European Economic Forecast - Autumn 2011

EUROPEAN ECONOMY 6|2011
(provisional version)

Economic and Financial Affairs
DIRECTORATE-GENERAL

EUROPEAN COMMISSION

The European Economy series contains important reports and communications from the Commission to the Council and the Parliament on the economic situation and developments, such as the *European economic forecasts* and the *Public finances in EMU* report.

Unless otherwise indicated the texts are published under the responsibility of the Directorate-General for Economic and Financial Affairs of the European Commission, BU-1 3/76, B-1049 Brussels, to which enquiries other than those related to sales and subscriptions should be addressed.

More information on the European Union is available on the Internet (http://europa.eu).

ISBN 978-92-79-19317-0
doi: 10.2765/15525

European Commission
Directorate-General for Economic and Financial Affairs

COMMISSION STAFF WORKING DOCUMENT

European Economic Forecast

Autumn 2011

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EDITORIAL

The global economy is in danger zone again. This time, the euro area is the focus of concern. In spring, it looked as if Europe's sovereign-debt troubles remained contained. Moreover, there were signs of domestic demand taking over as the engine of a moderate recovery of the European economy, despite fiscal tightening and weakening global economic conditions. These hopes were dashed. Uncertainty has increased, and doubts about the future path of growth in the advanced economies have grown. Stress in the banking sector – simmering since the collapse of Lehman Brothers – escalated, and investors and consumers switched back into precautionary modus. Increased public debt concerns are weighing on bank balance sheets with negative repercussions on credit and real growth going forward, further clouding the outlook for public finances. Compared to our 2011 spring forecast, we revised down our growth projections for 2012, for both the EU, euro area and the world economy, and remain cautious in our outlook for 2013. We do not expect a recession in our baseline scenario. But the probability of a more protracted period of stagnation is high. And, given the unusually high uncertainty around key policy decisions, a deep and prolonged recession complemented by continued market turmoil cannot be excluded.

Hard to measure for economists, confidence is fundamental for the functioning of modern economies. Its nature is systemic. In normal times, savers (as well as governments and economists) have confidence in the banks' capacity to turn savings into productive investment; consumers have confidence in their future income to finance big-ticket purchases; investors have confidence in the economic conditions to bring their projects to fruition; and so on. The confidence of economic actors is based on the record of their collective experience. This includes, for instance, the evolution of returns on investment, the stability of growth, inflation, and disposable income, but also (discounted) failures of the past. It reflects both, an assessment of individual risk as well as some consensus on the level of systemic risk. In the years running up to the crisis, systemic risks were (ill-)perceived to be minimal for most advanced economies. In the wake of the global financial crisis, however, many of the basic parameters that determine our assessment of risk have started shifting. It will take time before they settle, and collective consensus on a new more stable risk map will emerge. In this world of high uncertainty it is not surprising that market sentiment is volatile and confidence is fickle.

There is no silver bullet to restore confidence at this juncture. What is needed is a bold and encompassing strategy that is implemented with a steady hand over the long haul. Policy surprises or ambiguity in ambition are not helpful. For Europe, such a strategy is being pursued with vigour. As set out in the recent Commission Communication "A roadmap to stability and growth", key elements include the restoration of fiscal sustainability in Greece; the rigorous implementation of the adjustment measures agreed with countries implementing support programmes; the strengthening of financial backstops for sovereigns; the harnessing of banks; the determined but differentiated consolidation of public finances coupled with structural reforms to boost growth and productivity; but also the strengthening of economic governance. The package agreed by the euro area Heads of State and Government on 26 October confirms that Europe will do what it takes to safeguard financial stability and restore confidence in Europe. This strategy has to be spelled out and completed, where necessary, as a matter of urgency. At the global level, we must withstand the temptations of protectionism and re-energise our collaborative efforts, as confirmed at the Cannes G20 Summit, to steer out of the danger zone again.

Marco Buti
Director General
Economic and Financial Affairs

OVERVIEW

Growth in the EU has stalled and it will take time to pick up again.

The outlook for the European economy has taken a turn for the worse. Sharply deteriorating confidence and intensified financial turmoil is affecting investment and consumption, while urgent fiscal consolidation is weighing on domestic demand and weakening global economic conditions are holding back exports. Real GDP growth in the EU is now expected to come to a standstill around the end of this year, turning negative in some Member States. Only after some quarters of zero or close-to-zero GDP growth, a gradual and feeble return of growth is projected in the second half of 2012. The uncertainty related to the sovereign-debt crisis is expected to gradually fade over the forecast horizon, provided the necessary policy measures are implemented. Nevertheless, growth is likely to be held back by more difficult financing conditions, ongoing deleveraging and sectoral adjustment. Growth will be insufficient to deliver an overall reduction of unemployment within the forecast period.

Uncertainty has increased since the summer and is now extremely high. Accordingly, the downside risks have become very strong. If left unchecked, negative interactions between debt concerns, weak banks and slowing growth are likely to lead to a relapse of the EU economy into recession.

EU growth slowed down after a strong first quarter...

At the time of the spring 2011 forecast, there were signs of a pick-up of domestic demand offering the prospect of a self-sustained recovery, even though a soft patch was expected for the second half of 2011. However, already in the second quarter, domestic demand shrivelled and net exports took again over as the remaining driver of growth. Over the summer, the outlook worsened abruptly. Concerns about the sovereign-debt crisis in euro-area Member States intensified and broadened, debt sustainability in advanced economies outside the EU also moved into investors' focus, and the global economy lost steam.

… as financial market conditions have deteriorated sharply…

The aggravation of the sovereign-debt crisis and the deteriorating outlook for the global economy triggered global financial-market turmoil amid a generalised re-assessment of risk. Equities tumbled worldwide, but most strongly in Europe. While bond yields of the euro-area Member States with vulnerable fiscal positions increased, the yields of bonds considered as safe havens fell to record lows. Uncertainty about the exposure of banks to euro-area sovereigns resulted in a freeze-up of inter-bank lending and a sharp deterioration of the banking sector's funding conditions. While the predicaments of banks differ, banks are now expected to accelerate the strengthening of their capital buffers. Although banks can refinance at the Eurosystem with lengthened maturities and full allotment, the latest bank lending survey suggests tightening credit supply conditions going forward. By now, the weakening real economy, fragile public finances and the vulnerable financial sector appear to be mutually affecting each other in a vicious circle.

… and the global economy has moved to a lower growth trajectory.

While global financial markets are affected by spillovers from the sovereign-debt crisis, the global economy is also subject to events located outside Europe. Over the summer, the recovery in the US lost steam. Going forward, high unemployment, ongoing deleveraging and fiscal policy tightening are set to weigh on US growth. Emerging market economies have moved to a more moderate growth path, but are expected to hold up quite well. Growth in Japan is projected to experience a rebound in 2012. Meanwhile, world trade has slowed down strongly and is projected to go through a soft patch in 2012 before picking up again in 2013.

The EU economy is set to stagnate for some quarters before anaemic growth gradually returns.

As a result of the domestic and external weaknesses, GDP in the EU is projected to stagnate towards the end of 2011. This deterioration of the outlook is supported by the accelerated decrease of leading indicators in recent months. GDP is expected to recover very gradually from the spring of 2012 onward, returning to modest growth later in the forecast period. This outlook for a gradual recovery is in line with an assumption of declining uncertainty and financial market stress, which is, however, conditional on appropriate policy action. To the extent it materialises, it will allow a return of domestic demand, while net exports benefit from fading impediments to the global recovery. However, the need for ongoing balance-sheet adjustment, both in the private and the public sector, the legacy of high unemployment and the negative impact of the crisis on potential growth will continue to weigh on the speed of growth going forward.

As uncertainty will weigh on domestic demand in the coming quarters …

While at the time of the spring forecast a broadening of the recovery on the back of more robust domestic demand appeared to be in the cards, domestic demand turned out to be disappointing in the second quarter of 2011. Private consumption, which has made a moderate contribution to GDP growth since the 2008-09 recession, is set to be held back by the increase in uncertainty and the worsening outlook for employment. The projected further decrease of inflation and moderate wage growth will underpin disposable income, which should support a modest pick-up of private consumption along with the expected dissipation of uncertainty from the second half of 2012 on. However, deleveraging of household debt takes time and is expected to restrain consumption over the forecast horizon. The contribution of government consumption to growth has been vanishing in 2011, and further consolidation needs point to a moderately negative impact in 2012.

The outlook for investment has darkened rapidly following the strong rebound until the first quarter of 2011. Increased uncertainty accompanied by the perspective of a slowdown is expected to lead to stalling investment. As firms adopt a wait-and-see attitude, their generally strong financial position and still good conditions for external financing will not prevent a strong slowdown in investment. Only in the later half of the forecast horizon, investment is expected to pick up again, in line with the assumption of improved confidence and strengthening export demand.

… the growth forecast for 2012 has been revised down substantially.

Expected GDP growth is revised down for the second half of this year as well as for 2012; for 2013, a return of modest growth is projected. Mostly due to the strong GDP growth in the first quarter of this year, annual GDP growth for 2011 remains close to the values projected in the spring forecast, at 1.6% in the EU and 1.5% in the euro area. Growth for 2012 is revised down substantially, by 1¼ percentage points to ½% in both the EU the euro area. For 2013, annual growth is projected at 1.5% in the EU and 1.4% in the euro area. In terms of quarterly profile, growth is expected to be nil in the fourth quarter of 2011. On account of a gradual return of confidence and abating external drag, quarterly GDP growth is then expected to slowly increase to around 0.4% in both the EU and the euro area by the fourth quarter of 2012. This modest level of quarterly growth is forecast to be maintained throughout 2013.

The debt crisis hits growth in all EU Member States…

No group of Member States will escape the expected slowdown, but growth differences will persist. Growth in the Member States that displayed the strongest growth performance in 2010-11 is forecast to decelerate faster than the EU average. Some of the drivers of recent growth differentials are fading, as countries that had been hit by banking and/or housing market crises are gradually advancing in their adjustment. However, the aggravation of the sovereign-debt crisis has led to more differentiated financing costs across Member States for governments as well as the private sector. Member States' fiscal consolidation needs continue to differ. As a result, growth differentials across Member States are likely to persist in 2012-13.

but heterogeneity won't disappear, yet.

While the confidence shock related to the sovereign-debt crisis affects Member States in a broadly similar way, differences in their growth performance are mainly related to the legacy of the credit and housing boom as well as different openness to, and orientation of, international trade. In *Germany*, investment, consumption and exports are all set to weaken strongly in the fourth quarter of 2011. However, only a temporary interruption of growth dynamics is expected until uncertainty dissipates and a robust growth momentum is resumed. In *France*, weakening corporate investment and to lesser extent softening private consumption are set to cause a marked slowdown to slightly negative GDP growth at the end of 2011. A moderate return of growth is projected in the second half of 2012. *Italy* is set to experience two quarters of slightly negative GDP growth around the turn of the year and frail growth thereafter, as domestic demand remains very subdued. The *Spanish* economy is projected to go through some quarters of stagnation in late 2011 and early 2012 before growth very gradually returns. This projection is largely driven by the technical assumption of no change in fiscal policy reflecting the absence of a 2012 budget. However, further fiscal consolidation measures are very likely after the general elections. GDP in *the Netherlands* is forecast to stagnate in the current and coming quarters as domestic demand and exports simultaneously weaken. Modest growth in the second half of 2012 and into 2013 is set to mainly rely on net exports.

Among the largest Member States outside the euro area, the *UK* economy is set to stagnate in late 2011 and the first half of 2012, mainly on account of continued weakness of household consumption, before returning to growth around potential in the later part of the forecast horizon. *Poland* is expected to experience a comparably benign slowdown around the end of 2011, mainly on account of weaker foreign demand. Domestic demand is set to remain fairly resilient, though growth is projected to be more moderate than projected in spring.

Current-account adjustment continues.

Concerning Member States' current accounts, remarkable progress has been made in reducing imbalances in many Member States, in particular in the euro area. Many of those countries with a current-account deficit in 2010 are projected to reduce their external deficit over the forecast period. In some of the surplus countries, more balanced positions are also expected

With meagre employment growth, high unemployment is set to persist, …

The recovery in the past two years has entailed only slow employment growth. While this partly reflects labour hoarding during the recession, employment growth has not been strong enough to reduce persistently high unemployment markedly. With the expected slowdown ahead, firms are set to put hiring on hold, as is already reflected in their deteriorating employment expectations. Employment growth is expected to grind to a halt in 2012, and the low level of activity is even likely to lead to a temporary decrease in hours worked. The expected pick-up of GDP growth starting in the second half of next year is too moderate to produce any strong labour market performance within the forecast horizon. Employment growth in 2013 is therefore expected to remain meagre. As a result, unemployment is not expected to fall over the forecast horizon. However, cross-country differences in labour market performance are expected to remain large.

… and the risk of labour market sclerosis has increased.

Chapter 2 of this forecast examines the labour market developments since the end of the recession in 2009 and the forces likely to shape employment and joblessness going forward. Employment started to increase in late 2010, but the overall performance of the matching process in the labour market appears to have deteriorated. As job-finding rates have remained rather low, the unemployment rate remains persistently high, average unemployment spells have lengthened and youth unemployment has surged in many countries. Related to the adjustment of the pre-crisis imbalances, the skills of those laid off do not match the skills sought for new employment creation well, so firms find it harder to fill their vacancies than the headline unemployment figure would suggest. The increase of structural unemployment has negative repercussions on growth potential. On the positive side, labour market participation has remained high despite the increase in unemployment. If this resilience of participation continues it will contribute to potential growth going forward.

Inflation is expected to stabilise below 2%.

Headline HICP inflation accelerated in the first half of 2011, mainly driven by the pass-though of high energy and food commodity prices. As commodity prices have peaked in the first half of 2011, and oil futures prices point to a gradual further decrease going forward, headline inflation is expected to gradually abate, falling back below 2% in the course of 2012. Deferred pass-through can, however, still produce some volatility in the headline figure, as evidenced by the acceleration of inflation in September 2011. Increases in indirect taxes in Member States with fiscal consolidation needs can also temporarily affect headline inflation. As for the underlying price pressures, persistent output gaps, which are expected to widen slightly in most Member States in 2012, will continue to hold back inflation, while wages are expected to grow only moderately in view of high unemployment.

2011 marks the switch from fiscal stabilisation to consolidation; yet, debt-to-GDP ratios take time to stabilise.

Fiscal deficit outcomes for 2011 are now projected at 4.7% of GDP in the EU and 4.1% in the euro area. The slight improvement compared to the spring forecast for the euro area is mainly due to additional fiscal measures in some Member States. Deficits are forecast to decrease further, albeit at a slowing pace, due to both reduced expenditure and higher revenues. For 2012, deficits are projected at 3.9% in the EU and 3.4% in the euro area. The EU's gross debt ratio is forecast to reach a peak of about 85% of GDP in 2012 and to stabilise in 2013. In the euro area, gross public debt is projected to rise over the whole forecast horizon, albeit at decreasing pace compared to the 2008-10 period, breaching 90% already in 2012.

The projected turnaround strongly depends on the appropriate policy.

The present forecast heavily relies on the assumption that policy measures to combat the sovereign-debt crisis will eventually prove effective. It is assumed that the uncertainty related to the sovereign-debt and financial-market crisis will dissipate gradually towards mid-2012, and that this will lead to a reduction of financial-market volatility and gradually release deferred investment and consumption. Indeed, many important decisions have already been taken, not least in late October 2011. They cover a large spectrum of measures to ensure or restore debt sustainability, repair the financial sector and strengthen the policy rules within EMU.

The risks to the main scenario are strongly tilted to the downside.

Against the backdrop of the high level of uncertainty, the overall balance of risks to the growth outlook is strongly tilted to the downside. Some of the risks that were identified earlier on have materialised. Since the spring forecast, the global financial market situation has deteriorated against the backdrop of a deeper and longer sovereign-debt crisis with contagion, while global demand has weakened, in turn also contributing to the weakness of financial markets. This is now reflected in the present forecast's baseline scenario. Nonetheless, serious downside risks remain. In view of the frail GDP growth expected under the main scenario, the risk of a recession is not negligible.

The main downside risks of the GDP forecast stem from fiscal sustainability, the financial industry and world trade. Ensuring fiscal sustainability remains a challenge across Europe, but also in major advanced economies outside the EU. Lack of credible progress with in addressing the sustainability challenges could lead to even stronger financial stress. The banking sector, rather than increasing capital to improve balance sheets, might resort to divestment and lending restrictions, potentially producing a credit crunch as of early 2012, which would obviously depress domestic demand. The contraction of world trade in the second quarter of 2011 – though apparently influenced by supply chain disruptions in the wake of the earthquake in Japan – is also a reminder that trade is very sensitive to global growth dynamics. A further softening of global demand could affect net exports quite substantially. Moreover, there are worrying signs of mounting protectionist pressure. Finally, there is a potential for negative dynamic interactions (feedback loops), which could alter the growth dynamics more substantially. Slower growth already affects the sovereign debtors, whose weakness weighs on the health of the financial industry. If the latter were to restrict lending more strongly than currently projected, this would depress GDP growth and fiscal revenues further.

On the upside, confidence might return faster than currently assumed, releasing the potential for an earlier-than-expected recovery of investment and private consumption. Global growth could prove more resilient than projected in the baseline scenario, due e.g. to inherent growth dynamics in emerging market economies, and provide support to EU net exports. Finally, a larger decline in commodity prices could enhance real disposable incomes and consumption.

Risks to the inflation outlook appear broadly balanced. On the one hand, a stronger-than-expected slowdown of GDP growth or a more rapid fall of commodity prices could dampen price developments further. On the other hand, a stronger rebound in the global economy or renewed unrest in oil exporting countries could exert upward pressure on prices. Finally, the exceptionally large liquidity creation by central banks in advanced economies over the past years could yet be transmitted into inflation pressures.

1. THE EU ECONOMY: A RECOVERY IN DISTRESS

The EU economy is moving in dangerous territory. The recovery has already come to a standstill and a slew of forward looking indicators paint a rather gloomy picture. Financial market turmoil is intensifying as sovereign debt and banking sector concerns are becoming increasingly interrelated. Pulled down by elevated uncertainty, business and consumer confidence is plummeting, delaying spending decisions, thereby weighing on domestic demand and economic growth. Interactions between developments in the financial sector and in confidence are impacting negatively on economic activity. And the weaker-than-expected global recovery limits the hope for relief from the external side, while the broadening of economic growth towards domestic demand is not materialising. Sluggish economic growth begets market volatility that dampens confidence further, worsens the creditworthiness of sovereigns and erodes the value of assets held by financial institutions. At the current juncture, any further bad news could amplify adverse feedback loops pushing the EU economy back into recession.

The deterioration of the economic situation in the EU is associated with developments that had been incorporated as downside risks but not in the central scenario of the spring forecast. They include mainly a substantially worse development in financial markets, including sovereign debt concerns and banking sector issues, and a weaker-than-expected global recovery. As these developments will ripple through the EU economy, significant revisions to the spring forecast are inevitable. Their size depends crucially on assumptions about responses to the sovereign debt crisis and contagion effects. Despite progress made at European summits, recent developments suggest that it will take more than a few months to cope successfully with the formidable policy challenges. Steering a course between excessive optimism and pessimism, a realistic timeline for seeing turmoil disappearing and confidence returning would span over well into next year. This timeline is assumed in the central scenario of the forecast.

The ongoing loss of growth momentum pulls parts of the EU economy into periods with contracting economic activity. The return to the recovery path is only expected for late 2012, but economic growth will remain subdued. Real GDP in the EU and the euro area is expected to grow at annual rates of 1½% this year, to slow next year to ½%, before slightly regaining momentum in 2013 (1¼-1½%). The deterioration in the growth outlook keeps unemployment rates close to current levels (9½-10%), while it helps alleviating inflationary pressures. This year, reflecting sharp increases in commodity prices in the first half of the year, inflation is expected to stay at elevated levels (2½% in the euro area, 3% in the EU). But in 2012 and 2013 inflation rates should be about a full percentage point lower in both areas.

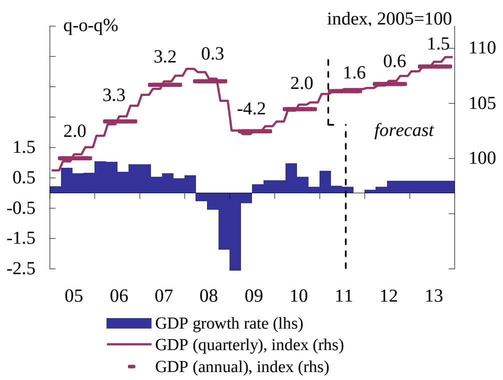
The central scenario comes along with substantial risks to the growth outlook that are considerably skewed to the downside, even more than before. By contrast, the risks to the inflation outlook appear now to be balanced.

1.1. OVERVIEW

In autumn 2011, the European economic recovery has come to a standstill, the near-term outlook is less favourable than foreseen in spring, and only in the second half of 2012 a return to subdued economic growth is expected (for an overview see Table I.1.1, for underlying assumptions Box I.1.4).

Despite short-term indicators pointing to an ongoing slowing of economic activity in the EU, the overall growth performance for this year is still relatively strong owing to a good start in the first quarter. The outlook for 2012 and 2013 is considerably less favourable (see Graph I.1.1).

Graph I.1.1: **Real GDP, EU**



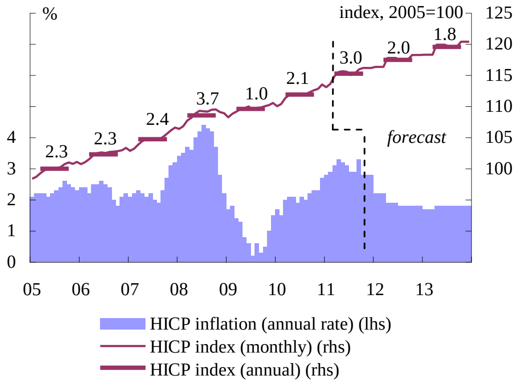
Figures above horizontal bars are annual growth rates.

At the current juncture there is evidence that the economic recovery has come to a standstill, but will in some Member States turn into stagnation or even contracting of real GDP in late 2011 and early 2012. Economic growth will only gain some modest traction in late 2012 and thereafter, but remain subdued towards the end of the forecast horizon.

Following the initial push from the extraordinary policy measures, external demand, and the inventory cycle, the recovery had shown signs of a broadening across components, but most recent data suggest that this process has come to a halt.

HICP inflation has so far been mostly driven by increases in commodity prices, but increases in indirect taxes and administered prices also contributed significantly in several Member States. As the impact of these temporary factors diminishes and against the background of slowing economic activity, HICP inflation is forecast to decline over the forecast horizon (see Graph I.1.2).

Graph I.1.2: **HICP, EU**



Figures above horizontal bars are annual inflation rates.

The balance of risks is predominantly on the downside, whereas risks to the inflation outlook are balanced.

Table I.1.1:

Overview - the autumn 2011 forecast

	Real GDP						Inflation					
		Autumn 2011 forecast			*Spring 2011 forecast*			Autumn 2011 forecast			*Spring 2011 forecast*	
	2010	2011	2012	2013	*2011*	*2012*	2010	2011	2012	2013	*2011*	*2012*
Belgium	2.3	2.2	0.9	1.5	*2.4*	*2.2*	2.3	3.5	2.0	1.9	*3.6*	*2.2*
Germany	3.7	2.9	0.8	1.5	*2.6*	*1.9*	1.2	2.4	1.7	1.8	*2.6*	*2.0*
Estonia	2.3	8.0	3.2	4.0	*4.9*	*4.0*	2.7	5.2	3.3	2.8	*4.7*	*2.8*
Ireland	-0.4	1.1	1.1	2.3	*0.6*	*1.9*	-1.6	1.1	0.7	1.2	*1.0*	*0.7*
Greece	-3.5	-5.5	-2.8	0.7	*-3.5*	*1.1*	4.7	3.0	0.8	0.8	*2.4*	*0.5*
Spain	-0.1	0.7	0.7	1.4	*0.8*	*1.5*	2.0	3.0	1.1	1.3	*3.0*	*1.4*
France	1.5	1.6	0.6	1.4	*1.8*	*2.0*	1.7	2.2	1.5	1.4	*2.2*	*1.7*
Italy	1.5	0.5	0.1	0.7	*1.0*	*1.3*	1.6	2.7	2.0	1.9	*2.6*	*1.9*
Cyprus	1.1	0.3	0.0	1.8	*1.5*	*2.4*	2.6	3.4	2.8	2.3	*3.4*	*2.3*
Luxembourg	2.7	1.6	1.0	2.3	*3.4*	*3.8*	2.8	3.6	2.1	2.5	*3.5*	*2.3*
Malta	2.7	2.1	1.3	2.0	*2.0*	*2.2*	2.0	2.6	2.2	2.3	*2.7*	*2.2*
Netherlands	1.7	1.8	0.5	1.3	*1.9*	*1.7*	0.9	2.5	1.9	1.3	*2.2*	*2.1*
Austria	2.3	2.9	0.9	1.9	*2.4*	*2.0*	1.7	3.4	2.2	2.1	*2.9*	*2.1*
Portugal	1.4	-1.9	-3.0	1.1	*-2.2*	*-1.8*	1.4	3.5	3.0	1.5	*3.4*	*2.0*
Slovenia	1.4	1.1	1.0	1.5	*1.9*	*2.5*	2.1	1.9	1.3	1.2	*2.6*	*2.1*
Slovakia	4.2	2.9	1.1	2.9	*3.5*	*4.4*	0.7	4.0	1.7	2.1	*3.6*	*2.9*
Finland	3.6	3.1	1.4	1.7	*3.7*	*2.6*	1.7	3.2	2.6	1.8	*3.6*	*2.2*
Euro area	**1.9**	**1.5**	**0.5**	**1.3**	***1.6***	***1.8***	**1.6**	**2.6**	**1.7**	**1.6**	***2.6***	***1.8***
Bulgaria	0.2	2.2	2.3	3.0	*2.8*	*3.7*	3.0	3.6	3.1	3.0	*4.3*	*3.4*
Czech Republic	2.7	1.8	0.7	1.7	*2.0*	*2.9*	1.2	1.8	2.7	1.6	*2.3*	*2.5*
Denmark	1.7	1.2	1.4	1.7	*1.7*	*1.5*	2.2	2.6	1.7	1.8	*2.5*	*1.8*
Latvia	-0.3	4.5	2.5	4.0	*3.3*	*4.0*	-1.2	4.2	2.4	2.0	*3.4*	*2.0*
Lithuania	1.4	6.1	3.4	3.8	*5.0*	*4.7*	1.2	4.0	2.7	2.8	*3.2*	*2.4*
Hungary	1.3	1.4	0.5	1.4	*2.7*	*2.6*	4.7	4.0	4.5	4.1	*4.0*	*3.5*
Poland	3.9	4.0	2.5	2.8	*4.0*	*3.7*	2.7	3.7	2.7	2.9	*3.8*	*3.2*
Romania	-1.9	1.7	2.1	3.4	*1.5*	*3.7*	6.1	5.9	3.4	3.4	*6.7*	*4.0*
Sweden	5.6	4.0	1.4	2.1	*4.2*	*2.5*	1.9	1.5	1.3	1.6	*1.7*	*1.6*
United Kingdom	1.8	0.7	0.6	1.5	*1.7*	*2.1*	3.3	4.3	2.9	2.0	*4.1*	*2.4*
EU	**2.0**	**1.6**	**0.6**	**1.5**	***1.8***	***1.9***	**2.1**	**3.0**	**2.0**	**1.8**	***3.0***	***2.0***
USA	3.0	1.6	1.5	1.3	*2.6*	*2.7*	1.6	3.2	1.9	2.2	*2.5*	*1.5*
Japan	4.0	-0.4	1.8	1.0	*0.5*	*1.6*	-0.7	-0.2	-0.1	0.8	*0.2*	*0.3*
China	10.3	9.2	8.6	8.2	*9.3*	*9.0*	3.3	:	:	:	*:*	*:*
World	**5.0**	**3.7**	**3.5**	**3.6**	***4.0***	***4.1***	**:**	**:**	**:**	**:**	***:***	***:***

1.2. PUTTING THE FORECAST INTO PERSPECTIVE

In 2011, the economic and financial crisis has entered a new phase as increased uncertainty about turmoil in financial markets, including sovereign bond markets in some Member States, is not only impacting negatively on the real economy, but is also creating the substantial risk of stronger and more adverse feedback loops in the coming months. This development comes on top of the consequences of the crisis that are still reverberating through the economy. Based on empirical analyses of previous recoveries there had been broad consensus that a recovery following deep financial crisis would necessarily be more *subdued* than a typical one.[1] But countries recovered from the downturn at different speeds, which pointed to a *multi-speed* recovery with substantial differences across countries.

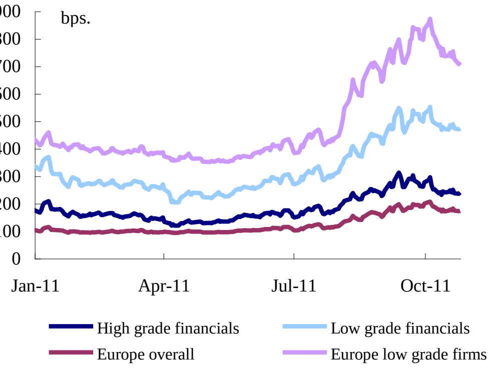
As the recovery progressed, the impact of the initial banking crisis on public finances became stronger and intensified the *sovereign debt crisis* that had been rather limited in early stages of the recovery. With linkages between the banking and the sovereign debt crisis widening, the impact on the real economy is increasing, and some *feedback effects* between the financial and the real sector have already occurred. [2] Against the background of increased uncertainty and ongoing market turmoil, the risk of stronger and more *adverse feedback loops* threatening the EU economy is substantial. It accentuates the downside risks to the growth outlook. This section looks at some of already observed or looming feedback effects and at those constituting substantial threats for the months ahead.

Strong linkages between the banking and the sovereign debt crises ...

The observation that banking (financial) crises are often followed by sovereign debt crisis had already been made in previous crises.[3] With government debt rising during the crisis, initially the question arose whether public debt thresholds exist beyond which GDP growth would be adversely affected.[4] But recent developments showed that the impact of rising debt on the sustainability of public finances and their knock-on effect on sovereign debt markets are the key challenge. These linkages received additional attention amid growing concerns about fiscal sustainability in EU-IMF programme countries and countries affected by contagion.

In the *financial sector* a particular sharp increase in uncertainty was observed since mid-July 2011. The exceptional change is visible in market indicators such as the iTraxx (see Graph I.1.3). It summarises the spread development of the most liquid investment grade credit default swap (CDS) contracts in the euro credit market and provides the benchmark for the price investors have to pay for protecting their bonds against default. The increase suggests that investors have started to pay more attention to banks financing their national sovereign debt or having a large exposure to programme countries and areas with contagion risks.

Graph I.1.3: **iTraxx - default risk, financials and overall**



Almost in parallel *stock markets* plummeted with substantial losses in all leading indices in the EU economy, particularly in Italy (MIB) (see Graph I.1.4).

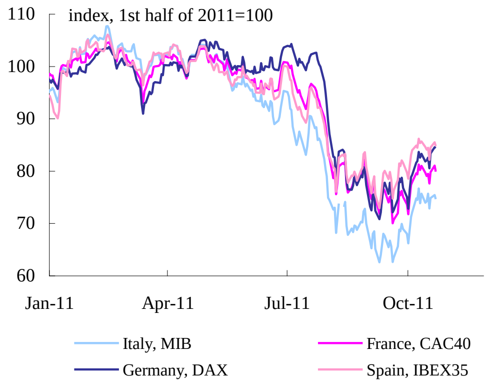
(1) See also previous forecast documents, *European Economy*, various issues. This topic has also been widely discussed in the literature. See for instance IMF, *World Economic Outlook*, various issues, ECB, The current recovery from a historical perspective (Box 5), *ECB Monthly Bulletin*, August 2011, pp. 52-57.

(2) For an in-depth analysis of links between the sectors see European Commission (DG ECFIN), European Economy Forecast – Spring 2010, *European Economy*, 2010, No. 2, pp. 30-47.

(3) C. M. Reinhart and K. S. Rogoff, From financial crash to debt crisis, *American Economic Review*, August 2011, 101(5), pp. 1676-1706. In a recent study, government debt has been found to become a drag on growth beyond a threshold of 85% of GDP, see S. G. Cecchetti, M. S. Mohanty and F. Zampoli, The real effects of debt, *BIS Working Papers* no. 352, September 2011.

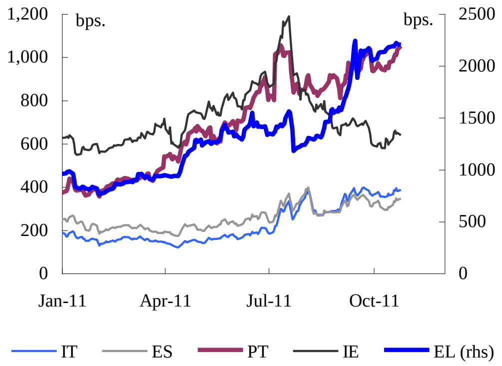
(4) See C. M. Reinhart and K. S. Rogoff, A decade of debt, *Policy Analyses in International Economics 95*, Peterson Institute for International Economics, September 2011 (particularly Section IV).

Graph I.1.4: **Stock market indices, selected euro-area Member States**



Developments in *sovereign bond markets* entered a new phase in July as benchmark yields were hitting new lows when higher risk aversion increased demand for save haven assets. In parallel, yields in several other Member States were increasing (see Graph I.1.5). The widening of the spreads was particularly strong in Greece, Portugal, Italy and Spain, whereas the Irish spread followed unabatedly its downward trend reflecting positive results within the Irish programme. The increase in Spanish and Italian yields was dampened by the ECB's sovereign bond purchases in the secondary market, which were conducted with the aim to restore a better transmission of monetary policy decisions.

Graph I.1.5: **Sovereign bond spreads, selected euro-area Member States**



Linkages between financial market segments are clearly visible. The worsening in the sovereign bond market, for instance with sovereign bond prices in some programme countries falling, is impacting negatively on banks' portfolios that usually comprise sovereign debt. Thus, a sovereign credit strain directly impacts on banks,[5] with the size of the impact depending on exposures, currently most notably to Greek bonds.[6] Moreover, the impact is amplified by interconnected and highly leveraged financial institutions in the respective countries. In turn, weakness in the banking sector affects investors' expectations about measures to be taken by sovereigns to support the banking sector and the impact on the sustainability of public debt. This argument is particularly relevant in cases where credit risks are transferred onto public-sector balance sheets, and where sovereigns provide the function of guarantor-of-last resort.[7] A more detailed look at financial markets provides additional evidence of the interaction of financial market segments (see Section I.1.4).

... are impacting negatively on the real economy...

Financial market turmoil has already impacted on the confidence of consumers and businesses. There are signs of an impact on financing conditions in the EU, both via financing costs and access to financing. Additional channels through which financial market turmoil affects the real economy are a direct impact on wealth (e.g. net worth of portfolios) and an indirect via enhanced needs for fiscal retrenchment.

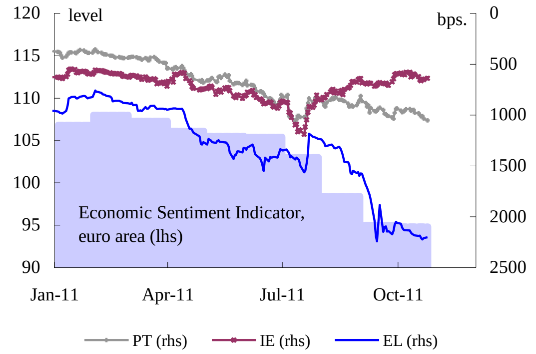
- An important channel through which financial sector woes impact on the real economy is via *confidence effects*. A weakening of business and consumer confidence typically leads to lower private consumption and investment and to higher saving rates. Both effects tend to slow economic growth independent of whether the loss of confidence is driven by banking sector weakness or concerns about the debt sustainability of sovereigns. A broader risk aversion would hamper the realisation of investment projects. Over the past months, survey data, such as the Commission's Economic Sentiment Indicator, showed strong declines (see Graph I.1.6).

(5) In September, the IMF has estimated an impact of sovereign bond developments in high-spread countries of about €200 bill. on banks in the EU since the start of the sovereign debt crisis in 2010, see IMF, *Global Financial Stability Report*, September 2011.

(6) See e.g. G. B. Wolff, Is recent bank stress really driven by the sovereign debt crisis?, *Bruegel Policy Contribution*, Issue 2011-12, October 2011.

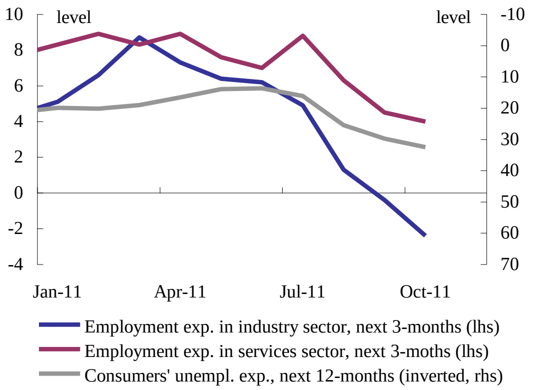
(7) See e.g. A. Estrella and S. Schich, Sovereign and banking sector debt: interconnections through guarantees, *OECD Financial Market Trends*, 2011, Issue 2, pp. 1-25.

Graph I.1.6: **Sovereign bond spreads and Economic Sentiment Indicator, euro area**



Dropping sentiment indicators reflect a worse economic outlook and increased unemployment fears (see Graph I.1.7), which then weigh additionally on spending decisions. Recent hard and soft data from the EU point to the materialisation of these effects that contribute to the explanation of the slowing of momentum in the EU economy (see Section I.1.5).

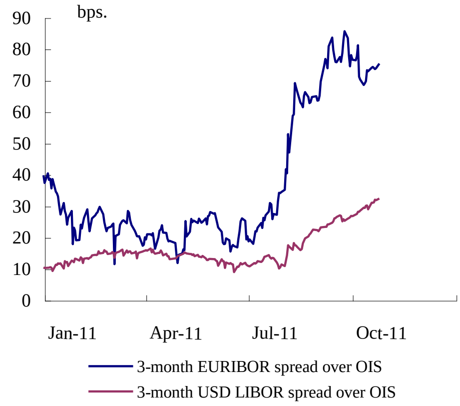
Graph I.1.7: **Employment expectations, DG ECFIN surveys, euro area**



- *Worsening financing conditions* resulting from financial market strains form another threat to economic growth (see also Box I.1.1). Banking sector problems weigh on banks' costs of and access to funding. Such funding stress is affecting the real economy through financial intermediation, i.e. from the lending of banks to the spending of companies and households. A decline in banks' capital could restrain banks from taking on credit risk. More generally, substantial deleveraging by banks, for instance to meet certain capital ratios, could imply credit contraction ("credit crunch"). The impact would then depend on how banks recover their (Tier I) capital ratio by raising fresh capital, retaining earnings or restraining bank lending, i.e. their risk assets. The faster they attempt to rebuild their capital ratio, the bigger the impact on the real economy could be.

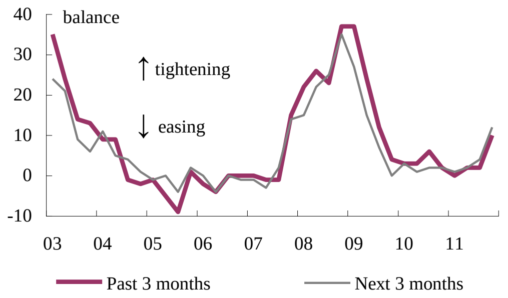
- Since mid-2011 most of the typical ingredients of credit contractions are in place in the euro area. The deterioration of bank funding via interbank lending is visible in the increasing Euribor-OIS (overnight index swaps) spreads (see Graph I.1.8), which reached the highest level since spring 2009. The increase since July points to financial market strains and suggests that the intensification of the crisis has already impacted unfavourably on overall financing conditions. Moreover, in the euro area there are outstanding developments in recourse to the marginal lending facility of the Eurosystem, which has markedly increased since the summer, and in recourse to the deposit facility, which banks would usually avoid by lending to counterparts in the banking sector. At the current juncture, funding stress has been aggravated by U.S. money funds reducing their lending to EU banks, which raised dollar funding costs and triggered supportive action from the ECB.

Graph I.1.8: **Interbank market spreads**



The latest ECB Bank Lending Survey (October 2011) provides some illustration of the impact of funding stress on financing conditions in the euro area. It provides evidence of an increased net tightening of credit standards (see Graph I.1.9) since July. This mainly affected credit to non-financial corporations and loans to households for house purchases (see also Section I.1.4), implying that recent developments might complicate private sector financing. The observation that respondents expected a further net-tightening of credit standards for loans to companies in the fourth quarter provide further evidence that the inter-linkages between the sovereign debt crisis and the banking sector is going to affect the real economy. A tightening of bank lending could also affect non-euro area economies via foreign trade, if export financing was to be affected.

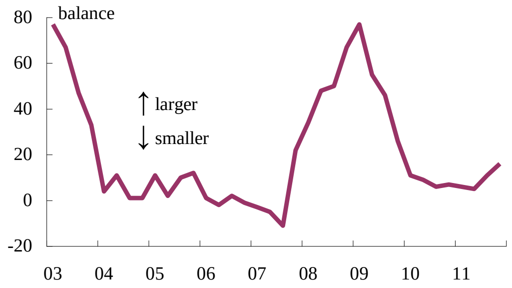
Graph I.1.9: **Net tightening of credit standards, loans to non-financial corporations**



Source: ECB, Bank Lending Survey

While these observations underline the importance of linkages between financial market turmoil and the real economy, banks when setting credit standards for enterprises apparently increased only moderately the weight they attach to the general economic outlook (see Graph I.1.10).

Graph I.1.10: **Impact of economic outlook on credit standards for enterprises**



Source: ECB, Bank Lending Survey

- *Wealth effects* incurred by falling equity and/or sovereign bond prices can be expected to affect private sector spending. As regards households, this effect will be stronger in economies where households are more involved in equity markets and where lower stock prices compress household wealth with a negative impact on private consumption. Households might also aim at restoring the ratio of incomes and wealth, which would require higher savings. The same effect would be observed where households enter a phase of precautionary savings due to increased uncertainty and unemployment fears. As regards companies, lower equity prices make refinancing via stock markets more difficult and, in conjunction with downward revised demand expectations, impact negatively on investment.[8] There is clear evidence from demand components that some of these effects are already materialising in the EU economy (see Section I.1.5).

- Additional *stress on sovereigns* constitutes a third way through which financial market developments may impact on the real economy.[9] Increased doubts about the sustainability of public finances make sovereign debt issuance more expensive. To address these doubts and to lower the debt burden, governments could speed up fiscal consolidation (e.g. more frontloading), which will, at least in the short run, harm economic growth directly and via its impact on spending decisions in the private sector, which may be postponed or dropped. The size of these effects can be expected to depend on the composition of the measures taken.[10]

At the current juncture, these negative interactions between the financial sector and the real economy weigh increasingly on the economic outlook (see Graph I.1.11) and explain an important part of the latest downward revisions for growth.

... and intensify the risk of more and stronger adverse feedback loops.

Additional feedback loops could aggravate the impact of financial markets on the real economy. The deteriorated outlook for the EU economy worsens the situation in financial markets, in particular in sovereign bond markets of some countries. A weakening of the real economy

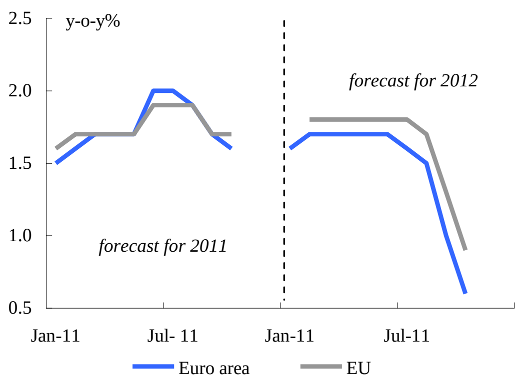
(8) See the box in the Commission's September 2011 Interim Forecast document.

(9) For the absorption of bank losses by government finance in selected Member States, e.g. F. Campolongo, M. Marchesi, and R. De Lisa, The potential impact of banking crises on public finances: an assessment of selected EU countries using SYMBOL, *OECD Financial Market Trends*, 2011, No. 2, pp. 1-13.

(10) For an in-depth analysis of the links between fiscal consolidation and economic growth see European Economy Forecast – Autumn Forecast 2010, *European Economy*, 2010, No. 7, pp. 31-47 (chapter I.2).

reduces the tax base and darkens the outlook for public finances. This could further raise doubts about the sustainability of sovereign debt. As a result, ratings downgrade could happen and investors may ask for higher compensation, which would add to turmoil in financial markets and trigger another round of feedback loops. At the same time, the increased uncertainty about public finances could make banks even more restrictive in their lending attitudes. A deteriorated growth outlook weakens the profit outlook of companies and lowers the valuation of stocks and securities. The erosion of asset values worsens the balance sheets of financial institutions and puts additional stress on the financial sector. This increases the risk of triggering another interaction round, creating a vicious cycle that, once in full swing, is difficult to stop.

Graph I.1.11: **Consensus forecast (mean) for real GDP growth in 2011 and 2012**



Recent evidence from the EU economy suggests that the risk of more and stronger adverse feedback loops is substantial. Economic history is only of limited help in assessing the risks to the EU economy at this juncture.[11] Several of the past banking and sovereign debt crises were limited in scope,[12] often faced by one country. The situation in 2008, following the collapse of Lehman Brothers, though sharing a number of similarities with the current situation,[13] was markedly different in many respects. Then, the collapse brought operations of wholesale funding markets to a sudden stop, making it harder for banks to continue financing credit-driven economic growth. With credit being dried up, in several Member States more fundamental obstacles to growth were laid bare (e.g. loss of competitiveness). At the same time, the weaker economic growth led to a deterioration of budgets and shifted attention to the sustainability of public finances. As investors focused on deteriorating balance sheets, several commercial banks in Member States came under scrutiny and needed support from EU governments, which translated the financial crisis in the private sector into a sovereign debt crisis.

In 2011, by contrast, central banks are providing as much liquidity as needed against a widened list of eligible collateral and more backstops have been introduced. Moreover, while the collapse of Lehman Brothers added a shock, current developments have been evolving more gradually leaving market participants time to take precautionary measures. But a decisive difference compared to 2008 is that sovereign debt concerns are now in the centre and not just liquidity and solvency concerns in the banking sector. And risks are not limited to vulnerable euro-area economies, but could affect countries elsewhere, for instance via balance sheet exposure to foreign assets, via capital flow reversals[14], and via the international correlation of asset returns translating into the correlation of credit spreads across economies.[15] These elements amplify the risk of strong adverse feedback loops. If materialising, it would inflict substantial economic losses on the EU economy and would render the baseline scenario of this forecast obsolete.

(11) For an overview of the history of financial crisis and their economic impact see C. M. Reinhardt and K. S. Rogoff, *This time is different: eight centuries of financial folly*, Princeton 2009.

(12) There is evidence from smaller banking crisis such as the one in Finland in 1991-1994 and its impact on lending and the real economy, see e.g. V. Vihriälä, Banks and the Finnish credit cycle 1986-1995, *Bank of Finland Studies* E7, 1997, and from Sweden, see e.g. L. Jonung, The Swedish model for resolving the banking crisis of 1991-93. Seven reasons why it was successful, *European Economy – Economic Papers* (DG ECFIN) no. 360, February 2009.

(13) Financial shocks have already been an important driver of the downturn in 2008-09. See e.g. U. Jermann and V. Quadrini, Macroeconomic effects of financial shocks, *American Economic Review*, 2011, Vol. 101 (forthcoming).

(14) See e.g. G.M. Milesi-Ferretti and C. Tille, The great retrenchment: international capital flows during the global financial crisis, *Economic Policy*, April 2011, Vol. 26, No. 66, pp. 289-346.

(15) See e.g. L. Dedola and G. Lombardo, Financial fictions, financial integration and the international propagation of shocks, *Economic Policy*, 2012, Vol. 27 (forthcoming).

Box I.1.1: Bank balance-sheet adjustment and credit supply

Pressure on EU banks to accelerate balance sheet adjustment has recently increased. Since the summer, European banks have been confronted with significant funding pressures triggered by markets' lack of trust in banks' assets valuation (especially for sovereign risk). Furthermore, banks have reasons to expect a further deterioration in funding conditions as tougher capital and liquidity requirements become effective.

Confronted with pressures, banks can adjust their balance sheets by raising additional capital, which may not be straightforward in a situation of market stress. Alternatively, they can recourse to downsizing of their balance sheets through divestment of activities, sale of securities or the reduction of loan supply.

This box discusses sources of pressure on EU banks' liquidity and solvency and their likely reaction. So far, the flow of credit to non-financial institutions and households appears to be only little affected – also because credit demand is subdued. But going forward, bank balance-sheet adjustment can be expected to impact negatively on economic activity, either in terms of pricing of credit (lending rates) or via a tightening of credit conditions (access to credit), in particular if bank funding conditions were to remain difficult.

The driving forces of balance-sheet adjustment

Current pressure on banks to adjust their balance sheets stems firstly from liquidity and funding risks, secondly from solvency issues, and thirdly from the restructuring requirements imposed on banks that received state aid.

Firstly, the deterioration in sovereign creditworthiness has made it more difficult for banks to access funds. This situation has been partly mitigated by the ECB’s provision of liquidity to the full amount of collateralised bids. However, should term-funding markets remain severely impaired into early 2012, this would pose a serious threat to banks’ ability to maintain the desired balance between the maturity of their commitments and the maturity of their resources. In the face of declining access to longer-term funds, banks could re-establish that balance by reducing the duration of their assets through the sale of longer-term tradable assets (including sovereign bonds) as well as shortening the maturity or limiting the supply of new loans. Divesting branches or business lines could also reduce the duration of banks' investments. Given that this usually takes some time for preparation and implementation, banks would typically give low priority to this option and thus the direct impact on the real economy would be limited.

Banks also have to anticipate higher funding pressures due to new planned or proposed regulatory liquidity requirements. The new liquidity ratios proposed by Capital Requirements Directive 4 and Capital Requirements Regulation 1 in line with the proposal of the Basel Committee on Banking Supervision would oblige banks to hold more liquid assets, which could happen at the expense of the share of loans.

Secondly, banks seek to enhance their solvency ratios in order to respond to higher prudential capital requirements, supervisory initiatives, as well as market pressures.

In December 2010, the European Banking Authority (EBA) estimated that the implementation of planned capital requirements would substantially increase the capital needs of EU banks in relatioin to their Risk Weighted Assets (RWA). Instead of raising additional capital or scaling back balance sheets, to a certain extent, banks can reduce their RWA technically, e.g. through risk modelling approaches or centralised management of capital and liquidity.

Supervisory initiatives have also contributed to pressures to increase capital. In anticipation of the 2011 EU-wide stress tests European banks in the EBA's sample raised about EUR 50 bn new capital. This was done through the issuance of common equity in the private market, conversion of lower-quality capital instruments into better loss-absorbing capital, government injections of capital or provision of other public facilities, and fully committed restructuring plans. Following the publication of the stress tests in July, banks pledged to implement additional solvency-improving measures including divestments amounting to EUR 11 bn.

Moreover, competition for funds is pushing banks to demonstrate the soundness of their balance sheets by anticipating on the future tighter capital requirements.

Thirdly, banks under state aid had to commit to restructuring. State-aid measures typically involve divestments of non-core assets and are scheduled to take place on a time span of between 2 and 5 years.

(Continued on the next page)

Box (continued)

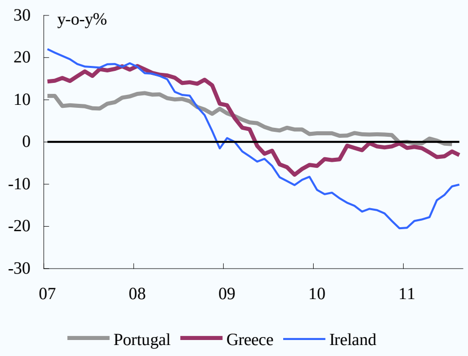
So far, evidence of a reduction of credit supply is limited …

Depending on the measure taken, bank balance sheet adjustment could have a significant negative impact on real economic activity. Sovereign bond sales would aggravate the European sovereign-debt crisis and increase uncertainty. Measures directed towards the cost or availability of loans would reduce the number of profitable investment projects, thereby constraining economic growth.

According to the ECB's Bank Lending Survey of October 2011, conditions to access financing have slightly tightened for banks in the euro area in the third quarter of 2011. Another possible indication of credit constraints is the increase of banks' intention to tighten credit standards to households and firms in the fourth quarter of 2011 (see also Section I.1.2), which is the first noticeable hardening of credit standards in more than a year. Furthermore, new issuance of debt by EU banks has been mostly negative, suggesting that deleveraging is indeed under way.

As the evolution goes hand in hand with a general decline in the demand for credit, it is not possible to conclude from recently weak credit growth dynamics whether credit supply constraints are currently binding. Survey data suggest that non-financial firms' production has so far not been hampered by difficulties in accessing finance.(1)

Graph 1: **Bank lending to households and corporates, Member States**



At the Member-State level, lending conditions and banks' intensions vary considerably. The situation appears more severe in programme countries, where loan volumes to non-financial institutions and households are almost stagnating (Portugal and Greece, see Graph 1) or significantly declining (Ireland). Adjustment programmes required significant write-downs of certain assets and depressed both the demand and supply of credit. In these economies a credit tightening appears unavoidable as banks have to deleverage in order to ensure macro-financial stability. Banks in Ireland and Portugal have to lower their loan-to-deposit ratio from around 200% for some banks to 122.5% and 120%, respectively, by end 2014.

… but credit supply constraints are likely to become more binding going forward

Going forward, recent developments suggest that credit supply constraints will gain importance with an increasingly detrimental impact on economic momentum in the EU economy. An outright "credit crunch" appears to be unlikely but cannot be completely ruled out.

Historical evidence indicates a strong correlation between the growth rates of bank lending to the private sector and real GDP in the euro area. The credit cycle usually picks up with a lag to the business cycle, but then facilitates the broadening of growth to domestic investment and private consumption. This does not appear to be happening at the current juncture.

Evidence from 2008-09 suggests that when confronted with scarce liquidity and pressure on their solvency ratios, banks are likely to reduce their loan supply, not only with respect to their riskier counterparties, but to clients across the board thereby creating contagion in all economic sectors.

In view of subdued credit demand, credit supply constraints do not appear to be binding at this point in time. To become a limiting factor, either credit supply would have to contract more sharply, or credit demand would have to pick up. Banks' efforts to improve their capital standing are thus expected to affect the economy once credit demand accelerates as private investment and consumption recover in line with this forecast.

The perspective of an outright credit crunch appears unlikely in view of the availability of liquidity from the ECB and the re-introduction of the covered bonds programme, which mitigates commercial banks' difficulty of accessing longer-term funding. However, should the risk of much sharper financial market stress (as discussed in Section I.1.6) materialise, bank balance sheets would be hit harder, and their access to finance would become even more difficult making a credit crunch more likely.

(1) In the quarterly Joint Business and Consumer Survey, manufacturing firms are asked about factors limiting their production.

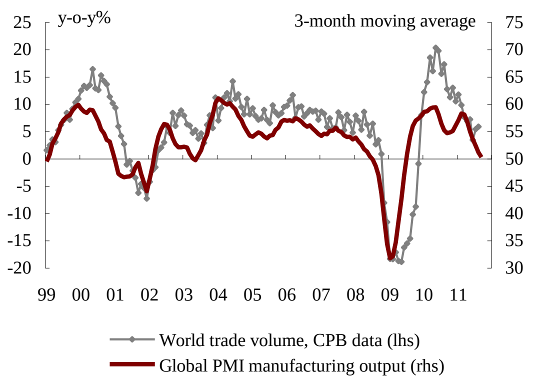
1.3. THE EXTERNAL ENVIRONMENT

Economic growth at the global level has lost momentum in recent months. Worsening US and EU economic prospects and their knock-on effects on other advanced but also emerging economies are the main drivers of the deterioration of the global outlook. In addition, a number of temporary factors are behind this deterioration which results in downward revisions of the forecast for output growth outside the EU in both 2011 and 2012 (each by about ½ pp. to around 4¼%) and the expectation of unchanged growth momentum in 2013 (see Table I.1.2).

Less support from the external environment...

The financial turmoil and deteriorating growth prospects in advanced economies have triggered renewed concerns about the global recovery, even if emerging market economies remain robust. In the first half of 2011, global growth has been slowing, partly reflecting a return to more normal patterns following last year's rather strong rebound in industrial production and world trade. Apart from this technical factor and a number of exceptional drags (disasters in Japan, geopolitical tensions in the Middle East and North Africa (MENA), and commodity price increases), the slowdown reflects the impact of stimuli being withdrawn in 2010/2011 and ongoing financial sector problems in several advanced economies. In regional terms, the deceleration can be associated with the weaker-than-expected economic activity in the US, which reinforced the policy-induced deceleration in the emerging market economies. Nevertheless inflationary pressures are yet to be contained in some emerging market economies, despite tightening policies that had been undertaken in many cases until very recently.

Graph I.1.12: **World trade and Global PMI manufacturing output**



As regards the near term outlook for *global output*, leading indicators of global manufacturing growth have been pointing to a loss of momentum for several months. The Global Purchasing Managers' Index (PMI) stood at 52.0 in September (output), slightly higher than in August (51.5), which had been the lowest reading in two years (see Graph I.1.12). Accordingly, the index continues signaling expansion. As the focus is on the direction of change, however, the information content

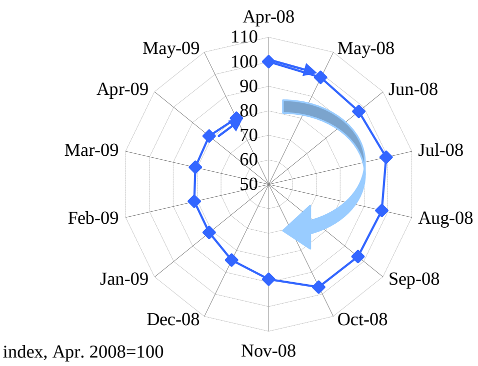
Table I.1.2:

International environment

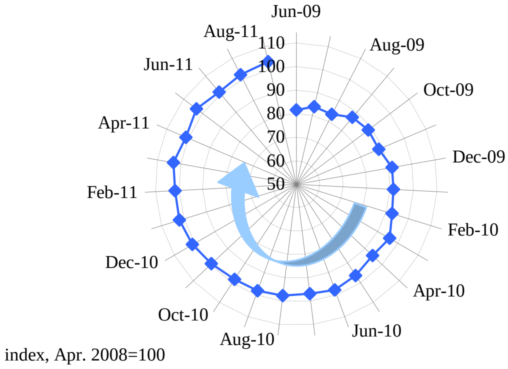
(Annual percentage change)					Autumn 2011 forecast			*Spring 2011 forecast*	
	(a)	2008	2009	2010	2011	2012	2013	*2011*	*2012*
					Real GDP growth				
USA	19.9	-0.4	-3.5	3.0	**1.6**	**1.5**	**1.3**	*2.6*	*2.7*
Japan	5.9	-1.2	-6.3	4.0	**-0.4**	**1.8**	**1.0**	*0.5*	*1.6*
Asia (excl. Japan)	27.6	6.9	6.4	9.1	**7.2**	**7.2**	**7.2**	*7.7*	*7.7*
- China	13.7	9.6	9.1	10.3	**9.2**	**8.6**	**8.2**	*9.3*	*9.0*
- India	5.5	6.7	8.0	8.5	**7.5**	**7.5**	**8.1**	*8.0*	*8.2*
Latin America	8.6	4.3	-1.9	6.0	**4.6**	**4.1**	**4.2**	*4.2*	*3.9*
- Brazil	3.0	5.1	-0.6	7.5	**3.6**	**4.0**	**4.5**	*4.4*	*4.3*
MENA	5.1	4.4	1.2	3.3	**3.6**	**3.6**	**3.7**	*3.1*	*3.7*
CIS	4.3	5.3	-6.7	4.6	**4.1**	**4.0**	**4.2**	*4.7*	*4.5*
- Russia	3.0	5.2	-7.8	4.0	**3.9**	**3.8**	**4.0**	*4.5*	*4.2*
Sub-Saharan Africa	2.5	5.6	2.9	5.1	**5.0**	**5.5**	**6.0**	*5.5*	*6.0*
Candidate Countries	1.5	0.9	-4.9	7.7	**6.8**	**2.8**	**3.9**	*5.6*	*5.1*
World (incl. EU)	100.0	2.8	-0.6	5.0	**3.7**	**3.5**	**3.6**	*4.0*	*4.1*
					World merchandise trade volumes				
World import growth		3.2	-12.6	15.8	**7.2**	**5.3**	**6.4**	*7.8*	*7.9*
Extra EU export market growth		3.6	-11.0	13.7	**8.4**	**6.2**	**6.7**	*8.2*	*8.2*

(a) Relative weights in %, based on GDP (at constant prices and PPS) in 2010.

Graph I.1.13a: **The decline in world trade in 2008-09**



Graph I.1.13b: **The rebound in world trade in 2009-11**



regarding the size of the change could be rather limited at the current juncture, in particular as the disruptions in the aftermath of natural disasters in Japan had a non-negligible impact on underlying national PMIs.

Further out, several of the factors acting as a drag in 2011 will exert only a temporary impact, provided economic growth in emerging market economies remains relatively robust. World output growth (including the EU) is expected to slow to 3¾% in 2011 and 3½% in 2012 before accelerating marginally in 2013.

Overall, weak growth prospects, high debt levels in advanced economies, and lingering policy challenges weigh on global risk sentiment. Adverse feedback loops between the sovereign, financial, and real sectors cannot be excluded. In addition, the geopolitical situation remains tense in the MENA region, resulting in still elevated commodity prices and volatile commodity prices.

... as world trade growth is easing...

The rebound in *world trade* had been one of the key drivers of the recovery from the downturn in 2008 and 2009. World trade volumes grew by 13% in 2010 and have already returned to pre-crisis levels, though not to the pre-crisis growth path. While the trade collapse in 2008-09, driven also by changes in the costs and availability of trade financing, took just about one year to lower trade volumes by about 20%, the return to the pre-crisis level took more than two years (see Graph I.1.13). As the rebound progresses, world trade growth is easing. The moderation in the first half of 2011 is also reflecting the slowing global growth and the deteriorating global outlook. According to the latest estimates of the Centraal Planbureau (CBP), world trade has lost momentum in the first half of 2011 and shrank in the second quarter (by ½%). Available data for July and August and leading indicators such as the Global PMI indicators suggest a continuation of this weak trend in the second half of this year. The experience of the initial phase of the crisis suggests that tighter credit conditions, as currently observed, may further weigh on trade. The forecast for global trade growth is revised down to about 6½% in 2011, slightly above 5% in 2012 and to 6% thereafter.

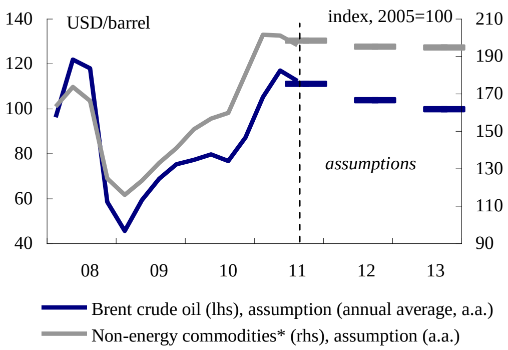
... global financial markets are becoming a drag to growth, ...

Global *financial markets* went through a sharp correction in August and September. The sell-off in equity markets, and in particular the negative wealth effects it entails especially in the US, reflects a marked reassessment of risks and weight on economic growth. Going forward these developments potentially increase the risk of recession. Exchange rate volatility has remained high since the spring forecast. It is most notably driven by uncertainties over the sovereign debt crisis in the euro area, the political gridlock in the US about the increase of the debt ceiling, downgrades by credit rating agencies, and data suggesting a deeper than expected slowdown of activity in the second half of the year. Over the summer, foreign exchange markets were characterised by a flight to safe havens. The Japanese and Swiss central banks intervened in the foreign exchange markets to stem rapid appreciation of the currencies. More recently, sharp depreciations of currencies of the emerging market economies against the US dollar have again triggered nervousness and interventions in some cases.

... while commodity prices are retreating from peaks.

Commodity prices had markedly increased in the first months of the year raising inflationary pressures at the global level (see Graph I.1.14). Most commodity price indices peaked in the second quarter and have slightly come down during the summer on the back of a worsening global outlook. As compared to pre-crisis notations, however, many prices stay at elevated levels reflecting large and sustained demand increases from emerging market economies. These structural features imply that cyclical features are not likely to lower commodity prices to pre-crisis levels.

Graph I.1.14: **Commodity-price developments**

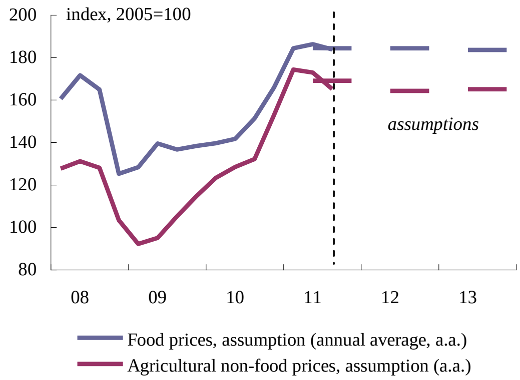


* *ECFIN calculations*

On the back of geopolitical tensions in the Middle East and North Africa and the improving economic outlook *oil prices* had increased substantially in the first months of the year and peaked in April at an average price of 123 USD per barrel (Brent). The expectations of easing tensions in the area and a deteriorating global outlook have eased oil price pressures. In the second half of October the price stood at around 110 USD per barrel, which is almost 10% lower than assumed in spring. Based on oil futures the technical assumption to this forecast, is that oil prices fall from an average of 111 USD/barrel this year (about 6% lower than assumed in spring), to 104 USD (11% lower) next year and 100 USD in 2013.

Non-energy commodity prices continued their upward trend in the first and second quarter of 2011 (18.2% and 10.4% quarter on quarter from an annual increase of 25.9% in 2010). This movement came to an end in mid-2011. Metal prices and agricultural non-food prices that had both surged in late 2010 and early 2011 fell already in the second quarter. In the third quarter, food prices departed from the upward trend they had followed since late 2008 on the back of limiting short-term supply-side factors (weather-related supply shocks, exports bans and rising oil prices) and rising global demand. Strong population and income growth in emerging market economies and its impact on dietary preferences keep food prices at high levels (see Graph I.1.15).

Graph I.1.15: **Food and agricultural non-food prices**

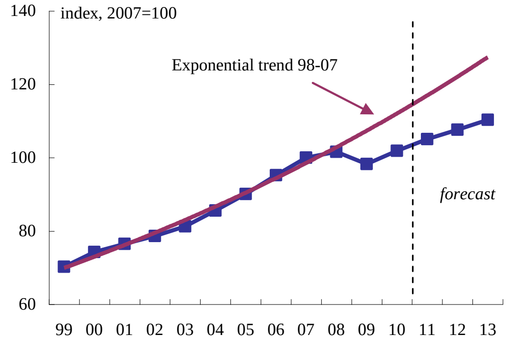


The price declines recently observed for commodities remained much smaller than the increases seen before. This also supports the view that scarcity has become a structural feature to which supply is only responding gradually. At the current juncture, slightly moderating growth in emerging market economies is expected to exert some downward pressure and therefore the assumptions on non-energy commodity prices contain declining prices over the forecast horizon. But these declines will be rather small and insufficient to return to the price levels recorded in the last quarter of 2010.

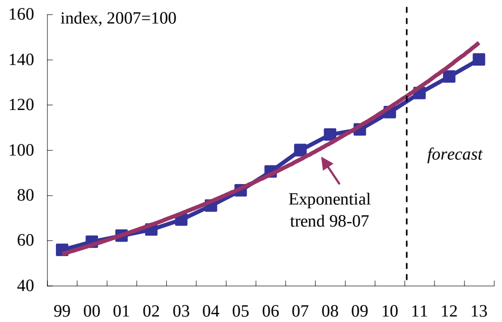
Marked differences between advanced and emerging market economies ...

A closer look to key regions shows that advanced economies continue growing more sluggishly than emerging market economies (see Graph I.1.16), which continue to display relatively robust growth. The highest speed has been achieved in economies 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. This group of countries includes emerging market economies such as China and India. They managed to recover strongly with industrial output and real GDP returning to their pre-crisis growth trajectory. A much lower speed of recovery is found in advanced economies that were in general harder hit by the crisis.

Graph I.1.16a: **GDP per capita, advanced economies**



Graph I.1.16b: **GDP per capita, emerging and developing economies**



... with weaker expansion in advanced economies ...

The outlook for the *US economy* has worsened compared to the spring forecast, reflecting the weak housing market, deteriorated prospects for consumption growth, and the contribution of fiscal policy becoming a drag on growth. Moreover, a substantial revision of national account data in July 2011 brought a massive downward revision of the trough of the recession, which implies that the road towards full recovery has become longer. By mid-2011, the US GDP had not returned to the pre-crisis level. GDP growth in the first two quarters of 2011 has slowed to quarter-on-quarter rates of 0.1% and 0.3%. Private consumption growth lost momentum in the first half of the year, reflecting higher oil prices, the uncertain employment situation, and, more generally, ongoing deleveraging processes and falling business and consumer confidence. In addition, supply-chain disruptions from the events in Japan, most notably in the automobile sector, were a drag on economic activity. Further out, the economy is expected to rebound only slightly, with private consumption still constrained by the high level of debt and the unfavourable labour market outlook, and financial market developments depressing household confidence. Residential investment will therefore remain sluggish, with house prices falling.

Fiscal policy is set to remain a drag on economic growth but also a key source of uncertainty for the markets. The preliminary debt-ceiling agreement set fiscal consolidation objectives that were deemed both not credible and insufficient by financial markets. In principle the tax cuts and infrastructure expenditure summarised in the American Jobs Act could lower the fiscal restraint. Assuming an extension of the current payroll tax cuts and some additional corporate tax reductions, the fiscal impulse will continue to provide a negative contribution to growth in 2011 and 2012. Overall, the forecast for GDP growth has been revised down for 2011 (from 2.6% to 1.6%) and 2012 (from 2.7% to 1.5%) and a deceleration is expected in 2013 (1.3%).

The outlook for *Japan* is strongly affected by the combination of the Tōhoku earthquake and the tsunami it caused on March 11, 2011. As a result the economy went through three quarters of negative growth with GDP still remaining below the level of the pre-crisis peak in 2008. In particular investment (20% lower) and exports (13% lower) have not yet recovered. Recently better-than-expected data outturns and supportive labour market conditions, constitute a glimmer of hope. Looking forward, purchases of energy-saving appliances are expected to support consumption growth as electricity prices are set to rise. GDP growth is expected gain momentum in 2012 (1.8%) mainly thanks to the boost provided by public spending, most notably public investment, associated with the third supplementary budget aimed to repair the damage caused by the earthquake. As these factors will be gone in 2013, private consumption and net exports are expected to contribute moderately to economic growth of about 1%. The downside risks to this outlook are related to the sustainability of the debt situation, the impact of a stronger-than-expected yen and to the tight energy supply. On the upside, the rebuilding might be finished earlier than expected, Japanese exports may be less affected by the global slowdown than envisaged in the forecast, and private consumption may rebound stronger than expected due to sound household balance sheets.

Economic growth is moderating in *EFTA countries*, which were subject to special conditions. In Norway, the substantial sovereign oil wealth continued providing a buffer to cushion the economy in times of distress without creating an external payment imbalance or public finance concerns. Economic growth is expected to pick up over the forecast horizon though less than in the pre-crisis period. In Switzerland, in 2011 the economy continued its rebound though slower than in the year before and increasingly weakened by the impact of the appreciation of the Swiss franc. In early September, the Swiss central bank stopped the appreciation by announcing unlimited intervention to let the exchange rate not fall below a floor of 1.20 CHF/EUR.

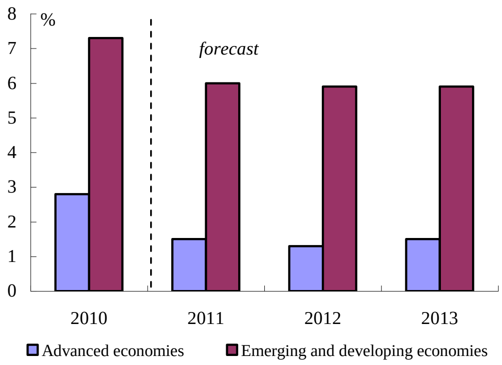
Across the five *EU candidate countries* macroeconomic developments remain diverse. Turkey continued its strong recovery (around 9% GDP growth in 2010) into 2011, but recent indicators point to a marked slowdown of economic growth in 2012 (to about 3%) and in 2013 (about 4%). Croatia, Montenegro and Iceland still have to return to pre-crisis output levels. The Former Yugoslav Republic of Macedonia is expected to grow at rates around 3% this year and 2½ in 2012, reflecting the expected deceleration of global demand. Overall, economic growth in the group of Candidate Countries is expected to slow from last year's 8% to around 7% in 2011 and 3% in 2012.

... and a modest loss of momentum in emerging market countries.

The growth performance of emerging market economies in 2011 broadly confirmed the spring forecast. Over the forecast horizon they are expected to grow much stronger than advanced economies (see Graph I.1.17). But developments have been uneven among them, partially reflecting linkages with advanced economies. Over the forecast horizon also the slowing in the EU economy will be felt. Moreover, countries exporting commodities performed relatively well (e.g. CIS, Latin America), while economic momentum in several countries in Asia has slightly weakened.

Emerging Asia continues to be the most dynamic region of the global economy. Economic growth is expected to continue at annual rates of around 7% over the forecast horizon amid more general concerns about the sustainability of high growth rates in emerging market economies. Downward revisions for economic growth in 2011 and 2012, as compared to the forecast in spring, reflect the impact of slowing economic activity elsewhere and of some policy tightening in Asia, an attempt to address inflationary pressures. Easing pressures in commodity markets is expected to contain inflationary pressures over the forecast horizon.

Graph I.1.17: **Real GDP growth in advanced and emerging economies**



In *China*, economic growth moderated slightly in the first three quarters of 2011 to 9.4% on average from 10.3% on average in 2010. Economic growth is expected to ease gradually in 2011, a soft landing rather than a sharp decline. Forecasts for 2011 and 2012 have been revised down slightly compared to the spring forecast, on the back of softer external demand and tighter domestic policies. Growth remains investment-led over the forecast horizon without major rebalancing towards consumption. China's economy will continue to slow slightly next year and efforts to spur growth may be constrained by inflation and local government debt burdens. Overall, China is expected to enjoy a period of substantial but decelerating economic growth in 2011 (9.2%), 2012 (8.6%) and 2013 (8.2%).

Strong domestic demand has driven economic growth in *India*, but with inflation running high and being broad-based, the challenge is to marry growth and price stability objectives. As the overall policy-mix is expected to turn more restrictive a slight moderation of economic growth to annual rates of about 7½-8% is expected over the forecast horizon.

In *Latin America* growth has continued to surpass expectations in the first quarter of 2011, driven by a surge in domestic demand, capital inflows and sustained high demand for and high prices of raw materials. The surge in private consumption is supported by high growth of loans to households. Increased inflationary pressures have prompted the region's central banks to raise policy interest rates and, in some cases, to take measures to curb capital inflows. Against this background, growth is expected to moderate in 2011 (from 6% to 4½%) and over the forecast horizon (to around 4% each year), but to continue coming in slightly higher than expected in spring.

In the *MENA region*, economic growth has resumed at differentiated pace. In 2011, many oil and gas exporting countries are benefitting from increased commodity prices, whereas others are facing the economic impact of political transformation (Egypt, Tunisia, and Syria), embargoes (Iran) or military action (Libya). Further political turmoil cannot be ruled out and constitutes downside risks to the growth outlook. Overall, the area is expected to grow over the forecast horizon by about 3½%.

In the *CIS region*, the moderation in oil prices and a more difficult access to international capital markets is weighing on the growth prospects of Russia. In line with the deterioration of the global outlook, the growth forecast for 2011 has been revised down by ½ pp. to about 4%. Further out, slowing growth in the EU worsens the outlook for Russia's oil and gas exports. The other countries in the region are expected to grow slightly stronger than Russia resulting in a growth forecast for the region of about 4% over the forecast horizon.

1.4. FINANCIAL MARKETS IN EUROPE

Financial markets are in the centre of the current slowing of economic growth in the EU. Turmoil in sovereign bond markets and financial disruptions such as distortions to credit supply and sharp declines in asset prices, notably in stock markets, have become key determinants for economic prospects. In line with historical evidence, interactions between financial markets and the real economy are shaping both recessions and recoveries[16] and form an acute risk of adverse feedback loops between sovereign debt, the banking sector and the real economy.

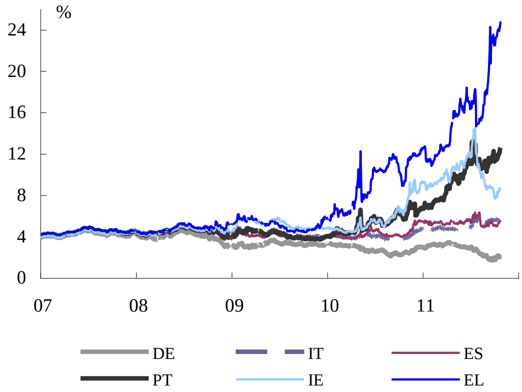
[16] See e.g. S. M. Claessens, M. A. Kose and M. E. Terrones, How do business and financial cycles interact?, *IMF Working Paper* 11/88, April 2011. The interaction between financial markets and real activity has been analysed in European Commission (DG ECFIN), European Economic Forecast – Spring 2010, *European Economy* no. 2, 2010.

Stress and volatility on financial markets have increased significantly since the spring 2011 forecast, and in particular over the summer months. Main drivers of a new wave of risk aversion were renewed tensions in EU sovereign debt markets, the protracted political negotiations on raising the US federal debt ceiling, and more general concerns about an economic slowdown. The sell-off in risky assets has intensified in the aftermath of the S&P downgrade of the US debt rating in August. It has become visible in sharp stock market declines and a widening spread between benchmark yields and sovereign bond yields in programme and vulnerable countries.

A deteriorated situation in sovereign bond markets ...

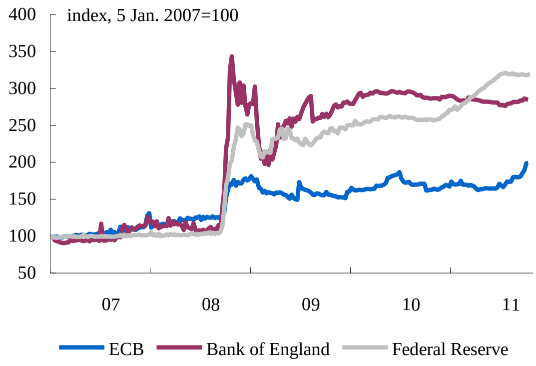
Over the summer, markets for *sovereign bonds* have seen a flight to safe havens with benchmark bonds hitting new yield lows. In parallel, yield spreads on the sovereign bonds of the programme countries, Greece, Portugal and Ireland, reached new record highs, on investor uncertainty about public debt sustainability (see Graph I.1.18). Moreover, tensions spilled over to other euro-area Member States, including Spain and Italy.

Graph I.1.18: **Government-bond yields, seleted euro-area Member States**



The counter-crisis measures agreed by the euro-area Heads of State or Government on 21 July and the extension of the ECB Securities Markets Programme (SMP) in early August have succeeded in temporarily calming sovereign market tensions. The ECB re-activated and extended its SMP to include purchases of Italian and Spanish sovereign bonds in the secondary market, which led, in early August, to an immediate decline in yields on both Italian and Spanish sovereign bonds. More generally, non-standard monetary policy measures including unlimited liquidity provision at a fixed rate against collateral (full allotment) have widened the balance sheet of central banks (see Graph I.1.19).

Graph I.1.19: **Central bank balance sheets, euro area, UK and US (weekly data)**

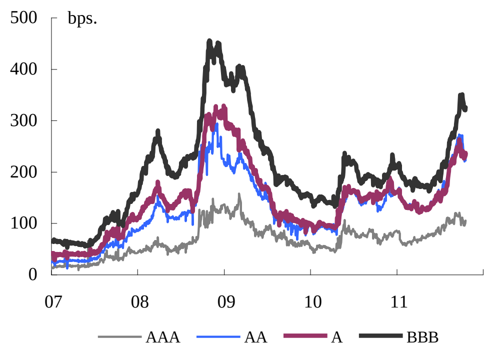


In September and October, investors have more clearly distinguished between sovereign bond markets of Member States. While Italian sovereign bonds, despite the ECB interventions, temporarily continued to erode on concerns that slowing economic growth would undermine public debt sustainability despite the announcement of a new fiscal adjustment package, the Irish spread continued narrowing reflecting the Irish determination as regards fiscal and banking sector reform.

... affecting corporate bond markets ...

In other market segments like *corporate bonds* and credit default swaps, rising spreads during past months confirm the reassessment of risk by investors (see Graph I.1.20).

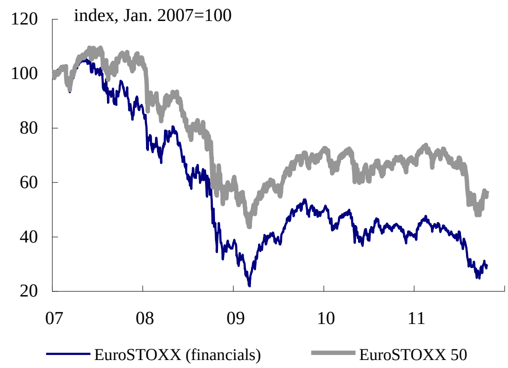
Graph I.1.20: **Corporate spreads over euro-area sovereign benchmark bonds (5-year maturity)**



... and tumbling equity markets ...

The slowing of the recovery on both sides of the Atlantic and increased risk aversion have resulted in a sell-off of equity and drove down *stock markets* along a path characterised by exceptional volatility.[17] In particular, equity markets corrected sharply over the summer, most strongly in the EU. As compared to the peaks recorded earlier this year, the Dow Jones lost up to 17%, the Nikkei up to 23%, the EuroSTOXX 600 up to 26%, the EuroSTOXX 50 up to 35%, and the EuroSTOXX Financial even up to about 48%. Banking shares have been particularly badly affected (see Graph I.1.21), amid concerns about the exposure of already weak balance sheets to the global economic slowdown and sovereign debt. The underperformance of bank shares began already in an early phase of the crisis and share prices for several major banks are now close the levels of spring 2009.

Graph I.1.21: **Stock-market indices, euro area**



... worsen the shape of the banking sector, affecting bank funding ...

A deteriorating situation in selected sovereign bond markets and falling equity prices are undermining the quality of assets held in the *banking sector* and thereby adversely affect the funding costs and market access of banks. Lower market prices of sovereign bonds weaken the banks' balance sheet and reduce the value of the collateral available for wholesale funding. Therefore markets remained concerned about the shape of the banking sector and its impact on credit supply. Although liquidity is more readily available than in 2008, persisting bank funding

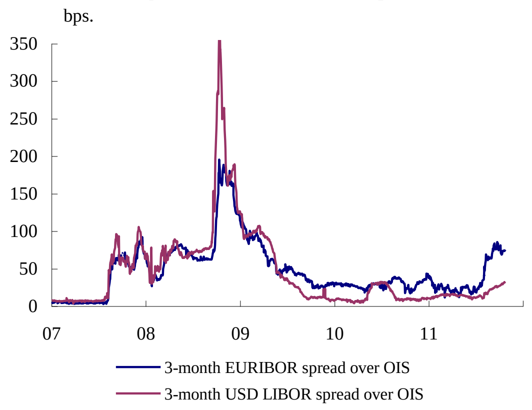
(17) Bekaert, G, M Ehrmann, M Fratzscher, and A Mehl, Global crises and equity market contagion, *NBER Working Paper* no. 17121, June 2011.

stress could increase the need for deleveraging, which would most likely impact on bank lending behaviour. Especially the banks relying on short-term wholesale funding may face funding vulnerabilities.

A number of ECB safety valves are meeting funding needs of the euro area banks including unlimited provision of liquidity against a wide set of collateral. Data on ECB liquidity operations point to high demand for liquidity with reliance on the central bank's liquidity provision remaining at elevated levels. Besides, the reduction in exposure to EU banks by US money market funds, and the shortening of their maturity have become a source of concern. To address US dollar funding stress in the euro-area banking system, the ECB has also announced that it will conduct liquidity-providing operations in US dollars.

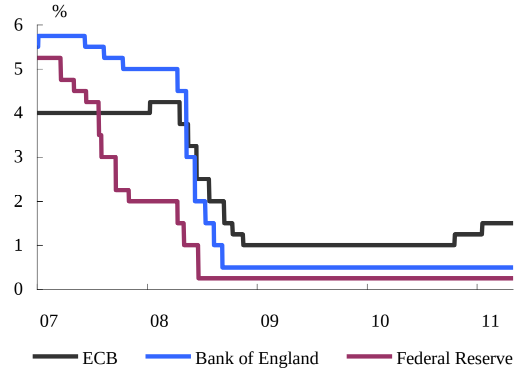
On the *money markets*, for European banks funding came under severe pressure during the last few months. As banks appear to be reluctant to lend to each other, the amount of liquidity banks deposit at the ECB remains relatively high. The 3-month spread between unsecured money market rates such as the Euribor and overnight index swaps (OIS), which is widely seen as a measure of counterparty risk on wholesale banking markets, picked up strongly over the summer (see Graph I.1.22), but remained at a lower level than after the collapse of Lehman in 2008. And persisting fiscal sustainability worries in some countries have negatively impacted on banks' ability to raise funds at a reasonable cost via covered bond issuance in several euro area countries.

Graph I.1.22: **Interbank market spreads**



The key ECB *policy interest rate*, the interest rate on the main refinancing operations, had been raised in April and July 2011 by a cumulative 50 basis points to 1.5% (see Graph I.1.23). Meanwhile the Fed has committed itself to keep policy interest rates at the current (exceptionally low) level at least until mid-2013 and more recently taken additional measures to lower long-term interest rates by selling short-term securities and to purchase longer-term ones ("Operation Twist").

Graph I.1.23: **Policy interest rates, euro area, UK and US**



Overall, in recent months the growing difficulty of EU banks to attract funding outside the ECB at a sustainable cost has become a major concern. Responding to ad-hoc questions about the impact of financial turmoil in the October 2011 ECB Bank Lending Survey, on balance euro-area banks saw a substantial deterioration of their access to money markets and in their issuance of debt securities, which could also affect banks' activities outside the euro area (see Box I.1.2).

... and thereby lending to the private sector.

As for lending activity, bank credit provision to the economy has slowed in mid-2011. After having recovered further in early 2011, reflecting the current slowing of economic activity, in August 2011 *lending to the private sector* (see Graph I.1.24) expanded at an annual rate of 2.5% (not adjusted for sales and securitisation), whereas loans to households increased by 3.0% and lending for house purchase, the most important component of household loans, recorded growth of 3.9%, all unchanged from July but lower than in June. Consumer credit dropped at an annual rate of 1.6% (2.0% in July), which reflects the weakening of private consumption, particularly with regard to major purchases (see also Section I.1.5). The annual growth rate of loans to non-financial corporations stood at 1.6% in July and August.

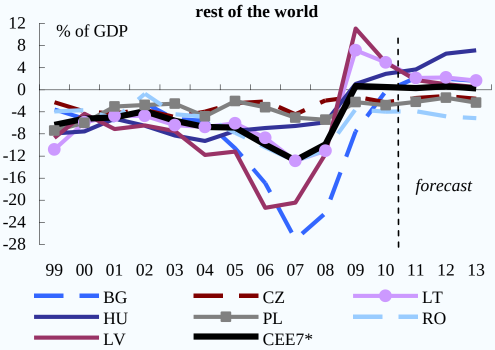
Box I.1.2: **Are capital flows to Central- and Eastern European Member States at risk?**

The persistent tensions in the sovereign-debt markets have led to increased stress in the euro-area banking sector. Consequently, also the banking sector of the New Member States of Central and Eastern Europe could be affected as it is largely owned by the euro-area banks. This box examines the risk of unfavourable credit market developments in these countries in light of the latest forecast.

Evolution of capital flows

All non-euro-area EU Member States from Central and Eastern Europe (CEE7 - BG, CZ, LV, LT, HU, PL and RO) were in a net external borrower position vis-à-vis the rest of the world during the whole period from 1999 until 2008. The intensification of the global financial crisis in late 2008 led to a sharp contraction (and in some cases reversal) of foreign capital inflows into the region in the context of a substantial correction of external imbalances. The (un-weighted) average annual external balance of the CEE7 increased from a deficit of almost 10% of GDP in 2008 to a surplus of about 1% of GDP in 2009 with countries running the highest deficits experiencing the largest contractions. Although the external funding situation seems to have stabilised recently, no clear trend towards a significant deterioration in external balances has arisen yet, apart from the gradual correction of temporarily high surpluses (overshooting) in Latvia and Lithuania. The (un-weighted) average annual external balance of the CEE7 is expected to remain in small surplus in 2011 and then to decline gradually over 2012-13 with only the Czech Republic, Poland and Romania recording external deficits over the forecast horizon. Economic activity in the region (and investment levels in particular) thus currently seems less dependent on foreign funding inflows than in mid-2008.

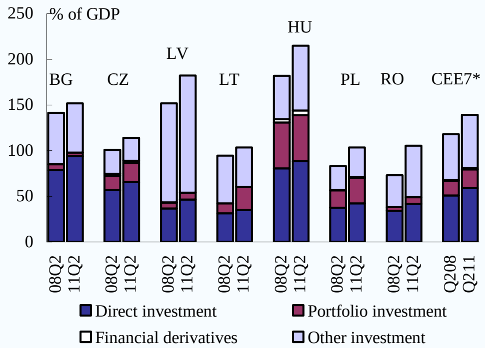
Graph 1: **Net external balance vis-à-vis the rest of the world**



* *unweighted average of BG, CZ, LV, LT, HU, PL and RO*

However, while their balance of payments position has in general improved, the CEE7 countries still have a substantial stock of gross foreign liabilities. Although their size and composition differ widely among the CEE7 countries, the region as a whole (un-weighted average) actually increased its reliance on more volatile types of foreign funding, such as portfolio, financial derivate and other investment flows between Q2-2008 and Q2-2011 despite also recording growth of foreign direct investment liabilities. In addition, over this time span, the stock of short-term external debt (in terms of annual GDP) declined only in Bulgaria and Lithuania. As a result, macro-financial stability across the CEE7 region remains, albeit to a varying degree, dependent on the continued involvement of foreign investors.

Graph 2: **Composition of gross foreign liabilities**



* *unweighted average of BG, CZ, LV, LT, HU, PL and RO*

The role of foreign banks

A particular channel of external funding in the CEE7 is through the largely foreign-owned banking sectors. Over the last decade, euro area parent banks have been key players in the foreign-owned banking sectors of these countries. The subsidiaries of euro area parent banks dominate the local banking sectors of all New Member States, with a share of total assets of the banking sector ranging between 65% and 95%.

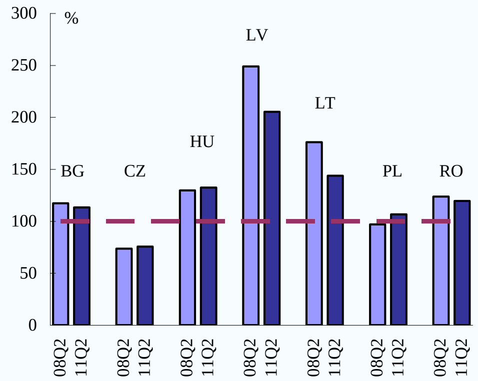
The resurfacing weaknesses in the euro area banking sectors coupled with the persistent tensions in the sovereign-debt markets therefore constitute downside risks to credit market developments in the New Member States of Central and Eastern Europe.[1]

(1) See also European Bank for Reconstruction and Development, *Regional Economic Prospects in EBRD Countries of Operations*: October 2011.

(Continued on the next page)

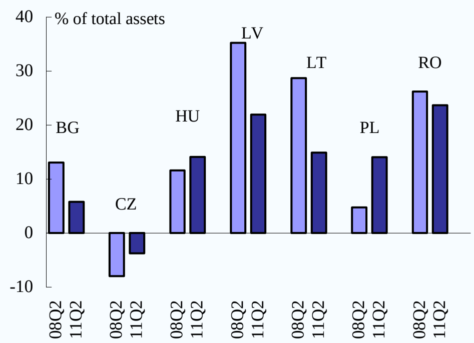
Box (continued)

Graph 3: **Loan-to-deposit ratio**



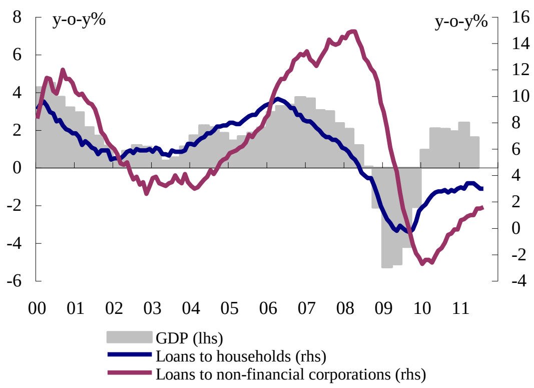
This differs somewhat from the situation in 2008-09, when parent banks in the euro area were seen as a stabilising factor for the region.(1) The sensitivity of the banking sectors to a potential drying up of parent bank funding is illustrated by the high loan-to-deposit ratios (except for the Czech Republic) and the net liability position of the banking sector. Apart from the Czech Republic, the banking sectors of these countries show a net liability position. The reliance of the banking sectors on external funding declined in Bulgaria, Latvia, Lithuania and Romania between Q2-2008 and Q2-2011, whereas it went up in Hungary and Poland. If parent banks scaled down funding to their subsidiaries in Central and Eastern Europe, the latter would have to curtail lending activity to cope with this situation. Under such a scenario, the export-oriented companies in Central and Eastern Europe, which are predominately financing their activities via bank credit, may be more adversely impacted than smaller companies less dependent on bank credit.

Graph 4: **Net liability position of banking sector**



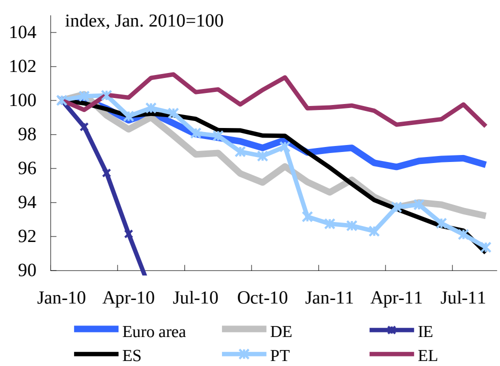
(1) See e.g. Deutsche Bank Research, Eastern Europe – Revival of credit?, *Credit Monitor Eastern Europe*, October 19, 2010.

Graph I.1.24: **Bank lending to households and non-financial corporations, euro area**



At the Member-State level, bank lending to non-financial institutions (NFI) has recently declined (in terms of GDP) in the programme countries, but also in Germany and Spain (see Graph I.1.25). According to the October 2011 ECB Bank Lending Survey, euro area banks reported in the third quarter for the first time in more than a year a falling demand for loans to non-financial institutions, driven by higher uncertainty and decreased financing needs in the context of slowing economic growth. This development is expected to continue in the fourth quarter. Developments also reflect higher financing costs for euro-area NFIs, in particular interest rates on new loans that have increased whereas interest rates on long-term maturities declined.

Graph I.1.25: **Loans to NFI relative to GDP**



** Adjusted for structural break in Greek data*

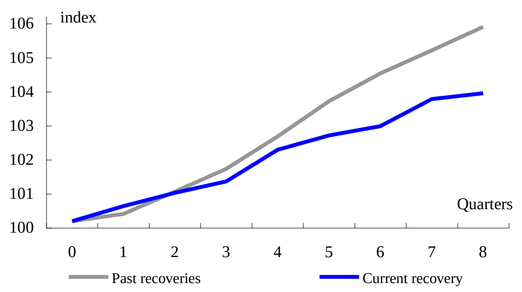
The Bank Lending Survey also pointed to a marked increase in the net tightening of credit standards that exceeded the expectations of respondents as presented in the July survey. It was most pronounced for loans to non-financial corporations (from 2% in the previous quarter to 16% of the banks) and for loans to households for house purchases (from 9% to 18%). The increase for loans to non-financial corporations was substantially lower than in the third quarter of 2008, in which Lehman Brothers collapsed (from 43% to 64%). Among the corporations the tightening was stronger for larger firms, which can usually easier substitute away from bank financing than small and medium size enterprises. Further out, banks expect a further net tightening of credit standards for loans to enterprises, whereas the opposite is expected regarding the net tightening of credit standards on loans for house purchases.

1.5. THE EU ECONOMY

A subdued recovery ...

Up to mid-2011, the pattern of the EU economic recovery has been in line with the features expected for a recovery following a downturn with a financial crisis at its origin.[18] It has been more subdued and sluggish than other recoveries (see Graph I.1.26), held back by weak private demand and tight credit conditions. The most recent evidence even points to a standstill and rejects views that the recovery would catch up with previous recoveries.[19]

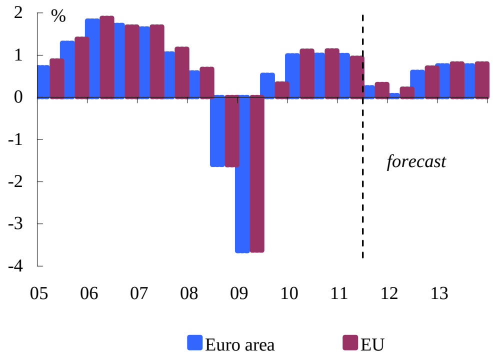
Graph I.1.26: **Comparison of recoveries, current against past average - GDP, euro area**



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

In principle, am temporary slowdown in economic activity is not unusual during a recovery. A soft patch had already been observed last year with the first half being stronger than the second, reflecting the softening of global output growth after the end of support from the inventory cycle and fiscal stimuli measures (see Graph I.1.27). On the basis of semi-annual growth rates, until mid-2011 the recovery looked more robust and steady. In the last three half years, real GDP grew at semi-annual growth rates of close to 1% (half year-on-half year) in both the EU and the euro area.

Graph I.1.27: **Real GDP growth, EU and euro area, semi-annual growth rates**



... with GDP growth momentum waning, ...

In the first quarter of 2011, real GDP grew at the relatively high rate of 0.7% (quarter on quarter) in the EU and 0.8% in the euro area, clearly exceeding the averages growth rates recorded since the start of the recovery in 2009. This reflected a catching up for a more modest fourth quarter of 2010 when adverse weather conditions in a number of countries had withheld growth momentum. This is particularly visible in developments in construction output, which had declined until the end of 2010 and recorded relatively strong growth in the first two quarters this year in both the EU and the euro area. In the second quarter the EU economy did not maintain its momentum, with GDP growing at meagre rates of 0.2% (quarter on quarter) in the EU and the euro area, i.e. respectively 0.2 pp. and 0.1 pp. lower than projected in the spring forecast.

In principle, the loss of momentum could be in line with cyclical patterns ("mid-cycle slowdown"). On the demand side, the relatively strong momentum at the beginning of a recovery is typically associated with private consumption expenditure postponed during the downturn and the replenishing of inventories as companies rebuild their stocks. As these drivers lose power, the growth momentum fades. And in addition, the

(18) See C. M. Reinhart and K. S. Rogoff, *This time is different: eight centuries of financial folly*, Princeton 2009.

(19) See e.g. ECB, The current recovery from a historical perspective (Box 5), *ECB Monthly Bulletin*, August 2011, pp. 52-57.

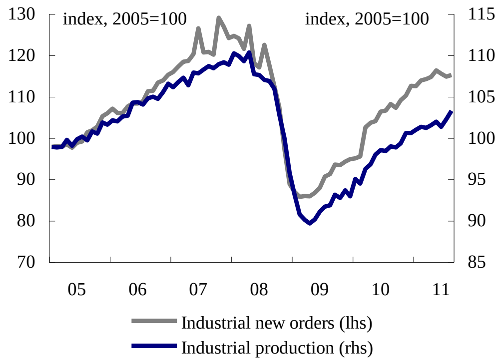
supply side would constrain the upturn as capacity utilisation rebounds but new equipment has not yet been installed. In mid-2011, the slowing of private consumption growth and the only marginal contribution of inventories would be in line with the end of such a "bounce back" effect, but there are no signs that supply-side constraints have mattered for the slowdown in economic activity. This confirms that the recovery has been atypical and suggests rejecting the hypothesis of a mid-cycle slowdown.

Instead, special factors were important for the loss of momentum. The deceleration of growth could be related to strong increases in the first quarter ("payback"). For instance, the strong growth in construction activity observed in the first quarter was not sustained. The impact of sharp increases in commodity prices and the global economic impact of the natural disasters in Japan in March weighed on economic activity in the EU. Finally, the ongoing process of withdrawal of fiscal stimulus measures (e.g. the phasing out of the car-scrapping schemes in France) may have exerted a negative impact as well.

... and a disappointing short-term outlook, ...

A slew of economic data released over the summer months as well as recent short-term indicators point to a further moderation of growth momentum. The slowing growth of global output and less dynamic world trade developments signal a weakening of external support to the European recovery. Increased financial market turmoil and heightened uncertainty about the handling of the European policy challenges, in particular in the wake of decisive actions by monetary and fiscal policymakers in late July and August, are factors that have pulled down business and consumer confidence that had already been on a declining trend since spring.

