

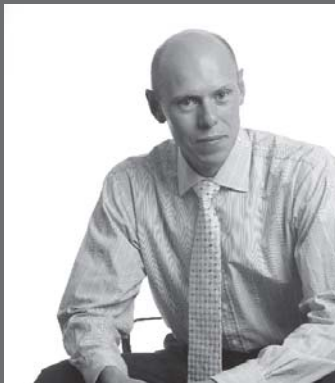
Ernst & Young Eurozone Forecast

Spring 2010



Foreword

Mark Otty
Area Managing Partner



Whenever two or more business people gather together, the one thing guaranteed to be discussed is the “market” – those trends, issues and challenges that create the competitive environment in which we all compete.

The global nature of the economic downturn has made all businesses raise their eyes to look for opportunities wherever they can find them. We have been meeting and working with thousands of companies around the world through our *Lessons from change* program and it is clear that in the new post-crisis economy many businesses are looking to increase their market reach, optimize their operational flexibility and optimize their access and use of capital. The euro and the Eurozone will be an increasingly important factor in the future global economy – not just for companies who are based there.

These factors have impacted Ernst & Young. It is the change in the market that has led us to bring our businesses across Europe, the Middle East, India and Africa into one operational unit – EMEIA. Our clients are looking across borders and we are looking to leverage the best of our resources to meet their needs. While EMEIA extends beyond the Eurozone, it is impossible to ignore the giant in our midst.

Collectively the Eurozone at €12.5 trillion remains by far the second largest economy in the world – just after the US and some two and a half times the size of China. It is both the source and destination of between 30% to 40% of all cross-border investment. While currently slow growing, it has outperformed the US economy for the past decade and continues to out-export it. Stable, democratic, inclusive, tolerant and with a rich social, educational and health infrastructure for all its inhabitants – the Eurozone remains a key market for international business.

One of the factors that we have consistently heard is that while there are currently many economic forecasts of the euro, they tend to be national or academic in origin. There is no independent forecast that adopts one methodology across the whole of the Eurozone. That is why we have chosen to build on our collaboration with Oxford Economics – to produce a high quality independent forecast that businesses can use in their planning.

Over the coming years our Eurozone Forecast will develop and evolve to reflect the developments and issues within the Eurozone itself. We hope that you find it useful – whether you are based in the Eurozone or one of the growing number of companies that trades there.

I encourage you to visit our dedicated Eurozone website www.ey.com/eef for additional information on the Ernst & Young Eurozone Forecast and the 16 individual country forecasts.

Ernst & Young Eurozone Forecast

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Our perspective for businesses in and beyond the Eurozone



This first Ernst & Young Eurozone Forecast comes at a time when the global economy is emerging from recession. But recovery is not the only issue. The economic crisis has also raised questions about the strength and integrity of the euro, and the strength and cohesion of the EU as an economy.

Companies involved in the Eurozone face a challenging economic environment in the coming months. Although the Eurozone showed signs of recovery earlier than other developed economies, its recovery as a whole will take longer to achieve and the development will be heterogeneous across the European geographies. Furthermore, in the Eurozone: the return to pre-crisis levels continues to depend on growth in other global regions – notably Asia and the US. The crisis has further shifted the world's economic centre of gravity towards Asia and emerging economies. But even among developed economies the Eurozone is losing ground. The US will see growth of more than 3% in 2010, with significant improvement in productivity and corporate profitability, while Eurozone countries will struggle to achieve half of that rate in double the time. This is challenging for the Eurozone, as companies are reconsidering their strategic planning and may conclude redirecting investment and further enlarging their geographical footprint to more attractive growth economies.

In particular, unemployment uncertainties and weak levels of investment are set to hold back growth in the medium term. The continued need for high levels of government borrowing to maintain recovery may discourage private investment, both by raising the cost of capital and reducing the availability of finance, and by expectations of higher taxation and the effect of increasingly complex regulation.

Reduced government spending will have an immediate effect on some sectors; life sciences and health care for instance will be affected directly by cuts in government funded health care systems in Europe, triggering the need for the industry to target consumers who are willing to pay for health care and medication privately and dealing with increasing pricing pressure. Similar issues apply in highly capital intensive sectors such as power and utilities and transportation, where the increasing cost of capital, combined with expected cuts in government spending, have already slowed the investment needed for driving productivity and efficiency.

To put public debt on a more sustainable course, a combination of significantly higher growth of at least 2% and sustained fiscal

restraint will be needed. BusinessEurope – which is the main horizontal business organization at EU-wide level – predicted in a recent report¹ that a combination of significantly higher growth, of at least 2%, and sustained primary surpluses of close to 3% of GDP, will be needed to put public debt on a sustainable course. It proposed a two-pillar strategy: On the one hand, a coherent exit strategy for government stimulus and funding which comprises credible commitment to fiscal sustainability, including a drive towards greater efficiency in public administration, greater recourse to market principles and reform of the pension and health care systems. On the other hand, these exit strategies should be combined with a renewed commitment to improving the Eurozone as a business-friendly area, most importantly by investing in education, research and modern infrastructure.

Businesses can benefit from these developments in at least three ways. Firstly, as suppliers to government for sectors such as telecoms and technology, which provide the modern communications infrastructure, including 4G mobile networks and fibre optic networks, and power and utilities companies which are driving the next generation of power generation and the integration of grids across Europe. Secondly, business will continue to benefit from a modern infrastructure and the availability of a highly educated workforce. Thirdly, companies should seek to benefit from continued tax and government incentives that will continue to be provided for key industries, such as the car scrappage scheme that helped to prevent a steep decline in automotive sales. Recent investments by developing eastern economies in the European automotive sector demonstrate the attractiveness of the Eurozone, particularly for hi-tech and R&D. This development will continue, even though more intractable issues such as diverse labor legislation in different economies will remain a long-term issue for the industry to address.

The crisis may also reinforce the commitment of governments to address necessary reforms of product, labor and capital

1. *Combining Fiscal Sustainability and Growth: A European Action Plan*, March 2010 (www.business-europe.eu)



markets. Arguably, the pace of reform has been slow in the last decade in a seemingly benign global environment. Combining government reform and a further liberalization of labor markets with an expected continued weak euro may encourage businesses to invest as the traditionally higher cost of labor may diminish in the Eurozone.

This Forecast also identifies imbalances within the Eurozone, notably the "Greece Effect". The outlook for the smaller euro economies looks grim if the current medicine of deflating their way back to competitiveness in very short timescales remains the policy of choice. A more measured approach is possible; consider Belgium in 1993 with government debt at 130% of GDP, reduced to 85% by 2007 as a demonstration of managed rebalancing. Hedge funds and opposition politicians love the volatility that rapid rebalancing creates just as much as long-term investors and companies hate it. As such, European governments are well advised to drive a more balanced approach that puts the competitiveness of European businesses at its center.

As we can see from our forecast, economic recovery is predicated on an upturn in corporate investment and exports to the rest of the world. Based on conversations with our clients, we are of the view that the recovery is widely based and that many businesses are ready to begin investing to make the forecast a reality.

The new performance agenda we identified in our insights program, *Lessons from change*, clearly shows that companies should expand their geographic footprint. The Eurozone Forecast and the insight we have gathered from over 45,000 client meetings suggest that they will allocate additional resources to faster growing markets. However, the Eurozone remains one of the two largest markets in the world with a stable and relatively solvent business environment. Now is the time to reinforce innovation and differentiation as a future source of growth in Europe. Companies should continue re-evaluating their business models, adapting their strategies and organizational structures and seeking collaborations with partners that allow them to lead in innovation and differentiation at the higher value end of the R&D, production and supply processes.

Companies also need to continue improving access to finance and the availability and the deployment of capital. This will be necessary to deal with the expected tightening of tax regimes and a continued need to work closely with the treasury function in the sourcing and allocation of capital and necessary provision for hedging.

The continued pressure on margins will create incentives for sector consolidation through mergers and other partnerships such as agreements to share infrastructure investments and cross-industry relationships. This has already started to happen within the telecoms, technology and media industry, where price pressure has not only been driven by the depressed GDP, but also by the fact that their services are increasingly viewed as commodities. Consolidation is also a trend within life sciences and there will be a window in the coming months during which cash-rich pharmaceutical companies can partner with successful biotechnology companies to bring price-resilient innovative products to market. There is also a growing trend towards mergers and partnerships within the power and utilities sector, driven mainly by environmental issues and the carbon trading regime.

Last but not least, it is important to reinforce that an economic outlook and GDP projections are only one part of the mix that influences companies' performance and success. Our research clearly has demonstrated that, even in the worst economic environment, there is opportunity for those who can apply and reinforce good business practice and are faster and more disciplined in executing upon revised business strategy than their peers.

The euro area has significant upward potential if Eurozone member states are committed to the necessary reform of product, labor and capital markets. The benefits would far outweigh the impact of the crisis for companies and citizens alike. Maybe this economic crisis, which has shaken the euro area to its core, will be a trigger for more radical change and will provide a boost to those willing to embrace it.



16 Eurozone countries



Please visit our dedicated Eurozone website for access to additional information on the Eurozone report, the 16 individual country reports and additional perspectives and interview content. The site contains the latest version of our reports, provides access to print ready files as well as an archive of previous releases.

To find out more please visit www.ey.com/eef

Highlights

Debt troubles will create a two-speed Eurozone

- ▶ The Eurozone recovery is stuttering but we do not believe it will stall, despite concerns generated by the Greek financial crisis. We expect GDP for the Eurozone as a whole to rise by 1% in 2010 and 1.6% in 2011. Nevertheless, unemployment is set to continue to rise until the first half of 2011 to a peak of more than 17 million across the Eurozone.
- ▶ The main factors that will underpin renewed growth are the recovery in the global economy – especially in Asia and the US – and continued support from expansionary monetary policy. Growth will also be supported by improved business and consumer confidence as economic and financial conditions gradually normalize.
- ▶ The Eurozone still faces considerable headwinds, which mean its recovery will be weak. In particular, recent events have highlighted the challenges faced by countries with weak fiscal positions – not only Greece, but also Portugal, Spain, Ireland and, to a lesser degree, Italy.
- ▶ There will be an opening of a North-South growth-divide, with Germany, France and the BeneLux economies gradually strengthening, while growth in the Eurozone's Mediterranean economies and Ireland will be held back by efforts to reduce their budget deficits. Growth in the Mediterranean economies and Ireland is forecast to average only 0.6% per year over 2010-12, compared with 1.8% per year in Germany, France and BeneLux.
- ▶ Even the Eurozone's strongest economies will be hampered by:
 - ▶ Further rises in unemployment – although a rapid escalation in redundancies is unlikely, the Eurozone economy needs to grow by another 1.5%-2% before productivity returns to pre-crisis levels and employment begins to recover.
 - ▶ Weak investment as capacity utilization remains low and banks remain cautious about lending.
- ▶ The Eurozone governments and the European Central Bank (ECB) continue to face acute challenges. Policy in the short term needs to remain focused on growth and employment. The main risks are to the downside, with a significant chance of a double-dip recession in the Eurozone and deflation in some of the Mediterranean economies. This means that the ECB should defer any increase in interest rates until well into 2011.
- ▶ A clear and credible exit strategy from the current stimulus policy needs to be put in place. A consequence of the Greek crisis for the Eurozone as a whole is that fiscal tightening will have to happen more quickly than previously intended. Our baseline forecast shows a significant reduction in deficits, from nearly 7% of GDP in 2010, to under 3% of GDP by 2014. This will inevitably weigh on the pace of recovery in the medium term and points to prolonged weakness in the euro.

Debt troubles will create a two-speed Eurozone



Eurozone growth stalls ...

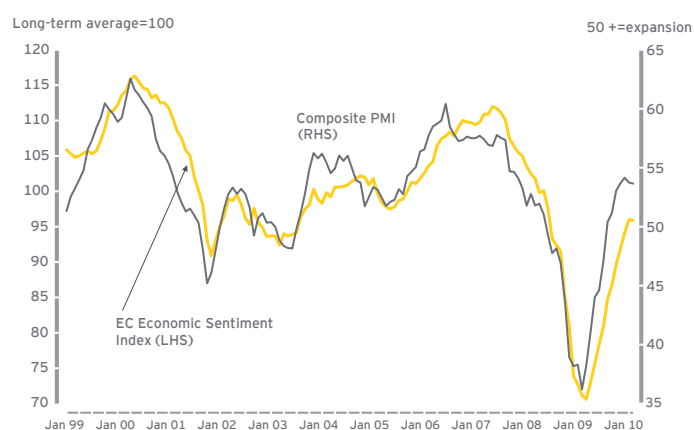
Countries in the Eurozone started to emerge from recession earlier than many other major developed economies. Germany and France returned to positive growth in 2009Q2, ahead of the US, with the Eurozone as whole growing again by Q3 as the UK only exited recession at the end of 2009.

However, the Eurozone recovery is now stuttering and the economy faces significant headwinds that have been compounded by the Greek financial crisis. GDP growth fell back from 0.4% in 2009Q3 to zero in 2009Q4. In addition, recent business and consumer surveys have been mixed, both across sectors and countries. As a result, we estimate that Eurozone GDP rose by only 0.1% in 2010Q1. (Box 1 provides more detail about our Q1 estimate and our forecast for growth in Q2.)

We think that some of the weakness reported in many of the recent headline activity indicators is temporary. The end of the car scrappage schemes in most countries, for instance, brought consumption forward from early 2010 to 2009 and this is depressing car sales now (passenger car registrations were down

more than 9% in January and only slightly recovered in February). In addition, the unusually cold weather across Europe will have further reduced activity at the end of 2009 and in early 2010 – growth in Germany is particularly vulnerable to this factor.

Figure 1
Eurozone: faltering confidence?



Source: Haver Analytics

Table 1

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

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-4.0	1.0	1.6	2.1	2.2	2.2
Private consumption	-1.0	0.0	1.1	1.7	1.9	2.0
Fixed investment	-11.0	-1.3	2.2	3.1	3.5	3.1
Stockbuilding (% of GDP)	-0.5	-0.2	0.0	0.1	0.1	0.3
Government consumption	2.2	1.0	0.7	0.9	1.1	1.1
Exports of goods and services	-13.2	4.4	4.9	6.5	6.4	5.7
Imports of goods and services	-11.8	2.6	4.8	6.3	6.3	5.9
Consumer prices	0.3	1.2	1.5	1.7	1.8	1.8
Unemployment rate (level)	9.4	10.4	10.8	10.5	9.9	9.4
Current balance (% of GDP)	-0.7	0.2	0.2	0.4	0.5	0.4
Government budget (% of GDP)	-6.3	-6.8	-5.5	-4.3	-3.4	-2.6
Government debt (% of GDP)	76.1	81.7	85.6	87.6	88.3	88.2
ECB main refinancing rate (%)	1.1	1.0	1.6	3.3	4.3	4.3
Euro effective exchange rate (1995=100)	129.7	124.8	122.0	119.7	117.7	116.3
Euro/US dollar exchange rate (\$ per €)	1.39	1.34	1.32	1.30	1.29	1.27



Box 1

GDP growth in the first half of 2010

Our short-term GDP models point to GDP growth at 0.2% in 2010Q1 and 0.3% Q2. Our actual forecast is slightly lower for Q1 at 0.1% as the impact of setbacks from the bad weather and the end of temporary fiscal measures is not fully accounted for in these short-term models.

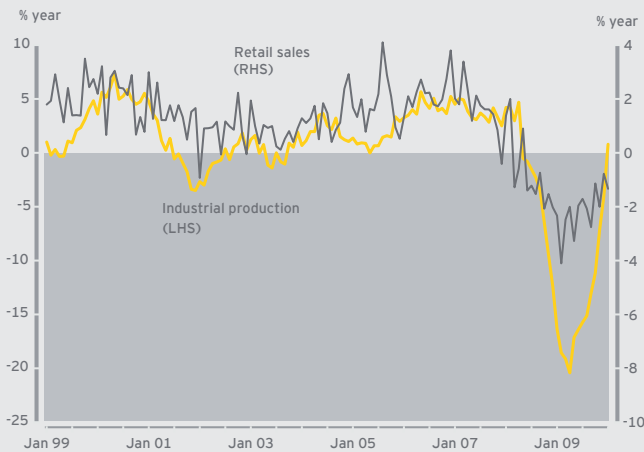
Current indicators for the Eurozone present mixed signals, highlighting the fact that growth is still fragile. For example, business confidence has continued to improve, albeit less rapidly than in mid-2009. Exports were up strongly in December (+2.2%) but down slightly in January.

In addition, industrial production fell in many sectors in January, while car registrations slumped more than 9%.

