unit labour costs whole economy	5.4	2.3	1.8	0.1	3.1	5.1	4.0	3.6	4.7
Real unit labour costs	-1.3	0.4	-0.4	-3.7	0.8	2.7	2.6	1.3	2.6
Savings rate of households (b)	-	-	-	9.3	10.0	12.2	24.1	25.9	27.9
GDP deflator	6.8	1.8	2.2	3.9	2.4	2.4	1.4	2.3	2.0
Harmonised index of consumer prices	5.5	2.5	2.3	1.8	1.9	1.8	0.9	1.0	1.2
Terms of trade of goods	-	-	-	4.7	0.1	0.1	2.9	2.7	0.2
Trade balance (c)	6.2	5.9	6.1	14.2	13.6	13.1	3.8	3.7	3.0
Current account balance (c)	-4.5	-4.9	-4.6	13.0	12.5	12.0	9.6	9.4	9.3
Net lending(+) or borrowing(-) vis-à-vis ROW (c)	-4.5	-4.9	-4.6	12.9	12.5	12.0	9.9	9.7	9.5
General government balance (c)	-6.2	-4.2	-3.2	9.2	9.3	9.8	1.0	0.7	0.1
Cyclically-adjusted budget balance (c)	-	-	-	-	-	-	-	-	-
Structural budget balance (c)	-	-	-	-	-	-	-	-	-
General government gross debt (c)	91.5	93.5	92.8	46.3	44.4	41.8	39.6	37.6	36.5

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

36. RUSSIAN FEDERATION

Below pre-crisis growth

The Russian economy started to recover during the third quarter of 2009. In the first two quarters of 2010, real GDP grew by 3.1% and 5.2% (y-o-y). Economic growth has been increasingly led by recovering domestic demand rather than external demand, with export growth decelerating significantly in recent months. Growth in the second half of 2010 is likely to be somewhat dented by the impact of the heat wave and drought, and the damage will be concentrated in the agricultural sector. These factors will likely limit GDP growth in 2010 to 3½%. Subsequently, the recovery will gain more traction and growth is expected to accelerate to 3.8% and 4.0% in 2011-12.



Growth has returned to positive territory

The return to positive GDP growth in 2009 was initially underpinned by an upturn in external demand, the large stimulus package adopted in April 2009 and monetary policy easing. While growth in the first quarter was mainly export driven, in the second quarter it has been led by recovering domestic demand. Both private consumption and fixed investment made a positive contribution. In contrast to many other economies, the return to domestic demand growth is unconstrained by the need for households to deleverage. The recovery took a hit in the third quarter of 2010 from the unusual hot weather. Agricultural output fell significantly. Developments in other sectors signal a deceleration in activity in the third quarter.

The rise in commodity prices and recovering external demand has led to a marked improvement in the current-account balance, rising from 4% of GDP in 2009 to 6% in the second quarter of 2010. However, export growth slowed sharply in the second quarter. The headwinds to export growth from rapid rouble appreciation and stabilisation of energy commodity prices have proved to be strong. Meanwhile, a large part of the domestic demand-driven rebound has leaked through higher imports; import growth has continued to grow rapidly. As a result, the current-account surplus is projected to contract from 5.1% of GDP in 2010 to 4.7% and 4.2% in both 2011 and 2012, respectively.

Against the backdrop of the return to positive growth, the labour market improved. The unemployment rate, which shot up from 5.8% in August 2008 to 9.4% in February 2009, has been coming down rapidly to around 7% in the third quarter of 2010. After a crisis-induced decline in real wages in 2009, real wage growth has resumed.

Amid a large output gap, falling food prices until the second quarter of 2010, and continuous rouble appreciation, inflation fell for twelve consecutive months, from 12% in July 2009 to a post-Soviet-era low of 5.5% a year later. Inflation edged up to 7% in September, largely driven by higher food prices, as a result of the heat wave.⁽⁸⁷⁾

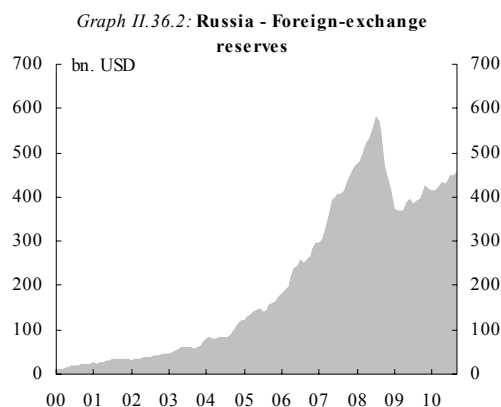
The strong monetary response

The Central Bank of Russia (CBR) manages the rouble against a dollar/euro basket, in which the dollar has a 55% weighting and the euro a 45% weighting. During the crisis, in late 2008 and early 2009, the CBR intervened to manage the rouble's depreciation against the basket. The central bank sold around USD 200 bn in hard currency reserves. In 2010, as the exchange rate stabilised, the CBR scaled back its intervention in currency markets and started replenishing foreign exchange reserves. Hard currency reserves are currently at around USD 450 bn.

More recently, and in contrast to other emerging economies, the CBR has not prevented the rouble

⁽⁸⁷⁾ Food prices represent about 40% of the CPI basket in Russia.

from appreciating. The rouble now lies within the central bank's range of 33.4-36.4 against the basket. Since early 2009, the rouble has strengthened, driven by rising oil prices. The real effective exchange rate of the rouble is now close to where it was on the eve of the crisis.



After ten interest rate cuts in the last seven months of 2009, the CBR further reduced its refinancing rate four times in 2010 from 8.75% in February to a record-low 7.75% in June. Since then, the overnight rate has been kept unchanged and the CBR has signalled that it has put an end to monetary easing. The CBR has also begun to withdraw liquidity measures introduced during the crisis as financial markets stabilised.

Spurred by the aggressive monetary easing, domestic credit to the private sector has started to recover in 2010. Non-performing bank loans have risen during the crisis, but appear to have peaked in the summer. The Russian banking sector appears in a relatively sound position to manage these non-performing loans, as the average capital adequacy ratio rose from around 13% in mid-2008 to around 19% by July 2010. The recent increase in inflation has pushed real interest rates into negative territory, which may slow down the growth in bank deposits, and thereby constrain bank lending.

Growth will remain below pre-crisis levels

The Russian economy is recovering after a deep recession, but the recovery is fragile. Over the forecast horizon, the strengthening of the labour market and relatively subdued inflation, coupled with revived bank lending, are expected to spur domestic demand. However, growth is unlikely to return to pre-crisis levels as the contribution from

net exports will be constrained by capacity in the energy sector and strong import growth.

The current upturn in inflation is expected to be temporary as the spillover from food prices to the rest of the CPI basket has been limited and the still substantial output gap dampens pricing power. Annual average inflation is forecast to ease to a yearly average of around 6-6½% in 2011-12.

The room for manoeuvre for fiscal policy was large before the recession and has been used to offset the shortfall of private demand. In 2009, the general government deficit came in at 5.9% of GDP. For 2010, only a modest reduction to a deficit of 5.4% of GDP is foreseen. The key policy challenges will be to withdraw the large fiscal stimulus and avoid excessive exchange rate volatility and high inflation.

Fiscal consolidation started in 2010 and will gather pace in 2011-12 through the winding down of some of the stimulus measures. According to the Medium Term Expenditure Framework, the budget balance would return by 2015. Under the recently revised budget proposals for 2011-13, the deficit is set to shrink to 3.6% of GDP in 2011 and to less than 3% of GDP by 2013. This is in line with the forecast, which projects a deficit of 3.2% in 2012. Fiscal consolidation helps to maintain fiscal sustainability and decreases the high vulnerability of the public finances to swings in oil prices by ensuring a better starting position in case of a negative terms-of-trade shock.

The Reserve Fund, which was set up to save part of the oil windfall and to reduce the vulnerability of the budget against oil-price volatility, is gradually being depleted. Reserves went down from USD 130 to 60 billion in 2009 as they were used to finance the budget deficit. In 2010, the Reserve Fund has continued to decline, to USD 40 billion in September and may be used to finance the 2010 deficit. With few funds left in the Fund at the end of 2010, the 2011-12 budget deficits will increasingly be financed through issuing domestic debt. Increased domestic public borrowing poses the risk of increasing domestic interest rates and crowding out private investment. To ease the financing needs, the government has approved a list of state-owned enterprises in which it will sell part of its shareholdings, while retaining majority ownership. The government aims to raise USD 30 billion out of privatisation proceeds. Drawing down the Reserve Fund implies less

fiscal space in the future, although public debt is expected to remain relatively low over the forecast horizon.

The weakening of the current-account balance and the sizeable output gap reduced the trade-off between the potentially conflicting objectives of maintaining price and exchange rate stability. Hence the rouble is being given somewhat higher exchange rate flexibility against the basket. The CBR scaled down interventions on the exchange market and increased the role of the policy rate in slowing inflation. The recent pick-up in inflation is currently largely seen as a temporary shock with limited second-round effects. Wage growth is expected to continue but remain moderate and definitely slower than before 2009. As a result, the inflation rebound has not prompted monetary tightening. However, should upward pressures on the rouble intensify; there is a risk that priority might again be given to exchange rate considerations.

GDP growth is expected to reach 4% towards the end of the forecast period and to remain well below the rates achieved before the crisis. The assessment of risks remains highly correlated to changes in oil prices. Higher oil prices would solve many of the challenges. There are several downside risks. The economy's high (and

increasing) dependence on the hydrocarbon sector may negatively impact the outlook. Sizeable energy output growth through increased production is unlikely to materialise, as existing fields are depleting and extraction becomes more complicated as well as more expensive. Recovery in investments is mild and unlikely to be strong enough to meet Russia's large investment needs in support of higher potential growth. With a contribution to GDP in 2010 of around 20%, Russian investments remain well below many other emerging economies. Despite improved fiscal rules and continuous budgetary surpluses in the years preceding the crisis, the gradual pace of consolidation poses the risk that fiscal policy could become pro-cyclical.

Whilst unemployment is foreseen to decline below 8% again towards the end of the forecast period some risks remain. Regional governments stimulated employment during the crisis (under pressure of the central government) by keeping industrial workers on the payroll. However, they may well lose the ability to continue supporting the labour market in the forecast years. Federal resources allocated last year to support regional governments are depleting and therefore there will be fewer incentives for local businesses to continue paying for an excessive supply of workers.

Table II.36.1:

Main features of country forecast - RUSSIA

	2009			92-05	Annual percentage change					
	bn RUB	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	39063.6		100.0	-	8.1	5.6	-7.9	3.5	3.8	4.0
Private consumption	21317.8		54.6	-	13.8	10.7	-7.6	4.1	4.3	4.5
Public consumption	7867.3		20.1	-	3.7	2.9	2.0	2.2	1.9	2.1
Gross fixed capital formation	8387.5		21.5	-	21.1	10.4	-15.7	5.9	4.3	7.8
of which : equipment	3140.9		8.0	-	-	-	-	5.0	0.9	8.0
Exports (goods and services)	10847.1		27.8	-	6.3	0.6	-4.7	5.1	4.9	4.5
Imports (goods and services)	7960.5		20.4	-	26.6	15.2	-30.4	11.6	7.7	6.9
GNI (GDP deflator)	37808.8		96.8	-	8.8	5.0	-8.2	3.2	4.1	3.9
Contribution to GDP growth :				-	11.2	7.9	-6.9	3.9	3.5	4.4
Domestic demand				-	-	-	-	-	-	-
Inventories				-	-	-	-	-	-	-
Net exports				-	-3.5	-3.1	5.2	-1.0	-0.1	-0.1
Employment				-	1.3	0.6	-2.9	0.4	1.9	2.9
Unemployment rate (a)				-	5.7	7.0	7.3	8.2	7.9	7.7
Compensation of employees/head				-	-	-	-	-	-	-
Unit labour costs whole economy				-	-	-	-	-	-	-
Real unit labour costs				-	-	-	-	-	-	-
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				-	14.4	18.0	2.3	12.1	7.1	4.0
General index of consumer prices				-	9.0	14.1	11.7	7.5	6.5	6.0
Terms of trade of goods				-	-	-	-	-	-	-
Trade balance (c)				-	10.1	10.8	9.1	9.8	9.1	8.6
Current account balance (c)				-	6.0	6.2	4.0	5.1	4.7	4.2
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	5.2	6.2	3.1	-	-	-
General government balance (c)				-	-	-	-	-5.4	-3.9	-3.2
Cyclically-adjusted budget balance (c)				-	-	-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-	-	-
General government gross debt (c)				-	-	-	-	11.3	11.1	10.7

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

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Statistical Annex

European Economic Forecast – Autumn 2010

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TABLE 1 : Gross domestic product, volume (percentage change on preceding year, 1992-2012)

15.11.2010

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	1.5	2.7	2.0	2.7	2.9	1.0	-2.8	2.0	1.8	2.0	1.3	1.6
Germany	1.4	2.1	1.0	3.4	2.7	1.0	-4.7	3.7	2.2	2.0	1.2	1.6
Estonia	:	7.0	8.5	10.6	6.9	-5.1	-13.9	2.4	4.4	3.5	0.9	3.8
Ireland	5.8	9.2	5.4	5.3	5.6	-3.5	-7.6	-0.2	0.9	1.9	-0.9	3.0
Greece	1.1	3.8	4.1	4.5	4.3	1.3	-2.3	-4.2	-3.0	1.1	-3.0	-0.5
Spain	1.5	4.4	3.3	4.0	3.6	0.9	-3.7	-0.2	0.7	1.7	-0.4	0.8
France	1.2	3.0	1.7	2.2	2.4	0.2	-2.6	1.6	1.6	1.8	1.3	1.5
Italy	1.2	2.0	0.9	2.0	1.5	-1.3	-5.0	1.1	1.1	1.4	0.8	1.4
Cyprus	5.5	4.2	3.3	4.1	5.1	3.6	-1.7	0.5	1.5	2.2	-0.4	1.3
Luxembourg	2.6	6.3	4.1	5.0	6.6	1.4	-3.7	3.2	2.8	3.2	2.0	2.4
Malta	5.0	3.4	2.2	3.6	3.7	2.6	-2.1	3.1	2.0	2.2	1.1	1.7
Netherlands	2.5	3.7	1.6	3.4	3.9	1.9	-3.9	1.7	1.5	1.7	1.3	1.8
Austria	1.8	2.6	2.2	3.6	3.7	2.2	-3.9	2.0	1.7	2.1	1.3	1.6
Portugal	2.0	3.9	0.7	1.4	2.4	0.0	-2.6	1.3	-1.0	0.8	0.5	0.7
Slovenia	2.0	4.2	4.3	5.9	6.9	3.7	-8.1	1.1	1.9	2.6	1.1	1.8
Slovakia	:	2.7	5.9	8.5	10.5	5.8	-4.8	4.1	3.0	3.9	2.7	3.6
Finland	1.3	4.5	3.0	4.4	5.3	0.9	-8.0	2.9	2.9	2.3	1.4	2.1
Euro area	1.5	2.8	1.7	3.0	2.9	0.4	-4.1	1.7	1.5	1.8	0.9	1.5
Bulgaria	-2.8	2.5	6.0	6.5	6.4	6.2	-4.9	-0.1	2.6	3.8	0.0	2.7
Czech Republic	2.3	1.2	4.6	6.8	6.1	2.5	-4.1	2.4	2.3	3.1	1.6	2.4
Denmark	2.6	2.4	1.8	3.4	1.6	-1.1	-5.2	2.3	1.9	1.8	1.6	1.8
Latvia	-8.8	6.3	9.0	12.2	10.0	-4.2	-18.0	-0.4	3.3	4.0	-3.5	3.3
Lithuania	-8.3	4.7	8.0	7.8	9.8	2.9	-14.7	0.4	2.8	3.2	-0.6	3.2
Hungary	0.5	4.3	3.9	3.6	0.8	0.8	-6.7	1.1	2.8	3.2	0.0	2.8
Poland	4.9	4.4	4.1	6.2	6.8	5.1	1.7	3.5	3.9	4.2	2.7	3.3
Romania	1.4	-0.7	6.2	7.9	6.3	7.3	-7.1	-1.9	1.5	3.8	0.8	3.5
Sweden	1.2	3.4	3.3	4.3	3.3	-0.4	-5.1	4.8	3.3	2.3	1.8	2.5
United Kingdom	2.5	3.4	2.6	2.8	2.7	-0.1	-5.0	1.8	2.2	2.5	1.2	2.1
EU	1.3	2.9	2.1	3.2	3.0	0.5	-4.2	1.8	1.7	2.0	1.0	1.7
USA	3.3	3.8	2.7	2.7	1.9	0.0	-2.7	2.7	2.1	2.5	2.8	2.5
Japan	1.3	0.5	1.7	2.0	2.4	-1.2	-5.2	3.5	1.3	1.7	2.1	1.5

TABLE 2 : Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter, 2010-2012) ¹

	2010/1	2010/2	2010/3	2010/4	2011/1	2011/2	2011/3	2011/4	2012/1	2012/2	2012/3	2012/4
Belgium	0.1	1.0	0.5	0.1	0.3	0.6	0.6	0.5	0.5	0.5	0.5	0.5
Germany	0.6	2.3	0.7	0.5	0.3	0.4	0.5	0.5	0.5	0.6	0.6	0.6
Estonia	1.1	1.9	0.5	0.9	1.1	1.2	1.2	0.9	0.8	0.7	0.7	0.6
Ireland	2.2	-1.2	:	:	:	:	:	:	:	:	:	:
Greece	:	:	:	:	:	:	:	:	:	:	:	:
Spain	0.1	0.2	0.0	0.1	0.1	0.2	0.3	0.4	0.5	0.5	0.5	0.5
France	0.2	0.7	0.4	0.4	0.4	0.3	0.3	0.4	0.5	0.5	0.5	0.5
Italy	0.4	0.5	0.2	0.2	0.3	0.3	0.4	0.4	0.3	0.3	0.4	0.3
Cyprus	0.4	0.5	0.6	0.5	0.2	0.3	0.4	0.5	0.5	0.6	0.7	0.7
Luxembourg	:	:	:	:	:	:	:	:	:	:	:	:
Malta	:	:	:	:	:	:	:	:	:	:	:	:
Netherlands	0.5	0.9	-0.1	0.5	0.3	0.3	0.4	0.4	0.4	0.4	0.5	0.5
Austria	0.0	1.2	0.9	0.6	0.3	0.3	0.3	0.3	0.7	0.7	0.7	0.7
Portugal	1.1	0.3	0.3	-1.4	-0.2	-0.2	0.3	0.2	0.2	0.2	0.2	0.2
Slovenia	-0.1	1.1	0.3	0.4	0.4	0.4	0.5	0.5	0.7	0.8	0.8	0.8
Slovakia	0.8	1.0	0.9	0.7	0.5	0.8	0.8	0.8	1.0	1.0	1.1	1.1
Finland	0.1	1.9	1.3	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.5	0.5
Euro area	0.3	1.0	0.4	0.3	0.3	0.3	0.4	0.4	0.5	0.5	0.5	0.5
Bulgaria	-0.5	0.5	0.3	0.4	0.7	0.8	0.9	1.0	0.9	0.9	1.0	1.0
Czech Republic	0.4	0.9	1.1	0.6	0.2	0.4	0.6	0.7	0.7	0.9	1.0	1.0
Denmark	:	:	:	:	:	:	:	:	:	:	:	:
Latvia	1.1	1.2	0.8	0.7	0.7	0.8	0.9	0.9	1.0	1.1	1.2	1.2
Lithuania	-4.0	3.2	1.8	4.6	-7.2	4.2	-2.0	3.1	-7.0	6.2	2.3	1.5
Hungary	1.0	0.4	0.8	0.5	0.7	0.7	0.7	0.8	0.8	0.7	0.7	0.6
Poland	0.7	1.1	0.8	0.7	1.0	1.1	1.0	1.1	1.0	1.0	1.1	1.0
Romania	-0.3	0.3	-0.7	0.2	0.7	0.5	0.8	0.7	1.0	1.1	1.1	1.2
Sweden	1.5	1.2	1.8	1.3	0.9	0.5	0.3	0.4	0.5	0.8	0.8	0.9
United Kingdom	0.5	1.2	0.8	0.6	0.5	0.4	0.4	0.4	0.7	0.8	0.8	0.8
EU	0.4	1.1	0.5	0.4	0.3	0.4	0.4	0.5	0.5	0.6	0.6	0.6
USA	0.9	0.4	0.5	0.6	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.6
Japan	1.6	0.4	0.9	-0.6	0.5	0.6	0.5	0.5	0.3	0.5	0.2	0.3

¹ While Eurostat's flash release of GDP data for Q3-2010 does not revise data for previous quarters, many national statistical institutes do present revisions at the same time. Accordingly, data for the euro-area and EU aggregates for the first three quarters of 2010 presented in this table may differ from the official numbers published by Eurostat at the cut-off date, as they are aggregated from individual Member States' data.

TABLE 3 : Profiles (yoy) of quarterly GDP, volume (percentage change from corresponding quarter in previous year, 2010-2012)

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	2010/1	2010/2	2010/3	2010/4	2011/1	2011/2	2011/3	2011/4	2012/1	2012/2	2012/3	2012/4
Belgium	:	:	:	1.7	1.9	1.4	1.5	1.9	2.1	2.0	1.9	2.0
Germany	:	:	:	4.2	3.9	1.9	1.7	1.7	1.9	2.2	2.3	2.4
Estonia	:	:	:	4.5	4.6	3.9	4.5	4.5	4.2	3.7	3.3	3.0
Ireland	:	:	:	:	:	:	:	:	:	:	:	:
Greece	:	:	:	:	:	:	:	:	:	:	:	:
Spain	:	:	:	0.4	0.4	0.4	0.8	1.1	1.4	1.7	1.9	2.1
France	:	:	:	1.7	1.9	1.6	1.6	1.5	1.5	1.7	1.9	2.0
Italy	:	:	:	1.3	1.1	1.0	1.3	1.4	1.5	1.5	1.4	1.3
Cyprus	:	:	:	2.0	1.8	1.6	1.3	1.4	1.7	2.1	2.4	2.6
Luxembourg	:	:	:	:	:	:	:	:	:	:	:	:
Malta	:	:	:	:	:	:	:	:	:	:	:	:
Netherlands	:	:	:	1.8	1.7	1.1	1.6	1.5	1.6	1.7	1.7	1.8
Austria	:	:	:	2.8	3.1	2.1	1.4	1.0	1.5	1.9	2.4	2.9
Portugal	:	:	:	0.2	-1.1	-1.6	-1.6	0.1	0.5	1.0	0.9	0.8
Slovenia	:	:	:	1.7	2.2	1.6	1.8	1.9	2.1	2.5	2.8	3.1
Slovakia	:	:	:	3.5	3.1	3.0	2.8	2.9	3.5	3.7	4.0	4.3
Finland	:	:	:	3.9	4.3	2.8	2.1	2.1	2.1	2.3	2.2	2.2
Euro area	:	:	:	2.1	2.0	1.3	1.4	1.5	1.6	1.8	1.9	2.0
Bulgaria	:	:	:	0.7	1.9	2.2	2.8	3.5	3.7	3.8	3.8	3.7
Czech Republic	:	:	:	3.1	3.0	2.4	2.0	2.0	2.4	2.9	3.3	3.7
Denmark	:	:	:	:	:	:	:	:	:	:	:	:
Latvia	:	:	:	3.8	3.4	3.0	3.1	3.3	3.6	3.9	4.2	4.5
Lithuania	:	:	:	5.5	2.1	3.0	-0.8	-2.2	-2.0	-0.1	4.2	2.5
Hungary	:	:	:	2.7	2.4	2.7	2.7	3.0	3.0	3.1	3.0	2.9
Poland	:	:	:	3.3	3.6	3.6	3.9	4.3	4.3	4.2	4.2	4.1
Romania	:	:	:	-0.5	0.5	0.7	2.2	2.7	3.0	3.6	4.0	4.5
Sweden	:	:	:	5.9	5.3	4.7	3.1	2.2	1.8	2.0	2.5	2.9
United Kingdom	:	:	:	3.1	3.0	2.3	1.9	1.6	1.9	2.3	2.7	3.2
EU	:	:	:	2.3	2.3	1.6	1.6	1.6	1.8	2.0	2.2	2.3
USA	:	:	:	2.5	2.0	2.1	2.2	2.2	2.4	2.5	2.5	2.5
Japan	:	:	:	2.4	1.2	1.4	0.9	2.0	1.9	1.8	1.6	1.4

TABLE 4 : Gross domestic product per capita (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	1.2	2.5	1.4	2.0	2.2	0.2	-3.5	1.3	1.1	1.3	0.6	0.9
Germany	0.9	1.9	1.0	3.5	2.8	1.2	-4.4	4.0	2.6	2.3	1.6	1.9
Estonia	:	7.9	8.9	10.8	7.1	-5.0	-13.9	2.4	4.3	3.4	1.0	3.8
Ireland	5.3	7.8	3.3	2.8	3.1	-5.2	-8.1	-0.3	1.0	1.8	-1.0	2.9
Greece	0.2	3.4	3.7	4.1	3.8	0.9	-2.5	-5.2	-3.2	0.9	-3.4	-1.0
Spain	1.3	3.7	1.7	2.4	1.7	-0.7	-4.4	-0.6	0.3	1.4	-0.7	0.5
France	0.8	2.4	1.0	1.5	1.8	-0.3	-3.2	1.1	1.2	1.3	0.8	1.0
Italy	1.2	2.0	0.2	1.5	0.7	-2.1	-5.7	0.6	0.8	1.1	0.4	1.1
Cyprus	3.3	3.0	1.3	2.1	3.6	2.4	-2.3	-0.2	0.8	1.5	-1.1	0.6
Luxembourg	1.2	5.0	2.7	3.3	4.9	-0.3	-5.5	1.6	1.3	1.9	0.8	1.3
Malta	4.1	2.7	1.5	2.9	3.0	1.8	-2.3	3.0	1.6	1.9	0.7	1.3
Netherlands	1.9	3.1	1.2	3.2	3.7	1.5	-4.4	1.2	1.2	1.4	1.1	1.6
Austria	1.3	2.4	1.6	3.1	3.3	1.7	-4.2	1.7	1.3	1.7	1.0	1.3
Portugal	1.8	3.4	0.1	1.1	2.2	-0.1	-2.7	1.1	-1.2	0.7	0.4	0.6
Slovenia	2.1	4.2	4.1	5.5	6.3	3.4	-9.0	1.7	1.7	2.4	1.5	1.6
Slovakia	:	2.7	5.9	8.4	10.4	5.6	-5.0	4.1	3.1	4.1	2.6	3.5
Finland	0.9	4.3	2.7	4.0	4.9	0.5	-8.5	2.4	2.3	1.7	0.9	1.6
Euro area	1.2	2.5	1.1	2.5	2.3	-0.1	-4.5	1.5	1.3	1.6	0.6	1.3
Bulgaria	-2.2	3.6	6.6	7.1	7.0	6.7	-4.5	0.4	3.1	4.3	0.5	3.2
Czech Republic	2.3	1.4	4.5	6.5	5.6	1.4	-4.9	2.1	2.3	3.3	1.3	2.1
Denmark	2.2	2.1	1.5	3.1	1.2	-1.7	-5.7	2.0	1.6	1.5	1.3	1.6
Latvia	-7.4	7.2	9.6	12.8	10.6	-3.8	-17.5	0.1	3.9	4.5	-3.0	3.8
Lithuania	-7.8	5.5	8.6	8.5	10.4	3.5	-14.3	1.8	3.3	3.7	0.0	3.8
Hungary	0.6	4.5	4.1	3.8	0.9	1.0	-6.5	1.2	2.9	3.3	0.1	2.9
Poland	4.7	4.4	4.2	6.3	6.8	5.1	1.6	3.4	3.9	4.2	2.6	3.2
Romania	1.8	-0.6	7.0	8.1	6.5	7.5	-7.0	-1.7	1.7	4.0	1.0	3.7
Sweden	0.7	3.3	2.9	3.7	2.6	-1.6	-6.0	4.6	3.3	2.3	1.6	2.5
United Kingdom	2.3	3.0	2.1	2.2	2.0	-0.7	-5.6	1.1	1.5	1.8	0.5	1.4
EU	1.1	2.7	1.6	2.8	2.5	0.1	-4.6	1.6	1.5	1.9	0.7	1.5
USA	2.1	2.6	1.8	1.7	0.9	-0.9	-3.5	1.9	1.3	1.6	1.9	1.6
Japan	1.0	0.2	1.6	2.0	2.4	-1.2	-5.1	3.6	1.4	1.8	2.2	1.7

TABLE 5 : Domestic demand, volume (percentage change on preceding year, 1992-2012)

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	1.4	2.2	1.7	2.2	3.1	2.1	-2.2	1.0	1.6	2.0	0.7	1.6
Germany	1.5	1.5	0.2	2.4	1.2	1.2	-1.9	2.6	2.3	2.2	0.4	1.4
Estonia	:	6.4	11.0	16.5	9.6	-11.0	-23.4	2.1	4.3	3.3	-2.2	3.6
Ireland	4.3	8.2	5.6	6.4	5.4	-5.0	-13.9	-4.3	-3.5	-0.9	-4.4	2.0
Greece	1.2	4.3	3.9	5.8	5.6	1.5	-3.8	-7.2	-5.4	-0.7	-6.1	-2.2
Spain	0.8	5.0	4.4	5.2	4.1	-0.6	-6.0	-1.2	-0.4	1.5	-1.7	0.1
France	0.7	3.0	2.2	2.5	3.2	0.5	-2.4	1.5	1.7	1.8	1.2	1.4
Italy	0.0	2.6	1.3	2.0	1.3	-1.5	-3.8	0.8	0.8	1.1	0.7	1.3
Cyprus	:	3.5	4.4	5.7	8.8	8.4	-7.0	-1.7	0.9	1.6	-1.3	1.0
Luxembourg	1.6	5.9	2.7	1.9	5.9	3.1	-5.9	4.9	3.9	3.9	1.8	3.1
Malta	:	1.4	2.9	3.3	0.3	2.5	-5.0	2.5	2.3	2.3	1.6	1.8
Netherlands	2.1	3.9	1.2	4.1	3.2	2.2	-4.0	1.1	0.5	1.2	-0.9	1.4
Austria	2.0	1.6	1.5	2.2	2.5	1.3	-2.3	0.4	1.1	1.3	0.4	0.9
Portugal	2.3	4.7	0.6	0.8	2.0	1.2	-3.0	0.7	-3.7	-0.7	-0.1	0.0
Slovenia	5.2	4.2	4.1	5.6	8.9	4.1	-9.8	0.0	1.3	2.2	0.5	1.8
Slovakia	:	2.5	4.8	6.6	6.3	5.8	-7.3	3.4	1.9	3.2	3.4	3.1
Finland	0.2	3.7	3.0	2.4	4.7	0.6	-5.9	2.2	2.7	2.2	1.4	1.8
Euro area	1.1	2.7	1.7	2.9	2.6	0.4	-3.5	0.9	1.0	1.6	0.1	1.1
Bulgaria	:	6.0	8.2	10.8	8.8	6.5	-13.1	-4.4	2.3	3.6	-3.0	2.3
Czech Republic	6.2	1.2	3.6	5.4	5.2	1.2	-3.7	1.7	1.3	2.4	0.5	2.0
Denmark	2.9	2.2	2.9	5.2	2.3	-1.2	-6.5	2.0	1.9	1.8	1.5	2.0
Latvia	:	6.9	11.2	18.1	12.4	-10.1	-27.6	-0.6	3.4	5.2	-9.1	2.3
Lithuania	:	5.3	9.6	9.1	14.1	3.2	-24.6	-1.2	4.0	4.4	-2.7	2.5
Hungary	0.5	4.7	3.7	1.4	-1.3	0.8	-10.8	-1.2	2.8	3.3	-1.5	2.7
Poland	5.4	4.5	3.9	7.3	8.7	5.6	-1.0	3.6	4.2	4.4	2.8	3.6
Romania	1.4	0.6	9.0	12.9	14.2	7.3	-12.8	-2.3	1.9	4.8	0.6	4.1
Sweden	0.1	2.8	2.5	3.9	4.6	0.1	-5.0	4.9	3.3	2.1	2.4	2.5
United Kingdom	2.3	4.1	2.8	2.5	3.1	-0.7	-5.5	2.8	1.6	1.6	1.3	1.9
EU	1.5	3.0	2.1	3.2	3.1	0.4	-4.1	1.3	1.3	1.8	0.4	1.4
USA	3.5	4.4	3.0	2.6	1.3	-1.2	-3.7	3.3	2.3	2.6	2.8	2.3
Japan	1.5	0.3	1.0	1.2	1.3	-1.3	-3.9	1.5	1.4	1.4	0.6	1.2

