Eurozone

Ernst & Young Eurozone Forecast

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Welcome

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Our projection for the Eurozone economy has worsened since we issued our Winter forecast in December. A number of countries have reported deterioration in their performance as consumer confidence has fallen and price pressures have persisted. Overall GDP is now forecast to fall 0.5% as opposed to our earlier forecast of 0.1%, with few countries likely to escape falling output in 2012.

But the disaster of a disorderly default in Greece has seemingly been avoided – albeit at the last hour and after much eye-balling and arm-twisting. The collective political leadership of Greece has invested its future credibility in making this deal work. Their colleagues in the other Eurozone countries have likewise invested their tax-payers' money. The pioneering nature of the European journey is more evident than ever before. Never has so much money passed from one collection of sovereign countries to another. Self-interest is clearly a key driver, but the power of the vision of a shared European future should not be underestimated and there are early signs that political confidence is returning.

In building that European future, 25 of the 27 countries in the EU have recognized the need to share more of their fiscal sovereignty if they are to create a sustainable governance framework. Much work remains to be done in translating the fiscal compact into enforceable legislation, but there is clearly sufficient substance to the proposal that the Irish government believes it needs to put the matter to a referendum. While most commentators have presented this as a potential challenge to the process, it can equally be seen as a measure of the seriousness of this collective intent. The Eurozone leaders have been vocal in their public support for the euro – their actions, albeit evolving in an incremental fashion, suggest that they are serious.

Liquidity is the key challenge we face – not just for countries but for many organizations. In addition to the rollover of state debt – estimated at €1.1 trillion – there is a further €1.4 trillion of corporate debt to be refinanced in the coming year. Banks are further stretched by the impact of regulations that require that they recapitalize their balance sheet and we estimate a further €500 billion will be "taken out" of the market as this is implemented.

Collective austerity is a concern

So the future in the Eurozone appears to be shaping up to be a difficult combination of tight credit markets, greater pooling of national sovereignty and local austerity enforced across border. It is the later policy of collective austerity that concerns many commentators most. We forecast that collectively these government cuts have dampened GDP growth by over 1% for this year and next, and recognize that they will delay economic recovery. Whether this is self-inflicted damage or the unavoidable precondition to sustainable recovery is the source of much macroeconomic and political debate.

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It is certainly true that there is a limit to what government can do and what it can spend. The track record of the public sector in creating sustainable private sector jobs is at best mixed — although good examples exist and Germany itself provides testimony to the role that joint public sector, union and management action can play in preserving employment during transitions. We comment in the report on a number of key reforms that governments can make to improve the competitiveness of the eurozone. None of these are easy — especially labor reform — but neither can they be avoided. The crisis has brought these issues to the forefront of government attention.

The longer-term solution, as we have argued, must be to find a way for the developed economies in Europe to grow above their recent pace so that they can pay down their debt to a sustainable level. Three areas seem to be particularly important:

Celebrating entrepreneurship

Our work on the *G20 Entrepreneurship Barometer* compared the performance of G20 members on their efforts to encourage entrepreneurial activity. This is critical to increasing the productivity of business — not just at start-up, but throughout the life of the organization. We found many examples of good practice in European countries that can be shared, but overall Europe lagged behind both the US and Asia-Pacific in the creation and celebration of the entrepreneurial culture that drives the reinvigoration of the economy. The role of SMEs in creating employment is well-known across Europe, but the disproportionate contribution of new start-ups in that achievement is less acknowledged.

Innovation is one related area where Europe is behind — both in new product development and process improvement. This is critical in both creating and capturing new markets and improving productivity. At the same time, public funding for innovation in Europe exceeds that available in the US and Japan. We have a private sector shortfall and much effort is being focused on what needs to happen to close this gap.

Exploiting new market opportunities

While developed markets struggle to return to growth, the world economy is being reshaped by the emergence of the rapid-growth economies. Europe is well-placed to benefit from these developments, both through strong cultural links and our extensive network of free trade agreements. The emergence of a new middle class in many of these countries provides new opportunities for a range of sectors where European companies enjoy strong positions, such as financial services and consumer products.

And new markets are not just geographical. Europe is also well-placed to benefit from the cleantech revolution that is sweeping through much of the industrial infrastructure of the world. The costs of our commitment to combating climate change are serving as a spur to innovation in the way that business operates and help make it more competitive in the medium to longer term.

An equally large opportunity exists in addressing and optimizing the role that women play in the wider economy. Fully utilizing the talents and potential of over 50% of the population impacts both the productivity of our economy and the costs of our social system. Europe is comparatively well-placed to make a step-change in this area, but only if it addresses labor market reform to introduce greater flexibility into employment and ways of working.

Unlocking the private sector cash mountain

At the end of 2011, cash on Eurozone-listed companies' balance sheets exceeded €770 billion — almost 16% up on the previous year. This huge sum, exceeding the GDP of the Netherlands, is currently earning minimal interest returns. Similarly, of the €500 billion bonds issued to banks by the ECB in its first wave, over €200 billion was immediately deposited by banks back with the ECB as part of their recapitalization rather than lent to companies. Almost €1 trillion are therefore currently out of the market rather than invested in business to drive improved growth. Unlocking these cash reserves into the productive economy is a key challenge and one where government and business need to focus and work together. Greater stability is required to generate the business confidence necessary for new investment, but business management is not a passive partner in this process.

All the above areas require active engagement, dialogue and joint action by business and government. I encourage you to visit our Eurozone website — www.ey.com/eurozone — for additional information on the *Ernst & Young Eurozone Forecast* and the 17 individual country forecasts it comprises.

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Difficult scenarios, difficult to assess

Although the members of the European Union are working hard to stabilize the Eurozone economy and create a platform for economic and financial recovery, the generally difficult economic outlook and the risk of disorderly debt defaults is furrowing brows in many a corporate boardroom. However, corporates that are skillful in assessing the risks and opportunities linked to the Eurozone crisis will lay a stronger foundation for their business.

Yet again, the threat of systemic crisis in the Eurozone forms the backdrop to the quarterly *Ernst & Young Eurozone Forecast* for the 17-country currency area. Concern that a full-blown crisis may ensue largely explains the deteriorating outlook for GDP figures and we now envisage that GDP across the Eurozone will fall 0.5% in 2012. In our previous report, published in December 2011, a drop of 0.1% was foreseen.

Nine Eurozone members are likely to escape a drop in output this year. Of these countries, prospects range from flat GDP for Slovenia to 2% growth for Estonia. Meanwhile, the southern peripheral countries, which are at the forefront of the crisis, face much steeper declines than the "modest contraction" of the overall forecast. Weak medium-term growth is also forecast. The Eurozone is set to grow by around 2% a year in 2015–16, though some northern countries, notably Finland, Slovakia and Estonia, should do better. The recovery, such as it is, will be slower than after any recession since the early 1970s.

Almost all governments are now torn between sticking to their course of austerity and fiscal discipline, and the pressing political requirement to offer some hope of jobs and higher living standards to electorates that have been hard hit by recession and weak recovery. Austerity measures are estimated to drag down economic growth by more than 1% of GDP this year and next. Respectful of the need to meet fiscal targets, our report proposes a reform agenda that will not deliver instant benefits, but will significantly improve medium-term prospects.

Risks to stability "more serious"

In the meantime, the risks to stability are even more serious than they were three months ago. Although our report considers a breakup of the Eurozone a remote possibility, our own experience with clients suggests that business fears of a breakup peaked some time before the most recent €130 billion rescue package for Greece was agreed in mid-February. However, most business leaders recognize that potential Eurozone instability will be a feature of their environment over the coming months.

Significantly, risk planners among our clients and elsewhere have been spending more time on disaster scenario exercises to assess potential threats to their businesses. Merely hoping for the best could be fatal, but knowing where to begin may be bewildering.

Scenario planning

Though we believe the chances of an actual breakup are no higher than one in ten, there are, nonetheless, potentially calamitous scenarios that fall short of a breakup. The most dangerous are triggered by a disorderly default by one or more of the crisis-hit countries, and by a banking crisis unleashed by a credit crunch and fear of a default in the Eurozone. The leading candidate for default is, of course, Greece, followed in order of risk by Portugal, Ireland, Spain and Italy.

Companies should assess a series of scenarios, and examine how they might affect their businesses. What are these scenarios, and how should companies begin their assessments?

Scenario 1. Calamitous credit crunch

The biggest risk we face is triggered by a credit crunch. This falls short of a Eurozone breakup and is addressed by our report's discussion of risks to the European banking system. It begins with the failure of the European Central Bank's long-term refinancing operation (LTRO) to avert a credit crunch. Instead of passing on the cheap money that LTRO is making available as loans into the economy, banks sit on it and give the highest priority to strengthening their capital base as required by the Basel III agreements. Small- and medium-sized enterprises are particularly badly hit and capital flees the Eurozone for fear of a systemic crisis.

Governments have to abandon fiscal discipline and borrow extensively to prop up their banks. Some countries are forced out of the euro.

Scenario 2. The breakup scenario

The Eurozone breakup scenario begins with a member country default, which immediately triggers other defaults and a widespread banking crisis. As national currencies are created, cross-border creditor banks are hit by debt redenomination and effective devaluation of these loan assets. The Eurozone banking system is brought to its knees as governments are not able to raise the funds to save it. The European Union would return to a world of capital controls, currency instability and protectionist policies that would destroy the single market. Europe's recession would be deep and last several years, while also depressing global growth.

While unlikely, both of these scenarios continue to be problematic. The permanent bailout fund, the European Stability Mechanism, will, by agreement of the European Council, begin operations in July with a fund of €500 billion. But many Eurozone members share the view that this so-called firewall could — and should — be strengthened by the addition of the €250 billion of unused funds allocated to the European Financial Stability Facility, which was created as an emergency mechanism two years ago. This would strengthen the financial defenses against contagion from a Greek default, but the move has been resisted for many months by Germany.

Risk assessment: seven suggestions for scenarios 1 and 2

Competitiveness issues: if the Eurozone was to survive the departure of some or all of its weakest economies, the euro would become a harder currency. How might this affect the Eurozone's competitiveness in global markets, and what new commercial strategies would be needed?

Impact on the supply chain: how would key suppliers based in a vulnerable country survive a critical currency and banking crisis? Would they need external financial help from clients? How could this be arranged?

Financing and treasury: what hedging requirements would be needed to cover exposure to new national currencies? Would they be available? How would banking relationships and strategies be changed?

Accounting: what systems would be needed to cope with redenomination? What are the impairment issues and how should they be dealt with?

Tax: what are the tax policy trends, and what changes to transfer pricing can we expect? What tax operating model would work best?

Opportunities: how can your business alter the competitive environment through strategies for seizing opportunities via mergers and acquisitions?

Focus on uncertainties regarding possible exits: there are a host of issues to be considered if a country or countries exit the euro and restore a national currency. All contracts in euros would clearly be affected, as would loans and bond values. In which currency would payees be bound to repay obligations? Whether or not a country's exit conforms to EU law could also be relevant.

Scenario 3. Restrained optimism

A third and much more optimistic scenario has the Eurozone resolving its financial crisis and entering a modest recovery in 2013. Concerns about possible defaults are eased as the positive impact of the Greek bailout makes itself felt. Businesses have large amounts of cash on their balance sheets that they begin to spend on investment and recruitment from 2013 onwards.

The European Central Bank provides strong support by further lowering interest rates and stepping up purchases of government bonds. The crisis becomes a catalyst for necessary reforms that governments have previously found hard to push through. The most pressing, and most country-specific, is the deregulation of labor markets to establish more effective links between growth of wages and productivity. Lower unit labor costs enable Eurozone countries to benefit from the strong growth forecast for rapidly growing markets in Asia and Latin America.

Meanwhile, Greece's economy urgently needs remedial treatment if the country is to be put back on its feet. It is significant that Germany, much reviled inside Greece as the driving force behind the austerity measures that the EU is imposing, is now incubating ideas for development investment. Both the BDI, representing German companies, and Werner Hoyer, the recently appointed president of the European Investment Bank, are talking publicly of the need for a Marshall Plan for Greece, that echoes the aid given to Europe by the United States at the end of the Second World War. Such German attempts to launch a debate on new growth initiatives chime with interest in European business circles for a stronger focus on boosting investments in infrastructure and other economic assets.

Assessing opportunities

For some companies, any sign of a meaningful recovery would encourage investment in equipment, assets, market development and people. Of course, much will depend on the pace and location of recovery. Our report draws a clear distinction between probable growth rates in northern and southern Europe, which will surely influence investment patterns. But we also draw attention to factors such as institutional weakness, which a number of countries should address as part of their reform programs. Many of these are related to inefficient and excessively long legal processes, and practices that raise ethical issues.

Our report also carries a reminder that the expanding middle class in many emerging markets will continue to offer important growth opportunities, especially for consumer-based manufactured goods and food, as well as in distribution, tourism and restaurants.

Elections may change the scene

Companies would be wise to keep a close eye on forthcoming elections in France and Greece. Elections can change market terms, and these polls in particular may affect current stability policies and have the potential to upset efforts to resolve the sovereign debt crisis. If, as expected, Greece goes to the polls in April, some experts are predicting increasing political instability. Support for the two main parties appears to have been hit by the financial crisis. Leaders of both parties have given undertakings to stick to the policy package agreed with other Eurozone countries on 21 February. However, mid-February polls suggested that not even a coalition of the two parties could command a parliamentary majority. Analysts are troubled by the strengthening of support for rejectionist parties on the extreme right and left.

Presidential elections in France also raise the risk of uncertainty and instability, and could threaten the consensus between France and Germany about the need for fiscal discipline in the EU.

The European Council's demands on national and EU policy

During its last meeting in early March the European Council discussed the implementation of the EU's economic strategy. This strategy pursues both continued fiscal consolidation and determined action to boost growth and jobs; sustainable growth and jobs cannot be built on deficits and excessive debt levels. The council concludes that the measures taken to stabilize the situation in the euro area are bearing

fruit both on a national level and EU level. In line with the Council conclusions of 17 February 2012, and respecting the role of social partners and national systems for wage-formation, Member States should:

- Increase efforts to make it easier and more attractive for employers to hire people, where necessary by improving wage-setting mechanisms
- Remove barriers to the creation of new jobs
- Implement active labor market policies, notably with a view to strengthening the participation of young people, women and older workers

As important EU measures, the European Council stresses the importance of completing the Single Market, removing the remaining barriers and completing the Digital Single Market by 2015, in particular by adopting measures to boost confidence in on-line trade and by providing better broadband coverage. This includes reducing the cost of high-speed broadband infrastructure and reducing the administrative and regulatory burdens at EU and national level.

The European Council also welcomed the Commission's intention to present a communication on further steps toward minimizing regulatory burdens, including measures to support microenterprises. It stresses the importance of removing the trade barriers and ensuring better market access and investment conditions. The European Council will review progress next June and discuss how the Union can deepen its trade and investment relationships with key partners.

How are leading companies managing Eurozone risk?

From our dialogues with our clients, we note that many business leaders consider Eurozone instability a risk factor in their operations and planning. We also note that leading practices tend to put risk high on the agenda, not only to avoid risks but in order to turn these risks into opportunities. There is a great deal to be gained from a thorough risk strategy that permeates the whole organization. Four key elements for a strong response to risk are:

- Enhancing the company's risk strategy by putting it on top of board and management committee agendas. It is also important to discuss risk regularly and transparently with stakeholders
- Embedding risk management in daily operations and planning by using formal methods for defining risks within the organization. It is also helpful to coordinate risk assessment with business planning and conduct stress tests on a regular basis to validate risk tolerance within the company
- Improving controls and processes by using standard tools for self-assessment and reports within the organization
- Optimizing risk management functions by using a reporting system that notifies all stakeholders affected by risk, not just those in the function or area where risk was identified. In order to further enhance risk awareness, the company should incorporate risk-related training into individual performance goals

Key tax trends in Europe

Tax policy in Europe is conditioned by the aftermath of the economic crisis and policy-makers are squeezed between the need to restore public finances and the need to be competitive.

According to this Eurozone forecast, austerity measures will be the main constraint on growth this year. This situation offers few opportunities to implement tax policies that promote economic growth, although some countries are choosing to raise indirect taxes, such as sales taxes, instead of increasing corporate tax.

One important tax trend is an ongoing drive for greater coordination and cooperation at a cross-jurisdiction level. The European Commission's proposal for a common consolidated corporate tax base is one important example. In a globalized world, it is easier to combat tax evasion. Governments and tax authorities around the world are increasingly exchanging information in an effort to clamp down on tax evasion and fraud.

How to navigate the global tax landscape

A well-developed tax strategy and strong tax operations will contribute to a company's prosperity. In this new global tax landscape, policy-makers expect corporate boards and management teams to understand a company's responsibilities with regard to their business tax. In our contact with clients, we have noted that leading practices have managed to elevate tax strategy to the boardroom agenda.

It makes strategic sense to adapt to ever-changing legislation, and the fact that governments and tax administrations are working closer together to enforce their tax rules on global companies and cross-border transactions. Therefore, it is of strategic importance to pay more attention to documentation and plan carefully to reduce the risk of future tax controversy.

A dedicated "tax policy and administration intelligence unit" can help a company to understand shifts in tax policy and tax administration. Companies should make use of existing tools for tax risk management and, if global, adopt a global approach to tax controversy and risk. For example, they should develop enhanced relationships with tax administrators in key jurisdictions, weave in their available tax administration intelligence and, where culture permits, encompass a more transparent, collaborative and responsive relationship with the tax authorities.

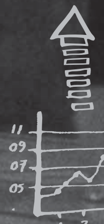
Checklist for tax management

Depending on the structure of the company there are a number of actions to take into consideration. One issue is the impact on deferred tax assets when the profitability of the business declines. This is an immediate impact at every reporting date, with or without one or more country leaving the Eurozone.

Other important actions may be:

- Review the tax efficiency of the supply chain
- Design guarantees and market support payments
- Consider provisions covering the potential developments
- Secure utilization of potential losses
- Review the legal form of the subsidiary
- Allocate cancellation of indebtedness income within the group
- Allocate loss from accounts receivable within the group
- Review thin capitalization position
- Review transfer pricing for goods, services and lending
- Review the requirements for invoicing
- Assess input VAT claims and VAT payments

Learn more about how to develop a strong global tax strategy by visiting www.ey.com/tax



Highlights

- This year will be very challenging for the Eurozone, with large amounts of public and private sector debt to be refinanced, tight credit conditions, further fiscal austerity and job losses. As a result, we forecast a mild contraction in economic activity, with further steep declines in peripheral countries only partly offset by the more resilient core countries. These economic conditions will test policy-makers' commitment and ability to preserve the Eurozone in its current form.

- Assuming that the agreed debt restructuring in Greece and putting a credible firewall around Spain and Italy, growth should return in 2013. After a fall of 0.5% this year, we expect Eurozone GDP to grow by about 1% in 2013 before picking up to some 2% a year in 2015–16. This implies that the recovery will be slower than after any recession since the early 1970s.

