Eurozone

EY Eurozone Forecast

June 2014

EY

Building a better working world

Published in collaboration with

OXFORD ECONOMICS

Contents

2

"Our forecast for the Eurozone remains largely unchanged from March, as the region continues to make slow but steady progress toward recovery. However, inflation in the Eurozone has fallen consistently for the last year, and the risk of deflation is mounting."

Mark Otty, Area Managing Partner, Europe, Middle East, India and Africa

June 2014 forecast

14

Recovery continues, but the threat of deflation is mounting

The Eurozone has sustained its gradual recovery. But growth will not be strong enough to erode the spare capacity in the economy. This suggests that inflation will remain very low and a period of deflation cannot be ruled out.

Forecast for Eurozone countries

22

Detailed forecasts for the 18 Eurozone member states.

Detailed tables and charts

42

The data that underpins our analysis, including forecast assumptions and cross-country comparison tables.

Customize data from EY's *Eurozone Forecast* and *Rapid-Growth Markets Forecast*.

Download the ***EY Forecasts in focus*** app at ey.com/eurozone.

Foreword

Mark Otty

Area Managing Partner, Europe, Middle East, India and Africa

Our forecast for the Eurozone remains largely unchanged from March, as the region continues to make slow but steady progress toward recovery. However, inflation in the Eurozone has fallen consistently for the last year, and the risk of deflation is mounting.

The last few months have certainly been eventful for Europe. March saw political unrest in Ukraine reach boiling point. May's elections to the European Parliament sent a swathe of Eurosceptics to Brussels. And in early June, the European Central Bank (ECB) took the unprecedented step of introducing negative interest rates.

Despite all this upheaval, our forecast for the Eurozone remains largely unchanged from March, as the region continues to make slow but steady progress toward recovery. Overall, we expect to see GDP growth of 1.1% in 2014, before it picks up to 1.5% in 2015.

But this headline figure doesn't tell the whole story. There is still divergence between the 18 member states. In competitive core countries, such as Germany and Austria, labor markets are tight, unemployment is low and wages are rising. And peripheral economies that have taken action to boost competitiveness, such as Ireland and Spain, can look forward to growth rates that exceed the Eurozone average.

And then there are the core Eurozone economies that have not made the same strides toward improving competitiveness, such as Italy, France, Belgium and the Netherlands. In these countries, we expect more sluggish growth and weaker labor markets. In Italy particularly, growth is being dragged down by poor competitiveness and ongoing fiscal consolidation. This year, unemployment will carry on rising in several large Eurozone economies, as it starts to fall in others.

Our forecast shows that the pace of export growth is now closely matched to overall economic performance. For Germany, Austria and Spain, we forecast export growth of 4%-5% this year and next. But the less competitive countries can expect exports to rise just 2%-3% over the same period. Where growth in export orders is greater, support for business investment will be stronger. If, as expected, the euro begins to weaken against the dollar, and Eurozone exports become more competitive, there is a chance for the stragglers to drive growth by boosting exports.

Although our forecast is broadly optimistic, there are certainly downside risks. The crisis in Ukraine, and its economic impact on Russia, which is now thought to be in recession, continues to loom over the Eurozone. Finland and Latvia have strong economic links with Russia, as does Lithuania, which will join the euro in January. While the effects of sanctions against Russia and the impacts of the crisis on investor sentiment in the region are not yet clear, some parts of the Eurozone may be hit even harder if this uncertainty continues.

Another potential stumbling block for the Eurozone is a period of ultra-low inflation or even deflation. The annual rate of inflation in the Eurozone has been slowing consistently for the last year, and fell to just 0.5% in May. Even in Germany, where the economy is strong, inflation has slumped to about 1%.

But in response to this threat, the ECB lowered its key interest rate to just 0.15% in June (from 0.25%). And at the same time, it cut its deposit rate to -0.1%, meaning that banks will now have to pay to deposit money at the ECB. It hopes that this will encourage banks to lend to businesses and consumers instead. However, the change in rates is small and may have little impact on recent trends, except at the margin. And once again, the ECB seemed to hold out little prospect of any unconventional monetary policy stimulus, such as quantitative easing.

Deflation, or a period of so-called "lowflation", would add to the problems of sluggish growth by raising real debt levels and delaying spending and investment decisions. With this in mind, more aggressive policy efforts to stimulate price growth would almost certainly be much easier to reverse in the future than an ongoing spiral toward deflation and more deleveraging.

Meanwhile, in most countries, credit conditions for consumers and firms are set to remain tight, despite the latest ECB move, as banks try to bolster their finances ahead of the findings of the ECB's asset quality review, due in October.

So prices, investment and growth are all subdued. But that doesn't mean businesses have to accept that low growth must limit opportunity. Organizations that think creatively and act decisively can make change happen.

I hope that you find the June 2014 *EY Eurozone Forecast* stimulating and useful. Be sure to visit ey.com/eurozone for additional information on the forecast and the 18 individual country reports.

Highlights

The Eurozone's growth prospects are still improving ...

- With some peripheral countries picking up speed as their competitiveness improves, the Eurozone is expected to continue to recover, despite sluggish growth in some core countries. Exports are strengthening and a slow pickup in domestic demand will drive a return to modest investment growth.
- After 2 years of GDP decline, we forecast growth of 1.1% for the Eurozone as a whole this year — assuming that the economic effects of the crisis in Ukraine are contained. We expect to see this followed by expansion of 1.5% in 2015, and a slightly faster pace in 2016–18.

... but divergence between member states persists

- The problem of divergence within the Eurozone — and not just between the core and periphery — looks set to remain. The outlook is still favorable for Germany, Ireland, Spain, Portugal and the Baltics (with Lithuania's accession to the Eurozone now confirmed for January 2015).
- However, countries that have been slow to respond to the need for change — such as France, Italy, Belgium and the Netherlands — continue to lose competitiveness and face sluggish growth both this year and next.

Action to avert deflation is likely ...

- The threat of deflation is mounting. Inflation in the Eurozone was just 0.5% in May and the growth of money supply is still weak and slowing in much of the region. Deflation, or even a period of very low inflation, would add to the problems of sluggish growth by raising real levels of debt and by delaying spending and investment decisions.
- So far, the ECB has appeared relaxed about the threat of deflation. But with inflation so far below its target of 2%, in early June the ECB cut its main policy rate to just 0.15%. It also set the deposit rate at -0.1%, thereby charging banks for depositing money at the central bank, in order to encourage them to lend to businesses and consumers.
- But the change in rates is small and will only influence decisions at the margin. And there is still little sign of unconventional action, such as quantitative easing. We still think that more aggressive efforts to stimulate price growth and faster economic growth would be much easier to reverse in the future than a slide into deflation and more deleveraging.
- At the same time, consumers and firms continue to face tight credit conditions in most countries, as banks try to repair their finances ahead of the findings of the ECB's asset quality review, due in October. Consumer demand will also be restrained by ongoing high unemployment, which is seen falling only very slowly from the current level of just below 12%.

... and would help to weaken the euro, boosting exports

- Contrary to expectations, the euro has strengthened in recent months. But with Eurozone monetary policy having been eased again in June (with the possibility of further stimulus measures in the coming months) and the US now moving toward tighter policy, the euro should start to weaken later this year and in 2015. This would in turn give a further boost to exports and help to support growth.

GDP
(annual change)

2014	2015	2016–18
1.1%	1.5%	1.6%

Inflation

2014	0.7%
2015	1.2%

Exports of goods and services
(annual change)

2014	2015	2016–18
3.5%	3.8%	3.9%

Unemployment

2014	11.7%

Eurozone forecast by sector (% change)	2014	2015
Manufacturing	1.9	2.6
Agriculture	0.6	1.1
Construction	1.8	2.0
Utilities	1.2	2.0
Trade	0.7	1.5
Financial and business services	1.2	1.6
Communications	2.2	2.7
Non-market services	-0.3	0.2

Implications for businesses:

Looking beyond the low-growth narrative

Looking beyond the low-growth narrative

Planning for growth

Our forecast should be the source of at least some optimism for businesses, as growth in the Eurozone appears to be slowly gathering momentum. We expect GDP growth of 1.1% this year, accelerating gradually to 1.5% next year and 1.6% over the medium to long term. So companies can start to feel more confident as they plan for expansion rather than recession. And on top of this, Eurozone exports are rising and domestic demand is beginning to recover, as consumers start to feel more comfortable.

However, growth is still very modest. In addition, persistently low inflation in the Eurozone is threatening to topple into deflationary territory, which could hold back the fragile recovery.

So businesses cannot afford to be overly optimistic. And low expectations delay investment decisions. If investors suspect that the Eurozone will stagnate in the long term, they are likely to seek better market conditions elsewhere. And there are other important consequences for businesses if low growth is widely seen as the new normal. For example, very high unemployment rates would persist in some parts of the Eurozone for an extended period. So it is important that firms do not allow the belief to take hold that low growth is a story that can't be challenged.

Indeed, despite our low-growth forecast, Europe is still seen as a solid destination for foreign direct investment (FDI), as *EY's attractiveness survey 2014: Europe* demonstrated. According to the report, Europe secured a record 3,955 FDI decisions in 2013, creating over 166,000 jobs. And 45% of executives responding to the survey voted Western Europe as the world's most attractive destination for FDI, just ahead of China, which took 44% of the votes.

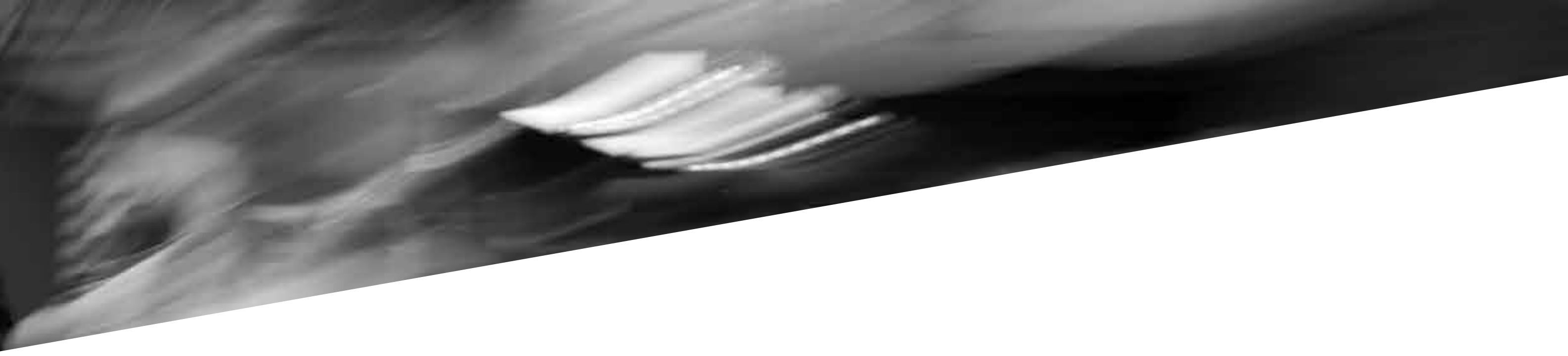
Dealing with the threat of deflation

With inflation slowing to just 0.5% in May, the threat of deflation in the Eurozone is mounting. What does a period of deflation or ultra-low inflation, which the International Monetary Fund (IMF) has called "lowflation", mean for businesses?

The more rigidity that is built into a contract, the more damage lowflation or deflation can cause. For instance, if a company is locked into agreements that stipulate in advance two or three years of price rises, then lowflation or deflation means it is likely to be losing money on these deals. So, when negotiating leases or service agreements, businesses should link any price rises over time to the actual inflation rate and ensure that they don't structure in higher costs than they are going to be able to charge their own clients in the future.

The impacts of a lasting period of lowflation represent a serious challenge for businesses that do not have sufficient differentiators to enable them to sustain prices or maintain margins that accommodate continued investments in innovation and research and development. As a result, firms must continually challenge the location of their value chain in order to identify opportunities to reduce costs and sustain or increase margins.

Economies of scale may prove crucial to sustaining competitiveness, with mergers and acquisitions and cross-border cooperation agreements likely tools for survival. Exports may prove the best way to attain growth, but with that comes the challenge of managing emerging market and exchange rate risks. Again, scale may be an adequate answer to mitigate these risks. Cooperative investment arrangements, or the acquisition of companies already present in such markets, may also provide a faster and more secure path to growth.



Viewpoint

Andris Vilks

Latvia's Minister of Finance

Our exit strategy from the IMF and European Commission (EC) bailout program was based on the introduction of the euro. Our vision and mission was to develop very strong, predictable fundamentals on which to build our economy. These were a low fiscal deficit, low foreign debt, low interest rates, mid-term budget planning and the introduction of a law to establish fiscal discipline. With the support of Latvia's people and business community, and effective social dialog, we have built these strong fundamentals. We are ahead of the cycle. We've gone through the consolidation, revised the functions of the state and changed our mind-set.

Being a small and open economy, it was important for us to join the euro. Entry commanded broad support among the business community. But public opinion was more skeptical. There was a lot of bad news coming from Greece, Portugal and Spain, and our people were very concerned. But we were able to explain our geopolitical goals, persuade people that troubles in the Eurozone would affect Latvia regardless of whether we were in or out, and point to countries like Finland and Germany that have been strong while in the Eurozone. We are looking forward to the introduction of the euro in Lithuania. We need to use one currency in all the Baltic states. That's important for our security and competitiveness.

Geopolitical tensions between Ukraine and Russia are not currently reflected in our GDP figures. Our economy grew by almost 3% in the first quarter of 2014, and the second quarter looks to be even stronger. Let's see what happens. But at the moment, it's business as usual with Russia. Russia is not such a large export partner as it was 20 years ago. Now, it attracts 9.5% of our exports. It is our third-largest trading partner after Estonia and Lithuania. Overall, 70% of our exports go to European Union (EU) countries.

Our people are not afraid to change their environment and seek new challenges. So easy access to jobs across the EU and the huge wage differentials mean that it's very difficult to stop people leaving Latvia in search of employment. Again, the fundamentals are important. If you can see that your country is growing and there are prospects for sustainable wage growth, then you are more likely to stay or return. The net flow of people has narrowed since 2007–09. However, we have recently established a plan to disburse information across Europe about jobs in Latvia and cover some relocation costs. This is a global issue. How can you stop people in the US moving from one state to another if there are good jobs to attract them? It's the same situation in our country, within the EU.

One of the hottest issues in Latvia today is education reform, especially at the tertiary and vocational levels. We have to make progress because demand for labor is outstripping supply in some industries, especially those where we need to increase our export capacity. Exports are a very strong driver of growth for Latvia, the Baltics and the Eurozone. Latvia has had annual export growth of 20%–30% in 2010–12. It is extremely important for all Eurozone countries to maintain a high level of exports. But this requires Europe to be competitive.

Looking beyond the low-growth narrative

If monetary policy does not start to signal a clear will to escape from a lowflation scenario, businesses should expect to face increased pressure from their clients to renegotiate supply contracts to eliminate price-increase clauses or to force productivity gains that translate into reduced prices. The same should be expected from suppliers, since it is unlikely that nominal wages will be reduced.

The ECB's decision in June to cut its main interest rate to 0.15% should go some way to reassuring businesses that it is committed to tackling the looming threat of deflation. And for companies across the Eurozone, the decision to introduce negative interest rates on deposits should be good news — as it is designed to push banks to make more money available to businesses (and consumers) for investment.

Weaker euro, stronger exports

The euro has confounded expectations by strengthening in recent months. However, with monetary policy still loosening in the Eurozone and set to tighten in the US, the euro should start to weaken later this year.

A weaker euro, combined with the outlook for sluggish growth within the Eurozone, will encourage businesses to look for external markets in which to operate. While a weakening of the euro against the dollar would encourage exports to the US, the main focus will be on fast-growing emerging markets. However, growth in some emerging economies is slowing, and there are risks of excessive leveraging in some of these countries.

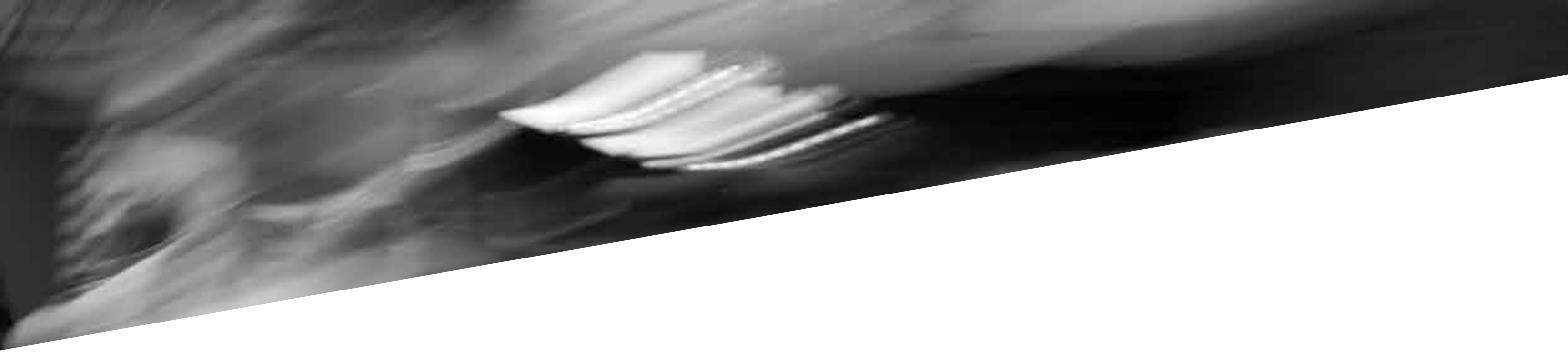
There is also the possibility that the economies of some key rapid-growth nations could be weaker than anticipated.
For instance, Brazil, a key growth market, is facing elections at the end of the year. And prior to that, it is hosting the football World Cup against a backdrop of growing civil unrest. There is also significant public investment to be made ahead of 2016's Olympic Games in Rio de Janeiro. This means that the country's mid- to long-term economic prospects are uncertain. If civil unrest grows further and it becomes clear that private consumption is very highly leveraged, opportunities for business could start to weaken.

On the other hand, many emerging economies in Asia continue to grow strongly. Although the GDP growth rate in China has slowed, this major world market continues to expand at over 7% a year and is driving activity in other Asian economies and intra-Asian trade. Emerging economies in Asia are forecast to grow by about 5.6% a year in 2014–15, well ahead of all other regions in the world and far faster than the Eurozone.

Ukraine: crisis and opportunity

The crisis in Ukraine looks set to continue. This will have an impact on trade and investment prospects in Ukraine, Russia and neighboring countries, including some Eurozone members. In terms of business strategy, those that have been looking to invest in Finland and the Baltics will be looking again at those plans. A sharp slowdown in the Russian economy is already under way, with growth likely to stagnate in 2014.

On the other hand, the crisis might accelerate moves to reduce dependency on Russian energy sources by diversifying supplies. This could involve some large projects that attract fresh investment into the region.



Viewpoint

Peter Fuß

Automotive spokesperson for the Eurozone, EY

+ 49 6196 996 27412

peter.fuss@de.ey.com

The biggest economic challenge for the Eurozone is to stay competitive. And this is the main priority for the automotive sector. But how can it be achieved?

