Eurozone

EY Eurozone Forecast

March 2014

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Contents

"Despite the recession coming to an end in mid-2013, the Eurozone economy contracted for the year as a whole. A return to growth is expected in 2014. But risks from deflation, divergence and unemployment mean optimism must be met with caution."

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

Opportunities begin to widen

The Eurozone is still a tough operating environment for businesses. But new opportunities – in the periphery and elsewhere – are available.

March 2014 forecast

12

Exports to drive a gradual recovery in 2014

The economy appears to be gaining momentum. But growth is still slow and the Eurozone will lag behind other major economies.

Forecast for Eurozone countries

20

Detailed forecasts for the 18 Eurozone member states.

Detailed tables and charts

40

The data that underpins our analysis, including forecast assumptions and cross-country comparison tables.

Foreword

Customize data from EY's *Eurozone Forecast* and *Rapid-Growth Markets Forecast*.
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Mark Otty
Area Managing Partner, Europe, Middle East, India and Africa

Despite the recession coming to an end in mid-2013, the Eurozone economy contracted for the year as a whole. A return to growth is expected in 2014. But risks from deflation, divergence and unemployment mean optimism must be met with caution.

Spring has been a long time coming in the Eurozone. After contraction in 2012, the economy shrank by a further 0.4% in 2013, despite the 18-month recession finally coming to an end in the middle of the year. But 2014 is set to see a return to growth. We expect GDP to expand 1% this year, before picking up to growth of about 1.5% a year in 2015–18. Nevertheless, these growth figures are modest, reflecting a number of concerns.

Deflation is the first threat. The latest inflation data, showing consumer price inflation in the Eurozone at just 0.8% in February, indicates that the danger of deflation is now very real, especially given the low levels of money supply and credit expansion and a large negative output gap. While we do not currently expect deflation, a period of falling prices would mean that consumers might postpone spending in anticipation of even lower prices, and that debt cannot be eroded by inflation. This could lead to renewed concerns about the solvency of peripheral countries with very high debt burdens.

Second, the pace of recovery will vary between member states. While divergence is not a new concept, the way in which different parts of the currency zone are diverging is changing. The divide is no longer simply between the core and the periphery. Now, a gap is opening between countries such as Ireland, Spain and Portugal on the one hand, which have taken action to improve their competitiveness, and on the other those such as France, Belgium and the Netherlands, which have been slow to act on the need for change. While the former are well placed to benefit by exporting to meet the rise in global demand, the latter risk enduring very slow growth.

The third concern is unemployment. With the Eurozone economy seen growing by only about 1% this year, there seems little scope for net job creation. The weakness of the recovery, combined with businesses keeping headcount down in an attempt to boost profitability and productivity in the face of tight credit conditions, means that we expect the jobless rate to fall only slowly — from about 12% in 2014, to 11% in 2018. With little prospect of significant job creation over the next few years, consumer confidence will remain subdued.

The developments in Ukraine are also a cause for concern for the Eurozone, and indeed the rest of the world. At the time of writing, the crisis is still unresolved. We hope for a swift resolution, but protracted uncertainty could push up oil and gas prices and undermine the Eurozone's new-found stability.

Nevertheless, the stability of the Eurozone over the last year has meant that pressure from financial markets and the European Commission has eased. Therefore, governments might start to spend with more confidence. If so, the drag on growth from fiscal austerity would be lower than assumed, and private sector demand would also strengthen as a result.

Meanwhile, the European Central Bank could ease monetary policy further, as it seeks to combat the threat of deflation. Together with the strength of the US recovery and its less-expansionary monetary policy, this combination could weaken the euro against the dollar, in turn boosting exports from the Eurozone and helping to guard against deflation.

Slow growth, low inflation, tight credit conditions and weak prospects for business investment mean that focusing on reducing costs and increasing efficiency will still be a top priority in boardrooms across Europe. But there are positive growth opportunities for those businesses that are prepared to grasp them.

After years in the doldrums, there is progress to report in peripheral countries, such as Ireland, Spain and Portugal. As their economies continue to rebalance and their labor markets open up, businesses could gain a competitive advantage by expanding or moving operations into these countries.

Partnering with companies in the periphery could also help to link businesses with opportunities in Africa and South America. Some important emerging markets share close historical and cultural ties with peripheral Eurozone nations — and these links could help companies to establish themselves in unfamiliar territory.

All in all, despite the slow pace of recovery, there are now opportunities for bold plans and exciting projects — in anticipation of gathering economic momentum in the coming years.

Highlights

The Eurozone's recovery will gradually gather momentum in 2014 ...

- Economic recovery in the Eurozone is expected to continue in 2014. It should gather pace slowly, as exports strengthen in response to rising global demand and a pickup in domestic demand triggers a return to modest investment growth.

- After two years of decline, we forecast Eurozone GDP growth of 1% in 2014, followed by a pickup to 1.4% in 2015, which is still very modest, and then only slightly faster growth of about 1.6% a year in 2016–18.

... and there are reasons for cautious optimism

- One source of upside risk to growth is on the government side. With less pressure from financial markets and the European Commission, governments may allow some fiscal slippage. The possibility of higher spending could mean that the drag on growth from fiscal austerity will be lower than we currently expect. In turn, this would enable stronger private sector demand to emerge.

- We might also see Eurozone monetary policy diverging markedly from US policy in 2014. While the US Federal Reserve is reducing its level of monetary stimulus, the European Central Bank (ECB) could ease monetary policy further, especially given the growing threat of deflation: inflation was just 0.8% in February. This should see the euro start to weaken, which in turn would give a further boost to exports.

But threats from divergence and deflation remain ...

- However, the pace of recovery will vary across different member states. Divergence is nothing new, but the divide is no longer simply between the core and peripheral countries. While the outlook is now relatively positive for Germany, Ireland and, to a lesser extent, Spain, countries that have been slow to respond to the need for change — including France, Belgium and the Netherlands — are losing competitiveness and face more sluggish growth.

- There is also a threat of deflation, which would add to the problems of slow growth by raising the real levels of debt. At the same time, businesses face continued tight credit conditions as banks try to repair their finances ahead of the ECB's asset quality review in November. Meanwhile, doubts persist about prospects for some leading emerging markets in the wake of recent market turmoil, and further escalation of the crisis in Ukraine could have a significant impact.

... and high unemployment is still a major concern

- While unemployment is expected to stabilize this year, it will remain high at about 12%. GDP growth of only 1% leaves little room for net job creation. And divergence among countries is marked, with some of the periphery facing much higher jobless levels, despite improving growth prospects.

- The level of youth unemployment is particularly worrying — in some peripheral countries it is now over 50%. This raises concerns about loss of skills and job opportunities for a generation of young people, and also poses questions about the effectiveness of education, the availability of training, and labor mobility.

GDP growth

2014	2015	2016–18
1.0%	1.4%	1.6%

Unemployment

2014 12.0%

Exports of goods and services

2014	2015	2016–18
3.5%	4.0%	3.9%

Inflation

2014 1.1%

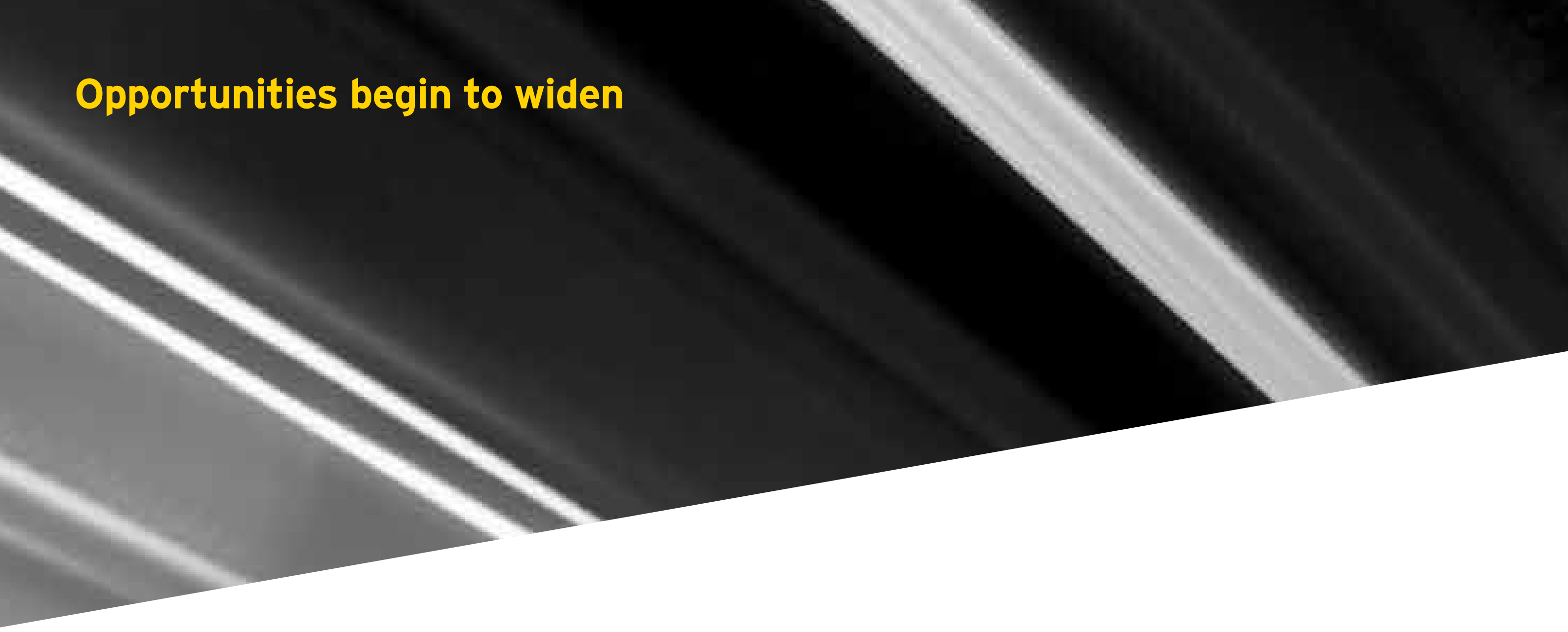
2015 1.5%

Eurozone forecast by sector (% change)	2014	2015
Manufacturing	1.9	2.3
Agriculture	0.5	1.1
Construction	1.4	1.5
Utilities	1.5	1.9
Trade	0.9	1.4
Financial and business services	1.2	1.4
Communications	2.0	2.6
Non-market services	-0.1	0.2

Implications for businesses:

Opportunities begin to widen

Opportunities begin to widen



The recession is behind us, but the recovery is modest and the outlook for businesses operating in the Eurozone is still difficult. Moreover, the global economy remains uncertain, especially given weaker demand in emerging markets and the recent crisis in Ukraine. The legacy of the Eurozone crisis, the need for debt reduction in the public and private sectors, ongoing problems in the financial system and high levels of unemployment will continue to inhibit growth in Europe.

Although financial investors think the Eurozone may be undervalued and have recently become more concerned about the risks of investing in emerging markets, business investment is set to remain low. As a result, cutting costs and boosting efficiency are still the main options open to businesses that are striving to increase profits. But growth opportunities are increasingly apparent. Some parts of the Eurozone have taken their medicine — making significant progress toward reforming their labor markets and rebalancing their economies — and now offer increasing trade and investment opportunities for businesses.

Progress in the periphery

Some of the peripheral Eurozone economies, in particular Spain, Portugal and Ireland, offer increasingly attractive conditions for companies looking to expand or move their operations. These economies still have high unemployment — especially among the young — but have made concerted efforts to reform their labor markets in a bid to attract employers and new investment.

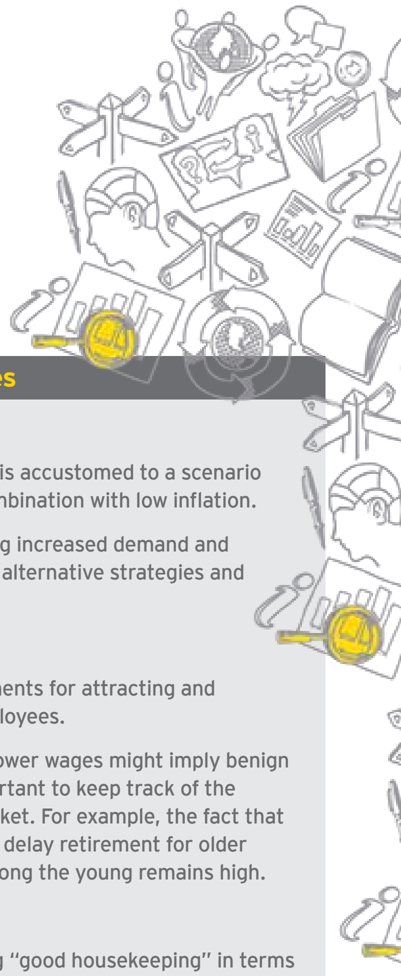
When assessing where in the Eurozone to establish operations, companies should consider the following questions:

- Does high unemployment, especially among young and well-educated people, mean that there is a strong supply of qualified labor?
- Does low inflation mean that there is little pressure to demand wage increases?
- Has the country implemented labor reforms that will lead to higher productivity?

For the peripheral countries that have been implementing reforms, the answer to all of these questions is yes. Unemployment has encouraged some young people in these nations to move to core Eurozone countries where employment prospects are brighter. But for businesses, the costs of setting up operations could be higher in the core than in the periphery.

Spain has increased its competitiveness as a location for business services. Italy is also becoming more attractive in this respect. These countries are responding to competition from eastern Europe, where low wages were a particular draw for businesses. However, a combination of rising wages in eastern Europe and rising competitiveness in the periphery has led a growing number of companies to increase their activities in the periphery and hire locally.

Portugal and Spain also have the advantage of links with important markets outside Europe. In trade terms, Portugal benefits from its historical ties with Brazil and parts of Africa, and Spain from its links with South America. Businesses can exploit these links when they are looking to expand into emerging markets. For example, if a Dutch company is looking to target an emerging market that it has never dealt with before — such as Brazil or Angola — partnering first with a Portuguese company, which already has strong cultural bonds and speaks the same business language, could be beneficial. The Portuguese partner could help to break down cultural barriers, provide contacts and identify potential pitfalls, thus saving time and money.



Changing patterns of divergence

It is important for businesses to recognize that divergence is no longer simply a split between the core and the periphery. As we have seen, some peripheral countries are becoming more attractive to investors. In contrast, some core countries have been slow to implement measures to increase their competitiveness. As a result, there is recent evidence that manufacturing jobs, for example, are moving to Spain at the expense of France and Belgium. So businesses should rethink what they mean by "divergence". Today, there could be as much opportunity in Ireland as there is in Austria.

A weaker euro would help exports

The euro has been resilient for longer than many expected. But we think it is still a matter of when, not if, the euro begins to weaken against the US dollar. Depreciation of the euro would clearly be a boost to exporters. Exports have been an important driver of the recovery in peripheral countries, and they will benefit further if a weaker euro makes their products more attractive on the global market. At a time of weak domestic demand in the Eurozone, exports are likely to be the main driver of the recovery in 2014, until investment and consumption start to respond more noticeably. Another positive effect is that the expected fall in the euro would help to guard against the threat of deflation.

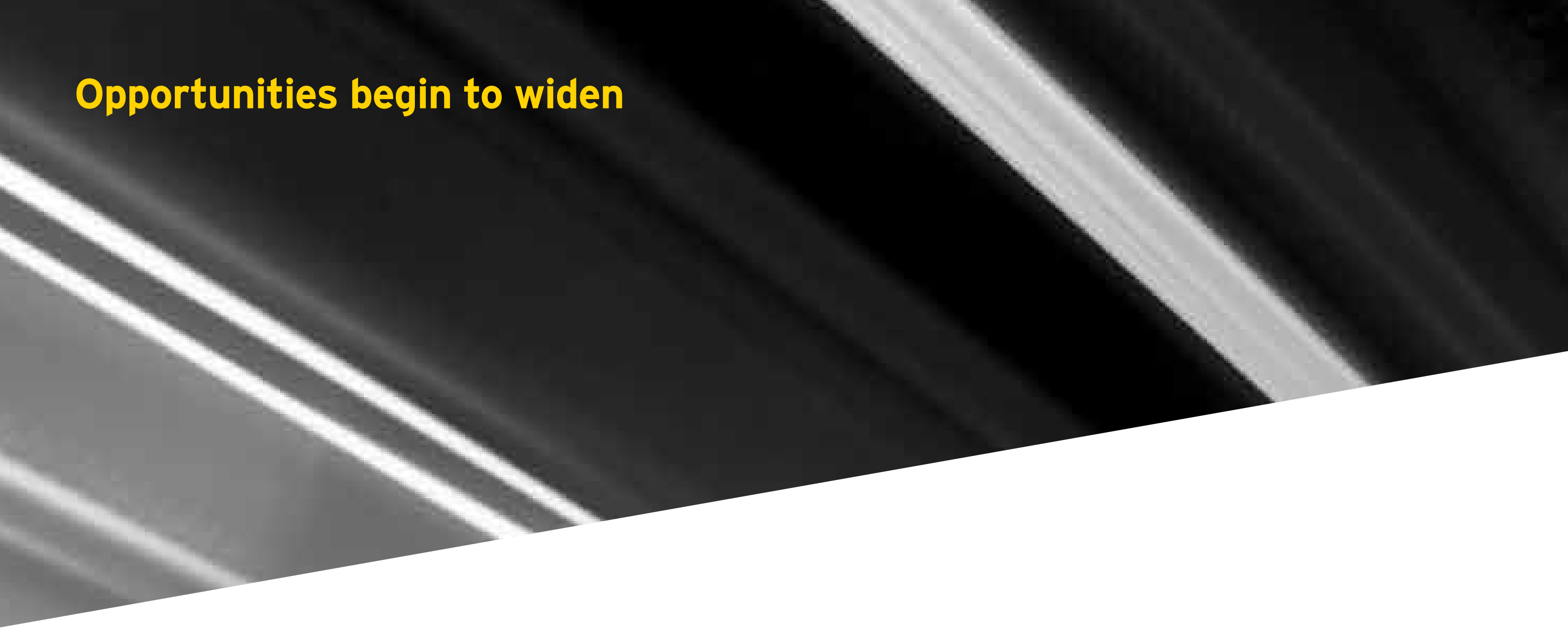
Deflationary pressure is mounting. If the Eurozone is hit by deflation, businesses will find it even more difficult to increase their prices, especially as consumers will delay purchases in anticipation of lower prices. Businesses must therefore immerse themselves in the detail of what is happening in their customer segments. We recommend working through a deflation scenario.

