Eurozone

Ernst & Young Eurozone Forecast

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welcome
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The uncertainty continues. While progress in Europe has been made, we have not yet seen the market stability we all desire. With unemployment rising until 2014 and corporate investment to remain below its pre-crisis peak until 2016, business must learn to live with much greater volatility in the global economy than we have known in previous decades. And with the fragility of the global economy causing even rapid-growth economies to slow, the prospect of sustainable recovery remains a distant goal. As you will find in this edition of our forecast, full-blown quantitative easing is one potential solution.

But it's not just about numbers. The 24-hour media cycle pumps out a relentless flow of data about high unemployment and stagnant growth rates, but lying behind those figures are stories of real people struggling with the challenge of making ends meet. In democratic Europe, these people are citizens with votes they can use to express their hopes and frustrations. As memories of the economic prosperity that underpinned the creation of the single currency recede, it's incumbent on policy-makers and business alike to search for the necessary answers and articulate them convincingly to a questioning electorate.

So what's the current state of play? GDP continues to stagnate, falling by 0.2% in Q2, and we continue to forecast a dip of about 0.5% for 2012 as a whole. Hard-pressed consumers have little cash to spare, and spending — already hit by high unemployment — remains limited by the ongoing squeeze on households. Even Germany, which has for so long been the powerhouse, is experiencing headwinds. Despite its recent growth of 0.3% exceeding expectations, indicators suggest the volatility and uncertainty that have scarred the Eurozone could penetrate German borders.

With companies still reluctant to unleash much-needed investment, the corporate world is faring little better. Leaving the corporate cash mountain untouched, however, prolongs the crisis. With the single currency continuing to be of huge benefit to businesses, the time has come for us to put our money where our interests lie.

However it's not all bad news. The slowdown in emerging markets could well persuade investors to look favorably on local investments. The European Central Bank's decision to start a vast bond purchase program has delivered a welcome boost. Policy-makers have also agreed to move toward European bank supervision and permit the European Stability Mechanism (ESM) to inject capital into banks directly. These are welcome developments, but we believe that more institutional reforms are required to deliver a lasting solution.

Although we remain optimistic that the closer banking and fiscal union necessary for the Eurozone's long-term survival will materialize, the time has come for governments to be bold. Innovation is a key word for those with a growth agenda. This relates to areas such as new product development, process improvement and entrepreneurship. Lessons from other parts of the world show that there are measures to take to support all these areas, and thereby create jobs and growth. As we see in our research[1], governments' ability to support entrepreneurial activity is key to increasing productivity. Investments are being made in Europe, but Europe is behind other parts of the world in creating the right environment for entrepreneurship to thrive.

But it's not only up to policy-makers to achieve change. Corporates that manage to adapt to the situation will also find the opportunities to thrive and contribute to growth. They can do this by overhauling their strategic thinking, by serving consumers differently, by managing diverse risks, by coping with austerity in the public sector and, not least, by identifying and targeting opportunities and sectors that will enable them to outperform.

Some five years after the start of the financial crisis, recovery is not assured. That much is certain. But the journey toward deeper integration — and with it a more prosperous future — has started. It's time to pick up the pace.

1 *The power of simplicity*, Ernst & Young, 2012. *G20 Entrepreneurship barometer*, Ernst & Young, 2011.

Contents

Looking beyond uncertainty in an era of rapid change

The near-term prospect of a breakup of the Eurozone appears to have receded. Mario Draghi, Governor of the European Central Bank (ECB), has calmed markets with a promise to buy the bonds of any countries in the 17-nation bloc that get into trouble, depressing yields in Spain and Italy. But companies, and those who invest in them, have no grounds for complacency. Though the prospect of imminent disaster has receded, so too has the prospect of a Eurozone economic recovery.

For economies and companies, uncertainty has become an exhausting enemy. A prolonged slowdown will compound business risks. Already, companies exposed to the euro, and especially the peripheral economies, seek to protect themselves from sudden shocks. They struggle to deal with shifting demand in once-familiar markets. And against a swirling backdrop, they are preparing for a future business environment that will present different challenges and opportunities from those seen in the past.

A shifting outlook: Germany slows and the Eurozone slides

Vanguard companies are resetting their course to navigate deeper currents of rapid change, modified customer behavior and a prolonged period of slow economic growth. That seems wise. For we expect only gradual progress toward the deeper economic integration required to cure the euro's woes. Combine this with austerity measures and credit constraints, and we expect slow policy progress to contribute to a further downturn in economic conditions during the second half of the year. Although Germany and France performed better than expected, Eurozone gross domestic product (GDP) fell 0.2% in the second quarter, after a standstill in the first. We continue to forecast a 0.5% contraction during 2012 as a whole.

The overall trend concealed substantial variation between countries. The Eurozone is no longer a homogenous bloc, but a northern core with a fragmented southern periphery. The German economy grew by 0.3% in the second quarter compared with the first. It beat expectations, but the pace of expansion in Germany — regarded as the engine of growth for the Eurozone economy — slowed from 0.5% in the first quarter.

France too avoided a widely-anticipated contraction, treading water for a third successive quarter. The Netherlands and Austria each achieved growth of 0.2%. But quarter-on-quarter output fell in Italy by 0.7%, by 0.4% in Spain and by 1.0% in Finland, previously a firm member of the "northern club." In Greece, the pain remains all too evident: the economy contracted 6.2% year-on-year, continuing a downtrend that has now lasted for more than four years.

The pattern in the second quarter was therefore one of slowing or stalled growth in the Eurozone core, and continuing contraction on the periphery, triggering an overall retrenchment.

Soft demand: deterring corporate investment

Understanding what is happening, where and why is vital for businesses striving to adapt. Across the Eurozone as a whole, consumer spending will remain under pressure from high and rising unemployment in many countries. Consumers are breaking into two camps: the "haves," with a job and cash to spare, and the "have-nots," who count every euro they spend.

Corporate investment, in the meantime, is being held back by uncertainty over the future of the single currency, sluggish earnings and high funding costs in many countries, plus weak demand in many sectors. De-stocking is likely to accentuate the downturn, as companies seek to clear the increase in inventories that has already built up.

In theory, the weakness of the euro should help exports and encourage import substitution, even as imports ease in response to soft demand. Until recently, many companies exporting beyond the Eurozone continued to prosper. Germany's economic resilience stemmed from competitive costs and from exporting a large proportion of output. But now many export markets in the US, China and emerging economies are weakening, alongside those in the Eurozone. The Ifo Business Climate Index for Germany recorded a fourth monthly fall in August, with export expectations turning slightly negative.[1]

Germany may escape recession, if it is lucky. For companies in most Eurozone countries, however, there seems little prospect of any rapid recovery in overall demand. Deleveraging has much further to go in the Eurozone. Falling demand from governments will hit consumers and companies, perhaps triggering a spiral of retrenchment. Looking further ahead, a reduction in consumer spending due to the number of baby boomers reaching retirement will in turn suppress growth.

1 Ifo Business Climate Index Germany, August 2012, Ifo Institute.

We foresee economic expansion of just 0.1% in 2013 for the Eurozone as a whole. Recovery may follow in 2014, but if so it is likely to remain very anemic. The best hope is that structural changes in peripheral countries will start to bear fruit and result in lower unemployment and a gradual return of confidence.

We believe that companies are becoming reconciled to low growth in the coming 18 months, but have yet to integrate the possibility of a slowdown lasting for the next two to three years.

Adapting to thrive: overhauling strategic thinking

Companies now need to anticipate the consequences of a prolonged slowdown. They need to reassess the demand outlook in national markets within the Eurozone and evaluate how it affects their corporate prospects. What is the right strategic allocation of resources to, and within, the Eurozone in the light of its changing prospects compared with other regions, where growth may also be slowing?

Is a change of business model required? Is the business or asset portfolio appropriate? Asset valuations remain high: if assets are to be sold, will write-downs be required? If the objective is in fact consolidation to bolster market share, what valuations are appropriate?

Strategic directions should reflect long-term prospects. Business plans and budgets should embrace the realities of financing … and risk.

Adapting to thrive: serving consumers differently

Retail and consumer goods companies in the Eurozone are adapting to a burgeoning population of cash-strapped consumers. According to Eurostat, 18 million Eurozone workers lack jobs. The unemployment rate of 11.3% shows a widening gap between the Eurozone and EU as a whole, where the rate is 10.4%. Worst hit is Spain, with 25% of workers unemployed, followed by Greece at 23%. Yet in Austria the unemployment rate is only 4.5%, and in the Netherlands just 5.3%.

But consumer-facing companies are simultaneously wrestling with the effects on consumption patterns of mobile computing and an aging population in an era of accelerating change. Many companies need to speed up efforts to adapt the products they offer, and the way they deliver them.

Around two-thirds of Eurozone consumers now do their shopping on a tighter budget than before. For daily needs, they stick to a shopping list and buy smaller quantities closer to home, paying careful attention to price. The "haves" with job security or healthy incomes may still fill a trolley at the hypermarket, yet may now favor own-brands, or order online. For bigger ticket items, both the "haves" and the "have-nots" can scan goods in-store, compare prices and buy where they are cheapest — increasingly on the internet.

Retailers are therefore experimenting with different formats. Own-label products fight for space (in smaller, more convenient stores) with fewer, more dominant brands. Mid-priced brands and products are being squeezed out.

Preparing the future

Astute consumer products companies are mimicking strategies learned in emerging markets, developing or repackaging products to hit price points that suit smaller spenders, whether families or retirees — especially in southern Europe. Detergents may sell in packs of 5 washes instead of 50. Six-packs are giving way to single cans.

Rather than sacrifice market share, the best branded product companies are resetting their prices at lower price points and striving to retain customers through innovation. To sustain margins, they must focus on continuous operational improvement, harvesting benefits derived from simpler, cheaper packaging and other cost savings.

Looking ahead, successful retailers will be those who anticipate rather than trail shifting consumer needs. Many supermarket chains now have convenient, wide-aisle stores with friendly service catering to the elderly. For the time-pressed they are complementing online ordering with scan-and-shop displays at commuter stations, backed by home delivery or drive-by pickups.

As brands battle for consumer loyalty and the internet becomes central to the purchasing decision, wherever it is made, developing effective dialogue via social media will be essential. And so will the ability to sell online.

In the meantime, with food commodity prices on a long-term upswing, forward-looking manufacturers will seek to secure supply, while bracing for tough battles ahead with retail clients who are reluctant to pass on higher prices to financially-stressed Eurozone consumers.

Adapting to thrive: coping with austerity in the public sector

Austerity is having a big impact on public sector markets, especially in southern Europe. When national or regional governments run out of cash, they often trim purchases and delay payments to suppliers, especially for recurrent expenditure on health care or education, which accounts for a large part of Eurozone public spending.

In health care, the effect on pharmaceutical companies is severe. The European Federation of Pharmaceutical Industries and Associations (EFPIA) has estimated that European states owe €12–€15 billion to the pharmaceutical industry.[2] In addition, Sir Andrew Witty, EFPIA President, wrote in June that "in just five countries (Greece, Ireland, Italy, Portugal and Spain) the pharmaceutical industry has contributed, through price cuts and discounts, more than €7 billion for the years 2010 and 2011."[3] According to him, the price cuts equaled more than 8% of annual industry turnover in these markets.

Suppliers of drugs, medical consumables and energy to health care organizations feel obliged to maintain supply despite payment arrears because refusal could put lives at stake. But even multinationals serving global markets feel the effects of payment delays and price cuts on such a scale. One effect, Sir Andrew warned, was to undermine incentives for innovation and push investment to countries where research and development are welcomed. A second was to promote re-exportation of pharmaceutical products from low-priced to higher-priced countries.

Smaller, local suppliers of goods and services may be still more dependent on troubled public sector clients and have little opportunity to develop complementary private sector markets. They can face severe liquidity problems as a result of cuts in public procurement or payment delays. Reported austerity impacts range from reduced purchases in Catalonia's state schools[4] to the sale of real estate and postponement of infrastructure projects.[5]

Selling property in depressed markets can drive down prices. Delaying building new hospitals, clinics, schools and bridges compounds the difficulties of a Eurozone construction industry already suffering from a sharp fall in private sector demand.

Managing risk: liquidity, leverage and finance

For companies, financial and operational challenges are intensifying. A year ago, many blue chips were enjoying strong revenue and profit performances from activities in, or exports to, emerging markets. As growth softens in Asia and Latin America, that cushion provides less insulation from troubles in the Eurozone.

Today revenues, margins and profits are being squeezed, making companies more vulnerable to external risks. These may include non-payment by customers, or the collapse of a supplier. The logical response is to reinforce liquidity.

A renewed credit crunch remains possible, however, and financing conditions are tightening. Many of Europe's banks are still wrestling with the aftermath of the financial crisis, including consolidation or divestment, restructuring and dealing with portfolios of underperforming loans. They are simultaneously seeking to strengthen their balance sheets to meet tougher capital requirements. Banks' ability to lend is being constrained.

According to a survey by the ECB, on balance 10% of Eurozone banks tightened lending criteria for companies in the second quarter, and 10% were expected to do so in the third. In July, Eurozone banks said demand for loans from enterprises fell 25% in the second quarter, and would fall again in the third. The biggest reason was a steep fall in companies' need to finance fixed investment.[6]

Though companies are finding it harder to borrow from banks, the issue draws limited attention because, with demand slack, companies have less need to borrow. But sooner or later companies will need more working capital to expand output, or to invest in expanding or modernizing capacity.

2 *Recession-hit nations owe pharma firms billions*, Swissinfo.ch, 25 February 2012.
3 EFPIA Letter to European Heads of States and Governments, 20 June 2012.
4 *School lunches fall victim to Spanish austerity*, France24.com, 11 August 2012.
5 *Spanish Budget Cuts Won't Have Lasting Impact, Economist Says*, Bloomberg, 24 August 2012.
6 *The Euro area bank lending survey*, European Central Bank, July 2012.

European companies are behaving cautiously. Some are deleveraging. Others are reinforcing their liquidity by raising extra funds. Many European blue chips are taking advantage of market strength to swap short-term debt for longer-term bonds, often at lower interest rates. During the first half of 2012, bond issuance by European companies matched the value of syndicated loans from banks, with French corporates leading the way. In bond markets, respected companies can often borrow more cheaply than banks.[7]

Small- and medium-sized enterprises (SMEs), which often rely heavily on banks for their funding, cannot easily access capital markets. Prudent managers of small companies will now begin building relationships with alternative lenders. New options are emerging. In one recent development, larger companies with ready access to finance at affordable rates have made loans to smaller key suppliers. Meanwhile some asset managers have set up loan funds to fill the gap left by banks, and this source has the potential for growth.

Managing risk: operating in a fragmented Eurozone

Companies are realizing that they should no longer treat the Eurozone as a homogenous bloc. Northern Europe has low interest rates and an undervalued exchange rate; southern Europe has an overvalued currency and interest rates that are too high. For companies, this creates risk.

Managing risks arising from mismatches between borrowings and assets is an urgent priority. Companies should establish where and in what currency their assets are denominated, and how they could be affected if the country quits the euro.

Some companies are seeking to match local assets and liabilities. One solution is to borrow against assets in high-risk countries, perhaps repatriating cash as an exceptional dividend.

Treasury operations merit close attention. Companies are increasingly striving to maximize liquidity and minimize the amount of cash kept in "at-risk" markets. Solutions may include frequent cash sweeps to withdraw surplus funds from countries where there is a perceived risk of a euro exit. However, resulting receivables in the peripheral country could lead to a taxable currency gain if the country quits the euro: sweeps should be followed by dividend distributions.

Similarly, redenomination of a currency could lead to windfall profits on inventory held in a peripheral country if the new currency depreciates, incurring a tax liability. Supply chain, inventory and related tax issues are coming to the fore. Companies must ask:

- Are business conditions within the Eurozone endangering any of my suppliers? If so, how should I respond?
- Should I develop in-country supply chains in Eurozone countries?
- Should I try to recreate a vertically integrated supply chain?
- Should inventory be owned where currency devaluation is possible, or elsewhere?

Finding the best solutions to customers' needs

Today, within the Eurozone's single market, we see a striking diversity of demand patterns and operating environments. Companies are learning to assess and react to risk — country by country. Astute financial and corporate investors from outside the EU have learned and are applying this lesson, buying loan portfolios and assets in a targeted way.

Companies must now join them in overhauling their long-term Eurozone strategies. They need to adjust to the prospect of a sustained regional downturn, with a slow and anemic recovery, when it comes. They must awaken to country risks. And they need to identify and target opportunities and sectors that will enable them to outperform.

Uncertainty over the future of the euro has tested the Eurozone economy to the limit. Demand has changed in scale, location and nature. Tough times lie ahead. But Europeans, and the companies that serve them, are here to stay. Companies that find the best solutions to the new and future needs of their customers will ultimately win. That ground rule for business success, at least, remains unchanged.

7 *Debt crisis sends European blue-chips to bonds,* Financial Times, 14 August 2012.

German companies stay on track as economy slows

Though Germany's growth is slowing, the corporate sector of what is widely regarded as the "motor" economy of Europe has proved more resilient than widely expected. Mid-market companies with revenues of €500 million to €2.5 billion are the backbone of the German economy. In the last downturn, many saw sales slide by 30% to 50%. But today, though margins are under pressure and some have reported lower profits, they are better equipped to weather the softening of demand that is undoubtedly under way.

Such companies became lean and fit through cost reduction programs, reshaping their supply chains, and enhancing their flexibility and agility. Today, most are continuing both research and development and capital investment.

Generally, companies with strong exposure to emerging markets, such as Germany's automotive champions, are also proving resilient. The exceptions lie in non-cyclical sectors that were spared restructuring pressure in the last downturn but now face structural issues, notably in power generation, pharmaceuticals and retail.

Power companies need to find new sources of revenue to replace nuclear plants threatened with closure and diminished margins on energy trading. Pharmaceutical company margins, in the meantime, are under pressure from increased competition. They must decide whether to focus on more individualized treatments, or instead use their distribution power to become more like consumer products companies, leaving more nimble innovators to develop the drugs of the future.

Today these sectors are belatedly cutting costs and seeking efficiencies. So are some mid-sized retailers that rely mainly on Germany's domestic market. But overall there are few signs that companies are cutting capital spending or economizing on the professional services that they need to continue business development.

Privatization: sell-offs can spur investment

Strategies to resolve the debt crisis in the southern Eurozone draw upon many lessons from the Latin American debt crisis of the 1980s, where the International Monetary Fund (IMF) also required government austerity packages and market liberalization in exchange for bailouts. In Latin America, some governments also used debt for equity schemes to encourage inward investment and a recovery of investor confidence.

In southern Europe, encouraged by the IMF, privatization schemes are part of the drive to enhance competitiveness. These are often overlooked, yet Greece, Spain, Portugal and Ireland have all launched substantial programs to sell state assets.

Such programs typically include the sale of utilities supplying electricity, gas and water; operators of airports, ports and railways; and interests in businesses ranging from airlines, telecoms and lotteries to postal distribution.

Shifting activities like these into the private sector can bring about fundamental changes in their relationship with the state. Strong, independent and fair-minded regulators must be set up to ensure the impartial promotion of competition and to underpin the confidence of investors. If this can be achieved, companies run by private sector managers may be more focused on customer service and cost control, especially if they are also subject to increased competition. Sell-offs can also spur investment by new owners, whether these are national or international companies.

