Eurozone

Highlights and Key Issues

- This year has developed broadly as expected in the Eurozone, with an estimated 0.4% fall in GDP. But we have pushed the recovery back by one year compared with our early 2012 expectations and we forecast another year of shallow contraction in 2013. By the end of the year, Eurozone GDP will still be over 2% below its pre-crisis peak.
- Some progress to stabilise the Eurozone has been achieved during 2012, but the process has been slow and erratic. As a result, the risk of a Eurozone break-up lingers, which negatively affects business confidence and investment decisions.
- We forecast a smaller but still significant contraction in investment in 2013 as the economic environment and outlook for profits remains unfavourable, while businesses focus on reducing debt.
- Consumer spending is likely to fall for the second consecutive year as household purchasing power declines again and debt deleveraging is also a priority.
- Any growth in 2013 will stem from exports. We remain confident that the Eurozone's key trade partners will strengthen during 2013, with demand for Eurozone exports forecast to rise by nearly 5%. Combined with an expected weakening of the euro, this should boost exports outside the Eurozone. But in the peripheral economies that most need such a boost, there are relatively few export companies well-placed to take advantage of these sources of stronger demand.

Forecast for Eurozone
(Annual percentage changes unless specified)

	2011	2012	2013	2014	2015	2016
Domestic Demand	0.5	-1.9	-0.8	0.8	1.3	1.4
Private Consumption	0.1	-1.0	-0.3	0.7	1.1	1.3
Fixed Investment	1.6	-3.5	-1.5	2.1	2.9	2.8
Government Consumption	-0.1	-0.1	-0.9	-0.3	0.3	0.6
Net exports (% of GDP)	2.8	4.3	4.8	5.1	5.2	5.3
GDP	1.5	-0.4	-0.2	1.0	1.4	1.5
Industrial Production	2.7	-2.4	-0.7	1.6	2.3	2.1
Consumer Prices	2.7	2.5	1.8	1.5	1.3	1.3
Current Account (% of GDP)	0.1	1.0	1.4	1.3	1.2	1.2
Government Budget (% of GDP)	-4.1	-3.3	-2.6	-2.1	-1.6	-1.3
Short-Term Interest rate (%)	1.4	0.6	0.2	0.3	0.4	0.5
Long-Term Interest Rates (%)	4.4	4.0	3.4	3.6	3.8	4.1
Exchange rate (US$ per Euro)	1.39	1.28	1.27	1.21	1.17	1.17
Exchange rate (YEN per Euro)	111.0	102.3	108.9	113.5	112.0	114.0

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Overview

Growth in 2012 much as expected…

- This year has developed broadly as expected in the Eurozone, with a slight contraction in GDP. At the start of the year we were forecasting that GDP would fall by 0.2%. Now, with three quarters of data in, we estimate that GDP will shrink by 0.4%. The recession in the peripheral countries has typically been deeper than we expected at the start of 2012, partly because we had underestimated the degree of fiscal tightening that would be implemented. But the core of the Eurozone has been more resilient than we had expected, with forecasts for Germany and France revised up during the course of the year.

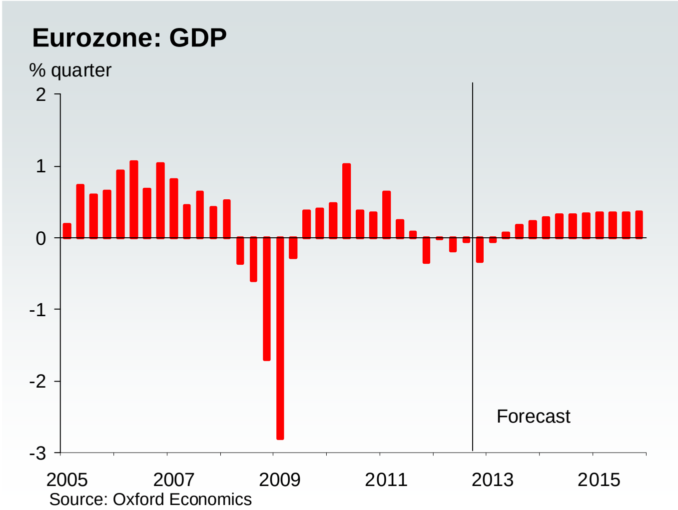
- We estimate that GDP will contract by 0.3% quarter-on-quarter in 2012Q4. This is consistent with information from surveys such as the PMI. In October and November, the manufacturing PMI was broadly unchanged from its Q3 average, at 46.2 in November and thereby pointing to a fall in activity in the sector. And from the services PMI survey, it looks like services activity also fell at the end of the year.

