

# European Economic Forecast - **Spring 2011**

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# European Economic Forecast

Spring 2011



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## EDITORIAL

The spring 2011 forecast confirms the continuing recovery of the EU economy. With private domestic demand gradually taking over as the main engine of growth and despite the ongoing sovereign-debt tensions in some countries, economic growth in the EU is set to become increasingly self-sustaining over the forecast horizon. Even though the pace of growth remains varied across Member States and rather muted when compared to past up-turns, the expectation of firmer growth is a welcome prospect to help heal the EU's wounded economy.

The historic shock inflicted by the global financial crisis in 2008 has led in many Member States to unsustainably high levels of public debt, distressed private-sector balance sheets and a surge in unemployment. Moreover, trend growth seems to have taken a hit due to slower capital deepening and increased labour mismatches. As pointed out in previous forecasts, the scope and time needed for the adjustment to these daunting macro-structural challenges varies across countries and goes beyond the two-year horizon of this forecast. But important progress is being made:

- Fiscal consolidation is making headway. Well-anchored in the EU fiscal framework, budget balances are projected to improve substantially over the forecast horizon. By 2012, the average fiscal deficit is projected to come down to 3¾% of GDP in the EU and 3½% in the euro area from the 2009 peaks of respectively 6¾% and 6½%.
- Financial-market conditions, for instance in terms of lending activity, are steadily improving, although stress in some sovereign-debt markets remains high, and banking sector consolidation is still incomplete.
- Labour markets, which on average have shown remarkable resilience during the crisis, stabilised in the course of 2010 and are set to improve, albeit only gradually, over the forecast horizon. Productivity has bounced back to pre-crisis levels, but there are many Member States where unemployment remains unacceptably high.
- Adjustment of intra-EU current-account imbalances is making some headway. Largely owed to the retrenchment of domestic consumption, the adjustment is most marked in countries where deficits were very large at the onset of the crisis. But some structurally high current-account surpluses also appear to be gradually coming down on the back of stronger domestic demand and dynamic imports.

However, the global economic outlook remains plagued with unusually high uncertainty. Political tensions in the Middle East and North Africa, commodity-price developments, and potential repercussions from the tragic events in Japan represent new risks to growth and inflation.

Within Europe, sovereign-debt tensions continue to loom large in several countries. The thematic chapter contained in this European Economic Forecast examines the channels through which high sovereign risks affect the macroeconomic performance of the EU. Bold and comprehensive measures are being taken with a view to safeguard the macro-financial stability in the EU economy. Following Greece and Ireland in 2010, EU Ministers of Finance and Economy at their meeting of 16 May 2011 are expected to agree an economic adjustment programme for Portugal which is designed to pave the way for a sustainable and more competitive Portuguese economy. EU Heads of State and Government in March decided to raise the effective lending capacity of the European Financial Stabilisation Facility and established with the European Stability Mechanism a permanent crisis resolution mechanism to provide conditional financial assistance to vulnerable euro-area Member States. With a total lending capacity of €500 billion, the ESM will replace the temporary lending facilities of the European Financial Stability Mechanism and the European Financial Stabilisation Facility, which will be in operation until June 2013. Moreover, with the adoption of the so-called 'Euro Plus Pact' all euro-area Member States and six non-euro area Member States reinforced their political commitment for economic reform.

Determined and sustained implementation of policy reform is vital in order to harness the EU economy's potential in the face of possible new headwinds and to complete its return to strong, balanced and sustainable growth. The European Commission's 2011 Annual Growth Survey stresses the key economic policy priorities at this juncture: continuing coordinated implementation of rigorous fiscal consolidation to bring public finances back on a sustainable track; completing the financial repair of banks; as well as measures to correct macroeconomic imbalances and to boost long-term growth and competitiveness. Tackling unemployment, facilitating the reallocation of resources and preventing long-term exclusion from the labour market are essential ingredients of this mix. While relevant for the EU as a whole, this comprehensive policy agenda is particularly pertinent for the EU Member States implementing economic adjustment programmes supported by financial assistance from the EU and the IMF.



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## OVERVIEW

EU recovery makes further headway, amid the emergence of new risks

The economic recovery in the EU continues to make headway, despite persistent volatility and tensions in financial markets and the emergence of new risks that have made the external environment more challenging. The European Commission's spring 2011 forecast confirms that the EU economy is set to further consolidate its gradual and fairly muted recovery over the forecast horizon. Prospects for 2011 have been slightly upgraded compared with last autumn, while the projections for 2012 remain broadly unchanged. Upward revisions for inflation are more marked, reflecting the surge in commodity prices, an important part of the new challenges that have come to the fore since last autumn.

EU GDP growth went through a soft patch in the second half of last year ...

After a strong performance in the first half of 2010, real GDP growth in both the EU and the euro area slowed down in the second half of last year. The deceleration was expected and in line with a soft patch in global growth and trade, which reflected the withdrawal of stimulus measures and the fading of positive impulses from the inventory cycle. Nonetheless, the global economy, particularly the US and emerging market economies, proved more dynamic in the fourth quarter, in particular thanks to the strengthening of (private) domestic growth drivers. This provided a positive offsetting impulse to the adverse weather effects observed in the final part of the year in some Member States.

... but, with strengthening global growth and upbeat EU industrial sentiment, it is expected to gather pace again in 2011-12

Looking ahead, EU GDP growth in 2011 is set to gather pace. This outlook is supported, inter alia, by better prospects for the global economy and by upbeat EU business sentiment. The former owes mainly to a better outlook for the US, continued buoyant growth in major emerging market economies and the expectation of a limited global macroeconomic impact from the earthquake and tsunami in Japan. As regards EU business sentiment, notwithstanding the tensions observed in some euro-area sovereign-bond markets, it has continued to improve since autumn. This points to economic activity gathering pace this year and shows signs that the recovery is also broadening across sectors, a picture corroborated by hard data readings.

With financial markets expected to continue gradually recovering and providing support, ...

Financial markets conditions have generally continued to improve since last autumn, but stress in some sovereign-bond markets has remained high. Lending activity to the private sector, including to non-financial corporations, has turned positive, broadly in line with past cyclical patterns. As the economic recovery gains firmer ground and concerns about fiscal sustainability are addressed, financial-market conditions should continue to gradually improve and provide support to the recovery. For the banking sector, the new EU-wide stress tests and the implementation of appropriate follow-up measures should help to enhance the resilience of the system as a whole. However, with balance-sheet adjustments remaining incomplete in several sectors/countries and lingering concerns about developments in certain market segments, the situation remains generally precarious and uncertainty high.

... a broadening out of the recovery is materialising, largely as expected last autumn ...

In terms of demand components, a broadening out of the recovery is taking hold and is projected to continue, largely as envisaged in the autumn. An upward revision to export growth is supporting a rebound of investment, which is set to return to positive growth this year. This reflects brighter prospects for equipment investment on the back of improved corporate

profits and higher capacity utilisation rates. In contrast, reflecting the ongoing adjustments in several Member States, construction investment is set to contract again this year, albeit at a lower pace than in 2010. As for private consumption, a modest pick-up is envisaged for this year in the EU. Further ahead, slowly improving labour markets, moderate income growth, and lower saving rates should underpin the gradual recovery of private consumption. However, higher inflation rates have slowed the pace of this gradual strengthening compared to the autumn. In addition, the still ongoing deleveraging process in the corporate and household sectors, heightened risk aversion and the impact of fiscal consolidation are set to weigh on capital and consumer spending in the short term.

... leading to GDP growth of about 1¼% in 2011 and about 2% in 2012

With private domestic demand gradually strengthening, the recovery is set to become increasingly self-sustaining over the forecast horizon. Overall, EU GDP growth is expected to gather pace in the first quarter of this year, then ease somewhat in the next three quarters, before regaining ground in 2012, when it reaches a pace of some ½% quarter-on-quarter. In terms of annual averages, GDP growth is expected to edge up from just above 1½% in the euro area and 1¾% in the EU this year, to some 2% in both regions in 2012. This implies slightly higher growth for 2011 than expected in the autumn. The EU economy continues to slowly close the sizeable output gap that opened up during the recession.

This is a sluggish (post-crisis) recovery, where the EU grapples with legacy headwinds ...

Yet, the EU recovery is expected to be more muted than the average of previous upturns. This is in line with the pattern that has in the past characterised recoveries following deep financial crises. It has been argued since autumn 2009, when the recovery had just started, that the EU faces significant legacy headwinds that are set to restrain domestic demand, while the economy transits to a new steady state in the coming years. These include the downsizing of construction sectors, which is still ongoing in a number of Member States; the increase in unemployment, which following financial crises tends to be accompanied by higher structural unemployment; the surge in government deficits and debt, which, as seen repeatedly last year, can have a direct bearing on financial stability; and the adverse impact of the financial crisis on potential output, which is estimated to remain well below pre-crisis levels over the forecast horizon. Against this background, the two thematic chapters in this document provide in depth analysis of two highly topical issues: (i) the macroeconomic impact of developments in sovereign risk premia, and (ii) savings and investment developments across the EU.

... and one with multispeed recoveries across EU countries, particularly between core and periphery ...

The aggregate picture masks marked differences in developments across Member States. Some countries, in particular Germany but also some smaller export-oriented economies, have registered a solid rebound in activity, while others, notably some peripheral countries are lagging behind. Factors explaining the divergences include trade orientation, the product mix of exports, degree of openness, exposure to the financial-sector disturbances and the existence of sizeable internal and/or external imbalances. Looking forward, the expectation remains for a differentiated pace of recovery within the EU, reflecting the challenges individual economies face and the policies they pursue. Lingering concerns about fiscal sustainability, especially in some euro-area Member States that remain under intense market scrutiny, and differences in competitiveness positions appear among the most important challenges in this regard.

... reflecting  
heterogeneity in  
individual challenges

Among the largest economies, the upturn is set to be markedly strong in Germany, where, after posting a remarkable 3.6% GDP growth last year, the pace of economic activity is expected to ease but remain noticeably above the euro-area average this year as well. France is set to grow at just above the area average, whereas Italy at about ½ pp. below and Spain at half of the euro-area average. Outside the euro area, the strong German performance is outpaced by Poland, the only EU economy to have escaped a recession in 2009, while growth in the United Kingdom is set to be more subdued, roughly on a par with the EU average. Among the smaller economies, the rebound is particularly pronounced for Slovakia (3.5%) and Sweden (4.2%). In the EU, only two Baltic countries have higher growth rates than Sweden in 2011. In contrast, GDP is projected to contract in Greece and Portugal, while Latvia, Romania, Bulgaria, Ireland are expected to be out of recession. With, inter alia, the strong momentum in Germany pulling other countries, and a general gradual strengthening of domestic demand, GDP growth will tend to firm up in the course of 2011 and 2012 for most Member States.

EU labour market  
conditions expected  
to gradually  
improve ...

Labour-market conditions stabilised in the course of last year and have recently begun to improve. Employment in the EU increased slightly in the last quarter of 2010, driven by improvements in all sectors except industry and construction. The unemployment rate edged down in the first months of 2011, after having held mostly steady for over a year, at just above 9½% in the EU and 10% in the euro area. The situation is, however, highly differentiated across countries, with the rate of unemployment ranging from 4-5% in the Netherlands and Austria to 17-21% in Spain and the Baltic States.

... albeit with rather  
subdued job growth in  
sight and with high  
unemployment levels  
generally prevailing

Looking ahead and taking into account the usual lag between output and employment growth, the outlook is for a gradual improvement in labour markets over the forecast horizon. After contracting by around ½% in the EU and the euro area in 2010, employment is projected to grow modestly this year. The outlook for unemployment is for a decline of some ½ pp. over the forecast horizon. However, despite brightening somewhat since the autumn, and given the extent of labour hoarding during the recession, the outlook remains for rather subdued job growth and potentially persistent high unemployment at the aggregate level.

Headline inflation  
heads higher, while  
remaining economic  
slack keeps underlying  
inflation in check

Consumer-price inflation has taken a sharp upward turn since the autumn, on the back of a surge in commodity prices. Lately, fears of disruptions to oil supply from developments in the Middle East and North Africa (MENA) region have taken oil prices to 125 USD per barrel, a level last seen in the summer of 2008 and some 35 USD above the price assumed in the autumn. However, core inflation has remained subdued. Going forward, the still sizeable slack in the economy is expected to keep wage growth in check, partly offsetting expected increases in energy and commodity prices. HICP inflation is projected to average 3% in the EU and 2½% in the euro area this year, before easing to about 2% and 1¾% respectively in 2012. This represents an upward revision of some ¾ pp. in both regions for 2011 compared to the autumn.

Public deficits  
continue to  
improve ...

Public finances, which had been severely hit by the crisis, albeit to differing degrees in different countries, began to improve last year. Most EU Member States posted lower general government deficits in 2010 than in 2009. On account of stronger growth, the end of the temporary stimulus measures and a switch to fiscal consolidation, the general government deficit in the EU is projected to fall from about 6½% of GDP in 2010 to around 4¾% in 2011

and 3¾% in 2012, with a broadly similar pattern – but at a somewhat lower level – for the euro area. This is a slightly better profile than envisaged in the autumn, with the adjustment expected to be mainly expenditure-based in the EU and euro area.

... while debt remains on an upward path

The government debt ratio, in contrast, remains on an increasing path over the forecast horizon, reaching some 83% of GDP in the EU and 88% in the euro area by 2012. Thus, correcting the upward debt path remains a key economic challenge for safeguarding long-term fiscal sustainability, given lower potential growth than in the past and unfavourable demographic developments in the not-too-distant future.

New risks heighten uncertainty ...

Developments in the MENA region and Japan have heightened uncertainty and constitute predominantly downside risks to global economic activity. At the same time, downside risks to EU growth previously mentioned in the autumn have not disappeared. Hence, the balance of risks is regarded as tilted to the downside for the economic growth outlook presented here.

... and tilt the balance of risks to the downside for the growth outlook ...

The impact of unrest in the MENA region, the disasters in Japan and increases in commodity prices are developments that have come to the fore since the autumn and risk leading to globally higher inflation and lower growth than included in the baseline. Related to these are risks from tensions in exchange rates and rekindled protectionist impulses. Domestically, the fragility of financial markets, particularly of some sovereign-bond segments, remains an important source of concern, with damaging negative feedback loops still possible. Moreover, fiscal consolidation, given uncertainty on the timing of measures and continued market concern on fiscal sustainability, may weigh on domestic demand more than currently envisaged. In contrast, on the upside, stronger-than-projected global growth, as a result of domestic demand in emerging markets being more buoyant than currently expected, could further benefit EU export growth. Domestically, the rebalancing of EU GDP growth towards domestic demand could prove stronger than envisaged in the forecast, with, for instance, the labour market surprising positively. Similarly, spill-overs from the strong momentum in Germany to other Member States could materialise to a larger extent than is currently expected. Finally, policy measures to redress the fiscal situation could prove more effective than presently foreseen in dissipating market concerns and thus further raising confidence among businesses and consumers.

... and to the upside for the inflation outlook

Turning to the inflation outlook, risks appear tilted to the upside. While the considerable slack remaining in the economy, weak labour market conditions and overall well-anchored inflation expectations should keep underlying inflation in check, the upward pressures stemming from developments in commodity prices could come to the fore more than is currently projected. In particular, should political tensions spread further in the MENA region, disruptions to oil supplies could not be excluded, fuelling oil-price increases beyond what was assumed in this forecast.



# PART I

Economic developments at the aggregated level



# 1. EUROPEAN RECOVERY MAINTAINS MOMENTUM AMID NEW RISKS

*The global economic recovery continues to make headway, but it is becoming more uneven, across major regions and within them. In the EU, the moderate economic recovery is generally developing as expected, with pronounced differences across countries and uncertainty at elevated levels. A positive contribution from the external side has started to impact positively on components of private domestic demand. The process of achieving a more balanced composition of economic growth has made further progress in the faster growing EU countries. Conversely, countries facing substantial economic adjustment challenges are understandably lagging behind, though there are encouraging signals that the recovery could materialise and gain momentum in 2011 and 2012. This leaves the European economies with a multi-speed recovery and the area as a whole, as with most other advanced economies, lagging behind the group of emerging market economies.*

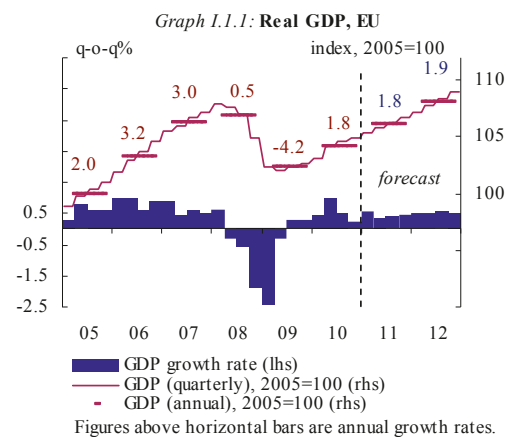
*An array of survey-based indicators points to a continued expansion of economic activity in the EU, a picture that is corroborated by hard data. Economic growth is expected to continue along a trajectory of around 2%, slightly higher in 2011 than forecast last autumn, but broadly unchanged in 2012. On the back of higher commodity prices, inflation rates are forecast to increase to close to 2½-3% in 2011, before falling back to around 2% in 2012. The resulting pressure on real disposable income is dampening private consumption growth in 2011. More moderate inflation and, with the usual lagged response to developments in output, higher employment are set to brighten growth prospects in 2012. Economic growth is expected to be strong enough to support the progressing fiscal consolidation.*

*The uncertainty surrounding the forecast has increased over recent months as the news about unrest in the Middle East and North Africa (MENA) and cascading disasters in Japan pose additional downside risks in the near future, while previously existing downside risks, in particular those related to the situation in financial markets (e.g. sovereign bonds) remain. Therefore, the balance of risks is regarded as tilted to the downside for the growth outlook and to the upside for the inflation outlook.*

## 1.1. A SUBDUED RECOVERY IN ITS THIRD YEAR

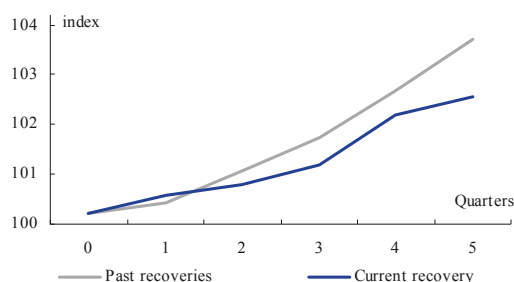
In spring 2011, the European economic recovery is progressing. Almost four years after the sub-prime crisis in the US triggered the global financial crisis and almost two years after the exceptionally deep recession ended, the economy is approaching its pre-crisis level in terms of output. Following the initial push from the extraordinary policy measures, external demand, and the inventory cycle, the recovery now shows signs of a broadening across components. Private domestic demand is contributing more strongly, although it is – particularly in 2011 – subject to additional constraints due to higher inflationary pressures.

With short-term indicators pointing to an ongoing expansion in the EU, the growth outlook for this year and next looks favourable (see Graph I.1.1). However, at the current juncture there is no convincing evidence that the economic upturn will gain substantially more pace over the forecast horizon.



Overall, the recovery is expected to continue to be more muted than recoveries in the past (see Graph I.1.2), not only in Europe but in almost all advanced economies. The main explanation for the subdued recovery can be found in the type of recession the economy is emerging from.

Graph I.1.2: Comparison of recoveries, current against past average - GDP, euro area

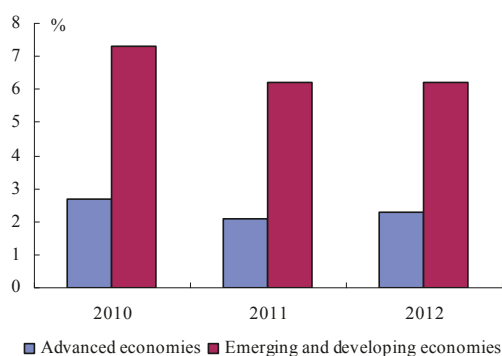


Note: Real GDP following the recessions of the mid 1970s, early 1980s and early 1990s

### "This time is different", but not everywhere ...

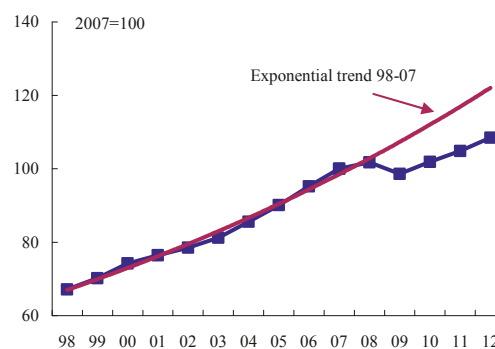
Recoveries following financial crises are typically being more subdued and sluggish than other recoveries.<sup>(1)</sup> Differences in the speed of recovery are accordingly related, inter alia, to the degree to which economies were hit by the shock and the number of challenges that had to be faced. These challenges include the deleveraging of households and firms, the repair of balance sheets in the financial sector, adjustment needs in the real economy, and, where needed, structural reforms to raise growth potential. Evidence from the first years of the recovery points to two major recovery speeds in the world economy (see Graph I.1.3).<sup>(2)</sup>

Graph I.1.3: A global multi-speed recovery - real GDP, annual growth

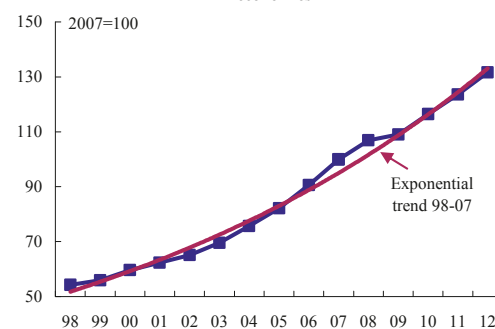


The highest speed is observed in countries that were almost unaffected by housing and real-estate bubbles, had few links to the financial sectors of the most affected countries and were mainly hit via trade links. Most emerging market economies, including China and India, belong to this group and managed to recover strongly, almost following a V-shape in terms of rebound of industrial output and real GDP. Many of them have completed catching up from crisis-related declines in output or are already approaching their pre-crisis growth trajectory. A much lower speed of recovery is found in advanced economies that were in general much more closely linked to the epicentres of the global crisis (see Graph I.1.4).

Graph I.1.4a: GDP per capita, advanced economies



Graph I.1.4b: GDP per capita, emerging and developing economies



While the growth differences between emerging market economies and advanced economies are undisputed, the differences among advanced economies tend to receive less attention. In general, two types of slowly recovering advanced economies can be distinguished. Some, like the US, were hit by a homemade financial crisis and the shock to world trade. These most severely hit advanced economies, almost entirely countries that had been large capital importers before the crisis, are experiencing a more sluggish recovery as financial sectors, firms, and households are going

<sup>(1)</sup> See Reinhart, C. M. and K. S. Rogoff, *This time is different: eight centuries of financial folly*, Princeton 2009; European Commission (DG ECFIN), *Economic crisis in Europe: causes, consequences and responses*, *European Economy*, 7/2009; and Kannan, P., *Credit conditions and recoveries from recessions associated with financial crises*, *IMF Working Paper* 10/83, March 2010.

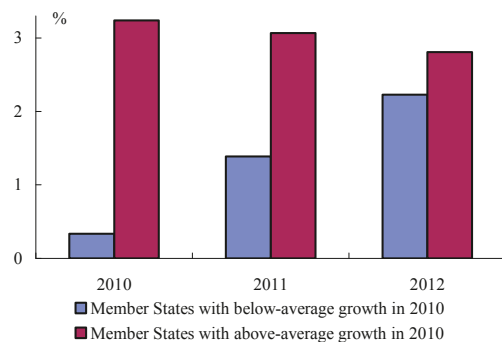
<sup>(2)</sup> See e.g. IMF, *Tensions from the two-speed recovery*, *World Economic Outlook*, April 2011; Janssen, N. and J. Scheide, *Growth patterns after the crisis: This time is not different*, *Kiel Policy Brief* no. 22, December 2010.

through a period of deleveraging. Ongoing deleveraging delays the pick-up in private consumption and investment. In several of these countries, public debt has moved up, eventually resulting in fiscal retrenchment that weighs on the speed of the recovery. A second group of advanced countries (e.g. Germany) was also hit by the crisis, but mostly via linkages of financial sectors (e.g. knock-on effects to their banking sectors) and trade links without experiencing sharp corrections in domestic housing markets. Many of these countries were able to recover more quickly and strongly than the others.

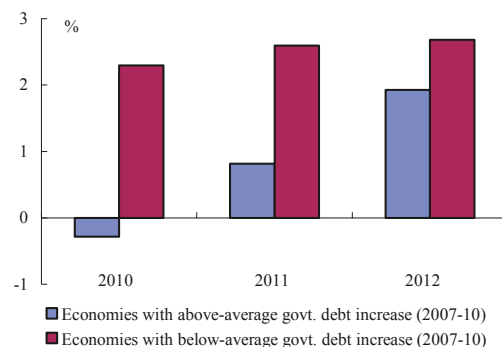
### ... with the EU facing the expected subdued and differentiated recovery.

The different recovery speed among advanced economies is clearly visible in differences in the pace of economic growth in the Member States in 2010. The group of countries with above-average growth comprises countries – such as Germany, Poland and Sweden – that did not experience the bursting of a housing or real estate bubble.

Graph I.1.5a: A multi-speed recovery in the EU - real GDP, annual growth (unweighted)



Graph I.1.5b: A multi-speed recovery in the EU - real GDP, annual growth (unweighted)

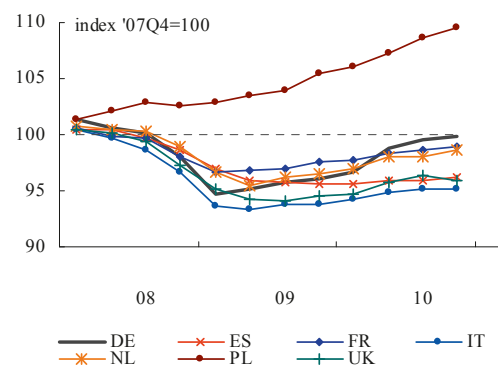


Among the economies that grew below EU average are Member States hit by a banking crisis (the UK) or a housing crisis (Spain), as well as

debt-troubled euro-area economies (Greece, Ireland, Portugal), where debt has been an obstacle to economic growth.<sup>(3)</sup> As adjustment continues, however, the speed difference between the fast growers and the followers is expected to diminish over time. The speed difference between countries that had above- and below-average increases in government debt is expected to narrow slowly (see Graph I.1.5).

However, due to the relatively moderate pace of the recovery in both groups, by the end of 2010 only a minority of EU Member States had fully recovered the output losses experienced during the recession. For instance, in the group of the seven largest economies, only Poland has clearly exceeded its pre-crisis level of output, whereas Germany just returned to the output level of the fourth quarter of 2007 (see Graph I.1.6).

Graph I.1.6: Real GDP 2008-10



A similar picture emerges from estimated output gaps. They had widened substantially during the downturn in 2009 and have not yet returned to pre-crisis levels. In line with the observed differences in growth momentum, wide output gaps in several Member States continue to signal an extended period of low resource utilisation, making a continuation of subdued economic recovery more likely. These observations support both the hypotheses that "this time is different", as put forward in previous forecast documents,<sup>(4)</sup> and that the EU economy is experiencing a multi-speed recovery.

<sup>(3)</sup> See Reinhart, C. M. and K. S. Rogoff, A decade of debt, *CEPR Discussion Paper* no. 8310, April 2011 (particularly Section IV).

<sup>(4)</sup> See e.g. European Commission (DG ECFIN), European Economic Forecast – Autumn 2009, *European Economy* 10/2009

## 1.2. THE EXTERNAL ENVIRONMENT

### Recovery of the world economy continues ...

The world economy is recovering gradually, faster in some regions than in others, and the pattern of world output growth remains broadly unchanged. World output (excl. EU) is forecast to grow at an annual rate of 4½% in 2011 and 2012, which is slightly above the autumn forecast in both years.

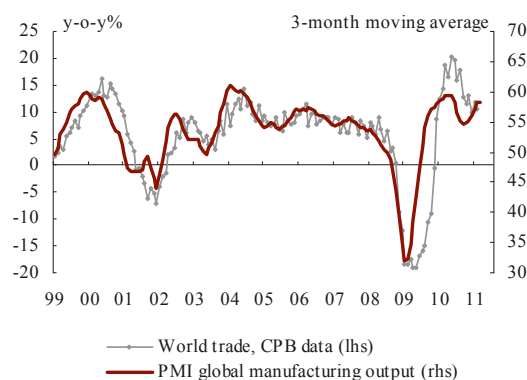
Advanced economies are growing more sluggishly than emerging market economies, particularly in Asia (see Table I.1.1). The upward revision to US growth compared to the autumn forecast is the main driver behind the slightly improved outlook for 2011 and partly offsets the downward revisions to economic growth in Japan and the effect of higher oil prices.

Emerging economies are forecast to continue to grow more strongly than advanced economies in 2011 and 2012, leaving little spare capacity and making them now more vulnerable to inflationary pressures. Monetary tightening that has started (e.g. in China) or is expected to start in several emerging countries is attracting capital flows from advanced countries, leading to appreciation trends in emerging markets' currencies and thereby potentially contributing to the reduction of external imbalances.

### ... with solid world trade growth ...

World trade volumes grew by 12% in 2010 and have already returned to pre-crisis levels, though not to the pre-crisis growth path. The carry-over from the re-acceleration after the soft patch in the third quarter of 2010 and readings of survey indicators such as the global PMI for the manufacturing sector (see Graph I.1.7) point to a continuation of strong world trade growth in 2011 and 2012, though it will be slightly less dynamic as the contribution from the inventory cycle fades away.

Graph I.1.7: World trade and PMI global manufacturing output



### ... despite higher commodity prices ...

Oil prices have increased substantially over the past months, in particular due to higher demand on

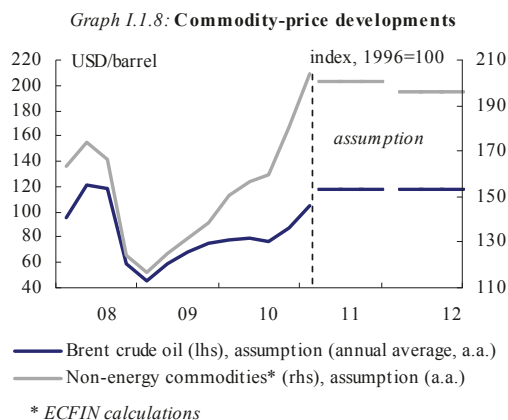
Table I.1.1:

#### International environment

(Annual percentage change)					Spring 2011 forecast			Autumn 2010 forecast	
(a)	2007	2008	2009		2010	2011	2012	2011	2012
<b>Real GDP growth</b>									
USA	20.5	1.9	0.0	-2.7	2.9	2.6	2.7	2.1	2.5
Japan	6.0	2.4	-1.2	-6.3	3.9	0.5	1.6	1.3	1.7
Asia (excl. Japan)	26.4	10.3	6.9	6.1	9.2	7.7	7.7	7.6	7.5
- China	13.0	14.2	9.6	9.1	10.3	9.3	9.0	9.2	8.9
- India	5.2	9.2	6.7	7.4	10.4	8.0	8.2	8.3	7.8
Latin America	8.5	5.8	4.3	-1.7	5.9	4.2	3.9	4.0	4.2
- Brazil	2.9	6.1	5.1	-0.2	7.5	4.4	4.3	4.8	5.1
MENA	5.0	6.0	4.8	1.4	3.8	3.1	3.7	4.0	4.0
CIS	4.3	8.9	5.3	-6.8	4.5	4.7	4.5	4.1	4.2
- Russia	3.0	8.5	5.2	-7.9	4.0	4.5	4.2	3.8	4.0
Sub-Saharan Africa	2.5	7.1	5.6	2.8	5.0	5.5	6.0	5.5	6.0
Candidate Countries	1.4	4.8	0.9	-4.9	7.6	5.6	5.1	5.1	4.3
World (incl. EU)	100.0	5.4	2.9	-0.6	4.9	4.0	4.1	3.9	4.0
<b>World merchandise trade volumes</b>									
World import growth		6.7	2.7	-12.7	14.0	7.8	7.9	7.4	7.3
Extra EU export market growth		8.9	3.6	-11.0	13.7	8.2	8.2	7.9	7.3

(a) Relative weights in %, based on GDP (at constant prices and PPS) in 2009.

the back of the recovery, especially in emerging economies where growth is relatively energy-intensive, a harsh winter in Europe and North America, and geopolitical tensions in some oil-exporting countries with contagion risks in the region (see Graph I.1.8). In the first four months of 2011, the price of Brent rose from 95 to 125 USD per barrel. High inventory levels and sufficient spare capacity, mostly in Saudi Arabia, contained the increase and were in place to step in for delayed and disrupted delivery from Libya, which is not among the largest oil exporters. Uncertainty about how events will develop in the region adds a geopolitical risk premium to oil prices. Apart from these exceptional factors, the structural upward trend in oil prices, in line with long-run growth in output and demand in emerging market economies, seems to be intact.



Non-energy commodities are also on an upward trend. In the first quarter of 2011, metal prices surged, after already strong increases in the second half of 2010. Scarcity has become a structural feature to which supply is only responding gradually. Although high prices and slightly moderating growth in emerging market economies exert some downward pressure, metal prices are expected to increase by about 25% in 2011, before easing somewhat in 2012. This implies that prices will remain at or close to historical peaks. Food prices surged by 15% in the second half of 2010 and continued their ascent in early 2011 due to both short-term supply-side factors (weather-related supply shocks, exports bans and rising oil prices) and rising global demand. The latter is driven by strong population and income growth in emerging market economies and its impact on dietary preferences, and increased biofuel demand, particularly in advanced economies. Food prices are assumed to remain high as future markets point

to a stabilisation. Due to base effects, this implies an annual increase of close to 20% in 2011 and a slight moderation in 2012.

#### ... and the impact of natural disasters in Japan.

The combination of natural disasters on March 11 and the subsequent nuclear catastrophe have changed the economic outlook for Japan (see Box I.1.1). It is difficult to gauge the impact on the economy of the Tōhoku earthquake and the tsunami it caused, but available preliminary estimates point to the need of a downward revision to the growth outlook in 2011 and an upward revision in the following year, when rebuilding efforts are expected to exert a positive impact. As for spillovers to the region and beyond, they can be expected to be manifold, including impacts on the real economy (e.g. production chains, trade linkages, and sentiment), financial markets (e.g. more adverse risk attitudes and "flight from fear", stock prices), commodity markets (e.g. oil and liquefied natural gas) or in other areas (e.g. repatriation of Japanese funds). While the spillovers cannot be quantified with precision at the current juncture, they are not expected to derail the recovery of the world and EU economy going forward.

#### While advanced economies continue expanding at moderate pace ...

The US economy showed an impressive rebound in 2010, expanding at a rate of nearly 3% after a contraction of about the same size in the year before. This rebound benefited from extraordinary fiscal and monetary policy measures (e.g. Quantitative Easing 2). Some of the momentum has been lost in the first quarter of 2011 as domestic demand weakened and net exports contributed negatively to growth. In particular, higher commodity prices will continue to weigh on the growth momentum in 2011, which is also hampered by still-sluggish employment growth and ongoing housing-market corrections. Despite these downward factors, economic growth in 2011 is expected to be higher than projected in the autumn forecast, mainly due to the prolongation of fiscal stimulus. The improved outlook is captured in upward revisions of growth in real GDP, private consumption and gross fixed capital formation in 2011. As some of the policy measures are expected to expire at the end of 2011, their support will fade away.



**Box 1.1.1: The impact of the Tōhoku earthquake in Japan on the world economy**

Two months after the large earthquake in Japan, which triggered a tsunami and substantial nuclear fallout from one of the damaged power plants, the economic consequences for Japan and the rest of the world are hard to quantify. A significant amount of productive capital was destroyed and a number of roads, ports, airports and plants were out of operation for some time after the quake, causing bottlenecks in production and transport. The immediate effect of the events was a synchronous short-term drop in stock markets around the world. The Japanese government estimated in end-April the direct damages at JPY 25 trillion (5.2% of GDP), representing less than 1% of the total capital stock of the Japanese economy. Furthermore, the catastrophe will imply significant costs for public finances and insurance companies.

The unspeakable human tragedy notwithstanding, past experience tells that natural disasters in mature and affluent economies like Japan usually cause only a brief interruption to economic growth. For instance the 1995 Kobe earthquake caused only a temporary interruption of production, mainly in the most affected region, followed by a strong rebound of economic activity, which boosted output in subsequent quarters, and resulted in overall minor short-term losses to GDP growth.

Also, the impact on the rest of the world economy through the trade channel is typically assessed to be limited. In recent years, the share of exports from Japan in world trade has declined considerably and constituted in 2010 around 5% of world exports. The share of EU's merchandise trade with Japan is still smaller, with 1.2% of EU exports going to and 1.6% of imports originating from Japan. However, for most Asian countries Japan is a significant trading partner with import shares varying between 5-10%. In 2010, 56.1% of Japanese exports were directed to Asia compared to 11.3% going to the EU.

Standard simulations in line with past experience project rather limited implications for economic growth in Japan and the rest of the world. In late March, the Japanese authorities presented an estimate of GDP growth losses for the Fiscal Year 2011 (April 2011 – March 2012) of 0.5-1.25 pps. compared to the baseline, including the effects of power outages and supply chain disruptions within the country. The Bank of Japan projects GDP growth for Fiscal Year (FY) 2010 to be 0.5-0.6 pp. lower than estimated in January 2011. The GDP

growth estimate for FY 2011 was revised down by 1 pp. to 0.6%. At the same time, it expects GDP growth for FY 2012 to be 0.9 pp. stronger than previously assumed. The IMF projects a 0.2 pp. dent compared to the baseline in 2011 expecting a 1 pp. drop in domestic demand to be partly compensated for by a series of fiscal packages.

However, the March 2011 triple disaster of earthquake, tsunami and nuclear fallout is characterised by a number of specific features which may aggravate the economic impact at this juncture. In particular, the consequences of widespread power outages, infrastructure and transport problems in a relatively wide area, supply-chain disruptions are important elements for assessing the economic consequences of the events, but also the impact of the lingering nuclear risks on confidence. Electricity supply in the Greater Tokyo area is currently still around 20% below the pre-quake capacity. Disruptions in manufacturing production have led to a shortage of key components in industries such as automotives and electronics, affecting temporarily productions processes world wide. In addition, the evolution of consumer and investor confidence is of major importance for the future development in Japan. The considerable scope of the disaster and uncertainty related to the nuclear fallout may have prolonged effects on sentiment curbing private consumption and investments for a longer period of time and with potential spillover effects to the rest of the world.

The Commission simulated the impact of the Japanese crisis on economic growth in the EU and in the rest of the world, using the QUEST model. The damage to the capital stock is assumed at 4% of GDP (JPY 20 trillion). Public infrastructure is assumed to be rebuilt within three years, after an initial delay of one quarter for the reconstruction to start in earnest. The announced power outages in the Greater Tokyo area are captured in the model as efficiency losses in the magnitude of 0.6% of GDP in the first quarter following the disasters. The Greater Tokyo area represents approximately 40% of Japanese GDP. Forced closures of production facilities in the days after the catastrophe are also computed in the simulation. The resulting efficiency losses are halved every subsequent quarter.

Due to the lower capital stock and the delayed resumption of economic activity by companies, stock prices would decline by around 10% over one

*(Continued on the next page)*



*Box (continued)*

quarter before gradually recovering. In addition, the shock to market confidence would cause a temporary decline of 3% in stock markets around the world capturing lower confidence by investors and consumers.

According to this scenario, on an annual basis, Japanese GDP would fall by some 1¼ pp. in 2011 compared to the baseline. Against the background of initially encouraging data in late 2010 and early 2011, the no-disaster baseline comprised a GDP forecast of around 1¾% to 2%, implying that the disasters lowered the growth rate to about ½% in 2011. As regards the impact on the EU, the loss in terms of GDP would be of around 0.2% in 2011,

mostly triggered by lower investor confidence.

The negative growth effect for the world economy is likely to be noticeable but by far not large enough to derail the ongoing recovery. Under the assumption that supply-chain disruptions will not last beyond the second quarter and no significant changes in the energy-mix will occur, the effects of the Japanese crisis are unlikely to deduct more than 0.2 pp. from world growth. Japan's increased demand for oil and the debate in several countries about changing the energy mix, triggered by the nuclear accident, could have further consequences on commodity prices over the medium-term.

In Europe, the recovery in EFTA countries is continuing. In Norway, the prospects for private consumption, oil revenues and oil investment have improved over the past months, providing reason to expect stronger economic growth ahead. In Switzerland, the economy rebounded strongly despite the strength of the (safe haven) currency. In the five EU candidate countries, the picture continued to be mixed. Turkey's economy experienced a strong broad-based recovery and its favourable outlook lifts the average growth forecast for the candidate countries (Croatia, Iceland, Turkey, the former Yugoslav Republic of Macedonia, and Montenegro) as a whole.

**... strong growth in emerging and developing countries is expected to continue.**

Asia continues to be home to some of the most important drivers of global growth. Driven by strong fixed-asset investment and buoyant private consumption, China's growth accelerated in 2010. To counteract strongly increased inflationary pressures, the central bank has started to tighten monetary policy, which should result in a slight growth moderation. In India, strong economic growth continues to be driven by buoyant domestic demand. The other main economies in South-East Asia are benefiting from the strong expansion in global trade and, in particular, demand from China.

Latin America continues to surpass expectations, having grown by about 6% last year – the fastest rate in two decades, – and solid economic growth is expected to continue at rates of about 4%. Particularly in South America, countries are thriving on a surge in domestic demand, capital inflows and a rebound in prices of raw materials.

In Brazil, GDP growth accelerated strongly, driven mainly by strong domestic demand, which is now expected to moderate somewhat in response to the tightening of fiscal and monetary policies.

In the MENA region, economic growth resumed at an annual rate of 4% last year, with the oil-producing countries in the region supported by higher oil prices. The economic outlook for the region, which has a share of about 40% in global oil supply, is closely associated with the price of oil and the region's ability to avoid oil-supply disruptions. Geopolitical upheaval and the conflict in Libya are expected to weigh on growth prospects, lowering output growth this year.

In the CIS region, the recovery resulted last year in an average growth rate of 4%, which is expected to be maintained over the forecast horizon. The region's largest economy, Russia, grew by 4% in 2010, supported by inventory investment, private consumption and fixed investment, but with agricultural output hit by an exceptional heat wave and droughts. Increases in commodity prices improve the growth outlook and explain upward revisions as compared to the autumn forecast.

Particularly in emerging economies, the rise in commodity prices and strong demand growth have raised inflationary pressures, which generally exceed those in advanced economies. Policymakers have started to address the challenge of containing inflation without endangering economic growth, mostly by monetary tightening. It is assumed that this approach will be continued over the forecast horizon.

### 1.3. FINANCIAL MARKETS IN EUROPE

Given the key role played by credit in recoveries, developments in financial markets are always an important determinant of the economic outlook. This is particularly the case at the current juncture, since almost all countries emerging from recession had been subject to financial disruptions such as distortions to credit supply and sharp declines in asset prices, notably in housing markets. Historical evidence suggests that interactions between developments in the financial sector and real economic activity are shaping not only recessions but also recoveries.<sup>(5)</sup> In that regard, gradual improvements in several segments of financial markets have sent encouraging signals. Over the forecast horizon, a further gradual improvement in financial markets is expected, as the economic recovery continues and fiscal consolidation progresses.

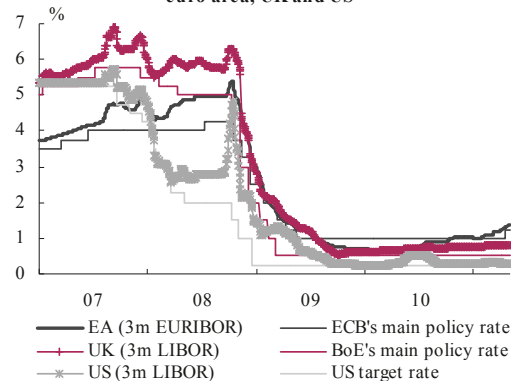
#### Economic recovery and sovereign-debt crisis in the focus of market participants ...

Two factors driving financial markets stood out in recent months. One was the ongoing economic recovery, which was accompanied by a revised inflation outlook and first steps towards a normalisation of the monetary policy environment. The other was persisting concerns about the sustainability of public finances in several euro-area Member States, which were affected by a number of factors. These include successful auctions by peripheral euro-area sovereigns and by the EFSM and the EFSF as well as the 'comprehensive package' including the adoption of the so-called Euro Plus Pact, adopted by the March European Council.<sup>(6)</sup> Several market segments have continued to recover, while the sovereign-debt crisis has continued despite the comprehensive measures taken by European institutions since May last year. The unrest in the MENA region and the disasters in Japan had an only temporary impact on some segments of financial markets.

#### ... as money-markets interest rates increase ...

The functioning of euro-area money markets has improved since the beginning of the year after a pick-up in tensions last autumn. However, the set of bidders in the Eurosystem operations remains segmented, with a small number of institutions excessively reliant on central bank liquidity accounting for a substantial share of the overall refinancing volumes. At the same time, for the majority of banks there have been signs of a further normalisation in access to market-based financing. Apart from liquidity management, money-market rates have reflected expectations about the future path of policy rates after the ECB has in April, for the first time since the recession, raised its key policy rates (by 25 bp), whereas other large central banks have kept policy rates unchanged (see Graph I.1.9). In April, slightly increased short-term rates reflected lower excess liquidity and an upward revision in market expectations about future monetary policy decisions. This development is behind the upward revisions to the interest-rate assumptions of this forecast (see Box I.1.6), which are derived from futures contracts.

Graph I.1.9: Policy interest rates, euro area, UK and US



#### ... and the better overall situation of EU banking sector supports lending ...

The overall situation of the EU banking sector has improved, but considerable variation at the level of individual banks persists. Returns on equity and on assets have both increased in 2010, suggesting a further strengthening of bank profitability for the sector as a whole. But bank profitability prospects remain very heterogeneous, as some banks have to cope with ongoing deleveraging (see Box I.1.2), further loan losses, high funding costs and low business growth.

<sup>(5)</sup> See e.g. Claessens, S., M. A. Kose and M. E. Terrones, How do business and financial cycles interact?, *IMF Working Paper* 11/88, April 2011. The interaction between financial markets and real activity has been analysed in European Commission (DG ECFIN), European Economic Forecast – Spring 2010, *European Economy* 2/2010.

<sup>(6)</sup> For an overview see European Commission (DG ECFIN), *Quarterly Report of the Euro Area*, April 2011, 10(1), pp. 7-14.

### Box I.1.2: How far is the private sector in its deleveraging process?

Historical evidence suggests that financial crises are typically followed by an extended period of sizeable balance-sheet adjustments by the most heavily indebted economic actors. Last autumn, the Commission's forecast assessed the state of deleveraging across the non-financial corporate (NFC) and the household (HH) sector in the EU until mid 2010.<sup>(1)</sup> This box provides an update of this adjustment process, based on the latest data available, i.e. including the third quarter of 2010.

In the EU, the overall progress of deleveraging remains slow by historical and international standards. In the NFC sector, the expansion of debt witnessed prior to the crisis continued well into the crisis. However, since mid-2010 a reduction of corporate debt levels has set in. Euro-area corporate debt to GDP peaked in the second quarter of 2010 at 107.1% and fell back slightly to 106.7% in the third quarter (see Graph 1).

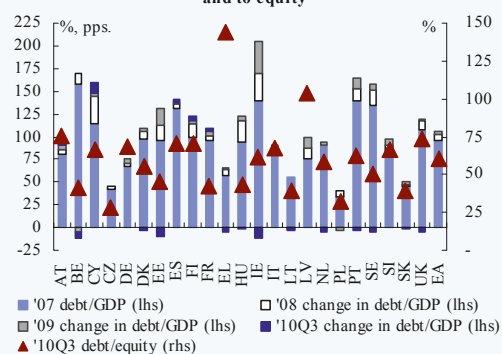
Progress of corporate balance-sheet adjustment is unevenly spread across Member States and companies: the debt-to-GDP ratios have fallen in some Member States (e.g. Belgium, Estonia, Greece, Ireland, and the United Kingdom) while in other Member States they are still trending higher (e.g. Cyprus, Finland, Spain). Large companies have issued significant volumes of corporate bonds. On the other hand, small and medium-sized enterprises (SMEs), which are often heavily dependent on bank lending, have experienced tighter credit constraints. Moreover, taking advantage of low interest rates, many companies have improved their external financing situation. Many have lengthened the maturity structure of their debt over the last couple of years, thereby reducing the refinancing risk over the coming years. 70% of euro-area companies' liabilities are now labelled 'long-term'.

Corporate debt is again backed by higher equity cushions. Following the gradual recovery in corporate earnings and the rebound in equity valuations, the debt-to-equity ratios have fallen in most Member States from their peaks in the first quarter of 2009 and were at 60% in the third quarter of 2010. Notable exceptions to the large equity buffers are Greece and Latvia (see Graph 1). Furthermore, many companies have built ample cash balances, but this trend seems to have

stabilised over 2010 or reversed in some countries (e.g. in Ireland, Italy and Greece).

Against this general trend, in particular more domestically focussed companies in Member States most affected by the sovereign-debt crisis are experiencing increasing borrowing rates and have on average more vulnerable balance sheets while cash flows have diminished owing to the slowdown in economic activity.

Graph 1: Non-financial corporations' debt to GDP and to equity



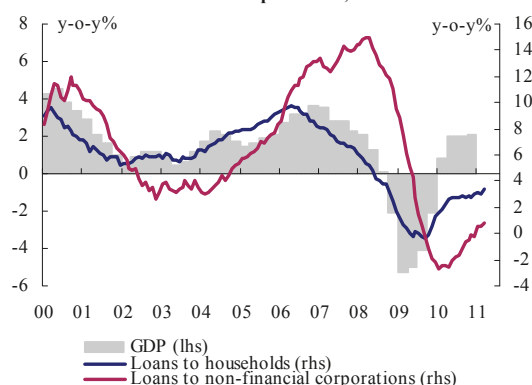
Along with rising residential real estate prices, HHS' gross debt, relative to gross disposable income (GDI), has risen steadily over the past decade to 97.3% in the third quarter of 2010 (euro area). Euro-area aggregate debt levels remain well below those of other advanced economies, such as the US and Japan (117.6% and 101.0% resp.). However, HHS' debt ratios are nevertheless high in international perspective in several Member States (i.e. Denmark, the Netherlands, Ireland, the UK, Sweden, Portugal, Spain and Cyprus).

Deleveraging has been necessarily more profound in countries facing strong housing market corrections, notably in Ireland, the UK and Spain. However, little progress has been made in the euro area at large: net growth of housing loans slowed down during the crisis and became even slightly negative in 2009; yet it has picked up since and stood at 3.8% in February 2011. Moreover, in several Member States, house prices seem to be picking up (modestly) again (e.g. in France). The historically low level of interest rates and the increased use of variable interest rates in several EU Member States have eased the debt-servicing burden and may have also reduced pressure to adjust debt levels, leaving still highly indebted households vulnerable to interest rate changes.

<sup>(1)</sup> See Box I.1.4 "How much deleveraging has taken place?", European Economic Forecast – Autumn 2010, *European Economy* 7/2010

As for lending activity, bank credit provision to the economy has expanded further in early 2011. In the first three months of 2011, bank lending to households has continued to increase, but remains generally subdued (see Graph I.1.10). The growth rate of bank loans to the non-financial corporate sector has recovered further until March. According to the ECB Bank Lending Survey (April 2011), demand for loans from enterprises expanded notably in the first quarter of 2011, mainly driven by increased financing needs for inventories, working capital, and, for the first time in two years, fixed investment. The survey suggests a moderate tightening of credit standards on loans to enterprises, which has mainly affected large companies, whereas credit standards on loans to small and medium-sized enterprises remained broadly unchanged. Looking forward, euro-area banks expect a further moderate tightening of credit standards in the second quarter of the year.

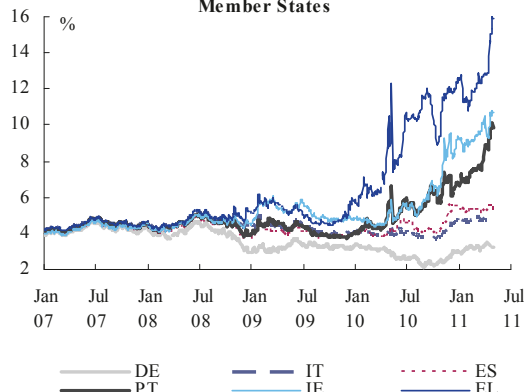
Graph I.1.10: Bank lending to households and non-financial corporations, euro area



#### ... while some sovereign-bond markets remain a concern ...

In sovereign-bond markets, benchmark yields had been on an upward trend since September 2009, rebounding from historical lows during the period of the "Great Moderation". Increases were driven by an improved economic outlook, lower safe-haven demand (less risk aversion) and rising inflation expectations, with fluctuations around the trend linked to tensions in the euro-area sovereign-bond markets. After the steep widening in autumn, bond spreads of distressed European sovereigns have remained at elevated levels (see Graph I.1.11). Particularly this holds, though to different degrees, for Greece, Ireland, and Portugal, the three countries that have requested financial assistance from the EU and the IMF.

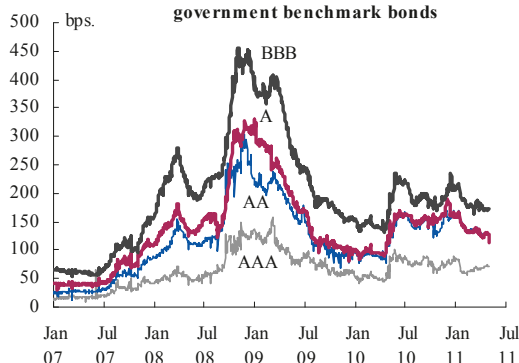
Graph I.1.11: Government-bond yields, selected Member States



The relief seen in markets following measures taken at the European level has repeatedly turned out to be temporary, since market participants have remained concerned about mutually-reinforcing interactions between fiscal retrenchment, weak economic development and lasting banking-sector problems. Financial-market concerns about selected Member States have also been reflected in reduced – or no – access to market-based funding for their domestic banks and more frequent recourse to ECB liquidity.

Fears that the sovereign-debt problems in some Member States would spill over to other market segments have not been supported by investment-grade corporate bonds. Declining default risks and an improved economic outlook narrowed their spreads vis-à-vis government benchmark bonds close to pre-crisis levels (see Graph I.1.12).<sup>(7)</sup>

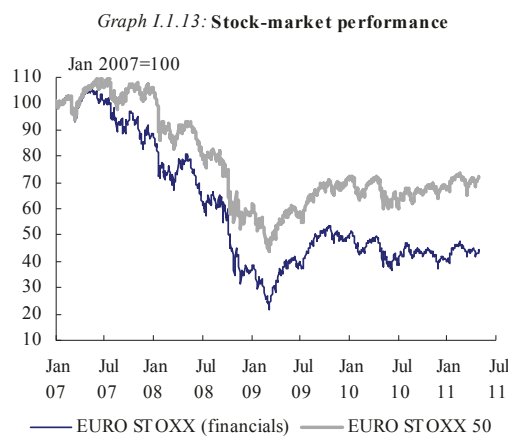
Graph I.1.12: Corporate spreads over euro-area government benchmark bonds



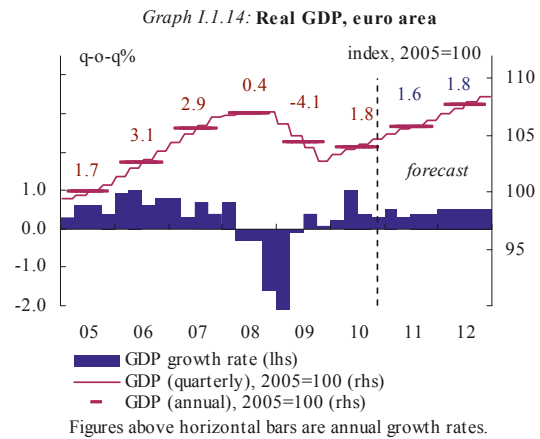
<sup>(7)</sup> For a more detailed analysis see chapter I.2 of this publication,

### ... and stock markets rise further.

Stock markets have benefited from continued positive economic data on both sides of the Atlantic in the first months of 2011. Geopolitical tensions, higher and volatile oil prices and uncertainty about the impact of the situation in Japan had temporarily erased some of the gains in March, but the most recent data show a continued upward movement. As compared to the pre-crisis level, gains are still unevenly distributed across sectors, with financial stocks lagging somewhat (see Graph I.1.13).



positive real GDP growth after the recession. In 2010, real GDP growth accelerated to 1.8% in the EU (see Table I.1.2) and the euro area (see Table I.1.4). Within the year, the growth momentum eased in the second half of 2010 (see Graph I.1.14), reflecting the soft patch in global growth after the end of the push from the inventory cycle and the fading away of fiscal support.



In the last quarter of 2010, real GDP grew by 0.3% (q-o-q) in the euro area and by 0.2% (q-o-q) in the EU. This resulted in a carry-over for GDP growth in 2011 of 0.6% in areas (see Table I.1.3).<sup>(8)</sup>

## 1.4. THE ECONOMIC RECOVERY IN THE EU

The economic recovery in the EU and the euro area gained momentum in 2010, the first year with

<sup>(8)</sup> Carry-over effects have been shown to be useful for short-term forecasting; see e.g. Toedter, K.-H., How useful is the carry-over effect for short-term economic forecasting?, *Deutsche Bundesbank Discussion Paper Series 1*, 21/2010.

Table I.1.2:

### Main features of the spring 2011 forecast - EU

(Real annual percentage change unless otherwise stated)				Spring 2011 forecast (a)			Autumn 2010 forecast	
	2007	2008	2009	2010	2011	2012	2011	2012
GDP	3.0	0.5	-4.2	1.8	1.8	1.9	1.7	2.0
Private consumption	2.1	0.7	-1.7	0.8	0.9	1.3	1.2	1.6
Public consumption	1.9	2.3	2.2	0.7	0.3	0.2	-0.2	0.0
Total investment	5.8	-0.8	-12.0	-0.7	2.5	3.9	2.8	4.2
Employment	1.7	0.9	-1.9	-0.5	0.4	0.7	0.4	0.7
Unemployment rate (b)	7.2	7.1	9.0	9.6	9.5	9.1	9.5	9.1
Inflation (c)	2.4	3.7	1.0	2.1	3.0	2.0	2.1	1.8
Government balance (% GDP)	-0.9	-2.4	-6.8	-6.4	-4.7	-3.8	-5.1	-4.2
Government debt (% GDP) (d)	59.0	62.3	74.4	80.2	82.3	83.3	81.8	83.3
Adjusted current-account balance (% GDP)	-1.0	-2.0	-0.9	-0.9	-0.6	-0.3	-0.5	-0.3
Contribution to change in GDP								
Domestic demand	2.8	0.7	-3.1	0.5	1.0	1.5	1.2	1.7
Inventories	0.2	-0.3	-1.1	0.8	0.1	0.1	0.1	0.0
Net exports	-0.1	0.1	-0.1	0.5	0.7	0.4	0.4	0.3

(a) The European Commission spring 2011 forecast is based on available data up to May 2, 2011.

(b) Percentage of the labour force. (c) Harmonised index of consumer prices, annual percentage change.

(d) Unconsolidated general government debt. For 2010, this implies a debt ratio, which is 0.2 pp. higher than the consolidated general government debt ratio (i.e. corrected for intergovernmental loans) published by Eurostat on April 26, 2011.



Table I.1.3:

**GDP growth forecast, additional features**

EU, (%)	2010	2011	2012
Carry-over from preceding year	0.3	0.7	0.7
Y-o-Y in Q4	2.2	1.8	2.1
Annual average	1.8	1.8	1.9

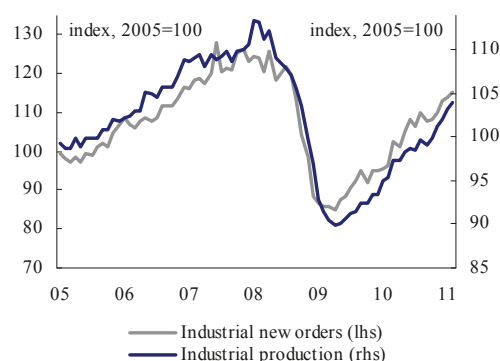
  

Euro area, (%)	2010	2011	2012
Carry-over from preceding year	0.3	0.6	0.6
Y-o-Y in Q4	2.0	1.6	2.0
Annual average	1.8	1.6	1.8

**The recovery is evolving at moderate pace over the forecast horizon ...**

On the supply side, industrial production has been on an upward trend for some time. Since bottoming out in April 2009 it has gained about 15% up to February 2011 (latest available data). However, the pre-crisis levels have not yet been reached. In the euro area, industrial output was still around 10% below the levels recorded in early 2008. Even in relatively strongly growing countries like Germany, pre-crisis levels have not yet been reached. Industrial production growth (excl. construction) was robust in early 2011 and indicators that lead industrial production growth, e.g. order inflows, showed upward movements in late 2010 and in the first months of this year (see Graph I.1.15). In February 2011, industrial new orders in the EU manufacturing sector were 20% higher than a year ago (21% in the euro area), whereas industrial production had only increased by 9% (in both areas). This supports expectations that industrial production will approach its pre-crisis levels over the forecast horizon.

Graph I.1.15: Industrial new orders and industrial production, EU



The prospects for economic growth as provided by survey indicators are generally favourable. The Economic Sentiment Indicator followed an upward trend in the EU and the euro area until March 2011. In April 2011 it declined, but remained well above the long-term average, whereas the readings of the euro-area and EU PMI Composite Output Index were close to the highest levels since mid-2006 (see Graph I.1.16).

The continued positive readings of leading survey indicators, not only in manufacturing but also in the services sector, suggest that the industrial upswing is broadening. This is in line with the historical evidence that the more cyclical manufacturing output, where stocks and export-oriented production have a key role, leads activity in the services sector (see Box I.1.3).

Table I.1.4:

**Main features of the spring 2011 forecast - euro area**

(Real annual percentage change unless otherwise stated)				Spring 2011 forecast (a)			Autumn 2010 forecast	
	2007	2008	2009	2010	2011	2012	2011	2012
GDP	2.9	0.4	-4.1	1.8	1.6	1.8	1.5	1.8
Private consumption	1.7	0.4	-1.1	0.8	0.8	1.2	0.9	1.4
Public consumption	2.2	2.3	2.5	0.7	0.2	0.3	-0.1	0.2
Total investment	4.7	-0.8	-11.4	-0.8	2.2	3.7	2.2	3.6
Employment	1.7	0.6	-2.0	-0.5	0.4	0.7	0.3	0.6
Unemployment rate (b)	7.6	7.6	9.6	10.1	10.0	9.7	10.0	9.6
Inflation (c)	2.1	3.3	0.3	1.6	2.6	1.8	1.8	1.7
Government balance (% GDP)	-0.7	-2.0	-6.3	-6.0	-4.3	-3.5	-4.6	-3.9
Government debt (% GDP) (d)	66.2	69.9	79.3	85.4	87.7	88.5	86.5	87.8
Adjusted current-account balance (% GDP)	:	-1.5	-0.3	-0.1	0.1	0.2	:	:
<b>Contribution to change in GDP</b>								
Domestic demand	2.4	0.5	-2.6	0.5	0.9	1.5	0.9	1.5
Inventories	0.2	-0.2	-0.9	0.5	0.0	0.1	0.1	0.0
Net exports	0.2	0.1	-0.7	0.8	0.7	0.2	0.5	0.2

(a) The European Commission spring 2011 forecast is based on available data up to May 2, 2011.

(b) Percentage of the labour force. (c) Harmonised index of consumer prices, annual percentage change.

(d) Unconsolidated general government debt. For 2010, this implies a debt ratio, which is 0.3 pp. higher than the consolidated general government debt ratio (i.e. corrected for intergovernmental loans) published by Eurostat on April 26, 2011.

### Box 1.1.3: How do business and consumer survey readings depict the ongoing recovery?

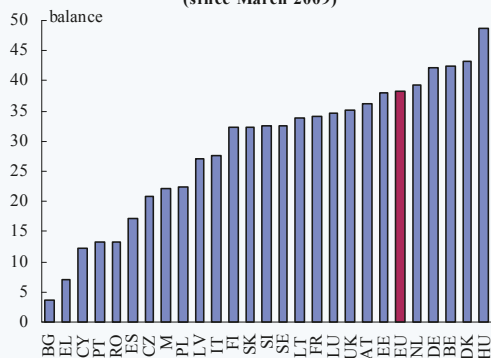
After almost two years of strong and nearly continuous rise, the Economic Sentiment Indicator (ESI) has been increasing more modestly since the beginning of 2011 and recorded a marked drop in the latest April reading. However, its level remains significantly above historical average, suggesting the ongoing recovery to remain on track.

Survey data highlight several peculiar features of the current recovery, which follows the unprecedentedly deep recession of 2008/2009.

First, the recovery so far has been rather unbalanced at the sectoral level, being primarily driven by industry. Until the latest reading, survey data had shown continuous and steady gains in confidence in industry, with both order books and activity showing a broadly steady upward trend over the last two years. Furthermore, manufacturers' assessment of stocks is close to historic lows, suggesting that stock-building will contribute significantly to demand in the coming months. This sectoral pattern is in line with the pattern of a sharp rebound in world trade acting as the initial engine of the current recovery, which has mainly boosted industrial activity, while domestic demand has been slower to get going. Latest readings of the surveys, with managers expressing increasing concerns for weakening demand, point to a softening of performance in the services sector.

Second, an unbalanced pattern is also visible at the country level. Whereas the crisis-related shock was highly synchronised, with confidence simultaneously plunging in all the Member States, the ensuing recovery has been characterised by renewed country divergence with marked differences in the rebound of sentiment (Graph 1).

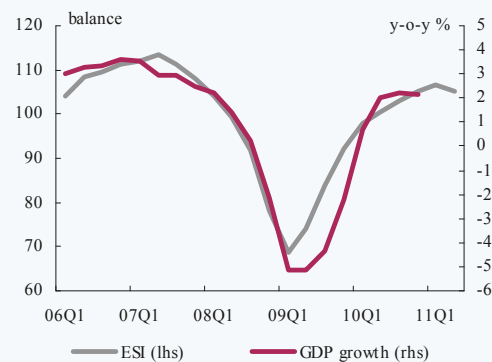
Graph 1: Rebound of ESI in EU Member States (since March 2009)



In particular the rebound of the ESI observed in core and Nordic countries has so far been significantly stronger than in peripheral countries.

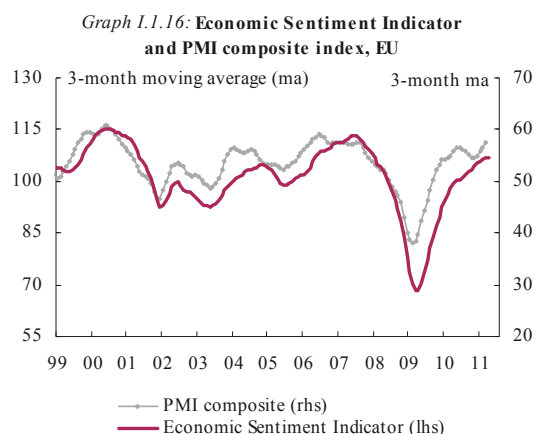
Third, the ongoing recovery is characterised by unusually sluggish GDP growth. Signals from hard data have so far not been as strong as relatively upbeat survey readings would have suggested (see Graph 2). Discrepancies between soft and hard data have been rather common throughout the crisis and in the subsequent recovery. While the decoupling around the trough of the cycle can be mainly explained by the existence of non-linearity at times of very deep recessions, the present decoupling could either signal an overshooting in household and business confidence, or reflect a downward shift of the EU economy onto a lower growth path in the wake of the crisis.

Graph 2: GDP growth and Economic Sentiment Indicator, EU



While latest survey data indicate that the current recovery remains on track, a comparison with developments in sentiment in the recovery of 1993-95 hints at a number of factors that could weigh on growth in the more medium term.

Consumers continue to express uncertainties about the general economic situation and concern about the effect of the crisis on their personal financial situation. Thus, precautionary household savings could remain high for some time, dampening the prospects for private consumption. Corporate investment plans, albeit improving, are still weaker than in the 1993-95 recovery, raising further concerns about prospects for domestic demand. Finally, survey evidence suggests that the latest recession has had a bigger negative impact on production capacity in industry than previous cyclical episodes.



Over the forecast horizon, the outlook for real GDP growth is almost unchanged from the autumn. While the stronger-than-expected growth in the US economy, as well as improvements in leading indicators, would support a somewhat more optimistic outlook, higher commodity prices and increased concerns about consumer price inflation dampen the outlook. Moreover, the withdrawal of policy support will be felt. Real GDP growth is expected to continue along a trajectory of around 2% in the EU and in the euro area, slightly higher in 2011 than forecast last autumn and in March (interim forecast), but broadly unchanged in 2012. Against the background of somewhat less buoyant growth in world output, less supportive fiscal and monetary policy, and commodity prices remaining at elevated levels, economic growth in the EU is expected to strengthen only marginally in 2012.

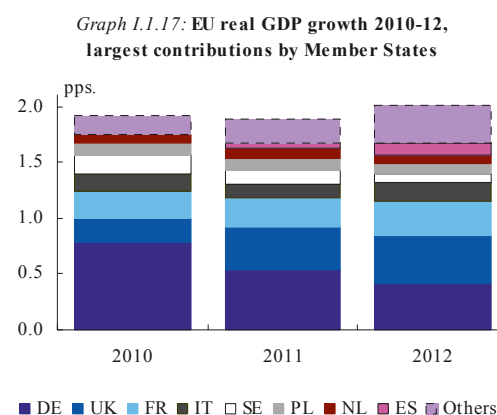
### ... despite higher commodity prices ...

Higher oil prices are weighing on European growth, but much less than in earlier episodes of rising oil prices, since the channels through which they could affect Europe have changed. The energy intensity of production is much lower due to a change in the sectoral composition of GDP (a higher share of services that are less energy-intensive) and better energy efficiency. This lowers the cost pressures emerging from higher oil prices and it reduces the impact on the profit outlook of companies and – via equity prices – the wealth impact on consumption. While the major post-war oil-price shocks were followed by economic downturns,<sup>(9)</sup> the current oil-price increase is not expected to cause a downturn. The direct impact via lowering real disposable income

and the indirect effect on consumer confidence have been rather limited during recent periods of oil-price increases (e.g. in 2008). Nevertheless, the oil-price increases are expected to be strong enough to cast a shadow on the European growth outlook (see Box I.1.4).

### ... but with persisting cross-country differences

The state of the recovery differs across Member States, with euro-area growth owing much to the strong rebound in economic activity in Germany, whereas at the EU level the growth performances of Poland and Sweden also stand out. The relative importance of these economies is reflected in their contribution to the aggregate growth rate of real GDP (see Graph I.1.17).



Since impulses to economic activity in Germany stem to a large extent from non-EU demand, the country's outstanding growth performance creates positive spillovers for other Member States, most notably via higher demand for imported inputs, but, as domestic demand strengthens in Germany, also via imports of consumer goods and tourism.<sup>(10)</sup>

There are hints that these cross-country differences will persist in the short term. The latest readings of leading indicators differ across Member States. For instance, the Economic Survey Indicator, derived from the Commission surveys, in April 2011 stood above its long-term average in 15 Member States (10 in the euro area) and below in 11 Member States (Ireland not covered in the surveys).

<sup>(9)</sup> See Hamilton, J. D., Historical oil shocks, *NBER Working Paper* no. 16790, February 2011.

<sup>(10)</sup> See the analysis of spillovers from Germany in Box I.1.3 in European Commission (DG ECFIN), European Economic Forecast – Autumn 2010, *European Economy* 7/2010.



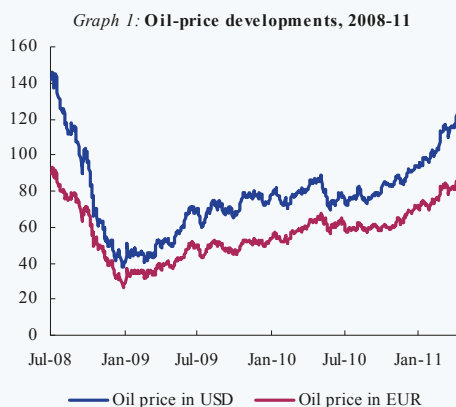
#### Box I.1.4: The macroeconomic impact of higher oil prices

Uncertainty regarding the evolution of oil prices is a major downside risk to growth and upside risk to inflation over the forecast horizon. Against this background, this box presents the macroeconomic impact of rising oil prices on the basis of model simulations (Commission's QUEST model).

Global oil markets started to tighten last year, when demand growth outstripped supply by ½ million barrels a day (mb/d). Robust economic growth, especially in Asia, coupled with stronger-than-expected oil demand in OECD countries, pushed oil prices above the 70-80 USD per barrel (bbl) range at the end of 2010 (see Graph 1). In December 2010 Brent oil averaged 92 USD/bbl (69 EUR/bbl).

In the first quarter of 2011, oil prices rose further on the back of supply risks and disruptions in the Middle East and North Africa. By the end of April, Brent oil was trading at 125 USD/bbl, a 2½ year high.

The rise in prices occurred as the spare capacity fell to its lowest level since late 2008, following the loss of 1.3 mb/d of Libyan exports. This loss was partly offset by increased production by other OPEC members such as Saudi Arabia. In addition to tight fundamentals, markets have concerns over unrest spreading to other regional producers. This has triggered a 'geopolitical' risk premium.



How will higher oil prices affect the economic recovery? Oil dependency of the EU economy has been much reduced since the oil-price shocks in the 1970s and 1980s, thanks to improvements in energy efficiency and more diversified energy mix. Extra-EU oil imports amounted to around 1.7% of GDP in 2010.

The impact of higher oil prices on the real economy depends on substitution possibilities, which will be limited in the short run. Higher oil prices imply a terms-of-trade loss and a wealth transfer to oil exporting countries. It also affects relative prices, by raising the cost of energy inputs in the production process.

Simulations with the energy module of the QUEST model illustrate the potential impact of oil-price shocks on the EU economy. The model captures both supply and demand channels as energy serves as an input in the production process and is consumed by households.

Table 1 shows the effects of a USD 30/bbl. increase in the price of oil on GDP, prices and unemployment. Such an increase is equivalent to the increase in prices between December 2010 and end-April 2011 and to the upward revision to oil-price assumptions since the autumn forecast. With limited substitution possibilities in the short run, the oil-price increase has an immediate negative wealth effect and reduces income. GDP falls by 0.3% in the first year and by a further 0.4% in the following year. Prices rise as costs of higher oil prices feed through into higher energy prices and raise costs for companies. The unemployment rate is 0.5 pp. higher compared to the baseline level. This simulation assumes the shock is exogenous and permanent. To the extent the increase in oil prices is partly driven by higher global demand, the trade effects could partly mitigate the impact of higher oil prices on the EU economy. A temporary shock would have smaller effects. The macroeconomic impact of higher oil prices will differ (particularly on prices) across countries as the oil dependency varies.

Table 1:

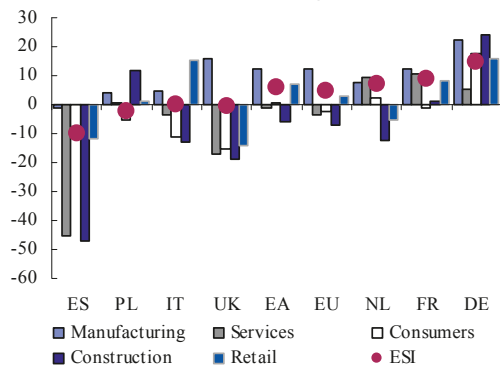
EU27: Effects of a USD 30/bbl. increase in the price of crude oil:

(% difference from baseline)	year 1	year 2
GDP level	-0.3	-0.7
GDP deflator	0.2	0.7
Unemployment rate	0.3	0.5

As with any simulations, the results should be interpreted with caution. Three sources of uncertainties should be highlighted. First, the impact of an oil-price shock on the economy depends crucially on how wages respond. Second, the price-elasticity of oil demand also influences the magnitude of the effects of oil-price shocks on the economy. Finally, the impact of higher oil prices could have non-linear effects that the model does not capture adequately.

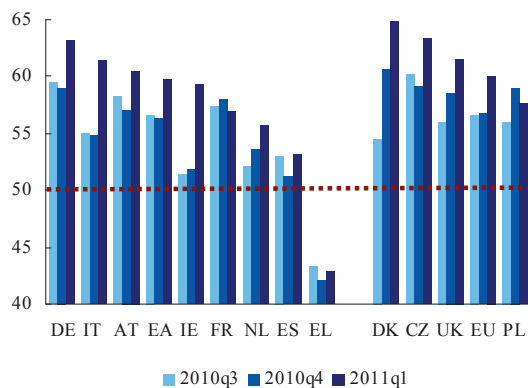
In the seven largest EU Member States the differences between the readings in April 2011 and long-term averages were in a range between 15 (Germany) and -10 (Spain). In addition, a lot of variety is indicated by the components, with pronounced differences in construction confidence (see Graph I.1.18).

Graph I.1.18: Economic Sentiment Indicator (ESI) and components - April 2011, difference from long-term average



Other survey indicators, such as the PMI manufacturing output index, also point to substantial cross-country differences. The index varied in the first quarter of 2011 in the euro area (59.7) between 42.8 in Greece and 63.2 in Germany (see Graph I.1.19).

Graph I.1.19: PMI manufacturing output index

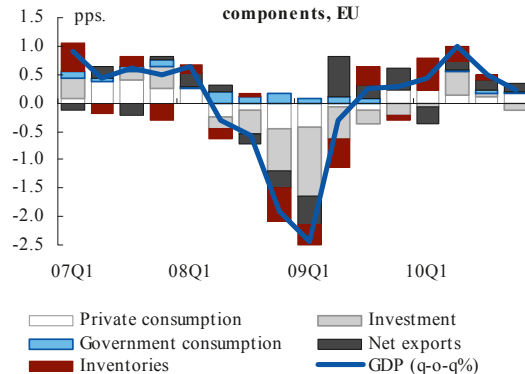


The differences between the national readings of the short-term indicators point to the short-term persistence of cross-country differences. Over the two-year forecast horizon, as more Member States begin reaping the benefits of successfully addressing adjustment challenges, differences in the pace of the recovery are expected to diminish, as explained in the introductory section of this chapter.

### The rebalancing of economic growth across components continues ...

The rebalancing of economic growth across demand components was one of the key features in 2010. An external stimulus from rebounding world trade, stimuli from extraordinary policy measures, and, last but not least, the positive influence of the inventory cycle, has helped the European economy to enter the recovery path. Over time, private consumption and investment demand have then increasingly supported the recovery, particularly in the first half of 2010, implying a larger role for domestic demand components (see Graph I.1.20).

Graph I.1.20: GDP growth and its components, EU



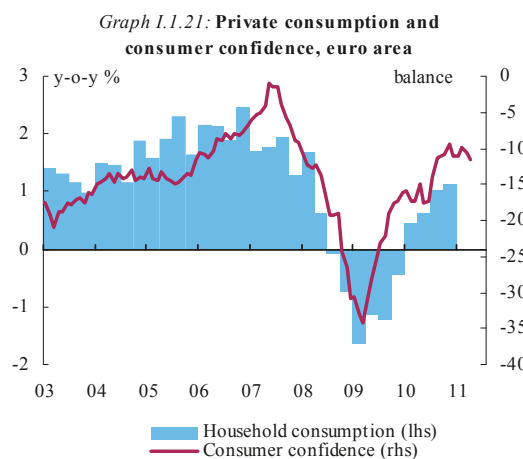
In the last quarter of 2010, this broadening was temporarily interrupted, as exceptionally bad weather conditions hit investment growth in several countries. Some economic activity is expected to have been postponed and could provide an extra push to economic growth in the first half of 2011. The expectation of postponed economic activity is supported by the strong inflow of orders in the fourth quarter of 2010, which must be worked off in 2011. The described rebalancing of economic growth is expected to continue as a closer look to the GDP demand components in the subsequent sections indicates.

### ... as the outlook for private consumption remains solid, ...

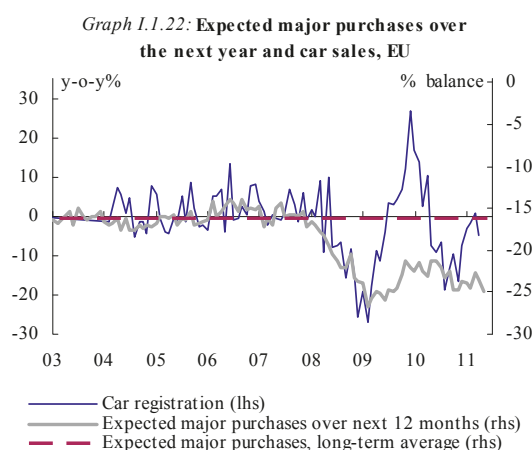
Following a decline during the recession, private consumption increased in 2010 by 0.8% in the EU and in the euro area, regaining more than half of the loss of the preceding year. The situation differed across countries, with nearly two thirds of the Member States recording increasing private consumption in 2010. The quarterly profile of private consumption has been rather volatile since the beginning of the recovery. In the fourth quarter of 2010, household spending growth accelerated to

0.3% (q-o-q) in the euro area (0.2% in the EU) after 0.2% in each of the two preceding quarters. This implies a carry-over of 0.4% for 2011.

Looking ahead, survey indicators signal moderate changes in the near term. The Consumer Confidence Indicator has been rather stable in the EU and the euro area in the first quarter of 2011 standing close to long-term averages, before falling in April, mainly reflecting increased concerns about the general economic situation and the future financial situation of households (see Graph I.1.21). However, as compared to autumn, the assessment of the general economic situation has improved and unemployment fears have receded.

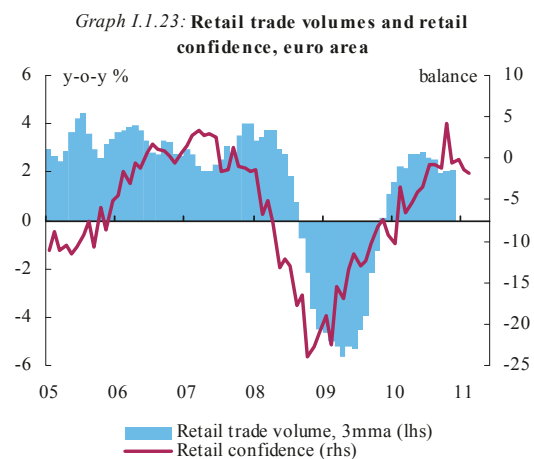


The improvement in consumer confidence has not yet become visible in households' expected major purchases, which remain well below long-term averages in the EU and the euro area (see Graph I.1.22), and between February and April 2011 the component has been falling again.



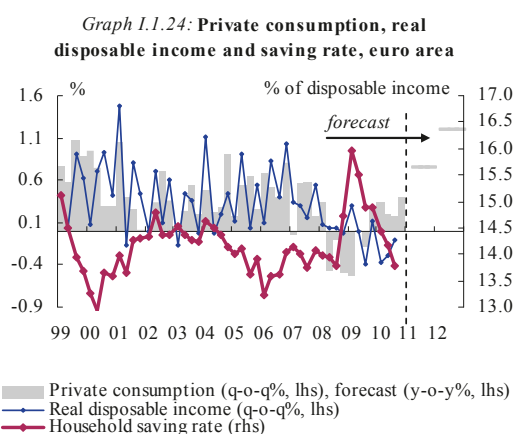
Other consumption-oriented indicators such as the number of car registration in the EU, point to a more upbeat picture. Following the sharp increase in 2009/10, triggered by the car-scrapping schemes in a number of Member States, and the subsequent sharp increase in purchases of new cars, the rebound from the trough had started and registration numbers had already moved up in the first quarter of 2011.

But until April 2011, retail confidence declined again, though it remained well above the long-term average in both the EU and the euro area. This relatively positive assessment is partly substantiated by retail sales volumes, which have rebounded after the sharp decline during the recession (see Graph I.1.23).



Beyond the short term, the outlook for private consumption remains on the up, as moderate employment growth and the ongoing recovery are expected to provide support, although higher inflation and – in a number of countries – tax rates will partially offset this effect. Thus, the traditional drivers of private consumption are expected to deliver only moderate contributions in 2011. Employment growth is expected to remain subdued and consumer price increases are taking away real purchasing power from consumers. Real disposable incomes are expected to grow at a mere ½% in 2011 in the largest Member States, with the exception of Germany (1¼%), before growing more strongly in 2012. While real compensation per employee, another driver of disposable incomes, is expected to shrink in 2011 in both the EU and the euro area (-¼%), relatively strong growth in non-labour incomes in both areas (about 4% in 2011 and 4½% in 2012) is expected to push disposable incomes.

In addition private consumption growth should benefit from higher real disposable income and an expected further decline in the households' saving rates. Despite ongoing deleveraging (see Box I.1.2) and saving incentives associated with increases in interest rates, euro-area households are expected to reduce their saving rate.<sup>(11)</sup> This expectation is supported by Commission household surveys, particularly by the more positive assessment of their financial situation and lower unemployment fears. Beyond the short term, the improving outlook and the stabilisation in the labour markets in most Member States support the expected decline in the savings rate.



All in all, private consumption growth is expected to keep pace in 2011 and to accelerate moderately in 2012 (see Graph I.1.24). Among the largest Member States, Poland, France and Germany are expected to record above average growth rates, whereas private consumption in Spain, Italy, the Netherlands and the UK will expand relatively modestly.

### ... public consumption eases as consolidation makes progress, ...

In 2010, public consumption increased by 0.7% in the EU and the euro area, particularly on the back of relatively strong growth in the second half of the year. Thus, the carry-over is positive for 2011.

Over the forecast horizon, fiscal consolidation is forecast to take hold. In 2011, public consumption growth is expected to fall to rates of 0.3% in the EU and 0.2% in the euro area. The impact of fiscal consolidation is also expected to show up in

government consumption in 2012, keeping its growth rate unchanged.<sup>(12)</sup>

The main contribution to the decline in the growth rate of government consumption comes from lower expenditures on the compensation of employees in the public sector and a drop in intermediate consumption in 2011, whereas social transfers are expected to grow almost in line with prices. Compared to the autumn forecast, the outlook for 2011 has been revised up by ½ pp., whereas the outlook for 2012 has been revised up.

### ... but gross fixed capital formation is expected to accelerate.

Investment, a very volatile component of GDP, had fallen sharply during the fierce recession, as companies trimmed business and reduced debt. In 2010, another decline was registered, but it was substantially smaller than in the year before and in the second quarter of 2010 positive growth rates (q-o-q) were recorded in the EU and the euro area. According to the most recent detailed national accounts data, however, gross fixed capital formation fell again in the fourth quarter of 2010, reflecting the impact of weather conditions towards the end of 2010, particularly in the UK, where construction investment fell sharply.

All types of investment (equipment, construction, and other) were weak during the recession and in the early phases of the recovery. As regards sectors, increases in government investment were not strong enough to offset declines in other sectors.

Looking ahead, investment growth is expected to accelerate on the back of growing domestic demand, higher capacity utilisation – according to Commission surveys, in the second quarter of 2011 it exceeded the long-term average in the EU for the first time since the trough – and still favourable financing conditions with real interest rates low by historical standards. Investment growth is also expected to be supported by strong earnings and strengthening balance sheets. Total investment is projected to rebound in 2011, by around 2½% in the EU and 2¼% in the euro area, and to increase in 2012 to 4% in the EU and slightly less in the euro area. This mainly reflects a relatively strong

<sup>(11)</sup> This pattern of the savings rate is in line with historical evidence as described in the analysis of savings and investment patterns in chapter I.3 in this document.

<sup>(12)</sup> For an in-depth analysis see chapter I.2 ("The impact of fiscal consolidation on Europe's economic outlook") in European Commission (DG ECFIN), European Economic Forecast – Autumn 2010, *European Economy* 7/2010.

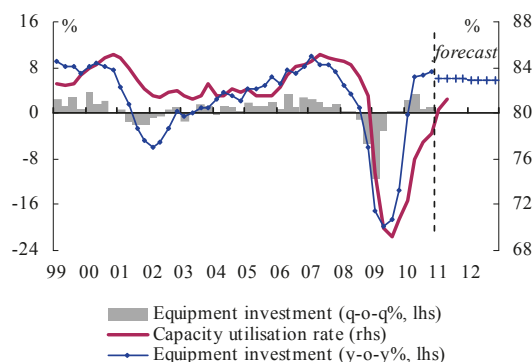
outlook for equipment investment, but a more muted one for investment in construction. It also reflects stronger growth momentum in the private sector (around 5% in 2012 in both areas) that offsets the decline in government investment (4½% on average in each year in both areas).

As compared to the autumn forecast, however, the investment outlook for the EU looks slightly less favourable due to a substantial downward revision in the forecast for investment in the UK (by 3½ pps. in 2011 and by 2½ pps. in 2012). In the euro area, the downward revisions introduced for debt-troubled Member States (on average 6 pps. in 2011) are offset by the brighter investment outlook in other economies.

#### Equipment investment taking a leading role ...

Equipment investment is expected to increase markedly this year and next, recovering up for some of the losses incurred during the downturn. The expected pick-up in equipment investment reflects stronger demand on the back of some catching-up of investment projects postponed during the recession, the dissipating uncertainty about the economic outlook and demand prospects. Further support is received from increasing average rates of capacity utilisation (see Graph I.1.25).

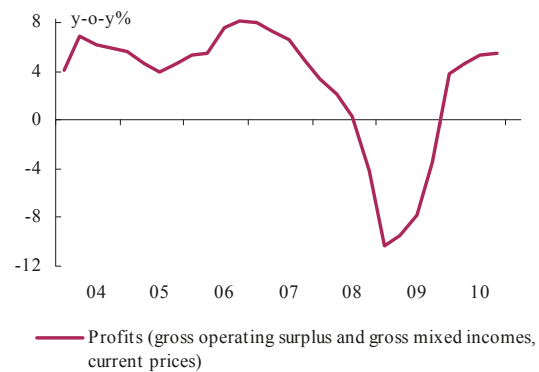
Graph I.1.25: Equipment investment and capacity utilisation in manufacturing, euro area



Investors are able to benefit from favourable financing conditions, as the recovery of the financial sector is ongoing and the expected tightening of monetary policy has as yet had a rather limited impact on short- and long-term interest rates. In addition, strong profit growth in 2010 (see Graph I.1.26) has improved financial positions of companies. In the euro area, recent information about access to credit (see also Section

I.3) indicates that there are no substantial obstacles from the financial side over the forecast horizon.

Graph I.1.26: Profit growth, euro area



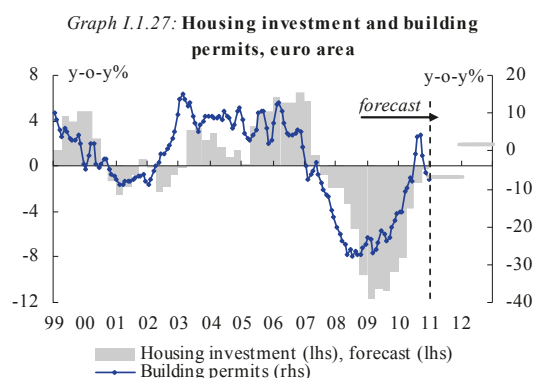
In 2011 and 2012, equipment investment is expected to grow strongly, with the highest euro-area growth rates in Estonia, Luxembourg and Germany. In Germany, the rebound is not only reflecting the recent strengthening of economic activity, but also a catching-up after more than a decade of low net investment, during which (financial) investments abroad had been perceived as more attractive. In that regard, revised risk perceptions after the financial crisis show up in the regional distribution of investment activity.

#### ... whereas construction and government investment remain weak ...

The shrinking of the EU construction sector had already started when the housing bubble burst in some peripheral countries. Since the trough in 2009, the situation has only slightly improved. Indicators from the housing market point to some recovery, albeit starting from low levels compared with pre-crisis levels. Construction sentiment is slightly improving and leading supply indicators, such as building permits, appear to gain ground. In the euro area the number of building permits is still close to its historical low after a long period of declines (see Graph I.1.27). But, according to available national data, the stock of unsold housing remains substantial and can be expected to act as a drag on investment activity.

Government investment had been one of the strongest components of investment during the crisis, reflecting efforts to counterbalance the economic downturn. As the recovery takes hold, however, public stimuli are being phased out and the needs of consolidation come to the fore.





Note: Forecast figures relate to overall construction investment

### ... and inventory investment is losing importance.

The inventory cycle has broadly followed historical patterns. In 2010, the increase in domestic demand was driven in part by a temporary boost from an end of the period of de-stocking, with firms raising production to replenish inventories. Inventories made a contribution of 0.7 pp. to GDP growth in 2010 in the EU (0.4 pp. in the euro area). However, compared with historical patterns, the contribution to GDP growth was modest. This may reflect that during the recession, according to Commission surveys, the relationship between stocks and production expectations has diverged from its historical path. Inventory management became more responsive to short-term fluctuations and managers showed increased risk aversion, making them hold stocks down.<sup>(13)</sup>

Recent survey indicators suggest that stocks are currently at a very low level by historical standards in some Member States. For instance, Commission surveys in early 2011 point to rather low inventory levels, so that a further pick-up in the first half of 2011 cannot be excluded, with inventory investment contributing to domestic demand. Nevertheless, the contribution of inventory investment should be moderate over the forecast horizon.

### Domestic demand is gaining importance ...

During the recession the sharp fall in domestic demand made by far the largest negative contribution to GDP growth, whereas contributions from inventories and net exports were relatively

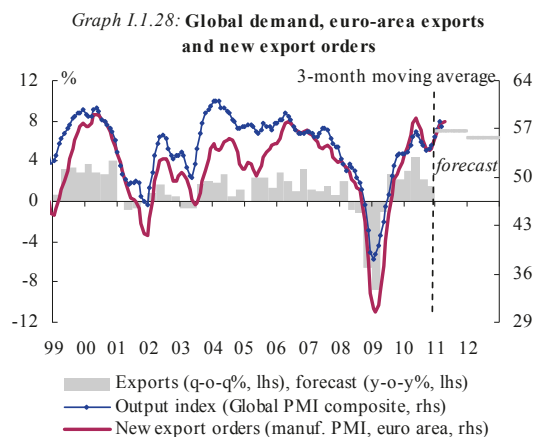
small. In the initial phase of the recovery, this situation changed substantially, as the upturn was export-led and the inventory cycle resulted in a large contribution from companies replenishing stocks. As the recovery matures, inventories and net exports are contributing relatively less to GDP growth and domestic demand components are gaining importance. This rebalancing of economic growth, though still moderate, became visible in 2010. While for the year as a whole the contributions from inventories and external demand were still substantial, the largest increase in the contributions to GDP growth was recorded for domestic demand. This was mainly driven by private consumption, since public consumption growth weakened due to the beginning of fiscal retrenchment, and investment growth remained in negative territory. On the back of the expected strengthening of household consumption and private investment, further substantial increases in the contribution of domestic demand are expected over the forecast horizon. In 2011 and 2012, domestic demand is expected to exceed by far the combined growth contributions of the other components.

### ... while European net exports continue to support the recovery ...

The recovery of exports has been the initial driver of the recovery; with world trade bouncing back strongly the contribution to economic growth was substantial. Following the sharp decline in export and import volumes in 2009 in the EU (both down by about 12%) and the euro area (down by 13% and 12% respectively), the strong growth in trade volumes in 2010 almost offset the declines in the preceding year. In the EU and the euro area, but also in all euro-area Member States except Italy, Luxembourg and Cyprus, the growth in export volumes exceeded that in import volumes. This could be seen as a reflection of relatively strong growth in emerging and developing economies as compared to the more moderate growth of advanced economies (see the first section of this chapter). With the EU export share to emerging and developing countries exceeding the import share even during the crisis year 2009, the different recovery speeds suggest that exports will grow more strongly than imports, which are more dependent on subdued growth in the EU. And on top of this, EU exporters gained market shares as overall export growth exceeded growth in export markets.

<sup>(13)</sup> See European Commission (DG ECFIN), *European Business Cycle Indicators*, April 2011, pp. 7-9.

Developments throughout 2010 were affected by the expected soft patch in the third quarter, which showed up in a slowdown of export growth. In the fourth quarter of 2010, however, euro-area export growth continued to decelerate though at a slower pace than in the previous quarter (2.0% q-o-q in fourth quarter of 2010 after 2.1% in the third and 4.5% in the second quarter) and than projected in the autumn forecast (1.2% in the fourth quarter). At the same time, import growth decelerated as well, by 1.0% compared to 1.3% in the third quarter, resulting in a positive contribution from net trade to GDP growth in the fourth quarter of 2010. Given lags in the impact of world output growth to EU exports, the deceleration was not necessarily at odds with the rebound in global activity in the fourth quarter of 2010 and the acceleration in world trade (see Graph I.1.28).



Over the forecast horizon, continued export growth appears to be in the cards, although the export components in EU survey indicators (e.g. the export orders in the Commission surveys) fell slightly in April 2011 after following an upward trend between the beginning of the recovery and February 2011. But for the euro area, the indicators recorded a slight increase in April, largely driven by results from Germany, France and Italy. The moderation in changes in indicators in recent months can be interpreted as signalling an increasing role for domestic economic activity. Overall, the continued robustness of world trade growth and strong export market growth put European exporters into a favourable position. Therefore the forecast for export growth in 2011 has been revised up from the autumn forecast, whereas the forecast for 2012 remains unchanged. Most Member States are expected to gain market shares in 2011 and 2012. Among them are

countries – for instance Spain – that had been losing market shares prior to the crisis.

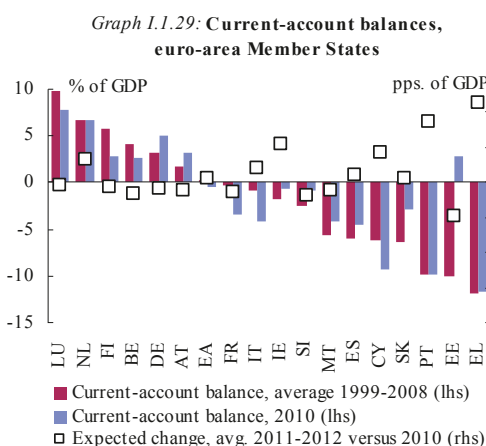
On the import side, a deceleration in the growth of import volumes is expected in the EU (from 10% in 2010 to 5½% this year and next) and in the euro area (from 9½% to 5½% in the respective years). European imports are closely related to the level and composition of demand as well as to the terms of trade, where the recent sharp increase in import prices (including oil price effects) is expected to partially deter households and companies from imports. Moreover, in countries experiencing a rebalancing of production towards tradable goods (versus non-tradable goods), households' demand for domestically produced (instead of imported) tradable goods might increase. While this would lower the growth of import volumes of final goods, increased demand for imported inputs could partly offset this increase. More generally, as the rebalancing of economic growth towards domestic demand components continues, imports should grow slightly more strongly than in 2010.

#### **... and current-account balances point to ongoing adjustments.**

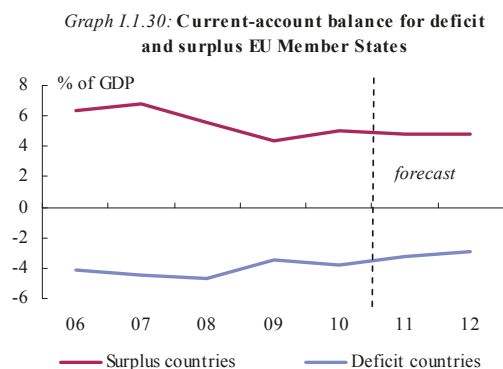
In 2010, the rebound in world trade affected EU and euro-area exports and imports of goods almost similarly, raising them in nominal terms by 18¼% and 17½%, which almost offset the declines in the year before. Services exports and imports also increased almost in parallel, but at a lower rate of about 7¼% in the EU and the euro area. While the trade balance surplus (goods and services) as a percentage of GDP remained almost unchanged in 2010 in the EU (at about ¾%) and the euro area (1¼%), the small current-account deficit observed in the EU and the euro area narrowed marginally, to around ½% of GDP.

The rather moderate developments in the EU and euro-area aggregates hide differences across EU Member States. While strong growth in export markets, particularly in emerging and developing economies, has boosted exports, the still more subdued growth of domestic demand in most Member States has limited import growth. Thus, some of the slower growing European economies were able to reap the benefits of the strong global rebound in terms of improvements in their external balances. In contrast, in those euro-area Member States with above-average economic growth, import growth was also relatively strong.

Over the forecast horizon, the relatively small current-account deficit is expected to narrow slightly, approaching balance in 2012 in the EU and close to balance in the euro area. At the Member-State level, many of those countries in deficit in 2010 are expected to reduce their external deficit in 2011 – in the euro area, seven of the ten countries, including Spain and Portugal, the countries with the highest deficits –, whereas in some of the countries in surplus a downward adjustment towards more balanced positions is expected (e.g. Germany, Belgium and Finland). A comparison of the pre-crisis situation and the recovery years points to substantial progress in reducing imbalances in many Member States, particularly in the euro area (see Graph I.1.29).



All in all, the current-account forecasts for 2011 and 2012 point to an ongoing adjustment of intra-EU current-account imbalances (see Graph I.1.30).



*Note:* Member States are identified as surplus or deficit countries on the basis of their current-account position in 2006; current-account balances are not consolidated.

The adjustment is most marked in countries where deficits were very large at the onset of the crisis. But some structurally high current-account

surpluses also appear to be gradually to be coming down on the back of stronger domestic demand and dynamic imports.

### Only moderate labour-market improvements so far ...

European labour markets have been remarkably resilient during the recession, with employment declining less than output. Drops in demand faced by firms were mainly met through a reduction in hours worked per person employed (labour hoarding), rather than through cuts in employment. These developments appear to be, to some extent, an aftermath of various labour-market support schemes put in place by governments in Member States.

Looking for signs of the recovery in labour markets, it is in line with historical evidence from past recoveries to find a lagged response to developments in GDP.<sup>(14)</sup> But this time, the resilience of the labour market during the crisis is still exerting its impact on current developments. The relative stability of employment, achieved inter alia by the hoarding of labour, implied a temporary reduction in productivity during the downturn. It now has now implications for employment outlook as companies try to rebuild productivity, thereby dampening the demand for labour. The recovery had an immediate impact on labour markets in terms of hours worked, which had already started to move up since mid-2009. Headcount employment, however, only started to recover in the course of 2010. As a result, the unemployment rate remained stable at high levels, lingering at 9½% in the EU and around 10% in the euro area.

The muted recovery in employment, combined with stronger output growth, has implied a rebound in productivity since the start of the recovery. During the recession, however, developments in compensation (in the euro area, compensation per hour increased by 3% in 2008 and by 3¼% in 2009) had not mirrored the decline in productivity (hourly labour productivity declined by ¼% and ¾% respectively) so that more recent increases in productivity can be understood as a catching-up with almost-maintained contract wages. In fact, compensation of employees and hourly labour

<sup>(14)</sup> See for instance Holland, D., S. Kirby and R. Whitworth, An international comparison of employment in recovery, *National Institute Economic Review*, No. 214, October 2010, pp. F35-F40.



costs rose only slightly during the first quarters of the recovery, resulting in declines in unit labour costs in 2010.

### ... but ongoing recovery prepares the ground for stronger employment growth ...

For 2011, the latest readings of survey indicators of firms' employment expectations, both from the European Commission and PMI employment index, point to further improvements in employment, with job creation flows only partially offset by expected public sector job losses in some Member States. Further on, employment growth in 2011 and 2012 will depend on developments in labour costs, productivity and demand.

The moderate improvement in the EU labour market during the recovery may suggest that companies that hoarded labour during the recession are (still) able to increase the hours worked per employee or to raise the productivity of their current workforce. As the crisis lowered potential output growth, it might also have impaired potential productivity growth, suggesting that any further increases in demand over the forecast horizon could now trigger stronger employment responses.

Developments in labour costs may not be an obstacle to such responses. During the recession, developments in compensation had only partially mirrored productivity developments, which has led to some cost pressures in companies, but hourly labour costs rose only moderately during the first quarters of the recovery (at an annual rate of 1.6% in the euro area and 2.0% in the EU in the fourth quarter of 2010, with the wage component rising similarly) and unit labour costs that had been rising during the crisis declined in 2010.

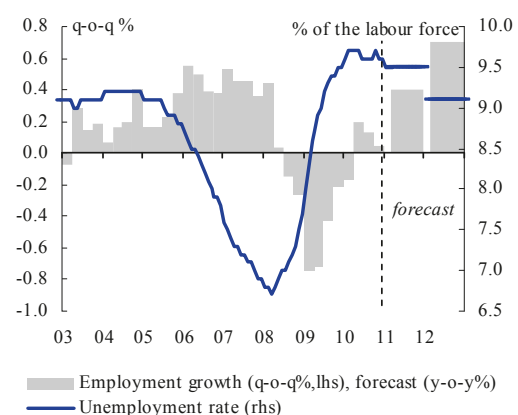
Given broadly unchanged prospects for output growth, labour markets should gradually improve, broadly as expected in the autumn forecast, with employment expanding as of this year and unemployment rates decreasing over the forecast horizon (see Graph I.1.31). This outlook comprises employment growth in many Member States but also in the EU and the euro area (0.4% in 2011, 0.7% in 2012 in both areas).

### ... with substantial cross-country differences.

However, the employment outlook for the EU continues to display rather different prospects at

the Member-State level. Employment growth is most dynamic, and delivering new jobs, in countries with strong growth and relatively flexible labour markets. Unemployment is persisting in countries that are facing large structural adjustments associated with downward revisions of activity in construction and real estate as well as the financial sector. Upside risks to this employment outlook are related to the size and speed of ongoing structural reforms that could improve labour-market conditions over the forecast horizon.

Graph I.1.31: The labour market, EU



Spain and Ireland are experiencing the highest unemployment rates in the euro area (20.6% and 14.8%, respectively, in the first quarter of 2011), together with Estonia, Greece (14.3% and 14.1% in the fourth quarter of 2010, the latest available data), Slovakia and Portugal (14.0% and 11.1% in the first quarter of 2011). However, in countries like Italy, France and Belgium, the impact of the crisis on unemployment has been milder (with unemployment rates at 8.3%, 9.5% and 7.7%, respectively). In contrast, Germany (6.4%) has even experienced a remarkable drop in its unemployment rate since the onset of the crisis.

Looking ahead, in 2011 increases in the unemployment rates are expected for Greece, Ireland, Portugal, Spain, Slovenia and the UK. Apart from the UK, these are also the only countries where employment is expected to shrink. As the recovery gathers pace again and the lagged impact of the European recovery becomes more visible in labour markets, employment is expected to grow in all Member States with the exception of Portugal. In all Member States except Portugal and Greece, a decline in the unemployment rate is forecast for 2012.

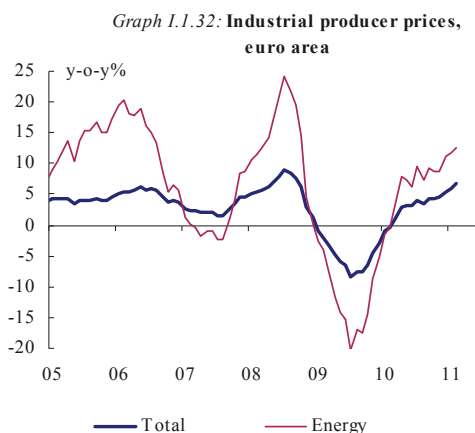
The end of restrictions on labour mobility in the EU as of 1 May 2011 (except for citizens of Bulgaria and Romania) is not expected to have significant short-term effects on European labour markets, since most old Member States had already opened their labour markets in previous years. The only countries now taking this step – Germany and Austria – are expected to face a moderate increase in migration with a high share of employable persons. This expectation is supported by studies on the impact of migration after enlargement,<sup>(15)</sup> but also by recent country-specific analyses.<sup>(16)</sup>

### Higher commodity prices feeding through the supply chain ...

On the back of soaring commodity prices, EU import prices have increased markedly throughout 2010 (7½% in the EU and the euro area) and early 2011. This upward trend impacts strongly on producer prices, exceeding the upward pressure from labour costs by far, since the weak labour-market conditions kept wage growth subdued. In the fourth quarter of last year, wages increased at an annual rate of about 2% in the EU (1½% in the euro area). Total hourly labour costs grew roughly at similar rates. With employment growth lagging and accelerating only slowly, faster – but still relatively moderate – wage growth is expected over the forecast horizon. Growing compensation per employee and lower productivity growth are expected to bring unit-labour-cost growth in the EU and the euro area to 1% in 2011 and 1½% in 2012.

Since July 2009, the annual rate of change in producer prices has been on an upward trend in both the EU and the euro area (see Graph I.1.32). Up to February 2011 (latest data), producer prices were mainly driven by the energy price component. As seen in the last episode of sharply increasing oil prices in 2008, the acceleration in the energy price component has exceeded that in

the general index (up at an annual rate of 7.1% in the EU and 6.6% in the euro area in February 2011) by far.

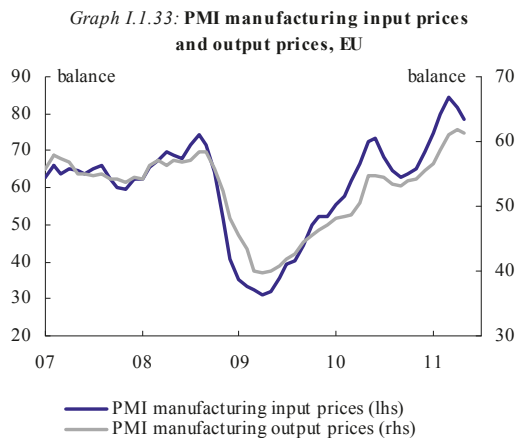


Looking ahead, a key determinant of the pass-through of producer-price increases to other levels in the supply chain, and finally to consumer prices, is the pricing power of manufacturers that is closely associated with the amount of spare capacity. According to the latest available data, labour productivity is well below the level it would have reached if it had increased in line with its pre-crisis trend, suggesting a substantial amount of underutilised capacity. Also the situation in the European labour markets, particularly the relatively high unemployment rate, suggests a sizeable degree of slack on average. This backward-looking analysis of hard data contrasts somehow with forward-looking information from surveys.

Survey indicators, capturing short-term developments ahead, point to capacity utilisation levels close to long-term averages, thus leaving a more limited amount of spare capacity and more price-setting power of producers. Such a situation could explain responses to questions in Commission surveys about selling price expectations. In March, selling price expectations in manufacturing increased to the highest level in more than a decade. In the euro area, both the PMI composite input and output price index have reached the highest levels since mid-2008. A comparison of the input and output price component in PMI indices suggests that manufacturers expect to be able to pass on higher input prices (see Graph I.1.33). This is less visible for services, which are more dependent on subdued domestic demand.

<sup>(15)</sup> See e.g. Barrell, R., J. Fitzgerald and R. Riley, EU enlargement and migration: assessing the macroeconomic impact, *Journal of Common Market Studies*, 2010, 48(2), pp. 373-395. The European Commission expects the total number of nationals from the EU-8 countries living in the EU-15 Member States to increase from currently 0.6% to 0.8% of the population in 2015, see European Commission, *Press Release IP/11/506*, 28 April 2011.

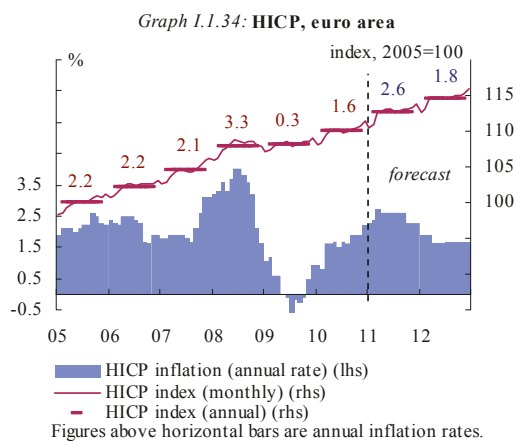
<sup>(16)</sup> See for Germany e.g. Baas, T. and H. Brückner, Arbeitnehmerfreizügigkeit zum 1. Mai 2011: Mehr Chancen als Risiken für Deutschland, *LAB Kurzbericht*, 10/2011; and for Austria e.g. Nowotny, K., AFLA – labour mobility and demand for skilled labour after the opening of the Austrian labour market, *WIFO*, April 2011.



Thus, hard data and surveys deliver different signals concerning the price-setting power of manufacturers. There are at least two ways to bring these ends together. On the one hand, the EU economy may have shifted to a markedly lower growth path, which could then have implications for the prospects of employment creation in the short term. On the other hand, respondents to surveys may slightly misperceive developments, a characteristic sometimes already observed in previous cycles (see Box I.1.3). In this case, price expectations may be on the high side and the risk of a jobless recovery is limited. An overshooting of business confidence would imply a certain decoupling of hard and soft (survey) data, which would not be surprising given the depth of the financial crisis.

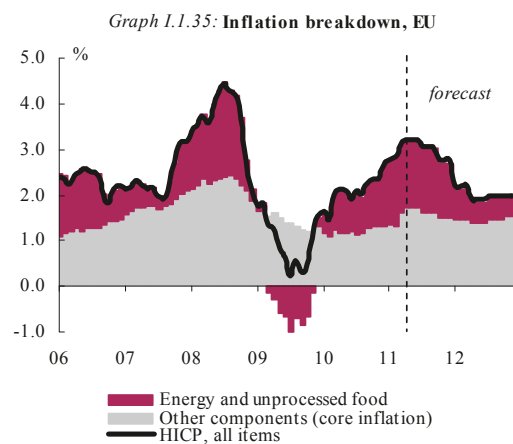
#### ... raising consumer price inflation ...

In line with expectations, consumer prices increased in the course of 2010, with headline inflation at an annual rate of 2.1% in the EU and 1.6% in the euro area (see Graph I.1.34).



The increase in HICP headline inflation reflects a rise in commodity prices (e.g. oil, agro-commodities), increases in administered prices and indirect taxes, higher import prices, as well as the impact of upward base effects from the food and energy components. In 2010, headline HICP inflation in the EU (2.1%) and euro area (1.6%) turned out higher than expected in the autumn forecast. HICP inflation has picked up further in early 2011 (in March it stood at 3.1% in the EU and the April flash HICP for the euro area was 2.8%).

Core inflation (i.e. all items excluding energy and unprocessed food) has remained substantially below headline inflation in 2010 in the EU and in the euro area. The main explanation is the large contribution of energy and unprocessed food to headline inflation (see Graph I.1.35). There may however be a new configuration as compared to past episodes of inflationary pressures in the EU, where lasting pressures would not primarily be associated with the wage-employment nexus but commodity prices. To the extent that energy inflation is driven by structural factors, the difference between headline and core inflation may this time not signal transitory, high-frequency price changes that will be reversed quickly.

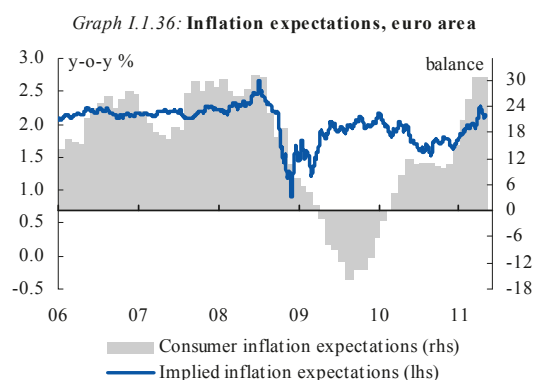


Overall, inflation prospects have worsened since the autumn forecast, but without endangering the delivery of price stability in the medium term. The remaining slack in the economy, along with moderate wage and unit-labour cost growth, are expected to keep inflation in check going forward, notwithstanding higher commodity prices and increases in indirect taxation and administered prices in some Member States.

### ... further in 2011 before easing in 2012...

Looking ahead, the annual rate of HICP inflation is expected to stay at close to 3% in the EU this year, before easing to around 2% in 2012, on account of a sharp fall in the UK (from 4% to 2½%). In the euro area, the headline rate is expected to pick up to an average of about 2½% this year, before falling back to 1¾% in 2012. On a quarterly basis, the outlook is for a peak in headline inflation in the second quarter of 2011 at 3% in the EU (2¾% in the euro area) and a gradual decrease throughout the rest of the year. This profile reflects the diminishing effects of pass-through from both the surge in commodity prices at the turn of the year and statistical base effects exerting a downward pressure on inflation for most of 2011.

In the euro area, core inflation is set to increase over the forecast horizon (1.5% in 2011, 1.6% in 2012), as services inflation firms in years. In the EU the outlook for core inflation (2.1% in 2011, 1.8% in 2012 in the EU) is different, most notably due to increases in indirect taxes and/or administered prices, particularly in the UK, but also due to exchange-rate changes. Since the tax rate increases are one-off-measures, base effects in 2012 should bring both headline and core inflation down towards the end of the forecast horizon. The difference between headline and core also points to the remaining slack in the economy, subdued wage growth and overall (still) well-anchored inflation expectations.



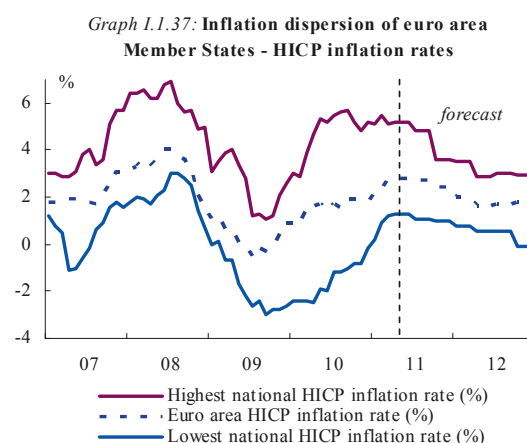
Note: Implied expectations derived from inflation-indexed government bonds, 10 year horizon

According to Commission surveys, short-term inflation expectations of companies and households have increased in 2010 moderately and early 2011 (see e.g. Graph I.1.36). A moderate increase is also seen in inflation expectations as derived from inflation-indexed bonds. In contrast, long-term inflation expectations, for instance those

from the ECB's Survey of Professional Forecasters, have remained broadly stable. The overall slow pick-up of inflation expectations can be associated with relatively stable core inflation and the market expectation of a subdued recovery.<sup>(17)</sup>

### ... with wide inflation dispersion across Member States

The inflation aggregates hide marked inflation differentials across EU Member States that are expected to remain above pre-crisis averages. The increase in HICP inflation rates is unevenly distributed across countries. The different impacts of higher oil prices and the pass-through of increases in indirect taxes are among the determinants of these differences (see Box I.1.5), whereas differences in wage growth have not yet been pronounced and thus not affected differences markedly.



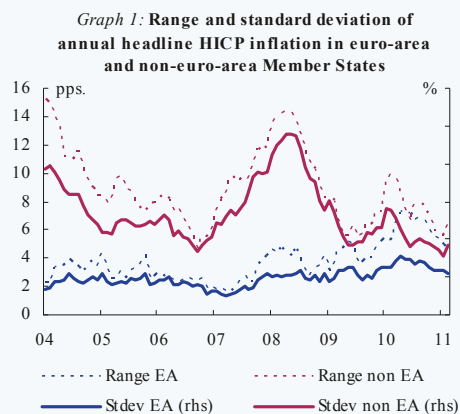
During the ongoing recovery the distance between the lowest and highest national inflation rates in the euro area initially widened, but then narrowed between June 2010 and March 2011 (see Graph I.1.37). The further narrowing over the forecast horizon is a common feature of macroeconomic forecasts.

<sup>(17)</sup> Evidence supporting this linkage has recently been presented by Gerlach, P., P. Hördahl and R. Moessner, Inflation expectations and the great recession, *BIS Quarterly Review*, March 2011, pp. 39-51.

### Box 1.1.5: Inflation differentials in the EU and euro area

This box looks at the drivers and implications of inflation differentials across Member States. Inflation differentials are at present above past averages in the euro area, while in non-euro-area EU Member States they have fallen back to the level observed before the 2007-08 price surge. In some Member States, high inflation rates largely reflect recent increases in indirect taxes, and differentials in tax-adjusted inflation are consequently lower. More generally, inflation differentials owe much to large differences in energy inflation across Member States. Different energy inflation has in the past contributed to the loss of competitiveness of some Member States and may now also stand in the way of the necessary adjustment. At the same time, looking at core inflation measures, the process of adjustment seems to have started, though it is still in an early stage.

Inflation differentials in the euro area increased since 2007 (Graph 1). The range of annual inflation rates across euro area Member States in 2010 was 6.3 pps., its standard deviation was 1.4%. The averages of the two indicators since 1999<sup>(1)</sup> were 3.5 pps. and 1.0% percent, respectively. Across non-euro-area EU Member States inflation differentials were even higher, with a range of 7.8 pps. and a standard deviation of 2.1% in 2010. However, measures of inflation dispersion for Member States outside the euro area have decreased since the peak of inflation in the summer of 2008, while for the euro area they continued to increase until the summer of 2010.

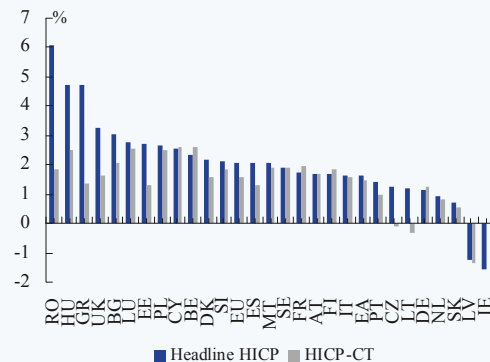


Graph 2 displays annual headline HICP inflation in 2010 and the constant-tax HICP measure (see below) by Member State. With many Member States having to consolidate public finances, the

<sup>(1)</sup> Euro area in varying composition.

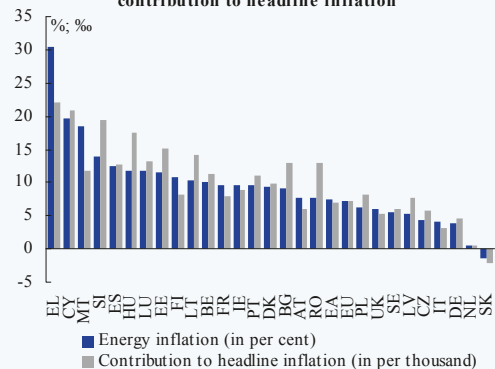
inflation ranking is reshuffled somewhat once the impact of indirect tax increases is taken into account. The constant-tax measure (HICP-CT) excludes variations in indirect taxes from the inflation figure, assuming full pass-through to consumer prices.<sup>(2)</sup>

**Graph 2: Annual headline inflation and constant-tax inflation, 2010**



In Romania, Hungary and Greece indirect tax increases particularly affected headline inflation in 2010. Hence, it appears that inflation differentials were significantly lower on the basis of constant-tax inflation. For the euro area and EU aggregates, the impact of indirect taxes was minor in 2010.

**Graph 3: Energy inflation in 2010 and its contribution to headline inflation**



A large part of Member-State inflation dispersion stems from differentials of energy inflation. Graph 3 plots the annual rate of energy inflation in 2010, which in spite of the symmetry of the global oil-price shock ranged from -1.3% in Slovakia to

<sup>(2)</sup> An incomplete inflation pass-through of indirect tax hike is, however, likely, which implies that the difference between the headline and the HICP-CT measures indicates an upper bound for the impact of changes in indirect taxes.

