Eurozone

EY Eurozone Forecast

March 2015

EY

Building a better working world

Published in collaboration with

OXFORD ECONOMICS

Contents

Published on 12 March 2015

March 2015 forecast

14

Cheap oil and supportive policy to drive the recovery

After a year of hesitant recovery in 2014, the Eurozone moves into 2015 supported by two important growth drivers: sharply lower oil prices and quantitative easing. These factors will help GDP growth to accelerate. But despite the improving near-term outlook, Eurozone growth will still be only 1.6% a year in 2017–19, as it is held down by a number of structural constraints.

Forecast for Eurozone countries

24

Detailed forecasts for the 19 Eurozone member states.

Detailed tables and charts

44

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

Foreword

Welcome to the first EY Eurozone Forecast of 2015. After a difficult second half of 2014, the Eurozone was in need of an encouraging start to the new year. And there are indeed some reasons to be cheerful.

Customize data from the *EY Eurozone Forecast* at ey.com/eurozone.

Welcome to the first *EY Eurozone Forecast* of 2015. After a difficult second half of 2014, the Eurozone was in need of an encouraging start to the new year. And there are indeed some reasons to be cheerful.

Both the September and December 2014 editions of the forecast saw further downgrades of already weak growth projections. It seemed that disillusionment was setting in across the continent as 2014's early promise was cut down by mid-year problems. The latest figures suggest that the Eurozone grew by 0.9% in 2014.

So it is something of a relief to be forecasting more robust growth this year. For 2015, we see expansion of 1.5%, and a further acceleration to 1.8% next year.

Although we are certainly more positive about market prospects — and we expect businesses to be too — we mustn't get carried away. Beyond the near term, deep-set structural problems mean that growth may be more limited, averaging about 1.6% a year for 2017–19.

But without doubt, readers should celebrate the positives before concerning themselves about mid-term prospects. Two key drivers have underpinned the upturn in fortunes. Externally, oil prices hit a six-year low in January this year. And, from within, the European Central Bank (ECB) quantitative easing (QE) program — weakening the euro and bringing bond yields down further — helped to allay fears of deflation and bolstered confidence more broadly.

The falling oil price will eventually translate into fuel savings for households throughout Europe, adding to consumer confidence that has already been improved by stabilizing levels of unemployment. The unemployment problem will be a stubborn one, however, and will act as a cap on domestic consumption for several years to come.

Businesses are also beginning to feel more optimistic. A number of business sentiment indices have been steadily rising in recent months, as the weaker euro and lower borrowing costs help to feed corporate confidence. But firms should consider that this growth uptick may level out. So businesses should focus on building in the agility required to profit from growth today, but also prepare for more difficult conditions, should activity slow down in the future.

I'm aware that this time last year, we were also feeling much more positive about the Eurozone, only to be disappointed at mid-year. So it is always wise to be cautious in the context of the single currency. External risks abound: although the UK and US continue to show stability and growth, the conflict in Ukraine still presents a risk to European economies. In addition, the deep recession now forecast for Russia will dampen prospects in some Eurozone nations, and uncertainties surrounding Greece may yet lead to more volatility on the financial markets.

Nevertheless, businesses would be wise to build on today's positive sentiment. We all look forward to finding out how long it lasts.

Make sure that you visit ey.com/eurozone to check for additional information on the forecasts and to access the 19 individual country reports.

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

Highlights

Domestic healing supported by cheaper oil

- After a year of tentative recovery in 2014, the Eurozone moves into 2015 aided by two important growth drivers — sharply lower oil prices and quantitative easing (QE). These factors will help GDP growth accelerate from 0.9% in 2014 to 1.5% this year and then 1.8% in 2016. But despite the improving near-term outlook, Eurozone growth will still be only 1.6% a year in 2017–19, as it is held down by a number of structural constraints.

- Throughout 2014 there was gradual domestic healing in the Eurozone as consumers regained confidence and the unemployment rate stopped rising. This will be supported in 2015 by lower oil prices, which we estimate will boost real household income by 1%–1.5%, enabling consumer spending growth to accelerate from 0.9% in 2014 to 1.6% this year. But the degree of spare labor will hold back wage growth for some years yet, so we expect consumer spending growth to remain around 1.5% from 2016 onwards.

ECB bond-buying will aid exports and investment ...

- But falling oil prices have heightened fears of deflation. Given the impact on energy bills, we now expect consumer prices to fall 0.2% in 2015, and then rise just 1.1% in 2016. But the ECB's recent announcement of substantial sovereign bond purchases is expected to prevent a deflationary spiral and underpin medium-term inflation expectations at 2%. QE will also weaken the euro further, but in light of weaker emerging market demand the pickup in export growth will be relatively muted — we forecast export growth of 4% in 2015 and 4.5% in 2016. Furthermore, in the longer term, export growth will be constrained by higher costs than elsewhere unless there are more structural reforms.

- Stronger domestic and external demand, plus improving access to finance, should underpin business confidence and spur faster capital spending. Alongside a tentative recovery in housing markets and stabilizing public investment, this will help fixed investment grow by 0.5% in 2015 and 2.8% in 2016. However, with limits on the pace of domestic and external demand growth, investment is unlikely to accelerate much further over the medium term.

... but tight fiscal policy can be eased only gradually

- Rising growth and lower borrowing costs will have a positive impact on public finances in the next few years. But with public debt above 90% of GDP in eight countries, and at 96% for the Eurozone overall, room for fiscal easing is limited. Nevertheless, the period of emergency austerity is over, and we now expect government spending to contribute modestly to growth.

- Threats to stability remain — principally from the prospect of difficult negotiations over Greece's debt. But at least these discussions are taking place in an improving macroeconomic and financial environment in much of the rest of the Eurozone. The conflict in Ukraine will also continue to pose a risk to confidence but, with much lower global energy prices, one of the key transmission mechanisms of a spiraling conflict to the Eurozone looks to be less potent.

GDP
(annual change)

2015	2016	2017–19
1.5%	1.8%	1.6%

Exports of goods and services
(annual change)

2015	2016	2017–19
4.0%	4.5%	3.8%

Exchange rate
(against US$)

2015 1.07

2016 1.01

Oil price
(per barrel)

2015 US$55

Inflation

2015 -0.2%

2016 1.1%

Unemployment

2015 11.2%

Eurozone forecast by sector (% change)	2015	2016
Manufacturing	1.6	2.4
Agriculture	1.3	1.5
Construction	0.6	1.3
Utilities	1.5	1.9
Trade	1.7	1.9
Financial and business services	1.7	2.0
Communications	3.4	3.4
Non-market services	0.5	0.7

Implications for businesses:

Build for growth today, but prepare for uncertainty tomorrow

Build for growth today, but prepare for uncertainty tomorrow

After some uncertainty in mid-2014, prospects for growth have become more favorable and businesses should be ready to build on this development.

A slump in oil prices has cut business costs and is rekindling consumer spending. And the announcement of the quantitative easing program from the ECB has further weakened the euro and pushed down the cost of borrowing. So growth is returning. We now expect GDP in the Eurozone to grow by 1.5% this year and by 1.8% in 2016.

The signs of a pickup are everywhere. Germany powered ahead in the final quarter of 2014 and its unemployment hit a post-reunification low. The Netherlands bounced back. Spain is growing at its fastest rate for seven years. Even in slow-growing Italy, consumers are showing some signs of renewed spending. And sentiment among investors and analysts is recovering, with survey measures showing a further rise in confidence in February.

What's changed?

Three elements of the recovery in particular should seize the attention of wealth-creators. First, the scale of this shift in outlook was largely unexpected and happened very quickly — factors that underline the ever-increasing need for business agility.

Second, we do not believe this is the start of a roaring recovery: rather, we see a pickup in growth this year and next, especially for consumers, but there is continuing uncertainty about long-term growth. And third, the recovery may simply widen the performance and attractiveness gap between Eurozone states that have pushed through reforms and those where hopes remain that economic recovery will render reform unnecessary.

Nevertheless, the recovery offers a window of opportunity for all companies. For half a decade, executives have been worried about the economic situation in Europe, reluctant to commit resources and concerned about the prospect of continued decline. Aided by a recovery in asset valuations and low interest rates, the next two years should now offer the chance for business to reposition in Europe. Companies can tidy European portfolios, achieve delayed divestments and acquire assets to consolidate markets.

Weaker euro and cheaper oil change outlook

The first significant shift will be precipitated by cheaper energy and a weaker euro, the latter reinforced by the announcement of the ECB's QE program. We believe that lower oil prices will add 1.5% to real household incomes in 2015. This will lift growth in consumer spending to 1.6% this year, up from just 0.9% in 2014. In the meantime, bond purchases by the ECB will further weaken the euro, helping to ramp up export growth.

These improvements in the economic environment are already making themselves felt. As fuel bills fall, consumers can use freed-up cash to replace durable goods or bolster their clothing and entertainment budgets. There are signs of this happening, notably in Germany, where private consumption is set to rise 2.5% this year, as well as in Spain (2.5%), Ireland (1.2%) and even France (1.5%). In the near term, strengthening demand across a range of consumer-facing businesses will drive many corporate growth opportunities.

Though rising consumption sucks in imports, a cheaper euro makes the region's exports more competitive in foreign markets. So export growth is set to reach a lively 4% this year and 4.5% in 2016, implying a significant demand surge for some exporters. Companies must adapt quickly to this improving demand outlook, stepping up investment as necessary.

Viewpoint

David Barker

Managing Partner, EMEIA Financial Services, Transaction Advisory Services

dbarker@uk.ey.com

Positive impacts from quantitative easing and the asset quality review are unlikely to be felt by Eurozone banks in the short term

The dramatic acceleration of the ECB's QE program may have boosted confidence in the durability and speed of the Eurozone's economic recovery, but it is important to stress that there are also a number of risks to be borne in mind. The continental European banking system is far from out of the woods.

The conclusion of the ECB's Comprehensive Assessment delivered positive headlines for the Eurozone banking sector, with a total capital shortfall of only €9.5b remaining to be filled across only 13 banks. However, the small print contained some rather larger numbers that underline the need for further recapitalization of the banks. In its final report, the ECB admitted that its capital figures were subject to transitional arrangements which, if removed, would require an additional €126.2b in Common Equity Tier 1 (CET1) from banks.

The ECB also highlighted the significant stock of deferred tax assets requiring future profitability that exist across Eurozone banks. Before the Comprehensive Assessment, this amounted to over €105.6b, equivalent to around 10.6% of aggregate CET1 starting capital. The ECB sees this as a significant issue and states that the Single Supervisory Mechanism (SSM) should be looking into this as part of its assessment of capital quality.

Additionally, the imposition of a leverage ratio across Europe — expected to be a minimum of 3% come 2018 — will force a number of the most highly leveraged banks in continental Europe to take one of two steps: either to raise significant further capital on top of that outlined in the asset quality review, or to continue to aggressively unwind parts of their balance sheet where the capital constraints are most onerous. Given this requirement, commentators have variously forecast an additional €2t to €3t of deleveraging by Eurozone banks over the next two to three years.

As a result, we see a continuing trend among some of Europe's largest banks toward focusing on a smaller number of core or domestic markets while reducing lending in other, more peripheral, geographies. Consequently, countries in central and eastern Europe will see several western European banks continue to reduce or cease lending, further constraining the supply of credit.

In the long term, a move toward European banking union and a revival of securitization would enable the European bank-lending landscape to rely less on equities and undergo a "great rotation" to look more like the US model of lending through capital markets. However, there are cultural and historical barriers to overcome in order to achieve this, so it may be a generation before banks are able to count on funds from the European capital markets.

Build for growth today, but prepare for uncertainty tomorrow

Long-run competitiveness concerns

Our concern, though, is that instead of accelerating further in 2017, the pace of Eurozone growth will ease in response to business costs that remain high relative to other regions. Much more could be done in this respect, including, for example: further liberalization of services markets both within economies and at a pan-European level, more competition in cross-border energy supply, and measures to enhance the working of the single labor market.

Barring such progress, prospects beyond 2017 are likely to be diminished. Severe levels of unemployment should fall noticeably — from 24.5% in Spain in 2014 to 18% in 2019, and from 26.5% in Greece to 17.4% over the same period. Ireland and Portugal should also see reductions in unemployment. Despite this, unemployment will remain at high levels in much of the periphery — and in France too. And unless it is addressed more vigorously, unemployment will limit growth in demand and hence GDP.

Firms will therefore be obliged to weigh long-term opportunities in the Eurozone against those elsewhere, at a time when growth in the US, the UK and some other countries is becoming more entrenched.

A widening internal performance and attractiveness gap

To make long-term decisions, companies must also be alert to diverging national trends within the Eurozone. Germany, the region's cost-competitive engine, is back on track, with likely growth of 2.2% this year and 2% in 2016, driven by stronger consumption and exports. And hopes of a lasting peace deal in Ukraine could reinforce a recovery in investment. But with unemployment seen falling to 4.9% this year, there is a risk that labor bottlenecks may constrain growth in the years ahead.

Growth in France will pick up too, driven by similar forces, but at 1.2% this year and 1.7% next, it will remain weaker than the Eurozone average. With unemployment staying above 10% this year, and a reform program that is both tentative and tardy, France's recovery is held back by weak investment and consumption and a workforce that, although skilled, is expensive and inflexible. Italy, the Eurozone's third-largest economy, suffers similar handicaps, and is likely to grow only 0.3% this year and 1% next.

The new growth hotspots are the peripheral countries, which are benefiting from labor market reform. Spain's economy is set to surge by around 2.4% annually for the next five years, driven by burgeoning investment and exports. Meanwhile, Ireland's annual growth will top 3% and Portugal is looking perkier too.

Ambitious firms are now seeking out reforming countries and focus investment where lower costs and employment flexibility combine with market growth, through rising consumer spending and exports, to offer attractive opportunities.

A chance to reposition in Europe

As companies take a fresh look at the Eurozone, they need to assess where their businesses can go within the single currency area. From this foundation, they should build a short-term action plan that might involve fixed investment, divestment or mergers and acquisitions (M&A).

Thanks to reduced levels of corporate leverage, very low interest rates and a recovery in banks' lending capacity, companies should find it easier to fund investment and deal-making. The bank lending survey for the Eurozone, published by the ECB in January, showed banks continuing to ease lending standards for non-financial companies and households. Net loan demand from non-financial businesses rose in the fourth quarter of 2014, with a marked upsurge in demand for loans to fund investment, as well as for financing M&A — which is now rising up the corporate agenda. EY's October 2014 *Capital Confidence Barometer* revealed that after a surge in megadeals last year, companies are primed for a burst of mid-market M&A: 40% of global companies expect to do deals in the next 12 months.

Viewpoint

Peter Englisch

Global Leader, Family Business Center of Excellence, EY
peter.englisch@de.ey.com

I believe the European economy is now at an inflection point, in which the economic recovery pioneered in Germany becomes generalized throughout most of the Eurozone.

EY's *European Mid-Market Barometer 2015*, published in January this year, revealed a remarkable level of optimism among the 6,000 medium-sized businesses we surveyed. Overall, 87% saw their current state of business as good or quite good, half expected sales to rise this year, and 46% predicted improving performance during the first half of the year, against only 7% foreseeing a decline.

I think these findings highlight a genuine recovery in business and business confidence in Europe, which has been underway for some time — and which I have seen myself during visits to companies across the continent.

That recovery began in Germany and the German-speaking countries about 18 months ago. Now peripheral economies, including those in Southern Europe where labor markets have been reformed, are picking up the baton as labor markets tighten in Germany and some of its neighbors.

Across Europe, export demand is being complemented by rising domestic consumption: with rock-bottom interest rates, people spend rather than save. Skills shortages are now becoming a problem for mid-sized firms in the German-speaking countries that are leading recovery. Here, to sustain the pace of economic expansion, more action is needed to create a "culture of welcome" for able immigrants and build the brands of medium-sized companies and the regions where they operate.

But nations that grasped the nettle of reform are now beginning to reap the benefits. Aided by a recovery in competitiveness, and in demand, mid-market companies in countries such as Ireland, Spain and Portugal are again starting to invest and hire, reinforcing the positive economic trend.

Key findings of EY's *European Mid-Market Barometer 2015:*

- A large majority of medium-sized companies in Europe are positive about their current level of business and outlook: turnover is expected to rise 1.7% on average.
- Mid-sized companies are generally close to their domestic economies. In 14 of the 21 countries surveyed, firms expect their economies to improve.
- Optimism is now strongest in parts of Europe's periphery, including Turkey, the UK, Ireland, Denmark, the Netherlands, Spain and Portugal. Companies in Russia, Germany, Italy and Poland are less optimistic, although they are still broadly positive.
- Companies plan to increase investment, and in every country — even Greece — aim to hire more workers.
- High prices for raw materials are the biggest threat for mid-sized firms, followed by economic weakness in domestic and export markets.
- Increasing public investment is the best way to promote growth, according to mid-sized companies in 17 countries: only in Germany, Austria, Switzerland and Luxembourg do firms surveyed favor budget consolidation and debt reduction.

EY's *European Mid-Market Barometer 2015* surveyed 6,000 companies with revenues of €10m–€500m in 21 countries: Germany, France, UK, Spain, Italy, Netherlands, Turkey, Austria, Belgium, Norway, Poland, Sweden, Switzerland, Russia, Czech Republic, Denmark, Finland, Ireland, Portugal, Greece and Luxembourg.

More: *European Mid-Market Barometer 2015*

Build for growth today, but prepare for uncertainty tomorrow

Improving opportunities in public sector markets

In addition, although national debt burdens remain heavy, cheaper borrowing has also eased pressure for austerity. After slowing to just 0.2% in 2015, we expect growth of government consumption to creep up again in the years ahead, even though it shrinks as a percentage of GDP. By reducing current spending, governments can invest more, including in areas such as skills training, to enhance competitiveness. They can also turn to technology and contracting-out to improve service delivery while reducing costs.

Rethinking government and digital transformation are among the top four megatrends identified by executives in EY's *Capital Confidence Barometer*. Overhauling government services amid a digital revolution — when borrowing is cheap and wages are flat — should offer a win-win situation for both taxpayers and outsourced providers. Business opportunities should arise wherever private sector practices can offer efficiency gains — including in health care, education and training, and online service delivery.

