

Ernst & Young Eurozone Forecast

Summer Edition

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Foreword

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Since Ernst & Young launched our first Eurozone Forecast on 16 April, developments within the Eurozone have continued to be dramatic with ongoing debate about sovereign bonds, the future of fiscal governance and indeed the future of the Euro itself.

The European business community shows a great deal of justifiable concern for the weak state of public finances but also for the manner in which governments may seek to address this. The costs of the current instability are manifested in terms of the risk of higher interest rates, increased inflation, and the strong likelihood of forced and painful fiscal consolidation. Getting the balance wrong, between higher taxes and reduced spending, risks returning the economy to recession. The immediate risks to the economy and to the Eurozone itself should not be underestimated.

From a government point of view, turning the economy around means strengthening public finances and returning to a fiscal position where economies can be stabilized and the capital markets reassured. Experience shows that a process of rising debt ratios is difficult to reverse. Even a decade after the start of the last crisis, most governments ran public debt-to-GDP ratios above pre-crisis levels, according to a recent European Commission report. But nationally focused responses to a collective challenge could easily make the situation worse.

While the current focus on public finance is justified, the crisis at its root is not only fiscal but structural. The first test of the Eurozone model has revealed fundamental flaws in its institutions, which lack the powers to support a more sustainable monetary union, and significant obstacles to the operation of the single market. The appetite of national governments in Europe to seriously address these issues is questionable.

The deterioration of public finances is a consequence of what has happened in the private sector rather than a trigger. There are some encouraging developments that we see today among European corporations and entrepreneurs. They are refocusing their efforts and beginning to increase their activity - particularly in manufacturing - and this is central to turning the

economy in the Eurozone around. But this recovery momentum is fragile. As we detail in the report, "crowding out" effects on private investment are already being seen, concern is being expressed about rising tax burdens and the cost of capital is being affected by renewed trouble in the banking sector. Urgent short-term consolidation measures are needed but these need to be balanced by measures to help the private sector pick up the momentum.

The current crisis has revealed longer term issues for Europe to address. Achieving the same growth in investment as expected for the US over the next five years would lift Eurozone GDP by 1.5% by 2014 and add a cumulative gain of around €300 billion in GDP over 2011-14. That is not, however, what is forecast. Indeed the impact of the sovereign debt crisis has been to reduce the prospects for the Eurozone.

Turning the situation around, however, will require radical change and strong political leadership. The untapped potential for innovation and entrepreneurship in Europe is huge but can only be released by strong political leadership to reform our markets, our labor practices and a renewed commitment to investment in education, training and innovation. To get Europe out of its current economic difficulties requires a renewed focus at both national and European level on the functioning of our markets and institutions. Now is a critical time for the Euro and business needs to actively engage in this urgent debate on our future.

We hope that you find our Eurozone Forecast useful - whether you are based in the Eurozone or one of the many 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.

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Recovery still underway despite growing uncertainty



European companies and entrepreneurs are sparing no effort to increase their activity and to take advantage of a robust upturn in global trade and industrial activity. Simultaneously, companies operating in Europe need to be ready for very limited growth in their markets, especially in the South.

Organizations need to achieve sustainable growth to ensure the Eurozone recovery continues. With volatility still high across the Eurozone, companies are reassessing their growth strategies, looking to innovation, industry consolidation, entrepreneurship and expansion into emerging markets to power their long-term plans. However, with capital markets remaining highly volatile, limited access to credit could prevent companies implementing these strategies and, ultimately, could put the recovery of the Eurozone at risk.

Most sectors are benefiting of the upturn, but the rebound in manufacturing activity is particularly marked. Looking at a cross-section of sectors, corporate profitability has recently stabilized and should start trending upwards in coming months. The chemical and automotive sectors are seeing a particularly significant improvement, although remaining far below pre-crisis levels.

But this recovery momentum is fragile and companies' investment decisions are already heavily influenced by the growing concerns about fiscal sustainability; which led to renewed instability on financial markets and a loss of confidence in the euro. These risk factors are clearly stressed in the Ernst & Young report and are of direct concern for companies.

To restore trust and avoid leaving an unbearable burden for future generations, many governments are prescribing tough but necessary medicine today. They are right to act swiftly.

"Crowding out" effects on private investments are already being seen. It is not only risk premia for companies operating in countries with severe fiscal imbalances that are rising today. The availability and cost of capital for all companies is gradually being affected by renewed trouble in the banking sector. Companies are also

concerned about the impact of this crisis on future tax levels, which is obviously not conducive to an investment-led recovery in a continent where the heavy tax burden is already perceived as a handicap to being globally competitive. Governments will have to address their need for raising tax revenues in the coming years but it is still uncertain whether tax policies will target corporates or individuals, and whether they will be in the shape of income or indirect taxes. Either way, these changes will have an impact on the recovery.

Consolidation measures are needed, but they should be well calibrated. It is very important that fiscal consolidation strategies are sufficiently coordinated and accompanied by measures to help the private sector pick up the momentum. Growth and fiscal sustainability must come together.

As stressed in our Eurozone Forecast, successful consolidation strategies in the past were always based on significant expenditure cuts and market reforms, rather than induced by rising taxation. Credible reforms of the public sector and social security systems and a renewed commitment to investment in education, training and innovation are the way forward.

But to get Europe out of its current economic difficulties, more radical changes in functioning of markets and institutions will be needed.

The untapped potential for innovation and entrepreneurship in Europe is huge and must be released by improving companies' access to global markets and finance, by reforming labor markets and by strengthening Europe's industrial base and digital economy.

Decision-makers must come to grips with the simple fact that companies are not part of the problem today, rather they are the solution.

- Pre-crisis indulgence and governance failure take their toll on the euro area

The current sovereign debt crisis has cast a long shadow on the euro's credibility and stability.

While the recent depreciation of the single currency is providing additional impetus to a predominantly export-led recovery, the parallel rise in risk premia and declining confidence will have a significant knock-on effect on medium-term prospects for growth, investment and, ultimately, job creation. This Ernst & Young Eurozone Forecast alerts us to an important point: the fact that a weaker euro is not sufficient to address structural competitiveness imbalances.

The instability that we are currently witnessing dates back to a period long before the financial crisis broke out. It is the result of years of indulgence at the national level and poor economic governance at euro area and EU level.

Both the financial and sovereign debt crises share a number of important features: easy money as markets barely differentiated risks amongst euro-area members high leverage and pro-cyclical behaviors (high debts and deficits and insufficient consolidation in good times); poor accounting and misreporting; and insufficient supervision (Stability and Growth Pact).

Beyond individual responsibility, this crisis has revealed crucial failure of the institutional framework of the European Monetary Union (EMU) to enforce discipline in the good times and prevent fiscal and broader macroeconomic imbalances from developing in the first place.

The current public finance crisis is a collective failure and should be addressed as such. Better surveillance and a much stronger preventive system are needed, together with faster and more forceful compliance mechanisms.



- **A new stability culture for the euro**

The business community at large is showing indefatigable support for the euro. It is one of the fundamental pillars of European integration and has brought great benefits to companies and citizens across our continent. Its stability and credibility is of highest importance and greatly influences the business environment not only in Europe but globally.

A sense of urgency and priority is critical to the current debate on euro area governance.

Surveillance of economic policies will need to be significantly reinforced. The Stability and Growth Pact (SGP) remains the appropriate instrument to coordinate budgetary policies in the euro area, but it will need to be strengthened, complemented and better enforced.

A more closely integrated budgetary process at both the national and European levels would provide important added value. This would require earlier discussions in the Eurogroup, a more integrated approach to the surveillance of member states and a more extended role for the European Commission.

The true underlying fiscal position of member states must be better understood and consideration given not only to the initial structural budget position and debt level, but also to the long-term growth potential of an economy, future contingent liabilities related to demographic trends and off-balance sheet financial commitments. Recent events have demonstrated that these reports, plus competitive imbalances and the accumulation of excessive private debt, are considered important hidden liabilities.

Stress tests to assess the impact of worse-case scenarios on public finance should be generalized and exposure to adverse shocks such as housing market or asset price corrections appropriately factored in.

The European Systemic Risk Board should also be part of a better preventive system. As such, it would issue early warnings about the emergence of excessive credit expansion and asset price misalignments across euro area member states in order for remedial action to be taken.

Strong and automatic enforcement mechanisms are crucial for the effectiveness of fiscal rules. This should start by requiring member states to make non-interest-bearing deposits when they fail to consolidate sufficiently in good times. At present, such a mechanism has only been proposed in the context of excessive deficit procedures, at a time when fiscal imbalances have already become a severe drag on the health of the economy.

Activation of a pre-emptive deposit scheme would create the incentives to run prudent, counter-cyclical budgetary policies in good times allowing sufficient room to maneuver in bad times. The deposits could be returned once improvement has been verified or they could be extended under stricter conditions if excessive deficit procedures are launched. These deposits would be transferred to a "rainy day" fund in cases of repeated indiscipline.

In the medium term, the euro area needs to be equipped with a more permanent crisis resolution system to fend off market speculation in times of severe financial stress, at the same time, preventing moral hazard. In a last resort situation, this system should allow for debt restructuring or orderly default.

- **Sense of direction and political leadership is needed**

The business community is supportive of the emergency actions that have been undertaken in recent months to safeguard financial stability and preserve a fragile recovery momentum.

The business community, Europe's citizens and our global partners are watching what is going on in Brussels and our national capitals very closely.

It is therefore essential that the European decision-makers set the right course of action and instill an even greater sense of urgency in the current debate.

Everyone, business in particular, wants to see the euro area resolve its current difficulties and emerge stronger from the turmoil.

Highlights



Is the Eurozone heading for a lost decade?

- The threat of a Greek default may have been postponed, but financial stress in the Eurozone remains high, with bond spreads in fiscally stretched economies still wide, the euro nose-diving and stock markets still volatile. The crisis is far from over and the repercussions will be felt over several years as the need to restore sound public finances will hit growth, potentially derailing an already lacklustre Eurozone economy. We forecast Eurozone GDP growth of 0.8% this year, 1.3% in 2011 and 2.1% on average in 2012-14.
- After months of half-hearted statements, the EU governments presented a comprehensive package of measures to address the sovereign debt crisis, with an impressive headline total of €750 billion. After the €110 billion EU-IMF Greek package, these measures were aimed primarily at the other Eurozone countries most under threat, mainly Spain and Portugal, and more generally at any EU country that could start facing the same kind of financial market pressure and debt financing difficulties. Meanwhile, most Eurozone countries have announced fiscal packages to reduce the budget deficit.
- The repercussions of the sovereign debt crisis will lead to growth in the Eurozone being 1-2.5 percentage points (ppts) lower than in the US in each of the next five years and some Eurozone economies enduring a "lost decade". In the period to 2014, growth in Eurozone GDP is forecast to be nearly 9% lower than US GDP, which amounts to nearly €2,500 per citizen. The impact on jobs is just as striking. While the US economy will generate more than 10 million new jobs by 2014, employment levels will barely change in the Eurozone.
- Poor growth prospects will hamper the Eurozone's attractiveness as a location for doing business. Surveys of business decision-makers also show that the Eurozone risks losing its attractiveness as a region in which to invest. We estimate that increasing investment growth in 2011-14 to the same rates that we expect for the US would lift Eurozone GDP by 1.5% over a four-year period. This is equivalent to a cumulative gain of around €300 billion in GDP over 2011-14. Similarly, employment would be around 600,000 higher than our baseline forecast by 2014. However, to rise to this challenge, investment in new technologies, from IT to green sectors, combined with reforms to labor and product markets, is needed.
- Policy-makers also need to work on the institutional framework of the Eurozone. Governments and the European Commission need to address the fundamental flaws that led to the crisis, namely the lack of fiscal policy coordination and overdue structural reforms.
- Moreover, action is needed to tackle the imbalances within the Eurozone that are at the root of the current crisis. This means addressing the factors contributing to the bubbles and unsustainable growth that occurred in countries such as Greece, Ireland, Portugal and Spain (what we term here the "South") as well as the causes of anemic domestic demand in the "North". The former implies a need to foster development of new sectors to take up the slack left by collapsed construction and real estate sectors. The latter requires reforms of labor, product and financial markets.



• 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 as well as an archive of previous releases.

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

Is the Eurozone heading for a lost decade?

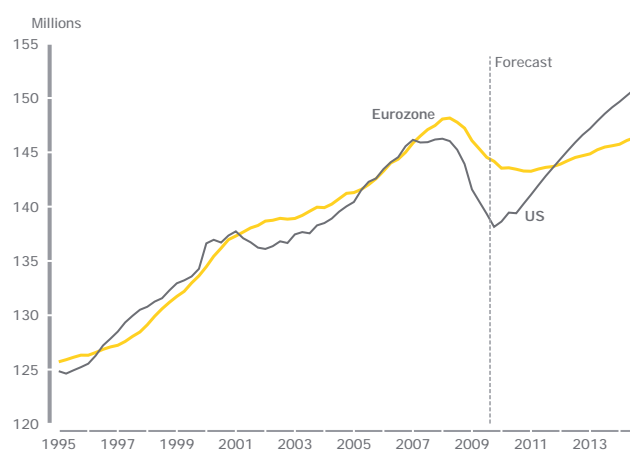


Sovereign debt has hit Europe hard ...

The sovereign debt crisis has hit hard an already very fragile Eurozone economy. The consequences are still unfolding, but it seems clear that they will depress Eurozone growth for several years to come. We have revised our forecast for GDP growth in the Eurozone down to 0.8% this year, 1.3% in 2011 and 2.1% on average in 2012-14, compared with 1%, 1.6% and 2.2%, respectively, in our Spring 2010 report. The growth rate in the Eurozone is expected to be 1-2.5 ppts lower than in the US in each of the next five years. Over the five-year forecast horizon, Eurozone GDP will grow by 9% less than US GDP, which amounts to nearly €2,500 per citizen. The impact on jobs is just as striking. While we expect the US economy to generate more than 10 million new jobs by 2014, employment levels will barely change in the Eurozone.

Moreover, the risks to the outlook for the Eurozone are skewed to the downside. As explained in this report, unless the Eurozone tackles necessary structural reforms in combination with deficit reduction measures, it risks a "lost decade" of very meager growth and deflation, especially for the countries in the South. Indeed, there are signs that Eurozone policy-makers are repeating many of the failures that led to Japan's poor performance and deflation over the last 20 years (see Box 1, page 9).

Figure 1
Employment total



Source: Oxford Economics

... forcing governments to rise to the challenge at last

After months of half-hearted statements, the EU governments presented, in early May, a comprehensive package of measures to shore up the Eurozone, with an impressive headline total of €750 billion. After the €110 billion EU-IMF Greek package, these measures were aimed primarily at the other Eurozone countries most under threat, mainly Spain and Portugal. The ECB has also stepped in by buying government bonds.

Table 1

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

Source: Oxford Economics

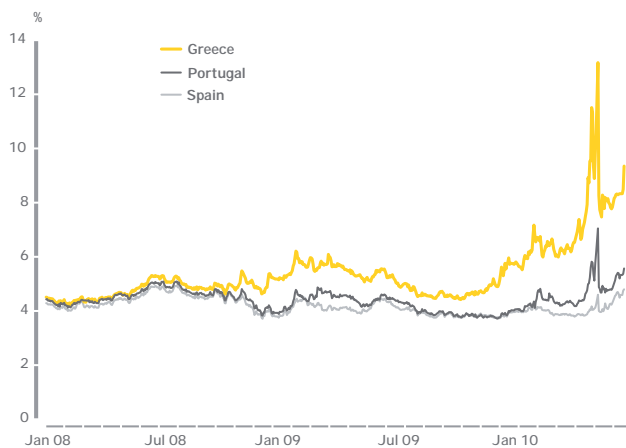
	2009	2010	2011	2012	2013	2014
GDP	-4.1	0.8	1.3	1.9	2.1	2.1
Private consumption	-1.2	0.0	0.6	1.4	1.7	1.8
Fixed investment	-10.9	-2.9	1.2	2.7	3.1	3.0
Stockbuilding (% of GDP)	-0.6	0.1	0.3	0.4	0.5	0.6
Government consumption	2.7	1.2	-0.3	0.4	0.9	1.2
Exports of goods and services	-13.2	6.0	4.5	6.4	6.5	5.9
Imports of goods and services	-11.9	5.1	3.3	5.7	6.3	5.9
Consumer prices	0.3	1.5	1.5	1.5	1.7	1.8
Unemployment rate (level)	9.4	10.2	10.5	10.3	9.9	9.4
Current balance (% of GDP)	-0.7	-0.2	-0.2	0.1	0.4	0.4
Government budget (% of GDP)	-6.3	-6.5	-5.2	-4.2	-3.4	-2.7
Government debt (% of GDP)	78.8	82.3	86.3	88.3	89.0	88.9
ECB main refinancing rate (%)	1.1	1.0	1.3	2.6	3.1	3.5
Euro effective exchange rate (1995=100)	129.7	115.7	108.6	109.9	111.7	112.0
Euro/US dollar exchange rate (\$ per €)	1.39	1.19	1.05	1.09	1.14	1.16



Will the EU package be enough?

