OXFORD ECONOMICS

Eurozone

Highlights

- We have lowered our forecast for growth in the Eurozone slightly and now expect GDP to fall by 0.6% this year, down from 0.5% last month. There are three main reasons. First, the Cyprus deal will probably result in higher funding costs for banks and therefore tighter credit conditions, especially in the peripheral countries. This is because bank bondholders and depositors may now expect losses in the event of bank failures.
- Second, economic activity data at the start of the year were disappointing; we estimate that Eurozone GDP fell by a further 0.2% in Q1. And third, a weaker yen (resulting from the aggressive monetary policy stance by the Bank of Japan) will hit Eurozone companies' international competitiveness and exports.
- As a result, it is not surprising that the ECB seems to be preparing some new measures to enhance credit availability. The ECB is worried that banking sector conditions mean that high interest rates are being charged to businesses and households in the peripheral countries. We now expect a 25bp rate cut in May and further liquidity provision. But the ECB has a limited set of policy tools to address the very different needs of core and peripheral countries, so the impact on growth is likely to be limited.
- Our medium-term forecast is unchanged. Eurozone growth will be hampered by the ongoing fiscal tightening needed to reduce debt in the private sector as well as by high unemployment, especially among the young, which reduces human capital.

Forecast for Eurozone

(Annual percentage changes unless specified)

	2011	2012	2013	2014	2015	2016
Domestic Demand	0.5	-2.2	-1.3	0.7	1.4	1.5
Private Consumption	0.1	-1.2	-0.9	0.6	1.1	1.3
Fixed Investment	1.6	-3.9	-1.9	2.0	2.9	2.8
Government Consumption	-0.1	-0.1	-0.5	-0.3	0.3	0.6
Net exports (% of GDP)	2.8	4.4	5.1	5.4	5.5	5.5
GDP	1.5	-0.5	-0.6	1.0	1.4	1.5
Industrial Production	2.3	-2.8	-1.4	1.6	2.4	2.2
Consumer Prices	2.7	2.5	1.7	1.6	1.4	1.4
Current Account (% of GDP)	0.1	1.2	1.6	1.6	1.5	1.5
Government Budget (% of GDP)	-4.1	-3.3	-2.7	-2.1	-1.6	-1.3
Short-Term Interest rate (%)	1.4	0.6	0.2	0.3	0.3	0.4
Long-Term Interest Rates (%)	4.4	4.0	3.2	3.3	3.5	3.8
Exchange rate (US$ per Euro)	1.39	1.28	1.28	1.21	1.17	1.17
Exchange rate (YEN per Euro)	111.0	102.5	124.3	127.1	131.6	132.3

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Forecast Overview

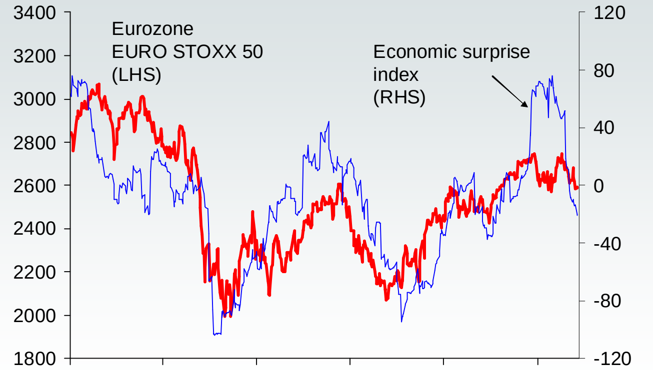
Forecast lowered slightly…

- We have lowered our forecast for growth in the Eurozone slightly this month and now expect GDP to fall by 0.6% this year, down from 0.5% last month.
- This change has been driven by three main developments. First, although it was a relief that a deal was finally agreed, the Cyprus bailout shows that banks, bondholders and depositors now expect to suffer losses in case of bank failure. This is likely to raise banks' funding costs, particularly in the peripheral countries. In turn, this will probably lead to tighter credit conditions, further restraining investment and consumption.
- Second, data for the beginning of the year have been disappointing. Industrial production rose in February, but only after a very weak January and the services and manufacturing PMIs have remained firmly in recession territory. And retail sales have been mixed, with a surprising rebound in Germany but further sharp falls in France. A measure of economic data 'surprises' (where outturns differ from expectations) by Citigroup indicates that data published up to the end of March tended to bring positive surprises, but more recently new data have fallen short of expectations.
- The third factor likely to weigh on the forecast is the aggressive monetary stance taken by the Bank of Japan. We have revised our yen forecast to take account of this policy change, which means that Japanese companies will be significantly more competitive against European companies than we had previously thought. Japanese and European companies compete in markets such as motor vehicles in the US and Chinese machinery equipment. As a result, we have revised down our forecasts for exports and growth in the Eurozone.

