



Eurozone

Ernst & Young Eurozone Forecast

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Welcome

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There is little point in denying that these are still testing times for Europe. Recession and rising unemployment continue to blight the Eurozone, with their shadows extending across borders and scarring countries large and small. This

latest *Ernst & Young Eurozone Forecast* considers the options for policy-makers and business leaders but, sadly, we find few glimmers of hope for the immediate future.

It wasn't supposed to be like this. When the credit markets first started to contract in 2007, few could have foreseen the extraordinary period that continues to play out. Since then, growth has evaporated, unemployment has surged and recession has returned to haunt Europe's economies once more. But there is no point in looking back. Instead, the reality of Europe, some six years on from the start of the crisis, must be faced.

The first step is to accept that there is no sign of imminent improvement. The GDP contraction of 0.2% in January to March this year meant that the recession in the Eurozone has now lasted for six quarters. Few countries are escaping. France, for example, is once again in recession after its economy shrank by 0.2% in the first quarter of the year. Germany too is struggling, with its growth in the same quarter at just 0.1%. We now think that

the Eurozone recession will last longer than previously projected. GDP in 2013 is forecast to fall 0.6%, a slightly larger decline than in 2012. A very slow recovery should then begin, with GDP growing just under 1% in 2014 and around 1.5% a year in 2015-17.

Unemployment, meanwhile, continues its relentless rise. Having hit a record high of 12.2% in April, a total of 19.4 million people are now out of work in the Eurozone. Think about that for a moment. It's not just a number, and "unemployment" is not just word. More than 19 million households across the region are currently coping not only with vastly reduced earnings, but also the pain and misery that unemployment leaves in its wake. Europe's core asset – its workforce – is left to decline, which is also a great threat for business and governments to consider in terms of political and social stability.

We now expect unemployment to peak in the first quarter of 2014, but at 12.7% rather than 12.5% – equivalent to an extra 500,000 unemployed workers. As a result, we forecast private consumption to contract again this year, by 0.8%, before growing 0.5% in 2014 and just over 1% in 2015. Such forecasts reflect the stream of disappointing market data seen in recent weeks, not only from the Eurozone, but across the global economy. Although positive jobs numbers in the US suggest that its economy has turned a corner, the recovery remains fragile. Western governments are still hugely over-indebted and worries are beginning to proliferate over China's slowing growth rate.

Given this bleak context, it is hardly surprising that European policy-makers are increasingly turning away from fiscal austerity toward fiscal credibility. And they are right to do so. Halving the austerity measures that are currently planned would raise Eurozone GDP by 1% by 2014.

This forecast reflects the fact that we are on the track back to recovery and growth, but more slowly than we anticipated in our March forecast. However, in this report we also note some positives. There are strong signs that the Eurozone, and particularly the countries that have been hit hardest, will emerge stronger from the crisis, as they are implementing much-needed structural reforms to increase their competitiveness. And in this respect they are progressing faster than the core countries in the Eurozone, which need to do more to rebalance their economies.

The *Eurozone Forecast* aims to provide an easily accessible overview of macroeconomic development and to stimulate a discussion among policy-makers and the business community on how to foster growth. We believe that there are still exciting opportunities in the huge Eurozone market and that one way of grasping these is to stay abreast of developments. I encourage you to follow these developments on our dedicated website, ey.com/eurozone, and through our comments on Twitter.

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Highlights

The recession will last longer than previously projected ...

- Eurozone GDP is forecast to fall 0.6% in 2013, a slightly larger decline than in 2012.
- The recovery should begin in 2014, with GDP growing just under 1%.
- Unemployment will peak at around 20.5 million in early 2014, equal to 12.7% of the workforce.

... as global conditions are unhelpful

- Softer activity in some emerging markets is holding back growth, particularly in the most trade-dependent Eurozone economies.
- The sharp fall in the yen is hampering European export prospects by intensifying competition from Japan.

But monetary and fiscal policies are being relaxed ...

- The European Central Bank cut interest rates in May, but is now thought less likely to implement measures to encourage loans to small and medium-sized businesses.
- There are clear signs that the European Commission has relaxed its stance on fiscal policy, shifting from fiscal austerity to fiscal credibility.
- Halving the austerity measures currently planned would raise Eurozone GDP by nearly 1% by 2014, with Greece and Spain benefiting most.

... and reforms will help peripheral countries

- Some peripheral countries have already made significant progress as extreme financing constraints have forced much-needed reforms, in areas such as labor market regulation and social welfare.
- Core countries have made less progress. They still need to boost competition in non-tradable sectors in order to help intra-Eurozone rebalancing.



Implications for businesses: adaptation required to deal with delayed Eurozone recovery



As slower growth in China, Brazil and some other emerging markets is undermining global demand, and rising unemployment is constraining domestic consumption, businesses will have to adapt to the fact that recovery in the Eurozone is taking longer than anticipated. Yet, as the 17-nation Eurozone enters what may be its seventh quarter of economic contraction, financial markets are signaling a pickup amid a more benign outlook. Business leaders now need to weigh up the Eurozone trends, sift for growth opportunities and refine strategies to meet a gradual rise in economic activity during 2014.

Securing the upside

It is important for business leaders to follow the two contrasting sets of forces that are at work. On the upside, we believe that the policy environment within the Eurozone has become substantially more supportive as the tone has shifted from fiscal austerity to fiscal reality. This is reflected both in the policies of the European Central Bank (ECB) and an acceptance of a slowing in the pace of the austerity planned by some European Union (EU) member states.

Better credit conditions are on the way. May's quarter-point cut in the ECB refinancing rate, to 0.5%, reflected both poorer growth prospects within the Eurozone and the ECB's determination to do something about it. The Bank urged governments to maintain progress on fiscal deficit reduction, but simultaneously stressed that reviving lending to small and medium-sized enterprises (SMEs) is a key objective. The ECB is aware that lending cheaper money to banks does not necessarily help SMEs in peripheral states, and is exploring ways to revive the market in securities backed by bank loans to small businesses. This would free banks to make more loans to the business sectors that find it hardest to access finance. Although an early move to lift credit to SMEs seems unlikely, making it easier for them to access finance would have a positive effect on Eurozone recovery. We calculate that if half the credit tightening that has happened since 2008 were reversed within two years, Eurozone GDP would increase by €65b, or 0.7%, and unemployment would be almost 500,000 lower by 2017.

The second upside for business stems from the growing recognition that markets and business alike need fiscal credibility rather than fiscal severity. Less austerity would help a return to economic growth. We estimate that halving the austerity measures currently planned would raise Eurozone GDP by almost 1% by 2014, with some of the southern peripheral economies benefiting most.

Feeling the global brakes

But our belief that recovery will be delayed arises partly from developments outside the Eurozone. Vital exports to emerging markets are likely to prove softer than previously envisaged. Cooling is especially marked in China and Brazil. This will weaken demand for Eurozone exports, which have hitherto remained a bright spot for economies such as Germany, and even Spain.

Meanwhile, business will have to consider the introduction of the growth-oriented policies initiated by Japan, which have precipitated a 40% fall in the value of the yen and are thus likely to rekindle Japanese business. Europe's exporters of products ranging from capital goods to automobiles and medicines will probably find that they face much more intense competition from Japanese rivals in both emerging markets and developed economies.

In recent years, China and Japan have emerged as top markets for luxury goods from the Eurozone. The slowdown in growth in China and depreciation of the yen could weaken demand for top-end French and Italian consumer products – though the US economic uptick might help to compensate.



Reading the markets

As they assess how best to respond to economic trends, business leaders inevitably turn to the markets for guidance. Today, the signals from the capital markets are far from unanimous: some are flashing green, while others show amber or linger on red.

Equity markets have risen strongly around the world for two principal reasons. Although this September's German parliamentary elections could have repercussions across the Eurozone, there is a broad belief that many of the major global political and economic uncertainties have been resolved. And against a backdrop of very low interest rates and quantitative easing in some developed economies, investors see equity markets as offering the best returns, especially compared with very low yields on sovereign bonds.

The extent to which equity markets reflect future prospects is debatable. Nominal peaks in equity indices are not as rosy in real terms. Yet some sharp and sudden corrections in late May, notably in Japan, could signal that markets have run ahead of events and need to stabilize. But they are reasonably well underpinned. Given the state of the economy, corporate profits have generally met or exceeded expectations. Companies have overachieved against low targets.

Investors are searching for yield. This creates opportunities for businesses to obtain affordable funding. Many companies are taking advantage and going to the market. Indeed, with investors hungry for returns, even markets in junk bonds have revived.

Many European companies have traditionally relied more heavily on bank borrowing than their US counterparts. With banks' capacity to lend limited by the need to rebuild their balance sheets, European corporates are tapping investors to renew their borrowings. By early May, European high-yield corporate issuance in 2013 had exceeded US\$57b, almost twice the amount during the same period in 2012, and almost three times the US\$19b issued in 2006. Issuers included companies from Greece, Italy and Portugal, and average yields fell below 5.5%.

As ECB President Mario Draghi and his colleagues examine how best to increase funding for SMEs, they will probably take a close look at the Bank of England's Funding for Lending Scheme. Today, smaller companies in peripheral Eurozone countries have to pay substantially higher borrowing rates than those in Germany and France.

Adapting to weak demand

With a total population of 740 million, Europe is a vast market – too big for international firms to ignore. More than 500 million well-educated and prosperous consumers within the EU alone are estimated to account for around 20% of world GDP.

But with demand growing much faster in emerging markets and the US, many non-European investors remain wary of adding capacity within the Eurozone. The blight on demand arises from the continuing increase in EU unemployment, which in turn undermines consumer demand. As consumers tighten their belts, they focus their spending on housing, utilities and food, dispensing with luxuries and seeking more cost-effective solutions to their needs.

Both manufacturing and services companies selling to these cash-strapped consumers need to brace themselves for continuing pressure on their profit margins and deferred recovery. Thus, competition seems likely to intensify further.

Adapting to structural reform

A loosening of the straitjacket of austerity spells hope for companies serving public markets, from pharmaceuticals to education supplies. But the trade-off sought by policy-makers for longer-lasting deficits may well prove to be accelerated market reform. More flexible labor markets could help companies to increase productivity, reduce costs and even relocate. But other reforms are designed to end historic privileges and protections enjoyed in some fields, such as professional services. The lesson from Germany's Agenda 2010 reform program, launched in 2003, is that they can take half a decade to deliver.



Yet simultaneously, many Eurozone governments are aiming to facilitate entrepreneurship. In Spain, where starting a business has historically been slow and cumbersome, a new law aims for a “one-stop shop” where entrepreneurs can create a company within 24 hours. Gradually, as it is made easier for innovators to bring their ideas to market more quickly and efficiently, companies will find more new suppliers clamoring to offer novel solutions to their needs.

Sustaining capacity, securing talent

We continue to believe that the Eurozone is partway through a “lost decade”. The delayed recovery creates challenges for companies and policy-makers alike. One critical challenge centers upon education and training. As unemployment surges, companies need to collaborate with employment agencies, educational institutions and training bodies to ensure that workers with appropriate skills will be available when demand recovers. Enterprises can take an “option” on skilled college leavers by expanding their internship programs to create a low-cost internal pipeline of young talent.

Another strategy being pursued by some vanguard companies is to step up recruitment in peripheral countries, such as Greece and Spain, where even highly qualified workers may be struggling to find jobs. Surging demand for German language classes in some peripherals reflects willingness among job-seekers to seize the opportunity of greater labor mobility. Meanwhile, the German Government has made it easier for firms to hire foreigners whose skills are in short supply.

As they await the tipping point, when demand from emerging economies and Eurozone consumers at last drives a sustained recovery, company directors have one overriding duty to themselves and their stakeholders: to ensure that their business is in the best possible shape to profit from the upturn when it finally comes.

Box 1

Attracting foreign direct investment

Ernst & Young's attractiveness survey: Europe 2013 reveals that a solid 3,797 foreign direct investment (FDI) projects were announced in Europe during 2012, creating over 170,000 jobs. The UK and Germany emerge as the top destinations for FDI. But it is significant that Spain, Belgium, Ireland and Finland have been able to attract substantially more projects than in previous years.

Despite the ongoing debt crisis, 37% of the global business leaders interviewed for the survey ranked Western Europe as the world's second most attractive FDI destination. One key explanation for the interest in Europe as a location is that investors have learned to master the crisis and find opportunities in the ongoing reconstruction, benefiting from the availability of cheap assets and declining labor costs.¹

Learn more at: ey.com/attractiveness

¹ *Ernst & Young's attractiveness survey: Europe 2013: Coping with the crisis, the European way*, measures the reality of FDI in terms of projects initiated and jobs created and is based both on Ernst & Young's European Investment Monitor database and a survey of 808 international decision-makers.



Implications for businesses: adaptation required to deal with delayed Eurozone recovery

Box 2

Key questions for businesses

- Follow domestic developments. What opportunities will tax changes, looser fiscal policy and better credit conditions mean for business?
- Keep an eye on the global market. What impact will the slowdown in growth in China and the depreciation of the yen have?
- Find new sources of funding. European companies depend more on bank borrowing than their US counterparts. What opportunities does this bring for investors?
- Adapting to weak Eurozone demand. The surge in unemployment undermines consumer demand. What is the effect of reduced demand and increased competitiveness? Will new markets and segments offer new opportunities?
- Spot opportunities created by structural reforms. Could labor market reforms bring new business opportunities? Is it time to relocate?
- Make sure your business is prepared for the upturn. Form a strategy to ensure that you have the appropriate skills to thrive when demand recovers. Could co-operation with employment agencies and educational institutions be a way forward? Have you considered introducing or expanding an internship program?



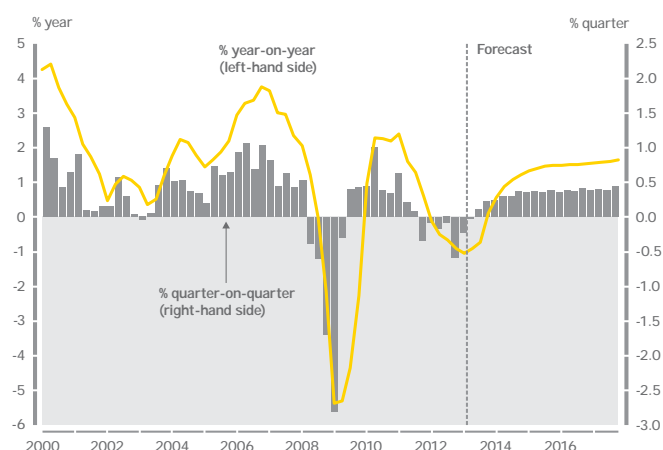
Policy environment becoming more supportive of growth



Recovery is taking longer to materialize than expected ...

Although to date this recession has not been deep, particularly when compared with the recession of 2008–09, it is proving to be protracted. Indeed, at six quarters, this recession is the longest in the Eurozone's history. We now expect it to last longer than previously projected, due to a weaker international backdrop (particularly in emerging markets) limiting exports and a weaker labor market holding back consumer spending as austerity continues to bite. GDP in 2013 is forecast to fall 0.6%, a slightly larger decline than in 2012. The steep depreciation of the yen is also limiting European export prospects by increasing competition from Japan.

Figure 1
GDP growth



Source: Oxford Economics.

Table 1 Forecast of the Eurozone economy (annual percentage changes unless specified)						
	2012	2013	2014	2015	2016	2017
GDP	-0.5	-0.6	0.9	1.4	1.5	1.6
Private consumption	-1.3	-0.8	0.5	1.1	1.3	1.5
Fixed investment	-3.9	-2.4	2.0	2.9	2.7	2.6
Stockbuilding (% of GDP)	0.0	-0.2	-0.2	-0.1	0.0	0.0
Government consumption	-0.3	-0.4	-0.3	0.3	0.6	0.8
Exports of goods and services	2.9	1.0	3.4	4.2	4.1	3.9
Imports of goods and services	-0.8	-0.1	3.0	4.4	4.4	3.9
Consumer prices	2.5	1.6	1.5	1.4	1.4	1.4
Unemployment rate (level)	11.4	12.4	12.7	12.4	12.0	11.6
Current account balance (% of GDP)	1.3	1.7	1.5	1.4	1.3	1.3
Government budget (% of GDP)	-3.7	-2.8	-2.4	-1.9	-1.5	-1.2
Government debt (% of GDP)	92.7	95.8	97.5	98.4	98.5	98.1
ECB main refinancing rate (%)	0.9	0.6	0.5	0.5	0.5	0.7
Euro effective exchange rate (1995 = 100)*	115.5	118.5	115.6	112.0	111.1	110.9
Exchange rate (\$ per €)	1.28	1.29	1.21	1.17	1.17	1.17

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

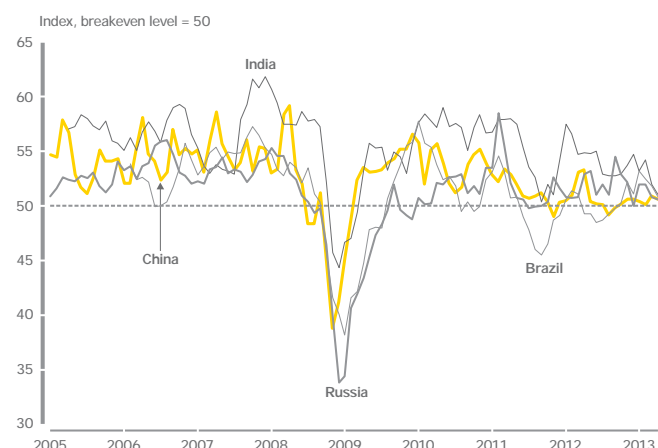
... and the international environment is taking time to improve

Although the forecast for growth in the developed economies in 2013 is little changed from our March 2013 report, our growth forecast for emerging markets has been cut from 5.4% to 5%. Notable downward revisions to individual countries include a 0.7 percentage point cut to our Chinese growth forecast (to 7.5%) and a 0.4 percentage point cut to our Brazilian growth forecast (to 2.7%).