(Continued on the next page)

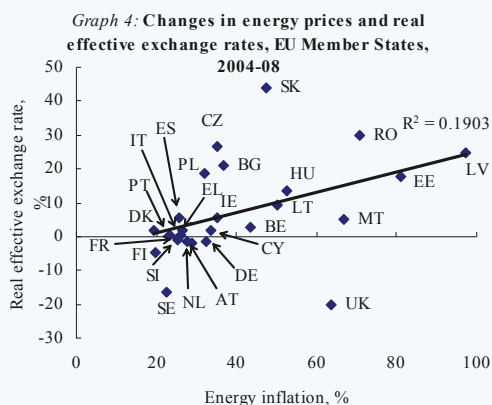


*Box (continued)*

30.3% in Greece. Several factors contribute to these differences, including an economy's energy intensity and mix, dependence on imported energy, taxation and subsidies as well as the functioning of energy markets.

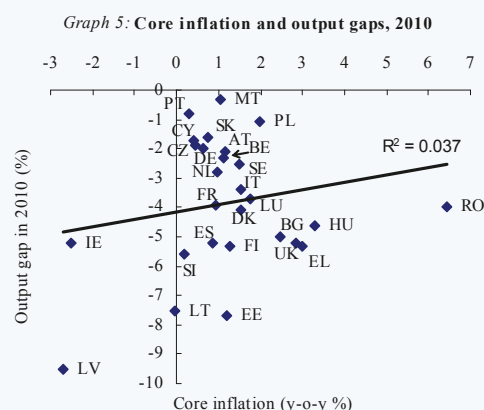
Moreover, the weight of the energy component in household consumption, which is 10.6% for the EU as a whole, differs significantly across countries (from 6.7% in Malta to 17.8% in Romania). Thus, the contribution of energy inflation to headline inflation across Member States is not strictly proportional to their level of energy inflation.

Energy inflation has accelerated towards the end of 2010 and in the first quarter of 2011. In March 2011, annual energy inflation in the EU stood at 12.0%, ranging from 5.7% in Sweden to 20.4% in Greece.



Graph 4 suggests that differences in energy inflation across Member States have contributed somewhat to relative competitiveness developments prior to the crisis. Going forward, high energy inflation could complicate the necessary adjustments in the shorter run.

Abstracting from the most volatile HICP items – energy and unprocessed food – there are some indications that national core inflation patterns do reflect growth differences. Member States hit particularly hard by the crisis are thus regaining competitiveness (Graph 5), helping over time with the adjustment of macroeconomic imbalances.



In 2011, still large negative output gaps are expected to continue contributing to moderate core inflation in most Member States, in particular those less advanced in terms of the recovery. At the same time, high and volatile energy prices are likely to further contribute to the dispersion of headline inflation rates.

### Fiscal positions: from stabilisation to consolidation ...

2011 is likely to mark the switch from fiscal stabilisation to fiscal consolidation in the euro area and in the EU as a whole: the improvement of budget balances in both areas, which began in 2010, is projected to further accelerate in 2011, and to continue in 2012 in the vast majority of countries, albeit at a slower pace and subject to the usual no-policy-change assumption.

In 2010, almost all Member States posted a lower general government deficit than in 2009 on the back of moderate structural adjustment measures and cyclical improvements of the budget, resulting in a slight improvement in the deficit ratio – the first since the onset of the crisis – in the euro area and the EU as a whole. In the preceding years,

discretionary fiscal measures under the European Economic Recovery Plan, in conjunction with the working of automatic stabilisers had resulted in a sharp deterioration in governments' fiscal positions, reflected in a sharp increase of deficit and debt-to-GDP ratios.

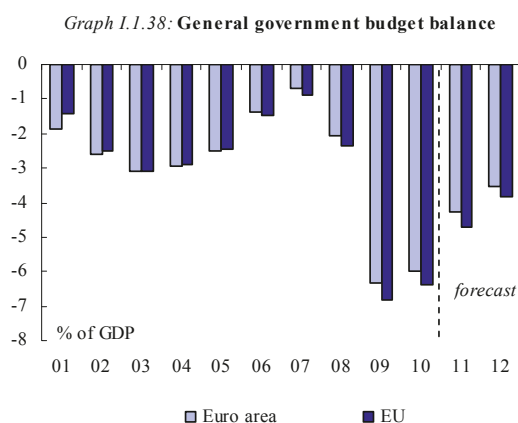
In 2011, the general government deficit ratio is projected to fall by a notable 1.7 pps. to 4.3% of GDP in the euro area, and equally by 1.7 pps. to 4.7% of GDP in the EU.<sup>(18)</sup>

Under the usual no-policy-change assumption for the outer year of the forecast, a further decline of

<sup>(18)</sup> The improvement in the 2011 headline deficit figures for the euro area and for the EU also reflects a notable one-off measure in Ireland. The intervention in 2010 by the Irish Government to support Anglo Irish Bank and two smaller building societies had temporarily increased the deficit by about 20 pps. in 2010.

the deficit ratio is projected in 2012: in the order of 0.8 pp. in the euro area and 0.9 pp. in the EU (see Graph I.1.38).

Compared with the autumn forecast, the Commission outlook on public finances improved somewhat. In 2011 and 2012, general government deficits in both the euro area and the EU as a whole are now seen a couple of decimal points lower. In the euro area, the improvement mainly reflects lower government expenditure in percent of GDP. In non euro-area countries, revenues have increased in percent of GDP. In 2011, this is largely explained by a very significant one-off operation in Hungary (see below). Beyond that, there is also a more general increase in government revenues compared to GDP.



In 2011, the projected improvement in the budget balance is expected to be mainly expenditure-based, with the bulk of the improvement in the euro-area deficit due to a decline in the expenditure ratio, and a slightly lower share for the EU. In almost all countries, expenditure ratios are set to decline.

By component, total current expenditure of the general government, as a share in GDP, is projected to decline markedly in both the euro area and the EU over the forecast horizon, with a major contribution coming from a decline in social benefits, mainly due to the economic recovery. Yet, the share of expenditure on public investment is declining by the same amount as social benefits, and is also expected to decline in nominal terms.

While the contribution of the revenue side to the projected improvement in the budget balance is expected to be relatively modest, general government revenue as a share of GDP is projected to rise in 2011 for the first time since 2006 in the euro area and in the EU, thus slowly approaching

its pre-crisis levels over the forecast horizon. This masks, however, diverging developments at the country level, with 9 EU Member States showing a lower ratio in 2011 than in 2010. The improvement in the 2011 revenue figure of the EU as a whole also includes a notable one-off measure in Hungary, where pension assets amounting to 9% of GDP are transferred from the second pillar into the public pillar. In Denmark, on the other hand, the revenue ratio is expected to decline by almost 2 pps., after an unexpected and temporary surge in revenues linked to pension yield taxation in 2010.

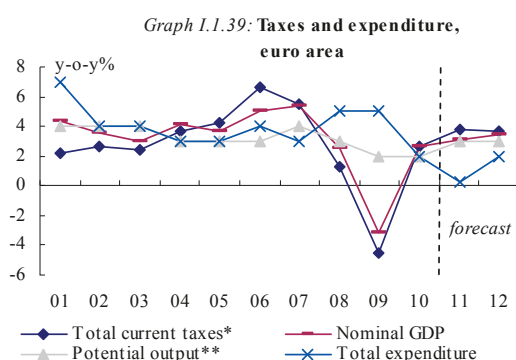
Overall, government revenues have proven fairly responsive to the pick up in economic growth and are set to increase at an apparent elasticity above average in 2011. While in 2009, in the aftermath of the financial crisis and the economic downturn in the EU, total current taxes<sup>(19)</sup> fell more sharply than nominal GDP, their growth slightly outperformed GDP growth in 2010 (see Graph I.1.39). This development is expected to continue over the forecast horizon, likely most pronounced in 2011, when total current taxes are expected to increase by 3.8% in the euro area, while nominal GDP growth is set to be 0.7 pp. lower. Among the main revenue categories, income from direct taxes is expected to post the biggest increase (4.7% in the euro area), followed by indirect taxes (4.2%) and social contributions (2.9%). The impact of the above-average sensitivity of revenues to the economic recovery is measurable: if government revenues were to grow at the same rate as nominal GDP in 2011, the general government deficit in the euro area and in the EU would turn out to be higher by 0.3 pp.

Over the forecast horizon, the projected improvement in the headline deficits originates from an improvement in the structural balance accompanied by smaller contributions from the economic cycle. In 2010, the structural balance, which denotes the budget balance net of cyclical factors and of one-off and other temporary measures, as a share of potential GDP, improved for the first time for the euro area and for the EU as a whole since 2007 – in the order of 0.3 pps., signalling a moderate fiscal tightening.<sup>(20)</sup> This

<sup>(19)</sup> Total current taxes comprise direct and indirect taxes and social contributions. They account for about 90% of total general government revenue.

<sup>(20)</sup> As the structural balance comprises the part of the budget balance which cannot be linked to cyclical developments, or to temporary fiscal measures, and would hence not be corrected through the cycle, it signals the need for consolidation of government finances.

development is expected to intensify in 2011, with a marked improvement in the structural balance of around 1 pp. in the euro area and 0.9 pp. in the EU as a whole. By components, the tightening is expected to come mainly from the expenditure side (about four fifths for the euro area, and somewhat more for the EU as a whole).



\* Direct and indirect taxes, social contributions

\*\* 10-year forward-looking average of potential output growth projections + annual percentage change of GDP deflator

The projected change in the structural balance in 2011 thus accounts for over 60% of the improvement in the overall deficit in the euro area, and for somewhat less in the EU. Particularly large improvements in the structural balance are expected in Portugal, Slovakia, Spain and Romania, which are set to see their structural deficit decline by more than 2 pps. in 2011. A significant decline in the expenditure ratio is driving the consolidation in these countries.

Under the usual no-policy-change assumption, the structural balance is projected to improve further – by another 0.4 pp. – in 2012 in the euro area and by 0.7 pp. in the EU.

### ... and some moderation in debt growth

In spite of the projected improvement in budget balances over the forecast period, the consolidation efforts are not sufficient to curb a further increase in general government debt levels in most countries and in the euro area and the EU as a whole. The debt-to-GDP ratio is projected to continue its upward path, albeit at a decreasing pace, largely thanks to improving primary balances. In the EU, the gross debt ratio is projected to rise to a level of 83% of GDP in 2012, and to over 88% in the euro area (see Table I.1.5). The expected debt figures for 2011 and 2012 in the euro area and in the EU are somewhat higher than projected in the Commission services 2010 autumn

forecast, inter alia due to statistical reclassifications in 2010.<sup>(21)</sup>

These statistical reclassifications are also an important driver of the large stock-flow adjustment (SFA) in 2010 – adding more than 2 pps. to the debt ratio –, representing an increase in debt levels beyond the increase in general government net lending. The snowball effect, which captures the impact of interest expenditure, GDP growth and inflation on public debt, and which was particularly high in 2009 due to the drop in economic growth, declined to below 1% of GDP in 2010. This resulted from a debt-increasing contribution from interest expenditure (2.8%), which was not offset by debt-reducing contributions from nominal growth (-1.4%) and inflation (-0.6%). The combined effect of interest expenditure and GDP growth is projected to further decline in 2011-2012, largely on the back of stronger price increases.

Table I.1.5:

#### Euro-area debt dynamics

(% of GDP)	average 2003-07	2008	2009	2010	2011	2012
Gross debt ratio <sup>1</sup>	68.6	69.9	79.3	85.4	87.7	88.5
Change in the ratio	-0.3	3.6	9.5	6.0	2.4	0.8
Contributions <sup>2</sup> :						
1. Primary balance	-0.9	-1.0	3.5	3.2	1.3	0.4
2. "Snow-ball" effect	0.2	1.4	5.1	0.8	0.5	0.3
Of which:						
Interest expenditure	3.0	3.0	2.8	2.8	3.0	3.2
Growth effect	-1.4	-0.3	3.0	-1.4	-1.3	-1.5
Inflation effect	-1.4	-1.3	-0.7	-0.6	-1.2	-1.4
3. Stock-flow adjustment	0.4	3.2	0.9	2.1	0.6	0.2

Notes:

<sup>1</sup> End of period. Unconsolidated general government debt. For 2010, this implies a debt ratio, which is 0.3 pp. higher than the consolidated general government debt ratio (i.e. corrected for intergovernmental loans) published by Eurostat on the 26 April 2011.

<sup>2</sup> The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

## 1.5. HEIGHTENED UNCERTAINTY

### New risks point to heightened uncertainty ...

While some of the risks surrounding the forecast had already been in place in autumn, some new risks, which heighten uncertainty, have surfaced. The risks that remain valid are on the upside (rebalancing of economic growth, spillover from Germany, consolidation efforts boosting confidence) and on the downside (external demand, fiscal consolidation weighing on domestic

<sup>(21)</sup> For instance, in Germany government debt increased by some 10% of GDP due to the transfer of impaired assets out of two banks into 'bad banks' which have been classified into the government sector.



demand, financial market fragility). Most of new risks are downside risks, including the impact of unrest and military conflict in the MENA region, commodity-price developments, and the disasters in Japan.

On the *upside*, as identified in the interim forecast, stronger global growth – beyond that allowed for in the baseline – would further support EU export growth. Also, the impetus from the export-led industrial rebound to domestic demand could prove stronger than assumed. Moreover, the strong business confidence could translate into stronger domestic demand than currently projected.

A further upside risk relates to the spillover from stronger activity in Germany to other Member States, which could materialise to a greater extent than expected at present.

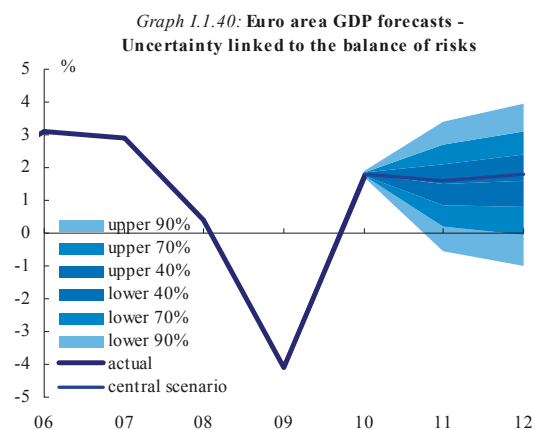
On the *downside*, the still relatively fragile European financial-market situation remains a concern. Tensions in some segments of the financial markets are still high, particularly in sovereign-bond markets, and spillovers to other market segments and to the real economy cannot be ruled out. These concerns would be aggravated in case of further increases in long-term government-bond yields. Significant fiscal sustainability issues are yet to be tackled in key countries outside the EU.

Additional downside risks relate to renewed increases in oil and other commodity prices, with substantially negative effects on real disposable incomes and profit margins – and thereby private consumption and investment – in the EU. They could also have a negative impact on economic growth outside the EU, due inter alia to policy measures then needed to curb inflationary pressures. In such a situation, abrupt exchange-rate changes could raise protectionist pressures and thereby damage the prospects for the global economy. The conflict in the MENA region and its impact on oil prices is a key determinant in this respect.

At the same time, the fiscal consolidation in a number of Member States may weigh more than currently envisaged on domestic demand. And finally, the economic impact of the disasters in Japan may deteriorate and hamper economic growth more than currently envisaged.

### ... and shift the balance of risks

The addition of downside risks to formerly broadly balanced risks to the growth outlook suggests that the balance of risks to the spring 2011 growth outlook is slightly tilted to the downside. The forecast presented in this chapter describes the most probable outcome given the chosen set of assumptions. It is thus the central scenario. Other possible outcomes are related to the assessment of the aforementioned upside and downside risks.



The uncertainty surrounding the *growth outlook* is visualised in the fan chart (see Graph I.1.40) that displays the probabilities associated with the forecast for real GDP growth in the EU in 2011 and 2012. While the darkest area indicates the most likely development, the shaded areas represent the different probabilities of future economic growth within the growth ranges depicted on the y-axis. As the balance of risks to economic growth is assessed as tilted to the downside, the fan chart is slightly skewed towards the x-axis.

Risks to the *inflation outlook* in 2011 seem somewhat tilted to the upside, on account of the ongoing geopolitical tensions in the MENA region and high inflationary pressure in world markets. While the slack remaining in the EU economy and well-anchored inflation expectations should keep underlying inflation in check, the upward pressures on non-core HICP components, stemming from the developments in commodity prices, could come to more to the fore than currently projected. In particular, should political tensions spread further in the MENA region, disruptions to oil supplies could not be excluded, fuelling oil-price increases beyond what was assumed in this forecast.

**Box 1.1.6: Some technical elements behind the forecast**

The cut-off date for taking new information into account in this European Economic Forecast was 2 May. The forecast incorporates validated public finance data from Eurostat's News Release 60/2011, dated 26 April 2011.

**External assumptions**

This forecast is based on a set of external assumptions, reflecting market expectations at the time of the forecast. To shield the assumptions from possible volatility during any given trading day, averages from a 10-day reference period (between 14 and 28 April) were used for exchange and interest rates, and for oil prices.

**Exchange and interest rates**

The technical assumption as regards exchange rates was standardised using fixed nominal exchange rates for all currencies. This technical assumption leads to implied average USD/EUR rates of 1.43 in 2011 and 1.45 in 2012. The average JPY/EUR rates are 118.08 in 2011 and 119.93 in 2012.

Interest-rate assumptions are market-based. Short-term interest rates for the euro area are derived from futures contracts. Long-term interest rates for the euro area, as well as short- and long-term interest rates for other Member States are calculated using implicit forward swap rates, corrected for the current spread between the interest rate and swap rate. In cases where no market instrument is available, the fixed spread vis-à-vis the euro-area interest rate is taken for both short- and long-term rates. As a result, short-term interest rates are expected to be 1.6% on average in 2011 and 2.5% in 2012 in the euro area. Long-term euro-area interest rates are assumed to be 3.3% on average in 2011 and 3.6% in 2012.

**Commodity prices**

Commodity price assumptions are also, as far as possible, based on market conditions. According to futures markets, prices for Brent oil are projected to be on average 117.4 USD/bl. in 2011 and 117.2 USD/bl. in 2012. This would correspond to an oil price of 82.1 EUR/bl. in 2011 and 80.8 EUR/bl. in 2012.

**Budgetary data**

Data up to 2010 are based on data notified by Member States to the European Commission on

1 April and validated by Eurostat on 26 April 2011. Eurostat has expressed a reservation on the quality of the data reported by Romania, due to uncertainties on the impact of some public corporations on the government deficit, on the reporting of ESA95 categories "other accounts receivable and payable", on the nature and impact of some financial transactions and on the consolidation of intra-governmental flows. Eurostat also expressed a reservation on the quality of the data reported by the United Kingdom, due to uncertainties on the time of recording of military expenditure. The United Kingdom does not record military expenditure on a delivery basis, as required by the relevant Eurostat Decision of 9 March 2006.

As usual, government deficit data notified by the UK for the years to 2010 have been slightly amended for consistency with Eurostat's view on the recording of UMTS licences proceeds.

For the forecast, measures in support of financial stability have been recorded in line with the Eurostat Decision of 15 July 2009.<sup>(1)</sup> Unless reported otherwise by the Member State concerned, capital injections known in sufficient detail have been included in the forecast as financial transactions, i.e. increasing the debt, but not the deficit. State guarantees on bank liabilities and deposits are not included as government expenditure, unless there is evidence that they have been called on at the time the forecast was finalised. Note, however, that loans granted to banks by the government, or by other entities classified in the government sector, usually add to government debt.

For 2011, budgets adopted or presented to national parliaments and all other measures known in sufficient detail are taken into consideration. For 2012, the 'no-policy-change' assumption used in the forecasts implies the extrapolation of revenue and expenditure trends and the inclusion of measures that are known in sufficient detail.

The general government balances that are relevant for the Excessive Deficit Procedure may be slightly different from those published in the national accounts. The difference concerns settlements under swaps and forward rate agreements (FRA). According to ESA95 (amended by regulation No. 2558/2001), swap- and FRA-related flows are financial transactions and therefore excluded from

<sup>(1)</sup> Eurostat News Release N° 103/2009.

*(Continued on the next page)*

*Box (continued)*

the calculation of the government balance. However, for the purposes of the excessive deficit procedure, such flows are recorded as net interest expenditure.

For the purpose of proper consolidation of general government debt in European aggregates and to provide users with information, Eurostat published in its News Release 60/2011, dated 26 April 2011, data on government loans to other EU governments. (For 2010 the intergovernmental lending figures relate mainly to lending to Greece.) However, the European aggregates for general government debt in the forecast years 2011 and 2012 are published on a non-consolidated basis (i.e. not corrected for intergovernmental loans). To ensure consistency in the time series, historical data are also published on the same basis. For 2010, this implies a debt ratio for the EU which is 0.2 pp.

higher than the consolidated general government debt ratio published by Eurostat on 26 April 2011. For the euro area, the difference is 0.3 pp.

#### **Calendar effects on GDP growth and output gaps**

The number of working days may differ from one year to another. The Commission's annual GDP forecasts are not adjusted for the number of working days, but quarterly forecasts are.

However, the working-day effect in the EU and the euro area is estimated to be limited over the forecast horizon, implying that adjusted and unadjusted growth rates differ only marginally. The calculation of potential growth and the output gap does not adjust for working days. Since the working-day effect is considered as temporary, it should not affect the cyclically-adjusted balances.

## 2. MACROECONOMIC IMPACT OF HIGHER SOVEREIGN RISK

*This chapter examines the channels through which higher sovereign risk impacts on macroeconomic performance and assesses their relevance within the context of the current business cycle. The increase in bonds spreads and CDS spreads as well as downgrades by major credit rating agencies suggest that sovereign debt has become much riskier. However, the magnitude of the actual increase varies across Member States and some factors suggest that the increase in market spreads overstates the extent to which sovereign risk has risen. Liquidity premia have also risen as some groups of investors have withdrawn from some Member States' sovereign bond markets in response to higher sovereign risk. If the withdrawal of certain investor groups is permanent and in consequence liquidity premia of vulnerable Member States' bonds remain durably higher, spreads cannot be expected to quickly return to the low levels seen in the past. The possibility of contagion across Member States has also led to a more widespread increase in spreads, though the analysis suggests that it has had a limited impact.*

*In macroeconomic models that use bond yields as benchmarks for interest rates, an increase in the sovereign-risk premium would give a similar result to a general rise in the real interest rate, which would apply equally to the whole economy and adversely affect GDP. However, this chapter finds that the increase in the sovereign-risk premium has not led to an equally strong rise in the risk premia for the non-financial corporate sector since early 2010. Corporate issuers benefited from a re-orientation of investors' portfolios from sovereign to corporate bonds. The analysis suggests that the impact on funding costs for non-financial corporations has been small at the aggregate level, though there are signs that the rise in sovereign risk has had a more sizeable impact in peripheral euro-area Member States, especially on utility companies. Nevertheless, it remains to be established whether the rise in credit risk for corporates stems from the rising sovereign-risk premium (increasing capital costs) or the drop in profitability due to the recession.*

*Due to the links between Member States' budgets and banks' balance sheets, the level of yields on sovereign debt is expected to be an important factor for the performance of the banking system. Indeed, there are abundant signs that the increase in sovereign risk has led to higher funding costs for banks. To keep net interest margins stable, banks are predicted to offset higher funding costs with higher lending rates. Particularly in certain vulnerable euro-area peripheral economies, the cost of credit has risen by more than in the euro area as a whole. However, higher credit costs have not led to systematically lower lending growth in these Member States. The impact of higher funding costs on lending growth seems to be more than offset by other factors, especially demand factors.*

### 2.1. INTRODUCTION

The re-assessment of financial risks that was initiated by the US sub-prime crisis in summer 2007, and spread over to wholesale bank-funding markets in 2008, eventually reached sovereign bond markets in 2010. As a consequence of the economic downturn and the credit transfer from the private to the public sector, several Member States had to offer considerably higher returns to investors when issuing public debt, up to the point at which the cost of debt financing was perceived as unsustainable. Programmes were agreed for Greece and for Ireland in 2010 and a decision on a programme for Portugal is expected in May 2011,

as these Member States were effectively cut off from market-based funding.

The real interest rate has picked up, in line with the perception that proliferating public debt has made market participants' assessment of sovereign risk less benign than in the past. Indeed, the timing, extent and variation of changes in yields across Member States imply that higher expected inflation, or the anticipation of upward moves in central bank rates, cannot fully explain the observed hike in interest rates on bond markets.

The phenomenon of pricing in a higher risk premium in the required return on sovereign bonds is not limited to EU Member States. Bond yields in the USA and Japan also edged up, reacting in

particular to announcements by credit rating agencies that questioned their existing credit ratings due to soaring debt levels.

Policymakers in the EU have recognised that increased interest rates are closely related to the perception in financial markets that public debt dynamics have deteriorated markedly since the beginning of the financial crisis. In general, the Member States have embarked on fiscal consolidation to contain any rise in real interest rates by assuring long-term debt sustainability.

A chapter in the Commission's autumn 2010 forecast analysed the impact of fiscal consolidation on economic growth. The analysis concluded that fiscal retrenchment may lead to short-term falls in GDP and employment.<sup>(22)</sup> In the long run, however, reducing government debt levels tends to produce positive GDP and employment effects, largely because lower debt servicing costs will create fiscal space for reducing distortionary taxes. Building upon this analysis, this chapter explores the channels through which an increase in the sovereign-risk premium could impact on macroeconomic performance and what the quantitative importance may be.

Traditionally, this question would be examined as a shock to the real interest rate. The reality however, is more complex. Although government bonds are used as proxy for the capital cost of the economy, it is not clear that a higher risk premium on sovereign debt implies that the risk premium for the total economy has increased. The observation that sovereign risk increases at the same time as private economic activity continues to recover suggests that this is not the case. Furthermore, traditional indicators of economic uncertainty, used as proxies for risk premia, did not follow the increase in sovereign bond yields. This supports the notion of an imperfect pass-through of sovereign risk to the total economy.

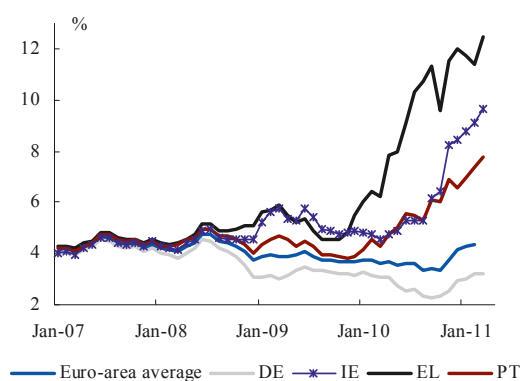
Another complication is that past episodes of sovereign-debt crisis, or of rapidly rising interest

rates, are hardly applicable in the euro-area context. First, past crises and defaults occurred in economies with very different monetary systems and financial-market environments. In most cases, sovereign-debt crises were associated with currency crises, implying that high inflation, currency devaluation and capital flight impacted on macroeconomic performance.<sup>(23)</sup> These factors are not at play in the euro area today. Second, past episodes of rapidly rising interest rates are misleading, as inflation or devaluation expectations rather than sovereign risk was the main driver. Analysing changes in real interest rates does not help either. They occurred in times of strong disinflation, which suggests that the monetary policy stance and business cycle factors were main determinants, rather than sovereign risk.

## 2.2. MEASURING THE INCREASE IN THE SOVEREIGN-RISK PREMIUM

The macroeconomic model simulations presented in the autumn 2010 forecast assumed that the sovereign-risk premium increased by 400 basis points over a period of 10 years without policy reaction. The actual increase may be higher or lower, longer or more short-lived. As Graph I.2.1 shows, the observed increases in bond yields have been different across countries, implying that the increase in the sovereign-risk premium is not uniform.

Graph I.2.1: Sovereign-bond yields



It is not straightforward to measure the increase in sovereign risk premia from the observed market yields, since factors such as inflation, exchange rate expectations and expected monetary policy

<sup>(22)</sup> See also Schaltegger, C. A. and M. Weder (2010), "Fiscal Adjustment and the Costs of Public Debt Service: Evidence from OECD Countries", CESifo Working Paper No. 3297. This empirical analysis came to similar conclusions, finding that the impact of fiscal consolidation on interest rates depends on size and composition of the budgetary adjustment. Since large adjustments and those based on expenditure cuts can lead to lower long-term interest rates, they argue that "financial markets only seem to value strict and decisive measures – a clear sign that the government's pledge to cut the deficit is credible."

<sup>(23)</sup> See Reinhart, C. M. and K. S. Rogoff (2009), "This time is Different, Eight Centuries of Financial Folly", Princeton University Press: Princeton and Oxford.



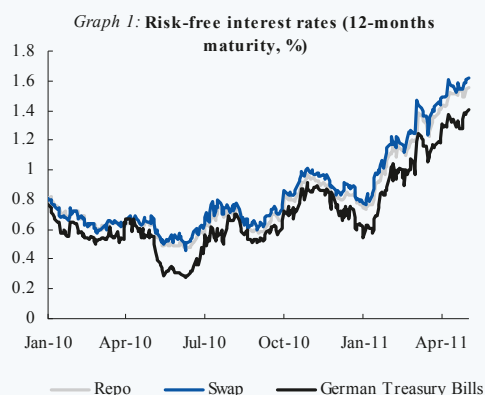
### Box 1.2.1: Measurement of the risk-free interest

It is standard practice to analyse the spread of a capital-market interest rate relative to a risk-free benchmark rate rather than to the nominal rate itself. This is done in order to neutralise the effect of factors such as inflation expectation or exchange rate risk that are common to both interest rates. Spreads among the sovereign bonds denominated in euro and issued by euro-area Member States are particularly meaningful because the euro abolished any exchange rate risks. Spreads to bonds of sovereign issuers denominated in currencies other than the euro have remained much wider than those within the euro area, reflecting in particular exchange rate risks. For this reason, the analysis in this chapter focuses on spreads of euro-area Member States.

The traditional benchmark for capital market interest rates in the euro area is the German Bund, i.e. the yield on the government bond with a 10-year maturity issued by the Federal German government.<sup>(1)</sup> The German Bund has usually been the lowest in the euro area, benefitting from a AAA rating, high volumes on a liquid spot market, and the availability of exchange traded derivatives that allow investors to hedge their exposure. Despite its use as a benchmark rate, the German Bund is not necessarily equal to the risk-free interest rate. The true risk-free rate may be higher or lower. It may be higher because sovereign bonds, including the Bund, are favoured by regulation as their use is stipulated for meeting liquidity and capital requirements. These requirements artificially increase demand and may lead to returns below the risk-free rate. It may be higher because there are operational risks associated with borrowing and lending, e.g. technical problems linked to the payment system that may lead to incapability of servicing the debt in time. Furthermore, the sheer existence of a CDS market for German bonds implies, though prices are low, that market participants do consider German bonds to contain some risk.<sup>(2)</sup>

<sup>(1)</sup> In practice, the rate is not directly observed, but derived from bonds with a maturity close to 10 years and taking into account coupon payments and the precise difference in maturity.

<sup>(2)</sup> Since CDS contracts are used for hedging purposes, there may be positive demand for CDS for a virtually risk-free or not even existing debt if there are other debt securities of which the return is correlated with the risk-free debt.



The difference between the benchmark rate and the true, but unknown, risk-free rate may become meaningful in times when the market assessment of risks undergoes substantial changes. These events are often characterised by safe-haven flows that depress benchmark yields. The chart shows the magnitude of this effect by comparing the yields on German government bills with two other quasi risk-free market rates. The first is the swap rate, which is the rate charged when a fixed interest payment for a specified period is exchanged against a floating one, with the daily overnight rate (EONIA) used for the floating leg. Since this transaction does not involve the exchange of the principal, but of the interest payment only, it is close to risk free. The second rate is the repo rate, which means that credit is given against high-value collateral. If the debtor is unable to repay, the debtor has the collateral and since this usually enters with a haircut, i.e. below market price, this transaction is also close to risk free.<sup>(3)</sup> The sovereign rate has constantly been somewhat below these two alternative rates. At times of financial market tensions, the difference widened between 10 and 20 basis points over the various maturities in May 2010 and again in December 2010. Daily peaks increased by up to 40 basis points. These changes are small compared to the changes in yields of other euro-area Member States. Nevertheless, they imply that short-term, daily monitoring needs to take this factor into account.

<sup>(3)</sup> Most repo transactions are short-term, i.e. generally within a week though quotes are available for up to 12 months. For swap transactions, there is also a liquid market for long-term maturities. Rates are quoted even for 50 year maturities.

rates also affect nominal bond prices. The analysis in this chapter focuses on spreads of euro-area Member States because these factors have the same impact on their bond yields. Standard practice is moreover to use spreads to a benchmark rate of a “risk-free” sovereign bond denominated in the common currency. However, this implicitly assumes that the riskiness of the benchmark rate and of the price of risk has remained constant, which is not obvious. For the reasons discussed in Box I.2.1, the analysis in this chapter is based on differences to swap rates. This has also the advantage that developments in the benchmark country, Germany, can be shown.

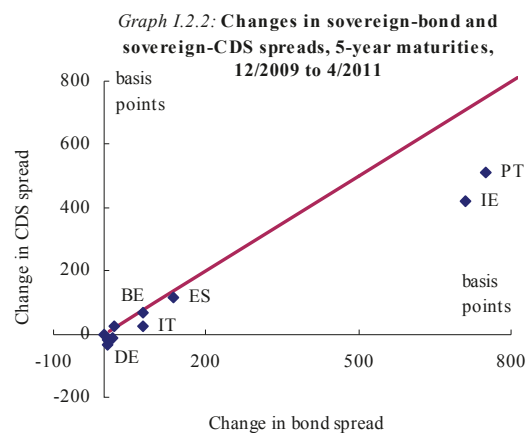
### Factors inherent to the capital market: difficult to disentangle risk and liquidity premia

The rise in yield spreads can partly be accounted for by increasing liquidity premia, which distorts the use of yield spreads as a measure of rising credit risk premia. There is some support for this notion. Market reports have noted that some investor groups withdrew from certain sovereign bond markets.<sup>(24)</sup> Other investors have decided to hold their bonds in order not to realise losses, and surveys revealed that some countries' bonds were no longer usable as collateral in repo transactions. As a consequence, markets have lost depth and liquidity. Thus, a rising liquidity premium is driving a wedge between the credit risk premium on government bonds and the observed yields and if the withdrawal of certain investor groups is permanent and, in consequence, liquidity premia remain durably higher, spreads cannot be expected to quickly return to the low levels seen in the past. Disentangling the liquidity premium from the credit risk premium is difficult because both are interdependent: a higher liquidity premium may increase the credit risk premium and vice versa.

An alternative gauge of the increase in sovereign risk is the price of credit default swaps (CDS),

which is not subject to some of the liquidity issues related to bond markets. CDS are financial derivatives originally created to provide protection against the risk of default. Today, they are also used for speculation. CDS contracts have become the most widely traded credit derivative product, with most liquid contracts traded with a maturity over 5 years. They are similar to an insurance contract, and pay out in the case of a credit event, i.e. if the creditor does not service his debt as contractually agreed. A CDS spread of 1 basis point implies an annual cost of EUR 1000 for insuring against the default of EUR 10 million of debt; this is equivalent to a risk premium to be paid.

Nevertheless, the difficulty of disentangling credit risk and liquidity effects also applies to the interpretation of CDS spreads. The price reflects both the preference for obtaining insurance and the liquidity of CDS markets, i.e. higher risk aversion leads to higher CDS spreads, but greater market depth reduces spreads. Furthermore, CDS are sometimes used by asset managers to hedge against other correlated risks – so-called proxy hedging. Thus, it is possible that sovereign CDS reflect the risk premia of risks other than sovereign risk.



The SovX index, which tracks the increase in CDS of Western European sovereign debt, increased by about 120 basis points since December 2009 to 184 basis points in early May 2011. Both

<sup>(24)</sup> See Chapter 1D in IMF Global Financial Stability Report, April 2011 for an overview of investor types that may have withdrawn from buying sovereign bonds in response to higher perceived risks.

Table I.2.1:

#### CDS spreads of sovereign debt

	BE	DK	DE	IE	EL	ES	FR	IT	NL	AT	PT	FI	SE	UK
end 2009	50.0	30.9	23.9	156.2	241.3	97.6	27.9	98.5	30.4	78.0	78.6	26.5	52.9	79.0
May-10	94.5	42.1	45.7	211.8	708.1	196.1	67.5	169.4	44.7	69.6	306.3	28.8	36.3	82.9
end 2010	207.9	43.7	53.7	570.2	992.8	330.0	100.9	218.2	59.0	92.1	468.2	32.2	32.5	71.5
Apr-11	135.7	33.8	42.7	593.7	1206.5	229.3	71.8	143.5	35.2	60.2	607.0	27.2	24.7	54.5

development over time and the cross-country variation of CDS spreads closely – though not perfectly – followed the developments in bond spreads.

### Credit ratings as a gauge of sovereign-risk premia

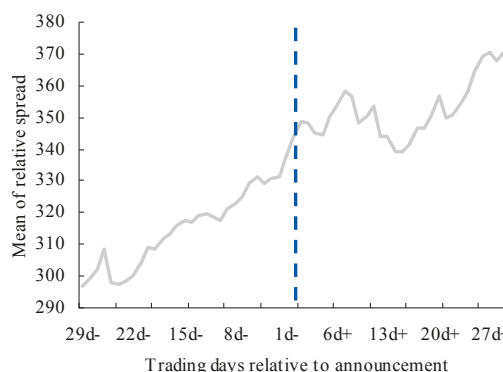
Rather than trying to derive the increase in sovereign-risk premia from market prices, one could follow the assessments of credit rating agencies. Their downgrades have been taken by market participants as an apparent sign of rising sovereign risks. Credit rating agencies have developed complex methodologies, which combine qualitative and quantitative information, and issue ratings that express their opinion of the probability of default. The quality and usefulness of ratings have been subject to a broad discussion following the role credit rating agencies played in structured credit markets in the wake of the subprime mortgage crisis. Rating agencies have again come under scrutiny in the context of the more recent wave of sovereign debt downgrades.

Several issues were raised with regard to the accuracy and timeliness of sovereign ratings. The key concern is that rating downgrades, especially those related to government debt, may destabilize financial markets, leading to pro-cyclicality and cliff-effects. Other concerns relate to the methodology of sovereign ratings. Here, a number of specific factors are worth noting. First, the empirical backing for the rating methodologies is scarce.<sup>(25)</sup> Second, the rating reflects less the issuer's ability to pay, but more its willingness to pay. A government can fail to meet its financial commitments even if it has the capacity to service its debts, since investors' rights to legal redress are limited.

Since 1 January 2009, the three main credit rating agencies announced 61 sovereign rating changes, covering Greece, Ireland, Portugal and Spain. 23 rating actions are attributed to Standard & Poor's, 21 to Moody's and 17 to Fitch. All rating changes were negative, except for two positive rating events: Standard & Poor's took Greece off a negative credit watch on 16 March 2010 and Fitch removed Ireland's sovereign rating from

a negative credit watch on 14 April 2011. Outside the euro area, rating changes have been more mixed, with, for example, China being upgraded by major rating agencies while the rating outlook for the USA was lowered.

Graph I.2.3: Rating events and sovereign-yield spreads



Changes in ratings, and in particular downgrades, can have a strong effect on bond spreads. An analysis of spread developments around the time of rating announcements shows that sovereign downgrades are followed by rising sovereign spread changes (see Graph I.2.3).<sup>(26)</sup> However, the analysis also shows that the spreads increase before the announcement of the sovereign downgrade, shown by the vertical line in the Graph. While the pre-movement of yields is to some extent due to credit rating agencies' signalling of future downgrades in advance, it also suggests at least partial endogeneity of rating changes.

For the sample used in Graph I.2.3, the impact of downgrades on spreads of euro-area Member States are considerably smaller than estimates reported in empirical economic studies. As a result of a one notch downgrade, the data used generate average changes in yield spreads that range between 0 and 17 basis points. Other empirical studies, on the other hand, have come up with estimates of yields increasing between 25 and 200 basis points.<sup>(27)</sup> The likely reason for the difference is that the academic literature uses data panels that cover more emerging markets.

<sup>(25)</sup> The economic literature shows that sovereign ratings tend to lag market reactions. Contrary to ratings of companies, for which credit rating agencies have access to timely information, sovereign ratings are typically based on publicly available information, which often becomes outdated before it is issued.

<sup>(26)</sup> The announcements used are from the three major credit rating agencies, and concern euro-area Member States starting from early 2009.

<sup>(27)</sup> For a recent empirical survey and new estimates, see Tejada, M. and L. Jaramillo, "Sovereign Credit Ratings and Spreads in Emerging Markets: Does Investment Grade Matter?" IMF Working paper 2011/44. Evidence of contagion of credit rating announcements in the euro area is found in Arezki, R., et al. (2011), "Sovereign Rating News and Financial Markets Spillovers: Evidence from the European Debt Crisis", IMF Working Paper 2011/68.



### Box 1.2.2: Contagion between Member States

This box attempts to measure the degree of contagion, or spill-over, of sovereign risk in one Member State to the sovereign risk of other Member States or different aggregates of EU Member States. An event-study approach is used to test whether a large increase in a Member State's sovereign risk affects the market price of sovereign risk of other Member States. For this purpose, the event is defined as a large relative increase in the spread of a 'source' country's credit default swap with a five-year maturity. Event dates are those days with the 15% highest daily increases in the spread from January 2009 to February 2011. For example, all daily increases in the Greek 5-year CDS spread are ranked according to the size of the change. The maximum daily change in the spread was 31.9% and the minimum change was 0%. Those days with the 15% largest changes are selected as event dates. For Greece as a source country there are 38 events where the minimum change was 6%. The analysis covers 17 EU Member States, including Greece, Ireland, Portugal, and Spain.

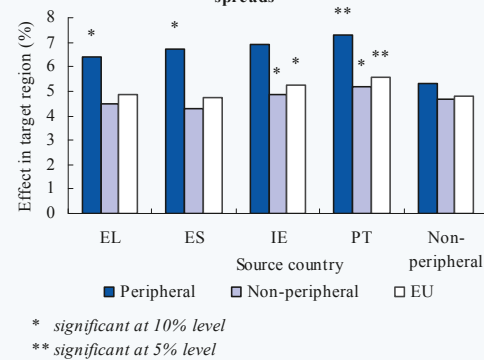
The procedure employed tests for an 'abnormal' change in the CDS spread of a 'target' economic region. Individual countries are grouped into three economic regions, namely the EU as a whole, peripheral countries and non-peripheral countries. In short, the procedure tests for significance of large changes in the CDS spread of a source country on above-average changes in the CDS spread of target regions. For example, on all the identified Greek event days, the 'abnormal' change in the Portuguese CDS spread is calculated as the daily relative change in the CDS spread minus the 'expected' change. The expected change is taken to be the average of the previous twenty days of relative changes. Thus, the procedure adjusts for any persistent trends in the changes of CDS spreads. The spillover is calculated as the average of all abnormal changes and tested for significance.

In general, taking peripheral Member States as source countries, an average increase of about 10.5% (the minimum threshold increase is about 6%) in their CDS spreads led to increases in the

other peripheral Member States' CDS spreads in the order of 7%. This effect is significant at the 10% level, and translates into a spill-over effect of about 20 basis points in Greece, Portugal, Ireland and Spain' CDS spreads. Ireland is the exception, for which the effect is not significant.

The spill-over from rising peripheral CDS spreads to the EU as a whole and to non-peripheral countries is less. Greece or Spain as source countries does not create a significant spill-over. However, Ireland and Portugal seem to affect the CDS spreads of non-peripheral Member States, where CDS spreads would increase by about 5%, which translates into a spill-over of about 10 basis points.

Graph 1: Effect of an abnormal increase in CDS spreads



Replicating the same analysis using non-peripheral Member States as source of contagion generally generates insignificant results. For those countries for which the spill-over effect is significant, they primarily affect other non-peripheral Member States.

In conclusion, the analysis illustrates that the risk of contagion primarily occurs between peripheral Member States. However, there is some spill over also from peripheral Member States to non-peripheral. The effects on peripheral Member States are relatively small, but economically relevant at the margin. The spill-over to non-peripheral Member States is small and not economically relevant.

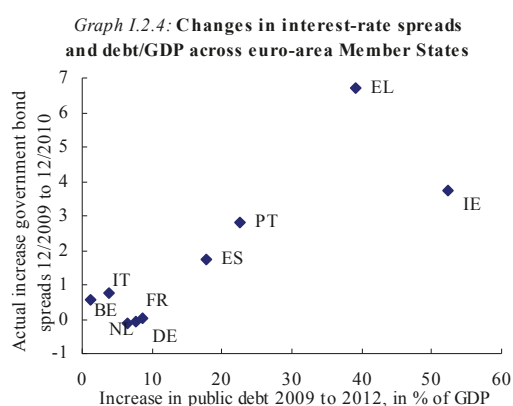
Table 1:

Descriptive statistics of events

	EL	ES	IE	PT	Peripheral	Non-peripheral
Max increase (%)	31.9	29.7	24.2	23.3	27.3	22.7
Average absolute change (%)	10.1	11.0	9.0	11.7	10.5	8.6
Threshold increase (%)	6.0	6.3	5.6	7.6	6.4	5.3
Number of events	38	39	38	38	38	39

### 2.3. IMPACT OF SOVEREIGN RISK ON PUBLIC SECTOR ACTIVITY

This chapter focuses on the channels through which higher sovereign-risk impacts on economic activity. It complements the analysis in the autumn 2010 forecast document on the impact of budgetary consolidation, which is the principal policy response to sovereign risks, on economic growth. Apart from its impact via financial markets, which are discussed in the sections below, the increase of sovereign risk can have a direct effect on public sector activity.



The analysis of higher sovereign risk on public sector activity is complicated by an endogeneity issue: increasing public debt contributes to higher sovereign risk, with following higher interest rates. *Ceteris paribus*, the higher debt service burden further increases the level of public debt. Indeed, even a naive regression analysis with the simplest specification possible suggests that more than 70% of the variation in the increase in bond spreads across the sixteen euro-area Member States from end-2009 to end-2010 can be explained by the level of public debt relative to GDP and its change. The share explained by public debt even increases

to 80% if the forecast change of the public debt-to GDP ratio between 2009 and 2012 is used instead.

The finding of a strong correlation between public debt and interest spreads contrasts with results of earlier studies of this effect in EMU. Recent studies suggest that this pattern has changed with the financial crisis. Fundamental factors, and in particular public debt, have become an important determinant of sovereign spreads.<sup>(28)</sup>

Generally, the direct impact of higher sovereign risk should be similar to the impact of higher public debt on savings and investment.<sup>(29)</sup> The most immediate effect may be that the public sector will provide fewer services to the economy. The higher the public debt, or the higher the average interest rate paid for the debt, the higher the debt servicing costs, and the fewer means are available for productive public expenses. Budgetary room for manoeuvre would in particular be curtailed in economic downturns. The possibilities to stabilise economic activity, for example by letting automatic stabilisers play freely or by cushioning solvent, but liquidity-constrained firms, are more inhibited if the public sector is facing a high debt servicing burden. The need to cut down on public expenditures in an economic downturn will reduce corporate earnings, thereby depressing aggregate demand. Private actors will also expect that with a high public debt service level, the likelihood of corrective action is

<sup>(28)</sup> See, for example, the literature reviewed and the empirical analysis in Gerlach, St. et al. (2010), "Banking and Sovereign Risk in the Euro Area", CEPR Discussion Paper No 7833 and Arghyrou, M. G. and A. Konstantikas (2011), "The EMU sovereign-debt crisis: Fundamentals, expectations and contagion", European Economy Economic Paper No 463.

<sup>(29)</sup> Thus, the arguments against the neutrality proposition of the Barro-Ricardo theorem, presented and discussed in the special chapter in the autumn forecast, apply yet again.

Table I.2.2:

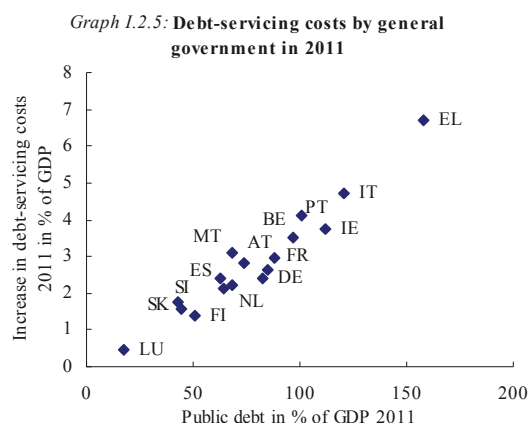
#### OLS Regression: Relationship between the change in bond spreads and public debt

Dependent variable: change in spread between 10-year sovereign bond and 10-year swap rate December 2009 to December 2010

	(1)	(2)	(3)	(4)	(5)
panel	Euro-area MS	Euro-area MS	as in (2) excl. IE, EL	as in (2) plus DK, SE, UK, USA, NO	as in (4) excl. IE, EL
	change in debt 2009-10	change in debt 2009-12			
Constant	-2.36	-2.28	-1.76	-2.09	-1.55
Standard deviation	0.59	0.74	0.55	0.43	0.42
Debt/GDP 2009	0.03	0.03	0.02	0.03	0.02
Standard deviation	0.01	0.01	0.01	0.01	0.01
Change in debt/GDP	0.13	0.09	0.12	0.13	0.10
Standard deviation	0.01	0.01	0.03	0.03	0.03
R <sup>2</sup>	0.70	0.79	0.65	0.75	0.57
No. of observations	16	16	14	21	19

increasing and with it the probability of being subject to higher distortionary taxes in the future.

The impact of a higher sovereign-risk premium on the costs of debt servicing are in principle straightforward to estimate, though it requires detailed information about the maturity structure of existing public debt and assumptions about future deficit developments and the maturity of future debt. Since the average maturity of public debt in the EU is around 4 years, 25% of total debt would need to be refinanced each year.<sup>(30)</sup> With a starting position of an 80% ratio of public debt to GDP and assuming that Member States will over the medium term run a deficit below 3% of GDP, they have to refinance about 25% of GDP each year. Under these assumptions, a 100 basis point increase in the sovereign-risk premium absorbs 0.25% of GDP of public resources in the first year. Latest projections for some euro-area Member States point to a somewhat lower effect, considering their lower debt level and more comfortable maturity structure (see Graph I.2.5).



Whereas the increase in sovereign risk seems to reduce available resources by a small amount, the economic impact may be large because it occurs at the margins and hits Member States in which public budgets are already squeezed. In QUEST model simulations run for the autumn 2010 forecast, a sovereign-risk shock of 400 basis points, lasting for 10 years, had only a modest impact on real GDP growth, if there was no spillover to risk premia in the financial sector. The shock leads to a gradual increase in government interest payments and an accumulation of debt.

<sup>(30)</sup> This assumption yields strictly speaking a broad approximation because public debt offices are also engaged in swap transactions that change the maturity profile and the impact of the term structure on public debt.

Since the Quest model applies a debt stabilisation rule, the increase in debt prompts an increase in labour taxes so that the government debt ratio is stabilised in the long run. The induced increase in distortionary labour taxes leads to lower consumption and employment. After 10 years, GDP falls 0.4% below the baseline.<sup>(31)</sup>

Economic studies found that the level of public debt is a crucial determinant of the impact of debt on GDP. Below a certain threshold, there is no empirical evidence that higher debt adversely affects GDP growth. Above some tipping point there is. In their analysis of 44 countries over two centuries, Reinhart and Rogoff (2010) identify such a tipping point at 90% of GDP.<sup>(32)</sup> If public debt is above this tipping point, GDP growth is on average one percentage point lower. A second, comparable analysis by Caner et al. (2010), which works with data from 101 countries over the period 1980 to 2008, set the threshold at 77% of the debt-to-GDP ratio.<sup>(33)</sup> According to their estimates, every additional point of public debt above this threshold reduces real GDP growth by 0.02 pps. This study found that the threshold lower, but the growth impact bigger in emerging than advanced economies; whereas the one by Reinhart and Rogoff concluded that the threshold was similar in both groups of economies. Interpolating the results of Caner et al (2010), would suggest that the threshold for advanced economies could be well above 100% of GDP.

The theoretical motivation for such a tipping point effect can be derived from the model analysis in Davig and Leeper (2011).<sup>(34)</sup> They assume that the higher the debt, the more agents expect tax rates to rise. Beyond a threshold, the tolerance for taxation fades and any increase in tax rates will not generate further tax returns, i.e. the so-called Laffer effect. It is useful to note that recent research on the Laffer effect found EU tax rates to be generally lower than the implied maximum rate, i.e. governments would have scope to raise taxes

<sup>(31)</sup> See European Commission DG ECFIN European Economic Forecast, Autumn 2010.

<sup>(32)</sup> Reinhart, C. M. and K. S. Rogoff (2010), "Growth in a Time of Debt", American Economic Review, Vol. 100, pp. 573-588.

<sup>(33)</sup> Caner, M., et al. (2010), "Finding the Tipping Point—When Sovereign Debt Turns Bad", World Bank Policy Research Working Paper No. 5391.

<sup>(34)</sup> Davig, T. and E. M. Leeper (2011), "Temporarily Unstable Government Debt and Inflation" NBER Working Paper No. 16799.

before the inflection point is reached.<sup>(35)</sup> According to the authors' model simulations, the room for manoeuvre is highest in those Member States in which bond spreads had increased the most over the last year, and is higher for taxes on labour than on capital income.

#### 2.4. EFFECTS OF HIGHER SOVEREIGN RISK ON THE FINANCING OF THE CORPORATE SECTOR

In macroeconomic models, an increase in the sovereign-risk premium would imply an impact comparable to that of a correspondingly higher real interest rate. The elasticity with respect to the cost of capital in investments and other demand components governs the effect on GDP. However, the risk premia for the rest of the economy, and thus the capital costs for firms, must not necessarily increase by the same amount, or may not increase at all, if savers perfectly discriminate between the risks attached to sovereign and private debt. In practice, it is likely that they re-orient their portfolios towards private debt securities in response to higher sovereign risk.

Higher demand for capital by the public sector may crowd out private investment, thereby depressing the growth prospects of the economy. The assumption behind crowding-out is that public demand for capital is inelastic to the interest rate. The government sector demands the amount it requires independently of the response of the interest rate, whereas private firms adjust their investment plans if capital costs increase beyond expected profitability. Currently, these assumptions do not fully hold. Some Member States have found interest rates increasing towards levels that were perceived as non-sustainable. Firms may afford a higher cost of capital if at the same time the economic outlook and therewith expected profitability improves. There is limited scope for this type of "reverse crowding-out", and it is mainly a theoretical possibility, but could be one explanation to why sovereign yields have ratcheted up so strongly.

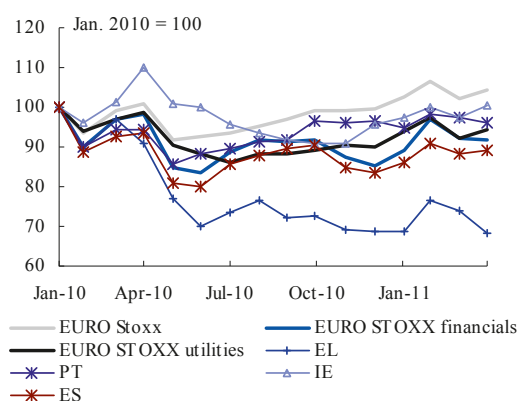
A further complication arises in the euro-area context: If the yield on sovereign bonds has an impact on capital costs in the private sector in one Member State, the source may be either the euro-

area benchmark, i.e. the German Bund, or the national debt of the Member State. After a decade of monetary union, the interest rate on national sovereign debt may have little guiding role for the capital cost of domestic private debtors. In addition, the guiding role of the interest rate of the national sovereign's debt may be different for the banking system and for the non-financial system. This carries a potential for cross-country differences in the transmission of sovereign risk via the process of financial intermediation. That is, the costs of bank lending may be affected differently depending on the domestic sovereign's risk. The following two sections discuss these issues.

##### 2.4.1. SPILLOVER OF SOVEREIGN RISK ON THE COST OF CAPITAL

The EU financial system is mainly bank-based. The euro-area financial accounts reveal that around a third of non-financial corporations' external financing stems from bank loans. For households, bank lending is the only relevant source of external finance. Among the sources of market funding of non-financial firms, the issuance of debt securities or of quoted shares has a small role, accounting for around 13% and 7% of financial transactions in 2010. Much more important is financing through unquoted shares and other equity or through trade credit. Yet, changes in the observed returns on quoted shares and corporate bonds may be informative about the impact of the sovereign-risk premia on the cost of capital.

Graph I.2.6: Stock-price developments



Developments of stock price indices clearly suggests that stock prices in euro-area Member States with increasing sovereign risk underperformed relative to the Eurostoxx (see Graph I.2.6). This is not necessarily due to a higher

<sup>(35)</sup> See Trabandt, M. and H. Uhlig (2009), "How Far Are We From The Slippery Slope? The Laffer Curve Revisited", NBER Working Paper No. 15343.

cost of capital, caused by higher sovereign risk. It could also be caused by lower profitability due to structural weaknesses and weak prospects for domestic demand. Investors may expect the higher public debt and the required budgetary consolidation, including higher taxes, to depress future corporate earnings.

Across sectors covered by the Eurostoxx index, utilities and banks underperformed considerably. Profitability in most utilities is strongly determined by revenues on the domestic market. Sectors with a stronger reliance on exports were less affected, suggesting that the impact of higher sovereign risk on the cost of equity capital may be dominated by its effect on domestic demand and corporate earnings. The underperformance of banks provides further support to the notion that the relationship between higher sovereign risk and the intermediation of credit through the banking system deserves special attention in the subsequent section.

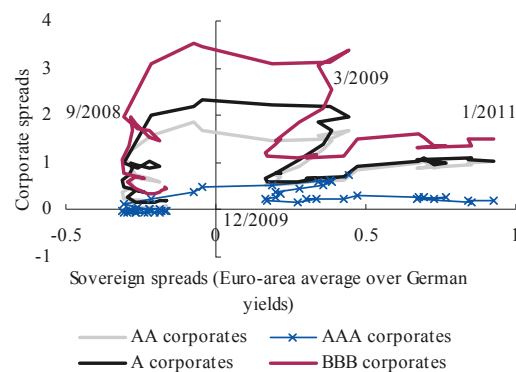
Developments in corporate bond spreads may give a better indication of the impact on capital costs than share prices because bond holders participate in the downside risks, but are less affected by the upside risks. That is, the holder of a corporate bond does not directly benefit from higher corporate earnings, but would suffer a loss if the firm defaulted. The spillover from higher sovereign risk to higher corporate default risk could therefore be expected to translate into higher required returns on corporate bonds.

Corporate bond rates tend to be highly correlated with the return on sovereign bonds and the more so the higher the rating of the issuer. In the recent past, however, the relationship between spreads on sovereign and corporate bond markets has been weak, as demonstrated by Graph I.2.7. Between 2007 and 2008, the pattern is consistent with safe haven flows driven by investors' rising concerns about the depth of the economic downturn. In early 2009, this trend partly reversed. Lately, however, sovereign spreads have increased, while corporate spreads have hardly changed. This lower correlation suggests that investors have begun to consider corporate bonds as an alternative to government bonds when trying to achieve a less risky position.

In particular, spreads of AAA corporate bonds decoupled from rising sovereign spreads, suggesting that highly rated corporate bonds have

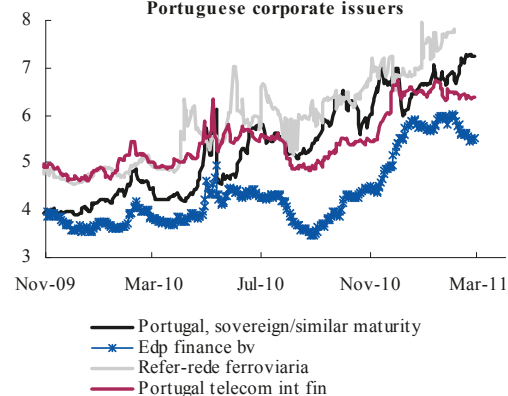
partly replaced sovereign bonds as the “risk free” investment choice. When these substitution effects are present, they imply that the spillover of sovereign risk into higher corporate risks is limited.

Graph I.2.7: Sovereign- and corporate-bond spreads 2008-11



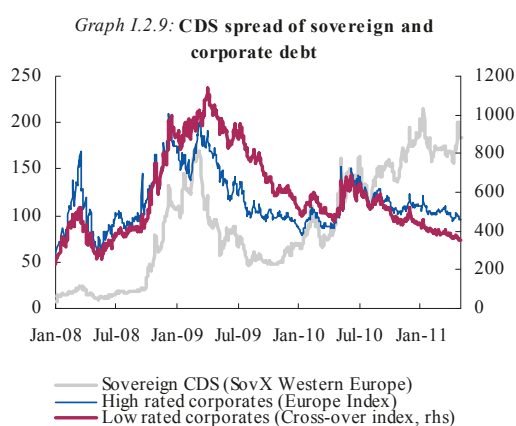
The picture is more ambiguous for lower-rated corporates. The correlation between corporate and sovereign spreads remained positive in 2010, albeit with a much smaller coefficient than in the past. However, changes in sovereign spreads were accompanied by over-proportional changes in AA to BBB rated corporate spreads during the banking crisis 2007-09. The changes were in the range of 1% to 1.5% for a 1% increase in sovereign spreads, this elasticity declined to below 1% in 2010. Graph I.2.8 shows that the yield on bonds issued by Portuguese corporations followed the yield of the sovereign in 2010, but that the relationship broke in early 2011, when some corporate bond yields moved sideward while the sovereign yield continued to increase.

Graph I.2.8: Yield on bonds issued by Portuguese corporate issuers





Developments of CDS spreads show a similar picture at the aggregate EU level. Benchmark corporate CDS indices have decoupled from the sovereign CDS index. Whereas the sovereign index was on an upward trajectory, starting in late 2009, corporate indices (Europe and Cross-over) fell over time (see Graph I.2.9). However, the geographical breakdown in the sovereign and corporate benchmark portfolios is likely to be different. This may imply that sovereign and corporate CDS spreads are different at country level, and in particular in those countries in which sovereign risk increased the most.

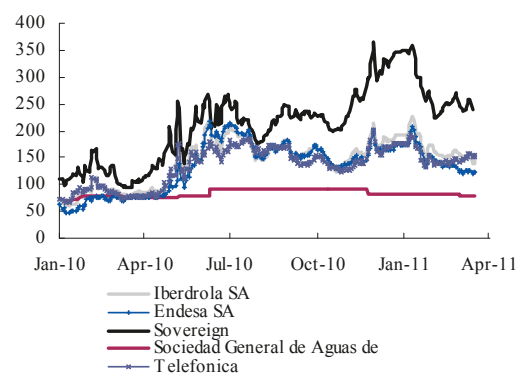


Employing a cross-country perspective on corporate bonds and corporate CDS is complicated by the absence of country-specific indices. Contracts are available for few firms only; usually these are big and concentrated among a few industrial sectors, i.e. often utilities. Trade in both individual CDS and corporate bonds is not very liquid. Corporate bonds have the further complication that they are difficult to compare across firms as their maturity, coupon, and other special features regularly differ. CDS contracts for individual corporates are easier to compare, because contracts have a common maturity of 5 years and do not pay a coupon.

Despite these caveats, it appears that the insight of diverging trends of corporate and sovereign CDS is not valid for Member States currently under elevated market stress, the so-called peripheral or vulnerable Member States (see Graph I.2.10). In a regression analysis, the correlations between corporate CDS in peripheral Member States and the relevant sovereign CDS are high, although corporate CDS increased proportionally less, as the regression coefficients were between 0.2 and

0.6.<sup>(36)</sup> However, the available corporate CDS in vulnerable Member States are almost exclusively from telecommunication or energy firms. Estimates with firms in the same sector but from other Member States, or with firms in other sectors in other Member States, yielded sometimes considerably smaller coefficients, with most estimates ranging between 0 and 0.4. A spill-over coefficient of 0.6 – the regression coefficient – seems therefore to be the maximum range of impact on the corporate risk premium and therewith on firms' cost of capital.

*Graph I.2.10: Spreads on CDS contracts on Spanish corporates, 5-years maturity*



The spillover might be lower if CDS prices tend to overstate the underlying risk of default, which is the view of rating agencies.<sup>(37)</sup> For example, recent analysis by Fitch Ratings (2011) sees little direct transfer of risks from the sovereign to the corporate sector. They argue that the spill-over effects from poor economic growth and government interventions are more important factors. A more direct link is only postulated for corporates in public ownership, mainly utilities, which is in line with the findings presented in this section.

For vulnerable Member States, the so-far observed increase in the cost of credit insurance underpins the validity of the assumptions used in the QUEST simulations in the autumn 2010 forecast. The simulation assumed that the spillover from a shock to the sovereign-risk premium to the risk in the corporate sector was less than proportionate, translating a 400 basis point shock to sovereign

<sup>(36)</sup> Estimates with daily observations since January 2010 controlled for the industry-average and a constant. The OLS estimates explain in most cases around 90% of the variation in corporate CDS

<sup>(37)</sup> See Fitch Ratings (2011), "Euro zone sovereign pressures and corporates, periphery countries' refinance risk", Europe Special Report, February 2011.

risk into a 100 basis point shock to corporate risk. Nevertheless, the simulations of this shock yielded a sharp fall in consumption and investment. Overall, euro-area GDP was projected to decline by 0.8% in the first year and 1.4% lower after a decade.

#### 2.4.2. Impact on financial intermediation and bank lending

The analysis in the previous section suggests that the increase in sovereign risk only led to a small increase of capital costs for those non-financial corporations that are able to fund themselves on financial markets. However, the situation may be different for those firms that rely on financing through banks. There are abundant signs that increased sovereign risk hampered banks' access to finance and worsened their liquidity positions. Although the impact of higher sovereign risk on banks' balance sheets and funding costs are difficult to quantify, some of these effects have already been passed through to potential borrowers either by tougher credit standards or higher lending rates. These effects seem to be pronounced in the vulnerable Member States, though still of limited magnitude in the euro-area aggregate.

#### Spillover to banks' funding costs

Typically, domestic financial institutions cannot be less risky than the sovereigns, which are supposed to back them in case of need. Accordingly, rating agencies downgraded various banks immediately, or soon after they downgraded the sovereign state in which the bank resided, often quoting the higher sovereign risk as their motivation for the downgrade.

Since the beginning of the banking crisis it became evident that bank and sovereign balance sheets are interwoven through various channels. Responding to the global financial crisis, governments used their fiscal resources and balance sheets to support aggregate demand and strengthen private balance sheets, particularly for banks. However, this happened at the cost of an expansion of public balance sheets, which not only took on many bad assets from private institutions, but were also hit by slow economic growth, high unemployment and impeded tax revenues. These states faced increasing borrowing needs in following years.

Rising sovereign-risk premia, being a partial result of problems in the financial system in some

Member States, have begun to spill back to the financial system through various channels. First, on the asset side, falling mark-to-market values of government bonds generate losses for local and foreign banks. Second, lower values of government bonds impact negatively on banks' liquidity positions, as government bonds are widely used as liquidity buffers, and as collateral in, for example, repo transactions.<sup>(38)</sup> Third, on the liability side, banks' funding costs increase due to a worsened access to funding. This is to a large extent the consequence of renewed counterparty risk. Markets doubt the solvency of banks that are not able to demonstrate their financial health and convincingly reveal their genuine exposure to sovereign risks. Finally, greater sovereign risks erode the potential for official support. Unresolved issues in the banking system thus fed back into the public sector.

Despite the sizeable sums already provided by EU governments in the framework of banking rescue measures, which amounted to 10% of GDP for the EU as a whole (direct spending and contingent liabilities), the perception in financial markets is that banking reforms will require considerably more public resources.<sup>(39)</sup>

Graph 1.2.11: CDS spread on sovereign and banks senior debt



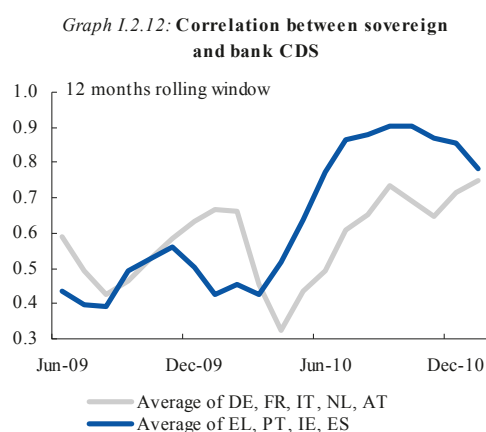
As the link between banks' and sovereign's balance sheets have tightened since the beginning of 2010, banks' CDS spreads have become highly

<sup>(38)</sup> The ICMA (2011), "European repo market survey No 20, conducted December 2010" shows that the use of Greek, Irish and Portuguese bonds as collateral in private repo transactions has notably declined in summer 2010.

<sup>(39)</sup> As examples of the potential sums involved, the Hellenic Financial Stability Fund has been endowed with EUR 10 billion to strengthen the equity base of the Greek banking system if needed. In the Irish programme, EUR 35 billion has been made available as a contingency fund to finance measures to overhaul the banking sector.



correlated with sovereign CDS. However, the high correlation is less visible at the aggregate level. The Markit index for senior bank debt has increased much less than the index for sovereign debt since late summer 2010 (see Graph I.2.11), and it has even become cheaper to insure against the default of senior bank debt than against sovereign debt. Despite the deviation in the trend, there is a strong correlation of short-term changes. Moreover, the different geographical composition in both indexes makes a direct comparison difficult. The interdependence between sovereign and bank risk has risen particularly in countries where sovereign risk increased the most, as evidenced by the rolling coefficients of correlation shown in Graph I.2.12.



In Member States currently under elevated market scrutiny, higher risk premia had a visible effect on banks' funding costs. Various banks located in these Member States had difficulties obtaining funding on wholesale financial markets and turned to financing from the ECB. In consequence, the use of ECB facilities in these Member States has become a widely observed gauge of funding stress. Banks' issuance of long-term debt securities was relatively stable in 2010 and rebounded strongly in the first quarter of 2011. However, this has to be seen against rising funding needs, as banks had to roll over considerable amounts of funding from redeemed bonds. Issuance of long-term debt securities by banks in Greece, Portugal, Ireland and Spain was not uniform. Portuguese and Irish banks tapped capital markets considerably less than the euro-area banking system as a whole at the end of 2010 and early 2011.

Banks have adjusted to changing funding conditions in many ways. Covered bonds, i.e. collateralised with real estate, became an important

vehicle for tapping wholesale financial markets. Thus, banks began to issue higher quality bonds in response to the perception of higher risk being attached to bank bonds. The virtual dying out of the use of state-guaranteed bonds is testimony that public support is no longer regarded as a quality-enhancing component of bank debt. This instrument was introduced during the financial crisis, to help banks to tap wholesale financial markets. In 2010, the instrument was largely in use by banks located in peripheral Member States, and in early 2011 only one Spanish bank issued state guaranteed bonds.<sup>(40)</sup> Banks have also adapted their lending conditions.

### Transmission to bank lending

The funding pressure on banks and the deleveraging forces within the euro area exerted by higher sovereign risk, have significantly reduced the margins of credit intermediation. Banks can react to changing market conditions in two ways: either by credit tightening or by adjusting interest rates charged on loans. Occasionally bank interest rates can be sticky and not respond immediately or fully to changes in corresponding reference rates against which they are priced. Because of problems with adverse selection and moral hazard, banks may choose not to adjust loan rates in response to a changing credit environment and ration credit instead.

The instrument to monitor changes in non-price credit terms is the ECB's Bank Lending Survey (BLS). Conducted on a quarterly basis and with a panel of around 120 euro-area banks, the BLS shows that the previous tightening of credit standards for non-financial institutions (NFIs) and households has slowly been reversed throughout 2009 and 2010. However, banks moderately resumed constraining credit in the first three months of 2011. They quoted rising funding costs, worsened balance sheet standings, and higher perception of risk as the main driving factors behind this change. Deteriorating banks' liquidity positions have also contributed to this trend. According to the survey, euro-area banks expect the tightening of credit standards to continue in the second quarter of the year, both for NFIs and households.

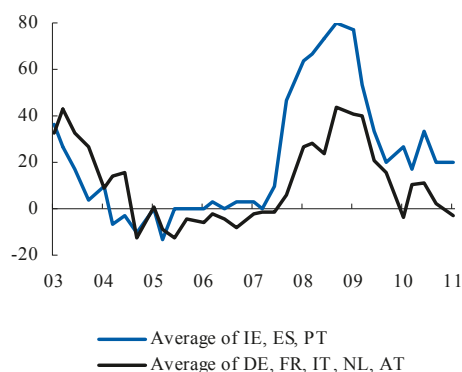
The main focus of the following analysis will be on NFIs, given the importance of credit to these

<sup>(40)</sup> The instrument was still used by entities that acted as bad banks on behalf of governments.

institutions (26% of all outstanding loans granted to euro-area residents) and for the performance of the economy.

Country data suggest that credit standards on loans granted to NFIs develop differently across Member States. In the vulnerable euro-area Member States, NFIs credit conditions have remained considerably tighter than in the core euro-area Member States (see Graph I.2.13),<sup>(41)</sup> implying that the availability of bank loans in euro-area peripheral countries continued to deteriorate. Evidence from the recent ECB survey on access to credit by SMEs confirms this finding, suggesting that access to finance by SMEs remains tight in the "stressed countries". Nevertheless, it should be noted that the indicators used in both surveys are qualitative in nature so it is difficult to draw concrete conclusions about the magnitude of the described developments.

Graph I.2.13: Credit standards on loans to NFIs



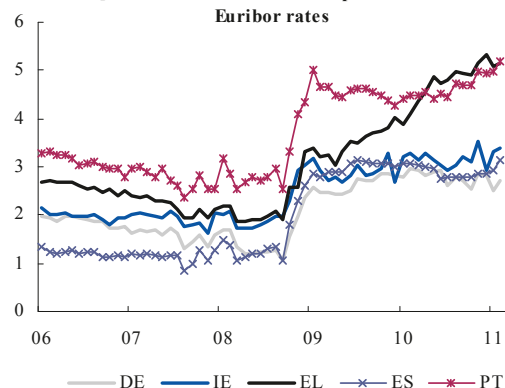
Without good quantitative measures of credit standards in a cross-country perspective, interest rates are the main tool available to study the credit intermediation process. During the period from January 2006 until end 2008, NFI interest rates were strongly correlated with each other. Furthermore, there was a low degree of dispersion of interest rates across Member States and signs that they were converging towards a common level. However, when the sovereign-debt problems intensified, rates started to widen across countries, and correlations decreased.

Interest rates charged by banks lending to NFIs have been rising since the sovereign-debt crisis aggravated in January 2010. This observation suggests that rising interest rates on public debt started to raise funding costs for banks (see

<sup>(41)</sup> Data on changes in credit standards for NFIs loans is not available for Greece.

Graph I.2.14). To keep net interest margins at a stable level, banks offset higher funding costs with higher lending rates. As a result, borrowing costs for NFIs increased. Particularly in Greece and Portugal, interest rates rose more than in the euro area on average.

Graph I.2.14: NFI Credit Rate Spreads - versus Euribor rates

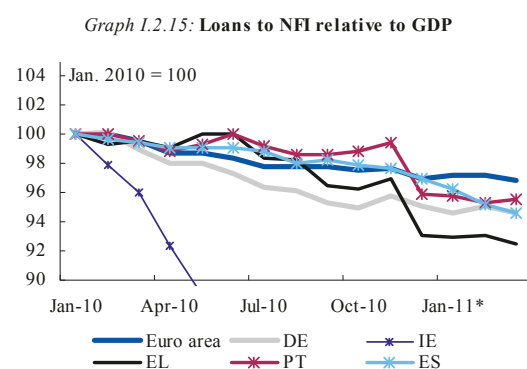


Graph I.2.14 also shows that changes in interest-rate spreads follow a common pattern across euro-area Member States and are rather more time-dependent than country-dependent. There are still differences in the levels of retail interest rates across euro-area Member States, but the changes in these rates are strongly determined by euro-area factors. For example, a panel regression incorporating random-effects of rates applied on loans for non-financial corporations reveals that Euribor rates explain most of the variation. Nevertheless, there is an additional, very small impact from national sovereign bond rates on credit spreads, which is statistically significant, but hardly economically relevant. Taking the available estimates at face value and controlling for the impact of Euribor rates on credit spreads, an increase in the national sovereign bond yield by 100 basis points drives up national credit spreads by a mere 3 basis points.

Such a small effect of national sovereign bond rates on credit spreads can be explained by banks adjusting lending in many ways. Increasing lending rates is only one possible action a bank can take. As stated above, banks may choose to ration credit instead. Credit rationing can be accomplished by, e.g. increasing non-interest charges, reducing the loan size, adapting the loan maturity, applying stricter collateral requirements, requiring a higher loan-to-value ratio, or increasing the margins on riskier loans.

Heightened sovereign risk and higher credit costs have not been unambiguously translated into systematically lower lending volumes in the Member States most affected by the sovereign-debt crisis. The impact of banks' higher funding costs seems to be dominated by other factors, especially the strength of the economic rebound.

Having achieved a bottom level at the end of 2009, NFI credit growth slowly started to recover in the euro area at large. It remained negative or close to zero, along with systematically rising sovereign bonds spreads. The credit-to-GDP ratio, which is a gauge to adjust for changes in business cycle conditions, continued to decline in the euro area and was particularly pronounced in Ireland and Spain (see Graph I.2.15). However, this is more likely due to the weakness of banks in these two countries, which also caused higher sovereign risks.



\* Based on forecast GDP for 2011Q1 and adjusted for structural break in EL data.

It should be stressed that falling credit growth was an implication of the financial crisis, the broad-based recession and the subsequent need for the NFC sector to reduce its debt position. The negative trend started well before the outburst of the sovereign-debt crisis in the euro area. Nevertheless, even if rising sovereign-risk premia are not the only determinant of declining credit, they may be adding to the negative development and reinforcing it.

### Model simulations of the impact of sovereign risk on bank lending

Since the full impact of higher sovereign risk on economic activity via the banking system may not yet have fully materialised and therefore not be visible in economic data, Table I.2.3 shows the effect of shocks to the banking system under

various assumptions in an extended version of the QUEST model, which includes a financial sector with monopolistically competitive banks. This means that banks set a loan interest rate as a mark-up over their funding costs; they also ration credit to borrowers by imposing an upper bound on borrower indebtedness which is determined as a fixed ratio of the value of their collateral (i. e. the market value of the capital stock of the borrower). They need to adjust both the mark-up and the supply of loans in response to a shock to their equity in order to avoid becoming insolvent.

The macro-econometric simulations assume that banks encounter losses to their equity of 1% of GDP on their sovereign bond holdings. For the benign scenario, it was furthermore assumed that there would not be a panic on financial markets and the central bank would reduce interest rates and thereby banks' funding costs by 40 basis points. Banks partially pass on the expected losses onto loan rates and reduce loan supply (partly as a demand response to higher interest rates and partly due to loan rationing). All these responses taken together contribute to stabilising the cash flow of banks and prevent a strong decline in the value of banks' capital.

The model predicts that the loan spread (loan rate minus deposit rate) increases by slightly less than 100 basis points. The spread over-predicts the actual increase in loan rates because the policy rate and therefore funding costs go down. Credit rationing increases the "shadow price" of bank lending by another 30 basis points in the first year.<sup>(42)</sup> In consequence, banks reduce the stock of loans to firms by about 0.3% in the first year. The increase of capital cost affects the real economy mostly via a reduction of investment (around -0.4% in the first year). Because of the negative demand shock, employment will be negatively affected, especially in the first year, resulting in a loss of GDP of close to 0.2%.

In the credit-crunch scenario, it is assumed banks respond entirely with credit rationing but have no possibility to increase the loan interest rate. The credit crunch reduces aggregate demand and the negative aggregate demand shock is partly compensated for by a reduction in the policy rate,

<sup>(42)</sup> The extent of loan rationing is given by the increase of the Lagrange multiplier of the collateral constraint, which can be translated into a shadow loan interest rate, i.e. the borrowing rate which would induce firms to adjust their debt to the level consistent with the collateral constraint imposed by the bank.

which increases expected inflation, thus leading to a stronger reduction in the real rate in the first year. Even though the loan interest rate declines, credit rationing increases the capital costs (shadow interest rate) for non financial firms.

In the severe scenario, it is assumed that a panic in the interbank market increases banks' funding costs by 150 basis points. This accentuates bank losses, and leads banks to increase spreads more and reduce loan rates more strongly than in the benign scenario, in order to ensure viability. The credit spread would increase by 160 basis points, while credit rationing adds 350 basis points to the cost of capital. Loans would decline by 1.8% and GDP by 1% in the first year.

## 2.5. SPILLOVER TO PRIVATE CONSUMPTION VIA WEALTH AND CONFIDENCE EFFECTS

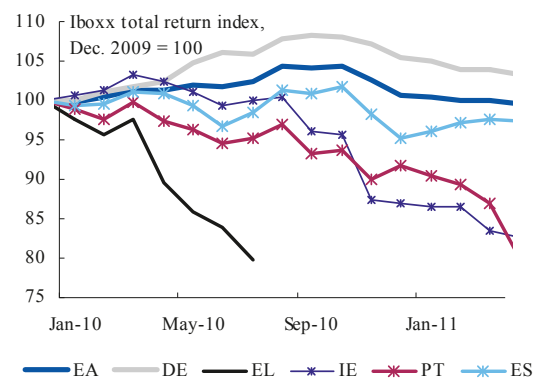
In addition to the impact via financial markets, tensions on sovereign-debt markets may also have direct effects on private spending, for example via their impact on financial wealth and economic confidence. In the euro-area aggregate, the households' saving ratio is closely and inversely correlated to the governments' net borrowing (see also the following chapter for an analysis of the determinants of savings and investments). In line with the expectation that the households' saving rate would increase in anticipation of higher future tax burdens and higher uncertainty, the saving rate is higher in 2010 than before the financial crisis. In a cross-country perspective, however, there is no sign yet that the saving rate increased more in those Member States most affected by sovereign risks. The evidence presented in this section suggests that the direct effect of lower market

values of sovereign bonds on households' financial wealth has been modest, whereas the severe tensions on sovereign markets can be associated with negative confidence shocks in the countries concerned, with potentially significant cross-border spillovers.

### Low direct impact on households' financial wealth

Rising risk premia imply a higher required return on new purchases of debt securities and a decline in the market value of outstanding debt. Graph I.2.16 documents how the value of bonds issued by various euro-area Member States have developed since the beginning of the sovereign-debt crisis.<sup>(43)</sup> To the extent that investors have a strong bias towards holding domestic assets, they are exposed to the loss in values of their sovereign bonds.

Graph I.2.16: Value of sovereign bonds



<sup>(43)</sup> The Greek benchmark portfolio was discontinued in June 2020 because the country lost its investment grade status.

Table I.2.3:

#### Simulations of bank losses of 1% of GDP: Impact in first year.

	Benign scenario	Credit crunch scenario	Banking panic scenario
GDP (1)	-0.2	-0.3	-1.0
Investment (1)	-0.4	-0.4	-2.6
Consumption (1)	-0.2	-0.3	-1.0
Employment (1)	-0.3	-0.4	-1.7
Funding rate (2)	-38	-74	102
Loan rate (2)	49	-99	260
Credit spread (2, 3)	121	-24	158
Total capital cost (2)	121	308	515
Loans (1)	-0.3	-1.2	-1.8

(1) in % deviation from baseline, (2) in basis points, (3) shadow interest rate.

Scenario 1: Banks adjust 2/3 by raising credit spread and 1/3 by rationing credit. Scenario 2: Banks react by rationing credit, but cannot increase the credit spread. Scenario 3: like Scenario 1, but with additional 150 basis point shock to funding costs

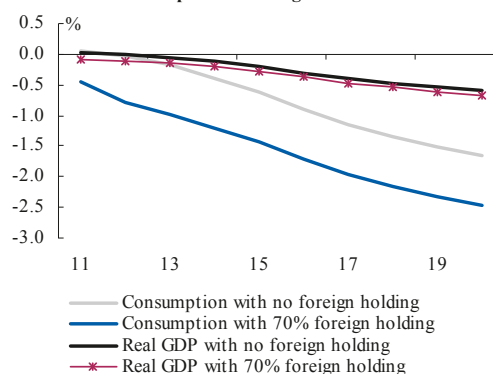
For creditors that use market prices to value their wealth and that base their spending decisions on the market value of their financial assets, the increase in sovereign risk could have a sizeable impact on spending or investment. Outside the financial sector, the effect is likely to be negligible. Even if households perceive to have encountered a loss in financial wealth, recent Commission estimates suggest that a decrease in financial worth of 1% is associated with a small decrease in consumption of 0.03%.<sup>(44)</sup> Comparable research, reported for the USA, yielded a slightly higher propensity to consume out of financial wealth.<sup>(45)</sup>

The direct effect on households' consumption is also likely to be limited because government bonds account for only a modest share of about 3% in households' financial assets and less than 0.5% of their disposable income.<sup>(46)</sup> For non-financial corporations, the share of financial assets held as debt securities and the contribution of interest income to gross value added is somewhat smaller. Whereas the direct impact of even a large decline in sovereign bond values on households' disposable income should be small, there may be much higher second round effects. Households are the ultimate holders of all debt. If the lower value of government bonds impact on the yields of banks, life insurance companies or pension funds, households should expect lower income streams in the future, beyond those from their direct exposure to sovereign bond holdings. This indirect effect should be higher than the direct effect, but also spread over households' life-time income. As a result, the impact on short-term consumption is expected to remain limited.

A sizeable impact on private consumption and investment emerges, however, from the transfer of purchasing power if a large share of public debt is financed by foreign investors. The simulations with the QUEST model shown in Graph I.2.17 with different assumptions on foreign indebtedness demonstrate that private consumption and private investment (not shown) would be considerably lower if – as for example in Ireland – a large share

of interest is paid to foreign creditors. In case of domestic indebtedness, the sovereign-risk shock implies a reallocation between public and private sector. The negative GDP effect occurs because higher taxes reduce GDP in the model and higher labour taxes are assumed to stabilise public debt. Because lower domestic demand goes hand in hand with lower demand for imports, the overall impact on GDP is similar in the scenarios with and without foreign indebtedness.

Graph I.2.17: Impact of a 10-year lasting 400-basis-point sovereign-risk shock



### Spillover to confidence

Although there is no generally agreed definition of confidence shocks, it is likely that economic sentiment of households and investors was affected by the reporting of tensions on sovereign-debt markets. Both the downgrades by rating agencies and the policy measures enacted by governments to restore sound public finances should be likely to have an impact on business and consumer confidence.

It is difficult to track a confidence shock in general and in the aggregate figures of the Commission's consumer and industry confidence indicators, but it seems possible to identify the impact of the sovereign-debt shock in the detailed survey replies for individual survey questions. This is especially true for those questions that are formulated both in backward looking terms (e.g. "how has your production developed over the past three months?") and in forward looking terms (e.g. "How do you expect your production to develop over the next three months?"). Responses to these questions are in most case closely correlated, but are also occasionally subject to phases of decoupling. The latter may be interpreted as indications of expectation shocks, i.e. periods during which households' and managers'

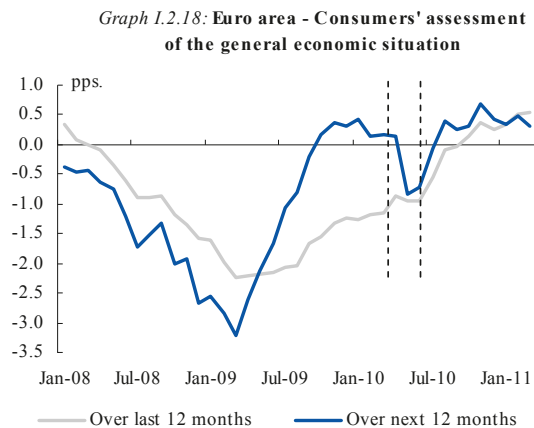
<sup>(44)</sup> See article "The interrelations between household savings, wealth and mortgage debt" in Quarterly Report on the Euro Area Volume 8 No 3 (2009).

<sup>(45)</sup> See Carroll, C. C. et al. (2010), "How large are housing and financial wealth effects", ECB Working Paper No 1283 and the literature quoted therein.

<sup>(46)</sup> According to the financial accounts, more than 80% of the households' interest-bearing financial assets are deposits and less than 20% debt securities. Of the latter approximately 40% are estimated to consist of government bonds.



expectations on a specific variable are not formed exclusively on the basis of past developments in that variable, but also integrate information about major new political or economic events which will affect the variable in the future.



Graph I.2.18 displays euro-area consumers' assessment of the general economic situation over, respectively, the past 12 months and the next 12 months. Consumers' expectations dropped sharply in May-June 2010, a period which was marked by sharp rises in spreads on government bonds in Greece (and to a lesser degree Portugal and Ireland). The drop was temporary and followed by a rapid recovery in July-August. Another – though much smaller – dip also took place in December 2010 and January 2011, following the intensification of the debt crisis in Ireland. These fluctuations are essentially visible for consumers' expectations, whereas their backward assessment was only subject to a mild inflection. A similar pattern of temporary deteriorations in expectations, although less marked, can be inferred from consumers' assessment of their past and future financial position (not reported in the chart).

These observations suggest that major tensions on sovereign markets may have a significant though temporary effect on euro-area consumers' expectations.<sup>(47)</sup> Box I.2.3 presents an econometric framework to test for possible shocks to consumer and business expectations in spring 2010. The estimated models compare backward- and forward-looking indicators of sentiment to extract changes in expectations that cannot be explained

by past values of the indicator considered, and therefore reflect information about new political or economic events. This work suggests the following:

- For both consumers and manufacturers, spring 2010 was associated with sizeable negative shocks to expectations in Greece, Portugal and Spain.<sup>(48)</sup>
- In December 2010 and January 2011, Greece, Portugal and Spain registered aftershocks to expectations. The magnitude of these aftershocks was smaller than those estimated in spring 2010 for Spain and Greece, while it was stronger for Portugal.
- Confidence shocks are also visible for consumers and manufacturers at the euro-area level, pointing to significant cross-border spillovers of major tensions on sovereign markets. In the euro area, the size of these spillovers seems, however, to diminish substantially over time, possibly reflecting economic agents' increasing familiarity with sovereign tensions, or increasing confidence that contagion effects will remain contained.

Overall, the analysis points to potentially significant effects of major sovereign-market tensions on confidence. Two limitations should, however, be stressed. First, the econometric work presented here focuses on expectations shocks and therefore neglects possible effects on backward-looking sentiment indicators. It may therefore underestimate the true size of confidence effects. Second, because it focuses on sentiment indicators, the analysis cannot be used to derive estimates of the growth implications of confidence shocks.

<sup>(47)</sup> It is obviously impossible to conclude with certainty that the sentiment indicator decreased in May-June 2010 because of tensions on sovereign markets. But in the absence of major other macroeconomic events during this period, this seems to be the most likely explanation.

<sup>(48)</sup> Survey data is not available for Ireland in the recent period.



### Box 1.2.3: Econometric model to identify expectations shocks

This box presents an econometric framework to identify possible shocks to consumers' and businesses' expectations using survey data.

The impact of a confidence shock can be studied indirectly by analysing saving and investment behaviours and ascribing developments that cannot be explained by macroeconomic fundamentals to shifts in confidence. The advantage of such a method is that it allows a straightforward assessment of the growth implications of the shocks. Its main drawback is that the interpretation of unusual saving or investment behaviours in terms of confidence shocks must be made with caution: they may reflect a genuine change in confidence, but also inappropriate modelling.

To avoid this pitfall, the analysis presented hereafter relies on a more direct approach based on measures of sentiment as reported in business and consumer surveys (BCS). BCS data are interesting to analyse in relation to tensions on financial markets for two reasons. First, the consumer survey includes questions to households on their assessment of the broad economic situation and of their own financial situation. Answers to these questions should help track respondents' perception of major macro-financial shocks. Second, some survey questions are formulated both in backward looking terms (e.g. "how has your production developed over the past three months?") and in forward looking terms (e.g. "How do you expect your production to develop over the next three months"). Responses to these questions are in most case closely correlated, but are also occasionally subject to phases of decoupling. The latter may be interpreted as indications of expectation shocks, i.e.

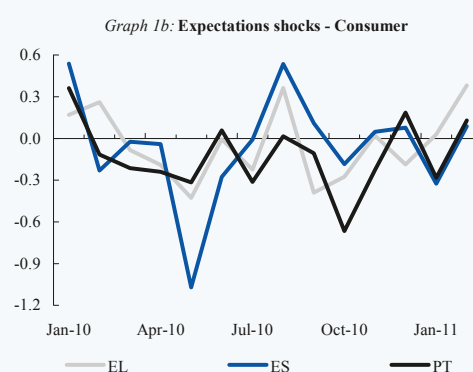
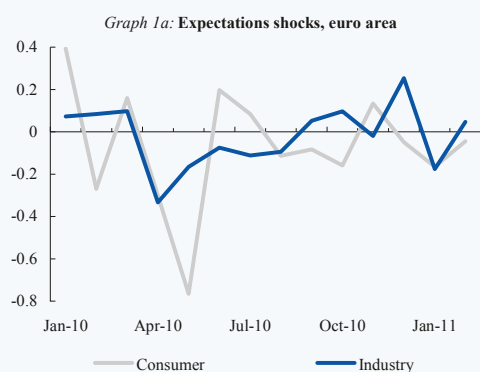
periods during which households' and managers' expectations on a specific variable are not formed exclusively on the basis of past developments in

that variable, but also integrate information about major new political or economic events, which will affect the variable in the future. As these economic events feed into the economy they become reflected in economic agents' backward looking assessments and gaps between backward- and forward-looking assessments eventually close.

Expectation shocks can be viewed as changes in the forward looking assessment (hereafter F) that cannot be explained by changes in the backward looking assessment (hereafter B), or in other words, by the history of the underlying variable as measured in the surveys. Estimating an econometric model where F is explained by B is one way to identify these expectation shocks.<sup>(1)</sup> Large positive (resp. negative) residuals in the model are then interpreted as positive (resp. negative) expectation shocks. Several models were tested, including a linear model, an autoregressive model (to correct for autocorrelation) and a structural VAR model. These models were tested on two survey questions: consumers' assessment of the general economic situation and manufacturers' assessment of production.

The three models produce broadly similar results, but the remainder of this box focuses on the VAR specification, which is econometrically sounder.

<sup>(1)</sup> An alternative could be to use hard data instead of soft data for the underlying variable (e.g. industrial production instead of manufacturers' assessment of production in the survey). However, this raises a problem difficult to take into account: the non-linearity of the relationship between soft and hard data during the crisis. Moreover, the hard data for consumers' assessment of general economic situation is not available.



(Continued on the next page)

Box (continued)

The VAR treats F and B symmetrically, each variable being explained by its own lags and lags of the other variable (see equation 1).

$$(1) \quad \begin{pmatrix} B_t \\ F_t \end{pmatrix} = A(L) \begin{pmatrix} B_{t-1} \\ F_{t-1} \end{pmatrix} + \begin{pmatrix} u_{Bt} \\ u_{Ft} \end{pmatrix}$$

With this specification it is possible to identify "structural" shocks (hereafter  $\omega_2$ ) using a Cholelsky decomposition of the variance covariance matrix of the residuals  $u$ . The structural shocks can be used as measures of expectation shocks. By construction, expectation shocks  $\omega_2$  are then assumed to have only an impact on the residuals of F and no impact on the residuals of B (see equation 2).

(2)

$$\begin{aligned} u_{Bt} &= P_{11}\omega_{1t} \\ u_{Ft} &= P_{21}\omega_{1t} + P_{22}\omega_{2t} \end{aligned}$$

Thus, strong and negative  $\omega_2$  in spring 2010 can be interpreted as expectation shocks that could be linked to an effect of the sovereign debt tensions on confidence. For the euro area (see Graph 1a) and the peripheral countries (see Graph 1b), most of the sizeable drop in the consumers' assessment of the general economic outlook over the next 12 months registered in May 2010 can be explained by a sizeable negative expectations shocks, while the magnitude of the aftershock in January 2011 is limited.

### 3. DEVELOPMENTS IN AND PROSPECTS FOR SAVING AND INVESTMENT TRENDS ACROSS THE EUROPEAN UNION AND THE EURO AREA

*This chapter investigates the factors behind saving and investment developments across the EU and the euro area, both ahead of and during the economic and financial crises, and considers likely adjustment over the forecast horizon. While the aggregate pattern of strong co-movement in saving and investment ratios predominated among Member States in the run-up to the crisis, quite striking divergences were also apparent in some Member States (mainly euro-area countries) at both aggregate and sectoral levels. The crisis witnessed a reaffirmation of co-movement, with both savings and investment ratios falling in a majority of Member States.*

*The empirical analysis reveals that the main factors driving private saving include the rate of growth of real income and the level of disposable income, dependency ratios, the government saving rate, real (short-term) interest rates and uncertainty. On the investment side, the main explanatory variables are the standard ones of real growth, real interest rates, the cost of capital and profitability. There are, however, considerable differences across Member States in the relative importance of these explanatory variables and country-specific factors play a significant role in some countries.*

*Looking forward, the Commission's spring forecast points to a very gradual recovery in overall saving and investment ratios and a marginal fall in the dispersion of saving-investment gaps in the EU and the euro area over the forecast horizon. While the saving-investment gap is projected to diminish in some euro-area countries with large external imbalances, there is still scope for further adjustment beyond the forecast horizon.*

#### 3.1. INTRODUCTION

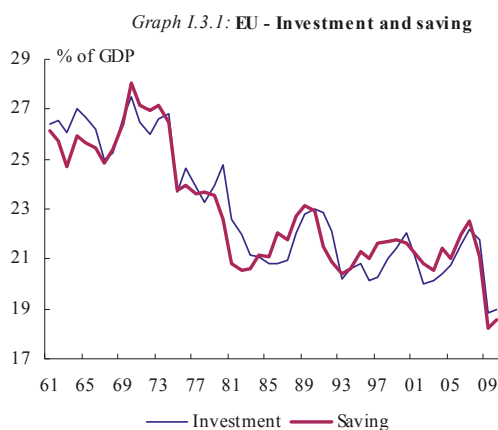
Much attention has been devoted in recent years to the sustainability and adjustment of global imbalances. This has put the spotlight on saving-investment balances across the world. While neither the EU nor the euro area is characterised by any apparent major imbalance at the aggregate level, this masks a considerable diversity across countries. Divergences across Member States have come under particular scrutiny in the course of the financial and economic crises. Gaps between gross national saving and investment are not problematic per se. Indeed, such gaps may be interpreted as reconciling the independent decisions of savers and investors and promoting the efficient allocation of savings towards productive investment across countries, which has in turn been facilitated by financial market liberalisation and financial deepening among EU countries. In the initial stages of transition of Eastern and Central European countries, it appears that capital flows were channelled towards investment in productive capital stock. However, against a background of robust growth and contained

inflationary pressures, the search for higher returns directed capital towards a wider range of opportunities, including less productive uses in both the emerging countries of the EU and the catching-up countries of the euro area.

This chapter investigates the factors behind developments in private saving and investment across Member States with a view to explaining trends and projecting the adjustment of saving-investment balances in the near term. Section 3.2. contains a description of aggregate saving and investment trends across Member States and the sectoral (i.e. households, corporate and public) behaviour underlying these balances. Section 3.3. assesses the potential factors underlying developments in saving and investment and continues with an empirical analysis of private-sector saving and investment across Member States. The final section considers the near-term adjustment prospects for saving and investment.

### 3.2. AGGREGATE AND SECTORAL PATTERNS IN SAVING AND INVESTMENT

Over the long run, there was a strong downward trend in both investment and saving ratios in the EU<sup>(49)</sup> between the early 1970s and the mid-1980s. From a cyclical perspective, the sharp drops incurred in the course of the recessions of the early and late 1970s were never recouped, leading to an overall contraction in savings and investment of about 5 pps. of GDP. This was followed by a relatively more stable period (1995-2000), characterised by average saving and investment ratios of around 21-23%. In the run-up to the financial crisis, both ratios recorded significant, albeit temporary, increases, while remaining below the previous peaks of the early 1990s. The crisis saw concurrent sharp drops in both ratios, which fell to all-time lows in 2009-10.



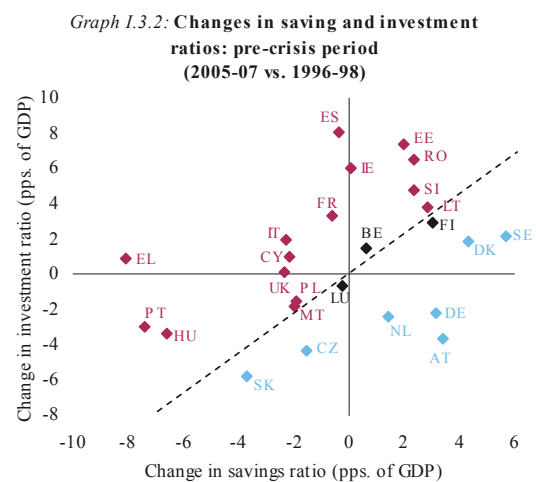
Overall, the saving-investment gap has remained very small over the past two decades for both the EU and the euro area.<sup>(50)</sup> This section describes some stylised facts on saving and investment across Member States and sectors over the period from the mid-nineties to date.

<sup>(49)</sup> In the absence of sufficiently long comparable series for all EU countries, the long-term series in Graph I.3.1 are based on fourteen EU Member States, comprising the following *euro-area* countries: Belgium, Germany, Ireland, Greece, Spain, France, Italy, Cyprus, Luxembourg, Malta, the Netherlands, Austria, Portugal and Finland. Note: Unless otherwise specified, the source of the data used in the graphs and the empirical analysis is Ameco or Eurostat.

<sup>(50)</sup> Looking at data from 1990 to date, it is apparent that the saving and investment ratios for the euro area were on average 1 pp. of GDP higher than for the EU as a whole. Although investment ratios have been generally higher for the catching-up countries of the recently-acceded Member States, this is counterbalanced by generally lower investment and saving ratios in both Sweden and the UK.

### Aggregate saving and investment patterns across the Member States prior to the crisis: stylised facts

The strong co-movement in saving and investment observed at the aggregate EU and euro-area levels was also the predominant pattern across countries in the period from the second half of the nineties to the mid 2000s (Graph I.3.2, upper right and lower left quadrants). However, important divergences in movements of savings and investment were visible across the Member States in the period preceding the crisis (Graph I.3.2, upper left and lower right quadrants).



*Note: Latvia and Bulgaria were significant outliers over the period under observation, recording a particularly high change in the investment ratio of 17.0 and 19.6 pps of GDP respectively*

Typically, many countries experiencing stronger growth in investment were catching-up economies, with lower per capita income levels compared with the EU average, which benefited from large inflows of foreign direct investment. Nonetheless, even for catching-up and post-transformation countries of Central and Eastern Europe – which have typically enjoyed relatively high investment ratios – investment growth was unusually strong compared with non-European emerging market economies with similar per capita income levels: e.g., the almost 20-pps. rise in the share of investment in GDP in Bulgaria and Latvia. In several countries, the investment boom was also linked to a strong expansion in house-building activity (e.g. the Baltics, Ireland and Spain).

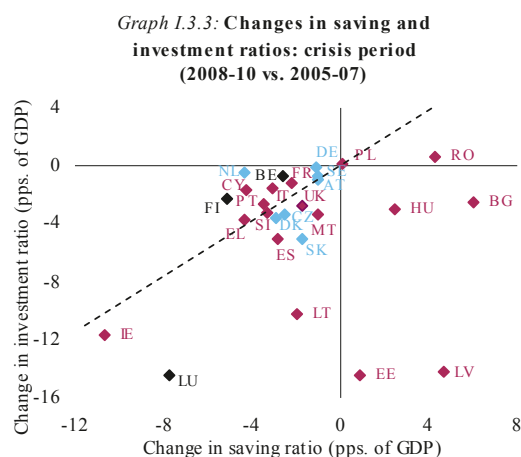
On the other hand, declines in investment-to-GDP ratios were recorded by several euro-area countries – Germany, Netherlands, Austria, Portugal and Slovakia – and some non-euro-area Member States – the Czech Republic, Hungary and Poland. In the

latter group of countries, the increases in residential housing investment were muted in comparison with their regional peers.

On the saving side, strong upswings were evident in the run-up to the crisis in a number of countries, namely Denmark, Germany, Ireland, Latvia, Lithuania, Austria, Slovenia, Finland and Sweden.<sup>(51)</sup> Conversely, some Member States saw a noticeable deterioration in their saving ratios – particularly those suffering from long-lasting fiscal imbalances (Greece, Portugal and Hungary).

### Adjustment during the crisis

Measures of dispersion broadly point to a reduction of cross-country divergences in investment and saving behaviour in the course of the crisis, although the dispersion of saving ratios broadly stabilised for the euro-area Member States. As a general pattern, both saving and investment ratios decreased noticeably as a direct consequence of the crisis (Graph I.3.3, lower left quadrant). The Baltic countries (together with Ireland and Luxembourg) experienced the most significant downward adjustments.



The reversal in investment activity, in particular, was sizeable in countries with buoyant investment in the pre-crisis period. These mostly catching-up countries – typically Member States with housing booms before the crisis – saw a significant downward correction in investment ratios (Estonia, Ireland, Latvia, Lithuania and Luxembourg).

Saving ratios also fell sharply in most Member States. However, despite the economic slump, saving ratios rose in Bulgaria, Estonia, Latvia, Hungary and Romania. All Member States with a marked increase in the saving ratio in the pre-crisis period experienced a drop during the crisis (Finland, the Netherlands and Denmark). Conversely, saving ratios continued to fall in most countries that had already witnessed noticeable reductions ahead of the crisis (Greece and Portugal).

### Sectoral patterns underlying saving and investment across Member States ahead of the crisis: stylised facts

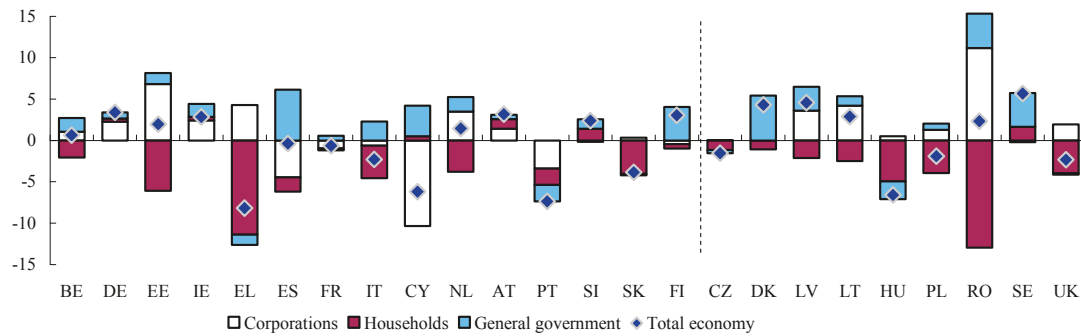
The various patterns in aggregate saving-investment dynamics across countries hide an even greater variation in sectoral trends (Graph I.3.4). Nevertheless, some common features may be identified. The private sector accounts for the major share (around 90%) of both gross national saving and investment. Within the private sector, the corporate sector predominates in most countries in terms of both source of saving and instrument of investment.

In the pre-crisis period, gross national saving was driven up largely by higher general government saving across the Member States.<sup>(52)</sup> This reflected – to varying degrees – successful fiscal consolidation efforts and boom-related windfall fiscal revenues. The corporate sector also contributed to higher savings. In particular, higher corporate saving was recorded in the non-euro-area countries and in some euro-area Member States (Germany, Estonia, Ireland and the Netherlands). In most Member States, the saving ratio was depressed primarily by lower saving in the household sector (Estonia, Greece, Italy, Romania and the United Kingdom). Nonetheless, the household sector made a neutral or slightly positive contribution to the change in overall saving in some Member States (Germany, Austria and Sweden).

<sup>(51)</sup> Some Member States with a significant increase in their saving ratio saw also a marked decline in investment ratio in the pre-crisis period (e.g. Germany and Austria).

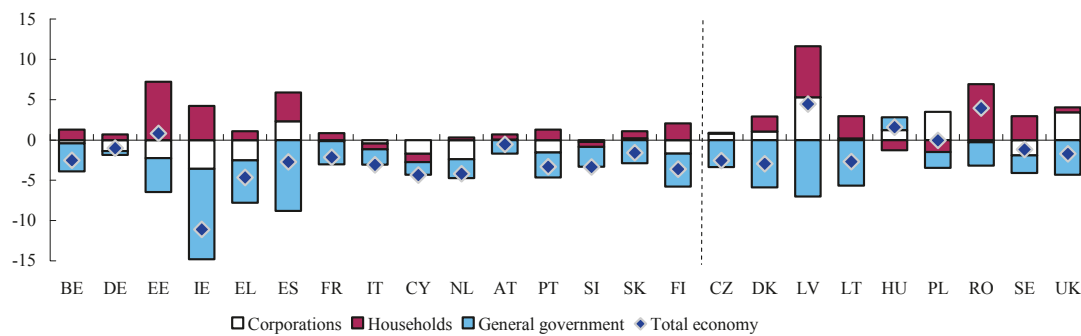
<sup>(52)</sup> Except for Greece, Portugal and Hungary, where government saving went down, and except for Slovakia and the UK, where the general government balance in remained broadly flat in the period under observation.

Graph I.3.4a: Changes in the saving ratio: pre-crisis period (2005-07 vs. 1996-98)



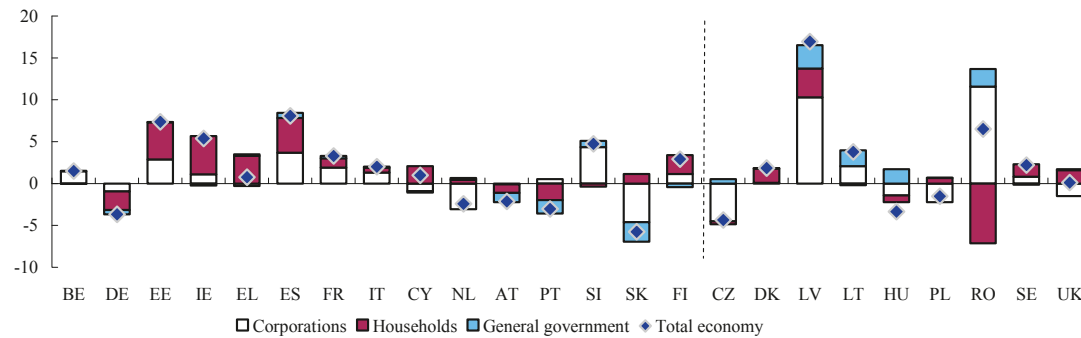
Note: for IE 2005-07 vs. 2002

Graph I.3.4b: Changes in the saving ratio: crisis period (2008-10 vs. 2005-07)



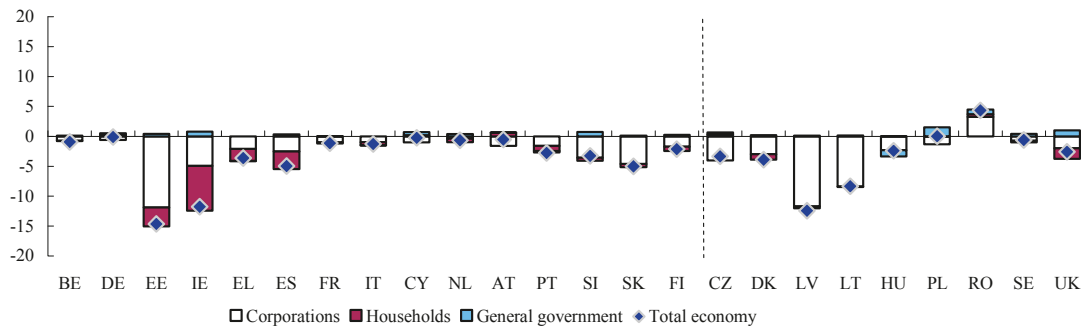
Note: for RO 2008 vs. 2005-07, for CY, LV, LT and HU 2008-09 vs. 2005-07

Graph I.3.4c: Changes in the investment ratio: pre-crisis period (2005-07 vs. 1996-98)



Note: for IE 2005-07 vs. 2002

Graph I.3.4d: Changes in the investment ratio: crisis period (2008-10 vs. 2005-07)



Note: for RO 2008 vs. 2005-07, for CY, LV, LT and HU 2008-09 vs. 2005-07



Aggregate investment was driven up in many Member States by high investment ratios in the household sector. Rising investment by the household sector was typical in countries experiencing a housing boom (Denmark, Estonia, Ireland, Spain, Latvia, Lithuania and the UK) and was partly driven by considerable foreign capital inflows in some countries. The corporate sector also contributed to higher investment (Estonia, Latvia, Romania and Slovenia) – linked in most cases to large inflows of foreign direct investment. At the same time, among the older Member States, Spain, France and Italy also recorded a marked increase in corporate investment rates. On the other hand, lower corporate-sector investment weighed on aggregate investment ratios in some Member States (Germany, the Netherlands, Slovakia and the Czech Republic). The general government sector had a mostly neutral or positive impact on the overall investment ratio (generally in the non-euro-area Member States), although some countries recorded a deterioration in the government investment ratio ahead of the crisis (Germany, Austria, Portugal and Slovakia).

In aggregate EU terms, the household sector has usually been a net lender and the corporate sector a net borrower. However, in the pre-crisis period, the household sector overshadowed the corporate sector in the share of investment in GDP in Ireland and Cyprus and in the share of gross saving in GDP in Germany, France, Italy and Cyprus. The household sector became a net borrower in many countries, including Bulgaria, the Czech Republic, Denmark, Estonia, Ireland, Greece, Spain, Cyprus, Latvia, Lithuania, Slovakia and the UK. The corporate sector, on the other hand, sustained a net lender position in Denmark and the Netherlands and moved from a net borrower position to a net lender position in Germany, Poland and the UK.

### Sectoral developments during the crisis

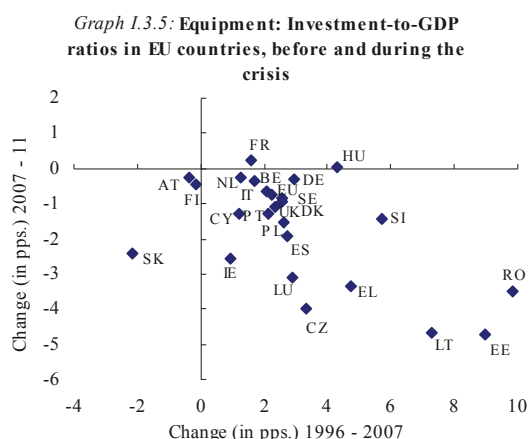
The decline in saving ratio was largely driven by a sharp drop in general-government saving during the crisis. This reflected, inter alia, the impact of the crisis on general-government revenues and expenditures via automatic stabilisers and stimulus measures. Only Hungary recorded an increase in general-government saving – the result of limited fiscal room for manoeuvre against the background of a balance-of-payments crisis. Moreover, in most euro-area Member States, where corporate saving had increased before the crisis, corporate saving also came under pressure (Estonia, Ireland, Greece

and the Netherlands). Nonetheless, an increase in household saving in most Member States – along with a continuous rise in saving in the non-euro-area corporate sector<sup>(53)</sup> – acted to partly offset this general trend.

The pre-crisis investment boom was abruptly reversed during the 2008-10 period. Most Member States experienced falling investment ratios largely due to a sharp drop in investment activity in the corporate sector (particularly in Ireland, Latvia, Lithuania and Estonia). The household sector also contributed significantly to a decline in the investment-to-GDP ratio – in particular in Member States with unwinding housing booms (Spain, Ireland, Estonia and Greece). However, in some Member States, higher public investment partly contained the drop in investment ratios in the private sector (Poland, the United Kingdom).

### Patterns in equipment and construction investment: stylised facts

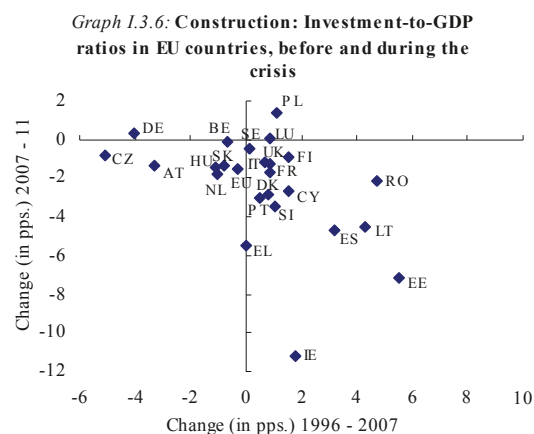
Besides the sectoral variations described above, it is also instructive to consider cross-country developments in construction and equipment investment. Differences across Member States are visible in Graphs I.3.5 and I.3.6, where the same scale is used to plot the changes in the equipment and construction ratio to GDP before and during the crisis.



Estonia, Latvia and Romania exhibited the largest swings in equipment investment, both before and during the financial crisis. The Czech Republic, Spain and Luxembourg are also characterised by a boom-bust cycle in equipment spending, but the scale of the adjustment is comparatively smaller.

<sup>(53)</sup> Except for Romania and Sweden.

In Greece and Slovenia, there is evidence of overheating of equipment investment during the pre-crisis period, which has not yet been fully corrected. Within the euro area, Austria and Finland experienced a protracted weakness in equipment expenditure, while Slovakia appears to be the only country where equipment investment as a share of GDP continued to decline both before and during the crisis. By contrast, a strengthening of equipment spending is observed in Germany.



Where construction investment is concerned, Estonia, Lithuania and Romania witnessed larger variations in the share of construction investment before the financial crisis. Booming construction activity was a key feature of the Irish and Spanish economies during most of the past decade. A necessary adjustment in construction activity is taking place in most of these countries and is set to be particularly painful for Ireland. By contrast, construction investment remained subdued both before and during the crisis in some core euro-area economies (primarily Germany, the Netherlands and Austria) as well as in the Czech Republic.

### 3.3. AN ASSESMENT OF POTENTIAL DRIVING FORCES BEHIND DEVELOPMENTS IN SAVING AND INVESTMENT<sup>(54)</sup>

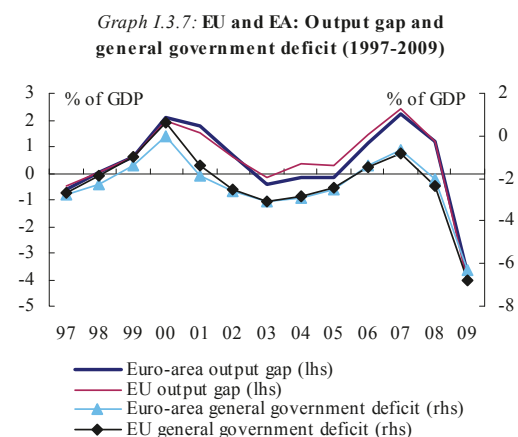
#### 3.3.1. Drivers of national saving

National saving is important from both the micro and the macro perspectives. At the micro level, households save to fund retirement, purchase houses or protect themselves against unexpected

expenditures. Corporations save to fund their own investments or to strengthen their balance sheets. At the macro level, depending on the current-account position of the country, saving can fund domestic investment either partially or completely and accumulate net claims against foreigners. Movements in the saving ratio (both public and private) have an important influence on domestic demand, helping to determine both domestic capacity utilisation and, through the saving-investment balance, the country's current-account position. This sub-section examines the factors which drive saving ratios in the government and private sector.

#### Drivers of government saving

The factors which lead governments to run deficits or surpluses are numerous, complex and much-studied.<sup>(55)</sup> The most important time-series determinant is usually the cyclical position of the economy, as higher transfer payments and lower tax receipts worsen the fiscal balance during cyclical downturns. At the EU and euro-area levels, this relationship appears to hold remarkably well, as shown in Graph I.3.7.



However, at the individual country level, the picture is more varied. For the ten years up to 2007, the correlation between the deficit and the output gap is significant at the 5% level in only ten Member States. This increases to 21 Member States when the end-date is moved to 2009 to include two years of the financial crisis which

<sup>(54)</sup> Although saving and investment are treated separately below, it is recognised that the decisions are not independent and there are many factors that appear to drive both variables.

<sup>(55)</sup> A number of authors have assessed empirically the determinants of government saving. See for example Bayer and Smeets (2009), available at [http://www.ifo.de/portal/page/portal/DocBase\\_Content/WP/WP-CESifo\\_Working\\_Papers/wp-cesifo-2009/wp-cesifo-2009-04/cesifo1\\_wp2611.pdf](http://www.ifo.de/portal/page/portal/DocBase_Content/WP/WP-CESifo_Working_Papers/wp-cesifo-2009/wp-cesifo-2009-04/cesifo1_wp2611.pdf)

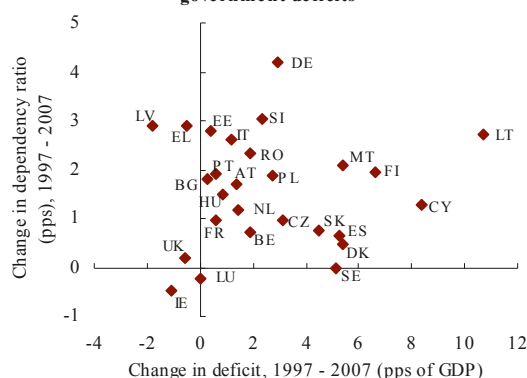
brought a relatively uniform worsening of fiscal balances and widening of output gaps across the EU. The remaining six Member States are Bulgaria, Greece, Hungary, Malta, Poland and Romania. Of these Member States, four had average deficits over the period of at least double the EU average. Persistent deficits could be linked to a weak cyclical response of the fiscal balance, for example if a less-than-reliable tax base caused revenues to respond to factors other than the cycle. Another common feature of this group is that four are relatively new democracies. Political budget cycles, where deficit spending is increased in pre-election periods, have been found by some studies<sup>(56)</sup> to be more prominent in newer democracies as voters have had fewer opportunities to learn about such strategies. It is possible that political cycles could be obscuring the effect of the economic cycle on the fiscal balance.

In all, these data suggest that, while an overall improvement in the EU fiscal balances can be expected as the economy recovers, the fiscal recovery may well not be uniform.

Longer-term factors may also play a role. In particular, there is at least a theoretical argument that expected increases in the old-age dependency ratio should make governments save more in preparation for higher spending in the future. Equally, if governments make no policy response to population ageing, a positive correlation could be expected between observed changes in the dependency ratio and the government deficit. However, empirical evidence of either effect is weak. Graph I.3.8 shows a slight but positive correlation between changes in the deficit and changes in the old-age dependency ratio in the decade to 2007.

A final set of determinants includes interest rates, the debt stock and access to domestic finance. Interest rates can work both ways, making debt more costly should discourage governments from borrowing more but, at least in the short-term, a rise in interest expenditure is likely to increase the deficit. Connected to this are the debt stock and access to domestic finance. International investors

Graph I.3.8: Dependency ratio and general government deficits



will be more reluctant, all other things being equal, to buy debt from a country with a high debt stock and they are likely to demand a higher interest rate. And governments with already-high debt stocks should be more hesitant in adding to them with high deficits. However, access to domestic finance may well lessen such effects. With a high private-sector saving ratio and a strong domestic asset bias among local investors, market discipline may be less stringent, particularly if the country concerned has its own national currency, thus reducing the substitutability of foreign bonds for domestic investors.

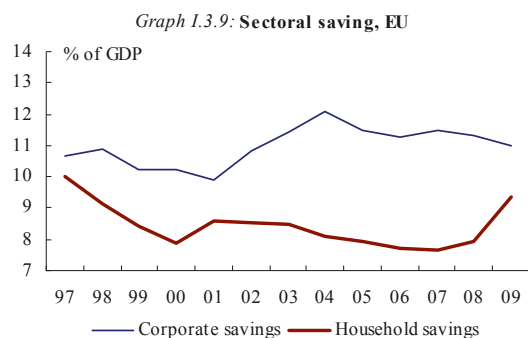
### Drivers of private saving

The drivers of private saving are more complex. An important issue is the distinction between the household and corporate sectors. However, data on the sectoral breakdown are not always reliable enough to draw strong inferences on the distinct behaviour of the two sectors. For households, the theoretical starting point for this section is a life-cycle consumption model although there are widely-acknowledged deviations from this model in practice, particularly due to considerations of uncertainty and constrained liquidity.