- The main constraints to growth this year will stem from fiscal consolidation, which we estimate will amount to more than 1% of GDP, and from credit constraints. Indeed, Eurozone banks are facing very difficult financing conditions, at a time when they need to achieve higher capital ratios. Tighter credit availability will dampen both investment and consumption. Indeed, there is a risk that credit constraints and fiscal austerity are more severe and protracted than we currently envisage; in this scenario, the Eurozone would experience a deeper recession.

- On the positive side, economic activity should benefit from lower inflation, helping to sustain households' real incomes. Also, businesses generally have large amounts of cash on their balance sheets. Assuming that confidence is restored during the year thanks to significant action from policy-makers, these cash surpluses are likely to be spent on investment and recruitment from 2013 onward.

- One key assumption in this forecast is that the European Central Bank (ECB) continues to provide extensive support to the economy. This involves keeping interest rates low and stepping up purchases of government bonds to facilitate debt refinancing by peripheral countries at affordable interest rates.

- Without this, there is a risk of a series of disorderly defaults among the peripheral countries that would threaten the future of the Eurozone. Although we think that a Greek exit from the Eurozone would not cause major systemic disruption, a scenario in which Portugal, Spain and others also leave would unleash a chain of negative reactions involving sharp currency movements, damage to banks' balance sheets and dampened business, consumer and investor confidence. In this scenario, the Eurozone would be plunged into a deep, multi-year recession, which in turn would lead to lower global growth.

- However, the current environment could well provide the trigger for reforms that would have otherwise been difficult to implement. Eurozone-wide reforms to speed up the move toward greater fiscal coordination and ultimately fiscal union are necessary to ensure that the Eurozone has appropriate structures to encourage growth in the medium term.

- At the country level, growth-enhancing changes should be given more focus, alongside the current emphasis on fiscal austerity. Lower unit labor costs, together with other reforms, would enable Eurozone countries to tap into demand in rapidly growing markets in Asia and Latin America, which will offer ever-increasing opportunities for trade and investment over the next decade as their share of the world economy rises steadily. Germany's success in this respect illustrates what can be achieved.

- Reforms should be country specific to address each country's key weaknesses and potential. Some areas that many countries need to look at include reform of labor markets to link pay more closely to productivity growth, structural changes to enhance the efficiency of the public sector and of tax collection and changes to prepare for aging populations.

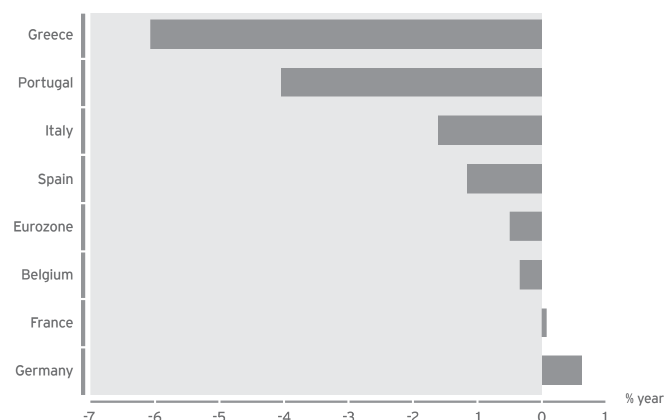
Crisis can be averted, but opportunity for reform must be grasped

Clouds still gathering ...

Already downbeat, the outlook for the Eurozone has deteriorated a little further since our Winter report. Challenges facing businesses, consumers and governments have persisted into 2012, price pressures have taken longer to ease than earlier anticipated, and risks to stability have become more serious. Overall Eurozone GDP is now forecast to fall 0.5%, with only 9 of the 17 countries likely to escape falling output in 2012. For several countries, at least two more years of painful adjustment are likely.

Figure 1

GDP 2012 growth



Source: Oxford Economics

The deterioration in the outlook increases the difficulty of resolving the Eurozone sovereign debt crisis and makes the possibility of a disorderly breakup of the currency area an increasingly plausible possibility. A substantial policy effort at the national and Eurozone level is under way to ensure that the Eurozone remains in its current shape and that the future can look brighter. We remain confident that Europe's policy-makers can deliver such results.

... as several challenges ...

The challenges that slowed the Eurozone's recovery during the second half of 2011 have persisted, and in some cases intensified, over the past quarter. Most seriously, market concerns over fiscal sustainability have remained elevated, with credit downgrades to a raft of Eurozone sovereigns in January. In response, a number of governments have announced further measures to tackle debt and deficits – measures that are far from popular, but on the whole necessary. We estimate that, together, these austerity measures amount to more than 1% of GDP in 2012. In some cases, there is a possibility of further fiscal tightening if either market conditions or the pace of recovery in tax revenues demand it.

Table 1

Forecast of the Eurozone economy (annual percentage changes unless specified) *Source: Oxford Economics*

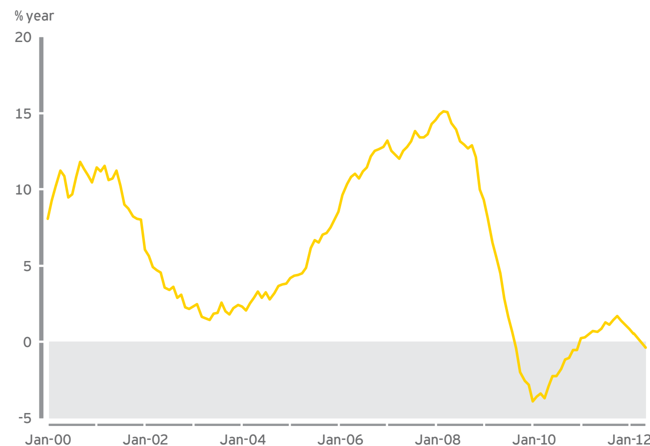
	2011	2012	2013	2014	2015	2016
GDP	1.5	-0.5	0.9	1.7	2.0	2.1
Private consumption	0.1	-0.7	0.5	1.2	1.6	1.7
Fixed investment	1.9	-1.5	1.7	3.5	3.6	3.4
Stockbuilding (% of GDP)	0.4	0.2	0.3	0.3	0.3	0.3
Government consumption	0.1	-0.9	-0.3	0.5	1.0	1.2
Exports of goods and services	6.6	1.2	4.4	5.7	5.5	5.0
Imports of goods and services	4.5	-0.1	4.2	5.8	5.5	5.0
Consumer prices	2.7	2.2	1.8	1.8	1.8	1.8
Unemployment rate (level)	10.2	11.1	11.3	10.9	10.3	9.7
Current account balance (% of GDP)	-0.3	0.2	0.2	0.2	0.3	0.3
Government budget (% of GDP)	-4.2	-3.4	-2.5	-2.0	-1.6	-1.2
Government debt (% of GDP)	88.9	91.2	92.2	92.4	92.3	91.7
ECB main refinancing rate (%)	1.2	1.0	1.0	1.6	2.6	3.9
Euro effective exchange rate (1995 = 100)*	120.8	115.6	119.8	117.6	115.6	115.3
Exchange rate ($ per €)	1.39	1.26	1.30	1.27	1.24	1.24

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

The deepening concern about fiscal sustainability across the Eurozone generated a rapid deterioration in confidence in the banking sector, as banks braced themselves for possible losses on sovereign debt holdings and worried about the creditworthiness of potential counterparties. In the final months of 2011, the combination of these market fears, ongoing efforts by banks to improve capital ratios and a slowdown in retail deposits led to a shortage of liquidity in the European intrabank market. This prompted the ECB to intervene by offering unlimited three-year loans to eligible institutions.

Figure 2

Lending to non-financial companies



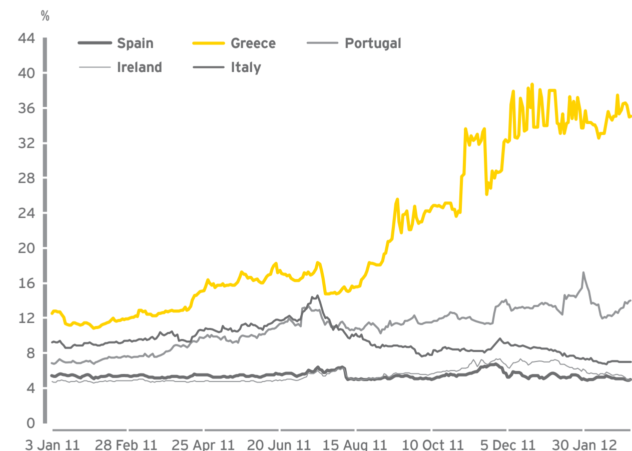
Source: Oxford Economics, Haver Analytics

While the prospect of a banking crisis now seems to have receded, boosting financial markets, latest data indicates that much of the liquidity provided under the facility has been redeposited with the ECB rather than being lent on into the wider economy (this theme is discussed further in Box 2, page 16). As such, the outlook for lending to households and businesses is still very weak.

Finally, the pace of the recovery in some of the Eurozone's key trade partners seems to be easing. Our assumptions for the global environment are covered in detail in Box 3, page 19, where we discuss our expectation that the US recovery will slow in the first half of 2012, moderating growth in Asia, and the risk of further commodity price shocks. While far from the greatest drag on Eurozone growth, the external environment has certainly cooled, and with it so has the Eurozone's prospect of further export-led growth in 2012. However, some countries will do better than others, with the more flexible and competitive economies able to continue to grow their trade with the rapid-growth markets.

Figure 3

Bond yields



Source: Oxford Economics, Haver Analytics

... force consumers and business to cut back in 2012

The combination of a worsening external outlook, fiscal austerity at home and the erosion of real wages through 2011, means that consumers' appetite to spend has waned moving into 2012. This is true in some countries more than others, of course — German consumers are likely to increase their spending by around 1%, while French household spending will be broadly flat and Italian consumers cut back substantially. At the Eurozone level, growth in consumer spending is likely to be slightly negative. Even a moderation in inflationary pressure in 2012 is likely to do little to comfort consumers, given that this mainly reflects commodity prices settling at high levels, rather than falls in the cost of other goods and services.

In response to tighter financing conditions, an increase in spare capacity and weaker domestic demand, businesses are likely to scale back investment spending. Spanish and Italian firms seem set to cut capital spending by 5% or more in 2012, while in France and Benelux investment will be flat or edge down slightly. Only in Germany is investment spending likely to grow meaningfully, and even here predominantly in the second half of the year.

Overall, we expect nine countries to escape falling output in 2012. Germany is likely to do so thanks to its growing links with emerging Asia and a resilient labor market. For the rest of the Eurozone, we expect to see output falling in 2012 — modestly in most countries but by 1% or more in Italy and Spain, and more like 4% in Portugal. Greece faces another decline in output of 6% or more this year.

Box 1

Eurozone membership helps some countries to outperform their similar but non-Eurozone neighbors

While the Eurozone is undergoing its most difficult period since its inception a little over ten years ago, there are some interesting examples of Eurozone countries that have outperformed their non-Eurozone neighbors — such as Estonia, which has performed better than Latvia and Lithuania, both outside the single currency but aspiring to join, and Finland, which has grown faster than Denmark and Norway.

Estonia continues to outgrow other Baltics

All three Baltic countries experienced deep recessions in 2009, undergoing GDP contractions of around 15%, by far the worst within the EU. Since then, however, Estonia has outperformed Latvia and Lithuania, growing 2.3% in 2010 and 8% in 2011, making it the fastest-growing economy in Europe and well ahead of its two neighbors. This performance was achieved despite Estonia's loss of independence over monetary policy when it joined the euro in January 2011 and the associated need for more cautious fiscal policy.

The Baltics are much smaller than other EU countries and therefore more vulnerable to the deep recession when it hit, but their differing industrial structures played a role in the pace of their respective recoveries. Estonia had enjoyed a faster and longer boom in exports because its production is heavily weighted towards consumer electronics (dominated by mobile phone parts for Ericsson) and wider export markets, whereas Lithuania is more focused on oil products and Latvia on oil transit and forest products, leaving the latter two still more focused on Russia, thereby catching the full effects of its steep 2009 downturn as well.

And despite many subdued trading partners in Europe, Estonia's membership of the Eurozone has brought significant benefits, including the relative absence of currency risk and also lower interest rates than in Latvia and Lithuania, which have been faced with a need to maintain currency stability. The Eurozone sovereign debt crisis has of course exposed some countries with high deficit and debt levels, but Estonia's very low public debt and small deficit, reflecting a strong tax base, have sheltered it from the storm.

Finland grew strongly in 2011 despite export exposure

Another interesting comparison of relative economic performance is Finland versus non-Eurozone Denmark, Norway and Sweden. Despite its trade links with the Eurozone, Finland managed to grow by a respectable 2.6% in 2011, well ahead of Denmark (1%) and Norway (only 1.3% despite its oil and gas resources), although this was in part due to a rebound from its rather steeper downturn in 2009.

Among other reasons for Finland's stronger performance are its solid financial system, its limited exposure to debt of the troubled peripheral countries in the region (as of Q3 2011, Finnish banks' exposure to the countries at the heart of the crisis totaled €2.7 billion), while its main trade partners of Germany, Sweden and Russia (albeit the latter was hit hard by lower oil prices in 2009) are among those countries that have weathered the impact of the Eurozone crisis better. Denmark, on the other hand, has suffered from a growing lack of competitiveness against its main trading partners in the Eurozone and high private sector debt, which has constrained consumer demand. The Norwegian economy has progressed more slowly in the last two years mainly because it did not suffer as much as other countries during the 2009 recession; given its oil wealth, public spending was maintained and it has continued to run large surpluses. Part of the reason for its slower growth in 2011 was due to the oil sector, which underwent maintenance.

In contrast, non-Eurozone Sweden has fared better than other Scandinavian countries. In large part this is due to its relatively strong public finances (with the government balance targeted at 1% of GDP over the medium term), which meant that the government was able to let the automatic stabilisers run their path and did not have to impose austerity measures, in contrast to most countries in Europe. This in turn kept consumer confidence high and unemployment has fallen since 2009, leading to higher consumer spending. Furthermore, interest rates have remained low and rising business confidence has helped investment.

Labor market tensions will worsen ...

This outlook for export orders, business investment and consumer spending means job creation is set to weaken in most Eurozone economies. With Germany likely to be one of the few exceptions, we forecast unemployment rates will rise across the Eurozone in 2012.

For those countries where youth unemployment is particularly high, this could cause already acute social problems to worsen. Targeted schemes to support and incentivize youth employment (if resources allow), as well as more general measures to make it simpler and cheaper to hire workers (such as recent Spanish reforms to labor market regulation), need to be adopted in a number of countries to mitigate the impact of the downturn on workers. Failure to do so risks workers becoming detached from the labor market, undermining long-term potential growth and fiscal sustainability.

... although large corporates do have the means to invest

On a more positive note, despite the deterioration in the economic outlook around the Eurozone, larger corporations remain in relatively good financial shape. The past two years or so have seen larger firms making efficiency savings, improving profit margins and adding cash and cash equivalents to balance sheets.

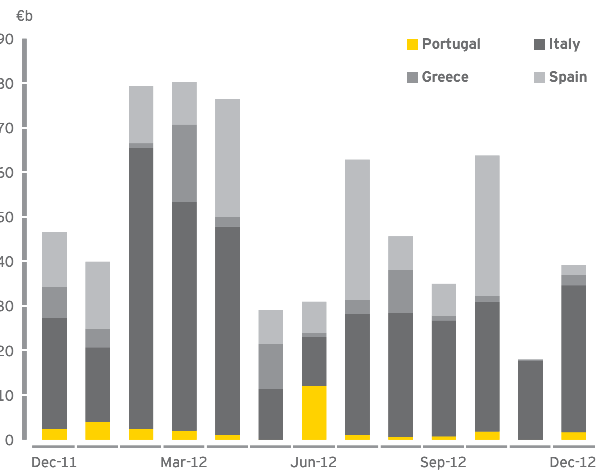
Amid the uncertainty of the global outlook and European financial environment, we think firms with cash are likely to continue to keep it in reserve. However, as the external outlook improves, and governments adopt the right policy measures, firms could start deploying their reserves relatively quickly, spurring job growth earlier than anticipated.

Even this modest recovery should not be taken for granted

However, although there are possible upsides to the forecast, we are also concerned about a number of threats that could trigger a more severe downturn in the Eurozone. We continue to believe the Eurozone will remain intact, with debt restructuring limited to Greece, but there are a number of challenges that need to be confronted to ensure this.

Figure 4

Maturing government debt

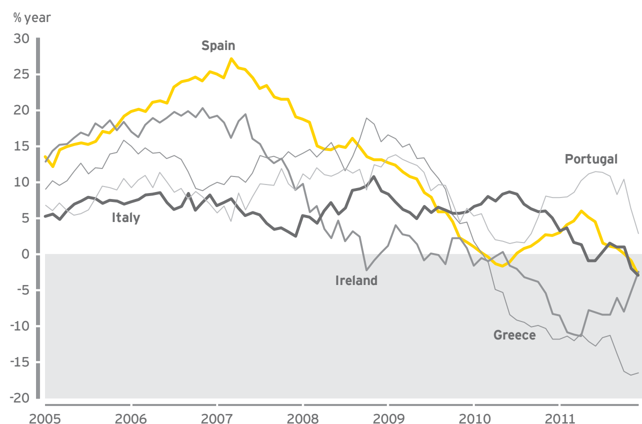


Source: Bloomberg

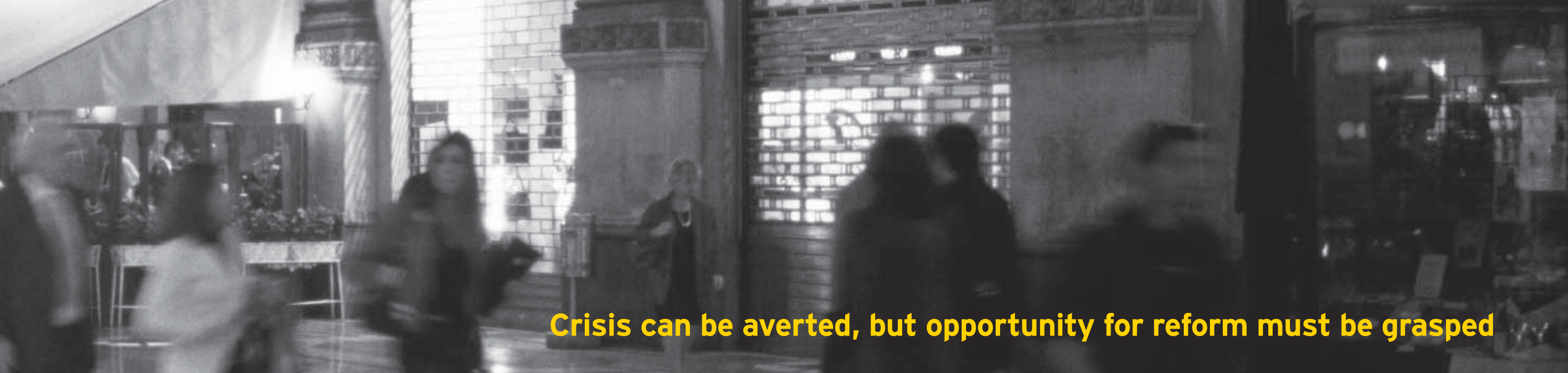
Principal among these are the large amounts of sovereign debt refinancing in the coming year or so. Recent policy measures in Italy and Spain in particular have encouraged markets, leading to lower financing costs, helped also by the impact of the ECB's first longer-term refinancing operation (LTRO) — see Box 2, page 16. But financing needs are higher in the first half of 2012 than in the second half of 2011, meaning the challenge for Italy, Spain, Portugal and Ireland to remain current on their debts will persist for some time.