Europe has adopted some strict regulations on reducing CO_2 emissions. Some in the industry think these regulations are too stringent; others are sure that they will benefit Europe's automotive companies. Those in the latter group believe that if you can produce the most innovative, low-carbon products for the European market, you will create something that will sell well outside Europe too. China is planning for a future of low- or zero-emission cars. By developing this technology, the automotive sector in Europe will be well placed to serve this potentially vast market.

Additional areas for advances in innovation include autonomous driving systems, mobility concepts, car-sharing and new parking systems. The sector will have to meet the needs of the mobility customer of the future. This means changing the business model from a product focused on hardware, to an offering of mobility services; for example, car-sharing or mobility apps to find the next free parking space in a city. This is the fundamental change that the industry has to go through in the next couple of years.

The automotive industry needs to co-operate better with companies from sectors such as information technology and telecoms. If they are open to new ideas, Europe's automotive producers will be able to serve the mobility customer of the future.

The proposed Transatlantic Trade and Investment Partnership between Europe and the US could have a very positive impact on the sector. There will be fewer customs charges and trade burdens, and access to a much larger market.

As growth in the global automotive markets comes increasingly from emerging markets — where improved infrastructure and living standards are supporting demand — more European car manufacturers and suppliers are considering localizing production in these emerging regions. This puts the production base in Europe under pressure.

Europe as a whole has to find a way to remain competitive from a production standpoint. For example, the industry needs more investment in production plants in order to make them more competitive. Having a competitive production base at home would help the sector to reduce dependency on volatile emerging markets.

A strengthened common market that includes aligned tax policies would benefit the industry. Furthermore, a stronger emphasis from the EU on creating an innovation-friendly environment, and enabling education and labor mobility, would help the industry to create better products that can win in today's increasingly competitive global market.

Looking beyond the low-growth narrative

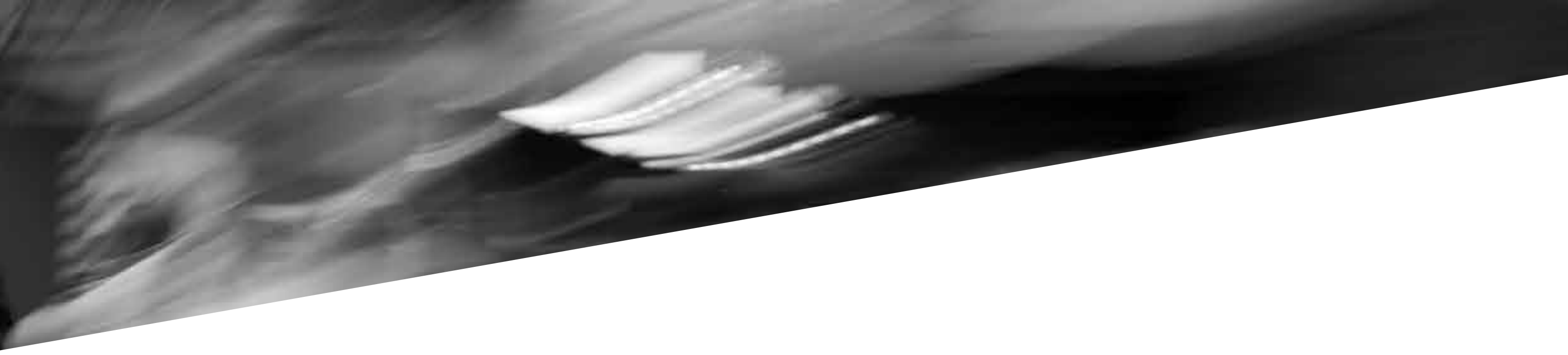
Reshoring: finding calmer waters?

As production costs increase in Asia, and unemployment remains high and labor costs fall in peripheral Eurozone nations, reshoring is becoming an attractive option for some businesses. With the competitiveness gap between Asia and the Eurozone periphery closing, companies can take advantage of reshoring benefits, such as increasing their speed to market. It takes too long for many consumer goods to be manufactured and then shipped from Asia to Europe. By hiring local producers, firms can have new product lines designed, manufactured and in stores in a couple of weeks, which is important when consumer tastes change so quickly.

Successful companies will need to think carefully about the reshoring options open to them, and the benefits that they can bring — but it won't be a practical option for every firm. Nevertheless, businesses across the Eurozone, and especially in the periphery, should consider reshoring.

Companies in the core Eurozone countries that currently have offshore operations in Asia could consider nearshoring to the Eurozone periphery. This could be a quick way to rebalance the value chain, gain effectiveness and reduce production costs. In Portugal and Spain, for example, the younger generation is highly qualified, with good language skills, and employment opportunities for them are scarce.

In the services sector, the nearshoring trend is most visible, as business services look for location opportunities in regions with wage stability and good infrastructure, particularly in telecommunications. Once again, the peripheral countries in southern and eastern Europe are promising locations for businesses, especially where there are high levels of unemployment among young, well-qualified workers with strong language skills.



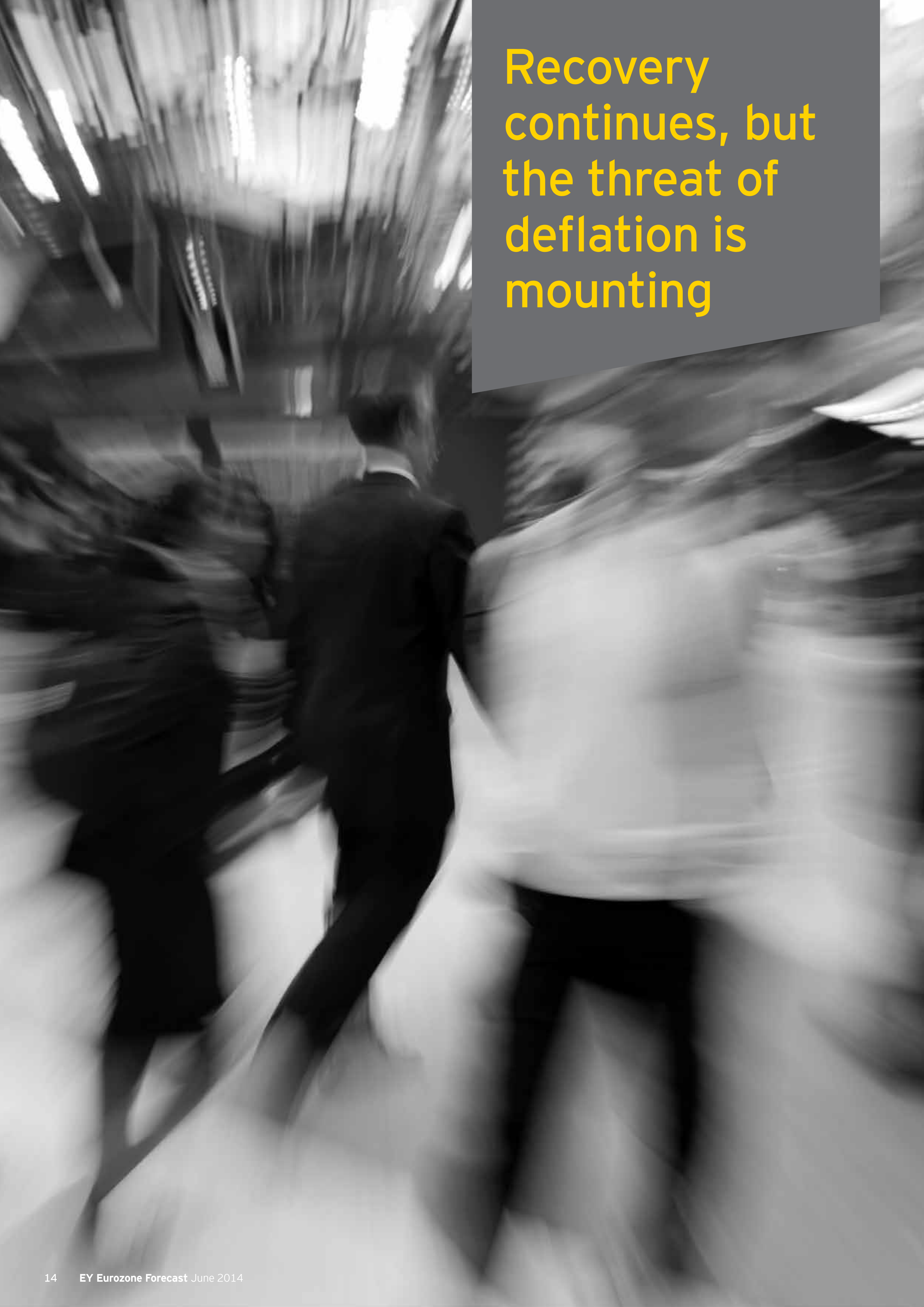
Key concerns for businesses

Today

- With the outlook mainly positive, have you considered renewing your strategy and operating model — moving your focus from survival to growth and generating returns?
- Are you scrutinizing your geographical portfolio and adjusting the balance of effort between cost reduction, inorganic expansion and organic growth?
- Have you reconsidered your inventory-purchase model in the current lowflation scenario?
- Are your contracts and agreements renegotiable when prices are lower?
- Are your products and services competitive in terms of quality or they are more dependent on price?
- Is your balance sheet highly leveraged?
- Have you identified the means to fulfil debt commitments or are you looking to restructure your high-cost debt?
- Are you prepared to utilize spare capacity optimally in order to meet the expected rise in export demand?
- Have you accounted for exchange rate fluctuations in your export contracts?
- Have you considered the spillover effect of slowdowns in emerging markets on your export volumes?
- Do you have a risk-management system in place to assess geopolitical risks — such as the Ukraine crisis — in the markets in which you operate?

Tomorrow

- Do your investment decisions consider the widening attractiveness gap or a competitiveness divide between European countries?
- As production costs continue to rise in emerging markets such as China (which is also seeing a significant appreciation of the yuan) are you evaluating the benefits and risks associated with reshoring operations?
- Are you reassessing your export markets and shifts in the supply chain as a result of upcoming trade routes and agreements, such as the Transatlantic Trade and Investment Partnership?
- Are you investing in training your workforce — particularly improving digital skills — in anticipation of the likely skills shortages eventually leading to a war for talent?



Recovery continues, but the threat of deflation is mounting

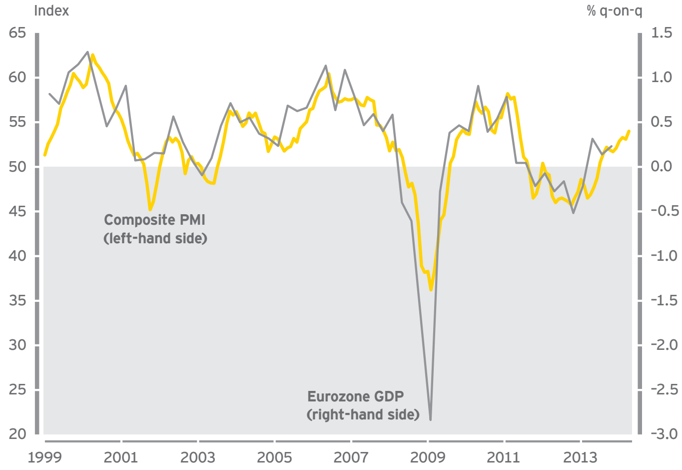
Economic recovery is gradually building momentum

Recent developments in the Eurozone suggest that the gradual economic recovery is continuing. We expect GDP to grow by 1.1% this year and 1.5% in 2015, far better than last year's fall of 0.4%. What is more, the divergence in economic performance between the core and the peripheral economies is likely to narrow. Nonetheless, growth will not be strong enough to erode the large amount of spare capacity in the economy, suggesting that inflation will remain below target for the foreseeable future. Against this backdrop, a period of deflation should not be ruled out, particularly if the euro continues to climb, or energy and commodity prices decline.

The 0.2% rise in Eurozone GDP in Q1 2014 was the fourth consecutive quarterly gain and lifted the annual growth rate to a solid 0.9%. And the closely watched survey-based indicators, such as the composite Purchasing Managers' Index (PMI) and the EC's Economic Sentiment Indicator remain at healthy levels. Indeed, the PMI — which has climbed to around a three-year high — pointed to a slight acceleration in quarterly GDP growth at the start of Q2.

Figure 1

Composite PMI and GDP



Source: Oxford Economics; Haver Analytics; Markit.

More generally, financial market conditions in the Eurozone have continued to improve. The region is still benefiting from capital inflows, which have probably been a key factor in the fall of Italian and Spanish 10-year government bond yields to around 3%. Encouragingly, bank lending rates in the periphery have begun to converge with those in the core economies, suggesting that financial fragmentation in the wider Eurozone economy is easing. Needless to say, these developments all bode well for future growth prospects in the region as a whole, and for the periphery in particular.

Table 1

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

	2013	2014	2015	2016	2017	2018
GDP	-0.4	1.1	1.5	1.5	1.6	1.7
Private consumption	-0.7	0.7	1.5	1.4	1.5	1.5
Fixed investment	-2.9	1.6	2.5	2.5	2.5	2.4
Stockbuilding (% of GDP)	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2
Government consumption	0.1	0.2	0.2	0.4	0.6	0.8
Exports of goods and services	1.4	3.5	3.8	4.1	4.0	3.7
Imports of goods and services	0.0	3.0	4.0	4.1	4.0	3.7
Consumer prices	1.3	0.7	1.2	1.6	1.6	1.5
Unemployment rate (level)	12.0	11.7	11.6	11.3	11.1	10.8
Current account balance (% of GDP)	2.4	2.7	2.4	2.3	2.3	2.3
Government budget (% of GDP)	-3.0	-2.6	-2.0	-1.7	-1.4	-1.1
Government debt (% of GDP)	95.1	97.2	98.2	98.5	98.2	97.5
ECB main refinancing rate (%)	0.5	0.2	0.1	0.1	0.4	1.4
Euro effective exchange rate (1995 = 100)*	120.8	125.3	123.7	122.4	121.7	120.9
Exchange rate (US$ per €)	1.33	1.37	1.34	1.32	1.31	1.29

*A rise in the effective exchange rate index corresponds to an appreciation of the euro.

Source: Oxford Economics.

Recovery continues, but the threat of deflation is mounting

The threat of deflation: a challenge for the ECB

Alongside the gradual recovery in Eurozone activity over recent months, a more worrying trend has been unfolding: inflation slowing across almost all member states to rates uncomfortably close to zero. At the Eurozone level, annual inflation fell from 1.6% in July 2013, to 0.5% in March 2014. And though April saw a rebound to 0.7%, this was largely due to the timing of Easter, which boosted travel and hotel costs a month later than last year, and the rate fell back to 0.5% in May.

Part of the slowdown over the past year has been down to lower energy costs, and another part to the steady appreciation of the euro. But measures of inflation that strip out commodity prices or that focus on the service sector have also plummeted. Looking ahead, with high unemployment set to persist for the rest of the decade, there are real concerns that inflation could turn to deflation, as firms start to bid down prices and wages in order to compete for orders. Business surveys indicate that companies are increasingly expecting such developments in the second half of 2014.

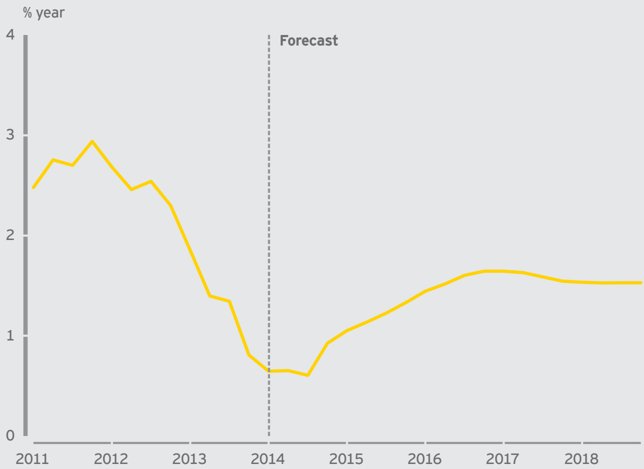
We expect two developments to sustain fairly tame rates of price growth in the coming year or two. First, the ECB's cut in the policy interest rate to just 0.15% in June and an increasing stream of positive economic news in the UK and US, should turn the euro's upward momentum toward modest depreciation. Second, as the world economy recovers, so will commodity prices. Combined with a modest improvement in business confidence and pricing power from 2015 onwards, these developments should boost inflation from 0.7% in 2014, to 1.2% in 2015 and 1.6% over the medium term.

Nevertheless, this remains well short of the ECB's target for inflation of "below, but close to, 2%". Even the ECB's own forecasts imply a very shallow path back toward 2% price growth. And with uncertain demand for lending among Eurozone firms, the risk of conflict in the east, and no guarantees over the pace of monetary tightening in the US, there remains a very real risk that prices will slow rather than pick up. A slip into deflation would have very serious consequences in the Eurozone, especially in the most highly indebted economies, where government and household liabilities are fixed, but tax revenues would decline in line with falling nominal GDP. A scenario in which prices fell modestly for three to four years would have a heavy impact on fiscal sustainability, and ultimately revive fears for the Eurozone's survival in its current form.

Worryingly, the ECB has been loath to acknowledge the risk of deflation, preferring instead to focus on household price expectations that (for now) remain close to 2%. And after hinting at the use of non-conventional measures earlier in 2014 — in particular the possibility of quantitative easing as seen in the US and UK — senior ECB policy-makers have since underlined that this would only happen if there were a substantial deflationary shock. There is a risk that, by waiting for indisputable evidence that disinflation has turned to deflation, the ECB either finds itself acting too late to prevent a deflationary period, or at least misses an opportunity to minimize its duration.

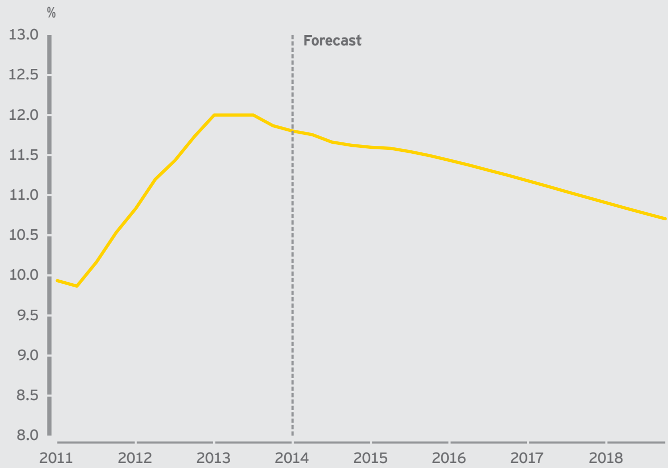
Part of the problem lies in the wording of the ECB's mandate, and the inherent preference for inflation to be below target in the medium term rather than above. During the crisis, the ECB has relied on the power of words to sway the behavior of markets, banks and firms. In this context, the ECB pressing its political masters to give it a symmetrical target (and therefore an ability to permit a period of above-target inflation) might have an impact, because it would lower the barriers to implementing more aggressive easing. But changing the ECB's mandate has not yet been raised as a serious option, because it would probably encounter stiff resistance among certain core member states.