Ireland and Portugal have made good progress with disposals. Spain is reportedly drafting a substantial program despite opposition from trade unions. And in Greece, where earlier plans stalled, Prime Minister Antonis Samaras in August promised a privatization program that would exceed expectations.

According to reports[8] Greece aims to raise €19 billion between 2012 and 2015. Alongside infrastructure facilities, state assets scheduled to be offered for sale include beach-front development sites, a shopping mall and broadcasting center, and a license to run the state lottery

Assets such as these can be attractive to both financial investors and specialist utility companies around the world. However, the Greek disposal program is hindered by excessive bureaucracy, the perceived risk that Greece could leave the euro and uncertainty over future demand levels in the economy.

8 *A renewed focus on privatizations*, Athens News, 10 August 2012


100
index
EUROS
Billion

Highlights

Slow progress on the journey toward deeper integration

- European policy-makers have taken important steps toward breaking the negative feedback loop between banks and sovereigns, but the policy response has nevertheless fallen short of the game-changer needed to restore stability and mitigate downside risks to the economy. Policy uncertainty is still clouding the economic outlook, and the threat of renewed bouts of financial market volatility will persist until leaders agree on a clear road map toward deeper integration. Our forecast assumes that crisis resolution will continue to progress gradually, allowing the Eurozone to "muddle through" in its current form.

- Austerity measures, credit constraints and heightened uncertainty about the future direction of economic policy are expected to contribute to a downturn in economic conditions in the second half of this year. Despite a better-than-expected performance in many countries, Eurozone GDP fell 0.2% in Q2 and we continue to forecast a contraction of about 0.5% in 2012 as a whole.

- Consumer spending will be dampened by high and rising unemployment and stretched household budgets, while corporate investment is held back by uncertainty over the future of the single currency area, sluggish earnings and high funding costs in many countries. Destocking will also weigh upon headline GDP as companies shed the unwanted increase in inventories. On the other hand, the economy should receive a positive boost from net exports, which will benefit from weaker import demand and the lower euro exchange rate.

- The Eurozone will still face significant headwinds next year and, although positive growth should resume, we expect only a marginal 0.1% expansion in 2013 as a whole. As the region's economy rebalances and the process of fiscal tightening starts to ease, we project that growth will pick up to 1.1% in 2014. But slow policy progress and a protracted dampening effect on activity from deleveraging have led us to revise down our medium-term forecast. We now expect GDP growth to remain below 1.5% during 2015–16, having previously expected it to pick up to around 2.0%.

- Given the weakness in economic activity, it is somewhat surprising that inflation has not slowed more abruptly in recent months. In part, this reflects the fact that commodity prices have been more resilient than we had assumed, but it is also linked to the introduction of higher indirect taxes in the peripheral economies. We expect that price pressures will moderate over the coming year as demand remains weak, tax increases drop out of the annual comparison and oil prices decline. We expect headline inflation to fall to 2% by the end of this year, and to continue to trend lower during the first half of 2013.

- Tensions in sovereign debt markets indicate that public finances are not the only concern in the peripheral economies, but divergences in competitiveness are also being taken into account. While the necessary economic adjustments in the periphery are yielding positive results, a return to external and internal balance cannot be achieved without higher consumer spending and inflation in Germany.

- The list of measures required to keep the Eurozone in its current form is long and politically challenging. It includes enlargement of the European Stability Mechanism (ESM), a banking union, progress toward fiscal union and a shift in macro policy so that it is focused less on austerity and more on growth. In addition, Greece's debt will need to be restructured once again to make its interest burden bearable; without this, a Greek exit from the Eurozone will remain a possibility, with painful consequences for other members. It also seems probable that Portugal will require another bailout in the first half of 2013.

- Serious downside risks remain, and a key assumption underlying our baseline forecast is that the ECB embarks upon additional non-conventional policy measures to address difficulties in funding markets and provide governments with more time to introduce the structural reforms needed to put the single currency area on a firmer footing. This is especially necessary given the lengthy decision-making process in the Eurozone, in which several summits and other meetings are usually needed to agree on new measures.

- With many Eurozone economies reporting GDP levels still some way below their pre-crisis peaks, attention is turning to the question of whether these economies have very large output gaps or whether the events of the past five years have caused permanent damage to their potential output growth. In our view, there is likely to have been a permanent loss of output across many economies in the region, with the largest losses coming in countries at the epicenter of the sovereign debt crisis, where severe austerity and sharp increases in unemployment have led to outflows of migrants.

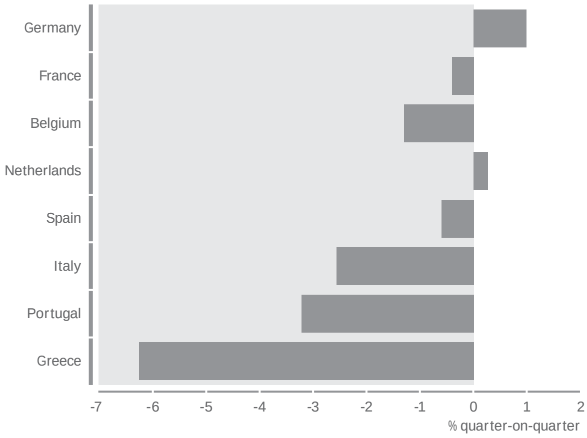
Slow progress on the journey toward deeper integration

The long and winding road to a more federal Europe

European policy-makers made some small but important steps forward during the summer, with an agreement to move toward European bank supervision and allow the ESM to inject capital into banks directly. The ECB announcement of a bond purchase plan has also contributed to a considerable easing of strains in financial markets. These reforms had been identified in our previous forecast as necessary, but not sufficient, to restore stability to the region. On their own, however, these three measures still fall short of the deep institutional reforms that we have for some time argued are necessary to deliver a lasting solution to the crisis.

Figure 1

GDP Q2 2012 growth



Source: Oxford Economics

We remain confident that the crisis will eventually push governments into adopting the bold solutions required to prevent a breakup of the single currency area. But it is likely that such progress will continue to be made in a piecemeal fashion rather than with any sudden breakthrough. The result is that lingering policy uncertainty will continue to cloud the economic environment and fuel renewed bouts of financial market volatility over the coming year. As the peripheral economies gradually regain their competitiveness and the region's economy rebalances, however, signs of recovery should become apparent from 2014.

The Eurozone faces many headwinds ...

After remaining flat in Q1 2012, economic activity in the Eurozone resumed its decline in Q2 with an estimated 0.2% contraction in GDP. The data continued to paint a predictable picture of resilience in Germany and a few other core Eurozone countries, and ongoing deep recession in southern Europe. But more recent sentiment indicators suggest that the German growth engine may also be starting to succumb to the crisis, with a gloomier tone overall from many companies regarding their earnings and sales expectations. Indeed, it is likely that economic conditions in the Eurozone as a whole will deteriorate further in the next few months, as the region bows in the face of multiple headwinds.

Table 1

Forecast of the Eurozone economy (annual percentage changes unless specified)

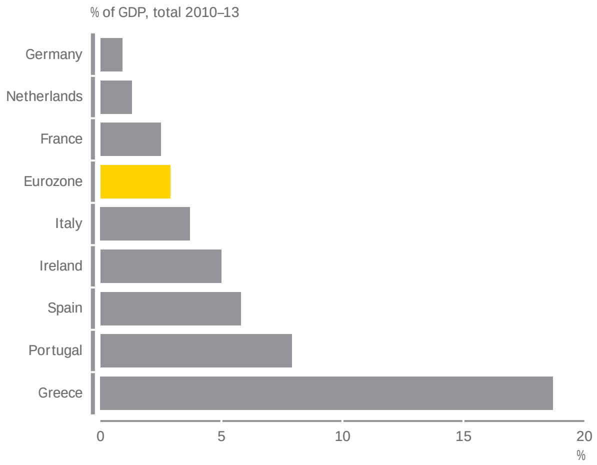
Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	1.5	-0.5	0.1	1.1	1.3	1.4
Private consumption	0.1	-0.8	-0.1	0.7	1.0	1.2
Fixed investment	1.6	-3.1	-0.2	2.3	2.7	2.6
Stockbuilding (% of GDP)	0.4	-0.3	-0.5	-0.4	-0.4	-0.5
Government consumption	-0.1	0.0	-0.7	-0.1	0.4	0.7
Exports of goods and services	6.3	2.7	3.0	4.7	4.7	4.4
Imports of goods and services	4.1	-0.4	2.2	4.5	4.8	4.4
Consumer prices	2.7	2.3	1.7	1.4	1.3	1.3
Unemployment rate (level)	10.2	11.3	12.0	12.0	11.7	11.4
Current account balance (% of GDP)	0.0	0.8	1.1	1.0	0.9	0.9
Government budget (% of GDP)	-4.1	-3.4	-2.5	-1.9	-1.4	-1.0
Government debt (% of GDP)	88.0	91.1	93.1	94.0	94.7	94.6
ECB main refinancing rate (%)	1.2	0.9	0.8	0.8	0.8	0.8
Euro effective exchange rate (1995 = 100)*	120.8	115.0	114.0	110.0	106.4	107.2
Exchange rate ($ per €)	1.39	1.27	1.24	1.17	1.12	1.13

* A rise in the effective exchange rate index corresponds to an appreciation of the euro

One major factor holding back activity in many economies in the region is the ongoing fiscal adjustment. Several Eurozone governments, notably those in the periphery, have announced additional fiscal tightening for 2012 over the last few months, which will weigh further on growth. In total, we estimate that Eurozone governments are introducing spending cuts and tax rises equivalent to more than 1% of GDP in both 2012 and 2013, which will reduce output in the Eurozone by over 1% over this period. The precise effect of this fiscal tightening on the economy is uncertain, however. This reflects not only a lack of clarity regarding the size of fiscal multipliers in each country, but also the potential for negative effects to be amplified in economies already mired in recession. The fact that a coordinated fiscal tightening is still being implemented by so many member states also raises the potential for additional negative spillover effects between economies. Risks are therefore skewed to the downside.

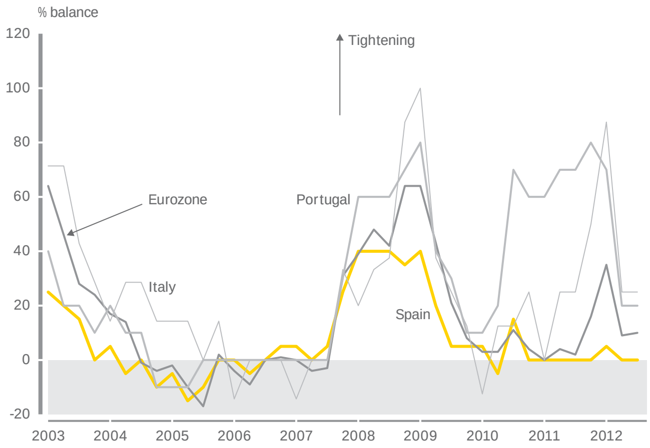
Figure 2
Discretionary fiscal tightening, 2010–13



Source: Oxford Economics, Haver Analytics

Tight credit conditions represent a second headwind buffeting the economy. Encouragingly, the July 2012 Bank Lending Survey from the ECB showed that net tightening of banks' credit conditions remained broadly stable in Q2 compared with the previous quarter, for loans to both non-financial corporations and households. In particular, the net tightening in Q2 2012 was much lower than in Q4 2011, despite the intensification of the sovereign debt crisis. This stabilization probably reflects the continued positive impact of the ECB's long-term refinancing operations (LTROs) on the funding positions of banks. Although the risk of an outright credit crunch in the Eurozone appears to have receded, credit is still difficult to access, which will restrict spending by businesses and consumers.

Figure 3
Credit conditions for loans to businesses



Source: Oxford Economics

The global economic climate has also darkened in the past few months. Our assumptions for the world economy are covered in detail in Box 1 (see page 19), where we discuss our expectation for a notable slowdown in world trade growth in H2 2012. This development has already been flagged by relatively weak releases of key indicators in both advanced and emerging economies in the past couple of months. To the extent that the external environment has cooled, this will dampen prospects for further export-led growth in the Eurozone this year.

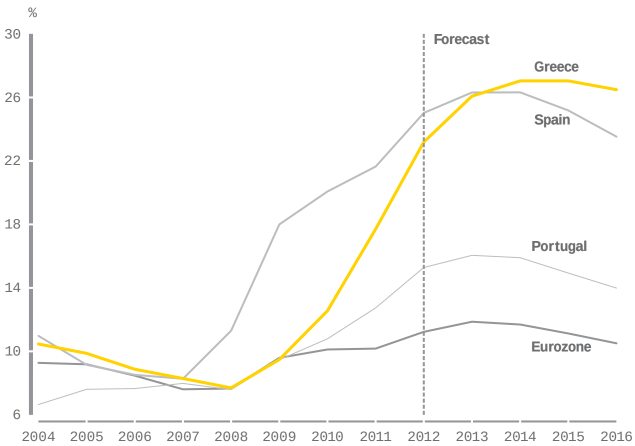
Finally, compounding the negative impact from these headwinds is the heightened level of uncertainty regarding the future direction of economic policy in the Eurozone. Uncertainty has increased materially in the past few months, with a number of political standoffs indicating that policy-makers in the core economies are gripped by bailout fatigue. This can only dampen confidence, leading businesses and consumers to postpone spending plans.

... which are forcing consumers and businesses to retrench

In this difficult environment, companies are likely to reduce employment further in order to preserve productivity and profitability. We now see the number of unemployed in the region peaking at around 19.2 million or just over 12% of the workforce in Q1 2014. In Portugal, the jobless rate is expected to exceed 16%, while in Spain it will probably top 26%. In Greece, where job losses are forecast to continue into 2014, unemployment is expected to reach 27% of the workforce.

Figure 4

Unemployment rate



Source: Oxford Economics

Tax hikes related to fiscal adjustments and the continuing rise in unemployment will cause real disposable income to fall further this year. Moreover, with consumer confidence indicators for July and August showing a sharp deterioration in sentiment, we are expecting a slight rise in the savings rate in H2 2012 for precautionary reasons. As a result, we forecast consumer spending will contract by 0.8% at the Eurozone level in 2012, with a further marginal decline of 0.1% in 2013.

These forecasts mask significant variation at the country level, however, with German consumers expected to increase their spending by 0.8% this year, while French household spending will remain broadly flat and Italian consumers will cut spending by almost 3%. Deep cuts in household spending are also expected in other peripheral economies.

Corporate investment will also be scaled back in response to tighter financing conditions, uncertainty over the future of the single currency area and sluggish earnings. Capital spending in the Eurozone as a whole is forecast to contract by 3.1% this year, with a further decline of 0.2% expected in 2013. The correction in investment spending is such that, by the end of 2016, the level of investment is expected to remain below its pre-crisis peak. Once again, the sharpest contractions are expected in the periphery, with Spanish and Portuguese firms set to curtail capital spending by 10% or more in 2012. Even in the core Eurozone countries, capital spending is expected to fall this year, with declines of 1.0% in Germany and almost 3.0% in the Netherlands.

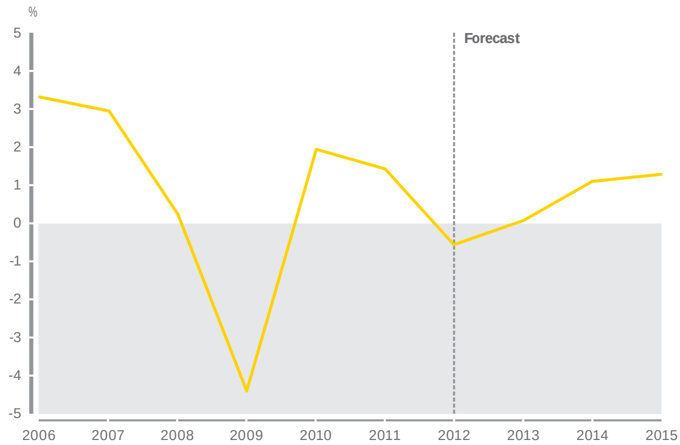
Destocking will also weigh on headline GDP in the Eurozone, both this year and next, as companies shed the unwanted increase in inventories. But the downturn in the inventory cycle is not expected to be as sharp as in 2008–09.

The external sector will help to offset weakness in domestic demand

While the downturn in the economy will largely be shaped by the expected weakness in domestic demand, the external sector will provide a positive offset to some extent. Net exports will benefit from weaker import demand and the decline in the value of the euro exchange rate, which will help to support the competitiveness of exporters amid slowing, albeit still solid, world trade. We expect net exports to make a positive contribution of 1.3 percentage points to headline GDP growth in the Eurozone this year, falling to 0.5 percentage points in 2013 as imports recover and global demand strengthens.

Figure 5

GDP



Source: Oxford Economics

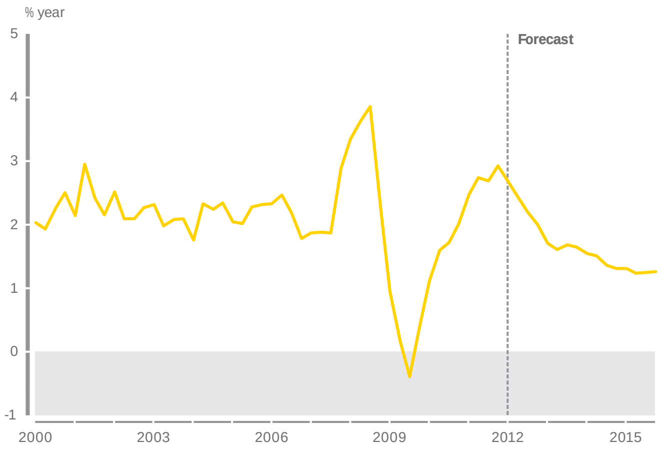
Given the weakness in most components of demand, we now forecast that GDP will contract by 0.5% this year. And 2013 is now expected to be a year of virtual stagnation, with growth of just 0.1%. Moreover, the stabilization next year will not be broad-based and will rely mainly on the strength of the northern Eurozone economies, with Germany forecast to expand by 1.0% in 2013, while France grows by 0.5%. Conversely, activity in some of the peripheral member states is expected to continue contracting next year, and to bottom out only in 2014. This implies some very large falls in output in these economies relative to their pre-crisis peaks. In Spain, for example, the peak-to-trough decline in GDP will amount to 7.8%, while Greek GDP is forecast to experience a massive 23% fall.

Inflation is expected to slow significantly over the coming year

Given the weakness in economic activity, it is a little surprising that headline inflation has not slowed more abruptly so far. Indeed, latest data from Eurostat indicates that consumer prices rose at an annual rate of 2.6% in August 2012. To the extent that headline inflation has remained quite high, this will further erode households' already weak real incomes.

The persistence of inflationary pressure at the Eurozone level is partly a reflection of the introduction of higher indirect taxes in peripheral economies, as well as the fact that commodity prices have been more resilient than we had assumed. Excluding the volatile energy, food, alcohol and tobacco components from the index, the core inflation rate was a more subdued 1.7% in July. Nevertheless, given the dire state of the economy, it would not be unreasonable to have expected core inflation to have fallen even more than it has. This is most likely due to underlying nominal rigidities that have prevented a more significant adjustment of prices in peripheral economies where demand has collapsed. If domestic demand remains weak, however, it is only a matter of time before this adjustment occurs.