Graph I.1.28: **Industrial new orders and industrial production, EU**



Several indicators that lead industrial production growth, e.g. order inflows, moved down during the summer months (see Graph I.1.28). In July 2011, industrial new orders in the EU manufacturing sector, a gauge of future activity, were 7.2% higher than a year ago (8.5% in the euro area), whereas in August industrial production in the EU had only increased at an annual rate of 4.3% (5.3% in the euro area). This supports expectations for a continuation of the moderately slowing industrial

Table I.1.3:

Main features of the autumn 2011 forecast - EU

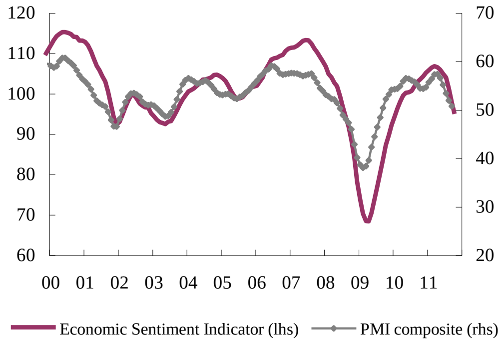
(Real annual percentage change unless otherwise stated)				Autumn 2011 forecast			*Spring 2011 forecast*	
	2008	2009	2010	2011	2012	2013	*2011*	*2012*
GDP	0.3	-4.2	2.0	**1.6**	**0.6**	**1.5**	*1.8*	*1.9*
Private consumption	0.3	-1.7	1.0	**0.4**	**0.4**	**1.1**	*0.9*	*1.3*
Public consumption	2.3	2.0	0.7	**0.3**	**-0.2**	**0.1**	*0.3*	*0.2*
Total investment	-0.9	-12.5	-0.3	**1.9**	**0.8**	**3.0**	*2.5*	*3.9*
Employment	0.9	-1.9	-0.6	**0.4**	**0.1**	**0.4**	*0.4*	*0.7*
Unemployment rate (a)	7.1	9.0	9.7	**9.7**	**9.8**	**9.6**	*9.5*	*9.1*
Inflation (b)	3.7	1.0	2.1	**3.0**	**2.0**	**1.8**	*3.0*	*2.0*
Government balance (% GDP)	-2.4	-6.9	-6.6	**-4.7**	**-3.9**	**-3.2**	*-4.7*	*-3.8*
Government debt (% GDP)	62.5	74.7	80.3	**82.5**	**84.9**	**84.9**	*82.3*	*83.3*
Adjusted current-account balance (% GDP)	-2.0	-0.8	-0.8	**-0.8**	**-0.4**	**-0.2**	*-0.6*	*-0.3*
Contribution to change in GDP								
Domestic demand	0.4	-3.2	0.7	**0.6**	**0.3**	**1.2**	*1.0*	*1.5*
Inventories	-0.2	-1.1	0.8	**0.2**	**0.0**	**0.0**	*0.1*	*0.1*
Net exports	0.1	0.0	0.5	**0.7**	**0.3**	**0.3**	*0.7*	*0.4*

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

production growth and thus does not bode well for economic growth.

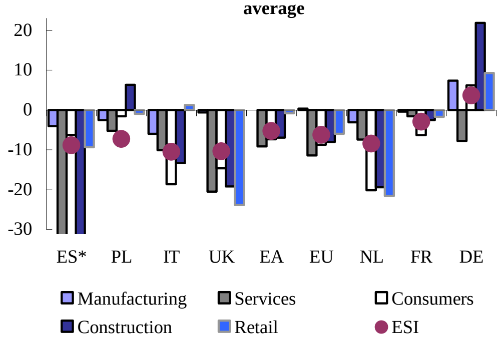
Survey indicators point to a slowing of economic activity in all Member States and across almost all sectors. The Commission's Economic Sentiment Indicator (ESI) followed a downward trend in the EU and the euro area since April 2011, starting from a very high level and remaining above the long-term average until July, but declining below in August and September (see Graph I.1.29). Apart from the low level, it is the speed of the decline that points, as experience suggests, to a marked GDP growth slowdown.

Graph I.1.29: **Economic Sentiment Indicator and PMI composite index, EU**



This development is shared by most components, including manufacturing, services, retail, households, but not construction (see Graph I.1.30). The Commission's Industrial Confidence Indicator has been declining in the EU since it peaked in March 2011 (since February 2011 in the euro area) and stood in October close to its long-term average in both the EU and the euro area. In particular, managers' assessment of the level of order books and of their expected production for the next months has declined strongly over the past months and the percentage of managers assessing their stocks to be too large increased. Not included in the Industrial Confidence Indicator, managers' assessment of production trends observed during recent months and of export order books has also worsened strongly over the last five/six months. Manufacturers are therefore likely to reduce their production further in the short term to meet the lower demand implied by continuous decreases in order books and required to reduce stocks.

Graph I.1.30: **Economic Sentiment Indicator (ESI) and components - October 2011, difference from long-term average**



** Sentiment in construction: -42 pts.; in services: -36 pts.*

Table I.1.4:

Main features of the autumn 2011 forecast - euro area

(Real annual percentage change unless otherwise stated)	2008	2009	2010	Autumn 2011 forecast 2011	2012	2013	*Spring 2011 forecast 2011*	*2012*
GDP	0.4	-4.2	1.9	**1.5**	**0.5**	**1.3**	*1.6*	*1.8*
Private consumption	0.4	-1.2	0.9	**0.5**	**0.4**	**1.0**	*0.8*	*1.2*
Public consumption	2.3	2.5	0.5	**0.1**	**-0.2**	**0.3**	*0.2*	*0.3*
Total investment	-1.1	-12.2	-0.5	**2.0**	**0.5**	**2.9**	*2.2*	*3.7*
Employment	0.7	-2.1	-0.5	**0.3**	**0.0**	**0.3**	*0.4*	*0.7*
Unemployment rate (a)	7.6	9.6	10.1	**10.0**	**10.1**	**10.0**	*10.0*	*9.7*
Inflation (b)	3.3	0.3	1.6	**2.6**	**1.7**	**1.6**	*2.6*	*1.8*
Government balance (% GDP)	-2.1	-6.4	-6.2	**-4.1**	**-3.4**	**-3.0**	*-4.3*	*-3.5*
Government debt (% GDP)	70.1	79.8	85.6	**88.0**	**90.4**	**90.9**	*87.7*	*88.5*
Adjusted current-account balance (% GDP)	-1.5	-0.3	-0.4	**-0.6**	**-0.5**	**-0.3**	*0.1*	*0.2*
Contribution to change in GDP								
Domestic demand	0.4	-2.8	0.5	**0.7**	**0.3**	**1.2**	*0.9*	*1.5*
Inventories	-0.1	-0.9	0.6	**0.3**	**-0.1**	**0.0**	*0.0*	*0.1*
Net exports	0.1	-0.6	0.8	**0.6**	**0.2**	**0.2**	*0.7*	*0.2*

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

More generally, the surveys show a marked deterioration in their forward-looking components, households' and companies' assessments of the current situation are also on a downward trend.

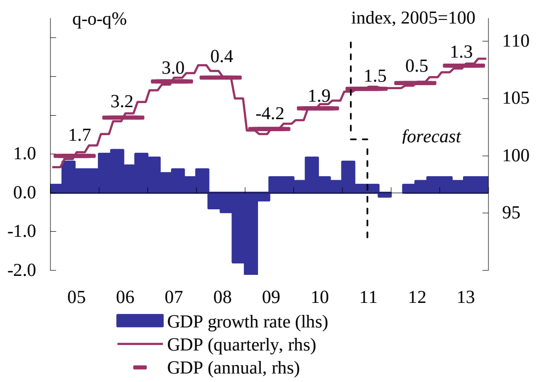
The Services Confidence Indicator had fallen between March and September (-14½ in the EU and -11 in the euro area), followed by a small increase in October (1¼ and ¼ respectively), which overall continues pointing to a further moderation in growth. The drop results from a general worsening of all the three components that compose the Services Confidence Indicator although the sector is usually less sensitive to cyclical developments than manufacturing. Managers' assessment of past business situation and past evolution of demand declined since the spring, while their demand expectations followed a more irregular path over the past months.

These results are confirmed by the Purchasing Managers' Index (PMI). Up to the second quarter of 2011, the readings of the euro-area and EU PMI Composite Output Index were close to the highest levels since mid-2006 (see Graph I.1.29). Since then, the euro-area PMI composite output index has dropped from its peak of 58.2 in February 2011 to 47.2 in October (Flash PMI), which signalled for the first time since mid-2009 a slight contraction in economic activity. The decline is also reflected in quarterly averages, which fell from 57.6 in the first and 55.6 in the second to 50.3 in the third quarter. This is almost in the middle of the average EU PMI composite output scores of 45.2 during the downturn (second quarter of 2008 to third quarter of 2009) and 55.3 during recovery (up to mid-2011). The decline in the PMI included manufacturing and services with the former already signalling shrinking activity in August. As in the ESI, the decline is observed across all countries covered by the survey, with the PMI recording the highest scores in Ireland, Germany and France.

Other survey indicators for the EU and the euro area have corroborated the aforementioned survey indices. The latest OECD composite leading indicators (August 2011) continued to point to a slowdown in economic activity in the euro area, but also in other countries, including the UK, the US and the BRICS economies. National leading indicators have also deteriorated during the summer months, but they are still at rather different levels with some being consistent with moderate growth in the near term. For instance, the Ifo business climate indicator for Germany has declined from its peak in February (114.4 points) to 106.4 in October, which is still above the long-term average. By now the overall index has declined for four consecutive months, whereas the manufacturing component has already declined in eight consecutive months. In September, the NBB Index for Belgium, which has in the past tracked the euro area rather well, has for the sixth time in a row weakened and has by now fallen to a level last seen in 2009.

Against this background, GDP growth in the EU is expected to come to a standstill in the fourth quarter this year. As some euro area Member States fall back into contraction, the euro area will even face a period of contraction (-0.1% q-o-q). For 2011 as a whole, the strong first half and the weak second half almost offset each other in their impact on the annual GDP growth forecast, which stands at 1.6% for the EU and 1.5% for the euro area (see Graph I.1.31).

Graph I.1.31: **Real GDP, euro area**



Figures above horizontal bars are annual growth rates.

The current readings of the indicators still seem to be consistent with a temporary standstill of economic growth without the EU economy falling back into recession, notwithstanding single quarters of contraction in a few Member States.

... with only modest improvements expected for 2012-13 ...

The period of weak economic activity is expected to continue into 2012 with almost no growth in the first quarter in the EU (0.1% q-o-q) and the euro area (0.0%). In line with the assumption that the strains from the European financial market crisis will successively disappear in 2012, business and consumer confidence is expected to return, lifting the EU economy back to a rather subdued recovery path. This limits the growth prospects for the first of 2012 half to only modestly positive rates. The economic situation is projected to improve slightly in the second half of 2012 as some of the headwinds of 2011 are expected to subside or turn into tailwinds. Commodity prices have already moderated since mid-2011 (see Section I.1.3). This will remove one of the cost pressures on European producers, help European consumers to gain more purchasing power and should thus be supportive to the economic rebound. The recovery in Japan is progressing and the repair of global supply chains will be completed so that the global impact will not only vanish but turn positive as reconstruction efforts intensify.

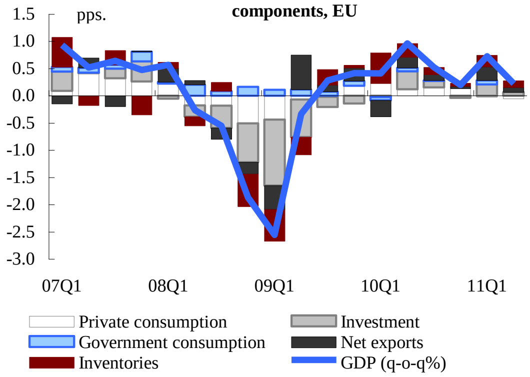
Further out, based on the assumption of a successful approach to sovereign debt problems and the return of confidence in late 2012, a certain normalisation is expected in the course of 2013. More confident consumers can be expected to lower their saving rates – at least where there is no need for further balance sheet adjustments - and raise consumption, which could then also have a positive impact on investment demand (capacity expansion) with gross fixed capital formation benefitting from favourable financing conditions.

... and the broadening of GDP growth across domestic components on hold.

Signs of a broadening of economic growth across domestic components, a condition for becoming self-sustained, had been visible for some time. While initial quarters of the recovery had followed the standard patterns of an export-led upturn, in 2010 the contribution of domestic demand to GDP growth in the EU (0.7 pp.) and in the euro area (0.5 pp.) increased substantially, almost catching up with the strongest single contributors (see Tables I.1.5 and I.1.6), which were inventories (0.8 pp.) in the EU and net exports in the euro area (0.8 pp.). Overall, domestic demand, in particular private consumption and investment demand, had delivered moderate contributions, but their profile had created expectations that a broadening of growth could become a key feature of the recovery. But the latest national account data do not support these expectations.

In the second quarter of 2011, net exports have again taken over as the main contributor to growth. The contribution of domestic demand (excluding inventories) was flat, with all demand components sharply decelerating compared to the first quarter. By contrast, exports expanded by 1.0% q-o-q, down from 2.0% in the first quarter, reflecting the weakening of global demand and world trade, and imports grew by 0.5%, leading to a positive contribution of net trade to growth of 0.2 pp. (see Graph I.1.32).

Graph I.1.32: **GDP growth and its components, EU**



Looking ahead, the slowing in private consumption and gross fixed capital formation will reduce the growth contribution of domestic demand components in the EU and the euro area (0.3 pp. in 2012) putting the broadening on hold. With the moderate acceleration of economic growth expected towards the end of next year, domestic components are projected to become the strongest contributor to economic growth (1.2 pps. in both the EU and the euro area).

Key factors of the multi-speed recovery in the EU are losing importance ...

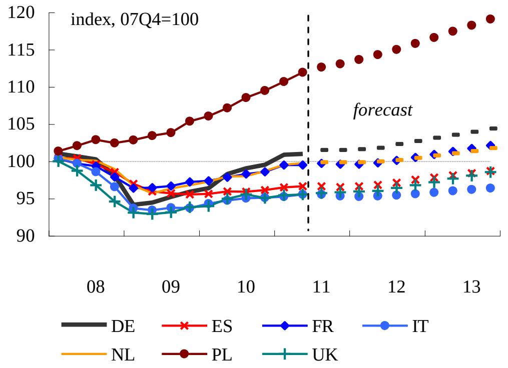
Substantial growth differences across Member States have been one of the key features of the recovery. A number of reasons have been identified, such as starting positions in terms of private indebtedness, bursting asset prices (housing market situation), banking sector health, and the solidity of public finances. Competitiveness and export structures (product composition, export destination) provided additional explanations. And, last but not least, the strong rebound in world trade (see Section I.1.3) impacted differently on countries, allowing those with export-oriented economies and strong competitiveness to benefit most, i.e. to grow faster than others. Only the fastest growing countries, such as Sweden, Poland and Germany, were able to reach output levels above those in pre-crisis periods.[20] For instance,

[20] See also the analysis in chapter I.1 in European Commission (DG ECFIN), European Economic Forecast – Spring 2011, *European Economy* no. 1, 2011.

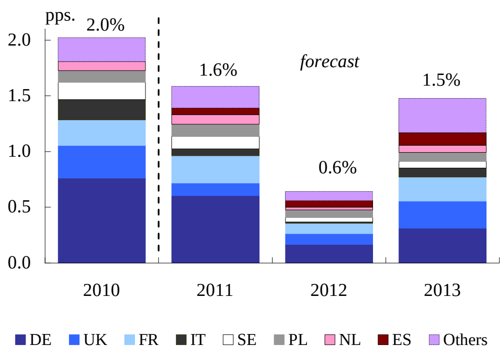
in the group of the seven largest economies, only Poland has clearly exceeded its pre-crisis level of output of the fourth quarter of 2007 whereas Germany returned to the pre-crisis level in the first quarter of 2011 (see Graph I.1.33). At the other end, economies hit by a banking crisis (the UK) or a housing crisis (Spain), as well as the debt-troubled programme countries (Greece, Ireland, Portugal) exhibited lacklustre economic growth and remain below pre-crisis levels.

Germany, whereas Sweden and Poland are the non-euro area Member States with the largest contributions. As regards the indirect contribution, several Member States are benefitting from strong growth in Germany. And since impulses to economic activity in Germany stemmed to a large extent from non-EU demand, the country's strong growth performance has created positive spillovers for other Member States, most notably via higher demand for imported inputs, but also via imports of consumer goods and services.

Graph I.1.33: **Real GDP growth, Member States, 2008-13**



Graph I.1.34: **Real GDP growth , EU, contributions by Member States**



Due to the multi-speed recovery the contributions countries made to economic growth in the EU differed markedly, both directly via national real GDP growth and indirectly via positive spillovers to other Member States. In terms of direct contributions (see Graph I.1.34), the highest contributions in 2011 are coming from France and

While the situation across Member States had markedly differed in 2010, the readings of national PMI manufacturing indices have fallen almost in parallel in the first three quarters of this year (see Graph I.1.35).

Table I.1.5:

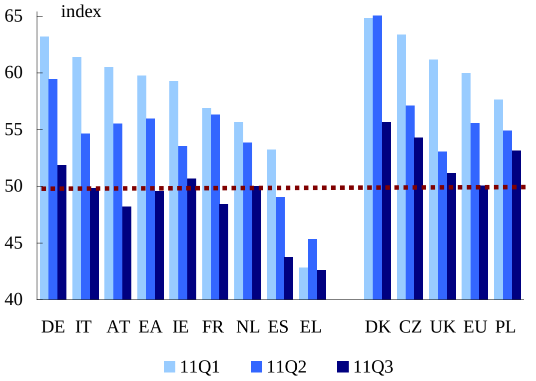
Composition of growth - EU

(Real annual percentage change)

	2010							Autumn 2011 forecast		
	bn Euro curr. prices	% GDP	2006	2007	2008	2009	2010	2011	2012	2013
			Real percentage change							
Private consumption	7031.9	58.1	2.3	2.2	0.3	-1.7	1.0	**0.4**	**0.4**	**1.1**
Public consumption	2693.2	22.2	2.0	1.8	2.3	2.0	0.7	**0.3**	**-0.2**	**0.1**
Gross fixed capital formation	2248.8	18.6	6.4	5.9	-0.9	-12.5	-0.3	**1.9**	**0.8**	**3.0**
Change in stocks as % of GDP	47.8	0.4	0.5	0.8	0.6	-0.4	0.4	**0.5**	**0.5**	**0.4**
Exports of goods and services	4967.5	41.0	9.7	5.8	1.5	-12.0	10.8	**6.3**	**3.6**	**5.3**
Final demand	16989.2	140.3	5.0	4.0	0.6	-6.6	4.1	**2.4**	**1.3**	**2.5**
Imports of goods and services	4876.8	40.3	9.6	6.0	1.2	-12.2	9.8	**4.6**	**2.9**	**4.8**
GDP	12112.4	100.0	3.3	3.2	0.3	-4.2	2.0	**1.6**	**0.6**	**1.5**
GNI	12128.2	100.1	3.4	3.0	0.0	-4.2	2.2	**1.4**	**0.7**	**1.4**
p.m. GDP euro area	9161.8	75.6	3.2	3.0	0.4	-4.2	1.9	**1.5**	**0.5**	**1.3**
			Contribution to change in GDP							
Private consumption			1.3	1.3	0.2	-1.0	0.6	**0.2**	**0.3**	**0.6**
Public consumption			0.4	0.4	0.5	0.4	0.2	**0.1**	**-0.1**	**0.0**
Investment			1.3	1.2	-0.2	-2.6	-0.1	**0.3**	**0.2**	**0.6**
Inventories			0.2	0.4	-0.2	-1.1	0.8	**0.2**	**0.0**	**0.0**
Exports			3.6	2.3	0.6	-5.0	4.0	**2.6**	**1.5**	**2.4**
Final demand			6.8	5.5	0.8	-9.3	5.5	**3.4**	**1.8**	**3.6**
Imports (minus)			-3.5	-2.3	-0.5	5.0	-3.5	**-1.8**	**-1.2**	**-2.1**
Net exports			0.1	0.0	0.1	0.0	0.5	**0.7**	**0.3**	**0.3**

Further out, almost all Member States are expected to experience a slowdown of economic growth or even periods of contraction. In 2012, all but six Member States are expected to grow slower than this year. Real GDP growth rates are ranging from significant contraction in Greece and Portugal to some slower, but compared to others, still rapidly growing New Member States. In most of the countries the deteriorated economic outlook will further delay full recovery. Cyclical measures, such as the output gap, confirm the delayed return to pre-crisis levels, and they continue to signal in many Member States an extended period of low resource utilisation.

Graph I.1.35: **PMI manufacturing output, Member States**



The growth outlook suggests that Member States' economies have entered a period of increased convergence towards low levels of economic growth ("re-coupling"). Indeed, some of the factors behind the multi-speed recovery have disappeared or lost importance, and common shocks have hit the Member States. World trade growth has been returning to more normal patterns and the importance of starting positions has diminished. Instead, common shocks such as financial turmoil and the slowdown in global output are hitting all economies simultaneously.

...but some heterogeneity might persist for different reasons.

But new arguments came to the fore that suggests growth differences across Member States ("de-coupling") to persist for some time. They include relatively low costs of sovereign refinancing due to the decline in sovereign bond yields in some countries, which would allow them to spread fiscal consolidation, if needed, over a longer period. Against the general observation that austerity measures tend to have, in the short to medium run, contractionary effects,[21] such differences in the size or profile of fiscal retrenchment would impact on economic growth. Further reasons may be found in different labour market conditions (see

(21) See for instance J. Guajardo, D. Leigh and A. Pescatori, Expansionary austerity: New international evidence, *IMF Working Paper* no. 11/158, July 2011, an earlier study by Commission staff had presented evidence of expansionary consolidations, see G. Giudice, A. Turrini and J. in 't Veld, Non-Keynesian fiscal adjustment? A close look at expansionary fiscal consolidations in the EU, *Open Economies Review*, November 2007, Vol. 18, No. 5, pp. 613-630.

Table I.1.6:

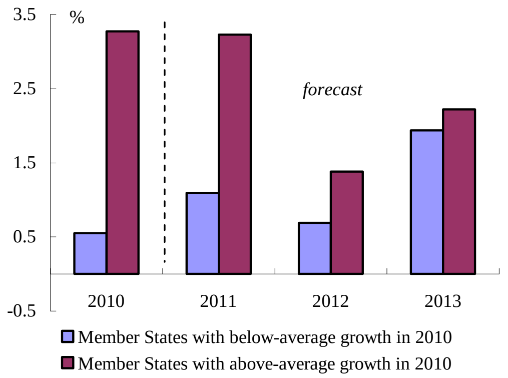
Composition of growth - euro area

(Real annual percentage change)

	2010							Autumn 2011 forecast		
	bn Euro curr. prices	% GDP	2006	2007	2008	2009	2010	2011	2012	2013
			Real percentage change							
Private consumption	5263.2	57.4	2.1	1.7	0.4	-1.2	0.9	**0.5**	**0.4**	**1.0**
Public consumption	2013.4	22.0	2.1	2.2	2.3	2.5	0.5	**0.1**	**-0.2**	**0.3**
Gross fixed capital formation	1749.6	19.1	5.7	4.7	-1.1	-12.2	-0.5	**2.0**	**0.5**	**2.9**
Change in stocks as % of GDP	20.2	0.2	0.4	0.8	0.7	-0.3	0.3	**0.5**	**0.4**	**0.4**
Exports of goods and services	3747.4	40.9	8.9	6.6	1.0	-12.8	11.3	**6.1**	**3.4**	**5.3**
Final demand	12793.7	139.6	4.7	3.9	0.6	-6.4	3.9	**2.5**	**1.2**	**2.5**
Imports of goods and services	3631.9	39.6	8.7	6.2	0.9	-11.7	9.6	**4.8**	**3.0**	**5.0**
GDP	9161.8	100.0	3.2	3.0	0.4	-4.2	1.9	**1.5**	**0.5**	**1.3**
GNI	9170.7	100.1	3.7	2.6	-0.2	-4.1	2.2	**1.5**	**0.4**	**1.3**
p.m. GDP EU	12112.4	132.2	3.3	3.2	0.3	-4.2	2.0	**1.6**	**0.6**	**1.5**
			Contribution to change in GDP							
Private consumption			1.2	0.9	0.2	-0.7	0.5	**0.3**	**0.3**	**0.6**
Public consumption			0.4	0.4	0.5	0.5	0.1	**0.0**	**-0.1**	**0.1**
Investment			1.2	1.0	-0.2	-2.6	-0.1	**0.4**	**0.1**	**0.6**
Inventories			0.2	0.4	-0.1	-0.9	0.6	**0.3**	**-0.1**	**0.0**
Exports			3.4	2.7	0.4	-5.4	4.1	**2.5**	**1.5**	**2.4**
Final demand			6.4	5.4	0.8	-9.0	5.3	**3.5**	**1.7**	**3.5**
Imports (minus)			-3.2	-2.4	-0.4	4.8	-3.4	**-1.9**	**-1.3**	**-2.2**
Net exports			0.2	0.2	0.1	-0.6	0.8	**0.6**	**0.2**	**0.2**

Chapter I.2) and their impact on domestic demand in the context of diminishing external contributions to growth.

Graph I.1.36: **A multi-speed recovery in the EU - real GDP, annual growth (unweighted)**



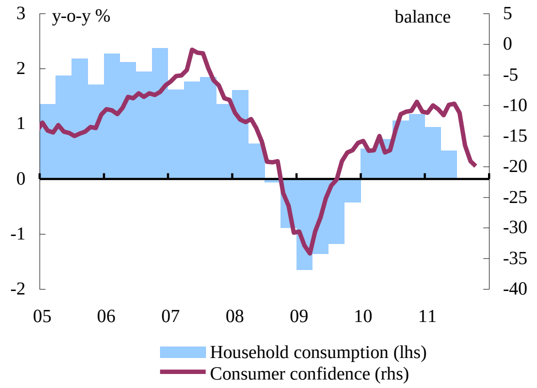
A comparison of the growth outlook for countries that distinguishes between last year's fast and slow growing economies supports the expectation of persisting differences in growth speeds (see Graph I.1.36) although the differences diminish in a low-growth environment. As regards the additional narrowing in 2013, the no-policy-change assumption has to be taken into account. In particular, some of the slow-growing countries might have to take additional fiscal measures which could widen the speed difference.

In addition, the differentiation markets introduced for sovereign bond issues means that the real interest rate channel can be expected to work differently from what had been experienced in the first years of monetary union. Now the less vulnerable and faster growing economies can benefit from low real interest rates associated with below-average nominal interest rates. This makes them more attractive as an investment location and contributes to speed differences with countries subject to concerns about the sustainability of their public finances.

Private consumption growth has been moderate ...

Private consumption, the largest GDP component, has contributed positively to GDP growth from the outset of the current recovery in mid-2009 until the first quarter of 2011. In 2010, the annual rate of growth stood at 0.8% in both the EU and the euro area (see Graph I.1.37). Among the key reasons for moderate consumption growth have been weak increases in real disposable incomes. Real compensation per employee had been falling during the crisis and only moderately recovered in 2010. In the first half of 2011, increased inflation rates, driven by higher food and energy prices, had more than offset increases in nominal compensation, which had remained subdued on the back of only slowly improving labour market conditions. Non-labour incomes had grown since the start of the recovery, but not strong enough to lift real disposable incomes. Other potential drivers of private consumption did not step in as private wealth was constrained by weak financial and housing market developments. And, in the wake of the sharp downturn, households moderately lowered their saving rates, which had gone up when precautionary actions had been an issue.

Graph I.1.37: **Private consumption and consumer confidence, euro area**

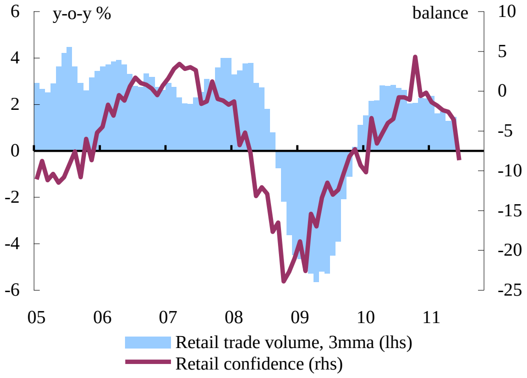


In the second quarter the weak upward trend of private consumption was stopped as declines were recorded in the EU and in the euro area (-0.3% quarter on quarter). The contraction can be mainly attributed to developments in Germany and France where real private consumption declined. A fall in real disposable income in Germany and the end of car-scrapping schemes in France can explain to some extent these developments.

... and is expected to slow in 2012 ...

Looking ahead, economic indicators signal a continuation of weak consumption growth in the near term. Hard data that account for about one half of private consumption came in at rather weak readings in the third quarter. Retail sales volumes (see Graph I.1.38), which reflect about 45% of private consumption in the euro area, declined in the second quarter in the EU (-0.2%, quarter on quarter) and in the euro area (-0.3%). The latest available data (July and August) point to a standstill in the euro area and slightly negative growth in the EU, which is in line with the latest readings of the Commission's Retail Confidence Indicator and the PMI for retail trade.

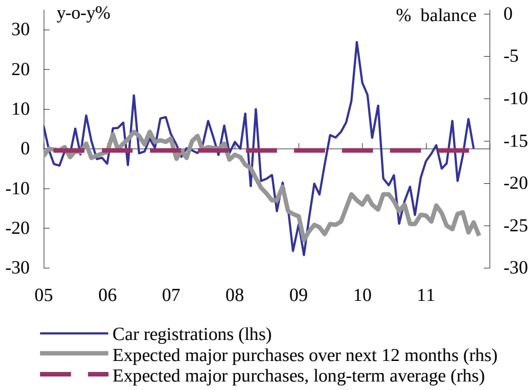
Graph I.1.38: **Retail trade volumes and retail confidence, euro area**



New passenger car registrations had declined markedly in the second quarter in the EU and in the euro area, after increasing in the first quarter in both areas. On the one hand, following the sharp increases in purchases of new cars in 2009-10, triggered by the car-scrapping schemes in a number of Member States, the level of registrations was expected to decline. On the other hand, anecdotal evidence from European car producers point to a solid situation, at least for the rest of 2011. With car purchases accounting for about 5% of euro area private consumption, however, positive news from this indicator would not provide a big push to the consumption aggregate.

Survey-based indicators tracking overall private consumption have signalled weak growth momentum throughout the year and weaker private consumption in the near term. According to the Commission's surveys, sentiment in Europe has shifted markedly since spring as consumers incorporated news about the deteriorated outlook and financial market turmoil. The Consumer Confidence Indicator (see Graph I.1.37) deteriorated markedly over the summer, with a very pronounced drop in August 2011 and smaller declines in September and October. This has brought confidence back to the level observed late 2009/early 2010. The recent deterioration is mainly due to very pessimistic expectations about the general economic situation and to higher unemployment fears. Consumers' appraisal of their expected savings has worsened, too. Households' expected major purchases, a question that is not included in the confidence indicator, had remained at a low level throughout the year and therefore not declined any further. The responses are almost at the same low level as since the beginning of 2010 and below long-term averages in the EU and the euro area (see Graph I.1.39). Uncertainty appears to keep households in a wait-and-see attitude resulting in postponed major purchases, which is also reflected in declining volumes of consumer credit in the euro area.

Graph I.1.39: **Expected major purchases over the next year and car registrations, EU**



... before accelerating slightly in late 2012 and 2013.

Looking further ahead, a return to moderate growth in private consumption rests on the disappearance of some of this year's drags on consumer spending and a more positive outlook for households' disposable incomes. While non-labour incomes that account for about one third in disposable income are expected to grow in 2011 and over the forecast horizon at annual rates of 3-4% in both the EU and the euro area, the compensation of employees will increase at annual rates of 2-3%. Increases in real disposable incomes will significantly depend on the retreat of inflationary pressures that helps households to lift purchasing power.

To what extent higher real disposable incomes will translate into a strengthening of private consumption growth depends also on the spending patterns of households that are subject to progress with household deleveraging. Overall, the saving rate is expected to remain almost unchanged in the EU and the euro area in 2012. This said the contribution would mainly come from a moderation of consumer price inflation and its impact on real incomes. Losses in equity markets are also likely to affect private consumption, through lower confidence and negative wealth effects. The extent of these is, however, difficult to assess and will vary across economies.

Among the largest Member States, Germany, Spain, France and Poland are expected to record above average growth rates in 2012, whereas in the other countries private consumption will shrink (the Netherlands and the UK) or expand modestly (Italy). In 2013, private consumption growth is expected to accelerate in all Member States except Germany.

Public consumption has already been on a downward trend for some time ...

While public consumption had been a strong driver of economic activity in the initial phase of the recovery, the withdrawal of fiscal stimulus has made the growth contribution of this GDP component almost disappearing. Given that several of the measures were still in place in the first half of 2010, last year's annual growth rate of government consumption still stood at 0.7% in the EU and 0.5% in the euro area. But the growth contribution already declined in 2010 to 0.2 pp. in the EU and 0.1 pp. in the euro area.

This year, against the background of enhanced fiscal consolidation efforts, government consumption growth decelerated further. This reflects developments in public employment, both in terms of employees and compensation, and expenditure-based consolidation measures, such as cuts in government transfers. After expanding in the first quarter (0.6% quarter on quarter in both the EU and the euro area), the rather volatile quarterly series recorded a fall in the second quarter in both the EU (to 0.1%) and in the euro area (to -0.1%). In the second quarter of 2011, government consumption declined in the larger euro-area Member States, except in Germany were it remained stable and in the Netherlands where it even increased somewhat. In 2011 as a whole, a moderate expansion of government consumption is expected in the EU (0.3%) and in the euro area (0.1%). In the euro area, the three programme countries as well as Spain, Slovakia and Slovenia are projected to record declines. Outside the euro area, the Czech Republic, Hungary and Romania are the only countries reducing government expenditures in 2011.

... with more to come as fiscal consolidation progresses.

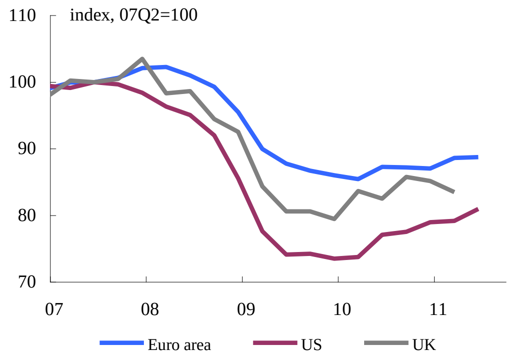
Looking ahead, ongoing consolidation efforts are expected to continue lowering public consumption growth during the current slowing and further in 2012, amid a deteriorated economic performance, which in the past has often been seen to be accompanied by higher government spending, for instance due to increased social transfers of stimulus measures. In 2012, shrinking government consumption is expected in the EU and the euro area (-0.1% in the EU, -0.2% in the euro area). Declines are expected in the three programme countries and three additional euro-area economies (Spain, Italy and the Netherlands) and three non-euro-area countries (Lithuania, Hungary, the UK). Further out, government consumption is expected to increase slightly in 2013 (0.1% in the EU and 0.3% in the euro area). But this small expansion should be seen against the background of the no-policy-change assumption, which could imply that a number of consolidation measures are not yet included as they do not meet the conditions for being fully accounted for (see also Box I.1.3).

Gross fixed capital formation contributed strongly in early 2011 ...

During the downturn in 2008 and 2009, gross fixed capital formation, a very volatile component of GDP, had fallen sharply as firms trimmed business and reduced debt. During the first quarters of the recovery, investment had continued shrinking. This resulted in negative growth rates in 2010 in both the EU (-0.3%) and the euro area (-0.5%) as positive growth in private sector investment has not been sufficient to compensate for shrinking general government investment (-7.1% and -8.3%). As the recovery gained momentum, there were signs that the impetus from the export-led rebound to investment demand was materialising.

In the first quarter of 2011, gross fixed capital formation was the main driver of growth (1.0% quarter on quarter in the EU, 1.6% in the euro area), but the slowing in the second quarter also showed up in declining growth in this demand component (0.4% quarter on quarter in the EU, 0.0% in the euro area). This deceleration was broad-based across countries, particularly strong in Germany and the Netherlands. Overall, investment in the euro area is still well below pre-crisis levels (see Graph I.1.40).

Graph I.1.40: **Gross fixed capital formation, euro area, US and Japan**



... but the outlook is deteriorating ...

Over the summer, however, the outlook for equipment investment has worsened as companies re-assessed their output forecasts. Quarterly results published in October 2011 show that capacity utilisation already declined in both the EU and the euro area, interrupting its two-year upward trend since the trough in July 2009. At around 80, capacity utilisation stands in the EU (by 1.1 pts.) and in the euro area (by 1.9 pts.) below long-term averages. In addition, increased uncertainty in the EU can be expected to act as substantial drag to firms' investment decisions, which are not only guided by the net present value of future profits of a project, but also by the riskiness of the profit stream. The higher the level of uncertainty, the larger is the probability of 'expensive mistakes'. When investment returns become highly uncertain, as at the current juncture, delaying investment decisions until new information becomes available brings a gain.[22] Thus, changes in uncertainty have large quantitative effects on optimal leverage and investment dynamics. Lower investment volumes imply deleveraging, as entrepreneurs reduce their demand for external financing to be able to hedge the larger shocks. Increased uncertainty thus in the short run tends to lower gross fixed capital formation. The initial deleveraging leads to a drop in overall investment.

In such a situation neither excellent shape of corporate balances in some countries nor relatively moderate financing costs can be expected to provide strong support for investment. Further out, the tightening of credit standards could even become an additional drag for many companies. And fiscal tightening is expected to further dampen the willingness to consume and invest, and this contributes to a downward adjustment in companies' demand expectations.

Gross fixed capital formation now might not need to build up as much capacity as expected in spring. And slowing activity puts pressure on profits lowering margins, as for instance indicated by changes in the ratio of the GDP deflator and unit labour costs in both the EU and the euro area.

Looking ahead, taking into account the downside factors the forecast is for a modest expansion of gross fixed capital formation. As general government investment is expected to remain constrained by consolidation efforts and be shrinking further, the growth rests on the investment activity of the other domestic sectors. The softening of economic activity lowers demand expectations, which, in connection with deteriorating profits, do not bode well for capacity-enhancing investment. Therefore, a markedly lower growth rate of gross fixed capital formation is forecast in 2012 (down to 1.0% in the EU and 0.5% in the euro area). This overall figure includes a relatively weak outlook for government investment, but a more positive though moderate one for other sectors' investment in construction, driven by returning business confidence. The unabated overall growth next year is mostly explained by increases in the EU Member States outside the euro area (1.7% in 2012). As the EU economy is overall losing investment strength, one of the sizeable pillars of support to the recovery will be breaking down. Further out, the return of confidence in late 2012 and 2013 is expected to raise gross fixed capital formation including the realisation of investment projects postponed during the current slowdown.

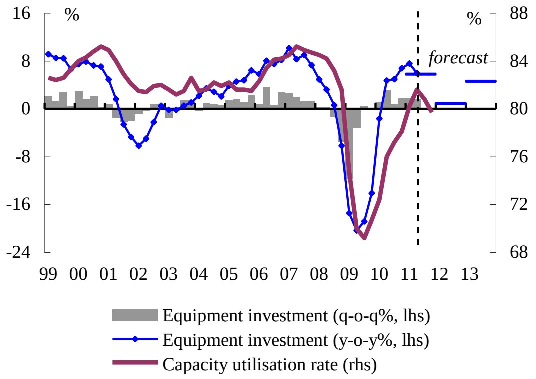
... as equipment investment weakens, ...

A weaker export outlook will translate into weaker impetus for equipment investment. In addition to this, downward pressures stemming from corporate balance sheet adjustment, declining order inflows, increasing level of stocks, decreasing capacity utilisation (see Graph I.1.41), the expected slight increase in the net tightening of credit standards for loans to enterprises, should weigh on equipment investment. On the positive side,

[22] See e.g. N. Bloom, S. Bond and J. Van Reenen, 'Uncertainty and investment dynamics', *Review of Economic Studies*, 2007, 74 (2), 391-415. Results of empirical studies point towards a significantly negative and quantitatively relevant relationship between uncertainty and the investment share of the capital stock (see also the overview in the spring 2010 forecast document).

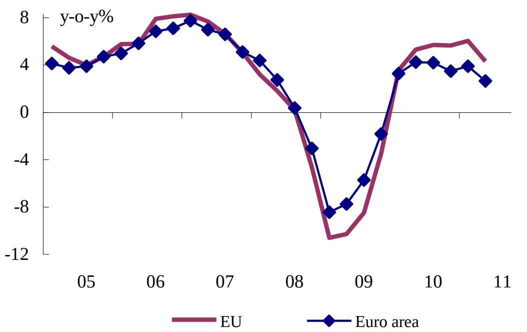
equipment investment could benefit from strong corporate profits as long as firms do not hold back on investment due to the uncertain outlook.

Graph I.1.41: **Equipment investment and capacity utilisation, euro area**



The first hard data for the third quarter give a mixed picture. On the one hand, industrial production of capital goods, an indicator of future non-construction investment, rose in the EU by 3% month-on-month in July and 1½% in August (3¼% and 2% in the euro area). Even anticipating some offsetting effect in September, the figure bodes well for capital goods production in the third quarter. On the other hand, data on industrial new orders showed a decline in the orders of capital goods in July that was only partially offset by the increase in August 2011. All in all, growth in equipment investment is expected to slow down and remain more subdued than expected in spring.

Graph I.1.42: **Profit growth, EU and euro area**



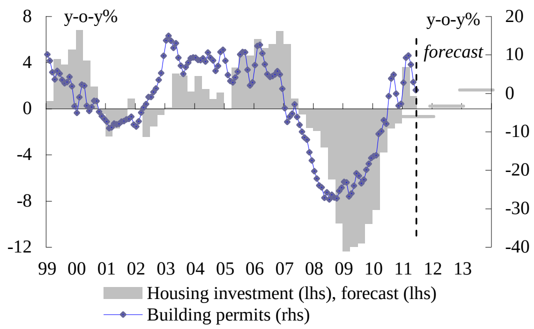
Note: Profits defined as gross operating surplus and gross mixed incomes at current prices.

Should the sovereign debt and banking crisis worsen the financing conditions of companies, investors would suffer (see also Section I.1.4), either in terms of funding costs or volumes (credit constraints). This would directly worsen the outlook for equipment investment, whereas the resulting negative impact on economic activity would lower the profitability of investment projects and lower the need for capacity expansion. A worse profit situation could also erode the basis for other types of financing, for instance by worsening the still reasonably good profit situation (see Graph I.1.42).

... construction investment is remaining relatively subdued ...

The construction sector had been in the centre of the downturn in 2008 and 2009 with output falling by more than a quarter in the EU. Since spring 2010, however, the declines have almost levelled off and over the past year changes in construction output have been moderate. Starting from low levels, the production index in the construction sector has recorded positive quarter-on-quarter growth rates in the EU and in the euro area for two consecutive quarters and the monthly figures for July and August seem to point to a continuation of this development in the third quarter of 2011. This is in line with leading supply indicators, such as building permits, have been gaining ground until mid-2011 although in several Member States the stock of unsold housing is set to continue acting as a drag on investment activity for some time to come and there may be some undershooting following the pre-crisis construction bubble.

Graph I.1.43: **Housing investment and building permits, euro area**



Note: Forecast figures relate to overall construction investment

Looking ahead, the Commission's Construction Confidence Indicator has weakened moderately in 2011 standing in October close to the levels seen at the beginning of the year and well below long-term averages in both the EU and the euro area. The readings differ substantially across Member States with the fastest growing countries like Germany, Sweden and Austria reporting strong confidence well above the long-term average.

Housing investment is expected to grow in 2011 (1.2% in the EU, 0.7% in the euro area) after a period of contraction (see Graph I.1.43). Benefitting from low interest rates moderate growth is expected over the forecast horizon for both the EU and the euro area (about 1% in 2012, about 2% in 2013). As for non-residential construction, prospects appear weaker than in the spring given the onset of fiscal consolidation, which is likely to weigh on public investment. Therefore, overall construction investment will develop more muted

… and the inventory cycle does not provide support over the forecast horizon.

Since the beginning of the crisis, the inventory cycle has broadly followed historical patterns. During the downturn in 2008 and 2009 inventories delivered a negative growth contribution as the demand outlook deteriorated and financing conditions tightened. During the first quarters of the recovery, 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 0.8 pp. to GDP growth in 2010 in the EU (0.6 pp. in the euro area). Although inventories were the largest contributor to GDP growth in the EU, compared with historical patterns, the contribution was modest. An explanation could be that during the recession, according to the Commission's surveys, the link between inventories and production expectations has diverged from its historical path. Inventory management became more responsive to short-term fluctuations and managers showed increased risk aversion keeping inventories low.[23]

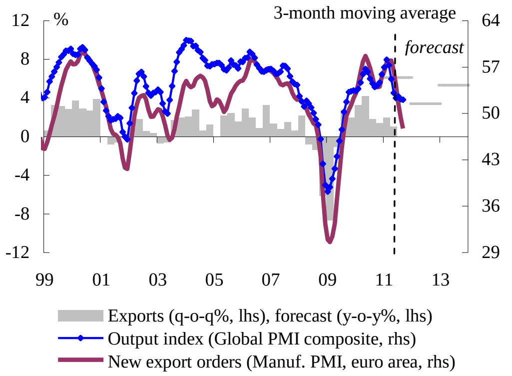
Recent survey indicators suggest that stocks in manufacturing are perceived as increasing. According to the Commission's survey data, since March manufacturers in the EU and in the euro area were regarding their stocks of finished goods as rising. This result is confirmed by the stock-related component in the PMI index, which has also been on an upward trend in the euro area in recent months. Increased funding costs could led companies to cut back on inventories. In terms of national account data, however, the contribution of changes in inventories has recently been rather small. Given the residual nature of the series it appears to be difficult to provide a convincing explanation. Over the forecast horizon no substantial contribution is expected at the EU or the euro area level.

Export growth looses steam as world trade slows …

The rebound in world trade had made the recovery of exports the initial driver of the recovery and strongly contributed to economic growth in the EU. The ongoing normalisation in the patterns of world trade growth has also impacted on the export performance of the EU (see Graph I.1.44). Following another strong quarter at the start of 2011, export growth in the second quarter already reflected partially the slowing in world trade growth and economic activity. In the EU the growth of export volumes (goods and services) slowed from 2.2% (quarter on quarter) in the first quarter to 0.6% (from 2.2% to 0.7% in the euro area).

In the second half of 2011, the slowing of world trade growth is expected to lower euro area export growth. Short-term indicators such as data on export orders from the Commission's surveys have recently been declining. This suggests a further weakening of export growth in the coming months. This outlook is supported by the PMI component for new export orders in the manufacturing sector that had already declined since February 2011 in both the EU and the euro area, fell below the no-change threshold in July and stood at around 45 in October signalling a dearth of foreign demand and thus contraction in exports.

Graph I.1.44: **Global demand, euro-area exports and new export orders**



Looking further ahead, the number of downside factors appears to dominate. The ongoing financial market turmoil puts the financing of trade to risk, the increased uncertainty could delay spending and

[23] See European Commission (DG ECFIN), *European Business Cycle Indictors*, April 2011, pp. 7-9.

investment decisions, which would then affect EU exports, and the deterioration in the global outlook does not bode well for global trade developments. Against this background a further moderation of exports is expected for 2012. Later, in 2013, the improved global outlook should help EU exporters achieving a higher path of export growth and to make a more substantial contribution to economic growth.

All in all, the deteriorated global outlook does not bode well for EU exports in the period ahead. The extent to which individual Member States can be expected to suffer from the global slowing will differ depending on their geographical and product specialisation, as well as on their competitive position. For Member States whose exports are directed in a large part towards emerging markets (e.g. Germany and Finland), the impact could be less negative given the relatively strong GDP growth expected for emerging economies over the forecast horizon. A comparative disadvantage is likely for countries whose exports are more heavily weighted towards capital goods (as trade in these goods usually declines more strongly during a slowdown). For euro-area countries, some relief might come about via the exchange-rate channel, owing to the depreciation of the euro in the third quarter that is reflected in the downward revision of the exchange rate assumption.

... and import growth falls below pre-crisis levels ...

On the import side, the slowing economic growth is expected to result in a deceleration in the growth of import volumes (goods and services) in the EU (from 10% in 2010 to 4½% this year and 3% in 2012) and in the euro area (from 9½% to 5% and 3% respectively). European imports are closely related to the level and composition of domestic demand as well as to the terms of trade.

In the first half of 2011, the strong increases in import prices (including the effects of oil price increases) has partially deterred households and companies from imports and this impact is expected to last in the near term. Moreover, in Member States experiencing a rebalancing of production towards tradable goods (versus non-tradable goods), households' demand for domestically produced (instead of imported) tradable goods increased lowering the import demand for final goods. Following strong growth in the first quarter, in the second quarter the slowing of economic growth in general and domestic demand in particular weakened the growth of imports.

Looking ahead, the ongoing slowing of economic growth is expected to lower the increased demand for imported inputs in 2012. With increasing growth momentum in 2013, domestic demand components will gain ground and both the increase in gross fixed capital formation and private investment are expected to induce additional imports and thus raise the growth rate of import volumes in the EU and the euro area to 5%.

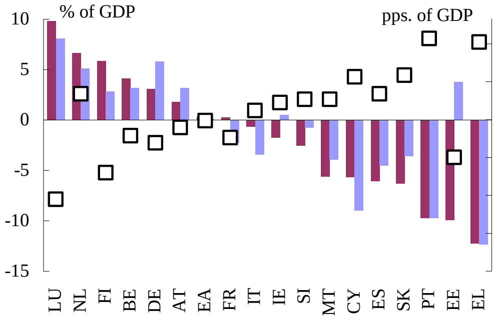
... while current-account balances point to ongoing adjustments.

The first two quarters of 2011 saw world trade, but also EU and euro area exports and imports returning to more normal growth patterns after the exceptional expansion in 2010, which marked the rebound after the trade collapse in 2008 and 2009 (see also Section I.1.3). In 2010, the rebound in world trade had affected EU exports and imports of goods similarly, raising them in nominal terms by about 18% (slight less in the euro area), which almost offset the declines in the year before. Services exports and imports had also increased almost in parallel, but at a lower rate of about 7% - 8% in the EU and the euro area. In 2011, the slowing of world trade and economic growth add to the aforementioned normalisation. As a result, exports and imports of goods will only grow by about 11%-13% in the EU and the euro area. As regards services, import growth in the EU is expected to slow significantly more than exports (declines by about 4½ pps. for imports and 1 pp. for exports).

Further out, in 2012 the growth of goods exports and imports is expected to fall drastically to less than a half of what was recorded this year. Services exports are expected to decline more moderately, whereas imports grow slightly more. Towards the end of the forecast horizon, trade growth is expected to accelerate on the back of increased economic activity in the EU.

The 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 in the past, the still more subdued and now fading 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. It is too early to assess whether the important role of domestic demand weakness, recently reinforced in several countries by fiscal consolidation measures, poses substantial risks to the sustainability of the adjustment.

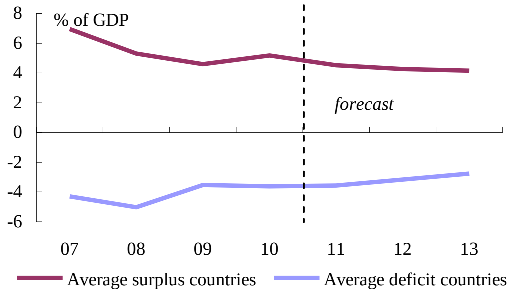
Graph I.1.45: **Current-account balances, euro-area Member States**



Over the forecast horizon, the mostly parallel developments on the export and the import side result in a moderate worsening of the trade balance in 2011 in the EU and the euro area, which is in deficit in the former and balanced in the latter. The current account is almost balanced in both areas (see Graph I.1.45). Changes in the trade and current-account balances are expected to remain marginal over the forecast horizon.

At the Member-State level, many of those countries in deficit in 2010 are expected to reduce their external deficit in both 2011 and 2012 – in the euro area, seven of the nine countries, including Spain and Portugal. The adjustment is most marked in countries where deficits were very large at the onset of the crisis.[24] With the onset of the crisis, the rapidly worsening financing conditions as well as the negative confidence shock had led to a significant decline in domestic demand. Both determinants are regaining importance as the EU economy is slowing. Over the same period in some of the countries in surplus a downward adjustment towards more balanced positions is expected (e.g. Germany, Belgium, and Finland). A comparison with the pre-crisis situation points to remarkable progress in reducing imbalances in many Member States, particularly in the euro area. A strengthening of competitiveness in deficit countries supports this process. In terms of relative unit labour costs, Spain, Ireland and Greece have gained in 2010 and are expected to advance further in 2011 and 2012, whereas Germany, Belgium and Finland are moving into the opposite direction. All in all, the current-account forecasts point to an ongoing adjustment of intra-EU current-account imbalances (see Graph I.1.46), which helps reducing adjustment needs in the context of the newly introduced Excessive Imbalance Procedure.

Graph I.1.46: **Cumulative current-account balances of deficit and surplus, euro-area Member States**



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 labour market situation has stabilised ...

Due to the resilience of European labour markets during the downturn in 2008-09, labour-market improvements have been rather modest in the early stages of the recovery. Since companies had adjusted their labour input by reducing the number of hours worked per employee rather than cutting headcounts, the expansion saw first a normalisation in terms of working hours but no or only marginal employment growth (see also Chapter I.2). This implies a deviation from the standard relationship between changes in economic growth and unemployment, often referred to as Okun's Law. As a consequence, to lower the unemployment rate more economic growth is needed than in the standard case. Thus, current labour market developments in the EU can, to some extent, still be seen as a reflection of labour hoarding during the downturn and the

[24] These observations are in line with results obtained for a broader sample of countries (including all Member States except Malta). See P. R. Lane and G. M. Milesi-Ferretti, External adjustment and the global crisis, *IMF Working Paper* no. 11/197, August 2011.

various labour-market support schemes put in place by governments in Member States.[25]

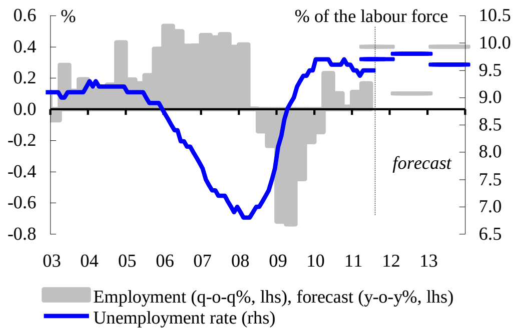
Up to mid-2011, labour market conditions in the EU and the euro area stabilised and signs of a recovery in labour markets became visible (see Table I.1.7).

- More hours have been worked since mid-2009, but the number of workers has only slowly moved up since autumn last year. In the euro area, the hours worked per person employed increased by 0.8% in 2010 (annual), but the annual rate fell to negative territory in the second quarter (-0.3%). Latest quarterly figures indicate that the adjustment in hours worked is levelling off, still driven by a growth in working hours in industry, whereas all other private sectors recorded declines in the second quarter.

- During the second quarter of 2011, the number of persons employed increased in the euro area and in the EU compared with the previous quarter (see Graph I.1.47). At the euro area level, employment rose on a quarterly basis by 0.3% (0.2% in EU), compared with 0.1% in the previous quarter (also 0.1% in the EU). The annual rate of employment growth stood at 0.4% in the euro area and 0.3% in the EU in the second quarter of 2011 compared with the same quarter of the previous year.

[25] According to estimates, during the recessionary trough in some countries (e.g. Germany and Italy) between 2½ and 5% of the labour force participated in short-time work. See T. Boeri and H. Bruecker, Short-time work benefits revisited: some lessons from the Great Recession, *Economic Policy*, October 2011, Vol. 26, No. 68, pp. 697-765.

Graph I.1.47: **Employment growth and unemployment rate, EU**



* *forecast figures are annual data*

- During the recovery, the unemployment rate has been relatively stable in the EU (about 9½%) and the euro area (around 10%), which means that about 22½ million persons are unemployed in the EU (slightly less than 16 million in the euro area). Only a small amount of unemployment has receded since the recessionary peak.

- Substantial differences persist across Member States both in terms of job creation and unemployment rates. Between August 2010 and 2011, among the largest economies Spain recorded the highest increase in unemployment rates (up to 21.2% from 20.4%) whereas Germany experienced a substantial drop in the unemployment rate (down by 0.9 pp. to 6.0%). Not only Germany,[26] also Poland, Belgium and Austria have come out of the downturn with lower unemployment rates (see Map I.1.1). Recently increasing unemployment in

[26] For an in-depth analysis see M. C. Burda and J. Hunt, What explains the German labor market miracle in the Great Recession?, *Brookings Papers on Economic Activity*, Spring 2011, No. 1, pp. 273-319.

Table I.1.7:

Labour market outlook - euro area and EU

(Annual percentage change)	Euro area				*Spring 2011 forecast*		EU				*Spring 2011 forecast*	
	2010	**2011**	**2012**	**2013**	***2011***	***2012***	**2010**	**2011**	**2012**	**2013**	***2011***	***2012***
Population of working age (15-64)	0.6	0.3	0.5	0.4	*0.3*	*0.4*	-0.3	-0.7	-0.3	-0.1	*0.0*	*0.2*
Labour force	0.1	0.1	0.1	0.2	*0.2*	*0.2*	0.2	0.3	0.3	0.2	*0.3*	*0.3*
Employment	-0.5	0.3	0.0	0.3	*0.4*	*0.7*	-0.6	0.4	0.1	0.4	*0.4*	*0.7*
Employment (change in million)	-0.7	0.4	0.0	0.5	*0.5*	*0.8*	-1.1	0.9	0.3	0.9	*0.9*	*1.5*
Unemployment (levels in in millions)	15.9	15.8	16.0	15.8	*15.8*	*15.4*	23.2	23.0	23.4	22.9	*22.9*	*22.1*
Unempl. rate (% of labour force)	10.1	10.0	10.1	10.0	*10.0*	*9.7*	9.7	9.7	9.8	9.6	*9.5*	*9.1*
Labour productivity, whole economy	2.4	1.2	0.4	1.0	*1.2*	*1.0*	2.5	1.2	0.6	1.2	*1.4*	*1.4*
Employment rate (a)	64.2	64.3	64.4	64.8	*64.3*	*64.7*	64.2	64.4	64.6	64.9	*64.4*	*64.9*

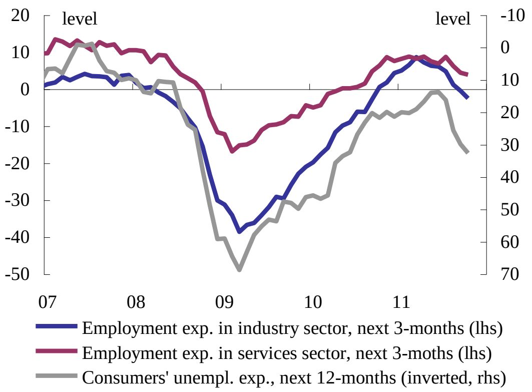
(a) As a percentage of population of working age. Definition according to structural indicators.
See also note 6 in the Statistical Annex.

some peripheral countries is raising the dispersion of labour market indicators across the EU and makes the lacklustre labour market a concern.

... but improvements are grinding to a halt as the recovery is flagging ...

The deteriorated economic outlook does not bode well for a continuation of labour market improvements. Forward-looking labour market indicators have deteriorated in recent months. According to the Commission's surveys the employment expectations in the EU industry and services sectors have declined over the past months, whereas consumers' unemployment fears have increased and exceed long-term averages (see Graph I.1.48). The euro area PMI employment index confirms this picture. Overall, the indicators suggest that the near-term outlook for the labour market is deteriorating.[27] But given the stabilisation observed earlier in 2011, the gradual deterioration that is expected for the remainder of the year does not result in any significant revision of the annual forecasts.

Graph I.1.48: **Employment expectations, DG ECFIN surveys, euro area**



... and the situation worsens in 2012-13 ...

Further out, the deterioration of the economic outlook results in downward revisions to the labour market forecasts for 2012. Employment is now forecast to remain almost unchanged in the EU (0.1%) and the euro area (0.0%), while the unemployment rate is expected to increase slightly in both areas (each by 0.1 pp. to 9.8% in the EU and 10.1% in the euro area). This forecast takes into account that, as already observed during the downturn of 2008-09, firms could adjust labour costs through the adjustment of the hours worked. The availability of short-time working schemes may also contribute to ease the effects, but by contrast to earlier periods the room for supportive policy measures appears to be limited. Moreover, the increase in financing costs may impinge on employment in different sectors depending on their exposure to external funding. In addition, shortages of high-skilled workers may raise labour adjustment costs in some Member States, particularly in those with ageing societies, and create incentives for a renewal of labour hoarding. Another issue emerging in this respect is the extent to which fiscal consolidation will translate into public sector job cuts.

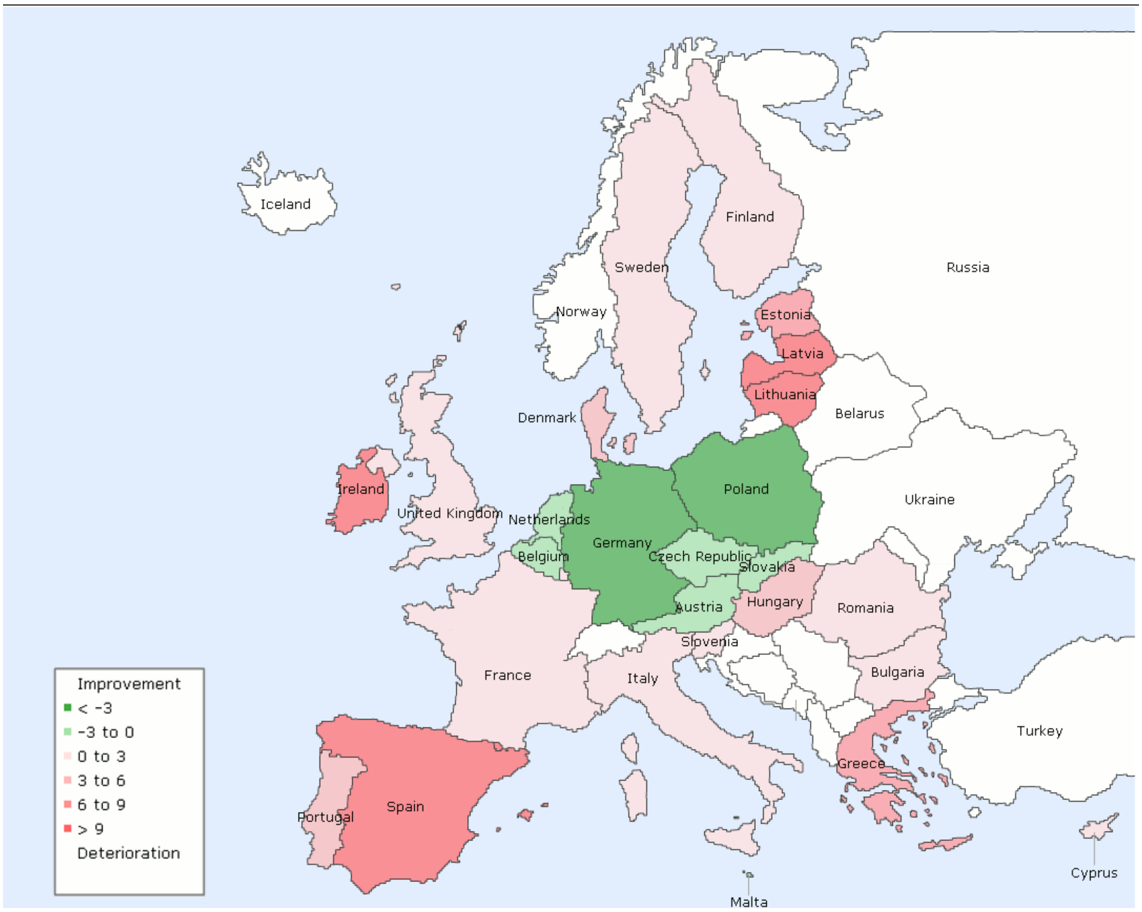
... while substantial cross-country differences persist.

Labour markets in the EU are exhibiting a high degree of diversity, which does not only reflect the asymmetric effects of the crisis and different constraints for the financial sector and fiscal policy, but also cross-country differences in the sectoral composition of past employment losses and different institutional settings. In general, the countries hit by the burst of housing bubbles and constrained in their policy manoeuvre by external and fiscal imbalances are those where job losses were the most severe. The deterioration in labour market conditions caused by the recession was particularly severe in the Baltic countries, Spain and Ireland. In 2009, substantial job losses were also recorded in several other Member States. In particular unemployment is persisting in countries that are facing large structural adjustments associated with downward revisions of activity in nontradable sectors such as construction and real estate as well as the financial sector.

Until mid-2011 the economic rebound has helped to reduce labour market problems, but due to the different recovery speed there have been substantial differences in how much unemployment rates have fallen since the recession. In many countries the labour-market impact of the recession remains visible (see Map I.1.1). The recovery has not been vigorous enough for a full rebound in employment in the EU or the euro area. Employment growth has been found to be most dynamic, and delivering new jobs in Member States that had already implemented reforms, such as the Hartz reforms in Germany. Migration flows across countries were insufficient

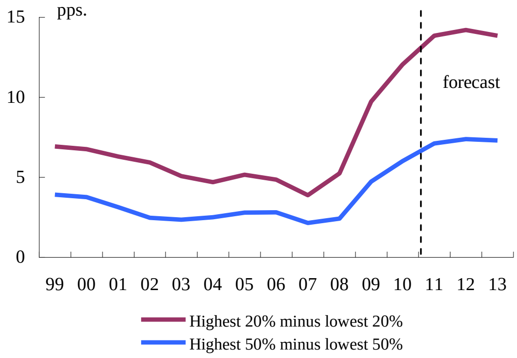
[27] On the information content of the Commission's survey data on employment expectations see *European Business Cycle Indicators*, October 2011, pp. 8-11.

Map I.1.1: **Labour market developments in the EU Member States, change in unemployment rates between 2005 and 2011**



to reduce cross-country differences. As expected in spring, the end of restrictions on labour mobility in the EU as of 1 May 2011 (except for citizens of Bulgaria and Romania) has not had significant short-term effects on European labour markets, since most old Member States had already opened their labour markets in previous years.

Graph I.1.49: **Unemployment rates across euro-area population**



Note: Figures are calculated using national population data."Highest" and "lowest" refer to average figures of the share of population (e.g. quintiles) as indicated in the legend.

In 2012, the weak economic performance is expected to slow employment growth in all Member States that had recorded expansion in 2011 except Hungary and Romania, where employment growth is expected to accelerate. In nearly half of the Member States the unemployment rate is forecast to increase in 2012 with only three Member States recording an increase by more than ½ pp. Unemployment rates are forecast to vary between about 4% in Austria and about 20% in Spain.

The dispersion of unemployment rates across Member States makes it difficult to assess the impact of increasing unemployment on larger groups of euro area citizens. This perspective can be added by looking at shares in the euro-area population that face the highest and the lowest unemployment rates and by analysing how labour market data differ between them. The situation of the 50% of the population living in economies with the highest unemployment had before the crisis rates that were about 3 pps. higher than those of the 50% of the population living in economies with the lowest unemployment (see Graph I.1.49).

During the crisis that gap between both groups has widened to more than 5 pps. The increase in the gap is even more pronounced for the top and bottom quintiles of the euro area population.

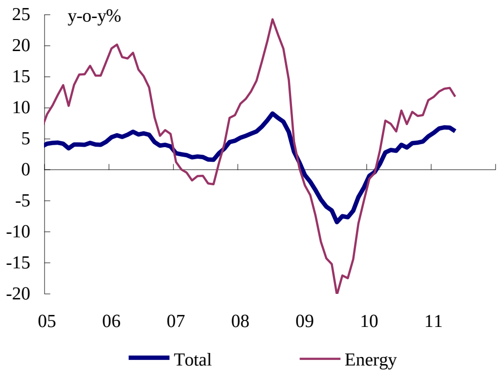
Inflationary pressures are declining as import prices ease, ...

Inflation developments in 2011 have been dominated by the impact of sharp increases in commodity prices in 2010 (about 30%) and the first months of 2011. They have pushed *import prices* in the EU and the euro area to high levels. In 2010, import prices, as measured by the deflator of imports of goods and services, increased at an annual rate of about 6% in the EU (5% in the euro area), which includes in the euro area the dampening effects of the appreciation of the euro. On the back of moderating commodity prices, energy import price inflation has slowed. The moderation in the second half of the year is expected to limit the annual rate of import price inflation in 2011 (to 5½% in the EU and 6% in the euro area). Over the forecast horizon, a marked moderation of import price inflation is expected (to annual rates of 1½-2% in the EU and the euro area), reflecting less buoyant growth outside the EU and the end of sharp commodity price increases.

... labour costs increases remain moderate ...

Wages have only increased moderately during the recovery, partly still reflecting the labour market response during the crisis. Most recent information on developments in negotiated wages in the euro area (annual increases of 1½%-2% in the first two quarters of 2011) confirms this assessment. Against the background of slowing growth and a deteriorated economic outlook for 2012, wage growth is expected to remain relatively stable. The compensation per employee is expected to grow at annual rates of about 2¼% in the EU in 2012 and 2013 (about 2% in the euro area). With non-wage labour costs growing at almost the same rate, labour cost pressures should remain well contained over the forecast horizon. After having increased by to about 2½% last year (after falling by 2¼% in 2009), labour productivity is expected to grow more moderately this year (1¼%) and in 2012 (about 1/2 %) in the EU and the euro area. The deceleration is mainly reflecting a loss of growth momentum and an only slightly deteriorating labour market situation. This implies that over the forecast horizon nominal unit labour costs will follow a rather smooth profile in the EU with increases of between 1¼ -1¾% (1-1½% in the euro area), whereas real unit labour costs will decline between 2011 and 2013 with the magnitude of the squeeze depending on the persistence of slow productivity growth once the economic growth gains traction.

Graph I.1.50: **Industrial producer prices, euro area**



... and producer prices grow less strongly.

Between mid-2009 and the first quarter of 2011 industrial *producer prices* had been on an upward trend (see Graph I.1.50), which appears to have come to an end after the summer. Up to the latest available data (August 2011), annual rates of change in producer prices were mainly driven by the energy price component, which accounts for about one quarter in the price index. The

Table I.1.8:

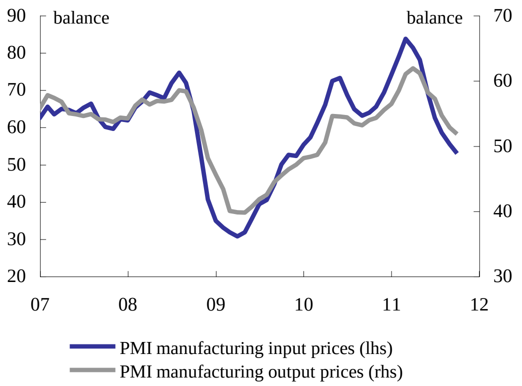
Inflation outlook - euro area and EU

(Annual percentage change)	Euro area				*Spring 2011 forecast*		EU				*Spring 2011 forecast*	
	2010	2011	2012	2013	*2011*	*2012*	2010	2011	2012	2013	*2011*	*2012*
Private consumption deflator	1.7	2.5	1.6	1.6	*2.4*	*1.7*	2.1	2.9	1.9	1.7	*2.5*	*1.8*
GDP deflator	0.7	1.2	1.6	1.6	*1.4*	*1.7*	1.1	1.6	1.8	1.8	*1.6*	*1.8*
HICP	1.6	2.6	1.7	1.6	*2.6*	*1.8*	2.1	3.0	2.0	1.8	*3.0*	*2.0*
Compensation per employee	1.6	2.3	2.0	2.0	*2.1*	*2.3*	2.0	2.4	2.2	2.3	*2.3*	*2.7*
Unit labour costs	-0.8	1.0	1.4	0.9	*0.8*	*1.2*	-0.4	1.3	1.7	1.2	*0.9*	*1.5*
Import prices of goods	5.7	6.9	1.9	1.4	*5.5*	*1.9*	5.1	6.4	2.0	1.5	*5.4*	*1.9*

acceleration in the energy price component (up to 15.2% in the EU and 13.2% in the euro area in March 2011) has exceeded that in the other components by far. Excluding energy and construction the annual rate peaked at 4.8% in the EU and 4.6% in the euro area in March 2011. Most recent information points to declining price pressures with industrial producer price inflation (excluding construction) easing in August to 6.7% in the EU (5.9% in the euro area). Against the background of easing import prices, moderating energy prices and well-contained labour cost development, prices pressure appear to be limited over the forecast horizon.

Whether producers will pass on price pressures to other levels in the supply chain, and finally to consumer prices, depends on the pricing power of manufacturers, which is closely associated with the amount of spare capacity. According to the latest Commission surveys, capacity utilisation rates have been declining slightly in October, now being just below long-term averages in both the EU (down to 80.7% versus a long-term average of 81.1%) and the euro area (80.9% versus 81.6%). This backward-looking analysis of hard data is in line with forward-looking information from surveys that point to a downward revision of selling-price expectations. According to data from the Commission surveys, selling price expectations in the EU and the euro area industry have been declining since they peaked in March and fell, for the first time since the start of the recovery, below their long-term averages.

Graph I.1.51: **PMI manufacturing input prices and output prices, EU**

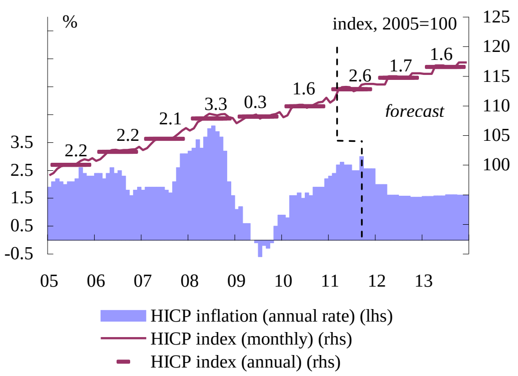


Across EU economies selling price expectations exceed historical averages only in five Member States, among them euro-area economies that had in the past recorded relatively strong economic growth (Germany, France and Austria). The decline in price expectations is confirmed by PMI surveys (see Graph I.1.51). Against these developments and the outlook for a further slowing of economic activity, or even a temporary contraction in some Member States, the ability of producers to widen margins and to raise prices seems limited in the near term. Instead, they may even consider using discounts to maintain market shares in a situation with weakening demand.

Consumer prices are still affected by past commodity price increases ...

In the first three quarters of 2011, *consumer prices* were strongly affected by volatile, but on the whole rising, global commodity prices and, in some Member States, increases in indirect taxes and administered prices. These factors pushed HICP inflation rates above the levels seen last year (see Graphs I.1.2 (EU) and I.1.52 (euro area)). In the third quarter HICP inflation stood at 3.0% in the EU and 2.7% in the euro area, despite the deteriorated economic environment exactly as forecast in spring. Within the quarter an uptick was recorded in September 2011 in both the EU (from 2.9% in August to 3.3%) and the euro area (from 2.5% to 3.0%).

Graph I.1.52: **HICP, euro area**



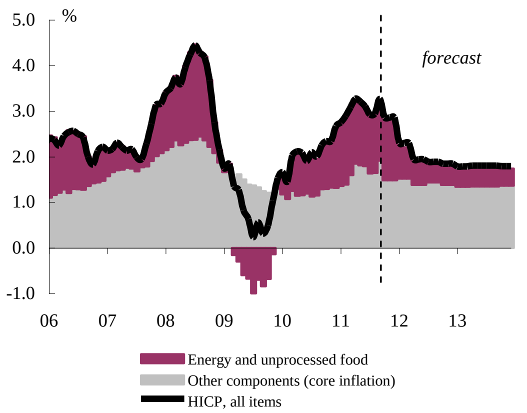
Figures above horizontal bars are annual inflation rates.

The important role of commodity prices (including oil) is reflected in the substantial contribution of energy prices to headline inflation (see Graphs I.1.53 and I.1.56), which was about 1¼ pps. in the first three quarters of 2011. Changes in tax rates added about ¼ pp. to EU headline inflation in recent months, in particular in the UK the rise in VAT to 20% (standard rate) is estimated to have added 1 pp. to headline inflation. In August (latest available data) the constant-tax HICP inflation rate stood at 2.6% in the EU (2.4% in the euro area) and thus 0.3 pp. (0.1 pp.) below the headline rate.

The uptick in September is related to the delayed impact of energy price increases and a methodological change in the treatment of items which are subject to end-of-season sales (e.g. clothing, footwear). The assumption of zero-price changes for items that are no longer available in post-sale months, can now be replaced by imputed price changes based on similar products. For instance, in July and August 2011, the usual months of summer sales, clothing prices in the euro area declined strongly (at annual rates of about 3%), but then increased again in September (at an annual rate of about 2%) while last year the rate of change was the same in August and September.

Indirect taxation and methodological changes impacted on both headline and *core inflation*, (see Graph I.1.53), i.e. all items without unprocessed food and energy. The uptick in September became also visible in core inflation that increased to the highest rates since December 2008 in the EU (2.3%) and in the euro area (2.0%), whereas the non-core components recorded substantially higher annual rates of increase (7.4% in the EU, 7.8%. in the euro area). To the extent that energy inflation is driven by structural factors, the inflation in non-core items may not only signal transitory, high-frequency price changes that will be reversed quickly, but more persistent developments that could also impact on core inflation as the pass-through progresses. But experiences from past oil price increases suggest that the impact on core inflation has become smaller over time.[28]

Graph I.1.53: **Inflation breakdown, EU**

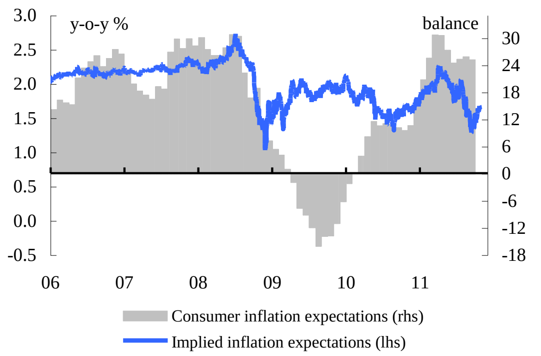


[28] See e.g. L. J. Bachmeier and I. Cha, Why don't oil shocks cause inflation? Evidence from disaggregate inflation data, *Journal of Money, Credit and Banking*, September 2011, Vol. 53, No. 6, pp. 1165-1183.

... but lower HICP inflation is forecast for 2012 and 2013 ...

Looking ahead, in the near term the easing of pressures from commodity price increases and the slowing of economic activity should lower consumer price inflation (see Table I.1.8). This would be in line with data from surveys that are tracking price expectations and that point to easing consumer price inflation (see e.g. Graph I.1.54). The Commission's Consumer Survey showed that consumers' qualitative inflation perceptions (over the past 12 months) fell back up to October 2011, while inflation expectations (over the coming 12 months) declined in the past months. At levels of 25.0 in the EU and 24.0 in the euro area they were close to their long-term averages (21.6 and 20.8 respectively).

Graph I.1.54: **Inflation expectations, euro area**



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

But in terms of annual rates consumer price inflation is expected to stay fairly high in the fourth quarter of 2011 with only a gradual easing towards the end of the year. In the EU, the headline rate is expected to pick up to an average of about 3% this year (2½% in the euro area). On a quarterly basis, the outlook is for the highest rates in headline inflation in the second and third quarter of 2011 at about 3% in the EU (2¾% in the euro area) and a gradual decrease in the fourth quarter. 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.

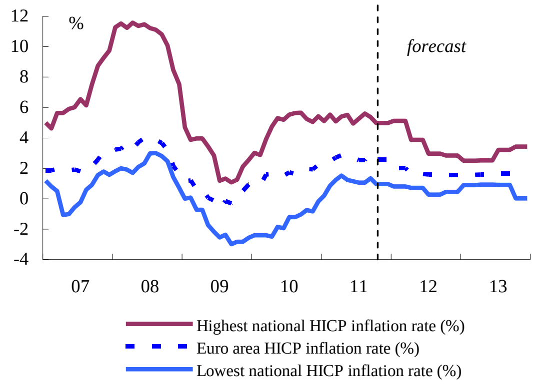
Further out, the ongoing weakening of economic activity is likely to increase the slack in the economy, constrain wage increases, and lower the price-setting power of producers, while the weakness of private consumption limits the price-setting power of retailers. Against this background the risk of second-round effects appears to be rather limited. Globally determined costs for energy will help reducing inflationary pressures further. With the peak in oil prices already observed in the first half of the year and some tax-related increases already passed through earlier this year, two key drivers of increases in inflation rates will be levelling off in 2012. The futures-based assumptions on commodity prices do not signal any further hike over the forecast horizon. Overall, the slack in the economy and weak labour market conditions are expected to keep inflation in check in 2012. The annual rate of HICP inflation is expected to ease to 2.0% in the EU in 2012 (1.7% in the euro area), particularly on account of a sharp fall in the UK (from 4.3% to 2.9%). The forecast of inflation rates returning to levels of 1½-2% is in line with break-even inflation rates derived from inflation-indexed sovereign bonds (see Graph I.1.54) and longer-term inflation expectations, as for instance in the ECB's Survey of Professional Forecasters.

Against the background of an only sluggish recovery in 2013, HICP inflation rates are expected to remain almost unchanged (1¾% in the EU, 1½% in the euro area). These figure, however, are based on the no-policy-change assumption that is applied where measures have not been sufficiently known for taking them into account. This could imply not taking on board all increases in indirect taxes and administered prices that might exert temporary effects on headline HICP inflation, which could then result in higher rates than currently forecast for 2013.

... with shrinking inflation dispersion across Member States.

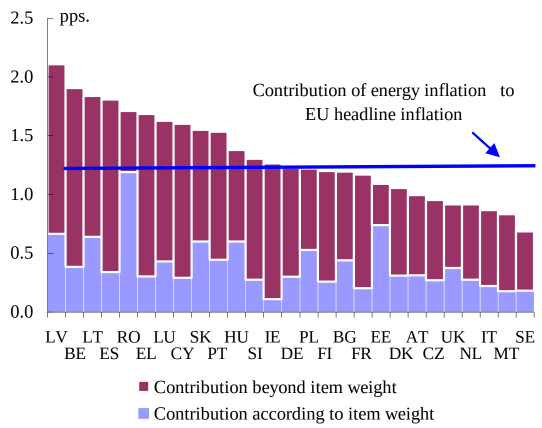
The HICP aggregates hide marked inflation differentials across EU Member States. This year, HICP inflation rates in the Member States are expected to range from 1.1% in Ireland to 5.2% in Estonia and 5.9% in Romania. As regards the euro area (see Graph I.1.55), the differential is wider than expected in the spring forecast. Inflation rates in the five largest euro-area economies are in a much narrower band between 2.2% and 3.0%. The two largest economies outside the euro area are expected to record higher inflation rates of 3.7% (Poland) and 4.3% (the UK).

Graph I.1.55: **Inflation dispersion of EA Member States - HICP inflation rates**



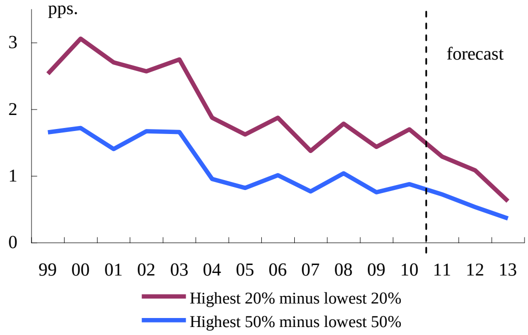
Among the determinants of these differentials are differences in the impact of higher oil prices and the pass-through of increases in indirect taxes, whereas differences in wage growth have been of minor importance. In the first three quarters of 2011 the contributions of energy price increases to HICP inflation in the Member States varied between ¾ pp. in Sweden and 2¼ pps. in Latvia. In all Member States they exceeded the contribution that would have been expected according to the weight of energy in the HICP (see Graph I.1.56). For instance, in the euro area with an average headline inflation in the first three quarters of 2.8% and an item weight of energy of 10.4% the "regular" contribution would have been 0.29 pp., but it was 1.25 pp. and thus 0.96 pp. higher than calculated on the basis of the item weight.

Graph I.1.56: **Contribution of energy inflation to headline inflation (Q1-2011 - Q3-2011)**



Looking ahead, all Member States except the Czech Republic and Hungary are expected to record a decline in the inflation rate in 2012. Over the forecast horizon, inflation dispersion is expected to decline in terms of the standard deviation of inflation rates, a common feature of macroeconomic forecasts. The focus on highest and lowest inflation rates makes it difficult to assess the importance of dispersion, because relatively small countries with exceptional inflation developments may dominate the comparison. To overcome this weakness it is useful to extend the analyses by including population data. Comparing the average inflation rate of the half of the euro area population that experiences the highest inflation rates with the half, which faces the lowest inflation rates, can give a hint on the distribution of price stability across population (see Graph I.1.57).

Graph I.1.57: **HICP inflation across euro-area population**



Note: Figures are calculated using national population data."Highest" and "lowest" refer to average figures of the share of population (e.g. quintiles) as indicated in the legend.

This supplementary analysis of inflation rates across euro-area population indicates that overall the inflation rates were broadly similar for population shares with the highest and lowest inflation rates. Moreover, differences between these groups appear to have become even smaller during the crisis years suggesting that a very similar level of price stability was delivered to most of the 330 million euro-area citizens.

Fiscal consolidation continues yet at a slowing pace….

The slowdown of economic growth coupled with the sharp deterioration of financial market conditions on the back of the sovereign debt crisis are likely to weigh on public finance developments in the euro area and in the EU. Although the economic situation has deteriorated since the spring and high uncertainty still prevails at the current juncture, available data confirm that 2011 marks the switch from fiscal stabilisation to fiscal consolidation in the euro area and in the EU as a whole (see also Box I.1.3).

In 2011, the general government deficit in the EU is projected to decline by about 2 pps., to 4.7% of GDP, broadly in line with the spring forecast. In the euro area, the decline in the deficit is of the same magnitude reaching 4.1% of GDP in 2011, indicating a better-than-expected outturn compared to the spring forecast. The improvement in 2011 compared to the spring forecast is mainly due to the additional consolidation measures taken by several Member States in response to financial market pressure but also on the back of downward revisions to the short-term growth outlook.

General government deficits are forecast to decrease further in 2012 and in 2013, albeit at a slowing pace. In 2012, the deficit is projected to improve by about 0.8 pp. in the euro area and in the EU as a whole, reaching respectively 3.4% and 3.9% of GDP. On the basis of the customary no-policy-change assumption for the outer year of the forecast, a further decline of the deficit is expected in 2013, to 3.0% of GDP in the euro area and 3.2% of GDP in the EU

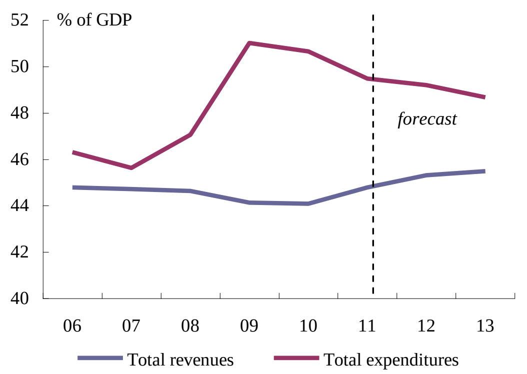
Table I.1.9:
General government net lending and EDP deadlines

(% of GDP)	2011	2012	2013	Deadline for correction
Belgium	-3.6	-4.6	-4.5	2012
Germany	-1.3	-1.0	-0.7	2013
Estonia	0.8	-1.8	-0.8	Not in EDP
Ireland	-10.3	-8.6	-7.8	2015
Greece	-8.9	-7.0	-6.8	2014
Spain	-6.6	-5.9	-5.3	2013
France	-5.8	-5.3	-5.1	2013
Italy	-4.0	-2.3	-1.2	2012
Cyprus	-6.7	-4.9	-4.7	2012
Luxembourg	-0.6	-1.1	-0.9	Not in EDP
Malta	-3.0	-3.5	-3.6	2011
Netherlands	-4.3	-3.1	-2.7	2013
Austria	-3.4	-3.1	-2.9	2013
Portugal	-5.8	-4.5	-3.2	2013
Slovenia	-5.7	-5.3	-5.7	2013
Slovakia	-5.8	-4.9	-5.0	2013
Finland	-1.0	-0.7	-0.7	Not in EDP
Bulgaria	-2.5	-1.7	-1.3	2011
Czech Republic	-4.1	-3.8	-4.0	2013
Denmark	-4.0	-4.5	-2.1	2013
Latvia	-4.2	-3.3	-3.2	2012
Lithuania	-5.0	-3.0	-3.4	2012
Hungary	3.6	-2.8	-3.7	2011
Poland	-5.6	-4.0	-3.1	2012
Romania	-4.9	-3.7	-2.9	2012
Sweden	0.9	0.7	0.9	Not in EDP
United Kingdom	-9.4	-7.8	-5.8	2014/15

Budget balances are set to improve broadly across Member States even though increasing deficits are expected in some countries in one or two of the forecast years. In 2011, the budget-balance-to-GDP ratio is expected to deteriorate markedly in Cyprus and Denmark. In Denmark, it is mainly due to the absence of windfall revenues compared to 2010 while in Cyprus the deterioration of the budget-balance-to-GDP ratio can be explained by lower than expected revenues as well as higher public expenditure. In Hungary, the budget balance posts a large surplus this year due to a temporary effect of the reversal of a previous pension reform. In 2012, the budget for Hungary is forecast to return to the red.

As regards EU budgetary surveillance, only 4 out of 27 Member States are not subjected to an Excessive Deficit Procedure (EDP), namely Estonia, Luxembourg and Sweden as well as Finland, for which the EDP is abrogated since 12 July 2011. Bulgaria, Hungary and Malta are required to bring the general government deficit below the 3% of GDP reference value of the Treaty this year, Belgium, Cyprus, Italy, Lithuania and Poland by 2012. For the remaining countries in the EDP is 2013 or later. Conditional on individual programmes of economic adjustment, Greece, Portugal, Ireland and Latvia[29] are countries benefiting from financial assistance. The programme for Latvia is scheduled to end in January 2012.

Graph I.1.58: **General government revenues and expenditure, EU**

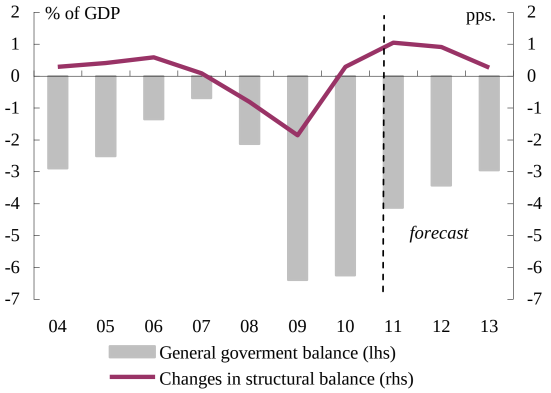


The improvement of the overall budget balance in the euro area and in the EU over the forecast horizon can both be attributed to increasing public revenues and decreasing expenditure as a percentage of GDP (see Graph I.1.58). The expenditure-to-GDP- ratio is expected to decrease only gradually in 2012 and at a slightly higher pace in 2013. The increase in revenues relative to GDP is expected to be most significant in 2012, before stabilising in 2013 at a level above the pre-crisis level that is about 46% of GDP in the euro area and 45% of GDP in the EU as a whole.

....based increasingly on discretionary consolidation ...

The excepted improvement in the general government budget balance of the euro area and the EU in 2011-13 will be the result of both structural and cyclical factors. In 2011, discretionary fiscal consolidation and the impact of the cycle are estimated to contribute to the improvement of the budget balance in equal measure that is about 1% of GDP each. By contrast, and also as a result of the economic slowdown setting in the second half of the year, the relative importance will clearly shift towards discretionary consolidation in 2012 and 2013. In those two years the improvement in the structural budget balance of respectively around 1% of GDP and ½% of GDP is the main if not exclusive driving force behind the projected change of the headline deficit (see Graph I.1.59).

Graph I.1.59: **Budgetary developments, euro area**



(29) Romania has a precautionary programme, where funds are not actually paid out.

Box I.1.3: **Fiscal consolidation, confidence and the economic outlook.**

Enduring stress on public finances and the financial system has been a strain on the outlook for growth since spring. Fiscal consolidation is required to confront the sovereign debt crisis in the euro area. Several countries started consolidating already in 2010, and the majority of member countries have introduced sizable measures in 2011. The rise of sovereign borrowing rates since spring 2011 has reinforced the demand for fiscal austerity.

Against this background, the box compares three scenarios in the context of high sovereign borrowing costs and illustrates their implications on the real economy over the forecast horizon. The technical baseline against which the three scenarios are compared is the spring 2011 forecast, where neither the rise of sovereign risk since spring 2011 nor resulting additional consolidation measures had been anticipated.

The three scenarios compare the implications of delayed versus immediate consolidation for output, private domestic demand and stock prices under alternative assumptions about associated confidence effects. The setup includes partial spillover from sovereign to private-sector borrowing costs, which mainly affects investment demand, and subdued consumer confidence.(1)

The exercise uses a 3-region version of DG ECFIN's QUEST III model.(2) The regions are: an average EMU member country, the rest of the euro area, and the rest of the world. The risk and consolidation scenarios apply to the entire euro area, i.e. the "average EMU member" and the "rest of the euro area" blocks of the model.

(1) Private consumption and investment responses to fiscal consolidation also depend on the design of the fiscal measures. Private demand responds more positively to reductions in non-productive public expenditure and more negatively to increases in distortionary taxes, which reduce labour and capital supply, potential output and income in the medium and longer term. For in-depth analysis of the differentiated impact of individual measures 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.

(2) Details on QUEST III and applications to policy analysis are available at: http://ec.europa.eu/economy_finance/research/macroeconomic_models_en.htm.

The three scenarios are:

1. *Delayed consolidation* (S1): Consolidation of *ex ante* 1% of GDP is announced, but its implementation is delayed until year 3.(3) The announced fiscal package includes lower government purchases and higher labour taxation, each accounting for half of the intended volume of consolidation. Given that consolidation is only announced, the sovereign-risk premium starts at 400 basis points (bps), a number in the range of current risk premia for EMU member states, but rises in subsequent years by ¼ annually. The premium declines gradually after the consolidation has been finally put in place. It is assumed that 25% of the sovereign premium spill over to private-sector financing costs, i.e. initially 100 bps.(4)

2. *Immediate consolidation without confidence gain* (S2): This scenario assumes an immediate and permanent consolidation of *ex ante* 1% of GDP (50% coming from lower government purchases and 50% from higher labour taxes) in year 1. There are no confidence gains in this scenario. Instead, risk premia remain at their initial level (400 bps sovereign and 100 bps private sector) over the forecast horizon.

   Immediate consolidation with confidence gain (S3): Fiscal consolidation is identical to S2 in structure and timing. Scenario S3, however, assumes consolidation to improve investor and consumer confidence. Sovereign-risk premia start declining with the implementation of the package in year 1 and also reduce financing

(3) *Ex ante* (planned) and *ex post* (effective) volumes of fiscal consolidation in GDP terms can (in most cases: do) differ due to the general-equilibrium effects of fiscal measures, namely their impact on output and the tax bases. The fiscal measures in all three scenarios are permanent.

(4) The shock size of 400 basis points (bps) in year 1 and the factor ¼ for spillover to the private sector are illustrative. However, the 400 bps. are in the range of risk premia currently faced by several EMU countries; ¼ risk spillover to the private sector has also been assumed in the detailed analysis of fiscal consolidation in the European Commission's European Economic Forecast in autumn 2010 and is in the range of estimates for (non-EMU) economies by E. Durbin and D. Ng, The sovereign ceiling and emerging market corporate bond spreads, *Journal of International Money and Finance*, June 2005, Vol. 24, No. 4, pp. 631-649, and E. A. Cavallo and P. Valenzuela, The determinants of corporate risk in emerging markets: an option-adjusted spread analysis, *International Journal of Finance and Economics*, January 2010, Vol. 15, No. 1, pp. 59-74.

(Continued on the next page)

Box (continued)

costs in the private sector. The confidence gain reduces the government's cost of debt servicing and investment costs in the private sector.[5]

The Graphs 1a-d illustrate the economic impact of the three scenarios in an average euro-area country. The demand and output effects include both the effects from domestic consolidation and borrowing costs as well as the spillover from other parts of the euro area.

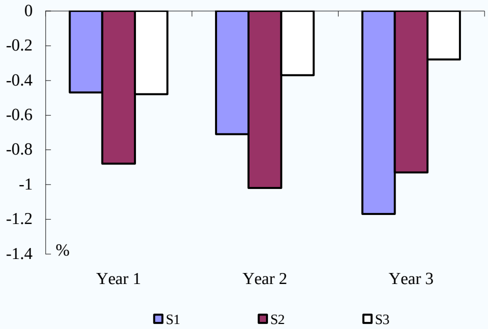
(1) The results show that confidence gains can substantially reduce the contractionary impact of fiscal consolidation, a result that stresses the importance of the credibility of fiscal adjustment. Comparing the consolidation packages without (S2) and with (S3) confidence improvement shows that the recovery of investor and consumer confidence in S3 reduces the GDP loss by more than one half.

The recovery of investment demand in S3 also has positive implications for output in the medium and longer term. Debt reduction and declining sovereign borrowing rates reduce future tax liabilities which also strengthens private demand.

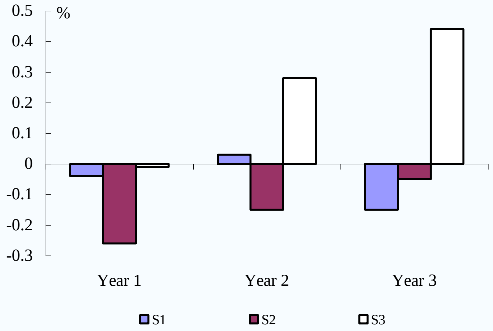
(2) Postponing consolidation (S1) at the expense of further increasing borrowing costs would postpone part of the output loss associated with reducing government purchases and increasing taxation, but deteriorating confidence would in the meanwhile amplify the drop in private demand. Contractionary effects of consolidation in S3 materialise in year 3 and add to depressed private demand. Postponing consolidation will, in addition, further increase government debt (here by 2% of GDP compared to S2 in year 3), requiring stronger subsequent tightening.

[5] The size and profile of sovereign risk and its spillover to the private sector in scenarios S1-S3 are introduced as exogenous shock to the model. They are not model-endogenous responses to public and private indebtedness. In principal, QUEST has an endogenous channel from debt to risk, where the risk premium depends on the distance between actual and target debt levels. The calibration of this endogenous mechanism builds on empirical evidence from pre-crisis periods, however, and does not match the size of currently observed sovereign spreads.

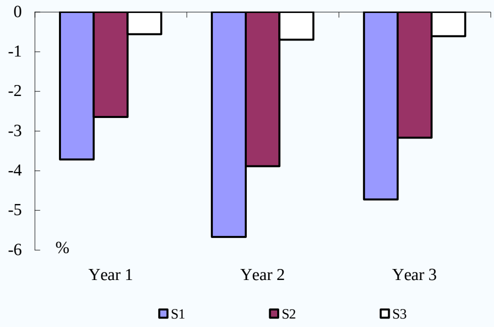
Graph 1a: **Real GDP**
Deviation from baseline



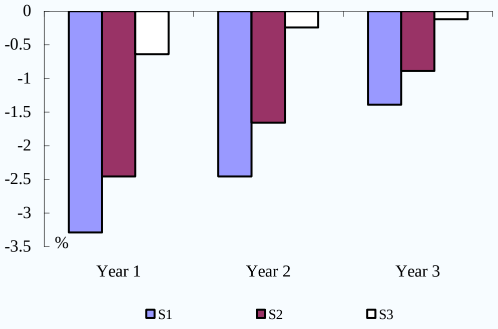
Graph 1b: **Private consumption**
Deviation from baseline



Graph 1c: **Private investment**
Deviation from baseline



Graph 1d: **Stock prices**
Deviation from baseline



...while debt growth moderates but from a higher level

In spite of the expected improvement in budgetary situation of most Member States over the forecast period, the Government debt ratios have been revised slightly upwards compared to the spring forecast, on account of the impact of interest expenditure on accumulated debt, of real GDP growth and inflation on the debt ratio as well as changes in the stock-flow adjustment. In 2011, the main driver of the upward revision of public debt ratios for the euro area is expected to be lower inflation while in 2012, the main element to explain the debt increase is given by the downward revision of economic growth prospects over the forecast period.

More specifically, in the EU, the gross debt ratio is now forecast to reach a peak of about 85% of GDP in 2012 and to stabilise in 2013. In the euro area, gross public debt is projected to rise over the whole forecast horizon, albeit at decreasing pace compared to the 2008-10 period, by breaching 90% of GDP already in 2012 (see Table I.1.10).

Table I.1.10:
Euro-area debt dynamics

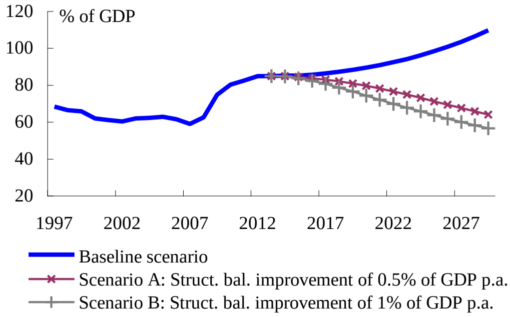
	average 2004-08	2009	2010	2011	2012	2013
Gross debt ratio[1] (% of GDP)	**68.9**	**79.8**	**85.6**	**88.0**	**90.4**	**90.9**
Change in the ratio	-0.2	9.7	5.8	2.4	2.4	0.6
Contributions to the change in the ratio:						
1. Primary balance	**-1.1**	**3.5**	**3.4**	**1.2**	**0.3**	**-0.3**
2. "Snow-ball" effect[2]	**0.3**	**5.3**	**0.8**	**0.7**	**1.4**	**0.7**
Of which:						
Interest expenditure	3.0	2.9	2.8	3.0	3.1	3.3
Growth effect	-1.4	3.1	-1.5	-1.3	-0.4	-1.2
Inflation effect	-1.3	-0.6	-0.5	-1.0	-1.3	-1.4
3. Stock-flow adjustment	**0.4**	**0.8**	**1.6**	**0.6**	**0.7**	**0.3**

[1] *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.*

[2] *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.*

Assuming that no further consolidation measures are taken beyond those already contained in the forecast, i.e., that the structural primary balance-to-GDP ratio is kept constant at the level estimated in 2013, simulations incorporating expected future age-related spending show that, for the EU as a whole, the upward trend in the debt-to-GDP ratio would continue (see Graph I.1.60). To reverse this trend and bring the debt-to-GDP ratio on a downward path, Member States would have to implement additional consolidations measures in line with the provisions of the Stability and Growth Pact (SGP). More specifically, if all Member States were to undertake a fiscal consolidation effort, in structural terms 0.5% of GDP per year – which is the benchmark adjustment effort required by the SGP – until the medium-term objective (MTO) reported by each Member States is reached, then the debt-to-GDP ratio of the EU would start to decrease gradually, however remain above the Maastricht reference value of 60% of GDP by 2030. To bring the government debt below 60% of GDP before 2030, a more significant structural improvement of 1% of GDP per year until each Member State reaches its MTO is required.

Graph I.1.60: **Medium-term public debt projections in the EU**



Note: In both consolidation scenarios the yearly improvement of the structural balance is assumed to continue until the medium-term objective by each Member State is reached.

1.6. RISKS

Uncertainty at the current juncture is high and downside risks to the EU outlook remain particularly acute. While the balance of risks to the growth outlook is predominantly on the downside, the risks to the inflation outlook appear to be balanced.

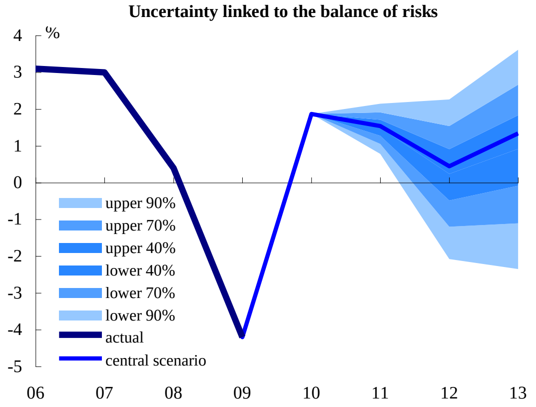
Risks to the growth outlook are tilted to the downside. Some elements of the downside risks to earlier forecasts – such as financial turmoil and a lower momentum of global growth - have materialised and are included in the central scenario of the autumn forecast. However, new risks have emerged, and the risk balance for the EU growth outlook remains now tilted to the downside.