Figure 2
Inflation



Source: Oxford Economics.

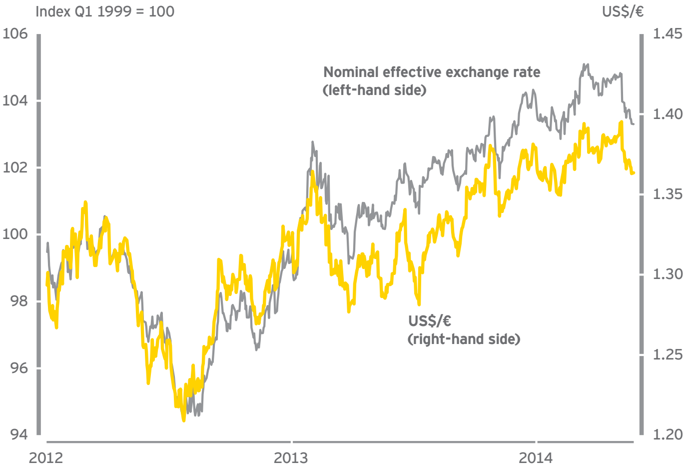
Figure 3
Unemployment rate



Source: Oxford Economics.

However, an undesirable side effect of all this is that the euro has continued to appreciate against the US dollar. The euro's effective exchange rate is now about 9% above its 2012 low. The ECB's concern about the euro's strength has grown and, at the bank's policy meeting press conference in May, President Mario Draghi provided a clear signal that the ECB Governing Council was likely to take further policy action soon. And in June, the ECB lowered its main policy rate to just 0.15%, with the deposit rate for banks reduced into negative territory to encourage more lending to businesses and consumers. But there still seems little sign of more aggressive action, such as quantitative easing. If this is the case, the euro may remain uncomfortably high. Based on these developments, we have raised our exchange rate forecast profile: we now only expect a fall in the euro of 4%, to about US$1.32 by the end of 2015.

Figure 4
Exchange rates

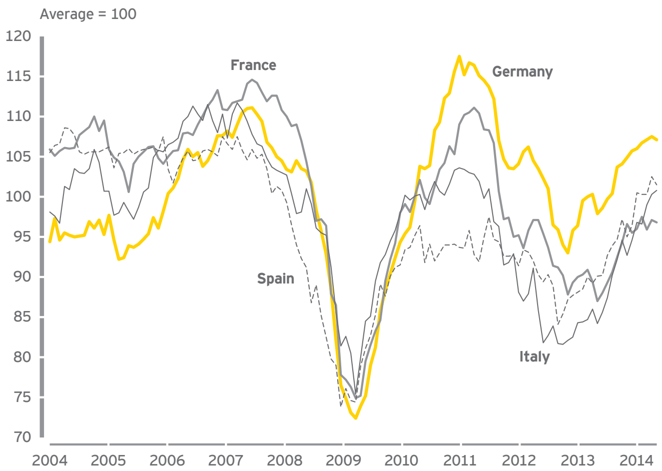


Source: Oxford Economics; Haver Analytics.

Prospects improving in both the core and the periphery

Encouragingly, the improving economic outlook appears to be fairly broad-based. Business and consumer confidence, as measured by the EC's Economic Sentiment Indicator, is substantially higher than a year ago in all four of the Eurozone's largest economies. The particularly large rises in the Spanish and Italian sentiment measures have resulted in a narrowing in the divergence between the indices for the main Eurozone economies.

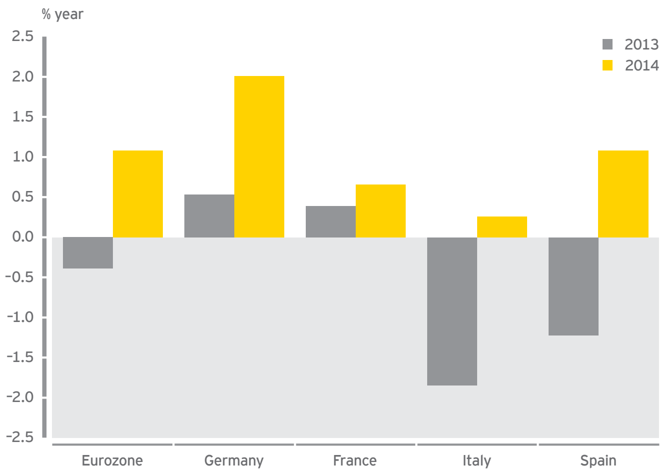
Figure 5
Economic sentiment indicator



Source: Oxford Economics; Haver Analytics.

Partly in response to this, we have made modest upward revisions to our 2014 GDP forecasts for most Eurozone countries. All of the region's largest economies look set to perform rather better than last year. We have also revised up our GDP growth forecast for the Eurozone as a whole to 1.1% for the year, up from the 1% forecast in our March report.

Figure 6
GDP growth



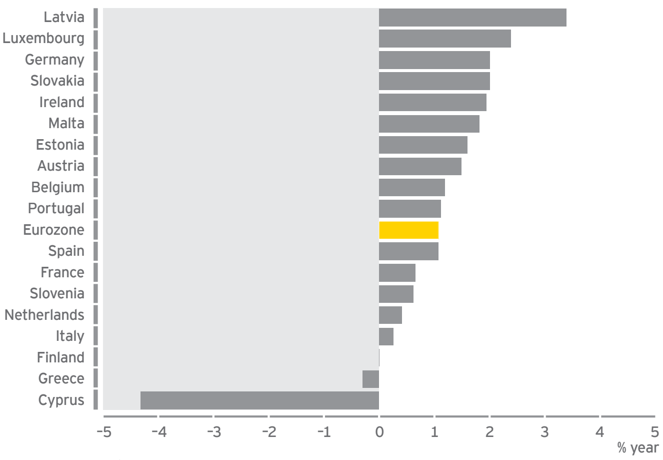
Source: Oxford Economics; Haver Analytics.

Recovery continues, but the threat of deflation is mounting

Economic divergence set to persist

Although the pattern of the past — which saw core economies outperforming their counterparts in the periphery — looks set to be less evident this year, we still expect divergence in economic performance across the Eurozone. Italy and Greece are likely to be among the weakest economies in the single currency, along with Cyprus and Finland, but we expect GDP growth in Spain and Portugal to pick up quite sharply this year, as the reforms implemented over the past few years begin to bear fruit. While GDP growth in the latter two economies will probably be close to the Eurozone average, both are likely to outperform some of the weaker core countries, such as France and the Netherlands, which are taking longer to address their fundamental economic problems.

Figure 7
GDP growth 2014



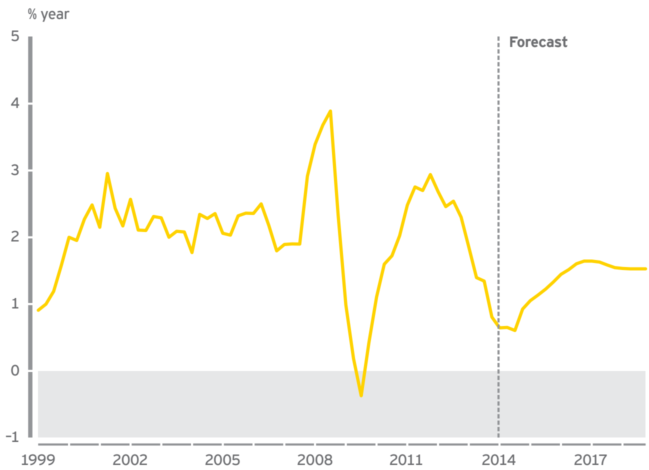
Source: Oxford Economics.

That said, there are still large divergences between core and periphery in terms of spare capacity. We estimate that Germany's economy is now running at close to full capacity. By contrast, we think that GDP in Italy and Spain is still around 6% below potential and the size of the Greek output gap is probably significantly larger.

Accordingly, while German inflation is likely to rise above the ECB's inflation target for the Eurozone of "below, but close to, 2%" in the latter part of 2015, inflation in the peripheral economies will remain far more subdued. We expect Eurozone inflation to pick up from around 0.7% this year to 1.2% in 2015 and 1.6% in 2016.

But while our central scenario is for the Eurozone to avoid deflation, this is contingent on the disinflationary forces from the exchange rate diminishing. However, if the euro continues to rise or energy and commodity prices are weaker than we anticipate, then the region as a whole — and the periphery in particular — could experience a period of deflation.

Figure 8
Inflation



Source: Oxford Economics.

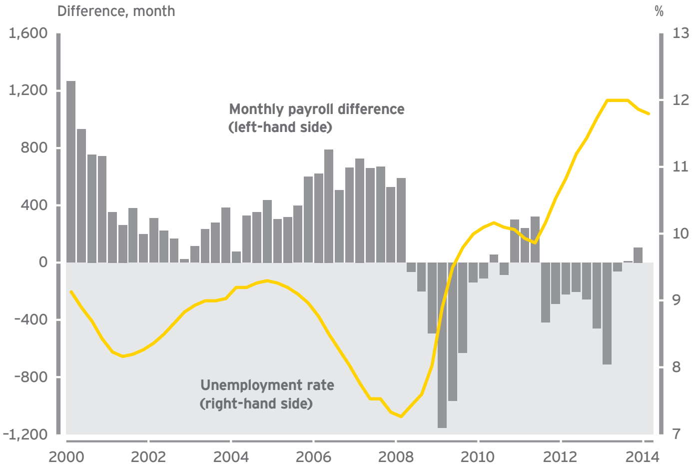
Households are getting more confident

The Eurozone upturn is also becoming broader-based in terms of expenditure. Household spending, which started to inch up last year, looks set to gain momentum over the coming quarters. The EC's measure of consumer sentiment is now at its highest level since late 2007, and the ECB's latest bank lending survey suggests that demand for loans from households is growing.

In addition, there are tentative signs that the labor market has now reached a turning point. Although at just below 12% the unemployment rate remains close to its record high, employment is beginning to rise. Coupled with a reduction in the pace of fiscal tightening in 2014, this suggests that households' nominal disposable incomes will rise at a faster pace than last year. With consumer price inflation set to average just 0.7% this year, compared with 1.3% in 2013, the pickup in disposable income growth in real terms will be sharper still.

Figure 9

Labor market



Source: Oxford Economics.

Having said that, a period of strong household spending growth seems unlikely for the region as a whole. The high level of unemployment should ensure that wage growth remains subdued by historical standards. Accordingly, real disposable income growth is likely to remain below the rates recorded prior to the global financial crisis. In parts of the Eurozone, such as Spain and the Netherlands, household debt is high, suggesting that consumers there are set for a further period of deleveraging. On balance, we expect household spending to rise by just 0.7% this year and a solid but unspectacular 1.5% in 2015.

It should be noted that, while weak or negative inflation may be a positive development for consumers in the near term, a sustained period of deflation would dampen spending in the medium term, as a prolonged decline in prices would probably be accompanied by a fall in wages. This would raise the real value of households' outstanding debts, potentially prompting them to try to pay down their debts even more quickly. And if asset and property prices fell too, this would leave the health of household balance sheets to deteriorate further. Falling prices might also result in delays in purchases of non-essential items.

Investment likely to expand, but only slowly

Investment spending has begun to increase, but it remains around 20% below its peak in the Eurozone as a whole. Improving business sentiment, the prospect of accommodative monetary policy for the foreseeable future, and the pickup in capital inflows suggest that investment will continue to rise. *EY's attractiveness survey: Europe 2014* highlights divergent national trends in this respect, with countries that have done most to reform and improve competitiveness, such as Spain and Ireland, becoming increasingly attractive to overseas investors. By contrast, less reform-minded economies, such as Italy and France, remain well below pre-crisis levels of foreign investment.

Sector outlook

On a sector-by-sector basis, manufacturing should fare well in response to stronger domestic investment spending, a pickup in global growth and, eventually, a weaker euro. We expect the manufacturing sector to expand by 1.9% this year and 2.6% in 2015.

Construction output is likely to grow this year, thanks to stronger residential investment in some parts of the region, such as Germany.

Less austerity could also boost public sector infrastructure investment. We expect annual rises of around 2% both this year and next, far better than last year's fall of 3.8%.

Trade should gradually benefit as the recovery in consumer spending gains momentum. We expect a 0.7% gain this year, followed by a 1.5% rise in 2015 and a steady acceleration thereafter.

Table 2

Forecast for the Eurozone by sector (annual percentage changes in gross added value)

	2013	2014	2015	2016	2017	2018
Manufacturing	-0.7	1.9	2.6	2.1	1.8	1.7
Agriculture	-0.3	0.6	1.1	1.2	1.3	1.2
Construction	-3.8	1.8	2.0	1.7	1.5	1.4
Utilities	-1.1	1.2	2.0	1.7	1.8	1.8
Trade	-0.4	0.7	1.5	1.5	1.7	1.8
Financial and business services	0.5	1.2	1.6	1.6	1.8	1.8
Communications	-0.7	2.2	2.7	2.7	2.9	2.9
Non-market services	0.0	-0.3	0.2	0.5	0.7	0.9

Source: Oxford Economics.

Recovery continues, but the threat of deflation is mounting

The picture is very different for Germany and Belgium. Both countries have confirmed their reputations as relative safe havens for overseas investment, maintaining investors' confidence in the midst of the crisis. However, with Eurozone banks still reducing the size of their balance sheets before the asset quality review and bank stress tests later this year, domestic financing conditions for investment will probably remain tight. Accordingly, investment spending by the region's smaller firms, which tend to rely heavily on banks for external financing, is unlikely to expand particularly sharply.

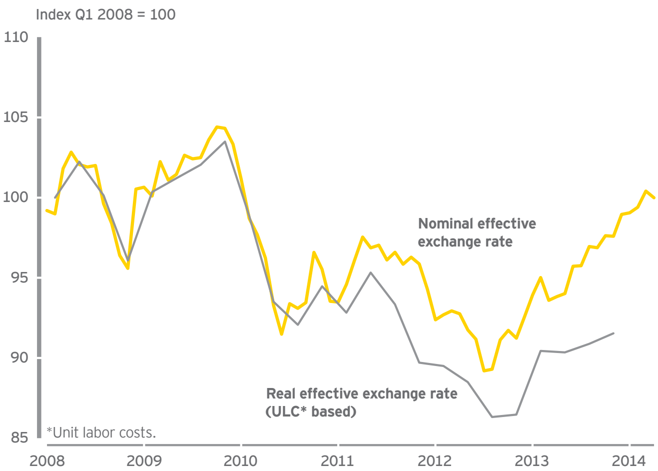
Exporters to withstand the euro's strength

In 2013, Eurozone export volumes grew by just 1.4%, the weakest annual gain since the global financial crisis. Although the further strengthening of the euro since the beginning of 2014 suggests that exporters may be set for another tough year, we forecast that export growth will accelerate to 3.5% and then to 3.8% in 2015, as global demand continues to pick up.

When assessing the Eurozone's competitiveness, it is the real exchange rate rather than the nominal measure that matters most. While the nominal exchange rate has appreciated by almost 10% from its low in the middle of 2012, the real exchange rate (based on relative changes in unit labor costs) has risen more gradually. Indeed, in 2013, the real exchange rate rose only very slightly (data for 2014 is not yet available). In other words, the negative effects of the rise in the euro have been partially offset by a fall in Eurozone firms' relative labor costs.

Figure 10

Nominal and real exchange rate



Source: Oxford Economics; Haver Analytics.

Even if the region's share of the export market falls, member states' export growth rates may still pick up if demand growth from within the Eurozone and the region's main export markets accelerates in line with our forecasts. Timely indicators of the region's recent export performance have been reasonably encouraging. Healthy monthly rises in the value of Eurozone goods exports in both January and February suggest that exports probably rose faster in Q1 2014 than in the previous two quarters.

Risks to our GDP forecast lie to the downside

The chances of a major re-intensification of the Eurozone crisis have continued to diminish, but the risks to our forecasts lie firmly to the downside. The most obvious near-term risk is that tensions in Ukraine build, perhaps triggering a military conflict. This could lead to higher energy prices — or even power shortages if Eurozone energy supplies from Russia were disrupted. It could also damage business and consumer sentiment and prompt a reversal of the capital inflows into the periphery. In such a scenario, it seems likely that the Eurozone's fragile recovery would peter out — at least temporarily.

Another significant risk is that parts of the Eurozone — or even the entire region — suffer from a sustained period of cost and wage deflation. The ECB appears to be increasingly concerned about the threat of deflation, but some of its Governing Council members' aversion to unconventional measures, such as quantitative easing, suggests that it will remain unwilling to take more decisive action.

A short period of deflation might not have major repercussions for the real economy. But a sustained period of falling prices and costs could lead to renewed worries about the solvency of some of the region's most indebted governments. It would also lead to a rise in banks' bad loans. In turn, this could reignite concerns about the underlying health of the Eurozone's banking system. In such an environment, pressures on the stronger Eurozone states to provide financial assistance to the weaker economies' governments and banks would be likely to grow.

Some causes for optimism

On a more positive note, the recovery could be stronger if global growth exceeds expectations, resulting in stronger export growth. Meanwhile, if the ECB were to unveil a bold quantitative easing program to try to push down the euro and longer-term interest rates, both domestic demand and exports could surprise on the upside. It is also possible that we have underestimated the potential economic boost from the reduction in the fiscal squeeze. Some governments might also take advantage of the drop in bond yields to scale back planned discretionary fiscal measures. Finally, in parts of the periphery, we may have underestimated the positive effects of past structural reforms on economic growth.

Forecast assumptions: international environment and commodity prices

Our forecast for the Eurozone depends on a number of assumptions about the international environment, world GDP, and trade and commodity prices.

The global recovery continued during the first half of the year, despite escalating tensions in the former Soviet Union, weather disruptions in North America, and an easing pace of growth in China. We estimate that world GDP growth in the year to Q1 2014 picked up to just below 3%, and the global economy should continue to accelerate gently through the remainder of this year and next: global GDP growth is forecast at 3.2%–3.3% a year over the medium term.

A disappointing Q1 in the US seems largely due to severe weather conditions preventing firms and households from spending. Meanwhile, US exports fell sharply despite the sustained global recovery. We have cut our forecast for US GDP growth in 2014 to 2.4% from just over 3% previously, although the fundamentals remain broadly unchanged. Consumer spending growth should pick up to 3% in 2014, aided by the ongoing improvement in the labor market, and exports should grow at a similar rate.

We expect the Federal Reserve to continue asset purchases throughout 2014, with the first hike in interest rates not likely until mid-2015. And when it does start tightening it will be at a measured pace, given the spare capacity remaining within firms. Gradual increases in interest payments for households and firms, along with renewed (though restrained) government spending, and export growth of 5% from 2015 onwards, should mean US growth picks up to about 3% a year.

The UK economy has also gathered pace. A return to real income growth looks set to put consumers on a firmer footing, while the recovery appears to be gaining greater balance, with companies raising investment plans and export growth starting to strengthen. We expect GDP growth of 3% in 2014 and 2.5% a year in the UK over the medium term.