The models used in these short-term forecasts are based on relationships between GDP and a wide range of monthly indicators including industrial production, retail sales, exports, unemployment and confidence indicators. Our models filter through the noise in the different data series to extract the best estimate of short-term GDP growth.

Figure 2

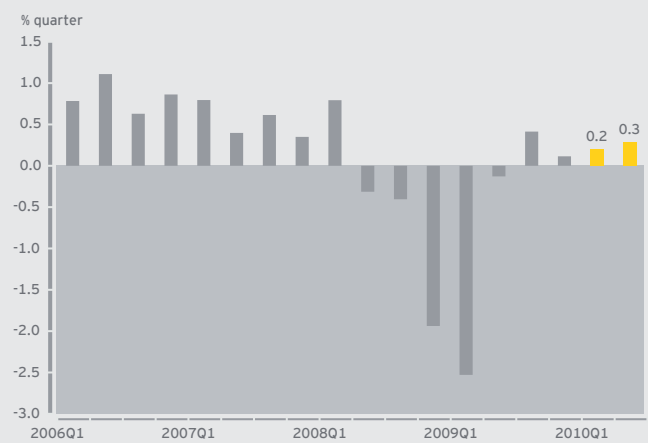
Eurozone: production and retail sales



Source: Haver Analytics

Figure 3

Eurozone GDP growth: short-term forecast



Source: Oxford Economics

... but recovery should resume ...

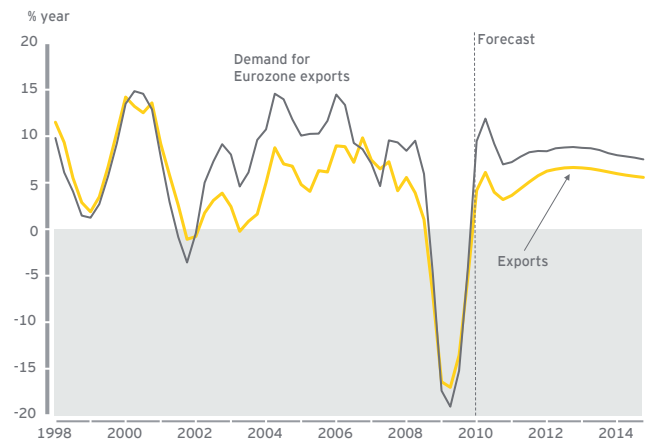
So, we do not believe that the Eurozone recovery has stalled, even though it will be at a fairly slow pace this year. The initial turnaround from recession in the middle of 2009 was generated by four main factors: a stabilization in global financial conditions; a strong rebound in foreign demand, especially in Asia; a turn in the inventory cycle; and support from expansive fiscal and monetary policy. All these factors will continue to support growth across the Eurozone as a whole through the rest of 2010, even though economies such as Spain, Ireland and Greece face a tough adjustment as a result of their previous excesses.

... driven by a strengthening in international trade ...

The external sector will be the main source of recovery as growth in emerging Asia and the US picks up strongly. We forecast net trade to contribute 0.7% point to Eurozone growth in 2010, thereby accounting for three-quarters of the rise in overall GDP. Exports are forecast to rise by more than 4% this year as demand in the Eurozone's main export markets increases by around 9.5% (see Box 2 on page 9).

Figure 4

Eurozone exports



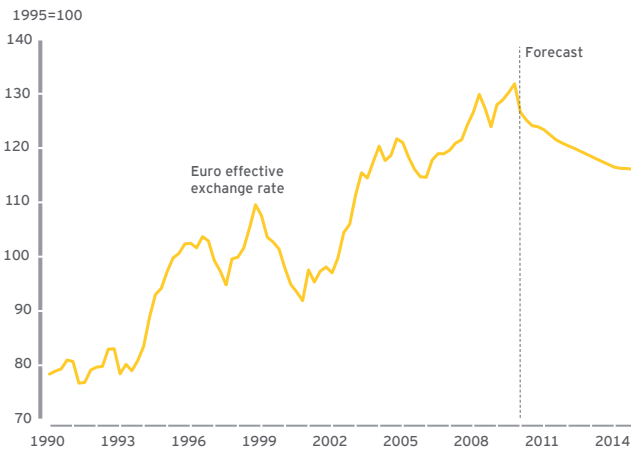
Source: Oxford Economics

Debt troubles will create a two-speed Eurozone



But while exports are expected to pick up, this forecast still implies that Eurozone companies will be under-performing in world markets, losing significant market share. In particular, the overall strength of the euro means that companies are struggling to compete in key markets. Although the euro has fallen from the highs it reached against the US\$ in early 2008 and has been weakening this year in the wake of the Greek financial crisis, sterling and key Central and Eastern European (CEE) currencies have been even weaker. This means that in effective terms – i.e., weighting together currencies based on countries' relative trade importance for the Eurozone – the euro is around 16% above its long run average. And in real terms, the euro is close to its historic peak.

Figure 5
Euro exchange rate

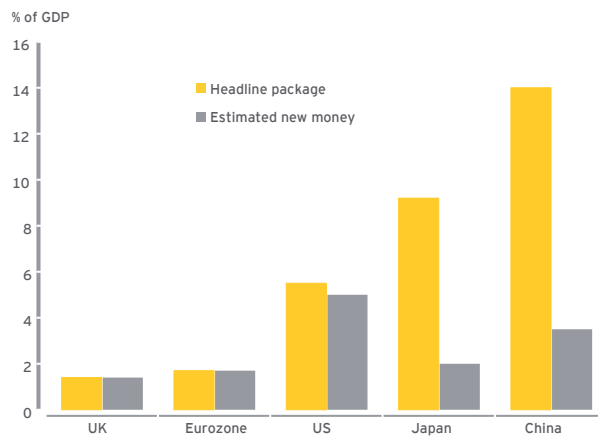


Source: Oxford Economics

... and still expansionary fiscal and monetary policy in Eurozone as a whole

Domestic demand is also expected to rise across the Eurozone in 2010, having fallen in 2009 by 3.3%. Demand is underpinned by an aggregate fiscal stimulus across the Eurozone this year equivalent to around 0.75% of GDP – after a stimulus of around 1% of GDP in 2009 – and monetary policy that remains very expansive. But it should be highlighted that a similar policy stance has stimulated a much more rapid recovery in the US, where we expect GDP to rise by 3.2% in 2010. In contrast, the Eurozone economy will struggle to achieve GDP growth of 1% in 2010 and 1.6% in 2011.

Figure 6
World: fiscal stimulus packages

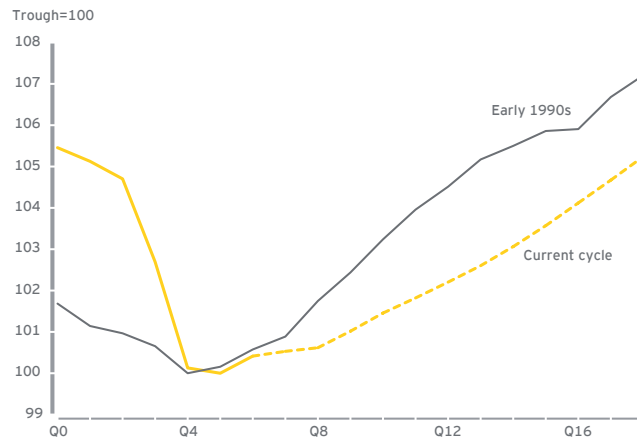


Source: Oxford Economics/Haver Analytics

But recovery will be slower than normal ...

As a result, the level of Eurozone GDP will only return to its pre-crisis peak around mid-2012. This means that it will take nearly 20 quarters for the Eurozone economy to recover from the global financial crisis, whereas after the recession in the early 1990s it took eight quarters to get back to pre-recession levels.

Figure 7
Eurozone: GDP growth



Source: Oxford Economics



Box 2

Forecast assumptions: international environment and commodity prices

The forecast for the Eurozone is conditional on a number of assumptions for the international environment, regarding world GDP and trade, commodity prices and exchange rates. This Box explains these assumptions.

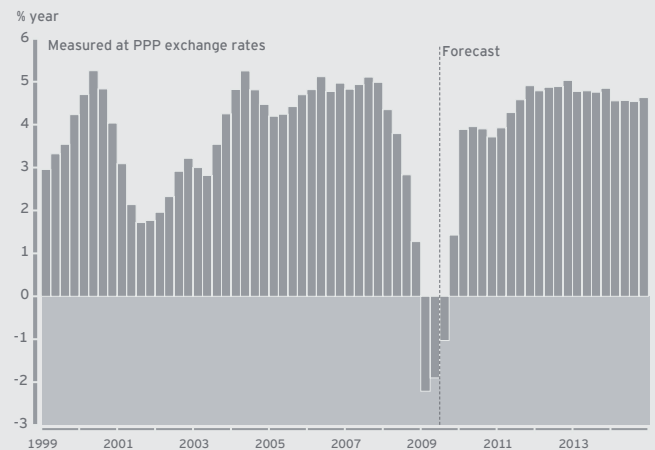
Demand for Eurozone exports collapsed during the global financial crisis, falling by 15% in 2009. It then rebounded strongly in the second half of the year, on the back of strengthening activity in Asia and, to a lesser extent, the US. We forecast a continued recovery in world GDP and trade, albeit at a slower pace than in the second half of 2009. China has led the economic upturn, with its GDP growth accelerating to 11% in the year to 2009Q4 (having fallen to a low of 6.1% in 2009Q1), supported by very expansive fiscal and monetary policy. There are, however, growing concerns that China's strong growth is fuelling bubbles in asset prices, particularly in the housing market, and increasing the risk of rapidly accelerating inflation. As a result, the Chinese authorities have already started to tighten policy, which we expect will hold China's GDP growth just below 10% in 2010. The recovery in international trade – particularly within the Asian region – is leading to a rebound in growth in other emerging Asian economies. We expect GDP across Asia as a whole to rise by 5.25% in 2010, up from 0.7% in 2009, despite still very weak growth in Japan. The recovery in the major industrialized economies has been much more subdued as households and businesses continue to reduce debt levels and banks rebuild their balance sheets. Growth in the US accelerated to an annualized rate of 5.6% in 2009Q4 and Oxford Economics expects US GDP to rise by 3.2% in 2010 as economic policy remains expansionary, net trade improves and the swing in the inventory cycle boosts production. But the pace of recovery will be held back by high unemployment and weak consumer confidence.

We expect world GDP to rise by nearly 4% this year (at PPP exchange rates) and by around 4.25% in 2011. World trade is forecast to increase significantly in 2010, although regaining its pre-crisis peak only in 2011. Demand for euro area exports would rise by around 9.5% this year and by around 8% per year in 2011–14.

Commodity prices are not expected to have a large impact on growth and inflation in the Eurozone over the forecast period. Oil prices are assumed to average at just under US\$80 per barrel (pb) in 2010 and then rise gradually to US\$91 pb by 2014. Non-oil commodity prices are expected to rise by around 15% in 2010 as a whole, having bounced back strongly in the second half of last year and to rise by 1.5% per year on average between 2011 and 2014.

Figure 8

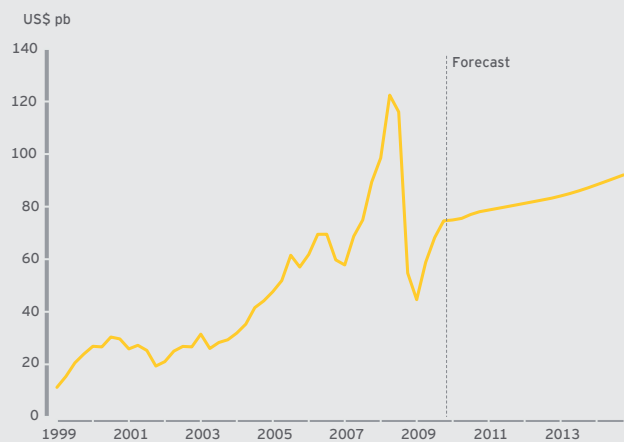
World: GDP growth



Source: Oxford Economics

Figure 9

Global: oil prices, nominal



Source: Oxford Economics

Debt troubles will create a two-speed Eurozone

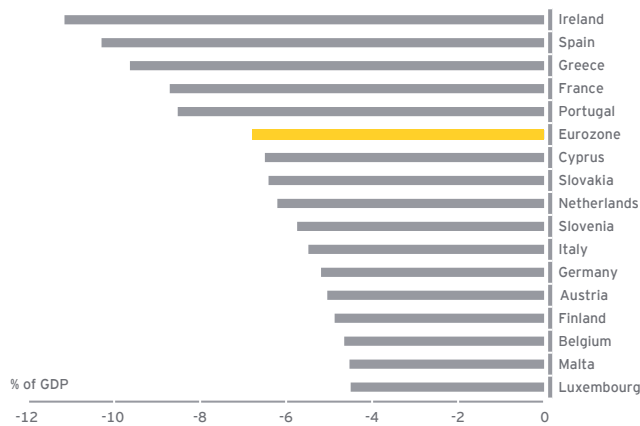


... especially in those countries with very weak fiscal positions ...

The Eurozone faces a number of problems that mean that its recovery will be slow. The most acute are those faced by countries with very weak fiscal positions.

The Greek financial crisis highlighted a lack of tolerance by financial markets to large fiscal deficits and government debt (as well as a lack of transparency around fiscal accounting). Spreads on Greek government bonds over German bunds rose to 3 ppt in mid-February 2010 and then further to around 4 ppt in early April, magnifying the cost of financing the Greek deficit and creating serious concerns about a default by the Greek government if access to capital markets could not be maintained.

Figure 10
Government balances in 2010



Source: Oxford Economics

Under pressure from its Eurozone partners, as well as the financial markets, Greece has introduced a series of fiscal packages aimed at slashing the budget deficit by 4% of GDP in 2010 and to below 3% of GDP by 2012. This plan, together with the agreement by Eurozone member states for a joint Eurozone/IMF support program provides some insurance against the risk of default. The announcement on 12 April that specified the amount and interest rates charged by Eurozone governments on the loans to Greece brought much-needed clarification. However, given the tensions between Eurozone governments that this agreement has exposed, financial markets remain volatile. Moreover, the repercussions of the Greek fiscal crisis have also spilled over to other Eurozone economies, notably other

Mediterranean countries with weak fiscal positions. As result, Portugal, Spain and Ireland are all implementing consolidation plans.

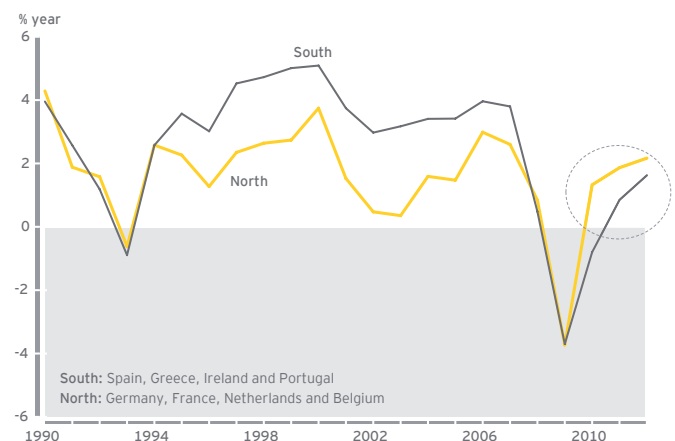
... leading to a North-South growth-divide ...

As a result, there will be an opening of a North-South growth-divide across the Eurozone, with Germany, France and the Benelux economies gradually strengthening, while growth in the Eurozone's Mediterranean economies and Ireland will be held back by efforts to reduce their budget deficits.

... which means Eurozone convergence will go into reverse

This represents a huge turnaround in relative growth performance within the Eurozone compared with the years before the global financial crisis. As explained in Box 3, the pre-crisis leaders in growth rate terms tended to be those countries that are now facing the weakest outlook and that also typically had below-average income levels. In the five years prior to the crisis, Greece, Ireland, Portugal and Spain together grew at an average rate of 3.5% per year, compared with 1.8% per year for Germany, France and Benelux. But over 2010-12, the relative growth rates are likely to be reversed. Germany, France and Benelux as a group are expected to grow at 1.8% per year in 2010-12, compared with just 0.6% per year for Greece, Ireland, Portugal and Spain. One consequence of this switch in relative growth rate is that the pre-crisis trend towards greater convergence across the Eurozone will be reversed over the next couple of years.