Figure 5

Retail deposits at Eurozone banks*



* Non-monetary financial institutions excluding central government
Source: Oxford Economics, European Central Bank



We also remain concerned about the risk of capital flight causing domestic banking crises in one or more countries. As residents become increasingly concerned about the impact of a possible Eurozone exit, they may move more of their deposits to "safe" Eurozone economies in order to preserve their value in the event of a breakup and devaluation.

Should outflows accelerate to a point where banks have difficulty keeping pace with depositor withdrawals, governments are likely to have to step in to prevent an outright collapse of the banking system. But providing further support or guarantees to banks will exert more strain on already stretched public finances.

The final risk to Eurozone stability is the threat of policy fatigue in either donor or debtor countries. Governments in countries with testing austerity programs will need to maintain consensus around their implementation, while in others the challenge will be to maintain support for European bailout mechanisms. These near-term efforts to put fiscal policy on a more sustainable footing need to be supported by the ratification of the fiscal compact agreed in December, in order to pin down investor confidence in longer-term sustainability.

The ECB also needs to play its part ...

The ECB will continue to play a critical role in 2012. The ECB's purchases of sovereign debt under the Securities Markets Programme have eased substantially since the final weeks of 2011 (although as we note in our box on the LTRO, indirect ECB exposure to sovereigns is probably still increasing). But given the spike in government debt that has to be refinanced through the first half of the year, the ECB may need to step up these purchases again in order to keep interest rates sustainable. But it is not clear whether this will happen, given the opposition of some policy-makers to intensifying the risks to the ECB balance sheet and the potential for moral hazard (where governments fail to make a full fiscal adjustment because they know the ECB will ultimately step in to contain interest rates).

The ECB will also need to consider how to encourage banks to provide more liquidity to the real economy should lending conditions not improve, given the links between lending, growth, investment and fiscal sustainability. The ECB conducted another LTRO at end February, but if access to more lending is not enough to encourage banks to lend on, it may need to think about alternative measures – one possibility would be to charge banks to deposit cash in Frankfurt.

On more conventional policy measures, we expect the ECB to keep its refinancing rate low for the next few years given the weakness of the economic outlook and the easing of price pressures. This is likely to prove far less contentious than the other measures discussed above.

... as the downside is daunting

In the event of a failure on the part of a Eurozone government to remain current on its obligations, there would be an immediate impact on bank balance sheets, since banks typically own large amounts of government debt. In itself, this would demand further capital injections from other already stretched governments.

As countries might then have to exit the Eurozone and redenominate their debts into new currencies, which would then depreciate, the losses incurred by banks in the creditor countries would mount. This would cause further tensions in banking sectors in other countries. The prospect of Greece having to exit the Eurozone has increased since our last report, despite its recently agreed debt write-down. A Greek exit would no doubt cause great hardship in the country, and would have an impact on banks elsewhere in Europe, but would not affect the Eurozone's recovery path too much, assuming that a firewall can be placed around Spain and Italy, with continued progress at the domestic level.

Should either of these elements not be achieved, though, and the situation deteriorated to a point where several countries left the euro, we estimate the Eurozone would suffer a recession as severe and twice as long as that seen in 2008–09. Given that unemployment is already 23% in Spain, 20% in Greece and 15% in Ireland and Portugal, the likely impacts of such a scenario on household incomes and living standards are worrying. We feel confident that such a prospect will continue to focus minds across the continent on their search for a lasting solution. As a result, we attribute only a small probability (approximately 10%) to such a scenario occurring.

Box 2

The ECB's recent liquidity operations

In late 2011 and early 2012, the ECB undertook a series of major policy interventions in an attempt to calm mounting financial tensions. The most important actions were a three-year long-term refinancing operation (LTRO) in December offering long-term funds to banks at 1% interest, and a significant easing of collateral requirements for loans. Banks responded enthusiastically to the ECB's offer and drew just under €500 billion. A substantial proportion was used to repay other borrowing from the ECB, but the ECB's overall lending to the banking sector nevertheless rose by over €200 billion or 35% in December alone.

Since then, financial conditions in the Eurozone have eased notably. Sovereign bond yields in troubled economies have fallen sharply (most notably Italy and Spain) and funding pressures on banks have eased. The spread between interbank rates and short-term swaps has dropped by around 20 basis points and bank shares have rallied. The improvement in the financial atmosphere has been sufficiently great that one ECB official has suggested it is now "mission accomplished" as far as the Eurozone banking system is concerned.

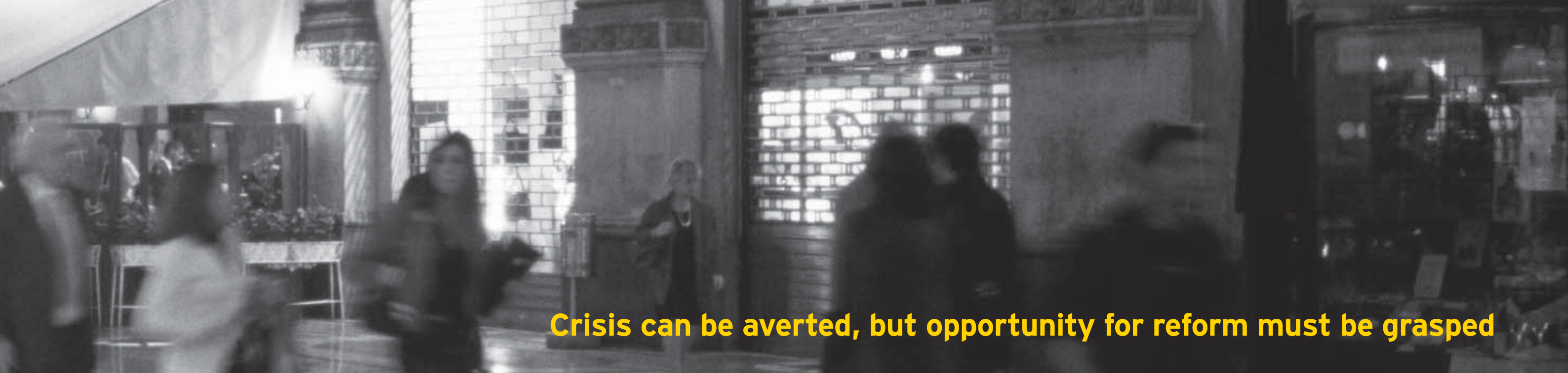
However, the LTRO by no means solves all the Eurozone's problems. The main aim was to stem the crisis in the banking sector which was threatening to push some Eurozone banks toward severe liquidity problems, leading to a savage credit crunch. Against this objective, the LTRO has clearly been a success thus far. As well as easing unsecured funding costs, the LTRO has allowed banks to take down funds which will allow them to replace maturing longer-term market funding in 2012.

The LTRO also comes with downsides though. It threatens to make banks in some countries dangerously dependent on ECB financing. Italian and Spanish banks now have 5% of their assets financed by the ECB and the more this rises, the more difficult it may be for banks to attract other financing, not least because of the ECB's preferred creditor status. The LTRO also ties up banks' assets and, should banks run into liquidity problems, having a large part of their balance sheet acting as collateral for secured financing could make it harder for them to avoid running out of cash. This is essentially what happened to the Belgian-French financial institution Dexia in 2011.

As well as rescuing the banking sector, the LTRO has been touted as a vehicle for easing or even solving the sovereign debt crisis. According to some observers, banks can load up with sovereign debt by taking LTRO funds at 1% and using the proceeds to buy high-yielding sovereign debt. However, data for December shows that Eurozone banks increased their holdings of sovereign debt only modestly and there are a number of reasons why we might be sceptical about very large additional net purchases of sovereign debt going forward, including the need to take unhedged positions in government debt.

The LTRO has also probably come too late in the day to prevent a credit crunch in the Eurozone this year. The ECB bank lending survey at the start of this year showed a sharp rise in the net balance of banks tightening credit standards. This tightening of credit conditions will contribute to weaker economic activity with a likely negative feedback into public finances.

How should the ECB respond? One obvious answer is to do more of the same — the ECB conducted another LTRO operation in late February, attracting a similar degree of take-up to the first. However, it seems likely these funds will again mostly be used to secure banks' financing needs rather than increase lending to the real economy or invest in sovereign debt. Banks may also wish to use LTRO funds to build up liquidity buffers to protect against the risk of renewed financial market tensions resulting from potential defaults. And should such defaults occur, we would argue that aggressive use of the LTRO facility may be one of the main tools the ECB can use to reduce the risk of financial contagion — albeit running the longer-term risks mentioned above of increasing balance sheet encumbrance and creating a large number of banks dependent on ECB finance.



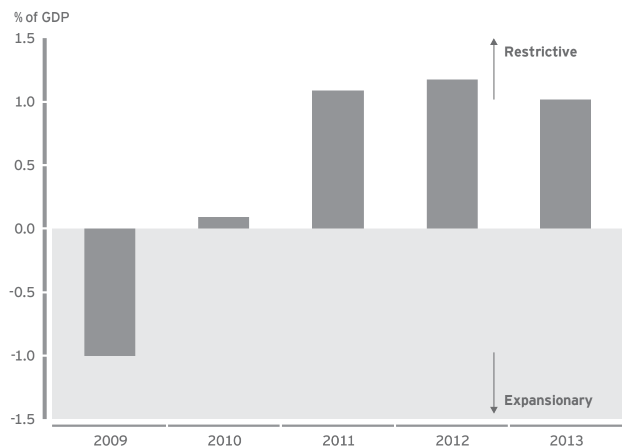
2013 *should* be better ...

Assuming that the Eurozone achieves an orderly resolution of the current financial crisis, we expect a modest recovery in 2013. As the impact of the Greek restructuring works through the financial sector, and concerns around possible defaults in other Member States begin to ease, banks should regain a level of certainty over their balance sheets. Combined with the liquidity provided by the ECB's recent operations, this should motivate banks to become less risk averse. Intra-Eurozone trade will be able to rebound and, as businesses see the outlook improving, investment and hiring should begin to recover.

Nevertheless, growth in 2013 would still be only about 1%. With unemployment remaining relatively high, real wages are likely to see low growth, tempering the recovery of consumer spending. At the same time, fiscal consolidation will continue and we estimate the drag on growth in 2013 will again be of the order of 1% of GDP.

Figure 6

Eurozone: fiscal measures



Source: Oxford Economics

Those countries that fare best in 2012 are likely to do so again in 2013, having suffered the mildest increases in unemployment and having the most modest fiscal challenges to confront (at least in the short term). Germany, France and other Northern European economies are expected to grow by approximately 1.5% to 2%, while those countries most exposed to the worst of the current crisis — Greece, Portugal and Spain — face another year of sharply falling output.

... but the medium-term recovery will be weak ...

The medium-term recovery is likely to be weaker than that from any previous recession since the 1970s, because of a number of factors that will undermine the pace of consumer spending and lending growth.

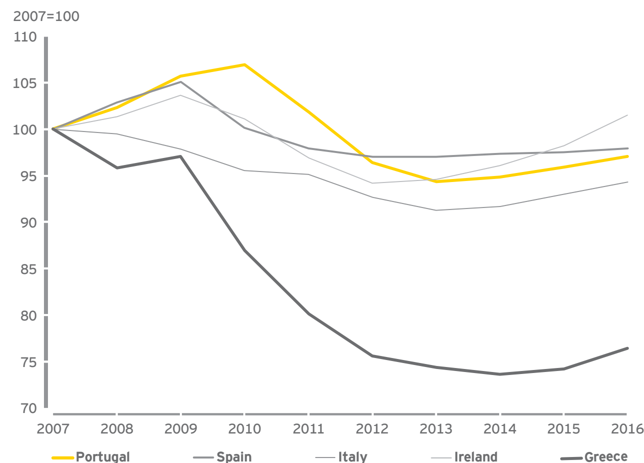
Most obviously, there is the impact of long-term fiscal consolidation. We noted earlier that the direct drag on growth in 2013 was likely to remain at 1% of Eurozone GDP. For some countries, this will remain a burden for much longer. Increases to retirement ages, cuts in benefits entitlements, muted increases, if any, in public sector employment and delinking of wages from inflation are all likely to be part of governments' medium-term strategies, and will all undermine consumers' ability to spend for some time.

Consumers in these countries also face unfavorable wealth effects from earlier fall in asset prices (in particular housing), which may undermine their propensity to spend in the years to come. And with unemployment remaining high, real wages will take some time to start growing again, curbing growth of household incomes.

Elsewhere, consumers are expected to start spending again by 2013–14 (France and Germany will see spending rise by 1.5% to 2% a year). But given the disproportionate role of the countries currently in crisis in driving consumer spending growth over the pre-crisis period (53% of total growth in nominal Eurozone consumer spending from 2002 to 2007), this will impact not only the countries concerned but also the manufacturers and service providers elsewhere in the Eurozone that have relied upon them for business. Households in Germany in particular are likely to account for a much greater share in future consumption growth than was the case in the pre-crisis years.

Figure 7

Real personal disposable income



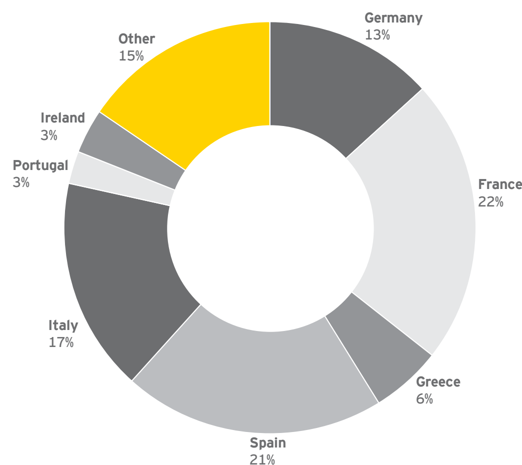
Source: Oxford Economics, Haver Analytics

In addition, banks will have to rebuild their capital after losses, including those incurred in the private sector in 2011–12, and also to increase capital ratios further in order to meet Basel III regulations by the end of the decade. Some of this capital could come from markets, but there is clearly a risk that banks will respond either by restricting lending to make existing capital go further, or by focusing lending on less risky borrowers in order to ensure a return. This will undermine the ability of small- and medium-sized businesses (which account for around 60% of Eurozone GDP) to invest and create jobs.

This means the medium-term recovery is likely to lag, with growth constrained to just below 2% a year in 2014–16. Compared with the seven years following the 1993 recession, when GDP (of the current Eurozone) grew on average by 2.6% a year, this poses the risk of an increase in structural unemployment. Given that debt stocks in most countries will remain uncomfortably high for some time, there is a risk that a focus on short-term fiscal austerity without a medium-term strategy to boost growth merely postpones further fiscal crises.

Figure 8

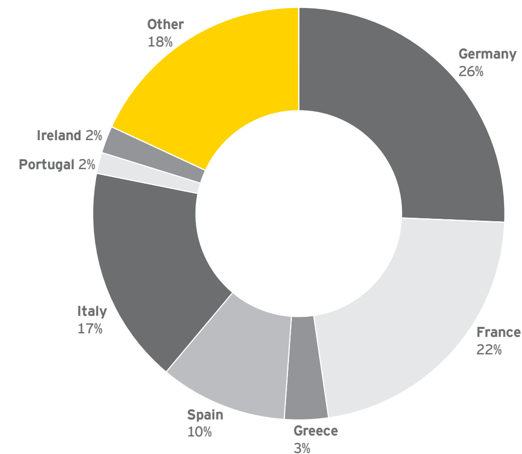
Contributions towards Eurozone nominal consumer spending growth, 2002–2007



Source: Oxford Economics, Haver Analytics

Figure 9

Contributions towards Eurozone nominal consumer spending growth, 2014–2020

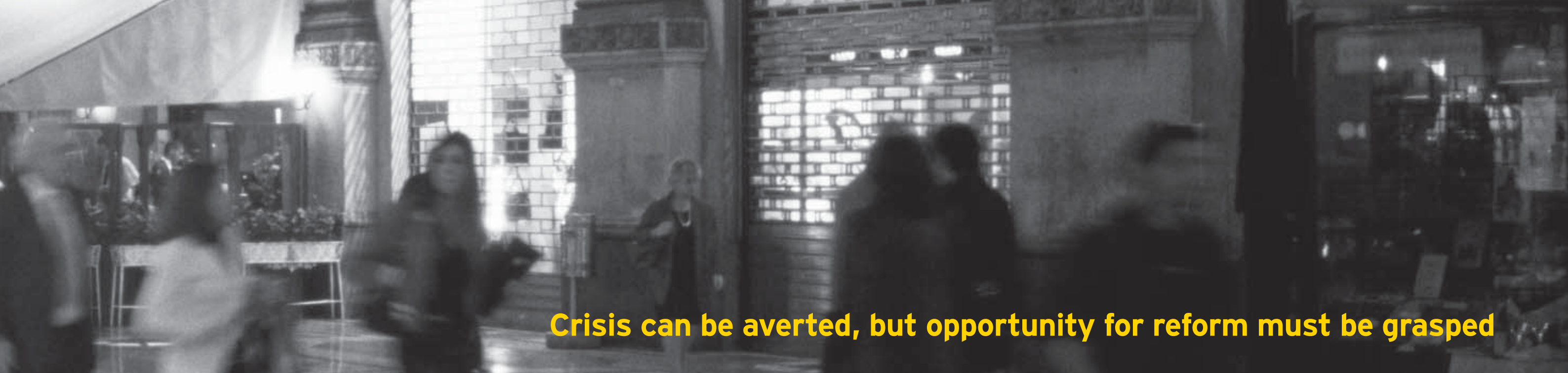


Source: Oxford Economics, Haver Analytics

... so reforms are crucial

However, there is plenty that policy-makers can do to promote a stronger recovery in the medium term. We believe that policy-makers are now seizing the opportunity to make fundamental improvements to the Eurozone economy.

