OXFORD ECONOMICS

Eurozone

Highlights

- Recent indicators underline the extent to which the economic recovery is continuing along divergent tracks within the Eurozone. German and Spanish GDP expanded by 0.8% and 0.4% respectively in Q1, much better than the quarterly rise of 0.2% in the Eurozone as a whole. By contrast, GDP in the less reform-minded French and Italian economies was broadly stagnant.
- While the Eurozone economy as a whole had an uninspiring start to the year, timelier activity indicators, such as the composite PMI imply that the recovery may have gained a bit of momentum in the early stages of Q2. And we have modestly revised upwards our forecast for Eurozone GDP growth in 2014, from 1% to 1.2%. The primary driver for our improved forecast is a more positive outlook for household income and spending – in Germany and Spain in particular. As previously though, the degree of momentum varies across countries. Those countries that have done less to resolve their structural economic problems will continue to lag behind their more reform-minded counterparts.
- More generally, a number of familiar constraints on growth remain. Ongoing fiscal consolidation efforts will slow growth by 0.4-0.5 percentage points in 2014 and 2015. Investment and trade will also be undermined by very different competitive positions, with overall Eurozone export growth of 3-4% a year masking a wide range of outcomes at national level. Finally, the banking system will remain fragmented, undermining investment in peripheral economies.
- We remain concerned about the risk of deflation in the Eurozone, despite an uptick in CPI inflation to 0.7%. We expect a further cut in official interest rates, as well as efforts to push banks to lend to SMEs in the upturn, but recent language from the ECB suggests unconventional policy measures are less likely than previously thought. As such we have revised upward our forecast for the euro and expect a more gradual pick-up in inflation through 2015-16.

Forecast for Eurozone

(Annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
Domestic Demand	-2.2	-1.1	0.8	1.4	1.4	1.5
Private Consumption	-1.4	-0.7	0.8	1.3	1.4	1.4
Fixed Investment	-3.8	-2.9	2.0	2.4	2.4	2.5
Government Consumption	-0.6	0.1	0.0	0.2	0.4	0.6
Net exports (% of GDP)	4.3	4.9	5.3	5.3	5.4	5.6
GDP	-0.6	-0.4	1.2	1.5	1.5	1.6
Industrial Production	-3.0	-1.1	2.0	2.5	2.1	1.9
Consumer Prices	2.5	1.3	0.7	1.2	1.6	1.6
Current Account (% of GDP)	1.5	2.4	2.6	2.4	2.3	2.2
Government Budget (% of GDP)	-3.7	-3.0	-2.5	-2.0	-1.6	-1.4
Short-Term Interest rate (%)	0.6	0.2	0.2	0.2	0.2	0.5
Long-Term Interest Rates (%)	3.9	3.0	2.6	3.1	3.5	3.9
Exchange rate (US$ per Euro)	1.28	1.33	1.37	1.34	1.32	1.31
Exchange rate (YEN per Euro)	102.5	129.6	144.8	150.2	149.0	145.2

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Research Briefing

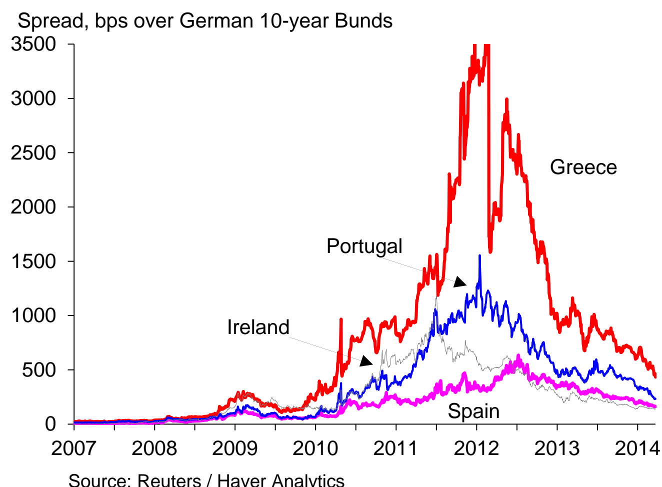
Why deflation matters for the Eurozone periphery

The peripheral Eurozone economies have recently enjoyed a notable rally in their government debt markets. In part, this reflects real progress in improving their creditworthiness, but it also reflects speculation about possible ECB QE and rapid disinflation. Some peripheral countries are already seeing falling prices, and this is a serious risk for the future. These economies have high debt burdens and weak fiscal positions that would be further strained by falling prices. Indeed, should deflation become entrenched it would risk reigniting concerns about long-term fiscal solvency in the Eurozone periphery. Deflation could also accelerate private sector deleveraging, snuffing out nascent economic recoveries. Given these risks, suggestions by some observers that falling prices in the Eurozone could be benign, rather than malign, are in our view flawed.

Peripheral bond markets rally…

The government bond markets of the 'peripheral' Eurozone states – Greece, Ireland, Portugal, and Spain – have enjoyed a notable rally this year. Ten-year bond yields have declined by over 200 basis points in Greece and Portugal, around 100 basis points in Spain and around 60 basis points in Ireland. Spreads over German bunds have declined to levels not seen since 2010.

Eurozone: Yield spreads over Germany



Source: Reuters / Haver Analytics

This is of course a welcome development, and reflects in part some genuine improvements in the fiscal situation in recent years. While the economic cost has been considerable, the budget positions of all these countries have improved considerably since 2009. Investor confidence and market conditions have also improved sufficiently for some countries to restart domestic debt issuance.

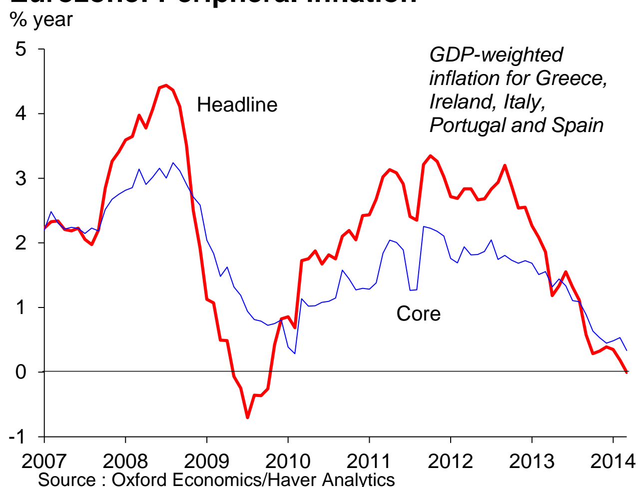
…but it is not all good news

The debt rally is not all good news, however. First, it appears to partly reflect growing expectations among investors that the ECB will begin a quantitative easing programme that would involve large-scale purchases of peripheral government debt. These hopes may prove misplaced given the formidable institutional and political barriers that exist to such a programme.