On the downside, further financial turmoil may have more substantial spill-over effects to other market segments and the real economy. It may ignite stronger and more harmful adverse feedback loops than currently expected. The forecast depends crucially on the assumption on current challenges being successfully addressed. Should the response to the challenges lack timeliness, clarity or ambition, a more negative development and a relapse into recession cannot be excluded. Moreover, significant fiscal sustainability challenges are yet to be tackled not only inside the EU but also in key countries outside. The resulting fiscal consolidation efforts, in particular taking them simultaneously in many countries, may weigh more on domestic demand than currently envisaged. And inflation concerns in some of the emerging market economies may trigger more measures than currently envisaged and make the EU's external environment more difficult than assumed in the forecast.

On the upside, should global growth turn out more resilient than assumed in the baseline due to inherent growth dynamics in emerging market economies, EU exports would benefit more than expected. A larger decline in oil prices could bring somewhat larger respite to real income and consumption.

The uncertainty surrounding the euro-area growth outlook is visualised in the fan chart (see Graph I.1.61) that displays the probabilities associated with various outcomes for euro area economic growth over the forecast horizon. 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 clearly tilted to the downside, the fan chart is slightly skewed towards the bottom.

Graph I.1.61: **GDP forecasts , euro area - Uncertainty linked to the balance of risks**



The risks to the outlook for inflation have become more balanced in recent months. Overall, the risks to the inflation outlook appear balanced.

On the downside, the economic activity may shrink and constrain price increases more than currently envisaged. Any attempt of competitive devaluations outside the EU, e.g. by setting minimum exchange rates vis-à-vis the euro, could reduce import prices and, if passed through via production and retail chains, lower consumer prices in the EU.

On the upside, a stronger-than-expected rebound in global growth or continued unrest in oil-exporting countries could result in stronger inflationary pressures. Moreover, the long-time build up of liquidity and exceptional liquidity-creating measures could eventually result in stronger than expected consumer price increases. Past periods of consumer price inflation above 2% could trigger currently not foreseen second-round effects.

Box I.1.4: **Some technical elements behind the forecast**

The cut-off date for taking new information into account in this European Economic Forecast was 24 October. The forecast incorporates validated public finance data from Eurostat's News Release 153/2011, dated 21 October 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 10 and 21 October) 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 1.40 in 2011, 1.37 in 2012 and 2013. The average JPY/EUR rates are 111.2 in 2011, 105.6 in 2012 and 2013.

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 1.4% on average in 2011, 1.2% in 2012 and 1.5% in 2013 in the euro area. Long-term euro-area interest rates are assumed to be 2.7% on average in 2011, 2.2% in 2012 and 2.5% in 2013.

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 111.1 USD/bl. in 2011, 103.8 USD/bl. in 2012 and 99.7 USD/bl. in 2013. This would correspond to an oil price of 79.4 EUR/bl. in 2011, 75.8 EUR/bl. in 2012 and 72.8 EUR/bl. in 2013.

Budgetary data

Data up to 2010 are based on data notified by Member States to the European Commission on 1 October and validated by Eurostat on 21 October 2011. Eurostat has withdrawn its reservations on the quality of the data reported by Romania and the United Kingdom in the April 2011 notification. No new reservations have been reported.

In the October 2011 notification the United Kingdom has recorded the proceeds from the sale of UMTS licences of 2000 according to the relevant Eurostat decision of 14 July 2000. Therefore, contrary to the past practices, Eurostat has not amended the deficit and debt data notified by the United Kingdom in this respect.

For the forecast, measures in support of financial stability have been recorded in line with the Eurostat Decision of 15 July 2009.(1) 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 2012, budgets adopted or presented to national parliaments and all other measures known in sufficient detail are taken into consideration. For 2013, 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 the calculation of the government balance. However, for the purposes of the excessive deficit procedure, such flows are recorded as net interest expenditure.

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

(Continued on the next page)

Box (continued)

European aggregates for general government debt in the forecast years 2011-13 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-to-GDP ratio which is 0.2 pp. higher than the consolidated general government debt ratio published by Eurostat in its news release 153/2011 of 21 October 2011 (for the euro area as well as the EU).

General government debt projections for individual Member States in 2011-13 include the impact of guarantees to the EFSF,[(1)] bilateral loans to other Member States, and the participation in the capital of the ESM as planned on the cut-off date of the forecast (subject to approval).

(1) In line with the Eurostat decision of 27 January 2011 on the statistical recording of operations undertaken by the European Financial Stability Facility, available at: http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-27012011-AP/EN/2-27012011-AP-EN.PDF

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. POST-RECESSION LABOUR MARKET PATTERNS IN THE EU

The outlook for the EU labour market, which proved rather resilient during the 2008-09 recession and restarted to create jobs by the end of 2010, has markedly deteriorated and continues to exhibit significant cross-country differences. The pick-up of employment that set in during the last quarter of 2010 has not been sufficient to bring about a significant reduction in the EU unemployment rate. With a waning growth momentum, country-specific labour market weaknesses are further exposed and tend to compound already dismal employment prospects. Displaced workers may face longer periods of unemployment and more jobs may be cut than are created. With job creation being inadequate concerns are reinforced that unemployment in Europe eventually becomes entrenched. Furthermore, in times of heightened uncertainty, the downside risks to the recovery of the labour market have clearly increased, as suggested by the rapid worsening of hiring intentions and of consumers' unemployment expectations during the last months.

2.1. INTRODUCTION

Apart from the uncertainties about the prospects of the economic recovery, additional determinants may impact the labour market outcome at this juncture, including the behaviour of labour supply and the response of wages to the renewed economic slowdown. The pivotal question is the extent to which recent shocks emanating from the housing and banking sector contributed to an increasing skill-mismatch in the labour market thus impeding the efficient reallocation of labour. With job creation insufficient to offset the losses in employment of the 2008-09 recession there are concerns about high unemployment becoming entrenched. The overall labour market outcome will thus depend on the shock-related type of adjustment and on possible constraints and policy responses.

Against this background, section 2 of this chapter highlights the stylised facts of the labour market adjustment triggered by the recession by analysing developments on the aggregate level and in the Member States. Section 3 discusses the key factors which are likely to influence the labour market performance in the short to medium term. In this regard, it is appropriate to distinguish between headcount employment and hours worked. In fact, these two variables are subject to quite different dynamics. Section 4 addresses the issue of efficiency of worker-job matching and examines how the matching process has possibly evolved following the recession. Recent developments in structural unemployment are illuminated in section 5 which focuses on the transition of labour from the shrinking construction sector to expanding sectors. Section 6 concludes.

2.2. SETTING THE SCENE: EMPLOYMENT PROSPECTS AND UNEMPLOYMENT DEVELOPMENTS

Headcount employment started to rise slowly in late 2010, as soon as the growth of hours worked began to level off. The delayed response of employment to the recovery was the counterpart to labour hoarding during the recession and entailed a considerable rebound in labour productivity. Despite the pick-up in economic growth in the EU, job creation has been weak and insufficient to bring about a significant reduction in the unemployment rate (Graph I.2.1). In both the euro area and the EU, the unemployment rate in 2010 and 2011 fluctuated only marginally and remained persistently high at 10.0% in the euro area and 9.5% in the EU respectively (Table I.2.1).

Graph I.2.1: **Employment and GDP growth in the EU**

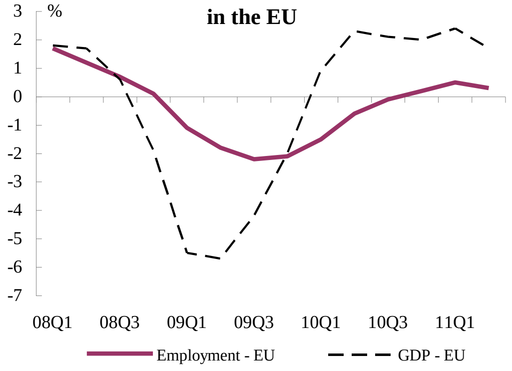


Table I.2.1:
Key labour market indicators by Member State

	Unemployment rate			Long-term unemployment rate (as % of total unemployment)			Youth unemployment rate (age: 15-24)			Participation rate		
	2007	2009q2	2011q2	2007	2009q2	2011q2	2007	2009q2	2011q2	2007	2009q2-2011q2	2011q2
EU	7.2	8.9	9.5	42.7	32.3	43.0	15.4	19.6	20.8	70.5	71.1	71.2
EA	7.6	9.5	10.0	43.5	34.9	45.3	15.0	19.6	20.1	71.0	71.6	71.5
BE	7.5	7.7	7.0	50.4	47.5	48.2	18.9	19.8	16.4	67.1	66.4	66.9
BG	6.9	6.4	11.3	59.2	44.5	56.6	15.1	14.6	25.3	66.3	67.6	65.6
CZ	5.3	6.5	6.9	52.2	28.7	39.1	10.7	14.8	18.0	69.8	69.9	70.5
DK	3.8	6.1	7.3	16.1	7.4	27.0	7.9	11.6	14.3	80.3	81.1	79.4
DE	8.7	7.9	6.0	56.6	45.9	48.7	11.9	11.5	8.6	76.0	76.8	77.1
EE	4.7	13.1	12.8	49.1	23.2	55.3	11.2	27.0	23.6	72.9	73.8	74.4
IE	4.6	11.8	14.2	29.6	23.9	57.6	9.0	25.6	29.8	72.5	70.8	69.6
EL	8.3	9.1	16.6	50.0	41.3	49.1	22.9	24.5	43.1	67.0	67.7	67.6
ES	8.3	17.9	21.0	20.4	21.4	40.9	18.2	38.1	46.1	71.6	73.1	73.8
FR	8.4	9.5	9.7	40.2	35.1	41.6	19.0	21.9	21.1	70.0	70.8	70.2
IT	6.1	7.6	8.1	47.4	45.4	53.6	20.3	24.0	27.4	62.5	62.6	62.1
CY	3.9	5.0	7.0	18.9	8.4	17.0	10.2	13.0	20.6	74.0	74.1	74.4
LV	6.0	16.4	16.1	26.1	24.1	54.2	10.7	30.5	32.1	72.8	74.1	73.6
LT	4.3	13.5	15.5	31.9	20.6	51.6	8.2	29.6	33.6	67.9	70.0	72.3
LU	4.2	5.3	4.6	28.5	26.3	36.1	15.1	13.0	18.7	66.9	69.2	67.4
HU	7.4	9.7	10.9	46.9	41.0	49.6	18.0	24.9	24.3	61.9	61.5	62.6
MT	6.5	6.8	6.7	41.8	45.0	43.8	13.9	16.1	15.0	58.4	59.2	61.5
NL	3.6	3.5	4.2	39.4	24.9	34.8	6.0	6.3	6.9	78.5	79.7	78.0
AT	4.4	4.8	4.1	26.8	19.3	27.0	8.6	10.0	8.1	74.8	75.3	75.2
PL	9.6	8.0	9.5	51.2	29.3	37.2	21.7	19.2	24.6	63.2	64.4	66.0
PT	8.9	10.5	12.5	47.1	43.6	50.7	16.6	18.7	27.0	74.1	73.8	74.3
RO	6.4	6.5	7.4	49.9	36.5	41.7	20.2	19.2	21.8	63.0	63.4	63.5
SI	4.9	5.8	7.9	45.6	30.4	45.0	10.2	12.3	13.2	71.3	71.7	69.9
SK	11.1	11.3	13.2	74.3	52.2	68.9	20.3	25.1	31.7	68.3	68.1	68.7
FI	6.9	8.2	7.9	23.0	12.3	18.8	16.5	28.3	25.7	75.6	77.3	77.0
SE	6.1	8.4	7.5	14.0	10.8	17.1	19.3	29.1	27.0	79.2	80.2	81.3
UK	5.3	7.7	7.9	23.7	22.8	33.9	14.3	18.8	20.0	75.5	75.5	75.4

Note: Series following Eurostat definition, based on the labour force survey (EU-LFS). No adjustments are made to the EU-LFS data.

The slowdown of GDP expansion in the second quarter of 2011 signalled rather subdued growth which is expected to pick up only in the course of next year. Given the usually lagged impact of GDP growth on employment, the unemployment rate is expected to remain mainly unchanged over the forecast horizon. Employment in the EU and the euro area is likely to be stuck below levels achieved before the 2008-09 recession. With this deteriorated economic outlook, the net effect of job creation and job destruction will depend on the capacity of firms to adjust labour costs either through wages or hours worked as well as on the reallocation needs within the economy and the prevailing policy framework.

Employment growth at the sectoral level

The overall evolution of employment results from different patterns at the sectoral level. During the 2008-09 recession, the bulk of job losses was concentrated in those sectors which resorted only to a limited extent to working time adjustment. Yet, the decline of employment exceeded the abrupt reduction of the workforce in the construction sector following the collapse of the housing bubble. Despite the widespread use of short-time working schemes, the recession also accelerated the historical downward trend of employment in manufacturing. The significant shift in the employment structure brought about by the recession is possibly linked to the excess capacity in different industries and to the concern that GDP losses incurred during the recession may be permanent. Looking forward, the uncertainties

Table I.2.2:
Sectoral employment growth

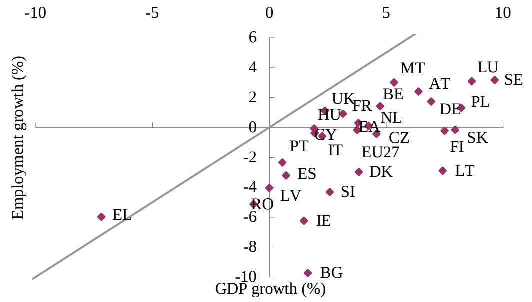
	Manufacturing				Construction				Market services				Public administration and community services; activities of households			
	2009	2010	2011q1	2011q2	2009	2010	2011q1	2011q2	2009	2010	2011q1	2011q2	2009	2010	2011q1	2011q2
EU	-5.5	-3.1	0.1	-0.1	-5.1	-3.4	-1.7	-1.0	-1.7	0.1	0.7	0.9	1.4	1.2	-0.1	-0.2
EA	-5.4	-3.3	0.9	0.1	-6.5	-3.6	-0.5	0.1	-0.5	0.0	0.8	0.7	1.5	1.1	0.2	0.1
DE	-2.9	-1.7	0.8	:	0.5	1.3	0.6	:	-0.2	1.0	0.6	:	2.1	1.3	0.0	:
ES	-14.4	-5.8	-0.6	-0.1	-22.5	-12.1	-2.7	-2.1	-5.2	-1.7	1.1	0.9	1.5	1.1	-0.4	0.7
FR	-4.0	-3.8	-0.1	0.1	-1.2	-1.5	0.0	0.2	-2.1	1.0	0.5	0.5	1.1	0.9	0.1	0.1
IT	-4.5	-3.8	1.2	0.0	-1.2	-1.4	-0.1	2.1	-2.0	-0.1	0.2	0.7	0.8	0.3	-0.9	-0.4
NL	-3.1	-3.1	-0.4	:	-1.8	-2.4	-1.4	:	-2.8	-1.9	0.5	:	2.3	2.3	0.0	:
UK	-6.5	:	:	:	-7.1	:	:	:	-3.1	:	:	:	1.3	:	:	:

for 2011Q1 and 2011Q2 % change compared to previous quarter of the same year about the developments of the sovereign-debt crisis resulting in tighter credit conditions and the corresponding difficulties for companies or households to obtain loans may have an additionally adverse effect on employment. This especially applies to industries that rely on customers who finance their purchases by loans or companies that are relatively more dependent on bank lending.[30]

Cross-country labour market outcomes

The response of employment to growth has been quite uneven across Member States in correspondence to different economic structures and conditions (e.g. sectoral composition of employment, corporate profitability) and policy settings.[31] Therefore, it is not surprising that labour market developments at the country level have largely followed the multi-speed recovery (Graph I.2.2), with stronger employment growth in countries with better growth performances (Belgium, Germany, Luxemburg, Malta, Austria, Poland and Sweden). However, GDP expansion has outstripped employment growth in almost all Member States, resulting in a sizeable increase in labour productivity.

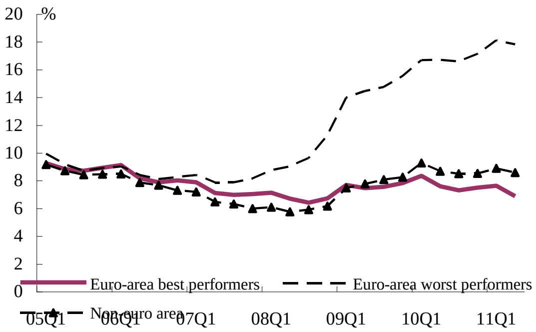
Graph I.2.2: **GDP and employment in the EU Member States: cumulated changes between Q2-2009 and Q2-2011**



Note: For BE, EL and LU cumul. changes between Q2-2009 and Q1-2011 .

The evolution of aggregate EU unemployment masks fairly wide differences across countries (Graph I.2.3).

Graph I.2.3: **Unemployment rates in the EU**



Note: The solid line represents countries with better labour market performance during the recession and the recovery; these include BE,

The labour market deterioration sparked by the recession proved particularly acute in the Baltic countries, Spain, and Ireland. Considerable job losses were also recorded in Bulgaria, Denmark, Portugal, Slovakia, and Finland. By contrast, labour markets were particularly resilient in Austria, Malta, Luxemburg and especially in Germany where past reforms and more flexible working-time arrangements contributed to a better than expected performance (Box I.2.1). In general, countries hit by the burst of housing bubbles and constrained in their policy manoeuvre by external and fiscal imbalances were the most affected in terms of job losses. In the second quarter of 2011, eight countries exhibited unemployment rates above 12% (the three Baltic countries, Spain, Ireland, Greece, Portugal and Slovakia). By contrast, the unemployment rate is below 7.2% (i.e. below the average value in the EU prevailing before the recession) in 7 countries. The unemployment rate is back at or below pre-recession levels in Austria and Germany, Belgium and Poland. As a consequence of these different developments, the larger share of unemployment is now concentrated in relatively few countries. Before the 2008-09 recession, Spanish unemployment represented only 10% (20%) of total EU (euro area) unemployment, a proportion comparable to the country's share in total population. With about 4.8 million unemployed in Q2-2011, this proportion accounts now for about one fifth and one third of total unemployment in the EU and the euro area respectively. An opposite evolution has been taking place in Germany where the share in total EU unemployment declined between the second quarter of 2007 and the same period in 2011 from 30% to 16%.

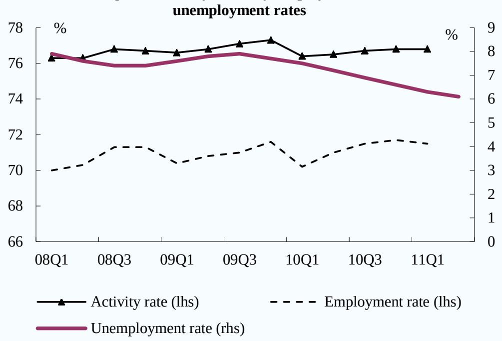
[30] Braun and Boria (2005) find that recessions coupled with a deteriorated financial environment have different impacts on industries according to their dependence on external funds. The financial mechanism is strong when recessions are accompanied by a credit crunch. Evidence for the US shows that the financial crisis caused a sizeable decrease in employment in firms that rely on external capital to finance their operations; Braun, M. and L. Borja, Finance and the Business Cycle: International Inter-Industry Evidence, *Journal of Finance*, May 2005, 60(3), pp. 1097-1128; Auer, P., R. Auer and S. Wehrmuller, Assessing the impact of the financial crisis on the US labour market, VOXEU, 2008, http://voxeu.org/index.php?q=node/2603.

[31] IMF, Unemployment Dynamics during Recessions and Recoveries: Okun's Law and Beyond, *World Economic Outlook, Rebalancing Growth*, April 2010, pp. 69-107.

Box I.2.1: **The German labour market during the recession**

The resilience of the German labour market during the crisis has surprised many observers and raises questions on the reasons behind. Indeed, employment remained remarkably stable during the recession and has been developing favourably in the subsequent recovery. While real GDP contracted by 5.1% in 2009 and expanded by 3.7% in 2010, changes in activity, employment and unemployment rates were relatively moderate (Graphs 1 and 2). The activity rate kept almost constant and even showed a slight increase in 2009. The employment rate remained at around 70%, after having increased significantly in the years previous to the recession. The unemployment rate increased slightly to 7.8% in mid-2009, before falling below the pre-recession level already in 2010; it continued to decline in 2011, down to 6.0% in August. The labour market is expected to improve further, albeit at a slower pace than before. In all, the unemployment rate decrease observed since early 2008 is stronger than what Okun's law would have predicted.

*Graph 1:***Germany - activity, employment and unemployment rates**

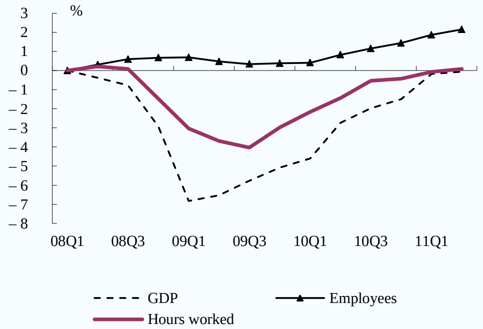


The mild response of the labour market in head-count terms is explained to a large extent by the adjustment in working time (*intensive margin*). The average yearly number of hours worked in 2009 decreased by 41.3 (-3.1%) from 2008[(1)] and rebounded in 2010 by 30.6 hours (2.3%).[(2)] Companies reacted to the recession by reducing overtime and surpluses in working time accounts, resorting to short time working schemes and reducing temporarily the statutory working time.

(1) Fuchs, J., M. Hummel, S. Klinger, E. Spitznagel, S. Wanger and G. Zika, *Prognose 2010/2011*. Der Arbeitsmarkt schließt an den vorherigen Aufschwung an, *IAB Kurzbericht* 18/2010.

(2) Fuchs, J., M. Hummel, S. Klinger, E. Spitznagel, S. Wanger and G. Zika, Neue Arbeitsmarktprognose 2011. Rekorde und Risiken, *IAB Kurzbericht* 7/2011.

*Graph 2:***Germany - cumulative change in GDP, number of employees and hours worked since 2008Q1**



Source: Federal Statistical Office Germany and Eurostat.

The impact of the recession differed across sectors, regions and types of employment. The manufacturing sector was most affected by the fall in exports, registering a decrease in employment and more notably in the number of hours worked. Some services such as business services, telecommunication or transport and storage were also affected by the recession, but overall the service sector remained stable and some services even recorded increases in employment and/or hours worked. While unemployment in 2009 even decreased in Eastern Germany from its very high pre-recession level, it went up markedly in Baden-Württemberg and Bavaria, which have specialised in manufacturing and had the lowest unemployment rates before the recession. First and foremost, job losses affected temporary workers (temporary agency workers and fixed-term contracts).

The structural developments of the last decade and the reforms undertaken before the recession are likely to have contributed to some extent to the resilience of the German labour market. The sectoral composition of the German economy has been changing, with a shift from manufacturing towards the service sector. The traditionally strong manufacturing sector has been increasingly relying on temporary workers who could be laid off during the recession, but the core labour force in the sector has remained covered by strict dismissal protection legislation. The reluctance of the manufacturing sector to reduce employment probably also reflects the expectation of a quick recovery, the solid financial situation before the recession and an increasing tightness in certain segments of the labour market.

Moreover, Germany had undertaken a number of reforms that resulted in higher flexibility of the

(Continued on the next page)

Box (continued)

labour market. The *Hartz* reforms introduced between 2003 and 2006 gave rise to the reorganisation of employment services, changes in the regulation of some forms of employment (e.g. publicly-funded low-wages contracts and self-employed, temporary employment) and a far-reaching reform of the unemployment and social benefit system. The duration of unemployment insurance benefits was reduced, the criteria for the decline of jobs offered were restricted, and the wage-related assistance scheme for unemployed who had exhausted the unemployment insurance benefits was merged with the social assistance scheme, leading in sum to a reduction of benefits for long-term unemployed. The reforms are likely to have contributed to improve the functioning of the labour market. Even though long-term unemployment as a percentage of total unemployment has decreased in Germany over the last years, the ratio remains higher than in other countries with low unemployment rates, such as the Netherlands (where it decreased significantly after 2006), Austria or Luxembourg.

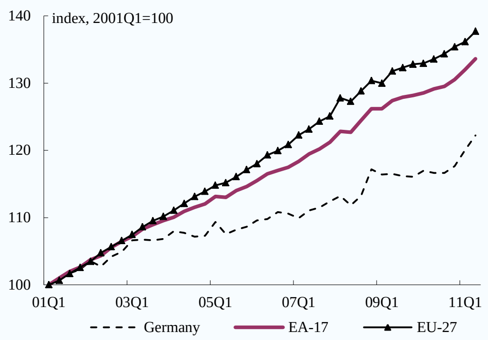
Flexibility within firms has also increased substantially. The traditional system of sectoral, multi-employer bargaining at the regional level has lost ground and the use of opening clauses allowing firms to deviate from collective agreements has increased. In most cases opening clauses are related to working time arrangements, e.g. the use of working time accounts or variable working hours. Opening clauses have been used to protect employment in exchange of concessions on payment or working conditions (*alliances for jobs*). In addition, the use of non-regular contracts has spread following a gradual liberalisation of fixed-term contracts and temporary agency work, while the employment protection legislation of permanent contracts remains relatively strict. The 2000 act on part-time work also encouraged more frequent recourse to part-time work.

Wage increases were moderate during the last decade, with real wages increasing less than productivity (Graph 3).

*Graph 3:***Germany - labour productivity and real wages**

The implicit decline in labour costs strengthened the competitiveness of the German economy vis-à-vis other European countries (Graph 4).

*Graph 4:***DE, EA, EU - labour cost index**



Note: Total labour costs, nominal value, business economy.

Finally, the government responded to the recession with a set of measures which contributed to reduce its impact on the labour market. In particular, the public short-time work scheme was modified regarding the maximum duration, the exemptions from social security contributions of hours not worked and the administrative requirements. The number of workers put on short-time work increased from around 50.000 in mid-2008 to more than 1.4 million in May 2009 and declined thereafter.

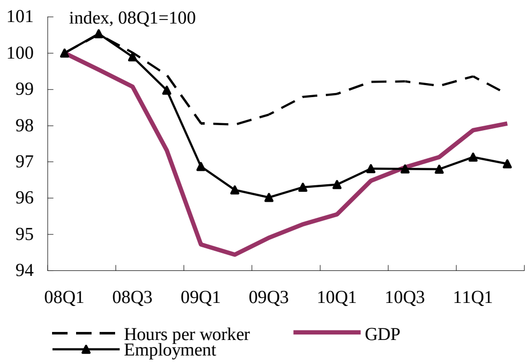
The widening gap in unemployment rates cannot be explained by divergent GDP developments alone. Other relevant factors include differences in the extent of adjustment of working hours, different needs of reallocating labour across sectors, notably away from construction, different economic and institutional frameworks and heterogeneous policy responses. Thus, the sizeable increase in unemployment in countries affected by the bust of housing bubbles was not only due to the severity of the recession. Moreover, the adjustment in terms of working hours and labour hoarding was far less prevalent in the shrinking construction sector, while the share of temporary workers was much higher which contributed to the large extent of dismissals on short notice.

2.3. FACTORS DRIVING LABOUR MARKET DEVELOPMENTS

In 2010, the EU economy headed upward, while the adjustment in the labour market was lagging behind. This section reviews the reasons for the delayed labour market recovery in Europe. The matching of vacant posts with the unemployed and the risk that high unemployment translates into high equilibrium unemployment is discussed in the next sections.

First, the decline in hours worked per employee during the recession, a key factor in minimising the rise of unemployment in several countries, implies that firms largely responded to the increase in economic activity via an expansion of *hours worked*.[32] This translated into strong productivity growth (per person employed) coupled with relatively muted employment dynamics. The latest figures for 2011 indicate that the increase in hours worked came to a halt during the first quarter of the year in line with the sharp GDP adjustment in the second quarter. In turn, this fading growth momentum may point to limited employment growth over the medium term (Graph I.2.4).

Graph I.2.4: **Cumulative changes in GDP, number of employees and hours per worker**



Second, the bulk of job losses of the 2008-09 recession was recorded among the young. In 2011, the *labour market conditions of young people* (aged 15-24) strongly deteriorated in many Member States, implying an increase in the aggregate youth unemployment rate of about 6 pps. compared with 2007 (Table I.2.1). In the second quarter of 2011, the youth unemployment rate reached nearly 21%. The young are a vulnerable group for several reasons. They have rather little work experience and their short tenure usually implies limited access to unemployment benefits. Given that the young are frequently employed on the basis of temporary contracts they were also relatively strongly hit by the recession in comparison to other age groups. This substantial and persistent fall in job creation coupled with the shedding of temporary jobs led to a major increase in the youth unemployment rate in most EU countries, reaching worrisome levels in Spain, the Baltics, Greece, Slovakia, Italy, Ireland and Portugal (Table I.2.1). But youth unemployment can also have substantial negative long-term effects. Research indicates that the longer the young remain unemployed the higher the probability that they will become disconnected from the labour market (i.e. join the pool of inactives) or they will have worse labour market outcomes in the future – the so-called scarring effects of unemployment (Bell and Blanchflower, 2009). One underlying reason is the fact that skills acquired during education deteriorate fast if these skills are not put to use. Moreover, when employers are uncertain about the productivity of a potential worker, they may use earlier periods of unemployment as a screening device in their hiring process and recruit those with shorter unemployment spells. Seniority rules may also play a role when a firm has to reduce the workforce (i.e. less experienced workers have to leave earlier). Finally, being part of a large pool of unemployed reduces the stigma of unemployment and thus lessens the intensity of job search.[33]

Third, during the 2008-09 recession the *participation rate* has evolved more positively than was to be expected. In spite of a large fall in output, participation rates (at 71.2% and 71.5% in the second quarter of 2011 in the EU and the euro area respectively) were generally highly resilient in almost all Member States (Table I.2.1): an unusual development when compared to the pro-cyclical participation rate of previous recessions. This resilience of participation rates is a feature that distinguishes the EU from the US, where in the second quarter of 2011 participation reached the lowest rate since 1984 (64%).[34] The development of the labour supply in Europe was driven by a

(32) Between Q2-2009 and Q2-2011 the hours worked per capita grew by about 1%, while employment remained mainly unchanged.

(33) For a review of the effects of the recession on youth unemployment and policy implications see Scarpetta, S., A. Sonnet and T. Manfredi, Rising Youth Unemployment During the Crisis: How to prevent negative long-term consequences on a generation?, OECD Social Employment and Migration Working Papers, No. 106, 2010.

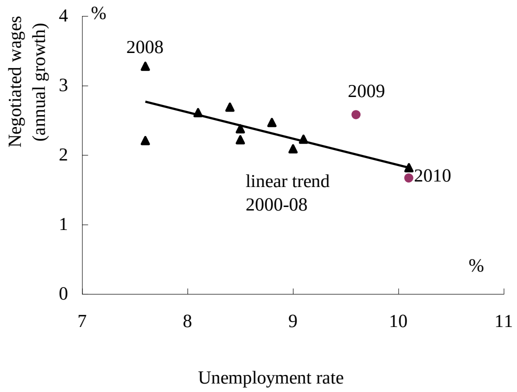
(34) In the US the participation rate refers to the population aged 16 years and over. For the EU and the euro area, the corresponding rates (16-74 years) are around 63.5%.

steep increase in the participation rate of women (up by 1 pp. to 65% in the EU and the euro area respectively) and a decline for men (by 0.5 and 0.7 pp. in the EU and the euro area respectively). While the participation rate of older workers kept rising at the pre-recession rate, the corresponding rate of young adults (aged between 19 and 24) declined.[35] Older workers' participation rose partly because of pension reforms that have increased the retirement age and have limited the access to early retirement schemes and partly because of concerns about pension incomes following the crisis-induced losses of pension funds. The increasing share of women in the total work population, especially of those married with children, was mainly linked to increased income and employment risks of male earners (the so-called added worker effect). Although the behaviour of labour supply may have contributed to persistently high unemployment levels in some countries, the resilience of the EU participation rates bodes well for the recovery, as a high participation rates is the key to restoring employment rates to pre-recession levels. However, it is an open question if participation rates will remain resilient in a context of prolonged weak job prospects. [36]

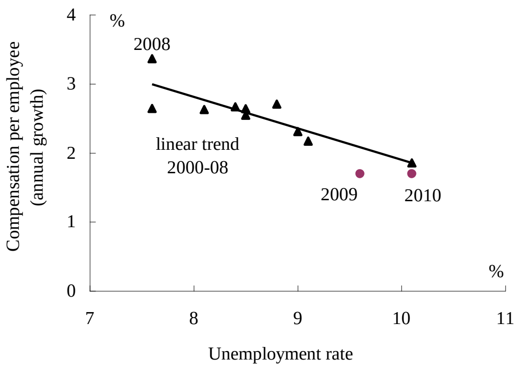
Fourth, a further element that may explain the belated and rather subdued response of employment to output growth in 2010 is *pending uncertainty* on the strength and sustainability of the recovery.[37] The combined effect of weaker growth and heightened uncertainty may induce firms to postpone hiring, thus delaying the recovery of employment. The availability of flexible employment practices may allow firms to adjust recruitment more to cyclical developments. The fact that employment creation in 2010 took place especially in terms of temporary and part-time jobs confirms the role played by uncertainty, as employers appeared very cautious to increase the rigidity of their costs structures, in particular in countries with overly protected permanent contracts.[38]

Fifth, the belated response of employment may also be partly linked to a *delayed adjustment in labour costs*. Although there is evidence that nominal compensations began to respond to the labour market slack in 2009, negotiated wages in the euro area started to adjust only in 2010. On the basis of a Phillips curve for the period 2000-08, Graph I.2.5 shows that the growth of negotiated wages in 2009 was about 0.5 pp. above the rate predicted by the historical relationship.

Graph I.2.5: **Phillips curve for the euro area 2000-10: growth of negotiated wages**



Graph I.2.6: **Phillips curve for the euro area 2000-10: growth of compensation per employee**



In 2010, the high unemployment rate had a dampening effect on negotiated wages, broadly in line with what is predicted on the basis of a Phillips curve-type relation. This effect was already observable in 2009 when measured in

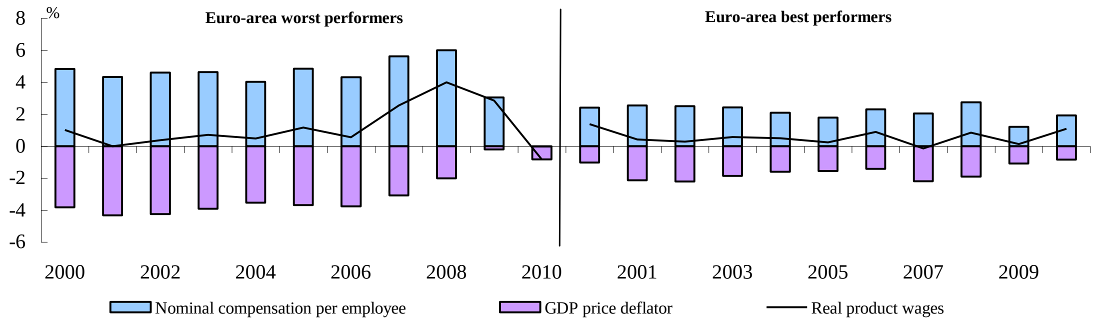
(35) In the US the participation rate of young adults has increased during the recession; the reduced supply of credit to students and the wealth losses of their parents may have induced the young to search for a job to finance their studies; see Daly, M., B. Hobijn and J. Kwok, Labor Supply Responses to Change in Wealth and Credit, *Federal Reserve Bank of San Francisco Economic Letter*, 2009-05, January 2009.

(36) Engemann, K. M. and H. J. Wall, The Effects of Recessions Across Demographic Groups, *Federal Reserve Bank of St. Louis Review*, 92(1), January/February 2010, pp. 1-26.

(37) Bernanke, B., Irreversibility, Uncertainty and Cyclical Investment, *Quarterly Journal of Economics*, 98(1), February 1983, pp. 85-106; Bloom, N., The Impact of Uncertainty Shocks, *Econometrica*, 77, May 2009, pp. 623-85.

(38) From the first quarter of 2010 to the second quarter of 2011, temporary contracts expanded by 8.3% in the EU against a rate of 1.6% for total employment.

Graph I.2.7: **Real wage growth, euro area**



Note: Best performers include countries with a better performance of unemployment during the recession and the recovery (i.e. BE, DE, FR, IT, CY, LU, MT, NL, AT and FI).

terms of compensation per employee. Graph I.2.6 shows that the growth rate of compensation per employee was below the Phillips curve. This evidence supports the view that the variable component of wages adjusted faster to labour market slack than the negotiated component.

Wage developments were very heterogeneous across Member States. In the non-euro area countries, wages in 2010 grew at a robust rate in Bulgaria, Poland and the Czech Republic but continued to decline in Latvia and Lithuania, though at a much slower rate than in 2009, and in Hungary. In the euro area compensations per employee remained close to the levels of 2009, but it varied considerably across euro area members. Compensation per employee declined in Greece, Ireland, and Malta while in Spain the level remained unchanged after strong wage growth in the years before.

By contrast, Cyprus, Luxembourg, Slovenia, Slovakia, and Finland recorded growth rates in compensation per employee well above the euro area average. These uneven developments reflect different exposures to the recession, the need of rebalancing in some countries and underlying labour market institutions. More importantly, it appears that real wage adjustment set in in countries with higher unemployment only in 2010. In fact, Graph I.2.7 shows that until 2009 the upward trend of real wages was actually stronger in countries with worse unemployment outcomes.[39] The remarkable productivity improvement, coupled with wage moderation, resulted in a reduction in unit labour costs for the euro area and the EU, the first one since the mid-1990s. The euro area realised an improvement in cost competitiveness by more than 7%, when measured in terms of unit-labour-cost-deflated real effective exchange rates. These developments seem to support the external rebalancing of EU economies. However, the competitiveness gains are likely to be short-lived, since the productivity boost of 2010 is largely the results of a rebound in working hours after labour hoarding during the recession.

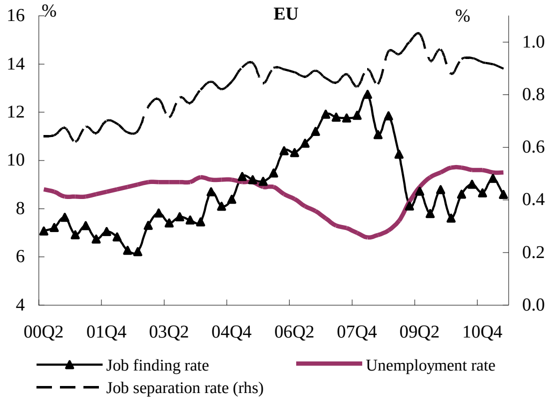
Sixth, displaced workers are not necessarily suitable to fill new vacancies, which translates into *longer spells of unemployment*. Long periods of unemployment entail a deterioration of skills and ultimately an increase in structural unemployment. A higher structural unemployment, however, requires more labour market slack to keep wage developments under control. After having temporarily fallen at the early stages of the recession, due to new displaced workers joining the existing stock of unemployed, long-term unemployment, i.e. unemployment spells lasting for more than a year, has rapidly increased. In the second quarter of 2011, the share of long-term unemployment in the EU reached 43%, with large differences across countries, ranging from less than 20% in Finland, Sweden and Cyprus to almost 70% in Slovakia (Table I.2.1). Compared with the second quarter of 2009, its share doubled or almost doubled in the Baltic countries, Ireland and Spain. Among the countries with low unemployment rates, the share of long-term unemployment declined in Belgium, Germany, the Czech Republic, and the Netherlands. The extension of unemployment duration might be linked to a series of factors, notably a persistently low rate of job creation. Prospects are largely country-specific however, depending inter-alia on possible further job destruction following sectoral

(39) However, given the decline in low skilled employment (-8% and -6% in 2009 and 2010 against a decline for total employment of 4% and 3%) compositional effects due to the fact that low-paid workers have been hit particularly hard by large-scale layoffs may have played a role.

adjustment and possible credit constraints, the extent of job shedding in the public sector, and the availability of government-sponsored short-time working schemes.

Additionally, the analysis of *job market flows* (i.e. inflows into and outflows out of unemployment) is also likely to shed some light on unemployment prospects. In this regard, it helps to examine whether the rise in unemployment is due to an increase in the job destruction rate or to a decline in the job finding rate.(40) Moreover, the inflow and outflow rates determine the degree of turnover in the unemployment pool and the persistence of unemployment. Graph I.2.8 shows the development of job separation(41) and job finding rates based on unemployment duration data. Before the crisis both rates were trending upwards, implying an increase in workers' reallocation (the sum of the job finding and separation rates).(42) With the economy entering recession, the unemployment rate started to rise due to higher separation rates and lower job finding rates. After reaching a peak at the turning point quarter of GDP (Q2-2009), the separation rate started to decline, while the job finding rate remained at a persistently low level. Although the flow into the pool of unemployed did not increase any further, it is mainly the low job finding rate that explains the persistently high unemployment rate and the longer spells of unemployment in the EU.(43)

Graph I.2.8: **Job finding and separation rates in the EU**



However, there are very pronounced cross-country differences in job finding and job separation rates. In Spain, Ireland, Portugal and Greece the low probability of leaving unemployment implies a steady lengthening of the average unemployment duration. Job destruction is not followed by sufficient job creation and unemployment becomes persistent. In contrast, the persistency of unemployment is apparently lower in countries such as Belgium, the Czech Republic, the Netherlands, Finland, and Germany where in the first half of 2011 job finding rates strongly increased (Graph I.2.9). Job separation rates remain high in several Member States and even increased in countries with low job finding rates such as Cyprus, Spain, Greece and Portugal.

Graph I.2.9: **Job finding rates – the probability of leaving unemployment has fallen during the crisis and remains low in many Member States**

ırce: Commision calculations on Eurostat LFS unemployment ·ation data.

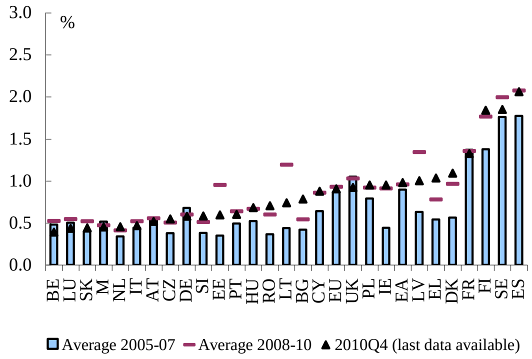
(40) The job finding rate is defined as the probability of finding a job when unemployed.

(41) The job separation rate is defined as the probability of losing a job when employed.

(42) The inflow and outflow rates are calculated on the basis of the methodology developed by Shimer, R., Reassessing the Ins and Outs of Unemployment, *NBER Working Paper*, 13421, 2007, for the US and Elsby, M., B. Hobjin and A. Sahin, The Labor Market and the Great Recession, *Brookings Papers on Economic Activity*, Spring 2010, pp. 1-48, for OECD countries; see Arpaia, A. and N. Curci, EU labour market behaviour during the Great Recession, Economic Papers 435, European Commission, Directorate General for Economic and Financial Affairs, February 2010 for details.

(43) A similar development of the unemployment outflow rate is found for OECD countries, most notably the US; see OECD, *Economic Outlook*, chapter 5: Persistence of high unemployment: what risks what policies?, Paris, May 2011, pp. 253-285.

Graph I.2.10: **Job separation rates - the probability of losing a job remains high in many Member States**



2.4. HAS THE LABOUR MATCHING PROCESS DETERIORATED?

Several factors may have contributed to the increase in long-term unemployment in the EU, including the preference of employers to hire people with short spells of unemployment, which became more relevant during the recession; the difficulty of screening a large number of job seekers because of incomplete knowledge about their characteristics (congestion effects);[(44)] the deterioration of workers' skills during unemployment; displaced workers facing financial constraints may have found it difficult to move to locations where jobs are abundant; and increased mismatch between labour demand and sector-specific skills. Furthermore, government policies put in place after the recession could have had an impact. Notably, the coverage and generosity of unemployment benefits have been raised in a number of EU countries. By reducing the costs of unemployment and thus lowering the intensity of job search, these measures may have lengthened the duration of unemployment.[(45)] However, the increase in generosity has been accompanied by a tightening of eligibility conditions. As a consequence, the overall effect on the unemployed persons' intensity of job search is likely to be limited.

Given low job finding rates and rather large job separation rates the duration of unemployment is likely to increase in many Member States. Job losses may translate into longer spells of unemployment, which would in turn lead to a deterioration of human capital and eventually to a rising skill mismatch between available vacancies and job seekers. As a result, unemployment may become more persistent and increase the likelihood of a fall in labour supply.

The Beveridge curve which represents the relationship between unemployment and job vacancy rates[(46)], delivers essential information about the labour market tightness and the impact of shocks on the efficiency of labour market matching. Over the business cycle this relationship exhibits a negative co-movement, with many vacancies and low unemployment when the economy is growing and vice versa when it is contracting. This leads to movements along the curve. Shifts of the curve – i.e. positive co-movements between vacancies and unemployment – reflect changes in the effectiveness of the matching process, possibly related to skill mismatches and sectoral or regional immobility.

Until the second half of 2009, the curve did not exhibit a clear shift, which is consistent with a weak demand for labour. However, unemployment hovered around 10% in 2010 and 2011 while the labour market was becoming tighter, which hints at a possible deterioration of the matching (Graph I.2.11). Shifts in the Beveridge curve might be temporary or could rather signal structural changes in the labour market. The latter view is supported by Graph I.2.12 which shows that the change in the unemployment rate due to the deterioration in the match and the evolution of structural unemployment as defined by the non-accelerating wage rate of unemployment (NAWRU), i.e. the unemployment rate consistent with stable inflation,[(47)] co-move and that this co-movement is particularly evident in recent years.

(44) This is also related to an imperfect adjustment of wages and to the limited mobility of workers.

(45) See European Commission, Economic crisis in Europe: causes, consequences and responses, *European Economy*, 7, 2009, for a review of policy responses to the crisis in the EU Member States. For the US the effect on the unemployment rate of extended duration of unemployment benefits ranges from 0.7 pp. to 1.7 pps. However, the effect is much lower when one takes into account the different eligibility to benefits of displaced workers (see Daly, M. et al., A Rising Natural Rate of Unemployment: Transitory or Permanent?, *Federal Reserve Bank of San Francisco Working Paper*, 2011-05, 2011).

(46) The vacancy rate is defined as the number of unfilled jobs as a share of the labour force.

(47) The NAWRU is described and analysed in more detail in section 2.5.

Box I.2.2: The effect of skill mismatches on unemployment

The burden of the 2008-09 recession was not evenly spread across different economic groups. Together with the young, the less qualified have been hit hardest. Between 2008 and 2010, low-skilled labour in the EU declined by 9% (7% in the euro area), while highly qualified employment grew at about 6% both in the EU and the euro area. The structural adjustment launched by the recession has entailed the need for an extensive inter-sectoral reallocation of labour. However, the mismatch between the skills of workers who exited shrinking sectors and the skills required in expanding ones is likely to induce longer spells of unemployment.

Following Estevao and Tsounta (2011),[1] a skill mismatch index (SMI) is computed representing the gap between the average proportion of the low-, medium- and high-skilled in the working age population and the corresponding proportion in employment. In symbols, for country *i* the index is

$$SMI_{it} = \sum_{j=1}^{3} \left(s_{ijt} - m_{ijt}\right)^2$$

where s_{ijt} is the share of the working population with skill level j in country i at time t; m_{ijt} is the equivalent share in employment.

Graph 1 reports the SMI by country for 2007 and 2010; countries are ranked in decreasing order of the change in the index between the two periods. Unsurprisingly, skill mismatches have increased after 2007 in countries hit by the burst of a housing bubble. It is noteworthy, however, that also countries which did not suffer from major imbalances in the housing sector before the recession and thus did not register any substantial employment losses in construction afterwards, exhibit a rising level of skill mismatch.

Graph 1: **Skill mismatch index by Member State**

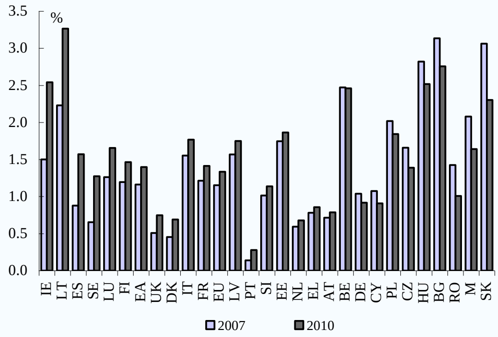


Table 1 reports the outcome of a panel data estimate on a sample of 27 Member States over the period 2001-10 of an Okun's law regression augmented with the index of skill mismatch; the estimates are based on a fixed effect estimator and a robust variance-covariance matrix. A time dummy is also included to account for common shocks that affect all countries.

The estimates suggest that an increase in the skill mismatch raises the unemployment rate after controlling for country and common GDP shocks. The effect is particularly strong during the recession period and is of the same order as those obtained by Estevao and Tsounta for the US States over the period 1991-2009.

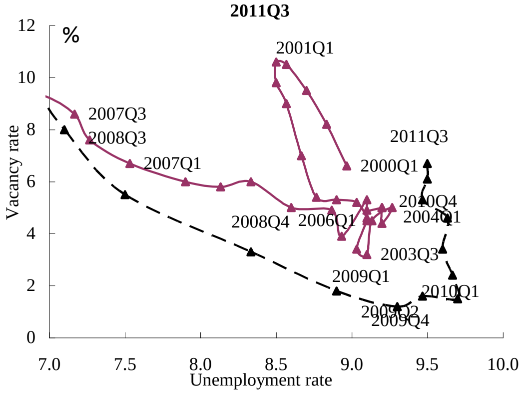
(1) Estevao, M. and E. Tsounta, Has the Great Recession Raised Structural Unemployment?, *IMF Working Paper*, 11/105, May 2011.

Table 1:
Okun law estimates controlling for skill mismatches

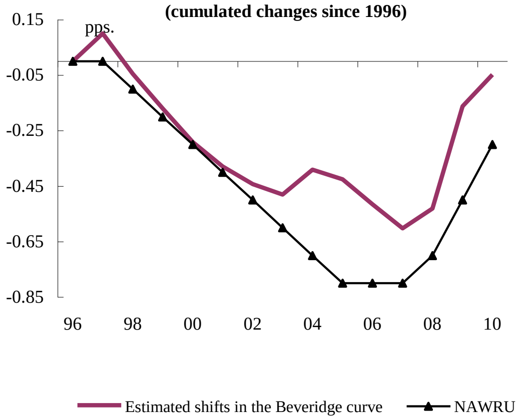
Dependent variable: Change in unemployment rate	EU countries					
Explanatory variables	(1)	(2)	(3)	(4)	(5)	(6)
Log change in GDP	-0.32*	-0.35*	-0.32*	-0.34*	-0.30*	-0.34*
	[0.027]	[0.034]	[0.028]	[0.035]	[0.026]	[0.005]
Log change in SMI			0.012*	0.01	0.0049	0.0007
			[0.063]	[0.062]	[0.005]	[0.005]
Log change in SMI crisis period					0.0325**	0.0398*
					[0.016]	[0.017]
Constant	0.94*	1.57*	0.86*	0.84*	0.80*	0.87*
	[0.069]	[0.326]	[0.068]	[0.251]	[0.069]	[0.24]
Observations	297	297	270	270	270	270
R-squared	0.58	0.64	0.63	0.68	0.70	0.70
Trend	No	Yes	No	Yes	No	Yes
Number of countries	27	27	27	27	27	27

*Estimation method: Least Square Dummy Variables. Robust standard errors in brackets. Clustering of standard errors by country** p<0.01, * p<0.05, + p<0.1.*

Graph I.2.11: **Beveridge curve for the EU 2000Q1-2011Q3**



Graph I.2.12: **Shifts in the euro-area Beveridge curve and NAWRU (cumulated changes since 1996)**



Between 1996 and 2007 the NAWRU declined and the Beveridge curve shifted leftward (i.e. the unemployment rate consistent with a specific vacancy rate falls) and both series pointed to declining structural unemployment. After 2008 however, both the NAWRU and the mismatch-related unemployment increased considerably. [48]

This evidence suggests that a higher share of unemployment has become structural due to the worsening labour market mismatch and that a given reduction of unemployment would require a stronger degree of wage adjustment. The evidence provided in Box I.2.2 also suggests that part of the increase in unemployment can indeed be attributed to the mismatch between the demand and supply of skill categories.

(48) The Beveridge curve has been estimated on euro area aggregate data: $u_t = \alpha+\beta_0 u_{t-1}+\beta_1 v_t+\beta_2 v_t^2+D_t+\varepsilon_t$, where u_t is the unemployment rate in year t, v_t is the job vacancy rate, and D_t is a dummy variable to account for shifts in the curve. These shifts capture the changing efficiency of the matching process over time.

2.5. TREND AND DETERMINANTS OF STRUCTURAL UNEMPLOYMENT IN THE AFTERMATH OF THE RECESSION

The previous section has shown that matching in the labour market has been worsening in the euro area and that this deterioration coincides with estimates of a higher NAWRU. Looking ahead, these trends raise the concern that the phenomenon of “unemployment hysteresis” will re-emerge in Europe as in the 1980s following the stagflation induced by oil price shocks. There is a risk that, in spite of a cyclical rebound, unemployment could remain persistently above pre-recession levels. Moreover, higher long-term unemployment might increase the number of workers who become discouraged or are hardly employable, thus exiting the labour force. These tendencies will eventually impinge upon the recovery of employment rates in the future.

Moderate growth and macroeconomic uncertainties during the recovery phase have heightened those concerns, calling for a close monitoring of developments in structural unemployment. The econometric analysis of structural unemployment in EU countries is based on a panel data study in order to investigate the relative performance across countries in terms of underlying structural factors. In addition, Boxes I.2.3 and I.2.4 examine the impact of different types of shocks on structural unemployment. Box I.2.3 reports simulations using a structural macro model that assess the impact of workers displacement away from the construction sector after the bursting of a housing bubble. A discussion on the magnitude and dynamics of such a shock, which is particularly relevant for countries like Ireland and Spain, is provided. In Box I.2.4, a model, estimated for Spain, illustrates the types of shocks affecting an economy during the recent recession, highlighting implications for its labour market.

2.5.1. Recent trends in structural unemployment across the EU

Structural unemployment is defined as the 'natural' rate of unemployment that the economy would settle at in the long run, i.e. in the absence of shocks. Its level is determined both by institutional factors and fiscal measures (unemployment benefits, tax rates) which influence the reservation wage.[49] Empirically the structural unemployment rate cannot be observed but has to be estimated.

The European Commission uses a so-called unobserved component model to estimate structural unemployment. The method's aim is to removing all short-term fluctuations based on the assumption that short-term unemployment fluctuations (i.e. cyclical unemployment) affect wage inflation while trend unemployment (i.e. structural unemployment) does not – i.e. the trend component is the NAWRU.[50]

Given that this estimation only provides an approximation for the structural unemployment rate, it cannot be excluded that (persistent) shocks bias this trend estimate. Therefore, the NAWRU should be interpreted a medium-term estimate (i.e. still including persistent shocks effects) rather than a purely structural unemployment rate estimate. This distinction will further be discussed in this section when providing evidence on the empirical importance of persistent shocks to the NAWRU series.

Graph I.2.13 shows the evolution of the NAWRU over the past decades. The series depicts a steady increase up to the mid-1990s followed by an improvement, which was interrupted by the recent recession. Table I.2.3 and Graph I.2.14 summarise the NAWRU estimates across EU countries and the US over the recent period. The estimates suggest that the increase since the recession concerned both the EU and the euro area and confirm the relatively worse performance of the US. Such general tendencies point to the existence of common shocks across countries.

Graph I.2.13: **EU15 NAWRU developments (1967-2012)**

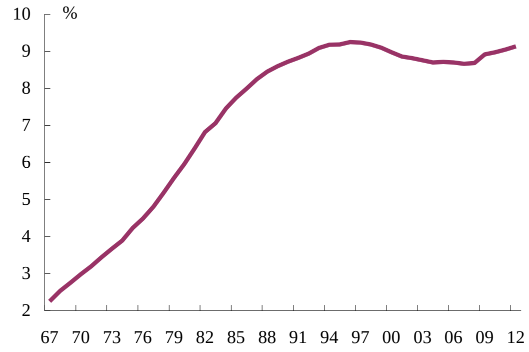


Table I.2.3:
Recent NAWRU developments across EU countries

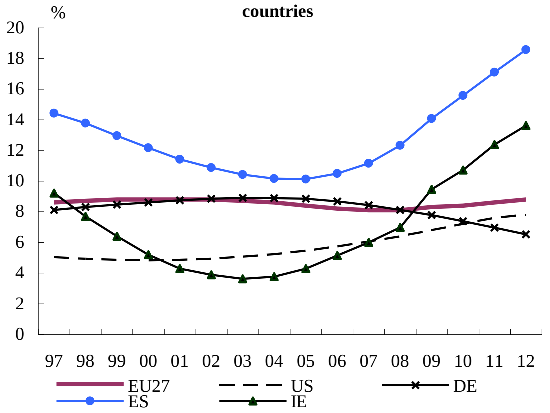
	Level in 2010	Change over the period (in pps.): 2006 to 2008	2008 to 2010	2010 to 2012
AT	4.3	-0.2	0.0	-0.1
BE	7.8	-0.2	0.1	0.1
BG	8.0	-1.6	0.3	0.7
CY	5.5	0.6	0.7	0.4
CZ	6.1	-0.6	-0.2	0.4
DE	7.4	-0.6	-0.7	-0.9
DK	4.9	0.0	0.1	0.0
EE	10.6	-0.1	2.3	2.9
ES	15.6	1.8	3.2	3.0
FI	7.1	-0.4	0.2	-0.4
FR	8.8	-0.2	0.0	0.0
EL	11.1	0.7	1.8	2.0
HU	9.7	1.3	1.4	1.5
IE	10.7	1.8	3.7	2.9
IT	7.6	-0.3	-0.1	-0.3
LT	12.0	-0.7	3.9	4.3
LU	4.5	0.3	0.1	0.2
LV	14.3	1.4	3.9	3.7
MT	6.6	-0.2	0.0	0.2
NL	3.7	-0.1	0.3	-0.1
PL	8.8	-3.6	-1.7	-0.6
PT	10.4	1.3	1.9	1.7
RO	6.7	-0.3	0.1	0.2
SE	7.0	-0.2	0.5	-0.3
SI	6.5	0.2	0.7	1.4
SK	12.4	-1.6	0.0	1.2
UK	6.9	0.6	0.9	0.8
EA	8.9	0.1	0.4	0.3
EU	8.4	-0.1	0.3	0.4
US	7.2	0.7	0.8	0.6

Apart from the recent recession other common shocks such as a trend decline in productivity (i.e. Total factor productivity), a rise in the real interest rate and adverse labour demand developments have been identified. Table I.2.3 and Graph I.2.14 also highlight substantial cross-country diversity.

[49] The concept of the reservation wage refers to the level of wage below which the worker would not accept a job offer.
[50] For further details see D'Auria, F. et al., The production function methodology for calculating potential growth rates and output gaps, *European Economy - Economic Paper*, 420, Directorate General Economic and Financial Affairs, European Commission, July 2010.

Countries such as Ireland, Spain, Greece, Portugal and the Baltic countries have witnessed substantial and protracted NAWRU increases while e.g. Germany experienced a steady decline over the recent past.[51]

Graph I.2.14: **NAWRU developments in selected countries**



2.5.2. Explain recent NAWRU developments across the EU countries

While it is true that recent movements in the NAWRU for the EU15, depicted in Graph I.2.15, appear moderate in regard to their increases in the 1970s and the 1980s, it remains of high policy relevance to understand the recent rise in the NAWRU, especially its likely persistence. This section addresses this issue by analysing the underlying factors driving NAWRU developments.

Explaining structural unemployment across countries requires taking into consideration labour markets' institutional differences.[52] Accordingly, the empirical literature relies to a large part on panel regressions featuring structural indicators (e.g. the level of unemployment insurance benefits, i.e. the replacement rate; the level of the labour tax wedge;[53] the degree of union density; the degree of employment protection legislation; the level of the minimum wage; or the degree of mismatch in the labour market.[54]

Such a panel, covering 14 EU countries (for which data were available), is estimated with the NAWRU as dependent variable and using four structural indicators as regressors. A trend is added to the regression to account for the portion of common shocks with similar pass-through across countries. Table I.2.4 shows significant and correctly signed coefficients for all variables and magnitudes are broadly in line with similar studies.[55] The coefficient of the replacement rate variable is relatively low, however. This could be due to the fact that the variable is not able to fully capture the degree of generosity of the unemployment benefit scheme, as it does not account for the duration of benefit entitlements.

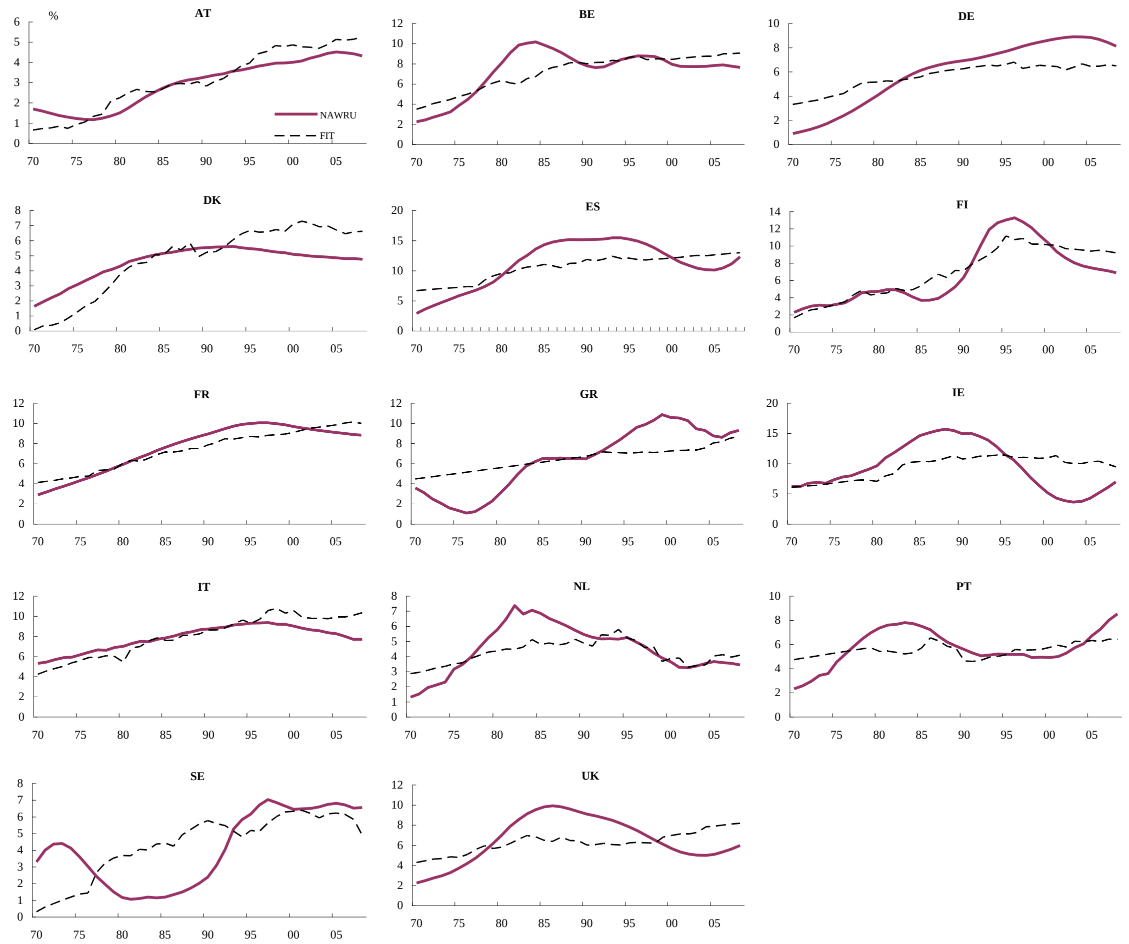
Table I.2.4:
Results of panel regression, with NAWRU as the dependent variable

	Replacement rate	Tax wedge	Employment protection legislation	Union density
Coef.	0.01	0.29	0.48	0.07
t-stat	1.69	5.89	2.22	6.33
R2	0.69			

Graph I.2.15 reports the evolution of the NAWRU estimate compared with the one derived from the panel regression (Fit) for the 14 EU countries. Broad changes in the NAWRUs are generally well captured by the data, suggesting that they are related to changes in the structural indicators included in the panel. The ability of the fit to capture the decline in the NAWRU in the Netherlands in the mid-1990s is a case in point. The labour tax wedge and employment protection legislation saw significant declines in that country over that period. The panel also captures the flattening of the trend in Belgium since the end of the 1990s, related to a decreasing labour tax wedge and union density and a decline in the unemployment benefit replacement rate. In Finland and in Italy the moderation in the NAWRU since the mid-1990s is matched by the fit, which reflects an improvement in all four indicators in the case of Finland and a decline in employment protection legislation and union density (as well as a flattening of the other two indicators) in the case of Italy.

(51) Note that Poland (which posts a significant decline) is not highlighted as the volatile unemployment rate in that country pose challenges for NAWRU estimation and results are subject to relatively high uncertainty.
(52) For an extensive discussion see Blanchard O. and J. Wolfers, The role of shocks and institutions in the rise of European unemployment: the aggregate evidence, *The Economic Journal*, 110 (462), March 2000, pp. C1-C33.
(53) For empirical evidence on the role of the labour tax wedge see for instance OECD, *Employment Outlook*, chapter 7: Reassessing the role of policies and institutions for labour market performance: a quantitative analysis, Paris 2006, pp. 207-231.
(54) For evidence of increased relevance of labour mismatch see European Commission, Labour Market Developments in Europe, *European Economy*, 2, 2011, pp. 14-18.
(55) The R2 for the estimation is around 0.7. Results are, for instance, comparable to those reported in Blanchard and Wolfers (2000), ibid.

Graph I.2.15: **NAWRU and fit based on a panel regression 1970-2008**



As mentioned before, the fit of the panel fails to reflect medium-term developments – i.e. the temporary volatility of the NAWRU. For instance, large swings around the fit in countries like Spain, Ireland, Greece and the United Kingdom suggest that the NAWRU might also be affected by other more persistent factors. Another reason of the rather poor fit in some cases is possibly related to econometric limitations, such as data quality issues or specification problems (e.g. omitted structural indicators).

As stated, a major problem of the NAWRU estimate is that rather persistent shocks feed into the results which, thus, do not solely reflect structural developments in the labour market. Supporting this view is the fact that a number of countries witnessing volatile NAWRUs have incidentally been those experiencing housing market boom-bust episodes, which cause persistent shocks to the economy. To account more formally for the claim that persistent shocks such as housing boom-busts can affect NAWRU estimates, a variable controlling for the presence of such effects has been added to the panel regression. The variable is the proportion of persons working in the construction sector. Intuitively, countries with a large variation in the size of the construction sector are expected to be subject to severe housing boom-bust effects. Adding this variable, which turns out to be significant in the panel, improves the fit for a number of countries.

Box I.2.3: The role of a housing market shock

This box illustrates the impact of the bursting of a housing bubble on sectoral and total employment using the Commission's structural macro-economic model QUEST. The simulations suggest that the size of the contraction in construction investment observed in some euro-area Member States can lead to a sizeable reduction not only in construction but also in total employment. In addition, unemployment initiating from the downturn in the housing market is likely to remain high for a number of years, thereby also influencing NAWRU estimates.

A small-open-economy version of QUEST is used, with trade shares and expenditure ratios calibrated to Spain. The model features tradable and non-tradable goods-production sectors with trade in final goods and intermediate inputs as well as a house construction sector which employs 10% of the total labour force in the steady state calibrated to match the average construction-employment-to-total-employment ratio in Spain between 1980 and 2010. Frictions in inter-sectoral labour mobility are captured by imperfect substitution between labour supplied to goods and house production sectors. The downturn in the housing market is captured by the increase in the risk premium on housing investments which generates a drop in house construction investment by around 30% in the model, roughly in line with the drop in this indicator observed in Spain between 2007 and 2011.

The simulation results (displayed in Graph 1) show that a downturn in the housing market of the observed size can directly cause a severe drop in construction employment by a similar magnitude, which tracks the evolution in Spanish construction employment data quite well. The housing shock and resulting negative demand effects lead to a fall in total employment by around 4%. This is larger than the reduction in employment purely accounted for by the fall in house-construction employment, which points to additional negative second-round effects of the housing bust on the total economy. At the same time, the drop in total employment in the model does not fully match the observed fall in total employment in Spain, suggesting that factors beyond the housing downturn also played an important role in the Spanish labour market.

This negative impact of the housing downturn on the labour market is likely to be highly persistent for various reasons.

Firstly, both earlier housing bust episodes and data of the current cycle suggest that the fall in housing demand per se is likely to be long-lasting and may not return to pre-bust peak levels at all. Finnish and Swedish housing busts in the early nineties e.g. lasted 4 to 7 years from peak to trough in house construction investment. Additional 7 years of recovery to pre-bust levels were needed in Finland while in Sweden housing investment never actually reached its 1989 peak level ever since. Also, in countries most concerned by the housing bust today, such as Spain or Ireland, the house-construction-investment-to-GDP ratio reached peak levels by 2006 which largely exceeded the average values of the past three decades, suggesting that a full recovery is unlikely to happen.

Secondly, (other things equal) employment is likely to remain subdued throughout the downturn in the housing market because of the low substitution (or even complementarity) between housing investment and other domestic demand items and the resulting fall in total demand. Finally, frictions in sectoral reallocation on the labour market itself can also hinder the recovery of employment in addition to the previous factors.

Based on the afore-mentioned Finnish and Swedish episodes, we illustrate two potential scenarios in the simulations: one with a very persistent downturn (thick solid line in Graph 1) and an alternative one with a shorter fall and a faster recovery (thin solid line) with the size of the fall in house construction investment kept similarly at 30%. The simulations suggest that unemployment would not return to its initial low level until up to ten years after the start of the downturn even in case of the more optimistic less protracted downturn scenario. In case of the long-lasting downturn, unemployment initiating from the housing market could remain around 3% above the baseline for a very long period.

Given the length of these cycles and given the method by which the NAWRU is calculated (i.e. the extraction of the medium- to long-term component from the observed unemployment rate), labour market pressures caused by the housing cycle are likely to influence the NAWRU in the upcoming years.

(Continued on the next page)

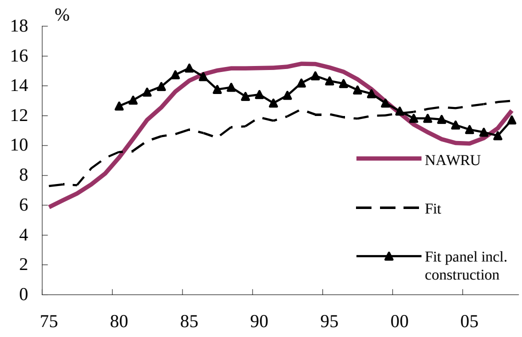
Box (continued)

Graph 1: **Simulating the impact of a housing shock**

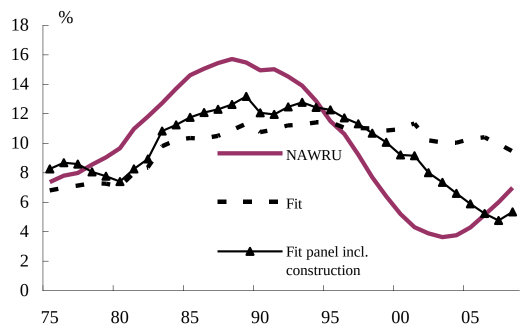
Note: Simulations as deviation from baseline; data deviation from 2007 .

Graph I.2.16 and I.2.17 below compares the fit of the panel for the specification that includes the construction variable to the one excluding it, for the case of Spain and Ireland. The new fit is able to track the recent evolution of the NAWRU much better, which suggests that the housing boom-bust effects influenced the NAWRU estimates in those countries.

Graph I.2.16: **Alternative fit for selected countries, Spain**



Graph I.2.17: **Alternative fit for selected countries, Ireland**



These results illustrate the interpretation to give to persistent movements in the NAWRU (i.e. medium-term variations lasting longer than a typical business cycle). Such movements are likely to be driven by persistent demand shocks.

Box I.2.4: Demand and supply factors driving the Spanish employment rate

The Spanish employment rate showed large fluctuations over the last decade which were likely to be driven by both supply and demand factors This box presents a historical decomposition of the Spanish employment rate into a number of more basic determinants ("shocks") like monetary policy, the situation on the housing market or wage shocks that act like labour demand or supply curve shifters. The decomposition is based on a version of the QUEST model that was estimated on Spanish data spanning between 1995 and 2010.

Graph 1 shows the evolution of the employment rate during the last decade (2001-10), indicating which shocks in the Spanish and the world economy explain both the relatively good performance of the labour market in the years 2001-07 and the sudden drop in the Spanish employment rate thereafter.([1]) In the first seven years of the 2000s employment in Spain grew at about 2% a year, which resulted in the employment rate reaching a peak in 2007 of about 8 pps. above its long-term average. One important demand factor behind this development was a strong expansion in the housing sector that led to an increased labour demand in construction. The fact that favourable conditions in construction positively contributed to the economy-wide employment growth indicates that the employment expansion in this sector did not merely come at the expense of the remaining sectors, but that new jobs were veritably created.

Several other demand factors played a non-negligible, if less prominent role in that period. Low interest rates (set at the euro area level) stimulated investment and consumption. In the first half of the decade, international trade slightly stimulated employment ("external factors"). However, the increasing trade deficit contributed negatively to employment in the second half of the decade. Finally, in the years immediately preceding the crisis, high consumer confidence increased consumption, which also translated into a slightly higher employment.

On the labour supply side the positive employment trend was strongly reinforced by a reduced pressure on wage growth resulting from a positive labour supply shock (increasing participation rate and immigration) and possibly complemented by structural factors such as a reduction of wage mark ups (limited labour market reforms).([2])

During the crisis the employment rate fell by 10 pps. from its peak. Again, both labour demand and labour supply factors take partial responsibility for this drop. On the labour demand side, the largest identified effect can be associated with the burst of the housing market bubble, which decreased the sectoral demand for labour and had a spillover effect on the rest of the economy. The contribution from the housing sector which according to the estimates added about 4 pps. to the employment rate at its peak, shrank to about 2 pps. in 2010 and keeps shrinking.

Other factors also exerted a negative influence on the demand for labour. In particular, the external conditions, which had contributed negatively to employment growth already since 2005, rapidly worsened during the recession. Unsurprisingly, also the positive effect of consumer confidence faded during this period. The loss of confidence among consumers led to a higher saving rate, a lower demand for goods and services, and in turn a lower demand for labour. Several additional shocks dragged the employment rate down during the recession (category 'Others' on the Graph 1), among which the increase in the equity risk premium with its negative impact on investment was perhaps the most prominent. On the positive side, monetary policy, characterized by lower policy rates due to the recession, somewhat attenuated the negative impact of other factors on the Spanish labour market.

Estimation results indicate also that a large shift of the labour supply curve, in QUEST identified as a shock to wages, occurred during the recession. The size of the shift can be explained only by the specific features of the Spanish economy, characterized by a combination of real wage rigidities and the dual labour market, which reinforced each other in dragging down the employment rate. With deteriorating economic conditions, facing inflexible wages on the one hand, and being able to shed a substantial part of their workforce at no cost on the other, firms had little choice but to reduce their payroll by substantial lay-offs.

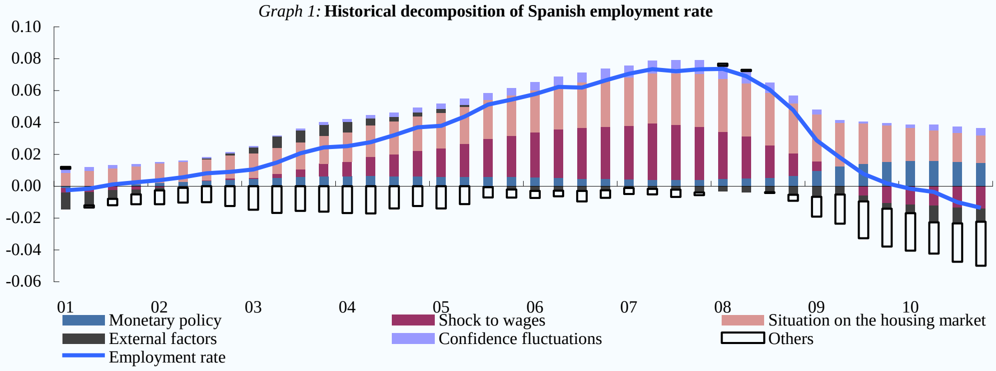
([1]) Zero on the scale of graph 1 corresponds to the average employment rate over the 1995-2010 period. The graph, hence, shows deviations of the employment rate from its long-term average.

([2]) QUEST does not distinguish the relative contribution of these individual components.

(Continued on the next page)

Box (continued)

Graph 1: **Historical decomposition of Spanish employment rate**



Note: QUEST based shock decomposition; the employment rate corresponds to the deviation from its long-term average .

Altogether, the results of the analysis indicate that both labour demand and labour supply factors stood behind the poor performance of the Spanish labour market during the crisis. In particular, the development and then the sudden burst of the housing bubble, an abrupt stop (and even reversal) of migration flows and the dual structure of the Spanish labour market all contributed to the observed drop in employment.

The distinction between a change in the NAWRU driven by a structural change and one driven by a rather persistent shock is crucial in the interpretation of NAWRU developments. While persistent shocks due to housing boom-bust episodes can cause long-lasting impact on unemployment patterns (see Box I.2.4), they do not affect long-term structural unemployment.(56)

In that sense, structural unemployment can still be expected to return to a pre-recession level once the effects of the shock disappear. From the above analysis it appears that in a number of countries the recent movements in the NAWRU feature, to substantial extent, medium-term variations. By contrast, structural features of the labour market appear to have been only moderately affected by the recession, as evidenced by the limited fluctuation of the fit based only on structural indicators. Following this line of reasoning, the NAWRU is likely to return to its long-term level once medium-term effects dissipate. Given that the aforementioned shocks might prove to be rather persistent however, this development risks to be protracted.

More generally, the limitations of such an analysis should be borne in mind. For instance, in the case of Germany, the approximation of structural unemployment provided by the fit of the panel is likely to underestimate the positive impact of the Hartz reforms, as a variable to control for the duration of unemployment benefits which is an important aspect of that reform could not be added to the panel due to data limitations. Also, the panel regression might not have been able to capture policies enacted recently in response to the recession, which included among others short-time working schemes, reductions in tax on labour (e.g. social security contributions), job search assistance programs and job subsidies to employers.(57)

2.6. OVERALL ASSESSMENT

So far, employment growth both in the EU and the euro area has not been able to keep pace with the recent output recovery when controlling for the usual time lags. The rather muted labour market response to GDP expansion is a major burden on the recovery, especially in times of substantial uncertainty and weakening growth prospects. Given that the positive effect of the recovery on job creation was rather small, there is substantial

(56) Similar findings are reported for the US. States that are hit more severely by the collapse of a housing bubble experience a worse deterioration in the unemployment rate (even after controlling for cyclical activity). See Estevao and Tsounta (2011) ibid.

(57) For further details on the policy reactions to the crisis see for instance European Commission (2009), ibid. On the experience and the characteristics of short-time working schemes in Europe see Arpaia, A., N. Curci, E. Meyermans, F. Pierini and J. Peschner, Short-time working arrangements as a response to cyclical fluctuations, *European Economy Occasional Paper* 64, 2010.

concern as to when unemployment will recede from currently high levels.

Even in times of solid GDP growth, labour resources move from declining sectors into expanding ones in response to wage differentials, but the adjustment takes time and may be incomplete. With a fading growth momentum at the current juncture, this process of labour reallocation may prove even more sluggish than usual given the rising skill mismatch in the labour market and the extent of sectoral adjustment needs in the economy. In fact, the increase in the duration of unemployment has gone along with a deterioration of the labour market matching and the persistency of unemployment is primarily due to the low chances of finding a job rather than to high waves of job losses.

But employment dynamics will not only depend on the economic outlook, but also on efficient policy frameworks which would facilitate the reallocation process. In this vein, unemployment benefit systems and activation policies should provide incentives for the unemployed to go back to work. Policies and wage setting frameworks supporting wage adjustment, tax systems encouraging job creation, and targeted active labour market and training policies would likewise facilitate labour market transitions and the re-entry of the long-term unemployed in the labour market. Such policies have a significant impact on structural unemployment and the experience of countries such as Sweden and Finland, which experienced a permanent ratcheting-up in structural unemployment rates following their recessions in the early 1990s, stresses the need for vigilance on the part of EU policy makers to ensure adequate policy response to the crisis.

Empirical evidence suggests that structural unemployment when measured by the NAWRU has been affected considerably by the recent recession and is to remain at elevated levels over the forecast horizon. In contrast to previous periods, the recent rise in structural unemployment is likely to be driven by persistent demand shocks, whereas institutional factors limiting the efficiency of the labour market (e.g. tax wedge, employment protection) appear to be less relevant. These persistent demand shocks related to boom-bust patterns in the housing and construction sector have contributed to the NAWRU decline in the pre-recession period and its reversal at the current juncture. In the long term, the NAWRU should return to a level implied by structural characteristics of the labour market and might finally settle at a level between the pre-recession and the current level. However, given the severity of the demand shock and its far-ranging implications for sectoral adjustment, a significant decline of unemployment over the forecast horizon is not to be expected.

On the contrary, especially countries in the middle of a deleveraging process and now confronted with a much weaker economic outlook may not see any major improvement in the labour market in the medium term. Additional downside risks such as a durable increase in risk premia or hysteresis effects might additionally impair employment prospects.

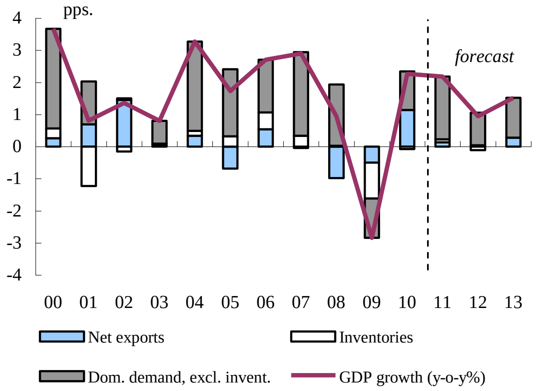
1. BELGIUM

Growth slowdown amidst weaker global growth and new bank worries

The export-led recovery is losing momentum

The Belgian economy started to recover from the crisis in 2010, thanks to a strong pick up in world trade, resulting in a sharp increase in net exports. While the first half of 2011 still benefitted from this export revival (with high quarterly GDP growth of 0.9% in Q1 and 0.5% in Q2), growth is projected to flatten out by the end of the year. The slowdown in global activity, the ongoing sovereign-debt crisis in the euro area and renewed concerns about the health of the banking sector depress consumer and business confidence and affect both trade and domestic demand.

Graph II.1.1: **Belgium - GDP growth and contributions**



Although credit provision to households and non-financial corporations is currently not affected (the year-over-year credit growth to corporations was 5.1% in August, compared to 4.9% in July), the renewed tensions in financial markets since August are expected to weigh on investment and - to a lesser extent - consumption in the last quarter of 2011 and at the start of 2012. Increased uncertainty is expected to discourage credit demand, while the need for banks to increase their capital buffers could tighten credit supply. On the back of better prospects for international trade, as well as a less uncertain economic environment, an acceleration of economic growth is expected for the second half of next year. All in all, GDP growth is projected to remain slightly below 1% in 2012, before reaching potential by 2013.

While this scenario for GDP growth is not overly bright, there are still important downside risks, including a more pronounced slowdown in world trade around the turn of the year and the risk of tighter financing conditions if banks need to deleverage more and faster than expected. Moreover, given the severe consolidation ahead, the implementation of the 2012 budget could also affect growth, depending on the type of measures taken. On the upside, a faster than expected recovery could materialise on the back of a rapid solution of the sovereign-debt crisis.

Falls in consumer and business confidence depress private consumption and investment

Private consumption picked up strongly in 2010 thanks to increased consumer confidence and better prospects on the labour market. With real disposable income declining and inflation rising, the saving rate dropped somewhat (from 18.4% in 2009 to 16.2% in 2010). In 2011, the continued rise of inflation is dampening private consumption growth, and a further drop in the saving rate (to 15.9%) helps sustaining consumption.

More recently, renewed uncertainty about labour market performance and the impact of the financial crisis on both current and future household wealth is reducing consumer confidence. Additionally, the anticipation of the implementation of decisive fiscal consolidation measures and a possible tightening of financing conditions create incentives for precautionary savings. Therefore, private consumption is expected to somewhat decelerate in 2012, in spite of a rise in real disposable income. In 2013, in the absence of financial turbulences, renewed confidence could set the basis for a pick up of households' spending.

While private and public investment rose strongly in the course of 2011, the latter possibly did so only due to the upcoming local elections next year, but both are expected to decelerate in the course of 2012. In the case of private investment, the financial sector – under stress as a result of the ongoing restructuring of banks and the sovereign crisis – exerts downward pressure from both the supply and demand side. Credit conditions may tighten as banks will continue to strengthen their capital positions as well as further clean up their balance sheets through writedowns. At the same time, depressed business confidence caused by the sovereign and financial crisis may trigger a postponement of planned investment projects. In 2013, government investment is projected to turn negative as the effect of the electoral cycle fades away, while private investment is likely to accelerate again moderately in the context of regained business confidence.

Belgium continues to lose competitiveness

While the recovery in 2010 was export-led, the positive contribution of net trade is fading out and remains weak over the forecast horizon. Exports and imports grew strongly in the first quarter of 2011 and their growth is expected to remain relatively high over the year as a whole. However, a slowdown is projected in 2012, due to the only gradual pick up in world trade, expected to take off only in the second half of next year.

Belgium's competitiveness has been deteriorating in recent years. The current-account surplus decreased from an average of 4.7% of GDP over the period 1995-2004 to below 3% of GDP after 2005 due to the evolution of the goods balance. While geographical (euro area-oriented) and product specialisation (low to medium technology goods) play a role, given the economy's lacking presence in the most dynamic product markets, a more worrying trend is the loss in export market shares for goods. Nevertheless, as the deterioration of the goods balance and the loss of export market shares for goods are partly compensated by the better performance of services, this trend might merely indicate a transition towards a more services-oriented economy.

Both cost and non-cost related factors contribute to the deterioration in competitiveness. Regarding price competitiveness, wages and energy prices are important determinants. While no real wage increase was foreseen in the inter-professional agreement, nominal wages have been rising faster than expected in 2011 due to high inflation (in combination with the automatic indexation mechanism). As indexation reacts with a lag to higher inflation and as a real wage increase of 0.3% has been agreed for 2012, wage growth will remain substantial next year. Together with a slowdown in productivity growth in 2011 and 2012, this implies that unit labour costs are rising in both years. A more moderate wage and higher productivity growth are foreseen for 2013. With respect to the price of intermediary products (mainly energy), the sharp increase in energy prices since the second half of 2010 made the terms of trade deteriorate significantly in 2010 and 2011, although improvements are expected from 2012 onward. Regarding non-price competitiveness, Belgium has high-quality human capital, but struggles with (i) mismatches between labour demand and supply, and (ii) efficient translation of R&D investments into innovative products and processes, due to a lack of entrepreneurship and administrative burdens.

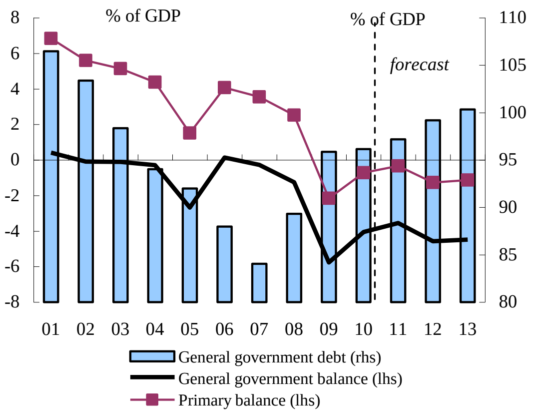
The labour market held up after the crisis, but weakening trends are visible

Employment creation started to rise again in 2010, faster and to a higher extent than could normally be expected after a crisis (by 0.8%). In 2011 employment growth has been further accelerating (by 1.2%), supported by the rise in hours worked and the increase of part-time work, partly subsidised by the government (e.g. service cheque jobs). This made the unemployment rate fall significantly (from 8.3% in 2010 to 7.6% in 2011). The positive trend in employment creation is expected to slow down by the end of 2011. For the rest of the forecast horizon the unemployment rate is expected to slightly rise again, mainly as a result of continued subdued job creation.

Optimism for public finances is decreasing

The general government deficit had declined from 5.8% of GDP in 2009 to 4.1% in 2010, a substantially better outcome than the initial target of 4.8% of GDP. Consequently, in the latest update of the country's stability programme, the Belgian authorities have reduced their deficit target for 2011 from 4.1% to 3.6% of GDP. Government revenues have been less dynamic than last year (rising by about 4½% compared to 5.7% in 2010) while the increase in current expenditure has also been more moderate than in 2010 (3.2% versus 3.4%). In particular, revenues from excise duties, VAT and corporate tax were disappointingly low despite the rather favourable macroeconomic environment in the first half of the year. On the spending side, the fact that the Leterme cabinet is acting as a care-taker since its resignation in April 2010 (Belgium has not had a fully-fledged government at the federal level since 18 months), which limits its action to the so-called "current affairs", probably played a role in limiting the rise in public expenditure. As a result, the target for 2011 is likely to be met as the deficit will decline to about 3.6% of GDP despite a large projected increase in public investment related to next year's local elections and the deterioration in the economic environment since the summer.

Graph II.1.2: **Belgium - Public finances**



The caretaker government has reiterated Belgium's commitment to meet the deficit target of 2.8% of GDP in 2012. However, the measures that will allow the achievement of this objective have not yet been decided and negotiations on the 2012 budget were still underway at the cut-off date of this forecast. Therefore, the public finance forecast for 2012 and 2013 has been made under the usual no-policy-change assumption. The deficit is projected to increase to about 4.6% of GDP in 2012, chiefly since expenditure is expected to accelerate following an unusually moderate 2011, but also due to the autonomous rising trend in spending, in particular on healthcare. On the other hand, revenues are expected to decelerate further as a result of the economic slowdown, but also due to incidental factors like the indexation of income tax brackets, which has a larger impact than in previous years due to the peak in inflation projected for 2011. In 2013, under the same unchanged-policy assumption, the deficit is projected to contract somewhat due to the acceleration in GDP, but also because of some specific factors which will slow down revenues or push up expenditure in 2012 will no longer apply (like the surge in public investment). After increasing by 1 pp. of GDP in 2012 the structural deficit is likely to remain unchanged in 2013.

Public debt, which reached 96.2% of GDP in 2010, will continue to rise as a result of the increase in the deficit and exogenous factors like the take-over of the Belgian subsidiary of Dexia. Debt projections also include the impact of guarantees to the EFSF, bilateral loans to Greece and the participation in the capital of the ESM as planned on the cut-off date of the forecast. In total, under the same unchanged-policy assumption, the debt will probably exceed 100% of GDP at the end of the period.

Table II.1.1:

Main features of country forecast - BELGIUM

		2010			Annual percentage change					
		bn EUR Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		354.4	100.0	2.1	1.0	-2.8	2.3	**2.2**	**0.9**	**1.5**
Private consumption		187.5	52.9	1.6	1.9	0.8	2.5	**1.2**	**0.8**	**1.3**
Public consumption		85.8	24.2	1.6	2.4	0.8	0.2	**0.6**	**1.3**	**1.4**
Gross fixed capital formation		71.6	20.2	2.5	2.0	-8.1	-0.7	**5.7**	**1.5**	**1.2**
of which : equipment		28.6	8.1	2.7	3.5	-11.6	-2.7	**4.9**	**1.6**	**1.3**
Exports (goods and services)		283.5	80.0	4.7	1.7	-11.2	9.9	**5.1**	**2.6**	**4.7**
Imports (goods and services)		274.0	77.3	4.5	3.1	-10.7	8.7	**5.2**	**2.6**	**4.5**
GNI (GDP deflator)		360.6	101.8	2.2	1.4	-4.8	4.7	**2.1**	**0.9**	**1.5**
Contribution to GDP growth :	Domestic demand			1.7	1.9	-1.2	1.2	**2.0**	**1.0**	**1.2**
	Inventories			0.1	0.0	-1.1	-0.1	**0.1**	**-0.1**	**0.0**
	Net exports			0.3	-1.0	-0.5	1.1	**0.1**	**0.0**	**0.3**
Employment				0.8	1.8	-0.2	0.8	**1.2**	**0.4**	**0.5**
Unemployment rate (a)				8.4	7.0	7.9	8.3	**7.6**	**7.7**	**7.9**
Compensation of employees/head				2.9	3.6	1.1	1.4	**3.0**	**2.9**	**2.4**
Unit labour costs whole economy				1.6	4.5	3.9	0.0	**2.0**	**2.4**	**1.4**
Real unit labour costs				-0.4	2.3	2.6	-1.8	**-0.3**	**0.3**	**-0.8**
Saving rate of households (b)				17.8	16.8	18.4	16.2	**15.9**	**16.9**	**16.8**
GDP deflator				2.0	2.2	1.2	1.8	**2.3**	**2.1**	**2.2**
Harmonised index of consumer prices				1.9	4.5	0.0	2.3	**3.5**	**2.0**	**1.9**
Terms of trade of goods				-0.3	-2.9	3.5	-2.1	**-1.5**	**-0.2**	**0.1**
Merchandise trade balance (c)				3.0	-1.5	-0.4	0.3	**-0.7**	**-0.9**	**-0.7**
Current-account balance (c)				4.4	1.1	0.7	3.2	**2.4**	**2.1**	**2.4**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				4.3	0.6	0.3	3.1	**2.3**	**2.1**	**2.3**
General government balance (c)				-2.1	-1.3	-5.8	-4.1	**-3.6**	**-4.6**	**-4.5**
Cyclically-adjusted budget balance (c)				-2.3	-2.1	-4.4	-3.2	**-3.2**	**-4.0**	**-4.0**
Structural budget balance (c)				-	-2.2	-3.8	-3.3	**-3.0**	**-4.0**	**-4.0**
General government gross debt (c)				111.2	89.3	95.9	96.2	**97.2**	**99.2**	**100.3**

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

2. BULGARIA

Moderate growth amid rising uncertainty

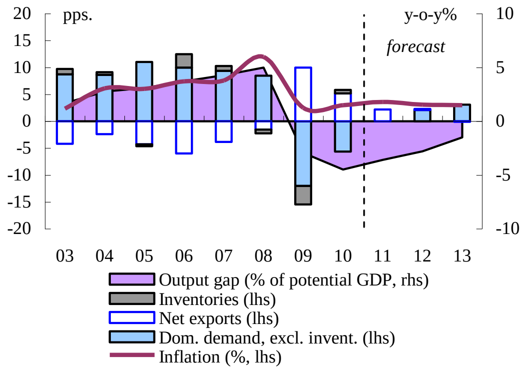
Growth slowing, inflation following suit

The recovery in Bulgaria has been slow so far and is lagging behind the rebound in most EU emerging economies. The necessary correction of large domestic and external imbalances accumulated during the boom years continues at a fast pace. While exports strongly picked up above pre-crisis levels, domestic demand components have not stabilised yet and real GDP remains almost 5% down from the peak. Although average wages continued to outpace inflation and consumer confidence gradually recovered from the record lows in 2010, consumer demand was constrained by a continued decline in employment, rising consumer prices and building of precautionary savings. Fading net FDI over the past year in a context of still high private-sector indebtedness, conservative bank lending policies and lingering uncertainties on demand expectations greatly restrained the resumption in investment activity.

After initially strong growth in Q4-2010, momentum is slowing in 2011. At 2.0% y-o-y (0.3% q-o-q), GDP surprised on the downside in Q2-2011, compared with 3.4% y-o-y (0.5% q-o-q) in Q1-2011. On the supply side, agriculture and construction continued to contribute negatively, but the decline of the latter narrowed significantly in the second quarter. Industrial sales were supported by continued strength in exports and surpassed pre-crisis levels. Despite continuing adjustment in household balance sheets and rising inflation, tentative signs of a mild recovery in private consumption are more visible in the second quarter. Final consumption inched up by 1.4% y-o-y in Q2-2011, arguably reflecting sustained real growth in wages. With the slowdown having only just been overcome, businesses are cautious to newly hire, increase leverage or invest again. Gross fixed capital formation is exceptionally weak and is set to post the largest negative contribution to growth for the third consecutive year, with both construction and investment in equipment dropping in the first half of 2011.

As in previous quarters, exports remained the key driver of economic growth, but the initial strong momentum is levelling off in line with decelerating demand in EU. Export growth halved to 12.2% y-o-y in Q2-2011, but as exports have significant import content, import growth also moderated to 7.5%. Reflecting a consistently improving trade balance, stronger services and current transfer balance, the current account turned positive in both the first and the second quarter and reached an unprecedented surplus of 2.6% of GDP for the 12-month-period ending in August 2011. A deceleration in exports is unlikely to lead to a sharp widening in the trade balance in 2011, as both private consumption and investment are still weak and unlikely to recover substantially during the second half.

Graph II.2.1: **Bulgaria - Output gap, inflation and contributions to GDP growth**

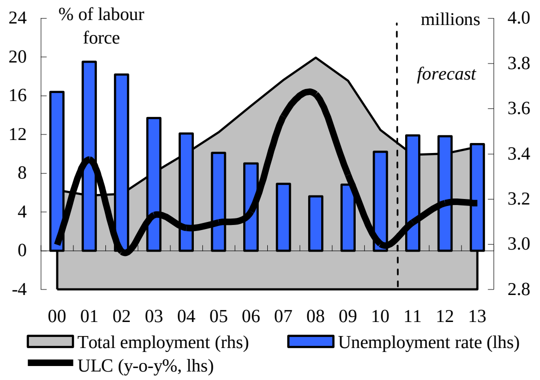


Overall, the standstill in domestic demand persisted in 2011 and growth has remained largely reliant on external demand. The strong export performance has not yet fed through to domestic demand, with unemployment remaining stubbornly high at 11.2% in Q2-2011. Unemployment and NPLs are lagging the economic recovery and seem to have reached double-digit highs, from which it is still difficult to come off. Employment contracted by a cumulative 12% over the last three years, but there are a few indications that it could start to grow again. In spite of high unemployment, nominal wage growth has continued to remain sticky at over 9% y-o-y in the first half of 2011, but the spike in inflation partly limited real wage dynamics in Q2-2011.

Soft growth with employment lagging behind

The second quarter of 2011 is illustrative for the soft growth outturns anticipated for the remainder of the year. Growth expectations for the last two quarters of 2011 remain positive in view of higher revenue from tourism and a very good harvest in agriculture, which would boost consumption and somewhat offset a slowdown in export and the continued slump in construction/investment. Tight credit conditions, worsening consumer and business sentiment and a weak global backdrop imply that growth will be fairly limited. Overall investment is likely to drop in 2011. However, a turnaround is expected in the second half of the year thanks to increased public capital spending. All in all, real GDP is projected to expand by 2.2% in 2011 and a similar 2.3% in 2012.

Graph II.2.2: **Bulgaria - Total employment, unemployment rate, unit labour cost**



Expectations for a recovery in domestic demand rely mainly on government support for important infrastructure projects and real wage dynamics in 2012. As food accounts for a high share of the consumer price basket, the easing of pressures from global food and energy prices as well as a weak growth profile will lead to lower inflation in the near term. These encouraging price developments are envisaged to gradually strengthen private consumption in 2012 from its current low base. Although lower inflation will sustain households' real disposable income from late 2011 on, the fragility of the labour market and the lack of consumer credit will restrain consumption growth. Negative wealth effects from a protracted slump in housing and equity prices may also weigh on consumer optimism. Against this background, private consumption is expected to expand less than GDP in 2012 and pick up to 3.0% in 2013 as job creation resumes.

While manufacturing activity may hold up relatively well in the coming quarters, investment growth is likely to remain subdued in the first part of 2012 in light of the worsening of investment sentiment. Moreover, jitters over the global economy could lead to further delays in rebuilding inventories. As the absorption of EU funds improves further and capacity utilisation reaches pre-crisis levels later in 2012, investment is expected to slowly increase from a very low level.

Weaker export growth will prevent notable progress in investment and employment until the second half of 2012. The cyclical slowdown in Europe will be reflected in a lacklustre labour market with unemployment remaining high in 2012. Entrenched high unemployment and prevailing uncertainty as well as the higher provisioning costs on overdue loans are expected to deter banks from increasing lending. Hence, the economy is likely to operate below potential for an extended period, which in turn should partly contain inflationary pressures. In this context, further disinflation is expected along the way, but inflation below 3% is unlikely to be reached before 2013, as wage rigidities and increases in regulated prices will feed inflationary pressures over the horizon.

Current account turns positive

The contribution to growth from net exports has been fading away since Q2-2011 and exports are expected to cool down in line with sluggish external demand ahead. Export and import growth rates should converge later in 2011, given the higher base for exports in H2-2010, and come even closer in 2012. Net exports are, however, expected to continue to contribute to growth in 2012 thanks to relatively strong demand from non-EU trade partners. An expected decline in the trade deficit and a lower services surplus, together with persistent investment income outflows, are expected to bring the current account into a monthly deficit for the remainder of 2011. However, it is projected to end 2011 with an annual surplus of 1.6% of GDP and to remain slightly positive over the forecast horizon, helping to further reduce the external debt-to-GDP ratio.

Risks tilted to the downside

The forecast baseline scenario is subject to particularly significant risks at the current juncture. The outlook for exports is clouded by uncertainty, particularly in the euro area. Moreover, prolonged stress in financial markets worldwide over fiscal and debt sustainability concerns, as well as continued adverse spillovers from Greece, have the potential to delay the recovery in consumption and investment. Although the capitalisation of banks has remained at reassuring levels, the further deterioration in asset quality and the subsequent erosion of banks' capital buffers is likely to put additional pressure on banks' solvency and lending capacity. The current forecast already assumes a tightening in credit, low foreign capital inflows and further deleveraging in the economy. While balance-sheet corrections might prove to be protracted, the extent to which investment recovers following the massive contraction over 2009-11 will largely depend on improving the absorption of EU funds. Uncertainty regarding the consumption behaviour of households remains one of the major risks to the outlook, both on the upside and on the downside. Should households lower their currently high precautionary saving rate, this could support stronger consumption growth even under a declining employment scenario.

Fiscal consolidation continues over 2011-13

Fiscal consolidation resulted in a narrowing of the budget deficit from 4.3% of GDP in 2009 to 3.1% in 2010, i.e. below the revised budget target of 3.8% of GDP. In 2011 the government has maintained the freeze in pensions and public-sector wages and has made cuts in discretionary spending to restrain primary expenditure growth. This is in line with the government's intention to pursue an expenditure-based fiscal consolidation. The latest budget execution data (September 2011, on a cash basis) reveals an improved fiscal performance against both the previous year budget execution and the 2011 budget targets. Although fiscal consolidation is expected to lose some ground in line with higher capital outlays during the remainder of the year, Bulgaria is on track to meet the accruals-based fiscal target of 2.5% of GDP in 2011, based on a no-policy-change assumption.