Further ECB action is likely

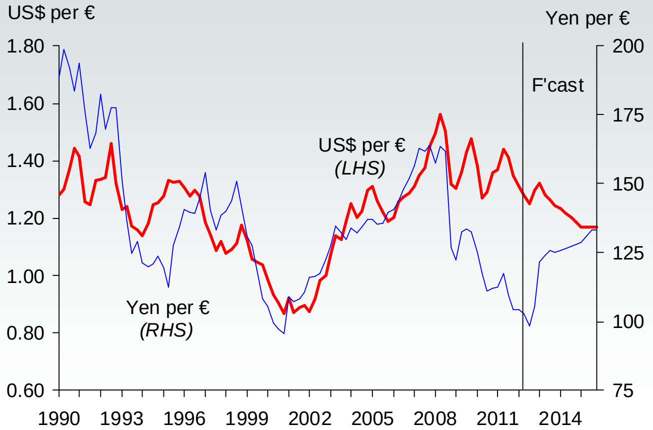
- This month the ECB hinted at possible further loosening of monetary policy. No specific measures have been mentioned but the ECB is concerned about conditions in the banking sector, which have resulted in widely different interest rates being charged across the Eurozone.

Equity markets vs. economic surprises



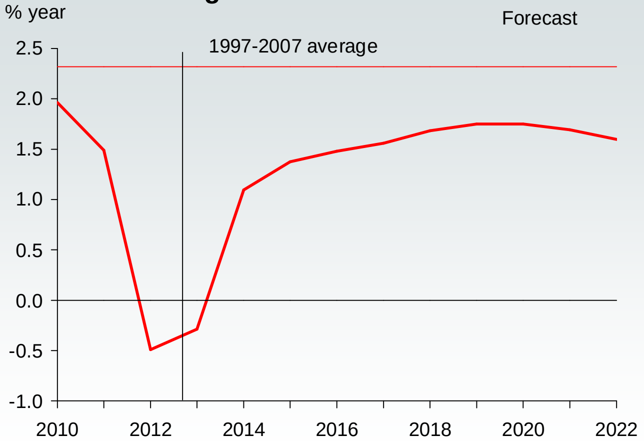
Source : ECB, Citi Group

Eurozone: Exchange rates



Source: Oxford Economics

Eurozone GDP growth



Source : Oxford Economics

- We now expect the ECB to cut rates by 25bp in May and to implement other measures to improve credit availability, especially in the periphery.

Structural hurdles in medium term

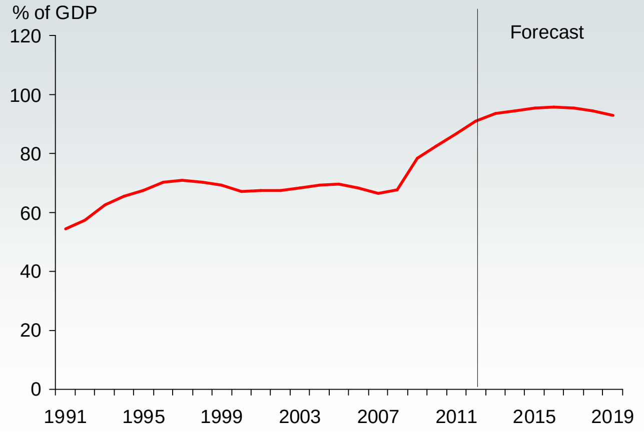
- These factors more than offset some positive surprises in Ireland that would otherwise have raised 2013 growth. The recovery from 2014 onwards will be slow at best, owing to significant structural challenges. The key factors that will dampen the pace of recovery for several years include fiscal tightening, deleveraging in the private sector and the long-term impact of high unemployment rates:

Decade-long fiscal tightening – we estimate that the fiscal tightening measures announced so far for 2013 amount to 1.2% of Eurozone GDP. According to our Global Economic Model, this will shave around 1% point off GDP growth. From 2014 onwards, the pace of tightening will probably lessen somewhat, as leaders in core countries seem increasingly aware of the negative impact of pursuing very stringent deficit targets. Peripheral countries will probably be given more time to restructure their public finances. Nevertheless, fiscal policy will remain tight and will continue to be a drag on growth for years to come.

Private-sector deleveraging yet to start – while the focus has been on reducing public sector debt, high private sector debt also needs to be reduced before the economy can sustain robust growth. Unlike the US, and to a lesser extent the UK, Eurozone private debt ratios have not yet fallen. The debts of non-financial companies stood at 138% of GDP in 2012, for example, up from 113% a decade ago. This compares unfavourably with 77% in the US.

Lost generation – unemployment is forecast to continue rising until the end of 2013, when it will reach 12.4%, or close to 20m people unemployed. Youth unemployment stands at 24% in the Eurozone, and more than 55% in Spain and Greece. The share of long-term (more than one year) unemployed has risen from 33% in early 2009 to 47% in 2012Q3. These developments raise concerns about a 'lost generation', whereby new entrants in the labour market do not get the necessary experience at the start of their career to gain the flexibillity to find new jobs and become tomorrow's managers. This will have a negative impact on growth in the Eurozone.