Second, and more importantly, we believe the bond market rally reflects a rapid decline in inflation and inflation expectations – and the possibility that this will turn into a period of prolonged price deflation.

Inflation has dropped sharply since early 2013 in the peripherals. A GDP-weighted measure of headline inflation for five countries (Italy, Spain, Ireland, Portugal and Greece) was over 2% at the start of 2013 but turned very slightly negative in March 2014. A similar core inflation measure (excluding energy and unprocessed food) dropped from 1.7% to 0.3% in the same period and now matches the record low seen in early 2010 in the wake of the global financial crisis.

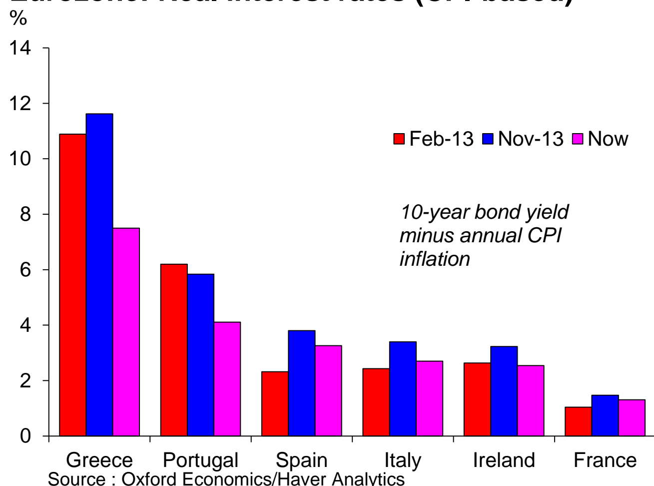
Eurozone: Peripheral inflation



Source : Oxford Economics/Haver Analytics

As a result of the decline in inflation, the decline in real 'ex-post' bond yields (measured using current CPI) has been less dramatic than the decline in nominal yields. Greece and Portugal have still seen a substantial compression in real yields measured this way over the last year. But Spain and Italy have actually seen real yields creep up compared to a year ago (while falling modestly since late 2013) while Irish real yields are little changed from early 2013.

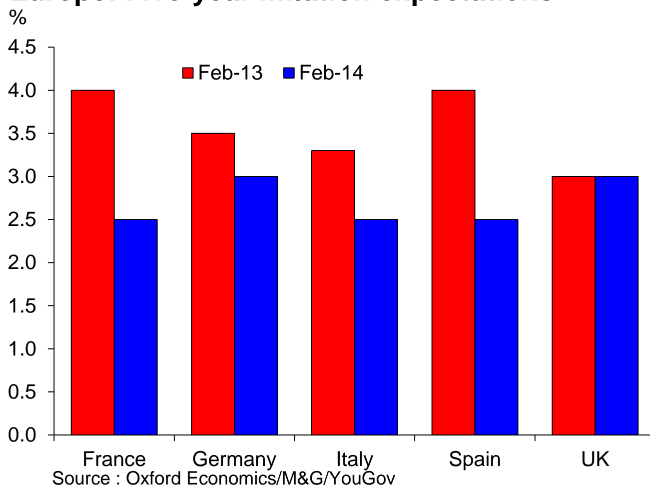
Eurozone: Real interest rates (CPI-based)



Source : Oxford Economics/Haver Analytics

The drop in real yields looks more impressive across the board if we calculate them using long-term inflation expectations rather than the current CPI. But the evidence suggests that inflation expectations are declining as well. The 'breakeven' inflation rate calculated using the difference between conventional and inflation-linked bond yields has dropped from around 1.6% to just above 1% in France over the last year and is at a similar low level in Italy. Survey based measures also show a considerable decline in the last year – the M&G/YouGov measure of five-year inflation expectations has tumbled by 100-150 basis points in Spain, France and Italy. By contrast, expectations have been much more stable in Germany and the UK.

Europe: Five-year inflation expectations



Source : Oxford Economics/M&G/YouGov

Deflation would damage public finances…

Should price deflation prove more than a brief phenomenon there is a danger that inflation expectations would decline further and give way to expectations of a falling price level. This would be potentially highly damaging for the public finances in the peripherals.

While deflation might reduce nominal bond yields further, the positive effect on the public finances from this would be slow to materialise. The interest burden on a given debt stock reflects many vintages of past debt issuance and changes only glacially in response to shifts in the cost of new borrowing. In this respect, it is notable that government debt interest payments, as a share of GDP, have been drifting higher in most of the peripherals in recent years and are forecast to continue to do so over the next two years. The one exception to this is Greece, where of course considerable debt relief has been granted by the country's creditors.

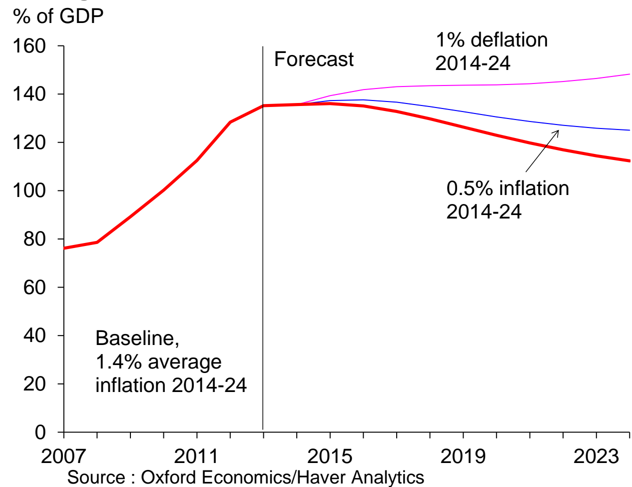
More damaging still is what might be termed the 'denominator effect'. Deflation means that nominal GDP will tend to stagnate or even shrink, contributing to a rise in the debt/GDP ratio. This effect has operated to a startling degree in Japan over recent years. Had Japan's nominal GDP been flat from 1998-2013 rather than declining, the debt/GDP ratio in 2013 would have been 14% points lower. Had nominal GDP grown by just 1% per year over that period, the terminal debt/GDP ratio would have been 41% points lower.

We can show the potential impact of low inflation and deflation on the debt/GDP ratios of the peripheral countries with some simple scenarios. Our baseline forecasts for the peripherals see inflation running at around 1.5% per year on average over the next decade, and given this and our forecasts for real GDP growth, interest rates and the budget balance, debt/GDP ratios generally start to stabilise and then decline from around the middle of the current decade.