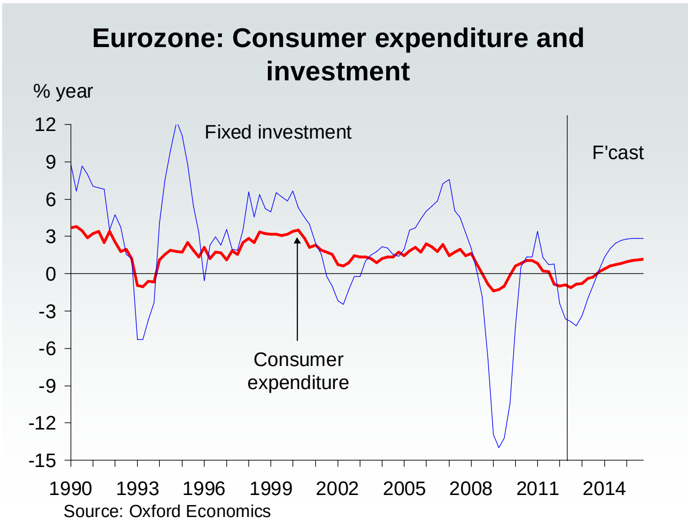
…but no recovery now seen in 2013

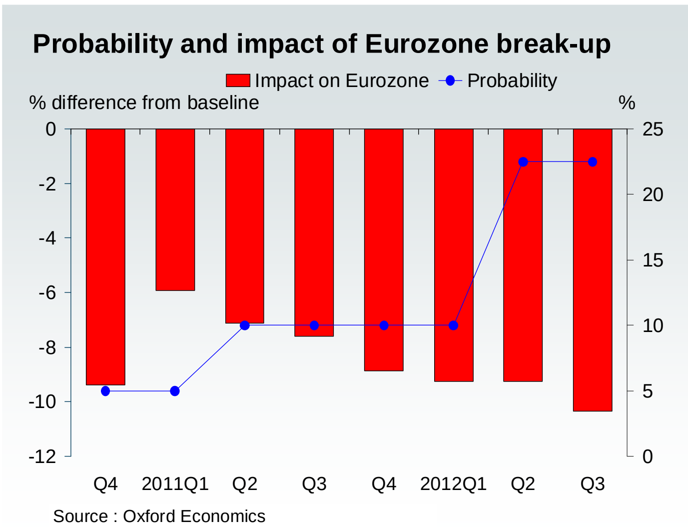
- While at the beginning of 2012 we were expecting a recovery in 2013, we have now pushed this back by one year. Instead we forecast another year of shallow contraction in 2013, with GDP seen falling 0.2%.

- But some progress to stabilise the Eurozone has been achieved during 2012. The ECB has committed to purchase bonds from Eurozone peripheral governments, as long as the countries are under some kind of bailout framework. This has contributed to reduce the risk of an imminent break-up of the Eurozone. In addition, banking union has been discussed and is seen as a key objective, although disagreement persists over its scope. In November, the European Commission presented its 'blueprint' for the Eurozone that, in some parts, sets very ambitious goals about closer fiscal and even political integration, including the issuance of commonly guaranteed eurobills and eurobonds.

- But the process has been slow and erratic. As a result, the risk of a Eurozone break-up lingers. We continue to attribute a near 25% probability that the Eurozone breaks up within a year to 18 months. This







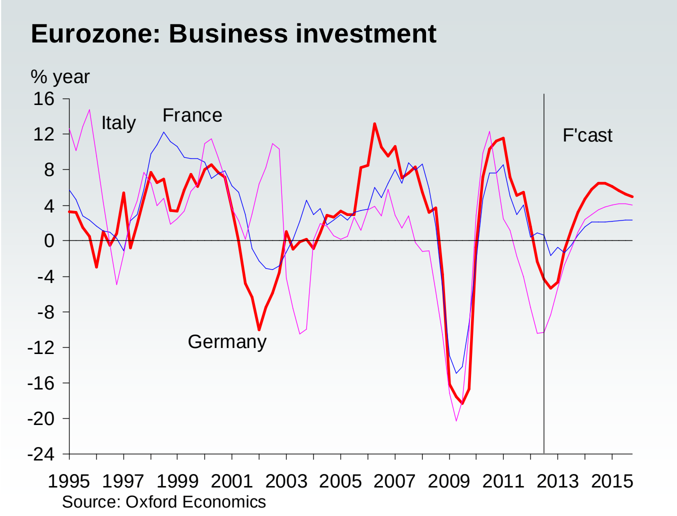
high level of uncertainty negatively affects business confidence and investment decisions.