The effects of deflation would be dramatic. It would increase the real level of debt and make it harder for companies to fulfil their commitments. There would be more non-performing loans in the financial system. The effects would be particularly problematic for companies in the periphery, where there are already significantly higher levels of debt in terms of GDP.

Key concerns for businesses

- **Business models**
  - Consider if your business model is accustomed to a scenario of faster economic growth in combination with low inflation.
  - Assess the options for addressing increased demand and understanding the economics of alternative strategies and investment plans.
- **Strategies for human resources**
  - Assess your company's requirements for attracting and retaining adequately skilled employees.
  - An increasing labor supply and lower wages might imply benign market conditions, but it is important to keep track of the structural shifts in the labor market. For example, the fact that many governments are trying to delay retirement for older people, while unemployment among the young remains high.
- **Balancing risk and reward**
  - After a long period of conducting "good housekeeping" in terms of cost reduction and increased efficiency, it may be time to assess expansion possibilities, as many conditions are in place for a rise in mergers and acquisitions.

Opportunities begin to widen



Unemployment is set to remain high

The social impact of the crisis is widespread. The unemployment rate in the Eurozone remains historically high, at an average of 12%, and youth unemployment is significantly higher.

In countries such as Spain, where half of young people remain out of work, with little prospect of a job, the risk of a "lost generation" is very real. It is a problem for businesses as well as politicians. This waste of human capital, alongside a lack of fixed capital investment, means that productive capacity is lost over time and sustainable growth becomes more difficult. The consequences for businesses could be dire.

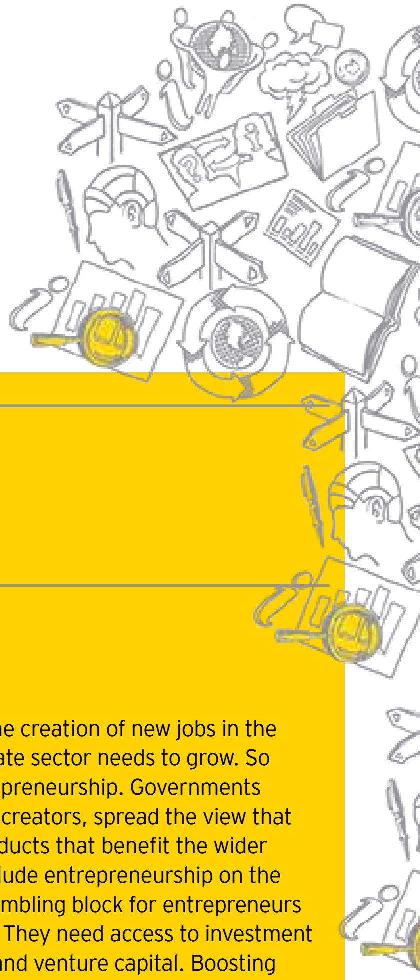
Businesses should work together with governments, schools and universities to devise ways in which young people can get workforce experience. Tax breaks can be used to encourage businesses to take on the long-term unemployed. Companies should put pressure on policy-makers to make sure that young unemployed people are offered vocational training to gain or regain skills. Educational reforms can obviously help in the longer term, but, to avoid a lost generation, the most effective action to stimulate demand for labor in the near term would be policies that boost aggregate demand and hence encourage businesses to take on more labor.

Businesses may feel positive about having such a large pool of labor to recruit from in the short term and the resultant low pressure on wages in the medium term. But in the long run this is harmful. One possible consequence of sustained periods of high unemployment could be that young people and their families start to invest less in further education, because they have no confidence that there will be a job to go to after they complete their studies. On the other hand, it is likely that there will be an increase in young people seeking vocational training, which over the long term will lead to a reduction in the current high levels of youth unemployment.

In addition to projects at the European Union (EU) level to stimulate innovation and infrastructure, an investment capacity of €400b has been created to support growth and employment at national and regional levels through the European Structural and Investment Funds.

Development through innovation

The recovery in Europe does not mean that the Eurozone industries can go back to business as usual. The goal now is to find new sources of growth and competitiveness for the long term, based on knowledge-intensive and high-productivity activities. This is well illustrated by the increasing integration of Europe's industries into global value chains, which will help to strengthen the European industry base. The development requires open and connected product and service markets, investment in research and innovation, and a workforce with appropriate qualifications.



Viewpoint

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Tackling unemployment

Despite the best efforts of policy-makers around the world, six years on from the start of the global economic crisis, unemployment rates remain stubbornly high. This problem is especially acute in the Eurozone. While the data suggests that unemployment in the currency zone has peaked, the jobless figures remain high, and there is little prospect of a sharp decline over the next few years.

In 2014, unemployment in the Eurozone is set to average 12%, with a gradual reduction to 11% by 2018. But within the 18 member states, unemployment rates differ wildly. While Austria is set for a 4.6% jobless rate in 2014–18, unemployment in Greece is projected to still be close to 25% in 2018.

Meanwhile, the number of young people who feature in these jobless figures is a particular concern. In Greece and Spain, more than half of young people are without a job.

So, how can the EU, member states and businesses work together to tackle unemployment, especially among the young? Here are three key areas where reform could bring results:

1. Education and skills

Information and communication technology is a key enabler of competitiveness and innovation. With the rise of digital networks, the creation of new jobs depends on the right skills. It is essential to upgrade the skills that enable the transition from education to work. One of the ways to achieve this is by following Erasmus+, the new EU funding program for education, training, youth and sport. This program creates opportunities to study, train and teach abroad. It is vital that young people leave school with the right skills and qualifications. The number of youngsters leaving school early has to be reduced if Europe wants to return to sustainable growth.

2. Supporting entrepreneurs

With budget constraints preventing the creation of new jobs in the public sector, employment in the private sector needs to grow. So it is crucial to foster a culture of entrepreneurship. Governments should promote entrepreneurs as job creators, spread the view that entrepreneurs provide innovative products that benefit the wider society, and encourage schools to include entrepreneurship on the curriculum. Funding is the biggest stumbling block for entrepreneurs looking to start their own businesses. They need access to investment from business angels, private equity and venture capital. Boosting incentives and curbing excessive taxation and regulation will also help them translate their ideas into growing businesses that generate jobs.

3. Labor market reform and mobility

While a series of measures have been taken to reform labor markets at a national level, a number of challenges remain. The Youth Guarantee program from the European Commission (EC) is a key initiative. It has been devised for all those under 25 years of age and aims to ensure that young people receive an employment offer, return to education, or take an apprenticeship or traineeship, within four months of leaving formal education or becoming unemployed.

Mobility is another important priority. Better balancing of supply and demand could lead to a European labor market where, for example, unemployed Spaniards find work in Germany.

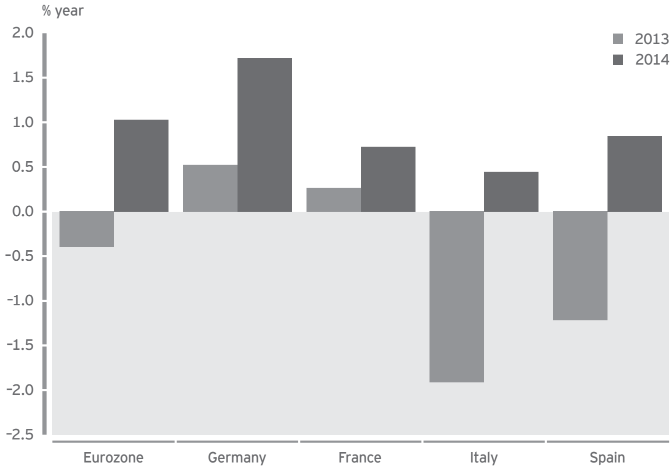
Exports to drive a gradual recovery in 2014

After the severe problems faced by the Eurozone in recent years, the outlook for 2014 appears more secure and some upside risks to our growth forecast are now emerging. But the Eurozone will continue to lag behind other major economies. GDP growth is seen at just 1% this year and 1.4% in 2015. This growth will initially be led by exports, which, over time, will encourage investment. While the US continues to lower monetary stimulus, monetary policy in the Eurozone could become even looser. This would increase the chances of a weaker euro, which may further enhance the outlook for exports. But domestic demand will remain weak, especially in some core member states, such as France, the Netherlands and Belgium, as credit conditions remain tight despite the mounting risk of deflation. At the same time, unemployment remains worryingly high in many countries, with youth unemployment a particular concern.

Having finally returned to growth in Q2 2013, the Eurozone economy has continued to advance, albeit slowly, with GDP rising by just 0.1% in Q3 and then 0.3% in Q4. This means that for 2013 as a whole, GDP fell by 0.4%. The latest business surveys suggest that momentum may be picking up slowly, with the composite Purchasing Managers' Index (PMI) rising further above the expansion threshold in February. The stronger Q4 GDP result means that our forecast for Eurozone growth in 2014 has risen slightly to 1%, from the 0.9% predicted in our December report. We now expect 1.4% growth in 2015, followed by 1.6% a year in 2016–18. There are also some signs that upside risks may now be emerging. Nevertheless, there is still worrying divergence among Eurozone member states, with some of the core countries, such as France, the Netherlands and Belgium, likely to experience very sluggish growth. In contrast, some of the peripheral countries that have implemented painful reforms in recent years, notably Spain, Ireland and Portugal, are benefiting as world trade picks up.

Figure 1

GDP growth



Source: Oxford Economics; Haver Analytics.

Table 1

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

	2013	2014	2015	2016	2017	2018
GDP	-0.4	1.0	1.4	1.5	1.6	1.7
Private consumption	-0.5	0.6	1.2	1.2	1.4	1.5
Fixed investment	-3.0	1.7	2.5	2.5	2.5	2.4
Stockbuilding (% of GDP)	-0.2	-0.1	0.0	0.0	0.0	0.0
Government consumption	0.3	0.0	0.2	0.4	0.7	0.8
Exports of goods and services	1.2	3.5	4.0	4.1	4.0	3.7
Imports of goods and services	0.0	3.1	4.0	4.1	3.9	3.7
Consumer prices	1.4	1.1	1.5	1.8	1.7	1.5
Unemployment rate (level)	12.1	12.0	11.8	11.6	11.3	11.0
Current account balance (% of GDP)	2.2	2.3	2.0	2.0	1.9	1.9
Government budget (% of GDP)	-3.0	-2.6	-2.1	-1.7	-1.4	-1.1
Government debt (% of GDP)	95.6	97.6	98.7	98.8	98.5	97.7
ECB main refinancing rate (%)	0.5	0.3	0.3	0.3	0.4	1.4
Euro effective exchange rate (1995 = 100)*	120.8	120.7	118.0	115.8	114.8	114.7
Exchange rate ($ per €)	1.33	1.30	1.25	1.22	1.20	1.20

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

Source: Oxford Economics.

Exports to drive a gradual recovery in 2014

The Eurozone is more secure, but divergence will persist

Growth in 2014 will initially be led by exports. This will be helped by the pickup in world demand, and in the US in particular, which is expected to grow by around 3%, its strongest pace since 2005. At the same time, the emerging markets are also expected to grow fairly strongly this year. They will still led by China, albeit at a more modest pace than in the last few years. The latest turmoil in some emerging markets may lead to a more marked slowdown than is currently expected, but the impact on the Eurozone should be minimal, unless China slows much more sharply than anticipated or the Ukraine crisis deepens further. This impetus from exports, which are expected to contribute 1.5 percentage points to GDP growth in 2014 (up from 0.5 percentage points in 2013) will see output starting to rise more strongly. In turn, this will feed through into a modest recovery in investment, which is forecast to rise by 1.7% in 2014, after falls of 3% or more in 2012 and 2013. As the year progresses and the recovery becomes more entrenched, overall domestic demand should also start to pick up.

The return to modest growth will reinforce hopes that the possibility of a Eurozone breakup will recede even further. The fact that 2014 opened with the accession of Latvia, the first new member since 2011, has given a welcome boost to faith in the Eurozone. Lithuania's probable accession in 2015 is also a positive sign. This is reflected in bond yields, which have fallen in recent months for all Eurozone countries, and for the periphery in particular, indicating greater confidence that the Eurozone will remain intact.

Nevertheless, the Eurozone is still expected to lag well behind other major economies during the recovery. Our forecast now shows GDP in 2018 will be only about 5% above its pre-financial crisis peak in Q1 2008. In contrast, we expect UK GDP to be almost 12% higher over the same period, while US output is forecast to be 23% above its late-2007 level.

Sector outlook

At this early stage of the Eurozone's modest recovery, performance remains somewhat uneven on the sector level.

With exports leading the upturn, we expect manufacturing to respond most quickly, with output growth of 1.9% forecast for 2014, after an estimated fall of 0.9% in 2013, and to gather momentum in 2015 with growth of 2.3%.

After five successive years of decline, construction is starting to pick up, helped by stabilizing housing markets and reduced emphasis on government austerity, enabling public sector investment to rise. We expect construction output to rise by 1.4% in 2014 and then about 1.5% a year in 2015–18.

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 0.1% in 2014 and to recover only very slowly thereafter, reflecting the fact that the Eurozone still faces a long period of austerity.

Table 2

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

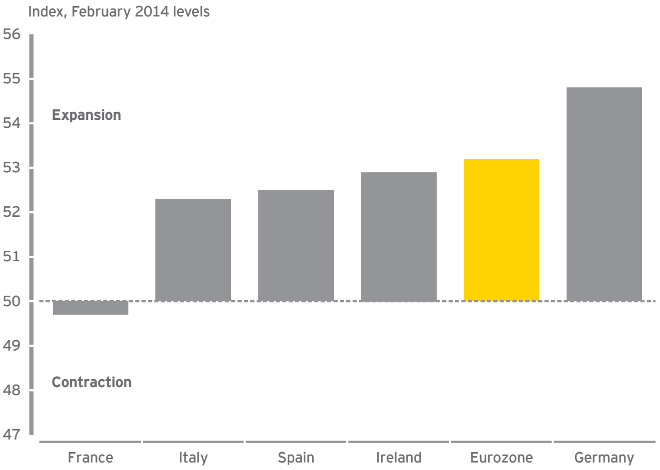
	2013	2014	2015	2016	2017	2018
Manufacturing	-0.9	1.9	2.3	2.1	1.8	1.7
Agriculture	-2.1	0.5	1.1	1.1	1.2	1.2
Construction	-3.9	1.4	1.5	1.6	1.4	1.4
Utilities	-0.2	1.5	1.9	1.7	1.8	1.8
Trade	-0.9	0.9	1.4	1.6	1.8	1.9
Financial and business services	0.2	1.2	1.4	1.6	1.8	1.8
Communications	0.0	2.0	2.6	2.7	2.9	3.0
Non-market services	-0.1	-0.1	0.2	0.5	0.8	1.0

Source: Oxford Economics.

Even as growth picks up across the Eurozone in 2014, worryingly divergent performance across member states is expected to persist. However, the pattern of divergence is shifting away from the simple divide between core and peripheral states seen in recent years. Now, stark differences in economic developments are appearing within the core and within the peripheral countries. This is highlighted by the latest survey indicators. While the February manufacturing PMIs for Ireland, Germany and Spain showed fairly strong expansion, France's PMI suggested continued contraction in economic activity. And recent developments in unemployment show a similar picture. The number of unemployed rose sharply in the year to November in Italy, and, to a lesser extent, France, while it stabilized or fell in Spain, Germany, Ireland and Portugal.

Figure 2

Manufacturing PMIs

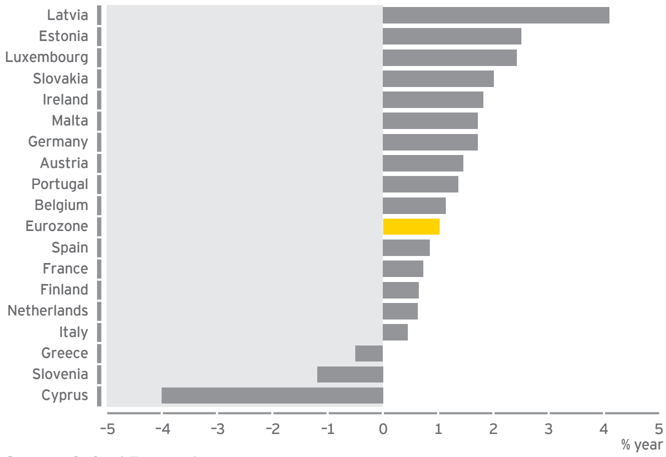


Source: Oxford Economics; Markit.

These divergences are reflected in our country forecasts. We have raised the outlook for Ireland, because recent data points to more robust domestic demand than we forecast in December. We now expect Irish GDP growth of 1.8% this year. German GDP growth should also be solid, at 1.7%, while Spain is set to return to growth of 0.8%. The fastest growth in the Eurozone is expected to be seen in the newest member, Latvia, which is projected to grow by over 4%, followed by Estonia at 2.5%. By contrast, GDP growth in France is forecast at only 0.7%, significantly below the Eurozone average. Other core countries, including Belgium, the Netherlands and Finland, are also set to experience very subdued growth, adding to concerns about their medium-term prospects.

Figure 3

GDP growth 2014



Source: Oxford Economics.

Prospect of easing austerity provides some hope

While there are still significant downside risks to our forecast, some upside risks are starting to emerge. At the country level, some of the peripheral countries have surprised on the upside and we could be underestimating the extent to which their economies will benefit from reforms and improvements in competitiveness. Meanwhile, German consumption and growth could be boosted to a larger extent than we currently envisage in 2015 by the introduction of the minimum wage.

Across the Eurozone, fiscal policy is another source of upside risk. Fiscal tightening dampened Eurozone GDP growth by more than 1 percentage point a year in 2011–13. This year, government budgets continue to imply a tightening stance, but much less so than in the past three years. We estimate that fiscal policy will dampen Eurozone growth by around 0.5 percentage points in 2014. And there is a possibility that budgets will be run in a more relaxed fashion this year. Financial markets and the EC have moved on from their focus on fiscal austerity at all costs and close scrutiny of budget plans.

Investor appetite for government bonds has been strong so far this year. Governments could well take advantage of this favorable environment to let fiscal ratios slip, or at least not try to improve them as much as planned. So far this year, Ireland, Spain and Portugal have all issued long-term bonds at relatively low rates. For instance, Portugal has issued bonds totaling over €6b in recent months, at yields around 100 basis points lower than in late 2013.