Despite the expected slowdown in the global economy and the outlook for Bulgaria, the government has maintained its strong commitment to fiscal consolidation over 2012-13. The gradual fiscal adjustment 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 are to remain frozen in 2012, while some other current non-interest expenditure are expected to be cut. Under a no-policy-change assumption, the budget deficit gradually declines to around 1.7% and 1.3% of GDP in 2012 and 2013 respectively. This implies a cumulated structural effort of ½% over 2011-13. Under the assumption of zero stock-flow adjustments, general government gross debt is envisaged to increase only marginally from around 17½% of GDP in 2011 to 18½% of GDP in 2013, in line with the budget deficits developments over the forecast period.

Table II.2.1:
Main features of country forecast - BULGARIA

	2010			Annual percentage change						
	bn BGN	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		70.5	100.0	2.1	6.2	-5.5	0.2	**2.2**	**2.3**	**3.0**
Private consumption		43.1	61.2	3.0	3.4	-7.6	-1.2	**1.0**	**2.1**	**3.0**
Public consumption		11.1	15.8	-1.9	-1.0	-6.5	-1.0	**2.6**	**0.5**	**0.5**
Gross fixed capital formation		16.5	23.5	-	21.9	-17.6	-16.5	**-4.5**	**3.5**	**5.4**
of which : equipment		-	-	-	2.9	-45.1	-18.4	**-**	**-**	**-**
Exports (goods and services)		40.7	57.8	-	3.0	-11.2	16.2	**10.9**	**4.7**	**5.9**
Imports (goods and services)		42.1	59.7	-	4.2	-21.0	4.5	**7.0**	**4.5**	**6.2**
GNI (GDP deflator)		68.0	96.5	-	9.3	-3.1	-0.2	**2.1**	**2.0**	**2.8**
Contribution to GDP growth :	Domestic demand			-	8.5	-12.0	-5.7	**0.0**	**2.1**	**3.1**
	Inventories			-	-0.7	-3.4	0.6	**0.0**	**0.0**	**0.0**
	Net exports			-	-1.5	10.0	5.2	**2.2**	**0.2**	**-0.1**
Employment				-	2.6	-2.6	-5.9	**-3.1**	**0.1**	**0.9**
Unemployment rate (a)				-	5.6	6.8	10.2	**12.2**	**12.1**	**11.3**
Compensation of employees/head				-	16.3	9.4	7.2	**9.0**	**7.2**	**7.1**
Unit labour costs whole economy				-	12.5	12.7	0.8	**3.3**	**4.9**	**4.9**
Real unit labour costs				-	3.7	8.1	-2.1	**-2.4**	**1.5**	**1.7**
Saving rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				43.4	8.4	4.3	3.0	**5.9**	**3.4**	**3.2**
Harmonised index of consumer prices				-	12.0	2.5	3.0	**3.6**	**3.1**	**3.0**
Terms of trade of goods				-	-2.5	0.6	4.7	**1.1**	**0.0**	**0.0**
Merchandise trade balance (c)				-9.2	-24.3	-12.0	-6.7	**-4.6**	**-4.4**	**-4.6**
Current-account balance (c)				-6.4	-23.2	-9.0	-1.0	**1.6**	**1.4**	**0.9**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-6.4	-22.4	-7.6	-0.3	**2.1**	**2.0**	**1.6**
General government balance (c)				-	1.7	-4.3	-3.1	**-2.5**	**-1.7**	**-1.3**
Cyclically-adjusted budget balance (c)				-	-0.2	-3.2	-1.5	**-1.2**	**-0.7**	**-0.7**
Structural budget balance (c)				-	-0.2	-3.2	-1.4	**-1.2**	**-0.7**	**-0.7**
General government gross debt (c)				-	13.7	14.6	16.3	**17.5**	**18.3**	**18.5**

(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

Soft patch in 2012 followed by moderate recovery

Rebound driven by restocking and exports

The Czech economy was hit by a collapse of foreign demand, but rising export orders have supported the recovery underway from the third quarter of 2009 onwards. Since then, GDP growth has been driven largely by net exports and the replenishing of inventories, while the ongoing fiscal consolidation and negative confidence effects have continued to weigh on consumption and gross fixed capital formation.

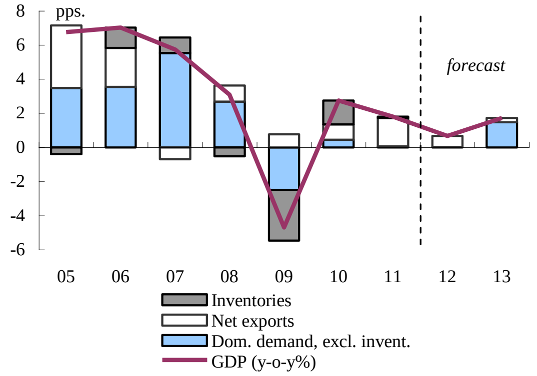
Based on estimates of economic activity for the first half of 2011, GDP growth is expected to have slowed to 1.8% for the year as a whole. Wage restraint in the public sector, a sluggish recovery in the labour market and higher prices of food and energy resulted in a negative growth rate of household consumption during the first half of 2011. The forecast for the full year is negative at -0.3%. Falling private consumption, together with cuts in government consumption expenditure (of 1.0% in real terms), are expected to bring domestic demand close to stalling. Growth in 2011 is expected to be driven by net exports and, to a smaller extent, by gross fixed capital formation. With capacity utilisation at its long-term average, improved access to financing and solid growth in orders during the first half of 2011, a 1.7% rise in gross fixed capital formation is projected for 2011. In particular residential construction, which according to revised data grew by more than 20% in 2010, is still forecast to reach solid growth in 2011, as a result of both the acceleration in the number of new mortgages and in anticipation of the 2012 increase in the value-added tax (VAT) rate applied to construction work.

A more complete picture of the developments in 2011 will emerge in December 2011 after the announced publication of revised quarterly national accounts.

Lower growth ahead...

The outlook for 2012-13 is shaped by uncertainties surrounding the sovereign-debt crisis, as reflected in the rapidly evaporating business confidence. The volatile situation in global financial markets, together with the approval of the 2012 budgetary consolidation measures in the Czech Republic, have considerably altered the prospects of growth for 2012 compared to the spring forecast. GDP growth is now projected at only 0.7% in 2012 and to moderately accelerate to 1.7% in 2013. Domestic growth factors are expected to remain weak over the first half of the forecast horizon and to start adding to growth only in 2013, accompanied by net exports

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



Private consumption expenditure will continue to be restrained by fiscal measures, most significantly by the increase in the reduced VAT rate from 10% to 14% scheduled for 2012. Given that some of the goods to which the reduced rate applies fall into the category of frequent out-of-pocket purchases, the hike in the tax rate is expected to affect consumption confidence and spending overall. The forecast assumes that VAT rates will be unified at 17.5% in 2013 by further raising the reduced rate by 3.5 pps. and cutting the standard rate from its current level of 20%. Lower price growth in 2013 is likely to provide some stimulus to consumption expenditure, but as the room for nominal wage increases is expected to remain limited throughout the forecast horizon consumption growth is not expected to revert to its pre-crisis pace yet.

As gross fixed capital formation - and equipment investment in particular - is typically the component of demand most sensitive to the business cycle, the extent of the underlying uncertainties is consistent with a negative growth outlook for this component for 2012. The two-step hike in the reduced VAT rate, which applies also to construction work, is set to discourage construction activity further, while in 2013 other components of investment may benefit from the decrease in the standard VAT rate. Assuming uncertainties will reduce in the course of 2012, gross fixed capital formation is expected to provide a positive contribution to growth in 2013. Exports and imports are projected to decelerate compared to their pre-crisis pattern. Low export growth is consistent with the expected slowdown in global economic activity and the intra-industry nature of most of Czech Republic's trade. Given the high import content of exports imports are expected to follow a similar pattern, although their growth is likely to be further limited by weak domestic demand.

...is likely to put hiring on hold

The economic slowdown forecast for 2012 is expected to put pressure on the labour market. The employment rate fell in 2010 on account of cuts in public sector workforce and labour shedding in the private sector. In 2011 and 2012, the planned freeze in the public sector wage bill and the government's goal to increase efficiency in the public sector are consistent with negative growth in public employment. Hiring in the private sector, after some recovery in 2011 is likely to be put on hold and improve only in the second half of 2012. These factors are consistent with falling employment and a slightly higher unemployment rate in 2012. The revised Employment Act and the Labour Code, expected to enter in force in January 2012, include measures that increase flexibility on the labour market by linking severance payments to job seniority and raise incentives for employees to stay in a given job by tightening the rules for unemployment benefits. These measures may help speed the recovery in employment in 2013.

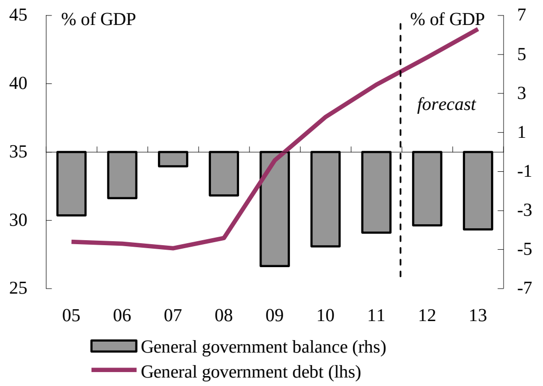
Higher inflation in 2012 due to VAT rise

Inflation is assumed to be driven predominantly by external factors and by the VAT changes, as domestic demand pressures are virtually absent over the forecast horizon. Supported by higher energy and food prices, the inflation rate is expected to average 1.8%, close to the middle of the band targeted by the Czech National Bank. The effects of the VAT changes, along with the ongoing deregulation of rents, will be the most important factors behind the developments in the inflation rate in 2012 and 2013, as imported price pressures are assumed to subside. The harmonised index of consumer prices is expected to reach 2.7% in 2012 and decelerate to 1.6% in 2013.

Substantial uncertainty around 2012 and 2013

The 2012-13 forecast is subject to significant risks. Should the sovereign-debt crisis cause another wave of European bank restructuring, the domestic credit sector could be negatively affected. While the amount of domestic deposits exceeds that of loans and regulatory capital is relatively high, the banking sector is predominantly foreign-owned, making the domestic credit provision a function of aggregate risk assessment as perceived in banks' central headquarters. On the positive side, decisive implementation of the competitiveness package adopted in September 2011 may help boost confidence and improve growth prospects towards the end of the forecast horizon. The package includes measures streamlining tax payments, improving the quality of public institutions, and increasing the supply of flexible jobs.

Graph II.3.2: **The Czech Republic - Public finances**



Fiscal position set to improve at a slower pace due to worsening cyclical conditions

The consolidation of public finances which started in 2010 is set to continue. The deficit reduction in 2011 relies mostly on additional expenditure cuts across a broad set of expenditure categories. The public sector wage bill has been cut by 10% and cuts have affected also social transfers. Additional savings have been achieved in interest expenditure on government debt on account of better-than-expected borrowing conditions. Larger-than-budgeted cuts are expected in government investment, partly due to the fact that financing of some investment programmes from the EU has been temporarily suspended. On the revenue side, the available cash figures for the central government indicate some slippages in the personal income tax (lower-than-expected revenue from tax on self-employed). Overall, the general government deficit is projected to decrease from 4.8% in 2010 to 4.1% in 2011.

Based on the draft budget currently under discussion in the Parliament, consolidation efforts in 2012 will focus predominantly on the revenue side. The planned increase of the lower VAT rate is projected to bring additional revenue of approximately 0.7% of GDP. However, taxes on income and social contributions will show relatively modest growth, in line with the slowdown of the economy. Personal income tax revenue will be negatively affected by the planned increase in tax allowances for families with children (0.1% of GDP). On the expenditure side, central government wages will be frozen until 2014 based on the multiannual budget submitted to the Parliament, while wages in the education and health sectors will be allowed to grow by approximately 0.1% of GDP. Additionally, subsidies to the building savings scheme are to be cut by 50%. Nevertheless, the consolidation effort is likely to lead only to a moderate improvement of the headline deficit to 3.8% of GDP in 2012, partly due to a worsening of the cyclical position of the Czech economy. The headline deficit in 2012 is subject to significant risk as it does not yet include a one-off expenditure on church restitutions (1.6% of GDP) which has already been agreed upon by the government but at the time of publication has not yet been approved by the Parliament.

For 2013, the forecast includes the impact of several revenue measures which are currently in the pipeline. First, a private pension pillar will be introduced, reducing revenues from social security contributions. As the reform will rely on a voluntary opt-in, this forecast is based on a conservative estimate of a revenue shortfall of 0.2% of GDP. Second, the fiscal impact of the envisaged harmonisation of VAT rates is expected to be positive but relatively modest (0.1% of GDP). With respect to the expenditure side, significant cuts in government consumption and savings in public procurement are envisaged but these have not been taken into account as concrete measures are not yet known. The above-mentioned measures combined with the projected modest improvement in the macroeconomic environment are expected to slightly worsen the general government deficit in 2013 to 4.0% of GDP. The structural balance will exhibit a moderate improvement over the forecast period. The debt-to-GDP ratio is projected to increase further over the forecast horizon reaching around 44% in 2013.

Table II.3.1:

Main features of country forecast - THE CZECH REPUBLIC

	2010		Annual percentage change						
bn CZK	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	3775.2	100.0	3.1	3.1	-4.7	2.7	**1.8**	**0.7**	**1.7**
Private consumption	1899.6	50.3	3.7	2.8	-0.4	0.6	**-0.3**	**0.3**	**1.5**
Public consumption	808.0	21.4	0.7	1.2	3.8	0.6	**-1.0**	**0.3**	**1.2**
Gross fixed capital formation	923.0	24.4	5.3	4.1	-11.5	0.1	**1.7**	**-0.8**	**2.0**
of which : equipment	377.5	10.0	8.9	10.5	-18.3	-1.3	**3.0**	**-1.0**	**3.0**
Exports (goods and services)	2561.9	67.9	10.3	4.0	-10.0	16.4	**9.8**	**3.8**	**7.0**
Imports (goods and services)	2441.4	64.7	12.3	2.7	-11.6	16.0	**7.7**	**3.1**	**7.1**
GNI (GDP deflator)	3521.0	93.3	-	5.8	-6.7	2.7	**1.7**	**0.4**	**1.4**
Contribution to GDP growth :	Domestic demand		3.5	2.7	-2.5	0.5	**0.1**	**0.0**	**1.5**
	Inventories		0.3	-0.5	-3.0	1.4	**0.1**	**0.0**	**0.0**
	Net exports		-0.6	0.9	0.8	0.9	**1.7**	**0.6**	**0.2**
Employment			-	2.3	-1.2	-1.7	**0.8**	**-0.1**	**0.3**
Unemployment rate (a)			-	4.4	6.7	7.3	**6.8**	**7.0**	**6.7**
Compensation of employees/head			-	4.2	-1.2	3.7	**2.2**	**2.3**	**1.9**
Unit labour costs whole economy			-	3.4	2.4	-0.7	**1.2**	**1.5**	**0.5**
Real unit labour costs			-	1.5	0.5	1.0	**0.4**	**-0.3**	**-0.6**
Saving rate of households (b)			-	9.4	10.7	10.3	**11.0**	**11.4**	**11.4**
GDP deflator			6.4	1.9	1.9	-1.7	**0.8**	**1.9**	**1.0**
Harmonised index of consumer prices			-	6.3	0.6	1.2	**1.8**	**2.7**	**1.6**
Terms of trade of goods			-	-1.9	2.9	-2.7	**-1.0**	**0.0**	**0.2**
Merchandise trade balance (c)			-2.8	0.6	2.3	1.3	**2.3**	**2.6**	**2.9**
Current-account balance (c)			-3.2	-2.9	-3.4	-4.4	**-3.6**	**-3.2**	**-3.5**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-3.3	-2.0	-1.3	-2.3	**-1.5**	**-1.2**	**-1.6**
General government balance (c)			-	-2.2	-5.8	-4.8	**-4.1**	**-3.8**	**-4.0**
Cyclically-adjusted budget balance (c)			-	-4.4	-5.2	-4.5	**-3.8**	**-3.1**	**-3.2**
Structural budget balance (c)			-	-4.4	-5.6	-4.6	**-3.6**	**-2.9**	**-3.2**
General government gross debt (c)			-	28.7	34.4	37.6	**39.9**	**41.9**	**44.0**

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

4. DENMARK

A modest recovery

Recovery losing momentum

Following the sharp recession in 2009, Danish output rebounded in 2010 on the back of an expansionary fiscal policy in addition to sizeable automatic stabilisers. The anticipated subsequent transition from the public to the private sector as a major growth driver has been hesitant thus far. Although Denmark is not affected by the sovereign-debt crisis directly as exposure to peripheral member states of the euro area is relatively low, the recovery is projected to be weak in the short term and to gain traction only in 2013.

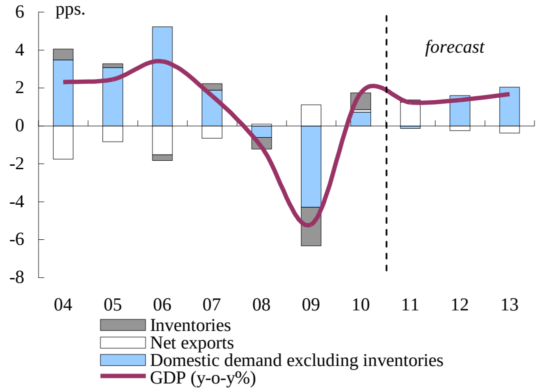
Private consumption continues to be held back by subdued consumer confidence and the high level of household debt. Private investment is expected to be postponed in the face of high economic uncertainty and as a consequence of banks' tightening credit conditions. Public consumption expenditure growth is set to be low in line with the agreed consolidation strategy, while the external environment is expected to deteriorate markedly in the short term. Hence, real GDP growth is projected not to exceed 1¼% this year resting almost exclusively on the strong contribution from net exports. Although major infrastructure investments and the planned reimbursement of early retirement pension contributions in 2012 will provide some support, annual real GDP growth rates are forecast to remain around 1½% and 1¾% in 2012 and 2013, respectively.

Lacklustre recovery of private consumption

Private consumption is expected to be rather subdued and to even fall this year. Heightened economic uncertainty, the need for deleveraging, and a stagnating labour market are weighing on consumer spending in the short run. Rises in disposable income this year and next are expected to translate into significantly higher household saving rates rather than increased consumption and will contribute to a gradual reduction in households' debt-to-GDI ratio.

The planned reimbursement of early retirement pension contributions in 2012 as envisaged by the retirement reform agreed under the previous government is expected to lift private consumption somewhat, especially during the second half of 2012 and the beginning of 2013. From the second half of 2012, an improving global economic environment, better labour market conditions and rising real wages should provide further support.

Graph II.4.1: **Denmark - GDP growth and contributions**



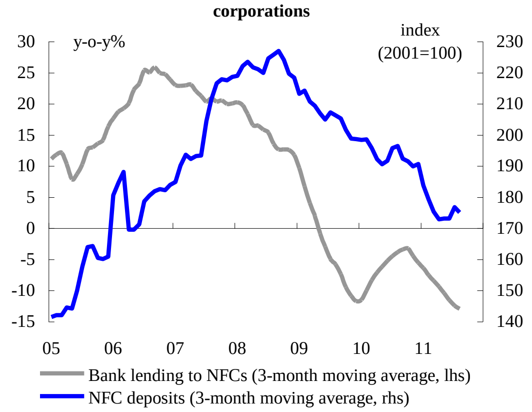
The situation in the housing market remains fragile. Despite the sharp correction in house prices since 2007 and low interest rates, amplified at present by safe-haven flows into Danish assets, house prices are not expected to pick-up soon. Nevertheless, residential construction should be propped up this year as a result of temporary public support for property renovations.

Slow recovery in private investment

Vulnerabilities in Denmark's banking sector – concentrated in particular among small regional banks – are likely to increase financing costs for Danish institutes. Furthermore, given banks' strong dependence on international funding sources, credit conditions for companies are expected to tighten. Credit-growth to non-financial corporations remains negative and companies are currently relying on previously-accumulated profits to finance investments. Growth in equipment investment will fall this year before improving in 2012 and 2013.[58] Overall gross fixed capital formation is expected to expand by ½%, 5% and 5¾% in 2011, 2012 and 2013, respectively, also supported by major infrastructure investments such as the extension of the Copenhagen Metro and the railway network.

(58) The fall in equipment investment in 2011 also reflects the export of an oilrig in Q1-2011 that lowers equipment investment and raises exports correspondingly.

Graph II.4.2: **Denmark - bank lending to non-financial corporations**



Deteriorating global outlook weighs on exports

The strong performance of Germany and Sweden, Denmark's main trading partners, has boosted Danish exports in 2011. However, the rapid deterioration of the global economic environment since this summer is projected to weigh on Danish exports in 2012. Recent gains in cost competitiveness are unlikely to bring about a structural turnaround in the trend of Denmark's past losses in export market shares. However, the product composition of goods exports should allow for further terms-of-trade gains, thus contributing to the stabilisation of the merchandise trade balance around 3% of GDP. The current-account surplus is expected to decline gradually towards 5½% of GDP.

Moderate improvements in the labour market

Following the historically large fall in private employment in 2009 and at the beginning of 2010, the labour market has stabilised. Private sector employment bottomed out in mid-2010 at the level reached in 2006, i.e. before the steep rise to unsustainable levels during the overheating period. In view of the uncertain economic environment, companies have been reluctant to raise staff levels at present. Employment is expected to shrink slightly this year before rising moderately in 2012 and 2013, also on the back of a gradually improving investment outlook.

Unemployment has been almost stable for more than a year. However, job turnover rates have rallied since the beginning of 2010 and long-term unemployment has remained contained. A slight increase in the unemployment rate can be expected for the second half of 2011 due to the recent rise in the number of notified job cuts by bigger companies. In line with stronger employment growth for 2012 and 2013, the unemployment rate is projected to decline gradually.

Falling inflation outlook, lower wage growth

On the back of base effects related to energy prices, headline inflation is expected to fall to 1.7% in 2012 from 2.6% in 2011 and to remain broadly stable in 2013. The effect of tax increases on unhealthy food gradually peters out and the contribution of the energy component is receding while services inflation will remain elevated. Core inflation, i.e. excluding energy and unprocessed food, is forecast to fall to 1.7% in 2012 and to pick up marginally in 2013.

In light of the currently sluggish labour market improvement, moderate productivity growth and a rather weak economic outlook, private sector wage negotiations scheduled for spring 2012 should allow for some degree of wage moderation over the subsequent two-year period. Public sector wages are expected to fall this year on the basis of the wage agreements reached in spring to compensate for higher public sector wage growth compared to the private sector during 2008-10. Overall, real wage growth of households is estimated to be negative in 2011 and to turn slightly positive in 2012 and 2013. Due to the crisis-induced surge in labour productivity, nominal unit labour costs have been falling in 2011 and are expected to rise moderately in 2012 and 2013.

2011 budget execution on track

Windfall gains linked to Danish pension yield taxation, a flat-rate tax levied on the annual gains of pension funds, resulted in additional revenue of around 2.4% of GDP in 2010, thus helping to reduce the general government deficit to 2.6% of GDP. In the absence of such positive surprises this year, the general government deficit is expected to widen to 4% of GDP. The improvement of the headline budget deficit in 2011 net of 2010 windfall gains builds on discretionary measures on the expenditure as well as revenue side in line with the 2010 Consolidation Agreement concluded for the period 2011-13. This agreement includes the postponement of previously planned tax cuts, the temporary suspension of the automatic indexation of various tax thresholds (so-called "§20 regulation") until 2014, the shortening of the unemployment benefit period from four to two years and the introduction of a ceiling on deductions for trade union membership fees. In addition, growth of government consumption expenditure is projected to be restrained in real terms between 2011 and 2013.

Need for continued consolidation efforts

In 2012, the increase in the general budget deficit is due to a one-off measure. Early retirement contributions are to be reimbursed in a lump-sum payment,[59] part of which is assumed to be reinvested in tax-exempt private pension funds. The general government deficit is therefore forecast to rise to 4.5% of GDP in 2012, despite continued consolidation efforts. In 2013, it is projected to fall to 2.1% of GDP, in the absence of the one-off measure, on the back of measures under the Consolidation Agreement and thanks to lower social transfers and higher pension yield revenue in line with an improving economic environment.

The general government expenditure ratio is expected to fall from 58.2% of GDP in 2011 to 56.9% of GDP in 2013 in particular due to the sustained government expenditure restraint, whereas the revenue share is projected to rise moderately from 54% of GDP to 54.7%.

The structural deficit is projected to fall from 2.1% in 2011 to 1.4% in 2013. However, low current estimates of potential output growth could potentially overstate the cyclical component of the budgetary adjustment. Moreover, the structural balance also includes very volatile revenue items such as pension yield tax and North Sea oil revenues. From a bottom-up perspective, discretionary measures of the 2010 Consolidation Agreement and the 2009 Spring Reform Package are estimated to entail consolidation of around 1½% of GDP over the period 2011-13.

After the sharp increase in 2008 and 2009, Denmark's general government gross debt level is forecast to remain broadly stable over the forecast horizon and to reach 44¾% of GDP in 2013. Debt projections also include the impact of bilateral loans to Ireland as planned on the cut-off date of the forecast.

(59) The retirement reform has been agreed among political parties before the general elections in September 2011. As these parties still command a majority in Parliament, the reform is expected to be adopted as planned. The size of the reimbursement is estimated at 0.9% of GDP.

Table II.4.1:
Main features of country forecast - DENMARK

		2010			Annual percentage change					
		bn DKK Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		1742.7	100.0	2.2	-1.1	-5.2	1.7	**1.2**	**1.4**	**1.7**
Private consumption		853.1	49.0	2.2	-0.6	-4.5	2.3	**-0.5**	**1.4**	**2.3**
Public consumption		511.7	29.4	2.1	1.6	3.1	0.7	**0.1**	**0.4**	**-0.2**
Gross fixed capital formation		289.4	16.6	4.3	-3.3	-14.3	-3.3	**0.4**	**4.9**	**5.7**
of which : equipment		109.4	6.3	4.5	-3.5	-13.2	2.7	**-7.5**	**8.9**	**4.5**
Exports (goods and services)		882.8	50.7	4.9	2.8	-9.7	3.8	**6.5**	**3.4**	**4.8**
Imports (goods and services)		790.6	45.4	6.2	2.7	-12.5	3.9	**4.4**	**4.4**	**6.1**
GNI (GDP deflator)		1775.3	101.9	2.5	-0.9	-4.7	1.8	**1.8**	**0.9**	**1.4**
Contribution to GDP growth :	Domestic demand			2.5	-0.6	-4.3	0.7	**-0.1**	**1.6**	**2.1**
	Inventories			0.1	-0.6	-2.0	0.9	**0.1**	**0.0**	**0.0**
	Net exports			-0.3	0.1	1.1	0.1	**1.3**	**-0.2**	**-0.4**
Employment				0.6	1.9	-3.1	-2.1	**-0.3**	**0.3**	**0.3**
Unemployment rate (a)				5.7	3.3	6.0	7.4	**7.4**	**7.3**	**7.1**
Compensation of employees/head				3.5	3.6	2.4	2.7	**1.7**	**2.1**	**2.0**
Unit labour costs whole economy				1.9	6.8	4.7	-1.1	**0.2**	**1.1**	**0.6**
Real unit labour costs				-0.1	2.8	4.3	-4.4	**-1.0**	**-0.6**	**-1.3**
Saving rate of households (b)				6.5	5.0	7.7	6.0	**8.5**	**8.7**	**6.6**
GDP deflator				1.9	3.9	0.4	3.4	**1.1**	**1.7**	**1.9**
Harmonised index of consumer prices				1.8	3.6	1.1	2.2	**2.6**	**1.7**	**1.8**
Terms of trade of goods				0.9	1.0	3.8	2.7	**0.2**	**0.5**	**1.1**
Merchandise trade balance (c)				3.5	0.2	2.6	2.9	**3.2**	**3.1**	**3.0**
Current-account balance (c)				2.1	2.7	3.6	5.2	**6.3**	**5.8**	**5.4**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				2.1	2.7	3.5	5.2	**6.4**	**5.9**	**5.4**
General government balance (c)				0.6	3.2	-2.7	-2.6	**-4.0**	**-4.5**	**-2.1**
Cyclically-adjusted budget balance (c)				0.4	2.8	0.7	-0.1	**-2.1**	**-3.2**	**-1.4**
Structural budget balance (c)				-	2.8	0.7	-0.1	**-2.1**	**-2.3**	**-1.4**
General government gross debt (c)				55.8	34.5	41.8	43.7	**44.1**	**44.6**	**44.8**

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

5. GERMANY

Growth momentum temporarily halted by uncertainty

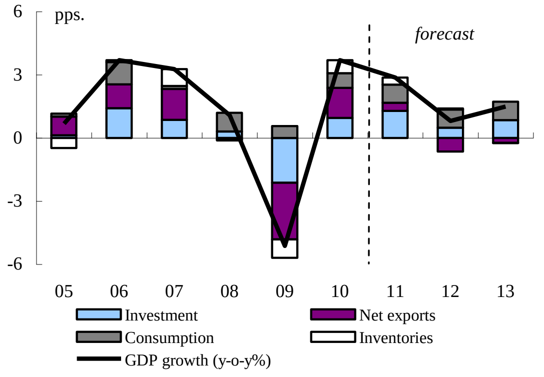
Heightened uncertainty clouds the short-term growth outlook

Following the remarkable rebound in 2010, Germany experienced a very dynamic start in 2011, with real GDP expanding by 1.3% in the first quarter from the previous period. This was followed by an expansion of only 0.1% in the second quarter. The underlying growth momentum is likely to have been steadier than suggested by this uneven pattern, with some special factors – including the impact of weather on construction activity and the accelerated phasing-out of some nuclear power plants – influencing the quarterly profile. Despite healthy export growth, the expansion in the first half of the year was driven predominantly by domestic demand.

In the meantime, however, downside risks have increased markedly and indicators are pointing to further moderation of growth in the second half of the year relative to the beginning of the year. While available data on industrial production bode well for the third quarter, the growth momentum could stall temporarily thereafter. The external environment deteriorated over the course of the autumn. Consumer confidence has been dampened by mounting uncertainty amid the ongoing debt crisis; firms' assessment of the business outlook has been on a downward trend for some months, albeit starting from a high level; and orders received have been on the decline. So far, neither the availability of credit nor financing conditions appear to be much affected by the uncertainty and reappraisal of risks in financial markets. Nevertheless, increased uncertainty is likely to weigh on the German growth outlook during the coming quarters. Export prospects are more subdued than expected earlier and uncertainty could have an impact on domestic confidence and demand.

However, the impact of uncertainty should be limited by the fact that the economy's fundamentals are essentially sound. An extended period of structural adjustment prior to the crisis led to increased flexibility in the labour market, restored competitiveness and strengthened corporate sector balance sheets. At the same time, given Germany's lack of major accumulated domestic imbalances such as overheating housing markets, the economy is not being held back by the need to repair private and public balance sheets. Therefore, only a temporary interruption of growth is expected before robust momentum is recaptured as uncertainty dissipates. The projected pace of expansion in 2013 is in line with the economy's medium-term growth trend. Domestic demand should remain the prime driver of growth over the forecast horizon, again reflecting sound domestic fundamentals in conjunction with slower export growth.

Graph II.5.1: **Germany - GDP growth and contributions**



Export prospects more subdued, rebalancing to continue

Exports were vigorous in the first half of 2011, with deliveries to the euro area expanding particularly strongly. For the year as a whole, net exports are expected to contribute 0.4 pp. to GDP growth, despite strong imports on the back of buoyant domestic demand. However, with more than 40% of German goods exports going to the euro area, export growth is set to moderate, especially in the next few quarters. Given the projected increase in unit labour cost, this moderation is not expected to be offset by market share gains. Import growth should remain relatively resilient, given that the slowdown in domestic demand is expected to be temporary and modest. Overall, this should lead to a markedly negative growth contribution from external trade in 2012, contributing further to the rebalancing among demand components and the ongoing reduction of the German current-account surplus. In 2013, a pick-up in both export and import growth is projected, with net trade exerting only a slight drag on GDP growth.

Moderating exports temporarily weighing on investment

Gross fixed capital formation was a key driver of the upturn, expanding by 5½% in 2010 and by 9½% y-o-y in the first half of 2011. However, the current uncertainty is likely to affect investment over the coming quarters. Specifically, while financing conditions are still favourable and capacity utilisation remains above the long-term average, the uncertain outlook is likely to lead firms to postpone their investment projects, with spending on machinery and equipment being particularly sensitive to the moderation of export prospects. However, such postponed plans are likely to be implemented once the economy returns to its previous stable growth path in the course of 2012. The momentum of construction investment was particularly buoyant in the first half of 2011. Looking forward, while the phasing out of public sector stimulus measures weighs on the construction outlook, private housing investment is likely to remain lively, supported by still favourable financing conditions and robust disposable income growth. Investors' likely preference for investment opportunities carrying relatively limited risk may also prop up residential construction activity.

Consumption growth dented by uncertainty in the near term

Private consumption held up well during the 2008-09 recession and expanded steadily in 2010 and early 2011, underpinned by buoyant labour market developments. The drop in household consumption recorded in the second quarter of 2011 was somewhat puzzling, as it exceeded by far the impact of the temporary increase in inflation on real disposable income, but the spending dip is expected to be offset in the short term. Over the coming quarters, the current uncertainty could impinge on household consumption behaviour, although labour market resilience should continue to support disposable income, as should continued robust wage growth. In comparison to other Member States the medium-term outlook for private consumption is further supported by the absence of large deleveraging needs in the household sector, as well as a relatively limited restraining effect from fiscal consolidation needs.

Labour market to remain resilient

Having proven remarkably resilient during the recession,[60] the performance of the German labour market has been vibrant during the upturn, with a projected rise in employment of about 1.3% in 2011, one of the highest rates of increase since reunification. Having recorded only a minor increase in the context of the recession, the unemployment rate dropped to an average of 6.1% in 2011, the best performance since the early 1990s, although the share of long-term unemployment in total unemployment remains high.

Only a moderate further improvement in the unemployment rate is expected over the forecast horizon. Survey data indicate that firms plan to further increase employment in the short term. However, with more subdued growth ahead, labour demand should also moderate. While a significant further increase in employment is forecast for 2012, this reflects to a large extent the statistical carry-over resulting from the continuous improvement in 2011. Developments should, however, continue to benefit from the increased flexibility in the German labour market. In 2009, the latter facilitated a substantial reduction in hours worked, thereby greatly limiting the impact of the crisis on the employment headcount. It is expected that firms will react in a similar manner to possible future demand shocks. Employment creation is projected to quicken slightly as the economy resumes its stable growth path later in the forecast period. In a medium-term perspective, shortages in certain high-skill segments of the labour market could turn into a major bottleneck for Germany's growth potential against the background of the trend decrease in the working-age population.

Wages and consumer price inflation to moderate

Supported by buoyant labour market conditions, wages rose substantially in the first half of 2011, with a sizeable increase in hours worked and voluntary one-off payments contributing to a markedly positive wage drift. Despite healthy productivity developments, this is projected to result in a clear increase in unit labour costs, contrary to the pre-crisis trend of improving cost competitiveness. While the clouding of the economic outlook might have a slightly damping

[60] See box 1.2.1 in chapter 1.2. Post-recession labour market patterns in the EU for details.

impact on forthcoming wage negotiations for 2012, wage growth is nevertheless expected to remain vigorous in view of the still tight labour market. Together with moderating productivity developments from firms making use of flexible working time agreements, this is forecast to lead to a further increase in unit labour costs.

Following the intensification of inflationary pressures on the back of rising energy prices in late 2010 and early 2011, consumer price inflation is projected to slow. HICP inflation should average 2.4% in 2011 and remain below 2% in 2012 and 2013, in view of the weaker economic outlook. Given comparatively more resilient domestic demand in Germany than in other euro-area economies, domestic forces are expected to take over as the main driver of price increases, reflected in a moderate rise in core inflation to 1¾% in 2013.

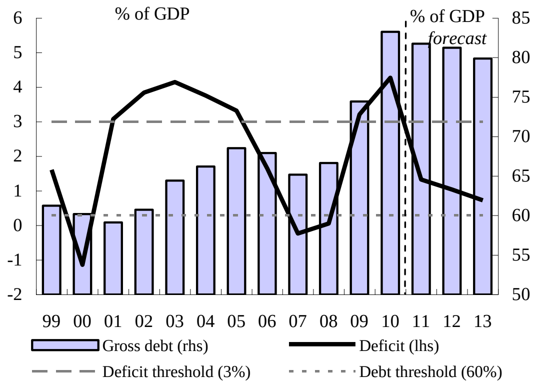
Key risks related to the resolution of the crisis

Risks to the forecast are mainly related to the successful resolution of the international sovereign-debt and financial crisis. On the one hand, the forecast assumes that major feedback loops from the financial sector via credit supply to economic activity are less likely to occur in Germany than in other countries. The increased profitability of firms limits their external financing needs, while Germany's current position as a perceived safe haven also benefits the private sector to some extent. Adverse effects cannot be excluded, however, should the current uncertainties drag on for a prolonged period of time. Moreover, should further substantial financial sector support measures prove necessary and put strain on the public finances, the resulting fiscal consolidation needs would weigh on domestic demand. At the same time, an earlier-than-expected resolution of the crisis could greatly limit its impact, especially on domestic demand.

Financial market stabilisation drove up deficit and debt ratios in 2010

The general government deficit rose from 3.2% of GDP in 2009 to 4.3% of GDP in 2010. Economic stimulus measures in line with the European Economic Recovery Plan (EERP) and financial market stabilisation were the main drivers behind the increase, while the swift economic recovery and the remarkably robust labour market had a favourable impact. Financial sector stabilisation measures, including in particular the asset transfer from *Hypo Real Estate Group (HRE)* to the related bad bank *FMS Wertmanagement*, contributed 1.3% of GDP to the deficit. The transfer of impaired assets from ailing banks to related bad banks was also the main reason for the increase of the debt-to-GDP ratio from 74.4% in 2009 to 83.2% in 2010.

Graph II.5.2: **Germany - General government gross debt and deficit**



Accelerated fiscal improvement in 2011

The general government deficit in 2011 is forecast to drop more rapidly than expected earlier, to 1.3% of GDP rather than the 2% predicted in the spring forecast. Favourable cyclical conditions are boosting tax and social contribution revenues. In addition, the phasing out of stimulus measures (around 0.2% of GDP) and fiscal consolidation efforts under the *"Zukunftspaket"* adopted in 2010 (around 0.3% of GDP) are contributing to deficit reduction. For example, the contribution rate for unemployment insurance was increased to 3% after its temporary reduction in 2009 from 3.3% to 2.8% as part of the stimulus package. Consolidation measures under the *"Zukunftspaket"* include on the revenue side new taxes on aviation and nuclear fuel, a bank levy and reduced energy tax exemptions and on the expenditure side lowered allowances for parents and benefits for long-term unemployed, as well as savings in federal administration and the employment agency. Moreover, the latest health care reform, which took effect in January 2011 and includes a 0.6 pp. increase in the contribution rate and measures to curb expenditure growth, also contributes to consolidation (around 0.4% of GDP).

Sustained, but slower consolidation in 2012-13

The deficit is predicted to decline further in 2012 and 2013, though at a slower pace due to the moderate growth outlook. It is estimated to reach 1% of GDP in 2012 and 0.7% of GDP in 2013. Consolidation should continue to be supported by the phasing-out of public investments undertaken in the context of the stimulus package and measures adopted under the *Zukunftspaket*. The structural general government deficit is estimated to fall from 1.3% of GDP in 2011 to 0.4% of GDP in 2013. The constitutional debt brake, which is being phased in as from 2011, is expected to further improve Germany's budgetary position by setting a structural deficit ceiling for the federal government of 0.35% of GDP as of 2016 and stipulating structurally balanced budgets for the federal states as of 2020. In contrast, demographic change poses a risk to the sustainability of social security systems and public finances in the medium to long term.

Gross debt is projected to fall by 1.5 pps. to 81.7% of GDP in 2011, to 81.2% of GDP in 2012 and to 79.9% of GDP in 2013 due to the denominator effect of GDP growth. Financial sector measures are expected to have a debt-decreasing effect of 0.4% of GDP in net terms in 2011, mainly due to the recent redemption of injected capital by *Commerzbank*. Debt projections also include the impact of guarantees to the EFSF, bilateral loans to Greece, and the participation in capital of the ESM as planned at the cut-off date of this forecast. The winding-up of assets accumulated in bad banks could potentially lead to falls in the debt stock, while the ongoing financial market turmoil poses downside risks for Germany's indebtedness in the medium term and could require new state intervention.

Table II.5.1:
Main features of country forecast - GERMANY

		2010		Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		2476.8	100.0	1.5	1.1	-5.1	3.7	**2.9**	**0.8**	**1.5**
Private consumption		1423.0	57.5	1.1	0.6	-0.1	0.6	**1.2**	**1.1**	**1.1**
Public consumption		488.8	19.7	1.4	3.1	3.3	1.7	**0.9**	**1.0**	**1.1**
Gross fixed capital formation		433.6	17.5	1.1	1.7	-11.4	5.5	**7.3**	**2.7**	**4.6**
of which : equipment		170.8	6.9	2.4	3.8	-22.8	10.0	**10.1**	**3.5**	**7.1**
Exports (goods and services)		1159.8	46.8	6.5	2.7	-13.6	13.7	**7.8**	**3.9**	**6.2**
Imports (goods and services)		1024.4	41.4	5.6	3.3	-9.2	11.7	**7.9**	**5.8**	**7.2**
GNI (GDP deflator)		2522.8	101.9	1.6	0.6	-4.3	3.4	**2.9**	**0.8**	**1.5**
Contribution to GDP growth :	Domestic demand			1.1	1.2	-1.6	1.6	**2.2**	**1.4**	**1.7**
	Inventories			-0.1	0.0	-0.9	0.6	**0.3**	**0.0**	**0.0**
	Net exports			0.5	-0.1	-2.7	1.4	**0.4**	**-0.6**	**-0.2**
Employment				0.2	1.2	0.0	0.5	**1.3**	**0.4**	**0.2**
Unemployment rate (a)				8.6	7.5	7.8	7.1	**6.1**	**5.9**	**5.8**
Compensation of employees/f.t.e.				2.0	2.1	0.0	2.0	**3.4**	**2.5**	**2.6**
Unit labour costs whole economy				0.7	2.3	5.5	-1.1	**1.8**	**2.1**	**1.3**
Real unit labour costs				-0.7	1.5	4.2	-1.7	**1.1**	**0.7**	**-0.2**
Saving rate of households (b)				16.2	17.4	17.0	17.0	**16.8**	**16.7**	**16.6**
GDP deflator				1.4	0.8	1.2	0.6	**0.8**	**1.4**	**1.5**
Harmonised index of consumer prices				-	2.8	0.2	1.2	**2.4**	**1.7**	**1.8**
Terms of trade of goods				0.3	-1.8	6.0	-2.5	**-3.0**	**-0.1**	**0.0**
Merchandise trade balance (c)				4.4	7.3	5.7	6.4	**5.5**	**4.9**	**4.7**
Current-account balance (c)				1.1	6.2	5.8	5.8	**5.1**	**4.4**	**4.2**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				1.1	6.2	5.8	5.8	**5.1**	**4.4**	**4.2**
General government balance (c)				-2.5	-0.1	-3.2	-4.3	**-1.3**	**-1.0**	**-0.7**
Cyclically-adjusted budget balance (c)				-2.5	-1.1	-1.2	-3.5	**-1.3**	**-0.7**	**-0.4**
Structural budget balance (c)				-	-0.8	-1.3	-2.4	**-1.3**	**-0.7**	**-0.4**
General government gross debt (c)				59.0	66.7	74.4	83.2	**81.7**	**81.2**	**79.9**

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

6. ESTONIA

Reviving domestic demand is balancing growth

Buoyant export still driving growth…

After a deep contraction of foreign trade and GDP the Estonian economy has rebounded promptly, leading to a vigorous growth acceleration in 2010, culminating at almost 9% in the first half of 2011 in annualised terms.

Estonia's remarkable export performance has been the main driving force behind the recovery. A favourable external environment, particularly in Sweden, pushed up foreign demand. Exports of goods increased by 47% y-o-y in the first half of 2011, with the main contribution coming from electrical machinery and equipment exports to Sweden. Such a strong export-driven recovery reflects a significant cost adjustment, which improved Estonia's competitiveness and has helped to gain market shares.

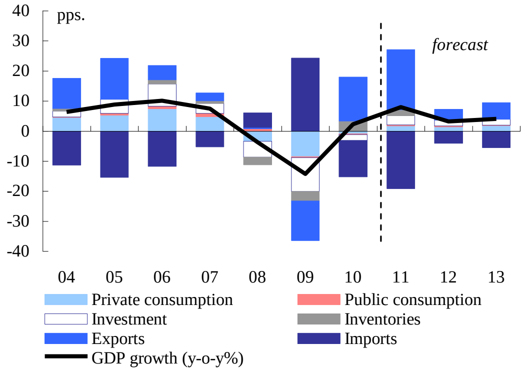
Along with foreign trade and its positive implications, domestic demand started to rebound in the second half of 2010 and increased by 10.6% y-o-y in the first half of 2011. Though approximately half of domestic demand growth came from the inventories cycle, private consumption and investment are also on solid footing. Consumption was boosted by strengthened confidence due to the recovering economy and the euro adoption on 1 January 2011. Investment increased by 17.6% in the first half of 2011, mostly supported by purchases of equipment. Household investment in dwellings started to increase at the end of 2010, though remains at a comparatively low level. Stalling public investment at the end of 2010 and in the beginning of 2011 were disappointing compared to the high investment planned by the government for 2011-12.

…but domestic demand is reviving

Estonia's export performance is slowing towards the end of 2011, although still growing by 25% on average in real terms. Along with the expected global slowdown and faltering external demand, exports are expected to weaken at the end of 2011, slowing down to 3.8% in 2012 and rebounding back up to 6% in 2013, supported by the cost and productivity adjustments during the past two years.

Reflecting increases in household disposable income and an improved labour market situation, private consumption is expected to grow by 3½% towards the end of the forecast horizon. Household savings, which increased significantly during the crisis, are on a downward trend but are expected to remain positive over the forecast horizon as individuals continue to deleverage. Consumption will be supported by the pension increases announced for spring 2012, bringing relief to elderly people who have been struggling with high food and energy inflation. Nevertheless, rising uncertainty and high unemployment may jeopardise the recovery and might lead to higher households' saving again.

Graph II.6.1: **Estonia - GDP growth and contributions**



Fixed investment is expected to remain strong during the whole forecast period. Corporate investment in equipment has rebounded against the backdrop of higher export demand. Though capacity utilisation reached 74% in summer 2011, indicating further investment needs, new projects may be put on hold until the global economy overcomes the current uncertainty. In 2012, strong public sector investment is set to counter the slowdown of corporate investment, with robust infrastructure investment reflecting a higher absorption of EU structural funds and investment related to the carbon credit trade contracts.

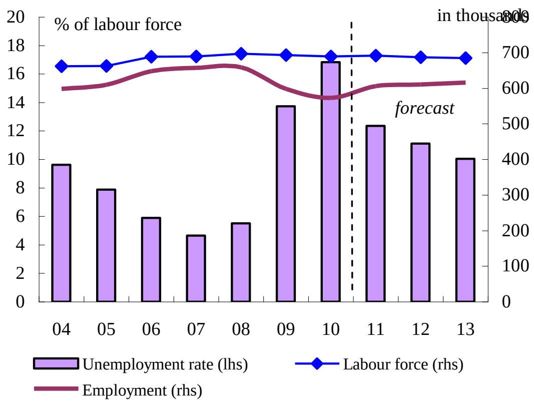
Stronger domestic demand and industrial exports will prop up imports, with a slightly negative trade balance reducing the current-account surplus towards 2013. The improved profitability of foreign-owned companies will lead to an increasing income account deficit.

Overall, annual GDP growth for 2011 of an expected 8% is higher than projected in the previous forecast. Weaker external demand would drive GDP growth down to 3.2% in 2012, followed by a rebound in 2013 to 4%. The growth profile is projected to be more balanced as domestic demand gains ground.

Unemployment and skill mismatches remain a concern despite labour market recovery

After peaking at 16.9% in 2010, unemployment (age 15-74) has declined very rapidly and is likely to be below 13% for 2011. Job creation, which resumed in the buoyant exporting industry already in 2010, has now largely spread to agriculture, construction and services. This strong rebound has been made possible by significant labour costs adjustments during the crisis, by Estonia's labour market flexibility as well as by recent changes to the status of the self-employed. Employment growth is expected to continue in 2012, though at a much slower pace, as external demand slows down before regaining strength in 2013, when both domestic and external demand are expected to reinforce. Activity rates, which remained high both in historic terms as well as by country comparison throughout the crisis, increased further in the first half of 2011, pulled by the strong output recovery. However, activity may decline somewhat in 2012 and 2013 as many young unemployed may return to the education system while discouraged long-term unemployed may decide to leave the labour force.

Graph II.6.2: **Estonia - Labour market**



Active labour market policies will progressively rebalance from wage subsidies to training or retraining activities as the economy strengthens. Nevertheless, unemployment is expected to remain relatively high in both 2012 and 2013, despite growing levels of vacancies for skilled professionals and technicians. As the economy rebalances towards tradable sectors as well as to "greener" production processes and output, there is a risk that growing skills mismatches feed into persistent unemployment and reduce labour supply and further growth.

Following the adjustment in the recent downturn, the average monthly gross wage in the whole economy reverted to positive growth in 2010 and could rise by more than 4% in 2011. Furthermore, nominal wage growth can be expected to accelerate in both 2012 and 2013, reflecting higher demand for labour but also likely skills mismatches and shortages. However, with nominal wage growth stabilised since spring 2011, real wage growth may not turn positive before mid-2012, when inflation starts to subside.

...as are persistently high prices

After negative values in the first half of 2010, average annual inflation rapidly rose and hovered around 5.0-5.5% in the first half of 2011, spurred by high international food and oil prices. Commodity prices in Estonia are very responsive to world market prices, reflecting a consumption basket rich in food and energy imports, the prevalence of short-term contracts as well as the price-taker nature of the economy. In parallel, prices in some specific (especially food) sectors likely suffered from oligopolistic market conditions, the extensive use of domestic inputs as well as higher demand from neighbouring countries. Tax changes and administered price increases also had a sizeable impact on average inflation (1.6 pps. in 2010 and 0.8 pp. expected in 2011). Conversely, core inflation (i.e. inflation excluding energy, processed and unprocessed food), in particular the contribution of non-energy industrial goods, remained low in both 2010 and 2011, alleviating the risk of competitiveness losses. The impact of the euro changeover on 1 January 2011 appeared limited and mostly concentrated on services categories.

Looking forward, the expected decline in global commodity prices should contribute to inflation moderation in 2012 and 2013. Nevertheless, there is a risk that second-round effects add to an upward pressure on wages due to relative shortages and skills mismatches in a growing and changing economy. Despite the flexibility of the labour market this may still hinder competitiveness and hence weigh on growth prospects. Finally, possible one-offs (e.g. the opening of the electricity market, to be completed in January 2013) may further contribute to price increases.

Sound public finances meet strong economic growth and sizeable investment commitments

General government finances are expected to reach a surplus of 0.8% of GDP in 2011. This is due to an increase in tax revenues due to strong economic growth, as well as to the positive one-off effects related to sales of the so-called "Kyoto units".[61]

Planned government investment will affect public finances over the forecast horizon noticeably. It includes investment related to EU structural funds and the absorption of the environmental quota. The bulk of the projects will take place in the next two years, pushing public sector investment up by 30% in 2012. While decreasing compared to 2012, investment volumes are likely to remain rather high also in 2013.

Total current expenditure is set to grow by over 4% in 2012-13 due to the planned increases in social transfers, notably increases in the state pensions. Overall, public finances are expected to deteriorate in the coming years due to higher expenditure and buoyant public sector investment. The nominal general government position is expected to be better than the cyclically adjusted one, reflecting the closing output gap. Taking into account the cyclical component and the one-off transactions related to the absorption of the environmental quota, the general government position is projected to be in deficit of -0.5% of GDP in 2012 and -0.9% in 2013.

The general government debt will remain very low and stable. It is projected to decline to less than 6% of GDP in 2011, before increasing marginally over the forecast horizon. It is assumed that the deficit in 2012 and 2013 will be financed partly by running down previously accumulated financial assets rather than by new borrowing. Debt projections also include the impact of guarantees to the EFSF and the participation in the capital of the ESM as planned on the cut-off date of the forecast.

[61] An Assigned Amount Unit (AAU) is a tradable 'Kyoto unit' or 'carbon credit' representing an allowance to emit greenhouse gases; their allocation is specified in 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 allocated for 2008-12. In 2010-11, the one-off revenues related to the quota sales amount to EUR 334 million, of which the bulk has to be invested in 2012-13.

Table II.6.1:

Main features of country forecast - ESTONIA

	2010		Annual percentage change						
	bn EUR Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	14.3	100.0	-	-3.7	-14.3	2.3	**8.0**	**3.2**	**4.0**
Private consumption	7.4	52.1	-	-6.1	-15.6	-1.7	**3.4**	**2.9**	**3.6**
Public consumption	3.0	20.9	-	5.0	-1.6	-1.1	**1.4**	**1.4**	**1.0**
Gross fixed capital formation	2.7	18.8	-	-15.1	-37.9	-9.1	**16.7**	**9.6**	**8.9**
of which : equipment	1.1	7.7	-	-17.9	-50.2	26.1	**23.0**	**3.0**	**16.0**
Exports (goods and services)	11.4	79.4	-	0.6	-18.6	22.5	**25.2**	**3.8**	**6.0**
Imports (goods and services)	10.4	72.5	-	-6.3	-32.4	20.6	**26.4**	**4.7**	**6.4**
GNI (GDP deflator)	13.6	95.0	-	-2.3	-12.0	0.0	**7.7**	**2.3**	**3.4**
Contribution to GDP growth : Domestic demand			-	-7.8	-20.6	-3.0	**5.2**	**3.7**	**4.0**
Inventories			-	-2.5	-3.2	3.4	**1.9**	**0.0**	**0.0**
Net exports			-	5.3	11.1	2.5	**0.9**	**-0.5**	**0.1**
Employment			-1.4	0.2	-10.0	-4.8	**5.9**	**1.2**	**1.2**
Unemployment rate (a)			-	5.5	13.8	16.9	**12.5**	**11.2**	**10.1**
Compensation of employees/f.t.e.			-	9.7	-3.4	1.4	**3.7**	**4.3**	**4.8**
Unit labour costs whole economy			-	14.1	1.4	-5.6	**1.7**	**2.3**	**1.9**
Real unit labour costs			-	8.3	2.4	-6.6	**-1.9**	**-0.6**	**-0.7**
Saving rate of households (b)			-	3.4	11.6	9.6	**7.7**	**6.9**	**6.2**
GDP deflator			-	5.3	-1.0	1.1	**3.6**	**2.9**	**2.7**
Harmonised index of consumer prices			-	10.6	0.2	2.7	**5.2**	**3.3**	**2.8**
Terms of trade of goods			-	-0.6	-2.2	-1.4	**-1.2**	**0.1**	**0.1**
Merchandise trade balance (c)			-	-12.1	-4.0	-2.3	**-2.7**	**-3.0**	**-3.1**
Current-account balance (c)			-	-9.1	4.6	3.8	**3.1**	**1.5**	**0.7**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-7.9	8.1	7.4	**6.2**	**4.0**	**3.2**
General government balance (c)			-	-2.9	-2.0	0.2	**0.8**	**-1.8**	**-0.8**
Cyclically-adjusted budget balance (c)			-	-4.5	1.1	2.7	**1.3**	**-1.7**	**-1.1**
Structural budget balance (c)			-	-4.7	-0.8	-0.1	**-0.2**	**-0.5**	**-0.9**
General government gross debt (c)			-	4.5	7.2	6.7	**5.8**	**6.0**	**6.1**

(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

Export-driven recovery weighed by continuing household deleveraging and fiscal consolidation

Irish economy returns to timid growth

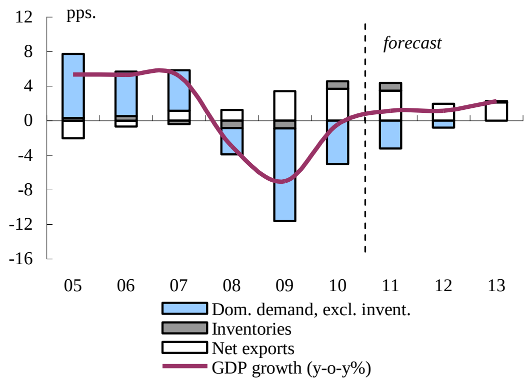
Ireland's economy saw an unprecedented collapse between 2007 and 2010, with GDP falling by 10% in real terms and 18% in nominal terms. The decline was led by the collapse in gross fixed capital formation (down 52% over the period in real terms). Although export gains were strong over the period despite the sharp decline in global demand, the interlinkages between the sovereign and banking sectors in the wake of the 2008 credit crunch saw borrowing costs jump to unsustainable levels by late 2010. This precipitated joint EU-IMF support to provide sovereign financing, allowing time to implement a policy programme aimed at restoring confidence in the Irish banking sector and public finances.

Since the programme was agreed in November 2010, Ireland's economy has continued to adjust broadly in line with expectations underpinning the EU-IMF programme. Domestic demand will contract again in 2011. However, this will be more than offset by a growth contribution from net exports of over 3 pps. of GDP, giving a headline growth figure of 1.1% for 2011 as a whole. This divergent economic development will continue in 2012. External demand will support growth with the domestic economy continuing to shrink, as exports continue to have only a limited impact on the labour market. Overall growth is projected at 1.1% in 2012. Moving to the medium term, growth is expected to pick up to 2.3% in 2013 as the non-traded sectors of the economy return to growth and the labour market begins to improve. Despite the slight upward revision to real growth in 2011, the deflator has been revised noticeably downward from 0.6% to -1.0%. This is due to the negative terms-of-trade developments in the first half of 2011 stemming from high energy prices as well as export price weakness. However these developments are expected to unwind in 2012.

Domestic economy will remain weak

Growth in the first half of 2011 was strong, with GDP increasing by 1.3% y-o-y, a tentative sign of economic stabilisation. Although quarterly output in Ireland is highly volatile, this was the first time since GDP peaked in 2007 that output expanded for two successive quarters. Although net exports and stock-building were the dominant contributions to growth in the second quarter, domestic demand showed positive signs too, growing by 0.8% q-o-q.

Graph II.7.1: **Ireland - GDP growth and contributions**



Still, private consumption is set to decline by 2.4% in 2011, with government consumption falling by slightly more. The contraction is being driven by continued high private saving due to both precautionary motives and the need for households to repair their balance sheets. Private consumption is set to fall again in 2012 (by 1.1%) as the effects of deleveraging and continued fiscal consolidation continue. Over the forecast horizon, public consumption is set to decline as consolidation continues. However, the annual profile is somewhat uneven as the provision of government guarantees to the banking sector affects.

Investment is set to decline again in 2011 with a positive contribution from machinery and equipment investment being outweighed by the continuing (but expected) contraction in construction output. Continuing the 2011 recovery, machinery and equipment investment is set to grow again in 2012 (despite credit constraints) as re-tooling is overdue after the large contraction since 2008. This will broadly offset a further fall in construction output in 2012 with the net contribution to growth from gross fixed capital formation essentially flat for the year. Following a strong increase in inventories in the first half of 2011, the contribution from stock-building has been revised upward to 0.9 pp. of GDP this year. Given the slowdown in external demand growth, stock-building is forecast to have a zero contribution to growth in 2012.

From 2013 on, domestic demand is set to provide a small but positive contribution to growth, for the first since 2007, on the back of a return to employment growth and a further decline in private savings.

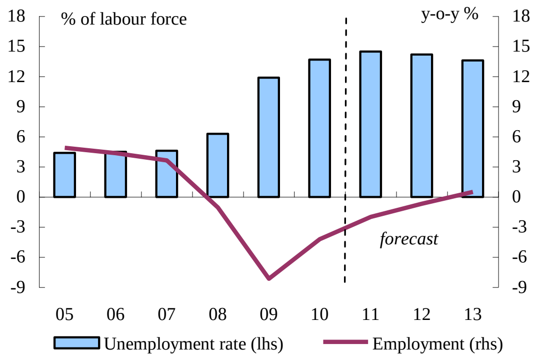
Exports stay solid

Ireland's export performance has remained strong this year on the back of strong demand in the pharmaceutical and agri-food sector, as well as gains from competitiveness improvements in recent years. Real exports grew by 5.5% in the first half of 2011 compared to the same period in 2010. Despite the global slowdown in the second half of the year, export growth for the year as a whole is set to average 4.5% in 2011. Due to the a-cyclical composition of exports (in particular pharmaceuticals), the impact of the current slowdown in global demand is set to be relatively limited in Ireland with export growth slowing to 3.8% in 2012, with a small terms of trade improvement expected too. A recovery in global trade combined with continuing labour cost improvements compared to trading partners should see exports return to robust growth approaching 5% in the medium term. Imports will continue to be held back by subdued domestic demand and net export growth is set to contribute substantially to medium-term economic activity.

Weak employment outlook over forecast horizon

Despite the timid economic upturn, the labour market is showing little sign of recovery. Employment contracted by 2.1% in the year to the second quarter and the monthly measure of unemployment has risen gradually through the year to 14.3% in September. Job growth has restarted in some export-oriented sectors but this is not likely to offset the continuing contraction in construction and public service employment this year or next. The rebalancing need is compounded by the skillsets of the considerable number of long-term unemployed (54% of total) who originate disproportionately from the construction and manufacturing sectors. Employment is set to fall by 1.9% in 2011 with a further reduction in 2012 of 0.6%. Net outward migration is set to continue over the forecast horizon, dampening unemployment growth, although strong natural increase will keep population growth positive. Unemployment is set to average 14.4% this year, with a gradual decline to 14.3% in 2012 and 13.6% in 2013. Over the medium term, the uniquely high propensity to migrate makes estimates of unemployment outcomes in Ireland difficult.

Graph II.7.2: **Ireland - Labour-market developments**



Headline average hourly earnings remained flat year-on-year to the second quarter. However, labour cost compression is continuing at the non-wage margin (for example reductions in bonuses and benefits-in-kind). Hourly labour costs fell by 3.5% in the year to the second quarter of 2011, in contrast to an increase of 3.6% in the euro area. Wage developments are expected to be very moderate in 2011-12, thereby helping to further recover past competitiveness losses and facilitating sectoral adjustment.

Inflation turns slightly positive

During the domestic boom, Ireland suffered significant losses in competitiveness, as reflected in a strong rise in unit labour costs from 2002 to 2008. Irish price levels grew to be among the highest in the euro area. Since early 2008, Irish inflation has been below the euro area average and a cumulative contraction of 3% in the HICP took place in 2009 and 2010. While inflation will return to positive territory this year and next, it should remain subdued in the absence of strong demand pressures. Inflation of 1.1% in 2011 will be driven by external energy and administered service increases, while core inflationary pressures remain very weak. Inflation of 0.7% is now expected for 2012 although this will largely be driven by administered prices. In the medium term, core inflation in Ireland is likely to remain below the euro area average.

Current account bounces back

Ireland's external position is rebalancing and an unexpected current-account surplus of 0.5% of GDP was recorded in 2010, the first surplus since 1999. However this was followed by a deficit of 1.1% of GDP in the first half of 2011 as corporate profit outflows to foreign affiliates surged on the back of the strong export performance. This trend often weakens in the second half of the year and another small surplus of 0.7% is forecast for 2011. Over the medium term this trend is expected to intensify with growth being export-led while domestic demand remains weak as household deleveraging and fiscal consolidation continue.

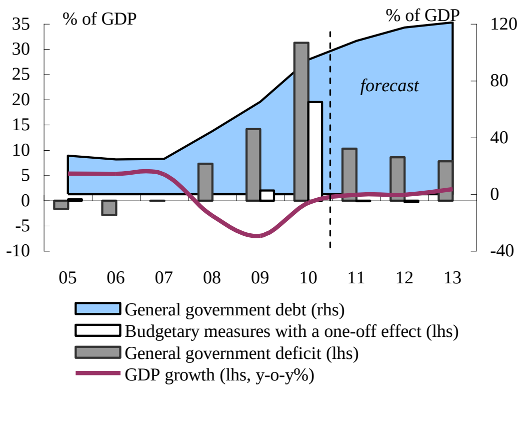
Pace of credit contraction slows

The contraction in bank credit has stabilised. On a year-on-year basis, credit advanced to households and to non-financial corporations contracted by 4.0% and 2.7% respectively in August. The credit contraction to households seems to be steadily recovering from its trough of 5.3% in December 2010. Credit to non-financial corporations has been volatile. Looking forward, credit expansion is not expected to be strong in the short to medium term in the context of banks deleveraging and limited credit demand.

Consolidation continues

The government deficit ratio to GDP reached a record 31.3% in 2010, including one-off banking sector support measures of 20% of GDP. As compared to the spring 2011 forecast the deficit is down by 1.1 pps. of GDP due to the revisions to the public finance data and nominal GDP.

Graph II.7.3: **Ireland - General government debt and deficit, one-offs and GDP growth**



The government deficit is estimated at 10.3% of GDP in 2011. Despite permanent fiscal consolidation measures of 3¼% of GDP, the structural deficit is estimated to decline by only ½ pp. of GDP over 2010. The difference stems from negative potential growth and closing output gap, as well as negative domestic demand developments – the main source of tax revenue and job creation. Lower tax revenue and some overruns in mainly social spending are estimated at 0.3% of GDP as compared to the spring 2011 forecast. However, these are more than offset by higher-than-expected non-tax revenue – fees on the bank guarantees (0.4% of GDP) and interests on the bonds injected as convertible contingent capital into the domestic banks (0.1% of GDP). The sale of the spectrum licenses announced in the 2011 budget is likely to take place in 2012 (one-off revenue of 0.3% of GDP), but the Jobs Initiative announced in May 2011 has a deficit-improving effect of 0.1% of GDP. The Jobs Initiative is budgetary neutral over the period 2011-14, while having a deficit-increasing effect of 0.1% of GDP in 2012 and 2013, and positive effect of similar size in 2011 and 2014. It includes a temporary levy on pension funds yielding almost 0.3% of GDP annually, which compensates for temporary reductions in some tourism-related VAT rates and social security contributions on low wages. Interest rate margin reduction on EU loans provided as part of the EU-IMF programme is estimated to produce savings of 0.2% of GDP. One-off banking support measures (including possible capital injection in the credit union sector) of 11% of GDP in 2011 are considered as financial transactions in the forecast until their statistical treatment is confirmed by Eurostat.

The deficit ratio is projected to decrease to 8.6% of GDP in 2012 and 7.8% in 2013 taking into account broad consolidation measures of 2½% of GDP and almost 2%, respectively, as agreed under the financial assistance programme. The forecast includes savings from the interest rate margin reduction (½% of GDP annually). The deficit in 2012 is improved by higher bank guarantee fees (0.2% of GDP), higher Central Bank's profits (0.2% of GDP) and return on the convertible bonds in the banks (0.2% of GDP). Overall, the positive effects on the 2012 deficit outweigh negative effects of the weaker growth on revenue and unemployment-related expenditure (1% of GDP). The temporary non-tax revenue, which help reduce the forecast deficit in 2012 are projected to recede in 2013.

From a level of 25% in 2007, the debt-to-GDP ratio is projected to peak at around 121% of GDP in 2013 before declining. This reflects the large primary deficits, banking sector support measures and rising debt servicing costs. Debt projections also include the impact of the participation in the capital of the ESM as planned on the cut-off date of the forecast. Precautionary cash balances are assumed at 7½% of GDP by end 2013.

Risks remain balanced

Over the medium term, growth is expected to pick up to 2.3% in 2013 as net export growth continues to make a positive contribution and domestic demand stabilises as the household saving ratio begins to fall.

Lower growth stemming from weaker-than-expected global demand in 2012 is a very real risk, as exports comprise a large share of Irish GDP. However, the composition of Irish exports and their relatively non-cyclical relationship with global demand would offset this to some extent. Although growth has returned, a pick-up in employment is likely to lag considerably, which has particularly pressing policy challenges. On the upside, precautionary savings are high giving scope for a reduction and the Irish household sector is likely to find considerable relief in 2012 given its exposure to short-term interest rates.

Table II.7.1:

Main features of country forecast - IRELAND

		2010		Annual percentage change						
		bn EUR Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		156.0	100.0	6.6	-3.0	-7.0	-0.4	**1.1**	**1.1**	**2.3**
Private consumption		79.6	51.0	5.6	-1.4	-7.2	-0.9	**-2.4**	**-1.1**	**0.5**
Public consumption		29.3	18.8	5.3	1.2	-3.7	-3.1	**-3.6**	**-1.0**	**-2.1**
Gross fixed capital formation		18.0	11.5	7.9	-10.1	-28.8	-25.1	**-10.5**	**0.6**	**4.2**
of which : equipment		6.1	3.9	8.8	-12.4	-23.5	-16.9	**8.3**	**15.0**	**8.0**
Exports (goods and services)		157.7	101.1	11.6	-1.1	-4.2	6.3	**4.5**	**3.8**	**4.3**
Imports (goods and services)		127.9	82.0	11.0	-3.0	-9.3	2.7	**1.6**	**2.6**	**3.1**
GNI (GDP deflator)		129.3	82.9	6.2	-3.0	-10.7	-0.8	**-1.5**	**-0.8**	**0.9**
Contribution to GDP growth :	Domestic demand			5.3	-3.0	-10.7	-5.0	**-3.1**	**-0.7**	**0.3**
	Inventories			0.0	-0.9	-0.9	0.9	**0.9**	**0.0**	**0.0**
	Net exports			1.7	1.2	3.4	3.7	**3.3**	**1.8**	**2.0**
Employment				3.8	-1.1	-8.1	-4.2	**-1.9**	**-0.6**	**0.6**
Unemployment rate (a)				8.0	6.3	11.9	13.7	**14.4**	**14.3**	**13.6**
Compensation of employees/head				5.3	5.4	-1.2	-3.2	**-0.1**	**0.4**	**0.9**
Unit labour costs whole economy				2.5	7.5	-2.4	-6.9	**-3.1**	**-1.2**	**-0.8**
Real unit labour costs				-1.1	10.1	1.7	-4.6	**-2.1**	**-1.9**	**-2.0**
Saving rate of households (b)				-	11.1	14.7	13.4	**14.9**	**12.8**	**11.4**
GDP deflator				3.7	-2.3	-4.1	-2.4	**-1.0**	**0.7**	**1.3**
Harmonised index of consumer prices				-	3.1	-1.7	-1.6	**1.1**	**0.7**	**1.2**
Terms of trade of goods				-0.5	-5.5	6.1	-3.4	**-4.9**	**0.8**	**0.0**
Merchandise trade balance (c)				19.4	13.2	20.2	23.4	**23.7**	**25.0**	**25.9**
Current-account balance (c)				0.4	-5.6	-2.9	0.5	**0.7**	**1.5**	**1.8**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				0.9	-5.6	-3.7	0.1	**0.4**	**1.4**	**1.5**
General government balance (c)				0.6	-7.3	-14.2	-31.3	**-10.3**	**-8.6**	**-7.8**
Cyclically-adjusted budget balance (c)				0.0	-7.2	-11.9	-29.3	**-9.1**	**-8.0**	**-8.1**
Structural budget balance (c)				-	-7.2	-9.8	-9.7	**-9.1**	**-8.3**	**-8.1**
General government gross debt (c)				52.3	44.3	65.2	94.9	**108.1**	**117.5**	**121.1**

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

8. GREECE

Painful adjustment

Note: The following text and the forecast were finalised before the European Union Summit of 26 October. Thus, they have not been updated to reflect the decisions taken at this summit which will have a direct impact on the debt and the deficit projections as of 2012.

Growth prospects are weakening further

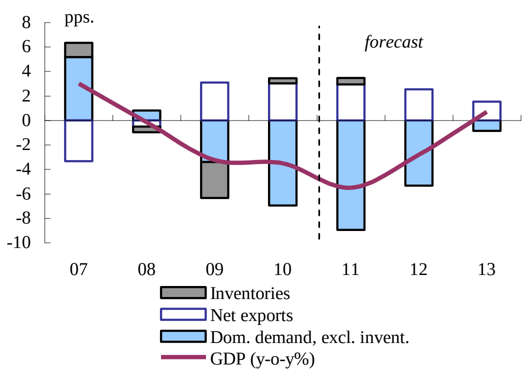
2011 is the fourth consecutive year of declining economic activity. Over the course of this year real GDP is expected to contract substantially more than in 2010, falling by 5.5%. This is mainly due to domestic demand remaining very weak, marked by income losses, the adjustment in the labour market and highly restrictive credit conditions. Growth is also expected to remain negative in 2012, with a recovery setting in from the last quarter of that year onwards. Overall, the Greek economy is expected to contract by about 15% from the beginning of the crisis.

Conversely, underlying inflation, wage settlements and unit labour costs are moderating, thereby improving overall competitiveness. The progressive rebalancing of the economy as well as growth-enhancing reforms and improving medium-term prospects abroad are expected to move the economy back onto stable footing from 2013 onwards, provided that the current adverse climate improves.

Labour market adjusting amid social tensions

The labour market is undergoing considerable adjustment. A profound contraction in economic activity, reflected in further weakening of labour demand, is weighing considerably on employment, which is set to fall in 2011 by nearly 6%. Reduced employment opportunities in the private sector and recruitment rearrangements in the public sector will likely push the unemployment rate above 18% in 2012. In turn, the weak labour market combined with declining wages is set to weigh on disposable income over the medium-term, dampening real demand. Furthermore, as a result of continuing uncertainty, private consumption is projected to contract further within the forecast horizon. 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 strive to recover competitiveness. However, this phenomenon will probably not ensure a fall in unemployment in the near term. Nonetheless, a faster rebound of employment in the recovery phase is possible, although this would depend on labour market reforms being implemented as planned and a swift reallocation of productive resources from non-tradable sectors to tradables occurring. Labour costs are falling, primarily as a result of the deterioration in the labour market but wage-setting reforms may also have contributed to this development. Moreover, wage moderation is driven by firms moving towards more flexible working arrangements, like part-time employment or intermittent jobs. Further declines in unit labour costs are likely to continue in coming years.

Graph II.8.1: **Greece - GDP growth and contributions**



Tight liquidity

Tight liquidity and a rising share of non-performing loans are putting strains on the banking system. In line with the slowdown of economic activity and continuing deposit outflows, the annual growth rate of credit to the private sector remains negative. The private sector's access to credit remains restricted due to its high costs stemming from market pressures and elevated spreads.

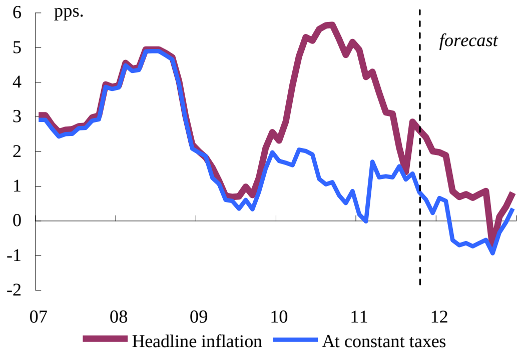
Investment in both housing and equipment has been continuously falling strongly. In 2011 fixed investment it is set to decrease by 16%. Public investment activity is also expected to remain particularly depressed in 2011 as a result of continued fiscal consolidation efforts. Several initiatives taken in the public domain – including the acceleration in the absorption of EU Structural

Funds resources and the new investment law – may help improve market sentiment and thus contribute to a recovery in public investment as of 2012.

Inflation pressure is on a declining path

In 2011 the inflation pressure that built up in 2010 (4.7% annual average) is set to decline. The latest available data indicate that prices (HICP basis) have increased by 2.9% y-o-y in September, down from 4.9% in January 2011. For 2011 as a whole the overall inflation rate is expected to be 3%, reflecting the impact of the recent tax measures, while constant tax inflation in 2011 is projected at 1%.

Graph II.8.2: **Greece - Inflation and inflation at constant taxes**



However, 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.

Slow adjustment in external imbalances

The contraction in domestic demand, which is expected to be sustained over the forecast horizon, is also mirrored by shrinking total imports, which in 2011 are expected to fall by more than 6%. Total exports will be further supported in 2011-12 by labour cost developments. However, these positive prospects may be weakened by less favourable than expected external conditions, including a slower pace of global economic growth. Exports of goods should rise by around 7% on average in 2011 and 2012, while exports of services – in particular world trade-sensitive merchant shipping and tourist receipts – should recover at a much slower pace in the wake of the global economic slow-down. All in all, the contribution of net exports to GDP growth should be clearly 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 be 10% of GDP in 2011 and to shrink to below 8% 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 to GDP growth may turn out to be stronger than projected in case the impact of ongoing and planned structural reforms arrives more swiftly and external demand recovers faster. 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 uncertainty about the turning point of the business cycle, it cannot currently be excluded that the economy may take longer than expected to return to positive territory. This risk is also reinforced by the projected global economic slowdown.

Fiscal effort during downturn

There has been progress in fiscal consolidation since the beginning of the adjustment programme, as the government deficit in 2011 will be just above half its 2009 level. Nonetheless, the fiscal target for 2011 will be missed again. This is mainly attributed to revenue fatigue associated with a deeper recession, an unstable tax environment and considerable income losses; on the other hand, primary current spending of the government has again proven its lack of responsiveness to policy intentions, making structural and institutional reform even more of a necessary condition for further consolidation. Under unchanged policies, the 2012 budget target of a government deficit of 7% of GDP is within reach.

While there have been deficiencies in the implementation of fiscal measures, the Government has made important progress in consolidation efforts. In June, Greece adopted the medium-term fiscal strategy (MTFS), specifying a set of consolidation and fiscal structural reform measures through to 2015. For 2011, the MTFS provided for fiscal consolidation measures quantified – at that time – at 3% of GDP, and above 10% for the period through 2014. Most measures provided for in the MTFS for 2011 have been duly legislated and are being implemented. However, in a number of cases the quantification of the measures had to be revised downwards because of implementation delays or changes to their design that reduce their impact; in a few instances, the agreed measures were not implemented. Nevertheless, the deeper-than-expected contraction in economic activity, taxpayers' liquidity constraints, as well as other fiscal slippages (e.g. in the fight against tax evasion) have also contributed to the reopening of a gap vis-à-vis the previously agreed annual fiscal targets. The Government has prepared an additional package of expenditure and revenue measures to minimise the fiscal slippage for 2011 and to meet the fiscal targets for 2012-14. It is no longer viable to close the fiscal gap for 2011.

The 2011 government deficit will most likely be between 8.5% and 9% of GDP, well above the ceiling of 7¾% of GDP. So far, Greece's fiscal consolidation has been well above the fiscal efforts in other European countries. According to available estimates, in 2010 and 2011 Greece has implemented consolidation measures worth more than 16% of GDP in order to reduce the deficit from 15½% of GDP in 2009 to 8.5-9% in 2011. The fiscal consolidation effort of Greece has been very large, but more measures will be necessary. Without these measures, the government deficit would have kept on increasing.

Table II.8.1:

Main features of country forecast - GREECE

	2010		Annual percentage change						
bn EUR	**Curr. prices**	**% GDP**	**92-07**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
GDP	227.3	100.0	3.1	-0.2	-3.2	-3.5	**-5.5**	**-2.8**	**0.7**
Private consumption	169.4	74.5	3.0	4.0	-1.3	-3.6	**-6.2**	**-4.3**	**-0.9**
Public consumption	41.3	18.2	2.9	-2.1	4.8	-7.2	**-8.5**	**-9.0**	**-7.0**
Gross fixed capital formation	37.8	16.6	4.9	-6.7	-15.2	-15.0	**-15.9**	**-3.6**	**6.3**
of which : equipment	13.8	6.1	11.0	1.3	-24.0	-20.0	**-13.4**	**-3.3**	**6.8**
Exports (goods and services)	48.9	21.5	6.2	3.0	-19.5	4.2	**4.8**	**6.5**	**6.5**
Imports (goods and services)	69.1	30.4	6.3	3.3	-20.2	-7.2	**-6.2**	**-3.2**	**0.7**
GNI (GDP deflator)	221.1	97.3	2.8	-0.6	-2.4	-3.8	**-5.7**	**-3.0**	**0.4**
Contribution to GDP growth : Domestic demand			3.6	0.8	-3.4	-7.0	**-9.0**	**-5.3**	**-0.8**
Inventories			0.0	-0.5	-2.9	0.4	**0.5**	**0.0**	**0.0**
Net exports			-0.6	-0.5	3.1	3.0	**2.9**	**2.5**	**1.5**
Employment			1.1	0.8	-0.2	-1.9	**-5.7**	**-2.8**	**0.4**
Unemployment rate (a)			9.8	7.7	9.5	12.6	**16.6**	**18.4**	**18.4**
Compensation of employees/head			7.6	6.1	4.0	-3.3	**-2.7**	**-2.8**	**-1.2**
Unit labour costs whole economy			5.6	7.1	7.2	-1.6	**-2.9**	**-2.8**	**-1.5**
Real unit labour costs			-0.4	2.2	4.3	-3.3	**-4.2**	**-3.0**	**-1.8**
Saving rate of households (b)			-	0.3	3.0	-3.0	**-0.1**	**1.3**	**2.3**
GDP deflator			6.1	4.7	2.8	1.7	**1.4**	**0.2**	**0.3**
Harmonised index of consumer prices			-	4.2	1.3	4.7	**3.0**	**0.8**	**0.8**
Terms of trade of goods			0.0	-0.6	-3.4	1.7	**-1.0**	**-0.9**	**-0.8**
Merchandise trade balance (c)			-15.4	-20.8	-16.0	-13.8	**-12.8**	**-11.9**	**-11.4**
Current-account balance (c)			-7.0	-17.9	-14.3	-12.3	**-9.9**	**-7.9**	**-6.9**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-16.2	-13.3	-10.6	**-7.8**	**-5.4**	**-4.4**
General government balance (c)			-6.6	-9.8	-15.8	-10.6	**-8.9**	**-7.0**	**-6.8**
Cyclically-adjusted budget balance (c)			-6.7	-10.6	-15.2	-8.7	**-5.3**	**-2.9**	**-3.4**
Structural budget balance (c)			-	-9.7	-15.4	-9.0	**-5.0**	**-2.9**	**-3.4**
General government gross debt (c)			99.2	113.0	129.3	144.9	**162.8**	**198.3**	**198.5**

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

9. SPAIN

Unwinding imbalances in a weakening external environment

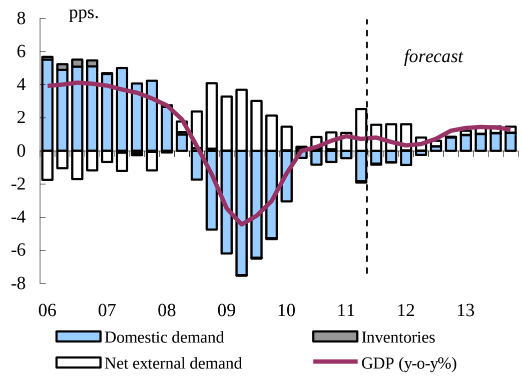
Continued rebalancing with slowing growth

Real GDP is forecast to grow by around 0.7% in 2011 and 2012 and to gather some pace in 2013. Net exports should continue to support growth, with domestic demand becoming less of a drag over the forecast horizon and gaining strength from 2013 onwards. However, in interpreting these numbers it has to be kept in mind that these forecasts are significantly influenced by the technical no-policy-change assumption for 2012 and 2013. Due to general elections scheduled for 20 November 2011, the draft budget for 2012 has not been adopted yet. Therefore, in line with the usual no-policy-change assumption, the current forecast only takes into account a temporary extension of the 2011 budget into the first few months of 2012 and measures already adopted or known with sufficient detail. The fiscal consolidation efforts required in 2012 and 2013 to meet the deficit targets of 4.4% and 3% of GDP, respectively, are not yet reflected in this forecast. Taking into account these consolidation measures would significantly change the picture both for real GDP growth and for individual components.

Spain has been recovering slowly from the sharp contraction experienced in the aftermath of the reversal of the housing and credit booms. The necessary correction of large internal and external imbalances accumulated during the boom years is ongoing and will prevail for some time. The medium-term growth outlook continues to be affected by private sector deleveraging aimed at reducing the large stock of debt, fiscal consolidation needed to bring the public deficit back to a sustainable level, banking sector restructuring and record-high unemployment. Weakening global growth and heightened uncertainty related to the intensification of the euro-area sovereign-debt crisis also impinge on growth prospects. Nevertheless, on the back of resilient external demand and the progressive absorption of earlier imbalances, the recovery is expected to continue in the coming years, albeit sluggish.

A weakening external environment and heightened uncertainty compared with spring have led to a downward revision of projected economic growth in 2011 and 2012. The weaker outlook has negative consequences for the Spanish banking sector. Despite already significant write-downs (amounting to 10% of GDP since 2008), banks still have large exposures to the real estate sector. Due to difficult funding conditions the deleveraging process has accelerated, further reducing lending to the private sector, which may have negative consequences for investment and consumption of durable goods. Bank profitability is declining and credit risk remains a concern, as non-performing loans are rising and house price adjustment is ongoing. In order to enhance the resilience of the banking system the Bank of Spain has increased minimum capital requirements, which have been already met by a vast majority of banks.

Graph II.9.1: **Spain - GDP growth and contributions**



Slow recovery of domestic demand

Private consumption has remained subdued in view of significant job shedding, which led to a record-high unemployment rate. In addition, households have started to reduce the large stock of debt accumulated in the run-up to the crisis. As the rebalancing process began, the saving rate jumped to close to 19% but has since declined sharply and is expected to further decrease somewhat over the forecast horizon. Under a no-policy-change assumption, private consumption is expected to increase moderately in 2012 despite wealth losses due to falling house prices. This increase will be driven by some strengthening of household incomes thanks to a weaker contraction of employment and somewhat higher wage growth (due to the assumed fading out of public sector wage cuts under a no-policy-change assumption). In addition, inflation is set to decline noticeably, thus boosting real disposable incomes. The impact of fiscal consolidation measures required to meet fiscal targets on household incomes is not reflected in this forecast. Household deleveraging is expected to continue and will be manifested mainly in lower housing investment. All in all, households are expected to remain net lenders over the forecast horizon.

The financial situation of non-financial corporations has been improving in recent years. Their gross operating surplus has increased, partly due to a significant adjustment in employment. This allowed them to achieve a net lending position for the first time in over a decade, leading to further reductions in the stock of accumulated debt. However, average capacity utilisation is low and GDP is set to remain below its potential over the forecast horizon even though the output gap is gradually closing. Given high levels of uncertainty investment has been very weak and has been almost entirely driven by replacement investment. In 2012 low growth prospects combined with a potentially binding credit constraint may delay a stronger recovery. At the same time, the improving financial situation of enterprises and historically low interest rates should support somewhat stronger investment growth over the forecast horizon.

It is envisaged that the post-boom adjustment in residential investment will have run its course by 2013, although this process is being held back by more acute credit restriction in this sector (credit to the construction sector has been declining at a higher rate than credit to other sectors of the Spanish economy). All in all, a gradual recovery in private investment is expected in 2012 followed by some acceleration in 2013.

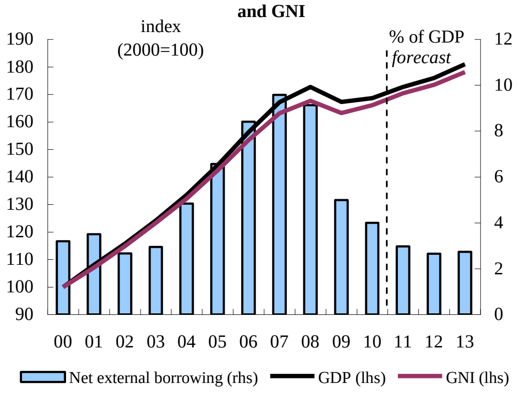
Exports continue to support economic growth

Exports surprised on the upside in the first half of 2011, recording a particularly strong performance in the first quarter. Robust export growth is expected to be sustained over the forecast horizon, although at a more moderate pace in line with the weaker external environment. The strength of 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 and capital 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, services, including tourism, have also been growing strongly. In terms of geographical diversification, Spanish exports go mainly to other EU economies, but this share has been decreasing in favour of countries from outside the EU, which accounted for 40% of total exports growth in the second quarter of 2011. In addition, exports to non-EU countries have been more dynamic, 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 compared to the rest of the Spanish economy. These firms tend to be larger, more productive, and characterised by lower unit labour costs. Furthermore, recent evidence suggests that some firms have switched from domestic to external markets, thus increasing the export base of the Spanish economy. These latest trends are expected to continue over the forecast horizon, also in view of the recent euro depreciation. However, the pace of growth of exports of goods and services is expected to decelerate significantly to more moderate year-on-year growth rates of 4-5% for goods and around 3% for services in 2012-13.

Strong export growth combined with less dynamic imports due to weak internal demand resulted in a decrease in the trade and current-account deficits. The adjustment of the external imbalance is expected to continue, supported by the relative strength of external demand in comparison to internal demand and by some fall in oil prices.

Graph II.9.2: **Spain - Net external borrowing, GDP and GNI**



Employment creation delayed until 2013

Compared to spring 2011 the outlook for employment has deteriorated somewhat, driven mainly by weaker growth. Employment is expected to decline more significantly in both

2011 and 2012. In 2012, additional job shedding should put upward pressure on the unemployment rate, although this is likely to be limited by a decrease in the active population due to a sizeable net outflow of migrant workers. Since the activity rate of immigrants is one third higher than the domestic population, the impact of this outflow on the size of the active population is greater than implied by the absolute outflow.

The unemployment rate is not expected to fall below 20% over the forecast horizon. The sharp economic contraction and the still weak economic growth during the recovery, together with the ongoing structural adjustment in the construction sector, largely explain the surge in unemployment. Furthermore, rising rates of long-term unemployment also point to an increase in the structural component of unemployment.

Moderation in wage growth and inflation

Inflation is expected to decline to just above 2% by the end of 2011 and to remain relatively low over the forecast horizon. The difference between headline and core inflation is expected to be small due to more contained movements in oil prices than in the past. In addition, the differential with the euro area is expected to be negative due to weak internal demand and a lower energy bill (with Spanish prices exhibiting higher sensitivity to oil prices than the euro-area average).

Nominal wage growth moderated since autumn 2010, partly due to a wage cut in public wages in June 2010. As these effects fade out (under the no-policy-change assumption), wage growth is bound to accelerate, albeit remaining below the historical trend. Data for the first half of 2011 point to a significant negative wage drift, linked partly to a rising share of temporary workers and lower wages for newly-hired workers. Nevertheless, persistent wage rigidities prevent a more substantial adjustment of wages in an environment of very high unemployment. Nominal unit labour costs are set to increase slightly but will remain below the euro-area average over the forecast horizon, partly due to increases in productivity. This should lead to an improvement in Spain's competitive position relative to other euro-area countries.

Risks to the baseline scenario

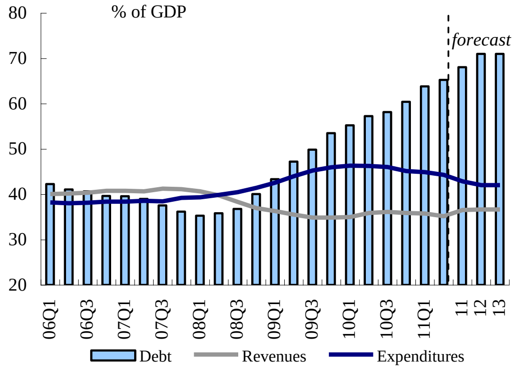
This baseline scenario is subject to considerable risks. In particular, the fiscal consolidation required in 2012 and 2013 to meet the deficit targets will impact on the forecast. Moreover, a more pronounced impact of credit constraints on firms and households, both in terms of cost and availability of credit, constitutes an additional downside risk. Finally, a persistently higher household saving rate due to increased uncertainty would also put negative additional pressure on private consumption.

Fiscal consolidation still needs further efforts to meet targets

The government deficit is projected to be 6.6% of GDP in 2011. This would imply a reduction of 2.7 pps. of GDP from the 9.3% of GDP recorded in 2010. The likely slippage from the 2011 target is confirmed by national accounts data for the first half of the year. This reflects in particular the fact that many autonomous communities exceeded considerably their budget deficit targets for the first half of the year. In the meantime, consolidation measures are being put in place both at regional and central level, which will have an impact in the second part of the year and contain the expected end-of-year slippage. Even further corrective action would be required to reach the deficit target this year.

The higher-than-targeted deficit in 2011 is due mainly to the emergence of a less favourable macroeconomic scenario than expected by the government. Together with the expected slippages at regional level this explains the deviation of 0.6 pp. of GDP from the 2011 official deficit target. Total revenues are set to rise by 2.3% in 2011, boosted by revenue-increasing fiscal measures in both direct and indirect taxation, such as the increases in VAT rates introduced in mid-2010, in excise duties in December 2010, changes to corporate taxation introduced in August of this year and the introduction of a wealth tax for 2011 and 2012 in September of this year. Nevertheless, total revenues are still expected to fall short relative to plans. Total expenditure is expected to decline by 3.9%, underpinned also by discretionary measures such as reductions in public investment and publicly-financed pharmaceutical expenses, a freeze in public sector wages and the phasing-out of the 0.5% of GDP 2010 stimulus package.

Graph II.9.3: **Spain - Public finances (moving average)**



The 2011 deficit outcome is expected to be uneven across the different levels of government in relation to the respective targets. Whereas the central government is broadly on track to meet its target, as reflected by budgetary execution data, slippages are expected for regional governments and the social security system.

Based on the no-policy-change assumption, the budget deficit is forecast to reach 5.9% and 5.3% of GDP in 2012 and 2013 respectively. For 2012, given the delay in the budget preparation due to the general elections to be held on 20 November 2011, the 2011 budget is likely to be temporarily extended as stated in the Constitution. Bearing this in mind, the forecast for 2012 has to be interpreted with particular caution, particularly as regards the expenditure side, for which the no-policy-change assumption has a particular relevance. Necessary consolidation measures to be included in the 2012 budget would significantly alter currently projected figures. Under the unchanged-policy assumption, an additional fiscal consolidation of 1.5 pps. of GDP in 2012 and 2.3 pps. of GDP in 2013 would be required to meet the deficit targets.

The structural balance is expected to improve from a deficit of 7% of GDP in 2010 to just below 5% of GDP in 2011 and further to 4¼% of GDP in 2013. Amidst the still-high public deficits and very low GDP growth, government debt is set to increase from 61% of GDP at the end of 2010 to 78 of GDP in 2013.

Table II.9.1:

Main features of country forecast - SPAIN

	2010			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		1051.3	100.0	3.1	0.9	-3.7	-0.1	**0.7**	**0.7**	**1.4**
Private consumption		606.9	57.7	3.0	-0.6	-4.3	0.8	**0.7**	**0.9**	**1.1**
Public consumption		221.7	21.1	3.8	5.9	3.7	0.2	**-0.9**	**-2.6**	**0.3**
Gross fixed capital formation		240.3	22.9	4.3	-4.7	-16.6	-6.3	**-5.4**	**-0.3**	**1.3**
of which : equipment		62.7	6.0	4.6	-3.2	-22.9	5.2	**-0.3**	**0.9**	**1.4**
Exports (goods and services)		283.9	27.0	7.6	-1.0	-10.4	13.5	**8.3**	**3.8**	**4.5**
Imports (goods and services)		306.2	29.1	8.4	-5.2	-17.2	8.9	**1.6**	**1.5**	**3.2**
GNI (GDP deflator)		1035.9	98.5	3.0	0.5	-3.3	0.7	**0.8**	**0.6**	**1.3**
Contribution to GDP growth :	Domestic demand			3.6	-0.7	-6.5	-1.0	**-1.0**	**0.0**	**1.0**
	Inventories			0.0	0.1	0.0	0.0	**0.0**	**0.0**	**0.0**
	Net exports			-0.5	1.5	2.8	0.9	**1.8**	**0.7**	**0.4**
Employment				2.3	-0.2	-6.5	-2.6	**-1.0**	**-0.4**	**0.5**
Unemployment rate (a)				13.3	11.3	18.0	20.1	**20.9**	**20.9**	**20.3**
Compensation of employees/f.t.e.				4.0	6.1	4.3	0.0	**0.9**	**1.1**	**1.0**
Unit labour costs whole economy				3.2	4.9	1.4	-2.6	**-0.8**	**0.1**	**0.1**
Real unit labour costs				-0.7	2.5	1.3	-3.0	**-2.3**	**-1.0**	**-1.2**
Saving rate of households (b)				-	13.5	18.5	13.9	**11.8**	**11.7**	**11.2**
GDP deflator				3.9	2.4	0.1	0.4	**1.5**	**1.1**	**1.3**
Harmonised index of consumer prices				-	4.1	-0.2	2.0	**3.0**	**1.1**	**1.3**
Terms of trade of goods				0.4	-2.3	5.0	-1.6	**-3.4**	**-0.8**	**-0.5**
Merchandise trade balance (c)				-5.0	-7.8	-4.0	-4.5	**-4.2**	**-4.0**	**-3.7**
Current-account balance (c)				-3.7	-9.6	-5.1	-4.5	**-3.4**	**-3.0**	**-3.0**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-2.8	-9.2	-4.7	-4.0	**-2.9**	**-2.5**	**-2.5**
General government balance (c)				-2.1	-4.5	-11.2	-9.3	**-6.6**	**-5.9**	**-5.3**
Cyclically-adjusted budget balance (c)				-2.1	-4.6	-9.2	-7.0	**-4.5**	**-4.2**	**-4.3**
Structural budget balance (c)				-	-4.3	-8.5	-7.0	**-4.9**	**-4.2**	**-4.3**
General government gross debt (c)				54.2	40.1	53.8	61.0	**69.6**	**73.8**	**78.0**

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

10. FRANCE

Domestic growth weakened by global risks and declining confidence

Economic recovery gradually fading away

After real GDP expanded by 1.5% in 2010, the economy continued accelerating in the first quarter of 2011 and grew by a strong 0.9% q-o-q, still supported by exceptional factors such as the car scrapping premium or the catch-up of inventories. Growth came to a halt in the second quarter, again partly reflecting temporary factors such as low energy consumption due to exceptionally mild weather conditions. Without these various elements, the decline in growth in the second quarter would have been less pronounced. Against this backdrop, GDP is still expected to increase in quarter-on-quarter terms in the third quarter, with a technical rebound of a modest 0.2% (mostly thanks to private consumption), before entering into slightly negative territory in the last quarter, in line with rapidly deteriorating confidence indicators. This quarterly profile translates into annual growth in 2011 of 1.6%.

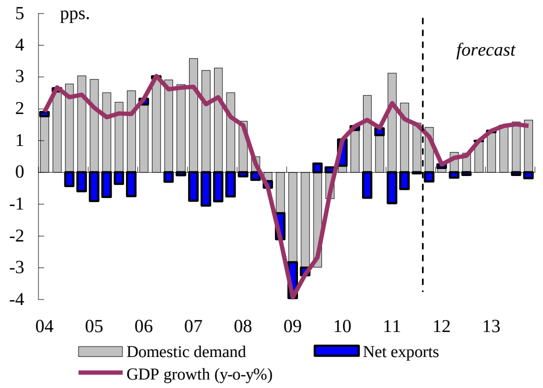
In 2012, growth is expected to turn marginally positive again in the first quarter, in parallel with a stabilisation of economic sentiment. However, the subdued pace of the recovery will only slightly strengthen during the second half of the year, resulting in annual 2012 growth of a mere 0.6%.

In 2013, annual growth is expected to accelerate to 1.4%, as confidence improves gradually in line with a fading of the sovereign-debt crisis. Investment growth is forecast to pick up towards the above-average pace seen in 2011, as the catch-up following the 2008-09 crisis has yet to fully materialise.

All components of domestic demand slowing down markedly

The significant downward growth revision compared to the spring forecast stems from the deterioration of the external environment, notably in the euro area and the US, with negative confidence effects weighing on both domestic and external demand and affecting consumers and companies. This can mainly be attributed to the impact of the sovereign-debt crisis on financial markets, which feeds into economic agents' expectations. In particular, the household saving rate is expected to stabilise at the high levels already recorded, and corporate investment is forecast to slow down markedly in 2012. Moreover, the inventory cycle seems to have now come to an end with the very strong contribution recorded in the first quarter of 2011. France's external trade deficit has reached new highs in mid-2011, although this was partly related to more resilient domestic demand than in some partner countries (as shown by the positive contribution of net trade to growth in the second quarter, when domestic demand retreated).

Graph II.10.1: **France - GDP growth and contributions**



The marked GDP slowdown in 2012 is expected to have the strongest impact on investment, in a context of somewhat tighter financing conditions, falling utilisation rates and demand, and deteriorating profit margins. A key issue will be the ability of the French banking system to take the necessary measures to satisfy Basel III requirements while limiting deleveraging in its domestic market.

Private consumption: retreating but still somewhat resilient

Household consumption growth is expected to be slowed down by a lacklustre labour market, which has been the principal factor driving the observed fall in consumer confidence indexes in mid-2011. The escalation of the sovereign-debt crisis and the corresponding tensions on financial markets further depressed sentiment.

In this regard, household consumption will be significantly shaped by the general climate of the crisis. Although wealth effects tend to be rather limited in France, the very high saving rate already reached in the second quarter of 2011 tends to suggest a more Ricardian attitude of French households: in spite of their relatively limited indebtedness, households might now be anticipating the consequences of fiscal consolidation needs in their country and abroad. Therefore, the household saving rate is expected to stay constant over the forecast period, in spite of its elevated level. Private consumption is nevertheless expected to accelerate from 0.9% in 2012 to 1.6% in 2013, in line with the evolution of real disposable income (increasing from 1.1% to 1.4%).

Additional tax measures announced in August are not expected to weigh heavily on private consumption, as they mostly target high revenue earners or large profitable firms, which show a lower propensity to consume or invest. A recent drop of inflation expectations – in line with the slowdown expected in this forecast – is also set to exert a positive impact on private consumption in 2012-13. Still, lower inflation expectations are projected to be more than offset by the above-mentioned significant deterioration of households' employment expectations, the uncertainties associated with the sovereign-debt crisis, and the continued fragility of the financial sector.

Investment and inventories significantly affected by uncertainty

Capacity utilisation rates have generally been retreating somewhat from June 2011 onwards, suggesting that the causes for the investment slowdown began to materialise even before the summer turmoil on financial markets. Moreover, composite business climate indices are now generally below their long-term averages and have been rapidly deteriorating, casting doubts over growth prospects for the coming quarters. A deceleration of gross fixed capital formation seems therefore unavoidable, although the third quarter of 2011 is expected to have benefited from the lagged impact of rather robust housing starts in the preceding quarters. Financial institutions sector, still posting large profits in the first half of the year despite a substantial provisioning for Greek bonds in balance sheets, is under stress as a result of the sovereign-debt crisis, which is forecast to weigh on credit supply. Specifically, credit conditions are expected to tighten as banks need to strengthen their capital positions. However, recent announcements by French banks suggest that adjustment will focus mostly on corporate and investment banking, export credit, and retail activities abroad. At the same time, on the demand side, depressed business confidence caused by the sovereign and financial crisis is expected to cause some postponement of planned investment projects. The above-mentioned supply constraints can therefore be masked for some time by depressed credit demand.