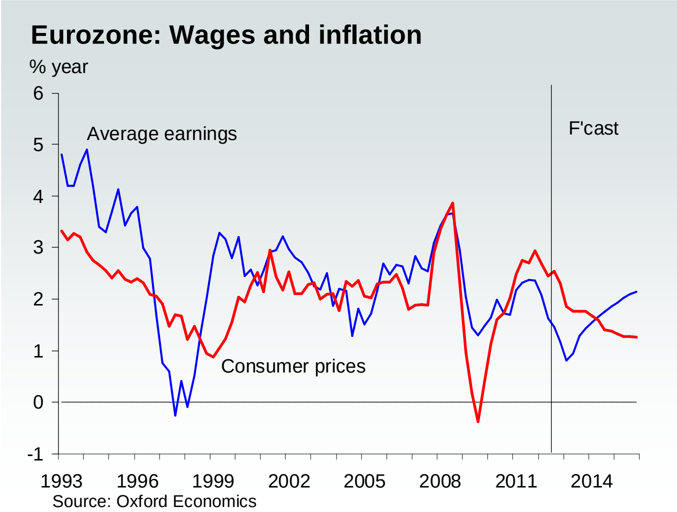
Austerity in the private sector too

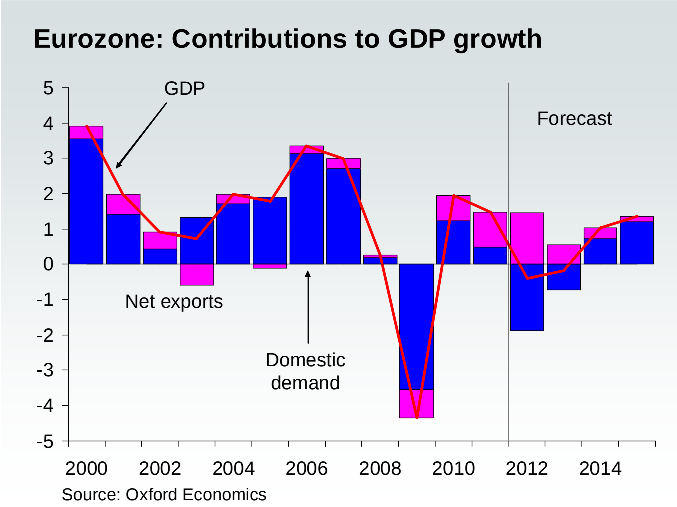
- We forecast a significant contraction in investment in 2013 as the economic environment and the outlook for profits remains unfavourable, while businesses focus on reducing debt. Indeed, unlike in the US where companies deleveraged aggressively in 2009 and 2010, Eurozone companies have yet to address their high debt levels, estimated at around 138% of GDP in 2012. Banks are still reluctant to lend and, while market financing conditions are very favourable for those deemed creditworthy, many firms have no choice but to reduce debt first.
- Consumer spending is likely to contract for a second consecutive year in 2013 as households' purchasing power falls further. Lower inflation, forecast to average 1.8% in 2013 compared with 2.5% in 2012, will only bring limited relief; rising unemployment rates suggest that nominal wages will not even keep up with the lower inflation rate. Moreover, as on the corporate side – and again contrasting with the situation in the US – households have yet to start reducing debt. So debt deleveraging is also a priority.
- Overall, while growth has so far been largely shaped by the pace of fiscal austerity in the periphery and the Eurozone as a whole, from 2013 onwards the private sector's need for austerity will significantly influence businesses and households' spending decisions.

…but recession is not over

- Any growth in 2013 will stem from exports. We remain confident that the Eurozone's key trade partners will strengthen during 2013. Demand for Eurozone exports is forecast to rise by nearly 5% next year. Combined with an expected weakening of the euro, this should boost exports outside the Eurozone. The traditional export champions like Germany and the Netherlands are likely to benefit most. For the peripheral economies, some improvement in competitiveness has already been achieved, which increases their chances of benefiting from stronger external demand. But in general, relatively few companies in the periphery are in a position to take advantage of such a strengthening in external demand.







Key Indicators: Eurozone

Percentage changes on a year earlier unless otherwise stated

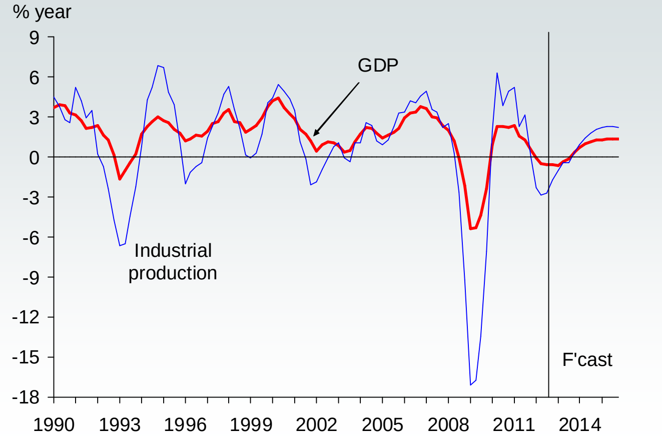
	Industrial production (% yr)	Unemploy-ment (% point)	CPI (% yr)	Business confidence (% balance)	Consumer confidence (% balance)	Exports (% yr)	Imports (% yr)	Trade balance (€ bn)
Nov	0.0	10.6	3.0	-0.4	-20.5	10.3	4.8	5.2
Dec	-1.5	10.7	2.7	-0.3	-21.3	9.7	2.2	8.4
2012								
Jan	-1.5	10.8	2.7	-0.2	-20.7	10.8	4.2	-8.8
Feb	-1.7	10.9	2.7	-0.1	-20.3	11.0	7.7	1.4
Mar	-1.7	11.0	2.7	-0.2	-19.1	4.6	0.5	7.7
Apr	-2.5	11.2	2.6	-0.5	-19.9	6.0	-0.1	4.2
May	-2.5	11.3	2.4	-0.8	-19.3	6.1	0.6	7.3
Jun	-1.8	11.4	2.4	-0.9	-19.8	12.3	3.2	13.4
Jul	-2.5	11.5	2.4	-1.2	-21.5	11.0	2.8	14.4
Aug	-2.1	11.5	2.6	-1.2	-24.6	10.1	1.9	5.2
Sep	-2.9	11.6	2.6	-1.3	-25.9	1.4	-4.0	9.8
Oct	-	11.7	2.5	-1.6	-25.7	-	-	-
Nov	-	-	2.2	-1.2	-26.9	-	-	-

Financial Indicators: Eurozone

Percentage changes on a year earlier unless otherwise stated

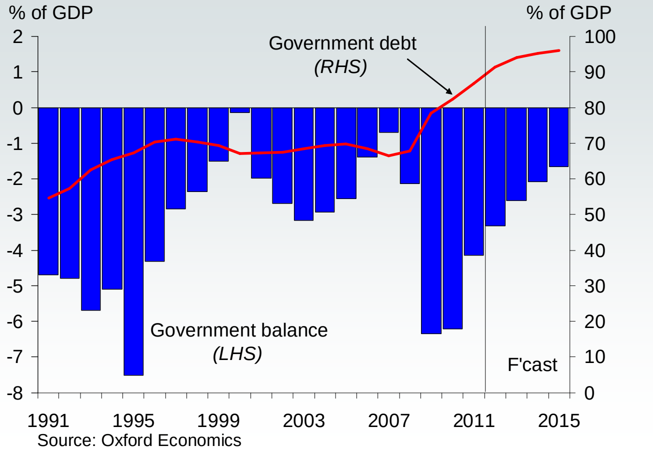
	Short rate %	Long rate %	Money Supply (M3)	Exchange rate \$/€ avg.	Exchange rate €/£	Nominal effective exch. rate	Share price DJ STOXX	Net FDI € bn
Nov	1.48	4.41	1.5	1.356	1.166	105.6	2330.4	-50.5
Dec	1.43	4.11	1.5	1.318	1.184	103.6	2316.6	10.9
2012								
Jan	1.22	3.92	2.0	1.290	1.203	101.6	2416.7	0.3
Feb	1.05	3.75	2.5	1.322	1.194	102.9	2512.1	5.7
Mar	0.86	3.29	2.9	1.320	1.198	103.4	2477.3	-9.4
Apr	0.74	3.39	2.3	1.316	1.216	102.8	2306.4	-0.8
May	0.68	3.53	2.9	1.279	1.244	100.8	2118.9	10.1
Jun	0.66	3.41	3.0	1.253	1.242	99.7	2264.7	-19.1
Jul	0.50	3.25	3.6	1.229	1.269	97.6	2325.7	-7.2
Aug	0.33	3.01	2.9	1.240	1.268	97.7	2440.7	-12.1
Sep	0.25	2.43	2.6	1.286	1.252	99.9	2454.3	-8.9
Oct	0.21	2.31	3.9	1.297	1.239	100.8	2503.6	-
Nov	0.19	2.25	-	1.283	1.244	100.3	2575.3	-