China's growth slowed more than we had been expecting in Q1 2013, and the authorities have indicated their willingness to accept slower growth now as a trade-off for more balanced expansion in future. Recent data suggests that domestic consumption will not support the growth that we had been expecting, despite a relatively loose monetary policy stance and expanding credit. We have therefore cut our outlook for both the short and medium term. This means that Chinese import demand will be weaker than we had previously forecast, with wider ramifications for world trade and therefore growth elsewhere, particularly in the country's main trading partners – including the Eurozone.



Figure 2
BRICs: Manufacturing Purchasing Managers' Index



Source: PMI; Markit; China NBS; Haver Analytics.

The pace of Eurozone export growth is being held back by demand that is weaker than expected. In addition, the depreciation of the yen against the euro means that European exporters will face tougher competition from Japanese companies. The yen has fallen by 40% against the euro since late July 2012, with the most recent decline coming in response to a marked expansion of the Bank of Japan's quantitative easing program.

Labor market weakness is hitting the domestic economy

In addition to a weaker global environment, Eurozone unemployment has risen more than we had expected as austerity has continued to bite. The rise in unemployment reflects both the continued weakness in the external environment and the fact that austerity has been far more damaging to the economy than many early estimates suggested. Nevertheless, we still expect unemployment to peak in the first quarter of 2014, but at 12.7% rather than 12.5%, which equates to an extra

500,000 more unemployed workers. The weakness of the labor market will curtail household incomes and thus consumer spending growth over the next three years. As a result, we expect private consumption to contract again this year, shrinking by 0.8%, before growing 0.5% in 2014 and just over 1% in 2015.

Increasing risk of unemployed becoming deskilled

At over 24%, youth unemployment is particularly high in the Eurozone overall. In Greece and Spain, it has reached alarming levels, at 62% and 56% respectively. The rising number of long-term unemployed is also a concern. Almost half of the jobless total is now classed as long-term unemployed, up from a third at the start of 2009. Such high levels of youth and long-term unemployment will result in workers becoming deskilled and detached from the labor market, hindering the Eurozone's medium-term prospects.

Conditions expected to improve in H2 2012

A very slow recovery should begin in the second half of 2013, with GDP growing just under 1% in 2014 and around 1.5% a year in 2015-17. Reflecting an international environment that is weaker than expected and the further deterioration in the labor market, the downward revisions to our forecast are focused on exports and consumer spending. The revisions to our export forecasts are most pronounced for more trade-dependent Eurozone economies, such as Germany.

But other sectors will remain under pressure as consumers and governments continue to make cuts. Construction is again expected to perform very poorly in 2013, with a decline of 3.3% seen in the Eurozone as a whole, after a decline of over 4% in 2012. Meanwhile, manufacturing is forecast to post a second consecutive decline of around 1.6%, before starting to recover in 2014 as export demand and trade flows pick up. Financial and business services are expected to grow very modestly this year, before accelerating in 2014 as business confidence starts to build.

	2012	2013	2014	2015	2016	2017
Manufacturing	-1.6	-1.7	1.6	2.2	2.1	1.9
Agriculture	-0.9	-0.9	1.0	1.3	1.2	1.2
Construction	-4.2	-3.3	0.2	1.5	1.8	1.7
Utilities	0.8	-0.4	2.1	1.9	1.8	1.7
Trade	-0.7	-1.1	0.6	1.2	1.4	1.5
Financial and business services	0.7	0.1	1.4	1.7	1.7	1.8
Communications	0.6	0.8	2.5	2.7	2.8	2.8
Non-market services	0.2	-0.5	-0.2	0.4	0.6	0.9

Inflation outlook is very benign

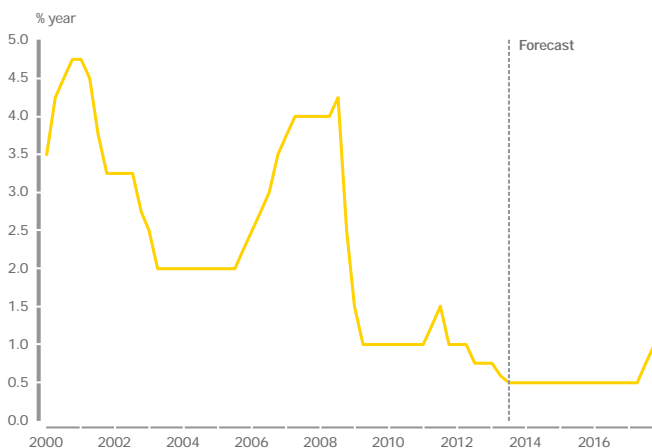
With the economy expected to contract for a second year running and spare capacity standing at 4% of GDP, we expect Eurozone inflation to fall from 2.5% in 2012 to 1.6% in 2013, and then stay close to 1.5% until 2018. And were it not for an anticipated 7% fall in the trade-weighted value of the euro by the end of 2016, the outlook for inflation would be weaker still. The forecast fall in the euro reflects the comparative weakness of a "lost decade" for the Eurozone economy, but it will also put upward pressure on import prices.

Interest rate cuts increase odds of recovery

In May, the ECB cut its policy interest rate from 0.75% to an historic low of 0.5%. Interest rates have now fallen by one percentage point since this easing cycle began in the final quarter of 2011, when the Eurozone was slipping back into recession.

This latest cut in rates has been driven by three main factors. First, there has been weakness in both the Eurozone and global activity. Eurozone activity data has been coming in below market expectations since March 2013. There have also been negative surprises outside the Eurozone, with data for the major developed economies as a whole, and for emerging markets, weaker than expected. Second, with Eurozone inflation so low, there is a clear risk of deflation, which the ECB is likely to wish to avert. Third, and perhaps most worrying, there are clear signs that credit conditions remain tight in the peripheral Eurozone countries.

Figure 3
ECB refinancing rate



Source: Oxford Economics.

Further steps will be necessary to ensure recovery

Given that corporate borrowing rates remain high in the periphery, we expect the ECB to take further steps to ease the policy environment. These are likely to be aimed at addressing the broken monetary policy transmission mechanism in the periphery, which has its origins in the fragmentation of the European banking system and financial markets. At present, low interest rates are not being passed through to the real economies in the periphery, where stimulus is most needed. Over the last year, the ECB has successfully reduced intra-Eurozone sovereign spreads. But it has been far less successful at reducing cross-country divergence in banks' lending rates to companies, which have remained stubbornly high, despite the stabilization of sovereign markets.

Figure 4
Weighted average peripheral bond spread

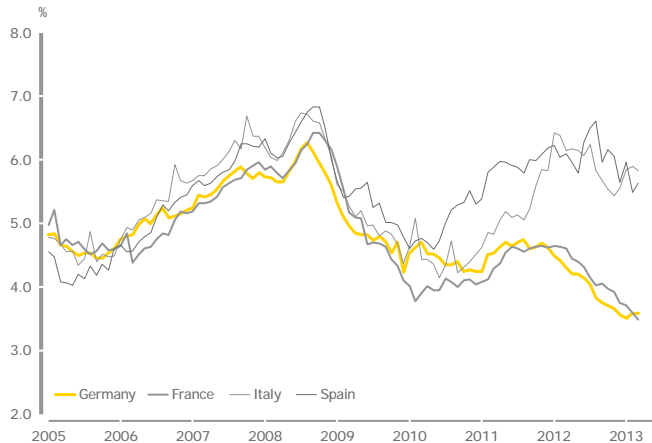


Source: Oxford Economics; Reuters.

There was a clear break in 2011, when interest rates charged to businesses in peripheral countries started to diverge from rates in the core countries. Before then, companies in the periphery and the core paid similar rates of interest on bank loans. Now, Spanish and Italian companies pay over 5.5% to borrow money, but their German and French counterparts pay only around 3.5%. This fragmentation of the banking system should be the ECB's next focus.



Figure 5
Ten-year bond yields



Source: Haver Analytics.

Further rate cuts could prove counterproductive

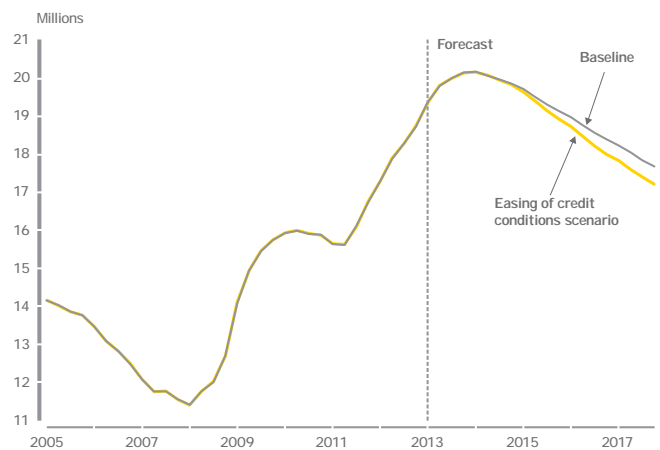
This problem will not be fixed by cutting interest rates again. Indeed, additional cuts in interest rates would probably mean that the deposit rate (the interest rate paid to banks for deposits with the ECB) would turn negative. This would hit banks' profits and therefore be counterproductive. Moreover, it is simply not possible for the ECB to cut interest rates to the extent needed in the periphery. An estimation of the appropriate rate of interest for each Eurozone country based on domestic inflation and spare capacity illustrates this point. While the ECB's current rates may be appropriate for Germany, monetary policy is far too tight for the peripheral countries. Greece would need negative interest rates of somewhere between -10% and -15%, while economic conditions in Spain and Italy would justify rates around the -1% to -4% mark. Although negative policy rates are highly unlikely, our estimates illustrate the degree of monetary policy easing that would be warranted in the peripheral countries.

Measures need to be targeted at reducing corporate borrowing rates

A more effective way for the ECB to ease monetary conditions would be to create new incentives for banks to lend to businesses, particularly SMEs. For example, this could be done by easing collateral rules in its liquidity operations, which would enable banks to fund their lending to SMEs more cheaply. ECB president Mario Draghi has mentioned that discussions are under way with the European Investment Bank to help fund a European asset-backed securities market for loans to SMEs.

Although early moves on this front now appear unlikely, we still think that easier and broader-based access to finance for SMEs could be a significant factor in securing the recovery of the Eurozone economy. At present, many small companies have to rely on retained profits or borrowing from banks if they wish to expand by investing in new machinery or hiring additional workers. Small companies tend not to have direct access to financial markets. Consequently, weakness in bank lending hits them much harder than large enterprises. Therefore, any measure that is successful in bringing down lending rates to SMEs should boost business investment, the labor market and hence the broader economy. For instance, if half the tightening in credit conditions that has occurred since 2008 were to be reversed within two years, Eurozone GDP would be raised by 0.7% (around €65b) and unemployment would be nearly 500,000 lower by 2017.

Figure 6
Unemployment



Source: Oxford Economics.

Support also needs to come from fiscal policy

As well as action from the ECB to ease credit conditions in the periphery, we also expect some easing in the pace of fiscal tightening. There is a growing recognition by policy-makers that what is needed to keep a lid on bond market borrowing costs is a credible fiscal plan rather than fiscal severity at any cost, which can kill growth and hence increase the likelihood of countries encountering debt problems. The European Commission (EC) signaled a clear shift in stance at the end of May, when it gave seven member states more time to meet their budget deficit targets.

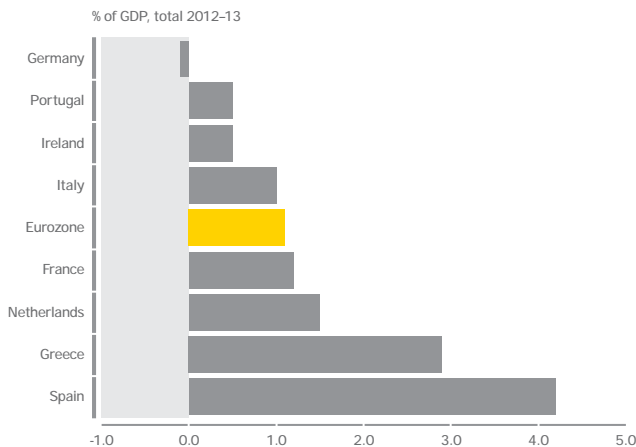
France, Spain, Poland and Slovenia have been given an extra two years to bring their deficits below the 3% of GDP under the Stability and Growth Pact. Meanwhile, Belgium, Portugal and the Netherlands have been given an extra year. This easing of targets removes the need for deeper spending cuts and revenue-raising measures, such as further increases in value-added tax (VAT), steps that would otherwise have harmed growth in the near term.

In addition, the new Italian Prime Minister has cancelled the first payment, due in June, of an unpopular property tax imposed by the previous government. There is also political pressure to cancel the next housing tax installment, due in December. Italy has ruled out a planned VAT increase in July and has promised to cut employers' welfare contributions, give tax breaks for energy-saving house improvements, expand a guarantee fund for SMEs and improve welfare benefits. Depending on how much of this actually happens, it would result in a revenue shortfall of some €10b–€20b. Yet the new Government has promised that Italy will respect its commitments to its Eurozone partners, including getting the budget deficit below 3% of GDP. The lower tax revenue is likely to be offset by reductions in current spending – there is much fat to trim, starting with one of the three existing layers of local government.

Easing austerity would be most beneficial for Spain and Greece

On current plans, discretionary cuts of 1.1% of GDP are still due to be implemented across the Eurozone in 2013, with cuts of 4.2% in Spain and 2.9% in Greece. However, given the postponement of fiscal targets in France, Spain and Italy, it is now possible to envisage a scenario in which the Eurozone moves toward abandoning austerity. Were this to happen, growth would exceed our expectations.

Figure 7
Discretionary fiscal tightening, 2013



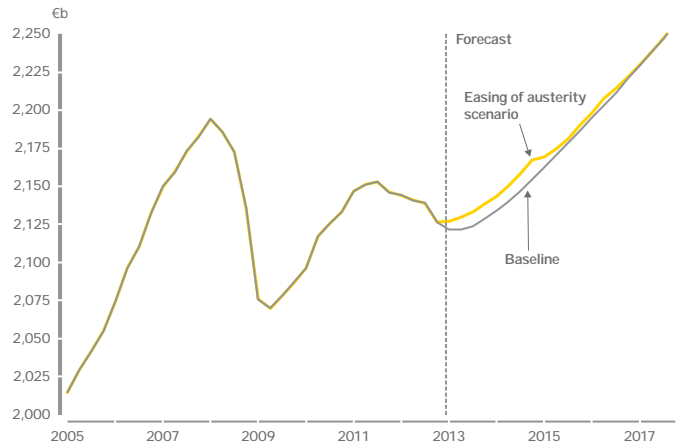
Source: Oxford Economics; Haver Analytics.

Simulations using Oxford Economics' Global Economic Model suggest that halving the currently planned austerity measures would raise the level of Eurozone GDP relative to our baseline forecast by 0.2% in 2013 and by a further 0.7% in 2014. This would take effect mainly through increased household consumption in response to a stronger labor market, as fewer public sector jobs are shed, and expanding private sector investment in response to improved business confidence. The most marked effects would be seen in Greece and Spain, where GDP would be, respectively, 0.5% and 2.3% higher in 2013 and 0.8% and 2.5% higher in 2014. However, the impact on France and Italy would also be substantial. Eurozone unemployment in 2014 would be reduced by 300,000.

But any letup in current policies would face substantial opposition from Germany and some other core Eurozone countries. This does not mean that it cannot happen, however. Some countries – notably France, Italy and Spain, which are not bound by any bailout terms and make up half of Eurozone GDP – can implement partial easing on their own, as long as their plans are approved by the EC. But a further easing of fiscal policy, notably involving fiscal stimulus in Germany, will have to wait until after the German elections in September.

Further fiscal stimulus, beyond that included in our simulation, could be provided if Germany increased public sector spending, which it has room to do. Easier fiscal policy would be the single most effective measure to foster growth in Germany and the Eurozone, but so far, this option has been rejected by the German Government.

Figure 8
GDP under alternative scenarios



Source: Oxford Economics.