This trend alters if we change our inflation forecasts while leaving other variables constant. If we reduce our inflation forecast to 0.5% per year over the next decade, the decline in the debt ratio slows considerably across most countries and virtually halts in Spain. By 2024, the debt/GDP ratios in the five peripherals are 10-15% points higher than in our baseline forecast.

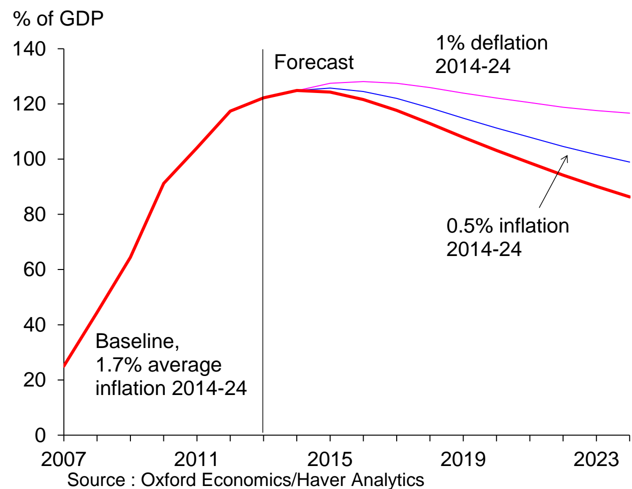
If we assume deflation sets in at 1% per year, the effects are even more dramatic. Rather than declining, the debt ratio rises in Spain, Italy and Portugal by 2024 – and is 30-40% points higher than in the baseline by this date. The rise relative to baseline is especially striking in Italy, where the government debt/GDP ratio rises to 166% by 2024. In Greece and Ireland, the debt ratio still declines by 2024 in this scenario, but by 2024 is much higher than in the baseline, by 30% points in Ireland and 40% points in Greece.

Portugal: Debt ratio in different inflation scenarios



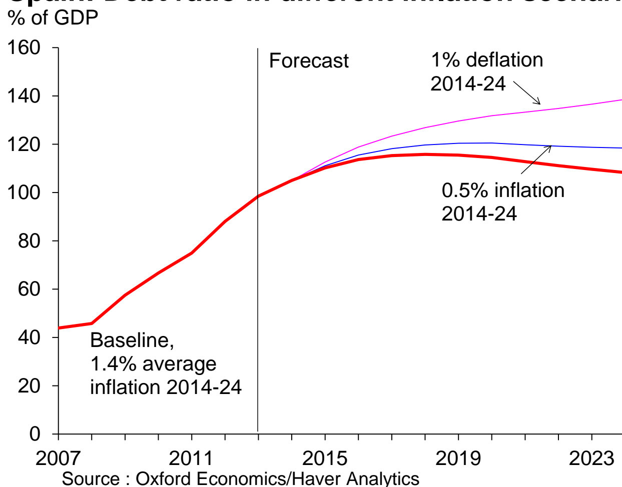
Source : Oxford Economics/Haver Analytics

Ireland: Debt ratio in different inflation scenarios



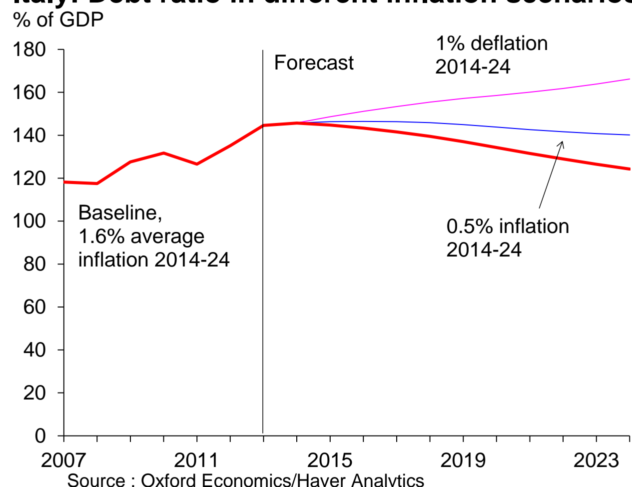
Source : Oxford Economics/Haver Analytics

Spain: Debt ratio in different inflation scenarios



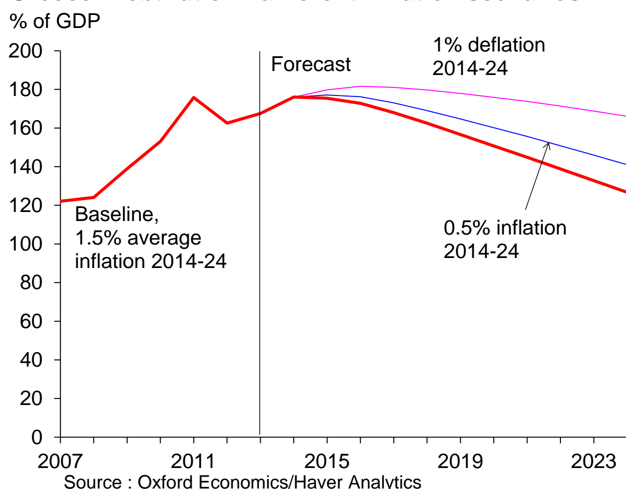
Source : Oxford Economics/Haver Analytics

Italy: Debt ratio in different inflation scenarios



Source : Oxford Economics/Haver Analytics

Greece: Debt ratio in different inflation scenarios



Source : Oxford Economics/Haver Analytics

These are very simple scenarios, and do not include all the possible implications of lower inflation or deflation. But they do give a flavour of the scale of the potential problem a slide into deflation could cause. Debt/GDP ratios would be much higher and this would be likely to quickly reignite concerns about long-term fiscal sustainability in these countries. This is in turn would probably feed back into higher risk premia on government debt, capital flight, weaker GDP growth and even more negative debt dynamics.