Figure 6
Inflation



Source: Oxford Economics

Our forecast assumes that raw material prices fall back later this year as the global economy cools. Also, the effect of earlier tax hikes will drop out of the annual inflation rate calculations over the coming year, while the Spanish VAT rate hike implemented in September 2012 should have only a modest impact on inflation at the Eurozone level.

The expected weakness in economic activity implies that underlying price pressures will also moderate further as the output gap widens and capacity utilization eases. We believe that these effects will more than outweigh the modest upward pressure from indirect taxes over the coming year. Headline inflation is therefore forecast to fall to 2% by the end of 2012, and to continue to trend lower during H1 2013.

A return to stability requires large economic adjustments ...

Despite the subdued outlook for the economy in our forecast, risks remain firmly tilted to the downside. A huge challenge facing the Eurozone is the need for substantial shifts in competitiveness to correct the imbalances that have built up in the region. These imbalances were accumulated in the years leading up to the crisis, when high inflation in the economies of the periphery undermined their competitiveness and gave rise to large current account deficits. External adjustment through wage restraint and productivity enhancement is therefore crucial as, without improvements in competitiveness, fiscal austerity will keep these economies mired in deep recession.

At the same time, domestic demand restraint in deficit countries needs to be matched by domestic demand expansion in surplus countries. The peripheral economies have little chance of reducing their borrowing substantially unless surplus countries such as Germany pursue policies that increase domestic spending and imports. Otherwise, this would imply a shift in the Eurozone's overall current account position to large surplus. Global demand is not sufficiently high to absorb export-led growth from both Asia and an economy the size of the Eurozone.

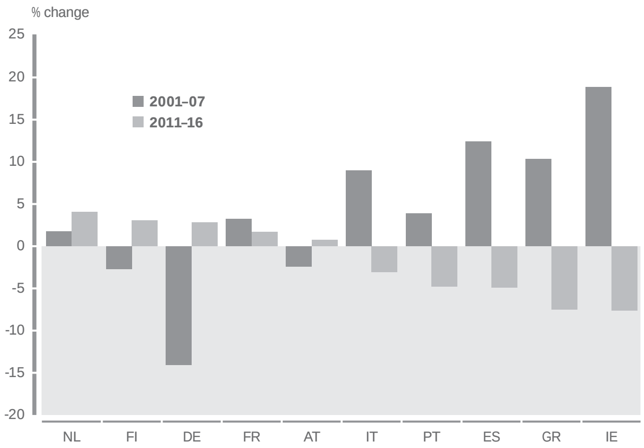
... and there are encouraging signs that these shifts are under way ...

Encouragingly, there have already been some significant adjustments in a number of countries. Ireland stands out for having corrected a large share of the overshoot in its labor costs, which has driven a substantial depreciation in its real effective exchange rate and helped to move the current account from deficit into surplus. Ireland's success in this regard appears to reflect the flexibility of its labor market, with firms able to hire and fire relatively quickly compared with many other Eurozone countries. As labor-intensive sectors such as construction and retail were worst-affected (construction alone accounted for roughly half the rise in Irish unemployment), this has helped to boost productivity.

The other peripherals have also experienced falling unit labor costs, while wage costs in Germany have been rising quite strongly. In fact, the 3.3% increase in average earnings in Germany last year was the highest since 1993. This contributed to robust growth in private consumption in H1 this year.

Figure 7

Real effective exchange rates (intra-Eurozone)*



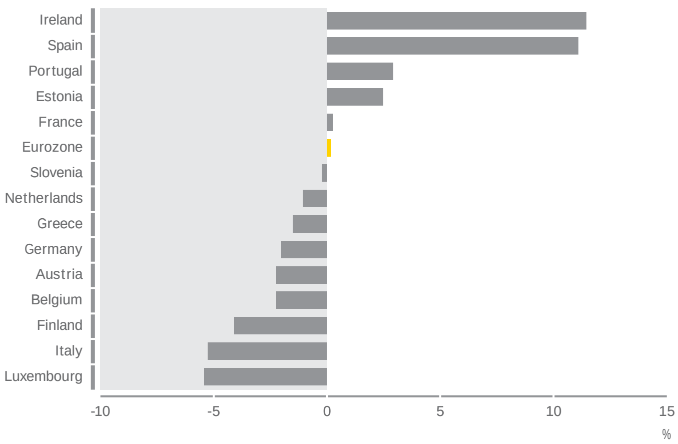
*Deflated by unit labor costs

Source: Oxford Economics, Haver Analytics

Spain, Ireland and Portugal have also achieved sharp increases in productivity in recent years. Since the beginning of 2008, productivity in these economies has risen by 11.1%, 11.5% and 2.9% respectively, compared with the Eurozone average of just 0.1%. A key reason for the substantial increase in measured productivity in these three economies, however, has been that employment has fallen even more sharply than output over this period, resulting in dramatic increases in unemployment. While a reduction in staff numbers has been a necessary response to the downturn in domestic demand, higher productivity needs to be achieved in order to generate sustainable growth in activity, along with rising employment.

Figure 8

Change in productivity, Q1 2008 – Q1 2012



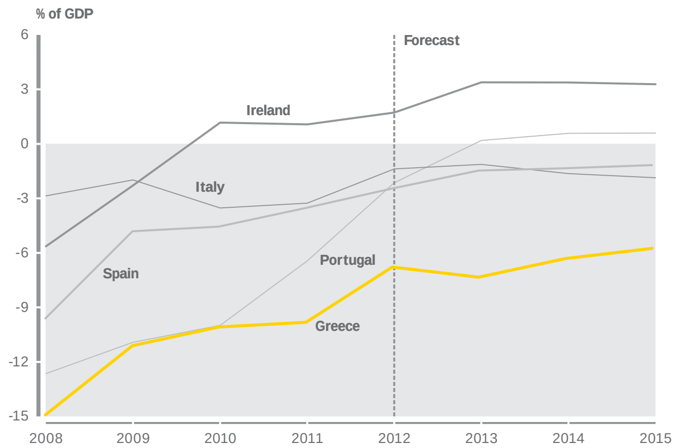
Source: Oxford Economics

... but ongoing improvements need to be supported by institutional reforms

These adjustments in competitiveness have already paid dividends in terms of reducing current account deficits in the periphery, and we expect these improvements to continue over the next few years as the correction in unit labor costs continues.

Figure 9

Current account balance



Source: Oxford Economics

However, the adjustment process is producing huge economic and social strains in the peripheral economies, where the burden of mass unemployment is raising the threat of social unrest. Mechanisms of financing therefore need to be put in place to allow these economies to manage the adjustment process while, at the same time, returning to growth without defaulting on their sovereign debt. This would entail a move toward a more federal Europe, where the provision of temporary and conditional support is provided on a more automatic basis to crisis-hit member states in order to ensure the stability of their banking systems and sovereign finances. We have argued for some time that closer banking and fiscal union is necessary for the Eurozone's long-term survival. Indeed, it was always envisioned by the architects of the euro that currency union would lead to deeper economic and fiscal integration.

Policy risk still clouds the economic outlook ...

Unfortunately, the institutional reforms needed to put the single currency on a firmer footing still face a number of political hurdles. European authorities first need to take decisive action to implement the agreements already reached regarding a common supervisory mechanism for banks in the region and the use of the ESM to recapitalize banks directly. Actions speak louder than words, and markets are very aware of the significant implementation risks that could leave these plans floundering.

But such measures alone will not be sufficient to preserve the Eurozone in its current form. Policy-makers also need to press ahead with the creation of a clear road map toward deeper political and financial integration. Confidence can only be restored when governments in the region can demonstrate that they have agreed a package of explicit policies to be implemented within a set time frame.

The reforms necessary to achieve this goal are long and politically challenging. They include enlargement of the ESM, progress toward fiscal union and a shift in macro policy so that it is less focused on austerity and more on growth. Details of many crucial aspects of the banking union have also yet to be worked out. Although the agreement to shift banking supervision to the Eurozone level is an encouraging step forward, a properly integrated banking system requires pooling not just of regulatory oversight but also support. A number of Eurozone countries have banking sectors that are just too large for their national governments to support. Without shared fiscal responsibility in the form of deposit guarantees, these national banking systems will remain at risk from runs on their deposits, and banks will continue to shrink their cross-border operations within the Eurozone to reduce funding and redenomination risk.

But before policy-makers can tackle these challenges, they need to confront the immediate risk of a Greek exit from the currency union, which depends on the willingness of other Eurozone governments to relax the terms of the bailout plan. Greece needs more time to implement the tough cuts demanded of it, otherwise its exit from the Eurozone will remain a possibility, with painful consequences for all remaining members. At some point, Greece's debt will also need to be restructured again to make its interest burden bearable.

It also seems likely that Portugal will require another bailout in the first half of next year. Portugal is currently expecting to return to bond markets in 2013, once it has exhausted its current €78 billion bailout package. However, with its debt-to-GDP ratio likely to rise from its current level of around 110% to a peak of 122% in 2014, and given that its 10-year bond yields are still over 8%, it is unlikely that Portugal will be able to return to markets as planned next year.

On the other hand, we expect that Spain should be able to avoid the need for a full bailout package on top of the funds it has already received to recapitalize the banking sector. But this assumes that the ECB/ESM will commence purchases of Spanish sovereign debt later this year to lower the country's borrowing costs.

... and the ECB will need to take a more proactive stance ...

Progress on such bold policy solutions is bound to be slow and erratic, especially as they would entail a substantial shift in the balance of power away from national governments in many cases. Such policies would inevitably require constitutional reforms both at the Eurozone level and at the national level. A key assumption underlying our forecast is therefore that the ECB takes a more proactive role to address difficulties in funding markets and provide governments with time to introduce the structural reforms that will put the single currency area on a firmer footing.

The ECB is already close to the limits of what it can do with conventional monetary policy as interest rates cannot go much lower. In July, the ECB reduced its key interest rate from 1.0% to 0.75%, a record low for the Eurozone. Although this was a smaller cut than we had been hoping for, we believe that this will now be the bottom of the current easing cycle. Nevertheless, a further rate cut cannot be ruled out if the economy deteriorates more sharply than expected.

... with further unconventional policy measures

Future ECB actions are more likely to be characterized by non-conventional policy measures, which could potentially include another LTRO to address difficulties in bank funding. The ECB provided a welcome surprise at its August and September meetings by announcing that it stands ready to begin unlimited purchases in the secondary bond markets (focusing on the short end of the yield curve). These bond purchases will not be a blank check to Eurozone governments — the ECB was keen to stress that unlocking this support requires a country firstly to apply for assistance from the ESM and secondly to accept the "strict and effective conditionality" that this entails.

It is understandable that the ECB has chosen this route as it does not wish to shelter governments against the pressure to reform by embracing unconditional sovereign bond purchases. But it remains unclear whether such strict conditionality would be politically feasible for the governments of Spain and Italy. We continue to believe that a better path for the ECB would be to engage in full quantitative easing, allowing it to buy any assets that it chooses. Such a strategy could, for example, be used by the ECB to help banks that are running out of eligible collateral to access its liquidity operations. In light of concerns that the monetary transmission mechanism may be damaged in the Eurozone, the ECB could also engage in purchases of corporate bonds, which would help to ease financing conditions for the corporate sector more directly.

Slow progress on the journey toward deeper integration

Growth rates are likely to remain modest in the medium term ...

Although we assume that policy-makers will eventually succeed in implementing the reform measures necessary to stabilize the Eurozone, we now believe the most likely outlook for the Eurozone is a "lost decade" for growth. Slow policy progress and a protracted dampening effect on activity as a result of deleveraging have led us to revise down our medium-term forecast. We now expect GDP growth to remain below 1.5% during 2015–16, having previously expected it to pick up to around 2.0%.

With many Eurozone economies continuing to report GDP levels that are still some way below their pre-crisis peaks, this inevitably raises the question of whether the output losses of the past five years can ever be recouped. This may not be possible if the crisis has inflicted lasting damage on the level and growth rate of the economy's underlying productive capacity (the level of output at full employment).

This issue is of crucial importance to the implementation of monetary policy, and also for fiscal policy, as authorities increasingly target measures of the "structural" budget balance, which take into account the economy's position in the business cycle. Structural deficit issues can only be addressed by explicit and direct government austerity measures. Conversely, when the economy's productive capacity is underutilized, there is more scope for the Government's overall budgetary position to improve as the economy recovers.

... indicating a permanent loss of output from the crisis

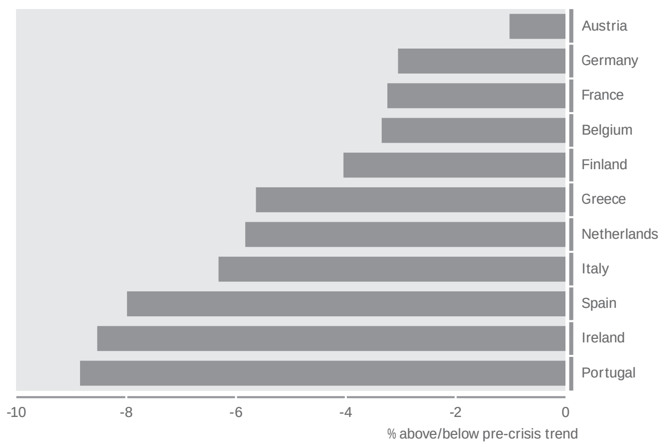
The economy's productive capacity depends upon the size of the labor force, the level of capital with which they have to work, and the efficiency with which they work. For the economy to have suffered a permanent loss of productive capacity, the recession would have to have inflicted permanent damage to one or more of these three factors. Our analysis indicates that many countries are likely to have experienced such damage, reflecting:

- The collapse in investment during the recession, which could have permanently reduced the capital stock.
- Tight credit conditions that continue to hinder investment in research and development, damaging workers' productivity.
- Sharp outflows of migrants from economies in deep recession, reducing the working age population.
- High unemployment, which may cause workers to become detached from the labor market, thereby reducing the numbers seeking employment.

Permanent output losses are therefore likely to have occurred in many Eurozone economies, but especially in member states at the epicenter of the sovereign debt crisis, where severe austerity is causing deep recessions. Our calculations suggest that the most significant loss of output so far has occurred in Portugal, where we estimate that the level of productive capacity in 2011 was almost 9% below where it would have been had the pre-recession trend continued, and Ireland, where the difference is around 8.5%.

Figure 10

Potential output relative to pre-crisis trend (2011)

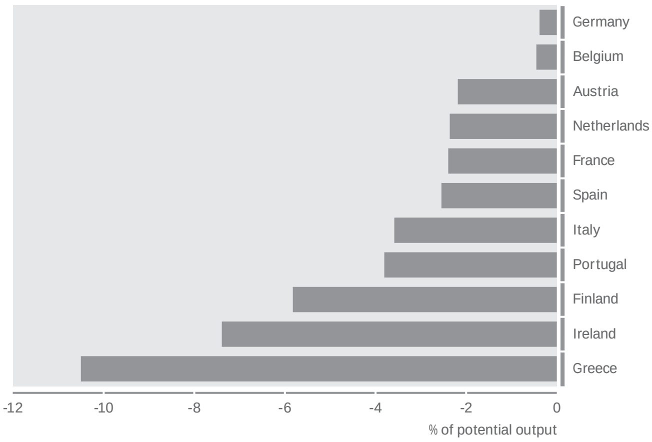


Source: Oxford Economics

Comparing our estimates of underlying productive capacity to actual levels of GDP, we can calculate the size of the differential at the end of 2011. This analysis suggests wide variations across countries. We estimate that levels of output in Greece and Ireland fell short of the economy's productive capacity by 10.5% and 7.4% respectively at the end of 2011, suggesting large amounts of spare capacity. Other economies such as Germany and Belgium, however, would appear to have very little spare capacity. Our forecast implies that these gaps will continue to widen across all the Eurozone member states in the near term, although spare productive capacity will gradually be reabsorbed from 2014.

Irrespective of the crisis, almost all countries are likely to see productive capacity grow at a slower pace in the future, due to the influence of aging populations on the contribution of labor supply. This will make reattaining pre-crisis living standards even more difficult for the peripheral economies. This analysis underlines once again the importance of structural reforms in the peripheral economies to lift their productive capacity.

Figure 11
Size of output gaps



Source: Oxford Economics

Conclusions

The second half of 2012 will prove difficult for the Eurozone, with the recession expected to deepen under the combined weight of austerity measures, credit constraints and weakening foreign demand. Heightened policy uncertainty is also casting a cloud over sentiment in the region, compounding these negative headwinds.

Nevertheless, we remain confident that European leaders will eventually reach agreement on the bold policy measures required to restore stability to the single currency area. Progress in reaching these solutions is likely to be characterized by gradual crisis resolution, however, rather than any sudden breakthrough that would provide a strong positive impetus to confidence and growth in the region. This continued "muddle-through" should lead to a gradual economic recovery driven by the core Eurozone member states next year.

Our forecast assumes that the competitiveness gains achieved so far by peripheral economies are extended, allowing for the necessary economic rebalancing between member states. But this adjustment process is already generating severe social and economic strains in the peripheral economies. Structural reforms in these economies must therefore be supported by a closer federal union with short-term financing mechanisms sufficient to allow these economies to manage the adjustment process and return to growth without defaulting on their sovereign debt.

Box 1

Forecast assumptions – international environment and commodity prices

Our forecast for the Eurozone depends on a number of assumptions about the international environment, world GDP, and trade and commodity prices. Here we explain these assumptions.

Since our last forecast, indicators from the US have given mixed signals, although with a downward bias that confirms our continued expectation for a relatively subdued rate of growth. On the positive side, there has been more upbeat news from the construction sector, and revisions to national accounts data offered extra momentum to growth in the first half of 2012. But survey indicators in the manufacturing sector have disappointed and the labor market remains lackluster. We expect employment growth to remain modest, with the unemployment rate staying above 8% at the end of the year. This should enable a slight improvement in consumption over the next six months. On the other hand, we expect business investment to slow in line with recent survey indicators. Overall, we have slightly revised down our forecast for US growth to 2.2% in 2012, followed by 2.3% growth in 2013 and 2.8% in 2014.

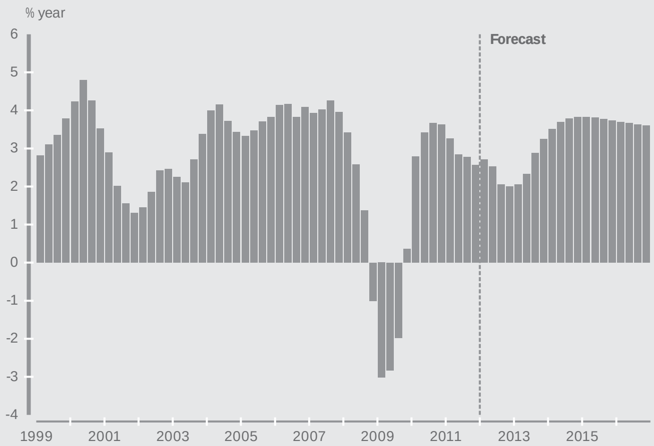
In Japan, growth is now expected to be 2.0% in 2012 and 1.3% in 2013, representing a slight upgrade from our last forecast. But much depends on developments in China, as Japanese exports to China have accounted for almost half of total export growth over the past decade. Indicators suggest that the Chinese economy may be slowing more sharply than indicated by headline GDP, but the authorities are taking action to support growth and it is likely that more policy support will be forthcoming. We now expect Chinese GDP to expand by 7.2% this year and by about 8% in 2013. Elsewhere in the emerging markets, India is also slowing but the authorities have no room to cut rates in the face of persistent inflation and a weak exchange rate. Mexico may also be cooling as the US recovery stutters, and Brazil is still struggling to make headway. Emerging European markets will struggle with the effects of the Eurozone recession this year, with exports and financing flows slowing, placing the onus on consumers and constrained governments to drive growth.