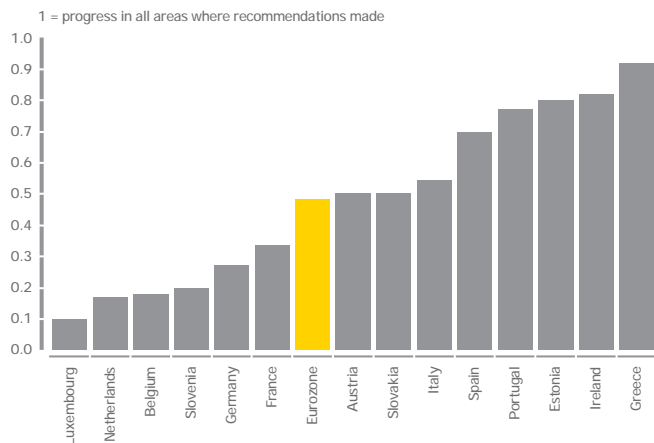


Economies could emerge stronger from the crisis

The Eurozone debt crisis and the continuing recession are acting as a catalyst for structural reforms that might not have otherwise taken place. Policy-makers are increasingly aware of the need to accompany macroeconomic stabilization policies with long-needed structural reforms. Consequently, the Eurozone could eventually emerge stronger from the crisis.

The pace of reforms has been particularly fast in the Eurozone countries that are under financial assistance programs or direct market pressures – Greece, Ireland, Italy, Portugal and Spain – even in politically sensitive areas such as labor regulation and welfare. In these countries, there has been a correlation between the pace of reform and increases in government bond yields during 2011 and 2012. This contrasts with the much more moderate pace of reforms in other Eurozone countries, in particular countries with current account surpluses such as Germany, Luxembourg and the Netherlands. Reforms, including measures to boost competitiveness in non-tradable sectors, are also needed in these countries to assist with intra-Eurozone rebalancing.

Figure 9
Responsiveness to structural reforms recommended by the OECD



Source: Oxford Economics; OECD.

Labor market reform is particularly intense in the periphery

The intensity of reform has been particularly high in the areas of wage bargaining and employment legislation, as countries have sought to boost job creation, facilitate the reallocation of resources toward growing sectors and reduce labor market duality (the existence of separate segments where comparable workers enjoy differential wage conditions and job protection). For example, Portugal and Spain have raised the responsiveness of wage adjustments to labor market conditions by allowing firms in weak markets to deviate from collective bargaining agreements. Reforms in the important area of job protection

Box 3

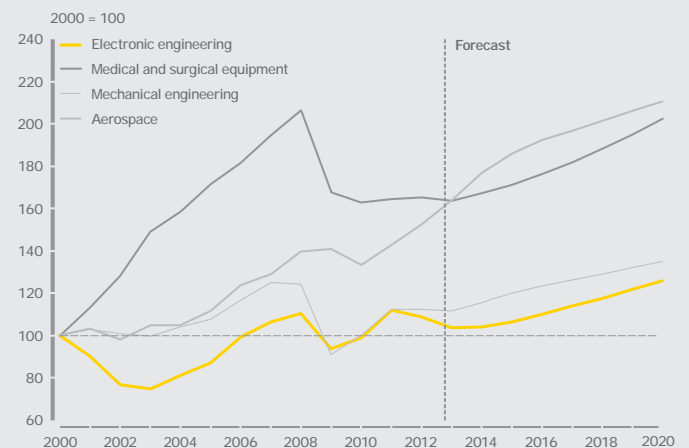
Eurozone manufacturing winners in the current environment

The manufacturing sectors that will perform best in the current environment are those in which the Eurozone has clear technological and quality advantages over lower-cost competitors. These include aerospace, electronics, machinery, and medical and surgical equipment.

Aerospace industry will benefit from global passenger growth

The European aerospace industry's prospects remain positive, with the International Air Transport Association raising its forecast in December for global airline profits – to US\$6.7b in 2012 and US\$8.4b for this year – and passenger growth continuing. The main long-term driver of expansion in passenger numbers is the increasing wealth of the middle classes in emerging markets. So, while globalization is resulting in more long-haul business travel, growing prosperity in emerging markets is raising demand for short-haul aircraft. Although the order cycle has probably peaked for civilian aircraft, backlogs remain substantial. Meanwhile, lower macroeconomic risks cement the prospects for airlines taking deliveries on schedule. Airlines in turn are keen for the delivery of new planes to help raise the fuel efficiency of their fleets.

Figure 10
Leading manufacturing sectors



Source: Oxford Economics.

Despite fewer new orders than Boeing booked last year, the €550b Airbus order book underpins European production prospects, and it seems that deliveries are finally being ramped up. Output prospects for Germany, Italy and the UK are all now felt to be significantly better than at the start of the year. EU output growth is now expected to be over 8.5% (with both the UK and Germany posting double-digit gains). The positive impact should be felt across the Eurozone, given that Airbus's supply chain reaches across the continent.

Although demand for civilian aircraft is buoyant, the military sector continues to suffer from pressured defense budgets. In the US, the sequester will cut US defense spending by US\$46b this fiscal year. As the cuts are indiscriminate and across-the-board, all programs are likely to be affected, which is particularly damaging to multi-year capital projects. As a result, the drag from lower military orders is set to intensify. Nor is this drag limited to the US. Defense budgets across the globe are under pressure and competition for the orders that are being placed is intense. As such, the profitability of any new orders is likely to be limited, with sector profits largely being generated by the civilian subsector, exposing those companies concentrated in the defense field.

Electronics and machinery have a quality edge

Eurozone companies are significant players in the production of electronics and machinery. The electronic engineering sector (which includes both consumer electronics as well as the sophisticated IT and measurement devices embedded in capital equipment, automobiles and a whole host of other products) is nearly twice the size of the European aerospace sector and has grown by almost 50% in the past decade. Robust protection of intellectual property is one key issue that makes Europe an attractive manufacturing center relative to emerging markets. This competitive advantage is reinforced by the importance of product quality standards that few emerging market competitors can meet, and the fact that labor is a relatively small share of overall production cost, so relative wage rates are a less important factor in the value proposition. These factors will allow sector output to increase by another 40% in the next 10 years, despite the continued migration of consumer electronic production to Southeast Asia.

A similar dynamic is at play in industrial machinery, particularly the highly engineered components that feed into mission-critical production applications. In some cases, these goods are also very costly to transport, so proximity to the European market can be an advantage. Germany has long been a global

leader in engineered products, and strong demand from the US, as well as China and other investment-intensive emerging markets, has offset weakness closer to home. Italy and Spain are also large players, though their European market focus has dampened short-term prospects. Despite this, Eurozone sector output is expected to grow by more than 25% over the next 10 years.

Medical and surgical equipment benefits from demographic trends

In the short term, the growth in health care spending in the Eurozone and the UK will be constrained by fiscal tightening. But aging populations and increasing wealth will be significant drivers of growth in demand for medical and surgical equipment – a sector in which European companies are global leaders. This is also a sector in which quality rather than cost or time to market is a key factor in determining which supplier wins the business. As well as experiencing secular demand growth, the sector is not particularly vulnerable to competition from businesses located in countries with low labor costs, given the high quality standards demanded by customers and the low labor intensity of the sector. We expect Eurozone output growth to accelerate to more than 3% per annum by the end of the decade, well ahead of the manufacturing sector as a whole, with France and Spain being the leaders.



have also been implemented over the last two years in European countries that need to regain competitiveness and where labor duality is high, particularly Italy, Portugal and Spain. Although notable progress has been made, the legislative changes implemented have often been less ambitious than initial announcements, reflecting their unpopularity and the associated public and political opposition.

Resources are being moved away from less efficient sectors

The need to put public finances on a sustainable path and regain competitiveness has been a major driver of reforms in Greece, Ireland, Italy and Portugal. This is designed to encourage the reallocation of resources away from inefficient sectors toward more efficient ones, with the aim of boosting productivity and potential growth rates.

Competition is being strengthened

Steps have been taken to encourage competition in product markets. To this end, barriers to entry are being removed in retailing, professional services, energy markets and public utilities. Regulation is being made more transparent and competition frameworks are being strengthened. Steps are also being taken to both improve the cost-efficiency of the public sector and reduce its size, which should also boost productivity.

Tax systems are being made more effective

Tax policies and pension systems are also being reformed as part of the process of putting public finances on a sustainable footing. Governments have increased the efficiency of tax collection and are widening the tax base, with notable progress made in Greece, Italy and Portugal. At the same time, steps are being taken to make the tax system more growth friendly, with some of the tax burden shifted from labor to consumption, immovable property and environmental taxation. Pension reforms that were already under way at the onset of the crisis have been accelerated as a result of the pressures to achieve debt sustainability. Retirement ages have been raised and contribution periods required for a full pension have increased, including in France and Spain.

More needs to be done to safeguard the financial system

As a result of the crisis, significant steps are being taken to make the financial system safer, not least with the increasing integration of supervision proposed by the EU's Economic and Financial Affairs Council. However, further reforms to improve the stability and integration of the system are needed. These might include, for example, ensuring robust regulatory requirements and adopting a consistent set of rules, common supervisory practices, and an EU-wide deposit insurance scheme, while also establishing a bank resolution mechanism based on common financing.

Conclusions

We now expect the recession in the Eurozone to last longer than previously forecast. The central causes of this are the negative impact of a weaker international environment on exports and higher unemployment weighing on domestic demand. GDP in 2013 is forecast to fall 0.6%, a slightly larger decline than in 2012. A very slow recovery should then begin, with GDP growing just under 1% in 2014 and around 1.5% a year in 2015-17. We expect the ECB to implement measures to encourage loans to SMEs. While new measures may take time to have an impact, we think that easier and broader-based access to finance could be a significant factor in securing a recovery. The authorities also now seem ready to slow the pace of fiscal consolidation.

However, it is important that easing austerity does not distract from politically difficult supply-side reforms. So far, the weak economy has encouraged national governments and the EU to push through much-needed structural reforms. Because of this, it is increasingly likely that some Eurozone countries will emerge stronger from the crisis. Those receiving financial assistance or facing market pressures have already made significant progress and extreme financing constraints have forced essential reforms in politically sensitive areas. However, the core countries have made less progress and they should still focus on intra-Eurozone rebalancing by increasing competition in non-tradable sectors.

Box 4

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.

With the main economies in the industrialized world struggling, and the leading emerging markets also experiencing some problems, world GDP growth in 2012 slowed to 2.3% from almost 3% in 2011. The main problems emanated from Europe, where fears of a Eurozone breakup, continuing austerity by governments to bring down fiscal deficits and debt, and sharply higher unemployment weighed heavily on activity. This slowdown partly offset a slight pickup in growth in the US to 2.2%.

Although concerns about a breakup of the Eurozone have receded, and prospects for the other major industrialized economies now appear to be improving slowly, the outlook for the leading emerging markets has worsened since the start of 2013. This has weighed on investment orders in the major economies and on world trade in the opening months of 2013. As a result, the Eurozone is now expected to contract by 0.6% in 2013, US growth of just 2%

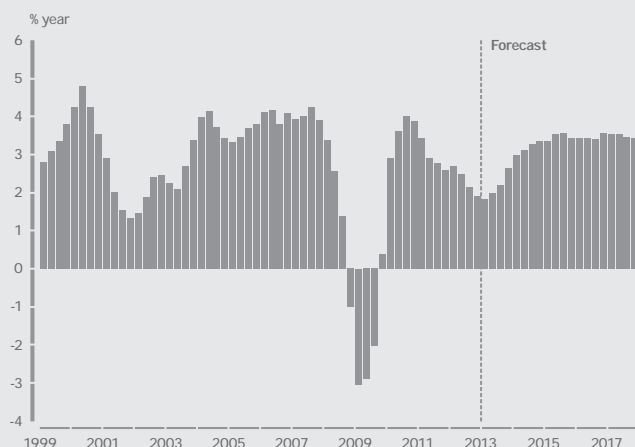
is envisaged and Japan is forecast to expand by just under 1% – all weaker than in 2012.

And the recent signs from China have been disappointing. Amid weaker export demand, we have cut our growth forecast for China to 7.5% for 2013 and 8% for 2014, which will have a significant impact on other emerging markets in Asia and on world trade and growth. We have also cut our medium-term forecast for China, based on the Government's reassessment of the pace of growth consistent with a rebalancing of the economy away from investment.

Most other emerging markets are also growing more slowly in 2013, with Brazilian growth now forecast at just 2.7%. Growth in India is expected to pick up to 5.2% this year, a little better than in 2012. But this will still be significantly below our March projection of about 6%. As a result, our forecast is for world GDP to grow by a lackluster 2.1% in 2013, a little below our forecast of three months ago, and then to pick up gradually to 3%–3.5% a year in 2014–17. This modest growth profile will be reflected in world trade, now forecast to rise by just 3% this year, only a little better than the 2.3% increase in 2012.

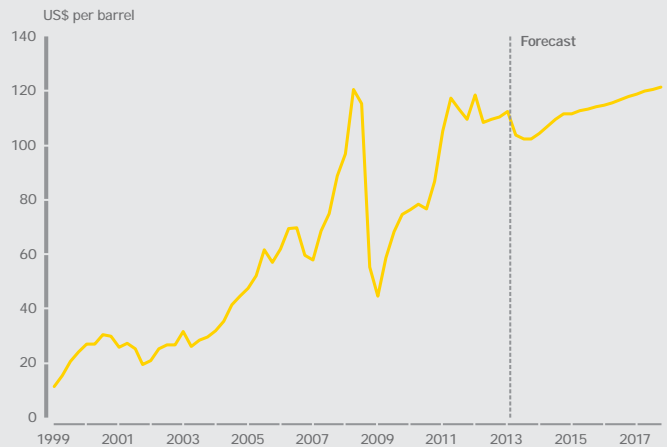
Despite continuing uncertainty about political developments in the Middle East and fears about the regional fallout from the civil war in Syria, Brent crude oil prices have fallen to just over US\$100 per barrel in recent months. Reduced output in sanctions-hit Iran has been offset partly by rising output in Iraq and some other states of the Organization of the Petroleum Exporting Countries (OPEC). Our forecast is for Brent crude to average US\$105 per barrel in 2013, below our estimate for the March forecast and down by about 6% from the 2012 average. For 2014, we forecast a small rise to about US\$108 per barrel, with a further pickup to around US\$115 seen in 2015–16 as stronger world demand offsets downward pressure from higher output in a number of important producers.

Figure 11
World: GDP growth



Source: Oxford Economics.

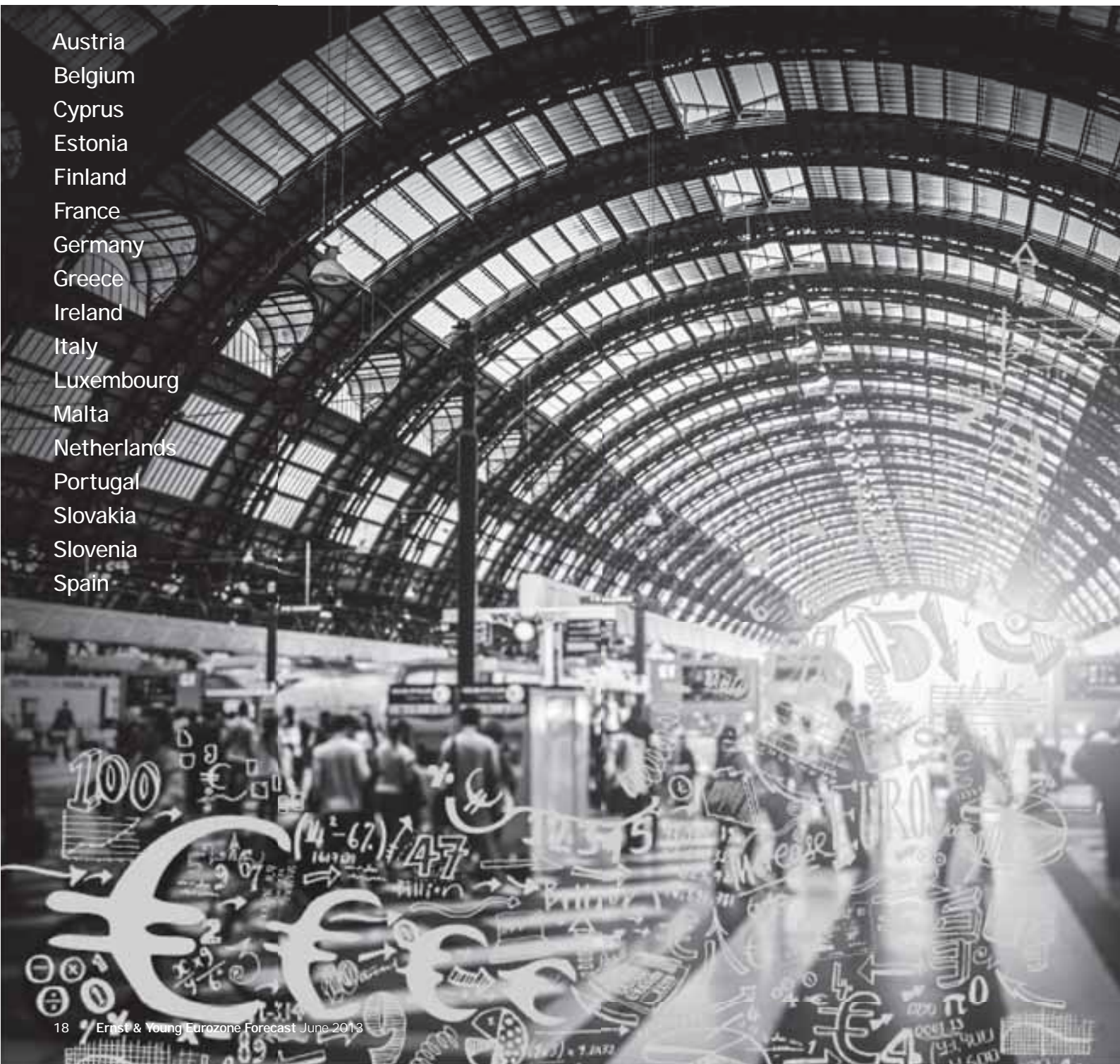
Figure 12
Oil price, nominal



Source: Oxford Economics.