Benefits to the bottom line

Cheaper oil, a weaker euro and a changing demand outlook will affect some companies more than others. Some European carmakers and exporters of luxury goods will reap windfall currency gains when reporting their profits. But by the same token, Asian, British or US multinationals will feel their Eurozone profits squeezed.

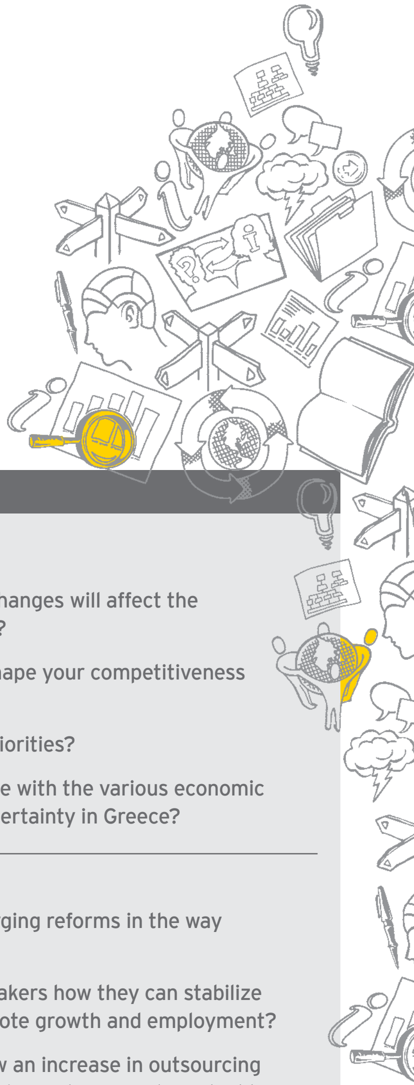
The corporate earnings season began strongly, with many companies beating expectations. That has helped to underpin a rapid re-rating of European companies that propelled the FTSEurofirst 300 Index sharply higher during the first six weeks of 2015. Some analysts are now looking for overall compound annual earnings of European companies to surge 10% during 2015.

But outcomes will vary significantly by sector. Oil and gas producers are already reining back development. Green-tech companies are likely to face margin pressure, given that oil prices are unlikely to top US$100 per barrel (the Q3 2014 average) until almost 10 years from now.

Meanwhile, energy-intensive companies, in chemicals, cement, metals and other industries, will become more competitive, especially relative to rival production locations in the US. Others, such as airlines, which in principle should benefit from cheaper fuel, may see slimmer gains because they have hedged currencies for several years ahead. Nevertheless, European firms in these sectors have a choice to make: use the extra profits to invest in new technology for a lower-cost, long-term future, or use the breathing space to facilitate further managed decline in heavy industrial sectors.

Grasping the opportunities

Amid a fast-changing business and economic environment, companies need to ensure they retain tight cost controls and continue to build agility into their operations. Responding to the Eurozone's improving demand outlook has become an urgent priority and now is the time to reassess opportunities in the region and draw up new plans to make the most of them.



Key questions for businesses

Today

Assess and address the new-found opportunities and threats to your business. In particular have you:

- Appraised the impact of a weaker euro and informed shareholders?
- Assessed the effects of cheaper fossil energy and taken appropriate action?
- Reviewed your supplier contracts and hedging strategies to ensure they remain a benefit and not a liability?
- Looked at how these fundamental changes will affect the competitiveness of your chief rivals?
- Examined how these changes will shape your competitiveness within the Eurozone and beyond?
- Discussed your M&A pipeline and priorities?
- Developed contingency plans to cope with the various economic outcomes possible from current uncertainty in Greece?

Tomorrow

Decision-makers need to build into their businesses the agility to adapt quickly to big, unexpected shifts in the economic environment. In particular, are you:

- Positioned to profit from a multi-speed recovery within the Eurozone?
- Monitoring the improving attractiveness of peripheral countries and adapting your supply chain?
- Building flexibility and resilience into your operations?
- Focusing on what you do best and forging partnerships to obtain the shared services you need to underpin your operations?
- Identifying ways to profit from emerging reforms in the way governments provide services?
- Explaining energetically to policy-makers how they can stabilize the business environment and promote growth and employment?
- Demonstrating to policy-makers how an increase in outsourcing by public entities could improve efficiency, lower costs and add opportunities for private companies?

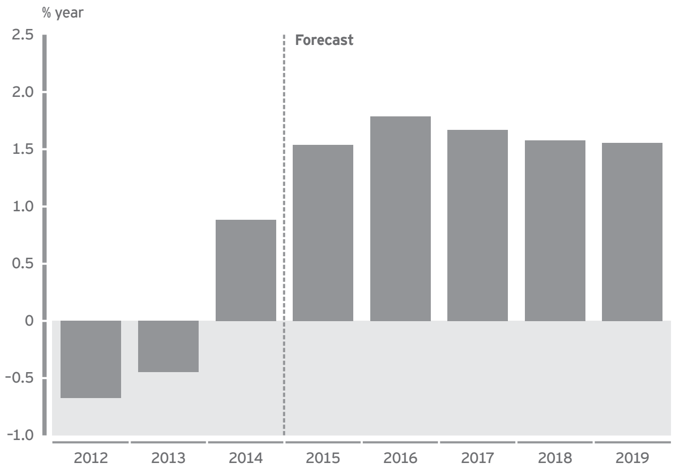
Cheap oil and supportive policy to drive the recovery

Cheap energy and quantitative easing support domestic recovery

The Eurozone economy has entered 2015 with a modest head of steam from recovering business and consumer confidence. In the months ahead, it will benefit from a combination of good fortune and good policy. The first of these is the result of the sharp fall in the oil price, which should provide a substantial boost to disposable incomes around the Eurozone, supporting the ongoing recovery in consumer spending. But in light of the deflationary impact of falling energy costs, the European Central Bank (ECB) has decided to intensify its asset-purchase program (quantitative easing) and extend its scope to government bonds. This seems likely to weaken the euro even further, aiding exporters, and also ease access to finance for firms.

The combined impact of a nascent domestic recovery, cheaper energy and QE should allow Eurozone GDP growth to accelerate to 1.5% in 2015. Thanks to the momentum generated by these positive factors through 2015, we have also raised our forecast for growth in 2016 to 1.8% (the highest since the post-Lehman Brothers rebound in 2010). But the medium-term outlook remains constrained by a number of structural problems, meaning that growth is expected to remain around 1.6% a year in 2017–19. Meanwhile, difficult negotiations over Greek debt will present a risk to financial stability for some time yet.

Figure 1
GDP growth



Source: Oxford Economics.

Table 1

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

	2014	2015	2016	2017	2018	2019
GDP	0.9	1.5	1.8	1.7	1.6	1.6
Private consumption	0.9	1.6	1.6	1.4	1.4	1.4
Fixed investment	0.6	0.5	2.8	2.9	2.7	2.5
Stockbuilding (% of GDP)	-0.3	0.0	0.0	0.1	0.2	0.3
Government consumption	0.8	0.2	0.5	0.6	0.8	1.0
Exports of goods and services	3.7	4.0	4.5	4.1	3.7	3.5
Imports of goods and services	3.5	3.7	4.5	4.3	4.0	3.7
Consumer prices	0.4	-0.2	1.1	1.4	1.6	1.7
Unemployment rate (level)	11.6	11.2	10.7	10.3	9.9	9.5
Current account balance (% of GDP)	2.4	3.0	2.7	2.5	2.5	2.4
Government budget (% of GDP)	-2.6	-2.1	-1.7	-1.4	-1.1	-0.9
Government debt (% of GDP)	96.0	97.6	97.9	97.6	96.9	95.6
ECB main refinancing rate (%)	0.1	0.1	0.1	0.1	0.1	0.3
Euro effective exchange rate (1995 = 100)*	123.6	108.6	104.7	105.4	106.6	108.0
Exchange rate (US$ per €)	1.33	1.07	1.01	1.01	1.02	1.04

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

Source: Oxford Economics.

Cheap oil and supportive policy to drive the recovery

Energy windfall fuels domestic healing

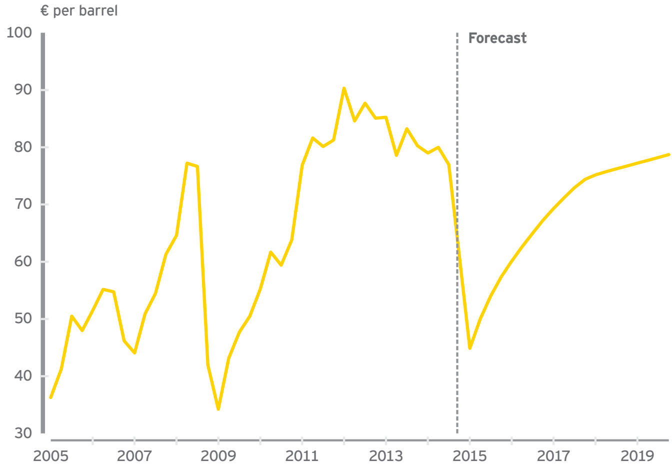
As we have discussed in previous editions of our forecast, the Eurozone has been undergoing a gradual process of domestic healing for much of the last 18 months. From Q2 2013, the Eurozone has expanded for seven straight quarters, albeit at a sometimes tepid and often uneven rate. Initially driven by net exports, the recovery became more balanced in mid-2014 as consumer spending picked up in response to stabilizing labor markets and easing fears of a Eurozone breakup.

This positive domestic dynamic is now receiving a timely boost from a hitherto unexpected source — much lower global oil prices (and hence domestic energy bills). We expect oil prices to average US$55 a barrel in 2015 (see box on p.20) compared with an average of about US$100 a barrel in 2014.

Even allowing for a depreciating euro, this will mean euro-denominated oil prices are around 40% lower than last year. Empirical evidence suggests that falls in the euro cost of oil feed through into Eurozone domestic energy and fuel bills with an elasticity of around one-third, meaning that households should see a 10%–15% reduction in their bills. Since energy and fuels account for around 10% of the Eurozone consumer basket, this will increase real incomes by 1%–1.5% from 2014. This will allow households to accelerate spending at the same time as partly rebuilding their savings. At 1.6% in 2015, we expect consumer spending growth to be the strongest since 2007.

Figure 2

Oil prices



Source: Oxford Economics; Haver Analytics.

Table 2

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

	2014	2015	2016	2017	2018	2019
Manufacturing	0.9	1.6	2.4	2.0	1.8	1.6
Agriculture	3.6	1.3	1.5	1.5	1.3	1.1
Construction	-0.8	0.6	1.3	1.3	1.5	1.7
Utilities	-1.9	1.5	1.9	1.7	1.5	1.4
Trade	1.3	1.7	1.9	1.9	1.7	1.7
Financial and business services	0.9	1.7	2.0	1.8	1.7	1.7
Communications	1.3	3.4	3.4	3.1	3.0	2.9
Non-market services	0.6	0.5	0.7	0.8	0.8	0.9

Source: Oxford Economics.

Quantitative easing and sovereign debt

The ECB's decision in January to purchase sovereign debt brought to a head a prolonged and increasingly public debate over such a move. Two developments over the last few months of 2014 were key factors in swaying the decision.

First, the sharp fall in the oil price has substantially lowered likely inflation in the Eurozone in 2015–16 compared with a few months ago. Greater monetary stimulus was therefore needed. As such, the ECB decided a faster and larger expansion of its balance sheet than originally envisaged was required (we estimate the ECB's balance sheet will now reach around €3.4t by September 2016, as opposed to around €3t by the end of 2016).

Second, the ECB's success in restoring confidence in the banking sector via the asset quality review (AQR) and stress tests has helped improve banks' access to wholesale funding. In turn, this has meant lower demand for the long-term loans the ECB is offering, and a greater reliance on asset purchases. With a greater target for balance sheet expansion, and a greater proportion to be filled by asset purchases, it became necessary to broaden the pool of eligible assets that the ECB could hold.

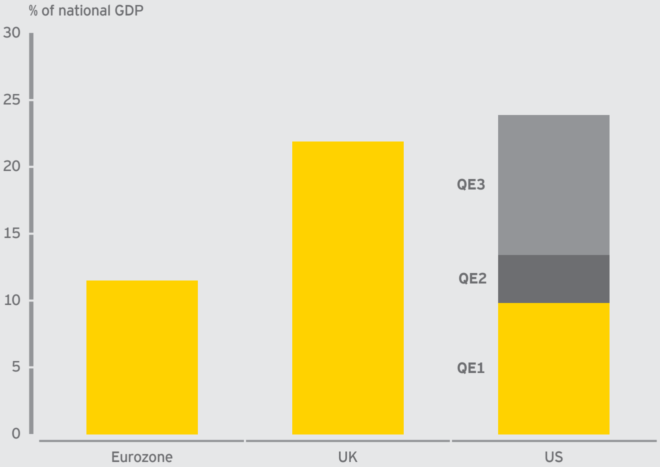
The ECB therefore decided to buy sovereign bonds as part of a €60b-a-month asset purchase program that would last until there was a "significant adjustment" in the path for inflation, and at least until September 2016. We estimate that public debt will account for as much as €50b of this. The announcement has had a substantial impact on confidence in the durability of the Eurozone recovery. But if it is unlikely to work via the same channels as QE in the past, how do we expect it to aid the Eurozone recovery?

The first answer is practical. Although interest rates might not fall much further, the ECB is nevertheless injecting a larger quantity of cash into the Eurozone financial system, and more quickly than anticipated. In itself, this should further weaken the euro, but the effect may be amplified by the fact that the US Federal Reserve is expected to tighten monetary policy over the coming year or two. So although the QE program is smaller relative to GDP (around 11% of Eurozone GDP) than in other economies, the ECB is "leaning with the wind". The euro fell three cents against the US dollar on the day of the announcement, and we expect a further fall to near-parity by the end of 2015.

The second answer is psychological. By purchasing government bonds, the ECB will make credible its (hitherto untested) pledge to do "whatever it takes" to save the euro. It is common knowledge that there is opposition to sovereign bond purchases at the highest level in some Eurozone governments, but the fact the ECB is moving ahead demonstrates it has full operational command of monetary policy, and that it has the determination to take necessary measures. This will underpin wider investor and business confidence in the Eurozone's durability.

Figure 3

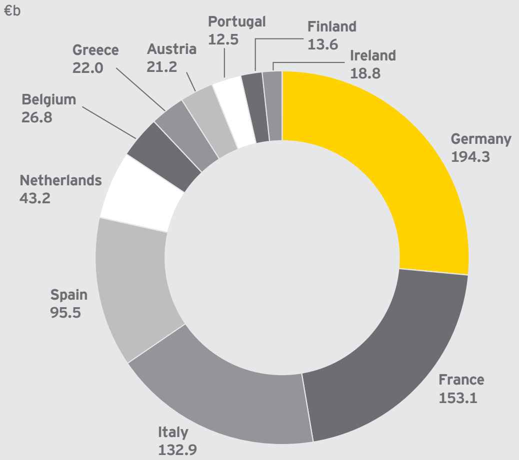
World: Quantitative easing programs



Source: Oxford Economics; Haver Analytics.

Figure 4

ECB sovereign bond purchases by country



Source: Oxford Economics; Haver Analytics.

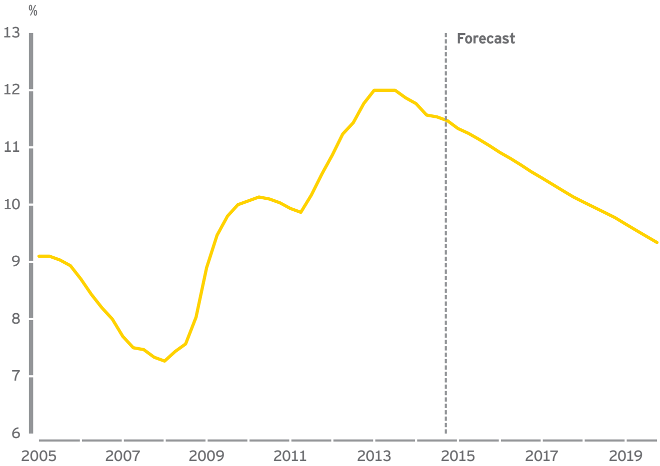
Cheap oil and supportive policy to drive the recovery

Spare labor supply will limit the consumer rebound

On a less positive note, barring a faster-than-expected recovery in other sectors of the economy, 2015 may mark the high point for consumer spending growth. As the one-off impact of lower oil prices eases, wages will become the chief fuel for consumer spending growth. But with unemployment still at near-record levels — 11.5% of the workforce in January 2015 — there will be limited upward pressure on nominal wages for some years to come. As such, we expect consumer spending growth to remain at 1.6% in 2016, and then ease to 1.4% a year in 2017–19.

Figure 5

Unemployment



Source: Oxford Economics; Haver Analytics.

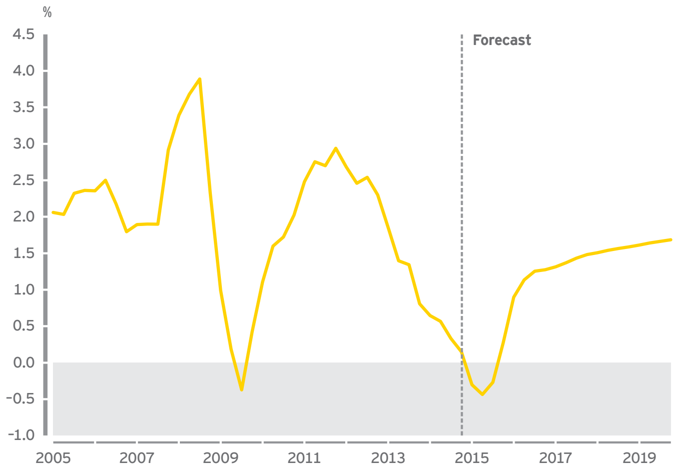
Deflation fears provoke ECB action, aiding exporters

The downside to lower oil prices has been a further slide in headline inflation, from an already tepid 0.4% in October to –0.6% in January, and the intensification of fears about a prolonged spell of falling prices in the Eurozone. We felt this was relatively unlikely even before the ECB's recent policy action. After all, core inflation (excluding energy and seasonal food) has been relatively stable in recent months, albeit at 0.7%–0.8%, less than half the ECB's target, and this too slipped a little in January. In addition, a boost to consumers' discretionary income should support pricing power in consumer-facing sectors.