The initial market reaction to this package was positive. €750 billion was perceived to cover the financing needs of Spain, Portugal and Ireland over the next few years. But, after an initial rapid fall, government bond yields in the peripheral countries have risen again. Interest rates on Spanish 10-year bonds, for instance, went from below 4% in early April to 4.45% on 7 May 2010, back down to around 4% on the following day, and then back up again to above 4.8% as of mid-June.

Figure 2
Eurozone: bond yields



Source: Oxford Economics/Haver analytics

Ongoing worries about the fiscal sustainability of some Eurozone countries, and their reluctance to tackle the underlying problems, are also weighing heavily on the euro. The euro currently stands at around US\$1.20, its lowest since early 2006 and nearly 20% below its value at the beginning of 2010.

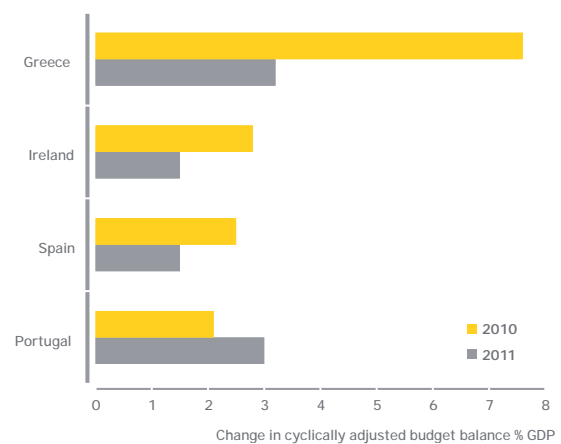
But years of stagnation ahead in the South ...

The problem is that, even if it works, the package can only help fireproof any escalation of the financial crisis. It does not solve the fundamental issues facing the Eurozone.

In particular, the problem countries still have to implement drastic deficit-reduction measures to restore the sustainability of their fiscal positions and it remains to be seen whether they can deliver. According to the IMF plan, Greece is meant to tighten its cyclically adjusted budget balance by 7.5% of GDP this year and a further 3.25% of GDP in 2011 and, not surprisingly, that is meeting massive public resistance. But Ireland, Spain and Portugal, as well as Greece,

are also seeking to tighten their fiscal stance by around 5% of GDP over a two-year period.

Figure 3
Fiscal tightening plans for 2010 and 2011



Source: IMF/Oxford Economics

Fiscal adjustment on this scale will have a very negative impact on economic growth. This year, much of the fiscal tightening is happening via tax increases, which experience shows are often particularly detrimental to growth. But even when the fiscal tightening shifts more toward cuts in expenditure, the packages will significantly restrict GDP growth, which in turn will limit the extent of any improvement in fiscal positions as it depresses tax revenues and adds to social security costs.

In addition, the prospect of years of weak or negative economic growth that faces the South is likely to have a negative impact on confidence, further undermining consumer spending and business investment. Moreover, within the Eurozone, there is no potential for an offsetting exchange rate devaluation that would boost competitiveness and net trade in the way that helped to ease the fiscal adjustments of the UK and Scandinavian economies in the early 1990s. A weaker euro helps to a degree, but it is not sufficient to address the fundamental competitiveness problem that the South now faces, which points to the risk of prolonged deflation.

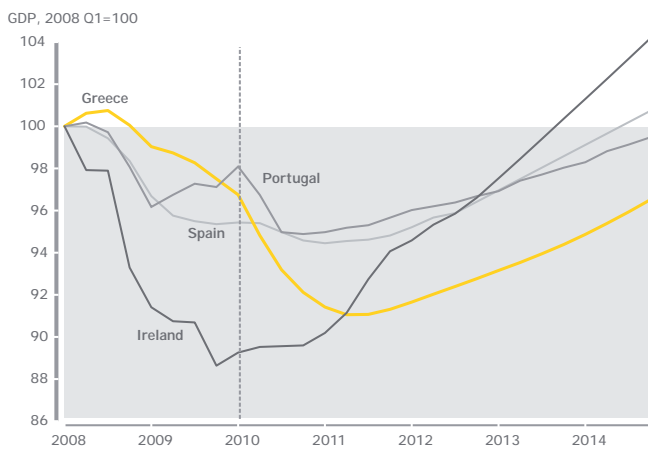


Is the Eurozone heading for a lost decade?

... and very real danger of eventual default ...

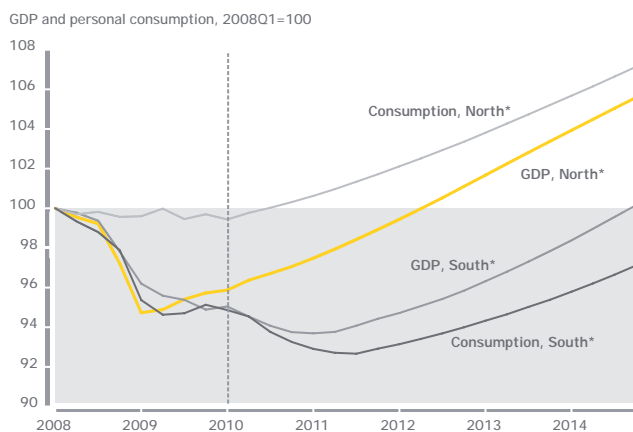
This means that countries in the South, with the exception of Ireland, are not expected to get back to their pre-crisis levels of activity until 2014, and all face significant further rises in unemployment. As a result, these countries could become "austerity weary" and not able to stay the course of fiscal adjustments, let alone achieve the fall in relative wages that is needed to restore their competitiveness within the Eurozone. An eventual default or restructuring is, therefore, still a very real danger.

Figure 4
Back to pre-crisis by 2010 only



Source: Oxford Economics/Haver Analytics

Figure 5
Lost decade in the South



* North = Germany, France, Netherlands, Belgium
* South = Spain, Greece, Portugal, Ireland

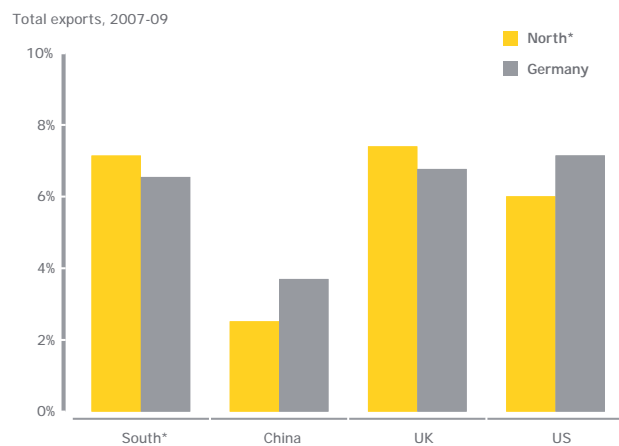
Source: Oxford Economics

... and growth is now likely to be weaker in the North too ...

Although the economic and fiscal situation is less precarious in the rest of the Eurozone, the sovereign debt crisis will have repercussions for all member states. One immediate consequence is likely to be weaker growth throughout the Eurozone.

Put together, the four countries in the South absorb around 7% of exports from the North (Germany, France, the Netherlands and Belgium), about as much as the UK or the US. So, while trade links with the South are not big enough in themselves to pull the North back into recession, they are sufficient to have a notable impact on their exports.

Figure 6
Trade spillovers



* North = Germany, France, Netherlands, Belgium
* South = Spain, Greece, Portugal, Ireland

Source: IMF/Oxford Economics



Box 1

Is the Eurozone repeating the pattern of Japan?

In the aftermath of the global financial and economic crisis, the bleak economic climate and fiscal and banking sector problems have led to mounting concerns that the Eurozone may be about to repeat the mistakes that were made in Japan that led to its poor economic performance in the 1990s and 2000s. This Box looks at the similarities, but also highlights some key differences.

Japan in the 1990s endured its lost decade, a long period of economic stagnation, after its property and stock market bubbles burst. In response to the deep crisis, the Bank of Japan cut short-term interest rates to zero for much of the decade while the Government tried to bolster the economy with frequent spending initiatives. But the situation worsened significantly in 1997 when the Government misread some positive economic signals and tightened fiscal policy prematurely, which led to the entrenchment of deflation. GDP fell in 1998 and 1999 and there was deflation in each year from 1999 to 2005. According to Japanese analysts, the situation did not improve until the Government started to remove non-performing loans (NPLs) from the banking system in 2002. But even then progress was slow, with growth remaining sluggish.

With underlying inflation (excluding oil price moves) in the Eurozone very low and moves to tighten fiscal policy about to be accelerated in a number of countries, including Germany, there are fears that this might trigger a move back into recession and a lengthy period of deflation. There are also similarities in the approach to banking sector problems. As in Japan, Eurozone banks have been hit hard by collapsing property and asset prices, with banks unable to write down NPLs to true market value for fear of insolvency. Despite large capital injections, until these NPLs are cleared from their books, the banks remain undercapitalized and are reluctant to restart large-scale new lending. Arguably, the European authorities have been slow to recognize and deal with the problems in the banking sector compared with their US and UK counterparts, again uncomfortably echoing the Japanese experience.

Slowness to recognize the scale of economic problems and put in place effective measures to deal with them has also been evident in the Eurozone's approach to the fiscal crisis. The protracted process of dealing with the Greek crisis allowed market sentiment to deteriorate dramatically and contributed to the crisis spreading to other parts of the Eurozone.

Arguably, monetary policy has also been too cautious, which has resulted in excessive dependence on fiscal policy – another possible parallel with Japan. While the UK and US have engaged in substantial quantitative easing as well as cutting interest rates to near zero, the ECB's "non-standard" monetary policy operations have been very limited in scope. That said, the ECB has still been arguably faster to respond to the financial crisis than the Bank of Japan was in the 1990s, and it also has the benefit of an inflation target – which the Bank of Japan lacked – that perhaps reduces the risk of a slide into deflation. The design of fiscal policy responses in the Eurozone may also be criticized, with the car scrappage schemes arguably only pulling some demand into 2009 at the expense of 2010 rather than providing a kick start for recovery. A number of the fiscal policy approaches taken in Japan were subject to similar criticism.

So, there are some worrying parallels between recent developments in the Eurozone and Japan. However, it should be noted that the Eurozone does not face the same scale of collapse in asset prices or the same scale of demographic problems (yet) that contributed to very weak Japanese growth in the 1990s. It is also not too late to improve policy responses – for example, by moving faster to clean up banks and put in place a coherent approach to fiscal policy management that will restore market confidence. But, in the absence of such moves, the Eurozone risks entering a deflation trap with some "Japanese characteristics".

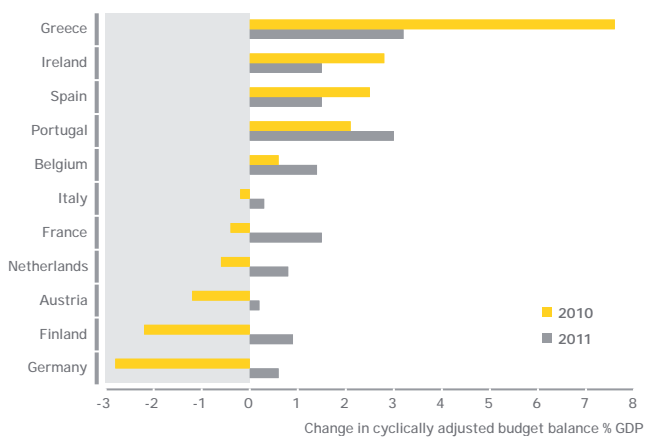


... as they are provoked into more and quicker fiscal tightening ...

More importantly, however, than the impact of the sovereign debt crisis on the trade performance of the North is its impact on domestic demand. In particular, consolidation of public finances will now happen much faster than would have been the case otherwise across the whole Eurozone and not only in the countries currently under closest scrutiny by markets.

For instance, the German Government has abandoned planned tax cuts next year and announced €80 billion worth of spending cuts and tax increases over four years, amounting to 0.75% of GDP per year. The French Government has committed to very tight plans that would keep current expenditure (excluding wages and salaries) constant in real terms, and the Italian Government has announced a new package aimed at saving €25 billion (around 1.5% of GDP) over the next two years. Overall we estimate that in the North the fiscal stance will be tightened by 1% of GDP next year and by around 0.5% per year in each of 2012-14.

Figure 7
Fiscal plans for 2010 and 2011



Source: IMF/Oxford Economics

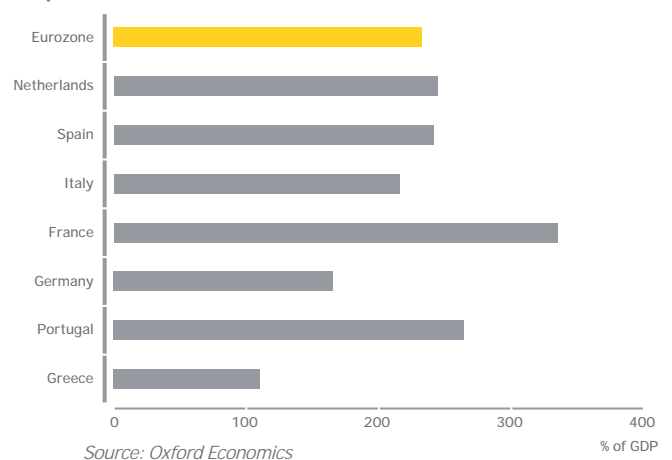
Fiscal tightening will, therefore, weigh on growth across the whole of the Eurozone for many years. But there are a number of other factors that will hold back domestic demand even in the North.

... banks continue to face heavy write-downs ...

For one thing, Eurozone banks are still in a stressed state. Having already written off €238 billion in 2007-09 as a result of the global financial crisis, the ECB estimates that Eurozone banks still face around €200 billion in write-downs this year and next. Moreover,

this could well be an underestimate given the potential for substantial losses on property loans and on the massive lending that took place for companies in countries such as Spain.

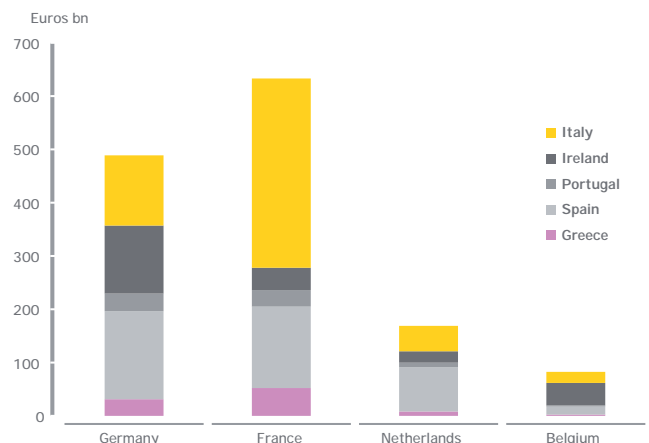
Figure 8
Corporate liabilities in 2009



Source: Oxford Economics

In addition, Eurozone banks are obviously very exposed to the sovereign debt crisis. Precise data on exposure to Greek debt is unavailable, but Bank for International Settlements (BIS) figures show European banks had €130 billion of claims on Greece at the end of 2009, a substantial chunk of which is likely to have been government bonds. Within Europe, the biggest exposures were in France (€52 billion), Germany (€31 billion), the UK (€10 billion) and the Netherlands (€8 billion), although these totals are likely to have shifted around somewhat since then.