While this will have obvious long-term benefits, credible action on this front in 2012 could contribute, through its impact on potential growth, towards easing the short-term fiscal and banking difficulties facing the Eurozone. Of course, reforms need to be country specific to target each country's key weaknesses and potential, but some common issues emerge when looking across the continent.



Box 3

Policy measures for a long-term recovery

In this quarter's Eurozone Forecast we discuss a number of policy priorities that will be needed to put Europe on the path to a sustainable recovery. These range from urgent measures that need to be delivered in the coming weeks and months, to those where a framework needs to be set out for progress in the coming few years, and longer-term questions about the responsibilities of state, households and businesses. This box brings these policy measures together, setting out a vision for a policy agenda that can see the Eurozone through the crisis, offer a robust recovery and deliver stability in the long-term.

In the short term, the role of the ECB will be crucial. We have already discussed the LTRO at length in Box 2, and do not repeat this analysis here, other than to note that the policy has been effective in addressing the short-term liquidity crisis seen in recent months and should remain on the table as a response to any further liquidity pressures. The ECB will also need to be prepared to resume its interventions in sovereign debt markets should financing conditions for Spain and Italy deteriorate, or those for Portugal not improve by June, when a major bond redemption is due.

Progress towards the implementation of the fiscal compact will also be key. While by no means a panacea for all the Eurozone's difficulties, the compact does offer a binding mechanism for putting public finances on a more sustainable path over the medium term. Ratification by national legislatures (in some cases referenda) will be crucial to ensuring this backstop to confidence in the Eurozone's more stable sovereigns is not removed.

These policy measures need to be implemented in the coming weeks and months, in conjunction with specific domestic priorities for fiscal consolidation and liberalization in Spain, Italy, Greece, Portugal and Ireland in particular. But the medium term will not take care of itself — potential growth rates across the continent are much lower than pre-crisis because of impaired banking systems, and the need to reorient production away from sectors that relied too heavily on external financing (in particular, consumer sectors and housing). Further, the danger that young workers become permanently detached from the labor market poses a risk that even our current estimates of potential growth are too optimistic. Weaker medium-term growth will make it more politically difficult to achieve the targets set out in the fiscal compact, thereby increasing the risk of further debt crises down the line.

In order to boost potential growth, leaders need to sustain the effort displayed in tackling the fiscal crisis into a reinvigoration of the growth agenda. Reforms to link pay with productivity, to make it easier for new workers to compete for jobs and to make it easier for older workers to continue in work, are top priorities in the labor market. Completing the single market in services would drive competition and innovation across the continent's service sector (which even in Germany accounts for 70% of GDP) as well as improving the chances of tapping into demand in rapid-growth economies, and ultimately job growth. Finally, in some countries the cost of doing business needs to be improved, with regulatory and legal uncertainties key.

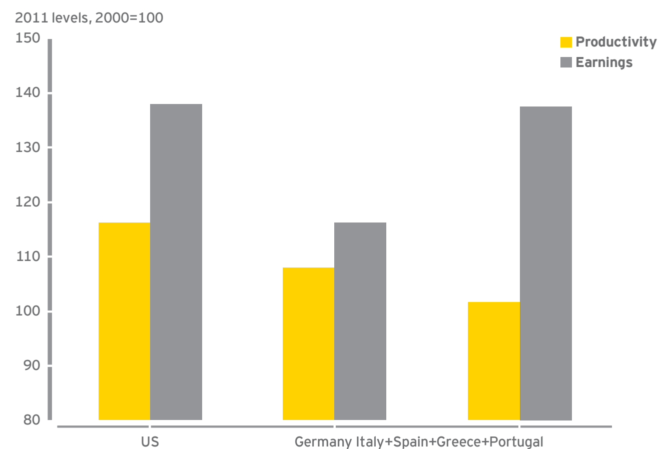
Such measures would help boost potential growth, and in conjunction with the fiscal compact help prevent a repetition of the crisis of the past couple of years in the medium term. Even then, though, there remain fundamental challenges to address. Key among these is an aging population. The pace of aging (already a factor in fiscal deterioration in a number of countries) will accelerate from the second half of the decade. For example, in Germany the ratio of retirees to working age persons is set to rise from 31.3% in 2010 to 32.5% by 2015, to 35.8% in 2020 and to 40.2% in 2025. This brings multiple challenges — not only the fiscal burden of pensions and providing health services, but the risk of falling potential growth as prime age workers stay home to care. In order to prevent future fiscal crises, societies facing the most challenging demographics will need to re-evaluate not just how long older workers stay in the labor force and what they can expect in retirement, but also how to provide care for an ever-increasing elderly cohort without undermining economic growth.

The most pressing among these is regulation of labor markets. Measures need to be taken to link pay and productivity growth better, to ensure that labor is incentivized to move into the right sectors, as well as ensuring firms can remain competitive in the face of pressure from manufacturers in countries with more flexible labor forces.

In practice, this could mean more local- and firm-level bargaining and a phasing out of indexation mechanisms that link wages to the cost of living rather than output. As a major employer in many countries (23% of the workforce at the Eurozone level), the public sector has a key role to play in setting the tone not only through the legislative framework, but also in the way it negotiates with its own workforce.

Figure 10

Productivity and wage increases



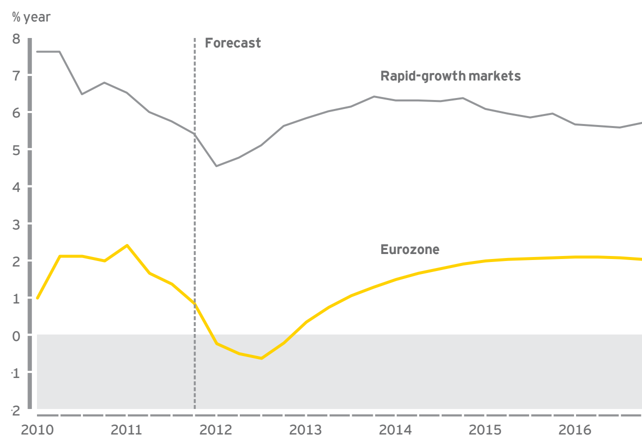
Source: Oxford Economics, Haver Analytics

Such reforms would help bring labor costs per unit of output down. Lower unit labor costs, together with other measures to boost the capacity of firms to innovate and develop new products, would enable Eurozone countries to tap into the strong growth forecast for rapidly growing markets in Asia and Latin America, which will offer ever-increasing opportunities for Eurozone firms. Germany has led by example in this respect, increasing annual exports to China from €13 billion in 2001 to almost €60 billion in 2010 (compared with France's €3.5 billion and €14 billion respectively).

Growth of the middle classes in the rapid-growth economies will offer a rapidly expanding new market for consumer-based manufactured goods and food — as well as in distribution, tourism, hotels and restaurants — sectors that are all suffering in European countries. Other sectors that will also grow strongly in the major emerging markets include financial and business services — areas in which Western businesses have a strong advantage.

Figure 11

GDP: Eurozone and rapid-growth markets

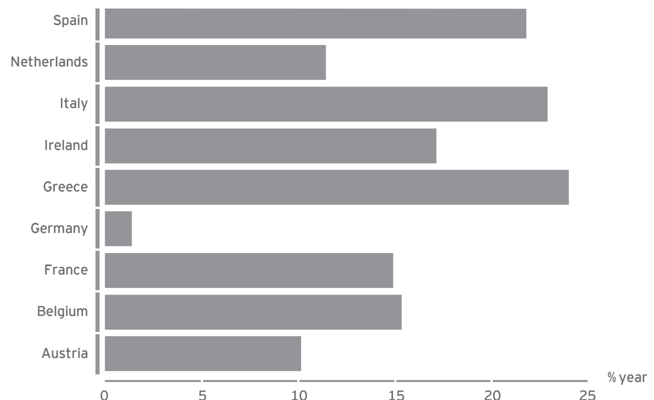


Source: Oxford Economics

In addition, in some countries, the enforcability of contracts and business' faith in institutions remains a barrier to investment. The World Economic Forum's latest *Global Competitiveness Report* found that institutional quality in a few Eurozone economies is worse than in some sub-Saharan African economies. In these countries, improvements to the institutional environment seem crucial to enhancing investor confidence and attracting foreign direct investment.

Figure 12

Growth in unit labor costs, 2002–2010



Source: Oxford Economics, OECD

Reforms to deal with the demographic challenge of aging societies are also a key priority for a most Eurozone countries. Amending retirement and pension entitlements are part of this and, in many countries, are already being tackled — in policy debates if not yet in practice. Measures are also likely to be necessary to ensure older workers are able to compete for jobs and sustain their incomes and tax contributions. In addition, a balance will need to be struck between the fiscal cost of

providing support for elderly health and care services, and placing responsibility on families, thereby drawing prime age workers out of the formal labor force.

One further area in which progress needs to be made is in deepening the single market for services. Services account for 70% of jobs around the EU, but cross-border trade in services is just 5% of Eurozone GDP. Liberalizing trade in services would enhance productivity in the sector and lower costs across the economy more widely.

Conclusions

The outlook for the Eurozone economy is as uncertain as it has been at any point since the founding of the single currency. At best, 2012 will be a difficult year for governments, businesses and households alike. Even the modest recovery forecast cannot be taken for granted, given the substantial challenges the continent faces.

But we are optimistic that the Eurozone policy community will tackle these challenges successfully and avoid a disorderly breakup. Nevertheless, given the damage the crisis has done to banks' balance sheets, and the weakness of public finances in so many countries, the recovery will be slower than after previous downturns.

We think the Eurozone needs to do more to improve the economic outlook beyond 2013. Tackling rigidities in the labor market, improving the quality of institutions in some countries, taking difficult decisions on the care of ageing populations, and encouraging the single market for services would all go a long way toward improving the long-term outlook. By taking these measures now, Eurozone governments would also take a big step toward easing the current crisis.

Box 4

Forecast assumptions — international environment and commodity prices

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

Since our last forecast the news from the US economy has surprised moderately on the upside. Most positively, the labor market is now in better shape than most analysts had expected (adding an above-consensus 240,000 jobs in January on top of upward revisions to the previous two months), which should provide some support to consumer spending in the coming months. In addition, both residential and non-residential construction have continued their modest recovery, while manufacturing and service sector surveys indicate a robust rate of expansion in the first quarter of the year.

But several headwinds will temper the recovery. Unemployment remains above 8% (2 percentage points below early 2010 but still 3 percentage points above pre-crisis). House prices continue to drift, generating further losses in household balance sheets, while fuel prices squeeze incomes. With consumers still wary on most measures, the recent boost to output looks likely to have been destined for inventories (as in 2011Q4) or export markets. Both factors seem set to wane moving into the second half of the year (exports to Europe in particular). On the plus side, the Federal Reserve has underlined its pledge to keep interest rates low, but uncertainty around the long-run path of fiscal policy poses an additional barrier to confidence among firms and consumers. We expect growth of 2.3% in 2012, picking up to 3% by 2014.

Japan should see some recovery from a very weak final quarter of 2011 (when GDP fell 0.5%) when falling output was driven partly by one off factors including flooding in Thailand. But fundamentals remain weak — from continued deflation deterring consumers, a weaker outlook for export demand, and severely constrained fiscal policy. We anticipate growth of just over 1% in 2012, compared to a contraction of a similar magnitude in 2011.

2012 should see only a gradual slowdown in Emerging Asia though. The growth of Chinese industrial output is easing, and alongside it business investment. But consumers seem to be picking up much of the slack (thanks in part to government payments to rural households). In addition, although inflation has edged up a little thanks to rising food prices, price growth remains well below the peaks seen in July last year, providing room for some monetary easing. House prices in many cities eased through January, providing some relief from the prospect of a bubble and eventual crash. Too sharp a correction could pose a risk to activity and local government finances, but this remains a risk rather than a central assumption.

Brazil and India seem set to enjoy another year of solid growth (3% and 6.5% respectively), supported by easing inflation and (in Brazil at least) monetary easing. In both economies business surveys have picked up, filtering through into official measures of output in Brazil. Elsewhere in the rapid-growth markets, most Asian and Latin American countries are expected to see growth at broadly the same rate as 2011. Emerging Europe, however, will be badly impacted by the Eurozone recession of 2012, with demand for exports and financing flows slowing, placing the onus on consumers and constrained governments.

In addition to familiar risks around stability in the Eurozone, a growing risk to the outlook is continued growth in the oil price. We expect the oil price to remain elevated through the first half of the year thanks to ongoing political tensions in the Middle East. We anticipate prices cooling a little in the second half of 2012 as these tensions ease, but strong Asian demand is likely to temper the fall in prices. We think oil prices will average US$112pb in 2012, up very slightly from US$111pb in 2011, but with upside risks given the unpredictable nature of events in Iran and key oil supply routes. We expect world GDP growth of around 3.3% in 2012, down from 3.8% in 2011.

Forecast for Eurozone countries

17 Eurozone countries

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

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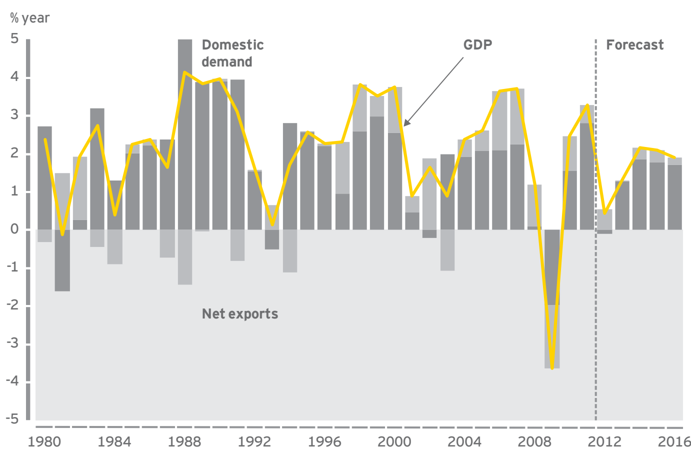
Austria

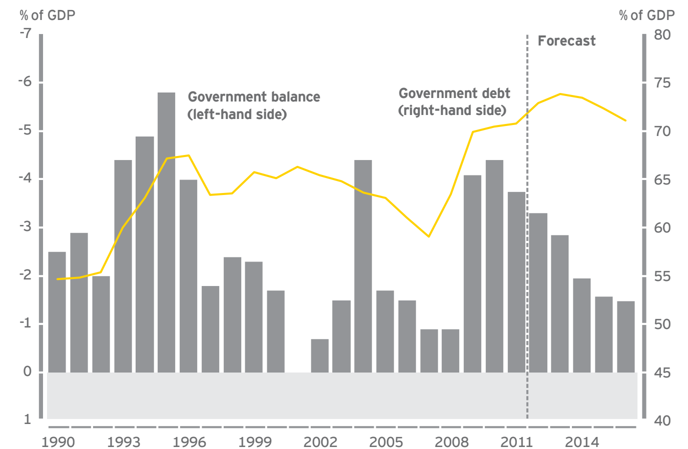
- We forecast GDP growth of 0.4% in 2012, with a mild recession likely at the start of the year, primarily due to the further weakening of external demand. The recovery in 2013 will be moderate, as the impact of the Eurozone debt crisis on the real economy will last beyond 2012.
- Uncertainties about further developments in the debt crisis, in particular an increased likelihood of a disorderly Greek default, skew the forecast risks to the downside. The exposure of Austrian banks to Eastern Europe represents a further, albeit more moderate, risk.
- The Government's substantial austerity package aims at balancing the budget by 2016. If fully implemented, it could have a detrimental effect on growth. But given its comparatively sound fiscal position, Austria should be able to accommodate a larger deficit to support growth if the external environment worsens further.

Figure 13
Contributions to GDP



Source: Oxford Economics

Figure 14
Government balance and debt



Source: Oxford Economics

Table 2
Austria (annual percentage changes unless specified)
Source: Oxford Economics

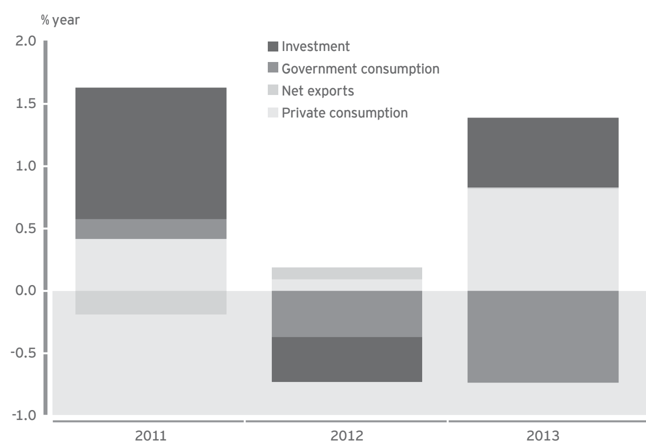
	2011	2012	2013	2014	2015	2016
GDP	3.1	0.4	1.3	1.9	2.0	1.9
Private consumption	0.8	0.9	1.2	1.4	1.7	1.7
Fixed investment	4.4	1.0	2.2	3.3	2.7	2.6
Stockbuilding (% of GDP)	1.8	1.0	0.9	0.9	0.8	0.7
Government consumption	2.5	1.1	1.0	1.3	1.7	1.8
Exports of goods and services	6.3	1.2	5.5	6.0	5.4	5.4
Imports of goods and services	6.5	0.8	6.2	6.3	5.5	5.7
Consumer prices	3.6	2.5	2.1	2.0	2.0	1.9
Unemployment rate (level)	4.1	4.5	4.6	4.5	4.3	4.3
Current account balance (% of GDP)	2.3	2.6	2.4	2.2	2.2	2.2
Government budget (% of GDP)	-3.7	-3.3	-2.9	-2.0	-1.6	-1.5
Government debt (% of GDP)	72.2	74.2	74.9	74.2	72.9	71.7

Belgium

- The Eurozone crisis has taken a heavy toll, initially through the impact on exports, but now feeding through to business and household confidence. The economy contracted 0.2% in Q4 2011.
- 2012 is likely to see contraction in GDP of around 0.3%. Consumers are braced for rising unemployment and firms are reluctant to invest and hire. We forecast a modest recovery in 2013, picking up a little pace to 1.5%–2% in 2014–15.
- In the short to medium term, the government is reinforcing its effort to lower the fiscal deficit towards 3% of GDP. However, beyond the medium term, Belgium has substantial challenges — to tackle its high debt stock and implement growth-boosting economic reforms.