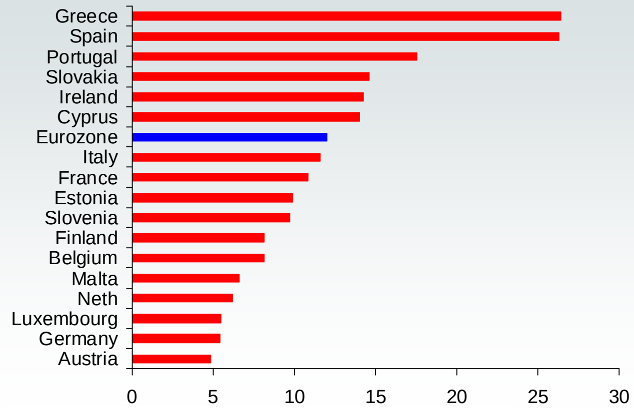
Eurozone: Government debt



Source: Oxford Economics

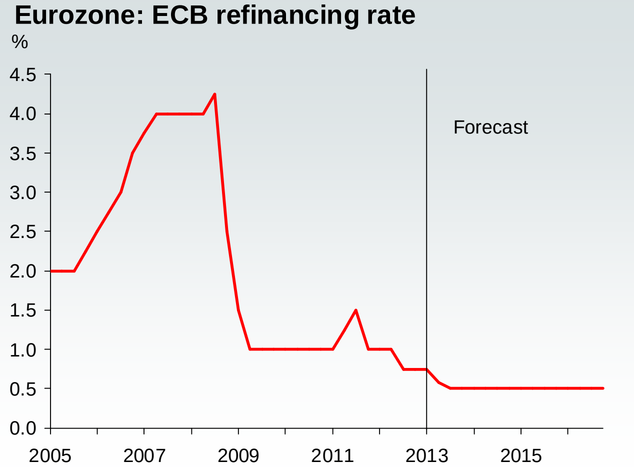
Unemployment rates

% labour force, February 2013 (Greece: Dec 2012)



Source : Eurostat

Eurozone: ECB refinancing rate



Source: Oxford Economics

Key Indicators: Eurozone

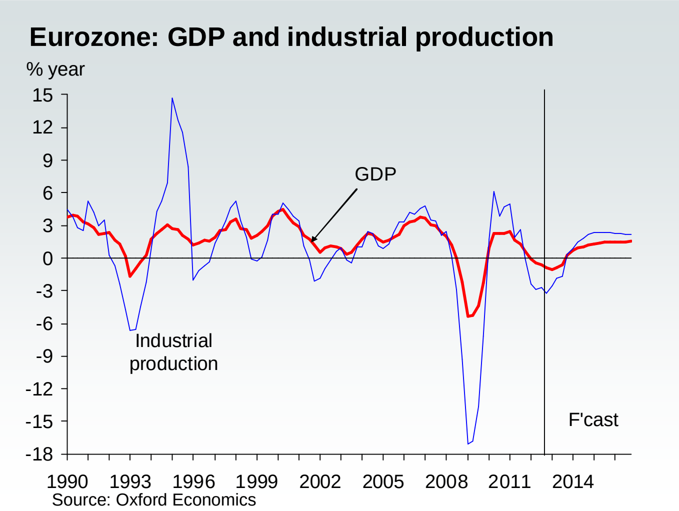
Percentage changes on a year earlier unless otherwise stated

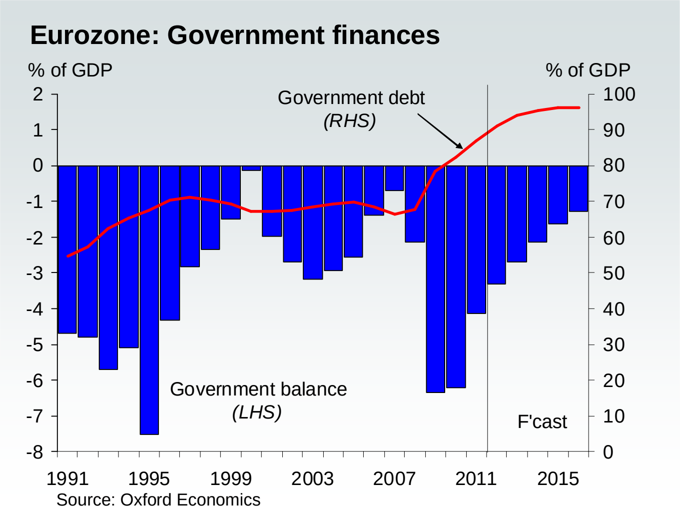
	Industrial production (% yr)	Unemploy-ment (% point)	CPI (% yr)	Business confidence (% balance)	Consumer confidence (% balance)	Exports (% yr)	Imports (% yr)	Trade balance (€ bn)
Mar	-2.0	11.0	2.7	-0.2	-18.9	4.5	0.6	7.0
Apr	-2.5	11.2	2.6	-0.4	-19.7	6.0	0.2	3.6
May	-2.4	11.3	2.4	-0.7	-19.1	6.2	1.0	6.6
Jun	-1.6	11.4	2.4	-0.9	-19.6	12.2	3.3	12.7
Jul	-2.5	11.4	2.4	-1.2	-21.3	11.2	3.3	13.6
Aug	-2.2	11.5	2.6	-1.1	-24.4	10.4	2.8	4.4
Sep	-2.5	11.6	2.6	-1.3	-25.7	1.1	-3.9	8.4
Oct	-3.1	11.7	2.5	-1.6	-25.5	14.5	7.8	9.1
Nov	-3.8	11.8	2.2	-1.2	-26.7	5.3	0.1	12.9
Dec	-1.9	11.8	2.2	-1.1	-26.3	-3.2	-5.4	10.8
2013								
Jan	-2.1	12.0	2.0	-1.1	-23.9	5.3	1.4	-3.9
Feb	-	12.0	1.8	-0.7	-23.6	-	-	-
Mar	-	-	1.7	-0.9	-23.5	-	-	-