The corporate sector is fundamentally an intermediate one, owned finally by the household sector and foreigners. The preferences and rights of shareholders therefore play a role in determining saving. If it can be assumed that shareholders generally prefer to have cash over and above that needed for the operation of the business paid to them as dividends and that company management has incentives to hoard cash and therefore maximise their range of strategic options, it would be reasonable to expect countries with more developed shareholder rights to have

<sup>(56)</sup> See for example "Political budget cycles in new versus established democracies", Adi Brender and Allan Drazen, *Journal of Monetary Economics*, Volume 52, Issue 7, October 2005, pp. 1271-1295

lower rates of corporate savings. More concentrated ownership of firms should have the same effect, because larger shareholders have greater incentives and opportunities to influence company managers. Because of such factors, interest rates may not have the same impact on corporate saving as in other sectors, since high interest rates could just as well be expected to increase shareholder demands for dividends, reflecting the higher opportunity cost to shareholders of leaving the money within the company. It is also possible that some households vary their saving behaviour according to the behaviour of the firms which they own, saving less when the firms they own save more, in anticipation of bigger dividends in the future. As shown in Graph I.3.9, household and corporate savings in the EU are not strongly correlated and trended in opposite directions during the pre-crisis decade, suggesting that the drivers of saving behaviour in each sector are different.

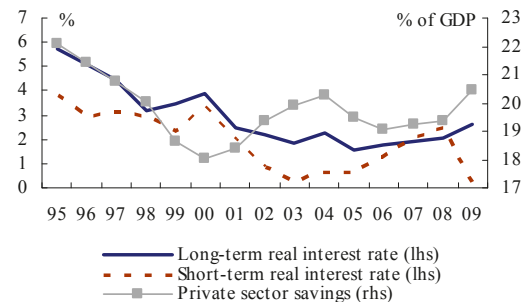


*Note: BG, IE, LU, MT & RO were excluded due to lack of complete data. The remaining 22 Member States account for about 97% of EU GDP.*

The role of interest rates in influencing saving behaviour is complex. It is clear that higher interest rates increase the incentive to save but they may also reduce disposable income, and therefore the opportunity for saving by net-debtor households and firms, meaning that the overall effect varies with the relative marginal propensities to save of net creditors and net debtors. The market-clearing interest rate also responds to developments in demand for financing and, in an open economy, foreign capital supply and demand. As shown in Graph I.3.10, EU real interest rates<sup>(57)</sup> and savings followed a markedly similar

downward path in the mid- and late nineties. But their paths have diverged in the more recent past.

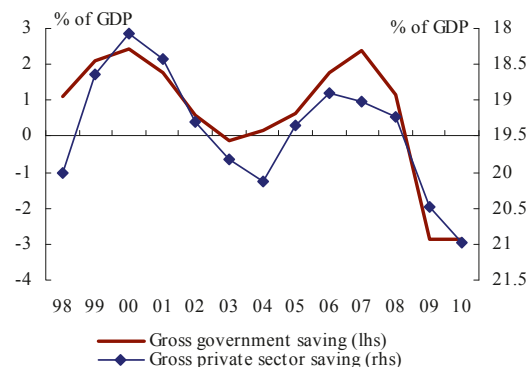
**Graph I.3.10: Real interest rates and savings, EU15**



*Note: This chart includes data only for the 15 Member States which belonged to the EU before May 2004, due to unavailability of historical interest rate data for other Member States.*

A common influence on private-sector saving, of particular current importance, is public-sector saving. Both households and corporations may save more in anticipation of future tax rises if the government has a large deficit. The causality could also run the other way, with governments increasing their borrowing at times of high private-sector saving in order to make up for shortfalls in aggregate demand which such higher saving could create in the absence of strong export demand or domestic investment. It is also likely that common factors will act in opposite directions on the private sector and government balances. For example, higher cyclical unemployment increases the government deficit and is also likely to increase household precautionary savings. The relationship between government and private saving is therefore also connected to the economic cycle and the output gap. Graph I.3.7 has already showed the correlation between government

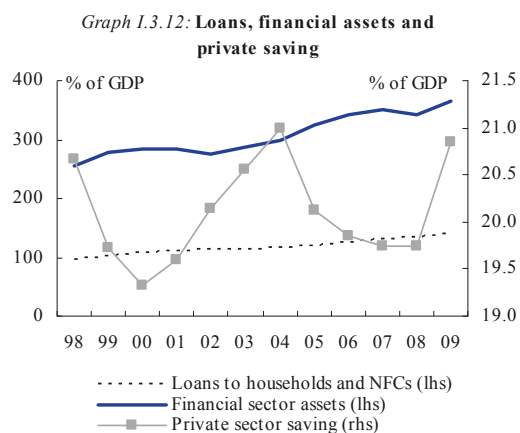
**Graph I.3.11: Gross government and private sector saving, EU**



<sup>(57)</sup> Both short- and long-term real interest rates are included to cover the spectrum of interest rates facing the saver. It may be that the short-term rate is more relevant for the saving decision given the uncertainty attached to long-term rates.

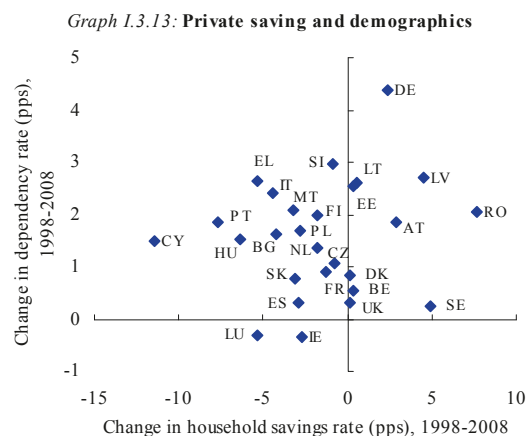
deficits and the output gap. As shown in Graph I.3.11, this negative correlation between government and private-sector saving does appear to hold for the EU as a whole. This implies that private-sector saving should moderate as governments consolidate their finances, helping to offset the contractionary effect of public consolidation.

A further set of factors with the potential to influence saving is related to the financial sector and the debt stock. Households and firms may be more inclined to save when they are highly indebted compared with historical norms. Equally, if the financial sector becomes more developed, making debt finance more readily available, the private sector may save less because agents know they can easily finance investment or emergency spending by borrowing from banks. Because total bank assets, which are a good proxy for the degree of financial-sector development, are partly a function of total debt, these two effects are likely to counterbalance each other to some extent. Graph I.3.12 compares these variables, suggesting no clear link between saving and either of the financial-sector variables.



A final potential influence is that of demographics. The greater the proportion of life a worker plans to spend in retirement, the more he should save during his working life. With a constant retirement age, this would translate into a positive relationship between saving and longevity. However, it would not be surprising if such phenomena did not show through in the data. In reality, few individuals make specific calculations about the exact level of saving needed to retire comfortably at a given age. It seems possible that the degree to which households make serious plans for the financing of their retirement at all might

vary more widely than any variation induced by marginal movements in longevity. Graph I.3.13 does not suggest any strong link between movements in the old-age dependency ratio and private saving ratios in the pre-crisis decade.



### 3.3.2. Determinants of investment

Investment is a crucial element of economic performance. It determines the size and structure of the capital stock and enables the penetration of new technologies, thereby influencing employment and growth prospects in the medium- and longer-term. Moreover, as one of the most volatile components of aggregate demand, investment is a key driving force of the business cycle. This section begins with a description of cyclical fluctuations in investment before turning to the drivers of investment.

Over the period 1996-2010,<sup>(58)</sup> real investment in the EU grew on average at about the same rate as real GDP, i.e. slightly below 2% per year. As a result, the share of investment to GDP (in constant prices) remained broadly unchanged for the period as a whole, at around 20%. This is in line with the standard growth literature which suggests a constant investment-to-GDP ratio over the long run.

In spite of this long-run stability, the investment-to-GDP ratio has fluctuated over the business cycle. This is because investment displays a clear pro-cyclical pattern, accelerating more than overall economic activity at the beginning of recoveries and decelerating more during slowdowns. Over the period 1996-2010, two cycles can be identified: the

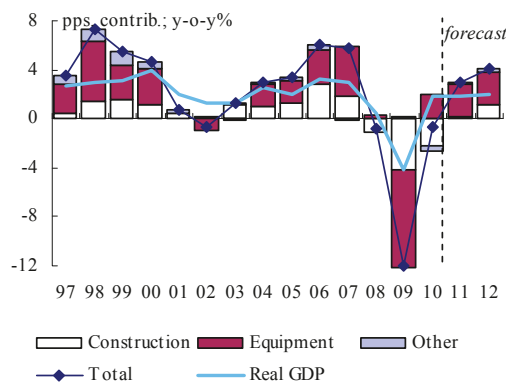
<sup>(58)</sup> The analysis does not start before 1966 due to limited data availability at the country level for some potential drivers of investment.



first in the late 1990s and the second towards the end of the last decade. During the second cycle, the investment-to-GDP ratio experienced a wider fluctuation: 2½ pps. in terms of annual figures between peak (2007) and trough (2010) against 1½ pps. in the previous cycle.

In terms of the breakdown between equipment and construction investment, the former has contributed most to boosting investment in the latest cycle, despite representing less than half of total investment. Between 2004 and 2007, about 60% of the increase in overall gross fixed capital formation was due to equipment investment. Also in the previous cycle, most of the variability in total investment was explained by equipment.

Graph I.3.14: Investment and economic activity, EU



This is partly due to the fact that the traditional link between equipment investment and world trade has strengthened, reflecting the rapidly rising importance of emerging markets, which generate growing demand for investment goods. As world trade collapsed because of the drying up of liquidity and the ensuing collapse in confidence in the aftermath of the Lehman crisis, equipment investment in the EU contracted by a cumulative 20% in 2008-09. But the stronger link between equipment investment and world trade also meant that investment acted as a powerful transmission belt, transforming the impulse from a revival of global trade into strong growth dynamics during the upswing.

#### Drivers of private investment<sup>(59)</sup>

The most straightforward model of investment – the "accelerator model" – in its simplest form,

<sup>(59)</sup> The focus is on private investment, which accounts for 90% of total investment.

postulates a linear relationship between investment and changes in output. As the microeconomic foundations of this relationship are rather poor, other models have been developed which emphasise the role of costs. Modern economic theory focuses on three main macroeconomic determinants of investment: aggregate demand, cost of capital and profitability.<sup>(60)</sup> In turn, the key components of the user cost of capital are financing costs, the purchase price of new capital relative to the output price, and the depreciation rate of the capital stock.<sup>(61)</sup>

The remainder of this section explores the potential explanatory power of these investment drivers<sup>(62)</sup> for the various investment trajectories of capital formation in the EU countries over the last 15 years.

Where aggregate demand is concerned, several Member States fared much better than the EU average in the years preceding the financial crisis. Between 1996 and 2007, the average growth rate of GDP exceeded 5% in Estonia, Ireland, Latvia, Lithuania and Slovakia compared to 2½% in the EU as a whole. Although demand growth may account for part of the difference in investment growth rates, it cannot provide an explanation for the diverging trends in the share of investment-to-GDP compared to the EU.

For the user cost of capital, long-term real interest rates are commonly used as indicators of borrowing costs. The latter decreased significantly in several EU countries in the ten years preceding the financial crisis. On average, their level in the EU in 2007 was about 2½ pps. lower than in 1996. However, Graph I.3.15 does not suggest any clear negative link between the change in the investment-to-GDP share and the change in long-term real interest rates. Focusing only on long-term real interest rates as a measure of the user cost of capital may be too restrictive. A better measure of

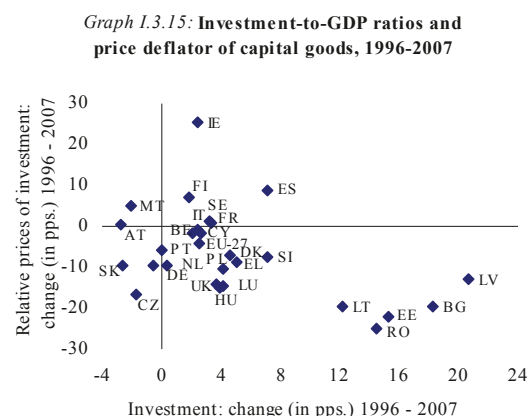
<sup>(60)</sup> See Chirinko, R. (1993), "Business Fixed Investment Spending: Modeling Strategies, Empirical Results, and Policy Implications", *Journal of Economic Literature*, vol. 31(4), pp. 1875-1911.

<sup>(61)</sup> The standard model of investment has been extended to incorporate market imperfections such as taxation, imperfect capital markets, liquidity constraints, adjustment costs, planning and time-to-build lags, irreversibility and uncertainty. These market imperfections usually imply more sluggish investment growth, for instance, because all firms may not have the same access to external financing even though expected developments in future profits are similar.

<sup>(62)</sup> The depreciation rate of the capital stock is excluded from the analysis due to a lack of comparable country data.



the overall cost of financing could be a composite indicator, which would take into account the composition of the source of financing, e.g. loans, debt securities and equities. However, while the various measures of the cost of capital may exhibit different developments and volatilities in the short run, the underlying trends tend to co-move in the long run.

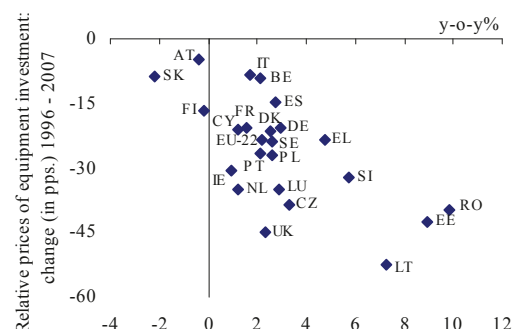


As regards the second component of the cost of capital, the price deflator of investment, there is evidence of a mild (negative) link to the overall investment-to-GDP ratio for most countries (Graph I.3.16). The equipment-construction breakdown of investment shows that this negative correlation between the investment price deflator and the investment to GDP ratio holds and largely stems from equipment rather than construction investment. This is hardly surprising. As the real-estate booms of the past decade in several EU countries have shown, it is the expected rather than the actual relative price of output which spurs capital spending in the construction sector. Observed patterns of construction investment in Ireland and Spain seem to confirm this. In both countries, expectations of rising real estate prices boosted construction investment well above normal levels.

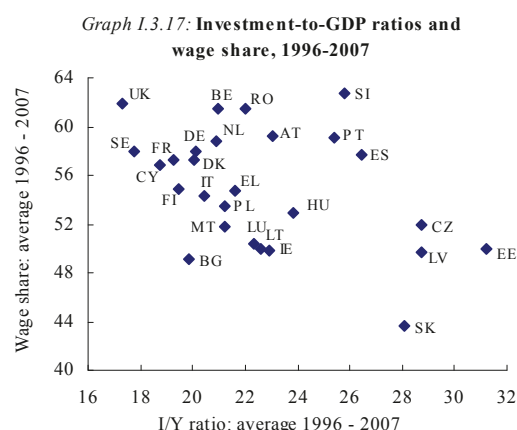
Where profitability is concerned, macroeconomic data typically show a strong co-movement between investment and profit indicators, like the gross operating surplus. However, this co-movement most often reflects a correlation between common determinants (e.g. GDP) rather than causality. It may therefore be difficult to attribute superior investment performance in some countries to observed profitability developments.

Moreover, what matters for investment plans is expected, rather than observed, profitability. Differences in FDI flows between EU countries or

**Graph I.3.16: Equipment investment-to-GDP ratios and price deflator of capital goods, 1996-2007**

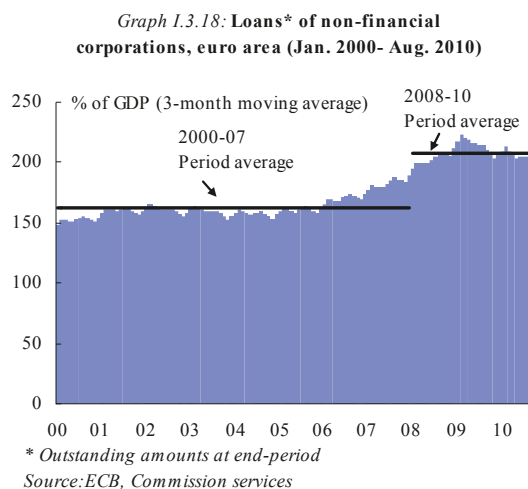


in the wage share may, to some extent, reflect differences in long-run profit expectations across economies. Preliminary empirical evidence does point to more optimistic profit expectations, especially in some EU Member States.



For instance, the recently-acceded EU Member States have traditionally enjoyed a lower wage share (higher profit share) than core euro-area countries (Graph I.3.17). The evidence is not categorical, however. Germany and Spain experienced very different investment patterns, particularly in the construction sector during most of the past decade, despite similar developments in the wage share.

All in all, the examination of traditional macroeconomic variables suggests that they are unlikely to be able to fully explain the different investment patterns observed in several EU countries since 1996. Divergent expectations about future profitability across countries, possibly related to underlying structural differences in labour and product markets, have also probably played a role. But there is reason to believe that financial conditions play a role in corporate investment decisions. Modern finance theory suggests that corporate investment is a function of liquidity and the strength of the company's balance sheet. In particular, the financial accelerator theory indicates that asymmetries in information can explain how a company's balance sheet position can influence capital formation.<sup>(63)</sup> Over the past decade non-financial corporations increasingly relied on funding from banks in the euro area (Graph I.3.18), suggesting that financial factors such as high cash flows, high leverage ratios and debt burdens, may have persistently underpinned investment.



### 3.3.3. Empirical estimates of saving and investment

This section investigates the empirical importance of the potential drivers of saving and investment discussed in the preceding section. In order to reach tentative conclusions on the possible impact of individual drivers, reduced-form equations for saving and investment are estimated separately. The focus is on private saving and investment, as

the decisions on public saving and investment are, to a large extent, a function of political considerations and cyclical conditions. Saving and investment decisions of households and corporations are driven by a multitude of factors and their interaction, and impacts are sometimes theoretically uncertain, as already illustrated in sections I.3.1 and I.3.2. The empirical analysis presented below seeks to identify factors that have driven movements in private saving and investment ratios and the relative importance of their impact. The equations are estimated using data from 1965 to 2008 for the older Member States and data from 1995 to 2008 for the recently-acceded Member States. The magnitudes of the estimated coefficients should be treated with caution as explained below.

The empirical approach employs panel co-integration techniques in order to take into account dynamic relationship between private saving or private investment and their likely determinants. The equations which link saving and investment ratios to the explanatory variables are estimated in an error-correction form, which allows the long-run relationships to be disentangled from short-run adjustment. The estimated equations take the following form:<sup>(64)</sup>

$$\Delta y_{it} = \phi_i(y_{it-1} - \sum_{j=1}^J \theta_{ij} x_{ijt}) + \sum_{j=1}^J \delta_{ij} \Delta x_{ijt} + \mu_i + u_{it}$$

where  $y_i$  is the private saving or investment ratio in country  $i$ ,  $x_{ij}$  is a set of  $J$  explanatory variables for country  $i$ ,  $\mu_i$  is the country-specific constant,  $u_i$  is the error term and  $t$  represents the time dimension.

The empirical analysis is based on the pooled mean-group (PMG) estimator developed by Pesaran et al. (1999), which assumes that the long-run relationship is the same for the investigated group of countries, while allowing for country-specific dynamics in the short run.<sup>(65)</sup> This approach appears plausible and efficient. The PMG estimator is in fact more flexible than the

<sup>(63)</sup> The EU Commission 2010 Forecasts provides an elaboration on the financial accelerator. See [http://ec.europa.eu/economy\\_finance/publications/european\\_economy/2010/pdf/ee-2010-2\\_en.pdf](http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/ee-2010-2_en.pdf).

<sup>(64)</sup> One lag for both dependent and explanatory variables is usually considered in the ARDL specification of the model, implying that the dynamic part of the error-correction model contains a first difference of the explanatory variables.

<sup>(65)</sup> Pesaran, M.H., Y. Shin, and R. Smith, (1999), "Pooled Mean Group Estimation of Dynamic Heterogeneous Panels", *Journal of the American Statistical Association*, Vol. 94, pp. 621-634.

dynamic-fixed-effects (DFE) estimator, which assumes full homogeneity at country level of all (short- and long-term) slope coefficients; however, it is more parsimonious than the mean-group estimator (MG), which estimates different regressions for each country. A similar approach was also used in previous studies exploring savings and/or investment (e.g. Hague et al., 2000; de Serres and Pelegrin, 2002; and Ferrucci and Miralles, 2007).<sup>(66)</sup>

### The empirical determinants of private saving

Table I.3.1 presents the results of the estimated long-run relationship between private gross savings as a share of GDP and its potential drivers. While further analysis is based on the PMG estimator, the table shows results based on the different estimators in order to assess the robustness of the estimated coefficients. Due to distinct structural features, as well as some data

availability issues, the Member States which joined the EU in 2004 and later, are treated separately from the older Member States and specific models are estimated for each of these groups. It appears plausible, though, to assume that the long-run relationship between the saving ratios and its possible drivers are the same within these two groups of countries.

The results of the econometric analysis are broadly in line with the theoretical reasoning described in the previous two sections:

- Higher growth of real GDP per capita tends to raise saving in the long run. This is consistent with the consumption smoothing pattern predicted by the life-cycle theory. The sign of the estimated coefficient is positive as expected in both older and recently-acceded Member States, although the relationship might be somewhat weaker in the latter, (possibly due to their still relatively low levels of GDP per capita). The size of the coefficient also varies considerably depending on model specifications or time periods covered.
- The long-term impact of demographic factors is unclear: while the youth dependency ratio has the expected negative sign, the sign on the old-age dependency ratio changes over different model specifications and is also unstable across different time periods. Clearly,

<sup>(66)</sup> Haque, N.U., M.H. Pesaran, and S. Sharma, (2000), "Neglected Heterogeneity and Dynamics in Cross-Country Savings Regressions", in J. Krishnakumar and E. Ronchetti (eds.): Panel Data Econometrics - Future Directions: Papers in Honour of Professor Balestra, Elsevier Science; de Serres, A. and F. Pelgrin (2002), "The Decline in Private Saving Rates in the 1990s in OECD Countries: How Much Can be Explained by Non-Wealth Determinants?," OECD Economics Department Working Papers 344, OECD Publishing; G. Ferrucci and C. Miralles (2007), "Saving behaviour and global imbalances - the role of emerging market economies," Working Paper Series 842, European Central Bank.

Table I.3.1:

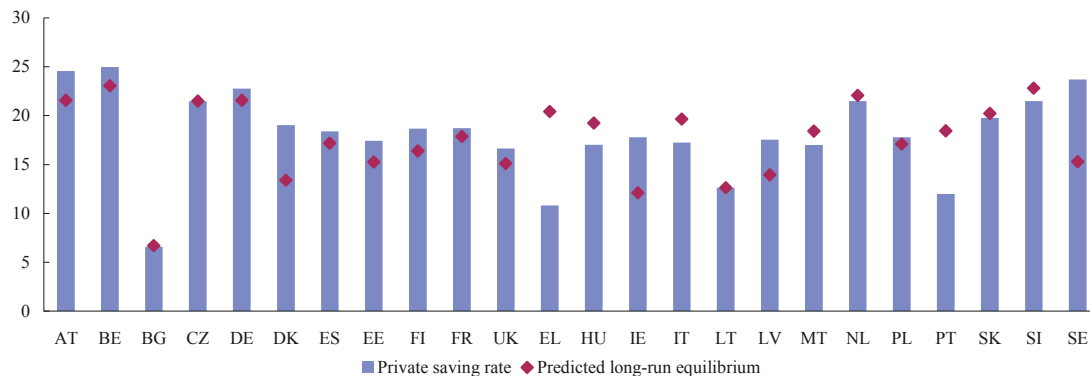
#### Main long-run determinants of the private sector gross saving ratio

	EU15* 1965-2008				Recently added MS 1995-2008		
	PMG	MG	Dynamic FE	Static panel	PMG	Dynamic FE	Static panel
GDP per capita growth	0.806***	0.759***	1.693***	0.247**	0.473***	0.279	0.514***
Old dependency ratio	0.151*	-0.288	-0.0185	-0.0358	0.967***	0.549	0.0257
Young dependency ratio	-0.0965***	-0.111	-0.169	-0.0978***			
Government saving rate	-0.609***	-0.528***	-1.014***	-0.861***	-0.831***	-1.031*	-0.592**
Government consumption (%GDP)	-0.467***	-0.742*	-1.262*	-0.833***			
Real interest rate (short-term)	-0.143***	-0.0471	-0.282	-0.299***	0.386***	0.207**	0.362***
Inflation rate	0.123***	0.165	0.274	0.137***	0.181***	0.00622	-0.0263
Terms of trade (growth)	0.110***	0.304**	0.534**	0.162***			
Error correction coefficient	-0.379***	-0.725***	-0.123**		-0.462**	-0.437***	
No. of observations	520	520	520	498	139	139	119

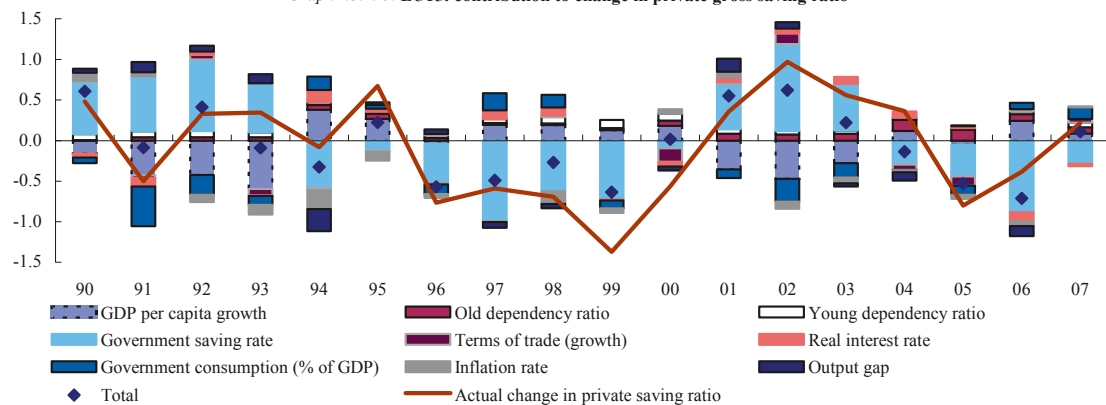
\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Note: \* EU15 excludes Luxembourg due to lack of data. The table shows the results of the dynamic panel specification for the Pooled Mean Group (PMG) estimator, the Mean Group (MG) estimator and the dynamic fixed-effects panel (DFE) estimator. For comparison, results from a static panel specification, using a dynamic OLS approach to account for the cointegration between variables, are also presented. The table shows the coefficients from the long-run cointegrating relationship, while the short-run dynamic coefficients are not presented. All the models contain one lag of the dependent variable as well as a measure of the output gap and time dummies to capture a possible regime shift after the launch of the euro and the extraordinary depth of the recent recession.

Graph I.3.19a: Private saving: actual and predicted long-run equilibrium ratio, 2008



Graph I.3.19b: EU15: contribution to change in private gross saving ratio



there are substantial differences across EU countries, which may reflect different stages of development.

- Lower government saving ratios lead to higher private-sector savings ratios, as postulated by the theory. The relationship is strong and the size of the estimated coefficient is typically less than 1 in absolute terms, which implies less than perfect Ricardian equivalence.
- The impact of (short-term) real interest rates on private saving ratios differs between older and recently-acceded Member States. While increases in real interest rates tend to lower saving ratios in the former, probably because of easier access to credit, the effect on saving ratios tends to be positive in recently-acceded Member States.
- Higher inflation, which may also be interpreted as an indicator of higher uncertainty, tends to increase saving in line with the precautionary saving motive, as well as the need to restore the desired level of real net financial assets.

- The estimated positive influence of the terms-of-trade on the private saving ratio in the long run in older Member States is linked to the effects of an increase/decrease in disposable income (the Haberman-Laursen-Meltzer effect).

The error-correction coefficients imply that any deviations from the long-run “equilibrium” level tend to close in around 2 to 3 years.<sup>(67)</sup>

The use of the error-correction representation also allows us to assess whether the actual saving ratios are in line with the long-run values predicted by the model on the basis of the observed fundamentals (Graph I.3.19a). The results show that, while the actual saving ratios were broadly in line with what the model would predict if there were no deviations from the long-run “equilibrium”, there were important exceptions to this trend in a number of Member States in 2008.

<sup>(67)</sup> The fact that the coefficients on the error-correction term are negative and less than 1 in absolute terms confirms the existence of a cointegrating relationship between the private saving ratio and (at least some of) the explanatory variables.

For Greece and Portugal and partially also Italy, Malta and Hungary, the actual private saving ratios were clearly lower than those predicted by the PMG model. On the other hand, private saving ratios in other countries, e.g. Denmark, Ireland and Sweden, largely exceeded the benchmark determined by the model for 2008. Accordingly, factors other than those included in the model must have played an important role in the determination of the private saving ratio.

A decomposition of past developments in private saving ratios shows the relative importance played by the various drivers (Graph I.3.19b). For the aggregate of the older Member States, it is the change in public savings that has been the determinant of movements in private saving rates over the past two decades. Changes in government current expenditures and per capita GDP growth were also important, particularly weighing on private savings in downswings. Other factors seem to have had a relatively more limited impact.

The picture is more diverse at the level of individual countries. While government decisions in terms of net public savings and the level of expenditures were the main drivers of changes in private savings, other factors played a significant role in some countries.<sup>(68)</sup> For example, population ageing seems to have been important in Germany, Italy or the Netherlands, where increasing old-age dependency has boosted saving ratios, while the increasing population share of young dependents has contributed to a rise in private savings in Greece, Ireland or Spain over the past decade. In addition, progress in catching-up in the latter group of countries and the related worse prospects for per capita growth have tended to weigh on saving ratios.

### The empirical determinants of private investment

Due to data constraints, the analysis of private investment ratios in this section is confined to the older Member States. While the investment equations have lower explanatory power than the saving equations, the main results are broadly in

line with what one would expect on the basis of theoretical considerations:

- Even after controlling for cyclical developments, the private investment ratio responds positively to GDP growth.
- The private investment ratio reacts negatively to real short-term interest rates. This relationship appears to be consistently significant and relatively stable across different specifications.
- The other main element with a significant effect on the private investment ratio is the relative cost of capital (defined here as the difference between the equipment investment deflator and the GDP deflator). While the coefficient on this variable is negative in line with expectations, this result is, however, not systematically robust to changes in the model specification and inclusion of other variables in the model.
- Higher profits (roughly proxied by the inverse of the wage share) appear to have a positive effect on the private investment ratio. Nevertheless, in this case also, the link is not systematically significant in the face of minor alterations to the model specification.
- Progress in financial integration and improvements in financial intermediation seem, in line with expectations, to have a positive effect on the private investment ratio. The proxy for financial integration used here is the credit to the private sector as share of GDP.<sup>(69)</sup> However, a thorough examination of the importance of such links is hampered by the lack of long time series on credit and the non-availability of other possible proxies for financial intermediation.
- Also where investment is concerned, there appear to be gaps between actual investment ratios and the "equilibrium" ratios predicted by the model in some Member States. In the cases of Spain, Ireland and to some extent also Belgium, the model predicts lower investment rates than those actually observed in 2008. While, in the case of Belgium, this reflects the fact that actual investment proved to be

<sup>(68)</sup> The decomposition of movements in private saving rates at country level should be interpreted carefully. While the model appears to explain changes in the private saving ratio relatively well at the aggregate level, its performance varies considerably across countries. Moreover, it seems likely that there are specific factors at the country level that are not captured by the model but which have an important impact on private savings.

<sup>(69)</sup> For the data-related reasons, the proxy for financial intermediation/integration was not included in the baseline specification.

relatively resistant at the onset of the economic crisis compared to the changes in fundamentals, actual investment levels in Spain and Ireland systematically outstripped the benchmarks determined by the fundamentals in years preceding the crisis. This appears to be a manifestation of the real-estate bubbles experienced by these countries. On the other hand, in a number of other Member States, investment rates appear to be below what one would expect on the basis of the underlying factors. This includes countries in which the private sector is in net surplus (e.g. Germany) and in net deficit (e.g. Greece or Portugal).

Table I.3.2:

**Main long-run determinants of the priv. investment ratio**

	EU15 1965-2008		
	PMG	Dynamic FE	Static panel
GDP growth	0.419**	0.486*	0.325***
Real interest rate	-0.395***	-0.396***	-0.190***
Relative cost of capital	-12.72***	-14.546***	-8.743***
Wage share	-0.240***	-0.107**	0.059*
Error correction coef.	-0.238***	-0.195***	
No. of observations	520	520	520

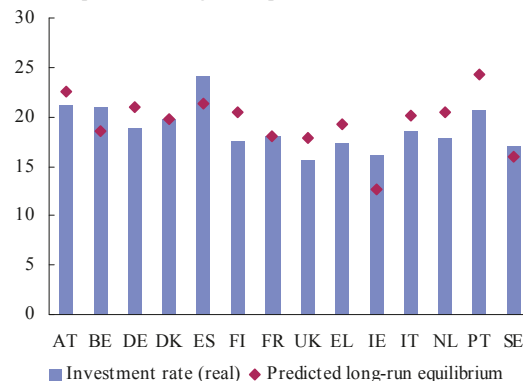
\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Note: The results present the Pooled Mean Group (PMG) estimator and, for comparison, dynamic fixed-effects panel (DFE) estimator and static panel estimator (based on the dynamic OLS approach). The table shows the coefficients from the long-run cointegrating relationship. All the models contain one lag of the dependent variable, a measure of output gap and a time dummy to capture a possible regime shift after the launch of the euro. EU15 includes Member States that joined the EU before 2004 (apart from Luxembourg).

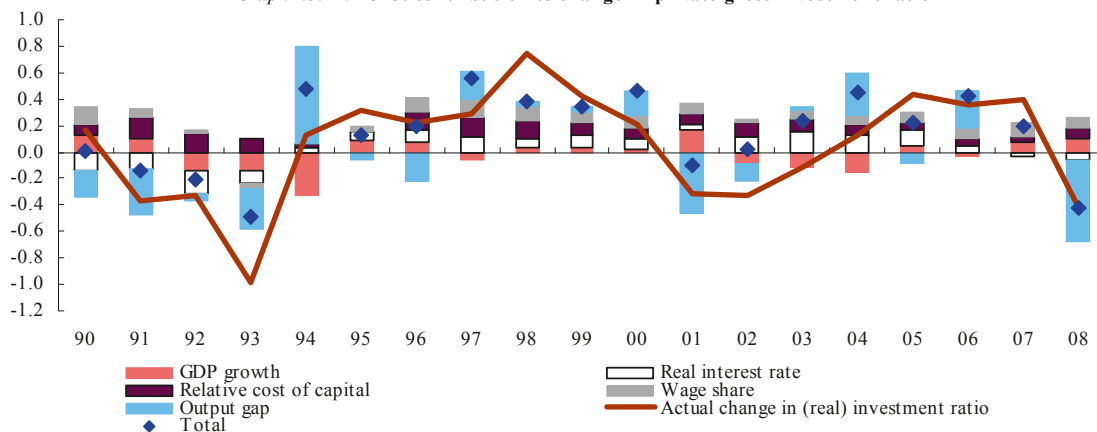
The decomposition of past developments in the (real) investment ratio in the EU15 (Graph I.3.21) indicates that changes in cyclical conditions have an important and immediate effect on investment activity. This was also the case at the onset of the recent economic crisis, when the increasingly negative output gap weighed on investment. In addition, growth prospects significantly influence investment, although there appears to be a lag

before higher growth translates into higher investment. Moreover, in the decade preceding the crisis, falling real interest rates, rising profits and the diminishing average relative price of capital seem to have been behind the increasing trend in private investment described in the previous sections. As in the case of saving, there is evidence of heterogeneity in the response to various explanatory variables at the country level. For example, the results show that, over the past decade, the investment ratios in the more peripheral countries such as Greece, Italy and Spain benefited significantly from declines in real interest rates although the contribution was also substantial in Ireland, Belgium or Denmark. Improvements in profitability, proxied by falls in the wage share, contributed importantly to investment, for example, in Ireland, Austria, Finland, Italy and Spain. On the other hand, the lower relative price of capital supported investment activity in Germany and the Netherlands.

Graph I.3.20: Private investment: actual and predicted long-run equilibrium ratios, 2008



Graph I.3.21: EU15: contribution to change in private gross investment ratio





### 3.4. NEAR-TERM ADJUSTMENT PROSPECTS FOR SAVING AND INVESTMENT

Following the sharp contraction experienced during the 2008-09 financial and economic crises and initial marginal increases recorded in 2010, the Commission's spring 2011 forecast points to a gradual recovery of overall saving and investment ratios in the EU and the euro area over the forecast horizon and a marginal fall in the dispersion of saving-investment gaps.

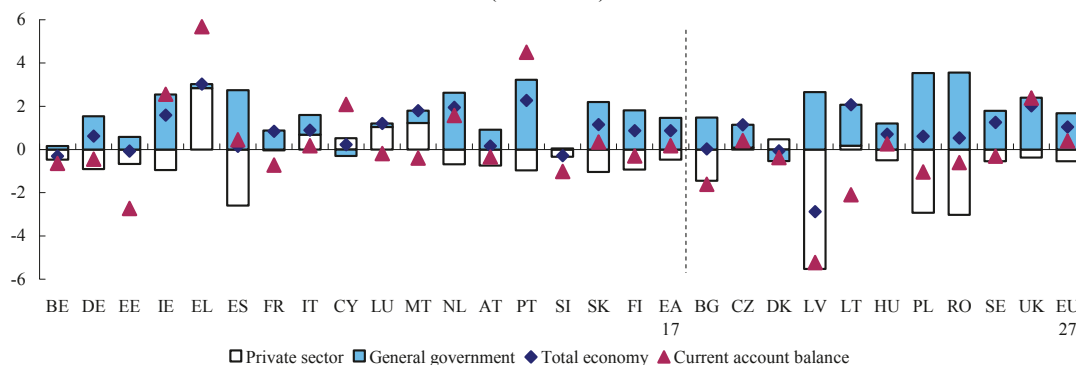
Regarding saving, Graph I.3.22a shows that, on one hand, the ongoing fiscal consolidation is set to improve government savings by around 1¾ pps. and 1½ pps. of GDP, respectively, in the EU and the euro area. On the other hand, saving ratios in the private sector are set to decline as, in line with the empirical results reported in section 3.3, they react negatively to the increase in government savings and possibly the worsened terms of trade related to higher prices of imported commodities. As a result, over 2011-12, the overall increase in the saving ratios of the economy as a whole is expected to be relatively limited in both the EU and the euro area – in the order of 1 pp. of GDP. These developments at aggregate level reflect

similar patterns projected for most Member States. However, the size and sectoral composition of the adjustment vary widely.

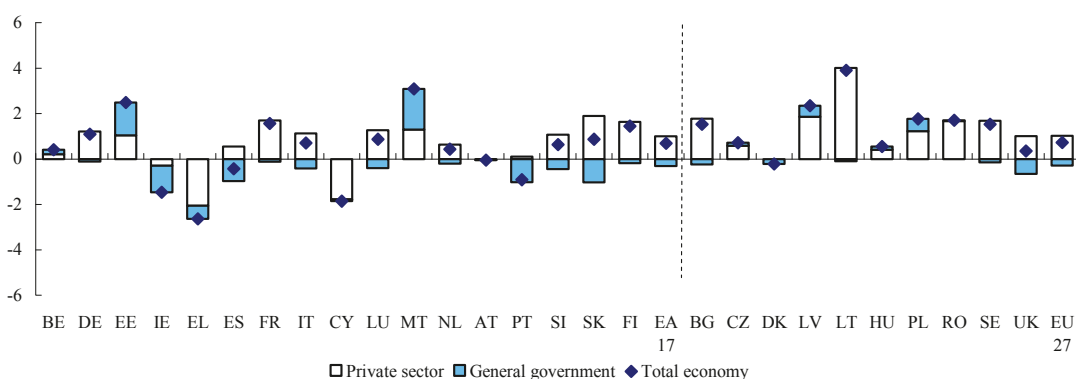
Some euro-area Member States, which are characterised by large imbalances and relatively low savings ratios, are expected to increase their saving by more than the average. This is particularly evident for Greece, where both the government and the household sectors are engaged in balance-sheet adjustments, while the large adjustments anticipated in the government sector in Ireland and Portugal are set to be only partly offset by lower savings in the private sector.

Outside the euro area, saving ratios are set to rise significantly in Lithuania and the UK between 2010 and 2012. In the former, private saving is expected to increase marginally in parallel with a large improvement in government saving. In the latter, it is envisaged that fiscal consolidation will improve the saving position of the government sector, while, within the private sector, the ongoing adjustment in household balance sheets is expected to largely compensate for the reduction in the saving ratio of the corporate sector. In contrast, the anticipated increase in government gross saving in

Graph I.3.22a: Changes in the saving ratio and the current account balance: forecast period (2012 vs. 2010)



Graph I.3.22b: Changes in the investment ratio: forecast period (2012 vs. 2010)



Poland is set to be largely offset by a falling private (household) saving ratio.

Forecasts of how the investment ratio will change in the EU and the euro area between 2010 and 2012 are presented in Graph I.3.22b. The expected overall moderate increase is driven by the rise in the private (especially corporate) investment ratio, while some decline is anticipated in government investment ratios, in line with the results of the previous empirical analysis. Corporate investment is set to benefit from improving demand prospects, still low real interest rates and moderate wage increases. At the country level, the decline in the investment ratio is set to continue over the forecast horizon in those euro-area Member States where large balance-sheet adjustments in both private (particularly household) and government sectors are still warranted, namely Ireland, Greece, Spain, Cyprus and Portugal. On the other hand, investment ratios in Estonia, Malta, Latvia and Lithuania are expected to benefit from renewed inflows of FDI.

The above projections for changes in saving and investment ratios imply broadly stable current-account balances in both the EU and the euro area over the forecast horizon (Graph I.3.22a). Where imbalances within the euro area are concerned, sizeable improvements in the current-account balance over the forecast horizon are anticipated, in particular in Greece and Portugal, due to higher saving but also lower investment ratios. The still-sizeable external imbalances in these countries would suggest that further adjustment in sectoral balance sheets and improvements in competitiveness are to be expected beyond 2012. Some further adjustment also seems likely in those euro-area Member States where the anticipated increase in domestic demand is not sufficient to shrink the large current-account surpluses by 2012.

The remainder of this section uses the econometric results in the previous section to consider the possible evolution of saving and investment ratios beyond the forecast horizon.

As regards private sector saving-investment balances, further convergence may be expected in the coming years. The econometric analysis indicates that the gaps between "equilibrium" ratios of private saving and investment have narrowed in a number of EU15 countries as the fundamentals have changed, while the actual levels often show larger differences. Assuming that the

pre-crisis structural relations still hold and, in the absence of large shocks that would drive the long-run equilibrium ratios apart, some convergence might therefore take place. The speed and extent of such convergence would clearly vary across countries and would depend on the developments in the main determinants of saving and investment.

On the saving side, progress on consolidation of public finances is likely to have a crucial impact on private saving ratios, which will differ depending on the fiscal space available. In Member States with the greatest need for fiscal restraint, reductions in the private saving ratio might partially compensate for this. On the other hand, inflationary pressures and precautionary savings could act in the opposite direction. Also, the effect of population ageing could induce higher savings, especially over short- to medium-term time horizons, although the impact would be differentiated across Member States.<sup>(70)</sup> The likely increases in real interest rates should also influence saving ratios, although the effect is likely to be more limited than in the case of private investment. The size of this effect should also differ across Member States, in particular due to the differential risk premia applied by financial markets. The contribution to private savings from this side is likely to be positive, though relatively limited, in a majority of Member States in view of their relatively subdued growth in potential output.

As regards private investment, an important boost is likely to come from the closing of the output gap and gradual improvements in GDP growth. The restoration of profits in the corporate sector could also support investment. The impact of other determinants are likely to vary considerably across Member States: differences in real interest rates as well as relative cost of capital (partially reflecting falling prices in the construction sector of many EU countries), should have a differentiated effect on investment levels across Member States.

<sup>(70)</sup> While there appears to be some uncertainty about the long-run relationship between old-age dependency and saving rate, the short-run dynamic coefficients appear to be negative.



# PART II

Prospects by individual economy



## Member States



## 1. BELGIUM

### Recovery continues as labour market improves

#### After the export-led recovery in 2010, GDP growth in 2011-12 will be mainly supported by domestic demand

Economic activity in 2010 benefitted from a strong increase in net exports, driven by the impressive economic recovery in Germany, Belgium's main trading partner. Real GDP grew by 2.2%, largely thanks to the strong growth in the second quarter (1.1% q-o-q). Economic growth in 2011-12 will mainly be supported by domestic demand due to a pick-up in private consumption and business investment, especially in 2012, while the positive effect of net exports will gradually diminish. Exports can be expected to slow down in the context of a deceleration of imports of Belgium's neighbouring countries after the strong rebound recorded in 2010. Two important issues are worth highlighting. On the positive side, the outlook on the labour market is better than previously foreseen (especially in 2011), as the recovery took place faster than one could normally expect after a serious crisis. On the negative side, inflation in 2011 is expected to be much higher than expected, due to peaking energy and food prices.

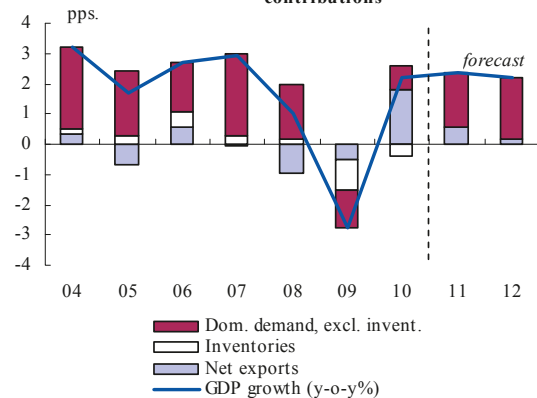
#### Boost in private consumption and investment from 2012 onwards

Due to the strong rebound in 2010 and very good growth prospects for the first quarter of this year (1% q-o-q), real GDP growth in 2011 and 2012 is expected to reach 2.4% and 2.2% respectively – higher than the euro-area average. In both years growth is driven by domestic demand with a shifting composition. While in 2011 the focus lies on accelerating private and public investment (the latter due to the upcoming local elections in 2012 as observed on previous occasions), domestic demand in 2012 is mainly driven by higher private consumption.

After a dip in 2010, real disposable income will start increasing again in 2011. Also, consumer confidence remains at relatively high levels, influenced by better prospects on the labour market. While these factors have a positive impact on private consumption in 2011, the rise in HICP inflation – to 3.6% – will play a dampening role. Despite the collective wage agreement to have no real wage growth in 2011 and to limit it to a maximum of 0.3% in 2012, the automatic wage

indexation mechanism compensates for the higher inflation, albeit with a lag. A higher pick-up in private consumption is therefore expected for 2012; as gross disposable income further increases, inflation will be lower, while the situation on the labour market is expected to remain positive. After the large drop seen in 2010 (from 18.3% to 17.1%), the savings rate is expected to decline further in 2011 and to stabilise in 2012 due to a substantial improvement of consumer confidence together with an increase in real disposable income, slightly below its long-run average.

Graph II.1.1: Belgium - GDP growth and contributions



Private investment will start increasing again in 2011 and is forecast to accelerate in 2012. Capacity utilisation rates reached their average historical levels (79%) in the third quarter of 2010 and kept on increasing thereafter (reaching 81% in April 2011). After having absorbed the existing excess capacity, companies are embarking on new investments. The high growth in total investment expected for 2011 is mainly due to a projected acceleration in government investment ahead of the local elections in 2012, as observed previously. This explains in particular the high increase in investment in construction in 2011, while housing investment also starts to be positive again from 2011 onwards after the relatively limited contraction in 2009 and 2010.

Inflation in Belgium reached an annual average of 2.3% in 2010, compared to 1.6% in the euro area. Inflation (3.6%) is expected to be well above the euro-area average in 2011 as well, due to the sharp increase in energy and – to a lesser extent – food prices since mid-2010. The higher sensitivity in

Belgium to changes in oil prices can be attributed to: (i) higher energy consumption by households; (ii) relatively low excise duties on energy products; and (iii) the price-setting mechanism for electricity and gas. Moreover, Belgium is one of the few countries in Europe that makes use of an automatic indexation system whereby not only wages but also rent prices, insurance policies and several public services are adjusted to changes in the "health index".<sup>(71)</sup> As energy and food prices are expected to decline again in the course of 2011, inflation is projected to decrease to 2.2% in 2012.

#### **Belgium's competitive position weakened in recent years and little improvement is expected...**

For 2011 and 2012 high export and import growth is still foreseen, but the contribution of net trade to GDP growth in these years will decrease.

At the same time, Belgium is losing market shares, especially for goods. The weak performance of goods exports also contributes to a deterioration of the current account balance in 2011, which however remains positive over the forecast horizon thanks to the better-than-expected performance of the services balance.

Belgium's disappointing export performance over recent years is partly related to its high unit labour costs (ULC). After a small decline in 2010, ULC are expected to rise again in 2011 and 2012. The rise in the next two years is related to the merely moderate increase in productivity together with higher wages, reacting with a lag to higher inflation in 2010 and 2011.

Weak export performance is not only due to cost competitiveness. The main reason for the loss in export market share is the overspecialisation in goods with relatively low technology content. Labour- and capital-intensive products are relatively overrepresented in Belgian exports (23% and 26%, respectively), while knowledge-intensive products are relatively underrepresented (35% compared to 46% in Germany and France). Looking forward, demand for those products may continue to underperform while price competition is likely to become even stronger, which poses

challenges regarding the sustainability of export growth and firms' profitability.

#### **...although post-crisis developments on the labour market turn out to be positive...**

The impact of the economic recession on domestic employment was relatively contained. A temporary decline in hours worked – thanks to the temporary unemployment schemes – and labour productivity per hour acted as buffer. Hours worked and productivity are expected to increase again over the forecast period. Employment started to rise again from 2010 onwards, faster than expected given the time it usually takes for the labour market to adjust after a crisis. Employment is expected to increase further in 2011 and 2012, by 0.8% and 0.7%, respectively. As a consequence, the unemployment rate in 2010 rose less than expected (from 7.9% in 2009 to 8.3% in 2010), and will start decreasing again from 2011 onwards (to 7.9% in 2011 and 7.8% in 2012). Although this short-run evolution is positive, the structure of the Belgian labour market increases the risk that in the longer term part of the cyclical rise in unemployment becomes structural (hysteresis effect).

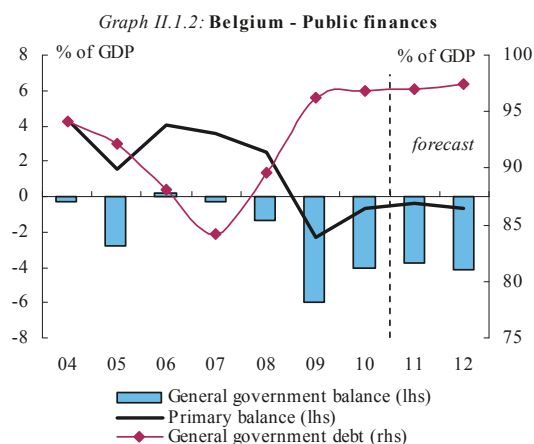
#### **...and the short-term outlook for public finances is relatively positive despite the political deadlock**

The 2010 general government deficit turned out to be substantially lower than expected (4.1% of GDP compared to 4.8% of GDP foreseen in the 2009/10 Stability Programme). The difference mainly comes from a revision of the 2010 data, which also positively affects the 2011 outcome, but also from a decrease in interest rates, extra revenues from banks of about 0.1% of GDP (dividends, interests paid on loans, contributions to the deposit guarantee fund) and higher VAT receipts due to stronger than expected private consumption.

Since the June 2010 general election, after which no fully-fledged federal government had been established, Belgium has lived under the "provisional twelfths" regime, which limits monthly expenditure to one twelfth of the level allowed by the 2010 budget. However, in view of the risks involved by this exceptionally long stalemate, King Albert II asked the caretaker government on 2 February to prepare a budget for 2011, which would foresee measures aiming at further reducing the deficit in 2011. The budget

<sup>(71)</sup> The "health index" excludes products which could be detrimental to health (alcohol, cigarettes, petrol and diesel) from the basket used for the CPI. However, the prices of heating oil, electricity and gas (together counting for about 60% of all energy carriers) are included in the health index.

was submitted to Parliament mid-April. It targets a deficit of 3.6% of GDP.



The Commission services forecast that the deficit will decline to about 3.7% of GDP in 2011, somewhat better than planned in the 2009/10 Stability Programme but slightly higher than the budget target. This would in part be achieved thanks to higher VAT receipts (due in particular to stronger nominal private consumption), higher than expected dividends from banks, the National Bank and Belgacom, extra revenues from the abrogation of banking secrecy and adjustments in the system of "notional interests" deduction.

Moreover, the system of the "provisional twelfths", which will remain in force as long as the budget is not approved, leads to a kind of "automatic consolidation" as it limits the possibility to increase expenditure. Under an unchanged policy assumption, the 2012 deficit is projected to increase by ½% of GDP to about 4.2% of GDP (compared to a target of 2.8% of GDP in the 2010/11 Stability Programme): revenues are expected to increase slightly more slowly than in 2011 as some revenues planned for this year (like the extra dividends) are not expected to be repeated. Moreover, expenditure is projected to rise somewhat faster in 2012 than this year due, among other factors, to the underlying upward trend e.g. in healthcare spending. The structural balance would even deteriorate by 0.9% of GDP due to the improved cyclical conditions.

Thanks to the lower deficit and higher nominal GDP growth, the public debt ratio turned out lower than projected in 2010 (96.8% of GDP compared to 100.6% in the 2009/10 Stability Programme). As the deficit will be close to its debt-stabilising level, both in 2011 and 2012, the debt ratio is projected to increase only marginally (to 97% and 97.5% respectively) and will thus most probably remain below 100% of GDP.

Table II.1.1:

**Main features of country forecast - BELGIUM**

	2009		92-06	Annual percentage change						
	bn EUR	Curr. prices % GDP		2007	2008	2009	2010	2011	2012	
GDP	339.2	100.0	2.1	2.9	1.0	-2.8	2.2	2.4	2.2	
Private consumption	177.8	52.4	1.6	1.8	1.5	-0.3	1.6	1.5	1.9	
Public consumption	83.7	24.7	1.6	2.1	2.3	0.6	1.1	1.2	1.6	
Gross fixed capital formation	72.3	21.3	2.3	6.2	2.6	-5.4	-1.6	3.5	3.4	
of which : equipment	30.0	8.8	2.4	9.4	3.1	-9.8	-1.0	4.1	4.6	
Exports (goods and services)	247.5	73.0	4.8	4.4	1.7	-11.6	10.5	5.9	5.5	
Imports (goods and services)	238.2	70.2	4.5	4.7	3.0	-11.1	8.4	5.4	5.5	
GNI (GDP deflator)	342.3	100.9	2.1	3.0	1.5	-3.3	2.1	2.4	2.2	
Contribution to GDP growth :	Domestic demand		1.7	2.7	1.8	-1.2	0.8	1.8	2.0	
	Inventories		0.1	0.3	0.1	-1.0	-0.4	0.0	0.0	
	Net exports		0.4	0.0	-1.0	-0.5	1.8	0.6	0.2	
Employment			0.7	1.6	1.7	-0.4	0.7	0.8	0.7	
Unemployment rate (a)			8.4	7.5	7.0	7.9	8.3	7.9	7.8	
Compensation of employees/head			2.9	3.4	3.6	1.8	1.1	3.1	3.6	
Unit labour costs whole economy			1.5	2.1	4.4	4.3	-0.4	1.5	2.0	
Real unit labour costs			-0.4	-0.2	2.4	3.2	-2.2	-0.4	0.0	
Savings rate of households (b)			17.8	16.4	17.0	18.3	17.1	16.5	16.5	
GDP deflator			1.9	2.3	1.9	1.1	1.8	1.9	2.1	
Harmonised index of consumer prices			1.9	1.8	4.5	0.0	2.3	3.6	2.2	
Terms of trade of goods			-0.4	0.3	-2.9	3.5	-2.1	-1.2	-0.1	
Trade balance (c)			3.1	1.6	-1.6	0.1	1.0	0.7	0.5	
Current-account balance (c)			4.5	3.9	1.1	2.0	2.4	2.0	2.0	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			4.3	3.6	0.6	1.6	2.1	1.8	1.8	
General government balance (c)			-2.2	-0.3	-1.3	-5.9	-4.1	-3.7	-4.2	
Cyclically-adjusted budget balance (c)			-2.5	-1.4	-1.8	-4.2	-2.8	-2.9	-3.7	
Structural budget balance (c)			-	-1.4	-1.9	-3.6	-2.9	-2.8	-3.7	
General government gross debt (c)			113.2	84.2	89.6	96.2	96.8	97.0	97.5	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 2. BULGARIA

### Moderate recovery alongside ongoing fiscal consolidation

#### Uneven recovery led to unwinding of external imbalances in 2010

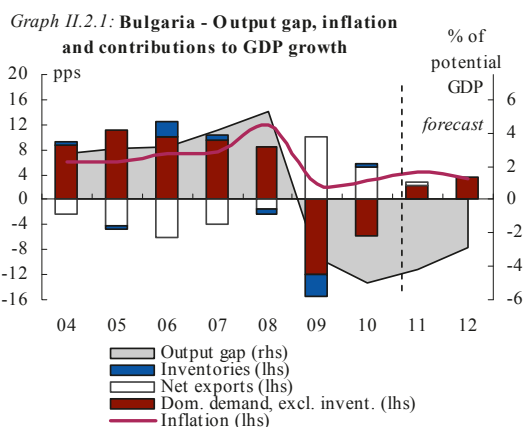
Following five consecutive quarters of decline which left real GDP around 7.1% below the peak reached at the end of 2008, the Bulgarian economy turned to positive quarterly growth by mid-2010. The main driving forces behind the economic turnaround include a continued strong export pick-up underpinned by favourable developments in world trade, and a replenishment of inventories. In contrast, domestic demand has remained predictably negative, as lagged effects of the financial and economic crisis continued to depress both private consumption and investment. Although average wages continued to outpace inflation and consumer confidence gradually recovered from the record lows of the beginning of 2010, consumer demand was constrained by a continued decline in employment and increased precautionary savings.

Gross fixed capital formation was the largest contributor to negative growth, as both construction and investment in equipment dropped in a context of high private-sector indebtedness, restrained bank lending and lingering uncertainties regarding demand expectations. However, steady export gains pushed up consumption and investment in the fourth quarter of last year. By sectors, industry, largely pulled by exports, and to a lesser extent agriculture, was leading the way to recovery, while services appeared to bottom out in 2010.

Growth was particularly strong in the last quarter of 2010, when it reached 2.1% q-o-q (seasonally and working day adjusted), the fastest pace since end-2007. Exports posted their sixth consecutive quarter-on-quarter gains and surpassed their pre-crisis level; investment climbed by 6.5% q-o-q on the back of strong public capital spending, though it still remained 30.9% below its pre-crisis level. Similarly, despite the continuing adjustment of household balance sheets, private consumption inched up by 1.4% following ten consecutive negative quarterly readings. Domestic demand turned out to be less weak with the fiscal impulse becoming the key driver in the last quarter, while net exports' performance was less robust compared to previous quarters. The growth rebound in the fourth quarter brought annual growth to 0.2%

against a contraction of 5.5% in 2009. The adjustment in external imbalances continued at a fast pace throughout 2010 and the current-account deficit declined to 1% of GDP, reflecting the combined effect of limited external financing and strong demand for Bulgarian exports.

Overall, the drag on growth from domestic demand persisted in 2010 and the economy has not yet embarked on a robust recovery path. Employment data do not point to a vigorous rebound either and elevated inflation is further eroding an already low purchasing power. Considering the severity of the output shock, nominal wage growth has proven rather resilient during the recession, posting 6.3% growth y-o-y in 2010. This has forced a large part of the adjustment on the employment side, with job destruction continuing throughout 2010, albeit at a declining pace in the second part. The downturn, reflected in falling labour demand from the retail, wholesale and construction sectors, weighed heavily on employment, which fell by cumulated 8% over 2009-10.



The fiscal consolidation resulted in a narrowing of the budget deficit from 4.7% of GDP in 2009 to 3.2% in 2010, below the 3.8% of GDP target as revised in July 2010. The government has implemented measures to restrain primary expenditure growth, mainly by freezing public sector wages and pensions and by cuts in discretionary spending, confirming its intention to pursue an expenditure-based fiscal consolidation. Total expenditure declined by 4.6%, while budget receipts declined by 1.2%, despite the efforts to advance tax collection and the hikes in some



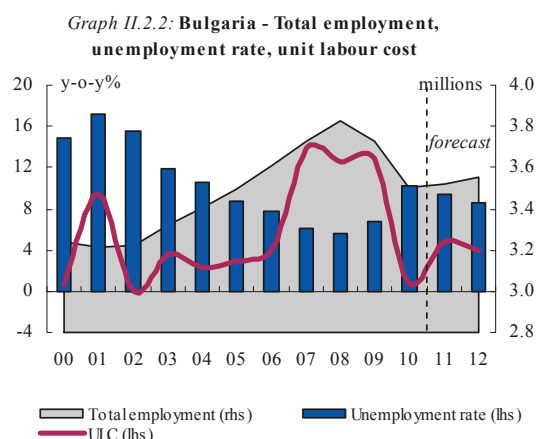
excises rates. The improved fiscal position and the absorption of earlier macroeconomic imbalances set the stage for a stronger economic rebound in 2011 and beyond by creating favourable macroeconomic conditions and restoring market confidence.

### Moderate growth ahead, but employment lagging behind

Whereas the recovery in 2010 relied heavily on external demand, Bulgaria is expected to gradually shift to a more balanced growth composition. Overall, real GDP is projected to expand by 2.8% in 2011 and to gather pace in 2012, with growth reaching 3.7%. Both domestic and external demand are expected to contribute positively to growth, reflecting a gradual stabilisation in the labour market, an expansion in FDI, and a continued recovery in the world economy. Bulgaria's exports are geographically diversified with about a third of its exports directed to fast-growing non-EU economies. The strong export performance is set to gradually feed through to domestic demand, create new job opportunities and reinforce the ongoing structural shift towards the tradable sector.

Private consumption is expected to benefit from higher precautionary saving created during the downturn. As consumer sentiment will improve into 2011, pointing towards a gradual expansion in household spending, the strength of the spending recovery is expected to be limited by lower earnings growth, weak credit activity and rather soft employment over the forecast horizon. A somewhat tighter policy stance resulting from the ongoing fiscal consolidation and higher euro-area interest rates will weigh on growth prospects. The output rebound witnessed over the last three quarters in 2010 has not yet resulted in a significant increase in lending to the private sector. Looking ahead, credit expansion is expected to be largely tied to deposit growth in 2011. Against this background, private consumption is expected to expand less than GDP in 2011 and pick up to 3.6% in 2012 as job creation improves. Nonetheless, for both 2011 and 2012, it is assumed that a frontloading of EU co-financed projects in line with a revival of highway and energy projects, progress with the government's privatisation programme as well as improved business confidence will turn investment into a key growth driver.

The recovery in imports started with a certain lag showing more moderate dynamics compared to exports, as a result of weak domestic demand. While the pickup of imports is expected to gain momentum, growing at 7% y-o-y in 2011, this is not projected to lead to significant external imbalances in the near future, as export growth is projected to continue to outpace import growth.



The labour market is expected to improve somewhat, especially during the second half of 2011, leading to a gradual decrease in the unemployment rate from 10.2% in 2010 to 9.4% in 2011 and 8.5% in 2012. The recovery so far remains jobless, particularly in the non-tradable sectors such as services, while the real-estate market does not yet seem to have bottomed out. The poor functioning of the labour-market in Bulgaria leads to low participation rates at both ends of the age spectrum (young and older workers) and the re-integration of the low-skilled and the young into the workforce will be a major challenge. Wages are expected to develop broadly in line with productivity growth, with the continued freeze in public sector wages in 2011 providing an anchor for the private sector.

### Mounting inflationary pressures

In view of labour market rigidities and high energy intensity of the economy, prices and wages are highly sensitive to both external factors and changes to domestic demand. Keeping inflation in check will thus be a key challenge in maintaining external competitiveness. Since inflationary pressures have built up in Bulgaria in line with the wider global trend, HICP accelerated to 4.6% y-o-y in February 2011 from 1.7% a year earlier, reflecting rising food and energy prices. Thus, inflation is set to stay elevated during most of

2011, as the recovery gathers pace and commodity prices are projected to remain on the up.

### Broadly balanced risks

Risks related to this baseline scenario seem broadly balanced. Foreign capital inflows may turn out to be larger than expected, either through a partial recovery in FDI, or through higher EU funds absorption, which would support the rebound in investment. Uncertainty regarding the consumption behaviour of households is one of the major risks to the outlook, both on the upside and on the downside. Moreover, the performance of the labour market will strongly affect the pace and sustainability of the recovery. Persistent structural problems, such as professional-skill mismatches, which led to significant labour shortages at the end of the previous boom, could slow down the rebound in employment. While balance-sheet corrections are likely to continue to weigh on domestic demand, the extent to which investment recovers, following the massive contraction over 2009-10, depends largely on an improving growth outlook as well as an increase in credit expansion.

### Gradual budgetary adjustment in 2011-12

The changing growth composition is expected to affect the tax base favourably, thereby relieving

the pressure on government revenue. Expenditure, however, will be kept up due to the functioning of the automatic stabilisers. The gradual fiscal adjustment in 2011-12 is expected to be achieved by a cyclical improvement in revenue as well as a containment of public expenditure. Spending items such as public sector wages and pensions would remain frozen, while some other current non-interest expenditures are expected to be cut. Under a no-policy-change assumption, the budget deficit will gradually decline to around 2¾% and 1½% of GDP in 2011 and 2012, respectively. General government gross debt is expected to increase only marginally from around 16% of GDP in 2010 to 18½% of GDP in 2012.

The risks to the budgetary projections are broadly balanced. On the revenue side, the 2011 budget execution could surprise positively if some recent improvements in revenue collection are sustained throughout 2011. A continuation of the rise in commodities prices could increase indirect tax revenue, partly compensating lower receipts from social security contributions. On the expenditure side, however, spending pressures could rise, whereby social spending could increase further given the delayed recovery in employment.

Table II.2.1:

#### Main features of country forecast - BULGARIA

	2009			92-06	Annual percentage change					
	bn BGN	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP		68.3	100.0	1.8	6.4	6.2	-5.5	0.2	2.8	3.7
Private consumption		43.2	63.2	2.6	9.0	3.4	-7.6	-1.2	2.1	3.6
Public consumption		11.1	16.3	-2.1	0.3	-1.0	-6.5	-1.0	-0.3	-0.1
Gross fixed capital formation		19.7	28.9	-	11.8	21.9	-17.6	-16.5	4.9	5.8
of which : equipment		-	-	-	28.8	2.9	-45.1	-	-	-
Exports (goods and services)		32.5	47.5	-	6.1	3.0	-11.2	16.2	7.7	7.1
Imports (goods and services)		38.5	56.3	-	9.6	4.2	-21.0	4.5	7.0	6.8
GNI (GDP deflator)		66.0	96.6	-	1.2	9.3	-3.1	-0.3	2.8	3.7
Contribution to GDP growth :	Domestic demand			-	9.4	8.5	-12.0	-5.7	2.4	3.6
	Inventories			-	0.9	-0.7	-3.4	0.6	0.1	0.0
	Net exports			-	-3.8	-1.5	10.0	5.2	0.3	0.0
Employment				-	3.2	2.6	-2.6	-5.9	0.5	1.0
Unemployment rate (a)				-	6.9	5.6	6.8	10.2	9.4	8.5
Compensation of employees/head				-	12.7	16.3	9.4	7.2	7.1	6.8
Unit labour costs whole economy				-	9.3	12.5	12.7	0.8	4.6	4.0
Real unit labour costs				-	0.1	3.7	8.1	-2.1	1.5	1.5
Savings rate of households (b)				-	-27.4	-	-	-	-	-
GDP deflator				46.0	9.2	8.4	4.3	3.0	3.1	2.5
Harmonised index of consumer prices				-	7.6	12.0	2.5	3.0	4.3	3.4
Terms of trade of goods				-	-1.3	-2.5	0.6	4.7	-1.5	-1.3
Trade balance (c)				-8.2	-23.6	-24.3	-12.0	-6.7	-7.5	-8.2
Current-account balance (c)				-5.1	-25.2	-23.2	-9.0	-1.5	-2.0	-2.6
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-5.0	-27.2	-22.4	-7.6	-0.8	-1.3	-1.8
General government balance (c)				-	1.1	1.7	-4.7	-3.2	-2.7	-1.6
Cyclically-adjusted budget balance (c)				-	-0.4	-0.2	-3.4	-1.4	-1.2	-0.6
Structural budget balance (c)				-	2.7	-0.2	-3.4	-1.3	-1.2	-0.6
General government gross debt (c)				-	17.2	13.7	14.6	16.2	18.0	18.6

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Note : Contributions to GDP growth may not add up due to statistical discrepancies.



### 3. THE CZECH REPUBLIC

#### A moderate recovery driven by external demand

##### Strong export growth in 2010...

In 2010, real GDP expanded by 2.3%, largely because of the swift rebound of exports associated with improving economic conditions in the Czech Republic's main trading partners (in particular in Germany) and the associated robust restocking. On the other hand, domestic demand (excluding inventories) subtracted 0.7 pp. from GDP growth. This was due to sluggish private and public consumption and a continued decline in investment, despite the significant increase in the construction of subsidised photovoltaic power-plants in the second half of the year.

##### ...is expected to drive the recovery in the years ahead

The pace of the economic recovery in the Czech Republic is expected to remain moderate and largely driven by foreign trade over the forecast horizon. GDP growth is projected to reach 2% in 2011, followed by a rebound to 2.9% in 2012, which would represent a slower pace than before the crisis.

Households' consumption expenditure is foreseen to remain subdued, due to the consolidation measures in place in 2011 (a substantial reduction in the public wage bill and cuts in social expenditure). Confidence effects together with sluggish credit growth are also assumed to keep the households' savings rate at a relatively high level, though on a slightly downward trend compared to 2010. Growth in private consumption is expected to remain restrained, reaching 0.4% in 2011. On the other hand, in 2012, consumption should be supported by expected increases in the disposable income of households stemming from higher wages in the private sector, as strong export growth progressively leads to tighter labour market conditions in the export sector. Growth in private consumption is expected to accelerate to 2% in 2012.

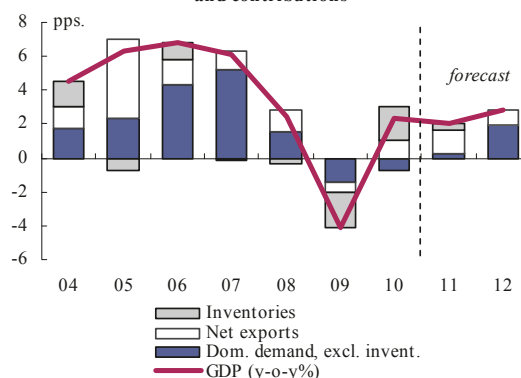
After three consecutive years of decline, investment growth is expected to pick up in 2011 to 2.4% through activity originating mostly in the corporate sector as a result of buoyant growth in exports and increasing capacity utilisation. A gradually rising volume of credit to businesses would also play a supportive role. On the other

hand, the one-off increase in investment due to subsidies for photovoltaic power plants in 2010 has come abruptly to an end and will have an impact on the annual investment growth rate in 2011 compared to 2010. In addition, investment conditions in the construction sector are likely to remain fragile, reflecting a sizeable stock of unsold dwellings. Finally, the consolidation measures adopted for 2011 suggest only modest growth in public investment in 2011, levelling up slightly in 2012.

As reflected also in the rising number of new orders in the Czech manufacturing industry, the recovery is assumed to continue to be driven by external demand, in particular from Germany. Limited consumption growth is consistent with more moderate import growth in 2011. These trends are expected to result in a contribution of net external trade to GDP growth of 1.4 pps. in 2011, up from 1 pp. in 2010. However, the still negative terms of trade, mostly due to high growth of import commodity prices, will allow for only a marginal increase in the trade balance surplus this year.

For 2012, with import price growth more in line with export price growth, the trade surplus is expected to increase to 4.4% of GDP. In terms of the current-account balance, the positive contribution of the trade balance would be offset by continuing profit remittances abroad (mostly FDI-originated) that weigh on the balance of income.

Graph II.3.1: The Czech Republic - GDP growth and contributions



The forecast is subject to several risks. In particular, the full extent of the impact of consolidation measures in 2011 on the behaviour of households is still subject to uncertainty. Furthermore, if the authorities proceed to increase in the reduced VAT rate by 4 pps. in 2012 as is being currently discussed, this would dampen household consumption growth and create additional inflationary pressure in 2012. Finally, given the importance of the external side for the Czech economy, future developments in the euro area, to which around 70% of Czech exports are directed, impinge crucially on the current outlook.

### Labour market conditions remain fragile

The unemployment rate peaked at 7.3% in 2010 and, on account of the slow recovery, is expected to decrease only modestly over the forecast horizon.

The planned cut in the public wage bill for 2011 (at the central government level) is being gradually implemented; it appears to have already produced some reduction in the number of public sector employees in the ministries at the end of 2010. Overall, the negative employment growth in the public sector on an annual basis is expected to be offset by moderately positive developments in the private sector due to rapid export growth. However, the recovery in the labour market should be muted as there is evidence of significant labour hoarding in 2010. From 2011 onwards, demographic developments will start to kick in, resulting in virtually zero employment growth. Accelerating economic activity is expected to push the unemployment rate further down to 6.4% in 2012.

### Moderate inflation in the years ahead

In 2010, the HICP inflation averaged 1.2% y-o-y, up from 0.6% in 2009, and was mostly driven by external factors, in particular energy and food price increases in the latter part of the year. Reflecting the sluggish economic recovery and the fiscal consolidation measures which began to be implemented at the end of the year, demand factors exercised pressure in the opposite direction.

For 2011, with substantial increases in world food and commodity prices, inflation is forecast to reach 2.3%. Nevertheless, inflationary pressures are projected to be partly offset by the appreciating Czech currency (up by 4.1% against the euro in

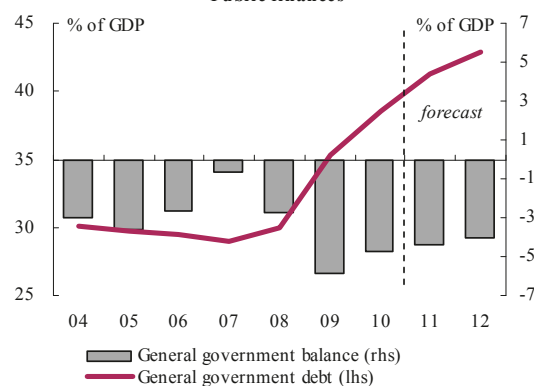
2011). Regulated prices are assumed to play only a relatively minor role, adding an additional 0.8 pp. to inflation in both 2011 and 2012. Domestic demand pressures as well as wage inflation should remain very low in 2011.

For 2012, HICP inflation would increase marginally to 2.5%, reflecting, among other, the acceleration in private consumption growth. If the authorities were to implement the increase in the reduced VAT rate from 10% to 14% in January 2012, as currently discussed, this would entail an increase in inflation; including second-round effects, the overall year-on-year additional impulse could reach 0.8 pp.

### Further reduction in government deficits

The headline deficit is projected to decrease over the forecast horizon from 4.7% of GDP in 2010 to 4.4% in 2011 as a result of consolidation efforts and to fall further to 4.1% of GDP in 2012 on a no-policy-change basis due to gradually improving cyclical conditions.

Graph II.3.2: The Czech Republic - Public finances



After a marked deterioration in the headline deficit in 2009 on account of the financial crisis coupled with a sizeable fiscal expansion, most stimulus measures expired at the end of that year and the Czech government had already begun to consolidate its public finances in 2010. The consolidation measures were focused mainly on the revenue side and included an increase in both VAT rates by 1 pp. and increases in excise duties and social contributions.

During 2010, having recognised that several revenue items were underperforming against the budgeted figures, notably income taxes and social contributions, the government took additional

measures aimed at cutting ministries' operational expenditure. Overall, the 2010 headline deficit reached 4.7% of GDP and more than 1 pp. lower than in 2009. The bulk of the improvement came from a dramatic decrease in public investment (by 0.5% of GDP y-o-y) resulting largely from the expenditure freezes.

The reduction in the deficit is set to continue in 2011 also, with most consolidation measures impacting on the expenditure side of the budget. These include a reduction in the wage bill in the public sector (excluding teachers) and in social expenditure, together with further cuts in operational expenditure. As the measures also target ministries' capital expenditure, the current deficit forecast assumes only a modest increase in public investment in 2011.

On the revenue side, the projected sluggish growth in household expenditure is expected to restrain the growth of receipts from taxes on production. Income taxes and social contributions will also be affected by the restraint in wages in the public sector. However, additional revenue will be generated by a temporary hike in direct taxes (the "flood tax"). The 50% one-off tax on subsidised returns from the building savings scheme, included in the already implemented consolidation package but repealed in April 2011 following a ruling of

the Constitutional Court, will have significant impact on revenue from direct taxes compared to the projections underlying the budget. Overall, the headline deficit is expected to decrease to 4.4% of GDP.

For 2012, additional consolidation measures (the largest of which would be the increase in the reduced VAT rate by 4 pps.) are in the pipeline, but given currently high implementation risks, they have not been considered in this forecast. Therefore, under the no-policy-change assumption, the deficit in 2012 is projected to decrease to 4.1% of GDP, mostly as a result of the improvement in cyclical conditions.

The consolidation effort so far has not allowed a stabilisation of the debt-to-GDP ratio within the horizon of the forecast. Government debt reached 38.5% of GDP in 2010 and is expected to increase further to 42.9% in 2012, also as a result of only moderate nominal GDP growth (averaging 3.5% over 2011-12).

Table II.3.1:

**Main features of country forecast - THE CZECH REPUBLIC**

	2009			92-06	Annual percentage change					
	bn CZK	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	3625.9	100.0	2.7	6.1	2.5	-4.1	2.3	2.0	2.9	
Private consumption	1836.9	50.7	3.8	5.0	3.6	-0.2	0.4	0.4	2.0	
Public consumption	799.0	22.0	1.0	0.5	1.1	2.6	0.3	-2.3	0.5	
Gross fixed capital formation	814.0	22.5	4.8	10.8	-1.5	-7.9	-4.6	2.4	3.8	
of which : equipment	311.8	8.6	8.5	16.9	-0.6	-19.0	-10.5	3.7	5.1	
Exports (goods and services)	2507.0	69.1	10.4	15.0	6.0	-10.8	18.0	9.8	10.3	
Imports (goods and services)	2305.5	63.6	13.2	14.3	4.7	-10.6	18.0	8.4	9.7	
GNI (GDP deflator)	3411.3	94.1	-	3.9	5.2	-5.6	1.6	1.8	2.7	
Contribution to GDP growth :	Domestic demand		3.4	5.2	1.6	-1.5	-0.7	0.2	1.9	
	Inventories		0.3	-0.1	-0.4	-2.1	2.0	0.3	0.0	
	Net exports		-1.0	1.1	1.3	-0.6	1.0	1.4	0.9	
Employment			-	2.7	1.2	-1.2	-0.8	0.0	0.0	
Unemployment rate (a)			-	5.3	4.4	6.7	7.3	6.8	6.4	
Compensation of employees/head			-	6.3	6.3	0.4	2.9	2.5	4.1	
Unit labour costs whole economy			-	2.9	5.1	3.5	-0.2	0.5	1.2	
Real unit labour costs			-	-0.5	3.2	1.0	0.9	0.3	-0.7	
Savings rate of households (b)			-	10.7	10.1	8.9	9.1	8.8	8.3	
GDP deflator			6.9	3.4	1.8	2.5	-1.1	0.2	1.9	
Harmonised index of consumer prices			-	3.0	6.3	0.6	1.2	2.3	2.5	
Terms of trade of goods			-	1.2	-2.3	3.0	-2.5	-1.6	0.0	
Trade balance (c)			-3.6	3.4	2.7	4.5	3.7	3.8	4.4	
Current-account balance (c)			-3.5	-2.6	-0.8	-1.2	-2.3	-2.5	-1.9	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-3.7	-2.0	0.3	0.6	-0.2	-0.4	-0.2	
General government balance (c)			-	-0.7	-2.7	-5.9	-4.7	-4.4	-4.1	
Cyclically-adjusted budget balance (c)			-	-2.9	-4.5	-5.1	-4.0	-3.8	-3.8	
Structural budget balance (c)			-	-2.9	-4.5	-5.5	-4.1	-3.5	-3.6	
General government gross debt (c)			-	29.0	30.0	35.3	38.5	41.3	42.9	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 4. DENMARK

### A gradual and moderate recovery

#### Gradual recovery...

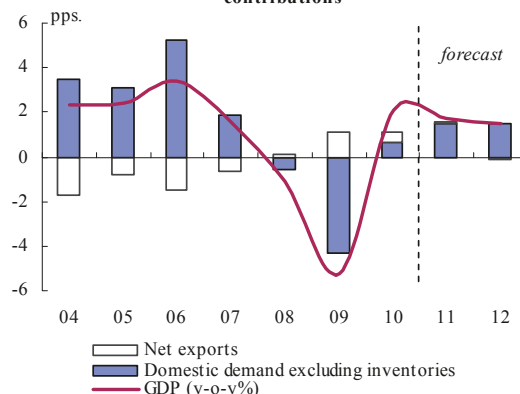
As a small open economy, Denmark was hit hard by the financial and economic crisis, the impact of which was amplified by an ongoing domestic housing market correction, tensions in the financial sector and the necessary adjustment following a period of overheating in 2004-07. Consequently, output plunged by more than 8% from peak to trough and has not yet recovered fully. The rebound of the Danish economy in 2010 was driven predominantly by fiscal stimulus measures, export growth and the turnaround in the inventory cycle. With fiscal support measures being phased out, GDP growth is expected to rely increasingly on the private sector, although the latter continues to face challenges stemming from the real estate sector and rising borrowing costs. Economic growth is thus projected to be moderate, at slightly below 1¾% in 2011 and around 1½% in 2012.

#### ...relying on the private sector

Household finances improved in 2010 as the reduction in top income tax rates and a rise in tax brackets (based on the 2009 tax reform) took effect. The surprisingly robust upturn in financial markets in 2010 also contributed positively to household wealth with possible spill-over effects continuing in 2011. A gradually strengthening labour market should further underpin consumer confidence and contribute to a moderate increase in private sector wages. The situation is expected to remain supportive over the coming years even though the financing elements of the tax reform will start to kick-in this year and higher energy prices are set to weigh on real disposable income. The household saving rate, which increased during the crisis, remains relatively high compared to long-term averages and should thus provide for some financial buffer.

Higher interest rates over the forecast horizon are expected to dampen activity on the housing market. Following the sharp price correction between 2007 and 2009, house prices have stabilised recently but the situation remains fragile. Future housing market developments and the impact of rising borrowing costs on real disposable incomes of households that rely on adjustable interest rate mortgages therefore remain the main risks to the outlook.

Graph II.4.1: Denmark - GDP growth and contributions



In spite of low interest rates, private investment as a share of GDP has fallen to its lowest level in 30 years as Denmark continues to cope with the consequences of a correction in real-estate prices and the sharp contraction in capacity utilisation. With the gradual recovery expected to continue this year and next, strong external demand and the filling of order books by companies are projected to lift capacity utilisation and activate investment intentions in the manufacturing sector. Overall, gross fixed capital formation is forecast to expand by 3¾% and 3% in 2011 and 2012, respectively, with major infrastructure projects – for example the extension of the Copenhagen metro – contributing to investment growth, in particular in 2011.

Public consumption is not expected to contribute significantly to GDP growth over the coming years. As part of its consolidation strategy, the government has announced a consumption expenditure freeze in real terms from 2011 until 2013.

#### ...and a robust global economy

The external sector is projected to remain supportive this year although import demand should overtake export growth. Denmark's cost competitiveness improved in 2010 as a strong crisis-induced rebound in productivity exceeded wage increases. However, the effect is expected to be only temporary as unit labour costs are projected to start growing in 2011 and 2012.

Recent gains in cost-competitiveness are thus unlikely to be sufficient to break the trend of export market share losses, which were amplified by a surge in Denmark's unit labour costs during the boom years. In addition, a majority of Danish companies face challenges when trying to take full advantage of rapidly growing emerging markets due to the traditional business structure and average company size. Although specific sectors, e.g. in the field of renewable energy or pharmaceuticals, are likely to benefit from increasing demand outside Europe, more than two thirds of Danish exports are still directed towards the EU.

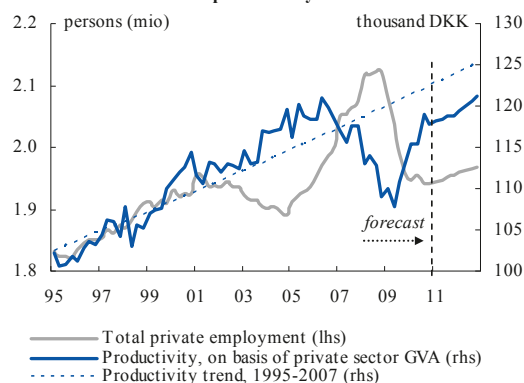
Denmark's merchandise trade surplus widened in 2009 mainly on the back of a sharp contraction in imports. In 2011 and 2012, the merchandise trade balance is expected to stabilise at around 3% of GDP. The current-account surplus as a percentage of GDP is expected to remain sizeable, partly due to strong services exports, especially maritime transport, which is linked to the expansion in world trade.

#### Improving labour-market conditions

The rapid rise in employment before the crisis was associated with a decrease in productivity which – due to the usual lag between output and employment fluctuations – continued during the crisis until 2009 (see Graph II.4.2). Given a huge fall in employment during 2009 and a stabilisation of the labour market in 2010, productivity increased discernibly but remained below the long-term trend. Hence, the projected rise in corporate investment in the coming years will allow for an only gradual increase in employment as companies are expected to boost productivity first. With the improvement in the labour market, students and others, who left the labour force in recent years, are expected to re-enter, thereby keeping the size of the labour force unchanged in spite of the continuously stronger downward pressure coming from demographic changes. The fall in unemployment is therefore expected to continue at a slow pace.

In light of the improved labour-market conditions and the union wage agreements reached last spring, private sector wages are expected to rise; albeit more moderately than during the boom years.

Graph II.4.2: Denmark - employment and productivity



#### Accelerating inflation

While the impact of the hike in indirect taxes on "unhealthy" products, which was introduced at the beginning of 2010, is expected to fade, base effects related to energy prices should push headline inflation higher. Inflation is expected to accelerate from 2.2% in 2010 to a yearly average of 2.5% this year, before falling to below 2% in 2012. In addition to the energy component, services inflation will remain the main driver behind headline inflation. Core inflation, which excludes energy and unprocessed food, is expected to increase marginally over the forecast horizon, broadly in line with the gradual closure of the output gap and moderate wage growth.

#### Budgetary performance better in 2010 ...

Sizeable budget surpluses prior to the crisis provided leeway for the adoption of a major fiscal stimulus programme to fight the adverse impact of the financial and economic crises on consumer sentiment and the financial sector. The pre-crisis surplus therefore turned into a deficit of 2.7% of GDP in 2009, which was forecast in the Commission's spring 2010 forecast and the Danish authorities' 2010 Convergence Programme to widen to above 5% of GDP in 2010. However as the budgetary performance in 2010 turned out better than expected, the deficit was contained at 2.7% of GDP. In particular unexpected and temporary windfall gains linked to the pension yield tax<sup>(72)</sup> accounted for additional revenue of around 2.5% of GDP. Furthermore, a better than expected labour market performance helped to limit government expenditure.

<sup>(72)</sup> The pension yield tax is a flat-rate tax levied on the annual gains of pension portfolios.



### ...but need for consolidation remains

As the better than expected outcome in 2010 is attributable first and foremost to temporary factors, the budget deficit is projected to widen to around 4% of GDP this year, before declining towards 3¼% of GDP in 2012.

With an ongoing recovery, the expenditure ratio is expected to decline further. At the same time, government revenues are set to increase as financing elements of the 2009 tax reform, including increased green taxes and business taxes, become operational. In addition, growth in private consumption should lead to higher revenue from indirect taxes. Rising energy prices will also have favourable effects on Denmark's public finances due to the country's oil and gas extraction in the North Sea.

Moreover, the effects of additional consolidation measures adopted by Parliament in Spring 2010 – including the reduction in the duration of the unemployment benefit period from four to two years, the suspension of automatic adjustments of the thresholds for income taxes, the postponement of income tax cuts and a real-term freeze in public consumption – continue to unfold. However, tight control of recurrent spending overruns at local and regional government levels will be important to achieve budgetary targets.

In structural terms, the deficit is projected to increase between 2010 and 2011. Yet, the structural balance is also influenced by very volatile pension yield revenues. Net of pension yield taxation, the structural balance is projected to gradually improve over the forecast horizon, in line with the consolidation measures adopted.

Table II.4.1:

#### Main features of country forecast - DENMARK

	2009			92-06	Annual percentage change					
	bn DKK	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	1656.1		100.0	2.3	1.6	-1.1	-5.2	2.1	1.7	1.5
Private consumption	813.6		49.1	2.1	3.0	-0.6	-4.5	2.2	2.0	1.9
Public consumption	496.3		30.0	2.2	1.3	1.6	3.1	1.0	-0.2	0.4
Gross fixed capital formation	300.8		18.2	4.5	0.4	-3.3	-14.3	-4.0	3.7	3.0
of which : equipment	109.7		6.6	4.5	4.9	-3.5	-13.2	2.3	4.6	4.7
Exports (goods and services)	792.8		47.9	5.0	2.8	2.8	-9.7	3.6	4.7	4.3
Imports (goods and services)	729.6		44.1	6.3	4.3	2.7	-12.5	2.9	5.0	4.9
GNI (GDP deflator)	1686.2		101.8	2.6	0.8	-0.9	-4.7	2.2	1.7	1.5
Contribution to GDP growth :										
Domestic demand				2.5	1.9	-0.6	-4.3	0.7	1.5	1.5
Inventories				0.1	0.3	-0.6	-2.0	0.9	0.1	0.0
Net exports				-0.3	-0.7	0.1	1.1	0.5	0.1	-0.1
Employment				0.5	2.8	1.9	-3.1	-2.1	0.2	0.4
Unemployment rate (a)				5.8	3.8	3.3	6.0	7.4	7.1	6.7
Compensation of employees/head				3.5	3.6	3.6	2.4	2.7	1.7	2.4
Unit labour costs whole economy				1.7	4.8	6.8	4.7	-1.5	0.1	1.3
Real unit labour costs				-0.2	2.4	2.8	4.3	-4.6	-1.6	-0.7
Savings rate of households (b)				6.6	4.2	5.0	7.7	5.1	8.0	7.1
GDP deflator				1.9	2.3	3.9	0.4	3.3	1.7	2.0
Harmonised index of consumer prices				1.9	1.7	3.6	1.1	2.2	2.5	1.8
Terms of trade of goods				0.9	0.5	1.0	3.8	2.7	-0.1	0.3
Trade balance (c)				3.8	0.1	0.2	2.6	2.9	3.1	3.1
Current-account balance (c)				2.1	1.4	2.7	3.6	5.3	5.2	5.1
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				2.2	1.4	2.7	3.5	5.0	4.9	4.8
General government balance (c)				0.3	4.8	3.2	-2.7	-2.7	-4.1	-3.2
Cyclically-adjusted budget balance (c)				0.3	2.8	3.0	0.9	0.0	-2.2	-1.8
Structural budget balance (c)				-	2.8	3.0	0.9	0.2	-2.2	-1.8
General government gross debt (c)				57.7	27.5	34.5	41.8	43.6	45.3	47.1

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

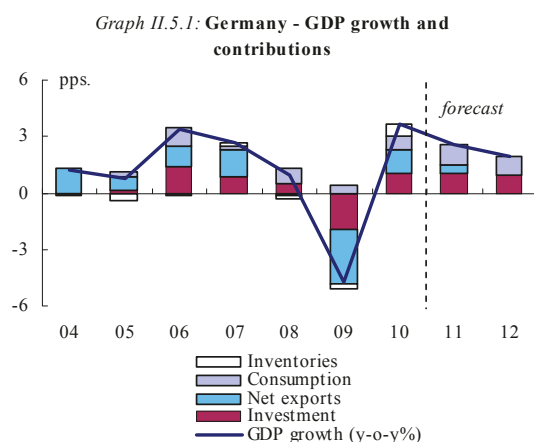


## 5. GERMANY

### Steady, broad-based growth supported by sound fundamentals

#### Broad-based recovery to continue after strong rebound in 2010

With real GDP expanding by 3.6% in 2010, the German economy saw a strong rebound after the recession. Having collapsed in the previous year, exports grew buoyantly in 2010, benefitting from the recovery in world trade and strong demand for investment goods. With imports picking up more slowly, net exports made an important contribution to GDP growth. Nevertheless, domestic demand was the strongest driver of growth last year, confirming the gradual broadening of the recovery of the German economy. In particular, catching-up effects as projects postponed during the crisis were initiated, rapidly increasing capacity utilisation and sustained public spending on infrastructure led to a rebound in investment. Meanwhile, private consumption was supported by the robust performance of the labour market.



Healthy GDP growth is expected to have been recorded in the first quarter of 2011, with a marked technical rebound estimated to have offset the exceptionally harsh weather conditions that hit construction investment in particular in the last quarter of 2010. In subsequent quarters, economic activity should continue to expand steadily. Overall, real GDP is projected to increase by 2.6% in 2011 and by 1.9% in 2012, exceeding the estimated rate of potential growth in both years. Convergence towards the longer-term growth trend in 2012 reflects a further shift towards domestic demand with a smaller contribution from net exports. Indeed, while export growth should remain dynamic over the forecast horizon, current

survey indicators and economic fundamentals bode well for the strength of domestic demand. German growth continues to benefit from improved labour-market conditions following past major reforms and from the absence of major macroeconomic imbalances. The expected rebalancing of growth should lead to a gradual decline in the current-account surplus.

#### Private consumption outlook supported by vibrant labour market

Having been a stabilising factor during the crisis due to the resilience of the labour market and the support from fiscal stimulus measures, household consumption continued to contribute steadily to economic growth throughout 2010. Looking forward, despite the current rise in inflation, real disposable income should increase noticeably, supported especially by buoyant labour market developments. Given a prospective further drop in unemployment, a slight decline in the savings rate may be expected. Overall, private consumption growth should see a slight acceleration from 1.2% in 2011 to 1.5% in 2012.

#### Investment to remain dynamic

Following a somewhat slower start in 2011 after the phasing out of degressive depreciation rules, investment in machinery and equipment is expected to remain dynamic over the forecast horizon, albeit with a slight deceleration in 2012. Order books are full, capacity utilisation exceeds its long-term average and real interest rates are projected to remain at unusually low levels, even in the face of the commonly expected normalisation of nominal policy rates. The strong financial position of the corporate sector should support investment plans in the medium term, as would a shift to more capital-intensive production in reaction to possible labour market shortages. At the same time, construction investment is likely to have been boosted by a strong technical rebound in the first quarter. Still-low mortgage interest rates, as well as favourable labour market and disposable income developments, should support housing investment. More generally, domestic investment is likely to benefit further from lower exports of capital after the end of foreign asset booms, with a possibly more cautious risk assessment

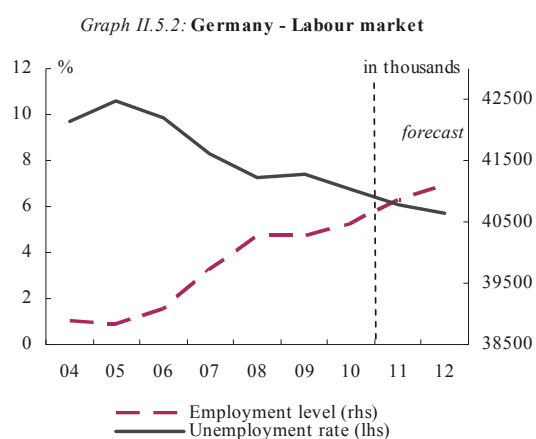
promoting greater home bias on the part of domestic investors.

### Net export contribution to diminish on the back of strengthening domestic demand

While a certain normalisation is expected after last year's exceptional 14% expansion, growth in exports of goods and services should remain dynamic over the forecast period. Germany's competitive position is still strong and the specialisation in investment goods should allow exporters to benefit from lively demand in emerging markets. However, strengthening domestic demand, in conjunction with the rising import content of German exports, should lead to even stronger import growth, implying a diminishing contribution of net exports to GDP growth.

### Buoyant labour market

Thanks to increased working-time flexibility at the company level, resulting from past labour market reforms and the use of short-time working arrangements, the labour market proved remarkably resilient during the crisis. Having increased only slightly in 2009, the unemployment rate fell to an average of 7.1% in 2010. While growing labour demand translated into a more pronounced increase in hours worked than in headcount employment (as the importance of short-time work diminished), the shrinking labour force also contributed to the drop in unemployment. With survey data reflecting firms' positive intentions on additional hiring and given the strong growth outlook, a more sizeable increase in employment numbers is expected in 2011 (0.9%), followed by a moderate expansion (0.5%) next year.



The unemployment rate should fall to 6% by the end of the forecast horizon. Shortages in certain high-skill segments of the labour market appear to be emerging. Should such shortages become more pronounced in the medium term, given the trend decrease in the working-age population, this could turn into a major bottleneck for Germany's growth potential. Over the forecast horizon, the tightening labour market is expected to translate into stronger wage increases, especially next year.

### Pick-up in wage growth; core inflation to remain contained while energy prices soar

Indeed, a pick-up in wage growth in 2011 and especially in 2012 is forecast against the background of healthy economic expansion. In view of the projected return to positive productivity growth following the crisis, this would only entail moderate increases in unit labour costs.

Inflationary developments surprised on the upside in the first quarter of 2011, essentially due to higher-than-expected energy prices mainly reflecting geo-political uncertainties. Energy prices are likely to continue to exert upward pressure well into this year, resulting in an acceleration of the HICP inflation rate to 2.6% for the year as a whole. The rate is then set to decelerate to 2% in 2012. While the impact of the increase in oil prices is limited by the fact that Germany is among the more energy-efficient economies in the euro area, the country is relatively dependent on energy imports. The ongoing discussion about the future energy policy could raise this dependency in the short term and could have an impact on the country's energy prices beyond the forecast horizon. Core inflation is forecast to remain contained at around 1¼% in 2011 and 1¼% in 2012. In particular, no significant second-round effects are expected, also in view of developments during the previous spike in commodity prices (2008).

### Downside risks to the forecast mainly on the external side

Persistent inflationary pressures from commodity prices are among the key downside risks to the forecast and could affect the economy through an adverse effect on consumer confidence or through a deterioration of the economy's trade prospects. Further risks to the external outlook relate to the impact of current developments in Japan. While

Germany's direct exposure to the Japanese economy is limited, given the worldwide integration of production processes, supply-chain disruptions in key industries, such as the automotive sector, cannot be excluded. A stronger-than-expected effect of developments in Japan on its Asian trade partners could in turn affect demand for German exports. On the upside, substitution effects in reaction to a possible temporary reduction of Japanese automobile production, for example, might generate additional demand for German products. Moreover, while the central scenario is for an orderly resolution of the international debt crisis, further tensions in financial markets could affect consumer confidence as well as bank lending conditions, although the increased profitability of companies has provided greater scope for internal financing of investment.

### Potential bottlenecks ahead

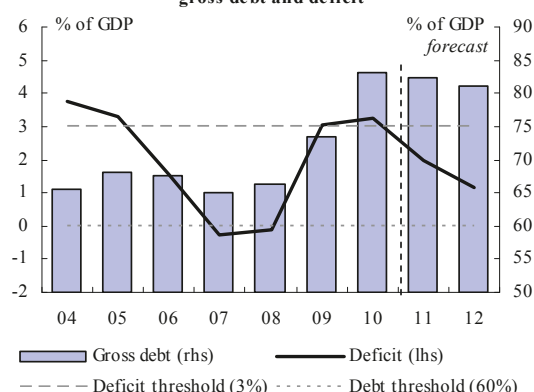
Despite the absence of major domestic imbalances and balance-sheet problems, some important challenges remain to be addressed. Tackling the near-term challenge of completing the restructuring of the Landesbanken would reduce the risk of future additional burdens on the public finances while supporting medium-term credit supply and productivity developments, through positive effects on the efficiency of financial intermediation and capital allocation. The economy's medium term growth prospects could also be affected by possible labour supply shortages. The forecast assumes a limited additional increase in participation rates. Further rising participation rates of women and older workers as well as an additional reduction in long-term unemployment could partly offset negative demographic trends. In this context, raising the quality of the available human resources would also be helpful, especially in view of the economy's specialisation in high-value industries and falling productivity trend growth. Further improvements in access to, and quality of, education as well as an increase in higher educational attainment rates would help relieve the emerging problem of shortages of medium- and high-skilled labour. At the same time, possible additional immigration flows from this year onwards, following the end of restrictions on the mobility of workers from New Member States, would help mitigate potential labour supply shortages. Indeed, the forecast assumes a limited rise in inward migration for 2011 and 2012.

### Deficit contained in 2010 but financial market support measures drive up the debt ratio

After having reached 3% of GDP in 2009, the general government deficit widened slightly to 3.3% of GDP in 2010. The deficit was almost entirely driven by the fiscal stimulus undertaken in line with the European Economic Recovery Plan (EERP) and financial market support measures. Its relatively contained increase can mainly be explained by the swift economic recovery and the remarkably robust labour market, which dampened expenditure growth and compensated somewhat for the tax revenue shortfalls resulting from tax relief.

Nevertheless, the 2010 debt-to-GDP ratio rose by almost 10 pps., reaching 83.2%. The bulk of this sizeable increase was related to the fact that two troubled banks transferred impaired assets to their respective "bad-banks", which are classified under the government sector. The corresponding liabilities of "bad-banks" have a direct impact on the debt level.<sup>(73)</sup>

Graph II.5.3: Germany - General government gross debt and deficit



### Sizeable fiscal improvement as of 2011

In the near-term, Germany's budgetary position is expected to improve on the back of the favourable macroeconomic environment, including steady employment growth, and the consolidation course adopted by the German authorities as of 2011 to meet the requirements of the constitutional budgetary rule in a timely manner. The rule sets a structural deficit ceiling of 0.35% of GDP for the Federal government from 2016 onwards and calls for structurally-balanced budgets for the Länder as of 2020.

<sup>(73)</sup> In line with the Eurostat guidance on accounting rules for financial defeasance structures (16 March 2011).

In 2011, the general government deficit is forecast to diminish to 2% of GDP benefiting from continuous positive cyclical conditions, federal fiscal consolidation measures (around ¼% of GDP), the expiry of certain stimulus measures (around ¼% of GDP) and health-care reform (around ¼% of GDP), including a 0.6 pp. increase in the contribution rate to finance rising health-care costs. The major 2011 measures encompass reduced social benefits for long-term unemployed, cuts in public sector wages, as well as a new tax on the nuclear energy sector and an air traffic charge. Gross debt is projected to decrease to 82.4% of GDP in 2011 thanks to a partial recuperation of some of the financial market support costs as well as to a favourable denominator effect.<sup>(74)</sup>

The deficit is set to decline further to 1¼% of GDP in 2012, also on the back of the expiry of certain stimulus measures, e.g. additional investment. The debt-to-GDP ratio should fall to 81% of GDP in 2012 reflecting healthy nominal GDP growth.

The ongoing federal consolidation appears to be largely growth-friendly – e.g. increases in the

R&D and education expenditure have been safeguarded. However, higher health-care and unemployment insurance contribution rates add to the already high tax wedge. Uncertainties about the sustainability of social security systems and a possible additional burden related to financial market stabilisation pose downside risks for Germany's public finance in the medium term. Further reconciling fiscal adjustment with raising potential growth therefore remains a key challenge for public finances in the years ahead.

<sup>(74)</sup> By a technical assumption the potential debt-decreasing effects related to the winding-down of the assets accumulated in the "bad-banks" classified into the government sector, have not been taken into account.

Table II.5.1:

**Main features of country forecast - GERMANY**

	2009			92-06	Annual percentage change						
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012	
GDP	2397.1	100.0	1.5	1.5	2.7	1.0	-4.7	3.6	2.6	1.9	
Private consumption	1411.1	58.9	1.3	1.3	-0.2	0.7	-0.2	0.4	1.2	1.5	
Public consumption	472.1	19.7	1.3	1.3	1.6	2.3	2.9	2.3	1.5	0.9	
Gross fixed capital formation	422.7	17.6	0.9	0.9	4.7	2.5	-10.1	6.0	6.0	4.8	
of which : equipment	154.7	6.5	1.9	1.9	11.1	4.0	-22.3	10.9	10.6	7.9	
Exports (goods and services)	978.8	40.8	6.4	6.4	7.6	2.5	-14.3	14.1	7.6	6.5	
Imports (goods and services)	860.3	35.9	5.5	5.5	5.0	3.3	-9.4	12.6	7.5	7.2	
GNI (GDP deflator)	2430.9	101.4	1.6	1.6	2.3	0.8	-4.9	3.5	2.6	2.0	
Contribution to GDP growth :											
Domestic demand			1.2	1.2	1.0	1.3	-1.5	1.8	2.1	1.9	
Inventories			-0.2	-0.2	0.2	-0.2	-0.3	0.6	0.0	0.0	
Net exports			0.5	0.5	1.5	-0.1	-2.9	1.2	0.5	0.0	
Employment			0.1	0.1	1.7	1.4	0.0	0.5	0.9	0.5	
Unemployment rate (a)			8.6	8.6	8.7	7.5	7.8	7.1	6.4	6.0	
Compensation of employees/f.t.e.			2.2	2.2	0.9	2.0	0.2	2.2	2.7	2.9	
Unit labour costs whole economy			0.7	0.7	-0.1	2.4	5.2	-0.9	1.0	1.4	
Real unit labour costs			-0.6	-0.6	-1.9	1.3	3.7	-1.5	0.0	-0.1	
Savings rate of households (b)			16.2	16.2	16.8	17.6	17.2	17.3	17.1	16.9	
GDP deflator			1.3	1.3	1.8	1.0	1.4	0.6	1.0	1.5	
Harmonised index of consumer prices			-	-	2.3	2.8	0.2	1.2	2.6	2.0	
Terms of trade of goods			0.3	0.3	0.7	-1.5	6.1	-2.9	-2.2	0.0	
Trade balance (c)			4.2	4.2	8.2	7.3	5.6	6.1	5.8	5.7	
Current-account balance (c)			0.8	0.8	7.6	6.7	5.0	5.1	4.7	4.6	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			0.8	0.8	7.7	6.7	5.0	5.1	4.7	4.6	
General government balance (c)			-2.6	-2.6	0.3	0.1	-3.0	-3.3	-2.0	-1.2	
Cyclically-adjusted budget balance (c)			-2.7	-2.7	-0.5	-0.5	-0.8	-2.2	-1.4	-0.8	
Structural budget balance (c)			-	-	-0.5	-0.2	-0.8	-1.9	-1.4	-0.8	
General government gross debt (c)			58.3	58.3	64.9	66.3	73.5	83.2	82.4	81.1	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 6. ESTONIA

### Economic recovery gaining further ground

#### Buoyant export growth supports the recovery...

Following a cumulative GDP loss of 19% in 2008-09, the Estonian economy rebounded swiftly, with growth accelerating throughout 2010 and reaching 3.1% for the year as a whole.

External trade has been the main driving force behind the recovery so far. A buoyant external environment, particularly in Sweden, but also in the main euro-area trading partners, pushed up external demand. Exports of goods increased by 53% y-o-y in the last quarter of 2010, with the main contribution coming from electrical machinery and equipment exports to Sweden. Overall, exports represented over 78% of GDP in 2010 – the highest share since the recovery from the Russian crisis ten years ago, contributing 14% to annual GDP growth. Such a strong export-driven recovery reflects the significant cost adjustment that took place in 2009-10, which improved competitiveness and helped to increase share in global trade.

In contrast to the external trade, domestic demand remained rather weak, with signs of recovery appearing only towards end-2010. Overall, domestic demand increased by 1.4% in 2010, with the main contribution coming from inventories in the first half of the year, and a strong rebound in investment in the fourth quarter, mainly in equipment. Government investment was lower than expected, while construction of dwellings stalled. Overall, fixed investment declined by over 9% in 2010. Private consumption was constrained by the ongoing deleveraging, high unemployment and lower wages, and picked up only moderately towards the end of the year.

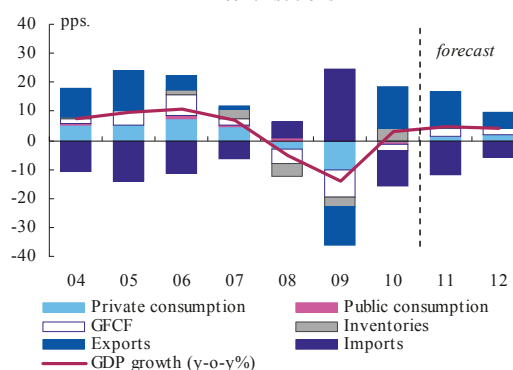
#### ...also in 2011, when domestic demand is expected to pick up strongly too

External demand is expected to contribute positively to growth on average over the forecast horizon due to a strong economic outlook in Estonia's main trading partners. Export growth is projected to remain rather high in 2011, decelerating somewhat in line with demand growth in export markets in 2012.

Private-consumption growth is expected to pick up to 3.5% towards the end of the forecast horizon,

but to remain significantly more moderate than before the crisis, with its GDP share stabilising at around 50%. Behind the improving outlook lie expected growth in household disposable income and a better employment outlook as economic growth accelerates. Savings by households, which increased significantly during the crisis, are expected to decrease but to remain positive over the forecast horizon, as households continue deleveraging. Rising interest rates could provide additional positive impetus to savings, while higher prices could reduce households' purchasing power, weighing on the recovery of private consumption. Uncertainty about the medium-term preferences of households with respect to saving represents one of the major risks to the forecast.

Graph II.6.1: Estonia - GDP growth and contributions



Fixed investment is expected to bounce back strongly in 2011-12, building on the growth momentum from the fourth quarter of 2010. Investment growth is likely to be broad-based, affecting equipment, public infrastructure and housing. In particular, investment in equipment is set to accelerate further in 2011 after a significant fall during the crisis. The positive external outlook, improved confidence and increasing profitability are expected to provide incentives for a substantial upgrade of existing production facilities and the creation of new ones to support the ongoing sectoral rebalancing. This increase in investment is also expected when taking into account the rising capacity utilisation, which amounted to more than 73% in the manufacturing sector in the first quarter of 2011. The renewal and extension of production capacities is also facilitated by higher profitability in the banking sector and stronger financial sector confidence, which contribute to more dynamic lending policies. In parallel, public sector



investment is set to rebound strongly, with infrastructure investment gaining ground through higher absorption of EU structural funds and investment related to the carbon credit trade contracts. Public investment is likely to spill over to residential construction. Overall, fixed investment is expected to increase by over 10% annually over the forecast horizon.

Stronger domestic demand and industrial export would support import growth, with a slightly negative trade balance reducing the current-account surplus towards 2012. The improved profitability of foreign-owned companies could lead to an increasing income account shortfall, but a significant part of these profits is likely to be reinvested.

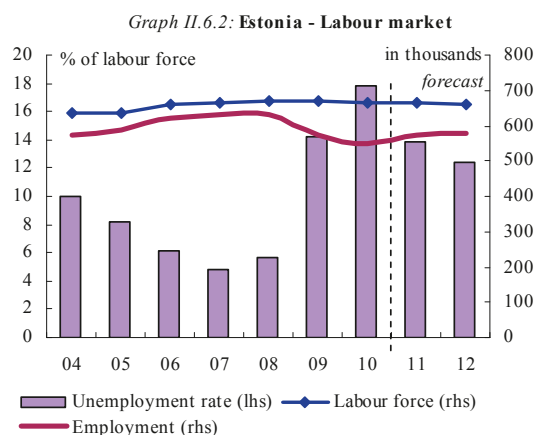
Overall, annual GDP growth is set to be higher than projected in the previous forecast, accelerating to 4.9% in 2011 before slowing down somewhat to 4% in 2012. The growth profile is also projected to be more balanced, with domestic demand gradually gaining ground both due to higher investment and recovering private consumption.

### **Labour market is recovering, but unemployment and skill mismatches remain major challenges...**

After peaking at some 20.4% in early 2010, unemployment (15-64) declined very rapidly to just below 14% towards the end of the year. Job creation has accelerated since spring 2010, reflecting the robust recovery in exporting manufacturing sectors. Such a strong rebound was possible due to the high flexibility of Estonia's labour market as well as to significant adjustment in labour costs. Employment growth is expected to accelerate further in 2011, in line with the overall improved growth outlook, before moderating somewhat in 2012. Activity rates, which were very high and increasing throughout the recession, are expected to decline somewhat.

The adjustment in the labour market was supported by active labour market policies, as expenditure increased considerably in 2009 and 2010 to prevent unemployment from becoming structural. The government recently announced its intention to reinforce labour market policies further and step up lifelong learning activities. Nevertheless, unemployment is expected to remain relatively high in both 2011 and 2012 notwithstanding rising

labour demand. As the ongoing sectoral rebalancing of the economy requires new skills, there is a risk that unemployment could become structural, resulting in an impoverished labour supply and a constraint on growth. In parallel, the increasing availability of employment opportunities in other EU countries could lead to further migration, compounding structural bottlenecks as labour demand rises.



Following the significant downward adjustment in 2009-10, nominal hourly wages in the whole economy reverted to positive growth in late 2010. Moderate nominal wage growth can be expected in both 2011 and 2012, reflecting higher demand for labour, likely skills mismatches and shortages, and rising inflation, with real wage growth turning positive towards the end of 2011.

### **...as are rapidly rising prices**

After almost a year of negative monthly headline inflation in 2009, prices started increasing again from spring 2010, with HICP inflation reaching 2.7% for 2010 as a whole and spiking by the end of the year. Commodity prices in Estonia remain very responsive to world prices, reflecting a consumption basket highly influenced by food and energy prices, the prevalence of short-term contracts, the price-taker nature of the economy, as well as higher demand in neighbouring countries, notably after a poor harvest in Russia last summer. Tax changes also had a sizeable impact (1 pp.) on average inflation. Nevertheless, inflation (overall index excluding energy, food, alcohol, and tobacco) remained fairly low in 2010. Despite the unusually turbulent time, the impact of the euro changeover of 1 January 2011 was broadly similar to the experience with previous changeovers. Limited euro-related price increases stemmed mostly from service categories.



Looking forward, global commodity prices are expected to bring inflation up to 4.7% in 2011, but would contribute to inflation moderation in 2012. Nevertheless, given the history of relatively high inflation in Estonia prior to the last downturn, there is a risk that current inflation developments may affect expectations, adding to an upward pressure on wages due to skills mismatches. This could hinder competitiveness and, hence, weigh on growth prospects.

### Budget balance – back in surplus, but some deterioration expected

The general government finances reached a marginally positive outcome in 2010, with a surplus of 0.1% of GDP. Although the result was markedly affected by sizeable sales of so-called "Kyoto units"<sup>(75)</sup>, which amounted to 1.0% of GDP in 2010, the outcome was better than previously expected and reflected the considerable adjustment of public finances implemented in 2009-10.

<sup>(75)</sup> An Assigned Amount Unit (AAU) is a tradable 'Kyoto unit' or 'carbon credit' representing an allowance to emit greenhouse gases. AAUs are issued up to the level specified in Annex 1 Party to the Kyoto Protocol. Due to the initial comparison basis, Estonia received a higher quota amount than needed given the current structure of the economy, and is able to sell the surplus of the CO<sub>2</sub> quota allocated for the 2008-12 commitment period.

However, the over-performance in comparison to previous projections was largely a result of a delay in the implementation of planned government investments, including those related to the absorption of EU structural funds.

Notwithstanding the strong improvement in the macroeconomic outlook, public finances are set to deteriorate again, moderately in 2011 and more markedly in 2012, based on the no-policy-change assumption. This is, firstly, the result of a gradual reversal of the consolidation measures that were introduced temporarily in 2009-10 to deal with acute phase the crisis. Secondly, sales of "Kyoto units" and environmental investment obligations related to those sales will continue to strongly affect the profile of public finances over the forecast period. Without these transactions, the headline general government position would have been fairly stable, with deficits of 0.9% of GDP in 2010, 1.0% in 2011 and 1.1% in 2012.

The general government debt will remain very low, projected to increase marginally to 6.9% of GDP by end-2012. It is assumed that deficit will be financed – fully in 2011 and partly in 2012 – by running down previously accumulated financial assets rather than new borrowing.

Table II.6.1:

### Main features of country forecast - ESTONIA

	2009			92-06	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP		13.9	100.0	-	6.9	-5.1	-13.9	3.1	4.9	4.0
Private consumption		7.2	51.9	-	8.6	-5.4	-18.4	-1.9	3.2	3.5
Public consumption		3.0	22.0	-	3.9	3.8	0.0	-2.1	0.3	0.9
Gross fixed capital formation		3.0	21.6	-	6.0	-15.0	-32.9	-9.2	14.9	10.6
of which : equipment		1.0	7.0	-	7.4	-11.6	-44.0	12.9	18.5	10.0
Exports (goods and services)		9.0	64.7	-	1.5	0.4	-18.7	21.7	16.0	6.4
Imports (goods and services)		8.1	58.6	-	7.8	-7.0	-32.6	21.0	16.9	7.1
GNI (GDP deflator)		13.5	97.7	-	5.0	-3.5	-11.1	0.8	3.8	2.9
Contribution to GDP growth :	Domestic demand			-	7.6	-7.9	-20.9	-3.0	4.4	4.1
	Inventories			-	3.0	-4.2	-3.4	4.3	0.0	0.0
	Net exports			-	-5.4	5.7	11.3	1.7	0.4	-0.1
Employment				-1.6	0.8	0.2	-9.9	-4.8	4.2	1.3
Unemployment rate (a)				-	4.7	5.5	13.8	16.9	13.0	11.5
Compensation of employees/f.t.e.				-	24.6	10.1	-3.3	-0.2	4.4	4.0
Unit labour costs whole economy				-	17.4	16.2	1.2	-7.9	3.8	1.3
Real unit labour costs				-	6.2	8.4	1.2	-9.2	1.4	-0.9
Savings rate of households (b)				-	-1.7	3.4	13.3	7.4	7.7	5.4
GDP deflator				-	10.5	7.2	-0.1	1.5	2.4	2.2
Harmonised index of consumer prices				-	6.7	10.6	0.2	2.7	4.7	2.8
Terms of trade of goods				-	4.6	-0.2	-2.6	-1.3	-0.4	-0.2
Trade balance (c)				-	-17.2	-12.2	-3.9	-2.6	-2.6	-3.0
Current-account balance (c)				-	-17.2	-8.8	4.5	2.8	1.8	0.1
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-16.2	-7.7	7.8	6.6	5.4	2.4
General government balance (c)				-	2.5	-2.8	-1.7	0.1	-0.6	-2.4
Cyclically-adjusted budget balance (c)				-	-1.0	-3.8	1.7	2.5	0.3	-2.3
Structural budget balance (c)				-	-1.4	-4.0	-0.2	-0.4	-0.9	-1.1
General government gross debt (c)				-	3.7	4.6	7.2	6.6	6.1	6.9

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Note : Contributions to GDP growth may not add up due to statistical discrepancies.

## 7. IRELAND

Ready for a gradual recovery after facing up to the full costs of the banking crisis

### **Economic activity continues to be weighed down by the aftershocks of real estate bust.**

Adjusting to the large imbalances built during the preceding boom years, economic activity in Ireland slowly recovers. The crisis started with a major correction in the Irish real-estate market and spread to the wider economy, with sharp declines in both employment and real GDP (by end-2010, these were respectively nearly 13% and 12% below their end-2007 levels). It also led to a dramatic deterioration in public finances.

In late 2010, as market confidence dwindled in the wake of large deficits, continued upward revisions of bank losses, and strong deposit outflows, the Irish authorities requested assistance from the European Union and the International Monetary Fund. A financial assistance programme providing for EUR 85 bn in financing over three years was put in place in December 2010. The programme is subject to quarterly reviews of fiscal, financial and structural conditionality and is designed to bring the deficit to below 3% of GDP by 2015, in line with the Council Recommendations to Ireland in the context of the excessive deficit procedure.

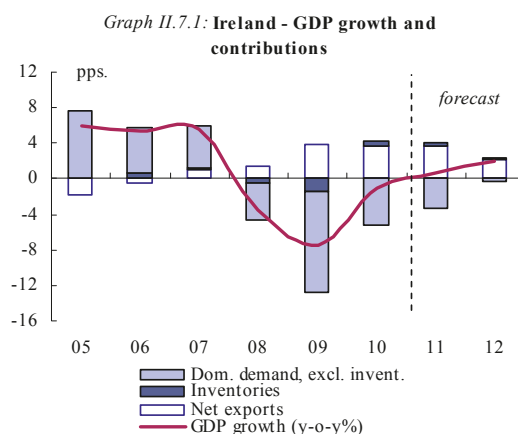
Elections earlier this year brought about a change in government, with a coalition of Fine Gael and the Labour Party. The new government has announced an ambitious strategy for the banking sector following the release of the 2011 vintage of the Prudential Capital and Liquidity Assessments (PCAR and PLAR, respectively). These "stress tests", which were well received as being based on a thorough and aptly conservative methodology, have resulted in an estimated capital need of EUR 24 bn, of which about EUR 19 bn is to be covered by public resources. This would bring the total amount of public support to the banks to around EUR 65 bn, or 42% of 2011 GDP.

### **Strong exports lead return to economic growth**

In 2010, real GDP declined by -1.0%. The extent of the contraction was somewhat larger than anticipated in the autumn forecast, mostly because of larger-than-anticipated imports and a further decline in investment. The lower 2010 base implies a downward revision of the 2011 growth forecast, which is now seen at 0.6%. Growth is still

forecast to accelerate somewhat in 2012. By historical standards (which are inflated by Ireland's successful catching up process and the unsustainable real estate boom) the projected growth is very modest. This reflects the drawn-out adjustment process, during which domestic demand is expected to continue to act as a drag, while exports should continue to drive the recovery.

Following its historic drop in 2009, household consumption continued to contract in 2010 and further moderate declines are expected over the forecast horizon. Households' deleveraging efforts should continue to weigh on their demand throughout the forecast period, while the declines in consumption would also reflect reductions in disposable income on account of higher taxes and increasing mortgage servicing costs, as well as continued subdued labour market developments. Albeit partly offset by positive confidence effects, fiscal consolidation measures will also have a dampening impact.



Gross fixed capital formation declined further by 28% in 2010, and another substantial but smaller reduction is envisaged in 2011, before it stabilises in 2012. While softening, the ongoing downsizing of the construction sector is expected to continue into 2012, also on the back of planned further reductions in public investment. This should be somewhat offset by a moderate pick-up in equipment and machinery investment once confidence has been restored and prospects improve.

Net exports are expected to continue making strong positive contributions to growth throughout the forecast horizon. After holding up reasonably well in 2009, Irish exports increased by 9.4% in 2010, on the back of continued competitiveness gains from contained wage dynamics and strengthening global demand. Similar factors are expected to continue to underpin a solid export performance in 2011-12. Imports have been held back by subdued domestic demand and, while picking up in late 2010, they are not expected to fully offset export growth contribution to overall GDP. The current-account balance is expected to turn into surplus in 2011, for the first time since the early part of the last decade, and to increase over the medium term.

