Eurozone

EY Eurozone Forecast

December 2013

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Foreword

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

The recession is receding, we see a reasonable prospect of growth next year and a new member will join the Eurozone in January. Nevertheless, challenges remain and the recovery will be slow. Both governments and businesses need to work hard to secure growth.

Customize data from EY's *Eurozone Forecast* and *Rapid-Growth Markets Forecast*.
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This may be our winter forecast, but at last things are beginning to thaw in the Eurozone. Austerity, rising unemployment, falling output and declining living standards have meant that good news has been scarce in recent years. However, after the confirmation that the 18-month Eurozone recession has come to an end, our latest *EY Eurozone Forecast* shows that the currency zone's recovery is ongoing. And, despite all the talk of countries exiting over the past few years, a new member is about to enter.

The Eurozone economy grew 0.1% in Q3 2013, a little below the rate seen in Q2. Early indications suggest that the rise in activity has continued through the tail end of 2013. In November, the Purchasing Managers' Index reported a fifth successive month of rising activity. The recovery is being led by the northern European economies, but the peripheral countries are beginning to play their part in the upturn as they start to benefit from improving competitiveness, stronger demand for exports and the gradual pickup in world trade.

We still expect GDP to fall 0.5% in 2013 as a whole, the same as we forecast three months ago. Businesses should prepare for a slow upturn: we still expect to see growth of just 0.9% in 2014, followed by annual growth of about 1.6% in 2015–17. Sentiment has also been strengthened by the resilience of Europe's financial markets in the face of political turmoil in Italy and fiscal uncertainty in the US. In part, this resilience is a result of the European Central Bank (ECB) giving the strong message that it will act as a backstop for the Eurozone bond markets.

The ECB will have an important role to play in 2014. If tighter credit conditions are imported from the US when the Federal Reserve starts to taper its quantitative easing, we think that the ECB should be ready to counter with an appropriate policy response.

Of course, tough challenges remain. Many European financial institutions are still over-leveraged and under pressure to cut lending. And policy-makers need to build on the recovery by broadening their outlook. Rather than concentrating solely on fiscal consolidation, they should refocus on a program of broader reforms aimed at boosting competitiveness. Then the medium-term recovery can be built on strong foundations, rather than a weak exchange rate.

So what can be done to underpin the recovery? At this stage, governments and businesses can and should contribute to secure this progress. Governments should implement the structural reforms that have been on the table for months and businesses should try to exploit the possibilities offered by improved competitiveness in parts of the European market.

On 1 January 2014, Latvia will become the 18th Eurozone member state. By overcoming the hurdles to entry, the Baltic state has demonstrated that its economy has stabilized after the economic crisis. It now enjoys conditions for sustainable growth, and a strong start to life in the Eurozone could encourage other eastern European economies to seek membership. We are pleased to be incorporating Latvia in the *Eurozone Forecast* from March 2014, and we anticipate adding Lithuania to the forecast in 2015.

A year ago, I wrote that "few in the Eurozone will mourn the passing of 2012." Back then, ending the year intact was the Eurozone's main achievement. But the single currency zone is much stronger now than 12 months ago. Policy-makers are talking of nurturing growth, not ending recession; long-term planning, not short-term survival; and Eurozone entries, not exits, are now on the agenda. Europe's long winter appears to be over.

Highlights

Eurozone membership remains attractive to eastern European countries

- Latvia will become the Eurozone's 18th member on 1 January 2014 and we expect it to be followed in 2015 by Lithuania.
- Joining the Eurozone remains an attractive prospect for eastern European economies. Many already send a large chunk of their exports to the single currency area, so membership removes the exchange rate risk. There is also a perception that they are more likely to attract foreign direct investment as the cost of doing business with other Eurozone countries would fall.
- The loss of control over monetary policy in joining a currency area is a potential risk to small and open economies. However, taking into account earlier substantial internal devaluation and structural reforms, we think that both Latvia and Lithuania are well placed to adapt to Eurozone membership.

The Eurozone continues along the road to recovery ...

- Ahead of Latvia's accession, the Eurozone is on course for recovery, having achieved a second successive quarter of expansion in Q3 2013.
- After falling by an expected 0.5% in 2013 as a whole, we forecast Eurozone GDP will grow by 0.9% in 2014 and then by about 1.6% a year in 2015–17.

... and now looks less vulnerable to external shocks ...

- The resilience of financial markets in the face of political turmoil in Italy and fiscal issues in the US has been a pleasant surprise. This reflects faith in the European Central Bank (ECB) as a backstop for Eurozone bond markets and greater confidence in the outlook now that the economy has returned to growth.
- But this resilience cannot be taken for granted. The next big test is the ECB's asset quality review and the subsequent restructuring of the banking sector. At the very minimum, policy-makers must ensure that the relatively modest expectations of the markets are met, so as not to threaten the current stability of the region.
- The ECB will also have a key role to play in 2014 in setting policy to counter any tightening in credit conditions that may be imported from the US once the Federal Reserve starts tapering quantitative easing. The surprise rate cut in November is unlikely to be enough to head off concerns about possible deflation.

... but policy-makers must push ahead with reform efforts

- The enduring strength of the euro acts as a reminder that the recovery cannot rely on factors beyond the control of Eurozone governments and companies.
- Policy-makers should be moving on from a narrow emphasis on fiscal consolidation. They should be refocusing on a program of broader reforms aimed at boosting competitiveness, rather than relying on a weaker exchange rate to support the recovery.

GDP growth

2013	2014	2015-17
-0.5%	0.9%	1.6%

Unemployment

2014 12.3%

Budget deficit

2013	2014	2015-17
-2.9%	-2.6%	-1.7%

Inflation

2013 1.4%

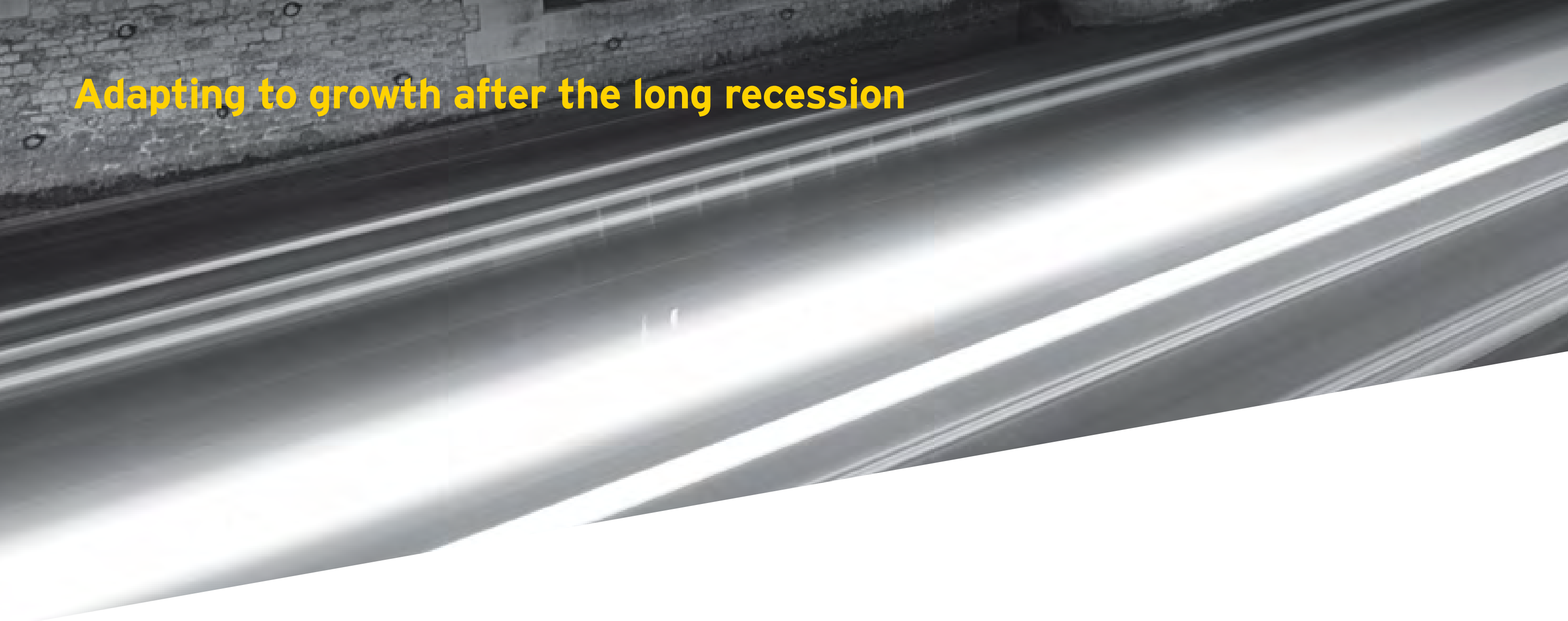
2014 1.1%

Eurozone forecast by sector (% change)	2013	2014
Manufacturing	-1.0	1.6
Agriculture	0.0	1.1
Construction	-3.1	1.1
Utilities	-0.5	1.9
Trade	-0.7	1.0
Financial and business services	-0.1	1.2
Communications	0.9	2.3
Non-market services	-0.6	-0.7

Implications for businesses:

Adapting to growth after the long recession

Adapting to growth after the long recession



Businesses are slowly starting to see an improvement in market conditions. And after a protracted period of bearish sentiment and risk containment, financial investors have more confidence in the Eurozone's prospects. As economic recovery in the 17-nation bloc gradually widens, executives are trying to assess how their businesses can benefit. But the recovery remains fragile and the outlook is tinged by sharpening debate over the extent to which policy-makers should do more to spur activity. Against this better, but imperfect, backdrop, business leaders need to find out where to get the best investment returns in coming years.

Deflation concerns

During 2013, worries about the survival of the euro have eased, but other concerns remain. The nascent recovery slowed in Q3, when Eurozone GDP rose by only 0.1%, compared with 0.3% in Q2. The ECB cut its benchmark interest rate by 25 basis points to just 0.25% on 7 November, reflecting fears that Eurozone inflation, which is already very low, could give way to deflation. And markets continue to fret about what the ECB's stress tests of European banks next year may uncover.

Peripheral countries are hoping for export-led recovery

Yet the Eurozone continues to attract new members and, despite all the recent problems, we believe the recovery will now strengthen gradually. We still expect an overall 0.5% decline in Eurozone GDP in 2013, but we continue to forecast GDP growth of 0.9% in 2014, rising to 1.4% in 2015. Spain and Portugal returned to growth in Q3, after two years of recession, and the Greek Government is predicting an end to six years of contraction in 2014. Glimmers of an export-led recovery in some of the most battered peripheral economies are brightened by long-awaited reports from shipping companies of rising freight volumes. And some big-name investors are bargain-hunting in beleaguered European economies.

Adding more Baltic states

Despite the recent troubles in the Eurozone, the accession of Latvia on 1 January 2014 confirms the region's continued appeal. Following its efforts to adjust and reform, Latvia is expected to achieve annual growth of just over 4% in 2013 and 2014. A focus on competitiveness has helped the Baltic state to deliver a near doubling of exports since the economic crisis, despite its exchange rate being pegged to the euro, while public debt is just 40% of GDP. Having been refused entry to the single currency in 2006 because of high inflation, Lithuania is now on course to join the Eurozone as well in 2015.

Getting used to an upturn

Rising exports from peripheral economies that have undertaken significant structural reforms, such as Ireland, Portugal and Spain, reflect efforts by businesses to take advantage of their improved competitiveness. In some cases, companies have renegotiated labor contracts and altered international sourcing strategies — by supplying more cars assembled in Spain to customers elsewhere, for example. Others are investing more in overseas marketing. In some cases, spare capacity is being used to supply markets outside the Eurozone, particularly customers in emerging markets, or in the US and the UK, where economic recovery is more advanced.

Taking stock

Yet the economic outlook still varies sharply between Eurozone countries, and overall growth will remain weak. Many firms have begun to review their portfolio of assets and activities carefully. They are seeking to identify where their best long-term potential lies, to ensure they are structured to make the most of their strengths and to address weaknesses. At the same time, they are reshaping their businesses to improve flexibility and minimize costs. Traditional industrial companies are improving efficiency and seeking growth opportunities for the products they provide.

Responding to low inflation

Low wage growth and households' need to reduce debt have led to weak consumer demand. That makes it hard for companies to raise prices, while spare capacity in many industries has intensified competition and eroded profit margins. As corporate restructuring continues, Eurozone unemployment has risen above 12% this year and is expected to peak at 12.3% in 2014. With inflation now very low, there is a risk that consumers will defer non-urgent purchases.

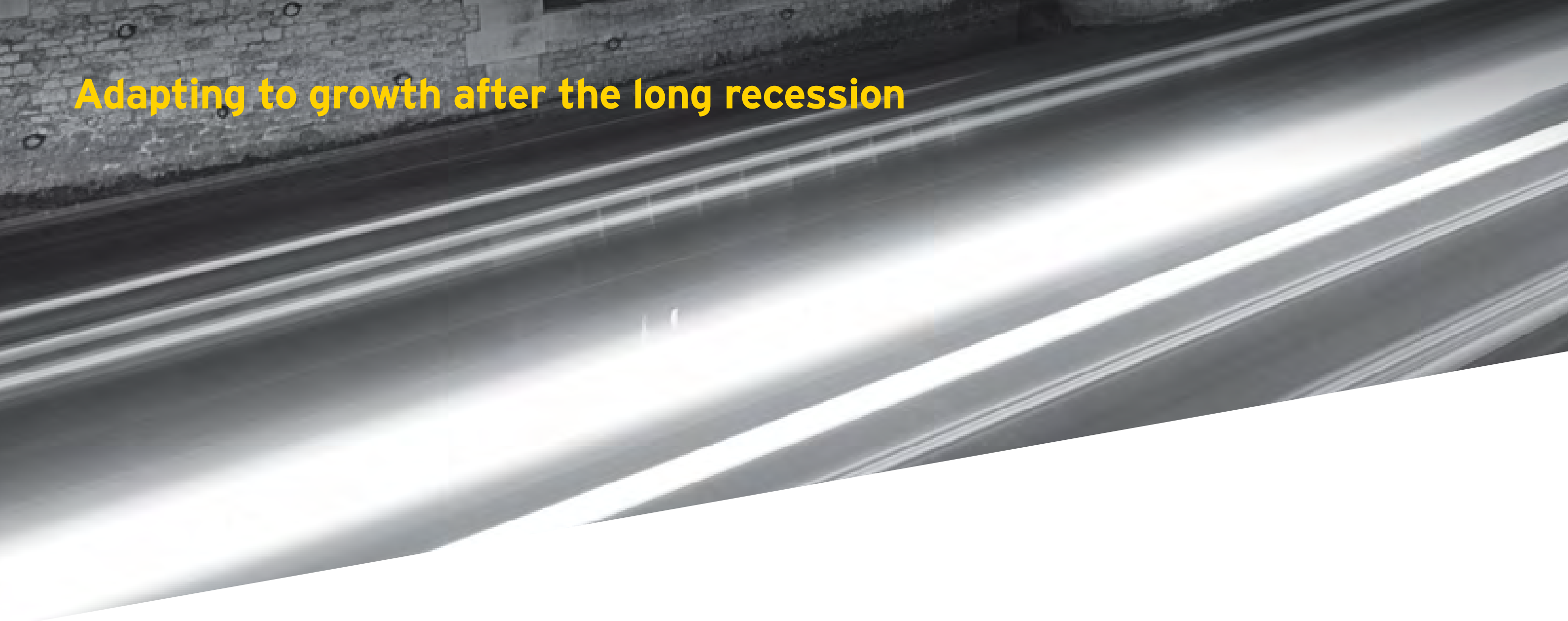
Reshaping your business for recovery

It is important for businesses to have a long-term plan and to consider carefully how to shape their futures.

What should businesses do to ensure they are best placed to exploit the recovery?

- Review portfolios by sector, segment and geography.
- Review business models to ensure that they can support competitiveness.
- Review the comparative competitiveness of European locations to supply international markets.
- Consider increased investment in international marketing to exploit the improved competitiveness of some European facilities.
- Enhance ability to compete on superior technology and quality of products and services, avoiding reliance on price for advantage.
- Increase due diligence before investment decisions, whether in plant or in mergers and acquisitions, to make the most of scarce capital.
- Review restructuring options, particularly those arising from improved valuations for acquisitions and disposals.
- Monitor ongoing political risks arising from high unemployment and discontent over austerity.

Adapting to growth after the long recession



Breaking down barriers for business

In the current climate, it is easy to overlook the market-liberalizing reforms that were initiated in the European Union (EU) in better times. These reforms are now beginning to take effect, breaking down barriers between national markets and reducing costs for business. One example is the Single European Payments Area program, which has pushed banks and payment card companies into creating a common platform with lower charges for users.

In the meantime, much of the focus on creating a single market within the EU has been on manufactured products. Yet, according to Eurostat, industry accounts for just 19.5% of EU gross value added, compared with 74.5% for services. This makes ongoing EU-US trade liberalization talks to achieve a "transatlantic trade and investment partnership" particularly crucial for business. The second round of talks, in November, began vital discussions on opening the door to services and investment, and harmonizing regulation. Success would provide a much-needed boost to weak Eurozone growth.

Eurozone forecast by sector

On a sector-by-sector basis, the early stages of the recovery are likely to be somewhat uneven. The biggest turnaround is forecast to come in manufacturing, where the pickup in export demand is expected to generate output growth of 1.6% in 2014, after an estimated fall of 1% in 2013.

Construction is another sector where output is forecast to rebound: 2013 is expected to mark the fifth successive year of falling output, but a stabilizing housing market and reduced emphasis on austerity are expected to underpin output growth of about 1% in 2014.