TABLE 6 : Final demand, volume (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	2.5	3.9	2.7	3.5	3.7	1.9	-6.6	4.7	3.4	3.8	2.3	2.8
Germany	1.7	3.2	2.3	5.8	3.4	1.7	-6.4	6.2	3.7	3.7	2.1	2.7
Estonia	:	8.9	10.2	12.2	6.3	-6.5	-21.4	7.1	5.3	4.7	1.5	4.7
Ireland	8.3	11.8	5.1	5.7	6.7	-3.1	-9.2	0.9	0.9	2.2	-1.1	3.2
Greece	1.6	5.3	3.8	5.7	5.6	2.0	-6.6	-6.1	-3.7	0.5	-4.7	-1.2
Spain	2.3	5.8	4.3	5.5	4.7	-0.7	-7.2	0.7	0.8	2.4	-0.5	1.0
France	1.5	4.0	2.3	3.0	3.1	0.3	-4.5	3.0	2.5	2.7	1.9	2.1
Italy	1.3	2.9	1.3	2.9	2.0	-2.0	-7.1	2.2	1.8	2.1	1.2	1.9
Cyprus	:	4.4	3.5	5.0	7.9	5.2	-8.4	-0.2	1.7	2.3	-0.7	1.7
Luxembourg	3.1	8.0	5.1	7.6	7.7	5.0	-7.3	8.5	6.6	5.5	2.5	4.4
Malta	:	2.7	2.9	6.6	1.4	-0.1	-6.2	10.0	4.3	4.3	2.9	2.9
Netherlands	3.4	5.6	2.7	5.6	4.7	2.5	-5.9	5.0	3.0	3.9	2.0	3.1
Austria	2.3	3.8	3.1	4.2	4.8	1.2	-7.6	3.4	3.0	3.2	1.7	2.3
Portugal	3.2	4.9	1.4	3.0	3.3	0.8	-5.0	2.4	-1.6	1.0	0.7	0.9
Slovenia	2.7	5.4	5.9	8.3	10.8	3.8	-12.9	3.0	3.1	4.2	2.0	3.0
Slovakia	:	5.5	7.7	12.7	9.9	4.6	-11.2	8.1	4.5	5.4	4.4	4.3
Finland	2.4	5.7	3.9	5.6	5.9	2.7	-11.2	3.4	3.6	2.9	2.3	3.2
Euro area	2.0	4.1	2.6	4.6	3.7	0.6	-6.5	3.5	2.5	3.0	1.4	2.2
Bulgaria	:	5.3	9.1	21.2	7.8	5.3	-12.2	0.2	3.4	4.5	-0.7	3.3
Czech Republic	7.3	4.4	6.7	9.8	9.6	3.4	-6.9	6.1	4.0	4.7	3.1	3.8
Denmark	3.1	3.7	3.5	6.5	2.3	0.0	-7.9	3.5	2.9	3.1	2.6	3.1
Latvia	:	6.6	10.7	14.9	11.8	-7.0	-23.8	2.3	4.3	5.6	-4.5	3.5
Lithuania	:	5.8	10.4	10.1	10.2	5.9	-20.4	3.1	4.9	5.3	0.3	3.6
Hungary	:	8.5	6.5	8.2	6.3	3.0	-10.2	5.4	5.7	6.5	2.2	5.5
Poland	6.4	5.5	5.6	9.3	8.8	6.0	-2.6	5.4	4.9	5.4	3.7	4.2
Romania	0.9	2.8	9.6	12.3	12.8	7.5	-11.2	2.1	3.0	5.1	1.7	4.7
Sweden	2.4	4.4	3.8	5.7	5.0	0.6	-7.6	6.9	4.6	3.4	2.9	3.9
United Kingdom	3.3	4.4	3.3	4.2	1.9	-0.3	-6.7	3.3	3.0	3.1	2.1	2.6
EU	2.2	4.2	3.0	4.9	3.8	0.7	-6.7	3.7	2.8	3.2	1.6	2.5
USA	3.9	4.4	3.2	3.2	2.0	-0.4	-4.3	4.2	3.0	3.1	3.7	2.9
Japan	1.7	0.5	1.9	2.3	2.2	-0.9	-6.7	4.5	1.9	2.0	3.0	2.1

TABLE 7 : Private consumption expenditure, volume (percentage change on preceding year, 1992-2012)

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	1.5	2.1	1.1	1.8	1.8	1.5	-0.3	1.4	1.3	1.9	0.6	1.4
Germany	1.9	1.9	0.2	1.4	-0.2	0.7	-0.2	0.1	1.4	1.6	-0.7	0.9
Estonia	:	6.5	10.4	13.7	8.6	-5.4	-18.4	-0.9	2.5	3.1	-4.4	2.9
Ireland	4.2	7.8	4.7	6.5	6.3	-1.8	-7.2	-1.4	-1.8	-1.0	-2.4	1.4
Greece	1.8	3.1	4.4	5.6	3.1	3.2	-1.8	-4.1	-4.3	0.5	-3.5	-2.4
Spain	1.1	4.3	3.6	3.8	3.7	-0.6	-4.2	1.1	0.9	1.6	0.2	1.2
France	1.0	2.8	2.4	2.4	2.6	0.5	0.6	1.5	1.4	1.7	0.6	1.3
Italy	0.5	2.5	0.9	1.3	1.1	-0.8	-1.7	0.4	0.9	1.0	0.8	1.3
Cyprus	:	4.4	3.7	4.7	9.4	8.4	-3.0	-1.5	2.1	2.2	-1.1	2.1
Luxembourg	1.7	4.3	1.6	3.2	3.3	4.8	0.3	2.2	1.6	2.1	0.5	1.5
Malta	:	3.6	1.8	0.6	0.9	4.4	0.0	1.0	1.6	2.1	0.8	1.7
Netherlands	2.1	3.9	0.5	-0.3	1.8	1.1	-2.5	0.2	0.7	0.9	-0.4	1.3
Austria	1.9	1.6	1.7	1.8	0.7	0.5	1.3	0.9	0.8	0.9	0.8	0.6
Portugal	2.0	3.8	1.4	1.8	2.5	1.8	-1.0	1.6	-2.8	-0.7	1.0	0.0
Slovenia	5.1	3.2	2.8	2.9	6.7	2.9	-0.8	-0.5	0.8	1.8	-0.2	1.2
Slovakia	:	3.8	4.9	5.9	6.8	6.2	0.3	-0.5	1.5	3.1	0.1	2.1
Finland	0.6	3.2	3.6	4.3	3.5	1.7	-1.9	2.4	2.4	2.3	1.7	1.7
Euro area	1.4	2.7	1.5	2.1	1.7	0.4	-1.1	0.6	0.9	1.4	0.0	1.1
Bulgaria	-1.4	2.8	6.7	8.6	9.0	3.4	-3.5	-3.6	2.2	3.8	-2.3	2.1
Czech Republic	6.2	1.5	3.7	5.2	5.0	3.6	-0.2	1.3	1.1	2.5	-0.8	1.6
Denmark	2.4	1.0	2.9	3.6	3.0	-0.6	-4.5	2.0	1.9	2.3	2.1	2.6
Latvia	:	4.7	11.4	21.2	14.8	-5.2	-24.1	-0.5	3.2	4.0	-8.5	2.0
Lithuania	:	5.0	10.2	10.6	12.1	3.7	-17.7	-5.9	2.9	4.0	-5.3	2.6
Hungary	:	4.5	5.5	1.9	0.2	0.4	-7.8	-3.2	2.8	3.2	-3.2	2.6
Poland	4.8	4.6	3.4	5.0	4.9	5.7	2.0	2.8	3.2	4.0	1.5	2.7
Romania	3.1	0.7	10.6	12.7	11.9	9.0	-10.6	-1.6	1.8	3.9	0.7	4.2
Sweden	0.0	3.2	2.6	2.7	3.7	-0.1	-0.8	3.4	2.7	2.0	2.4	2.2
United Kingdom	2.4	4.2	2.7	1.8	2.2	0.4	-3.3	1.1	1.6	1.6	0.6	1.5
EU	1.7	3.0	2.0	2.3	2.1	0.7	-1.7	0.7	1.2	1.6	0.1	1.3
USA	3.4	4.4	3.0	2.9	2.4	-0.3	-1.2	1.6	1.6	1.9	2.1	1.3
Japan	1.9	0.6	1.2	1.5	1.6	-0.7	-1.0	2.3	1.0	1.1	1.2	0.9

TABLE 8 : Government consumption expenditure, volume (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	1.2	2.0	1.6	0.6	2.1	2.3	0.6	1.4	1.2	1.4	1.3	1.5
Germany	2.4	1.1	0.5	1.0	1.6	2.3	2.9	2.9	1.0	0.9	1.4	0.9
Estonia	:	0.1	1.8	3.9	3.9	3.8	0.0	-1.5	1.1	0.9	-0.9	0.1
Ireland	2.8	7.4	4.4	5.8	7.3	2.8	-4.1	-2.2	-5.7	-0.8	-2.7	2.0
Greece	1.0	4.3	2.4	1.3	9.2	1.0	7.6	-9.0	-8.5	-6.0	-7.0	-3.1
Spain	2.1	3.8	5.1	4.6	5.5	5.8	3.2	0.0	-1.3	-0.3	1.0	-1.2
France	1.8	1.0	1.7	1.3	1.5	1.7	2.7	1.5	0.4	0.4	1.4	0.3
Italy	-1.0	1.7	1.8	0.5	0.9	0.8	0.6	-0.4	0.0	0.1	0.1	0.1
Cyprus	:	5.3	3.5	7.3	0.3	6.2	5.8	0.3	1.3	2.0	1.6	1.5
Luxembourg	4.1	4.8	3.6	1.6	2.8	2.7	4.5	3.7	3.2	3.5	2.7	2.6
Malta	:	0.0	2.5	5.9	0.0	12.8	-0.7	2.4	0.4	1.9	0.5	0.2
Netherlands	1.7	2.9	3.2	9.5	3.5	2.5	3.7	1.7	0.1	-0.4	2.0	0.2
Austria	2.6	2.0	1.4	2.7	2.1	4.0	0.4	0.8	0.0	0.5	1.2	1.0
Portugal	1.8	4.1	1.4	-0.7	0.5	0.8	2.9	3.0	-6.8	-1.3	-0.3	-0.2
Slovenia	2.2	3.7	3.3	4.0	0.7	6.2	3.0	0.9	-0.3	1.0	0.4	0.2
Slovakia	:	1.6	3.5	9.7	0.1	6.1	5.6	0.7	-4.5	0.5	2.5	2.2
Finland	-0.4	1.8	1.7	0.4	1.1	2.4	1.2	0.4	0.6	0.7	0.6	0.8
Euro area	1.5	1.8	1.9	2.1	2.3	2.4	2.4	1.0	-0.1	0.2	0.9	0.3
Bulgaria	-15.4	7.3	3.4	3.5	0.3	-1.0	-6.5	-2.4	0.6	0.9	-1.6	0.6
Czech Republic	-1.7	1.9	2.8	1.2	0.5	1.1	2.6	0.6	-2.2	0.8	0.4	1.4
Denmark	2.6	2.2	1.7	2.8	1.3	1.6	3.1	1.6	-0.1	0.4	1.0	0.6
Latvia	:	2.8	2.7	4.9	3.7	1.5	-9.2	-4.0	-2.6	-2.0	-10.0	-4.0
Lithuania	:	0.7	4.1	3.7	3.2	7.3	-1.9	-1.3	0.0	2.5	-4.5	-2.3
Hungary	-1.8	1.0	3.6	3.7	-7.3	1.0	-0.2	-0.9	-0.1	1.2	-0.4	1.8
Poland	3.3	2.4	4.1	6.1	3.7	7.4	2.0	3.5	-0.2	0.3	3.0	-0.1
Romania	3.6	0.6	-0.9	-4.1	-0.1	7.2	0.8	-3.9	-1.0	1.7	-2.5	1.0
Sweden	0.3	0.8	0.9	1.7	0.7	1.3	1.7	1.0	0.9	0.5	1.3	0.5
United Kingdom	0.6	1.9	2.6	1.4	1.3	1.6	1.0	2.3	-0.8	-2.0	1.5	-1.5
EU	0.8	1.8	2.0	2.0	1.9	2.3	2.0	1.2	-0.2	0.0	1.0	0.1
USA	-0.1	2.4	2.2	1.2	1.4	2.9	1.9	1.2	1.2	1.5	2.3	2.7
Japan	3.1	2.8	1.7	0.4	1.5	0.3	1.5	1.4	0.8	0.9	1.1	0.9

TABLE 9 : Total investment, volume (percentage change on preceding year, 1992-2012)

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	0.8	3.6	2.4	2.0	6.5	2.9	-5.3	-1.1	2.6	2.9	-1.5	2.1
Germany	0.7	1.8	0.3	8.0	4.7	2.5	-10.1	6.0	6.0	5.1	1.2	2.9
Estonia	:	10.2	17.1	23.2	6.0	-15.0	-32.9	-6.6	12.8	6.4	-2.9	8.7
Ireland	7.5	9.9	7.5	4.5	2.8	-14.3	-31.1	-21.1	-10.0	0.0	-17.6	4.2
Greece	-0.2	8.2	4.9	10.6	5.3	-7.6	-11.4	-17.4	-7.5	-2.6	-5.5	-0.8
Spain	-0.3	7.6	5.7	7.2	4.5	-4.8	-16.0	-7.9	-3.1	2.7	-8.3	-1.8
France	-0.9	5.0	2.5	4.1	6.0	0.5	-7.1	-1.7	2.4	3.5	-2.4	1.9
Italy	-0.8	3.7	1.7	2.9	1.7	-4.0	-12.1	2.4	1.6	3.1	-0.1	2.5
Cyprus	:	1.3	7.3	10.2	13.4	8.6	-12.0	-12.9	-3.8	-1.5	-12.9	-3.8
Luxembourg	1.1	8.2	4.1	3.8	17.9	1.4	-19.2	8.7	7.6	7.3	3.0	6.7
Malta	:	-0.1	3.0	5.2	5.9	-27.5	-16.3	9.6	8.2	3.3	6.5	4.5
Netherlands	3.3	4.9	0.6	7.5	5.5	5.1	-12.7	-4.3	3.2	4.2	-9.7	3.6
Austria	1.8	1.6	0.7	1.8	3.9	4.1	-8.8	-2.6	2.7	2.9	-1.4	1.7
Portugal	1.6	7.2	-2.4	-1.3	2.6	-1.8	-11.9	-4.1	-3.2	-0.4	-4.2	-0.6
Slovenia	6.9	7.8	5.6	10.1	12.8	8.5	-21.6	-4.4	2.9	4.1	1.6	3.5
Slovakia	:	1.4	5.6	9.3	9.1	1.0	-19.9	1.7	5.1	6.4	3.6	3.9
Finland	-1.9	6.8	1.9	1.9	10.7	-0.4	-14.7	0.4	4.8	3.0	-1.8	2.1
Euro area	0.3	4.0	2.1	5.4	4.7	-0.8	-11.4	-0.8	2.2	3.6	-2.6	1.9
Bulgaria	:	13.1	15.4	13.1	11.8	21.9	-29.0	-9.8	3.7	5.4	-6.3	3.2
Czech Republic	10.9	0.3	3.4	6.0	10.8	-1.5	-7.9	-1.8	3.1	3.7	-1.1	2.7
Denmark	4.3	4.8	4.4	14.3	0.4	-3.3	-14.3	-3.8	2.3	2.8	-3.7	1.7
Latvia	:	17.4	17.7	16.4	7.5	-13.6	-37.3	-24.8	9.5	15.0	-14.0	7.0
Lithuania	:	8.0	14.1	19.4	23.0	-5.2	-40.0	-8.5	13.0	8.5	-1.8	8.0
Hungary	2.1	7.2	4.5	-3.2	1.7	2.9	-8.0	-1.9	4.3	5.5	1.0	3.6
Poland	9.9	6.6	4.0	14.9	17.6	9.6	-1.1	0.1	8.4	9.2	3.0	8.0
Romania	10.4	1.9	12.7	19.9	30.3	15.6	-25.3	-9.9	4.2	7.3	2.3	5.8
Sweden	-1.0	4.8	4.6	9.2	8.9	1.7	-16.0	5.9	8.1	4.7	-1.9	5.4
United Kingdom	2.3	5.7	3.7	6.4	7.8	-5.0	-15.1	2.8	3.5	6.5	-0.9	4.4
EU	2.4	4.3	2.7	6.1	5.8	-0.8	-12.1	-0.6	2.8	4.2	-2.2	2.5
USA	7.0	6.6	2.7	2.3	-1.4	-5.1	-15.5	3.2	4.8	6.3	0.3	4.3
Japan	-0.2	-1.6	-0.1	0.5	-1.2	-2.6	-14.0	-0.2	2.6	3.0	-1.7	2.7

TABLE 10 : Investment in construction, volume (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	1.8	0.4	2.8	2.8	3.9	2.3	-1.9	-2.3	0.8	1.4	-1.8	0.4
Germany	2.9	-1.6	-2.0	4.9	-0.5	1.2	-1.5	3.5	3.0	2.8	0.6	1.6
Estonia	:	6.9	17.3	16.6	4.5	-16.5	-26.2	-11.6	10.4	6.0	-3.5	7.0
Ireland	7.3	10.0	8.4	5.8	-0.7	-13.9	-34.9	-28.0	-14.8	-3.2	-22.8	2.9
Greece	-3.1	6.6	3.3	16.4	-4.1	-18.9	-12.5	-24.4	-8.9	-2.5	-6.6	-0.3
Spain	-0.9	6.6	6.0	6.0	3.2	-5.9	-11.9	-11.4	-7.0	0.7	-10.7	-3.4
France	-2.5	2.8	3.1	5.3	4.4	-1.7	-6.3	-4.5	1.4	2.3	-3.2	0.8
Italy	-2.0	2.2	2.4	1.0	0.3	-3.4	-7.9	-2.8	0.1	1.5	-2.7	1.8
Cyprus	:	-0.3	8.5	8.0	14.1	3.9	-8.5	-12.5	-3.7	-2.6	-12.5	-3.7
Luxembourg	4.1	6.2	4.6	1.8	12.2	2.3	-6.5	6.5	6.0	6.5	0.8	5.4
Malta	:	:	:	:	:	:	:	:	:	:	:	:
Netherlands	1.4	3.7	-0.6	4.2	6.1	4.3	-8.3	-7.2	2.3	2.8	-10.0	2.1
Austria	2.1	-0.4	0.4	0.7	1.6	1.6	-6.0	-3.0	1.1	1.1	-1.3	1.0
Portugal	2.3	6.4	-3.9	-4.6	-0.4	-5.9	-11.7	-5.0	-3.2	-1.0	-4.0	-0.6
Slovenia	2.3	4.5	3.9	2.9	16.2	11.2	-19.2	-11.4	1.7	3.6	-4.7	2.2
Slovakia	:	1.7	6.8	31.0	4.9	3.8	-9.9	1.6	4.1	6.0	4.1	4.6
Finland	-4.3	6.7	3.0	3.0	8.8	-1.5	-14.5	3.1	5.8	2.1	-1.4	1.9
Euro area	0.2	2.2	1.6	4.2	2.0	-1.6	-6.9	-3.6	0.2	2.0	-4.0	0.8
Bulgaria	:	:	:	:	:	:	:	:	:	:	:	:
Czech Republic	4.3	-4.9	3.9	4.2	5.8	-2.8	-0.8	-2.6	2.8	3.4	0.8	2.0
Denmark	3.2	2.3	4.3	11.4	-2.4	-4.5	-16.7	-5.7	1.2	1.9	-3.7	1.4
Latvia	:	:	:	:	:	:	:	:	:	:	:	:
Lithuania	:	4.1	13.9	22.0	21.5	0.3	-37.3	-13.3	13.0	8.0	-0.4	9.2
Hungary	:	:	:	:	:	:	:	-5.4	2.6	3.0	0.7	2.8
Poland	:	5.6	3.7	13.0	13.4	8.2	4.2	4.1	8.1	7.0	5.6	10.1
Romania	15.0	4.0	11.4	15.3	37.3	20.3	-20.9	-13.5	2.4	7.3	1.7	7.1
Sweden	-7.5	2.1	4.2	10.4	7.5	-1.3	-10.1	6.9	6.1	3.4	0.4	4.3
United Kingdom	0.9	2.6	4.6	7.6	6.1	-5.7	-12.9	2.1	2.6	5.6	0.7	3.7
EU	:	:	:	:	:	:	:	:	:	:	:	:
USA	3.9	3.6	1.3	-1.7	-5.8	-8.2	-17.1	-8.8	-0.8	7.3	-6.3	4.0
Japan	:	:	:	:	:	:	:	:	:	:	:	:

TABLE 11 : Investment in equipment, volume (percentage change on preceding year, 1992-2012)

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	-0.9	6.9	1.2	0.7	9.4	3.1	-9.8	0.1	4.0	4.5	-1.2	3.9
Germany	-3.1	6.3	2.8	11.6	11.1	4.0	-22.3	9.9	10.3	8.2	1.1	4.5
Estonia	:	13.9	16.3	31.4	7.4	-11.6	-44.0	3.0	17.0	7.0	-2.0	12.0
Ireland	9.2	9.0	6.2	-1.9	17.2	-17.4	-22.5	-7.0	-3.2	3.8	-4.9	6.5
Greece	7.4	10.9	7.5	3.0	21.9	6.2	-12.2	-13.0	-7.3	-3.1	-5.0	-1.7
Spain	-0.1	9.1	5.0	9.9	10.4	-2.5	-24.8	3.0	3.7	6.0	-4.3	0.2
France	0.8	7.6	1.1	1.4	9.1	3.5	-9.6	2.8	3.1	4.5	-1.2	2.7
Italy	0.1	5.2	1.3	5.1	3.1	-5.0	-17.7	9.5	3.2	4.8	3.0	3.2
Cyprus	:	5.0	5.1	15.5	11.9	19.7	-19.5	-12.0	-4.0	1.0	-12.0	-4.0
Luxembourg	-4.2	11.0	3.5	7.4	23.9	3.3	-38.0	12.5	10.0	8.5	5.0	7.5
Malta	:	:	:	:	:	:	:	:	:	:	:	:
Netherlands	4.7	6.0	1.9	12.0	8.6	4.9	-19.0	2.5	5.4	7.2	-10.4	6.9
Austria	0.9	2.9	0.6	1.8	6.6	7.5	-14.5	-2.3	4.7	5.3	-2.2	2.5
Portugal	1.3	9.2	-0.1	5.2	7.9	3.7	-14.4	-3.0	-3.4	0.6	-5.2	-1.0
Slovenia	9.6	11.8	8.2	20.4	8.2	4.9	-26.2	6.0	4.4	4.7	10.9	5.2
Slovakia	:	1.8	4.4	-6.3	4.3	1.7	-27.8	1.9	6.7	7.2	3.5	3.5
Finland	1.0	6.1	-1.2	-1.1	17.9	3.9	-14.2	-4.9	2.6	5.2	-4.0	2.5
Euro area	0.2	6.9	2.4	6.6	9.3	1.3	-17.7	4.9	5.0	5.7	-0.7	3.1
Bulgaria	:	:	:	:	:	:	:	:	:	:	:	:
Czech Republic	17.0	5.6	3.2	8.4	16.9	-0.6	-19.0	-0.8	3.5	4.0	-4.6	4.0
Denmark	3.4	6.2	3.8	19.1	4.9	-3.5	-13.2	-1.5	3.9	4.5	-4.0	2.3
Latvia	:	:	:	:	:	:	:	:	:	:	:	:
Lithuania	:	13.5	15.2	16.8	21.9	-17.1	-49.8	0.0	15.0	10.0	-6.0	5.6
Hungary	:	:	:	:	:	:	:	3.2	7.0	9.3	3.1	4.5
Poland	:	7.1	4.8	17.1	22.3	13.0	-9.1	-6.0	9.0	13.0	-1.0	4.5
Romania	6.2	12.6	14.9	23.5	28.3	10.9	-32.7	-5.4	6.3	7.3	3.0	4.3
Sweden	5.1	6.1	5.2	9.3	12.9	5.9	-27.5	5.0	10.0	5.8	-4.0	6.5
United Kingdom	4.5	8.0	2.6	4.4	12.3	-5.2	-22.1	4.6	5.7	8.9	-3.9	6.3
EU	:	:	:	:	:	:	:	:	:	:	:	:
USA	10.0	8.2	4.1	8.2	3.3	-3.8	-18.6	13.7	8.8	5.6	6.7	4.5
Japan	:	:	:	:	:	:	:	:	:	:	:	:

TABLE 12 : Public investment (as a percentage of GDP, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	1.6	1.8	1.7	1.6	1.6	1.7	1.9	1.8	1.9	1.9	1.9	2.1
Germany	2.4	1.8	1.5	1.4	1.4	1.5	1.6	1.7	1.6	1.4	1.9	1.7
Estonia	:	4.2	4.4	4.7	5.1	5.3	5.1	4.9	4.9	5.0	5.6	5.4
Ireland	2.2	3.2	3.8	3.8	4.7	5.2	4.7	4.5	3.5	3.1	4.5	3.9
Greece	2.9	3.3	3.3	3.4	3.4	3.3	3.4	2.8	2.5	2.3	2.8	2.8
Spain	3.8	3.2	3.6	3.7	4.0	3.9	4.4	4.1	3.2	3.1	4.0	3.2
France	3.2	3.0	3.1	3.2	3.3	3.3	3.3	3.3	3.2	3.2	3.4	3.2
Italy	2.4	2.3	2.3	2.3	2.3	2.2	2.4	2.2	1.9	1.6	2.2	2.0
Cyprus	:	2.9	3.3	3.0	2.9	2.9	4.1	3.9	3.7	3.7	4.1	4.1
Luxembourg	4.2	4.0	4.4	3.6	3.3	3.2	3.5	3.5	3.3	3.1	3.7	3.5
Malta	:	4.0	4.3	3.9	3.7	2.3	2.2	2.9	3.9	4.0	3.0	2.9
Netherlands	2.5	3.1	3.4	3.3	3.3	3.5	3.9	3.8	3.7	3.7	4.1	4.1
Austria	3.1	1.6	1.2	1.1	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Portugal	3.6	4.0	3.1	2.4	2.4	2.3	2.4	2.5	2.2	2.2	2.2	2.1
Slovenia	:	3.1	3.3	3.7	4.2	4.4	4.6	4.4	4.3	4.2	4.9	4.7
Slovakia	:	3.6	2.5	2.2	1.9	2.0	2.3	2.2	2.2	2.2	2.3	2.3
Finland	2.9	2.7	2.6	2.3	2.4	2.5	2.8	2.8	2.7	2.6	2.8	2.6
Euro area	2.8	2.5	2.5	2.5	2.6	2.6	2.8	2.6	2.4	2.2	2.7	2.5
Bulgaria	:	3.2	3.3	4.0	5.2	5.6	4.9	4.5	4.4	4.3	4.5	4.5
Czech Republic	:	3.8	4.6	5.0	4.7	4.9	5.2	5.4	5.3	5.3	5.6	5.7
Denmark	1.8	1.7	1.8	1.9	1.9	1.9	2.0	2.3	2.1	1.9	2.4	1.9
Latvia	:	1.3	2.9	4.6	5.7	4.8	4.3	4.6	4.3	4.1	4.1	4.0
Lithuania	:	2.4	3.4	4.1	5.2	4.9	3.9	3.8	2.8	2.7	4.7	4.7
Hungary	:	3.0	4.1	4.4	3.6	2.9	3.1	3.5	3.1	3.1	2.7	2.4
Poland	:	3.4	3.5	3.9	4.2	4.6	5.2	6.2	6.6	6.3	6.3	7.4
Romania	:	2.5	3.8	5.1	5.7	5.6	5.3	4.8	4.6	4.6	5.4	5.4
Sweden	2.7	3.0	3.0	3.0	3.1	3.3	3.6	3.5	3.3	3.3	3.6	3.6
United Kingdom	1.8	1.3	1.5	1.8	1.9	2.3	2.7	2.4	1.9	1.7	2.6	2.0
EU	:	2.4	2.4	2.5	2.6	2.7	2.9	2.8	2.5	2.4	2.9	2.7
USA	2.4	2.4	2.5	2.4	2.4	2.6	2.6	3.5	3.5	3.5	4.0	4.1
Japan	6.1	5.5	4.0	3.3	3.1	3.0	3.2	3.2	3.2	3.2	3.0	2.9

TABLE 13 : Output gap relative to potential GDP (deviation of actual output from potential output as % of potential GDP, 1992-2012) ¹

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	-0.5	1.0	0.5	1.6	2.4	1.5	-2.6	-2.0	-1.7	-1.2	-2.4	-1.9
Germany	0.7	0.6	-1.0	0.2	1.7	1.6	-4.1	-1.7	-1.1	-0.8	-2.7	-2.3
Estonia	:	-1.8	3.7	9.2	11.5	3.2	-11.2	-8.5	-4.1	-0.8	-8.6	-4.8
Ireland	-0.9	2.9	0.5	1.7	4.3	-0.1	-6.4	-5.2	-3.1	-0.5	-7.3	-4.7
Greece	-0.4	0.1	0.5	1.5	3.2	2.6	-0.5	-5.2	-7.7	-6.7	-2.7	-4.0
Spain	-2.5	0.8	0.5	1.0	1.5	0.2	-4.4	-4.5	-3.5	-1.5	-4.6	-4.2
France	-1.2	1.1	1.7	1.8	2.1	0.4	-3.6	-3.5	-3.3	-2.8	-2.7	-2.3
Italy	-1.2	0.1	0.7	2.1	2.9	1.2	-3.7	-2.6	-1.7	-0.4	-3.4	-2.6
Cyprus	:	0.1	0.0	0.2	2.3	3.1	-1.2	-2.2	-1.8	-0.7	-2.1	-1.6
Luxembourg	-0.9	2.5	1.6	2.0	4.0	1.5	-4.9	-4.4	-4.2	-3.7	-4.1	-4.1
Malta	:	1.7	-0.8	-0.4	0.2	0.6	-2.6	-0.8	-0.2	0.5	-1.6	-0.7
Netherlands	-0.5	1.4	-1.2	-0.1	1.8	1.6	-3.6	-3.2	-3.0	-2.5	-2.6	-2.0
Austria	-0.4	0.8	-0.7	0.7	2.5	2.8	-2.5	-1.8	-1.5	-0.8	-2.3	-2.1
Portugal	-1.1	1.9	-0.6	-0.7	0.8	0.1	-2.5	-1.4	-2.5	-1.8	-2.4	-2.2
Slovenia	:	0.0	0.1	2.8	6.4	6.9	-4.1	-3.8	-3.2	-1.8	-3.7	-3.2
Slovakia	:	-1.5	-1.3	1.3	5.9	6.6	-2.0	-1.2	-1.0	0.1	-2.3	-2.3
Finland	-3.8	2.6	1.3	3.0	5.5	3.7	-6.0	-5.0	-4.0	-3.5	-4.6	-3.8
Euro area	-0.8	0.8	0.2	1.1	2.2	1.2	-3.8	-2.9	-2.4	-1.6	-3.1	-2.6
Bulgaria	:	-3.0	2.5	3.1	4.0	4.9	-2.9	-4.8	-4.2	-2.7	-4.8	-4.0
Czech Republic	:	-2.6	-0.1	4.2	6.3	5.1	-2.1	-2.1	-1.9	-0.8	-2.7	-2.5
Denmark	-2.1	1.2	0.7	2.8	2.7	0.2	-5.6	-3.6	-2.1	-0.8	-3.9	-2.7
Latvia	:	-1.3	2.4	9.3	14.6	7.5	-10.9	-9.6	-5.2	-0.9	-10.7	-5.6
Lithuania	:	-5.1	3.2	6.2	9.7	8.4	-8.2	-7.1	-3.7	-1.2	-8.6	-6.4
Hungary	:	-2.3	1.5	3.9	3.1	2.7	-4.8	-4.2	-2.2	0.0	-4.3	-2.1
Poland	:	-1.2	-0.5	1.6	3.0	2.7	-0.5	-1.3	-1.4	-1.2	-2.1	-3.4
Romania	:	-6.1	2.3	7.1	8.3	10.6	-0.2	-4.1	-4.6	-3.0	-3.9	-3.4
Sweden	-4.2	-0.5	1.6	3.7	4.3	1.6	-5.0	-2.0	-0.5	0.0	-3.3	-1.8
United Kingdom	-1.4	1.4	1.6	1.9	2.3	0.4	-5.5	-5.0	-4.1	-3.1	-3.9	-3.1
EU	:	0.7	0.5	1.5	2.4	1.2	-4.1	-3.2	-2.6	-1.8	-3.3	-2.7
USA	-1.2	0.5	0.6	1.6	1.5	0.0	-3.7	-2.3	-1.7	-1.2	-2.6	-1.9
Japan	:	:	:	:	:	:	:	:	:	:	-2.1	-1.1

¹ When comparing output gaps between the spring and the autumn forecast it has to be taken into account that the overall revisions to the forecast may have led to changes in the estimates for potential output.