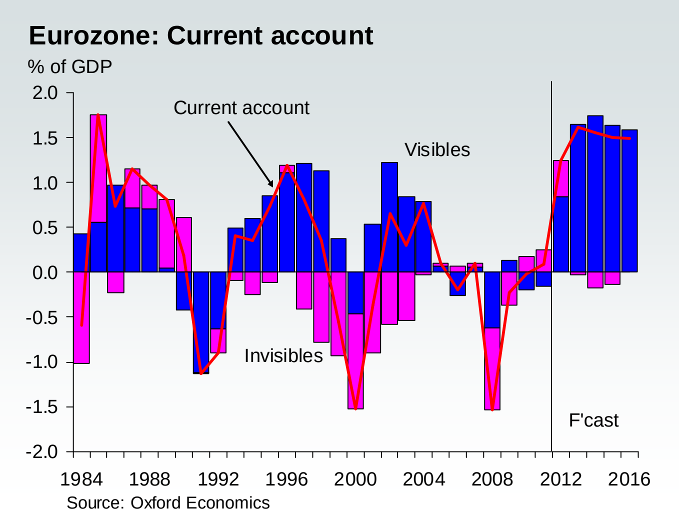
Financial Indicators: Eurozone

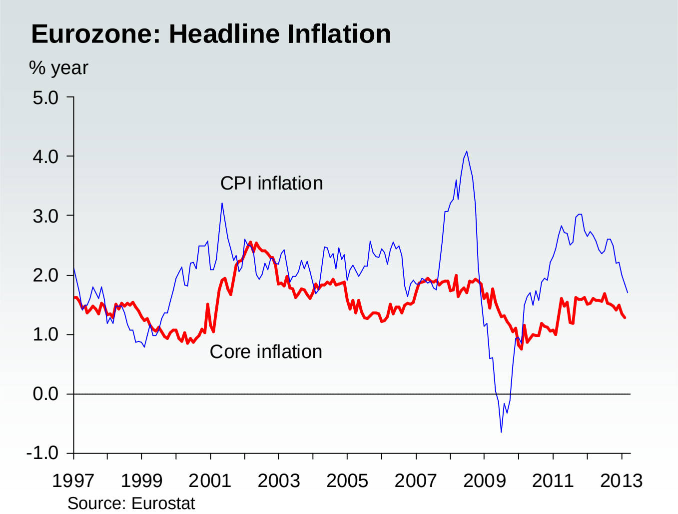
Percentage changes on a year earlier unless otherwise stated

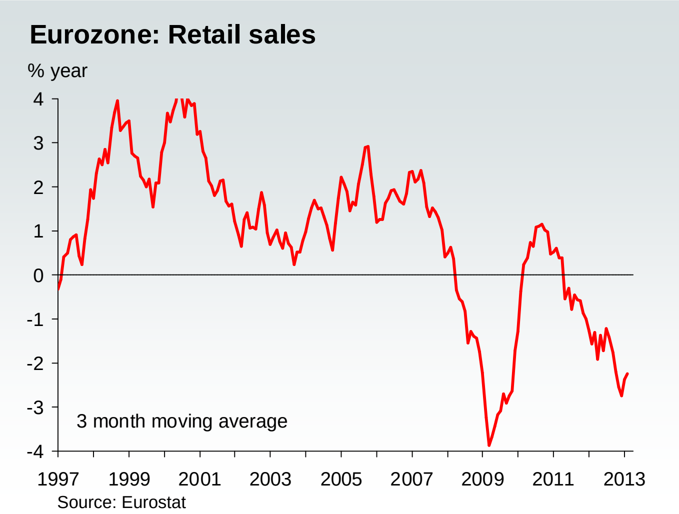
	Short rate %	Long rate %	Money Supply (M3)	Exchange rate $/€ avg.	Exchange rate €/£	Nominal effective exch. rate	Share price DJ STOXX	Net FDI € bn
Mar	0.86	3.29	2.8	1.32	1.20	103.4	2477	-9.4
Apr	0.74	3.39	2.3	1.32	1.22	102.8	2306	-3.5
May	0.68	3.53	2.9	1.28	1.24	100.8	2119	8.2
Jun	0.66	3.41	2.9	1.25	1.24	99.7	2265	-21.0
Jul	0.50	3.25	3.5	1.23	1.27	97.6	2326	-5.8
Aug	0.33	3.01	2.7	1.24	1.27	97.7	2441	14.7
Sep	0.25	2.43	2.7	1.29	1.25	99.9	2454	-34.6
Oct	0.21	2.31	3.9	1.30	1.24	100.8	2504	-10.6
Nov	0.19	2.25	3.7	1.28	1.24	100.3	2575	13.7
Dec	0.19	2.10	3.5	1.31	1.23	102.0	2636	-6.7
2013								
Jan	0.20	2.40	3.5	1.33	1.20	104.2	2703	-9.1
Feb	0.22	2.86	3.1	1.34	1.16	106.0	2634	-
Mar	0.21	3.03	-	1.30	1.16	104.5	2624	-