However, other advanced economies are faring less well. Japan's bullish Q1 was flattered by consumer spending being brought forward ahead of April's value-added tax (VAT) increase. More recent indicators suggest a contraction in Q2 and weak prospects for the rest of the year. More monetary stimulus may be needed to keep inflation positive and growth above 1% in the medium term.

A slower growth rate in China in Q1 reflects the gradual process of rebalancing that is under way: export and capital spending growth eased, but consumer spending growth picked up to 9%. China's growth is now forecast at just over 7% in 2014 — a level only just deemed tolerable by the Government. As a result, the Chinese Government has announced a set of tax and spending measures — but the overall impact is unlikely to lift growth much above 7% in the medium term.

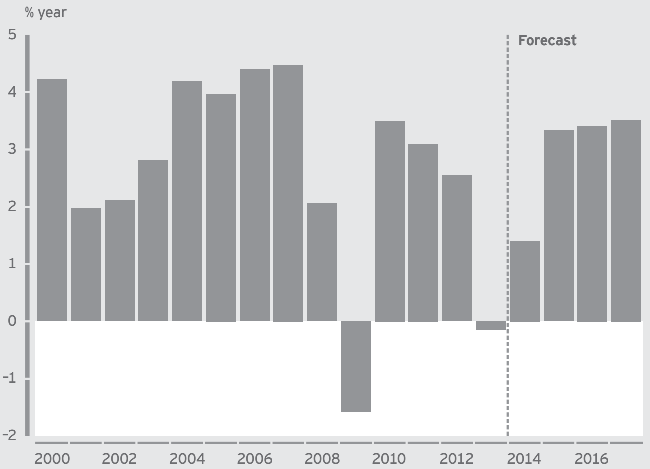
Meanwhile, in other emerging markets, expansion in Brazil looks moderately weaker than in our previous forecast, due to lower export growth. GDP growth of 1.4% this year and 1.9% in 2015 remains anemic by recent standards. Growth in Mexico is seen at 3.5%–4% a year, benefiting from a boost to confidence from a substantial public investment program, as well as the ongoing recovery in the US.

We have lowered our forecast for Russia sharply as a result of the crisis in Ukraine; Russian GDP is now set to stagnate in 2014 and grow by just over 1% in 2015. Although the impact of this is modest at the global level, varying degrees of reliance on Russian markets will mean the impact is felt more keenly in certain Eurozone economies.

Therefore, with the global recovery broadly on track, we have made only modest changes to our assessment of commodity prices. We expect the price of Brent oil to fall by about 4% to US$104 a barrel in 2014, with a further 2% decline in 2015, before a modest rise over the medium term to an average of US$112 a barrel in 2018.

Figure 11

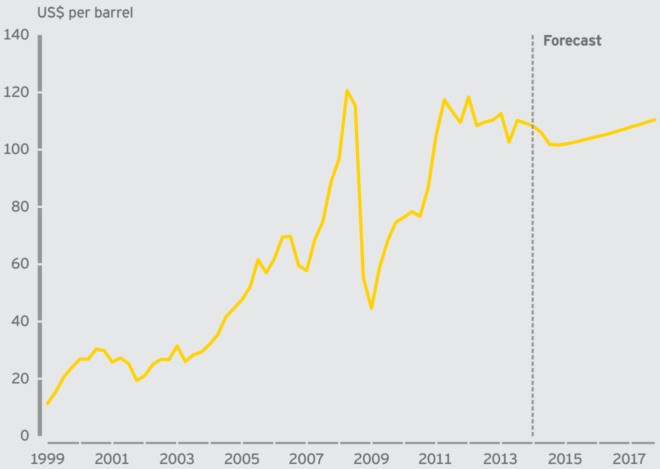
World: GDP growth



Source: Oxford Economics.

Figure 12

Oil price, nominal



Source: Oxford Economics.

Forecast for Eurozone countries

Austria
Belgium
Cyprus
Estonia
Finland
France
Germany
Greece
Ireland
Italy
Latvia
Luxembourg
Malta
Netherlands
Portugal
Slovakia
Slovenia
Spain

18 Eurozone countries

Please visit our Eurozone website for access to additional information on the *EY Eurozone Forecast*, the 18 individual country forecasts and additional perspectives and interview content. The site contains the latest version of our reports as well as an archive of previous releases.

Download our *EY Forecasts in focus* app, which allows you to create graphs and tables for the geographies most relevant to you. The app also makes it easy to share content and learn more about EY's other forecasts.

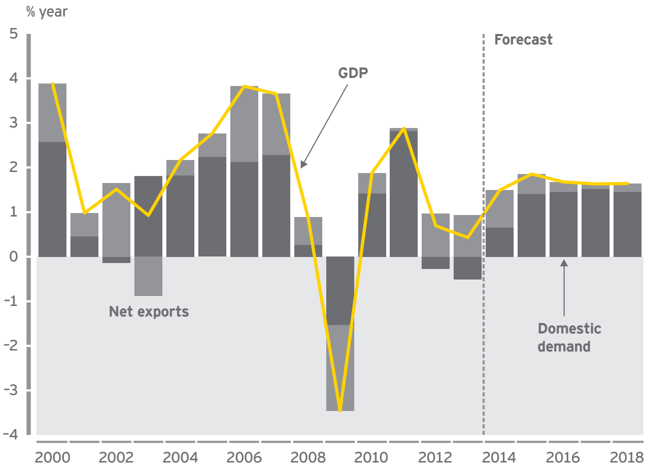
To find out more please visit **ey.com/eurozone.**

Austria

- The Austrian economy remains on track to achieve growth of 1.5% this year, despite recent data suggesting growth in Q2 2014 may not have accelerated much above the 0.3% quarterly rise in Q1.
- The economy is still largely being driven by external trade. As the domestic recovery gets stronger, expansion should pick up to 1.9% in 2015.
- Domestic conditions remain more favorable than in most other Eurozone countries. Conditions are particularly favorable for investment, with low interest rates, relatively good access to credit, and strong cash reserves held by non-financial corporates.
- Easing uncertainty, a gradually improving outlook, and increasing capacity utilization should soon trigger some previously shelved investment projects and help to underpin growth.
- While Austria is set to enjoy the Eurozone's lowest unemployment rate, the slowing labor market will limit the scope for stronger earnings growth this year. However, thanks to low inflation, real incomes will still rise moderately, supporting a return to growth of consumer spending.

Figure 13

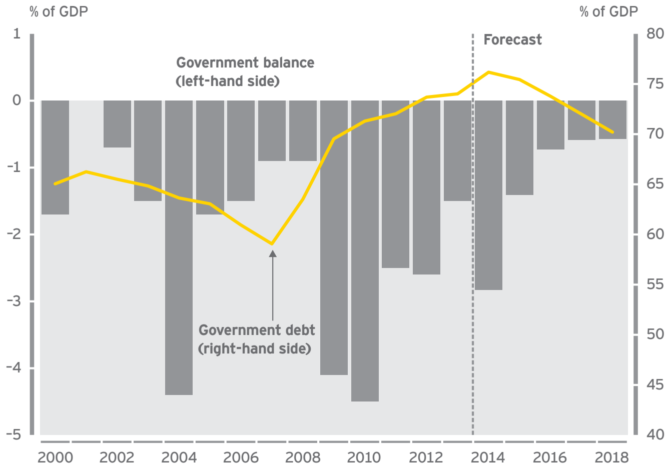
Contributions to GDP



Source: Oxford Economics.

Figure 14

Government balance and debt



Source: Oxford Economics.

Austria (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	0.4	1.5	1.9	1.7	1.6	1.6
Private consumption	0.0	0.7	1.1	1.3	1.4	1.4
Fixed investment	-0.5	2.0	3.2	2.5	1.8	1.6
Stockbuilding (% of GDP)	0.4	0.0	-0.1	-0.1	0.0	0.1
Government consumption	0.3	1.4	1.6	1.6	1.6	1.6
Exports of goods and services	2.4	4.6	5.6	4.7	4.2	4.2
Imports of goods and services	0.9	3.6	5.6	5.1	4.7	4.5
Consumer prices	2.1	1.6	1.8	1.8	1.8	1.8
Unemployment rate (level)	4.9	4.9	4.7	4.6	4.5	4.5
Current account balance (% of GDP)	2.7	3.4	3.4	3.3	3.2	3.2
Government budget (% of GDP)	-1.5	-2.8	-1.4	-0.7	-0.6	-0.6
Government debt (% of GDP)	74.5	77.3	75.9	74.0	72.2	70.4

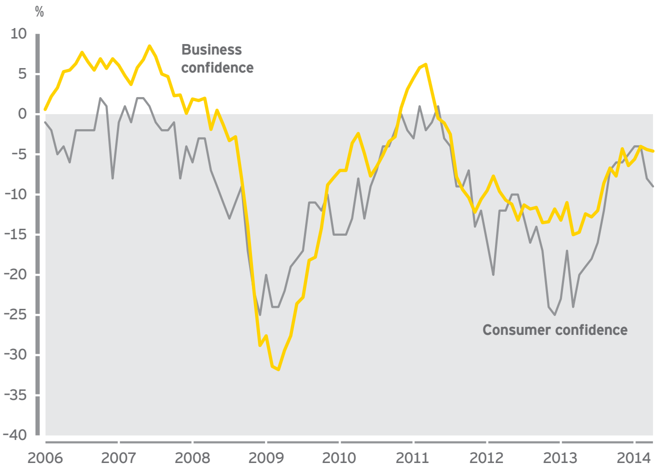
Source: Oxford Economics.

Belgium

- Belgium's gradual recovery has continued. Quarterly GDP growth in Q1 was surprisingly strong, up 0.4%. However, further modest increases in the unemployment rate and the weakening of survey indicators among firms and households in Q2 suggest this pace of growth might not be sustained for the remainder of the year. We expect an easing in the rate of growth, yielding 1.2% for 2014 as a whole.
- However, a number of factors will constrain the recovery in the near to medium term. In particular, we are concerned about deteriorating competitiveness, which means Belgian firms are unlikely to enjoy the same pace of growth as elsewhere. There is also still work to be done to ensure sustainable public finances for the long run.
- We expect GDP growth of 1.3% in 2015 and about 1.7% a year in 2016–18 – some way short of pre-crisis rates.
- In order to boost prospects, the Government should focus on a program of economic reform that reduces the cost of employment for businesses and boosts household spending power.

Figure 15

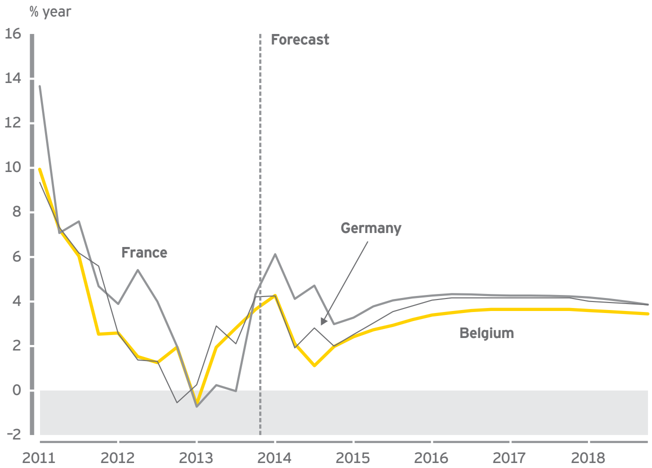
Consumer and business confidence



Source: Oxford Economics; Haver Analytics.

Figure 16

Export growth vs. Germany and France



Source: Oxford Economics; Haver Analytics.

Belgium (annual percentage changes unless specified)	2013	2014	2015	2016	2017	2018
GDP	0.2	1.2	1.3	1.6	1.7	1.8
Private consumption	0.8	1.2	1.2	1.2	1.3	1.4
Fixed investment	-1.4	1.6	2.3	2.7	2.9	3.0
Stockbuilding (% of GDP)	0.3	0.0	-0.1	-0.1	0.0	0.0
Government consumption	0.6	0.4	1.0	1.0	1.1	1.2
Exports of goods and services	1.9	2.3	2.8	3.5	3.6	3.5
Imports of goods and services	1.4	1.9	2.7	3.4	3.6	3.4
Consumer prices	1.2	0.9	1.3	2.0	2.0	2.0
Unemployment rate (level)	8.4	8.6	8.5	8.1	7.7	7.6
Current account balance (% of GDP)	-1.6	-0.2	-0.1	0.0	0.1	0.4
Government budget (% of GDP)	-2.6	-2.7	-2.3	-1.9	-1.7	-1.5
Government debt (% of GDP)	101.5	104.5	106.7	108.1	108.9	109.2

Source: Oxford Economics.

Cyprus

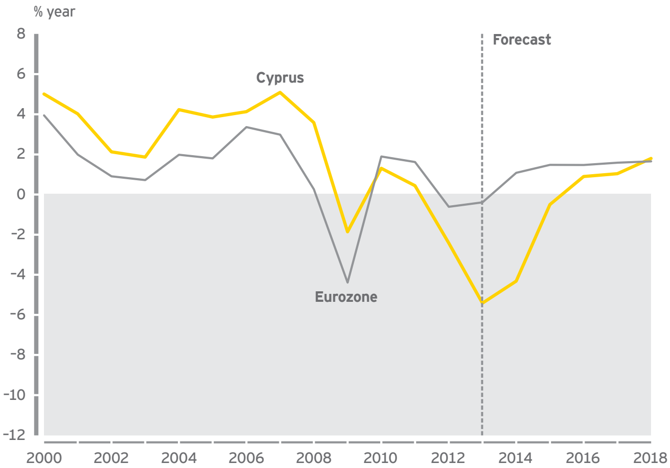
GDP growth

2014 **−4.3%**

- Although the near-term outlook remains grim, Cyprus' economy has been surprisingly resilient to the near-meltdown of its financial sector and an aggressive austerity program.
- We still expect GDP to contract by 4.3% this year, with growth only resuming in 2016. And the recovery is likely to be very modest, given the considerable debt burden facing the private sector and the hangover from a severe credit crunch.
- Solid progress has also been made on cleaning up the financial sector. Deposits have stabilized and the improving economic outlook encouraged the Government to further ease capital controls. But major challenges remain, with the private sector still highly leveraged and non-performing loans still weighing on banks' balance sheets.
- Overall, the outlook remains uncertain and the risks are high. Headline consumer prices have been falling on an annual basis since October 2013, underscoring the threat of a period of sustained deflation that would jeopardize the economic recovery.
- Although our baseline forecast is that Cyprus will avoid falling into such a deflationary spiral, growth would be adversely affected, particularly given the high levels of debt in the public and private sectors.

Figure 17

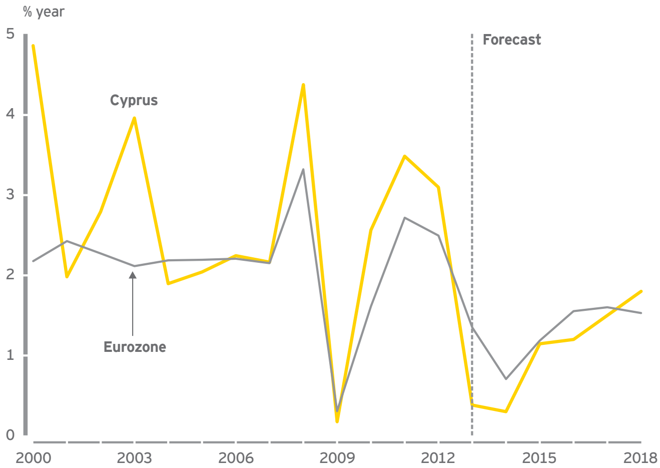
Real GDP growth



Source: Oxford Economics.

Figure 18

Inflation



Source: Oxford Economics.

Cyprus (annual percentage changes unless specified)

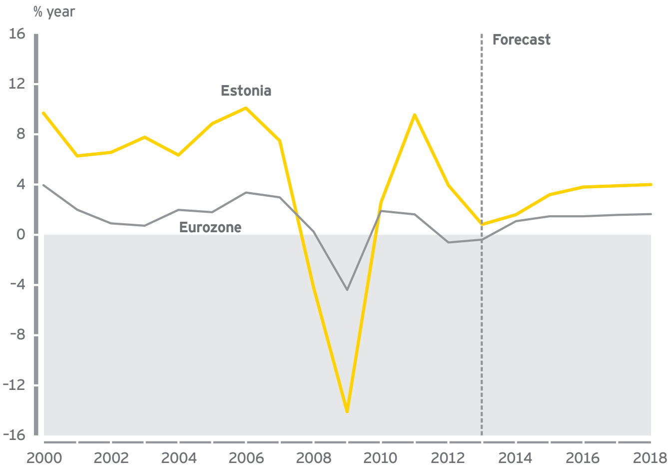
	2013	2014	2015	2016	2017	2018
GDP	-5.4	-4.3	-0.5	0.9	1.0	1.8
Private consumption	-5.2	-4.8	-2.0	0.2	0.9	1.6
Fixed investment	-20.0	-8.0	-3.2	1.5	6.3	9.9
Stockbuilding (% of GDP)	-2.8	-4.5	-2.2	0.8	1.9	2.0
Government consumption	-1.0	-3.6	-2.9	-2.9	-2.2	1.0
Exports of goods and services	-4.6	-1.5	2.9	3.1	4.5	5.1
Imports of goods and services	-15.0	-6.7	4.5	7.3	6.9	6.7
Consumer prices	0.4	0.3	1.1	1.2	1.5	1.8
Unemployment rate (level)	15.9	19.3	19.4	18.9	16.9	14.5
Current account balance (% of GDP)	-0.8	-0.3	-0.3	-0.3	-0.3	-0.4
Government budget (% of GDP)	-5.4	-5.6	-5.8	-4.6	-2.7	-1.6
Government debt (% of GDP)	111.7	122.0	127.1	129.0	128.5	125.6

Source: Oxford Economics.

Estonia

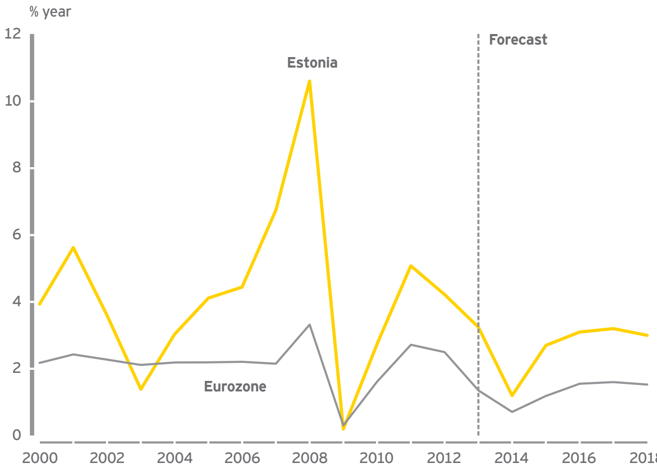
- Estonia's GDP growth was a sluggish 0.8% in 2013. But despite a fall in output in Q1 2014, we expect the pace to accelerate to 1.6% this year and over 3% in 2015. This pickup will be driven initially by stronger demand in Europe lifting exports, leading to rising investment.
- The crisis in Ukraine remains a downside risk this year, with a weakening Russian economy hitting Estonia's exports and dampening investment inflows. And if the Eurozone grows more slowly than currently expected, growth prospects would be further dampened.
- However, exports should receive a boost from the performances of Estonia's two main export markets: Swedish growth is seen moving above 2% and Finland is starting to move out of recession. And recent regional tensions should accelerate the efforts that are already under way to promote Baltic energy independence and trade diversification, with Lithuania's Eurozone accession now confirmed for January 2015.
- Medium-term prospects remain relatively bright, given the low levels of public debt and the sound banking system. And with recovery in Europe continuing, GDP growth is forecast to accelerate to close to 4% a year in 2016–18, well above the Eurozone average.

