Eurozone

Ernst & Young Eurozone Forecast

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Welcome

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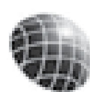

OXFORD ECONOMICS

Mark Otty
Area Managing Partner, Europe, Middle East, India and Africa

Welcome to the first Ernst & Young *Eurozone Forecast* of 2013. The year began with the hope that better times lay ahead, but has so far been marked by news both good and bad.

Even after the difficulties of 2012 and the relief that a near-term Eurozone breakup has been avoided, challenges still remain. The outcome of February's EU summit, which agreed to limit the EU's spending in 2014-20 to €960b, 3% below the current seven-year budget, prompted reassurance that European leaders can put aside individual country concerns and come together to address ongoing challenges.

However, it would be disappointing if the deal, which represents the first cut in the EU's budget in its 56-year history, also serves to hamper future growth. Cuts in funds to develop cross-border infrastructure for example, would hit peripheral EU and Eurozone countries particularly hard. While balancing the books is clearly crucial, policy-makers must also seek to create a balance between austerity and the necessary investment to promote growth, the pursuit of which has intensified since the turn of the year.

News that the Eurozone economy shrank by 0.6% in the final quarter of 2012 — the sharpest contraction since the beginning of 2009 and the first time the region failed to grow in any quarter during a calendar year — reverberated across the region. Even Germany, so long the engine of the European economy, has suffered, with its exports slumping by 2% in the fourth quarter of 2012, causing its overall economy to fall by 0.6%.

More recently, the political deadlock arising from the Italian elections has been an unwelcome reminder of the fragility of the Eurozone's attempts to recover from the financial crisis. The apparent rejection of austerity measures by Italian voters, together with the prospect of another election within months, will do little to build much-needed confidence and has already injected further uncertainty into the markets. Such issues help to explain why we now expect the Eurozone's GDP to decline by 0.5% in 2013, the same as the fall in 2012.

However, our forecast also expects some pickup during the second half of the year, in turn paving the way for growth of just over 1% in 2014. This will then be followed by slow-paced expansion, which will hit an annual rate of 1.6% in 2017. A number of different factors will underpin this slow recovery. Improved competitiveness and strengthening demand from the US and emerging markets will boost exports.

And while increased business investment and consumer spending will also play a significant role in the years to come, further policy reforms will also drive growth — a broader tax base, the ongoing restructuring of the public sector and developments such as reduced bureaucracy and stronger competition laws will all come into play.

It is important, too, to recognize that globalization is still increasing the levels of cross-border trade and capital and labor integration. And despite the problems of recent years, developed markets continue to be major drivers of world economic activity, a point highlighted by our recent report, *Globalization and new opportunities for growth*. With technology integral to our increasingly digital and connected world, the presence of advanced broadband, social and mobile technologies across the Eurozone offers a chance for agile businesses to leverage these capabilities into a significant competitive advantage.

Such opportunities are integral to unlocking the huge reserves of cash that many European companies have built up in recent years. Only time will tell whether this reluctance to invest will evaporate in the face of better economic news, but with the shadow of the financial crisis seemingly poised to begin its slow retreat, and concerns about an imminent breakup of the Eurozone now fading, we can be hopeful that this year will see a corner turned and a brighter Europe emerge on the horizon.

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Slow growth, rapid change

The Eurozone has avoided a breakup, the euro has survived and investors are regaining confidence in both. Yet improved faith in the region's economic outlook has been accompanied by an appreciating currency as well as a surge in financial markets. Business leaders must integrate the messages from a fast-shifting economic environment into their planning and position their firms to cope with the challenges — and to grasp the opportunities — of slow growth accompanied by rapid change.

The Eurozone economy remains in recession and we continue to believe 2013 will be a year of mild contraction. Across the 17-nation bloc as a whole, we expect GDP will decline by 0.5% in 2013, similar to the fall in 2012. But our Spring 2013 forecast foresees a mid-year turning point, with a modest recovery in growth during the second half and then growth of about 1% in 2014. That will be followed by slow-paced expansion in subsequent years, we believe, with growth finally edging up to 1.6% in 2017.

Grasping the good news

Both the policy backdrop and the economic environment continue to evolve rapidly. Three key positives stand out. First is that a near-term Eurozone breakup has been avoided. That is confirmed both by the gauge of systemic risk compiled by the European Central Bank (ECB) and by the more optimistic assessment of financial markets, which we share.

Second is the significant policy progress achieved represented by the European Union (EU) budget. In early February, EU leaders agreed to cap spending in the seven years from 2014–20 at €960b, 3% below the current seven-year budget. Though perceptions of the compromise deal vary, the agreement has bolstered confidence in the ability of EU leaders to confront and resolve difficult issues.

A third reason for enhanced optimism about the outlook is the announcement that the US and EU will open negotiations for a bilateral trade deal, which President Obama made during his February state of the union address. The proposed "transatlantic trade and investment partnership" seems a sincere attempt by developed economies to counter the shift of economic gravity towards rapid-growth markets (RGMs) by reinvigorating their own economies.

In their joint statement announcing the talks, set to open by the end of June, the US and EU estimated that a deal could add €86b of annual income to the EU economy by 2027, equal to 0.5% of GDP for the 27 member states. Though there are many impediments to agreement, especially over non-tariff barriers, with potential gains for the US equal to 0.4% of its GDP, there are strong incentives on both sides of the Atlantic that will drive the search for a deal.

Spotting potential hazards

But not all the signals are green. The EU's budget cutting may also erode confidence in Europe. Most of the new cuts come from a fund to build cross-border infrastructure that the European Commission (EC) had argued would promote economic growth. The burden of cuts may therefore fall most heavily upon peripheral EU and Eurozone countries with the poorest infrastructure — sending the wrong signals to business.

Business leaders keen for reassurance that Europe is determined to overcome its difficulties may also be discouraged by hesitant progress on the EU's commitment to banking union. Proposals that the ECB assume regulatory control of the biggest banks appear secure. But there are perceptions that European leaders are retreating from proposals for a single resolution authority and for common guarantees for deposits. Concerns were highlighted by a report from the International Monetary Fund (IMF), published on 13 February, which emphasized the need for a common resolution system and depositor safety nets if the Eurozone is to create a credible single supervisory mechanism.

A third negative for business and investor sentiment may be the controversial proposals, also unveiled in mid-February, for a financial transaction tax. The proposed levy of 0.1% on share and bond trades and 0.01% on derivative transactions involving a financial institution headquartered in the tax area, or for a client located within the 11 EU countries that have expressed interest in "enhanced cooperation" in this field, would in practice apply far beyond the core Eurozone countries seeking its implementation. It is therefore likely to trigger stiff resistance from the US, the UK and other nations with leading financial centers.

Focusing on the present

The decline in Eurozone GDP in the final quarter of 2012 was widely seen as disappointing, though broadly in line with our expectations. Overall, the economy of the 17-nation zone shrank by 0.6%, with a marked contraction in some core countries that had previously delivered a relatively robust performance. GDP in Germany fell 0.6% on the quarter, while in France it was down 0.3% and the Netherlands saw contraction of 0.2%. Key peripheral economies were even weaker, with Italy shrinking 0.9% and Spain showing contraction of 0.7%.

Following financial markets

In the meantime, financial markets have surged, apparently anticipating recovery despite the scarcity of green shoots in the seared European business landscape.

The market recovery appears to have been driven by an element of pent-up demand among investors, combined with a partial solution to the problem of the US "fiscal cliff," and a belief that European leaders are "making the right noises." Some market indexes have breached peaks seen in 2007, before the onset of the financial crisis.

A general belief that we are on the very slow road to recovery has increased the willingness of investors to put money into equities, rather than low-yielding government bonds, or even the bonds of blue-chip companies. Risk appetite has revived. Markets appear to be playing their long-standing role as leading indicators for the rest of the economy, but individual businesses and consumers, particularly in southern Eurozone countries, are not yet sharing this newfound optimism.

Rebuilding business confidence

Yet confidence does seem to be returning, though at different levels in different places. The EC's economic sentiment indicator rose for the fourth successive month in February. Managers are getting more bullish about the outlook for business activity, with industry confidence and sentiment in services both increasing. Though confidence in Italy, France, Spain and Portugal remained below average, the strongest improvement was in Germany, Denmark and Belgium.

Since Germany generates 30% of Eurozone GDP, a better outlook there is clearly beneficial for its suppliers elsewhere in the Eurozone. But the equanimity of German bosses in the face of recession and their optimism despite the strength of the euro continue to offer lessons for companies throughout the region.

Companies need to retain flexibility in their development planning and to model multiple scenarios. But those with sound balance sheets should now be seeking business opportunities, reviving investment options and starting to hire to underpin business development. The second lesson from Germany is that in capital goods at least, quality often continues to find customers, and even command a premium, when competition is intense. Selling on price alone is best avoided.

Seeking out finance

Companies seeking to borrow continue to face banks with reduced appetite to lend because of their own problems. As things start to improve, the banks will be more able to deal with some of their non-performing and non-core assets. Over time, this will make them better placed to lend to the sectors where they have confidence.

Banks are now thought to be around two-thirds of the way through the deleveraging process. Their focus is still on selectively shrinking their balance sheets. Our survey, the *European Banking Barometer*, published at the end of 2012, showed that companies in construction or commercial real estate, which were hit hard by the financial crisis, generally find it more difficult to obtain loans than those in sectors viewed more favorably by lenders, such as biotech, health care or information technology. These are seen as growth sectors offering a better chance of repayment. Overall, sentiment around lending conditions has improved, but the sovereign debt crisis has had a profound impact on lending within the Eurozone. After falls in 2012 and 2013, EY expects a 2014 recovery in lending to the levels of 2011, rising further thereafter.

With bank lending constrained, 2012 saw an upsurge in European capital market borrowing by well-regarded companies. But smaller companies, and those perceived as more risky, will probably continue to struggle to access capital markets.

Resurging interest in M&A

There are signs of an increase in mergers and acquisitions (M&A) activity in recent weeks. Though some of the most striking deals tabled have been in the US or UK, private equity activity also appears to be picking up in the Eurozone. Some of this activity centers upon restructuring or rolling over debt, rather than seeking out business synergies. Generally speaking, companies see the recovery of financial markets as a cue to sell, but higher prices make buying businesses less attractive. Business leaders are once again thinking about strategic steps, as well as organic growth opportunities. But only if the recovery in market sentiment is sustained, and accompanied by a recovery in corporate profit margins, is the market upturn likely to provide a more confident backdrop for companies to push through M&A deals.

Some industry consolidation is expected to occur within the financial sector itself. According to our December 2012 *European Banking Barometer*, banks in over-banked markets such as Germany expect considerable consolidation over the next one to three years. As regulation intensifies, smaller banks that lack a clear niche will find it increasingly difficult to achieve sustainable returns.

Trusting the euro

Yields on Spanish and Italian bonds fell last summer after remarks by Mario Draghi, President of the ECB, that it would do "whatever it takes" to defend the euro. Allegations of corruption in Spain and political uncertainty arising from the February election in Italy contributed to modest yield increases in the early weeks of 2013. But by the middle of February, 10-year Spanish bonds were still offering yields of around 5.3% and their Italian counterparts yields of 4.4% — both around 200 basis points below their levels of last summer.

Adapting to changing currency risks

Improved investor enthusiasm for the Eurozone has prompted a rise in the euro, which has appreciated by 8% against the US dollar and by 8.5% on a trade-weighted basis since mid-2012. A stronger euro has mixed consequences for Eurozone companies. Imports from outside the Eurozone become cheaper and therefore more cost-competitive with goods produced within the single currency area. A stronger euro also eases upward pressure on the price of imported inputs, but exporters will find their competitiveness in markets beyond the Eurozone eroded, and their margins may come under pressure. However, we believe the euro is now overvalued by about 10%, and expect it to depreciate towards US$1.25 by the end of the year. Corporate leaders need to shift the focus of their currency concerns from risks to the single currency to the risks around changes to the relative values of leading currencies.

Companies should urgently review the potential impact upon their supply chains and upon their competitiveness both within the Eurozone and in their external markets. Currency shifts could augment pressure on profit margins — or provide relief from rising input prices, depending upon location of manufacturing and markets. Caution will be required when negotiating contracts, and hedging will be necessary when the size of any deals that involve the euro and other leading international currencies is material in relation to company revenues or funds.

Global leaders appear increasingly concerned about the threat of competitive devaluations. A February statement from the G20 pledged, "We will not target our exchange rates for competitive purposes." Meanwhile leaders of the G7 richest-nations club insisted that they remained committed to "market-determined" exchange rates. Yet their statements appear to have had only limited effects upon currency markets.

Companies that report in euros, but which generate extensive revenues or profits outside the Eurozone, may find their figures undermined by changes in currency valuations. Those reporting in US dollars or sterling, on the other hand, may be able to show currency gains if recent rates are sustained.

Responding to improving export markets

Yet the drag of currency appreciation comes against the backdrop of improving demand in many markets beyond the Eurozone. The Ernst & Young *Rapid-Growth Markets Forecast: Winter 2013* noted an uptick in global growth, led by economies in Asia and Latin America. It predicted that RGM growth overall will accelerate from 4.6% in 2012 to 5.3% this year and 6.4% in 2014. The first engine of global growth in the next few years will be Asian RGMs, whose expansion is expected to

accelerate from 6.1% in 2012 to 7.8% in 2014. Simultaneously, growth in leading Latin American RGMs will rise from 2.6% in 2012 to 4.8% in 2014. Economic growth is also now expected to accelerate in the US following action to resolve the problem of the "fiscal cliff."

Against this backdrop, businesses within the Eurozone are pursuing export markets energetically. After a 3% rise in exports in 2012, we expect exports to expand by 2.5% this year — despite a stronger euro — and by 4% in 2014.

Companies in peripheral countries undergoing substantial structural reform are likely to be among those showing the strongest export growth. We expect Greek merchandise exports to expand by over 9% in 2014, with Ireland, traditionally a strong exporter, and Spain achieving export growth of about 4.5% and 4% respectively.

Coping with weak Eurozone demand

Overall demand within the Eurozone is likely to remain weak, however, reinforcing our expectation of a "lost decade" of very limited growth for many companies operating within the region. We expect that fiscal tightening will amount to 1% of GDP this year, paring one percentage point from Eurozone growth. Constraints on public spending in Eurozone peripheral countries, in particular, will hamper companies serving markets such as health care, education, and local authorities.

Tax increases and improvements in the efficiency of tax collection, in the meantime, will continue to impair the ability or confidence of consumers to spend in some countries. This will be compounded by a continuing rise in unemployment.

Weighing where to invest

As business leaders and consumers gradually regain their confidence in the growth outlook for the Eurozone, business investment will accelerate. The pickup will be bolstered by technology renewal as companies adopt more efficient ways of conducting business. We believe Eurozone business investment will continue to fall in 2013, shrinking by 2%, but will recover to grow on average by 3.5% a year in 2014–17.

Yet external competition for companies' investment funds is intensifying. Leaders of international companies will be obliged to make tough choices when allocating scarce funds. As RGMs mature, they grow larger; for businesses in some sectors their growth rates, now accelerating again, compare favorably with those of the Eurozone. A stronger euro, and currency instability, can only reinforce the appeal of developing capacity within regions and reducing reliance on interregional supply chains.

Spotting new investment opportunities

Business location decisions are built upon diverse factors. Stability, culture, and the availability of talent and skills can combine to create an attractive export base even where local demand is inadequate to sustain all of a firm's capacity. A strong performance on all these criteria helps to ensure that Germany remains an attractive location for many manufacturers.

Yet in recent months, structural reforms have awakened interest in some peripheral Eurozone countries. Companies contemplating investments within the Eurozone may now need to look more widely in their location decisions. They need to monitor recent and proposed changes in business legislation in countries undergoing structural reform, to ensure they integrate improvements in attractiveness into their decision-making process.

But cost factors are also changing substantially in some countries where competitiveness was previously penalized by high wages and poor productivity. Since 2008, hourly wages have fallen by 14% in Greece and by 5% in Spain and Ireland. Though productivity has stagnated in Greece overall, it has risen in Ireland and Spain. Overall, falls in relative unit labor costs have improved the competitiveness of these three economies since 2008.

The Eurozone remains central to business decisions

A market of 330 million relatively rich and sophisticated consumers, underpinned by high levels of public spending, is an alluring prospect for business. Little wonder that investors from around the world continue to be attracted to the Eurozone even as the global centre of economic gravity slides eastward.

Six months ago, amid intense fears of a Greek exit, the whereabouts of future Eurozone borders were the biggest uncertainty confronted by companies operating across the region. Today, however, the outline looks more predictable, but the landscape itself is changing. Unemployment, austerity, structural reforms and technological development combine to create a business operating environment characterized by the most rapid pace of change seen across the 17-nation bloc since the common currency became legal tender 11 years ago in January 2002.