Exports to drive a gradual recovery in 2014

Youth unemployment: policy reforms will produce long-term dividends

While current levels of unemployment in some Eurozone countries are worryingly high, youth unemployment is an even greater concern, especially in the periphery. Spain and Greece have youth unemployment rates of over 50%, while Slovakia, Italy and Portugal have rates of above 30%. For the Eurozone, this presents major concerns in terms of social tensions, education, training and labor mobility. And there are substantial long-term costs: individuals who spend a significant period of their youth in unemployment tend to spend less time in employment and on average earn lower wages over the rest of their lives.

Recession in the Eurozone has pushed up unemployment sharply in all age groups, but young people have suffered disproportionately. Employers tend to retain more experienced staff during recessions, as they have accumulated greater job-specific skills and experience and are therefore more productive. In general, experienced staff are also more costly to remove. Young people are also over-represented in low-skilled jobs in strongly cyclical sectors, such as hospitality and retail sales, both of which were hit particularly hard during the downturn.

For this reason, sustained economic growth is the best way to tackle youth unemployment. Therefore, the most effective tools at the disposal of policy-makers are those that stimulate demand. However, given high debt levels, and with many governments under pressure to restrain spending and bring down deficits, there are other measures that would improve the prospects for young people seeking employment:

- **Active microeconomic measures**

  Governments could follow a more microeconomic-oriented approach, by choosing to be more active in the job-matching process, by providing training or retraining schemes to the long-term unemployed, or by subsidizing firms to employ young people and guaranteeing jobs for a fixed period of time. Such schemes are popular in Scandinavia and northern Europe. Although such an active involvement would be costly in the short term, there are clear longer-term dividends from pursuing such an approach.

- **Labor market reforms**

  Labor markets should be deregulated to ensure that young people have a fair chance to gain employment. Areas for reform include social security and unemployment benefits, including the provision of vocational training and back-to-work schemes, wage-settlement systems, including minimum-wage legislation, and the system of employment protection, including the determination of severance pay and the freedom for employers to hire and fire workers at reasonable cost.

- **Encouraging entrepreneurship**

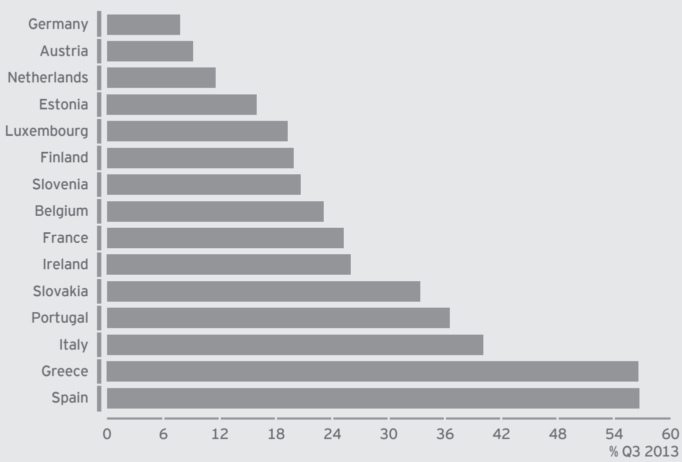
  Encouraging entrepreneurship and innovation is another way in which youth unemployment can be tackled. Entrepreneurial spirit in young people is often constrained by limited business-specific knowledge, a short credit history and lack of access to business networks, not to mention overly restrictive legislation for company formation. Creating a positive entrepreneurial culture should be a key building block in public policy aimed at combating long-term youth unemployment.

- **Education and training**

  Employers need to collaborate with the education sector and policy-makers to ensure a smoother transition for young people into the labor market. This could be achieved through designing training to include more vocational development, providing early careers advice and work experience, and providing more tailored on-the-job training, such as the high-quality apprenticeship schemes that are successful in Germany and Japan. But the role of business does not stop there. Firms need to change recruitment practices to be both more inclusive of young people and also more transparent and open to all applicants (rather than relying on informal methods of job searching). And firms need to be more committed to young employees, with the introduction of mentoring systems or ongoing skills development. This would allow individuals to complement technical ability with the other skills required in the labor market, such as effective communication and networking.

Figure 4

Youth unemployment rates

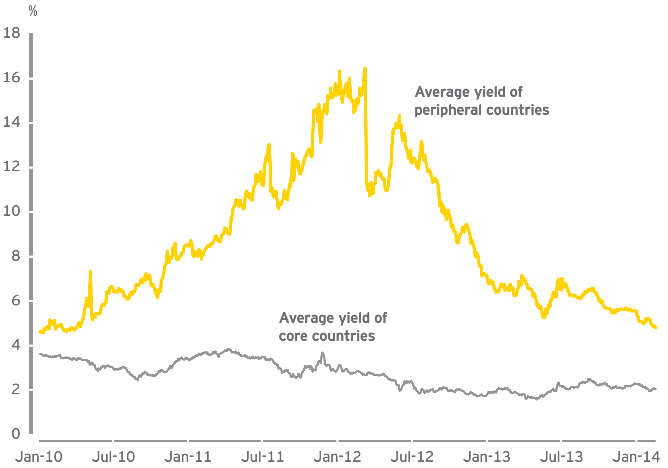


Source: Haver Analytics.

With these bond issues, Portugal has already fully funded its 2014 financing requirements. Ireland and Spain have been similarly successful in placing significant amounts of bonds at yields well below those that have prevailed in the last few years. These favorable developments could enable some governments to raise public spending more than currently expected.

Figure 5

Bond yields



Source: Oxford Economics; Haver Analytics.

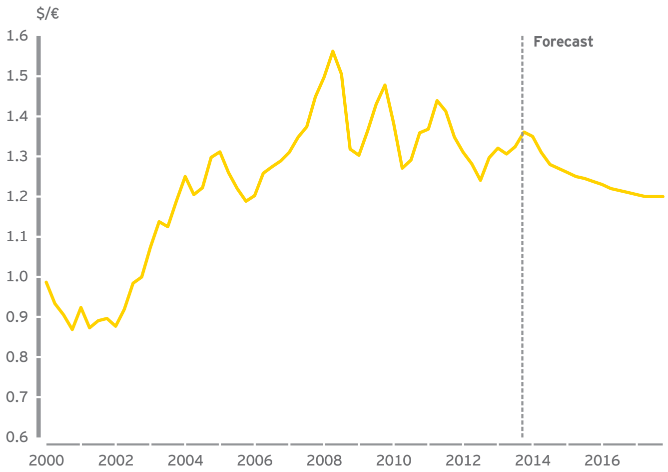
A weaker euro is also a possibility

As well as the possibility of less fiscal austerity than currently expected, it seems likely that the Eurozone's monetary stance will start to diverge from US policy in 2014. This should help the euro to start to weaken against the US dollar, and perhaps give an even larger boost to exports than we are expecting. We estimate that the euro is currently overvalued by around 10%, so a weaker euro would certainly be welcome news. In the US, the Federal Reserve is now tapering its quantitative easing program, meaning that monetary policy is becoming less accommodative. Meanwhile, the European Central Bank (ECB) is expected to ease monetary policy further. At the ECB's January press conference, President Mario Draghi stated that the central bank was ready to "take further decisive action if required." Admittedly, the ECB's main refinancing rate is now just 0.25%, so it is unclear what form this action might take, but there are still options to relax monetary policy.

Such an easing could either be achieved through a reduction of the key interest rate, which appears unlikely, or through non-standard measures, such as introducing negative rates for banks' deposits at the ECB or fresh liquidity injections. Other possibilities include stronger "forward guidance" from the ECB — purchasing loans from banks or even quantitative easing. And regardless of ECB policy moves, our forecast assumes there will be some loosening of monetary conditions in the next two years through a weakening of the exchange rate. We expect the euro to decline to around US$1.27 by end-2014 and then US$1.23 by end-2015, as stronger US growth and tapering supports the US dollar. But if the euro does not depreciate as we expect, this would weigh on the recovery by constraining export competitiveness and, combined with the large negative output gap, would heighten the threat of deflation.

Figure 6

US$/€ exchange rate



Source: Oxford Economics.

But there is a mounting threat of deflation ...

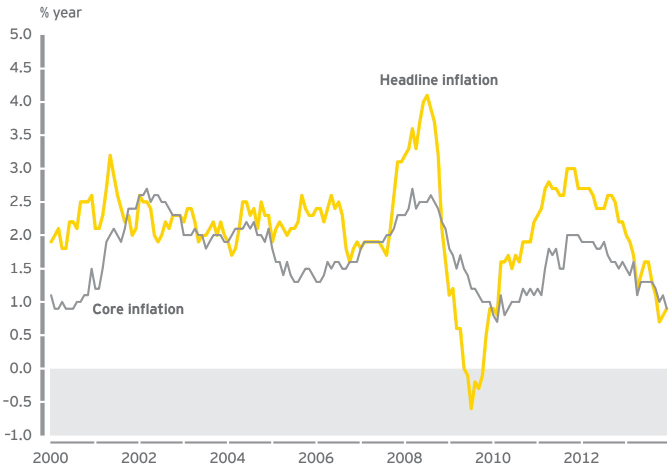
As a result of the growing deflationary threat, the need for the ECB to be prepared to loosen monetary policy further remains high. Latest inflation data shows that the danger of deflation is now very real. Consumer price inflation in the Eurozone was just 0.8% in the year to February. Underlying inflation (excluding food and energy) was also 0.8%, up slightly from December 2013, but still close to the lowest rate on record (since the early 1990s at least). And equally worrying was the fact that the annual growth of the broad money supply was just 1.2% in January, one of the lowest readings since late 2010. And of even more concern, the stock of broad money declined at an annualized rate of 1.2% on Q3. Such weak growth of the money supply adds to the risk of deflation in the Eurozone.

Exports to drive a gradual recovery in 2014

We forecast Eurozone inflation of just 1.1% on average in 2014, with a modest uptick to 1.5% in 2015. But with an output gap estimated at around 4% of GDP in 2014, the risks to our inflation projections are on the downside. Deflation would mean that debt cannot be eroded by inflation. As a result, deleveraging would need to happen via outright debt reduction, which would constrain government and consumer spending even more. In particular, the impact of deflation on the private and public sector debt burdens or spending could quickly lead to renewed concerns about the solvency of the peripheral countries, which have higher debt burdens, perhaps triggering a new period of heightened uncertainty about the Eurozone's future prospects.

Figure 7

Inflation



Source: Haver Analytics.

… while credit conditions remain tight

Despite the possibility of further monetary easing, credit conditions in much of the Eurozone will remain tight. With the results of the ECB's asset quality review (AQR) due in November, which have potential implications for the banking sectors in many countries, banks will remain reluctant to lend, especially in those countries where non-performing loans are still rising. The poor record of the previous stress-testing regime means that the findings of the AQR are likely to try to ensure that market expectations are not disappointed, otherwise this could lead to renewed instability within the region. As a result, banks will remain very cautious until the findings are known. This means that companies, especially small and medium-sized firms, will still find it difficult to borrow. As a result, investment prospects will remain constrained.

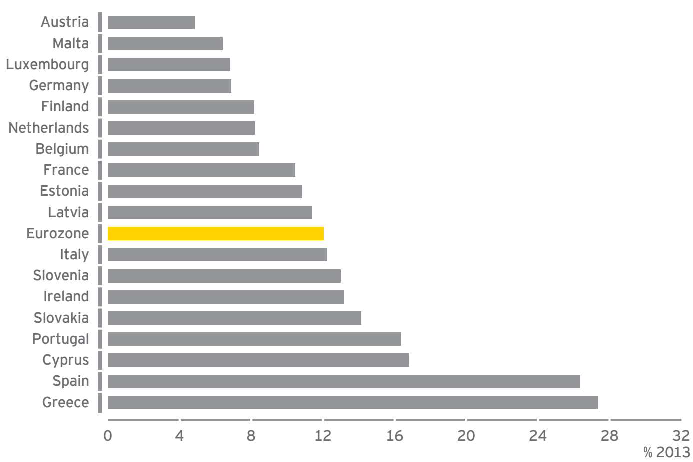
At the same time, although the decision on a Single Resolution Authority for banks at the end of last year is a further small step toward eventual banking union, banking systems remain largely the responsibility of individual governments. As a result, the fragmentation of the Eurozone banking sector that has become apparent in recent years will persist. And businesses and households in the countries with the most vulnerable banking systems will continue to face the tightest credit conditions.

Unemployment will remain high in most countries

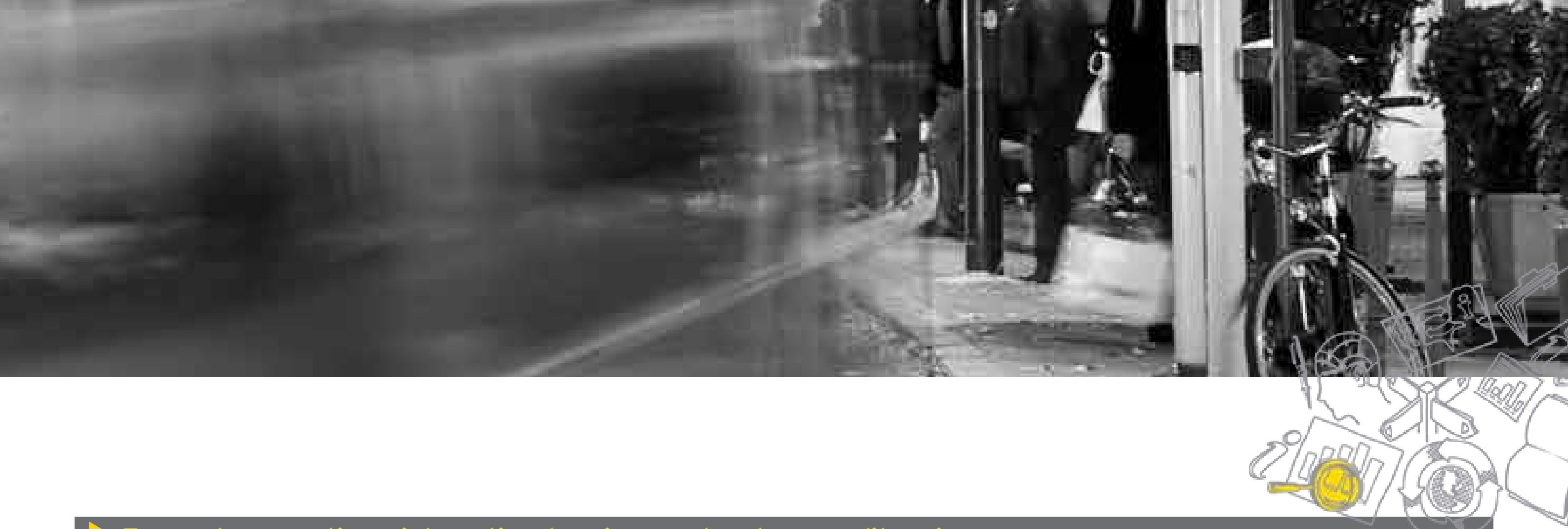
As well as tight credit conditions, a key factor in the forecast of subdued consumer demand in the coming years is the high level of unemployment. Recent data has been more encouraging: the unemployment rate at the Eurozone level has flattened out at about 12% in recent months and the countries with the highest rates of unemployment, such as Greece and Spain, are reporting much smaller rises. But the weak recovery that we forecast for the Eurozone, combined with businesses trying to improve profitability and productivity in the face of tight credit conditions, means that unemployment will fall only very slowly in the next two years. Our forecast shows unemployment in the Eurozone averaging 12% in 2014, slightly lower than in 2013, before edging down gradually to 11% in 2018. But, as with GDP growth rates, wide labor market divergence among member countries will persist. The Greek unemployment rate is projected to climb to over 28% this year, before falling slowly to just under 25% in 2018. Spain's rate is expected to fall slightly to 25.2% this year, and 23% in 2018. In contrast, Austria and Germany will continue to have the lowest unemployment rates, at about 4.6% and 5.3% in 2014–18.

Figure 8

Unemployment rates



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.

World GDP growth accelerated gradually through 2013, with the annual rate moving from a three-year low of 1.7% in Q1, to 2.8% in Q4. Growth for the full year is estimated at 2.2%, little changed from 2012. This upturn has been led by the emerging markets, with countries that are not part of the Organisation for Economic Co-operation and Development (OECD) posting growth of 4.5%, while the OECD region grew by just 1.2%. Among the advanced economies, the UK and Japan enjoyed particularly strong pickups through the year. Meanwhile, the US also accelerated, but at a somewhat disappointing pace, hampered 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 starting to taper its asset purchases. The Eurozone was the weakest region, posting its second full year of recession.

The performance of the leading emerging markets was mixed in 2013. The Chinese economy again recorded strong growth, estimated at 7.7%, the same as in 2012, but other major emerging nations, such as India, Brazil and Russia posted disappointing growth. Their prospects have been undermined by a wave of risk aversion that brought sharp currency depreciations, equity market underperformance and rising bond yields, and some of these factors have affected other economies that have close links with these major markets.

For 2014, we forecast that world GDP growth will accelerate, led by the US, where the combination of improving household finances, a stronger housing market and improved external competitiveness will enable growth to pick up to just over 3%. The UK recovery should continue to gain momentum as it broadens out into business investment and exports, and we expect growth of 2.6% in 2014, up from 1.9% in 2013. The Japanese recovery should also become more firmly entrenched, although the planned rise in consumption tax is likely to prevent a strong pickup in growth, which we expect to be 1.8%, only slightly better than in 2013.

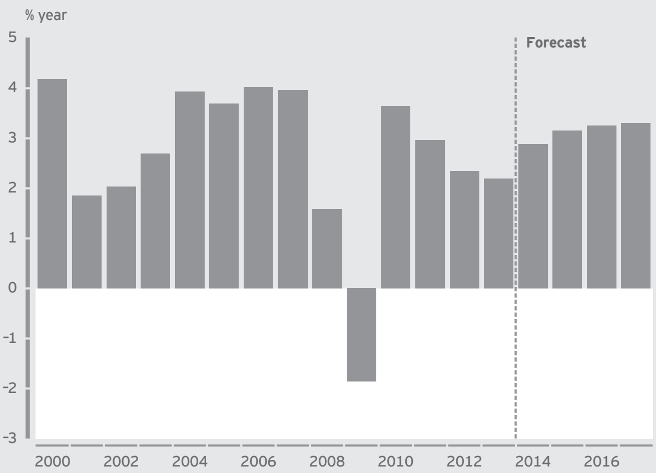
Among the main emerging markets, despite recent financial market turmoil, China is still expected to grow strongly, albeit a little more slowly, at 7.4%, as it seeks to rebalance its economy away from investment and toward consumption, with a further modest slowdown seen for 2015. Elsewhere, the developing world should benefit from stronger domestic demand in advanced economies, with growth in India seen rising to about 5% this year and next. However, Brazil will continue to struggle, with growth forecast to dip to just 1.7% in 2014, as it tries to tackle inflation pressures. Overall growth in the emerging markets is projected at 4.7% in 2014, a little higher than in 2013. While this growth rate would be much stronger than that of the advanced economies, which is forecast at 2.3% this year, a full percentage point higher than in 2013, it will still be well below par by historical standards, even though it will ensure that the emerging markets continue to raise their share in world GDP and trade and investment.

