OXFORD ECONOMICS

Eurozone

Highlights

- The Eurozone is moving out of the longest recession since at least the early 1970s. GDP declined for six consecutive quarters from Q4 2011 to Q1 2013. We estimate that quarterly GDP growth was positive in Q2, albeit only just at 0.1%. Given the available data on industrial production, the risks to this forecast appear to be on the upside.
- For the remainder of 2013, GDP growth should remain positive but still very low, resulting in a 0.6% contraction for the year as a whole. This is consistent with the PMI surveys. For the first time since January 2012, the combined manufacturing and services PMI reached the threshold of 50 that separates expansion from contraction.
- This stabilisation of the Eurozone economy has been in our forecast for some time. Financial markets' participants seem to have been more surprised than us by the relatively positive – or less negative – flow of data. Citigroup's index of data surprises that compares outcomes to the market consensus has moved very swiftly into positive territory. This has been accompanied by renewed increases in share prices and lower yields in the 'peripheral' government bond markets. Overall, the financial market environment is relatively benign again after a short period of turmoil following concerns about tightening in the US and political instability in the Eurozone.
- Beyond this year the environment has not changed much and we continue to forecast a slow recovery at best. The level of GDP is only forecast to reach its pre-crisis peak in 2016.

Forecast for Eurozone

(Annual percentage changes unless specified)

	2012	2013	2014	2015	2016	2017
Domestic Demand	-2.2	-1.3	0.5	1.2	1.4	1.5
Private Consumption	-1.3	-0.7	0.5	1.1	1.3	1.5
Fixed Investment	-4.2	-3.5	1.8	2.6	2.7	2.6
Stockbuilding (% of GDP)	0.1	-0.1	-0.2	-0.2	-0.2	-0.2
Government Consumption	-0.4	-0.6	-0.3	0.3	0.6	0.8
Exports of goods and services	2.9	0.0	3.3	4.3	4.4	4.0
Imports of goods and services	-0.7	-1.6	2.6	4.2	4.4	4.1
GDP	-0.5	-0.6	0.9	1.4	1.6	1.6
Industrial Production	-2.9	-0.9	1.7	2.2	2.4	2.1
Consumer Prices	2.5	1.6	1.6	1.4	1.4	1.4
Current Balance (% of GDP)	1.3	1.9	1.8	1.7	1.7	1.8
Government Budget (% of GDP)	-3.7	-2.8	-2.4	-2.0	-1.6	-1.3
Short-Term Interest Rates (%)	0.57	0.22	0.27	0.31	0.35	0.56
Long-Term Interest Rates (%)	3.92	3.04	3.22	3.38	3.71	4.06
Exchange rate (US$ per Euro)	1.28	1.31	1.24	1.19	1.18	1.18
Exchange rate (YEN per Euro)	102.54	126.80	129.71	133.70	133.81	131.11

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Decades of convergence undone by Eurozone crisis

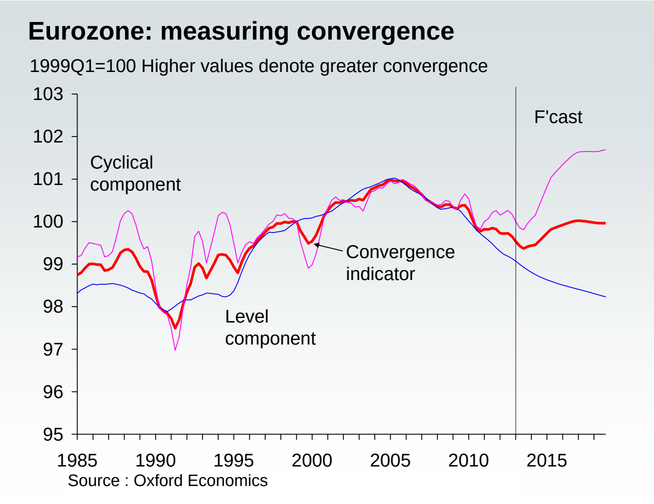
The two decades preceding the global financial crisis saw increasing economic convergence within the Eurozone, but over the past six years countries have diverged again. We have constructed an indicator of convergence that measures both cycles and trends on a number of economic aspects. Our forecast shows that by 2018 the degree of convergence will be back to levels prevailing in the early 2000s. Greater divergence within the Eurozone impedes the effectiveness of monetary policy and hinders Eurozone-wide decision making. It would benefit all to promote convergence, with monetary policy targeted at the peripheral countries and institutional reforms such as moves towards banking union and fiscal union. But none of this is likely to happen in the near future.

By reducing the apparent benefits of participating in the monetary union, divergence also raises the risk of a break-up as countries left behind may be tempted by the hope that they could achieve higher growth outside the Eurozone.

Reversing decades of convergence in incomes

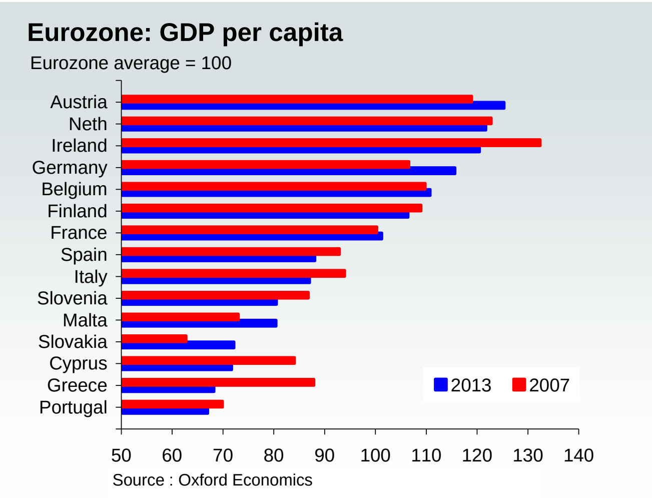
Since the start of the Eurozone crisis, we have tracked the degree of convergence between economies of the Eurozone. Convergence can be measured in various ways: in terms of economic cycles or levels; in terms of GDP, GDP per person, unemployment rates or inflation rates for instance. We have built a composite indicator that takes into account a wide range of measures. It comprises cyclical as well as trend (or level) indicators for GDP, inflation, unemployment rates and government balances. For each indicator, we measure the degree of convergence (or inverse of the standard deviation) across the Eurozone countries. The overall convergence indicator is an average of the measures of convergence across all indicators.