Figure 15

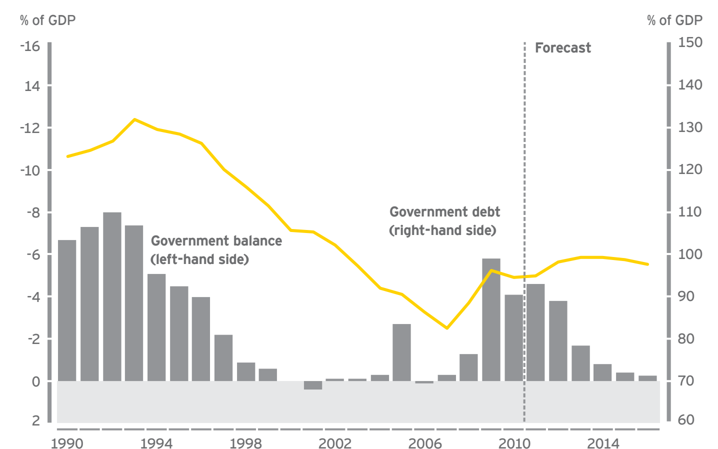
Contributions to GDP growth



Oxford Economics

Figure 16

Government balance and debt



Source: Oxford Economics

Table 3

Belgium (annual percentage changes unless specified) *Source: Oxford Economics*

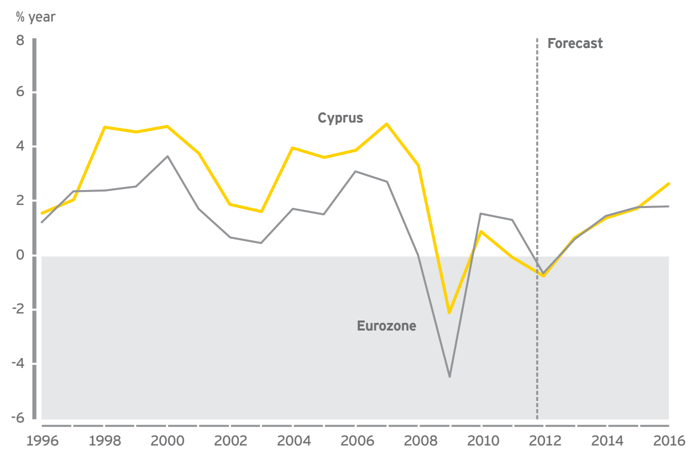
	2011	2012	2013	2014	2015	2016
GDP	1.9	-0.3	0.9	1.5	2.0	2.4
Private consumption	0.8	0.2	1.6	2.1	2.2	1.9
Fixed investment	5.2	-1.7	2.7	5.4	4.4	3.1
Stockbuilding (% of GDP)	-0.3	-0.3	-0.1	-0.2	-0.6	-0.3
Government consumption	0.7	-1.6	-3.1	-1.2	1.3	2.0
Exports of goods and services	4.8	-0.6	3.8	4.8	4.4	4.0
Imports of goods and services	5.4	-0.8	4.0	5.5	4.5	4.1
Consumer prices	3.4	2.1	1.7	1.9	1.9	1.8
Unemployment rate (level)	7.2	7.6	8.1	7.3	6.6	6.4
Current account balance (% of GDP)	-0.6	0.5	0.5	0.0	0.0	-0.1
Government budget (% of GDP)	-4.7	-3.8	-1.7	-0.8	-0.4	-0.3
Government debt (% of GDP)	97.0	99.9	100.5	100.6	99.9	98.7

Cyprus

- Cyprus is very vulnerable to adverse developments in the Eurozone via its exports and the banking system. In light of the deepening debt crisis in Greece, the outlook for the economy has worsened considerably and GDP is now forecast to decline by 0.5% in 2012, after growth of just 0.2% in 2011.
- Cypriot banks are estimated to have €4.2 billion of exposure to Greek sovereign debt. Therefore, a Greek default will have serious repercussions for Cyprus' banking sector.
- The intractable fiscal deficit casts major doubt over the sustainability of public finances. Cyprus' sovereign debt has now been cut to the lowest investment grade status and borrowing costs have been rising. The budget deficit is forecast to fall slightly to 5.3% of GDP in 2012, but this will be far short of the Government's target of 2.8%.

Figure 17

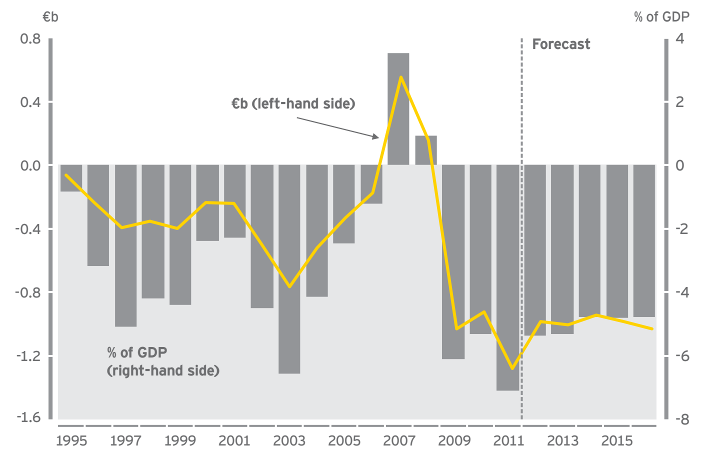
Real GDP growth



Source: Oxford Economics

Figure 18

Government budget balance



Source: Oxford Economics

Table 4

Cyprus (annual percentage changes unless specified)

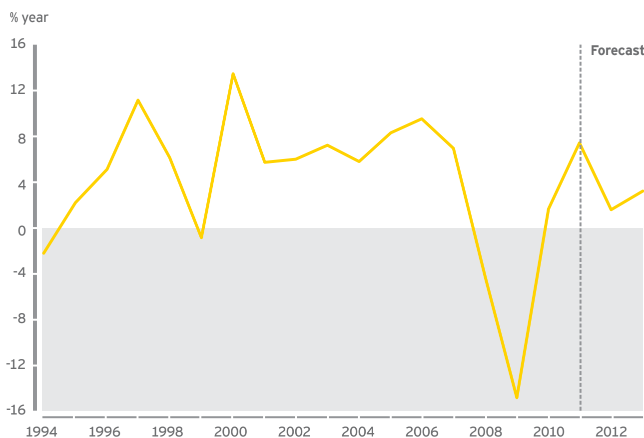
Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	0.2	-0.5	0.9	1.7	2.0	2.9
Private consumption	0.5	-0.3	0.8	1.5	2.0	3.0
Fixed investment	-9.7	-2.3	2.5	4.2	4.8	4.8
Stockbuilding (% of GDP)	2.0	1.8	1.1	0.1	-0.2	-0.4
Government consumption	-5.3	-3.0	1.2	2.0	2.5	3.3
Exports of goods and services	0.9	1.7	3.0	5.3	5.3	5.3
Imports of goods and services	-1.0	0.0	1.8	4.0	5.6	5.6
Consumer prices	3.5	3.3	2.3	2.3	2.3	2.3
Unemployment rate (level)	7.7	9.7	9.0	7.3	5.0	4.5
Current account balance (% of GDP)	-7.6	-7.6	-6.8	-6.2	-6.1	-5.8
Government budget (% of GDP)	-7.1	-5.3	-5.3	-4.7	-4.8	-4.7
Government debt (% of GDP)	66.4	69.9	73.0	75.0	76.7	77.6

Estonia

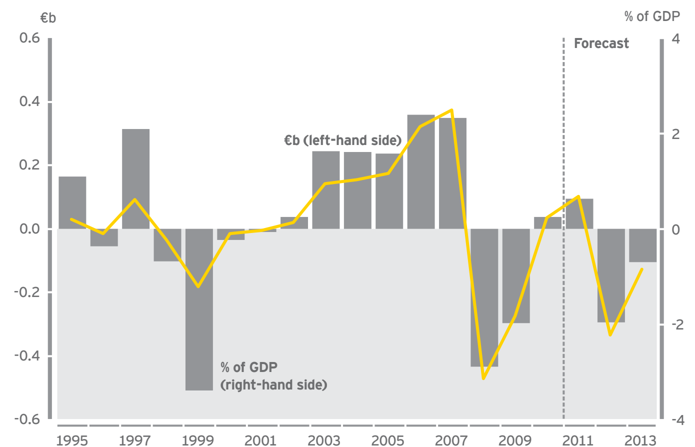
- After posting the Eurozone's fastest GDP growth in 2011, the pace of expansion will slow sharply in 2012 as the escalation of the Eurozone crisis and associated austerity dampens demand in Estonian export markets. The Government will partly offset the weakening of external demand by running small deficits in 2012-13, after moving the budget into surplus in 2011, but we still expect GDP growth to slow from 7.5% in 2011 to 2.0% in 2012.
- Prospects further ahead are better, with export demand expected to rebound strongly as the Eurozone recovers and the key markets of Sweden and Finland strengthen. GDP growth is expected to recover to almost 4% in 2013 and to average 4.7% in 2014-16, comfortably the fastest in the Eurozone.

Figure 19
Real GDP growth



Source: Oxford Economics

Figure 20
Government budget balance



Source: Oxford Economics

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

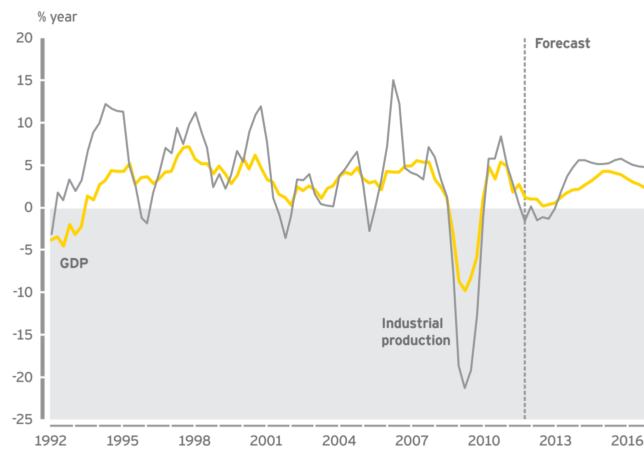
	2011	2012	2013	2014	2015	2016
GDP	7.5	2.0	3.8	4.8	4.7	4.5
Private consumption	3.3	2.6	3.5	4.3	4.7	4.6
Fixed investment	16.5	5.0	6.5	8.0	5.8	5.0
Stockbuilding (% of GDP)	-0.7	-0.3	0.0	0.2	0.2	0.2
Government consumption	1.5	1.0	1.0	1.8	2.7	3.0
Exports of goods and services	25.0	2.7	6.5	5.7	5.4	5.2
Imports of goods and services	26.0	4.1	6.9	6.0	5.4	5.1
Consumer prices	5.0	3.0	2.3	2.1	2.2	2.1
Unemployment rate (level)	12.1	10.9	9.2	7.4	6.1	5.0
Current account balance (% of GDP)	3.1	1.1	0.3	-0.1	0.0	0.0
Government budget (% of GDP)	0.7	-2.0	-0.7	0.1	0.0	0.0
Government debt (% of GDP)	5.3	7.0	7.3	6.7	6.3	6.0

Finland

- We have lowered our forecast for Finland's GDP growth in 2012 from 1.6% to 0.7% as the economy is hit by the ongoing Eurozone crisis. Nevertheless, we still expect Finland to outgrow its peers.
- Short-term indicators suggest that economic activity has already begun to slow and we expect this trend to continue for the foreseeable future. The manufacturing sector is particularly exposed to the slowdown in the Eurozone, which is one of its main customer bases.
- The unfavorable external environment will also dampen domestic activity, by hampering businesses' ability and willingness to invest and hire.
- Beyond 2012, the prospects are more encouraging. As the Eurozone economy starts to recover, Finland will reap the benefits of having a healthy financial sector, low levels of indebtedness, a productive workforce and relatively low labor costs.

Figure 21

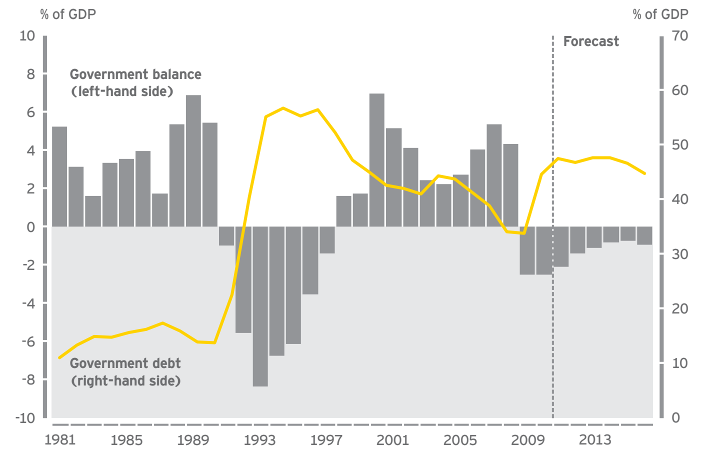
GDP and industrial production



Source: Oxford Economics

Figure 22

Government balance and debt



Source: Oxford Economics

Table 6

Finland (annual percentage changes unless specified)

Source: Oxford Economics

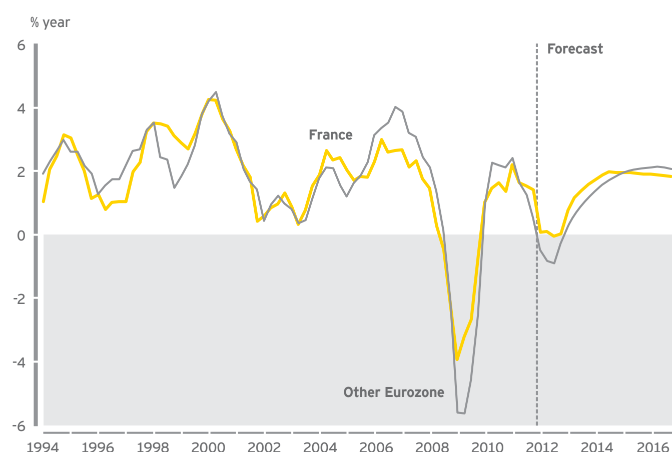
	2011	2012	2013	2014	2015	2016
GDP	2.6	0.7	1.4	2.9	4.1	2.9
Private consumption	3.3	0.6	1.0	3.0	3.3	3.0
Fixed investment	4.5	-1.3	1.8	5.3	5.1	4.4
Stockbuilding (% of GDP)	2.9	2.8	2.0	0.4	0.6	0.6
Government consumption	0.6	0.4	1.1	1.3	1.2	1.4
Exports of goods and services	-1.3	0.5	4.2	6.8	5.9	5.2
Imports of goods and services	-1.2	-0.6	1.9	3.7	4.7	6.1
Consumer prices	3.3	2.4	1.9	1.9	1.9	1.8
Unemployment rate (level)	7.8	7.8	7.5	7.1	6.9	6.8
Current account balance (% of GDP)	-0.5	2.1	2.5	2.6	2.5	2.7
Government budget (% of GDP)	-2.1	-1.4	-1.1	-0.8	-0.7	-0.9
Government debt (% of GDP)	47.6	48.1	48.0	46.8	44.9	43.8

France

- We expect zero growth in French GDP in 2012, as demand is dampened by fiscal austerity and tight credit conditions.
- In this environment, companies are likely to need to reduce headcount further in order to maintain productivity and profitability.
- This will dent households' incomes. However, we expect inflation to slow this year as energy price inflation abates. This means that households' purchasing power should not fall.
- Assuming that confidence in policy-makers' ability to resolve the Eurozone debt crisis is restored, France should recover from 2013 onward. The strength of the recovery will, in part, depend on the ability to pass reforms aimed at enhancing France's attractiveness as a business location. The crisis offers an opportunity to enact changes that would otherwise have been hard to implement, especially making the labor market more flexible.

Figure 23

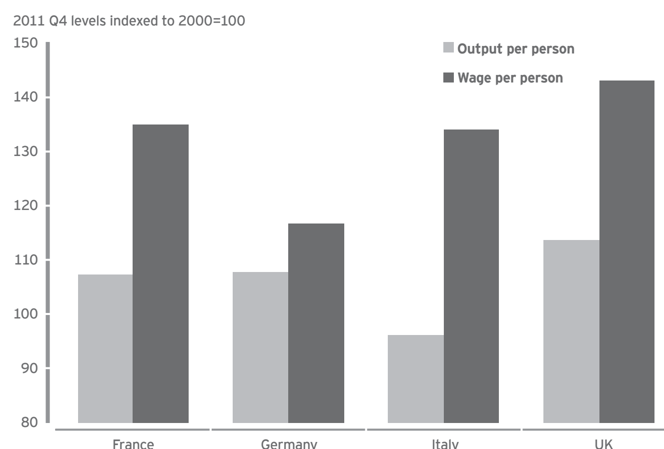
GDP: France versus rest of Eurozone



Source: Oxford Economics

Figure 24

Productivity and wage increases



Source: Oxford Economics

Table 7

France (annual percentage changes unless specified)

Source: Oxford Economics

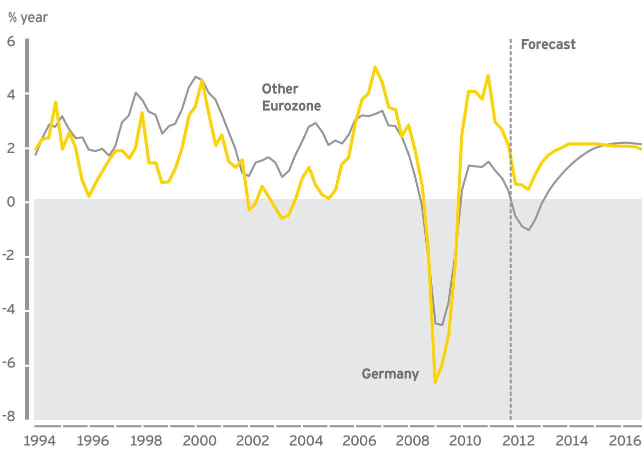
	2011	2012	2013	2014	2015	2016
GDP	1.7	0.0	1.2	1.9	2.0	1.9
Private consumption	0.3	0.1	1.4	1.7	1.8	1.8
Fixed investment	2.9	0.2	1.9	3.0	2.9	2.8
Stockbuilding (% of GDP)	0.7	0.3	0.2	0.3	0.3	0.3
Government consumption	0.9	-0.1	0.2	1.2	1.2	1.2
Exports of goods and services	5.0	2.1	5.3	5.9	5.5	5.0
Imports of goods and services	5.0	0.5	4.6	5.5	5.2	4.7
Consumer prices	2.3	2.2	1.9	1.9	1.9	1.9
Unemployment rate (level)	9.7	10.2	9.9	9.5	9.1	8.9
Current account balance (% of GDP)	-2.3	-2.2	-2.2	-2.2	-2.3	-2.3
Government budget (% of GDP)	-5.7	-4.8	-3.9	-3.1	-2.7	-2.3
Government debt (% of GDP)	85.4	89.0	91.2	92.5	94.3	95.7

Germany

- We forecast GDP growth at 0.6% in 2012, down from 3% in 2011, with a mild and short recession. A significant part of the slowdown from 2011 is a direct result of the adverse external environment.
- The ongoing Eurozone crisis will also have an indirect impact on domestic activity, notably by encouraging a "wait-and-see" attitude among businesses.
- Assuming that policies are implemented at the Eurozone level to help the region emerge from the sovereign debt crisis, Germany should bounce back relatively strongly starting next year. The main challenge is to build on past reforms to ensure that the country has enough skilled staff to sustain strong growth.