Figure 11
Eurozone: divergence in reverse



Source: Oxford Economics/Haver Analytics



Box 3

Convergence and divergence within the Eurozone

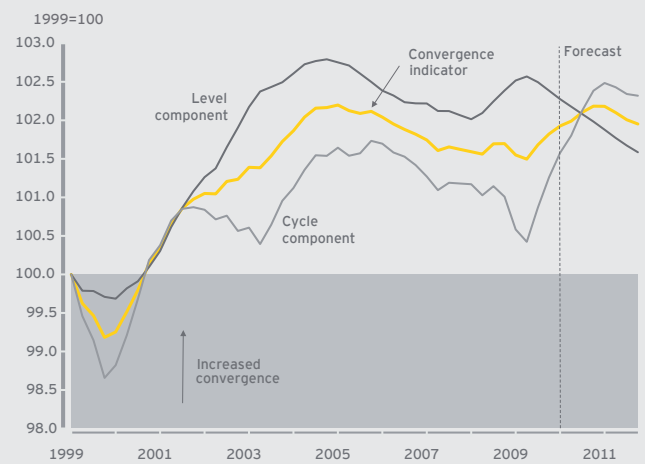
We have constructed an indicator of “convergence” within the Eurozone. We look at a broad range of measures in order to capture the many aspects of convergence. In particular, we look at both convergence in the “level” of economic performance and in economic cycles. Within each aspect, we look at several variables, including incomes (GDP per capita), prices, fiscal positions and labor markets. We then measure convergence/divergence by examining the cross-country standard deviations in these variables.

The results are shown in the chart opposite. Our indicator shows that there was increasing convergence within the Eurozone until 2005, when convergence paused. The global financial crisis has led to renewed divergence, in particular in terms of fiscal positions and unemployment rates. This has reflected different exposures of the Eurozone countries to the crisis, with, for instance, differences of the size and the impact of housing market corrections.

Recent cyclical divergence also reflects differences in structural features and national responses to the crisis. On the structural side, the size of automatic stabilizers, and hence the swing in fiscal positions, has varied between countries depending on the nature of their welfare systems. In addition, countries with a relatively large share of temporary workers in their workforce have experienced a bigger rise in unemployment rates. As regards national responses, the size of the fiscal stimulus packages has differed markedly, ranging from 1.5% of GDP in Germany to zero in Italy.

Looking ahead, the Eurozone economies are expected to diverge further as the countries with the largest deficit problems, and hence weakest growth prospects, are also typically those with below-average income levels.

Figure 12
Convergence within the Eurozone



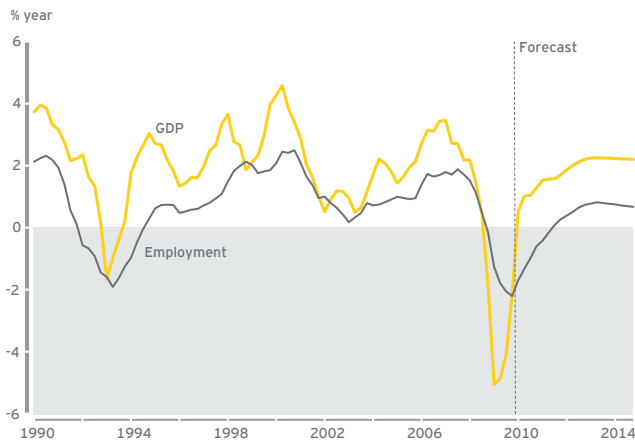
Source: Oxford Economics



Even stronger economies in the Eurozone will face headwinds from rising unemployment ...

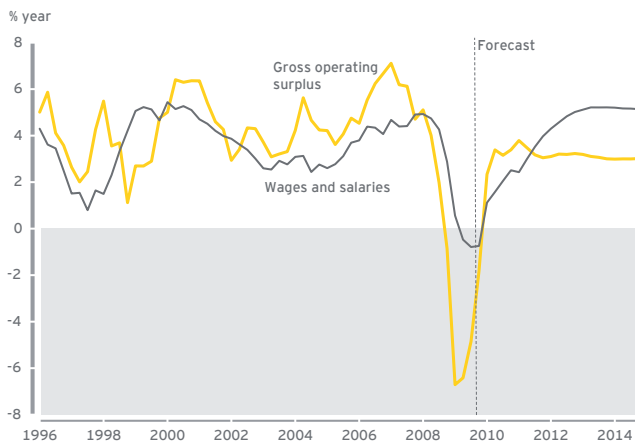
Even the stronger countries in the Eurozone, such as Germany, France and the BeneLux economies, face significant headwinds in recovering from recession. These headwinds include: a modest upturn in employment; a slow repair of private sector balance sheets and cautious lending by banks; and, especially from 2011 onwards, the withdrawal of fiscal stimulus.

Figure 13
Eurozone: GDP and employment growth



Source: Oxford Economics

Figure 14
Eurozone: profits and wages

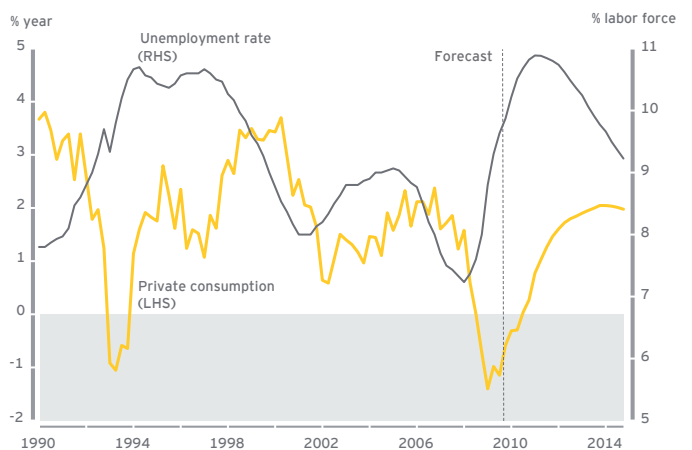


Source: Oxford Economics

Given relatively high costs of hiring and firing in the Eurozone, labor productivity growth is highly cyclical. For instance, while in the US the correlation between productivity growth and GDP growth is around 60%, the correlation is above 90% in the Eurozone. This is reflected in the slump in Eurozone productivity during the downturn, which contrasts markedly with the strong rise in productivity seen in the US. Eurozone employment fell by only 1.8% in 2009, far short of the GDP fall. In some countries, the fall in employment was also limited by government-sponsored schemes.

The limited job cuts have led to a sharp deterioration in corporate profitability in the Eurozone which in turn means that companies are likely to be slow to take on new staff during the recovery. Assuming no change in employment, output needs to grow by another 1.5%-2% before productivity returns to pre-crisis levels and profitability is restored. This will not happen quickly given the projections for economic growth. As a result, we forecast further increases in the unemployment rate throughout this year to close to 11% by December and expect unemployment to rise further in 2011 to over 17 million across the Eurozone as a whole. The unemployment rate is expected to start to fall only in the second half of next year.

Figure 15
Eurozone: consumption and unemployment



Source: Oxford Economics

Such a depressed Eurozone labor market will undermine consumer spending as it holds back household income growth: not only because employment will be weak, but also as higher unemployment dampens wage claims. We expect aggregate wage income to be broadly unchanged in 2010, which implies a deterioration in consumer purchasing power as prices rise.



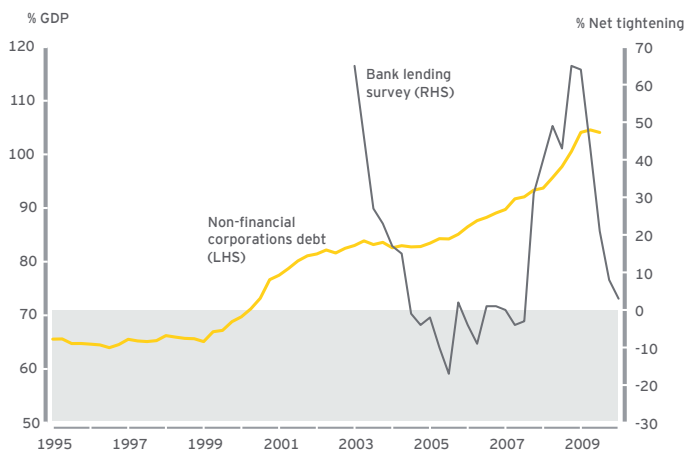
High and rising unemployment will also limit the improvement in consumer confidence and encourage households to increase precautionary saving: while down from its peak, households' expectations about unemployment in the next 12 months remain well above historical average levels. These factors are expected to offset the positive impact of tax cuts and transfer payments in some countries. Our forecast shows broadly flat private consumption in real terms in 2010 and only a gradual pick-up in 2011.

... as tighter credit and balance sheet restructuring cap investment growth

Corporate investment prospects are also weak across the Eurozone. Capacity utilization remains low across many sectors and banks remain cautious about lending as they continue to rebuild their balance sheets. While most Eurozone financial institutions now seem stable, they are unlikely to ease lending conditions significantly in the next few quarters. The January ECB bank lending survey shows that banks have not yet started to reverse the tightening in lending standards applied during the crisis. And banks do not anticipate loosening credit standards any time soon.

Figure 16

Corporate debt and banks' lending standards



Source: Oxford Economics/Haver analytics

Demand for credit is also expected to remain weak, Eurozone companies are still plagued by high debt ratios which leave them exposed to the rise in financing costs, thereby creating pressure to deleverage. These pressures will be exacerbated by the fact that their vulnerable financial positions have damaged firms' creditworthiness, making it more difficult to borrow at a time

when banks are seeking to reduce risk in their loan portfolios. Further deleveraging in the corporate sector will weigh on investment over the next few years.

Against this background, and given the impact of the uncertainty about economic prospects on business confidence, companies are unlikely to be willing or able to undertake large-scale capital investment for some time. After a 14% slump in 2009, we forecast a further small fall in private sector non-residential investment this year. The recovery in investment will then lag the general economic cycle and will not return to pre-crisis levels until 2014.

Fiscal retrenchment will hold back growth from 2011 onwards

With only a gradual pick-up in growth even in the strongest Eurozone economies, Eurozone governments and the ECB face acute challenges. Policy in the short term needs to remain focused on growth and employment. This means that the ECB should defer any increase in interest rates until well into 2011.

However, a clear and credible exit strategy from the current policy stimulus needs to be put in place. As noted earlier, discretionary fiscal stimulus packages in aggregate were equivalent to around 1% of Eurozone GDP in 2009, although there were significant differences across countries as regards the size and composition of these packages – Germany implemented a relatively large package amounting to 1.5% of GDP in 2009, whereas Italy did not have any additional fiscal stimulus. For the Eurozone on average, around one-third of the packages were investment spending, one-third permanent tax cuts and transfers, 15% temporary tax cuts and transfers and the remainder sector-specific measures such as car scrapping schemes and measures for the construction sector.² We estimate that these packages boosted growth by around 0.5% points in 2009.³ The confidence effects related to these packages were probably much larger though. Automatic stabilizers also cushioned the impact of the recession in the Eurozone, but contributed to the deterioration in public finances.

2. Estimates by Bruegel. In addition, governments offered large credit guarantees, worth 2% of Eurozone GDP, to make sure that loans were available when asked for by businesses and households. Bruegel is a European think tank working in the field of international economics.

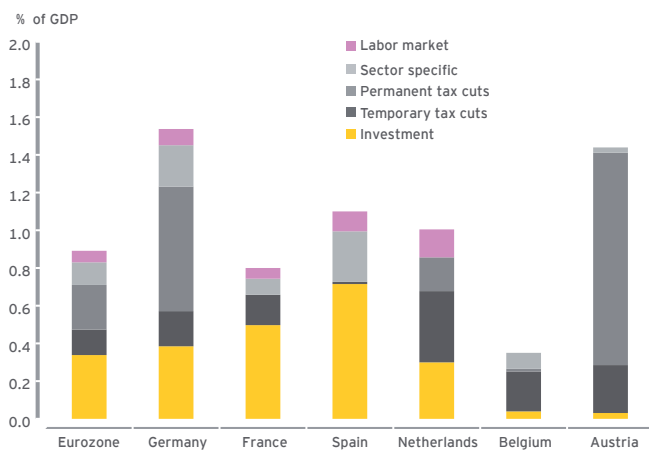
3. The IMF gives a similar estimate. "The Case for Global Fiscal Stimulus", D. Laxton, September 2009. The impact of the credit guarantees is even more uncertain since it depends on how many more loans were granted because of these guarantees and how much more cheaply.

Debt troubles will create a two-speed Eurozone



As a result, the size of the budget deficit for the Eurozone as a whole increased from around 2% of GDP in 2008 to more than 6% of GDP in 2009. Most governments have announced a broadly neutral stance this year. While they are not trying to stimulate the economy further, they are also not embarking on a significant fiscal tightening yet. Tightening is generally limited to the ending of some special measures, such as the car scrappage schemes and slowing infrastructure investment. But there are wide differences across the Eurozone. While Greece, Ireland, Portugal and Spain are having to reduce their very large deficits this year, Germany is actually implementing additional tax cuts so that its fiscal stimulus will increase to 2% of GDP in 2010.

Figure 17
Eurozone: stimulus packages

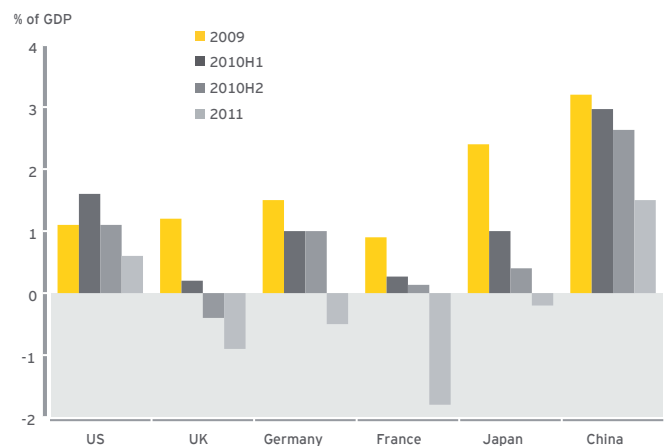


Source: Bruegel

A consequence of the Greek crisis for the Eurozone as a whole is that fiscal tightening, once it starts in 2011, will then happen more quickly than would have otherwise been the case. Most budget plans include some restriction on government spending, often with efficiency improvements supposedly supporting the level of public services. In the countries where the public deficit-GDP ratios have reached or are close to double digits, lower spending is also being achieved via freezes or cuts in public sector pay. Few outright tax increases are planned – again except for those countries most in trouble – although effective tax rates are meant to be raised by closing some fiscal loopholes.

Our forecast shows a significant reduction in average budget deficits from nearly 7% of GDP in 2010 to under 3% of GDP by 2014, although the debt-to-GDP ratio for the Eurozone as a whole still rises from 70% in 2008 to 88% in 2013-14. The fiscal tightening required will inevitably weigh on the pace of recovery in the medium term.

Figure 18
Fiscal packages



Source: Oxford Economics

However, our forecast for the public finances is slightly less ambitious than implied by the Eurozone governments in their deficit reduction plans. That is because some assumptions in those plans are unrealistic. For example, a number of governments are relying on overly optimistic growth assumptions and are therefore unlikely to generate the tax revenues they are projecting. Some of the efficiency gains assumed in current budget plans also look ambitious. Moreover, as deficits are brought down to more manageable levels and so the financial markets' and European Commission's scrutiny diminishes, governments' determination to reduce the deficits may well also wane.

Greek fiscal crisis to have long-lasting implications

At the Eurozone level, the Greek crisis has highlighted the inability of the authorities to enforce fiscal discipline. It has also shown that contagion risks when one country faces debt sustainability issues are high. Should a country face fiscal sustainability issues in the future, financial markets are likely to react even more strongly



than in the recent Greek episode, pushing spreads even higher for the crisis country and for those next on the sustainability issue list. In this respect, it is essential that ex-ante fiscal sustainability is better enforced. The Stability and Growth Pact, which was supposed to ensure fiscal discipline, appears ineffective in this role. This risks potentially undermining the euro in the longer term.

The Greek financial crisis is therefore likely to have long-lasting institutional implications in the Eurozone. Proposals are now circulating for a more effective mechanism for enforcing fiscal discipline in future. One suggestion is for a “European Monetary Fund” that would have the power to survey the fiscal policies of member states and impose tough sanctions on countries that breached the rules, including suspending them from voting at EU ministerial meetings and cutting them off from EU structural funds. To be effective, however, it seems likely that any new structures would have to compromise significantly the fiscal sovereignty of member states and it is unclear whether this would be acceptable to them.

Inflation will not exert any pressure on monetary policy ...

Between risks to growth and public finances, the outlook for the Eurozone remains uncertain and rather bleak. One area that should not concern the ECB though is inflation. While the rise in oil prices in the second half of 2009 has pushed headline inflation back up from around zero to 1%, we expect inflation to remain very subdued. Labor market slack will keep wage claims in check. The recent agreement by the German engineering workers' union, IG Metall, is a case in point. The union relinquished any significant wage increase against a commitment of job preservation. Moreover, in a number of countries, pay freezes or pay cuts for public sector workers are being implemented to restrain government spending. These will dampen inflation directly and may have an impact on wage claims in the private sector. Finally, with only a very timid recovery in consumer spending, Eurozone companies will have no choice but to resort to cost cuts and productivity improvements to restore margins rather than significant selling price increases.