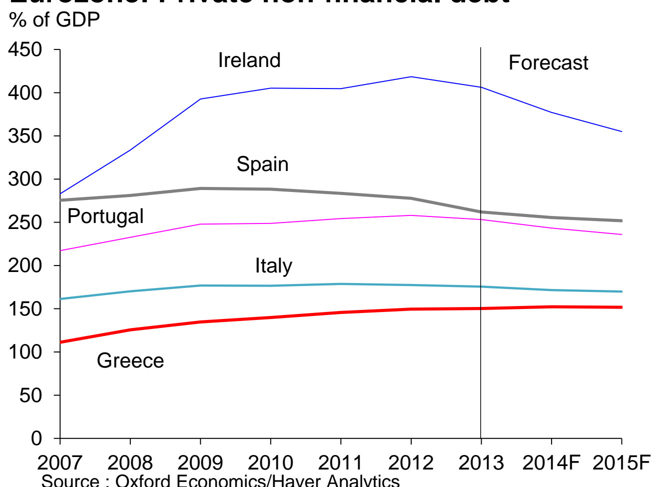
…and would harm the private sector, too

Deflation would not only be a problem for the public finances in the peripherals. As well as high levels of public debt, some of the peripherals suffer from high private levels as well – especially Ireland, Spain and Portugal. Indeed, private debt levels (here defined as household and non-financial company debt) have risen in Portugal, Greece and Ireland since 2007 despite weak growth and an atmosphere of austerity.

The risk would be that deflationary expectations would encourage intensified deleveraging by households and firms, alarmed at the prospect of rising debt burdens in real terms, with this in turn depressing consumer spending, investment and economic growth creating a negative spiral of 'debt deflation'.

Arguably, this process may already be under way. Spain's private sector has been cutting back on debt for several years and over the last year or two debt levels have started to fall (in nominal terms, not just as a share of GDP) in Ireland, Portugal and Greece. Interestingly, in the latter case (Greece) both household and corporate debt ratios have kept on rising despite falling nominal debt because household income and GDP have fallen even more. This is a striking demonstration of the 'denominator effect' operating malignly in the private sector – something that would be much more widespread if price deflation took a firm grip across the peripherals.

Eurozone: Private non-financial debt



Source : Oxford Economics/Haver Analytics

The risks of deflation for the Eurozone periphery, with its high public and private debts, are therefore clear. A slide into deflation would risk undoing the fiscal progress of recent years and would threaten to snuff out the nascent economic recovery in these countries. We therefore find recent suggestions from some observers that deflation in the Eurozone could be benign to be flawed.

Nor is the risk of deflation a mere theoretical one. Aside from the recent declines in inflation and inflation expectations, broad money growth is also negative or near zero in Italy, Spain, Portugal and Greece and output gaps remain very wide. Add to this the need to restore competitiveness against Germany – where inflation is also low and falling – and the level of deflation risk for the periphery looks high.

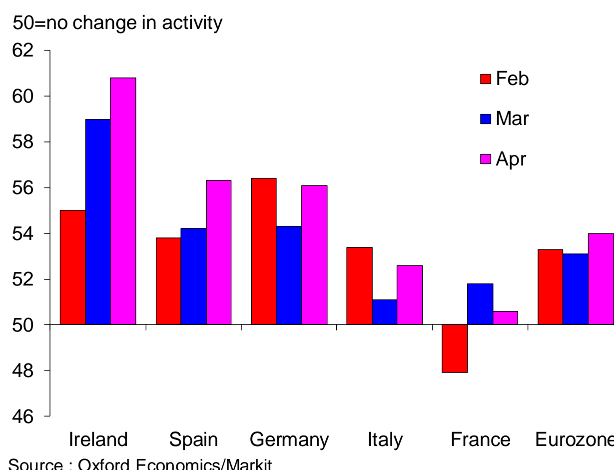
A slide into deflation would probably mean even further compression in nominal government bond yields in the periphery, at least initially. In principle, the ECB could also act to cap nominal yields in the periphery. However there is a limit to which real yields can be compressed once prices start falling – another lesson from Japan – and this is even more the case for real interest rates facing firms and households. Real yields could remain relatively high, above potential GDP growth, meaning downward pressure on economic growth and continued problems with regard to debt dynamics. This is an outcome the ECB should be doing its very best to avoid.

This article was originally published on 25 April as a Research Briefing for our newly launched Global Macro Service (Europe).

Forecast Overview

Divergent recovery continues…

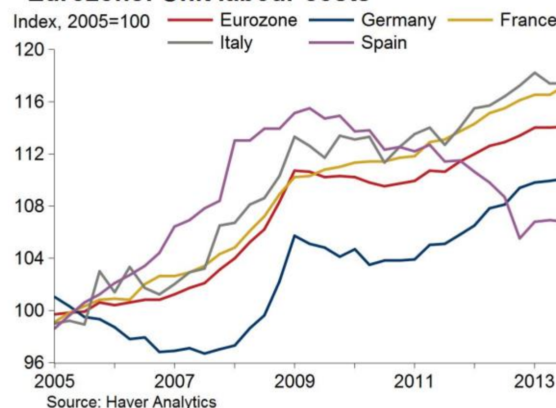
The divergence in the pace of recovery between Eurozone members continues. In Q1, German and Spanish GDP expanded by 0.8% and 0.4% respectively, much better than the quarterly rise of 0.2% in the Eurozone as a whole. By contrast, GDP growth in the less reform-minded French and Italian economies was 0.0% and -0.1% respectively. April PMI readings suggest that this divergence in economic performance may have continued in Q2. We have modestly upgraded our forecasts for growth in 2014 in the stronger performing economies, yielding an increase in our forecast for GDP growth at the Eurozone level from 1% to 1.2%.



…and headwinds to growth will persist

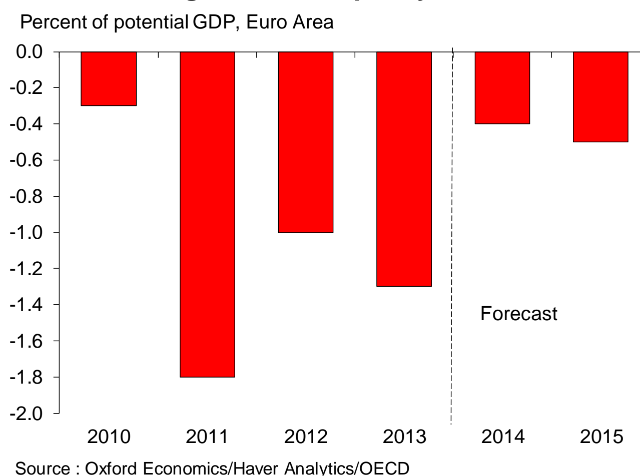
Moving into 2015 and beyond, several factors will constrain the pace of recovery around the Eurozone:

- **Competitiveness** – labour market weakness and reform efforts have yielded substantial improvements in competitiveness over the past few years, but results have been uneven across the Eurozone. Spain, Portugal and Ireland have achieved the greatest improvements while Italy, France and Belgium have seen costs stagnate or rise. As a result, with a couple of exceptions, we expect peripherals' export growth to outperform that of the core in the next few years.