The outlook is weaker for sectors exposed to the consumer and government sectors. Non-market services will be particularly badly affected, with output forecast to fall by 0.7% in 2014 and recover only very slowly thereafter, reflecting the fact that the Eurozone faces a long period of austerity.

Table 1

Forecast of Eurozone by sector (annual percentage changes in gross added value)

	2012	2013	2014	2015	2016	2017
Manufacturing	-1.3	-1.0	1.6	2.6	2.3	2.0
Agriculture	-5.0	0.0	1.1	1.3	1.3	1.3
Construction	-4.5	-3.1	1.1	1.5	1.5	1.4
Utilities	1.8	-0.5	1.9	1.9	1.8	1.8
Trade	-0.5	-0.7	1.0	1.4	1.7	1.9
Financial and business services	0.5	-0.1	1.2	1.5	1.7	1.8
Communications	0.5	0.9	2.3	2.6	2.8	2.9
Non-market services	0.1	-0.6	-0.7	0.1	0.5	0.8

Source: Oxford Economics.

Viewpoint

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Sector overview: property and construction

Two factors are likely to reinforce a nascent recovery in Eurozone construction and real estate in 2014. First, with central bank lending rates at record lows and a stock market recovery well established, property is an asset-backed investment with an appealing yield — and many pension funds and institutional investors are underweight in real estate. Second, demographics and changing consumer behavior will enhance the appeal of the "right" properties in the "right" cities.

5.5%

Prime yields averaging around 5.5% make commercial property an attractive investment in many leading Eurozone cities.

The uptick comes as construction is bottoming out after a sharp contraction. Activity has fallen by around 20% overall across Europe since 2008 and falls in some southern peripheral countries, such as Spain, have been even steeper. But many industry observers expect a pickup in 2014.

The downturn was caused partly by the protracted recession, which reduced private sector property investment, but also by cuts in public spending, as governments wrestled with deficits. Yet Europe badly needs infrastructure renewal and development, especially in some of its biggest cities (although in some countries there has been overdevelopment, leading to a property surplus). Some governments, particularly in southern Europe, are now turning to the private sector to finance infrastructure investment. Though public-private partnerships remain under-exploited, privatization programs are creating opportunities for investors, and are a route to increased investment. The Spanish Government is poised to sell up to 60% of Aena, which operates airports in 46 Spanish cities, including Madrid and Barcelona. Italy too is accelerating its privatization program, despite a failed attempt to privatize water utilities in 2011.

In the meantime, while some overbuilt southern countries suffer from a surplus of seaside residential property, many northern European cities, especially those of the Nordic countries, have shortages of homes. Citizens worldwide are flocking to the largest urban centers in search of jobs and better lifestyles. Rising prices and attractive yields in Germany and Sweden, for instance, are helping to bring investment by private equity firms as well as individuals, and should trigger a recovery in residential construction.

Rentals for prime offices in Germany and the Nordics continued to rise in 2013 and falls in southern European cities are leveling out. Prime yields, of around 4%-6%, make commercial property an attractive investment in many leading Eurozone cities, at a time when many pension funds and other investors are seeking investments. Yet changes in communication technology, and steady improvements by corporate occupiers in the efficiency with which they use space, suggest demand growth may remain weak.

At the same time, the retail property market is being recast by changing consumer behavior and ever-increasing online sales. Demand from luxury retailers for premium city-center locations remains strong. Declining car ownership, especially among young people, strengthens the appeal of local shopping centers with good public transport. Big malls with lots of restaurants and leisure attractions are also thriving. But edge-of-town retail sites relying upon cars for access are losing out as a lot of routine retailing moves online. However, this is driving increased demand for well-connected, centrally located logistics centers and city-edge national relays.

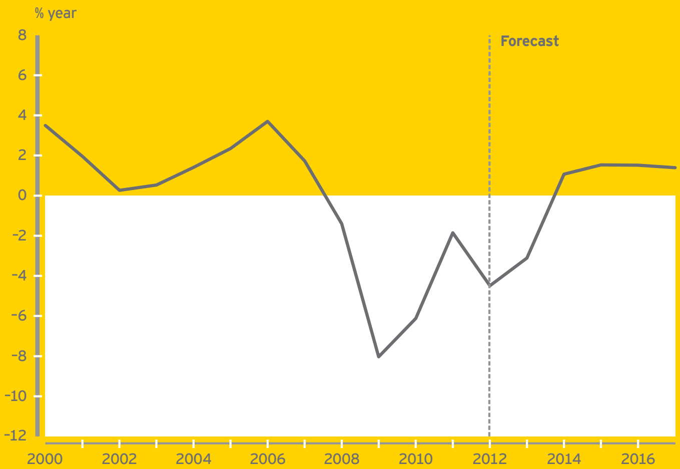
A construction and property recovery is clearly beginning in the Eurozone. But the sector's shape in the future will be different, as the market becomes increasingly urban and connected.

Year 2013 to mark the bottom of the construction cycle

We expect 2013 to mark the bottom of the cycle for construction. Our forecast shows a gradual recovery taking place from 2014, starting in the core Eurozone countries.

Figure 1

Construction GVA



Source: Oxford Economics.

We also expect the declines in output in the peripheral economies to end, thanks to a substantial easing in the pace of austerity. This implies that budgets for infrastructure spending will stop falling, as well as a stabilization of the housing market, driven by firmer labor market trends and a gradual erosion of the excess supply.

It will take some time for the sector to recover. We forecast construction output to grow by just 1.4% a year in 2014–17, which in 2017 would still leave it 18% below its 2007 level.

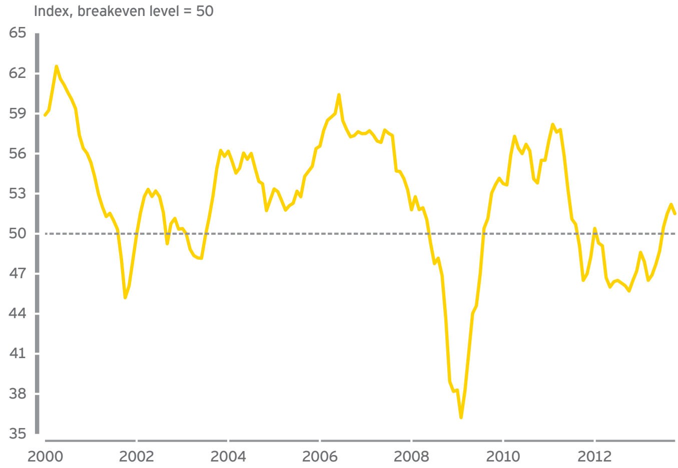
Economy to gather further momentum in 2014

Having shown its resilience in the face of political uncertainty in Italy and the fiscal problems in the US, the Eurozone economy should gather further momentum in 2014 after returning to growth in mid-2013. But with annual growth of around 1.6% expected in 2015-17, the Eurozone will lag well behind both the US and the UK. Another concern is the need for further monetary policy support, as inflation is now at a worryingly low level.

After six quarters of contraction, the Eurozone economy finally returned to growth in Q2 2013, when GDP rose 0.3%, and this was followed by a 0.1% increase in Q3. Business surveys suggest that this momentum has been sustained over the closing months of 2013. The Purchasing Managers' Index (PMI) has been particularly promising, with the composite index reporting a fifth successive month of rising activity in November. While the core northern European economies are continuing to lead growth in the Eurozone, we can take encouragement from evidence that the peripheral countries are also beginning to play their part in the upturn, benefiting from the boost to export demand from stronger growth in world trade.

Figure 2

Composite PMI



Source: Markit.

Table 2

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

	2012	2013	2014	2015	2016	2017
GDP	-0.6	-0.5	0.9	1.4	1.6	1.7
Private consumption	-1.4	-0.6	0.5	1.1	1.3	1.4
Fixed investment	-3.8	-3.7	1.3	2.5	2.6	2.5
Stockbuilding (% of GDP)	0.0	-0.1	-0.1	-0.1	0.0	0.0
Government consumption	-0.5	0.2	-0.3	0.3	0.5	0.8
Exports of goods and services	2.7	1.2	3.6	4.1	4.2	4.0
Imports of goods and services	-0.8	-0.1	2.8	4.0	4.2	4.0
Consumer prices	2.5	1.4	1.1	1.3	1.4	1.5
Unemployment rate (level)	11.4	12.1	12.3	12.1	11.8	11.5
Current account balance (% of GDP)	1.4	2.0	2.1	2.0	1.9	1.9
Government budget (% of GDP)	-3.7	-2.9	-2.6	-2.1	-1.6	-1.3
Government debt (% of GDP)	92.7	96.8	98.9	100.1	100.4	100.1
ECB main refinancing rate (%)	0.9	0.5	0.3	0.3	0.3	0.4
Euro effective exchange rate (1995 = 100)*	115.5	120.3	119.5	117.6	114.9	113.9
Exchange rate ($ per €)	1.28	1.32	1.29	1.25	1.22	1.20

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

Source: Oxford Economics.

Economy to gather further momentum in 2014

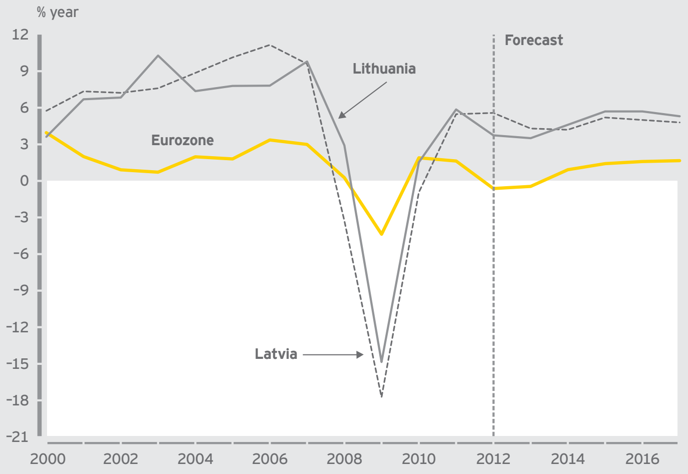
Latvia's accession demonstrates the Eurozone's attractiveness

Despite the struggles of the past five years and the prospect of a weak recovery, joining the Eurozone remains an attractive prospect for eastern European economies. Latvia will become the Eurozone's 18th member on 1 January 2014 and we expect it to be followed in 2015 by Lithuania. This is likely to mark the end of the expansion in the short term, as a condition of membership is being part of the Exchange Rate Mechanism (ERM) for two years. Apart from Latvia and Lithuania, the only other current ERM member is Denmark, which has an opt-out from the euro. However, attitudes to Eurozone membership appear to be softening in other eastern European countries, so others could join over the longer term.

The key motives for joining the Eurozone are the reduction in transaction costs and exchange rate risk. Both Latvia and Lithuania send around 30% of their goods exports to the Eurozone — a figure that will rise to 40%–45% if both join and trade between the two countries is included — and adoption of the single currency eliminates the need to either buy or sell currencies or hedge exchange-rate risks for these transactions. Latvia has also argued that it will become a more attractive destination for foreign direct investment (FDI) when it is part of the Eurozone. This is partly because of the lower cost of doing business with other Eurozone countries, which would make it a more attractive place for companies to site a European base. But it is also because being part of the wider bloc gives reassurance to investors that the economy will be supported were it to get into trouble.

Figure 3

GDP



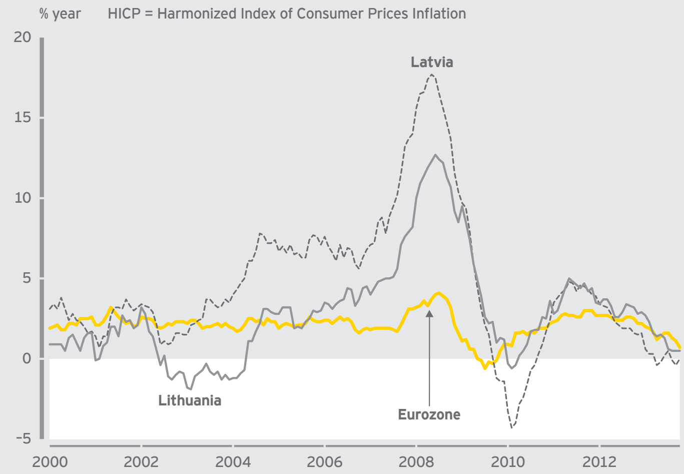
Source: Oxford Economics.

But joining a single currency area also has its drawbacks. Most notably, membership requires an economy to relinquish control of its monetary policy, which reduces its ability to respond to shocks. This is particularly important for small, open economies that tend to be most susceptible to such shocks.

However, Latvia and Lithuania look well placed to adapt to Eurozone membership. Both economies imposed severe austerity packages and underwent substantial internal devaluation and structural reform following the financial crisis. This has stabilized inflation and enabled them to maintain relatively low levels of government debt. While their economies remain significantly smaller than they were prior to the crisis, both have grown strongly in recent years. Latvia will be the fastest-growing Eurozone country in 2014, with GDP forecast to rise by over 4% and then accelerate to about 5% a year in 2015–17. And Lithuania may post even faster rates of growth. These rates will be well ahead of other Eurozone countries, although both countries experienced very deep recessions during the financial crisis.

Figure 4

HICP* inflation



Source: Haver Analytics.

Latvia: GDP forecast

2014 **4.2%**

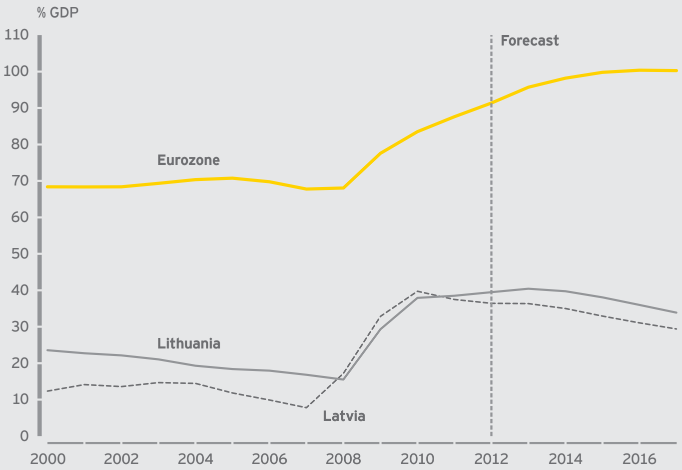
2015-17 **5.0%**

Latvia will be the fastest-growing Eurozone country in 2014, with GDP forecast to rise by 4.2% and then accelerate to about 5% a year in 2015-17.

Latvia comfortably complied with the five convergence criteria when assessed in June 2013. Lithuania's last assessment, in May 2012, revealed that it failed to comply with the criteria on inflation rates and the general government budget balance. But more recent data points to greater convergence in the period since. Our forecasts are consistent with these two criteria being achieved in time for entry on schedule in January 2015.

Figure 5

Government debt as % of GDP



Source: Oxford Economics.

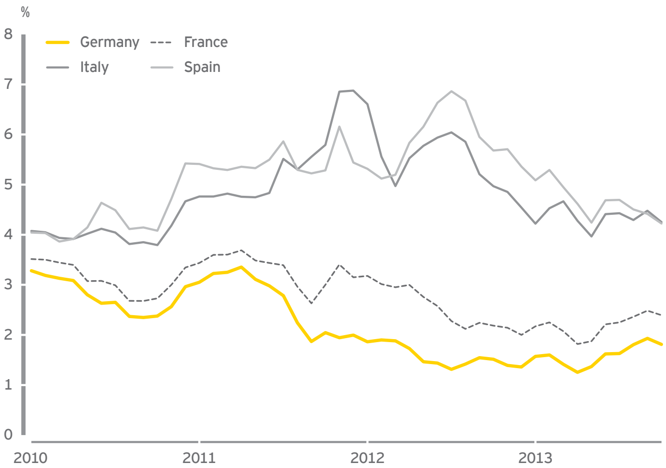
The Eurozone has shown resilience to shocks

This return to growth has come despite a backdrop of further political instability and turbulence in global financial markets. For instance, the markets were relatively unfazed by the political uncertainty in Italy in late-September. Movements in government bond yields have been more heavily influenced by events in the US. Yields rose in the first half of September, as markets anticipated that the Federal Reserve would taper its asset purchases, and then fell back when it decided against such a move. But the movements in Eurozone bond yields were much more muted than those in either the US or UK, while Spanish yields continued to fall and Italian yields remained stable. In contrast, yields emerging markets rose sharply. Brazilian and Turkish government bond yields, for example, rose by between 200 and 300 basis points between May and September 2013, to 12% and 9% respectively.

The fact that the peripheral Eurozone economies were not caught up in this wave of risk aversion demonstrates the turnaround in market sentiment about the Eurozone during 2013. In particular, markets have faith in the ECB as a backstop for Eurozone bond markets and greater confidence in the outlook now that the economy has returned to growth.

Figure 6

Bond yields



Source: Oxford Economics; Haver Analytics.

Economy to gather further momentum in 2014

Consumer demand and investment will start to support exports in driving growth

We expect to see the Eurozone's recovery gain momentum gradually through 2014. The initial phase of the recovery was driven by net trade and we think that export growth will accelerate further, as global growth strengthens and boosts world trade. This should be supplemented by domestic demand, which has been a sizeable drag on growth over the past couple of years, but should improve from 2014.

The improved outlook is due partly to a change of emphasis in fiscal policy. Though austerity will continue to weigh on growth, the drag will be considerably smaller than in previous years. The European Commission estimates that fiscal policy will be tightened by around 0.25% of GDP in 2014, compared with 0.5% in 2013, and over 1% in each of the previous two years.

Conditions for households should also improve. Consumer spending has been squeezed due to a prolonged period of falling real wages and rising unemployment. However, with inflation dropping back and unemployment stabilizing, this squeeze will abate. We expect to see consumer spending grow by 0.5% in 2014, after falling by an estimated 0.6% in 2013.