This pattern of subdued growth is reflected in our forecast for a notable slowdown in the pace of expansion of world trade to just 2.6% in 2012, historically a very slow pace and down from around 6.0% in 2011. Overall, our forecasts for world GDP in 2012 and 2013 have fallen back slightly, with growth at 3.1% and 3.4% respectively (on a purchasing power parity basis).

There remains considerable uncertainty regarding the future path of oil prices, which have proved highly volatile in recent months. Our central forecast is for oil prices to average $111 per barrel (pb) in 2012, little changed from 2011, with a decline to about $100pb expected in 2013. But demand conditions remain vulnerable to a further worsening in macroeconomic conditions and any developments in the management of the Eurozone debt crisis, whether positive or negative, are likely to have an impact on prices. At the same time, prices are also especially vulnerable to geopolitical risk given ongoing tensions over Iran.

Figure 12

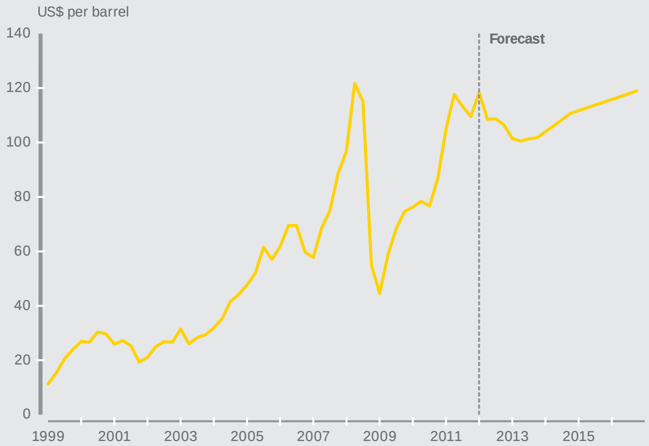
World GDP growth



Source: Oxford Economics

Figure 13

Oil price, nominal



Source: Oxford Economics

Box 2

A plan to save the euro

Our central scenario assumes that Eurozone leaders will do what it takes to secure the survival of the Eurozone in its present form. The list of measures needed to secure the future of the Eurozone is long and politically challenging. But a unified statement of support by governments for all these steps, with a clear timetable of decisions, would go a long way toward arresting the crisis of confidence engulfing the region.

Over the summer, European leaders took some important steps forward by pledging to move toward European bank supervision and allowing the ESM to recapitalize banks directly. It was also encouraging that the ECB indicated that it will reactivate its bond purchase program, although it has insisted that countries must first apply for assistance from the Eurozone's rescue funds and then accept "strict and effective conditionality". Still, the reopening of this program would help to ease tensions in financial markets and provide governments with time to introduce additional necessary reforms. If needed, it could also be complemented with **further LTROs** to address funding pressures in the banking sectors.

Building on the agreement to introduce a single bank regulator, authorities need to move toward establishing a **full banking union**. This will also require the setting up of a Eurozone deposit guarantee scheme, backed by all governments, and a common set of rules for the resolution of bank failures. Recognition that there are issues with banks outside the peripheral countries, and in particular in Germany, could help make banking union a more acceptable choice. The Eurozone-wide guarantees would need to be credible but, if they are, would need to be exercised only on a few rare and localized occasions, making the actual cost manageable.

Furthermore, if the euro is to survive then **further bailouts will be needed**. In addition to the direct support from the ESM for the Spanish banks, agreed at the EU leaders' summit in late June, it is possible that the interest on Greek debt to the IMF may be waived and its debt restructured once again. This needs to happen to make Greece's interest burden bearable. If it does not happen, then the Greek Government may fall, which could in turn trigger an exit from the Eurozone with all the painful consequences for remaining members that are outlined above. We do not think that such concessions will be granted in the immediate future. But if Greece shows commitment to sharp deficit reductions, with some results starting to be visible, EU lenders may become more amenable to relaxing the terms of the bailout. This should also be supplemented with additional official sector support for Portugal as necessary.

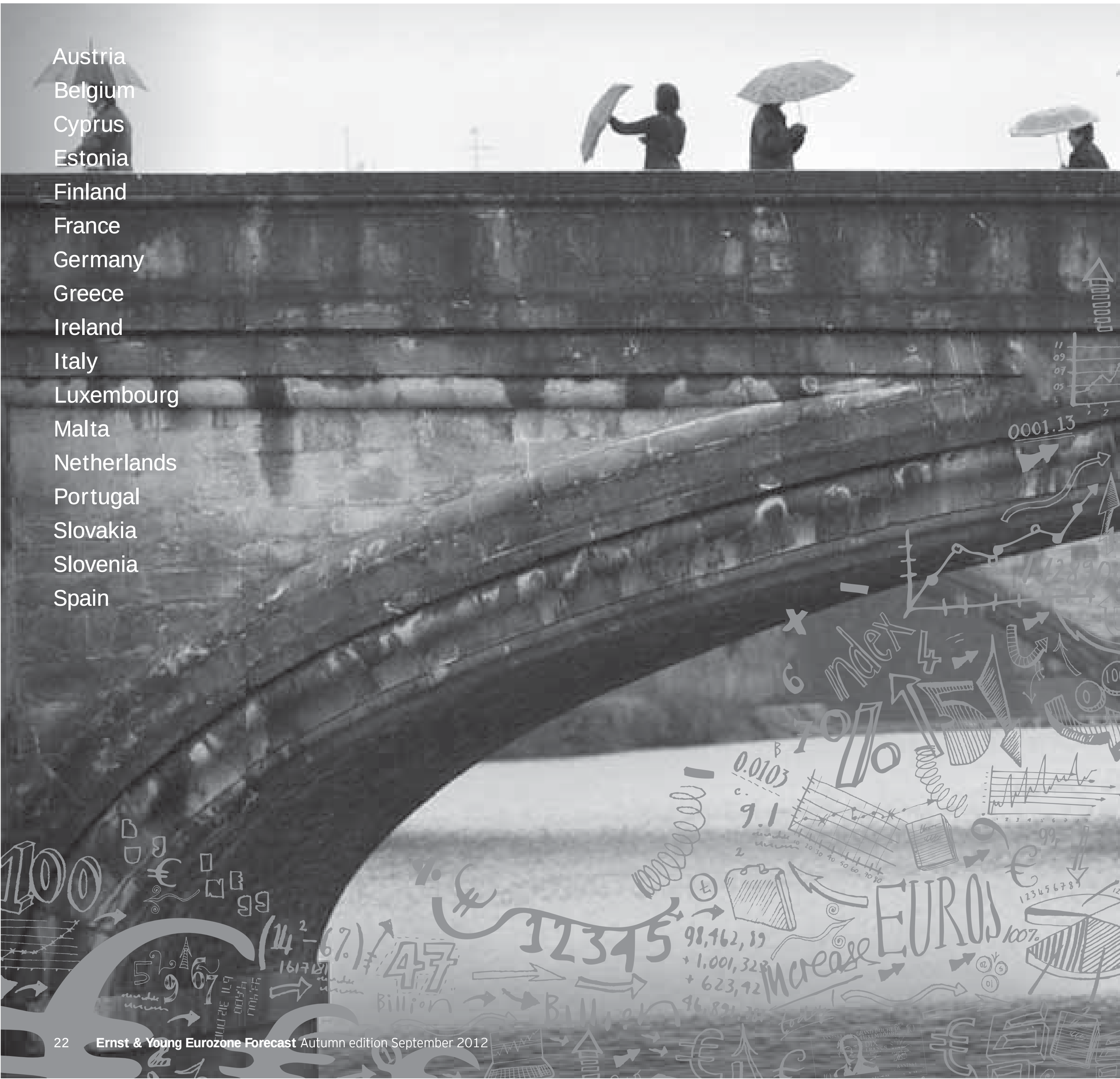
In order to deal with the growing list of demands on its funds, **ESM capacity needs to be enlarged** from €500 billion to €2 trillion or more. The ESM could be increased in size, either via additional contributions from Eurozone countries or, more likely, by granting it a banking license so it could leverage itself.

A move toward **fiscal union** would be the most sustainable way to bring down the borrowing costs of the embattled peripheral Eurozone countries, with their debt becoming jointly backed by the other Eurozone nations. Joint backing would mean that the debt of the peripheral nations was backed not just by their own tax revenues but also by the tax revenues of the more fiscally sound core nations. But a move toward Eurobonds is only likely in the longer term, and provided that any debt sharing is preceded by far-reaching reforms that give Brussels greater control over national budgets and borrowing.

On the growth side, as we have noted in our report, all parties in the Eurozone have obligations. For the peripheral economies, the need to **reform labor markets** and **improve the efficiency of domestic service sectors** in particular is familiar. Germany could support this process by **opening up its own service sector** to international firms and generating faster domestic demand and wage growth to support activity and competitiveness elsewhere in the Eurozone. The Government could help generate such a development by raising wages paid to public sector workers (even if it does so in a fiscally-neutral way, for example by making savings in future public sector pensions), forcing the private sector to respond in order to attract workers in a tight labor market.

Slow progress on the journey toward deeper integration

Forecast for Eurozone countries

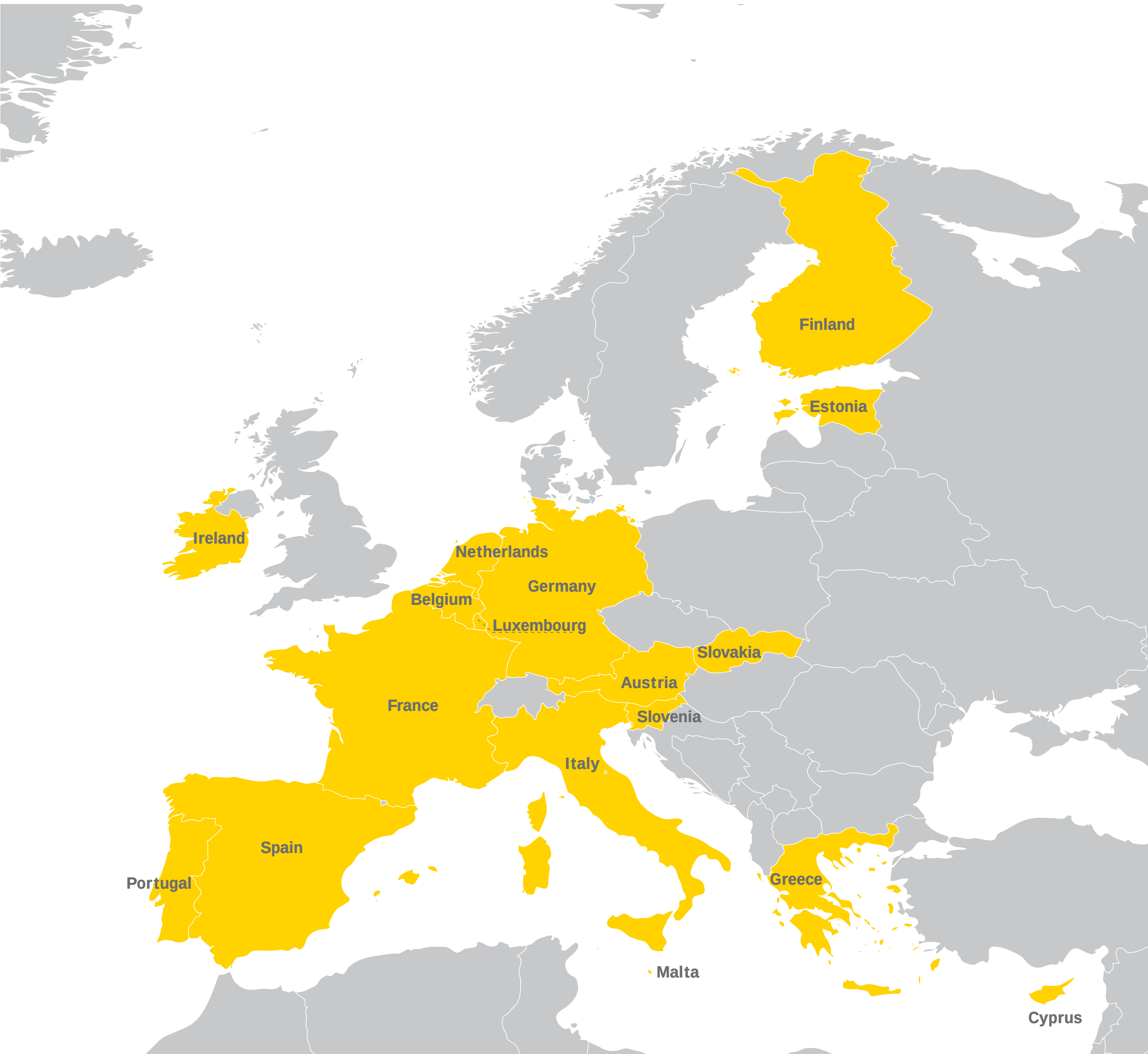


- Austria
- Belgium
- Cyprus
- Estonia
- Finland
- France
- Germany
- Greece
- Ireland
- Italy
- Luxembourg
- Malta
- Netherlands
- Portugal
- Slovakia
- Slovenia
- Spain

17 Eurozone countries

Please visit our Eurozone website for access to additional information on the *Ernst & Young Eurozone Forecast*, the 17 individual country forecasts and additional perspectives and interview content. The site contains the latest version of our reports as well as an archive of previous releases.

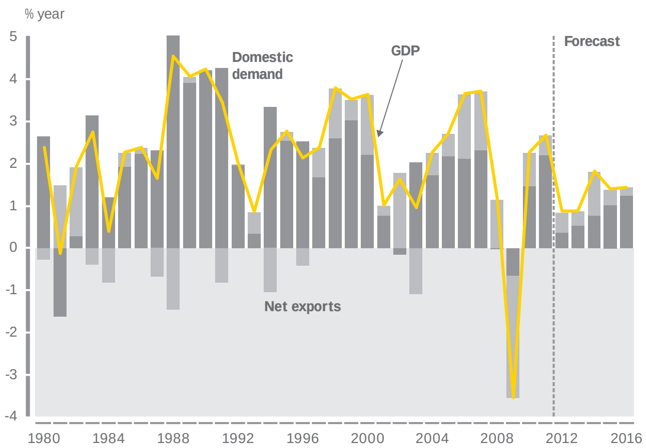
To find out more, please visit www.ey.com/eurozone



Austria

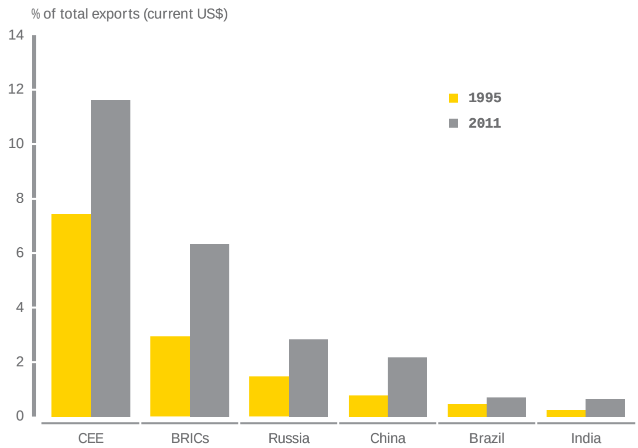
- The economy showed robust growth in H1 2012, but this resilience is likely to falter as external demand remains weak and uncertainty deters investment. With the Eurozone crisis dragging on, we have lowered our GDP growth forecast for 2013 to 0.9% after an expected 0.9% rise this year. For 2014–16 we forecast average growth of about 1.5% a year.
- Austria remains one of the strongest economies in the Eurozone, however, thanks to high competitiveness, sound public finances and strong trade links with Germany.
- With a budget deficit expected to be 3.3% of GDP this year, and debt at 72% of GDP, the fiscal position remains relatively sound. Despite this, the Government has announced an ambitious austerity package. But given the economic prospects, we do not expect the goal of a balanced budget in 2016 to be achieved, with the deficit seen falling more gradually to 1.8% of GDP. This does not pose a threat to long-term fiscal sustainability.

Figure 14
Contributions to GDP



Source: Oxford Economics

Figure 15
Export shares



Source: Oxford Economics, Haver Analytics

Table 2
Austria (annual percentage changes unless specified)

Source: Oxford Economics

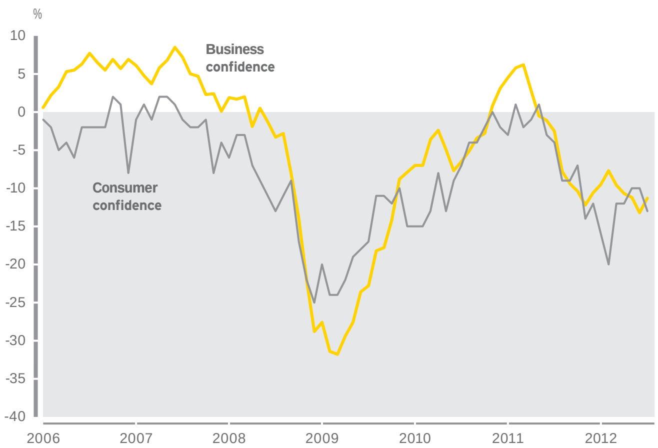
	2011	2012	2013	2014	2015	2016
GDP	2.7	0.9	0.9	1.8	1.4	1.4
Private consumption	0.9	0.6	0.9	1.4	1.5	1.6
Fixed investment	6.3	2.1	1.7	2.9	2.2	2.2
Stockbuilding (% of GDP)	2.0	1.3	0.9	0.0	-0.6	-0.9
Government consumption	1.2	2.3	1.1	1.5	1.6	1.6
Exports of goods and services	7.2	1.5	2.8	6.0	5.1	4.7
Imports of goods and services	6.9	1.0	2.8	4.7	5.0	4.9
Consumer prices	3.6	2.1	1.4	1.5	1.6	1.6
Unemployment rate (level)	4.1	4.5	4.9	4.6	4.3	4.3
Current account balance (% of GDP)	2.0	1.8	1.5	2.1	2.2	2.2
Government budget (% of GDP)	-2.6	-3.3	-2.8	-2.0	-1.8	-1.8
Government debt (% of GDP)	72.2	73.8	75.0	74.8	74.5	74.1

Belgium

- The economy slowed more than expected in H1 2012, with a 0.6% contraction in Q2. This year as a whole we will see a modest 0.3% decline in GDP as firms cut investment, exports to Eurozone markets fall further and households brace themselves for rising unemployment.
- There is likely to be only a modest rebound in 2013, with the weakness of the Eurozone recovery causing business investment and household spending to decline. Further ahead, growth is likely to be limited to around 1.5% because of the impact on banks' capacity to finance investment, and the need for substantial fiscal correction by the Government.
- More positively, Belgium has for now benefited from the "flight to safety" in bond markets. Nevertheless, over the longer term the size of Belgian debt stock means that it is more vulnerable than most core Eurozone economies to changes in investor sentiment.