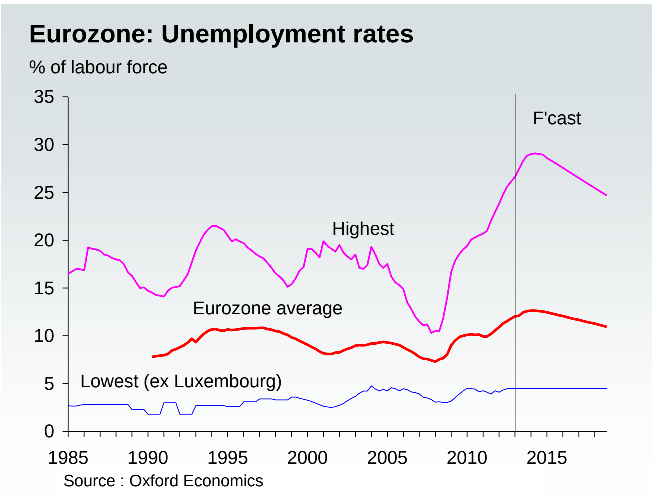
As the chart shows, the global financial crisis has brought convergence within the Eurozone to an abrupt end. Instead, economies have started to diverge again and the Eurozone countries are now at their most economically diverse since the early 2000s. Structural divergence has been particularly rapid. While the level of prices at purchasing power parity has evolved in a similar way across all 17 Eurozone countries, the level of GDP per capita, a common proxy for income levels, has diverged significantly. Unsurprisingly, Greece has fallen furthest behind. GDP per capita decreased from 88% of the Eurozone average in 2007 to 68% in 2013. This is by far the lowest level of relative income for Greece since at least the early 1980s. Cyprus and Ireland are next, losing 12 percentage points in relative terms, although Ireland's GDP per head remains around 20% higher than the Eurozone average. Meanwhile, Germany and Austria have moved further above the Eurozone average. The only two countries that have continued to catch up during this period are Slovakia and Malta.



Labour markets at their most heterogeneous in 30 years

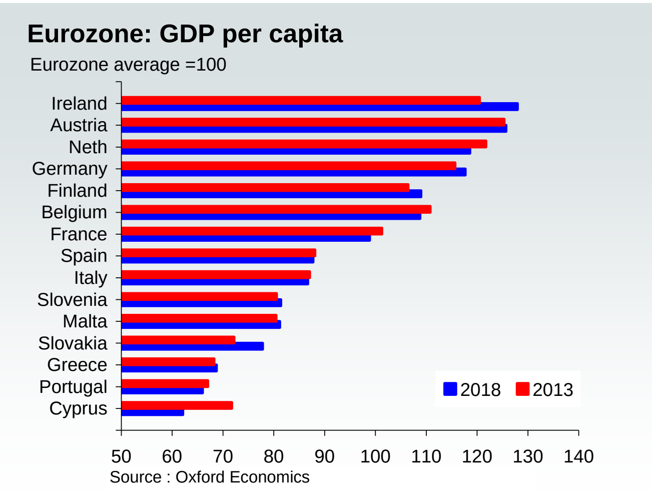
Divergence has also increased in terms of economic cycles. For instance, the standard deviation of GDP growth rates has risen from around two percentage points before the global financial crisis to around three percentage points in recent years. But the most striking change in relative economic cycles has been in unemployment rates. While some countries such as Luxembourg, Austria and Germany have maintained low unemployment rates, the number of jobless has skyrocketed in Greece, Spain, Ireland and Portugal. Divergence in unemployment rates is at its highest since at least the early 1980s.





Little convergence over the next five years in the absence of targeted policy

Little convergence is forecast to take place over the next five years. Economic cycles should move a little closer together as unemployment rates peak and then start to fall in peripheral countries. But this will be a very slow process, insufficient to bring income levels closer together. By 2018, Greek GDP per head is forecast at only 69% of the Eurozone average. Portugal's is forecast at 66% of the Eurozone average, compared with 67% currently.



Greater divergence within the Eurozone impedes the effectiveness of monetary policy and hinders Eurozone-wide decision making. It would benefit all to promote convergence, with monetary policy targeted at the peripheral countries and institutional reforms such as moves towards banking and fiscal unions. But none of this is likely to happen in the near future. By reducing the apparent benefits of participating in the monetary union, divergence also raises the risk of a break-up as countries left behind may be tempted by the hope that they could achieve higher growth outside the Eurozone.

Forecast Overview

Eurozone moving out of recession

- We estimate that the Eurozone moved out of its longest recession since at least the early 1970s in Q2, with the economy growing by 0.1% quarter-on-quarter. In H2 2013, GDP growth is expected to remain marginally positive. This is supported by the results of the July PMI surveys.