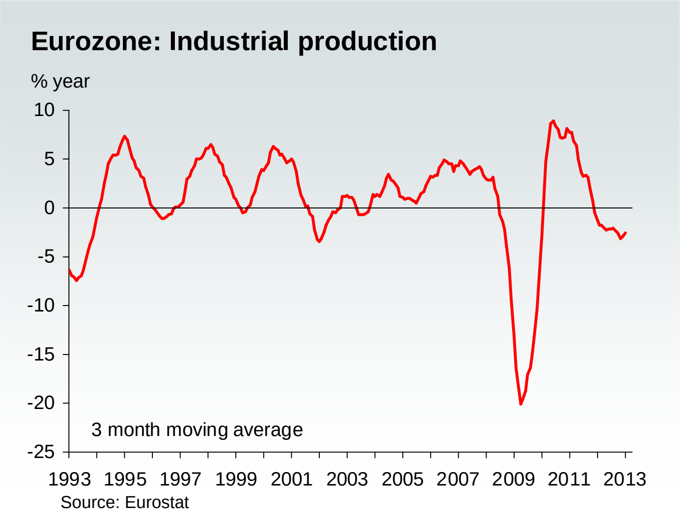

Eurozone: GDP and industrial production
% year
15
12
9
6
3
0
-3
-6
-9
-12
-15
-18
GDP
Industrial production
F'cast
1990
1993
1996
1999
2002
2005
2008
2011
2014
Source: Oxford Economics


Eurozone: Government finances
% of GDP
% of GDP
Government debt (RHS)
Government balance (LHS)
F'cast
2
1
0
-1
-2
-3
-4
-5
-6
-7
-8
100
90
80
70
60
50
40
30
20
10
0
1991
1995
1999
2003
2007
2011
2015
Source: Oxford Economics


Eurozone: Current account
% of GDP
2.0
1.5
1.0
0.5
0.0
-0.5
-1.0
-1.5
-2.0
Current account
Visibles
Invisibles
F'cast
1984
1988
1992
1996
2000
2004
2008
2012
2016
Source: Oxford Economics


Eurozone: Headline Inflation
% year
5.0
4.0
3.0
2.0
1.0
0.0
-1.0
CPI inflation
Core inflation
1997
1999
2001
2003
2005
2007
2009
2011
2013
Source: Eurostat


Eurozone: Retail sales
% year
4
3
2
1
0
-1
-2
-3
-4
3 month moving average
1997
1999
2001
2003
2005
2007
2009
2011
2013
Source: Eurostat


Eurozone: Industrial production
% year
10
5
0
-5
-10
-15
-20
-25
3 month moving average
1993
1995
1997
1999
2001
2003
2005
2007
2009
2011
2013
Source: Eurostat