As a result, our forecast is for world GDP to grow by 2.9% in 2014 and by 3.2% a year in 2015–17. This growth profile will be echoed by a similar pickup in world trade growth, which is forecast to accelerate from 2.7% in 2013, to 4.8% in 2014, and then about 6% a year in 2015–17, in turn helping to bolster investment flows.

After spiking above US$115 per barrel in August 2013 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, held down by the rise in the output of shale oil and gas. We expect Brent crude to average about US$104 a barrel in 2014, down from US$109 in 2013, before a modest pickup to US$105 a barrel in 2015. However, a deepening of the Ukraine crisis could push up oil and gas prices more than currently expected.

Figure 9

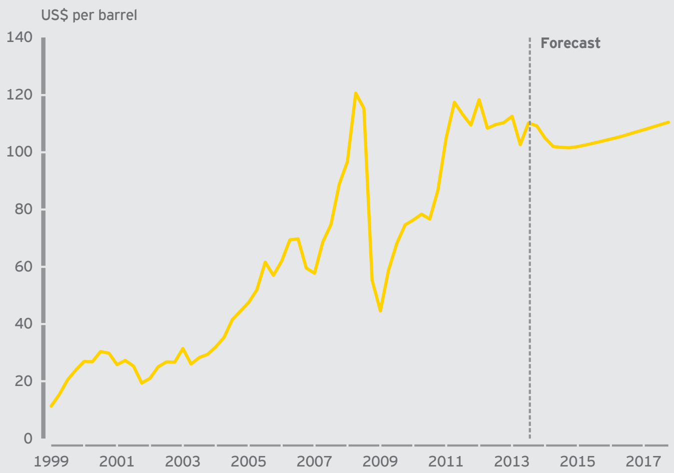
World: GDP growth



Source: Oxford Economics.

Figure 10

Oil price, nominal



Source: Oxford Economics.

Forecast for Eurozone countries

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

18 Eurozone countries

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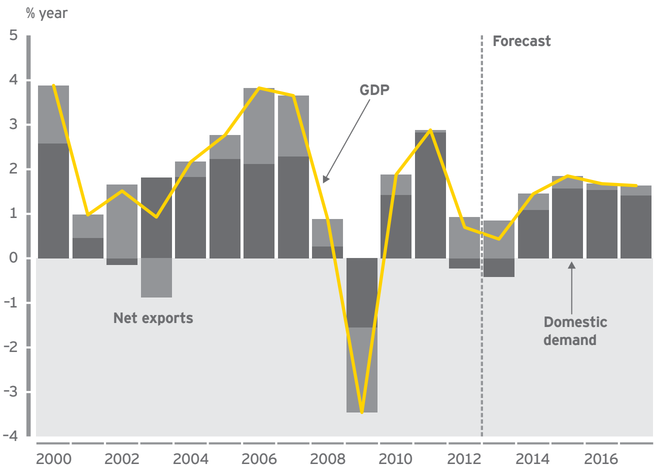
Austria

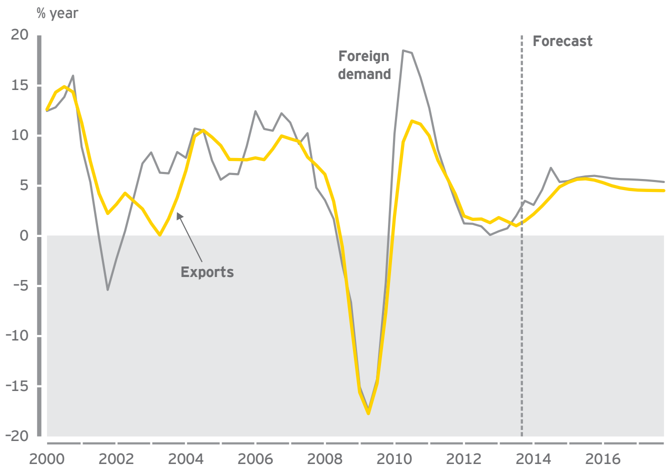
- Austria's recovery is set to accelerate, with GDP seen growing 1.5% in 2014, largely due to a pickup in external demand benefiting the large export-oriented manufacturing sector. As capacity constraints are approached, this will trigger investment, helped by comparatively good access to credit, before feeding through to the rest of the economy.
- After stagnating in 2013, consumer spending growth will accelerate to 0.7% this year. But it will remain some way short of pre-crisis rates in the coming years, as the positive dynamics in the labor market seen until recently will slow and real income growth will be modest.
- The new Government appears to be "muddling through" in its budget for 2014–15, rather than meeting structural saving potential. This means it is now less likely to achieve the target of a balanced budget by 2016. Nevertheless, given relatively low government debt, the fiscal position remains sound.

Figure 11
Contributions to GDP



Source: Oxford Economics.

Figure 12
Exports and foreign demand



Source: Oxford Economics.

Austria (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	0.4	1.5	1.9	1.7	1.6	1.6
Private consumption	0.0	0.7	1.1	1.3	1.4	1.4
Fixed investment	-0.5	2.1	3.2	2.5	1.8	1.6
Stockbuilding (% of GDP)	0.4	0.5	0.6	0.6	0.6	0.6
Government consumption	0.3	1.4	1.6	1.6	1.6	1.6
Exports of goods and services	1.4	3.5	5.6	4.9	4.5	4.5
Imports of goods and services	0.0	3.3	5.8	5.4	4.8	4.6
Consumer prices	2.1	1.8	1.8	1.8	1.8	1.8
Unemployment rate (level)	4.8	4.9	4.7	4.6	4.5	4.5
Current account balance (% of GDP)	2.3	3.4	3.3	3.3	3.2	3.2
Government budget (% of GDP)	-2.3	-1.7	-1.0	-0.6	-0.6	-0.6
Government debt (% of GDP)	75.0	74.4	72.9	71.1	69.4	67.7

Source: Oxford Economics.

Belgium

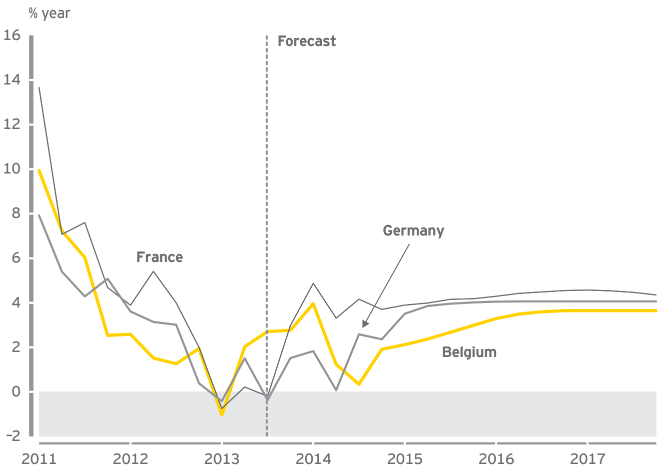
GDP growth

2014 **1.1%**

- We forecast Belgian GDP growth of just over 1% in 2014, driven by the combination of a modest recovery in consumer demand (aided by a second consecutive year of inflation at about 1%) and a tentative recovery in external trade.
- But the pace of recovery will be limited to about 1.5% a year over the medium term. Households will remain concerned about job security for some time, constraining the rebound in consumer spending, while the consequence of a lack of austerity over the past few years is that a long period of fiscal restraint is in order. Finally, wage indexation and high non-wage labor costs will undermine Belgian firms' ability to compete in global markets.
- The weakness of the recovery is a problem. Belgium's debt ratio (over 100% of GDP) is much higher than in other core Eurozone economies, making the country more vulnerable to faster increases in borrowing costs or to debt-deflation.
- The elections due in May provide an important opportunity for Belgium to debate these structural challenges, and to reassert its position as a center of high-value-added activity in the Eurozone. Tackling barriers to job creation and improving the labor participation rate are priorities in this respect.

Figure 13

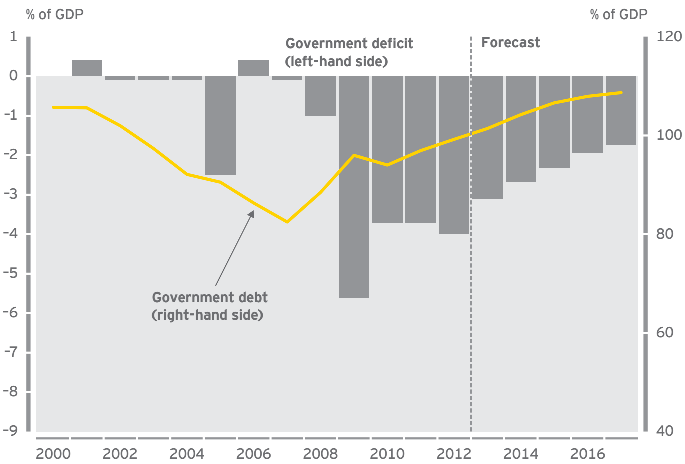
Export growth vs. Germany and France



Source: Oxford Economics; Haver Analytics.

Figure 14

Government deficit and debt



Source: Oxford Economics.

Belgium (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	0.2	1.1	1.4	1.6	1.7	1.8
Private consumption	0.6	1.2	1.1	1.2	1.3	1.3
Fixed investment	-2.9	0.4	2.3	2.7	2.9	2.9
Stockbuilding (% of GDP)	0.6	0.4	0.1	0.1	0.2	0.2
Government consumption	0.7	0.6	0.8	0.9	1.1	1.2
Exports of goods and services	1.6	1.8	2.5	3.5	3.6	3.5
Imports of goods and services	0.9	1.3	2.1	3.4	3.6	3.4
Consumer prices	1.2	1.0	1.7	1.9	2.0	2.0
Unemployment rate (level)	8.4	8.6	8.5	8.1	7.7	7.6
Current account balance (% of GDP)	-2.1	-1.3	-1.3	-1.2	-1.1	-0.9
Government budget (% of GDP)	-3.1	-2.7	-2.3	-1.9	-1.7	-1.5
Government debt (% of GDP)	103.2	106.3	108.5	109.7	110.3	110.4

Source: Oxford Economics.

Cyprus

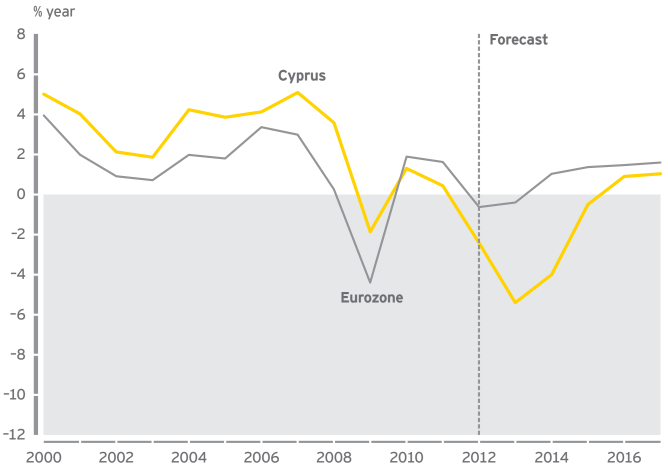
GDP growth

2014 **-4.0%**

- While Cyprus's economy continues to suffer, with estimates for Q4 showing that GDP shrank by 5.4% in 2013, the economy has not contracted as much as we initially expected. As such, we now expect GDP to decline by only 4% this year, down from the 8% forecast in our December report.
- Nevertheless, the headwinds facing the economy remain strong. Consumption remains under pressure from rising unemployment, fiscal consolidation and falling wages. We do not expect consumer spending to return to growth until 2016, by which time it will be more than 15% lower than its pre-crisis peak.
- But the outlook remains uncertain. In particular, the financial system is still vulnerable because of the high level of non-performing loans. Banks' continuing efforts to shrink their balance sheets could also potentially delay the fragile recovery. With the external accounts now improving, the main risk to the outlook is a slide into deflation. This would have an adverse impact on the growth outlook, because of the high levels of debt in the public and private sectors.

Figure 15

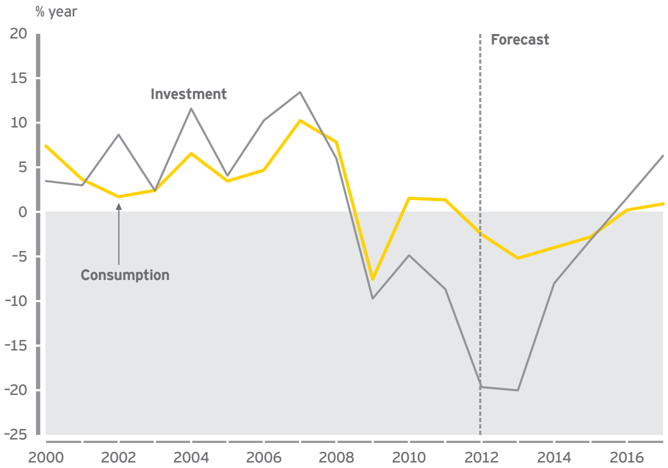
Real GDP growth



Source: Oxford Economics.

Figure 16

Real consumption and investment growth



Source: Oxford Economics.

Cyprus (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	-5.4	-4.0	-0.5	0.9	1.0	1.8
Private consumption	-5.2	-4.0	-2.8	0.2	0.9	1.6
Fixed investment	-20.0	-8.0	-3.2	1.5	6.3	9.9
Stockbuilding (% of GDP)	-2.7	-4.7	-1.8	1.1	2.2	2.3
Government consumption	-1.0	-3.6	-2.9	-2.9	-2.2	1.0
Exports of goods and services	-4.6	-1.5	2.9	3.1	4.5	5.1
Imports of goods and services	-15.0	-6.7	4.5	7.3	6.9	6.7
Consumer prices	0.4	0.9	1.1	1.2	1.5	1.8
Unemployment rate (level)	16.8	19.3	19.4	18.9	16.9	14.5
Current account balance (% of GDP)	-0.8	-0.3	-0.3	-0.3	-0.3	-0.4
Government budget (% of GDP)	-7.7	-7.0	-6.5	-3.6	-2.6	-1.1
Government debt (% of GDP)	97.4	107.6	113.5	114.8	114.5	111.5

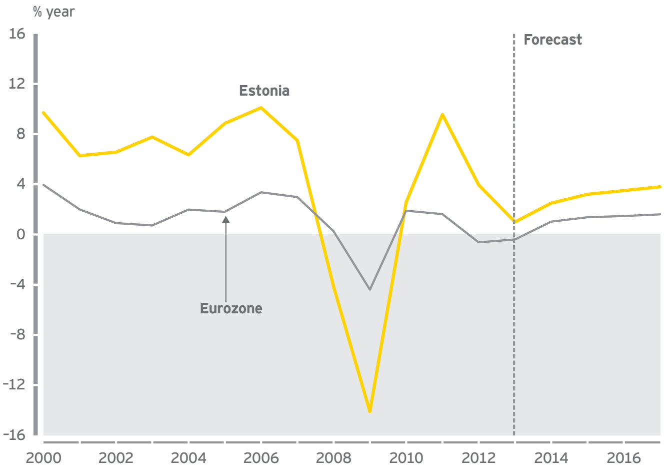
Source: Oxford Economics.

Estonia

- We expect the Estonian economy to pick up speed, with growth forecast at 2.5% this year and then 3.2% in 2015, after tepid growth of 0.8% in 2013. This improvement reflects a number of factors, including an increase in demand from abroad, a response from investment as firms increase capacity, significant rises in household income and the benefits of a growing Baltic presence in the Eurozone.
- The medium-term prospects are also relatively bright, given the low levels of public debt and the sound banking system. By 2017, the level of economic activity is expected to be about 10% higher than its pre-crisis peak, compared with an average of just 3.3% for the Eurozone overall.
- But there are downside risks. The economy continues to suffer from high (although falling) long-term unemployment, with over 40% of the jobless out of work for more than 12 months. Meanwhile inflation – the highest in the Eurozone last year at 3.2% – may erode competitiveness. And weaker Russian growth may dampen prospects this year.

Figure 17

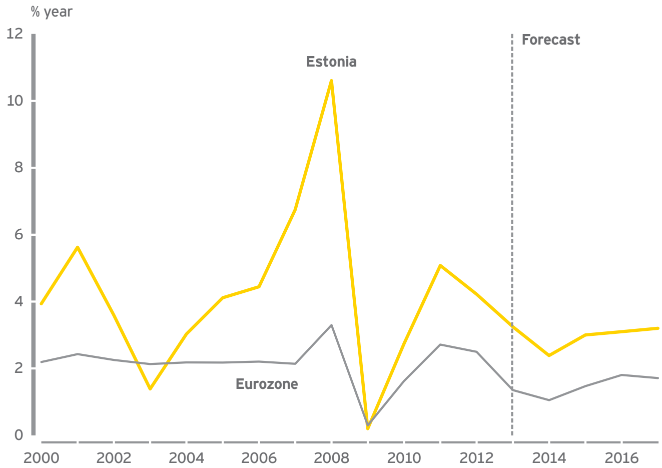
Real GDP growth



Source: Oxford Economics.

Figure 18

Inflation



Source: Oxford Economics.