However, in light of the risk that inflation expectations became more detached from its "below, but close to, 2%" target, the ECB responded by announcing a major increase in the size and change in the scope of its asset purchases (see box on p.17). Although this move was widely anticipated, there have since been important reactions in financial markets that we think will aid the recovery in the next couple of years. Through these impacts, we expect inflation in the Eurozone to pick up from –0.2% in 2015 to 1.1% in 2016, and then to 1.7% by 2019.

Figure 6

CPI inflation

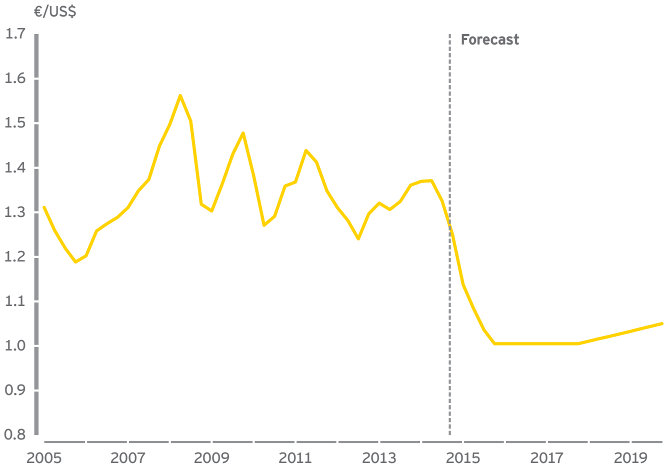


Source: Oxford Economics; Haver Analytics.

The exchange rate is one of the two main channels through which we expect QE to affect the Eurozone recovery. By purchasing government bonds and other euro-denominated fixed income assets, the ECB will increase the gap between yields on these assets and their dollar or sterling equivalents. All other things being equal, this should weaken the euro from US$1.14 on average in February (already down from almost US$1.40 in May 2014) to just over US$1 by the end of 2015 in our forecast. This will offer exporters across the Eurozone a substantial boost to competitiveness in global markets.

Figure 7

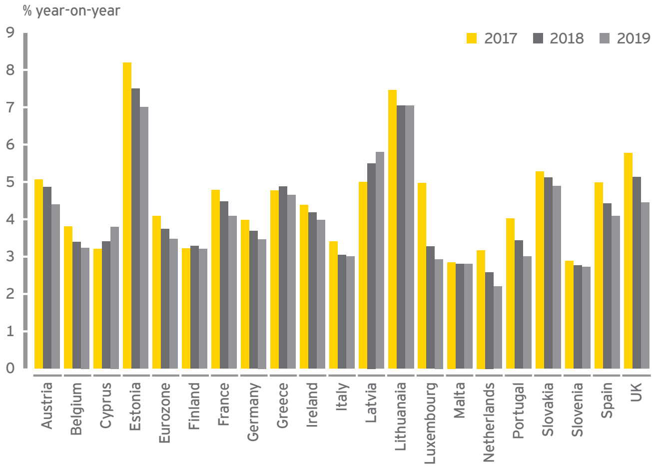
€/US$ exchange rate



Source: Oxford Economics.

Figure 8

Average export growth



Source: Oxford Economics; Haver Analytics.

Exporters will also enjoy a boost from lower oil and gas prices, particularly in the industrial sector, where Eurozone firms have increasingly had to compete with US firms, which are benefiting from much lower energy costs thanks to the rapid expansion in shale oil and gas. Alongside this, we expect stronger consumer spending and import growth in major advanced economy trading partners (see box on p.20). As such, we now expect Eurozone exports to grow by 4% in 2015 and 4.5% in 2016.

However, in spite of relatively favorable trading conditions in the next couple of years, internal and external factors will limit the pace of medium-term export growth. We forecast that exports will grow by 3.8% a year in 2017–19, compared with 6% a year in the decade to 2007. This is partly due to weaker longer-term growth in emerging markets, but also due to eroded competitiveness in some of the Eurozone's largest economies.

Positive domestic and external factors support investment

The improvement in the outlook for 2015–16, along with the range of ECB measures past and present, is set to trigger a rebound in capital spending in the next couple of years. January's ECB bank lending survey found that banks were anticipating an increase in loan demand for capital expenditure. The latest data on money supply suggests that increased demand for loans has not actually been felt by banks. But, with survey measures of business sentiment in line with the long-term average for most of the past six months, conditions seem right for increased investment over the coming quarters.

Cheap oil and supportive policy to drive the recovery

World economic forecast assumptions

The most notable development in the global economy since our December forecast has been the continued slide in oil prices, which averaged US$79 a barrel in November, US$63 in December and have recently been trading at a little above US$50. Our forecast now shows oil prices averaging US$55 a barrel in 2015, a fall of 45% from 2014, before edging higher in 2016. Of course, there are winners and losers in the global economy from this development, and oil-producing countries that have done least to save the gains of higher prices in the past are facing difficult times ahead. This is especially true for Russia, Venezuela and Iran.

Nevertheless, on balance, the fall in oil prices is a net positive for the global economy. Many major oil producers have indeed run more cautious fiscal policies than in previous oil price upswings, allowing them to avoid sharp cuts in expenditure in response to lower prices. Meanwhile, in net oil importers, which include the US, Japan, the EU and emerging Asia — together accounting for around 75% of world GDP — the effect is equivalent to a tax cut for consumers and lower costs for firms. We have therefore nudged up our expectation for growth in 2015 in the US, from 3% in our December forecast to 3.1%, and revisions of a similar magnitude have been made for the UK, China and Japan. Overall, we expect the world economy to grow by 2.8% in 2015.

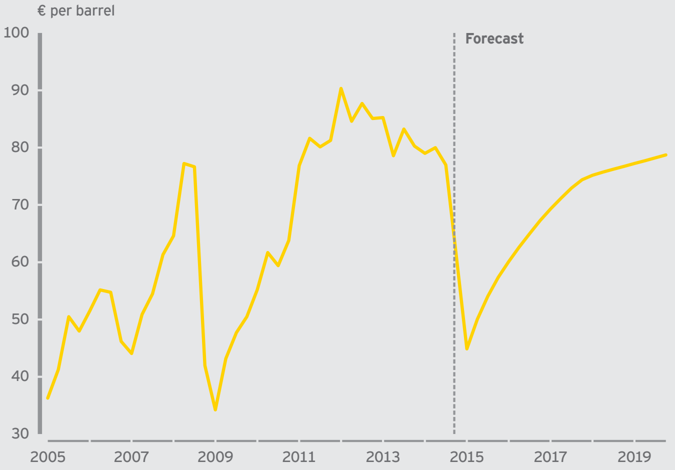
GDP growth in the US should remain close to 3% from 2016 onwards, with investment increasingly the key driver of growth, and a very gradual worsening of the current account as imports react to stronger consumer spending. The Federal Reserve seems likely to start raising interest rates in 2015, but as part of a very gradual tightening in light of an extremely flexible labor force. In the UK, the Eurozone's largest export market, GDP growth will be slightly slower, but still average 2.5%–3% in the coming few years, again with an ongoing recovery in business investment. Import growth, seen averaging over 5% in the UK in 2016–19, bodes especially well for Eurozone firms.

The outlook in emerging markets is a little different. In China, the authorities have shifted their focus from headline output growth toward employment targets, and in particular labor-intensive services sectors. Since output per worker tends to be lower in these sectors, the swing in China's economy toward the service sector and domestic demand will slow GDP. According to the latest IMF update*, China's economy is expected to grow 6.8% in 2015. Part of the slowdown will be offset by faster growth in India, as reforms bear fruit there, but overall emerging Asia seems set for slightly slower growth.

External risks also remain for the Eurozone recovery. The uppermost concern is the conflict in Ukraine, which will be a concern for some time to come. In light of lower oil prices, the impact of an interruption to energy supplies would be more modest than it might have been in the past (in any case, this seems less likely due to the deep recession now expected in Russia). Nevertheless, wider security and geopolitical risks might weigh on confidence and the investment recovery in Europe. Finally, while euro depreciation is a positive for exporters, the depreciation of the Japanese yen in recent months means there is an increased competitive threat from the east, particularly for German capital goods manufacturers and their suppliers around Europe.

Figure 9

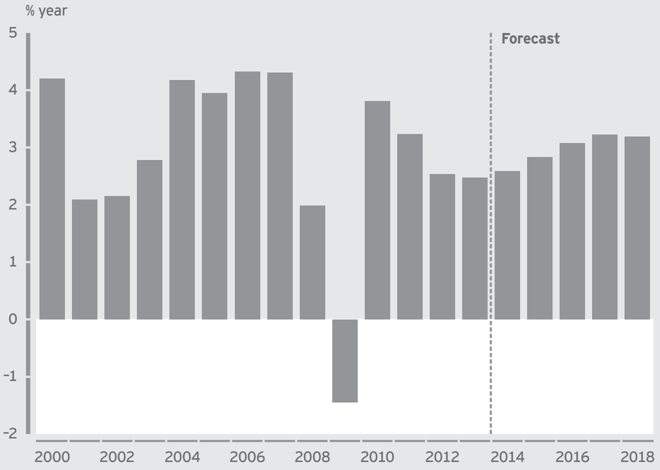
Oil prices



Source: Oxford Economics; Haver Analytics.

Figure 10

World: GDP Growth



Source: Oxford Economics; Haver Analytics.

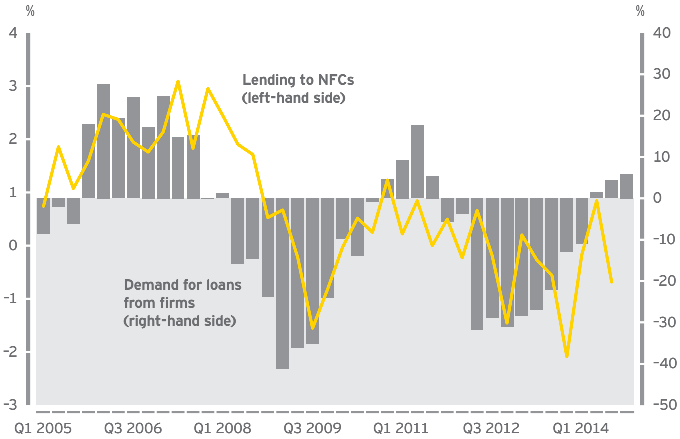
*IMF World Economic Outlook (WEO) Update — Cross Currents, January 2015 www.imf.org/external/pubs/ft/weo/2015/update/01/, accessed 09 March 2015

Meanwhile, banks are also reporting ever-improving access to wholesale funding markets, and lending rates across asset classes should be further compressed over the coming couple of years by the ECB's asset purchases. As such, rising demand for loans should be complemented by low lending rates, strengthening the recovery in investment.

We expect the rate of business investment growth to pick up gradually through 2015, growing by some 2% in the year to Q4 2015 and then about 3% for 2016 overall. In the medium term, however, business investment will pick up only a little further, reflecting the constraints on both domestic and external demand growth. Nevertheless, in combination with a nascent recovery in housing markets, and tentative increases in government investment, overall fixed capital spending growth should pick up from an expected 0.5% this year to 2.8% in 2016 and around 2.7% a year in 2017-19.

Figure 11

Lending to non-financial corporations (NFCs) and demand for loans from firms



Source: Oxford Economics; Haver Analytics.

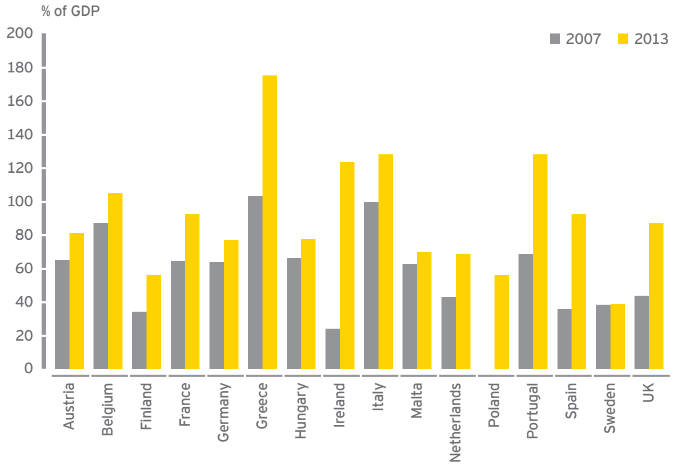
Fiscal constraints will ease, but only slowly

Meanwhile, governments should find that recovering tax revenues contribute more toward deficit reduction from 2015 onwards than in recent years. With less of the burden for consolidation coming from spending cuts, Eurozone government consumption should grow by 0.2% in 2015 (weighed down from 2014 by the French Government's relatively belated austerity measures). But after this, consumption should pick up to 0.5% in 2016 and 0.8% a year in 2017–19.

This is of course extremely modest by historical standards, reflecting the need to get government debt ratios on a declining path. That said, lower borrowing costs, as a result of both lower inflation and the ECB's bond purchases, might offer some relief in the form of lower debt interest payments. In turn, this could offer modest room for fiscal easing – in particular in government investment, where long-term economic benefits might make such spending self-financing.

Figure 12

Government debt



Source: Oxford Economics; Haver Analytics.

Cheap oil and supportive policy to drive the recovery

Temporary boost to growth should not postpone reforms

However, one possible downside from stronger Eurozone growth over the next couple of years is the temptation to postpone important structural reforms that might have short-term costs, but more substantial long-term benefits. Priorities vary by country, but in general these include labor market reforms, amendments to tax and benefits arrangements and entitlements, and regulation of product markets. An ongoing reform effort remains crucial, not only in the periphery but also in countries where the financial crisis has had less severe impacts, allowing structural weaknesses to remain untackled. Countries such as France and Belgium need to do more to address lost competitiveness and the future risks to debt sustainability from aging. At the European level, an ambitious set of trade agreements with the US and emerging markets could provide an additional spur to growth.

It would be a great pity if the boosts to near-term growth from lower oil prices and the ECB's QE program obscure the payoff from the reform efforts that countries have made. Where reforms have been implemented most ambitiously, particularly in Ireland, Portugal and Spain, export competitiveness has improved fastest and these countries have also become increasingly attractive to inward foreign investment, and their labor markets are recovering robustly.

Governments need to take advantage of this period of improving economic conditions to cushion any short-term impacts from reforms, so that their long-term payoffs can be realized. Recent progress in Italy, as well as a reiteration of the commitment to reform in France, are encouraging in this respect. Moreover, stronger progress in pursuing growth-enhancing structural reforms might ease longer-term fears over fiscal sustainability, allowing more significant easing of the fiscal effort in the medium term.

Commitment to the Eurozone should not waver

More generally, as the Eurozone recovery gets under way, it should be more feasible to strengthen the consensus over the benefits of currency union across member states. However, negotiations over Greece's debt burden provide an obvious flashpoint for confrontation in 2015. It will be important for all parties to be willing to compromise in order to achieve an outcome that provides a sustainable future for Greece and a sense of fairness for the rest of the Eurozone. A Greek exit from the Eurozone would have devastating impacts on the prosperity of Greek citizens and on stability in the rest of the currency union.

Forecast for Eurozone countries

Austria

Belgium

Cyprus

Estonia

Finland

France

Germany

Greece

Ireland

Italy

Latvia

Lithuania

Luxembourg

Malta

Netherlands

Portugal

Slovakia

Slovenia

Spain

19 Eurozone countries

Please visit our Eurozone website for access to additional information on the *EY Eurozone Forecast*, the 19 individual country forecasts and additional perspectives. The site contains the latest version of our reports and gives you the opportunity to compare data from across the Eurozone member states.

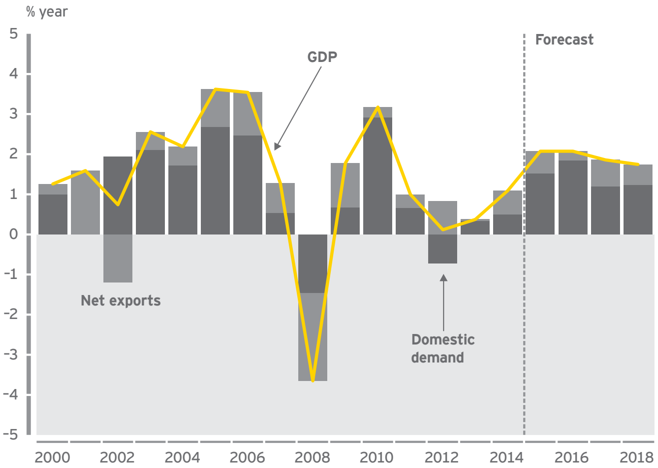
To find out more please visit **ey.com/eurozone.**

Austria

- Despite strong fundamentals, Austria's economy expanded by just 0.4% in 2014 and growth is seen at 1.1% this year. As such, it will lose further ground compared with the Eurozone as a whole, due mainly to weak external demand. But as external demand for investment goods rises more strongly, growth will pick up to rates above the Eurozone average from 2016.
- Household spending will remain solid, underpinned by the boost from lower inflation following the oil price plunge. But a moderate deterioration of the labor market, along with the need to restore savings that were drawn down in the post-crisis years, will partially offset this.
- The bulk of state aid to some struggling banks has now been absorbed, and the deficit is expected to drop to 1.8% of GDP in 2015 from 2.8% in 2014. But the Government's aim to balance the budget by the end of 2016 will probably be missed.

Figure 13

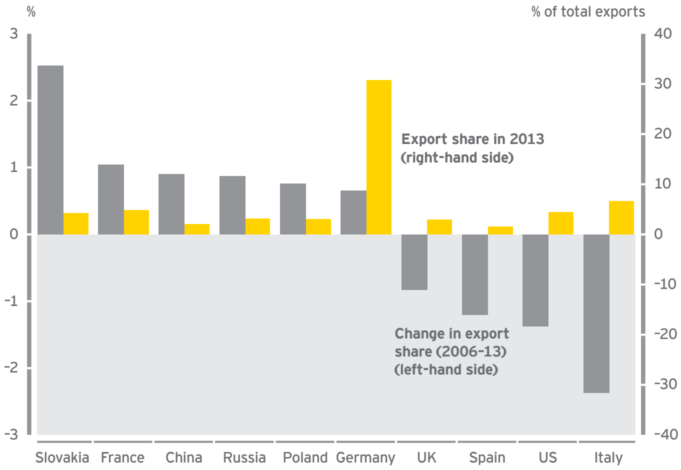
Contributions to GDP



Source: Oxford Economics.