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	2.3	10.2	2.3	1.2	1.6	5.6	2.7
2012	-1.2	-3.9	-2.2	-0.5	-2.8	11.4	1.6	0.2	2.7	2.4	2.5
2013	-0.9	-1.9	-1.3	-0.6	-1.4	12.4	1.0	0.5	1.9	1.6	1.7
2014	0.6	2.0	0.7	1.0	1.6	12.5	1.6	1.1	2.7	2.1	1.6
2015	1.1	2.9	1.4	1.4	2.4	12.2	2.0	1.2	3.5	2.1	1.4
2016	1.3	2.8	1.5	1.5	2.2	11.7	2.3	1.2	3.7	1.9	1.4
2011											
I	0.9	3.6	1.6	2.4	5.0	9.9	2.2	2.1	0.2	6.4	2.5
II	0.2	1.4	0.8	1.6	1.9	9.9	2.3	1.1	1.6	5.8	2.8
III	0.3	0.8	0.4	1.3	2.6	10.2	2.4	1.0	2.4	5.4	2.7
IV	-0.9	0.8	-0.7	0.6	-0.1	10.6	2.4	0.7	2.3	4.7	2.9
2012											
I	-1.1	-2.5	-1.7	-0.1	-2.4	10.9	2.0	0.4	2.9	3.4	2.7
II	-1.1	-4.0	-2.3	-0.5	-2.9	11.3	1.7	0.3	2.9	2.1	2.5
III	-1.5	-4.4	-2.5	-0.6	-2.8	11.5	1.7	0.0	2.4	2.2	2.5
IV	-1.2	-4.9	-2.2	-0.9	-3.3	11.8	1.2	-0.2	2.8	2.0	2.3
2013											
I	-1.4	-3.9	-2.2	-1.0	-2.6	12.1	0.9	-0.1	2.2	0.9	1.8
II	-1.0	-2.4	-1.6	-0.8	-1.9	12.4	0.9	0.4	1.8	1.5	1.6
III	-0.8	-1.4	-1.1	-0.6	-1.7	12.5	1.0	0.6	2.1	1.8	1.6
IV	-0.4	0.2	-0.4	0.2	0.4	12.6	1.3	1.2	1.6	2.0	1.6
2014											
I	0.2	1.1	0.2	0.7	0.9	12.6	1.5	1.2	2.2	2.1	1.7
II	0.5	1.9	0.6	0.9	1.4	12.6	1.6	1.1	2.6	2.0	1.6
III	0.7	2.4	0.8	1.1	1.9	12.5	1.7	1.1	2.9	2.0	1.5
IV	0.9	2.7	1.0	1.2	2.2	12.4	1.8	1.1	3.1	2.3	1.5
2015											
I	1.0	2.9	1.2	1.3	2.3	12.4	1.9	1.1	3.3	2.4	1.5
II	1.1	2.9	1.3	1.4	2.4	12.2	2.0	1.2	3.5	2.2	1.4
III	1.1	2.9	1.4	1.5	2.4	12.1	2.1	1.2	3.6	2.0	1.4
IV	1.2	2.9	1.5	1.5	2.4	12.0	2.1	1.2	3.7	2.0	1.4
2016											
I	1.2	2.9	1.5	1.5	2.3	11.9	2.2	1.2	3.7	1.9	1.4
II	1.3	2.8	1.5	1.5	2.3	11.8	2.2	1.2	3.7	1.9	1.4
III	1.3	2.8	1.5	1.5	2.2	11.7	2.3	1.2	3.7	1.9	1.4
IV	1.4	2.7	1.5	1.5	2.1	11.6	2.3	1.2	3.8	1.9	1.4

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	-15	9	0.1	-390	-4.1	1.39	4.41	-1.32	1.70	1.39	121.0
2012	80	118	1.3	-313	-3.3	0.57	4.01	-1.92	1.52	1.28	115.5
2013	158	155	1.6	-257	-2.7	0.24	3.19	-1.42	1.53	1.28	118.3
2014	170	152	1.6	-209	-2.1	0.30	3.27	-1.25	1.71	1.21	115.4
2015	165	150	1.5	-164	-1.6	0.34	3.47	-1.06	2.08	1.17	112.0
2016	164	154	1.5	-132	-1.3	0.37	3.82	-1.02	2.43	1.17	111.1
2011											
I	-7.3	0.7	0.03	-113.2	-4.84	1.10	4.32	-1.38	1.84	1.37	119.5
II	-9.0	-5.9	-0.25	-100.9	-4.29	1.42	4.51	-1.34	1.76	1.44	122.5
III	-7.3	1.1	0.05	-91.4	-3.86	1.56	4.30	-1.14	1.60	1.41	121.4
IV	8.9	12.8	0.54	-84.4	-3.58	1.50	4.53	-1.44	1.60	1.35	120.5
2012											
I	10.1	21.6	0.91	-94.2	-3.98	1.04	4.39	-1.64	1.70	1.31	116.9
II	18.5	26.6	1.12	-70.0	-2.95	0.69	4.27	-1.76	1.82	1.28	115.9
III	24.6	30.2	1.27	-79.5	-3.34	0.36	3.99	-2.18	1.45	1.25	113.4
IV	26.7	39.9	1.68	-69.6	-2.94	0.20	3.41	-2.11	1.10	1.30	115.9
2013											
I	38.0	56.4	2.38	-66.9	-2.82	0.21	3.18	-1.59	1.38	1.32	118.8
II	38.0	36.4	1.53	-69.4	-2.91	0.22	3.16	-1.41	1.53	1.28	118.3
III	40.5	30.2	1.26	-64.7	-2.70	0.24	3.20	-1.37	1.59	1.26	118.3
IV	41.1	31.7	1.32	-55.8	-2.32	0.28	3.22	-1.32	1.62	1.25	117.6
2014											
I	47.9	61.5	2.54	-55.4	-2.29	0.29	3.23	-1.37	1.58	1.23	117.0
II	42.7	35.2	1.44	-56.1	-2.30	0.30	3.23	-1.28	1.65	1.22	116.1
III	40.2	26.8	1.09	-52.5	-2.14	0.31	3.28	-1.19	1.78	1.20	114.9
IV	39.3	28.8	1.17	-44.7	-1.81	0.32	3.33	-1.17	1.84	1.19	113.7
2015											
I	46.1	59.6	2.40	-42.5	-1.71	0.33	3.38	-1.13	1.92	1.17	112.5
II	40.9	33.8	1.35	-45.0	-1.80	0.33	3.44	-1.06	2.05	1.17	112.1
III	38.9	27.1	1.07	-43.0	-1.70	0.34	3.50	-1.04	2.12	1.17	111.9
IV	38.7	30.0	1.18	-34.1	-1.34	0.35	3.59	-1.01	2.22	1.17	111.6
2016											
I	45.8	60.3	2.35	-33.4	-1.30	0.36	3.68	-1.01	2.31	1.17	111.2
II	40.5	34.7	1.34	-36.6	-1.42	0.37	3.77	-1.01	2.40	1.17	111.2
III	38.7	28.1	1.08	-35.2	-1.35	0.37	3.86	-1.02	2.48	1.17	111.1
IV	39.2	31.3	1.20	-26.7	-1.02	0.38	3.95	-1.03	2.55	1.17	111.0