Figure 16

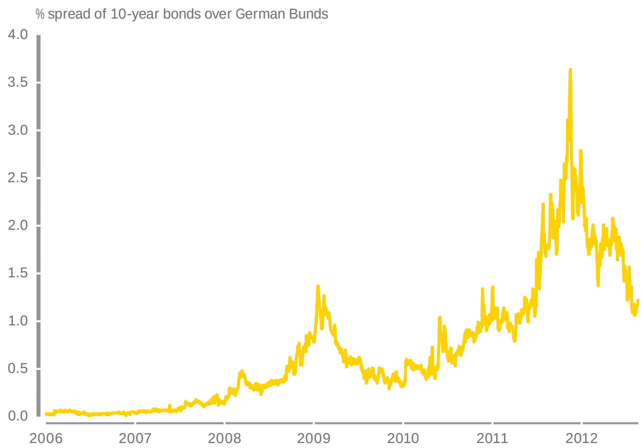
Consumer and business confidence



Source: Oxford Economics, Haver Analytics

Figure 17

Spread over Bunds



Source: Oxford Economics, Haver Analytics

Table 3

Belgium (annual percentage changes unless specified)

Source: Oxford Economics

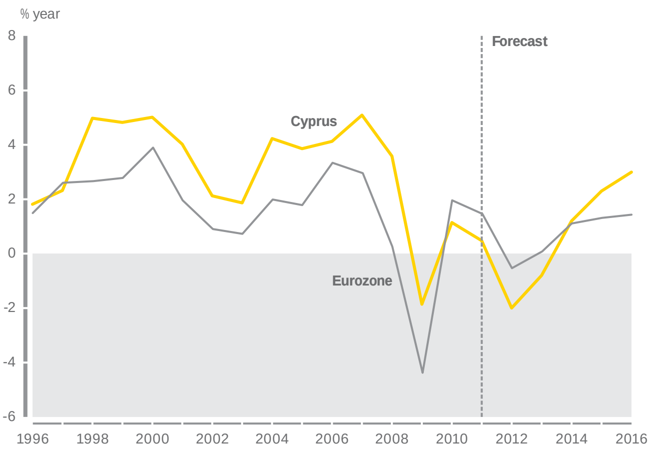
	2011	2012	2013	2014	2015	2016
GDP	1.8	-0.3	0.5	1.3	1.5	1.4
Private consumption	0.2	-0.4	0.4	1.2	1.4	1.4
Fixed investment	4.1	-1.9	-0.7	1.4	2.2	2.5
Stockbuilding (% of GDP)	1.3	0.6	-0.1	0.0	0.3	0.4
Government consumption	0.8	-0.4	-1.2	-0.8	-0.3	0.5
Exports of goods and services	5.5	-0.8	2.3	4.1	3.5	3.0
Imports of goods and services	5.7	-2.3	0.7	3.7	3.6	3.3
Consumer prices	3.4	2.6	1.3	1.4	1.5	1.6
Unemployment rate (level)	7.2	7.3	8.0	8.1	7.9	7.7
Current account balance (% of GDP)	-1.0	-0.5	1.4	1.8	1.9	2.0
Government budget (% of GDP)	-3.7	-3.3	-2.9	-2.3	-1.6	-1.0
Government debt (% of GDP)	98.0	99.7	102.3	104.3	105.5	105.9

Cyprus

- The ongoing quarterly decline in GDP accelerated to 0.8% in Q2 and is set to continue through this year as tourism fails to offset declines in other services, manufacturing and utilities. For 2012 overall, we still forecast a GDP decline of some 2.0%.
- Policy reforms, including budget cuts and reduction of bank leverage, will also constrain the pace of activity in 2013–14, with GDP predicted to fall 0.8% next year before returning to a growth rate of just over 1.0% in 2014. And any further downgrades to Cyprus's already speculative credit rating would further limit private sector borrowing opportunities.
- With slower growth eroding tax revenues, the fiscal deficit is forecast at 4.7% of GDP in 2012 – an improvement on last year, but still well above what is sustainable, given rising public borrowing costs. An IMF-led bailout should assist recovery and gradual reduction in the deficit, but the situation would worsen further if Greece falters with its current adjustment program.

Figure 18

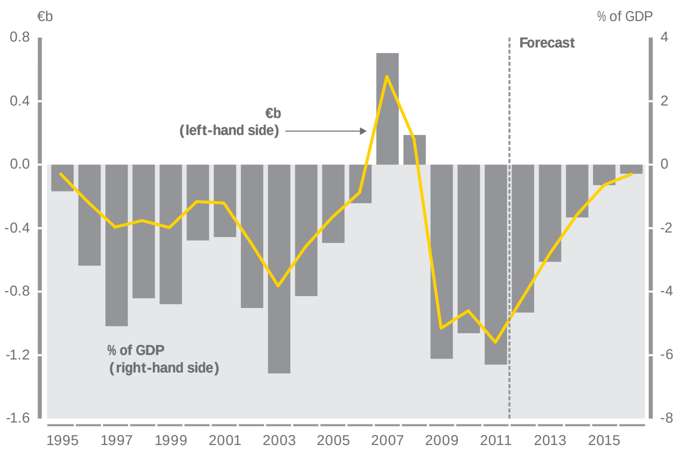
Real GDP growth



Source: Oxford Economics

Figure 19

Government budget balance



Source: Oxford Economics

Table 4

Cyprus (annual percentage changes unless specified)

Source: Oxford Economics

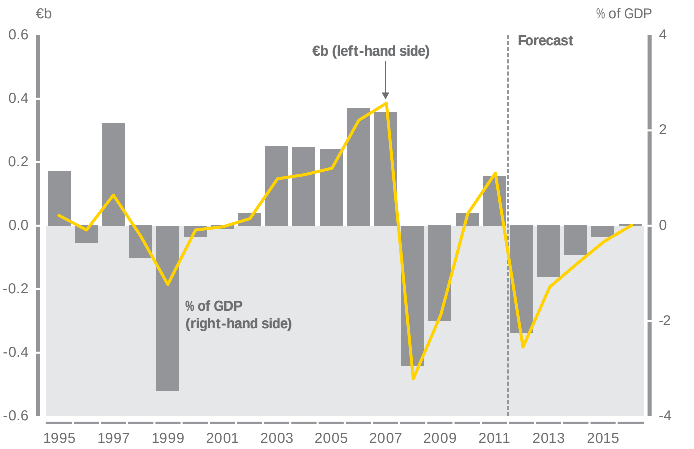
	2011	2012	2013	2014	2015	2016
GDP	0.5	-2.0	-0.8	1.2	2.3	3.0
Private consumption	0.2	-1.8	-0.3	0.8	1.5	2.8
Fixed investment	-13.8	-6.1	-1.8	2.0	3.0	4.8
Stockbuilding (% of GDP)	0.1	0.0	0.0	0.0	0.0	0.0
Government consumption	-4.7	-3.7	-1.2	1.0	1.5	2.3
Exports of goods and services	3.6	-0.8	0.9	2.0	4.0	5.3
Imports of goods and services	-5.0	-2.9	1.0	1.6	2.8	5.3
Consumer prices	3.5	3.4	2.5	2.3	2.3	2.3
Unemployment rate (level)	7.9	10.5	9.9	8.7	7.7	5.5
Current account balance (% of GDP)	-10.3	-7.8	-7.5	-7.0	-7.0	-6.6
Government budget (% of GDP)	-6.3	-4.7	-3.1	-1.7	-0.6	-0.3
Government debt (% of GDP)	71.6	75.3	77.1	76.2	73.5	70.1

Estonia

- Having powered growth in 2010–11, export demand has faded in recent months, following the slowdown in the Eurozone. This has led Estonian GDP growth to slow, although it remains well ahead of most other Eurozone economies.
- With successful internal adjustment achieved following the financial crisis, Estonia has been able to retain fiscal flexibility and now plans to implement a stimulus package. This will involve investment in schemes designed to support future private sector growth through improving transport, communications, workforce skills and energy supply.
- The additional public investment will fill some of the gap left by weaker export demand and we expect Estonia to remain the fastest-growing Eurozone economy over the coming years. GDP is forecast to rise 2.3% in 2012 and 3.1% in 2013, with growth set to average just over 4% a year in 2014–16.

Figure 20

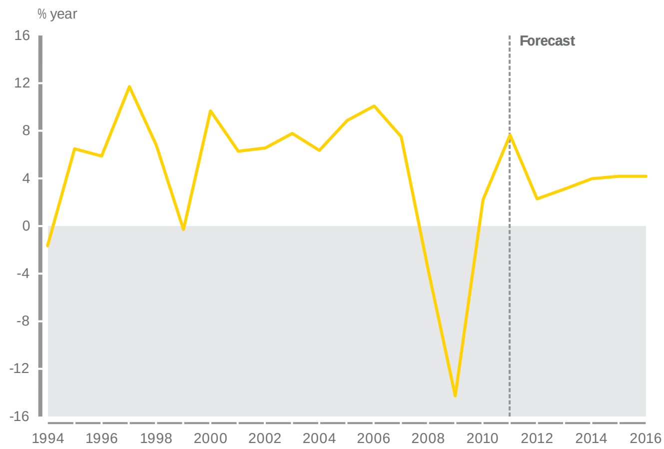
Government budget balance



Source: Oxford Economics

Figure 21

Real GDP growth



Source: Oxford Economics

Table 5

Estonia (annual percentage changes unless specified)

Source: Oxford Economics

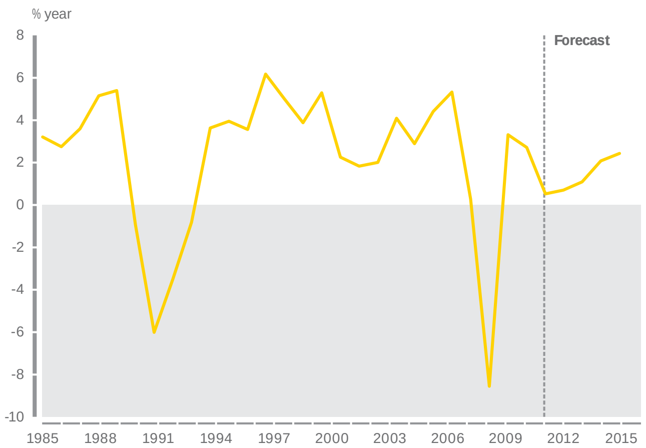
	2011	2012	2013	2014	2015	2016
GDP	7.6	2.3	3.1	4.0	4.2	4.2
Private consumption	4.2	2.0	3.0	3.5	4.2	4.6
Fixed investment	26.8	7.0	5.0	7.0	7.0	5.5
Stockbuilding (% of GDP)	-2.1	-2.3	-0.8	0.2	0.3	0.4
Government consumption	1.6	1.0	1.0	1.8	2.7	3.0
Exports of goods and services	24.9	2.5	3.3	4.0	4.3	4.3
Imports of goods and services	27.0	3.2	5.0	5.2	5.0	4.7
Consumer prices	5.0	3.8	2.6	2.2	2.2	2.1
Unemployment rate (level)	12.4	10.2	9.3	8.4	7.7	6.9
Current account balance (% of GDP)	2.1	0.0	-1.5	-2.7	-3.5	-3.7
Government budget (% of GDP)	1.0	-2.3	-1.1	-0.6	-0.2	0.0
Government debt (% of GDP)	6.0	10.6	11.5	11.5	11.1	10.4

Finland

- After a mixed performance in H1, when year-on-year growth averaged 1%, weak demand in the Eurozone means that GDP will probably contract in H2, with falling exports leading to lower production and weaker investment.
- With consumer demand faltering and public consumption no longer supporting growth, we now forecast GDP growth of just 0.5% in 2012, despite the fact that the Government does not face the same pressure for fiscal austerity as most other countries. This is significantly lower than our forecast of three months ago but still stronger than many in the Eurozone.
- The economy should also continue to benefit from its strong fiscal and debt position, with the budget deficit below 1% of GDP and debt equal to less than 50% of GDP. These factors have positioned Finland as one of the few Eurozone countries to retain its AAA credit rating from all three main rating agencies. As a result, after growth now forecast at just 0.7% in 2013, stronger investment is seen lifting the pace to 2%–2.5% in 2015–16.

Figure 22

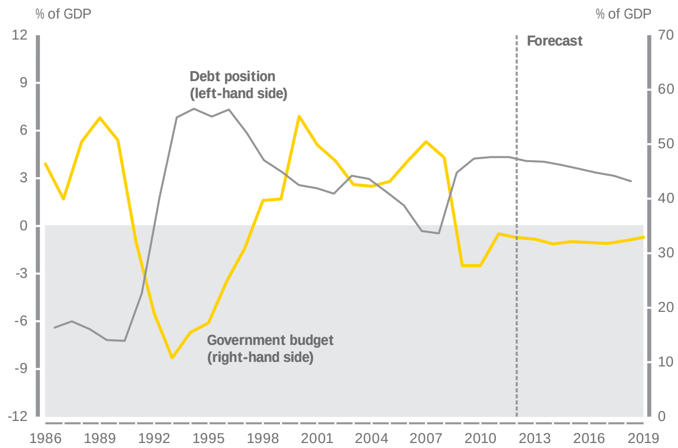
GDP growth



Source: Oxford Economics

Figure 23

Government balance and debt



Source: Oxford Economics

Table 6

Finland (annual percentage changes unless specified)

Source: Oxford Economics

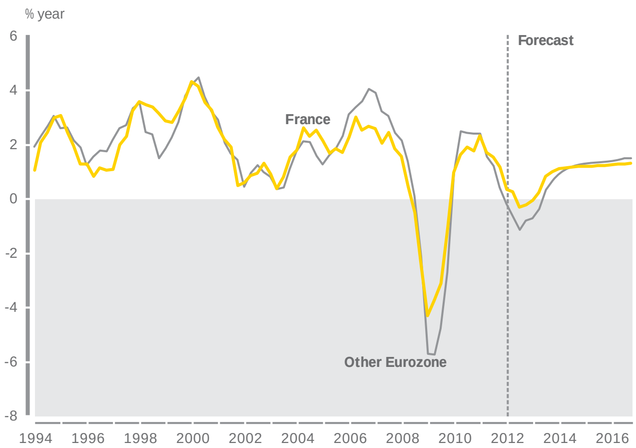
	2011	2012	2013	2014	2015	2016
GDP	2.7	0.5	0.7	1.1	2.1	2.4
Private consumption	2.4	0.8	0.9	1.9	2.4	2.6
Fixed investment	6.8	-0.5	-1.2	0.5	2.1	3.5
Stockbuilding (% of GDP)	2.2	2.8	2.6	1.4	0.9	0.5
Government consumption	0.4	-0.2	0.7	1.2	1.2	1.4
Exports of goods and services	2.0	-2.2	2.1	3.9	4.0	3.9
Imports of goods and services	5.0	-1.5	1.0	2.3	2.9	3.4
Consumer prices	3.3	2.9	2.2	1.2	1.0	0.8
Unemployment rate (level)	7.8	7.7	7.8	7.5	7.3	7.1
Current account balance (% of GDP)	-1.2	-2.0	0.5	1.7	2.2	2.4
Government budget (% of GDP)	-0.5	-0.7	-0.8	-1.2	-1.0	-1.1
Government debt (% of GDP)	48.6	48.0	47.4	47.3	46.6	45.9

France

- While H1 2012 was not as weak as feared, factors that could deliver positive growth rates in the short term are still missing. Instead, the economy is likely to stagnate or rise very slowly for some time.
- Deleveraging by the private and public sectors, while negative for growth in the short term, is needed to achieve sustained robust growth over the medium term.
- We now expect GDP growth to be zero this year. Assuming that measures are taken to restore confidence in the integrity of the Eurozone, growth should resume in 2013, albeit at a slow pace. We forecast growth of just 0.5% next year and 1.2% a year on average in 2014–16.
- In this context, the Government would typically have embarked on an expansionary fiscal policy. Unfortunately, this requires resources that are not currently available. Instead, the Government has rightly confirmed its commitment to reducing the deficit.

Figure 24

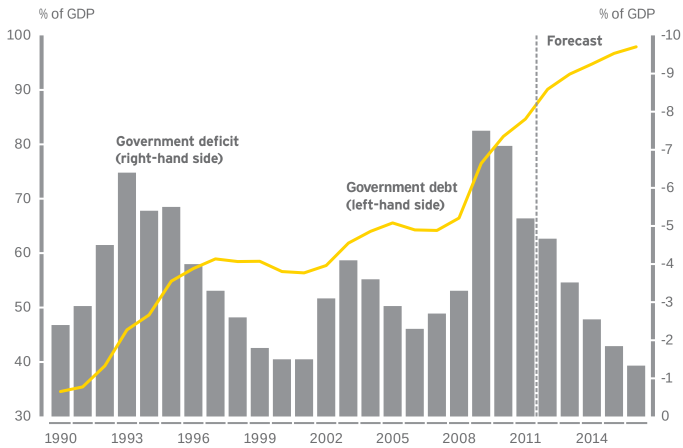
GDP growth: France versus rest of Eurozone



Source: Oxford Economics

Figure 25

Government deficit and debt



Source: Oxford Economics

Table 7

France (annual percentage changes unless specified)

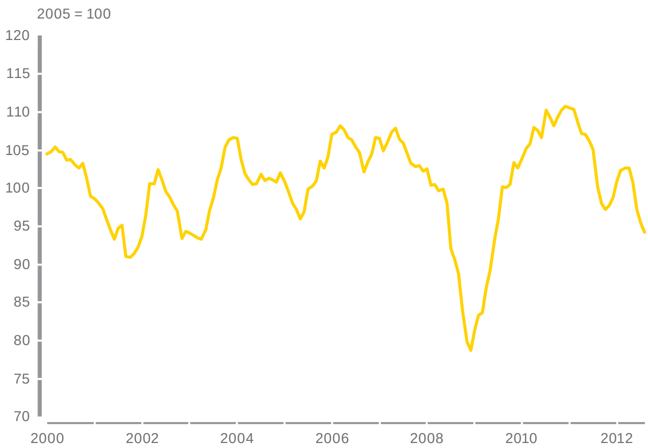
Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	1.7	0.0	0.5	1.2	1.2	1.3
Private consumption	0.3	-0.1	0.6	1.0	1.2	1.3
Fixed investment	3.5	0.6	0.8	2.0	2.0	2.1
Stockbuilding (% of GDP)	0.4	-0.3	-0.2	-0.1	0.1	0.0
Government consumption	0.2	1.1	0.4	0.8	0.9	0.9
Exports of goods and services	5.5	2.1	1.9	4.6	4.9	4.8
Imports of goods and services	5.2	0.8	2.5	4.7	5.1	4.6
Consumer prices	2.3	2.2	1.6	1.6	1.4	1.3
Unemployment rate (level)	9.6	10.2	10.5	10.3	10.2	10.0
Current account balance (% of GDP)	-2.0	-2.4	-2.5	-2.5	-2.5	-2.6
Government budget (% of GDP)	-5.2	-4.7	-3.5	-2.5	-1.8	-1.3
Government debt (% of GDP)	86.0	91.9	94.6	96.3	98.3	99.2

Germany

- The Eurozone crisis now seems to be catching up with Germany. As a result, we have lowered our GDP growth forecast for 2013 to 1.0% from 1.4% at the time of our last forecast in June, after an expected expansion of 0.8% this year.
- In Q2, positive contributions from consumption and exports were offset by the third consecutive quarterly decline in equipment investment, thereby preventing the economy from contracting. But this pattern will not be repeated in Q3, a view reinforced by the ongoing deterioration reported in business surveys.
- The Ifo employment barometer and falling numbers of job vacancies suggest that labor market conditions have been deteriorating since early this year, albeit from a very strong starting point. With these factors reflecting a weakening economy and business uncertainty, we expect the unemployment rate to rise slightly in H2 2012, before resuming a gradual decline in 2013 as uncertainty dissipates and growth picks up.