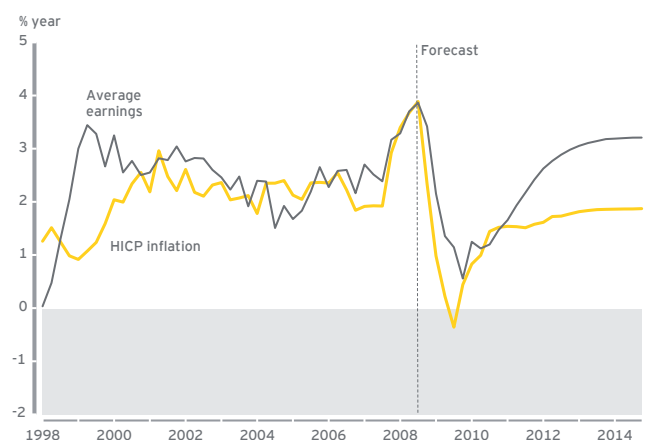
... but steering monetary policy back from unconventional domain will be tricky

The outlook for inflation is therefore benign and this will allow the ECB to withdraw monetary stimulus very gradually. We expect the ECB to leave its main refinancing rate on hold at 1% throughout

this year and for it only to get back up to 2% by the end of 2011. Rates might then increase towards 4% through 2012 but that would be dependent on a continued acceleration in GDP growth. This profile for the ECB's main refinancing rate would be similar to what happened in the aftermath of the 2002-03 downturn, when the ECB kept rates unchanged for a long time and then raised them slowly. It suggests that the recent weakness of the euro vis-à-vis the dollar is set to continue, taking the euro below US\$1.30.

Figure 19

Eurozone: inflation and wages



Source: Oxford Economics

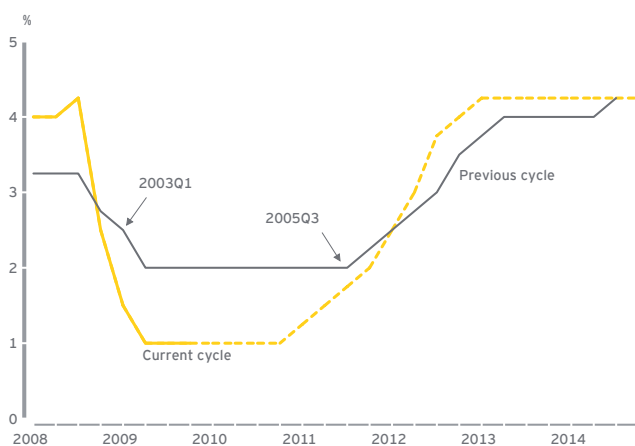
However, monetary tightening will start by the reversal of some of the unconventional measures put in place in 2008 and 2009. The ECB will gradually gain control of the amount of liquidity offered at its refinancing operations – during the crisis, the ECB switched to a full allotment procedure, whereby banks could get as much money as they request. It will also refocus on provision of short-term liquidity, leaving the interbank market to cater for longer-dated liquidity. In December 2009, the ECB announced that it would not renew its one-year liquidity provision. At the press conference on 4 March 2010, it also said that the six-month facility would be phased out and that some rationing would be introduced on the three-month liquidity provision.



The main monetary policy question for 2010 is whether the banking sector can survive without the life-support provided by the ECB. We think that on aggregate it can, although some institutions may run into trouble. The functioning of the interbank market since mid-2009 suggests that counterparty risk and liquidity issues have greatly diminished. With clear communication from the ECB about the nature and timing of the withdrawal of support, most banks should be able to adjust their funding sources.

What impact will less generous liquidity provision have on financing costs? As commercial banks shift from the ECB to markets as a source of funding, funding costs will likely increase somewhat. This will put pressure on lending rates. However, banks have increased their margins as a precaution against default. For instance, the spread between interest rates on loans to non-financial corporations and 12-month Euribor has increased to 200-300 bp from 50-100 bp before the crisis. Those margins will likely come down a bit, although probably not all the way to pre-crisis levels. It is therefore likely that lending rates will rise slightly during 2010.

Figure 20
ECB main reflecting rate



Source: Oxford Economics

A double-dip recession is still the main risk

This discussion clearly demonstrates that the risks to the Eurozone outlook are still mainly on the downside: we would give a probability of around 20% to a double-dip scenario in which the Eurozone slides back into recession in the second half of 2010. This could be triggered by renewed financial turmoil as a consequence of financial markets' concerns about the public finances of several Eurozone countries. Financial markets remain nervous given lingering uncertainties about political backing for Greek aid within the Eurozone. If Greece requests assistance, all Eurozone member states will still have to agree and opposition to aid for Greece is significant in some countries. Markets also remain concerned about Greece's medium-term solvency. Even interest rates of 5% will probably see the debt to GDP ratio rising further in the years ahead, and the aid deal will not prevent Greece having to endure a painful and politically challenging period of recession and possible deflation over the coming years. Moreover, as mentioned before, many deficit reduction plans seem to rely on optimistic assumptions about growth and effectiveness of efficiency measures. As data become available on actual developments in public budgets, it may become evident that the deficit reductions will not happen as planned. This could also send a new shock wave through Eurozone financial markets.

There is a danger that the financial markets' volatility could lead to a more widespread deterioration in confidence, which undermines consumer spending and business investment. And the anticipation of future fiscal tightening could limit the impact of the stimulus measures that remain in place in 2010. This could start a negative spiral whereby weak growth prevents significant deficit reduction, which requires more spending cuts and tax rises, which in turn pushes growth down further.

The scary reality is that Eurozone governments and the ECB have virtually no ammunition left to fight off such a renewed downturn. There can therefore be no buffer from policy action and deflation would become an imminent threat, especially in the Mediterranean economies. In such a scenario, the Eurozone would be even more dependent than now on net trade as an engine of growth. But that would require a major realignment in the euro at a time when both the US and Asia (especially China) are also seeking to trade their way to recovery.



Box 4

Model and forecast approach in the Ernst & Young Eurozone Forecast

The forecasts and analyses presented in the Ernst & Young Eurozone Forecast are based on the ECB's model of the Eurozone economy. This model embeds state-of-the-art economic theory and techniques and is used by the Eurosystem to produce its quarterly forecasts of the euro area. The details of the model have recently been published in an ECB Working Paper (Coenen *et al*: The New Area-Wide Model of the euro area: a micro-founded open-economy model for forecasting and policy analysis, WP 944, October 2008). Oxford Economics has programmed the model to use it in this forecast.

As well as using the ECB model, the Ernst & Young Eurozone Forecast process matches that of the Eurosystem in three essential respects:

- ▶ First, the data used are sourced from national statistics offices and Eurostat. The series used in the forecast covers a wide range of economic variables such as GDP, private consumption, unemployment rates, consumer prices, interest rates and exchange rates, current account and fiscal balances.
- ▶ Second, we will follow the Eurosystem practice of setting a few variables that are exogenous to the model or condition the forecast. These variables are interest rates, the euro exchange rate, oil prices and share prices.
- ▶ Third, the forecast for the Eurozone involves some iterations between the team looking at the Eurozone as a whole and the country economists. At the start of a forecast round, a Eurozone forecast is calculated from the aggregation of forecasts for the 16 member countries. This aggregated forecast is fed into the ECB's model to check that it is consistent and makes a proper account of what is perceived to be the main issues influencing economic prospects at the time. Country economists may then revise their forecasts to ensure that the aggregated Eurozone forecasts matches what seems to be the most likely outlook for the Eurozone based on the ECB's model.

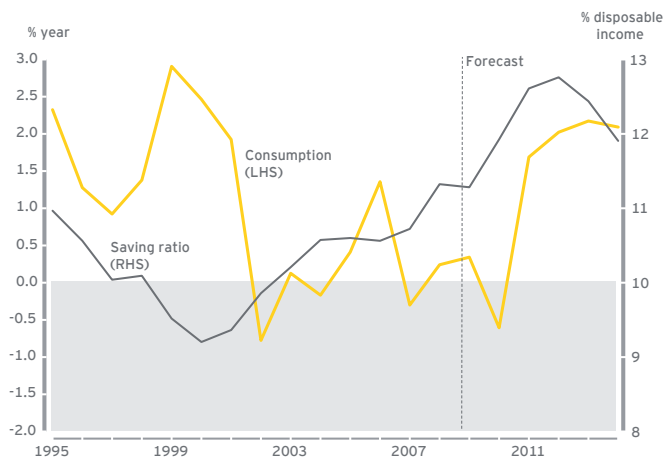
Finally, the ECB's model provides an essential tool for scenario analysis that greatly enriches the forecasting thought process.

Forecast for Eurozone countries

Germany

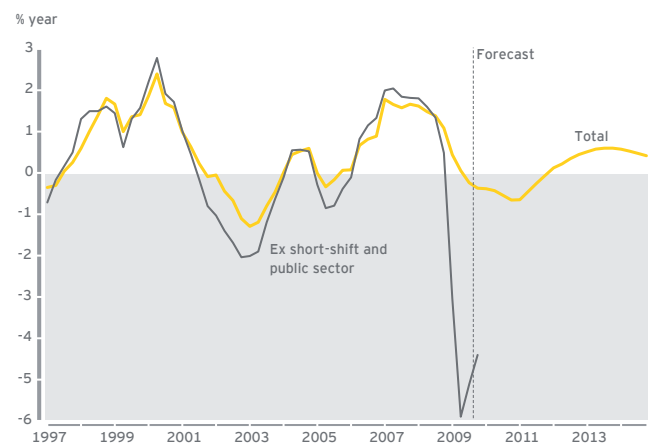
- ▶ Growth ground to a halt at the turn of 2010. Part of this was accounted for by unfavourable weather conditions and the removal of car subsidies. Survey indicators suggest an underlying robustness to the German economy and we expect it to be one of the Eurozone's strongest economies over the next couple of years.
- ▶ We forecast growth at 1.5% this year and close to 2% in 2011. Germany will benefit from robust export growth, especially to Asia. The tax cuts this year and next will also contribute to Germany being near the top of the Eurozone growth league table.
- ▶ However, the continued rise in unemployment will weigh on the recovery. We forecast that the unemployment rate will rise through 2010 and peak at over 8.5% in mid-2011.
- ▶ There are also upside risks if household confidence rises and leads to them spending a significant proportion of the income tax cuts. Unlocking the potential of consumer spending is perhaps the biggest challenge facing the government over the next few years.

Figure 21
Consumption and saving ratio



Source: Oxford Economics

Figure 22
Employment



Source: Oxford Economics

Table 2
Germany (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-4.9	1.5	1.9	2.1	2.3	2.3
Private consumption	0.3	-0.6	1.7	2.0	2.2	2.1
Fixed investment	-8.8	1.0	2.8	3.4	4.2	3.9
Stockbuilding (% of GDP)	-1.6	-1.3	-0.5	-0.3	-0.2	0.0
Government consumption	3.0	0.7	0.5	0.4	0.4	0.6
Exports of goods and services	-14.2	5.0	4.5	7.0	7.0	6.3
Imports of goods and services	-8.9	2.6	6.3	7.8	7.6	7.0
Consumer prices	0.2	1.1	1.3	1.4	1.6	1.7
Unemployment rate (level)	7.5	7.9	8.5	8.5	8.0	7.4
Current balance (% of GDP)	5.0	5.5	5.0	4.8	4.6	4.4
Government budget (% of GDP)	-3.9	-5.2	-4.5	-3.6	-2.8	-2.1
Government debt (% of GDP)	68.2	70.9	73.3	74.4	74.6	73.9

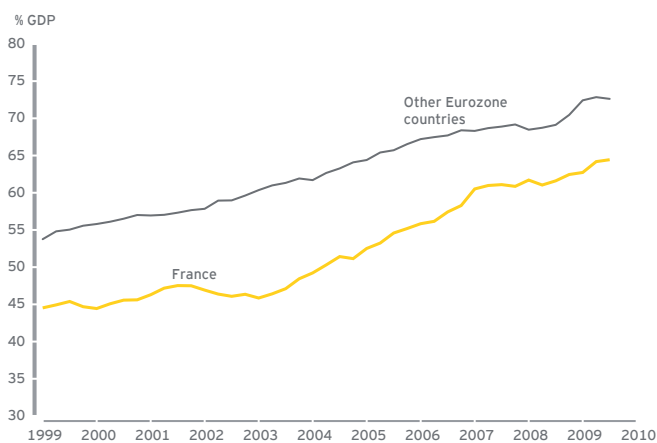


France

- ▶ Having fared much better than many of its Eurozone neighbours during the global financial crisis, we expect France to continue to outperform the rest of the Eurozone over the next few years. We forecast GDP growth at 1.2% this year and 2% on average in 2011-14.
- ▶ As the recovery firms up and unemployment stabilizes, households will be able to free up some of their (large) savings given that they have relatively low levels of debt. The financial position of French businesses appears less healthy. Debt increased sharply before the crisis and has merely levelled off during 2009. This will be a drag on investment.
- ▶ On the fiscal side, the currently large deficit mainly reflects the country's generous automatic stabilizers. The government can afford to focus on the medium term where pension reform should be a priority. But the government's poor results in the March regional elections are likely to make implementation of the reform difficult.

Figure 23

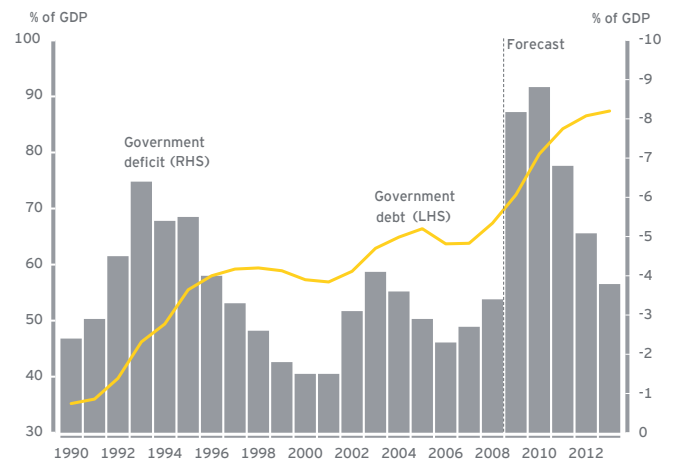
Households' debt



Source: Oxford Economics/Haver Analytics

Figure 24

Government deficit and debt



Source: Oxford Economics

Table 3

France (annual percentage changes unless specified)

Source: Oxford Economics

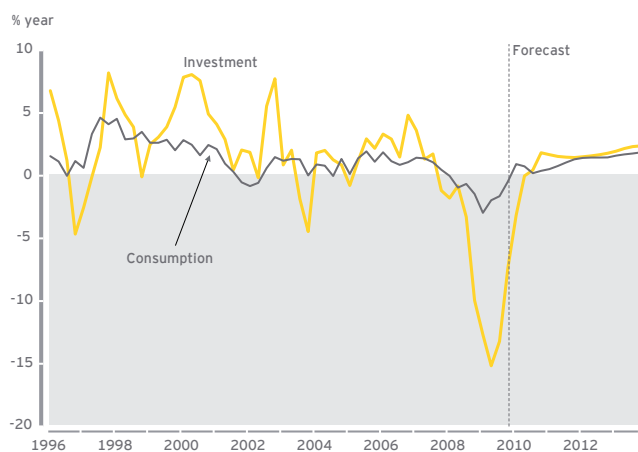
	2009	2010	2011	2012	2013	2014
GDP	-2.2	1.2	1.8	2.2	2.0	2.0
Private consumption	0.8	0.5	1.2	1.9	2.0	2.0
Fixed investment	-7.0	-0.6	2.8	3.2	2.9	2.5
Stockbuilding (% of GDP)	-0.8	-0.7	-0.6	-0.5	-0.5	-0.4
Government consumption	1.6	1.5	0.9	1.1	1.2	1.2
Exports of goods and services	-10.9	3.0	4.8	6.7	6.1	5.8
Imports of goods and services	-9.6	0.9	3.9	5.8	5.8	5.5
Consumer prices	0.1	1.4	1.7	1.8	1.9	1.9
Unemployment rate (level)	9.4	10.6	10.9	10.3	9.5	8.8
Current balance (% of GDP)	-2.0	-2.4	-2.4	-2.3	-2.2	-2.3
Government budget (% of GDP)	-7.5	-8.7	-6.9	-5.2	-3.9	-3.1
Government debt (% of GDP)	84.6	91.3	96.1	98.6	99.6	99.7



Italy

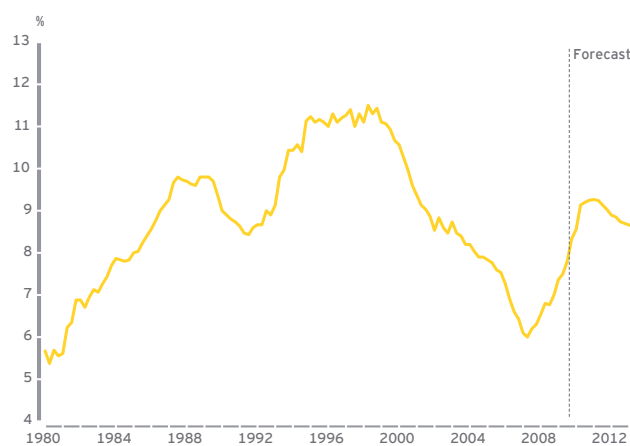
- ▶ The Italian economy remains weak on all fronts and we expect a slow and jobless recovery through 2010, even if a double-dip recession is avoided. We estimate growth was 0.2% in Q1.
- ▶ We expect GDP to grow by just 0.8% in 2010 and around 1% in 2011.
- ▶ The burden of public debt prevented the government from enacting any sizeable counter-cyclical fiscal policy. While this has avoided slippages in the budget, it also accounts for growth in Italy remaining well below the Eurozone average.
- ▶ The fall in employment has been, so far, relatively modest, thanks to government wage-supplementation schemes. However, their expiry this year will lead to further rises in the unemployment rate, which will peak at 9.3% in 2011Q1.
- ▶ Wage moderation will help the manufacturing sector recover some of the loss in competitiveness seen over the last 10 years, but the gains will be slow.