### Risks from de-leveraging will weigh on domestic demand

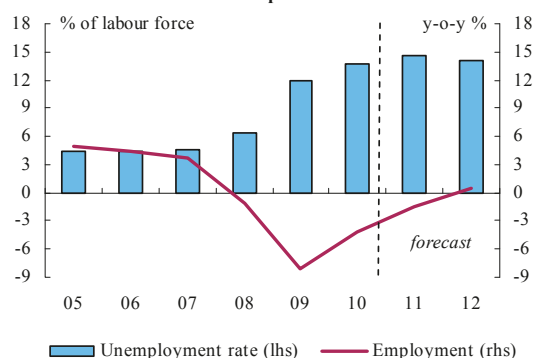
Considerable risks to the outlook remain. On the external side, Ireland's position as a price-taker in international markets implies that export prospects are strongly influenced by exchange rate developments, especially vis-à-vis USD and GBP. Domestically, there is uncertainty on how quickly and strongly positive confidence effects of fiscal consolidation could kick in, eventually supporting domestic demand. Further, a domestic upturn is conditional on the ability of a viable banking sector to extend credit to the economy. Although domestic banks are expected to be adequately capitalised in short order under the banking sector strategy announced by the government on 31 March 2011, it may take some time before new lending activity resumes in earnest, in which case the pace of investment could be slower. A key risk is represented by the elevated sensitivity of household disposable income to developments in interest rates, from both the ECB and heightened risk premia in the euro area periphery per se. The large exposure of Irish households to mortgages on short-term rates means that the effect of the pass-through of higher interest rates on private consumption could be substantial. At the same time, a faster-than-assumed pace of sectoral adjustment might provide support to consumption and investment demand.

### Correction of imbalances key for recovery

Beyond the challenges associated with reigning in and reversing the deterioration of the public finances (see below), the pace of the recovery will also depend on the speed of correction of other

imbalances accumulated in the past. Notably, the forecast assumes progress in the domestic rebalancing of economic activity from construction to more productive sectors, in the clean-up of household and corporate balance sheets as well as further regaining of competitiveness.

Graph II.7.2: Ireland - Labour-market developments



At the peak of the housing market cycle in 2006, the construction sector accounted for over 13% of total employment, nearly double the average share in the euro area. The shrinking of the construction sector and the wider recession have been reflected in a large decline in employment, which has hit young and low-skilled workers hardest. Although the participation rate has fallen and net outward migration has resumed, the rate of unemployment has been revised upward to 14.5% this year, as the stabilising mechanisms of emigration and lower participation have not proved as strong as previously anticipated. The export-led recovery and capital-intensive production in key export sectors imply a very gradual improvement in labour market conditions, lagging more than usual this year's expected return to positive economic growth.

### Price and wage adjustment supports competitiveness and export-led growth

During the domestic boom, Ireland suffered significant losses in competitiveness, as reflected in a strong rise in unit labour costs from 2002 to 2008. Over this period, Irish price levels grew to be among the highest in the euro area. A downward adjustment of prices began in 2009 and negative inflation of -1.6% was recorded in 2010. While inflation is projected to return to positive territory this year and next, it should remain subdued in the absence of strong demand pressures. Inflation of 1.0% this year will be driven by external energy and administered service

increases, while core inflationary pressures remain very weak. Nominal wage adjustment is also taking place, led by corresponding cuts in the public sector now feeding through to the private sector. Wage developments are projected to be very moderate in 2011-12, thereby helping to further recover past competitiveness losses and facilitating sectoral adjustment.

Balance-sheet adjustments are likely to continue to weigh on domestic demand over the next few years. After the steep increase in 2009, the household saving rate remained high in 2010 and is expected to decline only gradually over the forecast horizon. While confidence should improve and reduce precautionary savings, the need of the highly indebted household sector to further deleverage following the end of the housing boom will prevent a more marked drop.

Export growth over the forecast horizon is not projected to show growth in Ireland's market share. To the extent that competitiveness gains materialise, this could provide an upside risk, although this could be offset by the high import content of Irish exports. Overall export developments could be dominated by sector- and even firm-specific developments in chemicals and pharmaceuticals which have a very high weighting in exports.

#### Ambitious but realistic consolidation plans

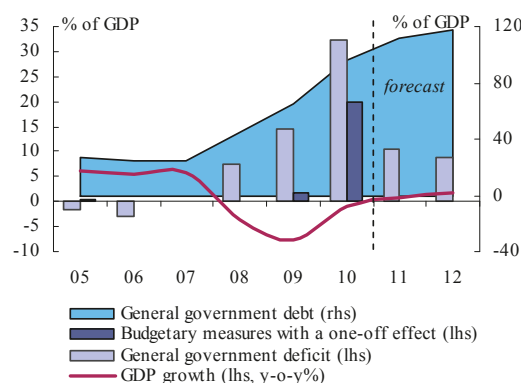
The economic crisis revealed a large structural deficit in Ireland. The substantial fall in tax revenue resulting from the sharp economic downturn was not matched by sufficiently fast adjustment on the expenditure side in 2008 and 2009 and double-digit deficit ratios emerged.

Despite sizeable fiscal consolidation effort of an estimated 8¼% of GDP of permanent measures in 2009-10, the structural balance relative to GDP deteriorated by 3 pps. The structural deficit is estimated at 10½% of GDP in 2010, but is projected to decline over the forecast period as further consolidation efforts are introduced.

In headline terms, the general government deficit reached a record-high level of 32.4% of GDP in 2010, due to large one-off banking sector support measures. The latter mostly reflects promissory notes of 20% of GDP injected into Anglo Irish Bank and two smaller building societies. While the full amount of promissory notes is included in the

government deficit and debt in 2010, the actual borrowing needs related to the notes are spread over a period of 10 years.

Graph II.7.3: Ireland - General government debt and deficit, one-offs and GDP growth



The 2011 budget implemented a consolidation package of almost EUR 6 bn (3¾% of GDP). Based on this, the deficit is expected to narrow to some 10½% of GDP this year, higher than projected by the national authorities due to lower tax revenue in line with macroeconomic developments. Three-quarters of the measures for 2011 are on the expenditure side, including cuts in capital expenditure (1.2% of GDP), savings on purchases (0.6%), lower social transfers (0.5%) and a reduction in public sector employment (0.2%). A reform of the personal income tax system accounts for most of the measures on the revenue side (0.8% of GDP). One-off measures amount to 0.3% of GDP in 2011.<sup>(76)</sup>

In 2012, the deficit ratio is projected to decrease to 8.8% of GDP taking into account broad consolidation measures of 2¼% of GDP outlined in the National Recovery Plan for 2011-14. The expenditure-to-GDP ratio should decline by 1½, taking into account a nominal freeze of expenditure and rates together with consolidation measures of 1¼% of GDP across main expenditure items. Demographic developments and the expiry of one-off measures would have a small expenditure-increasing effect. Despite further tax revenue increasing measures amounting to almost 1% of GDP including carry-over effect of previous measures, the revenue-to-GDP ratio is expected to remain broadly unchanged given lower fees from the bank guarantee scheme and smaller dividends from state bodies after frontloading in 2011.

<sup>(76)</sup> One-off measures include disposal of non-financial assets and higher dividends from state bodies.

A sharp increase in the gross-debt-to-GDP ratio from 66% in 2009 to 96% in 2010 reflects the large primary deficit, including bank rescue measures, rising interest expenditure and falling nominal GDP. Interest rates on the programme's financing are assumed at the levels when the programme was agreed in November 2010. Currently higher market interest rates pose a risk of higher interest expenditure, while a lowering of the margin on EU loans provided as part of the EU-IMF programme would work in the opposite direction. In 2011, gross public debt is projected to reach 112% of GDP, including capital injections into banks of EUR 19 bn (12% of GDP) with a net debt-increasing effect of around 6% of GDP, as

part is covered from Ireland's own resources. These injections are considered in the forecast as financial transactions with no effect on the government deficit. However, some of these capital injections may have a one-off deficit-increasing effect in 2011; this will be established on case-by-case basis post factum by Eurostat. Gross public debt is projected to rise to almost 118% of GDP by 2012. On the upside, debt could be lowered from the proceeds from any sale of the EUR 5 billion-worth in state-owned assets identified for potential sale by the Review Group on State Assets and Liabilities – none of which is included in the current forecast.

Table II.7.1:

**Main features of country forecast - IRELAND**

	2009			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP	159.6	100.0	6.8	5.6	-3.5	-7.6	-1.0	0.6	1.9	
Private consumption	80.8	50.6	5.6	6.3	-1.8	-7.2	-1.2	-1.9	-1.0	
Public consumption	31.3	19.6	4.8	7.3	2.8	-4.1	-2.0	-4.4	-0.4	
Gross fixed capital formation	24.7	15.5	7.8	2.9	-14.3	-31.1	-27.7	-13.5	2.0	
of which : equipment	6.8	4.3	8.1	17.2	-17.4	-22.5	-15.0	6.0	7.0	
Exports (goods and services)	144.8	90.7	11.7	8.2	-0.8	-4.1	9.4	6.0	5.2	
Imports (goods and services)	120.4	75.4	11.1	7.8	-2.9	-9.7	6.6	3.2	4.0	
GNI (GDP deflator)	132.6	83.1	6.4	4.4	-3.5	-11.4	-3.7	-0.3	0.1	
Contribution to GDP growth :										
Domestic demand			5.5	4.9	-3.9	-11.3	-5.5	-3.3	-0.4	
Inventories			0.0	0.0	-0.8	-1.4	0.8	0.2	0.1	
Net exports			1.7	1.1	1.5	3.8	3.6	3.5	2.2	
Employment			3.8	3.7	-1.1	-8.2	-4.1	-1.5	0.4	
Unemployment rate (a)			8.2	4.6	6.3	11.9	13.7	14.6	14.0	
Compensation of employees/head			5.3	5.4	3.4	0.0	-1.9	-0.3	0.7	
Unit labour costs whole economy			2.3	3.4	5.9	-0.6	-4.9	-2.5	-0.9	
Real unit labour costs			-1.4	2.3	7.5	3.6	-2.4	-3.1	-1.8	
Savings rate of households (b)			-	6.4	9.3	16.4	18.0	18.1	16.1	
GDP deflator			3.7	1.1	-1.5	-4.0	-2.6	0.6	0.9	
Harmonised index of consumer prices			-	2.9	3.1	-1.7	-1.6	1.0	0.7	
Terms of trade of goods			-0.3	-2.0	-5.9	4.9	0.2	-0.3	0.5	
Trade balance (c)			20.4	10.5	13.2	20.3	24.2	27.1	28.6	
Current-account balance (c)			0.6	-5.5	-5.6	-3.1	-0.7	1.2	1.8	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			1.0	-5.6	-5.9	-3.4	-1.6	0.9	1.4	
General government balance (c)			0.6	0.1	-7.3	-14.3	-32.4	-10.5	-8.8	
Cyclically-adjusted budget balance (c)			0.2	-1.8	-7.4	-12.0	-30.3	-9.2	-8.5	
Structural budget balance (c)			-	-1.8	-7.4	-10.0	-10.5	-9.5	-8.5	
General government gross debt (c)			54.3	25.0	44.4	65.6	96.2	112.0	117.9	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.



## 8. GREECE

### Rebalancing growth amidst ongoing fiscal consolidation

**Note: This text and the forecast was finalised in early May, ahead of the fourth quarterly review of the Economic Adjustment Programme. It has not been updated to reflect the findings of that review.**

#### Correcting twin fiscal and external deficits weighs on economic activity...

Following the establishment of the three-year Economic Adjustment Programme in May 2010, Greece adopted comprehensive fiscal consolidation measures. These are expected to continue to have a dampening impact on domestic demand, contributing to the correction of the twin fiscal and external deficits. In the short term, fiscal tightening will have a strong contraction impact on economic activity, on the back of cuts in public wages, an increasing tax burden and ensuing declining disposable income and public spending. However, credible fiscal adjustment efforts and determined implementation of structural reforms should boost confidence and improve sentiment.

The recent downward revision of annual real GDP data for 2010 (by almost -0.3 pp. to -4.5%) will have an adverse impact on real GDP dynamics in 2011. Domestic demand remains weak, driven by income losses, the adjustment in the labour market and credit conditions. Underlying inflation, wage settlements and unit labour costs are moderating, leading to improved competitiveness. The progressive rebalancing of the economy, supportive external demand and growth-friendly reforms are expected to move the economy back to its potential growth for 2013 onwards. The inflexion point of activity is estimated to be in the last quarter of 2010.

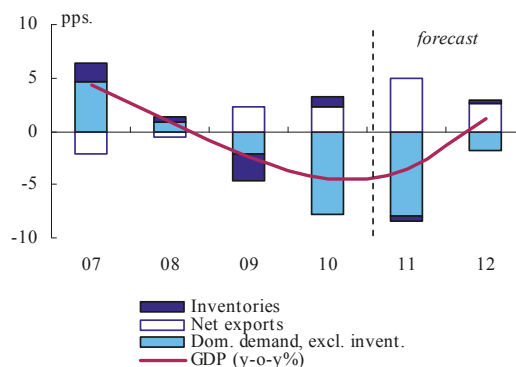
#### Fiscal consolidation is dampening domestic demand further...

For a third consecutive year, economic activity is set to decline. Real GDP is expected to further fall by 3.5% in 2011 – mainly due to heavy carry-over effects coming from 2010 – while growth is expected to turn positive only in the last quarters of the year or later, with the recovery gaining momentum in after 2012.

The contraction of economic activity, reflected in further weakening labour demand, is still weighing

heavily on employment, which is set to fall throughout 2011. Reduced employment opportunities in the private sector, along with the recruitment freeze and cuts in short-term contracts in the public sector, will push the unemployment rate up to above 15% through 2012. The situation in the labour market combined with declining wages should weigh on disposable income over the medium-term, dampening real demand. As a result also of continuing tax uncertainty, private consumption is projected to contract further within the forecast horizon.

Graph II.8.1: Greece - GDP growth and contributions



Tight liquidity and rising non-performing loans are putting strains on the banking system. In line with the slowdown of economic activity and continuing deposit outflow, the annual growth rate of credit to private sector is now slightly negative. Market pressures and high spreads have been keeping up the cost of financing and limiting private sector access to it.

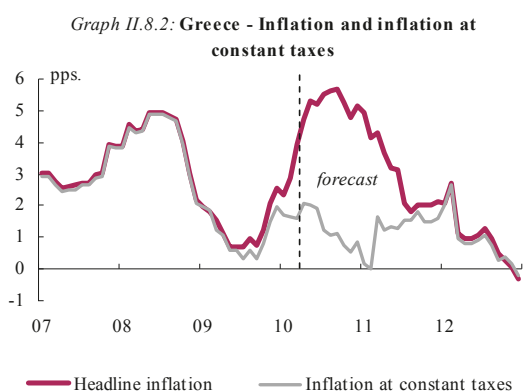
Investment has been falling in recent quarters, in both housing and equipment. Public investment activity is expected to remain particularly depressed in 2011, as a result of continued fiscal consolidation efforts. Several initiatives taken in the public domain – including the acceleration in the absorption rate of the EU Structural Funds resources and the new investment law – are improving market sentiment slightly and would assist a recovery in investment as of 2012.

#### Inflation pressures are fading in response to demand pressures

Inflationary pressures have built up in the course of 2010, fuelled by VAT-rate rises in the



programme and the increase in excise duties on alcohol, tobacco and fuel. Annual inflation in 2010 exceeded 4½% on average. A number of structural reforms targeting the existing inflexibilities in domestic markets would positively affect both inflation and inflation expectations. Looking forward, both headline and core inflation should decline, as base effects and tax effects fade out, and slack in the economy and wage moderation start feeding through.



The labour market is adjusting. There is evidence of strong downward pressure on labour costs, in particular non-basic pay, as the cuts in public sector wages spill over to the private sector and firms endeavour to recover competitiveness, and to absorb indirect taxes in their margins and costs. Employment contracted in 2010 and is projected to decline further by some 2½% in 2011, with the unemployment rate peaking at above 15%. On the other hand, a symmetric faster rebound of employment in the recovery phase is possible, especially if ongoing labour market reforms are implemented as planned, and the economy is successful in swiftly reallocating resources from the non-traded sectors to tradeables. Wage growth is projected to remain very subdued in line with the national collective agreement of July 2010 (for minimum wages, but which also plays a guiding role for other wages as well).

### Structural reforms to improve supply prospects

The adjustment programme for Greece contains a very wide agenda of structural reforms. The aim of these reforms is to improve the supply-side conditions of the economy and increase internal competition and external competitiveness. Their implementation will facilitate the return of the economy to potential growth, while strengthening this potential. In the course of 2010, Greece

adopted two batches of labour market reforms. By July, Parliament had already voted on legislative changes related to overtime pay rates, severance costs, and sub-minima wages for groups at risk, such as young and long-term unemployed. The Government and the social partners also agreed that the minimum wage would be frozen until summer 2012, and then expected to increase in line with expected euro-area inflation. The new labour law of December reforms the mediation and arbitration system and goes in the direction of moving the wage bargaining system towards the firm level, where the firms' growth strategies are decided. The establishment of special firm-level collective agreements could be a promising step towards making the wage-setting system better adapted to reflect the firms' economic conditions.

### ...while the recovery is entirely driven by the external sector

The contraction in domestic demand, which is expected to be sustained over the forecast horizon, is also mirrored by shrinking imports. Total exports, which started to recover already in 2010, will be further enhanced in 2011-12 by labour cost developments and favourable external demand factors as suggested by high-frequency indicators: new industrial orders for the non-domestic market are more dynamic than orders for the domestic market and the gap has been widening since mid-2010.

Exports of goods should rise by around 6% on average in 2011-12, while exports of services – in particular world trade sensitive merchant shipping and tourist receipts – should recover at a faster pace in the wake of a sustained adjustment in prices. All in all, the contribution of net exports to GDP growth should be highly positive in 2011 and 2012, due to both the accelerating pick-up in exports and the ongoing contraction in imports. The current-account deficit is expected to decline to around 8% of GDP in 2011 and to move closer to 6% of GDP in 2012. Expected competitiveness gains and the benefits from ongoing structural reforms may result in an even faster adjustment of the current-account balance.

The risks to this baseline scenario are broadly balanced. On the positive side, the contribution of net exports and investment to GDP growth may turn out to be stronger than projected, should the impact of ongoing and planned structural reforms materialise more swiftly. In particular, the rapid

implementation of measures aimed at enhancing investment opportunities and attract FDI may speed up the recovery. On the negative side, given the usual uncertainty on the inflexion of the cycle, one cannot at the time of the writing exclude the possibility that the economy will take longer than expected to return to positive territory.

### Ongoing fiscal consolidation to be further strengthened in 2011

The 2010 general government deficit published and validated by Eurostat stands at 10½% of GDP, 2¾ pps. of GDP higher than the ceiling established in May 2010 during the setting up of the adjustment programme. The fiscal slippage recorded in 2010 stems from the worse-than-expected revenue performance, which were only partly compensated for by lower expenditure, the sector reclassification of public enterprises and their inclusion in general government, and the significantly worse-than-estimated fiscal position of social security and local authorities. At the same time, the general government consolidated gross debt in 2010 was almost 143% of GDP, up from 127% of GDP in 2009.

The 2011 budget law foresees the implementation of fiscal consolidation measures – including those agreed in May – of some 5¾% of GDP. Around

half of these measures are intended to enhance revenue, and most of them are permanent. The rest comes from spending cuts and includes retrenchment of unproductive and untargeted spending, a reduction in short-term contracts in the public sector, better targeting of universal household subsidies, and better management and use of state assets, particularly in the collection of arrears.

The implementation of fiscal policy in 2011 remains challenging. While the Government has confirmed its commitment to meet the deficit target, fully recouping the slippage of 2010, it has not yet announced any additional measures. Based on current trends and the budgetary execution so far, additional measures will be needed to ensure that the 2011 deficit ceiling is respected. The upward revision of the 2011 budget deficit forecast stems mainly from the tax revenue performance in the first quarter of 2011, the downward revision for the yield of some fiscal measures in the state budget, and a base effect from the worse-than-expected 2010 fiscal outcome.

Table II.8.1:

### Main features of country forecast - GREECE

	2009			92-06	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	235.1	100.0	3.0	4.3	1.0	-2.0	-4.5	-3.5	1.1	
Private consumption	174.0	74.0	3.1	2.8	3.2	-2.2	-4.5	-6.4	-2.2	
Public consumption	48.4	20.6	3.1	8.2	1.5	10.3	-6.5	-2.6	0.1	
Gross fixed capital formation	40.2	17.1	4.3	5.5	-7.5	-11.2	-16.5	-16.6	-1.9	
of which : equipment	18.0	7.6	8.6	22.3	6.6	-11.8	-23.5	-16.0	1.2	
Exports (goods and services)	44.3	18.8	6.3	5.8	4.0	-20.1	3.8	10.7	6.9	
Imports (goods and services)	69.5	29.6	5.8	9.9	4.0	-18.6	-4.8	-8.4	-3.1	
GNI (GDP deflator)	228.6	97.3	2.9	3.4	0.7	-1.5	-4.5	-3.7	1.1	
Contribution to GDP growth :	Domestic demand		3.5	4.6	1.0	-1.8	-7.7	-8.0	-1.8	
	Inventories		-0.1	1.6	0.5	-2.3	0.9	-0.5	0.3	
	Net exports		-0.4	-2.0	-0.5	2.0	2.3	5.0	2.6	
Employment			1.2	1.7	0.2	-0.7	-2.1	-2.6	0.1	
Unemployment rate (a)			9.9	8.3	7.7	9.5	12.6	15.2	15.3	
Compensation of employees/head			7.9	6.1	7.0	3.6	-3.5	-1.0	0.1	
Unit labour costs whole economy			6.0	3.6	6.2	5.0	-1.1	-0.1	-0.9	
Real unit labour costs			-0.2	0.5	2.8	3.7	-3.5	-0.4	-1.3	
Savings rate of households (b)			-	4.4	-0.3	4.2	-0.2	3.2	5.0	
GDP deflator			6.3	3.1	3.3	1.3	2.6	0.3	0.4	
Harmonised index of consumer prices			-	3.0	4.2	1.3	4.7	2.4	0.5	
Terms of trade of goods			0.0	0.8	-3.3	1.0	4.0	-3.6	-0.9	
Trade balance (c)			-15.2	-19.5	-20.4	-16.3	-14.2	-13.0	-12.3	
Current-account balance (c)			-6.3	-15.6	-16.3	-14.0	-11.8	-8.3	-6.1	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-13.3	-14.9	-12.9	-10.1	-6.4	-4.0	
General government balance (c)			-6.5	-6.4	-9.8	-15.4	-10.5	-9.5	-9.3	
Cyclically-adjusted budget balance (c)			-6.6	-7.5	-10.4	-14.9	-8.2	-6.1	-6.6	
Structural budget balance (c)			-	-7.3	-9.5	-14.0	-8.6	-7.4	-7.9	
General government gross debt (c)			97.7	105.4	110.7	127.1	142.8	157.7	166.1	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 9. SPAIN

### Subdued growth despite strong external demand

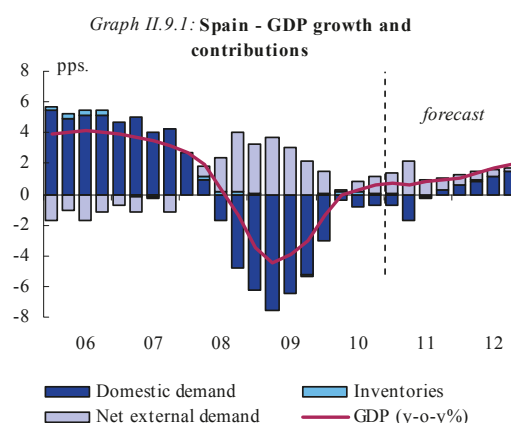
#### Rebalancing of the economy continues as positive growth returns

The Spanish economy experienced a long-lasting housing and credit boom before the financial and economic crisis, which resulted in the build-up of large internal and external imbalances. On the back of strong domestic demand, GDP growth averaged over 3½% per year between 1995 and 2007 and was accompanied by robust job creation. A correction began in early 2007 and was accelerated by the international financial crisis. After seven quarters of negative growth, the economy started to stabilise in the course of 2010, partly due to a positive impulse from world trade. The economic recovery is set to continue and GDP is forecast to grow by 0.8% and 1.5% in 2011 and 2012 respectively. Initially, economic growth should be driven predominantly by external demand, while domestic demand is expected to take over this role by 2012. Assumed higher oil prices and interest rates have prompted some changes in GDP growth projections compared to the autumn 2010 forecast. Despite these negative shocks, GDP growth has been upward revised for 2011 because of even stronger exports. In contrast, these negative shocks have prompted a downward revision of GDP growth in 2012.

Spanish exports grew more strongly than expected in 2010 and should continue to contribute positively to GDP growth going forward. Domestic demand is set to remain weak during 2011 due to the significant deleveraging taking place in all sectors of the economy. High private sector imbalances have accumulated during the housing boom. The sharp correction experienced since 2008 has prompted significant adjustments, including a reallocation of resources away from the construction sector, banking sector restructuring and consolidation, and a sharp increase in the saving rate of private sector, leading to positive net lending capacity for both households and firms. In addition, Spain has embarked on an ambitious fiscal consolidation path necessary to bring the public deficit back to a sustainable level. Domestic demand is forecast to gain some momentum in 2012 on the back of a gradual recovery of private investment and positive, albeit weak, private consumption.

#### Slow recovery of domestic demand

Annual average growth in private consumption turned positive in 2010, driven by some temporary factors, including a VAT increase in July, which prompted households to advance their spending to the first half of the year. Private consumption is set to remain subdued over the forecast horizon due to ongoing deleveraging, moderate wage growth, lower growth of social transfers and benefits, high unemployment, and a projected increase in interest rates (given that 85% of outstanding mortgage loans have variable rates). However, lower job destruction than in 2010 and some increase in private sector wages will underpin moderate growth in gross disposable income in 2011 and a further increase in 2012. In addition, the saving rate of households is expected to fall over the forecast horizon to its long-term average of around 11%, having jumped to 18% in 2009 as households embarked on a rebalancing process. This hike was caused by households increasing their precautionary savings when faced with a very high rise of unemployment. In addition, households tended to save the extra income from the fiscal stimulus. In contrast, temporarily higher inflation in 2011 will reduce real gross disposable income. In addition, a further decline in house prices is set to reduce households' wealth. All in all, households are expected to remain net lenders over the forecast horizon.



Low average capacity utilisation (although with large differences across sectors), tight financing conditions and the still-high indebtedness of the corporate sector, mainly related to the housing market, are weighing on investment growth.

Financing conditions for firms and households – in terms of both the availability and the cost of financing – continue to be tight and are set to remain a challenge in the medium term. This is partly explained by the ongoing restructuring of the banking sector, including the consolidation of the savings banks, which should result in a more sound and resilient banking system and eventually ease the current financing constraints. In addition, expected higher interest rates will put additional upward pressure on financing costs for the private sector over the forecast horizon. Nevertheless, investment is set to gradually improve and to record positive growth rates in 2012. This improvement is expected to come largely from corporate investment. In the last two years, private investment has been driven, almost exclusively, by replacement investment while net investment accounted for just 20% of total corporate investment. The stronger performance of the export sector, mainly in 2011, and the better business environment in 2012 will improve capacity utilisation, especially in export-oriented sectors. Also, the post-boom adjustment in residential investment is forecast to run its course during 2012. Public investment, however, is not expected to return to positive territory over the forecast horizon due to the ongoing fiscal consolidation.

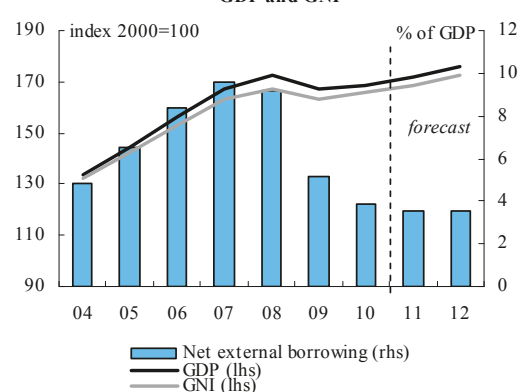
### Strong export performance driving economic growth

Exports grew more strongly in 2010 than initially expected, recording a particularly robust performance in the last quarter. This trend continued in the first few months of this year and is expected to be sustained over the forecast horizon, although at a more moderate pace. The recovery in exports stems mainly from the economic recovery of Spain's main trading partners, growing trade with emerging economies, and some improvement in the competitiveness of the Spanish economy due to declining unit labour costs.

Intermediate goods have been driving the strong export performance so far and they are expected to play a key role also in the future. In addition, tourism is expected to increase more strongly. In terms of geographical diversification, Spanish exports go mainly to other EU economies, which account for over 70% of total exports. While the contribution of extra-EU exports is still relatively low, they increased substantially in 2010,

recording twice the rate of growth of intra-EU exports. The robust export performance may also be explained by the presence of more competitive firms in the export sector as compared to the rest of Spanish economy. These firms tend to be larger, more productive, and characterised by lower unit labour costs. Furthermore, there is also some recent evidence that weaker domestic demand is causing some firms to switch from domestic to external markets, thus increasing the export base of the Spanish economy.

Graph II.9.2: Spain - Net external borrowing, GDP and GNI



Strong export growth combined with less dynamic imports, due to weak internal demand, resulted in a decrease in the trade and current-account deficits. While the adjustment of the external imbalance is expected to continue, supported by strong external demand, the pace of adjustment will be reduced over the forecast horizon due to a higher energy bill.

### Unemployment remains high, while employment picks up by the end-2011

High unemployment will weigh on private consumption over the forecast horizon. The unemployment rate has reached over 20% and is expected to further increase in 2011 due to additional job shedding. This forecast is subject to a high uncertainty given that the active population is being influenced by two opposing forces (the discouraged worker effect – mostly the young workers faced with a very high unemployment – and the additional worker effect – mostly women entering the labour force either as an additional earner or responding to a job loss in the household). First signs of employment creation are expected to appear no earlier than at the end of this year, in year-on-year terms, due to a gradual recovery of the private sector, driven to some

extent by the positive spillovers from exporting firms, and continued wage moderation.

Wages are expected to moderate by historical standards over the forecast horizon due to a wage cut followed by a wage freeze in the public sector, and relatively contained wage growth in the private sector. Recent labour-market reforms have allowed some flexibility for firms to opt out of the collective wage agreements and to introduce changes to working conditions (especially working hours). Creating permanent jobs at a sufficiently fast rate to absorb high unemployment is a key challenge for the Spanish economy. In addition to high cyclical unemployment, resulting from the economic contraction during the crisis and still weak economic growth during the recovery, the number of unemployed has also increased due to the ongoing structural adjustment in the construction sector. In addition, higher rates of long-term unemployment indicate an increase in the structural component of unemployment. Moreover, Spain's labour market is still quite segmented, with high levels of employment protection for permanent contracts and low levels of job security for temporary workers. While the reform of the labour market of June 2010 aims to reduce this duality, changes will inevitably take time.

#### **Some wage moderation despite temporarily higher inflation**

Higher inflation is expected in the first half of 2011 due to higher oil prices and other temporary factors, including the July 2010 increase in VAT, higher duty on tobacco and higher administrative prices (especially electricity). This will result in a relatively large divergence between headline (3%) and core (1.7%) inflation in 2011. Moreover, the differential with the euro area is expected to be positive for processed food and energy. In the second half of 2011, prices are forecast to grow more slowly and inflation is expected to fall to around 2% in December of this year and below that level in 2012.

Unlike previous years, despite temporarily higher inflation, aggregate wages are forecast to grow more moderately in 2011, mainly due to a wage cut in the public sector. That will lead to a second year of decline in unit labour costs (ULC). However, with somewhat higher wage growth in 2012 and a decrease in productivity growth (due to a positive employment growth for the first time

since 2007) ULC are forecast to increase slightly in 2012. All in all, ULC developments in Spain over the forecast horizon should lead to an improvement in Spain's competitive position relative to other euro-area countries.

#### **Risks to the baseline scenario**

The baseline scenario is subject to considerable risks. As external demand remains an important driver of economic growth, any weakening of external demand would have a negative impact on the overall economic recovery. In addition, availability and the cost of financing for firms and households continue to be a possible risk in the medium term, although progress with the restructuring of banks has lowered the risk premium on sovereign bonds. Further progress with banking sector restructuring and fiscal consolidation would boost confidence in the Spanish economy and improve access to, and the cost of, financing. There are also some additional risks on the domestic front. Further delays in employment creation, due to more negative perceptions on the strength and duration of the incipient recovery, would have repercussions for private consumption, hence weakening overall economic growth. Similarly, a higher-than-expected saving rate of households faced with persistent high unemployment may also put additional negative pressure on domestic demand.

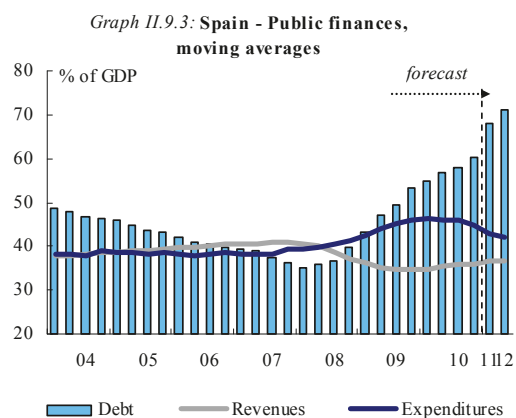
#### **Fiscal consolidation set to accelerate further**

The frontloading of fiscal consolidation delivered a significant correction of the budget balance. The general government deficit was 9.2% of GDP in 2010, down from 11.1% in 2009, and slightly below the government target of 9.3% of GDP. The sizeable reduction compared to 2009 was largely achieved mainly through higher revenue from taxes on production and imports. In particular, VAT revenue surged, mainly due to the increase in VAT rates in mid-2010 and the effect of the 2009 change in VAT returns. This modification of the VAT return system had trimmed down receipts in 2009, which then grew significantly in 2010 following the disappearance of this one-off effect.

The outcome for the different levels of government in relation to their targets has been uneven and the notable over-performance at central government level offset other slippages, mainly by the social security system and regional governments (9 out of



17 autonomous communities breached the budget deficit target of 2.4% of GDP).



This is underpinned by a number of discretionary measures formally adopted in the 2011 budget. These include a freeze in public sector wages and reductions in public investment, which are accompanied by the phasing out of the 2010 stimulus package of around 0.5% of GDP. Achieving the planned expenditure restraint in 2011 will also depend on full compliance with targets by the regional governments.

Based on the unchanged-policy assumption, the 2012 budget deficit is forecast to reach 5¼% of GDP. Amid still-high public deficits and low GDP growth, government debt is set to increase from 60.1% of GDP at the end of 2010 to 71% of GDP in 2012.

In 2011, fiscal consolidation is set to accelerate further. The government deficit is forecast at 6¼% of GDP, slightly above the government projection, due mainly to a less favourable macroeconomic scenario. Total revenues are set to rise by 4¼% in 2011, helped by revenue-increasing fiscal measures in both direct and indirect taxation – such as the increases in VAT rates introduced in mid-2010 – and in excise duties. Total expenditure is expected to decline by close to 3%, implying that it will also shrink as a percentage of GDP.

Table II.9.1:

**Main features of country forecast - SPAIN**

	2009			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP		1053.9	100.0	3.1	3.6	0.9	-3.7	-0.1	0.8	1.5
Private consumption		596.4	56.6	3.0	3.7	-0.6	-4.2	1.2	0.8	1.1
Public consumption		222.8	21.1	3.7	5.5	5.8	3.2	-0.7	-1.4	-0.3
Gross fixed capital formation		253.0	24.0	4.3	4.5	-4.8	-16.0	-7.6	-3.4	1.8
of which : equipment		59.7	5.7	4.6	10.4	-2.5	-24.8	1.8	3.1	4.4
Exports (goods and services)		246.4	23.4	7.6	6.7	-1.1	-11.6	10.3	7.0	5.8
Imports (goods and services)		269.0	25.5	8.4	8.0	-5.3	-17.8	5.4	1.7	3.8
GNI (GDP deflator)		1029.5	97.7	3.0	2.9	0.4	-3.3	0.9	0.5	1.3
Contribution to GDP growth :										
Domestic demand				3.5	4.5	-0.7	-6.4	-1.3	-0.6	1.0
Inventories				0.0	-0.1	0.1	0.0	0.1	0.0	0.0
Net exports				-0.4	-0.8	1.5	2.7	1.0	1.4	0.5
Employment				2.2	2.8	-0.5	-6.6	-2.4	-0.6	0.9
Unemployment rate (a)				13.7	8.3	11.3	18.0	20.1	20.6	20.2
Compensation of employees/f.t.e.				4.0	4.8	6.4	4.1	0.7	0.9	1.2
Unit labour costs whole economy				3.1	4.0	4.9	1.0	-1.5	-0.4	0.6
Real unit labour costs				-0.8	0.7	2.4	0.4	-2.5	-1.5	-0.5
Savings rate of households (b)				-	10.7	13.4	18.0	13.1	11.0	11.0
GDP deflator				4.0	3.3	2.4	0.6	1.0	1.0	1.1
Harmonised index of consumer prices				-	2.8	4.1	-0.2	2.0	3.0	1.4
Terms of trade of goods				0.4	0.1	-2.3	4.1	-4.2	-3.2	-0.8
Trade balance (c)				-4.8	-8.6	-7.8	-4.2	-4.4	-4.2	-4.0
Current-account balance (c)				-3.3	-10.0	-9.6	-5.5	-4.5	-4.1	-4.1
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-2.4	-9.6	-9.2	-5.1	-3.9	-3.6	-3.5
General government balance (c)				-2.4	1.9	-4.2	-11.1	-9.2	-6.3	-5.3
Cyclically-adjusted budget balance (c)				-2.3	1.3	-4.1	-9.2	-7.0	-4.3	-3.9
Structural budget balance (c)				-	1.3	-3.8	-8.6	-7.0	-4.3	-3.9
General government gross debt (c)				55.4	36.1	39.8	53.3	60.1	68.1	71.0

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.



## 10. FRANCE

### Continued recovery increasingly supported by investment

#### **Recovery throughout 2010: stable pace, changing nature**

France came out of the recession in the second quarter of 2009, and the economy recovered further in 2010, with GDP growing on average by 1.6%, at a rather stable pace across quarters. However, the composition of growth changed substantially in the course of the year: private consumption accelerated markedly during the final phase of the government's recovery plan, which supported purchasing power and households' consumption, including through one-off social transfers and a car scrapping premium. Investment growth turned positive in the second quarter after a strong and long correction, against the background of a progressive stabilisation in the construction sector. External trade and inventories proved uneven, broadly offsetting each other: contributions to growth were positive for net exports and negative for inventories in the first and fourth quarters, and vice-versa for the second and third quarters. This can be potentially explained by the importing and subsequent destocking of some equipment goods.

Overall, in spite of the recovery, the expected closure of the destocking cycle has not materialised yet; nevertheless the pick-up in world demand has resulted in a positive contribution of net exports to growth for the first time in ten years. Moreover, unemployment has started to decrease, albeit only slightly. The contraction of employment in industry and construction was only one third as large as its expansion in the services sector, half of which was due to short-time contracts. Subsidised employment increased, but at a much slower pace than in 2009. The impact on the economy of the autumn 2010 strikes against the pension reform has been marginal: less than 0.1% of GDP, mostly linked to lower energy production and exports. While adverse weather conditions in the last quarter contributed to a slowdown in the construction sector, they also boosted heating expenses.

Looking forward, some of the features of the French economy, which have allowed the country to perform much better than the euro-area average during the crisis, are expected to remain assets, like the resilience of private consumption (with substantial buffers due to historically high savings

rates, and a dynamic demography). Nevertheless, other features could moderate the recovery: the relatively large automatic stabilisers, the rather low degree of openness of the economy, and the limited size of the manufacturing sector. This explains why economic growth in 2010 lagged behind levels recorded in those member states with more open and manufacturing-based economies.

#### **Inflationary pressures under control**

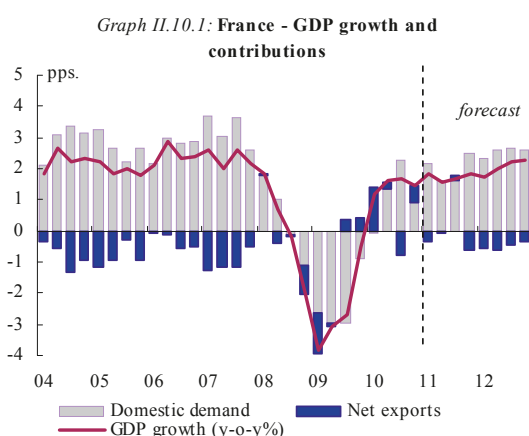
Core inflation is set to accelerate only mildly, from around 1% in 2011 to close to 1½% in 2012. The unemployment level, which stood at 9.5% in March, is expected to decrease by only 1/4 pp. a year over the forecast period. Another factor limiting the likelihood of intense wage bargaining is the new framework for the minimum-wage setting procedure, which has put an end to the practice of discretionary hikes on top of the legal indexation. This is expected to anchor wage expectations downwards, given the high share of employees paid the minimum wage or only slightly above.

The headline HICP (2.2% in 2011) is forecast to stay below levels recorded in some peer countries, due to historically lower contributions of energy to HICP inflation, coupled with the absence of any short-term debate on the energy mix. Moreover, at this stage no significant hikes have been planned for consumption taxes or administered prices. Such decisions seem particularly unlikely until the next electoral round (mid-2012), as recently shown by the cancellation of a gas price increase. However, in the medium-run, the convergence of some prices (e. g. electricity) towards market levels could have some inflationary impact. The current forecast assumes that most of this adjustment takes place after 2012.

#### **Growth acceleration still based on domestic demand, but rebalancing towards investment**

Economic growth is forecast to accelerate at a moderate pace, from 1.6% in 2010 to 1.8% in 2011 and 2.0% in 2012. It would still be driven by domestic demand. However, given the unsteady confidence of private households, as opposed to positive business surveys, some internal rebalancing of domestic demand towards investment is expected. This acceleration of

investment is set to improve employment prospects, notably with fewer job destructions in industry, and a gradual return to job creation in the construction sector. At the same time, the recent general pension reform and cancellation of exemptions to the job search obligation are assumed to boost the active population. All in all, the expected improvement of employment prospects, coupled with disinflation, is in turn set to support a moderate acceleration of private consumption in 2012.



### Private consumption: resilience in spite of inflationary pressures and fiscal consolidation

The pace of private consumption growth is expected to remain broadly stable, with a moderate acceleration in 2012. The substantial increase recorded in the last quarter of 2010 (linked to the end of the car-scrapping premium) implies a strongly positive base effect in 2011. Moreover, in the first quarter, the car-scrapping premium is still expected to support consumption, albeit to a lesser extent, due to the average delay between the orders and the corresponding deliveries. The negative after-effect of the premium is forecast to materialise in the second quarter of 2011, hence a slight decrease in private consumption for this quarter. As weather conditions have normalised compared to the very cold last quarter of 2010, energy consumption is set to decrease in early 2011.

Looking at private consumption in year 2011 as a whole, the positive impact of employment growth is expected to be offset by inflationary pressures, the withdrawal of the recovery plan, and proportionally increasing tax payments (partly due to the reduction in tax spending). In this context, and against the background of limited wage-

bargaining opportunities, real disposable income is forecast to slow down in 2011. However, the households' savings rate is expected to decrease, as it reached historically high levels during the crisis owing to precautionary savings. Consequently, no significant slowdown of private consumption is expected to occur in 2011.

As for 2012, consumption is supported by the acceleration of real disposable income, thanks to disinflation coupled with higher nominal increases in wages and non-labour income, which more than compensate for the effect of a moderate rebound in the savings rate.

### Investment and stocks set to be major growth drivers

Composite business climate indexes are above their long-term averages and increasing, suggesting a continued pace of expansion for the coming quarters.

An acceleration of gross fixed capital formation is therefore expected. Capacity utilisation rates are still slightly below their long-term averages, but rapidly increasing, and bottlenecks will become more likely. French firms anticipate stronger demand, and are set to adapt their supply capacities accordingly (notably through purchases of equipment goods). Moreover, they are expected to complete projects put on hold during the crisis, while financing conditions stay rather favourable. The reform of the local business tax, excluding productive assets from the tax base, is also likely to support investment. However, as financing conditions are forecast to become tighter, manufacturing investment is forecast not to accelerate further in 2012, unlike construction investment, which is set to recover markedly only in 2012. This lagged upswing in the construction sector should be seen against the background of a recent increase of building permits, and low stock levels. A catch-up of public works is also likely, owing to the electoral cycle at the local level.

Together with this expected increase in investment, destocking is expected to slow down markedly, in line with what has been already observed in some other advanced economies (whereas in France the destocking cycle has been of unusual duration and magnitude). The negative contribution of inventories to growth reached almost 2% of GDP in 2009, after a first negative contribution in 2008 (-0.3% of GDP), and no

significant upward contribution in 2010, due to a sharp destocking in the last quarter. Business surveys show that inventory levels are now assessed as low, whereas order books are filling up. Consequently, inventories are forecast to contribute positively to growth in 2011 (in spite of a negative base effect), and even more in 2012.

#### External trade: stabilisation in sight, at last

A striking trend in past years - even before the crisis - has been the constant erosion of export market shares. These market shares are expected to stabilise over the forecast period, as the absence of strong second round inflationary effects allows moderate increases in unit labour costs, of around 1% a year. Non-price competitiveness is likely to benefit somewhat from recent measures aiming at fostering innovation and research. In 2011, foreign demand is set to be driven by a rebound in imports from the US and Germany.

However, the contribution of external trade to GDP growth is set to remain negative: foreign demand addressed to France (the pace of which is broadly stable over the forecast period) is projected to be less dynamic than imports, which are driven by solid domestic demand accelerating in 2012. Against this background, the trade balance is set to deteriorate further in 2012. Overall, the current external deficit is expected to widen to more than 4% of GDP at the end of the forecast period.

#### Risks to the forecast are broadly balanced

Upside risks are mainly linked to the contribution of inventories to growth: although this contribution is projected to be positive, the assumption is only for a marked slowdown of destocking, not a rebuilding of previous stock levels.

There are upside as well as downside risks concerning the decrease assumed for the households' savings rate in 2011, depending on developments in the financial markets and fiscal consolidation, and their consequences and perception by households.

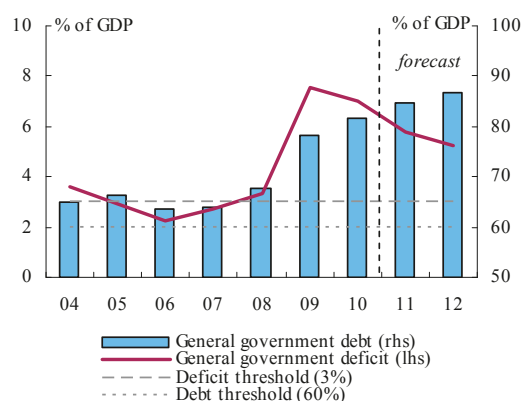
Other downside risks are linked to the recent events in Japan: the structure of French foreign trade shows a relatively small exposure, but the impact of this crisis may materialise through other channels, in view of the importance of Japanese supplies for certain production processes. For

instance, the relatively large French automobile sector could be hit by significant shortages of components.

#### Consolidation year zero

The recovering macroeconomic environment was accompanied by a decrease in the general government deficit, which reached 7% of GDP in 2010, down from 7½% in 2009. The balance of discretionary measures in 2010 is slightly positive (by around ¼% of GDP) and therefore contributed to this improvement: the positive impact of the phasing-out of the recovery plan (some ¾% of GDP) more than offset the new expansionary measures adopted in the 2010 budget, which included the reform of the local business tax (-½% of GDP) and reduced VAT in the catering sector (-0.1% of GDP). In addition, exceptional factors played a role, notably dividends from state-owned enterprises (around 0.1% of GDP).

Graph II.10.2: France - Public finances



The deficit is foreseen to improve in 2011 to around 5¾% of GDP, broadly in line with the official forecast contained in the latest update of the Stability Programme. The improvement is based on the budgetary retrenchment presented by the authorities in the Draft Budget for 2011. These measures consist mainly of tax increases and are expected to increase the tax burden by ¾% of GDP, to around 43½%, among the highest in the euro area and EU. On the expenditure side, the phasing out of the remaining measures of the recovery plan, together with the implementation of the RGPP (General Review of Public Policies) and the recently adopted reform of the pension system, would improve the deficit by around ½% of GDP. Those steps would more than offset the budgetary impact of the public investments related to the

"Investissements d'avenir" programme, worsening the 2011 deficit by around 0.1% of GDP.

The general government deficit is expected to continue to decrease in 2012, albeit only slightly, reaching approximately 5¼% of GDP. The increase in social benefits is set to decelerate thanks to the economic recovery and the improvement of the labour market. New discretionary measures with an impact in 2012, including the reform of the pension system, are also expected to contribute to lowering the deficit. This deficit projection is still significantly above the government's target of 4.6% of GDP included in the latest update of the Stability Programme. Possible additional measures that may support the improvement of the 2012 deficit projected by the French authorities still need to be further specified and could therefore not be taken into account at this stage. In addition, the French authorities anticipate a more favourable economic environment in 2012 than that in this forecast.

The debt ratio is expected to continuously rise over the forecast horizon, close to 90% of GDP in 2012. This rise is related to the still high expected deficits. The "Investissements d'avenir" programme should increase the general government debt by around ¼% of GDP in 2011 and 2012. The increase in debt-service

requirements could crowd out more productive expenditure necessary to further stimulate growth.

The consolidation strategy announced by the French authorities is backed by some structural reforms, targeting the long-term sustainability of public finances and the overall budgetary framework. The reform of the pension system includes a gradual raising of the minimum retirement age from 60 to 62. As for the budgetary framework, the French authorities have announced measures aiming at better monitoring and reaching the objective set for the evolution of healthcare spending. In addition, a constitutional reform has been announced; this notably introduces binding multiannual budget planning. For each year, this lays down a minimum level of fiscal receipts, together with a maximum growth rate of public expenditure, in volume terms. Each year, the annual central government and social security budgets will set targets on both the revenue and the expenditure side in line with those presented in the multiannual budget planning; otherwise the Constitutional Court would not enforce them. Still, local authorities, benefiting from a constitutional autonomy regarding their budgets, would not be constrained by this multiannual budget planning, therefore potentially limiting the impact of the reform. This constitutional reform still needs to be adopted by the Congress.

Table II.10.1:

**Main features of country forecast - FRANCE**

	2009			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP	1907.1	100.0	2.0	2.0	2.4	0.2	-2.6	1.6	1.8	2.0
Private consumption	1112.8	58.3	2.1	2.1	2.6	0.5	0.6	1.7	1.6	1.8
Public consumption	469.8	24.6	1.5	1.5	1.5	1.7	2.7	1.4	0.6	0.3
Gross fixed capital formation	392.1	20.6	2.2	2.2	6.0	0.5	-7.1	-1.4	3.4	5.0
of which : equipment	99.3	5.2	3.1	3.1	9.1	3.5	-9.6	4.1	7.0	7.0
Exports (goods and services)	439.6	23.0	5.2	5.2	2.5	-0.5	-12.4	10.5	6.7	6.6
Imports (goods and services)	476.6	25.0	5.3	5.3	5.6	0.6	-10.7	8.2	6.8	7.5
GNI (GDP deflator)	1922.8	100.8	2.0	2.0	2.6	0.1	-2.8	1.5	1.8	2.1
Contribution to GDP growth :										
Domestic demand			1.9	1.9	3.1	0.8	-0.6	1.0	1.8	2.1
Inventories			0.0	0.0	0.2	-0.3	-1.9	0.2	0.2	0.4
Net exports			0.0	0.0	-0.9	-0.3	-0.2	0.4	-0.2	-0.4
Employment			0.6	0.6	1.6	0.7	-1.2	0.1	0.8	0.9
Unemployment rate (a)			10.0	10.0	8.4	7.8	9.5	9.7	9.5	9.2
Compensation of employees/f.t.e.			2.7	2.7	2.3	2.4	1.6	2.3	2.0	2.3
Unit labour costs whole economy			1.3	1.3	1.5	2.9	3.0	0.8	1.1	1.1
Real unit labour costs			-0.3	-0.3	-1.0	0.3	2.5	0.3	-0.7	-0.8
Savings rate of households (b)			15.3	15.3	15.2	15.1	16.0	15.9	15.3	15.7
GDP deflator			1.6	1.6	2.5	2.6	0.5	0.5	1.8	1.8
Harmonised index of consumer prices			1.8	1.8	1.6	3.2	0.1	1.7	2.2	1.7
Terms of trade of goods			0.0	0.0	1.5	-1.2	2.3	-3.5	-1.3	0.9
Trade balance (c)			0.4	0.4	-2.1	-2.8	-2.2	-2.6	-3.1	-3.3
Current-account balance (c)			0.6	0.6	-2.2	-2.7	-2.9	-3.5	-3.9	-4.2
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			0.6	0.6	-2.1	-2.7	-2.8	-3.2	-2.9	-2.9
General government balance (c)			-3.4	-3.4	-2.7	-3.3	-7.5	-7.0	-5.8	-5.3
Cyclically-adjusted budget balance (c)			-3.7	-3.7	-3.7	-3.4	-5.6	-5.1	-3.9	-3.7
Structural budget balance (c)			-	-	-3.8	-3.5	-5.6	-4.9	-3.9	-3.7
General government gross debt (c)			57.1	57.1	63.9	67.7	78.3	81.7	84.7	86.8

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 11. ITALY

### Slow recovery continues

#### **A moderate recovery under way**

Italy is experiencing a moderate recovery after the severe output loss recorded during the 2008-09 crisis. Over the forecast horizon, real GDP is not expected to accelerate as long-standing structural weaknesses are set to continue weighing on Italy's economic growth prospects.

In 2010 as a whole, real GDP expanded by 1.3%. In quarterly terms, real GDP growth reached 0.5% in the first two quarters and then eased to 0.3% and 0.1% in the two subsequent quarters.

A strong expansion of external demand, particularly in the first half of the year, generated a rebound in export volumes, which led the recovery. Together with tax incentives that expired in June, external demand also supported investment in equipment. But investment in construction continued to decline in 2010 due to the protracted weakness of the property market and a strong contraction in government capital spending.

Exports of goods grew significantly faster than exports of services. However, driven by the upturn in investment in equipment and the significant upswing in stockbuilding, merchandise imports, especially of intermediate goods, outpaced exports. As a result, net exports provided a negative contribution to real GDP growth in 2010.

Despite improved financial market conditions, private consumption dynamics were muted throughout 2010 also due to a still-fragile labour-market situation. While overall private consumption rose compared to 2009, expenditure on durable goods, which until the end of 2009 had benefited from tax incentives to buy energy-efficient goods, declined.

#### **Exports to be the main growth driver also in 2011-12**

Real GDP is expected to grow by 1.0% in 2011 and 1.3% in 2012, around ½ pp. below the euro-area average in each year. In quarterly terms, real GDP growth is forecast to be modest in the first quarter of 2011 and accelerate thereafter, to around 0.3-0.4% q-o-q until the end of 2012.

Supported by sustained external demand, exports are set to continue driving the recovery in 2011-12. Although there is evidence of a gradual shift in their geographical orientation towards fast-growing emerging markets, Italian exports are still mainly dependent on demand prospects in euro-area partners. Export growth rates are thus set to remain below those of global demand. As imports are forecast to grow slightly less than exports in 2011-12, on the back of slow domestic demand dynamics, net exports are projected to make a small positive contribution to real GDP growth in both years.

External demand is expected to continue supporting investment in equipment, which will also benefit from improved profitability. At the same time, however, still low levels of capacity utilisation in industry and the need for further balance-sheet adjustment, notably within small and medium-sized enterprises, will limit the scope for new investment.

Investment in construction is projected to continue contracting in 2011 and return to modest positive growth only in 2012. While investment in residential building is expected to pick up as housing market conditions improve, government investment spending is set to continue declining over the forecast horizon as part of the budgetary consolidation strategy.

Private consumption growth is forecast to remain moderate in 2011-12, as labour market conditions are expected to improve only gradually and higher inflationary pressures are set to dampen the increase in real disposable income.

Risks to the outlook for the Italian economy appear somewhat tilted to the downside. In particular, inflation could prove higher than anticipated due to the effects of the ongoing geopolitical tensions in the MENA region on energy prices, with negative spillovers mainly on private consumption. Moreover, a more marked rise in interest rates than currently assumed by financial markets could adversely affect firms' investment decisions.

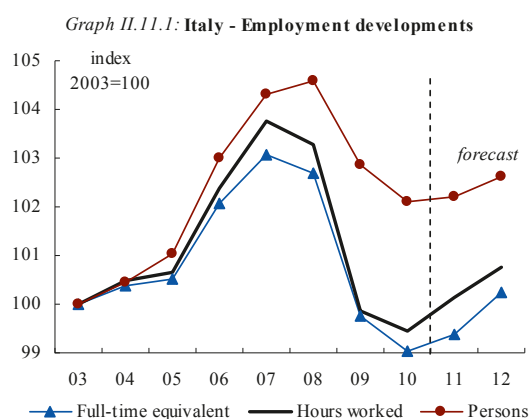
#### **A mild recovery in headcount employment**

In 2010, employment declined further, although by less than in 2009. Over 2009-10, the negative



impact of the crisis was more pronounced on full-time equivalent than on headcount employment (in cumulative terms -3.6% as against -2.3%) because firms chose to hoard labour through the wage supplementation scheme (CIG), whereby employees stop working or reduce hours worked but keep their job at reduced pay. Throughout the crisis, requests to access this scheme rose steadily. However, the composition shifted from ordinary CIG benefits to special ones under an extended CIG scheme covering longer inactivity spells and workers otherwise ineligible by reason of sector, firm size or type of employment contract.

Over the forecast horizon, firms – in particular in manufacturing – are expected to reabsorb employees benefiting from the CIG scheme before starting to hire new workers. Therefore, the gradual recovery in output is assumed to translate first into an expansion of hours worked and only at a later stage in additional headcount employment, which is set to start rising marginally in 2011 and accelerate somewhat in 2012.



Reflecting the moderate decline in headcount employment and a shrinking labour supply in response to depressed labour market conditions, the unemployment rate increased only gradually over 2009-10, stabilising at around 8½% at the end of 2010. However, the youth unemployment rate rose by more than 6 pps. over the same period, exceeding 28% in the first months of 2011. Also long-term unemployment<sup>(77)</sup> as a share of total unemployment soared by over 4 pps. in 2010, to 48.5%. Over the forecast period, the total unemployment rate is set to remain above 8% on account of the modest recovery in headcount employment.

<sup>(77)</sup> People having sought a job for more than 12 months.

As in 2009 the contraction in real GDP was much sharper than the fall in employment, the decline in labour productivity already under way since 2008 intensified. In 2010 further job losses, together with the moderate GDP recovery, implied a rebound in productivity. As labour market conditions are expected to improve slowly, productivity is forecast to rise mildly in 2011-12, in line with its pre-crisis trend.

Beyond the increases in contractual wages in line with projected HICP inflation excluding imported energy, as foreseen in the reformed wage-bargaining framework, weak labour-market conditions and productivity developments are poised to leave little scope for additional wage increases at the level of firms or sectors. As a result, after remaining broadly constant in 2010, unit labour costs are expected to increase only moderately in 2011-12. The projected evolution of unit labour costs over the forecast horizon, however, would not be sufficient to allow Italy to regain competitiveness vis-à-vis the rest of the euro area.

### Energy prices drive inflation up in 2011

After a sizeable decline in 2009, HICP inflation increased to 1.6% on average in 2010. The acceleration of prices in the last quarter of 2010 was mainly due to the dynamics of the energy component, amplified by a low base effect from 2009.

In 2011, mainly due to significantly higher energy prices, inflation is expected to continue increasing in the first half of the year and reach 2.6% on average, in line with the euro-area average. No major second-round effects from higher commodity prices are expected, thanks to still-weak demand and the inflation benchmark of the reformed wage-bargaining framework. As a consequence, core inflation is set to rise more mildly (1.8%, up from 1.5% in 2010). In 2012, as oil prices are expected to stabilise, the energy component of the HICP is set to decelerate significantly and both headline and core inflation are forecast at 1.9%.

As the Italian economy is highly dependent on imported energy, the marked rise in import prices worsened the terms of trade and led to a significant deterioration in the trade balance and thus in the external deficit in 2010. According to national accounts data, the external deficit reached around



3% of GDP in 2009 and 4¼% in 2010. According to recent balance-of-payments figures calculated by the Bank of Italy, the external deficit is estimated to be around ¾% of GDP lower in both years, due to a smaller deficit in the balance of primary income. External balance projections for 2011-12 incorporate the revised primary income statistics.<sup>(78)</sup> Over the forecast horizon, the external deficit is forecast to remain between ¾% and 3½% of GDP.

### Fiscal consolidation gains traction

After deteriorating in 2008-09 largely due to the effect of automatic stabilisers, the situation of Italy's public finances improved in 2010. The general government deficit narrowed to 4.6% of GDP in 2010, from 5.4% in 2009, mainly thanks to a decline in expenditure, and the primary balance remained only marginally negative.

Consolidation measures adopted in previous years helped to curb capital and current spending in 2010. As a share of GDP, current primary expenditure decreased by over 1 pp. Regarding the wage bill, very moderate increases in contractual public wages were granted, although some arrears were paid, while constraints to recruitment brought about a decline in payroll numbers. Government consumption for health services was kept in check also by measures to reduce the cost of pharmaceutical products. Social transfers rose only marginally as a share of GDP since pension expenditure reflected indexation to a subdued 2009 inflation rate, while transfers to the unemployed remained elevated, in particular due to those granted on an ad hoc basis through the extension of the CIG scheme. Interest expenditure fell further (to 4.5% of GDP) due to historically low short-term interest rates. Capital spending declined substantially in 2010 given the temporary impact of some recovery measures adopted in 2009. As a result, total expenditure fell by around 0.5% y-o-y and 1¼ pps. of GDP, to 50.6%.

Revenues declined by around ½ pp. of GDP in 2010, to 46.0%. Capital taxes were more than halved in 2010, mostly due to the scaling back of one-off measures. By contrast, current tax revenues rose by around ¼ pp. of GDP thanks to the recovery in indirect taxes, also supported by the larger-than-anticipated proceeds of a measure

adopted in 2009 that prohibits the offsetting of tax dues with unaudited tax credits above EUR 15 000. Direct taxes were broadly flat in terms of GDP, with positive developments in personal income taxes – also boosted by a deferred tax payment from 2009 – and some recovery in corporate taxes. In contrast, withholding taxes paid by households on bank deposit interests plunged.

The deficit is expected to continue declining over the forecast horizon, by around ½ pp. of GDP in 2011 and a further ¾ pp. in 2012. This outlook incorporates the multi-annual consolidation packages covering 2011 and 2012 in place, but with a more cautious assessment of the effectiveness of some of the measures to combat tax evasion and a smaller decline in capital expenditure.

In 2011, current primary expenditure is again set to grow less than nominal GDP. The ½ pp. of GDP fall from 2010 is almost entirely due to compensation of employees, which is affected by a freeze of nominal wages to their 2010 levels, accompanied by further restrictions on recruitment. Intermediate consumption is set to grow modestly in 2011, as strict limits on transfers to regional and local governments are assumed to curtail their purchases of goods and services. Social transfers are expected to increase in line with nominal GDP growth, as access to retirement has been postponed by several months while outlays related to the weak labour market are set to decrease. Capital spending is expected to drop by almost ½ pp. of GDP, with half of this fall explained by the planned sale of broadband licences, recorded as one-off disposal of government assets. Interest expenditure is anticipated to start growing again as a share of GDP. Overall, total expenditure is set to decline to around 50% of GDP in 2011.

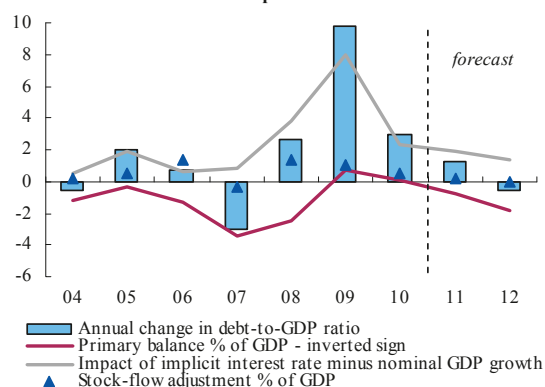
Revenues from current taxes are projected to increase broadly in line with nominal GDP in 2011, essentially thanks to indirect tax proceeds, while direct taxes are negatively affected by the postponement of some personal income tax payments to 2012. Capital revenues are expected to continue falling, mainly due to fading one-off capital tax proceeds. Total revenues are set to remain stable as a share of GDP.

As a result, the primary balance is projected to return to surplus in 2011, at around ¾% of GDP, whereas the headline deficit is expected to decrease to 4% of GDP. In 2012, the deficit is set

<sup>(78)</sup> This creates a break in the series in 2011. The balance of payments figures are expected to be incorporated in revised national accounts data later in 2011.

to decline further, to 3.2% of GDP, and the primary surplus to expand to almost 2% of GDP. After improving by  $\frac{3}{4}$  pp. of GDP in 2010, the structural deficit is expected to narrow by about the same amount over the rest of the forecast horizon.

Graph II.11.2: Italy - Drivers of debt developments



protracted restraint in local spending. Interest expenditure is set to increase further, to 5.1% of GDP.

Current revenues are expected to rise slightly more than nominal GDP in 2012, thanks in part to the above-mentioned postponement of personal income tax payments, whereas capital revenues are set to recover some of the previous years' losses.

Gross government debt as a share of GDP rose by a further 3 pps. in 2010, to 119%. The impact of the difference between the implicit interest rate paid on debt and nominal GDP growth – the so-called snowball effect – was the main contributor, together with the further accumulation of liquidity held by the Treasury with the Bank of Italy and loans to Greece, affecting the stock-flow adjustment. The debt ratio is set to peak at around 120 $\frac{1}{4}$ % of GDP in 2011 and then decline thanks to the increasing primary surplus.

In 2012, current primary expenditure is projected to increase by 1 $\frac{1}{4}$ % relative to 2011, resulting in a drop of  $\frac{3}{4}$  pp. of GDP. Compensation of employees is set to remain constant in nominal terms, while intermediate consumption is assumed to continue increasing at a moderate pace. Capital spending is expected to be held back mainly by the

Table II.11.1:

**Main features of country forecast - ITALY**

	2009			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP		1519.7	100.0	1.4	1.5	-1.3	-5.2	1.3	1.0	1.3
Private consumption		912.3	60.0	1.3	1.1	-0.8	-1.8	1.0	0.6	1.1
Public consumption		326.2	21.5	0.8	0.9	0.5	1.0	-0.6	-0.4	0.1
Gross fixed capital formation		289.7	19.1	1.5	1.7	-3.8	-11.9	2.5	2.2	3.1
of which : equipment		121.2	8.0	2.2	3.1	-5.0	-16.3	10.5	5.1	4.7
Exports (goods and services)		362.4	23.8	4.4	4.6	-4.3	-18.4	9.1	6.0	5.7
Imports (goods and services)		368.7	24.3	3.9	3.8	-4.4	-13.7	10.5	4.6	5.1
GNI (GDP deflator)		1496.9	98.5	1.5	1.0	-2.2	-5.2	1.5	1.7	1.3
Contribution to GDP growth :										
Domestic demand				1.2	1.2	-1.2	-3.3	0.9	0.7	1.3
Inventories				0.1	0.1	-0.2	-0.6	0.7	-0.1	-0.1
Net exports				0.1	0.2	0.0	-1.3	-0.4	0.3	0.1
Employment				0.3	1.0	-0.4	-2.6	-0.7	0.4	0.9
Unemployment rate (a)				9.6	6.1	6.7	7.8	8.4	8.4	8.2
Compensation of employees/f.t.e.				3.3	2.4	3.8	1.5	2.0	1.5	1.8
Unit labour costs whole economy				2.3	1.9	4.8	4.3	0.0	0.9	1.3
Real unit labour costs				-0.8	-0.7	2.0	2.0	-0.6	-0.7	-0.5
Savings rate of households (b)				18.6	14.8	15.2	14.9	13.4	13.2	13.1
GDP deflator				3.1	2.6	2.8	2.3	0.6	1.6	1.8
Harmonised index of consumer prices				3.0	2.0	3.5	0.8	1.6	2.6	1.9
Terms of trade of goods				-0.4	1.5	-2.9	8.0	-3.0	-1.9	0.5
Trade balance (c)				1.7	0.2	-0.1	0.1	-1.3	-1.5	-1.3
Current-account balance (c) (d)				0.4	-1.8	-3.2	-3.0	-4.2	-3.5	-3.3
Net lending(+) or borrowing(-) vis-à-vis ROW (c) (d)				0.5	-1.7	-3.2	-2.9	-4.2	-3.5	-3.2
General government balance (c)				-4.7	-1.5	-2.7	-5.4	-4.6	-4.0	-3.2
Cyclically-adjusted budget balance (c)				-4.9	-3.0	-3.2	-3.2	-2.9	-2.6	-2.2
Structural budget balance (c)				-	-3.1	-3.4	-3.9	-3.1	-2.7	-2.3
General government gross debt (c)				111.8	103.6	106.3	116.1	119.0	120.3	119.8

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

(d) Break in the series in 2011 as the forecast incorporates the recent revision of Italy's balance of payments made by the Bank of Italy that is not yet reflected in historical National Account data.

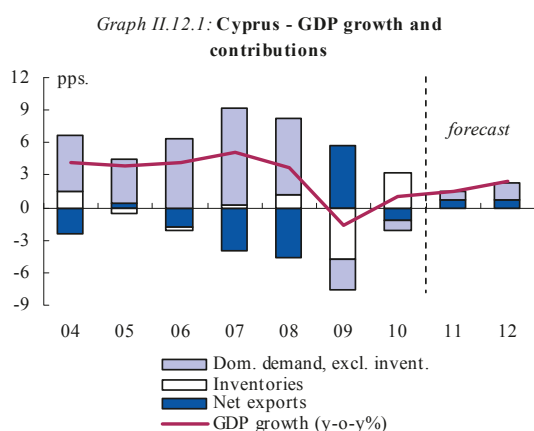
## 12. CYPRUS

### Imbalances weighing on the economic recovery

#### Moderate and rebalanced recovery in 2010...

The Cypriot economy exited the recession in the first half of 2010, with growth recovering at a stable pace throughout the year. Annual GDP growth averaged 1%.

Domestic demand (excl. inventories), hitherto the key driver of growth, continued to shrink, albeit at a slower pace than in the previous year. Despite tighter lending and adverse labour-market conditions, private consumption picked up moderately, on the back of continued wage growth and somewhat improved confidence. Public consumption also supported growth. Nevertheless, with lacklustre foreign demand for housing and the restructuring of corporate balance sheets, investment remained on a downward path. Inventory accumulation provided a considerable positive impulse to economic activity, after the large destocking that took place in 2009.



On the other hand, the improvement in the external environment also led to significant growth in exports of goods. Tourism receipts posted a mild recovery after a strong decline in 2009. Moreover, financial intermediation and business services continued to grow solidly. Inventory build-up and one-off factors, such as the import of buses and other equipment, led to growing imports, after a significant correction during the previous year.

The downward adjustment of the labour market continued in 2010 also, with the impact concentrated in labour-intensive sectors such as construction and trade. The unemployment rate

remained on a rising trend, averaging 6.5%, up from 5.3% in 2009.

#### ...is expected to continue in 2011, gain momentum in 2012...

The recovery of economic activity is projected to continue into 2011 and to gain momentum in 2012. During this period, the contribution of the external sector in growth composition is set to gain ground. Exports of goods and services, mainly financial and business services, should pick up in line with a rebound in global trade and an improved outlook in Cyprus' main trading partners. Also, tourism is expected to benefit from political developments in other competing Mediterranean destinations. Imports are projected to recover and to resume growth in line with domestic demand. The latter should expand moderately, driven by recovering private consumption, on the back of an improving labour market outlook and continued wage growth. However, weak foreign and domestic demand for housing is likely to continue to weigh on the construction sector. Although construction other than housing, such as infrastructure projects, should support investment, this would not be sufficient to fully offset the impact of the fall in housing demand on total construction investment. Investment in equipment is also projected to remain on a downward trend.

The strengthening economic outlook is expected to benefit the Cypriot labour market. Consistent with improving economic conditions, employment is projected to recover modestly while unemployment should ease gradually from its peak at the end of last year.

#### The external imbalance weighs on the economic recovery...

Given this economic outlook, the challenge for the Cypriot economy is to achieve a balanced growth path, leading to further correction of the large negative balance on the external account, in a context of higher potential growth.

Due to the economic slowdown, the current-account deficit almost halved between 2008 and 2010. The reduction would have been even more pronounced in the absence of one-off factors and rising oil prices, which affected 2010. It is

noteworthy that this improvement took place in tandem with a significant deterioration of the fiscal position. This implies a significant improvement in the private sector's balance sheet, following years of rising indebtedness and rapid credit expansion in the pre-crisis years. The substantial savings of the private sector are reflected in subdued consumption, shrinking investment and, consequently, lower growth.

However, the current-account deficit is still large, especially given the subdued economic activity. Significant dissavings of the public sector may be financed by either increasing foreign debt or a further rise in domestic private savings. The latter would entail lower output growth by crowding out private consumption or investment. In the medium term, the deficit is set to continue to improve, but at a moderate rate, reflecting lower GDP growth.

Competitiveness developments are important in determining how sustainable the adjustment of the external imbalance will be. Given the cyclical impact on productivity, wage developments are crucial in safeguarding the country's competitive position in price terms. In particular, it is envisaged that average annual compensation per employee will exceed projected productivity growth over the forecast period. Specifically, the wage indexation mechanism (Cost of living allowance; COLA), which adjusts wages to inflation over the previous 6 months, should exert upward pressure on wage levels in 2011. Productivity growth is expected to remain subdued, in line with moderate activity and rising employment. As a result, unit labour costs may rise by more than the average in the euro area. All in all, the disconnection between wage growth and productivity gains is undermining the competitiveness of the Cypriot economy.

Inflation is projected to rise to almost 3½%, in line with prices of imported oil, on which Cyprus is highly dependent, the impact of the VAT hike on foodstuffs and pharmaceuticals and the gradual recovery of domestic demand. In 2012, inflation is expected to move closer to its trend at 2¼%. Core inflation is likely to remain contained and approach the euro-area average in 2012.

Overall, risks appear to be balanced. Demand may strengthen beyond expectations should growth of Cyprus' major trading partners surprise on the upside or should improved confidence and

employment conditions lead to higher private consumption. MENA-area turmoil may strengthen further Cyprus' status as a regional safe-haven through the tourism, trading and shipping channels. Investment may be sustained through various announced construction and infrastructure projects. However, risks associated with adverse spillovers from Greece, particularly in view of the large exposure of the financial sector, are not negligible. Moreover, further oil price hikes, on which Cyprus is highly dependent, would weigh on growth. Furthermore, a tightening of credit conditions, coupled with the already higher financing costs and the high indebtedness of private agents, could delay the rebound in consumption and investment.

#### **...and so does the fiscal deficit**

Public finances in Cyprus deteriorated substantially as a result of the global economic crisis and discretionary fiscal stimulus measures, as well as rather large composition effects due to a less tax-rich GDP growth pattern. As economic growth rebalances towards a more export-oriented pattern, this may complicate consolidation efforts.

The budgetary deficit in 2010 declined to 5.3% of GDP from 6% the previous year. This is lower than the estimated outturn in the 2011 Budget Law for a deficit of 5.9%. In 2010 however, revenues benefited from a one-off factor of almost ¾ pp. of GDP, associated with the profit on an interest-swap agreement and a transfer of higher-than-usual Central Bank profits. The structural deficit fell to about 5% in 2010 from 5¾% of GDP in 2009.

These changes reflect higher revenues, which were partially offset by higher expenditure. On the one hand, direct tax revenues benefited from the lagged impact of the deemed dividend distribution fee.<sup>(79)</sup> Indirect tax revenues were supported by rise in the excise duties of petroleum products imposed in mid-2010, while social contribution revenues were boosted by the first full-year impact of the increased contribution rates adopted in the first half of the 2009 as part of the pension reform. On the other hand, current expenditure continued to rise, despite the containment of public consumption and interest payments, on the back of rising social outlays due to the increase in unemployment benefits and the enactment of other social policy measures.

<sup>(79)</sup> a 15% special contribution on the 70% of undistributed corporate profits realised in the last two years

For 2011, the Budget Law targeted a deficit of 5.4% of GDP, on the basis of an estimated deficit for 2010 of 5.9%. With a view to reducing the budget deficit in line with the Council's recommendations, the Cypriot authorities adopted both a fiscal consolidation package together with the Budget yielding an estimated consolidation impact of 1 pp. of GDP, out of which 0.6 pp. of GDP is on the revenue side and permanent in nature. At the same time, the coalition parties agreed on an additional package that was expected to be voted on by the Parliament last February and to yield an additional 0.6 pp. of GDP of consolidation in 2011, based on both revenue-supporting and expenditure-containing measures. The aforementioned consolidation packages, taken at face value, would have improved both the headline and the structural balance by 1.6 pps. of GDP, bringing the 2011 deficit down to 3.8%. However, at the current juncture, the latter package has been only partially implemented. In particular, only the bank levy has been adopted, although now as a permanent rather than as the temporary two-year measure first contemplated. The measures concerning the harmonisation of water pricing and savings from the public sector's wage moderation are still under discussion.

The present projection is for a deficit of 5.1% of GDP for 2011. This projection, taking into account

the one-off impact of measures adopted in 2010, incorporates a more prudent assessment of revenue prospects, given a less tax-rich growth composition, and possible overruns on the expenditure side, in view of past trends on key items such as the wage bill and social transfers. It also includes expenditure-increasing measures taken in the first quarter of the current year, such as: (i) 'social' measures to mitigate the impact of the VAT rise on foodstuffs and pharmaceuticals (0.13 pp. of GDP); (ii) support to Cyprus Airways (0.11 pp.); and (iii) compensation paid to the personnel of the failed Eurocypria airlines (0.04 pp.). Moreover, measures which are still under discussion with an uncertain outcome, or with no information on the modalities or the timing of implementation are not taken into account.

Based on the no-policy-change assumption, the deficit is set to subside marginally to 4.9% of GDP in 2012, due to minor savings on the public wage bill from the lower contribution from the COLA and the social outlays in line with an improvement in the labour market. With still moderate growth and an increasing deficit, the debt-to-GDP ratio should remain on a rising trend and reach about 64% of GDP by 2012.

Table II.12.1:

**Main features of country forecast - CYPRUS**

	2009			92-06	Annual percentage change					
	mio EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP		16945.7	100.0	4.3	5.1	3.6	-1.7	1.0	1.5	2.4
Private consumption		11538.6	68.1	-	9.4	7.1	-2.9	0.8	1.4	2.2
Public consumption		3364.4	19.9	-	0.3	6.2	5.8	0.5	3.0	1.8
Gross fixed capital formation		3486.7	20.6	-	13.4	6.0	-9.1	-7.9	-3.9	-0.8
of which : equipment		983.6	5.8	-	11.9	12.7	-9.3	-12.0	-5.0	1.0
Exports (goods and services)		6824.2	40.3	-	6.1	-0.3	-11.3	0.6	4.1	4.3
Imports (goods and services)		7720.3	45.6	-	13.3	8.1	-19.3	3.1	2.2	2.5
GNI (GDP deflator)		16640.9	98.2	4.1	3.9	3.0	3.1	0.3	1.6	2.4
Contribution to GDP growth :	Domestic demand			-	8.8	7.1	-2.9	-1.0	0.8	1.7
	Inventories			-	0.3	1.1	-4.7	3.3	0.0	0.0
	Net exports			-	-4.0	-4.5	5.7	-1.4	0.7	0.6
Employment				-	3.2	2.8	-0.7	-0.3	0.2	0.8
Unemployment rate (a)				-	4.0	3.6	5.3	6.5	6.3	5.6
Compensation of employees/head				-	3.0	2.3	3.2	2.8	3.8	3.2
Unit labour costs whole economy				-	1.1	1.5	4.3	1.5	2.5	1.7
Real unit labour costs				-	-3.4	-3.4	4.6	-0.5	-0.6	-0.4
Savings rate of households (b)				-	7.9	6.5	9.1	-	-	-
GDP deflator				3.2	4.6	5.1	-0.3	2.0	3.1	2.1
Harmonised index of consumer prices				-	2.2	4.4	0.2	2.6	3.4	2.3
Terms of trade of goods				-	0.6	-2.5	2.7	-0.7	-0.2	0.0
Trade balance (c)				-	-29.7	-31.9	-25.0	-26.7	-27.0	-27.2
Current-account balance (c)				-	-11.6	-17.0	-7.9	-8.9	-8.1	-7.2
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-11.6	-16.9	-7.6	-8.7	-7.9	-7.1
General government balance (c)				-	3.4	0.9	-6.0	-5.3	-5.1	-4.9
Cyclically-adjusted budget balance (c)				-	2.7	-0.1	-5.5	-4.6	-4.5	-4.7
Structural budget balance (c)				-	2.7	-0.1	-5.8	-5.1	-4.6	-4.8
General government gross debt (c)				-	58.3	48.3	58.0	60.8	62.3	64.3

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

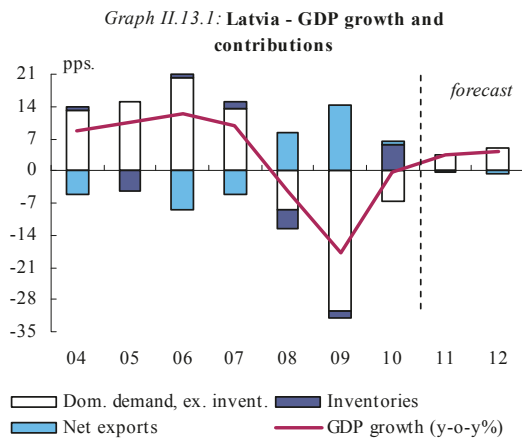


## 13. LATVIA

### Economic and budgetary re-balancing continues at full speed

#### Growth outlook remains favourable

With clearly positive quarterly indices during 2010, Latvia's economy recorded a minor decline of 0.3% in 2010, reflecting the strong negative carry-over from 2009. Recent indicators suggest a sustained pace of recovery and confirm a favourable outlook for 2011-12 in line with the Commission autumn forecast. The economy is undergoing a substantial rebalancing from non-tradeable to tradeable sectors as the share of exports in GDP widened to 53% in 2010 from a range of 42% to 48% in the pre-crisis period. Exports are further projected to rise to about 60% of GDP by 2012. The process of rebalancing is supported by significant drops in unit labour costs in 2009-10 as well as rapidly rising demand from major trading partners. On the other hand, the expected broadening of the growth base towards private consumption and investment will foster imports and is likely to bring net exports to nearly a zero contribution to GDP growth in 2011. This latter effect could be reinforced should the euro appreciate further.

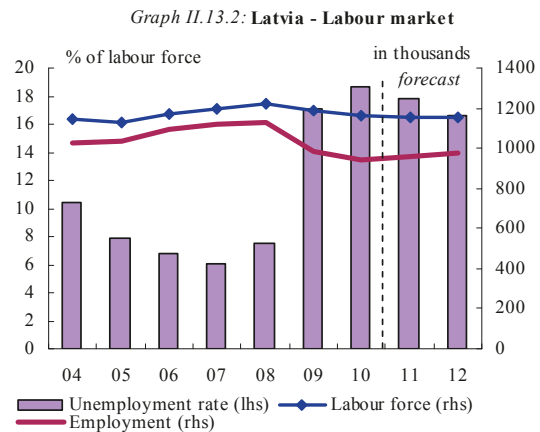


Another dimension of the re-balancing of the economy is the large growth dispersion across sectors. Value added in the manufacturing sector surged by 15.4% in 2010 and the underlying monthly indicators for sales and new orders point to further improvement in 2011. Public utilities also grew rapidly by 12.7% in 2010 due mainly to high energy demand, although the latter is likely to be tamed by higher prices of energy inputs. In stark contrast, construction output and financial intermediation fell by 24.2% and 10.5% in 2010 respectively, following even steeper declines in 2009. The two sectors are likely to bottom out in

2011 and are therefore expected to play an increasing role in the projected acceleration of GDP growth to 3.3% in 2011 and 4.0% in 2012.

#### Employment expectations pick up

After a significant contraction in 2008-09, the labour market is recovering at a slower pace than economic output and is expected to continue at this moderate pace, although net job creation surprised on the positive side towards the end of 2010. Furthermore, the economic sentiment surveys in the first four months of 2011 show favourable employment expectations in the industrial and service sectors and even in the construction sector employment prospects are rising again, although from a very low base and with some moderation in April. Therefore, stronger job creation could be considered a positive risk to the forecast.



The labour force is expected to remain relatively stable in 2011-12, as the trend decline in the working age population will be largely offset by higher participation rates under the assumption that the economic recovery would motivate part of the discouraged job seekers to re-enter the labour market. Migration flows, which are responsible for nearly half of the decline in the working age population, would reduce the rate of unemployment but also limit labour supply and potential growth, though it is not creating a distinct shortage of labour skills yet. Overall, the unemployment rate is set to improve relatively quickly from a year-average of 18.7% in 2010 to below 16% in 2012, but a faster decline could not be excluded. Job vacancy rates remain low, but a turning point could be reached soon, as the margin



between structural and actual unemployment is narrowing quickly. The share of structural unemployment increased dramatically, to 14.3% in the Commission estimates for 2010, due mainly to a large number of job losses in the construction sector which are unlikely to be recovered in full in the near future.

### Commodity prices, VAT hike push up inflation

The Harmonised Index of Consumer Prices (HICP) increased above the EU average in the beginning of 2011, due to increased VAT rates and the effects of labour costs increases, in the light of higher labour compensations in both the public and private sectors at the end of 2010, and the minimum wage hike by 11% as of January 2011. Nevertheless, when the impact of VAT and imported energy and agricultural commodities is excluded, price indices remain almost unchanged in relation to a year earlier. This illustrates that inflation pressures are strongly linked to supply-side factors while the impact of rising wages is relatively low. Commodity prices remain a major threat to inflation in 2011, given the country's high sensitivity to import price shocks, due to the small size of the domestic market and its high energy intensity.

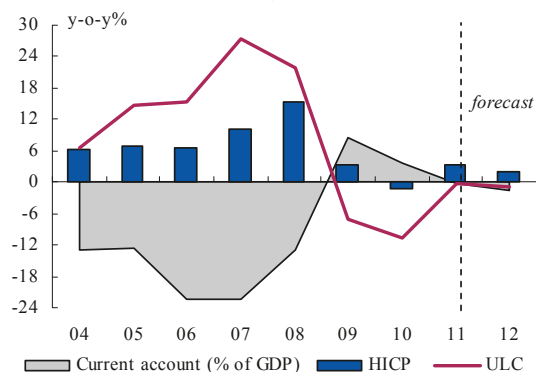
Looking ahead, inflation is expected to move very close to the EU average as the effects of import prices and administrative measures fade out. However, such price dynamics will also depend on moderate wage developments which limit the transmission of imported inflation to labour costs, and preserve recent gains in competitiveness.

### Falling Primary income exposes remaining external balance risks

The current-account surplus dropped to 3.6% of GDP in 2010 from 8.6% in 2009. The narrowing was driven by a steep decline in the net inflow of primary income while trade in goods and non-factor services improved for the third year in a row. Primary income is likely to shift into negative territory in 2011-12 since retained earnings in foreign-owned companies are rapidly improving, reflecting higher profitability of the banking sector in the beginning of 2011. This is likely to move the whole current account to a small deficit in 2011-12 (and, simultaneously, improve the financial account) along with the gradual recovery in import demand, pushed up by increasing household consumption and the expected rebound in

corporate investments. Exports will continue to grow at a rapid pace, as demand from the Baltic neighbours and Scandinavian countries is sustained.

Graph II.13.3: Latvia - Current account, inflation, unit labour costs



Although the current account is not projected to post excessive deficits in the medium run, some external imbalances remain, as private external debt and net foreign financial liabilities are relatively high at around 180% and 85% of GDP at the end of 2010, respectively. Nevertheless, the significant loss in external competitiveness accumulated before the crisis is to a large extent corrected and current estimates of unit labour costs point to further improvement against trading partners in 2011-12, but the margin of adjustment will be substantially weaker than in 2009-10. Further improvement in competitiveness will be key for the country's capacity to maintain sustainable economic growth. A return of foreign investor interest, helped by the macroeconomic stabilisation and the resulting recent sovereign rating upgrades, could improve non-price competitiveness, through factors such as technology upgrades, product quality and differentiation, trade channels, and energy efficiency.

### Fiscal position improves due to consolidation measures, but challenges remain

The general government deficit was 7.7% of GDP in 2010, 2 pps. lower than the 2009 outcome and clearly better than originally planned by the government (8.5% of GDP). Although the headline outcome is in line with expectations in the Commission's autumn forecast, it reflects a larger underlying adjustment, as it includes the impact of sizeable financial sector stabilisation measures, amounting to 2.3% of GDP, more than twice higher than what was previously expected. These

financial sector measures included the direct recapitalisation costs of Parex Banka and the Mortgage and Land Bank, as well as the recognition of expected losses on government's deposits in Parex Banka according to the restructuring plan. The outcome for 2009 was revised from -10.2% of GDP to -9.7% of GDP due to the clarified treatment of sales of the Assigned Amount Units or tradeable 'Kyoto carbon credits'.

After a substantial fall in 2009, revenues stabilised in 2010, due to several taxation measures, notably an increase in the VAT rate from 18% to 21%, and some revival in domestic demand. Current expenditure declined in 2010, as the government continued trimming public finances towards more sustainable levels. Additional savings came from some delays in the implementation of planned government investments, including ones co-financed by the EU structural funds.

The 2011 budget law was passed in December 2010, complemented by a supplementary budget in April 2011. The most notable measures that entered into force from January 2011 include a further increase in VAT standard and reduced rates to 22% and 12%, respectively, and a broadening of the tax base under the standard VAT rate. On the expenditure side, several subsidies and benefits have been abolished or revised, while expenditure

of government entities, including the wage bill, was further cut. Overall, consolidation measures in 2011 would improve the fiscal outlook by over 2 pps. of GDP. Coupled with the revival in economic activity, this is expected to bring the general government deficit to 4.5% of GDP in 2011. However, the accounting of financial sector stabilisation measures remains a risk factor to the outlook for 2011. Based on the assumption of unchanged policy, the fiscal outlook for 2012 further improves to reach a deficit of 3.8% of GDP in line with the macroeconomic scenario of the forecast and as the full effect of the supplementary 2011 budget materialises. Thanks to better than expected results so far, further consolidation needs to bring the deficit below 3% of GDP in 2012 in a sustainable manner would be of a clearly smaller magnitude compared to previous years.

The general government debt is set to increase somewhat, reaching 49.4% of GDP by the end of the forecast period. While no further borrowing is expected under the international assistance programme, the authorities are likely to return to borrowing from international financial markets in the second half of 2011.

Table II.13.1:

**Main features of country forecast - LATVIA**

	2009			92-06	Annual percentage change					
	mio LVL	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	13082.8		100.0	1.8	10.0	-4.2	-18.0	-0.3	3.3	4.0
Private consumption	8053.8	61.6		-	14.8	-5.2	-24.1	-0.1	3.0	3.5
Public consumption	2569.7	19.6		-	3.7	1.5	-9.2	-11.0	-2.0	0.0
Gross fixed capital formation	2806.8	21.5		-	7.5	-13.6	-37.3	-19.5	9.2	12.0
of which : equipment	1240.4	9.5		-	-	-	-	-	-	-
Exports (goods and services)	5741.7	43.9		-	10.0	2.0	-14.1	10.3	8.6	6.6
Imports (goods and services)	5935.3	45.4		-	14.7	-11.2	-33.5	8.6	8.6	7.7
GNI (GDP deflator)	14080.8	107.6		1.5	9.7	-2.0	-10.8	-5.5	-0.6	3.2
Contribution to GDP growth :										
Domestic demand				-	13.5	-8.4	-30.7	-6.7	3.5	4.9
Inventories				-	1.6	-4.1	-1.5	5.8	0.0	0.0
Net exports				-	-5.1	8.2	14.2	0.6	-0.2	-0.8
Employment				-1.7	3.6	0.9	-13.2	-4.8	1.5	1.7
Unemployment rate (a)				12.5	6.0	7.5	17.1	18.7	17.2	15.8
Compensation of employees/head				-	35.1	15.7	-12.2	-6.5	1.5	1.5
Unit labour costs whole economy				-	27.2	22.0	-7.0	-10.6	-0.3	-0.8
Real unit labour costs				-	5.8	6.6	-5.6	-8.5	-2.4	-2.3
Savings rate of households (b)				2.6	-5.0	5.0	9.4	-	-	-
GDP deflator				30.3	20.3	14.4	-1.5	-2.3	2.2	1.6
Harmonised index of consumer prices				-	10.1	15.3	3.3	-1.2	3.4	2.0
Terms of trade of goods				-	7.2	-1.8	-2.9	1.1	0.6	0.0
Trade balance (c)				-13.8	-23.9	-17.7	-7.1	-6.4	-6.8	-7.5
Current-account balance (c)				-4.6	-22.3	-13.1	8.6	3.6	-0.3	-1.6
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-2.2	-20.4	-11.6	11.1	5.6	3.1	1.5
General government balance (c)				-	-0.3	-4.2	-9.7	-7.7	-4.5	-3.8
Cyclically-adjusted budget balance (c)				-	-4.4	-6.3	-6.6	-5.1	-3.1	-3.6
Structural budget balance (c)				-	-4.4	-6.3	-6.1	-3.7	-4.0	-4.5
General government gross debt (c)				-	9.0	19.7	36.7	44.7	48.2	49.4

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

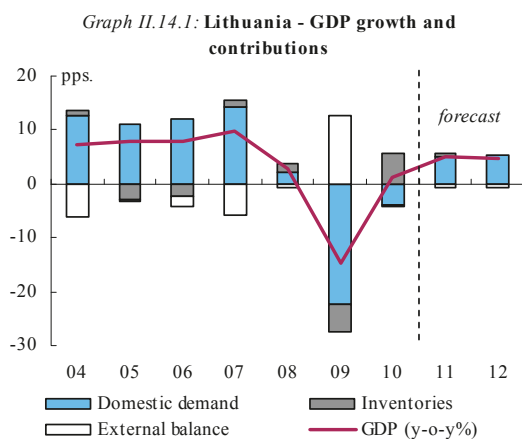
## 14. LITHUANIA

### Strong recovery as domestic demand picks up

#### The economy returns to growth due to strong exports and inventories

Lithuania's economy has quickly recovered from a deep recession. Following a contraction of nearly 15% in 2009, output expanded by 1.3% in 2010, reflecting a particularly strong fourth quarter (4.6% y-o-y growth).

The recovery has been driven by two factors. Firstly, the rebound in the global economy and in particular a robust growth performance of Lithuania's main export partners, namely Germany, Russia, the other Baltic States and Poland. This has led to a surge in exports, especially in oil products, pharmaceuticals, capital goods and transport services. Improved competitiveness, underpinned by strong wage discipline, has also supported the vigorous export dynamics. However, imports expanded somewhat more strongly than exports as the recovery gathered momentum. As a consequence trade deficit further widened in 2010. A second driver of growth has been the upturn in the inventory cycle, with firms starting to quickly rebuild depleted stocks. This upswing in inventories added almost 6 pps. to Lithuania's growth in 2010.



On the other hand, domestic demand (excluding inventories) further contracted as consumers, non-financial corporations and the public sector continued to restore their balance sheets. Private consumption was hampered by wage adjustment, cuts in social benefits, increases in indirect taxes and negative credit growth. Wages contracted by 1.9% in 2010, although quarterly data show an upward trend since the second quarter of the year.

Unemployment peaked at 18.3% in the second quarter of 2010 before resuming its downward trend along the rebound in output. In particular, youth unemployment soared to nearly 37% by the second quarter of 2010, spurring a pronounced emigration wave. Investment resumed strongly in the second half of 2010, especially in equipment and non-residential construction. However, for the year as a whole, investment was flat due to the weak first half.

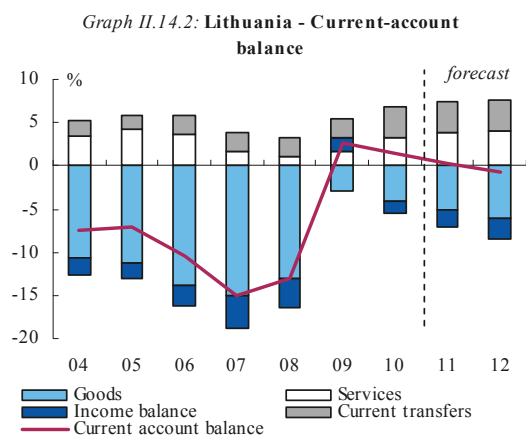
Inflation fell rapidly, although fears of a deflationary spiral proved unfounded. While turning negative in the first quarter of 2010, headline inflation quickly increased on the back of higher food and energy prices as well as lagged effects of excise duties hikes in the previous year. Core inflation turned negative in the first half of 2010 but has picked up towards the end of the year as macroeconomic conditions improved noticeably.

#### The recovery is expected to gather further momentum as domestic demand picks up

Economic activity is expected to accelerate in 2011 and remain strong in 2012 as domestic demand progressively becomes the main engine of growth. Private investment is set to increase on the back of a more favourable business outlook. Continued frontloading of EU co-financed projects, predominantly to infrastructure and energy efficiency enhancements, is to support public investment as well. Amid a brighter labour market outlook, private consumption is set to recover, especially at the end of the forecast horizon. Skill mismatches have been emerging in some sectors, putting upward pressure on wages. The planned reversal of pension cuts from 1 January 2012 will also add to consumption dynamics. The healthier financial sector is also expected to provide sufficient credit to sustain the rebound in output.

The current account surplus is projected to vanish in 2011, as the increasing trade deficit is compensated by positive net current transfers. In 2012, the current account balance is expected to turn negative, with the trade deficit widening. Export growth is expected to remain robust, but gradually ease over the forecast horizon, partly due

to negative base effects. The base effects will also affect imports, though to a smaller extent.



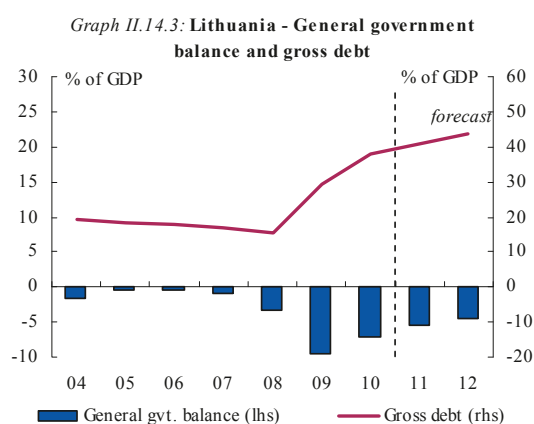
Inflation is likely to accelerate, driven by higher energy, commodity and food prices. Increases in excise duties on tobacco and fuel (from the beginning of 2011) as well as expiration of the reduced VAT rate on heating (currently planned for September 2011) will also add to inflation dynamics. Core inflation is projected to steadily increase over the forecast horizon, albeit from low levels, as the negative output gap is progressively closed.

The balance of risks to the baseline scenario seems to be tilted to the upside. Positive risks related to reduced global risk aversion and an improved business outlook might trigger stronger-than-projected capital inflows. Moreover, the deleveraging process might prove to be less protracted as both household and corporate debt remain relatively low compared to other EU Member States or major economies. As the momentum builds up and is sustained, a positive feedback loop between the real and financial sector might emerge, further strengthening output dynamics. On the other hand, downside risks relate to a slow reduction in structural unemployment, weakened resolve for the remaining fiscal consolidation as well as higher-than-expected energy prices.

#### **Significant fiscal consolidation efforts have yielded results, but need to continue**

The budgetary outturn in 2010 was much better than initially expected, with the general government deficit reaching 7.1% of GDP - far below the government's deficit target of 8.1% of GDP. This reflects higher-than-expected revenue

growth and continued fiscal consolidation efforts. In July 2010 the government extended some temporary expenditure-reducing measures, such as cuts in salaries for politicians, lawyers and government officials. It also prolonged the reduction of transfers of contributions to the second pillar pension funds. Moreover, maternity benefits were reduced and a part of the sickness leave benefits were to be permanently paid by the employers rather than the Social Security Fund. However, some other expenditure items, including interest payments, healthcare spending, capital expenditure and social benefits increased in 2010.



The 2011 budget aims at a deficit of 5.8% of GDP, in line with the EDP. On the back of an improved macro-economic forecast underlying the 2011 Convergence Programme, the government reduced its deficit targets to 5.3% of GDP in 2011 and 2.8% in 2012. To meet budgetary targets, the government relies on strong revenue growth, partly due to better tax compliance, and some increases in non-tax revenue, which mainly relate to a higher inflow of EU structural funds. However, additional tax revenues, expected in the Tax Compliance Strategy are uncertain and are likely to materialise only gradually. In January 2011 excise duties on tobacco and fuel were increased according to EU legislation. Personal income tax for the self-employed was reduced from 15% to 5% as of 2011. The 2011 budget foresees a 4.6% increase in government expenditures compared to the 2010 budget due to higher debt service costs and increased social expenditure. According to the three-year investment programme, general government investment is planned to slightly decrease in 2011, before resuming in 2012.

In 2012, some temporary consolidation measures (including reduced pension benefits) will expire, hence raising government expenditure by

approximately 0.6% of GDP. Under the customary no-policy-change assumption, government sector wages are projected to increase. While the government has adopted a broad recommendation extending the wage freeze for government officials into 2012, specific provisions have not yet been outlined. Consolidation measures under discussion for 2012 include the raising of excises on diesel

(0.1% of GDP), introducing a tax on cars (0.1% of GDP) and a real estate tax on private households (0.1% of GDP). On the basis of the no-policy-change assumption, the general government deficit is expected to narrow to 5.5% of GDP in 2011 and 4.8% in 2012. Government debt is projected to increase from around 38% of GDP in 2010 to nearly 44% in 2012.

Table II.14.1:

**Main features of country forecast - LITHUANIA**

	2009			92-06	Annual percentage change					
	bn LTL	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	91.5	100.0	100.0	1.2	9.8	2.9	-14.7	1.3	5.0	4.7
Private consumption	63.0	68.8	75.3	-	12.1	3.7	-17.7	-4.5	3.3	3.9
Public consumption	20.1	21.9	24.1	-	3.2	7.3	-1.9	-3.4	0.5	3.0
Gross fixed capital formation	15.7	17.1	18.8	-	23.0	-5.2	-40.0	0.0	16.9	13.8
of which : equipment	3.7	4.0	4.3	-	21.9	-17.1	-49.8	14.7	19.0	12.5
Exports (goods and services)	50.0	54.6	60.0	-	3.0	11.6	-12.7	17.4	11.2	7.1
Imports (goods and services)	51.3	56.1	61.7	-	10.7	10.3	-28.4	17.9	12.0	8.0
GNI (GDP deflator)	93.3	101.9	109.3	-	8.0	3.5	-10.1	-1.7	4.1	4.6
Contribution to GDP growth :										
Domestic demand				-	14.2	2.3	-22.2	-3.8	4.9	5.5
Inventories				-	1.3	1.4	-5.3	5.7	0.7	0.0
Net exports				-	-5.7	-0.7	12.7	-0.5	-0.7	-0.8
Employment				-0.9	2.8	-0.7	-6.8	-5.1	2.1	2.8
Unemployment rate (a)				9.5	4.3	5.8	13.7	17.8	15.5	12.7
Compensation of employees/head				-	13.9	14.3	-11.1	-1.3	3.4	5.8
Unit labour costs whole economy				-	6.5	10.4	-2.8	-7.6	0.5	3.9
Real unit labour costs				-	-1.8	0.5	0.9	-9.4	-2.7	1.0
Savings rate of households (b)				-	-5.2	-2.2	7.8	-	-	-
GDP deflator				40.2	8.5	9.8	-3.7	2.1	3.3	2.9
Harmonised index of consumer prices				-	5.8	11.1	4.2	1.2	3.2	2.4
Terms of trade of goods				-	0.9	3.6	-5.9	2.4	0.4	0.2
Trade balance (c)				-	-15.0	-13.0	-3.1	-4.3	-5.0	-5.5
Current-account balance (c)				-	-15.1	-13.1	2.6	1.8	0.2	-0.6
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-12.9	-11.2	7.0	5.8	3.9	2.9
General government balance (c)				-	-1.0	-3.3	-9.5	-7.1	-5.5	-4.8
Cyclically-adjusted budget balance (c)				-	-3.6	-5.4	-7.1	-5.1	-4.7	-4.8
Structural budget balance (c)				-	-3.0	-5.4	-7.5	-5.7	-5.3	-5.4
General government gross debt (c)				-	16.9	15.6	29.5	38.2	40.7	43.6

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.



## 15. LUXEMBOURG

### Strong growth, but still below pre-crisis average pace

#### Economic activity is back at its pre-crisis level

During the recession, real GDP in Luxembourg fell by 7.9% from peak to trough (from the second quarter of 2008 to the second quarter of 2009). GDP started to grow again in the third quarter of 2009, and almost reached its pre-crisis level in the autumn of 2010. The recovery in 2010 has essentially been generated by an increase in public consumption and public investment decided by the government as part of the EERP on the one hand, and a strong increase in net exports on the other hand. Private consumption, which slowed down from 4.7% in 2008 to 0.2% in 2009, as a side-effect of the strong rise in unemployment and the deterioration in consumer confidence, is expanding again and increased by 2.0% in 2010. In total, real GDP expanded by 3.5% in 2010 after falling by 3.6% in 2009.

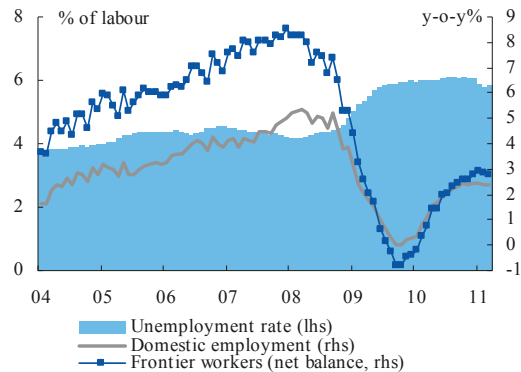
This rather strong growth momentum is expected to continue in 2011-12 as domestic demand will strengthen and external trade will probably remain rather supportive. In total, real GDP growth is expected to remain stable in 2011 and to accelerate slightly in 2012. Although such growth rates are substantially higher than those currently expected for most other Member States, they are still below the average rates recorded in Luxembourg before the crisis (4.7% on average between 2000 and 2007). A particular feature of the composition of growth this year is that investment figures are very dynamic, reflecting investment in equipment (mostly imported) planned by a number of large companies. The financial sector, which has been the country's main growth engine in recent decades and now represents almost 30% of total value added, seems to have withstood the crisis rather well. It is worth noting that the sector is strongly internationalised in its ownership and activities, which makes it particularly sensitive to developments abroad.

#### Job creation benefits mainly non-resident employment

Employment performed particularly well during the recession and its resilience surprised even the most optimistic observers. Employment never decreased during the crisis, although it decelerated strongly from the very high growth rates recorded in 2008 (4.7% over the year) to about 0.9% in

2009. This is the highest figure in the whole EU, where employment declined by nearly 2% on average. This massive labour hoarding was probably due to a large part to the reluctance of firms to lay off people whom they had found difficult to hire during the boom years, but it was also helped by a systematic recourse to short time working encouraged by the government. At the end of 2009 employment growth accelerated again, reaching an average growth of 1.6% in 2010. Employment is expected to rise faster in 2011 and 2012.

Graph II.15.1: Luxembourg - Domestic employment and frontier workers



Unemployment has risen during the crisis, from about 4.2% of the active population (national definition) in the spring of 2008 to around 6% in 2010, which is however still quite low in comparison with the rest of the EU. It strongly increased in the autumn of 2008 but began to slow down in the course of 2009 and remained broadly stable during 2010. The job creation expected over the forecast period is not likely to result in a strong decline in unemployment, as again mostly non-resident workers seem to benefit from it as was the case before the crisis. During the crisis, the number of non-resident workers was slightly decreasing while national employment growth remained slightly positive. This is explained by the relatively high share of non-resident workers in the private sector and in temporary jobs. But since the summer of 2010, non-resident employment growth has been outperforming national employment again, as in the years preceding the crisis.



### Inflationary pressure stemming from rising energy prices

Average inflation (measured by the HICP) fell to zero in 2009, but it resumed rising at the end of 2009, reaching 2.8% in 2010. It amounted to 3.8% in the first quarter of 2011 due to a strong increase in energy prices. Core inflation increased to around 2.3%, inter alia because of higher administered prices. Inflation is projected to decelerate slightly over the rest of 2011 and in 2012.

After having risen by 3.5% a year on average between 2004 and 2007, wage growth slowed down from 2008 onwards to 1.6% in 2010. Wages are expected to rise by 2% in 2011 as the automatic indexation of wages has been postponed from spring to October 2011. With the following indexation threshold already expected to be reached in spring 2012, wages are projected to increase strongly in that year (by around 4.5%).

### Slow improvement of the budget balance

The general government balance, which had amounted to a surplus of 3% in 2008, turned into a 0.9% deficit in 2009. This was one of the lowest deficits recorded in 2009 in the EU, in large part thanks to the favourable situation of public finances before the crisis. Based on recent updated

information, the deficit increased to about 1.7% of GDP in 2010, which is considerably less than previously expected. The increase is partly a result of the delayed impact of the crisis on government revenues and the rise in expenditure due to the stimulus package. Revenues rose slower than expenditure even though they are recovering after a slight decline in 2009. In 2011, revenues, and in particular taxes paid by households, should accelerate, while expenditure will slightly slow down after three years of strong growth (about 8.5% a year on average from 2008 to 2010). This will lower the deficit to about 1% of GDP. In 2012, a drop in revenues from corporate taxation is expected as a delayed effect of the crisis. Thus, at unchanged policy, the deficit is forecast to broadly stabilise despite better economic conditions.

Public debt rose from 14.6% of GDP in 2009 to 18.4% at the end of 2010. It is expected to rise to around 19% of GDP by 2012, still one of the lowest in the EU. The increase is essentially a result of the deficit position of the central government. In contrast, the social security system should continue to run substantial surpluses, which, as in the past, will be used to increase its reserves, currently estimated at 29% of GDP.

Table II.15.1:

#### Main features of country forecast - LUXEMBOURG

	2009			92-06	Annual percentage change					
	mio EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP		38072.9	100.0	4.3	6.6	1.4	-3.6	3.5	3.4	3.8
Private consumption		12939.5	34.0	2.5	3.3	4.7	0.2	2.0	1.8	2.3
Public consumption		6364.9	16.7	4.2	2.8	2.7	4.6	2.9	1.0	3.5
Gross fixed capital formation		6576.1	17.3	4.4	17.9	1.4	-19.2	2.6	12.0	6.0
of which : equipment		1627.3	4.3	3.3	23.9	3.4	-37.8	4.4	26.0	4.0
Exports (goods and services)		63802.4	167.6	7.5	9.1	6.6	-8.2	6.3	6.8	6.5
Imports (goods and services)		51260.2	134.6	7.3	9.3	8.5	-10.2	6.7	8.0	7.0
GNI (GDP deflator)		26793.9	70.4	2.7	12.8	-5.4	-9.6	4.8	3.5	3.1
Contribution to GDP growth :	Domestic demand			2.8	5.0	2.2	-3.1	1.6	2.7	2.3
	Inventories			0.0	-0.9	-0.1	-0.8	0.4	0.0	0.0
	Net exports			1.6	2.6	-0.6	0.3	1.5	0.7	1.5
Employment				3.3	4.5	4.7	0.9	1.6	2.1	2.3
Unemployment rate (a)				3.1	4.2	4.9	5.1	4.5	4.4	4.2
Compensation of employees/head				3.3	3.7	2.1	1.8	1.6	2.0	4.6
Unit labour costs whole economy				2.4	1.6	5.4	6.7	-0.3	0.7	3.0
Real unit labour costs				-0.6	-2.0	1.1	7.0	-5.5	-2.5	0.3
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				3.0	3.6	4.2	-0.3	5.5	3.3	2.6
Harmonised index of consumer prices				-	2.7	4.1	0.0	2.8	3.5	2.3
Terms of trade of goods				-0.4	3.3	0.5	-0.9	-1.3	-1.0	-0.5
Trade balance (c)				-11.1	-8.8	-10.4	-7.7	-8.1	-9.2	-9.4
Current-account balance (c)				11.1	10.1	5.3	6.9	7.8	7.8	7.6
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	9.7	4.7	6.2	7.8	7.8	7.6
General government balance (c)				2.2	3.7	3.0	-0.9	-1.7	-1.0	-1.1
Cyclically-adjusted budget balance (c)				-	1.9	2.3	1.5	0.1	0.3	-0.4
Structural budget balance (c)				-	1.9	2.3	1.5	0.1	0.3	-0.4
General government gross debt (c)				6.4	6.7	13.6	14.6	18.4	17.2	19.0

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 16. HUNGARY

### Recovery firming up, with a gradual rebalancing of growth

#### Export-led recovery in 2010

The economy, having emerged from a recession that saw GDP contracting by 6.7% in 2009, has now been growing for five consecutive quarters. The recovery has been led by a strong export performance, capitalising on better-than-expected global trade demand and translating to GDP growth of 1.2%. Domestic demand, by contrast, continued to decline. Private consumption expenditure fell by a further 2.1% following a sharp contraction of 7.8% in 2009. The boost to disposable income from personal income tax changes introduced in January 2010 was more than offset by the climbing costs of foreign currency denominated mortgage repayments as the Swiss franc appreciated against the forint, while the propensity to save increased compared to the previous year. The unemployment rate rose to 11.2%, masking a modest increase in employment and a larger increase in the activity rate.

Gross fixed capital formation dropped by 5.6% last year, suggesting that companies producing for the domestic market had not yet perceived favourable conditions for investment. Credit supply has remained tight both in the non-financial corporations sector and in the household sector. Since the weakness of domestic demand has kept imports from keeping pace with export growth, the current account continued to improve, posting a surplus of 1.7% of GDP in 2010.

#### A slow rebalancing

Looking ahead, the Hungarian economy is expected to consolidate its recovery and slowly move towards rebalancing as domestic demand starts to contribute to GDP growth. At the same time, the external sector will continue to contribute significantly to growth over the forecast horizon.

Specifically, GDP is expected to expand by 2.7% and 2.6% in 2011 and 2012, respectively. In 2011, domestic demand is forecast to contribute to growth by 1½ pps., with net exports contributing 1 pp. In 2012, the composition of growth is projected to remain similar, after taking into account the recent structural reform package and the other fiscal consolidation measures announced in Hungary's Convergence Programme.

Prospects for private consumption are set to improve from last year, although opposing factors are at work. Household consumption will be affected by several factors: first, the personal income tax (PIT) reform – to be phased in successive steps by 2013 – instituting a combination of a 16% flat tax rate with substantial tax credits for those with children (and amounting to a loss of 1.8% of GDP of revenue for the government from this year, with an additional cut of ¾% of GDP in 2012). The positive effect on disposable income is likely to be tempered by the fact that the tax cut mainly supports those households with higher wages, who tend to have a lower marginal propensity to consume; in fact, a large proportion of lower income households are actually expected to be worse off as a result.<sup>(80)</sup> Moreover, chiefly from 2012, the gradual phasing out of employment tax credits will further reduce the effect on disposable income.

Second, the twofold impact of the recent effective abolishment of the mandatory private pension pillar on private consumption also deserves special mention. The yield realised on assets that are being transferred to the public pension pillar is expected to boost consumption over the forecast horizon. These can be collected tax-free at the time of the transfer, or invested under favourable terms in voluntary pension funds. An adverse near-term effect may be expected associated with an increase in precautionary savings related to the pension reform reversal.

Third, private consumption may be negatively affected by the financial sector levy of 0.7% of GDP introduced in 2010, which is likely to dampen the supply of credit to households.

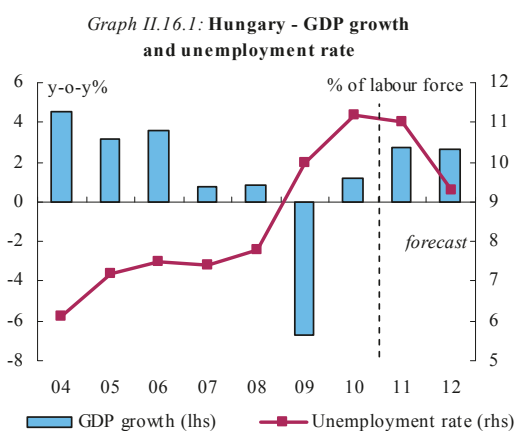
Finally, the planned cuts in social transfers, to be introduced mainly from 2012, are expected to have a significant negative effect on consumption.

In 2011 and 2012, investment will receive a boost from flagship investments by large multinationals

<sup>(80)</sup> According to the Fiscal Council's calculations published on 8<sup>th</sup> November 2010, as many as 40% of taxpayers are without children and do not earn enough income to benefit from the tax reform. Since then, a new policy has been introduced in the public sector to compensate those whose take-home pay would otherwise decrease because of the reform. Pressure has also been put on the private sector to follow suit.

and will also be supported by the corporate income tax cut. In contrast, the temporary levies on the energy, telecoms and retail sectors that were announced in autumn 2010 are likely to lead to lower investment in the affected sectors, which may have a broader negative impact on the business environment through increased institutional uncertainty. Finally, the financial sector levy that will also apply in 2012, although at a reduced level, will lengthen the persistence of tight credit conditions. Lending to medium and large corporations is forecast to remain particularly tight, with conditions easing towards the end of 2011. In addition to these developments, a reclassification of assets is also expected to take place between the public and the private sectors, as the state buys back selected public-private partnership investments.

The current account is expected to remain in surplus over the forecast horizon. The continued dynamism of exports should be more than sufficient to compensate for the import growth accompanying the rather subdued recovery of domestic demand.



### Public works continue to push up statistical employment

Unemployment will start to decline over the course of 2011, with the expansion of employment in the private sector expected to pick up pace in 2012. Public works are expected to continue to play a considerable part in this (during the recession, employment was propped up mainly by extended public work schemes). The new public works scheme foresees a switch to the large-scale employment of part-time workers this year, with an expansion in the number of those employed, but from a budget that is considerably smaller in 2011

than that in 2010. This means that in full time equivalent terms, the expected employment developments are considerably less positive. In 2012, too, part time employment is expected to dominate in the public works scheme, with an increased impact on the overall statistics due to a larger budget.

### Inflation decreasing but above target

The Harmonised Index of Consumer Prices in Hungary reached an annual average of 4.7% in 2010, with core inflation lower at 3%. This reflects imported inflation and poorly anchored inflationary expectations to a large extent, lifted further by an increase in certain indirect taxes and taking place in spite of a still negative output gap. In 2011 inflation is expected to start declining, with the appreciation of the forint to an extent mediating the impact of rising energy prices. As the shocks on the cost side are anticipated to fade away, inflation is projected to further decrease to 3.5% in 2012.

The relatively weak wage pressure given the PIT changes and the slow recovery of full time equivalent employment is expected to contribute to keeping core inflation low. An element to note in connection with the expected wage developments is that the additional pay provided to low-income employees in the public sector to ensure that their earned income does not decrease as a result of the PIT reform is administered in the form of non-wage compensation.

### Fiscal slippages and consolidation steps

In 2010, the general government budget deficit came out at 4.2% of GDP compared to the targeted 3.8% of GDP. The slippage was essentially due to lower tax revenues both at the central and local level.

In 2011, the budget is forecast to post a surplus of around 1.6% of GDP in 2011. This is much better than the targeted deficit of 2.9% of GDP in the budget, but somewhat worse than the updated government forecast of a 2% of GDP surplus.

The headline budgetary developments are improved by one-off items of 8% of GDP in net terms. Although some of these items, totalling close to 3% of GDP (receipts from the extraordinary levies and the repatriation of assets from the private pension fund to the budget), were

already included in the original budget, there are also some new developments. On the revenue side, the repatriated assets from the private pension pillar are expected to eventually generate higher one-off revenue than budgeted by about 7% of GDP (i.e. the overall revenue will be about 9% of GDP). On the expenditure side, the recent government decision on the assumption of the debt of two state-owned transport companies and the buy-out of selected PPP investments may generate one-off outlays of 2% of GDP. Overall, the headline deficit without the one-off items would be somewhat above 6% of GDP.

Regarding the underlying fiscal developments in 2011, this forecast foresees revenue shortfalls of 0.7% of GDP (in particular relating to the corporate income tax and indirect taxes) and expenditure overruns of 0.3% of GDP compared to the budgeted figures; this takes into account the slippages observed in 2010 and some recent worse than foreseen budgetary developments. The expected underlying budgetary slippages of 1% of GDP in 2011 are expected to be largely, but not fully, compensated by the recently adopted saving measures (such as a permanent cut of the operating expenditures of budgetary institutions) of around 0.7% of GDP in net terms.

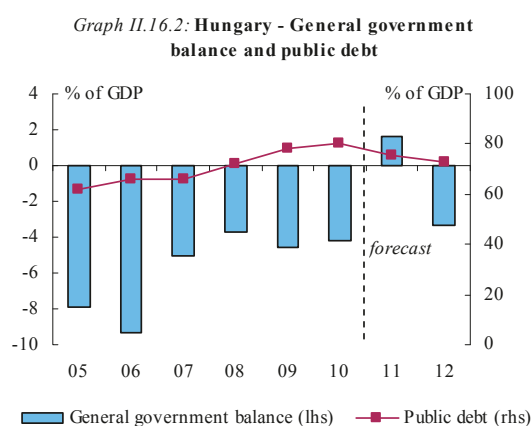
In order to address the high level of underlying deficit, which could have been only temporally compensated by one-off revenues and extraordinary levies, and also taking into account the enacted further tax cuts in 2012 and 2013, the Hungarian government announced its structural reform package on 1 March. It aims at a budgetary improvement of close to 2% and 3% of GDP in 2012 and 2013, respectively. Expenditure savings would chiefly be generated by: (i) a large-scale reduction in labour market spending; (ii) eliminating one-third of pharmaceutical subsidies; (iii) tightening early retirement schemes and sick pay; (iv) reviewing all current recipients of disability pension and benefits; and (v) streamlining the institutional network of local governments. Moreover, additional revenue is expected from: (i) a prolongation by one year of the full extraordinary levy on financial institutions rather than the planned reduction foreseen for 2012; (ii) the introduction of an electronic road toll from 2013; and (iii) the postponement of the earlier enacted further reduction of the corporate income tax in 2013.

Regarding the consolidation measures, in several cases the parameters are already worked out, while for a smaller part of the programme the conceptual work has only recently started (notably public transport and local governments). These latter areas have also been characterised by frequent slippages in the past. Taking the consolidation measures at face value and taking the second-round effects into account, the expected impact of the package is foreseen to be around 1½% of GDP and slightly more than 2% of GDP in 2012 and 2013 respectively. However, taking also into consideration the implementation risks, the budgetary impact is expected to be 1% and 1½% of GDP in the years in question.

In the context of the recent Convergence Programme, a number of additional corrective steps were published. They include: (i) a further reduction in the employment tax credit; (ii) some revenue increasing measures, such as the increase in excise duties, changes in the domain of green taxes and the widening of the tax base of corporate income tax; (iii) and the nominal freeze of public sector wages and of operating expenditures of central budgetary institutions in 2012. Taking into consideration also the indirect effects, e.g. the wage compensation provided to those with lower wages in the public sector, these corrective measures could generate an additional adjustment of close to 1% of GDP.