- **Fiscal policy** – at the Eurozone level, the degree of fiscal consolidation is forecast to ease compared to recent years. However, after avoiding austerity thus far, several "core" countries (Belgium, France and Netherlands) now need to implement more ambitious cuts to meet EC deficit targets and limit debt burdens. At the Eurozone level fiscal tightening amounted to 1.3% of GDP in 2013, and though the pace of consolidation is easing it will nevertheless slow growth by 0.4-0.5 percentage points in 2014 and 2015.

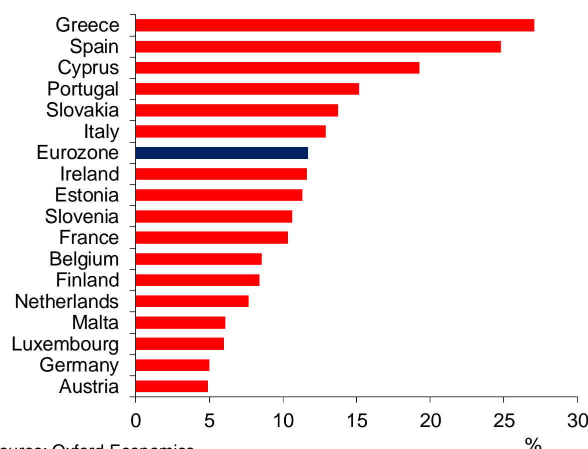
- **Slow recovery in household spending power** – with unemployment at crisis point in the periphery and double-digit rates in the core, it will take quite some time for labour markets to return to normal. Combined with austerity-induced cuts to transfer payments, this will limit the pick-up in household spending growth. We expect consumption to grow by 1.4% per year in the medium term, around 0.6 percentage points below the average in the decade to 2007.



- **Banking** – even financing a modest pace of capital expenditure growth will be a stretch for banking systems still struggling to cope with the impact of the crisis. This is particularly severe in "peripheral" economies but even in countries such as France bank lending to business appears a constraint. ECB action to restore more rapidly the flow of funds around the Eurozone (for example through the development of an asset-backed securities market) would allow borrowing costs in peripheral economies to fall, and improve the business investment outlook.

Overall we expect the Eurozone to grow by an average of 1.5% or so per year in the medium term, around 0.8 percentage points slower than in the decade to 2007.

Unemployment forecast for 2014



Source: Oxford Economics

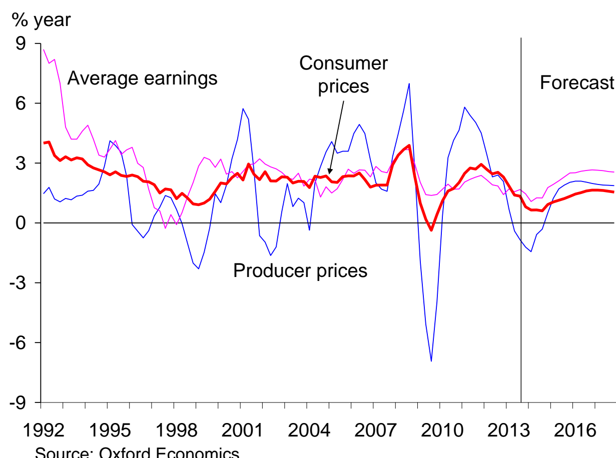
Deflation still a pressing concern

Against a backdrop of weak growth, a strengthening euro and weak commodity prices, the Eurozone risks sliding into deflation later this year. Inflation picked up to 0.7% in April but largely due to the timing of the Easter break – fundamentally, pricing power remains weak across the Eurozone, even in the stronger performing economies. Business surveys suggest firms expect further downward pressures on selling prices in the months to come, while French inflation-linked bonds also point towards falling prices in the coming year.

Deflation should be avoided, but largely thanks to the impact of diverging trends in monetary policy on the euro – we expect a further ECB rate cut to 0.1%, probably in June given hints by Mario Draghi at May's press conference, while US monetary policy will begin its tightening phase in 2015. With the euro depreciating modestly over the coming couple of years, and global commodity prices rising, Eurozone CPI inflation should remain positive in 2014 and pick up to 1.2% in 2015.

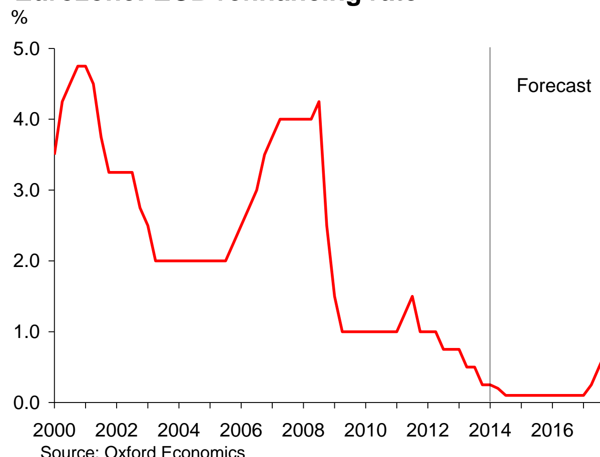
But the risk of deflation remains, especially if the euro strengthens further or if the global recovery is derailed. Recently-leaked results of an internal ECB assessment suggest quantitative easing might only have limited impact on prices, while the low levels of excess reserves held by banks at the ECB means that imposing a negative deposit rate on these holdings would probably have limited impact on money supply and activity. So it is not clear what the ECB's "plan B" is if inflation expectations become detached (or, indeed, what the ECB's benchmark is in this respect). As such, uncertainty seems set to prevail for now, undermining confidence in the recovery, especially in the most highly indebted economies.

Eurozone: Inflation



Source: Oxford Economics

Eurozone: ECB refinancing rate



Source: Oxford Economics

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Long-Term Prospects

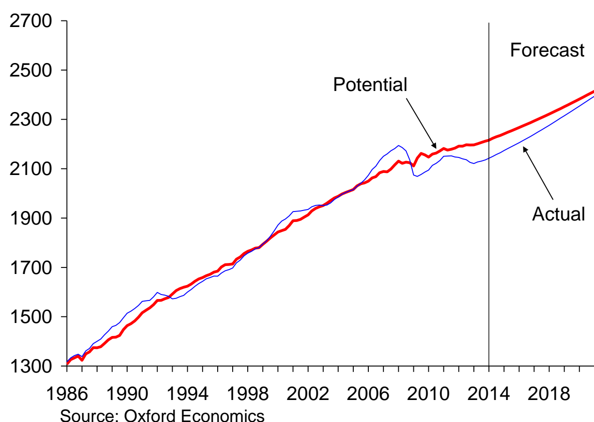
Very slow recovery from crises

The global and Eurozone crises will leave their mark on growth for years to come. We estimate that the Eurozone's potential growth rate is only 1.1%. This compares with 1.3% in the past decade, itself significantly affected by the crisis, and 1.8% in the 10 years to 2008.