The euro's collapse was feared only months ago; the currency now threatens to throttle exporters as it strengthens. That is a powerful reminder that the Eurozone is a substantial but also vulnerable region of an increasingly integrated world in which economic fortunes are beyond the capacity of any single state to control.

To thrive, business needs to scan for risk both within and beyond the Eurozone's borders, constantly re-evaluating dangers and opportunities. Yet ultimately, no-one investing in a factory with a lifespan of 20 years or more can be sure of the returns that will accrue. Business remains an act of faith, in the Eurozone as elsewhere.

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Highlights

A stabilizing economy

- The risk of an imminent Eurozone breakup, which weighed heavily on business and consumer confidence for much of 2012, has been averted.
- The economy is expected to start growing again from mid-2013, but overall a decline of 0.5% is now forecast for 2013, followed by very sluggish growth of only 1.4% a year in 2014–17.
- Improving competitiveness and strengthening demand from the US and emerging markets will start to boost Eurozone exports over the coming year.
- The return to very modest growth that we expect to see in the peripheral countries in 2014 will initially be driven by business investment and exports and subsequently, once the labor market starts to improve, by consumer spending.
- Some threats remain. Political concerns in Italy, Spain and some smaller Eurozone countries could start to undermine confidence again. This could lead to renewed market volatility and may heighten fears of "austerity fatigue" in some of the peripheral countries.
- Our forecast assumes that Italy does not backtrack on the economic reforms implemented by the last Government. Were the reform process to be discontinued, we believe this would have negative implications for the Italian economy and the bond and equity markets. It also seems likely that it would lead investors to question the commitment of other peripheral economies to reform, most notably Spain.

A slow return of confidence

- Over the last six months there has been a marked decline in risk premia priced into Eurozone financial markets. We think that markets have risen too strongly, given that economic fundamentals remain unsound and that some countries are facing political uncertainty.
- The euro has already surrendered some of its earlier gains, but it is still up by 8% against the US dollar and 8.5% on a trade-weighted basis since mid-2012. We expect it to fall later this year as investors focus on underlying growth prospects in the US and emerging markets rather than the Eurozone.
- Although the economic climate remains difficult, confidence among businesses and consumers should return gradually, as some of last year's major threats recede. But we still expect business investment to shrink by 2% in 2013, before recovering slowly to post average growth of 3.5% a year in 2014–17.
- Weighed down by austerity measures, consumer spending is expected to fall again in 2013, by 0.7%, before starting to grow slowly by an average of just over 1% a year in 2014–17.
- In addition, we estimate that fiscal tightening will amount to more than 1% of GDP again this year. This will cut around one percentage point from GDP growth.

Policy reforms encouraged by a more normal risk environment

- Public sector reforms are under way. In the peripheral countries particularly, a range of measures have been proposed and implemented.
- This restructuring has involved broadening tax bases, increasing tax rates, improving tax collection, reducing public sector wage bills, and lowering the scale and duration of welfare payments.
- The peripheral economies have strengthened competition laws. This has reduced bureaucracy and made it easier to start businesses and to hire and fire staff. Other reforms will also enhance the performance of these struggling countries.

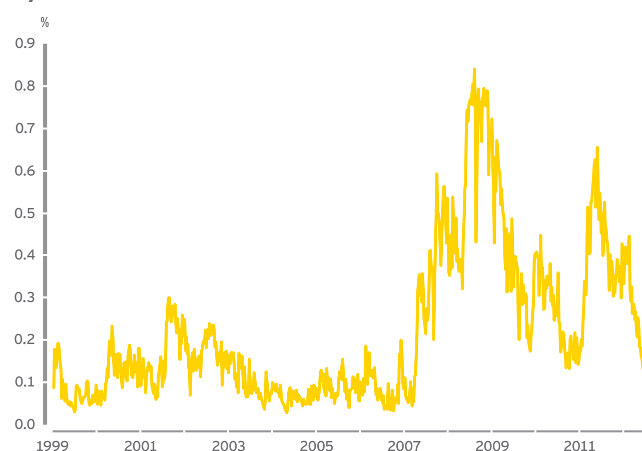
Downside risks greatly diminished, but recovery will be slow

Investors regain cautious optimism ...

The risk of an imminent Eurozone breakup has been averted and we expect the economy to start growing again from mid-2013, albeit only slowly. Reflecting this reduced threat, the ECB's gauge of systemic risk has fallen sharply since July and is now back to levels last seen in 2007 — prior to the financial crisis. This is a clear signal that the Eurozone financial system now represents much less of a threat to its economy. We share the confidence of the financial markets. We think that the Eurozone is much more stable now than during most of 2012.

This improved risk environment should allow businesses that have been hoarding cash to consider investing and hiring again. However, so far the improvement in confidence in the real economy has been less pronounced than the gains in financial markets. According to the recent EC surveys, Eurozone business confidence has only risen a little and consumer confidence has merely stabilized. The disparity between financial markets and the real economy will probably continue for some time.

Figure 1
Systemic stress indicator



Source: ECB, Haver Analytics

Table 1
Forecast of the Eurozone economy (annual percentage changes unless specified)

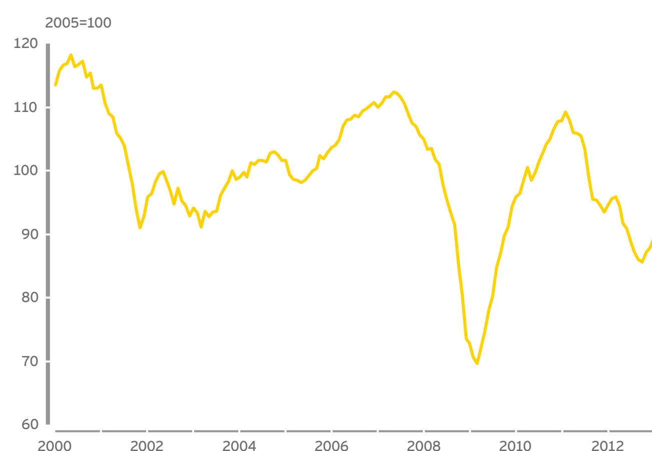
Source: Oxford Economics

	2012	2013	2014	2015	2016	2017
GDP	-0.5	-0.5	1.1	1.4	1.5	1.6
Private consumption	-1.3	-0.7	0.7	1.1	1.3	1.4
Fixed investment	-4.0	-2.0	2.1	2.9	2.8	2.5
Stockbuilding (% of GDP)	0.0	-0.1	0.0	0.0	0.1	0.0
Government consumption	-0.1	-0.7	-0.3	0.3	0.6	0.8
Exports of goods and services	2.7	1.9	4.0	4.4	4.1	3.9
Imports of goods and services	-0.7	0.7	3.7	4.5	4.3	3.9
Consumer prices	2.5	1.8	1.6	1.4	1.4	1.5
Unemployment rate (level)	11.4	12.2	12.2	11.8	11.4	10.9
Current account balance (% of GDP)	1.2	1.6	1.5	1.4	1.4	1.4
Government budget (% of GDP)	-3.3	-2.5	-1.9	-1.5	-1.2	-0.9
Government debt (% of GDP)	92.7	95.3	96.2	96.8	96.8	96.2
ECB main refinancing rate (%)	0.9	0.8	0.8	0.8	0.8	0.9
Euro effective exchange rate (1995 = 100)*	115.5	118.7	114.3	110.7	110.3	110.1
Exchange rate ($ per €)	1.28	1.27	1.21	1.17	1.17	1.17

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

The Eurozone still faces challenges that may partially undermine confidence again. The inconclusive elections in Italy, and political developments in Spain and some smaller Eurozone countries are sources of uncertainty.

Figure 2
Business and consumer confidences

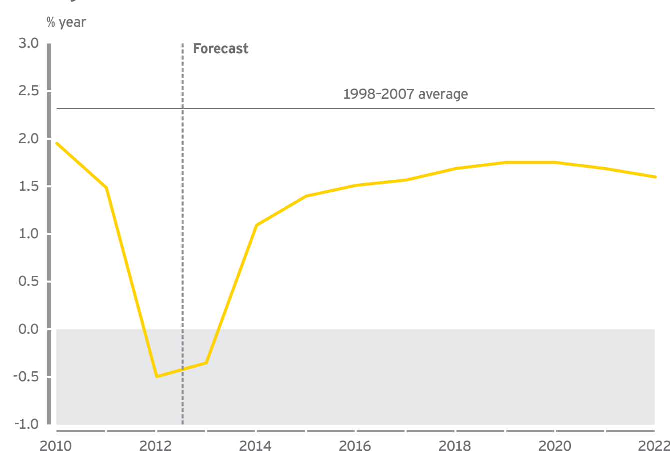


Source: Haver Analytics

... but we still expect a "lost decade" ...

For some time we have been forecasting a "lost decade" of growth for the Eurozone. Many other forecasters have now come to the same conclusion and our expectations remain broadly the same. It is likely that 2013 will be a second consecutive year of mild contraction, with GDP now forecast to fall by 0.5%. And we expect growth to average only 1.4% a year in 2014–17, almost a full percentage point below the 2.3% average in the 10 years preceding the global financial crisis. Consequently, unemployment will be slow to fall, with the number of employed in 2017 still 3% (or 4.65 million people) below its 2008 peak. The slow growth environment will increasingly force businesses to look beyond their home markets in search of opportunities in the rapidly growing economies of Asia and Latin America, as well as to the recovering US economy (see Box 2 on the international environment on page 17).

Figure 3
GDP growth



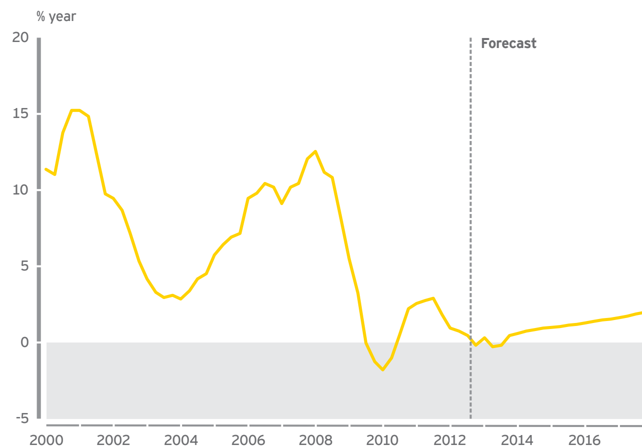
Source: Oxford Economics

... due to public and private sector deleveraging ...

Fiscal tightening is expected to be a medium-term drag on growth. We estimate that fiscal tightening will amount to more than 1% of GDP again this year, which will cut around one percentage point off GDP growth. From 2014 onwards, the pace of fiscal tightening should lessen, but at around 0.5%–1% of GDP a year, it will continue to dampen growth. But, after several years of austerity, one of the key challenges now facing policy-makers in the Eurozone — both in the peripheral countries and most others — is to apply public sector reforms in a way that does not continue to undermine growth (see Box 1 on the public sector perspective on page 16).

Banking sector deleveraging will also continue to constrain growth over the forecast horizon. Although the banking system is now much less of a systemic threat to the broader economy than a year ago, it is not yet in a position to drive an economic upswing through rapid lending growth. In the ECB's latest bank lending survey, conducted in January 2013, banks showed that they were not ready to ease credit standards yet. Generally, tight credit conditions will weigh on investment and consumer spending.

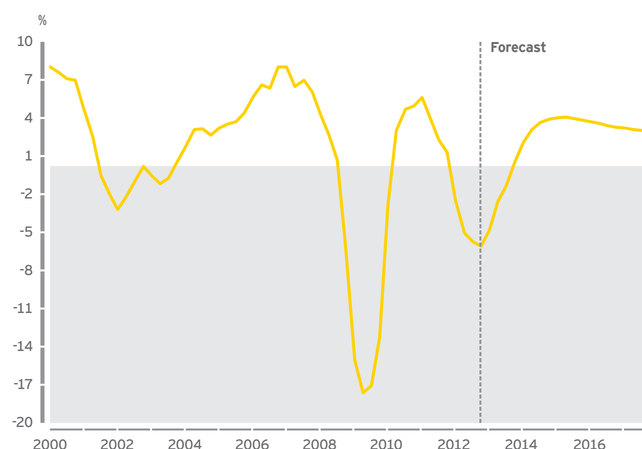
Figure 4
Lending growth to non-financial companies



Source: Oxford Economics

Lending to non-financial companies is expected to expand by just 1.2% on average over the next five years, far below the 6.8% annual average of the five years preceding the 2008-09 global financial crisis. Weak credit growth will mean that companies wishing to invest will have to rely more on internally generated funds and raising capital via financial markets than they did prior to 2008. The recent falls in the risk premia embedded in equity and bond markets should make it easier and cheaper for companies to raise external finance from markets, thereby partly offsetting tight financing from banks. We expect business investment to shrink by a further 2% in 2013, before growing by an average of 3.5% a year in 2014-17.

Figure 5
Investment, private sector business



Source: Oxford Economics

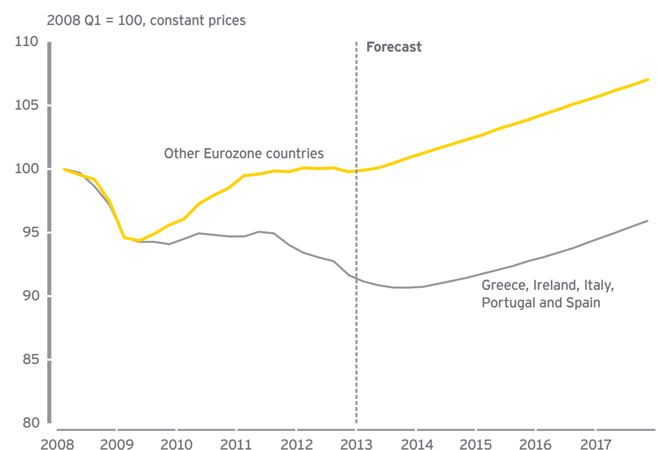
... and high unemployment

A further rise in unemployment in the short term, and only a slow decline from 2014, is likely to be another impediment to growth. Unemployment in the Eurozone overall reached a record high of 11.7% in December 2012, with the jobless rates in Spain and Greece at more than 26%. With productivity barely back to pre-crisis levels, companies and governments are still trying to adjust staff levels to enhance efficiency and restore profitability. By the end of 2017, we expect the unemployment rate to still be just above 11%, and the number of unemployed to be around 6.5 million higher than at the start of the financial crisis.

Signs that reforms in the periphery are bearing fruit

The contrast between low growth in the core Eurozone nations and ongoing recession in the peripheral countries will remain stark this year. Nevertheless, there are some tentative signs that the situation beyond the core nations is improving. We expect the pace of contraction in the periphery to slow from 1.9% in 2012 to 1.4% in 2013, before a return to growth in early 2014.

Figure 6
GDP



Source: Oxford Economics

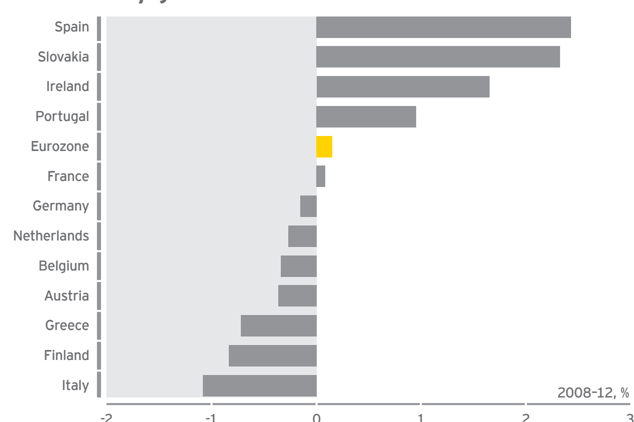
Indeed, in parts of the periphery, painful work being undertaken to reform economies is already yielding results in the form of improving international competitiveness.

Since the onset of the global financial crisis in 2008, employment in the periphery has fallen by 9%, or 5 million people. In the case of Spain, Ireland and Portugal, employment has fallen further than output, thereby providing a boost to productivity. Since 2008, output per worker has increased by 2.4% in Spain, 1.7% in Ireland and 1% in Portugal. But in the case of Italy and Greece, productivity has actually fallen since 2008 — both by about 1%. In Greece this has occurred despite a steep fall in employment, but in Italy it reflects a decline in

employment of just 1.9% over a period when output has fallen by 5.3%. Employment laws have made it difficult for Italian companies to adjust the size of their workforces as output has fallen. However, Italy has introduced legislation that will make it easier for companies to make workers redundant when needed.