For 2012, the deficit is forecast to come out at 3.3% of GDP in 2012 compared to the autumn 2010 forecast of 6.2% of GDP. This reflects the above-mentioned measures included in the consolidation package of 1% of GDP and additional corrective measures included in the Convergence Programme of close to 1% of GDP. This also takes into account implementation risks where appropriate as is standard practice. In addition, the forecast incorporates the permanently higher pension contributions and lower interest expenditures due to the pension reform reversal (1½% of GDP). On the other hand, the forecast also integrates slippages that are expected to be carried over from 2011 and the slightly slower and less tax rich economic recovery compared to the earlier expectations (independent from the effects of the consolidation measures). If all measures were taken at face value (i.e. without the integration of implementation risks), the deficit would be expected to come out just below 3% of GDP.

There are positive and negative risks around the presented scenario. Implementation risks could be higher than forecast, notably regarding the nominal freeze of the public wage bill and expenditure on goods and services, but the possibility that the government may take further steps to implement the consolidation package in full can also not be excluded. Furthermore, corporate income taxes may increase faster than it is assumed now based on the recovery of the economy.



The structural balance is expected to deteriorate by more than a cumulative 3% over 2010 and 2011 in the light of the fact that tax cuts have been offset

by one-off and temporary revenues. In 2012, due to the consolidation measures, a structural effort of about 1¼% of GDP is projected.

Regarding debt developments, the recently decided debt assumption from public transport companies of up to 1.4% of GDP and the buy-out of former PPP projects of 0.6% of GDP increase the gross debt. However, the pension reform reversal has created the potential to reduce the gross public debt by up to around 7% of GDP, since only a part (1.8% of GDP) of the one-off revenue of 9% of GDP will be used to contribute to the financing of the 2011 budget. According to the preliminary estimations, ⅓ of this is government papers, which will automatically reduce the public debt ratio by around 4% of GDP. The remaining assets of 3% of GDP (non-domestic securities) will be liquidated only slowly and it is assumed that one-third of this (around 1% of GDP) will reduce the gross public debt in 2011 and the remaining will reduce debt in 2012. Overall, assuming no reduction of the government's existing FX deposits at the central bank of around 3% of GDP and the maintenance of the current stronger HUF exchange rate compared to the end-2010 level, the gross public debt is expected to decrease to about 80% of GDP in 2010 to around 73% in 2012.

Table II.16.1:

**Main features of country forecast - HUNGARY**

	2009			92-06	Annual percentage change						
	bn HUF	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012	
GDP	26054.3		100.0	2.9	0.8	0.8	-6.7	1.2	2.7	2.6	
Private consumption	13901.8		53.4	-	0.2	0.4	-7.8	-2.1	2.7	1.0	
Public consumption	5792.7		22.2	0.9	-7.3	1.0	-0.2	-1.9	-0.8	0.5	
Gross fixed capital formation	5441.6		20.9	4.6	1.7	2.9	-8.0	-5.6	1.5	4.5	
of which : equipment	2010.0		7.7	-	8.0	2.9	-12.2	1.0	7.0	8.0	
Exports (goods and services)	20175.3		77.4	12.5	16.2	5.7	-9.6	14.1	9.6	9.2	
Imports (goods and services)	18817.2		72.2	12.7	13.3	5.8	-14.6	12.0	9.3	8.6	
GNI (GDP deflator)	24750.7		95.0	-	-0.8	1.3	-5.3	1.1	2.2	2.0	
Contribution to GDP growth :											
Domestic demand				2.8	-1.2	1.0	-6.0	-2.6	1.6	1.5	
Inventories				0.2	-0.1	-0.2	-4.7	1.6	0.2	0.0	
Net exports				-0.1	2.1	0.0	4.0	2.2	1.0	1.2	
Employment				-	-0.3	-1.3	-2.8	0.2	0.4	3.0	
Unemployment rate (a)				-	7.4	7.8	10.0	11.2	11.0	9.3	
Compensation of employees/f.t.e.				-	6.7	7.0	-2.2	-0.2	2.6	2.0	
Unit labour costs whole economy				-	5.6	4.8	1.9	-1.1	0.3	2.3	
Real unit labour costs				-	-0.3	0.0	-2.4	-3.9	-2.2	-0.2	
Savings rate of households (b)				-	10.3	8.4	10.9	-	-	-	
GDP deflator				12.8	5.9	4.8	4.4	2.9	2.6	2.5	
Harmonised index of consumer prices				-	7.9	6.0	4.0	4.7	4.0	3.5	
Terms of trade of goods				-	-0.1	-1.1	1.0	-0.2	-0.4	0.0	
Trade balance (c)				-4.5	-0.2	-0.6	3.5	4.7	5.0	5.9	
Current-account balance (c)				-	-7.0	-6.9	-0.4	1.7	1.6	1.9	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-6.2	-6.0	1.3	3.7	3.2	3.9	
General government balance (c)				-	-5.0	-3.7	-4.5	-4.2	1.6	-3.3	
Cyclically-adjusted budget balance (c)				-	-6.1	-4.5	-2.0	-2.1	2.7	-3.3	
Structural budget balance (c)				-	-5.2	-4.1	-2.0	-3.1	-5.2	-4.0	
General government gross debt (c)				-	66.1	72.3	78.4	80.2	75.2	72.7	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.



## 17. MALTA

### Moderate growth outlook after a strong rebound in 2010

#### After a sharper-than-estimated recession, the Maltese economy rebounded strongly in 2010...

Revised national accounts data released by the National Statistical Office in March 2011 show that the impact of the global recession on the Maltese economy was much stronger than initially reported, putting the scale of the contraction in real GDP in 2009 at 3.4% compared to less than 2% estimated earlier, and thus only slightly below that of the euro area as a whole (4.1%). Domestic demand, particularly the sharp retrenchment in investment and the drop in inventories, was the main driver of the GDP contraction. Exports also fell sharply but the high import-intensity of consumption and investment resulted in imports declining even faster, leading net exports to cushion the drop in real GDP.

Exports and business investment rebounded sharply in 2010, driving a strong economic recovery, with real GDP growth reaching 3.7%. Goods exports drove the rebound in exports, while services exports remained subdued. The increase in imports lagged behind that in exports, leading to a strong positive contribution of net exports. The pick-up in investment in machinery and equipment was partly offset by sustained weakness in housing construction. Also, private consumption declined further on the back of subdued wage growth and high energy prices.

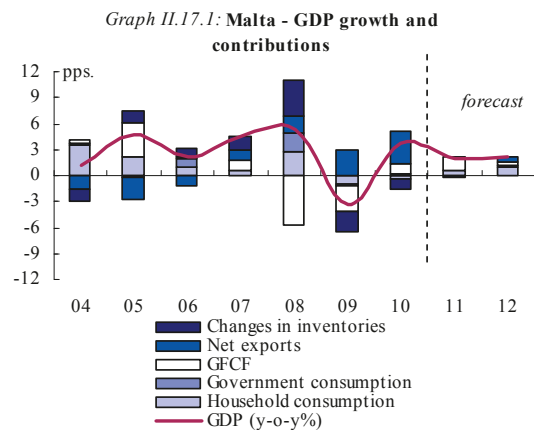
#### ...but some deceleration is expected over the forecast horizon

Real GDP growth is expected to slow down to 2% in 2011 as the momentum of the recovery moderated in the second part of 2010. Slightly higher growth, at 2.2%, is projected for 2012.

Investment is again expected to contribute strongly to overall growth in 2011, supported by a significant expansion in public investment. As capacity utilisation rates have risen to pre-crisis levels, private investment is also foreseen to remain relatively buoyant, mostly driven by further growth in machinery and equipment. Investment growth is expected to slow down considerably in 2012, mainly due to falling public investment, while private investment is projected to remain

dynamic. Housing construction is likely to remain relatively weak over the forecast horizon.

Private consumption is expected to return to positive growth in 2011, given rising disposable incomes but will remain subdued on account of very weak consumer confidence, affected also by expectations of rising inflation in the coming months. Private consumption is forecast to pick up more strongly in 2012 as inflationary pressures subside and disposable incomes improve further.



Exports of goods are projected to continue growing at a relatively fast pace over the forecast horizon, reflecting in particular the expected strong performance of the electronics component, which accounted for about 45% of merchandise exports in 2010. Services exports are also expected to pick up over the next two years.

Net exports are assumed to give rise to a marginally negative contribution to economic growth in 2011 due to the ongoing recovery in highly import-intensive domestic demand components. The slowdown in investment growth in 2012 is expected to contain import growth, thereby resulting in a positive contribution to GDP growth from net exports.

After widening to almost 6% of GDP in 2009 on account of a sharp increase in net outflows of primary incomes, the external deficit is estimated to have narrowed in 2010, reflecting the improved balance of goods and services. Unfavourable terms-of-trade developments are expected to lead to a worsening of the external balance in 2011.

A small downward correction is projected in 2012 from improved net exports.

Risks to the outlook are tilted to the downside. A rise in credit-servicing costs, on account of the expected increase in short-term interest rates, could have a negative impact on credit provision due to the large share of loans with floating interest rate arrangements. In addition, ongoing geopolitical tensions in the MENA region may have a toll on tourist arrivals as of this year and on net exports more generally in view of Malta's positive trade balance with Libya.

### Labour market conditions improve further...

Following a marginal decline in 2009, employment rebounded in 2010. This outweighed the increase in labour supply, resulting in a marginal drop in the unemployment rate. Employment is expected to increase at a more moderate pace in 2011 and 2012, in line with labour supply, leaving the unemployment rate broadly unchanged.

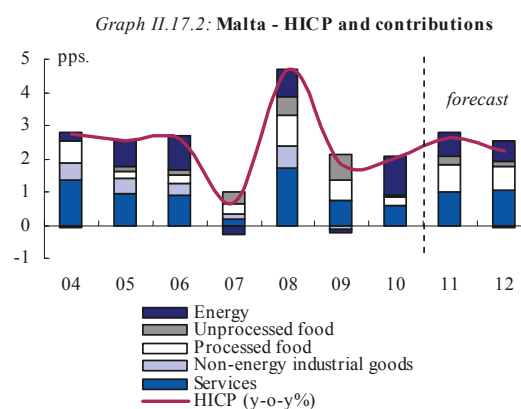
Compensation per employee fell in 2010 following years of relatively strong growth. This is projected to reverse in 2011-12. In 2012 in particular the cost-of-living adjustment mechanism (COLA) is bound to put pressure on wages. Following the recovery in labour productivity in 2010 as a result of the strong rebound in economic activity, productivity gains are expected to moderate over the forecast horizon. As a result, after declining considerably in 2010, unit labour costs are projected to grow faster than for the euro-area average, thereby putting pressure on the international competitiveness of the traditional manufacturing sectors.

### ...while inflation remains above the euro area average

HICP inflation in Malta has exceeded the euro-area average by over 1pp. in 2008-10. Average inflation is expected to rise to 2.7% in 2011, from 2% in 2010, before decelerating to 2.2% in 2012. As a result, it is projected to remain above the euro-area average during the forecast horizon, but to a lesser extent than in 2008-10.

Services are set to be the largest contributor to HICP inflation over the forecast horizon, also due to their relatively large weight in the index. Some factors that are expected to push up services prices are the announced increase in VAT for hotel and

private accommodation as of 2011 as well as improving demand conditions in 2012.



Given Malta's high dependence on imported oil for energy, the energy component of the HICP is also expected to be a strong driver of inflation in 2011, with a slight deceleration expected in 2012. Food inflation is also projected to be rather dynamic in 2011, as a result of increases in global food prices and the increase in excise duties on alcohol and tobacco in the budget for 2011, but is expected to ease in 2012.

### Further improvement in the budgetary position

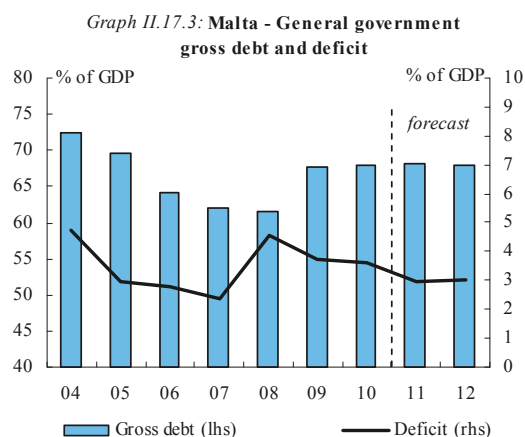
The general government deficit narrowed slightly to 3.6% of GDP in 2010, compared to 3.7% of GDP in 2009.

On the expenditure side, compensation of employees grew only moderately, whereas intermediate consumption and social transfers recorded more pronounced increases. Total current expenditure rose by 3.5%. Gross fixed capital formation remained flat reflecting weak absorption of EU funds, the postponement of some projects and one-off sales of shipyards assets. On the revenue side, tax proceeds grew moderately in 2010 as the rebound in the economy was driven by relatively tax-poor components (exports and investment). By contrast, social contributions increased by more than the economy-wide wage bill, also benefitting from the proceeds of a tax amnesty. Total current revenues grew by 2.8%.

The general government deficit is forecast to narrow to 3% of GDP in 2011, while a balanced position in primary terms is expected for the first time since 2007. Around two-thirds of the deficit reduction between 2010 and 2011 is related to the expiry of some temporary measures supporting the

economy that were adopted in the 2010 budget. Current primary expenditure is expected to decelerate compared to 2010, mainly due to the expiry of the above-mentioned support measures and the efficiency gains targeted in the budget, although social transfers are expected to keep increasing at a fast pace due to buoyant age-related entitlements. After the stagnation recorded in 2010, capital expenditure is set to rebound strongly. Meanwhile, direct taxes are set to accelerate on the back of improved corporate profitability as well as higher household income. Indirect taxes will benefit from the increase in excise duties and the modest rebound in private consumption, while social contributions are set to increase more moderately given the one-off impact of the tax amnesty in 2010.

In 2012, based on the no-policy-change assumption, the deficit ratio is expected to remain unchanged as higher tax revenues are broadly offset by expected increases in the public sector wage bill and social transfers.



The debt ratio increased by 6.5 pps. of GDP between 2008 and 2010 and, based on the no-policy-change assumption, is forecast to continue increasing over the forecast horizon reflecting a modest primary surplus. The upcoming restructuring of Air Malta may give rise to additional government expenditure, thereby entailing upward risks for both the deficit and debt projections.

Table II.17.1:

**Main features of country forecast - MALTA**

	2009			Annual percentage change						
	mio EUR	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP	5850.7		100.0	3.5	4.4	5.3	-3.4	3.7	2.0	2.2
Private consumption	3704.4		63.3	-	0.8	4.0	-1.4	-0.7	0.8	1.4
Public consumption	1239.4		21.2	-	0.5	12.1	-1.3	0.6	0.5	1.1
Gross fixed capital formation	875.5		15.0	-	4.8	-25.3	-18.6	10.0	11.0	3.0
of which : equipment	-	-	-	-	-	-	-	-	-	-
Exports (goods and services)	4540.9		77.6	-	3.1	1.0	-8.4	17.2	6.1	6.1
Imports (goods and services)	4579.2		78.3	-	1.6	-1.1	-11.1	12.6	6.4	5.6
GNI (GDP deflator)	5429.4		92.8	2.8	4.1	5.2	-6.6	3.9	2.0	2.2
Contribution to GDP growth :										
Domestic demand				-	1.7	-0.8	-4.1	1.0	2.2	1.6
Inventories				-	1.4	4.0	-2.3	-1.1	0.0	0.0
Net exports				-	1.3	2.0	3.0	3.7	-0.2	0.6
Employment				1.0	3.2	2.6	-0.3	2.2	1.3	1.4
Unemployment rate (a)				6.5	6.4	5.9	7.0	6.8	6.8	6.7
Compensation of employees/head				5.2	1.5	4.9	2.9	-1.7	2.0	3.0
Unit labour costs whole economy				2.7	0.3	2.3	6.1	-3.1	1.3	2.3
Real unit labour costs				0.1	-2.8	-0.4	3.5	-5.9	-1.3	0.0
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				2.5	3.2	2.7	2.6	3.0	2.6	2.3
Harmonised index of consumer prices				-	0.7	4.7	1.8	2.0	2.7	2.2
Terms of trade of goods				-	0.6	-5.6	-5.4	3.0	-0.4	0.4
Trade balance (c)				-18.3	-18.0	-21.1	-16.6	-14.9	-16.0	-15.8
Current-account balance (c)				-	-5.6	-5.6	-6.9	-4.1	-4.7	-4.5
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-4.6	-5.1	-5.7	-2.8	-3.3	-3.0
General government balance (c)				-	-2.4	-4.5	-3.7	-3.6	-3.0	-3.0
Cyclically-adjusted budget balance (c)				-	-2.1	-5.3	-2.8	-3.5	-3.0	-3.1
Structural budget balance (c)				-	-2.8	-5.6	-3.4	-4.3	-3.1	-3.1
General government gross debt (c)				-	62.0	61.5	67.6	68.0	68.0	67.9

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 18. THE NETHERLANDS

### Gradual rebalancing of growth

#### **The reliance of economic growth on net exports...**

After a severe contraction by 4% in 2009, the Dutch economy recorded positive GDP growth of 1.8% in 2010, driven by the external sector, while domestic demand (excluding inventories) still contributed negatively to economic growth.

Although private consumption growth turned positive again in 2010, it remained modest at only 0.4%. This outcome could be related to the rise in unemployment and relatively low wage increases. Consumer confidence, although improving, remained negative throughout the year. After recording virtually no q-on-q growth in the second and third quarters of 2010, consumption rebounded in the final quarter of 2010 with a positive rate of growth of 0.5% q-o-q. However, this improvement took place against the backdrop of a relatively cold winter, which increased energy consumption.

Investment growth turned out to be negative for the second consecutive year, mainly due to the strong negative carry-over from 2009. Moreover, the different components of investment displayed widely divergent patterns. Investment in construction remained depressed in 2010 and decreased even more compared to 2009. On the other hand, investment in equipment contributed positively and significantly to gross fixed capital formation. However, as capacity utilisation rates remained well below their long-term averages, investment in equipment was mainly based on replacement investment, and therefore it has also not yet recovered to pre-crisis levels.

Net exports proved to be one of the main drivers of economic growth, as the very open Dutch economy benefitted from the strong recovery in world trade. The reliance of growth on net exports improved the trade balance and positively contributed to the current-account surplus. However, it was the improvement in the balance of primary income (which turned negative in response to the crisis) that mainly accounted for the strong rebound in the current-account balance, bringing it back to its pre-crisis level at over 6½% of GDP.

#### **...is expected to gradually diminish as recovery becomes more broad-based.**

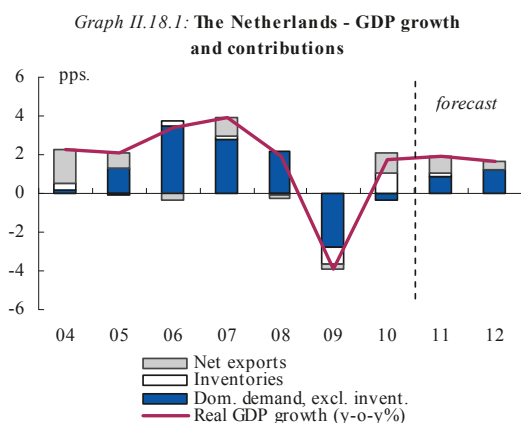
Economic activity is forecast to continue growing moderately, by 1.9% in 2011 and 1.7% in 2012. These growth rates are relatively modest in light of the severe contraction in 2009 and reflect the relatively drawn out and more moderate recovery following a financial crisis. In fact, only in the first half of 2012 is real GDP expected to reach its pre crisis level.

Consumer confidence, whilst still negative, has shown some signs of improvement in the first months of 2011 compared to 2010. Private consumption is expected to progressively firm over the forecast horizon, due to the recovery in household gross disposable income. This mainly results from the gradual improvement in the labour market, which is expected not only to lead to higher employment but also to exert upward pressure on wage developments. It is assumed, however, that real disposable income will be negatively impacted by the increase in inflation foreseen over the same period. Furthermore, the budgetary consolidation is expected to restrain consumption growth, through – amongst other things – lower public employment, wage moderation in the public sector and a higher tax burden. On balance real disposable income is expected to increase moderately. Finally, wealth effects, both financial and non-financial (in particular housing), which can have a large impact on private consumption in the Netherlands, are not expected to play an important role in 2011. Lagged effects from 2010 should be broadly neutral, as an increase in the stock market positively affected the wealth of households, while (limited) price declines on the housing market somewhat decreased housing wealth. All in all, private consumption growth is expected to increase gradually from 0.4% in 2010 to 0.8% in 2011 and 1.1% in 2012.

As the capacity utilisation rate and producer confidence are recovering, investment is expected to positively contribute to economic growth in both 2011 and 2012. A further pick-up in investment is expected in 2012 when capacity utilisation rates are forecast to reach their pre-crisis levels, driving corporations to undertake new investment. Since corporations have continuously

improved their balance sheets, financing conditions should not create constraints for investment, although rising interest rates could lead to somewhat muted dynamics. The outlook for investment in the construction sector, despite the recent improvement of the relevant confidence indicator, remains subdued. A large spare capacity in especially the non-residential segment is expected to dampen investment in construction. Finally, gross fixed capital formation by the government is set to decrease in 2012 as a result of the consolidation measures put in place. Overall, investment is forecast to expand by around 3% in 2011 and 4% in 2012.

Net exports are expected to positively contribute to economic growth throughout the forecast horizon. However, growth would rely gradually less on net exports and more on internal demand, as a result of a combination of higher domestic demand and lower export growth in the wake of moderating world trade developments. The contribution of net exports is expected to fall gradually from 1% in 2010 to 0.9% and 0.5% in 2011 and 2012 respectively, while domestic demand (including inventories) is expected to see its contribution to GDP growth gradually increase over the forecast horizon, from 0.8% pp. in 2010 to 1.2% pps. in 2012.



### Inflation on the rise

After two years of low inflation of around 1% in 2009 and 2010, HICP is expected to rise significantly to 2.2% in 2011, mainly as a result of increases in energy prices and unprocessed food prices. Although the impact of these increases is forecast to gradually fade out in 2012, the continuous improvement in the labour market in 2011-12 is expected to put pressure on wages and

unit labour costs. The continued expected improvement in private consumption in 2012 will also put additional pressure on inflation. On balance, HICP inflation is expected to only slightly decrease from 2.2% in 2011 to 2.1% in 2012.

This macroeconomic scenario is subject to both positive and negative risks. On the negative side, a further increase in the oil price could hold back the global recovery, which would particularly impact the Netherlands due to the openness of the economy. Furthermore, the recovery in the Dutch housing market might further lag the economic upturn, hampering the pick-up in private consumption through negative confidence and wealth effects. On the positive side, more buoyant demand from emerging markets could improve the growth outlook.

### The gradual improvement in the labour market is expected to continue.

In 2009, the unemployment rate increased by slightly more than ½ pp. to 3.7% and further to 4.5% in 2010, which is still rather modest given the size of the contraction in output during the economic and financial crisis. The tight labour market before the crisis played an important role, as employers were reluctant to fire personnel given the difficulties to attract and retain qualified workers before the crisis. Based on short-term indicators, in particular more positive consumer expectations about unemployment and rising numbers of unfilled vacancies, the prospects for unemployment developments point to a continued gradual decrease, though rates are expected to remain above pre-crisis levels over the forecast horizon. Employment growth in the course of 2011 is driven by the private sector, as the public sector is negatively affected by the consolidation measures of the government aiming to reduce the size of government. From a more medium-term perspective, positive economic growth is expected to increase both the labour supply, as discouraged workers return to the labour force, and labour demand, given the increase in economic output. Overall, the unemployment rate is forecast to follow a slightly downward path to 4.2% and 4.0% in 2011 and 2012 respectively.

Nominal unit labour costs are expected to increase over the forecast horizon as the improved labour market prospects and rising inflation are set to create upward pressure on wages in the private sector, although the wage moderation in the public



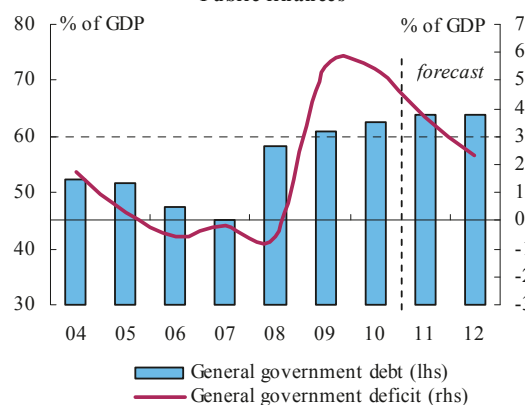
sector may have some spill-over effects on private sector wage dynamics. Furthermore, employers' social contributions are expected to increase, exerting further upward pressure on labour cost developments.

#### A strong improvement in the general government balance and debt set to stabilise

The general government balance stabilised in 2010, with a deficit of 5.4% of GDP. The deficit outturn was the result of a combination of higher expenditure and higher revenue. Total government expenditure increased mainly due to lagged effects of the economic crisis, in particular the rise in unemployment benefits, while higher total general government revenue was underpinned by the economic recovery. For 2011, the general government balance is expected to considerably improve from a deficit of 5.4% of GDP to 3.7% of GDP. The improvement mainly follows from the withdrawal of the stimulus package and the consolidation measures put in place by the previous and current government. Continued consolidation is expected to further improve the general government deficit in 2012 to 2.3% of GDP.

The general government debt increased from 60.8% of GDP in 2009 to 62.7% of GDP in 2010. The relative moderate increase, taking into account

Graph II.18.2: The Netherlands -  
Public finances



the size of the deficit, is mainly due to the repayment by banks of the financial support given by the government in response to the financial and economic crisis. The general government debt ratio is expected to increase further to 63.9% in 2011 as more debt redemption by banks is expected to mitigate the increase in the debt level ensuing from a still-high deficit and the debt ratio is expected to stabilise around that level in 2012.

Table II.18.1:

#### Main features of country forecast - THE NETHERLANDS

	2009			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP	572.0	100.0	100.0	2.6	3.9	1.9	-3.9	1.8	1.9	1.7
Private consumption	262.6	45.9		2.1	1.8	1.1	-2.5	0.4	0.8	1.1
Public consumption	162.7	28.4		2.6	3.5	2.5	3.7	1.5	-0.1	-0.1
Gross fixed capital formation	108.9	19.0		2.9	5.5	5.1	-12.7	-4.8	3.0	4.1
of which : equipment	31.3	5.5		4.2	8.6	4.9	-19.0	7.6	7.7	8.0
Exports (goods and services)	395.9	69.2		6.2	6.4	2.8	-7.9	10.9	6.4	6.0
Imports (goods and services)	354.6	62.0		6.2	5.6	3.4	-8.5	10.5	5.8	6.1
GNI (GDP deflator)	556.5	97.3		2.8	2.9	-1.7	-4.7	4.9	2.0	1.8
Contribution to GDP growth :										
Domestic demand				2.3	2.8	2.2	-2.8	-0.3	0.9	1.2
Inventories				0.0	0.1	-0.1	-0.9	1.1	0.1	0.0
Net exports				0.3	1.0	-0.2	-0.2	1.0	0.9	0.5
Employment				1.1	2.2	1.2	-1.2	-0.6	0.5	0.7
Unemployment rate (a)				4.7	3.6	3.1	3.7	4.5	4.2	4.0
Compensation of employees/f.t.e.				3.5	3.4	3.6	2.2	1.1	2.9	2.5
Unit labour costs whole economy				1.9	1.7	3.0	5.1	-1.2	1.4	1.6
Real unit labour costs				-0.4	-0.1	0.6	5.3	-2.8	-0.4	-0.6
Savings rate of households (b)				15.6	13.0	12.0	13.4	12.2	12.4	12.8
GDP deflator				2.4	1.8	2.4	-0.2	1.6	1.9	2.1
Harmonised index of consumer prices				2.2	1.6	2.2	1.0	0.9	2.2	2.1
Terms of trade of goods				0.5	-0.1	-0.1	-0.8	-0.6	0.0	0.2
Trade balance (c)				5.8	7.6	7.3	6.7	7.4	8.3	8.7
Current-account balance (c)				5.6	8.4	4.8	3.4	6.7	7.7	8.3
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				5.3	8.2	4.4	3.1	6.0	7.1	7.7
General government balance (c)				-1.6	0.2	0.6	-5.5	-5.4	-3.7	-2.3
Cyclically-adjusted budget balance (c)				-1.4	-0.9	-0.5	-3.6	-3.8	-2.5	-1.3
Structural budget balance (c)				-	-0.9	-0.5	-3.6	-3.7	-2.5	-1.3
General government gross debt (c)				62.4	45.3	58.2	60.8	62.7	63.9	64.0

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 19. AUSTRIA

Stronger growth, but subject to greater risk

### Export-driven recovery in 2010 setting the stage for higher investment

The recovery of the Austrian economy gained further ground in 2010. GDP growth averaged 1% q-o-q in the second to fourth quarter after essentially stagnating in the first and reached an annual average of 2%. Net exports were the main driver of growth, with a contribution of 1.2 pps. Exports of goods and services expanded by a robust 10.8%.

While overall gross fixed capital formation declined by 1.3% in 2010, investment in construction diminished by 3.4%, not least because of slashed local government residential construction budgets. In addition, sentiment in the construction sector has been broadly stable, leading indicators such as new orders and building permits still fall short of signalling an upturn. The performance of equipment investment was more promising. The strong rise in exports put capacity utilisation in manufacturing on a sustained upward path, which ignited a firm revival of equipment investment in the second quarter of 2010 and bodes well for investment activity in the coming quarters.

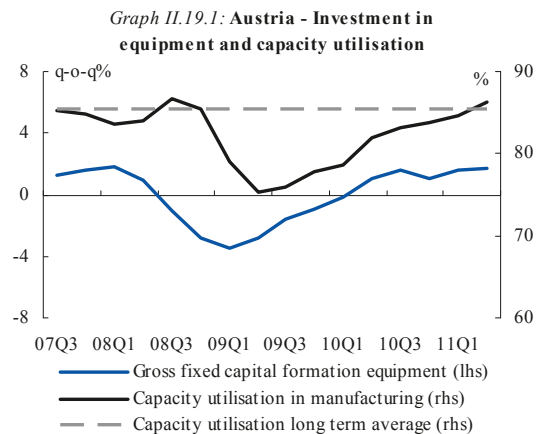
Having played a major stabilising role throughout the recession, private consumer demand continued to increase steadily, albeit moderately, throughout 2010, posting 1% growth for the year. This reflects above all favourable labour-market developments as evidenced by the reversal of the employment loss of 2009. Consumer confidence was also rather solid throughout the second half of 2010 and in the first few months of 2011.

### 2011 and beyond – domestic demand regains ground

The recovery of the Austrian economy is set to continue and become more broad-based. The latest survey data suggest that the upward trend in industrial activity will be sustained. Austria is among a group of countries enjoying close ties with the German economy, and with its exporting sectors in particular, and benefits indirectly from the ongoing buoyant demand in the emerging economies of Latin America and Asia. The increase in unit labour costs paused in 2010 as labour productivity growth resumed.

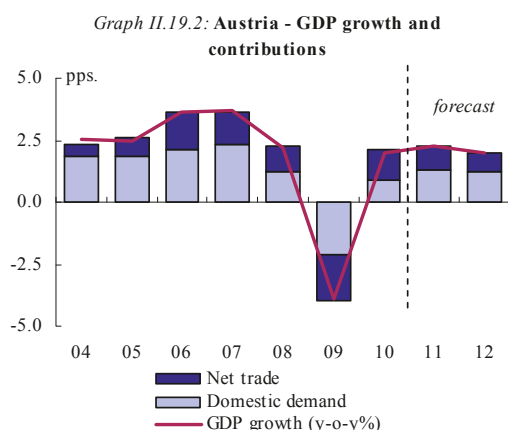
Labour-productivity growth is projected to remain solid in 2011-12 while wage growth continues to be moderate. Thus, relative unit labour costs are set to decrease mildly and to support strong export growth in line with demand in relevant markets.

Meanwhile, equipment investment is projected to increasingly turn into a major growth-supporting factor. Companies are expected to continue renewing and expanding their capital stock in response to rapidly increasing capacity utilisation. The latter reached 86.3% in April 2011 thus exceeding the long term average. A gradual recovery in construction investment may also take place later in 2011 and into 2012.



The growth of private consumption expenditure is set to remain restrained at about 1% in 2011-12. Higher energy and food prices at the onset of 2011 have worked their way into consumer price inflation and are likely to weigh on household real disposable income and consumer demand. Due to higher inflation, real wages are likely to decline in 2011 and to pick up only in 2012.

All in all, real GDP is forecast to grow by 2.4% in 2011 and 2% in 2012. The projected strengthening of investment activity along with continued growth of private consumption will bring about a rebalancing of growth towards domestic sources with net exports nevertheless maintaining an important role.



### Revival of inflation in 2011

Having stayed below 2% for most of 2010, inflation reached 3.3% in March 2011. About one third of this year-on-year increase was attributable to higher motor and heating fuel prices. Another 0.4 pp. was due to the increase in the tax on cigarettes introduced in the context of fiscal consolidation. Wholesale prices were up by 12% in March over the previous year. Core inflation, defined as HICP excluding energy and unprocessed food, has not remained unaffected by these surges as they seem to have spilled over into service prices, where the annual rate of change accelerated from 1.6% in January to 2.3% in March 2011. The rise in inflation is eroding purchasing power as it exceeds the increase in negotiated wages. These effects are projected to gradually subside by 2012, leading to a moderation of inflation. Wage dynamics should remain contained over the forecast horizon as unemployment remains above pre-crisis levels.

### Labour market to improve further

In view of the severity of the recession, employment held up relatively well, declining by around 1½% in 2009. In 2010, job growth resumed and by the end of the year the employment loss was reversed on the back of steadily growing labour demand in services and a recovery in industrial employment. As of March 2011, unemployment is 14% lower compared to the peak of October 2009. This, however, reverses less than half of the unemployment increase caused by the crisis. The economic recovery seems to be triggering additional labour supply as the participation rate has gained ½ pp. in 2010 to reach 77.4%. Accordingly, the projected employment increases of the order of slightly below 1% in both

2011 and 2012 are likely to bring about only a gradual decline in unemployment.

### Statistical revision leads to upward shift of government deficit

Following the outcome of the discussions between the Austrian authorities and Eurostat on the implementation of rules contained in the "Manual on Government Deficit and Debt", on 31 March 2011 Austrian public finance figures were revised from 1995 onwards. While the changes concerning the period up to 2006 are less significant, those for the years 2007-10 raised the general government deficit by between 0.4 and 1% of GDP. The revisions stem from three sources: 1) the assumption by the government of 70% of the costs of infrastructure financing of the Austrian Federal Railways, 2) the costs of financing the regional public hospitals, and 3) the assumption of a part of the liabilities of the "bad bank" KA Finanz.

The general government deficit rose from 4.1% in 2009 to 4.6% in 2010. The increase was entirely due to the above-mentioned statistical revision. Without it the deficit would have come in at about 3.5% of GDP in both years. Additional discretionary measures came into force in 2010 and burdened the budget by about ¼% of GDP (namely parts of the 2009 tax reform such as relief for families with children and tax cuts for the self-employed). The accelerated depreciation provision for investments, for fixed assets adopted in January 2009, also weighed somewhat on the budget in 2010. However, the discretionary measures were to a large extent offset by higher-than-expected tax receipts. It should be stressed that the estimated deterioration in the structural budget balance in 2010 includes the above-mentioned assumption of the bad bank's liabilities (equivalent to about 0.4% of GDP).

Fiscal consolidation, facilitated by the favourable economic developments, is set to begin in 2011, and is projected to result in a narrowing of the deficit to 3.7% of GDP in 2011 and 3.3% in 2012. The Austrian government's initial intention was to arrive at a deficit lower than 3% of GDP as soon as 2012, but the above-mentioned revision challenged this plan.

At the end of December 2010, the Austrian parliament adopted a budget law for 2011, which contained a package of measures (amounting to around ¾% of GDP) aimed at bringing Austrian

public finances back to a sustainable path. Almost half of the consolidation effort is to take place on the revenue side. The biggest item is a bank levy (0.2% of GDP), designed in response to the latest global financial crisis and intended to collect a contribution from financial institutions to the costs of stabilising the financial sector borne by the Austrian authorities. The effect of the latter is being mitigated, however, by the withdrawal of a fee on loans. Another substantial element in the package is a rise in the fuel tax and in the tax on cigarettes (a combined effect of around 0.2% of GDP). Apart from this, the set of agreed measures comprises inter alia: the introduction of a tax on airline tickets, a rise in the tax on property sales by private foundations and an increase in registration fees for less environment-friendly vehicles, the total effect of which should have only a modest budgetary impact.

The measures on the expenditure side consist mainly of cuts in family allowances and pension entitlements as well as some saving in the area of long-term care. Some reductions in administrative costs are also foreseen across the board. The effect of these expenditure measures will coincide with a drop in spending on labour market relief as the short-time work scheme is being phased out. However, the consolidation effort will partly be offset by additional spending on education, R&D

and energy-saving renovation of buildings agreed by the government coalition partners in the consolidation package.

The execution of consolidation plans should be facilitated by the recent agreement between the three layers of government on the new edition of the Austrian Stability Pact, which prescribes consolidation targets for each layer. The agreement also foresees strengthening the Pact's enforcement mechanism and streamlining the financing of long-term care across the central, regional and local governments.

Due to statistical revisions for the period from 1999 onwards, gross government debt surpassed 72% of GDP in 2010. The revision stemmed from both the above-mentioned adjustment to the general government deficit series and, less significantly, a reclassification of other items impacting only on debt (e.g. treatment of cash collaterals and regional public housing unit). Throughout the forecast period, the debt ratio is projected to rise continuously, from almost 74% of GDP in 2011 to over 75% of GDP in 2012.

Table II.19.1:

**Main features of country forecast - AUSTRIA**

	2009			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP	274.3		100.0	2.2	3.7	2.2	-3.9	2.0	2.4	2.0
Private consumption	149.0	54.3		1.7	0.7	0.5	1.3	1.0	1.1	1.1
Public consumption	54.5	19.9		2.0	2.1	4.0	0.4	-2.4	0.8	0.8
Gross fixed capital formation	58.0	21.1		1.4	3.9	4.1	-8.8	-1.3	3.0	2.9
of which : equipment	22.0	8.0		1.5	6.6	7.5	-14.5	1.8	8.3	5.0
Exports (goods and services)	138.6	50.5		6.1	8.6	1.0	-16.1	10.8	7.0	6.8
Imports (goods and services)	126.2	46.0		5.0	7.0	-0.9	-14.4	9.2	5.9	6.3
GNI (GDP deflator)	271.4	98.9		2.2	3.6	2.0	-3.6	1.8	2.4	1.9
Contribution to GDP growth :										
Domestic demand				1.7	1.6	1.8	-1.1	-0.2	1.4	1.4
Inventories				0.0	0.7	-0.6	-1.0	1.1	0.1	0.0
Net exports				0.5	1.3	1.1	-1.8	1.2	0.9	0.6
Employment				0.5	1.5	1.6	-1.6	1.0	0.8	0.7
Unemployment rate (a)				4.2	4.4	3.8	4.8	4.4	4.3	4.2
Compensation of employees/f.t.e.				2.7	3.0	3.2	2.3	1.6	2.5	2.7
Unit labour costs whole economy				0.9	0.8	2.7	4.8	0.6	1.0	1.4
Real unit labour costs				-0.6	-1.2	0.8	3.9	-0.9	-0.8	-0.3
Savings rate of households (b)				-	16.2	16.5	16.0	15.0	14.9	15.0
GDP deflator				1.6	2.1	1.9	0.8	1.5	1.7	1.8
Harmonised index of consumer prices				1.9	2.2	3.2	0.4	1.7	2.9	2.1
Terms of trade of goods				-0.1	-0.5	-2.1	2.1	-1.5	-1.8	-0.5
Trade balance (c)				-2.2	0.4	-0.2	-0.8	-0.8	-1.1	-1.2
Current-account balance (c)				-0.5	4.0	3.7	2.6	2.6	2.6	2.8
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-0.6	4.1	3.7	2.7	1.5	1.7	2.1
General government balance (c)				-2.6	-0.9	-0.9	-4.1	-4.6	-3.7	-3.3
Cyclically-adjusted budget balance (c)				-2.6	-2.0	-2.2	-2.9	-3.7	-3.2	-2.9
Structural budget balance (c)				-	-2.0	-2.2	-2.9	-3.7	-3.2	-2.9
General government gross debt (c)				64.7	60.7	63.8	69.6	72.3	73.8	75.4

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Note : Contributions to GDP growth may not add up due to statistical discrepancies.

## 20. POLAND

Recovery continues as strong private demand counterbalances rapid fiscal consolidation

### Broad-based rebound supported by exports and resilient labour market

In 2010, real GDP growth increased to 3.8% up from 1.7% in 2009. Compared to the countries which experienced a severe recession in 2009 the rebound was subdued, but from a strong base. The level of real GDP in Poland has increased by 11% since 2007, much more than in any other EU country.

Real GDP growth in 2010 was driven by private consumption and restocking. Improving labour market prospects underpinned private consumption while rebounding external demand fuelled the domestic manufacturing sector and strengthened the turnaround in the inventories cycle. Private investment, however, was held back by the uncertain global outlook and constrained credit supply, although inflows of EU funds supported public investment spending. All in all, investment shrank by 2% for the second year running. The contribution of net exports was slightly negative, as the appreciating currency and strengthening domestic demand resulted in accelerating import demand.

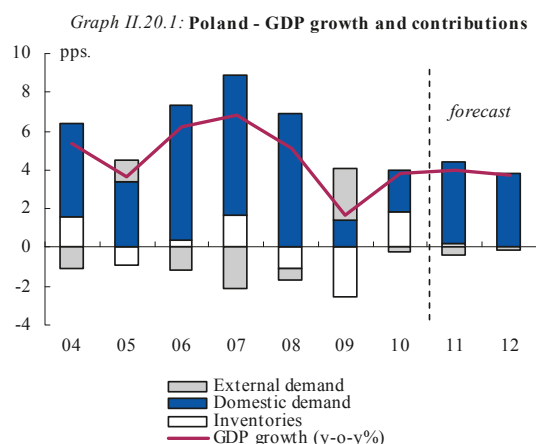
### Recovery broadens as investment spending picks up

The recovery is set to broaden further with real GDP projected to increase by 4% in 2011 and 3.7% in 2012. The main growth drivers are a gradually improving labour market (in particular accelerating wages in the private sector), rebounding consumer and business confidence, a long-awaited increase in private investment on the back of high rates of capacity utilisation and improved profitability, and increased foreign capital inflows.

Private investment is expected to pick up in 2011 after two years of decline. Many companies had put investment on hold during the crisis, uncertain about the global outlook. Given the improved global outlook, high rates of capacity utilisation, and the strong financial position of the corporate sector, these projects are likely to be implemented in the medium term. Finally, capital formation is set to benefit from a robust increase in public

investment in infrastructure ahead of the Euro 2012 football championship.

Real disposable income and consumption will benefit from growing employment, increasing wages and returning consumer confidence, though the increase in indirect taxes and higher inflation will somewhat limit this positive impact. The household saving rate is expected to fall, reflecting mainly recent changes in the pension system and other fiscal consolidation measures. Overall, private consumption growth will gradually increase over the forecast horizon, although still remaining below pre-crisis levels. The impact of external trade on growth is likely to be slightly negative in 2011, as accelerating domestic demand, in particular growing investment, may stimulate imports, outweighing the effects of ongoing strong expansion of exports.



The recovery is expected to moderate somewhat in 2012 due to public investment and public consumption growth. Still, real GDP growth is projected to remain close to potential as the labour market situation improves further and private investment accelerates on the back of a projected loosening of credit conditions.

This scenario is subject to broadly balanced risks. On the upside, a stronger-than-expected rebound in global demand and risk appetite would boost exports and investments. On the downside, a delayed consolidation of public finances could adversely affect market sentiment, and increase the costs of borrowing for the private sector.



### **Current-account deficit widens as foreign capital flows in**

The current-account deficit, which temporarily improved to 2.1% of GDP in 2009 following the sharp depreciation, is estimated to have reached 3.1% of GDP in 2010. It is projected to widen further to above 4% of GDP over the forecast horizon, reflecting a rebound in investment fuelling demand for imports. Ample global liquidity and a growing interest rate differential led to increased portfolio and other capital inflows reaching 8.7% of GDP in 2010, mainly financing sovereign debt. The resulting increase in income transfers is expected to widen the current-account deficit further.

### **Inflation set to moderate in the medium term**

The rate of HICP inflation decreased from 4% in 2009 to 2.6% in 2010, as the effects of the steep depreciation of the domestic currency petered out following the crisis. It is, however, expected to increase again in 2011 reaching 3.8%, as elevated food and energy prices and a rise in administered prices and indirect taxes (VAT and excise duties) start to push up headline inflation. Despite growing wage pressure, it is forecast to moderate to 3.2% in 2012, reflecting developments in non-core components of the index.

Despite relatively modest productivity increases, slow wage growth in 2009-10 kept unit labour costs in check. Looking ahead, emerging labour supply constraints and the unwinding of crisis-driven wage moderation are expected to result in wage acceleration in the private sector over the forecast horizon, which is likely to fuel core inflation and affect unit labour costs, despite a nominal freeze of the wage fund in the public sector.

### **Labour market faces supply side constraints**

After a moderate rise in the unemployment rate in 2009 (by 1.1 pps. to 8.2%), it increased further to 9.6% in 2010 as labour supply increased owing, inter alia, to recent structural reforms. The sharper-than-anticipated downward adjustment of real wages mitigated the effects of the slowdown on employment, which grew by 1% in 2009-10.

Employment growth is set to reach 1.1% in 2011 and 1% in 2012, as hiring is expected to remain muted due to the effect of labour hoarding during the crisis. This will result in unemployment falling

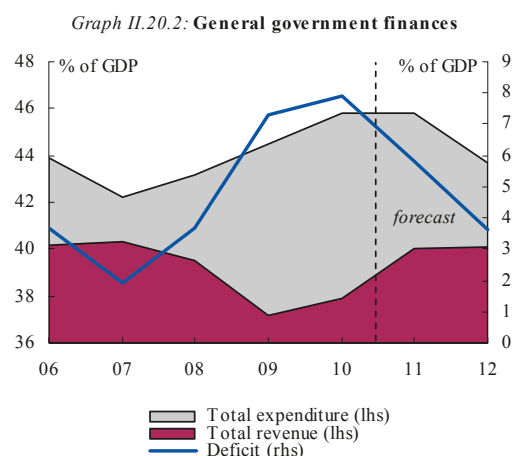
to 8.8% by the end of the forecast horizon. However, in the medium term, mounting demographic pressures will put a limit on the expansion of labour supply. Further reforms favouring dynamic employment creation and longer working life will be needed to sustain a permanent recovery of domestic demand without undermining the competitiveness of the economy.

### **Considerable fiscal consolidation**

After a sharp deterioration in 2009, due to the financial and economic crisis and a sizeable stimulus package to counteract its consequences, the general government deficit continued to increase in 2010. Despite higher-than-projected GDP growth and some minor consolidation measures, it increased from 7.3% to 7.9% of GDP on the back of lower-than-expected revenues from Corporate Income Tax (CIT), higher consumption and investment expenditure and higher-than-expected interest expenditure.

In the 2011 Budget Law, the government has implemented a range of reforms to consolidate public finances. These measures, together with the rebound in economic growth, are expected to bring about a considerable reduction in the headline deficit. On the revenue side, the main effect comes from the amendment of the pension reform that reduces the contribution transferred to the private pension funds from 7.3% to 2.3% of gross wages. The difference is henceforth retained in the public first pillar and classified as budget revenue. The other measures include a 1 pp. temporary increase in VAT rates, the abolition of some VAT and excise duty exemptions and a freeze in Personal Income Tax (PIT) thresholds. As a result of those measures, as well as a higher tax base resulting from faster GDP growth and improvement in CIT annual settlements, the revenue ratio is expected to increase from 37.9% in 2010 to 40.0% in 2011. Developments on the expenditure side are driven mainly by a freeze of the wage fund of public sector employees (with the exception of teachers), and an expenditure rule which limits real growth to 1% in all newly enacted and existing discretionary expenditure items. Together with additional cuts (spending on active labour market policies, funeral benefit) and the impact of the 2009 abolition of early retirement pensions, the new measures are expected to contain any further increase in the expenditure ratio, keeping it constant at 45.8% in 2011. As a result of the reforms implemented and the changes in the macroeconomic environment

the headline deficit is expected to drop from 7.9% of GDP in 2010 to 5.8% of GDP in 2011.



The headline deficit is projected to fall to 3.6% of GDP in 2012, driven by further budgetary consolidation. The main austerity measures (freeze in the wage fund, expenditure rule) implemented in the 2011 budget are expected to remain in force in 2012 and be complemented by an additional rule limiting the deficit of the local government entities, though the budgetary effect of this rule remains uncertain. The fiscal rules, together with announced cuts in public investment at both central and local levels, are expected to have

a large impact on the expenditure ratio which is forecast to drop from 45.8% in 2011 to 43.7% in 2012. A slightly worse labour market situation and tax elasticities lower than those underlying the national projections presented in the Convergence Programme would, however, result in a slowdown in the increase of the revenue ratio, to a mere 0.1 pp.

Given the structural character of most of the implemented and announced reforms and growth close to potential, the structural deficit is forecast to follow the evolution of the headline deficit, falling from 7.4% in 2010 to 5.3% in 2011 and 3.1% of GDP in 2012.

The pace of general government debt increase is projected to slow considerably, supported by the liquidity management reform introduced in 2011 and ambitious privatisation plans. After a sharp increase from 47.1% of GDP in 2008 to 55.0% of GDP in 2010, the debt ratio is projected to grow marginally to 55.4% in 2011 and fall back to 55.1% in 2012. The projected debt figures are, however, subject to considerable uncertainty due to high exchange rate volatility and the ensuing valuation effects on the large foreign-denominated part of the debt.

Table II.20.1:

**Main features of country forecast - POLAND**

	2009			92-06	Annual percentage change					
	bn PLN	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP		1343.7	100.0	4.5	6.8	5.1	1.7	3.8	4.0	3.7
Private consumption		820.7	61.1	4.3	4.9	5.7	2.0	3.2	3.3	3.7
Public consumption		247.8	18.4	3.3	3.7	7.4	2.0	3.5	1.5	0.3
Gross fixed capital formation		285.2	21.2	6.8	17.6	9.6	-1.1	-2.0	9.7	7.0
of which : equipment		103.7	7.7	-	22.3	13.0	-9.1	-9.0	3.5	13.0
Exports (goods and services)		530.3	39.5	11.0	9.1	7.1	-6.8	10.2	7.7	7.6
Imports (goods and services)		529.3	39.4	11.6	13.7	8.0	-12.4	10.7	8.5	7.5
GNI (GDP deflator)		1296.2	96.5	4.5	5.6	6.8	0.1	3.7	3.8	3.5
Contribution to GDP growth :	Domestic demand			4.6	7.2	6.9	1.4	2.2	4.2	3.8
	Inventories			0.1	1.7	-1.1	-2.5	1.8	0.2	0.0
	Net exports			-0.3	-2.1	-0.6	2.7	-0.2	-0.4	-0.1
Employment				-	4.4	3.8	0.3	0.4	1.1	1.0
Unemployment rate (a)				15.1	9.6	7.1	8.2	9.6	9.3	8.8
Compensation of employees/head				16.9	4.9	8.9	2.9	4.7	5.9	6.3
Unit labour costs whole economy				-	2.6	7.5	1.6	1.3	2.9	3.6
Real unit labour costs				-	-1.3	4.3	-2.0	0.0	-0.3	0.3
Savings rate of households (b)				-	8.5	3.7	9.9	10.7	8.2	7.5
GDP deflator				12.9	4.0	3.1	3.6	1.3	3.3	3.3
Harmonised index of consumer prices				-	2.6	4.2	4.0	2.7	3.8	3.2
Terms of trade of goods				0.2	2.0	-2.1	4.4	-1.7	-1.5	0.4
Trade balance (c)				-2.9	-4.0	-4.9	-1.0	-1.4	-2.2	-2.0
Current-account balance (c)				-1.9	-5.1	-4.8	-2.2	-3.1	-4.1	-4.1
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-1.3	-4.1	-4.1	-1.0	-1.1	-1.0	-1.3
General government balance (c)				-	-1.9	-3.7	-7.3	-7.9	-5.8	-3.6
Cyclically-adjusted budget balance (c)				-	-2.9	-4.6	-7.1	-7.4	-5.3	-3.1
Structural budget balance (c)				-	-2.9	-4.6	-7.4	-7.4	-5.3	-3.1
General government gross debt (c)				-	45.0	47.1	50.9	55.0	55.4	55.1

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 21. PORTUGAL

### Times of adjusting and rebalancing

#### Increasing market pressure triggered request for international financial assistance

On 7 April, Portugal requested international financial assistance from the European Union and the International Monetary Fund (IMF). Negotiations between the Portuguese authorities and a joint mission of the Commission, the IMF and the ECB led on 3 May to an agreement on an Economic Adjustment Programme for 2011-14. The Programme includes external financing from the European Union, the euro-area Member States and IMF of up to EUR 78 billion and a commitment by Portugal to embark on a three-pronged strategy of: (i) a credible and balanced fiscal consolidation strategy, supported by structural fiscal measures and better fiscal control over Public-Private-Partnerships and State-Owned Enterprises, aimed at putting the gross public debt-to-GDP ratio on a firm downward path in the medium term; The authorities are committed to reducing the deficit to 3% of GDP by 2013; (ii) deep and frontloaded structural reforms in the labour market, the judicial system, network industries and housing and services sectors, which should boost potential growth, create jobs, and improve competitiveness (including through fiscal devaluation); and (iii) efforts to safeguard the financial sector against disorderly deleveraging through market-based mechanisms supported by back-up facilities.

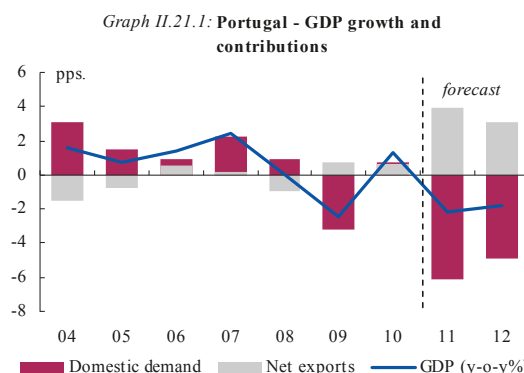
Prior to the request for assistance, unfavourable developments in public finances and a bleak outlook for economic growth had led to a deterioration of confidence and rising pressures in sovereign bond markets. In parallel, the banking sector, which is heavily dependent on external financing, became increasingly cut off from market funding and resorted extensively to funding from the Eurosystem. Failure to achieve parliamentary approval for the Stability Programme triggered the resignation of PM Sócrates's minority government on 24 March. In the wake of consecutive downgrades of Portuguese sovereign bonds, interest rates reached levels that were no longer compatible with long-term fiscal sustainability.

In 2010, Portugal's GDP grew a rate of 1.3%. This positive growth rate was, however, largely due to exceptional factors that boosted exports and

private consumption. The latter particularly benefited from anticipatory effects of the VAT increase in July 2010 and January 2011. Notwithstanding the significant growth contribution of external trade, Portugal lost 0.9% in export market share in 2010. Price and cost developments clearly indicated that Portugal was not gaining competitiveness at a sufficiently fast rate to redress its current account deficit, which was high at 10% of GDP last year. Similarly, fairly robust private consumption benefitted from temporary factors, such as relatively low inflation due to falling energy prices. Moreover, at the end of last year, expectations of increases in indirect taxes led to some front-loading of expenditures. The weak overall economy and the steep increase in unemployment spilled into large government deficits, which exceeded 10% of GDP in 2009 and 9% in 2010, up from 3.5% in 2008.

#### Adjustment recession underway

Economic indicators suggest that domestic demand has declined significantly in the first quarter of 2011 while industrial production has shown some resilience, presumably benefitting from the continued dynamism of exports. At the same time, amid a further tightening of bank-lending conditions, private households and non-financial corporations are expected to accelerate balance sheet repair. This process of deleveraging is expected to extend over the forecast period.



The expected further deterioration in labour-market conditions, significant cuts in public sector wages, a temporary acceleration in consumer prices on the back of a VAT increase and a limited supply of bank credit for households are expected to weigh heavily on household

consumption throughout the forecast period. Private consumption is therefore projected to decline by 4½% this year and by 4% in 2012. As a result of intensified fiscal consolidation efforts, government consumption is set to shrink by 6% and 4½% in 2011 and 2012, respectively, while public investment is projected to decrease by a cumulative 25% during the forecast period. The large fall in domestic consumption will take its toll on private investment, which is expected to continue its long lasting downward trend, shrinking by 10% in 2011 and 7½% in 2012. As a result, domestic demand is forecast to contract by 10% over the forecast horizon.

Exports are projected to increase by 6% per year during 2011-12 in line with expected growth of foreign demand. Imports should drop substantially given the strong projected decline in domestic demand components with a typically-high import content, such as durable consumer and investment goods. The cumulative decline in imports by 8% in 2011-12 and the buoyancy of exports are expected to contribute 7 pps. to GDP growth in the same period. Since this will not compensate for the drop in domestic demand, the cumulative output loss is expected to be 4% over the forecast horizon. On the other hand, the strong rebalancing of the economy from the domestic to the external sector should be reflected in a significant improvement in the current account balance, which is projected to decline from -10% of GDP in 2010 to -7½% in 2011 and -5% next year. However, due to the projected rise in the primary income deficit, net foreign indebtedness is expected to peak in 2012.

#### **Weak domestic demand dampens wage and price pressure**

The rebalancing of the economy is helped by shrinking unit labour costs. Employment accelerated its downward trend in the final quarter of 2010 and is expected to fall by 1.5% in 2011 and 1% in 2012. Compensation per employee in the whole economy is forecast to decline slightly this year and to remain flat in 2012. Moreover, price mark-ups are expected to be compressed in the recessionary environment and as a result of structural reforms. Accordingly, underlying HICP inflation is likely to be subdued over the forecast period. In 2011, headline inflation, boosted by the VAT rate hike and strong oil and commodity price increases is, however, set to reach an annual average rate of 3.4%. The reclassification of goods

in the VAT scheme is forecast to lift HICP inflation to 2% next year.

#### **Risks to the economic outlook are broadly balanced**

There are upside and downside risks to the forecast. On the positive side, labour market reforms – if enacted swiftly – could lead to a more rapid improvement in labour market conditions and trigger a swifter recovery of domestic demand. On the negative side, further increases in interest rates or a faster-than-expected deleveraging in the banking sector could weigh more heavily on private consumption and investment.

#### **Tight fiscal consolidation**

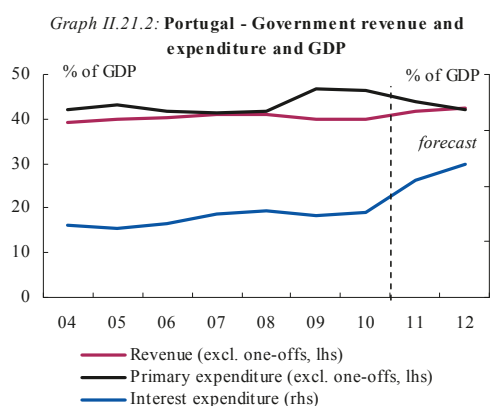
The coming years are expected to be marked by very sizeable efforts to reduce the government deficit and bring the public debt-to-GDP ratio on a downward path. After a notified outturn of 9.1% of GDP in 2010, the government deficit is expected to be 5.9% of GDP in 2011 and 4.5% of GDP in 2012.

The deficit outcome in 2010 turned out to be much worse than the targeted 7.3% of GDP. That was mostly due to the statistical reclassification by Eurostat and the National Statistical Institute of some State-Owned Enterprises and Public-Private Partnerships within the general government, which each added about ½% of GDP to the deficit as well as of the costs related to the rescue of two banks in late 2008 representing 1¼% of GDP (the latter two operations involving a temporary impact in the deficit). In addition, the 2010 budgetary execution was also marked by large one-off deficit-reducing operations, namely the transfer of a pension fund to the government worth around 1½% of GDP.

The plans for 2011 rely on a consolidation package amounting to about 5¾% of GDP as defined in the 2011 Budget, as well as on some additional consolidation measures taken more recently.

The consolidation effort is broad-based and supported by a wide range of measures to reduce spending and to increase revenue. Measures on the expenditure side include an average cut of 5% in government wages, reductions in government payroll lists, cuts in social transfers (such as unemployment benefits and family allowances), and a freeze of all other social outlays. Additional measures are targeted at reining in spending in

a number of other areas, including, for instance, the health sector, and transfers to State-Owned Enterprises or public investment. Consolidation efforts on the revenue side consist mainly of an additional rise of 2 percentage points of the standard VAT rate on 1 January 2011. In addition, revenue proceeds will reflect the carry-over effect of the tax hikes of mid-2010. A number of smaller measures are foreseen, notably to broaden the basis for social contributions and especially to increase non-tax revenues, both by charging higher prices and fees and by selling assets, the latter being more temporary in nature.



In 2012, Portugal is expected to undertake additional consolidation efforts worth about 3% of

GDP. Measures on the expenditure side include further resources rationalisation in the public administration, savings in the areas of health and education, a lowering of costs at state-owned enterprises, further cuts in the public sector wage bill, reductions in pensions, a freeze of cash transfers, and cuts in capital expenditure. On the revenue side, the programme foresees a further broadening of various tax bases. At the level of corporate and personal income, this will be achieved by reducing tax deductions and special regimes, and by the convergence of deductions applied to pension income to those for labour income. In addition, the structure of VAT rates will change, with more goods and service taxed at the standard and intermediate rates and some excise taxes will increase. Finally, temporary exemptions at the level of property taxation will be substantially reduced.

Government debt is projected to reach 102% of GDP in 2011 and 107% in 2012. It is expected to stabilise by 2013 and to fall thereafter. The rising debt levels should lead to a rapid increase in interest payments, which is expected to be the fastest-growing spending item over these years and a major force hampering a faster pace of deficit reduction.

Table II.21.1:

**Main features of country forecast - PORTUGAL**

	2009			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP	168.6	100.0	100.0	2.2	2.4	0.0	-2.5	1.3	-2.2	-1.8
Private consumption	110.9	65.8	65.8	2.4	2.5	1.3	-1.1	2.2	-4.4	-3.8
Public consumption	36.8	21.8	21.8	2.4	0.5	0.4	3.7	1.8	-6.1	-4.6
Gross fixed capital formation	33.6	19.9	19.9	2.0	2.6	-0.3	-11.2	-5.0	-9.9	-7.4
of which : equipment	10.9	6.4	6.4	3.4	7.9	6.9	-13.1	-4.5	-13.6	-9.3
Exports (goods and services)	47.1	28.0	28.0	5.9	7.6	-0.1	-11.6	8.8	6.2	5.9
Imports (goods and services)	59.8	35.5	35.5	6.0	5.5	2.3	-10.6	5.2	-5.3	-2.8
GNI (GDP deflator)	161.8	96.0	96.0	2.0	2.2	-0.4	-2.9	2.0	-2.6	-2.2
Contribution to GDP growth :										
Domestic demand				2.6	2.3	0.9	-2.5	0.8	-6.1	-4.8
Inventories				0.2	-0.1	0.0	-0.6	-0.1	0.0	-0.1
Net exports				-0.6	0.2	-1.0	0.7	0.6	4.0	3.1
Employment				0.5	0.0	0.5	-2.5	-1.5	-1.5	-0.9
Unemployment rate (a)				5.9	8.1	7.7	9.6	11.0	12.3	13.0
Compensation of employees/head				6.0	3.6	3.0	3.3	1.5	-0.3	0.1
Unit labour costs whole economy				4.2	1.2	3.5	3.3	-1.4	0.5	0.9
Real unit labour costs				0.1	-2.0	1.9	2.7	-2.3	-0.6	-0.3
Savings rate of households (b)				-	7.0	7.1	10.9	9.8	10.5	11.5
GDP deflator				4.1	3.2	1.6	0.5	1.0	1.1	1.2
Harmonised index of consumer prices				3.6	2.4	2.7	-0.9	1.4	3.4	2.0
Terms of trade of goods				0.4	0.3	-3.1	5.1	0.2	-2.6	-0.9
Trade balance (c)				-10.3	-10.9	-12.9	-10.1	-10.0	-8.0	-5.9
Current-account balance (c)				-7.8	-10.2	-12.6	-10.7	-9.8	-7.5	-5.2
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-5.6	-8.9	-11.4	-9.7	-8.5	-6.0	-3.7
General government balance (c)				-3.9	-3.1	-3.5	-10.1	-9.1	-5.9	-4.5
Cyclically-adjusted budget balance (c)				-4.0	-3.4	-3.5	-9.1	-8.8	-4.9	-3.1
Structural budget balance (c)				-	-3.6	-3.5	-8.8	-9.2	-5.4	-3.1
General government gross debt (c)				55.2	68.3	71.6	83.0	93.0	101.7	107.4

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.



## 22. ROMANIA

### Signs of recovery after a long recession

#### Weak domestic demand prolonged recession

In 2010, real economic activity declined by -1.3%, after -7.1% in 2009. The long duration of the recessionary period was a result of a sharp downward adjustment in domestic demand, which in the run-up to the crisis had been fuelled by expansionary fiscal policy and a boom in credit growth, mostly in foreign currencies. With the onset of the crisis, new fiscal measures were implemented to rein in government expenditure to bring down the government deficit. Most of these measures were implemented in the second half of 2010, thus prolonging the economic downturn while most of the euro area was already recovering.

Progress in the implementation of measures required by the EUR 20 bn multilateral financial assistance programme of the EU, the IMF and the World Bank has helped to restore confidence among investors in the country. The CDS spreads continued to come down in the first quarter of 2011, bringing them well below levels observed in 2009 during the peak of the crisis. The exchange rate has also strengthened in the first quarter of 2011.

Key economic reforms that can improve the economic outlook and strengthen confidence have been implemented in recent months. A new pension law has increased the retirement age and contains more effective checks against abusive early retirement. A new unified wage law for public sector employees provides a stable structure of career progression and reduces the scope for excessive spending on bonuses.

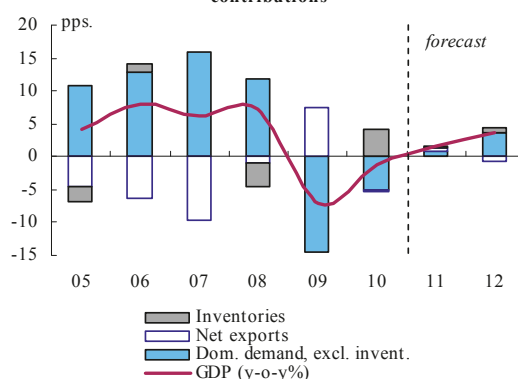
Signs of a moderate economic recovery emerged in the last quarter of 2010 and the economy registered a 0.1% quarter-on-quarter growth. This was mainly due to strong export growth and a recovery in investment helped by a massive increase in industrial value added. However, private consumption growth was still in negative territory as real wages in the economy were being eroded by high inflation, while lower wages and layoffs in the public sector resulted in lower government consumption.

#### Gradual recovery underpinned by stronger investment in 2011...

There are positive signals that economic growth will improve more convincingly in the first quarter of 2011. Industrial production and exports continued to increase, while also retail trade showed signs of recovery. Confidence has improved across the board, including among consumers, which may reflect a general sentiment that the worst is over. Economic sentiment among manufacturing companies is already above its historical average.

Real GDP in 2011 is forecast to grow by 1.5%. The main drivers of growth are expected to be higher gross fixed capital formation and a modest recovery in private consumption; both components had declined sharply during the recession. Private sector investment will be sustained on the back of robust industrial production and new orders. Continued strong external demand, coupled with even higher capacity utilisation rates, will induce companies to invest in new equipment. Public investment expenditure is also expected to pick up as new infrastructure projects, mostly financed by EU funds, get implemented at a faster pace.

Graph II.22.1: Romania - GDP growth and contributions



Household consumption is expected to strengthen this year, albeit to a lesser extent than investment because of still weak household balance sheets. Many households are still adjusting to the higher debt-service-to-income ratios that have resulted from high interest rates and lower incomes, leaving little margin for more consumption. In fact, non-performing loans increased further during the first quarter of 2011. Moreover, persistently high

inflation held back purchasing power of households. Nevertheless, the improvement in consumer confidence and a slight recovery in employment are expected to push up consumption in 2011.

#### ... and by strengthening consumption growth in 2012

GDP growth is expected to reach 3.7% in 2012, above its estimated rate of potential growth of 2½-3%. Growth will become more broadly based on the back of stronger domestic demand. Private consumption is expected to recover due to somewhat higher wage increases. Labour productivity increases in the past years in the private sector – only partially attributable to labour shedding – can be expected to translate into higher wages and, as demand strengthens, additional employment opportunities.

Government consumption is expected to increase somewhat but will be limited due to continued fiscal consolidation. Besides private households' consumption, investment will continue to be a key growth driver in 2012 as the country continues to modernise its infrastructure and companies respond to both external and internal demand.

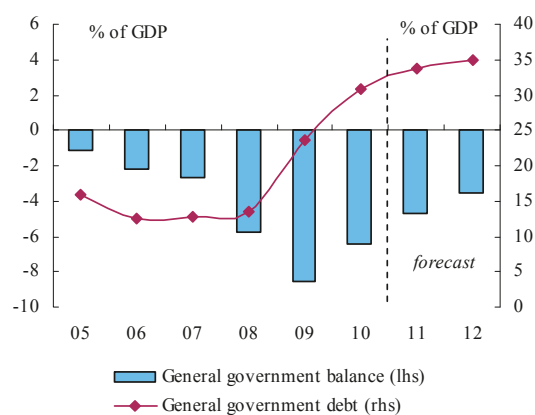
#### Further current-account adjustment hampered by lack of structural reforms

Following a sharp improvement, the current-account balance remained in negative territory in 2009 and 2010 despite a steep decline in domestic demand and sizeable depreciation of the exchange rate. The external balance is not expected to improve in 2011 and 2012 as structural reforms necessary to enhance export capacities and competitiveness have been insufficient so far. Thus, the current-account deficit is expected to remain stable at around 4½% of GDP in 2011. Data for the first months of 2011 show that the trade deficit has narrowed somewhat; however this is expected to reverse in the second half of 2011 on the back of stronger consumption and investment and a slightly worsening services balance. The current-account deficit is expected to widen somewhat in 2012 due to a stronger pick-up in private consumption.

#### High inflation continues to pose challenges to monetary policy

The end-year inflation target of 3% for 2011 will probably be missed by a significant margin, as inflation is expected to be above 5%. The higher-than-expected inflation is mainly due to substantial food and commodity price increases and the impact of the VAT increase in July 2010, which will be only partially counter-balanced by appreciation of the currency in the first months of 2011. With a projected annual average inflation rate of 6.7% in 2011, there is little scope for lowering the policy rate. Inflation should decelerate considerably in 2012 as the impact of energy and food price hikes fade. However, the expected price deregulation in the energy sector, for which the plans and timetable are not yet fully established, pose an upside risk to inflation.

Graph II.22.2: Romania - Public finances



#### Public Finances<sup>(81)</sup>

As a result of the implementation of ambitious fiscal consolidation measures in mid-2010 – including an increase in the VAT rate from 19% to 24%, a temporary 25% reduction in public wages and a 15% reduction in social spending excluding pensions – the budget deficit in 2010 decreased to 6.4% of GDP, better than originally expected. As a result of the consolidation measures, revenue from VAT increased, whereas compensation of employees decreased and income from current taxes on income and wealth and social security contributions fell reflecting negative labour market developments. The presence of arrears at the level

<sup>(81)</sup> The forecast for public finances is based on the figures notified by the Romanian authorities in their EDP notification of April 2011. However, Eurostat has expressed reservations as to the quality of the Romanian EDP figures. Therefore the public finances forecast may have to be revised as new information becomes available.

of state-owned enterprises (SOEs) remains an important contingent liability for the budget, and particularly so for enterprises that risk being reclassified in the general government sector in line with ESA95 requirements. The authorities are currently working on structural measures to reduce the stock of SOE arrears and to prevent their re-accumulation.

The budget deficit is projected to decrease to 4.7% of GDP in 2011. On the revenue side, the forecast assumes that all major taxes remain unchanged. However, revenue from social security contributions is expected to increase, partly due to

the introduction of health insurance contributions for pensioners with pensions higher than RON 740 per month. On the expenditure side, fiscal consolidation measures taken in 2010 will carry over into the first half of 2011. Further expenditure restraint, as well as a non-reversal of existing measures, should also contribute positively. Measures that should lead to further expenditure restraint include the continued freeze of pensions, a reduction of heating subsidies and the perpetuation of public sector hiring limits. In 2012, the budget deficit is forecast to decrease to 3.6% of GDP under a no-policy-change assumption.

Table II.22.1:

**Main features of country forecast - ROMANIA**

	2009			92-06	Annual percentage change					
	bn RON	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	498.0		100.0	2.5	6.3	7.3	-7.1	-1.3	1.5	3.7
Private consumption	311.5		62.5	5.0	11.9	9.0	-10.2	-1.7	0.6	3.1
Public consumption	90.8		18.2	0.6	-0.1	7.2	1.6	-3.6	-1.5	1.5
Gross fixed capital formation	130.6		26.2	8.2	30.3	15.6	-25.2	-13.1	3.5	5.9
of which : equipment	50.2		10.1	9.3	28.3	10.9	-32.7	-2.0	8.2	7.3
Exports (goods and services)	153.3		30.8	11.3	7.8	8.3	-5.3	13.1	8.4	7.3
Imports (goods and services)	183.6		36.9	13.0	27.3	7.9	-20.9	11.6	6.6	8.1
GNI (GDP deflator)	491.2		98.6	2.3	6.1	8.1	-5.6	-1.1	0.9	3.7
Contribution to GDP growth :										
Domestic demand				5.9	15.9	11.9	-14.4	-5.1	0.9	3.6
Inventories				-1.6	0.0	-3.5	-0.1	4.1	0.3	0.8
Net exports				-1.6	-9.6	-1.0	7.5	-0.2	0.3	-0.8
Employment				-2.6	0.4	0.0	-1.8	-1.8	0.1	0.6
Unemployment rate (a)				6.6	6.4	5.8	6.9	7.3	7.2	6.8
Compensation of employees/head				64.7	22.0	31.9	-6.6	1.3	2.2	6.0
Unit labour costs whole economy				56.5	15.2	22.9	-1.3	0.8	0.8	2.9
Real unit labour costs				-1.4	1.5	6.6	-5.2	-3.5	-3.5	-1.2
Savings rate of households (b)				-	-11.5	-1.1	-	-	-	-
GDP deflator				58.7	13.5	15.3	4.1	4.5	4.4	4.2
Harmonised index of consumer prices				-	4.9	7.9	5.6	6.1	6.7	4.0
Terms of trade of goods				0.9	10.6	3.2	0.1	2.4	-1.3	0.5
Trade balance (c)				-6.9	-14.3	-13.6	-5.8	-4.8	-4.9	-5.1
Current-account balance (c)				-	-13.6	-11.4	-4.2	-4.2	-4.4	-4.8
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-4.9	-13.0	-11.0	-3.6	-4.0	-4.2	-4.6
General government balance (c)				-	-2.6	-5.7	-8.5	-6.4	-4.7	-3.6
Cyclically-adjusted budget balance (c)				-	-4.9	-8.7	-8.3	-5.2	-3.3	-2.8
Structural budget balance (c)				-	-4.9	-8.2	-8.8	-5.5	-3.3	-2.8
General government gross debt (c)				-	12.6	13.4	23.6	30.8	33.7	34.8

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 23. SLOVENIA

### Momentum slow to build after particularly pronounced downturn

#### Moderate rebound in 2010

After a much more abrupt fall in real GDP in 2009 than in the euro area as a whole, Slovenia is now experiencing a relatively muted export-led recovery. Prospects for exports are subdued by cost competitiveness losses accumulated before and during the crisis and by the geographical orientation of exports, which are centred on EU and Western Balkan trade partners with a weak presence in high-growth emerging markets. Another factor holding back growth is the sustained slump in construction following the boom. Finally, the flow of credit to the real economy has dwindled as banks and non-financial corporations struggle to repair their balance sheets. Against this background, Slovenia's economic catching-up process has yet to resume.

The export-led recovery, underway since the third quarter of 2009, has been muted, both in the euro-area perspective and considering that real GDP fell by almost 10% in the three preceding quarters (largely driven by collapsing investment). In 2010 real GDP is estimated to have grown by 1.2% due to net exports and the turning of the inventory cycle. However, gross fixed capital formation, particularly construction, continued to subtract from growth. A weak labour market, high corporate indebtedness and adverse banking sector developments have all contained domestic demand.

The labour market reacted to the recession with a considerable lag in 2010 and employment continued to trend downwards, depressing household consumption. Whereas job losses came from the non-renewal of temporary contracts in the downturn, 2010 saw increased redundancies mainly from manufacturing and construction. Unemployment continued to rise in 2010, ending the year at 8% of the labour force. Labour cost pressures continued in 2010 with a large one-off increase in the minimum wage and some composition effects from job losses.

The difficulties of the banking sector and over-indebtedness of parts of the non-financial corporate sector may have held back recovery in gross fixed capital formation, as the delayed effects of the downturn on loan portfolios materialised. Slovenia's two largest banks have

required recapitalisation. Banks, whose capital adequacy remains low, even following recapitalisations amounting to over 1% of GDP, are particularly exposed to over-indebted construction companies and leveraged buy-out holding companies.

#### Subdued outlook

Over the forecast horizon real GDP growth is driven by the continuation of the export-led recovery. Net exports are expected to account for half of real GDP growth in 2011. In 2012, the recovery is expected to strengthen somewhat, with a weakening contribution from net exports more than compensated by strengthening contributions from domestic demand.

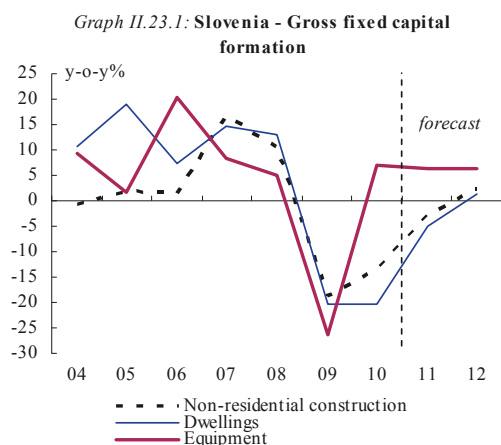
Export growth is forecast to outstrip import growth in volume terms over the forecast horizon, albeit by a diminishing margin as import growth accelerates in 2012. The growth rate of merchandise exports, which was boosted by recovering world trade in 2010, is expected to ease in 2011 and 2012, while services exports, which continued to decline in 2010, are projected to post accelerating growth.

The external deficit is projected to deteriorate over the forecast horizon due partly to projected increased interest payments and partly to adverse terms of trade developments. This may particularly squeeze margins for Slovenian manufacturers given the high energy intensity of the Slovenian economy relative to the euro area.

Domestic demand, which contracted by 1.2% in 2010, is forecast to return to positive territory and increase over the forecast horizon on the back of resumed growth in construction output and strengthening household consumption. Muted household consumption growth is forecast in 2011 due to still-deteriorating labour market conditions and incomes remaining static after the boost from the 2010 minimum wage increase. In 2012, improving labour-market conditions and rising household incomes are expected to lead to faster household consumption growth.

The substantial decrease in gross fixed capital formation in 2010 was driven by falling construction output. This drag from construction is

expected to dissipate in 2011-12, permitting a return to modest growth of overall investment in 2011. However, investment growth rates are expected to remain significantly below their pre-crisis trend, falling a long way short of reversing the falls in 2009-10. This reflects ongoing adjustment in the construction sector, decelerating export growth, continued low bank lending and the limited scope for financing investments out of retained earnings given the high indebtedness of parts of the non-financial corporate sector. Together with domestic banks' needs to refinance a large part of their funding in the next two years, these factors represent downside risks to the near-term outlook.



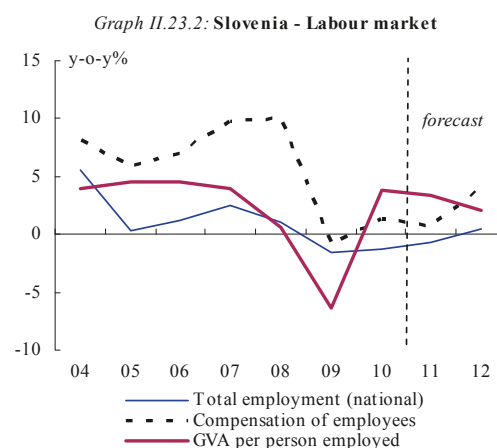
### Employment still falling in 2011

Employment is forecast to fall significantly again in 2011, due partly to carry-over from 2010, and to start improving only in 2012. Over the forecast horizon, increased output is initially expected to raise labour productivity, with employment growth occurring with a lag. This represents the reversal of the employment dynamics witnessed in the downturn. Moreover, ongoing employment losses in construction, many of them affecting foreign workers, are unlikely to be completely reversed if, as expected, the sector's share in gross value added settles at a lower, more sustainable level.

Nominal wage growth is expected to moderate somewhat in 2011 as the temporary factors which boosted compensation of employees per head in 2010 recede, but is expected to pick up again in 2012 as the economic recovery gathers pace. These productivity and wage developments are projected to contain unit labour costs in 2011, but as employment and nominal wages recover in 2012, unit labour costs are expected to rebound.

Throughout the crisis and the recovery, unit labour costs have risen by markedly more than in euro-area trading partners, suggesting that competitiveness vis-à-vis the euro area has deteriorated.

Inflation is forecast to rise to around 2½% in 2011 under the impact of world commodity price developments and to stay over 2% in 2012 as nominal wage increases pass through to consumer prices.



### Expenditure-based consolidation

The general government deficit narrowed to 5.6% of GDP in 2010, from 6.0% in 2009, reflecting the return to economic growth and the first steps made in expenditure-based fiscal consolidation. Tax revenue returned to positive – albeit weak – growth, with the impact of increases in excise duty rates offset by new direct tax allowances and the final reduction in the corporate income tax rate.

Total expenditure growth was kept to 1.8%, down from 5.4% in 2009. The public sector wage bill was contained through the non-payment of various bonuses, the halving of indexation and the postponement of agreed public sector wage increases. However, these savings were more than offset by an unbudgeted expansion of employment in the public sector. The usual indexation of social benefit rates to inflation and of pensions to wage growth was halved, but social transfers other than in kind still increased by 4¼%, due largely to increased numbers of recipients. Capital expenditures were sharply cut during the year to meet the overall deficit target.

For 2011, the general government deficit is forecast to widen to 5.8% of GDP, including the



deficit-increasing one-off of 0.7% of GDP related to the government recapitalisation of Slovenia's largest bank. Excluding one-offs, the deficit narrows to just above 5% of GDP. Tax revenue growth is expected to recover further due to developments in domestic demand and wages while no revenue-enhancing measures are expected beyond the 1 April and 1 October increases in excise duties on tobacco. Tax revenues are lowered by the policy of moderating the inflationary impact of high world oil prices through reductions in excise duty rates on mineral oils.

Total expenditure growth is forecast to stabilise at 1¾% (without the recapitalisation). Measures restraining primary expenditure growth have been reinforced. Public sector promotions have been frozen. A further halving of indexation formulae means public sector wages and social benefits will increase by only ¼ of inflation and pensions will increase by only ¼ of wage growth. Public sector employment is projected to fall marginally. For the third year in a row, interest expenditures are set to

increase by 15%, in line with higher debt. Capital expenditures are expected to grow by less than budgeted due to a cautious assumption on implementation of plans.

In 2012, the deficit is projected to narrow to 5% of GDP on a no-policy-change basis. Increased domestic demand and incomes are expected to support revenue growth, while the rising interest burden and the usual no-policy change assumption imply a return to stronger expenditure growth at around 3½%. Notably, for 2012 this forecast assumes no further measures to contain primary current expenditure dynamics, as the initiatives currently under consideration are largely to be specified and agreed.

The gross government debt ratio is forecast to rise to close to 43% of GDP in 2011, up from 38% in 2010, driven by the primary deficit and the increasing interest burden. The debt ratio is projected to grow further, reaching 46% in 2012, mainly as a result of persisting primary deficits.

Table II.23.1:

**Main features of country forecast - SLOVENIA**

	2009			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP	35.4	100.0	3.5	3.5	6.9	3.7	-8.1	1.2	1.9	2.5
Private consumption	19.6	55.4	3.7	3.7	6.7	2.9	-0.8	0.5	0.7	1.3
Public consumption	7.2	20.3	3.0	3.0	0.7	6.2	3.0	0.8	0.0	0.5
Gross fixed capital formation	8.5	23.9	6.7	6.7	12.8	8.5	-21.6	-6.7	0.8	3.9
of which : equipment	2.9	8.3	9.8	9.8	8.2	4.9	-26.2	7.1	6.2	6.2
Exports (goods and services)	20.6	58.1	4.8	4.8	13.7	3.3	-17.7	7.8	6.7	6.9
Imports (goods and services)	20.1	56.8	6.5	6.5	16.7	3.8	-19.7	6.6	5.2	6.1
GNI (GDP deflator)	34.7	97.9	3.4	3.4	5.9	3.1	-7.4	1.6	1.5	2.1
Contribution to GDP growth :										
Domestic demand			4.1	4.1	7.1	5.0	-6.1	-1.2	0.6	1.7
Inventories			0.4	0.4	1.9	-0.8	-4.0	1.6	0.4	0.2
Net exports			-1.0	-1.0	-2.0	-0.4	2.0	0.8	1.0	0.5
Employment			-	-	3.0	2.8	-1.9	-2.2	-1.3	0.3
Unemployment rate (a)			-	-	4.9	4.4	5.9	7.3	8.2	8.0
Compensation of employees/head			-	-	6.4	7.0	1.6	4.1	2.4	3.6
Unit labour costs whole economy			-	-	2.6	5.9	8.5	0.6	-0.8	1.4
Real unit labour costs			-	-	-1.5	1.8	5.1	-0.1	-1.8	-0.4
Savings rate of households (b)			-	-	15.7	15.5	15.9	15.3	14.5	14.6
GDP deflator			18.2	18.2	4.2	4.0	3.2	0.7	1.0	1.8
Harmonised index of consumer prices			-	-	3.8	5.5	0.9	2.1	2.6	2.1
Terms of trade of goods			0.8	0.8	0.6	-1.8	4.7	-3.2	-2.2	-0.3
Trade balance (c)			-2.8	-2.8	-4.9	-7.2	-2.1	-2.8	-3.4	-3.3
Current-account balance (c)			-0.2	-0.2	-4.5	-6.8	-1.3	-1.1	-1.4	-1.9
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-0.4	-0.4	-4.7	-6.7	-1.4	-1.1	-2.0	-1.3
General government balance (c)			-	-	-0.1	-1.8	-6.0	-5.6	-5.8	-5.0
Cyclically-adjusted budget balance (c)			-	-	-2.9	-4.6	-3.6	-3.0	-3.5	-3.3
Structural budget balance (c)			-	-	-2.9	-4.6	-3.5	-3.0	-2.9	-3.3
General government gross debt (c)			-	-	23.1	21.9	35.2	38.0	42.8	46.0

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 24. SLOVAKIA

### An externally-driven recovery continues

#### Growth returned to the black in 2010, spurred by strong export performance

Slovakia's recovery in 2010 was driven by the strong global acceleration in trade of durable manufacturing goods. On the back of a better-than-expected rebound in economic activity in Slovakia's main trading partners – especially Germany – the Slovak export sector recovered swiftly. After an unprecedented slump in 2009, investment grew by 3.6% in 2010, partly in response to the need to replace fixed capital in the wake of the crisis, but also as a result of a return to higher corporate profitability and a gradual improvement in access to credit. The strengthening of firms' investment and acceleration of industrial production led to real GDP growth of 4% for the year as a whole. The labour market, however, further deteriorated as jobs continued to be shed during the recovery and the unemployment rate surged to almost 14½% in 2010, one of the highest levels in the EU. Due to the rapid worsening of labour market conditions and with wages increasing only moderately, private consumption growth stalled. Inflation decelerated further to 0.7%.

#### Slightly decelerating economic activity in 2011 expected to pick-up in 2012

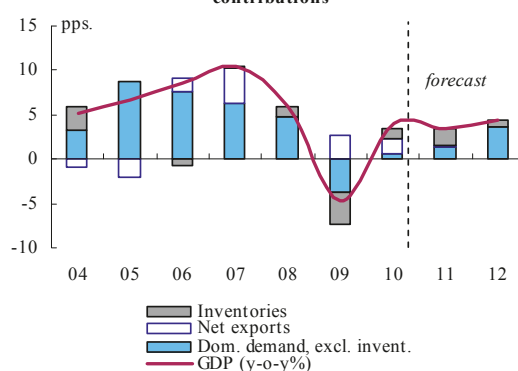
External demand is expected to drive economic activity in Slovakia in 2011. Output growth is forecast to slightly decelerate to 3.5% on account of the negative impact of a sizeable government consolidation package on private consumption and public investment. In 2012, the main contribution is expected to come from domestic demand: real GDP is forecast to grow at an annual rate above 4%, sustained by the pick-up in private consumption and in a resumption in large infrastructural investment financed with the EU funds. The trend improvement in the trade balance, which started in the second half of the last decade and is not expected to reverse its course, is assumed to bolster such developments.

Household consumption expenditure is projected to remain somewhat subdued in 2011. The labour market did not show signs of recovery throughout 2010 and registered unemployment reached a six-year high in February 2011. At the same time, stronger-than-expected inflation in the first quarter

of 2011 is eroding the margins for real wage growth. Moreover, the negative impact on disposable income, savings and consumption of many of the consolidation measures adopted (e.g. increase of the standard rate of VAT by 1 pp., broadening of tax bases for income tax and social security contributions, reduction of housing subsidies, increases in some excise duties, reduction of the wage bill in the public sector, etc.) is also foreseen to weigh on household consumption in 2011. Consumer confidence and retail sales, which have not significantly improved to date, should recover gradually in the course of 2011 as real wages respond with a lag to the marked post-crisis increase in labour productivity and on the assumption of a mild deceleration of inflation by the end of the year. After having averaged less than ½% in the previous three years, private consumption growth is forecast to rise in 2012, as the labour market situation is expected to improve in parallel with expanding economic activity.

Private investment is projected to increase by 4.6% in 2011 on account of continuing improvement in profitability and the implementation of some of the private investment put on hold during the crisis. Public investment is however likely to be depressed by delays in launching public infrastructure projects and generalised cuts in expenditure. In 2012, overall investment is expected to rise by 6½% under the assumption of an acceleration in drawing of EU funds and the implementation of postponed motorway projects.

Graph II.24.1: Slovakia - GDP growth and contributions



Turning to the external side, in 2011 both export and import growth are expected to continue

expanding, though more slowly, with imports set to be outpaced by exports also as a result of subdued private consumption. As FDIs that have reached the production phase before the crisis are fully utilised and more recent investment reaches the production phase, Slovakia is expected to continue to gain export market shares also in 2011-12 and a positive trade balance is expected to widen further under the assumption of a strong and sustained external demand and continued replacement of foreign by local suppliers. The latter development is signalled by the gradual decrease of import content of exports in the automotive sector and the rapid development of electronic equipment industries.

The baseline scenario is subject to a number of risks on both sides. Better-than-expected developments in the pace of recovery of Slovakia's main trading partners may result in a stronger export performance. At the same time, the external position is subject to negative risks depending on future trends in import, particularly the import intensity of exports. On the domestic demand side, higher absorption capacity of EU funds resulting in acceleration of motorway construction represent a positive risk to the 2011 forecast. On the other hand, a stronger-than-expected impact of consolidation measures in 2011, mainly on households' consumption, could have negative implications for growth.

#### Sluggish response from the labour market

In the wake of the crisis, employment fell by approximately 150,000 from peak-to-through. Nearly three-quarters of the jobs shed were in the manufacturing sector. Following a 5 pps. increase in 2009-10, the unemployment rate is set to gradually decline over the forecast horizon, but to remain far above pre-crisis levels. In 2011, it is expected to decrease only to 14% in view of improving, albeit low, labour demand, announced redundancies in state-owned companies (e.g. railway companies) and a reduction in the number of public sector employees at the central government level. The labour market is expected to pick up progressively in the course of 2011 as the recovery continues and to improve further in 2012 on the back of stronger growth. More substantial progress is hence foreseen in 2012. However a number of structural issues could hamper the adjustment, as the Slovak labour market features one of the highest pass-through rates to long-term unemployment and the highest

rate of long-term unemployed in the EU. Both are partly associated with persistent structural problems: very large and widening regional disparities, low labour mobility within the country and skill mismatches.

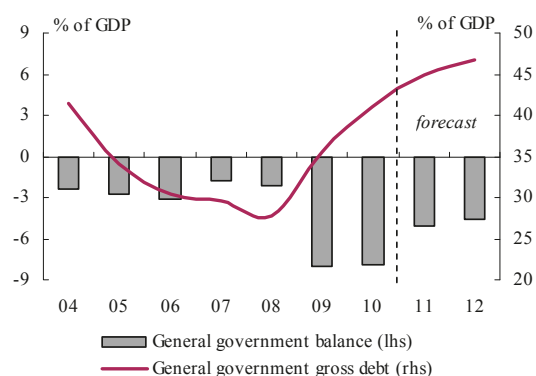
#### HICP inflation driven by energy prices

In the wake of the crisis, HICP inflation fell to a historically low level below 1% in 2009-10. During the first months of 2011, however, the spike in oil and food prices coupled with the increase in indirect and excise taxes (as part of the consolidation package) and the adjustment in regulated prices has driven inflation up. Headline inflation is forecast slightly above 3½% in 2011, whereas core inflation is expected to remain lower, stabilising at 2%. Subject to positive risks on future developments in energy prices, inflation is forecast to gradually decelerate in 2012 as the effects of the consolidation measures wear off and domestic demand pressures on prices remain low.

#### Consolidation measures expected to improve position of public finances

Falling tax revenues, the full operation of the automatic stabilisers, several anti-crisis measures (e.g. car scrapping scheme) and several ad hoc measures (i.e. capital transfers to loss-making railway companies and hospitals) in 2009, led to a rapid deterioration of the headline deficit by almost 6 pps. to 8% of GDP.

Graph II.24.2: Slovakia - Public finances



In 2010, the general government deficit improved only marginally to 7.9% of GDP. On the revenue side, two opposing factors were at play. First, tax receipts fell short of expectations by 1% of GDP, mainly due to the underperformance of VAT and excise duty revenue in view of falling household consumption. This was partly compensated by

higher-than-budgeted dividends from public companies. On the expenditure side, savings on interest expenditure were exceeded by additional non-budgeted spending, chiefly again capital injections in state-owned railway companies and hospitals, as well as some unexpected expenditure to cover floods damages and concessionary PPP contracts settlement. Local governments and remaining parts of the central government (e.g. the National Property Fund, the Environmental Fund) contributed almost 1½ pps. of GDP to the increase in the headline deficit.

The government adopted a set of consolidation measures amounting to 2.5% of GDP in 2011 with a somewhat larger emphasis on the expenditure side. The plan envisages a sizeable reduction in the public wage bill, expenditure cuts on goods and services and savings due to the increased efficiency of the health sector. The measures on the revenue side include a temporary increase in the VAT rate by 1 pp. to 20%, rises in some excise duties (i.e. tobacco, etc.), removing exemptions for personal income tax and social contributions and raising additional non-tax revenues (e.g. receipts from the sale of emission allowance quotas, special fees for electricity distributors, etc.).

The current forecast assumes a strong impact of the austerity measures on public finances, with the

general government deficit reaching 5.1% of GDP in 2011. This forecast takes into account an increase in interest expenditure in 2011 compared to the previous year, as the issuance of low-cost short-term paper in 2010 will need to be refinanced through longer-term issues at higher costs. However, based on the information available at the cut-off date for this forecast, the impact of the envisaged cuts in the public wage bill and intermediate consumption expenditure is assumed to be slightly less than in the official projections.

In 2012, the government has proposed an array of measures to continue consolidation, including a freeze of the public wage bill, further cuts in goods and services and an increase in property tax. The forecast is based on the customary no-policy-change assumption. The resulting headline deficit is thus projected to reach 4.6% of GDP in 2012.

The general government debt is expected to increase further to 45% of GDP in 2011 and 47% in 2012.

Table II.24.1:

**Main features of country forecast - SLOVAKIA**

	2009			92-06	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP		63.1	100.0	-	10.5	5.8	-4.8	4.0	3.5	4.4
Private consumption		38.4	60.9	-	6.8	6.2	0.3	-0.3	1.3	3.6
Public consumption		12.6	20.0	-	0.1	6.1	5.6	0.1	-2.2	1.0
Gross fixed capital formation		13.0	20.6	-	9.1	1.0	-19.9	3.6	4.5	6.5
of which : equipment		4.9	7.8	-	4.3	1.7	-27.8	7.9	7.0	6.0
Exports (goods and services)		44.5	70.6	-	14.3	3.1	-15.9	16.4	8.5	8.2
Imports (goods and services)		44.8	71.0	-	9.2	3.1	-18.6	14.9	5.9	7.3
GNI (GDP deflator)		62.1	98.4	-	10.5	6.3	-3.7	4.5	3.3	4.2
Contribution to GDP growth :	Domestic demand			-	6.3	4.8	-3.8	0.6	1.3	3.6
	Inventories			-	0.3	1.1	-3.6	1.8	0.2	0.0
	Net exports			-	3.9	0.0	2.6	1.0	2.0	0.8
Employment				-	2.1	2.9	-2.5	-1.4	0.6	0.9
Unemployment rate (a)				-	11.1	9.5	12.0	14.4	14.0	13.3
Compensation of employees/head				-	8.4	6.9	5.0	2.7	3.9	5.1
Unit labour costs whole economy				-	0.2	4.0	7.5	-2.7	0.9	1.6
Real unit labour costs				-	-0.9	1.1	8.8	-3.1	-0.6	-0.8
Savings rate of households (b)				-	7.5	6.6	8.1	9.5	8.6	8.2
GDP deflator				-	1.1	2.9	-1.2	0.5	1.6	2.4
Harmonised index of consumer prices				-	1.9	3.9	0.9	0.7	3.6	2.9
Terms of trade of goods				-	-1.1	-1.9	-0.7	-2.3	-1.8	-0.2
Trade balance (c)				-	-1.8	-1.6	1.5	0.0	0.6	1.2
Current-account balance (c)				-	-5.6	-6.9	-3.2	-2.9	-2.8	-2.6
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-5.2	-6.0	-2.4	-0.6	-0.7	-0.2
General government balance (c)				-	-1.8	-2.1	-8.0	-7.9	-5.1	-4.6
Cyclically-adjusted budget balance (c)				-	-3.6	-4.0	-7.4	-7.4	-4.8	-4.6
Structural budget balance (c)				-	-3.6	-4.2	-7.5	-7.3	-4.8	-4.8
General government gross debt (c)				-	29.6	27.8	35.4	41.0	44.8	46.8

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 25. FINLAND

### Economic recovery on a firm path

#### **Rapid rebound in economic activity after the global crisis**

In 2009, the trough of the global economic crisis, the Finnish economy recorded one of the steepest falls in GDP in the euro area – an unprecedented 8.2% decline, driven by a sudden drop in exports. However, in line with the revival of global demand, the rebound has also been relatively rapid, with GDP expanding by 3.1% in 2010. GDP growth was dampened in the first quarter of 2010 by a strike closing major Finnish seaports for an extended period. It picked up pace in the latter part of 2010 however, already reaching 5% y-o-y in the fourth quarter. This will result in a strong carry-over effect into 2011, when the growth rate is expected to exceed 5% y-o-y in the first quarter, but moderating in the following quarters as the base effect fades. 2011 as a whole is forecast to record GDP growth of 3.7%, well above the euro-area average. The growth difference with the EU average is forecast to narrow in 2012, as GDP expansion in Finland is set to moderate to rates closer to its economic growth potential, which is suppressed by the adverse demographic trends.

The economic recovery is underpinned by the solid fundamentals of the Finnish economy, which were overall well preserved through the crisis. The Finnish financial sector has remained strong, the labour market has proved resilient and consumer confidence has recovered rapidly to levels even exceeding the pre-crisis peak. Domestic demand, especially household consumption and residential construction, rebounded rapidly after a brief dip during the crisis in 2009. Housing construction volumes (and real-estate prices) rebounded rapidly to above the pre-crisis levels, driven by a relatively strong financial position among households, some regional housing shortages and stimulus measures to boost housing construction during the economic crisis. Corporate investment has taken longer to recover, but is also poised for a rebound in 2011, according to industry investment surveys.

#### **A solid contribution from external trade will support domestic demand**

In the highly export-dependent Finnish economy, the prospects of domestic demand are closely linked with the performance of the external sector. Judging from industry confidence surveys, the

main exporting industries are set to continue the recovery after losing about one fifth in export volume during the crisis. However, given the ongoing structural changes within some of the main industries (notably electronics, shipbuilding and paper production), the recovery in exports is expected to be gradual. Export volumes are forecast to reach pre-crisis levels only beyond the forecast horizon. The trade surplus of over 4% of GDP recorded before the crisis decreased to below 3% during the crisis and is forecast to remain at roughly the same level in 2011-12. The contribution to growth from foreign trade is forecast to be relatively moderate over the forecast period, as buoyant domestic demand also drives rapid import growth. The long-term trend of deteriorating terms of trade is set to continue over the forecast period.

Domestic demand is driven by favourable labour market developments, solid wage growth and strong consumer confidence. Due to a peak in inflation, however, real wage growth is projected to be negative in 2011. Household consumption is nevertheless forecast to show solid annual growth given the strong growth carry-over from the previous year. Since in 2012 the carry-over effect is smaller, household consumption growth is forecast to moderate from the previous year, even though the expected moderation of inflation would turn real wages to growth. The expected rise in interest rates would have a rapid pass-through to Finnish households, given that over 90% of housing loans are subject to variable interest rates. However, according to surveys, about a third of new loans are taken on a fixed monthly payment scheme whereby the change in interest rates influences loan maturity rather than monthly repayment. This should alleviate the impact on household purchasing power from interest rate changes. Household indebtedness has currently risen to over 100% of annual disposable income. This is around the average for euro-area countries, but it is expected to continue to grow in Finland over the medium term. House prices, which had increased rapidly to above pre-crisis levels, moderated in the last months of 2010 and in early 2011. The rise in interest rates is expected to cool both the housing market and the rise in household indebtedness to some extent.



The main risk factor for Finland's economic prospects is the global economic and trade outlook. Adverse developments in the exporting industries would have a significant and immediate impact on the domestic sectors, notably by affecting consumer and corporate confidence.

### Population ageing will gradually add to labour-market frictions

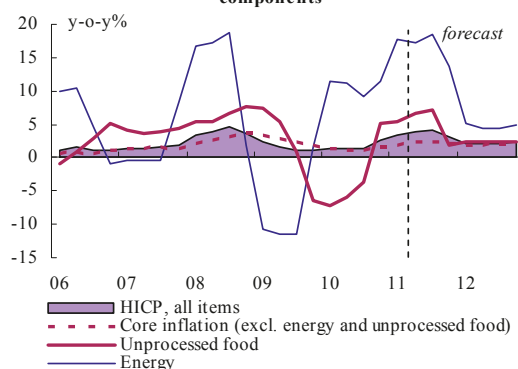
The economic crisis has had a relatively limited impact on the labour market, as the unemployment rate increased by only about 2 pps., peaking at 8½% of the labour force in the course of 2010. However, as is usual in the Finnish labour market, the inactivity rate also rose since some population groups tend to exit the labour market during periods of weaker labour market prospects, opting instead for studies or domestic work. These trends are expected to reverse and the activity rate is set to increase in the forecast period. In the short term, this will offset the decline in the working age population. However, in the medium term, the decline in working age population will inevitably cut labour supply. Due to the retirement of a large baby-boom generation, the working age population is projected to decline by about 140 000 people in 2010-20, representing over 5% of the current labour force. After 2020, this demographic shift will level off. Labour shortages and wage pressures will probably increase in some sectors, even though unemployment is expected to remain relatively high due to existing labour market mismatches.

### Inflation to peak in 2011, but no pass-through to wages

Inflation picked up considerably in the first months of 2011, largely driven by energy prices and to a lesser extent by food prices. Due to the higher energy intensity of the economy, the contribution to inflation from energy prices is higher in Finland than in the euro area on average. The increase in energy taxes in the beginning of 2011 is projected to add slightly less than ½ pp. to headline inflation. Moreover, the domestic electricity market went through some supply disruptions which boosted electricity prices in the short term. Assuming that energy prices (and global food prices) remain at an elevated level, the rate of HICP inflation is forecast to average 3½% in 2011, peaking at 4% in the third quarter. As the base effects from the elevated commodity prices fade in 2012, the

inflation rate is projected to fall back to slightly above 2%.

Graph II.25.1: Finland - Inflation and its components



The inflation peak in 2011 is not expected to generate major second-round effects. The pass-through to wage claims is expected to be minimal, given the forecast moderation of inflation in 2012 and the attempt to make up for the excessive wage growth in the last few years. The wage negotiation round in 2007, settled at the peak of the economic cycle, rigidly fixed exceptionally rapid wage growth for the following 2-3 years. However, this unexpectedly coincided with the economic crisis and a sharp loss in production. The ongoing rounds of wage negotiations are set to remain relatively moderate, attempting to compensate for the wage excesses during the economic crisis.

### Public finances set to improve

Public finances have benefited from the economic rebound in 2010. In spite of a discretionary fiscal stimulus of about 1% of GDP in 2010, the headline general government deficit did not deteriorate from the previous year. The fiscal deficit stood at 2.5% of GDP in 2010.

Fiscal policy is set to turn mildly restrictive in 2011 and 2012, as the government has decided to raise energy and some product taxes, which amount to some 0.5% of GDP in 2011 and 0.1% of GDP in 2012. Additionally, the government, in cooperation with social partners, has already decided to increase pension insurance contribution rates, which among other factors are estimated to improve the general government balance by 0.2% of GDP in 2011 and 0.3% in 2012. The current forecast does not include any potential policy initiatives of the next government taking office after the 17 April elections.

Expenditure growth is expected to abate to rates below nominal GDP growth, so that the expenditure-to-GDP ratio would decline. Some of the investment projects coming from the earlier stimulus package will come to an end and local governments (accounting for a third of general government expenditure) are likely to react to financing constraints by making savings in their budgets. Even though the general government debt level is currently increasing relatively quickly,

debt-servicing costs are being countered by exceptionally low effective interest rates on Finnish sovereign debt. The forecast projects a normalisation of interest costs in 2012 towards the long-term average, adding to expenditure growth. Overall, the deficit is forecast to narrow to 1% of GDP in 2011 and further to 0.7% of GDP in 2012. The debt ratio is forecast to climb from 48.5% of GDP in 2010 to above 52% of GDP in 2012.

Table II.25.1:

**Main features of country forecast - FINLAND**

	2009			92-06	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	171.2	100.0		3.0	5.3	0.9	-8.2	3.1	3.7	2.6
Private consumption	93.9	54.8		2.5	3.5	1.7	-2.1	2.6	2.3	2.0
Public consumption	43.3	25.3		1.0	1.1	2.4	1.0	0.4	1.0	0.7
Gross fixed capital formation	33.5	19.5		2.2	10.7	-0.4	-14.6	0.8	6.6	4.5
of which : equipment	8.9	5.2		1.9	17.9	3.9	-13.4	-5.2	7.0	6.0
Exports (goods and services)	64.2	37.5		9.0	8.2	6.3	-20.1	5.1	8.5	5.5
Imports (goods and services)	60.2	35.2		7.0	7.0	6.5	-17.6	2.6	7.2	5.1
GNI (GDP deflator)	174.5	101.9		3.3	4.4	1.4	-6.9	2.6	3.0	2.5
Contribution to GDP growth :										
Domestic demand				1.9	4.2	1.3	-4.0	1.7	2.7	2.1
Inventories				0.3	0.3	-0.7	-1.7	0.7	0.3	0.2
Net exports				1.0	0.9	0.3	-1.9	1.0	0.7	0.3
Employment				0.3	2.2	1.6	-2.7	-0.4	0.9	0.7
Unemployment rate (a)				11.4	6.9	6.4	8.2	8.4	7.9	7.4
Compensation of employees/head				2.9	3.7	5.1	1.7	2.0	2.8	3.4
Unit labour costs whole economy				0.2	0.5	5.8	7.8	-1.5	0.1	1.5
Real unit labour costs				-1.3	-2.4	3.9	6.8	-3.5	-2.4	-1.0
Savings rate of households (b)				9.5	7.2	7.9	11.5	11.6	9.3	8.7
GDP deflator				1.5	3.0	1.8	1.0	2.1	2.5	2.4
Harmonised index of consumer prices				1.6	1.6	3.9	1.6	1.7	3.6	2.2
Terms of trade of goods				-0.8	0.0	-3.3	-0.2	-1.3	-1.8	-0.3
Trade balance (c)				7.9	5.1	3.7	2.0	1.9	1.6	1.7
Current-account balance (c)				4.0	4.2	2.9	2.2	3.0	2.5	2.5
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				4.1	4.3	3.0	2.3	3.1	2.6	2.6
General government balance (c)				0.0	5.2	4.2	-2.6	-2.5	-1.0	-0.7
Cyclically-adjusted budget balance (c)				0.1	2.6	2.5	0.7	0.2	0.8	0.7
Structural budget balance (c)				-	2.6	2.5	0.7	0.3	0.8	0.7
General government gross debt (c)				47.5	35.2	34.1	43.8	48.4	50.6	52.2

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Note : Contributions to GDP growth may not add up due to statistical discrepancies.

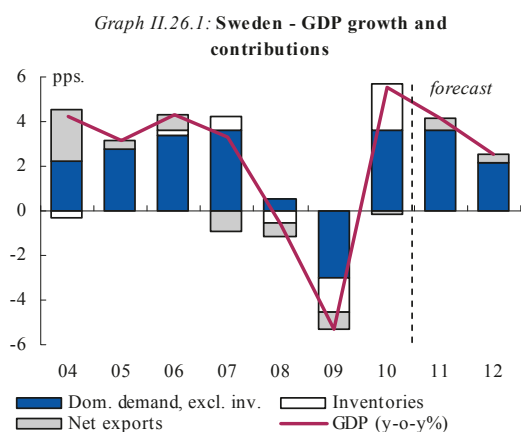
## 26. SWEDEN

### Strong growth set to moderate as recovery matures

#### Strong rebound from recession

After the sharp recession of 2008-09, economic activity rebounded strongly in 2010, with real GDP growing by 5.5%, the fastest pace of expansion in four decades. The strong growth rate reflects the rapid turnaround in global trade, supportive fiscal and monetary policy and the resilience of private consumption. The rebuilding of inventories, which had been run down during the recession, provided an exceptional and temporary boost, contributing more than 2 pps. to the annual growth figure. All the other domestic demand components also showed strength, with investment picking up particularly strongly.

Leading indicators generally point to continued strength in the first half of 2011. While business and consumer confidence indicators seem to have levelled off, both remain at elevated levels, pointing to a high degree of optimism among households and within the corporate sector. Industrial production and exports are also expanding, although new orders seem to be coming in at a somewhat slower pace in recent months. While data on retail sales also show continued growth, there has been some deceleration compared to a few months ago.



#### Pace of recovery to moderate

The recovery is expected to continue in 2011-12, albeit at a more moderate pace than during 2010. Household consumption should expand at a respectable pace, supported by employment growth and a pick-up in real wage growth. High levels of capacity utilisation together with strong

business sentiment and improved profitability should support continued investment growth. Residential investment is also expected to accelerate, at least in 2011, against the backdrop of strong demand for housing and dynamic house prices in 2010. A relatively strong public finance situation means that there is little need for fiscal consolidation. This should help prevent fiscal policy from exerting a significant drag on growth over the forecast horizon.

At the same time, a number of factors are combining to dampen the pace of the recovery. First, the inventory cycle seems to have come to an end. Second, the ongoing normalisation of the monetary policy stance, with the Riksbank continuing to hike its key policy rate, is expected to weigh on household consumption. It is envisaged that interest rate hikes will have a larger impact on the household budget than usual as household debt stands at a historically high level, with about half of loans at flexible rates. Third, the recent hike in oil prices will reduce real disposable income and dampen economic activity. On balance, annual real GDP growth is forecast to slightly exceed 4% in 2011 before slowing down to around 2½% in 2012.

This forecast implies that the output gap is likely to be closed by the end of the forecast horizon. Indicators such as the number of unfilled vacancies, which has risen fast across most sectors, point to emerging bottlenecks, despite unemployment remaining at a relatively high level. This could indicate a heightening of matching challenges in the Swedish labour market, which could become a drag on growth over the forecast period. However, such adverse effects may have been counteracted by recent reforms to increase labour supply, such as the in-work tax credit and reforms of the sickness insurance system.

#### Risks to growth appear broadly balanced

It cannot be excluded that the current momentum in both domestic and external demand will prove stronger than expected. While household optimism seems to have peaked, it remains at a very high level. Given the strong recovery of employment and the still rather high household saving rate, this could translate into higher-than-expected consumer spending. In addition, with the rapid improvement

in the cyclical position of the manufacturing sector, investment may expand faster than envisaged. On the other hand, Sweden's strong export dependence makes it particularly vulnerable to any setback in global trade. The withdrawal of both fiscal and monetary policy stimuli in a number of important trading partners poses a risk over the forecast horizon.

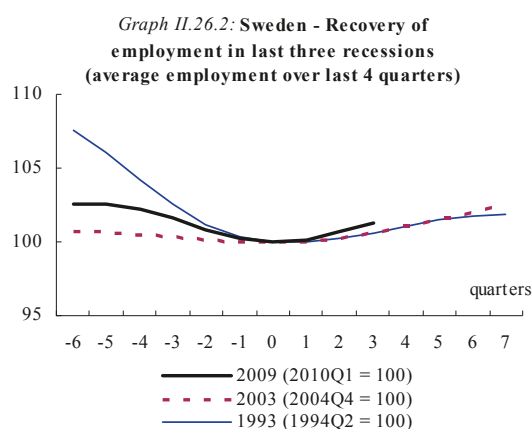
Another source of vulnerability stems from high household indebtedness, which has now reached a record level of more than 170% of disposable income. Over the last decade, rising indebtedness has gone hand in hand with rising house prices, as falling interest rates and easily available credit have spurred demand for mortgage-financed housing. While this trend seems to have slowed down in recent months, mainly thanks to monetary policy tightening and a widening of mortgage spreads, household debt is likely to remain high over the forecast period.

Although the exposure of the banking sector to the mortgage market has increased, defaults on mortgages are extremely rare in Sweden. The banking sector relies strongly, however, on short-term market financing in foreign currency. Renewed global financial market turmoil could thus quickly translate into rising financing costs for Swedish banks.

#### Unemployment above pre-crisis level

The turnaround in the Swedish labour market occurred earlier and more vigorously this time than in previous recessions. This was mainly due to the relatively swift recovery of global growth but was also supported by vigorous fiscal and monetary policy responses, which sustained domestic demand. Unemployment, having climbed by over 3 percentage points to more than 9% of the labour force during the recession, has already fallen back to 7.7% in March 2011 (in seasonally-adjusted terms). Companies' hiring plans also bode well for continued employment growth over the forecast horizon. The next collective bargaining round – covering large swathes of the Swedish work force – is due to start in the second half of 2011. With unemployment remaining well above its pre-crisis level, wage cost developments should generally remain under control. However, strong corporate profits and the rapidly improving employment outlook, coupled with the first signs of bottlenecks in some sectors, should lead to some wage acceleration in 2012. The unemployment rate is

expected to decrease gradually to average around 7½% in 2011 and 7¼% in 2012.



#### Inflation likely to remain below target

Inflation has been subdued in the post-recession period, falling from 3.3% in 2008 to below 2% in 2009 and 2010. Core inflation has been hovering at around 1% since August 2010. Important factors behind this subdued underlying dynamic include low resource utilisation, strong currency appreciation and falling unit labour costs, stemming from a rebound in productivity and record-low wage increases. While HICP inflation is expected to remain relatively stable below the 2% target over the forecast period, this masks important underlying trends. In 2011, the impact of higher energy and food prices is likely to be moderated by lagged effects of the krona's appreciation and still-significant spare capacity. In 2012, underlying inflation is likely to pick up as economic output approaches its potential, wages accelerate with the new collective agreements and the effects of previous currency appreciation fade away. On the other hand, for 2012 this is foreseen to be offset by lower energy and food price increases given the stable commodity price outlook. Overall, annual HICP inflation is forecast to reach 1.7% in 2011 and 1.6% in 2012. The government's plan to cut VAT for restaurant and catering services represents a downside risk to the inflation forecast for 2012.

#### Current-account surplus to remain large

The current-account surplus is expected to fall only slightly over the forecast period to about 6% as a share of GDP. This reflects the specific saving/investment characteristics of all sectors. While large public sector savings will continue to

be underpinned by the 1% surplus target, households are likely to remain in surplus due to ample pension savings. The corporate sector should also contribute to current-account surpluses with a positive trade balance resting on a competitive advantage and sizeable surpluses on the income balance supported by extensive profit repatriation. The substantial appreciation of the krona in 2010 and early 2011 is not likely to undermine the competitiveness of Swedish exporters given negative unit labour cost growth and increased profitability in 2010, which provides room for lower margins.

### Fiscal balance back in surplus

Thanks to the surprisingly strong rebound from the recession, Swedish public finances improved faster than expected in 2010, with the general government deficit disappearing. Given the positive outlook for economic growth and employment, public finances are expected to show rising surpluses once again over the forecast period. The surplus is expected to reach almost 1% in 2011 and, under a no-policy-change assumption, around 2% of GDP in 2012. The main explanation for the improvement in the government balance is the fact that expenditure is not projected to rise as fast as GDP. This is due to both temporary measures being phased out and the cyclical

recovery, which reduces expenditure on active labour market policies and social assistance.

While the government has stated that a return to surpluses is the primary goal of fiscal policy at the current juncture, the Spring Bill released in mid-April 2011 nevertheless indicated a number of measures that could be included in the 2012 Budget Bill, provided there is sufficient fiscal space. Among the measures listed by the government is a fifth step in the in-work tax credit for wage-earners, a further rise in the threshold for paying state income tax, lower VAT on restaurant services and lower taxes on pensions. Should these expansionary measures be implemented, the fiscal balance might not be as strong as currently projected.

With the continuation of the recovery and the government balance returning to surplus, general government gross debt is foreseen to continue its downward path, after only a brief interruption due to the recession. Planned privatisation receipts for 2011 of about 0.8% of GDP have been taken into account in this forecast. After diminishing to 39.8% of GDP in 2010, the debt ratio is forecast to fall to below 34% in 2012.

Table II.26.1:

### Main features of country forecast - SWEDEN

	2009			Annual percentage change						
	bn SEK	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP	3089.2	100.0	2.7	2.7	3.3	-0.6	-5.3	5.5	4.2	2.5
Private consumption	1526.7	49.4	1.9	1.9	3.7	0.0	-0.4	3.5	3.0	2.3
Public consumption	857.9	27.8	0.7	0.7	0.7	1.0	1.7	2.6	1.4	0.5
Gross fixed capital formation	549.9	17.8	2.6	2.6	8.9	1.4	-16.3	6.3	9.8	5.1
of which : equipment	203.2	6.6	5.4	5.4	12.9	5.5	-28.2	11.6	11.5	6.0
Exports (goods and services)	1495.2	48.4	7.5	7.5	5.7	1.7	-13.4	10.7	7.6	5.1
Imports (goods and services)	1293.8	41.9	5.7	5.7	9.0	3.5	-13.7	12.7	7.3	5.0
GNI (GDP deflator)	3144.9	101.8	3.0	3.0	4.3	0.6	-6.9	5.6	4.3	2.5
Contribution to GDP growth :										
Domestic demand			1.6	1.6	3.6	0.5	-3.0	3.6	3.6	2.2
Inventories			0.1	0.1	0.7	-0.5	-1.5	2.1	0.0	0.0
Net exports			1.0	1.0	-1.0	-0.6	-0.8	-0.1	0.6	0.3
Employment			-0.1	-0.1	2.3	0.9	-2.0	1.1	1.9	1.1
Unemployment rate (a)			7.6	7.6	6.1	6.2	8.3	8.4	7.6	7.2
Compensation of employees/head			4.0	4.0	5.2	1.5	1.3	2.7	2.8	3.3
Unit labour costs whole economy			1.2	1.2	4.2	3.1	4.8	-1.6	0.6	1.8
Real unit labour costs			-0.5	-0.5	1.4	-0.1	2.9	-2.8	-0.3	0.8
Savings rate of households (b)			9.0	9.0	11.6	13.9	15.5	13.5	13.8	13.8
GDP deflator			1.6	1.6	2.8	3.1	1.8	1.3	0.9	1.0
Harmonised index of consumer prices			1.8	1.8	1.7	3.3	1.9	1.9	1.7	1.6
Terms of trade of goods			-1.1	-1.1	1.7	-1.2	1.9	-0.6	-1.0	-1.0
Trade balance (c)			6.2	6.2	4.6	3.6	3.2	2.4	2.5	2.3
Current-account balance (c)			4.2	4.2	8.6	8.9	6.8	6.2	6.2	5.9
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			3.9	3.9	8.5	8.7	6.6	6.1	6.1	5.8
General government balance (c)			-2.0	-2.0	3.6	2.2	-0.7	0.0	0.9	2.0
Cyclically-adjusted budget balance (c)			-1.5	-1.5	1.4	1.7	2.6	1.4	1.3	2.1
Structural budget balance (c)			-	-	1.4	1.4	2.6	1.4	1.3	2.1
General government gross debt (c)			61.0	61.0	40.2	38.8	42.8	39.8	36.5	33.4

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.



## 27. THE UNITED KINGDOM

### New growth sources to sustain the moderate recovery

#### The recovery moves into an uncertain phase

After strong performance in the first three quarters of 2010, the 0.5% contraction in the fourth quarter was an unexpected bump in the UK's road to recovery. The first estimate for growth in the first quarter of 2011 suggests that it only just reversed the fourth quarter contraction, so that the two quarters combined recorded zero growth overall. Higher-than-expected inflation and persistently gloomy results from consumer surveys have contributed further to a deterioration in the overall outlook for the UK economy since the beginning of 2011. However, outside the consumer, retail and services sectors, survey readings remain strong. Recent employment data have also surprised on the upside, supporting the hypothesis that growth in the private sector can offset the upcoming public sector job cuts. In sum, these indicators make continued modest growth in 2011 and 2012 the most likely outcome.

The prospects for 2011 are made more uncertain by the fact that the demand-side composition of growth must shift fundamentally relative to 2010 if growth is to be maintained. Stockbuilding and, private and government consumption accounted for the vast majority of growth in 2010. With the stock cycle appearing to have peaked, government consumption restrained by planned spending cuts and household spending depressed by falling real incomes, these demand components will contribute little in 2011. This puts the emphasis on net exports and corporate investment. For both, the prospects are positive. Sterling's continued weakness should help maintain strong export growth while lower stockbuilding and weak consumption should slow imports. Corporate equipment investment, which already showed signs of recovery in 2010, should benefit from the large corporate sector surplus and the need for the economy to retool as output shifts towards tradeables. Thus, while the need for new growth drivers does increase the uncertainty around the 2011 forecast, continued growth still appears probable.