TABLE 14 : Deflator of gross domestic product (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	2.2	1.4	2.2	2.3	2.3	1.9	1.1	1.7	2.0	1.9	1.6	1.8
Germany	2.7	0.3	0.9	0.4	1.8	1.0	1.4	0.2	1.2	1.3	0.2	0.9
Estonia	:	6.4	5.0	8.3	10.5	7.2	-0.1	-0.1	2.7	2.2	-1.0	1.9
Ireland	3.0	5.1	3.1	3.7	1.1	-1.5	-4.0	-1.7	0.4	0.8	-1.7	0.8
Greece	11.5	4.3	3.2	3.1	3.1	3.2	1.2	3.0	1.5	0.4	2.9	1.7
Spain	5.1	3.0	4.2	4.1	3.3	2.4	0.6	0.0	1.1	1.4	0.3	1.1
France	1.6	1.1	2.1	2.4	2.5	2.6	0.5	0.5	1.6	1.5	0.7	1.5
Italy	4.3	2.4	2.6	1.8	2.6	2.8	2.1	0.7	1.6	1.7	1.3	1.9
Cyprus	3.6	3.0	3.0	3.0	4.6	4.8	0.0	2.5	3.2	2.5	2.1	2.4
Luxembourg	3.7	1.0	4.2	6.7	3.7	4.2	-0.4	2.7	2.5	2.3	2.8	3.0
Malta	3.0	2.1	2.7	3.1	3.0	2.2	2.3	3.0	2.7	2.5	1.8	2.1
Netherlands	1.9	3.1	2.2	1.8	1.8	2.4	-0.2	0.7	1.5	1.6	1.0	1.6
Austria	2.4	0.7	1.6	1.8	2.1	1.9	0.8	0.6	1.6	1.3	0.6	1.7
Portugal	5.8	3.6	2.9	2.8	2.8	2.0	0.2	0.7	1.3	1.0	1.1	1.6
Slovenia	47.9	7.2	4.0	2.0	4.2	4.0	3.2	0.2	1.3	1.5	0.0	1.8
Slovakia	:	6.6	4.1	2.9	1.1	2.9	-1.2	0.5	2.8	2.5	1.3	3.0
Finland	1.7	2.4	0.5	0.9	3.0	1.8	0.9	1.3	2.6	2.1	1.4	2.0
Euro area	3.4	1.6	2.1	1.9	2.4	2.0	1.0	0.5	1.5	1.5	0.7	1.4
Bulgaria	71.8	72.4	5.1	6.9	9.2	8.4	4.1	2.4	2.6	2.5	1.5	2.1
Czech Republic	13.4	5.7	1.8	1.1	3.4	1.8	2.5	-0.6	1.4	1.9	0.1	0.6
Denmark	1.4	2.1	2.3	2.1	2.3	3.9	0.4	2.4	2.3	2.2	1.1	1.6
Latvia	98.5	4.3	6.8	9.9	20.3	14.4	-1.5	-3.0	0.6	1.0	-6.3	-1.0
Lithuania	160.2	2.7	3.0	6.5	8.5	9.8	-3.7	1.1	1.8	2.5	-2.0	1.2
Hungary	22.1	11.8	5.1	4.2	5.9	4.8	4.4	2.7	2.8	2.2	2.6	2.2
Poland	30.3	8.3	2.2	1.5	4.0	3.1	3.6	1.7	2.7	2.8	2.2	2.4
Romania	115.1	62.5	16.7	10.6	13.5	15.3	2.8	6.3	4.6	5.1	4.6	4.0
Sweden	2.3	1.3	1.3	1.9	2.8	3.2	2.0	2.1	1.9	1.5	2.4	2.1
United Kingdom	2.9	2.1	2.8	3.1	3.0	3.0	1.4	2.7	2.0	1.5	2.5	1.4
EU	24.2	2.3	2.3	2.2	2.7	2.5	1.2	1.0	1.7	1.6	1.1	1.5
USA	2.1	1.8	2.6	3.3	2.9	2.2	0.9	0.9	0.8	1.3	0.2	0.1
Japan	0.2	-0.8	-1.3	-0.9	-0.7	-0.8	-0.9	-1.9	0.2	-0.4	-1.2	0.8

TABLE 15 : Price deflator of private consumption (percentage change on preceding year, 1992-2012)

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	1.8	1.6	2.2	3.0	2.8	3.2	-0.5	2.1	1.8	1.8	1.6	1.6
Germany	2.4	1.0	1.3	1.1	1.8	1.7	0.0	1.9	1.6	1.7	1.0	1.2
Estonia	:	6.2	3.1	5.0	7.5	8.7	-0.9	2.4	3.3	2.4	0.9	2.1
Ireland	2.6	3.8	3.1	2.4	3.3	3.0	-4.4	-1.5	0.3	0.8	-1.4	0.9
Greece	11.6	4.5	3.1	3.4	3.3	4.0	1.1	4.6	2.2	0.3	3.5	1.8
Spain	5.5	2.8	3.3	3.6	3.3	3.5	0.1	1.8	1.5	1.5	1.5	1.6
France	1.6	0.9	1.7	2.1	2.0	2.9	-0.4	1.2	1.5	1.5	1.3	1.5
Italy	5.1	2.4	2.6	2.7	2.3	3.2	-0.1	1.6	1.8	1.9	1.8	2.0
Cyprus	:	2.4	2.5	2.1	3.7	4.8	0.3	3.0	3.5	2.8	3.0	2.8
Luxembourg	2.8	2.3	2.1	2.4	2.2	2.0	0.8	2.3	2.1	1.6	2.1	1.9
Malta	:	1.9	2.0	2.3	1.8	3.3	0.6	1.8	2.1	2.2	2.0	2.1
Netherlands	2.4	2.9	2.1	2.2	1.8	1.4	-0.6	1.4	1.7	1.8	1.7	1.5
Austria	2.5	1.4	1.8	2.1	2.7	2.5	-0.8	1.7	2.1	1.7	1.3	1.4
Portugal	5.6	2.9	2.8	3.0	3.0	2.7	-2.3	1.3	2.2	1.2	1.1	1.5
Slovenia	45.8	7.3	4.0	2.2	4.1	5.4	0.0	2.1	2.0	2.2	1.8	2.0
Slovakia	:	7.4	4.8	4.9	2.6	4.5	0.1	0.6	3.1	2.7	1.5	2.8
Finland	1.9	2.4	0.8	1.4	2.2	3.5	0.5	1.4	2.3	2.0	1.5	2.1
Euro area	3.6	1.8	2.1	2.2	2.3	2.7	-0.2	1.7	1.7	1.6	1.4	1.6
Bulgaria	80.5	69.9	3.5	2.2	9.0	7.2	1.9	1.2	2.3	2.4	1.5	1.9
Czech Republic	11.2	5.3	1.3	1.4	2.9	4.9	0.3	0.9	2.0	1.9	0.7	1.1
Denmark	1.7	2.1	1.5	1.9	1.2	3.1	1.3	2.7	2.6	2.5	2.0	1.8
Latvia	:	4.1	5.4	6.0	10.1	16.8	4.2	-1.3	1.1	1.4	-3.3	-0.6
Lithuania	:	2.8	0.9	4.0	6.4	10.9	4.5	1.0	2.0	2.5	0.5	1.3
Hungary	:	12.0	3.9	3.6	6.3	5.4	4.1	4.7	3.9	3.1	4.2	2.3
Poland	31.6	9.0	2.0	1.2	2.4	4.3	2.5	2.6	2.9	3.0	2.4	2.6
Romania	117.3	59.5	12.0	4.9	4.8	10.0	3.3	6.1	5.5	4.1	4.0	3.3
Sweden	3.1	1.3	1.3	1.2	1.4	2.8	1.8	1.9	1.9	1.9	1.9	1.9
United Kingdom	3.4	1.8	2.0	2.7	2.9	3.1	1.3	3.7	2.6	1.4	2.4	1.4
EU	24.8	2.5	2.1	2.3	2.5	3.0	0.3	2.1	1.9	1.7	1.6	1.6
USA	2.3	1.8	2.3	2.7	2.7	3.3	0.2	1.7	1.2	1.4	1.1	0.4
Japan	0.6	-0.3	-0.8	-0.2	-0.6	0.4	-2.2	-1.3	-0.5	0.5	-1.5	-0.2

TABLE 16 : Harmonised index of consumer prices (national index if not available), (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	2.2	1.7	2.0	2.3	1.8	4.5	0.0	2.3	1.9	1.9	1.6	1.6
Germany	3.1	1.2	1.6	1.8	2.3	2.8	0.2	1.1	1.8	2.0	1.3	1.5
Estonia	120.7	6.1	3.3	4.4	6.7	10.6	0.2	2.7	3.6	2.3	1.3	2.0
Ireland	2.2	3.0	3.2	2.7	2.9	3.1	-1.7	-1.5	0.4	0.6	-1.3	0.8
Greece	11.6	3.7	3.4	3.3	3.0	4.2	1.3	4.6	2.2	0.5	3.1	2.1
Spain	4.7	2.4	3.3	3.6	2.8	4.1	-0.2	1.7	1.5	1.4	1.6	1.6
France	2.0	1.2	2.1	1.9	1.6	3.2	0.1	1.7	1.6	1.6	1.4	1.6
Italy	4.6	2.1	2.4	2.2	2.0	3.5	0.8	1.6	1.8	1.9	1.8	2.0
Cyprus	4.3	2.7	2.6	2.2	2.2	4.4	0.2	2.8	3.3	2.5	2.7	2.5
Luxembourg	1.8	1.9	2.9	3.0	2.7	4.1	0.0	2.8	2.1	1.6	2.6	2.0
Malta	3.3	3.1	2.5	2.6	0.7	4.7	1.8	1.9	2.0	2.3	2.0	2.1
Netherlands	2.5	2.6	2.1	1.7	1.6	2.2	1.0	1.0	1.5	1.6	1.3	1.5
Austria	2.9	1.3	1.7	1.7	2.2	3.2	0.4	1.7	2.1	1.8	1.3	1.5
Portugal	5.6	2.7	2.9	3.0	2.4	2.7	-0.9	1.4	2.3	1.3	1.0	1.4
Slovenia	:	8.0	4.3	2.5	3.8	5.5	0.9	2.1	2.0	2.2	1.8	2.0
Slovakia	:	8.5	5.3	4.3	1.9	3.9	0.9	0.7	3.2	2.8	1.3	2.8
Finland	1.5	1.9	1.1	1.3	1.6	3.9	1.6	1.6	2.1	1.8	1.7	1.9
Euro area	3.8	1.8	2.2	2.2	2.1	3.3	0.3	1.5	1.8	1.7	1.5	1.7
Bulgaria	87.7	:	5.5	7.4	7.6	12.0	2.5	2.9	3.2	3.1	2.3	2.7
Czech Republic	:	5.6	1.5	2.1	3.0	6.3	0.6	1.2	2.1	2.2	1.0	1.3
Denmark	1.9	2.1	1.8	1.9	1.7	3.6	1.1	2.2	2.1	2.0	2.3	1.5
Latvia	70.3	3.9	4.9	6.6	10.1	15.3	3.3	-1.3	1.1	1.8	-3.2	-0.7
Lithuania	179.8	3.9	1.4	3.8	5.8	11.1	4.2	1.2	2.3	2.8	-0.1	1.4
Hungary	23.2	12.3	4.8	4.0	7.9	6.0	4.0	4.7	3.9	3.7	4.6	2.8
Poland	31.4	9.8	1.9	1.3	2.6	4.2	4.0	2.6	2.9	3.0	2.4	2.6
Romania	116.9	63.2	12.9	6.6	4.9	7.9	5.6	6.1	5.5	3.2	4.3	3.0
Sweden	2.4	1.5	1.5	1.5	1.7	3.3	1.9	1.8	1.4	1.9	1.7	1.6
United Kingdom	2.8	1.3	1.7	2.3	2.3	3.6	2.2	3.2	2.6	1.4	2.4	1.4
EU	25.9	4.3	2.3	2.3	2.4	3.7	1.0	2.0	2.1	1.8	1.8	1.7
USA	2.9	2.5	2.6	3.2	2.8	3.8	-0.4	1.6	1.1	1.5	1.7	0.3
Japan	0.7	0.1	-0.2	0.3	0.0	1.4	-1.4	-0.9	-0.7	0.0	-0.5	-0.4

TABLE 17 : Profiles of quarterly harmonised index of consumer prices (percentage change on corresponding quarter in previous year, 2010-2012)

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	2010/1	2010/2	2010/3	2010/4	2011/1	2011/2	2011/3	2011/4	2012/1	2012/2	2012/3	2012/4
Belgium	1.2	2.4	2.6	2.9	2.4	1.7	1.7	1.8	1.9	1.8	1.9	1.9
Germany	0.8	1.0	1.2	1.2	1.7	1.8	2.0	1.8	1.8	1.9	2.0	2.2
Estonia	0.0	2.9	3.1	4.9	5.3	4.1	3.2	2.0	1.8	1.8	2.4	3.0
Ireland	-2.4	-2.1	-1.2	-0.4	0.3	0.3	0.2	0.6	0.4	0.5	0.6	0.7
Greece	3.0	5.1	5.6	4.2	4.7	1.9	1.1	1.3	0.9	0.5	0.4	0.3
Spain	1.2	1.6	1.9	2.2	2.0	1.7	1.1	1.1	1.3	1.4	1.5	1.5
France	1.5	1.8	1.8	1.8	1.6	1.5	1.6	1.7	1.6	1.6	1.6	1.6
Italy	1.3	1.6	1.7	1.9	1.8	1.7	1.8	1.9	1.9	1.9	1.9	1.9
Cyprus	2.5	2.2	3.3	3.1	3.1	3.2	3.6	3.4	2.6	2.4	2.5	2.4
Luxembourg	2.8	2.8	2.7	2.9	3.0	2.2	1.9	1.5	1.4	1.5	1.6	1.8
Malta	0.9	1.5	2.6	2.6	1.9	2.0	2.2	2.1	2.2	2.4	2.4	2.0
Netherlands	0.5	0.4	1.3	1.7	1.7	1.3	1.7	1.5	1.5	1.5	1.6	1.6
Austria	1.3	1.8	1.7	1.9	2.3	2.2	2.1	1.9	1.9	1.9	1.8	1.8
Portugal	0.3	1.0	2.0	2.1	2.7	2.5	1.9	2.0	1.2	1.2	1.3	1.4
Slovenia	1.7	2.4	2.3	2.0	2.0	2.0	1.9	1.9	2.1	2.1	2.2	2.2
Slovakia	0.0	0.7	1.0	1.2	3.2	3.2	3.2	3.2	2.8	2.8	2.9	2.9
Finland	1.5	1.4	1.3	2.1	2.1	2.2	2.4	2.0	1.8	1.8	1.8	1.8
Euro area	1.1	1.5	1.7	1.8	1.9	1.7	1.7	1.7	1.7	1.7	1.7	1.8
Bulgaria	1.9	2.9	3.3	3.3	3.2	3.2	3.3	3.4	2.9	3.1	3.2	3.3
Czech Republic	0.4	0.9	1.6	1.8	2.2	2.2	2.0	2.1	2.0	2.1	2.2	2.3
Denmark	1.9	2.0	2.3	2.6	2.1	2.3	2.0	2.0	2.0	2.0	2.0	2.0
Latvia	-3.9	-2.3	-0.3	1.3	1.9	1.2	0.5	0.9	1.3	1.6	2.0	2.2
Lithuania	-0.4	0.5	1.7	2.9	2.5	2.3	2.2	2.3	2.4	2.8	3.0	2.9
Hungary	5.8	5.2	3.6	3.4	4.1	3.9	3.9	3.7	3.8	3.8	3.8	3.5
Poland	3.4	2.5	2.1	2.5	2.7	2.8	3.0	3.1	3.0	2.9	3.0	3.1
Romania	4.6	4.3	7.5	8.0	7.0	7.1	4.6	3.7	3.3	3.2	3.1	3.1
Sweden	2.7	1.8	1.3	1.3	1.1	1.1	1.8	1.5	1.8	1.8	1.9	2.1
United Kingdom	3.2	3.4	3.0	2.9	2.9	2.5	2.5	2.4	1.4	1.3	1.5	1.6
EU	1.6	1.9	2.0	2.1	2.1	1.9	1.9	1.9	1.7	1.7	1.8	1.8
USA	2.4	1.8	1.2	0.8	0.7	1.2	1.2	1.3	1.3	1.4	1.6	1.7
Japan	-1.2	-0.9	-0.9	-0.5	-0.6	-1.2	-0.7	-0.2	-0.1	0.0	0.1	0.1

revisions at the same time. Accordingly, data for the euro area and EU aggregates for the first two quarters of 2010 presented in this table

TABLE 18 : Price deflator of exports of goods in national currency (percentage change on preceding year, 1992-2012)

	5-year averages								Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009		2010	2011	2012	2010	2011
Belgium	-0.7	1.3	1.3	3.2	1.8	3.6	-6.5		4.6	1.5	2.0	3.3	2.0
Germany	0.4	0.5	-0.1	1.3	0.4	0.3	-2.4		2.6	0.9	1.4	1.0	1.2
Estonia	:	4.5	1.6	4.8	8.1	5.3	-5.6		5.7	1.3	2.0	2.9	1.9
Ireland	1.1	3.3	-2.6	0.2	-2.3	-3.4	0.3		0.8	0.7	1.7	2.0	0.8
Greece	7.5	4.1	2.3	4.3	3.0	2.6	-1.1		5.5	1.1	1.2	2.1	1.5
Spain	3.5	2.1	1.7	4.5	2.0	2.0	-5.0		1.9	1.7	1.8	1.0	0.7
France	-0.8	0.0	0.0	2.9	1.9	2.7	-4.1		1.5	1.5	1.6	1.5	1.8
Italy	4.7	2.0	2.6	5.2	4.7	5.4	-0.7		4.9	2.0	2.0	3.9	2.0
Cyprus	:	3.7	0.6	6.8	2.7	1.6	0.3		3.1	3.3	2.7	2.5	3.0
Luxembourg	-0.2	0.5	2.4	4.1	2.7	6.2	-3.6		1.5	1.5	2.0	1.0	1.5
Malta	:	1.4	-0.4	8.2	8.8	2.5	-9.4		-3.3	1.4	2.1	2.9	1.6
Netherlands	-0.9	0.9	0.5	3.2	1.6	4.5	-8.3		4.6	1.4	1.7	3.3	1.7
Austria	0.3	0.5	0.9	3.2	1.4	2.2	-1.9		2.6	1.4	1.6	1.1	2.4
Portugal	1.2	1.8	0.9	4.8	1.4	2.4	-5.1		4.1	2.9	2.0	0.9	1.3
Slovenia	39.9	5.3	2.8	2.8	2.1	0.7	-1.5		2.0	1.2	1.2	1.3	1.5
Slovakia	:	5.0	1.7	1.8	0.5	0.9	-5.5		1.5	1.3	1.5	1.3	1.5
Finland	3.7	-1.6	-0.6	2.2	0.5	-3.0	-10.9		6.0	2.8	1.0	2.2	2.1
Euro area	1.6	1.0	0.5	2.8	1.5	2.1	-3.9		3.1	1.4	1.6	1.9	1.5
Bulgaria	:	:	4.8	17.0	5.9	8.1	-13.2		8.3	0.8	1.5	7.1	1.8
Czech Republic	:	2.0	-1.8	-1.5	-0.2	-5.8	-0.3		-1.1	-1.8	1.6	-0.3	0.3
Denmark	0.2	1.3	1.7	4.4	2.0	7.1	-6.1		2.0	2.0	2.0	3.5	1.7
Latvia	:	-0.2	8.8	9.7	13.4	7.7	-9.4		7.0	1.0	1.5	3.0	3.0
Lithuania	:	0.8	2.9	4.9	5.8	13.2	-16.7		11.5	0.3	2.0	3.3	2.0
Hungary	:	8.8	-0.3	6.5	-4.5	0.6	2.1		-0.9	1.8	2.9	-0.9	1.8
Poland	21.1	6.5	3.8	2.5	2.8	-1.8	13.5		-3.0	-0.2	1.2	-2.5	1.5
Romania	115.2	49.9	9.8	5.8	0.5	21.0	2.9		5.3	3.9	3.0	3.1	2.8
Sweden	2.1	0.0	0.2	3.6	1.9	3.1	0.9		-3.0	-1.0	1.0	-1.0	2.0
United Kingdom	3.1	-2.7	1.2	3.3	1.1	12.6	3.0		4.8	1.2	2.1	3.0	1.4
EU	:	7.0	0.7	2.9	1.4	3.0	-2.4		2.7	1.2	1.7	1.8	1.5
USA	-0.3	-1.3	2.3	3.3	3.4	4.9	-6.8		4.3	3.1	1.8	2.4	0.7
Japan	-2.6	-1.9	-0.3	3.7	2.2	-4.6	-11.4		-1.0	-2.5	-0.7	-3.2	0.0

TABLE 19 : Price deflator of imports of goods in national currency (percentage change on preceding year, 1992-2012)

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	-0.5	2.0	1.5	3.6	1.5	6.7	-9.6	7.0	1.4	2.1	2.8	1.6
Germany	-1.2	1.2	-0.2	3.1	-0.3	1.8	-8.0	6.0	1.0	1.7	3.6	1.7
Estonia	:	2.9	1.2	3.5	3.3	5.5	-3.0	8.0	1.2	2.2	4.2	1.9
Ireland	3.7	1.4	-2.3	2.6	-0.3	2.7	-4.4	0.9	0.7	1.7	2.2	1.1
Greece	7.2	4.3	2.4	3.9	2.2	6.0	-2.1	4.5	1.0	1.8	4.3	2.0
Spain	2.9	2.1	1.1	3.9	1.9	4.3	-8.8	5.8	1.3	1.4	3.0	1.3
France	-1.0	0.2	0.0	3.1	0.4	4.0	-6.3	5.2	1.0	1.8	3.9	1.7
Italy	5.0	2.1	3.3	8.9	3.1	8.5	-7.7	7.5	1.7	2.1	6.4	1.7
Cyprus	:	2.5	1.9	2.2	2.0	4.2	-2.3	4.3	2.0	2.5	3.5	3.0
Luxembourg	0.4	1.9	1.5	2.0	-0.7	5.6	-2.7	3.0	2.5	2.5	2.0	1.0
Malta	:	2.5	1.9	10.9	9.0	1.5	-7.7	-7.8	0.1	1.4	4.2	1.7
Netherlands	-1.3	0.2	0.1	3.5	1.7	4.6	-7.5	6.0	1.4	1.7	4.5	1.6
Austria	0.4	0.7	0.9	3.5	1.9	4.5	-3.9	4.8	1.6	1.9	2.8	1.4
Portugal	0.1	1.6	0.9	4.0	1.0	4.6	-9.7	6.0	2.7	2.4	2.3	1.6
Slovenia	36.0	5.5	3.1	3.3	1.6	2.5	-6.0	5.0	1.9	2.0	3.6	1.8
Slovakia	:	4.6	2.1	3.6	1.6	2.8	-4.9	2.2	1.0	1.5	3.2	1.3
Finland	3.2	-1.0	1.9	6.5	0.5	0.4	-10.7	8.5	2.5	1.5	4.2	2.8
Euro area	1.1	1.3	0.7	4.1	1.1	4.2	-7.4	5.9	1.3	1.8	3.9	1.6
Bulgaria	:	:	4.0	11.4	7.3	10.8	-13.7	5.3	0.6	1.9	6.8	1.7
Czech Republic	:	1.9	-1.7	0.2	-1.4	-3.6	-3.2	0.8	-1.5	1.5	0.8	1.1
Denmark	-0.6	0.2	0.8	3.6	4.9	6.1	-8.8	2.1	2.1	2.2	4.0	1.7
Latvia	:	2.2	8.6	9.6	5.7	9.7	-6.7	7.0	0.9	1.5	6.7	1.7
Lithuania	:	-1.5	1.6	8.8	4.9	9.3	-11.5	10.2	0.2	1.6	6.3	2.5
Hungary	:	9.3	0.6	8.0	-4.4	1.7	1.1	-0.4	2.2	4.0	-0.4	2.2
Poland	19.3	7.7	3.5	2.8	0.8	0.3	8.7	-1.4	0.8	1.8	-1.5	2.0
Romania	125.4	44.0	6.6	-1.2	-9.2	17.2	2.7	5.3	2.9	2.5	1.7	1.6
Sweden	2.9	1.5	1.3	3.9	0.2	4.3	-1.0	-3.0	-1.0	2.0	-2.0	2.0
United Kingdom	3.4	-2.8	0.6	3.4	-0.2	13.2	2.7	4.9	2.4	1.9	3.4	2.6
EU	:	6.5	0.8	4.0	0.7	5.2	-5.3	5.0	1.3	1.9	3.4	1.8
USA	-0.2	-1.7	3.3	4.2	3.1	11.3	-12.3	6.7	4.5	1.7	7.4	1.3
Japan	-3.2	-0.8	4.2	12.6	6.8	7.1	-22.0	5.5	-2.0	0.0	8.9	1.8

TABLE 20 : Terms of trade of goods (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	-0.1	-0.8	-0.2	-0.4	0.3	-2.9	3.5	-2.2	0.0	-0.1	0.5	0.4
Germany	1.6	-0.7	0.1	-1.8	0.7	-1.5	6.1	-3.2	-0.1	-0.3	-2.5	-0.5
Estonia	:	1.5	0.4	1.2	4.6	-0.2	-2.6	-2.1	0.1	-0.2	-1.2	0.0
Ireland	-2.4	1.8	-0.3	-2.4	-2.0	-5.9	4.9	-0.1	0.0	0.0	-0.2	-0.2
Greece	0.3	-0.1	-0.1	0.4	0.8	-3.3	1.0	1.0	0.1	-0.6	-2.1	-0.5
Spain	0.6	0.0	0.5	0.6	0.1	-2.3	4.1	-3.7	0.4	0.4	-1.9	-0.6
France	0.1	-0.2	0.0	-0.3	1.5	-1.2	2.3	-3.5	0.5	-0.2	-2.3	0.1
Italy	-0.3	-0.1	-0.7	-3.4	1.5	-2.8	7.6	-2.4	0.3	-0.1	-2.3	0.3
Cyprus	:	1.2	-1.3	4.5	0.6	-2.5	2.7	-1.2	1.3	0.2	-1.0	0.0
Luxembourg	-0.6	-1.4	0.8	2.0	3.4	0.5	-0.9	-1.5	-1.0	-0.5	-1.0	0.5
Malta	:	-1.1	-2.2	-2.5	-0.2	1.1	-1.8	4.9	1.3	0.7	-1.2	-0.1
Netherlands	0.4	0.7	0.4	-0.3	-0.1	-0.1	-0.8	-1.3	0.0	0.0	-1.1	0.1
Austria	-0.1	-0.2	0.1	-0.3	-0.5	-2.1	2.1	-2.1	-0.2	-0.3	-1.7	1.0
Portugal	1.1	0.2	0.0	0.8	0.4	-2.2	5.1	-1.8	0.2	-0.4	-1.4	-0.3
Slovenia	2.9	-0.2	-0.3	-0.4	0.6	-1.8	4.7	-2.9	-0.7	-0.8	-2.2	-0.3
Slovakia	:	0.4	-0.3	-1.8	-1.1	-1.9	-0.6	-0.7	0.3	0.0	-1.8	0.2
Finland	0.5	-0.6	-2.5	-4.1	0.0	-3.3	-0.2	-2.3	0.3	-0.5	-1.9	-0.7
Euro area	0.5	-0.3	-0.2	-1.3	0.4	-2.0	3.9	-2.6	0.1	-0.2	-1.9	-0.1
Bulgaria	:	:	0.8	5.1	-1.3	-2.5	0.6	2.8	0.2	-0.4	0.3	0.1
Czech Republic	:	0.1	-0.1	-1.7	1.2	-2.3	3.0	-1.9	-0.3	0.1	-1.1	-0.8
Denmark	0.8	1.0	0.9	0.7	-2.8	1.0	3.0	-0.1	-0.1	-0.2	-0.5	0.0
Latvia	:	-2.3	0.2	0.0	7.2	-1.8	-2.9	0.0	0.1	0.0	-3.5	1.3
Lithuania	:	2.3	1.2	-3.5	0.9	3.6	-5.9	1.2	0.1	0.4	-2.8	-0.5
Hungary	:	-0.4	-0.9	-1.4	-0.1	-1.1	1.0	-0.5	-0.4	-1.1	-0.5	-0.4
Poland	1.5	-1.1	0.3	-0.3	2.0	-2.1	4.4	-1.6	-1.0	-0.6	-1.0	-0.5
Romania	-4.5	4.1	3.0	7.2	10.6	3.2	0.1	0.0	1.0	0.5	1.3	1.2
Sweden	-0.7	-1.5	-1.1	-0.3	1.7	-1.2	1.9	0.0	0.0	-1.0	1.0	0.0
United Kingdom	-0.3	0.1	0.6	-0.1	1.3	-0.5	0.3	-0.1	-1.2	0.2	-0.4	-1.2
EU	:	0.5	-0.1	-1.0	0.7	-2.0	3.0	-2.2	-0.1	-0.2	-1.6	-0.2
USA	-0.1	0.4	-1.0	-0.8	0.2	-5.8	6.3	-2.3	-1.4	0.1	-4.6	-0.6
Japan	0.6	-1.1	-4.3	-8.0	-4.3	-10.9	13.6	-6.2	-0.5	-0.7	-11.1	-1.8

TABLE 21 : Total population (percentage change on preceding year, 1992-2012)

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	0.3	0.2	0.5	0.7	0.7	0.8	0.8	0.7	0.7	0.7	0.7	0.7
Germany	0.5	0.1	0.0	-0.1	-0.1	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Estonia	-2.0	-0.8	-0.3	-0.2	-0.2	-0.1	0.0	0.0	0.1	0.1	0.0	0.0
Ireland	0.6	1.3	2.0	2.4	2.4	1.8	0.6	0.1	0.0	0.1	0.1	0.2
Greece	0.9	0.4	0.4	0.4	0.4	0.4	0.2	1.0	0.2	0.2	0.4	0.4
Spain	0.2	0.6	1.6	1.5	1.8	1.6	0.7	0.4	0.3	0.3	0.4	0.3
France	0.4	0.5	0.7	0.7	0.6	0.6	0.6	0.5	0.5	0.5	0.5	0.5
Italy	0.0	0.0	0.7	0.6	0.7	0.8	0.7	0.4	0.4	0.3	0.4	0.4
Cyprus	2.1	1.2	1.9	2.0	1.5	1.2	0.6	0.7	0.7	0.7	0.7	0.7
Luxembourg	1.3	1.3	1.4	1.6	1.6	1.7	1.9	1.5	1.4	1.3	1.1	1.1
Malta	0.9	0.7	0.7	0.7	0.7	0.8	0.2	0.1	0.4	0.4	0.4	0.4
Netherlands	0.6	0.7	0.4	0.1	0.2	0.4	0.5	0.5	0.3	0.3	0.2	0.2
Austria	0.5	0.2	0.6	0.5	0.4	0.4	0.3	0.3	0.4	0.4	0.3	0.3
Portugal	0.2	0.5	0.6	0.3	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Slovenia	-0.1	0.0	0.2	0.4	0.5	0.3	1.0	-0.5	0.2	0.2	-0.4	0.2
Slovakia	0.3	0.0	0.0	0.1	0.1	0.2	0.2	0.0	-0.2	-0.2	0.1	0.1
Finland	0.4	0.2	0.3	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Euro area	0.3	0.3	0.6	0.5	0.6	0.5	0.4	0.3	0.2	0.2	0.2	0.2
Bulgaria	-0.6	-1.1	-0.6	-0.5	-0.5	-0.4	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Czech Republic	0.0	-0.2	0.1	0.3	0.5	1.0	0.7	0.3	0.1	-0.2	0.3	0.3
Denmark	0.4	0.4	0.3	0.3	0.4	0.6	0.5	0.3	0.3	0.3	0.3	0.3
Latvia	-1.5	-0.8	-0.6	-0.5	-0.5	-0.4	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Lithuania	-0.6	-0.7	-0.5	-0.6	-0.5	-0.5	-0.6	-1.4	-0.5	-0.5	-0.6	-0.6
Hungary	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Poland	0.2	0.0	-0.1	-0.1	0.0	0.0	0.1	0.1	0.0	0.0	0.1	0.0
Romania	-0.3	-0.2	-0.7	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Sweden	0.5	0.1	0.4	0.6	0.7	1.2	0.9	0.2	0.0	0.0	0.2	0.0
United Kingdom	0.3	0.3	0.5	0.6	0.7	0.7	0.6	0.7	0.7	0.7	0.7	0.7
EU	0.2	0.2	0.4	0.4	0.5	0.5	0.3	0.2	0.2	0.2	0.2	0.2
USA	1.2	1.1	0.9	1.0	1.0	0.9	0.9	0.8	0.8	0.8	0.9	0.9
Japan	0.3	0.2	0.1	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2

TABLE 22 : Total employment (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	0.1	1.4	0.7	1.2	1.6	1.7	-0.4	0.4	0.3	0.6	-0.9	0.2
Germany	-0.6	1.0	-0.1	0.6	1.7	1.4	0.0	0.3	0.7	0.4	-0.3	-0.1
Estonia	-5.2	-1.4	2.0	5.4	0.8	0.2	-9.9	-4.7	2.9	1.9	-2.6	1.5
Ireland	2.5	5.6	3.2	4.3	3.7	-1.1	-8.2	-4.0	-0.8	0.6	-3.5	0.4
Greece	0.9	0.7	2.0	3.3	1.7	0.2	-0.7	-2.8	-2.6	0.1	-1.9	-0.8
Spain	-0.3	4.1	2.8	3.3	2.8	-0.5	-6.6	-2.3	-0.3	1.1	-2.5	-0.1
France	-0.5	1.7	0.5	1.0	1.6	0.7	-1.2	0.0	0.5	0.7	-0.7	0.3
Italy	-0.9	1.1	0.8	1.5	1.0	-0.4	-2.6	-1.4	0.4	0.9	-0.7	0.4
Cyprus	:	1.6	3.0	1.8	3.2	2.8	-0.7	-0.9	0.2	0.8	-0.7	-0.2
Luxembourg	2.5	4.7	2.7	3.6	4.5	4.7	0.9	1.7	2.0	2.1	0.0	0.7
Malta	1.5	0.8	0.7	1.3	3.2	2.6	-0.5	1.1	1.2	1.4	0.3	0.7
Netherlands	1.0	2.4	-0.2	1.6	2.2	1.2	-1.2	-1.1	0.2	0.3	-1.6	-0.2
Austria	0.0	0.8	0.6	1.0	1.5	1.6	-1.6	0.7	0.7	0.8	-0.1	0.2
Portugal	-0.8	2.1	0.0	0.5	0.0	0.5	-2.6	-0.9	-0.7	-0.3	-0.5	0.0
Slovenia	:	0.2	0.5	1.5	3.0	2.8	-1.9	-2.3	-0.2	0.6	-2.3	-0.5
Slovakia	:	-1.1	0.9	2.3	2.1	2.8	-2.4	-2.8	0.3	0.8	-1.9	1.2
Finland	-2.3	2.2	0.9	1.8	2.2	1.6	-2.8	-0.1	0.9	0.9	-2.1	0.4
Euro area	-0.4	1.6	0.7	1.5	1.7	0.6	-2.0	-0.7	0.3	0.6	-1.0	0.1
Bulgaria	:	-2.3	2.4	3.3	3.2	2.6	-2.7	-5.2	0.7	1.1	-1.2	0.6
Czech Republic	:	-0.9	0.5	1.9	2.7	1.2	-1.1	-0.5	0.2	0.3	-1.9	0.4
Denmark	0.1	1.0	0.3	2.1	2.8	1.9	-3.1	-1.4	0.3	0.3	-1.9	-0.1
Latvia	-7.4	0.0	2.5	4.9	3.6	0.9	-13.6	-5.6	0.5	0.6	-7.2	0.8
Lithuania	-2.7	-2.1	2.0	1.8	2.8	-0.7	-6.8	-5.6	1.1	2.1	-3.6	0.2
Hungary	:	1.0	-0.2	0.6	-0.3	-1.3	-2.8	-0.8	0.1	0.8	-0.9	0.8
Poland	:	-1.1	0.5	3.2	4.4	3.8	0.4	0.7	1.3	1.4	0.0	0.6
Romania	-2.8	-2.5	-2.6	0.7	0.4	0.0	-2.0	-0.8	0.1	0.6	-1.7	0.8
Sweden	-1.9	1.4	0.1	1.7	2.5	0.9	-2.0	1.0	0.9	0.8	-0.9	0.3
United Kingdom	0.0	1.2	0.9	0.9	0.7	0.7	-1.6	-0.1	0.4	0.5	-0.3	0.7
EU	:	1.0	0.6	1.5	1.7	0.9	-1.9	-0.6	0.4	0.7	-0.9	0.3
USA	1.8	1.7	0.7	1.8	0.9	-0.7	-5.0	-0.5	0.8	1.1	-0.4	0.6
Japan	0.4	-0.6	-0.2	0.4	0.4	-0.3	-1.6	-0.6	-0.2	0.1	-1.0	-0.2

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 23 : Unemployment rate (number of unemployed as a percentage of total labour force, 1992-2012) ¹

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	8.9	8.1	8.2	8.3	7.5	7.0	7.9	8.6	8.8	8.7	8.8	9.0
Germany	7.8	8.4	9.6	9.8	8.4	7.3	7.5	7.3	6.7	6.3	7.8	7.8
Estonia	:	11.3	8.8	5.9	4.7	5.5	13.8	17.5	15.1	13.6	15.8	14.6
Ireland	13.9	6.2	4.5	4.5	4.6	6.3	11.9	13.7	13.5	12.7	13.8	13.4
Greece	8.8	10.9	9.9	8.9	8.3	7.7	9.5	12.5	15.0	15.2	11.8	13.2
Spain	17.8	13.1	10.1	8.5	8.3	11.3	18.0	20.1	20.2	19.2	19.7	19.8
France	11.0	10.0	9.1	9.2	8.4	7.8	9.5	9.6	9.5	9.2	10.2	10.1
Italy	10.3	10.5	7.9	6.8	6.1	6.7	7.8	8.4	8.3	8.2	8.8	8.8
Cyprus	:	3.8	4.5	4.6	4.0	3.6	5.3	6.8	6.6	5.9	6.7	7.0
Luxembourg	2.7	2.4	4.1	4.6	4.2	4.9	5.1	5.5	5.6	5.6	6.1	6.4
Malta	5.2	6.8	7.4	7.1	6.4	5.9	7.0	6.6	6.6	6.5	7.3	7.2
Netherlands	6.0	3.8	4.4	4.4	3.6	3.1	3.7	4.5	4.4	4.3	4.9	5.2
Austria	3.9	4.0	4.7	4.8	4.4	3.8	4.8	4.4	4.2	4.0	5.1	5.4
Portugal	6.2	4.9	6.7	7.8	8.1	7.7	9.6	10.5	11.1	11.2	9.9	9.9
Slovenia	:	6.9	6.4	6.0	4.9	4.4	5.9	7.2	7.2	6.6	7.0	7.3
Slovakia	:	15.8	16.8	13.4	11.1	9.5	12.0	14.5	14.2	13.4	14.1	13.3
Finland	14.9	10.6	8.6	7.7	6.9	6.4	8.2	8.3	7.8	7.2	9.5	9.2
Euro area	10.1	9.3	8.7	8.4	7.5	7.5	9.5	10.1	10.0	9.6	10.3	10.4
Bulgaria	:	15.7	12.6	9.0	6.9	5.6	6.8	9.8	9.1	8.0	7.9	7.3
Czech Republic	:	7.3	7.7	7.2	5.3	4.4	6.7	7.3	7.0	6.7	8.3	8.0
Denmark	7.8	4.8	4.8	3.9	3.8	3.3	6.0	6.9	6.3	5.8	6.9	6.5
Latvia	13.8	14.0	9.8	6.8	6.0	7.5	17.1	19.3	17.7	16.2	20.6	18.8
Lithuania	5.0	13.3	10.3	5.6	4.3	5.8	13.7	17.8	16.9	15.1	16.7	16.3
Hungary	:	7.3	6.5	7.5	7.4	7.8	10.0	11.1	11.0	10.3	10.8	10.1
Poland	13.4	13.8	18.1	13.9	9.6	7.1	8.2	9.5	9.2	8.5	9.2	9.4
Romania	5.8	6.4	7.6	7.3	6.4	5.8	6.9	7.5	7.4	7.0	8.5	7.9
Sweden	8.5	7.2	6.9	7.0	6.1	6.2	8.3	8.3	8.0	7.5	9.2	8.8
United Kingdom	9.1	5.8	5.0	5.4	5.3	5.6	7.6	7.8	7.9	7.8	7.8	7.4
EU	:	8.8	8.8	8.2	7.2	7.0	8.9	9.6	9.5	9.1	9.8	9.7
USA	6.3	4.5	5.4	4.6	4.6	5.8	9.3	9.6	9.4	9.0	9.7	9.8
Japan	2.8	4.4	4.8	4.1	3.9	4.0	5.1	5.1	4.9	4.8	5.3	5.3

¹ Series following Eurostat definition, based on the labour force survey.