In addition, the investment climate is showing signs of improvement. Surveys of business confidence report firmer sentiment on the back of an improving outlook — both at home and abroad — and a reduced level of downside risk. This should encourage cash-rich firms to begin committing to investment projects — although the extent to which investment recovers will be limited by credit conditions remaining relatively tight. As a result, we expect investment to rise by 1.3% in 2014, after declining in 2012–13, and to accelerate further in 2015–17.

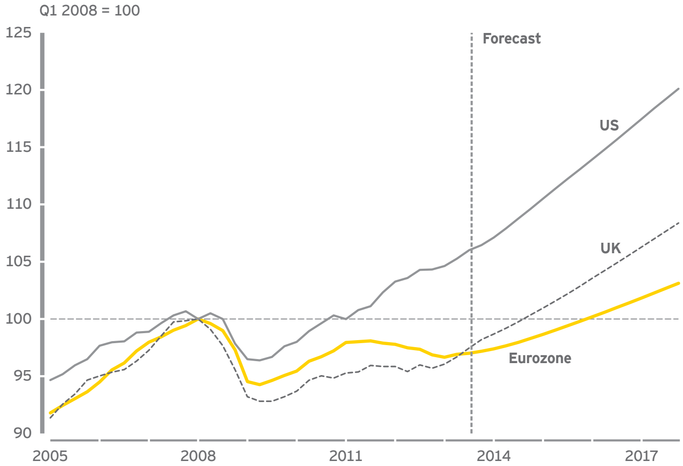
Eurozone growth will still be weak compared with other advanced economies

These factors point to a gradual recovery in 2014 — albeit a recovery that will be fragile and will have to negotiate several obstacles. After falling by an expected 0.5% in 2013, we forecast Eurozone GDP will grow by 0.9% in 2014 and then by about 1.6% a year in 2015–17. But while this would represent a substantial improvement relative to recent trends, in an international context it is less impressive.

Our forecast would see Eurozone GDP moving to a level just over 3% above its pre-financial crisis peak by the end of 2017. In contrast, by this time, we expect UK GDP to be more than 8% higher and US activity 20% above its late-2007 level.

Figure 7

Recoveries compared



Source: Oxford Economics.

The asset quality review puts high demands on the ECB

While the recovery appears to have become more firmly entrenched and the Eurozone economy looks less vulnerable to external shocks, this resilience cannot be taken for granted. It has been gained through policy-makers taking a more proactive and decisive approach. And this stance will need to be maintained, because there are more challenges on the horizon.

The next big test is the ECB's asset quality review (AQR) and the subsequent restructuring of the banking sector. The poor record of the previous stress-testing regime has meant that markets have relatively modest expectations for the AQR. At the very minimum, policy-makers must ensure that these expectations are met, so as not to threaten the current stability of the region.

ECB President Mario Draghi's recent assertion that some banks need to fail to demonstrate the credibility of the AQR at least suggests that the ECB is sensitive to these concerns. However, it must also be careful not to move too far in the opposite direction: if a bank has a viable business model, but is shown to need extra

capital in a stress scenario, it should not be forced to bail-in investors or the cost of bank funding will rise sharply. Furthermore, the degree to which failing banks will be able to raise capital from markets is very unclear, as is the capacity of governments to fund any remaining capital needs.

The threat of deflation could bring new risks

As well as adapting to its new banking-supervisory role, the ECB also needs to do more in terms of monetary policy. Eurozone inflation has been moving to worryingly low levels in recent months, reaching a four-year low of just 0.7% in October. The latest fall was driven mainly by falling energy prices but, at just 1%, core inflation (inflation excluding energy and unprocessed food) is also very weak. Furthermore, low inflation rates are not just prevalent in the peripheral economies, but also in the core countries.

Figure 8

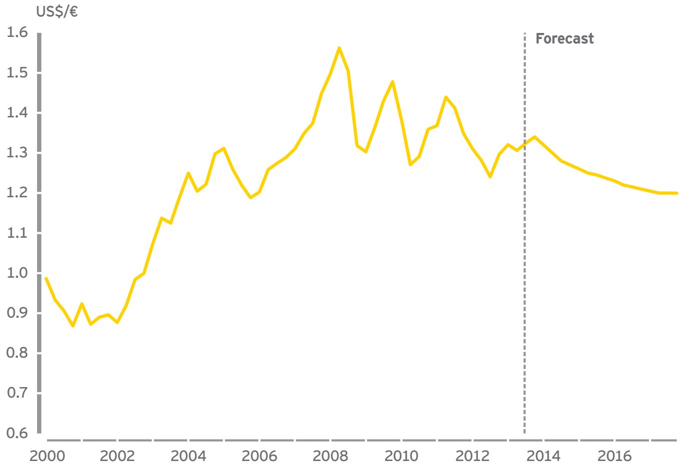
Inflation

Source: Haver Analytics.

Part of the reason for low inflation rates is the enduring strength of the euro, which climbed to a two-year high of US$1.38 in late October. We estimate that the euro is currently overvalued by around 10% compared with our estimates of an equilibrium value of the exchange rate. We are hopeful that some of this strength will unwind through 2014 as the US recovery gathers pace, causing growth differentials to widen, and as the Federal Reserve begins to taper its asset purchases. But such hopes have been disappointed before.

Figure 9

US$/€ exchange rate



Source: Oxford Economics.

If the euro does not depreciate, it will weigh on the recovery by constraining export competitiveness. And combined with the large negative output gap, this threatens to push inflation down further, opening up the threat of deflation.

Japan's experience over the past 15 years provides a stark warning of the risks of deflation and the difficulty of escaping it once it has set in. And such a scenario would be particularly undesirable given the high debt levels across the Eurozone. Deflation increases the level of debt in real terms and makes it harder to repay. So if the Eurozone were to slip into deflation, it could renew concerns about the solvency of the periphery and trigger a new phase of the crisis.

Monetary policy may need to be loosened further

These factors would have been central to the ECB's decision to cut the refinancing rate to 0.25% at its November meeting, a move that took markets by surprise. But the impact of this is likely to be more symbolic than practical and the ECB should still be looking to loosen monetary policy further. The deposit rate (the rate that the ECB pays on overnight deposits from banks) is already at zero and the ECB has discussed making this negative. However, this would be a risk because the reaction of banks to such a move is very uncertain. Alternative options would be another long-term refinancing operation, which could be used to boost bank liquidity and keep money-market interest rates low, or the ECB could actively try to talk down the value of the euro.

Economy to gather further momentum in 2014

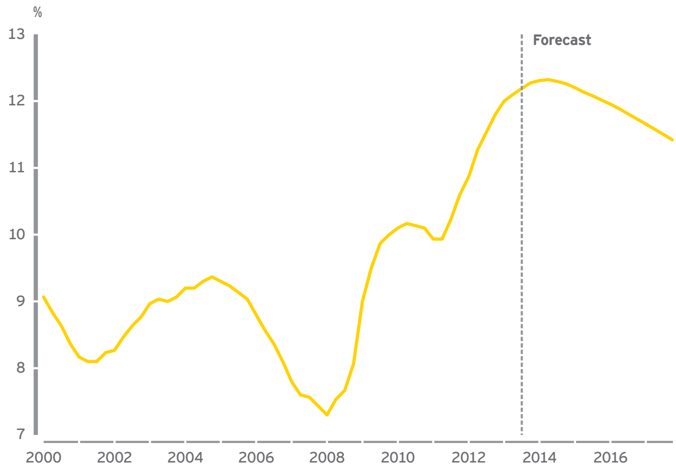
Concerns about the impact of a strong euro on exports act as a reminder of the dangers of relying on factors beyond the control of Eurozone governments and companies as the basis for recovery. Thus far, the efforts of policy-makers have been narrowly focused on fiscal consolidation and, while a program of broader reforms aimed at boosting competitiveness has often been mentioned, progress has been limited.

The labor market is set for a slow recovery

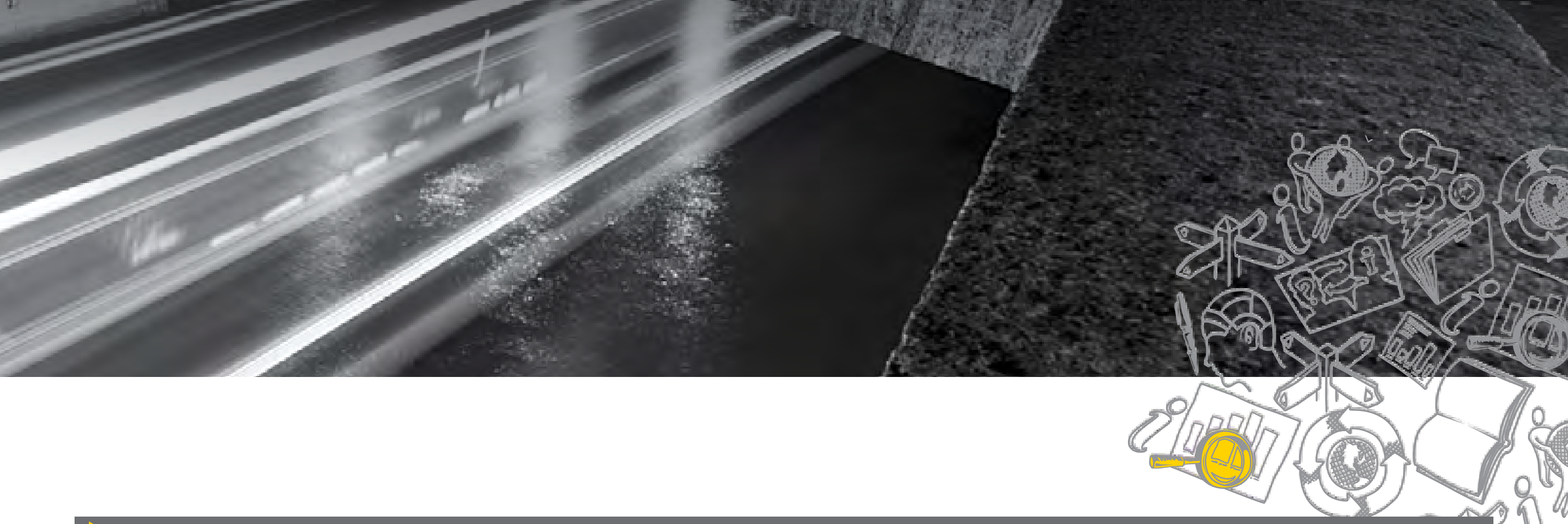
While the potential for credit conditions to tighten and for the euro to remain strong are downside risks, the labor market shows some encouraging signs. Recent data has been more encouraging, with the unemployment rate having been broadly flat at the Eurozone level over the latter part of 2013, and the countries with the highest rates of unemployment, such as Greece and Spain, reporting much smaller rises. Our forecast assumes that a relatively weak recovery, combined with businesses trying to improve profitability and productivity, mean that there will be further modest rises in unemployment in 2014. However, this may prove to be unduly pessimistic and a more favorable labor market outcome would offer the possibility of a firmer recovery in consumer spending.

Figure 10

Unemployment rate



Source: Oxford Economics.



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.

There has been a gentle acceleration in world GDP growth through 2013, with the annual growth rate moving from a three-year low of 1.7% in Q1, to 2.3% in Q3. This upturn has largely been led by the advanced economies, with the UK and Japan having enjoyed particularly strong pickups through the year. The US has also accelerated, but the pace of the upturn has disappointed, having been compromised by the prolonged political impasse caused by the budget and debt-ceiling problems, and also by market concerns about the prospect of the Federal Reserve tapering its asset purchases.

Meanwhile, the performance of the leading emerging markets has been patchy. While Chinese data has been better of late, several developing markets, most notably India and Brazil, have performed poorly. Their prospects have been undermined by a wave of risk aversion that brought sharp currency depreciations, equity market underperformance and rising bond yields.

We expect the combination of improving household finances, a stronger housing market and improved external competitiveness to accelerate US growth to an annualized rate in excess of 3% from Q2 2014 onwards. Though the recent deal only extended the debt ceiling until February, we think it unlikely that any party will be willing to repeat the October experience, and a more long-lasting deal looks likely. But residual uncertainty about the fiscal situation, plus the need to see a sustained run of stronger data, should see the Federal Reserve delaying tapering until March.

The UK recovery should continue to gain momentum as it broadens out into business investment and exports, and we expect growth of 1.4% in 2013 and 2.5% in 2014. The Japanese recovery should also become more firmly entrenched, although the planned rise in consumption tax is likely to cause growth to slow from 1.8% in 2013, to 1.6% in 2014.

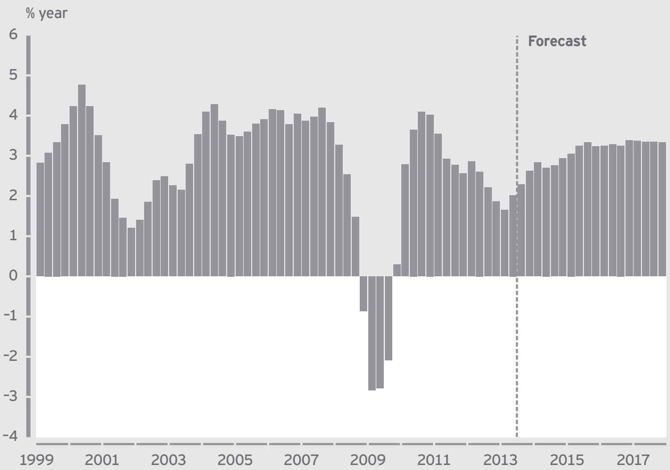
China's stronger recent performance has led us to revise our forecasts for 2013 and 2014 to 7.6% and 7.3% respectively, up from our September forecasts of 7.2% and 7.1%. Elsewhere, the developing world should benefit from stronger domestic demand in advanced economies, which is forecast to underpin a modest pickup in emerging market growth from 4.5% in 2013, to 4.7% in 2014. While this growth rate would be much stronger than that of the advanced economies, by historical standards it would be well below par for the emerging markets.

As a result, our forecast is for world GDP to grow by a lackluster 2.1% in 2013, before accelerating to 2.8% in 2014 and 3.3% a year from 2015–17. This growth profile will be echoed by a similar pickup in world trade growth, which is forecast to accelerate from 3.7% in 2013 to 5.5% in 2014.

After spiking above US$115 per barrel in late August, due to concerns about the situation in Syria, Brent crude oil prices have since stabilized below US$110 per barrel. Sluggish demand and ample supply should ensure that prices continue to fall in the short term, reaching US$102 per barrel by mid-2014. We expect prices to rise gradually from H2 2014, as the global recovery gains momentum. Brent oil prices are forecast to average US$107 a barrel in 2014–17, which is similar to the price we forecast in September.

Figure 11

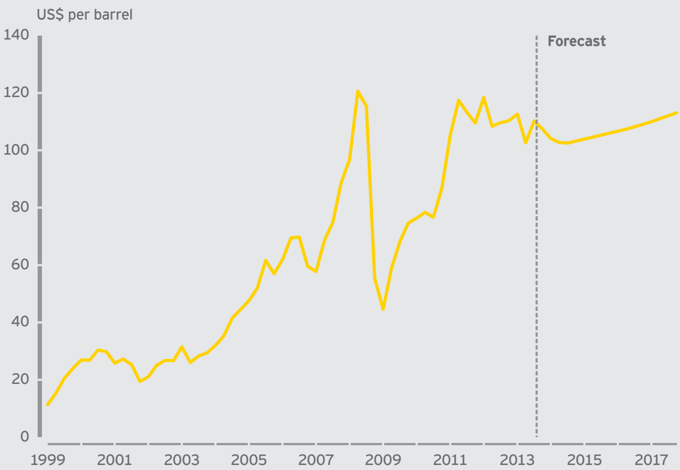
World: GDP growth



Source: Oxford Economics.

Figure 12

Oil price, nominal



Source: Oxford Economics.

Forecast for Eurozone countries

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

17 Eurozone countries

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Austria

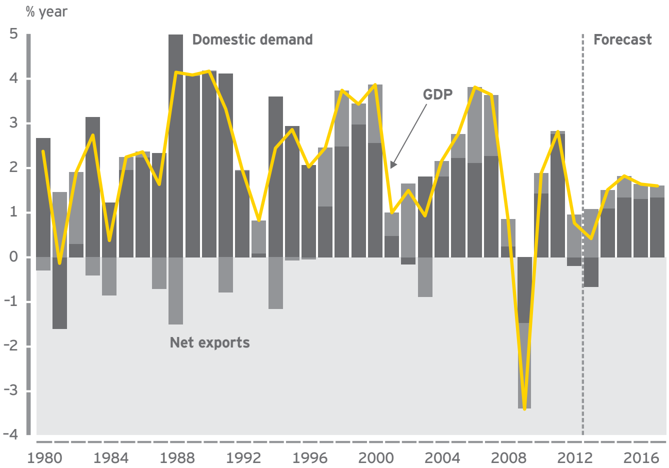
GDP growth

2014 1.6%

- The Austrian economy has accelerated in H2 2013, underpinned by gradual stabilization in the wider Eurozone. We expect GDP growth to accelerate to 1.6% in 2014, from an estimated 0.4% for 2013, as domestic demand strengthens alongside ongoing improvement in exports. For 2015–17, we forecast average GDP growth of about 1.7% a year.
- Stronger exports, helped also by good competitiveness and a high degree of specialization, will lift corporate confidence and stimulate business investment as capacity constraints are reached. After a fall of around 2.5% in 2013, investment should improve in 2014 and rise by 2%.
- Inflation fell below 2% in Q3 2013 and should stay below this level over the next few years. This will support household spending power as economy-wide real incomes rise. But consumer spending growth is likely to pick up only modestly, to 0.7% in 2014, before accelerating to a little over 1% a year in 2015–17.