As far as inventories are concerned, these are now found to be slightly above desired levels, suggesting a limited negative contribution to growth in the two last quarters of 2011 and the first quarter of 2012.

External trade improving somewhat, thanks to weak domestic demand

France has been losing market shares for a number of years. Some further decrease is expected over the forecast period in the context of steady increases of unit labour costs (peaking at 1.9% in 2012), as the French labour market is expected to adjust mostly through employment. Foreign demand will also suffer from the worsening of economic prospects in large economies like the US, Germany or the Mediterranean neighbours. However, the contribution of external trade to GDP growth is expected to be almost neutral, thanks to the marked slowdown of imports associated with weaker domestic demand. Overall, after a pronounced widening in 2011, in line with record trade deficits, the current external deficit is expected to decline somewhat, back to 3.0% of GDP in 2013.

Labour market weighs on confidence in spite of rising disposable income

Due to the rigidities of the French labour market, the corporate sector is likely to adjust wage bills more through a freeze on hiring than through wage adjustment. Unemployment is consequently expected to increase over the forecast period, with net job creation not fully absorbing the increase of the active population. This was already observed in the second quarter of 2011, even before the slowdown of investment. However, the rise in labour force participation observed in 2011 corresponds to a transitory supply shock. This shock is underpinned by recent measures, including the general pension reform and cancellation of exemptions to the job search obligation, which boost the active population, while the working age population is set to remain stable in 2012 and 2013. This largely explains why so far the increase in unemployment has hit older workers harder than other groups. Moreover, the rise in subsidised employment towards the end of 2011, in line with announcements made several months ago, is expected to cushion headline unemployment figures somewhat in the short run.

Overall, employment is still expected to expand. Combined with relatively steady nominal wage growth per head in the private sector (2.4% in 2012, 2.5% in 2013), this is set to result in fairly dynamic nominal compensation of employees.

Stable inflation prospects

The previous annual average HICP inflation forecast for 2011 remains unchanged at 2.2%, but in 2012 it is somewhat lower than expected in the spring (now 1.5% instead of 1.7%), and in 2013 inflation is set to decline to 1.4%. The disinflationary impact of lower oil prices and the dim macroeconomic environment in 2012 is set to be only partly offset by various measures associated with the latest fiscal package. These include the increase of excise taxes on tobacco, strong alcohols and soft drinks, as well as some other corporate taxation measures likely to indirectly impact consumer prices. In the absence of significant hikes of consumption taxes (VAT) or administered prices, headline HICP inflation is forecast to stay below levels recorded in a number of peer countries. Core inflation is set to amount to around 1½% in 2012 and 2013.

Risks to the forecast are large given the global uncertainty

There are upside as well as downside risks associated with the ongoing sovereign-debt crisis, depending on the timing of crisis decisions likely to impact on confidence. If confidence returns, it could prove robust and consequently translate into healthier growth patterns than those envisaged in the current forecast, particularly thanks to a drop in the household saving rate and a bringing forward of investment decisions.

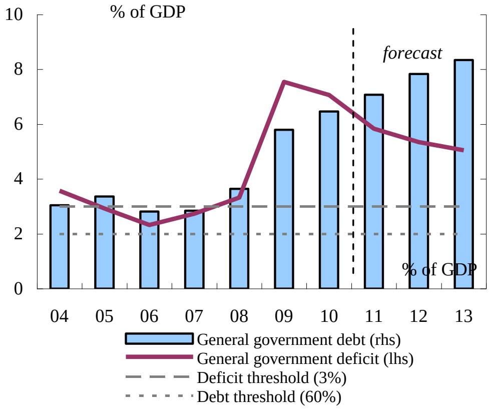
There is also significant uncertainty about the extent of the transmission of the financial tensions to the real economy. The current scenario only assumes some limited credit tightening, with a significant but contained impact on investment (and private consumption, via confidence and consumer credit). However, a more restrictive stance cannot be fully excluded, depending on the evolution of the global environment. In this adverse scenario, a sharper fall in investment would heavily affect employment prospects, with a significant second-round impact on private consumption. Exports would also drop due to the deterioration of domestic demand in partner countries.

Fiscal consolidation: need for close vigilance

In 2011, the public deficit is projected to reach around 5¾% of GDP, down from 7.1% of GDP last year. This is broadly in line with the latest official forecast (5.7% of GDP) at time of publication. Expenditure growth is set to remain below historical levels, with no increase in central government spending in volume terms and only subdued growth in social benefits. While this is partly due to the phasing-out of the remaining stimulus measures, some consolidation measures also contribute to the planned adjustment: a freeze on base wages for civil servants, the replacement of only half of retiring civil servants, a tighter healthcare spending norm combined with improved monitoring, and a nominal freeze on transfers to local authorities. On the revenue side, discretionary measures are expected to reduce the deficit by around 1% of GDP, mainly consisting of a reduction in tax expenditure together with the end of the temporary cost of the local business tax reform.

Concerning 2012, the French authorities announced in August 2011 a new fiscal package of around ½% of GDP. The package mainly consists of revenue measures, while new expenditure cuts represent less than 0.1% of GDP. In particular, additional revenues would be raised through a further cut in tax expenditure, limiting the possibilities for carrying over losses in the calculation of corporate income tax, and a rise in excise duties on tobacco and alcohol. An additional temporary tax on top incomes is due to remain in force until the 3% of GDP deficit target for 2013 is met. However, according to this forecast, the deficit is expected to reach about 5¼% of GDP in 2012, thus remaining well above the slightly revised official target of 4.5% of GDP (4.6% in the April 2011 update of the Stability Programme). The difference mainly stems from divergent macroeconomic scenarios (approximately 0.6 pp.) and does not take into account possible additional measures. Such measures might be adopted if the macroeconomic scenario underlying the draft budget for 2012 is revised downwards by the authorities after the cut-off date of this forecast, as these have recently indicated. Furthermore, while the recently adopted pension reform will start yielding savings, expenditure is set to increase somewhat faster than currently envisaged by the authorities. This is due to expected higher social benefits in line with a more cautious employment outlook and higher interest payments reflecting the recent rise in interest rate.

Graph II.10.2: **France - Public finances**



In 2013, under the usual no-policy-change assumption, the deficit is forecast to improve only marginally to around 5% of GDP, mainly due to the increasing impact of the pension reform (additional estimated impact of 0.2% of GDP). The expected outcome thus remains significantly above the official target of 3.0% of GDP. This is mainly linked to the less benign macroeconomic scenario and a significant base effect. In addition, the authorities envisage even more subdued expenditure growth than in previous years, for which corresponding structural measures are however not yet specified and which therefore cannot be taken into account in this forecast.

Overall, this implies an improvement in the structural balance of approximately 1¾% of GDP over the forecast horizon, mainly concentrated in 2011 and 2012 (1% and ¾% of GDP respectively).

The debt ratio is expected to continuously rise over the forecast horizon, reaching 92% of GDP in 2013. This projection includes the impact of guarantees to the EFSF, bilateral loans to Greece, and the participation in the capital of the ESM as planned on the cut-off date of the forecast (together 1% of GDP). The State guarantee to Dexia Group and its subsidiary Dexia Crédit Local is not expected to have an impact on public debt.

Table II.10.1:

Main features of country forecast - FRANCE

	2010		Annual percentage change						
	bn EUR Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	1932.8	100.0	2.0	-0.1	-2.7	1.5	**1.6**	**0.6**	**1.4**
Private consumption	1124.2	58.2	1.9	0.2	0.2	1.4	**0.7**	**0.9**	**1.6**
Public consumption	479.9	24.8	1.5	1.3	2.3	1.2	**0.8**	**0.4**	**0.3**
Gross fixed capital formation	373.3	19.3	2.4	0.3	-9.0	-1.2	**3.0**	**0.8**	**2.7**
of which : equipment	101.2	5.2	3.5	3.5	-9.6	4.1	**9.1**	**1.2**	**5.8**
Exports (goods and services)	492.2	25.5	5.0	-0.3	-12.4	9.7	**4.9**	**3.5**	**4.9**
Imports (goods and services)	537.5	27.8	5.2	0.9	-10.8	8.8	**6.1**	**3.3**	**4.6**
GNI (GDP deflator)	1968.1	101.8	2.1	-0.1	-2.9	1.7	**1.6**	**0.7**	**1.5**
Contribution to GDP growth : Domestic demand			1.9	0.5	-1.3	0.9	**1.2**	**0.8**	**1.5**
Inventories			0.1	-0.2	-1.2	0.6	**0.9**	**-0.2**	**0.0**
Net exports			0.0	-0.3	-0.2	0.1	**-0.4**	**-0.1**	**-0.1**
Employment			0.7	0.7	-1.4	0.1	**0.6**	**0.4**	**0.4**
Unemployment rate (a)			9.9	7.8	9.5	9.8	**9.8**	**10.0**	**10.1**
Compensation of employees/f.t.e.			2.6	2.4	1.8	2.1	**2.3**	**2.1**	**2.1**
Unit labour costs whole economy			1.3	3.2	3.2	0.7	**1.3**	**1.9**	**1.1**
Real unit labour costs			-0.3	0.6	2.7	-0.1	**0.1**	**0.4**	**-0.6**
Saving rate of households (b)			14.9	15.3	16.2	15.6	**15.5**	**15.6**	**15.5**
GDP deflator			1.6	2.5	0.5	0.8	**1.2**	**1.5**	**1.7**
Harmonised index of consumer prices			1.8	3.2	0.1	1.7	**2.2**	**1.5**	**1.4**
Terms of trade of goods			0.0	-0.7	2.2	-2.6	**-2.6**	**-0.4**	**1.1**
Merchandise trade balance (c)			0.2	-2.7	-2.2	-2.6	**-3.8**	**-4.0**	**-3.9**
Current-account balance (c)			0.8	-1.9	-2.1	-2.2	**-3.2**	**-3.3**	**-3.0**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			0.8	-1.9	-2.1	-2.2	**-3.1**	**-3.1**	**-2.8**
General government balance (c)			-3.4	-3.3	-7.5	-7.1	**-5.8**	**-5.3**	**-5.1**
Cyclically-adjusted budget balance (c)			-3.7	-3.9	-6.2	-5.8	**-4.7**	**-4.0**	**-3.9**
Structural budget balance (c)			-	-4.0	-6.2	-5.7	**-4.7**	**-4.0**	**-3.9**
General government gross debt (c)			57.7	68.2	79.0	82.3	**85.4**	**89.2**	**91.7**

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

11. ITALY
Subdued growth ahead

Increasing uncertainty weighs on growth prospects

The modest recovery experienced by Italy after the 2008-09 crisis is coming to a standstill in the second half of 2011 and growth is expected to remain subdued over the forecast horizon.

Real GDP expanded by 1.5% in 2010 as a whole, but in quarterly terms growth already eased in the second half of the year. This sluggish pace continued in the first quarter of 2011, while in the second quarter growth picked up somewhat. As for the euro area as a whole, a renewed slowdown in economic activity is now under way in Italy, amid high risk aversion and increasing uncertainty in the domestic and international economic environment. A particular factor weighing on the country's growth prospects is the steep increase in spreads on Italy's sovereign bonds vis-à-vis German benchmarks (around 350-400 bps for 10-year bonds) following the intensification of the euro-area sovereign-debt crisis during the summer. For Italian banks this has entailed higher funding costs and more difficult access to the interbank market. As a result, credit conditions for the wider economy are tightening, as signalled by the Bank Lending Survey for the third quarter of 2011 published by the Bank of Italy. The forecast assumes that financial markets will gradually stabilise in the course of 2012; should financial conditions deteriorate further, the growth outlook for Italy would worsen, especially via reduced credit availability for companies and households.

Another new factor is an accelerated and large fiscal consolidation effort envisaged for 2012-13 that was adopted in summer 2011 following the increase in Italian risk premia. While these consolidation measures – together with the ECB Securities Markets Programme (SMP) – have contributed to avoiding further increases in interest rates, they are set to weaken domestic demand in the short term. There may however be some limited scope for containing this impact through careful design of the still-to-be-specified tax and assistance reform.

The recovery at a standstill in the second half of 2011

Real GDP is projected to remain flat in the third quarter and even contract slightly in the fourth quarter (-0.2% q-o-q); in 2011 as a whole, GDP is forecast to grow by 0.5%.

After rebounding in 2010 exports continued to lead the recovery in the first half of 2011, with exports of goods significantly more dynamic than those of services. The deceleration in global demand in the second half of the year is set to weigh on Italian exports. Lacklustre domestic demand is damping goods imports in 2011 following a sizeable increase in 2010, while services imports are projected to decline further. As a result, net exports are set to provide a positive contribution to GDP growth in 2011.

The support to investment in equipment provided by external demand in the first two quarters of 2011 is weakening in the second half of the year. Moreover, the combination of tighter credit conditions and subdued domestic demand is set to adversely affect firms' investment decisions. As a result, investment in equipment is expected to grow at a modest pace in 2011 as a whole, while investment in construction is projected to decline due to the protracted weakness of the property market and significant contraction in government capital spending.

Private consumption came close to stagnating in the first half of 2011. Despite a moderate increase in real disposable income, persistently weak labour market conditions and inflationary pressures are expected to continue affecting consumer spending decisions in the second half of the year.

Net exports driving growth in 2012-13

Real GDP is expected to grow by 0.1% in 2012 and 0.7% in 2013. In quarterly terms, real GDP is projected to remain broadly flat in the first half of 2012 and slightly accelerate to 0.2% q-o-q as from the last quarter of 2012.

Export growth in 2012 and 2013 is expected to be largely determined by demand prospects in euro-area partners: modest in 2012 but improving in 2013. As the share of its exports going to fast-growing emerging markets remains relatively low, Italy is set to continue losing market shares. Still, as imports are assumed to grow considerably less than exports in 2012-13 on the back of very weak domestic demand, net exports are forecast to make a positive contribution to real GDP growth in both years.

Investment in equipment is set to decrease in 2012 due to higher financing costs, negative profitability prospects for firms, still low levels of capacity utilisation in industry and the need for further balance-sheet adjustment, notably within small and medium-sized enterprises. In 2013, it is forecast to regain some traction under the assumption of more stable financial markets and improved profitability.

Investment in construction is projected to continue contracting in 2012 before returning to modest growth in 2013. While investment in residential construction is expected to pick up somewhat over the forecast horizon as housing market conditions gradually improve, government investment spending is set to continue declining as part of the budgetary consolidation strategy.

Private consumption is forecast to remain almost flat in 2012-13 as labour market conditions are not expected to improve much and consolidation measures are set to dampen the increase in real disposable income, despite lower inflationary pressures.

A stagnating labour market

After further declining in 2010 because of the lagged effects of the 2008-09 crisis, headcount employment growth gradually recovered in the first half of 2011. This was true both for services, mainly in low-skilled activities, and manufacturing, mainly in the form of temporary contracts. The slowdown in economic activity expected as from the second half of 2011 is set to lead to a marginal decrease of headcount employment in 2012, followed by a modest rise in 2013, on the back of a gradual output recovery. Full-time equivalent employment is forecast to follow a similar path as employers are no longer expected to hoard labour through the wage supplementation scheme (CIG), as they did during the 2008-09 crisis.[62]

Reflecting the moderate decline in headcount employment and a shrinking labour supply in response to depressed labour market conditions, the unemployment rate increased only slightly since mid-2008 and peaked at 8.5% in the second quarter of 2010. It then declined slightly and stabilised at around 8% in mid-2011. However, the youth unemployment rate is still more than 6 pps. higher than before the crisis, at 27.6% in August 2011. Moreover, long-term unemployment [63] as a share of total unemployment soared by almost 5 pps. between mid-2010 and mid-2011 to around 53%. Over the forecast period the overall unemployment rate is set to remain slightly above 8% on account of the stagnating labour market.

The combination of job losses in 2010 and the moderate GDP recovery implied a rebound in productivity. As both labour market conditions and GDP developments are expected to be weak over the forecast horizon, productivity is forecast to rise only mildly in 2011-13, in line with its subdued pre-crisis trend.

Labour market and productivity developments are poised to leave little scope for wage increases beyond the adjustment to projected HICP inflation excluding imported energy, as foreseen in the reformed wage-bargaining framework. As a result, unit labour costs are expected to increase moderately in 2011-13, broadly in line with the rest of the euro area.

Easing inflationary pressures

After picking up in 2010 the rate of HICP inflation continued to rise in the first half of 2011, mainly due to sustained energy price increases. In spite of persistently weak demand some second-round effects from higher commodity prices were observed in the second quarter of 2011, notably in transport services, leading to a rise also in core inflation. Headline inflation is expected to reach 2.7% in 2011 on average, while core inflation is forecast at 2.0%.

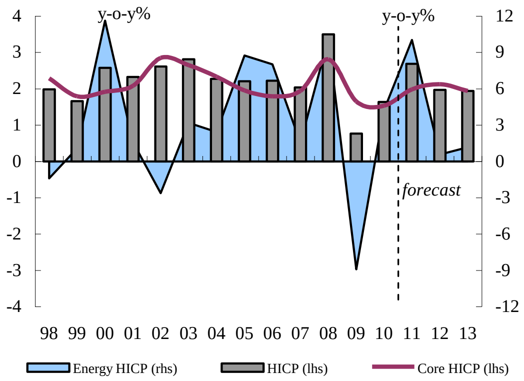
The September 2011 rise in the statutory VAT rate from 20% to 21% is expected to have a relatively moderate impact on the HICP in 2012, also in view of stagnating domestic demand. With the energy component of the HICP forecast to decelerate sharply to 2.0% on the back of declining oil prices and favourable base effects, core inflation is projected to be slightly higher than headline

[62] The CIG allows employees to stop working or reduce hours worked while keeping their job at reduced pay.

[63] People having sought a job for more than 12 months.

inflation in 2012 (2.1%). Under the assumption of a further decrease in oil prices, headline inflation in 2013 is set to decline slightly to 1.9%, in line with core inflation.

Graph II.11.1: **Italy - Price developments**



As the Italian economy is highly dependent on imported energy, the marked rise in import prices in 2010 worsened the terms of trade and contributed majorly to the significant deterioration in the trade balance and thus in the external deficit, which reached around 3½% of GDP.

In 2011 the external deficit is forecast to remain broadly stable as the further worsening of the terms of trade is broadly compensated by positive developments in net exports in volume terms. Over the forecast horizon the external deficit is projected to decline to 2¼% of GDP, driven by the balance of goods and services, which is set to improve thanks to modest growth in import volumes and slightly more favourable terms of trade.

Fiscal consolidation leads to a sizeable primary surplus

The general government deficit is projected to decline to 4.0% of GDP in 2011, from 4.6% in 2010. The primary surplus is set to improve more significantly (by 1 pp.), to 0.9% of GDP, on the back of consolidation measures adopted in 2008, 2010 and 2011. Conversely, interest expenditure is projected to rise by 0.4 pp. of GDP, driven by the higher risk premium on Italy's sovereign debt.

In structural terms the 2011 adjustment is just below ½ pp. of GDP for the overall balance and ¾ pp. for the primary balance.

On the revenue side, direct taxes are set to rise less than nominal GDP in 2011, also due to the temporary postponement of some personal income tax payments to 2012. Indirect taxes are sustained by imports and the initial effects of the summer consolidation packages, namely the rise in excise duties on transport fuel introduced in July and the 1 pp. increase in the statutory VAT rate from September. The gradual expiry of one-off taxes drives the decline in capital revenues. Overall, revenues are expected to remain stable as a share of GDP in 2011 relative to 2010 (45.8%).

As in 2010, primary expenditure is expected to fall in nominal terms in 2011. On the one hand, current primary expenditure is set to increase slightly compared with 2010, essentially due to higher social transfers, while intermediate consumption is projected to remain flat and the public wage bill to decrease, as wages are frozen and public employment declines. On the other hand, capital spending is forecast to fall by around 14% on 2010, also due to the one-off proceeds of the sale of broadband licences, which are recorded as negative expenditure (of more than 0.2% of GDP). As a share of GDP, primary expenditure is set to drop by 1 pp. relative to 2010 (to 44.8%).

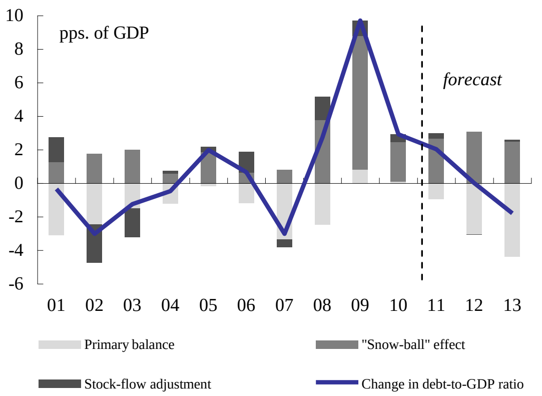
A significant further decline in the headline deficit is expected in 2012 and 2013, to 2.3% and 1.2% of GDP respectively. The primary surplus is set to increase to 3.1% and 4.4% of GDP respectively – the largest in the EU – thanks to the sizeable consolidation measures adopted in 2010 and 2011. By contrast, interest expenditure is set to rise further, by around ½ pp. of GDP in 2012 and ¼ pp. in 2013.

In structural terms the cumulative adjustment over 2012-13 compared to 2011 is expected to be around 2½ pps. of GDP for the overall balance and 3 pps. for the primary balance.

On the revenue side, the forecast for 2012-13 incorporates the full implementation of the safeguard clause enacted in the summer 2011 consolidation packages. It empowers the government to raise EUR 4 billion in 2012 (¼% of GDP) and EUR 16 billion in 2013 (1% of GDP) by cutting tax expenditure and/or increasing indirect taxation. This clause will be activated in case the planned reform of the tax and social assistance system, which must yield the same budgetary impact, is not adopted by September 2012. By contrast, no additional revenues are incorporated in the forecast from the measures against tax evasion adopted in 2010-11, as their effectiveness is difficult to assess ex ante. As a result of the safeguard clause and the revenue-enhancing measures adopted in 2011 (other than in the context of the fight against tax evasion), tax revenues are set to pick up considerably in 2012-13, with an annual increase of around 6.5% and 5% respectively. Social contributions are projected to rise modestly in both years on account of the moderate increase in the wage bill. Capital revenues are set to fall again in 2012 due to the expiry of one-off taxes, but are expected to recover somewhat in 2013. Overall, revenues are set to increase by around 1¾ pps. of GDP over the coming two years (to 47.4% in 2013).

On the expenditure side, the enacted cuts to ministerial and local spending in 2012-13 are assumed to fall on capital expenditure and intermediate consumption. Compensation of employees is projected to continue declining as a result of the continued restraint of recruitment and wages, while social transfers keep growing slightly above nominal GDP in both years. Overall, primary expenditure is projected to increase only marginally in 2012-13 relative to 2011. As a share of GDP, this implies a cumulative fall of around 1¾ pps. over the two years (to 43.0% in 2013).

Graph II.11.2: **Italy - Drivers of debt developments**



General government gross debt is expected to peak at 120½% of GDP in 2011-12 and start declining in 2013, mainly thanks to the rising primary surplus. Debt projections also include the impact of guarantees to the EFSF, bilateral loans to Greece, and the participation in the capital of the ESM as planned on the cut-off date of the forecast.

Table II.11.1:

Main features of country forecast - ITALY

	2010			Annual percentage change					
	bn EUR Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	1556.0	100.0	1.4	-1.2	-5.1	1.5	**0.5**	**0.1**	**0.7**
Private consumption	940.7	60.5	1.3	-0.8	-1.6	1.0	**0.7**	**0.1**	**0.4**
Public consumption	327.7	21.1	0.8	0.6	1.0	-0.5	**0.1**	**-0.3**	**-0.2**
Gross fixed capital formation	305.9	19.7	1.6	-3.7	-11.7	2.4	**0.1**	**-1.2**	**1.2**
of which : equipment	131.5	8.4	2.1	-5.2	-16.2	11.6	**2.0**	**-1.8**	**2.2**
Exports (goods and services)	414.8	26.7	4.7	-2.8	-17.5	12.2	**3.8**	**2.3**	**4.5**
Imports (goods and services)	444.5	28.6	4.1	-3.0	-13.4	12.7	**2.0**	**0.6**	**3.4**
GNI (GDP deflator)	1548.8	99.5	1.6	-2.2	-4.4	1.5	**0.4**	**0.0**	**0.6**
Contribution to GDP growth : Domestic demand			1.3	-1.1	-3.2	1.0	**0.5**	**-0.2**	**0.4**
Inventories			0.1	0.0	-0.8	0.7	**-0.4**	**-0.2**	**0.0**
Net exports			0.1	0.0	-1.1	-0.2	**0.4**	**0.5**	**0.3**
Employment			0.4	-0.4	-2.9	-0.7	**0.3**	**-0.2**	**0.3**
Unemployment rate (a)			9.4	6.7	7.8	8.4	**8.1**	**8.2**	**8.2**
Compensation of employees/f.t.e.			3.3	3.8	1.8	2.0	**1.8**	**1.5**	**1.4**
Unit labour costs whole economy			2.2	4.7	4.1	-0.3	**1.5**	**1.2**	**1.0**
Real unit labour costs			-0.8	2.1	2.0	-0.7	**0.1**	**-0.7**	**-0.9**
Saving rate of households (b)			18.4	14.6	14.2	12.6	**11.9**	**11.9**	**11.7**
GDP deflator			3.0	2.5	2.1	0.4	**1.4**	**1.9**	**2.0**
Harmonised index of consumer prices			3.0	3.5	0.8	1.6	**2.7**	**2.0**	**1.9**
Terms of trade of goods			-0.3	-3.4	7.2	-4.0	**-2.0**	**1.0**	**1.5**
Merchandise trade balance (c)			1.6	-0.1	0.1	-1.3	**-1.6**	**-0.9**	**-0.2**
Current-account balance (c)			0.4	-2.9	-2.0	-3.5	**-3.6**	**-3.0**	**-2.3**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			0.5	-2.9	-2.0	-3.5	**-3.6**	**-2.9**	**-2.3**
General government balance (c)			-4.5	-2.7	-5.4	-4.6	**-4.0**	**-2.3**	**-1.2**
Cyclically-adjusted budget balance (c)			-4.8	-3.2	-3.4	-3.3	**-2.8**	**-1.3**	**-0.4**
Structural budget balance (c)			-	-3.4	-4.0	-3.5	**-3.1**	**-1.3**	**-0.5**
General government gross debt (c)			111.0	105.8	115.5	118.4	**120.5**	**120.5**	**118.7**

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

12. CYPRUS

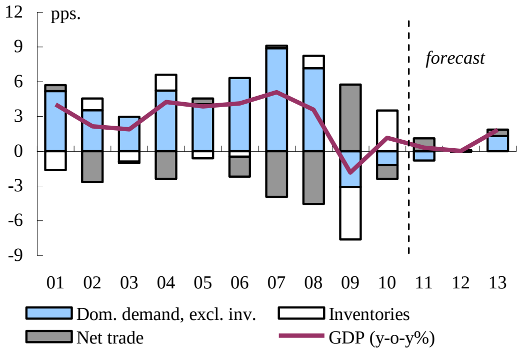
Subdued growth prospects while fiscal challenges persist

Economic activity stalled in 2011…

After a modest recovery in 2010, with GDP growth at 1.1%, economic activity expanded by 1.5% in the first half of 2011. However, despite an exceptionally good tourist season, growth prospects for the year as a whole have been badly affected by the accident in July that destroyed the Vassilikos electricity producing plant, accounting for half of total generating capacity. A worsening external environment and tightening financial and fiscal conditions compounded the damaging effect. As a result, annual economic growth is expected to grow only slightly, by 0.3%, this year.

Domestic demand, traditionally the main driver of growth, is expected to continue to shrink in 2011 at a similar pace to the previous year. Tightening bank lending conditions coupled with a worsening labour market outlook and weakening confidence have been weighing on private consumption. Public consumption has also put a brake on growth. In addition, weak foreign demand for housing and a restructuring of corporate balance sheets have kept investment on a correction path for a third year in a row.

Graph II.12.1: **Cyprus - GDP growth and contributions**



On the other hand, exports of services have enjoyed buoyant growth, driven mainly by an exceptionally good year for tourism. Tourist arrivals for the first nine months of the year surged by 11%, while tourism revenues for the first eight months recorded an increase of 16%. This was due to political instability in competing Mediterranean destinations and an increased flow of arrivals from developing markets such as the CIS. Moreover, financial intermediation and business services continued to grow solidly. In line with the contraction in domestic demand, import growth decelerated.

The downward adjustment of the labour market continued in 2011, with the impact concentrated in labour-intensive sectors such as construction and trade. The unemployment rate remained on a rising trend, reaching an average of 7.3% in the first two quarters of the year, up from 6.2% in 2010.

…and recovery is expected to resume only in 2013, with the labour market lagging behind

Economic activity is projected to stagnate in 2012 and to recover moderately only in 2013. During this period, domestic demand is set to remain weak. The deterioration in financial markets and the tightening of credit conditions should sustain the cost of and limit the access of the private sector to financing.

Leading indicators point to a weakening of consumer and business confidence. This suggests that the economy will lose further steam before recovery kicks in during the second half of 2012, alongside the improvement of the external environment, the start of the tourist season and the resumption of investment projects as uncertainty dissipates. In the short term, fiscal consolidation will have an adverse impact on economic activity through a decline in disposable income and public spending. Housing investment is projected to remain on a downward adjustment path, although to a lesser degree than in previous years. Overall, however, the outlook for investment is promising, as it is expected to benefit significantly from reconstruction work in the destroyed Vassilikos power station and from other public-private partnership infrastructure projects.

The contribution of the external sector to growth is set to remain positive. While slowing global trade and worsening economic prospects in Cyprus' main trading partners should weigh on exports of goods and services, this is expected to be partly offset by the healthy performance of business services and tourism. Against a backdrop of weak domestic demand growth, imports are expected to expand moderately throughout the forecast period.

The weak economic outlook is expected to adversely affect the Cypriot labour market. Full employment conditions and large migratory inflows seem to belong to the past. Subdued economic activity should dampen job creation while unemployment will ease only towards the latter year of the forecast period. Productivity growth is expected to remain sluggish in line with low economic activity and weak employment. Wage growth is expected to moderate given unfavourable labour market conditions in tandem with public sector wages restraint, which is also expected to spill over to private sector wages. In particular, it has been agreed that there will be no cost-of-living adjustment (COLA, adjusting wages to inflation over the previous 6 months) for public sector wages for the first half of 2012. In addition, the government and social partners agreed to reform the COLA by the end of 2011. Nevertheless, unit labour costs may rise by more than the average in the euro area until 2012, as productivity stagnates in tandem with growth, but decelerate significantly in 2013 with the resumption of recovery.

Risks appear broadly balanced

Overall, risks appear to be broadly balanced. On the one hand, risks associated with financial markets' reactions to developments in the euro area as well as adverse spillovers from Greece, particularly in view of the large exposure of the financial sector, are not negligible. Moreover, the tightening of financial and credit conditions together with the already higher financing costs and the high degree of leverage of private agents could delay the rebound in consumption and investment. On the other hand, successful implementation of fiscal consolidation, coupled with promising outcomes of the ongoing gas exploration, could have significant confidence effects. The continuation of turmoil in the Middle East and North Africa (MENA) region may further strengthen Cyprus' status as a regional safe-haven through the tourism, trading and shipping channels beyond what has already been assumed in this forecast.

Inflationary pressures are on the rise

After inching higher in 2010, almost exclusively driven by energy prices, HICP inflation is projected to rise further to 3½% in 2011. Higher prices of imported oil, on which Cyprus is highly dependent, an increased energy bill associated with higher energy production costs following July's accident and the impact of the VAT hike on food and pharmaceuticals are among the factors expected to exert inflationary pressures. In 2012, inflation is projected to decline somewhat and to return to its long-term trend only in 2013. Core inflation is forecast to remain contained at about 1.7% throughout the forecast period.

The current-account deficit declines moderately while remaining large…

Due to the economic slowdown, the current-account deficit declined further in 2011. The reduction would have been even more pronounced in the absence of rising oil prices. It is noteworthy that this improvement took place in tandem with a deterioration of the fiscal position. This suggests that the private sector continued to unwind outstanding debt. The substantial savings of the private sector were reflected in subdued consumption, shrinking investment and, consequently, lower growth.

However, at an estimated 7¼% of GDP in 2011, the current-account deficit is still large, especially given the weak economic activity. In the medium term the deficit is set to remain on a correction path, but at a moderate rate, reflecting lower GDP growth.

…reversing the deterioration of public finances

The budget deficit is estimated to have widened to 6.7% of GDP in 2011 from 5.3% in the previous year. This is significantly higher than the deficit of 4% of GDP planned in the May 2011 update of the Stability Programme. This deviation is explained mainly by lower-than-expected revenues (2¼ pps. of GDP), despite the rise in VAT on food and pharmaceuticals in the beginning of the year, but also slightly higher expenditure (½ pp.). The revenue shortfall was due to: (i) a slowdown of activity; (ii) reduced corporate profitability; and (iii) the disruption of economic activity following the Vassilikos power plant destruction. Compositional growth effects have also been non-negligible. At the same time, expenditure slippages appear to be related to rising social outlays due to higher unemployment and redundancy payments, as well as due to the electoral cycle and the higher cost of financing. With a view to reducing the budget deficit, the government adopted a fiscal consolidation package yielding an estimated annual consolidation impact of about ½ pp. of

GDP in 2011-12. This package also included two important structural measures: the enactment of contributions from public sector employees to their public pensions and the inclusion of newcomers in public sector in the social security fund, with the abolition of occupational pensions. The structural deficit, measured by the cyclically-adjusted balance net of one-offs, rose to almost 6% in 2011 from 5¾% of GDP in 2010.

For 2012, the draft Budget Law submitted to the Parliament on 13 October targets a deficit of 2.8% of GDP, on the basis of an estimated deficit for 2010 of 6.5%. The draft law incorporates a second package of consolidation measures yielding an estimated consolidation impact of about 3 pps. of GDP in 2012, of which 2.3 pps. of GDP are on the expenditure side and mostly permanent in nature. However, in this latter package the two main measures proposed by the government – namely the targeting of social transfer and the increase of the VAT rate from 15% to 17%, which account for almost 2 pps. of GDP – have not been adopted yet.

The forecast at hand projects a deficit of 4.9% of GDP for 2012. It incorporates a more prudent assessment of revenue prospects, given a less tax-rich growth composition, and possible overruns on the expenditure side, especially of current primary expenditure in view of past trends on key items such as the wage bill and social transfers. Moreover, measures that are still under discussion with an uncertain outcome or with no information on the modalities of their implementation, such as the two aforementioned measures, are not taken into account. The structural balance is expected to improve by about 1¾% of GDP in 2012.

Based on the no-policy-change assumption, the deficit is set to subside marginally to 4.7% of GDP in 2013, due to savings on the public wage bill from the abolition of public sector posts and the adopted measure of one new recruit for every four retirees in the broader public sector. With weak growth and an increasing deficit, the debt-to-GDP ratio should remain on a rising trend and reach almost 71% of GDP by 2013. Debt projections also include the impact of guarantees to the EFSF, bilateral loans to Greece, and the participation in the capital of the ESM as planned by the cut-off date of the forecast.

Table II.12.1:

Main features of country forecast - CYPRUS

		2010			Annual percentage change					
	mio EUR	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		17465.1	100.0	4.4	3.6	-1.9	1.1	**0.3**	**0.0**	**1.8**
Private consumption		11928.1	68.3	-	7.1	-2.9	0.8	**0.7**	**-0.4**	**0.7**
Public consumption		3440.7	19.7	-	6.2	5.8	0.5	**0.4**	**-3.0**	**1.4**
Gross fixed capital formation		3217.1	18.4	-	6.0	-9.1	-7.9	**-7.0**	**5.1**	**2.9**
of which : equipment		920.8	5.3	-	12.7	-9.3	-12.0	**-8.0**	**5.0**	**1.0**
Exports (goods and services)		7006.3	40.1	-	-0.3	-11.3	0.6	**3.5**	**2.5**	**4.0**
Imports (goods and services)		8131.2	46.6	-	8.1	-19.3	3.1	**0.8**	**2.3**	**2.5**
GNI (GDP deflator)		16989.2	97.3	4.1	8.6	-5.1	3.0	**0.9**	**0.6**	**1.8**
Contribution to GDP growth :	Domestic demand			-	7.2	-3.1	-1.2	**-0.8**	**0.1**	**1.3**
	Inventories			-	1.1	-4.5	3.5	**0.0**	**0.0**	**0.0**
	Net exports			-	-4.6	5.7	-1.2	**1.1**	**-0.1**	**0.5**
Employment				-	2.8	-0.7	-0.3	**-1.0**	**-0.2**	**0.4**
Unemployment rate (a)				-	3.7	5.3	6.2	**7.2**	**7.5**	**7.1**
Compensation of employees/head				-	2.3	3.2	2.8	**2.6**	**1.9**	**1.8**
Unit labour costs whole economy				-	1.6	4.5	1.4	**1.3**	**1.7**	**0.4**
Real unit labour costs				-	-2.9	4.4	-0.3	**-1.8**	**-0.9**	**-1.8**
Saving rate of households (b)				-	4.9	11.4	11.6	**-**	**-**	**-**
GDP deflator				3.3	4.6	0.1	1.7	**3.1**	**2.7**	**2.2**
Harmonised index of consumer prices				-	4.4	0.2	2.6	**3.4**	**2.8**	**2.3**
Terms of trade of goods				-	-2.5	2.7	-0.7	**-0.7**	**0.0**	**0.1**
Merchandise trade balance (c)				-	-32.2	-25.1	-26.9	**-27.1**	**-28.0**	**-28.2**
Current-account balance (c)				-	-11.9	-10.6	-9.0	**-7.3**	**-6.7**	**-6.1**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-11.9	-10.5	-8.8	**-7.2**	**-6.6**	**-5.9**
General government balance (c)				-	0.9	-6.1	-5.3	**-6.7**	**-4.9**	**-4.7**
Cyclically-adjusted budget balance (c)				-	-0.4	-6.0	-5.1	**-6.3**	**-4.1**	**-4.2**
Structural budget balance (c)				-	-0.4	-6.3	-5.7	**-5.9**	**-4.2**	**-4.2**
General government gross debt (c)				-	48.9	58.5	61.5	**64.9**	**68.4**	**70.9**

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

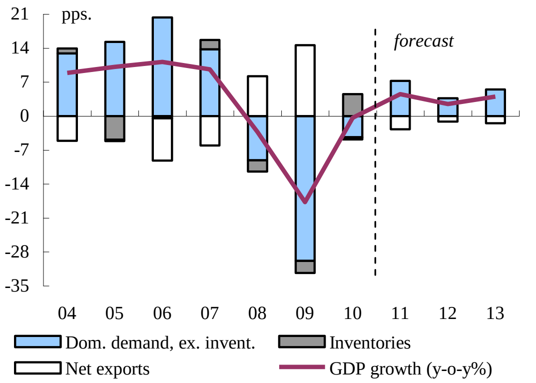
13. LATVIA

Growth exceeds expectations in 2011 but outlook for 2012 worsens

Corporate profits support investment and GDP growth in 2011

A strong rebound in corporate investment as well as sustained increases in private consumption and exports pushed up Latvia's economic growth to 5.6% y-o-y in the second quarter of 2011. Investment was mainly financed by corporate profits, with bank credit playing a decreasing role. On the supply side, manufacturing and tourism reported record rates of expansion of 14.7% and 25% in the first half of 2011. Both sectors benefited from the steep improvement in the country's price competitiveness in 2009-10 when unit labour costs (weighted according to trade patterns) dropped by around 20%. On the other hand, financial services and construction, which had been on a downward path for several quarters, eventually approached a turning point in the middle of the year.

Graph II.13.1: **Latvia - GDP growth and contributions**

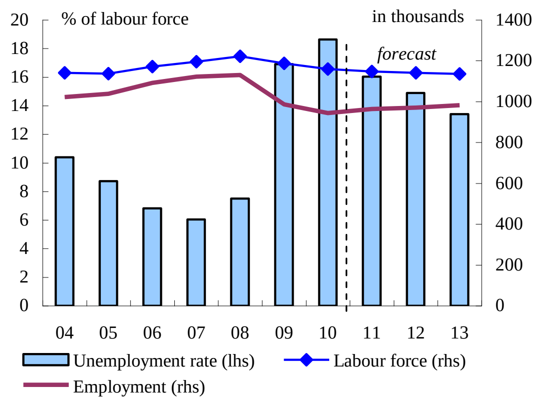


Despite global uncertainties, the latest monthly indicators suggest that retail sales, industrial production and exports grew at a fast pace also in the third quarter of 2011. These stronger developments support an upward revision of the GDP growth forecast to 4.5% in 2011 from 3.3% expected in spring. However, the expected slowdown in major EU economies and the steep fall in confidence in the euro area imply a significant downward revision of GDP growth to 2.5% in 2012 from previously projected 4%. Despite a relatively strong impact on the growth outlook, the new shock will not have such devastating effects on the economy as in 2008-09, when it compounded the burst of the property bubble, the collapse of the construction sector and resulting huge financial outflows. Moreover, the export sector is now expected to take some advantages from the softer euro, leading to a depreciation of Latvia's nominal effective exchange rate, which will partly offset the weakening external demand. Overall, the Commission's economic sentiment indicator (ESI) for Latvia also paints a broadly positive picture, balancing the dynamic internal demand and a softening external environment. After a one-off decline in August, the indicator recovered in September to a four-year high of 3.6 pps. above the long-term average.

Unemployment drops substantially, helped by emigration flows

The unemployment rate, based on the Eurostat definition for the age group of 15-74, dropped by 3.2 pps. to 16.2% y-o-y in the second quarter of 2011. The overall improvement was supported by net job creation as well as by strong emigration flows that lowered the number of job seekers. The labour force contracted by 0.7% y-o-y in the second quarter of 2011 and the monthly statistics on the international mobility of the population showed that the change was largely driven by an increasing rate of emigration. The participation rate remained stable, however, as both the labour force and the working age population contracted at similar rates.

Graph II.13.2: **Latvia - Labour market**

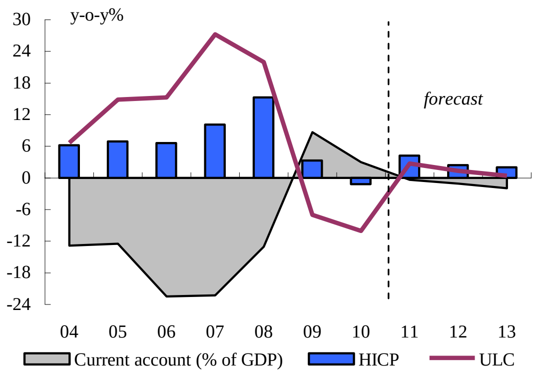


Thanks to improved economic conditions, wages increased at a relatively fast pace in the first half of the year but remained broadly in line with productivity gains. Employment and wages are expected to rise only marginally in 2012 as the weakening economic outlook will contain labour demand. This is supported by the latest economic surveys where employment expectations for manufacturing and service sectors stayed positive but below the levels at the start of the year, while retail and construction firms reported negative employment expectations.

Inflation to fluctuate near EU average

Consumer price inflation expectedly accelerated in 2011 reflecting higher energy and food prices as well as two rounds of consumer tax hikes at the beginning of 2011 and in the summer. The harmonised index of consumer prices (HICP) surged to an annualised 4.2% in January-August compared to a deflation of 1.1% in 2010. However, inflation was mainly affected by taxes, food and energy prices, with core inflation remaining subdued. The constant-tax estimates of the national statistics office show much lower inflation of 2.8%, of which around 2 pps. can be attributed to changes in prices of energy and unprocessed food. As tax and commodity price effects will fade away in 2012-13, headline HICP inflation is expected to decelerate substantially towards the EU average rate. On the demand side, prices could face certain upward pressure from second-round effects linked to the steep wage and employment growth in the first half of 2011 but this is likely to be offset by the supply-side impact of the global slowdown.

Graph II.13.3: **Latvia - Current account, inflation, unit labour costs**



Current account moves back to deficit

The current account moved to a small deficit in January-August 2011, following a two-year period of surpluses driven by internal adjustment and cyclical effects. In nominal terms, merchandise exports and imports rose at similar annual rates of about 32% in January-August. The reversal in the primary income balance as well as the gradual recovery of private consumption and investment is set to expand the current-account deficit further in 2012-13. Nevertheless, as capital account inflows will offset the current-account gap, the net external lending is projected to remain positive. The country's external indebtedness is therefore expected to decline further in relation to GDP, continuing the positive trend of deleveraging in the private sector that brought the country's external debt to 149% of GDP as of end-June 2011, down from 165% as of end-2010.

The net inflow of FDI marked an eight-fold improvement in annualised terms to LVL 437 million in January-August 2011 (3.2% of the projected full-year GDP). The rebound is largely driven by the reversal in reinvested earnings of foreign-owned companies that moved to a positive balance of LVL 84 million from a negative value of LVL 226 million a year earlier.

Outlook for public finances reflects growth revival and past consolidation effort

In line with the revival of economic growth, tax revenue continued improving in the first three quarters of 2011. Income taxes in particular performed above expectations, while the improvement in the labour market led to lower unemployment costs. Together with restrained expenditure growth, this points to a notable improvement in the outlook for public finances in 2011. At the same time, as plans for restructuring of a state-owned bank are being implemented, a negative risk factor for public finances identified in the spring forecast is expected to materialise. Moreover, the government has also decided to provide stop-gap financing to the national airline company, which has incurred significant losses over the past two years. The estimated impact of these decisions is ¾% of GDP in 2011. Overall, these offsetting items lead to only a modest deficit improvement in 2011 compared to the spring forecast, with the general government deficit now expected at 4.2% of GDP, significantly down from 8.3% of GDP recorded in 2010, which was negatively affected by a number of one-off factors. The structural balance is set to improve in 2011 less than the change in the headline deficit, by a still impressive 1½% of GDP.

Due to early elections that took place in mid-September, the annual budgetary process has been delayed, with the draft budget law for 2012 expected by early December. The current forecast therefore does not include measures which the government intends to adopt to fulfil its aim of a deficit of 2.5% of GDP in 2012. A number of earlier decisions with effect in 2012 are nevertheless already included in the forecast, notably the suspension of the pension indexation until end-2013, as well as the full-year impact of some tax increases that took place in mid-2011. The forecast for 2012 includes some estimated further costs of restructuring of the national airline. Overall, not considering the forthcoming measures of the 2012 budget, the general government deficit is expected to decline to 3.3% of GDP in 2012 as revenue is projected to grow faster than expenditure, while the structural deficit remains broadly stable. Although the exact composition of measures to support the consolidation is not yet known, the new government has restated publicly its commitment to meeting the deficit target of 2.5% of GDP in 2012 set under the Balance of Payment assistance programme.

Albeit exceptional restructuring costs are assumed to be considerably lower in 2012 than in 2011, such measures remain a risk factor to the fiscal outlook. Further downside risks for 2012 are related to uncertainties concerning the economic outlook discussed above and their impact on revenue. In 2013 the nominal general government deficit is projected to remain broadly unchanged as the planned increase in state contributions to the mandatory funded pension scheme, with a negative impact of 1.0% of GDP, offsets an improvement in tax revenue due to improving macroeconomic conditions.

In June 2011, Latvia returned successfully to the international financial market by issuing a USD 500 million Eurobond. Further borrowing from international financial markets is expected in both 2012 and 2013, including with the aim to pre-fund the repayment of loans under the international financial programme – these repayments will start in 2012 and peak in 2014-15. As a result, the gross general government debt is expected to continue increasing over the forecast horizon, reaching 47.1% of GDP by end-2013, though rapidly falling thereafter as large repayments are made.

Table II.13.1:

Main features of country forecast - LATVIA

		2010		Annual percentage change						
	mio LVL	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		12738.7	100.0	2.2	-3.3	-17.7	-0.3	**4.5**	**2.5**	**4.0**
Private consumption		8024.1	63.0	-	-5.8	-22.6	0.4	**3.5**	**2.4**	**3.3**
Public consumption		2230.6	17.5	-	1.6	-9.4	-9.7	**1.0**	**0.0**	**0.5**
Gross fixed capital formation		2487.2	19.5	-	-13.8	-37.4	-12.2	**21.5**	**8.0**	**12.0**
of which : equipment		860.4	6.8	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		6853.4	53.8	-	2.0	-14.1	11.5	**11.0**	**5.8**	**6.2**
Imports (goods and services)		7034.9	55.2	-	-10.8	-33.3	11.5	**14.9**	**7.0**	**7.7**
GNI (GDP deflator)		13006.5	102.1	1.9	-1.0	-10.6	-5.5	**2.2**	**2.6**	**3.8**
Contribution to GDP growth :	Domestic demand			-	-9.1	-29.8	-4.4	**7.2**	**3.7**	**5.5**
	Inventories			-	-2.4	-2.5	4.5	**0.0**	**0.0**	**0.0**
	Net exports			-	8.2	14.6	-0.5	**-2.7**	**-1.1**	**-1.5**
Employment				-1.4	0.9	-13.2	-4.8	**2.2**	**0.7**	**1.3**
Unemployment rate (a)				12.1	7.5	17.1	18.7	**16.1**	**15.0**	**13.5**
Compensation of employees/head				-	15.7	-12.7	-6.0	**4.4**	**2.8**	**3.2**
Unit labour costs whole economy				-	20.7	-7.9	-10.2	**2.1**	**1.1**	**0.5**
Real unit labour costs				-	6.9	-6.7	-8.2	**-1.8**	**-0.6**	**-1.1**
Saving rate of households (b)				1.3	4.9	10.3	4.2	**2.2**	**3.1**	**2.8**
GDP deflator				29.7	13.0	-1.2	-2.2	**4.0**	**1.7**	**1.6**
Harmonised index of consumer prices				-	15.3	3.3	-1.2	**4.2**	**2.4**	**2.0**
Terms of trade of goods				-	-1.8	-2.9	1.1	**3.2**	**0.0**	**0.2**
Merchandise trade balance (c)				-14.5	-17.8	-7.1	-7.1	**-8.2**	**-9.1**	**-10.0**
Current-account balance (c)				-5.7	-13.1	8.6	3.0	**-0.4**	**-1.1**	**-2.0**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-3.4	-11.6	11.1	4.9	**1.7**	**1.0**	**0.5**
General government balance (c)				-	-4.2	-9.7	-8.3	**-4.2**	**-3.3**	**-3.2**
Cyclically-adjusted budget balance (c)				-	-6.4	-6.8	-5.7	**-2.9**	**-2.5**	**-3.1**
Structural budget balance (c)				-	-6.4	-6.3	-4.6	**-3.2**	**-3.3**	**-3.1**
General government gross debt (c)				-	19.8	36.7	44.7	**44.8**	**45.1**	**47.1**

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

14. LITHUANIA

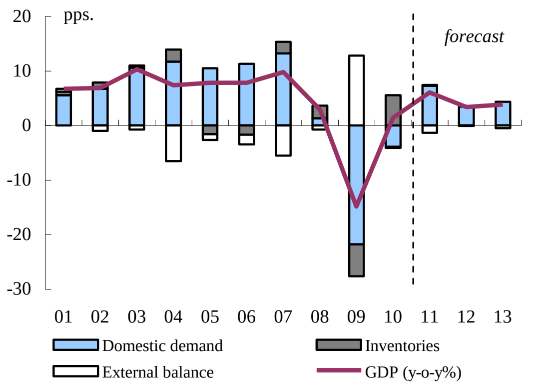
Strong recovery to dampen in line with global trends

Strong economic growth in 2011 as domestic demand picks up

With private domestic demand gradually taking over as the main engine of growth, Lithuania's economy has quickly recovered from a deep recession. Following a contraction of nearly 15% in 2009, output expanded by 1½% in 2010 and further by a robust 6½% in the first half of 2011. A determined and sustained implementation of broad policy reforms has been vital in harnessing Lithuania's growth potential to complete its return to strong and balanced growth.

The recovery was initially driven by strong external demand as exports expanded across sectors. Improved competitiveness underpinned by strong wage discipline supported the vigorous export performance. However, imports expanded somewhat more strongly than exports as the recovery gathered momentum. As a consequence, the trade deficit has further widened and the contribution of net exports is expected to turn slightly negative in 2011. The current-account balance turned negative in the first half of 2011 mainly due to a higher merchandise trade deficit, a higher income account deficit and a lower current transfers surplus.

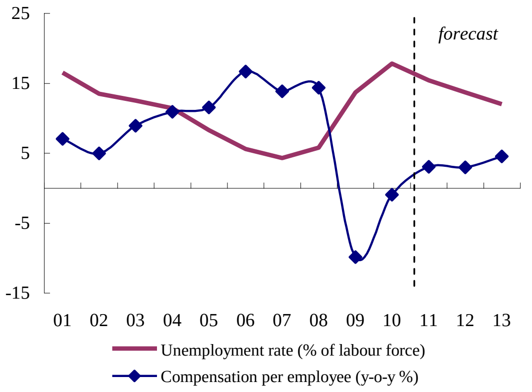
Graph II.14.1: **Lithuania - GDP growth and contributions**



Domestic demand has taken over as the main driver of economic growth since investment and private consumption growth started to resume in the second half of 2010. Financial market conditions have gradually improved while lending activity and saving rates have declined. Private investment has been strong, especially in equipment and non-residential construction while public investment was concentrated on energy and education.

Private consumption has picked up due to a remarkable rebound in employment in the second quarter of 2011 and moderate wage increases. Unemployment decreased markedly in the second quarter of 2011 to 15.6%, down from 17.2% in the first quarter. Wages have followed an upward trend since the second quarter of 2010, but increases have been limited due to the public sector wage freeze. However, previous post-crisis social benefit reductions have been extended and indirect tax increases maintained, thus continuing to limit private demand.

Graph II.14.2: **Lithuania - Unemployment rate and compensation per employee**



Inflation rose in the first three quarters of 2011 and is set to reach around 4.0% on average for the entire year, while headline inflation quickly increased on the back of higher energy and food prices as well as lagged effects of excise duties hikes in the previous year. After turning negative in the first half of 2010, core inflation has accelerated noticeably from 0.3% in Q3-2010 to nearly 3.0% in Q3-2011 as domestic demand growth gathered momentum.

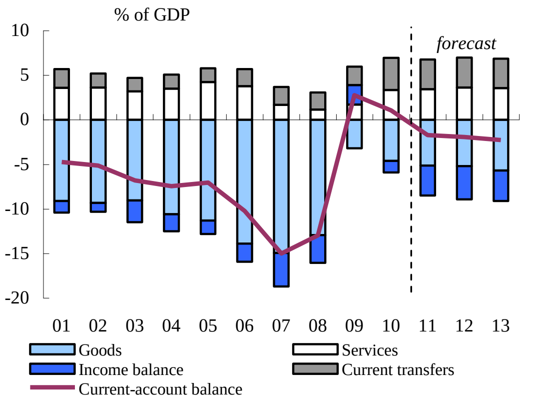
Looming slowdown due to worsening prospects for the global economy

Lithuania's GDP growth in 2012 and 2013 is set to slow markedly. Not only has the global economic outlook worsened, but persistent volatility and tensions in world financial markets are expected to lead to more downbeat business and consumer sentiment.

Private investment is expected to slow on the back of a less favourable business outlook and likely tighter credit conditions. However, continued frontloading of EU co-financed projects is to support public investment. A recovering labour market is set to increase private consumption. Skill mismatches have emerged in some sectors, putting upward pressure on wages. The planned reversal of previous pension cuts from 1 January 2012 will also add to consumption dynamics. However, overall unemployment remains high and structural unemployment has increased. Moreover, as consumers, non-financial corporations and the public sector continue to restore their balance sheets in the light of increased uncertainty, domestic demand will be more subdued than previously expected.

The current-account deficit is projected to widen slightly in 2012 and further in 2013. The goods trade deficit is expected to increase over the forecast horizon as external demand weakens at a faster pace than domestic demand. As growth prospects of Lithuania's main export partners, namely Germany, Russia, the other Baltic States and Poland have been revised downwards, export growth is expected to weaken.

Graph II.14.3: **Lithuania - Current-account balance**



Inflation is likely to decelerate in 2012, driven by lower global commodity prices. The 2012 increase of excise duties on tobacco will temporary add to inflation. Core inflation is projected to remain at elevated levels.

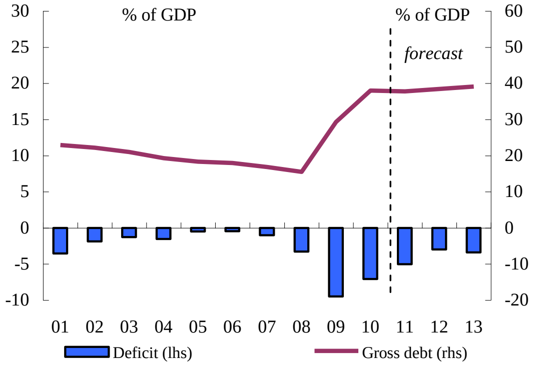
The balance of risks to the baseline scenario appears tilted to the downside. An increase in global risk aversion and a worsening business outlook might trigger stronger-than-projected capital outflows. Moreover, the deleveraging process in the economy might prove to be more protracted. A negative feedback loop between the real and financial sector might emerge, further weakening output dynamics. Upcoming parliamentary elections in October 2012 could result in a lack of commitment to continue fiscal consolidation, which could weaken market confidence in Lithuania's adjustment path.

Fiscal outlook improves on the back of higher growth, but challenges remain

Given strong economic growth in the first half of 2011 and continuing fiscal consolidation efforts undertaken by the government, recent budgetary outcomes were better than expected. In 2010 Lithuania's general government deficit reached 7.0% of GDP, outperforming its target of 8.1%. The government is also expected to be able to meet the 5.3% of GDP general government deficit target set for 2011 in the latest update of the convergence programme. The adjustment strategy has primarily relied on a nominal expenditure freeze, underpinned by the extension of temporary consolidation measures implemented during the crisis and the control of other expenditure. After the first three quarters of 2011 expenditure is considerably below target, while tax revenues are largely in line with the 2011 budget. Tax revenues are around 17% higher compared to the same period of the previous year on the back of reviving domestic demand and partly to government efforts to improve tax compliance. On the other hand, despite higher debt-servicing costs, expenditure remained slightly below their 2010 level as the public sector wage bill, spending on goods and services as well as social benefits further decreased.

For 2012, the forecast includes the measures adopted by the government in the draft 2012 budget. The 2012 draft budget targets a deficit of 2.8% of GDP, in line with the excessive deficit procedure. It assumes that tax changes are limited to the increases in excise duties on tobacco according to EU legislation. Other additional revenue is to come from non-tax revenue such as higher dividends from state-owned enterprises due to their higher profitability and increased efficiency (0.4% of GDP). Moreover, one-off measures, in particular the sales of the so-called "Kyoto units" (0.3%) and land sales also add to revenue. Following the implementation of the tax compliance strategy, the government is also expecting better tax compliance and collection in 2012; however, no additional revenue from this source is included in the budget. On the expenditure side, the government is to continue freezing all non-co-financing and non-interest expenditure, including the public sector wage bill. Furthermore, the budget includes across-the-board cuts of 2% in appropriations to line ministries, yielding around 0.3% of GDP. The only temporary measure which is to be reversed is the reduction in pension benefits. Their restoration back to pre-crisis levels would add 0.5% of GDP to the 2012 deficit. Some of the temporary measures adopted during the crisis concerning social benefits are to be made permanent. The 2012 draft budget foresees a 1.1% increase in the total government expenditure compared to the 2011 budget due to higher debt-servicing costs and higher social expenditure as mentioned above. General government investment is also planned to increase, mainly on the back of faster EU funds absorption. The draft budget includes a contingency provision. In case budgetary revenue falls short of plans or the deficit is likely to be above the 2.8% of GDP target, adoption of a supplementary budget is required.

Graph II.14.4: **Lithuania - General government deficit and gross debt**



In 2013 some temporary consolidation measures will expire, including the freeze of government wages. Furthermore, other previously contained expenditure is likely to increase. On the basis of the standard no-policy-change assumption, the government deficit is expected to narrow to 3.0% of GDP in 2012 and to increase to 3.4% in 2013. The general government debt is expected to stabilise at 38½% of GDP in 2011 before increasing to nearly 40% of GDP at the end of the forecast period.

Table II.14.1:

Main features of country forecast - LITHUANIA

	2010			Annual percentage change					
	bn LTL Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	95.1	100.0	1.7	2.9	-14.8	1.4	**6.1**	**3.4**	**3.8**
Private consumption	61.2	64.4	-	4.2	-17.5	-4.9	**6.1**	**2.8**	**3.2**
Public consumption	19.5	20.5	-	0.4	-1.4	-3.3	**1.2**	**-0.2**	**2.1**
Gross fixed capital formation	15.5	16.3	-	-5.2	-39.5	1.0	**18.9**	**9.2**	**10.1**
of which : equipment	4.5	4.8	-	-17.3	-50.0	19.6	**45.0**	**15.0**	**15.0**
Exports (goods and services)	64.9	68.3	-	11.4	-12.5	17.4	**12.2**	**6.3**	**6.5**
Imports (goods and services)	66.1	69.5	-	10.3	-28.3	17.3	**13.9**	**6.2**	**7.0**
GNI (GDP deflator)	93.1	98.0	-	3.6	-10.2	-2.0	**4.7**	**3.0**	**4.1**
Contribution to GDP growth : Domestic demand			-	1.3	-21.8	-3.9	**7.3**	**3.4**	**4.4**
Inventories			-	2.3	-5.8	5.6	**0.2**	**0.0**	**0.0**
Net exports			-	-0.7	12.8	-0.2	**-1.3**	**-0.1**	**-0.5**
Employment			-0.7	-0.7	-6.8	-5.1	**3.5**	**2.0**	**1.9**
Unemployment rate (a)			9.2	5.8	13.7	17.8	**15.1**	**13.3**	**11.6**
Compensation of employees/head			-	14.3	-9.9	-0.9	**3.0**	**3.0**	**4.5**
Unit labour costs whole economy			-	10.4	-1.4	-7.3	**0.5**	**1.7**	**2.6**
Real unit labour costs			-	0.6	2.4	-9.1	**-3.3**	**-1.3**	**-0.3**
Saving rate of households (b)			-	-3.0	7.1	7.9	**-**	**-**	**-**
GDP deflator			37.9	9.8	-3.7	2.0	**4.0**	**3.0**	**2.9**
Harmonised index of consumer prices			-	11.1	4.2	1.2	**4.0**	**2.7**	**2.8**
Terms of trade of goods			-	3.6	-5.9	1.4	**1.6**	**0.1**	**-0.2**
Merchandise trade balance (c)			-	-12.9	-3.2	-4.6	**-5.2**	**-5.2**	**-5.7**
Current-account balance (c)			-	-13.0	2.8	1.1	**-1.7**	**-1.9**	**-2.3**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-11.1	7.1	4.9	**2.1**	**2.2**	**1.7**
General government balance (c)			-	-3.3	-9.5	-7.0	**-5.0**	**-3.0**	**-3.4**
Cyclically-adjusted budget balance (c)			-	-5.5	-7.1	-4.9	**-4.2**	**-2.7**	**-3.5**
Structural budget balance (c)			-	-5.4	-7.5	-5.0	**-4.2**	**-2.9**	**-3.2**
General government gross debt (c)			-	15.5	29.4	38.0	**37.7**	**38.5**	**39.4**

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

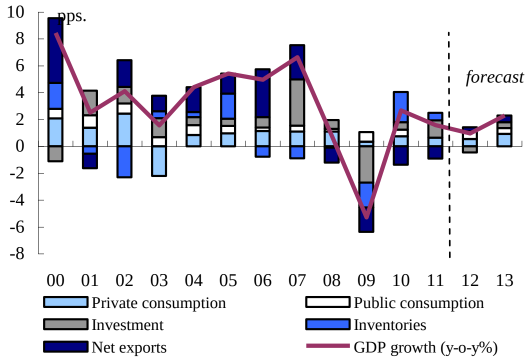
15. LUXEMBOURG

Uncertain times ahead for a large financial centre

An unfavourable international environment weighs on growth

Strong domestic demand boosted the Luxembourg economy in 2010. GDP growth of 2.7% was higher than in most other Member States, but remained far below the 4.7% recorded on average between 2000 and 2007. A large increase in government expenditure and changes in inventories were the main drivers of growth, while the external balance of goods and services contributed negatively. Exports of services (mainly financial services) are traditionally the main drivers of growth in Luxembourg, but these did not return to their dynamic pre-crisis growth path. Exports of services grew by 10% in value, but only by 1.3% in volume. Provisional figures for the first two quarters of 2011 show only subdued growth, with the quarter-on-quarter increase in GDP estimated at about 0.25% in both Q1 and Q2.

Graph II.15.1: **Luxembourg - GDP growth and contributions**



The financial sector has been the country's main growth engine in recent decades and now represents almost 30% of total value added. The nature of its activities and the international character of its ownership make it particularly sensitive to developments abroad. The continuing uncertainty on financial markets is affecting exports of financial services in 2011. Therefore, a contraction of exports of services cannot be discarded, also in view of the poor stock market performance of summer 2011. Activity indicators and consumer confidence are also on a sharp downward path. This suggests a contraction of the economy in the third and fourth quarter of 2011. GDP is expected to grow by an average 1.6% in 2011.

The unfavourable international environment should weigh further on the economy in the first half of 2012. As a consequence, growth expectations are moderate. GDP growth is projected at around 1% in 2012, with mainly private and government consumption contributing positively. From the second half of 2012 on, the international environment is expected to become more supportive again. In 2013, GDP growth will accelerate and is expected to reach some 2.3%. This is still below potential and well below the average rates recorded in the past, as no further expansion of the financial sector is expected. The main contributions in 2013 will come again from consumption and a revival of private investment, while the external balance will only contribute marginally.

Inflation will start to decline

Inflation has been stable at 3.3% y-o-y in September 2011 (HICP). Earlier changes in administered prices (water and health care) continue to have an upward effect on the index, while energy prices remain high compared to a year earlier. As was the case in the past, inflation is higher in Luxembourg than in France and Germany, but similar to the figure in Belgium. For 2012 a decline to 2.1% is foreseen as the effect of rising energy prices observed at the beginning of 2011 fades out.

Strong employment growth, but insufficient to reduce unemployment

Employment growth has been accelerating since the end of 2009 and has continued its dynamic path in the first half of 2011. For the whole of 2011, employment is projected to increase by 2.9%. Non-resident employment rises faster than national employment, as has been the case in the years preceding the crisis.

Unemployment had increased from around 4% in September 2007 to almost 5.5% in winter 2009, which is nevertheless still quite low in comparison with the rest of the EU. Between March 2009 and July 2010 it decreased steadily, before stabilising at around 4.5%. However, this decrease seems to be associated with a decline in the activity rate, pointing to a discouragement to seek a job. In recent months unemployment started to rise again despite the strong job creation. With a gloomier economic outlook for 2012, unemployment is projected to rise further to 4.8%. In 2013 (national) employment will increase again sufficiently to bring down the unemployment rate, although only marginally.

The automatic indexation of wages (2.5%), which was due in spring 2011, was postponed to 1 October 2011. The next automatic indexation is expected for spring 2012, unless an agreement with social partners is reached on a new postponement. Without such a postponement, wages are expected to grow by 4.5% on average in 2012. This will strongly push up unit labour costs, accelerating to a 5.3% increase in 2012. The lower inflation rates foreseen for 2012 and 2013 will somewhat slow the impact of the automatic indexation mechanism, so that wage growth will decelerate to 3.3% in 2013. Unit labour costs will increase by about the same rate in 2013.

The budget deficit increases in 2012 but remains low

According to recently released revised public finance data, the general government deficit in 2010 was only 1.1% of GDP instead of 1.7%, mainly thanks to upward revisions of revenue. In 2011, revenues were particularly buoyant over the first half of the year, with a large increase in income taxes paid by households and corporations and a boost in VAT receipts from e-commerce. A relapse is expected in the second half, as some positive factors are only temporary (like a catch-up in the backlog of corporate tax collection and delays in VAT-reimbursement) or heavily dependent on the economic climate. The budget balance in 2011 is expected to show a deficit of around 0.6% of GDP. With a gloomier economic outlook, the deficit is expected to deteriorate to around 1% of GDP in 2012, which is still one of the lowest in the EU. In 2013, under a no-policy-change assumption, the budget balance will slightly improve to a deficit of around 0.9%. The structural budget balance is expected to continue its deterioration over the forecast horizon, from a surplus of 0.5% in 2011 to a structural deficit of 0.2% in 2013.

Luxembourg gross debt will surpass the 20% of GDP level in 2012, after which it will stabilise. Debt projections also include the participation of the Luxembourg State in Dexia-BIL and the impact of guarantees to the EFSF, bilateral loans to Greece, and the participation in the capital of the ESM as planned on the cut-off date of the forecast.

Table II.15.1:

Main features of country forecast - LUXEMBOURG

	2010			Annual percentage change						
	mio EUR	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		40266.9	100.0	4.5	0.8	-5.3	2.7	**1.6**	**1.0**	**2.3**
Private consumption		13493.8	33.5	2.6	3.4	1.1	2.1	**1.9**	**1.6**	**2.7**
Public consumption		6695.7	16.6	4.1	1.4	4.8	2.9	**0.0**	**3.5**	**2.5**
Gross fixed capital formation		7407.3	18.4	5.2	3.2	-13.0	3.0	**7.1**	**-2.4**	**2.3**
of which : equipment		2228.7	5.5	4.4	5.8	-32.9	24.9	**18.3**	**-8.0**	**-4.0**
Exports (goods and services)		66435.8	165.0	7.6	4.0	-10.9	2.8	**2.8**	**-0.6**	**5.9**
Imports (goods and services)		53877.1	133.8	7.4	5.6	-12.0	4.6	**4.1**	**-0.9**	**6.8**
GNI (GDP deflator)		28633.6	71.1	3.3	-5.6	-15.6	8.7	**0.4**	**-1.3**	**1.1**
Contribution to GDP growth :	Domestic demand			2.9	2.0	-1.6	1.8	**1.9**	**0.7**	**1.8**
	Inventories			-0.1	-0.1	-1.8	2.3	**0.6**	**0.0**	**0.0**
	Net exports			1.7	-1.1	-1.8	-1.4	**-0.9**	**0.3**	**0.5**
Employment				3.4	4.7	1.0	1.8	**2.9**	**1.7**	**2.2**
Unemployment rate (a)				3.2	4.9	5.1	4.6	**4.5**	**4.8**	**4.7**
Compensation of employees/head				3.4	2.2	1.8	2.6	**2.6**	**4.5**	**3.4**
Unit labour costs whole economy				2.3	6.2	8.6	1.7	**3.9**	**5.3**	**3.3**
Real unit labour costs				-0.7	1.7	8.4	-3.0	**1.7**	**3.5**	**0.6**
Saving rate of households (b)				-	12.0	13.5	-	**-**	**-**	**-**
GDP deflator				3.0	4.4	0.1	4.9	**2.1**	**1.7**	**2.6**
Harmonised index of consumer prices				-	4.1	0.0	2.8	**3.6**	**2.1**	**2.5**
Terms of trade of goods				-0.2	0.5	0.7	2.3	**-1.9**	**0.5**	**0.0**
Merchandise trade balance (c)				-11.0	-10.7	-8.6	-9.5	**-10.7**	**-10.1**	**-9.7**
Current-account balance (c)				11.0	5.3	7.0	8.1	**5.3**	**3.4**	**2.9**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	4.7	6.3	7.5	**5.3**	**3.4**	**2.9**
General government balance (c)				2.3	3.0	-0.9	-1.1	**-0.6**	**-1.1**	**-0.9**
Cyclically-adjusted budget balance (c)				-	1.7	1.2	0.3	**0.5**	**0.0**	**-0.2**
Structural budget balance (c)				-	1.7	1.2	0.3	**0.5**	**0.0**	**-0.2**
General government gross debt (c)				6.4	13.7	14.8	19.1	**19.5**	**20.2**	**20.3**

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

16. HUNGARY
Bumpy ride ahead

Net exports again pull growth into positive territory

The Hungarian economy entered 2011 amidst a number of indicators pointing towards accelerating growth, supported by a slow rebalancing in the economy and a positive contribution from domestic demand. Developments over the course of the year have led to a significant revision of this picture.

The gloomier outlook stems from the deterioration of the external environment which played out through several channels, as well as an acute domestic perception of squeezed demand and policy uncertainties. The slowdown of global (and German) growth as well as the sovereign-debt crisis have implied a decline in external demand: the export sector showed a stellar performance in the first quarter (4.8% quarter-on-quarter), but unfavourable external developments prevented this pace of expansion from being sustained. Banks have also been facing higher funding costs and tighter liquidity, squeezing credit for the economy further. Finally, instalment payments on foreign currency–denominated (FX) loans surged as the forint depreciated, depressing consumption: around 65% of household loans from banks are denominated in FX, overwhelmingly in Swiss franc.

Domestically, uncertainties about further austerity measures to come (new measures were announced in September) have directly affected consumption expenditure and enterprises, and weighed on investment beyond an already sluggish demand and extraordinary sectoral taxes. Contrary to earlier official expectations, the large overall personal income tax cut appears not to have succeeded in lifting domestic demand, although it has cushioned the impact of negative developments. On the other hand, the payout of the real yield achieved on private pension fund investments repatriated into the state pension pillar was larger than estimated in the spring due to the favourable timing of the stock market, which may have delivered some boost to consumption (assuming a degree of myopic behaviour).

Overall, domestic demand will once again contribute negatively to growth in 2011, from an already weak base. According to preliminary annual data from the national accounts, the contraction of domestic demand in 2010 was more pronounced than previously thought: excluding inventories, it fell by 3.7% as opposed to 2.8% in previous notifications. The difference is largely attributable to a much steeper decline in gross fixed capital formation, although private and public consumption expenditure were also revised downwards. GDP is projected to grow by 1.4% in 2011, marginally higher than the revised figure of 1.3% growth in 2010.

Clouds on the horizon

In 2012 export capacity will increase as new plants are set to start production (Mercedes and Hankook). But uncertainty surrounding global economic activity will be an important factor in determining growth in the small, open Hungarian economy, although its impact in either direction is mediated by the high import content of exports.

Fiscal policy is also weighing on growth prospects. The additional fiscal measures planned in the context of the 2012 budget update (much of which is correcting a substantial fiscal loosening in 2010 and 2011) will further subdue economic activity through a variety of channels, including a broadly budget neutral tax reshuffle that again increases the burden on the poorest households, which also have the greatest propensity to consume. This comes on top of the significant cuts in social transfers, some of which (e.g. the reduction of unemployment benefits to at most three months) are already operational and others will come into effect in 2012.

The law adopted in a surprise move in September 2011 allowing the early repayment of FX mortgages at a discount to the prevailing exchange rates appears to intend to reduce the drag on household consumption. However, the households that are most likely to be able to participate in the scheme are the ones that have been relatively better able to weather the hike in FX loan repayments. Those who will be putting their savings towards repayment may then focus on rebuilding precautionary savings in the shorter term, even though their net asset position will not change dramatically. Households with longer than average FX loan maturities could face higher instalment payments for the duration of the new loans, since their maturity may need to be shorter in order to make the switch financially attractive. The full magnitude of the effect of the scheme will depend on the eventual participation rate, but its net impact on consumption among participants is ambiguous at best.

Furthermore, households in the greatest predicament are the where jobs have been lost or are at risk. The measure will have a negative impact on their consumption through: (i) further increasing the loan repayment burden in the case of households ineligible to participate in the scheme thanks to the depreciation of the forint; (ii) tightening credit to enterprises due to the resulting losses for the banking sector and hence endangering employment and, more generally, the investment climate.

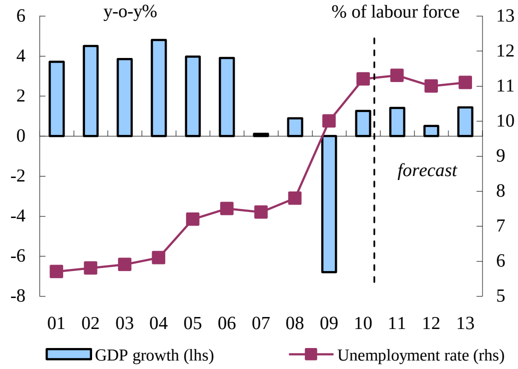
Expanding labour supply

In a positive development, labour supply has been expanding (which contributes to the unemployment rate projections). Increasing the very low activity rate has been one of Hungary's key structural bottlenecks to growth, and a series of policy decisions are now bearing fruit. Translating this into job creation, however, remains a challenge especially in the shorter term. The main source of new employment is set to remain the public works scheme. However, public works have so far not contributed to increasing participants' chances of finding subsequent employment in the private market.(64) The drastic cut in the duration of unemployment benefits further exacerbates the difficulties of finding another job in the available time frame before public works (which pay below the minimum wage) would become the main income source.

The plan to increase the minimum wage by 18% will further hit labour demand exactly in the segment where employment challenges are the most acute. This may also pose a serious threat to the viability of many small businesses that are already struggling and are facing serious liquidity constraints. The government intends to compensate the affected enterprises but the form this may take is unclear at the time of publication, and may not arrive in time to tide over the hardest-hit SMEs.

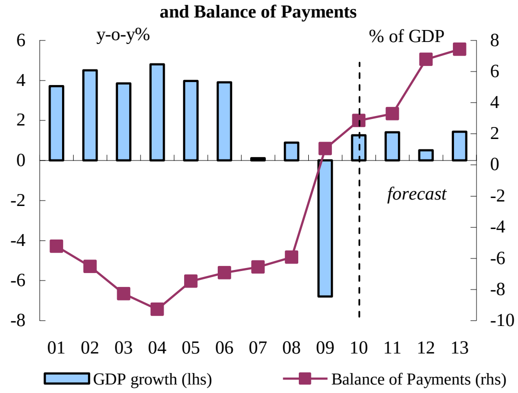
(64) Scharle et al (2011) A közcélú foglalkoztatás kibővülésének célzottsága, igénybevétele és hatása a tartós munkanélküliségre (Budapest Institute)

Graph II.16.1: **Hungary - GDP growth and unemployment rate**



The current account is expected to remain in surplus over the forecast horizon as weak domestic demand will keep import growth subdued. In addition, the capital account will receive a boost from swelling EU transfers as the current financial period comes to an end. Inflation will again increase in 2012, contrary to earlier expectations of a decreasing inflationary path, and thanks in large part to the VAT increase tabled in the budget.

Graph II.16.2: **Hungary - GDP growth and Balance of Payments**



Risks to GDP growth in 2012, currently projected at ½%, remain on the downside. The economy is projected to grow by just below 1.5% again in 2013, aided by the assumption of an improving external environment and the dissipation of associated uncertainties, with cautiously recovering domestic demand.

Turnaround from structural fiscal deterioration in 2011 to consolidation in 2012

Following a deficit of 4.2% of GDP in 2010, the general government balance is expected to turn to surplus thanks to one-off revenues linked to the elimination of the obligatory private pension scheme. The official estimate for this year's surplus has been revised up from 2% of GDP (contained in the April 2011 Convergence Programme update (CP)) to 3.9% of GDP in the autumn notification. The larger surplus is mainly due to: (i) higher one-off revenue stemming from the elimination of the obligatory private pension scheme (now amounting to 9¾% of GDP, i.e. ½% of GDP higher than previously assumed); (ii) an intention not to assume the debt of the public transport companies (1.4% of GDP) and not to buy out selected PPP projects (0.7% of GDP), contrary to earlier plans; and (iii) additional measures of 0.4% of GDP adopted in September 2011.[65] These factors are only partly counterbalanced by one-off expenditure of around 0.9% of GDP triggered by a decision of the European Court of Justice against Hungary on the rules of carrying forward excess VAT for enterprises. The forecast shows a somewhat lower surplus projection (3.6% of GDP), notably since it assumes a partial assumption of the debt of public transport companies (0.2% of GDP) based on recent information.

Regarding 2012, the draft budget submitted to Parliament on 30 September targets a deficit of 2.5% of GDP as set in the latest CP. In order to achieve this, the budget proposal contains several measures altogether amounting to a gross effect of more than 4% of GDP to reduce the underlying deficit of around 6% of GDP in 2011 and to compensate the earlier enacted personal income tax (PIT) cut of close to 1% of GDP. First, in compliance with the CP and the announcement of the Széll Kálmán Plan in March 2011, the draft budget reflects structural measures in several areas (such as labour market, pharmaceutical subsidies and retirement schemes). However, the expected gross saving of around 1½% of GDP is 0.3% of GDP lower than the original plans. Second, additional measures already announced in the CP of around 1¼% of GDP are also included, such as the nominal wage freeze and the limited increase of purchase of goods and services in the public sector as well as the cut of the employment tax credit. Third, the budget contains additional revenue increasing measures of around 2% of GDP (including a hike in indirect tax rates, the increase of the social security contribution rate and the full elimination of the employment tax credit) and further saving measures of ½% of GDP. Fourth, the deficit-decreasing measures are partly counterbalanced by deficit-increasing decisions of around 1% of GDP, such as the expansion of the public works programme, the tightening of the tax base of the PIT as well as the supplementary wage both in the public and the private sector. Finally, in order to counterbalance the negative budgetary effect of unforeseen adverse developments, the government, based on the revenue-increasing steps, created a substantial reserve of 0.7% of GDP.

In contrast to the deficit target set by the government, the Commission projects the 2012 general government deficit to reach 2.8% of GDP. Compared to the draft budget this higher deficit forecast reflects on the revenue side: (i) lower economic growth by 1 pp. as well as a more cautious assessment of revenue developments resulting in a higher deficit of around ½% of GDP; and on the expenditure side: (ii) higher outlays of ¼% of GDP related to state-owned transport enterprises[66] and maintenance of roads; as well as (iii) higher interest expenditure and higher contribution to the EU budget (altogether ¼% of GDP) due to exchange rate and yield assumptions. At the same time, these revenue shortfalls and expenditure slippages amounting altogether to 1% of GDP are assumed to be largely counterbalanced by the extraordinary reserves of 0.7% of GDP taking into account a recent proposal to amend the budget bill so that a cautious use of this reserve is ensured.[67]

Compared to the spring forecast of a deficit of 3.3% of GDP in 2012, the improvement of the budgetary forecast is explained by the recently announced consolidation measures, which more than offset the worse macroeconomic forecast.

In 2013, the budget deficit is forecast to deteriorate again, since the phasing out of the extraordinary levies on selected sectors (including the financial one) is not expected to be counterbalanced by the structural reform programme reaching its peak.

(65) The permanent wide-ranging cuts in budgetary appropriations with a gross deficit-improving impact of more than ¾% of GDP to counterbalance budgetary slippages was already incorporated in the latest CP.

(66) At the calculation of the additional financing need of the public transport companies, the partial assumption of the debt of these companies has already been taken into account.

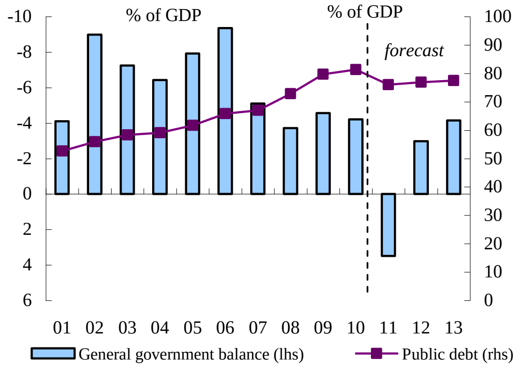
(67) According to an amending proposal submitted to the Budget Bill by the Audit and Budget Committee of Parliament, the extraordinary reserves cannot be used before September 20, 2012 and stipulates that the government may decide on the use only if in the Autumn 2012 Notification the expected EDP-deficit for 2012 does not exceed 2.5% of GDP.

This is based on the usual no-policy-change assumption and does not take into account potential measures that the government may take to achieve its deficit target of 2.2% of GDP. In particular, the decisions aiming at savings in local government and the public transport sector, as outlined in the CP, are not appropriately specified and planned revenue from the introduction of the electronic road toll is not backed by measures.

There are positive and negative risks around the scenario presented here. On the one hand, expenditure of the line ministries may be higher than budgeted if some of the detailed measures underpinning the savings are not fully implemented. Moreover, a further deterioration of the macroeconomic environment compared to what is already projected may result in additional revenue shortfalls. On the other hand, mainly in 2013, the full implementation of structural reform plans as set out in the CP could generate significant savings compared to the current forecast.

Following a structural deterioration of 1½% in 2010 and 1¼% in 2011, the structural balance is expected to improve by 2½% in 2012, in large part due to the measures described above. In 2013, a structural deterioration of ½% of GDP is expected.

Graph II.16.3: **Hungary - General government balance and public debt**



Given both the forecast deficit numbers and the exchange rate assumptions, gross public debt is expected to increase again to nearly 77% of GDP following a temporary drop in 2011 due to the takeover of the private pension assets.

Table II.16.1:

Main features of country forecast - HUNGARY

		2010			Annual percentage change					
	bn HUF	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		26747.7	100.0	2.6	0.9	-6.8	1.3	**1.4**	**0.5**	**1.4**
Private consumption		14246.6	53.3	-	-0.7	-6.2	-2.2	**0.2**	**-0.8**	**0.3**
Public consumption		5839.7	21.8	0.4	1.1	-0.6	-2.1	**-0.9**	**-0.7**	**0.9**
Gross fixed capital formation		4806.3	18.0	4.2	2.9	-11.0	-9.7	**-4.9**	**-1.0**	**1.8**
of which : equipment		1810.3	6.8	-	1.6	-16.7	-4.2	**0.0**	**1.0**	**4.5**
Exports (goods and services)		23148.8	86.5	12.7	5.7	-10.2	14.3	**9.1**	**7.2**	**7.9**
Imports (goods and services)		21409.8	80.0	12.7	5.5	-14.8	12.8	**7.1**	**6.4**	**7.9**
GNI (GDP deflator)		25446.1	95.1	-	1.5	-4.8	0.8	**0.1**	**0.1**	**1.5**
Contribution to GDP growth :	Domestic demand			2.4	0.5	-5.9	-3.7	**-1.0**	**-0.8**	**0.6**
	Inventories			0.2	0.2	-4.5	3.1	**0.2**	**0.0**	**0.0**
	Net exports			0.0	0.2	3.6	1.8	**2.2**	**1.3**	**0.8**
Employment				-	-1.3	-2.8	0.2	**0.5**	**1.1**	**0.0**
Unemployment rate (a)				-	7.8	10.0	11.2	**11.2**	**11.0**	**11.3**
Compensation of employees/f.t.e.				-	6.6	-1.3	-2.2	**3.6**	**3.2**	**3.8**
Unit labour costs whole economy				-	4.3	2.9	-3.2	**2.7**	**3.9**	**2.4**
Real unit labour costs				-	-0.9	-0.6	-6.1	**0.4**	**-0.2**	**-1.0**
Saving rate of households (b)				-	8.0	9.9	8.1	**-**	**-**	**-**
GDP deflator				12.5	5.3	3.6	3.1	**2.3**	**4.1**	**3.4**
Harmonised index of consumer prices				-	6.0	4.0	4.7	**4.0**	**4.5**	**4.1**
Terms of trade of goods				-	-1.1	1.1	-0.2	**-0.5**	**0.4**	**0.1**
Merchandise trade balance (c)				-4.3	-1.2	2.5	3.2	**4.6**	**6.2**	**6.7**
Current-account balance (c)				-	-6.9	-0.2	1.0	**1.7**	**3.2**	**3.8**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-5.9	1.0	2.8	**3.6**	**6.5**	**7.1**
General government balance (c)				-	-3.7	-4.6	-4.2	**3.6**	**-2.8**	**-3.7**
Cyclically-adjusted budget balance (c)				-	-4.9	-2.3	-2.4	**4.8**	**-1.8**	**-3.2**
Structural budget balance (c)				-	-4.5	-2.3	-3.8	**-5.0**	**-2.6**	**-3.2**
General government gross debt (c)				-	72.9	79.7	81.3	**75.9**	**76.5**	**76.7**

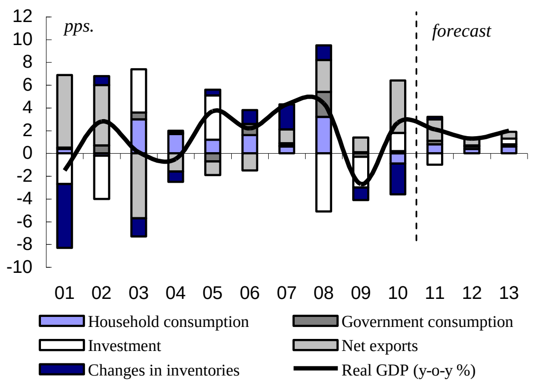
(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

17. MALTA

Global uncertainty hits domestic demand

After a relatively mild contraction in 2009, real GDP in Malta grew by 2.7% in 2010 on the back of a strong rebound in external demand as well as, to a smaller extent, an upturn in business investment. While the economy continued to grow at a relatively healthy pace in the first half of 2011, weak industrial production data and business confidence indicators point to a slowdown in the second half. In 2012, growth is expected to remain subdued before the economy starts gaining speed again in 2013.

Graph II.17.1: **Malta - Contributions to real GDP growth**



Loss of momentum after strong rebound in 2010

In the first half of 2011 economic growth continued to be driven by net exports as export growth outpaced the expansion in imports. External demand is expected to remain the main source of growth for 2011 as a whole. By contrast, domestic demand is set to contribute only marginally to economic growth in 2011. After contracting in 2010, private consumption is projected to grow in 2011, supported by positive labour market developments.

Gross fixed capital formation contracted in the first six months of 2011 given weak activity in the private sector. It is expected to remain strongly negative for the remainder of the year on account of declining capacity utilisation levels, global economic uncertainty and increased financing costs, as well as the base effect from a surge in transport investment in the second half of 2010.

Overall, Malta's real GDP is forecast to grow by 2.1% in 2011.

Domestic demand improves gradually in 2012-13, but remains subdued

The weakening of economic activity is set to continue into 2012, bringing real GDP growth down to 1.3%, before picking up to 2.0% in 2013.

Private consumption is projected to moderate in 2012, but remain positive supported by relatively strong wage growth. In 2013, it is forecast to accelerate, also boosted by more robust job creation.

Investment activity in the private sector is expected to remain subdued in 2012 on tight lending conditions by banks and a weak global outlook. As a result, the contribution from gross fixed capital formation to real GDP growth is set to be only marginal. While the improving global economic outlook in 2013 will impact positively on business confidence, investment activity is forecast to remain relatively moderate as excess supply and overpriced assets are expected to keep housing investment at low levels.

Net exports are projected to continue to add to real GDP growth in 2012-13, but less significantly so than in previous years. Subdued domestic demand, which is highly import-intensive, is forecast to weigh on import growth in 2012 and - to a lesser extent - in 2013. Notwithstanding the slowdown in activity in the euro area, the expansion in exports is projected to continue to outpace import growth, based on improving terms of trade, a relatively high share of trade with emerging markets and further market share gains for services exports.

The projected dynamics in net exports drive an improvement in the trade balance and, in spite of growing net outflows on the income account, also in the current account deficit, from over 7% of GDP on average in 2005-09 to around 2.7% of GDP in 2012-13.

Further gains in female participation and employment

After reaching 2.0% in 2010, employment growth is set to moderate over the forecast horizon, in line with the deceleration in economic growth. A sizeable share of the expansion in headcount employment is expected to be accounted for by women, also thanks to targeted policy action to attract them to the labour market. As a large share of the new jobs is likely to be part-time, average working hours are expected to decline over the forecast horizon.

While the increasing integration of women into the labour market entails further sizeable gains in the labour force over the forecast horizon, the projected pace of job creation is sufficiently strong to absorb them and produce a slight decrease in the unemployment rate.

After subdued developments in 2010, growth in compensation per employee is projected to rebound in 2011. Based on the cost-of-living-adjustment mechanism (COLA) and technical assumptions for public sector wages, compensation per head is forecast to speed up in 2012-13.

Headline inflation moderates while core inflation rises

HICP inflation is forecast to average 2.6% in 2011, up from 2.0% in 2010, mainly on the back of the foods and non-energy industrial goods components. Energy inflation is set to decelerate significantly, owing in part to a drop in oil prices in the second half of the year and a high base effect due to a hike in electricity tariffs in 2010 (coupled with the government's decision to keep them constant in 2011). Core inflation is projected to pick up to 1.8% from 1.0% in 2010.

HICP inflation is forecast to decelerate to an average of 2.2% in 2012-13 due to an expected moderation in oil and commodity prices on international markets. Nevertheless, energy inflation is projected to remain relatively high in 2012 as the decline in oil prices is offset by higher electricity rates. The biggest contribution to HICP inflation in 2012-13 is forecast to come from services, where prices are expected to accelerate over the forecast horizon, supported by robust wage growth. Core inflation is projected to slow down to 1.5% in 2012, due to moderation in the non-energy industrial goods component, before it accelerates back to 1.8% in 2013.

Risks tilted to the downside

Risks to this forecast appear to be tilted to the downside. The forecast assumes that financial markets will gradually stabilise in the course of 2012; should financial conditions deteriorate further, this could put additional upward pressure on interest rates and further tighten access to credit. Given the high share of loans with floating interest rates, higher rates could further increase credit risk, which already stands relatively high with a non-performing loan ratio of 7.3% for the domestically-oriented banks in the second quarter of 2011. In addition, high exposure to the construction sector (including real estate collateral on their books) leaves banks vulnerable to further adjustment in real estate prices. On the upside, a more resilient labour market could result in a less pronounced deceleration in private consumption in 2012.

Government deficit improves in 2011 but widens thereafter

In 2010 the general government deficit slightly narrowed to 3.6% of GDP, from 3.7% of GDP in 2009. Current primary expenditure rose by 3.6% as a result of moderate growth in compensation of employees and a more pronounced increase in intermediate consumption and social transfers. Gross fixed capital formation remained flat reflecting weak absorption of EU funds, the postponement of some projects and one-off sales of shipyards assets. In spite of some revenue-enhancing measures (including a tax amnesty), tax proceeds grew less than GDP as the rebound in economic activity was driven by relatively tax-poor components (mainly exports). Total current revenues grew by 2.8%.

The deficit is expected to narrow to 3% of GDP in 2011, when the primary balance is projected to be in surplus 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 with the 2010 budget. Nevertheless, current primary expenditure growth is expected to accelerate compared to 2010, to 4.0%. Compensation of employees is forecast to accelerate following a two-year period of containment, and social transfers are expected to keep increasing at a fast pace due to buoyant age-related entitlements. Capital expenditure is set to rebound after the stagnation recorded in 2010, helped also by an increased absorption of EU funds. On the revenue side, direct taxes are set to increase only slightly on the back of a deceleration in corporate profits' growth. Indirect taxes should benefit from the increase in excise duties and the projected modest rebound in private consumption, while social contributions are set to increase more moderately given the base effect from the 2010 tax amnesty. Total current revenues are projected to rise by 4.4%. The structural balance is expected to improve by ½ pp. of GDP compared to 2010.

The deficit projections for 2012-13 are based on the usual no-policy-change assumption, as the budget for 2012 had not been presented by the cut-off date for this forecast. The deficit is expected to widen to 3.5% of GDP in 2012 and 3.6% of GDP in 2013, with the primary balance turning negative again. The worsening of the budgetary position mainly reflects a deterioration in gross saving, again on a no-policy-change basis.

General government gross debt increased by 6.8 pps. of GDP between 2008 and 2010 to 69.0% of GDP, and is forecast to increase marginally to 69.6% of GDP in 2011. Based on the no-policy-change assumption, the debt ratio is expected to rise slightly further over the forecast horizon, reaching 71.5% of GDP in 2013, mainly reflecting the deterioration in the primary balance. Debt projections also include the impact of guarantees to the EFSF, bilateral loans to Greece and the participation in the capital of the ESM as planned at the cut-off date of this forecast.

The upcoming restructuring of Air Malta may give rise to additional government expenditure, thereby entailing upward risks for both the deficit and debt projections.

Graph II.17.2: **Malta - General government gross debt and deficit**

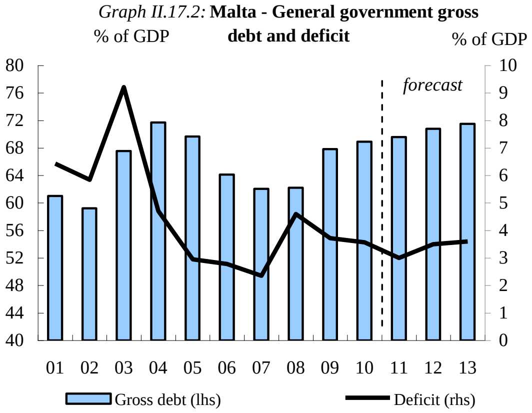


Table II.17.1:

Main features of country forecast - MALTA

	2010		Annual percentage change						
mio EUR	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	6163.7	100.0	3.4	4.4	-2.7	2.7	**2.1**	**1.3**	**2.0**
Private consumption	3804.6	61.7	-	4.9	0.2	-1.4	**1.2**	**0.6**	**1.0**
Public consumption	1293.5	21.0	-	12.1	-1.5	0.9	**1.4**	**1.3**	**1.1**
Gross fixed capital formation	1041.3	16.9	-	-23.5	-16.8	11.7	**-7.0**	**0.5**	**4.0**
of which : equipment	-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)	5435.4	88.2	-	2.6	-8.9	18.3	**4.5**	**3.9**	**5.2**
Imports (goods and services)	5224.7	84.8	-	-0.4	-10.1	12.9	**2.7**	**3.5**	**4.9**
GNI (GDP deflator)	5657.3	91.8	2.8	4.6	-7.4	3.0	**1.6**	**1.3**	**2.0**
Contribution to GDP growth :	Domestic demand		-	0.3	-2.8	0.9	**0.0**	**0.7**	**1.4**
	Inventories		-	1.3	-1.1	-2.7	**0.2**	**0.0**	**0.0**
	Net exports		-	2.8	1.3	4.6	**1.9**	**0.6**	**0.6**
Employment			1.1	2.6	-0.3	2.3	**1.0**	**0.8**	**1.4**
Unemployment rate (a)			6.4	6.0	6.9	6.9	**6.7**	**6.8**	**6.6**
Compensation of employees/head			5.0	4.5	2.7	-0.4	**2.0**	**2.4**	**2.3**
Unit labour costs whole economy			2.7	2.7	5.2	-0.8	**0.9**	**1.8**	**1.7**
Real unit labour costs			0.0	0.2	2.5	-3.6	**-1.5**	**-0.7**	**-1.0**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			2.7	2.6	2.6	2.9	**2.5**	**2.5**	**2.7**
Harmonised index of consumer prices			-	4.7	1.8	2.0	**2.6**	**2.2**	**2.3**
Terms of trade of goods			-	-9.7	-4.0	2.3	**1.3**	**0.6**	**0.1**
Merchandise trade balance (c)			-18.2	-21.0	-18.1	-16.0	**-15.1**	**-15.1**	**-15.2**
Current-account balance (c)			-	-5.1	-7.3	-4.0	**-3.1**	**-2.9**	**-2.6**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-4.6	-5.6	-2.2	**-1.7**	**-1.5**	**-1.2**
General government balance (c)			-	-4.6	-3.7	-3.6	**-3.0**	**-3.5**	**-3.6**
Cyclically-adjusted budget balance (c)			-	-5.0	-2.9	-3.3	**-3.0**	**-3.5**	**-3.8**
Structural budget balance (c)			-	-5.4	-3.4	-4.3	**-3.1**	**-3.5**	**-3.8**
General government gross debt (c)			-	62.2	67.8	69.0	**69.6**	**70.8**	**71.5**

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

18. THE NETHERLANDS

Moderate growth hinging on external demand

A broad-based recovery in the economy started towards the end of 2010...

In 2010 the Dutch economy recovered from its 2009 recession, recording positive GDP growth of 1.7%. The pick-up in economic activity was mainly driven by a strong rebound in world trade. On the other hand, domestic demand (excluding inventories) remained a drag on growth, although it did revert to positive territory in both the fourth quarter of 2010 and the first quarter of 2011, mainly as a result of a surge in investment. As a consequence, quarterly GDP growth rates showed a strong performance of 0.7% and 0.8% respectively.

The momentum of domestic demand was lost again in the second quarter of 2011, resulting in a growth slowdown to 0.2%. With the exception of inventories, all domestic demand categories contracted. Household consumption decreased for the second quarter in a row, in line with a fall in real disposable income and adverse wealth effects stemming from falling equity and house prices.

The decline in global growth lowered the contribution of external demand to GDP growth in the second quarter, which had been the main driver of the recovery since the second half of 2009.

...but future growth will rely on exports again

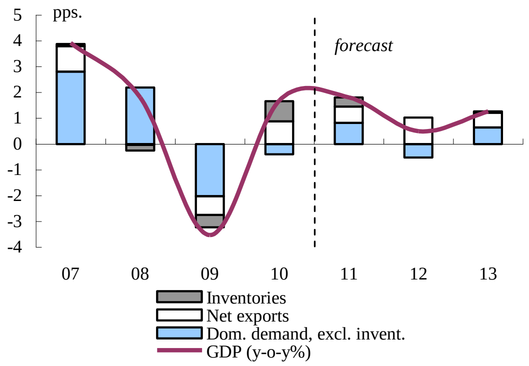
Growth in the last two quarters of 2011 is foreseen to remain subdued, owing to ongoing uncertainty related to the European sovereign-debt crisis. While consumption and investment are hit by confidence effects, exports are expected to slow down in view of worsening prospects for world trade. Overall, however, the external sector is still due to show a positive contribution to growth. Thanks to the relatively high carry-over from 2010 and the strong first quarter of 2011, annual GDP growth is projected to still amount to 1.8%.

Private investment is expected to suffer given low confidence levels and a slowdown in exports. Also, despite increases over the past quarters capacity utilisation rates remain at a low level, especially in the manufacturing sector, thereby not providing an incentive for capacity-increasing investments.

A progressive decline in consumer confidence since the start of 2011 culminated in a historically large drop in August and September and a further decline in October. This, together with the continued adjustment in the housing and stock markets, is foreseen to contribute to weak private consumption over the next quarters. Private consumption is expected to remain sluggish throughout the forecast period due to moderate real wage growth in combination with government consolidation measures. The latter mainly affect households, especially through a higher tax burden and sizeable cuts in social security transfers, notably health care allowances. Moreover, wealth effects have a relatively larger impact on consumption in the Netherlands compared to other EU Member States due to comparatively high levels of accumulated financial assets and leveraged housing wealth.

Dutch exports are set to suffer from worsened global trade prospects, which are also foreseen to affect its main trading partners. Exports of goods and services are projected to only grow moderately in 2012 and 2013. As imports are set to fall in line with domestic demand, net exports are expected to remain the major source of economic growth. Given the expected positive performance of the trade balance, the Dutch current-account surplus is expected to continue to show a significant surplus.