Figure 9
European bank exposure



Source: Bank for International Settlements (BIS)



That exposure implies multi-billion dollar losses for the banking sectors of France and Germany, in particular, in the event of a Greek default. And the impact would be greater still if there were major contagion to Portugal, Spain and Italy.

... holding back investment ...

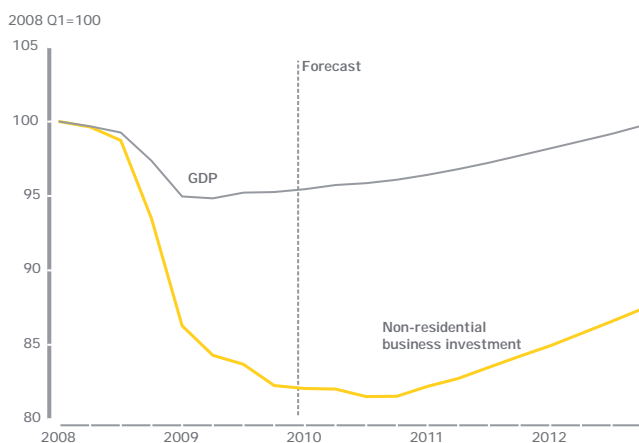
The weakness of the banking sector represents a particular constraint to Eurozone recovery because of the dependence of companies on bank finance to fund investment. External financing comes primarily from bank loans in the Eurozone (around 70%), as opposed to market-based financing in the US.

In addition, the uncertainty about the financial and economic outlook is also likely to depress business investment in the North as well as the South of the Eurozone. We forecast business investment for the Eurozone as a whole to fall by 2.8% this year, on top of a 14% drop last year. And any recovery thereafter will be very slow so that, in 2014, Eurozone business investment remains 5% lower than prior to the global financial crisis.

Moreover, residential investment is likely to be even weaker as markets struggle to adjust to over-investment during the boom: in 2014, residential investment is forecast still to be 10% lower than it was in 2007.

Figure 10

Very slow recovery in investment



Source: Oxford Economics

... and consumers remain cautious

Consumer spending prospects in the North are also weak. Uncertainty about the outlook will cause companies to postpone new hirings and unemployment is set to continue to rise for some

time in most countries, reaching 10.5% for the Eurozone by the end of this year and not peaking until 2011. Household incomes and confidence will therefore remain subdued, exacerbated by cuts in benefits and/or tax increases in many countries. These factors point to private consumption this year remaining, at best, at last year's depressed levels, with little improvement expected in 2011.

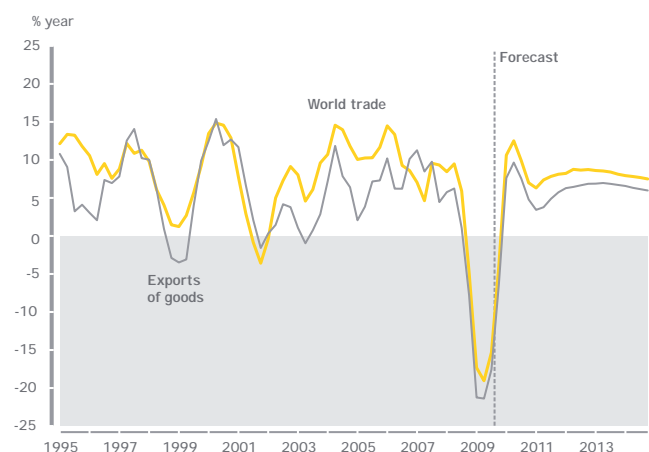
But the North still manages to grow (albeit slowly)

Nevertheless, we still expect the North to avoid the fate of the South and manage some growth in the next couple of years, albeit slow, averaging 0.7% p.a. over 2010-12 compared with -0.1% per year in the South (see Box 2, page 13). Two main factors account for this relative optimism.

First, years of robust productivity growth and wage moderation mean that countries like Germany and the Netherlands are now extremely competitive, and their position has been boosted further by recent falls in the euro. These countries are thus in a good position to reap the benefits of a robust recovery at the global level. While prospects for the Eurozone have weakened since our last report, those for the US and Asia have become more positive (see Box 3, page 16). Demand for euro area exports is expected to rise by around 10% this year and by around 7.5% per annum over 2011-14. And while the Eurozone is expected to continue to lose market share internationally, these losses will not be as rapid as in recent years. Overall, we expect net trade to boost overall Eurozone GDP growth by 0.4 ppts this year and on average 0.3 ppts per year over 2011-14.

Figure 11

World trade and exports of goods



Source: Oxford Economics



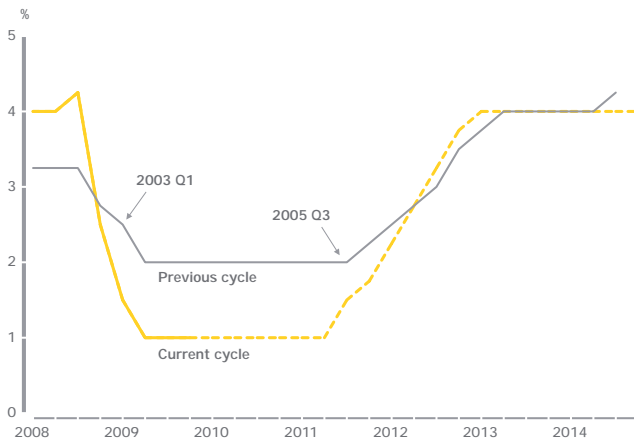
Is the Eurozone heading for a lost decade?

Second, while significant, the fiscal adjustment that is needed in the North is still manageable – but only if the ECB maintains an appropriately supportive monetary stance. Nevertheless, governments do need to avoid the temptation to rush into excessive and premature tightening in an effort to impress the markets. And the ECB needs to play its part in offsetting the negative growth implications of tighter fiscal policy.

The ECB to postpone its exit plans ...

At the beginning of this year, the ECB was preparing the unwinding of the unconventional measures taken in 2008 and 2009 to support the banks and Eurozone economy. Those plans are now on hold. Indeed, as well as purchasing government bonds, the ECB has reinstated some of its unconventional measures (swap lines with the US Federal Reserve and long-term refinancing operations) to provide liquidity to the financial system.

Figure 12
ECB main refinancing rate



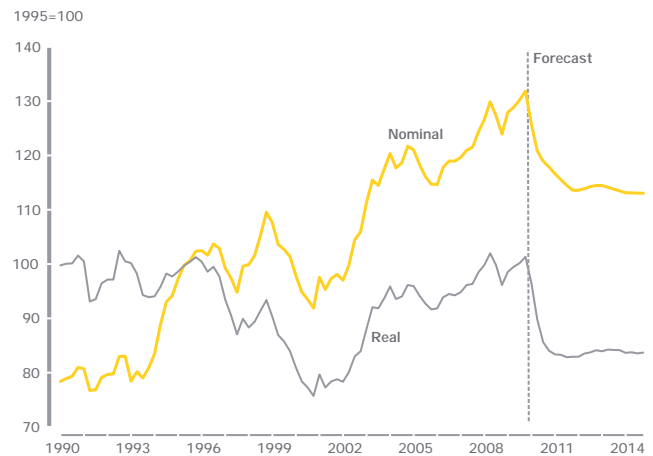
Source: Oxford Economics

But members of the ECB Council are clearly uncomfortable with this position and eager to get policy and interest rates back to “normal” as soon as possible. For instance, at the end of May, J. Stark, a Member of the Executive Board of the ECB, reminded financial markets and analysts that the ECB would proceed with its exit strategy, starting with the end of the one-year refinancing operation. Given the threats to the growth outlook and the absence of inflationary risks – and indeed the risk of deflation in much of the Eurozone – we think that the ECB should avoid any increase in interest rates until at least mid-2011, and rates should rise only gradually thereafter.

... and the euro to remain under pressure

In this bleak environment, the euro is likely to weaken further against other major currencies. We expect the euro to fall to US\$1.05 by the end of next year, and stay at this level, before rising slightly as Eurozone growth picks up. Set against a basket of currencies representing the Eurozone trade structure, this means that the euro will depreciate by around 20% from its peak at the turn of the year.

Figure 13
Euro effective exchange rate



Source: Oxford Economics

More peer scrutiny of public finances needed

More fundamentally, the crisis has clearly demonstrated that the Eurozone needs more policy coordination if it is to be a sustainable monetary union. For one thing, a reform of the SGP and its implementation is needed. The European Commission published some proposals in mid-May that aim to reinforce compliance with the SGP, extend surveillance of macroeconomic imbalances and put in place a framework for crisis management, i.e., to formalize the recent agreement. These proposals are of the right kind. But, as seen during the crisis, reaching an agreement and implementing these changes is likely to meet strong objections from national governments.

Moreover, some of the Commission's proposals are still too timid, focusing on raising awareness of and alarm about potential issues. The EU would still have no enforcement power when macroeconomic imbalances are detected. The sovereign debt crisis has shown that ex-ante policy coordination and scrutiny is essential. If the Eurozone is to function as a monetary union, governments will need to accept a loss of fiscal sovereignty and take some responsibility for public finances in other countries.



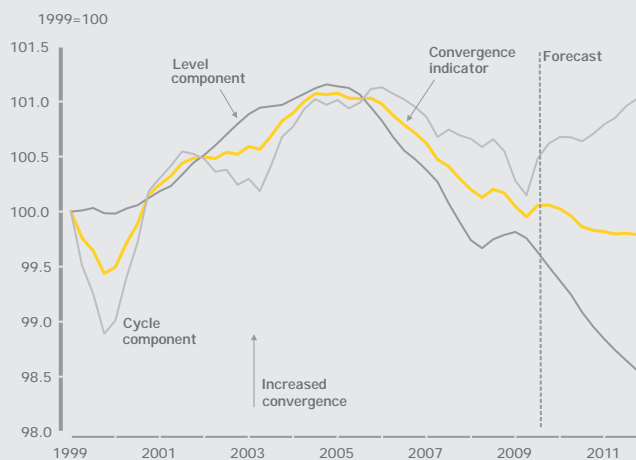
Box 2

Convergence and divergence within the Eurozone

We have updated our indicator of “convergence” within the Eurozone. The indicator looks 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. And, 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.

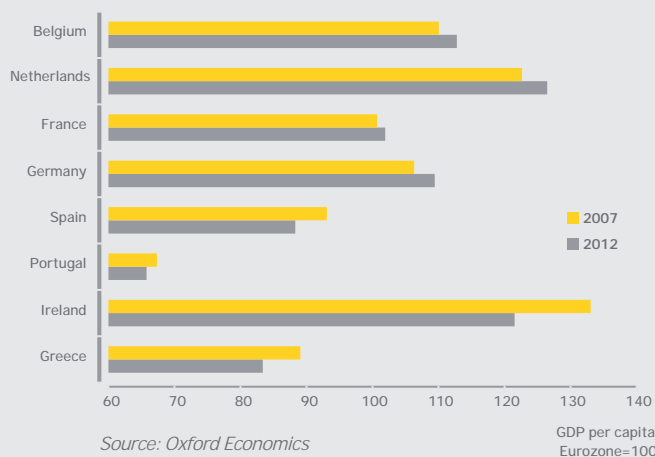
The results are shown in the first chart below. The broad pattern is the same as in our previous report. But the trends are more marked. By the end of next year, divergence in income and price levels will be much wider than it has been since the start of EMU. In fact, we have to go back to 1990 to find such a degree of divergence. Meanwhile, cyclical developments are expected to become more similar across countries, largely because former outperformers in the South are now expected to experience only muted growth, if any.

Figure 14
Convergence within the Eurozone



Source: Oxford Economics

Figure 15
Income gap widens



Source: Oxford Economics

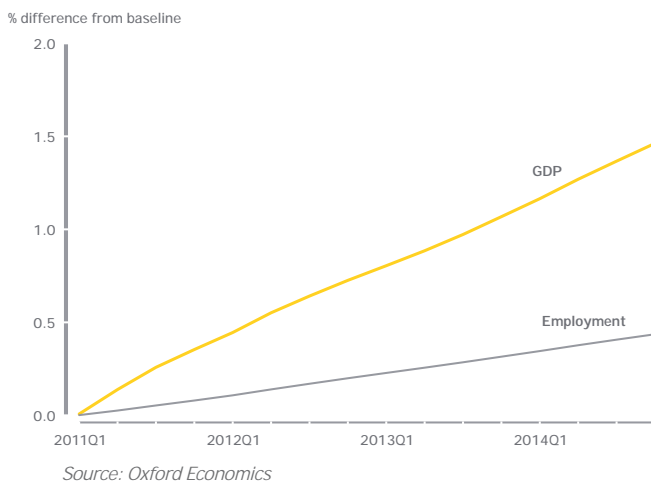
GDP per capita
Eurozone=100



Restructuring of public finances should target medium-term growth

In the current context, Eurozone governments could be tempted to make false savings and change regulation in a way that would hinder business investment and growth in general. For example, increasing corporate tax rates may be seen as a way to reduce budget deficits. However, experience and the economic literature suggest that such measures would be counterproductive. This is supported by the latest findings of the *Ernst & Young European Attractiveness Survey* (see page 17). In a world where locations compete for investment, tax increases are likely to be counterproductive, causing companies to locate investment in other parts of the world.

Figure 16
Impact of investment growth matching the US



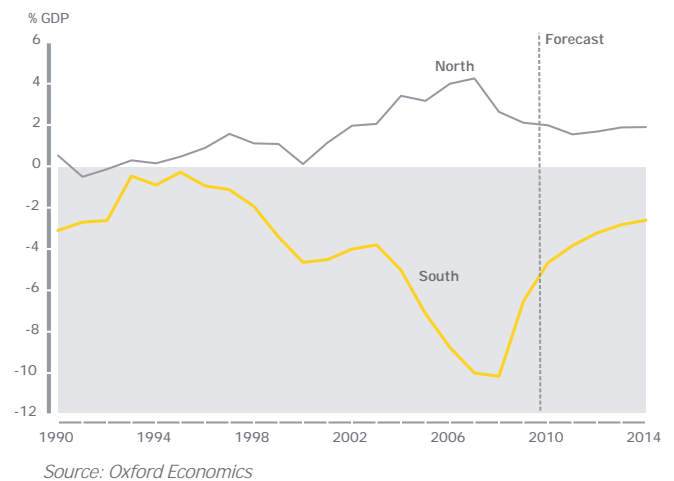
The ECB's macroeconomic model demonstrates what could be achieved by an investment-focused strategy in the Eurozone. Just achieving the same growth in investment as expected for the US over the next five years would lift Eurozone GDP by 1.5% by 2014. That is equivalent to a cumulative gain of around €300 billion in GDP over 2011-14. The impact on jobs is just as striking. Employment levels will barely change in the Eurozone, compared with the US economy which is expected to create more than 10 million jobs. Investment in new technologies, from IT to green sectors, combined with reforms to labor and product markets are needed to rise to this challenge.

Need to focus on macroeconomic imbalances ...

Moreover, while the current focus on public finances is justified, the crisis at its root is not only fiscal. In fact, in Ireland and Spain, the deterioration of public finances is a consequence of what has happened in the private sector rather than a trigger. Until 2007, both countries were running fiscal surpluses, which show that an exclusive focus on fiscal ratios as indicators of financial prudence is not sufficient. Wider-ranging imbalances and structural weaknesses need to be addressed.

In the South, this means tackling weaknesses in competitiveness that have contributed to the widening of current account deficits. Put together, the four countries in the South accumulated a current account deficit of 10% of GDP in 2008. Meanwhile, the North's current account surplus peaked at more than 4% of GDP in 2007. While the gap has narrowed recently, that is mainly because of the impact of recession, not significant changes in competitiveness.