Eurozone: GDP and industrial production



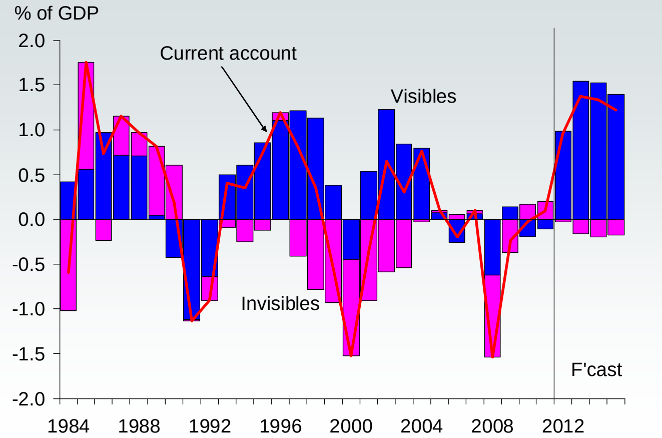
Source: Oxford Economics

Eurozone: Government finances



Source: Oxford Economics

Eurozone: Current account

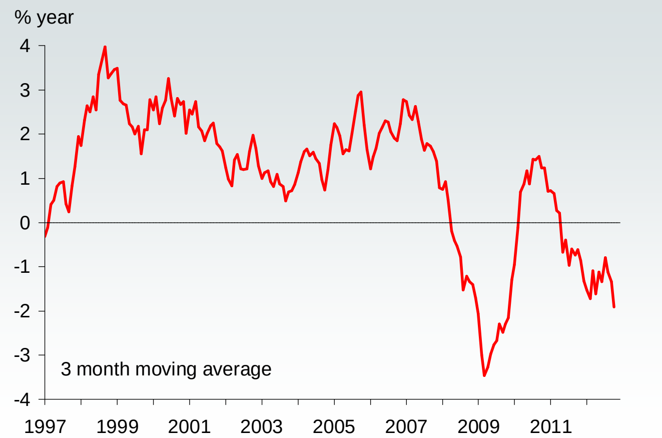


Source: Oxford Economics

Dollar/euro exchange rate

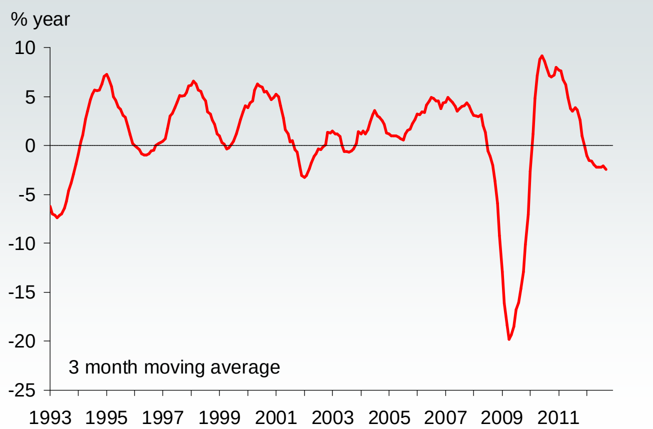
Source: Oxford Economics

Eurozone: Retail sales



Source: Oxford Economics

Eurozone: Industrial production



Source: Haver Analytics

EURO ZONE — **TABLE 1 SUMMARY ITEMS**

Annual Percentage Changes, Unless Otherwise Specified

	CONSUMERS EXPENDITURE (C)	GROSS FIXED INVESTMENT (IF)	DOMESTIC DEMAND (DOMD)	REAL GDP (GDP)	INDUSTRIAL PRODUCTION (IP)	UNEMPLOY-MENT RATE (%) (UP)	AVERAGE EARNINGS (ER)	WHOLE ECONOMY PRODUCT-IVITY (GDP/ET)	MONEY SUPPLY M3 (MON)	PRODUCER PRICES (PPI)	CONSUMER PRICES (CPI)
YEARS BEGINNING Q1											
2011	0.1	1.6	0.5	1.5	2.7	10.2	2.3	1.2	1.6	5.6	2.7
2012	-1.0	-3.5	-1.9	-0.4	-2.4	11.4	1.6	0.2	2.5	2.6	2.5
2013	-0.3	-1.5	-0.8	-0.2	-0.7	12.3	1.1	0.7	1.9	1.8	1.8
2014	0.7	2.1	0.8	1.0	1.6	12.3	1.7	1.1	3.1	1.9	1.5
2015	1.1	2.9	1.3	1.4	2.3	11.9	2.1	1.1	3.6	1.9	1.3
2016	1.3	2.8	1.4	1.5	2.1	11.6	2.3	1.2	3.6	1.9	1.3
2011											
I	0.9	3.4	1.6	2.4	5.3	9.9	2.2	2.0	0.1	6.4	2.5
II	0.2	1.3	0.9	1.6	2.3	9.9	2.3	1.1	1.6	5.8	2.8
III	0.2	0.7	0.3	1.3	3.2	10.2	2.4	1.0	2.4	5.4	2.7
IV	-0.8	0.8	-0.8	0.6	0.1	10.6	2.4	0.7	2.3	4.7	2.9
2012											
I	-1.0	-2.4	-1.6	0.0	-2.2	10.9	2.1	0.4	2.9	3.4	2.7
II	-0.9	-3.6	-2.2	-0.4	-2.9	11.3	1.6	0.2	2.9	2.1	2.5
III	-1.1	-3.8	-2.2	-0.6	-2.7	11.5	1.5	0.1	2.4	2.2	2.5
IV	-0.8	-4.1	-1.7	-0.6	-1.9	11.8	1.2	0.2	2.0	2.5	2.3
2013											
I	-0.7	-3.4	-1.5	-0.6	-1.3	12.1	0.8	0.1	1.8	1.8	1.9
II	-0.4	-2.0	-1.0	-0.4	-0.7	12.3	0.9	0.6	1.5	1.8	1.8
III	-0.2	-1.0	-0.5	-0.1	-0.9	12.4	1.3	0.8	2.0	1.8	1.8
IV	0.2	0.3	0.0	0.4	0.3	12.4	1.4	1.1	2.4	1.8	1.8
2014											
I	0.4	1.4	0.4	0.7	0.9	12.4	1.5	1.1	2.8	1.9	1.7
II	0.6	2.0	0.7	1.0	1.5	12.3	1.7	1.1	3.0	1.9	1.6
III	0.7	2.5	0.9	1.2	1.8	12.2	1.7	1.1	3.3	1.9	1.4
IV	0.8	2.7	1.1	1.3	2.1	12.1	1.9	1.1	3.4	1.9	1.4
2015											
I	1.0	2.8	1.2	1.3	2.2	12.1	1.9	1.1	3.5	1.9	1.3
II	1.1	2.9	1.2	1.4	2.3	12.0	2.0	1.1	3.6	1.9	1.3
III	1.1	2.9	1.3	1.4	2.3	11.9	2.1	1.2	3.6	1.9	1.3
IV	1.2	2.9	1.4	1.4	2.3	11.8	2.1	1.2	3.6	1.9	1.3
2016											
I	1.2	2.8	1.4	1.4	2.2	11.7	2.2	1.2	3.6	1.9	1.3
II	1.3	2.8	1.4	1.5	2.2	11.7	2.2	1.2	3.6	1.9	1.3
III	1.3	2.7	1.4	1.5	2.1	11.6	2.3	1.3	3.7	1.8	1.3
IV	1.3	2.7	1.4	1.5	2.0	11.5	2.3	1.3	3.7	1.8	1.3