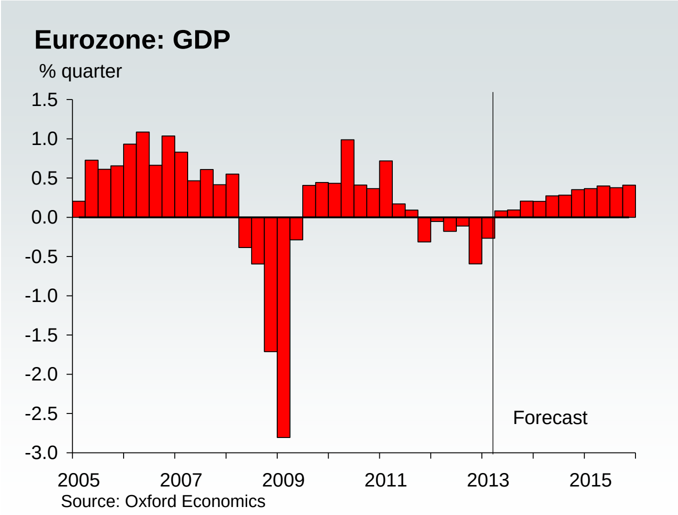
Financial environment benign again

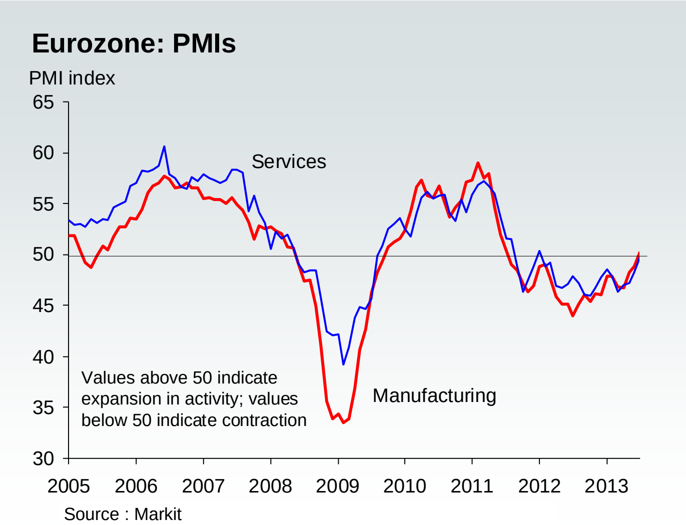
- The financial market environment has turned relatively benign again after a short period of turmoil following concerns about tightening in the US and political instability in the Eurozone. Share prices have risen and 'peripheral' bond yields fallen back.
- This will help in an environment of ongoing political uncertainty, notably in Italy and Portugal and, to a lesser extent, Greece. In the latter two countries, there is still considerable doubt about the ability of the government to deliver on the bailout plan targets. We continue to think that Portugal will need some form of second bailout, probably a credit line from the European Stability Mechanism. For Greece, some restructuring of debt owned by other Eurozone governments seems unavoidable. This is still very difficult politically and will be delayed as much as possible.

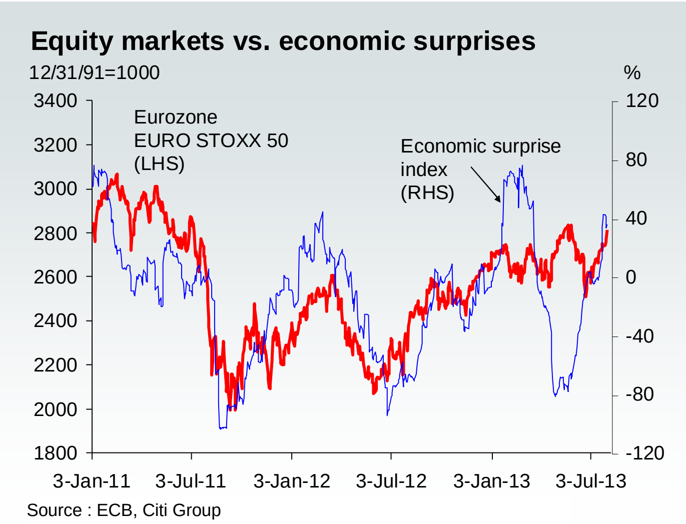
Private deleveraging to dominate

- A benign financial environment and some political stability are necessary conditions for our baseline forecast to materialise. This forecast assumes that restructuring of public and private balance sheets happens at a slow but steady pace. Turmoil in financial markets or on the political scene would disrupt such a process. We forecast GDP growth of below 1% in 2014 and at 1.6% per year on average in 2015-18. The main factors that shape the forecast from 2014 onwards are as follows:

  Less but still some fiscal tightening – whilst much reduced compared with the amount of fiscal tightening in 2012 and 2013, the Eurozone's fiscal stance will remain tight for the foreseeable future. The one measure that would help overcome this is a relaxation of fiscal policy in Germany. But nothing specific will be announced before the country's general elections in September.





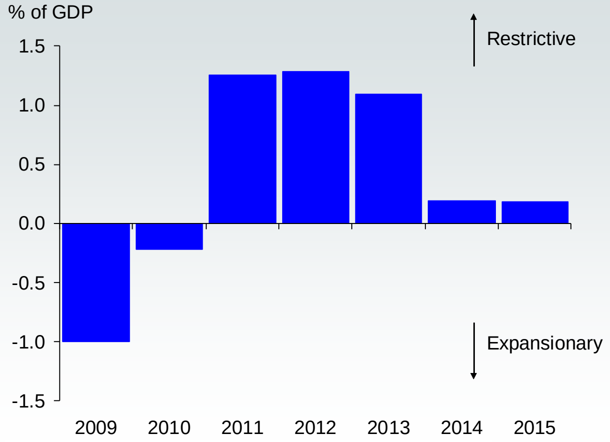


Private sector deleveraging required – though much focus has been on reducing public sector debt, high private sector debt also needs to be addressed before the economy can sustain robust growth. Unlike the US, and to a lesser extent the UK, Eurozone private debt ratios have not yet fallen. For instance, the debts of non-financial companies stood at 137% of GDP in 2012, up from 113% a decade ago.