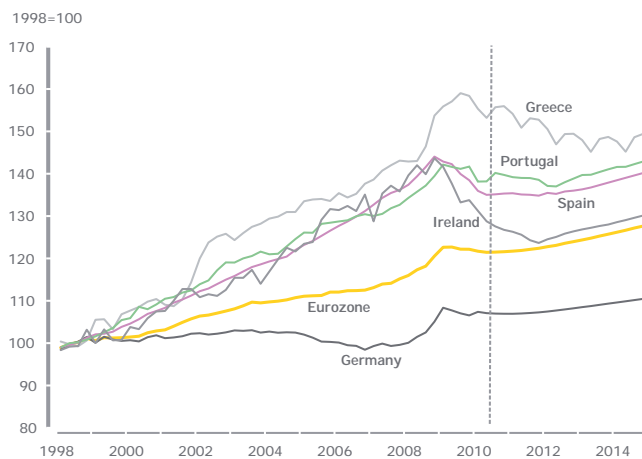
Figure 17
Current account balances



Ireland has made considerable progress in restoring its competitiveness. A combination of wage cuts and lay-offs aimed at improving productivity have reduced unit labor costs by around 8.5% compared with their peak. But Greece, Spain and Portugal have yet to start addressing the issue. This will necessitate rapid reforms of labor markets to allow cuts in nominal wages and payroll restructuring. Wage bargaining systems need to allow individual firms more flexibility and indexation clauses, explicit or implicit, need to be removed.



Figure 18
Unit labor costs

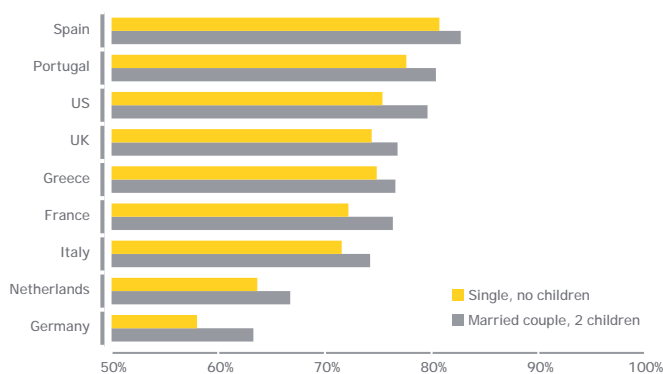


Source: Oxford Economics

... in the North too

The North needs to reform as well. Anemic domestic demand in these countries has led the ECB to keep rates lower than was appropriate for economic conditions in the South, which helped to fuel their credit and housing bubbles (often financed by banks in Germany or France). In order to foster domestic demand and, in particular, private consumption, reforms of the tax and benefit system are needed to make sure that employees retain a larger share of their gross wages. Reforms of the services sector would also make it easier to set up small companies and encourage competition.

Figure 19
Relatively high German wages do not make it home



Source: OECD

Conclusion

The Eurozone is going through the first serious test of its economic model. The sovereign debt crisis has exposed fundamental flaws in its institutions that require greater policy coordination to achieve a more sustainable monetary union. But the lengthy negotiations required to reach an agreement on the rescue package do not suggest that such policy coordination will happen any time soon. So, the most likely scenario is some muddling through whereby the countries in the South see growth at or below zero for several years, while the North achieves moderate growth, largely thanks to exports. So, the South of the Eurozone is definitely set for a lost decade. But, while there are reasons for being more optimistic about the North, its desire to avoid a lost decade cannot be taken for granted. European policy-makers are repeating too many of the mistakes of their Japanese counterparts for comfort leading to a real risk of deflation.

While restoring sustainable public finances is necessary, the current trend to cut deficits in a very rapid manner, even in countries that do not face any pressures in financing their deficits, risks being counter-productive. In particular, countries that can afford to reduce their deficits more gradually should do so in order to help sustain growth in the Eurozone in general and in the South in particular.

Meanwhile, other major faults still need to be tackled. The lack of transparent information makes assessing the health of the Eurozone banking sector difficult. But it seems that, in a number of countries, banks still hoard large amounts of bad assets on their balance sheets. The restructuring of the banking sector needs to be addressed to ensure the sustainability of the recovery.

Finally, significant structural reforms need to be tackled. In Southern countries, the reforms should aim at regaining competitiveness eroded by years of strong wage growth and low productivity gains. In Northern countries, the goal should be to unleash domestic demand by encouraging higher consumption and fostering investment at home.



Box 3

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 has rebounded strongly since the second half of last year. We estimate that demand in Q1 was up more than 10% from its (depressed) year-ago level. We forecast robust growth in foreign demand in the next few years.

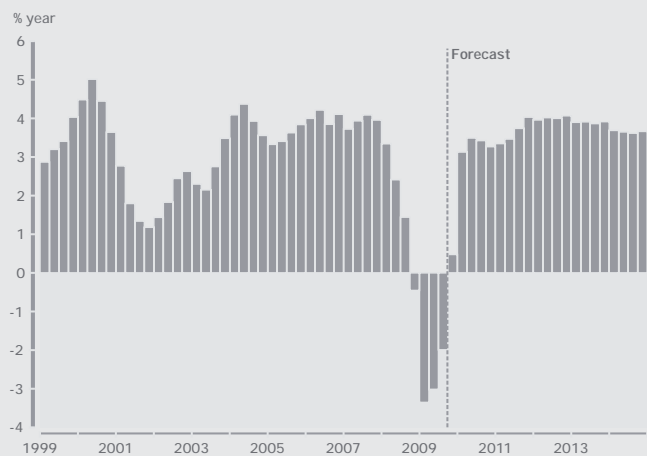
Asia will remain the most dynamic region. Growth in China, in particular, continues to surprise on the upside, to the extent that concerns about overheating now dominate. The authorities have restrained credit, which we expect will slow growth to close to 8% by the end of this year. But with inflationary pressures still rising and house price inflation strong, there remains the risk of a more severe policy response being required, triggering a bust after the boom.

In the US, we expect GDP growth of 3.4% in 2010 and 3.8% in 2011, slightly higher than in our spring report. Temporary factors that supported growth in late 2009 and early 2010 (mainly stock building and federal stimulus spending) are expected to fade over the next few quarters. But this should be offset by a leveling off and then revival in the construction sector and further strengthening in equipment investment. We expect world GDP to rise by around 3.4% this year (at market exchange rates) and by around 3.6% in 2011. World trade is forecast to increase by close to 10% this year and 7%-8% in 2011-14.

Commodity prices have fallen back, having risen strongly at the end of 2009 and the start of 2010. We forecast oil prices to average around US\$77 per barrel this year, rising to US\$80 next year and close to US\$95 in 2014. Given the recent weakening of the euro, many commodities will become more expensive, but not to an extent large enough to imply risks to inflation or a significant burden on GDP growth.

Figure 20

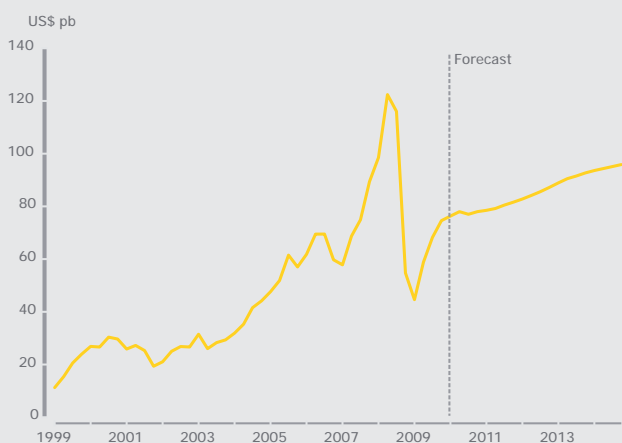
World: GDP growth



Source: Oxford Economics

Figure 21

Global: Oil prices, nominal



Source: Oxford Economics



Main findings from the *Ernst & Young European Attractiveness Survey*

- FDI projects down 11% in 2009 in Europe

Ernst & Young's 9th Annual *Ernst & Young European Attractiveness Survey* released at the World Investment Conference on 2-4 June 2010, revealed some stark contrasts in terms of inward investment projects announced across Europe in 2009. Overall, despite the deep recession, Europe remained in business, securing 3,303 investment projects, representing a modest 11% decline in project numbers. At a country level, there were some very mixed results.

- Investment by sector: a contrasting landscape

In general terms, investment in sectors that require heavy investment or that have traditionally gone to Central and Eastern Europe suffered in 2009, as did those sectors that were more associated with an expanding economy. Automotive, mining and transport projects were all significantly down, while business services and software projects also took a hit. However, other sectors such as food, pharmaceuticals and electrical goods showed growth in terms of project numbers.

- Where the investment is going: winners and losers

The larger European economies held up relatively well in terms of their ability to attract inward investment in 2009 (UK, France, Italy and Germany). There were some other winners in terms of investment projects: Russia, Ukraine and Turkey bucked the trend of their neighbors in Eastern Europe. All of them posted increases in the number of projects in 2009.

Understandably, with a 4% decline in European GDP, some countries were badly impacted in 2009 (Spanish and Irish economies). The impact of the recession was most dramatic, however, in countries like Poland, Hungary, Romania and the Czech Republic. In these countries, project numbers fell collectively by 40% as investors sought the stability of the larger Western economies.

- To download the full *Ernst & Young European Attractiveness Survey 2010*, please visit our website at www.ey.com/attractiveness

- Where the investment is coming from: Europe's new clients

The United States, which continues to account for roughly a quarter of all projects into Europe, saw a decline in investment levels both in absolute and relative terms, as did Germany, the UK, France and Japan, which combined make up a further 25% of the investment numbers.

There were some countries which did invest more in Europe in 2009 than 2008, notably China, whose project numbers increased by nearly 30%, from 87 to 111. Chinese projects were also responsible for the third largest numbers of jobs created across Europe in 2009.

- A modest improvement for 2010?

As well as analyzing project data for 2009, the *Ernst & Young European Attractiveness Survey* looked at investment outlook, asking over 800 executives about their future intentions. Although a high percentage of those questioned (53%) said they would be likely to hold off a little longer before committing to further investment in Europe, the investment environment is showing signs of improvement compared with 12 months ago.

- Where to next for Europe in terms of global attractiveness?

While investors still see Western Europe as an attractive region (38%) to do business in, just behind China (39%), they have concerns about Central and Eastern Europe, which ranked second globally in 2009. This year the region saw its attractiveness rating decline from 42% to 24%.

Longer term, however, investors continue to see Central and Eastern Europe as a priority: 59% of investors view the region as the third most attractive location over the next three years by, just behind China (66%) and India (61%).



Forecast for Eurozone countries



Germany

- So far, the Eurozone sovereign debt crisis does not seem to have hindered German recovery, although falling demand in southern Eurozone countries will dampen exports. We forecast GDP growth at 1.5% this year and 1.7% in 2011, as the weaker euro boosts German trade with the rest of the world.
- Increased uncertainty about the growth outlook will, however, weigh on investment and employment. Moreover, consumers remain very cautious.
- The German Government has abandoned planned tax cuts next year and announced €80 billion worth of spending cuts and tax increases over four years, amounting to 0.75% of GDP per year.
- While the current focus is on public finances, Germany needs to implement reforms to boost domestic demand. But such a shift is unlikely in the near future, which means that German growth is likely to remain sub-par and exposed to reversals in international trade

Figure 22
Trade spillovers

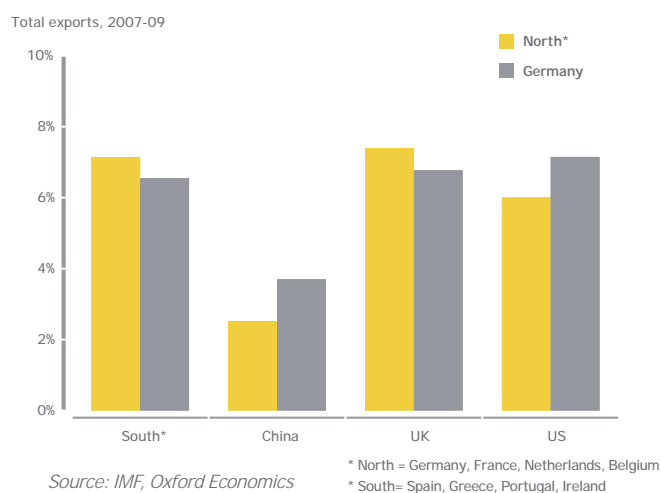


Figure 23
Fiscal stance

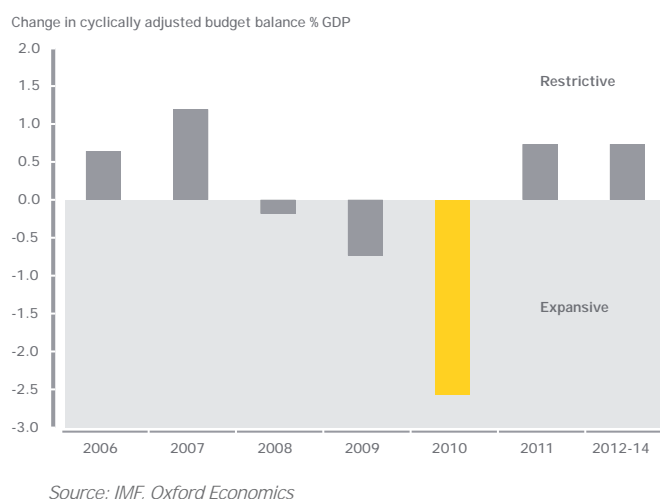


Table 2

Germany (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-4.9	1.5	1.7	1.9	2.2	2.3
Private consumption	0.0	-0.9	1.2	1.3	1.5	1.7
Fixed investment	-8.9	-0.4	2.2	3.4	4.2	3.9
Stockbuilding (% of GDP)	-1.5	-1.1	-1.0	-1.2	-0.9	-0.6
Government consumption	3.4	1.8	0.2	0.3	0.4	0.6
Exports of goods and services	-14.5	6.4	3.4	7.2	7.6	6.5
Imports of goods and services	-9.5	3.8	2.7	6.4	8.1	7.1
Consumer prices	0.2	1.3	1.5	1.5	1.6	1.7
Unemployment rate (level)	7.5	7.3	7.4	7.5	7.3	7.0
Current balance (% of GDP)	5.0	5.0	4.5	4.9	4.9	4.8
Government budget (% of GDP)	-3.3	-5.0	-4.1	-3.4	-2.7	-2.1
Government debt (% of GDP)	73.2	75.0	77.1	77.9	77.8	77.0

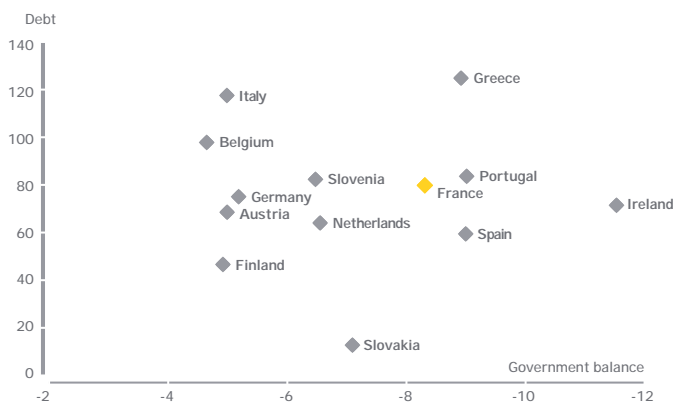


France

- Despite a budget deficit of over 8% of GDP, France has not come under much financial pressure. As a result, while it has announced a freeze on public spending in real terms, France will be able to avoid large spending cuts in the near term. That will allow the recovery to strengthen further before fiscal consolidation is implemented.
- We forecast GDP growth at 1.2% this year and 1.7% in 2011, around 0.5 ppts higher than the Eurozone average.
- Together, Spain, Greece, Portugal and Ireland account for around 11% of French trade and, with these countries expected to remain in recession for a while yet, French exports will take a hit.
- Moreover, renewed uncertainty about the economic outlook will weigh on investment and recruitment decisions, while high unemployment will depress consumer spending.