EURO ZONE — **TABLE 2 SUMMARY ITEMS**

	TRADE BALANCE (EURO BN) (BVI)	CURRENT ACCOUNT (EURO BN) (BCU)	CURRENT ACCOUNT (% OF GDP) (BCU*100 /GDP!)	GOVERNMENT FINANCIAL BALANCE (EURO BN) (GB)	GOVERNMENT FINANCIAL BALANCE (% OF GDP) (GB*100 /GDP!)	SHORT-TERM INTEREST RATE (RSH)	LONG-TERM INTEREST RATE (RLG)	REAL SHORT-TERM INTEREST RATE (Note 1)	REAL LONG-TERM INTEREST RATE (Note 1)	US DOLLAR PER EURO (RXD)	EFFECTIVE RATE (1995=100) (RX)
YEARS BEGINNING Q1											
2011	-9.9	8.7	0.09	-389.5	-4.14	1.39	4.41	-1.33	1.69	1.39	120.8
2012	93.4	90.6	0.95	-314.9	-3.32	0.57	4.00	-1.92	1.51	1.28	115.5
2013	147.8	132.2	1.38	-251.2	-2.62	0.22	3.41	-1.57	1.62	1.27	115.3
2014	150.1	131.0	1.33	-204.3	-2.08	0.31	3.59	-1.20	2.08	1.21	113.2
2015	140.9	123.2	1.22	-166.1	-1.64	0.39	3.80	-0.89	2.52	1.17	110.4
2016	147.9	120.8	1.16	-131.7	-1.27	0.46	4.12	-0.85	2.82	1.17	110.3
2011											
I	-7.2	0.7	0.03	-113.1	-4.83	1.10	4.32	-1.38	1.84	1.37	119.4
II	-7.7	-5.9	-0.25	-100.8	-4.28	1.42	4.51	-1.34	1.75	1.44	122.4
III	-5.9	1.1	0.05	-91.2	-3.86	1.56	4.30	-1.14	1.60	1.41	121.2
IV	10.9	12.8	0.54	-84.3	-3.57	1.50	4.53	-1.45	1.59	1.35	120.4
2012											
I	10.9	21.6	0.91	-79.7	-3.37	1.04	4.39	-1.64	1.70	1.31	116.8
II	21.0	28.1	1.19	-85.0	-3.58	0.69	4.27	-1.76	1.82	1.28	115.8
III	27.3	15.3	0.64	-77.1	-3.24	0.36	3.99	-2.18	1.45	1.25	113.3
IV	34.2	25.6	1.08	-73.1	-3.07	0.20	3.36	-2.11	1.06	1.29	116.0
2013											
I	35.9	57.1	2.39	-66.8	-2.80	0.20	3.43	-1.66	1.57	1.28	115.7
II	34.7	33.0	1.38	-68.4	-2.86	0.21	3.38	-1.55	1.62	1.27	115.3
III	36.6	12.6	0.52	-62.6	-2.60	0.23	3.39	-1.54	1.63	1.26	115.2
IV	40.5	29.6	1.23	-53.3	-2.21	0.25	3.44	-1.51	1.68	1.25	114.9
2014											
I	40.3	59.7	2.46	-53.0	-2.18	0.28	3.51	-1.40	1.84	1.23	114.4
II	35.5	32.7	1.34	-54.9	-2.24	0.30	3.58	-1.29	1.99	1.22	113.8
III	35.7	10.6	0.43	-52.6	-2.14	0.32	3.62	-1.09	2.21	1.20	112.9
IV	38.6	27.9	1.12	-43.7	-1.76	0.34	3.65	-1.04	2.28	1.19	111.8
2015											
I	37.8	57.7	2.31	-42.8	-1.71	0.36	3.69	-0.96	2.37	1.17	110.4
II	32.5	30.4	1.21	-45.2	-1.80	0.38	3.74	-0.89	2.47	1.17	110.4
III	33.2	8.9	0.35	-43.4	-1.71	0.40	3.83	-0.87	2.56	1.17	110.4
IV	37.4	26.3	1.03	-34.7	-1.36	0.42	3.92	-0.84	2.66	1.17	110.4
2016											
I	37.9	56.6	2.20	-34.0	-1.32	0.44	4.01	-0.84	2.73	1.17	110.4
II	33.5	29.4	1.14	-37.0	-1.43	0.45	4.08	-0.85	2.79	1.17	110.3
III	35.7	8.7	0.33	-35.0	-1.34	0.47	4.16	-0.85	2.85	1.17	110.4
IV	40.8	26.1	0.99	-25.7	-0.98	0.48	4.23	-0.86	2.90	1.17	110.3