Turnaround in labour market not yet in sight – the number of unemployed ticked down for the first time in more than two years in June. However, it is too early to call a turning point in the labour market. We expect further increases in unemployment and when it finally starts to fall it will only do so slowly. The number of unemployed will likely reach 20 million in H2 2013, more than 3.5 million of which are under 25. The share of long-term (more than one year) unemployed has risen from 33% in early 2009 to 47.9% in late 2012. This means that governments will continue to face stiff protests against fiscal consolidation and other reforms that would cost jobs in the short term. These developments also raise concerns about a ‘lost generation’, whereby new entrants in the labour market do not get the necessary experience to gain the flexibility to find new jobs and become tomorrow’s managers. The measures to tackle youth unemployment announced at the European Council in June are too little, too late.

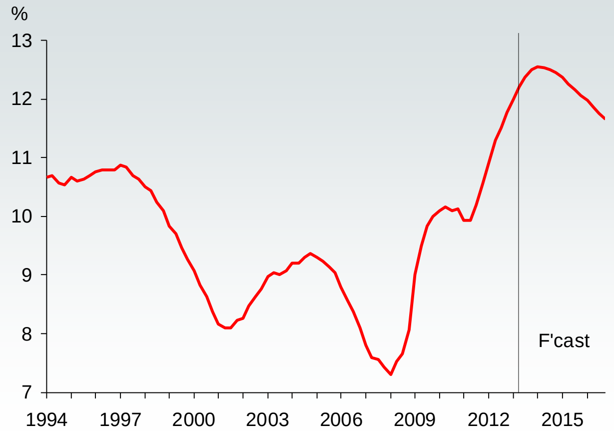
Divergence to persist – the process of convergence between Eurozone economies was reversed by the global financial crisis and then the Eurozone crisis. According to our indicator, the degree of convergence is at its lowest since the early 2000s. Our forecast implies some renewed convergence in cyclical terms as peripheral countries move out of recession, but the damage to income levels is such that income gaps will continue to widen throughout the next five years. By 2018, Greek GDP per head is forecast at only 69% of the Eurozone average, compared with 68% today and 88% before the crisis. This would be the lowest relative income level in at least 30 years. Divergence hinders the effectiveness of monetary policy and slows down agreements on further integration (particularly in the areas of fiscal and banking union). By reducing the apparent benefits of participating in the monetary union it also raises the risk of a break-up as countries left behind may be tempted by the hope that they could achieve higher growth outside the Eurozone.

Eurozone: fiscal measures



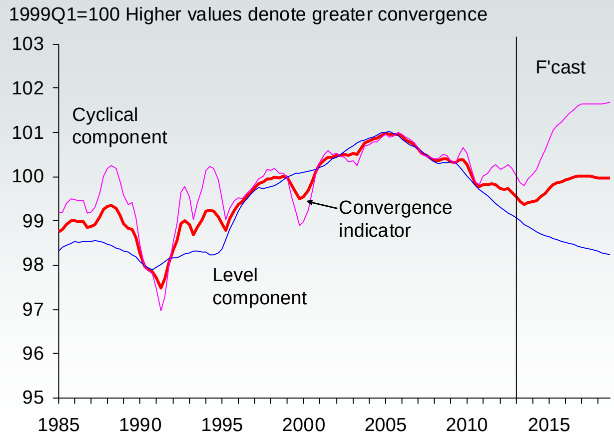
Source : Oxford Economics

Eurozone: Unemployment



Source: Oxford Economics

Eurozone: measuring convergence



Source : Oxford Economics

Key Indicators: Eurozone

Percentage changes on a year earlier unless otherwise stated

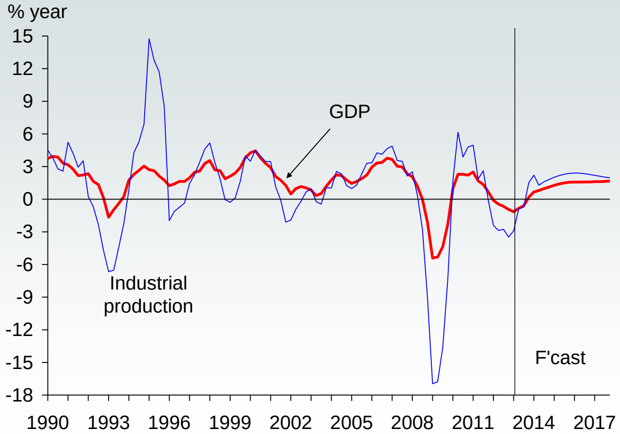
	Industrial production (% yr)	Unemploy-ment (% point)	CPI (% yr)	Business confidence (% balance)	Consumer confidence (% balance)	Exports (% yr)	Imports (% yr)	Trade balance (€ bn)
Jul	-2.5	11.5	2.4	-1.1	-21.3	11.2	3.1	13.8
Aug	-2.1	11.5	2.6	-1.1	-24.4	10.5	2.6	4.6
Sep	-2.7	11.6	2.6	-1.2	-25.7	1.2	-3.9	8.6
Oct	-3.1	11.7	2.5	-1.5	-25.5	14.7	7.7	9.0
Nov	-3.7	11.8	2.2	-1.1	-26.7	5.6	0.2	12.8
Dec	-2.3	11.9	2.2	-1.0	-26.3	-3.1	-5.3	10.2
2013								
Jan	-2.6	12.0	2.0	-1.0	-23.9	5.4	1.9	-4.8
Feb	-2.9	12.0	1.8	-0.7	-23.6	-1.1	-6.9	9.9
Mar	-1.6	12.1	1.7	-0.8	-23.5	0.1	-9.9	22.8
Apr	-0.5	12.1	1.2	-1.0	-22.2	8.9	1.6	14.1
May	-1.3	12.1	1.4	-0.8	-21.8	-0.1	-5.7	15.2
Jun	-	12.1	1.6	-0.7	-18.8	-	-	-
Jul	-	-	1.6	-0.5	-17.4	-	-	-