Estonia (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	0.8	2.5	3.2	3.5	3.8	3.9
Private consumption	4.2	3.4	3.7	3.9	4.1	4.1
Fixed investment	1.0	3.7	4.0	4.2	5.3	4.9
Stockbuilding (% of GDP)	2.0	1.8	1.2	0.1	0.1	0.3
Government consumption	1.3	0.3	2.7	3.0	3.0	2.7
Exports of goods and services	1.8	5.5	7.3	9.5	8.2	7.5
Imports of goods and services	2.6	5.4	7.0	8.6	8.6	7.8
Consumer prices	3.2	2.4	3.0	3.1	3.2	3.0
Unemployment rate (level)	10.8	9.2	8.8	8.3	6.1	5.6
Current account balance (% of GDP)	-1.8	-1.4	-0.7	-0.3	-0.1	0.1
Government budget (% of GDP)	-0.6	-0.2	-0.1	0.1	0.3	0.5
Government debt (% of GDP)	11.2	10.8	10.0	9.1	8.0	6.8

Source: Oxford Economics.

Finland

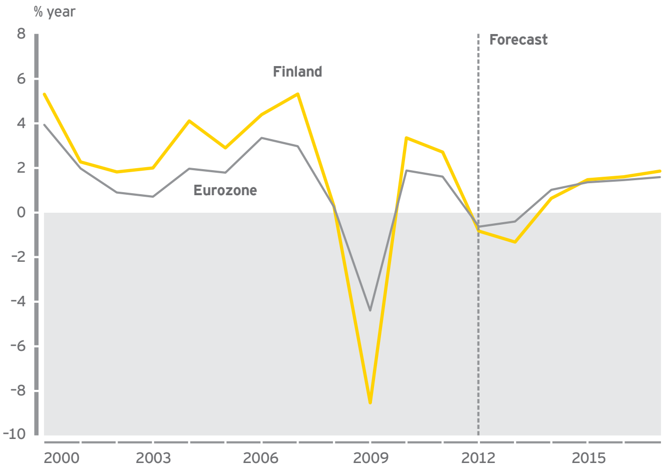
GDP growth

2014 0.6%

- The outlook for Finland remains uneasy as the recovery struggles to gain traction after the recent recession. And with no obvious catalyst to drive a strong recovery in output and demand from Russia likely to be slowing, the economy is set for a period of consolidation rather than significant acceleration, with GDP growth forecast at just 0.6% in 2014.
- Weak domestic fundamentals mean the pace of the recovery is heavily reliant on a marked improvement in external demand. Poor household income development, weighed down by modest wage growth and further fiscal consolidation from a government steadfastly committed to austerity, means that consumer spending will not provide the same impetus of 2010–11.
- But the economy is faced with significant structural challenges that cannot be resolved by a pickup in global trade alone. The decline of key export sectors has exposed a worryingly narrow industrial base that is struggling to identify the growth sectors of the future. With export growth falling short of pre-crisis levels, GDP growth is expected to average just 1.8% a year in 2015–18.

Figure 19

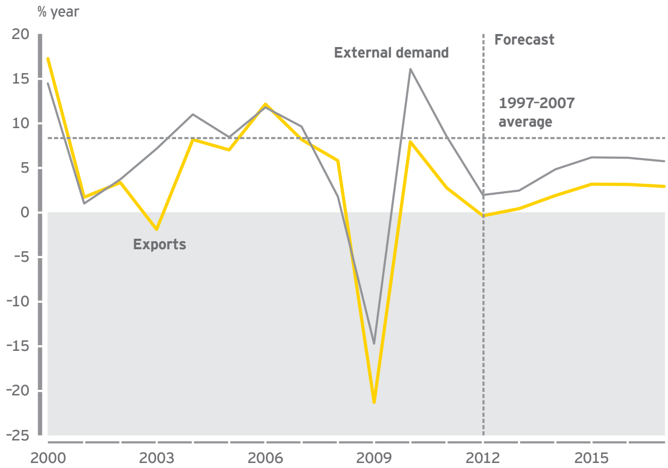
GDP growth



Source: Oxford Economics.

Figure 20

Exports and external demand



Source: Oxford Economics.

Finland (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	-1.3	0.6	1.5	1.6	1.9	2.1
Private consumption	-0.6	0.5	1.5	1.6	2.0	2.2
Fixed investment	-3.6	-0.1	2.4	2.2	2.3	2.5
Stockbuilding (% of GDP)	-0.5	0.3	0.1	0.0	0.0	0.0
Government consumption	-0.4	0.1	1.1	1.2	1.5	1.8
Exports of goods and services	0.4	1.9	3.2	3.1	2.9	2.8
Imports of goods and services	-2.9	3.3	3.2	3.3	3.2	2.8
Consumer prices	2.2	1.1	1.8	1.8	1.8	1.8
Unemployment rate (level)	8.2	8.4	8.0	7.6	7.4	7.2
Current account balance (% of GDP)	-0.8	-0.3	-0.2	-0.1	0.0	0.1
Government budget (% of GDP)	-3.2	-3.6	-3.4	-2.8	-1.9	-1.0
Government debt (% of GDP)	56.7	59.2	60.8	61.6	61.2	59.9

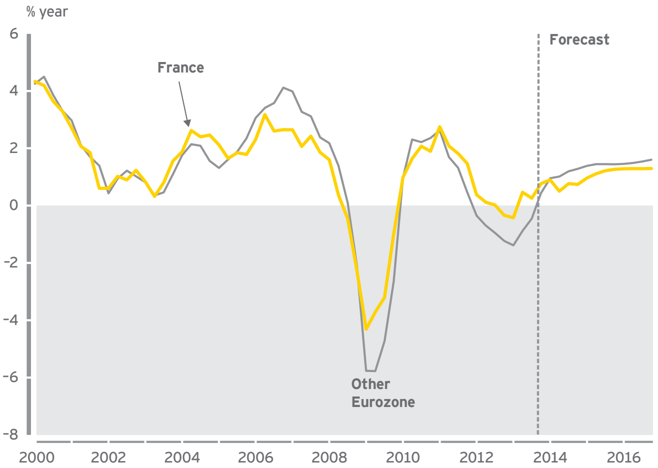
Source: Oxford Economics.

France

GDP growth
2014 0.7%

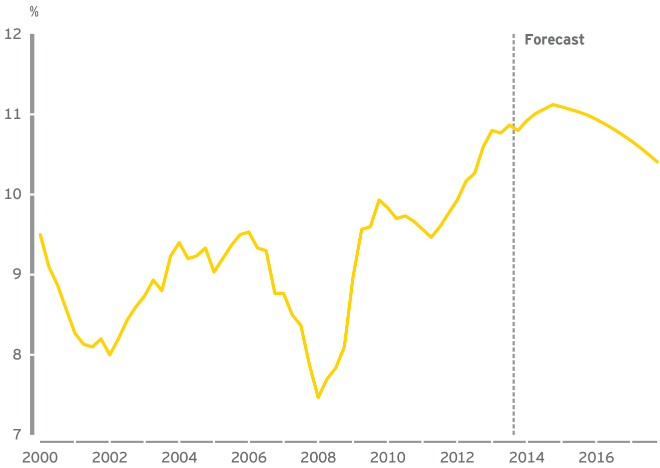
- France seems unlikely to emerge from stagnation in 2014. The economy is struggling to build on the stronger growth it saw in early 2013 and the current strength of other parts of the Eurozone. Growth surprised on the upside in Q4 2013, but indicators for early 2014 suggest a tough start to the year, while elsewhere in the Eurozone prospects are looking brighter.
- We forecast GDP growth of 0.7% this year and a gradual acceleration to 1.1% in 2015.
- Despite an expected pickup in growth in important trading partners, such as Germany, the UK and the US, export growth is likely to remain lackluster, reflecting an erosion of competitiveness. French exports are forecast to expand by only 1.7% this year and 3.8% in 2015.
- France needs to be committed to improving business conditions in order to reinvigorate its export sector. Recent announcements by the Government as part of the "responsibility pact" are encouraging, but need to be further developed.

Figure 21
GDP growth: France vs. rest of Eurozone



Source: Oxford Economics.

Figure 22
Unemployment



Source: Oxford Economics.

France (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	0.3	0.7	1.1	1.3	1.3	1.4
Private consumption	0.4	1.0	1.1	1.2	1.3	1.4
Fixed investment	-2.1	0.6	1.4	1.9	2.0	1.9
Stockbuilding (% of GDP)	-0.1	0.4	0.5	0.6	0.6	0.5
Government consumption	1.7	0.5	0.2	0.3	0.5	0.7
Exports of goods and services	0.6	1.7	3.8	4.1	4.1	4.1
Imports of goods and services	0.8	3.5	3.4	3.5	3.5	3.5
Consumer prices	1.0	1.1	1.3	1.6	1.6	1.7
Unemployment rate (level)	10.8	11.0	11.0	10.8	10.5	10.2
Current account balance (% of GDP)	-1.5	-1.7	-1.7	-1.8	-1.8	-1.7
Government budget (% of GDP)	-4.1	-3.7	-3.2	-2.6	-2.1	-1.8
Government debt (% of GDP)	93.5	97.5	101.2	103.1	103.9	103.6

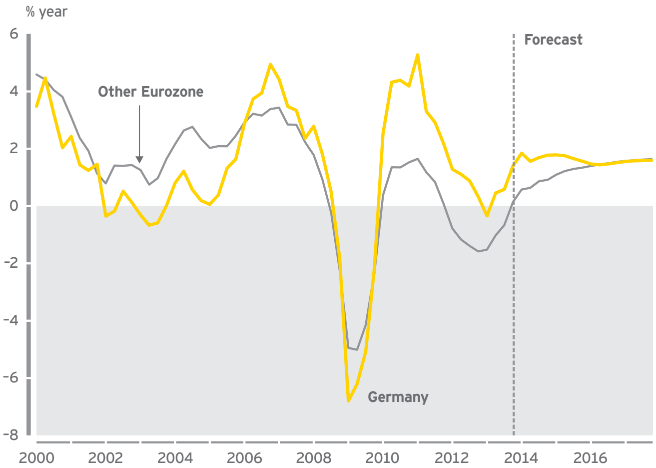
Source: Oxford Economics.

Germany

- After growth of 0.5% in 2013, the German economy is forecast to expand by 1.7% in 2014. It is expected to benefit from a pickup in the rest of the Eurozone, while sustained strength in the UK and US should also help to support exports.
- Private consumption should also play a key role. Households are in a strong financial position, with low levels of debt, and confidence has risen. Moreover, stable inflation and strong wage growth, underpinned by a tight labor market and rising production levels, should boost household disposable incomes.
- Meanwhile, a pickup in investment will be driven by greater confidence in the economic outlook, as well as supportive financial conditions and diminishing spare capacity.
- We expect growth to be sustained and broadly balanced in 2015. International economic recovery is expected to be more solid and this will be reflected in rising production and stronger export growth.

Figure 23

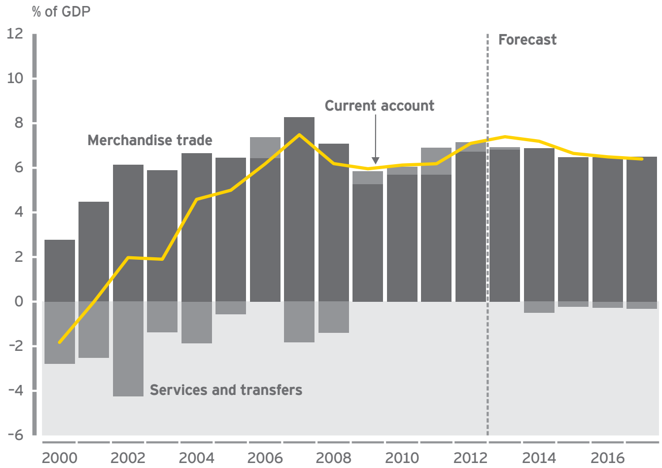
GDP growth: Germany vs. rest of Eurozone



Source: Oxford Economics.

Figure 24

Current account



Source: Oxford Economics.

Germany (annual percentage changes unless specified)

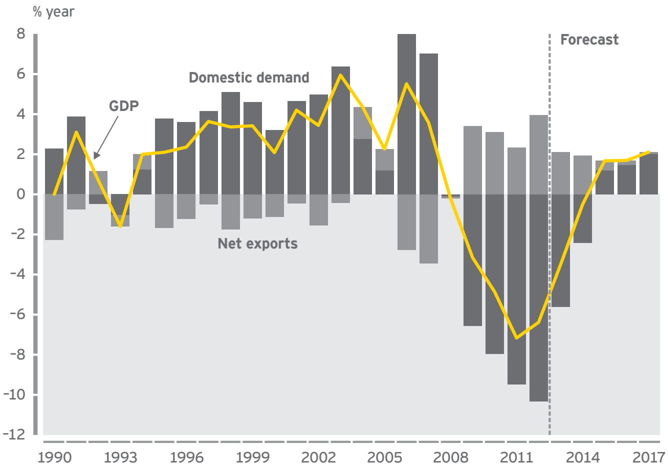
	2013	2014	2015	2016	2017	2018
GDP	0.5	1.7	1.7	1.5	1.6	1.6
Private consumption	1.0	1.1	1.8	1.1	1.2	1.3
Fixed investment	-0.7	3.8	3.3	2.9	2.7	2.4
Stockbuilding (% of GDP)	0.0	0.1	0.2	0.2	0.2	0.2
Government consumption	0.4	0.6	0.7	0.7	0.8	0.9
Exports of goods and services	0.6	4.0	4.1	4.4	4.5	4.0
Imports of goods and services	0.9	4.1	5.1	4.6	4.5	4.1
Consumer prices	1.6	1.5	2.2	2.9	2.5	1.6
Unemployment rate (level)	5.3	5.1	5.2	5.4	5.4	5.3
Current account balance (% of GDP)	7.4	7.2	6.6	6.5	6.4	6.4
Government budget (% of GDP)	-0.3	0.0	0.2	-0.1	-0.2	-0.2
Government debt (% of GDP)	80.1	79.6	79.3	78.8	78.5	78.4

Source: Oxford Economics.

Greece

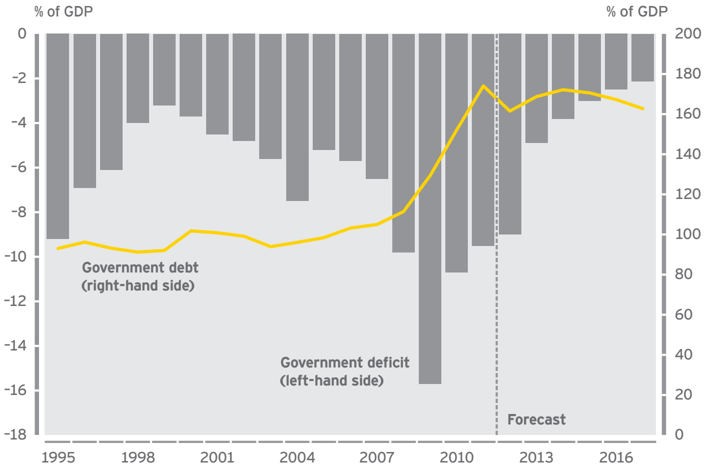
- The Greek economy's rate of contraction continued to slow toward the end of 2013, and with government finances (excluding interest payments) and the current account close to balancing, the outlook is much improved. However, in our view, talk of a recovery is premature and we expect GDP to contract by a further 0.5% in 2014.
- Households will continue to see wages fall, pushed down by high unemployment and the very large output gap. As a result, we expect consumer spending to fall further this year and, as the dominant component of GDP, this will offset much of the improvement in net exports.
- Meanwhile, there are still significant risks to the recovery. The political landscape remains fractious, while relations with international lenders appear strained over the lethargic pace of agreed reforms. The government debt burden, at over 170% of GDP, is unsustainable, and further debt relief will be needed in order to reduce high interest payments, especially if a deflationary spiral takes hold.

Figure 25
Contributions to GDP growth



Source: Oxford Economics.

Figure 26
Government deficit and debt



Source: Oxford Economics.

Greece (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	-3.7	-0.5	1.7	1.7	2.3	2.2
Private consumption	-6.5	-1.0	0.9	1.3	1.4	1.6
Fixed investment	-11.7	0.6	6.2	6.2	6.1	5.8
Stockbuilding (% of GDP)	1.8	0.8	0.6	0.1	0.2	0.1
Government consumption	-6.4	-4.6	-0.6	1.7	1.7	1.6
Exports of goods and services	2.5	4.8	4.0	4.0	3.9	3.8
Imports of goods and services	-5.0	-2.3	2.2	3.2	3.6	3.8
Consumer prices	-0.9	-0.7	0.5	1.1	1.6	1.8
Unemployment rate (level)	27.5	28.3	27.6	26.7	25.7	24.6
Current account balance (% of GDP)	-0.2	-0.4	0.0	0.1	0.2	0.3
Government budget (% of GDP)	-4.9	-3.8	-3.0	-2.5	-2.1	-1.9
Government debt (% of GDP)	171.0	173.6	171.7	168.2	163.2	158.2

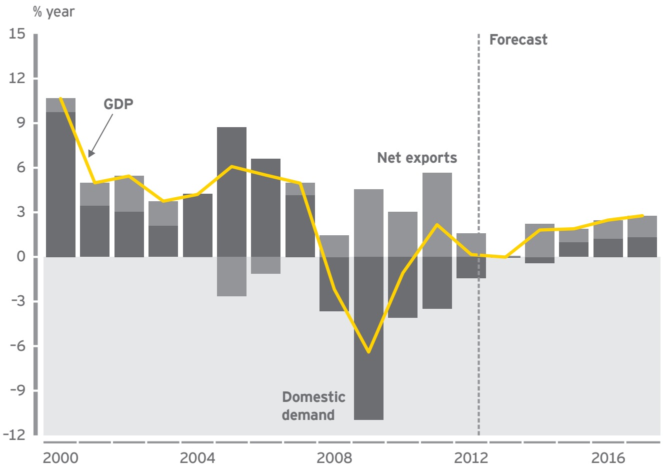
Source: Oxford Economics.

Ireland

- The Irish economy is expected to expand by 1.8% in 2014, up from the 1.7% growth we forecast in December. The recovery in domestic demand appears to now be more entrenched, while net trade will continue contributing positively to the economy, especially given the strong growth in the UK. Ireland is continuing to pull ahead of the other peripheral Eurozone countries in emerging from the crisis, and we expect GDP to increase by 1.9% in 2015 and then by 2.8% a year in 2016-18.
- Irish bond yields have fallen to just over 3% and the Government successfully exited its bailout program in December 2013. As a result, Moody's ratings agency has upgraded its sovereign debt to investment-grade status again. These are encouraging signs, suggesting that Ireland is gradually returning to normality.
- Risks to the outlook have abated considerably, but are still probably on the downside. Uncertainty about banks' ability to cope with the stock of distressed loans is the main source of downside risk. With inflation remaining exceptionally low, the threat of deflation also poses a downside risk to the outlook.