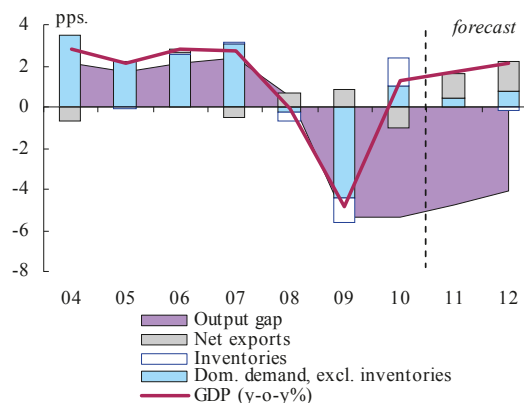
#### GDP more volatile than forecast

After catching up in the first quarter of 2011 some of the ground lost to weather effects in the final quarter of 2010, quarterly UK GDP growth should

remain positive throughout 2011 and 2012. However, this is unlikely to match the rates seen in mid-2010, as the fiscal consolidation and stretched households hold back domestic demand.

On the production side construction, which accounted for a third of total growth in the first three quarters of 2010 before falling off rapidly in the fourth quarter and the first quarter of 2011, could be a source of further volatility. If the apparently large contraction in construction in the first-quarter GDP is confirmed, this could offset strong growth in equipment investment and thus reduce total gross fixed capital formation. Manufacturing should remain strong given its large share in export and equipment investment demand. Services are likely to be weaker, in line with sluggish domestic demand. In sum, this should yield successive improvements in annual growth, with a 1.7% expansion in 2011 followed by 2.1% in 2012.

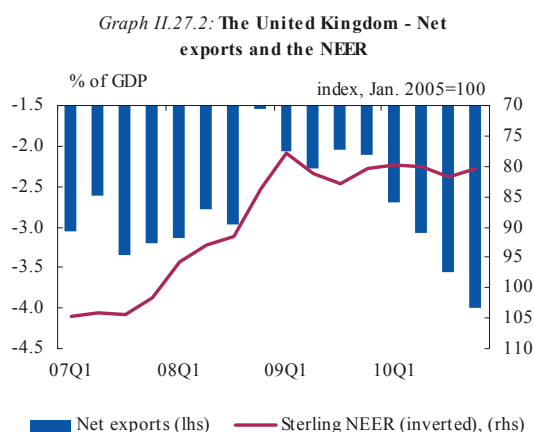
Graph II.27.1: The United Kingdom - Output gap and contributions to GDP growth



The growth forecast for 2012 is lower than the latest official forecast published by the UK Office for Budget Responsibility in March 2011 (2.1% compared to 2.5%). This is driven mainly by a lower forecast for household consumption. The Commission's more pessimistic view is based on the assumption that households will use a larger proportion of the expected real wage gains in 2012 for savings, which they have so far deferred to smooth the impact of negative real wage growth. The impact on GDP growth of this lower consumption is partially offset by a correspondingly lower forecast for import growth.

### Net exports – finally the motor of recovery?

Ever since sterling's 25% depreciation in 2008-09, the stage has appeared set for a net export rebound in the UK. 2010 was a disappointment on this front, with the external sector subtracting 1 pp. from growth. While export growth was strong, at 5.3%, import growth reached 8.5%.



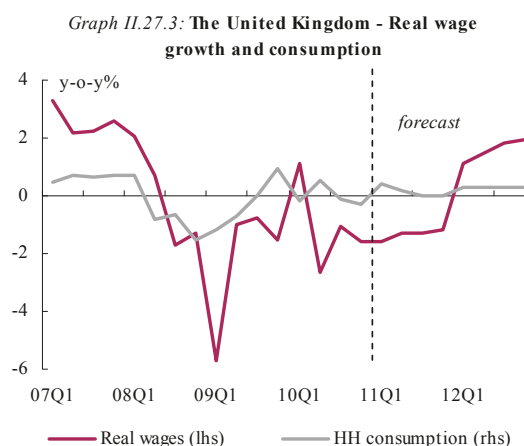
The factors driving this import surge included rapid restocking (which tends to be import-intensive) and, in the fourth quarter, a surge in aircraft imports driven by a pre-announced tax change. Neither is likely to be repeated in 2011 or 2012. Thus, with household consumption weak in both years, import growth should slow significantly, supported only by demand from exporters for raw materials and intermediate goods. Export growth should remain strong with solid growth in the US, the UK's largest single export destination, and a continuing recovery in most of the EU. Although to date sterling's weakness has led to higher margins for UK exporters rather than increasing market share, as the currency remains at lower levels, more domestic firms should start exploiting opportunities in foreign markets, driving up volumes and keeping a lid on sterling export prices.

### Domestic demand weak outside private investment

Domestic demand will grow slowly in 2011 and 2012, with corporate investment the only rapidly growing component. Falling real incomes will prevent any substantial increases in household consumption in 2011, although this constraint should be alleviated slightly in 2012 as wage growth picks up and inflation falls back. As shown in Graph II.27.3, the forecast is that consumers

will use this pick-up in real income growth mainly to fund higher net saving with consumption growth staying low.

There are significant risks to the private consumption outlook. In 2010, households smoothed the impact of weak real income growth on consumption by reducing savings. It is difficult to say how much leeway they retain to continue this smoothing behaviour should real incomes fall further. However, data on household mortgage interest cover ratios do not yet suggest that the sector is close to a financial crunch. As such, the saving rate is expected to remain low in 2011 as households prioritise maintaining reservation levels of consumption over restoring depleted savings, before recovering in 2012. Nonetheless an earlier flight to prudence by households, whether forced or discretionary, remains a risk. Increases in mortgage interest rates and persistent high inflation are further risks to the consumption outlook. While the level of household indebtedness may moderate slightly, it is likely to remain well above the EU average. The stock cycle appears to be close to its peak with a much larger-than-expected contribution from stockbuilding in 2010. This implies that little or no growth will come from stocks in 2011 or 2012.



Corporate investment began to recover in 2010 after 2009's unprecedented collapse. However, at around 14%, the investment-to-GDP ratio remains well below its long-run average of 17%, itself low by international standards. This leaves plenty of room for an investment rebound. Although credit availability remains a constraint at least for smaller firms, the large corporate sector surplus of 6% of GDP would be adequate on its own to fund a major investment revival. Survey data suggest that non-financial companies do not on average feel over-

leveraged, implying that they should soon start using their surplus either for investment or dividends rather than continuing to pay down debt. If firms choose to return the cash to shareholders in the form of dividends instead of investing, this would boost household incomes and, to a lesser extent, consumption. The main downside risks to investment are the above-mentioned dividend payments, credit availability, uncertainty about demand prospects and uncertainty over the extent to which firms need to invest in order to grow their output.

### **Employment outlook uncertain but stable in the central scenario**

Unemployment in the UK has remained stable at around 8% since the rapid rises of 2008 and 2009. If private sector employment followed a similar path to that seen after previous recessions, it would more than offset the 400 000 public sector job cuts expected over the period to 2014-15.<sup>(82)</sup> However, in current circumstances this scenario looks optimistic. At the micro level, there may well be skill mismatches between the people losing jobs in the public sector and sectors with strong employment growth such as manufacturing. There is also uncertainty as to the degree to which firms will need to recruit – the twin crisis phenomena of labour hoarding and forced shifts from full-time to part-time working are still unwinding. This will hold back new job creation to some extent. A further uncertainty is the degree to which falling government consumption will cause job losses among government's suppliers. Some estimate that one job will be lost in the private sector for every one lost in the public sector.

Notwithstanding these risks, the central scenario for private sector job creation is broadly positive, with consistently strong readings from employment intentions surveys. The unemployment rate is therefore forecast to remain broadly stable, with a slight peak in 2011, as the private sector roughly offsets the upward influences of government cuts and labour force growth.

### **Strong monetary stimulus as credit growth remains weak**

The Bank of England has provided a strong monetary stimulus over the past two years with the main policy rate at 0.5% and GBP 200 bn (14% of

GDP) of quantitative easing. However, net lending to non-financial corporations has remained negative, contributing to weak overall growth in broad money. Net lending should start to turn positive over the coming two years, with UK banks having committed to higher gross lending and loan repayments likely to slow as the corporate surplus is reduced to fund investment. However, if banks continue to deleverage in anticipation of tougher solvency standards or if the large peak in rollovers of UK bank debt in the fourth quarter of 2011 is not smoothly refinanced, credit growth could remain a check on overall economic performance.

### **Inflation: upward influences from import prices and VAT rises should finally dissipate in 2012**

Inflation has consistently surprised on the upside, remaining above the 3% top end of the Bank of England's target range throughout 2010. The January 2011 VAT increase and recent oil price rises will keep inflation well above the 2% central target throughout 2011. Although settlements data from early 2011 have suggested a slight uptick in wage growth, it remains well below inflation implying that second-round effects from the UK's import price- and VAT-driven inflation shock have not yet materialised. As long as this remains the case, it appears very likely that inflation will fall sharply in 2012 as these temporary factors fall out of the annual comparison. This would give inflation of 4.1% in 2011 and 2.4% in 2012.

### **Government perseveres with planned fiscal consolidation**

The fiscal projections in the UK's 2011 budget, published in March, were slightly more pessimistic than those published in June 2010, reflecting lower-than-expected growth and higher-than-expected inflation. The discretionary measures announced were fiscally neutral on aggregate. The government thus remains committed to a major consolidation focused largely on spending cuts. More detail on these spending cuts was set out in the Spending Review of October 2010 which set spending limits for each government department covering the four financial years to 2014-15. According to these plans, departmental budgets excluding health and overseas aid will be cut by an average of 19% in real terms over the four years.

The need for consolidation in the UK became urgent as the deficit increased from 2.8% of GDP

<sup>(82)</sup> The UK financial year runs from April to March

in 2007-08 to 11.5% in 2009-10. The consolidation began in 2010 with an improvement in the cyclically-adjusted primary balance of approximately 1.5% of GDP. The pace of improvement in the structural primary balance is projected to accelerate slightly over the next year. According to the official UK forecast, the planned consolidation would be sufficient to bring the deficit below 3% of GDP by the deadline of 2014-15 set in the UK's excessive deficit procedure. As a result of the government's planned spending cuts, government consumption is expected to rise by only 0.8% in 2011 before declining by 1% in 2012. Government capital spending is set to fall sharply in both years; by 12.1% in 2011 and 9.6% in 2012.

Table II.27.1:

**General government projections on a financial year basis**

	2008-09	2009-10	2010-11	2011-12	2012-13
	Actual		Forecast		
General government balance <sup>1</sup>	-6.9	-11.5	-9.5	-8.1	-6.6
Structural budget balance	-5.8	-9.0	-7.4	-6.2	-4.9
General government gross debt	55.8	71.2	78.1	84.3	87.6

The estimated nominal deficit for 2010-11 is 9.5% of GDP, slightly lower than in the autumn forecast, mainly reflecting lower-than-expected government spending. However, the forecast deficits for 2011-12 and 2012-13, at 8.1% and 6.6% of GDP are slightly higher than predicted in autumn, reflecting lower growth forecasts and, for 2010-11,

higher inflation. Although higher inflation would typically improve the fiscal balance by increasing nominal revenues, UK inflation is currently driven mainly by rising VAT which is already accounted for in the revenue estimation, and import inflation which contributes significantly less to revenues than domestically driven inflation which drives nominal income growth. The ongoing improvements in the fiscal balance will be driven by the spending cuts, the January 2011 increase in the VAT rate, GBP 2 bn extra taxation on North Sea oil and gas extraction and a levy on bank liabilities estimated to raise GBP 2.5 bn (0.2% of GDP). These will be only partly offset by a series of cuts in corporation tax, higher thresholds for income tax and lower petrol duty.

General government debt will increase as a percentage of GDP in both forecast years as the deficit remains at historically very high levels. It is forecast to reach 87.6% of GDP, above the European average, by 2012-13. According to the latest official UK forecasts, debt would continue rising until 2013-14, peaking at 87.2% of GDP.

Table II.27.2:

**Main features of country forecast - THE UNITED KINGDOM**

	2009			92-06	Annual percentage change					
	bn GBP	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP		1395.0	100.0	2.8	2.7	-0.1	-4.9	1.3	1.7	2.1
Private consumption		910.6	65.3	3.1	2.2	0.4	-3.1	0.6	0.3	0.8
Public consumption		326.9	23.4	1.7	1.3	1.6	1.0	0.8	0.8	-1.0
Gross fixed capital formation		203.6	14.6	3.9	7.8	-5.0	-15.4	3.0	0.1	4.0
of which : equipment		68.4	4.9	5.0	12.3	-5.2	-22.0	8.6	6.8	5.4
Exports (goods and services)		390.9	28.0	6.0	-2.6	1.0	-10.1	5.3	8.9	7.5
Imports (goods and services)		420.6	30.1	6.8	-0.8	-1.2	-11.9	8.5	4.0	2.5
GNI (GDP deflator)		1415.5	101.5	3.0	3.5	0.4	-5.2	2.0	2.2	1.1
Contribution to GDP growth :	Domestic demand			3.0	3.0	-0.3	-4.5	1.0	0.4	0.9
	Inventories			0.1	0.1	-0.4	-1.1	1.4	0.0	-0.1
	Net exports			-0.3	-0.5	0.6	0.9	-1.0	1.2	1.4
Employment				0.7	0.7	0.7	-1.6	0.2	0.4	0.5
Unemployment rate (a)				6.7	5.3	5.6	7.6	7.8	8.0	7.8
Compensation of employees/head				4.2	5.0	1.5	2.5	3.2	2.8	4.0
Unit labour costs whole economy				2.1	3.0	2.3	6.1	2.1	1.5	2.4
Real unit labour costs				-0.4	0.0	-0.7	4.6	-0.8	-0.5	0.3
Savings rate of households (b)				7.0	2.6	2.0	6.0	5.4	6.1	7.1
GDP deflator				2.6	3.0	3.0	1.4	2.9	1.9	2.1
Harmonised index of consumer prices				1.9	2.3	3.6	2.2	3.3	4.1	2.4
Terms of trade of goods				0.1	1.3	-0.5	0.3	-0.1	0.3	1.6
Trade balance (c)				-3.2	-6.4	-6.4	-5.9	-6.7	-6.1	-4.7
Current-account balance (c)				-1.7	-2.6	-1.6	-1.7	-2.5	-1.2	-0.1
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-1.6	-2.4	-1.4	-1.5	-2.3	-1.0	0.1
General government balance (c)				-2.8	-2.7	-5.0	-11.4	-10.4	-8.6	-7.0
Cyclically-adjusted budget balance (c)				-3.2	-3.8	-5.3	-9.1	-8.2	-6.5	-5.3
Structural budget balance (c)				-	-3.8	-4.8	-8.9	-8.2	-6.5	-5.3
General government gross debt (c)				43.7	44.5	54.4	69.6	80.0	84.2	87.9

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## Candidate Countries



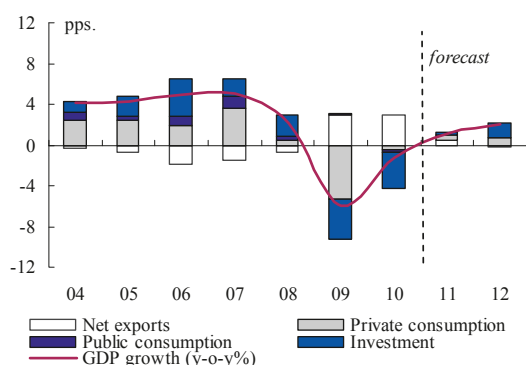
## 28. CROATIA

### Sluggish growth in the run-up to EU accession

#### Still recession in 2010

Croatia's economy was still marked by recession in 2010. Output contracted in three out of four quarters and annual average GDP declined by 1.2%. The labour-market conditions deteriorated more sharply than in the preceding year. Employment fell by 4% and the unemployment rate surged to an annual average of 11.8%. The current-account deficit narrowed to 1.4% of GDP as annual imports continued to decline while exports started to benefit from the recovery in the main export markets. As wage growth stagnated in nominal terms, annual average consumer price inflation fell to 1.1%.

Graph II.28.1: Croatia - GDP growth and contributions



#### Mixed signals from recent data

Recent GDP data do not give a clear picture about the strength of the economy. Quarterly data appear to indicate a relapse in the fourth quarter of 2010 (-0.6% y-o-y) following the improvement in the third quarter, when real GDP expanded for the first time in two years (0.3%). However, the negative GDP growth rate in the fourth quarter was a consequence of stock adjustments and not of faltering final demand.

Consumer spending continued to increase year-on-year in the fourth quarter of 2010 (1.2%), but somewhat less than in the preceding quarter. Fixed investment was still declining, but at a decelerating rate (-8.0%). Net exports of goods and services continued to rise as exports (10.8%) increased much more than imports (1.1%). The decline in import growth from 3.4% in the third quarter is

consistent with the softening of domestic demand including destocking.

In terms of contribution to GDP growth, the largest input in the fourth quarter again came from net exports (3.4 pps.). The other main positive contribution to GDP growth was private consumption (0.8 pp.). Fixed investment was again a major drag (-2.1 pps.) although somewhat less than in previous quarters. The largest negative contribution came from stock adjustments (-3.0 pps.).

Monthly data indicate that subdued economic activity has extended into the first quarter of 2011. The trend in industrial production has been flat to slightly down. In March the volume of industrial production was still 4.1% lower in annual terms. The year-on-year increase in retail sales volume, which started last July, has levelled off over the winter months and registered 0.8% in February. Construction output was still down by 7.1% in annual terms in February, which is nevertheless a relative improvement compared to the double-digit rates of decline in 2010. The data on merchandise trade show a decline in goods exports in the first quarter in annual terms, but are heavily distorted by volatile ship exports. For all items other than ships, exports increased by 5.8% while growth of imports increased at the lower rate of 2.8%. The registered unemployment rate in March was 0.9 pp. higher year-on-year.

#### The upturn is likely to remain subdued

Although economic activity seems to have bottomed out, it is unlikely that the economy will return to pre-recession growth rates, at least in the short term. The weak labour-market conditions continue to exert downward pressure on incomes and spending although last year's tax reduction has allowed a moderate increase in nominal net wages (1.6% y-o-y in February). The high level of indebtedness of households and companies and their need to deleverage are weighing on domestic demand. Credit availability is likely to remain relatively restricted. Investor confidence has taken a severe beating during the recession and will take some time to recover. Export performance is falling short of growth in major export markets. Overall, these headwinds are bound to restrain the recovery.

The banking sector has demonstrated resilience during the crisis and is well-capitalised and profitable. Maintaining soundness in the financial sector will be crucial for a sustained recovery. The quality of loan portfolios has continued to decline in 2010, reflecting in particular a strong rise in non-performing loans and continuing liquidity problems in the non-financial corporate sector. The government's credit programmes through the Croatian Bank for Reconstruction and Development have shown mixed results so far and may not provide the hoped-for boost to overall lending to the corporate sector. The levels of interest rates in lending to households and firms remain relatively high in view of financial market conditions. Together with the general credit restraint, this will continue to hold back business and consumer spending.

The government has announced a set of public investments projects, but they have not yet been budgeted for. Their eventual impact on overall investment activity remains uncertain, not least in view of the existing budgetary constraints. For the same reason, the recovery is expected to get no support from government spending.

Net exports provided a significant offset to faltering domestic demand during the recession. This was still evident in the annual GDP data for 2010 when imports were slow to recover (see Graph II.28.1). But given the structure of the economy, imports are bound to pick up soon as the recovery takes hold. Although export growth is set to continue, it will probably happen at lower rate than in 2010, since import growth among trading partners is projected to soften compared to last year's post-recession jump. Furthermore, Croatia is currently losing market share and this is likely to continue over the next two years. Going forward, net exports are therefore projected to provide only a modest contribution to GDP growth in 2011 and even exert a slight drag on growth in 2012.

The recovery is projected to result in annual average growth rates of 1.1% in 2011 and 2.0% in 2012. Private consumption and investment, including a renewed build-up of inventories, will emerge as the main drivers of this modest growth performance. Upside risks to this forecast are mainly related to a faster-than-projected economic recovery in the EU. The approaching accession to the EU may also provide some additional impetus to the economy through, inter alia, stronger net FDI inflows. But more importantly, there are

significant downside risks related to the speed of private sector deleveraging and dependence on external financing. Furthermore, a delay in fiscal consolidation may hurt both investment and consumption via higher borrowing costs.

#### **Current-account deficit set to widen slightly**

As a result of the recession, the high external deficits underwent severe adjustments. Reduced capital inflows and sharply lower domestic demand resulted in much lower trade and current-account deficits. In 2010, the latter fell to 1.4% of GDP, compared to more than 9% two years earlier. At this stage of the business cycle, the external balances are benefiting from still subdued import growth and from the earlier recovery in main export markets. As exports are expected to increase at a somewhat slower rate than in 2010 while import growth is projected to pick up, the current-account deficit widens to 2.2% of GDP in 2011 and to 2.5% in 2012. The risks around this projection are significant. On the one hand, declining unit labour costs could improve international competitiveness to an extent which is not factored into the projected export performance. On the other hand, the pent-up demand for foreign goods and services could also lead to a stronger-than-expected increase in imports.

#### **Inflation pressures to remain relatively low**

The recession was associated with a disinflationary process which lowered the monthly headline inflation rate to less than 1% in mid-2010. Last year, disinflation was primarily driven by the growing slack in the use of resources transmitted to price- and wage-setting. Most prominently, the compensation of employees declined slightly on an annual level. The rebound in energy prices and other commodity prices came too late to significantly raise consumer price inflation in annual average terms, which remained low at 1.1%. It was, however, the main reason behind the rise in the monthly headline inflation rate last winter. The year-on-year change of the CPI increased from 1.2% in November 2010 to 2.6% in March 2011.

Inflation pressures are expected to remain low over the forecast horizon in spite of the upturn in economic activity. Cost push pressures from the domestic side should be insignificant as unit labour costs continue to decline. There will be some pass-through from higher import prices,

particularly from energy and energy-related prices. Much of this will be transmitted via increases in administratively-set prices. The recent rise in agricultural raw materials can also be expected to find its way into the consumer basket. The forecast projects an uptick in consumer price inflation to the 2½ - 3% range over the next two years. The stability-oriented monetary policy framework should help to prevent a significant re-acceleration of inflation over the medium term.

### Labour market improving with a lag

The unemployment rate increased from an annual average of 9.1% in 2009 to 11.8% in 2010 and stood at 12.1% in the fourth quarter of 2010. The labour market is only expected to see a turnaround towards increasing employment in the second half of the current year. However, as the labour force is projected to decline even faster than employment, the unemployment rate will show a small decrease to 11.3% in 2011. As the recovery takes a somewhat stronger hold in 2012, the unemployment rate should fall more significantly, to just below 10%. In spite of the high level of unemployment, wages are likely to show some downward "stickiness" – more so in the public sector, less so in the private sector.

### Some decline of the fiscal deficit in 2012

The recession put public finances under severe pressures and necessitated adjustments to the original budget plans in the course of 2009 and 2010. Last year, a significant budget revision was adopted in August, taking into account weaker-than-expected economic activity and providing for some limited fiscal measures. As a result, the planned general government deficit increased by almost 2 pps. of GDP.

Preliminary data indicate that the budgetary outcome for general government in 2010 will be close to the 5.2% deficit planned by the government last autumn. In 2011, last year's changes in the tax regime will result in lower tax revenues. In spite of restraint on the expenditure side, this will lead to a further increase of the budgetary gap which this forecast projects at 6.0% of GDP. In 2012, a moderate pick-up in tax revenues in the context of slightly stronger economic activity in combination with continued spending restraint is forecast to result in a narrowing of the fiscal deficit to 5.0% of GDP. General government debt is set to increase from 40% in 2010 to 49% in 2012.

Table II.28.1:

### Main features of country forecast - CROATIA

	2009			92-06	Annual percentage change					
	bn HRK	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP		335.2	100.0	-	5.1	2.2	-6.0	-1.2	1.1	2.0
Private consumption		185.7	55.4	-	6.5	0.9	-8.3	-0.9	0.8	1.2
Public consumption		72.0	21.5	-	5.0	1.9	0.0	-0.8	-0.3	0.0
Gross fixed capital formation		83.4	24.9	-	7.1	8.2	-11.8	-11.3	-0.5	5.0
of which : equipment		-	-	-	-	-	-	-	-	-
Exports (goods and services)		118.7	35.4	-	3.7	2.2	-17.3	6.0	4.0	4.3
Imports (goods and services)		131.9	39.4	-	6.2	3.3	-20.4	-1.3	2.5	4.2
GNI (GDP deflator)		321.7	96.0	-	5.4	1.3	-6.6	-0.7	0.9	1.7
Contribution to GDP growth :	Domestic demand			-	6.6	3.0	-8.1	-3.8	0.3	1.9
	Inventories			-	0.0	-0.1	-0.9	-0.4	0.4	0.3
	Net exports			-	-1.5	-0.7	3.0	3.0	0.4	-0.2
Employment				-	3.5	1.1	-1.8	-4.0	-0.2	1.2
Unemployment rate (a)				-	9.6	8.4	9.1	11.8	11.3	9.8
Compensation of employees/head				-	5.7	9.0	2.2	-0.3	0.3	0.3
Unit labour costs whole economy				-	4.1	7.8	6.7	-3.1	-1.0	-0.5
Real unit labour costs				-	0.0	1.7	3.3	-4.1	-2.0	-2.6
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				-	4.1	6.1	3.3	1.0	1.1	2.1
Harmonised index of consumer prices				-	2.7	5.8	2.2	1.1	2.8	2.5
Terms of trade of goods				-	-	-	-	-	-	-
Trade balance (c)				-	-21.7	-22.6	-16.2	-13.1	-14.0	-14.3
Current-account balance (c)				-	-7.5	-9.1	-5.5	-1.4	-2.2	-2.5
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-7.4	-9.0	-5.4	-1.4	-2.2	-2.5
General government balance (c)				-	-2.4	-1.4	-4.1	-5.2	-6.0	-5.0
Cyclically-adjusted budget balance (c)				-	-	-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-	-	-
General government gross debt (c)				-	32.5	29.0	35.2	40.1	45.2	48.4

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 29. THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

### Between post-crisis and catching-up

#### Subdued recovery in 2010

After a moderate output decline of 0.9% in 2009, the recovery in 2010 was weaker than expected, with GDP increasing by 0.7% instead of the expected 1.3%. The main reasons for this lower growth dynamic were lower-than-expected public consumption and weaker gross capital formation. Economic activity gained momentum during the year, in particular in the second half, when year-on-year growth was already 1.6% and 2.3% respectively. Important sources of growth were external demand and private consumption. Gross fixed capital formation accelerated markedly in the fourth quarter. However, at the same time, private consumption declined, which raises doubts about the underlying strength of the recovery.

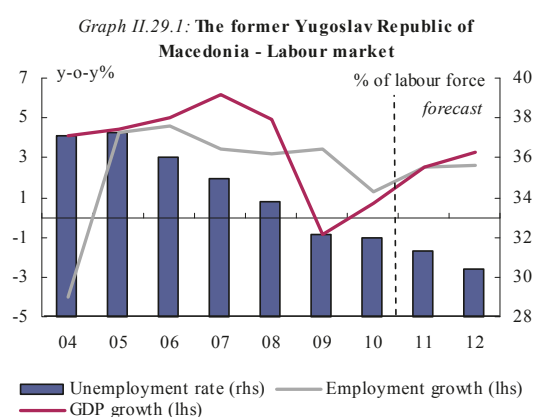
The continued decline in public consumption probably largely reflects the government's intentions to maintain low deficits, while increasing transfers and public capital spending. Capital inflows in the form of current private transfers remained high, which together with strong external demand resulted in a significant decline in the current-account deficit, from 6.7% of GDP in 2009 to 2.8% in 2010. Further support for growth came from declining interest rates and increased bank lending.

Public finances were characterised by lower than expected revenues, which were however compensated for by lower than planned public spending, in particular in the area of capital investment. In order to adjust spending to lower revenues, the government adopted a supplementary budget in June 2010.

Inflation accelerated markedly during the year, accelerating from close to zero percent at the beginning of the year to 3.7% in December, leading to an annual average inflation rate of 1.6% in 2010, compared to -0.8% in 2011. Overall, average annual inflation accelerated, from -0.8% in 2009 to 1.6% in 2010. The stronger price increase was mainly due to higher prices for energy imports, but also for food.

Official labour-market data point to a continued increase in overall employment, despite significant job losses in those industries primarily affected by the global crisis. However, employment appears to

have increased markedly in agriculture and in the public sector, in particular at municipal level. The former is probably due to government incentives to register so far unregistered employment. Unemployment continued to drop slightly, but still remained at the high level of some third of the labour force. However, youth unemployment declined to some 52%, mainly due to a strong reduction in female unemployment in this age group.



The exchange rate of the Denar has remained largely unchanged against the euro at a level of 61.5 MKD/EUR. The Central Bank intends to maintain its current informal peg to the euro.

#### The speed of the recovery will largely depend on domestic factors

In 2011, the main shock of the global crisis is expected to subside, which should allow the economy to expand by around 2½%. The main sources for this recovery will be private consumption, benefiting from improved consumer confidence and investment, which should recover after two years of strong declines. In 2012, the expected recovery of export market growth should help to bring output growth to some 3¼%. The recent increase in inflationary pressures however could erode households' purchasing power and thus slow down the recovery process.

In recent years, workers' remittances and other private capital inflows have increased to close to 20% of GDP. During the forecast period, these inflows are to gradually return to previous levels of

some 18% of GDP. This source of income is expected to remain at a very significant level.

During recent years, employment growth has been rather high at some 3% annually. However, a significant share of those additional jobs are a result of a stricter registration procedure and do not necessarily reflect newly created employment. In view of the probably still difficult international environment in 2011-12, the country's potential for creating employment or raising real wages will remain limited. Wage growth is likely to remain subdued, given the need to maintain competitive on external markets. Improving the country's labour income thus requires improving productivity by investing, so modernising and deepening the capital stock.

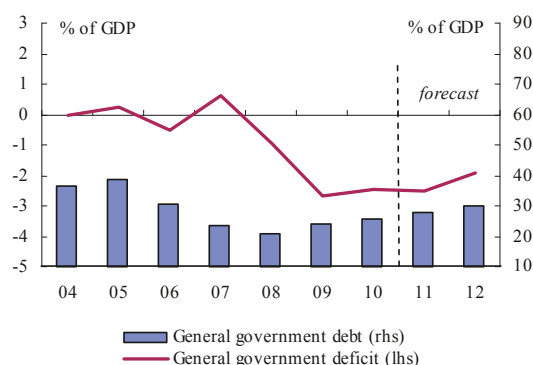
The current-account deficit is likely to rise again in 2011 and 2012 towards 4% of GDP, mainly reflecting the expected marked increase in investment and the levelling-off of inflows of current transfers.

#### Public finances are likely to remain under control

Based on the country's track-record of respecting fiscal targets, the forecast expects public sector deficits to decline from 2½% of GDP in 2010 to

2¼% in 2012. The forecast expects that in case of spending constraints, the authorities will reduce capital spending, as has happened in the past on similar occasions.

Graph II.29.2: The former Yugoslav Republic of Macedonia - Public finances



Protracted fiscal deficits and rather low nominal GDP growth will lead to a marked rise in public sector debt, reaching some 30% of GDP by 2012. However, given the government's intentions to finance a large part of its structural reform agenda through foreign funds, a faster increase in public indebtedness cannot be excluded.

Table II.29.1:

#### Main features of country forecast - THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

	2009			92-06	Annual percentage change			
	bn MKD	Curr. prices	% GDP		2007	2008	2009	2010
GDP	409.1	100.0	100.0	0.7	6.1	5.0	-0.9	0.7
Private consumption	312.0	76.3		-	7.5	7.4	-3.9	1.1
Public consumption	78.5	19.2		-	-0.3	10.6	-6.4	-3.0
Gross fixed capital formation	81.9	20.0		-	17.1	5.4	0.9	-7.5
of which : equipment	35.8	8.8		-	22.7	14.6	-12.6	-19.9
Exports (goods and services)	160.3	39.2		-	11.8	-6.3	-10.7	22.7
Imports (goods and services)	248.8	60.8		-	16.1	0.8	-11.1	10.7
GNI (GDP deflator)	405.5	99.1		-	1.7	8.6	-0.4	-0.6
Contribution to GDP growth :				-				
Domestic demand				-	8.6	7.9	-4.1	-1.2
Inventories				-	1.8	0.3	0.1	-0.5
Net exports				-	-4.9	-3.9	3.0	2.4
Employment				-	3.5	3.2	3.4	1.3
Unemployment rate (a)				-	34.9	33.8	32.2	32.0
Compensation of employees/head				-	-	12.9	-1.4	2.2
Unit labour costs whole economy				-	-	11.0	2.9	2.8
Real unit labour costs				-	-	3.3	2.7	-0.1
Savings rate of households (b)				-	-	-	-	-
GDP deflator				46.7	7.4	7.5	0.3	2.9
Harmonised index of consumer prices				-	2.3	8.3	-0.8	1.6
Terms of trade of goods				-	8.9	-3.7	-9.1	2.6
Trade balance (c)				-	-19.8	-26.2	-23.2	-21.3
Current-account balance (c)				-	-7.1	-12.8	-6.7	-2.8
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-	-	-	-
General government balance (c)				-	0.6	-0.9	-2.7	-2.5
Cyclically-adjusted budget balance (c)				-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-
General government gross debt (c)				-	22.7	20.7	23.9	25.3

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.



## 30. ICELAND

### Slow recovery after long and severe recession

**The recession has reached bottom but prospects for a strong recovery remain constrained...**

Following the collapse of its banking sector in October 2008, Iceland went into a long and deep recession. Real GDP declined by 6.8% in 2009 and by a further 3.5% in 2010, driven by a strong adjustment in domestic demand. The recession seemed to have bottomed out in the second half of 2010, when the economy started to recover mildly, based on somewhat stronger consumption and a stronger export performance of non-aluminium and non-maritime products. However, following a positive quarterly growth rate of 2.2% in the third quarter of 2010 (in seasonally adjusted terms), real GDP dropped again by 1.5% in the last quarter, as stronger domestic demand was offset by an acceleration of imports. Consumer sentiment and expectations have recently improved somewhat, but industrial production continued to fall in the first two months of 2011. Although the Icelandic economy seemed to be at a turning point, hard data do not yet provide evidence for a strong and robust recovery.

**...as disposable incomes will only slowly recover...**

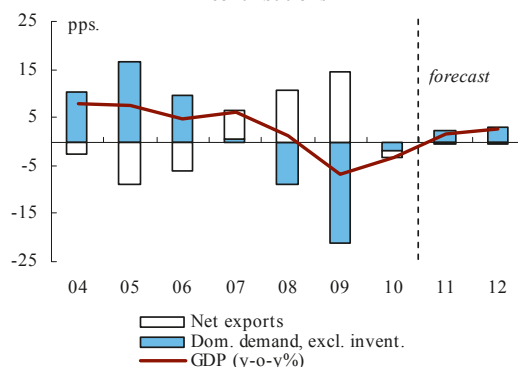
The outlook for private consumption growth may have improved somewhat compared to the autumn forecast. New frameworks for household debt restructuring were approved in December 2010 and are supposed to provide financial relief for a large number of private households. However, households will still be left with a significant debt burden even after debt restructuring. The level of unemployment, although declining, is projected to stay far above pre-crisis levels. Disposable incomes are unlikely to increase strongly over the short term, although the recent wage settlement for the private could lead to modest increases in real wages. At the same time, indirect tax increases and announced cuts on social transfers and family support will continue to put a lid on disposable incomes. Some limited support for private consumption growth could result from further withdrawals from individual pension savings, but the liquidation of savings cannot go on for an indefinite period.

**...and uncertainties persist with respect to firm's investment plans.**

The corporate sector is also suffering from financial problems and many firms first need to repair their balance sheets before being able to plan and finance new investment projects. A programme for debt restructuring of SMEs was set up last December to accelerate the process and create certainty among debtors and creditors. The new scheme is expected to become fully operational in May 2011 and to assist a large number of firms in financial distress. Once corporate debt restructuring starts gaining pace, investment activity is likely to unfold slowly. A boost to investment is expected to come from large projects, such as the construction at the Straumsvik smelter, a silicon plant in Helguvik and related power projects. The forecast projects, that private investment growth will pick up in the second half of 2011 at the earliest. At the same time, public investments are projected to decline in the context of the government's fiscal consolidation programme.

The global outlook has improved somewhat. Stronger economic growth in Iceland's main trading partner countries will improve the conditions for a strengthening of external demand. At the same time, the growth of a large share of merchandise exports will continue to be subject to technical constraints (fishing quotas, capacity of aluminium smelters). The growth of services exports is projected to benefit from somewhat stronger activities of the tourism industry as indicated by bookings and surveys.

Graph II.30.1: Iceland - GDP growth and contributions



In sum, the forecast projects mild recovery, mostly driven by domestic demand with stronger investment growth while net exports will add small negative contributions to growth.

#### **Inflation risks remain balanced...**

A process of disinflation continued through 2010, and average inflation came down to 5.4%, compared to 12% in 2009. During the first quarter of 2011, some mild inflationary pressures emerged, as higher energy and food prices led to an increase in monthly inflation. As a result, the annual inflation rate (CPI) rose to 2.8% y-o-y in April, up from 1.8% in January.

Inflation risks over the forecast horizon seem balanced. The lowering of inflation over the last two years has led to a stabilisation of inflation expectations. A modest recovery of growth and disposable incomes should not exert significant inflationary pressures. On the other hand, some price pressures could result from further tax increases and higher energy prices as well as from the recent surge of commodity and food prices and the slight krona depreciation during the first quarter of 2011. Although high unemployment and weak demand may generally not lead to very strong real wage increases over the short term, demands for higher wages are emerging in the context of the current wage bargaining round. There is also a risk that wage increases in the profitable tradeable sectors could subsequently spill-over into the non-tradeable sector. Most importantly, the inflation outlook very much rests on the basic assumption of a continued exchange rate stabilisation, the prime focus of monetary policy since the outbreak of the crisis.

#### **...and the trade balance will remain in surplus...**

External deficits have shrunk markedly following the recession. The sharp contraction in domestic demand and depreciation of the exchange rate (around 50% during the crisis) contributed to a substantial improvement in the trade balance. The forecast projects a slight reduction in the trade surplus as of 2011, as even a slowly growing economy will imply growing imports due to the high dependency rate while export growth will remain constrained, reflecting the low degree of diversification. The current-account balance is difficult to project, as net interest has appeared to be rather volatile. A large part of the net interest

balance is accounted for by the banks in winding-up proceedings. The forecast assumes that related accrued interest on the debt of those banks will be gradually reduced.

#### **...but labour markets continue to struggle with relatively high, though falling, unemployment**

The crisis had led to a marked increase in unemployment and a sharp drop in the number of employed compared to pre-crisis levels, although elements of flexibility seem to have provided a degree of cushioning, such as reduced hours worked, increased part-time work and real wage flexibility. Net emigration has also prevented a stronger increase in the jobless rate. Nonetheless, the recession continued to impact on labour market performance in 2010, when the level of employment continued to fall (by 0.6%) and the unemployment rate increased to 7.5% (from 7.2% in 2009).

The forecast projects that employment levels will respond to an increase in economic activity in 2011 and 2012 with some time lag. This will bring the unemployment rate down to around 6% at the end of the forecast period. However, this is still far above the average pre-crisis rate.

#### **Public finance consolidation continues...**

Public finances suffered a marked deterioration in the wake of the October 2008 crisis. Following budget surpluses in earlier years, the general government balance turned into huge deficits in 2008 and 2009, prompting the government to launch a series of fiscal adjustment measures in the context of the IMF programme which continued into 2010. The 2010 budget comprised a series of revenue enhancing measures (VAT, excise duties, energy taxes, social contributions) as well as cuts in current and capital spending, which helped to reduce the general government balance to -7.8% of GDP (down from 10% a year before). However, the deficit turned out to be significantly larger than the planned 6% target specified in Iceland's first Pre-Accession Economic Programme. This was mainly due to the activation of central government guarantees towards the end of 2010.

#### **...but the 2011 budget is based on optimistic assumptions**

The 2011 budget can be considered as an expression of the government's commitment to

continued fiscal consolidation. In order to achieve a primary surplus, the budget contains fiscal measures which are equivalent to around 2.7% of GDP, including a freeze on nominal wages and benefits as well as cuts in current and capital spending which may, however, be difficult to implement. Moreover, the budget is based on somewhat optimistic growth and revenue assumptions. Against this background, and on the

basis of less optimistic growth assumptions, the forecast assumes a reduction of the fiscal balance of around 3 pps. in 2011, assuming the realisation of budget savings equivalent to 2% of GDP and lower one-off expenditure related to government called guarantees. The general government debt ratio is set to remain in the range of 90-95% of GDP.

Table II.30.1:

**Main features of country forecast - ICELAND**

	2009			Annual percentage change						
	bn ISK	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP	1495.3	100.0		3.4	6.0	1.4	-6.9	-3.5	1.5	2.5
Private consumption	757.8	50.7		3.6	5.6	-7.9	-15.6	-0.2	2.3	2.7
Public consumption	396.9	26.5		3.0	4.1	4.6	-1.7	-3.2	-3.5	-3.2
Gross fixed capital formation	210.9	14.1		7.7	-11.1	-19.7	-50.9	-8.1	14.0	16.0
of which : equipment	40.4	2.7		9.6	-28.3	-31.0	-59.1	33.5	16.0	18.0
Exports (goods and services)	791.6	52.9		4.0	17.7	7.0	7.0	1.1	2.3	3.4
Imports (goods and services)	662.6	44.3		6.7	-0.7	-18.4	-24.0	3.9	4.0	4.8
GNI (GDP deflator)	1221.1	81.7		3.2	6.3	-15.8	-3.1	-2.9	4.3	4.2
Contribution to GDP growth :										
Domestic demand				4.7	0.5	-9.0	-21.2	-2.1	1.9	2.8
Inventories				0.0	-0.3	-0.2	-0.1	-0.2	0.0	0.1
Net exports				-1.3	6.1	10.8	14.4	-1.2	-0.5	-0.4
Employment				1.4	4.5	0.8	-6.0	-0.3	0.6	1.1
Unemployment rate (a)				3.4	2.3	3.0	7.2	7.5	6.9	6.2
Compensation of employees/head				6.4	9.0	4.1	-3.7	3.9	4.0	4.0
Unit labour costs whole economy				4.3	7.5	3.5	-2.8	7.3	3.1	2.5
Real unit labour costs				0.5	1.7	-7.4	-10.2	0.6	0.2	-0.3
Savings rate of households (b)				-	-	-	-	5.2	4.4	3.7
GDP deflator				3.8	5.7	11.8	8.3	6.7	2.9	2.8
Harmonised index of consumer prices				-	3.6	12.8	16.3	7.5	3.0	2.7
Terms of trade of goods				-0.2	-0.6	-6.3	-12.1	8.4	-1.4	0.0
Trade balance (c)				-2.0	-6.9	-0.4	6.0	7.7	7.1	6.8
Current-account balance (c)				-5.6	-16.4	-24.5	-10.3	-7.8	-6.2	-5.5
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-5.6	-16.6	-24.6	-10.4	-7.9	-6.2	-5.5
General government balance (c)				-	5.4	-13.5	-9.9	-7.8	-4.9	-3.6
Cyclically-adjusted budget balance (c)				-	-	-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-	-	-
General government gross debt (c)				-	28.5	70.5	87.8	93.3	94.3	93.0

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 31. MONTENEGRO

### A recovery of sorts

#### **A recovery driven by external demand ...**

After a sharp contraction of 5.7% in 2009, the economy slowly recovered in 2010 from the effects of the global crisis. The latest estimates for 2010 point to a real expansion close to 1%. The first signs of revitalisation appeared in the second quarter of 2010, after 18 months of continuous contraction. The turnaround of the global metal market gave an additional boost to the recently restructured local industries, raising total manufacturing output. The recovery of industry contributed to the increase of total merchandise exports by 19% y-o-y (exports of aluminium contributing 37% of the increase). At the same time, merchandise imports increased marginally by 0.2% in 2010. As a result, the trade gap decreased to 42% of GDP, from 46% a year earlier. After a successful tourism season, the surplus in services increased by 16% y-o-y. These positive developments brought down the current-account deficit to 25% of GDP, from 30% a year earlier. Net FDI reached 18% of GDP in 2010 despite the lack of major privatisation deals. The banking system seems to have stabilised somewhat, although the financial intermediation role of banks, especially the largest ones, remained morose as they consolidated their balance sheets.

Consumer prices remained subdued during 2010. The average price index averaged 0.5%, although the recovery of domestic demand in the third quarter pushed inflation up to 0.7% by the end of the year.

Unemployment rates remained high in 2010, above 19%, despite the construction industry expanding by 13% y-o-y and the rising number of workers employed in this sector. The weak dynamics of the labour market were reflected in the moderation of disposable income, which increased by 2.9% in 2010. However, the one-off increase of social security contributions boosted average gross wages by 8% over the year.

#### **... expected to broaden progressively**

In 2011, economic activity is expected to gain momentum, benefitting not only from improved consumer confidence but also from export growth, as metal industries reach full capacity and aluminium prices are assumed to remain high in

line with global energy prices. Despite a weak first half year, annual GDP growth could thus rise above 2% in real terms in 2011.

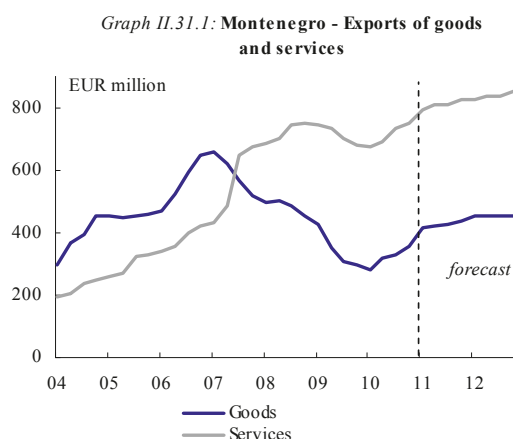
Domestic demand is likely to further accelerate in 2012, supported by the gradual recovery of banks' credit activity as the balance position of the major domestic lenders is expected to stabilise during 2011. A moderate increase of credit to domestic businesses and households, together with the acceleration of tourism and its related activities like transport, retail trade, catering and local food production, would be among the key factors supporting economic growth in 2012.

Although the present forecast does not take into account large infrastructure projects not yet initiated (e.g. highway, large hydropower plants), FDI inflows are expected to be rather high in 2011 and could further accelerate during 2012 due to the implementation of a number of investments launched during 2011 (windmills, small hydropower plants, ring-roads, waste treatment plants, railways and some tourist resorts). However, given the narrowness of the domestic economy, the potential positive impact of GFCF on GDP growth would be largely offset by an increase of imports, notably of equipment and construction material.

FDI inflows will have a positive impact on employment. The stronger demand for labour induced by foreign investment, as well as inflation expectations, would amplify the pressure on wages, especially in 2011. The combined growth of both employment and wages will further contribute to the increase in real disposable income and hence domestic consumption. The discernable upward trend in inflation in 2011 is also likely to be fed by the pass-through effect from global food and energy prices into domestic ones, pushing inflation well above 3%. Yet, as long as international prices for energy and raw materials moderate in 2012, average inflation could decline to some 2%.

The contribution to exports growth from the metal industries being constrained by capacity, services, and notably tourism, are expected to be the major contributors to exports. However, increasing imports, in line with stronger domestic demand supported by rising disposable income, higher

credit, and also investments and tourists' consumption, will result in a deterioration of the trade and current-account balances, driving the latter deficit above 30% of GDP in 2012.



### An expenditure-based consolidation of public finances

The general government deficit is expected to decline from 4% of GDP in 2010 to 3% in 2011 with the budget reaching equilibrium in 2012. The expenditure-based adjustment will take place progressively. While no increase in tax rates that could threaten the incipient recovery is planned,

fiscal revenues will benefit from the accelerating domestic demand and the subsequent inflow of indirect taxes revenue, notably from VAT on imports. Expenditures will decrease in real terms. In case of underperforming revenues, the authorities will reduce capital spending as was done in the past. Overall, the quality of public spending should remain stable, as many public infrastructure projects are not exclusively financed through the budget, but also through multilateral sources with concessionary interest rates.

General government debt should peak in 2011 at 45% of GDP and decrease afterwards thanks to budget consolidation as well as stronger nominal GDP growth. Although the government debt structure has shifted since 2009 from concessionary towards more expensive borrowing from financial markets with higher interest rates, the recourse to external budget financing should gradually decrease as the budget performance improves with the expected expansion of the economy.

Table II.31.1:

### Main features of country forecast - MONTENEGRO

2009			Annual percentage change							
	mio EUR	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP		2981.0	100.0	-	10.7	6.9	-5.7	1.2	2.4	4.0
Private consumption		2503.7	84.0	-	-	-	-	3.1	4.7	6.1
Public consumption		661.4	22.2	-	-	-	-	-2.3	-1.9	-1.6
Gross fixed capital formation		797.6	26.8	-	-	-	-	3.9	7.1	12.1
of which : equipment		-	-	-	-	-	-	-	-	-
Exports (goods and services)		957.5	32.1	-	-	-	-	-	-	-
Imports (goods and services)		1950.1	65.4	-	-	-	-	-	-	-
GNI (GDP deflator)		2986.3	100.2	-	-	-	-	0.4	2.4	4.1
Contribution to GDP growth :	Domestic demand			-	-	19.6	-23.2	3.1	5.3	8.2
	Inventories			-	-	1.5	-2.1	-0.4	0.0	0.0
	Net exports			-	-	-14.1	19.6	-1.5	-2.9	-4.1
Employment				-	19.3	4.5	-3.8	0.6	0.7	2.5
Unemployment rate (a)				-	19.4	16.8	19.1	19.3	19.4	17.9
Compensation of employees/head				-	-	17.9	-2.9	1.8	5.1	3.8
Unit labour costs whole economy				-	-	15.3	-1.0	1.2	3.4	2.3
Real unit labour costs				-	-	7.0	-3.3	-2.5	1.2	2.1
Savings rate of households (b)				-	-	-	-	19.7	17.5	15.5
GDP deflator				-	12.7	7.7	2.4	3.8	2.3	0.2
General index of consumer prices				-	4.2	8.5	3.4	0.5	3.7	2.2
Terms of trade of goods				-	-	-	-	-	-	-
Trade balance (c)				-	-58.7	-67.5	-46.2	-42.0	-45.0	-49.6
Current-account balance (c)				-	-39.6	-50.7	-30.1	-24.8	-27.3	-31.0
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-	-	-	-13.0	-10.5	-14.8
General government balance (c)				-	-	-0.4	-4.4	-3.9	-3.1	-0.1
Cyclically-adjusted budget balance (c)				-	-	-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-	-	-
General government gross debt (c)				-	27.5	29.0	38.2	41.7	44.7	42.7

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.



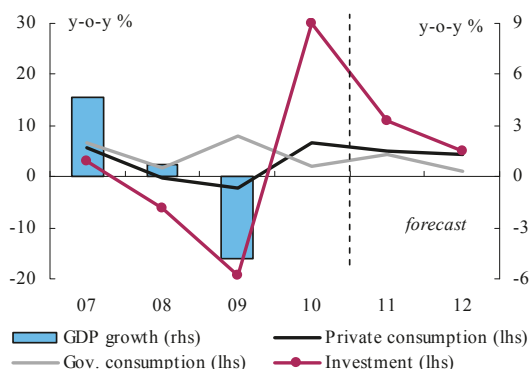
## 32. TURKEY

### Robust growth driven by private sector demand

#### The economy remains buoyant

GDP growth came out at 9% in 2010, helped – in particular in the first half of the year – by strong base effects, and in spite of low exports growth due to a more gradual recovery in Turkey's chief export markets. Monthly data point to a continuation of robust economic expansion in the first quarter of 2011. Industrial output rose at double digit rates in the first months of the year, the unemployment rate continued to fall and imports remained particularly buoyant. The economy shows some signs of overheating: external imbalances are widening rapidly and inflationary pressures are intensifying, in part due to a significant rise in energy prices and a deteriorating outlook for Turkish exports, which may be affected by the political turmoil in the Middle-East and Africa Region, the destination of over 20% of the country's exports. In the second half of 2011 and in 2012, growth is expected to moderate to a more sustainable pace as a result of a more restrictive monetary and fiscal policy mix.

Graph II.32.1: Turkey - GDP, consumption and investment growth



#### Strong base effects are expected to gradually fade away in 2011

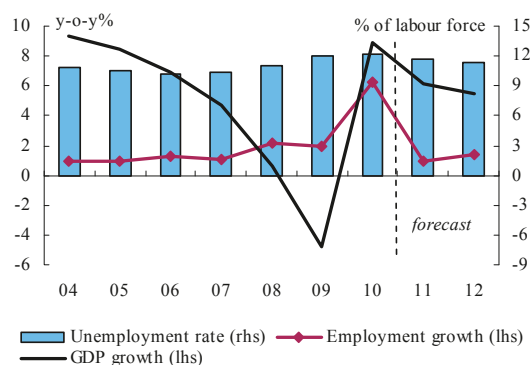
The trough of the current cycle came in the first quarter of 2009, when GDP tumbled by 14.5% y-o-y. While fixed investment boomed and recouped the losses of previous years, all components of domestic demand showed strong positive year-on-year growth in 2010 (in part due to strong base effects). Similar patterns can be expected to continue to drive growth, though at a

more moderate pace, as base effects gradually fade away over the forecasting period.

#### Consumption and investment as the driving forces behind the continuation of strong growth

Labour market developments, credit growth, capacity utilisation, and consumer and business confidence point to continued strong growth in 2011. The jobless rate fell to 11% in late 2010 from a high of 14% in 2009. Disposable income benefited substantially. Consumer and business confidence indices, as well as credit growth seem to confirm the strong growth in consumption.

Graph II.32.2: Turkey - Labour market

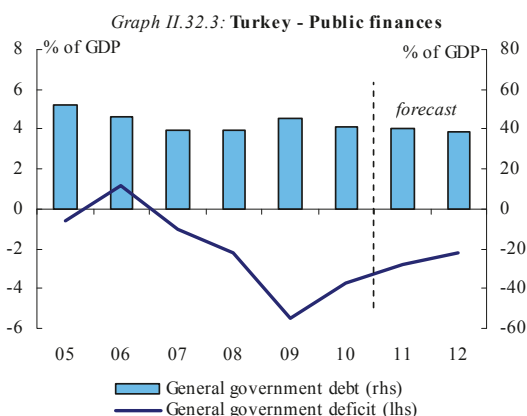


Credit growth started to increase in the fourth quarter of 2009, albeit from very low levels, and reached 30% in 2010. The banking data indicate that business lending is growing slightly faster than consumer lending, pointing to strong investment growth. Investment is therefore expected to remain stronger than the other expenditure categories.

Industrial production trends and Turkey's Purchasing Managers' Index (PMI) confirm the positive picture. Industrial production surprised on the upside in 2010, when it rose by 13%. In 2011, the most recent PMI increases indicate a marked improvement in business conditions and significant growth in new orders in the Turkish manufacturing sector. Aside from the structural boosts to growth, activity is still being supported by a not-too-tight monetary and fiscal policy mix, and any move on the latter is unlikely until the June 2011 general election.

### Fiscal rebalancing may be challenging...

Turkey's fiscal consolidation in the past decade is an impressive success story. In the wake of the 2001 financial crisis, the government managed to cut the public debt-to-GDP ratio from 75% to about 40% today. As a result of expansionary fiscal policy, public finances deteriorated in 2009 but improved in 2010, and continue to improve in early 2011. The general government budget deficit increased to 5½% of GDP from 2⅓% in 2008, while the public debt stock rose from 39½% of GDP to 45½%. The main contributors to the deterioration of the deficit were the acceleration in public spending, in particular in transfers to social security institutions, which recorded a deficit of 3% of GDP, and the impact of the various stimulus packages.



But by the end of 2010, these stimulus measures have been withdrawn. In addition, the strengthening economy has been positively affecting budget revenues. In 2010, the budget deficit narrowed to 3½% of GDP and is forecast to gradually narrow further to around 2⅓% by 2012. However, only a credible, strong and binding fiscal rule may lead to the forecast fiscal outcome.

Downside risks may also stem from increased expenditure. The government's Pre-accession Economic Programme for 2011-13 points to real expenditure remaining high even as growth returns. A specific concern is that the government might ramp up spending ahead of the 2011 parliamentary and the 2012 presidential elections in a bid to shore up support. Such a ramp-up may pressure interest rates and dent investor confidence, thereby slowing or even undermining the recovery.

### ... while monetary policy may affect the recovery prospects

The conduct of Turkey's monetary policy is complicated by strong capital inflows from the much slower-growing developed economies. With the current-account deficit widening markedly, the central bank is reluctant to place further upward pressure on the exchange rate by raising interest rates. At the same time, it has been actively using hikes in commercial bank reserve requirements to curb credit.

While core inflation remained relatively subdued, below 4% by March 2011, energy and food price inflation constitutes a major risk factor. Inflation is expected to be close to 8½% by December 2011, exceeding the central bank's inflationary end-year target of 5½%. A key question is how the inflationary developments will be reflected in monetary policy. In addition, any major cutback in investors' appetite for Turkey's – and emerging market – assets may negatively affect Turkey's recovery prospects.

### External imbalances widening rapidly

The correction in external accounts represented the silver lining of the recession. The positive terms-of-trade shock resulting from collapsing oil prices combined with the decline in domestic demand and imports led to a major contraction in the trade and current-account deficits, from 5¾% in 2008 to 2¼% in 2009.

The current-account deficit rose dramatically to 6½% of GDP in 2010 due to stronger domestic demand and higher energy prices. The current-account deficit is likely to widen further in 2011-12. At the same time, the outlook for exports remains somewhat mixed. Exports declined by 5% in 2009 and increased by 3.5% in 2010. Of particular importance is the automotive sector, Turkey's top export earner. Roughly three-quarters of vehicles manufactured in Turkey are exported to Europe. Special schemes supporting car sales in EU markets, which have now expired, brought forward future sales in 2009 and 2010.

Table II.32.1:

**Main features of country forecast - TURKEY**

	2009			92-06	Annual percentage change					
	bn TRY	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	914.6	100.0	4.4	4.7	0.7	-4.8	8.9	6.1	5.5	
Private consumption	656.7	71.8	4.3	5.5	-0.3	-2.3	6.6	5.1	4.3	
Public consumption	121.9	13.3	4.1	6.5	1.7	7.8	2.1	4.2	1.0	
Gross fixed capital formation	188.8	20.6	6.0	3.1	-6.2	-19.0	44.0	15.0	5.1	
of which : equipment	98.4	10.8	-	1.2	-5.6	-22.2	36.0	13.0	4.5	
Exports (goods and services)	212.5	23.2	9.3	7.3	2.7	-5.0	2.6	6.7	7.1	
Imports (goods and services)	225.6	24.7	10.4	10.7	-4.1	-14.3	14.7	6.3	5.0	
GNI (GDP deflator)	904.5	98.9	4.4	4.8	0.6	-5.0	8.6	7.2	5.5	
Contribution to GDP growth :										
Domestic demand			4.9	5.4	-1.6	-5.5	15.1	8.6	4.9	
Inventories			0.0	0.6	0.3	-2.1	1.8	-0.3	0.9	
Net exports			-0.5	-1.3	1.9	2.8	-3.7	-0.4	0.1	
Employment			0.8	1.1	2.2	2.0	6.2	0.9	1.4	
Unemployment rate (a)			7.8	8.8	9.7	12.5	10.7	10.2	9.8	
Compensation of employees/head			-	-	-	-	-	-	-	
Unit labour costs whole economy			-	-	-	-	-	-	-	
Real unit labour costs			-	-	-	-	-	-	-	
Savings rate of households (b)			-	-	-	-	-	-	-	
GDP deflator			50.8	6.2	12.0	5.3	9.9	5.8	4.6	
Harmonised index of consumer prices			-	8.8	10.4	6.3	8.6	6.5	5.5	
Terms of trade of goods			-	-	-	-	-	-	-	
Trade balance (c)			-5.0	-7.3	-6.8	-3.8	-9.5	-10.3	-10.4	
Current-account balance (c)			-1.6	-5.9	-5.7	-2.3	-6.7	-7.7	-8.1	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-	-	-	-	-	-	
General government balance (c)			-	-	-2.2	-6.7	-3.7	-2.8	-2.2	
Cyclically-adjusted budget balance (c)			-	-	-	-	-	-	-	
Structural budget balance (c)			-	-	-	-	-	-	-	
General government gross debt (c)			-	39.4	39.5	43.8	41.6	40.1	38.5	

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Other non-EU Countries

## 33. THE UNITED STATES OF AMERICA

### A subdued recovery after the financial crisis

#### Domestic demand finally took the baton

Economic activity in the US rebounded by 2.9% in 2010 from a 2.6% contraction in 2009. During 2010, the recovery accelerated from 0.4% q-o-q in the second quarter to 0.8% in the fourth, but growth fell back to 0.4% in the first quarter of this year. During 2010, the recovery was mostly driven by private consumption and inventory rebuilding, which contributed 1.2 pps. and 1.4 pps. to GDP growth, respectively. After the inventory boost around the turn of the year, domestic demand took the baton from the second quarter of 2010 onwards.

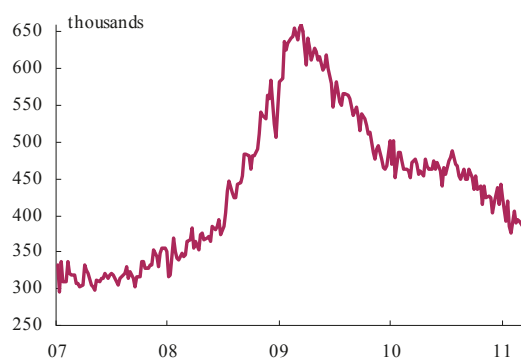
Private consumption growth accelerated to 1% in the last quarter of 2010 and 0.7% in the first of 2011. The gradual improvement in the labour market, the lower household debt burden and the rally in the equity market all underpinned consumption. Investment in equipment and software recovered forcefully, supported by improved profitability and the low cost of capital. The negative growth contribution of residential investment shrank in 2010 compared to 2009. Activity in the housing market started to bottom out by spring 2011, but prices continued to decline, due to the large supply of existing houses.

The growth contribution of net exports was volatile during 2010, ranging from -0.8 pp. in the second quarter to 0.8 pp. in the fourth. Exports have been growing at a healthy pace, supported by strong external demand and a weak dollar, while imports accelerated with final demand. As a result, net exports subtracted 0.5 pp. from annual growth in 2010. The current-account deficit widened from an average of 2.7% of GDP in 2009 to 3.4% in the third quarter of 2010, before shrinking again to 3.1% in the fourth. The annual average current-account deficit for 2010 was 3.3% of GDP.

The labour market has been recovering gradually since the end of 2010. Initial unemployment insurance claims have declined significantly since the peak in 2009. The unemployment rate declined from 9.8% in November 2010 to 8.8% in March 2011. Inflation had bottomed out in the second half of 2010 and rose strongly in recent months, mostly due to rising food and energy prices. Annual headline inflation rose from 1.1% in November 2010 to 2.7% in March 2011. Core inflation also

increased in recent months. In annual terms, the core index rose from 0.6% in October to 1.2% in March. Stronger growth has led to a small improvement in the general government deficit, which declined from 11.3% of GDP on average in 2009, to 10.3% in the fourth quarter of 2010. The annual average government deficit for 2010 was 10.6% of GDP.

Graph II.33.1: US - Initial jobless claims



#### Commodity prices and the housing market are limiting growth prospects, ...

Faster headline inflation due to high commodity prices reduces real disposable income (*ceteris paribus*), and puts downward pressure on profit margins. As a result, growth in consumption and investment are at risk. The housing market is another factor which is slowing down consumption growth, as the household balance-sheet repair effort is to some extent hampered by the ongoing decline in house prices.

#### ... but policies are still supportive of growth

Private demand is still supported by accommodative monetary and fiscal policies. The key question is whether private demand will be sufficiently strong to support the recovery once policy measures are withdrawn. So far tighter fiscal and monetary policies are not in the cards.

On the monetary side, the Federal Reserve has kept monetary policy very accommodative, due to the high unemployment rate (by US standards) and low core inflation. While, recently, unemployment declined and core inflation increased, their values are not yet consistent with the Fed's double



mandate. The Fed has kept its policy rate near zero since December 2008 and has provided additional monetary accommodation through quantitative easing (purchasing longer-term securities on the open market). Under its latest round of quantitative easing, the Fed is expected to complete the announced purchases of USD 600 bn Treasuries by June 2011. Afterwards, the central bank is likely to maintain the size of its expanded balance sheet for some time to prevent upward pressure on long-term yields.

The growth momentum is also supported by the broader- and larger-than-expected fiscal package which was agreed in December 2010. However, under the no-policy-change assumption, some of these measures (the expanded federal jobless benefits program and the reduced payroll tax) will expire at the end of 2011 and will not be prolonged. This is the main explanation behind the absence of a growth acceleration in 2012. The forecast assumes a resolution of the debt limit issue through an agreement on spending cuts which would not change the fiscal or growth outlook significantly due to their limited size and scope. At the same time, a credible medium-term plan for fiscal consolidation is still lacking. Its absence is the main downside risk to the outlook.

#### **A subdued recovery after the financial crisis**

Real GDP growth is expected to decelerate slightly in average annual growth terms, from 2.9% in 2010 to 2.6% in 2011 and 2.7% in 2012. This illustrates a slow recovery following the financial crisis. In 2011, the growth contribution from inventory building is projected to turn slightly negative. At the same time, domestic demand growth will accelerate from 2% in 2010 to 2¾% in 2011 and almost 3% in 2012. In all forecast years, net exports will subtract somewhat from growth.

Average annual private consumption growth is expected to jump from 1.7% in 2010 to 2.9% in 2011 (2.7% in 2012). However, carry-over effects play a large role in this increase (in Q4-over-Q4 terms, consumption growth is close to identical in the three years). The improved household balance sheet and labour market situation are expected to support consumption growth during the forecast period. Employment is projected to grow by 0.8% in 2011 and 1.3% in 2012. The fast decline in the unemployment rate in the months up to March 2011 is partly due to a decline in labour force participation, as unemployed workers stopped

looking for work (discouraged-worker effect). This limits the scope for further decreases in the unemployment rate when unemployed workers start seeking work again. As a result, the unemployment rate will decline only gradually, to 8.6% in 2011 and 8.1% in 2012.

Gross fixed capital formation will accelerate from 3½% in 2010 to 4¾% in 2011 and 6% in 2012. Construction will shrink less in 2011 (than in 2010) and grow again in 2012. Growth in equipment investment will decelerate from a buoyant 14% in 2010, to 10½% in 2011 and 7½% in 2012, hindered by higher commodity prices and an increased cost of capital.

The growth contribution of net exports will improve in 2011 as exports outpace imports. In 2012, the contribution would worsen again (-0.3 pp. after -0.1 pp. in 2010). While the weak dollar and healthy global demand will support export growth, import growth is underpinned by fairly robust domestic demand. The current-account deficit will widen from 3.3% of GDP in 2010 to 4% in 2011, due to the strength in imports and, even more so, to the terms-of-trade shock. Due to the combined effect of commodity-price and exchange-rate developments, the import deflator is projected to grow by 8¾% in 2011. Technical assumptions imply that the terms of trade would be stable in 2012 and the current-account deficit is foreseen to remain at 4% of GDP.

#### **Inflation above 2% in 2011; very little progress on the fiscal side**

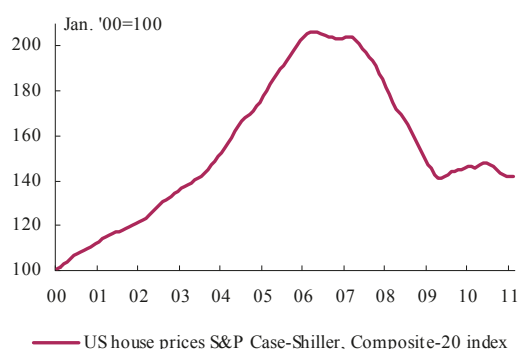
As a result of the technical assumptions on commodity prices and exchange rates, headline inflation is expected to peak in the current quarter at 2.8%, before decelerating to 2.3% in the fourth quarter (to a 2.5% annual average this year). Given the ongoing weakness in the labour market, the risk of second-round effects through higher wages seems low. In 2012, the remaining slack in the economy will drag inflation back down, to 1.5%. In view of the acceleration in core inflation to above 1% in February 2011, the downside risks to price stability have become negligible.

Due to the fiscal package agreed in December 2010, the decline in the general government deficit will be small this year. The deficit will shrink from about 11% of GDP in 2010 to 10% in 2011. Under the no-policy-change assumption, some measures will not be prolonged at the end of 2011 and this

helps to bring the deficit down to about 8½% of GDP, which still is very high by international standards.

As a result of the still-large deficits and subdued nominal growth of GDP, gross government debt is projected to rise rapidly from about 92% of GDP in 2010 to 98% in 2011. Gross government debt is forecast to exceed GDP in 2012, which is far above the projected levels for most EU Member States (EU average of 82% in 2012).

Graph II.33.2: US - House prices



### Risks are tilted to the downside

On the upside, stronger-than-expected external demand could give additional support to growth. Moreover, there is a small chance that a genuine growth-friendly fiscal consolidation is agreed before the Presidential elections of November 2012. Such agreement would boost overall confidence.

But risks are clearly tilted to the downside.

The three main downside risks to the growth outlook stem from the housing market, a further rise in oil prices and the fiscal situation. House prices have not yet bottomed out and could decrease further and during a longer period than expected. This would prolong the household balance-sheet repair process. The same would be true for a possible downward correction in equity prices, due to geopolitical events. Higher-than-expected commodity prices could curb consumption and investment growth. Finally, the lack of a credible medium-term plan for fiscal consolidation creates an upward risk for US long-term interest rates (in the light of a possible reassessment of risks by investors).

Table II.33.1:

### Main features of country forecast - THE UNITED STATES

	2009			Annual percentage change						
	bn USD	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP	14119.0	100.0	100.0	3.3	1.9	0.0	-2.7	2.9	2.6	2.7
Private consumption	10001.3	70.8	3.6	2.4	-0.3	-1.2	1.7	2.9	2.7	
Public consumption	2411.5	17.1	1.5	1.4	2.9	1.9	1.0	-0.3	0.4	
Gross fixed capital formation	2219.8	15.7	5.4	-1.4	-5.1	-15.5	3.5	4.7	5.9	
of which : equipment	1099.6	7.8	7.4	3.3	-3.8	-18.6	13.9	10.6	7.6	
Exports (goods and services)	1578.3	11.2	5.5	9.3	6.0	-9.5	11.9	7.8	9.3	
Imports (goods and services)	1964.7	13.9	8.1	2.7	-2.6	-13.8	12.7	6.7	9.3	
GNI (GDP deflator)	14265.3	101.0	3.5	0.5	-0.5	-3.2	3.1	2.6	2.9	
Contribution to GDP growth :										
Domestic demand			3.7	1.6	-0.7	-3.3	2.0	2.8	2.9	
Inventories			0.1	-0.2	-0.5	-0.6	1.4	-0.1	0.0	
Net exports			-0.5	0.6	1.2	1.2	-0.5	-0.1	-0.3	
Employment (*)			1.4	0.9	-0.7	-5.0	-0.6	0.8	1.3	
Unemployment rate (a)			5.4	4.6	5.8	9.3	9.6	8.7	8.1	
Compensation of employees/head			3.8	3.9	3.1	2.2	2.9	2.4	1.4	
Unit labour costs whole economy			1.8	2.9	2.4	-0.2	-0.5	0.6	0.1	
Real unit labour costs			-0.3	-0.1	0.2	-1.1	-1.5	-0.7	-1.3	
Savings rate of households (b)			8.3	6.8	8.7	10.5	8.5	7.8	7.4	
GDP deflator			2.2	2.9	2.2	0.9	1.0	1.3	1.5	
General index of consumer prices			-	2.8	3.8	-0.4	1.6	2.5	1.5	
Terms of trade of goods			-0.3	0.2	-5.8	6.3	-2.0	-3.5	0.4	
Trade balance (c)			-3.8	-6.0	-6.0	-3.7	-4.6	-5.3	-5.6	
Current-account balance (c)			-3.2	-5.1	-4.7	-2.7	-3.3	-4.0	-4.0	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-3.1	-5.3	-5.6	-4.0	-3.3	-4.0	-4.0	
General government balance (c)			-2.5	-2.8	-6.2	-11.2	-11.2	-10.0	-8.6	
Cyclically-adjusted budget balance (c)			-	-	-	-	-	-	-	
Structural budget balance (c)			-	-	-	-	-	-	-	
General government gross debt (c)			64.4	62.4	71.5	84.7	92.0	98.3	102.4	

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

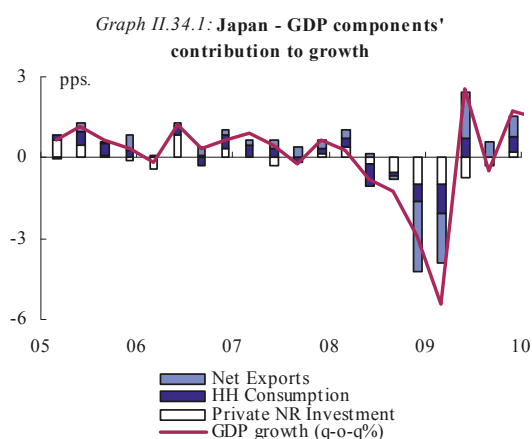
(\*) Employment data from the BLS household survey.

## 34. JAPAN

### Darkened outlook after the earthquake

#### Improving growth prospects followed by disaster ...

Japan's GDP grew by 3.9% in 2010, more strongly than in most other advanced economies. This was due to robust growth in the first three quarters, on the back of stimulus measures that supported growth until September 2010, and to some statistical revisions. The subsequent removal of some of these measures contributed to the contraction in the final quarter of 2010, when the Japanese economy declined by 0.3% q-o-q. This drop was of a temporary nature and high-frequency indicators from November onwards were upbeat again. The weakness in the final quarter of 2010 was mainly due to a 0.8% q-o-q drop in private consumption, which contributed -0.5 pp. to growth. This decline was mostly due to special purchasing incentives for durable goods being phased out in September 2010. The weak consumption was not compensated by strengths in other growth components. The negative contribution from exports in the final quarter of 2010 was an outlier.



Growth in 2010 was driven by net exports, which contributed 1.8 pps. Private consumption contributed 1.1 pps. and non-residential private investment 0.3 pp. However, only slightly more than half of the GDP lost during the slump from the first quarter of 2008 to the first quarter of 2009 had been recouped by the end of 2010.

The fiscal situation deteriorated further during the crisis and the debt-to-GDP ratio stood at 223% at the end of 2010. In the months preceding the

earthquake of March 2011 the fiscal situation was seen as even less sustainable than before, because the underlying balance had not improved noticeably and because a political stalemate prevented any decisive consolidation measures from being adopted. Interest rates inched up in line with world interest rates, but the debt crisis in parts of Europe as well as the worsening debt indicators increased nervousness about interest rate spikes resulting from a possible reassessment of risks by investors.

#### Until 11 March, prospects were bright

Until the Sendai earthquake on 11 March the Japanese economy was set for moderate growth of around 2% in 2011. Recent high-frequency indicators which are now available up to February 2011 suggested a return to positive growth in the first quarter of 2011. The April survey of short-term corporate expectations (Tankan), which were given until 11 March, showed that business sentiment had improved markedly since December 2010.

In 2011, private investments were expected to drive growth. Consumption was expected to grow in line with long-term trends (about 1%) and net exports were expected to contribute moderately to growth. The unemployment rate had improved to 4.6% in February from 4.9% in January 2011, the strongest showing in the recovery, owing to healthy company profits. Core inflation was on track to enter positive territory as of April 2011, but deflation was seen to reappear again in August. Prices were still being held back by a significant output gap, a flexible labour market and capacity utilisation ratio hovering around 70%.

#### After the earthquake, the outlook darkened

Taking into account the information available one month after the disaster, it appears likely that the growth outcome for 2011 will be at least 1 pp. below the baseline scenario. Supply-chain disruptions and production cuts resulting from damages and power outages, and the drop in consumer and investor confidence heightened by radiation fears are factors which are expected to reduce growth this year. As a result, exports and private consumption in 2011 will likely be significantly lower than earlier foreseen.

Initial economic data available after the earthquake indicate that the short-term economic impact is severe. The Purchasing Managers' Index (PMI, headline seasonally adjusted Markit/JMMA index) fell from 52.9 to 46.4 in March, the largest m-o-m decline in the series' history (since 2001) and the lowest index reading in almost two years (below 50 signals contraction). New orders intake also decreased sharply in March. Pre-production inventories fell at the second-fastest rate since March 2002. Export data for the last 10 days of March 2011 signalled a steep drop.

It is still unclear what the final evaluation of the damage caused by the Sendai earthquake, the tsunami, and the nuclear crisis will be. First official estimates, shared by many other observers, put the damage at between 3 and 5 points of Japan's GDP, which is twice as high as the Kobe earthquake. However, at this early stage, the range of uncertainty surrounding the estimates is wide.

Supply-chain disruptions could be more severe than assumed. In addition to potentially causing a steep fall of industrial production in March and April, these disruptions could also undermine the competitive position of Japanese companies in some fields, where competition is strong and where foreign competitors might seize the opportunity to replace their Japanese rivals. Some medium-term costs due to a forced reorganisation of companies' supply-and-inventory policies cannot be ruled out.

The impact from any extended power shortage or rationing could also be more lasting than assumed. Although the situation should gradually improve, some shortages are to be expected in the remainder of 2011. Given the widespread use of air-conditioning, a hot summer in Tokyo would be an additional challenge for electricity supply. In addition, for historical reasons there are technical limitations to supplying the most affected region with electricity from other regions in Japan. In the weeks after 11 March, electricity supply in the Tokyo area was around 15% short of demand.

Consumption in Japan could be negatively impacted in 2011 for several reasons. First, the psychological impact of the extent of the damages on consumers and investors might be severe. Second, the likelihood of higher taxes in the near term might also have increased. Third, an expected price rise for energy and food items in the short-term could curtail consumption. Japanese

consumers have proven to be sensitive to such unexpected price rises in the past. In addition, reduced operating hours for restaurants or reduced air-conditioning in shopping malls could limit consumption in the coming months. The share of *discretionary expenses*, defined as expenses not being made for buying necessities or recurrent expenses, is relatively high in Japan. Therefore households are able to cut expenses at will, even in the short term.

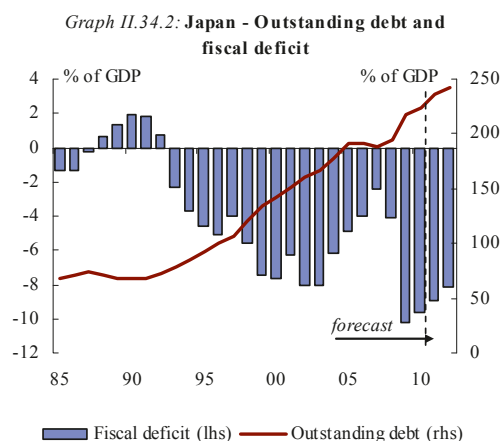
Private investments are crucial to the recovery from the disaster. On a positive note, several factors should drive up investments. Investments lagged behind in the early phase of the recovery and have some way to go from their low in 2008-09. Private investments were expected to drive 2011 growth before the disaster struck. Profits of companies have recovered. Companies have ample cash at hand and financing conditions for enterprises are generally supportive. The need to repair damages and rebuild should give a boost to investment. However, investments require planning and even scheduled investments might be delayed as power outages and other factors complicate the situation. Uncertainty about the economic outlook and profit prospects could hold back investments. Companies could find it difficult to pass on rising input costs to consumers in the second half of the year.

Public investments are likely to increase to repair and rebuild the damaged streets, facilities and houses. Based on the assessment by the government, statements by officials and on the post-Kobe earthquake in 1995, several supplementary budgets are likely to be passed and implemented in the remaining months of 2011. These packages, which could surpass 2% of GDP, could be financed by delaying planned expenses or by issuing new debt. Although the further weakening of public finances due to recent events increases the risk of a sudden spike in yields, the dent in consumption will facilitate the domestic financing of additional debt in the short term.

The urge to put together the means for additional spending has increased due to the earthquake.<sup>(83)</sup> However, the political window of opportunity may be too short to introduce serious fiscal reforms and implement longer-term consolidation efforts.

<sup>(83)</sup> The first supplementary budget totalling 4.05 trillion yen was passed by the Diet on 2 May but was not taken into account in the forecast, on the day of the cut-off date, which did not allow enough time to incorporate the details.

Given the reconstruction needs, additional expansionary measures are likely to be taken in the coming months to avoid another dip in economic activity and to rebuild damaged areas. The supplementary budget of JPY 4 trillion approved by the government on 23 April and approved by the Diet on 2 May is only a first step. Improving the debt situation is becoming an even more challenging and pressing task.



### Monetary policy remains supportive

On 14 March, the Bank of Japan (BoJ) injected a record amount of cash into the financial system and doubled the size of the asset-purchase plan to shield the economy from the effects of the nation's strongest earthquake on record. The BoJ then kept adding liquidity to the financial system in consecutive operations. The monetary base expanded by 10% m-o-m in March 2011. The BoJ made clear that it will take further measures if needed in order to help the reconstruction process.

For the year 2012, upside risks dominate. Consumption could rebound more strongly than expected as consumers might regain confidence and a higher saving rate in 2011 might allow for higher spending. Investments, after being delayed up to the later quarters of 2011 could accelerate. Exports could also recover more strongly than is currently expected.

Table II.34.1:

### Main features of country forecast - JAPAN

	2009			92-06	Annual percentage change					
	bn JPY	Curr. prices	% GDP		2007	2008	2009	2010	2011	2012
GDP	470936.6		100.0	1.1	2.4	-1.2	-6.3	3.9	0.5	1.6
Private consumption	279909.6		59.4	1.3	1.6	-0.7	-1.9	1.8	-0.3	1.0
Public consumption	94477.3		20.1	2.5	1.5	0.5	3.0	2.3	2.1	1.2
Gross fixed capital formation	99625.6		21.2	-0.7	-1.2	-3.6	-11.7	0.0	0.5	3.6
of which : equipment	-		-	-	-	-	-	-	-	-
Exports (goods and services)	59506.0		12.6	5.3	8.4	1.6	-23.9	24.2	1.0	3.8
Imports (goods and services)	58087.0		12.3	4.1	1.6	0.4	-15.3	9.3	4.5	3.7
GNI (GDP deflator)	483855.7		102.7	1.3	2.9	-1.2	-6.8	3.8	0.4	1.7
Contribution to GDP growth :										
Domestic demand				0.9	0.9	-1.1	-3.2	1.5	0.4	1.5
Inventories				0.0	0.3	-0.2	-1.4	0.6	0.3	0.0
Net exports				0.2	1.1	0.2	-1.5	2.2	-0.3	0.2
Employment				-0.1	0.4	-0.3	-1.6	-0.6	-0.2	0.1
Unemployment rate (a)				4.0	3.9	4.0	5.1	5.1	4.9	4.8
Compensation of employees/head				0.1	-1.3	0.0	-3.1	0.8	1.1	1.2
Unit labour costs whole economy				-1.1	-3.2	0.9	1.7	-3.6	0.3	-0.4
Real unit labour costs				-0.5	-2.5	1.9	2.1	-1.5	2.3	-0.6
Savings rate of households (b)				15.3	9.2	8.9	11.3	11.9	13.6	13.7
GDP deflator				-0.6	-0.7	-1.0	-0.4	-2.1	-2.0	0.2
General index of consumer prices				-	0.0	1.4	-1.4	-0.7	0.2	0.3
Terms of trade of goods				-1.6	-4.3	-11.3	15.8	-6.2	-9.7	-1.7
Trade balance (c)				2.5	2.4	0.8	0.9	1.8	0.2	-0.1
Current-account balance (c)				2.8	4.8	3.2	2.8	3.6	1.4	1.1
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				2.7	4.7	3.1	2.7	3.5	1.3	1.0
General government balance (c)				-5.3	-2.4	-2.2	-8.7	-9.3	-9.7	-9.8
Cyclically-adjusted budget balance (c)				-	-	-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-	-	-
General government gross debt (c)				131.5	187.7	195.0	217.6	223.1	236.1	242.1

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.



## 35. CHINA

### A soft landing?

#### Strong but imbalanced growth in 2010

Following a slight deceleration from 11.9% in the first quarter to 9.6% in the third quarter of 2010, China's GDP rose by 9.8% in the fourth quarter in annualised terms. This brought growth for 2010 as a whole to 10.3% in real terms compared to 9.1% in 2009.

In 2010, growth was primarily driven by investment and private consumption, with the GDP contribution of net exports diminishing compared to the previous year (China publishes a real figure for overall GDP and no nominal or real figures for GDP components). In the first quarter of 2011, China's GDP pursued rapid growth, as GDP rose by 9.7% y-o-y<sup>(84)</sup>.

Investment continues to be the largest contributor to growth, as real estate enjoys an ongoing boom. In 2010, investment in fixed assets rose by 19.5% in real terms and in the first quarter of 2011, investment in fixed assets (excluding rural households) further accelerated to 25% y-o-y. Investment in real estate rose by 33.2% in 2010. As investment in real estate continues to surge (34.1% in the first quarter of 2011), there is renewed concern about a bubble scenario in this market. However, the PMI (CFLP index) edged down at the beginning of this year, reflecting softening momentum. Surging inflation, monetary tightening, stricter property controls and the ending of some economic stimuli cast some uncertainty onto the outlook for investment in 2011.

The share of consumption in GDP pales in comparison, notwithstanding robust growth. In 2010, nominal retail sales increased by around 15% in real terms. The share of total retail sales of consumer goods in overall GDP reached 39.4% in 2010<sup>(85)</sup>, below the shares registered by other East Asian nations at a similar stage of development in the past. In the short term, inflation is likely to put

a lid on private consumption this year by denting consumers' purchasing power.

The external sector lends solid support to growth. In 2010, exports rose by 31.3% y-o-y, while imports rose by 38.7% (in value terms). China's trade surplus declined by 6.4% to reach USD 183.1 bn or 3.1% of GDP, compared to 3.9% of GDP in 2009. In the first quarter of 2011, China's trade continued to expand rapidly, with imports (up by 32.6% y-o-y) outpacing exports (up by 26.5% on the year), and driven by the recent strong rise in commodity prices. As a consequence, China posted an overall trade deficit in the order of USD 1 bn for the first quarter of 2011.

In 2011, export growth appears set to remain steady, especially as demand from advanced economies continues to recover gradually in the first months of 2011. Import growth is likely to continue to slow down as domestic demand moderates. Imports, of which a substantial share is used as intermediary components for processing trade, are being affected by measures targeted at reining in over-investment. The impact of the Japanese earthquake on China's economy will affect destocking and slow down exports, which may reduce growth in the first half of 2011, but which could already be offset by the second half of the year.

In March 2011, China's holdings of foreign exchange reserves reached USD 3.04 trillion compared to USD 2.45 trn in March 2010. As China experienced a trade deficit in the first quarter of 2011, the pace of reserve accumulation tends to indicate continued inflows of hot capital in the expectation of RMB appreciation. However, so far the RMB has appreciated only moderately against the US dollar. From June to October 2010, the RMB has even depreciated on a nominal effective basis. Since then, it has started to appreciate again, albeit at a slow pace, before reaching almost the same level in March as in the end of November. By contrast, on a nominal basis, the RMB has depreciated against the euro during the first quarter of 2011 by around 9%.

China's current-account surplus continued to rise in nominal terms from USD 297.1 in 2009 to USD 306.2 in 2010, but declined from 5.9% of GDP in 2009 to 5.1% of GDP in 2010. The nominal

<sup>(84)</sup> The National Bureau of Statistics (NBS) published for the first time a quarterly growth rate, showing 8.6% q-o-q (seasonally adjusted annualised rate).

<sup>(85)</sup> The total retail sales of consumer goods figure is only an approximation for total household consumption as for instance it includes government's purchases from retailers as well as an (unknown) share of wholesale activity. This explains why its share in GDP is higher than the consumption share.

current-account surplus is likely to experience a slight rise in 2011 in nominal terms, which – given ongoing high nominal GDP growth – would translate into a further decline in the current-account surplus in terms of GDP (around 4.4% of GDP).

The high (nominal) current-account surplus reflects imbalances in the savings and investment composition of Chinese growth, where investment fuels export-led growth and where the rate of national savings is high. This is due to Chinese households trying to compensate for the country's thin social safety net, limited options to finance major expenditure such as education, and few investment options other than bank deposits. Savings by the corporate sector and in particular by many state-owned enterprises (SOEs) are also high, due to the lack of coherent taxation as well as of SOEs' dividends payments strategy.

### Inflationary pressures on the rise

Developments on the price front are not in line with central bank targets. Due primarily to developments in food<sup>(86)</sup> and commodity prices, inflation reached 3.3% in 2010, higher than the official target of 3% for that year. In the first quarter of 2011, the increase in China's consumer price index reached 5% y-o-y. Breaching the 4% target for consumer price inflation in 2011 is therefore a substantial risk.

Graph II.35.1: China - Inflation



Loose monetary policy dominated in 2009 (monetary supply has increased by 27.7% on the year), and the year 2010 was marked by relatively less accommodative monetary policy. Since November 2010, the PBoC (Chinese central bank) has increased banks' reserve requirement ratio (RRR) seven times to 20.5% for the big banks. On

26 December the PBoC raised its main official policy instrument, the one-year lending rate, from 5.56% to 5.81%, the first increase since the collapse of Lehman Brothers. This rate was raised twice by 25 basis points until April, reaching 6.31%. These measures took place against the background of the shift in China's monetary policy stance from "appropriately loose" to "prudent".

As loose monetary policies in a number of advanced economies (e.g. US and UK) combined with ongoing strong growth performance in China are inducing hot capital inflows into China, the PBoC faces a considerable challenge: while increasing price pressures demand tighter monetary tightening, further interest rate hikes could induce even stronger inflows of hot speculative capital.

### A moderate growth deceleration is forecast in 2011-12

In the period from 2007 to 2012, China's contribution to global GDP growth is likely to be the highest in the world. In 2011 and 2012, China's GDP growth is likely to moderate somewhat. The fading of the stimulus measures as well as the inflationary pressures will limit China's growth. The moderate monetary tightening initiated by the PBoC will further soften China's domestic demand. On the other hand, private consumption is likely to benefit from growing incomes thanks to wage increases. China's GDP growth rate is now likely to reach 9.3% in 2011, down from 10.3% in 2010 and to pursue its moderate deceleration to around 9% in 2012.

On the fiscal side, the general government deficit in 2010 (2½% of GDP) was lower than the official target of 2.8% of GDP. In the current year, the combined deficit (central government and provinces) is targeted to decline to around 2% of GDP. A downside risk is that the financing of many crisis measures via the banking system might cause the ratio of non-performing loans (NPLs) to rise in the medium-term and require a bail-out of banks by the central government. Local governments might also end up with fiscal problems, if projects yield less than what was anticipated when loans were granted as support measures during the crisis.

Another domestic downside risk is a potential bursting of the housing bubble in some cities, (although on the basis of public Chinese statistics

<sup>(86)</sup> Food prices went up by 7.2% in 2010.

this risk is hard to quantify). External developments such as hot capital inflows or weaker-than-expected demand in some important advanced economies could negatively impact China's economic performance.

### The twelfth five-year plan aims at rebalancing growth but its implementation is uncertain

Rebalancing from an export- and investment-led growth to a model allowing domestic demand and consumption to play a greater role is one of the main challenges that China faces in the medium term. The twelfth five-year plan (FYP) that was published during the 2011 session of the National People's Congress in March 2011 aims at achieving a more balanced growth.

The plan targets annual average GDP growth rate of 7% as a floor during the next five years. Rebalancing growth is expected to be achieved through several channels. More inclusive growth is expected as a result of the improvement in basic health and pension systems. China's government is also committed to align gains in real wages with labour's marginal productivity contribution, increase minimum wages and establish "harmonious labour relations". A new housing policy completes this focus on improving people's welfare. The accelerated development of the

services sector – the services share of GDP is expected to grow by 4 pps. during the next five years – and the pursuit of urbanisation are intended to participate to China's growth rebalancing. Finally, achieving a greener growth is planned through the development of renewable energy, the reduction of energy consumption and intensity.

Table II.35.1:

Examples of 11th and 12th FYP indicators

	11 <sup>th</sup> FYP (objectives)	2010 (results)	12 <sup>th</sup> FYP (objectives)
GDP growth <sup>1</sup>	7.5%	11.2%	7%
R&D spending <sup>2</sup>	2%	1.7%	2.2%
Basic urban pension system coverage <sup>3</sup>	223	257	357
Energy consumption <sup>4</sup>	-20%	-19.1%	-16%

<sup>1)</sup> Annual average <sup>2)</sup> % of GDP

<sup>3)</sup> Million people <sup>4)</sup> per unit of GDP

However, the most challenging issue is the implementation of these objectives, where guidance by the central government needs to be implemented at sub-central level. As sub-national governments at the provincial, municipal, county and township levels account for more than 80% of national budgetary expenditures and are responsible for most public services, they represent key actors in the plan's implementation. Yet, the current responsibility system created to monitor local policy action so far has limited capacity to give incentives towards a shift from quantitative to qualitative growth targets.

Table II.35.2:

Main features of country forecast - CHINA

2009				Annual percentage change						
	bn CNY	Curr. prices	% GDP	92-06	2007	2008	2009	2010	2011	2012
GDP		34090.3	100.0	10.3	14.2	9.6	9.1	10.3	9.3	9.0
Private consumption		12113.0	35.5	14.8	16.5	15.7	9.5	-	-	-
Public consumption		4439.7	13.0	16.1	17.6	16.3	6.3	-	-	-
Gross fixed capital formation		164463.5	48.2	18.6	19.4	24.7	18.9	-	-	-
of which : equipment		-	-	-	-	-	-	-	-	-
Change in stocks as % of GDP		-	-	-	-	-	-	-	-	-
Exports (goods and services)		12016.1	35.2	16.7	36.0	5.9	-11.5	18.0	12.4	11.2
Final demand		-	-	-	-	-	-	-	-	-
Imports (goods and services)		10059.2	29.5	17.7	10.3	7.1	1.4	19.4	12.3	12.0
GNI (GDP deflator)		-	-	-	-	-	-	-	-	-
Contribution to GDP growth :		Domestic demand		-	-	-	-	-	-	-
		Stockbuilding		-	-	-	-	-	-	-
		Foreign balance		-	-	-	-	-	-	-
Employment				1.1	0.8	0.6	0.7	-	-	-
Unemployment (a)				3.3	4.0	4.2	4.3	4.1	-	-
Compensation of employees/head				-	-	-	-	-	-	-
Unit labour costs				-	-	-	-	-	-	-
Real unit labour costs				-	-	-	-	-	-	-
Savings rate of households				-	-	-	-	-	-	-
GDP deflator				5.7	4.8	8.0	0.4	6.8	5.9	4.0
Private consumption deflator				-	-	-	-	-	-	-
Index of consumer prices (c)				5.3	4.8	5.9	-0.7	3.3	-	-
Trade balance (b)				2.7	9.0	8.0	4.9	2.8	1.0	1.0
Current-account balance (b)				2.1	10.6	9.6	5.9	5.1	4.4	4.4
Net lending(+) or borrowing(-) vis-à-vis ROW (b)				-	-	-	-	-	-	-
General government balance (b)				-1.5	0.6	-0.4	-2.3	-1.6	-	-
General government gross debt (b)				-	-	-	-	-	-	-

(a) urban unemployment, as % of labour force. (b) as a percentage of GDP. (c) national indicator.

## 36. EFTA

### Well beyond the crisis

The EFTA countries<sup>(87)</sup> have recovered well from the recession. Fiscal packages are to be unwound during the forecast years, albeit at a different pace in the two countries. Government spending in the EFTA states is expected to be more restrained and domestic demand should, therefore, be more prominently driven by the private sector. While higher household spending is expected in Norway, rising domestic demand in Switzerland would be driven by higher investment.

For both economies, the traditionally positive contribution to growth from external trade is likely to resume. Growth in exports and imports is projected to continue its rebound from the crisis dip – particularly in the case of Switzerland – the recent developments in external trade have been significant. The relatively high unemployment rates are slowly coming down but will continue to be the common challenge. Although remaining well below EU levels, unemployment is likely to remain significantly above pre-crisis levels in the forecast years. The outlook for the forecast period shows moderate to solid growth in both Switzerland and Norway. Risks to the forecast are mainly in the area of prices. While the Norwegian forecast depends strongly on the price of oil, Switzerland's outlook is strongly related to the price of the Swiss franc.

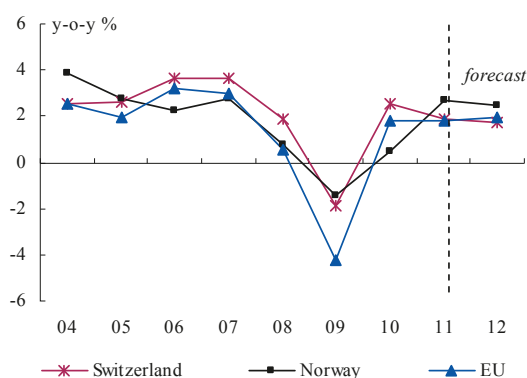
#### GDP growth on the back of household consumption in Norway

Real GDP contracted by 1.4% in 2009, with domestic demand shrinking except for government spending and external trade also contributing to the contraction. The return to growth in 2010 was rather hesitant with an increase of only 0.4% of GDP. The challenge for Norway is set to create a growth momentum as the fiscal stimulus fades away towards the end of the forecast period. The expansionary fiscal policy seen during the crisis is expected to become more restrained in the coming years. From 2011, the fiscal stance is expected to turn less expansionary as the fiscal stimulus package is envisaged to be halved as compared to 2010. GDP growth is likely to accelerate significantly in 2011, to 2.7% and decelerate

slightly to 2.5% in 2012. The growth rebound is mostly driven by domestic demand, even though also external trade is expected to continue to contribute to growth, albeit to a limited extent. The decline in investments in Norwegian mainland industries, which started in 2009, worsened in 2010. However, investment in the mainland industries is set to rebound to growth in 2011 and onwards, without, however, matching the pre-crisis level of 2008.

Export growth should be driven by services and traditional goods, such as wood products, industrial machinery and transport equipment rather than Norway's oil exports. Oil production is expected to slightly decrease in the forecast period. As this decrease is more than offset by the export of traditional goods, exports are likely to grow by around 1.9% both this year as well as in 2012. However, as import growth is expected to outpace the growth of exports in 2010, the external net contribution to GDP growth should be decreasing, to rebound again towards the end of the forecast period. External net contribution to GDP growth should remain (slightly) positive during both forecast years.

Graph II.36.1: EFTA vs EU GDP growth



#### Households continue to spend

Household consumption, which accounts for around 55% of GDP in mainland Norway, is likely to grow again in the forecast period. Low interest rates, rising income, increased wealth and better prospects all contributed to stabilise household consumption in 2009, after having declined for a year. The return to growth of consumer spending

<sup>(87)</sup> Norway and Switzerland, are covered in this section. Switzerland's outlook includes Liechtenstein. Iceland's outlook can be found in the section on candidate countries.

was strong at 3.7% in 2010 and growth should remain above 2% throughout the forecast period, despite planned higher policy interest rates. However, the relatively highly indebted Norwegian households could pose a downside risk to household spending. Taken together, the vast majority of the loans depending on flexible interest rates in combination with the gradual withdrawal of fiscal stimulus measures; these factors could negatively impact consumer's spending capacity and limit consumer spending.

### Norway's housing market remains strong

House prices are expected to continue to increase in 2011 and 2012. The improvement in the housing market is expected to contribute to increased investments, in particular in residential construction, thus turning the decline of the past two years into a possible upswing in the two forecast years.

### Inflation remains moderate...

Consumer inflation declined to an annual average of 2.3% in 2009 and remained on that level in 2010. Strengthening of the NOK is expected to contribute to putting a lid on inflation, resulting in inflation rates of around 1.9% this year. In the remainder of the forecast period the inflation rate will likely remain slightly below 2%. The recession period in the Norwegian economy is partly responsible for a fall in wage growth. Wage growth is expected to slow down slightly further in the forecast period, which should help to limit the pressure from the labour market on prices.

### ...while unemployment remains low

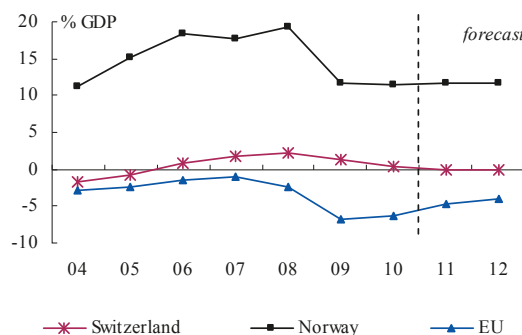
Unemployment in Norway is relatively low as compared to the EU. However in 2010, it reached 3.5% of the total work force – on the high side by Norwegian standards. In the next two years unemployment should ease to 3.3% by the end of 2012.

### Current account remains positive

Norway's current account should remain well in the positive throughout the forecast period. Although the trade surplus narrowed in 2010, it is likely to widen again this year, partly due to higher oil prices. In 2012, the current account should further benefit from this development, also supported by a surplus in the services balance.

However, the balance of primary incomes has shown a deficit in 2009 which remained, albeit narrow, in 2010. For 2011 this income balance is likely to approach a neutral status and in 2012 a small surplus is expected. All in all the current-account balance should remain around 12% of GDP for the duration of the two forecast years.

Graph II.36.2: EFTA vs EU Net lending  
General Government



### Switzerland's economy is rebounding

Switzerland's economy has recovered from its worst recession in over three decades with the global economic slump hitting its exporters hard. While the economy contracted by 1.9% in 2009 it picked up strongly in 2010 with GDP growth of 2.6%. However, growth is expected to decelerate to 1.9% in 2011, partly due to decreasing growth in government spending. GDP growth should continue to decelerate somewhat in 2012 to 1.7%. External trade made a positive net contribution in 2010. In 2010 exports of goods rebounded strongly at 10.5% while imports of goods grew at a slightly lower rate by 6.7%. However, the external sector is foreseen to post a (slight) negative contribution to growth again in 2011 and 2012, with import growth outperforming export growth in 2011. With increasing saving rates and low consumer confidence, household consumption dropped in 2009, but resumed moderately in 2010. Growth is likely to be continued, albeit at a modest pace of just over 1% per year in 2011 and 2012. Growth in public investment is also expected to be modest in the forecast years, despite increased government focus on infrastructure investments.



## External sector

Exports rebounded strongly in 2010, mostly due to strong growth in pharmaceutical and machineries exports to Asia, where Switzerland's exports are likely to continue to gain in market shares. Real growth in exports of goods and services is expected to continue, more moderately, however, in 2011-12. The Swiss have successfully been riding their image of high-quality products. Still, the strong, or even further appreciating, Swiss franc may negatively impact this outlook and there is a latent downside risk to the services sector in relation to the eroding bank secrecy. Overall, import growth will be outperformed by exports in 2011 but is likely to catch up in 2012.

## Swiss inflation

The Swiss National Bank is expected to maintain its course of expansionary monetary policy in 2011 and 2012. On a no-policy-change assumption, the key interest rate – the three-month Swiss-franc Libor – would remain low, supporting domestic demand. Recent robust domestic credit growth has supported consumption of the households, which are not burdened by particularly high debt levels. For the forecast years inflation is expected to remain low.

In 2009 and 2010, Switzerland intervened heavily in the currency markets, buying up large amounts of euros. However, the interventions merely slowed down the appreciation of the franc. A continuing strong franc may prompt the National Bank to maintain its current policies, using all available means, including additional currency interventions.

## Low unemployment

The unemployment rate stood at 2.8% by the end of 2010, which is high for Switzerland. For 2011 and 2012 unemployment is expected to slow to around 2.6%. Wage growth is expected to decelerate in the same period, thus accelerating pressure on inflation, turning in a slight increase towards the end of the forecast period.

## Current account

The current-account surplus increased to 12.2% of GDP in 2010. The trade and services balances should continue to record decreasingly large surpluses during the forecast years. The current account is forecast to remain significantly positive, albeit decreasing as a percentage of GDP, at 10.5% of GDP in 2011 and 11% in 2012.

Table II.36.1:

### Main features of country forecast - EFTA

	Iceland			Norway			Switzerland		
(Annual percentage change)	2010	2011	2012	2010	2011	2012	2010	2011	2012
GDP	-3.5	1.5	2.5	0.4	2.7	2.5	2.6	1.9	1.7
Private consumption	-0.2	2.3	2.7	3.6	2.9	2.4	1.7	1.3	1.2
Public consumption	-3.2	-3.5	-3.2	2.2	2.3	1.5	-1.6	0.6	-0.3
Gross fixed capital formation	-8.1	14.0	16.0	-8.9	4.2	3.3	4.6	1.9	1.9
of which : equipment	33.5	16.0	18.0	-7.8	5.1	3.7	4.6	1.9	1.8
Exports (goods and services)	1.1	2.3	3.4	-1.3	1.9	1.9	9.3	3.5	5.1
Imports (goods and services)	3.9	4.0	4.8	8.7	2.4	1.0	6.7	6.4	5.1
GNI (GDP deflator)	-2.9	4.3	4.2	1.5	1.0	2.5	4.3	-1.3	1.7
Contribution to GDP growth : Domestic demand	-2.1	1.9	2.8	0.1	2.6	2.0	1.7	1.2	1.0
Inventories	-0.2	0.0	0.1	3.5	0.0	0.0	-1.3	1.5	0.0
Net exports	-1.2	-0.5	-0.4	-2.9	0.1	0.5	2.1	-0.8	0.7
Employment	-0.3	0.6	1.1	-0.2	0.5	0.8	2.2	2.2	2.1
Unemployment rate (a)	7.5	6.9	6.2	3.5	3.5	3.3	2.8	2.8	2.6
Compensation of employees/head	3.9	4.0	4.0	3.8	3.5	2.7	-1.1	4.1	2.4
Unit labour costs whole economy	7.3	3.1	2.5	3.1	1.3	1.0	-1.5	4.4	2.8
Real unit labour costs	0.6	0.2	-0.3	-1.5	-2.4	-1.2	-1.0	0.9	0.9
Savings rate of households (b)	5.2	4.4	3.7	12.2	12.1	12.5	20.1	20.6	20.5
GDP deflator	6.7	2.9	2.8	4.7	3.8	2.2	-0.5	3.5	1.9
Harmonised index of consumer prices	7.5	3.0	2.7	2.3	1.9	1.8	0.6	1.0	1.2
Terms of trade of goods	8.4	-1.4	0.0	9.2	3.9	-0.4	-0.9	5.2	0.2
Trade balance (c)	7.7	7.1	6.8	12.8	13.2	13.0	3.3	3.9	3.7
Current-account balance (c)	-7.8	-6.2	-5.5	13.1	12.2	12.1	16.6	8.0	8.7
Net lending(+) or borrowing(-) vis-à-vis ROW (c)	-7.9	-6.2	-5.5	13.0	12.2	12.1	12.2	4.0	4.6
General government balance (c)	-7.8	-4.9	-3.6	10.7	9.7	9.7	0.5	-0.1	-0.1
Cyclically-adjusted budget balance (c)	-	-	-	-	-	-	-	-	-
Structural budget balance (c)	-	-	-	-	-	-	-	-	-
General government gross debt (c)	93.3	94.3	93.0	44.7	41.6	38.9	38.6	37.0	36.1

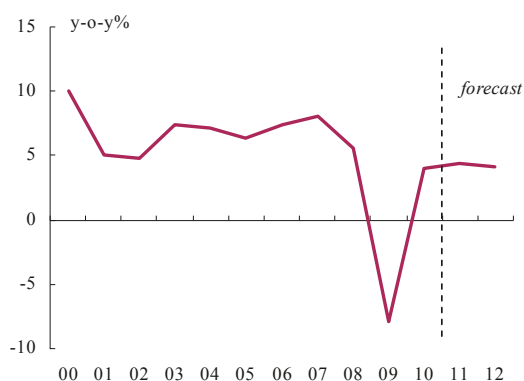
(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

## 37. RUSSIAN FEDERATION

### V-shaped recovery continues

The Russian economy grew by 4% in 2010, after contracting by -7.9% in 2009. Russia's recovery is V-shaped, with growth rebounding to an expected 4.5% in 2011 and to 4.2% in 2012. Economic growth has been increasingly supported by recovering domestic demand (consumption and investment). Because of higher external demand, export growth accelerated as well, but to a lesser degree than imports, resulting in a negative contribution from net exports in 2010. Growth in 2011 is likely to be negatively affected by sluggish growth in the advanced economies, Russia's main trading partners. Looking ahead, with Russia being one of the largest oil and gas exporters in the world, the pace of the recovery is likely to depend on commodity price developments.

Graph II.37.1: Russia - GDP growth



#### Growth continues to improve

The expansion of domestic demand was a major factor of economic growth in 2010. Growth in consumer spending and investment activity increased in 2010 and both are foreseen to continue increasing further.

Despite strongly increasing imports of goods due to strengthening domestic demand, Russia's trade surplus increased compared to 2009, as it grew by 24.7% in 2010. The strong increase in exports, supported by higher oil prices, and increasing external demand, resulted in a rise in the current-account surplus from 4% of GDP in 2009 to 5.8% in 2010 (around USD 71.1 bn). Expected high energy prices are the main reason behind the large current-account surplus throughout the forecast

horizon. Oil and gas account for two thirds of Russia's export receipts. However, export volume growth of the oil and gas sector is limited by sluggish productivity and lack of further investments in maintenance. According to estimates from the Central Bank of Russia (CBR), the current-account surplus fell to USD 33.8 bn, increasing 4.5% y-o-y in the first quarter of 2011. Overall, the current-account surplus is foreseen to increase to around 7.4% of GDP in 2011 and to 7.8% of GDP in 2012, mainly on the back of high oil prices.

The labour market has continued to improve. The unemployment rate, which shot up from 5.8% in August 2008 to 9.4% in February 2009, has been coming down rapidly. In 2010, the total number of unemployed declined to 7.2% of the economically active population from 8.2% as of the end of 2009. After a crisis-induced decline in real wages in 2009, real wage growth has resumed. Wage and pension increases contributed 4.3% to growth in household real disposable income.

A large output gap, temporarily falling food prices until July 2010, and continuous rouble appreciation, have kept a lid on inflation, which fell for twelve consecutive months, from 12% in July 2009 to a post-Soviet-era low of 5.5% a year later. Inflation edged up to 9.5% in March 2011, largely driven by higher food prices, as a result of the summer 2010 heat wave, while growth in non-food goods prices slowed from 9.7% in 2009 to 5% in 2010.<sup>(88)</sup>

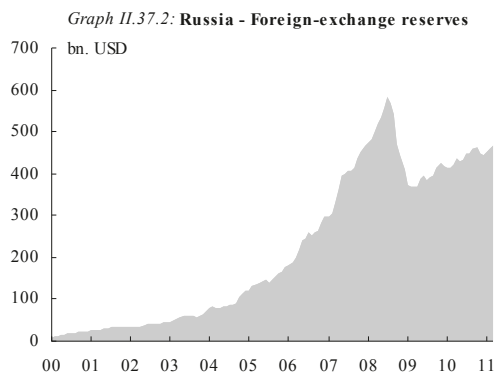
#### Accommodative monetary policy has been tightened

The Central Bank of Russia manages the rouble against a dollar/euro basket, in which the dollar weighs 55% and the euro 45%. In 2010, as the exchange rate stabilised, the CBR scaled back its intervention in currency markets and started replenishing foreign exchange reserves. In March 2011 the CBR intervened again, with monthly FX purchases still well below the levels seen in spring 2010. The rouble now lies within the central bank's range of 33.4-36.4 against the basket.<sup>(89)</sup> As of

<sup>(88)</sup> Food prices represent about 40% of the CPI basket in Russia.

<sup>(89)</sup> The value of the bi-currency basket stood at 34.6525 roubles as of February 2011.

end-March 2010, Russia's foreign-exchange reserves reached USD 465.5 bn.



After ten interest rate cuts in the last seven months of 2009, the CBR further reduced its refinancing rate four times in 2010, from 8.75% in February to a record-low 7.75% in June. Since then, the overnight rate has been kept unchanged and the CBR signalled that it had put an end to monetary easing. On 25 February 2011, in the light of high inflationary expectations and rising oil prices, the CBR increased the refinancing rate to 8%. Reserve requirements were also increased on 1 April 2011 to reach 5.5% for liabilities of credit institutions. Due to high inflationary risks, the refinancing rate will be increased to 8.25% as of 3 May 2011.

Spurred by aggressive monetary easing during the first half of 2010, domestic credit to the private sector started to recover in 2010. Non-performing bank loans rose during the crisis, but appeared to have peaked in the summer and declined to 6% by the end of 2010. The Russian banking sector seems to be in a relatively sound position to manage these non-performing loans, as the average capital adequacy ratio rose from around 13% in mid-2008 to around 18% by March 2011. The recent increase in inflation has pushed real interest rates into negative territory, which may slow down the growth in bank deposits, and thereby constrain bank lending.

#### Inflationary pressures are growing

The strengthening of the rouble, along with low import prices and sluggish demand, were the main reasons behind inflation tapering off until July 2010, when consumer prices stood at a record low of 5.5% (y-o-y). However, inflation picked up strongly afterwards, to 9.6% in January 2011. Food inflation remains the main factor pushing up

inflation in Russia. Prices rose by 14.1% y-o-y as of March 2011 (after an increase by 6.9% on average in 2010). On top of elevated food prices, high oil and gas prices, budgetary expenditures and rapid growth of the money supply have also underpinned inflationary pressures. The overall inflation rate stood at 9.5% in March 2011. The recent upturn in inflation is expected to be temporary as the spillover from food prices to the rest of the CPI basket has been limited and a remaining substantial output gap is containing the transmission. Annual average inflation is forecast to increase to a yearly average of around 9.4% in 2011 and 8.2% in 2012, overshooting the CBR's inflation target.

#### Growth will remain below pre-crisis levels

GDP growth is expected to reach 4.2% towards the end of the forecast period and to remain well below the rates achieved before the crisis.

The economy's high (and increasing) dependence on the hydrocarbon sector will negatively impact the outlook. Energy-related output growth will remain sluggish, despite high energy prices, as existing fields are depleting and extraction becomes more complicated and more expensive. The assessment of risks remains highly correlated to changes in oil prices.

Investment recovery is mild and not strong enough to meet Russia's large investment needs to support higher potential growth. With a contribution to GDP in 2010 of around 20%, Russian investments remain well below many other emerging economies.

Over the forecast horizon, the strengthening of the labour market coupled with revived bank lending is expected to spur domestic demand. While unemployment is foreseen to decline to below 8% again towards the end of the forecast period, some risks remain.

#### Risks are tilted to the downside

Regional governments had stimulated employment during the crisis (under pressure from the central government) by keeping industrial workers on the payroll. However, they may lose the ability to continue supporting the labour market in the forecast years. Federal resources allocated last year to support regional governments are depleting and there will be fewer incentives for local businesses

to continue paying for an excessive supply of workers.

Under the recently revised budget proposals for 2011-13, the federal budget deficit is set to shrink to 3.6% of GDP in 2011 and to less than 3% of GDP by 2013. This is more optimistic than the forecast here: a deficit of 4.6% and 3.2% of GDP in 2011 and 2012, respectively are projected. Despite improved fiscal rules and continuous budgetary surpluses in the years preceding the crisis, the gradual pace of consolidation poses the risk that fiscal policy could become pro-cyclical. The key challenge will be to withdraw the large fiscal stimulus and avoid excessive exchange rate volatility and high inflation. According to the Medium Term Expenditure Framework, the budget is expected to return to balance by 2015.

The Reserve Fund, which was set up to save part

of the oil windfall and to reduce the vulnerability of the budget against oil-price volatility, is being depleted. As a result, 2011-12 budget deficits will increasingly be financed through issuing domestic debt.

The rouble is being given somewhat higher exchange rate flexibility against the basket. The CBR scaled down interventions on the exchange market and increased the role of the policy rate in slowing inflation. Wage growth is expected to continue but to remain moderate and definitely slower than before 2009. Additional fiscal spending associated with the election cycle will remain in 2011 and 2012, creating an upside risk on inflation. However, should upward pressures on the rouble intensify, there is a risk that priority might again be given to exchange rate considerations.