Financial Indicators: Eurozone

Percentage changes on a year earlier unless otherwise stated

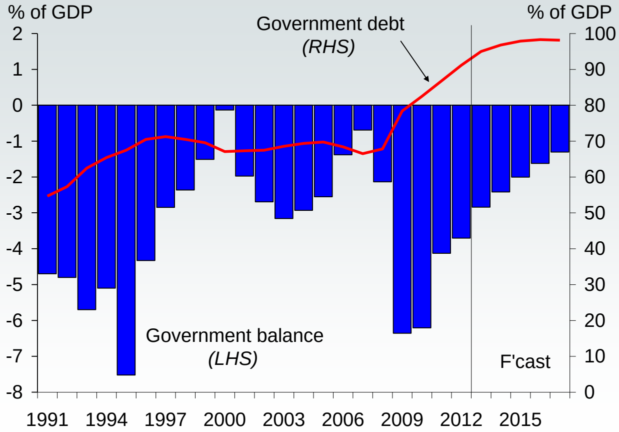
	Short rate %	Long rate %	Money Supply (M3)	Exchange rate $/€ avg.	Exchange rate €/£	Nominal effective exch. rate	Share price DJ STOXX	Net FDI € bn
Jul	0.50	3.25	3.5	1.23	1.27	97.6	2326	2.5
Aug	0.33	3.01	2.8	1.24	1.27	97.7	2441	12.6
Sep	0.25	2.43	2.7	1.29	1.25	99.9	2454	-20.0
Oct	0.21	2.31	3.9	1.30	1.24	100.8	2504	-7.7
Nov	0.19	2.25	3.8	1.28	1.24	100.3	2575	11.1
Dec	0.19	2.10	3.5	1.31	1.23	102.0	2636	-43.8
2013								
Jan	0.20	2.40	3.4	1.33	1.20	104.2	2703	-10.0
Feb	0.22	2.86	3.1	1.34	1.16	106.0	2634	11.0
Mar	0.21	3.03	2.5	1.30	1.16	104.5	2624	-24.6
Apr	0.21	2.86	3.2	1.30	1.18	105.0	2712	-6.9
May	0.20	2.69	2.9	1.30	1.18	105.5	2770	0.4
Jun	0.21	3.07	2.3	1.32	1.17	106.3	2603	-
Jul	0.22	3.10	-	1.31	1.16	106.5	2768	-