Figure 25
Consumption and investment



Source: Oxford Economics

Figure 26
Unemployment and rate



Source: Oxford Economics

Table 4
Italy (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-5.1	0.8	1.0	1.5	2.0	1.9
Private consumption	-1.8	0.6	0.9	1.4	1.7	1.8
Fixed investment	-12.2	-0.7	1.4	1.6	2.2	2.1
Stockbuilding (% of GDP)	0.0	0.0	-0.2	-0.5	-0.6	-0.5
Government consumption	0.6	0.5	1.0	1.3	1.4	1.3
Exports of goods and services	-19.1	4.1	4.1	6.4	7.5	6.2
Imports of goods and services	-14.6	2.0	2.9	4.9	6.4	6.0
Consumer prices	0.8	0.8	1.8	2.1	2.1	2.1
Unemployment rate (level)	7.8	9.0	9.2	8.8	8.6	8.4
Current balance (% of GDP)	-3.2	-2.8	-2.9	-2.7	-2.5	-2.4
Government budget (% of GDP)	-5.3	-5.5	-4.6	-3.9	-3.4	-3.1
Government debt (% of GDP)	124.6	127.8	129.5	129.5	128.1	126.4

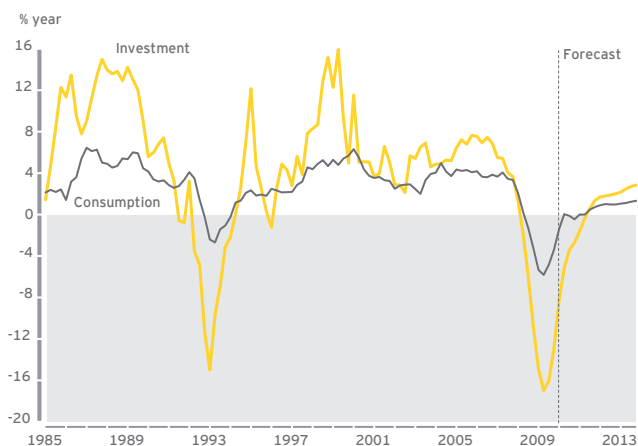


Spain

- ▶ The Spanish economy is expected to remain in recession in 2010, with GDP shrinking by 0.4% as the fallout from the real estate bubble remains a heavy drag on the economy and fiscal consolidation measures push back the recovery even further. Spain will struggle to emerge from recession before 2011.
- ▶ The unemployment rate peaked at 19% (a full 11 percentage point increase since mid-2007) and is not expected to fall this year. Real income growth will also be undermined by higher inflation this year.
- ▶ Deleveraging by households and firms pushed GDP down last year and will continue to cut growth for some time.
- ▶ The big stimulus plans in Europe led to an estimated budget deficit of 11.4% of GDP in 2009. In the aftermath of the Greek crisis, Spain needs to bring this deficit down more quickly than it had envisaged. Tighter fiscal policy will therefore also be a cause of continued weak growth over the next few years.

Figure 27

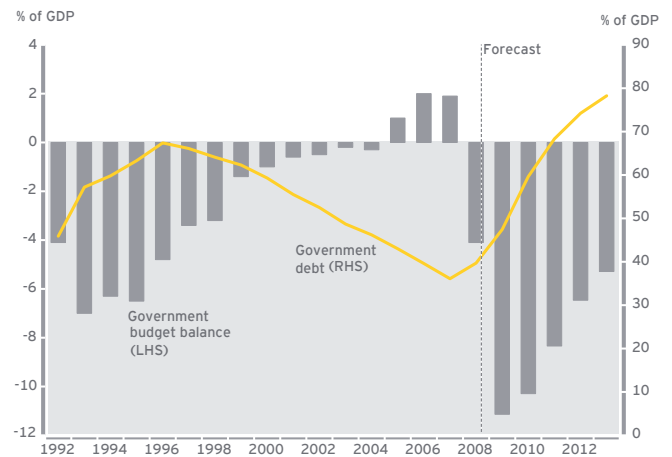
Consumption and investment



Source: Oxford Economics

Figure 28

Government balance and debt



Source: Oxford Economics

Table 5

Spain (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-3.6	-0.4	0.8	1.4	1.6	1.9
Private consumption	-4.9	-0.5	0.3	1.0	1.2	1.5
Fixed investment	-15.3	-5.0	0.0	1.8	2.5	2.5
Stockbuilding (% of GDP)	0.4	-0.3	-0.6	-0.5	-0.6	-0.7
Government consumption	3.8	1.5	0.6	0.5	1.6	1.5
Exports of goods and services	-11.5	5.5	4.6	5.3	5.4	5.7
Imports of goods and services	-17.9	0.1	1.6	4.1	4.5	4.7
Consumer prices	-0.3	1.5	1.4	1.5	1.8	1.7
Unemployment rate (level)	18.0	19.2	19.5	19.0	17.8	16.3
Current balance (% of GDP)	-5.4	-4.3	-3.7	-3.4	-3.1	-2.8
Government budget (% of GDP)	-11.4	-10.3	-8.3	-6.5	-5.3	-3.5
Government debt (% of GDP)	53.0	64.3	71.8	76.6	79.4	80.6

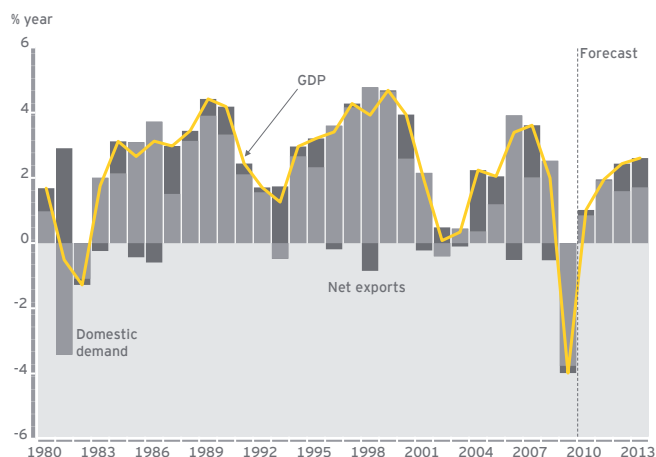


Netherlands

- ▶ Albeit fragile at this stage, the economic recovery is underway. GDP growth is projected at 1% for 2010. International trade is expected to be an important driver of growth while consumption and investment take longer to pick up pace. Further ahead, the Netherlands will continue to strengthen and will be one of the better performing countries of the Eurozone in 2011, with GDP growth of 2.0%.
- ▶ However, a jobless recovery is in prospect as firms continue to shed labour into 2011. We expect unemployment to peak at 6.7% in early 2011.
- ▶ We expect the budget deficit to deteriorate further to 6.2% of GDP this year. However, as the recovery builds up momentum, we forecast a reduction in the deficit to 5.2% of GDP in 2011 and down to 3% by 2013.

Figure 29

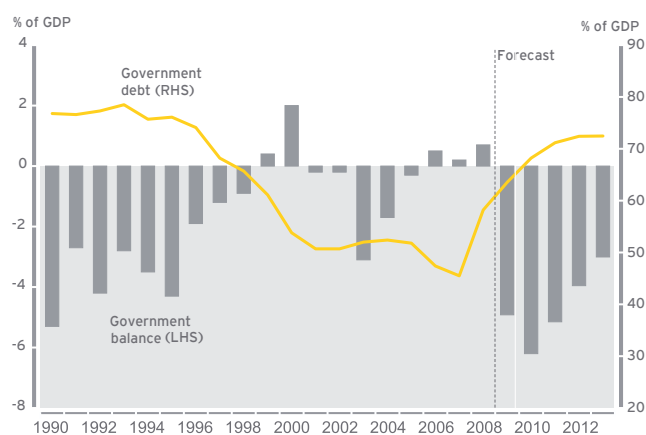
Contributions to GDP growth



Source: Oxford Economics

Figure 30

Government balance and debt



Source: Oxford Economics

Table 6

Netherlands (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-4.0	1.0	2.0	2.4	2.6	2.3
Private consumption	-2.5	0.0	1.6	1.9	2.1	2.1
Fixed investment	-13.0	-5.2	2.0	2.4	3.2	3.3
Stockbuilding (% of GDP)	-0.7	0.5	0.6	0.4	0.1	0.3
Government consumption	3.2	2.9	2.4	1.8	1.7	1.7
Exports of goods and services	-8.2	4.0	5.5	6.5	6.5	5.4
Imports of goods and services	-8.7	4.1	6.0	6.1	6.0	5.9
Consumer prices	1.0	0.7	1.6	1.9	2.0	2.0
Unemployment rate (level)	3.4	4.5	4.9	4.7	4.4	4.3
Current balance (% of GDP)	5.4	5.5	5.7	6.2	6.8	6.9
Government budget (% of GDP)	-4.9	-6.2	-5.2	-4.0	-3.0	-2.1
Government debt (% of GDP)	73.6	78.0	80.6	81.4	81.1	80.1

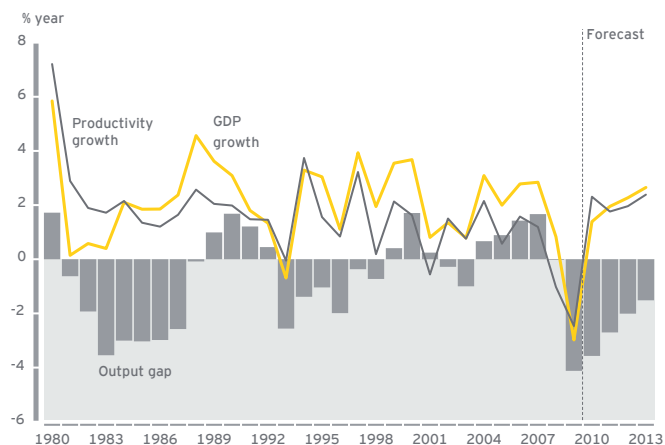


Belgium

- ▶ We expect the recovery to proceed at only a moderate pace in 2010, with Belgian GDP growth averaging just 1.4%. However, this would still be one of the strongest performances in the Eurozone.
- ▶ Government policies have helped stem the rise in job losses, although they will not be able to prevent a further cyclical decline in employment that will see the jobless rate peak at around 8.4%.
- ▶ The downturn has resulted in a significant weakening of the public finances, partially reversing the improvements witnessed in the years since 1993. With a substantial portion of the 2009 budget deficit being structural in nature, the government will struggle to bring it back down below the 3% of GDP Maastricht criterion before 2013.

Figure 31

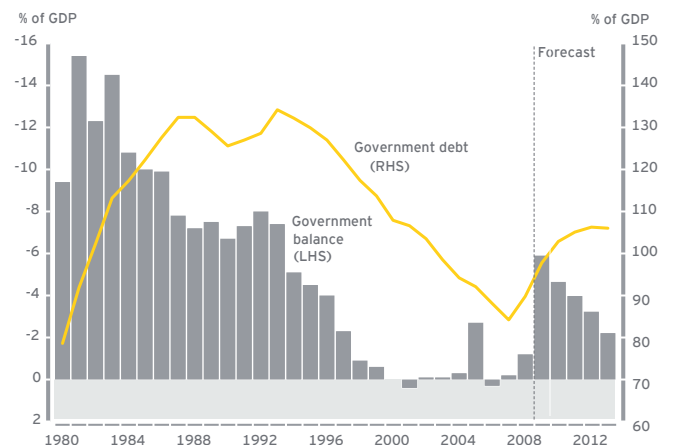
Supply-side performance



Source: Oxford Economics

Figure 32

Government balance and debt



Source: Oxford Economics

Table 7

Belgium (annual percentage changes unless specified)

Source: Oxford Economics

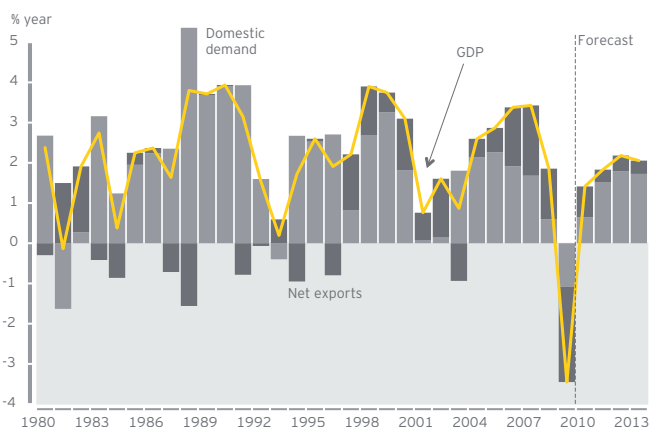
	2009	2010	2011	2012	2013	2014
GDP	-3.0	1.4	2.0	2.3	2.7	2.1
Private consumption	-1.6	0.4	1.7	2.4	2.4	2.0
Fixed investment	-4.5	-2.6	1.7	2.5	2.8	2.3
Stockbuilding (% of GDP)	-0.5	-0.2	0.2	0.1	0.4	0.5
Government consumption	1.6	1.3	1.4	1.5	1.6	1.6
Exports of goods and services	-10.8	5.8	4.5	4.6	3.8	3.7
Imports of goods and services	-11.0	4.6	4.7	4.5	3.9	3.7
Consumer prices	0.0	1.4	1.6	1.7	1.8	1.8
Unemployment rate (level)	7.9	8.3	8.2	8.0	7.8	7.7
Current balance (% of GDP)	0.5	1.6	2.1	3.1	3.6	3.9
Government budget (% of GDP)	-5.9	-4.6	-4.0	-3.2	-2.2	-1.0
Government debt (% of GDP)	101.2	104.2	107.0	108.8	109.0	108.6



Austria

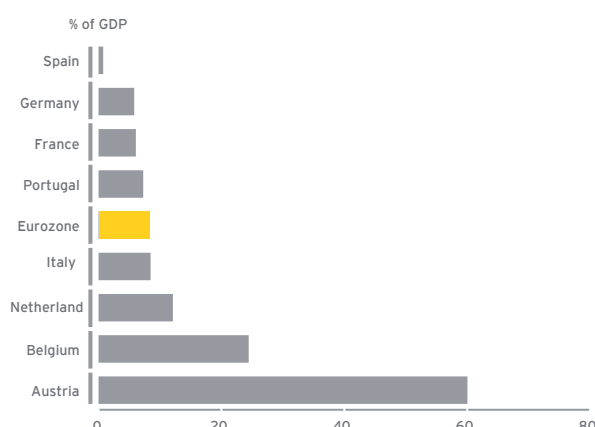
- ▶ Unlike many countries in the Eurozone, Austria has maintained its pace of recovery to date. Increased trade, supportive government measures and reasonably strong household demand will drive growth in 2010. We forecast growth of 1.4% in 2010 and 1.8% in 2011. Although this is sluggish compared to the growth seen since the mid-2000s, it is expected to outpace the Eurozone as a whole.
- ▶ A modest increase in the German economy and a return to growth in CEE should boost demand for Austrian exports. In volume terms, we forecast that exports will rise by 4.2% this year and by 6.5% in 2011.
- ▶ But Austria's exposure to CEE poses a serious downside risk to our central forecast, in particular via high exposure of local banks to the region.