Figure 24

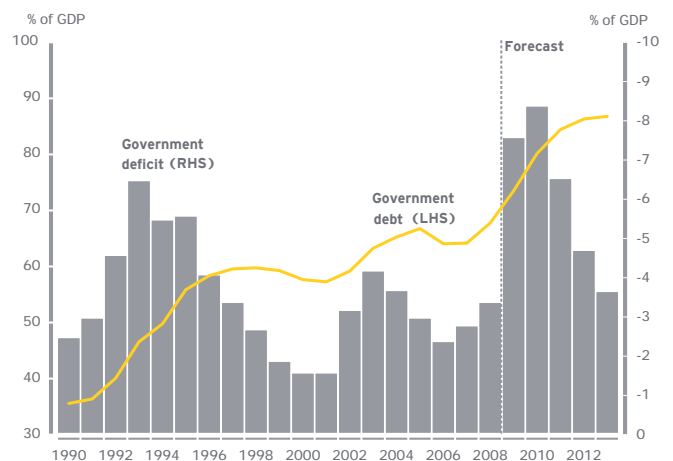
Government balance by government debt Maastricht definition
% of GDP (2010)



Source: Oxford Economics

Figure 25

Government deficit and debt



Source: Oxford Economics

Table 3

France (annual percentage changes unless specified)

Source: Oxford Economics

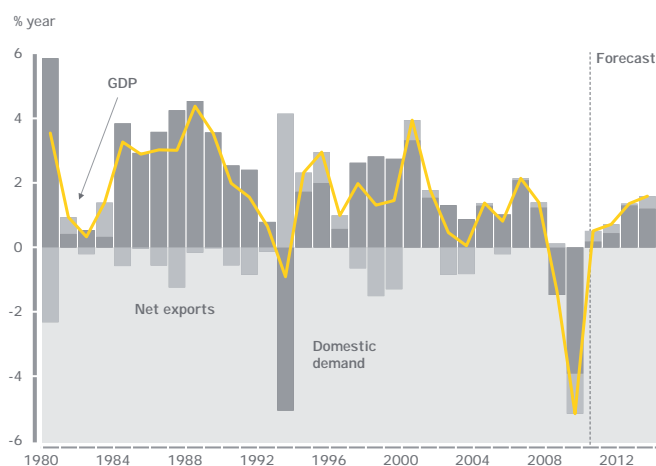
	2009	2010	2011	2012	2013	2014
GDP	-2.5	1.2	1.7	2.2	2.1	2.0
Private consumption	0.6	1.2	1.2	1.6	1.8	1.8
Fixed investment	-7.0	-1.8	2.5	3.2	2.9	2.5
Stockbuilding (% of GDP)	-1.2	-1.0	-0.7	-0.3	0.0	0.2
Government consumption	2.8	1.5	0.6	0.7	1.1	1.2
Exports of goods and services	-12.2	6.1	4.5	6.7	6.1	5.8
Imports of goods and services	-10.6	4.4	3.9	5.8	5.8	5.5
Consumer prices	0.1	1.8	1.7	1.8	1.9	1.9
Unemployment rate (level)	9.5	10.3	10.7	10.4	9.8	9.2
Current balance (% of GDP)	-2.2	-3.0	-3.5	-3.3	-3.1	-3.1
Government budget (% of GDP)	-7.5	-8.3	-6.5	-4.6	-3.6	-3.1
Government debt (% of GDP)	73.1	79.9	84.3	86.2	86.7	86.6



Italy

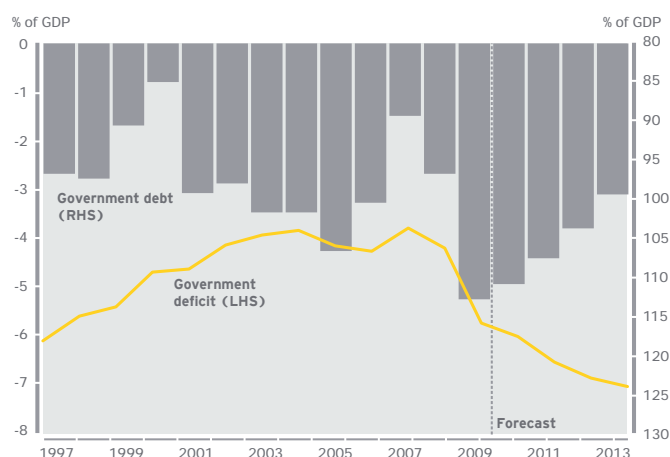
- The spread of the financial contagion from Greece to Italy has been so far very limited, despite government debt being expected to rise to nearly 120% of GDP by year-end 2010.
- Italy will continue to outperform its Eurozone Mediterranean neighbors, but prolonged recessions in these countries and weak domestic demand in Italy will weigh on growth. We expect growth to average just 0.5% in 2010 and remain under 1% in 2011.
- In order to ensure that Italy was not drawn into the crisis, the Government unveiled a fiscal adjustment program at the end of May aimed at saving €25 billion (around 1.5% of GDP) over the next two years. The plan relies heavily on cuts in expenditure and uncertain extra revenues to be raised through the fight against tax evasion. Based on previous experience, however, we think that realistically just more than half of the savings announced will be achieved, bringing deficit down to 4.3% of GDP by 2011.

Figure 26
Contributions to GDP growth



Source: Oxford Economics

Figure 27
Government deficit and debt



Source: Oxford Economics

Table 4
Italy (annual percentage changes unless specified)

Source: Oxford Economics

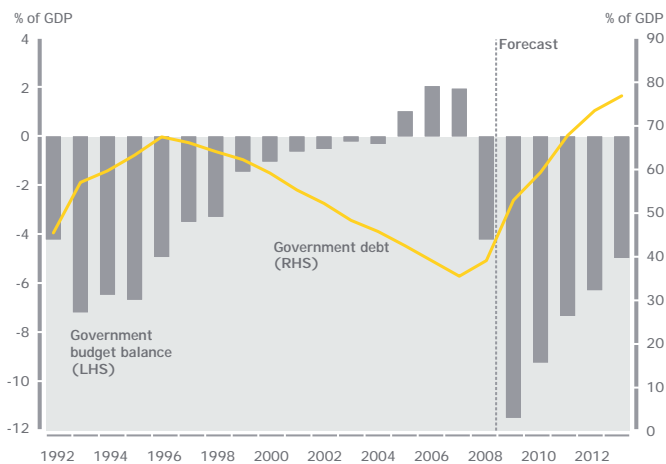
	2009	2010	2011	2012	2013	2014
GDP	-5.1	0.5	0.7	1.3	1.6	1.7
Private consumption	-1.8	0.4	0.8	1.3	1.7	1.8
Fixed investment	-12.2	-0.8	0.1	2.7	2.4	2.1
Stockbuilding (% of GDP)	0.0	0.1	0.3	0.2	-0.3	-0.5
Government consumption	0.6	-0.3	-1.3	0.1	1.0	1.0
Exports of goods and services	-19.1	4.3	4.8	5.2	6.1	6.2
Imports of goods and services	-14.6	2.7	3.6	4.8	4.5	5.3
Consumer prices	0.8	1.6	1.5	1.7	2.1	2.0
Unemployment rate (level)	7.8	9.1	9.3	8.9	8.6	8.4
Current balance (% of GDP)	-3.2	-2.9	-2.9	-2.7	-2.5	-2.5
Government budget (% of GDP)	-5.3	-5.0	-4.3	-4.1	-3.6	-2.9
Government debt (% of GDP)	115.8	118.0	121.8	124.0	125.1	125.3



Spain

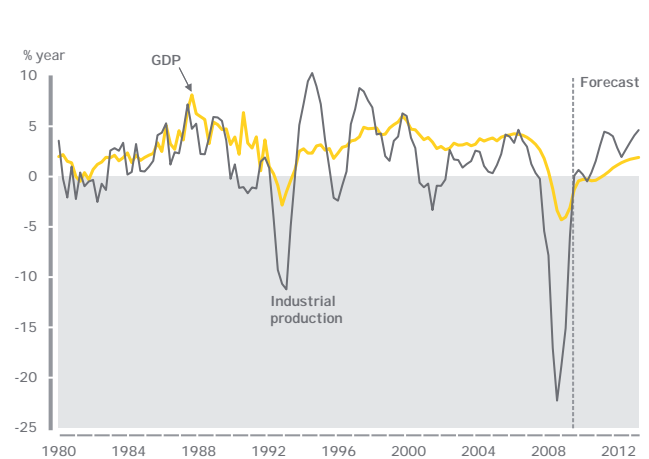
- Spain has been sucked into the Eurozone financial crisis, with bond spreads widening sharply. This, plus a slew of downgrades of Spanish debt by leading rating agencies, forced the Government at the end of May to announce another package to slash the budget deficit. Current expenditure is to be cut sharply in order to reduce the deficit to 6% of GDP by 2011.
- Although GDP grew slightly in Q1 2010, we expect this to prove only a temporary respite from recession. We expect Spanish GDP to contract by 0.6% this year and a further 0.2% in 2011.
- Inflation is likely to remain very subdued, despite increased indirect taxes, and there is a risk that weak domestic demand could tip Spain into deflation, with further negative consequences for a still highly leveraged private sector.
- An important downside risk to our forecast is a weakening of the banking sector, highlighted by recent moves by the Bank of Spain to take over two regional savings banks. Given the very large exposition of the European banking system to Spanish banks this could trigger a contagion.

Figure 28
Government balance and debt



Source: Oxford Economics

Figure 29
GDP and industrial production



Source: Oxford Economics

Table 5

Spain (annual percentage changes unless specified)

Source: Oxford Economics

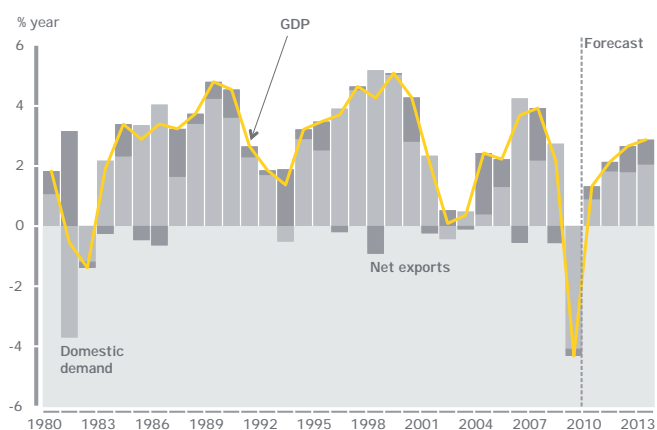
	2009	2010	2011	2012	2013	2014
GDP	-3.6	-0.6	-0.2	0.9	1.7	2.0
Private consumption	-4.9	-0.7	-1.0	0.8	1.4	2.0
Fixed investment	-15.3	-7.5	-2.5	-0.1	1.3	2.3
Stockbuilding (% of GDP)	0.4	0.5	0.6	0.8	0.8	0.4
Government consumption	3.8	0.1	-2.7	-0.4	1.5	2.8
Exports of goods and services	-11.5	6.8	4.6	5.3	5.4	5.7
Imports of goods and services	-17.9	0.9	-0.2	4.1	4.5	4.7
Consumer prices	-0.2	1.4	1.1	0.9	1.3	1.4
Unemployment rate (level)	18.0	19.4	20.1	19.6	18.5	17.2
Current balance (% of GDP)	-5.4	-4.5	-3.8	-3.1	-2.6	-2.3
Government budget (% of GDP)	-11.2	-9.6	-7.1	-6.1	-4.9	-4.0
Government debt (% of GDP)	53.2	59.4	68.0	73.8	77.4	79.7



Netherlands

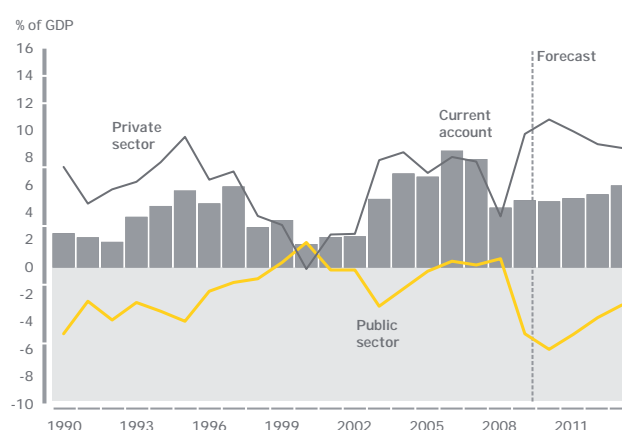
- A steady recovery fuelled by external demand and boosted by the weak euro is in prospect for the Dutch economy. Domestic demand will remain weak for some time. But the risk of severe financial contagion will be limited by the relatively sound position of the public finances.
- Although growth in Q1 was driven by the domestic economy, there remains an underlying weakness in the form of stretched households and subdued investment, and the key driver of growth in the quarters ahead will be net exports.
- While the labor market has shown a high degree of resilience through the recession, business surveys continue to point to rising unemployment, albeit at a slower pace than in 2009. We expect that unemployment will not peak until mid-2011, rising to 5%.
- Despite the austerity-favoring VVD win, lengthy negotiations may endanger deficit reduction plans and hence there is a downside risk to our forecast (-3% GDP by 2013).

Figure 30
Contributions to GDP growth



Source: Oxford Economics

Figure 31
Sectoral balances



Source: Oxford Economics

Table 6
Netherlands (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-4.0	1.2	2.0	2.4	2.6	2.3
Private consumption	-2.5	1.4	1.8	2.0	2.1	2.2
Fixed investment	-13.0	-7.2	2.2	2.4	3.2	3.3
Stockbuilding (% of GDP)	-0.7	0.5	0.7	0.7	0.7	0.8
Government consumption	3.2	1.6	1.0	1.1	1.2	1.6
Exports of goods and services	-8.2	9.2	6.0	6.5	6.4	5.5
Imports of goods and services	-8.7	9.7	6.2	6.2	6.2	6.0
Consumer prices	1.0	1.8	1.4	1.8	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	5.1	5.4	5.7	6.4	6.6
Government budget (% of GDP)	-5.3	-6.6	-5.4	-4.0	-3.0	-2.1
Government debt (% of GDP)	60.9	64.0	67.4	68.9	69.1	68.6



Belgium

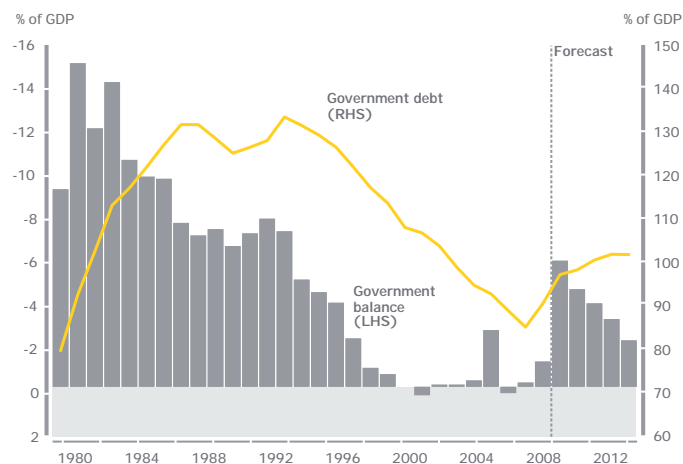
- Belgium's recent strong record of fiscal discipline has enabled it to avoid financial turmoil despite a high level of debt.
- We are slightly more pessimistic than the Government about the outlook for public finances, expecting that it will only be able to bring the budget down below 3% of GDP in 2013.
- In light of the recent political crisis that led to the collapse of the ruling coalition Government and early elections, and as coalition talks are underway and set

to last several months, there is a risk is that political paralysis will harm the fiscal adjustment efforts.

- The Belgian economy is forecast to grow by 1.4% this year, as domestic demand remains subdued against a background of a weak labor market and significant spare production capacity.
- But stronger domestic demand and exports - bolstered by the weak euro - are expected to push GDP growth up to 2.0% in 2011.