Figure 7

Productivity growth

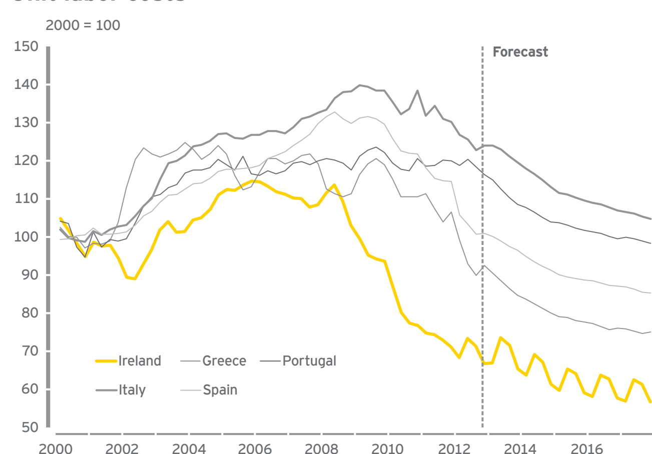


Source: Oxford Economics

As well as a reduction in the labor required for each unit of output, labor costs have fallen in some of the peripheral economies. Hourly wages since 2008 are down by 14% in Greece and by 5% in Spain and Ireland. Consequently, helped by an 8% fall in the trade-weighted value of the euro, the relative cost of labor for each unit of output has fallen by 36% in Ireland, 22% in Spain and 17% in Greece. These falls in relative unit labor costs have made the goods and services produced in these peripheral economies more competitive than they were in 2008.

Figure 8

Unit labor costs



Source: Oxford Economics

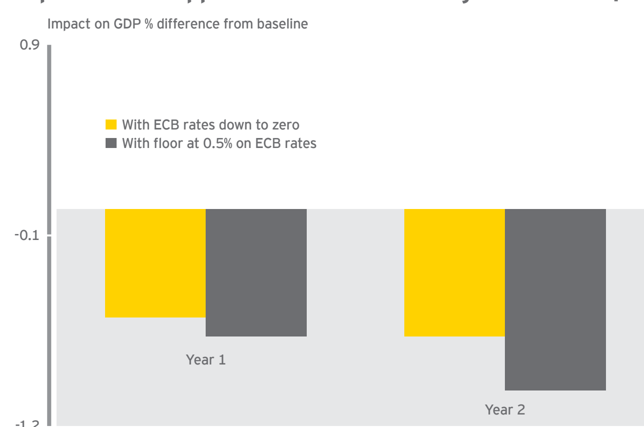
By 2014, we expect the peripheral Eurozone countries with the fastest export growth to be Greece, Ireland and Spain — at 4.3%, 4.4% and 4.2% respectively. These are the three countries that have seen the largest improvement in their relative unit labor costs, and hence competitiveness, since 2008. This will help these countries exit recession and allow gains in economic activity to accompany job creation.

Appreciation of the euro could curb Eurozone growth ...

One downside of the improvement in investor confidence has been the appreciation of the euro, up by 8% against the US dollar and 8.5% on a trade-weighted basis since mid-2012. Our global economic model shows that a sustained 10% appreciation against the US dollar (around 5% in effective terms) would cut Eurozone GDP by 0.5%–0.7% within one year.

Figure 9

Impact of 10% appreciation of the euro against the US$

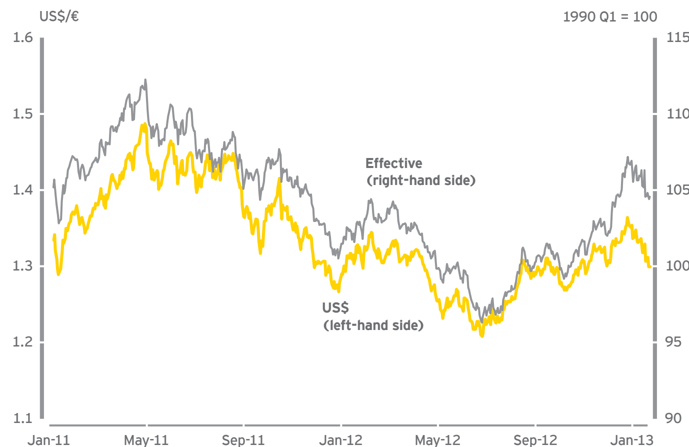


Source: Oxford Economics

This could deliver another blow to the already very weak economic conditions. But we think that, in the current circumstances, the impact of the appreciation will be mitigated by the fact that it is accompanied by a more stable environment. This will enable some companies, probably mainly in the core Eurozone countries, to start investing and hiring again.

It will be important to watch indicators such as business confidence, or orders for the more export-dependent countries like Germany, the Netherlands or Belgium, for any evidence of the euro's rise having any significant impact. For now, German businesses seem content with recent developments and prospects. Although their export sectors are much smaller, the countries that could suffer most from the appreciation of the euro are the peripherals. Exports have been the only growth areas in these countries over the past couple of years, but have been offset by ongoing recessions in the domestic economy. The rise in the euro, if sustained, may undo some of the painful work undertaken to restore competitiveness.

Figure 10
Exchange rate



Source: Oxford Economics, Reuters

Despite these concerns, we have not lowered our growth or export forecasts because we do not expect the euro to stay at its current level for long. Compared with our estimates of an equilibrium value of the exchange rate, based on relative productivity and net foreign asset positions, we estimate that the euro is overvalued by a little below 10% at present. But, as uncertainty about the US fiscal stance clears and the pickup in growth there and in emerging markets becomes more obvious, we expect the euro to depreciate again towards US$1.25 by the end of this year.

... but the ECB is unlikely to respond for now

The ECB has typically been very reluctant to respond to exchange rate movements, other than with a few, not too precise, verbal interventions. This time will probably be no different. The ECB would need to see the stronger euro having a significant negative impact on activity before it intervenes. But if we are wrong, and the recent rise in the euro continues, the ECB may need to intervene, perhaps even with an interest rate cut, to stem any further appreciation.

A stronger euro poses a new risk to the Eurozone outlook. However, it is a risk that is much less toxic than fears of a Eurozone breakup, because businesses are accustomed to this type of risk, having experienced such bouts of appreciation before. By the standards of the last 10 years, the euro does not look particularly high.

Conclusions

The immediate risk of a Eurozone breakup has been averted. This should bring significant relief to businesses and encourage investment and hiring by those that can afford it. Consequently, we expect a return to growth from mid-2013. However, the challenges to Eurozone growth identified in our previous forecasts persist and will hold back the pace of the recovery. Recent political developments in Italy, Spain and some smaller Eurozone countries may add to these challenges.

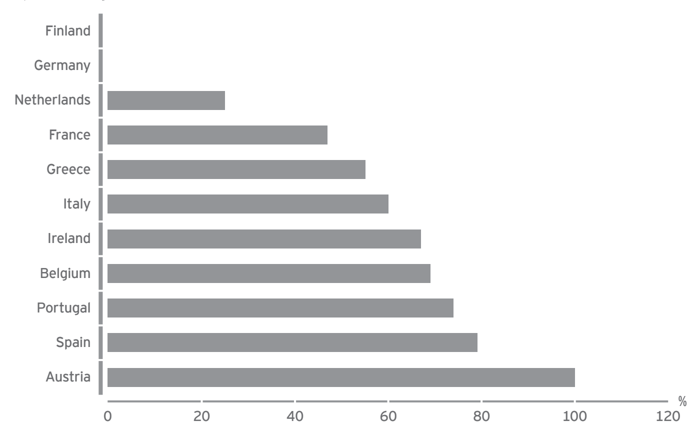
But downside risks to the Eurozone from the external environment have diminished significantly. In particular, strengthening demand from the US and emerging markets will help to boost exports. Export performance will also benefit from the painful process of improving competitiveness undertaken by the peripheral countries.

The improvement in confidence in the real economy has so far been less pronounced than the gains in financial markets. However, we believe that confidence will improve further over the course of the year. This will give businesses that have been hoarding cash an incentive to invest and hire additional workers. An improving economic backdrop should also, at the margin, increase the banks' willingness to lend to companies.

Consumers' willingness to make new purchases will be hampered by further increases in unemployment in 2013. Ongoing fiscal tightening also has a negative impact on household spending power. However, as the Eurozone economy stabilizes and then recovers, consumer spending is expected to start growing again in 2014.

Fiscal policy adjustment can be particularly complex in the aftermath of financial crises, given the need for supportive actions to revive growth. Consequently, Eurozone fiscal adjustment should rely not just on improvements in the primary balance, but also on steps to boost potential growth. The former should be achieved by a combined strategy of revenue increases and expenditure savings while preserving productive investment. The latter requires implementation of structural reforms to enhance productivity, as well as measures to reduce economic distortions across the economy.

Figure 11
Proportion of 2013 fiscal tightening due to come from spending cuts



Source: Oxford Economics

Box 1

Public sector perspective: can growth-friendly fiscal sustainability be achieved?

Having accumulated large public sector debts, many Eurozone economies need to restructure their public finances. Consequently, in the periphery in particular, a range of measures to restructure the public sector have been proposed and implemented. These measures include broadening tax bases, increasing tax rates, making tax collection more efficient and effective, reducing public sector wage bills and reducing the scale and duration of welfare payments. The peripheral economies are also becoming more business-friendly by strengthening their competition laws, reducing barriers to entry, making it easier to start businesses and to hire and fire staff, and generally reducing bureaucracy.

Studies of earlier episodes of fiscal consolidation suggest that the Eurozone economies are more likely to achieve their fiscal goals if the measures are skewed towards cuts in current expenditure — such as social security, social assistance, pensions and other welfare benefits — rather than towards tax rises and cuts in investment spending. However, because private sector offsets are less for spending cuts than tax increases, the immediate negative impact on the economy is large, while the benefits in terms of efficiency savings take time to accrue. This makes this a tough policy to sustain, both politically and socially.

Fiscal consolidation plans for 2013 show a significant focus on spending cuts. These account for at least 60% of the deficit-reduction measures implemented in Austria, Belgium, Ireland, Italy, Portugal and Spain. In contrast, spending cuts make up just 25% of the planned fiscal tightening in the Netherlands, 47% in France and 55% in Greece.

The chances of successfully achieving fiscal consolidation can be improved by keeping monetary conditions accommodative and risk premia contained. To hold down the latter, fiscal adjustment strategies need to be credible and to anchor market expectations about fiscal sustainability. A lack of credibility can make debt reduction much harder to achieve and lead to potentially self-fulfilling expectations about rising solvency risks. Where credibility of sustainable deficit reduction needs to be established, it makes sense to put a significant emphasis on spending cuts.

Efficiency of the tax system should also be a focus

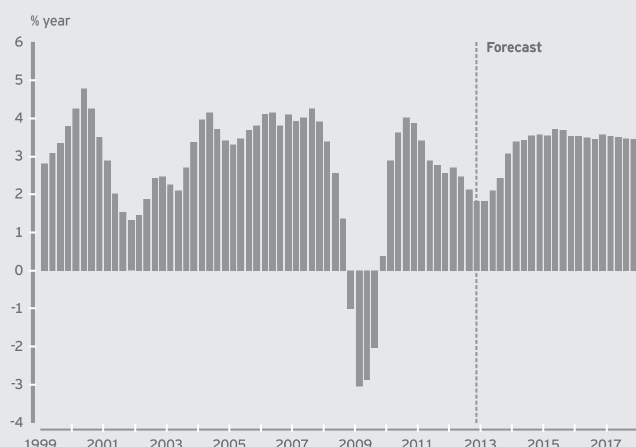
Given the scale of the fiscal consolidation needed in a number of Eurozone member states, raising tax revenues also constitutes an important part of their debt-reduction plans. This reflects the need to maintain a balance between expenditure savings and revenue-raising measures, in order to sustain the consolidation efforts long enough to bring debt under control. However, higher taxation should not harm efficiency and has to minimize distortions, particularly in countries with high tax ratios. Simplifying the tax system by reducing excessive tax rates, broadening the tax base and eliminating loopholes and exemptions will help enhance revenue collection. Meanwhile shifting the burden of taxes from income and capital to consumption, pollution and property taxes could help reduce distortions.

After the financial crisis, policy challenges are even tougher

Fiscal policy adjustment can be particularly complex in the aftermath of financial crises, given the need for supportive actions to revive growth. Consequently, Eurozone fiscal-adjustment policies should rely not just on improvements in the primary balance, but also on steps to boost growth. The latter require implementation of structural reforms to enhance productivity as well as measures to reduce economic distortions across the economy. Improving the budget composition could be another important ingredient in the strategy to support growth by removing distortions that limit efficiency and raising labor supply and savings.

Figure 12

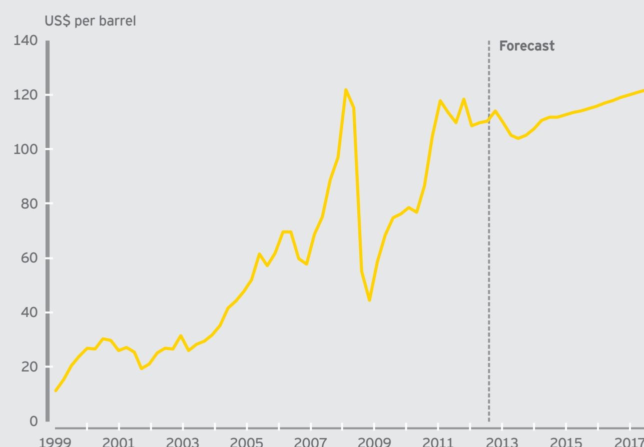
World: GDP growth



Source: Oxford Economics

Figure 13

Oil price, nominal



Source: Oxford Economics

Box 2

Forecast assumptions: international environment and commodity prices

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

With the main economies in the industrialized world continuing to experience problems and the leading emerging markets all slowing, world GDP growth is estimated to have slowed to 3% from 3.6% in 2011 (on a purchasing power parity basis). The main problems emanated from Europe, where fears of a Eurozone breakup, continuing austerity by governments to bring down fiscal deficits and debt, and rising levels of unemployment weighed heavily on activity.

But in recent months, global prospects have been seen more optimistically by financial markets. Measures announced by the European authorities and the ECB appear to have greatly diminished the threat of an early Eurozone breakup, the US averted the danger of its "fiscal cliff" at the turn of the year and the Chinese economy has started to grow faster again, allaying fears of a hard landing there. There are as yet few signs of any rise in activity — data for the final quarter of 2012 was largely disappointing, with the US economy flat and the Eurozone still in decline. Survey evidence for early 2013 has been mixed, still pointing to contraction in Europe but expansion in the US and China. However, with the risks to the world now much diminished and both the US and China showing signs of faster growth, we think the financial market rally is justified. As a result, our forecasts are for world GDP to grow by 3.5% in 2013 and then pick up to a little over 4% a year in 2014–17. The stronger activity will be reflected in rising world trade, forecast to grow by over 4% this year, more than double the meager 1.8% rise in 2012, with a further acceleration to over 6% a year in the period 2014–17.

Our growth forecast for the world's major economies remains broadly unchanged from our Winter 2012 report. The US economy is now expected to grow by a little over 2% in 2013 with a pickup to over 3%–3.5% in 2014–17. The Eurozone is seen contracting by 0.5% in 2013, with a very modest recovery thereafter to 1%–1.5% a year in 2014–2017, much slower than recoveries from previous recessions. The Japanese economy continues to struggle, with growth forecast to slow to just 0.7% this year before picking up to around 1.5%–2% in subsequent years. Among the leading emerging market economies, China is expected to grow by over 8% this year, up from 7.8% in 2012, and then pick up to 9% in 2014, while Indian growth is forecast at just over 6% in 2013 and 7.1% in 2014, after the slowdown to an estimated 5.4% in 2012.

Amid continuing uncertainty about political developments in the Middle East, oil prices have remained around US$110-US$120 per barrel in recent months, with falling output in sanctions-hit Iran being partly offset by rising output in Iraq and some other OPEC countries. Our forecast is for oil prices to average US$108 a barrel in 2013, down 3% from 2012, with a small rise to about US$113 seen by 2015 as stronger world demand offsets downward pressure from higher output in a number of important producers.