Figure 33
Contributions to GDP



Source: Oxford Economics

Figure 34
Bank exposures to CEE



Source: Oxford Economics/BIS

Table 8
Austria (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-3.5	1.4	1.8	2.2	2.1	2.0
Private consumption	0.7	1.0	1.5	1.7	1.7	1.7
Fixed investment	-7.7	-1.1	3.9	5.8	5.8	3.4
Stockbuilding (% of GDP)	1.5	1.3	1.1	0.6	0.0	0.1
Government consumption	0.9	2.4	1.0	0.6	1.0	1.7
Exports of goods and services	-14.1	4.2	6.5	8.4	6.6	5.6
Imports of goods and services	-11.6	3.0	6.6	8.6	6.8	6.2
Consumer prices	0.4	1.5	1.8	2.0	1.9	1.9
Unemployment rate (level)	4.8	5.3	5.5	4.9	4.5	4.4
Current balance (% of GDP)	2.0	2.0	2.5	2.6	2.5	2.1
Government budget (% of GDP)	-4.3	-5.0	-4.0	-2.6	-1.8	-1.4
Government debt (% of GDP)	72.2	75.5	77.4	77.5	76.8	75.5

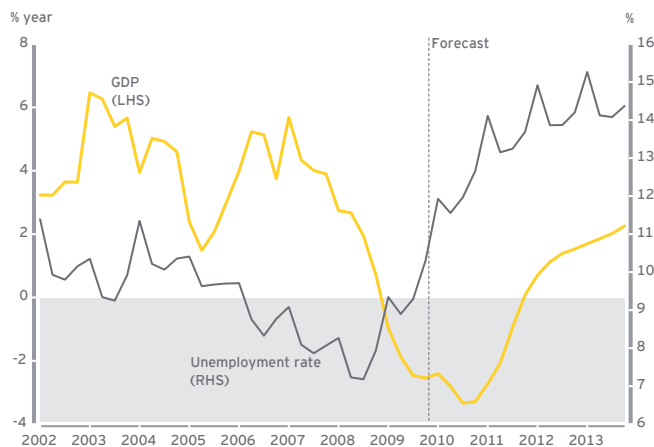


Greece

- ▶ Greece has entered a serious fiscal crisis in the last few months, provoking fears of a possible debt default. With a budget deficit of 13% of GDP and debt to GDP at more than 100%, fiscal policy will have to tighten dramatically in the years ahead to head off this risk. This will mean a heavy price in terms of lost output. We forecast a 3% fall in GDP in 2010 and below trend growth to 2014.
- ▶ Greece also faces an external adjustment problem, with the current account deficit around 11% of GDP.
- ▶ Achieving both fiscal and external adjustment is a major challenge. We expect both deficits to fall but this relies on strong wage restraint and very weak growth.
- ▶ The main risk to our forecast is that Greece succumbs to "austerity fatigue". But default or leaving the Eurozone would cause a major financial shock.

Figure 35

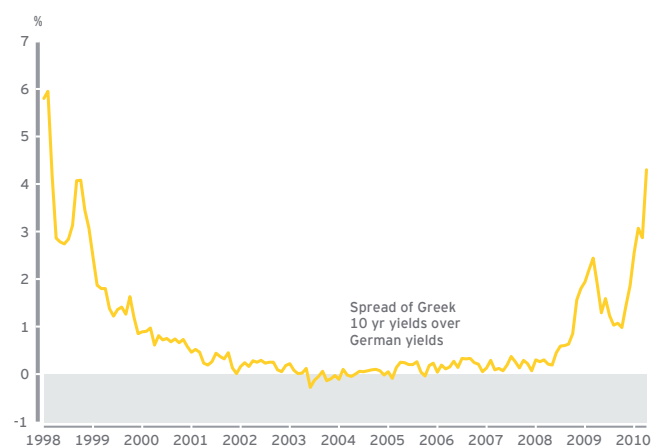
GDP and unemployment rate



Source: Oxford Economics/Haver Analytics

Figure 36

Long-term yield spread



Source: Oxford Economics/Haver Analytics

Table 9

Greece (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-2.0	-3.0	-1.4	1.2	2.0	2.9
Private consumption	-1.8	-2.3	-3.2	-0.3	1.9	3.2
Fixed investment	-13.9	-9.9	-3.0	1.7	4.8	5.2
Stockbuilding (% of GDP)	1.9	-0.2	0.0	0.8	0.8	0.8
Government consumption	9.6	-8.0	-6.9	-1.8	0.2	1.2
Exports of goods and services	-18.1	8.8	8.7	5.6	5.0	4.9
Imports of goods and services	-14.1	-7.5	-1.5	2.8	5.0	6.2
Consumer prices	1.3	3.1	0.7	0.7	1.2	1.6
Unemployment rate (level)	9.5	11.9	13.4	14.1	14.4	14.4
Current balance (% of GDP)	-11.2	-7.9	-5.0	-4.2	-4.1	-4.2
Government budget (% of GDP)	-12.7	-9.6	-6.0	-4.4	-3.3	-2.9
Government debt (% of GDP)	102.3	114.1	120.2	120.9	119.3	116.2

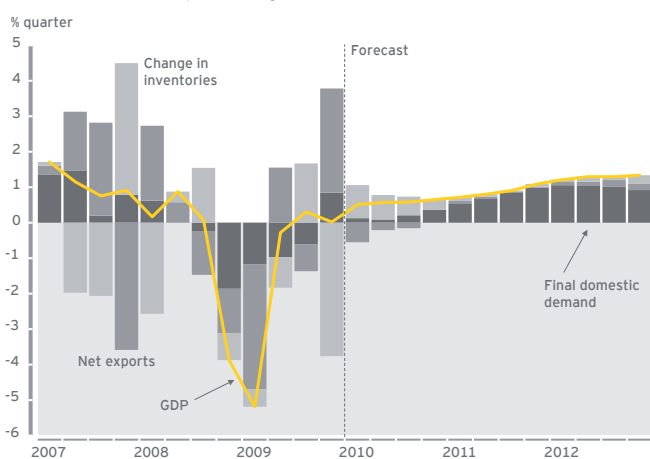
Forecast for Eurozone countries

Finland

- ▶ Despite growth being around zero in 2009Q4, we think that the foundations are in place for a strong recovery and expect growth to gather pace rapidly through 2010. GDP is forecast to increase by 1.5% in 2010, accelerating to 3% in 2011.
- ▶ The main grounds for optimism are related to the inventory cycle, which is expected to boost and support growth this year and to exports, which are set to perform better as Finland's markets pick up.
- ▶ Complacency needs to be avoided, however, as Finland has lost competitiveness since 2007. Moreover, the economic recovery is highly dependent on exports and, as a result, could be endangered by deteriorating conditions in key trading partners, such as Russia and the Eurozone.

Figure 37

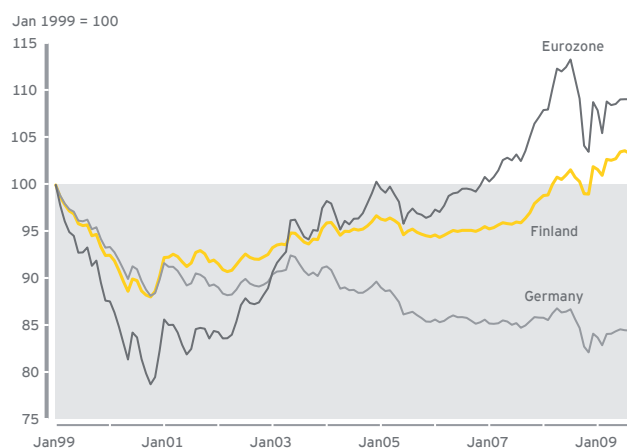
Contributions to quarterly GDP



Source: Oxford Economics

Figure 38

Real effective exchange rates



Source: IFS/Haver Analytics

Table 10

Finland (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-7.8	1.5	3.0	4.7	4.8	3.4
Private consumption	-1.8	1.1	0.8	3.2	3.7	3.5
Fixed investment	-13.4	-1.4	7.7	11.0	7.2	4.4
Stockbuilding (% of GDP)	-0.2	-0.6	0.2	0.6	1.2	1.2
Government consumption	0.8	0.9	1.6	1.2	0.9	1.1
Exports of goods and services	-24.4	7.8	6.4	9.4	8.8	6.4
Imports of goods and services	-22.3	5.4	7.8	10.5	9.2	6.7
Consumer prices	1.6	0.4	1.1	1.4	1.5	1.5
Unemployment rate (level)	8.2	10.2	10.1	8.7	7.7	7.4
Current balance (% of GDP)	1.3	2.2	1.7	1.6	1.5	1.4
Government budget (% of GDP)	-2.3	-4.9	-4.1	-2.2	-0.6	-0.2
Government debt (% of GDP)	44.3	48.4	52.8	54.5	54.2	53.7

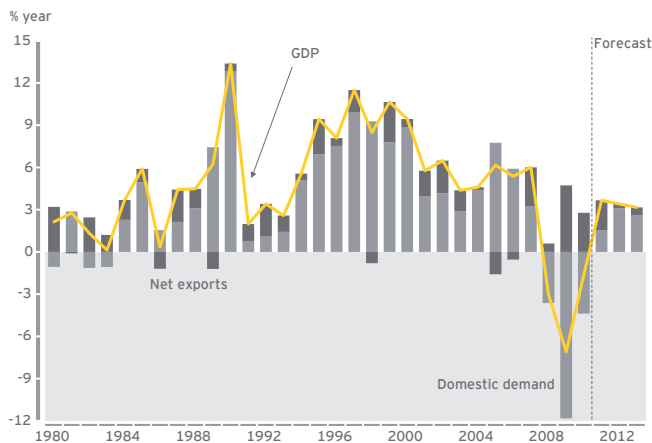


Ireland

- ▶ While the very worst is probably over in terms of the pace of output and job losses, the Irish economy has not yet emerged from recession. We estimate that it shrunk again in 2010Q1 and that in the remainder of 2010 it will merely stabilize. Further ahead, Ireland's strong productivity and high valued-added export growth will push it amongst, the fastest growing countries of the Eurozone again, but it will not return to the growth rates seen during the 1990s and early 2000s.
- ▶ This year, public spending cuts and tax rises as well as weak or still declining construction will weigh on growth. The main uncertainty relates to investment. The extent of the decline so far makes it difficult to call the trough.
- ▶ While painful in the short term, the forceful fiscal adjustment already underway, to cut the fiscal deficit from almost 13% of GDP in 2009, is one of the factors supporting our optimism for the medium term.

Figure 39

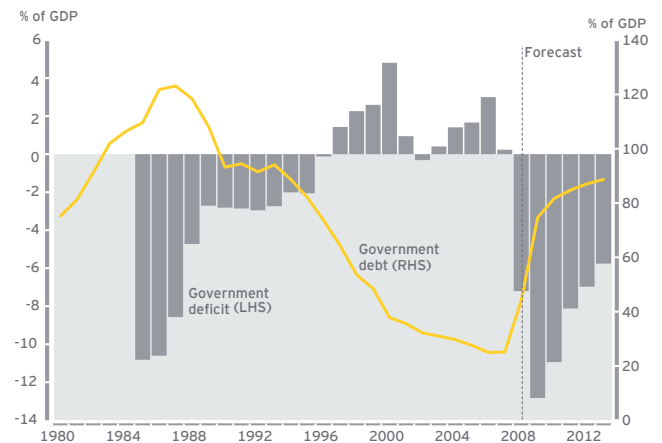
Contributions to GDP



Source: Oxford Economics

Figure 40

Government balance and debt



Source: Oxford Economics

Table 11

Ireland (annual percentage changes unless specified)

Source: Oxford Economics

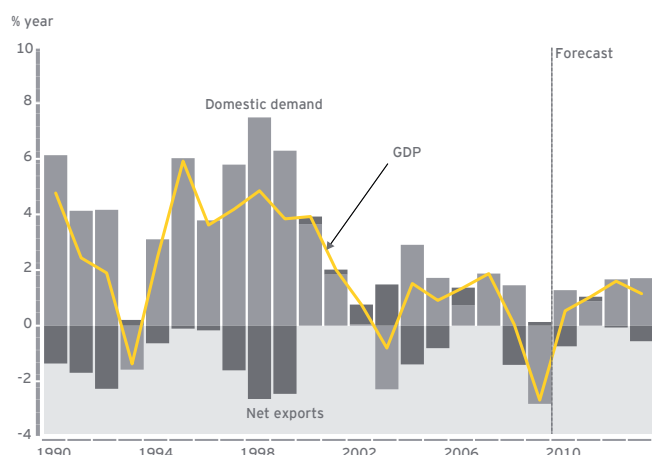
	2009	2010	2011	2012	2013	2014
GDP	-7.1	-1.6	3.7	3.4	3.2	3.6
Private consumption	-7.2	-0.4	2.3	3.1	3.4	3.4
Fixed investment	-29.7	-18.7	2.5	12.3	7.1	5.1
Stockbuilding (% of GDP)	-1.6	-0.1	0.3	0.1	0.0	0.0
Government consumption	-1.3	-4.3	-2.1	-0.1	0.0	0.0
Exports of goods and services	-2.3	1.6	6.8	5.9	5.3	5.2
Imports of goods and services	-9.3	-2.0	5.7	7.3	6.1	5.1
Consumer prices	-1.7	-1.2	1.1	2.0	2.0	2.0
Unemployment rate (level)	11.8	13.0	13.1	13.2	13.2	12.9
Current balance (% of GDP)	-2.9	1.2	2.7	2.3	2.0	2.6
Government budget (% of GDP)	-12.8	-10.9	-8.1	-7.0	-5.8	-4.6
Government debt (% of GDP)	74.6	81.6	84.8	87.1	88.7	88.8



Portugal

- ▶ Portugal started 2010 with the government fighting to reassure financial markets. While it is not the next Greece, the economy faces years of slow growth and painful adjustment. We forecast GDP growth at 0.5% in 2010, rising slowly to 1% in 2011 and 1.6% in 2012. Growth is forecast to remain below the Eurozone average over the entire forecast period.
- ▶ The current government projections assume a rather optimistic growth path. We do not expect the fiscal deficit to fall to below 3% of GDP until 2014.
- ▶ At present, investors appears to be supporting the Portuguese government's ability to meet its short-term debt obligations. But, while it is true that Portugal is in a less worrying position than Greece, markets can be fickle. Any negative turn in sentiment would see borrowing costs increase, prolonging the necessary period of lower government expenditure and subdued wages. This will add further pain to the economy.

Figure 41
Contributions to GDP growth



Source: Oxford Economics

Figure 42
Bonds spread over bunds



Source: Haver analytics

Table 12

Portugal (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-2.7	0.5	1.0	1.6	1.1	1.3
Private consumption	-0.8	1.8	0.7	1.1	1.4	1.5
Fixed investment	-11.1	-2.2	3.2	3.3	3.4	3.2
Stockbuilding (% of GDP)	0.5	0.6	0.4	0.5	0.3	0.3
Government consumption	3.5	1.6	0.2	0.5	1.1	1.5
Exports of goods and services	-11.6	6.4	4.1	4.4	3.9	3.9
Imports of goods and services	-9.2	6.5	2.7	3.5	4.1	4.4
Consumer prices	-0.9	0.9	1.0	1.0	1.9	1.8
Unemployment rate (level)	9.6	10.5	9.3	8.8	8.6	8.5
Current balance (% of GDP)	-10.3	-9.3	-9.0	-8.9	-9.1	-9.2
Government budget (% of GDP)	-9.3	-8.5	-7.2	-5.0	-3.6	-3.1
Government debt (% of GDP)	83.4	89.9	96.3	99.6	101.2	101.8

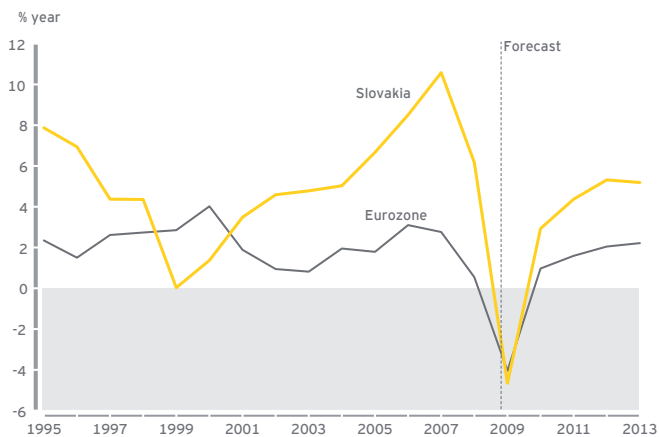


Slovakia

- ▶ The first half of 2010 will be tough for the export-oriented Slovakian economy, as Eurozone growth is expected to be weak. This is magnified by Slovakia's reliance on the automotive sector that is heading for a slump after 2009's scrappage-scheme bonanza.
- ▶ Slovakia is expected to return to a more solid growth path later this year as growth in the Eurozone firms up. GDP growth is forecast at around 3% in 2010 and 4%-5% in 2011-14.
- ▶ Slovakia will remain a privileged destination for foreign direct investment (FDI), given the availability of skilled and relatively cheap labor, the relatively high profitability of its manufacturing sector and its strategic position in Central Europe. However, the automotive sector is already characterized by overcapacity. As a consequence, the government will have to focus on efforts to attract investment in other sectors.
- ▶ Reforms are required to reduce the structurally high unemployment rate and encourage competition.