Figure 14

Changes in export shares



Source: Oxford Economics; Haver Analytics.

Austria (annual percentage changes unless specified)

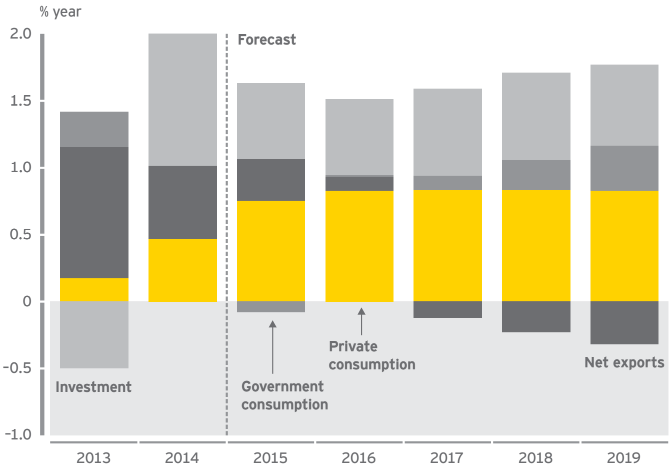
	2014	2015	2016	2017	2018	2019
GDP	0.4	1.1	2.1	2.1	1.9	1.7
Private consumption	0.2	1.0	1.5	1.4	1.4	1.4
Fixed investment	0.5	0.1	3.2	2.4	1.6	1.4
Stockbuilding (% of GDP)	1.4	1.0	0.8	1.0	0.9	0.8
Government consumption	0.5	1.3	1.5	1.4	1.5	1.5
Exports of goods and services	1.0	2.2	5.9	5.1	4.9	4.4
Imports of goods and services	1.0	1.2	5.3	5.2	4.1	4.0
Consumer prices	1.5	0.6	1.6	1.9	1.8	1.8
Unemployment rate (level)	5.0	5.1	5.1	5.0	4.8	4.6
Current account balance (% of GDP)	1.0	2.3	2.4	2.5	2.6	2.6
Government budget (% of GDP)	-2.8	-1.8	-0.8	-0.6	-0.6	-0.6
Government debt (% of GDP)	82.9	82.4	80.1	77.8	75.6	73.6

Source: Oxford Economics.

Belgium

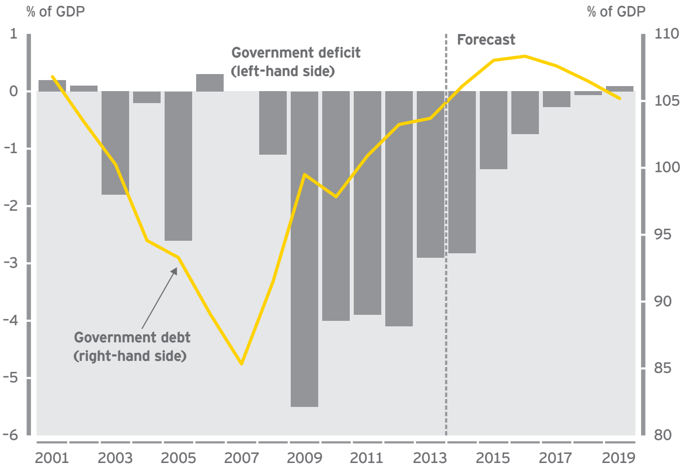
- After a surprisingly weak end to 2014, we expect Belgium's economy to recover a little in 2015, as consumers benefit from lower oil prices and exporters from the weaker euro.
- We forecast GDP growth will pick up from 1% in 2014 to 1.2% this year and then 1.6% in 2016.
- Nevertheless, with eroded export competitiveness and high government debt undermining medium-term prospects, we expect GDP to expand by only about 1.8% a year in 2017–19. This will slow the pace of decline in Belgium's debt-to-GDP ratio, which, at 108%, is one of the highest in the Eurozone.
- Belgium's fiscal challenges will become more acute in the future, as the estimated costs of aging are also among the highest (relative to GDP) in the Eurozone. Prospects could be made substantially brighter by a reinvigorated reform effort, in particular in the labor market.

Figure 15
Contributions to GDP growth



Source: Oxford Economics.

Figure 16
Government deficit and debt



Source: Oxford Economics.

Belgium (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	1.0	1.2	1.6	1.9	1.8	1.8
Private consumption	0.9	1.5	1.6	1.6	1.6	1.6
Fixed investment	5.4	2.4	2.4	2.7	2.7	2.5
Stockbuilding (% of GDP)	-1.2	-1.5	-1.4	-1.0	-0.6	-0.3
Government consumption	0.0	-0.3	0.0	0.5	1.0	1.5
Exports of goods and services	4.0	3.7	3.9	3.8	3.4	3.2
Imports of goods and services	3.4	3.4	3.9	4.0	3.7	3.6
Consumer prices	0.5	-0.3	2.0	1.9	1.8	1.9
Unemployment rate (level)	8.5	8.5	8.1	7.7	7.6	7.5
Current account balance (% of GDP)	0.4	1.4	0.9	0.4	0.3	0.2
Government budget (% of GDP)	-2.8	-1.4	-0.7	-0.3	-0.1	0.1
Government debt (% of GDP)	108.0	109.6	109.6	108.7	107.4	106.0

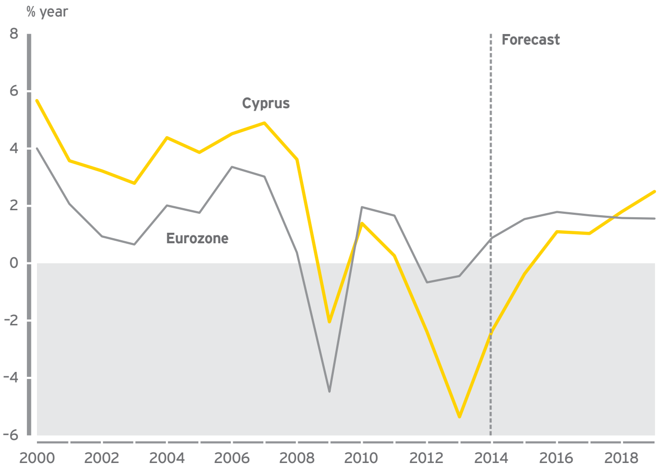
Source: Oxford Economics.

Cyprus

- The deep recession now expected in Russia will weigh heavily on tourism and banking in Cyprus this year. As a result, we expect GDP to contract for a fourth successive year in 2015, by 0.4%, after a 2.4% decline in 2014.
- While the plunge in oil prices will bring some benefits for consumers, deflation at the end of 2014 reflects the ongoing constraint on consumer spending from the high unemployment rate (over 16%), and could hold back investment recovery. In addition, the conditions of Cyprus's 2013 bailout require continued tight fiscal policy in 2015–16.
- Assuming that the current headwinds fade, the outlook is for a slow pickup in growth in the coming years. We expect a return to growth in 2016, at 1.1%, and then a pickup to 2.5% by 2019, helped by gradual strengthening in the Eurozone economy and recovery in Russia.

Figure 17

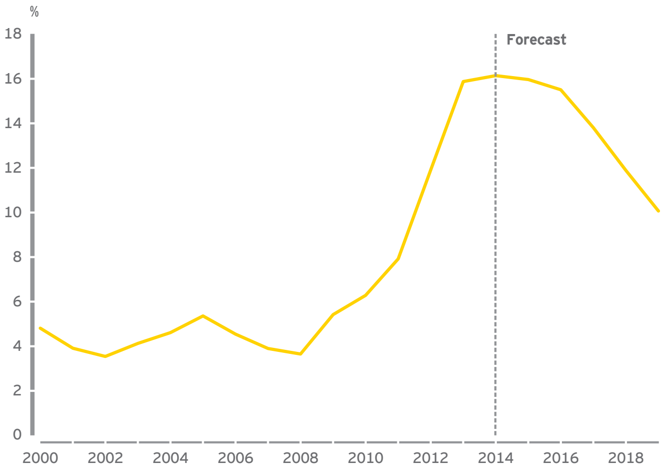
Real GDP growth



Source: Oxford Economics.

Figure 18

Unemployment rate



Source: Oxford Economics.

Cyprus (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	-2.4	-0.4	1.1	1.0	1.8	2.5
Private consumption	0.1	0.1	0.6	1.1	1.6	1.9
Fixed investment	5.9	1.0	4.5	5.3	6.9	7.5
Stockbuilding (% of GDP)	0.6	1.5	1.1	0.8	0.7	0.6
Government consumption	-7.7	-1.1	-2.0	0.9	1.0	1.8
Exports of goods and services	-1.1	-2.3	2.5	3.2	3.4	3.8
Imports of goods and services	6.6	0.2	1.1	3.9	4.2	4.3
Consumer prices	-0.3	0.4	1.5	1.7	2.0	2.0
Unemployment rate (level)	16.1	16.0	15.5	13.8	11.9	10.1
Current account balance (% of GDP)	-0.5	-0.5	-0.3	-0.3	-0.5	-0.6
Government budget (% of GDP)	-3.0	-2.9	-2.4	-2.2	-2.1	-1.2
Government debt (% of GDP)	108.0	110.9	110.5	109.7	107.7	104.1

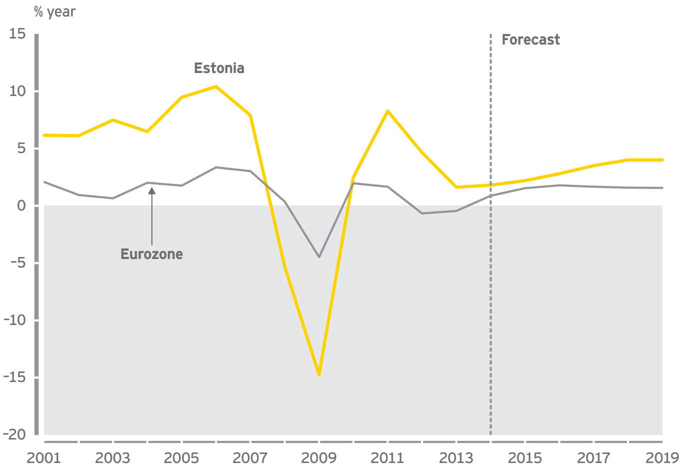
Source: Oxford Economics.

Estonia

- The Estonian economy expanded by 2.6% year-on-year in Q4 2014, yielding full-year growth of 1.8%. Our forecast for 2015 has been lowered to 2.2% from the 2.7% seen in December, as the economy is held back by weaker exports (as a result of the deep recession now expected in Russia), before a pickup to 2.8% in 2016.
- The fundamentals supporting consumer spending are strong. Real wages are rising rapidly and unemployment has fallen significantly compared with last year. Because of this, consumption is expected to grow by 3.7% in 2015 and 3.9% in 2016.
- The near-term outlook for investment remains weak, due to uncertainties surrounding exports and excess capacity. But the healthy banking system and the ECB's expansionary monetary policy should support investment further ahead.

Figure 19

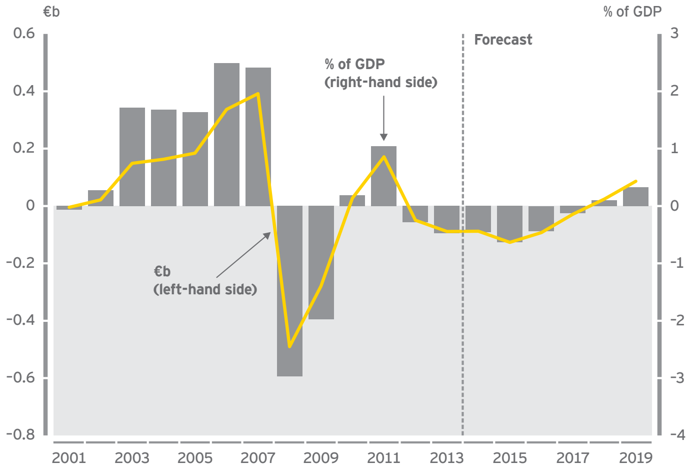
Real GDP growth



Source: Oxford Economics.

Figure 20

Government budget balance



Source: Oxford Economics.

Estonia (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	1.8	2.2	2.8	3.5	4.0	4.0
Private consumption	3.4	3.7	3.9	4.1	4.1	4.1
Fixed investment	1.9	2.2	4.5	5.3	4.9	4.9
Stockbuilding (% of GDP)	0.8	1.0	0.2	0.0	0.2	0.4
Government consumption	1.4	1.7	1.5	2.3	2.7	2.6
Exports of goods and services	1.7	3.5	7.1	8.2	7.5	7.0
Imports of goods and services	2.1	4.5	7.1	8.6	7.8	7.2
Consumer prices	0.5	2.2	3.1	3.2	3.0	3.0
Unemployment rate (level)	7.4	6.4	5.4	5.3	5.3	5.4
Current account balance (% of GDP)	-1.7	-2.1	-1.6	-1.3	-1.1	-0.7
Government budget (% of GDP)	-0.5	-0.6	-0.4	-0.1	0.1	0.3
Government debt (% of GDP)	10.4	10.6	10.5	9.9	9.2	8.2

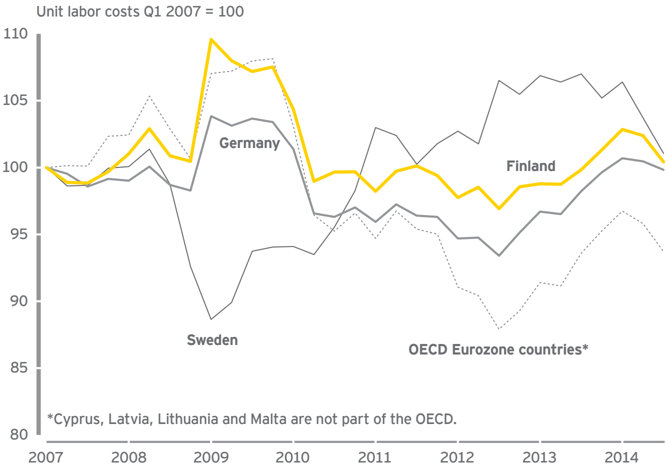
Source: Oxford Economics.

Finland

- Finland faces a lengthy period of industrial restructuring. After a 0.1% contraction in 2014, we expect only a very gradual recovery over the next few years. We forecast growth of just 0.3% in 2015 and 1.2% in 2016, with a pickup to 2.2% by 2019.
- Exporters will struggle to take advantage of the projected recovery in global demand. We forecast export growth of just 0.9% in 2015, before it rises gradually to about 3.2% in 2018-19. Sustained medium-term growth will depend on the development of new sectors to meet changing global demand and the restoration of cost competitiveness.
- The necessary restructuring of domestic industry will require significant private sector investment, but capital expenditure is restricted by weak demand and the uncertain outlook. We expect a further contraction in total investment of 0.7% in 2015, but rises of 1.9% in 2016 and then 2.3% a year in 2017-19.

Figure 21

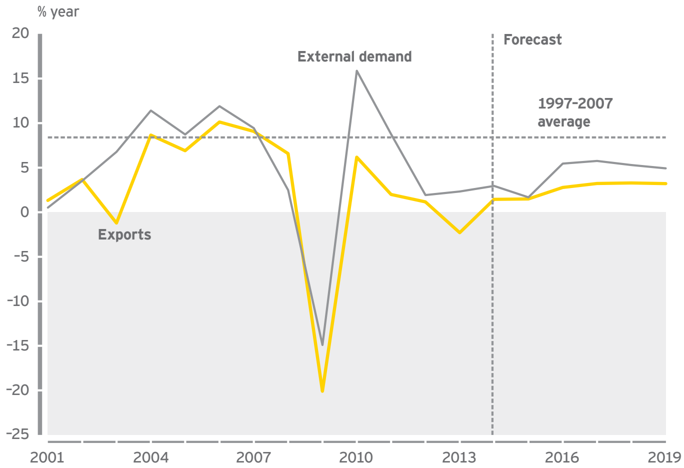
International competitiveness



Source: Oxford Economics; Haver Analytics.

Figure 22

Exports and external demand



Source: Oxford Economics.

Finland (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	-0.1	0.3	1.2	1.7	2.0	2.2
Private consumption	0.0	0.3	1.0	1.6	1.8	2.0
Fixed investment	-4.6	-0.7	1.9	2.3	2.3	2.3
Stockbuilding (% of GDP)	0.1	0.0	-0.1	-0.2	-0.1	0.1
Government consumption	-0.3	0.7	0.9	1.4	1.4	1.5
Exports of goods and services	1.4	0.9	2.8	3.2	3.3	3.2
Imports of goods and services	-0.4	0.4	2.4	2.9	3.2	3.2
Consumer prices	1.2	0.1	1.0	1.1	1.3	1.6
Unemployment rate (level)	8.7	8.8	8.6	8.0	7.5	7.1
Current account balance (% of GDP)	-1.1	-1.0	-0.3	-0.2	0.1	0.2
Government budget (% of GDP)	-2.8	-2.1	-1.2	-0.6	-0.2	0.0
Government debt (% of GDP)	58.9	60.0	59.4	57.8	55.7	53.5

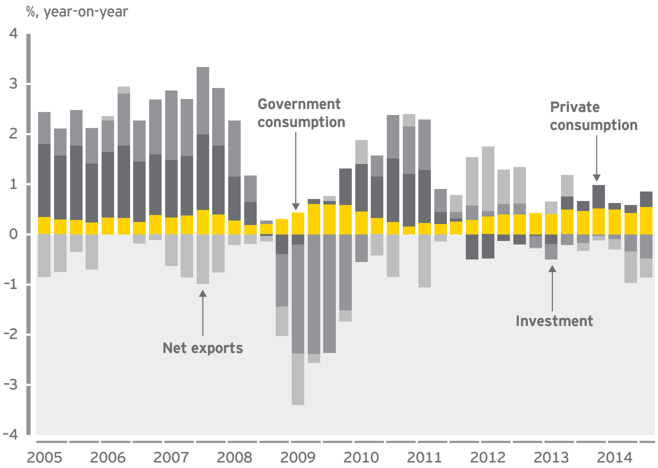
Source: Oxford Economics.