Note 1 : REAL INTEREST RATES = Nominal interest rate (RSH or RLG) - % change in CPI

Potential output growth 0.9%pa

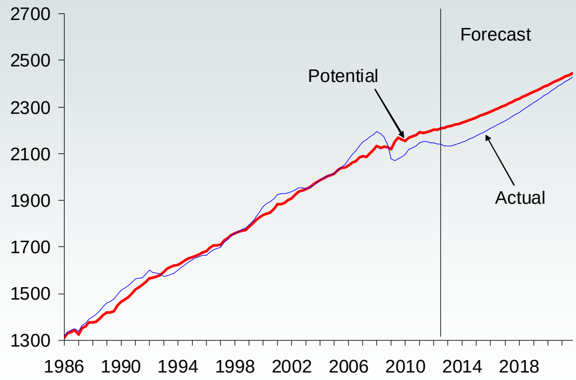
- Potential output is projected to rise by 0.9%pa over the next 10 years, a significantly lower rate than in the previous decade. GDP is set to contract by 0.4% in 2012, having grown by 1.5% in 2011 and to be significantly below potential growth at -0.2% in 2013. As a result, the large output gap of 2.0% in 2011 will expand in 2012 to 3.0% and increase in 2013 to 3.9%, and it is not forecast to close fully until 2024.

- The main contribution to growth in potential output over the coming decade comes from expanding capital usage.

- The 0.00%pt contribution from expanding labour usage reflects the 0.3%pa fall in the working population over the next ten years and an increase in the participation rate which combine to reduce the labour supply by 0.0%pa. For the capital stock's contribution of 0.5%pt, the main factor is significantly higher investment growth (at 1.4%pa) than in the previous decade. Finally, total factor productivity growth's slightly lower contribution of 0.4%pt reflects the worse contribution to potential growth from factors influencing production other than labour and capital over the coming decade.

Eurozone: Actual & potential output

Euro bn 2005 prices



Source: Oxford Economics

Potential GDP and Its Components
Average Percentage Growth

	2002-2011	2012-2021
Potential GDP*	1.56	0.86
Employment at NAIRU	0.66	0.00
Capital Stock	2.13	1.46
Total Factor Productivity	0.38	0.35

*ln(Potential GDP)=0.65*ln(Employment at NAIRU) +0.35*ln(Capital Stock)+ln(Total Factor Productivity)

Long-Term Forecast for Eurozone

(Average annual percentage change unless otherwise stated)

	2002-2006	2007-2011	2012-2016	2017-2021
GDP	1.8	0.4	0.7	1.7
Consumption	1.5	0.4	0.3	1.5
Investment	2.1	-1.8	0.5	2.2
Government Consumption	1.9	1.5	-0.1	1.1
Exports of Goods and Services	5.0	2.2	3.6	3.3
Imports of Goods and Services	5.0	1.7	2.7	3.3
Unemployment (%)	8.9	9.0	11.9	10.5
Consumer Prices	2.2	2.0	1.7	1.6
Current Balance (% of GDP)	0.3	-0.3	1.2	1.2
Exchange Rate (vs US$)	1.2	1.4	1.2	1.2
General Government Balance (% of GDP)	-2.5	-3.9	-2.2	-0.6
Short-term Interest Rates (%)	2.6	2.5	0.4	2.1
Long-term Interest Rates (%)	4.1	4.1	3.8	4.6
Working Population	0.5	0.2	-0.3	-0.3
Labour Supply	1.0	0.5	0.1	-0.1
Participation Ratio	72.5	74.0	75.4	76.0
Labour Productivity	0.8	0.3	0.9	1.4