Figure 13

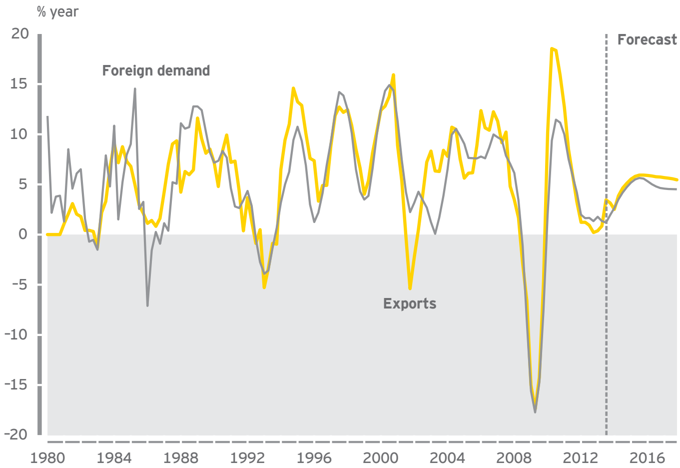
Contributions to GDP



Source: Oxford Economics.

Figure 14

Exports and foreign demand



Source: Oxford Economics.

Austria (annual percentage changes unless specified)

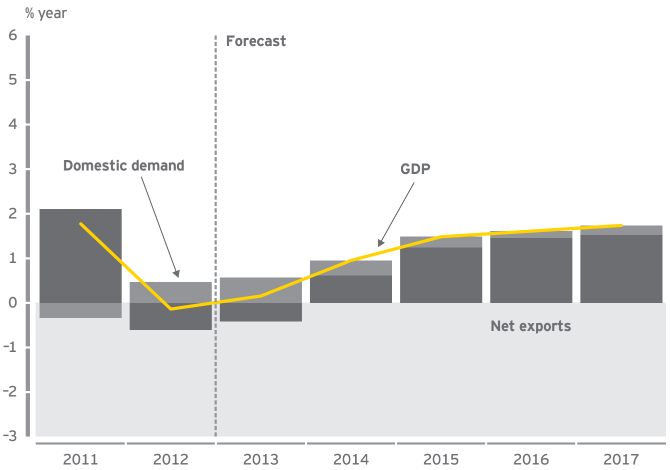
	2012	2013	2014	2015	2016	2017
GDP	0.6	0.4	1.6	1.8	1.6	1.6
Private consumption	0.3	-0.2	0.7	1.1	1.3	1.3
Fixed investment	1.7	-2.5	2.0	3.2	2.5	1.8
Stockbuilding (% of GDP)	0.8	0.5	0.6	0.4	0.2	0.2
Government consumption	0.0	1.0	1.4	1.6	1.6	1.6
Exports of goods and services	1.7	1.6	3.8	5.5	4.9	4.5
Imports of goods and services	0.0	-0.3	3.5	5.4	5.1	4.8
Consumer prices	2.6	2.1	1.8	1.8	1.8	1.8
Unemployment rate (level)	4.4	4.8	4.9	4.7	4.6	4.5
Current account balance (% of GDP)	1.6	2.8	3.4	3.3	3.3	3.2
Government budget (% of GDP)	-2.5	-2.4	-1.9	-1.0	-0.6	-0.6
Government debt (% of GDP)	74.0	74.9	74.7	73.1	71.3	69.6

Source: Oxford Economics.

Belgium

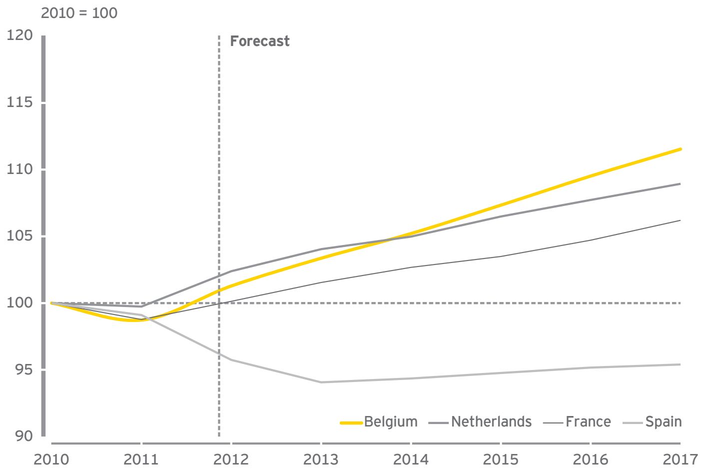
- Buoyed by a steadily improving Eurozone, Belgian firms and households are feeling more positive. In this context, GDP should grow by about 1% in 2014. This will be led by moderate consumer spending growth and a tentative pickup in business investment next year.
- It will take some time for unemployment to fall, however, constraining the pace of consumer spending growth. Eroded competitiveness will limit export growth, and a period of fiscal restraint is in order. As such, growth will be limited to around 1.6% a year in 2015–17.
- Belgium's outlook and its resilience to future economic shocks could be strengthened substantially with an ambitious program of economic reform. A recent Organisation for Economic Co-operation and Development (OECD) survey showed Belgium had the greatest potential gains in GDP in the OECD in this respect.

Figure 15
Contributions to GDP growth



Source: Oxford Economics.

Figure 16
Growth in manufacturing wage costs



Source: Oxford Economics.

Belgium (annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
GDP	-0.1	0.2	1.0	1.5	1.6	1.7
Private consumption	-0.3	0.5	1.0	1.3	1.5	1.5
Fixed investment	-2.0	-3.3	0.5	2.1	2.7	2.9
Stockbuilding (% of GDP)	1.0	0.8	0.6	0.6	0.5	0.4
Government consumption	1.4	0.7	0.5	0.7	0.9	1.1
Exports of goods and services	1.8	0.1	2.4	2.8	3.5	3.8
Imports of goods and services	1.3	-0.6	2.1	2.6	3.4	3.6
Consumer prices	2.6	1.3	1.8	2.0	2.0	2.0
Unemployment rate (level)	7.6	8.7	8.7	8.3	7.9	7.6
Current account balance (% of GDP)	-2.0	-3.0	-1.6	-1.6	-1.4	-1.2
Government budget (% of GDP)	-4.0	-3.2	-2.8	-2.4	-2.0	-1.7
Government debt (% of GDP)	99.8	103.2	105.9	107.8	108.9	109.5

Source: Oxford Economics.

Cyprus

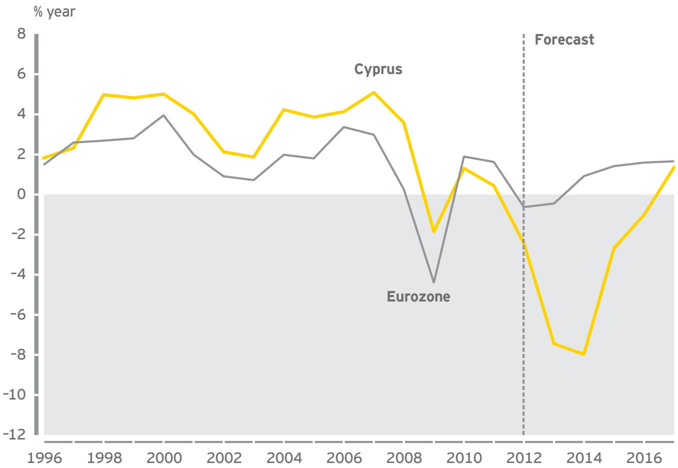
GDP growth

2014 **−8.0%**

- After a fall of 7.4% in 2013, GDP is expected to shrink by a further 8% in 2014 and 2.7% in 2015, against a backdrop of weak consumer and investor confidence, soaring unemployment and a credit crunch. The economy is forecast to return to growth in 2017, but, given the scale of the crisis, economic activity will be some 20% lower than the pre-crisis peak.
- Household income will continue to plunge due to fiscal consolidation and job losses. As a result, we expect consumer spending to decline throughout 2013–17. The outlook for investment remains bleak, because of the malfunctioning financial system, low confidence and capital controls, and is not expected to improve quickly given the scale of the crisis in the financial sector.
- Even with such dismal prospects, the downside risks remain considerable. Further private sector defaults would weaken bank balance sheets and increase recapitalization needs, while high unemployment would undermine fiscal consolidation efforts by cutting tax revenues and forcing up social transfers.

Figure 17

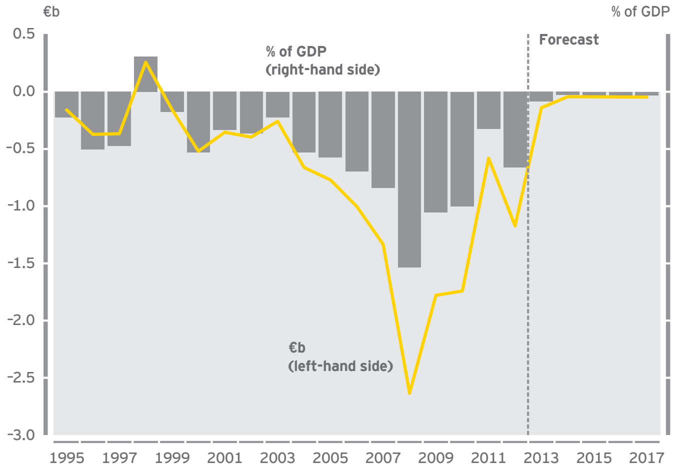
Real GDP growth



Source: Oxford Economics.

Figure 18

Current account balance



Source: Oxford Economics.

Cyprus (annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
GDP	-2.4	-7.4	-8.0	-2.7	-1.0	1.4
Private consumption	-2.5	-10.4	-9.5	-6.6	-3.7	-0.4
Fixed investment	-19.6	-34.0	-33.5	-3.4	1.4	6.3
Stockbuilding (% of GDP)	1.3	-1.9	-1.2	0.0	0.4	0.5
Government consumption	-3.1	-4.9	-8.9	-6.5	0.5	1.0
Exports of goods and services	-2.7	6.8	1.7	3.9	4.5	5.1
Imports of goods and services	-6.4	-11.5	-4.0	0.5	4.2	4.6
Consumer prices	3.1	0.8	0.8	1.1	1.2	1.5
Unemployment rate (level)	11.9	18.7	24.1	25.3	25.0	22.2
Current account balance (% of GDP)	-6.6	-0.8	-0.3	-0.3	-0.3	-0.3
Government budget (% of GDP)	-6.4	-8.4	-8.3	-7.5	-6.6	-5.6
Government debt (% of GDP)	86.6	121.0	164.5	194.2	200.5	200.5

Source: Oxford Economics.

Estonia

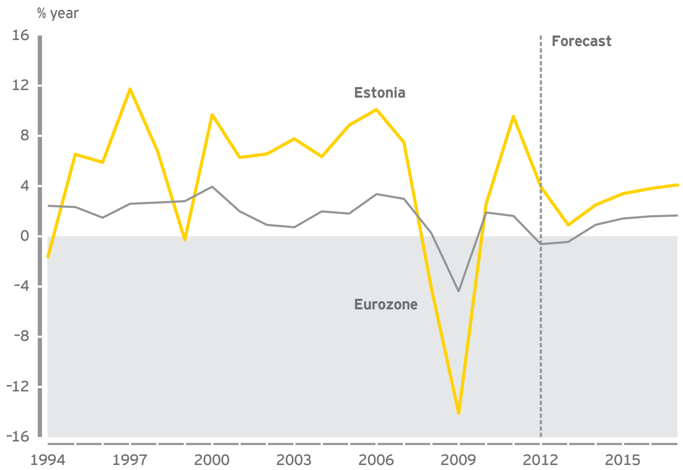
GDP growth

2014 **2.5%**

- GDP growth is expected to accelerate to 2.5% in 2014. This will be driven by external demand, as consumption, which has been the main engine of growth so far this year, slows. An improvement in economic conditions in Estonia's main trading partners (Finland, Russia and Sweden) will boost exports.
- Investment is forecast to rebound strongly in 2014, as firms react to the increase in demand from abroad and extend their productive capacity. The public sector will help too: the 2014 budget has announced an increase in public investment of 8.9%. After a fall of 3.2% in 2013, investment growth should pick up to 5%-6% a year in 2014-17.
- We expect inflation to average about 3% in 2014-17, although high wage growth without corresponding productivity increases represents a significant upside risk.

Figure 19

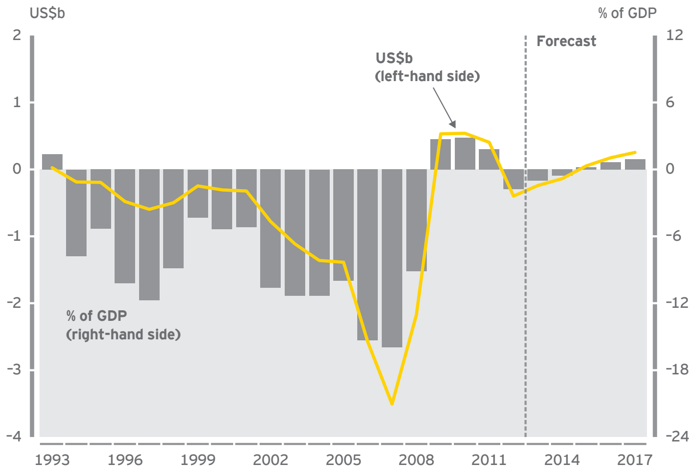
Real GDP growth



Source: Oxford Economics.

Figure 20

Current account balance



Source: Oxford Economics.

Estonia (annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
GDP	3.9	0.9	2.5	3.4	3.8	4.1
Private consumption	4.9	4.2	3.4	3.7	3.9	4.0
Fixed investment	10.9	-3.2	6.2	5.5	5.5	5.3
Stockbuilding (% of GDP)	3.2	2.6	1.7	1.8	1.4	1.9
Government consumption	3.8	0.8	0.3	2.7	3.0	3.0
Exports of goods and services	5.6	5.3	7.9	8.5	9.5	8.2
Imports of goods and services	8.8	5.2	8.0	9.2	9.4	8.6
Consumer prices	3.9	2.9	2.9	3.0	3.1	3.2
Unemployment rate (level)	10.1	8.2	7.6	7.2	6.6	6.1
Current account balance (% of GDP)	-1.8	-1.0	-0.6	0.2	0.7	0.9
Government budget (% of GDP)	-0.2	-0.1	0.0	0.1	0.1	0.0
Government debt (% of GDP)	9.8	10.9	10.5	9.7	9.0	8.4

Source: Oxford Economics.

Finland

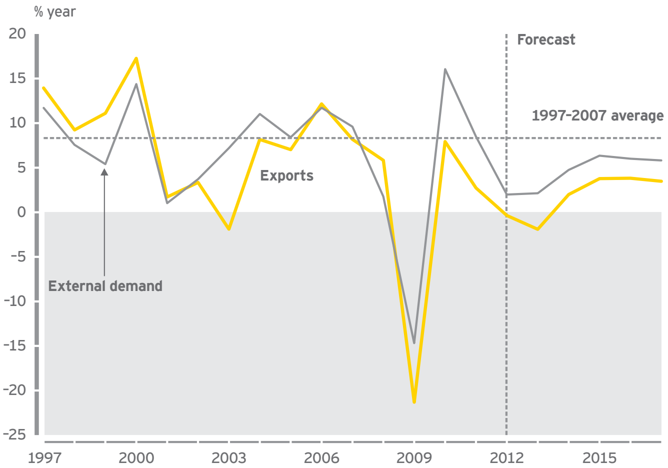
GDP growth

2014 **1.3%**

- The economy returned to growth in Q2 2013, but broad-based weaknesses will take some time to resolve, resulting in a slow recovery over the medium term. GDP is expected to grow by 1.3% in 2014 and then by just over 2% a year in 2015–17.
- The recession has precipitated the structural decline of key sectors and revealed a lack of diversification in Finland's export base. And the economy is heavily exposed to the fragile recovery in the Eurozone. Exports are forecast to grow by over 3.5% a year in 2015–17, but will remain some way below pre-crisis levels.
- Highly indebted households need to deleverage over the medium term, and we expect a steady increase in the savings ratio as a result. This factor will combine with further modest wage increases in an environment of relatively low growth. As a result, private consumption growth is forecast at only 2.1% a year in 2015–17.

Figure 21

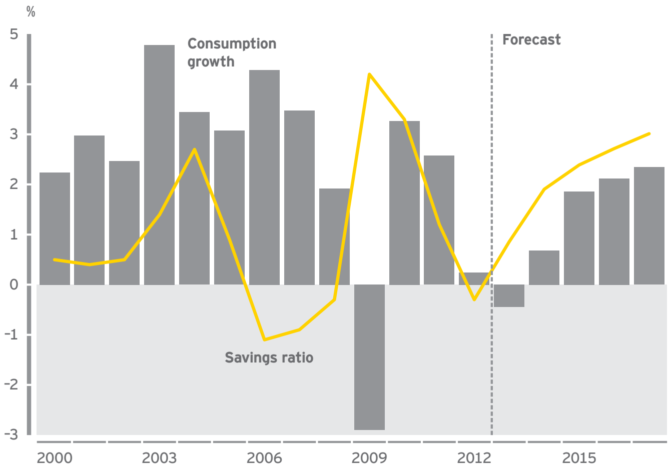
Exports and external demand



Source: Oxford Economics.

Figure 22

Private consumption and savings



Source: Oxford Economics.