France

- Although the French economy stuttered at the end of last year, we expect GDP growth to gain momentum gradually, rising to 1.2% this year and 1.7% in 2016. The growth gap with Eurozone peers will therefore narrow gradually in the period ahead.
- Household spending is set to be the main pillar of the recovery, sustained by low inflation and sharply lower oil prices.
- Meanwhile, business investment will remain sluggish in 2015, as companies are likely to rebuild profit margins that are at historical lows. Overall, investment is expected to fall 0.2% this year, before rising 2.1% in 2016.
- Upside risks to our forecasts are related to better financing conditions and the weaker euro translating into higher business investment and employment. Downside risks pertain to the possible postponement of structural reforms due to the improving economic environment.

Figure 23

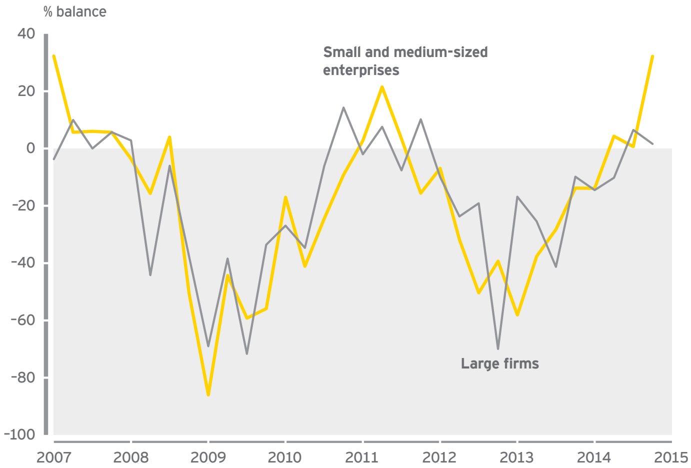
Contribution to GDP



Source: Oxford Economics; Haver Analytics.

Figure 24

Changes in loan demand



Source: Oxford Economics; ECB bank lending survey.

France (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	0.4	1.2	1.7	1.5	1.6	1.6
Private consumption	0.6	1.5	1.7	1.5	1.4	1.4
Fixed investment	-1.6	-0.2	2.1	2.5	2.8	2.4
Stockbuilding (% of GDP)	0.4	0.4	0.4	0.2	0.1	0.2
Government consumption	1.9	0.4	0.4	0.4	0.5	0.7
Exports of goods and services	2.7	3.4	3.9	4.8	4.5	4.1
Imports of goods and services	3.8	2.3	3.1	3.6	3.9	3.8
Consumer prices	0.6	0.3	1.0	1.4	1.6	1.7
Unemployment rate (level)	10.2	10.2	9.9	9.7	9.6	9.4
Current account balance (% of GDP)	-1.1	-0.9	-1.0	-1.0	-0.8	-0.5
Government budget (% of GDP)	-4.4	-4.3	-3.8	-3.1	-2.5	-2.3
Government debt (% of GDP)	96.6	101.8	104.9	106.4	106.5	105.7

Source: Oxford Economics.

Germany

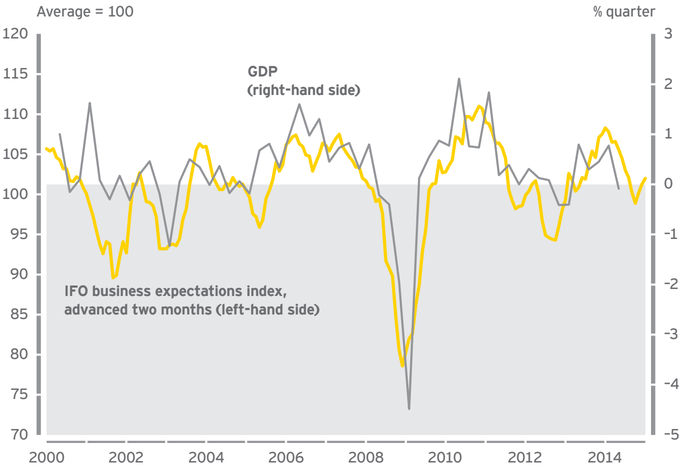
GDP growth

2015 **2.2%**

- Although Germany's recovery wobbled in mid-2014, fundamentals remain strong. We forecast GDP growth of 2.2% this year and 2% in 2016, up from 1.6% in 2014.
- Households will be a solid pillar of the recovery. We expect the strong labor market and low inflation to prompt a sustained period of healthy consumer spending growth.
- Meanwhile, we doubt that the recent soft patch for investment will be sustained. Much of the investment that was postponed due to the Russia-Ukraine conflict will eventually take place and fundamentals point to stronger growth beyond the next few quarters as well.
- In the near term, externally driven uncertainty could fade more gradually than we assume, resulting in the economy regaining momentum more slowly than forecast. But further ahead, the risks to growth are on the upside, particularly if rising participation or increased inward migration prevent bottlenecks from forming in the labor market.

Figure 25

GDP versus IFO business expectations index



Source: Oxford Economics; Haver Analytics.

Figure 26

Borrowing costs

Source: Oxford Economics; Haver Analytics.

Germany (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	1.6	2.2	2.0	1.6	1.2	1.2
Private consumption	1.2	2.5	1.7	1.3	1.3	1.2
Fixed investment	2.9	0.2	3.7	3.2	2.6	2.1
Stockbuilding (% of GDP)	-1.1	-0.4	-0.1	0.2	0.2	0.2
Government consumption	1.1	0.7	0.8	0.9	1.0	1.0
Exports of goods and services	3.9	5.3	5.0	4.0	3.7	3.5
Imports of goods and services	3.6	6.3	6.1	4.9	4.6	4.1
Consumer prices	0.8	-0.1	1.5	1.9	1.7	1.5
Unemployment rate (level)	5.0	4.9	4.9	4.7	4.6	4.5
Current account balance (% of GDP)	7.6	8.2	7.8	7.4	7.1	6.9
Government budget (% of GDP)	-0.1	0.3	0.3	0.2	0.2	0.3
Government debt (% of GDP)	76.6	76.5	76.2	76.1	76.0	75.1

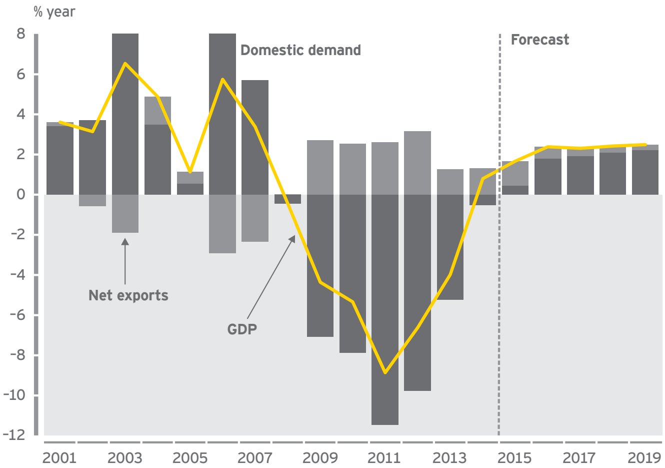
Source: Oxford Economics.

Greece

- After six years of recession, 2014 was a turning point for Greece, with the economy finally returning to growth, estimated at 0.8%. The recovery to date has largely been built on consumption and net trade.
- While recent political uncertainty and tense negotiations with the EU will have dented activity, the extension of the existing adjustment program should provide a window for a longer-term agreement. As a result, we forecast that GDP growth will pick up slowly, to 1.7% this year and 2.4% in 2016.
- In the short term, low oil prices mean continued deflation. Consumer prices fell 2.8% on the year in January. This is likely to boost real wages this year if growth in nominal earnings can be sustained.
- Improved Greek competitiveness is enabling exports to outpace imports. As a result, net trade has made a significant contribution to growth, adding 1.3 percentage points to GDP in 2014, and we expect a similar contribution in 2015.

Figure 27

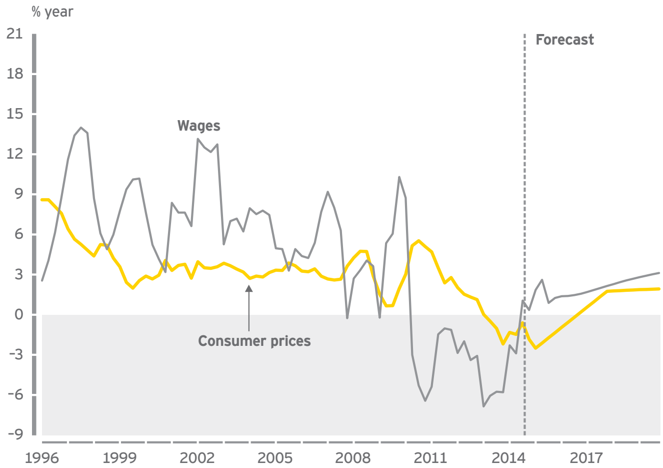
Contributions to GDP growth



Source: Oxford Economics.

Figure 28

Prices and wages



Source: Oxford Economics.

Greece (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	0.8	1.7	2.4	2.3	2.4	2.5
Private consumption	1.5	1.8	1.3	1.4	1.6	1.8
Fixed investment	-4.1	0.9	5.0	5.0	4.8	4.6
Stockbuilding (% of GDP)	-0.3	-1.0	-1.0	-1.0	-0.8	-0.6
Government consumption	-2.4	-0.8	1.6	1.8	1.6	1.7
Exports of goods and services	9.9	6.3	4.8	4.8	4.9	4.7
Imports of goods and services	4.7	2.2	3.0	3.7	4.0	4.1
Consumer prices	-1.4	-1.9	-0.4	1.2	1.8	1.9
Unemployment rate (level)	26.5	24.6	22.9	21.0	19.1	17.4
Current account balance (% of GDP)	1.3	1.4	1.4	1.4	1.3	1.3
Government budget (% of GDP)	-1.0	-1.2	-0.8	-0.7	-0.4	-0.1
Government debt (% of GDP)	171.4	172.4	168.3	162.0	155.1	148.0

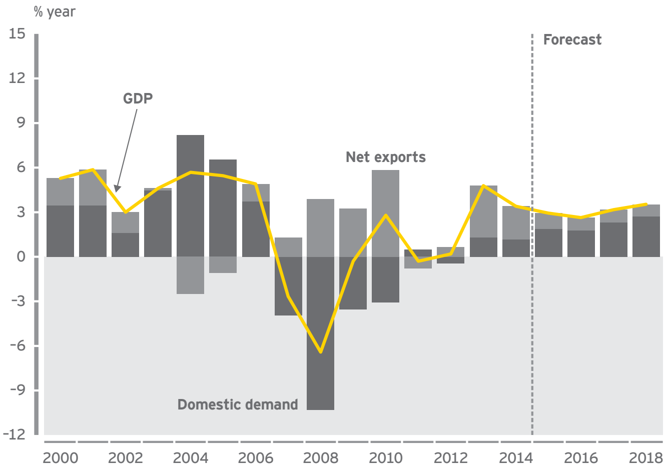
Source: Oxford Economics.

Ireland

- Statistical quirks arising from the accounting of offshore "contract manufacturing" mean that the rapid economic growth Ireland saw in 2014 (now estimated at 4.8%, the strongest in the Eurozone) may not have been as robust as the headline number implies.
- But 2015 appears to have begun with renewed momentum in the Irish economy. Unemployment has continued to fall and survey evidence points to the economy expanding at a decent pace.
- The economy should continue reap the benefits of low oil prices and a weaker euro, the latter assisted by the ECB's QE program. An unwinding of the "contract manufacturing" effect could weigh a little on growth this year, but overall the positives should prevail. We have raised our 2015 GDP growth forecast to 3.4% from 3.2% in December, with 2.9% growth expected in 2016.

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)

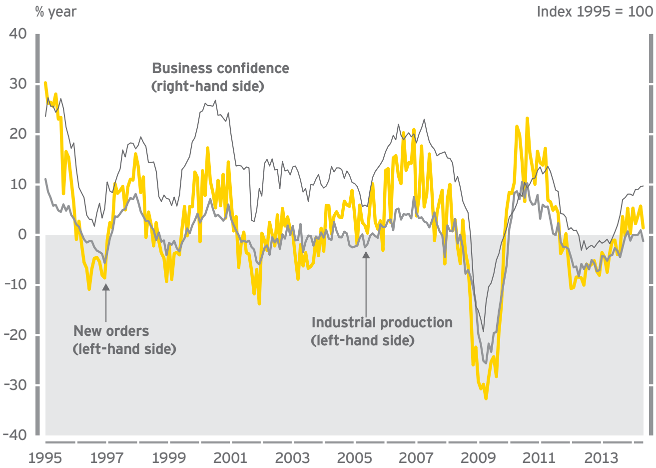
	2014	2015	2016	2017	2018	2019
GDP	4.8	3.4	2.9	2.6	3.2	3.5
Private consumption	0.6	1.2	2.8	3.0	3.0	2.9
Fixed investment	8.5	4.5	4.1	4.9	4.8	4.9
Stockbuilding (% of GDP)	0.9	1.0	1.0	0.5	0.6	1.1
Government consumption	1.0	-1.4	0.1	0.7	0.8	0.8
Exports of goods and services	12.3	5.4	4.2	4.4	4.2	4.0
Imports of goods and services	11.3	4.3	4.2	4.6	4.4	4.2
Consumer prices	0.3	1.1	1.6	1.8	1.9	2.0
Unemployment rate (level)	11.4	10.4	9.5	9.0	8.5	8.0
Current account balance (% of GDP)	5.9	5.0	3.8	3.9	3.9	3.8
Government budget (% of GDP)	-3.6	-2.0	-0.8	0.0	0.2	0.1
Government debt (% of GDP)	121.1	116.9	112.5	107.8	102.3	96.8

Source: Oxford Economics.

Italy

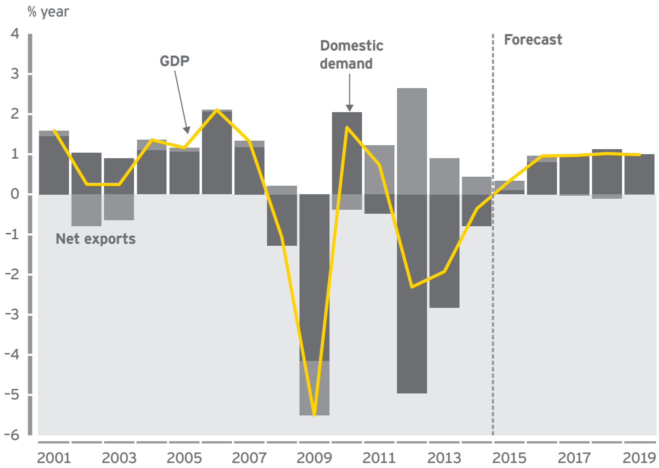
- Italy's GDP was flat in Q4 last year, marking the 14th consecutive quarter without growth. The economy contracted by 0.4% in 2014 overall.
- Sharply lower oil prices will bolster private consumption and raise net exports, helping the economy to return to growth in 2015. But the country will remain close to recession. We expect Italy to post growth of 0.3% in 2015, one of the slowest rates in the Eurozone, before a pickup to 1% in 2016.
- Consumption should improve gradually and net exports will also contribute, but investment will only start to rise in H2 2015. The Government could gain some fiscal leeway from lower government bond yields following the announcement of the ECB's QE program.
- Low oil prices mean that Italy will be in deflation for much of 2015. Inflation may rise to 0.6% in 2016, but will remain below the ECB's target until 2020.

Figure 31
Industrial performance



Source: Haver Analytics.

Figure 32
Contributions to GDP growth



Source: Oxford Economics.

Italy (annual percentage changes unless specified)

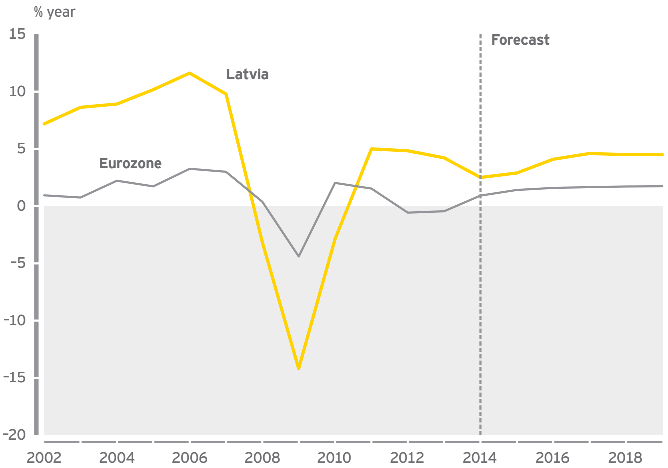
	2014	2015	2016	2017	2018	2019
GDP	-0.4	0.3	1.0	1.0	1.0	1.0
Private consumption	0.3	0.5	0.7	0.8	0.8	0.8
Fixed investment	-2.5	-1.2	1.6	2.0	2.0	2.0
Stockbuilding (% of GDP)	-0.5	-0.4	-0.3	-0.2	0.0	0.1
Government consumption	-0.3	-0.3	0.1	0.1	0.3	0.4
Exports of goods and services	1.8	2.9	4.0	3.4	3.0	3.0
Imports of goods and services	0.3	2.4	3.9	4.0	3.8	3.4
Consumer prices	0.2	-0.4	0.6	0.9	1.3	1.7
Unemployment rate (level)	12.8	12.7	12.3	12.0	11.7	11.1
Current account balance (% of GDP)	1.7	2.3	2.1	1.7	1.5	1.4
Government budget (% of GDP)	-3.0	-2.8	-2.4	-2.0	-1.8	-1.6
Government debt (% of GDP)	131.9	133.3	132.6	131.6	130.2	128.4

Source: Oxford Economics.