Forecast for Eurozone countries

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

17 Eurozone countries

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

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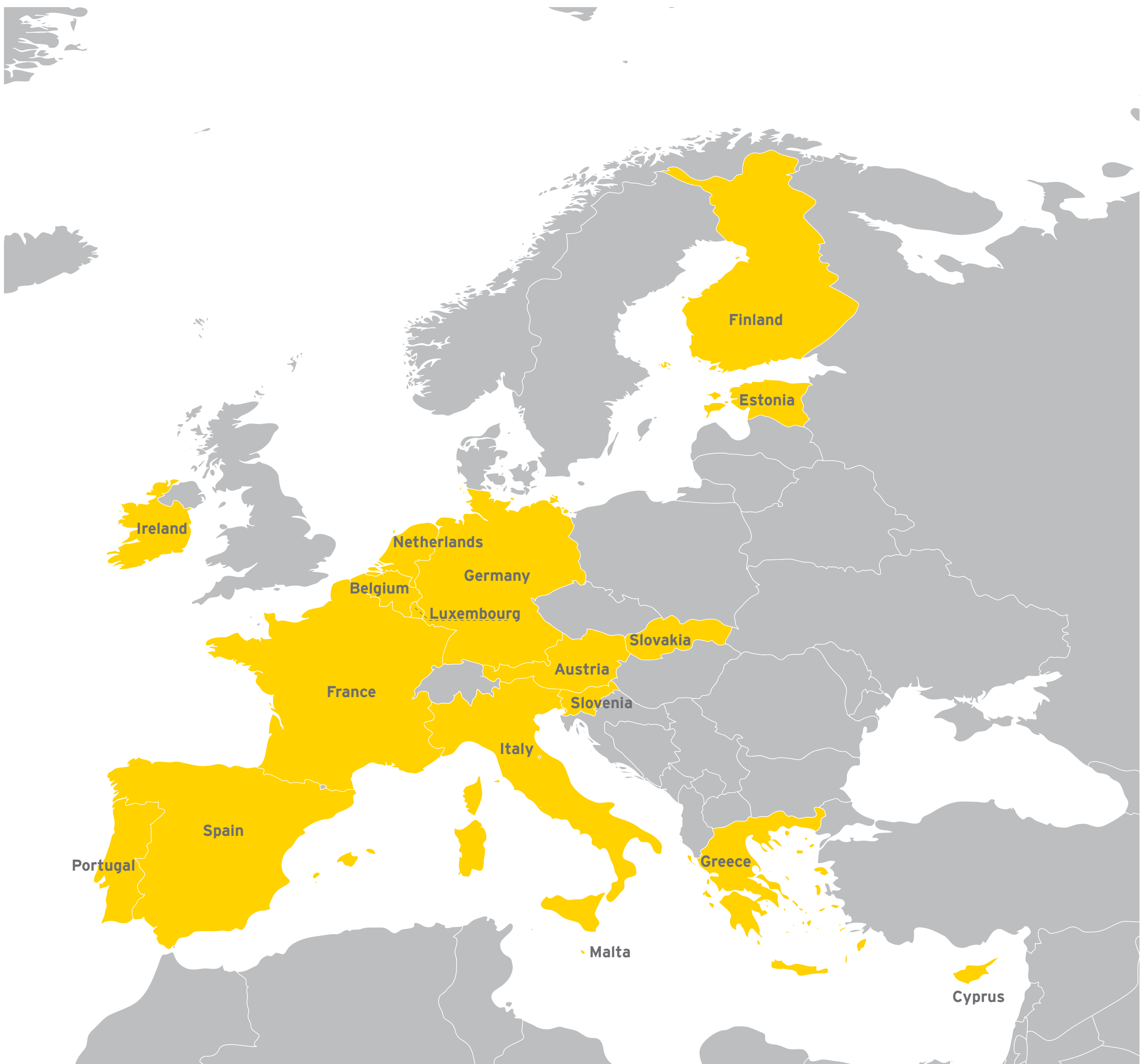
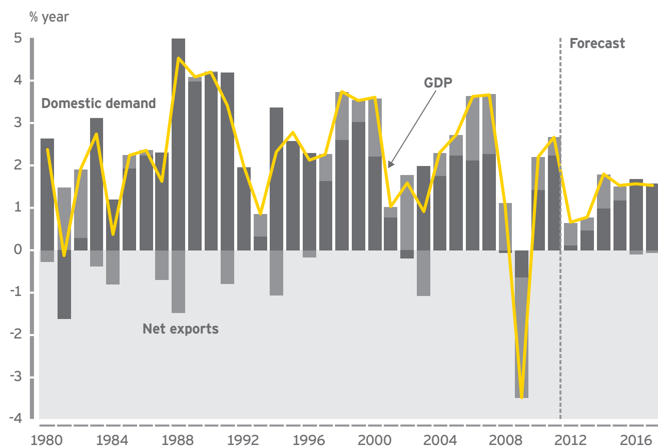


Austria

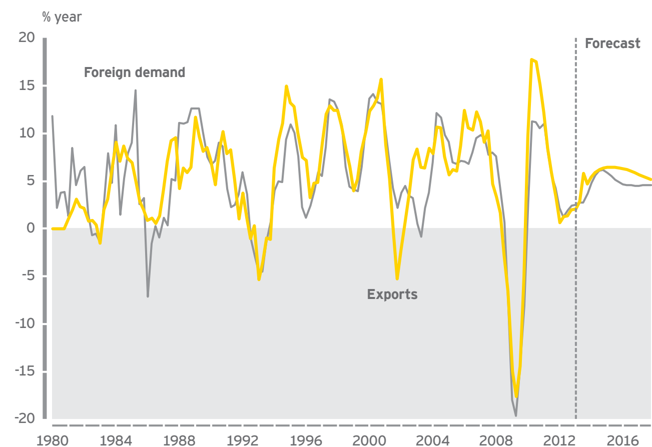
- Conditions remain relatively difficult, despite Austria being better placed than other economies to tackle current and future adversities and likely to outperform Eurozone peers.
- But the reduced threat of an imminent Eurozone breakup means that the risks to our forecast have become more balanced. And there is a chance that these lower risks, along with investment conditions that are still favorable on the supply side, will encourage businesses to activate investment plans they had shelved earlier. This would boost growth beyond our current forecast.
- Subdued GDP growth of 0.8% in 2013 will mainly come from private consumption, despite the fact that the latter is set to grow only moderately. From 2014, as the Eurozone stabilizes further and external demand picks up more strongly, exports will also start to boost growth, and the GDP growth rate could rise to around 1.5% a year.

Figure 14
Contributions to GDP



Source: Oxford Economics

Figure 15
Exports and foreign demand



Source: Oxford Economics

Table 2
Austria (annual percentage changes unless specified)

Source: Oxford Economics

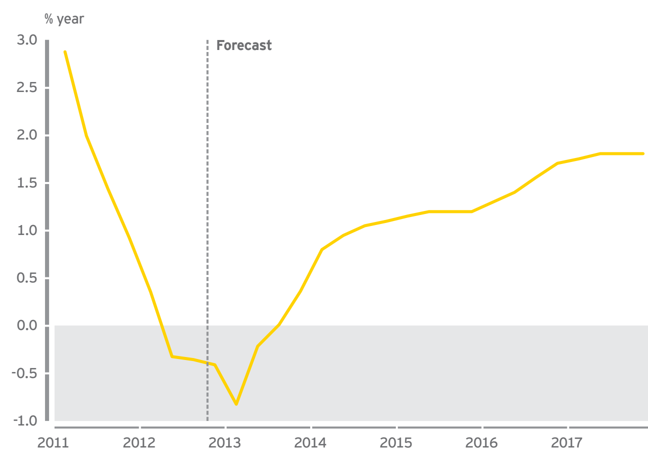
	2012	2013	2014	2015	2016	2017
GDP	0.7	0.8	1.8	1.5	1.6	1.5
Private consumption	0.2	0.4	1.3	1.5	1.6	1.6
Fixed investment	1.7	1.0	2.8	2.4	2.1	2.1
Stockbuilding (% of GDP)	1.7	1.7	1.0	0.6	0.7	0.6
Government consumption	0.3	0.3	1.7	1.8	1.8	1.8
Exports of goods and services	2.0	2.0	5.7	5.4	4.6	4.5
Imports of goods and services	1.2	1.6	4.8	5.4	5.3	5.2
Consumer prices	2.6	2.2	1.8	1.8	1.8	1.8
Unemployment rate (level)	4.3	4.7	4.8	4.6	4.5	4.5
Current account balance (% of GDP)	1.7	1.7	2.5	2.5	2.4	2.2
Government budget (% of GDP)	-3.3	-2.7	-2.1	-1.9	-1.8	-1.6
Government debt (% of GDP)	73.9	74.9	74.7	74.3	73.7	73.0

Belgium

- Belgium is set for another small 0.2% GDP decline in 2013. Deleveraging in key markets means that exports are set to grow by just 1.5%. And consumers are increasingly concerned about labor market prospects and will only increase their spending moderately. At the same time, cuts to government spending and falling business investment will weigh on growth.
- The recovery will be slower than after previous recessions, as the pace of fiscal consolidation in Belgium quickens in 2014-15. And although export growth will pick up, the loss of competitiveness will mean a slower pickup than in the pre-crisis years. We expect GDP growth to be just 1% in 2014 and 1.2% in 2015.
- Much more could be done to boost the pace of growth by accelerating the reform process, in particular by reorienting the burden of tax to encourage labor force participation and job creation.

Figure 16

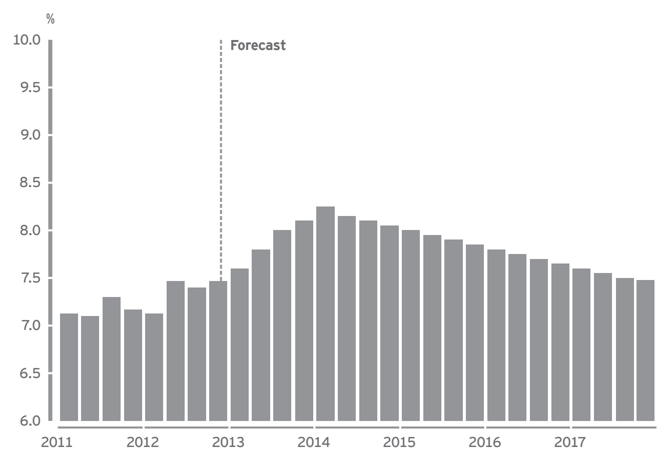
GDP growth



Source: Oxford Economics

Figure 17

Unemployment rate



Source: Oxford Economics

Table 3

Belgium (annual percentage changes unless specified)

Source: Oxford Economics

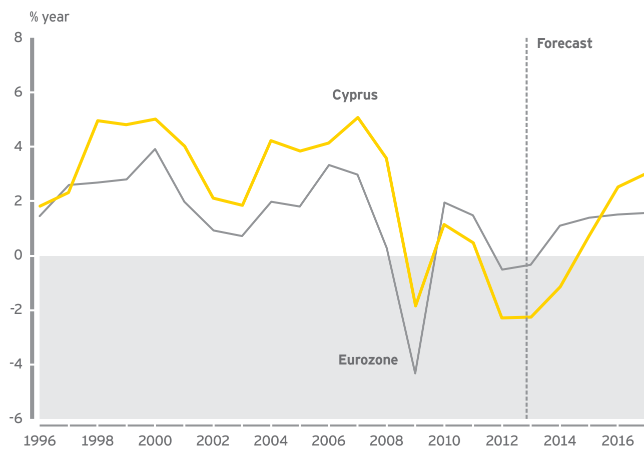
	2012	2013	2014	2015	2016	2017
GDP	-0.2	-0.2	1.0	1.2	1.5	1.8
Private consumption	-0.6	0.3	1.1	1.4	1.4	1.5
Fixed investment	-0.4	-0.8	0.9	1.7	2.2	2.5
Stockbuilding (% of GDP)	1.0	0.5	0.2	-0.4	-0.3	0.0
Government consumption	0.1	-0.2	-0.9	-0.7	0.3	0.9
Exports of goods and services	0.7	1.5	4.0	4.5	3.8	3.5
Imports of goods and services	0.1	1.1	3.2	3.8	3.8	3.6
Consumer prices	2.6	2.0	2.1	2.1	1.8	1.8
Unemployment rate (level)	7.4	7.9	8.1	7.9	7.7	7.5
Current account balance (% of GDP)	-0.6	1.4	1.8	1.9	2.0	2.2
Government budget (% of GDP)	-3.5	-2.8	-2.0	-1.3	-0.9	-0.8
Government debt (% of GDP)	100.0	102.4	104.3	105.4	105.6	105.3

Cyprus

- The banking crisis in Cyprus triggered by the restructuring of Greek sovereign debt is taking a heavy toll. The latest GDP data confirms that Cyprus is sliding deeper into recession.
- The strains that tipped the economy into recession show no sign of abating. Against this backdrop the shape of our forecast is broadly unchanged. We expect GDP to contract by just over 2% in 2013, similar to the outturn in 2012, and then by a further 1.1% in 2014.
- The result of the recent election means an agreement on a bailout is likely in the next couple of months. New President Nicos Anastasiades now has a mandate to seek the quick agreement with the EU and the IMF on the terms of a bailout that was part of his campaign agenda. It is estimated that Cyprus needs €10b to recapitalize its hobbled banking sector and a further €7.5b to support public sector finances.

Figure 18

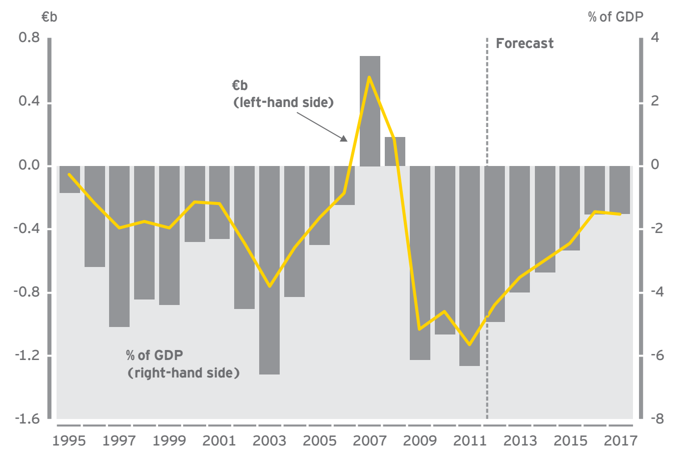
Real GDP growth



Source: Oxford Economics

Figure 19

Government budget balance



Source: Oxford Economics

Table 4

Cyprus (annual percentage changes unless specified)

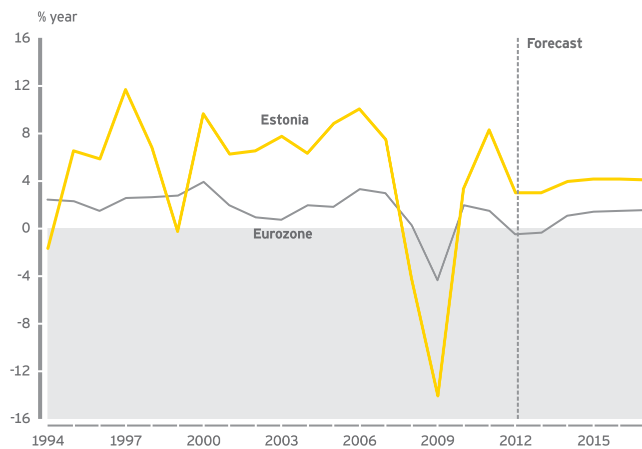
Source: Oxford Economics

	2012	2013	2014	2015	2016	2017
GDP	-2.3	-2.2	-1.1	0.8	2.5	3.0
Private consumption	-2.7	-3.7	-2.6	-0.2	1.8	3.1
Fixed investment	-24.2	-19.6	-12.5	-8.2	-1.7	3.5
Stockbuilding (% of GDP)	-0.3	0.1	0.2	0.3	0.3	0.2
Government consumption	-4.8	-4.6	-2.4	-0.5	1.0	2.2
Exports of goods and services	2.7	2.9	3.5	4.1	5.0	5.4
Imports of goods and services	-7.9	-4.3	-1.3	0.9	3.2	5.6
Consumer prices	3.1	2.2	1.9	1.6	1.8	2.0
Unemployment rate (level)	12.1	15.5	16.1	16.3	16.0	15.1
Current account balance (% of GDP)	-7.8	-4.4	-3.5	-3.5	-3.4	-3.2
Government budget (% of GDP)	-4.9	-4.0	-3.4	-2.7	-1.5	-1.5
Government debt (% of GDP)	84.8	109.0	133.9	149.6	144.9	139.4

Estonia

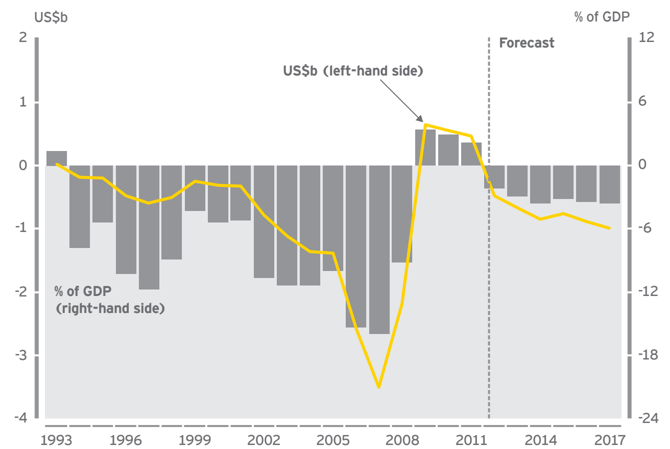
- Initial estimates show that Estonia's GDP grew by 3.2% in 2012. And the economy is set to continue to outgrow the Eurozone this year as exports start to recover and continued fiscal stimulus triggers more private sector investment. Growth is forecast to quicken to about 4% a year in 2014–17, with the economy gradually rebalancing towards domestic demand.
- Private consumption and investment will gradually replace exports as the main growth driver. As a result, imported inputs as well as higher inflation than the rest of Eurozone will lead to a widening of the trade deficit in 2013–15.
- Downside risks to our growth forecast remain, based on specialization within industrial and service sectors and reliance on a comparatively small number of large export orders. However, these risks are diminishing as production becomes more diversified, service-oriented and quality-competitive.