Figure 32

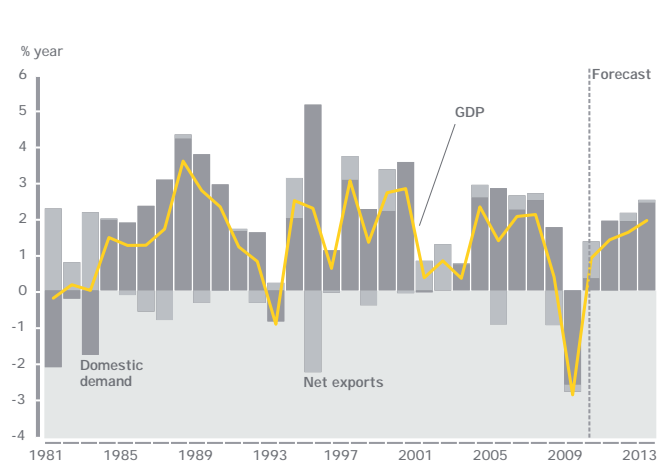
Government balance and debt



Source: Oxford Economics

Figure 33

Contributions to GDP growth



Source: Oxford Economics

Table 7

Belgium (annual percentage changes unless specified)

Source: Oxford Economics

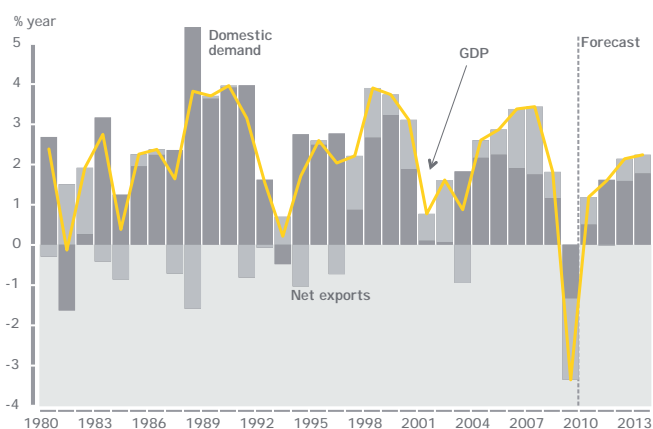
	2009	2010	2011	2012	2013	2014
GDP	-3.0	1.4	2.0	2.3	2.7	2.1
Private consumption	-1.7	1.1	1.8	2.4	2.4	2.0
Fixed investment	-4.2	-1.0	2.1	2.5	2.8	2.3
Stockbuilding (% of GDP)	-0.4	-0.1	0.4	0.3	0.7	0.8
Government consumption	1.6	1.4	1.2	1.3	1.5	1.6
Exports of goods and services	-12.6	5.8	4.3	4.6	3.8	3.7
Imports of goods and services	-12.8	5.5	4.6	4.5	3.9	3.7
Consumer prices	0.0	1.5	1.6	1.7	1.8	1.8
Unemployment rate (level)	7.9	8.2	8.2	8.0	7.8	7.7
Current balance (% of GDP)	0.5	0.5	-0.1	1.0	1.7	2.1
Government budget (% of GDP)	-6.0	-4.7	-4.0	-3.2	-2.2	-1.0
Government debt (% of GDP)	96.7	98.3	100.2	101.5	101.5	100.7



Austria

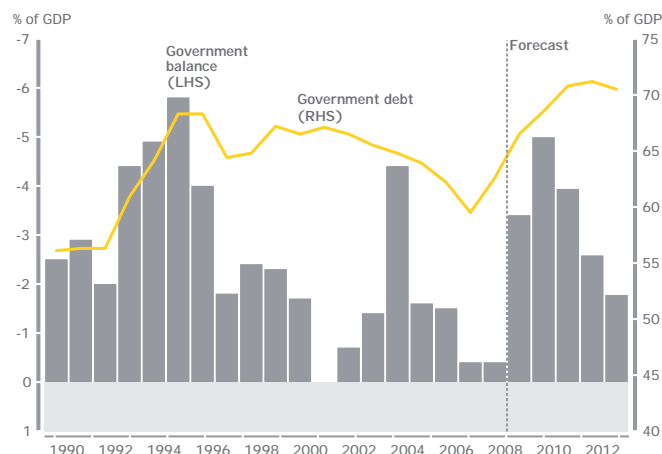
- Austria emerged from recession in the second half of 2009, but growth stalled again in Q1. We forecast GDP growth at 1.2% this year and 1.6% in 2011.
- The recovery this year will be largely driven by increased demand for Austrian exports, particularly from Germany. But not all of Austria's export markets are growing strongly, and the risks to Austrian exports are skewed to the downside.
- Increases in both household and government spending will be offset by a continued decline in fixed investment. But in the medium term, as investment begins to turn around, domestic demand will take over as the main driver of growth.
- As the result of higher spending and lower revenues during the crisis, the budget deficit is expected to rise to 4.7% of GDP this year. A period of fiscal consolidation will constrain growth in the medium term, but Austria's deficit and debt levels are relatively moderate, making it unlikely that it will get caught up in a fiscal crisis.

Figure 34
Contributions to GDP



Source: Oxford Economics

Figure 35
Government balance and debt



Source: Oxford Economics

Table 8

Austria (annual percentage changes unless specified)

Source: Oxford Economics

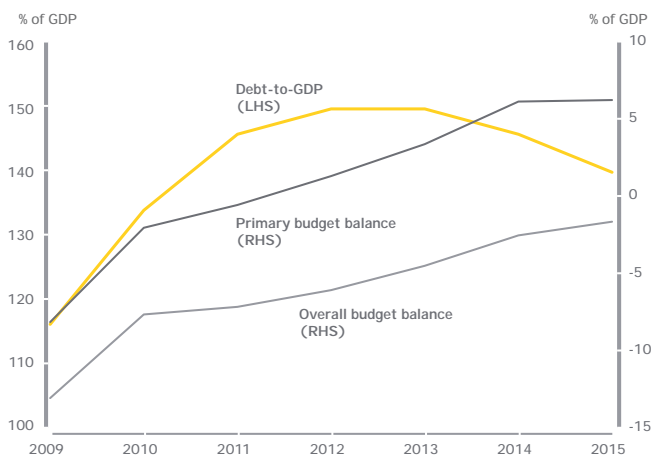
	2009	2010	2011	2012	2013	2014
GDP	-3.4	1.2	1.6	2.0	2.2	2.1
Private consumption	0.8	1.1	1.0	1.3	1.6	1.7
Fixed investment	-7.5	-3.4	3.6	4.3	3.8	3.4
Stockbuilding (% of GDP)	1.7	1.3	0.7	0.9	1.1	1.3
Government consumption	1.0	2.4	0.6	0.6	1.0	1.7
Exports of goods and services	-15.0	2.1	5.1	6.5	7.7	7.2
Imports of goods and services	-13.1	-0.1	4.0	7.3	8.5	8.1
Consumer prices	0.4	1.6	1.9	2.0	1.9	1.9
Unemployment rate (level)	4.8	5.1	5.4	4.9	4.5	4.5
Current balance (% of GDP)	2.1	2.3	3.3	3.2	2.9	2.5
Government budget (% of GDP)	-4.3	-4.7	-4.1	-3.7	-3.3	-3.0
Government debt (% of GDP)	66.5	68.4	70.6	71.9	72.6	73.0



Greece

- The near-term risk of a default in Greece has receded in the wake of a large financial support package from the EU and the IMF.
- Greece nevertheless faces a huge challenge to achieve the fiscal adjustment of 11% of GDP demanded in return for this support.
- Investors remain concerned that Greece will not be able to stick to the deal in the face of economic weakness and social pressures, as illustrated in Moody's latest downgrade.
- Debt will rise to 150% of GDP by 2013 under this package, implying a very large ongoing burden of interest payments.
- GDP is now forecast to contract for the next three years by a total of over 7%, with unemployment exceeding 15%. The banking sector is in a fragile condition.
- The challenge facing Greece is not unprecedented, but is extremely daunting and takes place against a very unhelpful macroeconomic background – the risk of failure remains significant.

Figure 36
IMF debt and deficit projections



Source: IMF

Figure 37
Bond spread and stock market



Source: Oxford Economics/Haver Analytics

Table 9

Greece (annual percentage changes unless specified)

Source: Oxford Economics

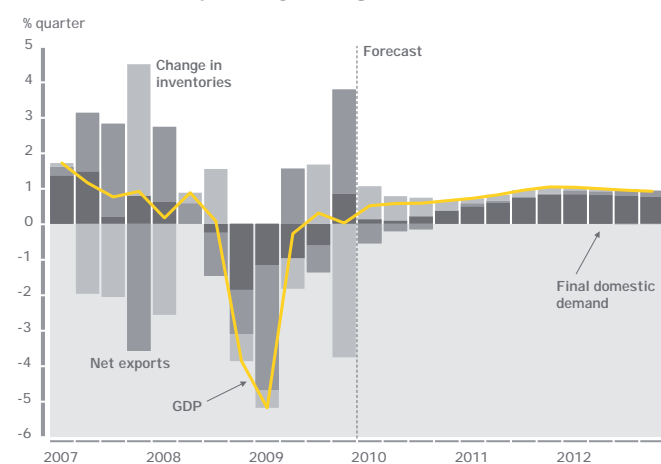
	2009	2010	2011	2012	2013	2014
GDP	-2.0	-4.3	-3.2	-0.1	1.3	1.5
Private consumption	-1.8	-2.0	-6.3	-0.4	0.9	1.3
Fixed investment	-13.9	-10.6	-6.5	-0.5	2.4	2.9
Stockbuilding (% of GDP)	1.9	0.9	0.9	0.3	0.4	0.1
Government consumption	9.6	-13.6	-6.8	-1.9	-0.1	1.0
Exports of goods and services	-18.1	4.7	9.4	8.1	6.0	5.4
Imports of goods and services	-14.1	-5.2	-5.4	2.5	4.6	3.8
Consumer prices	1.3	4.2	-0.4	-0.8	0.3	1.2
Unemployment rate (level)	9.5	12.6	14.5	15.2	15.2	15.0
Current balance (% of GDP)	-11.2	-10.5	-6.3	-4.9	-4.6	-4.2
Government budget (% of GDP)	-13.6	-8.9	-7.6	-6.6	-4.9	-4.0
Government debt (% of GDP)	115.1	124.8	139.1	146.8	150.0	150.4



Finland

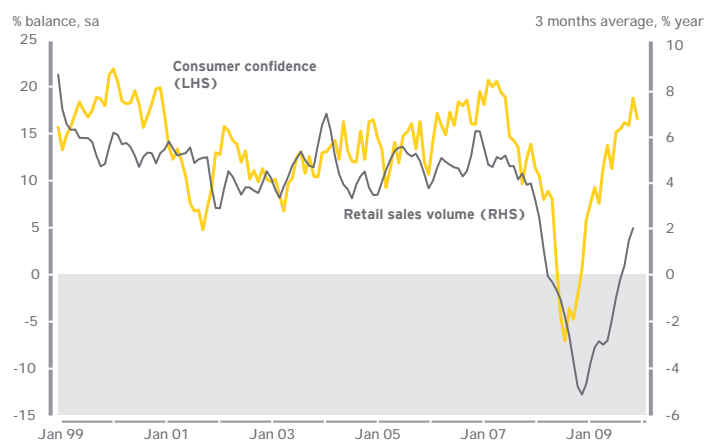
- Despite a weaker southern Eurozone, recovery momentum in Finland is building. We expect 0.4% GDP growth this year accelerating to 3% in 2011.
- Finland's fiscal credibility is intact, evident from its stable spread against German bunds of around 0.25 ppts. This will be an important factor supporting growth.
- An improved export performance is also boosting recovery. Finland's exposure to demand in southern European countries is very small. Instead, it is benefiting from robust growth in its main trading partners, now including Russia, and a strong rebound in trade in key sectors such as electronics. Domestic demand too is picking up gradually.
- However, nervousness about how the sovereign debt crisis might unfold is likely to lead to some caution in household and corporate spending plans.

Figure 38
Contributions to quarterly GDP growth



Source: Oxford Economics

Figure 39
Consumer confidence and retail sales



Source: Eurostat/Haver Analytics

Table 10
Finland (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-8.1	0.4	3.0	4.0	3.6	3.2
Private consumption	-2.1	0.8	1.3	3.1	3.7	3.5
Fixed investment	-13.8	-2.4	3.0	5.7	5.0	4.5
Stockbuilding (% of GDP)	0.1	0.5	2.0	2.8	2.9	2.9
Government consumption	0.6	1.4	1.6	1.2	0.9	1.1
Exports of goods and services	-24.2	-2.1	4.4	8.2	8.8	6.4
Imports of goods and services	-21.5	-1.5	5.4	9.3	9.2	6.7
Consumer prices	1.6	1.2	1.3	1.4	1.5	1.5
Unemployment rate (level)	8.2	9.1	8.9	8.0	7.2	6.8
Current balance (% of GDP)	1.3	0.9	0.6	0.6	0.6	0.5
Government budget (% of GDP)	-2.3	-4.9	-4.1	-2.2	-0.6	-0.2
Government debt (% of GDP)	44.0	46.8	49.1	49.4	47.9	46.0

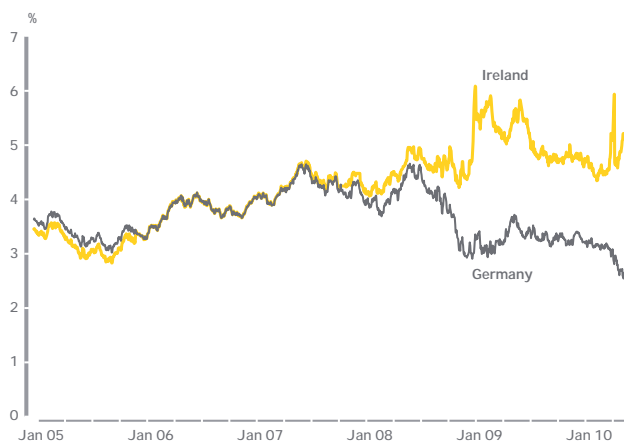


Ireland

- We expect Ireland to finally have emerged from recession in Q1 2010.
- Ireland has been grouped with crisis countries in the Eurozone's Mediterranean, but is in a much better position than other vulnerable countries. It has already implemented wide-ranging measures to consolidate its budget, starts from a position of relatively low government debt, has a large export sector, its prices and wages have been falling to improve competitiveness and its rate of corporation tax remains highly competitive.
- Ireland is unlikely to endure a "lost decade" and GDP is expected to return to relatively strong rates of growth in the medium term.
- Ireland's recovery, however, in labor market terms, will be sluggish and largely "jobless". We expect that it will be well over a decade before employment in Ireland returns to its peak achieved in 2007.