Graph II.18.1: **The Netherlands - GDP growth and contributions**



HICP inflation is expected to rise to 2.5% in 2011, mainly as a result of rising energy and food prices, continuing a rising trend since the second half of 2010. Owing to expected declines in commodity prices (notably oil) and depressed private and government consumption, HICP inflation is forecast to gradually decrease in 2012 and 2013 to respectively 1.9% and 1.3%, in spite of some upward pressure from government measures on administered prices.

The risks associated with the baseline scenario are predominantly on the downside. These are mainly associated with downward risks from the global economic environment. Risks are, however, not solely concentrated on the international side. Negative domestic developments, such as a sustained and more severe fall in house prices, could also hamper the recovery through adverse wealth effects affecting mainly private consumption and investment. Consumption could also be negatively affected if pensions were lowered due to problems in the pension funds, in view of continued financial market stress and the low interest rates.

Unemployment projected to rise slowly

The labour market is giving off mixed signals. The demand-led gradual improvement in the unemployment rate during the first half of 2011, exemplified by an increase in the number of job vacancies and temporary workers, has come to a halt. Month-on-month data for both July and August 2011 show a rise in unemployment. Over the forecast horizon, unemployment is expected to rise further, albeit at a slow pace, resulting in unemployment rates of 4.5% in 2011, 4.7% in 2012 and 4.8% in 2013.

Following a small decline in 2011 the labour force is assumed to grow at a mild pace in 2012 and 2013. The presence of the 'discouraged worker-effect' is diminishing, but is not expected to fully disappear in 2012. The projected slowdown of the economic recovery causes potential employees to refrain from entering the labour market in view of weak job prospects. In addition, demographic developments start to account for a small shrinking of the labour force, as population ageing starts to come into effect. These factors are, however, more than offset by a still growing participation rate, leading to an overall moderate increase in the labour force over the forecast period. The increasing participation is mainly related to the ongoing rise in the participation of women, although this effect is decreasing over time.

Employment prospects are forecast to remain subdued, showing a small decline in 2011 and 2012 and a limited rebound in 2013. The main negative contribution comes from the government, as a large part of the planned consolidation effort is concentrated in the reduction of the size of the public sector. Employment in the private sector is also expected to fall in 2012, as the past policy of labour hoarding will imply little need for additional personnel as the economy picks up. By contrast, a pronounced rise in employment in healthcare is projected over the forecast horizon.

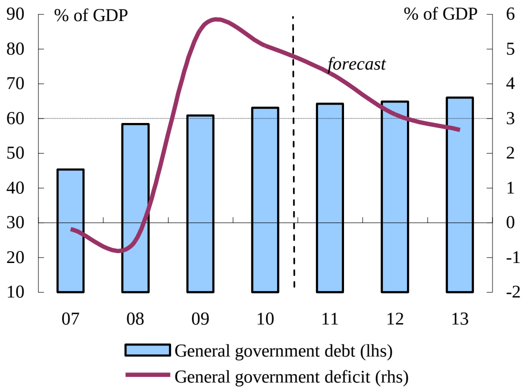
Following a stabilisation in 2011, nominal unit labour costs are expected to increase in 2012 and 2013 as the rising trend in inflation since mid-2010 puts upward pressure on wages in the private sector. Furthermore, employers' social contributions are expected to increase, exerting further upward pressure on nominal unit labour costs.

Sizeable consolidation leads to a considerable improvement of the general government balance

In 2010 the general government deficit improved to 5.1% from 5.6% in 2009, mainly as a result of a stronger-than-expected economic rebound from the crisis, which lead to higher revenues. For 2011 the general government deficit is expected to further improve to 4.3% of GDP as the government changed its expansionary fiscal stance of the preceding years to a restrictive one, reversing the stimulus package and introducing consolidation measures.

In 2012 the main budgetary cuts will be realised by reducing the number of civil servants and eliminating several government subsidies. These cuts are to be complemented by significant reductions in social security expenditure in the form of health and child care allowances. In total, the government is expected to cut expenditure by around EUR 5 billion (around 0.8% of GDP). At the same time, tax relief for companies of around EUR 2 billion (around 0.3% of GDP) should largely compensate for the loss in subsidies. On balance, despite the weak prospects for growth, the general government deficit is expected to improve to 3.1% of GDP in 2012. In 2013, continued consolidation is expected to lead to a further decrease in the general government deficit to 2.7% of GDP. In both years, falling interest payments mitigate the general government deficit outcome, due to the current historically low interest rates on Dutch government bonds. The structural balance is projected to improve over the forecast period, most significantly in 2012.

Graph II.18.2: **The Netherlands - Public finances**



Following the increase in 2010-11 by 1.3 pps., gross government debt is expected to rise further in 2012 and 2013, albeit at a slower pace. Debt projections include the impact of guarantees to the EFSF, bilateral loans to Greece, and the participation in the capital of the ESM as planned on the cut-off date of the forecast. In addition, the debt level will be affected by repayments by banks of the financial support given by the government (in some instances earlier than required). The government debt ratio is projected to increase from 64.2% of GDP in 2011 to 64.9% of GDP in 2012 and 66% of GDP in 2013.

Table II.18.1:

Main features of country forecast - THE NETHERLANDS

		2010		Annual percentage change						
		bn EUR Curr. prices	**% GDP**	**92-07**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
GDP		588.4	100.0	2.7	1.8	-3.5	1.7	**1.8**	**0.5**	**1.3**
Private consumption		267.0	45.4	2.1	1.3	-2.6	0.4	**-0.7**	**-0.4**	**0.2**
Public consumption		167.6	28.5	2.6	2.8	4.8	1.0	**0.1**	**-0.9**	**-0.6**
Gross fixed capital formation		107.2	18.2	3.1	4.5	-10.2	-4.4	**6.1**	**-0.3**	**3.9**
of which : equipment		36.9	6.3	4.4	7.1	-13.3	7.3	**8.8**	**-1.9**	**5.4**
Exports (goods and services)		459.2	78.0	6.3	2.0	-8.1	10.8	**5.5**	**3.2**	**4.3**
Imports (goods and services)		415.3	70.6	6.2	2.3	-8.0	10.6	**5.2**	**2.2**	**4.1**
GNI (GDP deflator)		583.4	99.2	2.8	-2.0	-3.9	3.4	**2.2**	**1.0**	**1.4**
Contribution to GDP growth :	Domestic demand			2.3	2.2	-2.0	-0.4	**0.8**	**-0.5**	**0.6**
	Inventories			0.0	-0.2	-0.5	0.8	**0.4**	**0.0**	**0.0**
	Net exports			0.4	0.0	-0.7	0.9	**0.6**	**1.0**	**0.6**
Employment				1.1	1.5	-1.1	-0.5	**-0.3**	**-0.1**	**0.0**
Unemployment rate (a)				4.7	3.1	3.7	4.5	**4.5**	**4.7**	**4.8**
Compensation of employees/f.t.e.				3.5	3.3	2.5	1.4	**2.6**	**2.3**	**2.1**
Unit labour costs whole economy				1.9	3.0	5.2	-0.8	**0.4**	**1.7**	**0.8**
Real unit labour costs				-0.4	0.8	5.6	-2.1	**-0.9**	**-0.3**	**-0.6**
Saving rate of households (b)				15.5	12.2	12.9	10.9	**11.3**	**12.0**	**12.5**
GDP deflator				2.4	2.1	-0.4	1.3	**1.4**	**2.0**	**1.4**
Harmonised index of consumer prices				2.2	2.2	1.0	0.9	**2.5**	**1.9**	**1.3**
Terms of trade of goods				0.4	-0.3	-1.0	-0.5	**-0.7**	**0.1**	**-0.4**
Merchandise trade balance (c)				6.0	7.3	6.2	6.9	**7.3**	**8.3**	**8.5**
Current-account balance (c)				5.8	4.7	2.9	5.1	**5.5**	**7.0**	**6.9**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				5.5	4.4	2.4	4.6	**5.0**	**6.4**	**6.5**
General government balance (c)				-1.4	0.5	-5.6	-5.1	**-4.3**	**-3.1**	**-2.7**
Cyclically-adjusted budget balance (c)				-1.5	-0.5	-3.9	-3.7	**-3.3**	**-1.8**	**-1.4**
Structural budget balance (c)				-	-0.5	-3.9	-3.5	**-3.2**	**-1.8**	**-1.4**
General government gross debt (c)				61.3	58.5	60.8	62.9	**64.2**	**64.9**	**66.0**

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

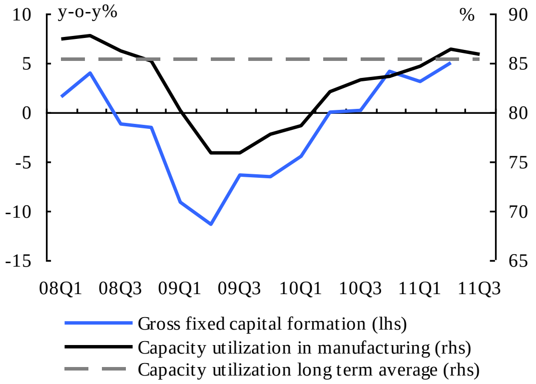
19. AUSTRIA

Recovery losing pace

Weakening exports and sagging confidence weighing on the recovery

The recovery of the Austrian economy has been gaining ground, albeit at a moderating pace. GDP growth averaged 3.8% y-o-y in the first half of 2011, reflecting a strong carry-over, and maintained a solid 0.7% on average for the first two quarters of 2011, with manufacturing being the main driving force. On the demand side, growth was supported by the ongoing increase in investment, including inventory build-up, while private consumption growth remained subdued and net exports weakened. Export growth remained robust at 6.4% in year-on-year terms in the second quarter. However, quarter-on-quarter growth has stalled and has been outstripped by import growth, possibly reflecting still-strong equipment imports.

Graph II.19.1: **Austria - Investment in equipment and capacity utilization**



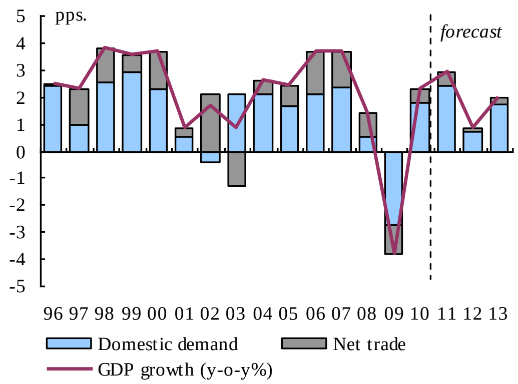
Whereas gross fixed capital formation for 2010 remained unchanged on the year before, it expanded by 4.1% y-o-y in the first half of 2011 due to a strong performance in the second half of last year and robust increases in the first two quarters of this year. Higher capacity utilisation in manufacturing, as well as hefty increases in real operating surpluses, have revived equipment investment in the past few quarters. In addition, the slump in construction seems to have ceased and may provide a boost to economic activity in the near future.

Having weathered the recession with a limited decline (-0.3% in 2009), private consumption recovered in 2010, posting 2.2% growth thanks to favourable labour market developments. Since the last quarter of 2010 some retrenchment has set in, despite sustained employment gains and positive real growth in the economy-wide wage bill. Real wages per worker have however been squeezed since mid-2010, not least due to rising inflation, and this is starting to weigh on consumer confidence. While holding up well throughout the second half of 2010 and in the first few months of 2011, consumer confidence has been subsiding in autumn.

Outlook for 2012 and beyond is fragile

The recovery of the Austrian economy is set to slow considerably. The first two quarters surprised on the upside. However, 2012 may well see a payback. Private consumption is likely to stay sluggish in the coming quarters amid growing uncertainty. The latest survey data suggest that the pace of the upward trend in industrial activity is likely to slow down. Expectations of import demand and GDP growth in relevant markets for next year have been revised downwards across the board.

Graph II.19.2: **Austria - GDP growth and contributions**



Financing conditions may tighten as banks are expected to focus on increasing capital buffers and further cleaning up balance sheets through write-downs. Credit extension, which has regained momentum since 2010 on the back of the economic recovery, is likely to tail off over the forecast horizon. The renewed tightening of credit standards coupled with lower credit demand from both companies and households due to the uncertainties related to the economic outlook in

Europe are expected to be the main causes of the subdued credit activity going forward.

Corporations and households seem to adopt a of "wait-and-see" attitude with regard to consumption and investment outlays, posing a risk of only marginal growth throughout most of 2012. A tangible revival of economic activity is not foreseen before the later quarters of 2012.

On the upside, Austria is well positioned to benefit from the ongoing buoyant demand in the emerging economies of Latin America and Asia. Firms have boosted their competitiveness by upgrading capacity and by retaining productivity gains. Productivity has continued to improve, while unit labour costs have declined even in nominal terms, providing corporations with a buffer to accommodate wage increase demands. Not least the nascent recovery in the construction sector, together with sound corporate and household balance sheets, bodes well for investment activity.

Unemployment to edge up again

In 2010 the moderate crisis-related employment loss was reversed as a result of steadily growing labour demand in services and a recovery in industrial employment. Strong employment growth – at 1½% y-o-y – has continued in 2011. In August 2011, the unemployment rate was 3.7%, close to its pre-crisis trough of 3.5% recorded in June 2008. However, these trends are unlikely to persist and the labour market outlook is highly uncertain. The outcome of first wage negotiations in October has pushed negotiated wages significantly upwards, limiting the scope for sustaining the pace of employment gains over the forecast horizon and putting upward pressure on unit labour costs going forward. However this wage signal may well be attenuated by the loss of momentum in economic activity and the possible rise in unemployment. The latter is projected to increase in 2012 to slightly above its level of 2010 as job creation stalls while both working age population and the participation rate edge up.

Externally induced easing of inflation

Having stayed below 2% for most of 2010, inflation has averaged 3.8% since April 2011 and reached 4% in September 2011, driven by higher motor and heating fuel prices, as well as rising food prices. Core inflation, defined as HICP excluding energy and unprocessed food, has not remained unaffected by these surges, which seem to have spilled over into the price of services, where the annual rate of change accelerated from 1.2% in August 2010 to a peak of 3.9% in August 2011. These effects are projected to disappear gradually, leading to a moderation of inflation by 2012. Wage dynamics should remain contained over the forecast horizon as the pace of economic expansion decelerates, although the transmission of negotiated wages into the effective wage level may exert upward pressure on service prices.

Fiscal consolidation stalls as growth loses momentum

The general government deficit rose from 4.1% in 2009 to 4.4% in 2010. The increase was largely due to the statistical revision of March 2011 made to Austrian public finance figures for the period 1995-2010.[68] Additional discretionary measures came into force in 2010 (namely parts of the 2009 tax reform such as relief for families with children and tax cuts for the self-employed), but these were offset to a large extent by higher-than-expected tax receipts.

Fiscal consolidation began in 2011, facilitated by the favourable economic developments, and is projected to result in a narrowing of the deficit to 3.4% of GDP this year. The budget law for 2011 contained a package of measures (amounting to around ¾% of GDP) aimed at bringing Austrian public finances back onto a sustainable path. Almost half of the consolidation effort is taking 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 incurred by the Austrian authorities of stabilising the financial sector. 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

(68) As a result of discussions between the Austrian authorities and Eurostat on the implementation of rules contained in the "Manual on Government Deficit and Debt", in March 2011, Austrian public finance figures were revised from 1995 onwards. While the changes concerning the period up to 2006 were less significant, those for the years 2007-10 raised the general government deficit by between 0.4 and 1 pp. 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.

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 the latter measures 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 phased out. However, the consolidation effort will be partly offset by additional spending on long-term care, education, R&D and energy-saving renovation of buildings.

The general government deficit is projected to edge down to 3.1% of GDP in 2012 as weaker economic activity to some extent offsets the additional impact of the 2011 consolidation measures. No significant new consolidation plans are included in the federal government's draft budget for 2012 which was presented to the Parliament on 19 October. For 2013, assuming no change in policy a further marginal correction of the deficit (to just below 3% of GDP) is expected on the back of accelerating GDP growth.

It should be also noted that developments in the structural budget deficits over the forecast period are affected by two one-off measures, namely by the assumption of a part of the liabilities of the "bad bank" KA Finanz in 2010 (equivalent of 0.3% of GDP) and cancellation of government participation in Hypo Alpe Adria bank in 2011 (0.2% of GDP).

Due to statistical revisions for the period from 1999 onwards, gross government debt reached almost 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 steadily, from 72.2% of GDP in 2011 to almost 74% of GDP in 2013. Debt projections also include the impact of guarantees to the EFSF and the participation in the capital of the ESM as planned on the cut-off date of the forecast.

Table II.19.1:

Main features of country forecast - AUSTRIA

	2010		Annual percentage change						
	bn EUR Curr. prices	**% GDP**	**92-07**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
GDP	286.2	100.0	2.4	1.4	-3.8	2.3	**2.9**	**0.9**	**1.9**
Private consumption	156.1	54.5	1.7	0.8	-0.3	2.2	**0.6**	**1.0**	**1.4**
Public consumption	55.4	19.3	2.0	4.4	0.2	-0.2	**1.0**	**1.0**	**1.2**
Gross fixed capital formation	58.6	20.5	1.6	0.7	-8.3	0.1	**4.7**	**0.7**	**3.0**
of which : equipment	22.2	7.8	1.5	-0.7	-9.7	4.3	**8.5**	**0.9**	**4.7**
Exports (goods and services)	154.5	54.0	6.3	1.4	-14.3	8.3	**6.8**	**3.8**	**6.4**
Imports (goods and services)	142.1	49.7	5.2	0.0	-13.8	8.0	**6.4**	**3.7**	**6.4**
GNI (GDP deflator)	285.6	99.8	2.4	2.4	-4.5	3.1	**2.9**	**0.9**	**1.9**
Contribution to GDP growth : Domestic demand			1.7	1.4	-1.9	1.2	**1.5**	**0.9**	**1.6**
Inventories			0.1	-0.6	-0.9	0.7	**0.9**	**-0.1**	**0.1**
Net exports			0.6	0.8	-1.1	0.5	**0.5**	**0.2**	**0.2**
Employment			0.2	1.8	-1.3	0.6	**1.4**	**0.2**	**0.8**
Unemployment rate (a)			4.2	3.8	4.8	4.4	**4.2**	**4.5**	**4.2**
Compensation of employees/f.t.e.			3.1	3.1	2.2	1.4	**2.8**	**1.9**	**1.8**
Unit labour costs whole economy			0.9	3.6	4.9	-0.3	**1.2**	**1.2**	**0.7**
Real unit labour costs			-0.7	1.8	3.8	-2.0	**-0.9**	**-0.9**	**-1.2**
Saving rate of households (b)			-	16.3	15.7	13.5	**12.5**	**12.4**	**12.4**
GDP deflator			1.6	1.8	1.0	1.8	**2.2**	**2.1**	**2.0**
Harmonised index of consumer prices			1.9	3.2	0.4	1.7	**3.4**	**2.2**	**2.1**
Terms of trade of goods			-0.1	-2.0	0.7	-2.0	**-2.3**	**-0.1**	**-0.1**
Merchandise trade balance (c)			-2.0	-0.3	-0.8	-1.1	**-1.6**	**-1.9**	**-2.1**
Current-account balance (c)			-0.2	4.9	3.0	3.2	**2.7**	**2.8**	**2.9**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-0.3	4.8	3.0	3.3	**2.5**	**2.8**	**2.9**
General government balance (c)			-2.5	-0.9	-4.1	-4.4	**-3.4**	**-3.1**	**-2.9**
Cyclically-adjusted budget balance (c)			-2.5	-1.9	-2.8	-3.5	**-3.3**	**-2.7**	**-2.8**
Structural budget balance (c)			-	-1.9	-2.8	-3.2	**-3.1**	**-2.7**	**-2.8**
General government gross debt (c)			64.3	63.8	69.5	71.8	**72.2**	**73.3**	**73.7**

(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

Progressing despite adverse global economic conditions

The economic rebound is losing steam

After a rebound in 2010 driven by a revival of international trade, inflows of EU funds and an improving labour market situation, economic growth strengthened further to 4.4% y-o-y in the first half of 2011. Activity was driven by domestic demand, in particular re-stocking of inventories, accelerating private investment on the back of soaring profitability as well as improved access to credit and, finally, rising private consumption underpinned by positive labour market prospects.

In the second half of 2011, however, the Polish economy is expected to feel the repercussions of the global slowdown. In particular, weaker external demand is set to hamper export growth. In addition, turbulences in financial markets have begun to weigh on consumer and producer confidence, ultimately limiting private investment expenditure, employment growth and the expansion of private consumption. These developments are expected to result in real GDP growth slowing to 3.6% y-o-y in the second half of the year, leading to annual growth of 4% in 2011.

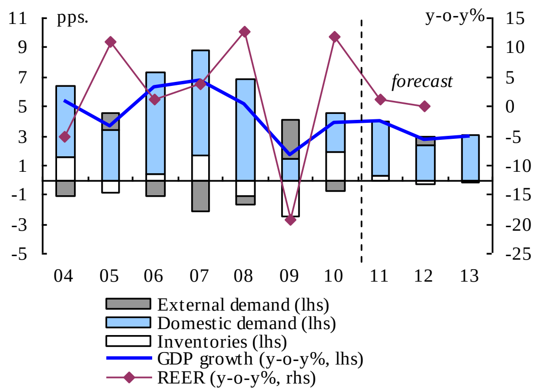
Weakening confidence and falling external demand hamper growth

The fallout from the global slowdown is expected to shape the prospects of the Polish economy over the forecast period. The economic uncertainty is likely to affect economic activity in 2012 and a marginal rebound is anticipated only in 2013. Real GDP is therefore projected to increase by 2.5% in 2012 and 2.8% in 2013. In 2012 both domestic and external demand are likely to contribute to growth, with favourable labour market conditions, inflows of EU funds and a depreciating currency being the main driving forces. In 2013 private investment and private consumption are expected to inch up against the background of a reviving global environment.

Public investment is set to accelerate further, at least until the summer of 2012, as several infrastructure projects are expected to be finalised before the Euro 2012 football championship. As the end of the EU financial perspective for 2007-13 is set to reduce the inflow of EU funds, this might however substantially curb public investment growth towards the end of 2012 and turn it negative in 2013. Private gross fixed capital formation is forecast to slow in 2012 after a temporary rebound in 2011. In particular, the corporate sector is set to delay investments as a result of uncertain demand prospects, weakened global confidence and hampered access to credit. However, the expected improvement in external demand in 2013 is likely to revive private investment as large and medium-sized companies have sufficient cash at their disposal and credit supply is set to accelerate.

Real disposable income and consumption will benefit from further real wage growth, higher than previously indexation of pensions, increased consumer spending during the Euro 2012 championship and sluggish but positive employment growth in 2012. Consumer confidence, which is expected to deteriorate further, might somewhat counterbalance these positive developments and result in increased household savings. Improving labour market conditions amid rebounding global demand and confidence are set to result in an accelerating private consumption towards the end of the forecast horizon.

Graph II.20.1: **Poland - GDP growth and contributions**



The impact of external trade on growth is likely to be positive in 2012 and broadly neutral thereafter. Decelerating external demand is set to hamper exports, though the depreciating currency will limit the negative effects. Moreover, the weakening currency will benefit domestic producers at the expense of importers, leading to lower import growth in 2012. In 2013 accelerating domestic demand is expected to stimulate imports, outweighing the effects of rebounding export growth.

This scenario is subject to broadly balanced risks. On the upside, a stronger-than-expected depreciation would further boost exports and enhance import substitution. On the downside, stronger deleveraging from emerging Europe could adversely affect credit markets for private and public borrowers, leading to lower investment and consumption.

Current-account deficit stabilises at a relatively high level

The current-account deficit deteriorated to 4.6% of GDP in 2010, following a sharp increase in imports and a correction of the sizeable errors and omission item of the balance of payments statistics. It is expected to reach 5% of GDP in 2011, and to thereafter improve temporarily to 4.3% of GDP in 2012 as a result of a depreciating currency and a moderate increase in current transfers, before reaching 4.8% in 2013. The rise in the deficit reflects a rebound in private investment fuelling demand for imports and higher income transfers linked to increased holdings of sovereign debt by foreigners.

Financial system is fundamentally stable but highly dependent on foreign financing

Poland's banking sector has substantially improved its liquidity and capital buffers since 2008 as profitability increased over the course of 2011. The overall share of non-performing loans is relatively stable at 8.5% of total loans, though loan quality varies significantly across segments. The proportion of impaired loans is highest in the consumer credit segment (18%), which could threaten the increase in private consumption going forward. Moreover, banks' reliance on foreign funding for liquidity provision and on foreign exchange swap markets for access to foreign currency might result in a credit squeeze if risk appetite wanes further.

Inflation decreases temporarily

The rate of HICP inflation is forecast to rise from 2.6% in 2010 to 3.7% in 2011 on the back of high fuel and food prices, an increase in indirect taxes and strong domestic demand in the first half of 2011. However, it is expected to moderate again in 2012 to 2.7%, reflecting lower commodity prices and weaker domestic demand. The effects of the depreciating currency and growing wage pressure will be felt towards the end of 2012 and result in an inflation rate 2.9% at the end of the forecast horizon. Increased economic activity and improved labour market conditions led to a gradual acceleration of nominal unit labour costs in 2010-11. Looking ahead, the gradual slowdown and stalling employment growth are likely to delay somewhat the expected wage acceleration. However, an emerging labour shortage is likely to fuel wage growth in 2013, affecting unit labour costs and adding to core inflation.

Labour market revival halts temporarily

Employment is expected to grow by 1% in 2011, leading to a moderate decrease in the unemployment rate to 9.3%. However, deteriorating external demand and falling confidence are forecast to freeze employment growth, especially in manufacturing, in the short term. It is set to rebound moderately in 2013 on the back of an improving global outlook, leading to a fall in the unemployment rate to 8.6% at the end of the forecast horizon.

Fiscal consolidation is losing momentum

After a continuous deterioration from 1.9% of GDP in 2007 to 7.9% of GDP in 2010 in the wake of the financial and economic crisis, owing in part to a sizeable stimulus package, the general government deficit is projected to have started declining in 2011 thanks to a sharp (but temporary) economic rebound in the first half of the year and an ambitious consolidation plan implemented in 2011.

In 2011 the headline deficit is expected to fall to 5.6% of GDP, driven by a significant increase in the revenue ratio (from 37.5% of GDP in 2010 to 39.6% of GDP in 2011) and a slight decline in the expenditure ratio (from 45.4% of GDP in 2010 to 45.2% of GDP in 2011). On the revenue side, a number of supportive developments are notable: a change in the pension system that retains part of the contribution in the public first pillar, an increase in VAT rates (by 1 pp.) and in excise duty on tobacco (by 4 pps.), the abolition of VAT (on company cars and fuel) and excise duty (on bio-fuels) exemptions, and a freeze in Personal Income Tax (PIT) thresholds. These are compounded by the impact of faster GDP growth and an improvement in Corporate Income Tax

(CIT) annual settlements, following a period of sharp economic slowdown and exceptionally low revenues. Growth in government spending has been constrained by the expenditure rule limiting increases in all newly enacted and existing discretionary expenditure items to 1 pp. over the rate of inflation, a freeze of the wage fund of public sector employees (except for teachers) and additional minor cuts in social spending.

In 2012, the lack of significant new reforms (and removal from the forecast of the effects of the deficit rule for local government entities due to its postponement), as well as the effect of the main austerity measures implemented in 2011 and remaining in force in 2012 (expenditure rule, freeze in the wage fund, higher VAT rate), are expected to be partially offset by a significantly slower GDP growth. The headline deficit is expected to decline to 4.0% of GDP, owing in part to a limited increase in the revenue ratio (from 39.6% of GDP to 40.8% of GDP), slower than in 2011 because of a stagnating labour market and diminishing responsiveness of tax revenues to the changes in tax base. A continuing slowdown in the expenditure ratio (from 45.2% to 44.8% of GDP), driven mainly by a significant deceleration in public investment spending, further drives the falling deficit.

The headline deficit is expected to keep decreasing in 2013, reaching 3.1% of GDP, on the back of rebounding economic growth and persistently low public investment expenditure, alongside a slowdown in inflows of structural funds.

Given the structural character of most implemented reforms and a negative but relatively stable output gap, the structural deficit is set to follow the evolution of the headline deficit, falling from 7.6% of GDP in 2010 to 2.5% in 2013.

Despite a significant reduction in the headline deficit and implementation of the liquidity management reform obliging some general government entities to deposit liquid funds in a centralised account, general government debt is expected to increase from 54.9% of GDP in 2010 to 56.7% of GDP in 2011. This comes not least as a result of a significant depreciation of the Polish zloty and consequently an increase in the value the debt denominated in foreign currency. The growing debt trend is forecast to slow in 2012-13, due to the return of the exchange rate to a level more in line with the fundamentals of the economy and a further decline in the general government deficit. The projected debt figures are, however, subject to large uncertainty due to high exchange-rate volatility affecting the debt valuation.

Table II.20.1:

Main features of country forecast - POLAND

		2010			Annual percentage change					
		bn PLN Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		1415.4	100.0	4.6	5.1	1.6	3.9	**4.0**	**2.5**	**2.8**
Private consumption		868.6	61.4	4.3	5.7	2.0	3.2	**3.4**	**2.6**	**2.9**
Public consumption		267.3	18.9	3.3	7.4	2.0	4.4	**1.3**	**1.2**	**2.3**
Gross fixed capital formation		281.2	19.9	7.5	9.6	-1.2	-0.2	**7.0**	**1.7**	**1.8**
of which : equipment		93.6	6.6	-	13.0	-10.8	-5.1	**3.5**	**1.1**	**8.7**
Exports (goods and services)		598.4	42.3	10.9	7.1	-6.8	12.1	**7.3**	**5.1**	**5.6**
Imports (goods and services)		615.5	43.5	11.7	8.0	-12.4	13.9	**7.0**	**3.5**	**5.1**
GNI (GDP deflator)		1364.3	96.4	4.6	6.8	0.1	4.1	**3.9**	**2.3**	**2.6**
Contribution to GDP growth :	Domestic demand			4.8	6.9	1.3	2.7	**3.7**	**2.2**	**2.6**
	Inventories			0.2	-1.1	-2.5	1.9	**0.3**	**-0.3**	**0.0**
	Net exports			-0.4	-0.6	2.7	-0.7	**0.0**	**0.6**	**0.2**
Employment				-	3.9	0.4	0.5	**1.0**	**0.2**	**0.4**
Unemployment rate (a)				14.7	7.1	8.2	9.6	**9.3**	**9.2**	**8.6**
Compensation of employees/head				16.1	8.9	3.5	5.7	**5.5**	**4.8**	**6.6**
Unit labour costs whole economy				-	7.5	2.2	2.2	**2.4**	**2.4**	**4.1**
Real unit labour costs				-	4.3	-1.4	0.8	**-0.9**	**0.4**	**2.1**
Saving rate of households (b)				-	3.7	9.9	9.4	**7.5**	**7.2**	**7.5**
GDP deflator				12.4	3.1	3.7	1.4	**3.4**	**2.0**	**2.0**
Harmonised index of consumer prices				-	4.2	4.0	2.7	**3.7**	**2.7**	**2.9**
Terms of trade of goods				0.3	-2.1	4.4	-1.4	**-0.5**	**-0.2**	**-1.4**
Merchandise trade balance (c)				-3.0	-4.9	-1.0	-1.8	**-1.8**	**-1.3**	**-1.6**
Current-account balance (c)				-2.9	-6.6	-3.9	-4.6	**-5.0**	**-4.3**	**-4.8**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-2.2	-5.4	-2.2	-2.8	**-2.2**	**-1.4**	**-2.3**
General government balance (c)				-	-3.7	-7.3	-7.8	**-5.6**	**-4.0**	**-3.1**
Cyclically-adjusted budget balance (c)				-	-4.6	-7.1	-7.6	**-5.5**	**-3.6**	**-2.5**
Structural budget balance (c)				-	-4.6	-7.4	-7.6	**-5.5**	**-3.6**	**-2.5**
General government gross debt (c)				-	47.1	50.9	54.9	**56.7**	**57.1**	**57.5**

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

21. PORTUGAL

Strong fiscal consolidation efforts in a challenging environment

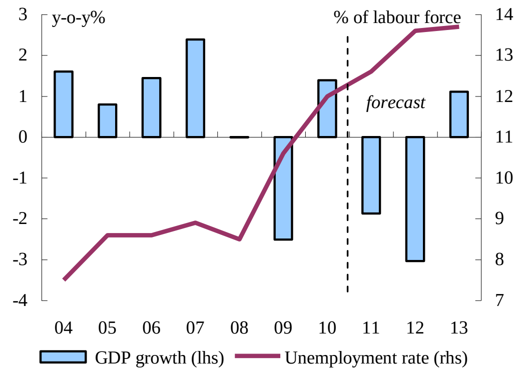
Deteriorating economic sentiment weighing on domestic demand[69]

The rebalancing of the economy away from its over-reliance on domestic demand is proceeding against the background of the economic adjustment programme. Business and consumer confidence indicators have been on a downward trend since the beginning of 2011, with some even reaching multi-annual lows in September. Domestic demand recorded a strong contraction in the first quarter of 2011, which was reflected in all major expenditure components. However, its impact on GDP was cushioned by a concomitant decline in imports. Domestic demand showed some resilience in the second quarter of 2011, helped by an unexpected but probably short-lived stabilisation in the labour market. As a consequence, private consumption expenditure declined by less than expected in the spring forecast. In addition, healthy export growth lifted GDP in the second quarter. In volume terms GDP remained flat in the second quarter, following two consecutive quarter-on-quarter declines in Q4-2010 and Q1-2011.

Favourable developments in the second quarter unlikely to persist

Headwinds buffeting the Portuguese economy have lately become stronger. The weaker growth outlook in the rest of the world is likely to harm foreign demand for Portuguese exports and the fall in global sentiment indicators is having spill-over effects on the Portuguese economy. Domestic economic developments will be influenced by accelerated fiscal consolidation efforts. Real GDP is projected to decline by a cumulated 5% this year and next, before recovering modestly in 2013. Credit supply to non-financial companies is likely to be constrained, in particular in 2012, as a consequence of accelerated deleveraging efforts in the banking sector, with possible adverse effects on business investment. However, the demand of non-financial corporations for bank credit should be equally subdued as the expected strong shrinking of domestic consumption is set to act as a drag on investment activity for the remainder of 2011 and in 2012. Fixed investment is thus projected to decline by a cumulative 20% in 2011-12 before a modest recovery of capital formation takes hold in 2013 due to the projected stabilisation of domestic consumption and strong export growth. Private consumption developments will be affected by two countervailing forces: ongoing debt reduction efforts by private households, but also consumption smoothing amid a sharp drop in real disposable income due to accelerated fiscal consolidation. The household saving rate is expected to drop by 0.4 pp. to 9.4% of disposable income in this year and to increase slightly in 2012-13. Real private consumption is forecast to decline by 4¼% this year and by 6% in 2012 before stabilising in 2013. As a result of intensified fiscal consolidation, government consumption is set to shrink in volume terms by 3% this year and by 6¼% and 4%, respectively, in 2012 and 2013. This would add up to a cumulated decline in domestic demand of 13% between 2010 and 2013.

Graph II.21.1: **Portugal - GDP growth and unemployment**



Export activity is predicted to slow down in the short term, following the recent significant deceleration of external demand, which is projected to last until mid-2012. However, due to strong export dynamics in the second quarter, export volumes should still increase by 6½% in this year before slowing down in 2012. In 2013 an acceleration of exports is expected in line with stronger foreign demand. The weakness of domestic demand is expected to affect goods with typically high import content, such as consumer durables and investment goods. Import volumes

[69] Note: This text and the forecast were finalised in late October, ahead of the second quarterly review of the Economic Adjustment Programme. It has not been updated to reflect the findings of that review.

are therefore anticipated to contract by a cumulated 10% in this year and next year, and to increase slightly by 1% in 2013. As a result, the hitherto high trade deficit is foreseen to turn into a small surplus in 2013. On the other hand, rising interest rates and a still-high level of external indebtedness should further widen the deficit in the primary income balance. The current-account deficit is thus is projected to narrow at a slower pace than the trade deficit and to reach 4% of GDP in 2013.

Price pressures remain subdued

Headline inflation is evolving as predicted in the spring forecast, with price developments being driven by high energy prices and the effects of VAT hikes. HICP decelerated during the summer but soared to 3.5% in September, largely due to an acceleration of goods prices. When measured at constant taxes, HICP inflation has been below the euro-area average since December 2007. Prices are anticipated to accelerate further in the final quarter of this year and in 2012 due to consecutive VAT rate changes on 1 October 2011 and 1 January 2012. Annual HICP inflation is forecast to average 3½% in 2011 and 3% in 2012, but to decelerate markedly thereafter amid continued mark-up compression and downward wage pressure in the context of relatively weak domestic demand. The recovery of the labour market in the second quarter is not expected to continue over the forecast period. Unemployment is set to increase into 2013.

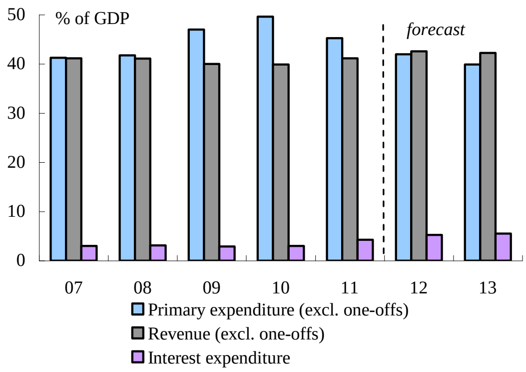
Risks to the economic outlook are tilted to the downside

Downside risks to the forecast prevail over the short term. In particular, accelerated deleveraging in the banking sector through lending restraint rather than raising capital would be detrimental to the prospective recovery in business investment, as would be a further worsening of the global economic outlook. On the positive side, an earlier recovery of the world economy could lift export volumes in 2012. Recently implemented reforms on labour and product markets could unlock economic growth earlier than expected.

Tight fiscal consolidation

Medium-term prospects are affected by the plans to sizeably reduce the government deficit and put the public debt ratio on a downward path. Under the ongoing Economic Adjustment Programme, government targets are for a deficit of 5.9% of GDP in 2011, 4.5% in 2012 and 3% of GDP in 2013. Taking into account the combined effect of the planned consolidation measures and the subdued GDP path over the period 2011-13, the reduction of the government deficit to 3% of GDP in 2013 from 9.8% of GDP in 2010 will largely be the result of a falling expenditure-to-GDP ratio, with an additional contribution of a slight rise in the revenue ratio. The improvement in the structural balance over the forecast period will amount to close to 8 pps. of GDP.

Graph II.21.2: **Portugal - Government revenue and expenditure**



A large fiscal consolidation effort has been implemented in 2011, encompassing a wide range of structural measures in various areas of the revenue and expenditure sides of the budget. On the expenditure side, these 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 essentially all other social outlays. Measures have also aimed at reining in spending, in particular in the health sector, state-owned enterprises (SOEs) and public investment. Consolidation efforts on the revenue side consist mainly of a 2 pps. increase in the standard VAT rate in January 2011. In addition, revenue inflows benefit from the carry-over effect of a number of tax hikes in mid-2010. Increases in non-tax revenues through higher prices, fees for services and through assets and concessions sales were also planned, the latter having only a temporary effect on the budget.

Nonetheless, the achievement of the government deficit target for 2011 would be at risk in the absence of further corrective measures. This is mainly due to expenditure overruns and shortfalls of non-tax revenue, also because some consolidation measures are not yielding the expected results. In addition, deficit-increasing events are hampering fiscal prospects for 2011, including notably the assumption of debts of about 0.3% of GDP from a financially-troubled government enterprise and a failed public-private partnership, both in the remit of the Madeira regional government. Additional costs related to the sale of the troubled bank BPN will add another 0.2% of GDP to the 2011 government deficit.

Against this backdrop, additional measures have been taken to counteract the emerging budgetary slippage. In particular a one-off tax surcharge in personal income has been introduced and the VAT rate on electricity and natural gas has been increased (with a substantial carry-over into 2012). Furthermore, the government will proceed with the transfer of bank pension funds to the state social security system, with the sizeable resulting up-front capital transfers contributing to a temporary reduction of the fiscal deficit.

In 2012, Portugal is expected to undertake additional consolidation efforts worth over 5% of GDP, included in a comprehensive package of spending cuts and tax increases. Measures on the expenditure side notably include cuts of government wages and pensions, which can amount up to a reduction of income by 1/7 for those earning or receiving more than 1000 euro per month, as 2 of the 14 annual payments will be eliminated. In addition, reductions in public sector employment are also foreseen and access to some social transfers is to be tightened. Savings in the area of health are expected to come from a restructuring of health services and lower spending on medication. Rationalisation in the area of education and of public administration in general should yield additional savings. A sharp decline in capital expenditure is also targeted, including by state-owned enterprises. On the revenue side, the consolidation plans for 2012 rely considerably on higher indirect taxation: at the level of VAT the structure of taxation is set to change, with more goods and services being taxed at the higher intermediate and standard rates and some excise taxes will also be increased. Regarding direct taxation, the focus is mainly on a broadening of the tax base by reducing deductions and exemptions at personal and corporate income tax levels. Exemptions relating to real estate taxation are also set to be reduced.

For 2013, additional sizeable consolidation efforts of 2% of GDP are foreseen, largely based on the deepening of previously implemented cost-cutting measures and a further broadening of tax bases. Government debt is projected to stabilise at 112% of GDP in 2013, up from 72% of GDP in 2008.

Table II.21.1:

Main features of country forecast - PORTUGAL

	2010		**Annual percentage change**						
	bn EUR Curr. prices	**% GDP**	**92-07**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
GDP	172.8	100.0	2.2	0.0	-2.5	1.4	**-1.9**	**-3.0**	**1.1**
Private consumption	115.3	66.7	2.4	1.3	-1.1	2.3	**-4.2**	**-5.9**	**-0.4**
Public consumption	37.1	21.4	2.3	0.4	3.7	1.3	**-3.2**	**-6.2**	**-3.8**
Gross fixed capital formation	32.8	19.0	2.1	-0.3	-11.3	-4.9	**-11.6**	**-9.4**	**1.5**
of which : equipment	10.3	6.0	3.7	6.9	-13.2	-4.3	**-11.3**	**-8.0**	**1.7**
Exports (goods and services)	53.5	30.9	6.0	-0.1	-11.6	8.8	**6.6**	**4.2**	**6.1**
Imports (goods and services)	65.8	38.1	6.0	2.3	-10.6	5.1	**-5.0**	**-5.2**	**1.2**
GNI (GDP deflator)	167.0	96.7	2.0	-0.4	-3.0	2.1	**-2.6**	**-4.0**	**0.4**
Contribution to GDP growth : Domestic demand			2.6	0.9	-2.6	0.8	**-5.7**	**-6.8**	**-0.7**
Inventories			0.2	0.0	-0.6	-0.1	**-0.2**	**0.2**	**0.0**
Net exports			-0.6	-1.0	0.7	0.6	**4.0**	**3.5**	**1.8**
Employment			0.4	0.5	-2.6	-1.5	**-1.1**	**-1.4**	**0.2**
Unemployment rate (a)			6.5	8.5	10.6	12.0	**12.6**	**13.6**	**13.7**
Compensation of employees/head			5.8	3.0	3.3	1.7	**0.0**	**-2.3**	**0.8**
Unit labour costs whole economy			4.0	3.5	3.3	-1.2	**0.9**	**-0.6**	**-0.2**
Real unit labour costs			0.0	1.9	2.7	-2.3	**-0.5**	**-1.7**	**-1.6**
Saving rate of households (b)			-	7.1	10.9	9.8	**9.4**	**9.5**	**9.6**
GDP deflator			4.0	1.6	0.5	1.1	**1.4**	**1.1**	**1.5**
Harmonised index of consumer prices			3.6	2.7	-0.9	1.4	**3.5**	**3.0**	**1.5**
Terms of trade of goods			0.4	-3.1	5.1	0.1	**-1.6**	**0.3**	**0.0**
Merchandise trade balance (c)			-10.3	-12.9	-10.1	-10.0	**-7.2**	**-4.0**	**-2.7**
Current-account balance (c)			-7.9	-12.6	-10.8	-9.7	**-7.6**	**-5.0**	**-3.8**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-5.8	-11.4	-9.7	-8.4	**-6.1**	**-3.5**	**-2.4**
General government balance (c)			-3.9	-3.6	-10.1	-9.8	**-5.8**	**-4.5**	**-3.2**
Cyclically-adjusted budget balance (c)			-4.0	-3.5	-9.0	-9.2	**-4.7**	**-2.4**	**-1.8**
Structural budget balance (c)			-	-4.6	-8.7	-9.6	**-6.9**	**-2.5**	**-1.8**
General government gross debt (c)			56.0	71.6	83.0	93.3	**101.6**	**111.0**	**112.1**

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

22. ROMANIA

Recovery to continue despite worsening external environment

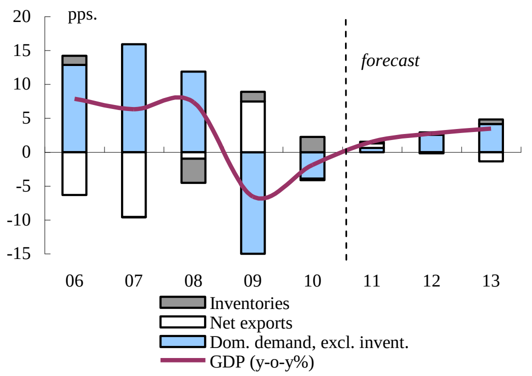
Modest recovery after a long recession

Economic growth was robust in the first quarter of 2011 (when GDP grew by 0.5% q-o-q), but tailed off in the second quarter to a mere 0.2% increase. Real GDP is currently projected to grow by around 1.7% in 2011 as a whole. On the demand side, net exports were the key driver for growth in the first half of 2011, but these are likely to contribute less to growth in the second half of the year due to the expected slowdown in external demand. Private consumption did not pick up significantly as it was held back by still weak household balance sheets. However, both retail trade developments and the retail sentiment indicator point to slight improvements lately. Public investment is assumed to increase towards the end of the year as the authorities are moving ahead with various road construction projects. The still very low EU funds absorption rate of 3.7% (as of end-September 2011) indicates that there is great potential for higher public investment.

Progress in implementing the measures required under the multilateral financial assistance programmes of the EU, the IMF and the World Bank[70] has reduced previously built-up imbalances and has helped restore confidence among investors in the country. Following the successful completion of the 2009-11 balance of payments assistance programme, Romania has returned to the financial markets and is now financing itself both on the domestic and the external market.

The labour market shows signs of improvement. The second quarter of 2011 saw significant improvement, probably also driven by important reforms implemented in April 2011 in the areas of labour market legislation (Labour Code) and social dialogue (Social Dialogue Code). While registered unemployment is coming down, indications from the labour force survey (LFS) point to a broadly stable unemployment rate of around 7% as job losses level off and wages begin to rise. However, young people (aged 15-24) remain a particularly vulnerable group as their employment dropped in the second quarter of 2011 by 9% (y-o-y).

Graph II.22.1: **Romania - GDP growth and contributions**



Growth becomes more broad-based in 2012, but is affected by international turbulence

Growth is expected to moderately accelerate in 2012 to 2.1%. After export-led growth in 2011 activity is expected to become more broad-based in 2012 as the increase in exports spills over into domestic demand. External demand is expected to remain supportive but to be less robust in 2012 due to the worsening economic outlook in Europe and other parts of the world. Although households and corporates are expected to continue to adjust their balance sheets during the first half of 2012, the projected increase in employment, coupled with lower inflation, should support real disposable income. This contributes to a revival of private consumption during the second half of 2012.

Government consumption is not expected to contribute much to growth in 2012 as it is constrained by the need for further fiscal consolidation and the continued reduction of public sector employment. Investment is expected to be an important growth driver next year given the country's high needs to modernise its public infrastructure, partly with the help of co-financing from EU structural funds. Private investment is, however, likely to be weaker on account of increased uncertainty linked to the 2012 elections and due to the lagged effects of the turbulences in international financial markets during 2011. Credit

(70) Following the successful completion of the 2009-11 balance-of-payments (BoP) assistance programme and at the request of the Romanian authorities, a follow-up precautionary BoP programme for Romania was approved by the Council in May 2011 which entered into force in June. The new programme is again a joint programme with the IMF and the WB and it focuses on structural reforms to support the re-launch of economic growth, but the continuation of fiscal consolidation and the preservation of financial stability remain important conditions.

activity is expected to show a modest recovery in 2012, as financial institutions continue to repair their balance sheets after a long period of deterioration in asset quality.

Economic growth is expected to increase to 3.4% in 2013 about 1 pp. above current estimates of potential growth. Wages are expected to continue to readjust upwards from still very low levels (compared with the main trading partners), thus improving household balance sheets and leading to higher growth in private consumption than in 2012. Both private and public investment are expected to accelerate; on the public side, the Government is planning to increase its capital spending in 2013 while on the private side some of the investments planned for 2011 and 2012 will be delayed and will shift into 2013. Moreover, the infrastructure projects started in 2011-12, mostly financed by EU funds, are assumed to be executed at full speed. Although economic growth will be mainly driven by domestic demand in 2013, exports are expected to continue to increase on account of wage competitiveness and the sustained expansion in Romanian export capacity.(71)

Risks to the current forecast are skewed to the downside for 2011 and balanced thereafter. There is a downside risk for 2011 due to the economic uncertainties surrounding the Eurozone, the sovereign-debt crisis and financial markets. However, going forward risks appear more balanced. Downside risks include: (i) the additional needs for repairing household balance sheets coupled with tighter credit standards for consumer lending may result in lower-than-expected private consumption; this in turn could harm the assumed transition to a more broad-based recovery driven by private household demand; (ii) continuing uncertainty in financial markets and sovereign debt developments in the euro-area periphery, as well as the global economic outlook in general may affect Romania's future prospects. However, there are upside risks: (i) the role of investment foreseen in the baseline may be more pronounced if the absorption of EU funds improves significantly in 2012 and 2013; (ii) moreover, since 2012 is an election year there is a an upside risk of stronger domestic demand induced by fiscal slippages, possibly in the form of a combination of reductions in social security contributions, increases in public sector wages, and investment spending. Although this will have a positive impact on short-term growth, it will negatively impact the fiscal deficit target for 2012.

Although the latest developments on the balance-of-payments front are positive, decreasing demand from European partners may have a negative impact in 2012. Exports – especially in the machinery sector – accounted for a decline of 22% in the first half of 2011 in the trade deficit (to 4.2% of GDP). The current-account deficit is expected to remain stable at around 4.3% of GDP in 2011 and to marginally widen in 2012 and 2013 due to a stronger pick-up in private consumption and a deterioration of the primary income and net transfers balances.

Inflation moderated significantly recently, but upside risks remain over medium-term

Significant upside risks to the medium-term inflation outlook remain in place, although price pressures eased in the course of the summer. In the second quarter of 2011, following a succession of upward price shocks, Romania was still the Member State with the highest inflation in the EU (at 8.4% in May 2011). Annual inflation dropped sharply in the third quarter of 2011 reaching its lowest level in 21 years (i.e. 3.5% in September 2011) due to a base effect resulting from the VAT hike a year ago and helped further by easing food prices. Therefore inflation has come into the NBR's target range of 3.0% ±1 pp. set for end-2011.

Inflation is expected to remain within the target range in Q4-2011 and the first half of 2012. Nonetheless, looking further ahead, the temporary downward pressure on headline price indices stemming from volatile food prices may reverse in the second half of 2012, although inflation is currently assumed to stay within the target range. Moreover, the main upside risks to the inflation outlook still relate to prospects for sizeable upward adjustments in administered prices (in particular of electricity, gas and other utilities). Conversely, a deterioration in global economic conditions (including lower commodity prices) would have a disinflationary effect.

Fiscal consolidation will continue

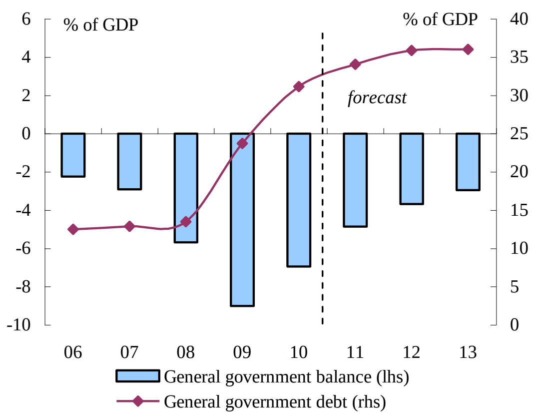
The budget deficit is projected to decrease from 6.9% of GDP in 2010 to 4.9% of GDP this year.

(71) Romania has seen an improvement in its price and cost competitiveness since the onset of the financial crisis; the ULC-deflated real effective exchange rate weakened both due to nominal effective depreciation of the leu and muted growth of unit labour costs.

The austerity measures taken by the authorities in July 2010 continued to have a decreasing effect on the deficit in the first half of 2011. Moreover, total revenue is expected to increase compared with 2010, although it has been showing signs of underperformance in the July and August budget execution. Income from both VAT and excises was better than expected in the first six months of the year as a result of improved tax collection. However, excises have been underperforming in the budget execution for end-August. Non-tax revenue has also been lower than projected, while other items are evolving broadly in line with expectations.

On the expenditure side, savings are higher than expected due to a better performance of personnel spending following a faster-than-anticipated reduction in public sector employment. Capital spending has also been under-executed in the first eight months of the year and is therefore projected to register a more modest growth rate for 2011 compared to original expectations.

Graph II.22.2: **Romania - Public finances**



Domestic payment arrears decreased at end-August relative to end-January 2011, but arrears in the health sector may re-accumulate by the end of the year if measures fall short of what is needed and funding is not increased. Moreover, while arrears continue to be on a decreasing trend, they have increased slightly at end-August compared to end-July. The fall in arrears between January and August was due to decreases at local government level and in social security, whereas arrears at central government level increased. Most of the arrears are at the level of local government (50% of the total stock of arrears), followed by the social security sector (39%).

Most of the arrears in the social security sector are in the health sector where the reforms implemented have not yielded the expected results. However, the authorities have committed to undertake an in-depth reform of the health sector by end-2011 to address persistent budgetary shortfalls. On the expenditure side, measures to restructure the system would include the implementation of a revised basic benefits package which would exclude non-essential health services from being insured by the government, a move to an increased use of generic drugs and a revision of the price and list of compensated drugs. On the revenue side, the reforms include a re-design of the clawback tax,[72] the introduction of a co-payment system for those using the healthcare system and the introduction of supplementary insurance to cover medical services which go beyond the basic benefits package.

[72] The tax is a mechanism to control spending overruns of the healthcare budget by requiring the pharmaceutical industry to pay back to the State the overrun in spending compared to the budget allocation for reimbursed drugs. The initial tax had not yielded the expected savings and is being redesigned

The budget deficit in 2012 is expected to decrease further to 3.7% of GDP under a no-policy-change assumption. The authorities have not yet finalised the 2012 budget, so therefore the current forecast does not include any additional policy measures that may be included in the 2012 budget. The current projections assume continued expenditure restraint, particularly regarding subsidies, as well as additional savings from the reforms that are currently being implemented such as the introduction of means tested social benefits, the reduction in the number of social assistance programmes and the continued implementation of the pension reform.

As part of the EU/IMF precautionary programme, the authorities are also working on shifting capital spending from domestic financing towards an increased use of EU structural funds, as well as prioritising the large number of existing investment projects and improving the capital budgeting process in order to achieve efficiency gains. No major discretionary measures have been taken into account in the revenue projections. In particular, no changes in the main tax rates are expected in 2012.

According to projections, the budget deficit is expected to decrease to 2.9% of GDP in 2013 as a result of a continued decrease in the share of total expenditure in GDP, as well as a slight increase in the share of total revenue in GDP.

Table II.22.1:
Main features of country forecast - ROMANIA

		2010		Annual percentage change						
bn RON		Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		513.6	100.0	2.7	7.3	-6.6	-1.9	**1.7**	**2.1**	**3.4**
Private consumption		321.3	62.5	5.4	9.0	-10.1	-1.6	**0.7**	**1.9**	**3.4**
Public consumption		84.1	16.4	0.5	7.2	3.1	-5.8	**-1.5**	**1.5**	**3.5**
Gross fixed capital formation		116.8	22.7	9.5	15.6	-28.1	-7.3	**2.4**	**2.6**	**6.5**
of which : equipment		50.4	9.8	10.4	10.9	-32.7	-2.0	**4.5**	**2.3**	**7.5**
Exports (goods and services)		183.8	35.8	11.1	8.3	-6.4	13.1	**7.3**	**4.3**	**5.9**
Imports (goods and services)		211.5	41.2	13.8	7.9	-20.5	11.6	**4.7**	**4.5**	**8.5**
GNI (GDP deflator)		507.3	98.8	2.5	8.1	-5.1	-1.8	**1.1**	**1.8**	**3.2**
Contribution to GDP growth :	Domestic demand			6.5	11.9	-15.0	-3.9	**0.7**	**2.0**	**4.1**
	Inventories			-1.5	-3.5	1.4	2.3	**0.3**	**0.3**	**0.6**
	Net exports			-2.1	-1.0	7.0	-0.2	**0.7**	**-0.3**	**-1.4**
Employment				-2.4	0.0	-1.8	-1.8	**0.1**	**0.6**	**0.6**
Unemployment rate (a)				6.4	5.8	6.9	7.3	**8.2**	**7.8**	**7.4**
Compensation of employees/head				61.6	31.9	-6.8	1.6	**4.7**	**6.4**	**8.5**
Unit labour costs whole economy				53.5	22.9	-2.0	1.7	**3.1**	**4.9**	**5.6**
Real unit labour costs				-1.2	6.6	-6.0	-2.7	**-1.8**	**1.2**	**0.7**
Saving rate of households (b)				-	-1.1	0.0	-	**-**	**-**	**-**
GDP deflator				55.4	15.3	4.2	4.5	**4.9**	**3.6**	**4.9**
Harmonised index of consumer prices				-	7.9	5.6	6.1	**5.9**	**3.4**	**3.4**
Terms of trade of goods				1.5	3.2	0.1	2.4	**0.7**	**-0.2**	**2.4**
Merchandise trade balance (c)				-7.3	-13.6	-5.8	-4.8	**-3.8**	**-3.9**	**-4.0**
Current-account balance (c)				-	-11.4	-4.2	-4.2	**-4.1**	**-5.0**	**-5.3**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-5.4	-11.0	-3.6	-4.0	**-3.9**	**-4.8**	**-5.1**
General government balance (c)				-	-5.7	-9.0	-6.9	**-4.9**	**-3.7**	**-2.9**
Cyclically-adjusted budget balance (c)				-	-8.7	-9.1	-5.9	**-3.7**	**-2.6**	**-2.2**
Structural budget balance (c)				-	-8.3	-9.6	-6.1	**-3.7**	**-2.6**	**-2.2**
General government gross debt (c)				-	13.4	23.6	31.0	**34.0**	**35.8**	**35.9**

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

23. SLOVENIA

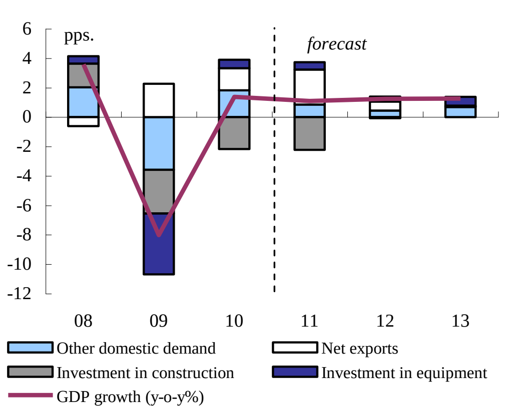
Prospects depend on stabilisation of construction

After a 1.4% increase in 2010, real GDP growth is expected to slow to 1.1% in 2011 and 1.0% in 2012, before accelerating back to 1.5% in 2013. Growth in 2011 continues the 2009 and 2010 pattern of strong net export performance offset by a sharp retrenchment in investment. This pattern is forecast to be partly reversed in 2012, as the worsening global environment is assumed to be counteracted by more benign domestic developments in the construction sector.

Uncertainty set to weigh on households

Total disposable income of households in 2011 is expected to contract slightly in real terms as the persistent decline in employment outpaces moderate real wage growth. Households therefore sustain their consumption only through reduced saving. In 2012 stabilising employment, the assumed expiry of certain freezes in social transfers and significantly lower inflation are forecast to revive growth in disposable incomes. However, the boost to consumption is assumed to be limited given higher precautionary savings amid increased economic uncertainty. The saving rate is forecast to stabilise in 2013 as the global crisis abates, allowing consumption to grow more closely in line with disposable income.

Graph II.23.1: **Slovenia - GDP growth and contributions**



Rebound depends on the fate of construction

Large falls in gross fixed capital formation occurred in early 2011, compounding the already significant declines throughout 2009-10 and driving the expected negative contribution of domestic demand to real GDP growth in 2011. Construction investment declined by almost 17% in the first two quarters, due in part to widespread deleveraging and bankruptcy proceedings for Slovenia's three biggest construction firms, which delayed many large projects. However, survey data indicate that conditions in the construction sector may be stabilising, with work on larger non-residential projects resuming under reorganised contracts. This forecast accordingly projects a moderate rebound in construction activity in the third quarter of 2011, bringing to an end three consecutive years of rapid contraction and ushering in a period of relative stability for all categories of construction output. By end-2011 the share of construction in the economy is expected to settle at around half its 2008 peak. This is assumed to be maintained over the forecast horizon.

Meanwhile, equipment investment, which had recovered in 2010, is expected to decelerate somewhat in 2011-12 owing to the slowdown in demand. With the near-disappearance in 2012 of the drag from construction, total gross fixed capital formation is forecast to return to mild positive growth, driven by investment in equipment. Growth is forecast to strengthen further in 2013 as investment in equipment picks up again.

Constrained credit

Investment prospects in Slovenia are also subject to financial developments. In 2011 credit growth has continued its sharp slowdown and has even turned negative for domestic bank lending to non-financial corporations. A demand-led reduction of credit, corresponding to adjustment to corporate over-indebtedness, may account for some deleveraging. However, high spreads between corporate borrowing rates in Slovenia and the euro area, coupled with evidence of strong companies obtaining credit directly from abroad, may also indicate that the credit needs of some viable companies are not adequately met by domestic banks, which could impose a speed limit on investment and growth. The position of the banks, the largest of which passed the EU-wide stress test with a very narrow margin, is made considerably more difficult by rapidly deteriorating credit quality, notably in the corporate segment, the uncertain value of collateral and the imperative to increase capital ratios, even after the recapitalisations in early 2011.

External demand does not lead all the way

External rebalancing continues to drive economic growth. Strong export growth in 2010 and 2011 has been coupled with sharply decelerating imports, the consequence of exceptionally weak domestic demand. Thus, also in 2011, net exports are expected to contribute strongly to real GDP growth. With declining export prices relative to trading partners, a portion of the market shares lost in 2010 is projected to be regained in 2011. Weaker external demand in 2012-13 and the rebound in domestic demand are forecast to gradually erode the positive contribution from net exports to real GDP growth. With relatively benign terms of trade in 2012-13 following the high commodity price inflation recorded in 2011, rebalancing is forecast to continue. These developments correspond to a small and increasing current-account surplus over the forecast horizon.

Stagnant labour market

The labour market remains weak, with employment continuing to fall into 2011. Private sector job losses in 2011 have been concentrated in the construction sector but have also affected, to a lesser degree, manufacturing and trade and distributive services. Only limited further job losses are forecast for 2012, with employment stabilising going into 2013. Unemployment is forecast to peak at 8.4% in 2012, with the share of long-term unemployed becoming an increasing concern on account of the persistence of labour market weakness and the existence of skills mismatches.

Average wage growth was very high in 2010 due to the temporary effects of the 2010 minimum wage increase, the transition back to normal working hours and some further composition effects from the loss of low-paid jobs. These effects are expected to fade away during 2011, leading to a profile of decelerating wage growth in the private sector over 2011 and 2012. By contrast, public sector wage growth is expected to resume from 2012 in the absence of further measures to contain the wage bill. Coupled with only modest productivity growth, these wage developments would lead to unit labour cost growth at around 1% in 2011-12, accelerating to 1.4% in 2013.

Core inflation is expected to rise substantially by the end of 2011 as temporary factors depressing services inflation to exceptionally low levels drop out of the calculation. Despite this, headline HICP is forecast to remain on a downward path through to the end of 2012 due to the unwinding of the effects of previous high commodity prices and temporarily high wage growth. Overall, HICP inflation is forecast to remain somewhat below the euro-area average over the forecast horizon.

This forecast is subject to a number of risks tilted to the downside. Most importantly, gross fixed capital formation and, consequently, real GDP could be significantly weaker if the incipient stabilisation of construction output is not sustained. Relatedly, abrupt falls in real-estate prices remain a possibility given the absence of significant adjustment to date. This would have knock-on effects on banks' collateral and mortgage delinquency, as well as on other sectors through channels including wealth effects and confidence. Difficulties in managing these asset impairments and raising fresh capital coupled with any renewed funding stress could further tighten credit conditions. This would accelerate deleveraging in non-financial corporations, causing further disruptions to illiquid, highly-indebted firms and curtailing investment.

Government deficit ratio stabilises in 2011

The general government deficit is forecast to broadly stabilise at 5.7% of GDP in 2011. However, without the deficit-increasing one-offs related to the recapitalisation of Slovenia's largest bank (0.7% of GDP) and the capital transfer to the railway company (0.4% of GDP), the budgetary position would improve. The structural balance is projected to improve by around 1 pp. of GDP.

On the revenue side, no measures were taken in 2011 except in the area of excise duties (increases for tobacco to achieve the minimum rates set at the European level and changes for mineral oils to counteract inflationary pressures from fluctuations in world oil prices). Accordingly, revenues except excise duties are projected to move in line with their tax bases. The forecast factors in some improvement in the absorption of EU funds.

Most of the temporary measures restraining primary expenditure growth in 2010 have been extended into 2011 and some of them have been reinforced. The public sector wage bill is contained through the non-payment of various bonuses, a ban on promotions, recruitment restrictions and limited indexation. Increases in the number of pensioners and the unemployed, as well as a broader safety net for the latter, are expected to result in social transfers growing by 4.4% in spite of more limited indexation arrangements. Intermediate consumption and capital expenditure were cut in the September supplementary budget; government gross fixed capital formation is thus projected to decline markedly for the second year running. Other capital spending is affected by the above-mentioned one-offs as well as support for the national airline and called state guarantees (together accounting for 1.3% of GDP). Interest expenditure will rise to around 2% of GDP due to higher debt and interest rates, from 1.6% in 2010.

The parliament was dissolved on 21 October 2011 ahead of early elections scheduled for December. Apart from the non-payment of bonuses in the public sector, no consolidation measures are in place for 2012-13 so that the forecast is based on the usual no-policy-change assumption. While tax revenue is projected to move in line with the underlying tax bases, many categories of expenditure are forecast to exhibit strong dynamics due to the expiry of the temporary measures restraining their growth. Coupled with the further strong increase in the number of pensioners and the announced higher basic minimum income for the most socially vulnerable people from 1 January 2012, this implies that current primary expenditure growth is projected at 3.4% in 2012 and 4.0% in 2013, compared to 0.9% in 2011. However, the deficit is still forecast to narrow in 2012 to 5.3% of GDP as a result of the disappearance of the one-offs recorded in 2011. In 2013 the deficit is projected to widen again to 5.7% of GDP, reflecting buoyant social transfers and compensation of employees. The structural balance is forecast to deteriorate by around ¾ pp. of GDP in both 2012 and 2013.

The gross government debt ratio is forecast to rise to 45½% of GDP in 2011, up from 39% in 2010, driven by the primary deficit and the increasing interest burden. Mainly as a result of persisting primary deficits, the debt ratio is projected to grow further over the forecast horizon, to around 54½% of GDP in 2013. The debt projections include the impact of guarantees to the EFSF, bilateral loans to Greece and the participation in the capital of the ESM as planned on the cut-off date of the forecast. They are subject to upside risks from further capital support operations and calling of guarantees.

Table II.23.1:

Main features of country forecast - SLOVENIA

	2010		Annual percentage change						
	bn EUR Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	35.4	100.0	3.7	3.6	-8.0	1.4	**1.1**	**1.0**	**1.5**
Private consumption	19.8	56.0	3.8	3.7	-0.1	-0.7	**0.1**	**0.6**	**1.5**
Public consumption	7.4	20.8	2.9	6.1	2.9	1.5	**-2.3**	**0.6**	**0.9**
Gross fixed capital formation	7.7	21.6	7.1	7.8	-23.3	-8.3	**-10.0**	**0.9**	**2.7**
of which : equipment	3.0	8.3	9.9	3.1	-28.9	4.4	**3.4**	**2.8**	**5.0**
Exports (goods and services)	23.2	65.4	5.3	2.9	-17.2	9.5	**7.8**	**4.2**	**5.9**
Imports (goods and services)	23.0	64.9	7.1	3.7	-19.6	7.2	**4.4**	**3.7**	**6.1**
GNI (GDP deflator)	34.9	98.5	3.6	2.9	-7.3	2.0	**0.7**	**0.7**	**1.4**
Contribution to GDP growth : Domestic demand			4.2	5.2	-6.3	-2.0	**-2.6**	**0.6**	**1.5**
Inventories			0.5	-1.0	-4.0	1.9	**1.3**	**0.0**	**0.0**
Net exports			-1.0	-0.6	2.3	1.5	**2.3**	**0.4**	**0.0**
Employment			-	2.6	-1.8	-2.5	**-0.7**	**-0.1**	**0.2**
Unemployment rate (a)			-	4.4	5.9	7.3	**8.2**	**8.4**	**8.2**
Compensation of employees/head			-	7.2	1.8	4.3	**2.5**	**2.1**	**2.8**
Unit labour costs whole economy			-	6.2	8.7	0.3	**0.7**	**1.0**	**1.5**
Real unit labour costs			-	2.0	5.6	1.4	**0.7**	**-0.1**	**-0.1**
Saving rate of households (b)			-	15.2	15.0	15.7	**15.1**	**15.6**	**15.6**
GDP deflator			17.2	4.1	3.0	-1.1	**0.1**	**1.1**	**1.6**
Harmonised index of consumer prices			-	5.5	0.9	2.1	**1.9**	**1.3**	**1.2**
Terms of trade of goods			0.8	-1.8	4.7	-4.7	**-2.2**	**-0.1**	**0.1**
Merchandise trade balance (c)			-2.9	-7.2	-2.1	-3.5	**-3.2**	**-3.1**	**-3.1**
Current-account balance (c)			-0.5	-7.0	-1.3	-0.8	**0.1**	**0.3**	**0.5**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-0.7	-6.9	-1.3	-0.8	**-0.9**	**0.6**	**0.8**
General government balance (c)			-	-1.9	-6.1	-5.8	**-5.7**	**-5.3**	**-5.7**
Cyclically-adjusted budget balance (c)			-	-5.0	-4.2	-3.9	**-4.1**	**-3.8**	**-4.7**
Structural budget balance (c)			-	-5.0	-4.1	-3.9	**-3.0**	**-3.8**	**-4.7**
General government gross debt (c)			-	21.9	35.3	38.8	**45.5**	**50.1**	**54.6**

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

24. SLOVAKIA

Growth slowdown ahead

Strong externally driven growth set to slow down significantly

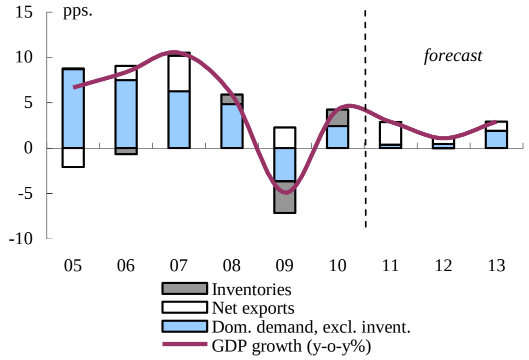
After posting one of the strongest rebounds in GDP in the EU in 2010, growth is expected to remain high in 2011, yet lower than in the previous year. This is chiefly on account of signs of slowdown in external demand in the second half of the year, the short-term impact of fiscal consolidation and sluggish private consumption recorded in the first half of 2011. As the economic outlook for 2012 among the main trading partners has recently significantly worsened, external demand and trade are likely to decelerate markedly. This is expected to put on hold private investment decisions, reducing inflationary pressures and exerting a drag on GDP growth, which in turn is expected to drop to about 1%. Growth is expected to gather momentum in 2013, reflecting an improvement in the global outlook, a decrease in uncertainty and a gradual resumption in domestic investment and foreign demand. Private consumption is also expected to recover in 2013 after several years of stagnation. The relatively sound fundamentals of the Slovak financial and industrial base should facilitate the recovery.

In the first half of 2011, exports continued to be strongly supported by the positive developments in industrial production and trade registered among Slovakia's main trading partners, notably Germany. From the production side, the increase in output has been driven by strong gains in value added in manufacturing, notably in the automotive industry, which have more than offset the declines registered in construction, wholesale and retail trade and agriculture. In response to the expected slowdown in world trade, the contribution of exports to growth is forecast to decrease in 2012 before rebounding in 2013, when the Slovak economy is projected to benefit from a cyclical lift as the global economic outlook improves and uncertainties about the recovery fade out.

Domestic demand subdued in 2011-12 but expected to pick up in 2013

Domestic demand has remained virtually flat in 2011, as moderate investment growth has been offset by a combination of stagnant household consumption and a significant contraction in government spending, both partly reflecting the major fiscal consolidation effort the authorities embarked on. As the measures to reduce the deficit in 2011 affect almost exclusively disposable income of households, the period of sluggish income growth is set to continue, putting a drag on growth.

Graph II.24.1: **Slovakia - GDP growth and contributions**



Households are expected to show near-stagnant consumption growth of around ½% in 2012, in line with trends in real disposable income. In 2013 private consumption should increase more significantly, by 1.3%, as the broader economic sentiment and outlook improves and the combination of a moderate rebound in the labour market and relatively benign inflation support disposable income.

Gross fixed capital formation is the only component of domestic demand expected to still contribute positively to growth in 2011. Profitability of non-financial corporations has remained among the highest in the EU, propping up investment. However, from the second half of 2011 onwards both domestic business and foreign direct investment will be weak, reflecting adverse financial conditions and uncertainty on the demand side, in particular as regards external demand, although a rebound is expected in 2013.

By contrast, investment in construction is forecast to hold up under the assumption that long-planned public investment projects in infrastructure are implemented in 2012 and 2013, also reflecting an acceleration of drawing on EU funds. This notwithstanding, private investment in housing, which had significantly contributed to growth in the years preceding the crisis, is expected to remain subdued in 2012 and to only gradually return to grow in volume terms in 2013. This is likely in view of the broader slowdown in economic activity, generally lower post-crisis cross-border investment in real estate and reduced household demand given continuing financial uncertainty.

After a hike in 2011, HICP inflation is forecast to moderate

After two years of historically low price increases below 1%, HICP inflation is forecast to spike at 4% in 2011. The main reasons are the steep increase in energy and commodity prices at the beginning of the year, the adjustment of regulated prices and the increase of some excises and indirect taxes, notably the hike of 1 pp. in the VAT standard rate. Downward pressures on oil and commodity prices for 2012 and 2013 should significantly lower imported inflation over the forecast horizon. As the effect of consolidation measures on prices also fades out, the projected marked slowdown of economic activity in 2012 should also contribute to reducing core inflation to 2%, while overall HICP inflation is forecast at 1.7%. Headline inflation is expected to reach about 2% in 2013, sustained by a recovery in domestic demand and further increases in administered prices. This forecast does not include the effect of additional consolidation measures currently under discussion but not yet approved.

Labour market improves in 2011 but risks worsen in 2012

After the disruption brought by the 2008-09 crisis, the labour market has shown signs of recovery in the first half of 2011. But the labour market is expected to stall going forward and only moderately advance towards the end of the forecast horizon.

Given that a sizeable and permanent productivity-oriented adjustment in the labour market had already taken place at the firm level in the wake of the crisis, the forecast assumes that adjustments in 2012 will initially mainly take place in the form of fewer hours worked, rather than a further reduction in headcount employment. Against this background, measures favouring internal flexibility may prove particularly effective in 2012 as the economic outlook is expected to improve in 2013. On the other hand, due to labour hoarding, the expected employment gains associated with the projected cyclical rebound will also be moderate.

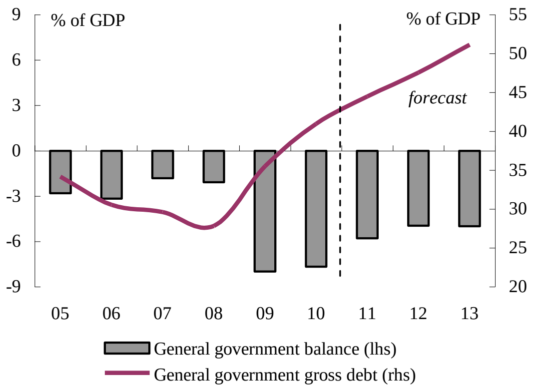
Over the forecast horizon economic growth is set to remain well below the high levels historically associated with a significant reduction in the unemployment rate. Despite the strong performance of private sector employment, the rate of registered unemployed has remained stable around a six-year peak in the first half of 2011. With growth in employment expected to stall in 2012, unemployment is forecast to remain high and to slightly increase in the second half of 2011. New secondary school graduates not continuing in education will enter a tight labour market at a time of slowing growth and youth unemployment of above 30%, more than 10 pps. higher than the pre-crisis level.

Public finances consolidation under way

The export-based rebound of the economy in 2010 did not translate into higher government revenues. In combination with higher-than-budgeted expenditure and extraordinary expenditure for floods, this led to the general government deficit remaining at a high level. In the 2011 autumn EDP notification the 2010 deficit was revised downwards by 0.2 pp. to 7.7% of GDP.

In 2011 the consolidation measures adopted by the government placed somewhat more emphasis on the expenditure side than the revenue side. Expenditure measures featured a reduction of the public sector wage bill and intermediate consumption as well as increase in efficiency of healthcare and capital spending (e.g. through a requirement to publish public tenders online). Revenue side measures included a 1 pp. hike in the VAT rate and broadening of the base for personal income tax and social contributions, all of which amounted to some 1% of GDP. In addition to these consolidation measures there are several developments with a deficit-increasing impact of about 1% of GDP in total, e.g. increased costs related to restructuring of railway companies; higher-than-budgeted transfers to healthcare providers. These are, however, broadly offset by developments with a deficit-decreasing impact, notably higher-than-budgeted dividend income, lower co-financing of EU projects, and lower-than-budgeted pension expenditure. Methodological revisions in the autumn of 2011 required that the government expenditure related to outstanding debt of state-owned railway companies and hospitals over the period 2008-10 is to be assigned to 2011, the year when the government recognised the debt. This would lead to an increase in the headline deficit of almost 1% of GDP. Taking these developments into account, the general government deficit is expected to reach 5.8% of GDP in 2011.

Graph II.24.2: **Slovakia - Public finances**



In view of the upcoming early elections in March 2010, implementation in particular of expenditure-reducing measures is uncertain as the current government budget proposal has so far not been adopted by the Parliament. The envisaged restrictions on growth in the public wage bill through a freeze of wage costs at the central government level and a further reduction of intermediate consumption may hence not materialise. Moreover, there are further negative risks of expenditure slippages such as possible overspending of municipalities. The forecast takes into account sufficiently specified measures, in particular an increase of excise duties on cigarettes and a broadening of the corporate income tax base. Growth will be tax-weak as most of it is expected to come from external demand and investment, with more heavily taxed private consumption remaining flat. Coupled with the continued increase of expenditure, this is expected to result in a reduction of the deficit to just below 5% of GDP in 2012. Under the no-policy-change assumption for 2013, the deficit is projected to stabilise at 5% of GDP. Over the entire forecast period the structural balance is expected to improve slightly.

The debt-to-GDP ratio is projected to continue increasing over the forecast period, reaching some 51% of GDP in 2013, more than 20 pps. higher compared to 2008. Debt projections also include the impact of guarantees to the EFSF and the participation in the capital of the ESM as planned on the cut-off date of the forecast.

Table II.24.1:
Main features of country forecast - SLOVAKIA

	2010		Annual percentage change						
	bn EUR Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	65.9	100.0	-	5.9	-4.9	4.2	**2.9**	**1.1**	**2.9**
Private consumption	38.4	58.3	-	6.1	0.2	-0.7	**0.2**	**0.4**	**1.3**
Public consumption	12.9	19.6	-	6.9	6.2	1.5	**-2.7**	**0.6**	**1.7**
Gross fixed capital formation	14.6	22.2	-	1.0	-19.7	12.4	**3.7**	**0.7**	**3.8**
of which : equipment	5.8	8.9	-	1.2	-26.6	16.6	**5.5**	**-4.4**	**4.0**
Exports (goods and services)	53.4	81.1	-	3.1	-15.9	16.5	**7.8**	**2.4**	**6.3**
Imports (goods and services)	54.3	82.4	-	3.1	-18.1	16.3	**4.7**	**1.6**	**5.2**
GNI (GDP deflator)	65.0	98.6	-	7.0	-4.4	4.5	**3.1**	**0.8**	**2.5**
Contribution to GDP growth : Domestic demand			-	4.8	-3.7	2.4	**0.4**	**0.5**	**1.9**
Inventories			-	1.1	-3.5	1.8	**0.0**	**0.0**	**0.0**
Net exports			-	0.0	2.3	0.0	**2.5**	**0.6**	**1.0**
Employment			-	2.9	-2.5	-1.4	**1.6**	**0.1**	**1.1**
Unemployment rate (a)			-	9.5	12.0	14.4	**13.2**	**13.2**	**12.3**
Compensation of employees/head			-	6.8	4.8	4.3	**2.1**	**2.8**	**2.9**
Unit labour costs whole economy			-	3.8	7.5	-1.3	**0.8**	**1.7**	**1.2**
Real unit labour costs			-	0.9	8.8	-1.8	**-2.3**	**0.5**	**-0.8**
Saving rate of households (b)			-	6.1	7.8	11.3	**10.9**	**10.6**	**10.4**
GDP deflator			-	2.9	-1.2	0.5	**3.2**	**1.3**	**1.9**
Harmonised index of consumer prices			-	3.9	0.9	0.7	**4.0**	**1.7**	**2.1**
Terms of trade of goods			-	-1.9	-0.7	-0.8	**-0.4**	**-0.7**	**-0.8**
Merchandise trade balance (c)			-	-1.6	1.1	-0.1	**1.9**	**2.0**	**2.2**
Current-account balance (c)			-	-6.3	-3.6	-3.6	**-0.7**	**-1.2**	**-1.9**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-5.4	-2.7	-2.0	**1.2**	**0.3**	**-0.3**
General government balance (c)			-	-2.1	-8.0	-7.7	**-5.8**	**-4.9**	**-5.0**
Cyclically-adjusted budget balance (c)			-	-4.3	-7.7	-7.7	**-5.7**	**-4.4**	**-4.6**
Structural budget balance (c)			-	-4.5	-7.9	-7.5	**-4.9**	**-4.5**	**-4.6**
General government gross debt (c)			-	27.8	35.5	41.0	**44.5**	**47.5**	**51.1**

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

25. FINLAND

Economic recovery slowing but public finances stable

Strong recovery in GDP after the crisis

Finland's export-reliant economy proved highly sensitive to the collapse in global demand in 2009, with GDP falling by an unprecedented 8% in that year. The subsequent rebound in GDP has also been rapid, with GDP expanding by 3.6% in 2010 and continuing strongly in the first half of 2011. GDP grew by just under 4% y-o-y in the first half of 2011 on the basis of quarterly growth of 0.3% and 0.6% in the first and second quarter respectively.

The strong economic activity in 2010 and 2011 was driven by both a rebound in exports and a rapid recovery in domestic demand (notably household consumption and investment). Household consumption growth has accelerated from 2.7% in 2010 to over 4% y-o-y in the first half of 2011, driven by demand for transport vehicles and consumer durables. Despite a sharp decline in consumer confidence over the course of 2011, with the latest reading from September already well below the long-term average, the latest retail trade reading (from August) still showed robust growth. The resilience of consumption expenditure appears to be influenced by the strength of the labour market, rising wages and a decline in the saving rate (after a temporary rise over the 2009 crisis). Households also benefit from low interest rates, with a vast majority of mortgage loans tied to the variable EURIBOR rate.

House prices and construction volumes have continued to increase in the first half of 2011, albeit more slowly than over 2010 when activity rebounded from the trough in 2009. Taking account of the weakening in consumer confidence and the projected slowdown in activity, the housing market is expected to cool further over the forecast period. The latest data on residential building permits and construction starts indicates a stabilisation of residential construction volumes in positive territory close to the current level, suggesting that the expected cooling of the housing market will be gradual. Business investment is forecast to decelerate, but remain in marginally positive territory, upheld by replacement investment needs after the extended low point in 2009-10.

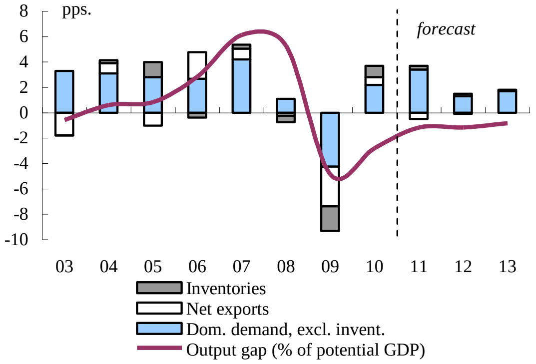
While in 2010 and in the first quarter of 2011 export volumes rebounded by over 10% in year-on-year terms, trade stalled in the second quarter of 2011. Of the main industry sectors, the electronics and paper industries have shown the weakest performance, whereas mining, chemicals, basic metals and the machinery industry have been leading growth. While exports of goods increased, exports of services declined significantly in the first half of 2011. This is most likely partly explained by a Finnish flagship company Nokia, which is downsizing its locally developed software.

The shift towards domestic-demand-driven growth is set to continue

In spite of the rapid rebound, GDP volume is expected to surpass the pre-crisis peak of 2008 only in 2012-13. While household consumption volume has already exceeded its pre-crisis level, export volumes are forecast to remain below the peak even in 2013. The Finnish economic structure, traditionally heavily reliant on industry and its export performance, has been shifting towards services and domestic demand over the past decade, with the trend picking up in the past years. Nevertheless, as the share of industry in the Finnish economy is still well above the euro-area average, GDP continues to be relatively sensitive to external demand conditions.

The global economic slowdown and ongoing structural changes within some of the main Finnish industries will weigh on exports in 2012 and 2013. As imports will be boosted by relatively buoyant domestic demand, the external sector is not forecast to add significantly to growth over the forecast period. Despite the rise in global uncertainty, short-term leading indicators for export growth, industrial new orders and production growth even rebounded somewhat in August, although growth appears low compared to the brisk recovery period in 2010. This suggests that the growth momentum for goods exports will slow in the short term. In the longer term, the projected gradual improvement in global sentiment should back the resumption of recovery in exports. However, the current account is stay close to balance over the forecast period, contrasting with the previous decade when the surplus averaged 5% of GDP (although already on a declining trend).

Graph II.25.1: **Finland - Contributions to GDP growth and output gap**



While Finland has preserved its solid economic fundamentals (healthy financial sector, strong public finances, resilient labour market), continued uncertainty in global financial markets is likely to eventually take its toll on growth. Quarter-on-quarter GDP growth is forecast to decelerate to marginally above zero in the fourth quarter of 2011 and the first half of 2012. In line with the forecast gradual recovery in the global economic outlook, GDP growth is expected to pick up thereafter. However, taking account of the weakening of the growth potential of the Finnish economy due to its declining working-age population, the recovery will be more subdued than in previous recovery cycles, with annual GDP growth expected to reach slightly below 2% in 2013.

Labour market is set to remain relatively strong

Labour market developments have been positive in the first half of 2011, with unemployment declining from 8.5% in the second quarter of 2010 to 7.9% in the same period in 2011. In spite of slowing economic growth, both employment and unemployment are expected to continue to improve marginally in 2012 and 2013, given that the trend decline in employment in industry is compensated by services.

The Finnish labour market is confronted with a notable demographic shock. Due to the retirement of a large baby-boom generation, the working-age population is projected to decline by over 5% of the current labour force by the end of the decade. Beyond 2020, this demographic shift will level off. By 2013 the decline in working age population is expected to start affecting the labour market more forcefully; unemployment rates are likely to fall even in a context of lower employment growth.

Risks arising from the global outlook

Similarly to 2008-09, trade remains the primary transmission channel of global economic shocks, which would in turn suppress domestic confidence and investment activity. The Finnish financial system is assessed in both domestic and international stress tests as being on a strong footing and thus unlikely to act as a drag on growth.

Although the share of exports in GDP has declined in the aftermath of the 2008-09 crisis, Finland's small and open economy is still highly dependent on external demand. Finnish exports have a bias towards investment goods and are therefore dependent on global investment conditions in emerging markets and in Europe. Should the potential global risk scenarios materialise, growth in Finland would be strongly affected, as was the case in 2008-09. However, given that the main export industries have had time to adjust to volatile global demand (while in 2008 the depth of the shock was unexpected and the economy was entering the recession from a cyclical peak), GDP is not expected to be as sensitive as in 2009.

Prices stabilising in 2012-13

HICP inflation picked up considerably in the first nine months of 2011, averaging 3.4%, also boosted by tax rises on energy, VAT and excises on alcohol, tobacco and sugar, which are estimated to have contributed ½ pp. to annual inflation. Recent falls in global energy and food prices have not yet translated into a decrease in inflation, but are expected to drive down inflation in the fourth quarter of 2011. The government has decided on further increases in taxes on alcohol, tobacco, sweets, energy, cars and some services from 2012, which are estimated to add almost 1 pp. to inflation in 2012. However, as base effects from elevated commodity prices fade, HICP inflation is nevertheless forecast to decline from the peak of 3.2% in 2011 to 2.6% in 2012 and further to 1.8% in 2013.

Relatively high inflation has led to a decrease in real earnings despite rises in nominal wages. This complicates the new rounds of wage negotiations as employee demands for wage growth have increased. Wage growth, which is settled by multiannual collective agreements and is in the short term relatively insensitive to swings in output, is set to remain relatively robust. Nevertheless, second-round inflation effects are forecast to be relatively small in light of decelerating economic activity.

Public deficit forecast to settle at slightly over ½% of GDP in 2012-13

A buoyant economic recovery and discretionary tax increases of about 0.7% of GDP have boosted public finances in 2011, with the general government deficit forecast to decline from 2.5% of GDP in 2010 to 1% of GDP in 2011. On 5 October the government announced its budget proposal for 2012 and the medium-term spending limits extending until 2015. The government plans a wide range of both increases and decreases to various revenue and expenditure items, aiming to shift taxation from direct to indirect taxation and increase social spending while cutting administrative expenditure and transfers to local governments (the latter is technically neutral in terms of direct impact on the consolidated general government finances, but might indirectly induce budget consolidation at the local governments). At the general government level, the consolidated measures foreseen in the budget proposal improve public finances in 2012 by 0.5% of GDP on account of revenue measures. For 2013, based on measures detailed in the spending limits decision, the current forecast includes revenue-based consolidation measures worth about 0.3% of GDP and expenditure side consolidation of 0.2% of GDP. Some additional tax measures will likely be detailed over the course of 2012 and included in the 2013 budget in due course.

Fiscal policy is estimated to be broadly neutral in 2012-13, as the consolidation effort by the central government is partly offset by the somewhat looser aggregate fiscal position at the municipal level and by a projected rise in debt-servicing costs in 2013. Even though the general government debt level has been increasing relatively quickly since the 2009 global crisis brought public finances into deficit, a rise in debt servicing costs was averted by exceptionally low effective interest rates on Finnish sovereign debt. The forecast assumes a normalisation of interest costs in 2013 towards the long-term average, adding to expenditure growth in that year. The general government deficit is projected to settle to 0.7% of GDP in 2012-13. The debt ratio is forecast to climb from 49.1% of GDP in 2011 to 53.5% of GDP in 2013. Debt projections also include the impact of guarantees to the EFSF, and the participation in the capital of the ESM as planned on the cut-off date of the forecast.

Table II.25.1:

Main features of country forecast - FINLAND

	2010			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		180.3	100.0	3.1	1.0	-8.2	3.6	**3.1**	**1.4**	**1.7**
Private consumption		98.5	54.6	2.5	1.8	-3.1	2.7	**3.7**	**1.4**	**1.9**
Public consumption		44.3	24.6	1.0	1.7	0.9	0.6	**0.5**	**0.6**	**0.6**
Gross fixed capital formation		33.9	18.8	2.7	-0.8	-13.5	2.8	**6.4**	**1.9**	**2.4**
of which : equipment		8.3	4.6	2.8	1.3	-12.0	-6.6	**7.0**	**1.0**	**3.0**
Exports (goods and services)		72.6	40.3	8.9	5.9	-21.5	8.6	**-0.3**	**3.4**	**5.0**
Imports (goods and services)		70.3	39.0	7.0	7.3	-16.1	7.4	**1.1**	**3.5**	**4.8**
GNI (GDP deflator)		183.3	101.7	3.4	1.5	-7.1	3.7	**2.2**	**1.3**	**1.6**
Contribution to GDP growth :	Domestic demand			2.0	1.1	-4.3	2.2	**3.4**	**1.3**	**1.7**
	Inventories			0.3	-0.5	-1.9	0.9	**0.3**	**0.2**	**0.0**
	Net exports			1.0	-0.2	-3.1	0.6	**-0.5**	**-0.1**	**0.1**
Employment				0.4	2.6	-3.5	-1.4	**1.0**	**0.3**	**0.2**
Unemployment rate (a)				11.1	6.4	8.2	8.4	**7.8**	**7.7**	**7.4**
Compensation of employees/head				3.0	4.4	2.3	3.5	**3.2**	**3.2**	**3.2**
Unit labour costs whole economy				0.2	6.0	7.6	-1.5	**1.2**	**2.1**	**1.7**
Real unit labour costs				-1.4	3.7	5.8	-1.9	**-1.2**	**-0.7**	**-0.5**
Saving rate of households (b)				9.4	8.1	11.9	11.3	**7.5**	**7.3**	**7.1**
GDP deflator				1.6	2.2	1.7	0.4	**2.4**	**2.8**	**2.2**
Harmonised index of consumer prices				1.6	3.9	1.6	1.7	**3.2**	**2.6**	**1.8**
Terms of trade of goods				-0.8	-2.4	2.8	-3.0	**-1.7**	**0.3**	**0.1**
Merchandise trade balance (c)				7.7	3.7	1.7	1.6	**0.6**	**0.7**	**0.8**
Current-account balance (c)				4.0	3.2	2.7	2.8	**-0.1**	**0.0**	**0.1**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				4.1	3.3	2.8	2.9	**0.0**	**0.1**	**0.2**
General government balance (c)				0.3	4.3	-2.5	-2.5	**-1.0**	**-0.7**	**-0.7**
Cyclically-adjusted budget balance (c)				0.4	2.5	0.6	-0.6	**0.1**	**0.3**	**0.1**
Structural budget balance (c)				-	2.5	0.7	-0.5	**0.1**	**0.3**	**0.1**
General government gross debt (c)				46.7	33.9	43.3	48.3	**49.1**	**51.8**	**53.5**

(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

Growth to decelerate amid rising uncertainty

Growth shifting to a lower gear

After growing by 5.6% in 2010 the Swedish economy continued its rapid recovery in the first half of 2011, recording an average quarterly growth rate of slightly below 1% q-o-q. Most sectors of the economy contributed to this performance, with household consumption and investment showing particular strength. Although retail sales have had a difficult year of 2011 so far, household consumption has held up well thanks to brisk sales of durable consumer goods such as cars in the first half of the year. Over the summer, however, increased uncertainty regarding sovereign risk in the euro area and its implications for economic growth sapped business and consumer confidence, which has fallen sharply to levels usually observed in connection with very slow or even negative output growth. In addition, the stock market also fell by some 20% over the summer. Hard data for the third quarter are sending mixed messages, with industrial production and new orders on a slightly declining path, while the production of services is still holding up well.

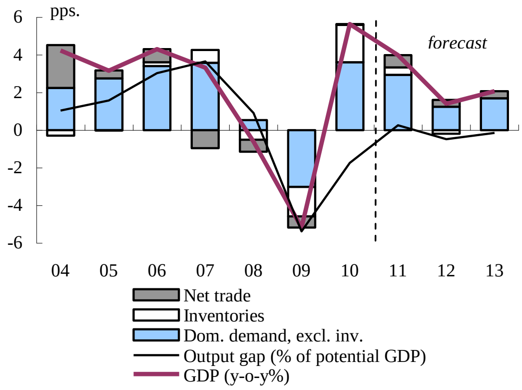
Recovery hampered by weak housing and credit markets

The end of 2011 and early 2012 are likely to be characterised by stagnation. Investment is forecast to contract somewhat as the weaker growth outlook and higher financing costs discourage new investment. The spread between an investment-grade corporate bond and a similarly-rated government bond has reached levels not seen since mid-2009. The inventory cycle is also expected to turn once again, with a negative contribution to growth in 2012.

The outlook for export growth in 2012 is also rather subdued, as a number of trading partners are weighed down by the fallout from the sovereign-debt crisis. Private consumption should also grow less briskly, with household spending held back by bleaker employment prospects and higher perceived uncertainty, including regarding house prices. Some relief is expected from a more accommodative monetary policy stance and stronger real wage developments, whereas fiscal policy is not expected to do much to boost demand in the short term.

To the extent that sovereign debt concerns are expected to abate in the second half of 2012, a gradual recovery is likely to get underway and gain some traction in 2013. However, some lingering uncertainty and the effects of fiscal retrenchment in many trade-partner countries are likely to keep external demand fairly muted. On the domestic side, household consumption should gain support from improving consumer confidence and wage growth, although weak employment growth and a more subdued housing market are likely to have a dampening effect. Investment activity is likely to pick up after a fairly weak 2012, when housing investment in particular slows down significantly. Overall, GDP is expected to grow by 4.0%, 1.4% and 2.1% in 2011, 2012 and 2013 respectively.

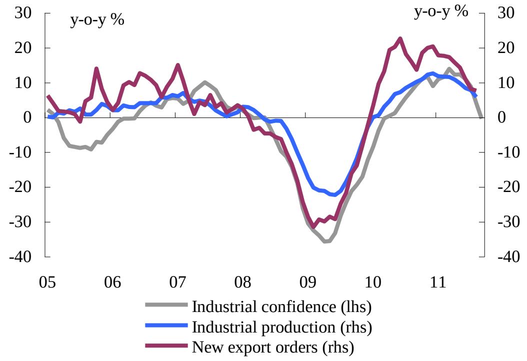
Graph II.26.1: **Sweden - GDP growth and contributions**



Unusually large risks to baseline scenario

Given the concerns regarding the resolution of sovereign-debt problems and the pace of deleveraging in large indebted economies, the degree of uncertainty is particularly large at this juncture. On the upside, given the very high saving rate among Swedish households, private consumption could turn out stronger than expected even under a moderate wage and employment growth scenario. On the downside, a more pronounced correction in the housing market could weigh on growth as households cut spending to rebuild their asset position and housing investment growth slows down further. Swedish household indebtedness is at historically high levels, as a consequence of a more-than-decade-long mortgage borrowing boom. This makes Swedish households very sensitive to mortgage rate hikes. The recently observed trend towards wider spreads between the repo rate and the actual rate facing mortgage borrowers could squeeze household purchasing power even when monetary policy remains in an accommodative mode.

Graph II.26.2: **Sweden - Industrial confidence, industrial production and new export orders**



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. If banks were to pass these higher costs of funding on to their customers, the more costly debt servicing would force households and corporations to rein in consumption and investment. At the same time, heavy reliance of Swedish banks on short-term funding could lead to liquidity shortages and constraints on the supply of credit, which would dampen domestic demand even further.

Decline in unemployment to pause

Strong employment growth since late 2009 brought employment back to its pre-crisis level already by mid-2011. Since labour supply has grown strongly in parallel, the unemployment rate has only retraced half of its previous rise, falling from a peak of about 9% to 7.2% by September 2011 in seasonally-adjusted terms. Companies' hiring plans point to continued growth in employment in the months ahead, although at a slower pace. Sub-par growth is expected to result in meagre job creation over the forecast horizon, limiting further declines in the unemployment rate, which is expected to remain at around 7.3% in 2013. There is some uncertainty as to the net effect on potential labour supply of hysteresis effects following the last recession, on the one hand, and the impact of various reforms aimed at increasing labour supply, on the other.

Over the coming months, a new round of wage bargaining will take place, which will set the scene for wage developments for large swathes of the Swedish work force. As labour market conditions are currently much tighter than was the case when the expiring agreements were concluded in 2010, the new agreements are likely to result in somewhat higher agreed pay increases in 2012 and 2013. However, the still-low labour utilisation rate and the expected economic slowdown should keep overall wage growth stable at 2.7% per year due to weaker wage drift.

Inflation stable below the target

Inflation has remained below 2% in 2011 despite rising food and oil prices. The impact of high commodity prices has been moderated by strong currency appreciation which continued until spring 2011. At the same time, low core inflation (HICP excluding energy and unprocessed food) reflects subdued unit labour costs, stemming from reasonable productivity growth and modest wage increases.

Looking forward, underlying inflation is expected to pick up slightly as the effects of the appreciation of the krona fade out and unit labour costs increase along with decelerating productivity. The increase in core inflation is foreseen to be offset by minimal energy and food price increases reflecting slightly declining commodity prices for both 2012 and 2013. As a result of these opposing forces, annual HICP inflation is forecast to remain relatively stable over the forecast horizon at around 1.5%, rising towards 2% at the end of 2013.

The changes in indirect taxes foreseen for 2012 are expected to have a neutral effect on inflation. The VAT reduction for restaurant and catering services from 25% to 12% is estimated to reduce headline inflation by 0.2 pp. This effect will be counterbalanced by an increase in the excise tax on tobacco and indexing of energy taxes.

Large current-account surplus to persist

The factors behind the persistently high current-account surplus – a high level of saving in both the public and the private sector – are likely to remain in place in the years ahead. The government is determined to ensure sufficient safety margins to maintain the 1% of GDP surplus target. Households, which have recorded significant surpluses due to ample pension savings, are assumed to further increase their savings in the short-run in response to the overall economic uncertainty and declining real house prices. The corporate sector is likely to continue to record a positive trade balance based on a competitive advantage and sizeable surpluses on the income balance supported by extensive profit repatriation. As a result, the current-account surplus is forecast to remain relatively stable over the forecast period at about 6-6.5% of GDP.

Prudent fiscal policy to keep public finances in surplus

With the strong recovery, general government net lending improved in 2010, posting a small surplus of 0.2% of GDP. This is expected to strengthen further to around 1% of GDP in 2011 as a result of still buoyant employment growth having a positive impact on tax revenues. As a percentage of GDP, however, revenues are likely to decrease somewhat, partly due to tax cuts for pensioners. The expenditure ratio is expected to fall more markedly due to the phasing-out of temporary support to municipalities, scaling-back of labour market measures and lower sick-leave payments resulting from previous reforms. As a result of the deceleration of growth and new discretionary measures being introduced as part of the 2012 Budget Bill, the surplus is likely to shrink somewhat next year to around 0.7% of GDP. The main expansionary measures contained in the Budget Bill presented in September are a halving of the VAT rate for restaurant and catering services, extra funding for infrastructure investment and a package of active labour market measures. Overall, the Bill contains measures of about 0.5% of GDP. However, the fiscal stance is likely to be neutral, as some previous measures are expiring.