Long-Term Forecast for Eurozone

Annual percentage changes unless otherwise specified

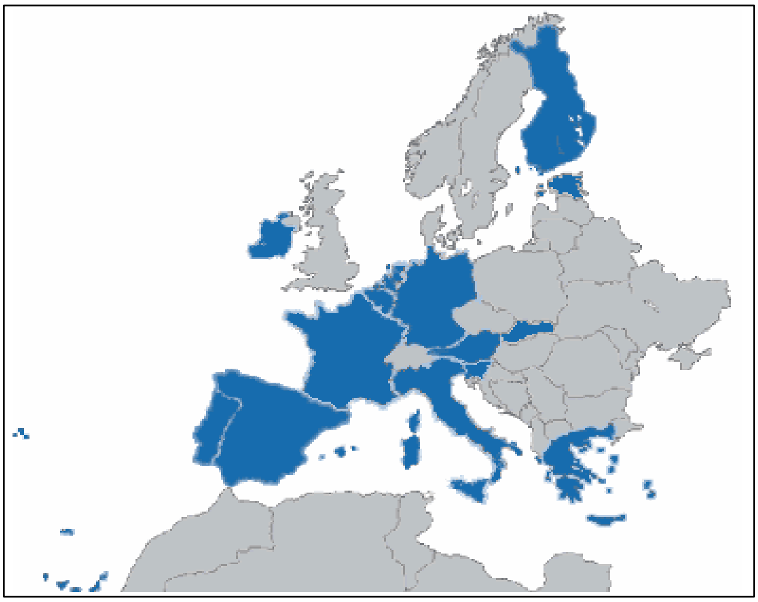
	2002-2011	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2021
GDP	1.1	0.3	-4.3	1.9	1.5	-0.4	-0.2	1.0	1.4	1.5	1.5	1.7	1.8	1.8	1.7	1.2
Consumption	1.0	0.4	-0.9	0.9	0.1	-1.0	-0.3	0.7	1.1	1.3	1.4	1.5	1.5	1.5	1.5	0.9
Investment	0.1	-1.6	-12.7	-0.3	1.6	-3.5	-1.5	2.1	2.9	2.8	2.5	2.3	2.1	2.1	1.9	1.4
Government Consumption	1.7	2.3	2.6	0.7	-0.1	-0.1	-0.9	-0.3	0.3	0.6	0.8	1.0	1.1	1.2	1.3	0.5
Exports of Goods and Services	3.6	0.9	-12.4	11.0	6.4	3.0	2.6	4.0	4.4	4.1	3.8	3.6	3.3	3.0	2.8	3.5
Imports of Goods and Services	3.3	0.7	-11.0	9.4	4.2	-0.4	1.5	3.7	4.5	4.2	3.8	3.5	3.3	2.9	2.8	3.0
Unemployment (%)	9.0	7.7	9.6	10.1	10.2	11.4	12.3	12.3	11.9	11.6	11.3	11.0	10.5	10.1	9.6	11.2
Consumer Prices	2.1	3.3	0.3	1.6	2.7	2.5	1.8	1.5	1.3	1.3	1.4	1.5	1.6	1.7	1.8	1.6
Current Balance (% of GDP)	0.0	-1.5	-0.2	0.0	0.1	1.0	1.4	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.3	1.2
Exchange Rate (per $)	1.3	1.5	1.4	1.3	1.4	1.3	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
General Government Balance (% of GDP)	-3.2	-2.1	-6.3	-6.2	-4.1	-3.3	-2.6	-2.1	-1.6	-1.3	-0.9	-0.7	-0.6	-0.5	-0.5	-1.4
Short-term Interest Rates (%)	2.5	4.6	1.2	0.8	1.4	0.6	0.2	0.3	0.4	0.5	0.6	1.2	2.2	2.9	3.4	1.2
Long-term Interest Rates (%)	4.1	4.3	3.8	3.6	4.4	4.0	3.4	3.6	3.8	4.1	4.3	4.5	4.6	4.8	4.9	4.2
Working Population	0.3	0.4	0.1	0.1	-0.1	-0.2	-0.3	-0.3	-0.3	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Labour Supply	0.7	0.9	0.2	0.1	0.3	0.7	0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	0.0
Participation Ratio (%)	73.2	74.0	74.0	74.0	74.3	75.0	75.3	75.5	75.5	75.6	75.8	75.9	76.0	76.1	76.2	75.7
Labour productivity	0.6	-0.5	-2.6	2.5	1.2	0.2	0.7	1.1	1.1	1.2	1.3	1.4	1.4	1.4	1.4	1.1
Employment	0.5	0.8	-1.8	-0.5	0.3	-0.6	-0.8	-0.1	0.2	0.2	0.2	0.3	0.4	0.3	0.3	0.0
Output gap (% of potential GDP)	0.0	2.0	-3.4	-2.4	-2.0	-3.0	-3.9	-3.7	-3.4	-3.1	-2.8	-2.3	-1.8	-1.3	-0.8	-2.6