Finland (annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
GDP	-0.8	-1.1	1.3	2.0	2.2	2.3
Private consumption	0.2	-0.4	0.7	1.9	2.1	2.3
Fixed investment	-1.0	-1.4	0.4	2.5	3.4	3.0
Stockbuilding (% of GDP)	1.1	-1.2	-0.1	-0.1	-0.2	-0.2
Government consumption	0.6	0.6	0.7	1.1	1.3	1.4
Exports of goods and services	-0.4	-1.9	2.0	3.8	3.8	3.5
Imports of goods and services	-1.2	-5.9	3.3	3.6	4.0	3.7
Consumer prices	3.2	2.0	1.0	1.6	1.9	1.9
Unemployment rate (level)	7.7	8.1	8.0	7.8	7.6	7.3
Current account balance (% of GDP)	-1.7	-0.7	0.2	0.5	0.7	1.0
Government budget (% of GDP)	-1.8	-3.2	-4.1	-3.5	-2.7	-1.8
Government debt (% of GDP)	53.6	56.6	59.2	60.6	60.9	60.3

Source: Oxford Economics.

France

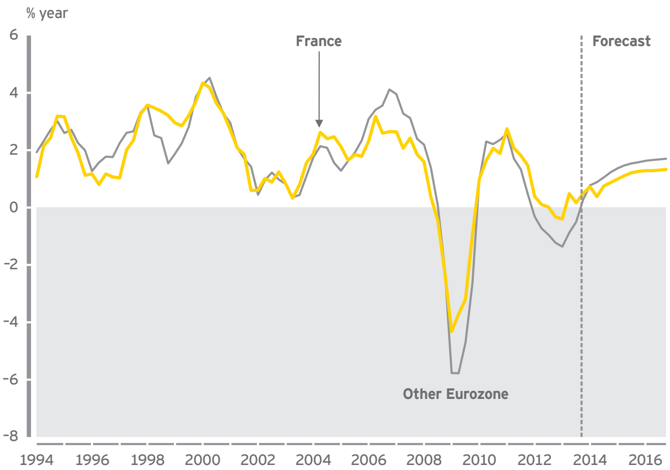
GDP growth

2014 0.7%

- France is recovering steadily, albeit slowly. We forecast GDP will grow by 0.7% in 2014, up from just 0.2% in 2013, and by around 1.3% a year in 2015–17.
- The recovery will be supported by a reduced drag from fiscal consolidation. The 2014 budget also marks a significant shift from a focus on raising revenues to cutting spending, marking a positive move toward creating a more business-friendly environment.
- The external sector will help drive faster growth than in 2012 and 2013. But the domestic economy will be slower to recover. Private consumption will be constrained by low growth in purchasing power and businesses are likely to show some caution about expanding investment.

Figure 23

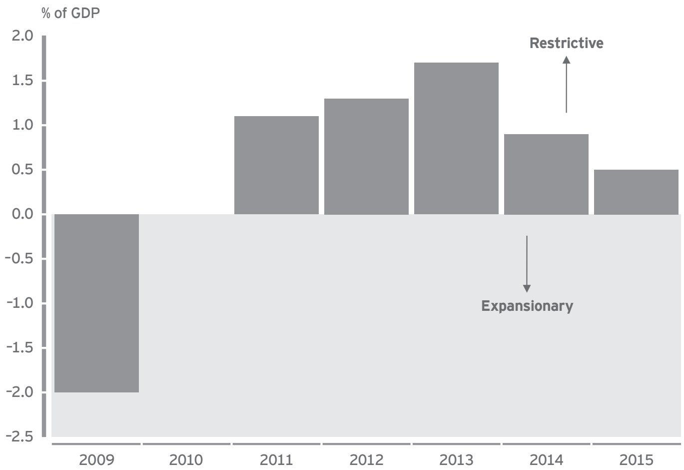
GDP growth: France vs. rest of Eurozone



Source: Oxford Economics.

Figure 24

Fiscal tightening



Source: Oxford Economics.

France (annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
GDP	0.0	0.2	0.7	1.1	1.3	1.4
Private consumption	-0.3	0.4	1.0	1.1	1.2	1.3
Fixed investment	-1.2	-2.4	-0.2	1.4	1.9	2.0
Stockbuilding (% of GDP)	-0.2	0.0	0.3	0.4	0.4	0.4
Government consumption	1.4	1.7	0.5	0.4	0.7	0.9
Exports of goods and services	2.5	0.2	2.3	3.9	4.1	4.1
Imports of goods and services	-0.9	1.1	3.2	3.4	3.5	3.5
Consumer prices	2.2	1.0	1.1	1.3	1.6	1.6
Unemployment rate (level)	10.3	11.0	11.2	11.1	10.9	10.6
Current account balance (% of GDP)	-2.2	-1.9	-2.0	-2.0	-2.1	-2.0
Government budget (% of GDP)	-4.8	-4.2	-3.8	-3.1	-2.4	-2.0
Government debt (% of GDP)	90.3	95.5	99.5	103.0	104.8	105.4

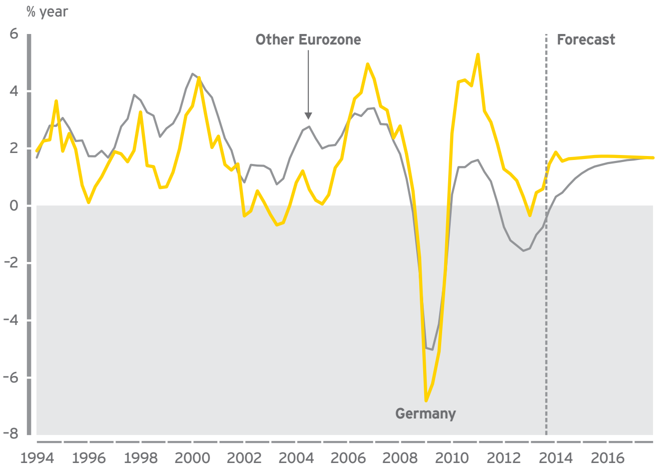
Source: Oxford Economics.

Germany

GDP growth
2014 **1.7%**

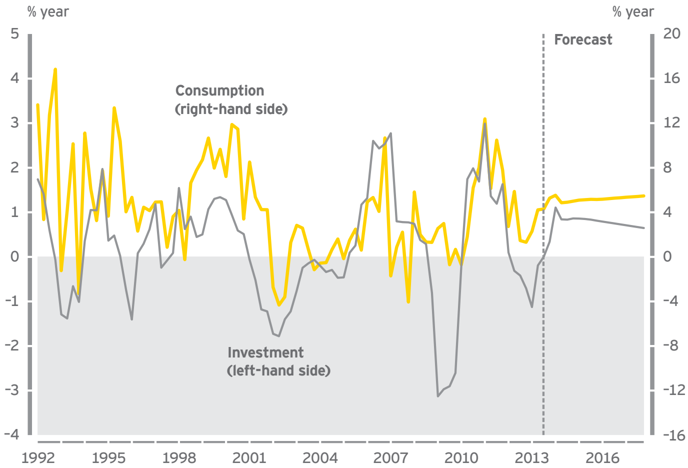
- The German economy is expected to grow by 0.5% in 2013 and 1.7% in 2014, significantly outpacing the rest of the Eurozone. Household consumption will be the key growth driver in the short term. As unemployment stabilizes at historically low levels, wages will continue to rise strongly. Net immigration reached a 17-year high in 2012.
- Households will also benefit from a revival of the housing market. After years of stagnating prices, the house price index was up 6.6% year-on-year in Q3. As a result, the rebound of construction investment in Q2 is likely to continue and the construction sector will act as a catalyst for private investment in the short term.
- As external demand also picks up in the medium term, we expect GDP to increase by 1.7% a year in 2015–17. However, downside risks to our export forecasts stem from continued disappointing growth in emerging markets and a strengthening euro.

Figure 25
GDP growth: Germany vs. rest of Eurozone



Source: Oxford Economics.

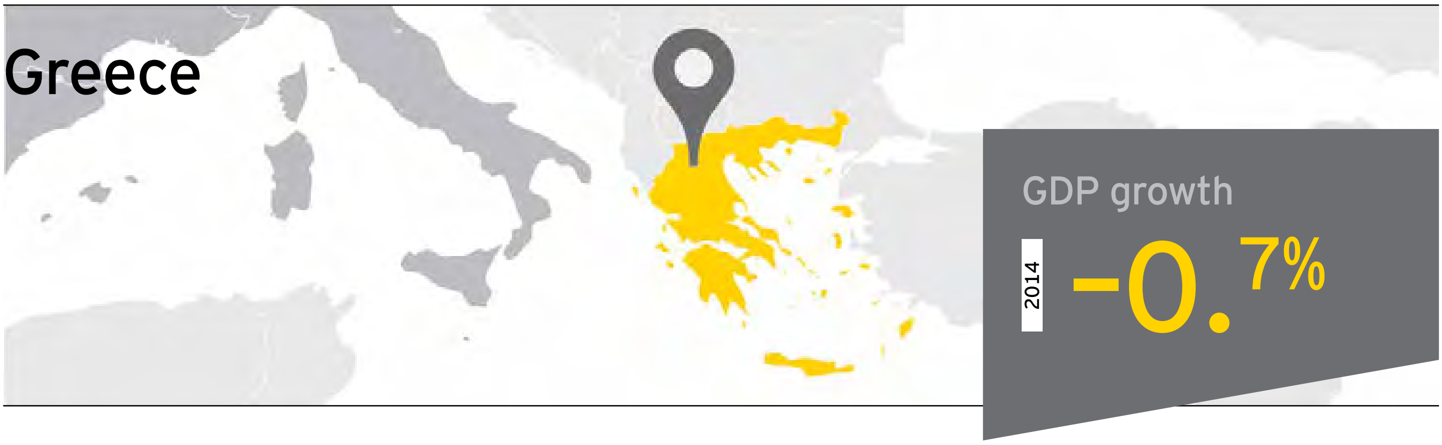
Figure 26
Consumption and investment



Source: Oxford Economics.

Germany (annual percentage changes unless specified)	2012	2013	2014	2015	2016	2017
GDP	0.9	0.5	1.7	1.7	1.7	1.7
Private consumption	0.7	1.0	1.3	1.3	1.3	1.4
Fixed investment	-1.3	-1.0	3.6	3.4	3.0	2.7
Stockbuilding (% of GDP)	-0.1	0.1	0.1	0.1	0.1	0.1
Government consumption	1.0	0.9	0.8	0.7	0.7	0.8
Exports of goods and services	3.8	0.6	3.8	4.5	4.7	4.5
Imports of goods and services	1.8	1.2	4.0	4.7	4.8	4.6
Consumer prices	2.1	1.6	1.5	1.6	1.7	1.7
Unemployment rate (level)	5.5	5.3	5.2	5.2	5.1	5.1
Current account balance (% of GDP)	7.0	7.0	6.9	6.7	6.7	6.6
Government budget (% of GDP)	0.1	0.0	0.0	0.0	0.0	0.0
Government debt (% of GDP)	81.0	79.8	79.3	79.6	79.7	79.8

Source: Oxford Economics.



Greece

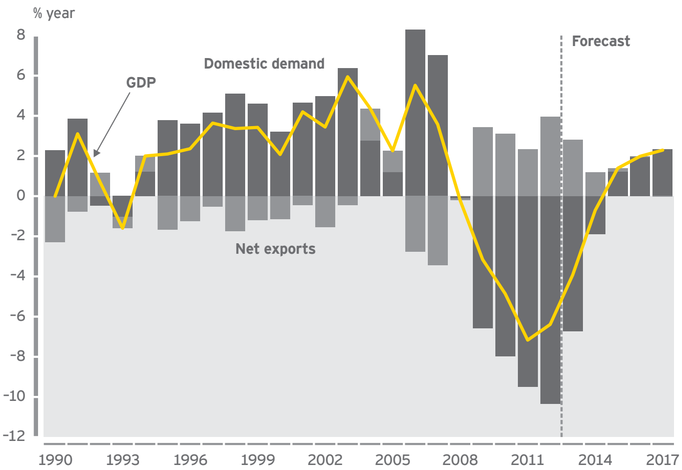
GDP growth

2014 –0.7%

- The Greek economy is slowly stabilizing and authorities have made significant progress in rectifying pre-crisis imbalances. Indeed, the pace of GDP decline has begun to ease and confidence indicators have strengthened a little in 2013. But the outlook remains fragile and there are still many risks to the recovery, not least the potentially destabilizing impact of strong deflationary pressures.
- We do not expect the recovery to materialize until late in 2014. With households' disposable income forecast to fall by some 3% in real terms in 2014, high unemployment and the large output gap continue to apply downward pressure on wages. Private consumption will keep falling in the short term as a result, crowding out any small positive contribution in net exports arising from a cyclical upturn in external demand.
- Structural reform and falling labor costs are improving Greek exporters' competitiveness. This should mean that foreign demand will begin to drive growth. But with the debt burden rising toward 170% of GDP, interest payments will impede recovery unless Greece can negotiate a further debt-relief package with its European partners.

Figure 27

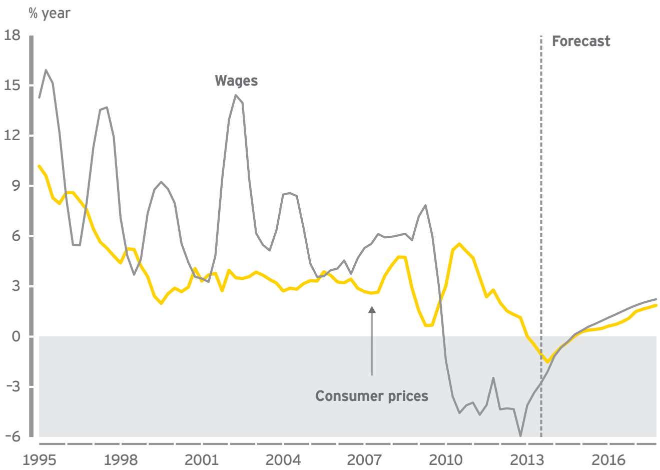
Contributions to GDP growth



Source: Oxford Economics.

Figure 28

Prices and wages



Source: Oxford Economics.

Greece (annual percentage changes unless specified)	2012	2013	2014	2015	2016	2017
GDP	-6.4	-3.9	-0.7	1.4	2.0	2.3
Private consumption	-9.1	-7.1	-2.3	1.3	1.6	1.6
Fixed investment	-19.4	-9.7	1.9	5.4	5.8	6.1
Stockbuilding (% of GDP)	0.0	1.0	1.2	0.9	0.6	0.6
Government consumption	-4.3	-6.6	-4.5	-0.6	1.7	1.7
Exports of goods and services	-2.1	-0.4	3.7	4.1	3.9	3.8
Imports of goods and services	-13.8	-9.8	-0.8	3.4	3.7	3.8
Consumer prices	1.0	-0.7	-0.5	0.4	0.8	1.7
Unemployment rate (level)	24.3	27.4	28.0	27.6	26.7	25.6
Current account balance (% of GDP)	-2.4	-1.0	-2.1	-1.6	-1.5	-1.3
Government budget (% of GDP)	-8.9	-5.0	-3.9	-3.0	-2.5	-2.1
Government debt (% of GDP)	151.4	164.0	169.0	167.4	163.6	159.2

Source: Oxford Economics.

Ireland

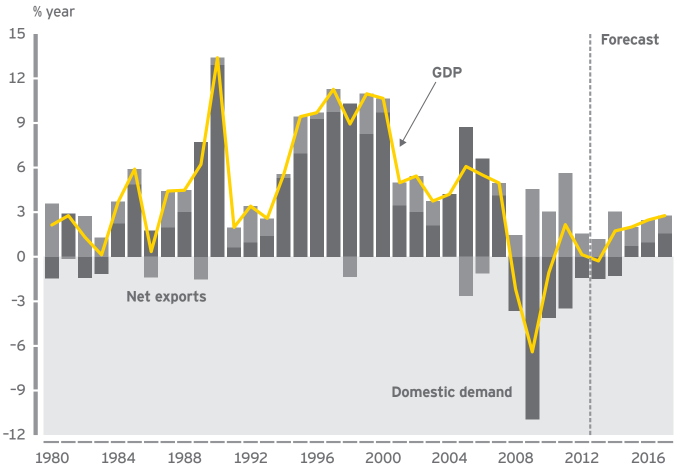
GDP growth

2014 1.7%

- The Irish economy returned to growth in Q2 2013, after three successive quarters of decline. However, the pace of growth was slightly weaker than expected and suggests there will be a decline of 0.3% in GDP for 2013 as a whole. But looking ahead, net trade is on track to contribute strongly to growth, while domestic demand is likely to start increasing as well. As such, we expect growth to accelerate to 1.7% in 2014 and 2% in 2015.
- The bailout from the EU and the International Monetary Fund expired in November 2013 and the Government is likely to be able to fund itself fully with market financing from now on. It has indicated that it may apply for a precautionary credit line from its international lenders, but is wary of accepting any further stringent conditions related to fiscal and economic reforms.
- But the banking sector poses a downside risk to the forecast. The central bank is carrying out stress tests on Irish banks, the results of which will form the basis of Ireland's bailout exit. We expect the results to be favorable, but if they are not, it could cause significant financial stress, which would limit growth.

Figure 29

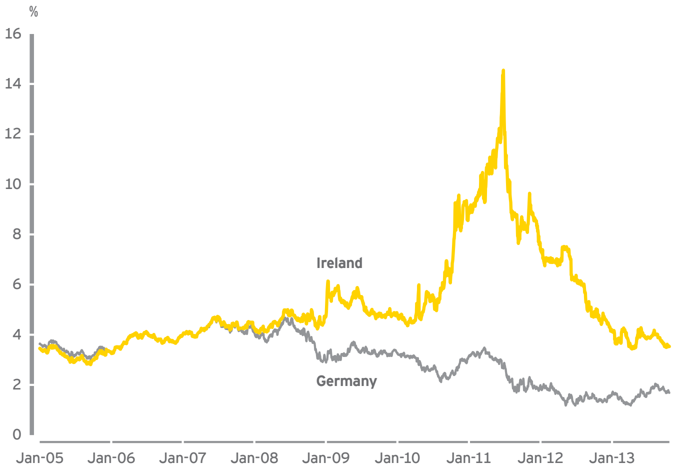
Contributions to GDP growth



Source: Oxford Economics.