Forecast for Eurozone countries

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

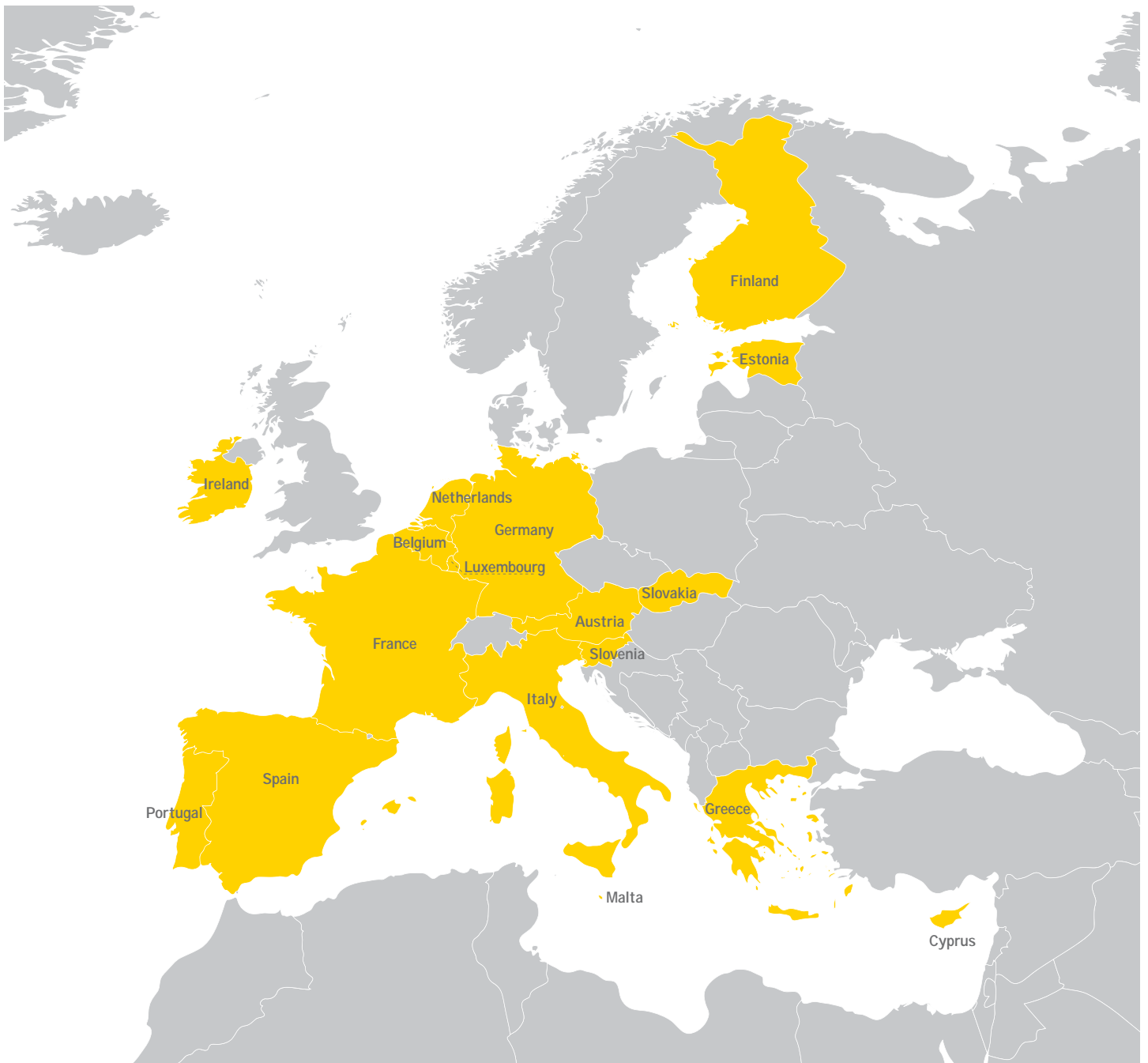


17 Eurozone countries

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Download our new *EY Forecasts in focus* app, which allows you to create graphs and tables for the geographies most relevant to you. The app also makes it easy to share content and learn more about our other forecasts.

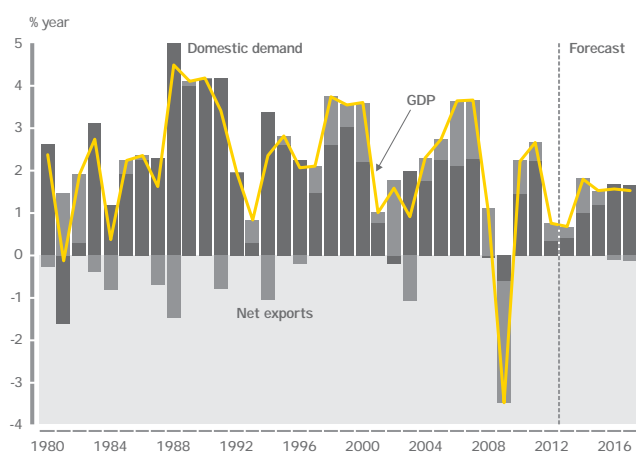
To find out more, please visit www.ey.com/eurozone



Austria

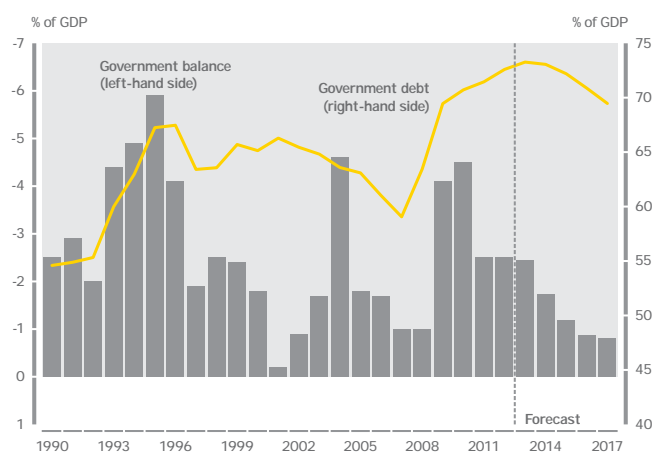
- Despite growth stagnating in Q1 2013, conditions for a domestically driven recovery remain intact. Business investment is supported by favorable financing conditions and strong corporate cash reserves, while consumers will benefit from falling inflation improving their purchasing power.
- But persistent uncertainty regarding the general economic outlook continues to weigh on investment and consumption decisions, while exports are dampened by weaker external demand. As a result, we continue to forecast GDP growth of under 1% this year, before it accelerates in 2014 as uncertainty recedes and the external environment improves.
- The fiscal deficit for 2012 was lower than expected, owing mainly to strong adjustment by Austria's regional governments. Due to weak revenue growth, further major improvement is likely to be delayed until 2014 and thereafter. We expect the budget deficit to narrow to 0.9% of GDP in 2016, above the official target, but representing no threat to fiscal sustainability.

Figure 13
Contributions to GDP



Source: Oxford Economics.

Figure 14
Government balance and debt



Source: Oxford Economics.

Table 3
Austria (annual percentage changes unless specified)

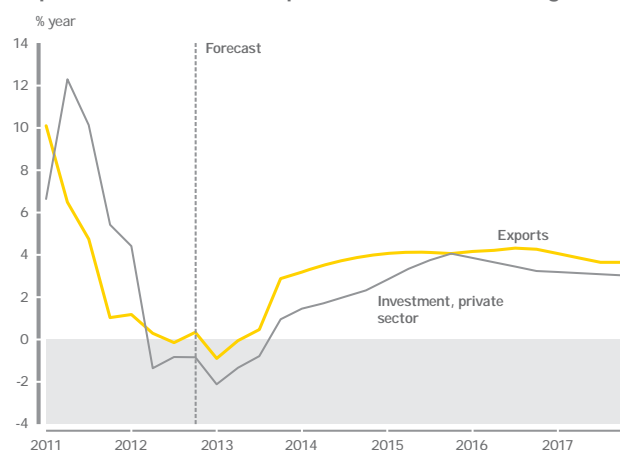
Source: Oxford Economics.

	2012	2013	2014	2015	2016	2017
GDP	0.8	0.7	1.8	1.5	1.6	1.5
Private consumption	0.4	0.4	1.3	1.5	1.6	1.5
Fixed investment	1.8	1.2	2.8	2.4	2.1	2.1
Stockbuilding (% of GDP)	1.8	1.6	1.0	0.6	0.6	0.7
Government consumption	0.4	0.5	1.6	1.8	1.8	1.8
Exports of goods and services	1.8	1.7	5.7	5.4	4.6	4.5
Imports of goods and services	1.2	1.4	4.8	5.4	5.4	5.3
Consumer prices	2.6	2.2	1.8	1.8	1.8	1.8
Unemployment rate (level)	4.4	5.1	5.0	4.6	4.5	4.5
Current account balance (% of GDP)	1.8	1.7	2.5	2.5	2.4	2.2
Government budget (% of GDP)	-2.5	-2.5	-1.7	-1.2	-0.9	-0.8
Government debt (% of GDP)	73.4	74.2	73.7	72.6	71.2	69.8

Belgium

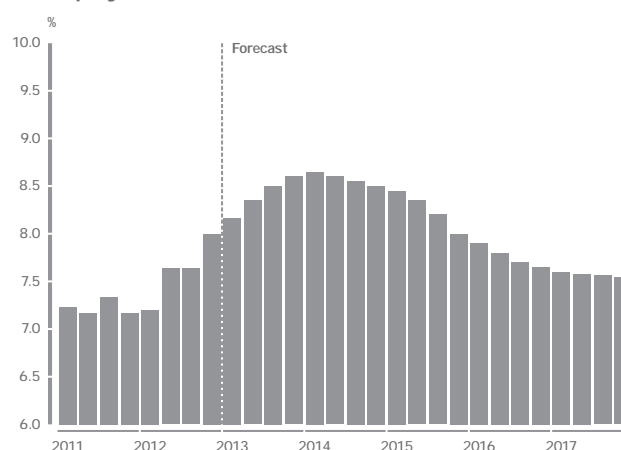
- Belgium is enduring a second year of mild contraction in 2013, with falling or stagnant demand across most sectors. We forecast a limited pickup from 2014, as multiple factors inhibit the recovery, and GDP growth is forecast to be constrained below 1.5% through to 2016.
- We now expect export growth of just 0.6% in 2013, picking up to 3.6% in 2014. However, as fiscal austerity and bank deleveraging hamper the recovery around Europe, Belgium's export growth will subsequently be limited to around 4% a year.
- Firms are set to cut capital spending further in 2013, and the investment recovery will then be tempered by the slow recovery in export markets. And the Government will continue to trim spending to lower the budget deficit.
- We expect the unemployment rate to rise above 8.5% by the end of 2013. Some support to households will be provided by easing energy prices, but consumer spending growth of just 0.3% is expected in 2013, rising to about 1% in 2014 and 2015.

Figure 15
Exports and investment, private sector business growth



Source: Oxford Economics.

Figure 16
Unemployment rate



Source: Oxford Economics.

Table 4
Belgium (annual percentage changes unless specified)

Source: Oxford Economics.

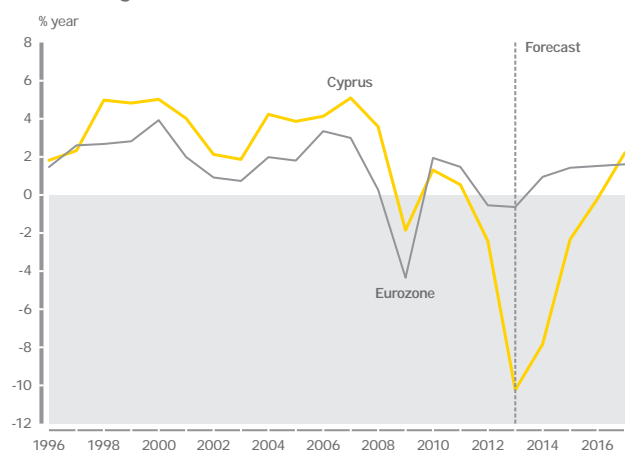
	2012	2013	2014	2015	2016	2017
GDP	-0.2	-0.4	0.7	1.2	1.4	1.7
Private consumption	-0.6	0.3	0.8	1.1	1.2	1.3
Fixed investment	-0.5	-1.7	0.6	2.6	3.0	2.8
Stockbuilding (% of GDP)	1.0	0.5	0.4	0.2	-0.2	-0.2
Government consumption	0.1	-0.1	-0.4	-0.4	0.2	0.5
Exports of goods and services	0.4	0.6	3.6	4.1	4.2	3.8
Imports of goods and services	-0.1	0.2	3.3	3.8	3.8	3.6
Consumer prices	2.6	1.5	2.1	2.2	2.0	2.0
Unemployment rate (level)	7.6	8.4	8.6	8.3	7.8	7.6
Current account balance (% of GDP)	-1.4	0.7	0.8	0.9	0.9	1.0
Government budget (% of GDP)	-3.9	-3.1	-2.0	-1.4	-1.1	-0.9
Government debt (% of GDP)	99.6	103.0	105.3	106.4	106.9	106.7

Cyprus

- The bailout deal agreed with the EC, the ECB and the International Monetary Fund has now been approved by the Cypriot parliament. Some €2b has already been paid out with the remaining €1b of the first tranche expected to be released by the end of June.
- The deal sees bank depositors with assets above €100,000 facing significant losses and the implementation of an austerity program, in return for €10b of bailout money to keep the country afloat. The austerity program comprises cuts to public spending and tax hikes, such as raising VAT to 19% by 2014 and corporation tax to 12.5%, as well as privatization of some semi-government organizations.
- The bailout will come at a very heavy economic cost, with the impact more severe than in Greece following the bailout deal there. We now expect GDP to contract by over 10% in 2013 and by almost 8% in 2014.

Figure 17

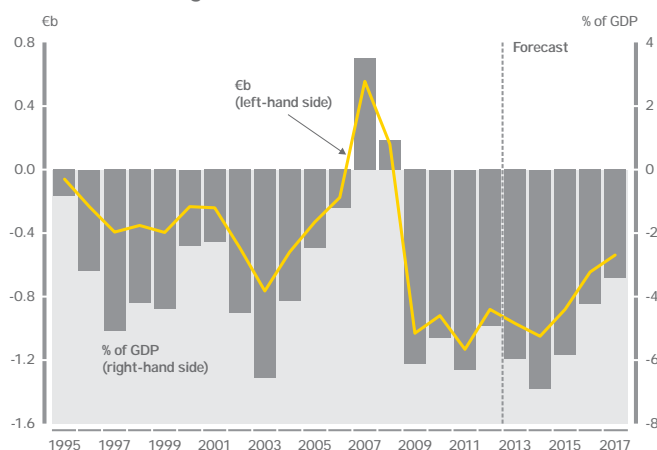
Real GDP growth



Source: Oxford Economics.

Figure 18

Government budget balance



Source: Oxford Economics.

Table 5

Cyprus (annual percentage changes unless specified)

Source: Oxford Economics.