Figure 27

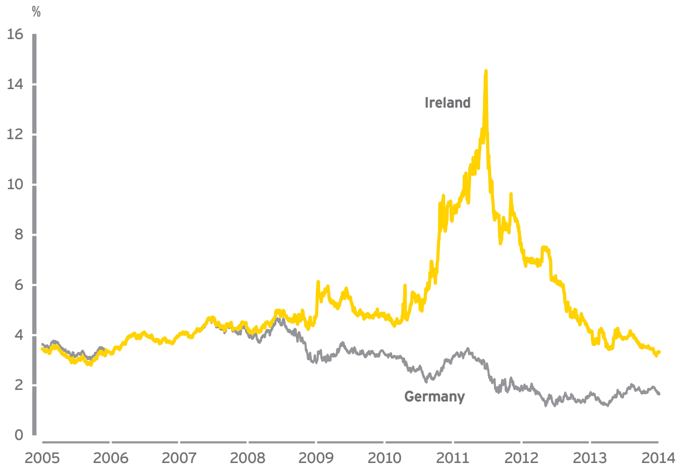
Contributions to GDP



Source: Oxford Economics.

Figure 28

Long-term government bond yields



Source: Oxford Economics; Haver Analytics.

Ireland (annual percentage changes unless specified)

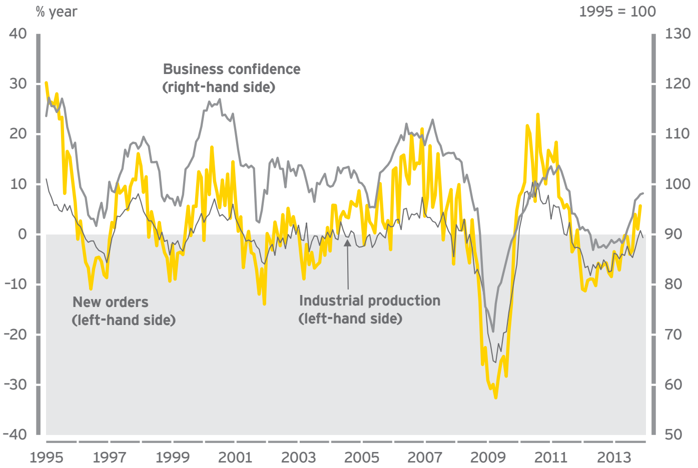
	2013	2014	2015	2016	2017	2018
GDP	0.0	1.8	1.9	2.5	2.8	3.1
Private consumption	-0.8	1.1	1.3	1.3	1.3	1.7
Fixed investment	1.1	3.5	5.3	5.5	5.2	5.0
Stockbuilding (% of GDP)	0.2	0.0	0.0	0.0	0.0	0.0
Government consumption	-0.9	-1.3	-1.5	-0.2	0.6	0.7
Exports of goods and services	-0.4	3.5	3.7	4.0	4.0	4.4
Imports of goods and services	-0.6	1.7	3.7	3.7	3.5	3.9
Consumer prices	0.5	0.4	1.5	1.7	1.8	1.9
Unemployment rate (level)	13.1	11.7	10.8	10.2	9.7	9.1
Current account balance (% of GDP)	5.7	4.3	4.2	4.1	4.0	3.9
Government budget (% of GDP)	-7.5	-5.1	-3.0	-1.9	-1.1	-0.9
Government debt (% of GDP)	124.1	124.9	123.6	120.6	116.8	112.5

Source: Oxford Economics.

Italy

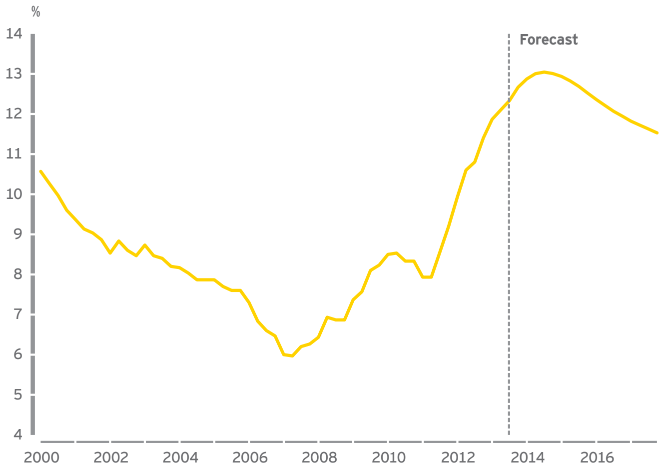
- Italy's longest post-war recession came to an end in H2 2013 and conditions are in place for a gradual expansion of economic activity in 2014. However, tight fiscal and lending conditions are likely to result in GDP growth of just 0.4% this year. Growth is then expected to accelerate to 1.1% in 2015 and 1.4% a year in 2016–18.
- Strengthening demand from key export markets and a weaker euro will lead to a steady rise in exports in 2014. Meanwhile, rising production will stimulate capital spending and we expect investment to increase 0.6% in 2014 and around 2.4% a year on average in 2015–18.
- Employment will stabilize in H1 2014 and is expected to recover only gradually from 2015. As a result, unemployment is forecast to remain above 12% until 2016. The weak labor market will contribute to a further 0.6% decline in private consumption in 2014. Consumption is then expected to grow by just over 1% a year in 2015–18.

Figure 29
Industrial performance



Source: Haver Analytics.

Figure 30
Unemployment rate



Source: Oxford Economics.

Italy (annual percentage changes unless specified)

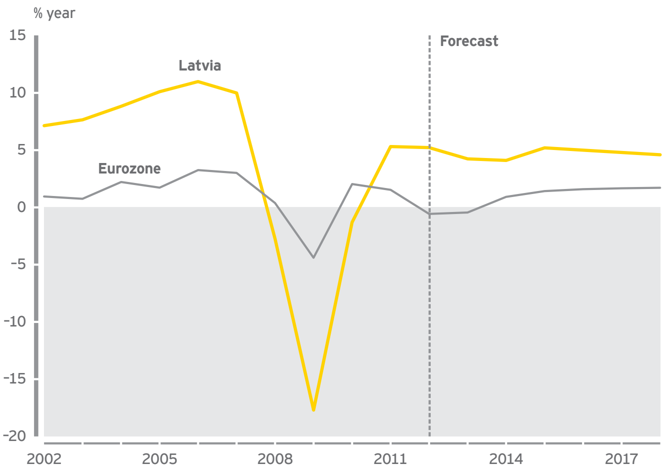
	2013	2014	2015	2016	2017	2018
GDP	-1.9	0.4	1.1	1.4	1.4	1.4
Private consumption	-2.5	-0.6	0.7	1.2	1.3	1.2
Fixed investment	-5.5	0.6	2.2	2.4	2.5	2.4
Stockbuilding (% of GDP)	-0.4	-0.4	-0.4	-0.1	0.0	0.2
Government consumption	-0.2	-0.7	0.0	0.1	0.2	0.3
Exports of goods and services	0.1	3.5	4.2	4.1	3.9	3.7
Imports of goods and services	-2.8	0.8	3.8	4.8	4.5	4.2
Consumer prices	1.3	0.8	1.0	1.3	1.3	1.4
Unemployment rate (level)	12.2	12.9	12.7	12.1	11.6	11.3
Current account balance (% of GDP)	0.7	1.0	0.8	0.5	0.3	0.2
Government budget (% of GDP)	-3.0	-2.9	-2.5	-2.1	-1.8	-1.5
Government debt (% of GDP)	131.4	133.3	132.8	131.3	129.5	127.4

Source: Oxford Economics.

Latvia

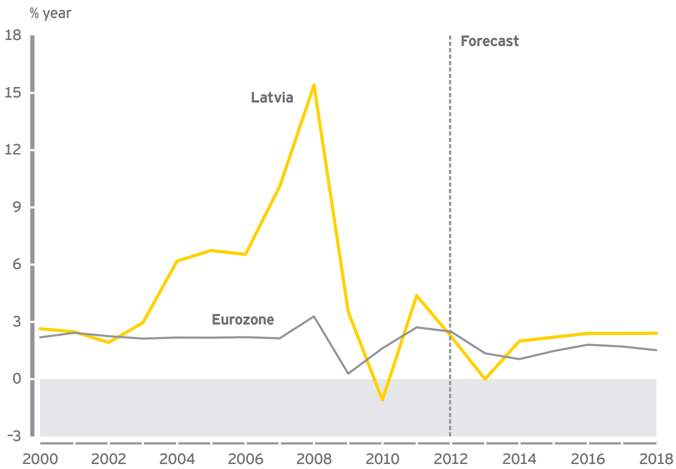
- Economic expansion in Latvia moderated last year and we expect the pace to remain broadly unchanged at just over 4% in 2014. GDP growth is then expected to pick up to around 5% a year in 2015–18, supported by a rebound in domestic demand. This means that Latvia will be the fastest-growing Eurozone member throughout the forecast period.
- Inflation may pick up rapidly in the coming months as a result of stronger demand, higher energy costs and some currency-conversion adjustments. Indeed, the annual rise in hourly labor costs is already well above the Eurozone average, highlighting the speed at which cost advantages from earlier "internal devaluation" could be eroded if labor productivity growth is not maintained.
- Ahead of elections scheduled for October 2014, there is a risk that progress on the reform agenda could stall. Some reforms are still necessary to help reduce structural unemployment and improve the business environment, so a lack of progress on this front risks undermining long-term growth prospects.

Figure 31
Real GDP growth



Source: Oxford Economics; World Bank.

Figure 32
Inflation



Source: Oxford Economics.

Latvia (annual percentage changes unless specified)

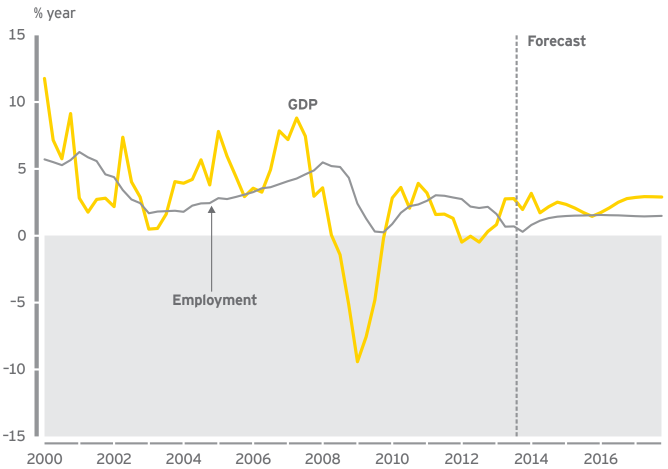
	2013	2014	2015	2016	2017	2018
GDP	4.1	4.1	5.2	5.0	4.8	4.6
Private consumption	5.3	4.0	4.5	4.5	4.5	4.5
Fixed investment	1.6	4.5	5.0	5.0	5.0	5.0
Stockbuilding (% of GDP)	0.4	1.3	2.5	3.4	3.9	4.0
Government consumption	2.0	2.0	2.0	2.7	2.4	2.3
Exports of goods and services	2.1	3.8	6.5	6.5	6.5	6.5
Imports of goods and services	0.6	4.7	7.0	6.8	6.3	6.1
Consumer prices	0.0	2.0	2.2	2.4	2.4	2.4
Unemployment rate (level)	11.4	10.3	9.1	7.7	7.7	7.7
Current account balance (% of GDP)	-0.8	-0.6	-0.8	-0.6	0.4	0.5
Government budget (% of GDP)	-1.4	-1.0	-1.0	-1.0	-1.0	-1.0
Government debt (% of GDP)	40.7	39.3	37.5	35.8	34.4	33.0

Source: Oxford Economics.

Luxembourg

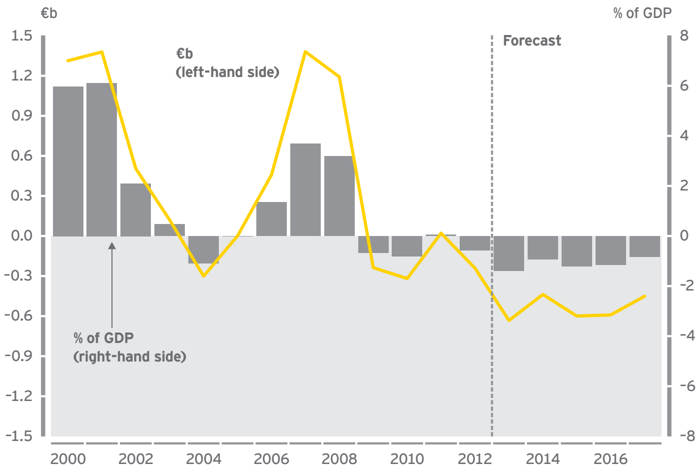
- We continue to expect GDP growth for Luxembourg in the short term to be well above the Eurozone average, at 2.4% in 2014. This is mainly because of robust domestic demand adding to the impetus from the gradual acceleration of external demand, in particular from other countries in the Eurozone, its main export destination.
- From 2015, GDP growth will be hampered by the introduction of new EU rules on value-added tax (VAT) in e-commerce. Under the new legislation, e-commerce businesses will be required to charge tax at the rates in operation in customers' countries, and these countries will also be entitled to the resulting receipts. In order to offset the anticipated fiscal losses, the Government will raise its own VAT rates by 2 percentage points. This will undermine real incomes in 2015 and dampen domestic demand, resulting in slower growth.
- Despite the fact that the measures currently envisaged are unlikely to be sufficient to fully offset any losses, government finances will remain sound in the medium term. Equivalent to 30% of GDP, social security reserves exceed public debt, which stands at a mere 22% of GDP. Moreover, systemically important banks are moderate in size in the context of Luxembourg's economy.

Figure 33
Real GDP and employment



Source: Oxford Economics.

Figure 34
Government budget balance



Source: Oxford Economics.

Luxembourg (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	2.1	2.4	1.9	2.3	2.9	2.8
Private consumption	1.8	1.8	1.9	2.2	2.5	2.5
Fixed investment	2.1	5.5	2.8	2.6	3.0	3.0
Stockbuilding (% of GDP)	4.3	3.6	3.0	1.9	1.9	2.1
Government consumption	1.7	1.9	1.9	1.9	1.9	2.0
Exports of goods and services	2.5	4.9	6.0	4.3	3.5	3.1
Imports of goods and services	2.8	5.1	6.2	3.9	3.4	3.1
Consumer prices	1.7	1.7	3.1	2.0	2.0	1.9
Unemployment rate (level)	5.9	6.0	5.7	5.2	4.7	4.2
Current account balance (% of GDP)	4.4	3.5	4.0	4.7	4.7	4.7
Government budget (% of GDP)	-1.4	-0.9	-1.2	-1.2	-0.8	-0.7
Government debt (% of GDP)	21.9	21.9	22.3	22.5	22.3	21.9

Source: Oxford Economics.

Malta

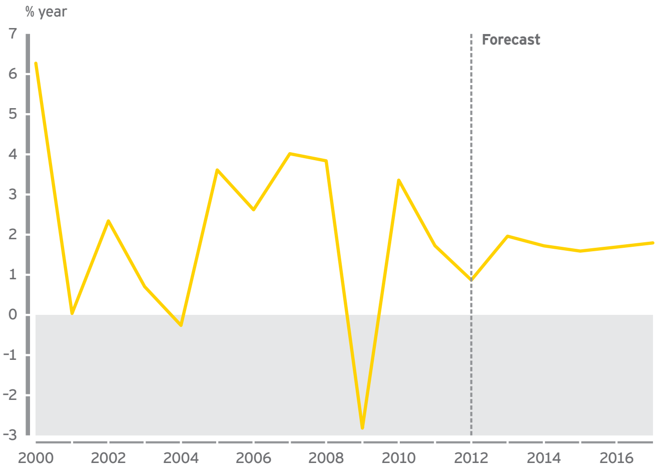
GDP growth

2014 **1.7%**

- We expect Malta to continue to outperform the Eurozone this year, with GDP growing by 1.7%, after an estimated 2.4% rise in 2013. Tourist arrivals picked up notably last year, rising by over 9%, following an increase of 2% in 2012. Domestic demand is estimated to have improved in H2 2013 following weakness in H1, helped by growth in real wages. This will continue into 2014, allied with stronger export demand.
- We expect the Maltese Government to have met the EC target of a budget deficit of 3.4% of GDP in 2013. And although Malta is unlikely to meet its deficit target of 2.7% for 2014, its relatively benign fiscal position suggests that the EC will not impose additional austerity measures.
- The risks to our GDP growth forecast for this year are balanced. On the downside, if the Eurozone fiscal situation remains very fragile, greater fiscal consolidation may be required, hindering activity in Malta. But on the upside, if Eurozone demand grows more quickly than expected this year, demand for exports would increase.

Figure 35

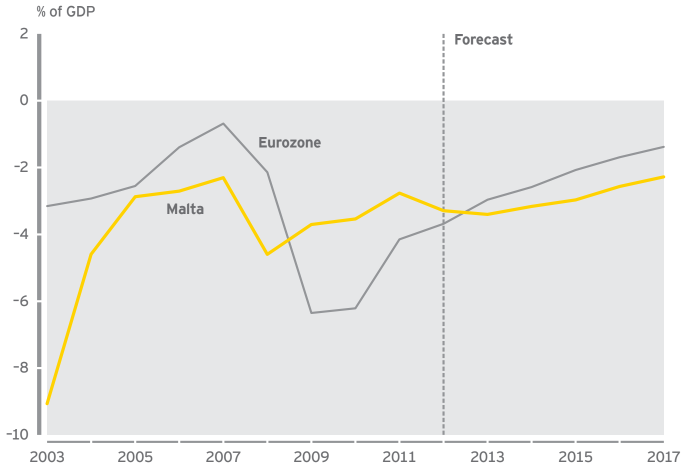
GDP



Source: Oxford Economics.

Figure 36

Fiscal balance vs. Eurozone



Source: Oxford Economics.