Figure 30

Long-term government bond yields



Source: Oxford Economics; Haver Analytics.

Ireland (annual percentage changes unless specified)

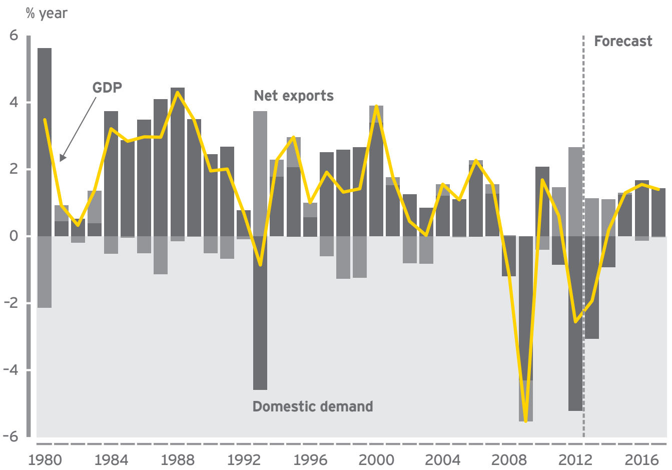
	2012	2013	2014	2015	2016	2017
GDP	0.1	-0.3	1.7	2.0	2.5	2.8
Private consumption	-0.3	-1.8	-0.2	0.8	1.0	1.8
Fixed investment	-0.7	-9.5	5.1	5.9	5.0	6.0
Stockbuilding (% of GDP)	0.2	0.5	0.0	0.0	0.0	0.0
Government consumption	-3.8	-1.8	-1.9	-1.5	-0.2	0.6
Exports of goods and services	1.6	0.6	3.0	3.1	4.0	4.0
Imports of goods and services	0.0	-0.7	0.2	2.5	3.5	3.9
Consumer prices	1.9	0.5	1.4	2.0	1.9	1.9
Unemployment rate (level)	14.7	13.7	12.9	11.9	10.9	10.2
Current account balance (% of GDP)	4.4	4.9	4.4	4.3	4.1	4.0
Government budget (% of GDP)	-8.1	-7.6	-5.1	-3.0	-1.9	-1.1
Government debt (% of GDP)	117.4	125.7	126.7	125.2	122.2	118.3

Source: Oxford Economics.

Italy

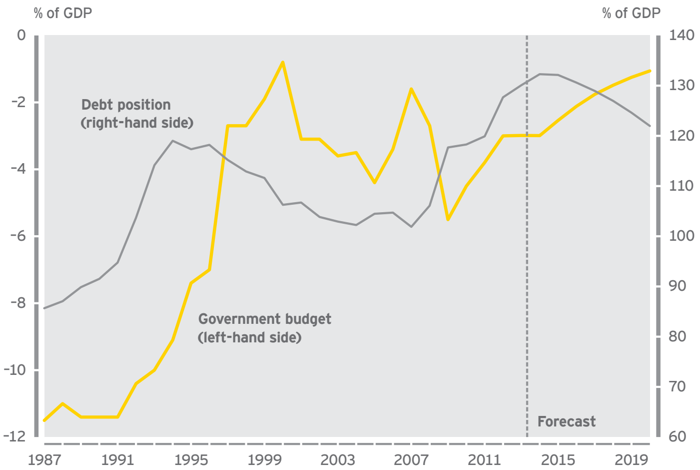
- GDP will decline by almost 2% in 2013, dragged down by a contraction of domestic demand. The recovery from 2014 will be driven by a pickup in export growth. However, it will be very gradual — we expect GDP growth of just 0.2% in 2014 and 1.4% a year in 2015–17.
- Rising exports will lift investment in 2014, but tight credit constraints and a lot of spare capacity are expected to keep investment growth below 1%. Moreover, high unemployment and fiscal consolidation imply consumption will continue to decline in the short term. Meanwhile, the Government has little room for easing austerity in 2014, as public debt rises above 130% of GDP.
- Several downside risks weigh on our baseline forecast. A vicious circle of rising bad debts, tightening credit conditions and recession risks driving the economy to a credit crunch, while political instability remains unresolved. In the shorter term, a pickup in external demand is necessary to avoid another year of recession.

Figure 31
Contributions to GDP growth



Source: Oxford Economics.

Figure 32
Government balance and debt



Source: Oxford Economics.

Italy (annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
GDP	-2.6	-1.9	0.2	1.3	1.5	1.4
Private consumption	-4.1	-2.5	-0.7	0.8	1.2	1.3
Fixed investment	-8.4	-5.6	0.7	2.2	2.4	2.5
Stockbuilding (% of GDP)	-0.2	-0.7	-1.1	-0.7	-0.1	0.1
Government consumption	-2.7	-0.5	-1.5	0.1	0.2	0.2
Exports of goods and services	1.9	0.0	3.6	4.2	4.1	3.9
Imports of goods and services	-7.5	-4.2	0.0	4.9	5.3	4.7
Consumer prices	3.3	1.3	0.9	1.2	1.2	1.3
Unemployment rate (level)	10.7	12.2	12.8	12.6	12.0	11.5
Current account balance (% of GDP)	-0.4	0.6	1.1	0.8	0.5	0.3
Government budget (% of GDP)	-3.0	-3.0	-3.0	-2.5	-2.1	-1.8
Government debt (% of GDP)	127.0	131.5	133.7	133.0	131.4	129.6

Source: Oxford Economics.

Luxembourg

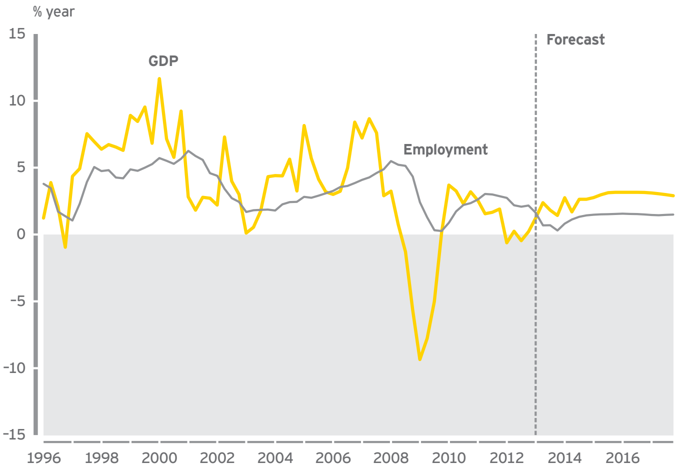
GDP growth

2014 **2.4%**

- GDP growth is seen at 1.7% in 2013 and will benefit from a favorable starting point. As the external environment improves further and private consumption strengthens, growth should accelerate to 2.4% in 2014. For 2015–17, we forecast average GDP growth of just over 3% a year.
- The initial growth impetus for the recovery will come from services exports – financial and non-financial, and especially communications – as they will be able to lock into demand from the gradually strengthening Eurozone earlier than sectors that export goods. This will be reflected in relatively strong export growth of around 5.5% in 2014.
- With government debt equal to only 22% of GDP in 2013, Luxembourg's medium-term fiscal position remains sound, despite the risk of a deterioration from 2015, due to the introduction of new EU rules on value-added tax (VAT) in e-commerce. These will become a challenge to the public finances when gradually increasing shares of VAT revenues from e-commerce activities are transferred to the countries where customer purchases are made.

Figure 33

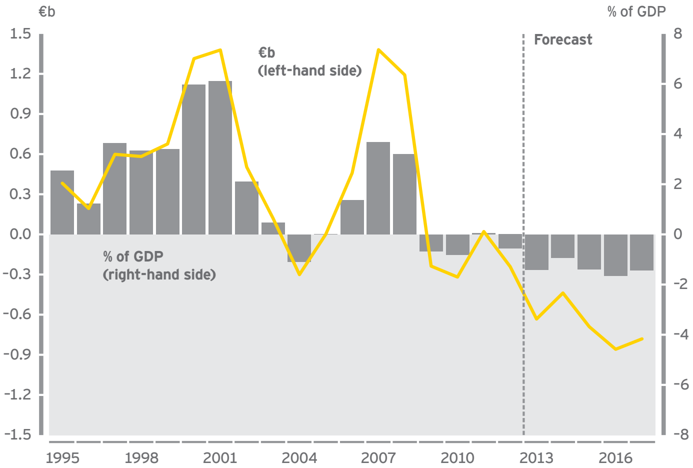
Real GDP and employment



Source: Oxford Economics.

Figure 34

Government budget balance



Source: Oxford Economics.

Luxembourg (annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
GDP	-0.2	1.7	2.4	3.0	3.2	3.0
Private consumption	2.2	1.0	1.8	2.8	2.9	2.7
Fixed investment	3.5	2.7	4.8	2.8	2.6	3.0
Stockbuilding (% of GDP)	3.1	2.1	0.8	0.5	0.5	0.5
Government consumption	4.8	2.4	1.8	1.9	1.9	1.9
Exports of goods and services	-1.9	2.9	5.5	5.8	4.6	3.6
Imports of goods and services	-1.0	2.4	5.3	5.9	4.6	3.5
Consumer prices	2.9	1.8	2.0	2.0	2.0	2.0
Unemployment rate (level)	5.1	5.8	6.2	5.9	5.5	4.9
Current account balance (% of GDP)	6.6	4.4	5.3	5.8	6.1	6.2
Government budget (% of GDP)	-0.6	-1.4	-0.9	-1.4	-1.6	-1.4
Government debt (% of GDP)	21.7	22.0	22.0	22.3	22.8	23.1

Source: Oxford Economics.

Malta

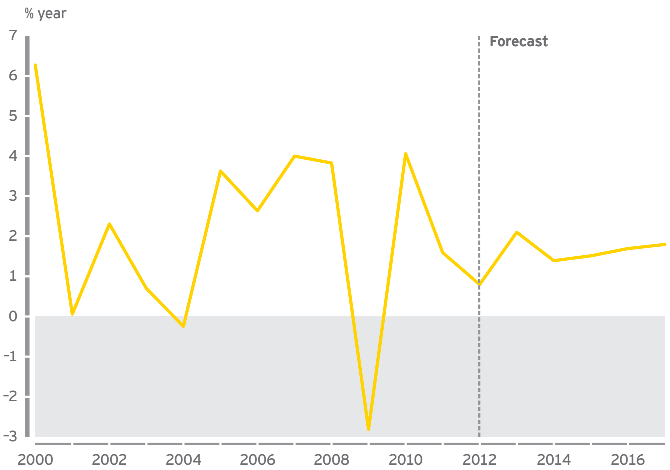
GDP growth

2014 1.4%

- GDP growth is now forecast at 2.1% in 2013, largely driven by net trade, before slowing to 1.4% in 2014. Expansion is still forecast to average 1.6% a year in 2015-17 — relatively low by previous standards, but still above the Eurozone average.
- Inflation, at just 0.5% in September, has dropped below the Eurozone average. It is forecast to rise to 1.3% in 2014 and to over 2% in the medium term, pushed up partly by indirect tax rises, as the Government seeks to reduce the budget deficit.
- The fiscal deficit is forecast to peak at 3.4% of GDP this year and to narrow only gradually, not dropping below 3% of GDP until 2016. Besides higher indirect taxes in 2014, the narrowing of the deficit will also be helped by higher growth, which will lift revenues and reduce social spending.

Figure 35

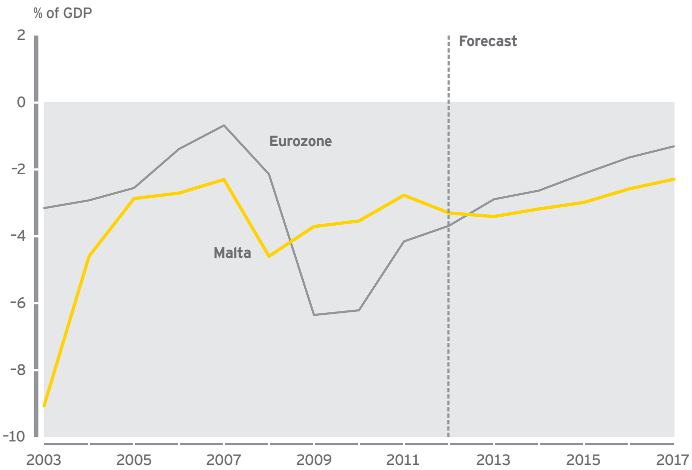
GDP



Source: Oxford Economics.

Figure 36

Fiscal balance vs. Eurozone



Source: Oxford Economics.

Malta (annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
GDP	0.8	2.1	1.4	1.5	1.7	1.8
Private consumption	1.5	-3.3	2.2	1.4	1.5	1.7
Fixed investment	-3.2	-7.5	4.0	2.9	2.9	2.5
Stockbuilding (% of GDP)	-1.3	0.7	0.0	0.3	0.5	0.7
Government consumption	5.9	-0.7	0.5	0.8	1.3	1.4
Exports of goods and services	5.6	-1.6	4.1	3.1	2.7	2.8
Imports of goods and services	5.5	-5.3	4.2	3.5	3.0	3.0
Consumer prices	3.2	1.0	1.3	1.7	2.0	2.3
Unemployment rate (level)	6.4	6.4	6.1	5.9	5.7	5.5
Current account balance (% of GDP)	1.0	0.6	0.3	0.2	0.2	0.1
Government budget (% of GDP)	-3.3	-3.4	-3.2	-3.0	-2.6	-2.3
Government debt (% of GDP)	71.3	72.6	73.8	74.5	74.4	73.8

Source: Oxford Economics.

Netherlands

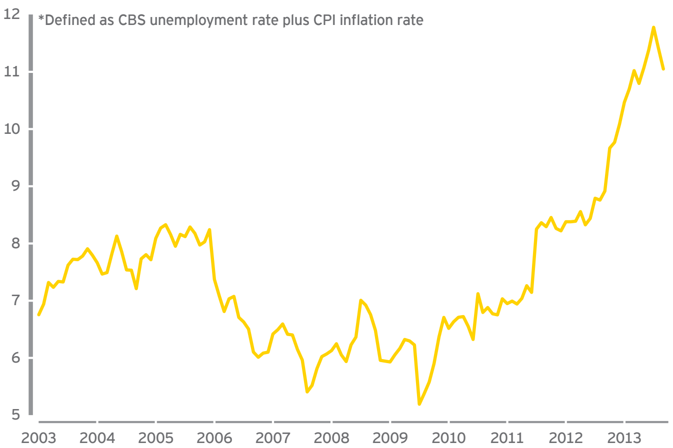
GDP growth

2014 0.3%

- After four consecutive quarters of contraction, the Netherlands returned to growth in Q3 2013, boosted by an improvement in net trade. But GDP is still seen contracting by 1.1% in 2013, before growing by just 0.3% in 2014 and 0.8% in 2015, as improving exports begin to feed through the economy, boosting production and lifting employment growth.
- However, the recently agreed budget deal is expected to dampen GDP growth in 2014. In addition, ongoing deleveraging by households and poor credit conditions will also limit domestic demand.
- Over the medium term, growth is likely to be constrained by deleveraging across the household, corporate and government sectors. The household sector, which is the most heavily indebted in Europe, has suffered from falling house prices and rising unemployment As a result, we expect GDP growth to average just 1.2% in 2015-17.

Figure 37

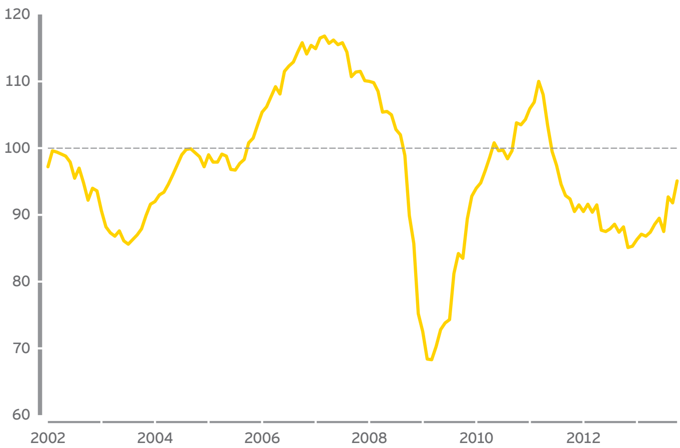
Misery index*



Source: Haver Analytics.

Figure 38

Economic sentiment indicator



Source: Haver Analytics.

Netherlands (annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
GDP	-1.3	-1.1	0.3	0.8	1.3	1.6
Private consumption	-1.6	-1.9	-0.6	0.3	0.8	1.3
Fixed investment	-4.0	-8.0	0.9	1.9	2.2	2.1
Stockbuilding (% of GDP)	1.0	0.5	0.3	0.2	0.2	0.2
Government consumption	-0.7	-0.9	-0.6	-0.4	-0.1	0.5
Exports of goods and services	3.2	2.0	2.8	3.4	3.4	3.2
Imports of goods and services	3.3	-0.5	2.5	3.2	3.2	3.1
Consumer prices	2.8	2.9	1.4	1.1	1.1	1.1
Unemployment rate (level)	5.3	6.7	7.3	7.3	7.1	6.9
Current account balance (% of GDP)	9.4	11.3	9.8	8.8	8.8	8.9
Government budget (% of GDP)	-4.1	-3.1	-3.2	-2.6	-2.1	-2.0
Government debt (% of GDP)	71.3	74.2	76.7	78.1	78.5	78.5

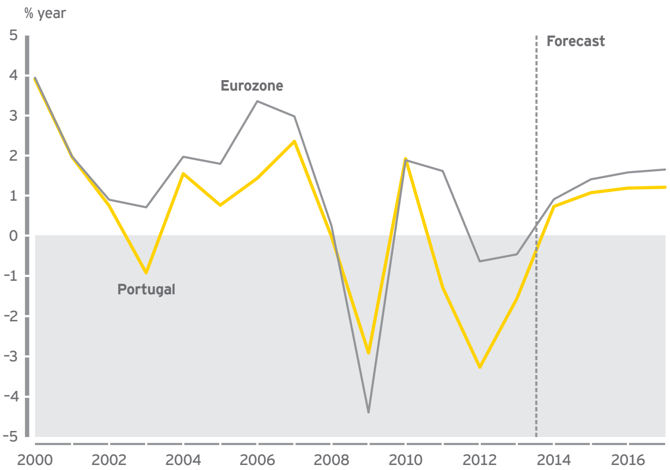
Source: Oxford Economics.