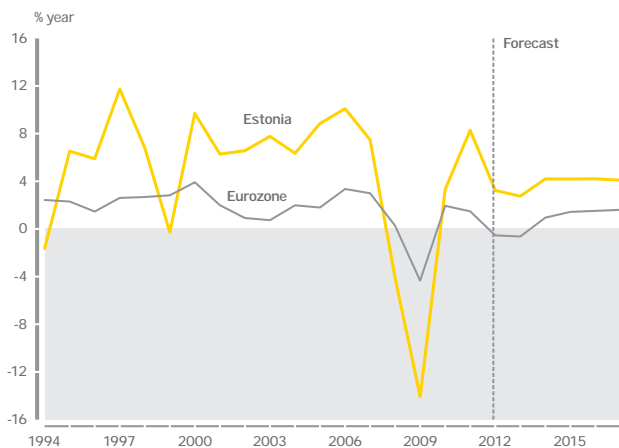
	2012	2013	2014	2015	2016	2017
GDP	-2.4	-10.2	-7.8	-2.3	-0.2	2.2
Private consumption	-3.0	-11.8	-12.1	-7.0	-4.8	0.4
Fixed investment	-23.0	-35.2	-35.1	-7.5	2.2	7.5
Stockbuilding (% of GDP)	0.3	-1.2	-0.6	-0.1	0.5	0.4
Government consumption	-1.7	-9.7	-7.3	-4.6	0.5	1.0
Exports of goods and services	2.3	1.5	1.7	3.9	4.5	5.1
Imports of goods and services	-7.2	-10.3	-7.1	-1.3	2.0	4.0
Consumer prices	3.1	2.0	1.7	1.2	1.2	1.5
Unemployment rate (level)	12.1	19.1	24.1	25.3	25.0	22.1
Current account balance (% of GDP)	-7.7	-0.9	-0.3	-0.3	-0.3	-0.3
Government budget (% of GDP)	-4.9	-6.0	-6.9	-5.8	-4.2	-3.4
Government debt (% of GDP)	84.5	120.5	161.7	189.4	191.8	188.3

Estonia

- Estonia's growth is forecast to slow to just under 3% in 2013, although this will still be the fastest growth in the Eurozone. The country is benefiting from the robust performance of Russia and the Nordic countries and not needing to impose restrictive fiscal policy. Inflation should also continue to subside, although it should stay above the Eurozone average.
- We expect expansion to accelerate to about 4% in 2014, as domestic demand rebounds and Eurozone growth turns positive. And sound fundamentals, such as a competitive and service-oriented export sector and a liquid and solvent banking system, will help to maintain growth above 4% over the medium term.
- But the possibility of the economy overheating if capacity constraints left by the deep 2009-11 recession prevent output from meeting rising domestic demand is a downside risk to medium-term growth. And loss of competitiveness or growth that is slower than expected in key trade partners could also weigh on activity.

Figure 19

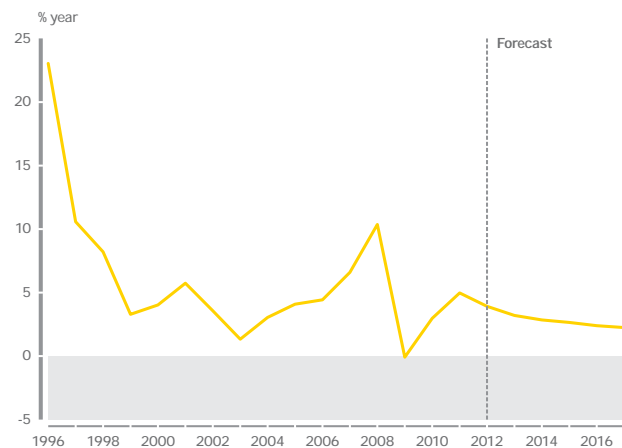
Real GDP growth



Source: Oxford Economics.

Figure 20

Inflation



Source: Oxford Economics.

Table 6

Estonia (annual percentage changes unless specified)

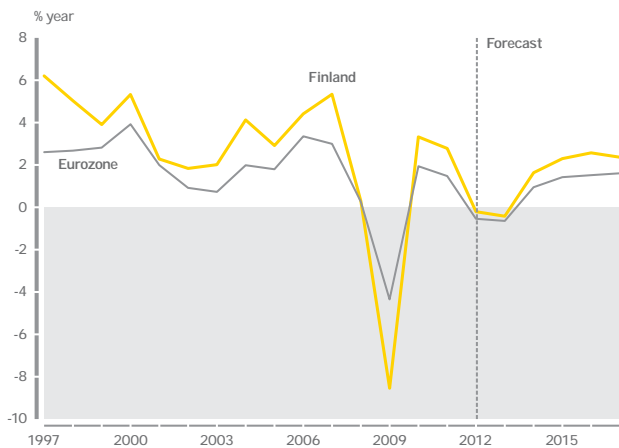
Source: Oxford Economics.

	2012	2013	2014	2015	2016	2017
GDP	3.2	2.8	4.2	4.2	4.2	4.1
Private consumption	4.4	3.0	3.4	4.0	4.6	4.6
Fixed investment	21.0	3.4	7.0	7.0	6.5	6.3
Stockbuilding (% of GDP)	-1.9	0.2	0.2	-0.3	-1.7	-3.1
Government consumption	4.0	0.8	0.3	2.7	3.0	3.0
Exports of goods and services	5.6	3.2	5.5	5.3	5.4	5.5
Imports of goods and services	9.1	5.5	5.2	5.2	4.7	4.8
Consumer prices	3.9	3.2	2.8	2.6	2.4	2.3
Unemployment rate (level)	10.1	9.0	8.3	7.6	7.0	6.5
Current account balance (% of GDP)	-1.2	-1.0	-0.8	-0.5	0.0	0.2
Government budget (% of GDP)	-0.3	-0.4	0.3	0.2	0.3	0.2
Government debt (% of GDP)	10.1	11.2	10.3	9.4	8.6	7.9

Finland

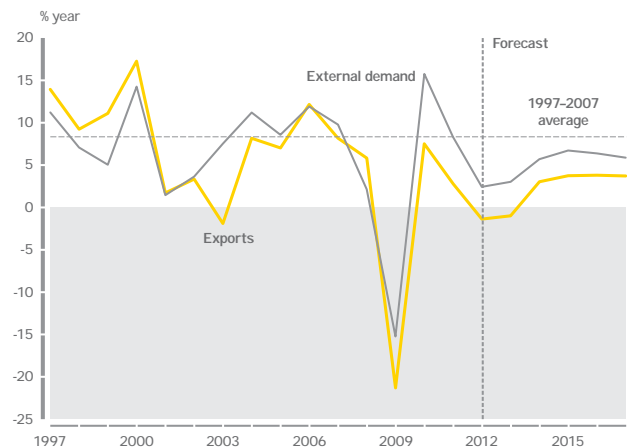
- The Finnish economy is expected to shrink slightly again in 2013, as subdued foreign demand hits exports and companies' willingness to invest. Subsequently, we forecast economic growth to recover gradually over the medium term. Weak external demand and austerity measures at home will weigh on the recovery.
- We still forecast GDP growth of 2.2% a year in 2014–17, which will be a slow recovery compared with the 3.9% pace seen in the decade prior to the global crisis. This is due to the modest performance of exports and to an ongoing process of private sector deleveraging.
- The Government is expected to miss its deficit target again this year. Despite higher taxes and a drop in expenditure in real terms, we forecast a budget deficit of 1.6% of GDP this year, as revenue growth is likely to disappoint on the back of another contraction in GDP.

Figure 21
GDP growth



Source: Oxford Economics.

Figure 22
Exports and external demand



Source: Oxford Economics.

Table 7
Finland (annual percentage changes unless specified)

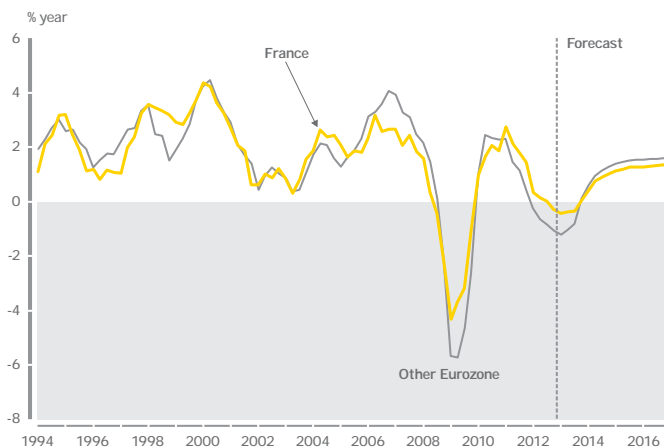
Source: Oxford Economics.

	2012	2013	2014	2015	2016	2017
GDP	-0.2	-0.4	1.6	2.3	2.6	2.4
Private consumption	1.6	1.1	1.9	2.2	2.4	2.4
Fixed investment	-2.9	-2.6	2.3	2.3	3.5	3.2
Stockbuilding (% of GDP)	0.7	0.7	0.5	0.5	0.5	0.4
Government consumption	0.8	-0.2	1.1	1.2	1.4	1.6
Exports of goods and services	-1.4	-1.0	3.0	3.7	3.8	3.7
Imports of goods and services	-3.7	0.0	3.0	3.3	3.7	3.9
Consumer prices	3.2	2.2	1.6	1.5	1.6	1.7
Unemployment rate (level)	7.7	8.2	7.9	7.4	7.1	6.8
Current account balance (% of GDP)	-1.9	-2.5	-2.3	-2.0	-1.9	-1.8
Government budget (% of GDP)	-1.9	-1.6	-1.2	-0.5	-0.2	-0.1
Government debt (% of GDP)	53.0	53.9	53.6	52.2	50.3	48.4

France

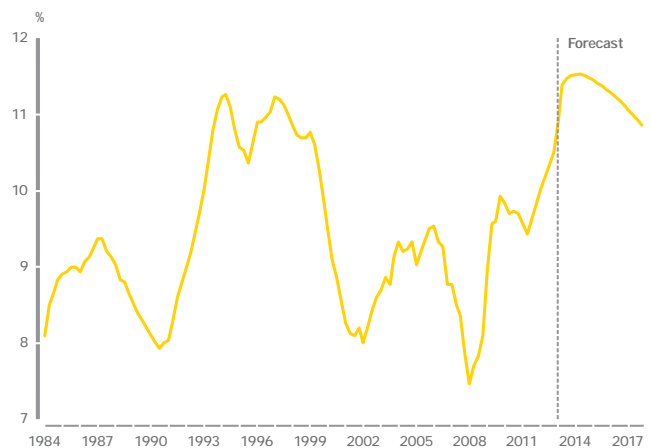
- The shift in policy toward less fiscal austerity and more public investment will help secure a gradual recovery from 2014 onwards. But a number of factors will weigh on economic activity, including high corporate debt and unemployment. Fiscal consolidation will also continue, albeit at a slower pace.
- We expect GDP to fall 0.3% in 2013, followed by growth of 0.8% in 2014 and 1.3% a year on average in 2015–17.
- Only limited growth can be expected in the export sector because demand from trade partners is forecast to grow more slowly than in the past decade, at 5.5% a year in 2013–17, compared with 7.2% a year in the decade before the crisis.
- For those companies that already have robust balance sheets, financing conditions are favorable, with very low interest rates, which should encourage some investment.

Figure 23
GDP growth: France vs. rest of Eurozone



Source: Oxford Economics.

Figure 24
Unemployment



Source: Oxford Economics.

Table 8
France (annual percentage changes unless specified)

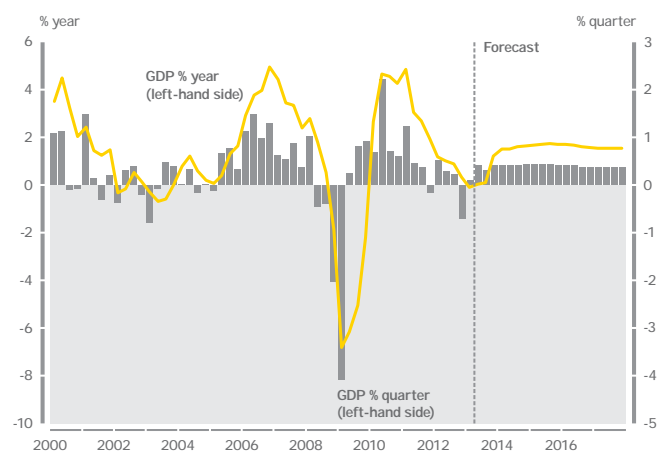
Source: Oxford Economics.

	2012	2013	2014	2015	2016	2017
GDP	0.0	-0.3	0.8	1.2	1.3	1.4
Private consumption	-0.3	-0.1	0.9	1.1	1.2	1.3
Fixed investment	-1.2	-1.9	1.3	2.0	2.0	2.0
Stockbuilding (% of GDP)	-0.2	-0.3	-0.1	0.2	0.4	0.4
Government consumption	1.4	0.7	0.2	0.7	0.9	1.0
Exports of goods and services	2.5	-0.2	2.6	4.0	4.3	4.5
Imports of goods and services	-0.9	-0.2	3.2	4.7	4.4	4.2
Consumer prices	2.2	1.2	1.6	1.5	1.4	1.4
Unemployment rate (level)	10.3	11.3	11.5	11.4	11.2	11.0
Current account balance (% of GDP)	-2.3	-2.1	-2.4	-2.9	-3.0	-3.0
Government budget (% of GDP)	-4.8	-3.9	-3.3	-2.6	-2.1	-1.7
Government debt (% of GDP)	90.3	94.0	97.0	99.6	101.0	101.3

Germany

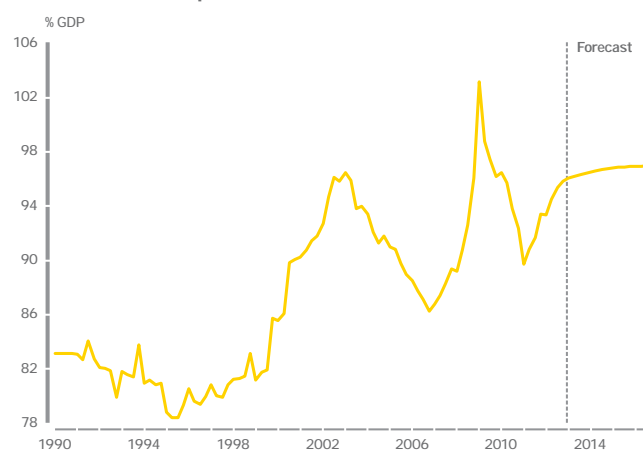
- Weaker growth than previously expected in emerging markets and stiffer competition from the depreciating Japanese yen are hitting Germany's exports and GDP. We now forecast GDP growth at just 0.3% in 2013. But strong fundamentals mean that Germany will remain one of the better-performing Eurozone economies.
- With low debt and favorable financing conditions, German companies are well placed to take advantage of the expected global recovery in 2014. We continue to expect a solid economic recovery from 2014. GDP growth is forecast at 1.6% in 2014 and 1.6% a year in 2015-17.
- Easier fiscal policy would be the single most effective measure to foster growth in Germany and the Eurozone.

Figure 25
GDP



Source: Oxford Economics.

Figure 26
Non-financial corporate debt



Source: Oxford Economics.

Table 9

Germany (annual percentage changes unless specified)

Source: Oxford Economics.

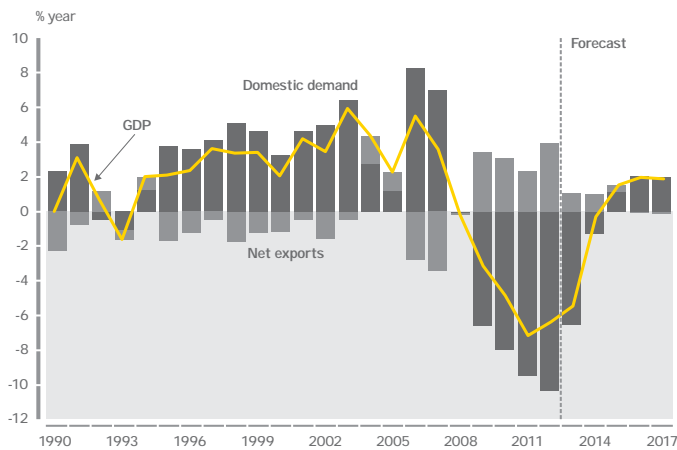
	2012	2013	2014	2015	2016	2017
GDP	0.8	0.3	1.6	1.7	1.6	1.5
Private consumption	0.6	0.8	1.2	1.2	1.2	1.2
Fixed investment	-1.9	-0.4	4.0	3.9	3.2	2.8
Stockbuilding (% of GDP)	0.2	0.0	0.0	-0.1	-0.2	-0.4
Government consumption	1.4	0.9	0.7	0.7	0.7	0.8
Exports of goods and services	4.3	0.5	3.3	4.8	5.0	4.6
Imports of goods and services	2.2	0.9	3.7	4.9	5.1	4.5
Consumer prices	2.1	1.5	1.6	1.7	1.7	1.7
Unemployment rate (level)	5.5	5.5	5.5	5.3	5.0	4.9
Current account balance (% of GDP)	7.1	7.1	6.6	6.3	6.3	6.4
Government budget (% of GDP)	-0.1	0.0	0.0	0.0	0.0	0.0
Government debt (% of GDP)	79.1	78.9	78.6	78.8	79.0	79.1

Greece

- GDP shrank more than 20% in the five years to 2012 and is expected to drop a further 5.5% in 2013, driven by fiscal austerity and surging unemployment. Growth is expected to resume in H2 2014, as fiscal policy gradually eases and the acceleration of global growth results in a rebound of exports. We expect GDP growth to average 1.5%–2% in 2015–17.