TABLE 24 : Compensation of employees per head (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	3.4	2.8	2.5	3.3	3.4	3.6	1.8	1.5	2.3	2.3	1.6	2.1
Germany	4.4	1.2	0.9	1.1	0.9	2.0	0.2	2.0	2.6	2.8	0.7	1.1
Estonia	:	13.2	11.6	14.1	24.6	10.1	-3.3	0.2	2.2	3.5	-3.3	1.3
Ireland	4.5	5.9	5.4	4.7	5.4	3.4	0.0	-1.9	0.5	0.1	-2.5	0.8
Greece	10.8	7.0	6.0	3.5	6.2	6.8	2.3	-1.8	-0.2	0.1	-0.8	0.4
Spain	6.0	2.5	3.5	4.0	4.8	6.4	4.1	1.0	0.7	1.3	1.1	1.2
France	2.8	2.1	3.1	3.2	2.3	2.4	1.6	2.0	1.7	1.8	1.6	1.7
Italy	4.8	2.1	3.1	2.7	2.4	3.7	2.1	2.3	1.5	1.8	2.0	1.7
Cyprus	:	4.6	3.8	3.0	3.0	3.5	5.2	2.7	3.1	3.2	3.2	3.6
Luxembourg	3.9	3.2	2.9	2.6	3.7	2.1	1.8	2.2	2.0	2.5	2.5	2.5
Malta	7.8	4.5	2.9	3.6	2.0	3.7	2.3	0.6	2.0	3.0	2.2	2.3
Netherlands	2.9	4.1	3.4	2.4	3.4	3.6	2.2	1.7	2.3	2.1	1.8	1.7
Austria	3.9	1.9	2.3	3.4	3.0	3.2	2.3	1.6	2.2	2.1	1.6	2.1
Portugal	9.4	5.4	3.2	1.8	3.6	2.7	3.6	1.7	-1.3	0.7	1.6	1.6
Slovenia	:	10.4	7.1	5.3	6.4	7.0	1.6	3.1	2.8	3.3	2.9	3.4
Slovakia	:	10.3	8.5	7.7	8.4	7.1	4.8	3.2	3.7	4.5	3.5	4.2
Finland	2.5	3.3	2.9	2.9	3.7	5.1	1.9	2.4	2.7	2.8	2.6	2.1
Euro area	4.4	2.2	2.5	2.5	2.6	3.3	1.8	1.8	1.8	2.1	1.4	1.5
Bulgaria	:	80.9	5.8	7.4	17.4	20.3	7.8	6.8	5.7	5.5	4.7	4.0
Czech Republic	:	7.9	6.5	5.9	6.3	6.3	0.3	2.5	2.9	4.7	2.3	3.7
Denmark	3.2	3.8	3.6	3.5	3.6	3.6	2.4	3.5	3.1	3.1	1.8	1.8
Latvia	:	7.7	15.0	23.2	35.1	15.7	-11.7	-4.0	0.7	1.8	-8.0	1.0
Lithuania	:	9.1	10.5	16.7	13.9	14.3	-11.1	-0.2	1.2	4.4	-2.4	1.5
Hungary	:	14.7	9.4	5.3	6.7	7.0	-2.2	1.3	3.1	4.8	-0.3	3.7
Poland	37.8	13.8	1.9	1.8	4.9	8.9	2.9	3.7	4.0	5.9	3.2	4.4
Romania	117.4	73.1	19.6	12.4	22.0	31.9	10.5	1.8	3.3	4.2	2.3	2.5
Sweden	4.8	4.0	3.0	2.1	5.0	1.3	1.3	2.3	2.6	3.0	2.1	2.5
United Kingdom	3.6	5.1	4.0	4.9	5.0	1.5	2.1	2.7	2.8	4.0	1.4	1.6
EU	:	4.0	2.8	2.8	3.2	3.2	1.8	2.1	2.1	2.5	1.4	1.6
USA	3.0	4.4	3.9	3.9	3.9	3.1	2.2	2.1	1.0	0.5	1.5	0.7
Japan	1.1	-0.2	-0.7	0.2	-1.1	-0.4	-2.9	0.7	1.1	1.2	-0.1	0.9

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 25 : Real compensation of employees per head ¹ (percentage change on preceding year, 1992-2012)

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	1.6	1.1	0.3	0.3	0.6	0.4	2.3	-0.6	0.4	0.5	0.0	0.6
Germany	1.9	0.3	-0.4	0.0	-0.9	0.2	0.2	0.1	0.9	1.1	-0.3	-0.1
Estonia	:	6.6	8.2	8.7	15.9	1.4	-2.4	-2.2	-1.1	1.1	-4.1	-0.8
Ireland	1.9	2.0	2.2	2.2	2.0	0.3	4.6	-0.4	0.1	-0.7	-1.1	-0.1
Greece	-0.7	2.4	2.8	0.1	2.8	2.7	1.2	-6.2	-2.3	-0.2	-4.1	-1.4
Spain	0.5	-0.3	0.2	0.4	1.5	2.7	4.0	-0.8	-0.8	-0.2	-0.4	-0.4
France	1.1	1.2	1.4	1.1	0.2	-0.5	2.0	0.8	0.2	0.3	0.3	0.2
Italy	-0.3	-0.2	0.5	0.0	0.1	0.5	2.3	0.7	-0.3	-0.1	0.1	-0.2
Cyprus	:	2.1	1.3	0.8	-0.7	-1.3	4.9	-0.3	-0.4	0.4	0.2	0.8
Luxembourg	1.0	0.9	0.8	0.2	1.5	0.1	1.1	0.0	-0.1	0.8	0.4	0.6
Malta	:	2.5	0.9	1.2	0.2	0.4	1.7	-1.2	-0.1	0.7	0.2	0.2
Netherlands	0.5	1.2	1.3	0.3	1.6	2.2	2.8	0.3	0.6	0.3	0.1	0.2
Austria	1.4	0.6	0.5	1.3	0.3	0.7	3.1	-0.1	0.1	0.4	0.3	0.7
Portugal	3.6	2.4	0.4	-1.2	0.6	-0.1	6.0	0.4	-3.5	-0.5	0.5	0.1
Slovenia	:	2.8	2.9	3.0	2.2	1.5	1.6	1.0	0.8	1.1	1.1	1.3
Slovakia	:	2.7	3.5	2.7	5.6	2.5	4.7	2.6	0.5	1.8	2.0	1.4
Finland	0.6	0.9	2.1	1.4	1.4	1.6	1.4	1.0	0.3	0.8	1.1	0.0
Euro area	1.0	0.5	0.4	0.3	0.3	0.6	2.0	0.2	0.2	0.4	0.0	-0.1
Bulgaria	:	6.5	2.3	5.1	7.7	12.2	5.8	5.5	3.3	3.0	3.2	2.0
Czech Republic	:	2.4	5.2	4.4	3.4	1.3	0.0	1.6	0.9	2.7	1.6	2.5
Denmark	1.5	1.7	2.0	1.5	2.3	0.6	1.0	0.7	0.4	0.5	-0.2	0.0
Latvia	:	3.4	9.2	16.3	22.7	-0.9	-15.3	-2.7	-0.4	0.4	-4.9	1.6
Lithuania	:	6.2	9.6	12.1	7.0	3.1	-14.9	-1.1	-0.8	1.9	-2.9	0.2
Hungary	:	2.4	5.3	1.7	0.4	1.5	-6.0	-3.2	-0.7	1.6	-4.3	1.4
Poland	4.7	4.4	-0.1	0.6	2.4	4.4	0.4	1.0	1.1	2.8	0.8	1.8
Romania	0.0	8.6	6.8	7.2	16.5	19.9	7.1	-4.1	-2.1	0.1	-1.6	-0.8
Sweden	1.7	2.7	1.8	0.8	3.6	-1.5	-0.5	0.4	0.7	1.1	0.2	0.6
United Kingdom	0.2	3.2	1.9	2.1	2.1	-1.6	0.9	-1.0	0.2	2.6	-1.0	0.2
EU	:	1.4	0.7	0.5	0.7	0.2	1.5	0.0	0.1	0.8	-0.2	0.0
USA	0.7	2.6	1.5	1.2	1.1	-0.2	2.1	0.4	-0.2	-0.8	0.4	0.3
Japan	0.5	0.1	0.1	0.4	-0.5	-0.9	-0.7	2.1	1.6	0.7	1.4	1.1

¹ Deflated by the price deflator of private consumption.

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 26 : Labour productivity (real GDP per occupied person) (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	1.4	1.3	1.3	1.5	1.3	-0.7	-2.4	1.6	1.5	1.3	2.2	1.4
Germany	2.0	1.1	1.1	2.7	1.0	-0.4	-4.7	3.3	1.5	1.6	1.6	1.7
Estonia	:	8.6	6.4	4.9	6.1	-5.2	-4.4	7.4	1.5	1.6	3.7	2.2
Ireland	3.3	3.4	2.1	0.9	1.9	-2.4	0.6	3.9	1.7	1.3	2.6	2.6
Greece	0.2	3.1	2.0	1.2	2.5	1.1	-1.6	-1.5	-0.3	1.0	-1.1	0.3
Spain	1.8	0.2	0.5	0.7	0.7	1.4	3.1	2.1	1.0	0.6	2.1	0.9
France	1.6	1.2	1.2	1.2	0.8	-0.5	-1.4	1.6	1.2	1.1	2.0	1.2
Italy	2.2	0.9	0.1	0.5	0.5	-0.9	-2.5	2.5	0.8	0.6	1.6	1.0
Cyprus	:	2.6	0.2	2.3	1.8	0.8	-1.0	1.4	1.2	1.3	0.3	1.5
Luxembourg	0.1	1.5	1.3	1.3	2.1	-3.2	-4.6	1.4	0.8	1.1	1.9	1.7
Malta	3.5	2.6	1.4	2.3	0.5	0.0	-1.6	2.0	0.8	0.8	0.8	1.0
Netherlands	1.4	1.4	1.8	1.7	1.7	0.6	-2.8	2.8	1.3	1.4	3.0	2.0
Austria	1.8	1.8	1.6	2.6	2.2	0.5	-2.3	1.3	1.0	1.3	1.5	1.4
Portugal	2.8	1.7	0.7	0.9	2.4	-0.4	0.0	2.2	-0.3	1.1	1.0	0.7
Slovenia	:	4.0	3.7	4.3	3.8	0.9	-6.4	3.6	2.1	2.0	3.5	2.3
Slovakia	:	3.9	4.9	6.1	8.2	3.0	-2.5	7.2	2.6	3.1	4.7	2.4
Finland	3.7	2.3	2.1	2.5	3.1	-0.6	-5.3	3.0	1.9	1.3	3.6	1.7
Euro area	1.9	1.3	1.1	1.6	1.2	-0.1	-2.1	2.5	1.1	1.2	1.8	1.3
Bulgaria	:	4.9	3.5	3.1	3.2	3.5	-2.3	5.3	1.9	2.6	1.2	2.0
Czech Republic	:	2.1	4.1	4.8	3.4	1.2	-3.1	2.9	2.2	2.8	3.6	2.1
Denmark	2.5	1.4	1.5	1.3	-1.1	-2.9	-2.2	3.8	1.6	1.5	3.6	1.9
Latvia	-1.5	6.2	6.3	7.0	6.2	-5.1	-5.1	5.5	2.9	3.4	4.0	2.5
Lithuania	-5.8	6.9	5.9	5.9	6.9	3.6	-8.5	6.4	1.7	1.1	3.2	3.0
Hungary	:	3.3	4.1	3.0	1.1	2.1	-4.0	1.9	2.7	2.3	0.9	2.0
Poland	:	5.5	3.6	2.9	2.3	1.3	1.3	2.8	2.6	2.8	2.7	2.7
Romania	4.3	1.8	9.0	7.1	5.9	7.3	-5.2	-1.1	1.4	3.2	2.5	2.6
Sweden	3.2	2.0	3.2	2.6	0.8	-1.3	-3.2	3.8	2.4	1.4	2.7	2.2
United Kingdom	2.5	2.1	1.6	1.9	2.0	-0.8	-3.5	1.9	1.8	2.0	1.5	1.5
EU	:	1.9	2.0	2.2	1.7	0.3	-2.3	2.4	1.4	1.6	1.9	1.6
USA	1.5	2.1	2.1	0.9	1.0	0.7	2.5	3.2	1.4	1.3	3.2	1.9
Japan	0.9	1.1	1.9	1.6	2.0	-0.9	-3.7	4.1	1.5	1.6	3.1	1.7

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 27 : Unit labour costs, whole economy ¹ (percentage change on preceding year, 1992-2012)

15.11.2010

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	2.0	1.5	1.2	1.8	2.1	4.4	4.3	-0.1	0.7	1.0	-0.5	0.8
Germany	2.4	0.2	-0.3	-1.6	-0.1	2.4	5.2	-1.2	1.0	1.2	-0.9	-0.7
Estonia	:	4.3	4.8	8.7	17.4	16.2	1.2	-6.7	0.7	1.9	-6.7	-0.9
Ireland	1.2	2.4	3.3	3.7	3.4	5.9	-0.6	-5.6	-1.3	-1.2	-5.0	-1.7
Greece	10.6	3.7	3.9	2.3	3.7	5.7	3.9	-0.4	0.1	-0.9	0.3	0.1
Spain	4.1	2.3	3.0	3.3	4.0	4.9	1.0	-1.1	-0.3	0.6	-1.0	0.3
France	1.1	0.8	1.9	2.0	1.5	2.9	3.0	0.3	0.5	0.7	-0.4	0.5
Italy	2.6	1.2	3.0	2.2	1.9	4.6	4.7	-0.1	0.7	1.2	0.4	0.7
Cyprus	:	1.9	3.5	0.6	1.1	2.7	6.3	1.3	1.8	1.8	2.9	2.1
Luxembourg	3.8	1.7	1.6	1.2	1.6	5.4	6.7	0.8	1.2	1.4	0.5	0.7
Malta	4.2	1.9	1.5	1.2	1.5	3.8	3.9	-1.4	1.2	2.1	1.4	1.3
Netherlands	1.5	2.7	1.6	0.7	1.7	3.0	5.1	-1.1	1.0	0.7	-1.1	-0.3
Austria	2.0	0.1	0.6	0.8	0.8	2.7	4.8	0.3	1.2	0.8	0.1	0.7
Portugal	6.5	3.6	2.5	0.9	1.2	3.1	3.5	-0.5	-1.1	-0.4	0.6	0.9
Slovenia	:	6.2	3.2	1.0	2.6	5.9	8.5	-0.4	0.7	1.3	-0.6	1.0
Slovakia	:	6.2	3.4	1.5	0.2	4.0	7.5	-3.7	1.0	1.4	-1.1	1.7
Finland	-1.2	1.0	0.8	0.3	0.5	5.8	7.7	-0.6	0.7	1.5	-1.0	0.4
Euro area	2.4	1.1	1.6	1.1	1.5	3.6	4.0	-0.6	0.6	0.9	-0.6	0.1
Bulgaria	:	72.5	2.3	4.2	13.8	16.2	10.4	1.4	3.7	2.8	3.5	1.9
Czech Republic	:	5.7	2.4	1.1	2.9	5.1	3.5	-0.3	0.7	1.8	-1.2	1.6
Denmark	0.6	2.3	2.1	2.2	4.8	6.8	4.7	-0.3	1.4	1.5	-1.7	-0.1
Latvia	:	1.3	8.2	15.2	27.2	22.0	-7.0	-9.0	-2.1	-1.5	-11.5	-1.5
Lithuania	:	2.1	4.4	10.1	6.5	10.4	-2.8	-6.1	-0.4	3.3	-5.5	-1.4
Hungary	:	11.0	5.0	2.3	5.6	4.8	1.9	-0.5	0.4	2.4	-1.2	1.7
Poland	:	7.9	-1.7	-1.1	2.6	7.5	1.6	0.8	1.3	3.0	0.5	1.7
Romania	108.4	70.0	9.7	4.9	15.2	22.9	16.6	2.9	1.9	1.0	-0.2	-0.1
Sweden	1.6	2.0	-0.1	-0.5	4.1	2.6	4.7	-1.4	0.2	1.6	-0.5	0.3
United Kingdom	1.1	2.9	2.4	2.9	3.0	2.3	5.8	0.8	1.0	2.0	-0.1	0.2
EU	:	2.1	1.7	1.4	2.2	3.8	4.3	-0.4	0.7	1.2	-0.5	0.2
USA	1.5	2.3	1.8	3.0	2.9	2.4	-0.2	-1.1	-0.3	-0.8	-1.6	-1.1
Japan	0.2	-1.3	-2.5	-1.4	-3.0	0.4	0.8	-3.3	-0.4	-0.4	-3.1	-0.8

¹ Compensation of employees per head divided by labour productivity per head, defined as GDP in volume divided by total employment.

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 28 : Real unit labour costs ¹ (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	-0.2	0.1	-0.9	-0.5	-0.2	2.4	3.2	-1.8	-1.2	-0.9	-2.1	-1.0
Germany	-0.3	-0.2	-1.2	-2.0	-1.9	1.3	3.7	-1.4	-0.2	-0.1	-1.1	-1.5
Estonia	:	-2.0	-0.1	0.4	6.2	8.4	1.2	-6.7	-1.9	-0.3	-5.7	-2.8
Ireland	-1.7	-2.6	0.1	0.0	2.3	7.5	3.6	-3.9	-1.6	-1.9	-3.4	-2.5
Greece	-0.8	-0.5	0.7	-0.8	0.6	2.4	2.7	-3.2	-1.4	-1.3	-2.6	-1.6
Spain	-1.0	-0.7	-1.2	-0.8	0.7	2.4	0.4	-1.1	-1.3	-0.8	-1.3	-0.7
France	-0.4	-0.2	-0.1	-0.3	-1.0	0.3	2.5	-0.1	-1.1	-0.8	-1.2	-1.0
Italy	-1.6	-1.2	0.4	0.3	-0.7	1.8	2.5	-0.9	-0.9	-0.6	-0.9	-1.2
Cyprus	:	-1.1	0.6	-2.3	-3.4	-2.1	6.3	-1.2	-1.3	-0.7	0.8	-0.3
Luxembourg	0.1	0.7	-2.5	-5.1	-2.0	1.2	7.1	-1.8	-1.3	-0.9	-2.2	-2.2
Malta	1.2	-0.2	-1.2	-1.9	-1.4	1.5	1.6	-4.3	-1.4	-0.4	-0.3	-0.8
Netherlands	-0.4	-0.4	-0.6	-1.1	-0.1	0.6	5.3	-1.8	-0.5	-0.9	-2.1	-1.9
Austria	-0.3	-0.6	-1.0	-1.0	-1.2	0.8	3.9	-0.3	-0.4	-0.5	-0.5	-1.0
Portugal	0.6	0.0	-0.4	-1.8	-1.6	1.1	3.3	-1.2	-2.3	-1.4	-0.5	-0.7
Slovenia	:	-1.0	-0.8	-1.0	-1.5	1.8	5.1	-0.6	-0.6	-0.2	-0.7	-0.7
Slovakia	:	-0.3	-0.6	-1.4	-1.0	1.1	8.7	-4.1	-1.7	-1.1	-2.3	-1.2
Finland	-2.8	-1.3	0.3	-0.5	-2.4	3.9	6.8	-1.8	-1.8	-0.6	-2.3	-1.6
Euro area	-0.7	-0.6	-0.6	-0.9	-0.9	1.4	3.0	-1.1	-0.8	-0.6	-1.2	-1.2
Bulgaria	:	0.0	-2.7	-2.5	4.2	7.2	6.1	-1.0	1.1	0.3	2.0	-0.2
Czech Republic	:	0.0	0.5	0.0	-0.5	3.2	1.0	0.2	-0.6	-0.1	-1.3	0.9
Denmark	-0.8	0.3	-0.2	0.1	2.4	2.8	4.3	-2.6	-0.9	-0.7	-2.8	-1.7
Latvia	:	-2.8	1.3	4.9	5.8	6.6	-5.6	-6.2	-2.7	-2.5	-5.6	-0.5
Lithuania	:	-0.7	1.4	3.4	-1.8	0.5	0.9	-7.1	-2.2	0.8	-3.5	-2.6
Hungary	:	-0.7	-0.1	-1.9	-0.3	0.0	-2.4	-3.1	-2.3	0.2	-3.6	-0.6
Poland	:	-0.4	-3.8	-2.5	-1.3	4.3	-1.9	-0.8	-1.4	0.2	-1.7	-0.7
Romania	-3.1	4.6	-6.0	-5.1	1.5	6.6	13.4	-3.2	-2.6	-4.0	-4.6	-4.0
Sweden	-0.6	0.6	-1.4	-2.4	1.4	-0.6	2.7	-3.4	-1.7	0.0	-2.9	-1.8
United Kingdom	-1.7	0.8	-0.4	-0.1	0.0	-0.7	4.3	-1.8	-1.1	0.5	-2.5	-1.3
EU	:	-0.3	-0.9	-1.1	-0.7	1.0	3.0	-1.3	-0.9	-0.4	-1.5	-1.3
USA	-0.6	0.5	-0.8	-0.2	-0.1	0.2	-1.1	-2.0	-1.1	-2.0	-1.8	-1.2
Japan	0.0	-0.5	-1.2	-0.5	-2.3	1.3	1.8	-1.4	-0.6	0.1	-2.0	-1.5

¹ Nominal unit labour costs divided by GDP price deflator.

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 29 : Nominal bilateral exchange rates against Ecu/euro (1992-2012)

15.11.2010

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	39.91	40.43	:	:	:	:	:	:	:	:	:	:
Germany	1.93	1.96	:	:	:	:	:	:	:	:	:	:
Estonia	15.36	15.68	15.65	15.65	15.65	15.65	15.65	15.65	:	:	:	:
Ireland	0.79	0.78	:	:	:	:	:	:	:	:	:	:
Greece	282.43	328.65	:	:	:	:	:	:	:	:	:	:
Spain	152.86	166.45	:	:	:	:	:	:	:	:	:	:
France	6.62	6.58	:	:	:	:	:	:	:	:	:	:
Italy	1888.18	1936.35	:	:	:	:	:	:	:	:	:	:
Cyprus	0.59	0.58	0.58	0.58	0.58	:	:	:	:	:	:	:
Luxembourg	39.91	40.43	:	:	:	:	:	:	:	:	:	:
Malta	0.45	0.42	0.42	0.43	0.43	:	:	:	:	:	:	:
Netherlands	2.17	2.21	:	:	:	:	:	:	:	:	:	:
Austria	13.60	13.79	:	:	:	:	:	:	:	:	:	:
Portugal	190.37	200.35	:	:	:	:	:	:	:	:	:	:
Slovenia	143.42	197.20	235.62	239.60	:	:	:	:	:	:	:	:
Slovakia	:	41.54	40.01	37.23	33.77	31.24	:	:	:	:	:	:
Finland	6.05	5.94	:	:	:	:	:	:	:	:	:	:
Euro area	:	:	:	:	:	:	:	:	:	:	:	:
Bulgaria	0.09	1.95	1.95	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
Czech Republic	34.86	35.71	30.53	28.34	27.77	24.95	26.43	25.23	24.56	24.56	25.40	25.25
Denmark	7.53	7.46	7.44	7.46	7.45	7.46	7.45	7.45	7.45	7.45	7.44	7.44
Latvia	0.75	0.61	0.66	0.70	0.70	0.70	0.71	0.71	0.71	0.71	0.71	0.71
Lithuania	4.45	4.11	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45
Hungary	152.74	244.33	252.11	264.26	251.35	251.51	280.33	274.81	273.43	273.43	266.24	265.49
Poland	2.88	3.91	4.14	3.90	3.78	3.51	4.33	3.99	3.93	3.93	3.89	3.85
Romania	0.20	1.61	3.62	3.53	3.34	3.68	4.24	4.21	4.29	4.29	4.12	4.12
Sweden	8.73	8.81	9.19	9.25	9.25	9.62	10.62	9.56	9.30	9.30	9.77	9.71
United Kingdom	0.79	0.65	0.67	0.68	0.68	0.80	0.89	0.86	0.86	0.86	0.88	0.88
EU	:	:	:	:	:	:	:	:	:	:	:	:
USA	1.25	1.03	1.16	1.26	1.37	1.47	1.39	1.33	1.39	1.39	1.36	1.35
Japan	135.36	122.59	133.27	146.02	161.25	152.45	130.34	116.54	113.25	113.25	125.85	125.98

TABLE 30 : Nominal effective exchange rates to rest of a group ¹ of industrialised countries (percentage change on preceding year, 1997-2012)

	5-year						Autumn 2010			Spring 2010	
	averages								forecast		
	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	-1.1	1.4	0.4	1.2	1.8	1.0	-2.4	0.2	0.0	-1.6	-0.2
Germany	-1.0	1.8	0.5	1.8	1.8	1.3	-3.4	0.1	0.0	-2.4	-0.3
Estonia	-0.4	1.0	0.2	1.1	1.4	2.2	-3.0	-0.1	0.0	-2.3	-0.2
Ireland	-1.8	2.4	0.6	2.6	4.0	0.8	-3.3	0.7	0.0	-2.0	-0.3
Greece	0.3	1.7	0.6	0.9	2.0	1.9	-2.2	0.1	0.0	-1.6	-0.2
Spain	-1.1	1.4	0.4	1.3	2.0	1.2	-2.4	0.2	0.0	-1.7	-0.2
France	-1.0	1.7	0.6	1.6	2.1	0.8	-2.9	0.2	0.0	-1.9	-0.2
Italy	0.1	1.9	0.6	1.6	1.9	0.9	-3.0	0.2	0.0	-2.1	-0.2
Cyprus	5.0	1.6	0.6	-0.3	2.2	1.8	-2.3	0.0	0.0	-1.4	-0.1
Luxembourg	-1.1	1.4	0.4	1.2	1.8	1.0	-2.4	0.2	0.0	-1.6	-0.2
Malta	0.4	1.3	1.0	3.1	2.2	-1.2	-3.8	0.3	0.0	-2.1	-0.2
Netherlands	-1.0	1.2	0.3	1.1	2.0	1.4	-2.4	0.1	0.0	-1.6	-0.2
Austria	-0.1	1.1	0.3	1.0	0.9	1.2	-2.4	0.0	0.0	-1.8	-0.2
Portugal	-1.1	1.1	0.3	1.1	1.6	0.6	-1.9	0.2	0.0	-1.2	-0.1
Slovenia	-3.9	-1.1	0.2	0.3	0.5	2.0	-1.9	-0.1	0.0	-1.6	-0.2
Slovakia	-1.3	3.6	3.7	10.4	8.7	6.5	-2.1	-0.1	0.0	-1.8	-0.2
Finland	-1.0	1.7	0.5	1.6	1.9	1.5	-3.7	0.0	0.0	-2.7	-0.3
Euro area	-1.7	3.6	1.2	3.5	4.2	2.8	-6.4	0.2	0.0	-4.4	-0.5
Bulgaria	-32.2	1.7	0.8	0.6	1.8	2.6	-2.5	0.0	0.0	-1.9	-0.2
Czech Republic	0.8	4.5	5.2	2.3	12.2	-3.7	2.8	2.7	0.0	2.4	0.5
Denmark	-1.0	1.4	0.3	1.4	2.2	2.2	-3.8	-0.1	0.0	-2.7	-0.3
Latvia	4.3	-3.4	0.0	0.0	0.9	2.3	-3.0	-0.3	0.0	-2.4	-0.1
Lithuania	8.3	2.1	0.1	0.8	1.0	2.7	-2.5	-0.1	0.0	-2.1	-0.2
Hungary	-4.7	0.3	-6.1	5.4	0.9	-8.4	0.0	0.5	0.0	3.6	0.1
Poland	-1.1	-0.5	3.5	3.4	9.2	-17.7	6.5	1.5	0.0	9.8	0.7
Romania	-30.1	-4.7	3.6	6.2	-8.3	-11.4	-1.5	-1.9	0.0	1.3	-0.2
Sweden	-2.5	1.8	0.8	1.7	-1.8	-8.5	7.6	3.2	0.0	6.1	0.4
United Kingdom	4.8	0.2	1.0	1.9	-12.9	-11.5	0.3	0.1	0.0	-1.3	-0.1
EU	-0.8	5.2	2.8	6.6	1.5	-5.4	-7.1	0.9	0.0	-4.5	-0.5
USA	5.0	-3.9	-0.8	-5.0	-4.3	6.3	-3.6	-4.4	0.0	-3.5	0.1
Japan	1.5	-2.4	-5.8	-5.9	11.3	15.9	6.5	4.4	0.0	-0.3	-0.6

¹ 35 countries : EU (excl. LU), TR, CH, NO, US, CA, JP, AU, MX and NZ.