Figure 19
Real GDP growth



Source: Oxford Economics.

Figure 20
Inflation



Source: Oxford Economics.

Estonia (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	0.8	1.6	3.2	3.8	3.9	4.0
Private consumption	4.2	3.4	3.7	3.9	4.1	4.1
Fixed investment	1.1	3.0	3.8	4.2	5.3	4.9
Stockbuilding (% of GDP)	2.0	1.2	0.7	0.9	1.1	1.4
Government consumption	1.3	1.7	2.7	3.0	3.0	2.7
Exports of goods and services	1.8	3.5	7.0	8.5	8.2	7.5
Imports of goods and services	2.6	4.0	6.8	8.6	8.6	7.8
Consumer prices	3.2	1.2	2.7	3.1	3.2	3.0
Unemployment rate (level)	8.6	8.4	8.1	7.8	7.8	7.8
Current account balance (% of GDP)	-1.0	-1.6	-0.9	-0.5	-0.3	-0.1
Government budget (% of GDP)	-0.2	-0.5	-0.2	0.1	0.4	0.6
Government debt (% of GDP)	10.0	10.3	9.9	9.2	8.2	7.1

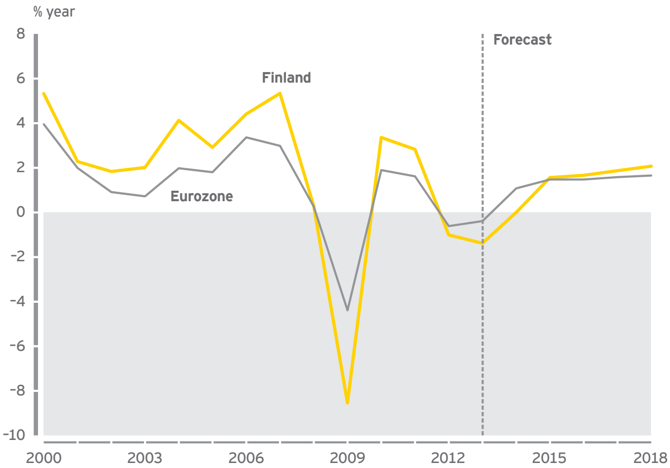
Source: Oxford Economics.

Finland

- Finland's economy disappointed toward the end of 2013, and the environment has not improved at the start of this year. GDP fell by 0.4% in Q1 and is expected to stagnate in 2014. Finland now has one of the lowest growth forecasts of the core Eurozone nations, as it struggles in the face of significant headwinds, both at home and abroad.
- Prospects for a consumer-led recovery are limited. Modest wage growth and an increasing tax burden will limit growth in household incomes, and demand for credit has already weakened quite significantly. Consumer spending will remain flat this year, while ongoing austerity will also ensure limited growth in government consumption.
- Exports are forecast to grow by just 0.4% in 2014, as the Ukraine crisis weighs on external demand from Russia. And manufacturers will continue to lose global market shares until the economy can restore cost competitiveness and fill the void left by the decline of key export sectors.

Figure 21

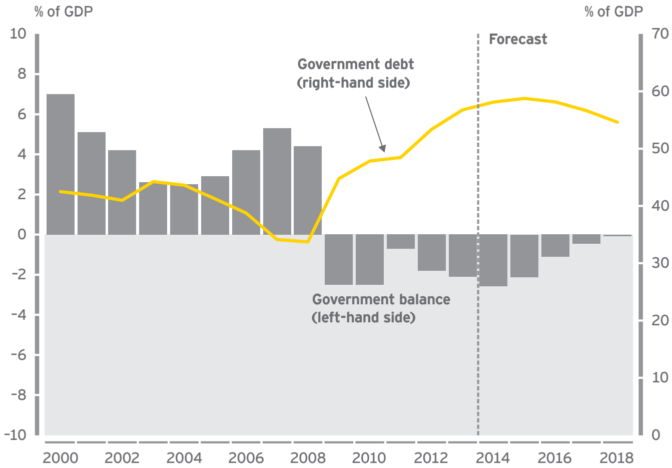
GDP growth



Source: Oxford Economics.

Figure 22

Government balance and debt



Source: Oxford Economics.

Finland (annual percentage changes unless specified)

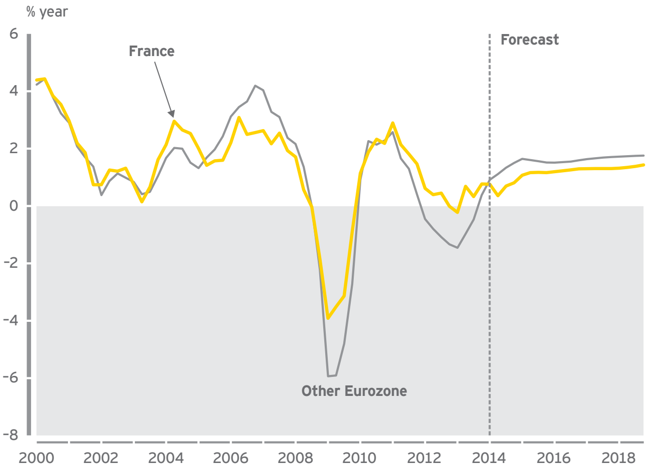
	2013	2014	2015	2016	2017	2018
GDP	-1.4	0.0	1.6	1.7	1.9	2.1
Private consumption	-0.8	0.0	1.6	1.6	1.8	1.8
Fixed investment	-4.6	-1.6	3.7	2.3	2.3	2.3
Stockbuilding (% of GDP)	0.0	0.3	-0.3	-0.4	-0.5	-0.5
Government consumption	0.8	0.5	1.1	1.2	1.3	1.4
Exports of goods and services	0.3	0.4	2.5	2.7	2.8	2.9
Imports of goods and services	-1.8	0.7	2.1	2.4	2.5	2.6
Consumer prices	2.2	1.2	1.6	2.0	2.0	2.0
Unemployment rate (level)	8.2	8.4	8.0	7.6	7.4	7.2
Current account balance (% of GDP)	-1.1	-0.7	-0.3	-0.1	0.0	0.1
Government budget (% of GDP)	-2.1	-2.6	-2.1	-1.1	-0.5	-0.1
Government debt (% of GDP)	57.0	59.2	59.5	58.5	56.8	54.6

Source: Oxford Economics.

France

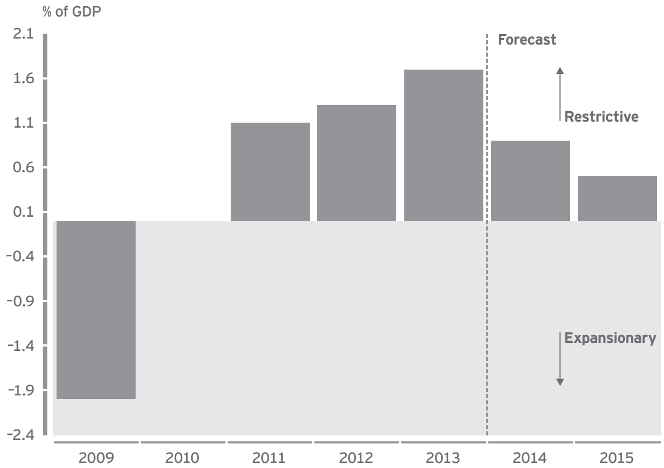
- France's recovery lost momentum in Q1 2014, with surveys suggesting the slowdown was felt across manufacturing and services. But the gradual upturn in European trade, and the US recovery, mean French exporters should enjoy strengthening demand this year. In turn, this should trigger a modest improvement in investment.
- However, unemployment will stay close to 10% and household budgets will remain tight. We expect consumer spending to grow just 0.4% in 2014 and GDP by 0.7%. Buoyed by improving export demand and falling spare capacity, we expect investment spending and hiring to pick up in 2015. But France will continue to lose its share in key export markets to Eurozone states that have done more to improve competitiveness.
- More ambitious reforms would enable firms to create jobs more quickly, compete more successfully for export orders, mobilize investment and boost long-term growth. In turn, this might facilitate a modest easing in the pace of fiscal consolidation, which we expect to drag on growth by 0.5 percentage points this year and 0.4 percentage points in 2015. This will constrain GDP growth to 1.3% a year in 2015-18.

Figure 23
GDP growth: France vs. rest of Eurozone



Source: Oxford Economics.

Figure 24
Fiscal tightening



Source: Oxford Economics.

France (annual percentage changes unless specified)

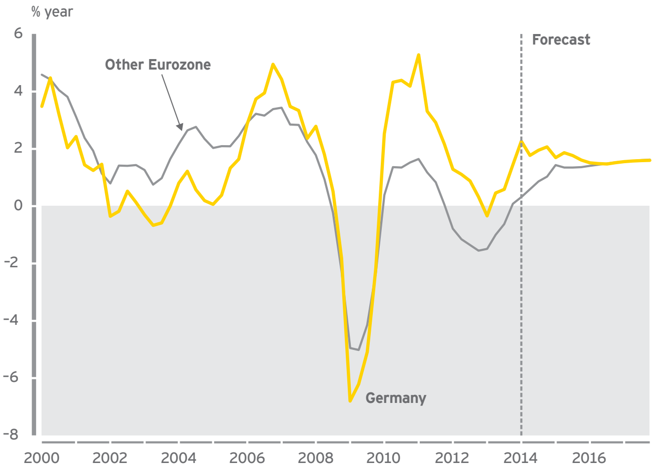
	2013	2014	2015	2016	2017	2018
GDP	0.4	0.7	1.1	1.2	1.3	1.4
Private consumption	0.3	0.4	1.5	1.6	1.5	1.4
Fixed investment	-0.8	-0.5	1.9	2.3	2.1	1.8
Stockbuilding (% of GDP)	0.1	0.5	0.3	-0.1	-0.3	-0.4
Government consumption	2.0	1.5	0.4	0.4	0.5	0.6
Exports of goods and services	2.4	2.7	3.2	4.1	4.2	3.9
Imports of goods and services	1.9	3.0	3.0	3.6	3.6	3.4
Consumer prices	1.0	0.9	1.1	1.5	1.6	1.7
Unemployment rate (level)	10.3	10.3	10.1	9.9	9.8	9.7
Current account balance (% of GDP)	-1.3	-1.2	-1.5	-1.5	-1.4	-1.4
Government budget (% of GDP)	-4.3	-3.6	-3.1	-2.5	-2.0	-1.7
Government debt (% of GDP)	91.0	95.0	98.5	100.5	101.2	100.9

Source: Oxford Economics.

Germany

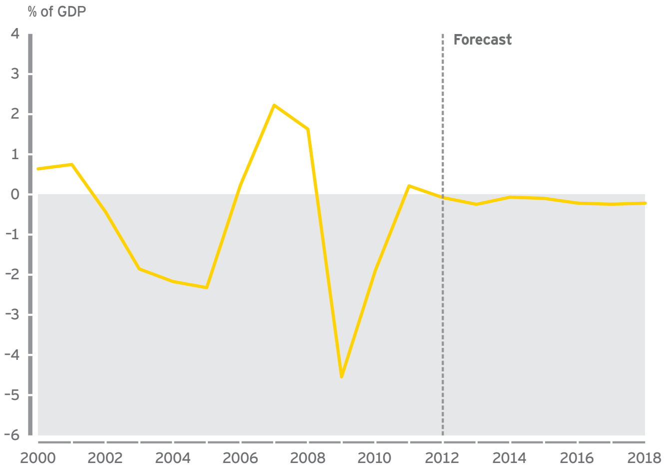
- Germany will remain one of the Eurozone's strongest performers over the next couple of years. However, GDP growth of 2% in 2014, and then about 1.6% a year in 2015–18, will not be as strong as expansion in the US or the UK.
- We expect the recovery to broaden over the next year or two and be less reliant on exports, Germany's traditional engine of growth. There are signs that strengthening income growth is prompting households to spend a bit more freely.
- Meanwhile, with GDP now close to potential and monetary policy set to remain accommodative for the foreseeable future, investment growth is likely to strengthen too.
- Although inflation is currently well below the ECB's price stability ceiling, the risk of a period of deflation in Germany is fairly low. We expect consumer price inflation to rise gently to just over 2% by the end of 2015.

Figure 25
GDP growth: Germany vs. rest of Eurozone



Source: Oxford Economics.

Figure 26
Output gap



Source: Oxford Economics.

Germany (annual percentage changes unless specified)

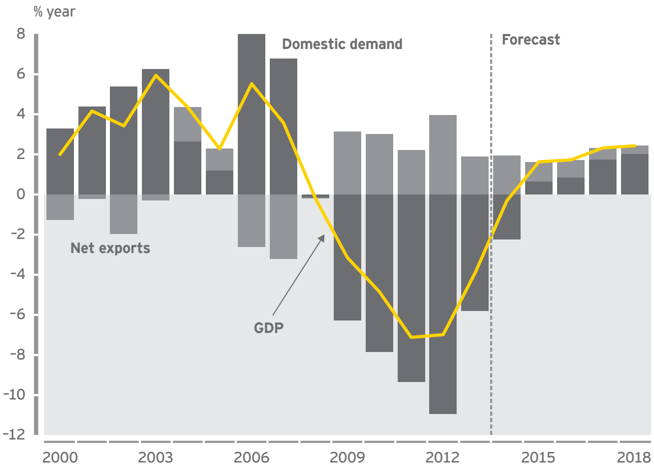
	2013	2014	2015	2016	2017	2018
GDP	0.5	2.0	1.7	1.5	1.6	1.6
Private consumption	1.0	1.5	2.0	1.5	1.4	1.3
Fixed investment	-0.5	4.0	3.4	2.9	2.7	2.4
Stockbuilding (% of GDP)	-0.2	-0.1	0.1	0.0	0.0	0.0
Government consumption	0.7	0.8	0.7	0.6	0.7	0.9
Exports of goods and services	1.0	4.5	3.8	4.3	4.3	4.0
Imports of goods and services	1.0	4.7	5.1	4.9	4.6	4.1
Consumer prices	1.6	1.1	1.8	2.2	2.0	1.5
Unemployment rate (level)	5.3	5.0	5.3	5.5	5.4	5.3
Current account balance (% of GDP)	7.6	7.6	7.1	6.7	6.4	6.3
Government budget (% of GDP)	0.0	0.0	0.2	-0.1	-0.2	-0.2
Government debt (% of GDP)	78.4	77.8	77.8	77.8	77.8	77.7

Source: Oxford Economics.

Greece

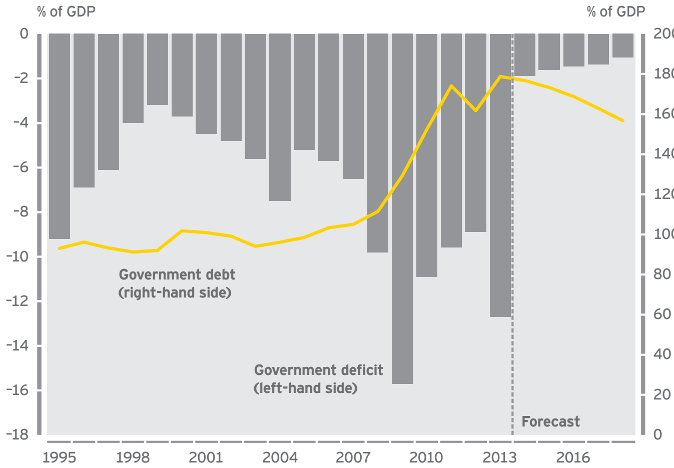
- After four years "in exile", Greece returned to the debt markets in April. The bond issue was heavily oversubscribed, highlighting the renewed level of optimism about prospects for a recovery. But fundamentals may not justify such enthusiasm, and we expect GDP to contract by 0.3% this year.
- Elevated unemployment and a very large output gap will continue to put downward pressure on wages this year. Consumer spending is expected to decline by 1.3% as a result and, as the dominant component of GDP, keep the economy in recession for another year.
- Net exports should again be positive in 2014, due to a combination of strong travel receipts and further import contraction. However, this will not be enough to offset falling domestic demand, with business investment and public consumption also expected to decline.
- A sustained pickup in external demand will drive a rebound in fixed investment expenditure in 2015. Private consumption will also recover, albeit weakly, while the drag of fiscal consolidation will subside, allowing GDP to expand by 1.6% in 2015, and then about 2% a year in 2016–18.

Figure 27
Contributions to GDP growth



Source: Oxford Economics.

Figure 28
Government deficit and debt



Source: Oxford Economics.

Greece (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	-3.9	-0.3	1.6	1.7	2.3	2.4
Private consumption	-5.9	-1.3	0.9	1.2	1.4	1.6
Fixed investment	-12.7	-2.6	4.0	5.2	5.0	4.8
Stockbuilding (% of GDP)	1.6	1.2	1.1	0.2	0.1	0.1
Government consumption	-4.2	-3.5	-1.6	1.7	1.7	1.6
Exports of goods and services	1.3	4.7	4.9	5.1	4.9	4.9
Imports of goods and services	-5.4	-2.4	1.5	2.3	3.3	3.9
Consumer prices	-0.9	-0.8	0.3	1.3	1.7	1.8
Unemployment rate (level)	27.3	27.0	26.8	26.4	25.8	25.0
Current account balance (% of GDP)	0.8	0.9	1.1	1.1	1.1	1.1
Government budget (% of GDP)	-12.7	-1.9	-1.6	-1.5	-1.4	-1.1
Government debt (% of GDP)	175.0	177.0	173.5	168.9	163.1	156.9

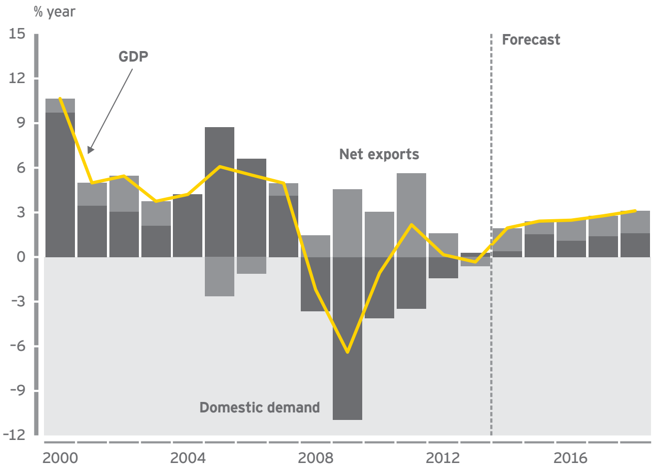
Source: Oxford Economics.