Figure 25

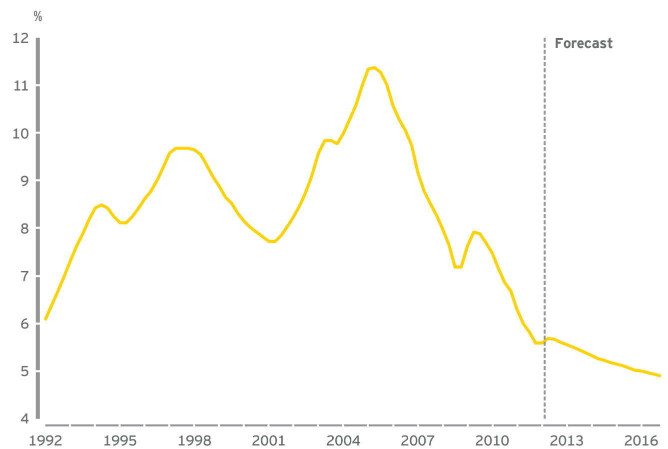
GDP: Germany versus rest of Eurozone



Source: Oxford Economics

Figure 26

Unemployment



Source: Oxford Economics

Table 8

Germany (annual percentage changes unless specified)

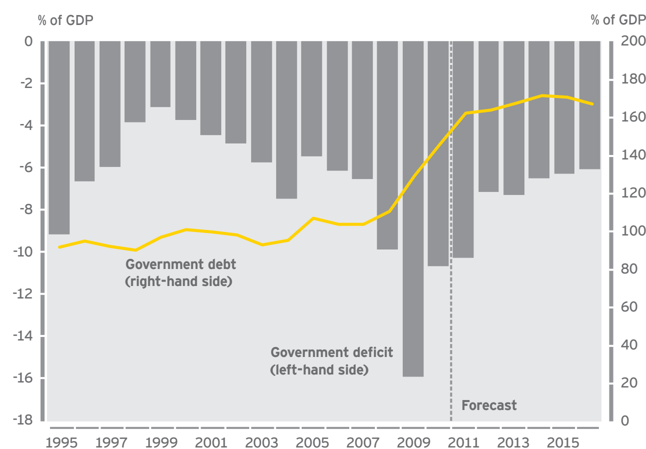
Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	3.1	0.6	1.7	2.1	2.0	2.0
Private consumption	1.4	0.8	1.4	1.4	1.5	1.5
Fixed investment	6.6	1.9	3.7	5.0	4.4	3.7
Stockbuilding (% of GDP)	0.5	0.4	0.5	0.3	0.1	0.1
Government consumption	1.4	0.7	0.5	0.7	0.7	0.7
Exports of goods and services	8.4	2.1	5.4	6.9	6.2	5.3
Imports of goods and services	7.5	2.8	6.2	6.8	6.1	5.4
Consumer prices	2.5	1.9	1.8	1.8	1.8	1.8
Unemployment rate (level)	5.9	5.5	5.3	5.1	4.9	4.8
Current account balance (% of GDP)	5.3	5.4	5.0	4.7	4.6	4.5
Government budget (% of GDP)	-1.0	-1.2	-1.1	-0.9	-0.6	-0.1
Government debt (% of GDP)	81.1	81.1	80.6	80.7	81.1	81.0

Greece

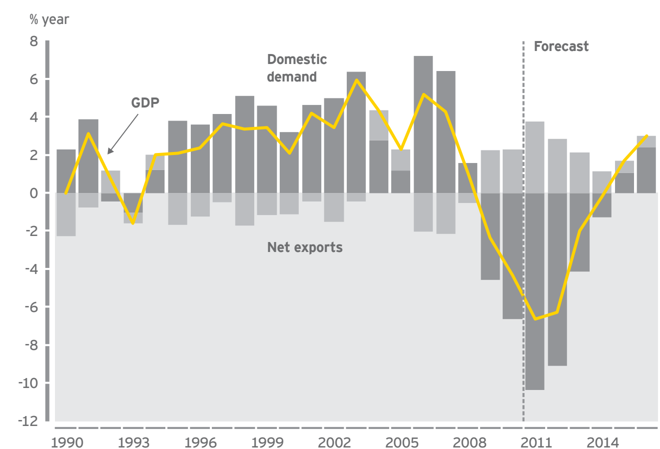
- It has become increasingly clear in recent months that the 50% write-down of privately held Greek government debt agreed in October 2011 will not be sufficient. This reflects doubts about Greece's long-term debt sustainability, its chronically weak economy and budget deficits that have continually overshot agreed targets.
- Greece has had further difficult rounds of negotiations with both official and private sector lenders aimed at securing new external finance and increased private sector debt relief. In return for new financing, Greece is implementing a number of new fiscal measures and a debt write-down of 53.5% has been agreed by private sector creditors.
- But the austerity program has grown extremely unpopular as it has plunged the economy into a deep recession. This raises the risk of "austerity fatigue," whereby Greece could lose the political will to keep implementing harsh measures.

Figure 27
Government deficit and debt



Source: Oxford Economics

Figure 28
Contributions to GDP growth



Source: Oxford Economics

Table 9
Greece (annual percentage changes unless specified)

Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	-6.8	-6.4	-1.9	-0.1	1.8	3.0
Private consumption	-6.1	-6.7	-3.8	-0.9	1.4	2.8
Fixed investment	-16.4	-11.8	-5.6	-1.1	2.4	4.8
Stockbuilding (% of GDP)	-0.4	-0.1	0.5	0.4	0.2	0.0
Government consumption	-12.4	-15.7	-6.4	-2.7	0.6	1.3
Exports of goods and services	-0.5	1.5	2.0	4.3	6.0	6.7
Imports of goods and services	-12.2	-8.4	-5.7	-0.1	3.8	5.3
Consumer prices	3.1	1.3	0.5	1.0	1.7	2.2
Unemployment rate (level)	17.5	21.3	22.8	23.5	23.6	23.0
Current account balance (% of GDP)	-9.8	-9.7	-7.2	-5.6	-4.8	-4.2
Government budget (% of GDP)	-10.2	-7.1	-7.2	-6.5	-6.2	-6.0
Government debt (% of GDP)	166.6	160.8	170.2	173.9	172.9	169.6

Ireland

- Of the five peripheral Eurozone countries, Ireland has been the most successful in addressing its economic issues. Ten-year bond yields are less than one-half of their peak level in July 2011 reflecting a gradual restoration of investors' faith.
- The Government lowered its budget deficit to 10% of GDP in 2011 (beating the EU and IMF's target of 10.6%) and is on track to cut it further to 8.6% of GDP in 2012 by means of further austerity measures.
- But tight fiscal policy is taking its toll on domestic demand, and the short-term outlook is not very favorable. GDP is expected to decline by 0.1% in 2012 before growing by 0.6% in 2013.
- Ireland remains vulnerable to developments in the Eurozone and downside risks dominate its economic outlook. The Government is on track to return to financial markets by mid 2013, when the international money is due to run out, but this depends heavily on how events in the Eurozone unfold.

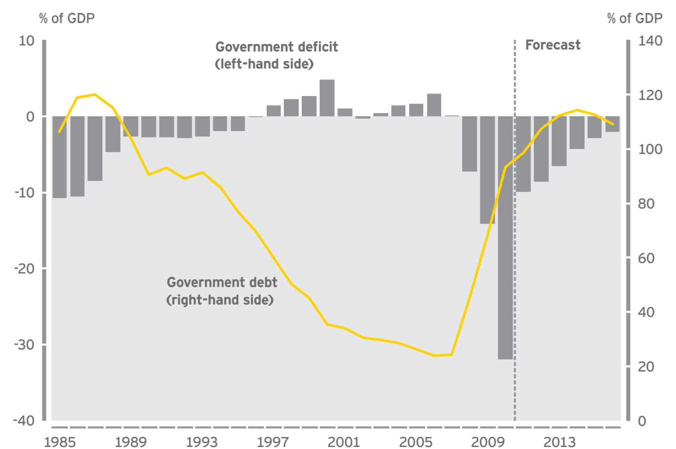
Figure 29

Long-term government borrowing interest rate

Source: Oxford Economics, Haver Analytics

Figure 30

Government balance and debt



Source: Oxford Economics

Table 10

Ireland (annual percentage changes unless specified)

Source: Oxford Economics

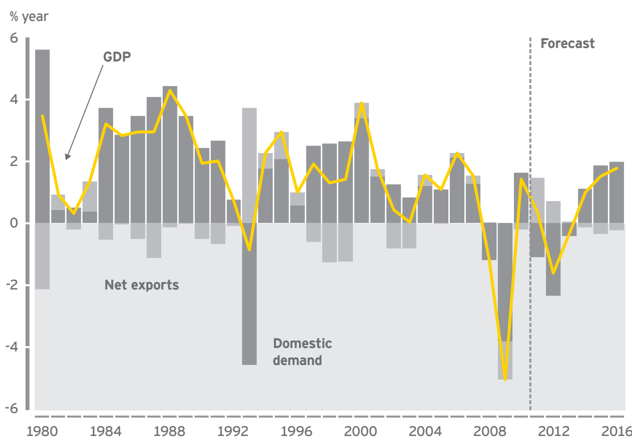
	2011	2012	2013	2014	2015	2016
GDP	1.0	-0.1	0.6	1.4	3.0	3.8
Private consumption	-3.0	-1.2	-0.8	0.5	1.4	2.5
Fixed investment	-15.0	-5.9	0.8	5.3	13.6	11.8
Stockbuilding (% of GDP)	0.5	0.0	-0.1	0.1	0.4	0.1
Government consumption	-3.8	-3.7	-1.8	-1.3	-0.1	0.7
Exports of goods and services	4.3	2.1	3.8	4.0	4.0	4.3
Imports of goods and services	-0.2	1.2	3.2	4.5	4.5	4.0
Consumer prices	1.2	0.6	0.1	0.5	0.8	1.4
Unemployment rate (level)	14.4	14.7	14.8	14.3	13.6	12.7
Current account balance (% of GDP)	0.5	3.2	3.3	3.4	3.3	3.0
Government budget (% of GDP)	-10.0	-8.6	-6.6	-4.4	-2.9	-2.1
Government debt (% of GDP)	102.3	110.8	114.7	115.9	113.9	109.9

Italy

- Italy now faces two years of GDP decline as fiscal tightening hits domestic demand and the faltering Eurozone weakens support from trade; we expect GDP to fall 1.6% in 2012 and then by another 0.3% in 2013. Assuming financial stability in the region is restored and the economy starts to benefit from structural reforms in the medium term, we expect growth to resume, averaging 1.4% in 2014-16.
- Additional fiscal tightening and a tough stance in favor of structural reforms appear to have helped reduce long-term interest rates. However, the risk that the situation worsens again is high as GDP shrinks and short-term refinancing needs remain large. Moreover, credit conditions were tightened significantly at the start of 2012, exacerbating the effect of the fiscal adjustment on domestic demand.

Figure 31

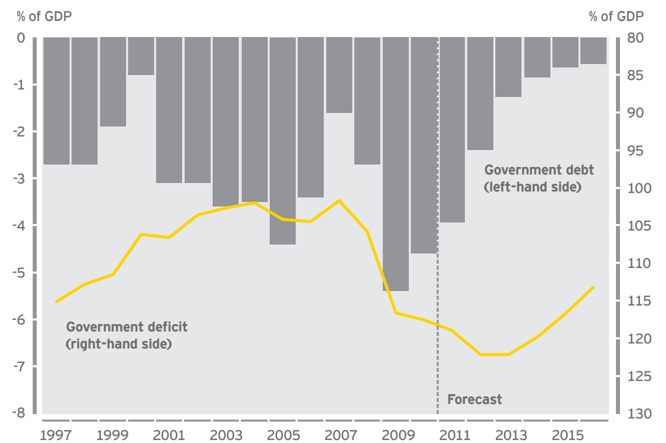
Contributions to GDP growth



Source: Oxford Economics

Figure 32

Government deficit and debt



Source: Oxford Economics

Table 11

Italy (annual percentage changes unless specified)

Source: Oxford Economics

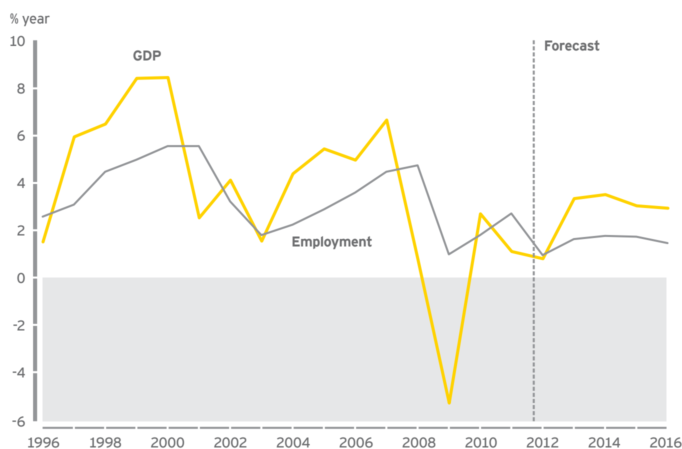
	2011	2012	2013	2014	2015	2016
GDP	0.4	-1.6	-0.3	0.9	1.5	1.8
Private consumption	0.4	-1.8	-0.9	0.7	1.3	1.6
Fixed investment	-1.0	-4.5	0.0	2.4	3.3	3.2
Stockbuilding (% of GDP)	-0.6	-0.7	-0.2	0.0	0.3	0.4
Government consumption	-0.3	-1.5	-1.1	-0.1	0.9	1.4
Exports of goods and services	6.3	0.1	1.3	4.0	4.7	5.1
Imports of goods and services	0.8	-2.5	1.2	4.6	6.0	5.9
Consumer prices	2.9	2.8	2.2	2.2	2.0	2.0
Unemployment rate (level)	8.2	9.6	10.1	9.8	9.0	8.1
Current account balance (% of GDP)	-3.2	-2.4	-2.1	-1.9	-1.9	-2.0
Government budget (% of GDP)	-4.0	-2.5	-1.3	-0.9	-0.6	-0.6
Government debt (% of GDP)	120.5	123.0	122.6	120.3	117.1	113.6

Luxembourg

- We expect growth to slow to 0.7% this year as the external sector remains a drag on activity and financial services are expected to suffer from the impact of the sovereign debt crisis on the European financial system as a whole.
- The restoration of confidence and stability within the Eurozone in 2013 should further boost the orientation of Luxembourg's economy toward business services, which will become an important growth driver in the medium term.
- New EU financial regulation is generally favorable for Luxembourg, promoting renewed onshoring of investment funds and pan-European distribution, but the financial sector would be adversely affected by the proposed financial transaction tax.

Figure 33

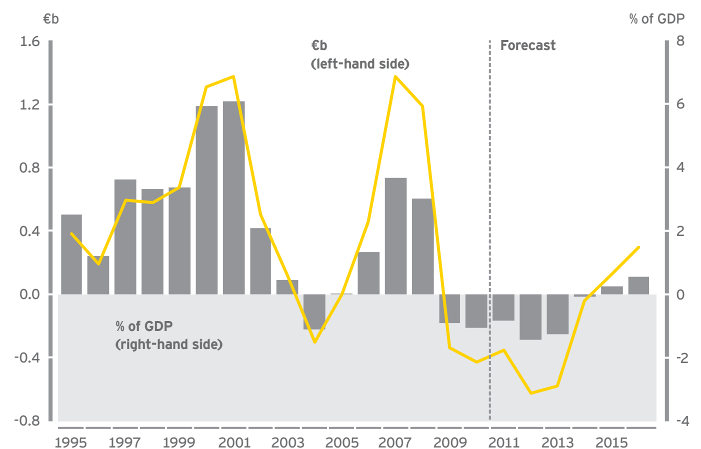
Real GDP and employement



Source: Oxford Economics

Figure 34

Government budget balance



Source: Oxford Economics

Table 12

Luxembourg (annual percentage changes unless specified)

Source: Oxford Economics

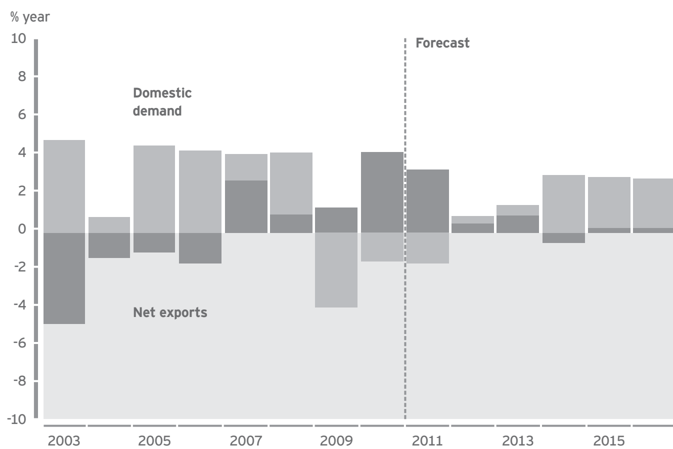
	2011	2012	2013	2014	2015	2016
GDP	1.1	0.7	3.1	3.5	3.0	2.9
Private consumption	1.3	1.4	3.0	2.9	2.5	2.4
Fixed investment	10.3	6.3	5.3	3.9	1.6	1.2
Stockbuilding (% of GDP)	1.6	0.6	0.7	0.5	0.7	0.1
Government consumption	0.4	2.2	2.0	2.0	1.9	1.8
Exports of goods and services	3.2	2.8	6.0	5.5	4.2	3.8
Imports of goods and services	6.0	3.6	6.6	5.4	4.0	3.1
Consumer prices	3.7	2.5	2.1	2.1	2.0	2.0
Unemployment rate (level)	4.8	5.5	5.4	4.6	4.0	3.6
Current account balance (% of GDP)	7.4	5.8	6.2	6.5	7.0	7.4
Government budget (% of GDP)	-0.8	-1.4	-1.3	-0.1	0.3	0.6
Government debt (% of GDP)	18.9	19.7	20.0	19.0	17.9	16.4

Malta

- Subdued Eurozone export markets make a slowdown in GDP growth unavoidable in 2012, with modest expansion of 0.9% forecast to follow an estimated 1.8% rise in 2011. We expect a gradual quickening of growth toward 3% between 2013 and 2015, in line with the expected improvement in the external outlook.
- This year's slowdown leaves the Government with a difficult task in achieving fiscal deficit reduction and we expect the budget deficit to remain stable at close to 3% of GDP in 2012, before falling below 2% of GDP by 2015.
- Fiscal consolidation, together with credit tightening, will weigh on domestic demand. Investment and consumption are both expected to expand by a modest 0.5% in 2012, after declining in 2011.