TABLE 31 : Relative unit labour costs, to rest of a group ¹ of industrialised countries (nat. curr.) (percentage change on preceding year, 1997-2012) 15.11.2010

	5-year averages						Autumn 2010 forecast			Spring 2010 forecast	
	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	-0.7	-0.3	0.5	0.2	0.9	0.5	0.3	0.0	:	0.2	0.6
Germany	-3.0	-2.1	-3.6	-2.5	-1.6	1.6	-0.9	0.3	:	-0.2	-1.1
Estonia	1.3	3.2	6.6	13.3	10.1	-2.2	-5.3	0.1	:	-5.1	-1.1
Ireland	0.2	1.7	1.9	1.3	2.7	-3.9	-5.2	-1.9	:	-4.3	-1.8
Greece	-1.9	1.7	0.5	0.7	0.8	-0.9	-0.2	-0.8	:	0.5	-0.4
Spain	-0.2	1.1	1.7	2.0	1.2	-2.9	-0.8	-1.0	:	-0.5	-0.1
France	-1.7	0.3	0.5	-0.6	-0.8	-0.7	1.0	-0.2	:	0.3	0.4
Italy	-2.0	1.3	0.6	-0.4	0.8	1.0	0.3	0.0	:	1.1	0.4
Cyprus	-6.4	1.5	-1.2	-1.3	-1.6	1.9	1.7	1.1	:	3.4	1.8
Luxembourg	:	:	:	:	:	:	:	:	:	:	:
Malta	0.0	0.1	-0.3	0.1	0.8	0.8	-0.6	0.7	:	2.4	1.4
Netherlands	0.7	0.2	-0.5	-0.2	-0.6	1.1	-0.6	0.3	:	-0.4	-0.5
Austria	-2.5	-0.8	-0.1	-1.1	-1.2	0.5	0.8	0.3	:	0.8	0.5
Portugal	1.6	0.7	-1.0	-1.2	-0.6	0.3	0.1	-1.6	:	1.4	0.7
Slovenia	3.3	1.7	-0.1	0.5	1.6	3.9	0.1	-0.2	:	-0.1	0.7
Slovakia	2.9	2.1	0.7	-1.9	-0.1	3.1	-3.3	0.1	:	-0.5	1.4
Finland	-1.6	-0.6	-1.2	-2.0	1.8	4.0	0.2	0.0	:	0.0	0.2
Euro area	-3.7	-0.6	-1.7	-1.8	-0.8	1.1	-0.8	-0.1	:	0.1	-0.5
Bulgaria	60.9	-0.6	2.2	10.4	10.5	5.1	1.6	2.8	:	3.7	1.3
Czech Republic	2.9	1.2	0.4	1.0	1.2	-0.8	0.2	-0.1	:	-0.6	1.4
Denmark	0.2	0.8	0.9	2.4	3.0	0.8	0.4	0.7	:	-1.0	-0.3
Latvia	-1.8	6.5	13.0	23.4	15.9	-10.2	-7.7	-2.8	:	-10.3	-1.6
Lithuania	-1.8	2.4	7.7	2.2	4.2	-5.9	-4.8	-1.1	:	-3.8	-1.6
Hungary	7.7	3.6	1.3	3.4	0.3	-2.7	-0.1	-0.5	:	-0.6	1.4
Poland	5.3	-3.2	-2.3	0.4	3.3	-2.6	1.5	0.5	:	1.3	1.5
Romania	62.8	7.3	3.1	12.4	17.8	11.6	3.2	1.0	:	0.1	-0.7
Sweden	-0.7	-1.7	-2.4	1.5	-1.5	0.8	-0.9	-0.7	:	0.3	-0.1
United Kingdom	0.6	0.8	1.2	0.9	-1.3	2.8	1.8	0.4	:	1.0	0.2
EU	-3.2	-0.5	-1.7	-0.5	0.1	2.1	-0.2	-0.1	:	0.3	-0.4
USA	-0.7	0.1	0.6	1.1	-1.2	-4.3	-0.5	-1.5	:	-1.3	-1.9
Japan	-3.6	-4.3	-3.7	-5.4	-2.8	-1.5	-2.9	-1.1	:	-2.4	-0.7

¹ 35 countries : EU (excl. LU), TR, CH, NO, US, CA, JP, AU, MX and NZ.

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 32 : Real effective exchange rate : ulc relative to rest of a group ¹ of industrialised countries (usd) (% change on preceding year, 1997-2012)

	5-year averages						Autumn 2010 forecast			Spring 2010 forecast	
	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	-1.8	1.0	0.8	1.4	2.8	1.5	-2.0	0.2	:	-1.4	0.4
Germany	-4.0	-0.3	-3.1	-0.8	0.2	2.9	-4.3	0.5	:	-2.6	-1.4
Estonia	0.9	4.2	6.8	14.5	11.6	0.0	-8.2	0.0	:	-7.3	-1.3
Ireland	-1.6	4.1	2.5	3.9	6.8	-3.1	-8.3	-1.2	:	-6.2	-2.1
Greece	-1.6	3.4	1.1	1.5	2.8	1.0	-2.4	-0.7	:	-1.2	-0.5
Spain	-1.3	2.5	2.1	3.3	3.3	-1.7	-3.2	-0.8	:	-2.2	-0.2
France	-2.7	2.0	1.1	1.0	1.3	0.1	-2.0	0.0	:	-1.6	0.2
Italy	-1.8	3.2	1.2	1.2	2.7	1.9	-2.8	0.2	:	-1.0	0.2
Cyprus	-1.7	3.1	-0.7	-1.6	0.5	3.7	-0.7	1.2	:	1.9	1.7
Luxembourg	:	:	:	:	:	:	:	:	:	:	:
Malta	0.4	1.4	0.7	3.2	3.0	-0.4	-4.4	1.0	:	0.2	1.2
Netherlands	-0.3	1.4	-0.2	0.9	1.4	2.6	-2.9	0.4	:	-2.0	-0.6
Austria	-2.6	0.2	0.2	-0.2	-0.3	1.7	-1.7	0.3	:	-1.1	0.3
Portugal	0.5	1.8	-0.7	0.0	1.0	0.9	-1.8	-1.4	:	0.1	0.6
Slovenia	-0.8	0.6	0.1	0.8	2.2	6.0	-1.8	-0.3	:	-1.7	0.6
Slovakia	1.5	5.8	4.4	8.4	8.6	9.7	-5.3	0.0	:	-2.3	1.3
Finland	-2.6	1.1	-0.7	-0.4	3.7	5.6	-3.5	0.0	:	-2.7	-0.1
Euro area	-5.3	3.0	-0.5	1.6	3.4	3.9	-7.1	0.1	:	-4.3	-1.0
Bulgaria	9.0	1.1	3.0	11.0	12.5	7.8	-1.0	2.8	:	1.7	1.1
Czech Republic	3.8	5.8	5.6	3.4	13.5	-4.5	3.0	2.6	:	1.8	1.8
Denmark	-0.8	2.2	1.1	3.8	5.2	3.0	-3.4	0.6	:	-3.7	-0.6
Latvia	2.5	2.8	13.1	23.3	16.9	-8.1	-10.5	-3.1	:	-12.4	-1.7
Lithuania	6.3	4.6	7.8	3.0	5.2	-3.3	-7.2	-1.1	:	-5.8	-1.8
Hungary	2.6	3.9	-4.8	9.0	1.2	-10.9	-0.1	0.0	:	3.0	1.6
Poland	4.1	-3.6	1.1	3.8	12.8	-19.9	8.1	2.0	:	11.2	2.2
Romania	13.7	2.3	6.8	19.4	8.0	-1.2	1.7	-0.9	:	1.4	-0.9
Sweden	-3.2	0.1	-1.6	3.2	-3.3	-7.8	6.6	2.4	:	6.4	0.3
United Kingdom	5.3	1.0	2.3	2.8	-14.0	-9.0	2.0	0.5	:	-0.3	0.1
EU	-4.0	4.7	1.0	6.0	1.6	-3.4	-7.3	0.8	:	-4.2	-0.9
USA	4.4	-3.8	-0.1	-4.0	-5.4	1.7	-4.0	-5.8	:	-4.8	-1.9
Japan	-2.2	-6.6	-9.3	-11.0	8.1	14.1	3.5	3.3	:	-2.7	-1.3

¹ 35 countries : EU (excl. LU), TR, CH, NO, US, CA, JP, AU, MX and NZ.

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 33 : Short term interest rates (1992-2010)

15.11.2010

	5-year averages			2002	2003	2004	2005	2006	2007	2008	2009	2010
	1992-96	1997-01	2002-06									
Belgium	6.2	3.7	2.6	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2	0.8
Germany	6.0	3.7	2.6	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2	0.8
Estonia	:	8.3	3.0	3.9	2.9	2.5	2.4	3.2	4.9	6.7	5.9	0.8
Ireland	7.8	4.6	2.6	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2	0.8
Greece	20.3	9.8	2.6	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2	0.8
Spain	10.0	4.2	2.6	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2	0.8
France	7.1	3.7	2.6	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2	0.8
Italy	10.3	4.7	2.6	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2	0.8
Cyprus	:	:	4.1	4.4	3.9	4.7	4.3	3.4	4.2	4.6	1.2	0.8
Luxembourg	:	:	:	:	:	:	:	:	:	4.6	1.2	0.8
Malta	:	5.1	3.4	4.0	3.3	2.9	3.2	3.5	4.3	4.6	1.2	0.8
Netherlands	5.7	3.7	2.6	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2	0.8
Austria	5.9	3.7	2.6	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2	0.8
Portugal	11.5	4.3	2.6	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2	0.8
Slovenia	:	:	5.4	8.0	6.8	4.7	4.0	3.6	4.3	4.6	1.2	0.8
Slovakia	:	15.0	5.2	7.8	6.2	4.7	2.9	4.3	4.3	4.6	1.2	0.8
Finland	7.1	3.7	2.6	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2	0.8
Euro area	7.9	4.1	2.6	3.4	2.4	2.2	2.2	3.1	4.3	4.6	1.2	0.8
Bulgaria	:	:	3.9	4.9	3.7	3.7	3.6	3.7	4.9	7.1	5.7	4.1
Czech Republic	:	9.5	2.5	3.5	2.3	2.4	2.0	2.3	3.1	4.0	2.2	1.3
Denmark	7.8	4.2	2.7	3.5	2.4	2.2	2.2	3.2	4.4	5.3	2.5	1.2
Latvia	:	7.0	4.0	4.4	3.8	4.2	3.1	4.4	8.7	8.0	13.1	2.1
Lithuania	:	:	3.0	3.7	2.8	2.7	2.4	3.1	5.1	6.0	7.1	1.8
Hungary	:	15.1	8.6	9.2	8.5	11.5	6.7	7.2	7.9	8.8	9.1	5.5
Poland	:	18.7	6.1	9.0	5.7	6.2	5.3	4.2	4.7	6.4	4.4	3.9
Romania	:	64.4	16.1	27.3	17.7	19.1	8.4	8.1	7.2	12.3	11.3	6.8
Sweden	8.9	4.1	2.9	4.3	3.2	2.3	1.9	2.6	3.9	4.7	0.9	0.9
United Kingdom	6.8	6.2	4.4	4.1	3.7	4.6	4.8	4.9	6.0	5.5	1.2	0.7
EU	:	9.3	3.3	4.1	3.0	3.1	2.9	3.5	4.6	5.1	1.8	1.0
USA	4.7	5.4	2.7	1.8	1.2	1.6	3.6	5.2	5.3	2.9	0.7	0.3
Japan	2.3	0.4	0.1	0.1	0.1	0.1	0.1	0.3	0.8	0.9	0.5	0.2

TABLE 34 : Long term interest rates (1992-2010)

	5-year averages			2002	2003	2004	2005	2006	2007	2008	2009	2010
	1992-96	1997-01	2002-06									
Belgium	7.5	5.2	4.1	5.0	4.2	4.2	3.4	3.8	4.3	4.4	3.9	3.4
Germany	6.9	5.0	4.0	4.8	4.1	4.0	3.4	3.8	4.2	4.0	3.2	2.7
Estonia	:	:	5.4	8.4	5.3	4.4	4.2	5.0	6.1	8.2	7.8	5.9
Ireland	8.0	5.3	4.1	5.0	4.1	4.1	3.3	3.8	4.3	4.5	5.2	5.7
Greece	19.9	7.2	4.3	5.1	4.3	4.3	3.6	4.1	4.5	4.8	5.2	9.0
Spain	10.4	5.3	4.1	5.0	4.1	4.1	3.4	3.8	4.3	4.4	4.0	4.2
France	7.3	5.0	4.1	4.9	4.1	4.1	3.4	3.8	4.3	4.2	3.7	3.1
Italy	11.3	5.4	4.2	5.0	4.3	4.3	3.6	4.1	4.5	4.7	4.3	4.0
Cyprus	:	7.2	5.1	5.7	4.7	5.8	5.2	4.1	4.5	4.6	4.6	4.6
Luxembourg	7.0	5.1	4.0	4.7	4.0	4.2	3.4	3.9	4.6	4.6	4.2	3.1
Malta	:	:	4.9	5.8	5.0	4.7	4.6	4.3	4.7	4.8	4.5	4.2
Netherlands	6.9	5.0	4.1	4.9	4.1	4.1	3.4	3.8	4.3	4.2	3.7	2.9
Austria	6.9	5.1	4.1	5.0	4.2	4.2	3.4	3.8	4.3	4.3	3.7	3.2
Portugal	10.8	5.4	4.1	5.0	4.2	4.1	3.4	3.9	4.4	4.5	4.2	5.4
Slovenia	:	:	5.5	8.7	6.4	4.7	3.8	3.9	4.5	4.6	4.4	3.8
Slovakia	:	:	5.0	6.9	5.0	5.0	3.5	4.4	4.5	4.7	4.7	3.8
Finland	9.1	5.2	4.1	5.0	4.1	4.1	3.4	3.8	4.3	4.3	3.7	3.0
Euro area	8.6	5.2	4.1	4.9	4.2	4.1	3.4	3.8	4.3	4.3	3.8	2.7
Bulgaria	:	:	5.6	8.3	6.5	5.4	3.9	4.2	4.5	5.4	7.2	6.1
Czech Republic	:	:	4.2	4.9	4.1	4.8	3.5	3.8	4.3	4.6	4.8	3.9
Denmark	7.9	5.4	4.2	5.1	4.3	4.3	3.4	3.8	4.3	4.3	3.6	2.9
Latvia	:	:	4.6	5.4	4.9	4.9	3.9	4.1	5.3	6.4	12.4	10.7
Lithuania	:	:	4.7	6.1	5.3	4.5	3.7	4.1	4.6	5.6	14.0	5.6
Hungary	:	:	7.2	7.1	6.8	8.2	6.6	7.1	6.7	8.2	9.1	7.2
Poland	:	:	6.1	7.4	5.8	6.9	5.2	5.2	5.5	6.1	6.1	5.8
Romania	:	:	:	:	:	:	:	7.2	7.1	7.7	9.7	7.4
Sweden	9.3	5.4	4.3	5.3	4.6	4.4	3.4	3.7	4.2	3.9	3.3	2.8
United Kingdom	8.2	5.6	4.7	4.9	4.6	4.9	4.5	4.4	5.1	4.5	3.4	3.4
EU	:	:	:	:	:	:	:	4.1	4.6	4.5	4.1	3.6
USA	6.7	5.7	4.4	4.6	4.0	4.3	4.3	4.8	4.6	3.7	3.3	3.1
Japan	4.0	1.7	1.4	1.3	1.0	1.5	1.4	1.7	1.7	1.5	1.4	1.2

TABLE 35 : Total expenditure, general government (as a percentage of GDP, 1992-2012) ¹

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	52.8	50.0	50.2	48.6	48.4	50.1	54.1	53.1	52.9	53.0	53.7	53.9
Germany	47.8	47.4	47.2	45.3	43.5	43.8	47.5	46.7	45.6	44.5	48.0	47.2
Estonia	:	37.5	34.4	33.6	34.4	39.9	45.1	42.5	42.0	41.4	45.8	44.1
Ireland	39.3	34.0	33.7	34.5	36.8	42.7	48.9	67.5	45.2	43.8	47.1	46.0
Greece	43.4	45.1	44.8	44.9	46.2	49.1	53.2	49.8	49.3	49.2	48.4	48.4
Spain	45.2	40.0	38.6	38.4	39.2	41.3	45.8	45.7	43.4	42.9	45.7	44.7
France	53.3	52.5	53.0	52.7	52.3	52.8	56.0	56.5	56.1	55.8	56.1	55.9
Italy	53.2	48.3	48.0	48.7	47.9	48.9	51.9	51.0	50.0	49.4	51.3	50.5
Cyprus	:	37.0	43.0	43.4	42.2	42.5	45.8	46.1	46.1	46.2	48.3	49.0
Luxembourg	:	39.3	41.2	38.6	36.2	36.9	42.2	42.9	42.7	42.7	43.2	42.9
Malta	:	42.6	45.0	43.8	42.4	44.8	43.9	44.6	44.1	44.3	46.0	45.5
Netherlands	52.0	45.9	45.9	45.5	45.2	46.0	51.4	51.7	50.7	49.5	52.3	51.7
Austria	53.7	52.9	51.1	49.3	48.3	48.7	52.3	52.7	52.3	52.1	52.5	52.2
Portugal	39.9	41.3	44.2	44.5	43.7	43.5	48.1	49.3	46.8	46.9	51.0	50.9
Slovenia	:	46.3	45.7	44.5	42.4	44.1	49.0	49.7	49.0	48.3	50.7	49.9
Slovakia	:	47.9	39.5	36.6	34.3	35.0	41.5	40.0	38.0	37.4	40.3	39.3
Finland	59.8	51.4	49.5	48.9	47.2	49.3	55.8	55.8	54.9	55.0	55.9	55.3
Euro area	50.1	47.7	47.4	46.6	45.9	46.9	50.8	50.8	49.4	48.7	50.8	50.2
Bulgaria	:	38.9	38.3	34.4	39.7	37.6	40.6	38.0	37.1	36.0	39.7	39.1
Czech Republic	:	43.0	45.5	43.8	42.5	42.9	46.0	45.8	44.9	44.1	47.0	47.4
Denmark	59.0	55.2	53.5	51.5	50.8	51.9	58.3	57.9	56.9	56.1	59.2	58.1
Latvia	:	38.1	36.0	38.1	35.7	38.8	43.9	42.7	41.7	39.7	44.8	44.4
Lithuania	:	41.1	33.6	33.6	34.8	37.4	43.6	42.7	41.5	41.8	42.5	41.7
Hungary	:	48.6	50.3	52.0	50.0	48.9	50.5	48.9	47.4	46.9	48.8	48.1
Poland	:	43.7	43.8	43.9	42.2	43.2	44.4	46.2	45.5	44.6	46.0	46.2
Romania	:	37.0	34.2	35.5	36.2	38.2	41.0	40.2	37.2	36.4	39.9	38.8
Sweden	64.4	57.4	54.2	52.6	50.9	51.5	54.6	52.9	51.6	50.5	55.9	54.8
United Kingdom	42.2	39.2	42.9	44.2	43.9	47.5	51.7	51.1	49.5	47.9	52.6	51.3
EU	:	46.7	46.7	46.3	45.6	46.9	50.8	50.6	49.2	48.4	51.0	50.3
USA	36.5	34.6	36.1	36.0	36.8	38.9	42.2	43.2	41.2	40.3	39.3	40.0
Japan	34.4	38.9	37.8	36.2	35.9	37.1	40.2	40.4	40.7	41.4	43.0	42.9

¹ ESA 79 up to 1994, ESA 95 from 1995 onwards.TABLE 36 : Total revenue, general government (as a percentage of GDP, 1992-2012) ¹

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	47.5	49.3	49.6	48.8	48.1	48.8	48.1	48.3	48.3	48.3	48.7	48.8
Germany	44.8	45.9	43.9	43.7	43.8	43.9	44.5	43.1	42.9	42.7	43.1	42.5
Estonia	:	37.1	35.9	36.0	36.9	37.0	43.4	41.5	40.1	38.7	43.4	41.7
Ireland	37.7	36.3	34.9	37.4	36.8	35.4	34.5	35.1	34.9	34.7	35.4	33.9
Greece	33.8	40.9	39.0	39.1	39.8	39.7	37.8	40.2	41.9	41.5	39.0	38.5
Spain	39.6	38.1	39.0	40.4	41.1	37.1	34.7	36.4	37.0	37.4	35.9	35.9
France	48.4	50.4	49.8	50.4	49.6	49.5	48.4	48.8	49.8	50.0	48.2	48.6
Italy	44.9	46.1	44.5	45.4	46.4	46.2	46.6	46.0	45.7	45.8	46.0	45.5
Cyprus	:	33.3	39.3	42.2	45.5	43.4	39.8	40.2	40.4	40.5	41.2	41.3
Luxembourg	:	43.8	41.8	39.9	39.9	39.9	41.5	41.2	41.4	41.5	39.7	39.0
Malta	:	35.0	39.8	41.0	40.1	40.0	40.1	40.5	41.1	41.0	41.7	41.9
Netherlands	48.7	46.0	44.6	46.1	45.4	46.6	46.0	45.9	46.8	46.7	46.0	46.6
Austria	49.6	51.2	49.1	47.8	47.9	48.2	48.8	48.5	48.7	48.8	47.8	47.6
Portugal	35.3	37.9	40.3	40.5	40.9	40.6	38.8	42.0	41.9	41.7	42.5	43.0
Slovenia	:	43.2	43.6	43.2	42.4	42.3	43.2	43.9	43.7	43.7	44.6	44.7
Slovakia	:	40.3	35.6	33.4	32.5	32.9	33.6	31.8	32.6	32.4	34.3	33.9
Finland	54.0	54.1	52.6	52.9	52.4	53.5	53.3	52.7	53.3	53.9	52.1	52.4
Euro area	45.1	46.0	44.9	45.3	45.3	44.9	44.5	44.4	44.8	44.8	44.2	44.1
Bulgaria	:	39.4	38.9	36.2	40.8	39.3	35.9	34.1	34.1	34.2	36.8	36.8
Czech Republic	:	38.6	41.0	41.1	41.8	40.2	40.2	40.6	40.3	39.9	41.4	41.7
Denmark	56.5	56.1	56.1	56.6	55.6	55.2	55.6	52.8	52.6	52.6	53.7	53.3
Latvia	:	36.6	34.8	37.7	35.4	34.6	33.7	35.0	33.8	32.5	36.2	34.5
Lithuania	:	36.2	32.5	33.1	33.8	34.1	34.5	34.3	34.4	35.0	34.1	33.2
Hungary	:	43.3	42.3	42.6	45.0	45.1	46.1	45.1	42.6	40.8	44.7	44.2
Poland	:	39.8	38.9	40.2	40.3	39.5	37.2	38.2	38.9	38.6	38.7	39.3
Romania	:	32.9	32.6	33.3	33.6	32.5	32.4	32.9	32.3	32.9	31.9	31.3
Sweden	56.7	58.5	54.8	54.9	54.5	53.7	53.7	52.0	51.5	51.5	53.9	53.2
United Kingdom	36.2	39.7	39.9	41.5	41.2	42.5	40.3	40.6	40.9	41.5	40.6	41.3
EU	:	45.3	44.2	44.8	44.7	44.5	44.0	43.9	44.1	44.2	43.8	43.8
USA	32.3	34.9	32.4	33.9	34.0	32.7	31.0	32.0	32.3	32.5	29.3	30.1
Japan	32.0	31.6	31.7	34.5	33.5	35.0	33.9	33.8	34.3	35.1	36.2	36.3

¹ ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 37 : Net lending (+) or net borrowing (-), general government (as a percentage of GDP, 1992-2012) ¹

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	-5.4	-0.7	-0.6	0.2	-0.3	-1.3	-6.0	-4.8	-4.6	-4.7	-5.0	-5.0
Germany	-3.0	-1.6	-3.3	-1.6	0.3	0.1	-3.0	-3.7	-2.7	-1.8	-5.0	-4.7
Estonia	:	-0.5	1.5	2.4	2.5	-2.8	-1.7	-1.0	-1.9	-2.7	-2.4	-2.4
Ireland	-1.7	2.4	1.2	2.9	0.0	-7.3	-14.4	-32.3	-10.3	-9.1	-11.7	-12.1
Greece	-9.6	-4.2	-5.8	-5.7	-6.4	-9.4	-15.4	-9.6	-7.4	-7.6	-9.3	-9.9
Spain	-5.6	-1.9	0.4	2.0	1.9	-4.2	-11.1	-9.3	-6.4	-5.5	-9.8	-8.8
France	-4.9	-2.1	-3.2	-2.3	-2.7	-3.3	-7.5	-7.7	-6.3	-5.8	-8.0	-7.4
Italy	-8.3	-2.2	-3.5	-3.4	-1.5	-2.7	-5.3	-5.0	-4.3	-3.5	-5.3	-5.0
Cyprus	:	-3.6	-3.7	-1.2	3.4	0.9	-6.0	-5.9	-5.7	-5.7	-7.1	-7.7
Luxembourg	1.6	4.5	0.6	1.4	3.7	3.0	-0.7	-1.8	-1.3	-1.2	-3.5	-3.9
Malta	:	-7.6	-5.2	-2.7	-2.3	-4.8	-3.8	-4.2	-3.0	-3.3	-4.3	-3.6
Netherlands	-3.3	0.0	-1.3	0.5	0.2	0.6	-5.4	-5.8	-3.9	-2.8	-6.3	-5.1
Austria	-4.1	-1.6	-1.9	-1.5	-0.4	-0.5	-3.5	-4.3	-3.6	-3.3	-4.7	-4.6
Portugal	-4.6	-3.3	-3.9	-4.1	-2.8	-2.9	-9.3	-7.3	-4.9	-5.1	-8.5	-7.9
Slovenia	:	-3.1	-2.0	-1.3	0.0	-1.8	-5.8	-5.8	-5.3	-4.7	-6.1	-5.2
Slovakia	:	-7.6	-3.9	-3.2	-1.8	-2.1	-7.9	-8.2	-5.3	-5.0	-6.0	-5.4
Finland	-5.8	2.7	3.1	4.0	5.2	4.2	-2.5	-3.1	-1.6	-1.2	-3.8	-2.9
Euro area	-5.0	-1.6	-2.5	-1.4	-0.6	-2.0	-6.3	-6.3	-4.6	-3.9	-6.6	-6.1
Bulgaria	:	0.5	0.6	1.9	1.1	1.7	-4.7	-3.8	-2.9	-1.8	-2.8	-2.2
Czech Republic	:	-4.4	-4.5	-2.6	-0.7	-2.7	-5.8	-5.2	-4.6	-4.2	-5.7	-5.7
Denmark	-2.5	0.9	2.6	5.2	4.8	3.2	-2.7	-5.1	-4.3	-3.5	-5.5	-4.9
Latvia	:	-1.4	-1.2	-0.5	-0.3	-4.2	-10.2	-7.7	-7.9	-7.3	-8.6	-9.9
Lithuania	:	-4.9	-1.1	-0.4	-1.0	-3.3	-9.2	-8.4	-7.0	-6.9	-8.4	-8.5
Hungary	:	-5.2	-8.0	-9.3	-5.0	-3.7	-4.4	-3.8	-4.7	-6.2	-4.1	-4.0
Poland	:	-3.9	-4.9	-3.6	-1.9	-3.7	-7.2	-7.9	-6.6	-6.0	-7.3	-7.0
Romania	:	-4.1	-1.6	-2.2	-2.6	-5.7	-8.6	-7.3	-4.9	-3.5	-8.0	-7.4
Sweden	-7.7	1.0	0.6	2.3	3.6	2.2	-0.9	-0.9	-0.1	1.0	-2.1	-1.6
United Kingdom	-6.1	0.5	-3.0	-2.7	-2.7	-5.0	-11.4	-10.5	-8.6	-6.4	-12.0	-10.0
EU	:	-1.4	-2.5	-1.5	-0.9	-2.3	-6.8	-6.8	-5.1	-4.2	-7.2	-6.5
USA	-4.2	0.3	-3.7	-2.0	-2.8	-6.2	-11.2	-11.3	-8.9	-7.9	-10.0	-9.9
Japan	-2.5	-7.3	-6.1	-1.6	-2.4	-2.1	-6.3	-6.5	-6.4	-6.3	-6.7	-6.6

¹ ESA 79 up to 1994, ESA 95 from 1995 onwards.TABLE 38 : Interest expenditure, general government (as a percentage of GDP, 1992-2012) ¹

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	9.5	7.0	4.8	3.9	3.8	3.8	3.6	3.5	3.5	3.6	3.8	3.8
Germany	3.3	3.2	2.9	2.8	2.8	2.7	2.6	2.4	2.4	2.4	2.6	2.7
Estonia	:	0.3	0.2	0.2	0.2	0.2	0.3	0.4	0.4	0.4	0.4	0.4
Ireland	5.6	2.7	1.2	1.0	1.0	1.4	2.2	3.0	3.5	4.4	2.9	3.5
Greece	11.1	7.7	4.8	4.3	4.4	4.9	5.3	6.0	6.2	7.4	5.4	5.8
Spain	4.9	3.7	2.1	1.6	1.6	1.6	1.8	2.0	2.4	2.8	2.2	2.6
France	3.4	3.1	2.7	2.5	2.7	2.9	2.4	2.6	2.7	2.8	2.6	2.9
Italy	11.3	7.3	5.0	4.7	5.0	5.2	4.7	4.6	4.8	4.9	4.6	4.8
Cyprus	:	3.1	3.3	3.3	3.0	2.8	2.5	2.3	2.4	2.4	2.7	2.9
Luxembourg	0.3	0.4	0.2	0.2	0.2	0.3	0.4	0.4	0.4	0.5	0.5	0.6
Malta	:	3.3	3.6	3.5	3.3	3.3	3.2	3.1	3.1	3.1	3.3	3.3
Netherlands	5.7	4.1	2.5	2.2	2.2	2.2	2.2	2.2	2.3	2.4	2.3	2.3
Austria	4.0	3.5	2.9	2.7	2.7	2.5	2.7	2.8	2.8	2.9	2.8	2.9
Portugal	5.6	3.1	2.6	2.6	2.8	2.9	2.8	2.9	3.7	4.0	3.1	3.5
Slovenia	:	2.3	1.8	1.4	1.3	1.1	1.4	1.6	1.7	1.8	1.8	2.0
Slovakia	:	3.3	2.3	1.5	1.4	1.2	1.4	1.4	1.8	2.1	1.5	1.5
Finland	4.0	3.2	1.7	1.4	1.5	1.4	1.2	1.2	1.3	1.6	1.1	1.2
Euro area	5.5	4.2	3.1	2.9	2.9	3.0	2.8	2.9	3.0	3.2	3.0	3.2
Bulgaria	:	4.7	1.9	1.3	1.2	0.9	0.8	0.7	0.8	0.9	0.8	0.9
Czech Republic	:	1.0	1.2	1.1	1.1	1.1	1.3	1.3	1.8	1.9	1.7	2.1
Denmark	6.4	4.1	2.3	1.6	1.6	1.4	1.8	1.8	1.9	1.9	2.1	2.2
Latvia	:	0.8	0.6	0.4	0.3	0.6	1.5	1.8	2.1	2.3	2.4	2.9
Lithuania	:	1.3	1.0	0.7	0.7	0.7	1.2	1.9	2.2	2.6	1.6	1.9
Hungary	:	6.6	4.1	3.9	4.1	4.1	4.6	4.1	3.8	3.7	4.5	4.1
Poland	:	3.5	2.8	2.7	2.3	2.2	2.5	2.8	2.9	3.0	2.9	3.0
Romania	:	4.2	1.5	0.8	0.7	0.7	1.6	1.9	1.9	1.8	1.9	2.1
Sweden	5.5	4.0	1.9	1.6	1.7	1.7	0.9	0.9	0.9	1.0	0.8	0.8
United Kingdom	3.1	3.0	2.0	2.0	2.2	2.3	2.0	2.7	3.0	3.2	2.7	3.2
EU	:	4.0	2.9	2.6	2.7	2.8	2.6	2.7	2.9	3.0	2.8	3.1
USA	4.7	3.8	2.7	2.7	2.9	2.7	2.5	2.7	2.8	2.8	2.9	3.0
Japan	3.6	3.4	2.6	2.4	2.5	2.5	2.7	2.7	2.8	2.8	2.8	2.9

¹ ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 39 : Primary balance, general government (as a percentage of GDP, 1992-2012) ^{1 2}

15.11.2010

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	4.1	6.3	4.1	4.1	3.5	2.4	-2.4	-1.3	-1.1	-1.1	-1.3	-1.2
Germany	0.3	1.7	-0.4	1.2	3.0	2.8	-0.4	-1.2	-0.3	0.6	-2.3	-2.0
Estonia	:	-0.2	1.7	2.6	2.7	-2.6	-1.4	-0.7	-1.6	-2.3	-2.0	-1.9
Ireland	4.0	5.0	2.4	3.9	1.1	-5.9	-12.2	-29.3	-6.9	-4.8	-8.8	-8.6
Greece	1.6	3.5	-0.9	-1.4	-1.9	-4.5	-10.1	-3.7	-1.2	-0.3	-4.0	-4.1
Spain	-0.8	1.8	2.5	3.7	3.5	-2.6	-9.4	-7.3	-4.1	-2.7	-7.6	-6.2
France	-1.5	1.0	-0.5	0.3	0.0	-0.5	-5.2	-5.2	-3.6	-2.9	-5.4	-4.5
Italy	3.0	5.1	1.4	1.3	3.5	2.5	-0.6	-0.4	0.5	1.4	-0.7	-0.2
Cyprus	:	-0.5	-0.4	2.1	6.4	3.7	-3.4	-3.6	-3.3	-3.3	-4.4	-4.8
Luxembourg	1.9	4.9	0.8	1.5	3.9	3.3	-0.4	-1.4	-0.8	-0.8	-3.0	-3.3
Malta	:	-4.3	-1.6	0.8	1.0	-1.5	-0.6	-1.1	0.2	-0.2	-1.1	-0.4
Netherlands	2.4	4.1	1.1	2.7	2.4	2.8	-3.2	-3.7	-1.7	-0.4	-4.0	-2.8
Austria	-0.1	1.9	1.0	1.2	2.3	2.1	-0.8	-1.5	-0.8	-0.4	-1.8	-1.7
Portugal	1.0	-0.3	-1.3	-1.4	0.0	0.0	-6.5	-4.4	-1.2	-1.1	-5.5	-4.4
Slovenia	:	-0.8	-0.3	0.1	1.3	-0.7	-4.4	-4.2	-3.6	-2.9	-4.3	-3.3
Slovakia	:	-4.3	-1.6	-1.7	-0.4	-0.8	-6.5	-6.8	-3.5	-3.0	-4.5	-3.9
Finland	-1.8	5.9	4.8	5.5	6.7	5.6	-1.3	-1.8	-0.3	0.4	-2.6	-1.7
Euro area	0.6	2.6	0.6	1.5	2.3	1.0	-3.4	-3.5	-1.6	-0.8	-3.6	-2.9
Bulgaria	:	5.2	2.5	3.2	2.3	2.5	-3.9	-3.1	-2.1	-1.0	-2.0	-1.4
Czech Republic	:	-3.3	-3.3	-1.5	0.5	-1.6	-4.5	-4.0	-2.8	-2.4	-3.9	-3.6
Denmark	3.9	5.0	4.9	6.8	6.4	4.7	-0.9	-3.3	-2.4	-1.5	-3.4	-2.7
Latvia	:	-0.6	-0.5	0.0	0.0	-3.6	-8.7	-5.9	-5.8	-4.9	-6.2	-6.9
Lithuania	:	-3.6	-0.1	0.3	-0.3	-2.6	-7.9	-6.5	-4.8	-4.2	-6.8	-6.6
Hungary	:	1.4	-3.9	-5.4	-0.9	0.4	0.2	0.3	-1.0	-2.5	0.5	0.1
Poland	:	-0.4	-2.0	-1.0	0.4	-1.5	-4.7	-5.2	-3.7	-3.0	-4.5	-4.0
Romania	:	0.1	-0.1	-1.4	-1.8	-5.0	-7.1	-5.4	-2.9	-1.6	-6.2	-5.4
Sweden	-2.2	5.0	2.5	3.9	5.3	3.8	0.0	0.0	0.9	2.0	-1.2	-0.7
United Kingdom	-2.9	3.5	-1.0	-0.7	-0.5	-2.7	-9.3	-7.8	-5.6	-3.3	-9.3	-6.9
EU	:	2.6	0.4	1.2	1.8	0.4	-4.2	-4.0	-2.2	-1.2	-4.3	-3.5
USA	0.5	4.1	-1.0	0.7	0.1	-3.5	-8.7	-8.5	-6.1	-5.1	-7.2	-6.8
Japan	1.1	-3.9	-3.5	0.8	0.1	0.4	-3.6	-3.8	-3.6	-3.6	-4.0	-3.7

¹ ESA 79 up to 1994, ESA 95 from 1995 onwards.² Net lending/borrowing excluding interest expenditure.