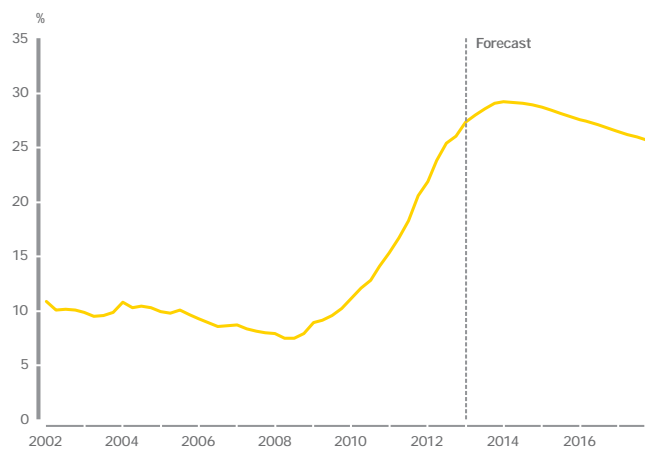
- Fiscal tightening – estimated at around 6% of GDP in 2013–17 – will continue to be the main drag on growth in the short to medium term. However, the odds of Greece abandoning the Eurozone have shrunk markedly, partly because of the perceived stronger commitment of the Eurozone authorities to preserve the monetary union.
- Downside risks are still significant, as the effects of austerity may continue to surprise policy-makers on the downside and fiscal fatigue may surface. As a result, the policy focus should now shift to the delayed structural reforms.

Figure 27
Contributions to GDP growth



Source: Oxford Economics.

Figure 28
Unemployment



Source: Oxford Economics.

Table 10
Greece (annual percentage changes unless specified)

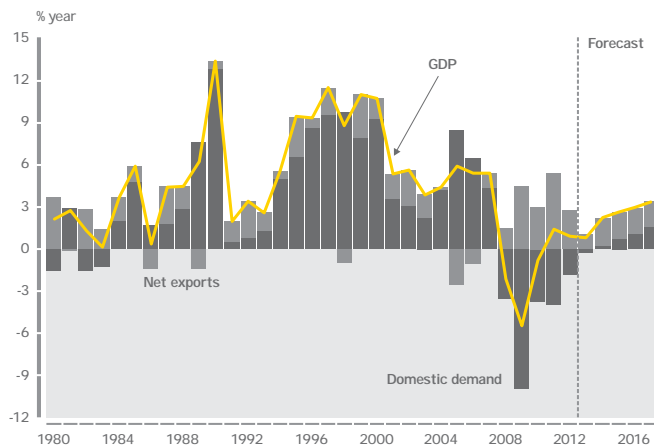
Source: Oxford Economics.

	2012	2013	2014	2015	2016	2017
GDP	-6.4	-5.5	-0.3	1.5	2.0	1.9
Private consumption	-9.1	-7.6	-1.4	0.6	1.7	1.9
Fixed investment	-19.4	-5.0	1.4	4.9	5.8	6.1
Stockbuilding (% of GDP)	0.0	1.2	1.4	1.5	1.2	0.7
Government consumption	-4.3	-8.2	-3.8	-0.4	1.7	1.7
Exports of goods and services	-2.1	-1.7	5.3	5.0	3.4	3.5
Imports of goods and services	-13.8	-5.0	1.4	3.3	3.4	3.6
Consumer prices	1.0	-0.2	0.0	0.4	0.8	1.4
Unemployment rate (level)	24.3	28.3	29.1	28.3	27.2	26.1
Current account balance (% of GDP)	-3.4	-3.4	-3.1	-2.7	-2.6	-2.4
Government budget (% of GDP)	-10.0	-6.7	-5.6	-4.5	-3.7	-3.2
Government debt (% of GDP)	152.2	166.1	170.5	170.1	168.0	165.2

Ireland

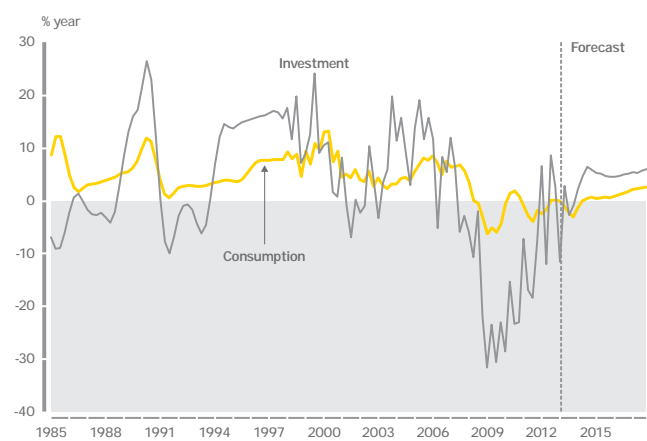
- The Irish economy grew by 0.9% in 2012, outpacing most other Eurozone countries. We expect the economy to continue expanding in the coming months, but this is likely to be driven entirely by net trade.
- The domestic economy remains in the doldrums: high unemployment and weak real income growth will restrict consumer spending. Meanwhile, a depressed housing market and tight credit conditions suggest that the prospects for investment are also bleak.
- But a more broad-based recovery is expected to take hold in the medium term as the Government's fiscal and structural reforms start to bear fruit. We expect GDP growth to accelerate from 2.2% in 2014 to an average of 3% a year in 2015-17.
- Downside risks, stemming from the possibility of a global environment that is weaker than expected and a shakeout in Ireland's housing market, are dominating the outlook.

Figure 29
Contributions to GDP



Source: Oxford Economics.

Figure 30
Consumption and investment



Source: Oxford Economics.

Table 11
Ireland (annual percentage changes unless specified)

Source: Oxford Economics.

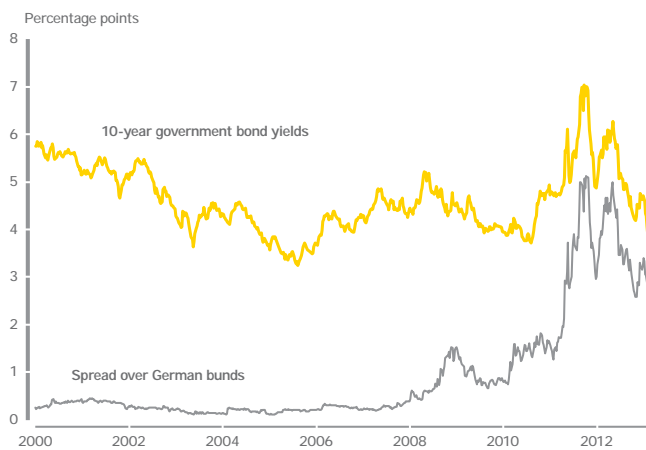
	2012	2013	2014	2015	2016	2017
GDP	0.9	0.8	2.2	2.6	3.0	3.4
Private consumption	-0.9	-1.6	0.0	0.6	1.3	2.4
Fixed investment	1.1	-3.4	4.9	4.9	4.9	5.7
Stockbuilding (% of GDP)	-0.1	0.0	0.0	0.1	0.2	0.0
Government consumption	-3.8	-2.7	-1.3	-1.1	-0.7	0.1
Exports of goods and services	2.9	2.2	4.2	4.5	4.1	4.0
Imports of goods and services	0.3	1.6	3.2	3.7	3.4	3.2
Consumer prices	1.9	1.0	1.7	1.9	1.7	1.6
Unemployment rate (level)	14.7	14.0	13.7	13.3	12.4	11.4
Current account balance (% of GDP)	4.9	4.2	4.2	4.1	4.0	3.8
Government budget (% of GDP)	-7.5	-7.4	-4.7	-2.9	-1.9	-1.2
Government debt (% of GDP)	117.6	122.6	122.6	120.4	117.1	112.8

Italy

- We forecast that GDP will drop 1.8% in 2013, weighed down by tight credit conditions, depressed domestic demand and slower growth in export markets. Growth will resume gradually from 2014, but is expected to remain modest, at 0.4% in 2014 and just above 1% on average in 2015-17.
- A two-month political stalemate was resolved with the formation of a left-right coalition led by Prime Minister Enrico Letta, deputy-secretary of the Democratic Party. The new Government promises to curb austerity and push through growth-boosting measures. Lower interest rates will create some room for maneuver, but fiscal discipline needs to be maintained as market sentiment remains volatile.
- The new Government is expected to continue the process of reform initiated by the Monti administration. In addition, the structure of the current coalition may make it easier to build a consensus for reform. This could represent an opportunity to address the well-recognized structural weaknesses of the Italian economy.

Figure 31

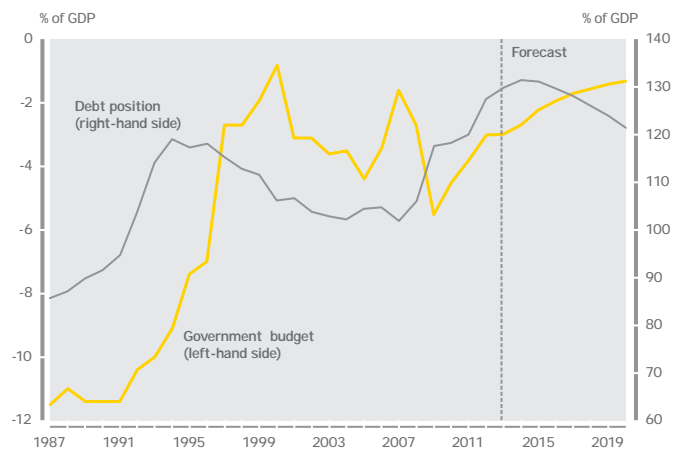
Government bond yields and spreads



Source: Oxford Economics.

Figure 32

Government balance and debt



Source: Oxford Economics.

Table 12

Italy (annual percentage changes unless specified)

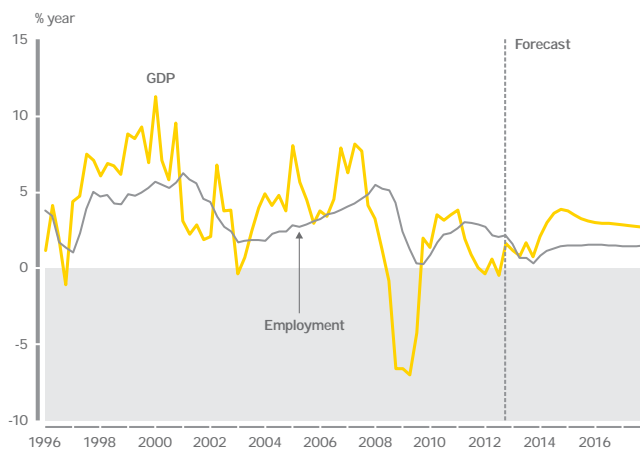
Source: Oxford Economics.

	2012	2013	2014	2015	2016	2017
GDP	-2.4	-1.8	0.4	1.2	1.3	1.3
Private consumption	-4.2	-2.6	-0.6	0.9	1.5	1.7
Fixed investment	-8.0	-3.6	1.3	3.0	2.9	2.6
Stockbuilding (% of GDP)	-0.6	-1.2	-0.7	-0.3	0.1	0.1
Government consumption	-2.9	-0.8	-0.7	0.0	0.3	0.6
Exports of goods and services	2.2	1.5	2.5	2.8	2.3	2.1
Imports of goods and services	-7.8	-2.5	1.9	4.4	4.6	3.3
Consumer prices	3.3	1.8	1.8	1.2	1.2	1.3
Unemployment rate (level)	10.6	12.1	12.7	12.4	11.9	11.4
Current account balance (% of GDP)	-0.7	0.2	0.3	0.1	-0.2	-0.4
Government budget (% of GDP)	-3.0	-3.0	-2.7	-2.2	-1.9	-1.7
Government debt (% of GDP)	127.0	131.3	132.8	131.9	130.5	128.7

Luxembourg

- We continue to forecast relatively strong growth of just over 1% this year and an acceleration to about 3% in 2014, provided that the Eurozone continues to stabilize gradually. Growth should also be helped by the recovery of the financial markets leading the real economy.
- The forecast is largely unchanged from our March report, as the strong end to 2012 (largely due to one-off factors) is not indicative of an improvement of any underlying momentum and will be offset by a now-weaker export outlook.
- Faced by rising unemployment and the impact of the 2013 budget, household spending will remain subdued, especially against the background of already low confidence. Easing inflation will be a mitigating factor, but not sufficient to offset these headwinds fully.

Figure 33
Real GDP and employment



Source: Oxford Economics.

Figure 34
Systemic stress indicator



Source: ECB, Haver Analytics.

Table 13
Luxembourg (annual percentage changes unless specified)

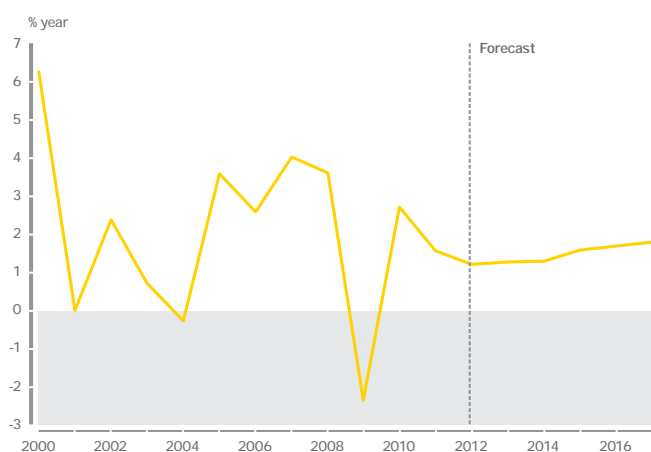
Source: Oxford Economics.

	2012	2013	2014	2015	2016	2017
GDP	0.3	1.1	3.2	3.4	3.0	2.8
Private consumption	1.7	0.9	2.9	2.8	2.5	2.4
Fixed investment	7.0	3.3	3.3	2.6	2.5	2.4
Stockbuilding (% of GDP)	1.4	1.1	2.3	2.4	1.7	1.5
Government consumption	4.9	1.7	1.7	2.0	1.8	1.8
Exports of goods and services	-2.5	3.0	6.0	5.6	4.4	3.5
Imports of goods and services	-2.7	3.5	7.0	5.5	3.8	3.3
Consumer prices	2.9	2.0	2.0	2.0	2.0	2.0
Unemployment rate (level)	5.1	5.8	5.8	5.3	4.8	4.3
Current account balance (% of GDP)	5.5	5.9	4.9	5.1	5.8	6.1
Government budget (% of GDP)	-0.8	-1.2	-0.8	-0.5	-0.2	0.5
Government debt (% of GDP)	20.8	21.3	21.0	20.4	19.7	18.3

Malta

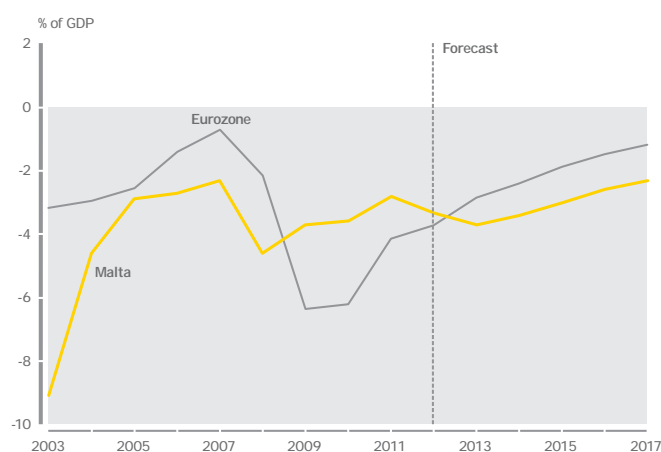
- Both domestic and external conditions support ongoing growth in Malta, albeit at slower rates than those achieved before the crisis. We expect GDP growth of 1.3% in 2013 and 2014, followed by 1.7% a year on average in 2015-17. This is little changed from our March forecast.
- The budget deficit is likely to be significantly higher than planned by the Government. But with the EC now willing to relax fiscal targets, this should not trigger additional fiscal consolidation measures.
- While the size of the financial sector remains a source of risk, rating agencies have been quick to recognize the differences between Malta and Cyprus. This makes it unlikely that a banking crisis comparable to Cyprus' could occur, or that similarly unaffordable fiscal costs could be imposed.
- The main economic challenge is to ensure that growing sectors, such as tourism and financial services, remain competitive. This will require further investment, both from domestic and foreign sources.

Figure 35
Real GDP



Source: Oxford Economics.

Figure 36
Fiscal balance vs. Eurozone



Source: Oxford Economics.

Table 14

Malta (annual percentage changes unless specified)

Source: Oxford Economics.

	2012	2013	2014	2015	2016	2017
GDP	1.2	1.3	1.3	1.6	1.7	1.8
Private consumption	-1.1	1.0	1.3	1.4	1.5	1.6
Fixed investment	0.4	2.0	3.5	2.8	2.5	2.2
Stockbuilding (% of GDP)	-2.8	-2.1	-2.1	-2.0	-1.7	-1.4
Government consumption	5.8	2.0	0.7	0.8	1.3	1.4
Exports of goods and services	5.0	3.2	2.7	3.0	2.7	2.8
Imports of goods and services	4.6	4.2	3.0	3.0	3.0	3.0
Consumer prices	3.2	1.7	1.7	1.8	2.0	2.3
Unemployment rate (level)	6.4	6.7	6.3	6.0	5.7	5.5
Current account balance (% of GDP)	0.3	0.6	0.3	0.2	0.2	0.1
Government budget (% of GDP)	-3.3	-3.7	-3.4	-3.0	-2.6	-2.3
Government debt (% of GDP)	71.9	73.5	74.7	75.3	75.1	74.5

Netherlands

- A weak domestic economy is keeping the Netherlands in recession, despite an improved contribution from the external sector. The weakness of the domestic economy has both short- and longer-term origins. In the short term it has been suffering from a chronic lack of demand, caused by a severe and prolonged squeeze on household spending power and an overly aggressive austerity program.