Figure 35

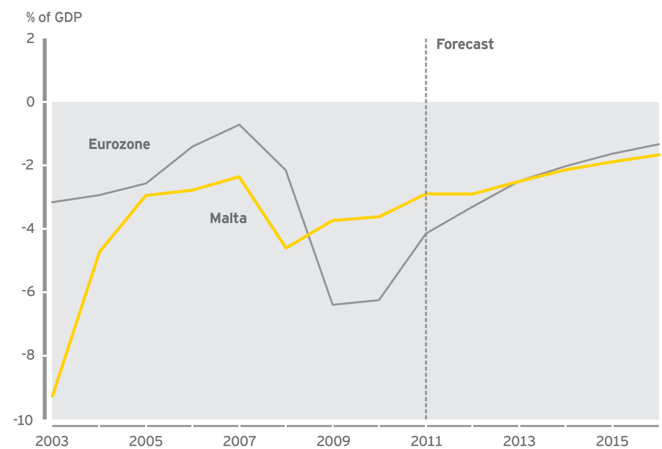
Contributions to GDP



Source: Oxford Economics

Figure 36

Fiscal balance versus Eurozone



Source: Oxford Economics

Table 13

Malta (annual percentage changes unless specified)

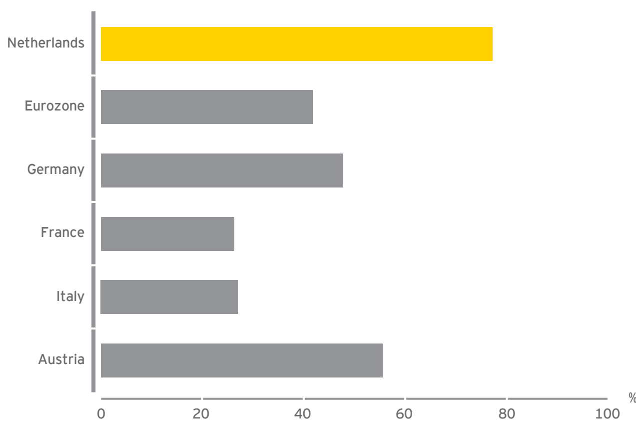
Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	1.8	0.9	1.5	2.6	3.0	3.0
Private consumption	-0.9	0.6	1.2	2.3	2.9	3.2
Fixed investment	-11.6	0.5	1.7	4.5	6.0	4.0
Stockbuilding (% of GDP)	0.4	0.3	-0.2	0.6	0.4	0.2
Government consumption	1.6	0.3	1.0	2.2	2.8	3.0
Exports of goods and services	-3.0	1.5	2.4	3.0	3.0	3.0
Imports of goods and services	-7.0	1.0	1.5	4.0	3.0	3.0
Consumer prices	2.4	1.6	2.1	2.3	2.3	2.3
Unemployment rate (level)	6.5	6.2	6.1	5.6	5.1	4.5
Current account balance (% of GDP)	-4.4	-4.5	-4.1	-4.0	-4.0	-3.6
Government budget (% of GDP)	-2.9	-2.9	-2.5	-2.1	-1.9	-1.7
Government debt (% of GDP)	68.8	69.6	69.5	68.3	66.7	65.0

Netherlands

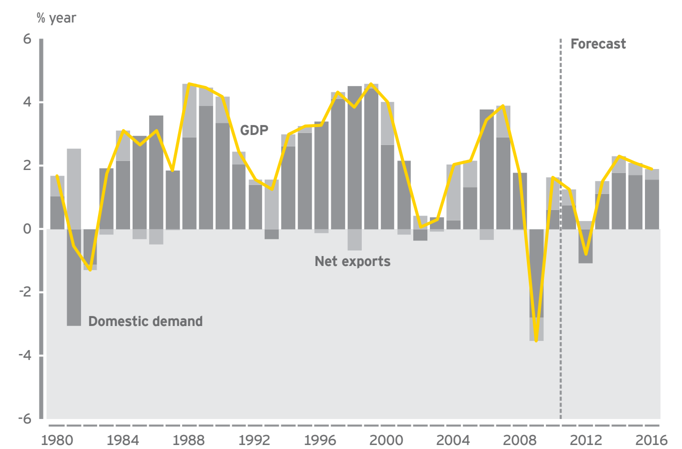
- The Dutch economy has been particularly badly affected by the Eurozone crisis, because of its openness and its heavy reliance on trade with other Eurozone countries. The softening in export prospects has coincided with a period of sustained weakness in the domestic economy, plunging the Netherlands into recession.
- We expect recovery to follow in H2 2012, providing that policy-makers are able to prevent financial contagion spreading. In this case, export growth should improve, particularly given the more positive outlooks for Germany and Scandinavia, the key export markets for Netherlands. Recovery should also be supported by the boost to consumer spending power caused by a sharp slowdown in inflation. We expect GDP to fall by 0.8% in 2012 before recovering to grow by 1.5% in 2013.

Figure 37
Exports as a share of GDP, 2010



Source: Oxford Economics, Haver Analytics

Figure 38
Contributions to GDP growth



Source: Oxford Economics

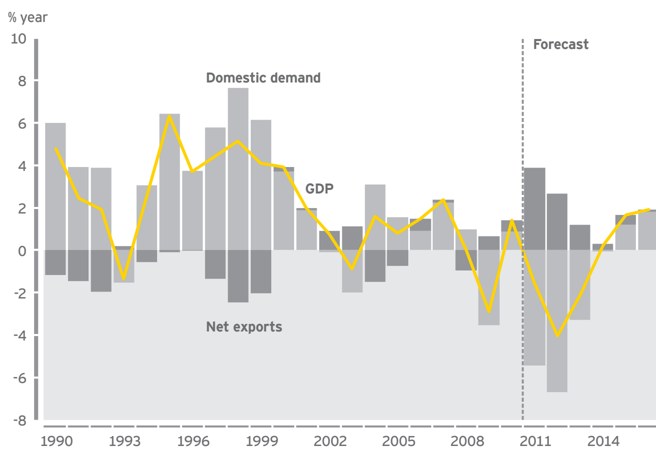
Table 14
Netherlands (annual percentage changes unless specified)
Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	1.3	-0.8	1.5	2.3	2.1	1.9
Private consumption	-0.9	-1.0	1.0	2.0	1.9	1.7
Fixed investment	5.6	-1.3	3.3	3.3	2.9	2.5
Stockbuilding (% of GDP)	0.5	0.2	0.2	0.2	0.2	0.2
Government consumption	0.4	-0.4	0.1	1.0	1.2	1.2
Exports of goods and services	3.7	0.8	4.8	5.3	4.1	3.4
Imports of goods and services	3.5	0.5	4.9	5.2	4.2	3.4
Consumer prices	2.5	2.4	1.6	1.8	1.8	1.8
Unemployment rate (level)	4.4	5.3	5.3	4.6	4.0	3.8
Current account balance (% of GDP)	8.0	7.6	7.2	7.1	7.0	7.1
Government budget (% of GDP)	-4.0	-4.3	-3.6	-2.9	-1.8	-1.1
Government debt (% of GDP)	65.2	68.8	70.3	70.5	69.6	68.1

Portugal

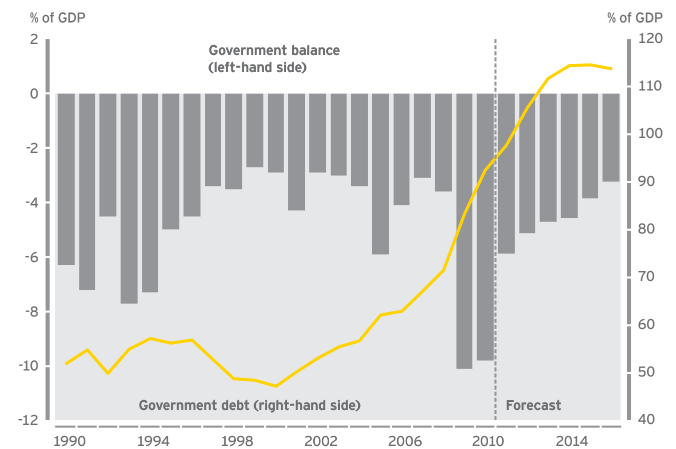
- Being able to return to financial markets by mid-2013 now looks very unlikely, and the need for more financial assistance from the EU and the IMF is almost certain. Stringent fiscal and structural conditions will weigh heavily and GDP is now forecast to decline by 4% in 2012 and a further 2.1% in 2013.
- The deficit target of 5.9% of GDP in 2011 was only met because of a one-off transfer from banks' pension funds to the state. To enable it to lower the deficit to 4.5% of GDP in 2012, the Government has unveiled a very tough budget. This will hit both consumer spending and investment.
- Encouraging structural reforms agreed with the EU and the IMF – particularly in the labor market – are under way. These are likely to benefit the Portuguese economy in the long-term.

Figure 39
Contributions to GDP growth



Source: Oxford Economics

Figure 40
Government balance and debt



Source: Oxford Economics

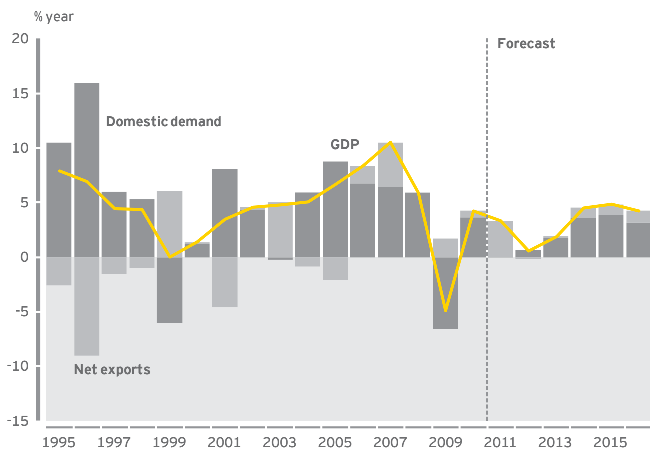
Table 15
Portugal (annual percentage changes unless specified)
Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	-1.5	-4.0	-2.1	0.2	1.7	1.9
Private consumption	-3.6	-6.2	-3.1	0.4	1.1	1.2
Fixed investment	-10.8	-12.7	-6.4	-1.3	3.0	3.8
Stockbuilding (% of GDP)	-0.2	0.4	0.6	0.5	0.4	0.5
Government consumption	-3.3	-4.0	-2.3	-0.1	0.9	1.7
Exports of goods and services	7.0	2.7	4.5	4.6	4.8	3.5
Imports of goods and services	-4.0	-4.1	1.2	3.8	3.6	3.3
Consumer prices	3.6	3.1	1.6	1.2	1.8	1.8
Unemployment rate (level)	12.7	14.1	14.9	14.8	13.6	12.3
Current account balance (% of GDP)	-6.7	-4.5	-3.6	-3.1	-2.8	-2.6
Government budget (% of GDP)	-5.9	-5.1	-4.7	-4.6	-3.8	-3.2
Government debt (% of GDP)	99.5	107.5	113.4	116.0	115.9	114.9

Slovakia

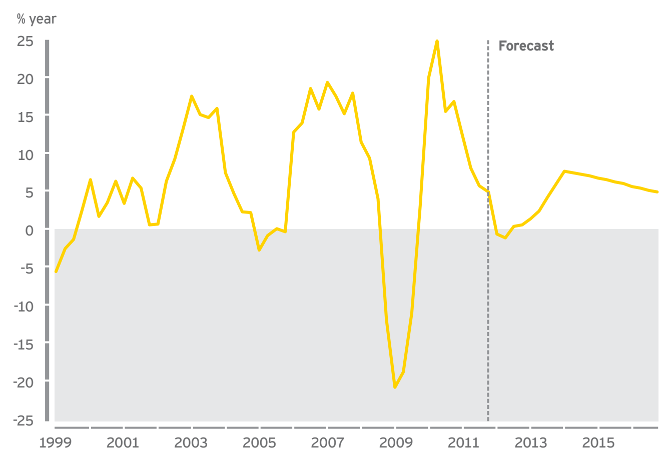
- Heavy dependence on exports to the Eurozone means that GDP growth will be weak in the short term. After growth of about 3% in 2011, we forecast that the pace will slow to just 0.6% in 2012.
- The downturn will be even more severe in the manufacturing sector, with the key automotive industry particularly badly hit.
- The outlook is also complicated by the looming credit crunch in Europe. Liquidity concerns in the Eurozone, coupled with the need to comply with tougher EU capital requirements, will force many banks to reduce the flow of funds to their subsidiaries in Eastern Europe. With heavy foreign participation in its banking system, Slovakia would be severely hit by a credit crunch.
- But growth will pick up over the medium term on the back of the country's high productivity, the need to enhance capacity and the fact that the economy is well integrated with European supply chains.

Figure 41
Contributions to GDP growth



Source: Oxford Economics

Figure 42
Industrial production growth



Source: Oxford Economics

Table 16
Slovakia (annual percentage changes unless specified)

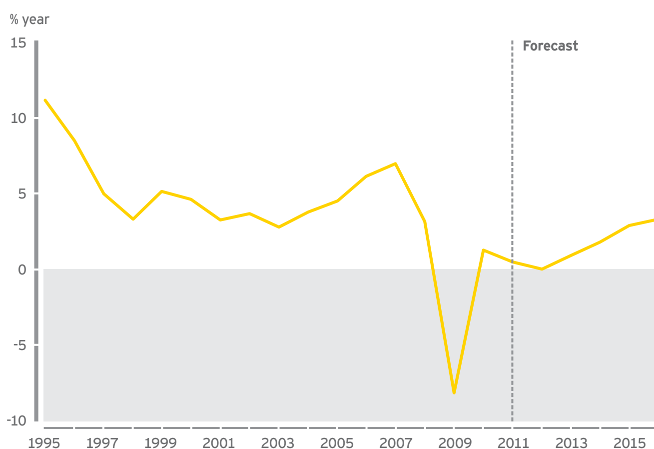
Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	3.3	0.5	1.9	4.5	4.8	4.3
Private consumption	-0.3	0.1	2.4	3.4	3.6	3.5
Fixed investment	4.4	0.3	2.0	4.6	6.0	5.8
Stockbuilding (% of GDP)	0.0	1.0	0.6	0.9	1.0	0.7
Government consumption	-3.1	0.6	2.0	2.3	2.2	2.0
Exports of goods and services	8.1	-1.7	5.6	8.1	8.3	7.9
Imports of goods and services	4.4	-1.7	5.8	7.6	7.8	7.3
Consumer prices	3.9	2.8	2.4	2.4	2.4	2.3
Unemployment rate (level)	13.4	15.3	14.1	12.0	11.1	10.4
Current account balance (% of GDP)	-0.4	-1.2	-1.9	-1.4	0.3	-0.2
Government budget (% of GDP)	-5.6	-5.3	-4.8	-4.6	-3.5	-3.2
Government debt (% of GDP)	43.0	45.9	47.6	47.8	46.7	45.6

Slovenia

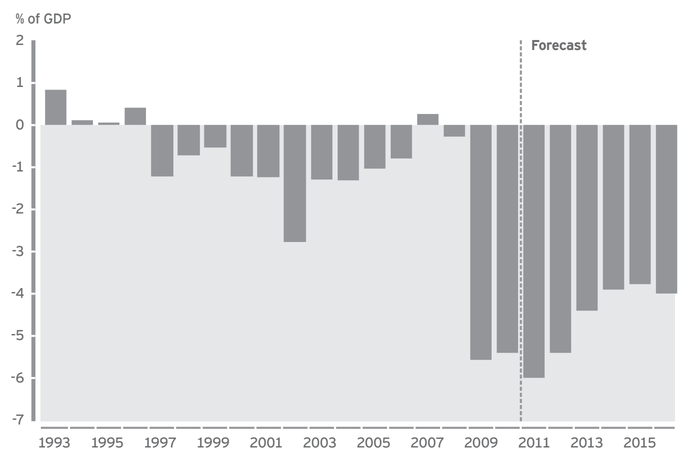
- The already weak economy ground to a halt in H2 2011, despite strong tourism. GDP is forecast to stagnate in 2012 as exports and investment remain subdued and fiscal tightening weakens domestic demand. Growth is forecast to recover to about 1% in 2013 as external demand strengthens, boosting exports, with a gradual pickup to around 3% in 2015-16.
- Public debt in Slovenia has doubled in under four years. Furthermore, the new coalition Government's proposals for spending cuts are expected to fall short of what the central bank regards as necessary. The deficit is forecast to remain above 3% of GDP throughout the forecast period and public debt will continue to rise.
- The short-term risks to the economy are on the downside. A further deterioration in the Eurozone would cut demand from Slovenia's largest export markets, stalling any export-led growth. The financial tensions created would also lead to a tightening of credit conditions.

Figure 43
Real GDP



Source: Oxford Economics

Figure 44
Government budget balance



Source: Oxford Economics

Table 17
Slovenia (annual percentage changes unless specified)

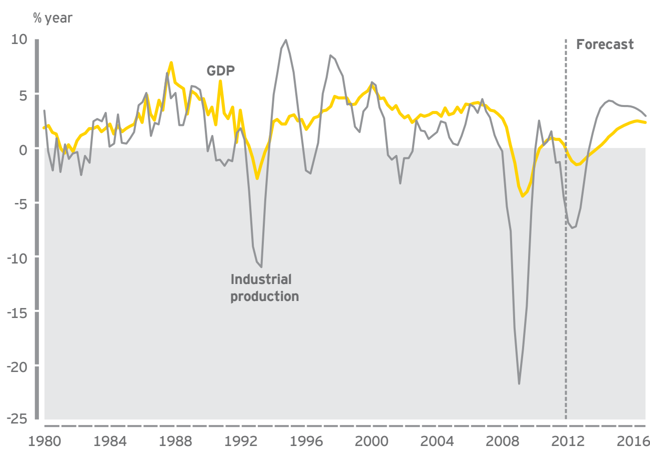
Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	0.5	0.0	0.9	1.8	2.9	3.3
Private consumption	0.2	0.1	1.1	2.0	2.5	2.6
Fixed investment	-11.9	-5.0	-0.8	2.5	4.2	4.0
Stockbuilding (% of GDP)	2.6	2.5	2.6	2.6	2.5	2.7
Government consumption	-0.2	0.3	0.8	1.2	2.2	2.5
Exports of goods and services	8.0	3.5	4.0	5.1	5.3	5.0
Imports of goods and services	5.5	2.2	4.0	5.4	5.1	4.8
Consumer prices	1.8	1.7	2.0	2.3	2.5	2.6
Unemployment rate (level)	8.1	8.2	7.5	6.8	6.0	5.1
Current account balance (% of GDP)	-1.1	-1.0	-0.7	0.1	0.3	0.3
Government budget (% of GDP)	-6.0	-5.4	-4.4	-3.9	-3.8	-4.0
Government debt (% of GDP)	44.2	48.8	51.9	53.7	54.7	55.6

Spain

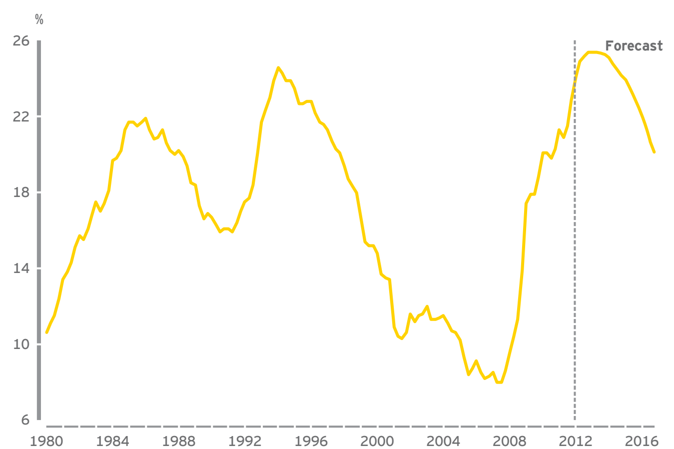
- With the 2011 fiscal deficit even higher than expected, the Government has announced yet more austerity measures to try to retain investor confidence and allay fears of deeper deficit and debt problems.
- But with domestic demand likely to be further depressed as a result, we now forecast GDP will decline by 1.2% in 2012 and by a further 0.6% in 2013, after growth of just 0.7% in 2011. With consumer demand expected to decline by over 1% in each of the next two years, companies will make further cutbacks in investment and personnel, so unemployment is now expected to rise to over 25% by the end of 2012.
- But the process of fiscal consolidation and structural reform is expected to bear fruit over the medium term, with GDP growth forecast to return in 2014 and then rise to over 2% a year in 2015-16.