Figure 26
Ifo expectations



Source: Haver Analytics

Figure 27
Job vacancies

Source: Haver Analytics

Table 8
Germany (annual percentage changes unless specified)

Source: Oxford Economics

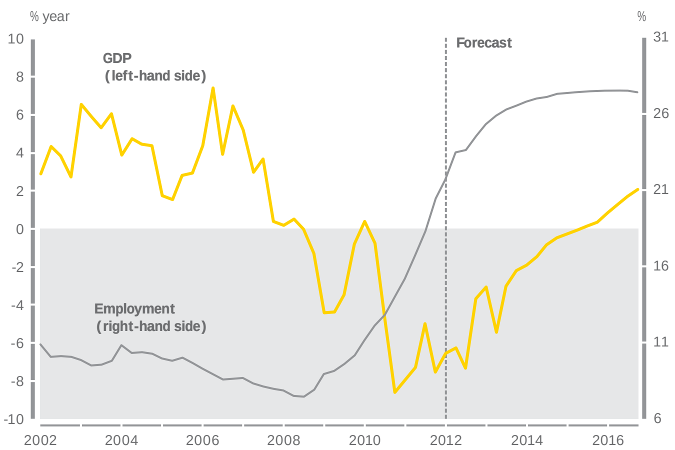
	2011	2012	2013	2014	2015	2016
GDP	3.1	0.8	1.0	1.7	1.7	1.6
Private consumption	1.7	0.8	1.0	1.2	1.3	1.3
Fixed investment	6.4	-1.0	1.5	4.4	4.1	3.4
Stockbuilding (% of GDP)	0.8	0.1	-0.3	-0.2	-0.3	-0.5
Government consumption	1.0	1.1	0.6	0.7	0.7	0.7
Exports of goods and services	7.9	4.5	4.1	5.3	5.6	5.1
Imports of goods and services	7.5	3.0	3.9	6.2	5.9	5.2
Consumer prices	2.5	2.0	1.4	1.4	1.4	1.5
Unemployment rate (level)	6.0	5.5	5.5	5.4	5.2	5.1
Current account balance (% of GDP)	5.7	6.9	7.1	6.3	5.7	5.7
Government budget (% of GDP)	-1.0	-1.2	-1.0	-0.9	-0.6	-0.2
Government debt (% of GDP)	81.2	80.9	81.2	81.6	82.5	82.9

Greece

- The new Greek Government elected in June has faced a tough round of political negotiations with its official creditors. At the time of writing, the next tranche of bailout funding had been delayed, so the country's future in the Eurozone is not yet secure.
- The economy remains mired in recession, with GDP in Q2 down 6.3% on the year. Looking ahead, further spending cuts and tax hikes will hit wages and employment, cutting disposable incomes and depressing consumer spending. Continued risk aversion and capital flight will keep credit conditions tight, denting business confidence. We now expect GDP to contract by 6% this year and by 3.4% in 2013, with the unemployment rate climbing to almost 28% by 2016.
- Given the extent of output contraction so far this year, meeting fiscal targets will be very difficult. It may be the case that official lenders (who hold two-thirds of Greek debt) have to accept some debt restructuring.

Figure 28

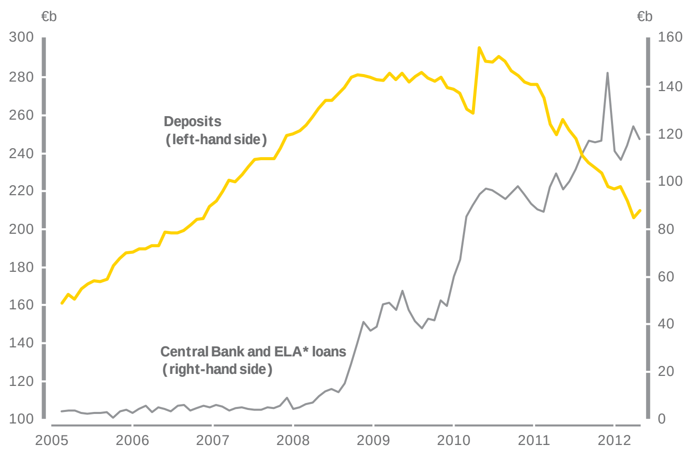
Real GDP and employment



Source: Oxford Economics

Figure 29

Banking sector



* Emergency Liquidity Assistance
Source: Haver Analytics

Table 9

Greece (annual percentage changes unless specified)

Source: Oxford Economics

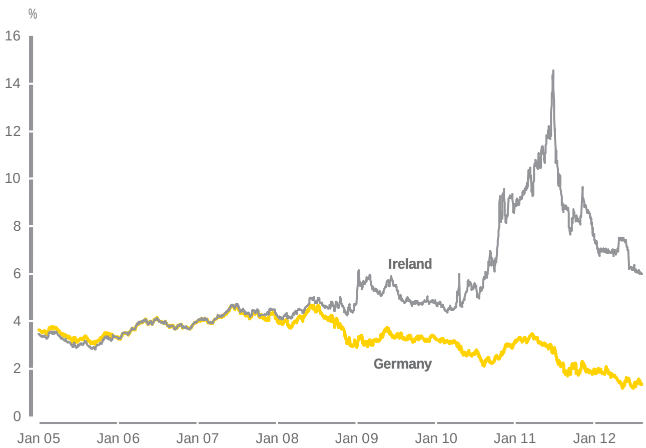
	2011	2012	2013	2014	2015	2016
GDP	-6.9	-6.0	-3.4	-1.2	0.0	1.5
Private consumption	-7.1	-8.5	-3.0	-1.5	-0.6	0.2
Fixed investment	-20.8	-20.0	-9.4	-0.2	2.8	4.3
Stockbuilding (% of GDP)	-1.0	0.3	-0.2	-0.3	-0.5	0.1
Government consumption	-9.1	-6.8	-7.6	-4.1	-0.7	1.2
Exports of goods and services	-0.9	-5.9	1.9	2.8	3.6	3.8
Imports of goods and services	-8.0	-15.6	-4.8	-0.3	1.7	3.4
Consumer prices	3.1	1.1	0.2	0.1	0.4	0.8
Unemployment rate (level)	17.7	23.4	26.1	27.2	27.5	27.6
Current account balance (% of GDP)	-9.8	-6.8	-7.3	-6.3	-5.7	-5.6
Government budget (% of GDP)	-9.1	-8.0	-6.5	-5.7	-5.9	-6.0
Government debt (% of GDP)	165.3	160.2	170.9	176.6	179.5	179.4

Ireland

- Ireland's long-term borrowing costs have declined sharply since the EU summit at the end of June, as investors are pricing in the positive implications of the summit for the economy. As a result, the Irish debt agency has been able to issue various forms of debt over the past couple of months, lowering the debt burden of nearly €12 billion scheduled for January 2014 to just over €2 billion.
- This implies that Ireland is likely to be able to fund itself fully through financial markets once the current bailout money runs out, and will not require further financial assistance from the EU and IMF.
- While this is a very encouraging development, the economic outlook remains very weak. Domestic demand is forecast to decline sharply over the coming months. Exports are the only component of GDP expected to continue increasing, but the rate of growth is likely to slow to almost zero this year as the Eurozone — Ireland's main export market — slips into recession.

Figure 30

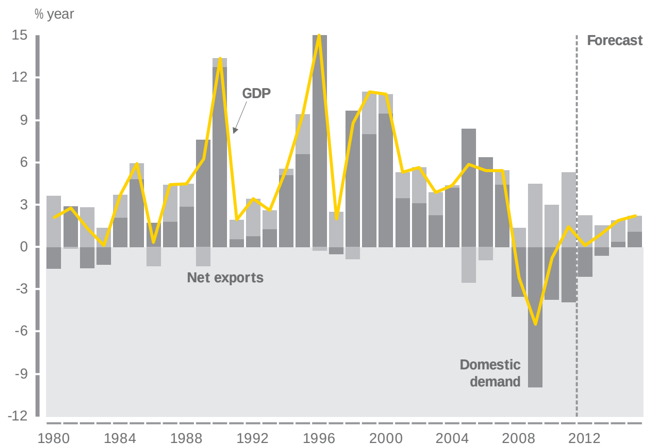
Long-term government borrowing interest rate



Source: Oxford Economics, Haver Analytics

Figure 31

Contributions to GDP



Source: Oxford Economics

Table 10

Ireland (annual percentage changes unless specified)

Source: Oxford Economics

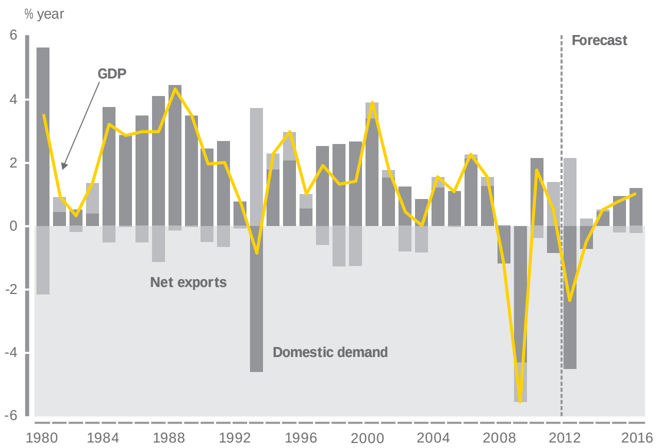
	2011	2012	2013	2014	2015	2016
GDP	1.4	0.1	1.0	1.9	2.2	2.8
Private consumption	-2.4	-2.2	-1.4	0.4	1.0	1.4
Fixed investment	-12.8	-1.7	-5.0	4.5	7.8	7.8
Stockbuilding (% of GDP)	0.1	-0.4	0.1	0.0	0.0	0.0
Government consumption	-4.3	-2.7	-2.0	-1.3	-0.9	-0.8
Exports of goods and services	5.0	3.0	2.6	4.6	4.1	3.9
Imports of goods and services	-0.3	1.1	1.5	4.3	4.1	3.5
Consumer prices	1.2	1.7	1.3	1.2	1.4	1.5
Unemployment rate (level)	14.5	14.9	15.5	15.3	15.0	14.6
Current account balance (% of GDP)	1.1	1.6	3.2	3.2	3.2	3.1
Government budget (% of GDP)	-12.6	-8.3	-6.7	-4.6	-3.1	-2.0
Government debt (% of GDP)	108.2	114.3	118.6	119.5	118.4	115.5

Italy

- The Italian economy is going through its second severe recession in five years. Problems in the financial sector, fiscal austerity and the weak external outlook mean that economic activity will decline significantly in 2012. We now expect GDP to fall by 2.3% this year, and by 0.5% in 2013, before a return to very slow growth averaging just 0.8% in 2014–16.
- Tighter credit conditions and plunging domestic demand will make it harder for companies to expand in the short term. Meanwhile, conditions in the labor market are expected to worsen, with the unemployment rate forecast to peak above 12% in H2 2013.
- General elections will be held in April 2013. Although the outcome of the elections is uncertain, a faltering economy will remain an incentive for continued policy action. But the risk that voters will vote against further austerity and reform is not negligible.

Figure 32

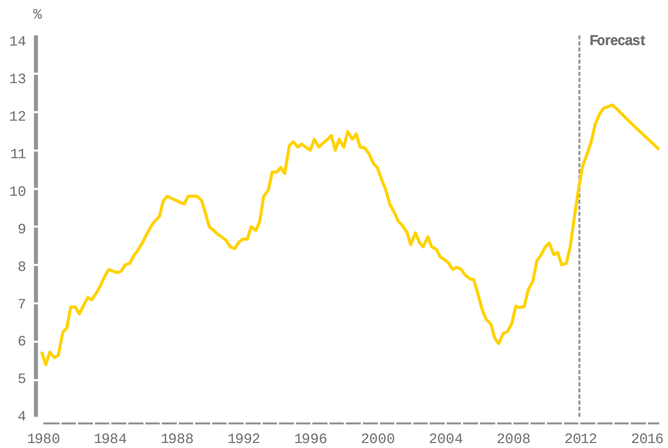
Contributions to GDP growth



Source: Oxford Economics

Figure 33

Unemployment rate



Source: Oxford Economics

Table 11

Italy (annual percentage changes unless specified)

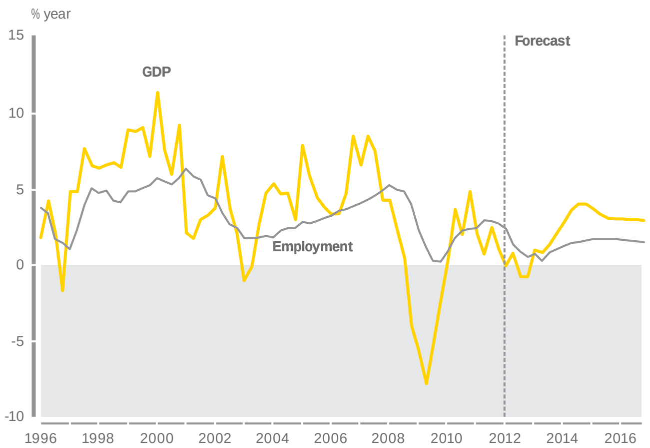
Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	0.5	-2.3	-0.5	0.5	0.8	1.0
Private consumption	0.2	-2.7	-0.9	0.0	0.4	0.8
Fixed investment	-1.2	-8.1	-0.2	1.5	2.0	2.2
Stockbuilding (% of GDP)	0.0	-1.2	-1.0	-0.6	-0.3	0.0
Government consumption	-0.9	-0.8	-1.6	-0.8	0.1	0.4
Exports of goods and services	6.3	0.3	1.7	3.9	4.3	4.6
Imports of goods and services	1.0	-7.3	1.0	4.1	5.4	5.7
Consumer prices	2.9	3.4	2.6	1.8	1.1	1.2
Unemployment rate (level)	8.4	10.7	12.0	12.0	11.6	11.2
Current account balance (% of GDP)	-3.3	-1.4	-1.1	-1.4	-1.6	-1.7
Government budget (% of GDP)	-3.9	-2.4	-1.3	-0.8	-0.6	-0.4
Government debt (% of GDP)	120.1	123.9	124.4	123.0	121.1	118.8

Luxembourg

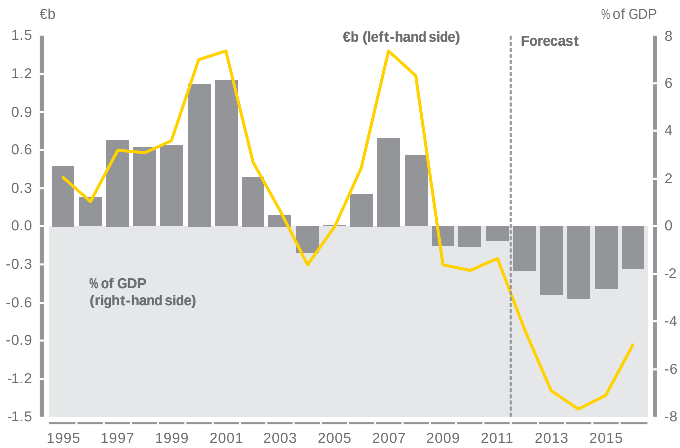
- We have lowered our forecast for GDP in 2012 and now expect it to contract 0.2%. This reflects the lingering Eurozone crisis and its impact on financial markets, and the surprisingly large 1.5% drop in GDP in Q1. And with no end in sight to the Eurozone woes, the recovery previously expected for the start of next year is likely to come later, and growth in 2013 is now forecast at 1.3%.
- The GDP decline in Q1 this year was largely due to weakness in the banking sector. Having barely recovered since the 2008–09 crisis, prospects for a more robust recovery in the banking sector remain bleak, particularly given the current turmoil in European banking.
- Consumers face a difficult period ahead. In particular, we expect slowing economic activity to lead to higher unemployment rates, forecast to rise to 6.7% in 2013–14 from about 6% this year. Inflation, at 2.7% in July, is declining only gradually and will continue to weigh on consumers. But the budget deficit remains low compared with most Eurozone countries.

Figure 34
Real GDP and employment



Source: Oxford Economics

Figure 35
Government budget balance



Source: Oxford Economics

Table 12
Luxembourg (annual percentage changes unless specified)

Source: Oxford Economics

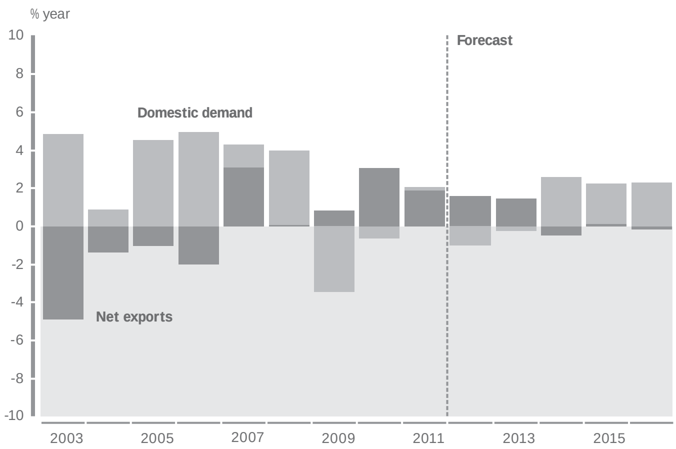
	2011	2012	2013	2014	2015	2016
GDP	1.6	-0.2	1.3	3.6	3.3	3.0
Private consumption	1.8	0.9	2.1	2.9	2.7	2.4
Fixed investment	8.4	10.8	5.7	3.0	1.7	1.2
Stockbuilding (% of GDP)	0.4	1.4	1.2	1.8	0.8	0.8
Government consumption	2.5	1.9	2.5	2.0	1.9	1.8
Exports of goods and services	1.7	-0.8	3.5	6.2	5.8	4.0
Imports of goods and services	3.2	2.0	4.8	6.5	4.9	3.6
Consumer prices	3.7	2.6	1.9	2.0	2.0	2.0
Unemployment rate (level)	4.9	5.7	6.7	6.7	6.2	5.6
Current account balance (% of GDP)	7.1	4.3	2.0	2.5	4.1	4.4
Government budget (% of GDP)	-0.6	-1.9	-2.9	-3.0	-2.6	-1.8
Government debt (% of GDP)	18.2	19.7	21.9	23.7	25.1	25.7

Malta

- The 2012 growth forecast has been downgraded to 0.7%, but achieving any expansion — after slipping back into technical recession in Q1 — will be an achievement given the hostile external conditions. With tourism holding up well, investment now starting to recover and export growth set to rise next year, GDP growth is expected to pick up gradually to 1.3% in 2013 and then to an average of 2%–2.5% in 2014–16.
- High public debt and the unusually large banking and finance sector remain risks to growth in the current Eurozone climate. But banks and hedge funds should be shielded from systemic risk, having maintained capitalization above international minimum ratios.
- The Government is also making progress in allaying the debt risk, with the fiscal deficit now set to stay below 3% of GDP this year despite slow growth.