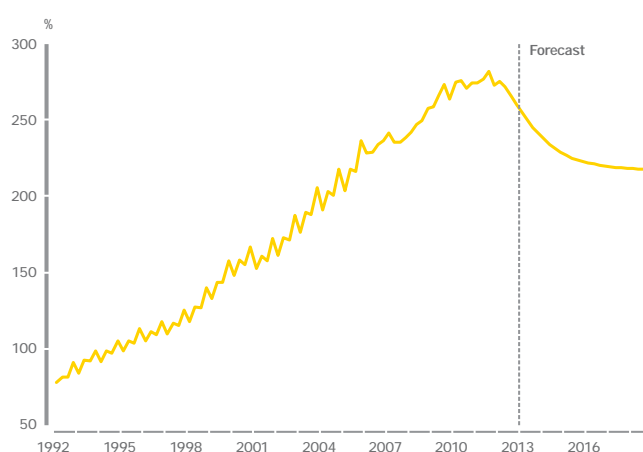
- These headwinds should begin to ease as we move through this year and into 2014, with real incomes set to stabilize and the pace of austerity due to decline substantially. Our forecast shows GDP falling by 1% this year, before a weak recovery yields growth of 0.7% in 2014.
- Beyond 2014, growth prospects will be constrained by the need to deal with serious structural problems in the household and banking sectors. We expect this to limit GDP growth to just 1.2% a year in 2015-17.

Figure 37
Misery Index*



Source: Haver Analytics.

Figure 38
Household debt-to-income ratio



Source: Oxford Economics.

Table 15
Netherlands (annual percentage changes unless specified)

Source: Oxford Economics.

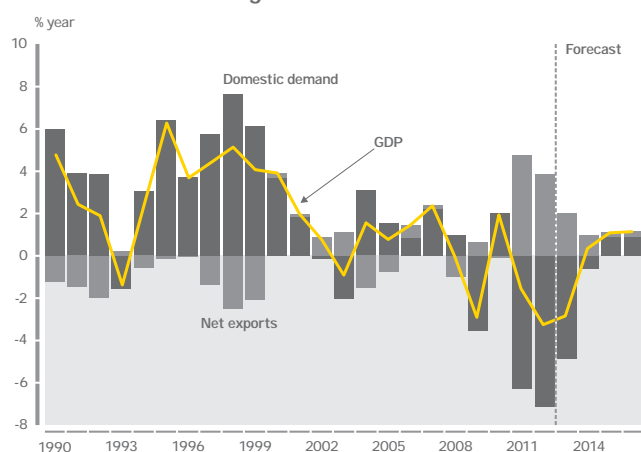
	2012	2013	2014	2015	2016	2017
GDP	-1.0	-1.0	0.7	1.0	1.2	1.4
Private consumption	-1.4	-1.7	0.3	0.6	0.9	1.3
Fixed investment	-4.6	-2.0	1.4	2.0	2.1	2.0
Stockbuilding (% of GDP)	0.8	0.5	0.5	0.5	0.5	0.5
Government consumption	0.0	-0.1	-0.3	-0.3	-0.1	0.5
Exports of goods and services	3.3	1.8	2.7	3.5	3.4	3.0
Imports of goods and services	3.1	1.4	2.5	3.4	3.2	3.0
Consumer prices	2.8	2.6	1.4	1.3	1.1	1.1
Unemployment rate (level)	5.3	6.8	7.2	7.1	7.0	7.0
Current account balance (% of GDP)	9.9	8.4	7.9	8.0	8.2	8.4
Government budget (% of GDP)	-4.0	-3.4	-3.4	-2.7	-2.4	-2.0
Government debt (% of GDP)	69.7	72.8	75.1	76.4	76.9	76.9

Portugal

- With the restructuring of the economy still in progress, we forecast another sharp contraction in economic activity in 2013. GDP is set to decline 2.8%, followed by growth of just 0.3% in 2014 and weak expansion of a little over 1% a year in 2015–17.
- Our growth forecast is lower than the Government's for two main reasons. First, developments in 2011 and 2012 throughout the Eurozone have shown that fiscal consolidation measures have had a larger impact on growth than the Government currently estimates. Second, the global environment is relatively muted, especially in the short term, limiting opportunities to take advantage of improved competitiveness via rising exports.
- Exports are forecast to be the only source of growth in the short term, due to ongoing reforms to restore competitiveness. Exports are expected to pick up in 2014, when demand from Portugal's main trade partners starts to improve.

Figure 39

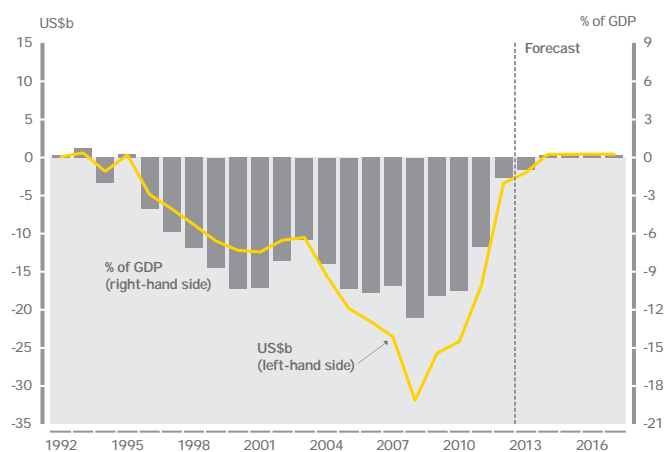
Contributions to GDP growth



Source: Oxford Economics.

Figure 40

Current account balance



Source: Oxford Economics.

Table 16

Portugal (annual percentage changes unless specified)

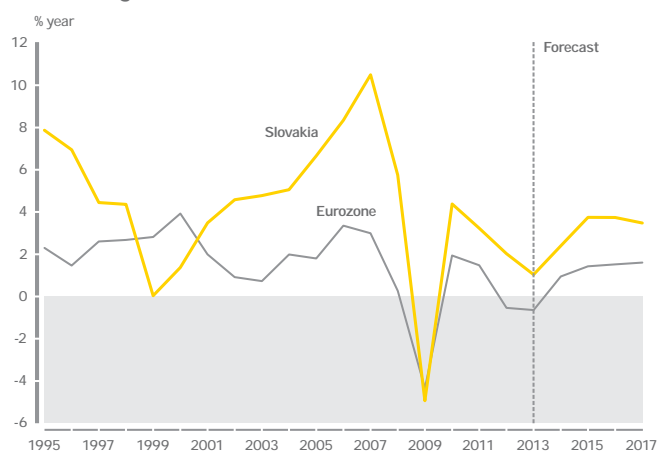
Source: Oxford Economics.

	2012	2013	2014	2015	2016	2017
GDP	-3.3	-2.8	0.3	1.1	1.1	1.1
Private consumption	-5.6	-3.8	-0.3	0.5	0.5	0.6
Fixed investment	-14.5	-8.4	-1.6	2.1	2.4	2.3
Stockbuilding (% of GDP)	0.1	-0.6	-0.5	-0.5	-0.7	-0.9
Government consumption	-4.4	-2.4	-0.9	1.3	1.6	1.5
Exports of goods and services	3.3	1.6	4.3	3.9	3.8	3.6
Imports of goods and services	-6.9	-3.7	2.0	3.7	3.4	3.0
Consumer prices	2.8	0.2	0.8	0.8	0.8	0.9
Unemployment rate (level)	15.9	17.9	18.2	17.5	16.5	15.5
Current account balance (% of GDP)	-1.5	-0.9	0.2	0.2	0.2	0.2
Government budget (% of GDP)	-6.4	-6.0	-4.2	-2.9	-1.7	-0.8
Government debt (% of GDP)	123.6	132.5	134.5	134.2	132.8	130.5

Slovakia

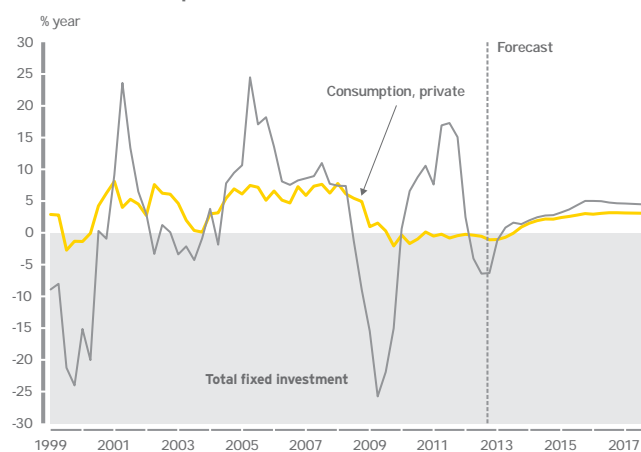
- The weaker global and Eurozone outlook is taking its toll on Slovakia. We have lowered our forecast for GDP growth in the short term and expect only 1% this year.
- However, unlike in many other Eurozone countries, neither the public nor the private sector needs to reduce debt. This means that, once the global and Eurozone economies pick up, robust growth should resume. We forecast GDP growth at 2.4% in 2014 and about 3.6% a year on average in 2015-17.
- Fiscal consolidation will weigh on growth in the short term, in particular in 2013, when most of the fiscal effort is planned. Low debt levels and favorable financing conditions mean that companies in Slovakia are well placed to take advantage of the global recovery from 2014.
- One concern is high structural unemployment. Labor reforms, such as policies encouraging higher labor force participation, should be implemented to ensure robust growth in the medium term.

Figure 41
Real GDP growth



Source: Oxford Economics.

Figure 42
Private consumption and total fixed investment



Source: Oxford Economics.

Table 17

Slovakia (annual percentage changes unless specified)

Source: Oxford Economics.

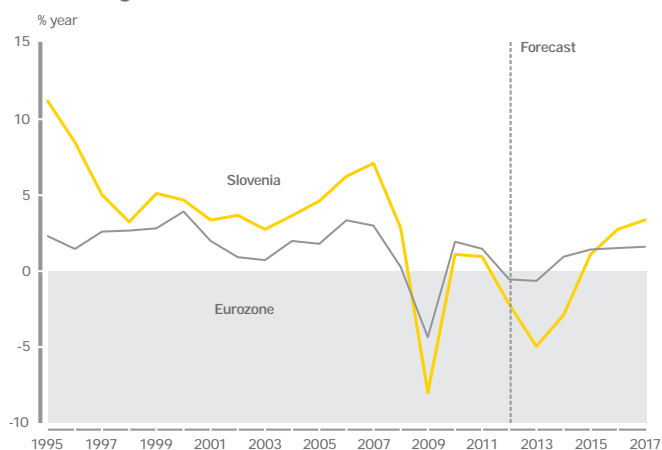
	2012	2013	2014	2015	2016	2017
GDP	2.0	1.0	2.4	3.7	3.7	3.5
Private consumption	-0.6	-0.2	1.9	2.7	3.1	3.1
Fixed investment	-3.7	0.7	2.5	4.1	4.9	4.5
Stockbuilding (% of GDP)	-2.3	-1.9	-1.2	-0.8	-0.1	0.0
Government consumption	-0.6	-0.4	1.6	3.5	2.9	2.7
Exports of goods and services	8.6	2.4	3.4	4.7	4.3	4.6
Imports of goods and services	2.8	1.9	4.0	4.7	5.0	4.7
Consumer prices	3.6	2.0	2.2	2.1	2.1	2.1
Unemployment rate (level)	14.0	14.6	14.2	13.3	12.3	11.2
Current account balance (% of GDP)	2.3	2.2	1.4	1.3	0.7	0.7
Government budget (% of GDP)	-4.3	-2.3	-1.9	-1.8	-1.5	-1.2
Government debt (% of GDP)	52.1	53.1	52.8	51.6	50.2	48.8

Slovenia

- Following the package agreed for Cyprus, fears rose that Slovenia might be the next country to require a bailout. But we believe the country should be able to avoid an EU loan. The successful bond auctions of recent weeks suggest international investors now share this view.
- Market concerns center on the troubled banking sector and the likely spillover to the public finances and the wider economy. The recapitalization needs of the three largest banks have been estimated by the regulatory authority at €1b in 2013 (around 3% of GDP).
- Deleveraging in the public and private sectors will significantly dampen economic activity this year, amid tight financial conditions, rising unemployment and lackluster exports due to weak Eurozone demand. We expect the economy to contract by nearly 5% in 2013, and then by almost 3% in 2014.
- However, downside risks remain high, with continued market access likely to hinge on the Government's ability to retain investor confidence by implementing plans to restructure the financial sector efficiently.

Figure 43

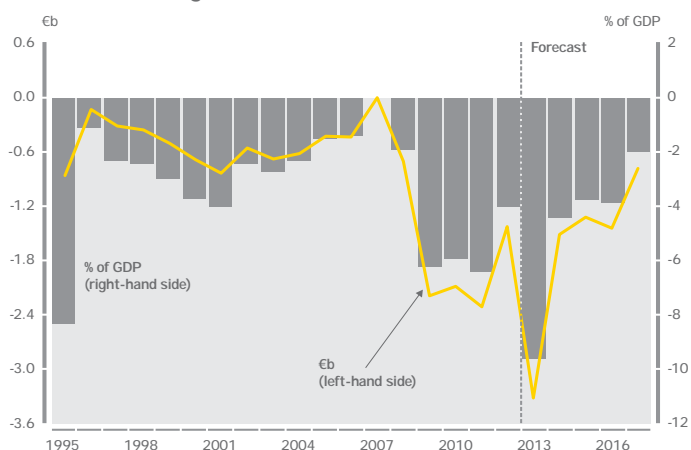
Real GDP growth



Source: Oxford Economics.

Figure 44

Government budget balance



Source: Oxford Economics.

Table 18

Slovenia (annual percentage changes unless specified)

Source: Oxford Economics.

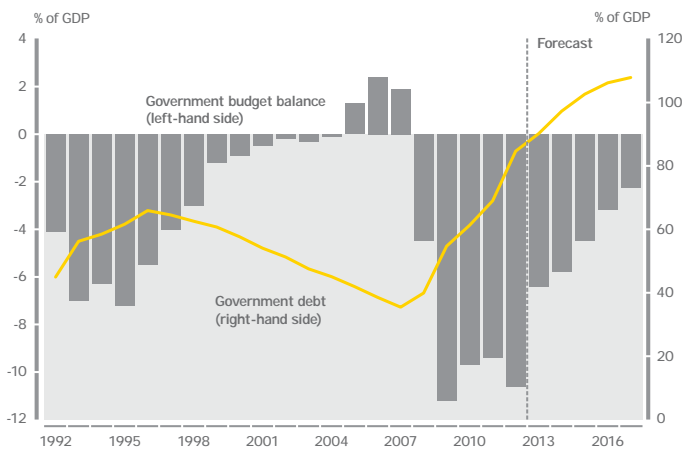
	2012	2013	2014	2015	2016	2017
GDP	-2.2	-4.9	-2.9	1.1	2.8	3.4
Private consumption	-2.9	-6.7	-2.5	2.7	5.1	4.7
Fixed investment	-9.1	-11.1	-5.5	3.0	6.4	5.7
Stockbuilding (% of GDP)	-0.3	0.2	2.0	1.5	-0.1	-0.7
Government consumption	-1.6	-3.0	-2.0	0.1	2.2	3.0
Exports of goods and services	1.3	-2.5	-1.7	0.7	2.0	2.5
Imports of goods and services	-3.4	-4.0	0.9	1.3	2.2	3.0
Consumer prices	2.6	2.4	2.0	2.1	2.2	2.5
Unemployment rate (level)	9.0	13.9	14.0	14.0	13.1	12.0
Current account balance (% of GDP)	2.5	3.9	2.1	1.6	1.5	1.1
Government budget (% of GDP)	-4.0	-9.6	-4.4	-3.7	-3.9	-2.0
Government debt (% of GDP)	50.8	70.4	75.4	76.8	77.0	74.7

Spain

- The pace of fiscal consolidation is easing and competitiveness improvements mean that Spain is well placed to take advantage of the upturn forecast in global trade over the next year. We believe this will help the Spanish economy to return to positive growth in 2014.
- But in the near term, the economy continues to face significant headwinds. Activity proved slightly weaker than expected in the early months of 2013 and we are now rather less positive about the outlook for global trade for the rest of this year. As a result, we expect Spanish GDP to shrink by 1.7% in 2013, a slight downgrade from our March 2013 forecast.
- There is also a risk that the recent improvement in financial market conditions could engender complacency among policy-makers, as it removes the pressure to pursue reforms. Indeed, the reform agenda has slowed this year, which may represent a lost opportunity to boost the economy's longer-term growth potential.