Figure 20
Real GDP growth



Source: Oxford Economics

Figure 21
Current account balance



Source: Oxford Economics

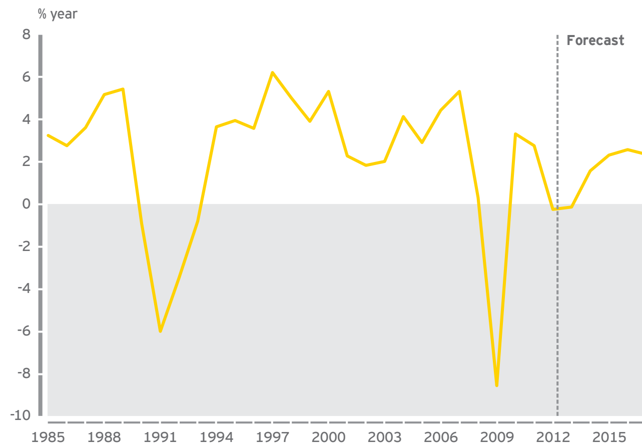
Table 5
Estonia (annual percentage changes unless specified)
Source: Oxford Economics

	2012	2013	2014	2015	2016	2017
GDP	3.2	3.0	4.0	4.2	4.2	4.1
Private consumption	4.0	3.0	3.2	4.0	4.6	4.6
Fixed investment	23.3	4.0	7.0	7.0	5.5	5.0
Stockbuilding (% of GDP)	-3.8	-2.2	-1.1	-0.7	-0.8	-0.8
Government consumption	3.0	1.0	1.0	2.7	3.0	3.0
Exports of goods and services	5.0	3.3	4.0	4.3	4.3	4.5
Imports of goods and services	6.5	5.0	5.2	5.2	4.7	4.8
Consumer prices	3.9	3.2	2.9	2.6	2.4	2.2
Unemployment rate (level)	10.0	9.0	8.2	7.4	6.6	6.0
Current account balance (% of GDP)	-2.2	-2.9	-3.6	-3.1	-3.4	-3.6
Government budget (% of GDP)	-1.1	-1.2	-0.6	-0.3	-0.1	0.0
Government debt (% of GDP)	9.5	11.4	11.4	10.9	10.3	9.6

Finland

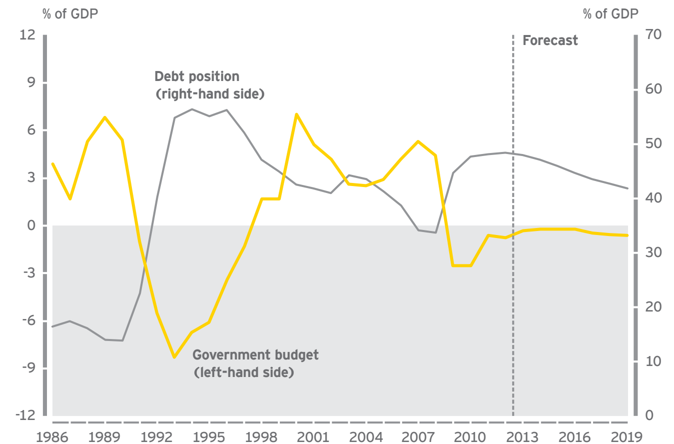
- After contracting for two consecutive years, with GDP forecast to decline 0.2% in 2013, the same as in 2012, the Finnish economy is expected to gain momentum gradually over the medium term, helped by a recovery in the Eurozone. We forecast GDP will grow by about 2.2% a year in 2014–17, supported by stronger exports and fixed investment.
- The risks to our growth forecasts are no longer skewed to the downside, as fears of an imminent Eurozone breakup have reduced significantly, world trade is now picking up and activity in emerging markets appears to be accelerating again.
- Despite its AAA credit rating, the Finnish Government will implement a €2.7b cut (equal to 1.3% of GDP) to its budget in the medium term. While this will not dent growth much, it may be a missed opportunity to foster activity via some fiscal stimulus, given that Finland has one of the healthiest public finances within the Eurozone.

Figure 22
GDP growth



Source: Oxford Economics

Figure 23
Government balance and debt



Source: Oxford Economics

Table 6
Finland (annual percentage changes unless specified)
Source: Oxford Economics

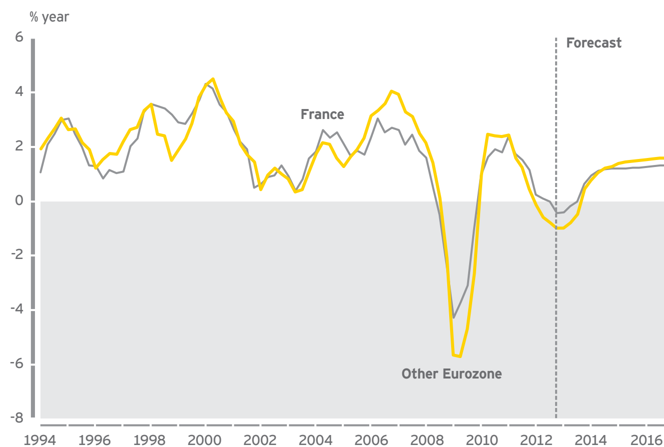
	2012	2013	2014	2015	2016	2017
GDP	-0.2	-0.2	1.6	2.3	2.6	2.4
Private consumption	1.7	0.5	1.9	2.1	2.4	2.4
Fixed investment	-2.1	-1.3	1.6	2.3	3.5	3.2
Stockbuilding (% of GDP)	0.8	-0.1	-0.1	-0.2	-0.1	-0.2
Government consumption	-0.4	0.5	1.1	1.2	1.4	1.6
Exports of goods and services	-0.6	1.0	2.4	3.7	3.8	3.7
Imports of goods and services	-2.3	-0.4	2.6	3.0	3.7	3.9
Consumer prices	3.2	2.0	1.4	1.5	1.6	1.7
Unemployment rate (level)	7.7	7.8	7.7	7.4	7.1	6.8
Current account balance (% of GDP)	-1.7	-0.4	0.7	1.6	1.9	2.1
Government budget (% of GDP)	-0.7	-0.3	-0.2	-0.2	-0.2	-0.4
Government debt (% of GDP)	48.7	48.2	47.3	46.0	44.8	43.8

France

- Reduced downside risk from the global environment means that the outlook for the French economy is beginning to improve. But positive effects on growth and employment will take some time to emerge, and so we forecast a second year of stagnation in 2013. As conditions stabilize and confidence returns, we then forecast GDP growth of about 1.3% a year on average in 2014–17.
- A further rise in unemployment will constrain income growth this year, which implies that consumer spending will remain very subdued in 2013. As employment eventually starts to pick up and inflation subsides, we expect consumer demand to rise gradually in 2014–17, averaging 1.1% for the period.
- Fiscal measures announced so far suggest that fiscal policy will be tightened by around 1.2% of GDP in 2013, somewhat more than in 2012. The pace of fiscal tightening will probably lessen from 2014 onwards, which should cut the deficit from 4.7% of GDP in 2012 to 1.4% in 2017.

Figure 24

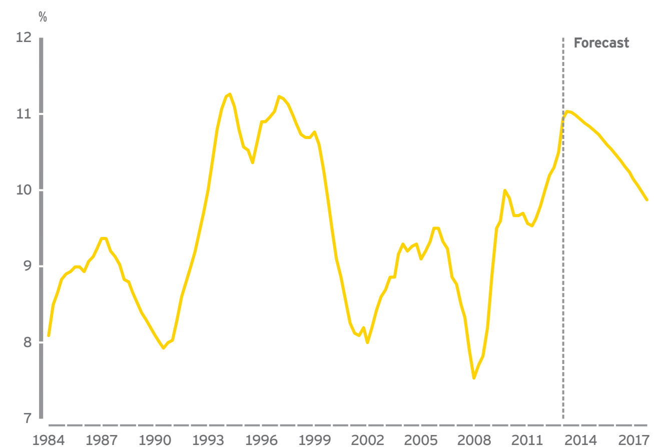
GDP growth: France vs. rest of Eurozone



Source: Oxford Economics

Figure 25

Unemployment



Source: Oxford Economics

Table 7

France (annual percentage changes unless specified)

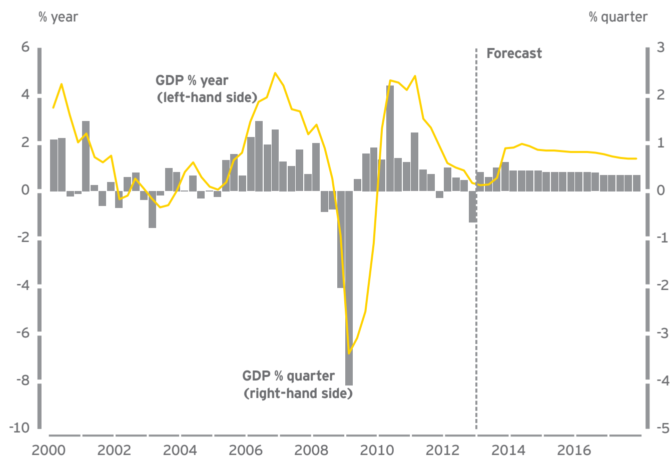
Source: Oxford Economics

	2012	2013	2014	2015	2016	2017
GDP	0.0	0.0	1.1	1.2	1.3	1.4
Private consumption	0.0	0.5	1.0	1.1	1.2	1.3
Fixed investment	0.0	-0.3	1.7	2.0	2.0	2.0
Stockbuilding (% of GDP)	-0.7	-1.2	-1.0	-0.9	-0.9	-1.0
Government consumption	1.4	0.4	0.3	0.7	0.9	1.0
Exports of goods and services	2.3	1.4	4.0	4.7	4.8	4.7
Imports of goods and services	-0.3	0.9	4.0	4.7	4.4	4.2
Consumer prices	2.2	1.7	1.5	1.5	1.4	1.4
Unemployment rate (level)	10.3	11.0	10.9	10.6	10.4	10.0
Current account balance (% of GDP)	-2.4	-1.9	-1.9	-2.0	-2.1	-2.1
Government budget (% of GDP)	-4.7	-3.3	-2.5	-2.1	-1.7	-1.4
Government debt (% of GDP)	90.8	93.9	95.8	97.9	98.9	99.0

Germany

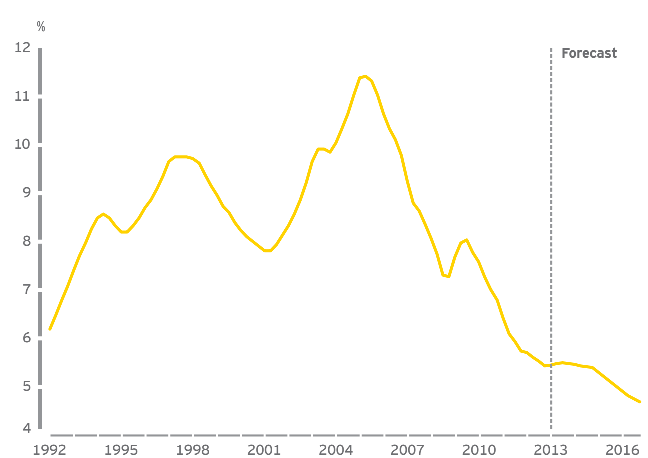
- The German economy ended 2012 on a weak note, with a contraction of 0.6% in Q4. However, the combination of sound domestic fundamentals, a normalizing risk environment and an improving global backdrop mean that a return to growth is expected in the first half of 2013. But the weak end to last year means that we forecast growth of just 0.7% in 2013 before a pickup to 1.9% in 2014.
- A more predictable environment for business planning means that business investment will move from a contraction of 2.7% in 2012 to close to zero this year and then growth of almost 6% in 2014.
- We expect the export situation to improve during the next few years as world trade picks up and the European economy returns to growth. After an expected slowdown to 2% in 2013, export growth is forecast to rise to 4.7% in 2014.
- A resilient labor market, strong household balance sheets and above-inflation wage growth mean that we expect consumer spending growth to rise slowly to 0.8% in 2013 and then 1.2% in 2014.

Figure 26
GDP



Source: Oxford Economics

Figure 27
Unemployment



Source: Oxford Economics

Table 8
Germany (annual percentage changes unless specified)
Source: Oxford Economics

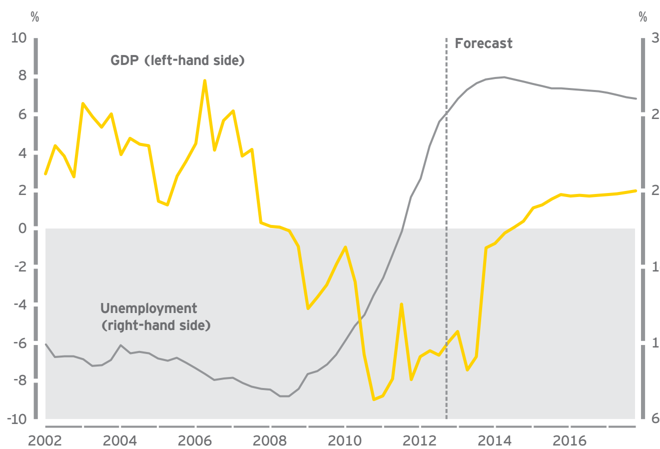
	2012	2013	2014	2015	2016	2017
GDP	0.9	0.7	1.9	1.7	1.6	1.4
Private consumption	0.6	0.8	1.2	1.2	1.2	1.2
Fixed investment	-1.9	0.3	4.0	3.9	3.2	2.8
Stockbuilding (% of GDP)	0.2	0.4	0.6	0.5	0.4	0.1
Government consumption	1.4	0.9	0.7	0.7	0.7	0.8
Exports of goods and services	4.3	2.0	4.7	5.0	4.9	4.6
Imports of goods and services	2.2	2.8	5.1	5.3	5.1	4.5
Consumer prices	2.1	1.6	1.7	1.8	1.7	1.7
Unemployment rate (level)	5.5	5.4	5.3	5.0	4.7	4.4
Current account balance (% of GDP)	6.4	6.3	5.7	5.2	5.0	5.0
Government budget (% of GDP)	-0.1	0.0	0.0	0.0	0.0	0.0
Government debt (% of GDP)	79.1	78.6	78.1	78.3	78.4	78.6

Greece

- A much-needed overhaul of Greece's bailout has relaxed the conditions attached to its continued receipt of funds, implying a commitment by creditors to keeping the country in the Eurozone. As a result, we now think the risk of Greek euro exit in 2013 is very low.
- However, even the revised program could easily be knocked off track. One issue is implementation risk — the program still requires stringent fiscal tightening, which will heighten social costs. The other major risk is that GDP continues to decline for longer than the Government projects; we expect this will cause Greece to continue to miss even the revised targets.
- The next two years will be difficult as more austerity measures take effect. Unemployment is expected to peak at over 28% and a return to growth is not expected until 2014–15. The speed of the recovery will depend critically on progress in structural reform beyond the labor market, which has so far been uneven.