Eurozone: GDP and industrial production



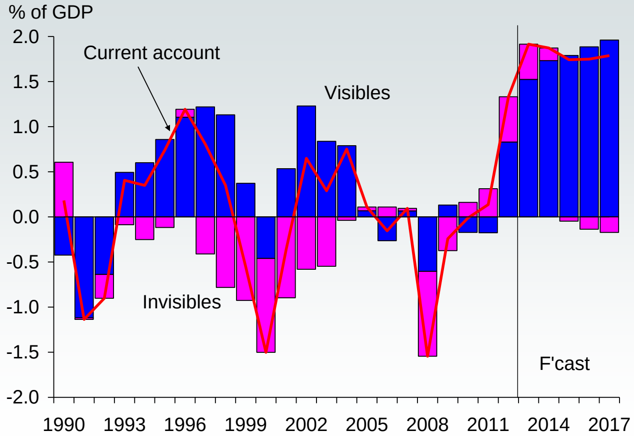
Source: Oxford Economics

Eurozone: Government finances



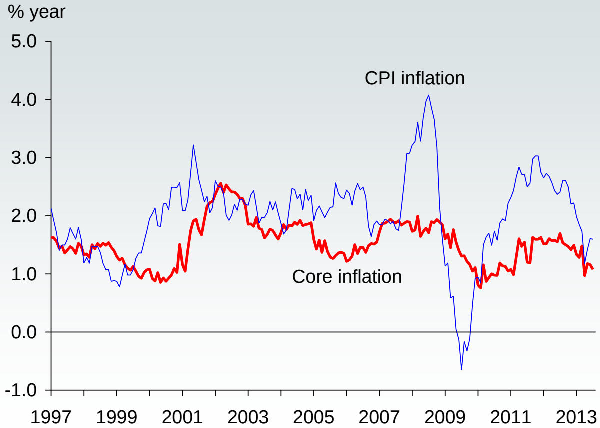
Source: Oxford Economics

Eurozone: Current account



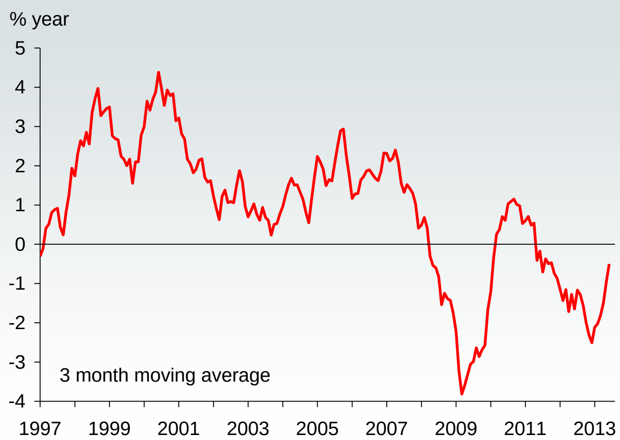
Source: Oxford Economics

Eurozone: Headline Inflation



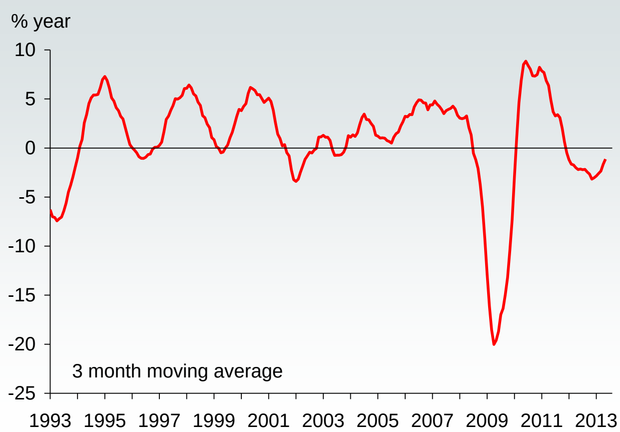
Source: Haver Analytics

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											
2012	-1.3	-4.2	-2.2	-0.5	-2.9	11.4	1.7	0.1	2.8	2.6	2.5
2013	-0.7	-3.5	-1.3	-0.6	-0.9	12.2	1.6	0.3	2.6	0.2	1.6
2014	0.5	1.8	0.5	0.9	1.7	12.6	1.6	1.0	5.0	1.4	1.6
2015	1.1	2.6	1.2	1.4	2.2	12.4	2.1	1.2	4.8	2.0	1.4
2016	1.3	2.7	1.4	1.6	2.4	12.0	2.3	1.3	4.3	1.9	1.4
2017	1.5	2.6	1.5	1.6	2.1	11.6	2.5	1.3	3.9	1.8	1.4
2012											
I	-1.1	-2.8	-1.7	-0.1	-2.4	10.9	2.0	0.4	3.0	3.6	2.7
II	-1.2	-4.1	-2.3	-0.5	-2.9	11.3	1.8	0.3	3.0	2.4	2.5
III	-1.6	-4.5	-2.5	-0.7	-2.8	11.5	1.7	0.0	2.5	2.4	2.5
IV	-1.5	-5.3	-2.3	-0.9	-3.5	11.8	1.3	-0.2	2.9	2.1	2.3
2013											
I	-1.3	-5.9	-2.2	-1.1	-2.9	12.0	1.8	-0.2	2.2	0.8	1.9
II	-0.8	-3.9	-1.5	-0.9	-1.1	12.1	1.4	0.1	1.8	-0.4	1.4
III	-0.6	-2.9	-1.2	-0.7	-0.9	12.3	1.5	0.3	3.1	-0.1	1.5
IV	0.1	-1.1	-0.4	0.1	1.3	12.5	1.8	0.9	3.3	0.3	1.7
2014											
I	0.2	1.3	0.1	0.6	2.0	12.6	1.2	0.9	4.5	0.5	1.8
II	0.4	1.6	0.3	0.8	1.3	12.6	1.7	1.0	5.4	1.8	1.7
III	0.6	2.0	0.6	1.0	1.6	12.6	1.8	1.0	5.1	1.6	1.5
IV	0.8	2.3	0.9	1.1	1.8	12.5	1.8	1.1	5.0	1.8	1.4
2015											
I	0.9	2.5	1.0	1.3	2.0	12.5	1.9	1.1	4.9	1.9	1.4
II	1.1	2.6	1.2	1.4	2.2	12.4	2.0	1.2	4.8	2.1	1.4
III	1.2	2.7	1.3	1.5	2.3	12.3	2.1	1.2	4.7	1.9	1.4
IV	1.2	2.7	1.4	1.6	2.4	12.2	2.2	1.3	4.6	1.9	1.4
2016											
I	1.3	2.7	1.4	1.6	2.4	12.2	2.2	1.3	4.5	1.9	1.4
II	1.3	2.7	1.4	1.6	2.4	12.1	2.3	1.3	4.3	1.9	1.4
III	1.4	2.7	1.4	1.6	2.4	12.0	2.3	1.3	4.2	1.9	1.4
IV	1.4	2.7	1.5	1.6	2.3	11.9	2.4	1.3	4.1	1.9	1.4
2017											
I	1.5	2.6	1.5	1.6	2.2	11.8	2.4	1.3	4.1	1.8	1.4
II	1.5	2.6	1.5	1.6	2.1	11.7	2.5	1.3	4.0	1.8	1.4
III	1.5	2.6	1.5	1.6	2.0	11.6	2.5	1.3	3.9	1.8	1.4
IV	1.5	2.6	1.5	1.7	2.0	11.5	2.5	1.3	3.7	1.8	1.5