Figure 43

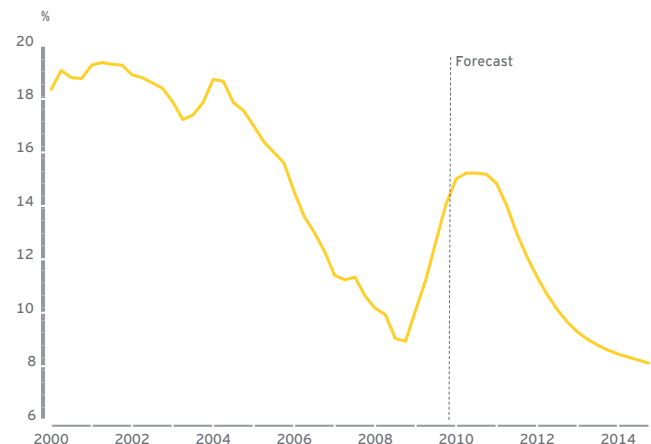
Real GDP growth



Source: Oxford Economics

Figure 44

Unemployment rate



Source: Oxford Economics/Haver Analytics

Table 13

Slovakia (annual percentage changes unless specified)

Source: Oxford Economics

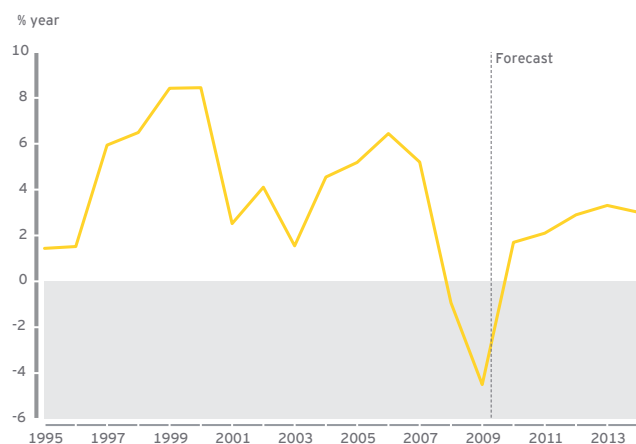
	2009	2010	2011	2012	2013	2014
GDP	-4.7	2.9	4.4	5.3	5.2	4.3
Private consumption	-0.7	1.6	3.0	3.6	3.8	3.9
Fixed investment	-10.5	1.3	6.8	7.0	7.3	7.6
Stockbuilding (% of GDP)	-1.1	-0.2	0.1	0.4	0.5	0.3
Government consumption	2.8	1.3	2.3	2.4	2.5	2.6
Exports of goods and services	-16.5	10.1	11.1	11.3	9.0	7.5
Imports of goods and services	-17.6	9.8	11.2	10.9	8.7	7.8
Consumer prices	1.6	1.4	2.1	2.1	2.2	2.2
Unemployment rate (level)	12.0	15.1	13.5	10.5	9.0	8.4
Current balance (% of GDP)	-2.5	-3.3	-3.7	-4.5	-4.2	-4.0
Government budget (% of GDP)	-6.3	-6.4	-4.8	-3.6	-2.8	-2.3
Government debt (% of GDP)	31.8	34.9	36.6	36.2	35.3	34.2



Luxembourg

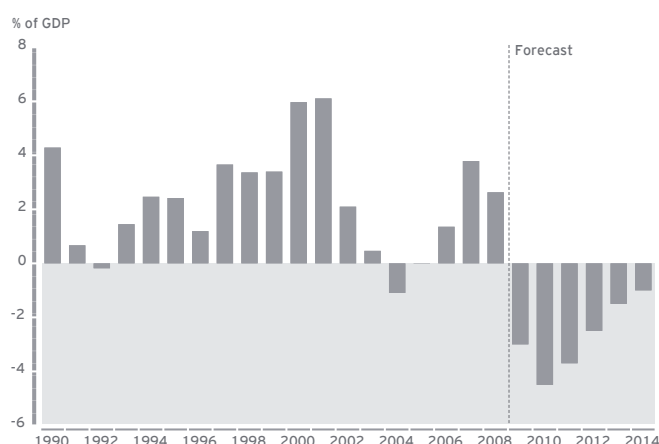
- ▶ Growth is under way again, but we forecast that GDP will rise by only 1.7% in 2010 and 2.1% in 2011 as banks and investment funds continue to rebuild capital.
- ▶ The end of the recession was hastened by a significant widening of the public deficit, but the government can afford to close this slowly because of its low initial debt.
- ▶ However, the downturn caused a slump in labor productivity that is now prompting extensive job cuts.
- ▶ Longer-term growth is still sustainable at around 3%, through attraction of new financial business.
- ▶ Further financial growth depends on complementing the surviving tax havens – by bringing administration and management back onshore – as EU-driven tax changes rule out competing with them.

Figure 45
Real GDP growth



Source: Oxford Economics

Figure 46
Government budget balance



Source: Oxford Economics

Table 14

Luxembourg (annual percentage changes unless specified)

Source: Oxford Economics

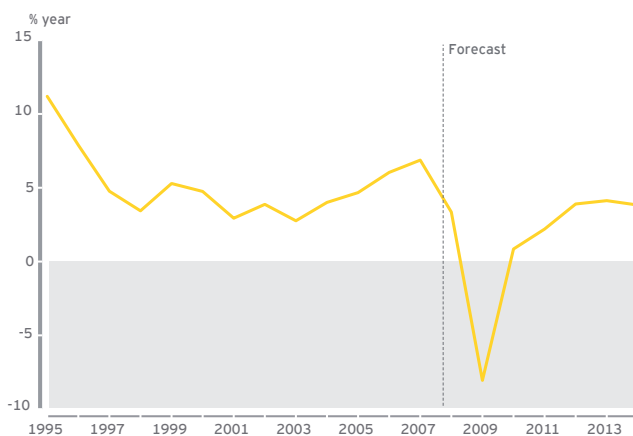
	2009	2010	2011	2012	2013	2014
GDP	-4.5	1.7	2.1	2.9	3.3	3.0
Private consumption	-3.9	1.1	2.7	3.3	3.0	3.1
Fixed investment	-16.5	1.8	3.0	6.0	5.0	4.0
Stockbuilding (% of GDP)	0.4	0.4	0.4	0.4	0.3	0.3
Government consumption	1.9	2.3	3.4	3.6	3.0	3.1
Exports of goods and services	-8.9	3.1	3.8	5.3	5.7	5.3
Imports of goods and services	-11.0	3.2	4.5	6.3	6.3	5.8
Consumer prices	0.0	2.0	2.2	2.0	2.0	2.0
Unemployment rate (level)	5.7	6.4	5.9	5.4	5.0	4.5
Current balance (% of GDP)	8.2	9.6	10.6	12.3	12.6	12.8
Government budget (% of GDP)	-3.0	-4.5	-3.7	-2.5	-1.5	-1.0
Government debt (% of GDP)	18.2	22.1	24.8	26.2	26.3	26.1



Slovenia

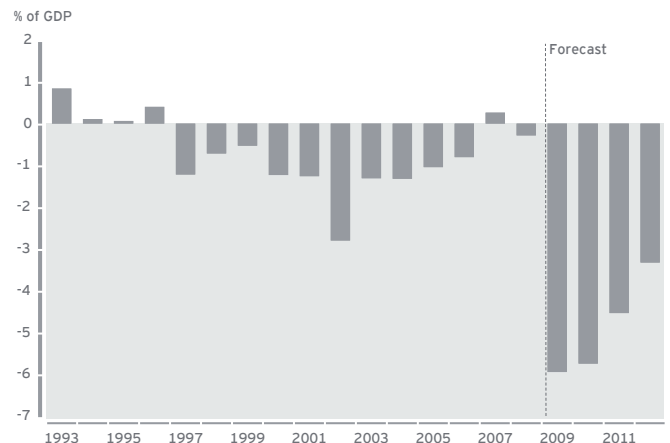
- ▶ Growth is forecast at 0.9% in 2010 as exports start to revive, rising to 2.2% in 2011 which triggers an investment upturn.
- ▶ The government has taken advantage of its low initial debt position to apply significant stimulus, with the fiscal deficit reaching almost 6% of GDP in 2009 and not due to fall below 3% until 2013.
- ▶ Rapid growth in public debt creates pressure for further privatizations, but competition issues may block the sale of the two big state-owned banks.
- ▶ There are downside risks to exports and growth from the expected renewed rise in labor and energy costs.
- ▶ Last year's sharp fall in net inward investment, though part of the Eurozone-wide trend, also reflects diversion of inward investment to lower-cost countries and rising outward investment due to Slovenia's small domestic market.

Figure 47
Real GDP



Source: Oxford Economics/World Bank

Figure 48
Government budget balance



Source: Oxford Economics

Table 15

Slovenia (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-8.1	0.9	2.2	3.9	4.1	3.8
Private consumption	-1.5	0.2	1.6	2.1	3.6	3.5
Fixed investment	-30.4	-0.1	4.2	4.4	6.6	4.6
Stockbuilding (% of GDP)	2.8	2.4	2.2	2.6	2.2	2.1
Government consumption	3.4	0.7	0.6	2.2	3.3	3.3
Exports of goods and services	-16.6	2.2	4.4	6.5	6.2	5.6
Imports of goods and services	-18.6	0.7	3.7	5.5	5.8	5.4
Consumer prices	0.8	2.2	2.5	2.7	2.8	2.8
Unemployment rate (level)	6.0	7.2	6.5	5.5	5.1	5.1
Current balance (% of GDP)	-2.8	-1.8	-1.4	-1.3	-1.0	-0.8
Government budget (% of GDP)	-5.9	-5.7	-4.5	-3.5	-1.8	-0.7
Government debt (% of GDP)	29.6	34.8	37.9	39.1	38.6	37.2

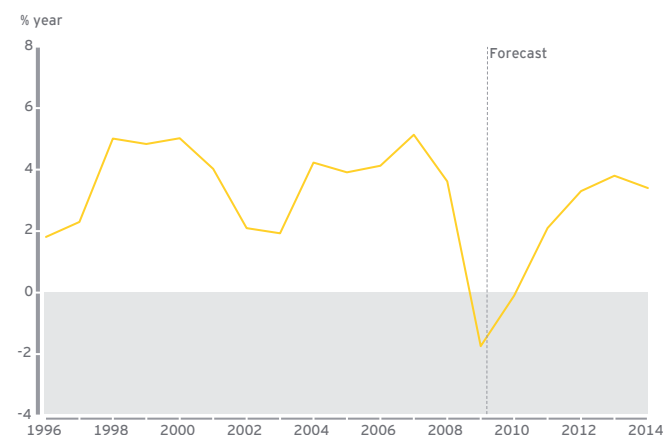


Cyprus

- ▶ The recovery is underway, but growth is forecast around zero in 2010, rising to 2% in 2011 as tourism revives slowly.
- ▶ Fiscal measures pushed the budget deficit to 6% of GDP last year and helped shorten the recession. But fiscal tightening is now due, which will require tight curbs on public pay and social expenditures.
- ▶ The current account deficit virtually halved in 2009 but was still close to 9% of GDP. Further reduction is needed as inward investment falls following the end of property boom.
- ▶ The offshore financial sector has survived the global downturn without contributing to Cyprus' recession. It may assist external financing in the short term, but expansion prospects are now reduced.

Figure 49

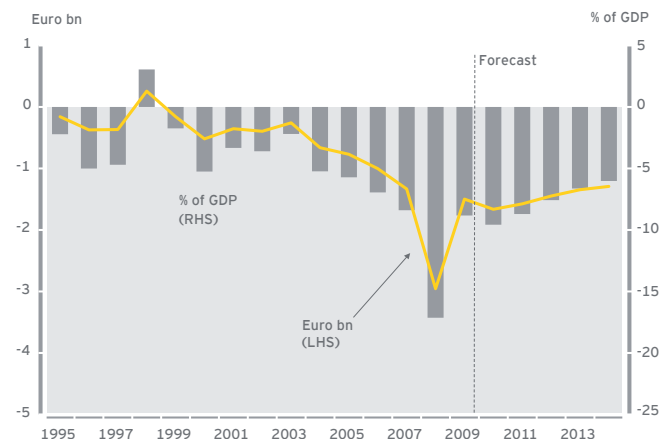
Real GDP growth



Source: Oxford Economics

Figure 50

Current account balance



Source: Oxford Economics

Table 16

Cyprus (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-1.7	-0.1	2.1	3.3	3.8	3.4
Private consumption	-3.0	-6.0	3.9	4.4	4.0	3.8
Fixed investment	-6.0	-10.0	6.8	8.5	7.1	5.5
Stockbuilding (% of GDP)	-4.1	3.5	1.3	0.4	0.5	0.2
Government consumption	5.8	3.3	3.5	2.4	2.7	3.0
Exports of goods and services	-11.8	-1.6	6.0	6.4	5.5	5.3
Imports of goods and services	-19.8	2.0	5.6	7.2	6.5	5.6
Consumer prices	0.2	2.5	2.0	2.2	2.3	2.3
Unemployment rate (level)	5.3	5.5	5.3	4.9	4.6	4.6
Current balance (% of GDP)	-8.8	-9.6	-8.7	-7.6	-6.6	-6.0
Government budget (% of GDP)	-6.1	-6.5	-5.1	-3.6	-2.9	-2.5
Government debt (% of GDP)	55.2	60.4	63.1	63.4	62.6	61.7

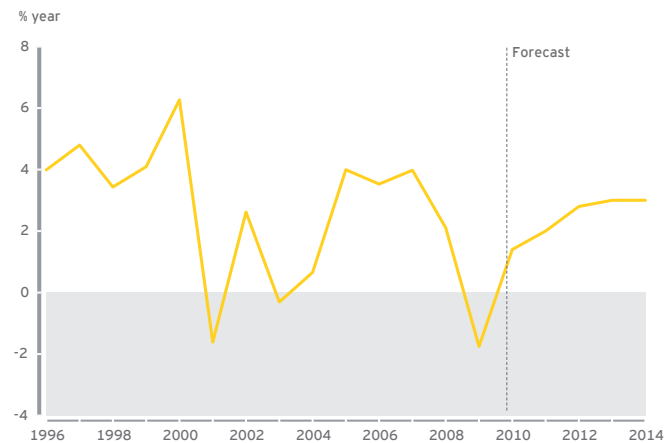


Malta

- ▶ We forecast only a modest upturn, with growth of around 1.5% in 2010 and 2% in 2011.
- ▶ The slow growth trend reflects adjustment problems of Malta's heavily state-run economy that rapidly lost its textile base to low-cost countries, raising reliance on tourism.
- ▶ The recession raised the fiscal deficit to almost 5% of GDP and, while the EU has extended the deadline for its reduction, rising pension and welfare costs make budget rebalancing politically difficult.
- ▶ The fund-focused financial sector proved relatively resilient to the global downturn and its expansion offers the main short-term route to diversification from tourism.
- ▶ Wider diversification into new industrial sectors is held back by distance from main markets and rising energy and labor costs.