Figure 28

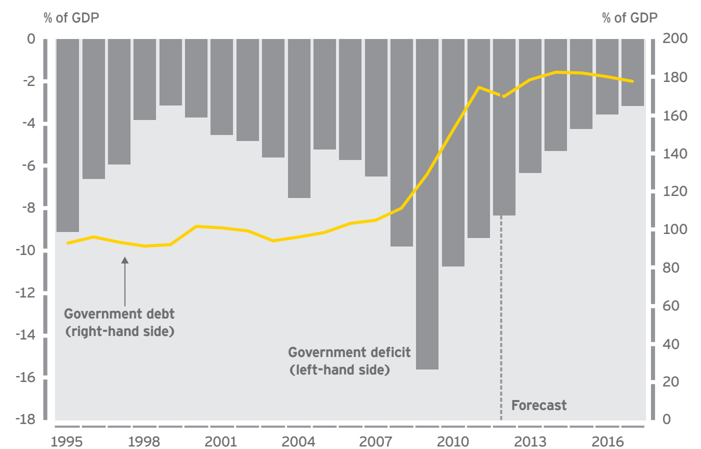
Real GDP and unemployment



Source: Oxford Economics

Figure 29

Government deficit and debt



Source: Oxford Economics

Table 9

Greece (annual percentage changes unless specified)

Source: Oxford Economics

	2012	2013	2014	2015	2016	2017
GDP	-6.4	-5.2	-0.1	1.4	1.7	1.9
Private consumption	-8.2	-3.2	-1.0	0.6	0.9	1.3
Fixed investment	-21.0	-22.2	1.7	5.3	6.4	4.9
Stockbuilding (% of GDP)	-0.4	-0.5	-0.4	-0.5	-0.5	-0.5
Government consumption	-9.1	-9.0	-3.2	-0.3	1.4	1.5
Exports of goods and services	-3.1	-1.9	4.8	5.1	3.8	4.0
Imports of goods and services	-17.0	-7.9	1.4	3.1	3.4	3.6
Consumer prices	1.0	0.1	0.1	0.4	0.8	1.4
Unemployment rate (level)	24.4	27.8	28.3	27.8	27.6	27.2
Current account balance (% of GDP)	-2.9	-4.7	-4.0	-3.7	-3.5	-3.5
Government budget (% of GDP)	-8.3	-6.3	-5.3	-4.2	-3.6	-3.2
Government debt (% of GDP)	166.5	180.4	184.3	183.5	181.3	178.4

Ireland

- Despite improving financial market conditions and sharply lower bond yields, Ireland's growth prospects remain weak in the short term. In the light of the latest budget, which included further fiscal tightening, we have lowered our growth forecast for 2013. GDP is now expected to rise just 0.1% compared with our previous forecast of 1%.
- A weak labor market, high levels of household debt and fiscal tightening have meant that the fundamentals underpinning consumer spending are unsupportive. We expect consumption to fall by almost 2% in 2013, followed by very marginal growth in 2014.
- Meanwhile, investment, which is already 55% below its level in 2007, is expected to continue to fall until the end of 2013. This is due to a combination of tight credit conditions, weak domestic demand and a lack of appetite among firms to borrow for investment. Investment is forecast to fall by 9.5% in 2013, before starting to rise again in 2014.

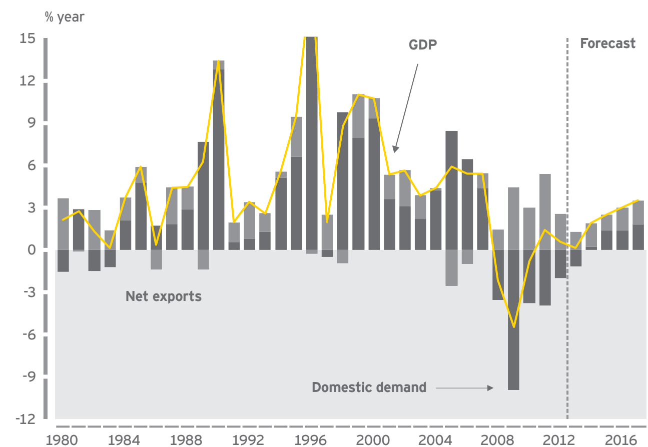
Figure 30

Long-term government bond yields

Source: Oxford Economics; Haver Analytics

Figure 31

Contributions to GDP



Source: Oxford Economics

Table 10

Ireland (annual percentage changes unless specified)

Source: Oxford Economics

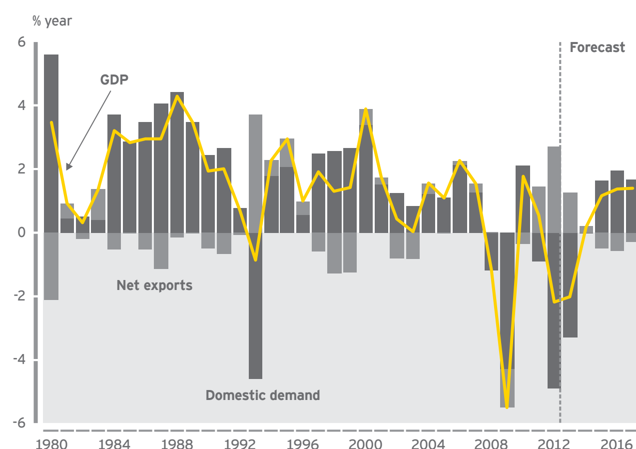
	2012	2013	2014	2015	2016	2017
GDP	0.6	0.1	1.9	2.5	3.0	3.5
Private consumption	-1.4	-1.9	0.1	1.3	1.4	2.4
Fixed investment	-0.2	-9.5	4.1	9.1	8.0	7.2
Stockbuilding (% of GDP)	0.1	0.1	0.1	0.2	0.2	0.1
Government consumption	-3.9	-2.7	-1.3	-0.9	-0.8	0.1
Exports of goods and services	3.1	3.0	4.4	3.9	3.8	3.7
Imports of goods and services	0.8	2.3	3.9	3.9	3.1	3.0
Consumer prices	1.9	1.5	1.6	1.6	1.6	1.6
Unemployment rate (level)	14.9	14.9	14.6	13.8	13.1	12.0
Current account balance (% of GDP)	4.3	4.2	4.3	4.2	4.0	3.9
Government budget (% of GDP)	-8.5	-7.8	-5.0	-3.5	-2.5	-1.5
Government debt (% of GDP)	111.4	117.5	118.9	118.0	115.4	111.3

Italy

- The Italian economy has been in recession since Q3 2011, with the contraction in 2012 now estimated at 2.2%. GDP is expected to decline further in 2013, by 2%. However, several indicators point to an improvement in business conditions and a stabilization of activity in the near future. We expect GDP to rise by 0.2% in 2014, with growth then seen averaging about 1.3% a year in 2015–17.
- Household consumption is expected to lag behind the recovery. Household income has been trimmed by fiscal austerity and credit constraints remain tight. We expect consumption to decline some 3% in 2013 and then to be stagnant in 2014.
- The budget deficit appears under control, but the fiscal situation remains a source of downside risks. Public debt is expected to reach 129% of GDP in 2014 and a weak government after the inconclusive election in February could exacerbate financial tensions again. As a result, fiscal rigor, although negative for growth, will remain imperative.

Figure 32

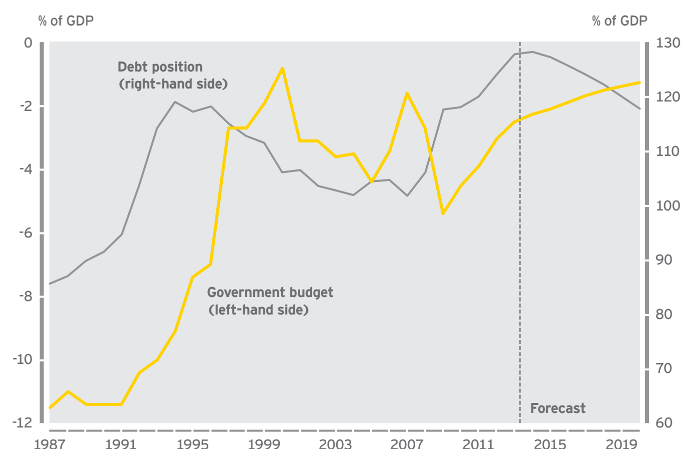
Contributions to GDP growth



Source: Oxford Economics

Figure 33

Government balance and debt



Source: Oxford Economics

Table 11

Italy (annual percentage changes unless specified)

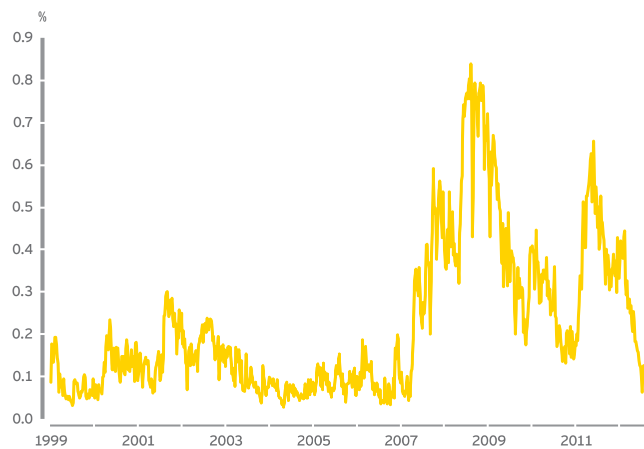
Source: Oxford Economics

	2012	2013	2014	2015	2016	2017
GDP	-2.2	-2.0	0.2	1.2	1.4	1.4
Private consumption	-4.3	-3.1	-0.1	1.1	1.6	1.7
Fixed investment	-9.1	-4.2	1.1	3.3	3.3	2.6
Stockbuilding (% of GDP)	-0.4	-0.8	-0.7	-0.3	0.1	0.2
Government consumption	-1.0	-2.1	-1.0	0.1	0.4	0.6
Exports of goods and services	1.7	1.3	2.2	2.3	2.3	2.1
Imports of goods and services	-7.9	-3.3	1.8	4.5	4.7	3.3
Consumer prices	3.3	2.1	1.8	1.1	1.2	1.3
Unemployment rate (level)	10.6	11.9	12.3	12.0	11.5	11.1
Current account balance (% of GDP)	-0.6	-0.3	-0.3	-0.4	-0.5	-0.5
Government budget (% of GDP)	-3.0	-2.5	-2.3	-2.1	-1.9	-1.7
Government debt (% of GDP)	125.2	128.7	129.1	128.0	126.5	124.7

Luxembourg

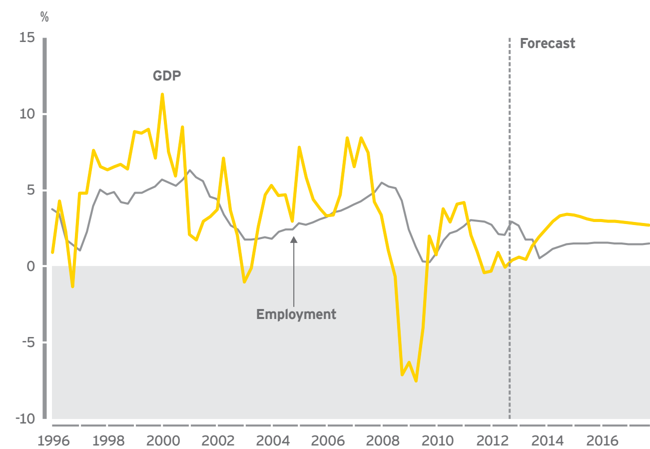
- Greatly diminished risks of an imminent Eurozone breakup are likely to underpin the recovery of the financial sector as a whole in 2013, although the banking segment is still in a phase of consolidation.
- Business and related services will show only muted growth this year and, as they have been the main drivers of job creation since the crisis, employment growth is to slow or probably reverse. Fear of job losses will add to the uncertain outlook and keep consumer confidence low, with a dampening effect on spending.
- The weak external environment will restrain GDP growth to about 1% this year. Only in 2014, with a more marked pickup in external demand, not least for financial services, will exports contribute positively to GDP growth of 3% — a relatively strong rate as a result of the financial sector in the Eurozone recovering earlier than the real economy.

Figure 34
Systemic stress indicator



Source: ECB, Haver Analytics

Figure 35
Real GDP and employment



Source: Oxford Economics

Table 12
Luxembourg (annual percentage changes unless specified)
Source: Oxford Economics

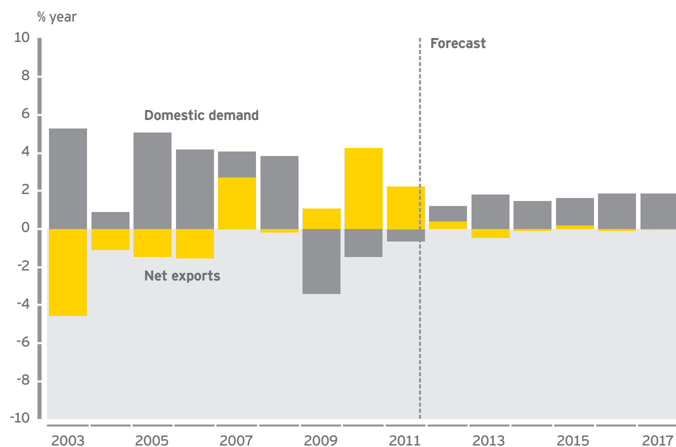
	2012	2013	2014	2015	2016	2017
GDP	0.2	1.0	3.0	3.2	3.0	2.8
Private consumption	1.5	1.0	2.9	2.7	2.4	2.4
Fixed investment	2.6	6.3	4.5	2.6	2.5	2.4
Stockbuilding (% of GDP)	3.9	3.5	3.5	2.7	2.4	2.2
Government consumption	4.2	1.8	1.7	2.0	1.8	1.8
Exports of goods and services	-3.6	2.9	6.2	5.7	4.2	3.5
Imports of goods and services	-2.8	3.7	6.6	5.2	3.8	3.3
Consumer prices	2.9	2.1	2.0	2.0	2.0	2.0
Unemployment rate (level)	5.0	5.7	5.8	5.5	4.9	4.3
Current account balance (% of GDP)	5.3	3.8	3.9	4.7	5.1	5.4
Government budget (% of GDP)	-1.8	-2.1	-1.8	-1.6	-1.3	-0.6
Government debt (% of GDP)	19.5	20.9	21.7	22.2	22.4	22.0

Malta

- The Maltese economy remains relatively resilient. The tourism sector continues to attract visitors and the financial and industrial sectors have scope to develop further. We forecast GDP growth at 1.3% in 2013, similar to 2012, accelerating to about 1.6% a year on average in 2014–17, somewhat above the Eurozone average, but not fast enough to maintain employment growth.
- Despite the economy typically being favorably perceived by investors, investment has been weak in the recovery so far and will need to be lifted to ensure continued growth of tourism and exports. The 2013 budget includes measures to enhance Malta's attractiveness to domestic and foreign investors.
- Fiscal policy remains focused on gradual deficit reduction and inflation control. We forecast the public deficit will narrow from an estimated 2.3% of GDP in 2012 to 1.4% in 2017, falling short of EU calls to cut the deficit to 0.3% of GDP in 2015 because of the need for more spending on new energy sources and social welfare.

Figure 36

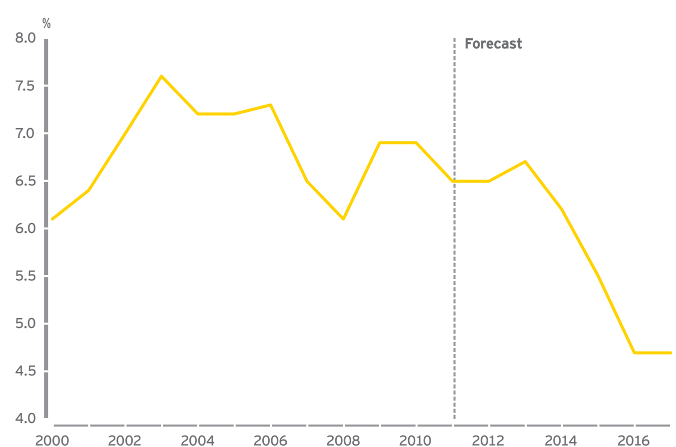
Contributions to GDP



Source: Oxford Economics

Figure 37

Unemployment



Source: Oxford Economics

Table 13

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	-1.7	1.5	1.3	1.4	1.5	1.6
Fixed investment	2.0	2.5	4.0	2.8	2.5	2.2
Stockbuilding (% of GDP)	-2.5	-2.3	-2.3	-2.3	-2.0	-1.7
Government consumption	6.0	1.8	0.7	0.8	1.3	1.4
Exports of goods and services	6.5	2.0	2.7	3.0	2.7	2.8
Imports of goods and services	6.5	2.7	3.0	3.0	3.0	3.0
Consumer prices	3.2	2.4	2.0	1.8	2.0	2.3
Unemployment rate (level)	6.5	6.7	6.2	5.5	4.7	4.7
Current account balance (% of GDP)	2.8	1.1	0.6	0.2	0.2	0.1
Government budget (% of GDP)	-2.3	-2.1	-2.0	-1.8	-1.6	-1.4
Government debt (% of GDP)	69.7	69.3	69.1	68.6	67.7	66.5

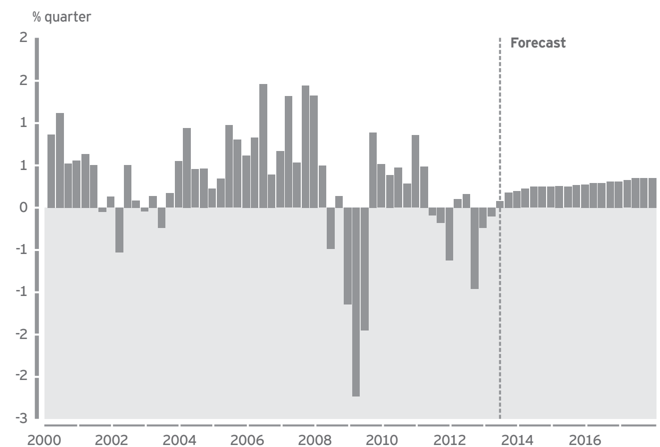
Netherlands

- Though the economy is likely to remain in recession in early 2013, an improving external outlook should see a return to growth later in the year. Stronger external demand, plus diminishing external risks, should also encourage firms to begin releasing funds for investment.
- But the pace of the recovery will be constrained by the weakness of consumer spending, which is expected to continue falling for the remainder of 2013, and the austerity program, which will exert a further drag. Our forecast shows GDP falling by 0.5% this year, before a weak recovery yields growth of 0.9% in 2014 and about 1.2% a year in 2015–17.
- Although external risks are more balanced than they were for much of 2012, the risks to the forecast are still skewed to the downside and revolve around the highly indebted consumer sector. Deeper retrenchment would cause the consumer sector to weigh on the recovery to an even greater extent, while the possibility of higher unemployment or further falls in house prices threaten more stress in the banking sector.