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

Potential output growth 1.1%pa

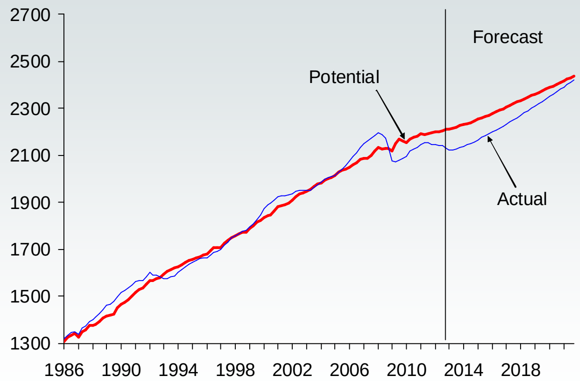
- Potential output is projected to rise by 1.1%pa over the next 10 years, a slightly lower rate than in the previous decade. GDP is set to contract by 0.6% in 2013, having shrunk by 0.5% in 2012 and to be slightly below potential growth at 1.0% in 2014. As a result, the large output gap of 3.0% in 2012 will expand in 2013 to 4.2% and decrease in 2014 to 4.1%, 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 total factor productivity.

- The 0.08%pt detraction from shrinking labour usage reflects the 0.4%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 0.2%pa. For the capital stock's contribution of 0.5%pt, the main factor is significantly higher investment growth (at 1.9%pa) than in the previous decade. Finally, total factor productivity growth's slightly higher contribution of 0.6%pt reflects the better 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	2003-2012	2013-2022
Potential GDP*	1.34	1.08
Employment at NAIRU	0.67	-0.12
Capital Stock	1.98	1.52
Total Factor Productivity	0.21	0.63

*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	1.0	1.7
Consumption	1.6	-0.2	0.7	1.5
Investment	3.4	-3.5	1.7	2.1
Government Consumption	1.8	1.1	0.2	1.2
Exports of Goods and Services	5.9	1.5	3.5	3.1
Imports of Goods and Services	6.2	0.3	3.2	3.1
Unemployment (%)	8.7	9.8	12.0	9.8
Consumer Prices	2.2	2.1	1.5	1.7
Current Balance (% of GDP)	0.2	-0.1	1.5	1.6
Exchange Rate (US$ per Euro)	1.25	1.37	1.20	1.19
General Government Balance (% of GDP)	-2.1	-4.4	-1.7	-0.6
Short-term Interest Rates (%)	2.8	1.7	0.4	2.8
Long-term Interest Rates (%)	4.0	4.0	3.6	4.7
Working Population	0.5	0.1	-0.3	-0.4
Labour Supply	1.0	0.4	-0.1	-0.2
Participation Ratio	72.9	74.2	75.6	76.4
Labour Productivity	1.0	0.1	1.1	1.4