TABLE 40 : Cyclically adjusted net lending (+) or net borrowing (-), general government (as a percentage of GDP, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	-5.1	-1.2	-0.9	-0.7	-1.6	-2.1	-4.6	-3.7	-3.7	-4.1	-3.7	-4.0
Germany	-3.3	-1.9	-2.7	-1.7	-0.6	-0.7	-1.0	-2.8	-2.2	-1.4	-3.6	-3.5
Estonia	:	0.1	0.4	-0.3	-0.9	-3.8	1.7	1.5	-0.7	-2.5	0.2	-0.9
Ireland	-1.3	1.1	1.0	2.2	-1.7	-7.3	-11.8	-30.2	-9.1	-8.9	-8.7	-10.2
Greece	-9.4	-4.2	-6.0	-6.4	-7.7	-10.5	-15.2	-7.4	-4.1	-4.7	-8.2	-8.2
Spain	-4.5	-2.3	0.2	1.6	1.3	-4.2	-9.2	-7.4	-4.9	-4.8	-7.8	-7.0
France	-4.3	-2.7	-4.1	-3.2	-3.7	-3.5	-5.8	-6.0	-4.6	-4.4	-6.6	-6.2
Italy	-7.7	-2.3	-3.9	-4.4	-3.0	-3.3	-3.5	-3.7	-3.5	-3.3	-3.6	-3.7
Cyprus	:	-3.7	-3.7	-1.3	2.5	-0.3	-5.5	-5.1	-5.0	-5.4	-6.3	-7.1
Luxembourg	:	3.3	-0.2	0.4	1.7	2.3	1.7	0.4	0.8	0.6	-1.4	-1.9
Malta	:	-8.1	-4.9	-2.6	-2.4	-5.0	-2.9	-3.9	-2.9	-3.5	-3.8	-3.4
Netherlands	-3.0	-0.8	-0.6	0.6	-0.8	-0.3	-3.4	-4.1	-2.3	-1.5	-4.9	-4.0
Austria	-3.9	-2.0	-1.6	-1.8	-1.6	-1.8	-2.3	-3.4	-2.9	-2.9	-3.6	-3.6
Portugal	-4.2	-4.1	-3.6	-3.7	-3.1	-3.0	-8.2	-6.7	-3.8	-4.3	-7.5	-7.0
Slovenia	:	-3.1	-2.1	-2.6	-3.0	-5.0	-3.9	-4.0	-3.8	-3.8	-4.4	-3.8
Slovakia	:	-7.1	-3.5	-3.5	-3.5	-4.0	-7.3	-7.9	-5.0	-5.1	-5.4	-4.7
Finland	-3.8	1.3	2.4	2.5	2.4	2.4	0.6	-0.6	0.4	0.6	-1.4	-1.0
Euro area	-4.6	-2.1	-2.6	-1.9	-1.7	-2.6	-4.4	-4.9	-3.5	-3.2	-5.1	-4.8
Bulgaria	:	:	-0.3	0.7	-0.3	-0.1	-3.6	-2.1	-1.4	-0.9	-1.1	-0.8
Czech Republic	:	-3.5	-4.5	-4.2	-3.0	-4.6	-5.0	-4.5	-3.9	-3.9	-4.7	-4.8
Denmark	-1.1	0.1	2.1	3.4	3.1	3.1	0.9	-2.7	-2.9	-3.0	-3.0	-3.1
Latvia	:	-1.0	-1.8	-3.0	-4.4	-6.2	-7.2	-5.1	-6.5	-7.0	-5.7	-8.3
Lithuania	:	-3.4	-2.0	-2.1	-3.6	-5.5	-7.0	-6.5	-6.0	-6.5	-6.1	-6.8
Hungary	:	-4.3	-8.7	-11.1	-6.4	-5.0	-2.3	-1.9	-3.7	-6.2	-2.1	-3.0
Poland	:	-3.4	-4.7	-4.3	-3.1	-4.8	-7.0	-7.4	-6.1	-5.5	-6.5	-5.7
Romania	:	-2.1	-2.3	-4.4	-5.1	-8.9	-8.6	-6.1	-3.5	-2.6	-6.9	-6.4
Sweden	-5.3	1.3	-0.3	0.2	1.1	1.2	2.0	0.2	0.2	1.0	-0.2	-0.5
United Kingdom	-5.6	0.0	-3.7	-3.5	-3.7	-5.2	-9.0	-8.3	-6.9	-5.1	-10.4	-8.7
EU	:	-1.8	-2.7	-2.2	-2.0	-3.0	-4.9	-5.3	-3.9	-3.4	-5.6	-5.2

TABLE 41 : Cyclically adjusted primary balance, general government (as a percentage of GDP, 1992-2012)

15.11.2010

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	4.4	5.7	3.8	3.3	2.2	1.7	-1.0	-0.2	-0.2	-0.5	0.0	-0.2
Germany	-0.1	1.4	0.1	1.1	2.2	2.0	1.6	-0.4	0.2	1.1	-1.0	-0.8
Estonia	:	0.4	0.6	-0.2	-0.8	-3.6	2.0	1.9	-0.3	-2.0	0.6	-0.5
Ireland	4.4	3.8	2.2	3.3	-0.7	-5.9	-9.7	-27.2	-5.6	-4.6	-5.9	-6.7
Greece	1.7	3.5	-1.1	-2.0	-3.3	-5.6	-9.9	-1.4	2.1	2.6	-2.8	-2.4
Spain	0.3	1.4	2.3	3.2	2.9	-2.6	-7.5	-5.4	-2.5	-2.0	-5.7	-4.4
France	-0.9	0.5	-1.3	-0.6	-1.1	-0.7	-3.4	-3.5	-2.0	-1.5	-4.1	-3.3
Italy	3.6	5.0	1.1	0.3	2.0	1.9	1.2	1.0	1.3	1.6	1.0	1.1
Cyprus	:	-0.6	-0.4	2.0	5.5	2.5	-2.9	-2.8	-2.6	-3.0	-3.6	-4.2
Luxembourg	:	3.7	0.0	0.6	2.0	2.6	2.1	0.7	1.2	1.1	-1.0	-1.3
Malta	:	-4.8	-1.3	0.9	1.0	-1.7	0.3	-0.8	0.2	-0.4	-0.5	-0.1
Netherlands	2.7	3.4	1.8	2.8	1.4	1.9	-1.2	-1.9	0.0	0.9	-2.6	-1.7
Austria	0.1	1.5	1.3	0.9	1.1	0.8	0.4	-0.6	-0.1	-0.1	-0.8	-0.7
Portugal	1.4	-1.0	-1.0	-1.1	-0.3	-0.1	-5.4	-3.8	-0.1	-0.3	-4.4	-3.4
Slovenia	:	-0.7	-0.3	-1.2	-1.7	-3.9	-2.6	-2.4	-2.1	-2.0	-2.5	-1.8
Slovakia	:	-3.8	-1.2	-2.1	-2.1	-2.8	-5.9	-6.5	-3.2	-3.0	-3.9	-3.2
Finland	0.2	4.6	4.1	3.9	3.9	3.8	1.7	0.6	1.7	2.2	-0.3	0.2
Euro area	0.9	2.2	0.5	1.0	1.2	0.4	-1.6	-2.1	-0.5	0.0	-2.1	-1.7
Bulgaria	:	:	1.6	2.1	0.9	0.8	-2.8	-1.4	-0.6	0.0	-0.3	0.1
Czech Republic	:	-2.4	-3.3	-3.0	-1.8	-3.4	-3.7	-3.2	-2.1	-2.1	-2.9	-2.6
Denmark	5.3	4.2	4.5	5.0	4.6	4.5	2.7	-0.9	-1.1	-1.0	-0.9	-1.0
Latvia	:	-0.2	-1.2	-2.6	-4.0	-5.6	-5.7	-3.3	-4.4	-4.7	-3.3	-5.4
Lithuania	:	-2.1	-1.0	-1.4	-2.9	-4.9	-5.7	-4.6	-3.8	-3.9	-4.5	-4.9
Hungary	:	2.3	-4.5	-7.2	-2.3	-0.8	2.4	2.2	0.0	-2.5	2.4	1.1
Poland	:	0.1	-1.9	-1.6	-0.8	-2.5	-4.5	-4.7	-3.2	-2.5	-3.6	-2.6
Romania	:	2.0	-0.8	-3.5	-4.3	-8.2	-7.0	-4.2	-1.5	-0.7	-5.0	-4.4
Sweden	0.2	5.3	1.6	1.8	2.8	2.9	2.9	1.2	1.1	2.0	0.7	0.3
United Kingdom	-2.4	2.9	-1.7	-1.5	-1.5	-2.9	-7.0	-5.7	-3.8	-2.0	-7.6	-5.6
EU	:	2.3	0.1	0.5	0.7	-0.2	-2.3	-2.5	-1.0	-0.4	-2.8	-2.2

TABLE 42 : Gross debt, general government (as a percentage of GDP, 2003-2012)

								Autumn 2010 forecast			Spring 2010 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	98.5	94.2	92.1	88.1	84.2	89.6	96.2	98.6	100.5	102.1	99.0	100.9
Germany	63.9	65.8	68.0	67.6	64.9	66.3	73.4	75.7	75.9	75.2	78.8	81.6
Estonia	5.6	5.0	4.6	4.4	3.7	4.6	7.2	8.0	9.5	11.7	9.6	12.4
Ireland	30.9	29.6	27.4	24.8	25.0	44.3	65.5	97.4	107.0	114.3	77.3	87.3
Greece	97.4	98.9	100.3	106.1	105.0	110.3	126.8	140.2	150.2	156.0	124.9	133.9
Spain	48.7	46.2	43.0	39.6	36.1	39.8	53.2	64.4	69.7	73.0	64.9	72.5
France	62.9	64.9	66.4	63.7	63.8	67.5	78.1	83.0	86.8	89.8	83.6	88.6
Italy	104.4	103.8	105.8	106.6	103.6	106.3	116.0	118.9	120.2	119.9	118.2	118.9
Cyprus	68.9	70.2	69.1	64.6	58.3	48.3	58.0	62.2	65.2	68.4	62.3	67.6
Luxembourg	6.1	6.3	6.1	6.7	6.7	13.6	14.5	18.2	19.6	20.9	19.0	23.6
Malta	69.3	72.2	69.9	63.4	61.7	63.1	68.6	70.4	70.8	70.9	71.5	72.5
Netherlands	52.0	52.4	51.8	47.4	45.3	58.2	60.8	64.8	66.6	67.3	66.3	69.6
Austria	65.5	64.8	63.9	62.1	59.3	62.5	67.5	70.4	72.0	73.3	70.2	72.9
Portugal	55.1	56.5	61.7	63.9	62.7	65.3	76.1	82.8	88.8	92.4	85.8	91.1
Slovenia	27.5	27.2	27.0	26.7	23.4	22.5	35.4	40.7	44.8	47.6	41.6	45.4
Slovakia	42.4	41.5	34.2	30.5	29.6	27.8	35.4	42.1	45.1	47.4	40.8	44.0
Finland	44.5	44.4	41.7	39.7	35.2	34.1	43.8	49.0	51.1	53.0	50.5	54.9
Euro area	69.0	69.4	70.0	68.4	66.0	69.7	79.1	84.1	86.5	87.8	84.6	88.4
Bulgaria	44.4	37.0	27.5	21.6	17.2	13.7	14.7	18.2	20.2	20.8	17.4	18.8
Czech Republic	29.8	30.1	29.7	29.4	29.0	30.0	35.3	40.0	43.1	45.2	39.8	43.5
Denmark	47.2	45.1	37.8	32.1	27.3	34.1	41.5	44.9	47.5	49.2	46.0	49.5
Latvia	14.6	14.9	12.4	10.7	9.0	19.7	36.7	45.7	51.9	56.6	48.5	57.3
Lithuania	21.1	19.4	18.4	18.0	16.9	15.6	29.5	37.4	42.8	48.3	38.6	45.4
Hungary	58.3	59.1	61.8	65.7	66.1	72.3	78.4	78.5	80.1	81.6	78.9	77.8
Poland	47.1	45.7	47.1	47.7	45.0	47.1	50.9	55.5	57.2	59.6	53.9	59.3
Romania	21.5	18.7	15.8	12.4	12.6	13.4	23.9	30.4	33.4	34.1	30.5	35.8
Sweden	51.7	50.4	50.2	45.0	40.0	38.2	41.9	39.9	38.9	37.5	42.6	42.1
United Kingdom	39.0	40.9	42.5	43.4	44.5	52.1	68.2	77.8	83.5	86.6	79.1	86.9
EU	61.8	62.2	62.7	61.5	58.8	61.8	74.0	79.1	81.8	83.3	79.6	83.8

TABLE 43 : Gross national saving (as a percentage of GDP, 1992-2012)

15.11.2010

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	24.8	25.9	25.2	25.8	26.7	25.1	22.2	22.5	23.1	23.4	23.0	23.2
Germany	21.2	20.3	21.4	24.2	26.0	25.2	21.5	22.5	23.0	23.3	22.3	22.6
Estonia	:	21.8	22.4	23.0	22.0	20.6	24.5	26.2	24.9	24.9	24.8	24.7
Ireland	18.6	23.5	23.0	24.8	21.7	16.4	11.5	10.3	11.8	12.7	10.4	11.0
Greece	18.5	14.0	10.2	8.0	6.3	4.4	2.5	3.4	5.1	6.7	6.4	8.5
Spain	20.6	22.3	22.5	22.0	21.0	19.4	18.9	18.1	18.4	18.8	18.0	17.5
France	18.9	21.1	19.1	19.3	20.0	19.3	16.1	15.9	16.3	16.5	16.4	16.4
Italy	20.6	21.3	20.0	19.6	20.1	18.0	15.8	16.3	17.0	17.7	15.9	16.5
Cyprus	:	13.8	14.7	13.8	10.7	6.4	8.7	10.3	9.1	8.5	9.0	7.9
Luxembourg	35.0	33.4	32.3	30.7	31.0	25.5	23.1	23.9	24.5	25.0	17.0	18.2
Malta	:	14.2	12.7	12.4	14.7	13.2	8.5	11.5	13.4	14.3	8.2	9.1
Netherlands	25.9	27.1	26.9	29.0	28.8	25.7	21.8	23.8	25.1	26.6	22.7	23.4
Austria	22.1	23.1	24.9	25.6	27.2	26.9	23.8	23.8	24.4	25.1	24.1	25.0
Portugal	19.4	19.1	15.1	12.4	12.7	10.6	9.4	8.2	10.9	12.0	8.0	8.1
Slovenia	23.5	24.3	25.2	26.5	27.2	25.2	21.7	22.5	23.0	23.2	22.3	22.6
Slovakia	:	23.7	19.8	19.6	22.6	21.1	16.6	19.5	21.6	22.2	18.9	19.9
Finland	17.8	26.5	26.0	25.9	27.1	25.2	18.8	19.1	20.1	20.3	18.1	18.6
Euro area	20.9	21.6	21.1	21.9	22.5	21.1	18.2	18.6	19.3	19.8	18.5	18.8
Bulgaria	:	:	12.3	10.0	7.9	13.2	13.8	19.8	20.6	20.9	18.6	19.4
Czech Republic	28.1	24.9	22.7	24.7	24.4	24.5	20.5	20.5	21.6	22.1	21.8	20.9
Denmark	19.9	22.0	24.0	25.7	24.7	24.5	20.7	21.6	21.9	21.8	21.0	21.0
Latvia	31.2	16.6	20.0	17.2	18.1	18.1	28.9	24.3	21.0	20.7	26.2	23.9
Lithuania	:	13.1	15.7	16.0	15.8	13.7	13.3	15.7	15.9	16.3	17.3	17.4
Hungary	:	21.9	16.9	16.3	16.4	16.8	18.8	20.6	20.8	20.6	18.8	19.4
Poland	17.2	19.9	17.1	18.0	19.4	19.1	18.5	18.1	19.1	19.8	18.3	19.0
Romania	22.9	13.6	17.2	15.9	17.4	19.8	20.6	20.3	20.3	21.4	21.0	20.3
Sweden	17.6	22.3	24.3	26.6	28.9	29.3	23.9	24.9	25.8	25.9	22.4	23.1
United Kingdom	15.2	16.2	14.8	14.1	15.6	15.0	12.4	12.3	13.4	15.3	12.0	12.8
EU	:	21.0	20.1	20.6	21.4	20.4	17.7	18.0	18.7	19.4	17.6	18.0
USA	15.0	17.7	14.5	15.8	13.9	11.9	10.3	12.7	12.9	13.3	11.8	12.2
Japan	31.6	28.5	26.7	27.7	28.5	26.9	23.8	23.6	24.3	23.9	24.0	24.9

TABLE 44 : Gross saving, private sector (as a percentage of GDP, 1992-2012) ¹

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	28.0	24.1	23.7	23.8	24.9	24.3	25.3	25.2	25.4	25.7	25.7	25.7
Germany	20.8	19.6	22.2	23.6	23.5	22.8	22.0	23.9	23.4	23.0	24.5	24.9
Estonia	:	17.7	16.7	16.2	14.4	17.4	22.3	24.5	22.9	23.2	22.3	22.4
Ireland	18.6	18.0	18.4	18.6	17.5	17.8	19.2	19.2	18.9	19.1	18.6	19.6
Greece	24.6	14.5	12.5	11.6	10.6	10.9	14.7	11.4	11.1	13.5	13.1	15.7
Spain	21.8	20.1	17.8	15.6	14.1	18.4	24.1	22.0	20.7	20.5	22.8	22.0
France	20.0	19.7	18.9	18.0	18.8	18.7	19.5	19.0	18.7	18.6	20.2	19.8
Italy	25.6	20.5	20.1	18.3	17.8	17.2	17.8	18.0	18.6	18.5	17.8	18.2
Cyprus	:	14.0	14.9	11.3	3.7	2.1	9.7	11.4	10.3	9.7	11.3	10.8
Luxembourg	:	24.4	26.1	24.2	23.0	18.5	19.1	20.8	21.2	21.9	15.5	17.3
Malta	:	17.9	14.5	13.7	14.3	15.4	10.3	13.7	14.5	15.4	10.6	10.8
Netherlands	26.4	24.1	24.8	25.5	25.4	21.5	22.3	24.9	24.7	25.3	24.3	23.8
Austria	21.6	21.2	23.1	24.0	24.6	24.5	24.4	25.3	25.2	25.6	26.1	27.0
Portugal	20.7	18.5	16.8	14.1	13.1	12.0	15.8	14.8	14.4	15.7	14.4	13.8
Slovenia	:	22.9	23.0	23.7	22.5	21.5	22.0	23.2	23.3	23.2	23.2	22.9
Slovakia	:	23.5	19.9	19.9	21.9	20.1	20.3	24.0	23.8	24.2	21.1	21.6
Finland	19.8	21.0	20.4	19.8	19.6	18.6	18.4	19.3	18.9	18.8	19.0	18.8
Euro area	22.2	20.2	20.4	20.0	19.9	19.7	20.7	21.1	20.8	20.8	21.5	21.6
Bulgaria	:	:	8.2	4.7	-0.5	6.6	13.8	19.4	19.4	19.0	17.1	17.6
Czech Republic	:	21.5	19.8	21.0	19.7	21.5	21.5	20.7	21.2	21.4	22.4	21.4
Denmark	20.4	19.3	19.9	18.9	18.2	19.1	21.3	24.5	24.2	23.5	24.2	24.0
Latvia	:	15.5	17.2	11.7	12.3	17.5	33.8	26.7	25.1	24.3	32.3	31.1
Lithuania	:	11.7	13.5	12.9	12.2	12.6	19.6	21.3	21.1	21.4	22.9	23.1
Hungary	:	21.5	19.3	20.3	16.9	17.0	20.5	21.1	22.8	24.1	20.3	21.1
Poland	:	19.7	17.9	17.4	16.9	17.8	20.2	20.8	20.7	20.7	20.3	20.5
Romania	:	14.2	13.9	11.6	13.2	18.8	23.5	22.4	19.9	19.6	23.7	21.9
Sweden	21.4	18.4	20.7	21.2	22.2	23.9	21.1	22.3	22.4	21.5	20.7	20.9
United Kingdom	18.6	14.5	15.6	14.3	15.9	16.7	19.0	18.8	18.8	18.8	19.5	19.1
EU	:	19.4	19.5	18.9	19.0	19.2	20.5	20.8	20.6	20.6	21.0	21.0
USA	17.1	15.3	15.7	15.6	14.1	15.1	17.8	19.4	18.6	17.5	18.1	17.9
Japan	26.6	27.7	28.4	27.6	28.2	27.2	28.3	28.4	29.1	28.8	28.8	30.0

¹ ESA 79 up to 1994; ESA 95 from 1995 onwards.

TABLE 45 : Gross saving, general government (as a percentage of GDP, 1992-2012) ¹

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	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	-3.3	1.8	1.5	2.0	1.8	0.8	-3.1	-2.6	-2.3	-2.4	-2.7	-2.4
Germany	0.4	0.7	-0.7	0.7	2.4	2.5	-0.5	-1.3	-0.4	0.3	-2.2	-2.3
Estonia	:	4.0	5.8	6.8	7.6	3.2	2.3	1.7	2.0	1.7	2.5	2.4
Ireland	0.0	5.4	4.6	6.2	4.2	-1.4	-7.8	-9.0	-7.1	-6.4	-8.1	-8.6
Greece	-6.1	-0.5	-2.3	-3.5	-4.4	-6.5	-12.2	-8.0	-6.0	-6.8	-6.6	-7.2
Spain	-1.1	2.1	4.7	6.4	6.9	1.0	-5.2	-3.9	-2.4	-1.7	-4.8	-4.5
France	-1.1	1.5	0.2	1.3	1.1	0.6	-3.4	-3.1	-2.4	-2.1	-3.8	-3.4
Italy	-5.0	0.8	-0.1	1.4	2.2	0.8	-2.1	-1.7	-1.5	-0.8	-1.8	-1.7
Cyprus	:	-0.2	-0.3	2.5	7.0	4.3	-1.1	-1.2	-1.2	-1.2	-2.3	-2.9
Luxembourg	:	9.0	6.2	6.5	8.1	7.0	4.0	3.1	3.3	3.2	1.5	0.8
Malta	:	-3.7	-1.8	-1.3	0.4	-2.3	-1.8	-2.2	-1.1	-1.1	-2.4	-1.8
Netherlands	-0.4	3.0	2.0	3.5	3.4	4.2	-0.5	-1.0	0.4	1.3	-1.6	-0.4
Austria	0.5	1.9	1.8	1.6	2.6	2.4	-0.6	-1.4	-0.8	-0.5	-2.0	-2.0
Portugal	-1.2	0.6	-1.7	-1.7	-0.4	-1.3	-6.4	-6.7	-3.6	-3.6	-6.3	-5.7
Slovenia	:	1.4	2.1	2.8	4.7	3.7	-0.3	-0.8	-0.3	0.0	-0.9	-0.3
Slovakia	:	0.2	-0.1	-0.2	0.7	1.0	-3.7	-4.5	-2.2	-1.9	-2.2	-1.7
Finland	-2.0	5.5	5.6	6.2	7.6	6.6	0.4	-0.2	1.1	1.5	-0.9	-0.2
Euro area	-1.4	1.4	0.7	2.0	2.6	1.4	-2.6	-2.5	-1.5	-1.0	-3.0	-2.8
Bulgaria	:	4.1	4.2	5.3	8.4	6.6	0.1	0.4	1.1	1.9	1.5	1.9
Czech Republic	:	3.3	2.9	3.7	4.7	3.0	-0.9	-0.2	0.3	0.8	-0.6	-0.5
Denmark	-0.6	2.7	4.1	6.8	6.5	5.5	-0.6	-2.8	-2.3	-1.8	-3.1	-3.0
Latvia	:	1.0	2.8	5.5	5.8	0.6	-4.9	-2.5	-4.1	-3.6	-6.2	-7.2
Lithuania	:	1.4	2.2	3.0	3.6	1.1	-6.3	-5.6	-5.2	-5.1	-5.6	-5.7
Hungary	:	0.4	-2.4	-4.0	-0.4	-0.3	-1.7	-0.6	-2.0	-3.5	-1.5	-1.7
Poland	:	0.2	-0.8	0.7	2.5	1.3	-1.7	-2.7	-1.7	-0.9	-2.1	-1.5
Romania	:	-0.5	3.4	4.3	4.1	1.0	-2.9	-2.1	0.4	1.8	-2.7	-1.6
Sweden	-3.8	3.9	3.6	5.5	6.7	5.4	2.8	2.6	3.3	4.4	1.7	2.2
United Kingdom	-3.4	1.7	-0.8	-0.2	-0.3	-1.6	-6.6	-6.5	-5.4	-3.5	-7.4	-6.2
EU	:	1.5	0.6	1.8	2.4	1.2	-2.9	-2.5	-1.4	-0.6	-3.4	-3.0
USA	-2.0	2.4	-1.3	0.2	-0.2	-3.2	-7.5	-6.8	-5.7	-4.2	-6.4	-5.7
Japan	5.0	0.8	-1.7	0.1	0.3	-0.4	-4.5	-4.8	-4.8	-4.9	-4.8	-5.2

¹ ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 46 : Exports of goods and services, volume (percentage change on preceding year, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	4.0	6.3	3.9	5.1	4.4	1.7	-11.6	9.6	5.7	6.0	4.3	4.3
Germany	2.8	9.1	7.5	13.1	7.6	2.5	-14.3	14.7	6.6	6.7	6.2	5.5
Estonia	:	13.0	9.0	6.7	1.5	0.4	-18.7	14.3	6.6	6.3	6.5	5.9
Ireland	14.2	16.9	4.6	4.8	8.2	-0.8	-4.1	5.7	4.5	4.5	2.0	4.3
Greece	4.2	11.2	3.6	5.3	5.8	4.0	-20.1	0.6	5.1	6.0	2.6	4.1
Spain	10.3	8.9	3.8	6.7	6.7	-1.1	-11.6	9.1	5.5	5.6	4.4	4.7
France	5.2	8.1	2.4	4.8	2.5	-0.5	-12.4	9.5	5.9	6.2	4.7	5.1
Italy	7.7	4.3	1.4	6.2	4.6	-3.9	-19.1	7.9	5.6	5.7	3.4	4.1
Cyprus	:	6.1	1.6	3.5	6.1	-2.1	-11.8	3.6	3.5	3.8	0.6	3.3
Luxembourg	4.4	10.7	7.4	13.0	9.1	6.6	-8.2	9.9	7.6	6.1	2.8	4.9
Malta	:	4.8	3.0	10.5	2.7	-3.0	-7.6	19.0	6.3	6.2	4.4	4.1
Netherlands	5.8	8.3	4.7	7.3	6.4	2.8	-7.9	10.3	6.0	6.9	5.9	5.2
Austria	3.2	9.1	6.1	7.7	8.6	1.0	-16.1	9.0	6.3	6.5	4.2	4.9
Portugal	7.5	5.9	4.4	11.6	7.6	-0.3	-11.8	9.1	5.6	6.4	3.8	4.4
Slovenia	-2.1	7.9	9.0	12.5	13.7	3.3	-17.7	8.1	5.9	7.2	4.3	4.9
Slovakia	:	10.8	11.7	21.0	14.3	3.1	-15.9	14.7	7.9	8.0	5.7	5.9
Finland	10.8	10.5	5.6	12.2	8.2	6.3	-20.3	6.5	6.1	4.8	4.8	6.8
Euro area	5.8	8.2	4.8	8.6	6.3	1.0	-13.2	10.7	6.1	6.3	4.9	5.0
Bulgaria	:	3.2	11.0	50.7	6.1	3.0	-10.3	10.5	5.6	6.2	4.2	5.2
Czech Republic	9.7	10.3	11.3	15.8	15.0	6.0	-10.8	12.1	7.3	7.6	6.5	6.1
Denmark	3.4	7.2	4.5	9.0	2.2	2.4	-10.2	6.4	5.0	5.6	4.8	5.2
Latvia	:	5.8	9.2	6.5	10.0	2.0	-14.1	8.6	6.0	6.4	6.0	6.0
Lithuania	:	6.7	11.9	12.0	3.0	11.6	-12.7	11.0	6.3	6.6	6.1	5.5
Hungary	11.5	15.2	10.9	18.6	16.2	5.7	-9.6	13.5	9.0	10.0	6.6	8.7
Poland	12.2	9.7	11.0	14.6	9.1	7.1	-6.8	10.0	6.9	7.7	6.0	5.8
Romania	10.4	11.2	11.6	10.4	7.8	8.3	-5.5	17.0	6.0	6.1	5.5	6.5
Sweden	7.8	8.3	6.3	9.0	5.7	1.4	-12.4	10.8	6.9	5.9	3.9	6.7
United Kingdom	7.2	5.4	5.3	11.1	-2.6	1.0	-11.1	5.5	8.3	8.9	5.2	5.4
EU	6.9	7.9	5.3	9.4	5.5	1.5	-12.5	10.2	6.4	6.6	5.0	5.2
USA	7.4	4.1	4.9	9.0	9.3	6.0	-9.5	11.8	8.4	7.4	11.3	8.1
Japan	3.7	2.9	9.4	9.7	8.4	1.6	-23.9	24.7	4.8	5.1	21.5	7.7

TABLE 47 : Imports of goods and services, volume (percentage change on preceding year, 1992-2012)

15.11.2010

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	4.0	5.8	3.7	4.6	4.7	3.0	-11.1	8.5	5.5	6.1	3.6	4.5
Germany	3.2	7.5	5.9	11.9	5.0	3.3	-9.4	13.4	7.2	7.6	4.6	5.3
Estonia	:	12.4	12.2	13.3	7.8	-7.0	-32.6	15.0	6.6	6.2	2.4	6.0
Ireland	12.0	16.8	4.8	6.4	7.8	-2.9	-9.7	2.3	0.9	2.5	-1.3	3.5
Greece	3.8	10.8	3.0	9.7	9.8	4.0	-18.6	-12.0	-6.4	-1.5	-10.5	-3.4
Spain	6.4	11.4	7.5	10.2	8.0	-5.3	-17.8	4.5	1.4	4.5	-1.1	1.8
France	3.2	8.6	4.3	5.6	5.6	0.6	-10.7	8.2	5.7	5.7	4.1	4.5
Italy	2.1	7.0	2.7	5.9	3.8	-4.3	-14.5	6.8	4.3	4.6	2.8	3.5
Cyprus	:	4.7	4.0	6.7	13.3	8.0	-19.8	-1.5	2.1	2.4	-1.3	2.4
Luxembourg	3.6	11.1	7.2	12.8	9.3	8.5	-10.3	11.8	8.8	6.7	2.9	5.6
Malta	:	2.4	3.7	9.5	-0.8	-2.9	-10.6	18.1	6.5	6.3	5.1	4.2
Netherlands	5.5	8.9	4.4	8.8	5.6	3.4	-8.5	10.4	5.2	6.9	3.1	5.1
Austria	3.3	6.7	5.1	5.4	7.0	-0.9	-14.4	6.4	5.6	5.5	2.5	3.8
Portugal	7.0	8.0	3.2	7.2	5.5	2.8	-10.9	5.8	-3.2	1.5	1.1	1.5
Slovenia	3.1	7.7	8.7	12.2	16.7	3.8	-19.7	6.3	5.0	6.5	3.4	4.9
Slovakia	:	9.6	10.0	17.8	9.2	3.1	-18.6	13.7	6.6	7.2	6.8	5.2
Finland	6.0	8.4	6.6	7.9	7.0	6.5	-18.1	5.1	5.8	4.8	5.0	6.3
Euro area	3.9	8.3	4.9	8.5	5.8	0.8	-12.0	8.7	5.1	5.9	2.9	4.2
Bulgaria	:	11.5	14.1	47.7	9.6	4.2	-21.5	0.7	4.9	5.8	-2.0	4.3
Czech Republic	20.1	9.8	9.9	14.3	14.3	4.7	-10.6	12.0	6.3	7.0	5.3	5.7
Denmark	4.3	7.2	7.5	13.4	2.6	3.3	-13.2	6.6	5.3	5.9	4.9	5.8
Latvia	:	7.3	13.6	19.4	14.7	-11.2	-33.5	7.6	6.0	8.5	-6.5	4.0
Lithuania	:	7.5	14.6	13.7	10.7	10.3	-28.4	7.8	8.1	8.4	2.1	4.3
Hungary	11.9	16.0	10.4	14.8	13.3	5.8	-14.6	11.5	9.5	10.6	5.4	9.1
Poland	15.3	9.7	9.9	17.3	13.7	8.0	-12.4	10.2	7.5	8.2	6.3	6.7
Romania	8.1	12.4	17.8	22.6	27.3	7.9	-20.6	12.9	6.4	8.3	3.9	7.6
Sweden	4.4	7.6	5.0	9.0	9.0	2.9	-13.2	12.1	7.7	6.1	5.7	7.3
United Kingdom	6.2	8.1	6.0	9.1	-0.8	-1.2	-12.3	8.6	5.7	5.2	5.3	4.1
EU	5.4	8.4	5.6	9.4	5.7	1.1	-12.4	8.9	5.4	6.1	3.4	4.6
USA	8.8	9.2	6.2	6.1	2.7	-2.6	-13.8	14.1	8.0	6.9	10.1	5.7
Japan	6.5	1.3	4.6	4.2	1.6	1.2	-16.7	10.9	5.4	4.3	8.2	8.4