Ireland

- After a number of false dawns, the Irish economy may now be seeing the start of a sustained recovery, with a broad range of indicators picking up since the beginning of the year. Consequently, we have raised our forecast for GDP growth in 2014 to 2%, up from the 1.8% seen in our March report.
- Consumer spending, investment and exports should all contribute to growth this year, and for 2015–18. Ireland continues to enjoy important economic advantages, including a very low corporate tax rate, a flexible labor market and a dynamic, internationally oriented economy.
- But the dominant role of exports means that the ability of the economy to exploit these factors is to some extent out of Ireland's hands. And with the ratio of private and public sector debt-to-GDP the highest in the world on some measures, a continuation of very low inflation would pose a particular risk to the Irish economy.

Figure 29

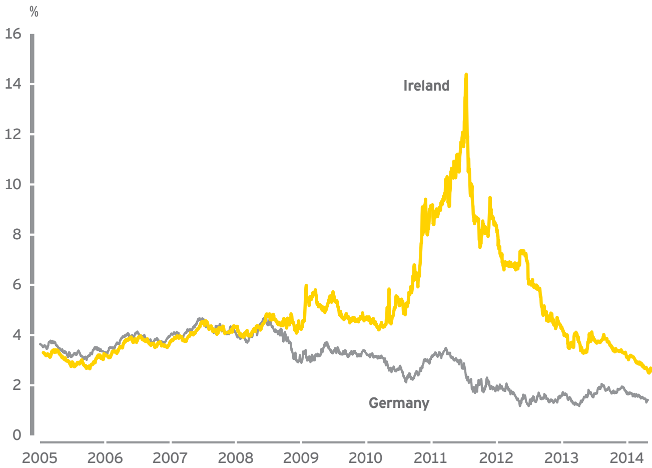
Contributions to GDP



Source: Oxford Economics.

Figure 30

Long-term government bond yields



Source: Oxford Economics; Haver Analytics.

Ireland (annual percentage changes unless specified)

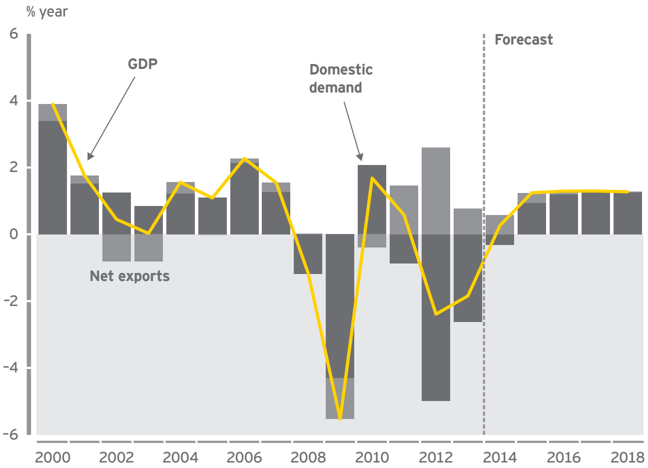
	2013	2014	2015	2016	2017	2018
GDP	-0.3	2.0	2.4	2.5	2.8	3.1
Private consumption	-1.1	1.7	1.4	1.3	1.3	1.8
Fixed investment	4.9	11.9	2.9	3.8	5.1	5.0
Stockbuilding (% of GDP)	0.3	-0.3	0.4	0.4	0.4	0.4
Government consumption	-0.6	-1.6	-1.5	-0.2	0.6	0.7
Exports of goods and services	0.1	3.7	3.7	4.0	4.0	4.4
Imports of goods and services	1.0	2.9	3.7	3.5	3.5	3.9
Consumer prices	0.5	0.6	1.3	1.6	1.8	1.9
Unemployment rate (level)	13.1	11.6	10.1	9.5	9.0	8.5
Current account balance (% of GDP)	6.6	4.3	4.2	4.0	3.9	3.8
Government budget (% of GDP)	-7.0	-5.1	-2.9	-1.8	-1.1	-0.8
Government debt (% of GDP)	123.7	124.2	121.8	118.4	114.1	109.5

Source: Oxford Economics.

Italy

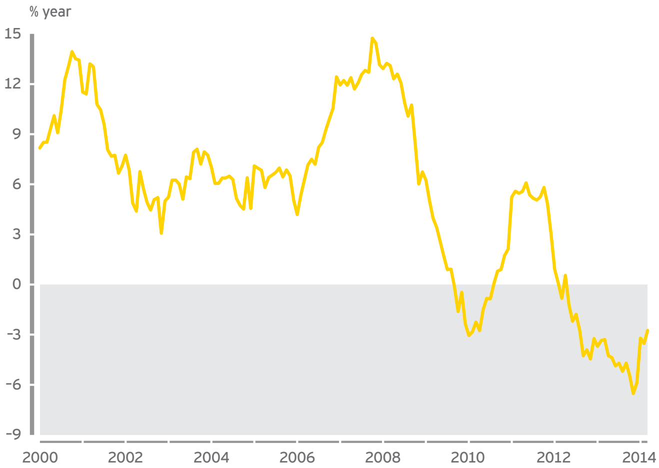
- Italy's longest post-war recession came to an end in H2 2013, when GDP finally stabilized after contracting for eight successive quarters. However, the economy has remained weak, with the first estimate of Q1 GDP showing an unexpected 0.1% quarterly decline.
- We still expect the economy to expand at a moderate pace in the coming quarters, supported by recent changes to fiscal policy and improving external conditions. We forecast GDP growth of 0.3% this year, before an acceleration to 1.3% a year in 2015–18.
- While domestic demand is expected to remain subdued, growth in the short term will be driven mainly by stronger external demand. Merchandise exports to Germany, the US and the UK are expected to push up overall exports. Having been flat in 2013, export volumes are expected to increase by 2.7% this year.
- Inflation has been subdued in the early months of this year. Although we expect Italy to avoid deflation, this remains one of the main risks. Inflation is forecast at just 0.5% this year and will remain weak in the years ahead, reflecting weak domestic demand and a substantial output gap.

Figure 31
Contributions to GDP growth



Source: Oxford Economics.

Figure 32
Bank lending to non-financial corporations



Source: Haver Analytics.

Italy (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	-1.8	0.3	1.2	1.3	1.3	1.3
Private consumption	-2.6	-0.2	1.0	1.2	1.2	1.0
Fixed investment	-4.6	0.1	1.6	1.9	2.3	2.4
Stockbuilding (% of GDP)	-0.3	-0.5	-0.3	-0.2	-0.1	0.1
Government consumption	-0.8	-0.1	-0.1	0.1	0.2	0.3
Exports of goods and services	0.0	2.7	4.1	4.1	3.9	3.7
Imports of goods and services	-2.9	1.0	3.7	4.4	4.4	4.2
Consumer prices	1.3	0.5	0.9	1.2	1.3	1.5
Unemployment rate (level)	12.2	12.9	12.7	12.1	11.7	11.3
Current account balance (% of GDP)	1.0	1.6	1.6	1.7	1.7	1.6
Government budget (% of GDP)	-3.0	-3.1	-2.6	-2.2	-1.9	-1.7
Government debt (% of GDP)	132.6	135.1	134.4	133.1	131.6	129.7

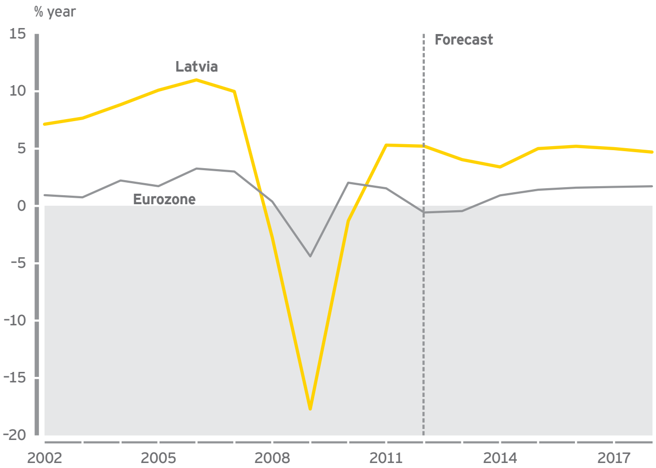
Source: Oxford Economics.

Latvia

- With the Ukraine crisis and the slowdown in Russia denting business confidence and trade, we have lowered our forecast for Latvia's GDP growth in 2014 to 3.4%, down from the 4.1% seen in our March report.
- But a return to growth of around 5% a year is forecast for 2015-18, which would make Latvia the fastest-growing economy in the Eurozone. This will be aided by the shift to a more sustainable pattern, with exports driving investment and public sector debt staying relatively low, despite infrastructure and energy commitments.
- Investment recovery could be jeopardized if last year's fall in credit growth persists, but the outlook should brighten as bad debts are eliminated and property price pressures are defused.
- Inflation is set to pick up after last year's price stability, but will stay close to the Eurozone average. Faster wage inflation reflects a tightening labor market, but will help to sustain private consumption as the fiscal stimulus is slowly withdrawn.

Figure 33

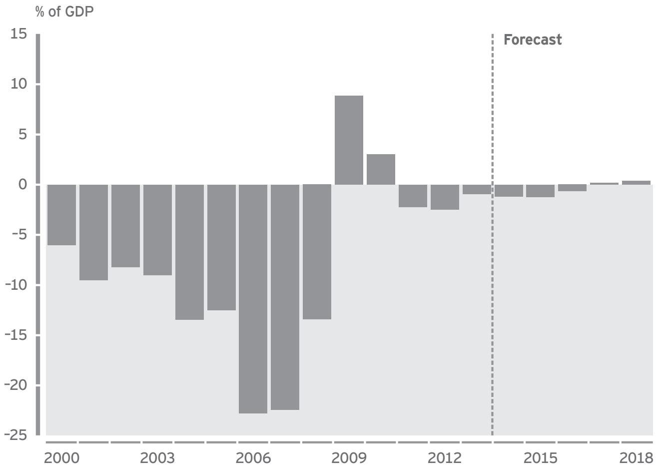
Real GDP growth



Source: Oxford Economics; World Bank.

Figure 34

Current account balance



Source: Oxford Economics.

Latvia (annual percentage changes unless specified)	2013	2014	2015	2016	2017	2018
GDP	4.1	3.4	5.0	5.2	5.0	4.7
Private consumption	5.3	4.1	4.8	4.8	4.8	4.8
Fixed investment	1.6	4.5	5.0	5.0	5.0	5.0
Stockbuilding (% of GDP)	0.2	0.0	-0.5	-0.5	-0.1	0.0
Government consumption	2.0	2.2	2.6	2.7	2.4	2.3
Exports of goods and services	2.1	3.8	6.5	6.5	6.5	6.5
Imports of goods and services	0.6	4.2	4.7	5.4	6.2	6.2
Consumer prices	0.0	1.5	2.2	2.4	2.4	2.4
Unemployment rate (level)	12.1	11.0	9.7	8.2	8.0	7.8
Current account balance (% of GDP)	-0.9	-1.2	-1.2	-0.7	0.2	0.4
Government budget (% of GDP)	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0
Government debt (% of GDP)	40.3	39.4	37.7	35.9	34.4	33.1

Source: Oxford Economics.

Luxembourg

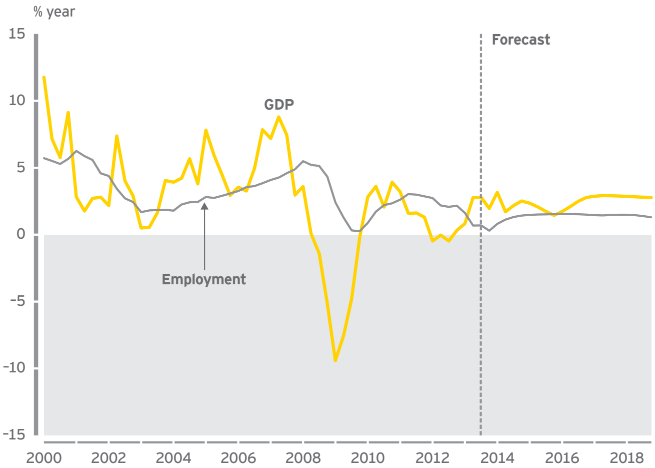
GDP growth

2014 **2.4%**

- After accelerating to an expected 2.4% this year, Luxembourg's GDP growth is forecast to dip just below 2% in 2015, as new EU VAT rules cause a permanent loss of e-commerce receipts.
- Growth is then forecast to rise to 2.7% a year in 2016–18, but this is subject to some uncertainty while tax arrangements are overhauled and finance adjusts to a smaller banking sector. Fiscal and inflationary pressures will focus more attention on containing labor costs.
- Pay restraint is expected to dampen the recent strength in consumer spending, raising the reliance of growth on net exports in the longer term, with asset management and business services an increasingly important source of these.
- Although public debt is low and social obligations fully financed, there will be growing pressure to reduce welfare costs and restrain wage growth in order to keep the traded sectors competitive.

Figure 35

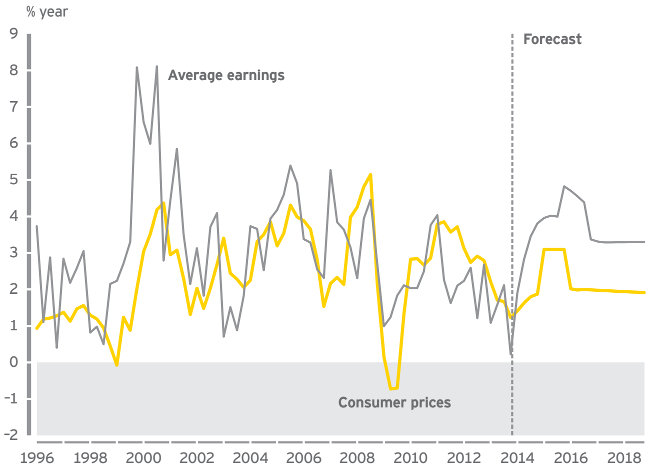
Real GDP and employment



Source: Oxford Economics.

Figure 36

Inflation and earnings



Source: Oxford Economics.

Luxembourg (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	2.1	2.4	1.9	2.3	2.9	2.8
Private consumption	1.8	1.8	1.9	2.2	2.5	2.5
Fixed investment	2.1	5.5	2.8	2.6	3.0	3.0
Stockbuilding (% of GDP)	4.3	3.6	3.0	1.9	1.9	2.1
Government consumption	1.7	1.9	1.9	1.9	1.9	2.0
Exports of goods and services	2.5	4.9	6.0	4.3	3.5	3.1
Imports of goods and services	2.8	5.1	6.2	3.9	3.4	3.1
Consumer prices	1.7	1.3	2.6	2.0	2.0	1.9
Unemployment rate (level)	5.9	6.0	5.7	5.2	4.7	4.2
Current account balance (% of GDP)	4.4	3.5	4.0	4.7	4.7	4.7
Government budget (% of GDP)	-1.4	-0.9	-1.2	-1.2	-0.8	-0.7
Government debt (% of GDP)	21.9	21.9	22.3	22.5	22.3	21.9

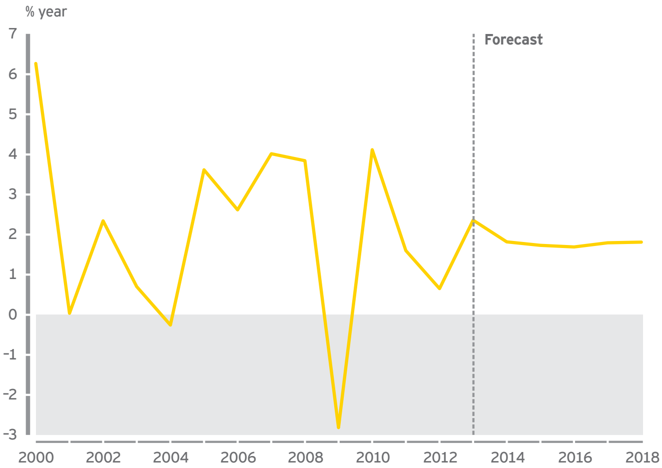
Source: Oxford Economics.

Malta

- Malta's GDP is forecast to grow 1.8% in 2014 — still above the Eurozone average, but down from the 2.4% expansion seen last year. This is due to a sharp drop in public consumption as the fiscal deficit is reined in under pressure from the EU.
- Growth is still expected to settle at a rate close to 1.8% in 2015-18, with inflation much closer to the Eurozone average, as exports and investment take over as the main drivers of the economy.
- Although the fiscal deficit has dropped within the EU-imposed parameters, it must be tightened further to reduce Malta's high public debt. This will leave expansion largely reliant on private investment.
- Plans are under way to speed up energy conversion, centered on a shift from oil to gas. This will lower import costs and emissions and reduce public debt. And solid growth of tourism and other service exports should ensure a continued current account surplus, reducing vulnerability to volatile capital flows.

Figure 37

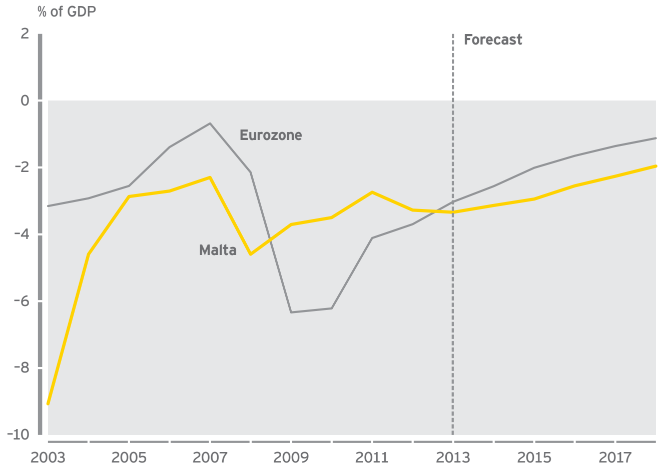
GDP



Source: Oxford Economics.

Figure 38

Fiscal balance vs. Eurozone



Source: Oxford Economics.

Malta (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	2.4	1.8	1.7	1.7	1.8	1.8
Private consumption	1.8	2.0	2.1	1.8	1.7	1.7
Fixed investment	-3.9	1.4	2.2	2.4	2.5	2.3
Stockbuilding (% of GDP)	0.9	0.4	0.1	0.8	1.3	1.5
Government consumption	-0.2	0.4	0.8	1.3	1.4	1.5
Exports of goods and services	-5.5	4.8	4.6	2.7	2.8	3.0
Imports of goods and services	-5.1	4.0	4.6	3.8	3.4	3.1
Consumer prices	1.0	1.2	1.5	1.9	2.3	2.3
Unemployment rate (level)	6.5	6.1	5.9	5.8	5.6	5.6
Current account balance (% of GDP)	1.4	2.4	2.7	3.1	3.3	3.1
Government budget (% of GDP)	-3.3	-3.1	-2.9	-2.6	-2.3	-2.0
Government debt (% of GDP)	71.1	72.9	73.5	73.5	72.8	71.9

Source: Oxford Economics.