Malta (annual percentage changes unless specified)

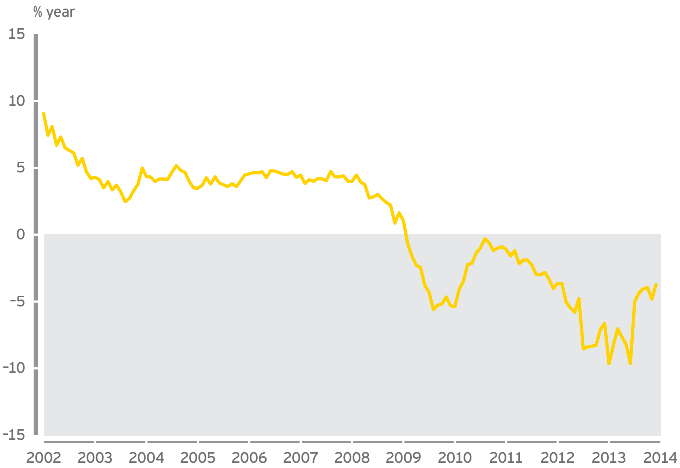
	2013	2014	2015	2016	2017	2018
GDP	2.4	1.7	1.6	1.7	1.8	1.8
Private consumption	1.8	2.1	1.4	1.5	1.7	1.7
Fixed investment	-3.9	4.1	2.9	2.9	2.5	2.3
Stockbuilding (% of GDP)	-0.8	-1.3	-1.0	-0.7	-0.6	-0.5
Government consumption	-0.2	0.5	0.8	1.3	1.4	1.5
Exports of goods and services	-5.5	4.4	3.3	2.7	2.8	3.0
Imports of goods and services	-5.1	4.4	3.7	3.0	3.0	3.0
Consumer prices	1.0	1.3	1.7	2.0	2.3	2.3
Unemployment rate (level)	6.4	6.1	5.9	5.8	5.6	5.6
Current account balance (% of GDP)	2.0	0.5	0.4	0.2	0.1	0.0
Government budget (% of GDP)	-3.4	-3.2	-3.0	-2.6	-2.3	-2.0
Government debt (% of GDP)	72.5	73.5	74.1	74.0	73.3	72.4

Source: Oxford Economics.

Netherlands

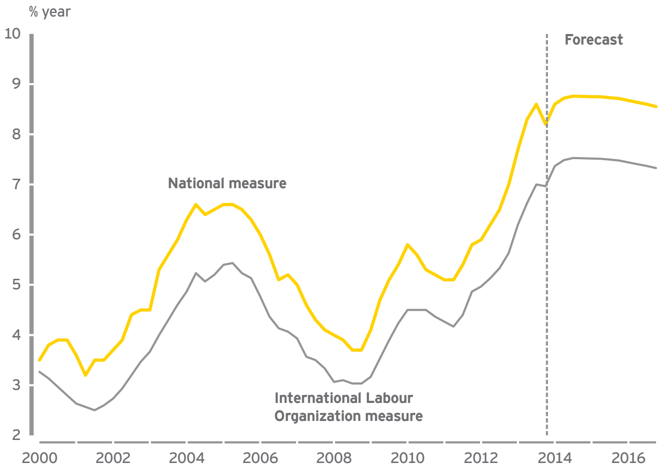
- The Netherlands emerged from recession in Q3 2013 and posted surprisingly strong growth in Q4. And there are some positive signs for domestic demand in 2014. Real incomes should experience positive growth for the first time since 2010, as inflation begins to slow.
- Improving demand from the EU and the US for Dutch exports should help lift production, and this will eventually feed into a pickup in investment and greater employment.
- However, compared with the rest of the Eurozone, the pace of recovery will be limited, weighed down by still-fragile consumer demand, with unemployment remaining stubbornly high. Combined with ongoing deleveraging by households, we expect private consumption to remain weak in 2014.
- Ongoing austerity measures will also weigh on growth. We expect the Dutch economy to expand by 0.6% this year, after a contraction of 0.8% in 2013, before picking up slowly to 0.8% in 2015.

Figure 37
House prices



Source: Oxford Economics; Haver Analytics.

Figure 38
Unemployment



Source: Oxford Economics.

Netherlands (annual percentage changes unless specified)

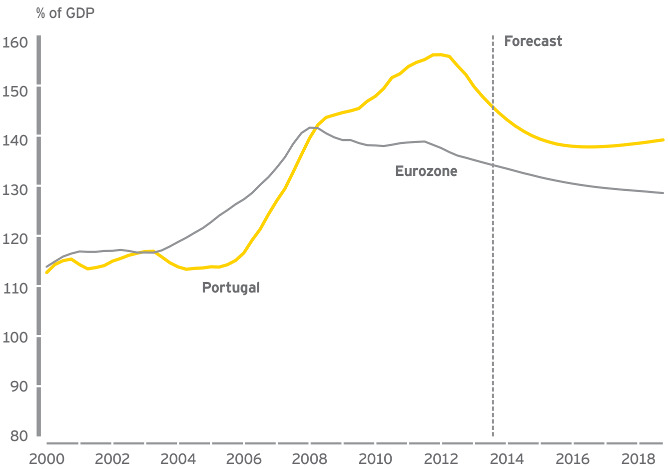
	2013	2014	2015	2016	2017	2018
GDP	-0.8	0.6	0.8	1.2	1.5	1.7
Private consumption	-2.1	-0.5	0.3	0.8	1.3	1.5
Fixed investment	-4.9	3.3	1.5	2.1	2.0	2.2
Stockbuilding (% of GDP)	0.7	0.7	0.7	0.5	0.3	0.3
Government consumption	-0.7	-0.6	-0.4	-0.1	0.5	1.0
Exports of goods and services	1.3	2.6	3.4	3.4	3.1	2.6
Imports of goods and services	-0.5	2.4	3.1	3.1	2.8	2.6
Consumer prices	2.6	0.9	1.1	1.1	1.2	1.3
Unemployment rate (level)	6.7	7.5	7.5	7.4	7.2	6.9
Current account balance (% of GDP)	10.8	9.7	8.7	8.8	9.1	9.1
Government budget (% of GDP)	-2.9	-3.2	-2.6	-2.2	-2.1	-1.7
Government debt (% of GDP)	73.8	76.4	77.8	78.3	78.3	77.8

Source: Oxford Economics.

Portugal

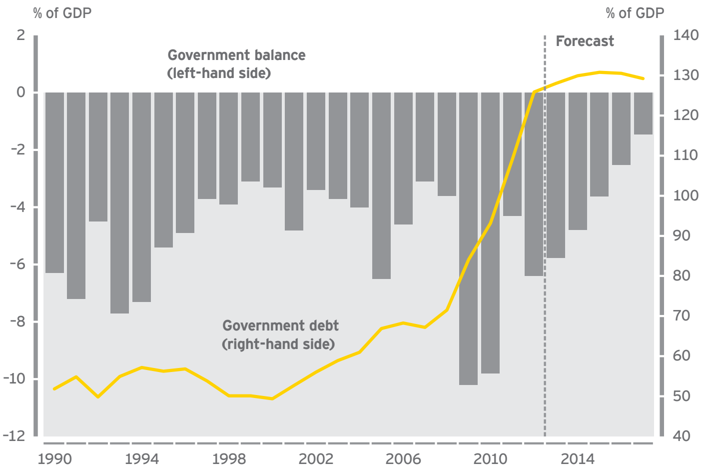
- The Portuguese economy emerged from recession last year, with the estimate for Q4 2013 showing growth of 0.6% on the quarter. But the recovery from the deep recession of the last three years will be slow. Our forecasts indicate that GDP will grow by 1.4% this year, after a fall of 1.4% in 2013, and by 1.2% in 2015.
- Domestic demand will remain subdued, making only a limited contribution to growth. Companies are highly indebted and face very high borrowing rates. Austerity measures will continue to take a toll on the economy, with the majority of the effort to trim the budget deficit on the expenditure side.
- Against a backdrop of depressed domestic demand, exports will continue to be the main driver of growth in the next couple of years. The recovery expected in Portugal's export markets, combined with an improvement in competitiveness, will help to lift exports by around 4% a year in 2014-16.
- The rise in consumer confidence and some improvement in financial markets are upside risks to our forecast. Yields on Portuguese debt have fallen by around 100 basis points since the start of the year and the Government has issued bonds totaling over €6b, covering this year's funding needs.

Figure 39
Corporate sector deleveraging



Source: Oxford Economics; Haver Analytics.

Figure 40
Government balance and debt



Source: Oxford Economics.

Portugal (annual percentage changes unless specified)

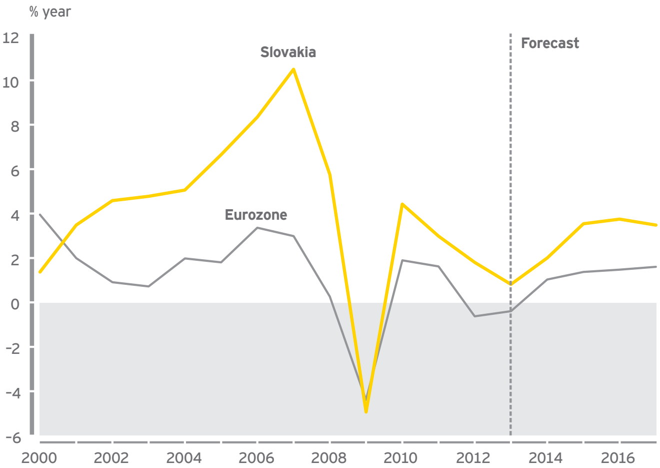
	2013	2014	2015	2016	2017	2018
GDP	-1.4	1.4	1.2	1.2	1.2	1.2
Private consumption	-1.7	1.0	0.6	0.7	0.7	0.8
Fixed investment	-7.7	0.9	1.6	2.4	2.3	2.3
Stockbuilding (% of GDP)	0.6	1.0	1.0	0.9	1.0	1.0
Government consumption	-2.6	-2.2	0.1	1.0	1.3	1.2
Exports of goods and services	5.8	4.7	4.3	3.5	3.0	2.7
Imports of goods and services	2.1	3.1	3.2	3.0	2.8	2.6
Consumer prices	0.4	0.7	0.9	1.0	1.0	1.0
Unemployment rate (level)	16.5	16.0	16.1	16.0	15.7	15.4
Current account balance (% of GDP)	0.7	0.3	0.4	0.7	0.6	0.7
Government budget (% of GDP)	-5.8	-4.8	-3.6	-2.5	-1.5	-0.6
Government debt (% of GDP)	129.8	131.6	132.1	131.4	129.7	127.2

Source: Oxford Economics.

Slovakia

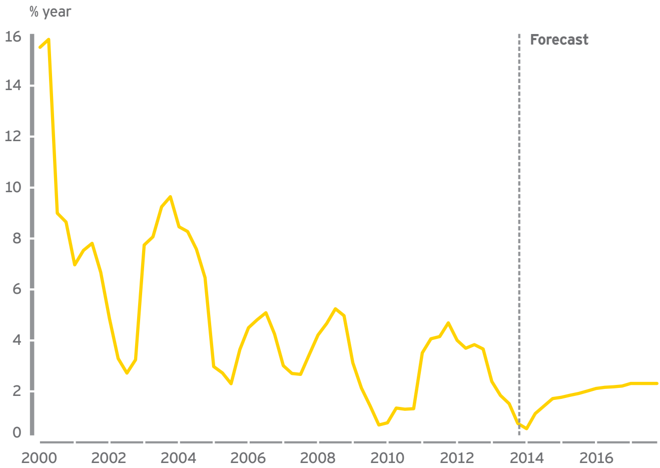
- GDP growth is expected to accelerate to 2% this year, up from 0.8% in 2013. The main drivers for this are the easing of fiscal policy and a strengthening of foreign demand. However, export growth is likely to be tempered by capacity constraints on car plants. GDP growth should accelerate further, to 3.5% in 2015, with a similar pace forecast in 2016–18, when exports are expected to pick up more decisively, contributing to stronger employment growth.
- Inflation should remain lower than we previously expected in 2014. It will average just 1% this year and then pick up to around 1.7% in 2015 and 2.1% on average in 2015–18 as the negative output gap gradually closes.
- However, there is a risk of deflation. Low inflation at the end of 2013 and cuts in electricity prices in January could lead to consumer prices falling. If households and businesses start expecting lower price levels in the future as a result of this, they might delay their consumption and investment plans.

Figure 41
Real GDP growth



Source: Oxford Economics.

Figure 42
Inflation



Source: Oxford Economics; World Bank.

Slovakia (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	0.8	2.0	3.5	3.7	3.5	3.2
Private consumption	-0.1	1.2	2.6	2.8	2.7	2.7
Fixed investment	-7.5	0.5	4.0	4.8	4.5	4.0
Stockbuilding (% of GDP)	-1.4	-1.0	-0.4	0.3	0.4	0.4
Government consumption	0.6	2.0	2.9	2.9	2.7	2.5
Exports of goods and services	3.7	4.6	5.7	5.8	5.2	4.8
Imports of goods and services	2.0	4.7	6.2	6.6	5.3	4.6
Consumer prices	1.4	1.0	1.7	2.0	2.1	2.2
Unemployment rate (level)	14.2	13.7	13.0	12.1	11.0	9.9
Current account balance (% of GDP)	3.3	3.4	3.3	3.3	3.3	3.3
Government budget (% of GDP)	-2.9	-3.0	-2.9	-2.5	-2.3	-2.1
Government debt (% of GDP)	54.6	56.1	56.2	55.6	54.9	54.3

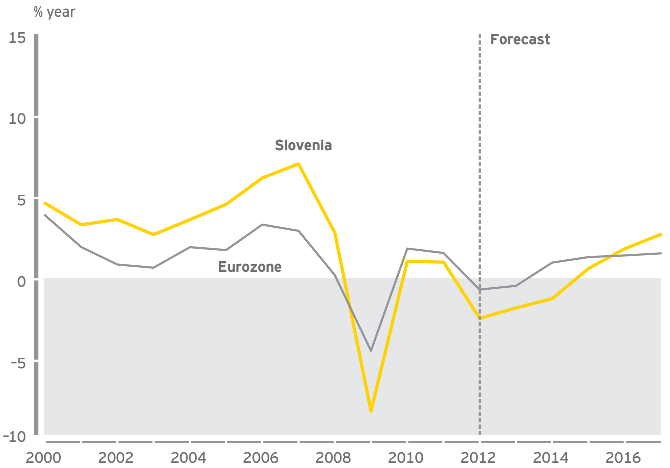
Source: Oxford Economics.

Slovenia

- The long-awaited results of the Slovenian bank stress tests were revealed in December, indicating the total cost of reforming the banking sector will be €4.8b — more than 10% of GDP.
- Economic activity stabilized in H2 2013, but even so GDP contracted by 0.9% in 2013 and we forecast a further 1.2% decline this year. This is a marked upgrade from our December 2013 forecast, when we were more cautious because of the high level of uncertainty regarding banking reform.
- The Government injected €3.2b into Slovenia's 5 largest banks in December 2013 to cover the immediate problems revealed by the stress tests. The Government will need to borrow €3.5b this year to finance the budget and recapitalize the banking sector, taking the fiscal deficit to more than 15% of GDP.
- Modest growth should resume from 2015, helped by a gradual improvement in Eurozone activity. But the risks remain high and fixed investment is almost 50% lower than its 2008 peak, which is likely to constrain growth in the medium term.

Figure 43

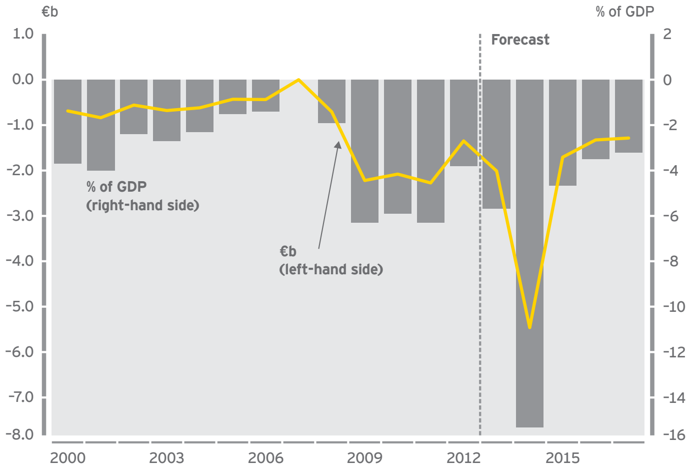
Real GDP growth



Source: Oxford Economics.

Figure 44

Government budget balance



Source: Oxford Economics.

Slovenia (annual percentage changes unless specified)

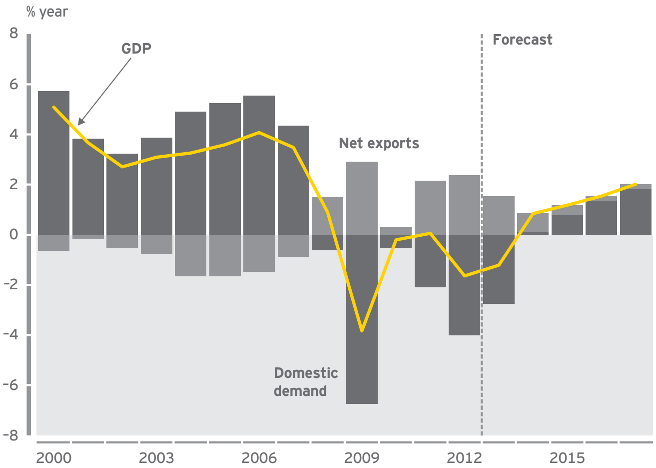
	2013	2014	2015	2016	2017	2018
GDP	-0.9	-1.2	0.7	1.9	2.8	3.3
Private consumption	-2.9	-1.1	0.5	1.8	2.6	3.3
Fixed investment	-0.2	-2.9	2.1	4.7	5.3	4.7
Stockbuilding (% of GDP)	-0.9	-2.6	-2.4	-2.2	-2.5	-2.4
Government consumption	-2.0	-2.0	0.1	1.4	2.5	2.9
Exports of goods and services	2.7	2.0	1.9	1.7	2.7	2.5
Imports of goods and services	1.0	1.1	2.4	2.5	2.7	2.7
Consumer prices	1.8	1.8	1.8	2.1	2.5	2.5
Unemployment rate (level)	10.1	10.2	9.9	9.4	8.4	7.5
Current account balance (% of GDP)	6.6	7.3	7.0	6.3	6.3	6.1
Government budget (% of GDP)	-5.7	-15.3	-4.7	-3.5	-3.2	-3.2
Government debt (% of GDP)	68.3	83.2	77.7	72.9	70.5	69.8

Source: Oxford Economics.