Background

- The creation of a single European currency was achieved in 1999, with notes and coins being introduced in 2002. The eleven initial members were Germany, France, Italy, Finland, Ireland, Netherlands, Belgium, Luxembourg, Austria, Portugal and Spain, with Greece joining European Monetary Union (EMU) in 2001 and introducing notes and coins at the same time as the other countries. Slovenia was the 13th member in January 2007, Malta and Cyprus joined a year later, Slovakia became the 16th member in January 2009 and Estonia the 17th in January 2011.
- To qualify for membership of the Eurozone, countries have to pass a number of nominal convergence criteria set out in the Maastricht Treaty: the inflation rate should not exceed by more than 1.5% points the average inflation rate of the three EU countries with the lowest inflation; the government deficit should not exceed 3% of GDP and gross government debt should be no higher than 60% of GDP; countries should have been members of ERM II and have not devalued their currency in the previous two years; and long-term interest rates should not be more than 2% points higher than the average in the three EU countries with the lowest inflation. In practice, these conditions were applied quite loosely to the original EMU members, with elements of the fiscal criteria being selectively overlooked for Italy and Belgium (and then Greece) and with little attention as to whether the budget deficit was below 3% of GDP on a sustainable basis. However, the narrow failure of Lithuania to win approval for adopting the euro in 2007 suggests that the convergence criteria will be applied much more strictly to new EU members.
- Joining EMU sees the member country pass control of its monetary policy to the European Central Bank (ECB). The ECB is one of the most independent central banks in the world and was built on the lines of the German Bundesbank. Not only does the ECB have ‘operational’ independence – allowing it to set interest rates free from political control – but it also has ‘goal’ independence to set its own targets. The ECB objective is to achieve price stability and this is pursued through economic and monetary analysis; the ECB targets inflation of close to, but not exceeding, 2%, and maintains a reference target of 4.5% for M3 money supply growth. The two components of analysis were to act as a crosscheck, but economic analysis has taken precedence in recent years, with monetary targeting slipping into the background. Since 2008, the ECB has increasingly focused on providing liquidity to banks, with in particular two sets of three-year loans granted in December 2011 and February 2012.
- National governments retain control of fiscal policy, although there are limits to their freedom in this area as specified in the Growth and Stability Pact, which essentially applies the fiscal requirements of the Maastricht Treaty on an ongoing basis. However, even before the global crisis, a number of Eurozone countries had difficulty keeping their budget deficits below 3% of GDP and debt below 60% of GDP on a sustained basis and faced sanctions by the EC. However, the effectiveness of the Growth and Stability Pact against the major Eurozone economies of Germany, France and Italy proved limited, while smaller countries such as the Netherlands made painful adjustments when their deficit exceeded the 3% of GDP threshold and others observed the requirements stringently. This forced a re-interpretation of the Pact, which is now applied over the economic cycle.
- The fallout from the financial crisis, and in particular the troubled fiscal situation faced by Greece, Italy, Ireland, Portugal and Spain, showed the limitations of the fiscal framework behind the single currency. The possibility of a debt default by Greece, coupled with the threat of contagion to Italy and Spain, has put Eurozone leaders under immense pressure to come up with a rescue plan that would prevent the collapse of the single currency. However, there are significant difference of opinion among the largest members regarding who should carry the burden and what mechanisms should be used to provide financial support to the European banking system. The core of the discussions focuses on a reform of the European Union Treaty in order to impose tougher rules regarding budget and fiscal discipline. Other measures include a move towards a banking union that would severe the links between banks and their sovereigns. However, political hurdles to closer integration and debt burden sharing remains very high. So significant changes are unlikely to be agreed upon in the near future.

Key Facts

Politics
President of the ECB: Mario DRAGHI
Vice president of the ECB: Vítor CONSTANCIO
EC commissioner for Economic and Monetary Affairs:
Olli Rehn
Chairman of Euro Group of Finance Ministers:
Claude Juncker



Source : ECB
Member countries: Germany, France, Italy, Finland, Ireland, Netherlands, Belgium, Luxembourg, Austria, Portugal, Spain, Greece, Slovenia, Malta, Cyprus, Slovakia & Estonia

Long-term economic & social development

	1980	1990	2000	2011*
GDP per capita (US$)	-	19175	19886	39435
Inflation (%)	9.9	4.2	2.2	2.7
Population (mn)	286	305	315	332
Urban population (% of total)	69.9	71.0	72.3	73.9
Life expectancy (years)	-	76.2	78.5	80.9

Source : Oxford Economics & World Bank

Structure of GDP by output

	2009
Agriculture	0.9%
Industry	22.5%
Services	76.6%

Source : Eurostat

* 2011 or latest available year

Corruption perceptions index 2011

	Score
Developed economies (average)	7.70
Emerging economies (average)	3.44
Eurozone	6.81

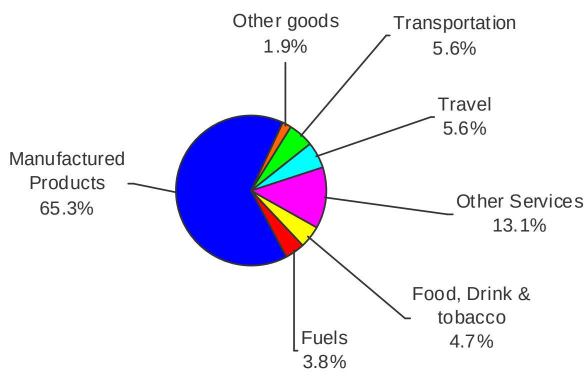
Source: Transparency International
Scoring system 10 = highly clean, 0 = highly corrupt

Structural economic indicators

	1990	1995	2000	2011*
Current account (US$ billion)	11	54	-95	12
Trade balance (US$ billion)	-25	63	-28	-14
FDI (US$ billion)	-	-	30	-83
Govt budget (% of GDP)	-4.1	-7.5	-0.1	-4.1
Govt debt (% of GDP)	13.5	67.3	67.1	86.8
Long-term interest rate	10.9	8.7	5.4	4.4
Oil production (000 bpd)	217	270	227	218
Oil consumption (000 bpd)	9715	10483	10916	9959

Source : Oxford Economics / World Bank / EIA / ECB

Composition of extra-EMU goods & services exports, 2008



Source : Eurostat

Destination of goods' exports (2009)

Eurozone	50.4%
UK	6.8%
United States	5.9%
Switzerland	3.1%
China	2.7%
Poland	2.6%

Source : Eurostat