Latvia

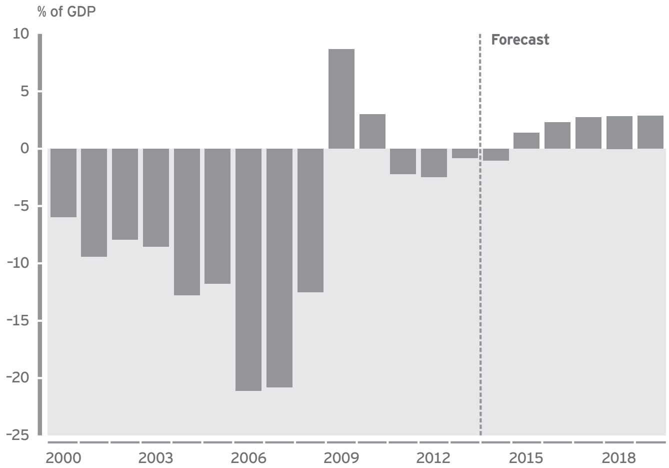
- Our growth forecast for Latvia has been lowered a little, as external events weigh on exports and investment. But GDP is still forecast to rise almost 3% this year and by 4%–4.5% a year over the medium term.
- Exports and private consumption will be the main economic drivers in 2015, reinforced by private investment from 2016.
- Inflation fell to just 0.3% in December and low oil prices are likely to lead to deflation early this year. But we forecast inflation of 0.9% in 2015 and 2.4% a year from 2016. Price and wage inflation, spurred by the absorption of spare capacity and shrinkage of the skilled workforce, could constrain growth from 2018.
- Although the fiscal deficit will persist in 2016–19 and could add to inflationary pressure, the risk is reduced by the public spending focus on investment and the current account's probable surplus this year, which also insulates against risks from volatile capital flows.

Figure 33
Real GDP growth



Source: Oxford Economics; World Bank.

Figure 34
Current account balance



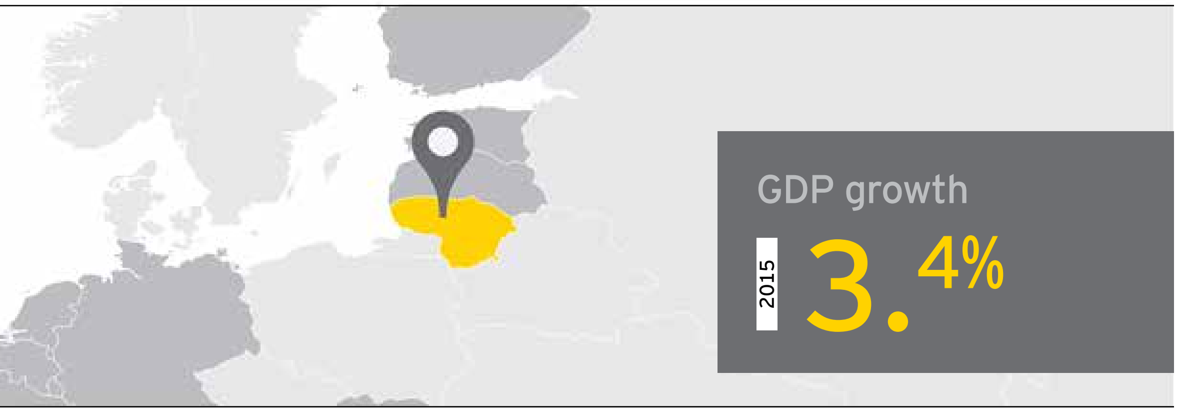
Source: Oxford Economics.

Latvia (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	2.5	2.9	4.1	4.6	4.5	4.5
Private consumption	2.5	3.6	3.4	3.7	4.2	4.4
Fixed investment	3.8	5.0	5.0	5.0	5.0	5.0
Stockbuilding (% of GDP)	1.6	0.3	0.3	0.7	0.5	0.5
Government consumption	5.2	2.6	2.7	2.5	2.4	2.3
Exports of goods and services	2.5	3.0	4.5	5.0	5.5	5.8
Imports of goods and services	1.8	2.3	3.8	4.2	4.5	5.2
Consumer prices	0.6	0.9	2.4	2.4	2.4	2.4
Unemployment rate (level)	11.0	9.7	8.2	8.0	7.8	7.7
Current account balance (% of GDP)	-1.0	1.4	2.3	2.7	2.8	2.9
Government budget (% of GDP)	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Government debt (% of GDP)	35.6	35.3	34.2	33.1	32.0	31.0

Source: Oxford Economics.

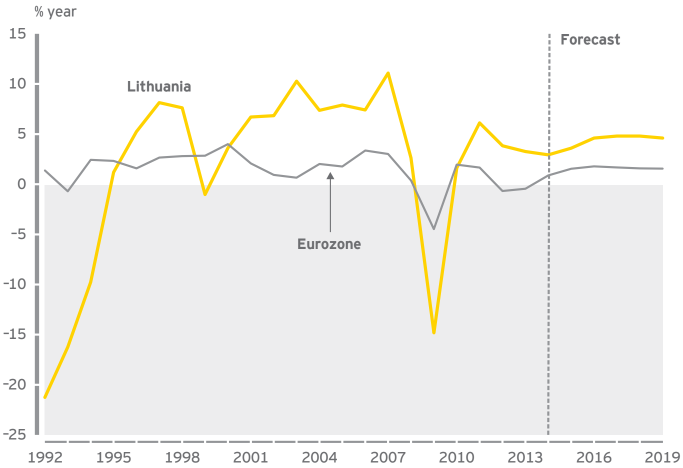
Lithuania



- Lithuania, the Eurozone's newest member, is on course for 3.4% growth in 2015, moving above the pre-crisis peak, propelled by investment and private consumption. A further pickup to about 4.7% a year is forecast for 2016-19, as exports recover and improved credit supply sustains private investment. Lower energy costs will limit the return to external deficit, despite faster-rising imports.
- Deflation at the end of 2014 is set to continue in H1 2015. Prices are now forecast to fall 0.3% in 2015 overall, before rising 0.9% in 2016 and then just over 2% a year in 2017-19.
- The fiscal deficit is forecast to decline to 0.6% of GDP this year, easing down further in 2016-19, as lower social costs offset increased infrastructure and defense commitments.
- Inward investment should offset the expected decline in the current account surplus seen in the coming years and promote productivity improvement, shielding faster growth from potential labor and capacity shortages.

Figure 35

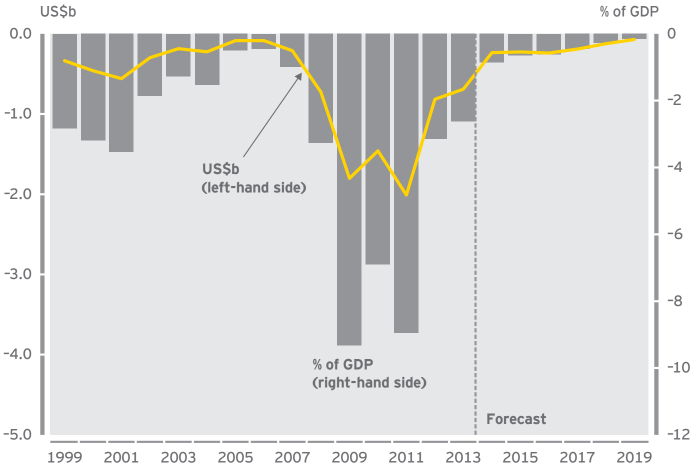
Real GDP growth



Source: Oxford Economics.

Figure 36

Government budget balance



Source: Oxford Economics.

Lithuania (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	2.9	3.4	4.4	4.8	4.8	4.6
Private consumption	5.3	4.5	4.6	4.7	4.5	4.2
Fixed investment	5.5	4.0	5.0	6.0	5.5	4.4
Stockbuilding (% of GDP)	-3.6	-4.4	-3.7	-3.3	-2.6	-1.8
Government consumption	1.2	2.3	2.0	3.1	3.7	3.8
Exports of goods and services	2.0	5.8	7.2	7.5	7.0	7.0
Imports of goods and services	2.7	5.5	7.9	7.8	7.7	7.6
Consumer prices	0.1	-0.3	0.9	2.2	2.1	2.1
Unemployment rate (level)	10.6	10.5	9.5	8.5	7.5	6.5
Current account balance (% of GDP)	1.3	1.2	0.6	0.5	0.3	0.2
Government budget (% of GDP)	-0.9	-0.6	-0.6	-0.5	-0.3	-0.2
Government debt (% of GDP)	38.3	37.8	36.4	34.5	32.5	30.6

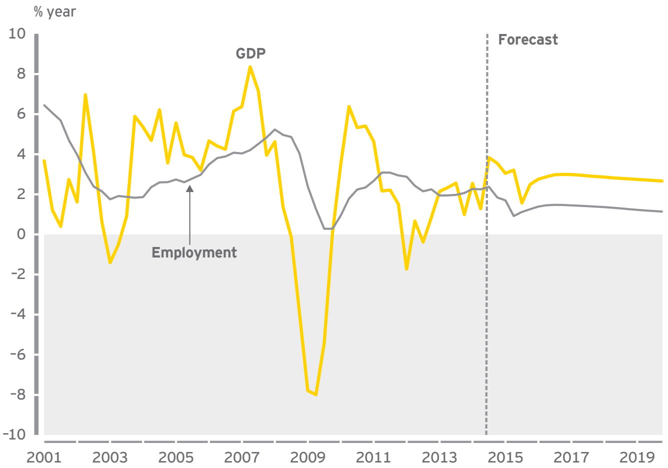
Source: Oxford Economics.

Luxembourg

- Luxembourg continues to outpace the Eurozone overall, thanks to ongoing robust growth in the services sector as a whole, despite a still-muted recovery in banking. We forecast GDP growth of 2.6% this year, slightly slower than the 2.8% seen in 2014.
- Consumer spending power will benefit from inflation remaining below 1% in 2015, thanks to the fall in oil prices. The latter will mitigate inflationary pressures from the VAT hike at the beginning of 2015 and higher import prices due to the weaker euro.
- Investment remains affected by the sluggish growth prospects in the Eurozone. But the relatively favorable outlook for Luxembourg will still translate into robust investment growth, helped by ongoing and new large-scale investment projects, such as a public-private joint venture satellite program due for launch in 2017.

Figure 37

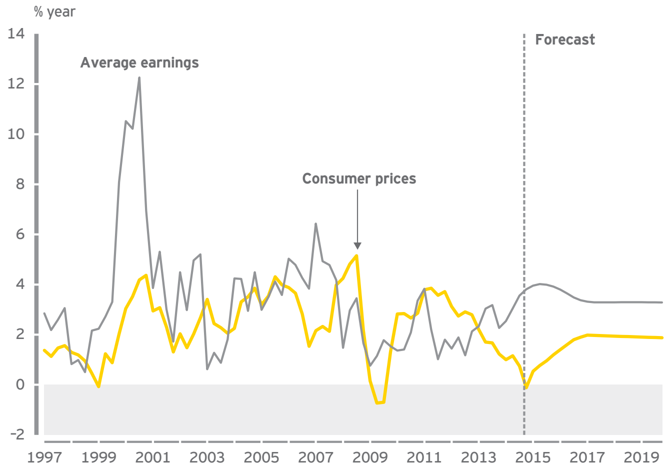
Real GDP and employment



Source: Oxford Economics.

Figure 38

Inflation and earnings



Source: Oxford Economics.

Luxembourg (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	2.8	2.6	2.9	2.9	2.8	2.7
Private consumption	2.6	2.0	2.6	2.6	2.4	2.4
Fixed investment	3.9	4.8	3.9	3.3	3.0	2.7
Stockbuilding (% of GDP)	-1.3	0.7	0.4	0.2	0.2	0.2
Government consumption	3.2	1.4	1.9	1.9	1.9	1.9
Exports of goods and services	2.4	4.6	5.8	5.0	3.3	2.9
Imports of goods and services	1.8	3.6	5.5	4.7	3.3	2.9
Consumer prices	0.7	0.9	1.7	2.0	1.9	1.9
Unemployment rate (level)	6.0	6.1	6.1	5.9	5.4	4.9
Current account balance (% of GDP)	4.7	4.7	5.7	6.2	5.9	5.7
Government budget (% of GDP)	0.4	-0.8	-0.4	0.0	0.0	0.0
Government debt (% of GDP)	22.2	22.4	21.6	20.3	19.4	18.5

Source: Oxford Economics.

Malta

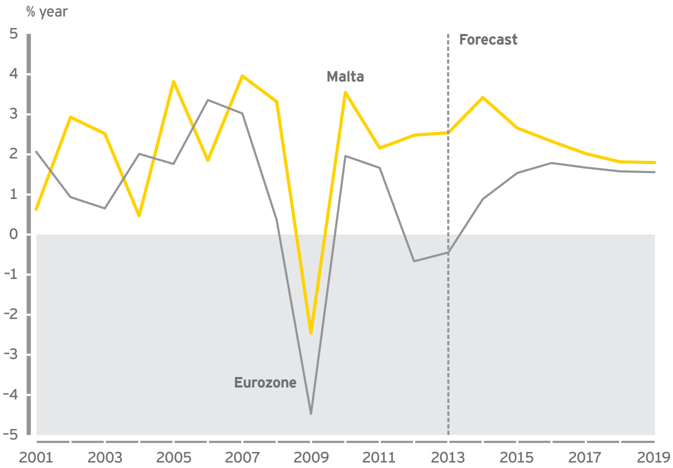
GDP growth

2015 2.7%

- After a strong Q3, we now expect GDP growth of 3.4% in Malta for 2014. And with strong investment momentum, particularly in the energy sector, we forecast growth of 2.7% in 2015 and 2.3% in 2016, also underpinned by robust domestic activity and strong services exports.
- Both households and businesses will benefit from lower oil prices, and we now expect inflation to average just 0.6% in 2015. As a result, consumer spending growth should be at least 2% this year and next, helped also by low and falling unemployment and positive real wages.
- Malta is a substantial fuel importer. As a result, lower oil prices will ease the import bill. We expect the current account surplus to remain above 2% of GDP in 2015, also supported by strong services exports.
- Tourist arrivals rose by 6.8% in 2014 and should continue to expand this year. Online gaming is also growing strongly.

Figure 39

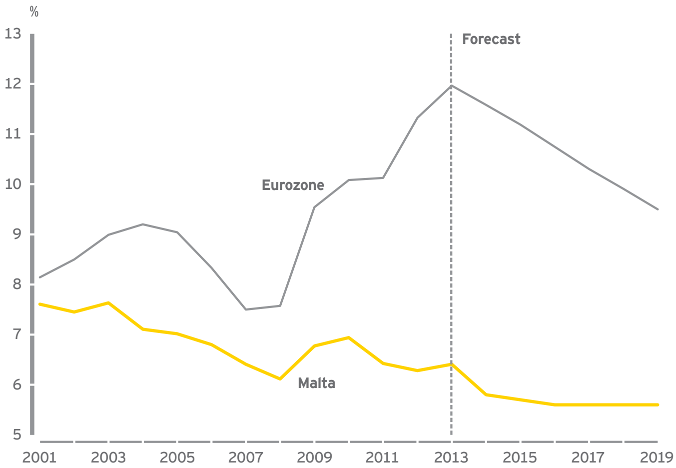
Real GDP growth



Source: Oxford Economics.

Figure 40

Unemployment rate



Source: Oxford Economics.

Malta (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	3.4	2.7	2.3	2.0	1.8	1.8
Private consumption	2.3	2.3	2.0	1.9	1.8	1.8
Fixed investment	5.1	3.0	2.7	2.5	2.3	2.2
Stockbuilding (% of GDP)	-1.6	-0.8	-0.1	0.4	0.7	0.9
Government consumption	5.8	3.0	2.0	1.6	1.7	1.6
Exports of goods and services	0.5	2.5	2.9	2.9	2.8	2.8
Imports of goods and services	-0.7	3.0	3.3	3.2	3.1	3.0
Consumer prices	0.8	0.6	1.9	2.3	2.3	2.3
Unemployment rate (level)	5.8	5.7	5.6	5.6	5.6	5.6
Current account balance (% of GDP)	0.2	2.3	0.9	0.9	0.3	0.7
Government budget (% of GDP)	-2.1	-2.0	-1.7	-1.4	-1.2	-1.0
Government debt (% of GDP)	69.5	69.4	68.3	66.8	65.3	63.7

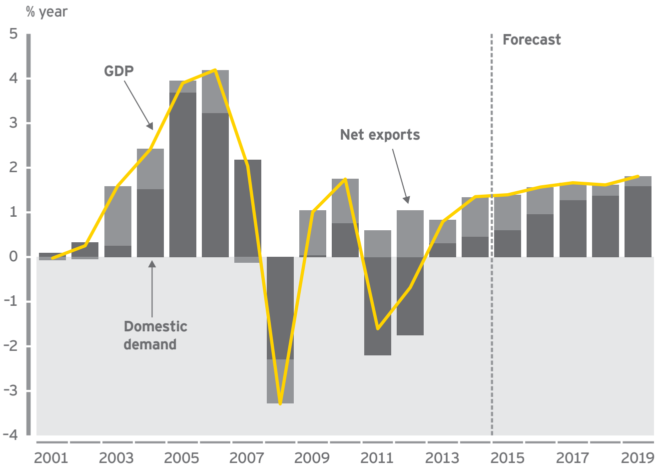
Source: Oxford Economics.

Netherlands

- Economic prospects in the Netherlands are improving and 2015 could be the year that the country's lackluster recovery gathers some momentum. We expect GDP growth of 1.4% in both 2015 and 2016, up from 0.8% in 2014, but still weaker than in the Eurozone as a whole.
- Household spending will be a key driver of the improvement. While rising employment and a modest pickup in nominal wages will support spending, low inflation will be important too. But households' heavy debt burdens suggest that spending growth may be slower than income growth.
- The openness of the economy suggests that it may benefit from the fall in the euro more than most of its Eurozone peers. However, if the gas price follows the oil price down in the coming months, this may offset some of the boost to the economy from the recent slump in oil prices.