The slow restructuring of the banking sector means that credit availability will be limited for a long time, hindering investment and affecting the efficiency of capital allocation in the economy. Moreover, high unemployment for a prolonged period, especially among the young, will have long-lasting negative effects on skill levels and ability to work. Combined with a shrinking population of working age, despite increases in the retirement age, these factors imply that availability and quality of labour will be constrained compared with the pre-crisis period. These factors will only be partly offset by further increases in the participation rate.

Some of the reforms implemented in the peripheral countries should help raise the economy's productivity growth to at least what it was before 2008. But much more will be needed to offset other negative trends.

Eurozone: Actual & potential output



Source: Oxford Economics

Potential GDP and Its Components Average Percentage Growth	2003-2012	2013-2022
Potential GDP*	1.3	1.1
Employment at NAIRU	0.6	0.1
Capital Stock	1.5	1.2
Total Factor Productivity	0.3	0.7

*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)

	2003-2007	2008-2012	2013-2017	2018-2022
GDP	2.2	-0.3	1.1	1.7
Consumption	1.6	-0.1	0.8	1.5
Investment	3.4	-3.5	1.3	2.2
Government Consumption	1.8	1.0	0.3	1.1
Exports of Goods and Services	5.9	1.5	3.4	3.2
Imports of Goods and Services	6.2	0.5	3.0	3.2
Unemployment (%)	8.7	9.7	11.5	10.2
Consumer Prices	2.2	2.1	1.3	1.6
Current Balance (% of GDP)	0.2	0.0	2.4	2.2
Exchange Rate (US$ per Euro)	1.25	1.37	1.33	1.27
General Government Balance (% of GDP)	-2.1	-4.5	-2.1	-0.8
Short-term Interest Rates (%)	2.8	1.7	0.2	2.9
Long-term Interest Rates (%)	4.0	4.0	3.2	4.6
Working Population	0.4	0.1	0.0	-0.1
Labour Supply	0.9	0.4	0.0	0.1
Participation Ratio	73.5	75.0	75.2	75.8
Labour Productivity	1.0	0.1	1.0	1.3

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, Estonia the 17th in January 2011 and Latvia the 18th at the start of 2014.

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 Cyprus, Greece, Italy, Ireland, Portugal, Slovenia 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 differences 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 measures proposed include a move towards a banking union that would sever the links between banks and their sovereigns. However, political hurdles to closer integration and debt burden sharing remains very high. Changes to the Eurozone's structure and institutions are likely to be slow and erratic.

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Data & Forecasts

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)
Apr	-0.6	12.0	1.2	-1.1	-22.1	9.1	1.6	14.0
May	-1.9	12.0	1.4	-0.8	-21.7	-0.1	-5.8	14.6
Jun	-0.3	12.0	1.6	-0.7	-18.7	-2.9	-5.3	15.9
Jul	-1.8	12.0	1.6	-0.5	-17.3	3.2	0.3	18.2
Aug	-1.7	12.0	1.3	-0.2	-15.5	-5.6	-7.4	7.2
Sep	0.2	12.0	1.1	-0.2	-14.8	3.1	1.1	11.6
Oct	0.4	11.9	0.7	0.0	-14.4	1.4	-3.1	16.8
Nov	2.5	11.9	0.9	0.3	-15.3	-1.9	-5.2	17.2
Dec	1.5	11.8	0.8	0.3	-13.5	3.9	0.8	14.1
2014								
Jan	1.8	11.8	0.8	0.2	-11.7	0.9	-2.8	0.8
Feb	1.7	11.8	0.7	0.4	-12.7	2.9	0.4	13.6
Mar	0.5	11.8	0.5	0.4	-9.3	-0.7	2.5	17.1
Apr	-	-	0.7	0.3	-8.6	-	-	-

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
Apr	0.21	2.86	3.2	1.30	1.18	105.0	2712	-7.5
May	0.20	2.69	2.8	1.30	1.18	105.5	2770	43.7
Jun	0.21	3.07	2.4	1.32	1.17	106.3	2603	-14.3
Jul	0.22	3.10	2.1	1.31	1.16	106.5	2768	6.9
Aug	0.23	3.10	2.3	1.33	1.16	107.2	2721	-0.3
Sep	0.22	3.41	2.0	1.33	1.19	106.7	2893	-19.3
Oct	0.23	3.16	1.4	1.36	1.18	107.8	3068	20.4
Nov	0.22	3.17	1.5	1.35	1.19	107.4	3087	-19.8
Dec	0.27	3.31	1.0	1.37	1.19	108.8	3109	-9.7
2014								
Jan	0.29	3.21	1.2	1.36	1.21	108.3	3014	-9.1
Feb	0.29	3.09	1.3	1.37	1.21	108.2	3149	31.9
Mar	0.31	2.89	1.1	1.38	1.20	109.1	3162	-
Apr	0.33	2.61	-	1.38	1.21	108.7	3198	-