Netherlands

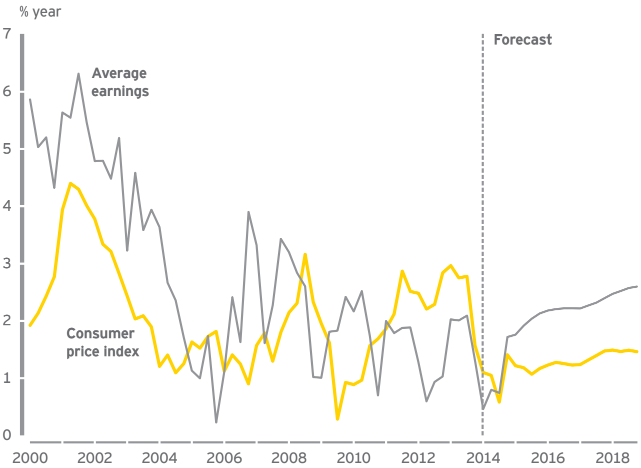
GDP growth

2014 0.4%

- The Dutch economy contracted sharply in Q1 2014. The mild winter weighed on production and consumption of natural gas, and there was also some payback from the strong growth in Q4 2013, which was boosted by temporary factors.
- We expect to see a rebound in Q2, as natural gas dynamics return to their normal seasonal pattern. There are also other positives: consumer and business confidence have been on a steady upward trend since mid-2013. Evidence of new export orders and rising external demand should also provide an impetus to domestic production.
- The much lower rate of inflation is protecting the spending power of consumers and, in addition, the housing market appears to have bottomed out. This means that the drag on confidence from the housing market will begin to fade.
- Yet the Netherlands still faces considerable headwinds. Low real income growth, public and private sector deleveraging, high unemployment and difficulty in obtaining credit will prevent domestic demand from gaining much traction for a number of years.
- We expect GDP growth of just 0.4% this year, before accelerating to 1.2% in 2015, and then about 1.4% a year in 2016–18.

Figure 39

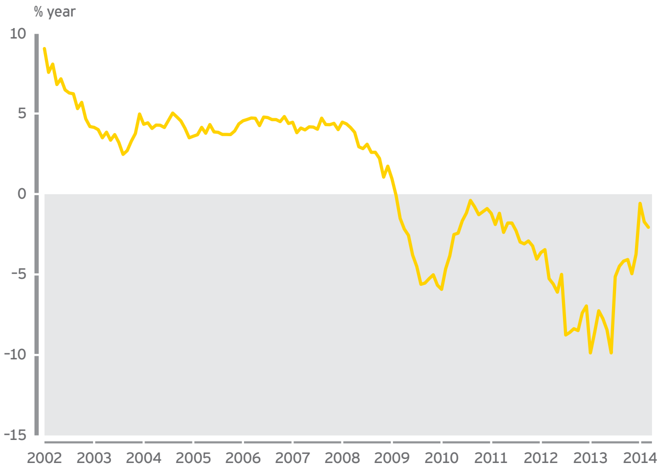
Prices and earnings



Source: Oxford Economics.

Figure 40

House prices



Source: Oxford Economics; Haver Analytics.

Netherlands (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	-0.8	0.4	1.2	1.2	1.5	1.6
Private consumption	-2.1	-0.7	0.5	0.8	1.2	1.5
Fixed investment	-4.8	3.2	1.9	2.1	2.0	2.2
Stockbuilding (% of GDP)	0.7	0.2	0.2	0.1	0.2	0.2
Government consumption	-0.2	0.0	-0.3	0.0	0.3	0.8
Exports of goods and services	1.4	2.0	3.7	3.7	3.2	2.6
Imports of goods and services	-0.2	1.4	3.5	3.4	3.1	2.7
Consumer prices	2.6	0.8	1.1	1.2	1.3	1.4
Unemployment rate (level)	6.7	7.3	7.2	7.0	6.8	6.5
Current account balance (% of GDP)	10.4	9.7	8.8	8.9	9.1	9.0
Government budget (% of GDP)	-2.5	-2.9	-2.5	-2.4	-2.2	-1.8
Government debt (% of GDP)	73.5	75.7	77.1	77.9	78.1	77.8

Source: Oxford Economics.

Portugal

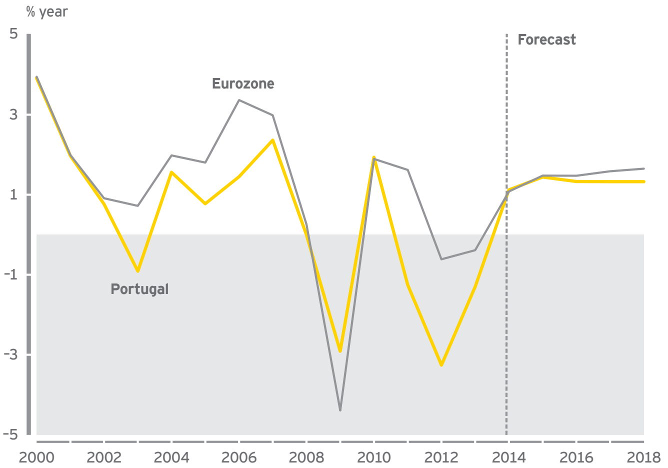
GDP growth

2014 **1.1%**

- After 3 years of recession, Portugal's GDP is forecast to grow 1.1% in 2014 and financial market conditions have improved considerably. As a result, Portugal has decided to exit its €78b bailout without a precautionary credit line from the European Stability Mechanism.
- Labor market reforms and stagnant real wages are helping Portuguese firms to recover the competitiveness lost in the years preceding the global crisis, which should support trade.
- On the domestic side, demand will still face several constraints. For instance, the flash Q1 GDP showed a fall of 0.7% from Q4 2013 and, after a marked fall of around 2 percentage points in the unemployment rate over the course of 2013, the labor market appears to have stagnated in recent months.
- The forecast is dominated by the downside risk of deflation. Portugal slipped into deflation in Q1, primarily because of a high degree of spare capacity in the economy, but also because of factors such as a stronger euro and lower energy prices. Although we expect Portugal to avoid falling into a deflationary spiral, this remains one of the main risks facing the economy.

Figure 41

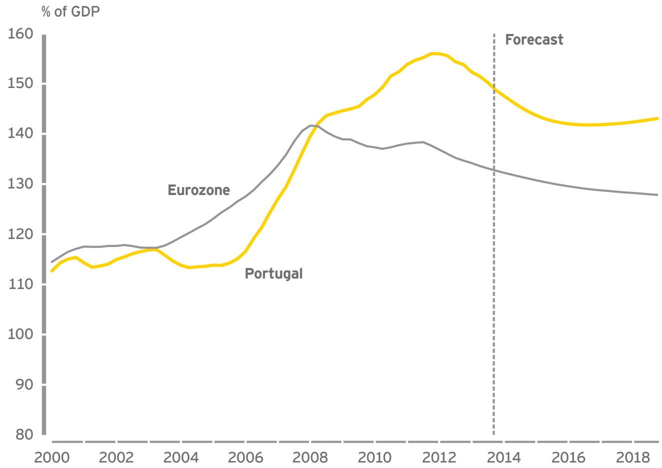
Real GDP growth



Source: Oxford Economics.

Figure 42

Corporate sector deleveraging



Source: Oxford Economics; Haver Analytics.

Portugal (annual percentage changes unless specified)

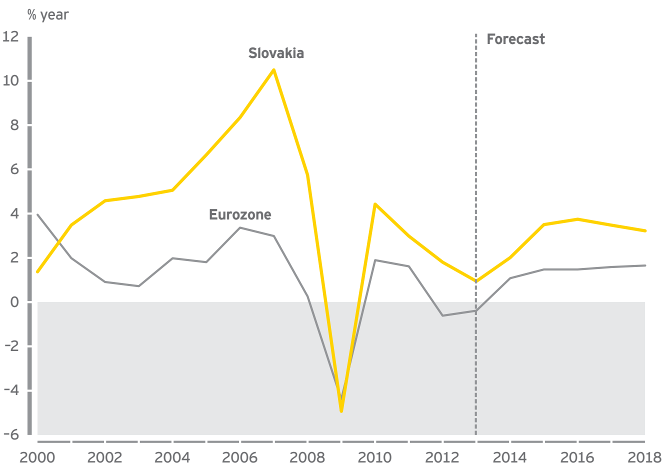
	2013	2014	2015	2016	2017	2018
GDP	-1.3	1.1	1.4	1.3	1.3	1.3
Private consumption	-1.7	0.9	0.9	0.9	0.9	0.9
Fixed investment	-6.6	3.2	2.3	2.4	2.4	2.4
Stockbuilding (% of GDP)	0.4	0.4	0.3	0.1	0.0	0.1
Government consumption	-1.7	-1.0	-1.0	0.9	1.3	1.2
Exports of goods and services	6.1	4.1	4.8	4.0	3.9	3.4
Imports of goods and services	2.8	3.6	2.9	3.2	3.5	3.4
Consumer prices	0.4	-0.1	0.7	0.8	1.1	1.4
Unemployment rate (level)	16.5	15.2	15.1	14.8	14.4	14.1
Current account balance (% of GDP)	0.5	0.5	1.0	1.2	1.4	1.6
Government budget (% of GDP)	-4.9	-4.3	-3.4	-2.8	-2.3	-1.8
Government debt (% of GDP)	129.0	130.4	130.3	129.8	128.9	127.4

Source: Oxford Economics.

Slovakia

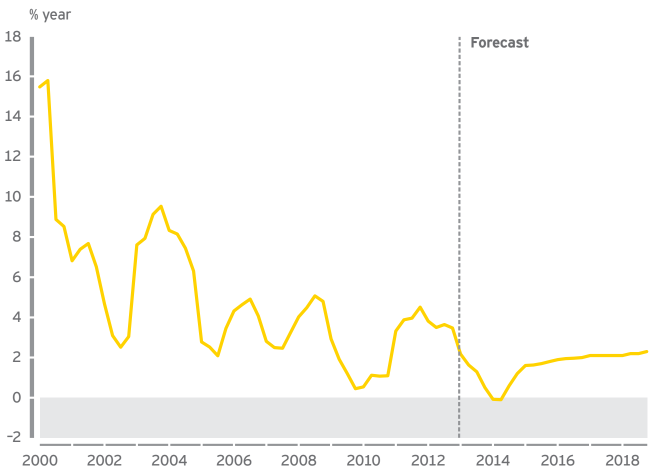
- Our forecast for Slovakia is broadly unchanged from our March report. GDP growth is expected to accelerate to 2% in 2014, from just 0.9% in 2013, due to a pickup in foreign demand and some support from fiscal policy.
- However, the increase in exports will be limited by both capacity constraints and model changes in the car sector. Moreover, the unemployment rate is still high, at 13.8% this year. This will hold back consumption growth in 2014.
- Economic growth will accelerate to 3.5% in 2015, as demand in key trading partners strengthens further and employment finally picks up. In 2016–18, GDP growth is expected to average a modest 3.5%, reflecting sluggish performances in the Eurozone and the Czech Republic — Slovakia's key trading partners.
- One downside risk to our forecast comes from the threat of deflation. If consumers and business start expecting lower inflation in future, they will delay consumption and investment activities, which will hurt domestic demand.

Figure 43
Real GDP growth



Source: Oxford Economics.

Figure 44
Inflation



Source: Oxford Economics; World Bank.

Slovakia (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	0.9	2.0	3.5	3.7	3.5	3.2
Private consumption	-0.1	1.1	2.6	2.8	2.7	2.7
Fixed investment	-4.3	1.3	3.7	4.7	4.5	4.0
Stockbuilding (% of GDP)	-2.1	-1.8	-1.2	-0.3	-0.2	-0.1
Government consumption	1.4	1.9	2.9	2.9	2.7	2.5
Exports of goods and services	4.5	4.8	5.7	5.8	5.2	4.8
Imports of goods and services	2.9	5.0	6.1	6.6	5.3	4.8
Consumer prices	1.4	0.4	1.7	2.0	2.1	2.2
Unemployment rate (level)	14.2	13.8	13.1	12.2	11.1	10.0
Current account balance (% of GDP)	2.2	2.4	2.3	2.3	2.3	2.3
Government budget (% of GDP)	-2.8	-2.6	-2.3	-1.9	-1.7	-1.5
Government debt (% of GDP)	55.4	54.8	54.4	53.3	52.1	51.0

Source: Oxford Economics.

Slovenia

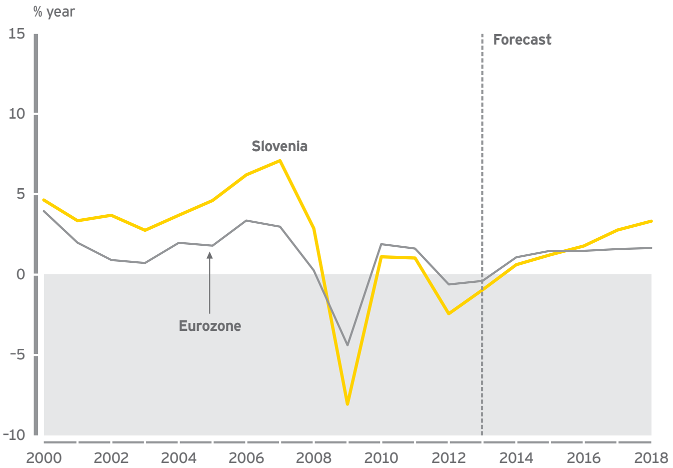
GDP growth

2014 0.6%

- The economic outlook for Slovenia has improved. GDP growth picked up steadily in H2 2013 and recapitalization of the banking sector began in December. As a result, we have raised our growth forecast for 2014 to 0.6%, from the 1.2% contraction we forecast in March. We have also revised up our forecast for 2015 from 0.7% to 1.2%.
- Export volumes improved notably in H2 2013, helped by stronger demand from within the Eurozone. We forecast that exports will continue to improve, driving the return to growth in 2014 after two years of recession.
- But with the budget deficit likely to exceed 15% of GDP this year, as a result of the recapitalization of the banking sector, we remain cautious about the outlook for domestic activity. We expect private spending and fixed investment to fall this year, and unemployment to remain close to 10%.
- Political uncertainty has risen since April and general elections have been called for July, which may hinder the reform process.

Figure 45

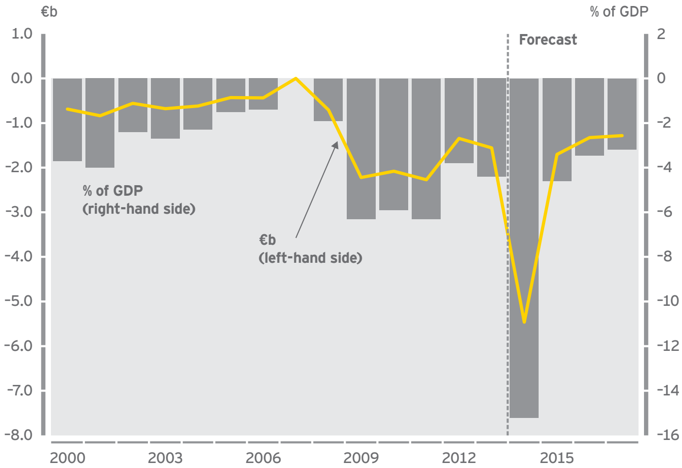
Real GDP growth



Source: Oxford Economics.

Figure 46

Government budget balance



Source: Oxford Economics.

Slovenia (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	-0.9	0.6	1.2	1.8	2.8	3.3
Private consumption	-2.9	-0.7	0.8	1.5	2.3	2.9
Fixed investment	-0.2	-2.2	2.4	4.4	4.9	4.6
Stockbuilding (% of GDP)	-0.9	-1.3	-1.8	-2.5	-2.5	-2.1
Government consumption	-2.0	-3.8	0.1	1.4	2.5	2.9
Exports of goods and services	2.7	3.9	3.5	3.0	2.7	2.5
Imports of goods and services	1.0	0.9	2.7	2.8	2.8	2.8
Consumer prices	1.8	0.9	1.6	2.0	2.4	2.5
Unemployment rate (level)	10.2	10.6	10.4	9.9	8.9	8.0
Current account balance (% of GDP)	6.4	8.2	8.9	9.2	9.1	8.8
Government budget (% of GDP)	-4.4	-15.2	-4.6	-3.5	-3.2	-3.2
Government debt (% of GDP)	67.1	81.3	75.6	71.1	68.9	68.2

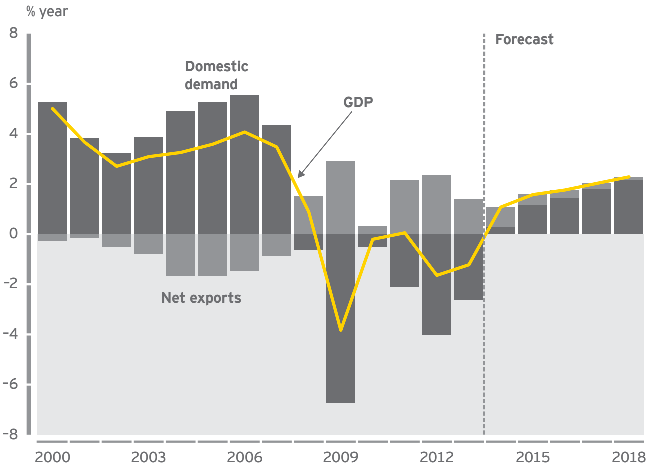
Source: Oxford Economics.

Spain

- Recent developments in the Spanish economy have been encouraging, with activity indicators surprising on the upside. We have therefore raised our forecasts for GDP growth to 1.1% this year and 1.6% in 2015.
- The composition of growth is expected to become more balanced, as private domestic demand is being supported by stronger investment in capital goods, as well as rising consumer spending.
- Economic expansion will also continue to benefit from Spain's dynamic export sector, although renewed growth in imports will dampen the positive contribution to GDP growth from net trade.
- Unemployment remains painfully high at about 25%, but the upturn in activity is now feeding into net job creation. However, most of these new jobs have been temporary positions, underscoring the need for further reforms to reduce labor market segmentation.
- We expect the budget deficit for 2014 to narrow to close to the target of 5.8% of GDP. Tax revenues are expected to pick up with the strengthening in economic activity, while expenditures will be constrained by fiscal adjustments already undertaken. But further policy measures will be required to bring the deficit down to the target of 4.2% of GDP in 2015.

Figure 47

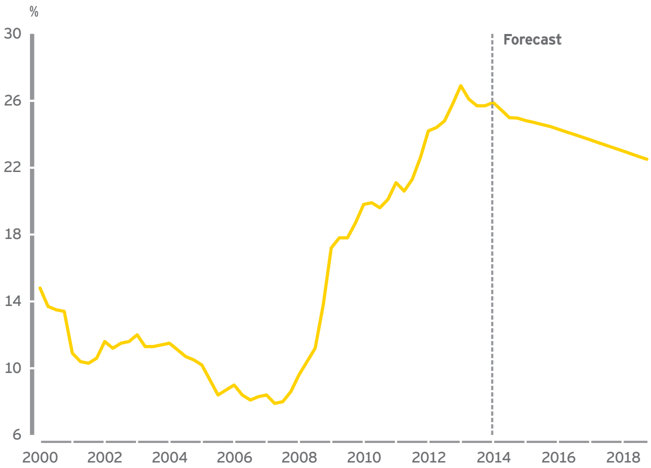
Contributions to GDP growth



Source: Oxford Economics.