Portugal

- The Portuguese economy is expected to return to growth in 2014. We forecast expansion of 0.7% after a contraction of 1.6% in 2013. Further ahead, the recovery is likely to be slow, due to a combination of a debt overhang and financial fragmentation. As a result, we forecast GDP growth of just 1.2% a year in 2015–17.
- Portugal may miss its targets for the budget deficit in the coming years, as the Government's ability to cut spending in certain areas could be limited by the constitutional court. But the Government will probably be given more time to reconcile fiscal discipline and economic growth.
- We believe that Portugal may need to request further external assistance in the form of a precautionary program with the Eurozone's rescue fund.

Figure 39

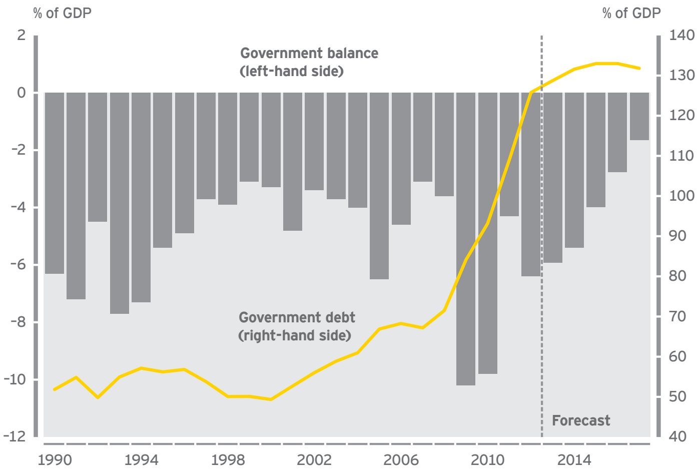
Real GDP growth



Source: Oxford Economics.

Figure 40

Government balance and debt



Source: Oxford Economics.

Portugal (annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
GDP	-3.3	-1.6	0.7	1.1	1.2	1.2
Private consumption	-5.4	-1.8	0.6	0.6	0.6	0.7
Fixed investment	-14.3	-8.6	0.5	1.6	2.4	2.3
Stockbuilding (% of GDP)	0.5	1.0	0.4	0.3	0.3	0.3
Government consumption	-4.8	-2.9	-1.7	0.1	1.0	1.3
Exports of goods and services	3.2	5.6	4.9	4.3	3.5	3.0
Imports of goods and services	-6.6	2.7	1.7	3.2	3.0	2.8
Consumer prices	2.8	0.5	0.4	1.0	1.0	1.0
Unemployment rate (level)	15.9	16.8	16.7	17.0	17.0	17.0
Current account balance (% of GDP)	-1.5	1.0	-0.1	0.5	0.6	0.6
Government budget (% of GDP)	-6.4	-5.9	-5.4	-4.0	-2.8	-1.7
Government debt (% of GDP)	124.1	130.5	133.5	134.4	133.9	132.3

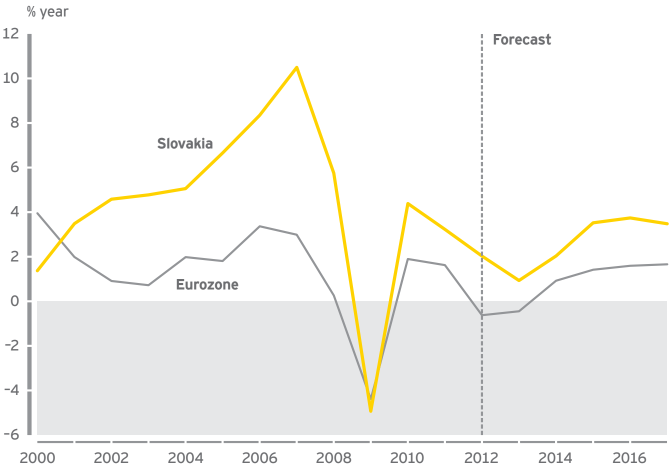
Source: Oxford Economics.

Slovakia

- The outlook for Slovakia's economy has remained broadly unchanged since our September report. The slower pace of fiscal tightening and rising external demand will enable growth to pick up from 2014, but the sluggish labor market will be a drag on growth. After growth of close to 1% in 2013, we expect GDP to grow 2% in 2014 and by around 3.5% a year in 2015-17.
- In the absence of any significant FDI projects in the pipeline, the country's exports will be largely driven by Eurozone demand, in particular in the car market. Rising exports should translate into stronger domestic demand, given the positive multiplier effect of export-oriented industries for growth in Slovakia.
- The risks to our forecast are broadly balanced. Eurozone growth could disappoint due to the possible tightening of credit conditions ahead of the ECB's AQR. But, more positively, a greater-than-expected drawdown of EU funds could provide a further boost to the economy.

Figure 41

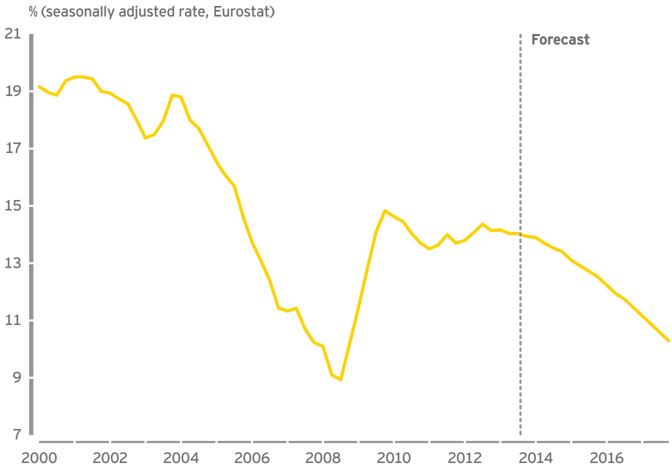
Real GDP growth



Source: Oxford Economics.

Figure 42

Unemployment rate



Source: Oxford Economics.

Slovakia (annual percentage changes unless specified)

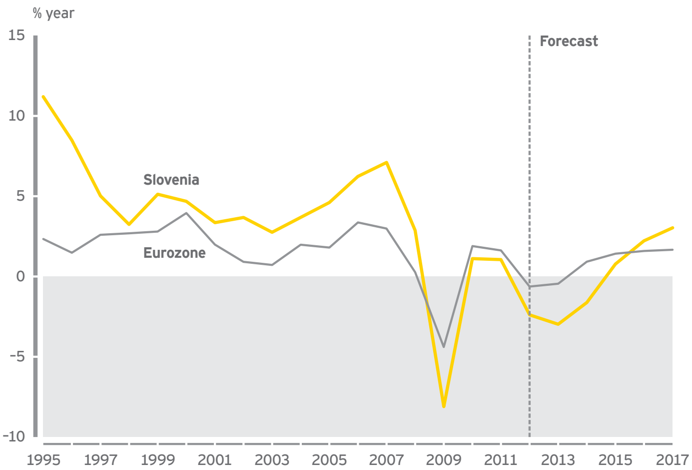
	2012	2013	2014	2015	2016	2017
GDP	2.0	0.9	2.0	3.5	3.7	3.5
Private consumption	-0.6	0.8	1.4	2.6	2.8	2.7
Fixed investment	-3.7	-6.3	1.8	4.0	4.8	4.5
Stockbuilding (% of GDP)	-2.3	-2.4	-1.4	-0.7	0.1	0.1
Government consumption	-0.6	-0.4	0.5	2.9	2.9	2.7
Exports of goods and services	8.6	4.3	5.0	5.5	5.6	5.2
Imports of goods and services	2.8	2.4	6.0	6.1	6.3	5.1
Consumer prices	3.6	1.6	1.6	1.8	2.0	2.1
Unemployment rate (level)	14.0	14.1	13.8	13.0	12.1	11.0
Current account balance (% of GDP)	2.2	3.9	3.4	3.2	3.2	3.2
Government budget (% of GDP)	-4.5	-2.9	-2.8	-2.7	-2.4	-2.1
Government debt (% of GDP)	52.4	54.1	55.1	54.9	54.3	53.5

Source: Oxford Economics.

Slovenia

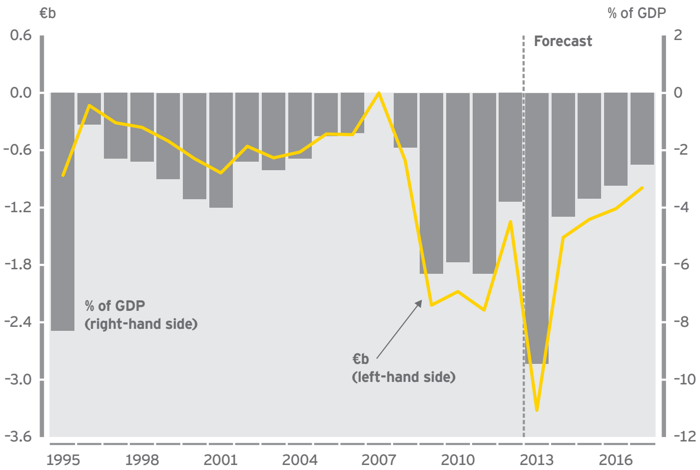
- Economic activity has stabilized this year, but financial tensions have risen again in recent weeks because the results of bank stress tests have not yet been released. These must be approved before the recapitalization, which was originally due to start in July, can begin.
- Our forecast of GDP contractions of 3% in 2013 and 1.6% in 2014 assumes the stress tests confirm that the recapitalization costs will be in line with official estimates. However, there is a chance that the results reveal that more funding is required.
- We expect that the recession will continue for at least another year, with the economy weighed down by fierce austerity and uncertainty hanging over the banking sector.

Figure 43
Real GDP growth



Source: Oxford Economics.

Figure 44
Government budget balance



Source: Oxford Economics.

Slovenia (annual percentage changes unless specified)	2012	2013	2014	2015	2016	2017
GDP	-2.4	-3.0	-1.6	0.8	2.2	3.0
Private consumption	-4.3	-4.8	-1.3	0.7	1.8	2.6
Fixed investment	-7.7	-9.4	-3.9	2.1	4.7	5.3
Stockbuilding (% of GDP)	-0.5	0.1	-0.7	-1.1	-0.6	-0.4
Government consumption	-1.2	-2.9	-1.2	0.1	1.4	2.5
Exports of goods and services	1.6	0.3	1.4	1.6	1.7	2.7
Imports of goods and services	-3.7	-1.5	0.6	1.2	2.4	3.0
Consumer prices	2.6	2.2	1.3	1.8	2.1	2.5
Unemployment rate (level)	8.9	9.9	9.8	9.5	9.0	8.0
Current account balance (% of GDP)	3.3	5.4	6.1	6.5	5.8	5.6
Government budget (% of GDP)	-3.8	-9.4	-4.3	-3.7	-3.2	-2.5
Government debt (% of GDP)	54.1	72.6	77.1	78.9	78.8	77.1

Source: Oxford Economics.

Spain

GDP growth

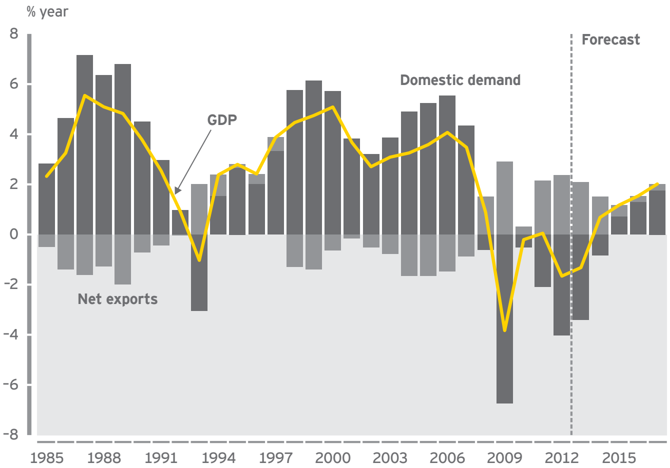
2014

0.7%

- Recovery is finally under way in Spain. The economy emerged from recession in Q3 2013 and the latest indicators suggest that a moderate pace of expansion has been sustained in Q4.
- Renewed growth in Europe is now supporting Spanish exports and the economy is benefiting from more modest fiscal cutbacks.
- Nevertheless, domestic demand will continue to act as a drag on activity for some time, despite positive spillovers from the foreign sector. As a result, we forecast only a modest 0.7% increase in GDP in 2014, after an expected contraction of 1.3% in 2013, with a gradual acceleration in growth to 2% by 2017.
- The recent uptick in economic activity already appears to have translated to some stability in the labor market. But we do not expect any significant job growth over the coming year, and the unemployment rate is forecast to be around 25% even in 2017.

Figure 45

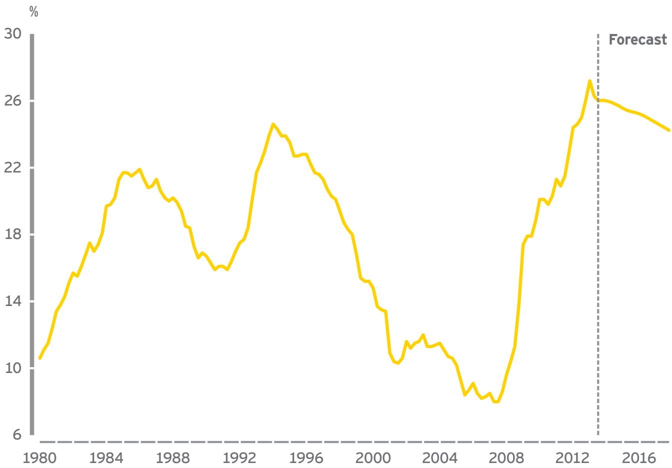
Contributions to GDP growth



Source: Oxford Economics.

Figure 46

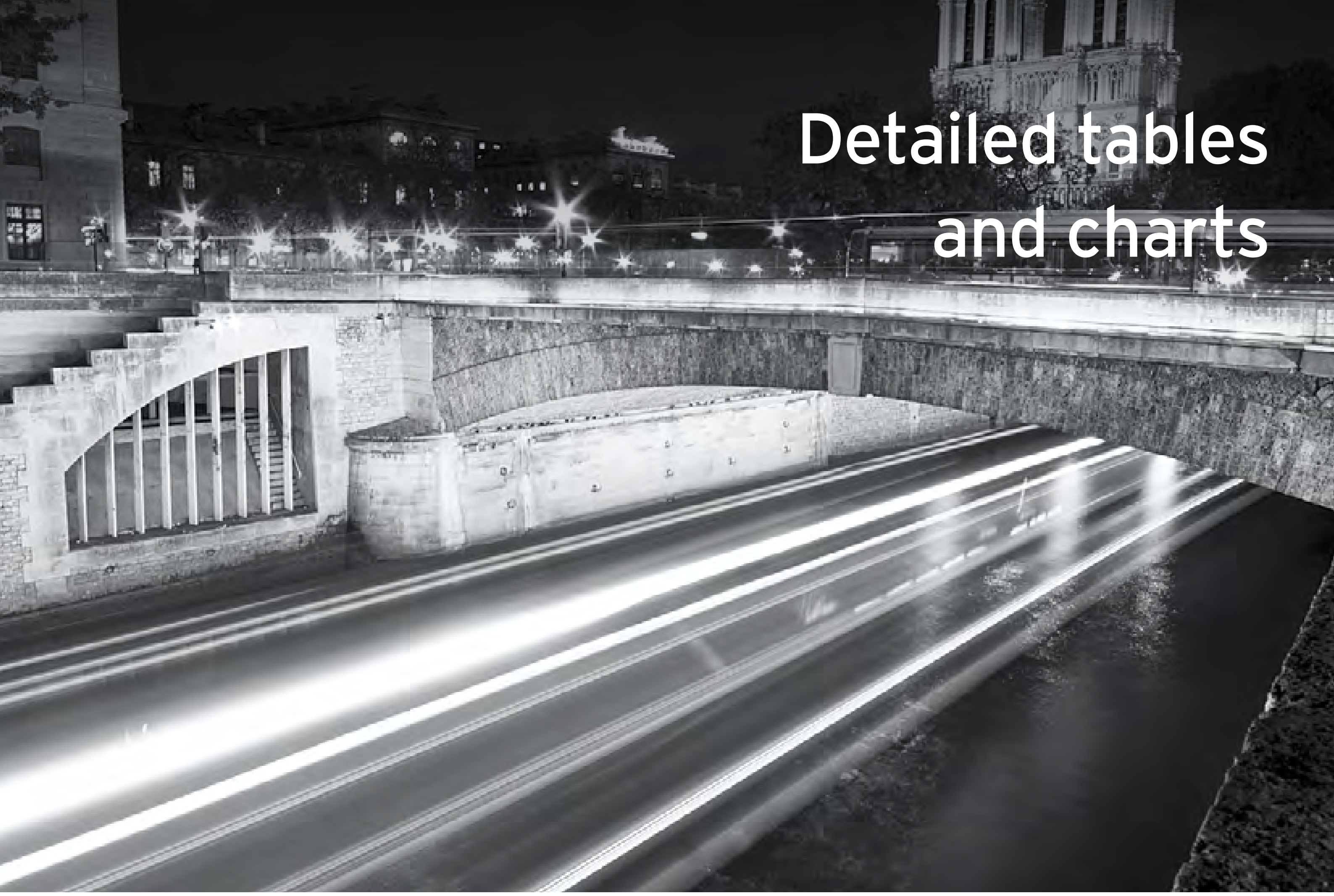
Unemployment rate



Source: Oxford Economics.