Figure 41

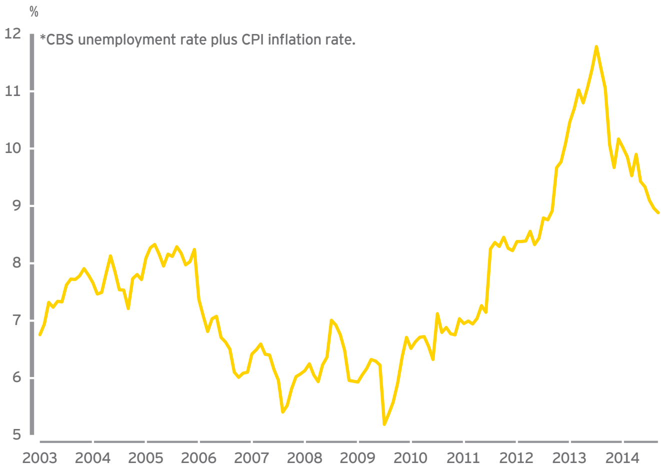
Contributions to GDP growth



Source: Oxford Economics; Haver Analytics.

Figure 42

Misery index*



Source: Haver Analytics.

Netherlands (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	0.8	1.4	1.4	1.6	1.7	1.6
Private consumption	0.1	0.5	0.8	1.1	1.4	1.6
Fixed investment	2.4	0.4	2.1	2.0	2.1	2.2
Stockbuilding (% of GDP)	0.0	0.2	0.1	0.1	0.2	0.1
Government consumption	-0.1	-0.3	0.0	0.3	0.8	1.3
Exports of goods and services	3.9	3.0	3.6	3.2	2.6	2.2
Imports of goods and services	3.8	2.2	3.1	2.9	2.5	2.3
Consumer prices	0.3	0.6	1.3	1.4	1.5	1.6
Unemployment rate (level)	6.8	6.5	6.5	6.4	6.3	6.1
Current account balance (% of GDP)	10.6	10.2	10.3	10.4	10.5	10.5
Government budget (% of GDP)	-2.6	-1.9	-1.6	-1.5	-1.3	-1.1
Government debt (% of GDP)	70.1	70.5	70.3	69.9	69.3	68.4

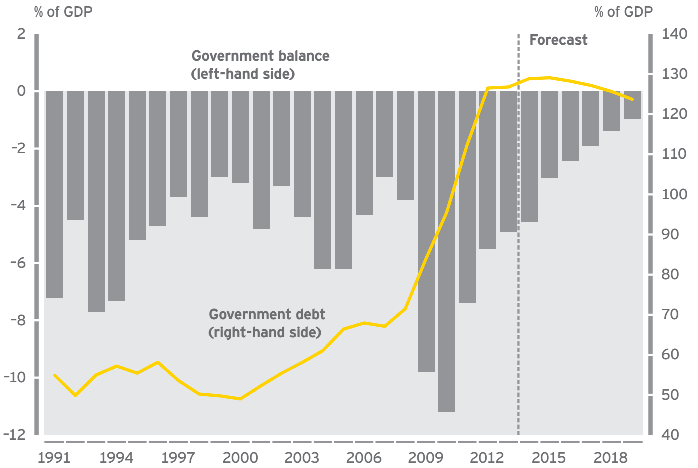
Source: Oxford Economics.

Portugal

- Portugal's economy continues to recover, but the pace of expansion remains modest. GDP expanded by just 0.9% in 2014, after three consecutive years of decline.
- Lower oil prices and a more competitive euro, boosting exports, should help to lift growth to 1.7% this year. Growth is then seen at 1.4% in 2016, before stabilizing at about 1.2% a year in 2017-19.
- The pace of the recovery in the years ahead will continue to be constrained by the need to deleverage. Although the household sector has made good progress in reducing its debt, public and corporate indebtedness remains critically high.
- Portugal experienced deflation in 2014, and consumer prices in January 2015 were 0.4% below a year earlier. With world oil prices expected to hold around current levels, Portugal is forecast to experience a second year of deflation (of -0.4%) in 2015.

Figure 43

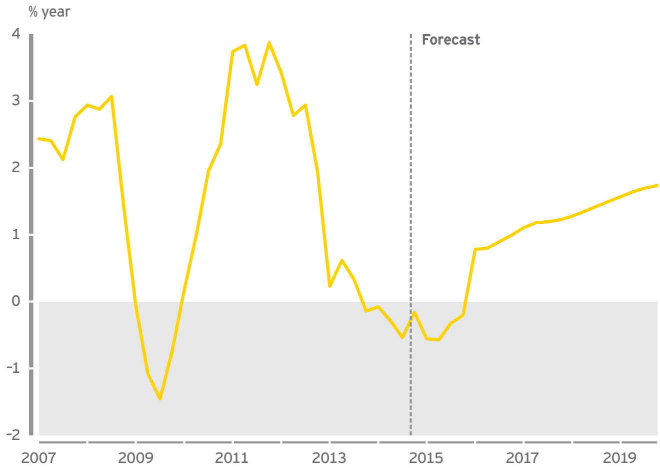
Government balance and debt



Source: Oxford Economics.

Figure 44

Consumer price inflation



Source: Oxford Economics.

Portugal (annual percentage changes unless specified)

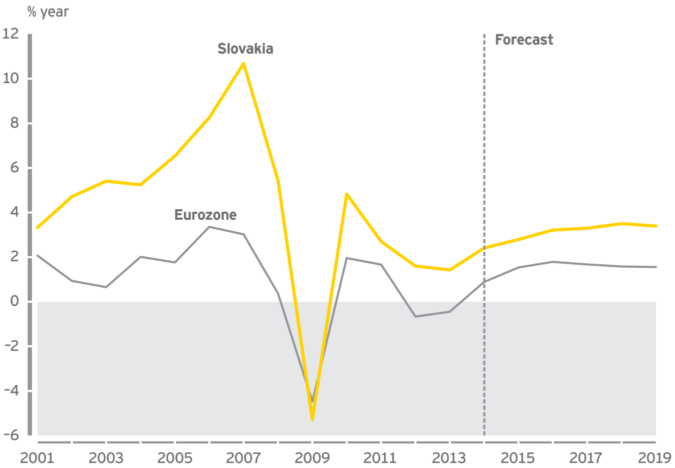
	2014	2015	2016	2017	2018	2019
GDP	0.9	1.7	1.4	1.3	1.2	1.2
Private consumption	2.0	1.2	0.9	0.9	1.0	0.9
Fixed investment	2.1	3.0	2.9	2.5	2.4	2.4
Stockbuilding (% of GDP)	0.8	0.7	0.5	0.5	0.5	0.4
Government consumption	-0.6	-0.9	0.9	1.3	1.2	1.2
Exports of goods and services	2.6	5.5	5.2	4.0	3.4	3.0
Imports of goods and services	5.6	3.4	4.3	3.9	3.3	2.9
Consumer prices	-0.2	-0.4	0.9	1.2	1.4	1.7
Unemployment rate (level)	14.1	13.1	12.0	11.1	10.6	10.3
Current account balance (% of GDP)	0.5	1.9	2.4	2.4	2.4	2.1
Government budget (% of GDP)	-4.6	-3.0	-2.4	-1.9	-1.4	-1.0
Government debt (% of GDP)	130.2	130.1	129.1	127.8	126.1	124.1

Source: Oxford Economics.

Slovakia

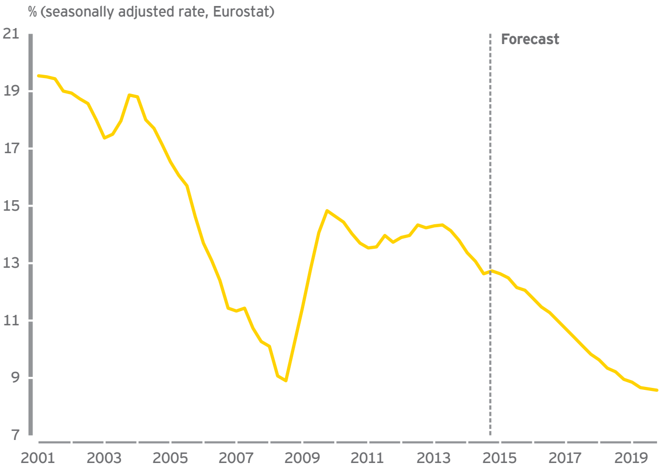
- We forecast Slovakia's GDP growth will rise to 2.8% this year, from an estimated 2.4% in 2014. This will be driven by low oil prices, rising real wages, falling unemployment, accommodative fiscal policy and robust confidence levels.
- Inflation was negligible throughout 2014, averaging -0.1% for the year. In 2015, rising demand, the weaker euro and looser monetary policy in the Eurozone should help lift prices. But the steep fall in oil prices seen since mid-2014 will partially offset these factors, holding inflation down to just 0.3%.
- Risks to our forecast stem from weakness in key trading partners, especially Germany and some other Eurozone countries. Sentiment could be dampened by renewed volatility in Greece, or any escalation of geopolitical tensions between Russia and the EU. Meanwhile, growth in the important automotive sector will be limited by capacity constraints.

Figure 45
Real GDP growth



Source: Oxford Economics.

Figure 46
Unemployment rate



Source: Oxford Economics.

Slovakia (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	2.4	2.8	3.2	3.3	3.5	3.4
Private consumption	2.1	2.6	2.7	2.7	2.7	2.5
Fixed investment	4.3	3.5	3.9	4.0	3.9	3.8
Stockbuilding (% of GDP)	0.0	0.6	0.8	1.2	1.3	1.1
Government consumption	4.1	2.2	2.3	2.4	2.6	2.4
Exports of goods and services	4.6	3.7	6.0	5.3	5.1	4.9
Imports of goods and services	5.0	4.3	6.2	5.5	4.9	4.2
Consumer prices	-0.1	0.3	1.9	2.5	2.5	2.5
Unemployment rate (level)	13.2	12.5	11.6	10.6	9.5	8.8
Current account balance (% of GDP)	1.3	4.0	3.8	3.8	3.7	3.7
Government budget (% of GDP)	-3.4	-2.9	-1.9	-1.8	-1.2	-1.1
Government debt (% of GDP)	53.9	54.6	53.7	52.8	51.1	49.6

Source: Oxford Economics.

Slovenia

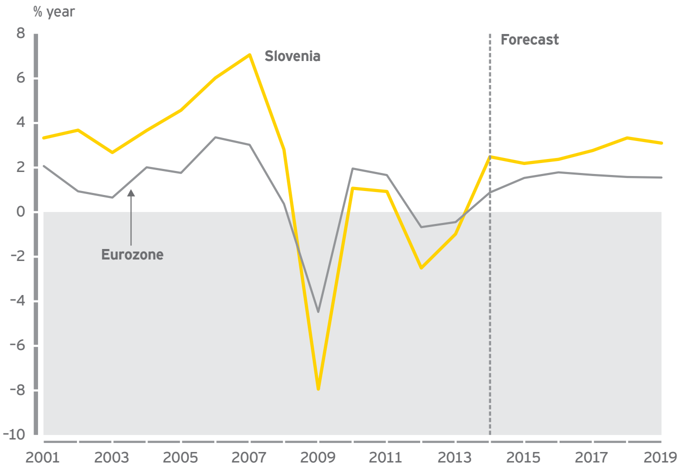
GDP growth

2015 **2.2%**

- The Eurozone's return to growth has helped Slovenia to build momentum, with strong 5.5% export growth having lifted GDP growth to an estimated 2.5% in 2014 after two years of recession.
- We forecast that expansion will slow a little, to 2.2% this year, helped by lower oil prices, but still weighed down by fiscal austerity. We do not expect the fiscal deficit to fall to the 3% target until 2017. But, as fiscal constraints gradually ease, domestic activity will gather momentum, enabling growth to pick up to 2.8% in 2017 and then over 3% a year in 2018-19.
- In the near term, fiscal austerity and high unemployment will constrain spending, but the drop in fuel prices will boost purchasing power for both households and businesses.
- It is important that the Government continues with the reform program to boost longer-term growth prospects, but progress may be slower than hoped for.

Figure 47

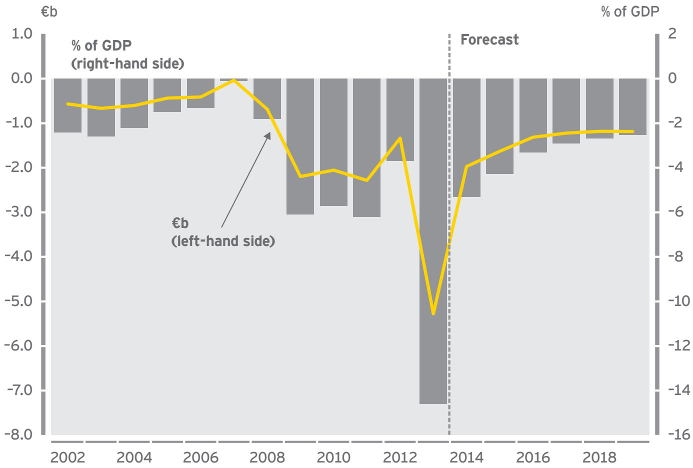
Real GDP growth



Source: Oxford Economics.

Figure 48

Government budget balance



Source: Oxford Economics.

Slovenia (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	2.5	2.2	2.4	2.8	3.3	3.1
Private consumption	0.6	0.9	1.3	2.7	3.1	3.3
Fixed investment	5.9	4.5	4.4	4.9	4.5	5.0
Stockbuilding (% of GDP)	0.1	0.4	1.3	1.5	2.0	1.6
Government consumption	-1.5	-0.4	1.4	2.5	2.9	3.3
Exports of goods and services	5.5	3.9	3.0	2.9	2.8	2.7
Imports of goods and services	3.9	3.5	4.0	3.7	3.4	3.0
Consumer prices	0.2	0.4	2.1	2.2	2.5	2.5
Unemployment rate (level)	9.8	9.7	9.2	8.4	7.5	6.8
Current account balance (% of GDP)	6.3	6.6	6.0	5.4	5.0	4.8
Government budget (% of GDP)	-5.3	-4.3	-3.3	-2.9	-2.7	-2.5
Government debt (% of GDP)	70.4	65.0	60.5	58.7	58.1	57.5

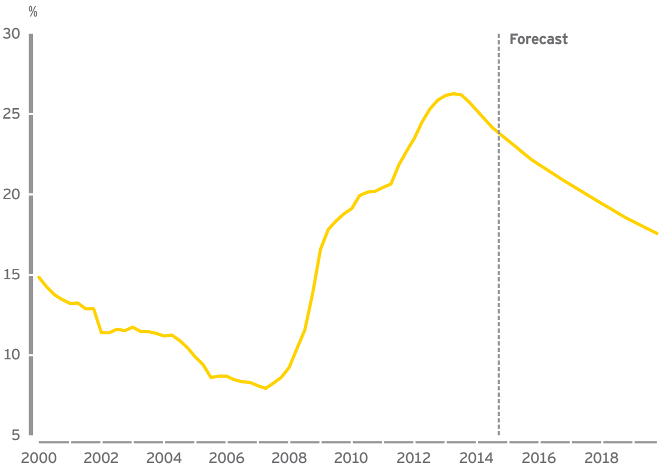
Source: Oxford Economics.

Spain

- Spain's economy has continued to outperform the rest of the Eurozone in recent months and, with supportive global conditions and regional policy measures, we expect GDP growth to pick up to 2.4% this year, and then 2.5% in 2016.
- Growth is likely to ease a little over the medium term, as the boost from cheaper energy and a depreciating euro fades. Nevertheless, with unemployment falling and exports still more competitive, GDP should grow by about 2.4% a year in 2017–19.
- Spanish firms are benefiting from much-improved competitiveness compared with the rest of the Eurozone, enabling them to compete more effectively in export markets. This dynamic is supported by increased attractiveness for inward investment.
- We expect a weaker euro and rising external demand to lift export growth to 4.4% this year and 5.3% in 2016. Combined with robust domestic demand, this will support business investment growth of 3.7% in 2015 and 4% in 2016.

Figure 49

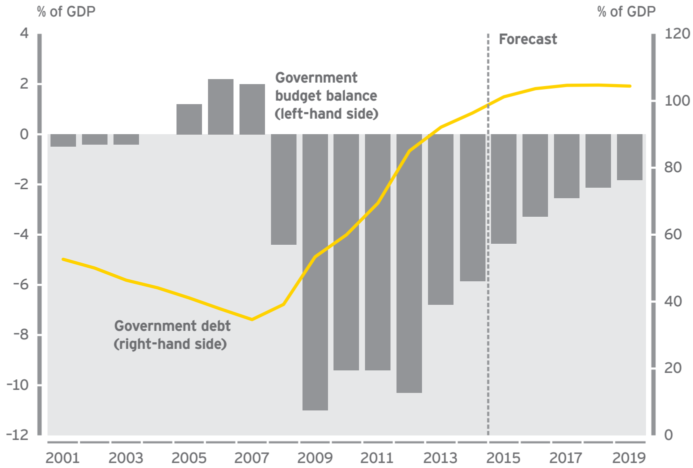
Unemployment rate



Source: Oxford Economics.

Figure 50

Government balance and debt



Source: Oxford Economics.

Spain (annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
GDP	1.4	2.4	2.5	2.4	2.4	2.3
Private consumption	2.3	2.5	2.7	2.4	1.9	1.8
Fixed investment	2.6	3.3	3.5	3.9	4.1	3.7
Stockbuilding (% of GDP)	0.5	0.4	0.3	0.3	0.5	0.6
Government consumption	0.8	0.2	0.5	0.7	1.0	1.3
Exports of goods and services	4.0	4.4	5.3	5.0	4.4	4.1
Imports of goods and services	6.6	3.5	5.0	5.2	4.6	4.2
Consumer prices	-0.2	-1.1	1.4	1.1	1.4	1.7
Unemployment rate (level)	24.5	22.8	21.4	20.2	19.0	18.0
Current account balance (% of GDP)	-0.1	0.9	0.5	0.1	0.0	0.0
Government budget (% of GDP)	-5.9	-4.4	-3.3	-2.5	-2.1	-1.8
Government debt (% of GDP)	99.3	103.6	105.7	106.4	106.3	105.8

Source: Oxford Economics.