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	78.9	126.4	1.33	-351.4	-3.70	0.57	3.92	-1.92	1.42	1.29	115.5
2013	143.6	181.2	1.90	-271.9	-2.84	0.22	3.04	-1.39	1.43	1.31	119.5
2014	166.3	180.0	1.84	-236.4	-2.42	0.27	3.22	-1.31	1.64	1.24	117.7
2015	176.8	172.0	1.71	-201.4	-2.00	0.31	3.38	-1.07	2.00	1.19	114.1
2016	192.1	178.0	1.72	-168.3	-1.62	0.35	3.71	-1.04	2.32	1.18	112.8
2017	206.1	187.7	1.76	-139.4	-1.30	0.56	4.07	-0.88	2.63	1.18	112.1
2012											
I	9.1	20.5	0.87	-91.3	-3.86	1.04	4.29	-1.64	1.61	1.31	116.9
II	18.5	27.2	1.15	-88.9	-3.75	0.69	4.17	-1.76	1.71	1.28	115.9
III	25.0	35.2	1.48	-86.7	-3.64	0.36	3.89	-2.18	1.35	1.25	113.3
IV	26.3	43.5	1.84	-84.6	-3.57	0.20	3.32	-2.11	1.02	1.30	115.8
2013											
I	38.8	57.3	2.41	-68.9	-2.90	0.21	3.06	-1.64	1.20	1.32	118.8
II	32.3	44.7	1.87	-72.4	-3.04	0.21	2.82	-1.20	1.42	1.31	119.2
III	35.3	39.1	1.63	-70.2	-2.93	0.23	3.12	-1.29	1.60	1.31	120.4
IV	37.1	40.1	1.67	-60.4	-2.51	0.24	3.17	-1.42	1.51	1.29	119.6
2014											
I	46.0	60.0	2.48	-60.5	-2.50	0.25	3.19	-1.52	1.42	1.27	119.1
II	38.3	45.3	1.86	-62.6	-2.57	0.27	3.20	-1.43	1.51	1.25	118.3
III	40.6	37.0	1.51	-59.9	-2.44	0.28	3.23	-1.22	1.73	1.23	117.2
IV	41.4	37.8	1.53	-53.4	-2.17	0.29	3.27	-1.09	1.90	1.22	116.2
2015											
I	49.5	57.1	2.30	-51.4	-2.07	0.30	3.30	-1.08	1.92	1.20	115.4
II	40.1	42.1	1.68	-54.0	-2.16	0.31	3.35	-1.07	1.97	1.19	114.0
III	42.8	35.4	1.41	-52.4	-2.08	0.32	3.40	-1.06	2.02	1.19	113.7
IV	44.3	37.4	1.47	-43.7	-1.72	0.33	3.47	-1.06	2.08	1.18	113.3
2016											
I	52.8	57.6	2.25	-43.0	-1.68	0.34	3.56	-1.04	2.19	1.18	112.9
II	44.2	43.6	1.69	-45.9	-1.78	0.34	3.66	-1.04	2.28	1.18	112.9
III	46.9	37.2	1.43	-44.2	-1.70	0.35	3.76	-1.04	2.37	1.18	112.7
IV	48.2	39.5	1.51	-35.2	-1.34	0.36	3.86	-1.04	2.46	1.18	112.6
2017											
I	56.6	59.8	2.26	-34.6	-1.31	0.37	3.94	-1.05	2.53	1.18	112.3
II	47.5	45.8	1.72	-38.3	-1.44	0.37	4.03	-1.06	2.60	1.18	112.1
III	50.2	39.7	1.48	-37.5	-1.40	0.63	4.11	-0.82	2.66	1.18	112.0
IV	51.9	42.4	1.57	-29.1	-1.08	0.89	4.18	-0.58	2.72	1.18	111.9

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

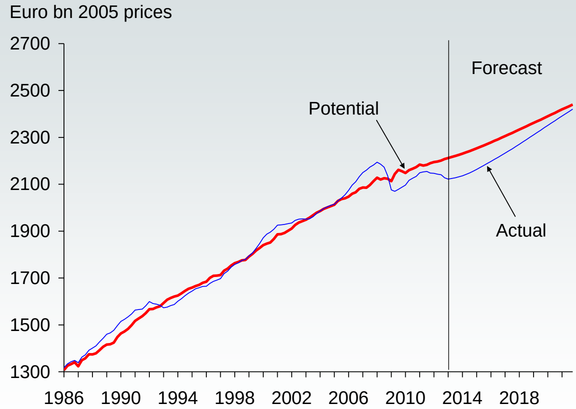
Potential output growth 1.1%pa

- 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 0.9% in 2014. As a result, the large output gap of 2.8% in 2012 will expand in 2013 to 4.3% and increase in 2014 to 4.3%, 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 0.03%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 0.1%pa. For the capital stock's contribution of 0.5%pt, the main factor is significantly higher investment growth (at 1.7%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



Source: Oxford Economics

Potential GDP and Its Components
Average Percentage Growth

	2003-2012	2013-2022
Potential GDP*	1.31	1.10
Employment at NAIRU	0.63	-0.04
Capital Stock	1.97	1.41
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	-0.1	0.8	1.5
Investment	3.4	-3.6	1.2	2.1
Government Consumption	1.8	1.0	0.2	1.2
Exports of Goods and Services	5.9	1.5	3.2	3.1
Imports of Goods and Services	6.2	0.3	2.7	3.1
Unemployment (%)	8.7	9.8	12.2	10.4
Consumer Prices	2.2	2.1	1.5	1.7
Current Balance (% of GDP)	0.2	-0.1	1.8	1.8
Exchange Rate (US$ per Euro)	1.25	1.37	1.22	1.19
General Government Balance (% of GDP)	-2.1	-4.5	-2.0	-0.8
Short-term Interest Rates (%)	2.8	1.7	0.3	2.8
Long-term Interest Rates (%)	4.0	4.0	3.5	4.7
Working Population	0.5	0.1	-0.3	-0.4
Labour Supply	1.0	0.4	0.0	-0.2
Participation Ratio	72.9	74.3	75.7	76.7
Labour Productivity	1.0	0.1	1.0	1.4