Figure 39

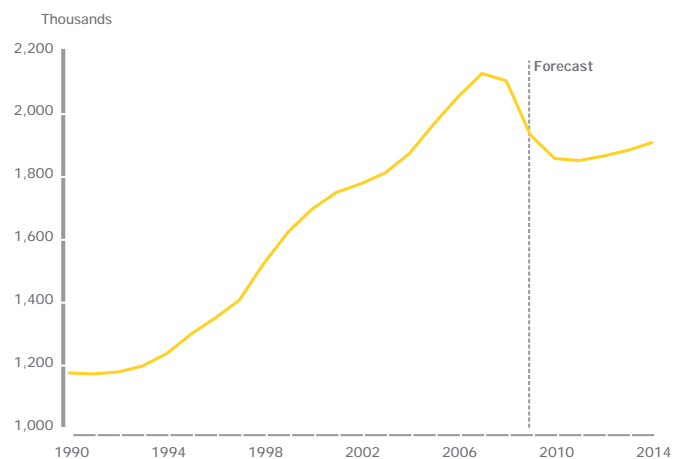
Long term government borrowing interest rate



Source: Haver Analytics

Figure 40

Employment



Source: Haver Analytics

Table 11

Ireland (annual percentage changes unless specified)

Source: Oxford Economics

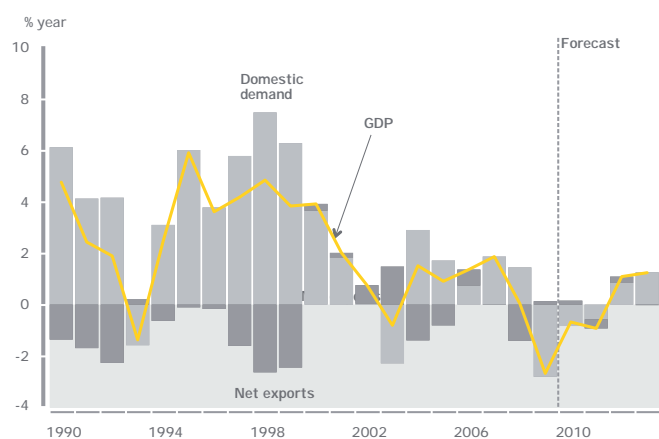
	2009	2010	2011	2012	2013	2014
GDP	-7.1	-1.0	2.8	3.9	3.5	3.8
Private consumption	-7.2	-2.2	1.5	3.4	3.4	3.4
Fixed investment	-29.7	-18.7	2.6	7.0	4.7	5.0
Stockbuilding (% of GDP)	-1.6	-0.1	0.3	0.1	0.0	0.0
Government consumption	-1.3	-4.1	-2.0	-0.1	0.0	0.0
Exports of goods and services	-2.3	3.8	5.4	5.5	5.3	5.2
Imports of goods and services	-9.3	-1.3	4.7	5.3	5.1	4.8
Consumer prices	-1.7	-1.0	1.2	2.0	2.0	2.0
Unemployment rate (level)	11.8	13.1	12.2	11.1	10.5	9.7
Current balance (% of GDP)	-2.9	2.7	2.2	2.2	2.3	2.3
Government budget (% of GDP)	-14.3	-11.5	-9.2	-8.2	-7.0	-5.8
Government debt (% of GDP)	64.0	71.4	77.8	81.9	84.9	86.2



Portugal

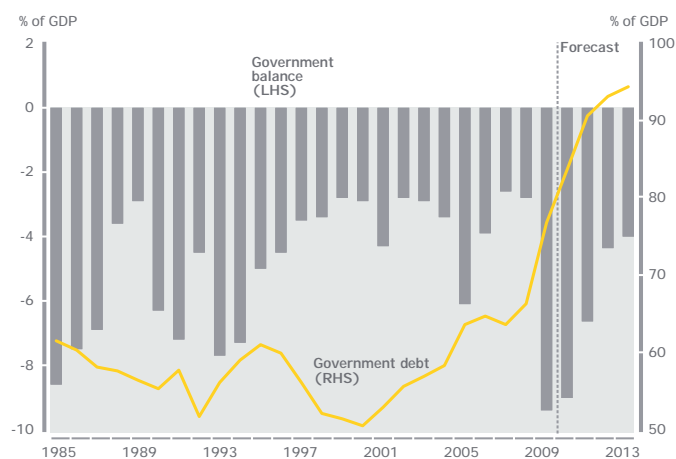
- Despite an unexpectedly strong performance in Q1 2010, the Portuguese economy is forecast to contract in the next couple of years. We expect GDP to fall by 1.1% in 2010 and 1.5% in 2011.
- Fiscal consolidation, low levels of capacity utilization and high borrowing costs will weigh on domestic demand, with investment expected to fall sharply again this year. High and rising unemployment will also depress consumer spending.
- While exports may recover modestly, Portugal has strong trade links with other southern European countries with weak economic growth, such as Spain.
- There is a risk of a negative spiral setting in, as deficit targets are not met, further exacerbating financial markets tensions, pushing the Government to implement further austerity measures which, in turn, dampen growth and make it more difficult to achieve the fiscal targets.

Figure 42
Contributions to GDP growth



Source: Oxford Economics

Figure 43
Government balance and debt



Source: Oxford Economics

Table 12

Portugal (annual percentage changes unless specified)

Source: Oxford Economics

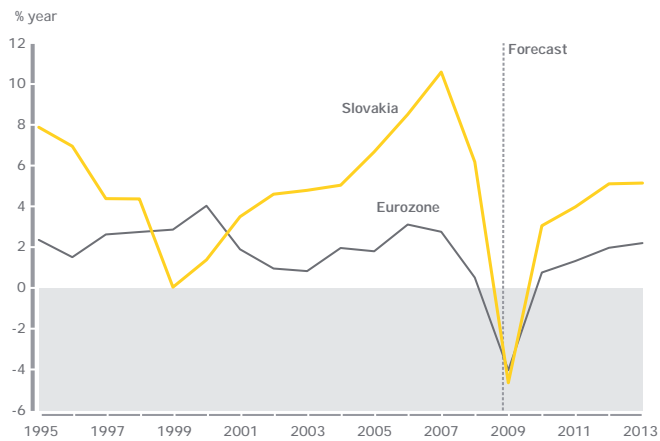
	2009	2010	2011	2012	2013	2014
GDP	-2.6	-1.1	-1.5	1.1	1.4	1.8
Private consumption	-1.0	0.2	-2.2	0.4	1.1	1.4
Fixed investment	-11.9	-3.6	-1.1	1.4	2.8	3.2
Stockbuilding (% of GDP)	0.3	-1.3	-2.5	-2.5	-2.4	-2.5
Government consumption	3.0	-0.5	-2.0	-0.1	0.5	1.1
Exports of goods and services	-11.8	3.0	3.3	3.5	4.8	5.1
Imports of goods and services	-10.8	-0.9	-2.1	1.7	4.0	4.1
Consumer prices	-0.9	0.9	0.7	1.0	1.9	1.8
Unemployment rate (level)	9.6	11.1	11.7	11.6	11.5	11.1
Current balance (% of GDP)	-10.1	-8.4	-8.6	-8.2	-8.2	-7.7
Government budget (% of GDP)	-9.4	-9.5	-8.5	-6.0	-5.5	-5.1
Government debt (% of GDP)	76.8	85.2	96.1	101.1	104.4	107.0



Slovakia

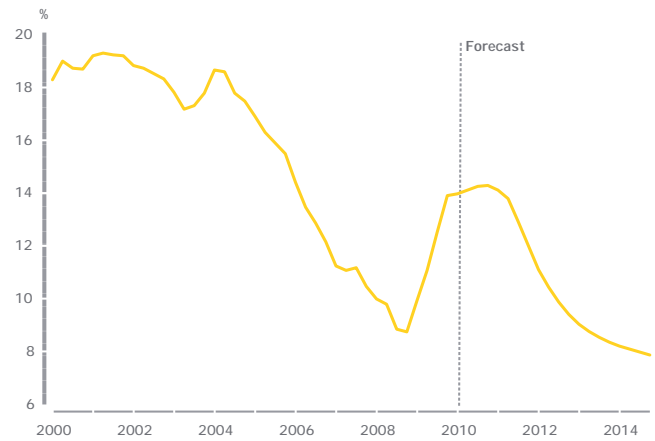
- After a strong rebound in H2 2009, Slovakia will continue to outpace the rest of the Eurozone, growing by 3.0% this year. We expect investment to be the main driver of growth this year.
- Medium-term prospects are strong and we forecast growth to remain above the Eurozone average in the next few years. Unemployment is expected to peak later this year and fall back steadily to pre-recession levels by late 2012.
- However, the fragility of the recovery in rest of the Eurozone is likely to hold back exports.
- Moreover, wages in Slovakia have risen significantly faster than in neighboring economies which compete in the same export markets. This could damage competitiveness if it continues.

Figure 44
Real GDP growth



Source: Oxford Economics

Figure 45
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	3.0	4.0	5.1	5.1	4.3
Private consumption	-0.7	1.1	2.7	3.6	3.8	3.9
Fixed investment	-10.5	3.2	5.2	6.5	7.3	7.4
Stockbuilding (% of GDP)	-1.1	-0.3	0.2	0.4	0.5	0.3
Government consumption	2.8	1.7	2.3	2.4	2.5	2.6
Exports of goods and services	-16.5	10.5	11.1	11.3	9.0	7.5
Imports of goods and services	-17.6	10.3	11.2	10.9	8.7	7.8
Consumer prices	1.6	1.3	2.5	2.5	2.4	2.4
Unemployment rate (level)	12.0	14.2	12.9	9.8	8.3	7.7
Current balance (% of GDP)	-3.2	-4.9	-5.2	-5.6	-4.7	-4.4
Government budget (% of GDP)	-6.8	-7.1	-5.4	-4.2	-3.5	-2.9
Government debt (% of GDP)	8.9	12.8	15.9	17.7	18.5	19.0

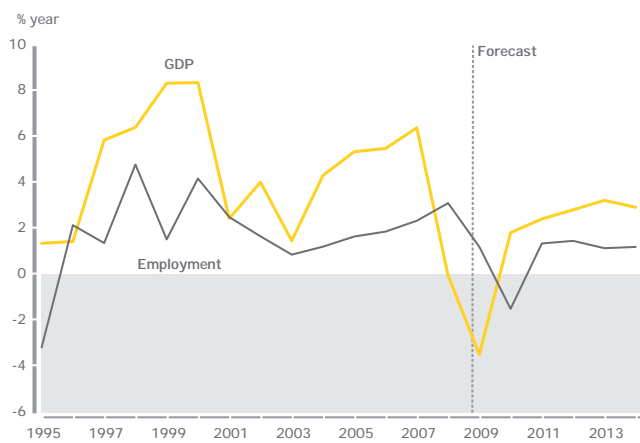


Forecast for Eurozone countries

Luxembourg

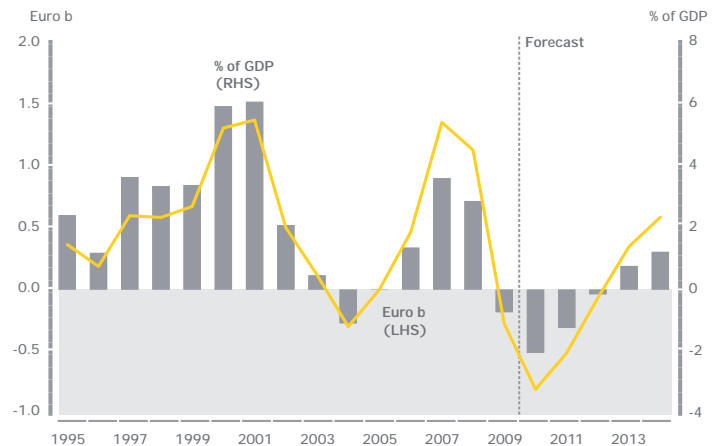
- The GDP decline of 3.4% in 2009 was less severe than initially estimated, reflecting the beginnings of recovery in the financial sector as fund inflows and values recovered. Industrial production took the main impact of falling export demand last year, but a broad-based recovery is expected to lift this year's GDP growth rate back toward 2%.
- The outlook is clouded by the sovereign debt crisis that has gradually engulfed the Eurozone, which brings with it the risk of a renewed bout of turmoil in financial markets that could see investors once again withdrawing funds from financial institutions in Luxembourg.
- The medium-term outlook is for a further acceleration of growth, as financial-sector expansion resumes, although the need to tighten public finances will raise the economy's reliance on export expansion. There is also a risk that investment inflows from the wider Eurozone could suffer if the region experiences a "lost decade" of growth.

Figure 46
Real GDP and employment



Source: Oxford Economics

Figure 47
Government budget balance



Source: Oxford Economics

Table 14
Luxembourg (annual percentage changes unless specified)

Source: Oxford Economics

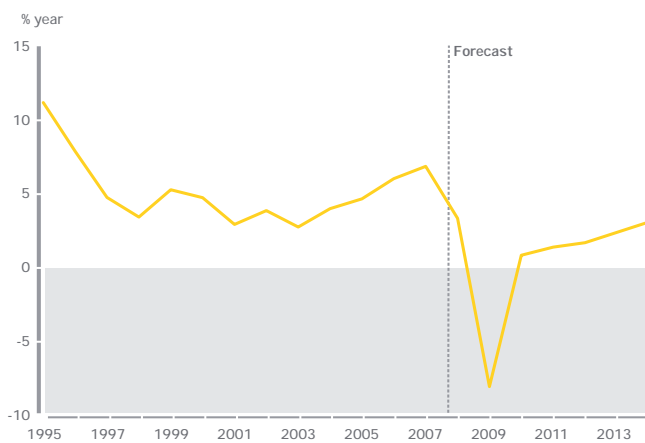
	2009	2010	2011	2012	2013	2014
GDP	-3.4	1.9	2.5	2.9	3.3	3.0
Private consumption	-0.5	1.0	2.8	3.3	3.0	3.0
Fixed investment	-14.9	1.9	3.2	6.0	5.0	4.0
Stockbuilding (% of GDP)	0.4	0.4	0.4	0.3	0.3	0.3
Government consumption	2.9	2.2	3.0	3.0	3.0	3.1
Exports of goods and services	-7.6	1.9	4.0	5.3	5.8	5.3
Imports of goods and services	-9.2	1.5	4.5	6.3	6.3	5.8
Consumer prices	0.0	2.5	2.1	2.0	2.0	2.0
Unemployment rate (level)	5.4	6.0	5.6	5.0	4.6	4.1
Current balance (% of GDP)	5.6	4.0	4.2	6.7	9.7	10.5
Government budget (% of GDP)	-0.7	-2.1	-1.2	0.1	1.0	1.4
Government debt (% of GDP)	14.5	15.9	16.4	15.5	13.8	11.7



Slovenia

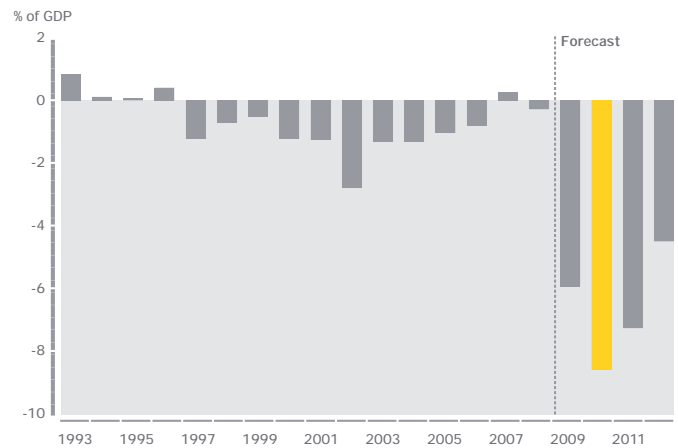
- GDP growth in 2010 will likely be, at 0.8%, below the officially forecast 1.3% despite a Q1 upturn in manufacturing orders and output. Recovery from the 8.1% slump in GDP in 2009 will be heavily dependent on exports, whose growth is at risk from weak Eurozone demand and rising internal costs.
- Subdued demand and spare capacity mean that fixed investment activity will not recover strongly until 2011. Consumption demand has recovered more rapidly, helped by real wage growth and a rise in public-sector employment, but this adds to short-term inflation risks in the absence of supply-side expansion.
- Given the low level of debt, financing the deficit is unlikely to be problematic despite the recent panic over Greece and fear of contagion spreading to other Eurozone countries, but possible pressure for faster reduction presents a downside risk to the growth forecast until 2012.