Figure 38
Prices and earnings

Source: Oxford Economics

Figure 39
GDP



Source: Oxford Economics

Table 14
Netherlands (annual percentage changes unless specified)
Source: Oxford Economics

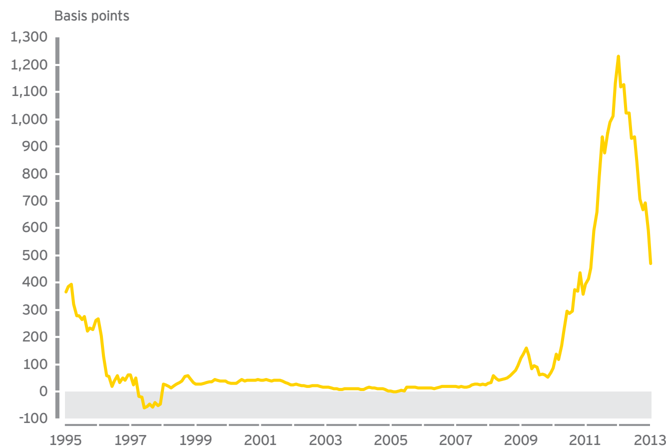
	2012	2013	2014	2015	2016	2017
GDP	-0.9	-0.5	0.9	1.0	1.1	1.3
Private consumption	-1.4	-1.4	0.3	0.6	0.9	1.3
Fixed investment	-4.7	-0.6	1.5	2.1	2.2	2.0
Stockbuilding (% of GDP)	0.7	0.3	0.3	0.3	0.3	0.3
Government consumption	0.7	0.1	-0.3	-0.3	-0.1	0.5
Exports of goods and services	3.1	2.0	3.2	3.5	3.1	2.8
Imports of goods and services	2.8	1.5	3.0	3.4	3.1	2.8
Consumer prices	2.8	2.1	1.5	1.3	1.2	1.2
Unemployment rate (level)	5.3	6.4	6.7	6.7	6.7	6.6
Current account balance (% of GDP)	9.3	8.3	7.8	8.0	8.3	8.4
Government budget (% of GDP)	-3.7	-3.2	-3.0	-2.7	-2.3	-2.0
Government debt (% of GDP)	69.3	72.0	73.9	75.2	75.9	76.0

Portugal

- Despite yields on Portuguese bonds falling sharply since September 2012, the outlook for the economy is still very weak due to severe austerity measures and poor prospects for the rest of the Eurozone. Portuguese GDP contracted by 3.2% in 2012 and we expect a similar decline in 2013, followed by weak growth in 2014 and then expansion of just over 1% a year in 2015–17.
- The severe austerity measures adopted in the 2013 budget are likely to have more of an impact on domestic economic activity than the Government anticipates. We expect consumption to decline by 4% in 2013 and then post zero growth in 2014. The outlook for investment is also grim, with declines of about 9% seen in 2013 and 0.5% in 2014.
- Given weak demand in the Eurozone, and particularly in Spain, we forecast export growth of only about 2% in 2013 and then around 3.5% a year in 2014-15.

Figure 40

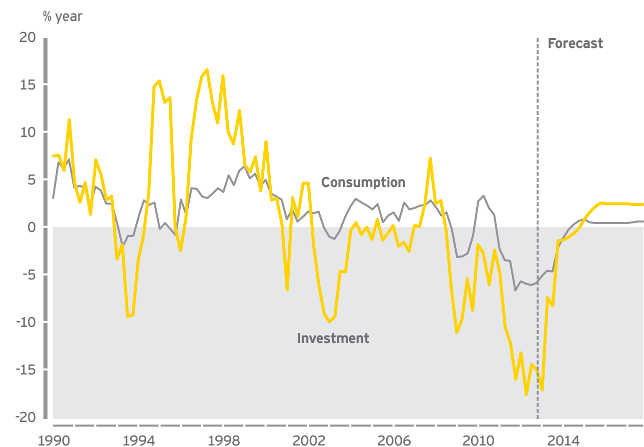
Bond spread over German Bunds



Source: Haver Analytics

Figure 41

Consumption and investment



Source: Oxford Economics

Table 15

Portugal (annual percentage changes unless specified)

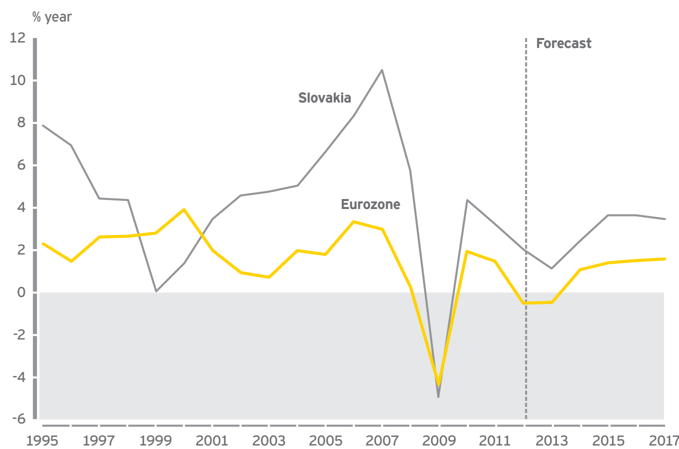
Source: Oxford Economics

	2012	2013	2014	2015	2016	2017
GDP	-3.2	-3.2	0.4	1.1	1.1	1.1
Private consumption	-5.7	-4.0	0.0	0.7	0.6	0.7
Fixed investment	-14.9	-8.8	-0.6	2.0	2.6	2.6
Stockbuilding (% of GDP)	-0.1	-0.7	-0.7	-0.7	-0.6	-0.7
Government consumption	-4.4	-3.3	-1.3	1.6	1.2	1.1
Exports of goods and services	3.6	2.1	3.6	3.5	3.4	3.0
Imports of goods and services	-7.5	-3.3	1.9	3.6	3.4	3.0
Consumer prices	2.8	1.1	0.8	0.8	0.8	0.9
Unemployment rate (level)	15.7	17.9	17.1	15.2	14.1	12.4
Current account balance (% of GDP)	-1.7	-0.9	-0.8	-0.7	-0.7	-0.7
Government budget (% of GDP)	-5.4	-5.5	-4.2	-2.9	-1.7	-0.8
Government debt (% of GDP)	117.1	125.3	127.7	127.9	126.8	124.7

Slovakia

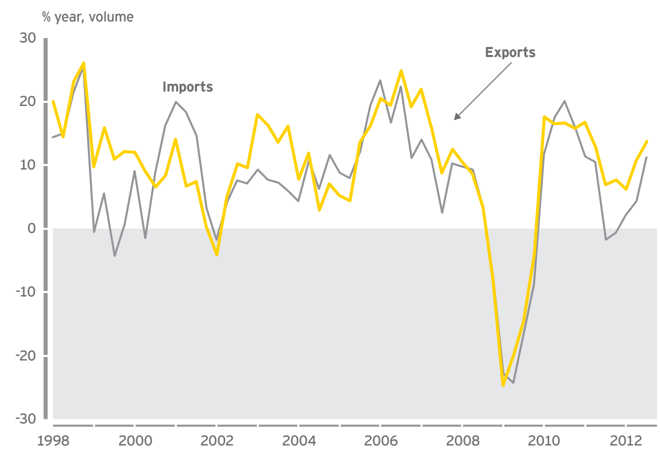
- Growth in 2013 is expected to slow to just over 1%, from a relatively strong 2% in 2012, as one-off factors that boosted car production unwind, key export partners experience sluggish growth, and domestic demand is held back by fiscal austerity and high unemployment.
- The first phase of a cyclical upswing is seen in 2014, with growth forecast to pick up to 2.4%, as domestic demand returns to normal and the Eurozone starts to grow again. But given Slovakia's reliance on exports, this outlook would be vulnerable to more prolonged Eurozone weakness, and it is also possible that domestic demand will remain weak if supply-side problems in the labor market persist.
- Slovakia is forecast to grow at about 3.5% a year over the medium term, supported by high-value manufacturing exports. But this prospect could be optimistic if the Government's reforms — including ending the flat tax and the new labor code, which reregulates the labor market — hold back new investment in these key sectors more than anticipated.

Figure 42
Real GDP growth



Source: Oxford Economics

Figure 43
Exports and imports



Source: Haver Analytics

Table 16
Slovakia (annual percentage changes unless specified)
Source: Oxford Economics

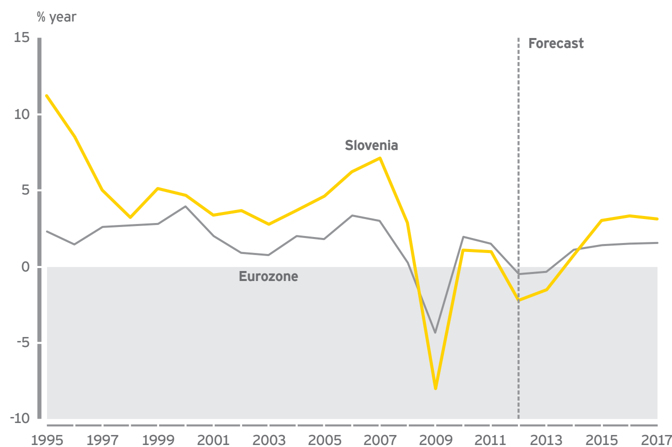
	2012	2013	2014	2015	2016	2017
GDP	2.0	1.1	2.4	3.6	3.6	3.5
Private consumption	-0.4	0.3	1.8	2.4	3.0	3.0
Fixed investment	-2.1	0.5	2.4	3.4	4.6	4.3
Stockbuilding (% of GDP)	-1.9	-1.5	-1.0	-0.3	0.0	0.3
Government consumption	0.0	1.1	1.5	2.3	2.5	2.6
Exports of goods and services	8.5	2.1	4.5	4.9	4.6	4.4
Imports of goods and services	2.9	3.0	4.8	4.9	4.7	4.7
Consumer prices	3.6	2.6	2.3	2.1	2.1	2.1
Unemployment rate (level)	14.0	14.5	13.5	12.0	11.0	10.4
Current account balance (% of GDP)	2.2	1.0	0.4	0.3	0.2	0.1
Government budget (% of GDP)	-5.5	-4.7	-3.7	-3.1	-2.8	-2.5
Government debt (% of GDP)	47.4	50.8	52.4	52.7	52.6	52.3

Slovenia

- The Slovenian economy remained in recession in 2012 and we expect it to continue to decline through most of 2013. We see GDP falling 1.5%, with only gradual improvement in 2014 driven by stronger activity in the rest of the Eurozone. But growth is seen picking up to 3% in 2015 on stronger public finances and global growth.
- Political tensions remain high following the collapse of the coalition Government, adding substantial downside risk to our forecast. The formation of a new coalition may take time and the uncertain political outlook reduces the chances of key fiscal and bureaucratic reforms being implemented.
- Weaker domestic demand than the rest of the Eurozone led to imports falling at a faster pace than exports in 2012, meaning that the current account moved into surplus. The external surplus is set to rise in the coming years, as exports will drive the recovery once Eurozone demand improves.

Figure 44

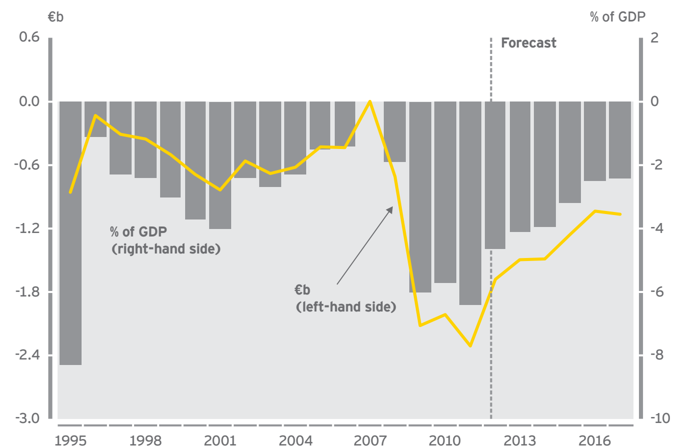
Real GDP growth



Source: Oxford Economics

Figure 45

Government budget balance



Source: Oxford Economics

Table 17

Slovenia (annual percentage changes unless specified)

Source: Oxford Economics

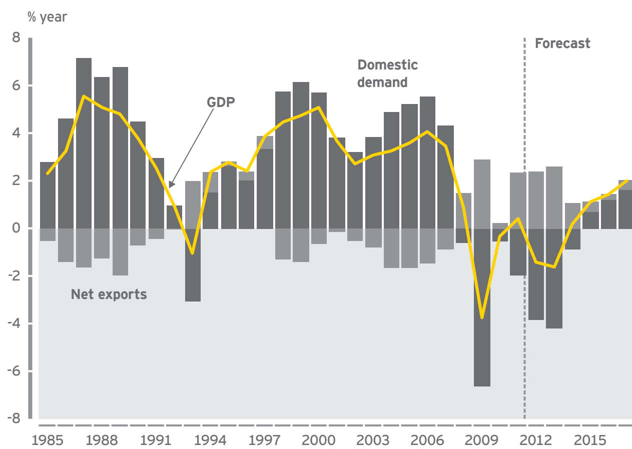
	2012	2013	2014	2015	2016	2017
GDP	-2.2	-1.5	0.8	3.0	3.3	3.1
Private consumption	-2.1	-1.9	0.4	2.0	1.8	2.1
Fixed investment	-8.9	-3.7	1.9	6.0	5.2	5.2
Stockbuilding (% of GDP)	-0.2	0.0	0.0	0.2	1.0	1.4
Government consumption	-2.5	-3.0	0.1	1.0	1.4	1.7
Exports of goods and services	1.1	1.2	2.6	3.0	3.5	3.9
Imports of goods and services	-3.0	0.4	2.5	2.8	3.5	3.9
Consumer prices	2.6	2.3	2.0	2.1	2.2	2.5
Unemployment rate (level)	8.5	9.0	9.5	8.5	7.7	7.0
Current account balance (% of GDP)	2.2	2.6	2.7	2.9	2.9	3.0
Government budget (% of GDP)	-4.6	-4.1	-4.0	-3.2	-2.5	-2.4
Government debt (% of GDP)	51.4	55.1	57.6	57.9	57.4	56.7

Spain

- The Spanish recession deepened at the end of last year, but we believe that the pace of contraction in the economy will ease in coming quarters — as signaled by the recent improvement in leading indicators. Even so, GDP is forecast to fall by 1.6% in 2013, similar to the drop in 2012.
- We remain hopeful that positive growth in economic activity will finally resume from 2014. The prospect of ECB intervention is keeping bond yields low, which should provide room for the restrictive fiscal policy stance to be eased next year, allowing the economy to recover gradually.
- Although the ECB's moves have reduced the risk of a near-term systemic crisis, investor confidence remains dependent on the ability of the Government to control public finances. We estimate that the budget deficit for 2012 was 7.5% of GDP, well above the official target of 6.3%. With the economy still in recession, the risk of continued fiscal slippage is significant, adding to the risk of an adverse reaction in the financial market.