Table II.37.1:

**Main features of country forecast - RUSSIA**

	2009				Annual percentage change						
	bn RUB	Curr. prices	% GDP		92-06	2007	2008	2009	2010	2011	2012
GDP		39100.7	100.0	-		8.5	5.2	-7.9	4.0	4.5	4.2
Private consumption		21319.5	54.5	-		14.2	10.7	-7.7	2.7	3.0	3.6
Public consumption		7871.3	20.1	-		2.7	2.8	2.0	0.7	2.3	2.1
Gross fixed capital formation		8075.9	20.7	-		21.1	9.5	-16.1	3.5	4.3	7.7
of which: equipment		3024.2	7.7	-		-	-	-	3.5	0.7	6.0
Exports (goods and services)		10844.0	27.7	-		6.3	0.6	-4.7	11.8	7.6	4.5
Imports (goods and services)		7964.0	20.4	-		26.2	14.8	-30.4	11.7	7.8	7.1
GNI (GDP deflator)		37862.3	96.8	-		9.2	4.6	-8.1	3.6	4.8	4.1
Contribution to GDP growth :	Domestic demand			-		11.2	7.7	-6.9	2.3	2.9	3.7
	Inventories			-		0.8	0.6	-6.0	1.0	0.3	0.4
	Net exports			-		-3.4	-3.0	5.2	0.9	0.7	0.0
Employment				-		2.4	-0.3	-1.8	-0.8	1.9	2.9
Unemployment rate (a)				-		5.7	7.0	8.2	8.0	7.7	7.5
Compensation of employees/head				-		-	-	-	-	-	-
Unit labour costs whole economy				-		-	-	-	-	-	-
Real unit labour costs				-		-	-	-	-	-	-
Savings rate of households (b)				-		12.7	11.5	-	-	-	-
GDP deflator				-		13.8	18.4	2.5	9.5	8.6	4.9
Harmonised index of consumer prices				-		9.0	14.1	11.7	6.9	9.4	8.2
Terms of trade of goods				-		2.8	15.3	-32.6	8.0	4.9	4.9
Trade balance (c)				-		10.1	10.7	9.0	10.7	11.7	12.2
Current-account balance (c)				-		6.0	6.1	4.0	5.8	7.4	7.8
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				8.0		5.2	6.1	3.0	5.0	6.7	7.1
General government balance (c)				-		-	-	-	-4.6	-3.2	-2.6
Cyclically-adjusted budget balance (c)				-		-	-	-	-	-	-
Structural budget balance (c)				-		-	-	-	-	-	-
General government gross debt (c)				-		-	-	-	9.9	9.2	9.8

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

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# Statistical Annex

European Economic Forecast – Spring 2011

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TABLE 1 : Gross domestic product, volume (percentage change on preceding year, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	1.5	2.7	2.0	2.7	2.9	1.0	-2.8	2.2	2.4	2.2	1.8	2.0
Germany	1.4	2.1	1.0	3.4	2.7	1.0	-4.7	3.6	2.6	1.9	2.2	2.0
Estonia	:	7.0	8.5	10.6	6.9	-5.1	-13.9	3.1	4.9	4.0	4.4	3.5
Ireland	5.8	9.2	5.4	5.3	5.6	-3.5	-7.6	-1.0	0.6	1.9	0.9	1.9
Greece	1.1	3.8	4.2	5.2	4.3	1.0	-2.0	-4.5	-3.5	1.1	-3.0	1.1
Spain	1.5	4.4	3.3	4.0	3.6	0.9	-3.7	-0.1	0.8	1.5	0.7	1.7
France	1.2	3.0	1.7	2.2	2.4	0.2	-2.6	1.6	1.8	2.0	1.6	1.8
Italy	1.2	2.0	0.9	2.0	1.5	-1.3	-5.2	1.3	1.0	1.3	1.1	1.4
Cyprus	5.5	4.2	3.3	4.1	5.1	3.6	-1.7	1.0	1.5	2.4	1.5	2.2
Luxembourg	2.6	6.3	4.1	5.0	6.6	1.4	-3.6	3.5	3.4	3.8	2.8	3.2
Malta	5.0	3.4	2.0	2.1	4.4	5.3	-3.4	3.7	2.0	2.2	2.0	2.2
Netherlands	2.5	3.7	1.6	3.4	3.9	1.9	-3.9	1.8	1.9	1.7	1.5	1.7
Austria	1.8	2.6	2.2	3.6	3.7	2.2	-3.9	2.0	2.4	2.0	1.7	2.1
Portugal	2.0	3.9	0.7	1.4	2.4	0.0	-2.5	1.3	-2.2	-1.8	-1.0	0.8
Slovenia	2.0	4.2	4.3	5.9	6.9	3.7	-8.1	1.2	1.9	2.5	1.9	2.6
Slovakia	:	2.7	5.9	8.5	10.5	5.8	-4.8	4.0	3.5	4.4	3.0	3.9
Finland	1.3	4.5	3.0	4.4	5.3	0.9	-8.2	3.1	3.7	2.6	2.9	2.3
Euro area	1.5	2.8	1.7	3.1	2.9	0.4	-4.1	1.8	1.6	1.8	1.5	1.8
Bulgaria	-2.8	2.5	6.0	6.5	6.4	6.2	-5.5	0.2	2.8	3.7	2.6	3.8
Czech Republic	2.3	1.2	4.6	6.8	6.1	2.5	-4.1	2.3	2.0	2.9	2.3	3.1
Denmark	2.6	2.4	1.8	3.4	1.6	-1.1	-5.2	2.1	1.7	1.5	1.9	1.8
Latvia	-8.8	6.3	9.0	12.2	10.0	-4.2	-18.0	-0.3	3.3	4.0	3.3	4.0
Lithuania	-8.3	4.7	8.0	7.8	9.8	2.9	-14.7	1.3	5.0	4.7	2.8	3.2
Hungary	0.5	4.3	3.9	3.6	0.8	0.8	-6.7	1.2	2.7	2.6	2.8	3.2
Poland	4.9	4.4	4.1	6.2	6.8	5.1	1.7	3.8	4.0	3.7	3.9	4.2
Romania	1.3	0.1	6.2	7.9	6.3	7.3	-7.1	-1.3	1.5	3.7	1.5	3.8
Sweden	1.2	3.4	3.3	4.3	3.3	-0.6	-5.3	5.5	4.2	2.5	3.3	2.3
United Kingdom	2.5	3.4	2.6	2.8	2.7	-0.1	-4.9	1.3	1.7	2.1	2.2	2.5
EU	1.3	2.9	2.1	3.2	3.0	0.5	-4.2	1.8	1.8	1.9	1.7	2.0
USA	3.3	3.8	2.7	2.7	1.9	0.0	-2.7	2.9	2.6	2.7	2.1	2.5
Japan	1.3	0.5	1.7	2.0	2.4	-1.2	-6.3	3.9	0.5	1.6	1.3	1.7

TABLE 2 : Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter, 2010-2012)

	2010/1	2010/2	2010/3	2010/4	2011/1	2011/2	2011/3	2011/4	2012/1	2012/2	2012/3	2012/4
Belgium	0.1	1.1	0.4	0.5	1.0	0.3	0.5	0.5	0.5	0.6	0.6	0.7
Germany	0.6	2.2	0.7	0.4	0.9	0.3	0.5	0.5	0.5	0.6	0.6	0.6
Estonia	1.1	2.1	1.1	2.3	-0.1	1.3	1.3	1.2	1.0	0.8	0.6	0.6
Ireland	1.7	-1.1	0.6	-1.6	:	:	:	:	:	:	:	:
Greece	-0.6	-1.7	-1.3	-0.1	:	:	:	:	:	:	:	:
Spain	0.1	0.3	0.0	0.2	0.2	0.2	0.2	0.3	0.4	0.5	0.5	0.5
France	0.3	0.6	0.2	0.4	0.7	0.3	0.4	0.5	0.5	0.5	0.6	0.6
Italy	0.5	0.5	0.3	0.1	0.2	0.3	0.4	0.3	0.4	0.3	0.3	0.3
Cyprus	0.7	0.7	0.6	0.5	0.2	0.3	0.3	0.5	0.6	0.7	0.8	0.8
Luxembourg	0.3	1.4	1.1	1.7	:	:	:	:	:	:	:	:
Malta	2.5	-0.3	0.5	1.1	:	:	:	:	:	:	:	:
Netherlands	0.5	1.0	0.1	0.6	0.8	0.3	0.3	0.4	0.4	0.5	0.5	0.5
Austria	0.2	1.0	1.1	0.8	0.4	0.4	0.1	0.4	0.6	0.6	0.8	0.6
Portugal	0.7	0.5	0.3	-0.5	-0.7	-1.4	-0.4	-0.4	-0.4	-0.4	-0.3	-0.1
Slovenia	-0.1	1.1	0.3	0.6	0.4	0.4	0.4	0.5	0.6	0.7	0.7	0.7
Slovakia	0.7	0.9	0.9	0.9	0.7	0.8	1.1	1.1	0.8	1.5	1.4	0.9
Finland	0.2	2.7	0.4	1.7	0.6	0.6	0.6	0.6	0.7	0.6	0.6	0.5
Euro area	0.4	1.0	0.4	0.3	0.5	0.3	0.4	0.4	0.5	0.5	0.5	0.5
Bulgaria	-0.5	0.5	0.7	2.1	0.2	0.3	0.5	0.7	0.8	1.2	1.4	1.6
Czech Republic	0.7	0.7	0.9	0.3	0.2	0.5	0.6	0.6	0.7	0.8	0.9	1.0
Denmark	1.2	0.4	1.7	-0.4	0.5	0.4	0.4	0.2	0.4	0.4	0.4	0.5
Latvia	0.2	0.6	1.6	1.1	0.5	0.5	0.7	1.1	1.1	1.0	1.0	0.9
Lithuania	1.3	1.0	0.3	1.8	3.5	0.1	-1.2	0.7	1.7	2.1	1.9	1.8
Hungary	1.4	0.1	0.5	0.2	0.5	1.2	1.3	1.2	0.6	0.3	0.3	0.3
Poland	0.6	1.2	1.2	0.8	0.8	0.9	1.0	1.0	0.9	0.9	0.8	0.8
Romania	-0.2	0.2	-0.7	0.1	0.7	0.6	0.7	0.8	0.9	1.0	1.0	1.0
Sweden	1.6	2.1	2.1	1.2	0.6	0.7	0.7	0.5	0.7	0.5	0.5	0.3
United Kingdom	0.2	1.1	0.7	-0.5	0.5	0.6	0.4	0.5	0.5	0.7	0.5	0.5
EU	0.4	1.0	0.5	0.2	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.5
USA	0.9	0.4	0.6	0.8	0.4	0.8	0.7	0.7	0.5	0.7	0.7	0.7
Japan	1.5	0.5	0.8	-0.3	0.0	-1.0	0.8	1.1	0.2	0.3	0.2	0.3



TABLE 3 : Profiles (yoy) of quarterly GDP, volume (percentage change from corresponding quarter in previous year, 2010-2012)

2.5.2011

	2010/1	2010/2	2010/3	2010/4	2011/1	2011/2	2011/3	2011/4	2012/1	2012/2	2012/3	2012/4
Belgium	1.7	2.7	2.0	2.1	3.0	2.2	2.3	2.3	1.9	2.1	2.2	2.4
Germany	2.1	3.9	3.9	4.0	4.2	2.3	2.1	2.1	1.8	2.1	2.3	2.5
Estonia	-2.7	3.1	5.5	6.8	5.5	4.8	5.0	3.9	5.0	4.5	3.7	3.0
Ireland	-1.2	-1.9	-0.5	-0.5	:	:	:	:	:	:	:	:
Greece	-2.7	-4.0	-4.6	-3.7	:	:	:	:	:	:	:	:
Spain	-1.4	0.0	0.2	0.6	0.7	0.6	0.8	0.9	1.1	1.4	1.7	1.9
France	1.2	1.6	1.7	1.5	1.9	1.6	1.7	1.9	1.8	2.0	2.2	2.3
Italy	0.6	1.5	1.4	1.5	1.1	0.9	0.9	1.2	1.4	1.4	1.3	1.2
Cyprus	-1.0	0.6	2.0	2.6	2.0	1.5	1.3	1.2	1.7	2.2	2.6	3.0
Luxembourg	1.0	5.3	3.2	4.6	:	:	:	:	:	:	:	:
Malta	3.9	3.5	3.2	3.9	:	:	:	:	:	:	:	:
Netherlands	0.3	2.7	1.9	2.2	2.5	1.7	1.9	1.6	1.3	1.5	1.8	1.9
Austria	0.5	2.3	2.7	3.1	3.3	2.7	1.7	1.2	1.5	1.7	2.4	2.6
Portugal	1.7	1.4	1.2	1.0	-0.4	-2.3	-3.0	-3.0	-2.7	-1.6	-1.5	-1.2
Slovenia	-0.2	1.5	1.3	1.9	2.4	1.7	1.9	1.8	2.0	2.3	2.6	2.8
Slovakia	4.5	4.2	4.0	3.4	3.4	3.4	3.5	3.7	3.8	4.4	4.8	4.6
Finland	0.1	4.1	3.0	5.0	5.5	3.4	3.5	2.4	2.5	2.5	2.6	2.5
Euro area	0.8	2.0	2.0	2.0	2.3	1.5	1.5	1.6	1.5	1.7	1.9	2.0
Bulgaria	-0.8	-0.3	0.5	2.8	3.5	3.2	3.0	1.6	2.3	3.2	4.2	5.1
Czech Republic	1.1	2.3	2.7	2.6	2.2	2.0	1.7	2.0	2.5	2.7	3.0	3.3
Denmark	-0.8	2.6	3.7	2.9	2.2	2.2	0.9	1.5	1.4	1.4	1.4	1.7
Latvia	-5.3	-2.8	2.6	3.6	3.8	3.7	2.8	2.8	3.4	4.0	4.3	4.1
Lithuania	-1.9	1.2	1.6	4.6	6.8	5.8	4.2	3.1	1.3	3.3	6.6	7.7
Hungary	-0.6	0.8	2.2	2.3	1.3	2.4	3.3	4.3	4.3	3.4	2.3	1.5
Poland	3.1	3.7	4.6	3.9	4.0	3.7	3.4	3.7	3.8	3.8	3.7	3.5
Romania	-2.1	-0.5	-2.1	-0.6	0.3	0.7	2.1	2.8	3.0	3.4	3.8	4.0
Sweden	2.6	4.4	6.8	7.2	6.2	4.7	3.3	2.6	2.7	2.5	2.3	2.1
United Kingdom	-0.4	1.5	2.5	1.5	1.8	1.3	1.0	2.1	2.0	2.1	2.2	2.2
EU	0.7	2.0	2.2	2.2	2.3	1.6	1.5	1.8	1.7	1.9	2.1	2.1
USA	2.4	3.0	3.2	2.8	2.2	2.6	2.7	2.6	2.7	2.6	2.6	2.6
Japan	5.4	3.3	4.7	2.5	1.0	-0.5	-0.5	0.9	1.1	2.5	1.9	1.1

TABLE 4 : Gross domestic product per capita (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	1.2	2.5	1.4	2.0	2.2	0.2	-3.5	1.4	1.6	1.5	1.1	1.3
Germany	0.9	1.9	1.0	3.5	2.8	1.2	-4.4	3.8	2.7	2.1	2.6	2.3
Estonia	:	7.9	8.9	10.8	7.1	-5.0	-13.9	3.1	4.7	3.9	4.3	3.4
Ireland	5.3	7.8	3.3	2.8	3.1	-5.2	-8.1	-1.7	0.3	1.7	1.0	1.8
Greece	0.2	3.4	3.8	4.7	3.9	0.6	-2.4	-4.7	-3.7	0.9	-3.2	0.9
Spain	1.3	3.7	1.7	2.4	1.7	-0.7	-4.4	-0.5	0.4	1.2	0.3	1.4
France	0.8	2.4	1.0	1.5	1.8	-0.3	-3.2	1.0	1.2	1.5	1.2	1.3
Italy	1.2	2.0	0.2	1.5	0.7	-2.1	-5.8	0.8	0.6	1.0	0.8	1.1
Cyprus	3.3	3.0	1.3	2.1	3.6	2.4	-2.5	0.6	0.9	1.7	0.8	1.5
Luxembourg	1.2	5.0	2.7	3.3	4.9	-0.3	-5.4	1.6	2.0	2.5	1.3	1.9
Malta	4.1	2.7	1.4	1.4	3.7	4.4	-3.6	3.5	1.7	1.8	1.6	1.9
Netherlands	1.9	3.1	1.2	3.2	3.7	1.5	-4.4	1.3	1.6	1.4	1.2	1.4
Austria	1.3	2.4	1.6	3.1	3.3	1.7	-4.2	1.9	2.0	1.6	1.3	1.7
Portugal	1.8	3.4	0.1	1.1	2.2	-0.1	-2.6	1.3	-2.2	-1.7	-1.2	0.7
Slovenia	2.1	4.2	4.1	5.5	6.3	3.4	-9.0	0.9	1.7	2.2	1.7	2.4
Slovakia	:	2.7	5.9	8.4	10.4	5.6	-5.0	3.9	3.4	4.3	3.1	4.1
Finland	0.9	4.3	2.7	4.0	4.9	0.5	-8.6	2.7	3.2	2.1	2.3	1.7
Euro area	1.2	2.5	1.1	2.5	2.3	-0.1	-4.5	1.5	1.4	1.5	1.3	1.6
Bulgaria	-2.2	3.6	6.6	7.1	7.0	6.7	-5.0	0.7	3.3	4.2	3.1	4.3
Czech Republic	2.3	1.4	4.5	6.5	5.6	1.4	-4.9	2.0	2.0	2.9	2.3	3.3
Denmark	2.2	2.1	1.5	3.1	1.2	-1.7	-5.7	1.8	1.4	1.2	1.6	1.5
Latvia	-7.4	7.2	9.6	12.8	10.6	-3.8	-17.5	0.4	4.0	4.7	3.9	4.5
Lithuania	-7.8	5.5	8.6	8.5	10.4	3.5	-14.3	2.9	6.2	5.5	3.3	3.7
Hungary	0.6	4.5	4.1	3.8	0.9	1.0	-6.5	1.4	2.9	2.9	2.9	3.3
Poland	4.7	4.4	4.2	6.3	6.8	5.1	1.6	3.7	3.9	3.7	3.9	4.2
Romania	1.6	0.3	7.0	8.1	6.5	7.5	-6.9	-1.1	1.7	3.9	1.7	4.0
Sweden	0.7	3.3	2.9	3.7	2.6	-1.4	-6.1	3.8	3.9	2.2	3.3	2.3
United Kingdom	2.3	3.0	2.1	2.2	2.0	-0.7	-5.5	0.5	1.0	1.4	1.5	1.8
EU	1.1	2.7	1.6	2.8	2.5	0.1	-4.6	1.5	1.6	1.7	1.5	1.9
USA	2.1	2.6	1.8	1.7	0.9	-0.9	-3.5	2.0	1.7	1.8	1.3	1.6
Japan	1.0	0.2	1.6	2.0	2.4	-1.1	-6.2	4.0	0.6	1.7	1.4	1.8

TABLE 5 : Domestic demand, volume (percentage change on preceding year, 1992-2012)

2.5.2011

	5-year averages			2006	2007	2008	2009	Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06					2010	2011	2012	2011	2012
Belgium	1.4	2.2	1.7	2.2	3.1	2.1	-2.2	0.4	1.9	2.1	1.6	2.0
Germany	1.5	1.5	0.2	2.4	1.2	1.2	-1.9	2.5	2.3	2.0	2.3	2.2
Estonia	:	6.4	11.0	16.5	9.6	-11.0	-23.4	1.4	4.9	4.5	4.3	3.3
Ireland	4.3	8.2	6.4	6.4	5.4	-5.1	-13.9	-5.6	-3.9	-0.4	-3.5	-0.9
Greece	1.2	4.3	4.0	6.4	5.7	1.3	-3.6	-6.1	-7.7	-1.5	-5.4	-0.7
Spain	0.8	5.0	4.4	5.2	4.1	-0.6	-6.0	-1.1	-0.6	1.0	-0.4	1.5
France	0.7	3.0	2.2	2.5	3.2	0.5	-2.4	1.2	1.9	2.4	1.7	1.8
Italy	0.0	2.6	1.3	2.0	1.3	-1.4	-3.9	1.6	0.7	1.2	0.8	1.1
Cyprus	:	3.5	4.4	5.7	8.8	7.7	-6.9	2.2	0.8	1.6	0.9	1.6
Luxembourg	1.6	5.9	2.7	1.9	5.9	3.1	-5.9	3.0	4.2	3.6	3.9	3.9
Malta	:	1.4	2.9	3.0	2.9	3.0	-6.1	-0.1	2.2	1.6	2.3	2.3
Netherlands	2.1	3.9	1.2	4.1	3.2	2.2	-4.0	0.8	1.1	1.3	0.5	1.2
Austria	2.0	1.6	1.5	2.2	2.5	1.3	-2.3	0.9	1.6	1.5	1.1	1.3
Portugal	2.3	4.7	0.6	0.8	2.0	0.8	-2.9	0.7	-5.7	-4.7	-3.7	-0.7
Slovenia	5.2	4.2	4.1	5.6	8.9	4.1	-9.8	0.4	1.0	2.0	1.3	2.2
Slovakia	:	2.5	4.8	6.6	6.3	5.8	-7.3	2.4	1.5	3.6	1.9	3.2
Finland	0.2	3.7	3.0	2.4	4.7	0.6	-6.0	2.4	3.1	2.3	2.7	2.2
Euro area	1.1	2.7	1.7	3.0	2.6	0.4	-3.5	1.0	0.9	1.6	1.0	1.6
Bulgaria	:	6.0	8.2	10.8	8.8	6.5	-12.8	-4.6	2.5	3.6	2.3	3.6
Czech Republic	6.2	1.2	3.6	5.4	5.2	1.2	-3.7	1.4	0.6	2.0	1.3	2.4
Denmark	2.9	2.2	2.9	5.2	2.3	-1.2	-6.5	1.7	1.7	1.6	1.9	1.8
Latvia	:	6.9	11.2	18.1	12.4	-10.1	-27.6	-0.9	3.5	4.7	3.4	5.2
Lithuania	:	5.3	9.6	9.1	14.1	3.2	-24.6	1.8	5.6	5.4	4.0	4.4
Hungary	0.5	4.7	3.7	1.4	-1.3	0.8	-10.8	-1.1	1.9	1.6	2.8	3.3
Poland	5.4	4.5	3.9	7.3	8.7	5.6	-1.0	4.0	4.4	3.7	4.2	4.4
Romania	1.1	1.5	9.0	12.9	14.2	7.3	-12.9	-1.0	1.1	4.2	1.9	4.8
Sweden	0.1	2.8	2.5	3.9	4.6	0.0	-4.9	6.1	3.8	2.3	3.3	2.1
United Kingdom	2.3	4.1	2.8	2.5	3.1	-0.7	-5.5	2.4	0.4	0.7	1.6	1.6
EU	1.4	3.0	2.1	3.2	3.1	0.4	-4.2	1.3	1.1	1.6	1.3	1.8
USA	3.5	4.4	3.0	2.6	1.3	-1.2	-3.7	3.2	2.6	2.8	2.3	2.6
Japan	1.5	0.3	1.0	1.2	1.3	-1.4	-4.6	2.2	0.7	1.5	1.4	1.4

TABLE 6 : Final demand, volume (percentage change on preceding year, 1992-2012)

	5-year averages			2006	2007	2008	2009	Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06					2010	2011	2012	2011	2012
Belgium	2.5	4.0	2.7	3.5	3.7	1.9	-6.6	4.7	3.7	3.7	3.4	3.8
Germany	1.7	3.2	2.3	5.8	3.4	1.7	-6.4	6.3	4.0	3.6	3.7	3.7
Estonia	:	8.9	10.2	12.2	6.3	-6.5	-21.4	10.3	10.1	5.5	5.3	4.7
Ireland	8.3	11.8	5.5	5.7	6.7	-3.1	-9.2	2.0	1.7	2.9	0.9	2.2
Greece	1.6	5.3	3.9	6.2	5.7	1.8	-6.5	-4.6	-4.7	0.1	-3.7	0.5
Spain	2.3	5.8	4.3	5.5	4.7	-0.7	-7.2	1.0	1.0	2.0	0.8	2.4
France	1.5	4.0	2.3	3.0	3.1	0.3	-4.5	2.9	2.9	3.3	2.5	2.7
Italy	1.3	2.9	1.3	2.9	2.0	-2.0	-7.1	3.1	1.8	2.2	1.8	2.1
Cyprus	:	4.4	3.5	5.0	7.9	5.2	-8.2	1.7	1.7	2.4	1.7	2.3
Luxembourg	3.1	8.0	5.1	7.6	7.7	5.0	-7.3	4.8	6.1	5.7	6.6	5.5
Malta	:	2.7	2.9	5.8	3.0	2.1	-7.2	7.8	4.2	3.9	4.3	4.3
Netherlands	3.4	5.6	2.7	5.6	4.7	2.5	-5.9	5.5	3.5	3.5	3.0	3.9
Austria	2.3	3.8	3.1	4.2	4.8	1.2	-7.6	4.3	3.5	3.5	3.0	3.2
Portugal	3.2	4.9	1.4	3.0	3.3	0.6	-4.9	2.4	-3.1	-2.0	-1.6	1.0
Slovenia	2.7	5.4	5.9	8.3	10.8	3.8	-12.9	3.2	3.2	3.9	3.1	4.2
Slovakia	:	5.5	7.7	12.7	9.9	4.6	-11.2	8.2	4.6	5.8	4.5	5.4
Finland	2.4	5.7	3.9	5.6	5.9	2.7	-11.2	3.3	4.6	3.3	3.6	2.9
Euro area	2.0	4.1	2.6	4.6	3.7	0.5	-6.5	3.9	2.7	3.0	2.5	3.0
Bulgaria	:	5.3	9.1	21.2	7.8	5.3	-12.3	1.7	4.4	4.9	3.4	4.5
Czech Republic	7.3	4.4	6.7	9.8	9.6	3.4	-6.9	8.4	4.8	5.9	4.0	4.7
Denmark	3.1	3.7	3.5	6.5	2.5	0.1	-7.7	2.3	2.7	2.6	2.9	3.1
Latvia	:	6.6	10.7	14.9	11.8	-7.0	-23.8	2.6	5.2	5.4	4.3	5.6
Lithuania	:	5.8	10.4	10.1	10.2	5.9	-20.4	7.3	7.9	6.1	4.9	5.3
Hungary	:	8.5	6.5	8.2	6.3	3.0	-10.2	5.7	5.6	5.4	5.7	6.5
Poland	6.4	5.5	5.6	9.3	8.8	6.0	-2.6	5.8	5.3	4.9	4.9	5.4
Romania	0.8	3.5	9.6	12.3	12.8	7.5	-11.3	2.2	3.0	5.0	3.0	5.1
Sweden	2.4	4.4	3.8	5.7	5.0	0.6	-8.0	7.6	5.1	3.3	4.6	3.4
United Kingdom	3.3	4.4	3.3	4.2	1.9	-0.3	-6.4	2.9	2.2	2.2	3.0	3.1
EU	2.2	4.2	3.0	4.9	3.8	0.7	-6.6	3.9	2.9	3.1	2.8	3.2
USA	3.9	4.4	3.2	3.2	2.0	-0.4	-4.3	4.1	3.2	3.6	3.0	3.1
Japan	1.7	0.5	1.9	2.3	2.2	-1.0	-7.4	4.8	0.7	1.9	1.9	2.0

TABLE 7 : Private consumption expenditure, volume (percentage change on preceding year, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	1.5	2.1	1.1	1.8	1.8	1.5	-0.3	1.6	1.5	1.9	1.3	1.9
Germany	1.9	1.9	0.2	1.4	-0.2	0.7	-0.2	0.4	1.2	1.5	1.4	1.6
Estonia	:	6.5	10.4	13.7	8.6	-5.4	-18.4	-1.9	3.2	3.5	2.5	3.1
Ireland	4.2	7.8	4.7	6.5	6.3	-1.8	-7.2	-1.2	-1.9	-1.0	-1.8	-1.0
Greece	1.8	3.1	4.3	5.2	2.8	3.2	-2.2	-4.5	-6.4	-2.2	-4.3	0.5
Spain	1.1	4.3	3.6	3.8	3.7	-0.6	-4.2	1.2	0.8	1.1	0.9	1.6
France	1.0	2.8	2.4	2.4	2.6	0.5	0.6	1.7	1.6	1.8	1.4	1.7
Italy	0.5	2.5	0.9	1.3	1.1	-0.8	-1.8	1.0	0.6	1.1	0.9	1.0
Cyprus	:	4.4	3.7	4.7	9.4	7.1	-2.9	0.8	1.4	2.2	2.1	2.2
Luxembourg	1.7	4.3	1.6	3.2	3.3	4.7	0.2	2.0	1.8	2.3	1.6	2.1
Malta	:	3.6	2.4	1.4	0.8	4.0	-1.4	-0.7	0.8	1.4	1.6	2.1
Netherlands	2.1	3.9	0.5	-0.3	1.8	1.1	-2.5	0.4	0.8	1.1	0.7	0.9
Austria	1.9	1.6	1.7	1.8	0.7	0.5	1.3	1.0	1.1	1.1	0.8	0.9
Portugal	2.0	3.8	1.4	1.8	2.5	1.3	-1.1	2.2	-4.4	-3.8	-2.8	-0.7
Slovenia	5.1	3.2	2.8	2.9	6.7	2.9	-0.8	0.5	0.7	1.3	0.8	1.8
Slovakia	:	3.8	4.9	5.9	6.8	6.2	0.3	-0.3	1.3	3.6	1.5	3.1
Finland	0.6	3.2	3.6	4.3	3.5	1.7	-2.1	2.6	2.3	2.0	2.4	2.3
Euro area	1.4	2.7	1.5	2.1	1.7	0.4	-1.1	0.8	0.8	1.2	0.9	1.4
Bulgaria	-1.4	2.8	6.7	8.6	9.0	3.4	-7.6	-1.2	2.1	3.6	2.2	3.8
Czech Republic	6.2	1.5	3.7	5.1	5.0	3.6	-0.2	0.4	0.4	2.0	1.1	2.5
Denmark	2.4	1.0	2.9	3.6	3.0	-0.6	-4.5	2.2	2.0	1.9	1.9	2.3
Latvia	:	4.7	11.4	21.2	14.8	-5.2	-24.1	-0.1	3.0	3.5	3.2	4.0
Lithuania	:	5.0	10.2	10.6	12.1	3.7	-17.7	-4.5	3.3	3.9	2.9	4.0
Hungary	:	4.5	5.5	1.9	0.2	0.4	-7.8	-2.1	2.7	1.0	2.8	3.2
Poland	4.8	4.6	3.4	5.0	4.9	5.7	2.0	3.2	3.3	3.7	3.2	4.0
Romania	3.1	1.6	10.6	12.7	11.9	9.0	-10.2	-1.7	0.6	3.1	1.8	3.9
Sweden	0.0	3.2	2.6	2.7	3.7	0.0	-0.4	3.5	3.0	2.3	2.7	2.0
United Kingdom	2.4	4.2	2.7	1.8	2.2	0.4	-3.1	0.6	0.3	0.8	1.6	1.6
EU	1.7	3.0	2.0	2.3	2.1	0.7	-1.7	0.8	0.9	1.3	1.2	1.6
USA	3.4	4.4	3.0	2.9	2.4	-0.3	-1.2	1.7	2.9	2.7	1.6	1.9
Japan	1.9	0.6	1.2	1.5	1.6	-0.7	-1.9	1.8	-0.3	1.0	1.0	1.1

TABLE 8 : Government consumption expenditure, volume (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	1.2	2.0	1.6	0.6	2.1	2.3	0.6	1.1	1.2	1.6	1.2	1.4
Germany	2.4	1.1	0.5	1.0	1.6	2.3	2.9	2.3	1.5	0.9	1.0	0.9
Estonia	:	0.1	1.8	3.9	3.9	3.8	0.0	-2.1	0.3	0.9	1.1	0.9
Ireland	2.8	7.4	4.4	5.8	7.3	2.8	-4.1	-2.0	-4.4	-0.4	-5.7	-0.8
Greece	1.0	4.3	3.9	8.8	8.2	1.5	10.3	-6.5	-2.6	0.1	-8.5	-6.0
Spain	2.1	3.8	5.1	4.6	5.5	5.8	3.2	-0.7	-1.4	-0.3	-1.3	-0.3
France	1.8	1.0	1.7	1.3	1.5	1.7	2.7	1.4	0.6	0.3	0.4	0.4
Italy	-1.0	1.7	1.8	0.5	0.9	0.5	1.0	-0.6	-0.4	0.1	0.0	0.1
Cyprus	:	5.3	3.5	7.3	0.3	6.2	5.8	0.5	3.0	1.8	1.3	2.0
Luxembourg	4.1	4.8	3.6	1.6	2.8	2.7	4.6	2.9	1.0	3.5	3.2	3.5
Malta	:	0.0	2.4	5.7	0.5	12.1	-1.3	0.6	0.5	1.1	0.4	1.9
Netherlands	1.7	2.9	3.2	9.5	3.5	2.5	3.7	1.5	-0.1	-0.1	0.1	-0.4
Austria	2.6	2.0	1.4	2.7	2.1	4.0	0.4	-2.4	0.8	0.8	0.0	0.5
Portugal	1.8	4.1	1.4	-0.7	0.5	0.4	3.7	1.8	-6.1	-4.6	-6.8	-1.3
Slovenia	2.2	3.7	3.3	4.0	0.7	6.2	3.0	0.8	0.0	0.5	-0.3	1.0
Slovakia	:	1.6	3.5	9.7	0.1	6.1	5.6	0.1	-2.2	1.0	-4.5	0.5
Finland	-0.4	1.8	1.7	0.4	1.1	2.4	1.0	0.4	1.0	0.7	0.6	0.7
Euro area	1.5	1.8	1.9	2.2	2.2	2.3	2.5	0.7	0.2	0.3	-0.1	0.2
Bulgaria	-15.4	7.3	3.4	3.5	0.3	-1.0	-6.5	-1.0	-0.3	-0.1	0.6	0.9
Czech Republic	-1.7	1.9	2.8	1.2	0.5	1.1	2.6	0.3	-2.3	0.5	-2.2	0.8
Denmark	2.6	2.2	1.7	2.8	1.3	1.6	3.1	1.0	-0.2	0.4	-0.1	0.4
Latvia	:	2.8	2.7	4.9	3.7	1.5	-9.2	-11.0	-2.0	0.0	-2.6	-2.0
Lithuania	:	0.7	4.1	3.7	3.2	7.3	-1.9	-3.4	0.5	3.0	0.0	2.5
Hungary	-1.8	1.0	3.6	3.7	-7.3	1.0	-0.2	-1.9	-0.8	0.5	-0.1	1.2
Poland	3.3	2.4	4.1	6.1	3.7	7.4	2.0	3.5	1.5	0.3	-0.2	0.3
Romania	2.8	-0.2	-0.9	-4.1	-0.1	7.2	1.6	-3.6	-1.5	1.5	-1.0	1.7
Sweden	0.3	0.8	0.9	1.7	0.7	1.0	1.7	2.6	1.4	0.5	0.9	0.5
United Kingdom	0.6	1.9	2.6	1.4	1.3	1.6	1.0	0.8	0.8	-1.0	-0.8	-2.0
EU	0.7	1.8	2.0	2.1	1.9	2.3	2.2	0.7	0.3	0.2	-0.2	0.0
USA	-0.1	2.4	2.2	1.2	1.4	2.9	1.9	1.0	-0.3	0.4	1.2	1.5
Japan	3.1	2.8	1.7	0.4	1.5	0.5	3.0	2.3	2.1	1.2	0.8	0.9

TABLE 9 : Total investment, volume (percentage change on preceding year, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	0.8	3.6	2.4	2.7	6.2	2.6	-5.4	-1.6	3.5	3.4	2.6	2.9
Germany	0.7	1.8	0.3	8.0	4.7	2.5	-10.1	6.0	6.0	4.8	6.0	5.1
Estonia	:	10.2	17.1	23.2	6.0	-15.0	-32.9	-9.2	14.9	10.6	12.8	6.4
Ireland	7.5	9.9	5.9	4.5	2.9	-14.3	-31.1	-27.7	-13.5	2.0	-10.0	0.0
Greece	-0.2	8.2	4.9	10.6	5.5	-7.5	-11.2	-16.5	-16.6	-1.9	-7.5	-2.6
Spain	-0.3	7.6	5.7	7.2	4.5	-4.8	-16.0	-7.6	-3.4	1.8	-3.1	2.7
France	-0.9	5.0	2.5	4.1	6.0	0.5	-7.1	-1.4	3.4	5.0	2.4	3.5
Italy	-0.8	3.7	1.7	2.9	1.7	-3.8	-11.9	2.5	2.2	3.1	1.6	3.1
Cyprus	:	1.3	7.3	10.2	13.4	6.0	-9.1	-7.9	-3.9	-0.8	-3.8	-1.5
Luxembourg	1.1	8.2	4.1	3.8	17.9	1.4	-19.2	2.6	12.0	6.0	7.6	7.3
Malta	:	-0.1	3.8	0.4	4.8	-25.3	-18.6	10.0	11.0	3.0	8.2	3.3
Netherlands	3.3	4.9	0.6	7.5	5.5	5.1	-12.7	-4.8	3.0	4.1	3.2	4.2
Austria	1.8	1.6	0.7	1.8	3.9	4.1	-8.8	-1.3	3.0	2.9	2.7	2.9
Portugal	1.6	7.2	-2.4	-1.3	2.6	-0.3	-11.2	-5.0	-9.9	-7.4	-3.2	-0.4
Slovenia	6.9	7.8	5.6	10.1	12.8	8.5	-21.6	-6.7	0.8	3.9	2.9	4.1
Slovakia	:	1.4	5.6	9.3	9.1	1.0	-19.9	3.6	4.5	6.5	5.1	6.4
Finland	-1.9	6.8	1.9	1.9	10.7	-0.4	-14.6	0.8	6.6	4.5	4.8	3.0
Euro area	0.3	4.0	2.1	5.5	4.7	-0.8	-11.4	-0.8	2.2	3.7	2.2	3.6
Bulgaria	:	13.1	15.4	13.1	11.8	21.9	-17.6	-16.5	4.9	5.8	3.7	5.4
Czech Republic	10.9	0.3	3.4	6.0	10.8	-1.5	-7.9	-4.6	2.4	3.8	3.1	3.7
Denmark	4.3	4.8	4.4	14.3	0.4	-3.3	-14.3	-4.0	3.7	3.0	2.3	2.8
Latvia	:	17.4	17.7	16.4	7.5	-13.6	-37.3	-19.5	9.2	12.0	9.5	15.0
Lithuania	:	8.0	14.1	19.4	23.0	-5.2	-40.0	0.0	16.9	13.8	13.0	8.5
Hungary	2.1	7.2	4.5	-3.2	1.7	2.9	-8.0	-5.6	1.5	4.5	4.3	5.5
Poland	9.9	6.6	4.0	14.9	17.6	9.6	-1.1	-2.0	9.7	7.0	8.4	9.2
Romania	10.4	1.9	12.7	19.9	30.3	15.6	-25.2	-13.1	3.5	5.9	4.2	7.3
Sweden	-1.4	4.8	4.6	9.2	8.9	1.4	-16.3	6.3	9.8	5.1	8.1	4.7
United Kingdom	2.3	5.7	3.7	6.4	7.8	-5.0	-15.4	3.0	0.1	4.0	3.5	6.5
EU	2.4	4.3	2.6	6.2	5.8	-0.8	-12.0	-0.7	2.5	3.9	2.8	4.2
USA	7.0	6.6	2.7	2.3	-1.4	-5.1	-15.5	3.5	4.7	5.9	4.8	6.3
Japan	-0.2	-1.6	-0.1	0.5	-1.2	-3.6	-11.7	0.0	0.5	3.6	2.6	3.0

TABLE 10 : Investment in construction, volume (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	1.8	0.4	2.8	2.8	3.9	2.3	-1.9	-2.4	3.0	2.2	0.8	1.4
Germany	2.9	-1.6	-2.0	4.9	-0.5	1.2	-1.5	2.8	2.8	2.4	3.0	2.8
Estonia	:	6.9	17.3	16.6	4.5	-16.5	-26.2	-20.7	12.8	11.3	10.4	6.0
Ireland	7.3	10.0	8.4	5.8	-0.7	-13.9	-34.9	-36.5	-24.0	-2.9	-14.8	-3.2
Greece	-3.1	6.6	3.3	16.4	-4.1	-18.9	-12.3	-12.5	-20.0	-5.4	-8.9	-2.5
Spain	-0.9	6.6	6.0	6.0	3.2	-5.9	-11.9	-11.1	-7.4	0.2	-7.0	0.7
France	-2.5	2.8	3.1	5.3	4.4	-1.7	-6.3	-5.9	-0.4	2.7	1.4	2.3
Italy	-2.0	2.2	2.4	1.0	0.3	-3.0	-8.7	-3.7	-0.7	1.6	0.1	1.5
Cyprus	:	-0.3	8.5	8.0	14.1	3.1	-9.0	-5.5	-2.8	-1.7	-3.7	-2.6
Luxembourg	4.1	6.2	4.6	1.8	12.2	2.3	-6.5	2.8	7.1	6.7	6.0	6.5
Malta	:	:	:	:	:	:	:	:	:	:	:	:
Netherlands	1.4	3.7	-0.6	4.2	6.1	4.3	-8.3	-11.8	0.0	2.0	2.3	2.8
Austria	2.1	-0.4	0.4	0.7	1.6	1.6	-6.0	-3.4	-1.1	1.1	1.1	1.1
Portugal	2.9	7.0	-1.9	-2.7	3.9	-0.4	-8.9	-5.7	-8.9	-7.3	-3.2	-1.0
Slovenia	2.3	4.5	3.9	2.9	16.2	11.2	-19.2	-15.7	-3.5	1.9	1.7	3.6
Slovakia	:	1.7	6.8	31.0	4.9	3.8	-9.9	0.9	2.7	7.4	4.1	6.0
Finland	-4.3	6.7	3.0	3.0	8.8	-1.5	-14.7	2.0	6.9	4.0	5.8	2.1
Euro area	0.2	2.2	1.7	4.2	2.1	-1.5	-7.0	-4.5	-1.0	1.8	0.2	2.0
Bulgaria	:	:	18.8	28.9	-2.4	46.2	1.0	:	:	:	:	:
Czech Republic	4.3	-4.9	3.9	4.2	5.8	-2.8	-0.8	-1.5	1.7	3.2	2.8	3.4
Denmark	3.2	2.3	4.3	11.4	-2.4	-4.5	-16.7	-11.6	3.2	1.9	1.2	1.9
Latvia	:	:	:	:	:	:	:	:	:	:	:	:
Lithuania	:	4.1	13.9	22.0	21.5	0.3	-37.3	-7.4	15.5	14.9	13.0	8.0
Hungary	:	3.7	3.7	-5.4	-5.2	2.3	-5.5	-10.0	-2.5	1.8	2.6	3.0
Poland	:	5.6	3.7	13.0	13.4	8.2	4.2	2.7	13.1	4.0	8.1	7.0
Romania	15.2	-2.1	11.4	15.3	37.3	20.3	-18.8	-15.5	3.6	4.5	2.4	7.3
Sweden	-7.5	2.1	4.2	10.4	7.5	-2.6	-10.5	3.0	8.2	4.0	6.1	3.4
United Kingdom	0.9	2.6	4.6	7.6	6.1	-5.7	-13.7	0.2	-4.5	2.6	2.6	5.6
EU	:	1.9	3.6	6.7	7.7	1.2	-9.3	-5.2	-0.1	2.3	1.2	3.3
USA	3.9	3.6	1.3	-1.7	-5.8	-8.2	-17.1	-8.3	-3.7	3.2	-0.8	7.3
Japan	:	:	:	:	:	:	:	:	:	:	:	:

TABLE 11 : Investment in equipment, volume (percentage change on preceding year, 1992-2012)

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	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-0.9	6.9	1.2	0.7	9.4	3.1	-9.8	-1.0	4.1	4.6	4.0	4.5
Germany	-3.1	6.3	2.8	11.6	11.1	4.0	-22.3	10.9	10.6	7.9	10.3	8.2
Estonia	:	13.9	16.3	31.4	7.4	-11.6	-44.0	12.9	18.5	10.0	17.0	7.0
Ireland	9.2	9.0	6.2	-1.9	17.2	-17.4	-22.5	-15.0	6.0	7.0	-3.2	3.8
Greece	7.4	10.9	7.5	3.0	22.3	6.6	-11.8	-23.5	-16.0	1.2	-7.3	-3.1
Spain	-0.1	9.1	5.0	9.9	10.4	-2.5	-24.8	1.8	3.1	4.4	3.7	6.0
France	0.8	7.6	1.1	1.4	9.1	3.5	-9.6	4.1	7.0	7.0	3.1	4.5
Italy	0.1	5.2	1.3	5.1	3.1	-5.0	-16.3	10.5	5.1	4.7	3.2	4.8
Cyprus	:	5.0	5.1	15.5	11.9	12.7	-9.3	-12.0	-5.0	1.0	-4.0	1.0
Luxembourg	-4.2	11.0	3.5	7.4	23.9	3.4	-37.8	4.4	26.0	4.0	10.0	8.5
Malta	:	:	:	:	:	:	:	:	:	:	:	:
Netherlands	4.7	6.0	1.9	12.0	8.6	4.9	-19.0	7.6	7.7	8.0	5.4	7.2
Austria	0.9	2.9	0.6	1.8	6.6	7.5	-14.5	1.8	8.3	5.0	4.7	5.3
Portugal	1.3	9.2	-0.1	5.2	7.9	6.9	-13.1	-4.5	-13.6	-9.3	-3.4	0.6
Slovenia	9.6	11.8	8.2	20.4	8.2	4.9	-26.2	7.1	6.2	6.2	4.4	4.7
Slovakia	:	1.8	4.4	-6.3	4.3	1.7	-27.8	7.9	7.0	6.0	6.7	7.2
Finland	1.0	6.1	-1.2	-1.1	17.9	3.9	-13.4	-5.2	7.0	6.0	2.6	5.2
Euro area	0.2	6.9	2.4	6.6	9.3	1.4	-17.4	5.4	6.2	5.9	5.0	5.7
Bulgaria	:	:	12.3	0.7	28.8	2.9	-45.1	:	:	:	:	:
Czech Republic	17.0	5.6	3.2	8.4	16.9	-0.6	-19.0	-10.5	3.7	5.1	3.5	4.0
Denmark	3.4	6.2	3.8	19.1	4.9	-3.5	-13.2	2.3	4.6	4.7	3.9	4.5
Latvia	:	:	:	:	:	:	:	:	:	:	:	:
Lithuania	:	13.5	15.2	16.8	21.9	-17.1	-49.8	14.7	19.0	12.5	15.0	10.0
Hungary	:	10.4	5.6	1.8	8.0	2.9	-12.2	1.0	7.0	8.0	7.0	9.3
Poland	:	7.1	4.8	17.1	22.3	13.0	-9.1	-9.0	3.5	13.0	9.0	13.0
Romania	7.3	5.9	14.9	23.5	28.3	10.9	-32.7	-2.0	8.2	7.3	6.3	7.3
Sweden	5.1	6.1	5.2	9.3	12.9	5.5	-28.2	11.6	11.5	6.0	10.0	5.8
United Kingdom	4.5	8.0	2.6	4.4	12.3	-5.2	-22.0	8.6	6.8	5.4	5.7	8.9
EU	:	7.0	4.4	9.2	12.6	2.3	-20.0	4.3	6.7	6.3	5.5	6.5
USA	10.0	8.2	4.1	8.2	3.3	-3.8	-18.6	13.9	10.6	7.6	8.8	5.6
Japan	:	:	:	:	:	:	:	:	:	:	:	:

TABLE 12 : Public investment (as a percentage of GDP, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	1.6	1.8	1.6	1.6	1.6	1.6	1.8	1.7	1.8	1.8	1.9	1.9
Germany	2.4	1.8	1.5	1.4	1.4	1.5	1.6	1.6	1.5	1.4	1.6	1.4
Estonia	:	4.2	4.4	4.7	5.1	5.3	5.1	3.6	5.0	5.3	4.9	5.0
Ireland	2.2	3.2	3.7	3.8	4.7	5.3	4.2	3.9	3.0	2.7	3.5	3.1
Greece	2.9	3.3	3.3	3.4	3.4	3.6	3.0	2.8	2.2	2.1	2.5	2.3
Spain	3.7	3.2	3.6	3.7	4.0	3.9	4.4	3.7	2.9	2.7	3.2	3.1
France	3.2	3.0	3.1	3.2	3.2	3.2	3.4	3.0	3.1	3.1	3.2	3.2
Italy	2.4	2.3	2.3	2.3	2.3	2.2	2.5	2.1	1.9	1.7	1.9	1.6
Cyprus	:	2.9	3.3	3.0	2.9	2.9	4.1	3.6	3.5	3.5	3.7	3.7
Luxembourg	4.2	4.0	4.4	3.6	3.3	3.2	3.7	4.1	3.9	3.6	3.3	3.1
Malta	:	4.0	4.3	4.0	3.8	2.3	2.2	2.1	3.3	2.7	3.9	4.0
Netherlands	2.5	3.1	3.4	3.3	3.3	3.5	3.9	3.7	3.6	3.5	3.7	3.7
Austria	3.1	1.7	1.2	1.1	1.1	1.1	1.2	1.2	1.1	1.1	1.1	1.1
Portugal	3.6	4.0	3.1	2.4	2.7	2.9	2.9	3.3	2.5	2.1	2.2	2.2
Slovenia	:	3.2	3.3	3.7	4.2	4.4	4.6	4.3	4.3	4.5	4.3	4.2
Slovakia	:	3.6	2.5	2.2	1.9	2.0	2.3	2.6	1.8	1.6	2.2	2.2
Finland	2.9	2.7	2.6	2.3	2.4	2.5	2.8	2.7	2.6	2.5	2.7	2.6
Euro area	2.8	2.5	2.5	2.5	2.6	2.6	2.8	2.4	2.3	2.2	2.4	2.2
Bulgaria	:	3.2	3.3	4.0	5.2	5.6	4.9	4.6	4.4	4.8	4.4	4.3
Czech Republic	:	3.8	4.6	5.0	4.7	4.9	5.2	4.6	4.7	4.8	5.3	5.3
Denmark	1.8	1.7	1.8	1.9	1.9	1.9	2.0	2.2	2.3	2.1	2.1	1.9
Latvia	:	1.3	2.9	4.6	5.7	4.8	4.3	3.6	4.3	4.2	4.3	4.1
Lithuania	:	2.4	3.4	4.1	5.2	4.9	3.9	4.6	4.2	3.9	2.8	2.7
Hungary	:	3.0	4.1	4.4	3.6	2.9	3.1	3.2	3.9	3.4	3.1	3.1
Poland	:	3.4	3.5	3.9	4.2	4.6	5.2	5.6	6.6	5.8	6.6	6.3
Romania	:	2.5	3.8	5.1	5.6	5.7	5.3	5.5	5.6	5.6	4.6	4.6
Sweden	2.7	3.0	3.0	3.0	3.1	3.3	3.6	3.5	3.3	3.2	3.3	3.3
United Kingdom	1.8	1.3	1.5	1.8	1.9	2.3	2.7	2.5	2.2	1.9	1.9	1.7
EU	:	2.4	2.4	2.5	2.6	2.7	2.9	2.6	2.5	2.4	2.5	2.4
USA	2.4	2.4	2.5	2.4	2.4	2.6	2.6	3.5	3.3	3.3	3.5	3.5
Japan	6.1	5.5	4.0	3.3	3.1	3.0	3.4	3.3	3.3	3.4	3.2	3.2



TABLE 13 : Output gap relative to potential GDP (deviation of actual output from potential output as % of potential GDP, 1992-2012) <sup>1</sup>

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-0.3	1.2	0.5	1.3	2.1	1.0	-3.1	-2.3	-1.5	-0.8	-1.7	-1.2
Germany	0.7	0.7	-1.1	0.1	1.5	1.2	-4.3	-2.0	-1.1	-0.8	-1.1	-0.8
Estonia	:	-2.2	6.6	10.7	11.8	3.2	-11.1	-7.7	-3.2	-0.3	-4.1	-0.8
Ireland	-0.9	2.7	1.1	2.3	4.7	0.2	-5.7	-5.2	-3.3	-0.8	-3.1	-0.5
Greece	-0.2	0.7	0.1	0.9	2.5	1.5	-1.2	-5.3	-7.7	-6.1	-7.7	-6.7
Spain	-2.3	1.0	0.8	1.1	1.4	-0.1	-4.5	-5.2	-4.7	-3.3	-3.5	-1.5
France	-1.3	1.2	1.9	1.9	2.0	0.3	-3.9	-3.9	-3.7	-3.2	-3.3	-2.8
Italy	-0.7	0.8	1.1	2.2	2.9	1.0	-4.3	-3.4	-2.8	-1.9	-1.7	-0.4
Cyprus	:	0.1	-0.1	-0.1	1.8	2.6	-1.1	-1.7	-1.5	-0.5	-1.8	-0.7
Luxembourg	-0.9	2.2	1.0	1.4	3.7	1.3	-4.9	-3.7	-2.6	-1.4	-4.2	-3.7
Malta	:	1.7	-1.0	-1.7	-0.7	2.2	-2.5	-0.3	-0.1	0.2	-0.2	0.5
Netherlands	-0.6	1.1	-1.4	0.0	2.0	1.9	-3.4	-2.8	-2.2	-1.8	-3.0	-2.5
Austria	-0.4	0.9	-0.6	0.8	2.5	2.6	-2.7	-2.1	-1.2	-0.8	-1.5	-0.8
Portugal	-0.8	2.0	-0.8	-0.9	0.7	0.0	-2.3	-0.8	-2.2	-3.2	-2.5	-1.8
Slovenia	:	0.4	1.2	3.1	6.0	5.9	-5.1	-5.6	-4.9	-3.7	-3.2	-1.8
Slovakia	:	-1.5	-1.2	1.5	6.0	6.7	-2.1	-1.6	-1.2	0.2	-1.0	0.1
Finland	-3.8	2.5	0.9	2.6	5.1	3.3	-6.5	-5.3	-3.5	-2.7	-4.0	-3.5
Euro area	-0.7	1.0	0.3	1.1	2.1	1.0	-4.1	-3.2	-2.7	-2.0	-2.4	-1.6
Bulgaria	:	-3.0	2.6	3.2	4.2	5.3	-3.5	-5.0	-4.2	-2.9	-4.2	-2.7
Czech Republic	:	-2.6	-0.2	4.1	6.2	5.0	-2.1	-1.9	-1.8	-0.8	-1.9	-0.8
Denmark	-1.9	1.2	0.8	3.2	3.1	0.4	-5.6	-4.1	-3.0	-2.1	-2.1	-0.8
Latvia	:	-1.3	2.4	9.4	14.7	7.5	-10.9	-9.5	-5.2	-0.8	-5.2	-0.9
Lithuania	:	-5.1	3.4	6.3	9.6	8.0	-8.9	-7.5	-2.9	0.1	-3.7	-1.2
Hungary	:	-0.7	2.0	3.4	2.4	1.8	-5.5	-4.6	-2.3	0.0	-2.2	0.0
Poland	:	0.5	-0.3	1.1	2.5	2.3	-0.7	-1.1	-1.2	-1.4	-1.4	-1.2
Romania	:	-5.5	2.2	6.8	7.8	9.9	-0.8	-4.0	-4.4	-2.8	-4.6	-3.0
Sweden	-3.8	-0.3	1.3	3.4	3.9	0.9	-5.8	-2.5	-0.7	-0.2	-0.5	0.0
United Kingdom	-1.3	1.5	1.8	2.2	2.5	0.6	-5.2	-5.2	-4.8	-4.1	-4.1	-3.1
EU	:	0.9	0.6	1.5	2.4	1.1	-4.3	-3.6	-3.0	-2.3	-2.6	-1.8
USA	:	:	:	:	:	:	:	:	:	:	-1.7	-1.2
Japan	:	:	:	:	:	:	:	:	:	:	:	:

<sup>1</sup> When comparing output gaps between the spring and the autumn forecast it has to be taken into account that the overall revisions to the forecast may have led to changes in the estimates for potential output.

TABLE 14 : Deflator of gross domestic product (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	2.2	1.4	2.2	2.3	2.3	1.9	1.1	1.8	1.9	2.1	2.0	1.9
Germany	2.7	0.3	0.9	0.4	1.8	1.0	1.4	0.6	1.0	1.5	1.2	1.3
Estonia	:	6.4	5.0	8.3	10.5	7.2	-0.1	1.5	2.4	2.2	2.7	2.2
Ireland	3.0	5.1	3.1	3.7	1.1	-1.5	-4.0	-2.6	0.6	0.9	0.4	0.8
Greece	11.5	4.3	3.2	3.1	3.1	3.3	1.3	2.6	0.3	0.4	1.5	0.4
Spain	4.7	3.0	4.2	4.1	3.3	2.4	0.6	1.0	1.0	1.1	1.1	1.4
France	1.6	1.1	2.1	2.4	2.5	2.6	0.5	0.5	1.8	1.8	1.6	1.5
Italy	4.3	2.4	2.6	1.8	2.6	2.8	2.3	0.6	1.6	1.8	1.6	1.7
Cyprus	3.6	3.0	3.0	3.0	4.6	5.1	-0.3	2.0	3.1	2.1	3.2	2.5
Luxembourg	3.7	1.0	4.2	6.7	3.6	4.2	-0.3	5.5	3.3	2.6	2.5	2.3
Malta	3.0	2.1	2.6	3.0	3.2	2.7	2.6	3.0	2.6	2.3	2.7	2.5
Netherlands	1.9	3.1	2.2	1.8	1.8	2.4	-0.2	1.6	1.9	2.1	1.5	1.6
Austria	2.4	0.7	1.6	1.8	2.1	1.9	0.8	1.5	1.7	1.8	1.6	1.3
Portugal	5.8	3.6	2.9	2.8	3.2	1.6	0.5	1.0	1.1	1.2	1.3	1.0
Slovenia	47.9	7.2	4.0	2.0	4.2	4.0	3.2	0.7	1.0	1.8	1.3	1.5
Slovakia	:	6.6	4.1	2.9	1.1	2.9	-1.2	0.5	1.6	2.4	2.8	2.5
Finland	1.7	2.4	0.5	0.9	3.0	1.8	1.0	2.1	2.5	2.4	2.6	2.1
Euro area	3.3	1.6	2.1	1.9	2.4	2.0	1.0	0.8	1.4	1.7	1.5	1.5
Bulgaria	71.8	72.4	5.1	6.9	9.2	8.4	4.3	3.0	3.1	2.5	2.6	2.5
Czech Republic	13.4	5.7	1.8	1.1	3.4	1.8	2.5	-1.1	0.2	1.9	1.4	1.9
Denmark	1.4	2.1	2.3	2.1	2.3	3.9	0.4	3.3	1.7	2.0	2.3	2.2
Latvia	98.5	4.3	6.8	9.9	20.3	14.4	-1.5	-2.3	2.2	1.6	0.6	1.0
Lithuania	160.2	2.7	3.0	6.5	8.5	9.8	-3.7	2.1	3.3	2.9	1.8	2.5
Hungary	22.1	11.8	5.1	4.2	5.9	4.8	4.4	2.9	2.6	2.5	2.8	2.2
Poland	30.3	8.3	2.2	1.5	4.0	3.1	3.6	1.3	3.3	3.3	2.7	2.8
Romania	114.8	59.5	16.7	10.6	13.5	15.3	4.1	4.5	4.4	4.2	4.6	5.1
Sweden	2.3	1.3	1.3	1.9	2.8	3.1	1.8	1.3	0.9	1.0	1.9	1.5
United Kingdom	2.9	2.1	2.8	3.1	3.0	3.0	1.4	2.9	1.9	2.1	2.0	1.5
EU	24.1	2.3	2.3	2.2	2.7	2.5	1.2	1.2	1.6	1.8	1.7	1.6
USA	2.1	1.8	2.6	3.3	2.9	2.2	0.9	1.0	1.3	1.5	0.8	1.3
Japan	0.2	-0.8	-1.3	-0.9	-0.7	-1.0	-0.4	-2.1	-2.0	0.2	0.2	-0.4

TABLE 15 : Price deflator of private consumption (percentage change on preceding year, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	1.8	1.6	2.2	3.0	2.8	3.2	-0.5	2.4	3.3	2.0	1.8	1.8
Germany	2.4	1.0	1.3	1.1	1.8	1.7	0.0	2.0	2.2	1.7	1.6	1.7
Estonia	:	6.2	3.1	5.0	7.5	8.7	-0.9	2.1	3.5	2.5	3.3	2.4
Ireland	2.6	3.8	3.1	2.4	3.3	3.0	-4.5	-3.4	1.0	0.7	0.3	0.8
Greece	11.6	4.5	3.1	3.4	3.3	4.0	1.1	4.8	2.6	0.6	2.2	0.3
Spain	4.9	2.8	3.3	3.6	3.3	3.5	0.1	2.8	2.7	1.5	1.5	1.5
France	1.6	0.9	1.7	2.1	2.0	2.9	-0.4	1.2	2.1	1.6	1.5	1.5
Italy	5.1	2.4	2.6	2.7	2.3	3.2	0.0	1.5	2.6	1.9	1.8	1.9
Cyprus	:	2.4	2.5	2.1	3.7	5.1	0.2	2.6	3.2	2.2	3.5	2.8
Luxembourg	2.8	2.3	2.1	2.4	2.2	2.0	0.8	1.9	3.0	2.0	2.1	1.6
Malta	:	1.9	1.8	2.2	1.7	3.6	1.8	3.0	2.7	2.2	2.1	2.2
Netherlands	2.4	2.9	2.1	2.2	1.8	1.4	-0.6	1.7	2.0	2.0	1.7	1.8
Austria	2.5	1.4	1.8	2.1	2.7	2.5	-0.8	1.6	2.8	2.0	2.1	1.7
Portugal	5.6	2.9	2.8	3.0	3.0	2.6	-2.5	1.6	3.4	2.0	2.2	1.2
Slovenia	45.8	7.3	4.0	2.2	4.1	5.4	0.0	2.9	2.6	2.1	2.0	2.2
Slovakia	:	7.4	4.8	4.9	2.6	4.5	0.1	0.9	3.6	2.7	3.1	2.7
Finland	1.9	2.4	0.8	1.4	2.2	3.5	0.5	1.0	3.4	2.4	2.3	2.0
Euro area	3.5	1.8	2.1	2.2	2.3	2.7	-0.2	1.8	2.4	1.7	1.7	1.6
Bulgaria	80.5	69.9	3.5	2.2	9.0	7.2	1.5	1.1	3.7	3.0	2.3	2.4
Czech Republic	11.2	5.3	1.3	1.4	2.9	5.0	0.4	1.3	2.2	2.3	2.0	1.9
Denmark	1.7	2.1	1.5	1.9	1.2	3.1	1.3	2.6	2.5	2.0	2.6	2.5
Latvia	:	4.1	5.4	6.0	10.1	16.8	4.2	-0.3	3.2	1.8	1.1	1.4
Lithuania	:	2.8	0.9	4.0	6.4	10.9	4.5	1.4	3.2	2.5	2.0	2.5
Hungary	:	12.0	3.9	3.6	6.3	5.4	4.1	5.0	4.0	3.5	3.9	3.1
Poland	31.6	9.0	2.0	1.2	2.4	4.3	2.5	2.7	3.8	3.2	2.9	3.0
Romania	118.0	55.6	12.0	4.9	4.8	10.0	3.9	4.9	6.7	4.2	5.5	4.1
Sweden	3.1	1.3	1.3	1.2	1.4	3.1	1.9	1.3	1.2	1.2	1.9	1.9
United Kingdom	3.4	1.8	2.0	2.7	2.9	3.1	1.3	4.3	2.8	1.6	2.6	1.4
EU	24.8	2.5	2.1	2.3	2.5	3.0	0.3	2.2	2.5	1.8	1.9	1.7
USA	2.3	1.8	2.3	2.7	2.7	3.3	0.2	1.7	2.2	1.5	1.2	1.4
Japan	0.6	-0.3	-0.8	-0.2	-0.6	0.4	-2.1	-1.5	-0.5	0.5	-0.5	0.5

TABLE 16 : Harmonised index of consumer prices (national index if not available), (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	2.2	1.7	2.0	2.3	1.8	4.5	0.0	2.3	3.6	2.2	1.9	1.9
Germany	3.1	1.2	1.6	1.8	2.3	2.8	0.2	1.2	2.6	2.0	1.8	2.0
Estonia	120.7	6.1	3.3	4.4	6.7	10.6	0.2	2.7	4.7	2.8	3.6	2.3
Ireland	2.2	3.0	3.2	2.7	2.9	3.1	-1.7	-1.6	1.0	0.7	0.4	0.6
Greece	11.6	3.7	3.4	3.3	3.0	4.2	1.3	4.7	2.4	0.5	2.2	0.5
Spain	4.7	2.4	3.3	3.6	2.8	4.1	-0.2	2.0	3.0	1.4	1.5	1.4
France	2.0	1.2	2.1	1.9	1.6	3.2	0.1	1.7	2.2	1.7	1.6	1.6
Italy	4.6	2.1	2.4	2.2	2.0	3.5	0.8	1.6	2.6	1.9	1.8	1.9
Cyprus	4.3	2.7	2.6	2.2	2.2	4.4	0.2	2.6	3.4	2.3	3.3	2.5
Luxembourg	1.8	1.9	2.9	3.0	2.7	4.1	0.0	2.8	3.5	2.3	2.1	1.6
Malta	3.3	3.1	2.5	2.6	0.7	4.7	1.8	2.0	2.7	2.2	2.0	2.3
Netherlands	2.5	2.6	2.1	1.7	1.6	2.2	1.0	0.9	2.2	2.1	1.5	1.6
Austria	2.9	1.3	1.7	1.7	2.2	3.2	0.4	1.7	2.9	2.1	2.1	1.8
Portugal	5.6	2.7	2.9	3.0	2.4	2.7	-0.9	1.4	3.4	2.0	2.3	1.3
Slovenia	:	8.0	4.3	2.5	3.8	5.5	0.9	2.1	2.6	2.1	2.0	2.2
Slovakia	:	8.5	5.3	4.3	1.9	3.9	0.9	0.7	3.6	2.9	3.2	2.8
Finland	1.5	1.9	1.1	1.3	1.6	3.9	1.6	1.7	3.6	2.2	2.1	1.8
Euro area	3.8	1.8	2.2	2.2	2.1	3.3	0.3	1.6	2.6	1.8	1.8	1.7
Bulgaria	87.7	:	5.5	7.4	7.6	12.0	2.5	3.0	4.3	3.4	3.2	3.1
Czech Republic	:	5.6	1.5	2.1	3.0	6.3	0.6	1.2	2.3	2.5	2.1	2.2
Denmark	1.9	2.1	1.8	1.9	1.7	3.6	1.1	2.2	2.5	1.8	2.1	2.0
Latvia	70.3	3.9	4.9	6.6	10.1	15.3	3.3	-1.2	3.4	2.0	1.1	1.8
Lithuania	179.8	3.9	1.4	3.8	5.8	11.1	4.2	1.2	3.2	2.4	2.3	2.8
Hungary	23.2	12.3	4.8	4.0	7.9	6.0	4.0	4.7	4.0	3.5	3.9	3.7
Poland	31.4	9.8	1.9	1.3	2.6	4.2	4.0	2.7	3.8	3.2	2.9	3.0
Romania	116.9	63.2	12.9	6.6	4.9	7.9	5.6	6.1	6.7	4.0	5.5	3.2
Sweden	2.4	1.5	1.5	1.5	1.7	3.3	1.9	1.9	1.7	1.6	1.4	1.9
United Kingdom	2.8	1.3	1.7	2.3	2.3	3.6	2.2	3.3	4.1	2.4	2.6	1.4
EU	25.9	4.3	2.3	2.3	2.4	3.7	1.0	2.1	3.0	2.0	2.1	1.8
USA	2.9	2.5	2.6	3.2	2.8	3.8	-0.4	1.6	2.5	1.5	1.1	1.5
Japan	0.7	0.1	-0.2	0.3	0.0	1.4	-1.4	-0.7	0.2	0.3	-0.7	0.0

TABLE 17 : Profiles of quarterly harmonised index of consumer prices (percentage change on corresponding quarter in previous year, 2010-2012)

2.5.2011

	2010/1	2010/2	2010/3	2010/4	2011/1	2011/2	2011/3	2011/4	2012/1	2012/2	2012/3	2012/4
Belgium	1.2	2.4	2.6	3.2	3.6	3.7	3.7	3.2	2.7	2.2	2.0	1.9
Germany	0.8	1.0	1.2	1.6	2.2	2.8	3.0	2.5	2.2	1.8	1.9	2.0
Estonia	0.0	2.9	3.1	5.0	5.2	5.2	4.8	3.6	3.6	2.7	2.4	2.6
Ireland	-2.4	-2.1	-1.2	-0.6	0.8	1.3	1.1	1.0	0.8	0.7	0.7	0.7
Greece	3.0	5.1	5.6	5.1	4.6	2.7	1.2	1.0	0.8	0.6	0.6	-0.1
Spain	1.2	1.6	1.9	2.5	3.2	3.4	2.9	2.6	1.4	1.3	1.5	1.6
France	1.5	1.8	1.8	1.9	2.0	2.2	2.4	2.3	2.0	1.5	1.6	1.6
Italy	1.3	1.6	1.7	2.0	2.3	2.8	2.6	2.5	2.2	1.8	1.7	1.7
Cyprus	2.5	2.2	3.3	2.3	3.1	3.4	3.7	3.5	2.6	2.4	2.0	2.2
Luxembourg	2.8	2.8	2.7	2.9	3.8	3.6	3.3	3.3	2.4	2.0	2.2	2.4
Malta	0.9	1.5	2.6	3.2	2.8	2.5	3.1	2.3	2.2	2.3	2.3	2.1
Netherlands	0.5	0.4	1.3	1.5	2.0	2.1	2.4	2.4	2.1	1.7	2.2	2.2
Austria	1.3	1.8	1.7	2.0	3.0	3.0	2.9	2.6	2.3	2.0	2.0	1.9
Portugal	0.3	1.0	2.0	2.3	3.6	3.7	3.3	3.2	1.9	1.8	2.0	2.2
Slovenia	1.7	2.4	2.3	2.0	2.2	2.7	2.7	2.6	2.3	2.1	2.0	1.9
Slovakia	0.0	0.7	1.0	1.1	3.5	3.7	3.7	3.6	2.8	2.9	3.0	2.9
Finland	1.5	1.4	1.3	2.5	3.4	3.8	4.0	3.1	2.2	2.2	2.2	2.3
Euro area	1.1	1.5	1.7	2.0	2.5	2.8	2.7	2.4	2.0	1.6	1.7	1.8
Bulgaria	1.9	2.9	3.3	4.0	4.4	4.3	4.2	4.1	3.2	3.4	3.5	3.6
Czech Republic	0.4	0.9	1.6	2.0	1.9	2.2	2.5	2.6	2.5	2.5	2.5	2.5
Denmark	1.9	2.0	2.3	2.5	2.6	2.8	2.3	2.3	1.8	1.7	1.9	2.0
Latvia	-3.9	-2.3	-0.3	1.7	3.8	3.8	3.3	2.9	2.1	2.0	1.9	1.9
Lithuania	-0.4	0.6	1.8	2.9	3.2	3.4	3.2	3.0	2.6	2.4	2.4	2.4
Hungary	5.8	5.2	3.6	4.3	4.3	4.1	3.9	3.8	3.8	3.6	3.4	3.3
Poland	3.4	2.5	2.1	2.7	3.6	4.1	3.9	3.6	3.4	3.2	3.2	3.1
Romania	4.6	4.3	7.5	7.8	7.5	8.3	5.7	5.3	4.7	3.7	3.9	3.7
Sweden	2.7	1.8	1.3	1.8	1.3	1.8	2.0	1.5	1.5	1.5	1.6	1.7
United Kingdom	3.2	3.4	3.0	3.3	4.1	4.5	4.1	3.8	2.4	2.4	2.4	2.4
EU	1.6	1.9	2.0	2.3	2.8	3.1	3.0	2.7	2.2	1.9	1.9	1.9
USA	2.4	1.8	1.2	1.2	2.2	2.8	2.6	2.3	1.4	1.3	1.6	1.8
Japan	-1.2	-0.9	-0.8	0.1	0.0	0.2	0.4	0.0	0.4	0.0	0.3	0.7

TABLE 18 : Price deflator of exports of goods in national currency (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-0.7	1.3	1.3	3.2	1.8	3.6	-6.5	5.6	3.5	2.0	1.5	2.0
Germany	0.4	0.5	-0.1	1.3	0.4	0.3	-2.4	2.8	2.9	1.9	0.9	1.4
Estonia	:	4.5	1.6	4.8	8.1	5.3	-5.6	3.8	6.1	1.9	1.3	2.0
Ireland	1.1	3.3	-2.6	0.2	-2.3	-3.4	0.3	0.2	2.0	1.3	0.7	1.7
Greece	7.5	4.1	2.3	4.3	3.0	2.6	-1.1	6.7	0.5	1.2	1.1	1.2
Spain	3.5	2.1	1.7	4.5	2.0	2.0	-5.0	3.3	3.5	1.5	1.7	1.8
France	-0.8	0.0	0.0	2.9	1.9	2.7	-4.1	1.5	3.9	2.7	1.5	1.6
Italy	4.7	2.0	2.6	5.2	4.7	5.4	-1.9	5.9	5.7	2.5	2.0	2.0
Cyprus	:	3.7	0.6	6.8	2.7	1.6	0.3	1.6	3.3	2.5	3.3	2.7
Luxembourg	-0.2	0.5	2.4	4.1	2.7	6.1	-3.7	5.3	3.0	2.0	1.5	2.0
Malta	:	1.4	-0.1	9.5	8.2	-2.5	-7.7	1.9	2.4	1.7	1.4	2.1
Netherlands	-0.9	0.9	0.5	3.2	1.6	4.5	-8.3	6.8	4.2	1.7	1.4	1.7
Austria	0.3	0.5	0.9	3.2	1.4	2.2	-1.9	3.3	1.8	1.7	1.4	1.6
Portugal	1.2	1.8	0.9	4.8	1.3	2.2	-5.0	5.2	4.2	1.7	2.9	2.0
Slovenia	39.9	5.3	2.8	2.8	2.1	0.7	-1.5	3.1	2.0	1.9	1.2	1.2
Slovakia	:	5.0	1.7	1.8	0.5	0.9	-5.4	3.0	3.6	1.7	1.3	1.5
Finland	3.7	-1.6	-0.6	2.2	0.5	-3.0	-10.9	5.4	6.0	2.5	2.8	1.0
Euro area	1.6	1.0	0.5	2.8	1.5	2.1	-4.0	3.8	3.6	2.0	1.4	1.6
Bulgaria	:	:	4.8	17.0	5.9	8.1	-13.2	10.4	4.4	2.3	0.8	1.5
Czech Republic	:	2.0	-1.8	-1.5	-0.2	-5.8	-0.3	-1.1	-1.0	1.0	-1.8	1.6
Denmark	0.2	1.3	1.7	4.4	2.2	7.1	-6.1	4.6	4.4	3.2	2.0	2.0
Latvia	:	-0.2	8.8	9.7	13.4	7.7	-9.4	8.7	8.6	1.5	1.0	1.5
Lithuania	:	0.8	2.9	4.9	5.8	13.2	-16.7	12.8	7.7	2.9	0.3	2.0
Hungary	:	8.8	-0.3	6.5	-4.5	0.6	2.1	1.7	1.0	1.5	1.8	2.9
Poland	21.1	6.5	3.8	2.5	2.8	-1.8	13.5	0.1	1.5	2.1	-0.2	1.2
Romania	114.5	50.8	9.8	5.8	0.5	21.0	2.8	5.9	4.5	3.5	3.9	3.0
Sweden	2.1	0.0	0.2	3.6	1.9	3.1	0.9	-0.8	-1.0	1.0	-1.0	1.0
United Kingdom	3.1	-2.7	1.2	3.3	1.1	12.6	3.0	5.2	9.1	3.4	1.2	2.1
EU	:	7.1	0.7	2.9	1.4	3.0	-2.6	3.6	3.7	2.1	1.2	1.7
USA	-0.3	-1.3	2.3	3.3	3.4	4.9	-6.8	4.8	5.9	1.6	3.1	1.8
Japan	-2.6	-1.9	-0.3	3.7	2.2	-4.6	-11.5	-1.0	-2.5	-0.7	-2.5	-0.7

TABLE 19 : Price deflator of imports of goods in national currency (percentage change on preceding year, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-0.5	2.0	1.5	3.6	1.5	6.7	-9.6	7.8	4.8	2.1	1.4	2.1
Germany	-1.2	1.2	-0.2	3.1	-0.3	1.8	-8.0	5.9	5.2	1.8	1.0	1.7
Estonia	:	2.9	1.2	3.5	3.3	5.5	-3.0	5.2	6.5	2.1	1.2	2.2
Ireland	3.7	1.4	-2.3	2.6	-0.3	2.7	-4.4	0.0	2.3	0.8	0.7	1.7
Greece	7.2	4.3	2.4	3.9	2.2	6.0	-2.1	2.6	4.3	2.1	1.0	1.8
Spain	2.9	2.1	1.1	3.9	1.9	4.3	-8.8	7.8	6.9	2.3	1.3	1.4
France	-1.0	0.2	0.0	3.1	0.4	4.0	-6.3	5.2	5.2	1.8	1.0	1.8
Italy	5.0	2.1	3.3	8.9	3.1	8.5	-9.2	9.1	7.8	2.0	1.7	2.1
Cyprus	:	2.5	1.9	2.2	2.0	4.2	-2.3	2.3	3.5	2.5	2.0	2.5
Luxembourg	0.4	1.9	1.5	2.1	-0.6	5.6	-2.9	6.6	4.0	2.5	2.5	2.5
Malta	:	2.5	1.8	10.7	7.5	3.3	-2.4	-1.1	2.8	1.3	0.1	1.4
Netherlands	-1.3	0.2	0.1	3.5	1.7	4.6	-7.5	7.5	4.2	1.5	1.4	1.7
Austria	0.4	0.7	0.9	3.5	1.9	4.5	-3.9	4.9	3.7	2.2	1.6	1.9
Portugal	0.1	1.6	0.9	4.0	1.0	5.5	-9.7	5.1	7.0	2.6	2.7	2.4
Slovenia	36.0	5.5	3.1	3.3	1.6	2.5	-6.0	6.5	4.3	2.2	1.9	2.0
Slovakia	:	4.6	2.1	3.6	1.6	2.8	-4.8	5.4	5.5	1.9	1.0	1.5
Finland	3.2	-1.0	1.9	6.5	0.5	0.4	-10.7	6.7	7.9	2.8	2.5	1.5
Euro area	1.1	1.3	0.7	4.1	1.1	4.2	-7.6	6.4	5.5	1.9	1.3	1.8
Bulgaria	:	:	4.0	11.4	7.3	10.8	-13.7	5.4	6.0	3.6	0.6	1.9
Czech Republic	:	1.9	-1.7	0.2	-1.4	-3.6	-3.2	1.4	0.6	1.0	-1.5	1.5
Denmark	-0.6	0.2	0.8	3.6	1.8	6.0	-9.5	1.8	4.5	2.9	2.1	2.2
Latvia	:	2.2	8.6	9.6	5.7	9.7	-6.7	7.5	8.0	1.5	0.9	1.5
Lithuania	:	-1.5	1.6	8.8	4.9	9.3	-11.5	10.2	7.3	2.7	0.2	1.6
Hungary	:	9.3	0.6	8.0	-4.4	1.7	1.1	1.9	1.4	1.5	2.2	4.0
Poland	19.3	7.7	3.5	2.8	0.8	0.3	8.7	1.8	3.0	1.7	0.8	1.8
Romania	123.6	44.9	6.6	-1.2	-9.2	17.2	2.6	3.4	5.9	3.0	2.9	2.5
Sweden	2.9	1.5	1.3	3.9	0.2	4.3	-1.1	-0.2	0.0	2.0	-1.0	2.0
United Kingdom	3.4	-2.8	0.6	3.4	-0.2	13.2	2.7	5.4	8.8	1.8	2.4	1.9
EU	:	6.5	0.8	4.0	0.7	5.2	-5.5	5.7	5.4	1.9	1.3	1.9
USA	-0.2	-1.7	3.3	4.2	3.1	11.3	-12.3	7.0	9.7	1.2	4.5	1.7
Japan	-3.2	-0.8	4.2	12.6	6.8	7.6	-23.5	5.5	8.0	1.0	-2.0	0.0

TABLE 20 : Terms of trade of goods (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-0.1	-0.8	-0.2	-0.4	0.3	-2.9	3.5	-2.1	-1.2	-0.1	0.0	-0.1
Germany	1.6	-0.7	0.1	-1.8	0.7	-1.5	6.1	-2.9	-2.2	0.0	-0.1	-0.3
Estonia	:	1.5	0.4	1.2	4.6	-0.2	-2.6	-1.3	-0.4	-0.2	0.1	-0.2
Ireland	-2.4	1.8	-0.3	-2.4	-2.0	-5.9	4.9	0.2	-0.3	0.5	0.0	0.0
Greece	0.3	-0.1	-0.1	0.4	0.8	-3.3	1.0	4.0	-3.6	-0.9	0.1	-0.6
Spain	0.6	0.0	0.5	0.6	0.1	-2.3	4.1	-4.2	-3.2	-0.8	0.4	0.4
France	0.1	-0.2	0.0	-0.3	1.5	-1.2	2.3	-3.5	-1.3	0.9	0.5	-0.2
Italy	-0.3	-0.1	-0.7	-3.4	1.5	-2.9	8.0	-3.0	-1.9	0.5	0.3	-0.1
Cyprus	:	1.2	-1.3	4.5	0.6	-2.5	2.7	-0.7	-0.2	0.0	1.3	0.2
Luxembourg	-0.6	-1.4	0.8	2.0	3.3	0.5	-0.9	-1.3	-1.0	-0.5	-1.0	-0.5
Malta	:	-1.1	-1.9	-1.0	0.6	-5.6	-5.4	3.0	-0.4	0.4	1.3	0.7
Netherlands	0.4	0.7	0.4	-0.3	-0.1	-0.1	-0.8	-0.6	0.0	0.2	0.0	0.0
Austria	-0.1	-0.2	0.1	-0.3	-0.5	-2.1	2.1	-1.5	-1.8	-0.5	-0.2	-0.3
Portugal	1.1	0.2	0.0	0.8	0.3	-3.1	5.1	0.2	-2.6	-0.9	0.2	-0.4
Slovenia	2.9	-0.2	-0.3	-0.4	0.6	-1.8	4.7	-3.2	-2.2	-0.3	-0.7	-0.8
Slovakia	:	0.4	-0.3	-1.8	-1.1	-1.9	-0.7	-2.3	-1.8	-0.2	0.3	0.0
Finland	0.5	-0.6	-2.5	-4.1	0.0	-3.3	-0.2	-1.3	-1.8	-0.3	0.3	-0.5
Euro area	0.5	-0.3	-0.2	-1.3	0.4	-2.0	3.9	-2.5	-1.8	0.1	0.1	-0.2
Bulgaria	:	:	0.8	5.1	-1.3	-2.5	0.6	4.7	-1.5	-1.3	0.2	-0.4
Czech Republic	:	0.1	-0.1	-1.7	1.2	-2.3	3.0	-2.5	-1.6	0.0	-0.3	0.1
Denmark	0.8	1.0	0.9	0.7	0.5	1.0	3.8	2.7	-0.1	0.3	-0.1	-0.2
Latvia	:	-2.3	0.2	0.0	7.2	-1.8	-2.9	1.1	0.6	0.0	0.1	0.0
Lithuania	:	2.3	1.2	-3.5	0.9	3.6	-5.9	2.4	0.4	0.2	0.1	0.4
Hungary	:	-0.4	-0.9	-1.4	-0.1	-1.1	1.0	-0.2	-0.4	0.0	-0.4	-1.1
Poland	1.5	-1.1	0.3	-0.3	2.0	-2.1	4.4	-1.7	-1.5	0.4	-1.0	-0.6
Romania	-4.1	4.0	3.0	7.2	10.6	3.2	0.1	2.4	-1.3	0.5	1.0	0.5
Sweden	-0.7	-1.5	-1.1	-0.3	1.7	-1.2	1.9	-0.6	-1.0	-1.0	0.0	-1.0
United Kingdom	-0.3	0.1	0.6	-0.1	1.3	-0.5	0.3	-0.1	0.3	1.6	-1.2	0.2
EU	:	0.6	-0.1	-1.0	0.8	-2.1	3.1	-2.0	-1.6	0.2	-0.1	-0.2
USA	-0.1	0.4	-1.0	-0.8	0.2	-5.8	6.3	-2.0	-3.5	0.4	-1.4	0.1
Japan	0.6	-1.1	-4.3	-8.0	-4.3	-11.3	15.8	-6.2	-9.7	-1.7	-0.5	-0.7

TABLE 21 : Total population (percentage change on preceding year, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	0.3	0.2	0.5	0.7	0.7	0.8	0.8	0.8	0.7	0.7	0.7	0.7
Germany	0.5	0.1	0.0	-0.1	-0.1	-0.2	-0.3	-0.2	-0.1	-0.1	-0.3	-0.3
Estonia	-2.0	-0.8	-0.3	-0.2	-0.2	-0.1	0.0	0.0	0.1	0.1	0.1	0.1
Ireland	0.6	1.3	2.0	2.4	2.4	1.8	0.6	0.7	0.3	0.2	0.0	0.1
Greece	0.9	0.4	0.4	0.4	0.4	0.4	0.4	0.2	0.2	0.2	0.2	0.2
Spain	0.2	0.6	1.6	1.5	1.8	1.6	0.7	0.3	0.3	0.3	0.3	0.3
France	0.4	0.5	0.7	0.7	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Italy	0.0	0.0	0.7	0.6	0.7	0.8	0.6	0.5	0.4	0.3	0.4	0.3
Cyprus	2.1	1.2	1.9	2.0	1.5	1.2	0.9	0.5	0.7	0.7	0.7	0.7
Luxembourg	1.3	1.3	1.4	1.6	1.6	1.7	1.9	1.9	1.4	1.3	1.4	1.3
Malta	0.9	0.7	0.7	0.7	0.7	0.8	0.2	0.1	0.4	0.4	0.4	0.4
Netherlands	0.6	0.7	0.4	0.1	0.2	0.4	0.5	0.5	0.3	0.3	0.3	0.3
Austria	0.5	0.2	0.6	0.5	0.4	0.4	0.3	0.1	0.3	0.4	0.4	0.4
Portugal	0.2	0.5	0.6	0.3	0.2	0.1	0.1	0.0	0.0	0.0	0.2	0.2
Slovenia	-0.1	0.0	0.2	0.4	0.5	0.3	1.0	0.3	0.2	0.2	0.2	0.2
Slovakia	0.3	0.0	0.0	0.1	0.1	0.2	0.2	0.1	0.1	0.1	-0.2	-0.2
Finland	0.4	0.2	0.3	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Euro area	0.3	0.3	0.6	0.5	0.6	0.5	0.4	0.3	0.3	0.2	0.2	0.2
Bulgaria	-0.6	-1.1	-0.6	-0.5	-0.5	-0.4	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Czech Republic	0.0	-0.2	0.1	0.3	0.5	1.0	0.7	0.3	0.0	-0.1	0.1	-0.2
Denmark	0.4	0.4	0.3	0.3	0.4	0.6	0.5	0.3	0.3	0.3	0.3	0.3
Latvia	-1.5	-0.8	-0.6	-0.5	-0.5	-0.4	-0.5	-0.7	-0.7	-0.7	-0.5	-0.5
Lithuania	-0.6	-0.7	-0.5	-0.6	-0.5	-0.5	-0.6	-1.6	-1.2	-0.8	-0.5	-0.5
Hungary	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.1	-0.1
Poland	0.2	0.0	-0.1	-0.1	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0
Romania	-0.3	-0.2	-0.7	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Sweden	0.5	0.1	0.4	0.6	0.7	0.8	0.9	1.7	0.3	0.3	0.0	0.0
United Kingdom	0.3	0.3	0.5	0.6	0.7	0.7	0.6	0.7	0.7	0.7	0.7	0.7
EU	0.2	0.2	0.4	0.4	0.5	0.5	0.3	0.3	0.2	0.2	0.2	0.2
USA	1.2	1.1	0.9	1.0	1.0	0.9	0.9	0.9	0.8	0.8	0.8	0.8
Japan	0.3	0.2	0.1	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1

TABLE 22 : Total employment (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	0.1	1.4	0.7	1.2	1.6	1.7	-0.4	0.7	0.8	0.7	0.3	0.6
Germany	-0.6	1.0	-0.1	0.6	1.7	1.4	0.0	0.5	0.9	0.5	0.7	0.4
Estonia	-5.2	-1.4	2.0	5.4	0.8	0.2	-9.9	-4.8	4.2	1.3	2.9	1.9
Ireland	2.5	5.6	3.2	4.3	3.7	-1.1	-8.2	-4.1	-1.5	0.4	-0.8	0.6
Greece	0.9	0.7	2.0	3.3	1.7	0.2	-0.7	-2.1	-2.6	0.1	-2.6	0.1
Spain	-0.3	4.1	2.8	3.3	2.8	-0.5	-6.6	-2.4	-0.6	0.9	-0.3	1.1
France	-0.5	1.7	0.5	1.0	1.6	0.7	-1.2	0.1	0.8	0.9	0.5	0.7
Italy	-0.9	1.1	0.8	1.5	1.0	-0.4	-2.6	-0.7	0.4	0.9	0.4	0.9
Cyprus	:	1.6	3.0	1.8	3.2	2.8	-0.7	-0.3	0.2	0.8	0.2	0.8
Luxembourg	2.5	4.7	2.7	3.6	4.5	4.7	0.9	1.6	2.1	2.3	2.0	2.1
Malta	1.5	0.8	0.7	1.3	3.2	2.6	-0.3	2.2	1.3	1.4	1.2	1.4
Netherlands	1.0	2.4	-0.2	1.6	2.2	1.2	-1.2	-0.6	0.5	0.7	0.2	0.3
Austria	0.0	0.8	0.6	1.0	1.5	1.6	-1.6	1.0	0.8	0.7	0.7	0.8
Portugal	-0.8	2.1	0.0	0.5	0.0	0.5	-2.5	-1.5	-1.5	-0.9	-0.7	-0.3
Slovenia	:	0.2	0.5	1.5	3.0	2.8	-1.9	-2.2	-1.3	0.3	-0.2	0.6
Slovakia	:	-1.1	0.9	2.1	2.1	2.9	-2.5	-1.4	0.6	0.9	0.3	0.8
Finland	-2.3	2.2	0.9	1.8	2.2	1.6	-2.7	-0.4	0.9	0.7	0.9	0.9
Euro area	-0.4	1.6	0.7	1.5	1.7	0.6	-2.0	-0.5	0.4	0.7	0.3	0.6
Bulgaria	:	-2.3	2.4	3.3	3.2	2.6	-2.6	-5.9	0.5	1.0	0.7	1.1
Czech Republic	:	-0.9	0.5	1.9	2.7	1.2	-1.2	-0.8	0.0	0.0	0.2	0.3
Denmark	0.1	1.0	0.3	2.1	2.8	1.9	-3.1	-2.1	0.2	0.4	0.3	0.3
Latvia	-7.4	0.0	2.5	4.9	3.6	0.9	-13.2	-4.8	1.5	1.7	0.5	0.6
Lithuania	-2.7	-2.1	2.0	1.8	2.8	-0.7	-6.8	-5.1	2.1	2.8	1.1	2.1
Hungary	:	1.0	-0.2	0.6	-0.3	-1.3	-2.8	0.2	0.4	3.0	0.1	0.8
Poland	:	-1.1	0.5	3.2	4.4	3.8	0.3	0.4	1.1	1.0	1.3	1.4
Romania	-2.8	-2.5	-2.6	0.7	0.4	0.0	-1.8	-1.8	0.1	0.6	0.1	0.6
Sweden	-1.9	1.4	0.1	1.7	2.3	0.9	-2.0	1.1	1.9	1.1	0.9	0.8
United Kingdom	0.0	1.2	0.9	0.9	0.7	0.7	-1.6	0.2	0.4	0.5	0.4	0.5
EU	:	1.0	0.6	1.5	1.7	0.9	-1.9	-0.5	0.4	0.7	0.4	0.7
USA	1.8	1.7	0.7	1.8	0.9	-0.7	-5.0	-0.6	0.8	1.3	0.8	1.1
Japan	0.4	-0.6	-0.2	0.4	0.4	-0.3	-1.6	-0.6	-0.2	0.1	-0.2	0.1

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.



TABLE 23 : Unemployment rate (number of unemployed as a percentage of total labour force, 1992-2012) <sup>1</sup>

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	8.9	8.1	8.2	8.3	7.5	7.0	7.9	8.3	7.9	7.8	8.8	8.7
Germany	7.8	8.4	9.8	10.3	8.7	7.5	7.8	7.1	6.4	6.0	6.7	6.3
Estonia	:	11.3	8.8	5.9	4.7	5.5	13.8	16.9	13.0	11.5	15.1	13.6
Ireland	13.9	6.2	4.5	4.5	4.6	6.3	11.9	13.7	14.6	14.0	13.5	12.7
Greece	8.8	10.9	9.9	8.9	8.3	7.7	9.5	12.6	15.2	15.3	15.0	15.2
Spain	17.8	13.1	10.1	8.5	8.3	11.3	18.0	20.1	20.6	20.2	20.2	19.2
France	11.0	10.0	9.1	9.2	8.4	7.8	9.5	9.7	9.5	9.2	9.5	9.2
Italy	10.3	10.5	7.9	6.8	6.1	6.7	7.8	8.4	8.4	8.2	8.3	8.2
Cyprus	:	3.8	4.5	4.6	4.0	3.6	5.3	6.5	6.3	5.6	6.6	5.9
Luxembourg	2.7	2.4	4.1	4.6	4.2	4.9	5.1	4.5	4.4	4.2	5.6	5.6
Malta	5.2	6.8	7.4	7.1	6.4	5.9	7.0	6.8	6.8	6.7	6.6	6.5
Netherlands	6.0	3.8	4.4	4.4	3.6	3.1	3.7	4.5	4.2	4.0	4.4	4.3
Austria	3.9	4.0	4.7	4.8	4.4	3.8	4.8	4.4	4.3	4.2	4.2	4.0
Portugal	6.2	4.9	6.7	7.8	8.1	7.7	9.6	11.0	12.3	13.0	11.1	11.2
Slovenia	:	6.9	6.4	6.0	4.9	4.4	5.9	7.3	8.2	8.0	7.2	6.6
Slovakia	:	15.8	16.8	13.4	11.1	9.5	12.0	14.4	14.0	13.3	14.2	13.4
Finland	14.9	10.6	8.6	7.7	6.9	6.4	8.2	8.4	7.9	7.4	7.8	7.2
Euro area	10.1	9.3	8.8	8.5	7.6	7.6	9.6	10.1	10.0	9.7	10.0	9.6
Bulgaria	:	15.7	12.6	9.0	6.9	5.6	6.8	10.2	9.4	8.5	9.1	8.0
Czech Republic	:	7.3	7.7	7.2	5.3	4.4	6.7	7.3	6.8	6.4	7.0	6.7
Denmark	7.8	4.8	4.8	3.9	3.8	3.3	6.0	7.4	7.1	6.7	6.3	5.8
Latvia	13.8	14.0	9.8	6.8	6.0	7.5	17.1	18.7	17.2	15.8	17.7	16.2
Lithuania	5.0	13.3	10.3	5.6	4.3	5.8	13.7	17.8	15.5	12.7	16.9	15.1
Hungary	:	7.3	6.5	7.5	7.4	7.8	10.0	11.2	11.0	9.3	11.0	10.3
Poland	13.4	13.8	18.1	13.9	9.6	7.1	8.2	9.6	9.3	8.8	9.2	8.5
Romania	5.8	6.4	7.6	7.3	6.4	5.8	6.9	7.3	7.2	6.8	7.4	7.0
Sweden	8.5	7.2	7.0	7.1	6.1	6.2	8.3	8.4	7.6	7.2	8.0	7.5
United Kingdom	9.1	5.8	5.0	5.4	5.3	5.6	7.6	7.8	8.0	7.8	7.9	7.8
EU	:	8.8	8.8	8.2	7.2	7.1	9.0	9.6	9.5	9.1	9.5	9.1
USA	6.3	4.5	5.4	4.6	4.6	5.8	9.3	9.6	8.7	8.1	9.4	9.0
Japan	2.8	4.4	4.8	4.1	3.9	4.0	5.1	5.1	4.9	4.8	4.9	4.8

<sup>1</sup> Series following Eurostat definition, based on the labour force survey.

TABLE 24 : Compensation of employees per head (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	3.4	2.8	2.5	3.3	3.4	3.6	1.8	1.1	3.1	3.6	2.3	2.3
Germany	4.4	1.2	0.9	1.1	0.9	2.0	0.2	2.2	2.7	2.9	2.6	2.8
Estonia	:	13.2	11.6	14.1	24.6	10.1	-3.3	-0.2	4.4	4.0	2.2	3.5
Ireland	4.5	5.9	5.4	4.7	5.4	3.4	0.0	-1.9	-0.3	0.7	0.5	0.1
Greece	10.8	7.0	6.1	3.6	6.1	7.0	3.6	-3.5	-1.0	0.1	-0.2	0.1
Spain	6.0	2.5	3.5	4.0	4.8	6.4	4.1	0.7	0.9	1.2	0.7	1.3
France	2.8	2.1	3.1	3.2	2.3	2.4	1.6	2.3	2.0	2.3	1.7	1.8
Italy	4.8	2.1	3.1	2.7	2.4	3.8	1.5	2.0	1.5	1.8	1.5	1.8
Cyprus	:	4.6	3.8	3.0	3.0	2.3	3.2	2.8	3.8	3.2	3.1	3.2
Luxembourg	3.9	3.2	2.9	2.6	3.7	2.1	1.8	1.6	2.0	4.6	2.0	2.5
Malta	7.8	4.5	3.4	3.6	1.5	4.9	2.9	-1.7	2.0	3.0	2.0	3.0
Netherlands	2.9	4.1	3.4	2.4	3.4	3.6	2.2	1.1	2.9	2.5	2.3	2.1
Austria	3.9	1.9	2.3	3.4	3.0	3.2	2.3	1.6	2.5	2.7	2.2	2.1
Portugal	9.4	5.4	3.2	1.8	3.6	3.0	3.3	1.5	-0.3	0.1	-1.3	0.7
Slovenia	:	10.4	7.1	5.3	6.4	7.0	1.6	4.1	2.4	3.6	2.8	3.3
Slovakia	:	10.3	8.5	7.9	8.4	6.9	5.0	2.7	3.9	5.1	3.7	4.5
Finland	2.5	3.3	2.9	2.9	3.7	5.1	1.7	2.0	2.8	3.4	2.7	2.8
Euro area	4.4	2.2	2.5	2.5	2.6	3.3	1.7	1.7	2.1	2.3	1.8	2.1
Bulgaria	:	83.1	6.4	6.3	12.7	16.3	9.4	7.2	7.1	6.8	5.7	5.5
Czech Republic	:	7.9	6.5	5.9	6.3	6.3	0.4	2.9	2.5	4.1	2.9	4.7
Denmark	3.2	3.8	3.6	3.5	3.6	3.6	2.4	2.7	1.7	2.4	3.1	3.1
Latvia	:	7.7	15.0	23.2	35.1	15.7	-12.2	-6.5	1.5	1.5	0.7	1.8
Lithuania	:	9.1	10.5	16.7	13.9	14.3	-11.1	-1.3	3.4	5.8	1.2	4.4
Hungary	:	14.7	9.4	5.3	6.7	7.0	-2.2	-0.2	2.6	2.0	3.1	4.8
Poland	37.8	13.8	1.9	1.8	4.9	8.9	2.9	4.7	5.9	6.3	4.0	5.9
Romania	118.0	71.2	19.7	12.4	22.0	31.9	-6.6	1.3	2.2	6.0	3.3	4.2
Sweden	4.8	4.0	3.0	2.1	5.2	1.5	1.3	2.7	2.8	3.3	2.6	3.0
United Kingdom	3.6	5.1	4.0	4.9	5.0	1.5	2.5	3.2	2.8	4.0	2.8	4.0
EU	:	4.0	2.8	2.8	3.2	3.2	1.6	2.1	2.3	2.7	2.1	2.5
USA	3.0	4.4	3.9	3.9	3.9	3.1	2.2	2.9	2.4	1.4	1.0	0.5
Japan	1.2	0.0	-0.8	0.4	-1.3	0.0	-3.1	0.8	1.1	1.2	1.1	1.2

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 25 : Real compensation of employees per head <sup>1</sup> (percentage change on preceding year, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	1.6	1.1	0.3	0.3	0.6	0.4	2.3	-1.3	-0.2	1.5	0.4	0.5
Germany	1.9	0.3	-0.4	0.0	-0.9	0.2	0.2	0.2	0.5	1.2	0.9	1.1
Estonia	:	6.6	8.2	8.7	15.9	1.4	-2.4	-2.3	0.8	1.5	-1.1	1.1
Ireland	1.9	2.0	2.3	2.2	2.0	0.3	4.7	1.6	-1.3	0.0	0.1	-0.7
Greece	-0.7	2.4	2.8	0.2	2.7	3.0	2.5	-7.9	-3.5	-0.5	-2.3	-0.2
Spain	1.0	-0.3	0.2	0.4	1.5	2.7	4.0	-2.0	-1.7	-0.3	-0.8	-0.2
France	1.1	1.2	1.4	1.1	0.2	-0.5	2.0	1.1	-0.1	0.6	0.2	0.3
Italy	-0.3	-0.2	0.5	0.0	0.1	0.6	1.5	0.5	-1.0	-0.1	-0.3	-0.1
Cyprus	:	2.1	1.3	0.8	-0.7	-2.6	3.1	0.3	0.5	1.0	-0.4	0.4
Luxembourg	1.0	0.9	0.8	0.2	1.5	0.1	1.1	-0.3	-1.0	2.5	-0.1	0.8
Malta	:	2.5	1.5	1.4	-0.2	1.3	1.1	-4.5	-0.6	0.8	-0.1	0.7
Netherlands	0.5	1.2	1.3	0.3	1.6	2.2	2.8	-0.5	0.9	0.5	0.6	0.3
Austria	1.4	0.6	0.5	1.3	0.3	0.7	3.1	-0.1	-0.3	0.7	0.1	0.4
Portugal	3.6	2.4	0.4	-1.2	0.6	0.5	5.9	-0.1	-3.6	-1.9	-3.5	-0.5
Slovenia	:	2.8	2.9	3.0	2.2	1.5	1.6	1.2	-0.2	1.5	0.8	1.1
Slovakia	:	2.7	3.5	2.9	5.7	2.3	4.9	1.8	0.3	2.4	0.5	1.8
Finland	0.6	0.9	2.1	1.4	1.4	1.6	1.2	0.9	-0.5	0.9	0.3	0.8
Euro area	1.1	0.5	0.4	0.3	0.3	0.6	1.9	0.0	-0.3	0.6	0.2	0.4
Bulgaria	:	7.7	2.8	4.0	3.4	8.6	7.8	6.1	3.2	3.7	3.3	3.0
Czech Republic	:	2.4	5.2	4.4	3.3	1.3	0.0	1.6	0.3	1.8	0.9	2.7
Denmark	1.5	1.7	2.0	1.5	2.3	0.6	1.0	0.1	-0.8	0.4	0.4	0.5
Latvia	:	3.4	9.2	16.3	22.7	-0.9	-15.7	-6.2	-1.7	-0.3	-0.4	0.4
Lithuania	:	6.2	9.6	12.1	7.0	3.1	-14.9	-2.7	0.2	3.3	-0.8	1.9
Hungary	:	2.4	5.3	1.7	0.4	1.5	-6.0	-4.9	-1.3	-1.4	-0.7	1.6
Poland	4.7	4.4	-0.1	0.6	2.4	4.4	0.4	2.0	2.0	3.0	1.1	2.8
Romania	0.0	10.0	6.9	7.2	16.5	19.9	-10.1	-3.4	-4.2	1.7	-2.1	0.1
Sweden	1.7	2.7	1.8	0.8	3.8	-1.5	-0.6	1.3	1.6	2.0	0.7	1.1
United Kingdom	0.2	3.2	1.9	2.1	2.1	-1.6	1.2	-1.1	-0.1	2.4	0.2	2.6
EU	:	1.4	0.7	0.5	0.7	0.2	1.3	-0.1	-0.3	0.9	0.1	0.8
USA	0.7	2.6	1.5	1.2	1.1	-0.2	2.1	1.2	0.2	-0.1	-0.2	-0.8
Japan	0.6	0.3	0.0	0.6	-0.7	-0.4	-1.0	2.3	1.6	0.7	1.6	0.7

<sup>1</sup> Deflated by the price deflator of private consumption.

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 26 : Labour productivity (real GDP per occupied person) (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	1.4	1.3	1.3	1.5	1.3	-0.7	-2.4	1.5	1.6	1.5	1.5	1.3
Germany	2.0	1.1	1.1	2.7	1.0	-0.4	-4.7	3.1	1.6	1.4	1.5	1.6
Estonia	:	8.6	6.4	4.9	6.1	-5.2	-4.4	8.3	0.6	2.7	1.5	1.6
Ireland	3.3	3.4	2.1	0.9	1.9	-2.4	0.6	3.2	2.2	1.5	1.7	1.3
Greece	0.2	3.1	2.2	1.8	2.5	0.8	-1.3	-2.4	-0.9	1.0	-0.3	1.0
Spain	1.8	0.2	0.5	0.7	0.7	1.4	3.1	2.3	1.4	0.6	1.0	0.6
France	1.6	1.2	1.2	1.2	0.8	-0.5	-1.4	1.5	0.9	1.2	1.2	1.1
Italy	2.2	0.9	0.1	0.5	0.5	-0.9	-2.6	2.0	0.6	0.5	0.8	0.6
Cyprus	:	2.6	0.2	2.3	1.8	0.8	-1.0	1.3	1.3	1.5	1.2	1.3
Luxembourg	0.1	1.5	1.3	1.4	2.1	-3.2	-4.5	1.9	1.3	1.5	0.8	1.1
Malta	3.5	2.6	1.3	0.8	1.2	2.6	-3.1	1.4	0.7	0.7	0.8	0.8
Netherlands	1.4	1.4	1.8	1.7	1.7	0.6	-2.8	2.4	1.4	1.0	1.3	1.4
Austria	1.8	1.8	1.6	2.6	2.2	0.5	-2.3	1.0	1.6	1.3	1.0	1.3
Portugal	2.8	1.7	0.7	0.9	2.4	-0.5	0.0	2.9	-0.8	-0.8	-0.3	1.1
Slovenia	:	4.0	3.7	4.3	3.8	0.9	-6.4	3.4	3.3	2.1	2.1	2.0
Slovakia	:	3.9	4.9	6.3	8.3	2.8	-2.3	5.5	2.9	3.5	2.6	3.1
Finland	3.7	2.3	2.1	2.5	3.1	-0.6	-5.6	3.5	2.7	1.9	1.9	1.3
Euro area	1.9	1.3	1.1	1.6	1.2	-0.1	-2.1	2.2	1.2	1.0	1.1	1.2
Bulgaria	:	4.9	3.5	3.1	3.2	3.5	-2.9	6.4	2.3	2.7	1.9	2.6
Czech Republic	:	2.1	4.1	4.8	3.4	1.2	-3.0	3.1	2.0	2.9	2.2	2.8
Denmark	2.5	1.4	1.5	1.3	-1.1	-2.9	-2.2	4.2	1.6	1.0	1.6	1.5
Latvia	-1.5	6.2	6.3	7.0	6.2	-5.1	-5.5	4.6	1.8	2.3	2.9	3.4
Lithuania	-5.8	6.9	5.9	5.9	6.9	3.6	-8.5	6.8	2.8	1.9	1.7	1.1
Hungary	:	3.3	4.1	3.0	1.1	2.1	-4.0	1.0	2.3	-0.3	2.7	2.3
Poland	:	5.5	3.6	2.9	2.3	1.3	1.3	3.4	2.9	2.7	2.6	2.8
Romania	4.1	2.6	9.0	7.1	5.9	7.3	-5.4	0.5	1.3	3.0	1.4	3.2
Sweden	3.2	2.0	3.2	2.6	1.0	-1.5	-3.4	4.4	2.2	1.4	2.4	1.4
United Kingdom	2.5	2.1	1.6	1.9	2.0	-0.8	-3.4	1.0	1.3	1.6	1.8	2.0
EU	:	2.0	2.0	2.2	1.7	0.3	-2.3	2.3	1.4	1.4	1.4	1.6
USA	1.5	2.1	2.1	0.9	1.0	0.7	2.5	3.5	1.7	1.3	1.4	1.3
Japan	0.9	1.1	1.9	1.6	2.0	-0.8	-4.7	4.6	0.7	1.5	1.5	1.6

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 27 : Unit labour costs, whole economy <sup>1</sup> (percentage change on preceding year, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	2.0	1.5	1.2	1.8	2.1	4.4	4.3	-0.4	1.5	2.0	0.7	1.0
Germany	2.4	0.2	-0.3	-1.6	-0.1	2.4	5.2	-0.9	1.0	1.4	1.0	1.2
Estonia	:	4.3	4.8	8.7	17.4	16.2	1.2	-7.9	3.8	1.3	0.7	1.9
Ireland	1.2	2.4	3.3	3.7	3.4	5.9	-0.6	-4.9	-2.5	-0.9	-1.3	-1.2
Greece	10.6	3.7	3.8	1.8	3.6	6.2	5.0	-1.1	-0.1	-0.9	0.1	-0.9
Spain	4.1	2.3	3.0	3.3	4.0	4.9	1.0	-1.5	-0.4	0.6	-0.3	0.6
France	1.1	0.8	1.9	2.0	1.5	2.9	3.0	0.8	1.1	1.1	0.5	0.7
Italy	2.6	1.2	3.0	2.2	1.9	4.8	4.3	0.0	0.9	1.3	0.7	1.2
Cyprus	:	1.9	3.5	0.6	1.1	1.5	4.3	1.5	2.5	1.7	1.8	1.8
Luxembourg	3.8	1.7	1.6	1.2	1.6	5.4	6.7	-0.3	0.7	3.0	1.2	1.4
Malta	4.2	1.9	2.1	2.8	0.3	2.3	6.1	-3.1	1.3	2.3	1.2	2.1
Netherlands	1.5	2.7	1.6	0.7	1.7	3.0	5.1	-1.2	1.4	1.6	1.0	0.7
Austria	2.0	0.1	0.6	0.8	0.8	2.7	4.8	0.6	1.0	1.4	1.2	0.8
Portugal	6.5	3.6	2.5	0.9	1.2	3.5	3.3	-1.4	0.5	0.9	-1.1	-0.4
Slovenia	:	6.2	3.2	1.0	2.6	5.9	8.5	0.6	-0.8	1.4	0.7	1.3
Slovakia	:	6.2	3.4	1.5	0.2	4.0	7.5	-2.7	0.9	1.6	1.0	1.4
Finland	-1.2	1.0	0.8	0.3	0.5	5.8	7.8	-1.5	0.1	1.5	0.7	1.5
Euro area	2.4	1.1	1.6	1.0	1.5	3.6	4.0	-0.5	0.8	1.2	0.6	0.9
Bulgaria	:	74.5	2.8	3.1	9.3	12.5	12.7	0.8	4.6	4.0	3.7	2.8
Czech Republic	:	5.7	2.4	1.1	2.9	5.1	3.5	-0.2	0.5	1.2	0.7	1.8
Denmark	0.6	2.3	2.1	2.2	4.8	6.8	4.7	-1.5	0.1	1.3	1.4	1.5
Latvia	:	1.3	8.2	15.2	27.2	22.0	-7.0	-10.6	-0.3	-0.8	-2.1	-1.5
Lithuania	:	2.1	4.4	10.1	6.5	10.4	-2.8	-7.6	0.5	3.9	-0.4	3.3
Hungary	:	11.0	5.0	2.3	5.6	4.8	1.9	-1.1	0.3	2.3	0.4	2.4
Poland	:	7.9	-1.7	-1.1	2.6	7.5	1.6	1.3	2.9	3.6	1.3	3.0
Romania	109.4	66.8	9.8	4.9	15.2	22.9	-1.3	0.8	0.8	2.9	1.9	1.0
Sweden	1.6	2.0	-0.1	-0.5	4.2	3.1	4.8	-1.6	0.6	1.8	0.2	1.6
United Kingdom	1.1	2.9	2.4	2.9	3.0	2.3	6.1	2.1	1.5	2.4	1.0	2.0
EU	:	2.1	1.7	1.4	2.1	3.8	4.1	-0.2	0.9	1.5	0.7	1.2
USA	1.5	2.3	1.8	3.0	2.9	2.4	-0.2	-0.5	0.6	0.1	-0.3	-0.8
Japan	0.3	-1.1	-2.6	-1.2	-3.2	0.9	1.7	-3.6	0.3	-0.4	-0.4	-0.4

<sup>1</sup> Compensation of employees per head divided by labour productivity per head, defined as GDP in volume divided by total employment.

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 28 : Real unit labour costs <sup>1</sup> (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-0.2	0.1	-0.9	-0.5	-0.2	2.4	3.2	-2.2	-0.4	0.0	-1.2	-0.9
Germany	-0.3	-0.2	-1.2	-2.0	-1.9	1.3	3.7	-1.5	0.0	-0.1	-0.2	-0.1
Estonia	:	-2.0	-0.1	0.4	6.2	8.4	1.2	-9.2	1.4	-0.9	-1.9	-0.3
Ireland	-1.7	-2.6	0.1	0.0	2.3	7.5	3.6	-2.4	-3.1	-1.8	-1.6	-1.9
Greece	-0.8	-0.5	0.6	-1.3	0.5	2.8	3.7	-3.5	-0.4	-1.3	-1.4	-1.3
Spain	-0.6	-0.7	-1.2	-0.8	0.7	2.4	0.4	-2.5	-1.5	-0.5	-1.3	-0.8
France	-0.4	-0.2	-0.1	-0.3	-1.0	0.3	2.5	0.3	-0.7	-0.8	-1.1	-0.8
Italy	-1.6	-1.2	0.4	0.3	-0.7	2.0	2.0	-0.6	-0.7	-0.5	-0.9	-0.6
Cyprus	:	-1.1	0.6	-2.3	-3.4	-3.4	4.6	-0.5	-0.6	-0.4	-1.3	-0.7
Luxembourg	0.1	0.7	-2.5	-5.1	-2.0	1.1	7.0	-5.5	-2.5	0.3	-1.3	-0.9
Malta	1.2	-0.2	-0.5	-0.2	-2.8	-0.4	3.5	-5.9	-1.3	0.0	-1.4	-0.4
Netherlands	-0.4	-0.4	-0.6	-1.1	-0.1	0.6	5.3	-2.8	-0.4	-0.6	-0.5	-0.9
Austria	-0.3	-0.6	-1.0	-1.0	-1.2	0.8	3.9	-0.9	-0.8	-0.3	-0.4	-0.5
Portugal	0.6	0.0	-0.4	-1.8	-2.0	1.9	2.7	-2.3	-0.6	-0.3	-2.3	-1.4
Slovenia	:	-1.0	-0.8	-1.0	-1.5	1.8	5.1	-0.1	-1.8	-0.4	-0.6	-0.2
Slovakia	:	-0.3	-0.6	-1.4	-0.9	1.1	8.8	-3.1	-0.6	-0.8	-1.7	-1.1
Finland	-2.8	-1.3	0.3	-0.5	-2.4	3.9	6.8	-3.5	-2.4	-1.0	-1.8	-0.6
Euro area	-0.7	-0.6	-0.6	-0.9	-0.9	1.5	2.9	-1.3	-0.6	-0.4	-0.8	-0.6
Bulgaria	:	1.2	-2.2	-3.5	0.1	3.7	8.1	-2.1	1.5	1.5	1.1	0.3
Czech Republic	:	0.0	0.5	0.0	-0.5	3.2	1.0	0.9	0.3	-0.7	-0.6	-0.1
Denmark	-0.8	0.3	-0.2	0.1	2.4	2.8	4.3	-4.6	-1.6	-0.7	-0.9	-0.7
Latvia	:	-2.8	1.3	4.9	5.8	6.6	-5.6	-8.5	-2.4	-2.3	-2.7	-2.5
Lithuania	:	-0.7	1.4	3.4	-1.8	0.5	0.9	-9.4	-2.7	1.0	-2.2	0.8
Hungary	:	-0.7	-0.1	-1.9	-0.3	0.0	-2.4	-3.9	-2.2	-0.2	-2.3	0.2
Poland	:	-0.4	-3.8	-2.5	-1.3	4.3	-2.0	0.0	-0.3	0.3	-1.4	0.2
Romania	-2.5	4.6	-6.0	-5.1	1.5	6.6	-5.2	-3.5	-3.5	-1.2	-2.6	-4.0
Sweden	-0.6	0.6	-1.4	-2.4	1.4	-0.1	2.9	-2.8	-0.3	0.8	-1.7	0.0
United Kingdom	-1.7	0.8	-0.4	-0.1	0.0	-0.7	4.6	-0.8	-0.5	0.3	-1.1	0.5
EU	:	-0.3	-0.9	-1.1	-0.7	1.1	2.8	-1.4	-0.6	-0.3	-0.9	-0.4
USA	-0.6	0.5	-0.8	-0.2	-0.1	0.2	-1.1	-1.5	-0.7	-1.3	-1.1	-2.0
Japan	0.1	-0.3	-1.4	-0.3	-2.5	1.9	2.1	-1.5	2.3	-0.6	-0.6	0.1

<sup>1</sup> Nominal unit labour costs divided by GDP price deflator.

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 29 : Nominal bilateral exchange rates against Ecu/euro (1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	39.91	40.43	:	:	:	:	:	:	:	:	:	:
Germany	1.93	1.96	:	:	:	:	:	:	:	:	:	:
Estonia	15.36	15.68	15.65	15.65	15.65	15.65	15.65	15.65	:	:	:	:
Ireland	0.79	0.78	:	:	:	:	:	:	:	:	:	:
Greece	282.43	328.65	:	:	:	:	:	:	:	:	:	:
Spain	152.86	166.45	:	:	:	:	:	:	:	:	:	:
France	6.62	6.58	:	:	:	:	:	:	:	:	:	:
Italy	1888.18	1936.35	:	:	:	:	:	:	:	:	:	:
Cyprus	0.59	0.58	0.58	0.58	0.58	:	:	:	:	:	:	:
Luxembourg	39.91	40.43	:	:	:	:	:	:	:	:	:	:
Malta	0.45	0.42	0.42	0.43	0.43	:	:	:	:	:	:	:
Netherlands	2.17	2.21	:	:	:	:	:	:	:	:	:	:
Austria	13.60	13.79	:	:	:	:	:	:	:	:	:	:
Portugal	190.37	200.35	:	:	:	:	:	:	:	:	:	:
Slovenia	143.42	197.20	235.62	239.60	:	:	:	:	:	:	:	:
Slovakia	:	41.54	40.01	37.23	33.77	31.24	:	:	:	:	:	:
Finland	6.05	5.94	:	:	:	:	:	:	:	:	:	:
Euro area	:	:	:	:	:	:	:	:	:	:	:	:
Bulgaria	0.09	1.95	1.95	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
Czech Republic	34.86	35.71	30.53	28.34	27.77	24.95	26.43	25.28	24.24	24.19	24.56	24.56
Denmark	7.53	7.46	7.44	7.46	7.45	7.46	7.45	7.45	7.46	7.46	7.45	7.45
Latvia	0.75	0.61	0.66	0.70	0.70	0.70	0.71	0.71	0.71	0.71	0.71	0.71
Lithuania	4.45	4.11	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45
Hungary	152.74	244.33	252.11	264.26	251.35	251.51	280.33	275.48	267.32	265.67	273.43	273.43
Poland	2.88	3.91	4.14	3.90	3.78	3.51	4.33	3.99	3.95	3.95	3.93	3.93
Romania	0.20	1.61	3.62	3.53	3.34	3.68	4.24	4.21	4.12	4.09	4.29	4.29
Sweden	8.73	8.81	9.19	9.25	9.25	9.62	10.62	9.54	8.93	8.95	9.30	9.30
United Kingdom	0.79	0.65	0.67	0.68	0.68	0.80	0.89	0.86	0.88	0.88	0.86	0.86
EU	:	:	:	:	:	:	:	:	:	:	:	:
USA	1.25	1.03	1.16	1.26	1.37	1.47	1.39	1.33	1.43	1.45	1.39	1.39
Japan	135.36	122.59	133.27	146.02	161.25	152.45	130.34	116.24	118.08	119.93	113.25	113.25

TABLE 30 : Nominal effective exchange rates to rest of a group <sup>1</sup> of industrialised countries (percentage change on preceding year, 1997-2012)

	5-year averages						Spring 2011 forecast			Autumn 2010 forecast	
	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-1.1	1.4	0.4	1.2	1.8	1.0	-2.5	0.7	0.3	0.2	0.0
Germany	-1.0	1.8	0.5	1.8	1.8	1.3	-3.5	0.8	0.4	0.1	0.0
Estonia	-0.4	1.0	0.2	1.1	1.4	2.2	-3.1	-0.1	0.2	-0.1	0.0
Ireland	-1.8	2.4	0.6	2.6	4.0	0.8	-3.5	1.6	0.6	0.7	0.0
Greece	0.3	1.7	0.6	0.9	2.0	1.9	-2.3	0.8	0.2	0.1	0.0
Spain	-1.1	1.4	0.4	1.3	2.0	1.2	-2.5	0.8	0.3	0.2	0.0
France	-1.0	1.7	0.6	1.6	2.1	0.8	-3.0	0.9	0.4	0.2	0.0
Italy	0.1	1.9	0.6	1.6	1.9	0.9	-3.1	0.9	0.3	0.2	0.0
Cyprus	5.0	1.6	0.6	-0.3	2.2	1.8	-2.4	0.6	0.3	0.0	0.0
Luxembourg	-1.1	1.4	0.4	1.2	1.8	1.0	-2.5	0.7	0.3	0.2	0.0
Malta	0.4	1.3	1.0	3.1	2.2	-1.2	-4.0	1.6	0.6	0.3	0.0
Netherlands	-1.0	1.2	0.3	1.1	2.0	1.4	-2.5	0.6	0.3	0.1	0.0
Austria	-0.1	1.1	0.3	1.0	0.9	1.2	-2.5	0.3	0.2	0.0	0.0
Portugal	-1.1	1.1	0.3	1.1	1.6	0.6	-2.0	0.7	0.3	0.2	0.0
Slovenia	-3.9	-1.1	0.2	0.3	0.5	2.0	-1.9	0.2	0.1	-0.1	0.0
Slovakia	-1.3	3.6	3.7	10.4	8.7	6.5	-2.1	0.1	0.1	-0.1	0.0
Finland	-1.0	1.7	0.5	1.6	1.9	1.5	-3.9	0.4	0.4	0.0	0.0
Euro area	-1.7	3.6	1.2	3.5	4.2	2.8	-6.7	1.6	0.7	0.2	0.0
Bulgaria	-32.2	1.7	0.8	0.6	1.8	2.6	-2.5	1.2	0.2	0.0	0.0
Czech Republic	0.8	4.5	5.2	2.3	12.2	-3.7	2.5	4.3	0.3	2.7	0.0
Denmark	-1.0	1.4	0.3	1.4	2.2	2.2	-3.9	-0.1	0.3	-0.1	0.0
Latvia	4.3	-3.4	0.0	0.0	0.9	2.3	-3.1	0.0	0.0	-0.3	0.0
Lithuania	8.3	2.1	0.1	0.8	1.0	2.7	-2.6	0.2	0.2	-0.1	0.0
Hungary	-4.7	0.3	-6.1	5.4	0.9	-8.4	-0.3	3.2	0.8	0.5	0.0
Poland	-1.1	-0.5	3.5	3.4	9.2	-17.7	6.2	1.0	0.1	1.5	0.0
Romania	-30.1	-4.7	3.6	6.2	-8.3	-11.4	-1.5	2.9	1.0	-1.9	0.0
Sweden	-2.5	1.8	0.8	1.7	-1.8	-8.5	7.6	7.6	0.0	3.2	0.0
United Kingdom	4.8	0.2	1.0	1.9	-12.9	-11.5	0.4	-0.9	-0.5	0.1	0.0
EU	-0.8	5.2	2.8	6.6	1.5	-5.4	-7.4	3.6	0.9	0.9	0.0
USA	5.0	-3.9	-0.8	-5.0	-4.3	6.3	-3.2	-6.7	-0.8	-4.4	0.0
Japan	1.5	-2.4	-5.8	-5.9	11.3	15.9	6.5	0.7	-1.0	4.4	0.0

<sup>1</sup> 35 countries : EU (excl. LU), TR, CH, NO, US, CA, JP, AU, MX and NZ.

TABLE 31 : Relative unit labour costs, to rest of a group <sup>1</sup> of industrialised countries (nat. curr.) (percentage change on preceding year, 1997-2012) 2.5.2011

	5-year averages						Spring 2011 forecast			Autumn 2010 forecast	
	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-0.7	-0.3	0.5	0.2	0.9	0.5	-0.1	0.5	0.7	0.0	:
Germany	-3.0	-2.1	-3.6	-2.5	-1.6	1.7	-0.6	-0.1	0.1	0.3	:
Estonia	1.3	3.2	6.6	13.3	10.0	-2.2	-6.4	3.0	-0.1	0.1	:
Ireland	0.2	1.7	1.9	1.3	2.7	-3.9	-4.8	-3.5	-2.1	-1.9	:
Greece	-1.9	1.5	0.0	0.7	1.4	0.8	-1.0	-1.3	-2.4	-0.8	:
Spain	-0.2	1.2	1.7	2.0	1.2	-2.8	-1.4	-1.5	-0.7	-1.0	:
France	-1.7	0.3	0.5	-0.6	-0.8	-0.6	1.4	0.1	-0.2	-0.2	:
Italy	-2.0	1.3	0.6	-0.4	0.9	0.7	0.4	-0.2	0.0	0.0	:
Cyprus	-6.4	1.5	-1.2	-1.3	-2.8	0.1	1.8	1.6	0.6	1.1	:
Luxembourg	:	:	:	:	:	:	:	:	:	:	:
Malta	-0.1	0.7	1.3	-1.2	-0.7	2.9	-2.6	0.3	1.2	0.7	:
Netherlands	0.7	0.2	-0.5	-0.2	-0.6	1.2	-0.9	0.4	0.2	0.3	:
Austria	-2.5	-0.8	-0.1	-1.1	-1.2	0.8	1.1	-0.1	0.0	0.3	:
Portugal	1.6	0.7	-1.0	-1.2	-0.2	0.1	-0.9	-0.2	-0.2	-1.6	:
Slovenia	3.3	1.7	-0.1	0.5	1.6	4.3	1.0	-1.9	-0.1	-0.2	:
Slovakia	2.9	2.1	0.8	-1.8	-0.1	3.4	-2.4	-0.1	0.1	0.1	:
Finland	-1.6	-0.6	-1.2	-2.0	1.7	4.1	-0.8	-1.0	0.1	0.0	:
Euro area	-3.8	-0.6	-1.6	-1.8	-0.7	1.2	-0.5	-0.5	-0.2	-0.1	:
Bulgaria	62.8	-0.1	1.2	6.0	6.9	7.9	1.2	3.6	2.7	2.8	:
Czech Republic	2.9	1.2	0.4	1.0	1.1	-0.6	0.2	-0.6	-0.3	-0.1	:
Denmark	0.2	0.8	0.9	2.4	2.9	0.8	-1.0	-0.9	0.0	0.7	:
Latvia	-1.8	6.5	13.1	23.4	15.9	-10.2	-9.3	-1.4	-2.5	-2.8	:
Lithuania	-1.8	2.4	7.7	2.3	4.2	-5.8	-6.2	-0.5	2.5	-1.1	:
Hungary	7.8	3.6	1.3	3.4	0.3	-2.1	-0.7	-0.8	0.8	-0.5	:
Poland	5.3	-3.1	-2.3	0.4	3.3	-2.5	1.9	2.0	2.1	0.5	:
Romania	59.6	7.4	3.2	12.5	17.9	-5.6	1.1	-0.3	1.5	1.0	:
Sweden	-0.7	-1.7	-2.4	1.6	-1.1	1.0	-1.3	-0.4	0.5	-0.7	:
United Kingdom	0.5	0.8	1.3	0.9	-1.3	3.1	3.0	0.6	1.3	0.4	:
EU	-3.3	-0.4	-1.6	-0.6	0.1	1.8	0.3	-0.5	0.7	-0.1	:
USA	-0.7	0.3	1.2	1.1	-1.0	-4.1	-0.1	-0.7	-1.6	-1.5	:
Japan	-3.4	-4.4	-3.5	-5.6	-2.3	-0.7	-3.5	-0.9	-1.5	-1.1	:

<sup>1</sup> 35 countries : EU (excl. LU), TR, CH, NO, US, CA, JP, AU, MX and NZ.

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 32 : Real effective exchange rate : ulc relative to rest of a group <sup>1</sup> of industrialised countries (USD) (% change on preceding year, 1997-2012)

	5-year averages						Spring 2011 forecast			Autumn 2010 forecast	
	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-1.8	1.0	0.9	1.5	2.8	1.5	-2.6	1.2	1.0	0.2	:
Germany	-4.0	-0.3	-3.0	-0.8	0.2	3.0	-4.0	0.7	0.5	0.5	:
Estonia	0.9	4.2	6.8	14.5	11.6	0.0	-9.2	2.9	0.2	0.0	:
Ireland	-1.6	4.1	2.5	3.9	6.8	-3.1	-8.1	-2.0	-1.6	-1.2	:
Greece	-1.6	3.3	0.6	1.5	3.4	2.6	-3.2	-0.5	-2.2	-0.7	:
Spain	-1.3	2.6	2.2	3.3	3.2	-1.6	-3.8	-0.8	-0.4	-0.8	:
France	-2.7	2.0	1.1	1.0	1.3	0.1	-1.7	0.9	0.1	0.0	:
Italy	-1.8	3.2	1.2	1.2	2.8	1.7	-2.8	0.7	0.4	0.2	:
Cyprus	-1.7	3.1	-0.6	-1.6	-0.7	1.9	-0.6	2.2	0.9	1.2	:
Luxembourg	:	:	:	:	:	:	:	:	:	:	:
Malta	0.3	2.0	2.3	1.9	1.5	1.6	-6.5	1.9	1.8	1.0	:
Netherlands	-0.3	1.4	-0.2	0.9	1.3	2.6	-3.4	1.1	0.5	0.4	:
Austria	-2.6	0.2	0.2	-0.1	-0.3	2.0	-1.5	0.2	0.2	0.3	:
Portugal	0.5	1.8	-0.7	-0.1	1.3	0.7	-2.8	0.4	0.0	-1.4	:
Slovenia	-0.8	0.6	0.1	0.8	2.2	6.4	-0.9	-1.7	0.1	-0.3	:
Slovakia	1.5	5.8	4.5	8.4	8.6	10.1	-4.4	-0.1	0.2	0.0	:
Finland	-2.7	1.1	-0.7	-0.4	3.7	5.7	-4.7	-0.5	0.5	0.0	:
Euro area	-5.4	3.0	-0.4	1.7	3.4	4.0	-7.2	1.1	0.6	0.1	:
Bulgaria	10.4	1.6	2.0	6.6	8.8	10.7	-1.4	4.9	3.0	2.8	:
Czech Republic	3.8	5.8	5.6	3.4	13.5	-4.3	2.7	3.7	0.0	2.6	:
Denmark	-0.8	2.2	1.2	3.8	5.1	3.0	-4.9	-1.0	0.3	0.6	:
Latvia	2.5	2.8	13.1	23.4	16.9	-8.1	-12.1	-1.4	-2.5	-3.1	:
Lithuania	6.3	4.6	7.8	3.0	5.2	-3.2	-8.6	-0.3	2.7	-1.1	:
Hungary	2.7	3.9	-4.8	9.0	1.2	-10.3	-1.0	2.4	1.6	0.0	:
Poland	4.1	-3.6	1.2	3.8	12.8	-19.7	8.2	3.0	2.2	2.0	:
Romania	11.5	2.4	6.9	19.4	8.0	-16.4	-0.5	2.5	2.5	-0.9	:
Sweden	-3.2	0.1	-1.6	3.2	-2.9	-7.6	6.2	7.1	0.6	2.4	:
United Kingdom	5.3	1.0	2.3	2.8	-14.0	-8.7	3.3	-0.3	0.9	0.5	:
EU	-4.0	4.7	1.1	6.0	1.6	-3.7	-7.2	3.1	1.7	0.8	:
USA	4.3	-3.6	0.4	-4.0	-5.3	2.0	-3.4	-7.4	-2.4	-5.8	:
Japan	-2.0	-6.7	-9.1	-11.2	8.7	15.1	2.7	-0.2	-2.5	3.3	:

<sup>1</sup> 35 countries : EU (excl. LU), TR, CH, NO, US, CA, JP, AU, MX and NZ.