Figure 51

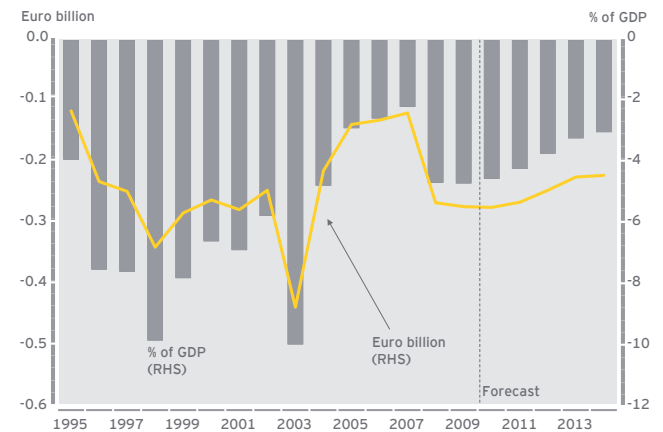
Real GDP growth



Source: Oxford Economics

Figure 52

Government budget balance



Source: Oxford Economics

Table 17

Malta (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-1.8	1.4	2.0	2.8	3.0	3.0
Private consumption	0.9	2.0	2.7	3.0	2.8	2.8
Fixed investment	-19.4	0.0	6.0	11.0	10.5	7.2
Stockbuilding (% of GDP)	7.2	-4.3	-0.3	1.4	3.0	3.7
Government consumption	-7.3	1.5	3.0	3.0	3.0	3.0
Exports of goods and services	-3.3	2.2	3.0	4.4	3.8	3.0
Imports of goods and services	-9.2	4.2	5.8	7.0	6.0	4.0
Consumer prices	1.8	1.2	1.9	2.3	2.3	2.3
Unemployment rate (level)	7.0	7.4	6.7	6.0	5.6	4.8
Current balance (% of GDP)	-2.8	-4.1	-4.3	-4.0	-3.4	-3.4
Government budget (% of GDP)	-4.7	-4.5	-4.2	-3.7	-3.2	-3.0
Government debt (% of GDP)	67.1	69.2	70.5	70.7	70.3	69.7

Detailed tables and charts



Forecast assumptions

	2009	2010	2011	2012	2013	2014
Short-term interest rates (%)	1.2	0.9	1.7	3.4	4.4	4.4
Long-term interest rates (%)	3.8	4.2	5.1	4.9	4.7	4.7
Euro effective exchange rate (1995=100)	129.7	124.8	122.0	119.7	117.7	116.3
Oil prices (€/barrel)	44.2	58.4	61.4	64.0	67.3	71.7
Share prices (% year)	-17.3	4.4	4.3	8.4	8.7	8.7

	2009				2010			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Short-term interest rates (%)	2.0	1.3	0.9	0.7	0.7	0.8	1.0	1.1
Long-term interest rates (%)	3.9	4.0	3.8	3.7	3.7	4.1	4.3	4.6
Euro effective exchange rate (1995=100)	128.0	128.9	130.2	131.8	127.0	124.8	123.6	123.7
Oil prices (€/barrel)	34.2	43.2	47.7	50.5	55.8	59.3	59.1	59.5
Share prices (% year)	-42.9	-28.4	-5.4	21.2	41.5	6.1	-9.2	-9.9



Eurozone GDP and components

Quarterly forecast

(Quarterly percentage changes)

	2009				2010			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-2.5	-0.1	0.4	0.1	0.1	0.4	0.4	0.4
Private consumption	-0.5	0.1	-0.2	0.0	-0.2	0.1	0.1	0.2
Fixed investment	-5.4	-1.7	-0.9	-0.8	-0.2	0.2	0.3	0.5
Government consumption	0.6	0.6	0.8	-0.1	0.3	0.3	0.1	0.1
Exports of goods and services	-8.3	-1.1	2.9	1.7	0.6	0.8	0.8	1.0
Imports of goods and services	-7.6	-2.9	2.8	0.9	0.1	0.5	0.9	1.1

Contributions to GDP growth

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

	2009				2010			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-2.5	-0.1	0.4	0.1	0.1	0.4	0.4	0.4
Private consumption	-0.3	0.0	-0.1	0.0	-0.1	0.1	0.1	0.1
Fixed investment	-1.2	-0.4	-0.2	-0.2	0.0	0.0	0.1	0.1
Government consumption	0.1	0.1	0.2	0.0	0.1	0.1	0.0	0.0
Stockbuilding	-0.9	-0.7	0.5	0.0	0.0	0.1	0.3	0.1
Exports of goods and services	-3.6	-0.5	1.1	0.7	0.3	0.3	0.4	0.4
Imports of goods and services	3.3	1.2	-1.1	-0.4	0.0	-0.2	-0.4	-0.4

Annual levels – Real terms

(€ billion, 2000 prices)

	2009	2010	2011	2012	2013	2014
GDP	7459	7531	7652	7809	7982	8154
Private consumption	4336	4335	4383	4458	4544	4633
Fixed investment	1507	1488	1520	1567	1621	1671
Government consumption	1599	1616	1628	1642	1660	1679
Stockbuilding	-39	-19	0	5	9	21
Exports of goods and services	3047	3179	3336	3554	3781	3999
Imports of goods and services	2991	3068	3215	3418	3634	3848

Annual levels – Nominal terms

(€ billion)

	2009	2010	2011	2012	2013	2014
GDP	8985	9182	9485	9856	10263	10682
Private consumption	5173	5261	5398	5583	5799	6025
Fixed investment	1774	1776	1841	1927	2027	2128
Government consumption	1972	2008	2059	2124	2201	2281
Stockbuilding	-58	-16	23	43	47	55
Exports of goods and services	3258	3450	3644	3891	4153	4417
Imports of goods and services	3133	3297	3481	3712	3963	4224



Prices and costs indicators

(annual percentage changes unless specified)

	2009	2010	2011	2012	2013	2014
HICP headline inflation	0.3	1.2	1.5	1.7	1.8	1.8
Inflation ex-energy	1.3	1.8	1.3	0.5	1.9	1.9
GDP deflator	1.1	1.2	1.7	1.8	1.9	1.9
Import deflator	-1.6	2.5	2.3	2.0	1.8	1.8
Export deflator	-9.5	8.6	2.1	1.2	1.5	1.9
Terms of trade	-7.9	6.1	-0.3	-0.8	-0.3	0.1
Earnings	1.3	1.2	2.0	2.8	3.1	3.2
Unit labor costs	3.7	-0.4	0.3	1.3	1.6	1.7
Output gap (% of GDP)	-5.3	-4.7	-3.8	-2.9	-2.2	-1.6
Oil prices (€ per barrel)	44.2	58.4	61.4	64.0	67.3	71.7
Euro effective exchange rate (1995=100)	129.7	124.8	122.0	119.7	117.7	116.3

	2009				2010			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
HICP headline inflation	0.9	0.2	-0.4	0.4	0.8	1.0	1.4	1.5
Inflation ex-energy	1.7	1.5	1.2	1.0	1.3	1.9	1.7	2.2
GDP deflator	2.0	1.2	1.0	0.4	0.7	1.2	1.3	1.7
Import deflator	-0.1	-1.5	-2.4	-2.5	1.0	2.8	2.6	3.6
Export deflator	-7.1	-9.9	-13.1	-7.8	8.5	9.0	7.5	9.5
Terms of trade	-7.0	-8.3	-10.7	-5.3	7.5	6.1	4.9	5.9
Earnings	2.1	1.3	1.1	0.5	1.2	1.1	1.2	1.4
Unit labor costs	5.7	4.6	3.4	1.4	-0.2	-0.5	-0.3	-0.4
Output gap (% of GDP)	-5.1	-5.4	-5.3	-5.5	-5.2	-4.9	-4.5	-4.3
Oil prices (€ per barrel)	34.2	43.2	47.7	50.5	55.8	59.3	59.1	59.5
Euro effective exchange rate (1995=100)	128.0	128.9	130.2	131.8	127.0	124.8	123.6	123.7



Labor market

(annual percentage changes unless specified)

	2009	2010	2011	2012	2013	2014
Employment	-1.8	-0.9	0.0	0.6	0.8	0.7
Unemployment rate (%)	9.4	10.4	10.8	10.5	9.9	9.4
NAIRU (%)	7.8	8.3	8.5	8.5	8.4	8.3
Participation rate (%)	72.9	72.8	73.0	73.3	73.6	73.9
Earnings	1.3	1.2	2.0	2.8	3.1	3.2
Unit labor costs	3.7	-0.4	0.3	1.3	1.6	1.7

	2009				2010			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employment	-1.3	-1.9	-2.1	-2.0	-1.4	-1.0	-0.7	-0.6
Unemployment rate (%)	8.8	9.3	9.7	9.9	10.1	10.4	10.6	10.7
NAIRU (%)	7.7	7.8	7.9	8.0	8.1	8.2	8.3	8.4
Participation rate (%)	72.9	72.9	72.8	72.7	72.8	72.9	72.9	72.8
Earnings	2.1	1.3	1.1	0.5	1.2	1.1	1.2	1.4
Unit labor costs	5.7	4.6	3.4	1.4	-0.2	-0.5	-0.3	-0.4



Current account and fiscal balance

	2009	2010	2011	2012	2013	2014
Trade balance (€ bn)	17.4	18.0	22.6	38.5	46.0	43.6
Trade balance (% GDP)	0.2	0.2	0.3	0.5	0.6	0.5
Current account balance (€ bn)	-58.4	15.7	23.6	38.8	48.3	46.7
Current account balance (% GDP)	-0.7	0.2	0.2	0.4	0.5	0.4
Government budget balance (€ bn)	-567	-622	-524	-424	-344	-275
Government budget balance (% GDP)	-6.3	-6.8	-5.5	-4.3	-3.4	-2.6
Cyclically adjusted surplus (+)/deficit (-) (% GDP)	-6.2	-6.0	-4.1	-2.3	-0.7	0.6
Government debt (€ bn)	6836	7505	8122	8637	9064	9419
Government debt (% GDP)	91.6	99.7	106.1	110.6	113.6	115.5

Measures of convergence/divergence within the Eurozone

	1999-2003	2004-2008	2009-2013
Growth and incomes			
Standard deviation of GDP growth rates	1.9	1.9	1.3
Growth rate gap (max-min)	7.2	7.2	3.7
Highest GDP per capita (Eurozone=100)	228.1	244.5	242.3
Lowest GDP per capita (Eurozone=100)	23.6	23.7	24.4
Inflation and prices			
Standard deviation of inflation rates	2.1	0.9	0.7
Inflation rate gap (max-min)	8.1	3.7	3.1
Highest price level (Eurozone=100)	114.9	116.7	113.2
Lowest price level (Eurozone=100)	42.6	56.1	66.0



Cross-country tables

Real GDP

(% year)

Rank		2009	2010	2011	2012	2013	2014	Average 2010-2014
1	Slovakia	-4.7	2.9	4.4	5.3	5.2	4.3	4.4
2	Finland	-7.8	1.5	3.0	4.7	4.8	3.4	3.5
3	Slovenia	-8.1	0.9	2.2	3.9	4.1	3.8	3.0
4	Luxembourg	-4.5	1.7	2.1	2.9	3.3	3.0	2.6
5	Cyprus	-1.7	-0.1	2.1	3.3	3.8	3.4	2.5
6	Ireland	-1.8	1.4	2.0	2.8	3.0	3.0	2.4
7	Malta	-7.1	-1.6	3.7	3.4	3.2	3.6	2.4
8	Belgium	-3.0	1.4	2.0	2.3	2.7	2.1	2.1
9	Netherlands	-4.0	1.0	2.0	2.4	2.6	2.3	2.1
10	Germany	-4.9	1.5	1.9	2.1	2.3	2.3	2.0
11	Austria	-3.5	1.4	1.8	2.2	2.1	2.0	1.9
12	France	-2.2	1.2	1.8	2.2	2.0	2.0	1.8
13	Eurozone	-4.0	1.0	1.6	2.1	2.2	2.2	1.8
14	Italy	-5.1	0.8	1.0	1.5	2.0	1.9	1.4
15	Portugal	-2.7	0.5	1.0	1.6	1.1	1.3	1.1
16	Spain	-3.6	-0.4	0.8	1.4	1.6	1.9	1.1
17	Greece	-2.0	-3.0	-1.4	1.2	2.0	2.9	0.3

Inflation rates

(% year)

Rank		2009	2010	2011	2012	2013	2014	Average 2010-2014
1	Finland	1.6	0.4	1.1	1.4	1.5	1.5	1.2
2	Ireland	-1.7	-1.2	1.1	2.0	2.0	2.0	1.2
3	Portugal	-0.9	0.9	1.0	1.0	1.9	1.8	1.3
4	Germany	0.2	1.1	1.3	1.4	1.6	1.7	1.4
5	Greece	1.3	3.1	0.7	0.7	1.2	1.6	1.5
6	Spain	-0.3	1.5	1.4	1.5	1.8	1.7	1.6
7	Eurozone	0.3	1.2	1.5	1.7	1.8	1.8	1.6
8	Netherlands	1.0	0.7	1.6	1.9	2.0	2.0	1.6
9	Belgium	0.0	1.4	1.6	1.7	1.8	1.8	1.6
10	France	0.1	1.4	1.7	1.8	1.9	1.9	1.7
11	Italy	0.8	0.8	1.8	2.1	2.1	2.1	1.8
12	Austria	0.4	1.5	1.8	2.0	1.9	1.9	1.9
13	Malta	1.8	1.2	1.9	2.3	2.3	2.3	2.0
14	Slovakia	1.6	1.4	2.1	2.1	2.2	2.2	2.0
15	Luxembourg	0.0	2.0	2.2	2.0	2.0	2.0	2.0
16	Cyprus	0.2	2.5	2.0	2.2	2.3	2.3	2.3
17	Slovenia	0.8	2.2	2.5	2.7	2.8	2.8	2.6



Cross-country tables

Unemployment rate (%)								
Rank		2009	2010	2011	2012	2013	2014	Average 2010-2014
1	Netherlands	3.4	4.5	4.9	4.7	4.4	4.3	4.6
2	Austria	4.8	5.3	5.5	4.9	4.5	4.4	4.9
3	Cyprus	5.3	5.5	5.3	4.9	4.6	4.6	5.0
4	Luxembourg	5.7	6.4	5.9	5.4	5.0	4.5	5.4
5	Slovenia	6.0	7.2	6.5	5.5	5.1	5.1	5.9
6	Malta	7.0	7.4	6.7	6.0	5.6	4.8	6.1
7	Belgium	7.9	8.3	8.2	8.0	7.8	7.7	8.0
8	Germany	7.5	7.9	8.5	8.5	8.0	7.4	8.1
9	Italy	7.8	9.0	9.2	8.8	8.6	8.4	8.8
10	Finland	8.2	10.2	10.1	8.7	7.7	7.4	8.8
11	Portugal	9.6	10.5	9.3	8.8	8.6	8.5	9.2
12	France	9.4	10.6	10.9	10.3	9.5	8.8	10.0
13	Eurozone	9.4	10.4	10.8	10.5	9.9	9.4	10.2
14	Slovakia	12.0	15.1	13.5	10.5	9.0	8.4	11.3
15	Ireland	11.8	13.0	13.1	13.2	13.2	12.9	13.1
16	Greece	9.5	11.9	13.4	14.1	14.4	14.4	13.7
17	Spain	18.0	19.2	19.5	19.0	17.8	16.3	18.4

Public deficits (% of GDP)								
Rank		2009	2010	2011	2012	2013	2014	Difference 2010-2014
1	Malta	-4.7	-4.5	-4.2	-3.7	-3.2	-3.0	1.7
2	Germany	-3.9	-5.2	-4.5	-3.6	-2.8	-2.1	1.8
3	Luxembourg	-3.0	-4.5	-3.7	-2.5	-1.5	-1.0	2.0
4	Finland	-2.3	-4.9	-4.1	-2.2	-0.6	-0.2	2.1
5	Italy	-5.3	-5.5	-4.6	-3.9	-3.4	-3.1	2.2
6	Netherlands	-4.9	-6.2	-5.2	-4.0	-3.0	-2.1	2.8
7	Austria	-4.3	-5.0	-4.0	-2.6	-1.8	-1.4	2.9
8	Cyprus	-6.1	-6.5	-5.1	-3.6	-2.9	-2.5	3.6
9	Eurozone	-6.3	-6.8	-5.5	-4.3	-3.4	-2.6	3.7
10	Slovakia	-6.3	-6.4	-4.8	-3.6	-2.8	-2.3	3.9
11	France	-7.5	-8.7	-6.9	-5.2	-3.9	-3.1	4.4
12	Belgium	-5.9	-4.6	-4.0	-3.2	-2.2	-1.0	4.9
13	Slovenia	-5.9	-5.7	-4.5	-3.5	-1.8	-0.7	5.2
14	Portugal	-9.3	-8.5	-7.2	-5.0	-3.6	-3.1	6.2
15	Spain	-11.4	-10.3	-8.3	-6.5	-5.3	-3.5	7.9
16	Ireland	-12.8	-10.9	-8.1	-7.0	-5.8	-4.6	8.3
17	Greece	-12.7	-9.6	-6.0	-4.4	-3.3	-2.9	9.8

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