The structural balance is expected to be fairly stable at slightly below 1% of GDP over the forecast period. With growth picking up in 2013, the headline surplus is expected to widen again. Thanks to this, and planned privatisation receipts of about 0.5% of GDP per year over the forecast period, gross public debt is expected to fall gradually from almost 40% of GDP in 2010 to around 32½% of GDP in 2013.

Table II.26.1:
Main features of country forecast - SWEDEN

		2010			Annual percentage change					
	bn SEK	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		3308.1	100.0	2.7	-0.6	-5.2	5.6	**4.0**	**1.4**	**2.1**
Private consumption		1604.9	48.5	2.0	0.0	-0.3	3.7	**2.6**	**1.2**	**1.6**
Public consumption		893.1	27.0	0.7	1.0	1.2	2.2	**1.1**	**0.9**	**1.0**
Gross fixed capital formation		591.1	17.9	3.0	1.4	-15.9	6.6	**8.5**	**2.3**	**3.5**
of which : equipment		220.9	6.7	5.9	5.5	-25.5	11.7	**8.0**	**2.5**	**6.0**
Exports (goods and services)		1652.7	50.0	7.4	1.7	-13.2	11.1	**7.8**	**3.3**	**5.0**
Imports (goods and services)		1452.9	43.9	5.9	3.5	-13.8	12.7	**7.6**	**2.9**	**4.8**
GNI (GDP deflator)		3368.7	101.8	3.1	0.6	-6.8	5.7	**4.1**	**1.4**	**2.1**
Contribution to GDP growth :	Domestic demand			1.7	0.5	-3.0	3.6	**3.1**	**1.2**	**1.7**
	Inventories			0.1	-0.5	-1.6	2.0	**0.4**	**-0.2**	**0.0**
	Net exports			0.9	-0.6	-0.6	0.0	**0.5**	**0.4**	**0.4**
Employment				0.0	0.9	-2.0	1.1	**2.2**	**0.2**	**0.4**
Unemployment rate (a)				7.5	6.2	8.3	8.4	**7.4**	**7.4**	**7.3**
Compensation of employees/head				4.0	1.5	1.2	2.7	**2.9**	**2.7**	**2.7**
Unit labour costs whole economy				1.3	3.1	4.6	-1.7	**1.1**	**1.5**	**1.0**
Real unit labour costs				-0.4	-0.1	2.8	-2.9	**-0.3**	**0.5**	**-0.3**
Saving rate of households (b)				9.2	13.9	15.6	13.4	**14.0**	**14.9**	**15.0**
GDP deflator				1.7	3.1	1.8	1.2	**1.5**	**1.0**	**1.3**
Harmonised index of consumer prices				1.8	3.3	1.9	1.9	**1.5**	**1.3**	**1.6**
Terms of trade of goods				-0.9	-1.2	1.8	-0.7	**-0.7**	**-0.5**	**0.0**
Merchandise trade balance (c)				6.1	3.7	3.3	2.5	**2.7**	**2.6**	**2.8**
Current-account balance (c)				4.5	8.8	6.8	6.3	**6.4**	**6.3**	**6.4**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				4.2	8.7	6.6	6.2	**6.2**	**6.1**	**6.2**
General government balance (c)				-1.7	2.2	-0.7	0.2	**0.9**	**0.7**	**0.9**
Cyclically-adjusted budget balance (c)				-1.3	1.7	2.5	1.3	**0.9**	**0.9**	**1.0**
Structural budget balance (c)				-	1.4	2.5	1.3	**0.9**	**0.9**	**1.0**
General government gross debt (c)				59.7	38.8	42.7	39.7	**36.3**	**34.6**	**32.4**

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

27. THE UNITED KINGDOM

The pause in growth risks becoming prolonged

Growth slows as external events increase uncertainty

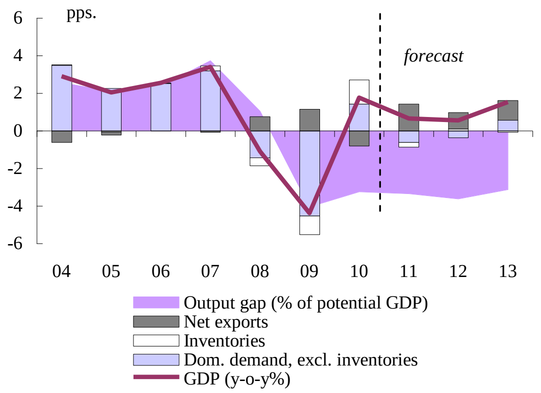
After a promising start to 2010, the UK economic outlook has deteriorated significantly since the turn of the year. Output in the second quarter of 2011 was just 0.6% higher than in the same quarter of 2010. Quarterly output did not grow at all in the three quarters to the second quarter of 2011, remaining 4.4% below its pre-crisis peak. This puts the UK's recovery performance well behind its major peers.

Much of this weakness can be traced back to household consumption, which has contracted for four successive quarters. Households spent 6.4% less in the second quarter of 2011 than at the pre-crisis peak in the fourth quarter of 2007. Survey indicators suggest that this weakness will continue, with consumer confidence as measured by the Commission's Business and Consumer survey having fallen sharply since May 2011 to below its average for 2008 and 2009, although still well above its January 2009 trough. Overall economic sentiment, as measured by the Economic Sentiment Indicator, has also declined sharply since May, having risen above its long-term average in the early part of the year.

On the output side, while the manufacturing sector's strong recovery has faltered recently, services sector performance has strengthened during 2011, growing 0.7% and 0.2% in the first two quarters respectively. Without the growth contribution from services, the economy would have contracted in both quarters. However, it seems unlikely that this stronger services performance will be maintained. Confidence in the sector appears to have declined even more sharply than in the rest of the economy over recent months. Domestic consumption and financial services exports, the two main sources of demand for services, also appear likely to remain subdued.

Net exports and corporate investment remain the best hopes for a return to stronger growth although the prospects for both are mixed. On the export side, the Bank of England's announcement in October that it would increase the size of its quantitative easing programme should help prevent any substantial appreciation in sterling, protecting exporters' price competitiveness. Weak domestic demand should also hold back import growth. However, the external sector's growth contribution has remained volatile; it contributed 1.4 pps. q-o-q in the first quarter of 2011 but subtracted 0.3 pp. in the second quarter. Weakness in the euro area, the UK's main export market, will hold back external demand at least in the short term. As regards corporate investment, the sector's large financial surplus, the government's announcement that it will explore options to use its own balance sheet to support corporate debt issuance and highly expansionary monetary policy all provide reasons for optimism. However, weak demand prospects are likely to make firms cautious about investing and ongoing stress in the banking sector will continue to hamper credit availability.

Graph II.27.1: **The United Kingdom - Output gap and contributions to GDP growth**



In all, this yields an uncertain outlook. The slowdown which began at the end of 2010 now looks more like a prolonged soft patch than a simple weather-related blip. Risks from the euro-area sovereign-debt markets and the banking sector heighten this uncertainty. As such a contraction in GDP in at least one of the next few quarters cannot be ruled out. However, the outlook for corporate investment and net exports still appears positive enough to justify a forecast of modest positive growth with the economy expanding by 0.7% in 2011, 0.6% in 2012 and 1.5% in 2013. The substantial downward revision from the spring forecast is explained mainly by the bleaker outlook for household consumption, corporate investment and exports, offset partially by slower expected import growth.

Is the net exports rebound finally with us?

Hopes of an imminent growth impetus from the external sector have been a feature of many UK economy forecasts ever since world trade started to recover with sterling remaining well below pre-crisis exchange rates. Recent data revisions suggest that the external sector has made a more significant contribution to UK growth than first thought. However, strong data on export orders suggest the export rebound may still have further to go. The surge in import growth which accompanied the UK's exit from recession has evaporated with imports falling in both the first two quarters of 2011. Weak consumption growth and the ending of the acceleration in stock building are likely to keep import growth weak or negative throughout the forecast period.

While exports also fell in the second quarter, this followed four consecutive quarters of expansion. The outlook for exports is clouded by uncertainty in the global economy and particularly in the euro area. Given the worsening external conditions, forecast export growth has been revised down significantly since the spring forecast. However, with the exchange rate likely to remain competitive following the Bank of England's decision to undertake more quantitative easing firms should have a continuing incentive to explore new foreign markets. With hindsight it is not surprising that an increase in the resources devoted to export markets has been slow to materialise given economic uncertainty and restricted credit availability, but the longer the exchange rate remains at its current level, the greater should be firms' confidence that a sudden appreciation is not imminent. As such, the forecast is for modest export growth to exceed weak import growth, with the external sector contributing positively in all three years of the forecast.

Consumption and investment yield weaker outlook for domestic demand

It has been clear for some time that domestic demand growth in the coming years would be weak. With government consumption falling, consumers struggling with falling real incomes and the stock cycle having peaked, the only bright spot on the horizon was business investment which is overdue a rebound after its unprecedented collapse during the recession.

The surprise has been the degree of weakness in household consumption, which was 1.7% lower in the second quarter of 2011 than in the same period in 2010. During 2010, as the household saving rate fell steadily from its crisis peak it appeared that households were eschewing additional saving in favour of maintaining reservation levels of consumption as falling real wages pushed down their disposable incomes. However, this trend now appears to be going into reverse. Households could be becoming more cautious as the risk of unemployment heightens. The partial reversal of the 2010 housing market recovery could also have discouraged households from relying on house price rises as a means to increase net worth. Finally, while household debt has fallen as a percentage of GDP since 2009, it remains well above the EU average, implying a continuing incentive for households to deleverage. The increasing certainty that interest rates will remain at record lows for a significant period is the only compensating factor. Given that these conditions are likely to persist, consumption is forecast to remain very subdued with a strong possibility of further quarterly contractions around the turn of the year. With real wages forecast to return to at least modest growth, this implies a continuing increase in the household saving rate.

This leaves business investment likely to be the only significant support to domestic demand. With investment as a share of GDP having fallen to around 14% of GDP in the aftermath of the crisis, compared to a long-run average of 17%, a significant recovery seems likely at some point if only to keep up with depreciation. What remains uncertain is the timing. The sharp fall in investment in the first quarter of 2011 is likely to push its annual growth rate into negative territory, barring a significant rebound in the last two quarters. Whether this represents a one-off reverse or a more persistent malaise is as yet unclear. On the one hand, low real and nominal interest rates (which should go even lower once credit easing and increased quantitative easing are implemented), the huge corporate sector surplus and the need for further investment to maintain the existing capital stock should all push investment higher. However, on the other hand, continued problems with access to credit for some firms, uncertain prospects for domestic and external demand and lower capacity utilisation seem to offer a strong incentive to firms to wait and see before committing to large scale capital spending. On balance, this yields a forecast of moderate investment growth with the level remaining well below pre-crisis peaks.

Employment: can private sector growth offset public sector cuts?

The most concrete signal that the slowdown in the recovery had begun to impact the labour market came through data showing that unemployment increased from 7.7% over the period March-May 2011 to 8.1% for June-August. This was its highest level since 1996. Over the past year, the labour market has been characterised by strong falls in public sector employment offset by modest private sector growth. Because it accounts for 80% of employment, a small percentage growth rate in the private sector can offset a much bigger percentage fall in public sector employment. However, it appears that in the three months to August, private sector growth was insufficient to achieve this.

The speed of the reduction in public sector jobs has been surprising. Excluding the impact of the state-owned banks, it fell by 228 000, or 3.8%, in the year to June 2011. This already equates to around half the total job cuts which the Office for Budget Responsibility (OBR) estimated would be necessary to deliver the government's spending reduction targets over the period to 2014-15.[73] To the extent that this represents an unexpected frontloading of the planned job cuts, it should improve the employment outlook since fewer cuts can be expected later on. However, it could also imply that government departments are implementing a higher-than-expected share of the cuts through job losses rather than cuts to other spending. In that case, the employment outlook could be worse than previously thought. Both explanations probably have some validity. However, once falling private sector employment intentions are also taken into account the overall employment outlook does appear markedly worse. As such, unemployment is forecast to rise to 8.7% in 2012 before falling back to 8.6% in 2013.

Stronger monetary stimulus but credit growth remains weak

In spite of the extraordinary monetary stimulus provided by the Bank of England (interest rates at 0.5% and quantitative easing increased from GBP 200 bn to GBP 275 bn, or 19% of GDP), net lending to business has remained mainly negative. Some positive signs may be starting to emerge. Net lending by UK banks to UK businesses was positive in August, only the fourth positive month since January 2009, although three-month and annual net lending remained negative. Furthermore, data suggest that in the first half of the year UK banks met their targets for increased lending to businesses agreed under the Project Merlin initiative. The government's plans for credit easing should further support net lending. However, if this does represent the start of a recovery in net lending it will be severely tested in its early days. A peak in maturities of UK banks' debt in the fourth quarter of 2011, coupled with heightened risk aversion and tighter liquidity conditions as a result of the distress in some euro area sovereign debt markets will test banks' already fragile will to lend. As such, any recovery in business lending seems likely to be reliant on a degree of government support.

Inflation: still high but still likely to fall

The short-term outlook for inflation has worsened somewhat over recent months, with household energy prices pushing the annual rate to 5.2% in September. However, while the upward shock to inflation, driven by VAT rises, commodity price increases and sterling depreciation, has lasted long enough to stretch the definition of "temporary" right to its limit, the case for believing that inflation will fall sharply in 2012 remains as strong as ever. While average earnings growth ticked up in the three months to July 2011, it fell back again sharply in August, in line with the generally weaker labour market picture, continuing to show an absence of second round effects from the price shock. Furthermore, the circumstances which have driven inflation so high over the past eighteen months look unlikely to be repeated. While sterling may weaken slightly in response to looser monetary policy, a further fall on the scale seen in 2008 and 2009 seems highly unlikely. Weakness in the global economy makes any sharp increases in world commodity prices improbable and all of the announced VAT rises have now been implemented. Inflation is therefore forecast to fall to 2.9% in 2012 and 2.0% in 2013.

Continuing commitment to fiscal consolidation

Despite the downturn in both the global economy and the outlook for the UK, the government has maintained its strong commitment to fiscal consolidation. Recently published outturn data for 2010/11 produced a positive surprise with the deficit estimated at 9.6%, below the 9.9% forecast in the March 2011 budget. The main sources of the

(73) Here and throughout 20xx/xx refers to the UK financial year which runs from 1 April to 31 March.

lower-than-expected deficit were methodological changes and upward revisions to GDP.

Recent data have shown government revenues to be slightly below their forecast levels. However government consumption has been lower than expected leaving overall borrowing lower than forecast by the OBR in March 2011. Significant improvements in the structural deficit have already been delivered, as it fell to 8.3% of GDP in 2010/11 from 9.8% of GDP in 2009/10. The consolidation is forecast to slow slightly in 2011/12 before picking up again through 2012/13 and 2013/14. The worsening growth outlook implies clear downward risks to the latest UK official fiscal forecasts published in March. However, given that the UK's own fiscal targets are assessed in cyclically-adjusted terms, there will be flexibility to accommodate a nominal overshoot in the deficit to the extent that the OBR judges the overshoot to have been driven by cyclical rather than structural weakness. The higher deficit forecast does imply some risk to the 2014/15 Excessive Deficit Procedure deadline for reducing the deficit below 3% of GDP. However, given the uncertainty around current growth forecasts it is preferable to focus on the structural budget which is still forecast to show a strong improvement.

In policy terms, the only change of note since the spring forecast has been the decision that central government will fund the extension to 2013 of a freeze in the Council Tax collected by local authorities. This is estimated to cost GBP 800 million (0.06% of GDP) and will be funded through efficiency savings in other areas.

Gross debt for 2010/11 was revised up by 3.9 pps. to 80.6% of GDP, following the inclusion of Eurostat's amendments on the treatment of financial sector interventions. It is projected to rise throughout the forecast period although the rise will slow significantly in 2013/14, reflecting the lower forecast deficit.

Table II.27.1:

General government projections on a financial year basis

	2009/10	2010/11	2011/12	2012/13	2013/14
	Actual		Forecast		
General government balance	-11.7	-9.6	-8.6	-7.3	-5.2
Structural budget balance	-9.8	-8.3	-7.2	-5.8	-4.0
General government gross debt	72.6	80.6	83.3	87.7	89.7

Table II.27.2:

Main features of country forecast - THE UNITED KINGDOM

	2010			Annual percentage change						
	bn GBP	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		1458.5	100.0	3.0	-1.1	-4.4	1.8	**0.7**	**0.6**	**1.5**
Private consumption		937.9	64.3	3.3	-1.5	-3.5	1.1	**-1.1**	**-0.5**	**0.8**
Public consumption		338.1	23.2	1.9	1.6	-0.1	1.5	**1.5**	**-1.0**	**-1.6**
Gross fixed capital formation		217.1	14.9	4.1	-4.8	-13.4	2.6	**-1.6**	**1.1**	**2.9**
of which : equipment		76.5	5.2	5.5	-5.2	-22.0	8.6	**-5.7**	**3.4**	**6.1**
Exports (goods and services)		429.0	29.4	5.6	1.3	-9.5	6.2	**5.1**	**3.4**	**4.8**
Imports (goods and services)		478.0	32.8	6.4	-1.2	-12.2	8.5	**0.2**	**0.5**	**1.4**
GNI (GDP deflator)		1481.3	101.6	3.2	-0.6	-4.8	1.8	**-0.1**	**1.0**	**1.1**
Contribution to GDP growth :	Domestic demand			3.2	-1.4	-4.5	1.5	**-0.6**	**-0.4**	**0.6**
	Inventories			0.1	-0.4	-1.0	1.3	**-0.2**	**0.1**	**-0.1**
	Net exports			-0.3	0.8	1.1	-0.8	**1.4**	**0.9**	**1.1**
Employment				0.7	0.7	-1.6	0.2	**0.9**	**0.5**	**0.5**
Unemployment rate (a)				6.6	5.6	7.6	7.8	**7.9**	**8.6**	**8.5**
Compensation of employees/head				4.3	1.7	2.7	3.3	**2.0**	**2.5**	**3.0**
Unit labour costs whole economy				2.0	3.6	5.7	1.7	**2.2**	**2.5**	**2.0**
Real unit labour costs				-0.4	0.5	4.0	-1.1	**-0.7**	**-0.6**	**-0.2**
Saving rate of households (b)				6.8	2.0	6.0	5.3	**7.7**	**7.3**	**7.6**
GDP deflator				2.4	3.1	1.7	2.8	**2.9**	**3.1**	**2.2**
Harmonised index of consumer prices				2.0	3.6	2.2	3.3	**4.3**	**2.9**	**2.0**
Terms of trade of goods				0.0	-0.6	0.1	0.6	**-0.9**	**-0.6**	**-0.5**
Merchandise trade balance (c)				-3.4	-6.6	-5.9	-6.8	**-6.3**	**-5.6**	**-5.0**
Current-account balance (c)				-1.8	-1.8	-1.4	-2.5	**-2.5**	**-0.9**	**-0.2**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-1.7	-1.5	-1.2	-2.3	**-2.3**	**-0.7**	**0.0**
General government balance (c)				-2.8	-5.0	-11.5	-10.3	**-9.4**	**-7.8**	**-5.8**
Cyclically-adjusted budget balance (c)				-3.2	-5.5	-9.7	-8.9	**-8.0**	**-6.3**	**-4.5**
Structural budget balance (c)				-	-5.0	-9.5	-8.9	**-8.0**	**-6.3**	**-4.5**
General government gross debt (c)				43.7	54.8	69.6	79.9	**84.0**	**88.8**	**85.9**

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

28. CROATIA

Subdued economic activity in the near term

From recession to stabilisation in 2011

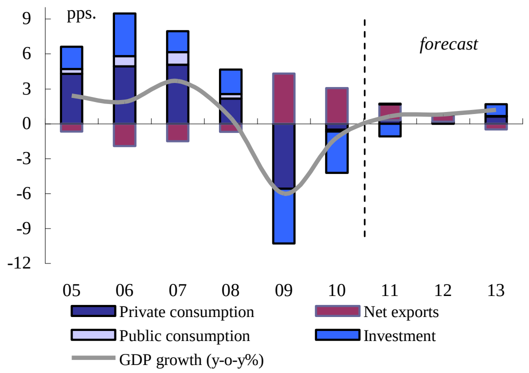
Croatia's economy remained in recession through the first quarter of 2011 when output was still contracting. Economic activity seems to have stabilised subsequently. In the second quarter real GDP increased 0.8% y-o-y (0.4% in seasonally-adjusted quarter-on-quarter terms). Monthly data suggest a higher growth rate for the third quarter, partly thanks to a strong tourist season.

In spite of improving GDP data the economy has not yet generated self-sustaining growth momentum. Consumer spending increased 1.7% y-o-y in the second quarter and monthly retail trade indicate that it is on track for a somewhat stronger increase in the third quarter. Capital spending, however, is still far from recovering. Fixed investment was 7.3% lower year-on-year in the second quarter. Construction activity, in particular, has not shown any sign yet of reversing its declining trend. The working-day adjusted index of construction works was 11.2% lower year-on-year in August. Exports, which had picked up in 2010, are not a main driver of the economy in 2011. Real exports were only 1.1% higher year-on-year in the second quarter in spite of relatively strong import growth among trading partners. If net exports remain the main contributor to GDP growth in 2011 (see *Graph II.28.1*), it is only due to declining import volumes which were 6% lower year-on-year in the second quarter. This in itself is indicative of a still depressed level of economic activity.

Monthly data on industrial production also indicate that an economic recovery has not yet materialised. The working-day adjusted volume of industrial production was 4.4% lower year-on-year in August and the trend is pointing downwards. Tourism, on the other hand, is providing substantial support for the economy in 2011. One important physical indicator, the number of foreign tourist arrivals, increased 7.6% year-on-year in the first eight months.

The labour market has so far remained weak, but shows first signs of stabilising. Employment was 3.5% lower year-on-year in the second quarter according to the labour force survey. The unemployment rate stood at 13.5%, which is 1.1 pps. higher year-on-year. More timely unemployment rate readings, however, stopped rising in year-on-year terms in September, when the rate was 0.1 pp. lower than a year earlier.

Graph II.28.1: **Croatia - GDP growth and contributions**



A sluggish growth performance

Although economic activity seems to have bottomed out in the first half of 2011 at 8% below the pre-recession level, it is unlikely that the economy will return to even moderately high growth in the near term. The economy is facing considerable headwinds on the way to a full recovery. Weak labour market conditions continue to exert downward pressure on incomes and spending. The high level of indebtedness of households and companies and their need to deleverage are weighing on domestic demand. Consumer confidence seems to suffer from the uncertainties originating in the international environment. Investor confidence has taken a severe hit during the recession and will take some time to recover. On the positive side, EU accession, expected to take place in mid-2013, should provide a stimulus to investment activity over the forecast period.

Although the banking sector showed resilience during adverse conditions in recent years, the renewed turbulence in international financial markets may become a challenge for Croatia's foreign-owned banks. Maintaining financial stability will be crucial for a recovery of the real economy. The quality of loan portfolios has continued to decline in 2011 as reflected in a rising share of non-performing loans. The government's credit programmes via the Croatian Bank for Reconstruction and Development and the central bank's provision of additional liquidity to the banking sector in March seem to have had only a marginal impact on overall lending to the corporate sector. More recently, the central bank has withdrawn kuna liquidity from the banking sector in the context of downward pressure on the kuna's exchange rate vis-à-vis the euro. The downward trend of interest rates for bank loans, which persisted through the summer months, is therefore unlikely to be maintained. Worsening financing conditions for the foreign parent banks of Croatia's main banks are also likely to result in less favourable credit conditions for households and businesses.

The need for fiscal consolidation restricts the room for government spending. In the present forecast, public consumption and investment develop in line with the government's current fiscal policy strategy. Overall, government spending will only contribute marginally to GDP growth.

Following a disappointing performance and a large loss of market share in 2011, Croatia's exports are projected to accelerate moderately over the following two years, but still remain below the Croatia's export market growth. During the recent recession, net exports provided a significant offset to faltering domestic demand (see *Graph II.28.1*). This pattern will, to a more limited extent, be continued in 2011, particularly because imports are still declining. In the following year, when imports are projected to increase marginally, the contribution of net exports will be significantly smaller. When investment activity picks up speed in 2013, imports will accelerate and net exports will subtract from GDP growth just as before the recession.

The forecast projects annual GDP growth of 0.6% in 2011. Thereafter, growth is forecast to increase moderately to 0.8% in 2012 and 1.2% in 2013. Over this three-year period domestic demand gradually replaces net exports as the driver of GDP growth. Uncertainties emanating from the international banking system and financial markets constitute the major downside risk to this growth scenario.

Current account close to balance

Croatia's external balances underwent significant correction in the context of the recent recession. Sharply reduced capital inflows and 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.

In 2011 the value of imports has started to rise again because of higher prices for imported goods and services which, in terms of the overall import bill, more than offset still declining import volumes. Export receipts have also been boosted by higher prices. Overall, the external balance of goods and services is projected to swing into surplus in 2011 for the first time since the early 1990s. However, this improvement is being counteracted by a rising deficit on the balance of primary incomes and current transfers. Consequently, the current-account deficit is only projected to narrow marginally to 1.2% of GDP.

In 2012, the current-account deficit is projected to decline to 0.6% of GDP partly because the growth of export volumes will again outstrip the growth of import volumes in the context of still sluggish output growth. Another factor is the assumed decline in commodity prices which leads to a small improvement in Croatia's terms of trade. In 2013, when domestic demand strengthens, the current-account deficit is projected to widen to 1.4% of GDP again. The rise in imports in that year is to a large extent a reflection of the projected pick-up in investment activity.

Low inflation and high unemployment

The recession was associated with a disinflationary process that lowered headline inflation rate to 1.1% in 2010. Disinflation was primarily driven by growing spare resources feeding through to price- and wage-setting. Most prominently, compensation of employees declined slightly on an annual basis. While domestic inflationary pressures have remained subdued in 2011, energy prices and other commodity prices have rebounded. This has raised headline inflation, i.e. the annual change of the consumer price index, to 2.2% in September 2011.

Inflation pressures are expected to remain low over the forecast horizon. Cost-push pressures from the domestic side should remain insignificant as unit labour costs are projected to be almost flat. There should be no imported inflation given the assumption of energy and commodity prices following a slightly declining trajectory. There is some pent-up pressure to increase administered prices, which the government is likely to give in to after the upcoming parliamentary elections. Certain VAT rates may also be hiked in the context of EU accession. Taking all these factors into account, headline inflation is forecast to fall back to 1.5% in 2011 and to rise slightly to 1.7% in 2012.

In the labour market, a turnaround towards employment growth is only expected for 2013. However, the unemployment rate will already peak in 2011 because the ongoing shrinking of the labour force will prevent falling employment to be converted into a rising unemployment rate in 2012. When economic activity picks slightly more strongly in 2013, the unemployment rate is projected to fall to 12.4%, still 4 pps. higher than before the recession. In spite of high unemployment, wages are expected to show downward "stickiness", though more so in the public sector than in the private sector.

A small reduction of the fiscal deficit

The recent recession put public finances under severe pressures, pushing the general government deficit up to 4.9% of GDP in 2010. The deficit is budgeted to increase further to 5.5% in 2011. Based on fiscal outturns in the first three quarters of the year, it appears realistic that this target will be achieved. For the first time in many years a supplementary budget is unlikely to be needed.

Total budgetary revenues are forecast to increase relatively slowly in 2012 and 2013 given the projections for private consumption, employment, wages and inflation. Total budgetary expenditure is are forecast to increase in line with the government's current fiscal policy strategy. On this basis the general government deficit is projected to decline to 5.4% of GDP in 2012 and to 5.2% in 2013. General government debt is projected to increase gradually from 41.2% of GDP at the end of 2010 to 53.8% of GDP at the end of 2013.

The fiscal projections are sensitive to changes in the macroeconomic environment and to the measures that will be taken by the authorities in the context of the state budget for 2012, to be adopted after the upcoming parliamentary elections.

Table II.28.1:

Main features of country forecast - CROATIA

		2010			Annual percentage change					
	bn HRK	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		334.6	100.0	-	2.2	-6.0	-1.2	**0.6**	**0.8**	**1.2**
Private consumption		186.1	55.6	-	0.9	-8.3	-0.8	**0.5**	**0.3**	**1.0**
Public consumption		71.9	21.5	-	1.9	0.0	-0.9	**0.3**	**0.2**	**0.2**
Gross fixed capital formation		72.4	21.6	-	8.2	-11.8	-11.3	**-6.0**	**-1.0**	**4.0**
of which : equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		128.6	38.4	-	2.2	-17.3	6.0	**0.9**	**2.5**	**4.5**
Imports (goods and services)		129.7	38.8	-	3.3	-20.4	-1.3	**-2.0**	**1.0**	**5.0**
GNI (GDP deflator)		323.4	96.7	-	1.3	-6.6	-1.5	**0.2**	**0.7**	**0.9**
Contribution to GDP growth :	Domestic demand			-	3.0	-8.1	-3.5	**-1.1**	**0.0**	**1.6**
	Inventories			-	-0.1	-0.9	-0.4	**0.4**	**0.2**	**0.1**
	Net exports			-	-0.7	3.0	2.6	**1.4**	**0.6**	**-0.5**
Employment				-	1.1	-1.8	-4.0	**-4.0**	**-0.1**	**0.6**
Unemployment rate (a)				-	8.4	9.1	11.8	**13.6**	**13.2**	**12.4**
Compensation of employees/head				-	9.0	2.2	-0.4	**1.1**	**0.4**	**0.8**
Unit labour costs whole economy				-	7.8	6.7	-3.2	**-3.5**	**-0.5**	**0.2**
Real unit labour costs				-	1.7	3.3	-4.2	**-5.1**	**-2.3**	**-1.5**
Saving rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				-	6.1	3.3	1.0	**1.7**	**1.9**	**1.8**
Harmonised index of consumer prices				-	5.8	2.2	1.1	**2.1**	**1.5**	**1.7**
Terms of trade of goods				-	0.6	3.8	1.5	**-1.0**	**0.4**	**-0.3**
Merchandise trade balance (c)				-	-22.6	-16.2	-13.0	**-12.8**	**-12.4**	**-13.1**
Current-account balance (c)				-	-9.1	-5.5	-1.4	**-1.2**	**-0.6**	**-1.4**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-	-	-	**-**	**-**	**-**
General government balance (c)				-	-1.4	-4.1	-4.9	**-5.5**	**-5.4**	**-5.2**
Cyclically-adjusted budget balance (c)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				-	28.7	35.0	41.2	**45.8**	**50.0**	**53.8**

(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
Catching up, albeit with question marks ...

Post-crisis recovery in 2010 and first half of 2011

Output growth accelerated markedly during 2010, from around 1% y-o-y in the first half to about 3% in the second, bringing annual growth to 1.8%, compared to -0.9% the year before. In the first half of 2011, output growth was at around 5% y-o-y. The main sources of growth have shifted, from external demand in the first half of 2010, to investment in the second half of 2010 and the first quarter of 2011 and finally to private consumption in the second quarter of 2011. However, besides a base effect a significant part of the domestic recovery appears to reflect public spending, in particular in the area of construction but also in the form of early transfer payments ahead of general elections in June 2011.

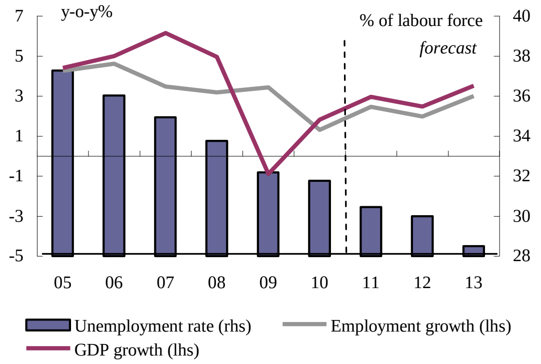
On the back of strong domestic demand, the current account deteriorated, from 2.8% of GDP in the fourth quarter 2010 to around 4¼% of GDP in the second quarter of 2011 (four-quarter moving average). Capital inflows in the form of current private transfers were slightly lower in the first half of 2011, but the overall level is still high at 19% of GDP. In March, the government decided to use about half of an IMF Precautionary Credit Line. As a result, additional funds amounting to some 3% of GDP strengthened the country's foreign exchange reserves.

The central government deficit rose from -2.5% of GDP at the end of 2010 to a full-year estimate of around -3½% of GDP in 2011. Revenues rose in line with nominal GDP, but spending was slightly higher, mainly due to increased capital spending. In September 2011, the government adopted a supplementary budget, mainly reallocating spending in order to meet the -2.5% deficit target.

Inflation started to decelerate after a peak in May 2011, coming down to 3.4% y-o-y in September. On average, inflation was 4.1% in the first nine months, with the main drivers being strong rises for food, rents but also energy prices.

Official labour market data point to a continued, albeit decelerated increase in overall employment. Employment has 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 high, affecting one third of the labour force. Youth unemployment declined to some 52%.

Graph II.29.1: **The former Yugoslav Republic of Macedonia - Labour market**



The exchange rate of the Denar has remained largely stable 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 growth will largely depend on domestic factors

In the second half of 2011, domestically-driven growth impulses are expected to peter out, leading to annual GDP growth of around 3%. Private consumption and investment are likely to be the main sources for growth, benefiting from improved consumer confidence, stable private transfers and an improved business environment. In 2012, export market growth is expected to decelerate, but thanks to the completion of some export-oriented FDI projects, the country's exports are likely to expand in 2012 and 2013. This, together with stable private consumption and increased investment, will allow the economy to grow at 2½% in 2012 and around 3½% in 2013. Inflation is expected to decelerate in 2012, following the expected slowdown in prices for energy and metals, but – on the back of stronger growth – to accelerate again in 2013.

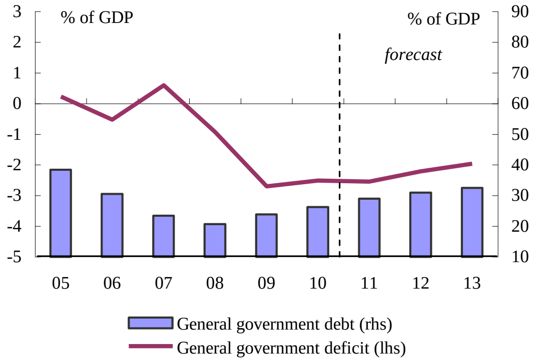
Employment growth has been rather high in recent years, at about 3% a year. However, a significant share of those additional jobs are probably the result of a stricter registration procedure and do not necessarily reflect newly created employment. In view of the probably still difficult international environment in 2012-13, 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 remain externally competitive. Improving the country's labour income thus requires raising productivity by modernising and deepening the capital stock.

In response to the mainly domestically-driven growth, the current-account deficit in 2011 is likely to rise above 5% of GDP. In 2012 and 2013, the surplus in private current transfers is expected to decline from its current exceptionally high level of nearly 20% of GDP towards its longer term average. In 2012, this will keep the current-account deficit fairly stable despite a slight drop in the trade deficit, reflecting weaker domestic demand. In 2013, the deceleration of current transfers will contribute to the rise in the current-account deficit.

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 2011 to 2¼% in 2012 and 2% in 2013. 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**



Extra-budgetary, credit-financed public spending will lead to a marked rise in public sector debt, from around 26% of GDP in 2010 to 32½% in 2013. Given the government's intentions to continue financing large parts of its structural reform agenda through extra-budgetary loans, a faster increase in public indebtedness cannot be excluded.

The main risk to the forecast is related to a deterioration of the international business environment.

Table II.29.1:

Main features of country forecast - THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

	2010		Annual percentage change						
	bn MKD Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	427.2	100.0	1.0	5.0	-0.9	1.8	**3.0**	**2.5**	**3.5**
Private consumption	320.0	74.9	-	6.6	-5.5	0.6	**2.5**	**1.5**	**3.0**
Public consumption	78.2	18.3	-	10.6	0.5	-3.0	**-1.5**	**-0.2**	**1.5**
Gross fixed capital formation	80.0	18.7	-	5.4	-8.3	-2.7	**6.0**	**9.0**	**12.0**
of which : equipment	-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)	202.1	47.3	-	-6.3	-16.2	23.4	**10.0**	**6.0**	**6.5**
Imports (goods and services)	281.4	65.9	-	0.8	-15.3	10.9	**6.7**	**4.9**	**7.1**
GNI (GDP deflator)	413.5	96.8	-	8.6	-0.4	-0.8	**2.8**	**2.6**	**4.2**
Contribution to GDP growth : Domestic demand			-	8.6	-5.4	-0.6	**2.7**	**2.9**	**5.2**
Inventories			-	0.3	1.3	0.0	**0.0**	**0.0**	**0.0**
Net exports			-	-3.9	3.4	2.5	**0.3**	**-0.5**	**-1.7**
Employment			-	3.2	3.4	1.3	**2.5**	**2.0**	**3.0**
Unemployment rate (a)			-	33.8	32.2	31.8	**30.5**	**30.0**	**28.5**
Compensation of employees/head			-	12.9	6.2	1.6	**2.0**	**1.9**	**3.0**
Unit labour costs whole economy			-	11.0	10.9	1.1	**1.5**	**1.5**	**2.5**
Real unit labour costs			-	3.3	10.1	-1.1	**-0.3**	**-2.3**	**-2.1**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			43.9	7.5	0.7	2.2	**1.8**	**3.9**	**4.7**
Harmonised index of consumer prices			-	8.3	-0.8	1.6	**3.8**	**2.5**	**3.3**
Terms of trade of goods			-	-3.7	-4.7	2.3	**-4.9**	**-0.1**	**-0.1**
Merchandise trade balance (c)			-	-26.2	-23.1	-21.0	**-23.0**	**-22.5**	**-23.0**
Current-account balance (c)			-	-12.5	-6.4	-2.2	**-5.5**	**-5.5**	**-6.5**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-	-	-	**-**	**-**	**-**
General government balance (c)			-	-0.9	-2.7	-2.5	**-2.5**	**-2.2**	**-2.0**
Cyclically-adjusted budget balance (c)			-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)			-	-	-	-	**-**	**-**	**-**
General government gross debt (c)			-	20.7	23.8	26.2	**29.0**	**31.0**	**32.5**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

30. ICELAND

Uncertainties persist amid a tentative recovery

Economic recovery has continued in the first half of 2011….

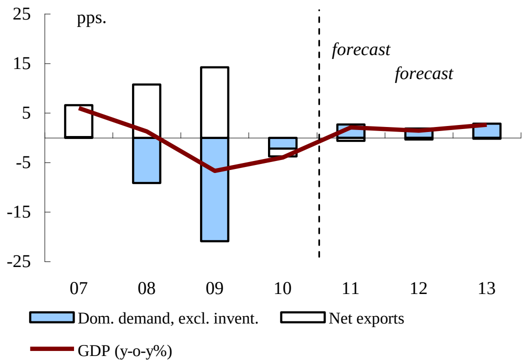
Following the collapse of its banking sector in October 2008, Iceland went into a long and deep recession. Real GDP declined by 6.7% in 2009 and by 4% in 2010, driven by a strong adjustment in domestic demand. The recession bottomed out in the second half of 2010 and the economy started to recover mildly, based on stronger private consumption and exports. In the first half of 2011, the recovery continued with real GDP growing at 2.5%. However, the pace of recovery is faltering and uncertainties continue to persist. Annual growth decelerated in the second quarter of 2011 compared to the first, as investment spending remained subdued. Export performance deteriorated while imports continued to grow markedly, while private consumption was buoyed by temporary measures.

High-frequency indicators for the third quarter present a mixed picture of the economic situation. Consumer confidence indicators dropped, the number of corporate insolvencies doubled in July on a year-on-year basis and most of Iceland's trading partners have revised downwards their economic forecasts. On the other hand, tourism has performed particularly well during the summer months and there were indications for a rise in private spending.

… with household spending being supported by temporary measures…

The outlook for domestic demand in 2011 has improved somewhat compared to the spring forecast due to stronger private consumption. However, this improvement is expected to be short-lived as private consumption in 2011 is largely driven by transitory factors. These include one-off pay increases related to wage settlements, extraordinary mortgage interest allowances, temporary withdrawals of savings from voluntary pension schemes, as well as one-off debt relief measures provided in the context of debt restructuring. While those factors provide temporary stimuli to private consumption, the three year wage agreement between social partners of May 2011 with relatively strong wage increases may have a more lasting positive impact on disposable incomes and on consumers' expectations. However, at the same time there are constraining factors as well. Consumer inflation has been on the rise recently, eating into households' real purchasing power. Many households will be left with a significant debt burden even after benefiting from various debt restructuring measures. The level of unemployment, although declining, is projected to stay far above pre-crisis levels. The 2012 budget contains further tax increases, reducing disposable incomes. Fiscal consolidation measures could lead to further cuts in benefits and transfers to households. Overall, this points to a deceleration of private consumption growth in 2012.

Graph II.30.1: **Iceland - GDP growth and contributions**



…while uncertainties persist with respect to firms' investment plans.

The corporate sector continues to suffer from financial problems and many firms still 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 in late 2010 to accelerate this process and create certainty among debtors and creditors. The scheme became fully operational in May 2011 and is supposed to assist a large number of firms in financial distress. Once corporate debt restructuring starts gaining pace, investment activity by SMEs is likely to unfold slowly. However, some investment related to the construction of the planned aluminium smelter at Helguvik is likely to be postponed beyond the forecast horizon, and investment in another energy company has been scaled down. Over the short term, a boost to investment is expected from the construction at the Straumsvik smelter. Moreover, some private public partnership projects in transport and tourism are being elaborated, but their implementation is unlikely to start soon. In line with government's announcements, public investments are projected to decline again in 2011, before new projects will lead to some growth acceleration in 2012. Taking this into account, this forecast projects gross fixed capital formation to grow by around 7% in 2011 and around 9% in 2012.

A weaker global outlook limits prospects for stronger exports

Weaker than expected economic growth in Iceland's main trading partner countries has worsened the prospects for external demand and export growth. Moreover, growth in a large share of merchandise exports will continue to be subject to technical constraints (fishing quotas, capacity of aluminium smelters). Services exports are projected to benefit from stronger activity in the tourism industry.

In sum, the forecast projects a mild recovery in 2011, followed by a moderation of growth in 2012. Over the forecast horizon, domestic demand will be the main driver of growth whereas the contribution of net exports is likely to remain negative.

The inflation outlook has worsened…

After annual inflation fell below the Central Bank's official 2.5% inflation target in early 2011, it accelerated markedly to 5.7% in September as a result of rising oil, house and food prices and strong pass-through effects from unexpectedly high wage increases negotiated in the collective wage agreements of May. As those effects have worsened the inflation outlook, inflation expectations have risen markedly.

At the same time, a modest recovery of GDP growth and disposable incomes should not exert significant additional inflationary pressure over the medium term. The inflation outlook rests on the assumption of a continued exchange rate stabilisation, which has been a prime focus of monetary policy. As a result, annual average inflation is forecast to fall gradually over the forecast horizon.

…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 a weaker outlook for Iceland's main trading partners limits external demand and export growth. 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 banks in winding-up proceedings. The forecast assumes that related accrued interest on the debt of those banks will be gradually reduced.

…but the labour market continues to struggle with relatively high, but falling, unemployment

The labour market remains weak, with unemployment close to historic highs. The unemployment rate rose from 7.8% in the first to 8.5% in the second quarter of 2011, only slightly lower than in the same period of 2010. The level of total employment fell by 1% y-o-y in the first quarter and rose marginally in the second quarter (0.3%).

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 below 7% by the end of the forecast period, still far above the average pre-crisis rate.

Public finance consolidation continues…

Following a marked deterioration of public finances in the wake of the crisis, the authorities took a series of fiscal consolidation measures with a view to reducing the fiscal deficit by around 3 pps. in 2010, from 10% of GDP in 2009. While the measures were successful in reining in spending and strengthening revenues, the revised general government deficit in 2010 remained at virtually the same level as in 2009 as a percentage of GDP, as the overall budget spending was affected by called guarantees for the Housing Financing Fund and the Agricultural Fund. The 2011 budget framework adopted in late 2010 initially foresaw new fiscal measures amounting to around 2.7% of GDP, with most of the adjustment on the expenditure side (2% of GDP). This changed the structure of fiscal adjustment compared to 2009 and 2010, which was largely based on revenue measures. The first half of the year showed strong revenue performance and spending below projections. Total general government revenues increased by 3.9% and total spending by 0.9% y-o-y. The general government balance recorded a deficit of 2.5% of (annual) GDP, compared to a deficit of 3.1% in the first half of 2010.

...but fiscal policy has been relaxed somewhat in the course of 2011.

However, in the context of the three-year collective wage agreement adopted in spring, the government took additional spending commitments, comprising additional public investment as well as social protection, active labour market policy and education measures. As a result, expenditure adjustment measures in 2011 are expected to account for 1% of GDP instead of 2% as initially foreseen, and total spending is likely to exceed the initial level. Therefore, the budget balance for 2011 has been revised and a higher fiscal deficit is projected as compared to the spring forecast. A continuation of fiscal consolidation is, however, assumed for 2012 and 2013, leading to a gradual reduction of the fiscal deficit and allowing for a marginal decrease of the general government debt-to-GDP ratio below 90%.

Table II.30.1:

Main features of country forecast - ICELAND

		2010		Annual percentage change						
		bn ISK Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		1537.1	100.0	3.6	1.3	-6.7	-4.0	**2.1**	**1.5**	**2.7**
Private consumption		787.7	51.2	3.8	-7.9	-14.9	-0.4	**3.8**	**1.5**	**2.0**
Public consumption		398.6	25.9	3.0	4.6	-1.7	-3.4	**-0.7**	**-0.3**	**0.0**
Gross fixed capital formation		199.9	13.0	6.4	-20.0	-51.1	-8.0	**6.8**	**8.9**	**13.4**
of which : equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		861.3	56.0	4.8	7.0	6.6	0.4	**1.8**	**2.1**	**3.0**
Imports (goods and services)		707.0	46.0	6.2	-18.4	-24.0	4.0	**3.4**	**3.3**	**3.9**
GNI (GDP deflator)		1219.4	79.3	3.5	-16.4	-4.3	-5.4	**4.5**	**3.5**	**3.7**
Contribution to GDP growth :	Domestic demand			4.5	-9.1	-20.9	-2.2	**2.7**	**1.9**	**2.9**
	Inventories			0.0	-0.3	-0.1	-	**-**	**0.0**	**0.0**
	Net exports			-0.8	10.8	14.2	-1.5	**-0.6**	**-0.4**	**-0.2**
Employment				1.6	0.8	-6.0	-0.3	**0.2**	**0.2**	**0.5**
Unemployment rate (a)				3.4	3.0	7.2	8.0	**7.6**	**7.3**	**6.7**
Compensation of employees/head				6.6	4.1	-3.0	3.7	**5.1**	**4.7**	**4.7**
Unit labour costs whole economy				4.6	3.6	-2.4	7.6	**3.2**	**3.5**	**2.4**
Real unit labour costs				0.6	-7.4	-9.8	0.7	**-0.5**	**0.0**	**-0.7**
Saving rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				3.9	11.8	8.3	6.9	**3.7**	**3.4**	**3.1**
Harmonised index of consumer prices				-	12.8	16.3	7.5	**4.1**	**3.6**	**2.8**
Terms of trade of goods				-0.2	-6.3	-12.1	8.5	**-1.7**	**-0.3**	**-0.1**
Merchandise trade balance (c)				-2.3	-0.4	6.0	7.8	**5.8**	**5.0**	**4.5**
Current-account balance (c)				-6.2	-24.5	-11.7	-11.2	**-10.4**	**-9.6**	**-9.5**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-	-	-	**-**	**-**	**-**
General government balance (c)				-	-13.5	-10.0	-10.1	**-5.7**	**-4.4**	**-3.1**
Cyclically-adjusted budget balance (c)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				-	70.3	87.9	92.9	**92.4**	**90.2**	**88.3**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

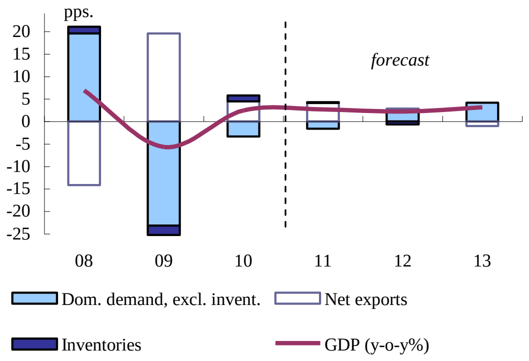
31. MONTENEGRO

A dilemma of growth and sluggish credit

Return to positive territory

The economy recorded growth of 2.5% in 2010, significantly higher than the 1% expected in the spring forecast. Final demand registered a slight recovery of 0.5% in 2010 compared with a contraction of 17.6% a year earlier. Although credit provision contracted throughout 2010, resilient tourism supported private consumption, especially in the second half of the year. The recovery of the metal industry was reflected in the positive growth contributions of stocks but also in the expansion of exports, which nevertheless remained below pre-crisis levels. Exports of services rose faster than exports of goods. Constraints on public spending resulted in a marginal (-0.3%) decline of public consumption.

Graph II.31.1: **Montenegro - GDP growth and contributions**



In the first half of 2011, the economy continued to register sustained output growth of between 2.1% and 2.5% according to national sources. Retail sales increased by 14.3% y-o-y as consumers remained confident and employment recorded positive growth. On the supply side, manufacturing grew by 9.7%, while the construction sector expanded by 30.8%. Tourism, catering, and agriculture also grew on an annual basis.

A credit-constrained catching-up

Compared to the spring, the current forecast presents a revised growth scenario based on the higher than expected outcome in 2010. Early indications point to slightly stronger growth in 2011 as credit activity - at least for households - is expected to show some positive growth in the last quarter of the year. Tourism will continue to support private domestic demand.

Risk aversion has resulted in the failure of several privatisation tenders, hampering the outlook for gross fixed capital formation in the medium term. Therefore, any GFCF growth would likely result from ongoing works in some tourism resorts, as well as some new energy and water treatment projects. However, towards the end of the forecast period investment should benefit from more favourable financing conditions.

The unemployment rate remains high, although it decreased marginally from 19.7% in 2010 to 19.2% in June 2011. Its persistence at high rates reflects significant layoffs resulting from the restructuring of the metal and mining industries and a subdued and lagged response of the labour market to the initial phase of recovery. Stronger domestic demand over the forecast horizon should progressively improve the employment situation, although given the seasonal nature of key sectors like tourism, agriculture or construction, full-year employment rates will remain still weak.

Consumer prices remained subdued in 2010 thanks to a reduction in the prices of food and electricity. Inflation accelerated in the first half of 2011, averaging 3.5%, due to oil and food price dynamics. However, the gradual recovery of domestic demand should not exert strong inflationary pressures and consumer price inflation is expected to remain around 3% in the medium-term. Moreover, the expected moderation of global energy prices should support price stability.

Net exports supported the recovery in 2010 as imports still contracted while exports benefited from the rise in metal prices. However, local aluminium production should reach full capacity by end-2011, thus limiting the scope for further expansion of the main merchandise exports.

The current-account deficit narrowed to 25% of GDP in 2010, and decreased further during the first half of 2011 to 22.4% of GDP, driven by a widening surplus of the services and income accounts. Yet, the recovery of domestic demand and in particular of investment will result in an acceleration of imports, leading to a negative contribution of net exports by 2013.

The most important downside risk is probably related to a liquidity squeeze that would result from a contraction of credit and the very high level of non-performing loans. Other main risks are related to the external environment, including a slowdown of the global and EU economic recovery as well as potential metal price shocks.

Overall, growth is likely to decelerate in 2012 before rebounding in 2013 due to stronger external demand, but also owing to a recovery of bank lending supporting private consumption and investment.

The case for a structurally balanced budget

Past efforts to balance the budget have showed their limitations in an economic environment of scarce credit. In 2010, the lack of liquidity in the economy resulted in the accumulation of tax arrears worth 2% of GDP, fuelling a larger than planned consolidated deficit of 4.9% of GDP. For the first half of 2011 the cumulative deficit stood at 1.6% of annual GDP. On current trends, the activation of state guarantees extended to the bankrupt steel mill will further increase the projected full-year deficit by 1 pp. to 4% of GDP, compared to the 2.5% target of the medium-term fiscal framework. Based on the expectation that the authorities will effectively address the issue of tax arrears, the forecast envisages a steady annual decline in the deficit during the forecast period.

Public debt increased from 41% of GDP in 2010 to 45% of GDP in June 2011, and is expected to increase slightly in 2012 as a consequence of additional budgetary financing needs. The gradual improvement in the budget balance should reduce borrowing requirements, and consequently the public debt stock. However, contingent liabilities from state guarantees amounting to some 10% of GDP pose an important risk to this debt projection, in particular as about half of the guarantees are linked to a single company.

Table II.31.1:

Main features of country forecast - MONTENEGRO

		2010		Annual percentage change						
	mio EUR	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		3103.9	100.0	-	6.9	-5.7	2.5	**2.7**	**2.2**	**3.2**
Private consumption		2550.7	82.2	-	-	-	-	**1.0**	**1.6**	**2.5**
Public consumption		727.2	23.4	-	-	-	-	**0.2**	**1.4**	**1.8**
Gross fixed capital formation		655.1	21.1	-	-	-	-	**-11.5**	**4.5**	**10.0**
of which : equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		1077.4	34.7	-	-	-	-	**-**	**-**	**-**
Imports (goods and services)		1958.9	63.1	-	-	-	-	**-**	**-**	**-**
GNI (GDP deflator)		3083.1	99.3	-	-	-	-	**3.6**	**2.2**	**2.6**
Contribution to GDP growth :	Domestic demand			-	19.6	-23.2	-3.4	**-1.6**	**2.4**	**4.2**
	Inventories			-	1.5	-2.1	1.4	**0.2**	**-0.7**	**0.0**
	Net exports			-	-14.1	19.6	4.5	**4.1**	**0.5**	**-1.0**
Employment				-	4.5	-3.8	-1.9	**0.9**	**0.9**	**1.7**
Unemployment rate (a)				-	16.8	19.1	19.7	**19.2**	**19.0**	**18.6**
Compensation of employees/head				-	17.9	-2.9	4.3	**4.4**	**3.7**	**5.3**
Unit labour costs whole economy				-	15.3	-1.0	-0.2	**2.5**	**2.4**	**3.8**
Real unit labour costs				-	7.0	-3.3	-1.8	**-1.9**	**-2.8**	**-2.0**
Saving rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				-	7.7	2.4	1.6	**4.5**	**5.3**	**5.9**
General index of consumer prices				-	8.5	3.4	0.5	**3.1**	**2.6**	**3.2**
Terms of trade of goods				-	-	-	-	**-**	**-**	**-**
Merchandise trade balance (c)				-	-67.5	-46.2	-42.8	**-40.0**	**-39.2**	**-40.0**
Current-account balance (c)				-	-50.7	-30.1	-	**-21.5**	**-20.4**	**-21.3**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-	-	-	**-**	**-**	**-**
General government balance (c)				-	-	-4.4	-4.9	**-4.2**	**-2.6**	**-1.3**
Cyclically-adjusted budget balance (c)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				-	31.9	40.7	42.9	**44.0**	**44.4**	**42.8**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

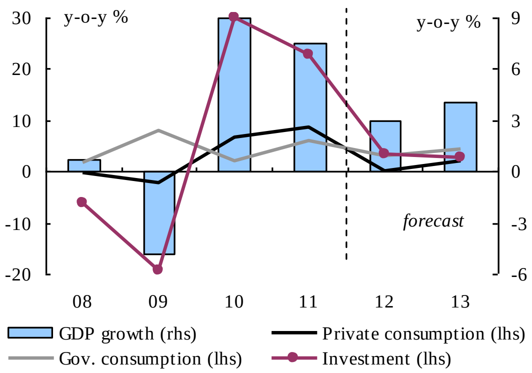
32. TURKEY

Riding the tides of the slowdown

Growth in 2011 stronger than expected …

Annual GDP growth reached 9% in 2010 and 10% in the first half of 2011, helped by strong base effects, in spite of low exports growth caused by sluggish demand in Turkey's chief export markets. The major factors behind this robust performance were the continued buoyancy of investment and a positive contribution from net trade (as import volumes weakened for the first time since 2009). At the same time, the economy showed some signs of overheating: external imbalances widened rapidly and inflationary pressures intensified, in part due to a significant rise in core inflation and the uncertain outlook for Turkish exports. In the second half of 2011 and in 2012, growth is therefore 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**



…but is set to slow sharply in 2012…

A marked growth slowdown is expected until end-2012. In 2011 consumer spending was buoyed by rapidly increasing access to bank lending and a sharp improvement in the labour market; but lending growth to consumers has slowed noticeably and the seasonally adjusted unemployment rate has edged up since March. In addition, core inflation is picking up. It has moved up steadily this year (unlike the very volatile headline inflation) to 7.5% in September – the highest since early 2009 – reflecting the exchange rate pass-through, relatively high commodity prices and declining spare capacity in the economy as a whole. This will undermine consumers' purchasing power.

As a result of these headwinds, consumer spending growth is expected to slow from 8⅔% in 2011 to less than 1% in 2012, and accelerate in 2013 to about 2%. While investment was still very robust in the second quarter of 2011, it too is set to weaken sharply. Though lending to corporate sector has held up better than that to consumers in recent months, it is only a matter of time before it starts to slow significantly. In early September, bank lending rates on commercial loans were 3 pps. higher than in March. This development, together with the sharp deterioration in the global economic environment, is likely to make businesses more cautious about expanding investment, particularly in the light of the very strong recovery since 2009. Annual investment growth is expected to slow from nearly 33% in 2011 to 3% next year and 4.6% in 2013.

The combination of much more subdued domestic demand and a more competitive exchange rate should ensure that net exports continue to support GDP growth in 2012 and 2013. However, the scale of the boost will be constrained by the weakness of demand in the EU, the main destination of Turkey's exports. Although export volume growth is expected to hover around 5% in 2012, slightly higher than in 2011, overall GDP growth is forecast to ease to 3% in 2012 next year, before accelerating to 4% in 2013.

External deficits pose a major risk

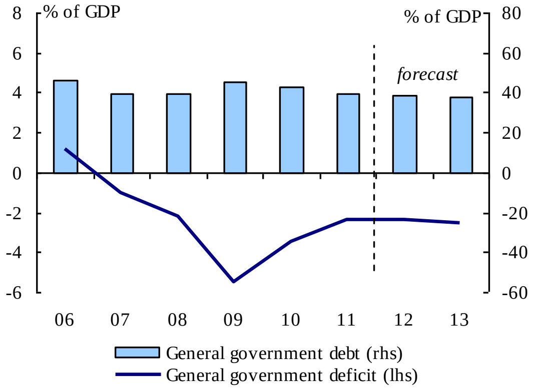
While signs of improving external balances in recent months are clearly welcome (July's seasonally-adjusted trade gap was the smallest this year), the prospective turnaround is still set to be comparatively modest, with the current-account deficit shrinking gradually from about 10% of GDP this year to 8.5% of GDP in 2013. This still represents a large external financing requirement during a period of very sluggish global growth and fragile financial markets. However, notwithstanding this major vulnerability, the Turkish lira has not been as badly affected by the market turmoil of summer 2011 as may have been feared, even rallying against the euro since the end of August. But the risk of a disorderly fall in the lira's exchange rate – with all its negative consequences for the economy – remains significant. Provided this danger can be avoided, the central bank is expected to leave its key repo rate unchanged at 5.75% until mid-2012, by which time the headwinds facing both the domestic and global economy should be easing.

Fiscal and monetary fine-tuning 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 currently about 40%. As a result of expansionary fiscal policy, public finances deteriorated in 2009 but thereafter continued to improve through to 2011. In 2010 and 2011, the budget deficit narrowed to 3½% of GDP and is forecast to amount to 2.5% in 2012-013. However, only a credible, strong and binding fiscal rule will lead to this expected fiscal outcome.

Downside risks also stem from increased expenditure, as the Medium-Term Programme (2012-14) appears rather optimistic on medium-term growth.

Graph II.32.2: **Turkey - Public finances**



Eventual policy tightening will be required if the 5% inflation target for 2012 and 2013 is to be hit. However, given the state of global markets and the scale of Turkish banks' need for foreign financing, the policy rate seems currently of limited importance.

Labour markets are affected by the slowdown in growth. Employment growth is expected to fall back to levels of about 1% annually, from the 6% growth registered in 2010. The rapid decrease in the unemployment rate, which came down from 12½% in 2009 to less than 11% in 2010 and 10% by mid-2011, is virtually halted.

Table II.32.1:
Main features of country forecast - TURKEY

	2010		Annual percentage change						
bn TRY	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	1105.1	100.0	4.4	0.7	-4.8	8.9	**7.5**	**3.0**	**4.1**
Private consumption	786.1	71.1	4.4	-0.3	-2.3	6.6	**8.7**	**0.2**	**1.9**
Public consumption	157.5	14.2	4.3	1.7	7.8	2.0	**6.0**	**3.1**	**4.4**
Gross fixed capital formation	206.9	18.7	5.8	-6.2	-19.0	29.9	**22.8**	**3.3**	**2.7**
of which : equipment	-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)	233.1	21.1	9.2	2.7	-5.0	3.4	**4.1**	**4.9**	**8.7**
Imports (goods and services)	294.0	26.6	10.4	-4.1	-14.3	20.7	**18.6**	**-1.9**	**2.0**
GNI (GDP deflator)	1092.2	98.8	4.4	0.6	-5.0	9.2	**7.6**	**3.1**	**4.2**
Contribution to GDP growth : Domestic demand			4.9	-1.6	-5.5	11.3	**11.5**	**1.3**	**2.5**
Inventories			0.1	0.3	-2.1	2.3	**-0.1**	**-0.1**	**0.0**
Net exports			-0.5	1.9	2.8	-4.5	**-4.1**	**1.6**	**1.3**
Employment			0.8	2.2	2.0	6.2	**1.6**	**1.0**	**1.4**
Unemployment rate (a)			7.9	9.7	12.5	10.7	**10.2**	**10.3**	**10.4**
Compensation of employees/head			49.2	8.6	3.5	9.9	**-15.4**	**11.8**	**7.1**
Unit labour costs whole economy			44.1	10.3	10.9	7.1	**-20.0**	**9.6**	**4.3**
Real unit labour costs			-2.3	-1.5	5.4	0.6	**-25.8**	**3.4**	**-0.8**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			47.5	12.0	5.3	6.5	**7.7**	**6.0**	**5.2**
Harmonised index of consumer prices			-	10.4	6.3	8.6	**8.5**	**7.2**	**7.2**
Terms of trade of goods			-0.3	-3.2	2.5	-	**-**	**-**	**-**
Merchandise trade balance (c)			-5.1	-6.8	-3.8	-7.6	**-10.8**	**-9.9**	**-9.6**
Current-account balance (c)			-1.8	-5.7	-2.3	-6.6	**-9.8**	**-8.8**	**-8.6**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-	-	-	**-**	**-**	**-**
General government balance (c)			-	-2.2	-6.7	-3.5	**-2.4**	**-2.4**	**-2.5**
Cyclically-adjusted budget balance (c)			-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)			-	-	-	-	**-**	**-**	**-**
General government gross debt (c)			-	39.5	45.5	43.2	**39.7**	**38.7**	**37.8**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

33. THE UNITED STATES OF AMERICA

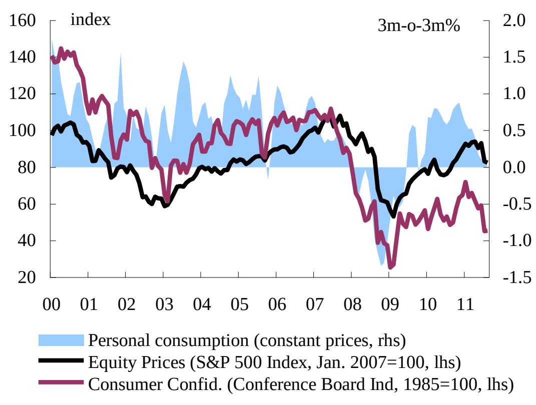
Slowing growth amid greater uncertainty and fiscal consolidation

Weak private consumption and fiscal policies depress growth

The outlook for the US economy has worsened considerably compared to the spring forecast. Real GDP growth decelerated from 0.8% q-o-q in the fourth quarter of 2010 to a mere 0.1% and 0.3% in the first and second quarter of 2011, the weakest growth since the first half of 2009. The slowdown largely reflected weak private consumption coupled with an increasingly negative impulse from the fiscal side. Some temporary factors weighed on activity in the first half of 2011. High commodity prices combined with supply-chain disruptions relating to the Japanese tsunami disaster constrained output across the economy and deferred corporate employment and investment decisions despite buoyant profits.

Private consumption slowed sharply from a robust 0.9% q-o-q in Q4-2010, down to 0.3% and 0.5% in the first and second quarter of 2011. Households have borne the brunt of peaking oil prices and stagnation in the labour market, where improving trends from 2010 and early 2011 have stalled leaving unemployment above 9% amid the lowest activity rates since the early 1980s. Confidence and wealth were further depressed by a series of stock market declines that wiped out most of the gains from the 2010 equity rally and led consumers to further curtail spending.

Graph II.33.1: **US - Household consumption and confidence vs. equity prices**



Private capital formation fared better, supported by robust corporate investment in equipment, software and structures in selected industries (e.g. mining). Investment benefited from robust corporate balance sheets and the low cost of capital but has become increasingly thwarted by rising uncertainty regarding the economic outlook.

The housing market remained subdued in 2011 and most indicators suggest that it has not bottomed out yet. New residential construction stabilised at a low level but the large supply of existing homes coupled with weak demand is putting downward pressure on prices. House price indices declined in the first quarter of 2011 and have remained flat since then.

Fiscal contraction vs. loose monetary policy

The gradual phasing out of crisis stimulus packages as well as shrinking public consumption and investment resulted in a fiscal contraction in the first half of 2011. By contrast, monetary policy remained accommodative with the Fed committing to keep policy interest rates at historically low levels (0% to ¼%) at least until mid-2013. Furthermore, during its September meeting the Fed decided to extend the average maturity of its holdings of securities so as to put downward pressure on longer-term interest rates and help make broader financial conditions more accommodative (*'Operation Twist')*.

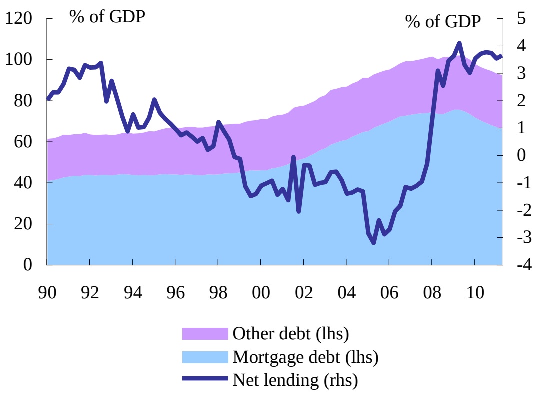
Labour market improvements, still tentative at the turn of 2010, have stalled. After falling to 8.8% in March 2011 the unemployment rate rebounded above 9% in April and has remained there since then. Persistently weak labour demand led to the lengthening of unemployment duration, increased exits from the labour force and depressed activity rates. High commodity prices (predominately oil and food) pushed consumer price inflation up to its pre-crisis level (3.9% y-o-y in September 2011). At roughly half the rate of headline inflation, core inflation has been accelerating as well to reach 2% in August (up by 1 pp. from January), suggesting significant pass-through of supply shocks to core prices.

Slow growth scenario

Real GDP is expected to rebound from the exceptionally sluggish growth in the first half of 2011, but the overall outlook for the coming years has deteriorated considerably compared to the spring forecast. Real GDP growth is expected to decelerate from 1.6% in 2011 to 1.5% in 2012 and 1.3% in 2013, largely reflecting the negative impact of fiscal policies combined with slack private demand, weakened by domestic and global uncertainties.

Private consumption, which accounts for almost 70% of US GDP, is predicted to remain sluggish over the forecast horizon. Weak employment prospects coupled with a contractionary fiscal environment (particularly in 2013) will generally restrain spending, as will the feeble situation in the housing market and the ongoing process of deleveraging. While households have made great progress in deleveraging in recent years (see graph below), the process is likely to continue over the forecast horizon, limiting the chances of robust credit-led spending growth.

Graph II.33.2: **US - Housholds debt and net lending**

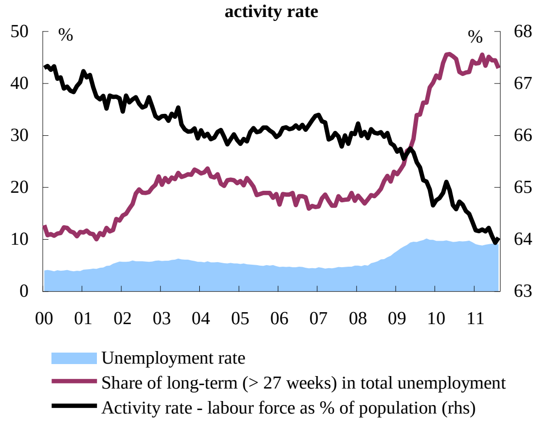


Grim labour market outlook delays recovery

The labour market outlook is expected to remain challenging, reflecting high unemployment combined with declining activity rates. The share of long-term unemployed (27 weeks +) in the total number of unemployed has registered historical highs (above 40% since early 2010 compared to 10% in the 1990s), pointing to new labour market and social challenges emerging in the US. These negative trends limit prospects for a major decline in the number of unemployed over the forecast horizon. The unemployment rate is expected to remain at around 9% until 2013.

Gross fixed capital formation is expected to regain some strength in line with rebounding corporate investment. We expect confidence to improve gradually over the forecast horizon under the assumption of a resolution to the European debt crisis and the emergence of a convincing plan for medium-term fiscal consolidation in the US. This should lead corporations to intensify investment particularly in areas neglected in the past couple of years (e.g. structures, transportation equipment).

Graph II.33.3: **US - Unemployment and activity rate**



Private residential investment has yet to bottom out as the persistently difficult labour market situation limits the scope for a rebound in the short term. At present, a flat supply of new homes meets a rising number of existing homes on sale. The resulting downward pressure on prices further worsens the position of homeowners , leading to more mortgage defaults via a feedback loop. This situation is expected to ease in the course of 2012 and trigger a very subdued and gradual recovery of house prices and, subsequently, of residential investment.

Uncertain profile of fiscal consolidation

Fiscal policy is set to exert an increasing drag on economic growth over the forecast horizon. On 2 August President Obama signed *the Budget Control Act of 2011* (*BCA*) which cuts federal spending over the next 10 years in exchange for raising the debt ceiling. The act imposes budget cuts amounting to at least USD 2.1 trillion until 2021. Out of this amount USD 0.9 trillion will come from agreed caps on discretionary spending while an additional USD 1.2 trillion is to be found by 23 November by the bipartisan Congressional Committee for Deficit Reduction (CCDR). If the Committee fails to reach an agreement, broad-based spending cuts are to be applied automatically from 2013 of an amount equal to the difference between the agreed savings and the USD 1.2 trillion target.

The *BCA* sets the US on a path of steady consolidation that is designed to be front-loaded in

2012 and 2013, with deficit reduction equivalent to 2.3% and 3% of GDP in both years. This results from the *BCA*-agreed spending cuts coupled with the scheduled expiration of the 2010 payroll tax cuts and unemployment benefits, the expiration of the 2001 and 2003 Bush tax cuts as well as the ongoing effect of crisis-linked stimulus and other programmes coming to an end.

However, the amount of actual fiscal tightening over the forecast horizon is likely to be lower than implied by the current law, due to a number of recent initiatives aimed at easing the major fiscal drag ahead. This forecast assumes that: (i) the least disputed tax-cuts-related part of the USD 447 bn *American Jobs Act* proposed by President Obama in early September will be enacted into law generating a positive fiscal impulse of around 1% of GDP; (ii) the Bush tax cuts set to expire in 2012 are likely to be partially extended, thus easing the 2013 consolidation by around 1% of GDP. The extent of fiscal restraint in 2013 is unclear, due to the unknown outcome of the Committee's negotiations at the time of publication, as well as to the number of policy options currently discussed in Congress.

Risks tilted to the downside

The risks to the outlook are clearly tilted to the downside. Fiscal policy will remain a source of uncertainty as the design of medium-term fiscal consolidation is complicated by the weak economic outlook and a political gridlock ahead of the presidential elections. Should the consolidation plan to emerge from the current debate be insufficiently ambitious or credible for financial markets, this would undermine already weak business and household confidence. Resuming stock market declines triggered by any unfavourable policy developments domestically or internationally could further harm consumer confidence and discourage spending, putting the modest growth scenario at risk.

Table II.33.1:
Main features of country forecast - THE UNITED STATES

	2010			Annual percentage change						
	bn USD	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP		14531.0	100.0	3.2	-0.4	-3.5	3.0	**1.6**	**1.5**	**1.3**
Private consumption		10245.5	70.5	3.5	-0.6	-1.9	2.0	**2.1**	**1.3**	**1.6**
Public consumption		2618.3	18.0	1.5	2.6	2.0	1.0	**-0.8**	**0.0**	**-1.3**
Gross fixed capital formation		2116.4	14.6	5.0	-5.8	-16.0	1.8	**3.3**	**4.0**	**4.9**
of which : equipment		1116.8	7.7	7.2	-5.5	-18.6	17.3	**7.1**	**4.6**	**5.5**
Exports (goods and services)		1840.8	12.7	5.7	6.1	-9.4	11.3	**6.6**	**5.9**	**7.7**
Imports (goods and services)		2356.9	16.2	7.7	-2.7	-13.6	12.5	**5.8**	**5.5**	**8.0**
GNI (GDP deflator)		14678.5	101.0	3.3	-0.1	-4.2	3.8	**2.2**	**1.6**	**1.4**
Contribution to GDP growth :	Domestic demand			3.5	-1.1	-3.8	1.9	**1.9**	**1.6**	**1.7**
	Inventories			0.0	-0.5	-0.8	1.7	**-0.1**	**0.1**	**-0.1**
	Net exports			-0.4	1.2	1.2	-0.5	**-0.1**	**-0.1**	**-0.3**
Employment (*)				1.3	-0.7	-5.0	-0.6	**0.4**	**0.4**	**0.7**
Unemployment rate (a)				5.3	5.8	9.3	9.6	**9.0**	**9.0**	**8.8**
Compensation of employees/head				3.8	3.3	2.1	2.7	**3.0**	**2.5**	**2.5**
Unit labour costs whole economy				1.9	2.9	0.5	-0.9	**1.8**	**1.4**	**1.8**
Real unit labour costs				-0.3	0.7	-0.6	-2.1	**-0.3**	**-0.4**	**0.4**
Saving rate of households (b)				8.3	9.9	9.8	9.7	**9.1**	**9.3**	**9.1**
GDP deflator				2.2	2.2	1.1	1.2	**2.1**	**1.8**	**1.4**
General index of consumer prices				-	3.8	-0.4	1.6	**3.2**	**1.9**	**2.2**
Terms of trade of goods				-0.2	-5.9	6.3	-1.8	**-0.3**	**1.6**	**-0.2**
Merchandise trade balance (c)				-3.9	-6.0	-3.8	-4.6	**-5.1**	**-5.0**	**-5.4**
Current-account balance (c)				-3.2	-4.8	-3.3	-3.3	**-3.3**	**-3.1**	**-3.5**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-3.2	-4.7	-3.3	-3.3	**-3.3**	**-3.2**	**-3.5**
General government balance (c)				-2.6	-6.4	-11.5	-10.6	**-10.0**	**-8.5**	**-5.0**
Cyclically-adjusted budget balance (c)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				64.0	71.8	85.8	95.2	**101.0**	**105.6**	**107.1**

(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.

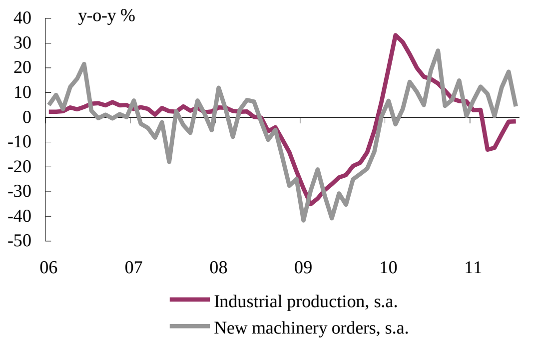
34. JAPAN

Strong rebound in the short run but fading prospects

Earthquake fallout was sharp but short-lived

The 2008-09 crisis was followed by six quarters of relatively strong growth up to the third quarter of 2010. The resulting cumulative GDP growth of 6% over this period helped make good almost two thirds of the GDP losses posted during the crisis. However, the final quarter of 2010 GDP marked a turning point in this recovery, as GDP subsequently fell by a cumulative 2% up to the second quarter of 2011, mainly due to the triple disaster that hit on 11 March. The ensuing shock curtailed consumption significantly in the weeks following the earthquake. In April the supply-chain disruptions led to the biggest drop in industrial production on record.

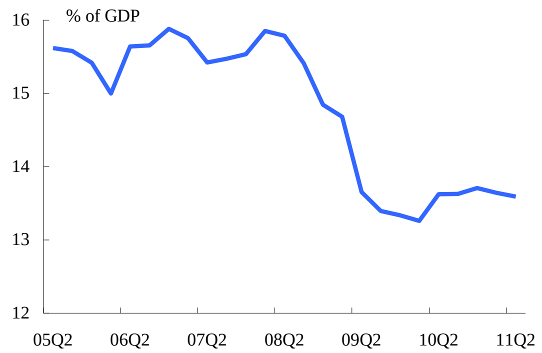
Graph II.34.1: **Japan - Industrial production and new machinery orders**



Exports, as well as world production of cars and some other items, were severely constrained for a couple of months because intermediate components were difficult to replace. A shortage in electricity supply forced corporations and consumers alike to reduce energy consumption. From late April/early May onwards the supply-chain disruptions were overcome. Consumers regained confidence and spending increased (energy-saving appliances rose strongly). Corporations adjusted rapidly to electricity shortages, limiting negative effects on production. However, with a significant number of nuclear power plants shutting down either permanently or for inspection, and the need for additional oil imports for electricity production, the disaster is set to have a more long-lasting impact on the Japanese economy over and above the immediate reconstruction costs.

As a result of the disaster GDP contracted 0.9% q-o-q in the first quarter of 2011. The blow to the economy continued in the second quarter, as quarterly GDP declined again (-0.5%). However, the very weak start of the second quarter combined with the significant improvement in the following months has laid the ground for a strong rebound. Third quarter GDP is expected to have grown by 1.4% q-o-q due to a strong base effect. Some more recent indicators such as machinery orders for August, a leading indicator for non-residential private investment, surprised on the upside and suggest moderately positive GDP growth (0.3%) in the final quarter of 2011.

Graph II.34.2: **Japan - Non residential investment**



Moderate growth ahead

Looking ahead, the prospects for 2012 are for growth of 1.8%, one of the highest expected growth rates among advanced countries. Nevertheless, a strong underlying carry-over of 1 pp. masks the relative weakness of in-year growth. At the end of 2012 GDP is due to still be 4% below the level reached five years earlier.

Exports are likely to grow at a moderate pace and slightly more than imports, allowing a small positive contribution of net exports. However, the strong yen, a narrowing technological advantage compared to some key competitors like Korea, and the dwindling prospects for world trade will limit exports. In addition, anecdotal evidence points to an accelerating relocation of production facilities abroad due to the appreciating yen, an improved skill base in the recipient countries and energy shortages in Japan. However, there are two reasons to believe that exports will nevertheless rise in

2012. First, the recovery in exports has been cut short by the earthquake and recent gains still leave the export level below where it would have been without the earthquake. Second, the weighted average of Japan's export market is growing much stronger than world trade. Almost 60% of Japanese exports go to Asia, whereas only slightly more than a quarter of exports are directed towards either the USA or Western Europe. Assuming that emerging markets continue to outperform advanced economies in 2012, a relatively solid outcome for Japanese exports can be expected.

Investment is expected to positively contribute to growth in 2012 despite some negative factors. Recently falling corporate profits, relocation of production facilities and the strong yen are elements that do not bode well for private non-residential investment. However, the reconstruction needs, investment delays immediately after the earthquake and the base effect do suggest a potential for a rise in non-residential private investment (2.2%) in 2012. Currently private non-residential investment stands at 2003 levels, about 19% below the peak reached in 2008. Non-residential investment is barely 5% higher than at the trough. Despite a structural lack of demand, demographic challenges and confidence problems at the global level, such depressed levels of investment are not likely to last. The desire to keep or regain a technological advantage, to innovate in order to adjust to a shrinking workforce and the superior access to capital compared to foreign competitors suggest a moderately positive investment outlook.

Private residential investment collapsed by about a third between 2007 and 2010, but is likely to grow by around 3% in 2011 and 2012 alike. Easy financing conditions, declining construction prices and changed preferences towards property away from potential Tsunami sites are the main reasons for this moderate growth.

Public investments are a large risk factor to this forecast. Reconstruction needs after the March earthquake are evident and the Diet already passed two supplementary budgets totalling around JPY 6 trillion (1.3% of GDP). A third supplementary budget totalling JPY 12.1 trillion was further outlined by the government. However, neither the composition nor the timing of the planned spending is clear. In addition the government is lacking a majority in the upper house and the final version of the third supplementary budget will be a compromise between the government and at least one opposition party. Public investment is expected to increase by JPY 2.3 trillion (11.5%) to a level last seen in 2006. However, this outcome is far from certain given possible implementation delays and the unclear composition of the spending of the third supplementary budget. Given a broad political consensus about the general need for a third package a significant effect on public investment is assumed in this forecast.

Household consumption is expected to rise only very moderately. A further improvement of the labour market is unlikely over the forecast period. Recent discussions about pension cuts and tax increases amidst rising awareness about the precarious fiscal situation as well as the long-term problems of the pension system will continue to weigh on consumer sentiment. The continuing decline in property values and the large and increasing concentration of wealth among older citizens are negative for the consumption outlook. The strong yen and falling commodity prices will lift the purchasing power of consumers and eventually boost household consumption. However, the strength of the yen, in particular vis-à-vis other Asian currencies, might raise imports and encourage consumption abroad, as anecdotal evidence points to a surge in shopping trips to Seoul and Hong Kong.

Government consumption is steadily increasing due to a rising demographic burden. For 2012 only a very small increase is envisaged, as consolidation pressures are mounting and sufficient revenue-enhancing measures are not likely to be implemented in the short term. In 2013 moderate growth is forecast to continue. It is reasonable to expect lower government expenditure growth as immediate needs due to the earthquake diminish and consolidation efforts are likely to take centre stage.

Fiscal consolidation efforts are stalling

Japan remains the only advanced economy with a gross government debt-to-GDP ratio above 200%. The ratio is still rising and a combination of low growth rates and muted consolidation efforts will not help in correcting this trend. Market access is still granted and the insecurity in world bond markets might even strengthen the home bias of Japanese investors in the short run. But the rising debt ratio makes a serious and workable plan for fiscal consolidation crucial for keeping the situation under control in the medium term. Even an increase of the average interest rate for outstanding government bonds of only 100 basis points would result in higher debt servicing costs worth 2% of GDP. Managing expectations of Japanese investors and implementing a credible fiscal consolidation plan are therefore of utmost importance.

While monetary policy remains supportive of the outlook…

Deflation has stopped for now, even after the rebasing of the goods basket in August, which lowered the official inflation rate by more than ½ pp. Falling commodity prices, the effects of the strong yen and sluggish demand might result in a return to moderate deflation in the forecast period. A return to the more serious deflation seen in 2009 seems unlikely in light of higher price expectations of households. Moreover, if needed the Bank of Japan has a margin for increasing its asset purchasing program further. Financing conditions for companies are easy and currently imply a competitive advantage for corporations in particular compared to Asian rivals.

…downside risks prevail

Downside risks to the forecast dominate. The energy shortage might create more medium-term problems than visible now. Because of the global slowdown, world trade might be weaker than foreseen, and possible falls in sentiment may weigh on investment more heavily than expected in the baseline. There is, however, an upside risk to consumption growth as income prospects might brighten somewhat and households tap into their still sizeable savings. In addition, investments might surprise on the upside if easy financing conditions and the need to modernise and improve equipment win the upper hand.

Table II.34.1:

Main features of country forecast - JAPAN

	2010		Annual percentage change						
bn JPY	Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	479175.9	100.0	1.2	-1.2	-6.3	4.0	**-0.4**	**1.8**	**1.0**
Private consumption	280713.2	58.6	1.3	-0.7	-1.9	1.8	**-0.6**	**0.6**	**0.6**
Public consumption	96061.8	20.0	2.5	0.5	3.0	2.2	**2.3**	**0.9**	**0.5**
Gross fixed capital formation	98434.8	20.5	-0.7	-3.6	-11.7	-0.2	**0.2**	**4.0**	**1.7**
of which : equipment	-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)	72912.0	15.2	5.5	1.6	-23.9	23.9	**1.4**	**3.2**	**4.9**
Imports (goods and services)	67419.0	14.1	3.9	0.4	-15.3	9.8	**4.1**	**2.5**	**4.1**
GNI (GDP deflator)	491703.7	102.6	1.4	-1.2	-6.8	3.8	**-0.3**	**1.8**	**1.1**
Contribution to GDP growth :	Domestic demand		0.9	-1.1	-3.2	1.5	**0.1**	**1.3**	**0.8**
	Inventories		0.0	-0.2	-1.4	0.6	**0.1**	**0.2**	**0.0**
	Net exports		0.3	0.2	-1.5	1.8	**-0.2**	**0.2**	**0.3**
Employment			-0.1	-0.3	-1.5	-0.4	**-0.2**	**0.1**	**0.1**
Unemployment rate (a)			4.0	4.0	5.1	5.1	**4.9**	**4.8**	**4.7**
Compensation of employees/head			0.0	0.0	-3.1	1.0	**1.1**	**1.2**	**1.2**
Unit labour costs whole economy			-1.3	0.9	1.8	-3.2	**1.3**	**-0.5**	**0.2**
Real unit labour costs			-0.7	1.9	2.2	-1.1	**1.7**	**-0.8**	**0.2**
Saving rate of households (b)			15.0	8.9	11.3	9.7	**13.3**	**13.7**	**14.5**
GDP deflator			-0.6	-1.0	-0.4	-2.1	**-0.4**	**0.3**	**0.0**
General index of consumer prices			-	1.4	-1.4	-0.7	**-0.2**	**-0.1**	**0.8**
Terms of trade of goods			-1.8	-11.3	15.8	-6.2	**-1.7**	**-0.7**	**-1.4**
Merchandise trade balance (c)			2.5	0.8	0.9	1.7	**1.2**	**1.2**	**1.1**
Current-account balance (c)			2.9	3.2	2.8	3.5	**2.9**	**2.9**	**2.8**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			2.8	3.1	2.7	3.4	**2.8**	**2.8**	**2.7**
General government balance (c)			-5.1	-2.2	-8.7	-6.8	**-7.2**	**-7.4**	**-7.2**
Cyclically-adjusted budget balance (c)			-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)			-	-	-	-	**-**	**-**	**-**
General government gross debt (c)			125.7	174.1	194.1	197.6	**206.2**	**210.0**	**215.7**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

35. CHINA

Growth is slowing down

In 2010 China's real GDP grew by 10.3%. It was primarily driven by investment, which accounted for around half of GDP (while household consumption was down to one third). In the first half of 2011, China's GDP decelerated slightly from 9.7% in the first quarter to 9.5% in the second quarter in annualised terms. It eased further in the third quarter, posting 9.1% growth. China's manufacturing PMI registered the longest consecutive fall since February 2009 in the second quarter of 2011, even dropping below the 50 mark dividing expansion from contraction in the third quarter, before rebounding to 51.1 points in October. The growth moderation appears set to continue in the second half of the year, bringing annual growth for 2011 to 9.2%. Growth is expected to slow further to 8.6% in 2012 and 8.2% in 2013.

China's economic growth is likely to moderate throughout the forecast horizon because of the fading of stimulus measures and weak net external demand. In addition, ongoing credit and monetary tightening will limit prospects for GDP growth. China has now less room than in 2008 for a stimulus response in case of need, given the rise of off-balance sheet lending and the indebtedness of local governments. On the other hand, private consumption is likely to benefit somewhat from growing incomes thanks to wage increases and a healthy labour market.

Investment remains the main driver of economic growth. Especially investment in the real estate sector is expected to remain buoyant (in part due to an expansion in the construction of social housing as part of the 12th five-year plan), although the government has enacted measures to slow house price appreciation and deter speculation. In the second quarter of 2011 real estate investment held up well (33.2% y-o-y), showing a small decline from the first quarter (34.1%). In the first half of 2011 investment in fixed assets picked up by 25% y-o-y in both quarters, from a growth rate of 19.5% in real terms in 2010. Tighter monetary policy and the government's clampdown on the property market could in principle contribute to softening investment, but so far China continues to be powered by investment.

Consumption growth remained robust. Retail sales have gained momentum during 2011, reaching year-on-year growth of 17.7% in September. Real wages have been increasing steadily since 2010, which bodes well for private consumption contributing more to China's GDP growth in 2011. However, for this trend to fully take hold would require the policy measures mentioned in the 12th Five-Year Plan to boost domestic consumption to be specified and succeed in shifting towards a more balanced growth model. Moreover, annual inflation is still expected to be around 6% in the third quarter of 2011, potentially limiting consumers' purchasing power.

The external sector held up well amid the global weakness, driven by the resilience of demand within Asia. In 2010, exports rose in value terms by 31.3% y-o-y, while imports rose by 38.7%. Export growth appears to have lost some steam in the second half of 2011, with year-on-year growth slowing to 17.1% in September from 24.5% in August. Import growth decelerated to 20.9% in September after an increase of 30.2% y-o-y in August. As a consequence, China's trade surplus decreased to USD 107.1 bn in the second quarter of 2011 compared to USD 197 bn in the first quarter. In the second half of 2011, Chinese authorities expect a further moderation of export growth and a narrowing of the trade surplus, mainly due to weaker demand in advanced economies. Import growth could continue to outpace export growth, in relative if not absolute terms, led by robust domestic demand for both commodities and capital goods.

China's current account surplus has been stabilising in nominal terms from USD 297 bn in 2009 to USD 306 bn in 2010, although it declined as a share of GDP from 5.9% in 2009 to 5.1% in 2010. In 2011, the nominal surplus could turn out to be smaller than expected, given weaker external global conditions. On the assumption that the government engages in fiscal consolidation, that external demand sees a moderate recovery and the real exchange rate remains stable, the current account surplus should remain stable as a share of GDP before widening again in 2013.

Foreign exchange reserves continued to rise, growing by further USD 153 bn in the second quarter of 2011 to USD 3.2 trillion (from USD 3.04 trillion in the first quarter). While the renminbi has continued to appreciate moderately versus the US dollar, against the euro it has depreciated up to October 2011 by 4.3% since being released from its dollar peg in June 2010.

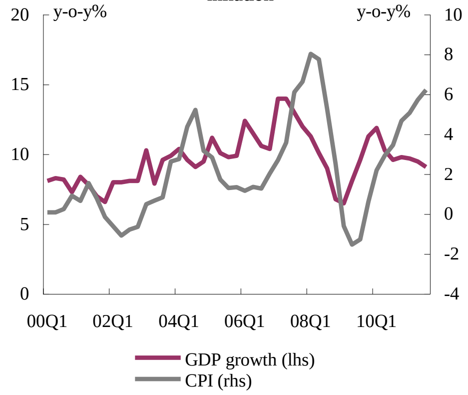
Inflation is declining gradually

After an increase of 5% y-o-y in the first quarter, annual consumer price inflation reached 6.1% in September 2011. Since the target of the Chinese central bank was to keep inflation below 4% in 2011, the People's Bank of China (PBoC) therefore tightened monetary policy. This is expected to have an impact on prices in the second half of 2011. Inflation is estimated to have already peaked in year-on-year terms and is foreseen to gradually ease to between 5% and 6% in 2011. Barring further food supply shocks, inflation should continue on a gradual downward path until the end of the forecast horizon. However, this might be offset by rising labour costs due to higher wages and broader cost pressures, or due to a surge in commodity prices.

The PBoC raised its benchmark policy rate five times since October 2010 to counter price pressures. The one-year lending rate reached 6.5% in August 2011. However, the strong growth performance of China and market expectations of a continuing appreciation of the renminbi against the dollar have induced a (partly speculative) inflow of capital. This somewhat hampers the ability of the PBoC to tame inflation by raising interest rates further in the near future, especially if the global growth slowdown proves more marked than expected.

In a further step to counteract inflation and overheating, banks' reserve requirement ratio (RRR) was increased six times to 21.5% for large banks during the first two quarters of 2011. Furthermore, the rate of currency appreciation vis-à-vis the USD has edged up in the second and third quarter of 2011, notwithstanding the continuing robust increase in USD reserves accumulation over the period.

Graph II.35.1: **China - GDP growth and inflation**



The property market poses a threat to China's economic stability

Since 2010, the Chinese authorities have moved aggressively to counteract the construction boom and the speculative excesses in the property market. Home purchase limits have been expanded to cover smaller cities, raising required down payments to 50% for second homes and to 100% for third homes. For the first time since 2008 prices in the largest cities – including Beijing, Shanghai, Guangzhou and Shenzhen – remained flat both in July and August 2011. Growth in new mortgages moderated to 18.6% in the second quarter of 2011 compared to 50% in the same period of 2010. Growth in house sales has also moderated its peak in 2009, to about 20% in the second quarter of 2011.

However, China remains vulnerable to property bubbles, also because of structural factors such as excessive liquidity, low real interest rates and lack of investment channels for individuals. Especially the government's policy moves targeting house prices, as well as weakening sales, have pushed real estate companies into an increasingly tight credit environment. China's central bank also curbed lending to property developers. For this reason, developers are forced to seek more expensive and riskier forms of financing (such as, for example, offshore bonds).

Fears of a banking crisis represent another downside risk

Local government debt has expanded considerably following the credit and monetary stimulus launched in response to the global financial crisis in 2008-09, bringing the banking sector's exposure to local government to around USD 1.7 trillion to date compared to USD 0.5 trillion in 2007. Since 2010 credit conditions have been tightened and deposit and loan rates have increased. The PBoC has also enacted measures to prevent off-balance sheet lending. Despite this shift in policy, credit growth had continued to increase during 2010, especially for lending to local government financing vehicles. In the first three quarters of 2011, new lending moderated to within the government's target range; against the backdrop declining inflation, it is unclear to what degree Chinese authorities will pursue their restrictive measures. Amid growing concerns that the accumulation of local government debt poses an important credit risk, the Ministry of Finance approved a trial program that will allow some provinces and municipalities to issue short-term bonds.

The banking system appears capable of absorbing potential losses, as the system-wide loan-to-deposit ratio is reportedly still relatively low compared to pre-crisis levels. However, a deterioration of the economic situation (coming from either lower growth, a real estate downturn or higher interest rates) risks causing distress for smaller banks that would find it difficult to meet regulatory requirements.

To counter the associated risks, the bank regulatory agency has asked banks to raise capital requirements and provisioning for lending to local government vehicles and has strengthened the effectiveness and frequency of credit risk assessments. Moreover, the domestic arm of China's sovereign wealth fund, Central Huijin, increased its stakes in China's big four commercial banks, signalling the government's commitment to stand behind the banking sector should failures materialise.

Table II.35.1:

Main features of country forecast - CHINA

	2010			Annual percentage change						
	bn CNY Curr. prices	% GDP	92-07	2008	2009	2010	2011	2012	2013
GDP	40120.2	100.0	10.3	9.6	9.1	10.3	**9.2**	**8.6**	**8.2**
Private consumption	13329.1	33.2	14.9	15.7	9.5	10.0	**-**	**-**	**-**
Public consumption	5361.4	13.4	16.2	16.3	9.4	17.3	**-**	**-**	**-**
Gross fixed capital formation	191690.8	47.8	18.6	24.7	18.9	16.6	**-**	**-**	**-**
of which : equipment	-	-	-	-	-	-	**-**	**-**	**-**
Change in stocks as % of GDP	-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)	15777.5	39.3	16.7	5.9	-11.5	12.6	**9.8**	**8.6**	**7.6**
Final demand	-	-	-	-	-	-	**-**	**-**	**-**
Imports (goods and services)	13962.5	34.8	17.6	6.9	1.6	23.8	**10.1**	**7.9**	**8.4**
GNI (GDP deflator)	-	-	-	-	-	-	**-**	**-**	**-**
Contribution to GDP growth : Domestic demand			-	-	-	-	**-**	**-**	**-**
Stockbuilding			-	-	-	-	**-**	**-**	**-**
Foreign balance			-	-	-	-	**-**	**-**	**-**
Employment			0.9	0.3	0.3	0.4	**-**	**-**	**-**
Unemployment (a)			3.4	4.2	4.3	4.1	**-**	**-**	**-**
Compensation of employees/head			-	-	-	-	**-**	**-**	**-**
Unit labour costs			-	-	-	-	**-**	**-**	**-**
Real unit labour costs			-	-	-	-	**-**	**-**	**-**
Saving rate of households			-	-	-	-	**-**	**-**	**-**
GDP deflator			5.6	4.8	7.8	-0.5	**6.0**	**5.5**	**5.0**
Private consumption deflator			-	-	-	-	**-**	**-**	**-**
Index of consumer prices (c)			5.3	5.9	-0.7	3.3	**-**	**-**	**-**
Merchandise trade balance (b)			3.4	8.0	5.0	4.3	**2.9**	**3.7**	**4.1**
Current-account balance (b)			3.1	9.7	5.2	5.2	**3.7**	**4.4**	**4.5**
Net lending(+) or borrowing(-) vis-à-vis ROW (b)			-	-	-	-	**-**	**-**	**-**
General government balance (b)			-1.3	-0.4	-2.3	-1.7	**-**	**-**	**-**
General government gross debt (b)			-	-	-	-	-	-	-

(a) urban unemployment, as % of labour force. (b) as a percentage of GDP. (c) national indicator.

36. EFTA

The outlook deteriorates

Having recovered from the crisis, both Switzerland and Norway are weathering the headwinds from renewed volatility in financial markets and its impact on the world economy. With the fiscal stance in a more neutral position, public finances are in good shape to withstand downside risks, should they materialise. At the current juncture government spending in the EFTA countries is still constrained, with domestic demand being driven by the private sector. While in Norway strong growth in household spending is expected, Switzerland is likely to rely on increased investment to drive domestic demand growth. Risks to the forecast mainly concern prices. While the Norwegian forecast will depend strongly on the price of oil, Switzerland's outlook hinges upon the value of the Swiss franc.

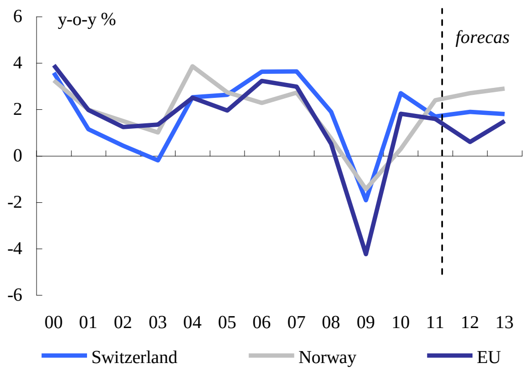
For both economies the positive contribution to growth from external trade is likely to resume. Growth in exports and imports is projected to continue its rebound from crisis lows. Although remaining well below EU levels, unemployment is likely to remain above pre-crisis levels over the forecast horizon. Addressing labour market developments is arguably the main policy challenge EFTA states share. The outlook for the forecast period shows moderate to solid growth in both Switzerland [74] and Norway.

GDP growth back on track in Norway...

Real GDP contracted by 1.4% in 2009, with rising government spending contrasting with shrinking private domestic demand and net external trade but. The return to growth in 2010 was rather hesitant with an annual increase of only 0.3% of GDP. The challenge for Norway will be to create growth momentum as the fiscal stimulus fades out towards the end of the forecast period. The expansionary fiscal policy exercised during the crisis is expected to become much more constrained in the coming years. In 2011 the fiscal stance turned less expansionary as the fiscal stimulus package is envisaged to be halved compared to 2010.

GDP growth is likely to accelerate in 2011 to 2.4%, rising further and to 2.7% in 2012 and 2.9% in 2013. This rebound is mostly driven by domestic demand, with external trade expected to continue contributing to growth, albeit in a minor way. The decline in investments in Norwegian mainland industries, which started in 2009, worsened in 2010. However, a rebound is expected for 2011 and beyond, even though it will not return to its pre-crisis level during the forecast period.

Graph II.36.1: **EFTA vs EU GDP growth**



Export growth is likely to be driven by services and traditional goods, rather than Norway's oil exports. Oil production is expected to decrease slightly in the forecast period. However, as this decrease is more than offset by the export of traditional goods, exports are likely to grow by around 1.1% in 2011 and 2012 respectively, moving up to around 1.5% in 2013. Import growth is expected to outpace the growth of exports. The net contribution to GDP growth of net exports is expected to decrease towards the end of the forecast period, though remaining positive.

Households continue to spend...

Household consumption, which accounts for around 55% of GDP in mainland Norway, is likely to grow solidly throughout the forecast period. Low interest rates, increased incomes and wealth and better economic prospects all helped to stabilise household consumption in 2010. Consumer spending is expected to grow by 2.8% in 2011. On the back of good prospects for household incomes, consumption growth is likely to peak at 3.5% in 2012 before moderating to 2.9%

[74] 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.

in 2013, despite slightly higher expected policy interest rates during the forecast years. However, the relatively high indebtedness of Norwegian households is a downside risk to household spending. The dominance of loans at variable interest rates in combination with the gradual withdrawal of fiscal stimulus measure could negatively impact consumer spending.

Norway's housing market on solid foundations

House prices are expected to maintain their upward trend during the forecast years. The solid underpinnings of the residential property market are expected to support increased investment, in particular in residential construction, thus turning the decline of the past two years into an upswing in the forecast years.

Inflation in Norway remains moderate...

Consumer price inflation declined to an annual rate of 2.3% in both 2009 and 2010. The strengthening of the NOK should dampen inflationary pressures, resulting in a slowdown of inflation of about 1.5% in 2011. In the remainder of the forecast period the inflation rate will likely remain below 2%, at 1.5% in 2012 and 1.9% in 2013. The recession in the Norwegian economy was partly responsible for the past fall in wage growth, which is now expected to rebound over the forecast horizon, translating into some upward pressure on prices.

... while unemployment remains low

Unemployment in Norway is relatively low compared to the EU. However, in 2010 it affected 3.5% of the total labour force, a high reading by Norwegian standards. Unemployment is expected to ease to 3.1% by the end of 2013.

Current account remains positive

Norway's current account should remain comfortably positive throughout the forecast period. Although the trade surplus narrowed in 2010 it is likely to widen again in 2011, partly due to higher oil prices. In 2012 the trade surplus is expected to remain stable, supported by a surplus in the services balance. However, the balance of primary incomes has shown somewhat more volatility. The income balance is likely to turn positive this year, with a neutral stance in 2012 and a small surplus in 2013. All in all, the current-account surplus is set to remain around 12% of GDP within the forecast horizon.