Figure 46

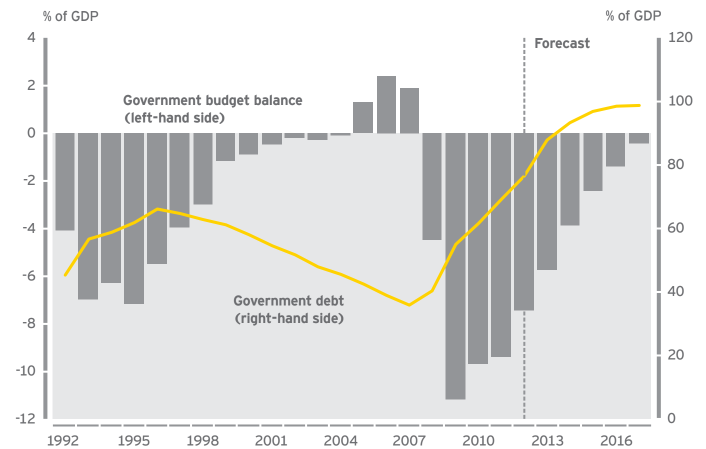
Contributions to GDP growth



Source: Oxford Economics

Figure 47

Government balance and debt



Source: Oxford Economics

Table 18

Spain (annual percentage changes unless specified)

Source: Oxford Economics

	2012	2013	2014	2015	2016	2017
GDP	-1.4	-1.6	0.2	1.1	1.4	2.0
Private consumption	-2.2	-2.6	-0.1	1.0	1.4	1.6
Fixed investment	-9.1	-6.5	-0.2	2.0	2.1	2.1
Stockbuilding (% of GDP)	0.8	0.3	0.2	0.1	0.2	0.4
Government consumption	-3.7	-4.5	-3.4	-1.0	-0.3	0.7
Exports of goods and services	3.1	4.8	4.2	4.4	3.4	3.3
Imports of goods and services	-5.0	-3.8	1.1	3.8	3.3	2.6
Consumer prices	2.4	2.0	1.0	0.9	1.0	1.0
Unemployment rate (level)	25.1	26.7	26.7	25.9	25.1	24.0
Current account balance (% of GDP)	-0.8	1.4	1.4	1.4	1.4	1.5
Government budget (% of GDP)	-7.5	-5.8	-3.9	-2.4	-1.4	-0.4
Government debt (% of GDP)	82.0	90.3	95.5	98.4	99.9	99.6

Detailed tables and charts

Forecast assumptions

	2012	2013	2014	2015	2016	2017
Short-term interest rates (%)	0.6	0.2	0.3	0.4	0.5	0.6
Long-term interest rates (%)	4.0	3.2	3.4	3.6	4.0	4.3
Euro effective exchange rate (1995 = 100)	115.5	118.7	114.3	110.7	110.3	110.1
Oil prices (€/barrel)	87.0	85.1	89.8	96.5	99.4	102.8
Share prices (% year)	-4.1	15.0	8.6	8.9	8.2	7.0

	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	0.3	0.3
Long-term interest rates (%)	4.4	4.3	4.0	3.4	3.1	3.2	3.2	3.2
Euro effective exchange rate (1995 = 100)	116.9	115.9	113.4	115.9	119.6	119.6	118.3	117.2
Oil prices (€/barrel)	90.3	84.7	87.7	85.1	87.7	85.7	83.3	83.5
Share prices (% year)	-14.9	-20.5	12.6	13.8	12.5	23.5	15.4	9.7

Eurozone GDP and components

Quarterly forecast
(quarterly percentage changes)

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	0.0	-0.2	-0.1	-0.6	-0.1	0.0	0.2	0.3
Private consumption	-0.3	-0.5	-0.1	-0.6	-0.2	0.0	0.1	0.1
Fixed investment	-1.4	-1.7	-0.6	-1.7	-0.2	0.0	0.2	0.5
Government consumption	0.1	-0.1	-0.1	0.0	-0.3	-0.2	-0.2	-0.1
Exports of goods and services	0.5	1.6	0.9	-1.0	0.6	0.7	0.9	1.0
Imports of goods and services	-0.3	0.6	0.3	-1.1	0.3	0.5	0.7	0.9

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

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	0.0	-0.2	-0.1	-0.6	-0.1	0.0	0.2	0.3
Private consumption	-0.1	-0.3	-0.1	-0.3	-0.1	0.0	0.0	0.1
Fixed investment	-0.3	-0.3	-0.1	-0.3	0.0	0.0	0.0	0.1
Government consumption	0.0	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0
Stockbuilding	0.0	0.0	-0.1	0.0	-0.1	0.0	0.0	0.1
Exports of goods and services	0.2	0.7	0.4	-0.4	0.3	0.3	0.4	0.5
Imports of goods and services	0.1	-0.3	-0.1	0.5	-0.1	-0.2	-0.3	-0.4

Annual levels — real terms
(€ billion, 2000 prices)

	2012	2013	2014	2015	2016	2017
GDP	8,557	8,518	8,611	8,732	8,864	9,003
Private consumption	4,794	4,759	4,790	4,845	4,908	4,978
Fixed investment	1,562	1,531	1,563	1,608	1,653	1,695
Government consumption	1,834	1,822	1,816	1,822	1,833	1,848
Stockbuilding	1	-9	-3	0	5	-1
Exports of goods and services	3,873	3,947	4,106	4,285	4,460	4,632
Imports of goods and services	3,508	3,532	3,663	3,829	3,995	4,149

Annual levels — nominal terms
(€ billion)

	2012	2013	2014	2015	2016	2017
GDP	9,489	9,562	9,794	10,073	10,377	10,698
Private consumption	5,449	5,497	5,615	5,759	5,916	6,089
Fixed investment	1,754	1,738	1,797	1,875	1,956	2,036
Government consumption	2,047	2,061	2,080	2,117	2,162	2,215
Stockbuilding	-14	-78	-47	-17	3	8
Exports of goods and services	4,325	4,471	4,731	5,022	5,310	5,604
Imports of goods and services	4,071	4,128	4,381	4,682	4,970	5,254

Prices and cost indicators

(annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
HICP headline inflation	2.5	1.8	1.6	1.4	1.4	1.5
Inflation ex-energy	1.8	1.7	1.5	1.3	1.3	1.4
GDP deflator	1.3	1.2	1.3	1.4	1.5	1.5
Import deflator	3.9	1.1	1.8	1.8	1.6	1.7
Export deflator	4.9	-2.4	2.0	2.0	1.4	1.4
Terms of trade	0.9	-3.5	0.3	0.3	-0.2	-0.2
Earnings	1.7	1.1	1.7	2.1	2.3	2.5
Unit labor costs	1.5	0.6	0.5	0.9	1.1	1.3
Output gap (% of GDP)	-3.0	-4.2	-4.0	-3.7	-3.4	-3.0
Oil prices (€ per barrel)	87.0	85.1	89.8	96.5	99.4	102.8
Euro effective exchange rate (1995 = 100)	115.5	118.7	114.3	110.7	110.3	110.1

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
HICP headline inflation	2.7	2.5	2.5	2.3	1.9	1.8	1.8	1.8
Inflation ex-energy	2.0	1.8	1.8	1.6	1.8	1.7	1.8	1.7
GDP deflator	1.2	1.2	1.3	1.3	1.2	1.3	1.2	1.2
Import deflator	3.9	4.3	4.7	2.8	1.3	1.0	0.3	1.7
Export deflator	6.0	4.9	5.9	2.6	-1.7	-2.2	-4.2	-1.5
Terms of trade	2.2	0.6	1.2	-0.1	-3.0	-3.2	-4.5	-3.2
Earnings	2.1	1.6	1.7	1.3	1.0	1.1	1.1	1.2
Unit labor costs	1.5	1.3	1.7	1.3	0.9	0.8	0.5	0.2
Output gap (% of GDP)	-2.5	-2.7	-3.0	-3.8	-4.1	-4.3	-4.3	-4.2
Oil prices (€ per barrel)	90.3	84.7	87.7	85.1	87.7	85.7	83.3	83.5
Euro effective exchange rate (1995 = 100)	116.9	115.9	113.4	115.9	119.6	119.6	118.3	117.2

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	-0.7	-1.0	-0.1	0.2	0.2	0.3
Unemployment rate (%)	11.4	12.2	12.2	11.8	11.4	10.9
NAIRU (%)	8.2	8.5	8.5	8.4	8.3	8.2
Participation rate (%)	75.0	75.3	75.4	75.6	75.8	76.0
Earnings	1.7	1.1	1.7	2.1	2.3	2.5
Unit labor costs	1.5	0.6	0.5	0.9	1.1	1.3

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employment	-0.5	-0.7	-0.7	-1.0	-1.0	-1.1	-1.1	-0.7
Unemployment rate (%)	10.9	11.3	11.5	11.7	12.0	12.2	12.3	12.3
NAIRU (%)	8.1	8.2	8.2	8.3	8.4	8.4	8.5	8.5
Participation rate (%)	74.8	75.1	75.2	75.1	75.2	75.2	75.3	75.3
Earnings	2.1	1.6	1.7	1.3	1.0	1.1	1.1	1.2
Unit labor costs	1.5	1.3	1.7	1.3	0.9	0.8	0.5	0.2

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)	82.4	160.6	166.8	158.1	159.5	170.4
Trade balance (% of GDP)	1.0	1.9	1.9	1.8	1.8	1.9
Current account balance (€b)	116.2	155.6	149.0	143.4	144.1	149.9
Current account balance (% of GDP)	1.2	1.6	1.5	1.4	1.4	1.4
Government budget balance (€b)	-310	-238	-188	-152	-125	-100
Government budget balance (% of GDP)	-3.3	-2.5	-1.9	-1.5	-1.2	-0.9
Cyclically adjusted surplus (+)/deficit (-) (% of GDP)	-2.8	-1.9	-1.3	-0.9	-0.6	-0.3
Government debt (€b)	8,800	9,109	9,427	9,752	10,041	10,294
Government debt (% of GDP)	102.8	106.9	109.5	111.7	113.3	114.3

Measures of convergence and divergence within the Eurozone

	2003-2007	2008-2012	2013-2017
Growth and incomes			
Standard deviation of GDP growth rates	2.0	2.3	1.1
Growth rate gap (max-min)	7.0	9.2	4.0
Highest GDP per capita (Eurozone = 100)	241.7	241.3	244.5
Lowest GDP per capita (Eurozone = 100)	56.2	67.5	65.7
Inflation and prices			
Standard deviation of inflation rates	1.2	1.0	0.6
Inflation rate gap (max-min)	4.8	3.9	2.1
Highest price level (Eurozone = 100)	122.2	121.1	120.0
Lowest price level (Eurozone = 100)	55.6	69.1	71.9

Cross-country tables

Real GDP
(% year)

Rank		2012	2013	2014	2015	2016	2017	Average 2013-2017
1	Estonia	3.2	3.0	4.0	4.2	4.2	4.1	**3.9**
2	Slovakia	2.0	1.1	2.4	3.6	3.6	3.5	**2.9**
3	Luxembourg	0.2	1.0	3.0	3.2	3.0	2.8	**2.6**
4	Ireland	0.6	0.1	1.9	2.5	3.0	3.5	**2.2**
5	Finland	-0.2	-0.2	1.6	2.3	2.6	2.4	**1.7**
6	Slovenia	-2.2	-1.5	0.8	3.0	3.3	3.1	**1.7**
7	Malta	1.2	1.3	1.3	1.6	1.7	1.8	**1.5**
8	Germany	0.9	0.7	1.9	1.7	1.6	1.4	**1.4**
9	Austria	0.7	0.8	1.8	1.5	1.6	1.5	**1.4**
10	Belgium	-0.2	-0.2	1.0	1.2	1.5	1.8	**1.1**
11	Eurozone	-0.5	-0.5	1.1	1.4	1.5	1.6	**1.0**
12	France	0.0	0.0	1.1	1.2	1.3	1.4	**1.0**
13	Netherlands	-0.9	-0.5	0.9	1.0	1.1	1.3	**0.8**
14	Spain	-1.4	-1.6	0.2	1.1	1.4	2.0	**0.6**
15	Cyprus	-2.3	-2.2	-1.1	0.8	2.5	3.0	**0.6**
16	Italy	-2.2	-2.0	0.2	1.2	1.4	1.4	**0.4**
17	Portugal	-3.2	-3.2	0.4	1.1	1.1	1.1	**0.1**
18	Greece	-6.4	-5.2	-0.1	1.4	1.7	1.9	**-0.1**

Inflation rates
(% year)

Rank		2012	2013	2014	2015	2016	2017	Average 2013-2017
1	Greece	1.0	0.1	0.1	0.4	0.8	1.4	**0.6**
2	Portugal	2.8	1.1	0.8	0.8	0.8	0.9	**0.9**
3	Spain	2.4	2.0	1.0	0.9	1.0	1.0	**1.1**
4	Netherlands	2.8	2.1	1.5	1.3	1.2	1.2	**1.5**
5	France	2.2	1.7	1.5	1.5	1.4	1.4	**1.5**
6	Italy	3.3	2.1	1.8	1.1	1.2	1.3	**1.5**
7	Eurozone	2.5	1.8	1.6	1.4	1.4	1.5	**1.6**
8	Ireland	1.9	1.5	1.6	1.6	1.6	1.6	**1.6**
9	Finland	3.2	2.0	1.4	1.5	1.6	1.7	**1.7**
10	Germany	2.1	1.6	1.7	1.8	1.7	1.7	**1.7**
11	Austria	2.6	2.2	1.8	1.8	1.8	1.8	**1.9**
12	Cyprus	3.1	2.2	1.9	1.6	1.8	2.0	**1.9**
13	Belgium	2.6	2.0	2.1	2.1	1.8	1.8	**2.0**
14	Luxembourg	2.9	2.1	2.0	2.0	2.0	2.0	**2.0**
15	Malta	3.2	2.4	2.0	1.8	2.0	2.3	**2.1**
16	Slovakia	3.6	2.6	2.3	2.1	2.1	2.1	**2.2**
17	Slovenia	2.6	2.3	2.0	2.1	2.2	2.5	**2.2**
18	Estonia	3.9	3.2	2.9	2.6	2.4	2.2	**2.7**

Cross-country tables

Unemployment rate
(% of labor force)

Rank		2012	2013	2014	2015	2016	2017	Average 2013-2017
1	Austria	4.3	4.7	4.8	4.6	4.5	4.5	**4.6**
2	Germany	5.5	5.4	5.3	5.0	4.7	4.4	**5.0**
3	Luxembourg	5.0	5.7	5.8	5.5	4.9	4.3	**5.2**
4	Malta	6.5	6.7	6.2	5.5	4.7	4.7	**5.6**
5	Netherlands	5.3	6.4	6.7	6.7	6.7	6.6	**6.6**
6	Finland	7.7	7.8	7.7	7.4	7.1	6.8	**7.3**
7	Estonia	10.0	9.0	8.2	7.4	6.6	6.0	**7.4**
8	Belgium	7.4	7.9	8.1	7.9	7.7	7.5	**7.8**
9	Slovenia	8.5	9.0	9.5	8.5	7.7	7.0	**8.3**
10	France	10.3	11.0	10.9	10.6	10.4	10.0	**10.6**
11	Eurozone	11.4	12.2	12.2	11.8	11.4	10.9	**11.7**
12	Italy	10.6	11.9	12.3	12.0	11.5	11.1	**11.8**
13	Slovakia	14.0	14.5	13.5	12.0	11.0	10.4	**12.3**
14	Ireland	14.9	14.9	14.6	13.8	13.1	12.0	**13.7**
15	Portugal	15.7	17.9	17.1	15.2	14.1	12.4	**15.3**
16	Cyprus	12.1	15.5	16.1	16.3	16.0	15.1	**15.8**
17	Spain	25.1	26.7	26.7	25.9	25.1	24.0	**25.7**
18	Greece	24.4	27.8	28.3	27.8	27.6	27.2	**27.8**

Government budget
(% of GDP)

Rank		2012	2013	2014	2015	2016	2017	Difference 2013-2017
1	Finland	-0.7	-0.3	-0.2	-0.2	-0.2	-0.4	**-0.1**
2	Germany	-0.1	0.0	0.0	0.0	0.0	0.0	**0.0**
3	Malta	-2.3	-2.1	-2.0	-1.8	-1.6	-1.4	**0.7**
4	Italy	-3.0	-2.5	-2.3	-2.1	-1.9	-1.7	**0.8**
5	Austria	-3.3	-2.7	-2.1	-1.9	-1.8	-1.6	**1.1**
6	Netherlands	-3.7	-3.2	-3.0	-2.7	-2.3	-2.0	**1.2**
7	Estonia	-1.1	-1.2	-0.6	-0.3	-0.1	0.0	**1.2**
8	Luxembourg	-1.8	-2.1	-1.8	-1.6	-1.3	-0.6	**1.5**
9	Eurozone	-3.3	-2.5	-1.9	-1.5	-1.2	-0.9	**1.6**
10	Slovenia	-4.6	-4.1	-4.0	-3.2	-2.5	-2.4	**1.7**
11	France	-4.7	-3.3	-2.5	-2.1	-1.7	-1.4	**1.9**
12	Belgium	-3.5	-2.8	-2.0	-1.3	-0.9	-0.8	**2.0**
13	Slovakia	-5.5	-4.7	-3.7	-3.1	-2.8	-2.5	**2.2**
14	Cyprus	-4.9	-4.0	-3.4	-2.7	-1.5	-1.5	**2.5**
15	Greece	-8.3	-6.3	-5.3	-4.2	-3.6	-3.2	**3.1**
16	Portugal	-5.4	-5.5	-4.2	-2.9	-1.7	-0.8	**4.7**
17	Spain	-7.5	-5.8	-3.9	-2.4	-1.4	-0.4	**5.4**
18	Ireland	-8.5	-7.8	-5.0	-3.5	-2.5	-1.5	**6.3**

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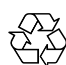

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