TABLE 48 : Merchandise trade balance (fob-fob, as a percentage of GDP, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	3.1	3.0	3.4	2.0	1.6	-1.6	0.1	-0.4	-0.2	-0.3	0.1	0.2
Germany	2.2	3.6	6.7	7.0	8.2	7.3	5.6	6.1	6.0	5.8	5.5	5.6
Estonia	:	-16.6	-15.7	-17.3	-17.2	-12.2	-3.9	-4.7	-4.1	-4.1	-2.7	-2.6
Ireland	16.5	23.9	20.6	13.2	10.5	13.2	20.3	22.9	25.1	26.7	23.1	23.6
Greece	-12.0	-15.4	-18.2	-18.1	-19.7	-20.5	-16.4	-13.1	-11.1	-10.3	-12.0	-10.9
Spain	-3.3	-4.6	-6.5	-8.4	-8.6	-7.8	-4.2	-4.3	-3.5	-3.2	-3.8	-3.3
France	0.6	1.0	-0.5	-1.5	-2.1	-2.8	-2.2	-3.0	-3.0	-3.0	-2.7	-2.6
Italy	2.7	2.1	0.4	-0.7	0.2	-0.1	0.1	-0.7	-0.3	0.0	-0.1	0.0
Cyprus	:	-24.6	-25.8	-27.2	-29.7	-32.2	-24.8	-24.5	-24.3	-24.4	-24.6	-25.2
Luxembourg	-10.2	-12.7	-10.5	-9.6	-8.8	-10.4	-7.8	-10.5	-12.8	-14.3	-7.6	-8.3
Malta	-22.4	-17.6	-14.8	-18.8	-17.9	-21.4	-16.5	-14.8	-14.9	-15.2	-14.7	-15.2
Netherlands	5.0	5.3	7.2	7.7	7.6	7.3	6.7	6.8	7.7	8.1	8.3	8.5
Austria	-4.2	-2.2	-0.1	0.2	0.4	-0.2	-0.8	-0.4	-0.3	0.1	-0.6	0.2
Portugal	-9.8	-10.8	-10.1	-10.9	-10.9	-12.9	-10.1	-10.8	-8.5	-7.6	-9.6	-9.1
Slovenia	-1.1	-4.4	-2.9	-3.8	-4.9	-7.2	-2.1	-2.1	-2.0	-1.9	-2.0	-2.2
Slovakia	:	-8.6	-5.2	-5.4	-1.8	-1.6	1.5	1.7	2.9	3.5	-0.2	0.3
Finland	7.3	9.8	6.6	5.2	5.1	3.7	2.1	2.4	2.3	2.2	1.9	1.9
Euro area	1.1	1.5	1.5	0.6	0.8	0.2	0.7	0.6	1.0	1.1	0.8	1.0
Euro area, adjusted ¹	:	:	:	:	:	:	:	:	:	:	:	:
Bulgaria	-2.6	-5.3	-16.8	-21.1	-23.6	-24.3	-11.7	-6.8	-6.5	-6.5	-9.5	-9.3
Czech Republic	-5.2	-5.3	-0.4	2.0	3.4	2.7	4.5	5.0	5.6	6.4	5.4	5.4
Denmark	4.1	3.7	3.4	1.1	-0.5	-0.6	1.9	2.1	1.9	1.5	2.4	2.3
Latvia	-7.0	-14.8	-19.7	-25.6	-23.9	-17.7	-7.1	-7.7	-7.8	-8.9	-4.0	-3.0
Lithuania	:	-11.3	-10.8	-13.9	-15.0	-13.0	-3.1	-1.1	-2.2	-3.2	-2.8	-2.4
Hungary	-5.7	-4.5	-3.3	-2.8	-0.2	-0.6	3.5	4.9	4.4	3.5	5.7	5.7
Poland	-0.1	-6.4	-2.3	-2.0	-4.0	-4.9	-1.0	-1.6	-2.0	-2.5	-1.2	-1.7
Romania	-7.3	-6.1	-8.8	-12.0	-14.3	-13.6	-5.8	-4.6	-4.4	-5.0	-5.1	-5.1
Sweden	5.0	7.1	6.4	5.7	4.6	3.8	3.5	3.5	3.3	3.0	3.3	3.2
United Kingdom	-1.8	-2.9	-5.0	-5.7	-6.4	-6.4	-5.9	-6.4	-6.3	-5.8	-6.4	-6.7
EU	-0.5	0.7	0.3	-0.6	-0.7	-1.1	-0.2	-0.3	0.0	0.1	-0.1	0.0
EU, adjusted ¹				-1.4	-1.2	-1.7	-0.7	-0.8	-0.5	-0.4	-0.8	-0.7
USA	-2.1	-3.6	-5.7	-6.5	-6.0	-6.0	-3.7	-4.8	-5.3	-5.5	-4.5	-4.5
Japan	2.7	2.5	2.3	1.9	2.4	0.8	0.9	1.6	1.4	1.4	1.0	0.8

¹ See note 8 on concepts and sources.

TABLE 49 : Current account balance (as a percentage of GDP, 1992-2012)

15.11.2010

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	4.3	4.5	4.5	3.4	3.9	1.1	2.0	1.7	2.0	2.0	3.0	3.3
Germany	-1.1	-0.8	4.2	6.6	7.6	6.7	5.0	4.8	4.6	4.3	4.8	4.8
Estonia	:	-7.4	-11.8	-15.7	-17.2	-8.8	4.5	4.1	1.4	0.9	4.9	3.8
Ireland	2.6	0.5	-1.3	-3.7	-5.5	-5.6	-3.1	-1.1	1.5	2.7	-0.9	-0.6
Greece	-0.5	-6.7	-11.8	-12.8	-15.7	-16.4	-14.0	-10.6	-8.0	-6.5	-10.3	-8.6
Spain	-1.4	-2.4	-6.0	-9.0	-10.0	-9.6	-5.5	-4.8	-3.8	-3.6	-4.6	-4.5
France	0.5	1.9	-0.6	-1.8	-2.2	-2.7	-2.9	-3.3	-3.4	-3.5	-3.3	-3.6
Italy	1.0	1.2	-1.0	-2.0	-1.8	-3.1	-3.2	-3.2	-2.7	-2.4	-3.2	-2.9
Cyprus	:	-4.3	-4.8	-7.0	-11.7	-17.7	-8.5	-6.1	-5.7	-5.4	-7.1	-7.0
Luxembourg	12.8	10.0	10.5	10.4	10.1	5.3	6.7	8.4	9.4	9.9	0.9	1.5
Malta	:	-6.4	-4.9	-9.2	-6.2	-5.6	-6.1	-3.9	-2.9	-2.2	-4.9	-4.4
Netherlands	4.6	4.8	7.5	9.0	8.4	4.8	3.4	5.2	6.8	7.9	5.9	6.4
Austria	-2.5	-1.4	2.4	3.3	4.0	3.7	2.6	3.0	3.5	4.1	3.1	4.1
Portugal	-5.5	-8.8	-8.9	-10.8	-10.2	-12.5	-10.4	-10.7	-8.0	-6.7	-10.1	-10.0
Slovenia	2.5	-1.8	-1.4	-2.4	-4.5	-6.8	-1.3	-0.7	-0.6	-0.8	-1.4	-1.6
Slovakia	:	-6.5	-7.5	-8.3	-5.1	-6.9	-3.4	-2.9	-1.9	-1.7	-4.5	-4.1
Finland	0.5	6.6	5.6	4.6	4.2	3.5	1.3	1.3	1.6	1.4	1.1	1.3
Euro area	0.2	0.4	0.5	0.3	0.2	-0.8	-0.7	-0.5	0.0	0.1	-0.4	-0.3
Euro area, adjusted ¹	:	:	:	:	:	:	:	:	:	:	:	:
Bulgaria	-4.3	-2.8	-8.6	-17.4	-20.1	-20.6	-8.4	-3.3	-2.5	-2.3	-6.0	-5.2
Czech Republic	-2.1	-4.1	-4.4	-2.1	-2.6	-0.8	-1.2	-1.9	-1.5	-1.1	-0.3	-1.5
Denmark	1.8	1.2	3.3	3.0	1.4	2.7	3.6	4.5	4.2	4.0	3.9	3.7
Latvia	6.0	-7.3	-12.5	-22.5	-22.3	-13.1	8.6	3.9	-0.5	-2.9	8.3	4.6
Lithuania	:	-8.5	-7.4	-10.4	-15.1	-13.1	2.6	2.6	1.3	1.0	2.8	2.0
Hungary	:	-6.2	-8.1	-7.7	-7.0	-6.9	-0.4	0.8	0.4	-0.4	-0.2	-0.3
Poland	0.6	-4.0	-2.4	-3.0	-5.1	-4.8	-1.9	-2.7	-3.3	-3.7	-2.8	-3.3
Romania	:	-5.4	-6.3	-10.6	-13.6	-11.4	-4.5	-5.5	-5.6	-6.2	-4.4	-5.6
Sweden	1.2	4.7	6.7	7.9	8.6	8.9	7.3	6.6	6.5	6.1	6.1	6.1
United Kingdom	-1.4	-1.5	-2.3	-3.4	-2.6	-1.6	-1.3	-2.2	-1.5	-0.2	-1.8	-2.0
EU	-0.2	0.0	0.0	-0.4	-0.5	-1.0	-0.6	-0.5	-0.1	0.1	-0.4	-0.4
EU, adjusted ¹				-1.2	-1.0	-1.9	-1.0	-0.9	-0.5	-0.3	-1.4	-1.3
USA	-1.3	-3.0	-5.2	-6.0	-5.1	-4.7	-2.7	-3.4	-4.0	-4.2	-3.7	-3.7
Japan	2.4	2.5	3.5	3.9	4.8	3.2	3.5	3.8	3.7	3.7	3.1	2.5

¹ See note 8 on concepts and sources.

TABLE 50 : Net lending (+) or net borrowing (-) of the nation (as a percentage of GDP, 1992-2012)

	5-year averages							Autumn 2010 forecast			Spring 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	4.1	4.5	4.5	3.4	3.6	0.6	1.6	1.4	1.7	1.8	2.7	3.0
Germany	-1.1	-0.7	4.2	6.6	7.7	6.7	5.0	4.8	4.6	4.3	4.8	4.8
Estonia	:	-7.0	-10.9	-13.6	-16.2	-7.7	7.8	9.2	5.4	4.6	7.4	6.2
Ireland	3.4	1.4	-1.9	-3.1	-5.6	-5.9	-3.4	-1.1	1.4	2.6	-0.9	-0.6
Greece	:	-5.0	-10.3	-10.5	-13.5	-15.0	-12.9	-9.5	-6.7	-5.1	-9.4	-7.6
Spain	-0.7	-1.4	-5.1	-8.4	-9.6	-9.2	-5.1	-4.3	-3.3	-3.1	-4.0	-4.0
France	0.5	2.0	-0.7	-1.8	-2.1	-2.7	-2.8	-3.8	-3.1	-3.0	-3.4	-3.6
Italy	1.1	1.4	-0.9	-1.9	-1.7	-3.1	-3.1	-3.0	-2.5	-2.2	-2.9	-2.6
Cyprus	:	-4.3	-4.3	-6.8	-11.7	-17.6	-8.2	-5.8	-5.4	-5.1	-6.8	-6.7
Luxembourg	:	:	10.3	9.5	9.7	4.7	6.0	8.4	9.4	9.9	0.9	1.5
Malta	:	-6.0	-3.3	-6.2	-5.2	-5.1	-4.8	-2.1	-0.9	-0.2	-3.4	-2.7
Netherlands	4.2	4.6	7.2	8.7	8.2	4.4	3.1	4.7	6.5	7.7	5.6	6.0
Austria	-2.6	-1.5	2.3	3.0	4.1	3.7	2.7	3.0	3.5	4.1	3.1	4.1
Portugal	-2.9	-6.7	-7.2	-9.5	-8.9	-11.0	-9.3	-9.5	-6.7	-5.3	-8.8	-8.6
Slovenia	2.4	-1.7	-1.8	-2.8	-4.7	-6.7	-1.4	-0.4	-0.2	-0.2	-0.7	-1.0
Slovakia	:	-6.6	-7.8	-7.8	-4.7	-5.9	-2.9	-1.7	-0.1	0.1	-3.7	-3.2
Finland	0.1	6.5	5.7	4.7	4.3	3.6	1.3	1.4	1.7	1.5	1.2	1.4
Euro area	0.3	0.6	0.6	0.5	0.5	-0.6	-0.5	-0.4	0.2	0.4	-0.3	-0.1
Euro area, adjusted ¹	:	:	:	:	:	:	:	:	:	:	:	:
Bulgaria	-4.6	-2.4	-8.2	-17.1	-20.0	-21.3	-6.6	-1.7	-0.8	-0.6	-4.3	-3.5
Czech Republic	-3.0	-4.0	-4.1	-1.7	-2.0	0.3	0.6	-0.1	0.0	0.0	1.3	-0.2
Denmark	1.8	1.4	3.3	3.0	1.4	2.7	3.5	4.5	4.2	3.9	4.2	3.9
Latvia	11.9	-7.0	-11.6	-21.3	-20.4	-11.6	11.1	6.4	1.9	-0.6	10.8	7.1
Lithuania	:	-8.5	-6.6	-8.9	-12.9	-11.2	7.0	6.9	5.4	4.9	6.3	5.6
Hungary	:	-6.0	-7.8	-7.1	-6.2	-6.0	1.3	2.4	2.1	1.3	1.4	1.5
Poland	2.4	-4.0	-2.2	-2.1	-4.1	-4.1	-0.3	-0.3	-0.5	-1.2	-0.8	-1.0
Romania	-3.9	-5.2	-5.7	-10.4	-13.0	-11.0	-4.0	-5.1	-5.1	-5.7	-3.9	-5.1
Sweden	0.8	4.3	6.6	7.3	8.5	8.7	7.2	6.5	6.4	6.0	6.0	6.1
United Kingdom	-1.3	-1.4	-2.2	-3.3	-2.4	-1.4	-1.0	-2.0	-1.3	0.0	-1.6	-1.7
EU	-0.6	-0.6	-1.0	-2.3	-2.7	-3.0	-1.1	-0.4	0.2	0.5	-0.2	-0.1
EU, adjusted ¹				-3.0	-3.2	-3.9	-1.5	-0.8	-0.2	0.1	-1.1	-1.0
USA	-2.6	-2.1	-4.7	-4.3	-5.3	-5.6	-4.0	-3.4	-4.0	-4.2	-3.8	-3.8
Japan	2.4	2.3	3.4	3.8	4.7	3.1	3.4	3.8	3.7	3.7	2.9	2.4

¹ See note 8 on concepts and sources.

TABLE 51 : Merchandise trade balance (fob-fob, in billions of euro, 2003-2012)

15.11.2010

								Autumn 2010 forecast			Spring 2010 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	12.3	10.2	6.4	6.4	5.3	-5.4	0.4	-1.3	-0.8	-1.0	0.3	0.8
Germany	132.0	154.0	158.7	162.2	199.0	180.4	135.2	151.0	155.5	154.3	135.1	140.3
Estonia	-1.4	-1.6	-1.6	-2.3	-2.7	-2.0	-0.5	-0.7	-0.6	-0.7	-0.4	-0.4
Ireland	33.1	32.0	27.9	23.5	19.8	23.8	32.4	35.8	39.9	43.5	36.8	39.1
Greece	-31.9	-33.5	-33.2	-37.9	-44.4	-48.4	-38.3	-30.0	-25.2	-23.7	-28.5	-26.3
Spain	-40.2	-53.2	-67.9	-82.5	-90.8	-85.2	-44.7	-45.1	-37.3	-35.2	-39.7	-35.8
France	2.4	-5.1	-21.6	-27.1	-39.5	-53.7	-42.0	-58.1	-59.5	-62.2	-53.4	-52.2
Italy	9.5	8.8	0.4	-10.2	3.2	-2.1	2.2	-11.1	-4.2	0.1	-2.0	0.7
Cyprus	-2.8	-3.3	-3.4	-4.0	-4.7	-5.5	-4.2	-4.3	-4.5	-4.7	-4.2	-4.5
Luxembourg	-2.7	-2.7	-3.6	-3.3	-3.3	-4.1	-3.0	-4.2	-5.4	-6.4	-3.0	-3.5
Malta	-0.6	-0.7	-0.9	-1.0	-1.0	-1.2	-0.9	-0.9	-1.0	-1.0	-0.9	-0.9
Netherlands	31.0	35.4	40.7	41.5	43.7	43.7	38.4	39.8	46.4	50.5	48.2	51.5
Austria	-1.5	-0.6	-1.0	0.4	1.1	-0.6	-2.3	-1.2	-0.7	0.2	-1.7	0.6
Portugal	-12.2	-15.2	-17.1	-17.5	-18.4	-22.2	-16.9	-18.4	-14.5	-13.2	-16.0	-15.6
Slovenia	-0.6	-1.0	-1.0	-1.2	-1.7	-2.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.8
Slovakia	-0.7	-1.3	-2.1	-2.4	-1.0	-1.0	1.0	1.1	2.0	2.6	-0.1	0.2
Finland	11.0	9.8	7.4	8.6	9.1	6.9	3.6	4.2	4.4	4.4	3.3	3.5
Euro area	136.6	132.2	87.9	53.3	73.8	20.6	59.5	55.8	93.6	106.7	73.0	96.7
Euro area, adjusted ¹	:	:	:	:	:	:	:	:	:	:	:	:
Bulgaria	-2.4	-3.0	-5.6	-5.6	-7.3	-8.6	-4.1	-2.4	-2.5	-2.6	-3.3	-3.3
Czech Republic	-2.2	-0.4	2.0	2.3	4.3	4.0	6.2	7.3	8.8	10.4	7.8	8.1
Denmark	8.9	7.3	5.9	2.4	-1.1	-1.4	5.4	4.9	4.6	3.9	5.4	5.4
Latvia	-1.8	-2.3	-2.5	-4.1	-5.1	-4.1	-1.3	-1.4	-1.4	-1.7	-0.7	-0.5
Lithuania	-1.5	-1.9	-2.4	-3.3	-4.3	-4.2	-0.8	-0.3	-0.6	-1.0	-0.7	-0.6
Hungary	-2.9	-3.2	-2.6	-2.5	-0.2	-0.6	3.3	4.8	4.6	3.8	5.8	6.0
Poland	-5.1	-4.6	-2.2	-5.5	-12.3	-17.8	-3.1	-5.5	-7.9	-10.1	-4.5	-6.4
Romania	-4.0	-5.3	-7.8	-11.8	-17.9	-19.0	-6.7	-5.6	-5.6	-6.9	-6.3	-6.9
Sweden	18.2	20.4	17.9	18.2	15.6	12.8	10.3	12.2	12.3	11.8	10.6	11.0
United Kingdom	-70.2	-89.8	-100.3	-111.9	-131.2	-117.1	-92.5	-108.9	-111.4	-107.2	-105.7	-113.8
EU	73.6	49.6	-9.6	-68.5	-85.5	-135.4	-23.9	-39.1	-5.4	7.0	-18.5	-4.4
EU, adjusted ¹	:	-41.8	-97.0	-163.3	-154.9	-217.5	-84.4	-99.6	-66.0	-53.6	-104.1	-89.9
USA	-497.3	-551.0	-644.8	-685.6	-613.0	-582.1	-377.2	-525.6	-576.8	-615.7	-488.4	-507.4
Japan	91.4	103.5	75.5	64.8	76.4	26.6	31.2	67.6	61.4	63.3	39.5	31.7

¹ See note 8 on concepts and sources.

TABLE 52 : Current account balance (in billions of euro, 2003-2012)

15.11.2010

								Autumn 2010 forecast			Spring 2010 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	15.4	13.0	9.8	10.9	13.2	3.8	6.8	5.9	7.3	7.7	10.4	11.7
Germany	44.5	106.5	117.3	153.6	185.9	167.0	120.0	119.5	119.7	115.4	117.4	121.3
Estonia	-1.0	-1.1	-1.1	-2.1	-2.7	-1.4	0.6	0.6	0.2	0.1	0.7	0.5
Ireland	1.2	-0.2	-4.9	-6.6	-10.4	-10.2	-4.8	-1.7	2.3	4.4	-1.5	-1.1
Greece	-21.2	-19.4	-20.9	-26.9	-35.4	-38.7	-32.6	-24.4	-18.1	-14.9	-24.4	-20.7
Spain	-31.6	-49.5	-67.8	-88.9	-105.3	-104.9	-58.0	-50.7	-40.7	-40.1	-48.1	-48.3
France	3.9	-9.7	-30.8	-33.0	-42.0	-52.9	-54.4	-64.0	-67.4	-73.7	-64.8	-73.5
Italy	-12.0	-7.6	-17.1	-29.5	-28.1	-48.7	-48.0	-49.7	-42.3	-39.1	-50.3	-47.2
Cyprus	-0.3	-0.6	-0.8	-1.0	-1.9	-3.0	-1.4	-1.1	-1.0	-1.0	-1.2	-1.3
Luxembourg	2.1	3.3	3.5	3.5	3.8	2.1	2.5	3.4	4.0	4.4	0.3	0.6
Malta	-0.1	-0.3	-0.4	-0.5	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.3	-0.3
Netherlands	29.2	42.2	38.4	48.7	48.1	28.6	19.4	30.7	41.0	49.0	34.7	38.5
Austria	3.9	5.2	5.3	8.5	10.9	10.4	7.1	8.5	10.1	12.2	8.7	12.0
Portugal	-9.6	-12.3	-15.9	-17.2	-17.2	-21.4	-17.4	-18.4	-13.8	-11.8	-16.9	-17.1
Slovenia	-0.2	-0.7	-0.5	-0.7	-1.6	-2.5	-0.5	-0.2	-0.2	-0.3	-0.5	-0.6
Slovakia	-1.9	-2.3	-3.3	-3.7	-2.8	-4.4	-2.0	-1.9	-1.4	-1.3	-3.0	-2.9
Finland	7.4	9.6	5.5	7.7	7.6	6.4	2.1	2.3	2.9	2.7	1.9	2.3
Euro area	29.8	76.0	16.2	22.9	21.6	-70.3	-60.9	-41.8	2.4	13.7	-36.9	-25.7
Euro area, adjusted ¹	:	:	:	:	:	:	:	:	:	:	:	:
Bulgaria	-1.0	-1.3	-2.5	-4.6	-6.2	-7.3	-3.4	-1.2	-0.9	-0.9	-2.1	-1.9
Czech Republic	-5.3	-4.8	-1.7	-2.4	-3.3	-1.2	-1.7	-2.7	-2.4	-1.7	-0.5	-2.3
Denmark	6.5	5.9	9.0	6.5	3.1	6.2	9.8	10.5	10.3	10.0	9.0	8.7
Latvia	-0.8	-1.4	-1.6	-3.6	-4.7	-3.0	1.6	0.7	-0.1	-0.6	1.4	0.8
Lithuania	-1.1	-1.4	-1.5	-2.5	-4.3	-4.2	-0.1	0.7	0.4	0.3	0.7	0.5
Hungary	-6.2	-7.8	-7.3	-6.9	-7.1	-7.4	-0.4	0.8	0.4	-0.5	-0.2	-0.3
Poland	-3.3	-8.4	-2.9	-8.3	-15.8	-17.3	-5.9	-9.7	-12.7	-15.1	-10.1	-12.7
Romania	-2.6	-3.5	-7.1	-10.4	-17.0	-16.0	-5.2	-6.7	-7.1	-8.5	-5.5	-7.6
Sweden	19.2	19.7	21.1	25.2	29.0	29.6	20.9	23.0	24.5	23.9	19.9	21.1
United Kingdom	-26.5	-36.7	-48.0	-65.9	-53.3	-29.9	-19.8	-37.6	-27.1	-3.4	-30.2	-33.5
EU	8.8	36.2	-26.4	-50.1	-58.0	-120.8	-65.0	-64.1	-12.3	17.1	-54.4	-52.8
EU, adjusted ¹	:	-35.7	-83.5	-139.6	-125.9	-252.2	-117.2	-116.3	-64.5	-35.0	-171.0	-169.4
USA	-456.3	-502.7	-595.4	-636.1	-523.4	-457.1	-273.0	-377.7	-435.3	-475.8	-403.6	-417.1
Japan	120.4	138.6	133.4	136.0	153.8	108.2	126.1	157.6	158.4	162.5	116.1	98.2

¹ See note 8 on concepts and sources.

TABLE 53 : Export markets (a) (percentage change on preceding year, 2003-2012)

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								Autumn 2010 forecast			Spring 2010 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	:	:	6.1	8.8	5.3	2.1	-10.6	10.2	6.2	6.4	5.0	5.2
Germany	:	:	6.2	8.7	6.8	2.2	-11.7	10.1	6.3	6.4	5.6	5.2
Estonia	:	:	9.7	10.0	9.3	1.8	-17.7	9.1	6.4	6.2	4.9	5.4
Ireland	:	:	5.7	8.3	4.1	1.2	-11.5	10.7	6.5	6.4	6.2	5.2
Greece	:	:	6.5	8.7	5.7	1.7	-12.4	9.9	6.3	6.3	5.5	5.3
Spain	:	:	5.6	8.3	5.0	1.9	-10.6	9.4	5.5	5.9	5.0	4.9
France	:	:	6.0	8.6	5.9	1.8	-11.1	10.0	6.1	6.4	5.4	5.2
Italy	:	:	6.7	9.2	6.6	2.7	-11.0	9.8	6.2	6.4	5.2	5.2
Cyprus	:	:	8.3	10.8	6.7	2.2	-13.6	6.9	5.0	5.6	3.1	3.7
Luxembourg	:	:	5.3	7.9	4.9	1.6	-11.2	9.6	5.8	6.1	4.4	4.8
Malta	:	:	6.4	8.6	5.2	1.8	-11.7	9.9	6.4	6.4	6.0	5.6
Netherlands	:	:	5.8	8.8	5.5	2.3	-11.2	10.2	6.2	6.4	5.1	5.1
Austria	:	:	6.0	10.0	6.8	2.8	-11.5	11.1	6.6	6.9	5.2	5.3
Portugal	:	:	6.2	8.7	5.5	0.9	-12.6	8.9	5.2	5.7	4.3	4.5
Slovenia	:	:	5.5	9.3	7.3	2.7	-13.1	8.7	6.0	6.4	4.3	4.9
Slovakia	:	:	5.9	10.8	8.3	3.2	-12.3	10.6	6.5	6.9	5.0	5.4
Finland	:	:	8.4	10.6	8.7	3.6	-12.2	11.6	7.0	6.8	6.4	5.6
Euro area (b)	:	:	6.1	8.8	6.1	2.2	-11.3	10.1	6.2	6.4	5.3	5.2
Bulgaria	:	:	6.6	9.4	8.5	2.4	-12.8	8.2	5.1	5.9	4.1	4.9
Czech Republic	:	:	6.5	10.8	7.0	3.2	-12.3	10.9	6.5	6.9	5.1	5.2
Denmark	:	:	7.0	8.8	6.4	2.4	-11.4	10.5	6.6	6.4	6.1	5.8
Latvia	:	:	9.1	11.8	8.9	3.8	-17.0	10.4	6.6	6.5	5.0	5.1
Lithuania	:	:	10.2	12.0	11.1	2.5	-16.6	10.5	6.2	6.4	5.2	5.0
Hungary	:	:	6.2	10.2	7.8	3.5	-12.5	10.6	6.2	6.6	5.1	5.2
Poland	:	:	7.3	10.5	8.0	3.5	-12.4	10.7	6.2	6.5	5.3	5.1
Romania	:	:	5.6	8.4	7.0	1.7	-12.4	9.2	5.8	6.2	4.9	5.1
Sweden	:	:	7.5	9.0	5.9	2.3	-11.9	9.0	6.1	6.1	5.7	5.4
United Kingdom	:	:	6.5	7.8	6.2	1.6	-11.1	10.0	6.1	6.2	5.7	5.5
EU (b)	:	:	6.3	8.8	6.2	2.2	-11.5	10.1	6.2	6.4	5.4	5.2
USA	:	:	6.7	8.2	7.2	3.5	-11.2	12.6	7.1	6.9	8.5	6.7
Japan	:	:	7.2	8.8	7.7	3.7	-9.0	14.9	8.6	8.1	10.6	7.0

(a) Imports of goods and services to the various markets (incl. EU-markets) weighted according to their share in country's exports of goods and services.

(b) Intra- and extra-EU trade.

TABLE 54 : Export performance (a) (percentage change on preceding year, 2003-2012)

								Autumn 2010 forecast			Spring 2010 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2010	2011
Belgium	:	:	-1.4	-3.4	-0.9	-0.4	-1.1	-0.5	-0.5	-0.4	-0.7	-0.9
Germany	:	:	1.4	4.0	0.8	0.3	-2.9	4.1	0.3	0.2	0.6	0.3
Estonia	:	:	8.1	-3.0	-7.2	-1.4	-1.2	4.9	0.2	0.2	1.5	0.6
Ireland	:	:	-0.5	-3.2	3.9	-2.0	8.3	-4.5	-1.9	-1.8	-4.0	-0.9
Greece	:	:	-3.8	-3.1	0.1	2.3	-8.8	-8.5	-1.1	-0.3	-2.7	-1.1
Spain	:	:	-2.9	-1.5	1.6	-2.9	-1.1	-0.2	0.1	-0.3	-0.5	-0.2
France	:	:	-2.7	-3.5	-3.2	-2.2	-1.4	-0.5	-0.2	-0.2	-0.7	-0.1
Italy	:	:	-5.3	-2.7	-1.9	-6.4	-9.1	-1.7	-0.6	-0.7	-1.7	-1.0
Cyprus	:	:	-3.2	-6.6	-0.6	-4.2	2.0	-3.1	-1.4	-1.7	-2.4	-0.4
Luxembourg	:	:	-0.8	4.7	4.0	4.9	3.4	0.3	1.7	0.0	-1.5	0.1
Malta	:	:	-5.5	1.7	-2.4	-4.7	4.6	8.3	-0.1	-0.2	-1.5	-1.4
Netherlands	:	:	0.2	-1.4	0.8	0.5	3.7	0.3	-0.1	0.6	0.9	0.2
Austria	:	:	1.3	-2.1	1.7	-1.8	-5.2	-1.8	-0.3	-0.4	-1.0	-0.4
Portugal	:	:	-4.0	2.7	2.0	-1.2	0.9	0.2	0.4	0.7	-0.5	-0.1
Slovenia	:	:	4.8	3.0	6.0	0.6	-5.3	-0.5	-0.1	0.8	0.1	0.0
Slovakia	:	:	3.8	9.2	5.5	-0.1	-4.2	3.7	1.3	1.0	0.8	0.5
Finland	:	:	-1.3	1.4	-0.5	2.6	-9.2	-4.5	-0.8	-1.9	-1.4	1.2
Euro area (b)	:	:	-1.0	-0.2	0.2	-1.2	-2.2	0.5	-0.1	-0.1	:	:
Bulgaria	:	:	1.8	37.7	-2.2	0.6	2.8	2.3	0.5	0.3	0.3	0.4
Czech Republic	:	:	4.8	4.5	7.5	2.7	1.8	1.0	0.8	0.7	1.3	0.9
Denmark	:	:	1.0	0.2	-4.0	0.0	1.3	-3.8	-1.5	-0.8	-1.3	-0.6
Latvia	:	:	10.2	-4.7	1.0	-1.7	3.5	-1.6	-0.6	-0.1	1.0	0.9
Lithuania	:	:	6.8	0.0	-7.3	8.8	4.6	0.6	0.1	0.2	0.8	0.5
Hungary	:	:	4.8	7.7	7.8	2.2	3.4	2.6	2.6	3.2	1.5	3.3
Poland	:	:	0.6	3.7	1.0	3.4	6.4	-0.7	0.7	1.2	0.7	0.7
Romania	:	:	1.9	1.9	0.8	6.5	7.9	7.3	0.2	-0.1	0.6	1.3
Sweden	:	:	-0.8	0.0	-0.2	-0.8	-0.6	1.7	0.8	-0.2	-1.7	1.2
United Kingdom	:	:	1.3	3.0	-8.3	-0.6	0.0	-4.1	2.1	2.5	-0.5	-0.1
EU (b)	:	:	-0.4	0.6	-0.7	-0.7	-1.2	0.1	0.2	0.3	-0.4	0.0
USA	:	:	0.0	0.7	2.0	2.4	1.9	-0.7	1.2	0.5	2.6	1.3
Japan	:	:	-0.2	0.8	0.7	-2.0	-16.3	8.5	-3.5	-2.8	9.9	0.7

(a) Index for exports of goods and services divided by an index for growth of markets.

(b) Intra- and extra-EU trade.