Figure 48
Real GDP



Source: Oxford Economics

Figure 49
Government budget balance



Source: Oxford Economics

Table 15

Slovenia (annual percentage changes unless specified)

Source: Oxford Economics

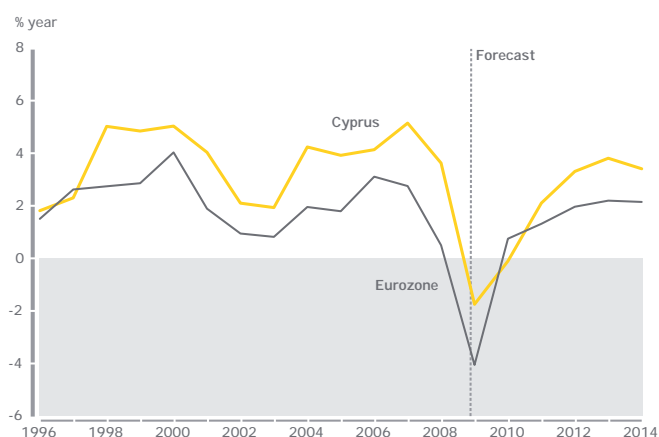
	2009	2010	2011	2012	2013	2014
GDP	-8.1	0.8	1.5	2.2	2.4	3.1
Private consumption	-1.6	1.1	2.3	1.0	1.7	2.3
Fixed investment	-21.6	-3.4	1.7	6.4	5.1	4.6
Stockbuilding (% of GDP)	-0.1	0.0	0.0	0.0	0.0	0.0
Government consumption	3.1	0.6	0.3	1.9	2.2	2.5
Exports of goods and services	-16.6	2.1	4.4	5.1	5.5	5.6
Imports of goods and services	-18.8	0.9	4.7	5.5	5.8	5.4
Consumer prices	0.8	2.9	2.8	2.7	2.8	2.8
Unemployment rate (level)	5.9	7.2	6.5	5.5	5.1	5.1
Current balance (% of GDP)	-1.0	-0.4	0.1	0.8	1.3	2.3
Government budget (% of GDP)	-5.7	-6.3	-5.1	-3.9	-2.8	-2.2
Government debt (% of GDP)	36.0	41.0	44.4	46.0	46.5	46.1



Cyprus

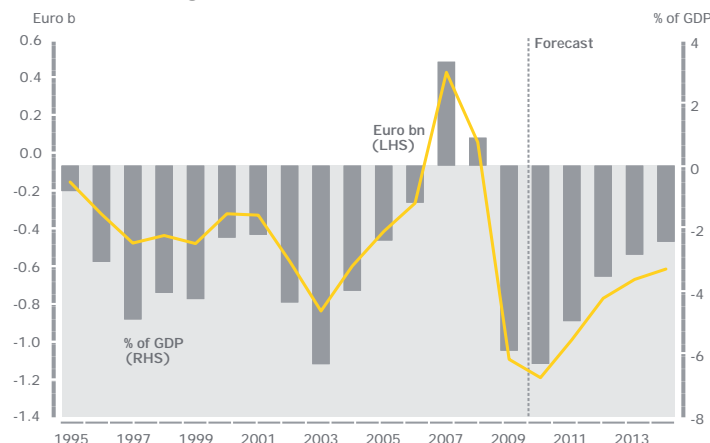
- With GDP increasing slightly in Q1, the economy is finally out of recession. However, setbacks to tourism in Q2 will temper growth, and any significant upturn in the economy will be delayed until the second half. We continue to forecast sub-zero growth in 2010, with the pace of recovery in 2011-12 limited by twin deficits.
- The budget deficit has widened to an unsustainable level, and spending cuts and tax rises in this year's budget will at best broadly stabilize the deficit, with substantially more public-sector restructuring required to bring it down.
- External accounts will also remain heavily in deficit through the forecast period, and the need to finance this through increased inward investment is a further downside risk to growth prospects.
- The North's election of a new leader in April 2010 signals its reduced willingness to cede political autonomy or land, and has slowed the reunification process. Delays in re-linking the divided economies are another factor restraining medium-term growth.

Figure 50
Real GDP growth



Source: Oxford Economics

Figure 51
Government budget balance



Source: Oxford Economics

Table 16

Cyprus (annual percentage changes unless specified)

Source: Oxford Economics

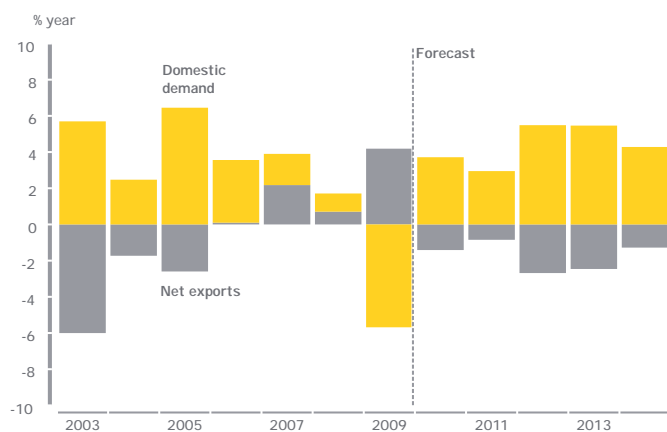
	2009	2010	2011	2012	2013	2014
GDP	-1.7	-0.3	1.8	2.8	3.8	3.4
Private consumption	-3.0	-4.5	3.9	4.4	4.0	3.8
Fixed investment	-12.0	-5.6	6.9	8.5	7.1	5.5
Stockbuilding (% of GDP)	-2.7	3.6	1.4	0.1	0.2	0.0
Government consumption	5.8	0.9	1.8	2.1	2.7	3.0
Exports of goods and services	-11.8	-1.8	6.0	6.4	5.5	5.3
Imports of goods and services	-19.8	2.9	5.6	7.2	6.5	5.6
Consumer prices	0.2	2.7	2.4	2.3	2.2	2.3
Unemployment rate (level)	5.3	6.3	5.8	5.1	4.7	4.6
Current balance (% of GDP)	-8.1	-10.8	-10.9	-9.2	-7.6	-6.8
Government budget (% of GDP)	-6.1	-6.5	-5.1	-3.7	-2.9	-2.5
Government debt (% of GDP)	56.2	61.3	63.9	64.5	63.7	62.7



Malta

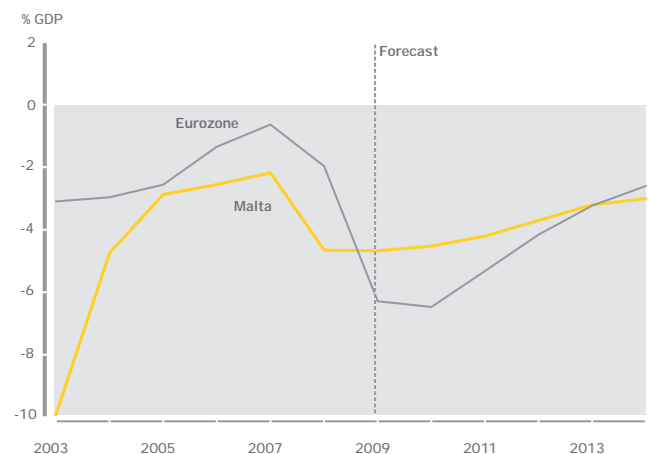
- Last year's recession was relatively mild by regional standards with real GDP contracting by 1.5%, compared with an overall decline of over 4% in the Eurozone.
- Growth is unlikely to sustain the momentum generated during H2 2009, particularly given the weak external environment. In the medium term, the need to correct both external and internal imbalances should limit growth to around 3%.
- Despite last year's recession, the deficit actually narrowed slightly to 3.8% of GDP from 4.5% in 2008. This reflected the removal of certain exceptional expenditure items which meant that expenditure growth was virtually flat.
- Debt and deficit metrics now appear relatively favorable by European standards.

Figure 52
contributions to GDP



Source: Oxford Economics

Figure 53
Fiscal balance versus Eurozone



Source: Oxford Economics

Table 17

Malta (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-1.5	2.3	2.1	2.8	3.0	3.0
Private consumption	1.3	1.2	2.2	3.0	3.0	3.0
Fixed investment	-18.8	4.0	8.0	13.0	16.0	8.0
Stockbuilding (% of GDP)	0.0	0.4	1.2	3.3	3.7	4.1
Government consumption	-0.7	0.5	0.3	1.1	3.0	3.0
Exports of goods and services	-4.2	11.8	5.0	4.4	3.8	3.0
Imports of goods and services	-8.5	13.4	5.8	7.0	6.0	4.0
Consumer prices	1.8	1.9	2.6	2.3	2.3	2.3
Unemployment rate (level)	6.9	7.0	6.7	6.0	5.6	4.8
Current balance (% of GDP)	-2.9	-4.5	-5.4	-4.7	-3.8	-3.7
Government budget (% of GDP)	-3.8	-4.5	-4.2	-3.7	-3.2	-3.0
Government debt (% of GDP)	69.0	69.8	71.0	71.2	70.7	70.1

Detailed tables and charts



Forecast assumptions

	2009	2010	2011	2012	2013	2014
Short-term interest rates (%)	1.2	0.8	1.4	2.7	3.2	3.6
Long-term interest rates (%)	3.8	3.9	4.2	4.7	4.9	4.7
Euro effective exchange rate (1995=100)	129.7	115.7	108.6	109.9	111.7	112.0
Oil prices (€/barrel)	44.2	65.1	76.1	78.1	79.4	81.4
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	0.7	0.8	1.1
Long-term interest rates (%)	3.9	4.0	3.8	3.7	3.7	3.8	3.9	4.0
Euro effective exchange rate (1995=100)	128.0	128.9	130.2	131.8	125.8	116.6	111.3	109.2
Oil prices (€/barrel)	34.2	43.2	47.7	50.5	55.2	63.9	70.0	74.3
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	0.2	0.3	0.2	0.2
Private consumption	-0.6	0.1	-0.2	0.2	-0.1	0.1	-0.1	0.1
Fixed investment	-5.1	-1.7	-1.0	-1.3	-1.1	0.4	-0.3	0.0
Government consumption	0.7	0.7	0.7	0.0	0.6	0.2	-0.1	0.0
Exports of goods and services	-8.4	-1.1	2.8	1.7	2.5	0.6	0.5	0.8
Imports of goods and services	-8.1	-2.7	2.8	1.2	4.0	-1.1	0.2	0.6

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	0.2	0.3	0.2	0.2
Private consumption	-0.4	0.0	-0.1	0.1	-0.1	0.0	0.0	0.1
Fixed investment	-1.1	-0.4	-0.2	-0.3	-0.2	0.1	-0.1	0.0
Government consumption	0.1	0.2	0.1	0.0	0.1	0.0	0.0	0.0
Stockbuilding	-1.1	-0.6	0.5	0.1	0.9	-0.6	0.1	0.1
Exports of goods and services	-3.6	-0.4	1.1	0.7	1.0	0.3	0.2	0.3
Imports of goods and services	3.5	1.1	-1.1	-0.5	-1.6	0.5	-0.1	-0.2

Annual levels – Real terms

(€ billion, 2000 prices)

	2009	2010	2011	2012	2013	2014
GDP	7,449	7,507	7,602	7,746	7,911	8,081
Private consumption	4,327	4,329	4,356	4,416	4,490	4,572
Fixed investment	1,504	1,461	1,478	1,518	1,566	1,613
Government consumption	1,608	1,627	1,622	1,628	1,643	1,663
Stockbuilding	-44	7	21	28	40	50
Exports of goods and services	3,042	3,223	3,367	3,581	3,814	4,040
Imports of goods and services	2,987	3,139	3,242	3,425	3,641	3,857

Annual levels – Nominal terms

(€ billion)

	2009	2010	2011	2012	2013	2014
GDP	8,964	9,117	9,356	9,699	10,086	10,493
Private consumption	5,156	5,254	5,352	5,511	5,700	5,909
Fixed investment	1,767	1,728	1,775	1,848	1,934	2,025
Government consumption	1,979	2,030	2,065	2,122	2,192	2,271
Stockbuilding	-56	-24	32	58	81	97
Exports of goods and services	3,247	3,557	3,744	3,991	4,257	4,527
Imports of goods and services	3,129	3,428	3,612	3,831	4,078	4,336



Detailed tables and charts

Prices and costs indicators

(annual percentage changes unless specified)

	2009	2010	2011	2012	2013	2014
HICP headline inflation	0.3	1.5	1.5	1.5	1.7	1.8
Inflation ex-energy	1.3	1.7	1.7	0.5	1.8	1.8
GDP deflator	1.0	0.9	1.3	1.7	1.8	1.8
Import deflator	-1.7	5.6	2.7	1.8	1.6	1.6
Export deflator	-9.4	11.0	6.2	0.5	0.1	1.0
Terms of trade	-7.7	5.4	3.5	-1.4	-1.4	-0.6
Earnings	1.4	1.3	1.4	2.3	2.7	2.9
Unit labor costs	3.8	-0.8	0.1	0.9	1.2	1.3
Output gap (% of GDP)	-5.4	-4.9	-4.1	-3.4	-2.6	-1.9
Oil prices (€ per barrel)	44.2	65.1	76.1	78.1	79.4	81.4
Euro effective exchange rate (1995=100)	129.7	115.7	108.6	109.9	111.7	112.0

	2009				2010			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
HICP headline inflation	0.9	0.2	-0.4	0.4	1.1	1.4	1.8	1.8
Inflation ex-energy	1.7	1.5	1.2	1.0	0.9	2.0	1.7	2.1
GDP deflator	1.9	1.1	0.9	0.2	0.5	0.9	1.0	1.2
Import deflator	-0.1	-1.3	-2.6	-2.7	3.8	5.7	6.1	6.8
Export deflator	-7.2	-9.7	-13.1	-7.5	5.4	11.6	11.4	15.6
Terms of trade	-7.0	-8.4	-10.4	-4.8	1.6	5.9	5.4	8.8
Earnings	2.0	1.3	1.3	1.2	1.8	1.2	1.1	0.9
Unit labor costs	5.9	4.6	3.4	1.3	-0.8	-1.1	-0.7	-0.7
Output gap (% of GDP)	-5.3	-5.6	-5.4	-5.3	-5.2	-4.9	-4.8	-4.6
Oil prices (€ per barrel)	34.2	43.2	47.7	50.5	55.2	63.9	70.0	74.3
Euro effective exchange rate (1995=100)	128.0	128.9	130.2	131.8	125.8	116.6	111.3	109.2



Labor market

(annual percentage changes unless specified)

	2009	2010	2011	2012	2013	2014
Employment	-1.9	-1.1	-0.1	0.5	0.7	0.6
Unemployment rate (%)	9.4	10.2	10.5	10.3	9.9	9.4
NAIRU (%)	7.9	8.5	9.0	9.1	9.1	8.9
Participation rate (%)	72.9	72.6	72.7	73.0	73.3	73.6
Earnings	1.4	1.3	1.4	2.3	2.7	2.9
Unit labor costs	3.8	-0.8	0.1	0.9	1.2	1.3

	2009				2010			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employment	-1.3	-1.9	-2.2	-2.1	-1.7	-1.2	-0.8	-0.7
Unemployment rate (%)	8.8	9.3	9.7	9.8	10.0	10.1	10.2	10.4
NAIRU (%)	7.7	7.8	8.0	8.1	8.2	8.4	8.5	8.8
Participation rate (%)	73.0	73.0	72.8	72.7	72.5	72.6	72.6	72.5
Earnings	2.0	1.3	1.3	1.2	1.8	1.2	1.1	0.9
Unit labor costs	5.9	4.6	3.4	1.3	-0.8	-1.1	-0.7	-0.7



Current account and fiscal balance

	2009	2010	2011	2012	2013	2014
Trade balance (€ bn)	17.4	-9.1	-35.1	-10.2	8.5	19.0
Trade balance (% GDP)	0.2	-0.1	-0.5	-0.1	0.1	0.2
Current account balance (€ bn)	-58.4	-14.2	-19.8	13.3	36.0	44.0
Current account balance (% GDP)	-0.7	-0.2	-0.2	0.1	0.4	0.4
Government budget balance (€ bn)	-565	-591	-488	-409	-339	-283
Government budget balance (% GDP)	-6.3	-6.5	-5.2	-4.2	-3.4	-2.7
Cyclically adjusted surplus (+)/deficit (-) (%GDP)	-4.7	-0.8	1.1	2.6	3.9	5.0
Government debt (€ bn)	7,063	7,507	8,078	8,567	8,978	9,331
Government debt (% GDP)	94.8	100.0	106.3	110.6	113.5	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	1.5
Growth rate gap (max-min)	7.2	7.2	3.5
Highest GDP per capita (Eurozone=100)	228.3	245.2	247.7
Lowest GDP per capita (Eurozone=100)	23.5	23.6	24.6
Inflation and prices			
Standard deviation of inflation rates	2.1	0.9	0.8
Inflation rate gap (max-min)	8.1	3.5	3.4
Highest price level (Eurozone=100)	114.9	116.8	114.9
Lowest price level (Eurozone=100)	42.6	56.1	66.0



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