Long-Term Forecast for Eurozone

Annual percentage changes unless otherwise specified

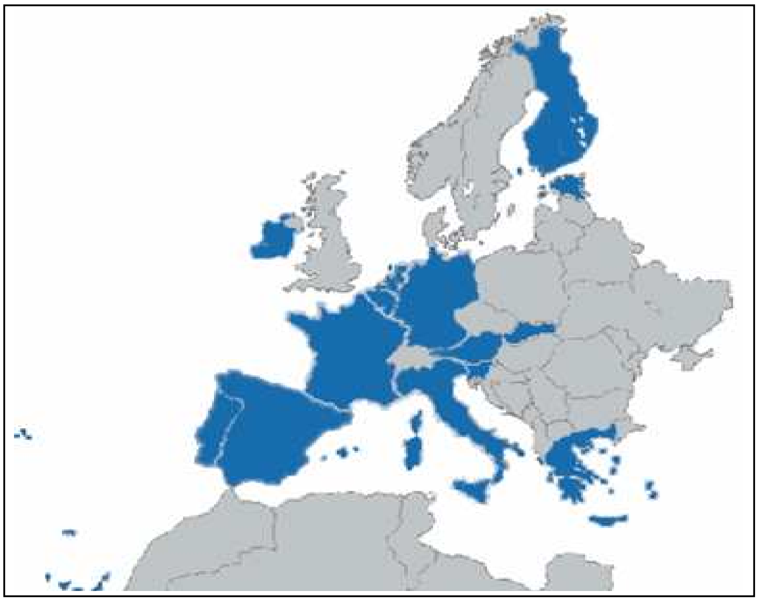
	2003-2012	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2022
GDP	0.9	-4.3	2.0	1.5	-0.5	-0.6	1.0	1.4	1.5	1.6	1.7	1.8	1.8	1.7	1.6	1.3
Consumption	0.7	-0.9	0.9	0.1	-1.2	-0.9	0.6	1.1	1.3	1.5	1.5	1.6	1.6	1.5	1.5	1.1
Investment	-0.1	-12.7	-0.3	1.6	-3.9	-1.9	2.0	2.9	2.8	2.6	2.4	2.3	2.1	1.9	1.8	1.9
Government Consumption	1.5	2.6	0.7	-0.1	-0.1	-0.5	-0.3	0.3	0.6	0.8	1.0	1.2	1.3	1.3	1.3	0.7
Exports of Goods and Services	3.7	-12.4	11.0	6.5	2.9	1.9	3.6	4.2	4.1	3.8	3.6	3.3	3.0	2.8	2.7	3.3
Imports of Goods and Services	3.2	-11.0	9.5	4.3	-0.9	0.4	3.2	4.4	4.3	3.9	3.6	3.3	3.0	2.8	2.7	3.2
Unemployment (%)	9.2	9.6	10.1	10.2	11.4	12.4	12.5	12.2	11.7	11.3	10.8	10.4	9.9	9.3	8.9	10.9
Consumer Prices	2.1	0.3	1.6	2.7	2.5	1.7	1.6	1.4	1.4	1.4	1.5	1.6	1.7	1.8	1.8	1.6
Current Balance (% of GDP)	0.1	-0.2	0.0	0.1	1.2	1.6	1.6	1.5	1.5	1.5	1.5	1.6	1.7	1.7	1.7	1.6
Exchange Rate (US$ per Euro)	1.31	1.39	1.33	1.39	1.28	1.28	1.21	1.17	1.17	1.17	1.17	1.17	1.18	1.19	1.21	1.19
General Government Balance (% of GDP)	-3.3	-6.3	-6.2	-4.1	-3.3	-2.7	-2.1	-1.6	-1.3	-1.0	-0.8	-0.7	-0.6	-0.5	-0.5	-1.2
Short-term Interest Rates (%)	2.3	1.2	0.8	1.4	0.6	0.2	0.3	0.3	0.4	0.6	1.4	2.3	2.9	3.5	3.9	1.6
Long-term Interest Rates (%)	4.0	3.8	3.6	4.4	4.0	3.2	3.3	3.5	3.8	4.1	4.3	4.5	4.7	4.9	5.0	4.1
Working Population	0.3	0.1	0.1	0.0	-0.3	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5	-0.4
Labour Supply	0.7	0.2	0.1	0.3	0.6	0.1	0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3	-0.2
Participation Ratio (%)	73.6	74.1	74.0	74.2	75.0	75.3	75.5	75.6	75.8	75.9	76.1	76.3	76.4	76.6	76.7	76.0
Labour productivity	0.6	-2.6	2.5	1.2	0.2	0.5	1.1	1.2	1.2	1.2	1.4	1.4	1.4	1.4	1.4	1.2
Employment	0.4	-1.8	-0.5	0.3	-0.7	-1.1	-0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.1
Output gap (% of potential GDP)	-0.3	-3.4	-2.4	-1.9	-3.0	-4.2	-4.1	-3.8	-3.4	-3.0	-2.5	-2.0	-1.4	-0.9	-0.5	-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 Cyprus, 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 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 severe 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.

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

Long-term economic & social development

	1980	1990	2000	2011*
GDP per capita (US$)	-	19175	19886	39418
Inflation (%)	9.9	4.2	2.2	2.7
Population (mn)	287	305	315	333
Urban population (% of total)	69.7	70.9	72.4	75.5
Life expectancy (years)	73.7	76.0	78.3	80.7

Source : Oxford Economics & World Bank

Structure of GDP by output

	2010
Agriculture	1.5%
Industry	26.5%
Services	72.0%

Source : WDI

* 2011 or latest available year

Corruption perceptions index 2012

	Score
Developed economies (average)	74.8
Emerging economies (average)	38.0
Eurozone	66.6

Source: Transparency International

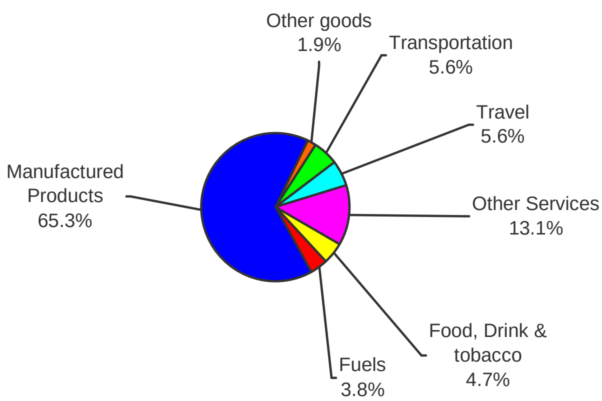
Scoring system 10 = highly clean, 0 = highly corrupt

Structural economic indicators

	1990	1995	2000	2011*
Current account (US$ billion)	11	54	-95	12
Trade balance (US$ billion)	-25	63	-29	-20
FDI (US$ billion)	-	-	30	-96
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)	271	313	240	216
Oil consumption (000 bpd)	9715	10483	10927	9960

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