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											
2012	-1.4	-3.8	-2.2	-0.6	-3.0	11.3	1.8	0.0	2.8	2.6	2.5
2013	-0.7	-2.9	-1.1	-0.4	-1.1	12.0	1.6	0.5	1.4	-0.4	1.3
2014	0.8	2.0	0.8	1.2	2.0	11.7	1.4	1.2	1.3	-0.5	0.7
2015	1.3	2.4	1.4	1.5	2.5	11.6	2.2	1.3	2.6	1.7	1.2
2016	1.4	2.4	1.4	1.5	2.1	11.3	2.6	1.1	3.2	2.1	1.6
2017	1.4	2.5	1.5	1.6	1.9	11.1	2.6	1.1	3.4	1.9	1.6
2012											
I	-1.2	-2.7	-1.7	-0.2	-2.6	10.8	2.2	0.2	3.0	3.4	2.7
II	-1.2	-3.8	-2.3	-0.5	-3.0	11.2	1.9	0.3	3.0	2.3	2.5
III	-1.6	-4.1	-2.4	-0.7	-2.9	11.4	1.9	-0.1	2.5	2.4	2.5
IV	-1.5	-4.8	-2.3	-1.0	-3.5	11.7	1.4	-0.2	2.9	2.1	2.3
2013											
I	-1.4	-5.5	-2.2	-1.2	-2.8	12.0	1.7	0.0	2.1	0.7	1.9
II	-0.8	-3.7	-1.4	-0.6	-1.5	12.0	1.6	0.4	1.7	-0.4	1.4
III	-0.6	-2.5	-0.6	-0.3	-1.1	12.0	1.7	0.6	1.5	-0.8	1.3
IV	0.1	0.0	-0.1	0.5	1.2	11.9	1.5	0.9	0.4	-1.2	0.8
2014											
I	0.5	1.9	0.4	0.9	1.7	11.8	1.1	1.1	0.9	-1.4	0.6
II	0.7	2.3	0.8	1.0	1.9	11.8	1.3	1.1	1.0	-0.6	0.7
III	0.9	2.2	0.7	1.3	2.1	11.7	1.3	1.2	1.5	-0.3	0.6
IV	1.1	1.7	1.2	1.4	2.3	11.6	1.8	1.4	2.0	0.5	0.9
2015											
I	1.2	2.2	1.5	1.5	2.6	11.6	1.9	1.3	2.4	1.2	1.1
II	1.3	2.3	1.4	1.5	2.4	11.6	2.1	1.3	2.4	1.7	1.1
III	1.4	2.5	1.4	1.5	2.5	11.6	2.3	1.3	2.7	1.9	1.2
IV	1.4	2.5	1.4	1.5	2.4	11.5	2.5	1.2	2.9	2.0	1.3
2016											
I	1.4	2.4	1.3	1.5	2.3	11.4	2.5	1.1	3.0	2.1	1.4
II	1.3	2.4	1.3	1.5	2.2	11.4	2.6	1.1	3.1	2.1	1.5
III	1.3	2.4	1.4	1.5	2.1	11.3	2.6	1.1	3.2	2.0	1.6
IV	1.4	2.5	1.4	1.5	2.0	11.3	2.7	1.1	3.3	2.0	1.6
2017											
I	1.4	2.5	1.4	1.6	1.9	11.2	2.6	1.1	3.4	1.9	1.6
II	1.4	2.5	1.5	1.6	1.9	11.1	2.6	1.1	3.4	1.9	1.6
III	1.4	2.5	1.5	1.6	1.9	11.0	2.6	1.1	3.4	1.9	1.6
IV	1.4	2.5	1.5	1.6	1.9	11.0	2.6	1.1	3.3	1.9	1.5

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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											
2012	82.7	138.6	1.46	-350.7	-3.70	0.57	3.92	-1.92	1.42	1.29	115.5
2013	159.5	230.2	2.40	-290.1	-3.03	0.22	3.00	-1.13	1.65	1.33	120.8
2014	186.3	256.5	2.62	-246.6	-2.52	0.24	2.56	-0.47	1.85	1.37	125.3
2015	183.7	237.1	2.35	-200.3	-1.99	0.18	3.11	-1.01	1.92	1.34	123.7
2016	193.6	235.3	2.27	-170.3	-1.64	0.16	3.52	-1.39	1.97	1.32	122.4
2017	202.4	237.5	2.22	-145.2	-1.35	0.45	3.85	-1.15	2.25	1.31	121.7
2012											
I	12.0	21.3	0.90	-91.6	-3.87	1.04	4.29	-1.64	1.61	1.31	116.9
II	17.9	32.9	1.39	-89.8	-3.79	0.69	4.17	-1.77	1.71	1.28	115.9
III	25.3	43.1	1.82	-86.8	-3.66	0.36	3.89	-2.18	1.35	1.25	113.3
IV	27.5	41.3	1.74	-82.5	-3.48	0.20	3.32	-2.11	1.02	1.30	115.8
2013											
I	38.3	52.2	2.19	-78.0	-3.28	0.21	3.06	-1.64	1.20	1.32	118.8
II	41.0	61.8	2.58	-74.0	-3.09	0.21	2.82	-1.19	1.43	1.31	119.2
III	36.0	49.9	2.08	-70.5	-2.94	0.22	3.15	-1.12	1.80	1.32	121.7
IV	44.1	66.3	2.75	-67.6	-2.81	0.24	2.97	-0.57	2.16	1.36	123.7
2014											
I	48.4	71.5	2.95	-66.4	-2.74	0.30	2.66	-0.35	2.01	1.37	125.6
II	44.5	67.3	2.76	-62.3	-2.55	0.30	2.32	-0.36	1.67	1.38	125.4
III	48.2	59.6	2.43	-60.5	-2.46	0.19	2.53	-0.42	1.93	1.37	125.5
IV	45.1	58.0	2.35	-57.4	-2.32	0.19	2.71	-0.74	1.78	1.36	124.8
2015											
I	47.9	66.1	2.66	-55.9	-2.25	0.18	2.89	-0.87	1.84	1.35	124.4
II	42.7	61.7	2.46	-50.2	-2.00	0.18	3.06	-0.96	1.92	1.34	124.0
III	47.4	54.2	2.14	-48.4	-1.91	0.17	3.19	-1.05	1.96	1.33	123.4
IV	45.7	55.1	2.16	-45.8	-1.80	0.17	3.29	-1.16	1.96	1.32	122.8
2016											
I	49.5	64.7	2.52	-46.9	-1.83	0.17	3.39	-1.28	1.95	1.32	122.6
II	45.3	61.2	2.37	-42.9	-1.66	0.16	3.48	-1.35	1.96	1.32	122.5
III	50.1	54.1	2.08	-41.5	-1.59	0.16	3.56	-1.44	1.96	1.32	122.3
IV	48.7	55.2	2.10	-39.0	-1.48	0.16	3.65	-1.49	2.00	1.32	122.1
2017											
I	52.0	64.7	2.44	-39.9	-1.51	0.15	3.73	-1.49	2.09	1.31	121.9
II	47.5	61.8	2.31	-36.3	-1.36	0.30	3.81	-1.33	2.18	1.31	121.8
III	52.2	55.1	2.05	-35.7	-1.33	0.55	3.89	-1.04	2.31	1.31	121.6
IV	50.7	55.9	2.06	-33.2	-1.22	0.80	3.98	-0.75	2.43	1.30	121.4