Figure 48

Unemployment rate



Source: Oxford Economics.

Spain (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	-1.2	1.1	1.6	1.8	2.0	2.3
Private consumption	-2.1	1.5	1.5	1.8	2.1	2.5
Fixed investment	-5.1	1.8	2.2	2.4	2.8	3.1
Stockbuilding (% of GDP)	0.9	0.6	0.7	0.7	0.6	0.5
Government consumption	-2.3	-3.2	-0.8	-0.3	0.7	1.0
Exports of goods and services	4.9	5.4	4.5	4.0	3.6	3.3
Imports of goods and services	0.4	3.3	3.7	3.6	3.4	3.4
Consumer prices	1.5	0.1	0.4	0.9	1.0	1.1
Unemployment rate (level)	26.1	24.8	24.1	23.5	22.9	22.2
Current account balance (% of GDP)	0.8	1.4	1.2	1.1	0.9	0.8
Government budget (% of GDP)	-7.1	-5.9	-4.5	-3.2	-2.2	-1.6
Government debt (% of GDP)	93.9	100.2	104.7	107.5	108.8	109.1

Source: Oxford Economics.

Detailed tables and charts

Forecast assumptions

	2013	2014	2015	2016	2017	2018
Short-term interest rates (%)	0.2	0.2	0.2	0.2	0.5	1.4
Long-term interest rates (%)	3.0	2.6	3.1	3.5	3.9	4.2
Euro effective exchange rate (1995 = 100)	120.8	125.3	123.7	122.4	121.7	120.9
Oil prices (€/barrel)	81.8	76.2	77.1	80.3	83.5	87.3
Share prices (% year)	15.8	14.2	6.6	7.2	7.0	6.2

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Short-term interest rates (%)	0.2	0.2	0.2	0.2	0.3	0.3	0.2	0.2
Long-term interest rates (%)	3.1	2.8	3.1	3.0	2.7	2.3	2.5	2.7
Euro effective exchange rate (1995 = 100)	118.8	119.2	121.7	123.7	125.6	125.4	125.5	124.8
Oil prices (€/barrel)	85.2	78.6	83.2	80.3	79.0	76.7	74.4	74.7
Share prices (% year)	8.2	21.1	15.9	18.6	15.5	17.8	15.9	8.4

Eurozone GDP and components

Quarterly forecast (quarterly percentage changes)

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-0.2	0.3	0.1	0.2	0.2	0.4	0.4	0.4
Private consumption	-0.2	0.1	0.1	0.1	0.1	0.3	0.3	0.3
Fixed investment	-1.7	0.1	0.5	1.1	-0.3	0.5	0.6	0.6
Government consumption	0.2	-0.1	0.4	-0.3	0.2	0.0	0.0	0.0
Exports of goods and services	-0.9	2.4	0.1	1.3	0.8	0.6	0.8	0.9
Imports of goods and services	-1.2	1.7	0.9	0.5	0.6	0.6	0.8	1.0

Contributions to GDP growth (percentage point contribution to quarter-on-quarter GDP growth)

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-0.2	0.3	0.1	0.2	0.2	0.4	0.4	0.4
Private consumption	-0.1	0.1	0.1	0.0	0.1	0.2	0.2	0.2
Fixed investment	-0.3	0.0	0.1	0.2	-0.1	0.1	0.1	0.1
Government consumption	0.0	0.0	0.1	-0.1	0.0	0.0	0.0	0.0
Stockbuilding	0.1	-0.1	0.3	-0.3	0.0	0.1	0.1	0.1
Exports of goods and services	-0.4	1.1	0.0	0.6	0.4	0.3	0.4	0.4
Imports of goods and services	0.5	-0.7	-0.4	-0.2	-0.2	-0.3	-0.4	-0.4

Annual levels — real terms (€b, 2000 prices)

	2013	2014	2015	2016	2017	2018
GDP	8,515	8,607	8,734	8,863	9,004	9,152
Private consumption	4,767	4,800	4,869	4,940	5,012	5,085
Fixed investment	1,515	1,539	1,577	1,617	1,657	1,696
Government consumption	1,825	1,828	1,832	1,840	1,852	1,866
Stockbuilding	-9	-10	-8	-15	-17	-16
Exports of goods and services	3,948	4,086	4,243	4,417	4,592	4,763
Imports of goods and services	3,531	3,636	3,780	3,936	4,092	4,243

Annual levels — nominal terms (€b)

	2013	2014	2015	2016	2017	2018
GDP	9,583	9,791	10,071	10,383	10,719	11,060
Private consumption	5,481	5,561	5,709	5,883	6,066	6,249
Fixed investment	1,695	1,740	1,808	1,885	1,964	2,042
Government consumption	2,061	2,075	2,106	2,149	2,197	2,248
Stockbuilding	3	17	46	54	68	85
Exports of goods and services	4,398	4,558	4,801	5,084	5,376	5,672
Imports of goods and services	4,055	4,159	4,400	4,671	4,952	5,237

Prices and cost indicators

(annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
HICP headline inflation	1.3	0.7	1.2	1.6	1.6	1.5
Inflation ex. energy	1.2	0.9	1.1	1.5	1.5	1.5
GDP deflator	1.4	1.1	1.4	1.6	1.6	1.5
Import deflator	-0.4	-0.6	1.5	1.7	1.7	1.7
Export deflator	-2.6	-1.2	1.8	2.0	2.0	2.0
Terms of trade	-2.2	-0.6	0.3	0.3	0.3	0.3
Earnings	1.7	1.3	2.2	2.6	2.6	2.6
Unit labor costs	1.2	0.1	1.0	1.5	1.5	1.4
Output gap (% of GDP)	-3.5	-3.4	-3.1	-2.8	-2.4	-1.9
Oil prices (€ per barrel)	81.8	76.2	77.1	80.3	83.5	87.3
Euro effective exchange rate (1995 = 100)	120.8	125.3	123.7	122.4	121.7	120.9

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
HICP headline inflation	1.9	1.4	1.3	0.8	0.6	0.7	0.6	0.9
Inflation ex. energy	1.5	1.2	1.3	1.0	1.0	0.9	0.9	1.0
GDP deflator	1.6	1.6	1.4	1.1	1.0	0.9	1.1	1.3
Import deflator	0.5	0.2	-1.4	-0.8	-1.6	-0.7	-0.1	-0.1
Export deflator	-1.0	-2.0	-3.7	-3.6	-3.1	-1.2	-1.1	0.7
Terms of trade	-1.6	-2.2	-2.3	-2.9	-1.5	-0.5	-1.0	0.7
Earnings	1.8	1.6	1.7	1.5	1.1	1.2	1.2	1.7
Unit labor costs	1.8	1.2	1.2	0.6	0.1	0.1	0.0	0.3
Output gap (% of GDP)	-3.5	-3.4	-3.5	-3.6	-3.6	-3.5	-3.4	-3.3
Oil prices (€ per barrel)	85.2	78.6	83.2	80.3	79.0	76.7	74.4	74.7
Euro effective exchange rate (1995 = 100)	118.8	119.2	121.7	123.7	125.6	125.4	125.5	124.8

Note: HICP is the European Harmonized Index of Consumer Prices.

Labor market indicators

(annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
Employment	-0.9	-0.1	0.3	0.4	0.5	0.5
Unemployment rate (%)	12.0	11.7	11.6	11.3	11.1	10.8
NAIRU (%)	9.0	9.1	9.0	9.0	8.9	8.8
Participation rate (%)	75.2	75.0	75.0	75.2	75.4	75.5
Earnings	1.7	1.3	2.2	2.6	2.6	2.6
Unit labor costs	1.2	0.1	1.0	1.5	1.5	1.4

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employment	-1.1	-1.0	-0.8	-0.5	-0.2	-0.1	0.0	0.0
Unemployment rate (%)	12.0	12.0	12.0	11.9	11.8	11.8	11.7	11.6
NAIRU (%)	9.0	9.0	9.1	9.1	9.1	9.1	9.1	9.0
Participation rate (%)	75.3	75.2	75.2	75.2	75.0	75.0	74.9	75.0
Earnings	1.8	1.6	1.7	1.5	1.1	1.2	1.2	1.7
Unit labor costs	1.8	1.2	1.2	0.6	0.1	0.1	0.0	0.3

Note: NAIRU is the non-accelerating inflation rate of unemployment; i.e., the rate of unemployment below which inflationary pressures would start to appear due to labor market tightness.

Current account and fiscal balance

	2013	2014	2015	2016	2017	2018
Trade balance (€b)	159.5	185.1	185.6	196.2	205.9	214.3
Trade balance (% of GDP)	1.7	1.9	1.8	1.9	1.9	1.9
Current account balance (€b)	230.2	259.7	242.4	240.5	243.2	250.4
Current account balance (% of GDP)	2.4	2.7	2.4	2.3	2.3	2.3
Government budget balance (€b)	-290	-251	-202	-171	-146	-125
Government budget balance (% of GDP)	-3.0	-2.6	-2.0	-1.7	-1.4	-1.1
Government debt (€b)	9,112	9,515	9,894	10,229	10,528	10,782
Government debt (% of GDP)	95.1	97.2	98.2	98.5	98.2	97.5

Measures of convergence and divergence within the Eurozone

	2004-08	2009-13	2014-18
Growth and incomes			
Standard deviation of GDP growth rates	2.0	2.3	1.1
Growth rate gap (max – min)	7.5	9.2	5.1
Highest GDP per capita (Eurozone = 100)	242.0	232.9	232.2
Lowest GDP per capita (Eurozone = 100)	59.2	68.0	68.4
Inflation and prices			
Standard deviation of inflation rates	1.0	0.9	0.6
Inflation rate gap (max – min)	4.0	3.9	2.1
Highest price level (Eurozone = 100)	117.3	116.0	118.9
Lowest price level (Eurozone = 100)	56.0	65.1	66.1

Cross-country tables

Real GDP (% year)

Rank		2013	2014	2015	2016	2017	2018	Average 2014-18
1	Latvia	4.1	3.4	5.0	5.2	5.0	4.7	4.7
2	Estonia	0.8	1.6	3.2	3.8	3.9	4.0	3.3
3	Slovakia	0.9	2.0	3.5	3.7	3.5	3.2	3.2
4	Ireland	-0.3	2.0	2.4	2.5	2.8	3.1	2.5
5	Luxembourg	2.1	2.4	1.9	2.3	2.9	2.8	2.5
6	Slovenia	-0.9	0.6	1.2	1.8	2.8	3.3	1.9
7	Malta	2.4	1.8	1.7	1.7	1.8	1.8	1.8
8	Spain	-1.2	1.1	1.6	1.8	2.0	2.3	1.7
9	Germany	0.5	2.0	1.7	1.5	1.6	1.6	1.7
10	Austria	0.4	1.5	1.9	1.7	1.6	1.6	1.7
11	Greece	-3.9	-0.3	1.6	1.7	2.3	2.4	1.6
12	Belgium	0.2	1.2	1.3	1.6	1.7	1.8	1.5
13	Eurozone	-0.4	1.1	1.5	1.5	1.6	1.7	1.5
14	Finland	-1.4	0.0	1.6	1.7	1.9	2.1	1.4
15	Portugal	-1.3	1.1	1.4	1.3	1.3	1.3	1.3
16	Netherlands	-0.8	0.4	1.2	1.2	1.5	1.6	1.2
17	France	0.4	0.7	1.1	1.2	1.3	1.4	1.1
18	Italy	-1.8	0.3	1.2	1.3	1.3	1.3	1.1
19	Cyprus	-5.4	-4.3	-0.5	0.9	1.0	1.8	-0.2

Inflation rates (% year)

Rank		2013	2014	2015	2016	2017	2018	Average 2014-18
1	Spain	1.5	0.1	0.4	0.9	1.0	1.1	0.7
2	Portugal	0.4	-0.1	0.7	0.8	1.1	1.4	0.8
3	Greece	-0.9	-0.8	0.3	1.3	1.7	1.8	0.9
4	Italy	1.3	0.5	0.9	1.2	1.3	1.5	1.1
5	Netherlands	2.6	0.8	1.1	1.2	1.3	1.4	1.1
6	Cyprus	0.4	0.3	1.1	1.2	1.5	1.8	1.2
7	Eurozone	1.3	0.7	1.2	1.6	1.6	1.5	1.3
8	France	1.0	0.9	1.1	1.5	1.6	1.7	1.3
9	Ireland	0.5	0.6	1.3	1.6	1.8	1.9	1.4
10	Belgium	1.2	0.9	1.3	2.0	2.0	2.0	1.6
11	Slovakia	1.4	0.4	1.7	2.0	2.1	2.2	1.7
12	Austria	2.1	1.6	1.8	1.8	1.8	1.8	1.7
13	Germany	1.6	1.1	1.8	2.2	2.0	1.5	1.7
14	Finland	2.2	1.2	1.6	2.0	2.0	2.0	1.8
15	Malta	1.0	1.2	1.5	1.9	2.3	2.3	1.8
16	Slovenia	1.8	0.9	1.6	2.0	2.4	2.5	1.9
17	Luxembourg	1.7	1.3	2.6	2.0	2.0	1.9	2.0
18	Latvia	0.0	1.5	2.2	2.4	2.4	2.4	2.2
19	Estonia	3.2	1.2	2.7	3.1	3.2	3.0	2.6

Cross-country tables

Unemployment rate (% of labor force)

Rank		2013	2014	2015	2016	2017	2018	Average 2014-18
1	Austria	4.9	4.9	4.7	4.6	4.5	4.5	4.7
2	Luxembourg	5.9	6.0	5.7	5.2	4.7	4.2	5.2
3	Germany	5.3	5.0	5.3	5.5	5.4	5.3	5.3
4	Malta	6.5	6.1	5.9	5.8	5.6	5.6	5.8
5	Netherlands	6.7	7.3	7.2	7.0	6.8	6.5	7.0
6	Finland	8.2	8.4	8.0	7.6	7.4	7.2	7.7
7	Estonia	8.6	8.4	8.1	7.8	7.8	7.8	8.0
8	Belgium	8.4	8.6	8.5	8.1	7.7	7.6	8.1
9	Latvia	12.1	11.0	9.7	8.2	8.0	7.8	8.9
10	Slovenia	10.2	10.6	10.4	9.9	8.9	8.0	9.5
11	Ireland	13.1	11.6	10.1	9.5	9.0	8.5	9.8
12	France	10.3	10.3	10.1	9.9	9.8	9.7	10.0
13	Eurozone	12.0	11.7	11.6	11.3	11.1	10.8	11.3
14	Slovakia	14.2	13.8	13.1	12.2	11.1	10.0	12.0
15	Italy	12.2	12.9	12.7	12.1	11.7	11.3	12.2
16	Portugal	16.5	15.2	15.1	14.8	14.4	14.1	14.7
17	Cyprus	15.9	19.3	19.4	18.9	16.9	14.5	17.8
18	Spain	26.1	24.8	24.1	23.5	22.9	22.2	23.5
19	Greece	27.3	27.0	26.8	26.4	25.8	25.0	26.2

Government budget (% of GDP)

Rank		2013	2014	2015	2016	2017	2018	Difference 2014-18
1	Germany	0.0	0.0	0.2	-0.1	-0.2	-0.2	-0.2
2	Latvia	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0	0.0
3	Luxembourg	-1.4	-0.9	-1.2	-1.2	-0.8	-0.7	0.2
4	Greece	-12.7	-1.9	-1.6	-1.5	-1.4	-1.1	0.8
5	Malta	-3.3	-3.1	-2.9	-2.6	-2.3	-2.0	1.1
6	Netherlands	-2.5	-2.9	-2.5	-2.4	-2.2	-1.8	1.1
7	Slovakia	-2.8	-2.6	-2.3	-1.9	-1.7	-1.5	1.1
8	Estonia	-0.2	-0.5	-0.2	0.1	0.4	0.6	1.1
9	Belgium	-2.6	-2.7	-2.3	-1.9	-1.7	-1.5	1.2
10	Italy	-3.0	-3.1	-2.6	-2.2	-1.9	-1.7	1.4
11	Eurozone	-3.0	-2.6	-2.0	-1.7	-1.4	-1.1	1.5
12	France	-4.3	-3.6	-3.1	-2.5	-2.0	-1.7	1.9
13	Austria	-1.5	-2.8	-1.4	-0.7	-0.6	-0.6	2.2
14	Finland	-2.1	-2.6	-2.1	-1.1	-0.5	-0.1	2.5
15	Portugal	-4.9	-4.3	-3.4	-2.8	-2.3	-1.8	2.5
16	Cyprus	-5.4	-5.6	-5.8	-4.6	-2.7	-1.6	4.0
17	Ireland	-7.0	-5.1	-2.9	-1.8	-1.1	-0.8	4.3
18	Spain	-7.1	-5.9	-4.5	-3.2	-2.2	-1.6	4.3
19	Slovenia	-4.4	-15.2	-4.6	-3.5	-3.2	-3.2	12.0

EY Forecasts in focus: macroeconomic data and analysis at your fingertips

App

EY Forecasts in focus gives you swift access to the data and analysis from EY's *Eurozone Forecast* and *Rapid-Growth Markets Forecast* on your tablet.

- Compare economic indicators for the 18 Eurozone countries and 25 rapid-growth markets.
- Create tailored charts and tables for a broad range of economic indicators based on data from 2000 to the present and make forecasts up to 2018.
- Use the app to improve your own business planning and share customized information with clients.

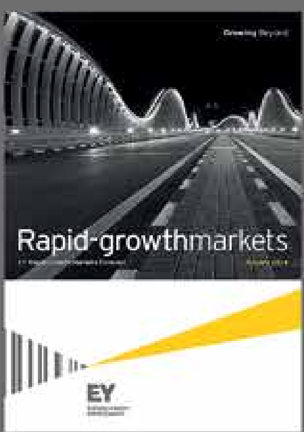
Download the *EY Forecasts in focus* app at ey.com/eurozone.

Web

- Highlights, data and other information from the *EY Eurozone Forecast*.

Other EY publications

- Rapid-Growth Markets Forecast
- EY Eurozone Forecast: Outlook for financial services



EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EYG no. AU2475

EMEIA Marketing Agency
1001127

ED None

In line with EY's commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

ey.com

About Oxford Economics
Oxford Economics was founded in 1981 to provide independent forecasting and analysis tailored to the needs of economists and planners in government and business. It is now one of the world's leading providers of economic analysis, advice and models, with over 700 clients including international organizations, government departments and central banks around the world, and a large number of multinational blue-chip companies across the whole industrial spectrum.

Oxford Economics commands a high degree of professional and technical expertise, both in its own staff of over 80 professional economists based in Oxford, London, Belfast, Paris, the UAE, Singapore, New York and Philadelphia, and through its close links with Oxford University and a range of partner institutions in Europe and the US. Oxford Economics' services include forecasting for 200 countries, 100 sectors, and 3,000 cities and sub-regions in Europe and Asia; economic impact assessments; policy analysis; and work on the economics of energy and sustainability.