TABLE 55 : World GDP, volume (percentage change on preceding year, 2005-2012)

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	(a)	2005	2006	2007	2008	2009	Autumn 2010 forecast			Spring 2010 forecast	
							2010	2011	2012	2010	2011
EU	21.4	2.0	3.2	3.0	0.5	-4.2	1.8	1.7	2.0	1.0	1.7
Euro area	15.3	1.7	3.0	2.9	0.4	-4.1	1.7	1.5	1.8	0.9	1.5
Belgium	0.6	1.7	2.7	2.9	1.0	-2.8	2.0	1.8	2.0	1.3	1.6
Bulgaria	0.1	6.4	6.5	6.4	6.2	-4.9	-0.1	2.6	3.8	0.0	2.7
Czech Republic	0.2	6.3	6.8	6.1	2.5	-4.1	2.4	2.3	3.1	1.6	2.4
Denmark	0.4	2.4	3.4	1.6	-1.1	-5.2	2.3	1.9	1.8	1.6	1.8
Germany	4.4	0.8	3.4	2.7	1.0	-4.7	3.7	2.2	2.0	1.2	1.6
Estonia	0.0	9.4	10.6	6.9	-5.1	-13.9	2.4	4.4	3.5	0.9	3.8
Ireland	0.3	6.0	5.3	5.6	-3.5	-7.6	-0.2	0.9	1.9	-0.9	3.0
Greece	0.4	2.3	4.5	4.3	1.3	-2.3	-4.2	-3.0	1.1	-3.0	-0.5
Spain	1.9	3.6	4.0	3.6	0.9	-3.7	-0.2	0.7	1.7	-0.4	0.8
France	3.5	1.9	2.2	2.4	0.2	-2.6	1.6	1.6	1.8	1.3	1.5
Italy	2.8	0.7	2.0	1.5	-1.3	-5.0	1.1	1.1	1.4	0.8	1.4
Cyprus	0.0	3.9	4.1	5.1	3.6	-1.7	0.5	1.5	2.2	-0.4	1.3
Latvia	0.0	10.6	12.2	10.0	-4.2	-18.0	-0.4	3.3	4.0	-3.5	3.3
Lithuania	0.0	7.8	7.8	9.8	2.9	-14.7	0.4	2.8	3.2	-0.6	3.2
Luxembourg	0.1	5.4	5.0	6.6	1.4	-3.7	3.2	2.8	3.2	2.0	2.4
Hungary	0.2	3.2	3.6	0.8	0.8	-6.7	1.1	2.8	3.2	0.0	2.8
Malta	0.0	4.0	3.6	3.7	2.6	-2.1	3.1	2.0	2.2	1.1	1.7
Netherlands	1.0	2.0	3.4	3.9	1.9	-3.9	1.7	1.5	1.7	1.3	1.8
Austria	0.5	2.5	3.6	3.7	2.2	-3.9	2.0	1.7	2.1	1.3	1.6
Poland	0.6	3.6	6.2	6.8	5.1	1.7	3.5	3.9	4.2	2.7	3.3
Portugal	0.3	0.8	1.4	2.4	0.0	-2.6	1.3	-1.0	0.8	0.5	0.7
Romania	0.2	4.2	7.9	6.3	7.3	-7.1	-1.9	1.5	3.8	0.8	3.5
Slovenia	0.1	4.5	5.9	6.9	3.7	-8.1	1.1	1.9	2.6	1.1	1.8
Slovakia	0.1	6.7	8.5	10.5	5.8	-4.8	4.1	3.0	3.9	2.7	3.6
Finland	0.3	2.9	4.4	5.3	0.9	-8.0	2.9	2.9	2.3	1.4	2.1
Sweden	0.5	3.2	4.3	3.3	-0.4	-5.1	4.8	3.3	2.3	1.8	2.5
United Kingdom	2.8	2.2	2.8	2.7	-0.1	-5.0	1.8	2.2	2.5	1.2	2.1
Candidate countries	1.4	8.0	6.7	4.8	0.8	-4.8	6.3	5.1	4.3	4.1	4.2
- Croatia	0.1	4.2	4.7	5.5	2.4	-5.8	-1.8	1.5	2.1	-0.5	2.0
- Turkey	1.3	8.4	6.9	4.7	0.7	-4.7	7.5	5.5	4.5	4.7	4.5
- The former Yugoslav Republic of Macedonia	0.0	4.4	5.0	6.1	5.0	-0.9	1.3	2.2	2.5	1.3	2.0
- Iceland	0.0	7.5	4.6	6.0	1.0	-6.8	-3.5	0.7	2.1	-1.1	1.9
Potential candidates	0.1	5.0	5.5	6.7	6.0	-1.9	1.9	3.4	3.7	2.0	3.2
USA	20.7	3.1	2.7	1.9	0.0	-2.7	2.7	2.1	2.5	2.8	2.5
Japan	6.0	1.9	2.0	2.4	-1.2	-5.2	3.5	1.3	1.7	2.1	1.5
Canada	1.9	3.0	2.9	2.5	0.4	-2.7	3.0	2.3	2.8	2.9	3.1
Norway	0.4	2.7	2.3	2.7	0.8	-1.4	1.9	2.1	2.2	1.6	2.1
Switzerland	0.5	2.6	3.6	3.6	1.9	-1.9	2.6	1.8	2.0	1.6	2.2
Australia	1.2	3.0	3.3	3.7	3.0	3.0	3.1	3.8	3.1	3.2	3.5
New Zealand	0.2	3.0	1.8	3.1	-1.0	-1.6	2.6	3.7	3.3	2.5	3.1
Advanced economies	53.6	2.6	2.9	2.6	0.2	-3.5	2.6	2.0	2.3	2.0	2.1
CIS	4.3	6.0	7.7	7.8	4.9	-7.0	3.7	4.1	4.2	3.7	4.2
- Russia	3.1	6.4	7.7	8.1	5.6	-7.9	3.5	3.8	4.0	3.7	4.0
- Other	1.2	4.9	7.7	7.2	3.3	-4.9	4.3	4.7	4.6	3.6	4.8
MENA	5.0	5.3	5.7	5.6	4.8	2.1	3.8	4.0	4.0	4.2	5.3
Asia	26.0	8.3	9.1	9.8	6.5	5.8	8.5	7.6	7.5	8.2	7.5
- China	12.7	10.4	11.7	13.0	9.0	8.7	10.5	9.2	8.9	10.3	9.4
- India	5.1	9.5	9.7	9.2	6.7	7.4	8.5	8.3	7.8	8.1	8.0
- Hong Kong	0.4	7.1	7.0	6.4	2.2	-2.8	6.4	6.5	8.1	6.8	4.9
- Korea	2.0	4.0	5.2	5.1	2.2	0.2	6.1	4.5	4.5	5.0	4.7
- Indonesia	1.4	5.7	5.5	6.4	6.0	4.5	6.0	6.1	6.2	5.4	4.9
Latin America	8.6	4.7	5.6	5.8	4.2	-1.9	5.6	4.0	4.2	4.2	4.0
- Brazil	2.9	3.2	4.0	6.1	5.1	-0.2	7.4	4.8	5.1	5.7	4.5
- Mexico	2.1	3.3	5.0	3.4	1.3	-6.5	4.8	3.6	4.0	4.0	4.2
Sub-Saharan Africa	2.5	6.0	6.7	6.9	5.6	2.1	5.0	5.5	6.0	4.7	5.9
Emerging and developing economies	46.4	7.0	7.8	8.3	5.7	2.6	6.8	6.1	6.1	6.3	6.2
World	100.0	4.6	5.2	5.2	2.8	-0.7	4.5	3.9	4.0	4.0	4.0
World excluding EU	78.6	5.4	5.8	5.8	3.4	0.3	5.3	4.5	4.6	4.8	4.6
World excluding euro area	84.7	5.2	5.7	5.7	3.2	0.0	5.1	4.4	4.5	4.6	4.5

(a) Relative weights in %, based on GDP (at constant prices and PPS) in 2009.

TABLE 56 : World exports of goods and services, volume (percentage change on preceding year, 2005-2012)

15.11.2010

	(a)	2005	2006	2007	2008	2009	Autumn 2010 forecast			Spring 2010 forecast	
							2010	2011	2012	2010	2011
EU (b)	38.8	5.8	9.4	5.5	1.5	-12.5	10.2	6.4	6.7	5.0	5.2
Euro area (b)	29.4	5.1	8.6	6.3	1.0	-13.2	10.7	6.1	6.3	4.9	5.0
Candidate countries	1.1	7.3	6.7	6.9	2.4	-7.0	4.4	5.8	6.0	4.3	5.7
- Croatia	0.1	3.7	6.5	4.3	1.7	-16.2	5.1	3.8	4.2	2.4	2.5
- Turkey	0.9	7.9	6.6	7.3	2.7	-5.4	5.1	6.7	7.1	5.7	7.2
- The former Yugoslav Republic of Macedonia	0.0	13.4	8.2	11.8	-6.3	-8.8	13.2	5.9	6.5	5.5	7.0
- Iceland	0.0	7.5	-4.6	17.7	7.1	7.4	2.0	2.4	3.0	0.8	0.9
USA	10.2	6.7	9.0	9.3	6.0	-9.5	11.8	8.4	7.4	11.3	8.1
Japan	4.1	7.0	9.7	8.4	1.6	-23.9	24.7	4.8	5.1	21.5	7.7
Canada	2.5	1.9	0.8	1.1	-4.7	-14.1	7.2	6.0	7.1	7.4	5.3
Norway	1.0	1.1	0.0	2.3	1.0	-4.0	1.3	1.6	1.5	2.6	3.1
Switzerland	1.7	7.8	10.3	9.6	3.3	-8.7	10.7	3.5	5.1	1.7	3.4
Australia	1.2	3.1	2.6	3.2	0.7	-1.0	6.3	5.5	5.8	7.6	8.2
New Zealand	0.2	-6.6	9.0	-6.9	22.2	-8.8	12.2	6.1	4.7	2.5	4.4
Advanced economies	60.9	5.8	8.7	6.1	2.1	-12.3	11.0	6.4	6.5	7.2	5.8
CIS	3.3	4.1	6.5	5.1	9.9	-15.4	4.5	4.3	4.1	3.5	2.4
- Russia	2.2	6.5	7.3	6.3	0.6	-4.7	5.1	4.9	4.5	3.5	2.0
- Other	1.1	-0.8	5.0	2.7	29.0	-37.4	3.4	3.2	3.2	3.5	3.2
MENA	5.5	11.8	5.7	7.2	13.3	-5.7	2.2	4.5	4.9	2.9	5.3
Asia	23.2	12.1	12.8	20.2	9.1	-16.1	16.9	10.0	8.8	11.1	8.0
- China	8.6	15.1	17.2	36.9	11.9	-22.3	22.3	11.6	9.5	12.3	8.4
- India	1.6	20.9	21.6	8.3	26.8	-21.9	18.0	12.4	8.6	14.4	11.0
- Hong Kong	2.6	10.8	9.3	8.1	2.4	-12.3	13.4	9.5	8.8	9.0	7.8
- Korea	2.8	8.2	12.2	11.7	13.3	0.5	15.2	8.8	8.8	10.4	8.3
- Indonesia	0.9	60.9	7.3	6.6	11.0	-17.7	12.0	7.3	5.8	9.1	5.8
Latin America	5.2	8.5	7.8	7.0	1.4	-5.7	13.7	7.5	7.4	9.3	6.2
- Brazil	1.2	4.3	6.1	8.5	3.1	-0.6	13.5	9.4	8.7	8.6	6.2
- Mexico	1.6	6.0	11.0	6.0	-1.2	-10.3	14.9	6.1	6.9	9.6	5.9
Sub-Saharan Africa	1.8	24.6	1.0	6.3	16.6	-34.1	11.7	7.2	6.6	9.6	5.8
Emerging and developing economies	39.1	11.5	10.0	14.7	9.1	-14.0	13.1	8.3	7.6	8.7	6.7
World	100.0	8.0	9.2	9.5	4.8	-12.9	11.8	7.2	6.9	7.8	6.2
World excluding EU	61.2	9.4	9.1	12.0	7.0	-13.2	12.9	7.6	7.1	9.6	6.8
World excluding euro area	70.6	9.2	9.5	10.9	6.5	-12.8	12.3	7.6	7.2	9.0	6.7

(a) Relative weights in %, based on exports of goods and services (at current prices and current exchange rates) in 2009.

(b) Intra- and extra-EU trade.

TABLE 57 : Export shares in EU trade (goods only - 2009)

	Candidate		Other advanced					Rest			Latin		Sub	
	EU	countries	USA	Japan	economies	China	Asia	CIS	MENA	America	Africa	World		
EU	66.5	1.7	6.4	1.2	5.6	2.7	4.4	2.8	4.8	2.2	1.7	100		
Belgium	77.0	1.0	4.8	0.7	2.8	1.7	4.3	1.1	3.5	1.3	1.6	100		
Bulgaria	67.9	10.7	1.7	0.3	1.8	1.2	3.5	6.1	4.5	0.6	1.7	100		
Czech Republic	84.5	1.3	1.7	0.4	2.7	0.8	1.6	3.4	2.1	1.0	0.5	100		
Denmark	67.3	1.1	6.3	2.2	9.4	2.4	4.0	2.0	2.5	2.0	0.6	100		
Germany	62.2	1.7	6.6	1.4	7.1	4.8	5.2	3.3	3.9	2.4	1.2	100		
Estonia	71.1	1.3	3.2	0.7	5.3	0.9	1.2	11.1	1.3	0.4	3.4	100		
Ireland	60.0	0.7	20.6	2.8	5.8	2.0	3.9	0.5	1.8	1.1	0.7	100		
Greece	66.2	8.6	4.9	0.3	3.7	0.8	2.4	3.1	7.6	1.0	1.6	100		
Spain	70.3	1.9	3.8	0.9	3.5	1.5	2.6	1.3	7.3	5.3	1.6	100		
France	61.6	1.6	6.4	1.6	5.3	2.4	5.6	1.9	8.3	2.4	2.9	100		
Italy	56.7	2.8	6.4	1.4	7.4	2.5	5.2	3.3	9.5	3.2	1.7	100		
Cyprus	74.6	0.2	1.9	0.8	1.1	0.9	4.9	3.4	10.3	0.2	1.8	100		
Latvia	68.4	0.7	1.7	0.5	3.3	0.3	2.8	15.4	5.5	0.8	0.6	100		
Lithuania	64.6	0.8	3.6	0.2	4.3	0.2	1.7	21.3	1.6	0.4	1.3	100		
Luxembourg	86.8	0.8	2.3	0.2	3.6	1.0	1.3	0.9	1.7	0.8	0.5	100		
Hungary	79.4	2.7	2.6	0.7	2.4	1.7	1.4	5.6	2.5	0.6	0.5	100		
Malta	46.0	3.6	7.3	3.6	1.7	3.9	22.6	0.5	7.5	1.4	1.8	100		
Netherlands	78.0	1.0	3.8	0.7	3.3	1.4	3.5	1.6	3.1	1.5	2.0	100		
Austria	71.4	2.0	4.4	0.9	7.2	2.2	3.4	3.3	2.8	1.7	0.8	100		
Poland	79.8	1.7	1.8	0.3	3.4	1.2	1.3	7.3	1.7	0.7	0.7	100		
Portugal	73.9	0.9	3.7	0.4	2.2	0.8	1.1	0.5	3.3	2.9	10.2	100		
Romania	73.1	6.3	1.6	0.4	2.6	0.9	2.2	5.8	5.5	0.9	0.7	100		
Slovenia	74.7	9.5	1.6	0.1	1.9	0.5	1.5	6.1	3.2	0.5	0.3	100		
Slovakia	85.8	2.2	1.2	0.2	2.0	1.6	0.8	4.7	0.9	0.5	0.3	100		
Finland	56.0	1.4	7.1	1.7	6.4	4.4	5.3	9.6	3.7	3.1	1.4	100		
Sweden	59.1	1.7	6.4	1.3	12.5	3.4	5.1	2.1	4.1	2.3	2.0	100		
Unifed Kingdom	55.3	1.1	14.2	1.5	6.9	2.4	7.0	1.3	5.8	2.0	2.5	100		

TABLE 58 : World imports of goods and services, volume (percentage change on preceding year, 2005-2012)

15.11.2010

	(a)	2005	2006	2007	2008	2009	Autumn 2010 forecast			Spring 2010 forecast	
							2010	2011	2012	2010	2011
EU (b)	38.7	6.2	9.4	5.7	1.1	-12.4	9.1	5.4	6.1	3.5	4.6
Euro area (b)	29.0	5.8	8.5	5.8	0.8	-12.0	8.8	5.1	6.0	2.9	4.3
Candidate countries	1.2	10.7	7.0	10.2	-2.9	-15.1	10.5	6.1	4.9	7.4	8.1
- Croatia	0.2	3.9	7.4	6.5	3.6	-20.7	-3.7	4.0	4.6	0.2	3.0
- Turkey	1.0	12.2	6.9	10.7	-4.1	-14.4	14.4	6.3	5.0	9.5	9.6
- The former Yugoslav Republic of Macedonia	0.0	8.2	10.1	16.1	0.8	-9.1	5.7	5.6	6.6	4.0	6.1
- Iceland	0.0	29.3	10.4	-0.7	-18.2	-24.1	1.6	3.2	3.1	2.6	3.2
USA	13.0	6.1	6.1	2.7	-2.6	-13.8	14.1	8.0	6.9	10.1	5.7
Japan	4.1	5.8	4.2	1.6	1.2	-16.7	10.9	5.4	4.3	8.2	8.4
Canada	2.7	7.1	4.7	5.8	0.8	-13.5	13.3	6.2	6.1	10.5	7.1
Norway	0.7	8.7	8.4	8.6	4.3	-11.4	-1.0	2.4	2.3	3.4	4.1
Switzerland	1.3	6.6	6.5	6.1	0.3	-5.4	10.1	6.4	6.4	2.3	2.7
Australia	1.3	7.6	7.2	10.6	-7.1	6.3	11.2	8.1	6.6	8.6	8.6
New Zealand	0.2	0.3	10.5	-5.0	14.4	-14.2	13.0	5.8	3.9	5.3	6.7
Advanced economies	63.3	6.3	8.0	5.0	0.2	-12.5	10.4	6.1	6.1	5.7	5.3
CIS	2.9	9.7	15.1	20.2	13.7	-27.0	12.7	6.2	5.7	9.4	3.6
- Russia	1.7	16.6	21.3	26.6	15.2	-30.4	11.8	7.8	7.0	5.7	3.3
- Other	1.2	0.2	6.5	11.3	11.7	-22.2	14.1	3.9	4.0	14.9	4.0
MENA	5.0	13.5	8.1	11.0	12.0	-1.4	3.7	5.8	6.5	4.9	6.7
Asia	21.6	13.3	12.0	8.0	7.7	-14.1	17.8	9.9	9.4	13.6	8.1
- China	7.4	15.0	16.6	11.2	6.3	-17.1	25.8	11.6	10.8	18.0	7.0
- India	1.9	46.6	24.4	12.5	26.7	-27.1	16.1	12.3	12.6	21.0	14.3
- Hong Kong	2.6	7.5	9.2	8.3	1.9	-10.3	13.6	9.0	7.2	8.1	9.2
- Korea	2.6	5.8	9.6	9.7	6.0	-1.1	17.1	9.0	8.4	9.9	8.7
- Indonesia	0.7	23.7	-2.7	5.5	17.3	-13.2	12.5	7.0	6.3	17.0	5.2
Latin America	5.1	6.1	12.0	12.8	5.7	-16.9	17.1	9.6	8.0	10.4	7.5
- Brazil	1.2	-6.1	6.6	15.1	6.9	-10.7	22.5	12.4	8.1	13.3	7.9
- Mexico	1.7	7.4	12.4	7.3	2.1	-17.3	16.1	6.8	6.8	11.0	6.5
Sub-Saharan Africa	2.1	15.7	9.3	8.7	14.0	-21.5	10.1	5.8	3.5	9.4	5.4
Emerging and developing economies	36.7	12.2	11.6	10.1	8.8	-14.2	15.0	8.8	8.2	11.5	7.3
World	100.0	8.5	9.3	6.8	3.3	-13.1	12.1	7.1	6.9	7.7	6.0
World excluding EU	61.3	9.9	9.3	7.6	4.7	-13.6	14.0	8.1	7.3	10.4	6.9
World excluding euro area	71.0	9.5	9.7	7.4	4.4	-13.6	13.3	7.8	7.2	9.7	6.7

(a) Relative weights in %, based on imports of goods and services (at current prices and current exchange rates) in 2009.

(b) Intra- and extra-EU trade.

TABLE 59 : Import shares in EU trade (goods only - 2009)

	Candidate		Other advanced					Rest	Latin			Sub	
	EU	countries	USA	Japan	economies	China	Asia	CIS	MENA	America	Saharan	Africa	World
EU	65.3	1.3	4.8	1.6	5.2	6.0	5.1	4.1	3.1	2.2	1.4	100	
Belgium	71.7	0.7	6.2	2.1	2.9	3.8	4.6	1.6	2.6	2.5	1.1	100	
Bulgaria	63.6	7.5	1.0	0.4	1.5	2.8	1.8	17.4	1.1	2.8	0.3	100	
Czech Republic	79.5	0.6	1.1	1.7	1.7	5.5	3.9	5.5	0.2	0.2	0.1	100	
Denmark	72.0	1.1	3.0	0.5	8.2	6.1	5.1	1.6	0.3	1.8	0.3	100	
Germany	66.4	1.3	4.5	2.0	6.6	6.4	5.1	3.5	1.3	1.9	1.0	100	
Estonia	78.8	0.7	1.5	0.4	2.1	2.5	2.1	10.2	0.1	0.9	0.8	100	
Ireland	68.5	0.6	14.7	1.2	3.8	3.7	4.8	0.2	1.0	1.1	0.5	100	
Greece	66.1	3.3	3.6	1.4	2.4	6.4	8.5	3.0	2.7	2.0	0.6	100	
Spain	63.9	1.2	3.2	1.0	2.8	5.4	4.4	2.4	8.2	4.6	2.9	100	
France	70.5	1.1	4.7	1.1	4.7	4.1	3.5	2.8	4.1	1.3	1.9	100	
Italy	59.0	2.0	3.1	1.2	4.9	6.0	4.4	6.3	9.4	2.4	1.3	100	
Cyprus	68.7	0.8	1.5	2.2	1.4	7.4	4.8	4.0	8.0	0.9	0.3	100	
Latvia	63.8	0.5	1.6	0.2	2.9	2.1	1.8	26.4	0.3	0.2	0.1	100	
Lithuania	60.7	1.0	1.8	0.2	1.4	2.8	2.0	28.8	0.3	1.0	0.1	100	
Luxembourg	75.4	0.1	3.8	0.3	0.9	16.0	2.9	0.1	0.1	0.4	0.1	100	
Hungary	70.1	0.9	1.7	2.5	1.1	8.3	6.7	8.2	0.2	0.4	0.0	100	
Malta	55.9	7.5	2.6	2.2	4.4	9.9	10.0	3.2	0.7	0.4	3.0	100	
Netherlands	49.5	0.8	7.5	2.9	4.5	10.6	8.0	6.2	3.3	4.5	2.2	100	
Austria	80.5	1.4	1.7	0.6	7.2	2.1	2.1	2.4	1.3	0.4	0.3	100	
Poland	74.0	1.0	1.5	0.9	1.8	4.9	4.3	9.5	0.4	1.0	0.5	100	
Portugal	78.3	0.7	1.7	0.6	2.3	2.3	2.4	1.3	3.2	3.2	4.1	100	
Romania	74.5	4.3	1.3	0.5	1.4	4.9	3.0	7.9	1.0	1.0	0.2	100	
Slovenia	76.1	7.2	1.4	0.4	1.7	3.0	4.7	1.1	1.6	2.6	0.2	100	
Slovakia	77.8	0.6	0.5	0.8	0.8	3.4	7.8	7.9	0.3	0.1	0.0	100	
Finland	64.9	0.4	2.4	1.2	3.9	5.4	3.9	15.7	0.3	1.5	0.4	100	
Sweden	70.8	0.8	3.8	1.5	9.0	4.4	3.7	3.4	0.5	1.3	0.9	100	
United Kingdom	54.4	1.4	9.4	2.2	9.8	7.9	7.4	1.7	2.0	2.2	1.7	100	

TABLE 60 : World merchandise trade balances (fob-fob, in billions of US dollar, 2004-2012)

15.11.2010

							Autumn 2010 forecast			Spring 2010 forecast	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2010	2011
EU	61.6	-12.0	-86.0	-117.1	-198.5	-33.2	-52.0	-7.5	9.7	-25.2	-5.9
EU, adjusted ¹	-51.9	-120.6	-204.9	-212.1	-319.0	-117.4	-132.5	-91.7	-74.4	-141.5	-121.4
Euro area	164.3	109.4	66.9	101.1	30.2	82.8	74.2	130.2	148.3	99.3	130.5
Euro area, adjusted ¹	:	:	:	:	:	:	:	:	:	:	:
Candidate countries	-33.2	-42.7	-51.6	-61.8	-68.3	-46.9	-76.1	-96.3	-107.3	-49.7	-59.7
USA	-684.7	-801.9	-860.5	-839.6	-853.7	-524.8	-699.1	-801.8	-855.9	-664.2	-685.1
Japan	128.6	93.9	81.4	104.7	39.0	43.4	89.9	85.4	87.9	53.7	42.7
Norway	32.4	46.8	55.9	53.2	78.6	50.4	59.3	61.5	61.8	59.2	60.5
Switzerland	5.4	2.4	4.0	7.8	13.9	15.4	20.3	21.8	18.6	14.4	13.6
Advanced economies	-458.8	-678.0	-824.7	-827.7	-922.1	-502.9	-652.3	-727.5	-768.4	-577.7	-604.5
CIS	90.9	123.9	142.6	121.9	213.9	103.7	117.6	118.1	121.4	166.1	146.2
- Russia	85.8	118.4	139.3	130.9	177.9	111.1	148.3	149.3	152.9	152.1	137.3
MENA	118.5	212.0	292.8	275.1	409.7	160.5	193.9	272.7	291.7	289.7	306.8
Asia	150.5	213.0	311.2	409.1	338.5	351.0	258.4	259.8	276.8	249.5	277.5
- China	59.0	134.2	217.7	315.4	360.7	249.5	211.2	243.4	265.4	228.6	292.3
Latin America	58.9	81.3	100.1	71.5	45.7	57.1	84.1	78.2	63.0	55.3	50.9
Sub-Saharan Africa	22.2	37.0	47.3	49.1	65.4	21.2	50.8	53.8	75.3	73.8	76.4
Emerging and developing economies	441.1	667.2	893.9	926.8	1073.3	693.6	704.8	782.6	828.3	834.5	857.7
World	-17.7	-10.8	69.3	99.1	151.2	190.7	52.5	55.2	59.9	256.8	253.2

¹ See note 8 on concepts and sources.

TABLE 61 : World current account balances (in billions of US dollar, 2004-2012)

							Autumn 2010 forecast			Spring 2010 forecast	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2010	2011
EU	45.0	-32.9	-62.8	-79.5	-177.2	-90.5	-85.3	-17.1	23.8	-74.0	-71.3
EU, adjusted ¹	-44.4	-103.8	-175.2	-172.4	-369.8	-163.0	-154.6	-89.7	-48.7	-232.6	-228.7
Euro area	94.5	20.1	28.7	29.6	-103.2	-84.7	-55.6	3.3	19.0	-50.2	-34.8
Euro area, adjusted ¹	:	:	:	:	:	:	:	:	:	:	:
Candidate countries	-16.7	-24.8	-35.6	-43.3	-49.6	-17.2	-42.6	-60.0	-70.4	-35.5	-46.7
USA	-624.6	-740.5	-798.3	-716.9	-670.4	-379.7	-502.4	-605.1	-661.5	-548.9	-563.1
Japan	172.2	165.9	170.6	210.7	158.7	175.4	209.7	220.2	225.9	157.9	132.6
Norway	32.9	49.1	58.1	54.8	80.2	49.7	54.2	56.5	56.8	62.0	63.8
Switzerland	43.3	53.5	52.3	39.3	12.3	62.5	51.1	55.7	57.2	35.5	34.2
Advanced economies	-370.9	-560.1	-648.2	-595.5	-696.9	-286.5	-395.0	-431.4	-440.3	-452.5	-507.6
CIS	62.2	86.5	93.7	66.2	98.5	35.0	39.4	40.3	40.7	66.8	40.5
- Russia	59.5	84.6	94.7	77.8	101.8	49.0	77.2	76.7	75.0	59.8	37.4
MENA	89.9	189.2	266.0	239.7	352.3	96.4	84.6	111.9	126.0	130.2	111.2
Asia	170.6	239.4	367.1	512.5	492.8	432.4	293.4	278.6	323.8	347.0	348.7
- China	68.7	160.8	253.3	371.8	436.1	297.1	285.0	325.0	370.0	300.0	340.0
Latin America	22.8	37.5	51.3	15.9	-27.1	-15.9	-27.2	-45.8	-45.9	-37.3	-50.0
Sub-Saharan Africa	2.5	21.8	18.0	1.9	-3.9	-45.7	-2.9	-5.5	14.6	30.1	30.4
Emerging and developing economies	348.0	574.3	796.1	836.1	912.6	502.1	387.3	379.5	459.2	536.9	480.9
World	-22.9	14.2	147.8	240.6	215.7	215.6	-7.7	-51.9	18.8	84.3	-26.7

¹ See note 8 on concepts and sources.

TABLE 62 : Primary commodity prices (in US dollar, percentage change on preceding year, 2004-2012)

SITC Classification							Autumn 2010 forecast			Spring 2010 forecast	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2010	2011
Food (0 + 1)	12.4	4.2	11.4	9.2	20.7	-9.8	16.4	9.7	-3.6	21.0	2.9
Basic materials (2 + 4)	16.9	6.9	31.7	13.4	8.7	-25.3	29.5	1.2	-1.6	24.9	0.4
- of which :											
Agricultures non-food	6.7	-4.5	7.4	16.8	10.9	-15.9	23.2	-2.1	-4.2	19.5	-2.8
- of which :											
Wood and pulp	13.5	3.3	8.5	0.6	3.2	-10.9	7.0	-8.1	-4.3	9.5	-9.1
Minerals and metals	32.2	20.4	54.7	11.1	7.1	-31.4	33.9	4.0	0.4	29.6	3.0
Fuel products (3)	32.3	44.0	19.7	9.0	36.4	-36.5	28.0	10.9	2.0	35.4	6.0
- of which :											
Crude petroleum	33.4	44.7	20.2	9.5	35.9	-37.1	29.0	11.2	2.1	36.3	5.6
Primary commodities											
- Total excluding fuels	14.9	5.7	22.9	11.7	13.3	-19.0	23.5	4.9	-2.5	23.1	1.5
- Total including fuels	27.6	35.9	20.2	9.5	32.2	-33.9	27.2	9.8	1.3	33.1	5.3
Crude petroleum - price per barrel											
Brent (usd)	38.0	55.1	66.2	72.5	98.5	62.0	79.9	88.9	90.8	84.5	89.2
Brent (euro)	30.6	44.3	52.7	52.9	67.2	44.6	60.1	64.0	65.3	62.1	66.1

¹ See note 8 on concepts and sources.

Note on concepts and sources

1. The directorate general for economic and financial affairs (DG ECFIN) produces, under its own responsibility, short-term fully-fledged economic forecasts twice a year : in the spring and in the autumn. These forecasts cover the principal macroeconomic aggregates for the Member States, the candidate countries, the European Union as a whole, the euro area and the international environment. Interim forecasts, updating the outlook for the seven largest Member States, EU and the euro area, are presented in between the fully-fledged forecasts.
2. Data for 2010, 2011 and 2012 are forecasts.
The source for all tables is the European Commission, unless otherwise stated.
Historical data for the Member States are based on the European System of Accounting (ESA 1995). Most Member States have now introduced chain-linking in their national accounts to measure the development of economic aggregates in volume terms. For the USA and Japan the definitions are as in the SNA.
3. Tables 5 and 6 on domestic demand and final demand respectively, present data including inventories.
4. In Tables 16 and 17, the data are based on the national index for USA and Japan, and for EU Member States and aggregates prior to 1996.
5. The potential output gap is calculated with reference to potential output as estimated via a production function, where the increase in the capital stock and the difference between actual unemployment and the NAWRU play a key role.
6. Employment data used in tables 21-25, 27 and 31-32 are based on full-time-equivalents (FTEs), where available. Currently, Germany, Estonia, Spain, France, Italy, Hungary and the Netherlands report FTE data (taken together, these countries represent over 80% of euro-area GDP and more than 60% of EU GDP). In the absence of FTE data, employment is based on numbers of persons. In the calculation of EU and euro-area aggregates, priority is given to FTE data, as this is regarded as more representative of diverse patterns of working time.
7. The nominal short term interest rates are defined as the 3-month inter-bank rates. The nominal long term interest rates are defined as the yield on the central government benchmark 10-year bond. For Estonia, where no appropriate benchmark government bond is available, the indicator provided in Table 34 is a weighted average of MFI interest rates for new EEK-denominated loans to households and non-financial businesses.
8. EU and euro-area data are aggregated using exchange rates. World GDP is aggregated using Purchasing Power Standards (PPS). In the tables on world trade and international payments, the aggregation is carried out on the basis of current exchange rates. Tables 48 - 52, 60 and 61 show also EU and euro-area "adjusted" balances. Theoretically, balances of EU and euro area vis-à-vis third countries should be identical to the sum of the balances of the individual countries in the EU or the euro area. However, intra-EU or intra-euro-area balances are non-zero because of reporting errors. The creation of the internal market in 1993 reduced border controls and formalities, and accordingly the scope and precision of intra-EU trade coverage. Typically, intra-EU imports are underestimated compared to intra-EU exports, leading to an overestimation of the surplus. For the past the "adjusted" balances are Eurostat estimates for EU and ECB estimates for the euro area. For the future, they are ECFIN's forecasts based on the extrapolation of the discrepancies observed in 2009. Given the treatment of Estonia in this edition of the forecast and the lack of ECB's estimates for the EA-17 aggregate, this adjustment is currently unavailable.
9. With respect to the 12 RAMS (recently-acceded Member States), which are currently in a transition phase, the quality of statistical data may not always be directly comparable to most EU15 Member States.
10. Geographical zones are defined as follows :
Euro area :
EA 17 (BE,DE,EE,IE,EL,ES,FR,IT,CY,LU,MT,NL,AT,PT,SI,SK,FI)
Candidate countries :
Croatia, Turkey, the former Yugoslav Republic of Macedonia and Iceland.
Potential candidates :
Albania, Bosnia-Herzegovina, Kosovo, Montenegro and Serbia.
Advanced economies :
EU, candidate countries, USA, Japan, Canada, Norway, Switzerland, Australia and New Zealand.
MENA (Middle East and Northern Africa) :
Algeria, Bahrain, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, and the United Arab Emirates.
Asia :
All countries in that region except Japan and the Asian MENA countries.
Latin America :
All countries in that region.
Sub-Saharan Africa :
All countries in that region except the African MENA countries.