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

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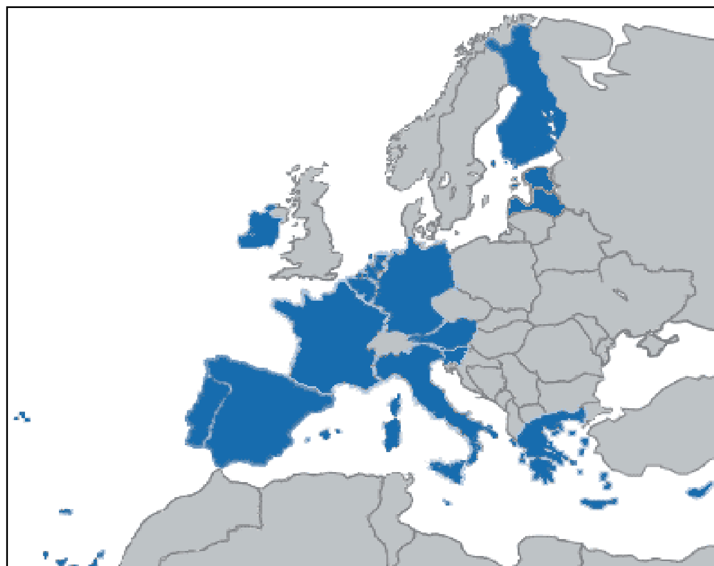
Long-Term Forecast for Eurozone

Annual percentage changes unless otherwise specified

	2003-2012	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2022
GDP	0.9	-4.4	1.9	1.6	-0.6	-0.4	1.2	1.5	1.5	1.6	1.7	1.7	1.7	1.7	1.6	1.4
Consumption	0.8	-0.9	1.0	0.3	-1.4	-0.7	0.8	1.3	1.4	1.4	1.5	1.6	1.5	1.5	1.5	1.2
Investment	-0.1	-12.7	-0.6	1.7	-3.8	-2.9	2.0	2.4	2.4	2.5	2.4	2.3	2.2	2.0	2.0	1.7
Government Consumption	1.4	2.6	0.6	-0.1	-0.6	0.1	0.0	0.2	0.4	0.6	0.8	1.0	1.1	1.2	1.2	0.7
Exports of Goods and Services	3.7	-12.3	11.4	6.7	2.7	1.4	3.6	3.9	4.1	4.0	3.8	3.4	3.2	3.0	2.7	3.3
Imports of Goods and Services	3.3	-10.8	9.8	4.6	-0.8	0.0	3.0	4.0	4.1	4.0	3.7	3.4	3.2	2.9	2.7	3.1
Unemployment (%)	9.2	9.6	10.1	10.1	11.3	12.0	11.7	11.6	11.3	11.1	10.8	10.5	10.2	9.9	9.6	10.9
Consumer Prices	2.1	0.3	1.6	2.7	2.5	1.3	0.7	1.2	1.6	1.6	1.5	1.6	1.6	1.7	1.8	1.5
Current Balance (% of GDP)	0.1	-0.2	0.1	0.1	1.5	2.4	2.6	2.4	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.3
Exchange Rate (US$ per Euro)	1.31	1.39	1.33	1.39	1.28	1.33	1.37	1.34	1.32	1.31	1.29	1.28	1.27	1.26	1.26	1.30
General Government Balance (% of GDP)	-3.3	-6.3	-6.2	-4.1	-3.7	-3.0	-2.5	-2.0	-1.6	-1.4	-1.1	-0.9	-0.8	-0.7	-0.6	-1.5
Short-term Interest Rates (%)	2.3	1.2	0.8	1.4	0.6	0.2	0.2	0.2	0.2	0.5	1.4	2.4	3.0	3.5	4.0	1.6
Long-term Interest Rates (%)	4.0	3.8	3.6	4.4	3.9	3.0	2.6	3.1	3.5	3.9	4.1	4.4	4.6	4.8	5.0	3.9
Working Population	0.3	0.0	0.0	0.0	0.3	0.2	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.2	0.0
Labour Supply	0.7	0.3	0.1	0.3	0.7	-0.1	-0.3	0.0	0.1	0.2	0.2	0.1	0.1	0.0	0.0	0.0
Participation Ratio (%)	74.3	74.9	75.0	75.2	75.5	75.2	75.0	75.0	75.2	75.3	75.5	75.7	75.8	75.9	76.1	75.5
Labour productivity	0.6	-2.6	2.4	1.3	0.0	0.5	1.2	1.3	1.1	1.1	1.2	1.2	1.3	1.3	1.3	1.1
Employment	0.4	-1.8	-0.5	0.3	-0.7	-0.9	0.0	0.2	0.4	0.5	0.5	0.5	0.4	0.4	0.3	0.2
Output gap (% of potential GDP)	-0.2	-3.2	-2.1	-1.4	-2.7	-3.5	-3.3	-3.0	-2.6	-2.2	-1.8	-1.4	-1.1	-0.7	-0.4	-2.0

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: Jeroen Dijsselbloem



Source : ECB

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

Long-term economic & social development

	1980	1990	2000	2012*
GDP per capita (US$)	-	18088	19881	36678
Inflation (%)	9.9	4.2	2.2	2.5
Population (mn)	287	305	315	332
Urban population (% of total)	69.7	70.9	72.4	75.8
Life expectancy (years)	73.6	76.0	78.3	81.3

Source : Oxford Economics & World Bank

* 2012 or latest available year

Structure of GDP by output

	2010
Agriculture	1.6%
Industry	26.3%
Services	72.0%

Source : WDI

Corruption perceptions index 2013

	Score
Developed economies (average)	74.5
Emerging economies (average)	37.3
Eurozone	66.5

Source: Transparency International

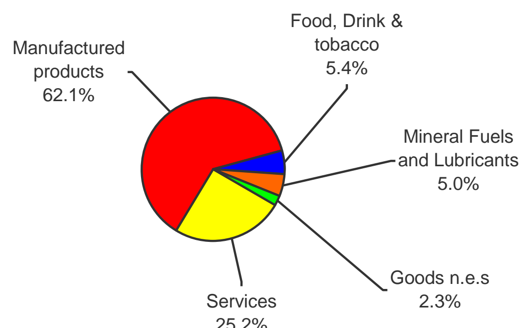
Scoring system 100 = highly clean, 0 = highly corrupt

Structural economic indicators

	1990	1995	2000	2012*
Current account (US$ billion)	10	54	-95	178
Trade balance (US$ billion)	-23	63	-27	106
FDI (US$ billion)	-	-	-25	-97
Govt budget (% of GDP)	-4.1	-7.5	-0.1	-3.7
Govt debt (% of GDP)	13.5	67.4	67.1	91.4
Long-term interest rate	10.9	8.7	5.4	3.9
Oil production (000 bpd)	271	313	240	227
Oil consumption (000 bpd)	9715	10483	10927	9611

Source : Oxford Economics / World Bank / EIA / ECB

Composition of extra-EMU goods & services exports, 2012



Source : Eurostat\ Haver Analytics

Destination of goods' exports (2012)

Eurozone	46.3%
UK	6.6%
US	6.4%
China	3.4%
Switzerland	3.3%
Poland	2.6%

Source : Eurostat \ Haver Analytics