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.



TABLE 33 : Total expenditure, general government (as a percentage of GDP, 1992-2012) <sup>1</sup>

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	52.8	50.0	50.2	48.6	48.4	50.1	54.0	53.0	53.1	53.6	52.9	53.0
Germany	47.8	47.4	47.2	45.3	43.5	43.8	47.5	46.6	45.3	44.3	45.6	44.5
Estonia	:	37.5	34.4	33.6	34.4	39.9	45.1	40.0	39.8	40.4	42.0	41.4
Ireland	39.3	34.0	33.8	34.5	36.7	42.8	48.2	67.0	45.5	43.9	45.2	43.8
Greece	43.4	45.1	44.8	44.9	46.3	49.6	52.7	49.6	49.7	49.5	49.3	49.2
Spain	44.6	40.0	38.6	38.4	39.2	41.3	45.8	45.0	42.9	42.0	43.4	42.9
France	53.3	52.5	53.0	52.7	52.4	52.8	56.2	56.2	55.8	55.4	56.1	55.8
Italy	53.2	48.3	48.0	48.7	47.9	48.9	51.9	50.6	49.9	49.2	50.0	49.4
Cyprus	:	36.6	42.2	42.6	41.2	41.7	45.8	46.6	46.1	45.9	46.1	46.2
Luxembourg	:	39.3	41.2	38.6	36.2	36.9	42.2	41.2	40.3	40.1	42.7	42.7
Malta	:	42.6	45.1	44.3	42.6	43.5	43.2	42.3	42.7	42.4	44.1	44.3
Netherlands	52.0	45.9	45.9	45.5	45.2	46.0	51.4	51.3	50.2	49.4	50.7	49.5
Austria	53.8	53.0	51.2	49.4	48.8	49.2	52.9	53.0	52.4	52.0	52.3	52.1
Portugal	39.9	41.3	44.2	44.5	44.3	44.6	49.8	50.7	47.7	46.9	46.8	46.9
Slovenia	:	46.3	45.7	44.6	42.5	44.1	49.0	49.0	49.1	48.1	49.0	48.3
Slovakia	:	47.9	39.5	36.6	34.3	35.0	41.5	41.0	38.8	37.4	38.0	37.4
Finland	59.8	51.4	49.5	48.9	47.2	49.3	56.0	54.8	53.7	53.5	54.9	55.0
Euro area	50.1	47.7	47.4	46.6	46.0	46.9	50.8	50.4	49.1	48.5	49.4	48.7
Bulgaria	:	38.8	38.3	34.4	39.7	37.6	40.7	37.7	37.4	36.6	37.1	36.0
Czech Republic	:	43.0	45.5	43.8	42.5	42.9	46.0	45.2	45.6	45.2	44.9	44.1
Denmark	59.0	55.2	53.5	51.5	50.8	51.9	58.3	58.0	57.5	56.8	56.9	56.1
Latvia	:	38.1	36.0	38.1	35.8	38.8	44.2	42.9	41.4	40.4	41.7	39.7
Lithuania	:	41.1	33.6	33.6	34.8	37.4	44.0	41.2	39.0	38.3	41.5	41.8
Hungary	:	48.6	50.3	52.0	50.0	48.9	50.6	48.8	50.4	45.3	47.4	46.9
Poland	:	43.7	43.8	43.9	42.2	43.2	44.5	45.7	45.8	43.7	45.5	44.6
Romania	:	36.9	34.2	35.5	36.3	38.3	40.6	40.8	38.8	38.1	37.2	36.4
Sweden	64.4	57.4	54.2	52.6	50.9	51.7	54.9	52.7	51.5	50.6	51.6	50.5
United Kingdom	42.2	39.2	42.9	44.2	43.9	47.5	51.6	51.0	49.8	48.6	49.5	47.9
EU	:	46.7	46.7	46.3	45.6	46.9	50.8	50.3	49.1	48.3	49.2	48.4
USA	36.5	34.6	36.1	36.0	36.8	38.9	42.2	43.3	41.7	40.8	41.2	40.3
Japan	34.4	38.9	37.8	36.2	35.9	37.2	41.8	42.3	44.1	44.8	40.7	41.4

<sup>1</sup> ESA 79 up to 1994, ESA 95 from 1995 onwards.TABLE 34 : Total revenue, general government (as a percentage of GDP, 1992-2012) <sup>1</sup>

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	47.5	49.3	49.6	48.8	48.1	48.8	48.1	48.9	49.3	49.4	48.3	48.3
Germany	44.8	45.9	43.9	43.7	43.8	43.9	44.5	43.3	43.3	43.2	42.9	42.7
Estonia	:	37.1	35.9	36.0	36.9	37.0	43.4	40.1	39.2	38.0	40.1	38.7
Ireland	37.7	36.3	34.9	37.4	36.8	35.5	33.9	34.6	35.0	35.1	34.9	34.7
Greece	33.8	40.9	39.0	39.2	40.0	39.9	37.3	39.1	40.2	40.2	41.9	41.5
Spain	39.1	38.1	39.0	40.4	41.1	37.1	34.7	35.7	36.5	36.7	37.0	37.4
France	48.4	50.4	49.8	50.4	49.6	49.5	48.7	49.2	50.1	50.1	49.8	50.0
Italy	44.9	46.1	44.5	45.4	46.4	46.1	46.5	46.0	45.9	46.1	45.7	45.8
Cyprus	:	33.0	38.5	41.4	44.6	42.6	39.8	41.3	41.0	41.0	40.4	40.5
Luxembourg	:	43.8	41.8	39.9	39.8	39.8	41.3	39.5	39.3	39.0	41.4	41.5
Malta	:	35.0	39.9	41.5	40.3	39.0	39.5	38.7	39.7	39.4	41.1	41.0
Netherlands	48.7	46.0	44.6	46.1	45.4	46.6	45.9	45.9	46.5	47.1	46.8	46.7
Austria	49.7	51.3	49.2	47.8	48.0	48.3	48.8	48.3	48.7	48.7	48.7	48.8
Portugal	35.3	37.9	40.3	40.5	41.1	41.1	39.7	41.5	41.8	42.4	41.9	41.7
Slovenia	:	43.2	43.6	43.2	42.4	42.3	43.1	43.4	43.3	43.1	43.7	43.7
Slovakia	:	40.3	35.6	33.4	32.5	32.9	33.6	33.1	33.6	32.9	32.6	32.4
Finland	54.0	54.1	52.6	52.9	52.4	53.5	53.4	52.3	52.8	52.9	53.3	53.9
Euro area	45.1	46.0	44.9	45.3	45.3	44.9	44.5	44.5	44.9	44.9	44.8	44.8
Bulgaria	:	39.4	38.9	36.2	40.8	39.3	36.0	34.5	34.7	35.0	34.1	34.2
Czech Republic	:	38.6	41.0	41.1	41.8	40.2	40.1	40.5	41.2	41.2	40.3	39.9
Denmark	56.5	56.1	56.1	56.6	55.6	55.2	55.6	55.3	53.4	53.6	52.6	52.6
Latvia	:	36.6	34.8	37.7	35.4	34.6	34.6	35.2	36.9	36.5	33.8	32.5
Lithuania	:	36.2	32.5	33.1	33.8	34.1	34.5	34.2	33.5	33.5	34.4	35.0
Hungary	:	43.3	42.3	42.6	45.0	45.2	46.1	44.6	52.0	42.0	42.6	40.8
Poland	:	39.8	38.9	40.2	40.3	39.5	37.2	37.8	40.0	40.1	38.9	38.6
Romania	:	32.8	32.6	33.3	33.7	32.6	32.1	34.3	34.1	34.5	32.3	32.9
Sweden	56.7	58.5	54.8	54.9	54.5	53.9	54.2	52.7	52.4	52.7	51.5	51.5
United Kingdom	36.2	39.7	39.9	41.5	41.2	42.5	40.2	40.6	41.2	41.6	40.9	41.5
EU	:	45.3	44.2	44.8	44.7	44.6	44.0	44.0	44.5	44.5	44.1	44.2
USA	32.3	34.9	32.4	33.9	34.0	32.7	31.0	32.1	31.7	32.3	32.3	32.5
Japan	32.0	31.6	31.7	34.5	33.5	35.0	33.1	33.0	34.5	35.0	34.3	35.1

<sup>1</sup> ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 35 : Net lending (+) or net borrowing (-), general government (as a percentage of GDP, 1992-2012) <sup>1</sup>

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-5.4	-0.7	-0.6	0.1	-0.3	-1.3	-5.9	-4.1	-3.7	-4.2	-4.6	-4.7
Germany	-3.0	-1.6	-3.3	-1.6	0.3	0.1	-3.0	-3.3	-2.0	-1.2	-2.7	-1.8
Estonia	:	-0.5	1.5	2.4	2.5	-2.8	-1.7	0.1	-0.6	-2.4	-1.9	-2.7
Ireland	-1.7	2.4	1.2	2.9	0.1	-7.3	-14.3	-32.4	-10.5	-8.8	-10.3	-9.1
Greece	-9.6	-4.2	-5.8	-5.7	-6.4	-9.8	-15.4	-10.5	-9.5	-9.3	-7.4	-7.6
Spain	-5.6	-1.9	0.4	2.0	1.9	-4.2	-11.1	-9.2	-6.3	-5.3	-6.4	-5.5
France	-4.9	-2.1	-3.2	-2.3	-2.7	-3.3	-7.5	-7.0	-5.8	-5.3	-6.3	-5.8
Italy	-8.3	-2.2	-3.5	-3.4	-1.5	-2.7	-5.4	-4.6	-4.0	-3.2	-4.3	-3.5
Cyprus	:	-3.6	-3.7	-1.2	3.4	0.9	-6.0	-5.3	-5.1	-4.9	-5.7	-5.7
Luxembourg	1.6	4.5	0.6	1.4	3.7	3.0	-0.9	-1.7	-1.0	-1.1	-1.3	-1.2
Malta	:	-7.6	-5.2	-2.8	-2.4	-4.5	-3.7	-3.6	-3.0	-3.0	-3.0	-3.3
Netherlands	-3.3	0.0	-1.3	0.5	0.2	0.6	-5.5	-5.4	-3.7	-2.3	-3.9	-2.8
Austria	-4.1	-1.6	-2.0	-1.6	-0.9	-0.9	-4.1	-4.6	-3.7	-3.3	-3.6	-3.3
Portugal	-4.6	-3.3	-3.9	-4.1	-3.1	-3.5	-10.1	-9.1	-5.9	-4.5	-4.9	-5.1
Slovenia	:	-3.1	-2.0	-1.4	-0.1	-1.8	-6.0	-5.6	-5.8	-5.0	-5.3	-4.7
Slovakia	:	-7.6	-3.9	-3.2	-1.8	-2.1	-8.0	-7.9	-5.1	-4.6	-5.3	-5.0
Finland	-5.8	2.7	3.1	4.0	5.2	4.2	-2.6	-2.5	-1.0	-0.7	-1.6	-1.2
Euro area	-5.0	-1.6	-2.5	-1.4	-0.7	-2.0	-6.3	-6.0	-4.3	-3.5	-4.6	-3.9
Bulgaria	:	0.5	0.6	1.9	1.1	1.7	-4.7	-3.2	-2.7	-1.6	-2.9	-1.8
Czech Republic	:	-4.4	-4.5	-2.6	-0.7	-2.7	-5.9	-4.7	-4.4	-4.1	-4.6	-4.2
Denmark	-2.5	0.9	2.6	5.2	4.8	3.2	-2.7	-2.7	-4.1	-3.2	-4.3	-3.5
Latvia	:	-1.4	-1.2	-0.5	-0.3	-4.2	-9.7	-7.7	-4.5	-3.8	-7.9	-7.3
Lithuania	:	-4.9	-1.1	-0.4	-1.0	-3.3	-9.5	-7.1	-5.5	-4.8	-7.0	-6.9
Hungary	:	-5.2	-8.0	-9.3	-5.0	-3.7	-4.5	-4.2	1.6	-3.3	-4.7	-6.2
Poland	:	-3.9	-4.9	-3.6	-1.9	-3.7	-7.3	-7.9	-5.8	-3.6	-6.6	-6.0
Romania	:	-4.0	-1.6	-2.2	-2.6	-5.7	-8.5	-6.4	-4.7	-3.6	-4.9	-3.5
Sweden	-7.7	1.0	0.6	2.3	3.6	2.2	-0.7	0.0	0.9	2.0	-0.1	1.0
United Kingdom	-6.1	0.5	-3.0	-2.7	-2.7	-5.0	-11.4	-10.4	-8.6	-7.0	-8.6	-6.4
EU	:	-1.4	-2.5	-1.5	-0.9	-2.4	-6.8	-6.4	-4.7	-3.8	-5.1	-4.2
USA	-4.2	0.3	-3.7	-2.0	-2.8	-6.2	-11.2	-11.2	-10.0	-8.6	-8.9	-7.9
Japan	-2.5	-7.3	-6.1	-1.6	-2.4	-2.2	-8.7	-9.3	-9.7	-9.8	-6.4	-6.3

<sup>1</sup> ESA 79 up to 1994, ESA 95 from 1995 onwards.TABLE 36 : Interest expenditure, general government (as a percentage of GDP, 1992-2012) <sup>1</sup>

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	9.5	7.0	4.8	3.9	3.8	3.8	3.6	3.4	3.4	3.5	3.5	3.6
Germany	3.3	3.2	2.9	2.8	2.8	2.7	2.6	2.4	2.4	2.4	2.4	2.4
Estonia	:	0.3	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.3	0.4	0.4
Ireland	5.6	2.7	1.2	1.0	1.0	1.4	2.1	3.3	3.8	4.6	3.5	4.4
Greece	11.1	7.7	4.8	4.3	4.4	4.9	5.1	5.6	6.7	7.4	6.2	7.4
Spain	4.8	3.7	2.1	1.6	1.6	1.6	1.8	1.9	2.2	2.5	2.4	2.8
France	3.4	3.1	2.7	2.5	2.7	2.9	2.4	2.5	2.6	2.9	2.7	2.8
Italy	11.3	7.3	5.0	4.7	5.0	5.2	4.6	4.5	4.8	5.1	4.8	4.9
Cyprus	:	3.1	3.4	3.3	3.0	2.8	2.5	2.2	2.4	2.4	2.4	2.4
Luxembourg	0.3	0.4	0.2	0.2	0.2	0.3	0.4	0.4	0.5	0.5	0.4	0.5
Malta	:	3.3	3.6	3.5	3.3	3.2	3.1	3.0	3.1	3.0	3.1	3.1
Netherlands	5.7	4.1	2.5	2.2	2.2	2.2	2.2	2.0	2.1	2.2	2.3	2.4
Austria	4.0	3.5	2.9	2.8	2.8	2.6	2.8	2.7	2.8	3.0	2.8	2.9
Portugal	5.6	3.1	2.6	2.6	2.9	3.0	2.9	3.0	4.2	4.8	3.7	4.0
Slovenia	:	2.3	1.8	1.4	1.3	1.1	1.3	1.6	1.8	2.0	1.7	1.8
Slovakia	:	3.3	2.3	1.5	1.4	1.2	1.4	1.3	1.6	1.7	1.8	2.1
Finland	4.0	3.2	1.7	1.4	1.5	1.4	1.2	1.1	1.2	1.4	1.3	1.6
Euro area	5.5	4.2	3.1	2.9	3.0	3.0	2.8	2.8	3.0	3.2	3.0	3.2
Bulgaria	:	4.7	1.9	1.3	1.2	0.9	0.8	0.6	0.8	0.9	0.8	0.9
Czech Republic	:	1.0	1.2	1.1	1.1	1.1	1.3	1.4	1.8	1.8	1.8	1.9
Denmark	6.4	4.1	2.3	1.6	1.6	1.4	1.8	1.8	1.9	2.0	1.9	1.9
Latvia	:	0.8	0.6	0.4	0.3	0.6	1.5	1.5	1.9	2.1	2.1	2.3
Lithuania	:	1.3	1.0	0.7	0.7	0.7	1.3	1.8	2.0	2.0	2.2	2.6
Hungary	:	6.6	4.1	3.9	4.1	4.1	4.6	4.0	3.8	3.8	3.8	3.7
Poland	:	3.5	2.8	2.7	2.3	2.2	2.6	2.7	2.8	2.7	2.9	3.0
Romania	:	4.2	1.5	0.8	0.7	0.7	1.5	1.6	1.8	1.8	1.9	1.8
Sweden	5.5	4.0	1.9	1.6	1.7	1.7	0.9	0.7	0.7	0.8	0.9	1.0
United Kingdom	3.1	3.0	2.0	2.0	2.2	2.3	2.0	3.0	3.1	3.4	3.0	3.2
EU	:	4.0	2.9	2.6	2.7	2.8	2.6	2.7	2.9	3.0	2.9	3.0
USA	4.7	3.8	2.7	2.7	2.9	2.7	2.5	2.8	2.9	2.9	2.8	2.8
Japan	3.6	3.4	2.6	2.4	2.5	2.5	2.6	2.6	2.7	2.7	2.8	2.8

<sup>1</sup> ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 37 : Primary balance, general government (as a percentage of GDP, 1992-2012) <sup>1 2</sup>

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	4.1	6.3	4.1	4.1	3.5	2.5	-2.3	-0.7	-0.4	-0.7	-1.1	-1.1
Germany	0.3	1.7	-0.4	1.2	3.0	2.8	-0.4	-0.9	0.4	1.2	-0.3	0.6
Estonia	:	-0.2	1.7	2.6	2.7	-2.6	-1.4	0.3	-0.4	-2.1	-1.6	-2.3
Ireland	4.0	5.0	2.4	3.9	1.1	-6.0	-12.2	-29.2	-6.8	-4.2	-6.9	-4.8
Greece	1.6	3.5	-0.9	-1.4	-2.0	-4.8	-10.3	-4.9	-2.8	-1.8	-1.2	-0.3
Spain	-0.8	1.8	2.5	3.7	3.5	-2.6	-9.4	-7.3	-4.1	-2.9	-4.1	-2.7
France	-1.5	1.0	-0.5	0.3	0.0	-0.4	-5.1	-4.5	-3.1	-2.4	-3.6	-2.9
Italy	3.0	5.1	1.4	1.3	3.5	2.5	-0.7	-0.1	0.8	1.9	0.5	1.4
Cyprus	:	-0.5	-0.4	2.1	6.4	3.7	-3.4	-3.1	-2.7	-2.5	-3.3	-3.3
Luxembourg	1.9	4.9	0.8	1.5	3.9	3.3	-0.5	-1.3	-0.5	-0.6	-0.8	-0.8
Malta	:	-4.3	-1.6	0.8	1.0	-1.4	-0.6	-0.6	0.0	0.1	0.2	-0.2
Netherlands	2.4	4.1	1.1	2.7	2.4	2.8	-3.3	-3.4	-1.6	-0.1	-1.7	-0.4
Austria	-0.1	1.9	0.9	1.2	1.9	1.7	-1.3	-2.0	-0.9	-0.3	-0.8	-0.4
Portugal	1.0	-0.3	-1.3	-1.4	-0.2	-0.5	-7.2	-6.1	-1.7	0.3	-1.2	-1.1
Slovenia	:	-0.8	-0.3	0.0	1.2	-0.7	-4.6	-4.0	-4.1	-3.1	-3.6	-2.9
Slovakia	:	-4.3	-1.6	-1.7	-0.4	-0.8	-6.5	-6.6	-3.6	-2.9	-3.5	-3.0
Finland	-1.8	5.9	4.8	5.5	6.7	5.6	-1.5	-1.4	0.2	0.7	-0.3	0.4
Euro area	0.6	2.6	0.6	1.5	2.3	1.0	-3.5	-3.2	-1.3	-0.4	-1.6	-0.8
Bulgaria	:	5.2	2.5	3.2	2.3	2.5	-3.9	-2.6	-1.9	-0.7	-2.1	-1.0
Czech Republic	:	-3.3	-3.3	-1.5	0.5	-1.6	-4.5	-3.3	-2.7	-2.3	-2.8	-2.4
Denmark	3.9	5.0	4.9	6.8	6.4	4.7	-0.9	-1.0	-2.2	-1.2	-2.4	-1.5
Latvia	:	-0.6	-0.5	0.0	0.0	-3.6	-8.2	-6.2	-2.7	-1.8	-5.8	-4.9
Lithuania	:	-3.6	-0.1	0.3	-0.3	-2.6	-8.3	-5.3	-3.5	-2.8	-4.8	-4.2
Hungary	:	1.4	-3.9	-5.4	-0.9	0.5	0.1	-0.1	5.5	0.5	-1.0	-2.5
Poland	:	-0.4	-2.0	-1.0	0.4	-1.5	-4.7	-5.2	-3.0	-0.9	-3.7	-3.0
Romania	:	0.1	-0.1	-1.4	-1.9	-5.0	-7.0	-4.9	-2.9	-1.8	-2.9	-1.6
Sweden	-2.2	5.0	2.5	3.9	5.3	3.9	0.2	0.7	1.6	2.8	0.9	2.0
United Kingdom	-2.9	3.5	-1.0	-0.7	-0.5	-2.7	-9.4	-7.4	-5.5	-3.6	-5.6	-3.3
EU	:	2.6	0.4	1.2	1.8	0.4	-4.2	-3.7	-1.8	-0.8	-2.2	-1.2
USA	0.5	4.1	-1.0	0.7	0.1	-3.5	-8.7	-8.4	-7.1	-5.7	-6.1	-5.1
Japan	1.1	-3.9	-3.5	0.8	0.1	0.4	-6.1	-6.6	-7.0	-7.1	-3.6	-3.6

<sup>1</sup> ESA 79 up to 1994, ESA 95 from 1995 onwards.<sup>2</sup> Net lending/borrowing excluding interest expenditure.

TABLE 38 : Cyclically-adjusted net lending (+) or net borrowing (-), general government (as a percentage of GDP, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-5.2	-1.3	-0.9	-0.6	-1.4	-1.8	-4.2	-2.8	-2.9	-3.7	-3.7	-4.1
Germany	-3.4	-1.9	-2.7	-1.6	-0.5	-0.5	-0.8	-2.2	-1.4	-0.8	-2.2	-1.4
Estonia	:	0.2	-0.5	-0.8	-1.0	-3.8	1.7	2.5	0.3	-2.3	-0.7	-2.5
Ireland	-1.3	1.2	0.8	2.0	-1.8	-7.4	-12.0	-30.3	-9.2	-8.5	-9.1	-8.9
Greece	-9.5	-4.5	-5.8	-6.1	-7.5	-10.4	-14.9	-8.2	-6.1	-6.6	-4.1	-4.7
Spain	-4.6	-2.4	0.1	1.5	1.3	-4.1	-9.2	-7.0	-4.3	-3.9	-4.9	-4.8
France	-4.2	-2.7	-4.1	-3.2	-3.7	-3.4	-5.6	-5.1	-3.9	-3.7	-4.6	-4.4
Italy	-8.0	-2.6	-4.1	-4.5	-3.0	-3.2	-3.2	-2.9	-2.6	-2.2	-3.5	-3.3
Cyprus	:	-3.7	-3.7	-1.2	2.7	-0.1	-5.5	-4.6	-4.5	-4.7	-5.0	-5.4
Luxembourg	:	3.5	0.1	0.6	1.9	2.3	1.5	0.1	0.3	-0.4	0.8	0.6
Malta	:	-8.1	-4.8	-2.2	-2.1	-5.3	-2.8	-3.5	-3.0	-3.1	-2.9	-3.5
Netherlands	-2.9	-0.6	-0.6	0.6	-0.9	-0.5	-3.6	-3.8	-2.5	-1.3	-2.3	-1.5
Austria	-3.9	-2.1	-1.7	-1.9	-2.0	-2.2	-2.9	-3.7	-3.2	-2.9	-2.9	-2.9
Portugal	-4.3	-4.1	-3.5	-3.6	-3.4	-3.5	-9.1	-8.8	-4.9	-3.1	-3.8	-4.3
Slovenia	:	-3.3	-2.6	-2.8	-2.9	-4.6	-3.6	-3.0	-3.5	-3.3	-3.8	-3.8
Slovakia	:	-7.1	-3.5	-3.6	-3.6	-4.0	-7.4	-7.4	-4.8	-4.6	-5.0	-5.1
Finland	-3.8	1.4	2.6	2.7	2.6	2.5	0.7	0.2	0.8	0.7	0.4	0.6
Euro area	-4.7	-2.1	-2.6	-1.9	-1.7	-2.5	-4.3	-4.4	-3.0	-2.5	-3.5	-3.2
Bulgaria	:	:	-0.3	0.7	-0.4	-0.2	-3.4	-1.4	-1.2	-0.6	-1.4	-0.9
Czech Republic	:	-3.5	-4.4	-4.1	-2.9	-4.5	-5.1	-4.0	-3.8	-3.8	-3.9	-3.9
Denmark	-1.3	0.1	2.1	3.1	2.8	3.0	0.9	0.0	-2.2	-1.8	-2.9	-3.0
Latvia	:	-1.0	-1.8	-3.1	-4.4	-6.3	-6.6	-5.1	-3.1	-3.6	-6.5	-7.0
Lithuania	:	-3.4	-2.0	-2.1	-3.6	-5.4	-7.1	-5.1	-4.7	-4.8	-6.0	-6.5
Hungary	:	-5.0	-8.9	-10.9	-6.1	-4.5	-2.0	-2.1	2.7	-3.3	-3.7	-6.2
Poland	:	-4.1	-4.7	-4.1	-2.9	-4.6	-7.1	-7.4	-5.3	-3.1	-6.1	-5.5
Romania	:	-2.3	-2.3	-4.3	-4.9	-8.7	-8.3	-5.2	-3.3	-2.8	-3.5	-2.6
Sweden	-5.5	1.2	-0.2	0.4	1.4	1.7	2.6	1.4	1.3	2.1	0.2	1.0
United Kingdom	-5.6	-0.1	-3.8	-3.6	-3.8	-5.3	-9.1	-8.2	-6.5	-5.3	-6.9	-5.1
EU	:	-1.8	-2.8	-2.2	-2.0	-2.9	-4.8	-4.7	-3.3	-2.8	-3.9	-3.4

TABLE 39 : Cyclically-adjusted primary balance, general government (as a percentage of GDP, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	4.3	5.7	3.9	3.4	2.4	2.0	-0.6	0.6	0.5	-0.3	-0.2	-0.5
Germany	-0.1	1.3	0.2	1.2	2.3	2.2	1.8	0.1	0.9	1.6	0.2	1.1
Estonia	:	0.5	-0.3	-0.6	-0.9	-3.6	2.0	2.6	0.5	-2.0	-0.3	-2.0
Ireland	4.4	3.9	1.9	3.0	-0.8	-6.0	-9.9	-27.0	-5.4	-3.9	-5.6	-4.6
Greece	1.6	3.2	-1.0	-1.8	-3.1	-5.5	-9.8	-2.7	0.6	0.8	2.1	2.6
Spain	0.2	1.4	2.2	3.2	2.9	-2.5	-7.4	-5.1	-2.1	-1.4	-2.5	-2.0
France	-0.8	0.4	-1.4	-0.7	-1.1	-0.6	-3.2	-2.6	-1.3	-0.8	-2.0	-1.5
Italy	3.3	4.7	0.9	0.2	2.0	2.0	1.4	1.6	2.2	2.9	1.3	1.6
Cyprus	:	-0.6	-0.3	2.1	5.7	2.7	-3.0	-2.4	-2.1	-2.3	-2.6	-3.0
Luxembourg	:	3.8	0.3	0.8	2.1	2.6	1.9	0.5	0.8	0.1	1.2	1.1
Malta	:	-4.8	-1.2	1.4	1.2	-2.1	0.3	-0.5	0.1	0.0	0.2	-0.4
Netherlands	2.8	3.5	1.9	2.7	1.3	1.7	-1.4	-1.9	-0.4	0.9	0.0	0.9
Austria	0.1	1.4	1.2	0.8	0.7	0.4	-0.1	-1.0	-0.4	0.0	-0.1	-0.1
Portugal	1.3	-1.1	-0.9	-1.0	-0.5	-0.5	-6.2	-5.8	-0.7	1.7	-0.1	-0.3
Slovenia	:	-0.9	-0.9	-1.4	-1.6	-3.5	-2.2	-1.4	-1.7	-1.3	-2.1	-2.0
Slovakia	:	-3.8	-1.2	-2.1	-2.2	-2.8	-5.9	-6.1	-3.2	-3.0	-3.2	-3.0
Finland	0.2	4.6	4.3	4.1	4.1	3.9	1.8	1.3	2.0	2.1	1.7	2.2
Euro area	0.9	2.1	0.5	1.0	1.2	0.5	-1.5	-1.6	0.0	0.6	-0.5	0.0
Bulgaria	:	:	1.6	2.0	0.8	0.6	-2.6	-0.8	-0.4	0.3	-0.6	0.0
Czech Republic	:	-2.4	-3.3	-3.0	-1.8	-3.4	-3.8	-2.6	-2.0	-2.0	-2.1	-2.1
Denmark	5.1	4.2	4.4	4.7	4.4	4.4	2.7	1.7	-0.3	0.2	-1.1	-1.0
Latvia	:	-0.2	-1.2	-2.6	-4.1	-5.7	-5.1	-3.6	-1.2	-1.5	-4.4	-4.7
Lithuania	:	-2.1	-1.0	-1.4	-2.9	-4.8	-5.9	-3.3	-2.7	-2.8	-3.8	-3.9
Hungary	:	1.6	-4.8	-7.0	-2.0	-0.4	2.6	2.0	6.5	0.4	0.0	-2.5
Poland	:	-0.5	-1.9	-1.4	-0.6	-2.4	-4.4	-4.7	-2.6	-0.3	-3.2	-2.5
Romania	:	1.9	-0.8	-3.4	-4.2	-8.0	-6.7	-3.7	-1.5	-1.0	-1.5	-0.7
Sweden	0.0	5.2	1.7	2.0	3.1	3.3	3.6	2.1	2.0	2.9	1.1	2.0
United Kingdom	-2.5	2.9	-1.8	-1.6	-1.6	-3.0	-7.1	-5.2	-3.5	-1.9	-3.8	-2.0
EU	:	2.2	0.1	0.4	0.7	-0.1	-2.2	-2.0	-0.5	0.3	-1.0	-0.4

TABLE 40 : Gross debt, general government (as a percentage of GDP, 2003-2012)

								Spring 2011 forecast			Autumn 2010 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	98.5	94.2	92.1	88.1	84.2	89.6	96.2	96.8	97.0	97.5	100.5	102.1
Germany	63.9	65.8	68.0	67.6	64.9	66.3	73.5	83.2	82.4	81.1	75.9	75.2
Estonia	5.6	5.0	4.6	4.4	3.7	4.6	7.2	6.6	6.1	6.9	9.5	11.7
Ireland	30.9	29.6	27.4	24.8	25.0	44.4	65.6	96.2	112.0	117.9	107.0	114.3
Greece	97.4	98.9	100.3	106.1	105.4	110.7	127.1	142.8	157.7	166.1	150.2	156.0
Spain	48.7	46.2	43.0	39.6	36.1	39.8	53.3	60.1	68.1	71.0	69.7	73.0
France	62.9	64.9	66.4	63.7	63.9	67.7	78.3	81.7	84.7	86.8	86.8	89.8
Italy	104.4	103.9	105.9	106.6	103.6	106.3	116.1	119.0	120.3	119.8	120.2	119.9
Cyprus	68.9	70.2	69.1	64.6	58.3	48.3	58.0	60.8	62.3	64.3	65.2	68.4
Luxembourg	6.1	6.3	6.1	6.7	6.7	13.6	14.6	18.4	17.2	19.0	19.6	20.9
Malta	69.3	72.4	69.6	64.2	62.0	61.5	67.6	68.0	68.0	67.9	70.8	70.9
Netherlands	52.0	52.4	51.8	47.4	45.3	58.2	60.8	62.7	63.9	64.0	66.6	67.3
Austria	65.5	64.8	63.9	62.1	60.7	63.8	69.6	72.3	73.8	75.4	72.0	73.3
Portugal	55.9	57.6	62.8	63.9	68.3	71.6	83.0	93.0	101.7	107.4	88.8	92.4
Slovenia	27.3	27.4	26.7	26.4	23.1	21.9	35.2	38.0	42.8	46.0	44.8	47.6
Slovakia	42.4	41.5	34.2	30.5	29.6	27.8	35.4	41.0	44.8	46.8	45.1	47.4
Finland	44.5	44.4	41.7	39.7	35.2	34.1	43.8	48.4	50.6	52.2	51.1	53.0
Euro area (a)	69.0	69.4	70.0	68.4	66.2	69.9	79.3	85.4	87.7	88.5	86.5	87.8
Bulgaria	44.4	37.0	27.5	21.6	17.2	13.7	14.6	16.2	18.0	18.6	20.2	20.8
Czech Republic	29.8	30.1	29.7	29.4	29.0	30.0	35.3	38.5	41.3	42.9	43.1	45.2
Denmark	47.2	45.1	37.8	32.1	27.5	34.5	41.8	43.6	45.3	47.1	47.5	49.2
Latvia	14.6	14.9	12.4	10.7	9.0	19.7	36.7	44.7	48.2	49.4	51.9	56.6
Lithuania	21.1	19.4	18.4	18.0	16.9	15.6	29.5	38.2	40.7	43.6	42.8	48.3
Hungary	58.3	59.1	61.8	65.7	66.1	72.3	78.4	80.2	75.2	72.7	80.1	81.6
Poland	47.1	45.7	47.1	47.7	45.0	47.1	50.9	55.0	55.4	55.1	57.2	59.6
Romania	21.5	18.7	15.8	12.4	12.6	13.4	23.6	30.8	33.7	34.8	33.4	34.1
Sweden	51.7	50.3	50.4	45.0	40.2	38.8	42.8	39.8	36.5	33.4	38.9	37.5
United Kingdom	39.0	40.9	42.5	43.4	44.5	54.4	69.6	80.0	84.2	87.9	83.5	86.6
EU (a)	61.8	62.2	62.8	61.5	59.0	62.3	74.4	80.2	82.3	83.3	81.8	83.3

(a) Unconsolidated general government debt. For 2010, this implies a debt ratio, which is 0.3 pp. higher for the euro area (0.2 pp. higher for the EU) than the consolidated general government debt ratio (i.e. corrected for the intergovernmental loans) published by Eurostat on April 26, 2011.

TABLE 41 : Gross national saving (as a percentage of GDP, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	24.8	25.9	25.2	25.8	26.7	25.1	22.2	22.5	22.3	22.5	23.1	23.4
Germany	21.2	20.3	21.4	24.2	26.0	25.2	21.5	22.6	22.9	23.2	23.0	23.3
Estonia	:	21.8	22.4	23.0	22.0	20.6	24.5	25.9	26.4	25.9	24.9	24.9
Ireland	18.6	23.5	23.0	24.8	21.7	16.4	11.5	10.1	11.5	12.1	11.8	12.7
Greece	18.5	14.0	10.1	7.7	6.3	4.2	2.1	2.8	3.4	5.8	5.1	6.7
Spain	20.6	22.3	22.5	22.0	21.0	19.4	18.9	18.5	18.2	18.6	18.4	18.8
France	18.9	21.1	19.1	19.3	20.0	19.3	16.1	15.3	15.5	16.2	16.3	16.5
Italy	20.6	21.3	20.0	19.6	20.1	18.0	15.9	16.0	17.0	17.6	17.0	17.7
Cyprus	:	16.7	14.4	13.5	10.8	7.2	9.4	9.6	9.2	9.3	9.1	8.5
Luxembourg	35.0	33.4	32.3	30.7	31.0	25.5	23.2	24.1	25.2	25.3	24.5	25.0
Malta	:	14.2	12.1	11.1	16.5	14.8	9.2	12.3	13.4	14.1	13.4	14.3
Netherlands	25.9	27.1	26.9	29.0	28.8	25.7	21.8	24.9	26.1	26.9	25.1	26.6
Austria	22.1	23.1	24.9	25.6	27.2	26.9	23.8	24.4	24.8	25.4	24.4	25.1
Portugal	19.4	19.1	15.1	12.4	12.7	10.6	9.2	9.2	10.3	11.5	10.9	12.0
Slovenia	23.5	24.3	25.2	26.5	27.2	25.2	21.7	22.1	22.0	22.0	23.0	23.2
Slovakia	:	23.7	19.9	19.7	22.1	20.7	16.4	20.2	20.8	21.4	21.6	22.2
Finland	17.8	26.5	26.0	25.9	27.1	25.2	20.6	21.7	22.1	22.7	20.1	20.3
Euro area	20.9	21.6	21.1	21.9	22.5	21.1	18.2	18.7	19.1	19.7	19.3	19.8
Bulgaria	:	:	16.0	14.5	8.8	14.4	20.4	23.4	23.8	24.0	20.6	20.9
Czech Republic	28.1	24.9	22.7	24.7	24.4	24.5	20.5	20.0	20.5	21.2	21.6	22.1
Denmark	19.9	22.0	24.0	25.7	24.7	24.5	20.7	21.4	21.5	21.5	21.9	21.8
Latvia	31.2	16.6	20.0	17.2	18.1	18.1	28.9	24.3	21.3	21.4	21.0	20.7
Lithuania	:	13.1	15.7	16.0	15.8	13.7	13.3	17.7	18.5	19.4	15.9	16.3
Hungary	:	21.9	16.9	16.3	16.4	16.8	18.8	20.1	20.1	20.8	20.8	20.6
Poland	17.2	19.9	17.1	18.0	19.4	19.1	18.2	17.3	17.7	18.1	19.1	19.8
Romania	22.0	13.7	17.2	15.9	17.4	19.8	21.1	22.3	22.2	22.8	20.3	21.4
Sweden	17.6	22.3	24.3	26.6	28.9	29.1	23.0	24.6	25.6	25.9	25.8	25.9
United Kingdom	15.2	16.2	14.8	14.1	15.6	15.0	11.7	12.1	13.0	14.2	13.4	15.3
EU	:	21.0	20.1	20.6	21.4	20.4	17.6	18.0	18.5	19.1	18.7	19.4
USA	15.0	17.7	14.5	15.8	13.9	11.9	10.3	12.7	12.1	12.6	12.9	13.3
Japan	31.6	28.5	26.7	27.7	28.5	26.8	23.0	23.7	22.2	22.3	24.3	23.9

TABLE 42 : Gross saving, private sector (as a percentage of GDP, 1992-2012) <sup>1</sup>

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	28.0	24.1	23.7	23.8	24.9	24.3	25.3	24.5	23.9	24.4	25.4	25.7
Germany	20.8	19.6	22.2	23.6	23.5	22.8	22.0	23.3	22.7	22.4	23.4	23.0
Estonia	:	17.7	16.6	16.2	14.4	17.4	22.3	24.0	23.7	23.3	22.9	23.2
Ireland	18.6	18.1	18.5	18.7	17.5	17.7	19.1	18.5	18.8	18.0	18.9	19.1
Greece	24.6	14.5	12.4	11.2	10.5	10.6	14.1	11.2	10.8	13.9	11.1	13.5
Spain	21.8	20.1	17.8	15.6	14.1	18.4	24.1	22.8	20.6	20.2	20.7	20.5
France	20.0	19.7	18.9	18.0	18.9	18.7	19.5	18.7	18.3	18.7	18.7	18.6
Italy	25.6	20.5	20.1	18.3	17.8	17.2	18.0	17.6	18.3	18.2	18.6	18.5
Cyprus	:	16.9	14.7	11.0	3.6	2.6	10.1	9.9	9.9	9.9	10.3	9.7
Luxembourg	:	24.4	26.1	24.2	23.0	18.5	19.2	20.6	21.2	21.7	21.2	21.9
Malta	:	17.9	13.9	12.4	16.1	16.8	11.0	14.2	14.9	15.4	14.5	15.4
Netherlands	26.4	24.1	24.8	25.5	25.4	21.5	22.4	25.8	25.4	25.1	24.7	25.3
Austria	21.6	21.2	23.2	24.1	24.6	24.5	24.3	25.0	24.8	25.1	25.2	25.6
Portugal	20.7	18.5	16.8	14.1	13.3	11.8	16.1	15.7	14.7	14.8	14.4	15.7
Slovenia	:	22.9	23.0	23.7	22.5	21.5	22.2	22.8	22.4	22.7	23.3	23.2
Slovakia	:	23.6	20.0	19.9	21.5	19.8	20.1	24.4	22.7	23.2	23.8	24.2
Finland	19.8	21.0	20.4	19.8	19.6	18.6	20.2	21.4	20.4	20.7	18.9	18.8
Euro area	22.2	20.2	20.4	20.0	19.9	19.7	20.8	21.0	20.5	20.5	20.8	20.8
Bulgaria	:	:	11.8	9.2	0.5	7.8	20.3	22.6	22.7	21.6	19.4	19.0
Czech Republic	:	21.5	19.8	21.0	19.7	21.5	21.5	20.5	20.5	20.5	21.2	21.4
Denmark	20.4	19.3	19.9	18.9	18.2	19.1	21.3	21.8	23.2	22.5	24.2	23.5
Latvia	:	15.5	17.2	11.7	12.4	17.6	33.9	26.5	21.9	21.0	25.1	24.3
Lithuania	:	11.7	13.5	12.9	12.2	12.6	20.0	22.3	21.9	22.4	21.1	21.4
Hungary	:	21.5	19.3	20.3	16.9	17.0	20.5	22.4	23.0	21.9	22.8	24.1
Poland	:	19.7	17.9	17.4	16.9	17.8	20.0	20.1	18.6	17.3	20.7	20.7
Romania	:	14.2	13.9	11.6	13.3	18.8	23.9	22.9	20.3	19.9	19.9	19.6
Sweden	21.4	18.4	20.7	21.2	22.2	23.7	20.2	21.2	21.3	20.6	22.4	21.5
United Kingdom	18.6	14.5	15.6	14.3	15.9	16.7	18.3	18.8	18.5	18.4	18.8	18.8
EU	:	19.4	19.5	18.9	19.0	19.2	20.5	20.7	20.2	20.1	20.6	20.6
USA	17.1	15.3	15.7	15.6	14.1	15.1	17.8	19.3	18.9	17.6	18.6	17.5
Japan	26.6	27.7	28.4	27.6	28.2	27.2	29.2	30.7	29.8	30.0	29.1	28.8

<sup>1</sup> ESA 79 up to 1994, ESA 95 from 1995 onwards.



TABLE 43 : Savings rate of households (1992-2012) <sup>1</sup>

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	20.1	17.3	16.1	15.9	16.4	17.0	18.3	17.1	16.5	16.5	16.6	16.8
Germany	17.0	15.5	16.1	16.4	16.8	17.6	17.2	17.3	17.1	16.9	17.2	17.0
Estonia	:	4.1	-3.3	-6.3	-1.7	3.4	13.3	7.4	7.7	5.4	7.1	6.7
Ireland	:	:	8.9	8.6	6.4	9.3	16.4	18.0	18.1	16.1	15.8	15.1
Greece	:	9.1	-0.3	-1.8	4.4	-0.3	4.2	-0.2	3.2	5.0	1.3	1.0
Spain	:	11.9	11.4	11.1	10.7	13.4	18.0	13.1	11.0	11.0	14.6	13.7
France	15.0	15.3	15.5	14.8	15.2	15.1	16.0	15.9	15.3	15.7	15.7	15.7
Italy	23.3	16.6	16.0	15.2	14.8	15.2	14.9	13.4	13.2	13.1	14.3	14.0
Cyprus	:	10.3	10.5	10.5	7.9	6.5	9.1	:	:	:	:	:
Luxembourg	:	:	:	:	:	:	:	:	:	:	:	:
Malta	:	:	:	:	:	:	:	:	:	:	:	:
Netherlands	18.9	15.1	12.9	12.2	13.0	12.0	13.4	12.2	12.4	12.8	14.7	14.7
Austria	:	13.5	14.1	15.1	16.2	16.5	16.0	15.0	14.9	15.0	15.7	15.9
Portugal	:	10.6	9.8	8.0	7.0	7.1	10.9	9.8	10.5	11.5	9.9	10.2
Slovenia	:	13.9	16.1	17.6	15.7	15.5	15.9	15.3	14.5	14.6	15.5	15.3
Slovakia	:	11.4	6.7	5.8	7.5	6.6	8.1	9.5	8.6	8.2	7.2	6.8
Finland	11.6	8.6	8.3	6.8	7.2	7.9	11.5	11.6	9.3	8.7	10.0	9.4
Euro area	:	:	14.3	13.9	14.2	14.7	15.8	14.7	14.3	14.3	15.1	14.9
Bulgaria	:	:	-21.3	-29.2	-27.4	:	:	:	:	:	:	:
Czech Republic	:	8.9	7.8	9.4	10.7	10.1	8.9	9.1	8.8	8.3	8.3	8.0
Denmark	7.3	5.6	7.0	5.4	4.2	5.0	7.7	5.1	8.0	7.1	10.4	9.7
Latvia	5.4	1.2	1.2	-3.6	-5.0	5.0	9.4	:	:	:	:	:
Lithuania	:	5.1	2.2	1.1	-5.2	-2.2	7.8	:	:	:	:	:
Hungary	:	15.9	11.2	12.4	10.3	8.4	10.9	:	:	:	:	:
Poland	:	13.5	9.9	9.8	8.5	3.7	9.9	10.7	8.2	7.5	7.9	7.5
Romania	:	0.6	-8.7	-14.0	-11.5	-1.1	:	:	:	:	:	:
Sweden	10.7	6.9	9.5	9.4	11.6	13.9	15.5	13.5	13.8	13.8	12.4	11.2
United Kingdom	10.3	6.6	4.2	3.4	2.6	2.0	6.0	5.4	6.1	7.1	3.7	4.0
EU	:	:	11.7	11.1	10.9	11.1	13.4	13.0	12.8	12.9	13.1	12.9
USA	9.9	7.8	7.2	7.0	6.8	8.7	10.5	8.5	7.8	7.4	7.8	7.2
Japan	19.5	15.7	10.9	10.3	9.2	8.9	11.3	11.9	13.6	13.7	9.0	8.9

<sup>1</sup> ESA 79 up to 1994, ESA 95 from 1995 onwards.TABLE 44 : Gross saving, general government (as a percentage of GDP, 1992-2012) <sup>1</sup>

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	-3.3	1.8	1.5	2.0	1.8	0.8	-3.1	-2.0	-1.5	-1.9	-2.3	-2.4
Germany	0.4	0.7	-0.7	0.7	2.4	2.5	-0.5	-0.8	0.2	0.8	-0.4	0.3
Estonia	:	4.0	5.8	6.8	7.6	3.2	2.3	2.0	2.6	2.5	2.0	1.7
Ireland	0.0	5.4	4.5	6.1	4.2	-1.4	-7.7	-8.5	-7.3	-5.9	-7.1	-6.4
Greece	-6.1	-0.5	-2.3	-3.5	-4.1	-6.5	-11.9	-8.4	-7.4	-8.1	-6.0	-6.8
Spain	-1.1	2.1	4.7	6.4	6.9	1.0	-5.2	-4.3	-2.3	-1.5	-2.4	-1.7
France	-1.1	1.5	0.2	1.3	1.1	0.6	-3.4	-3.4	-2.8	-2.5	-2.4	-2.1
Italy	-5.0	0.8	-0.1	1.4	2.2	0.8	-2.1	-1.6	-1.3	-0.6	-1.5	-0.8
Cyprus	:	-0.2	-0.3	2.5	7.2	4.7	-0.7	-0.3	-0.6	-0.6	-1.2	-1.2
Luxembourg	:	9.0	6.2	6.5	8.0	7.0	4.0	3.5	4.0	3.6	3.3	3.2
Malta	:	-3.7	-1.8	-1.3	0.4	-2.0	-1.7	-2.0	-1.5	-1.4	-1.1	-1.1
Netherlands	-0.4	3.0	2.0	3.5	3.4	4.2	-0.6	-0.9	0.7	1.8	0.4	1.3
Austria	0.6	1.9	1.7	1.5	2.6	2.4	-0.5	-0.7	0.0	0.3	-0.8	-0.5
Portugal	-1.2	0.6	-1.7	-1.7	-0.6	-1.3	-7.0	-6.5	-4.3	-3.3	-3.6	-3.6
Slovenia	:	1.4	2.1	2.8	4.7	3.7	-0.5	-0.7	-0.5	-0.7	-0.3	0.0
Slovakia	:	0.2	-0.1	-0.2	0.7	1.0	-3.7	-4.2	-1.9	-1.8	-2.2	-1.9
Finland	-2.0	5.5	5.6	6.2	7.6	6.6	0.3	0.3	1.7	2.0	1.1	1.5
Euro area	-1.4	1.4	0.7	1.9	2.6	1.4	-2.6	-2.3	-1.4	-0.8	-1.5	-1.0
Bulgaria	:	4.1	4.2	5.3	8.4	6.6	0.1	0.9	1.1	2.3	1.1	1.9
Czech Republic	:	3.3	2.9	3.7	4.7	3.0	-1.0	-0.4	0.0	0.6	0.3	0.8
Denmark	-0.6	2.7	4.1	6.8	6.5	5.5	-0.6	-0.4	-1.6	-0.9	-2.3	-1.8
Latvia	:	1.0	2.8	5.5	5.7	0.5	-5.0	-2.2	-0.6	0.4	-4.1	-3.6
Lithuania	:	1.4	2.2	3.0	3.6	1.1	-6.7	-4.7	-3.4	-3.0	-5.2	-5.1
Hungary	:	0.4	-2.4	-4.0	-0.4	-0.2	-1.7	-2.3	-2.9	-1.1	-2.0	-3.5
Poland	:	0.2	-0.8	0.7	2.5	1.3	-1.8	-2.8	-0.9	0.7	-1.7	-0.9
Romania	:	-0.5	3.4	4.3	4.1	1.1	-2.8	-0.6	1.9	3.0	0.4	1.8
Sweden	-3.8	3.9	3.6	5.5	6.7	5.4	2.9	3.5	4.3	5.2	3.3	4.4
United Kingdom	-3.4	1.7	-0.8	-0.2	-0.3	-1.6	-6.6	-6.6	-5.4	-4.3	-5.4	-3.5
EU	:	1.5	0.6	1.8	2.4	1.2	-2.9	-2.7	-1.7	-1.0	-1.4	-0.6
USA	-2.0	2.4	-1.3	0.2	-0.2	-3.2	-7.5	-6.6	-6.8	-5.1	-5.7	-4.2
Japan	5.0	0.8	-1.7	0.1	0.3	-0.4	-6.2	-7.0	-7.5	-7.7	-4.8	-4.9

<sup>1</sup> ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 45 : Exports of goods and services, volume (percentage change on preceding year, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	4.0	6.3	3.9	5.1	4.4	1.7	-11.6	10.5	5.9	5.5	5.7	6.0
Germany	2.8	9.1	7.5	13.1	7.6	2.5	-14.3	14.1	7.6	6.5	6.6	6.7
Estonia	:	13.0	9.0	6.7	1.5	0.4	-18.7	21.7	16.0	6.4	6.6	6.3
Ireland	14.2	16.9	4.6	4.8	8.2	-0.8	-4.1	9.4	6.0	5.2	4.5	4.5
Greece	4.2	11.2	3.6	5.3	5.8	4.0	-20.1	3.8	10.7	6.9	5.1	6.0
Spain	10.3	8.9	3.8	6.7	6.7	-1.1	-11.6	10.3	7.0	5.8	5.5	5.6
France	5.2	8.1	2.4	4.8	2.5	-0.5	-12.4	10.5	6.7	6.6	5.9	6.2
Italy	7.7	4.3	1.4	6.2	4.6	-4.3	-18.4	9.1	6.0	5.7	5.6	5.7
Cyprus	:	6.1	1.6	3.5	6.1	-0.3	-11.3	0.6	4.1	4.3	3.5	3.8
Luxembourg	4.4	10.7	7.4	13.0	9.1	6.6	-8.2	6.3	6.8	6.5	7.6	6.1
Malta	:	4.8	2.8	9.3	3.1	1.0	-8.4	17.2	6.1	6.1	6.3	6.2
Netherlands	5.8	8.3	4.7	7.3	6.4	2.8	-7.9	10.9	6.4	6.0	6.0	6.9
Austria	3.2	9.1	6.1	7.7	8.6	1.0	-16.1	10.8	7.0	6.8	6.3	6.5
Portugal	7.5	5.9	4.4	11.6	7.6	-0.1	-11.6	8.8	6.2	5.9	5.6	6.4
Slovenia	-2.1	7.9	9.0	12.5	13.7	3.3	-17.7	7.8	6.7	6.9	5.9	7.2
Slovakia	:	10.8	11.7	21.0	14.3	3.1	-15.9	16.4	8.5	8.2	7.9	8.0
Finland	10.8	10.5	5.6	12.2	8.2	6.3	-20.1	5.1	8.5	5.5	6.1	4.8
Euro area	5.8	8.2	4.8	8.6	6.3	0.9	-13.1	11.2	6.9	6.2	6.1	6.3
Bulgaria	:	3.2	11.0	50.7	6.1	3.0	-11.2	16.2	7.7	7.1	5.6	6.2
Czech Republic	9.7	10.3	11.3	15.8	15.0	6.0	-10.8	18.0	9.8	10.3	7.3	7.6
Denmark	3.4	7.2	4.5	9.0	2.8	2.8	-9.7	3.6	4.7	4.3	5.0	5.6
Latvia	:	5.8	9.2	6.5	10.0	2.0	-14.1	10.3	8.6	6.6	6.0	6.4
Lithuania	:	6.7	11.9	12.0	3.0	11.6	-12.7	17.4	11.2	7.1	6.3	6.6
Hungary	11.5	15.2	10.9	18.6	16.2	5.7	-9.6	14.1	9.6	9.2	9.0	10.0
Poland	12.2	9.7	11.0	14.6	9.1	7.1	-6.8	10.2	7.7	7.6	6.9	7.7
Romania	11.2	11.1	11.6	10.4	7.8	8.3	-5.3	13.1	8.4	7.3	6.0	6.1
Sweden	7.8	8.3	6.3	9.0	5.7	1.7	-13.4	10.7	7.6	5.1	6.9	5.9
United Kingdom	7.2	5.4	5.3	11.1	-2.6	1.0	-10.1	5.3	8.9	7.5	8.3	8.9
EU	7.0	7.9	5.3	9.4	5.5	1.5	-12.4	10.6	7.3	6.5	6.4	6.6
USA	7.4	4.1	4.9	9.0	9.3	6.0	-9.5	11.9	7.8	9.3	8.4	7.4
Japan	3.7	2.9	9.4	9.7	8.4	1.6	-23.9	24.2	1.0	3.8	4.8	5.1

TABLE 46 : Imports of goods and services, volume (percentage change on preceding year, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	4.0	5.8	3.7	4.6	4.7	3.0	-11.1	8.4	5.4	5.5	5.5	6.1
Germany	3.2	7.5	5.9	11.9	5.0	3.3	-9.4	12.6	7.5	7.2	7.2	7.6
Estonia	:	12.4	12.2	13.3	7.8	-7.0	-32.6	21.0	16.9	7.1	6.6	6.2
Ireland	12.0	16.8	4.8	6.4	7.8	-2.9	-9.7	6.6	3.2	4.0	0.9	2.5
Greece	3.8	10.8	3.0	9.7	9.9	4.0	-18.6	-4.8	-8.4	-3.1	-6.4	-1.5
Spain	6.4	11.4	7.5	10.2	8.0	-5.3	-17.8	5.4	1.7	3.8	1.4	4.5
France	3.2	8.6	4.3	5.6	5.6	0.6	-10.7	8.2	6.8	7.5	5.7	5.7
Italy	2.1	7.0	2.7	5.9	3.8	-4.4	-13.7	10.5	4.6	5.1	4.3	4.6
Cyprus	:	4.7	4.0	6.7	13.3	8.1	-19.3	3.1	2.2	2.5	2.1	2.4
Luxembourg	3.6	11.1	7.2	12.8	9.3	8.5	-10.2	6.7	8.0	7.0	8.8	6.7
Malta	:	2.4	3.7	9.7	1.6	-1.1	-11.1	12.6	6.4	5.6	6.5	6.3
Netherlands	5.5	8.9	4.4	8.8	5.6	3.4	-8.5	10.5	5.8	6.1	5.2	6.9
Austria	3.3	6.7	5.1	5.4	7.0	-0.9	-14.4	9.2	5.9	6.3	5.6	5.5
Portugal	7.0	8.0	3.2	7.2	5.5	2.3	-10.6	5.2	-5.3	-2.8	-3.2	1.5
Slovenia	3.1	7.7	8.7	12.2	16.7	3.8	-19.7	6.6	5.2	6.1	5.0	6.5
Slovakia	:	9.6	10.0	17.8	9.2	3.1	-18.6	14.9	5.9	7.3	6.6	7.2
Finland	6.0	8.4	6.6	7.9	7.0	6.5	-17.6	2.6	7.2	5.1	5.8	4.8
Euro area	3.9	8.3	4.9	8.5	5.8	0.8	-11.9	9.3	5.4	5.9	5.1	5.9
Bulgaria	:	11.5	14.1	47.7	9.6	4.2	-21.0	4.5	7.0	6.8	4.9	5.8
Czech Republic	20.1	9.8	9.9	14.3	14.3	4.7	-10.6	18.0	8.4	9.7	6.3	7.0
Denmark	4.3	7.2	7.5	13.4	4.3	2.7	-12.5	2.9	5.0	4.9	5.3	5.9
Latvia	:	7.3	13.6	19.4	14.7	-11.2	-33.5	8.6	8.6	7.7	6.0	8.5
Lithuania	:	7.5	14.6	13.7	10.7	10.3	-28.4	17.9	12.0	8.0	8.1	8.4
Hungary	11.9	16.0	10.4	14.8	13.3	5.8	-14.6	12.0	9.3	8.6	9.5	10.6
Poland	15.3	9.7	9.9	17.3	13.7	8.0	-12.4	10.7	8.5	7.5	7.5	8.2
Romania	8.1	13.1	17.8	22.6	27.3	7.9	-20.9	11.6	6.6	8.1	6.4	8.3
Sweden	4.5	7.6	5.0	9.0	9.0	3.5	-13.7	12.7	7.3	5.0	7.7	6.1
United Kingdom	6.2	8.1	6.0	9.1	-0.8	-1.2	-11.9	8.5	4.0	2.5	5.7	5.2
EU	5.4	8.4	5.6	9.4	5.7	1.1	-12.3	9.5	5.6	5.7	5.4	6.1
USA	8.8	9.2	6.2	6.1	2.7	-2.6	-13.8	12.7	6.7	9.3	8.0	6.9
Japan	6.5	1.3	4.6	4.2	1.6	0.4	-15.3	9.3	4.5	3.7	5.4	4.3

TABLE 47 : Merchandise trade balance (fob-fob, as a percentage of GDP, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	3.1	3.0	3.4	2.0	1.6	-1.6	0.1	1.0	0.7	0.5	-0.2	-0.3
Germany	2.2	3.6	6.7	7.0	8.2	7.3	5.6	6.1	5.8	5.7	6.0	5.8
Estonia	:	-16.6	-15.7	-17.3	-17.2	-12.2	-3.9	-2.6	-2.6	-3.0	-4.1	-4.1
Ireland	16.5	23.9	20.6	13.2	10.5	13.2	20.3	24.2	27.1	28.6	25.1	26.7
Greece	-12.0	-15.4	-18.1	-17.9	-19.5	-20.4	-16.3	-14.2	-13.0	-12.3	-11.1	-10.3
Spain	-3.3	-4.6	-6.5	-8.4	-8.6	-7.8	-4.2	-4.4	-4.2	-4.0	-3.5	-3.2
France	0.6	1.0	-0.5	-1.5	-2.1	-2.8	-2.2	-2.6	-3.1	-3.3	-3.0	-3.0
Italy	2.7	2.1	0.4	-0.7	0.2	-0.1	0.1	-1.3	-1.5	-1.3	-0.3	0.0
Cyprus	:	-24.6	-25.8	-27.2	-29.7	-31.9	-25.0	-26.7	-27.0	-27.2	-24.3	-24.4
Luxembourg	-10.2	-12.7	-10.5	-9.6	-8.8	-10.4	-7.7	-8.1	-9.2	-9.4	-12.8	-14.3
Malta	-22.4	-17.6	-14.8	-19.1	-18.0	-21.1	-16.6	-14.9	-16.0	-15.8	-14.9	-15.2
Netherlands	5.0	5.3	7.2	7.7	7.6	7.3	6.7	7.4	8.3	8.7	7.7	8.1
Austria	-4.2	-2.2	-0.1	0.2	0.4	-0.2	-0.8	-0.8	-1.1	-1.2	-0.3	0.1
Portugal	-9.8	-10.8	-10.1	-10.9	-10.9	-12.9	-10.1	-10.0	-8.0	-5.9	-8.5	-7.6
Slovenia	-1.1	-4.4	-2.9	-3.8	-4.9	-7.2	-2.1	-2.8	-3.4	-3.3	-2.0	-1.9
Slovakia	:	-8.6	-5.2	-5.4	-1.8	-1.6	1.5	0.0	0.6	1.2	2.9	3.5
Finland	7.3	9.8	6.6	5.2	5.1	3.7	2.0	1.9	1.6	1.7	2.3	2.2
Euro area	1.1	1.5	1.5	0.6	0.8	0.2	0.6	0.7	0.6	0.7	1.0	1.1
Euro area, adjusted <sup>1</sup>	:	:	:	:	:	-0.2	0.4	0.4	0.4	0.5	:	:
Bulgaria	-2.6	-5.3	-16.8	-21.1	-23.6	-24.3	-12.0	-6.7	-7.5	-8.2	-6.5	-6.5
Czech Republic	-5.2	-5.3	-0.4	2.0	3.4	2.7	4.5	3.7	3.8	4.4	5.6	6.4
Denmark	4.1	3.7	3.4	1.1	0.1	0.2	2.6	2.9	3.1	3.1	1.9	1.5
Latvia	-7.0	-14.8	-19.7	-25.6	-23.9	-17.7	-7.1	-6.4	-6.8	-7.5	-7.8	-8.9
Lithuania	:	-11.3	-10.8	-13.9	-15.0	-13.0	-3.1	-4.3	-5.0	-5.5	-2.2	-3.2
Hungary	-5.7	-4.5	-3.3	-2.8	-0.2	-0.6	3.5	4.7	5.0	5.9	4.4	3.5
Poland	-0.1	-6.4	-2.3	-2.0	-4.0	-4.9	-1.0	-1.4	-2.2	-2.0	-2.0	-2.5
Romania	-6.3	-5.6	-8.8	-12.0	-14.3	-13.6	-5.8	-4.8	-4.9	-5.1	-4.4	-5.0
Sweden	5.0	7.1	6.4	5.7	4.6	3.6	3.2	2.4	2.5	2.3	3.3	3.0
United Kingdom	-1.8	-2.9	-5.0	-5.7	-6.4	-6.4	-5.9	-6.7	-6.1	-4.7	-6.3	-5.8
EU	-0.4	0.7	0.3	-0.6	-0.7	-1.1	-0.2	-0.3	-0.3	0.0	0.0	0.1
EU, adjusted <sup>1</sup>				-1.4	-1.2	-1.7	-0.7	-0.8	-0.7	-0.5	-0.5	-0.4
USA	-2.1	-3.6	-5.7	-6.5	-6.0	-6.0	-3.7	-4.6	-5.3	-5.6	-5.3	-5.5
Japan	2.7	2.5	2.3	1.9	2.4	0.8	0.9	1.8	0.2	-0.1	1.4	1.4

<sup>1</sup> See note 7 on concepts and sources.

TABLE 48 : Current-account balance (as a percentage of GDP, 1992-2012)

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	4.3	4.5	4.5	3.4	3.9	1.1	2.0	2.4	2.0	2.0	2.0	2.0
Germany	-1.1	-0.8	4.2	6.6	7.6	6.7	5.0	5.1	4.7	4.6	4.6	4.3
Estonia	:	-7.4	-11.8	-15.7	-17.2	-8.8	4.5	2.8	1.8	0.1	1.4	0.9
Ireland	2.6	0.5	-1.3	-3.7	-5.5	-5.6	-3.1	-0.7	1.2	1.8	1.5	2.7
Greece	-0.5	-6.7	-11.8	-12.7	-15.6	-16.3	-14.0	-11.8	-8.3	-6.1	-8.0	-6.5
Spain	-1.4	-2.4	-6.0	-9.0	-10.0	-9.6	-5.5	-4.5	-4.1	-4.1	-3.8	-3.6
France	0.5	1.9	-0.6	-1.8	-2.2	-2.7	-2.9	-3.5	-3.9	-4.2	-3.4	-3.5
Italy <sup>1</sup>	1.0	1.2	-1.0	-2.0	-1.8	-3.2	-3.0	-4.2	-3.5	-3.3	-2.7	-2.4
Cyprus	:	-1.3	-5.0	-7.2	-11.6	-17.0	-7.9	-8.9	-8.1	-7.2	-5.7	-5.4
Luxembourg	12.8	10.0	10.5	10.4	10.1	5.3	6.9	7.8	7.8	7.6	9.4	9.9
Malta	:	-6.4	-4.9	-9.3	-5.6	-5.6	-6.9	-4.1	-4.7	-4.5	-2.9	-2.2
Netherlands	4.6	4.8	7.5	9.0	8.4	4.8	3.4	6.7	7.7	8.3	6.8	7.9
Austria	-2.5	-1.4	2.4	3.3	4.0	3.7	2.6	2.6	2.6	2.8	3.5	4.1
Portugal	-5.5	-8.8	-8.9	-10.8	-10.2	-12.6	-10.7	-9.8	-7.5	-5.2	-8.0	-6.7
Slovenia	2.5	-1.8	-1.4	-2.4	-4.5	-6.8	-1.3	-1.1	-1.4	-1.9	-0.6	-0.8
Slovakia	:	-6.5	-7.5	-8.3	-5.6	-6.9	-3.2	-2.9	-2.8	-2.6	-1.9	-1.7
Finland	0.1	6.4	5.6	4.6	4.2	2.9	2.2	3.0	2.5	2.5	1.6	1.4
Euro area	0.2	0.4	0.5	0.3	0.2	-0.8	-0.6	-0.4	-0.2	-0.1	0.0	0.1
Euro area, adjusted <sup>1</sup>	:	:	:	:	:	-1.5	-0.3	-0.1	0.1	0.2	:	:
Bulgaria	-4.3	-2.3	-8.7	-17.6	-25.2	-23.2	-9.0	-1.5	-2.0	-2.6	-2.5	-2.3
Czech Republic	-2.1	-4.1	-4.4	-2.1	-2.6	-0.8	-1.2	-2.3	-2.5	-1.9	-1.5	-1.1
Denmark	1.8	1.2	3.3	3.0	1.4	2.7	3.6	5.3	5.2	5.1	4.2	4.0
Latvia	6.0	-7.3	-12.5	-22.5	-22.3	-13.1	8.6	3.6	-0.3	-1.6	-0.5	-2.9
Lithuania	:	-8.5	-7.4	-10.4	-15.1	-13.1	2.6	1.8	0.2	-0.6	1.3	1.0
Hungary	:	-6.2	-8.1	-7.7	-7.0	-6.9	-0.4	1.7	1.6	1.9	0.4	-0.4
Poland	0.6	-4.0	-2.4	-3.0	-5.1	-4.8	-2.2	-3.1	-4.1	-4.1	-3.3	-3.7
Romania	:	-5.4	-6.3	-10.6	-13.6	-11.4	-4.2	-4.2	-4.4	-4.8	-5.6	-6.2
Sweden	1.2	4.7	6.7	7.9	8.6	8.9	6.8	6.2	6.2	5.9	6.5	6.1
United Kingdom	-1.4	-1.5	-2.3	-3.4	-2.6	-1.6	-1.7	-2.5	-1.2	-0.1	-1.5	-0.2
EU	-0.2	0.0	0.0	-0.4	-0.5	-1.0	-0.6	-0.5	-0.2	0.0	-0.1	0.1
EU, adjusted <sup>1</sup>				-1.2	-1.0	-2.0	-0.9	-0.9	-0.6	-0.3	-0.5	-0.3
USA	-1.3	-3.0	-5.2	-6.0	-5.1	-4.7	-2.7	-3.3	-4.0	-4.0	-4.0	-4.2
Japan	2.4	2.5	3.5	3.9	4.8	3.2	2.8	3.6	1.4	1.1	3.7	3.7

<sup>1</sup> See note 7 on concepts and sources.

TABLE 49 : Net lending (+) or net borrowing (-) of the nation (as a percentage of GDP, 1992-2012)

2.5.2011

	5-year averages							Spring 2011 forecast			Autumn 2010 forecast	
	1992-96	1997-01	2002-06	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	4.1	4.5	4.5	3.4	3.6	0.6	1.6	2.1	1.8	1.8	1.7	1.8
Germany	-1.1	-0.7	4.2	6.6	7.7	6.7	5.0	5.1	4.7	4.6	4.6	4.3
Estonia	:	-7.0	-10.9	-13.6	-16.2	-7.7	7.8	6.6	5.4	2.4	5.4	4.6
Ireland	3.4	1.4	-1.9	-3.1	-5.6	-5.9	-3.4	-1.6	0.9	1.4	1.4	2.6
Greece	:	-5.0	-10.3	-10.4	-13.3	-14.9	-12.9	-10.1	-6.4	-4.0	-6.7	-5.1
Spain	-0.7	-1.4	-5.1	-8.4	-9.6	-9.2	-5.1	-3.9	-3.6	-3.5	-3.3	-3.1
France	0.5	2.0	-0.7	-1.8	-2.1	-2.7	-2.8	-3.2	-2.9	-2.9	-3.1	-3.0
Italy <sup>1</sup>	1.1	1.4	-0.9	-1.9	-1.7	-3.2	-2.9	-4.2	-3.5	-3.2	-2.5	-2.2
Cyprus	:	-1.3	-4.6	-7.1	-11.6	-16.9	-7.6	-8.7	-7.9	-7.1	-5.4	-5.1
Luxembourg	:	:	10.3	9.5	9.7	4.7	6.2	7.8	7.8	7.6	9.4	9.9
Malta	:	-6.0	-3.3	-6.3	-4.6	-5.1	-5.7	-2.8	-3.3	-3.0	-0.9	-0.2
Netherlands	4.2	4.6	7.2	8.7	8.2	4.4	3.1	6.0	7.1	7.7	6.5	7.7
Austria	-2.6	-1.5	2.3	3.0	4.1	3.7	2.7	1.5	1.7	2.1	3.5	4.1
Portugal	-2.9	-6.7	-7.2	-9.5	-8.9	-11.4	-9.7	-8.5	-6.0	-3.7	-6.7	-5.3
Slovenia	2.4	-1.7	-1.8	-2.8	-4.7	-6.7	-1.4	-1.1	-2.0	-1.3	-0.2	-0.2
Slovakia	:	-6.7	-7.9	-7.8	-5.2	-6.0	-2.4	-0.6	-0.7	-0.2	-0.1	0.1
Finland	0.1	6.5	5.7	4.7	4.3	3.0	2.3	3.1	2.6	2.6	1.7	1.5
Euro area	0.3	0.6	0.6	0.5	0.5	-0.6	-0.5	-0.3	0.1	0.3	0.2	0.4
Euro area, adjusted <sup>1</sup>	:	:	:	:	:	:	:	:	:	:	:	:
Bulgaria	-4.6	-2.1	-8.2	-16.9	-27.2	-22.4	-7.6	-0.8	-1.3	-1.8	-0.8	-0.6
Czech Republic	-3.0	-4.0	-4.1	-1.7	-2.0	0.3	0.6	-0.2	-0.4	-0.2	0.0	0.0
Denmark	1.8	1.4	3.3	3.0	1.4	2.7	3.5	5.0	4.9	4.8	4.2	3.9
Latvia	11.9	-7.0	-11.6	-21.3	-20.4	-11.6	11.1	5.6	3.1	1.5	1.9	-0.6
Lithuania	:	-8.5	-6.6	-8.9	-12.9	-11.2	7.0	5.8	3.9	2.9	5.4	4.9
Hungary	:	-6.0	-7.8	-7.1	-6.2	-6.0	1.3	3.7	3.2	3.9	2.1	1.3
Poland	2.4	-4.0	-2.2	-2.1	-4.1	-4.1	-1.0	-1.1	-1.0	-1.3	-0.5	-1.2
Romania	-3.8	-5.2	-5.7	-10.4	-13.0	-11.0	-3.6	-4.0	-4.2	-4.6	-5.1	-5.7
Sweden	0.8	4.3	6.6	7.3	8.5	8.7	6.6	6.1	6.1	5.8	6.4	6.0
United Kingdom	-1.3	-1.4	-2.2	-3.3	-2.4	-1.4	-1.5	-2.3	-1.0	0.1	-1.3	0.0
EU	-0.6	-0.6	-1.0	-2.2	-3.1	-3.1	-1.2	-0.3	0.2	0.4	0.2	0.5
EU, adjusted <sup>1</sup>	:	:	:	-3.0	-3.6	-4.0	-1.5	-0.6	-0.2	0.1	-0.2	0.1
USA	-2.6	-2.1	-4.7	-4.3	-5.3	-5.6	-4.0	-3.3	-4.0	-4.0	-4.0	-4.2
Japan	2.4	2.3	3.4	3.8	4.7	3.1	2.7	3.5	1.3	1.0	3.7	3.7

<sup>1</sup> See note 7 on concepts and sources.

TABLE 50 : Current-account balance (in billions of euro, 2003-2012)

								Spring 2011 forecast			Autumn 2010 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	15.4	13.0	9.8	10.9	13.2	3.8	6.8	8.4	7.4	7.8	7.3	7.7
Germany	44.5	106.5	117.3	153.6	185.9	167.0	120.0	126.6	122.9	123.7	119.7	115.4
Estonia	-1.0	-1.1	-1.1	-2.1	-2.7	-1.4	0.6	0.4	0.3	0.0	0.2	0.1
Ireland	1.2	-0.2	-4.9	-6.6	-10.4	-10.2	-4.7	-1.1	1.8	2.9	2.3	4.4
Greece	-21.2	-19.4	-20.9	-26.9	-35.3	-38.7	-32.8	-27.1	-18.6	-13.8	-18.1	-14.9
Spain	-31.6	-49.5	-67.8	-88.9	-105.3	-104.9	-58.0	-48.0	-44.5	-45.2	-40.7	-40.1
France	3.9	-9.7	-30.8	-33.0	-42.0	-52.9	-54.4	-67.3	-78.7	-87.5	-67.4	-73.7
Italy	-12.0	-7.6	-17.1	-29.5	-28.1	-50.3	-45.3	-65.0	-56.4	-54.5	-42.3	-39.1
Cyprus	-0.3	-0.7	-0.8	-1.1	-1.9	-2.9	-1.3	-1.5	-1.5	-1.4	-1.0	-1.0
Luxembourg	2.1	3.3	3.5	3.5	3.8	2.1	2.6	3.3	3.4	3.6	4.0	4.4
Malta	-0.1	-0.3	-0.4	-0.5	-0.3	-0.3	-0.4	-0.3	-0.3	-0.3	-0.2	-0.2
Netherlands	29.2	42.2	38.4	48.7	48.1	28.6	19.4	39.9	47.6	53.1	41.0	49.0
Austria	3.9	5.2	5.3	8.5	10.9	10.4	7.1	7.4	7.7	8.7	10.1	12.2
Portugal	-9.6	-12.3	-15.9	-17.2	-17.2	-21.7	-18.1	-16.9	-12.7	-8.8	-13.8	-11.8
Slovenia	-0.2	-0.7	-0.5	-0.7	-1.6	-2.5	-0.5	-0.4	-0.5	-0.7	-0.2	-0.3
Slovakia	-1.9	-2.3	-3.3	-3.7	-3.1	-4.4	-2.0	-1.9	-1.9	-1.9	-1.4	-1.3
Finland	7.4	9.6	5.5	7.7	7.6	5.3	5.1	5.4	4.8	5.0	2.9	2.7
Euro area	29.7	76.0	16.1	22.8	21.5	-73.2	-56.0	-39.5	-19.1	-9.2	2.4	13.7
Euro area, adjusted <sup>1</sup>	:	:	:	:	:	-142.4	-25.7	-9.2	11.1	21.0	:	:
Bulgaria	-1.0	-1.3	-2.7	-4.7	-7.8	-8.2	-3.3	-0.5	-0.8	-1.1	-0.9	-0.9
Czech Republic	-5.3	-4.8	-1.7	-2.4	-3.3	-1.2	-1.7	-3.4	-3.8	-3.1	-2.4	-1.7
Denmark	6.5	5.9	9.0	6.5	3.1	6.2	7.9	12.3	12.7	12.8	10.3	10.0
Latvia	-0.8	-1.4	-1.6	-3.6	-4.7	-3.0	1.6	0.6	-0.1	-0.3	-0.1	-0.6
Lithuania	-1.1	-1.4	-1.5	-2.5	-4.3	-4.2	0.7	0.5	0.1	-0.2	0.4	0.3
Hungary	-6.2	-7.8	-7.3	-6.9	-7.1	-7.4	-0.4	1.6	1.8	2.2	0.4	-0.5
Poland	-3.3	-8.4	-2.9	-8.3	-15.8	-17.3	-6.8	-10.8	-15.7	-16.9	-12.7	-15.1
Romania	-2.6	-3.5	-7.1	-10.4	-17.0	-16.0	-4.9	-5.1	-5.8	-6.8	-7.1	-8.5
Sweden	19.2	19.7	21.1	25.2	29.0	29.6	19.7	21.5	24.0	23.7	24.5	23.9
United Kingdom	-26.5	-36.7	-48.0	-65.9	-53.3	-29.9	-26.8	-42.1	-21.2	-2.0	-27.1	-3.4
EU	8.8	36.1	-26.7	-50.1	-59.8	-124.7	-69.9	-64.8	-27.9	-1.1	-12.3	17.1
EU, adjusted <sup>1</sup>	:	-35.7	-83.5	-139.6	-125.9	-254.9	-113.2	-108.1	-71.2	-44.4	-64.5	-35.0
USA	-456.3	-502.7	-595.4	-636.1	-523.4	-457.1	-273.0	-361.0	-426.5	-436.4	-435.3	-475.8
Japan	120.4	138.6	133.4	136.0	153.8	108.2	102.0	150.2	55.1	43.5	158.4	162.5

<sup>1</sup> See note 7 on concepts and sources.

TABLE 51 : Export markets (a) (percentage change on preceding year, 2003-2012)

2.5.2011

								Spring 2011 forecast			Autumn 2010 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	:	:	6.1	8.8	5.3	2.1	-10.6	10.3	6.4	6.6	6.2	6.4
Germany	:	:	6.2	8.7	6.8	2.2	-11.7	10.5	6.5	6.7	6.3	6.4
Estonia	:	:	9.7	10.0	9.3	1.8	-17.7	9.6	7.3	6.3	6.4	6.2
Ireland	:	:	5.7	8.3	4.1	1.2	-11.5	10.7	6.2	6.4	6.5	6.4
Greece	:	:	6.5	8.7	5.7	1.7	-12.4	10.4	6.2	6.5	6.3	6.3
Spain	:	:	5.6	8.3	5.0	1.9	-10.6	9.8	5.3	5.7	5.5	5.9
France	:	:	6.0	8.6	5.9	1.8	-11.1	10.3	6.0	6.3	6.1	6.4
Italy	:	:	6.7	9.2	6.6	2.7	-11.0	9.9	6.2	6.6	6.2	6.4
Cyprus	:	:	8.3	10.8	6.7	2.2	-13.6	8.1	4.6	5.0	5.0	5.6
Luxembourg	:	:	5.3	7.9	4.9	1.6	-11.2	10.1	6.0	6.1	5.8	6.1
Malta	:	:	6.4	8.6	5.2	1.8	-11.7	10.3	6.3	6.4	6.4	6.4
Netherlands	:	:	5.8	8.8	5.5	2.3	-11.2	10.4	6.3	6.4	6.2	6.4
Austria	:	:	6.0	10.0	6.8	2.8	-11.5	11.3	6.9	6.9	6.6	6.9
Portugal	:	:	6.2	8.7	5.5	0.9	-12.6	9.7	5.4	6.0	5.2	5.7
Slovenia	:	:	5.5	9.3	7.3	2.7	-13.1	9.8	6.3	6.5	6.0	6.4
Slovakia	:	:	5.9	10.8	8.3	3.2	-12.3	11.7	7.0	7.1	6.5	6.9
Finland	:	:	8.4	10.6	8.7	3.6	-12.2	11.9	7.3	6.9	7.0	6.8
Euro area (b)	:	:	6.1	8.8	6.1	2.2	-11.3	10.4	6.3	6.5	6.2	6.4
Bulgaria	:	:	6.6	9.4	8.5	2.4	-12.8	9.4	5.3	5.9	5.1	5.9
Czech Republic	:	:	6.5	10.8	7.0	3.2	-12.3	11.2	6.7	6.7	6.5	6.9
Denmark	:	:	7.0	8.8	6.4	2.4	-11.4	11.4	6.7	6.3	6.6	6.4
Latvia	:	:	9.1	11.8	8.9	3.8	-17.0	12.5	8.7	6.7	6.6	6.5
Lithuania	:	:	10.2	12.0	11.1	2.5	-16.6	11.2	8.1	6.8	6.2	6.4
Hungary	:	:	6.2	10.2	7.8	3.5	-12.5	11.0	6.5	6.7	6.2	6.6
Poland	:	:	7.3	10.5	8.0	3.5	-12.4	11.4	6.8	6.7	6.2	6.5
Romania	:	:	5.6	8.4	7.0	1.7	-12.4	10.2	6.2	6.3	5.8	6.2
Sweden	:	:	7.5	9.0	5.9	2.3	-11.9	9.7	6.2	6.1	6.1	6.1
United Kingdom	:	:	6.5	7.8	6.2	1.6	-11.1	10.5	6.3	6.9	6.1	6.2
EU (b)	:	:	6.3	8.8	6.2	2.2	-11.5	10.5	6.3	6.5	6.2	6.4
USA	:	:	6.7	8.2	7.2	3.5	-11.2	13.1	7.6	7.5	7.1	6.9
Japan	:	:	7.2	8.8	7.7	3.7	-9.0	14.8	9.1	9.1	8.6	8.1

(a) Imports of goods and services to the various markets (incl. EU-markets) weighted according to their share in country's exports of goods and services.

(b) Intra- and extra-EU trade.

TABLE 52 : Export performance (a) (percentage change on preceding year, 2003-2012)

								Spring 2011 forecast			Autumn 2010 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2011	2012
Belgium	:	:	-1.4	-3.4	-0.9	-0.4	-1.1	0.2	-0.5	-1.0	-0.5	-0.4
Germany	:	:	1.4	4.0	0.8	0.3	-2.9	3.2	1.0	-0.2	0.3	0.2
Estonia	:	:	8.1	-3.0	-7.2	-1.4	-1.2	11.2	8.3	0.1	0.2	0.2
Ireland	:	:	-0.5	-3.2	3.9	-2.0	8.3	-1.3	-0.2	-1.1	-1.9	-1.8
Greece	:	:	-3.8	-3.1	0.1	2.3	-8.8	-6.0	4.2	0.4	-1.1	-0.3
Spain	:	:	-2.9	-1.5	1.6	-2.9	-1.1	0.5	1.6	0.1	0.1	-0.3
France	:	:	-2.7	-3.5	-3.2	-2.2	-1.4	0.2	0.7	0.3	-0.2	-0.2
Italy	:	:	-5.3	-2.7	-1.9	-6.8	-8.3	-0.7	-0.2	-0.8	-0.6	-0.7
Cyprus	:	:	-3.2	-6.6	-0.6	-2.5	2.6	-6.9	-0.5	-0.7	-1.4	-1.7
Luxembourg	:	:	-0.8	4.7	4.0	4.9	3.4	-3.5	0.8	0.3	1.7	0.0
Malta	:	:	-5.5	0.7	-2.0	-0.8	3.8	6.3	-0.2	-0.3	-0.1	-0.2
Netherlands	:	:	0.2	-1.4	0.8	0.5	3.7	0.5	0.1	-0.4	-0.1	0.6
Austria	:	:	1.3	-2.1	1.7	-1.8	-5.2	-0.4	0.0	-0.1	-0.3	-0.4
Portugal	:	:	-4.0	2.7	2.0	-1.0	1.2	-0.9	0.8	-0.1	0.4	0.7
Slovenia	:	:	4.8	3.0	6.0	0.6	-5.3	-1.8	0.4	0.4	-0.1	0.8
Slovakia	:	:	3.8	9.2	5.5	-0.1	-4.2	4.3	1.4	1.0	1.3	1.0
Finland	:	:	-1.3	1.4	-0.5	2.6	-9.0	-5.7	1.1	-1.4	-0.8	-1.9
Euro area (b)	:	:	-1.0	-0.2	0.2	-1.2	-2.1	0.7	0.6	-0.3	-0.1	-0.1
Bulgaria	:	:	1.8	37.7	-2.2	0.6	1.8	6.7	2.3	1.1	0.5	0.3
Czech Republic	:	:	4.8	4.5	7.5	2.7	1.8	6.1	2.8	3.3	0.8	0.7
Denmark	:	:	1.0	0.2	-3.4	0.4	1.9	-7.0	-1.9	-1.9	-1.5	-0.8
Latvia	:	:	10.2	-4.7	1.0	-1.7	3.5	-2.0	-0.1	-0.1	-0.6	-0.1
Lithuania	:	:	6.8	0.0	-7.3	8.8	4.6	5.7	2.9	0.3	0.1	0.2
Hungary	:	:	4.8	7.7	7.8	2.2	3.4	2.8	2.9	2.3	2.6	3.2
Poland	:	:	0.6	3.7	1.0	3.4	6.4	-1.1	0.8	0.8	0.7	1.2
Romania	:	:	1.9	1.9	0.8	6.5	8.1	2.8	2.2	0.9	0.2	-0.1
Sweden	:	:	-0.8	0.0	-0.2	-0.5	-1.7	0.9	1.3	-0.9	0.8	-0.2
United Kingdom	:	:	1.3	3.0	-8.3	-0.6	1.1	-4.7	2.4	0.6	2.1	2.5
EU (b)	:	:	-0.4	0.6	-0.7	-0.7	-1.0	0.2	0.9	0.0	0.2	0.3
USA	:	:	0.0	0.7	2.0	2.4	1.9	-1.1	0.2	1.7	1.2	0.5
Japan	:	:	-0.2	0.8	0.7	-2.0	-16.4	8.2	-7.4	-4.9	-3.5	-2.8

(a) Index for exports of goods and services divided by an index for growth of markets.

(b) Intra- and extra-EU trade.

TABLE 53 : World GDP, volume (percentage change on preceding year, 2005-2012)

2.5.2011

	(a)	2005	2006	2007	2008	2009	Spring 2011 forecast			Autumn 2010 forecast	
							2010	2011	2012	2011	2012
EU	21.3	2.0	3.2	3.0	0.5	-4.2	1.8	1.8	1.9	1.7	2.0
Euro area	15.2	1.7	3.1	2.9	0.4	-4.1	1.8	1.6	1.8	1.5	1.8
Belgium	0.6	1.7	2.7	2.9	1.0	-2.8	2.2	2.4	2.2	1.8	2.0
Bulgaria	0.1	6.4	6.5	6.4	6.2	-5.5	0.2	2.8	3.7	2.6	3.8
Czech Republic	0.2	6.3	6.8	6.1	2.5	-4.1	2.3	2.0	2.9	2.3	3.1
Denmark	0.4	2.4	3.4	1.6	-1.1	-5.2	2.1	1.7	1.5	1.9	1.8
Germany	4.3	0.8	3.4	2.7	1.0	-4.7	3.6	2.6	1.9	2.2	2.0
Estonia	0.0	9.4	10.6	6.9	-5.1	-13.9	3.1	4.9	4.0	4.4	3.5
Ireland	0.3	6.0	5.3	5.6	-3.5	-7.6	-1.0	0.6	1.9	0.9	1.9
Greece	0.4	2.3	5.2	4.3	1.0	-2.0	-4.5	-3.5	1.1	-3.0	1.1
Spain	1.9	3.6	4.0	3.6	0.9	-3.7	-0.1	0.8	1.5	0.7	1.7
France	3.4	1.9	2.2	2.4	0.2	-2.6	1.6	1.8	2.0	1.6	1.8
Italy	2.7	0.7	2.0	1.5	-1.3	-5.2	1.3	1.0	1.3	1.1	1.4
Cyprus	0.0	3.9	4.1	5.1	3.6	-1.7	1.0	1.5	2.4	1.5	2.2
Latvia	0.0	10.6	12.2	10.0	-4.2	-18.0	-0.3	3.3	4.0	3.3	4.0
Lithuania	0.0	7.8	7.8	9.8	2.9	-14.7	1.3	5.0	4.7	2.8	3.2
Luxembourg	0.1	5.4	5.0	6.6	1.4	-3.6	3.5	3.4	3.8	2.8	3.2
Hungary	0.2	3.2	3.6	0.8	0.8	-6.7	1.2	2.7	2.6	2.8	3.2
Malta	0.0	4.7	2.1	4.4	5.3	-3.4	3.7	2.0	2.2	2.0	2.2
Netherlands	1.0	2.0	3.4	3.9	1.9	-3.9	1.8	1.9	1.7	1.5	1.7
Austria	0.5	2.5	3.6	3.7	2.2	-3.9	2.0	2.4	2.0	1.7	2.1
Poland	0.6	3.6	6.2	6.8	5.1	1.7	3.8	4.0	3.7	3.9	4.2
Portugal	0.3	0.8	1.4	2.4	0.0	-2.5	1.3	-2.2	-1.8	-1.0	0.8
Romania	0.2	4.2	7.9	6.3	7.3	-7.1	-1.3	1.5	3.7	1.5	3.8
Slovenia	0.1	4.5	5.9	6.9	3.7	-8.1	1.2	1.9	2.5	1.9	2.6
Slovakia	0.1	6.7	8.5	10.5	5.8	-4.8	4.0	3.5	4.4	3.0	3.9
Finland	0.3	2.9	4.4	5.3	0.9	-8.2	3.1	3.7	2.6	2.9	2.3
Sweden	0.5	3.2	4.3	3.3	-0.6	-5.3	5.5	4.2	2.5	3.3	2.3
United Kingdom	2.8	2.2	2.8	2.7	-0.1	-4.9	1.3	1.7	2.1	2.2	2.5
Candidate countries	1.4	7.9	6.7	4.8	0.9	-4.9	7.6	5.6	5.1	5.1	4.3
- Croatia	0.1	4.3	4.9	5.1	2.2	-6.0	-1.2	1.1	2.0	1.5	2.1
- Turkey	1.2	8.4	6.9	4.7	0.7	-4.8	8.9	6.1	5.5	5.5	4.5
- The former Yugoslav Republic of Macedonia	0.0	4.4	5.0	6.1	5.0	-0.9	0.7	2.5	3.3	2.2	2.5
- Iceland	0.0	7.5	4.6	6.0	1.4	-6.9	-3.5	1.5	2.5	0.7	2.1
- Montenegro	0.0	4.2	8.6	10.7	6.9	-5.7	1.2	2.4	4.0	:	:
Potential candidates	0.1	5.1	5.3	6.5	6.0	-1.6	1.9	3.2	3.7	3.4	3.7
USA	20.5	3.1	2.7	1.9	0.0	-2.7	2.9	2.6	2.7	2.1	2.5
Japan	6.0	1.9	2.0	2.4	-1.2	-6.3	3.9	0.5	1.6	1.3	1.7
Canada	1.8	3.0	2.8	2.2	0.5	-2.5	3.2	3.1	2.7	2.3	2.8
Norway	0.4	2.7	2.3	2.7	0.8	-1.4	0.4	2.7	2.5	2.1	2.2
Switzerland	0.5	2.6	3.6	3.6	1.9	-1.9	2.6	1.9	1.7	1.8	2.0
Australia	1.2	3.1	3.8	3.7	1.1	3.0	2.8	2.1	3.3	3.8	3.1
New Zealand	0.2	3.2	0.9	2.9	-1.4	-1.6	1.7	1.0	3.2	3.7	3.3
Advanced economies	53.2	2.6	3.0	2.6	0.2	-3.6	2.7	2.1	2.3	2.0	2.3
CIS	4.3	6.6	8.7	8.9	5.3	-6.8	4.5	4.7	4.5	4.1	4.2
- Russia	3.0	6.4	8.2	8.5	5.2	-7.9	4.0	4.5	4.2	3.8	4.0
- Other	1.2	7.3	10.2	9.9	5.3	-4.0	6.0	5.3	5.2	4.7	4.6
MENA	5.0	5.4	5.8	6.0	4.8	1.4	3.8	3.1	3.7	4.0	4.0
Asia	26.4	8.7	9.6	10.3	6.9	6.1	9.2	7.7	7.7	7.6	7.5
- China	13.0	11.3	12.7	14.2	9.6	9.1	10.3	9.3	9.0	9.2	8.9
- India	5.2	9.5	9.7	9.2	6.7	7.4	10.4	8.0	8.2	8.3	7.8
- Hong Kong	0.4	7.1	7.0	6.4	2.2	-2.8	6.8	6.3	5.5	6.5	8.1
- Korea	2.0	4.0	5.2	5.1	2.3	0.2	6.4	4.4	4.6	4.5	4.5
- Indonesia	1.4	5.7	5.5	6.4	6.0	4.5	6.2	6.1	6.2	6.1	6.2
Latin America	8.5	4.6	5.6	5.8	4.3	-1.7	5.9	4.2	3.9	4.0	4.2
- Brazil	2.9	3.2	4.0	6.1	5.1	-0.2	7.5	4.4	4.3	4.8	5.1
- Mexico	2.1	3.3	5.1	3.4	1.5	-6.0	5.3	4.5	4.0	3.6	4.0
Sub-Saharan Africa	2.5	5.9	6.6	7.1	5.6	2.8	5.0	5.5	6.0	5.5	6.0
Emerging and developing economies	46.8	7.2	8.2	8.7	6.0	2.8	7.3	6.2	6.2	6.1	6.1
World	100.0	4.8	5.4	5.4	2.9	-0.6	4.9	4.0	4.1	3.9	4.0
World excluding EU	78.7	5.5	6.0	6.1	3.5	0.4	5.7	4.6	4.7	4.5	4.6
World excluding euro area	84.8	5.4	5.9	5.9	3.4	0.1	5.5	4.5	4.6	4.4	4.5

(a) Relative weights in %, based on GDP (at constant prices and PPS) in 2009.



TABLE 54 : World exports of goods and services, volume (percentage change on preceding year, 2005-2012)

2.5.2011

	(a)	2005	2006	2007	2008	2009	Spring 2011 forecast			Autumn 2010 forecast	
							2010	2011	2012	2011	2012
EU (b)	38.8	5.8	9.4	5.5	1.5	-12.4	10.7	7.3	6.5	6.4	6.7
Euro area (b)	29.3	5.1	8.6	6.3	0.9	-13.1	11.2	6.9	6.2	6.1	6.3
Candidate countries	1.1	7.4	6.1	7.3	2.6	-6.3	3.4	6.2	6.6	5.8	6.0
- Croatia	0.1	3.5	5.8	3.7	2.2	-17.3	6.0	4.0	4.3	3.8	4.2
- Turkey	0.9	7.9	6.6	7.3	2.7	-5.0	2.6	6.7	7.1	6.7	7.1
- The former Yugoslav Republic of Macedonia	0.0	13.4	8.2	11.8	-6.3	-10.7	22.7	6.7	8.4	5.9	6.5
- Iceland	0.0	7.5	-4.6	17.7	7.0	7.0	0.7	2.3	3.4	2.4	3.0
- Montenegro	0.0	:	:	:	:	:	13.0	12.0	11.3	:	:
USA	10.2	6.7	9.0	9.3	6.0	-9.5	11.9	7.8	9.3	8.4	7.4
Japan	4.1	7.0	9.7	8.4	1.6	-23.9	24.2	1.0	3.8	4.8	5.1
Canada	2.5	1.9	0.6	1.2	-4.6	-14.2	6.5	7.3	7.4	6.0	7.1
Norway	1.0	1.1	0.0	2.3	1.0	-4.0	-1.4	1.8	1.9	1.6	1.5
Switzerland	1.6	7.8	10.3	9.6	3.3	-8.7	9.3	3.5	5.1	3.5	5.1
Australia	1.2	3.0	2.2	3.0	1.2	-1.1	8.9	6.2	4.5	5.5	5.8
New Zealand	0.2	-1.7	1.9	3.8	-1.2	3.3	8.0	5.9	4.7	6.1	4.7
Advanced economies	60.8	5.8	8.6	6.2	2.0	-12.1	11.2	6.7	6.6	6.4	6.5
CIS	3.3	4.1	6.6	5.1	9.9	-15.4	12.3	8.8	6.2	4.3	4.1
- Russia	2.2	6.5	7.3	6.3	0.6	-4.7	12.1	7.7	4.5	4.9	4.5
- Other	1.1	-0.8	5.1	2.6	29.1	-37.5	12.7	11.0	9.6	3.2	3.2
MENA	5.5	12.3	6.5	8.0	10.4	-12.6	2.3	4.5	5.3	4.5	4.9
Asia	23.4	11.7	12.3	19.5	5.8	-10.8	17.0	10.5	9.9	10.0	8.8
- China	8.6	15.1	16.9	36.0	5.9	-11.5	18.0	12.4	11.2	11.6	9.5
- India	1.7	20.0	20.5	7.7	16.9	-7.4	17.3	16.3	16.6	12.4	8.6
- Hong Kong	2.6	10.8	9.3	8.0	2.9	-12.4	18.3	9.9	9.8	9.5	8.8
- Korea	2.8	8.0	12.0	11.8	12.9	3.0	24.5	11.1	8.2	8.8	8.8
- Indonesia	0.9	62.9	8.1	6.7	12.2	-17.6	15.0	7.3	5.8	7.3	5.8
Latin America	5.2	8.5	7.9	6.7	2.2	-4.5	7.9	5.8	6.8	7.5	7.4
- Brazil	1.2	4.0	6.0	7.8	3.1	-3.4	13.3	7.6	8.0	9.4	8.7
- Mexico	1.6	6.0	11.2	5.6	1.1	-10.2	15.4	7.9	7.5	6.1	6.9
Sub-Saharan Africa	1.8	25.1	0.9	6.3	16.7	-33.3	13.5	7.8	8.1	7.2	6.6
Emerging and developing economies	39.2	11.4	9.9	14.4	6.8	-11.7	13.2	8.8	8.5	8.3	7.6
World	100.0	8.0	9.1	9.4	3.9	-11.9	12.0	7.5	7.4	7.2	6.9
World excluding EU	61.2	9.4	9.0	11.9	5.4	-11.7	12.8	7.7	7.9	7.6	7.1
World excluding euro area	70.7	9.2	9.4	10.8	5.1	-11.5	12.3	7.7	7.8	7.6	7.2

(a) Relative weights in %, based on exports of goods and services (at current prices and current exchange rates) in 2009.

(b) Intra- and extra-EU trade.

TABLE 55 : Export shares in EU trade (goods only - 2009)

	EU	Euro area	Candidate countries	USA	Japan	Other advanced economies	China	Rest Asia	CIS	MENA	Latin America	Sub Saharan Africa
EU	66.5	50.5	1.7	6.4	1.2	5.6	2.7	4.4	2.8	4.8	2.2	1.7
Euro area	66.5	50.3	1.7	6.1	1.2	5.5	2.9	4.5	2.6	5.0	2.3	1.7
Belgium	77.0	64.0	1.0	4.8	0.7	2.8	1.7	4.3	1.1	3.5	1.3	1.6
Bulgaria	67.9	52.1	10.7	1.7	0.3	1.8	1.2	3.5	6.1	4.5	0.6	1.7
Czech Republic	84.5	67.2	1.3	1.7	0.4	2.7	0.8	1.6	3.4	2.1	1.0	0.5
Denmark	67.3	41.9	1.1	6.3	2.2	9.4	2.4	4.0	2.0	2.5	2.0	0.6
Germany	62.2	42.9	1.7	6.6	1.4	7.1	4.8	5.2	3.3	3.9	2.4	1.2
Estonia	71.1	36.3	1.3	3.2	0.7	5.3	0.9	1.2	11.1	1.3	0.4	3.4
Ireland	60.0	41.5	0.7	20.6	2.8	5.8	2.0	3.9	0.5	1.8	1.1	0.7
Greece	66.2	45.9	8.6	4.9	0.3	3.7	0.8	2.4	3.1	7.6	1.0	1.6
Spain	70.3	58.8	1.9	3.8	0.9	3.5	1.5	2.6	1.3	7.3	5.3	1.6
France	61.6	49.1	1.6	6.4	1.6	5.3	2.4	5.6	1.9	8.3	2.4	2.9
Italy	56.7	43.5	2.8	6.4	1.4	7.4	2.5	5.2	3.3	9.5	3.2	1.7
Cyprus	74.6	57.0	0.2	1.9	0.8	1.1	0.9	4.9	3.4	10.3	0.2	1.8
Latvia	68.4	34.9	0.7	1.7	0.5	3.3	0.3	2.8	15.4	5.5	0.8	0.6
Lithuania	64.6	34.5	0.8	3.6	0.2	4.3	0.2	1.7	21.3	1.6	0.4	1.3
Luxembourg	86.8	72.4	0.8	2.3	0.2	3.6	1.0	1.3	0.9	1.7	0.8	0.5
Hungary	79.4	58.1	2.7	2.6	0.7	2.4	1.7	1.4	5.6	2.5	0.6	0.5
Malta	46.0	37.0	3.6	7.3	3.6	1.7	3.9	22.6	0.5	7.5	1.4	1.8
Netherlands	78.0	62.5	1.0	3.8	0.7	3.3	1.4	3.5	1.6	3.1	1.5	2.0
Austria	71.4	54.2	2.0	4.4	0.9	7.2	2.2	3.4	3.3	2.8	1.7	0.8
Poland	79.8	56.9	1.7	1.8	0.3	3.4	1.2	1.3	7.3	1.7	0.7	0.7
Portugal	73.9	63.8	0.9	3.7	0.4	2.2	0.8	1.1	0.5	3.3	2.9	10.2
Romania	73.1	56.8	6.3	1.6	0.4	2.6	0.9	2.2	5.8	5.5	0.9	0.7
Slovenia	74.7	57.3	9.5	1.6	0.1	1.9	0.5	1.5	6.1	3.2	0.5	0.3
Slovakia	85.8	48.9	2.2	1.2	0.2	2.0	1.6	0.8	4.7	0.9	0.5	0.3
Finland	56.0	33.6	1.4	7.1	1.7	6.4	4.4	5.3	9.6	3.7	3.1	1.4
Sweden	59.1	39.8	1.7	6.4	1.3	12.5	3.4	5.1	2.1	4.1	2.3	2.0
United Kingdom	55.3	49.4	1.1	14.2	1.5	6.9	2.4	7.0	1.3	5.8	2.0	2.5

TABLE 56 : World imports of goods and services, volume (percentage change on preceding year, 2005-2012)

2.5.2011

	(a)	2005	2006	2007	2008	2009	Spring 2011 forecast			Autumn 2010 forecast	
							2010	2011	2012	2011	2012
EU (b)	38.6	6.2	9.4	5.7	1.1	-12.3	9.7	5.6	5.7	5.4	6.1
Euro area (b)	28.9	5.8	8.5	5.8	0.8	-11.9	9.4	5.4	5.9	5.1	6.0
Candidate countries	1.2	11.4	7.3	9.9	-3.4	-15.3	12.1	5.7	4.9	6.1	4.9
- Croatia	0.2	4.2	8.3	6.2	3.3	-20.4	-1.3	2.5	4.2	4.0	4.6
- Turkey	1.0	12.2	6.9	10.7	-4.1	-14.3	14.7	6.3	5.0	6.3	5.0
- The former Yugoslav Republic of Macedonia	0.0	8.2	10.1	16.1	0.8	-11.1	10.7	6.1	7.5	5.6	6.6
- Iceland	0.0	29.3	10.4	-0.7	-18.4	-24.0	3.8	4.0	4.8	3.2	3.1
- Montenegro	0.0	:	:	:	:	:	8.7	11.4	12.4	:	:
USA	13.0	6.1	6.1	2.7	-2.6	-13.8	12.7	6.7	9.3	8.0	6.9
Japan	4.1	5.8	4.2	1.6	0.4	-15.3	9.3	4.5	3.7	5.4	4.3
Canada	2.7	7.1	4.9	5.9	1.2	-13.9	11.0	8.0	8.0	6.2	6.1
Norway	0.7	8.7	8.4	8.6	4.3	-11.4	8.7	2.4	1.0	2.4	2.3
Switzerland	1.3	6.6	6.5	6.1	0.3	-5.4	6.8	6.4	5.1	6.4	6.4
Australia	1.3	7.4	6.8	10.3	-6.6	6.1	13.7	9.5	7.5	8.1	6.6
New Zealand	0.2	5.1	0.3	7.0	1.1	-9.9	8.9	5.8	5.0	5.8	3.9
Advanced economies	63.1	6.3	8.0	5.1	0.1	-12.4	10.4	5.9	6.4	6.1	6.1
CIS	2.8	9.8	15.2	20.1	13.3	-27.8	12.8	9.5	7.8	6.2	5.7
- Russia	1.7	16.6	21.3	26.2	14.8	-30.4	11.7	7.7	7.0	7.8	7.0
- Other	1.2	0.1	6.5	11.4	11.3	-24.1	14.4	11.9	9.0	3.9	4.0
MENA	5.0	13.5	8.3	11.3	11.9	-2.7	3.1	4.4	5.5	5.8	6.5
Asia	21.9	12.7	11.4	7.2	7.9	-6.8	17.5	11.1	10.4	9.9	9.4
- China	7.4	14.8	16.1	10.3	7.1	1.4	19.4	12.3	12.0	11.6	10.8
- India	2.2	46.1	24.0	12.2	27.6	-2.8	16.9	17.2	18.4	12.3	12.6
- Hong Kong	2.6	7.5	9.2	8.3	2.2	-10.5	17.3	9.0	9.1	9.0	7.2
- Korea	2.6	5.8	9.5	9.8	6.0	-3.6	26.5	13.9	8.5	9.0	8.4
- Indonesia	0.7	24.9	-2.0	5.5	21.0	-16.8	17.4	7.2	6.4	7.0	6.3
Latin America	5.1	6.1	12.0	12.6	6.1	-17.5	20.5	8.9	9.0	9.6	8.0
- Brazil	1.2	-5.7	6.4	14.0	6.5	-12.6	31.8	12.2	10.4	12.4	8.1
- Mexico	1.7	7.4	12.5	7.3	3.3	-16.9	21.2	7.1	8.6	6.8	6.8
Sub-Saharan Africa	2.1	15.9	9.3	8.8	12.7	-18.7	13.0	7.1	8.1	5.8	3.5
Emerging and developing economies	36.9	11.8	11.2	9.6	8.8	-10.0	15.4	9.5	9.2	8.8	8.2
World	100.0	8.4	9.2	6.7	3.3	-11.5	12.2	7.3	7.4	7.1	6.9
World excluding EU	61.4	9.7	9.1	7.4	4.7	-11.0	13.8	8.3	8.5	8.1	7.3
World excluding euro area	71.1	9.4	9.5	7.2	4.3	-11.3	13.3	8.0	8.0	7.8	7.2

(a) Relative weights in %, based on imports of goods and services (at current prices and current exchange rates) in 2009.

(b) Intra- and extra-EU trade.

TABLE 57 : Import shares in EU trade (goods only - 2009)

	EU	Euro area	Candidate countries	USA	Japan	Other advanced economies	China	Rest of Asia	CIS	MENA	Latin America	Sub-Saharan Africa
EU	65.3	51.1	1.3	4.8	1.6	5.2	6.0	5.1	4.1	3.1	2.2	1.4
Euro area	65.5	51.1	1.3	4.7	1.6	4.7	5.9	4.9	3.9	3.7	2.4	1.5
Belgium	71.7	61.8	0.7	6.2	2.1	2.9	3.8	4.6	1.6	2.6	2.5	1.1
Bulgaria	63.6	45.5	7.5	1.0	0.4	1.5	2.8	1.8	17.4	1.1	2.8	0.3
Czech Republic	79.5	64.5	0.6	1.1	1.7	1.7	5.5	3.9	5.5	0.2	0.2	0.1
Denmark	72.0	47.8	1.1	3.0	0.5	8.2	6.1	5.1	1.6	0.3	1.8	0.3
Germany	66.4	47.4	1.3	4.5	2.0	6.6	6.4	5.1	3.5	1.3	1.9	1.0
Estonia	78.8	37.9	0.7	1.5	0.4	2.1	2.5	2.1	10.2	0.1	0.9	0.8
Ireland	68.5	26.2	0.6	14.7	1.2	3.8	3.7	4.8	0.2	1.0	1.1	0.5
Greece	66.1	54.0	3.3	3.6	1.4	2.4	6.4	8.5	3.0	2.7	2.0	0.6
Spain	63.9	53.4	1.2	3.2	1.0	2.8	5.4	4.4	2.4	8.2	4.6	2.9
France	70.5	59.4	1.1	4.7	1.1	4.7	4.1	3.5	2.8	4.1	1.3	1.9
Italy	59.0	47.7	2.0	3.1	1.2	4.9	6.0	4.4	6.3	9.4	2.4	1.3
Cyprus	68.7	54.0	0.8	1.5	2.2	1.4	7.4	4.8	4.0	8.0	0.9	0.3
Latvia	63.8	33.5	0.5	1.6	0.2	2.9	2.1	1.8	26.4	0.3	0.2	0.1
Lithuania	60.7	33.9	1.0	1.8	0.2	1.4	2.8	2.0	28.8	0.3	1.0	0.1
Luxembourg	75.4	71.9	0.1	3.8	0.3	0.9	16.0	2.9	0.1	0.1	0.4	0.1
Hungary	70.1	55.5	0.9	1.7	2.5	1.1	8.3	6.7	8.2	0.2	0.4	0.0
Malta	55.9	44.6	7.5	2.6	2.2	4.4	9.9	10.0	3.2	0.7	0.4	3.0
Netherlands	49.5	37.7	0.8	7.5	2.9	4.5	10.6	8.0	6.2	3.3	4.5	2.2
Austria	80.5	69.0	1.4	1.7	0.6	7.2	2.1	2.1	2.4	1.3	0.4	0.3
Poland	74.0	59.7	1.0	1.5	0.9	1.8	4.9	4.3	9.5	0.4	1.0	0.5
Portugal	78.3	70.9	0.7	1.7	0.6	2.3	2.3	2.4	1.3	3.2	3.2	4.1
Romania	74.5	53.8	4.3	1.3	0.5	1.4	4.9	3.0	7.9	1.0	1.0	0.2
Slovenia	76.1	64.1	7.2	1.4	0.4	1.7	3.0	4.7	1.1	1.6	2.6	0.2
Slovakia	77.8	40.8	0.6	0.5	0.8	0.8	3.4	7.8	7.9	0.3	0.1	0.0
Finland	64.9	39.6	0.4	2.4	1.2	3.9	5.4	3.9	15.7	0.3	1.5	0.4
Sweden	70.8	49.1	0.8	3.8	1.5	9.0	4.4	3.7	3.4	0.5	1.3	0.9
United Kingdom	54.4	47.0	1.4	9.4	2.2	9.8	7.9	7.4	1.7	2.0	2.2	1.7

TABLE 58 : World merchandise trade balances (fob-fob, in billions of US dollar, 2004-2012)

2.5.2011

							Spring 2011 forecast			Autumn 2010 forecast	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2011	2012
EU	61.6	-12.0	-86.0	-115.1	-196.9	-36.5	-58.0	-52.1	-4.2	-7.5	9.7
EU, adjusted <sup>1</sup>	-51.9	-120.6	-204.9	-212.1	-319.0	-119.4	-137.3	-137.3	-90.6	-91.7	-74.4
Euro area	164.3	109.4	66.9	101.1	30.1	80.5	80.7	84.8	105.8	130.2	148.3
Euro area, adjusted <sup>1</sup>	:	:	:	:	-33.0	52.2	53.6	55.6	76.2	:	:
Candidate countries	-34.2	-44.9	-54.9	-65.4	-71.5	-49.1	-80.0	-95.3	-106.7	-96.3	-107.3
USA	-684.7	-801.9	-860.5	-839.6	-853.7	-524.8	-670.9	-814.4	-882.6	-801.8	-855.9
Japan	128.6	93.9	81.4	104.7	39.0	43.0	101.0	8.6	-7.3	85.4	87.9
Norway	32.4	46.8	55.9	53.2	78.6	50.4	53.1	64.7	67.5	61.5	61.8
Switzerland	5.4	2.4	4.0	7.8	13.9	15.4	17.1	25.0	25.2	21.8	18.6
Advanced economies	-459.9	-680.1	-828.0	-829.7	-924.3	-509.0	-633.7	-841.0	-904.3	-727.5	-768.4
CIS	90.9	124.1	142.9	121.9	213.8	103.4	157.6	228.0	260.3	118.1	121.4
- Russia	85.8	118.5	139.6	130.9	177.8	110.7	156.9	209.5	239.6	149.3	152.9
MENA	118.5	212.0	292.8	275.1	409.7	151.0	181.8	379.5	170.0	272.7	291.7
Asia	150.3	213.1	311.1	412.5	341.4	320.6	173.9	-73.0	-27.7	259.8	276.8
- China	59.0	134.2	217.7	315.4	360.7	249.5	169.4	72.6	81.7	243.4	265.4
Latin America	58.9	81.3	100.1	71.6	47.7	58.5	39.7	56.0	20.0	78.2	63.0
Sub-Saharan Africa	22.2	37.0	47.3	49.7	62.5	20.2	65.9	100.1	87.7	53.8	75.3
Emerging and developing economies	440.9	667.5	894.1	930.8	1075.1	653.6	618.8	690.6	510.2	782.6	828.3
World	-19.0	-12.6	66.1	101.1	150.8	144.6	-14.9	-150.4	-394.1	55.2	59.9

<sup>1</sup> See note 7 on concepts and sources.

TABLE 59 : World current-account balances (in billions of US dollar, 2004-2012)

							Spring 2011 forecast			Autumn 2010 forecast	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2011	2012
EU	44.9	-33.2	-62.9	-81.9	-182.8	-97.2	-86.2	-39.9	-1.6	-17.1	23.8
EU, adjusted <sup>1</sup>	-44.4	-103.8	-175.2	-172.4	-373.8	-157.5	-143.8	-101.8	-64.4	-89.7	-48.7
Euro area	94.4	20.1	28.7	29.4	-107.4	-77.8	-52.5	-27.3	-13.4	3.3	19.0
Euro area, adjusted <sup>1</sup>	:	:	:	:	-208.8	-35.8	-12.3	15.9	30.5	:	:
Candidate countries	:	:	:	-48.2	-55.5	-19.8	-51.6	-66.0	-76.7	-60.0	-70.4
USA	-624.6	-740.5	-798.3	-716.9	-670.4	-379.7	-480.2	-609.9	-632.8	-605.1	-661.5
Japan	172.2	165.9	170.6	210.7	158.7	141.9	199.8	78.7	63.1	220.2	225.9
Norway	32.9	49.1	58.1	54.8	80.2	49.7	54.5	59.8	62.9	56.5	56.8
Switzerland	43.3	53.5	52.3	39.3	12.3	69.5	87.5	51.2	58.5	55.7	57.2
Advanced economies	:	:	:	-603.5	-711.4	-321.5	-350.1	-585.1	-607.6	-431.4	-440.3
CIS	61.6	86.4	94.3	66.4	98.8	34.6	81.2	143.8	165.9	40.3	40.7
- Russia	59.0	84.5	95.2	78.0	102.1	49.4	85.6	132.3	153.1	76.7	75.0
MENA	89.9	189.3	266.1	239.6	352.0	84.2	88.0	220.8	176.8	111.9	126.0
Asia	170.2	238.8	366.3	523.5	515.6	455.5	360.5	284.4	360.9	278.6	323.8
- China	68.7	160.8	253.3	371.8	436.1	297.1	306.1	325.0	370.0	325.0	370.0
Latin America	22.8	37.1	50.9	15.6	-26.0	-15.3	-37.2	-66.2	-114.6	-45.8	-45.9
Sub-Saharan Africa	2.4	20.8	21.0	0.0	-6.2	-21.7	12.6	39.0	20.4	-5.5	14.6
Emerging and developing economies	347.0	572.4	798.5	845.0	934.2	537.2	505.0	621.9	609.3	379.5	459.2
World	:	:	:	241.6	222.8	215.7	154.9	36.8	1.7	-51.9	18.8

<sup>1</sup> See note 7 on concepts and sources.

TABLE 60 : Primary commodity prices (in US dollar, percentage change on preceding year, 2004-2012)

SITC Classification							Spring 2011 forecast			Autumn 2010 forecast	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2011	2012
Food (0 + 1)	12.4	2.3	10.3	12.6	21.6	-11.1	11.0	19.2	-2.3	9.7	-3.6
Basic materials (2 + 4)	17.0	8.3	32.5	12.3	8.7	-23.7	40.0	28.9	-4.9	1.2	-1.6
- of which :											
Agricultures non-food	5.9	-2.4	9.1	11.3	7.7	-20.2	30.2	35.2	-10.4	-2.1	-4.2
- of which :											
Wood and pulp	13.2	3.5	8.5	0.3	3.0	-10.3	7.5	12.2	-3.9	-8.1	-4.3
Minerals and metals	32.0	20.0	53.4	12.9	9.3	-25.9	46.5	25.2	-1.5	4.0	0.4
Fuel products (3)	32.3	44.0	19.7	9.0	36.4	-36.5	28.8	45.6	-0.3	10.9	2.0
- of which :											
Crude petroleum	33.4	44.7	20.2	9.5	35.9	-37.1	29.5	46.4	-0.2	11.2	2.1
Primary commodities											
- Total excluding fuels	14.8	5.5	22.3	12.4	14.1	-18.1	26.0	24.8	-3.9	4.9	-2.5
- Total including fuels	28.1	35.8	20.1	9.6	32.4	-33.8	28.3	41.9	-0.8	9.8	1.3
Crude petroleum - price per barrel											
Brent (usd)	38.0	55.1	66.2	72.5	98.5	62.0	80.2	117.4	117.2	88.9	90.8
Brent (euro)	30.6	44.3	52.7	52.9	67.2	44.6	60.3	82.1	80.8	64.0	65.3

**Note on concepts and sources**

1. The directorate general for economic and financial affairs (DG ECFIN) produces, under its own responsibility, short-term fully-fledged economic forecasts twice a year : in the spring and in the autumn. These forecasts cover the principal macroeconomic aggregates for the Member States, the candidate countries, the European Union as a whole, the euro area and the international environment. Interim forecasts, updating the outlook for the seven largest Member States, EU and the euro area, are presented in between the fully-fledged forecasts.
  2. Data for 2010, 2011 and 2012 are forecasts.  
The source for all tables is the European Commission, unless otherwise stated.  
Historical data for the Member States are based on the European System of Accounting (ESA 1995). Most Member States have now introduced chain-linking in their national accounts to measure the development of economic aggregates in volume terms. For the USA and Japan the definitions are as in the SNA.
  3. Tables 5 and 6 on domestic demand and final demand respectively, present data including inventories.
  4. In Tables 16 and 17, the data are based on the national index for USA and Japan, and for EU Member States and aggregates prior to 1996.
  5. The potential output gap is calculated with reference to potential output as estimated via a production function, where the increase in the capital stock and the difference between actual unemployment and the NAWRU play a key role.
  6. Employment data used in tables 21-25, 27 and 31-32 are based on full-time-equivalents (FTEs), where available. Currently, Germany, Estonia, Spain, France, Italy, Hungary and the Netherlands report FTE data (taken together, these countries represent over 80% of euro-area GDP and more than 60% of EU GDP). In the absence of FTE data, employment is based on numbers of persons. In the calculation of EU and euro-area aggregates, priority is given to FTE data, as this is regarded as more representative of diverse patterns of working time.
  7. EU and euro-area data are aggregated using exchange rates. World GDP is aggregated using Purchasing Power Standards (PPS). In the tables on world trade and international payments, the aggregation is carried out on the basis of current exchange rates.
- Tables 47 - 50, 58 and 59 show also EU and euro-area "adjusted" balances. Theoretically, balances of EU and euro area vis-à-vis third countries should be identical to the sum of the balances of the individual countries in the EU or the euro area. However, intra-EU or intra-euro-area balances are non-zero because of reporting errors. The creation of the internal market in 1993 reduced border controls and formalities, and accordingly the scope and precision of intra-EU trade coverage. Typically, intra-EU imports are underestimated compared to intra-EU exports, leading to an overestimation of the surplus. For the past the "adjusted" balances are Eurostat estimates for EU and ECB estimates for the euro area. For the future, they are ECFIN's forecasts based on the extrapolation of the discrepancies observed in 2009. Break in the series for Italy in 2011 for tables 48 and 49, as the forecast incorporates the recent revision of Italy's balance of payments made by the Bank of Italy that is not yet reflected in historical National Account data.
8. With respect to the 12 RAMS (recently-acceded Member States), which are currently in a transition phase, the quality of statistical data may not always be directly comparable to most EU15 Member States.
  9. Geographical zones are defined as follows :  
Euro area :  
EA17 (BE,DE,EE,IE,EL,ES,FR,IT,CY,LU,MT,NL,AT,PT,SI,SK,FI)  
Candidate countries :  
Croatia, Turkey, the former Yugoslav Republic of Macedonia  
Iceland and Montenegro.  
Potential candidates :  
Albania, Bosnia-Herzegovina, Kosovo and Serbia.  
Advanced economies :  
EU, candidate countries, USA, Japan, Canada, Norway,  
Switzerland, Australia and New Zealand.  
MENA (Middle East and Northern Africa) :  
Algeria, Bahrain, Egypt, Iran, Iraq, Israel, Jordan, Kuwait,  
Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria,  
Tunisia, and the United Arab Emirates.  
Asia :  
All countries in that region except Japan and  
the Asian MENA countries.  
Latin America :  
All countries in that region.  
Sub-Saharan Africa :  
All countries in that region except the African MENA countries.

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