Spain

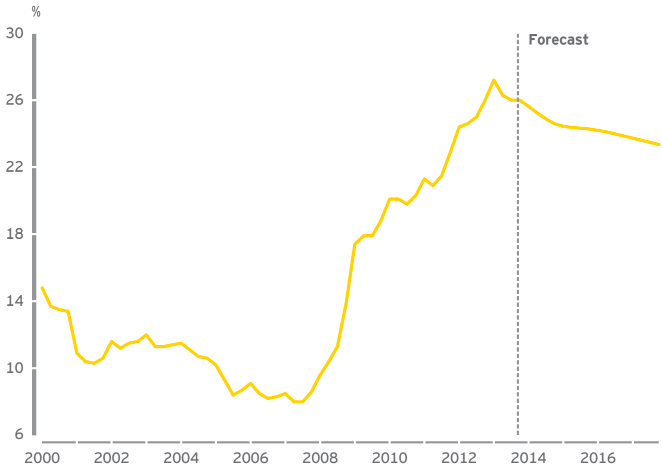
- We forecast that Spain's GDP will rise by 0.8% in 2014, with the risks now tilted to the upside, due to signs of a renewed upswing in domestic demand at the end of last year. While the export sector will be the main engine of growth in 2014, we now also expect a modest positive contribution from domestic demand, arising from improvements in both consumer spending and non-residential private investment.
- The structural reforms introduced over the past few years support our view that the economic recovery is sustainable, but deleveraging pressures and the ongoing adjustment in the real estate sector will continue to hamper prospects for some time. We therefore expect GDP growth to accelerate only gradually, reaching just 2.3% in 2018.
- It is vital that the Government pushes ahead with its reform agenda in order to build the foundations for long-term growth. For example, the latest labor reforms still do not go far enough in addressing the two-tier jobs market, where it still costs far more to fire permanent workers than those on temporary contracts.

Figure 45
Contributions to GDP growth



Source: Oxford Economics.

Figure 46
Unemployment rate



Source: Oxford Economics.

Spain (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	-1.2	0.8	1.2	1.5	2.0	2.3
Private consumption	-2.1	0.9	1.1	1.7	2.1	2.5
Fixed investment	-5.1	0.4	2.0	2.0	2.4	2.8
Stockbuilding (% of GDP)	0.9	0.6	0.5	0.6	0.6	0.7
Government consumption	-2.3	-1.0	-0.8	-0.3	0.7	1.0
Exports of goods and services	4.9	6.7	4.5	3.7	3.5	3.3
Imports of goods and services	0.4	4.9	3.8	3.6	3.4	3.4
Consumer prices	1.5	0.8	1.0	1.0	1.0	1.1
Unemployment rate (level)	26.4	25.2	24.4	24.1	23.6	23.0
Current account balance (% of GDP)	0.7	1.4	1.2	1.1	0.9	0.8
Government budget (% of GDP)	-6.8	-5.9	-4.8	-3.5	-2.5	-1.9
Government debt (% of GDP)	94.6	101.3	106.4	109.7	111.2	111.7

Source: Oxford Economics.

Detailed tables and charts

Forecast assumptions

	2013	2014	2015	2016	2017	2018
Short-term interest rates (%)	0.2	0.3	0.3	0.3	0.5	1.4
Long-term interest rates (%)	3.0	2.9	3.3	3.6	3.9	4.2
Euro effective exchange rate (1995 = 100)	120.8	120.7	118.0	115.8	114.8	114.7
Oil prices (€/barrel)	81.8	78.8	82.5	86.8	90.9	94.2
Share prices (% year)	15.8	14.7	7.1	7.6	7.4	6.6

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Short-term interest rates (%)	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3
Long-term interest rates (%)	3.1	2.8	3.1	3.0	2.8	2.8	2.9	3.0
Euro effective exchange rate (1995 = 100)	118.8	119.2	121.7	123.7	122.7	121.0	119.8	119.4
Oil prices (€/barrel)	85.2	78.6	83.2	80.3	77.8	77.9	79.5	80.0
Share prices (% year)	8.2	21.1	15.9	18.6	16.9	17.7	16.0	8.8

Eurozone GDP and components

Quarterly forecast (quarterly percentage changes)

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-0.2	0.3	0.1	0.3	0.2	0.3	0.3	0.3
Private consumption	-0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.3
Fixed investment	-2.0	0.3	0.5	0.7	0.1	0.5	0.5	0.6
Government consumption	0.3	0.0	0.2	0.1	-0.2	0.0	0.0	0.1
Exports of goods and services	-0.9	2.1	0.3	0.8	0.8	0.9	0.9	1.0
Imports of goods and services	-1.1	1.5	1.2	0.1	0.7	0.8	0.9	1.0

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

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-0.2	0.3	0.1	0.3	0.2	0.3	0.3	0.3
Private consumption	-0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.2
Fixed investment	-0.4	0.0	0.1	0.1	0.0	0.1	0.1	0.1
Government consumption	0.1	0.0	0.0	0.0	-0.1	0.0	0.0	0.0
Stockbuilding	0.1	-0.2	0.3	-0.3	0.1	0.1	0.0	-0.1
Exports of goods and services	-0.4	1.0	0.1	0.4	0.4	0.4	0.4	0.5
Imports of goods and services	0.4	-0.6	-0.5	-0.1	-0.3	-0.3	-0.4	-0.4

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

	2013	2014	2015	2016	2017	2018
GDP	8,513	8,601	8,719	8,848	8,990	9,139
Private consumption	4,774	4,803	4,860	4,920	4,987	5,061
Fixed investment	1,513	1,540	1,578	1,617	1,657	1,697
Government consumption	1,830	1,829	1,833	1,841	1,853	1,869
Stockbuilding	-13	-7	-3	1	2	2
Exports of goods and services	3,938	4,074	4,235	4,408	4,585	4,756
Imports of goods and services	3,529	3,638	3,785	3,939	4,094	4,246

Annual levels — nominal terms (€b)

	2013	2014	2015	2016	2017	2018
GDP	9,583	9,793	10,074	10,404	10,750	11,093
Private consumption	5,481	5,572	5,722	5,900	6,087	6,272
Fixed investment	1,692	1,741	1,811	1,890	1,971	2,050
Government consumption	2,067	2,087	2,123	2,171	2,226	2,282
Stockbuilding	13	33	56	71	84	93
Exports of goods and services	4,387	4,569	4,831	5,117	5,414	5,710
Imports of goods and services	4,056	4,210	4,469	4,745	5,031	5,314

Prices and cost indicators

(annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
HICP headline inflation	1.4	1.1	1.5	1.8	1.7	1.5
Inflation ex energy	1.2	1.3	1.4	1.8	1.7	1.5
GDP deflator	1.4	1.1	1.5	1.8	1.7	1.5
Import deflator	-0.9	0.3	1.6	1.7	1.7	1.7
Export deflator	-3.0	0.2	2.0	2.1	2.0	1.9
Terms of trade	-2.1	-0.1	0.4	0.3	0.3	0.2
Earnings	1.6	1.6	2.3	2.7	2.6	2.5
Unit labor costs	1.2	0.6	1.2	1.5	1.4	1.4
Output gap (% of GDP)	-4.0	-3.9	-3.6	-3.3	-2.8	-2.4
Oil prices (€/barrel)	81.8	78.8	82.5	86.8	90.9	94.2
Euro effective exchange rate (1995 = 100)	120.8	120.7	118.0	115.8	114.8	114.7

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
HICP headline inflation	1.9	1.4	1.3	0.8	1.0	1.0	1.0	1.3
Inflation ex energy	1.5	1.2	1.3	1.0	1.4	1.2	1.2	1.3
GDP deflator	1.6	1.6	1.3	1.3	1.1	1.0	1.2	1.3
Import deflator	0.4	0.0	-1.5	-2.7	-0.7	-0.5	0.4	2.2
Export deflator	-1.0	-2.1	-3.7	-5.2	-1.9	-0.4	0.0	3.2
Terms of trade	-1.5	-2.1	-2.2	-2.5	-1.2	0.1	-0.3	1.0
Earnings	1.7	1.5	1.5	1.8	1.4	1.6	1.7	1.8
Unit labor costs	1.8	1.2	1.1	0.9	0.4	0.5	0.6	0.8
Output gap (% of GDP)	-4.0	-4.0	-4.0	-4.0	-4.0	-3.9	-3.8	-3.8
Oil prices (€/barrel)	85.2	78.6	83.2	80.3	77.8	77.9	79.5	80.0
Euro effective exchange rate (1995 = 100)	118.8	119.2	121.7	123.7	122.7	121.0	119.8	119.4

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

Labor market indicators

(annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
Employment	-0.8	0.0	0.3	0.4	0.5	0.5
Unemployment rate (%)	12.1	12.0	11.8	11.6	11.3	11.0
NAIRU (%)	9.0	9.0	9.0	8.9	8.8	8.7
Participation rate (%)	75.2	75.2	75.2	75.4	75.5	75.7
Earnings	1.6	1.6	2.3	2.7	2.6	2.5
Unit labor costs	1.2	0.6	1.2	1.5	1.4	1.4

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employment	-1.0	-1.0	-0.8	-0.5	-0.1	0.0	0.0	0.1
Unemployment rate (%)	12.0	12.1	12.1	12.0	12.0	12.0	12.0	11.9
NAIRU (%)	8.9	9.0	9.0	9.0	9.1	9.0	9.0	9.0
Participation rate (%)	75.2	75.2	75.3	75.2	75.2	75.2	75.2	75.2
Earnings	1.7	1.5	1.5	1.8	1.4	1.6	1.7	1.8
Unit labor costs	1.8	1.2	1.1	0.9	0.4	0.5	0.6	0.8

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

	2013	2014	2015	2016	2017	2018
Trade balance (€b)	156.6	171.1	170.8	178.4	186.8	196.5
Trade balance (% of GDP)	1.6	1.7	1.7	1.7	1.7	1.8
Current account balance (€b)	214.9	223.0	204.2	204.2	207.3	213.9
Current account balance (% of GDP)	2.2	2.3	2.0	2.0	1.9	1.9
Government budget balance (€b)	-284	-253	-209	-176	-148	-125
Government budget balance (% of GDP)	-3.0	-2.6	-2.1	-1.7	-1.4	-1.1
Government debt (€b)	9,159	9,558	9,943	10,283	10,585	10,839
Government debt (% of GDP)	95.6	97.6	98.7	98.8	98.5	97.7

Measures of convergence and divergence within the Eurozone

	2004-08	2009-13	2014-18
Growth and incomes			
Standard deviation of GDP growth rates	2.0	2.3	1.0
Growth rate gap (max – min)	7.5	9.1	4.1
Highest GDP per capita (Eurozone = 100)	243.6	234.5	233.5
Lowest GDP per capita (Eurozone = 100)	59.6	68.4	68.8
Inflation and prices			
Standard deviation of inflation rates	1.0	0.9	0.6
Inflation rate gap (max – min)	4.0	3.9	2.3
Highest price level (Eurozone = 100)	117.3	116.0	118.3
Lowest price level (Eurozone = 100)	56.0	65.1	66.0

Cross-country tables

Real GDP (% year)								
Rank		**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**Average 2014-18**
1	Latvia	4.1	4.1	5.2	5.0	4.8	4.6	4.7
2	Estonia	0.8	2.5	3.2	3.5	3.8	3.9	3.4
3	Slovakia	0.8	2.0	3.5	3.7	3.5	3.2	3.2
4	Luxembourg	2.1	2.4	1.9	2.3	2.9	2.8	2.5
5	Ireland	0.0	1.8	1.9	2.5	2.8	3.1	2.4
6	Malta	2.4	1.7	1.6	1.7	1.8	1.8	1.7
7	Austria	0.4	1.5	1.9	1.7	1.6	1.6	1.7
8	Germany	0.5	1.7	1.7	1.5	1.6	1.6	1.6
9	Spain	-1.2	0.8	1.2	1.5	2.0	2.3	1.6
10	Finland	-1.3	0.6	1.5	1.6	1.9	2.1	1.6
11	Belgium	0.2	1.1	1.4	1.6	1.7	1.8	1.5
12	Slovenia	-0.9	-1.2	0.7	1.9	2.8	3.3	1.5
13	Greece	-3.7	-0.5	1.7	1.7	2.3	2.2	1.5
14	Eurozone	-0.4	1.0	1.4	1.5	1.6	1.7	1.4
15	Portugal	-1.4	1.4	1.2	1.2	1.2	1.2	1.2
16	Netherlands	-0.8	0.6	0.8	1.2	1.5	1.7	1.2
17	France	0.3	0.7	1.1	1.3	1.3	1.4	1.2
18	Italy	-1.9	0.4	1.1	1.4	1.4	1.4	1.2
19	Cyprus	-5.4	-4.0	-0.5	0.9	1.0	1.8	-0.2

Inflation rates (% year)								
Rank		**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**Average 2014-18**
1	Greece	-0.9	-0.7	0.5	1.1	1.6	1.8	0.9
2	Portugal	0.4	0.7	0.9	1.0	1.0	1.0	0.9
3	Spain	1.5	0.8	1.0	1.0	1.0	1.1	1.0
4	Netherlands	2.6	0.9	1.1	1.1	1.2	1.3	1.1
5	Italy	1.3	0.8	1.0	1.3	1.3	1.4	1.2
6	Cyprus	0.4	0.9	1.1	1.2	1.5	1.8	1.3
7	Ireland	0.5	0.4	1.5	1.7	1.8	1.9	1.4
8	France	1.0	1.1	1.3	1.6	1.6	1.7	1.5
9	Eurozone	1.4	1.1	1.5	1.8	1.7	1.5	1.5
10	Finland	2.2	1.1	1.8	1.8	1.8	1.8	1.7
11	Belgium	1.2	1.0	1.7	1.9	2.0	2.0	1.7
12	Austria	2.1	1.8	1.8	1.8	1.8	1.8	1.8
13	Slovakia	1.4	1.0	1.7	2.0	2.1	2.2	1.8
14	Malta	1.0	1.3	1.7	2.0	2.3	2.3	1.9
15	Luxembourg	1.7	1.7	3.1	2.0	2.0	1.9	2.1
16	Slovenia	1.8	1.8	1.8	2.1	2.5	2.5	2.1
17	Germany	1.6	1.5	2.2	2.9	2.5	1.6	2.2
18	Latvia	0.0	2.0	2.2	2.4	2.4	2.4	2.3
19	Estonia	3.2	2.4	3.0	3.1	3.2	3.0	2.9

Cross-country tables

Unemployment rate (% of labor force)

Rank		2013	2014	2015	2016	2017	2018	Average 2014-18
1	Austria	4.8	4.9	4.7	4.6	4.5	4.5	4.7
2	Luxembourg	5.9	6.0	5.7	5.2	4.7	4.2	5.2
3	Germany	5.3	5.1	5.2	5.4	5.4	5.3	5.3
4	Malta	6.4	6.1	5.9	5.8	5.6	5.6	5.8
5	Netherlands	6.7	7.5	7.5	7.4	7.2	6.9	7.3
6	Estonia	10.8	9.2	8.8	8.3	6.1	5.6	7.6
7	Finland	8.2	8.4	8.0	7.6	7.4	7.2	7.7
8	Belgium	8.4	8.6	8.5	8.1	7.7	7.6	8.1
9	Latvia	11.4	10.3	9.1	7.7	7.7	7.7	8.5
10	Slovenia	10.1	10.2	9.9	9.4	8.4	7.5	9.1
11	Ireland	13.1	11.7	10.8	10.2	9.7	9.1	10.3
12	France	10.8	11.0	11.0	10.8	10.5	10.2	10.7
13	Eurozone	12.1	12.0	11.8	11.6	11.3	11.0	11.6
14	Slovakia	14.2	13.7	13.0	12.1	11.0	9.9	11.9
15	Italy	12.2	12.9	12.7	12.1	11.6	11.3	12.1
16	Portugal	16.5	16.0	16.1	16.0	15.7	15.4	15.8
17	Cyprus	16.8	19.3	19.4	18.9	16.9	14.5	17.8
18	Spain	26.4	25.2	24.4	24.1	23.6	23.0	24.1
19	Greece	27.5	28.3	27.6	26.7	25.7	24.6	26.6

Government budget (% of GDP)

Rank		2013	2014	2015	2016	2017	2018	Difference 2014-18
1	Germany	-0.3	0.0	0.2	-0.1	-0.2	-0.2	-0.2
2	Latvia	-1.4	-1.0	-1.0	-1.0	-1.0	-1.0	0.0
3	Luxembourg	-1.4	-0.9	-1.2	-1.2	-0.8	-0.7	0.2
4	Estonia	-0.6	-0.2	-0.1	0.1	0.3	0.5	0.7
5	Slovakia	-2.9	-3.0	-2.9	-2.5	-2.3	-2.1	0.9
6	Austria	-2.3	-1.7	-1.0	-0.6	-0.6	-0.6	1.1
7	Belgium	-3.1	-2.7	-2.3	-1.9	-1.7	-1.5	1.2
8	Malta	-3.4	-3.2	-3.0	-2.6	-2.3	-2.0	1.2
9	Italy	-3.0	-2.9	-2.5	-2.1	-1.8	-1.5	1.4
10	Eurozone	-3.0	-2.6	-2.1	-1.7	-1.4	-1.1	1.5
11	Netherlands	-2.9	-3.2	-2.6	-2.2	-2.1	-1.7	1.5
12	France	-4.1	-3.7	-3.2	-2.6	-2.1	-1.8	1.9
13	Greece	-4.9	-3.8	-3.0	-2.5	-2.1	-1.9	1.9
14	Finland	-3.2	-3.6	-3.4	-2.8	-1.9	-1.0	2.6
15	Spain	-6.8	-5.9	-4.8	-3.5	-2.5	-1.9	4.0
16	Ireland	-7.5	-5.1	-3.0	-1.9	-1.1	-0.9	4.2
17	Portugal	-5.8	-4.8	-3.6	-2.5	-1.5	-0.6	4.2
18	Cyprus	-7.7	-7.0	-6.5	-3.6	-2.6	-1.1	5.9
19	Slovenia	-5.7	-15.3	-4.7	-3.5	-3.2	-3.2	12.1

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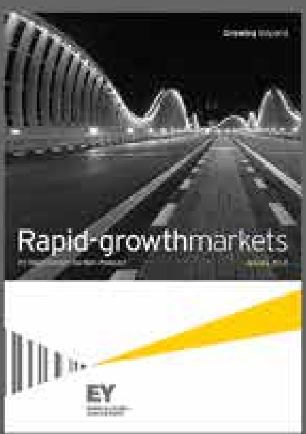

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