Figure 45
GDP and industrial production



Source: Oxford Economics

Figure 46
Unemployment rate



Source: Oxford Economics

Table 18
Spain (annual percentage changes unless specified)
Source: Oxford Economics

	2011	2012	2013	2014	2015	2016
GDP	0.7	-1.2	-0.6	0.8	2.0	2.4
Private consumption	-0.1	-1.9	-1.0	0.5	1.7	1.9
Fixed investment	-5.1	-8.1	-1.3	2.0	3.0	3.0
Stockbuilding (% of GDP)	0.4	0.0	-0.4	0.1	0.1	-0.1
Government consumption	-2.2	-4.0	-0.9	0.0	1.1	1.5
Exports of goods and services	9.0	1.1	2.9	4.6	6.8	6.4
Imports of goods and services	-0.1	-8.4	0.2	6.3	7.0	5.3
Consumer prices	3.1	1.8	1.4	1.4	1.4	1.5
Unemployment rate (level)	21.7	24.8	25.3	24.6	23.2	21.0
Current account balance (% of GDP)	-3.9	-3.1	-3.0	-2.7	-2.3	-1.9
Government budget (% of GDP)	-8.5	-6.1	-3.4	-3.0	-2.5	-2.2
Government debt (% of GDP)	68.3	75.1	79.2	82.4	84.3	85.5

Detailed tables and charts

Forecast assumptions

	2011	2012	2013	2014	2015	2016
Short-term interest rates (%)	1.4	1.1	1.1	1.7	2.7	4.0
Long-term interest rates (%)	4.4	4.4	4.8	5.1	5.3	5.2
Euro effective exchange rate (1995 = 100)	120.8	115.6	119.8	117.6	115.6	115.3
Oil prices (€/barrel)	80.0	88.7	80.6	86.1	91.4	94.7
Share prices (% year)	-7.1	-3.1	12.1	14.6	12.9	9.4

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Short-term interest rates (%)	1.1	1.4	1.6	1.5	1.1	1.1	1.1	1.1
Long-term interest rates (%)	4.3	4.5	4.3	4.5	4.3	4.4	4.4	4.5
Euro effective exchange rate (1995 = 100)	119.4	122.4	121.2	120.3	115.7	115.0	114.9	116.9
Oil prices (€/barrel)	76.6	81.7	80.2	81.2	92.3	93.7	86.4	82.3
Share prices (% year)	-0.7	10.7	-20.7	-17.1	-15.3	-14.2	13.5	10.2

Eurozone GDP and components

Quarterly forecast
(quarterly percentage changes)

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	0.8	0.2	0.1	-0.3	-0.3	-0.1	0.0	0.2
Private consumption	0.0	-0.5	0.2	-0.3	-0.3	-0.2	0.0	0.1
Fixed investment	1.8	-0.1	-0.1	-0.3	-0.9	-0.5	0.0	0.3
Government consumption	0.2	-0.1	-0.1	-0.3	-0.3	-0.2	-0.2	-0.1
Exports of goods and services	1.8	1.2	1.2	-0.3	-0.3	0.4	0.7	1.0
Imports of goods and services	1.1	0.5	0.8	-1.0	-0.5	0.1	0.6	0.9

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

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	0.8	0.2	0.1	-0.3	-0.3	-0.1	0.0	0.2
Private consumption	0.0	-0.3	0.1	-0.2	-0.2	-0.1	0.0	0.0
Fixed investment	0.3	0.0	0.0	-0.1	-0.2	-0.1	0.0	0.1
Government consumption	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0
Stockbuilding	0.0	0.2	-0.1	-0.3	0.0	0.0	0.0	0.0
Exports of goods and services	0.8	0.5	0.5	-0.2	-0.1	0.2	0.3	0.4
Imports of goods and services	-0.4	-0.2	-0.3	0.4	0.2	-0.1	-0.2	-0.4

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

	2011	2012	2013	2014	2015	2016
GDP	8,601	8,560	8,633	8,780	8,958	9,145
Private consumption	4,840	4,808	4,830	4,890	4,969	5,055
Fixed investment	1,638	1,613	1,641	1,698	1,760	1,819
Government consumption	1,835	1,818	1,814	1,823	1,841	1,863
Stockbuilding	35	16	22	25	26	28
Exports of goods and services	3,766	3,811	3,980	4,208	4,438	4,658
Imports of goods and services	3,512	3,507	3,654	3,864	4,076	4,278

Annual levels — nominal terms
(€ billion)

	2011	2012	2013	2014	2015	2016
GDP	9,416	9,503	9,734	10,066	10,449	10,854
Private consumption	5,402	5,411	5,526	5,696	5,895	6,108
Fixed investment	1,810	1,800	1,857	1,953	2,059	2,164
Government consumption	2,032	2,044	2,079	2,132	2,197	2,267
Stockbuilding	36	38	31	57	74	80
Exports of goods and services	4,120	4,242	4,498	4,845	5,205	5,563
Imports of goods and services	3,986	4,032	4,257	4,617	4,981	5,328

Prices and costs indicators

(annual percentage changes unless specified)

	2011	2012	2013	2014	2015	2016
HICP headline inflation	2.7	2.2	1.8	1.8	1.8	1.8
Inflation ex-energy	1.7	1.0	1.7	1.6	1.7	1.7
GDP deflator	1.3	1.4	1.6	1.7	1.7	1.8
Import deflator	5.2	2.6	1.3	1.8	1.9	1.8
Export deflator	9.5	-1.8	0.5	2.2	2.0	1.6
Terms of trade	4.3	-4.4	-0.8	0.3	0.1	-0.2
Earnings	2.5	1.5	2.0	2.7	3.0	3.1
Unit labor costs	1.0	0.8	0.9	1.4	1.6	1.7
Output gap (% of GDP)	-1.8	-2.9	-2.8	-2.3	-1.6	-1.1
Oil prices (€ per barrel)	80.0	88.7	80.6	86.1	91.4	94.7
Euro effective exchange rate (1995=100)	120.8	115.6	119.8	117.6	115.6	115.3

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
HICP headline inflation	2.4	2.7	2.7	2.9	2.5	2.2	2.0	2.1
Inflation ex-energy	1.3	1.7	1.7	2.0	1.1	0.9	0.8	1.2
GDP deflator	1.1	1.2	1.3	1.6	1.5	1.4	1.4	1.3
Import deflator	7.3	4.4	3.9	5.5	3.0	3.5	2.7	1.5
Export deflator	15.3	10.2	7.4	5.7	-0.6	-1.6	-3.2	-1.7
Terms of trade	8.0	5.8	3.5	0.2	-3.6	-5.1	-5.8	-3.2
Earnings	2.5	2.5	2.5	2.3	1.3	1.3	1.5	1.7
Unit labor costs	0.2	1.2	1.3	1.2	0.8	0.6	0.9	0.8
Output gap (% of GDP)	-1.7	-1.7	-1.7	-2.2	-2.7	-2.9	-3.0	-3.0
Oil prices (€ per barrel)	104.8	117.6	113.3	109.5	117.2	118.0	108.0	104.6
Euro effective exchange rate (1995=100)	119.4	122.4	121.2	120.3	115.7	115.0	114.9	116.9

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

Labor market

(annual percentage changes unless specified)

	2011	2012	2013	2014	2015	2016
Employment	0.3	-1.1	-0.2	0.4	0.6	0.7
Unemployment rate (%)	10.2	11.1	11.3	10.9	10.3	9.7
NAIRU (%)	8.1	8.1	7.9	7.7	7.5	7.2
Participation rate (%)	74.1	74.4	74.5	74.7	74.9	75.1
Earnings	2.5	1.5	2.0	2.7	3.0	3.1
Unit labor costs	1.0	0.8	0.9	1.4	1.6	1.7

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employment	0.3	0.5	0.4	-0.2	-0.7	-1.2	-1.3	-1.0
Unemployment rate (%)	10.0	10.0	10.2	10.5	10.9	11.1	11.2	11.3
NAIRU (%)	8.1	8.1	8.1	8.1	8.1	8.1	8.1	8.0
Participation rate (%)	73.8	74.1	74.2	74.2	74.3	74.4	74.4	74.4
Earnings	2.5	2.5	2.5	2.3	1.3	1.3	1.5	1.7
Unit labor costs	0.2	1.2	1.3	1.2	0.8	0.6	0.9	0.8

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

Current account and fiscal balance

	2011	2012	2013	2014	2015	2016
Trade balance (€b)	-4.8	51.0	80.2	65.0	59.5	66.8
Trade balance (% of GDP)	-0.1	0.6	0.9	0.7	0.7	0.7
Current account balance (€b)	-30.7	16.5	19.3	22.9	29.2	32.7
Current account balance (% of GDP)	-0.3	0.2	0.2	0.2	0.3	0.3
Government budget balance (€b)	-396	-322	-240	-198	-162	-133
Government budget balance (% of GDP)	-4.2	-3.4	-2.5	-2.0	-1.6	-1.2
Cyclically adjusted surplus (+) /deficit (-) (% of GDP)	-3.2	-2.4	-1.4	-0.9	-0.5	-0.2
Government debt (€b)	8,372	8,663	8,974	9,302	9,640	9,949
Government debt (% of GDP)	97.3	101.2	103.9	105.9	107.6	108.8

Measures of convergence and divergence within the Eurozone

	2002–2006	2007–2011	2012–2016
Growth and incomes			
Standard deviation of GDP growth rates	1.9	2.3	1.3
Growth rate gap (max–min)	6.6	9.2	4.9
Highest GDP per capita (Eurozone = 100)	237.4	242.7	242.8
Lowest GDP per capita (Eurozone = 100)	53.5	66.6	66.7
Inflation and prices			
Standard deviation of inflation rates	1.3	1.0	0.5
Inflation rate gap (max–min)	5.4	4.0	2.0
Highest price level (Eurozone = 100)	116.8	116.1	116.2
Lowest price level (Eurozone = 100)	64.6	65.9	67.6

Cross-country tables

Real GDP
(% year)

Rank		2011	2012	2013	2014	2015	2016	Average 2012-2016
1	Estonia	7.5	2.0	3.8	4.8	4.7	4.5	**4.0**
2	Slovakia	3.3	0.5	1.9	4.5	4.8	4.3	**3.2**
3	Luxembourg	1.1	0.7	3.1	3.5	3.0	2.9	**2.7**
4	Finland	2.6	0.7	1.4	2.9	4.1	2.9	**2.4**
5	Malta	1.8	0.9	1.5	2.6	3.0	3.0	**2.2**
6	Slovenia	0.5	0.0	0.9	1.8	2.9	3.3	**1.8**
7	Ireland	1.0	-0.1	0.6	1.4	3.0	3.8	**1.7**
8	Germany	3.1	0.6	1.7	2.1	2.0	2.0	**1.7**
9	Austria	3.1	0.4	1.3	1.9	2.0	1.9	**1.5**
10	France	1.7	0.0	1.2	1.9	2.0	1.9	**1.4**
11	Netherlands	1.3	-0.8	1.5	2.3	2.1	1.9	**1.4**
12	Cyprus	0.2	-0.5	0.9	1.7	2.0	2.9	**1.4**
13	Belgium	1.9	-0.3	0.9	1.5	2.0	2.4	**1.3**
14	Eurozone	1.5	-0.5	0.9	1.7	2.0	2.1	**1.2**
15	Spain	0.7	-1.2	-0.6	0.8	2.0	2.4	**0.7**
16	Italy	0.4	-1.6	-0.3	0.9	1.5	1.8	**0.5**
17	Portugal	-1.5	-4.0	-2.1	0.2	1.7	1.9	**-0.5**
18	Greece	-6.8	-6.4	-1.9	-0.1	1.8	3.0	**-0.8**

Inflation rates
(% year)

Rank		2011	2012	2013	2014	2015	2016	Average 2012-2016
1	Ireland	1.2	0.6	0.1	0.5	0.8	1.4	**0.7**
2	Greece	3.1	1.3	0.5	1.0	1.7	2.2	**1.3**
3	Spain	3.1	1.8	1.4	1.4	1.4	1.5	**1.5**
4	Germany	2.5	1.9	1.8	1.8	1.8	1.8	**1.8**
5	Netherlands	2.5	2.4	1.6	1.8	1.8	1.8	**1.9**
6	Portugal	3.6	3.1	1.6	1.2	1.8	1.8	**1.9**
7	Eurozone	2.7	2.2	1.8	1.8	1.8	1.8	**1.9**
8	Belgium	3.4	2.1	1.7	1.9	1.9	1.8	**1.9**
9	France	2.3	2.2	1.9	1.9	1.9	1.9	**1.9**
10	Finland	3.3	2.4	1.9	1.9	1.9	1.8	**2.0**
11	Austria	3.6	2.5	2.1	2.0	2.0	1.9	**2.1**
12	Malta	2.4	1.6	2.1	2.3	2.3	2.3	**2.1**
13	Luxembourg	3.7	2.5	2.1	2.1	2.0	2.0	**2.1**
14	Italy	2.9	2.8	2.2	2.2	2.0	2.0	**2.2**
15	Slovenia	1.8	1.7	2.0	2.3	2.5	2.6	**2.2**
16	Estonia	5.0	3.0	2.3	2.1	2.2	2.1	**2.4**
17	Slovakia	3.9	2.8	2.4	2.4	2.4	2.3	**2.5**
18	Cyprus	3.5	3.3	2.3	2.3	2.3	2.3	**2.5**

Cross-country tables

Unemployment rate
(% of labor force)

Rank		2011	2012	2013	2014	2015	2016	Average 2012-2016
1	Austria	4.1	4.5	4.6	4.5	4.3	4.3	**4.4**
2	Netherlands	4.4	5.3	5.3	4.6	4.0	3.8	**4.6**
3	Luxembourg	4.8	5.5	5.4	4.6	4.0	3.6	**4.6**
4	Germany	5.9	5.5	5.3	5.1	4.9	4.8	**5.1**
5	Malta	6.5	6.2	6.1	5.6	5.1	4.5	**5.5**
6	Slovenia	8.1	8.2	7.5	6.8	6.0	5.1	**6.7**
5	Cyprus	7.7	9.7	9.0	7.3	5.0	4.5	**7.1**
8	Belgium	7.2	7.6	8.1	7.3	6.6	6.4	**7.2**
9	Finland	7.8	7.8	7.5	7.1	6.9	6.8	**7.2**
10	Estonia	12.1	10.9	9.2	7.4	6.1	5.0	**7.7**
11	Italy	8.2	9.6	10.1	9.8	9.0	8.1	**9.3**
12	France	9.7	10.2	9.9	9.5	9.1	8.9	**9.5**
13	Eurozone	10.2	11.1	11.3	10.9	10.3	9.7	**10.7**
14	Slovakia	13.4	15.3	14.1	12.0	11.1	10.4	**12.6**
15	Portugal	12.7	14.1	14.9	14.8	13.6	12.3	**13.9**
16	Ireland	14.4	14.7	14.8	14.3	13.6	12.7	**14.0**
17	Greece	17.5	21.3	22.8	23.5	23.6	23.0	**22.8**
18	Spain	21.7	24.8	25.3	24.6	23.2	21.0	**23.8**

Government budget
(% of GDP)

Rank		2011	2012	2013	2014	2015	2016	Average 2012-2016
1	Estonia	0.7	-2.0	-0.7	0.1	0.0	0.0	**-0.7**
2	Germany	-1.0	-1.2	-1.1	-0.9	-0.6	-0.1	**0.9**
3	Finland	-2.1	-1.4	-1.1	-0.8	-0.7	-0.9	**1.2**
4	Malta	-2.9	-2.9	-2.5	-2.1	-1.9	-1.7	**1.2**
5	Luxembourg	-0.8	-1.4	-1.3	-0.1	0.3	0.6	**1.4**
6	Slovenia	-6.0	-5.4	-4.4	-3.9	-3.8	-4.0	**2.0**
7	Austria	-3.7	-3.3	-2.9	-2.0	-1.6	-1.5	**2.3**
8	Cyprus	-7.1	-5.3	-5.3	-4.7	-4.8	-4.7	**2.4**
9	Slovakia	-5.6	-5.3	-4.8	-4.6	-3.5	-3.2	**2.4**
10	Portugal	-5.9	-5.1	-4.7	-4.6	-3.8	-3.2	**2.7**
11	Netherlands	-4.0	-4.3	-3.6	-2.9	-1.8	-1.1	**2.8**
12	Eurozone	-4.2	-3.4	-2.5	-2.0	-1.6	-1.2	**3.0**
13	France	-5.7	-4.8	-3.9	-3.1	-2.7	-2.3	**3.4**
14	Italy	-4.0	-2.5	-1.3	-0.9	-0.6	-0.6	**3.4**
15	Greece	-10.2	-7.1	-7.2	-6.5	-6.2	-6.0	**4.2**
16	Belgium	-4.7	-3.8	-1.7	-0.8	-0.4	-0.3	**4.4**
17	Spain	-8.5	-6.1	-3.4	-3.0	-2.5	-2.2	**6.3**
18	Ireland	-10.0	-8.6	-6.6	-4.4	-2.9	-2.1	**7.9**

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