Figure 36

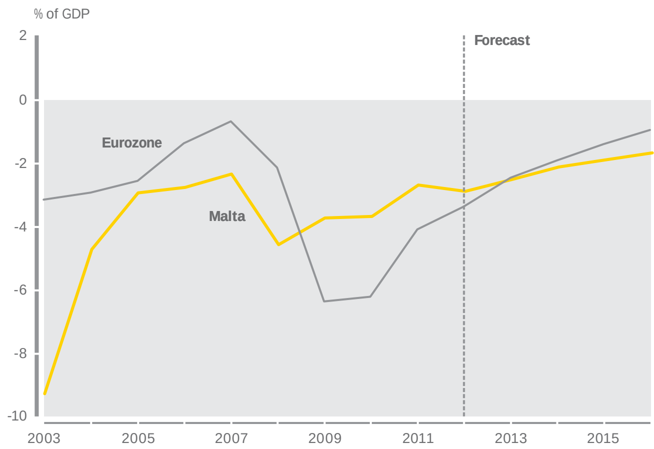
Contributions to GDP



Source: Oxford Economics

Figure 37

Fiscal balance versus Eurozone



Source: Oxford Economics

Table 13

Malta (annual percentage changes unless specified)

Source: Oxford Economics

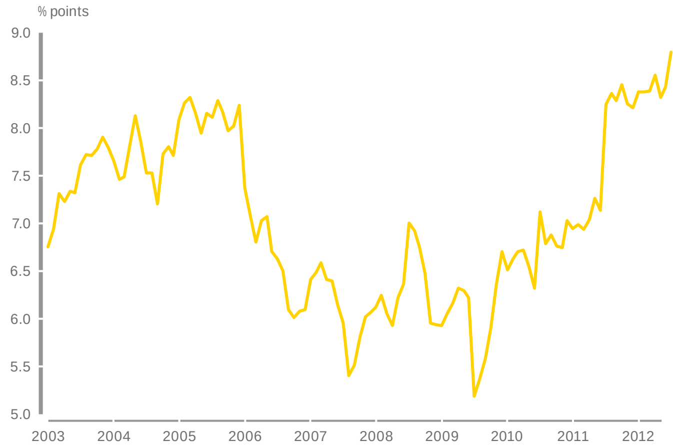
	2011	2012	2013	2014	2015	2016
GDP	2.1	0.7	1.3	2.3	2.3	2.3
Private consumption	3.6	-1.8	0.7	2.6	2.3	2.8
Fixed investment	-22.7	0.0	2.0	5.2	3.2	1.9
Stockbuilding (% of GDP)	0.3	0.2	-0.6	-0.8	-0.9	-0.8
Government consumption	4.3	1.7	0.1	3.3	2.4	1.6
Exports of goods and services	1.9	2.3	3.0	3.3	3.0	2.7
Imports of goods and services	0.0	0.5	1.5	4.0	3.0	3.0
Consumer prices	2.5	3.9	2.7	2.2	2.3	2.3
Unemployment rate (level)	6.5	6.3	6.1	5.5	5.0	4.4
Current account balance (% of GDP)	-3.2	-2.9	-2.7	-2.6	-2.5	-2.3
Government budget (% of GDP)	-2.7	-2.9	-2.5	-2.1	-1.9	-1.7
Government debt (% of GDP)	71.6	72.0	71.9	70.9	69.6	68.2

Netherlands

- Though the Q2 2012 GDP data came in slightly stronger than expected once again, the near-term outlook for the Dutch economy remains gloomy.
- Domestic demand remains very subdued, with consumers continuing to face falling real wages and rising unemployment. Meanwhile, companies are reluctant to invest against an uncertain economic backdrop. The Netherlands has avoided renewed recession only because of the strength of exports, but the escalation of the sovereign debt crisis through the summer, and signs of weakening activity elsewhere in the Eurozone, point to export demand softening.
- As a result, we expect the economy to lapse back into recession in H2 2012, with GDP set to fall by 0.4% in 2012 as a whole. Our forecast of a gradual recovery from next year is contingent on policy-makers taking measures to stem the Eurozone crisis, reduce financial stress and bolster confidence.

Figure 38

Misery Index*

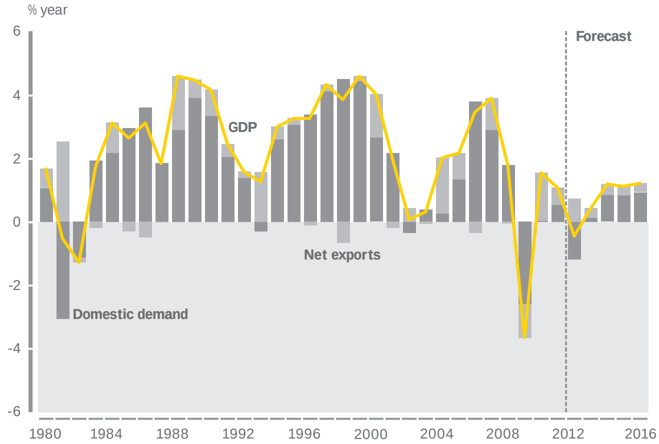


* Defined as CBS (Centraal Bureau voor de Statistiek) unemployment rate plus CPI (Consumer Price Index) inflation rate

Source: Haver Analytics

Figure 39

Contributions to GDP growth



Source: Oxford Economics

Table 14

Netherlands (annual percentage changes unless specified)

Source: Oxford Economics

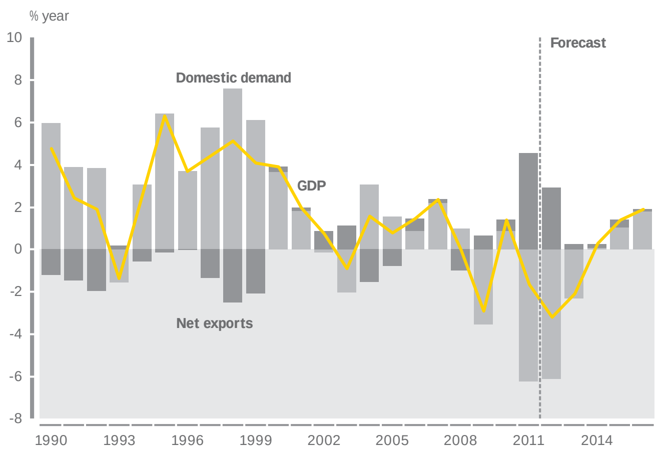
	2011	2012	2013	2014	2015	2016
GDP	1.1	-0.4	0.4	1.2	1.1	1.2
Private consumption	-1.0	-1.1	0.0	1.0	1.1	1.2
Fixed investment	5.7	-2.9	1.8	2.7	2.2	2.2
Stockbuilding (% of GDP)	0.7	0.4	0.3	0.3	0.3	0.3
Government consumption	0.1	0.7	-0.4	-0.2	-0.2	0.0
Exports of goods and services	3.9	3.6	3.4	3.8	3.3	2.8
Imports of goods and services	3.6	3.0	3.5	3.9	3.3	2.8
Consumer prices	2.5	2.7	2.3	1.6	1.3	1.2
Unemployment rate (level)	4.4	5.3	5.9	6.0	5.9	5.8
Current account balance (% of GDP)	8.5	8.8	7.3	7.2	7.2	7.4
Government budget (% of GDP)	-4.7	-3.6	-3.2	-2.9	-1.8	-1.4
Government debt (% of GDP)	65.2	68.5	70.3	71.4	71.6	71.1

Portugal

- Portuguese GDP fell by 1.2% quarter-on-quarter in Q2 2012, and the recession is set to deepen. Monthly economic indicators remain unfavorable and point to sharp declines in consumer spending. Meanwhile, low business confidence and tight credit conditions imply that investment will fall as well.
- But the Government's efforts to restructure the economy have helped to improve competitiveness, and the current account deficit is falling sharply. Exports are expected to continue growing, albeit more slowly than in previous years, despite the Eurozone slipping into recession.
- But the weak economic outlook suggests that Portugal will miss its budget deficit target for 2012, and the Government is hoping to achieve some leeway in this regard from the EU and IMF. Bond yields have fallen to the lowest levels since early 2011, but they are still too high for Portugal to be able to access financial markets.

Figure 40

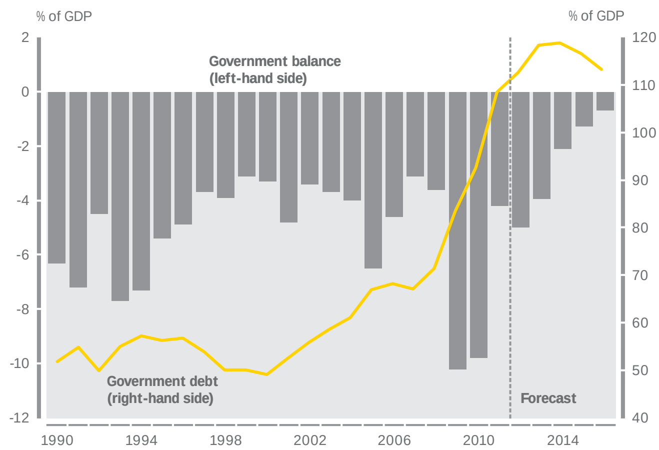
Contributions to GDP growth



Source: Oxford Economics

Figure 41

Government balance and debt



Source: Oxford Economics

Table 15

Portugal (annual percentage changes unless specified)

Source: Oxford Economics

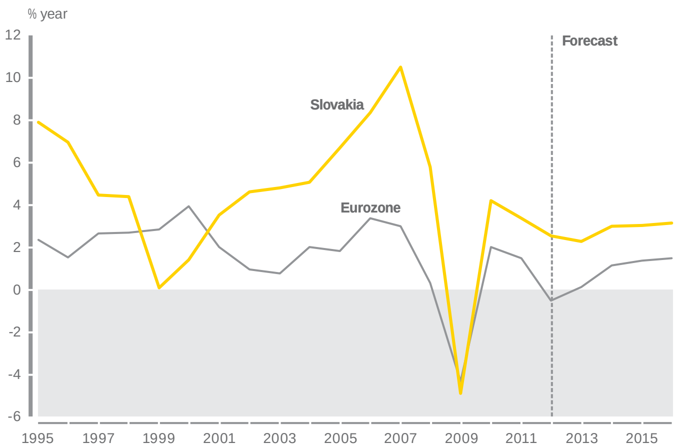
	2011	2012	2013	2014	2015	2016
GDP	-1.7	-3.2	-2.0	0.5	1.2	1.2
Private consumption	-4.0	-6.0	-3.2	0.2	0.9	0.9
Fixed investment	-11.3	-13.3	-6.8	-1.7	1.7	2.6
Stockbuilding (% of GDP)	-0.7	-0.5	0.1	0.1	0.0	-0.3
Government consumption	-3.8	-3.1	-3.2	-0.4	1.0	1.1
Exports of goods and services	7.5	3.9	2.7	4.2	4.0	3.8
Imports of goods and services	-5.3	-5.8	-0.3	2.4	3.3	3.3
Consumer prices	3.6	2.9	0.9	0.8	0.9	1.0
Unemployment rate (level)	12.9	15.6	16.6	16.8	16.5	16.1
Current account balance (% of GDP)	-6.5	-2.6	0.2	0.6	0.6	0.6
Government budget (% of GDP)	-4.2	-5.4	-4.1	-2.2	-1.2	-0.6
Government debt (% of GDP)	107.8	116.4	121.8	122.4	121.0	119.0

Slovakia

- Economic activity in Slovakia has been surprisingly solid so far this year, with GDP posting quarterly rises of 0.7% in both Q1 and Q2 and showing year-on-year growth of 3.0% in H1. This was one of the strongest performances in the Eurozone. Activity has been driven by exports, but domestic demand remains very weak.
- The export-oriented economy will lose momentum, however, as the sovereign debt crisis in the Eurozone undermines regional demand, and we expect GDP to decline in H2. As a result, our forecast for overall 2012 GDP growth is 2.5%, a relatively modest slowdown from 3.3% in 2011.
- Slowing growth will make the process of fiscal consolidation even harder. The Government has announced further austerity measures in an attempt to reduce the budget deficit to 3.0% of GDP in 2013, but based on our growth forecast we expect the deficit to fall only as far as 3.8% of GDP. Moreover, the proposed bank levy may further undermine growth prospects.

Figure 42

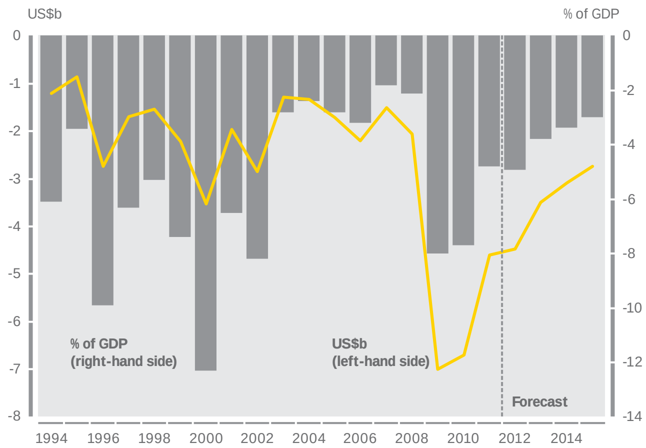
Real GDP growth



Source: Oxford Economics

Figure 43

Government budget balance



Source: Oxford Economics

Table 16

Slovakia (annual percentage changes unless specified)

Source: Oxford Economics

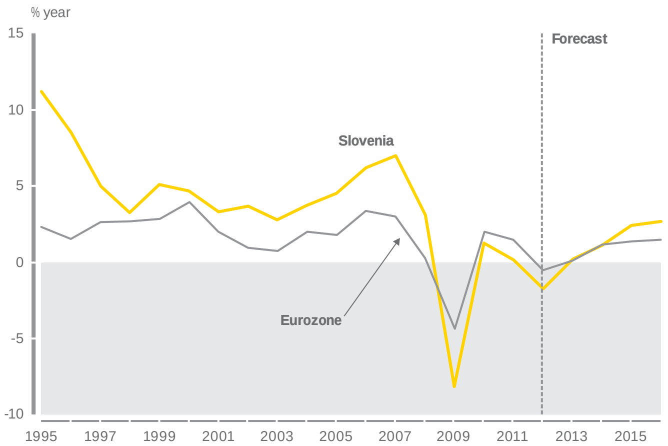
	2011	2012	2013	2014	2015	2016
GDP	3.3	2.5	2.3	3.0	3.0	3.1
Private consumption	-0.4	-0.1	1.0	2.3	2.7	3.0
Fixed investment	5.7	-0.8	1.8	3.7	4.3	4.5
Stockbuilding (% of GDP)	-1.8	-1.6	0.2	0.4	0.3	0.3
Government consumption	-3.5	0.0	1.8	2.1	2.2	2.4
Exports of goods and services	10.8	6.5	0.6	4.5	5.0	4.7
Imports of goods and services	4.5	3.9	1.7	4.4	5.1	5.1
Consumer prices	3.9	3.5	2.8	2.1	2.1	2.1
Unemployment rate (level)	13.6	14.1	13.9	12.7	11.7	10.9
Current account balance (% of GDP)	0.1	2.2	0.5	0.2	0.1	-0.2
Government budget (% of GDP)	-4.8	-4.9	-3.8	-3.4	-3.0	-2.7
Government debt (% of GDP)	43.3	46.7	48.7	49.8	50.3	50.5

Slovenia

- Growth prospects have been undermined by the weakness of external demand, and recession will return this year as budget cuts lead to a fall in domestic demand. GDP is set to fall by 1.7% in 2012 before a weak export-led return to growth of just 0.2% in 2013.
- Renewed worsening in the condition of the major banks due to the slowdown has heightened their need for additional capital, adding to budget strains despite assistance from the ECB. And even allowing for further austerity measures, the fiscal deficit — seen at 4.6% of GDP this year — remains well above the target agreed with the EU. This has led to sharp downgrades in credit ratings, and it now seems increasingly likely that Slovenia will resort to EU bailout assistance.
- An EU bailout would promote a return to medium-term growth by stabilizing confidence and helping investment to recover. But it would also reinforce the need for public spending cuts and measures to reduce debt, delaying substantial recovery until 2015.

Figure 44

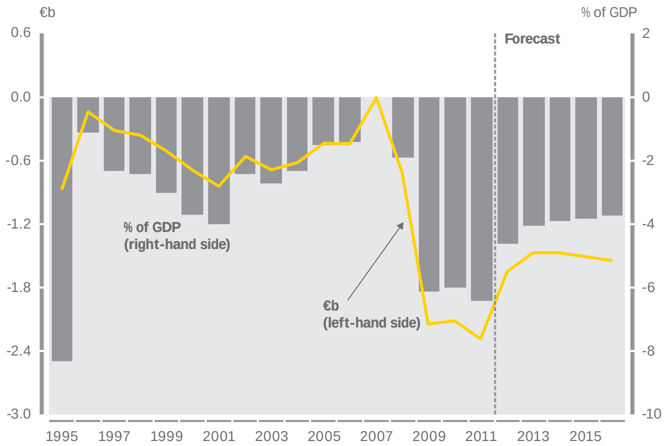
Real GDP growth



Source: Oxford Economics

Figure 45

Government budget balance



Source: Oxford Economics

Table 17

Slovenia (annual percentage changes unless specified)

Source: Oxford Economics

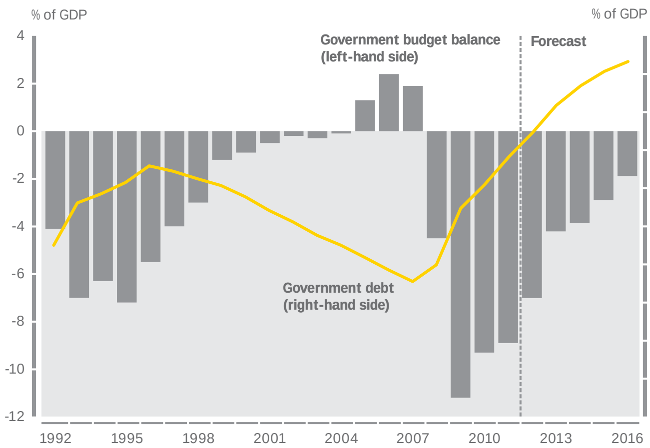
	2011	2012	2013	2014	2015	2016
GDP	0.2	-1.7	0.2	1.1	2.4	2.7
Private consumption	-0.2	-1.9	-0.6	0.8	1.5	2.2
Fixed investment	-10.4	-5.2	-0.8	1.9	3.6	3.8
Stockbuilding (% of GDP)	2.1	1.2	0.5	0.0	0.1	-0.1
Government consumption	-0.9	-4.1	-1.3	0.3	1.7	2.5
Exports of goods and services	7.8	0.7	3.2	4.2	4.4	5.0
Imports of goods and services	5.6	-2.2	1.1	3.5	4.2	4.8
Consumer prices	1.8	2.3	1.8	2.0	2.1	2.2
Unemployment rate (level)	8.2	8.3	8.7	8.5	8.1	7.4
Current account balance (% of GDP)	0.0	-0.5	-0.3	0.0	0.2	0.2
Government budget (% of GDP)	-6.4	-4.6	-4.0	-3.9	-3.8	-3.7
Government debt (% of GDP)	47.6	52.0	55.0	57.2	58.5	59.5

Spain

- Spanish bond yields have moderated since the ECB announced that it stands ready to resume purchases in the secondary bond market. But unlocking this support may be conditional on Spain first applying for aid from the ESM and then accepting the "strict and effective conditionality" that this entails. While this may prove politically challenging for the Government, our forecast assumes that Spain will enter into this program, thus ensuring that sovereign risk premiums are contained.
- Market jitters appear to have been fueled by the Government's announcement of €65 billion of additional austerity measures. There are worries that Spain is being forced into the same self-defeating cycle of austerity and economic contraction that has afflicted Greece.
- In light of the additional fiscal austerity measures, we have lowered our GDP forecasts for the next two years. After an expected GDP decline of 1.5% this year, we now forecast that the economy will shrink by 2.0% in 2013 before returning to very modest growth of just 0.3% in 2014.