Spain (annual percentage changes unless specified)	2012	2013	2014	2015	2016	2017
GDP	-1.7	-1.3	0.7	1.2	1.5	2.0
Private consumption	-2.8	-2.6	0.4	1.0	1.7	2.1
Fixed investment	-7.0	-6.7	-1.1	2.0	2.0	2.4
Stockbuilding (% of GDP)	0.8	0.7	0.6	0.5	0.5	0.5
Government consumption	-4.8	-2.3	-3.1	-1.0	-0.3	0.7
Exports of goods and services	2.1	5.9	6.7	4.5	3.7	3.5
Imports of goods and services	-5.7	-0.8	2.5	3.8	3.6	3.4
Consumer prices	2.4	1.5	0.7	0.9	1.0	1.0
Unemployment rate (level)	25.1	26.5	26.4	26.0	25.6	25.0
Current account balance (% of GDP)	-1.1	0.6	1.3	1.1	1.0	0.9
Government budget (% of GDP)	-10.6	-6.8	-5.9	-4.8	-3.5	-2.5
Government debt (% of GDP)	86.0	94.7	101.6	106.7	110.0	111.5

Source: Oxford Economics.



Forecast assumptions

	2012	2013	2014	2015	2016	2017
Short-term interest rates (%)	0.6	0.2	0.2	0.2	0.2	0.4
Long-term interest rates (%)	3.9	3.0	3.0	3.3	3.6	3.9
Euro effective exchange rate (1995 = 100)	115.5	120.3	119.5	117.6	114.9	113.9
Oil prices (€/barrel)	86.9	81.8	79.8	84.1	88.5	92.9
Share prices (% year)	-7.8	15.7	12.4	7.3	7.8	6.6

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Short-term interest rates (%)	1.0	0.7	0.4	0.2	0.2	0.2	0.2	0.2
Long-term interest rates (%)	4.3	4.2	3.9	3.3	3.1	2.8	3.2	2.9
Euro effective exchange rate (1995 = 100)	116.9	115.9	113.3	115.8	118.8	119.2	121.7	121.7
Oil prices (€/barrel)	90.3	84.6	87.7	85.1	85.2	78.6	83.2	80.1
Share prices (% year)	-15.7	-22.2	0.8	11.7	8.2	21.1	15.9	18.2

Eurozone GDP and components

Quarterly forecast (quarterly percentage changes)

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-0.1	-0.3	-0.1	-0.5	-0.2	0.3	0.1	0.2
Private consumption	-0.4	-0.6	-0.1	-0.4	-0.3	0.1	0.2	0.0
Fixed investment	-1.2	-2.0	-0.4	-1.2	-2.3	0.2	0.1	0.1
Government consumption	-0.3	-0.3	-0.2	0.1	0.0	0.4	0.0	-0.1
Exports of goods and services	0.8	0.9	0.7	-0.5	-0.9	2.1	0.3	0.8
Imports of goods and services	0.0	-0.2	0.3	-0.9	-1.0	1.6	0.2	0.5

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

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-0.1	-0.3	-0.1	-0.5	-0.2	0.3	0.1	0.2
Private consumption	-0.2	-0.3	-0.1	-0.2	-0.1	0.1	0.1	0.0
Fixed investment	-0.2	-0.4	-0.1	-0.2	-0.4	0.0	0.0	0.0
Government consumption	-0.1	-0.1	0.0	0.0	0.0	0.1	0.0	0.0
Stockbuilding	0.0	-0.1	-0.1	-0.2	0.3	-0.2	-0.1	0.0
Exports of goods and services	0.4	0.4	0.3	-0.2	-0.4	0.9	0.1	0.4
Imports of goods and services	0.0	0.1	-0.1	0.4	0.4	-0.7	-0.1	-0.2

Annual levels – real terms (€b, 2000 prices)

	2012	2013	2014	2015	2016	2017
GDP	8,548	8,509	8,588	8,710	8,848	8,995
Private consumption	4,798	4,771	4,797	4,849	4,912	4,983
Fixed investment	1,561	1,503	1,523	1,561	1,601	1,642
Government consumption	1,825	1,828	1,823	1,828	1,837	1,851
Stockbuilding	-1	-8	-11	-5	1	2
Exports of goods and services	3,893	3,939	4,079	4,246	4,424	4,602
Imports of goods and services	3,529	3,524	3,622	3,768	3,927	4,085

Annual levels – nominal terms (€b)

	2012	2013	2014	2015	2016	2017
GDP	9,484	9,591	9,794	10,064	10,369	10,694
Private consumption	5,447	5,485	5,577	5,712	5,872	6,047
Fixed investment	1,741	1,684	1,724	1,790	1,862	1,937
Government consumption	2,041	2,068	2,086	2,120	2,164	2,215
Stockbuilding	6	20	28	53	75	88
Exports of goods and services	4,352	4,407	4,620	4,891	5,183	5,483
Imports of goods and services	4,102	4,074	4,241	4,502	4,787	5,077

Prices and cost indicators

(annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
HICP headline inflation	2.5	1.4	1.1	1.3	1.4	1.5
Inflation ex energy	1.8	1.3	1.2	1.2	1.3	1.4
GDP deflator	1.3	1.6	1.2	1.3	1.4	1.4
Import deflator	3.8	-0.1	1.1	1.7	1.7	1.7
Export deflator	5.2	-1.4	1.1	2.1	2.1	2.0
Terms of trade	1.3	-1.3	0.0	0.4	0.4	0.3
Earnings	1.8	1.6	1.6	2.0	2.2	2.4
Unit labor costs	1.9	1.3	0.8	0.9	1.1	1.2
Output gap (% of GDP)	-2.8	-4.1	-4.1	-3.8	-3.3	-2.8
Oil prices (€/barrel)	86.9	81.8	79.8	84.1	88.5	92.9
Euro effective exchange rate (1995 = 100)	115.5	120.3	119.5	117.6	114.9	113.9

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
HICP headline inflation	2.7	2.5	2.5	2.3	1.9	1.4	1.3	0.9
Inflation ex energy	1.9	1.8	1.8	1.6	1.5	1.2	1.3	1.2
GDP deflator	1.3	1.3	1.3	1.4	1.6	1.7	1.6	1.5
Import deflator	3.8	4.0	4.4	3.2	0.5	0.1	-0.8	-0.3
Export deflator	6.1	5.0	6.3	3.4	-1.0	-2.0	-2.0	-0.7
Terms of trade	2.3	1.0	1.9	0.2	-1.4	-2.1	-1.2	-0.4
Earnings	2.1	1.9	1.8	1.4	1.7	1.5	1.5	1.9
Unit labor costs	1.8	1.8	2.2	1.8	1.9	1.1	1.2	1.1
Output gap (% of GDP)	-2.2	-2.6	-2.9	-3.7	-4.1	-4.0	-4.1	-4.2
Oil prices (€/barrel)	90.3	84.6	87.7	85.1	85.2	78.6	83.2	80.1
Euro effective exchange rate (1995 = 100)	116.9	115.9	113.3	115.8	118.8	119.2	121.7	121.7

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	-0.8	0.1	0.3	0.4	0.5
Unemployment rate (%)	11.4	12.1	12.3	12.1	11.8	11.5
NAIRU (%)	8.5	8.8	8.9	8.8	8.8	8.7
Participation rate (%)	75.4	75.4	75.5	75.6	75.8	75.9
Earnings	1.8	1.6	1.6	2.0	2.2	2.4
Unit labor costs	1.9	1.3	0.8	0.9	1.1	1.2

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employment	-0.5	-0.8	-0.6	-0.7	-1.0	-1.0	-0.7	-0.4
Unemployment rate (%)	10.9	11.3	11.5	11.8	12.0	12.1	12.2	12.3
NAIRU (%)	8.4	8.5	8.6	8.7	8.7	8.7	8.8	8.8
Participation rate (%)	75.3	75.4	75.5	75.4	75.3	75.3	75.4	75.5
Earnings	2.1	1.9	1.8	1.4	1.7	1.5	1.5	1.9
Unit labor costs	1.8	1.8	2.2	1.8	1.9	1.1	1.2	1.1

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)	85.6	152.9	187.7	197.6	207.1	218.2
Trade balance (% of GDP)	0.9	1.6	1.9	2.0	2.0	2.0
Current account balance (€b)	128.2	195.5	206.9	198.6	198.7	203.4
Current account balance (% of GDP)	1.4	2.0	2.1	2.0	1.9	1.9
Government budget balance (€b)	-349	-277	-258	-214	-170	-140
Government budget balance (% of GDP)	-3.7	-2.9	-2.6	-2.1	-1.6	-1.3
Government debt (€b)	8,790	9,284	9,688	10,079	10,413	10,706
Government debt (% of GDP)	92.7	96.8	98.9	100.1	100.4	100.1

Measures of convergence and divergence within the Eurozone

	2003-07	2008-12	2013-17
Growth and incomes			
Standard deviation of GDP growth rates	2.0	2.3	1.8
Growth rate gap (max – min)	7.1	9.4	7.4
Highest GDP per capita (Eurozone = 100)	241.6	238.9	239.2
Lowest GDP per capita (Eurozone = 100)	56.2	67.7	63.9
Inflation and prices			
Standard deviation of inflation rates	1.2	1.0	0.6
Inflation rate gap (max – min)	4.8	3.9	2.0
Highest price level (Eurozone = 100)	117.0	116.0	117.4
Lowest price level (Eurozone = 100)	52.6	64.8	66.6

Cross-country tables

Real GDP (% year)

Rank		2012	2013	2014	2015	2016	2017	Average 2013-17
1	Estonia	3.9	0.9	2.5	3.4	3.8	4.1	2.9
2	Slovakia	2.0	0.9	2.0	3.5	3.7	3.5	2.7
3	Luxembourg	-0.2	1.7	2.4	3.0	3.2	3.0	2.7
4	Ireland	0.1	-0.3	1.7	2.0	2.5	2.8	1.7
5	Malta	0.8	2.1	1.4	1.5	1.7	1.8	1.7
6	Germany	0.9	0.5	1.7	1.7	1.7	1.7	1.5
7	Austria	0.6	0.4	1.6	1.8	1.6	1.6	1.4
8	Finland	-0.8	-1.1	1.3	2.0	2.2	2.3	1.3
9	Belgium	-0.1	0.2	1.0	1.5	1.6	1.7	1.2
10	Eurozone	-0.6	-0.5	0.9	1.4	1.6	1.7	1.0
11	France	0.0	0.2	0.7	1.1	1.3	1.4	0.9
12	Spain	-1.7	-1.3	0.7	1.2	1.5	2.0	0.8
13	Netherlands	-1.3	-1.1	0.3	0.8	1.3	1.6	0.6
14	Portugal	-3.3	-1.6	0.7	1.1	1.2	1.2	0.5
15	Italy	-2.6	-1.9	0.2	1.3	1.5	1.4	0.5
16	Slovenia	-2.4	-3.0	-1.6	0.8	2.2	3.0	0.3
17	Greece	-6.4	-3.9	-0.7	1.4	2.0	2.3	0.2
18	Cyprus	-2.4	-7.4	-8.0	-2.7	-1.0	1.4	-3.6

Inflation rates (% year)

Rank		2012	2013	2014	2015	2016	2017	Average 2013-17
1	Greece	1.0	-0.7	-0.5	0.4	0.8	1.7	0.3
2	Portugal	2.8	0.5	0.4	1.0	1.0	1.0	0.8
3	Spain	2.4	1.5	0.7	0.9	1.0	1.0	1.0
4	Cyprus	3.1	0.8	0.8	1.1	1.2	1.5	1.1
5	Italy	3.3	1.3	0.9	1.2	1.2	1.3	1.2
6	France	2.2	1.0	1.1	1.3	1.6	1.6	1.3
7	Eurozone	2.5	1.4	1.1	1.3	1.4	1.5	1.4
8	Netherlands	2.8	2.9	1.4	1.1	1.1	1.1	1.5
9	Ireland	1.9	0.5	1.4	2.0	1.9	1.9	1.5
10	Germany	2.1	1.6	1.5	1.6	1.7	1.7	1.6
11	Malta	3.2	1.0	1.3	1.7	2.0	2.3	1.7
12	Finland	3.2	2.0	1.0	1.6	1.9	1.9	1.7
13	Slovakia	3.6	1.6	1.6	1.8	2.0	2.1	1.8
14	Belgium	2.6	1.3	1.8	2.0	2.0	2.0	1.8
15	Austria	2.6	2.1	1.8	1.8	1.8	1.8	1.8
16	Luxembourg	2.9	1.8	2.0	2.0	2.0	2.0	2.0
17	Slovenia	2.6	2.2	1.3	1.8	2.1	2.5	2.0
18	Estonia	3.9	2.9	2.9	3.0	3.1	3.2	3.0

Cross-country tables

Unemployment rate (% of labor force)

Rank		2012	2013	2014	2015	2016	2017	Average 2013–17
1	Austria	4.4	4.8	4.9	4.7	4.6	4.5	4.7
2	Germany	5.5	5.3	5.2	5.2	5.1	5.1	5.2
3	Luxembourg	5.1	5.8	6.2	5.9	5.5	4.9	5.7
4	Malta	6.4	6.4	6.1	5.9	5.7	5.5	5.9
5	Netherlands	5.3	6.7	7.3	7.3	7.1	6.9	7.1
6	Estonia	10.1	8.2	7.6	7.2	6.6	6.1	7.2
7	Finland	7.7	8.1	8.0	7.8	7.6	7.3	7.8
8	Belgium	7.6	8.7	8.7	8.3	7.9	7.6	8.2
9	Slovenia	8.9	9.9	9.8	9.5	9.0	8.0	9.2
10	France	10.3	11.0	11.2	11.1	10.9	10.6	11.0
11	Ireland	14.7	13.7	12.9	11.9	10.9	10.2	11.9
12	Eurozone	11.4	12.1	12.3	12.1	11.8	11.5	12.0
13	Italy	10.7	12.2	12.8	12.6	12.0	11.5	12.2
14	Slovakia	14.0	14.1	13.8	13.0	12.1	11.0	12.8
15	Portugal	15.9	16.8	16.7	17.0	17.0	17.0	16.9
16	Cyprus	11.9	18.7	24.1	25.3	25.0	22.2	23.1
17	Spain	25.1	26.5	26.4	26.0	25.6	25.0	25.9
18	Greece	24.3	27.4	28.0	27.6	26.7	25.6	27.1

Government budget (% of GDP)

Rank		2012	2013	2014	2015	2016	2017	Difference 2013–17
1	Germany	0.1	0.0	0.0	0.0	0.0	0.0	0.0
2	Luxembourg	-0.6	-1.4	-0.9	-1.4	-1.6	-1.4	0.0
3	Estonia	-0.2	-0.1	0.0	0.1	0.1	0.0	0.1
4	Slovakia	-4.5	-2.9	-2.8	-2.7	-2.4	-2.1	0.8
5	Malta	-3.3	-3.4	-3.2	-3.0	-2.6	-2.3	1.1
6	Netherlands	-4.1	-3.1	-3.2	-2.6	-2.1	-2.0	1.1
7	Italy	-3.0	-3.0	-3.0	-2.5	-2.1	-1.8	1.2
8	Finland	-1.8	-3.2	-4.1	-3.5	-2.7	-1.8	1.4
9	Belgium	-4.0	-3.2	-2.8	-2.4	-2.0	-1.7	1.5
10	Eurozone	-3.7	-2.9	-2.6	-2.1	-1.6	-1.3	1.6
11	Austria	-2.5	-2.4	-1.9	-1.0	-0.6	-0.6	1.8
12	France	-4.8	-4.2	-3.8	-3.1	-2.4	-2.0	2.2
13	Cyprus	-6.4	-8.4	-8.3	-7.5	-6.6	-5.6	2.8
14	Greece	-8.9	-5.0	-3.9	-3.0	-2.5	-2.1	2.9
15	Portugal	-6.4	-5.9	-5.4	-4.0	-2.8	-1.7	4.2
16	Spain	-10.6	-6.8	-5.9	-4.8	-3.5	-2.5	4.3
17	Ireland	-8.1	-7.6	-5.1	-3.0	-1.9	-1.1	6.5
18	Slovenia	-3.8	-9.4	-4.3	-3.7	-3.2	-2.5	6.9

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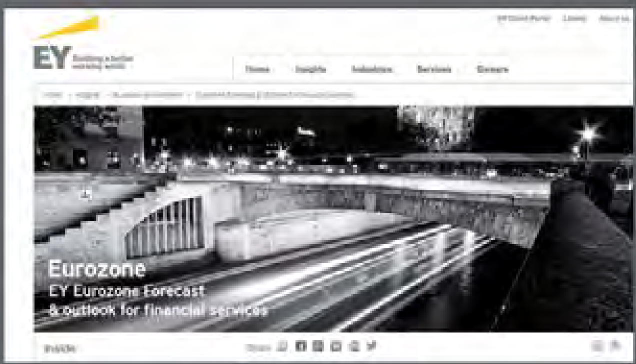

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