Figure 45

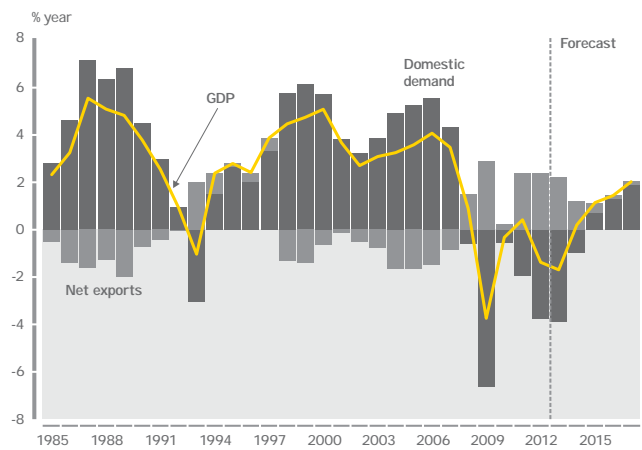
Government balance and debt



Source: Oxford Economics.

Figure 46

Contributions to GDP growth



Source: Oxford Economics.

Table 19

Spain (annual percentage changes unless specified)

Source: Oxford Economics.

	2012	2013	2014	2015	2016	2017
GDP	-1.4	-1.7	0.2	1.1	1.4	2.0
Private consumption	-2.2	-2.6	-0.1	1.0	1.5	2.2
Fixed investment	-9.1	-7.1	-0.2	2.0	2.1	2.3
Stockbuilding (% of GDP)	0.8	0.7	0.5	0.4	0.5	0.6
Government consumption	-3.7	-4.1	-3.3	-1.0	-0.3	0.7
Exports of goods and services	3.1	3.6	4.6	4.4	3.4	3.3
Imports of goods and services	-5.0	-3.8	1.1	3.8	3.5	3.4
Consumer prices	2.4	1.8	1.0	0.9	1.0	1.0
Unemployment rate (level)	25.1	27.2	27.6	27.1	26.4	25.5
Current account balance (% of GDP)	-1.1	0.7	0.6	0.6	0.6	0.5
Government budget (% of GDP)	-10.6	-6.4	-5.8	-4.5	-3.2	-2.3
Government debt (% of GDP)	84.2	93.2	100.2	105.1	108.2	109.5



Detailed tables and charts





Forecast assumptions

	2012	2013	2014	2015	2016	2017
Short-term interest rates (%)	0.6	0.2	0.3	0.3	0.3	0.6
Long-term interest rates (%)	4.0	2.9	3.0	3.3	3.7	4.0
Euro effective exchange rate (1995 = 100)	115.5	118.5	115.6	112.0	111.1	110.9
Oil prices (€/barrel)	86.9	81.5	89.1	96.5	99.4	102.8
Share prices (% year)	-4.1	8.4	8.0	8.6	7.8	6.6

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Short-term interest rates (%)	1.0	0.7	0.4	0.2	0.2	0.2	0.2	0.2
Long-term interest rates (%)	4.4	4.3	4.0	3.4	3.2	2.8	2.8	2.9
Euro effective exchange rate (1995 = 100)	116.9	115.9	113.4	115.9	118.8	118.6	118.7	117.9
Oil prices (€/barrel)	90.3	84.6	87.7	85.1	85.2	79.9	79.6	81.3
Share prices (% year)	-14.9	-20.5	12.6	13.8	5.9	16.7	8.8	3.1

Eurozone GDP and components

Quarterly forecast

(quarterly percentage changes)

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-0.1	-0.2	-0.1	-0.6	-0.2	0.0	0.1	0.2
Private consumption	-0.2	-0.5	-0.2	-0.5	-0.2	-0.1	0.1	0.1
Fixed investment	-1.4	-1.6	-0.8	-1.2	-0.8	-0.1	0.2	0.4
Government consumption	-0.1	-0.3	-0.1	0.1	-0.1	-0.2	-0.2	-0.2
Exports of goods and services	0.5	1.7	0.9	-0.8	-0.1	0.5	0.6	0.8
Imports of goods and services	-0.4	0.6	0.1	-0.9	-0.2	0.3	0.4	0.6

Contributions to GDP growth

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

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-0.1	-0.2	-0.1	-0.6	-0.2	0.0	0.1	0.2
Private consumption	-0.1	-0.3	-0.1	-0.3	-0.1	-0.1	0.0	0.1
Fixed investment	-0.3	-0.3	-0.1	-0.2	-0.1	0.0	0.0	0.1
Government consumption	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Stockbuilding	-0.1	0.0	-0.2	-0.1	0.1	0.0	0.0	0.0
Exports of goods and services	0.2	0.7	0.4	-0.4	-0.1	0.2	0.3	0.4
Imports of goods and services	0.2	-0.3	0.0	0.4	0.1	-0.1	-0.2	-0.3

Annual levels – real terms

(€b, 2000 prices)

	2012	2013	2014	2015	2016	2017
GDP	8,550	8,496	8,576	8,698	8,830	8,972
Private consumption	4,794	4,754	4,779	4,831	4,894	4,967
Fixed investment	1,560	1,522	1,553	1,597	1,641	1,683
Government consumption	1,829	1,822	1,816	1,822	1,833	1,848
Stockbuilding	-4	-17	-13	-5	0	-3
Exports of goods and services	3,877	3,917	4,048	4,218	4,392	4,563
Imports of goods and services	3,505	3,502	3,607	3,765	3,930	4,085

Annual levels – nominal terms

(€b)

	2012	2013	2014	2015	2016	2017
GDP	9,489	9,552	9,772	10,055	10,360	10,687
Private consumption	5,449	5,482	5,592	5,733	5,891	6,066
Fixed investment	1,752	1,728	1,785	1,862	1,942	2,022
Government consumption	2,040	2,053	2,073	2,111	2,156	2,210
Stockbuilding	-6	-36	-7	30	52	59
Exports of goods and services	4,329	4,414	4,641	4,922	5,210	5,503
Imports of goods and services	4,074	4,088	4,312	4,602	4,890	5,174

Prices and cost indicators

(annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
HICP headline inflation	2.5	1.6	1.5	1.4	1.4	1.4
Inflation ex-energy	1.8	1.5	1.5	1.3	1.3	1.4
GDP deflator	1.3	1.3	1.4	1.4	1.5	1.5
Import deflator	4.1	1.1	1.7	1.8	1.7	1.7
Export deflator	5.0	0.4	2.6	2.4	1.8	1.8
Terms of trade	1.0	-0.7	0.9	0.6	0.1	0.1
Earnings	1.7	1.1	1.6	2.0	2.3	2.5
Unit labor costs	1.7	0.5	0.5	0.8	1.0	1.2
Output gap (% of GDP)	-3.0	-4.4	-4.3	-3.9	-3.5	-3.1
Oil prices (€ per barrel)	86.9	81.5	89.1	96.5	99.4	102.8
Euro effective exchange rate (1995 = 100)	115.5	118.5	115.6	112.0	111.1	110.9

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
HICP headline inflation	2.7	2.5	2.5	2.3	1.9	1.4	1.5	1.5
Inflation ex-energy	1.9	1.8	1.8	1.6	1.5	1.3	1.6	1.5
GDP deflator	1.3	1.3	1.3	1.3	1.4	1.3	1.2	1.3
Import deflator	4.0	4.5	4.5	3.3	1.4	1.1	0.6	1.2
Export deflator	5.7	4.8	6.1	3.5	0.4	0.5	-0.5	1.3
Terms of trade	1.7	0.4	1.6	0.2	-1.1	-0.6	-1.2	0.1
Earnings	2.0	1.8	1.7	1.3	1.0	1.0	1.1	1.3
Unit labor costs	1.6	1.6	2.0	1.6	1.0	0.6	0.4	0.0
Output gap (% of GDP)	-2.5	-2.7	-3.0	-3.8	-4.2	-4.4	-4.5	-4.4
Oil prices (€ per barrel)	90.3	84.6	87.7	85.1	85.2	79.9	79.6	81.3
Euro effective exchange rate (1995 = 100)	116.9	115.9	113.4	115.9	118.8	118.6	118.7	117.9

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

Labor market indicators

(annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
Employment	-0.6	-1.2	-0.2	0.2	0.3	0.3
Unemployment rate (%)	11.4	12.4	12.7	12.4	12.0	11.6
NAIRU (%)	8.2	8.6	8.7	8.6	8.5	8.4
Participation rate (%)	75.0	75.3	75.5	75.7	75.9	76.0
Earnings	1.7	1.1	1.6	2.0	2.3	2.5
Unit labor costs	1.7	0.5	0.5	0.8	1.0	1.2

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employment	-0.4	-0.7	-0.6	-0.7	-1.1	-1.3	-1.4	-1.1
Unemployment rate (%)	10.9	11.3	11.5	11.8	12.0	12.4	12.5	12.7
NAIRU (%)	8.1	8.2	8.3	8.4	8.5	8.6	8.6	8.7
Participation rate (%)	74.6	74.9	75.1	75.2	75.1	75.3	75.3	75.4
Earnings	2.0	1.8	1.7	1.3	1.0	1.0	1.1	1.3
Unit labor costs	1.6	1.6	2.0	1.6	1.0	0.6	0.4	0.0

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

	2012	2013	2014	2015	2016	2017
Trade balance (€b)	80.1	138.4	144.6	136.3	136.6	145.0
Trade balance (% of GDP)	0.9	1.6	1.7	1.6	1.5	1.6
Current account balance (€b)	121.8	159.3	150.2	136.2	136.0	140.7
Current account balance (% of GDP)	1.3	1.7	1.5	1.4	1.3	1.3
Government budget balance (€b)	-352	-272	-235	-188	-152	-124
Government budget balance (% of GDP)	-3.7	-2.8	-2.4	-1.9	-1.5	-1.2
Cyclically adjusted surplus (+)/deficit (-) (% of GDP)	-3.3	-2.3	-1.9	-1.3	-0.9	-0.6
Government debt (€b)	8,795	9,149	9,529	9,894	10,210	10,487
Government debt (% of GDP)	102.9	107.7	111.1	113.7	115.6	116.9

Measures of convergence and divergence within the Eurozone

	2003-07	2008-12	2013-17
Growth and incomes			
Standard deviation of GDP growth rates	2.0	2.3	1.8
Growth rate gap (max-min)	7.1	9.4	6.8
Highest GDP per capita (Eurozone = 100)	241.6	239.0	242.2
Lowest GDP per capita (Eurozone = 100)	56.2	67.8	65.8
Inflation and prices			
Standard deviation of inflation rates	1.2	1.0	0.6
Inflation rate gap (max-min)	4.8	3.9	2.3
Highest price level (Eurozone = 100)	122.2	121.1	120.1
Lowest price level (Eurozone = 100)	55.6	69.1	71.7

Cross-country tables

Real GDP (% year)								
Rank		2012	2013	2014	2015	2016	2017	Average 2013-17
1	Estonia	3.2	2.8	4.2	4.2	4.2	4.1	3.9
2	Slovakia	2.0	1.0	2.4	3.7	3.7	3.5	2.9
3	Luxembourg	0.3	1.1	3.2	3.4	3.0	2.8	2.7
4	Ireland	0.9	0.8	2.2	2.6	3.0	3.4	2.4
5	Finland	-0.2	-0.4	1.6	2.3	2.6	2.4	1.7
6	Malta	1.2	1.3	1.3	1.6	1.7	1.8	1.5
7	Austria	0.8	0.7	1.8	1.5	1.6	1.5	1.4
8	Germany	0.8	0.3	1.6	1.7	1.6	1.5	1.3
9	Eurozone	-0.5	-0.6	0.9	1.4	1.5	1.6	1.0
10	Belgium	-0.2	-0.4	0.7	1.2	1.4	1.7	0.9
11	France	0.0	-0.3	0.8	1.2	1.3	1.4	0.9
12	Netherlands	-1.0	-1.0	0.7	1.0	1.2	1.4	0.7
13	Spain	-1.4	-1.7	0.2	1.1	1.4	2.0	0.6
14	Italy	-2.4	-1.8	0.4	1.2	1.3	1.3	0.5
15	Portugal	-3.3	-2.8	0.3	1.1	1.1	1.1	0.1
16	Greece	-6.4	-5.5	-0.3	1.5	2.0	1.9	-0.1
17	Slovenia	-2.2	-4.9	-2.9	1.1	2.8	3.4	-0.2
18	Cyprus	-2.4	-10.2	-7.8	-2.3	-0.2	2.2	-3.8

Inflation rates (% year)								
Rank		2012	2013	2014	2015	2016	2017	Average 2013-17
1	Greece	1.0	-0.2	0.0	0.4	0.8	1.4	0.5
2	Portugal	2.8	0.2	0.8	0.8	0.8	0.9	0.7
3	Spain	2.4	1.8	1.0	0.9	1.0	1.0	1.1
4	France	2.2	1.2	1.6	1.5	1.4	1.4	1.4
5	Eurozone	2.5	1.6	1.5	1.4	1.4	1.4	1.5
6	Italy	3.3	1.8	1.8	1.2	1.2	1.3	1.5
7	Netherlands	2.8	2.6	1.4	1.3	1.1	1.1	1.5
8	Cyprus	3.1	2.0	1.7	1.2	1.2	1.5	1.5
9	Ireland	1.9	1.0	1.7	1.9	1.7	1.6	1.6
10	Germany	2.1	1.5	1.6	1.7	1.7	1.7	1.7
11	Finland	3.2	2.2	1.6	1.5	1.6	1.7	1.7
12	Austria	2.6	2.2	1.8	1.8	1.8	1.8	1.9
13	Malta	3.2	1.7	1.7	1.8	2.0	2.3	1.9
14	Belgium	2.6	1.5	2.1	2.2	2.0	2.0	2.0
15	Luxembourg	2.9	2.0	2.0	2.0	2.0	2.0	2.0
16	Slovakia	3.6	2.0	2.2	2.1	2.1	2.1	2.1
17	Slovenia	2.6	2.4	2.0	2.1	2.2	2.5	2.2
18	Estonia	3.9	3.2	2.8	2.6	2.4	2.3	2.7

Cross-country tables

Unemployment rate (% of labor force)								
Rank		2012	2013	2014	2015	2016	2017	Average 2013-17
1	Austria	4.4	5.1	5.0	4.6	4.5	4.5	4.8
2	Luxembourg	5.1	5.8	5.8	5.3	4.8	4.3	5.2
3	Germany	5.5	5.5	5.5	5.3	5.0	4.9	5.2
4	Malta	6.4	6.7	6.3	6.0	5.7	5.5	6.1
5	Netherlands	5.3	6.8	7.2	7.1	7.0	7.0	7.0
6	Finland	7.7	8.2	7.9	7.4	7.1	6.8	7.5
7	Estonia	10.1	9.0	8.3	7.6	7.0	6.5	7.7
8	Belgium	7.6	8.4	8.6	8.3	7.8	7.6	8.1
9	France	10.3	11.3	11.5	11.4	11.2	11.0	11.3
10	Italy	10.6	12.1	12.7	12.4	11.9	11.4	12.1
11	Eurozone	11.4	12.4	12.7	12.4	12.0	11.6	12.2
12	Ireland	14.7	14.0	13.7	13.3	12.4	11.4	13.0
13	Slovakia	14.0	14.6	14.2	13.3	12.3	11.2	13.1
14	Slovenia	9.0	13.9	14.0	14.0	13.1	12.0	13.4
15	Portugal	15.9	17.9	18.2	17.5	16.5	15.5	17.1
16	Cyprus	12.1	19.1	24.1	25.3	25.0	22.1	23.1
17	Spain	25.1	27.2	27.6	27.1	26.4	25.5	26.7
18	Greece	24.3	28.3	29.1	28.3	27.2	26.1	27.8

Government budget (% of GDP)								
Rank		2012	2013	2014	2015	2016	2017	Difference 2013-17
1	Germany	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
2	Estonia	-0.3	-0.4	0.3	0.2	0.3	0.2	0.6
3	Slovakia	-4.3	-2.3	-1.9	-1.8	-1.5	-1.2	1.1
4	Italy	-3.0	-3.0	-2.7	-2.2	-1.9	-1.7	1.3
5	Malta	-3.3	-3.7	-3.4	-3.0	-2.6	-2.3	1.4
6	Netherlands	-4.0	-3.4	-3.4	-2.7	-2.4	-2.0	1.4
7	Finland	-1.9	-1.6	-1.2	-0.5	-0.2	-0.1	1.5
8	Eurozone	-3.7	-2.8	-2.4	-1.9	-1.5	-1.2	1.6
9	Austria	-2.5	-2.5	-1.7	-1.2	-0.9	-0.8	1.7
10	Luxembourg	-0.8	-1.2	-0.8	-0.5	-0.2	0.5	1.7
11	Belgium	-3.9	-3.1	-2.0	-1.4	-1.1	-0.9	2.2
12	France	-4.8	-3.9	-3.3	-2.6	-2.1	-1.7	2.2
13	Cyprus	-4.9	-6.0	-6.9	-5.8	-4.2	-3.4	2.6
14	Greece	-10.0	-6.7	-5.6	-4.5	-3.7	-3.2	3.5
15	Spain	-10.6	-6.4	-5.8	-4.5	-3.2	-2.3	4.1
16	Portugal	-6.4	-6.0	-4.2	-2.9	-1.7	-0.8	5.2
17	Ireland	-7.5	-7.4	-4.7	-2.9	-1.9	-1.2	6.2
18	Slovenia	-4.0	-9.6	-4.4	-3.7	-3.9	-2.0	7.6



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