Long-Term Forecast for Eurozone

Annual percentage changes unless otherwise specified

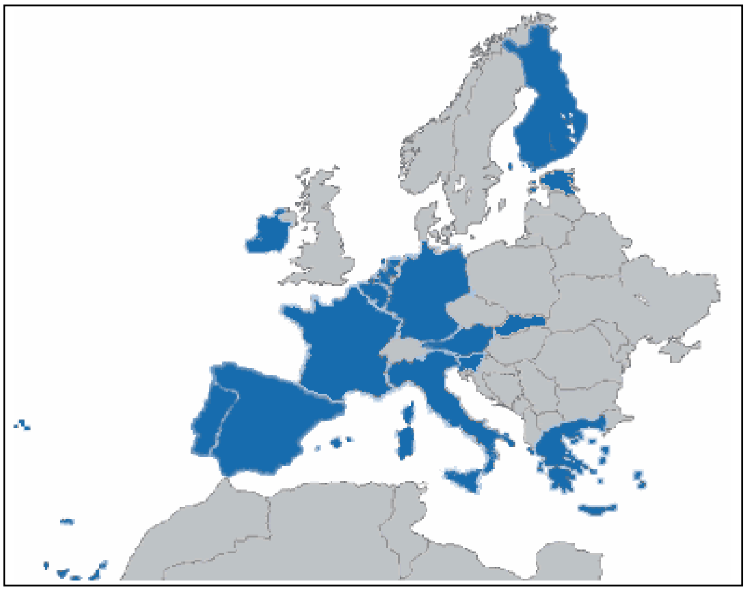
	2003-2012	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2022
GDP	1.0	-4.3	1.9	1.5	-0.5	-0.6	0.9	1.4	1.6	1.6	1.7	1.8	1.7	1.7	1.6	1.3
Consumption	0.7	-0.9	1.0	0.2	-1.3	-0.7	0.5	1.1	1.3	1.5	1.6	1.6	1.6	1.5	1.5	1.1
Investment	-0.2	-12.7	-0.5	1.5	-4.2	-3.5	1.8	2.6	2.7	2.6	2.5	2.3	2.1	2.0	1.8	1.7
Government Consumption	1.4	2.6	0.8	-0.1	-0.4	-0.6	-0.3	0.3	0.6	0.8	1.0	1.1	1.2	1.3	1.3	0.7
Exports of Goods and Services	3.7	-12.4	11.0	6.5	2.9	0.0	3.3	4.3	4.4	4.0	3.7	3.3	3.0	2.8	2.6	3.1
Imports of Goods and Services	3.2	-11.0	9.5	4.3	-0.7	-1.6	2.6	4.2	4.4	4.1	3.7	3.3	2.9	2.8	2.6	2.9
Unemployment (%)	9.2	9.6	10.1	10.2	11.4	12.2	12.6	12.4	12.0	11.6	11.3	10.9	10.4	10.0	9.6	11.3
Consumer Prices	2.1	0.3	1.6	2.7	2.5	1.6	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	1.3	1.9	1.8	1.7	1.7	1.8	1.8	1.8	1.8	1.8	1.9	1.8
Exchange Rate (US$ per Euro)	1.31	1.39	1.33	1.39	1.28	1.31	1.24	1.19	1.18	1.18	1.18	1.18	1.19	1.19	1.21	1.21
General Government Balance (% of GDP)	-3.3	-6.4	-6.2	-4.1	-3.7	-2.8	-2.4	-2.0	-1.6	-1.3	-1.1	-0.9	-0.7	-0.6	-0.6	-1.4
Short-term Interest Rates (%)	2.3	1.2	0.8	1.4	0.6	0.2	0.3	0.3	0.3	0.6	1.3	2.3	2.9	3.4	3.9	1.6
Long-term Interest Rates (%)	4.0	3.8	3.6	4.4	3.9	3.0	3.2	3.4	3.7	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	-0.2	-0.3	-0.4	-0.4	-0.3	-0.3	-0.4	-0.4	-0.5	-0.4
Labour Supply	0.7	0.2	0.1	0.3	0.7	0.0	0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.1
Participation Ratio (%)	73.6	74.1	74.0	74.3	75.0	75.2	75.5	75.8	76.0	76.2	76.4	76.6	76.7	76.9	77.1	76.2
Labour productivity	0.6	-2.6	2.5	1.2	0.1	0.3	1.0	1.2	1.3	1.3	1.4	1.4	1.4	1.4	1.4	1.2
Employment	0.4	-1.8	-0.5	0.3	-0.7	-0.9	-0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.1
Output gap (% of potential GDP)	-0.2	-3.1	-2.0	-1.5	-2.8	-4.3	-4.3	-3.9	-3.5	-3.1	-2.5	-2.0	-1.5	-1.0	-0.5	-2.7

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 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.

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	2012*
GDP per capita (US$)	-	18088	19885	36605
Inflation (%)	9.9	4.2	2.2	2.5
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

* 2012 or latest available year

Corruption perceptions index 2012

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

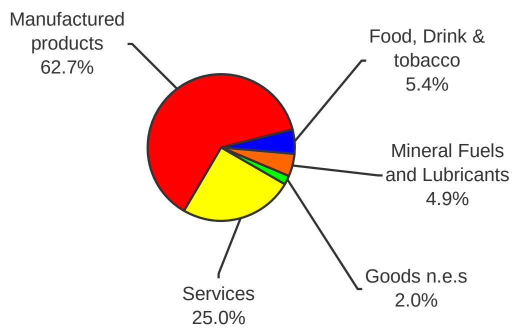
Source: Transparency International
Scoring system 100 = highly clean, 0 = highly corrupt

Structural economic indicators

	1990	1995	2000	2012*
Current account (US$ billion)	10	54	-94	162
Trade balance (US$ billion)	-23	63	-29	101
FDI (US$ billion)	-	-	30	-96
Govt budget (% of GDP)	-4.1	-7.5	-0.1	-3.7
Govt debt (% of GDP)	13.5	67.5	67.1	91.1
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	9493

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	46.4%
UK	6.6%
US	6.4%
China	3.5%
Switzerland	3.3%
Poland	2.6%

Source : Eurostat \ Haver Analytics