Detailed tables and charts

Forecast assumptions

	2014	2015	2016	2017	2018	2019
Short-term interest rates (%)	0.2	0.1	0.1	0.1	0.1	0.3
Long-term interest rates (%)	2.0	0.9	0.8	1.2	1.6	2.0
Euro effective exchange rate (1995 = 100)	123.6	108.6	104.7	105.4	106.6	108.0
Oil prices (€/barrel)	74.6	51.4	63.8	72.0	76.0	78.0
Share prices (% year)	12.6	9.0	7.3	6.0	5.7	5.6

	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Short-term interest rates (%)	0.3	0.3	0.2	0.1	0.1	0.1	0.1	0.1
Long-term interest rates (%)	2.7	2.2	1.8	1.5	1.0	0.9	0.8	0.8
Euro effective exchange rate (1995 = 100)	125.6	125.1	122.5	121.2	113.4	109.6	106.7	104.8
Oil prices (€/barrel)	79.0	80.0	77.0	61.2	44.9	50.0	54.0	57.3
Share prices (% year)	15.5	19.2	14.0	2.8	7.6	5.7	9.1	13.6

Eurozone GDP and components

Quarterly forecast (quarterly percentage changes)

	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	0.3	0.1	0.2	0.3	0.5	0.5	0.5	0.5
Private consumption	0.2	0.3	0.5	0.4	0.4	0.4	0.4	0.4
Fixed investment	0.3	-0.7	-0.3	0.1	-0.1	0.4	0.6	0.7
Government consumption	0.1	0.3	0.3	-0.1	0.0	0.1	0.1	0.1
Exports of goods and services	0.4	1.4	1.3	0.7	0.6	1.2	1.2	1.2
Imports of goods and services	0.4	1.3	1.4	0.5	0.6	1.1	1.2	1.2

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

	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	0.3	0.1	0.2	0.3	0.5	0.5	0.5	0.5
Private consumption	0.1	0.1	0.3	0.2	0.2	0.2	0.2	0.2
Fixed investment	0.1	-0.1	-0.1	0.0	0.0	0.1	0.1	0.1
Government consumption	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Stockbuilding	0.1	-0.1	-0.1	0.0	0.2	0.1	0.0	0.0
Exports of goods and services	0.2	0.6	0.6	0.3	0.3	0.5	0.5	0.6
Imports of goods and services	-0.2	-0.5	-0.6	-0.2	-0.2	-0.4	-0.5	-0.5

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

	2014	2015	2016	2017	2018	2019
GDP	9,638	9,786	9,961	10,128	10,287	10,447
Private consumption	5,310	5,397	5,481	5,558	5,635	5,711
Fixed investment	1,894	1,903	1,956	2,012	2,067	2,118
Government consumption	2,047	2,052	2,062	2,075	2,091	2,112
Stockbuilding	-26	-4	3	13	20	27
Exports of goods and services	4,268	4,437	4,637	4,825	5,005	5,179
Imports of goods and services	3,854	3,998	4,177	4,355	4,531	4,699

Annual levels – nominal terms (€b)

	2014	2015	2016	2017	2018	2019
GDP	10,080	10,316	10,641	10,983	11,330	11,689
Private consumption	5,626	5,708	5,865	6,034	6,214	6,404
Fixed investment	1,964	1,987	2,071	2,164	2,260	2,353
Government consumption	2,125	2,144	2,182	2,230	2,283	2,343
Stockbuilding	-32	-2	51	91	102	104
Exports of goods and services	4,458	4,674	4,991	5,297	5,590	5,882
Imports of goods and services	4,060	4,195	4,520	4,834	5,121	5,397

Prices and cost indicators

(annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
HICP headline inflation	0.4	-0.2	1.1	1.4	1.6	1.7
Inflation ex. energy	0.9	0.6	0.9	1.2	1.5	1.6
GDP deflator	0.8	0.8	1.3	1.5	1.6	1.6
Import deflator	0.1	0.6	2.3	2.0	1.7	1.7
Export deflator	-2.3	-0.9	3.5	2.8	1.9	1.6
Terms of trade	-2.4	-1.4	1.3	0.8	0.1	-0.1
Earnings	1.7	1.8	2.3	2.5	2.5	2.6
Unit labor costs	1.0	0.8	1.0	1.2	1.3	1.3
Output gap (% of GDP)	-3.8	-3.4	-2.7	-2.2	-1.7	-1.3
Oil prices (€ per barrel)	74.6	51.4	63.8	72.0	76.0	78.0
Euro effective exchange rate (1995 = 100)	123.6	108.6	104.7	105.4	106.6	108.0

	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
HICP headline inflation	0.6	0.6	0.3	0.2	-0.3	-0.4	-0.3	0.3
Inflation ex. energy	1.0	0.9	0.8	0.7	0.6	0.6	0.5	0.7
GDP deflator	1.0	0.8	0.8	0.7	0.6	0.7	0.9	1.0
Import deflator	-0.4	-0.4	1.4	-0.3	-0.1	0.5	0.0	1.9
Export deflator	-2.7	-2.2	-1.8	-2.5	-3.5	-1.3	-0.7	2.0
Terms of trade	-2.2	-1.9	-3.2	-2.2	-3.3	-1.8	-0.7	0.1
Earnings	1.9	1.7	1.6	1.4	1.4	1.8	1.9	2.2
Unit labor costs	0.7	1.0	1.1	1.1	0.9	0.8	0.6	0.8
Output gap (% of GDP)	-3.6	-3.8	-3.9	-3.9	-3.7	-3.5	-3.3	-3.1
Oil prices (€ per barrel)	79.0	80.0	77.0	61.2	44.9	50.0	54.0	57.3
Euro effective exchange rate (1995 = 100)	125.6	125.1	122.5	121.2	113.4	109.6	106.7	104.8

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

Labor market indicators

(annual percentage changes unless specified)

	2014	2015	2016	2017	2018	2019
Employment	0.5	0.6	0.5	0.4	0.4	0.3
Unemployment rate (%)	11.6	11.2	10.7	10.3	9.9	9.5
NAIRU (%)	8.8	8.7	8.6	8.5	8.4	8.3
Participation rate (%)	75.5	75.6	75.8	75.9	75.9	76.0
Earnings	1.7	1.8	2.3	2.5	2.5	2.6
Unit labor costs	1.0	0.8	1.0	1.2	1.3	1.3

	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employment	0.0	0.4	0.6	0.8	0.8	0.6	0.5	0.5
Unemployment rate (%)	11.8	11.6	11.5	11.5	11.3	11.2	11.1	11.0
NAIRU (%)	8.8	8.8	8.8	8.8	8.8	8.7	8.7	8.7
Participation rate (%)	75.3	75.4	75.5	75.6	75.6	75.6	75.7	75.7
Earnings	1.9	1.7	1.6	1.4	1.4	1.8	1.9	2.2
Unit labor costs	0.7	1.0	1.1	1.1	0.9	0.8	0.6	0.8

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

	2014	2015	2016	2017	2018	2019
Trade balance (€b)	200.6	275.2	259.0	246.1	246.9	255.2
Trade balance (% of GDP)	2.0	2.7	2.4	2.2	2.2	2.2
Current account balance (€b)	244.3	305.7	292.3	279.1	279.9	286.2
Current account balance (% of GDP)	2.4	3.0	2.7	2.5	2.5	2.4
Government budget balance (€b)	-267	-218	-180	-151	-124	-109
Government budget balance (% of GDP)	-2.6	-2.1	-1.7	-1.4	-1.1	-0.9
Government debt (€b)	9,678	10,072	10,416	10,721	10,974	11,171
Government debt (% of GDP)	96.0	97.6	97.9	97.6	96.9	95.6

Measures of convergence and divergence within the Eurozone

	2005-09	2010-14	2015-19
Growth and incomes			
Standard deviation of GDP growth rates	5.2	2.7	1.1
Growth rate gap (max – min)	5.5	8.6	3.5
Highest GDP per capita (Eurozone = 100)	251.9	240.0	235.2
Lowest GDP per capita (Eurozone = 100)	55.5	58.0	52.7
Inflation and prices			
Standard deviation of inflation rates	2.5	1.4	0.9
Inflation rate gap (max – min)	6.9	2.7	2.4
Highest price level (Eurozone = 100)	134.3	138.8	142.4
Lowest price level (Eurozone = 100)	82.5	91.5	92.5

Cross-country tables

Real GDP (% year)

Rank		2014	2015	2016	2017	2018	2019	Average 2015-19
1	Lithuania	2.9	3.4	4.4	4.8	4.8	4.6	4.4
2	Latvia	2.5	2.9	4.1	4.6	4.5	4.5	4.1
3	Estonia	1.8	2.2	2.8	3.5	4.0	4.0	3.3
4	Slovakia	2.4	2.8	3.2	3.3	3.5	3.4	3.2
4	Ireland	4.8	3.4	2.9	2.6	3.2	3.5	3.1
6	Luxembourg	2.8	2.6	2.9	2.9	2.8	2.7	2.8
7	Slovenia	2.5	2.2	2.4	2.8	3.3	3.1	2.8
8	Spain	1.4	2.4	2.5	2.4	2.4	2.3	2.4
9	Greece	0.8	1.7	2.4	2.3	2.4	2.5	2.3
10	Malta	3.4	2.7	2.3	2.0	1.8	1.8	2.1
11	Austria	0.4	1.1	2.1	2.1	1.9	1.7	1.8
12	Belgium	1.0	1.2	1.6	1.9	1.8	1.8	1.7
13	Germany	1.6	2.2	2.0	1.6	1.2	1.2	1.7
14	Eurozone	0.9	1.5	1.8	1.7	1.6	1.6	1.6
15	France	0.4	1.2	1.7	1.5	1.6	1.6	1.5
16	Netherlands	0.8	1.4	1.4	1.6	1.7	1.6	1.5
17	Finland	-0.1	0.3	1.2	1.7	2.0	2.2	1.5
18	Portugal	0.9	1.7	1.4	1.3	1.2	1.2	1.4
19	Cyprus	-2.4	-0.4	1.1	1.0	1.8	2.5	1.2
20	Italy	-0.4	0.3	1.0	1.0	1.0	1.0	0.9

Inflation rates (% year)

Rank		2014	2015	2016	2017	2018	2019	Average 2015-19
1	Greece	-1.4	-1.9	-0.4	1.2	1.8	1.9	0.5
2	Italy	0.2	-0.4	0.6	0.9	1.3	1.7	0.8
3	Spain	-0.2	-1.1	1.4	1.1	1.4	1.7	0.9
4	Portugal	-0.2	-0.4	0.9	1.2	1.4	1.7	0.9
5	Finland	1.2	0.1	1.0	1.1	1.3	1.6	1.0
6	Eurozone	0.4	-0.2	1.1	1.4	1.6	1.7	1.1
7	France	0.6	0.3	1.0	1.4	1.6	1.7	1.2
8	Netherlands	0.3	0.6	1.3	1.4	1.5	1.6	1.2
9	Germany	0.8	-0.1	1.5	1.9	1.7	1.5	1.3
10	Lithuania	0.1	-0.3	0.9	2.2	2.1	2.1	1.4
11	Belgium	0.5	-0.3	2.0	1.9	1.8	1.9	1.4
12	Cyprus	-0.3	0.4	1.5	1.7	2.0	2.0	1.5
13	Austria	1.5	0.6	1.6	1.9	1.8	1.8	1.5
14	Luxembourg	0.7	0.9	1.7	2.0	1.9	1.9	1.7
15	Ireland	0.3	1.1	1.6	1.8	1.9	2.0	1.7
16	Malta	0.8	0.6	1.9	2.3	2.3	2.3	1.9
17	Slovenia	0.2	0.4	2.1	2.2	2.5	2.5	1.9
18	Slovakia	-0.1	0.3	1.9	2.5	2.5	2.5	1.9
19	Latvia	0.6	0.9	2.4	2.4	2.4	2.4	2.1
20	Estonia	0.5	2.2	3.1	3.2	3.0	3.0	2.9

Cross-country tables

Unemployment rate (% of labor force)

Rank		2014	2015	2016	2017	2018	2019	Average 2015-19
1	Germany	5.0	4.9	4.9	4.7	4.6	4.5	4.7
2	Austria	5.0	5.1	5.1	5.0	4.8	4.6	4.9
3	Estonia	7.4	6.4	5.4	5.3	5.3	5.4	5.6
4	Malta	5.8	5.7	5.6	5.6	5.6	5.6	5.6
5	Luxembourg	6.0	6.1	6.1	5.9	5.4	4.9	5.7
6	Netherlands	6.8	6.5	6.5	6.4	6.3	6.1	6.4
7	Belgium	8.5	8.5	8.1	7.7	7.6	7.5	7.9
8	Finland	8.7	8.8	8.6	8.0	7.5	7.1	8.0
9	Latvia	11.0	9.7	8.2	8.0	7.8	7.7	8.3
10	Slovenia	9.8	9.7	9.2	8.4	7.5	6.8	8.3
11	Lithuania	10.6	10.5	9.5	8.5	7.5	6.5	8.5
12	Ireland	11.4	10.4	9.5	9.0	8.5	8.0	9.1
13	France	10.2	10.2	9.9	9.7	9.6	9.4	9.8
14	Eurozone	11.6	11.2	10.7	10.3	9.9	9.5	10.3
15	Slovakia	13.2	12.5	11.6	10.6	9.5	8.8	10.6
16	Portugal	14.1	13.1	12.0	11.1	10.6	10.3	11.4
17	Italy	12.8	12.7	12.3	12.0	11.7	11.1	12.0
18	Cyprus	16.1	16.0	15.5	13.8	11.9	10.1	13.4
19	Spain	24.5	22.8	21.4	20.2	19.0	18.0	20.3
20	Greece	26.5	24.6	22.9	21.0	19.1	17.4	21.0

Government budget (% of GDP)

Rank		2014	2015	2016	2017	2018	2019	Difference 2015-19
1	Germany	-0.1	0.3	0.3	0.2	0.2	0.3	0.0
2	Latvia	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	0.0
3	Lithuania	-0.9	-0.6	-0.6	-0.5	-0.3	-0.2	0.4
4	Luxembourg	0.4	-0.8	-0.4	0.0	0.0	0.0	0.8
5	Netherlands	-2.6	-1.9	-1.6	-1.5	-1.3	-1.1	0.8
6	Estonia	-0.5	-0.6	-0.4	-0.1	0.1	0.3	0.9
7	Malta	-2.1	-2.0	-1.7	-1.4	-1.2	-1.0	1.0
8	Greece	-1.0	-1.2	-0.8	-0.7	-0.4	-0.1	1.1
9	Eurozone	-2.6	-2.1	-1.7	-1.4	-1.1	-0.9	1.2
10	Austria	-2.8	-1.8	-0.8	-0.6	-0.6	-0.6	1.2
11	Italy	-3.0	-2.8	-2.4	-2.0	-1.8	-1.6	1.2
12	Belgium	-2.8	-1.4	-0.7	-0.3	-0.1	0.1	1.5
13	Cyprus	-3.0	-2.9	-2.4	-2.2	-2.1	-1.2	1.7
14	Slovakia	-3.4	-2.9	-1.9	-1.8	-1.2	-1.1	1.8
15	Slovenia	-5.3	-4.3	-3.3	-2.9	-2.7	-2.5	1.8
16	France	-4.4	-4.3	-3.8	-3.1	-2.5	-2.3	2.0
17	Portugal	-4.6	-3.0	-2.4	-1.9	-1.4	-1.0	2.0
18	Finland	-2.8	-2.1	-1.2	-0.6	-0.2	0.0	2.1
19	Ireland	-3.6	-2.0	-0.8	0.0	0.2	0.1	2.1
20	Spain	-5.9	-4.4	-3.3	-2.5	-2.1	-1.8	2.6

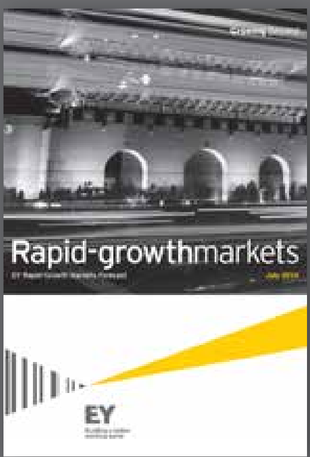
Macroeconomic data and analysis at your fingertips

Learn more about the *EY Eurozone Forecast* at ey.com/eurozone:

- Download the latest *EY Eurozone Forecast* and individual forecasts for the 19 member states.
- Use our dynamic Eurochart to compare country data for the next five years.
- Use the trend analysis tool to compare forecasts for specific economic indicators across the 19 Eurozone nations.

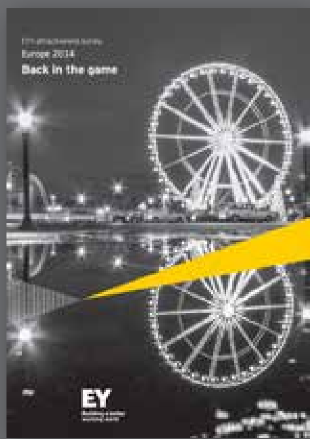
EY Eurozone Forecast: outlook for financial services – Winter 2014

- The *EY Eurozone Forecast: outlook for financial services* explores the implications of the latest Eurozone economic forecasts for banks, asset managers and insurers.
- Our latest forecast sees improving GDP, growth in consumer spending and falling unemployment across the Eurozone.
- Learn more and download the report at ey.com/fseurozone.



EY Rapid-Growth Markets Forecast: July 2014

- *EY's Rapid-Growth Markets Forecast* provides analysis of 25 emerging economies.
- Our latest report explores the role of urbanization in the rapid-growth markets.
- Learn more and download the report at ey.com/rapidgrowth.



EY's attractiveness survey: Europe 2014

- *EY's attractiveness surveys* are annual reports that examine the attractiveness of selected nations and regions to foreign investors.
- *EY's attractiveness survey: Europe 2014* finds that Europe remains the world's top destination for foreign direct investment.
- Learn more and download the report at ey.com/attractiveness.

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. AU2998

BMC Agency
GA 0342_01385

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 850 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 150, including 90 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.