Figure 46

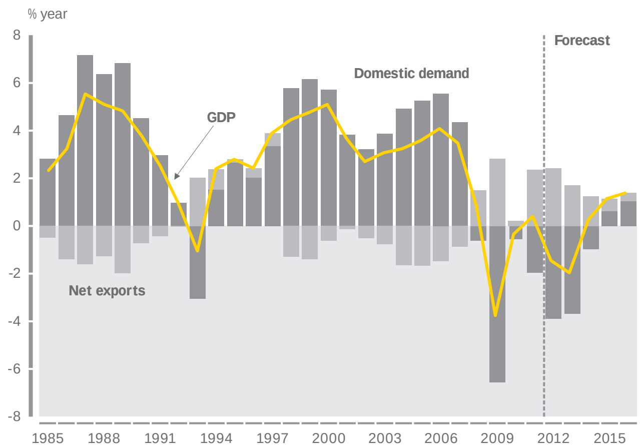
Government balance and debt



Source: Oxford Economics

Figure 47

Contributions to GDP growth



Source: Oxford Economics

Table 18

Spain (annual percentage changes unless specified)

Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	0.4	-1.5	-2.0	0.3	1.2	1.4
Private consumption	-1.0	-1.7	-2.7	-0.6	1.0	1.2
Fixed investment	-5.3	-9.6	-6.1	-0.2	1.8	1.7
Stockbuilding (% of GDP)	0.6	0.4	0.4	0.4	0.3	0.3
Government consumption	-0.5	-3.3	-4.4	-3.2	-0.4	0.5
Exports of goods and services	7.6	1.9	3.0	4.8	4.7	3.7
Imports of goods and services	-0.9	-6.2	-2.8	1.1	3.8	3.3
Consumer prices	3.1	1.8	1.3	1.1	0.9	1.0
Unemployment rate (level)	21.7	24.9	26.4	26.4	25.5	24.6
Current account balance (% of GDP)	-3.5	-2.4	-1.4	-1.3	-1.1	-1.0
Government budget (% of GDP)	-8.9	-7.0	-4.2	-3.9	-2.9	-1.9
Government debt (% of GDP)	68.5	77.0	84.0	89.1	92.6	94.7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Detailed tables and charts

Forecast assumptions

	2011	2012	2013	2014	2015	2016
Short-term interest rates (%)	1.4	0.8	0.8	0.8	0.9	0.9
Long-term interest rates (%)	4.4	4.1	3.7	3.8	4.0	4.3
Euro effective exchange rate (1995=100)	120.8	115.0	114.0	110.0	106.4	107.2
Oil prices (€/barrel)	80.0	87.0	82.0	90.9	100.3	104.0
Share prices (% year)	-7.1	-7.5	7.2	10.0	9.3	8.6

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Short-term interest rates (%)	1.1	1.4	1.6	1.5	1.0	0.7	0.8	0.8
Long-term interest rates (%)	4.3	4.5	4.3	4.5	4.4	4.3	3.9	3.7
Euro effective exchange rate (1995=100)	119.4	122.4	121.2	120.4	116.8	115.8	113.0	114.4
Oil prices (€/barrel)	76.6	81.7	80.2	81.2	90.3	84.7	88.5	84.5
Share prices (% year)	-0.7	10.7	-20.7	-17.1	-14.9	-20.5	8.0	3.4

Eurozone GDP and components

Quarterly forecast
(quarterly percentage changes)

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	0.6	0.2	0.1	-0.3	0.0	-0.2	-0.4	-0.1
Private consumption	0.0	-0.4	0.2	-0.5	-0.2	-0.2	-0.1	-0.1
Fixed investment	2.0	-0.2	-0.4	-0.5	-1.3	-0.8	-1.1	-0.2
Government consumption	-0.2	0.0	-0.2	0.0	0.2	0.1	-0.2	-0.3
Exports of goods and services	1.5	0.6	1.5	-0.2	0.7	1.3	0.2	0.4
Imports of goods and services	1.1	0.2	0.5	-1.4	-0.2	0.9	-0.2	0.3

Contributions to GDP growth
(percentage point contribution to quarter-on-quarter GDP growth)

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	0.6	0.2	0.1	-0.3	0.0	-0.2	-0.4	-0.1
Private consumption	0.0	-0.2	0.1	-0.3	-0.1	-0.1	-0.1	-0.1
Fixed investment	0.4	0.0	-0.1	-0.1	-0.2	-0.2	-0.2	0.0
Government consumption	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
Stockbuilding	0.1	0.3	-0.4	-0.5	-0.1	-0.2	-0.3	0.0
Exports of goods and services	0.6	0.3	0.6	-0.1	0.3	0.6	0.1	0.2
Imports of goods and services	-0.4	-0.1	-0.2	0.6	0.1	-0.4	0.1	-0.1

Annual levels – real terms
(€ billion. 2000 prices)

	2011	2012	2013	2014	2015	2016
GDP	8,595	8,549	8,557	8,653	8,767	8,893
Private consumption	4,859	4,817	4,811	4,844	4,894	4,953
Fixed investment	1,623	1,572	1,568	1,605	1,649	1,692
Government consumption	1,836	1,837	1,824	1,822	1,83	1,843
Stockbuilding	39	-29	-39	-35	-36	-41
Exports of goods and services	3,761	3,862	3,98	4,166	4,361	4,55
Imports of goods and services	3,523	3,51	3,587	3,749	3,93	4,104

Annual levels – nominal terms
(€ billion)

	2011	2012	2013	2014	2015	2016
GDP	9,422	9,491	9,625	9,864	10,13	10,416
Private consumption	5,413	5,477	5,565	5,68	5,809	5,955
Fixed investment	1,801	1,773	1,788	1,853	1,929	2,006
Government consumption	2,034	2,051	2,063	2,089	2,13	2,178
Stockbuilding	37	-38	-64	-19	24	40
Exports of goods and services	4,137	4,32	4,512	4,803	5,111	5,416
Imports of goods and services	4,001	4,092	4,24	4,542	4,873	5,179

Prices and cost indicators

(annual percentage changes unless specified)

	2011	2012	2013	2014	2015	2016
HICP headline inflation	2.7	2.3	1.7	1.4	1.3	1.3
Inflation ex-energy	1.7	1.7	1.7	1.3	1.1	1.2
GDP deflator	1.2	1.3	1.3	1.3	1.4	1.4
Import deflator	5.1	3.1	1.2	1.7	1.7	1.5
Export deflator	10.2	1.4	-0.9	2.2	2.1	1.5
Terms of trade	5.1	-1.8	-2.1	0.5	0.4	-0.1
Earnings	2.4	1.6	1.4	1.8	2.1	2.4
Unit labor costs	0.8	1.6	0.6	0.6	1.1	1.2
Output gap (% of GDP)	-1.8	-2.9	-3.6	-3.4	-3.2	-2.9
Oil prices (€ per barrel)	80.0	87.0	82.0	90.9	100.3	104.0
Euro effective exchange rate (1995=100)	120.8	115.0	114.0	110.0	106.4	107.2

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
HICP headline inflation	2.5	2.8	2.7	2.9	2.7	2.5	2.2	2.0
Inflation ex-energy	1.3	1.7	1.7	2.0	1.9	1.8	1.5	1.6
GDP deflator	1.1	1.2	1.2	1.3	1.2	1.3	1.3	1.4
Import deflator	7.2	4.3	3.9	4.9	4.1	3.1	3.0	2.5
Export deflator	15.4	10.0	7.3	8.3	6.0	2.3	-0.8	-1.9
Terms of trade	8.2	5.6	3.5	3.4	2.0	-0.8	-3.8	-4.4
Earnings	2.2	2.4	2.6	2.4	2.0	1.5	1.5	1.3
Unit labor costs	-0.2	0.9	1.1	1.4	1.5	1.4	1.9	1.5
Output gap (% of GDP)	-1.9	-1.6	-1.7	-2.2	-2.3	-2.6	-3.2	-3.5
Oil prices (€ per barrel)	76.6	81.7	80.2	81.2	90.3	84.7	88.5	84.5
Euro effective exchange rate (1995=100)	119.4	122.4	121.2	120.4	116.8	115.8	113.0	114.4

Note: HICP is the European Harmonized Index of Consumer Prices.

Labor market indicators

(annual percentage changes unless specified)

	2011	2012	2013	2014	2015	2016
Employment	0.1	-0.5	-0.7	0.0	0.2	0.3
Unemployment rate (%)	10.2	11.3	12.0	12.0	11.7	11.4
NAIRU (%)	8.1	8.2	8.4	8.5	8.3	8.1
Participation rate (%)	74.1	74.8	75.1	75.2	75.3	75.5
Earnings	2.4	1.6	1.4	1.8	2.1	2.4
Unit labor costs	0.8	1.6	0.6	0.6	1.1	1.2

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employment	0.2	0.3	0.2	-0.2	-0.4	-0.5	-0.6	-0.6
Unemployment rate (%)	9.9	9.9	10.2	10.6	10.9	11.2	11.4	11.7
NAIRU (%)	8.1	8.1	8.1	8.1	8.1	8.2	8.2	8.3
Participation rate (%)	73.9	74.1	74.2	74.4	74.5	74.9	74.9	75.0
Earnings	2.2	2.4	2.6	2.4	2.0	1.5	1.5	1.3
Unit labor costs	-0.2	0.9	1.1	1.4	1.5	1.4	1.9	1.5

Note: NAIRU is the Non-Accelerating Inflation Rate of Unemployment, i.e., the rate of unemployment below which inflationary pressures would start to appear due to labor market tightness.

Current account and fiscal balance

	2011	2012	2013	2014	2015	2016
Trade balance (€b)	-7.4	88.9	137.2	132.0	115.2	118.1
Trade balance (% of GDP)	-0.1	1.0	1.6	1.5	1.3	1.3
Current account balance (€b)	-3.1	74.9	108.1	96.2	87.3	90.9
Current account balance (% of GDP)	0.0	0.8	1.1	1.0	0.9	0.9
Government budget balance (€b)	-387	-321	-237	-189	-143	-100
Government budget balance (% of GDP)	-4.1	-3.4	-2.5	-1.9	-1.4	-1.0
Cyclically adjusted surplus (+) /deficit (-) (% of GDP)	-3.6	-2.9	-1.9	-1.3	-0.8	-0.3
Government debt (€b)	8,287	8,649	8,957	9,276	9,591	9,856
Government debt (% of GDP)	96.4	101.2	104.7	107.2	109.4	110.8

Measures of convergence and divergence within the Eurozone

	2002–2006	2007–2011	2012–2016
Growth and incomes			
Standard deviation of GDP growth rates	1.9	2.3	1.3
Growth rate gap (max–min)	6.6	9.1	4.9
Highest GDP per capita (Eurozone = 100)	238.5	243.8	242.1
Lowest GDP per capita (Eurozone = 100)	53.4	66.5	65.9
Inflation and prices			
Standard deviation of inflation rates	1.3	1.0	0.6
Inflation rate gap (max–min)	5.4	4.0	2.2
Highest price level (Eurozone = 100)	122.5	121.7	121.0
Lowest price level (Eurozone = 100)	52.1	67.7	71.5

Cross-country tables

Real GDP
(% year)

Rank		2011	2012	2013	2014	2015	2016	Average 2012–2016
1	Estonia	7.6	2.3	3.1	4.0	4.2	4.2	**3.6**
2	Slovakia	3.3	2.5	2.3	3.0	3.0	3.1	**2.8**
3	Luxembourg	1.6	-0.2	1.3	3.6	3.3	3.0	**2.2**
4	Malta	2.1	0.7	1.3	2.3	2.3	2.3	**1.8**
5	Ireland	1.4	0.1	1.0	1.9	2.2	2.8	**1.6**
6	Finland	2.7	0.5	0.7	1.1	2.1	2.4	**1.4**
7	Germany	3.1	0.8	1.0	1.7	1.7	1.6	**1.3**
8	Austria	2.7	0.9	0.9	1.8	1.4	1.4	**1.3**
9	Slovenia	0.2	-1.7	0.2	1.1	2.4	2.7	**0.9**
10	Belgium	1.8	-0.3	0.5	1.3	1.5	1.4	**0.9**
11	France	1.7	0.0	0.5	1.2	1.2	1.3	**0.8**
12	Cyprus	0.5	-2.0	-0.8	1.2	2.3	3.0	**0.7**
13	Netherlands	1.1	-0.4	0.4	1.2	1.1	1.2	**0.7**
14	Eurozone	1.5	-0.5	0.1	1.1	1.3	1.4	**0.7**
15	Italy	0.5	-2.3	-0.5	0.5	0.8	1.0	**-0.1**
16	Spain	0.4	-1.5	-2.0	0.3	1.2	1.4	**-0.1**
17	Portugal	-1.7	-3.2	-2.0	0.5	1.2	1.2	**-0.5**
18	Greece	-6.9	-6.0	-3.4	-1.2	0.0	1.5	**-1.9**

Inflation rates
(% year)

Rank		2011	2012	2013	2014	2015	2016	Average 2012–2016
1	Greece	3.1	1.1	0.2	0.1	0.4	0.8	**0.5**
2	Spain	3.1	1.8	1.3	1.1	0.9	1.0	**1.2**
3	Portugal	3.6	2.9	0.9	0.8	0.9	1.0	**1.3**
4	Ireland	1.2	1.7	1.3	1.2	1.4	1.5	**1.4**
5	Germany	2.5	2.0	1.4	1.4	1.4	1.5	**1.5**
6	Eurozone	2.7	2.3	1.7	1.4	1.3	1.3	**1.6**
7	France	2.3	2.2	1.6	1.6	1.4	1.3	**1.6**
8	Finland	3.3	2.9	2.2	1.2	1.0	0.8	**1.6**
9	Austria	3.6	2.1	1.4	1.5	1.6	1.6	**1.6**
10	Belgium	3.4	2.6	1.3	1.4	1.5	1.6	**1.7**
11	Netherlands	2.5	2.7	2.3	1.6	1.3	1.2	**1.8**
12	Italy	2.9	3.4	2.6	1.8	1.1	1.2	**2.0**
13	Slovenia	1.8	2.3	1.8	2.0	2.1	2.2	**2.1**
14	Luxembourg	3.7	2.6	1.9	2.0	2.0	2.0	**2.1**
15	Slovakia	3.9	3.5	2.8	2.1	2.1	2.1	**2.5**
16	Cyprus	3.5	3.4	2.5	2.3	2.3	2.3	**2.5**
17	Estonia	5.0	3.8	2.6	2.2	2.2	2.1	**2.6**
18	Malta	2.5	3.9	2.7	2.2	2.3	2.3	**2.7**

Cross–country tables

Unemployment rate
(% of labor force)

Rank		2011	2012	2013	2014	2015	2016	Average 2012–2016
1	Austria	4.1	4.5	4.9	4.6	4.3	4.3	**4.5**
2	Germany	6.0	5.5	5.5	5.4	5.2	5.1	**5.4**
3	Malta	6.5	6.3	6.1	5.5	5.0	4.4	**5.5**
4	Netherlands	4.4	5.3	5.9	6.0	5.9	5.8	**5.8**
5	Luxembourg	4.9	5.7	6.7	6.7	6.2	5.6	**6.2**
6	Finland	7.8	7.7	7.8	7.5	7.3	7.1	**7.5**
7	Belgium	7.2	7.3	8.0	8.1	7.9	7.7	**7.8**
8	Slovenia	8.2	8.3	8.7	8.5	8.1	7.4	**8.2**
9	Cyprus	7.9	10.5	9.9	8.7	7.7	5.5	**8.5**
10	Estonia	12.4	10.2	9.3	8.4	7.7	6.9	**8.5**
11	France	9.6	10.2	10.5	10.3	10.2	10.0	**10.3**
12	Italy	8.4	10.7	12.0	12.0	11.6	11.2	**11.5**
13	Eurozone	10.2	11.3	12.0	12.0	11.7	11.4	**11.7**
14	Slovakia	13.6	14.1	13.9	12.7	11.7	10.9	**12.7**
15	Ireland	14.5	14.9	15.5	15.3	15.0	14.6	**15.1**
16	Portugal	12.9	15.6	16.6	16.8	16.5	16.1	**16.3**
17	Spain	21.7	24.9	26.4	26.4	25.5	24.6	**25.6**
18	Greece	17.7	23.4	26.1	27.2	27.5	27.6	**26.4**

Government budget
(% of GDP)

Rank		2011	2012	2013	2014	2015	2016	Difference 2012–2016
1	Estonia	-0.5	-0.7	-0.8	-1.2	-1.0	-1.1	**-0.4**
2	Finland	-0.6	-1.9	-2.9	-3.0	-2.6	-1.8	**0.1**
3	Luxembourg	-6.4	-4.6	-4.0	-3.9	-3.8	-3.7	**0.9**
4	Germany	-1.0	-1.2	-1.0	-0.9	-0.6	-0.2	**1.0**
5	Malta	-2.7	-2.9	-2.5	-2.1	-1.9	-1.7	**1.2**
6	Austria	-2.6	-3.3	-2.8	-2.0	-1.8	-1.8	**1.5**
7	Belgium	-3.9	-2.4	-1.3	-0.8	-0.6	-0.4	**2.0**
8	Slovakia	-9.1	-8.0	-6.5	-5.7	-5.9	-6.0	**2.1**
9	Slovenia	1.0	-2.3	-1.1	-0.6	-0.2	0.0	**2.3**
10	Portugal	-4.8	-4.9	-3.8	-3.4	-3.0	-2.7	**2.3**
11	France	-4.7	-3.6	-3.2	-2.9	-1.8	-1.4	**2.3**
12	Eurozone	-3.7	-3.3	-2.9	-2.3	-1.6	-1.0	**2.3**
13	Italy	-4.1	-3.4	-2.5	-1.9	-1.4	-1.0	**2.4**
14	Greece	-5.2	-4.7	-3.5	-2.5	-1.8	-1.3	**3.3**
15	Netherlands	-6.3	-4.7	-3.1	-1.7	-0.6	-0.3	**4.4**
16	Cyprus	-4.2	-5.4	-4.1	-2.2	-1.2	-0.6	**4.8**
17	Spain	-8.9	-7.0	-4.2	-3.9	-2.9	-1.9	**5.1**
18	Ireland	-12.6	-8.3	-6.7	-4.6	-3.1	-2.0	**6.3**

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