Switzerland's economy remains on a stable growth path

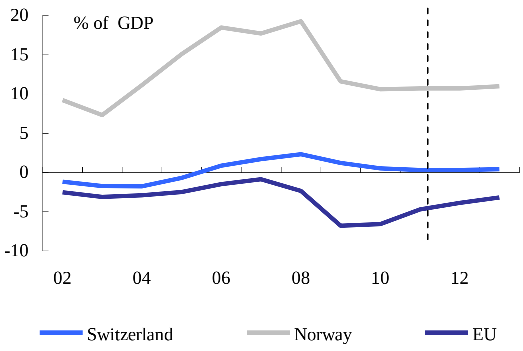
The Swiss economy performed relatively well during the crisis compared with many other European countries. Still, the drop in GDP by almost 2% in 2009 made it the worst recession in more than three decades. The Swiss economy rebounded with a growth of 2.7% last year and this relatively strong performance continued in the first two quarters of 2011. However, renewed financial turbulence has put strong upward pressure on the Swiss franc, threatening the export sector. Growth is expected to decelerate to 1.7% in 2011, partly due to weaker government spending growth. GDP growth is likely to accelerate in 2012 to 1.9% and to continue at 1.8% of GDP in 2013.

Household consumption growth resumed only moderately in 2010 after dropping in 2009. The spending recovery is likely to continue, starting at a modest pace of just over 1.1% in 2011 to reach 1.8% in 2012 and 2.1% in 2013. Growth in public investment is expected to be modest as well in the coming years, despite increased government focus on infrastructure investment.

Exports are picking up again in Switzerland

Exports rebounded strongly in 2010, mostly due to strong growth in pharmaceutical and machineries exports to Asia. Real growth in exports of goods and services is expected to moderate significantly in 2011 and 2012. However, further strengthening of the Swiss Franc may threaten this outlook. Downside risks remain for the services sector in relation to the erosion of bank secrecy, which may have a negative impact on the contribution of the financial sector to GDP.

Graph II.36.2: **EFTA vs EU Net lending General Government**



Swiss inflation

The Swiss National Bank is expected to maintain the course of its expansionary monetary policy in 2011 and 2012. The SNB is likely to keep its key interest rate at low levels, around 0.25% in 2011. However, the SNB has signalled its intention to consider a small rise in the key interest rate. Recent robust domestic credit growth seems not to pose an imminent threat to financial stability because of the still relatively low debt levels in the private sector. For the forecast years, inflation is expected to remain low, not least due to moderate wage growth. The efforts of the Central Bank to keep the Swiss franc above the level of 1.20 CHF/EUR following the commitment made in September 2011 may lead to some inflationary pressure. The National Bank has committed to defend the rate of 1.20 CHF/EURO, using all available means, including currency interventions.

Low unemployment

The unemployment rate was elevated, at 4.1% at the end of 2010, a level not seen since the mid-nineties. Unemployment is expected to decrease gradually to 3% by the end of the forecast period. Wage growth is expected to steadily slow down over the same period, with a slight increase towards the end of the forecast horizon.

Swiss current account

External trade turned positive again in 2010, mostly due to strong exports. The external sector is expected to continue to post a positive contribution to growth in 2012 and 2013. The current-account surplus stood at 16.3% of GDP in 2010. Overall, the current account is set to remain significantly positive. It is forecast at 13.9% of GDP in 2011, 14.1% in 2012 and 13.7% in 2013.

Table II.36.1:
Main features of country forecast - EFTA

		Norway					Switzerland				
(Annual percentage change)		**2009**	**2010**	**2011**	**2012**	**2013**	**2009**	**2010**	**2011**	**2012**	**2013**
GDP		-1.7	0.3	2.4	2.7	2.9	-1.9	2.7	1.7	1.9	1.8
Private consumption		0.2	3.7	2.8	3.5	2.9	1.4	1.7	1.1	1.8	2.1
Public consumption		4.8	2.2	2.7	1.9	2.1	3.3	0.8	1.3	1.5	1.6
Gross fixed capital formation		-7.4	-8.9	7.4	5.4	6.3	-4.9	7.5	2.0	2.5	2.7
of which : equipment		-15.6	-7.8	7.9	5.5	6.5	-12.1	4.6	1.9	2.5	2.5
Exports (goods and services)		-3.9	-1.7	1.1	1.1	1.5	-8.6	8.4	4.2	3.8	3.3
Imports (goods and services)		-11.7	9.0	6.2	2.7	2.9	-5.5	7.3	4.1	4.8	4.9
GNI (GDP deflator)		-1.9	1.2	-0.4	2.9	3.0	9.0	6.8	-2.5	1.6	2.4
Contribution to GDP growth :	Domestic demand	-0.6	0.1	3.3	3.0	3.1	0.2	2.6	1.2	1.7	1.9
	Inventories	-2.8	3.7	0.4	0.0	0.0	0.4	-1.2	0.0	0.1	0.0
	Net exports	1.6	-3.2	-1.3	-0.3	-0.2	-2.4	1.3	0.5	0.2	-0.1
Employment		-0.6	-0.2	0.5	0.8	1.8	0.7	0.4	1.8	1.0	1.0
Unemployment rate (a)		3.1	3.5	3.5	3.3	3.1	3.8	4.2	3.4	3.2	3.0
Compensation of employees/head		3.6	4.1	3.5	2.7	3.7	1.2	0.2	-0.5	2.5	2.6
Unit labour costs whole economy		4.8	3.5	1.6	0.8	2.7	3.9	-2.0	-0.4	1.5	1.8
Real unit labour costs		10.9	-3.0	-2.1	-1.6	0.3	3.7	-2.1	-5.2	-1.3	-0.2
Saving rate of households (b)		12.4	12.4	13.0	12.8	14.4	17.1	6.8	5.0	4.8	2.3
GDP deflator		-5.6	6.7	3.7	2.5	2.4	0.2	0.1	5.1	2.9	2.0
Harmonised index of consumer prices		2.3	2.3	1.5	1.6	1.8	-0.7	0.6	0.7	1.1	1.4
Terms of trade of goods		-20.9	13.9	3.9	1.0	0.2	5.8	-0.7	8.8	2.8	-0.4
Merchandise trade balance (c)		12.0	12.6	12.7	12.1	11.5	3.1	3.0	5.8	6.2	5.6
Current-account balance (c)		11.8	12.4	9.3	8.9	8.3	12.6	16.3	13.9	14.1	13.7
Net lending(+) or borrowing(-) vis-à-vis ROW (c)		11.7	12.4	9.3	8.9	8.2	12.4	16.9	13.8	13.9	13.5
General government balance (c)		10.7	10.6	10.7	10.7	11.0	1.0	0.6	0.3	0.3	0.4
Cyclically-adjusted budget balance (c)		-	-	-	-	-	-	-	-	-	-
Structural budget balance (c)		-	-	-	-	-	-	-	-	-	-
General government gross debt (c)		44.0	44.1	40.9	37.1	32.9	41.5	40.2	38.7	37.1	36.2

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

37. RUSSIAN FEDERATION

The recovery stutters

In Russia, real GDP grew by 4% in 2010 and continued at this rate (at 4.1% y-o-y) during the first quarter of 2011. However, some moderation is visible in the second quarter's slowdown to 3.4% y-o-y. Surveys point to a deceleration in already sluggish economic activity, notably the PMI, which declined to 50.2 in September from 50.8 in August, having declined for four consecutive months. GDP growth in 2011 has therefore been revised down to 3.9% compared to the spring forecast. Economic growth has been increasingly supported by domestic demand (both consumption and investment), while external demand is slowing.

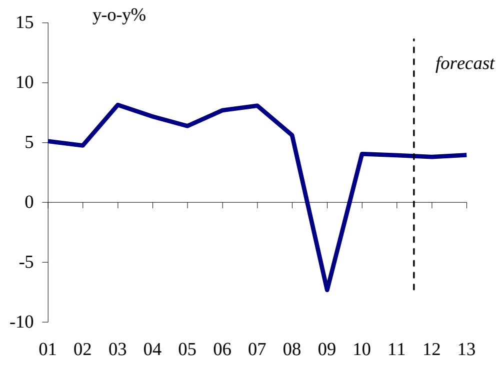
Russia's growth outlook is still strongly dependent on international commodity prices, and a considerable amount of non-performing loans continues to inhibit credit growth. Economic growth is expected to decelerate slightly from 3.9% in 2011 to 3.8% in 2012 and to edge up to 4.0% in 2013.

Exports accelerated in 2010, but the sluggish expansion in the oil and gas sector (where some existing fields are almost depleted), combined with the negative demand effects of the euro-area debt crisis, are likely to limit export volume growth to 5-5½% per year between 2011 and 2013. In the second half of 2011 higher agricultural output could partially boost exports, as exports of grain in 2011 could exceed the record high of 22.4 million tonnes exported in 2008. Imports increased strongly in 2011 due to the strengthening of domestic demand but the ongoing sharp deceleration in the growth of imports is expected to continue.

Growth stabilises on a lower level compared to pre-crisis

The expansion of domestic demand was a major driver of economic growth in 2010. Growth in consumer spending and investment activity is still increasing in 2011, and both are expected to continue growing slightly. With expected GDP growth of around 4% a year, growth will remain below the rates achieved before the crisis. In the absence of a more comprehensive growth strategy, GDP growth will remain relatively subdued.

Graph II.37.1: **Russia- GDP growth**



Despite increasing imports of goods due to strengthening domestic demand, Russia's trade surplus is increasing compared to 2010, growing by 19% y-o-y in H1 of 2011. In the fist six months of 2011, exports rose at an annual rate of 32.1%, while imports increased by 39.9%. The main imported items in this period were machinery, equipment and transport (46% of total imports). The growth in exports, supported by high oil prices, resulted in a rise in the current-account surplus from 4.8% of GDP in 2010 to an expected 5.9% in 2011. High energy prices for 2011 are the main reason behind this strong current-account surplus. While oil and gas account for two thirds of Russia's exports, their growth is limited due to sluggish productivity and a lack of maintenance. Overall, the current-account surplus is expected to decrease to 4% of GDP in 2012 and to 3.8% of GDP in 2013, mainly due to assumed lower oil prices.

The labour market situation is improving slightly. The unemployment rate, which rose from 7% in 2008 to 8.2% in 2009, has started to edge down. In 2011 the unemployment rate is expected to decline to 7.4% and to 6.9% in 2012, returning to pre-crisis levels on the back of a reduction in the unemployment gap between rural and urban areas and between men and women.

Inflation picked up to almost 10% by January 2011 due to higher food prices following widespread damage to crops caused by forest fires in August 2010.[75] CPI inflation moderated to 7.2% y-o-y in

[75] Food prices represent about 40% of the CPI basket in Russia.

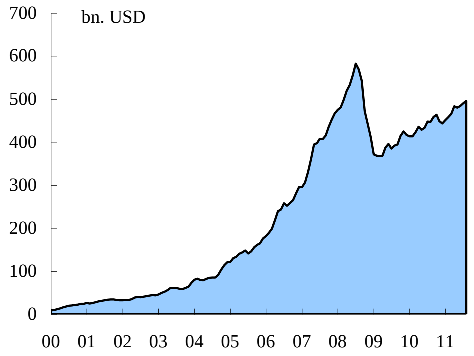
September 2011, continuing its slowdown from 9.5% on average in the first half of this year. Inflation has been slowing down for the fifth month in a row. This downward trend was largely driven by food prices. For the fifth consecutive month, food price inflation declined to 6.6% in September from 8.7% in August. Global uncertainty affects exchange rate dynamics

In the current financial environment of heightened risk aversion, Russia’s equity market has dropped more than any other emerging market economy's. Since end July, interbank lending rates have risen, and the rouble has dropped against the euro.

The Central Bank of Russia (CBR) manages the rouble against a USD/EUR basket made up of 55 cents of a USD and 45 cents of a EUR. The real effective exchange rate appreciated by about 9.5% in 2010. Strong appreciation pressure on the rouble continued in the first half of 2011 as a result of surging oil prices (in Jan-Aug 2011 the rouble strengthened in real terms to USD by 8.5%, by 2.4% to EUR). Starting in August this year, Russia has experienced a significant weakening of its currency in reaction the uncertain global outlook.

As of mid-October the rouble lay within the central bank's range of 32.5-37.6 against the basket (after the last change in the beginning of October). The value of the bi-currency basket stood at RUB 35.7 as of 6 October 2011. As of September 2011, Russia's foreign-exchange reserves reached USD 496.4 bn, their highest level since November 2008.

Graph II.37.2: **Russia- Foreign Exchange Reserves**



Preventing exchange rate volatility

The CBR reduced its refinancing rate four times in 2010, from 8.75% in February to a record low of 7.75% in June. In the light of high inflationary expectations and rising oil prices, the CBR increased the refinancing rate to 8% on 25 February 2011 and to 8.25% as of 3 May 2011. Since May the CBR has not undertaken further monetary tightening.

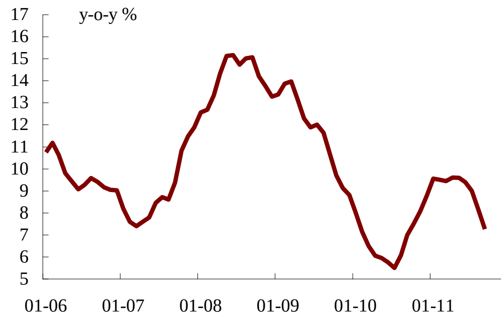
The CBR is committed to inflation-targeting. The CBR set inflation targets of 5-6% in 2012 and 4.5-5.5% in 2013. There is a commitment to move towards a floating exchange rate, with the CBR's intervention confined to preventing excessive volatility of the rouble.

The banking system is quite liquid and CBR data show an improvement in the quality of banks' balance sheets, as the share of non-performing loans has declined to 8% of loans in April 2011, having peaked during the crisis at 10%, showing an improvement in the quality of banks' balance sheets.

Inflationary pressures are slowing down

Inflation picked up during the first four months of 2011. Food inflation was the main factor pushing up inflation. Not only elevated food prices, but also high oil and gas prices, budgetary expenditure and money supply growth have underpinned inflationary pressures. The inflation rate stood at 9.6% in April 2011.

Graph II.37.3: **Russia - Consumer Price Index**



The latest inflation figures show continued deceleration in September (7.2% y-o-y), on the back of lower food prices. The overall inflation rate is expected to continue moderating towards the turn of 2011, although annual average inflation in 2011 is forecast at 8.8%, a higher rate than in 2010. Annual average inflation is foreseen to decline in 2012 and 2013 to 7.7% and 7.4%

respectively, due to an expected easing of upward pressure on inflation from commodity prices.

Fiscal developments

Under the current budget proposals for 2012-14 the central government deficit is set to shrink to 1.5% of GDP in 2012, before reaching 1.6% in 2013 and 0.7% in 2014. This is in line with the Commission forecast at hand, which expects a deficit of 1.5% of GDP in both 2012 and 2013. According to the Medium Term Expenditure Framework, the budget is expected to return to balance by 2015. Additional fiscal spending associated with the election cycle, however, appears possible in the current year and in 2012.

In the medium term, the hosting of the 2014 Winter Olympic Games and of the 2018 football World Cup will necessitate substantial investment in transport, hotel and sports infrastructure, estimated at around USD 70 bn. This event could support, in part, the modernisation of the economy, which is needed in order for Russia to enhance its competitiveness in the global economy.

Table II.37.1:

Main features of country forecast - RUSSIA

	2010			Annual percentage change						
bn RUB	**Curr. prices**	**% GDP**		**92-07**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
GDP	44938.7	100.0		-	5.2	-7.8	4.0	**3.9**	**3.8**	**4.0**
Private consumption	23251.9	51.7		-	10.4	-4.8	3.0	**3.2**	**3.6**	**3.7**
Public consumption	8929.9	19.9		-	3.4	0.2	1.4	**1.4**	**1.9**	**1.9**
Gross fixed capital formation	9226.3	20.5		-	9.7	-14.7	6.3	**6.4**	**7.3**	**7.7**
of which : equipment	3329.0	7.4		-	-	-	-	**5.0**	**7.0**	**7.0**
Exports (goods and services)	13574.6	30.2		-	0.6	-4.7	7.1	**5.4**	**5.5**	**5.4**
Imports (goods and services)	9947.8	22.1		-	14.8	-30.4	25.6	**15.2**	**9.5**	**8.2**
GNI (GDP deflator)	43365.8	96.5		-	4.6	-8.1	4.0	**4.2**	**3.7**	**4.0**
Contribution to GDP growth :	Domestic demand			-	7.7	-5.5	3.3	**3.2**	**3.6**	**3.8**
	Inventories			-	0.5	-7.3	4.0	**2.4**	**0.6**	**0.5**
	Net exports			-	-3.0	5.2	-3.3	**-1.7**	**-0.4**	**-0.3**
Employment				-	-0.3	-1.8	-0.3	**0.6**	**0.5**	**0.6**
Unemployment rate (a)				8.6	7.0	8.2	8.2	**7.4**	**6.9**	**6.4**
Compensation of employees/head				-	-	-	-	**-**	**-**	**-**
Unit labour costs whole economy				-	-	-	-	**-**	**-**	**-**
Real unit labour costs				-	-	-	-	**-**	**-**	**-**
Saving rate of households (b)				-	10.7	14.2	-	**-**	**-**	**-**
GDP deflator				-	18.0	1.9	11.4	**11.9**	**6.0**	**7.2**
General index of consumer prices				-	14.1	11.7	6.9	**8.8**	**7.7**	**7.4**
Terms of trade of goods				-	15.3	-32.6	21.0	**11.9**	**-2.9**	**3.1**
Merchandise trade balance (c)				-	10.7	9.1	10.2	**10.4**	**8.6**	**8.4**
Current-account balance (c)				-	6.1	4.0	4.8	**5.9**	**4.0**	**3.8**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				7.9	6.1	3.0	4.8	**5.1**	**3.3**	**3.2**
General government balance (c)				-	-	-	-	**-1.3**	**-1.5**	**-1.5**
Cyclically-adjusted budget balance (c)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				-	-	-	-	**10.0**	**9.5**	**8.9**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

ACKNOWLEDGEMENTS

This report was prepared in the Directorate-General for Economic and Financial Affairs under the direction of Marco Buti, Director-General, Servaas Deroose, Deputy Director-General, and Elena Flores, Director "Policy strategy, coordination and communication".

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The Overview was prepared by Björn Döhring.

Chapter 1 on "The EU economy: a recovery in distress" was prepared by Oliver Dieckmann under the responsibility of Elena Flores and Reinhard Felke. This chapter benefited from contributions by Paolo Biraschi, Julie Cassaigne, Daniela Porubska and Ann-Louise Winther. Boxes were contributed by Victor Corneliu Savin, Chris Bosma, Björn Döhring, Nikolay Gertchev, Florentine Hopmeier, Jan in 't Veld, Anton Jevcak, Filip Keereman, Daniel Kosicki, Werner Röger, Lukas Vogel, Corina Weidinger Sosdean, Markus Wintersteller and Alexandru Zeana.

Chapter 2 on "Post-recession labour market patterns in the EU" was prepared by Alfonso Arpaia and Fabrice Orlandi under the responsibility of respectively Alessandro Turrini, Head of Unit for "Labour market reforms" and Werner Röger, Head of Unit for "Models and databases". Contributions by Mercedes de Miguel Cabeza, Julia Lendvai, Adam Kowalski, Bettina Kromen, Rafał Raciborski are gratefully acknowledged.

Chapter 2 was edited by Karl Pichelmann, Senior Adviser in the Directorate "Structural reforms and competitiveness", and Michael Sket, economist in the unit "Forecast and economic situation".

The sections on "Member States" were prepared under the supervision of Jürgen Kröger, Matthias Mors and István Pál Székely, Directors for the "Economies of the Member States". These sections benefited from contributions by Lourdes Acedo Montoya, Jean-Luc Annaert, Pasquale D'Apice, Davide Balestra, Narcissa Balta, Paolo Battaglia, Barbara Bernardi, Piotr Bogumił, Reuben Borg, Mateo Capó Servera, Pedro Cardoso, Jakob Christensen, Fotini Dionyssopoulou, Anna Dimitríjevics, Christophe Doin, Gatis Eglitis, Polyvios Eliofotou, Shane Enright, Riccardo Ercoli, Leila Fernandez Stembridge, Olivia Galgau, Julien Genet, Agne Geniusaite, Michael Grams, Oskar Grevesmühl, Dalia Grigonyte, Zoltán Gyenes, Martin Hradisky, László Jankovics, Javier Jareño Morago, Markita Kamerta, Julda Kielyte, Mitja Košmrl, Bozhil Kostov, Radoslav Krastev, Bettina Kromen, Stefan Kuhnert, Baudouin Lamine, Milan Lisický, Erki Lohmuste, Davide Lombardo, Natalie Lubenets, Mart Maivali, Petr Maleček, Janis Malzubris, Anton Mangov, Renata Mata Dona, Dan Matei, Olivia Mollen, Marco Montanari, Magdalena Morgese Borys, Manuel Palazuelos Martínez, Christos Paschalides, Presyian Petkov, Nicolas Philiponnet, Bartosz Przywara, An Renckens, Vito Ernesto Reitano, Julien Rousselon, Monika Sherwood, Louise Skouby, Peeter Soidla, Vladimír Solanič, Erik Sonntag, Thomas Springbett, Harald Stieber, Alina Tanasa, Ingrid Toming, Mariana Tomova, Tsvetan Tsalinski, Thomas Usher, Henk Van Noten, Rafał Wielądek and Pavlína Žáková. Coordination and editorial support was provided by Martin Larch, Head of Unit "Coordination of country-specific policy surveillance" and Jost Angerer, Gerrit Bethuyne, Jörn Griesse, Karolina Leib and Barbara Stearns-Bläsing.

The sections on "Candidate Countries" and "Other non-EU countries" were prepared under the supervision of Peter Bekx, Director of the "International economic and financial relations, global governance". These sections, and forecasts for all other non-EU economies, benefited from contributions by Nicolaas Beinema, Bernhard Böhm, Nicola Costa, Hans Feddersen, Michael Horgan, Alexandra Janovskaia, Tim Kaiser, Plamen Kaloyanchev, Neil Kay, Willem Kooi, Stefan Kramer, Roberto Paulo

Lieto, Eulalia Ortiz Aguilar, Valérie Rouxel-Laxton, Antonio Sanchez Pareja, Uwe Stamm, Dirk Verbeken and Przemyslaw Wozniak.

Editorial support by Robert Kuenzel is gratefully acknowledged. Support on the communication and publication of this report by Lisbeth Ekelöf, Robert Gangl, Dominique Marchalant, Jens Matthiessen, Irena Novakova, Sarka Novotna, Chris Maxwell, Yasmina Quertinmont and Roman Schönwiesner is gratefully acknowledged. IT support was provided by Marius Bold, Françoise Demarliere, Rudy Druine, Jeanette Fokkens and Frédéric Petre.

Follow-up calculations were performed by Cécile Denis, Karel Havik, Kieran Mc Morrow, Fabrice Orlandi, Rafał Raciborski and Werner Röger. Forecast assumptions were prepared by Chris Bosma, Angela D'Elia, Roberta Friz, Sara Tägtström, Eulalia Ortiz Aguilar and Alexandru Zeana. Statistical and layout assistance was provided by Antoine Avdoulos, Yves Bouquiaux, Julie Cassaigne, Myrle Claessens, Eulalia Claros Gimeno, Justyna Gniadzik, Oscar Gomez Lacalle, Noel Doyle, Andrzej Erdmann, Oana Simona Garjoi, Julien Genet, Michel Gerday, Johann Korner, Adam Kowalski, Anders Lindqvist, Fabrizio Melcarne, Christiaan Muller, Daniela Porubská, Mariola Przygoda, Emilio Rodriguez Castro, Ewa Sdrakas, Jacek Szelożyński, Windy Vandevyvere, Carmela Zammit, and Christos Zavos.

Valuable comments and suggestions by Laura Bardone, Moreno Bertoldi, Gerrit Bethuyne, Lina Bukeviciute, Georg Busch, Julie Cassaigne, Oliver Dieckmann, Carole Garnier, Gabriele Giudice, Laura González Cabanillas, Peter Grasmann, Heinz Jansen, Barbara Kauffmann, Joost Kuhlmann, Paul Kutos, Sven Langedijk, Martin Larch, Mary McCarthy, Michał Narożny, João Nogueira Martins, Lucio Pench, Karl Pichelmann, Elena Reitano, Albers Ronald, Valérie Rouxel-Laxton, Michael Sket, Massimo Suardi, Charlotte van Hooydonk, Jan in 't Veld, Vesa Vihriälä, Christian Weise, Ann-Louise Winther, Norbert Wunner and Javier Yaniz Igal are gratefully acknowledged.

Secretarial support for the finalisation of this report was provided by Anita Janicka and Els Varblane.

Comments on the report would be gratefully received and should be sent to:
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TABLE 1 : Gross domestic product, volume (percentage change on preceding year, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	1.5	2.7	2.0	2.9	1.0	-2.8	2.3	**2.2**	**0.9**	**1.5**	*2.4*	*2.2*
Germany	1.2	2.0	1.0	3.3	1.1	-5.1	3.7	**2.9**	**0.8**	**1.5**	*2.6*	*1.9*
Estonia	:	7.0	8.4	7.5	-3.7	-14.3	2.3	**8.0**	**3.2**	**4.0**	*4.9*	*4.0*
Ireland	6.5	8.5	5.0	5.2	-3.0	-7.0	-0.4	**1.1**	**1.1**	**2.3**	*0.6*	*1.9*
Greece	1.1	3.8	4.3	3.0	-0.2	-3.2	-3.5	**-5.5**	**-2.8**	**0.7**	*-3.5*	*1.1*
Spain	1.5	4.4	3.3	3.5	0.9	-3.7	-0.1	**0.7**	**0.7**	**1.4**	*0.8*	*1.5*
France	1.2	2.9	1.7	2.3	-0.1	-2.7	1.5	**1.6**	**0.6**	**1.4**	*1.8*	*2.0*
Italy	1.2	2.1	1.0	1.7	-1.2	-5.1	1.5	**0.5**	**0.1**	**0.7**	*1.0*	*1.3*
Cyprus	5.5	4.2	3.2	5.1	3.6	-1.9	1.1	**0.3**	**0.0**	**1.8**	*1.5*	*2.4*
Luxembourg	2.6	6.3	4.1	6.6	0.8	-5.3	2.7	**1.6**	**1.0**	**2.3**	*3.4*	*3.8*
Malta	5.0	3.4	1.7	4.3	4.4	-2.7	2.7	**2.1**	**1.3**	**2.0**	*2.0*	*2.2*
Netherlands	2.5	3.7	1.6	3.9	1.8	-3.5	1.7	**1.8**	**0.5**	**1.3**	*1.9*	*1.7*
Austria	1.9	2.8	2.2	3.7	1.4	-3.8	2.3	**2.9**	**0.9**	**1.9**	*2.4*	*2.0*
Portugal	2.0	3.9	0.7	2.4	0.0	-2.5	1.4	**-1.9**	**-3.0**	**1.1**	*-2.2*	*-1.8*
Slovenia	2.0	4.2	4.2	6.9	3.6	-8.0	1.4	**1.1**	**1.0**	**1.5**	*1.9*	*2.5*
Slovakia	:	2.7	5.9	10.5	5.9	-4.9	4.2	**2.9**	**1.1**	**2.9**	*3.5*	*4.4*
Finland	1.3	4.5	3.1	5.3	1.0	-8.2	3.6	**3.1**	**1.4**	**1.7**	*3.7*	*2.6*
Euro area	1.5	2.8	1.8	3.0	0.4	-4.2	1.9	**1.5**	**0.5**	**1.3**	*1.6*	*1.8*
Bulgaria	-2.8	2.5	6.0	6.4	6.2	-5.5	0.2	**2.2**	**2.3**	**3.0**	*2.8*	*3.7*
Czech Republic	2.4	1.6	4.9	5.7	3.1	-4.7	2.7	**1.8**	**0.7**	**1.7**	*2.0*	*2.9*
Denmark	2.6	2.4	1.8	1.6	-1.1	-5.2	1.7	**1.2**	**1.4**	**1.7**	*1.7*	*1.5*
Latvia	-8.8	6.0	9.0	9.6	-3.3	-17.7	-0.3	**4.5**	**2.5**	**4.0**	*3.3*	*4.0*
Lithuania	-8.3	4.7	8.0	9.8	2.9	-14.8	1.4	**6.1**	**3.4**	**3.8**	*5.0*	*4.7*
Hungary	0.4	3.7	4.2	0.1	0.9	-6.8	1.3	**1.4**	**0.5**	**1.4**	*2.7*	*2.6*
Poland	4.9	4.4	4.1	6.8	5.1	1.6	3.9	**4.0**	**2.5**	**2.8**	*4.0*	*3.7*
Romania	1.3	0.1	6.2	6.3	7.3	-6.6	-1.9	**1.7**	**2.1**	**3.4**	*1.5*	*3.7*
Sweden	1.2	3.4	3.3	3.3	-0.6	-5.2	5.6	**4.0**	**1.4**	**2.1**	*4.2*	*2.5*
United Kingdom	2.5	3.7	2.8	3.5	-1.1	-4.4	1.8	**0.7**	**0.6**	**1.5**	*1.7*	*2.1*
EU	1.3	3.0	2.1	3.2	0.3	-4.2	2.0	**1.6**	**0.6**	**1.5**	*1.8*	*1.9*
USA	3.3	3.8	2.7	1.9	-0.4	-3.5	3.0	**1.6**	**1.5**	**1.3**	*2.6*	*2.7*
Japan	1.3	0.5	1.7	2.4	-1.2	-6.3	4.0	**-0.4**	**1.8**	**1.0**	*0.5*	*1.6*

TABLE 2 : Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter, 2011-2013)

	2011/1	2011/2	2011/3	2011/4	2012/1	2012/2	2012/3	2012/4	2013/1	2013/2	2013/3	2013/4
Belgium	0.9	0.5	0.2	0.0	0.0	0.1	0.3	0.5	0.4	0.4	0.4	0.4
Germany	1.4	0.1	0.5	0.0	0.1	0.2	0.5	0.4	0.4	0.4	0.4	0.4
Estonia	3.1	1.7	1.1	0.2	0.7	0.8	1.0	1.0	0.9	1.0	1.1	1.1
Ireland	1.9	1.6	:	:	:	:	:	:	:	:	:	:
Greece	0.2	-2.7	-0.7	-0.7	-0.7	-0.5	-0.3	0.0	0.3	0.4	0.5	0.6
Spain	0.4	0.2	0.0	-0.1	0.1	0.2	0.3	0.4	0.3	0.3	0.3	0.3
France	0.9	0.0	0.2	-0.1	0.0	0.2	0.3	0.4	0.4	0.4	0.4	0.4
Italy	0.1	0.3	0.0	-0.2	-0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Cyprus	0.1	0.3	-1.7	-1.8	0.3	0.5	0.9	1.0	0.4	0.5	0.6	0.7
Luxembourg	0.2	0.3	-0.2	-0.1	0.2	0.4	0.6	0.7	0.6	0.6	0.6	0.6
Malta	0.0	0.4	:	:	:	:	:	:	:	:	:	:
Netherlands	0.9	0.2	0.1	0.0	0.0	0.1	0.2	0.3	0.3	0.3	0.3	0.4
Austria	0.8	0.7	0.4	0.3	0.0	0.0	0.1	0.1	0.9	0.6	0.7	0.7
Portugal	-0.6	0.0	-1.4	-1.5	-1.0	-0.3	0.0	0.3	0.3	0.4	0.4	0.5
Slovenia	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.4	0.4	0.5
Slovakia	0.9	0.9	0.0	0.0	0.0	0.3	0.7	1.0	0.6	0.7	0.7	0.9
Finland	0.3	0.6	0.5	0.3	0.2	0.2	0.4	0.4	0.4	0.4	0.6	0.6
Euro area	0.8	0.2	0.2	-0.1	0.0	0.2	0.3	0.4	0.4	0.3	0.4	0.4
Bulgaria	0.5	0.3	1.0	0.8	0.1	0.1	1.3	1.4	0.5	0.5	0.7	0.6
Czech Republic	0.9	0.1	:	:	:	:	:	:	:	:	:	:
Denmark	-0.3	1.0	0.5	0.0	0.2	0.3	0.7	0.5	0.4	0.4	0.6	0.6
Latvia	1.1	2.0	0.6	0.1	0.2	0.6	1.3	1.5	1.0	1.0	1.0	0.9
Lithuania	3.5	0.4	0.6	0.3	0.6	0.9	2.0	1.8	0.6	0.5	0.4	0.2
Hungary	0.3	0.0	0.0	-0.1	0.1	0.2	0.2	0.3	0.2	0.4	0.4	0.5
Poland	1.1	1.1	0.6	0.4	0.5	0.6	0.6	0.7	0.7	0.7	0.7	0.7
Romania	0.5	0.2	0.8	0.2	0.1	0.2	0.7	1.1	0.8	0.5	1.2	0.9
Sweden	0.8	0.9	1.3	0.1	0.0	0.5	0.5	0.5	0.6	0.6	0.6	0.6
United Kingdom	0.4	0.1	0.2	0.1	0.1	0.1	0.4	0.4	0.4	0.5	0.4	0.5
EU	0.7	0.2	0.2	0.0	0.1	0.2	0.4	0.4	0.4	0.4	0.4	0.4
USA	0.1	0.3	0.5	0.3	0.5	0.3	0.3	0.5	0.1	0.4	0.4	0.5
Japan	-0.9	-0.5	1.4	0.3	0.4	0.3	0.1	0.2	0.3	0.3	0.2	0.3

TABLE 3 : Profiles (yoy) of quarterly GDP, volume (percentage change from corresponding quarter in previous year, 2011-2013) 24.10.2011

	2011/1	2011/2	2011/3	2011/4	2012/1	2012/2	2012/3	2012/4	2013/1	2013/2	2013/3	2013/4
Belgium	2.9	2.3	2.1	1.6	0.7	0.4	0.5	1.0	1.4	1.7	1.8	1.7
Germany	4.6	2.8	2.4	2.0	0.8	0.9	0.9	1.3	1.5	1.7	1.6	1.5
Estonia	9.5	8.4	8.1	6.2	3.7	2.8	2.8	3.6	3.8	4.0	4.0	4.1
Ireland	0.3	2.3	:	:	:	:	:	:	:	:	:	:
Greece	-5.5	-6.8	-5.9	-3.8	-4.7	-2.6	-2.2	-1.5	-0.6	0.4	1.2	1.8
Spain	0.9	0.7	0.8	0.5	0.3	0.4	0.7	1.2	1.4	1.4	1.4	1.3
France	2.2	1.7	1.5	1.1	0.3	0.5	0.5	1.0	1.3	1.5	1.5	1.5
Italy	1.0	0.8	0.5	0.3	0.0	-0.2	-0.1	0.3	0.6	0.6	0.7	0.7
Cyprus	1.6	1.3	-1.0	-3.1	-2.8	-2.6	0.0	2.8	2.8	2.8	2.5	2.2
Luxembourg	2.9	1.9	1.3	0.2	0.1	0.2	1.1	1.9	2.3	2.6	2.5	2.4
Malta	2.1	2.8	:	:	:	:	:	:	:	:	:	:
Netherlands	2.3	1.8	1.9	1.2	0.4	0.3	0.5	0.8	1.1	1.3	1.3	1.4
Austria	4.3	3.5	2.5	2.2	1.4	0.8	0.4	0.2	1.1	1.7	2.3	2.9
Portugal	-0.4	-0.9	-2.6	-3.6	-4.0	-4.2	-2.9	-1.1	0.3	1.0	1.5	1.7
Slovenia	2.1	1.0	0.8	0.4	0.6	0.7	1.0	1.2	1.2	1.4	1.5	1.7
Slovakia	3.5	3.5	2.7	1.9	1.0	0.4	1.0	2.0	2.6	3.0	3.0	3.0
Finland	4.8	2.7	3.0	1.7	1.7	1.3	1.2	1.3	1.5	1.7	1.8	2.0
Euro area	2.4	1.6	1.4	1.1	0.3	0.3	0.4	0.9	1.2	1.4	1.4	1.4
Bulgaria	3.4	2.0	2.3	2.7	2.3	2.0	2.3	2.8	3.2	3.6	3.0	2.2
Czech Republic	2.8	2.2	:	:	:	:	:	:	:	:	:	:
Denmark	1.5	1.7	0.8	1.2	1.7	1.0	1.2	1.8	2.0	2.0	1.9	2.0
Latvia	2.9	5.0	4.5	3.8	2.9	1.5	2.1	3.6	4.4	4.8	4.5	3.9
Lithuania	6.8	6.2	6.5	4.9	1.9	2.4	3.8	5.4	5.4	5.0	3.4	1.7
Hungary	1.7	1.2	0.4	0.1	-0.1	0.1	0.3	0.7	0.9	1.1	1.4	1.6
Poland	4.4	4.5	3.7	3.2	2.6	2.1	2.2	2.4	2.7	2.7	2.8	2.8
Romania	0.8	0.8	1.8	1.6	1.2	1.3	1.2	2.1	2.8	3.1	3.6	3.5
Sweden	6.1	5.0	4.3	3.1	2.4	2.0	1.1	1.5	2.0	2.1	2.2	2.3
United Kingdom	1.6	0.6	0.1	0.8	0.5	0.4	0.7	0.9	1.2	1.6	1.6	1.7
EU	2.4	1.7	1.4	1.2	0.5	0.5	0.6	1.0	1.3	1.5	1.6	1.6
USA	2.2	1.6	1.5	1.1	1.5	1.5	1.3	1.6	1.2	1.2	1.4	1.4
Japan	-0.7	-1.1	-0.7	0.2	1.5	2.4	1.2	1.1	1.0	1.0	1.1	1.1

TABLE 4 : Gross domestic product per capita (percentage change on preceding year, 1992-2013)

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	1.2	2.5	1.5	2.1	0.1	-3.6	1.4	**1.4**	**0.1**	**0.7**	*1.6*	*1.5*
Germany	0.7	1.9	1.0	3.4	1.3	-4.8	3.8	**2.9**	**0.9**	**1.6**	*2.7*	*2.1*
Estonia	:	7.9	8.8	7.7	-3.6	-14.2	2.3	**8.0**	**3.2**	**4.0**	*4.7*	*3.9*
Ireland	5.9	7.2	3.0	2.7	-4.7	-7.5	-0.6	**0.8**	**0.6**	**1.6**	*0.3*	*1.7*
Greece	0.2	3.4	3.9	2.6	-0.5	-3.6	-3.7	**-5.7**	**-3.0**	**0.5**	*-3.7*	*0.9*
Spain	1.3	3.7	1.7	1.6	-0.7	-4.4	-0.4	**0.4**	**0.7**	**1.5**	*0.4*	*1.2*
France	0.8	2.3	1.0	1.7	-0.6	-3.3	0.9	**1.0**	**0.0**	**0.9**	*1.2*	*1.5*
Italy	1.2	2.0	0.4	0.9	-1.9	-5.6	1.1	**0.1**	**-0.3**	**0.4**	*0.6*	*1.0*
Cyprus	3.3	3.0	1.3	3.6	2.4	-2.7	0.7	**-0.4**	**-0.6**	**1.2**	*0.9*	*1.7*
Luxembourg	1.2	5.0	2.7	4.9	-1.0	-7.1	0.8	**0.0**	**-0.5**	**0.9**	*2.0*	*2.5*
Malta	4.1	2.7	1.0	3.6	3.5	-3.0	2.2	**1.6**	**0.8**	**1.5**	*1.7*	*1.8*
Netherlands	1.9	3.1	1.2	3.7	1.4	-4.0	1.2	**1.7**	**0.3**	**1.0**	*1.6*	*1.4*
Austria	1.4	2.6	1.7	3.3	1.0	-4.1	2.0	**2.6**	**0.6**	**1.6**	*2.0*	*1.6*
Portugal	1.8	3.4	0.1	2.2	-0.1	-2.6	1.4	**-1.9**	**-3.0**	**1.2**	*-2.2*	*-1.7*
Slovenia	2.1	4.2	4.0	6.3	3.4	-8.9	1.0	**0.8**	**0.8**	**1.2**	*1.7*	*2.2*
Slovakia	:	2.7	5.8	10.4	5.7	-5.1	4.0	**2.8**	**1.0**	**2.8**	*3.4*	*4.3*
Finland	0.9	4.3	2.7	4.9	0.5	-8.7	3.2	**2.6**	**0.9**	**1.2**	*3.2*	*2.1*
Euro area	1.1	2.5	1.2	2.4	-0.2	-4.6	1.6	**1.2**	**0.3**	**1.1**	*1.4*	*1.5*
Bulgaria	-2.2	3.6	6.5	7.0	6.7	-5.0	0.8	**2.9**	**3.1**	**3.7**	*3.3*	*4.2*
Czech Republic	2.4	1.7	4.8	5.2	2.0	-5.3	2.5	**1.6**	**0.3**	**1.4**	*2.0*	*2.9*
Denmark	2.2	2.1	1.5	1.2	-1.7	-5.7	1.3	**0.9**	**1.1**	**1.4**	*1.4*	*1.2*
Latvia	-7.4	6.9	9.6	10.2	-2.8	-17.3	0.4	**5.2**	**3.2**	**4.7**	*4.0*	*4.7*
Lithuania	-7.8	5.5	8.6	10.4	3.4	-14.4	3.1	**8.2**	**4.2**	**4.4**	*6.2*	*5.5*
Hungary	0.5	3.9	4.4	0.3	1.1	-6.7	1.5	**1.6**	**0.8**	**1.7**	*2.9*	*2.9*
Poland	4.7	4.4	4.2	6.8	5.1	1.5	3.9	**3.9**	**2.5**	**2.8**	*3.9*	*3.7*
Romania	1.6	0.3	7.0	6.5	7.5	-6.4	-1.7	**1.8**	**2.3**	**3.6**	*1.7*	*3.9*
Sweden	0.7	3.3	2.9	2.6	-1.4	-6.0	4.7	**3.2**	**0.7**	**1.4**	*3.9*	*2.2*
United Kingdom	2.3	3.3	2.3	2.8	-1.8	-5.0	1.4	**0.0**	**-0.1**	**0.9**	*1.0*	*1.4*
EU	1.1	2.7	1.7	2.7	-0.1	-4.6	1.7	**1.3**	**0.4**	**1.3**	*1.6*	*1.7*
USA	2.1	2.6	1.8	0.9	-1.3	-4.4	2.2	**0.8**	**0.7**	**0.5**	*1.7*	*1.8*
Japan	1.0	0.2	1.6	2.4	-1.1	-6.1	3.5	**-0.3**	**1.9**	**1.1**	*0.6*	*1.7*

TABLE 5 : Domestic demand, volume (percentage change on preceding year, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	1.4	2.2	1.7	3.1	2.0	-2.4	1.2	**2.1**	**0.9**	**1.3**	*1.9*	*2.1*
Germany	1.2	1.6	0.2	1.9	1.3	-2.6	2.4	**2.6**	**1.5**	**1.8**	*2.3*	*2.0*
Estonia	:	6.4	10.9	9.1	-9.4	-22.9	0.4	**7.7**	**4.0**	**4.3**	*4.9*	*4.5*
Ireland	4.5	8.1	5.6	4.7	-4.3	-12.7	-4.9	**-2.7**	**-0.9**	**0.4**	*-3.9*	*-0.4*
Greece	1.2	4.3	4.1	5.7	0.3	-5.5	-5.9	**-7.7**	**-5.0**	**-0.8**	*-7.7*	*-1.5*
Spain	0.8	5.0	4.4	4.1	-0.5	-6.2	-1.0	**-1.0**	**0.0**	**1.0**	*-0.6*	*1.0*
France	0.8	2.9	2.0	3.2	0.3	-2.5	1.4	**2.0**	**0.6**	**1.5**	*1.9*	*2.4*
Italy	0.0	2.6	1.3	1.4	-1.2	-3.9	1.7	**0.1**	**-0.4**	**0.4**	*0.7*	*1.2*
Cyprus	:	3.5	4.4	8.8	7.7	-6.9	2.2	**-0.7**	**0.1**	**1.2**	*0.8*	*1.6*
Luxembourg	1.6	5.9	2.7	5.9	2.8	-5.1	5.9	**3.6**	**0.9**	**2.5**	*4.2*	*3.6*
Malta	:	1.4	2.5	2.9	1.5	-3.9	-1.9	**0.2**	**0.7**	**1.5**	*2.2*	*1.6*
Netherlands	2.1	3.9	1.2	3.1	2.2	-2.7	0.4	**1.3**	**-0.6**	**0.8**	*1.1*	*1.3*
Austria	2.0	1.8	1.5	2.5	0.9	-3.0	2.0	**2.5**	**0.8**	**1.8**	*1.6*	*1.5*
Portugal	2.3	4.7	0.6	2.0	0.8	-2.9	0.7	**-5.4**	**-6.3**	**-0.7**	*-5.7*	*-4.7*
Slovenia	5.2	4.2	4.0	8.9	4.1	-10.0	-0.1	**-1.2**	**0.6**	**1.6**	*1.0*	*2.0*
Slovakia	:	2.5	4.8	6.3	5.8	-7.0	4.2	**0.4**	**0.4**	**1.9**	*1.5*	*3.6*
Finland	0.2	3.7	3.0	4.7	0.6	-6.4	3.1	**3.7**	**1.4**	**1.7**	*3.1*	*2.3*
Euro area	1.1	2.8	1.7	2.8	0.3	-3.7	1.1	**1.0**	**0.3**	**1.2**	*0.9*	*1.6*
Bulgaria	:	6.0	8.2	8.8	6.5	-12.8	-4.6	**0.0**	**2.2**	**3.2**	*2.5*	*3.6*
Czech Republic	6.2	0.9	3.6	6.6	2.2	-5.6	1.9	**0.1**	**0.0**	**1.5**	*0.6*	*2.0*
Denmark	2.9	2.2	2.9	2.3	-1.2	-6.5	1.7	**0.0**	**1.7**	**2.2**	*1.7*	*1.6*
Latvia	:	6.6	11.2	12.9	-9.1	-27.4	0.1	**6.9**	**3.4**	**5.1**	*3.5*	*4.7*
Lithuania	:	5.3	9.6	13.9	3.2	-24.7	1.6	**7.3**	**3.4**	**4.3**	*5.6*	*5.4*
Hungary	0.4	4.1	4.0	-1.4	0.7	-10.5	-0.5	**-0.8**	**-0.8**	**0.7**	*1.9*	*1.6*
Poland	5.4	4.5	3.9	8.7	5.6	-1.1	4.6	**3.9**	**1.8**	**2.6**	*4.4*	*3.7*
Romania	1.1	1.5	9.0	14.2	7.3	-12.0	-1.5	**0.9**	**2.2**	**4.6**	*1.1*	*4.2*
Sweden	0.1	2.8	2.5	4.6	0.0	-4.9	6.0	**3.7**	**1.1**	**1.8**	*3.8*	*2.3*
United Kingdom	2.3	4.4	3.0	3.5	-1.7	-5.4	2.7	**-0.8**	**-0.3**	**0.5**	*0.4*	*0.7*
EU	1.4	3.0	2.1	3.3	0.2	-4.3	1.5	**0.9**	**0.3**	**1.2**	*1.1*	*1.6*
USA	3.5	4.4	3.0	1.2	-1.5	-4.5	3.5	**1.7**	**1.6**	**1.6**	*2.6*	*2.8*
Japan	1.5	0.3	1.0	1.3	-1.4	-4.6	2.2	**0.2**	**1.6**	**0.8**	*0.7*	*1.5*

TABLE 6 : Final demand, volume (percentage change on preceding year, 1992-2013)

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	2.5	4.0	2.6	4.0	1.9	-6.4	4.9	**3.5**	**1.7**	**2.9**	*3.7*	*3.7*
Germany	1.6	3.1	2.3	3.9	1.7	-6.4	6.0	**4.3**	**2.3**	**3.3**	*4.0*	*3.6*
Estonia	:	8.9	10.1	6.9	-5.5	-21.1	9.8	**15.8**	**3.9**	**5.1**	*10.1*	*5.5*
Ireland	8.3	12.0	5.0	6.7	-2.5	-8.3	0.9	**1.3**	**1.8**	**2.7**	*1.7*	*2.9*
Greece	1.6	5.3	3.9	5.9	0.8	-8.0	-4.4	**-5.6**	**-2.9**	**0.7**	*-4.7*	*0.1*
Spain	2.3	5.8	4.3	4.6	-0.6	-7.0	1.8	**0.9**	**0.8**	**1.8**	*1.0*	*2.0*
France	1.5	3.8	2.2	3.0	0.1	-4.5	3.0	**2.6**	**1.2**	**2.2**	*2.9*	*3.3*
Italy	1.3	2.8	1.6	2.5	-1.6	-6.9	3.7	**0.9**	**0.2**	**1.3**	*1.8*	*2.2*
Cyprus	:	4.4	3.5	7.9	5.2	-8.2	1.7	**0.5**	**0.8**	**2.0**	*1.7*	*2.4*
Luxembourg	3.1	8.8	5.8	8.2	3.6	-9.3	3.7	**3.0**	**-0.1**	**4.9**	*6.1*	*5.7*
Malta	:	2.4	3.0	2.8	2.0	-6.3	7.5	**2.4**	**2.4**	**3.4**	*4.2*	*3.9*
Netherlands	3.4	5.6	2.6	4.6	2.1	-5.2	4.8	**3.2**	**1.2**	**2.5**	*3.5*	*3.5*
Austria	2.3	3.9	3.1	4.9	1.1	-7.4	4.2	**4.0**	**1.9**	**3.5**	*3.5*	*3.5*
Portugal	3.2	4.9	1.4	3.3	0.6	-4.9	2.4	**-2.7**	**-3.6**	**1.1**	*-3.1*	*-2.0*
Slovenia	2.7	5.4	5.8	10.8	3.6	-12.8	3.5	**2.4**	**2.1**	**3.4**	*3.2*	*3.9*
Slovakia	:	5.5	7.7	9.9	4.6	-11.0	9.3	**3.7**	**1.3**	**4.0**	*4.6*	*5.8*
Finland	2.4	5.7	3.9	5.9	2.5	-12.0	5.0	**2.6**	**2.0**	**2.6**	*4.6*	*3.3*
Euro area	2.0	4.0	2.6	3.9	0.6	-6.4	3.9	**2.5**	**1.2**	**2.5**	*2.7*	*3.0*
Bulgaria	:	5.3	9.1	7.8	5.3	-12.3	1.7	**4.0**	**3.2**	**4.3**	*4.4*	*4.9*
Czech Republic	7.4	4.3	6.0	8.5	2.9	-7.4	7.5	**4.1**	**1.7**	**3.9**	*4.8*	*5.9*
Denmark	3.1	3.7	3.5	2.5	0.1	-7.7	2.4	**2.2**	**2.3**	**3.1**	*2.7*	*2.6*
Latvia	:	6.4	10.7	12.1	-6.3	-23.7	3.7	**8.3**	**4.2**	**5.5**	*5.2*	*5.4*
Lithuania	:	5.8	10.4	10.1	5.9	-20.5	7.1	**9.3**	**4.6**	**5.2**	*7.9*	*6.1*
Hungary	:	8.2	6.7	5.7	2.9	-10.4	6.1	**4.0**	**3.2**	**4.5**	*5.6*	*5.4*
Poland	6.4	5.5	5.6	8.8	6.0	-2.7	6.8	**4.9**	**2.8**	**3.5**	*5.3*	*4.9*
Romania	0.8	3.5	9.6	12.8	7.5	-10.8	1.7	**2.5**	**2.8**	**4.9**	*3.0*	*5.0*
Sweden	2.4	4.4	3.8	5.0	0.6	-7.9	7.7	**5.1**	**1.9**	**2.9**	*5.1*	*3.3*
United Kingdom	3.3	4.7	3.6	2.4	-1.1	-6.3	3.4	**0.5**	**0.6**	**1.5**	*2.2*	*2.2*
EU	2.2	4.2	3.0	4.0	0.6	-6.6	4.1	**2.4**	**1.3**	**2.5**	*2.9*	*3.1*
USA	3.9	4.4	3.2	2.0	-0.7	-5.0	4.2	**2.3**	**2.1**	**2.3**	*3.2*	*3.6*
Japan	1.7	0.5	1.9	2.2	-1.0	-7.4	4.7	**0.4**	**1.8**	**1.4**	*0.7*	*1.9*

TABLE 7 : Private consumption expenditure, volume (percentage change on preceding year, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	1.5	2.1	1.2	1.7	1.9	0.8	2.5	**1.2**	**0.8**	**1.3**	*1.5*	*1.9*
Germany	1.7	1.5	0.3	-0.2	0.6	-0.1	0.6	**1.2**	**1.1**	**1.1**	*1.2*	*1.5*
Estonia	:	6.5	10.3	8.8	-6.1	-15.6	-1.7	**3.4**	**2.9**	**3.6**	*3.2*	*3.5*
Ireland	4.2	7.8	4.7	6.3	-1.4	-7.2	-0.9	**-2.4**	**-1.1**	**0.5**	*-1.9*	*-1.0*
Greece	1.8	3.1	4.1	3.7	4.0	-1.3	-3.6	**-6.2**	**-4.3**	**-0.9**	*-6.4*	*-2.2*
Spain	1.1	4.3	3.6	3.5	-0.6	-4.3	0.8	**0.7**	**0.9**	**1.1**	*0.8*	*1.1*
France	1.1	2.6	2.0	2.4	0.2	0.2	1.4	**0.7**	**0.9**	**1.6**	*1.6*	*1.8*
Italy	0.5	2.6	0.9	1.1	-0.8	-1.6	1.0	**0.7**	**0.1**	**0.4**	*0.6*	*1.1*
Cyprus	:	4.4	3.7	9.4	7.1	-2.9	0.8	**0.7**	**-0.4**	**0.7**	*1.4*	*2.2*
Luxembourg	1.7	4.3	1.6	3.3	3.4	1.1	2.1	**1.9**	**1.6**	**2.7**	*1.8*	*2.3*
Malta	:	3.6	2.2	0.9	4.9	0.2	-1.4	**1.2**	**0.6**	**1.0**	*0.8*	*1.4*
Netherlands	2.1	3.9	0.5	1.8	1.3	-2.6	0.4	**-0.7**	**-0.4**	**0.2**	*0.8*	*1.1*
Austria	1.9	1.7	1.7	0.9	0.8	-0.3	2.2	**0.6**	**1.0**	**1.4**	*1.1*	*1.1*
Portugal	2.0	3.8	1.4	2.5	1.3	-1.1	2.3	**-4.2**	**-5.9**	**-0.4**	*-4.4*	*-3.8*
Slovenia	5.1	3.1	2.8	6.1	3.7	-0.1	-0.7	**0.1**	**0.6**	**1.5**	*0.7*	*1.3*
Slovakia	:	3.8	4.9	6.8	6.1	0.2	-0.7	**0.2**	**0.4**	**1.3**	*1.3*	*3.6*
Finland	0.6	3.2	3.6	3.5	1.8	-3.1	2.7	**3.7**	**1.4**	**1.9**	*2.3*	*2.0*
Euro area	1.3	2.6	1.5	1.7	0.4	-1.2	0.9	**0.5**	**0.4**	**1.0**	*0.8*	*1.2*
Bulgaria	-1.4	2.8	6.7	9.0	3.4	-7.6	-1.2	**1.0**	**2.1**	**3.0**	*2.1*	*3.6*
Czech Republic	6.0	1.3	3.8	4.2	2.8	-0.4	0.6	**-0.3**	**0.3**	**1.5**	*0.4*	*2.0*
Denmark	2.4	1.0	2.9	3.0	-0.6	-4.5	2.3	**-0.5**	**1.4**	**2.3**	*2.0*	*1.9*
Latvia	:	4.8	11.3	14.3	-5.8	-22.6	0.4	**3.5**	**2.4**	**3.3**	*3.0*	*3.5*
Lithuania	:	5.0	10.0	11.3	4.2	-17.5	-4.9	**6.1**	**2.8**	**3.2**	*3.3*	*3.9*
Hungary	:	4.3	4.4	1.1	-0.7	-6.2	-2.2	**0.2**	**-0.8**	**0.3**	*2.7*	*1.0*
Poland	4.8	4.6	3.4	4.9	5.7	2.0	3.2	**3.4**	**2.6**	**2.9**	*3.3*	*3.7*
Romania	3.1	1.6	10.6	11.9	9.0	-10.1	-1.6	**0.7**	**1.9**	**3.4**	*0.6*	*3.1*
Sweden	0.0	3.2	2.6	3.7	0.0	-0.3	3.7	**2.6**	**1.2**	**1.6**	*3.0*	*2.3*
United Kingdom	2.4	4.7	2.9	2.7	-1.5	-3.5	1.1	**-1.1**	**-0.5**	**0.8**	*0.3*	*0.8*
EU	1.7	3.0	2.0	2.2	0.3	-1.7	1.0	**0.4**	**0.4**	**1.1**	*0.9*	*1.3*
USA	3.4	4.4	3.0	2.3	-0.6	-1.9	2.0	**2.1**	**1.3**	**1.6**	2.9	*2.7*
Japan	1.9	0.6	1.2	1.6	-0.7	-1.9	1.8	**-0.6**	**0.6**	**0.6**	*-0.3*	*1.0*

TABLE 8 : Government consumption expenditure, volume (percentage change on preceding year, 1992-2013)

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	1.2	2.0	1.6	2.0	2.4	0.8	0.2	**0.6**	**1.3**	**1.4**	*1.2*	*1.6*
Germany	2.6	1.1	0.4	1.4	3.1	3.3	1.7	**0.9**	**1.0**	**1.1**	*1.5*	*0.9*
Estonia	:	0.1	2.0	6.6	5.0	-1.6	-1.1	**1.4**	**1.4**	**1.0**	*0.3*	*0.9*
Ireland	3.7	7.6	4.3	7.0	1.2	-3.7	-3.1	**-3.6**	**-1.0**	**-2.1**	*-4.4*	*-0.4*
Greece	1.0	4.3	2.6	7.6	-2.1	4.8	-7.2	**-8.5**	**-9.0**	**-7.0**	*-2.6*	*0.1*
Spain	2.1	3.8	5.1	5.6	5.9	3.7	0.2	**-0.9**	**-2.6**	**0.3**	*-1.4*	*-0.3*
France	1.8	1.0	1.7	1.5	1.3	2.3	1.2	**0.8**	**0.4**	**0.3**	*0.6*	*0.3*
Italy	-1.0	1.5	1.9	1.0	0.6	1.0	-0.5	**0.1**	**-0.3**	**-0.2**	*-0.4*	*0.1*
Cyprus	:	5.3	3.5	0.3	6.2	5.8	0.5	**0.4**	**-3.0**	**1.4**	*3.0*	*1.8*
Luxembourg	4.1	4.8	3.6	2.8	1.4	4.8	2.9	**0.0**	**3.5**	**2.5**	*1.0*	*3.5*
Malta	:	0.0	1.8	0.6	12.1	-1.5	0.9	**1.4**	**1.3**	**1.1**	*0.5*	*1.1*
Netherlands	1.7	2.9	3.2	3.5	2.8	4.8	1.0	**0.1**	**-0.9**	**-0.6**	*-0.1*	*-0.1*
Austria	2.4	2.0	1.4	2.1	4.4	0.2	-0.2	**1.0**	**1.0**	**1.2**	*0.8*	*0.8*
Portugal	1.8	4.1	1.4	0.5	0.4	3.7	1.3	**-3.2**	**-6.2**	**-3.8**	*-6.1*	*-4.6*
Slovenia	2.2	3.7	3.3	0.6	6.1	2.9	1.5	**-2.3**	**0.6**	**0.9**	*0.0*	*0.5*
Slovakia	:	1.6	3.4	-0.2	6.9	6.2	1.5	**-2.7**	**0.6**	**1.7**	*-2.2*	*1.0*
Finland	-0.4	1.8	1.7	1.1	1.7	0.9	0.6	**0.5**	**0.6**	**0.6**	*1.0*	*0.7*
Euro area	1.5	1.7	1.9	2.2	2.3	2.5	0.5	**0.1**	**-0.2**	**0.3**	*0.2*	*0.3*
Bulgaria	-15.4	7.3	3.4	0.3	-1.0	-6.5	-1.0	**2.6**	**0.5**	**0.5**	*-0.3*	*-0.1*
Czech Republic	-1.7	1.7	2.3	0.4	1.2	3.8	0.6	**-1.0**	**0.3**	**1.2**	*-2.3*	*0.5*
Denmark	2.6	2.2	1.7	1.3	1.6	3.1	0.7	**0.1**	**0.4**	**-0.2**	*-0.2*	*0.4*
Latvia	:	2.8	2.9	4.9	1.6	-9.4	-9.7	**1.0**	**0.0**	**0.5**	*-2.0*	*0.0*
Lithuania	:	0.4	3.0	1.6	0.4	-1.4	-3.3	**1.2**	**-0.2**	**2.1**	*0.5*	*3.0*
Hungary	-1.8	0.9	3.6	-7.2	1.1	-0.6	-2.1	**-0.9**	**-0.7**	**0.9**	*-0.8*	*0.5*
Poland	3.3	2.4	4.1	3.7	7.4	2.0	4.4	**1.3**	**1.2**	**2.3**	*1.5*	*0.3*
Romania	2.8	-0.2	-0.9	-0.1	7.2	3.1	-5.8	**-1.5**	**1.5**	**3.5**	*-1.5*	*1.5*
Sweden	0.3	0.8	0.9	0.7	1.0	1.2	2.2	**1.1**	**0.9**	**1.0**	*1.4*	*0.5*
United Kingdom	0.6	2.2	3.1	0.6	1.6	-0.1	1.5	**1.5**	**-1.0**	**-1.6**	*0.8*	*-1.0*
EU	0.7	1.8	2.1	1.8	2.3	2.0	0.7	**0.3**	**-0.2**	**0.1**	*0.3*	*0.2*
USA	-0.1	2.4	2.2	1.4	2.6	2.0	1.0	**-0.8**	**0.0**	**-1.3**	*-0.3*	*0.4*
Japan	3.1	2.8	1.7	1.5	0.5	3.0	2.2	**2.3**	**0.9**	**0.5**	*2.1*	*1.2*

TABLE 9 : Total investment, volume (percentage change on preceding year, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	0.8	3.6	2.4	6.0	2.0	-8.1	-0.7	**5.7**	**1.5**	**1.2**	*3.5*	*3.4*
Germany	0.7	1.7	0.2	4.7	1.7	-11.4	5.5	**7.3**	**2.7**	**4.6**	*6.0*	*4.8*
Estonia	:	10.2	17.0	9.3	-15.1	-37.9	-9.1	**16.7**	**9.6**	**8.9**	*14.9*	*10.6*
Ireland	7.8	9.7	7.4	2.3	-10.1	-28.8	-25.1	**-10.5**	**0.6**	**4.2**	*-13.5*	*2.0*
Greece	-0.2	8.2	6.7	5.4	-6.7	-15.2	-15.0	**-15.9**	**-3.6**	**6.3**	*-16.6*	*-1.9*
Spain	-0.3	7.6	5.7	4.5	-4.7	-16.6	-6.3	**-5.4**	**-0.3**	**1.3**	*-3.4*	*1.8*
France	-0.8	5.0	2.4	6.3	0.3	-9.0	-1.2	**3.0**	**0.8**	**2.7**	*3.4*	*5.0*
Italy	-0.8	4.1	1.7	1.8	-3.7	-11.7	2.4	**0.1**	**-1.2**	**1.2**	*2.2*	*3.1*
Cyprus	:	1.3	7.3	13.4	6.0	-9.1	-7.9	**-7.0**	**5.1**	**2.9**	*-3.9*	*-0.8*
Luxembourg	1.1	8.2	4.1	17.9	3.2	-13.0	3.0	**7.1**	**-2.4**	**2.3**	*12.0*	*6.0*
Malta	:	-0.2	3.9	1.0	-23.5	-16.8	11.7	**-7.0**	**0.5**	**4.0**	*11.0*	*3.0*
Netherlands	3.3	4.9	0.6	5.5	4.5	-10.2	-4.4	**6.1**	**-0.3**	**3.9**	*3.0*	*4.1*
Austria	2.0	1.8	0.5	3.6	0.7	-8.3	0.1	**4.7**	**0.7**	**3.0**	*3.0*	*2.9*
Portugal	1.6	7.2	-2.4	2.6	-0.3	-11.3	-4.9	**-11.6**	**-9.4**	**1.5**	*-9.9*	*-7.4*
Slovenia	6.9	7.9	5.2	13.3	7.8	-23.3	-8.3	**-10.0**	**0.9**	**2.7**	*0.8*	*3.9*
Slovakia	:	1.4	5.6	9.1	1.0	-19.7	12.4	**3.7**	**0.7**	**3.8**	*4.5*	*6.5*
Finland	-1.9	6.8	1.9	10.7	-0.8	-13.5	2.8	**6.4**	**1.9**	**2.4**	*6.6*	*4.5*
Euro area	0.4	4.1	2.1	4.7	-1.1	-12.2	-0.5	**2.0**	**0.5**	**2.9**	*2.2*	*3.7*
Bulgaria	:	13.1	15.4	11.8	21.9	-17.6	-16.5	**-4.5**	**3.5**	**5.4**	*4.9*	*5.8*
Czech Republic	10.7	0.2	3.8	13.2	4.1	-11.5	0.1	**1.7**	**-0.8**	**2.0**	*2.4*	*3.8*
Denmark	4.3	4.8	4.4	0.4	-3.3	-14.3	-3.3	**0.4**	**4.9**	**5.7**	*3.7*	*3.0*
Latvia	:	17.5	17.6	7.9	-13.8	-37.4	-12.2	**21.5**	**8.0**	**12.0**	*9.2*	*12.0*
Lithuania	:	8.0	14.0	21.8	-5.2	-39.5	1.0	**18.9**	**9.2**	**10.1**	*16.9*	*13.8*
Hungary	2.2	7.0	3.5	3.8	2.9	-11.0	-9.7	**-4.9**	**-1.0**	**1.8**	*1.5*	*4.5*
Poland	9.9	6.6	4.0	17.6	9.6	-1.2	-0.2	**7.0**	**1.7**	**1.8**	*9.7*	*7.0*
Romania	10.4	1.9	12.7	30.3	15.6	-28.1	-7.3	**2.4**	**2.6**	**6.5**	*3.5*	*5.9*
Sweden	-1.4	4.8	4.6	8.9	1.4	-15.9	6.6	**8.5**	**2.3**	**3.5**	*9.8*	*5.1*
United Kingdom	2.3	5.6	3.7	8.1	-4.8	-13.4	2.6	**-1.6**	**1.1**	**2.9**	*0.1*	*4.0*
EU	2.4	4.3	2.6	5.9	-0.9	-12.5	-0.3	**1.9**	**0.8**	**3.0**	*2.5*	*3.9*
USA	7.0	6.6	2.8	-1.6	-5.8	-16.0	1.8	**3.3**	**4.0**	**4.9**	*4.7*	*5.9*
Japan	-0.2	-1.6	-0.1	-1.2	-3.6	-11.7	-0.2	**0.2**	**4.0**	**1.7**	*0.5*	*3.6*

TABLE 10 : Investment in construction, volume (percentage change on preceding year, 1992-2013)

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	1.8	0.2	2.8	3.5	0.4	-6.7	0.3	**6.4**	**1.3**	**1.2**	*3.0*	*2.2*
Germany	2.9	-1.7	-2.2	-0.3	-0.7	-3.0	2.2	**5.7**	**1.8**	**2.7**	*2.8*	*2.4*
Estonia	:	6.9	17.2	7.1	-13.4	-31.2	-24.5	**12.6**	**15.0**	**4.2**	*12.8*	*11.3*
Ireland	7.7	9.7	8.0	-0.5	-9.4	-31.8	-30.3	**-23.5**	**-14.1**	**-1.2**	*-24.0*	*-2.9*
Greece	-3.1	6.6	4.3	-8.9	-12.7	-10.0	-12.2	**-17.5**	**-5.0**	**6.0**	*-20.0*	*-5.4*
Spain	-0.9	6.5	6.3	2.4	-5.8	-15.4	-10.1	**-7.6**	**-0.9**	**1.2**	*-7.4*	*0.2*
France	-2.5	2.8	3.1	4.4	-1.7	-6.3	-5.9	**-0.9**	**0.7**	**0.8**	*-0.4*	*2.7*
Italy	-2.0	2.9	2.4	0.5	-2.8	-8.9	-4.0	**-1.5**	**-0.9**	**0.3**	*-0.7*	*1.6*
Cyprus	:	-0.3	8.5	14.1	3.1	-9.0	-6.0	**-6.6**	**5.2**	**3.7**	*-2.8*	*-1.7*
Luxembourg	4.1	6.2	4.6	12.3	4.4	-2.9	-3.4	**2.6**	**0.8**	**4.7**	*7.1*	*6.7*
Malta	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*
Netherlands	1.4	3.7	-0.6	6.0	2.6	-8.1	-11.7	**3.9**	**1.0**	**3.0**	*0.0*	*2.0*
Austria	3.0	-0.3	0.1	1.8	1.0	-7.6	-2.9	**2.3**	**0.3**	**1.9**	*-1.1*	*1.1*
Portugal	2.3	6.4	-3.9	-0.4	-4.6	-11.2	-5.7	**-13.0**	**-11.5**	**1.3**	*-8.9*	*-7.3*
Slovenia	2.4	4.9	2.8	15.7	12.1	-20.6	-17.3	**-21.7**	**-0.9**	**0.7**	*-3.5*	*1.9*
Slovakia	:	1.7	6.7	4.9	3.9	-10.3	-1.3	**2.0**	**5.6**	**4.0**	*2.7*	*7.4*
Finland	-4.3	6.7	3.0	8.8	-1.6	-15.2	7.7	**6.5**	**2.4**	**2.1**	*6.9*	*4.0*
Euro area	0.2	2.3	1.6	1.9	-2.0	-7.9	-4.2	**-0.7**	**0.2**	**1.6**	*-1.0*	*1.8*
Bulgaria	:	:	18.8	-2.4	46.2	1.0	-15.5	**:**	**:**	**:**	*:*	*:*
Czech Republic	5.2	-4.0	3.4	5.9	-1.9	-5.4	1.2	**0.7**	**-0.6**	**1.1**	*1.7*	*3.2*
Denmark	3.2	2.3	4.3	-2.4	-4.5	-16.7	-11.4	**5.9**	**2.3**	**3.6**	*3.2*	*1.9*
Latvia	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*
Lithuania	:	4.0	13.9	21.5	0.3	-37.1	-7.7	**9.4**	**6.3**	**7.7**	*15.5*	*14.9*
Hungary	:	3.7	3.2	-3.2	2.2	-5.9	-13.7	**-8.7**	**-2.6**	**-0.2**	*-2.5*	*1.8*
Poland	:	5.6	3.7	13.4	8.2	4.9	3.4	**9.0**	**2.0**	**-1.9**	*13.1*	*4.0*
Romania	15.2	-2.1	11.4	37.3	20.3	-18.8	-15.5	**4.4**	**2.7**	**5.6**	*3.6*	*4.5*
Sweden	-7.5	2.1	4.2	7.5	-2.6	-10.3	3.0	**9.2**	**2.1**	**0.6**	*8.2*	*4.0*
United Kingdom	0.9	2.6	4.6	6.1	-5.7	-13.7	0.2	**1.1**	**0.2**	**1.4**	*-4.5*	*2.6*
EU	:	1.9	3.6	7.6	0.9	-9.9	-5.0	**1.1**	**0.6**	**2.0**	*-0.1*	*2.3*
USA	3.9	3.6	1.3	-5.8	-8.1	-17.4	-8.9	**-2.0**	**3.0**	**4.1**	*-3.7*	*3.2*
Japan	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*

TABLE 11 : Investment in equipment, volume (percentage change on preceding year, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-0.9	6.9	1.1	9.3	3.5	-11.6	-2.7	**4.9**	**1.6**	**1.3**	*4.1*	*4.6*
Germany	-3.2	6.4	2.7	10.5	3.8	-22.8	10.0	**10.1**	**3.5**	**7.1**	*10.6*	*7.9*
Estonia	:	13.9	16.6	12.1	-17.9	-50.2	26.1	**23.0**	**3.0**	**16.0**	*18.5*	*10.0*
Ireland	9.3	9.1	6.3	17.9	-12.4	-23.5	-16.9	**8.3**	**15.0**	**8.0**	*6.0*	*7.0*
Greece	7.4	10.9	10.0	37.0	1.3	-24.0	-20.0	**-13.4**	**-3.3**	**6.8**	*-16.0*	*1.2*
Spain	-0.1	8.9	4.3	9.6	-3.2	-22.9	5.2	**-0.3**	**0.9**	**1.4**	*3.1*	*4.4*
France	0.8	7.6	1.1	9.1	3.5	-9.6	4.1	**9.1**	**1.2**	**5.8**	*7.0*	*7.0*
Italy	0.1	4.5	1.4	3.2	-5.2	-16.2	11.6	**2.0**	**-1.8**	**2.2**	*5.1*	*4.7*
Cyprus	:	5.0	5.1	11.9	12.7	-9.3	-12.0	**-8.0**	**5.0**	**1.0**	*-5.0*	*1.0*
Luxembourg	-4.3	10.9	3.4	25.4	5.8	-32.9	24.9	**18.3**	**-8.0**	**-4.0**	*26.0*	*4.0*
Malta	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*
Netherlands	4.7	6.0	1.9	8.3	7.1	-13.3	7.3	**8.8**	**-1.9**	**5.4**	*7.7*	*8.0*
Austria	0.0	3.0	0.4	6.6	-0.7	-9.7	4.3	**8.5**	**0.9**	**4.7**	*8.3*	*5.0*
Portugal	1.3	9.2	-0.1	7.9	6.9	-13.2	-4.3	**-11.3**	**-8.0**	**1.7**	*-13.6*	*-9.3*
Slovenia	9.6	11.7	8.7	9.2	3.1	-28.9	4.4	**3.4**	**2.8**	**5.0**	*6.2*	*6.2*
Slovakia	:	1.8	4.6	4.5	1.2	-26.6	16.6	**5.5**	**-4.4**	**4.0**	*7.0*	*6.0*
Finland	1.0	6.0	-1.3	17.8	1.3	-12.0	-6.6	**7.0**	**1.0**	**3.0**	*7.0*	*6.0*
Euro area	0.1	6.8	2.3	9.4	1.1	-17.1	5.9	**5.8**	**0.9**	**4.6**	*6.2*	*5.9*
Bulgaria	:	:	12.3	28.8	2.9	-45.1	-18.4	**:**	**:**	**:**	*:*	*:*
Czech Republic	16.2	4.8	3.6	23.0	10.5	-18.3	-1.3	**3.0**	**-1.0**	**3.0**	*3.7*	*5.1*
Denmark	3.4	6.2	3.8	4.9	-3.5	-13.2	2.7	**-7.5**	**8.9**	**4.5**	*4.6*	*4.7*
Latvia	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*
Lithuania	:	13.5	15.1	23.4	-17.3	-50.0	19.6	**45.0**	**15.0**	**15.0**	*19.0*	*12.5*
Hungary	:	10.0	4.1	11.6	1.6	-16.7	-4.2	**0.0**	**1.0**	**4.5**	*7.0*	*8.0*
Poland	:	7.1	4.8	22.3	13.0	-10.8	-5.1	**3.5**	**1.1**	**8.7**	*3.5*	*13.0*
Romania	7.3	5.9	14.9	28.3	10.9	-32.7	-2.0	**4.5**	**2.3**	**7.5**	*8.2*	*7.3*
Sweden	5.1	6.1	5.2	12.9	5.5	-25.5	11.7	**8.0**	**2.5**	**6.0**	*11.5*	*6.0*
United Kingdom	4.5	8.0	2.6	12.3	-5.2	-22.0	8.6	**-5.7**	**3.4**	**6.1**	*6.8*	*5.4*
EU	:	6.9	4.3	12.8	2.1	-19.8	4.8	**4.1**	**1.7**	**5.4**	*6.7*	*6.3*
USA	10.0	8.2	4.4	2.9	-5.5	-18.6	17.3	**7.1**	**4.6**	**5.5**	*10.6*	*7.6*
Japan	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*

TABLE 12 : Public investment (as a percentage of GDP, 1992-2013)

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	1.6	1.8	1.6	1.6	1.6	1.7	1.6	**1.8**	**1.9**	**1.5**	*1.8*	*1.8*
Germany	2.4	1.9	1.6	1.5	1.6	1.7	1.6	**1.7**	**1.6**	**1.6**	*1.5*	*1.4*
Estonia	:	4.2	4.4	5.1	5.2	5.1	3.9	**4.0**	**5.1**	**4.4**	*5.0*	*5.3*
Ireland	2.2	3.1	3.7	4.6	5.2	4.0	3.8	**3.1**	**2.7**	**2.4**	*3.0*	*2.7*
Greece	2.9	3.3	3.3	3.4	3.7	3.1	2.8	**2.6**	**2.7**	**2.7**	*2.2*	*2.1*
Spain	3.7	3.3	3.6	4.0	4.0	4.5	3.8	**2.7**	**2.4**	**2.4**	*2.9*	*2.7*
France	3.2	2.9	3.1	3.3	3.2	3.4	3.1	**3.1**	**3.2**	**3.2**	*3.1*	*3.1*
Italy	2.4	2.3	2.3	2.3	2.2	2.5	2.1	**1.9**	**1.4**	**1.3**	*1.9*	*1.7*
Cyprus	:	2.9	3.3	3.0	3.1	4.2	3.8	**3.8**	**3.5**	**3.5**	*3.5*	*3.5*
Luxembourg	4.2	4.0	4.4	3.3	3.2	3.7	4.1	**4.2**	**4.2**	**4.2**	*3.9*	*3.6*
Malta	:	4.0	4.3	3.8	2.4	2.2	2.2	**2.3**	**2.3**	**2.3**	*3.3*	*2.7*
Netherlands	2.5	3.1	3.4	3.3	3.5	3.8	3.6	**3.6**	**3.5**	**3.4**	*3.6*	*3.5*
Austria	3.1	1.7	1.2	1.1	1.1	1.2	1.0	**1.0**	**1.0**	**1.0**	*1.1*	*1.1*
Portugal	3.6	4.0	3.1	2.7	2.9	3.0	3.6	**2.4**	**2.1**	**1.8**	*2.5*	*2.1*
Slovenia	:	3.1	3.3	4.2	4.4	4.6	4.3	**3.9**	**3.9**	**3.9**	*4.3*	*4.5*
Slovakia	:	3.6	2.5	1.9	2.0	2.3	2.6	**1.8**	**1.8**	**1.6**	*1.8*	*1.6*
Finland	2.9	2.7	2.6	2.4	2.5	2.8	2.5	**2.7**	**2.7**	**2.7**	*2.6*	*2.5*
Euro area	2.8	2.5	2.5	2.6	2.6	2.8	2.5	**2.3**	**2.1**	**2.1**	*2.3*	*2.2*
Bulgaria	:	3.2	3.3	5.2	5.6	4.9	4.8	**4.4**	**4.4**	**4.5**	*4.4*	*4.8*
Czech Republic	:	3.6	4.6	4.2	4.6	5.1	4.4	**4.3**	**4.2**	**4.2**	*4.7*	*4.8*
Denmark	1.8	1.7	1.8	1.9	1.9	2.0	2.2	**2.3**	**2.2**	**2.0**	*2.3*	*2.1*
Latvia	:	1.3	2.9	5.7	4.9	4.3	3.7	**4.5**	**3.4**	**3.4**	*4.3*	*4.2*
Lithuania	:	2.4	3.4	5.2	4.9	3.9	4.6	**4.5**	**4.7**	**5.1**	*4.2*	*3.9*
Hungary	:	3.1	4.1	3.6	2.9	3.1	3.4	**3.2**	**4.2**	**4.4**	*3.9*	*3.4*
Poland	:	3.4	3.5	4.2	4.6	5.2	5.6	**6.4**	**6.1**	**5.4**	*6.6*	*5.8*
Romania	:	2.5	3.8	6.2	6.6	5.9	5.8	**5.6**	**5.6**	**5.2**	*5.6*	*5.6*
Sweden	2.7	3.0	3.0	3.1	3.3	3.5	3.4	**3.3**	**3.3**	**3.4**	*3.3*	*3.2*
United Kingdom	1.8	1.3	1.5	1.9	2.3	2.7	2.5	**2.2**	**1.9**	**1.8**	*2.2*	*1.9*
EU	:	2.4	2.4	2.6	2.7	2.9	2.7	**2.5**	**2.3**	**2.3**	*2.5*	*2.4*
USA	2.4	2.4	2.5	2.4	2.6	2.6	2.5	**2.4**	**2.3**	**2.2**	*3.3*	*3.3*
Japan	6.1	5.5	4.0	3.1	3.0	3.4	3.2	**3.1**	**3.5**	**3.6**	*3.3*	*3.4*

TABLE 13 : Output gap relative to potential GDP (deviation of actual output from potential output as % of potential GDP, 1992-2013) [1] 24.10.2011

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-0.6	0.7	0.4	2.4	1.6	-2.6	-1.5	**-0.7**	**-1.1**	**-1.0**	*-1.5*	*-0.8*
Germany	0.6	0.4	-1.1	2.1	2.0	-4.0	-1.5	**0.0**	**-0.6**	**-0.7**	*-1.1*	*-0.8*
Estonia	:	-2.7	7.0	12.7	5.1	-10.2	-8.1	**-1.6**	**-0.3**	**1.0**	*-3.2*	*-0.3*
Ireland	-1.0	4.1	1.2	3.7	-0.3	-5.8	-5.0	**-3.1**	**-1.5**	**0.6**	*-3.3*	*-0.8*
Greece	-0.2	-0.1	0.4	3.4	1.9	-1.4	-4.3	**-8.3**	**-9.5**	**-7.9**	*-7.7*	*-6.1*
Spain	-2.6	0.9	1.4	2.1	0.2	-4.7	-5.4	**-5.0**	**-4.1**	**-2.5**	*-4.7*	*-3.3*
France	-1.4	0.9	1.8	2.8	1.1	-2.8	-2.6	**-2.3**	**-2.7**	**-2.4**	*-3.7*	*-3.2*
Italy	-0.6	0.8	0.9	2.8	1.0	-4.1	-2.7	**-2.3**	**-2.1**	**-1.6**	*-2.8*	*-1.9*
Cyprus	:	0.0	-0.1	2.2	3.2	-0.3	-0.4	**-1.0**	**-2.1**	**-1.3**	*-1.5*	*-0.5*
Luxembourg	-0.7	2.0	0.9	4.6	2.6	-4.2	-2.8	**-2.2**	**-2.3**	**-1.4**	*-2.6*	*-1.4*
Malta	:	1.9	-0.9	-0.9	1.3	-2.4	-0.9	**0.0**	**0.0**	**0.4**	*-0.1*	*0.2*
Netherlands	-0.6	1.3	-1.0	2.2	1.9	-3.0	-2.5	**-1.9**	**-2.4**	**-2.2**	*-2.2*	*-1.8*
Austria	-0.5	0.8	-0.5	2.6	2.1	-2.9	-1.8	**-0.4**	**-0.8**	**-0.3**	*-1.2*	*-0.8*
Portugal	-0.7	2.3	-0.6	0.6	-0.3	-2.7	-1.2	**-2.6**	**-4.7**	**-3.2**	*-2.2*	*-3.2*
Slovenia	:	0.5	1.1	6.6	6.7	-4.0	-4.2	**-3.6**	**-3.1**	**-2.2**	*-4.9*	*-3.7*
Slovakia	:	-1.7	-1.2	6.5	7.7	-0.9	0.0	**-0.2**	**-1.7**	**-1.4**	*-1.2*	*0.2*
Finland	-4.1	2.0	0.4	4.8	3.5	-6.0	-3.9	**-2.2**	**-2.0**	**-1.6**	*-3.5*	*-2.7*
Euro area	-0.8	0.8	0.3	2.5	1.4	-3.7	-2.6	**-2.0**	**-2.2**	**-1.7**	*-2.7*	*-2.0*
Bulgaria	:	-3.0	2.5	4.0	5.2	-3.2	-4.5	**-3.6**	**-2.8**	**-1.6**	*-4.2*	*-2.9*
Czech Republic	:	-2.7	0.1	6.4	5.8	-1.6	-0.9	**-0.9**	**-1.9**	**-2.1**	*-1.8*	*-0.8*
Denmark	-1.7	1.3	0.8	3.2	0.6	-5.2	-3.9	**-2.9**	**-2.0**	**-1.1**	*-3.0*	*-2.1*
Latvia	:	-1.4	2.7	14.0	8.0	-10.4	-9.3	**-4.7**	**-2.8**	**-0.5**	*-5.2*	*-0.8*
Lithuania	:	-5.1	3.4	9.9	8.2	-9.1	-8.0	**-3.1**	**-1.3**	**0.3**	*-2.9*	*0.1*
Hungary	:	-1.3	2.5	3.1	2.6	-4.9	-3.9	**-2.5**	**-2.2**	**-1.1**	*-2.3*	*0.0*
Poland	:	0.5	-0.3	2.4	2.3	-0.6	-0.7	**-0.3**	**-1.1**	**-1.4**	*-1.2*	*-1.4*
Romania	:	-5.6	2.2	7.9	10.2	0.2	-3.6	**-3.8**	**-3.7**	**-2.6**	*-4.4*	*-2.8*
Sweden	-3.6	-0.3	0.9	3.6	0.9	-5.4	-1.8	**0.1**	**-0.4**	**-0.2**	*-0.7*	*-0.2*
United Kingdom	-1.6	0.9	2.1	3.7	1.0	-4.0	-3.2	**-3.3**	**-3.6**	**-3.1**	*-4.8*	*-4.1*
EU	:	0.7	0.7	2.9	1.5	-3.7	-2.7	**-2.1**	**-2.4**	**-1.9**	*-3.0*	*-2.3*
USA	-1.2	0.5	0.7	2.0	0.4	-3.8	-1.7	**-1.1**	**-1.0**	**-1.5**	*:*	*:*
Japan	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*

[1] 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, 1992-2013)

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	2.2	1.4	2.2	2.3	2.2	1.2	1.8	**2.3**	**2.1**	**2.2**	*1.9*	*2.1*
Germany	2.9	0.3	0.9	1.6	0.8	1.2	0.6	**0.8**	**1.4**	**1.5**	*1.0*	*1.5*
Estonia	:	6.4	5.1	11.6	5.3	-1.0	1.1	**3.6**	**2.9**	**2.7**	*2.4*	*2.2*
Ireland	2.4	6.0	3.4	1.3	-2.3	-4.1	-2.4	**-1.0**	**0.7**	**1.3**	*0.6*	*0.9*
Greece	11.5	4.3	3.1	3.5	4.7	2.8	1.7	**1.4**	**0.2**	**0.3**	*0.3*	*0.4*
Spain	4.7	3.0	4.2	3.3	2.4	0.1	0.4	**1.5**	**1.1**	**1.3**	*1.0*	*1.1*
France	1.5	1.1	2.0	2.6	2.5	0.5	0.8	**1.2**	**1.5**	**1.7**	*1.8*	*1.8*
Italy	4.3	2.5	2.4	2.4	2.5	2.1	0.4	**1.4**	**1.9**	**2.0**	*1.6*	*1.8*
Cyprus	3.6	3.0	3.1	4.4	4.6	0.1	1.7	**3.1**	**2.7**	**2.2**	*3.1*	*2.1*
Luxembourg	3.7	1.0	4.2	3.6	4.4	0.1	4.9	**2.1**	**1.7**	**2.6**	*3.3*	*2.6*
Malta	3.0	2.4	2.6	3.1	2.6	2.6	2.9	**2.5**	**2.5**	**2.7**	*2.6*	*2.3*
Netherlands	1.9	3.1	2.2	1.8	2.1	-0.4	1.3	**1.4**	**2.0**	**1.4**	*1.9*	*2.1*
Austria	2.3	0.6	1.6	2.0	1.8	1.0	1.8	**2.2**	**2.1**	**2.0**	*1.7*	*1.8*
Portugal	5.8	3.6	2.9	3.2	1.6	0.5	1.1	**1.4**	**1.1**	**1.5**	*1.1*	*1.2*
Slovenia	47.9	7.2	4.0	4.2	4.1	3.0	-1.1	**0.1**	**1.1**	**1.6**	*1.0*	*1.8*
Slovakia	:	6.6	4.1	1.1	2.9	-1.2	0.5	**3.2**	**1.3**	**1.9**	*1.6*	*2.4*
Finland	1.7	2.4	0.5	3.0	2.2	1.7	0.4	**2.4**	**2.8**	**2.2**	*2.5*	*2.4*
Euro area	3.4	1.6	2.1	2.3	1.9	0.9	0.7	**1.2**	**1.6**	**1.6**	*1.4*	*1.7*
Bulgaria	71.8	72.4	5.1	9.2	8.4	4.3	3.0	**5.9**	**3.4**	**3.2**	*3.1*	*2.5*
Czech Republic	13.3	5.2	1.5	3.3	1.9	1.9	-1.7	**0.8**	**1.9**	**1.0**	*0.2*	*1.9*
Denmark	1.4	2.1	2.3	2.3	3.9	0.4	3.4	**1.1**	**1.7**	**1.9**	*1.7*	*2.0*
Latvia	98.5	4.3	7.0	20.7	13.0	-1.2	-2.2	**4.0**	**1.7**	**1.6**	*2.2*	*1.6*
Lithuania	160.2	2.7	3.0	8.6	9.8	-3.7	2.0	**4.0**	**3.0**	**2.9**	*3.3*	*2.9*
Hungary	22.0	12.5	5.0	5.4	5.3	3.6	3.1	**2.3**	**4.1**	**3.4**	*2.6*	*2.5*
Poland	30.3	8.3	2.2	4.0	3.1	3.7	1.4	**3.4**	**2.0**	**2.0**	*3.3*	*3.3*
Romania	114.8	59.5	16.7	13.5	15.3	4.2	4.5	**4.9**	**3.6**	**4.9**	*4.4*	*4.2*
Sweden	2.3	1.3	1.3	2.8	3.1	1.8	1.2	**1.5**	**1.0**	**1.3**	*0.9*	*1.0*
United Kingdom	2.9	1.8	2.6	2.3	3.1	1.7	2.8	**2.9**	**3.1**	**2.2**	*1.9*	*2.1*
EU	24.0	2.3	2.2	2.6	2.5	1.1	1.1	**1.6**	**1.8**	**1.8**	*1.6*	*1.8*
USA	2.1	1.8	2.6	2.9	2.2	1.1	1.2	**2.1**	**1.8**	**1.4**	*1.3*	*1.5*
Japan	0.2	-0.8	-1.3	-0.7	-1.0	-0.4	-2.1	**-0.4**	**0.3**	**0.0**	*-2.0*	*0.2*

TABLE 15 : Price deflator of private consumption (percentage change on preceding year, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	1.8	1.6	2.1	2.9	3.3	-0.9	1.8	**3.5**	**2.0**	**1.9**	*3.3*	*2.0*
Germany	2.6	1.0	1.3	1.5	1.7	0.1	1.9	**2.2**	**1.6**	**1.7**	*2.2*	*1.7*
Estonia	:	6.2	3.1	7.9	8.5	-0.9	2.3	**4.8**	**2.7**	**2.7**	*3.5*	*2.5*
Ireland	2.5	4.0	3.1	3.2	3.2	-4.4	-2.1	**1.3**	**0.7**	**1.4**	*1.0*	*0.7*
Greece	11.6	4.5	3.1	3.3	4.4	0.7	4.5	**3.0**	**0.8**	**0.6**	*2.6*	*0.6*
Spain	4.9	2.8	3.4	3.2	3.6	-1.2	2.4	**3.6**	**0.9**	**1.5**	*2.7*	*1.5*
France	1.6	1.1	1.8	2.1	2.9	-0.5	1.2	**1.9**	**1.3**	**1.2**	*2.1*	*1.6*
Italy	5.1	2.4	2.6	2.2	3.1	0.0	1.5	**2.7**	**2.0**	**1.9**	*2.6*	*1.9*
Cyprus	:	2.4	2.5	3.7	5.1	0.2	2.6	**3.4**	**2.8**	**2.3**	*3.2*	*2.2*
Luxembourg	2.8	2.3	2.1	2.2	2.8	1.0	1.4	**3.3**	**2.1**	**1.9**	*3.0*	*2.0*
Malta	:	1.7	2.0	1.6	3.5	1.8	3.0	**2.6**	**2.2**	**2.3**	*2.7*	*2.2*
Netherlands	2.4	2.9	2.1	1.8	1.1	-0.5	1.5	**2.3**	**1.9**	**1.5**	*2.0*	*2.0*
Austria	2.5	1.4	1.8	2.4	2.1	0.6	2.1	**3.4**	**2.2**	**1.9**	*2.8*	*2.0*
Portugal	5.6	2.9	2.8	3.0	2.6	-2.5	1.6	**3.4**	**2.9**	**1.9**	*3.4*	*2.0*
Slovenia	45.8	7.3	4.0	4.1	5.4	-0.4	1.4	**1.9**	**1.3**	**1.2**	*2.6*	*2.1*
Slovakia	:	7.4	4.8	2.6	4.5	0.1	1.0	**4.0**	**2.2**	**2.9**	*3.6*	*2.7*
Finland	1.9	2.4	0.8	2.2	3.4	1.6	1.9	**2.8**	**2.8**	**1.8**	*3.4*	*2.4*
Euro area	3.6	1.8	2.1	2.2	2.7	-0.4	1.7	**2.5**	**1.6**	**1.6**	*2.4*	*1.7*
Bulgaria	80.5	69.9	3.5	9.0	7.2	1.5	1.1	**6.0**	**3.0**	**3.0**	*3.7*	*3.0*
Czech Republic	11.2	5.3	1.4	2.9	4.8	0.2	0.4	**1.5**	**2.4**	**1.0**	*2.2*	*2.3*
Denmark	1.7	2.1	1.5	1.2	3.1	1.3	2.5	**2.6**	**1.8**	**1.8**	*2.5*	*2.0*
Latvia	:	4.0	5.6	9.9	16.2	3.2	-0.5	**4.3**	**2.4**	**1.8**	*3.2*	*1.8*
Lithuania	:	2.8	0.9	5.9	10.9	4.5	1.3	**4.2**	**3.5**	**2.7**	*3.2*	*2.5*
Hungary	:	12.2	4.5	6.9	5.3	3.7	4.2	**4.0**	**4.6**	**4.0**	*4.0*	*3.5*
Poland	31.6	9.0	2.0	2.4	4.3	2.5	2.5	**3.7**	**2.7**	**2.9**	*3.8*	*3.2*
Romania	118.0	55.6	12.0	4.8	10.0	3.7	4.9	**6.0**	**3.6**	**3.8**	*6.7*	*4.2*
Sweden	3.1	1.3	1.3	1.4	3.1	1.8	1.3	**1.2**	**1.1**	**1.3**	*1.2*	*1.2*
United Kingdom	3.4	1.4	1.9	2.6	3.4	1.4	3.8	**4.4**	**2.9**	**1.9**	*2.8*	*1.6*
EU	24.7	2.4	2.1	2.3	3.1	0.2	2.1	**2.9**	**1.9**	**1.7**	*2.5*	*1.8*
USA	2.3	1.8	2.3	2.7	3.3	0.2	1.8	**2.4**	**1.7**	**1.6**	*2.2*	*1.5*
Japan	0.6	-0.3	-0.8	-0.6	0.4	-2.1	-1.5	**-0.5**	**0.5**	**0.0**	*-0.5*	*0.5*

TABLE 16 : Harmonised index of consumer prices (national index if not available), (percentage change on preceding year, 1992-2013)

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	2.2	1.7	2.0	1.8	4.5	0.0	2.3	**3.5**	**2.0**	**1.9**	*3.6*	*2.2*
Germany	3.1	1.2	1.6	2.3	2.8	0.2	1.2	**2.4**	**1.7**	**1.8**	*2.6*	*2.0*
Estonia	120.7	6.1	3.3	6.7	10.6	0.2	2.7	**5.2**	**3.3**	**2.8**	*4.7*	*2.8*
Ireland	2.2	3.0	3.2	2.9	3.1	-1.7	-1.6	**1.1**	**0.7**	**1.2**	*1.0*	*0.7*
Greece	11.6	3.7	3.4	3.0	4.2	1.3	4.7	**3.0**	**0.8**	**0.8**	*2.4*	*0.5*
Spain	4.7	2.4	3.3	2.8	4.1	-0.2	2.0	**3.0**	**1.1**	**1.3**	*3.0*	*1.4*
France	2.0	1.2	2.1	1.6	3.2	0.1	1.7	**2.2**	**1.5**	**1.4**	*2.2*	*1.7*
Italy	4.6	2.1	2.4	2.0	3.5	0.8	1.6	**2.7**	**2.0**	**1.9**	*2.6*	*1.9*
Cyprus	4.3	2.7	2.6	2.2	4.4	0.2	2.6	**3.4**	**2.8**	**2.3**	*3.4*	*2.3*
Luxembourg	1.8	1.9	2.9	2.7	4.1	0.0	2.8	**3.6**	**2.1**	**2.5**	*3.5*	*2.3*
Malta	3.3	3.1	2.5	0.7	4.7	1.8	2.0	**2.6**	**2.2**	**2.3**	*2.7*	*2.2*
Netherlands	2.5	2.6	2.1	1.6	2.2	1.0	0.9	**2.5**	**1.9**	**1.3**	*2.2*	*2.1*
Austria	2.9	1.3	1.7	2.2	3.2	0.4	1.7	**3.4**	**2.2**	**2.1**	*2.9*	*2.1*
Portugal	5.6	2.7	2.9	2.4	2.7	-0.9	1.4	**3.5**	**3.0**	**1.5**	*3.4*	*2.0*
Slovenia	:	8.0	4.3	3.8	5.5	0.9	2.1	**1.9**	**1.3**	**1.2**	*2.6*	*2.1*
Slovakia	:	8.5	5.3	1.9	3.9	0.9	0.7	**4.0**	**1.7**	**2.1**	*3.6*	*2.9*
Finland	1.5	1.9	1.1	1.6	3.9	1.6	1.7	**3.2**	**2.6**	**1.8**	*3.6*	*2.2*
Euro area	3.8	1.8	2.2	2.1	3.3	0.3	1.6	**2.6**	**1.7**	**1.6**	*2.6*	*1.8*
Bulgaria	87.7	:	5.5	7.6	12.0	2.5	3.0	**3.6**	**3.1**	**3.0**	*4.3*	*3.4*
Czech Republic	:	5.6	1.5	3.0	6.3	0.6	1.2	**1.8**	**2.7**	**1.6**	*2.3*	*2.5*
Denmark	1.9	2.1	1.8	1.7	3.6	1.1	2.2	**2.6**	**1.7**	**1.8**	*2.5*	*1.8*
Latvia	70.3	3.9	4.9	10.1	15.3	3.3	-1.2	**4.2**	**2.4**	**2.0**	*3.4*	*2.0*
Lithuania	179.8	3.9	1.4	5.8	11.1	4.2	1.2	**4.0**	**2.7**	**2.8**	*3.2*	*2.4*
Hungary	23.2	12.3	4.8	7.9	6.0	4.0	4.7	**4.0**	**4.5**	**4.1**	*4.0*	*3.5*
Poland	31.4	9.8	1.9	2.6	4.2	4.0	2.7	**3.7**	**2.7**	**2.9**	*3.8*	*3.2*
Romania	116.9	63.2	12.9	4.9	7.9	5.6	6.1	**5.9**	**3.4**	**3.4**	*6.7*	*4.0*
Sweden	2.4	1.5	1.5	1.7	3.3	1.9	1.9	**1.5**	**1.3**	**1.6**	*1.7*	*1.6*
United Kingdom	2.8	1.3	1.7	2.3	3.6	2.2	3.3	**4.3**	**2.9**	**2.0**	*4.1*	*2.4*
EU	25.8	4.3	2.3	2.4	3.7	1.0	2.1	**3.0**	**2.0**	**1.8**	*3.0*	*2.0*
USA	2.9	2.5	2.6	2.8	3.8	-0.4	1.6	**3.2**	**1.9**	**2.2**	*2.5*	*1.5*
Japan	0.7	0.1	-0.2	0.0	1.4	-1.4	-0.7	**-0.2**	**-0.1**	**0.8**	*0.2*	*0.3*

TABLE 17 : Profiles of quarterly harmonised index of consumer prices (percentage change on corresponding quarter in previous year, 2011-2013) 24.10.2011

	2011/1	2011/2	2011/3	2011/4	2012/1	2012/2	2012/3	2012/4	2013/1	2013/2	2013/3	2013/4
Belgium	3.6	3.4	3.6	3.2	2.2	2.1	1.9	2.0	1.9	1.9	1.9	1.8
Germany	2.2	2.5	2.6	2.4	2.1	1.7	1.7	1.5	1.6	1.7	1.9	2.0
Estonia	5.3	5.3	5.4	5.0	5.1	3.9	2.5	1.7	2.3	2.3	3.2	3.4
Ireland	0.8	1.3	1.1	1.0	0.8	0.7	0.7	0.7	0.9	0.9	0.9	0.9
Greece	4.5	3.3	2.1	2.3	1.6	0.7	0.3	0.4	0.9	0.9	1.2	0.0
Spain	3.2	3.3	2.9	2.5	1.2	1.0	0.9	1.1	1.3	1.3	1.3	1.3
France	2.0	2.2	2.3	2.3	1.9	1.4	1.4	1.3	1.4	1.4	1.3	1.3
Italy	2.3	2.9	2.7	2.8	2.2	1.9	1.8	1.9	1.9	1.9	1.9	1.9
Cyprus	3.1	4.0	3.2	3.1	3.5	3.4	2.2	1.9	2.2	2.3	2.3	2.3
Luxembourg	3.8	3.9	3.6	3.3	2.1	1.9	2.2	2.4	2.5	2.5	2.5	2.5
Malta	2.8	2.6	2.7	2.3	2.3	2.0	2.3	2.2	2.1	2.2	2.3	2.4
Netherlands	2.0	2.3	2.8	2.9	2.5	1.8	1.9	1.5	1.4	1.2	1.2	1.3
Austria	3.0	3.7	3.8	3.1	2.5	1.8	2.0	2.4	2.3	2.0	2.0	2.0
Portugal	3.7	3.7	3.1	3.8	3.2	2.8	3.0	2.8	1.5	1.5	1.5	1.5
Slovenia	2.2	2.0	1.5	2.1	1.9	1.4	1.1	1.0	1.2	1.2	1.2	1.1
Slovakia	3.5	4.1	4.4	4.0	1.6	1.6	1.7	1.9	2.1	2.3	2.1	2.1
Finland	3.4	3.4	3.5	2.7	2.5	2.5	2.8	2.8	2.0	1.8	1.8	1.8
Euro area	2.5	2.7	2.7	2.6	2.0	1.6	1.6	1.5	1.6	1.6	1.6	1.6
Bulgaria	4.4	3.4	3.1	3.6	3.0	3.1	3.1	3.3	3.0	3.0	2.9	2.9
Czech Republic	1.9	1.8	1.9	1.6	3.1	2.8	2.6	2.4	1.7	1.6	1.5	1.5
Denmark	2.6	2.9	2.5	2.5	1.9	1.5	1.6	1.8	1.8	1.8	1.8	1.8
Latvia	3.8	4.7	4.4	3.8	2.9	2.5	2.1	2.0	2.1	2.0	1.9	1.9
Lithuania	3.2	4.7	4.4	3.7	3.2	2.6	2.4	2.4	2.6	2.7	2.7	3.3
Hungary	4.3	3.9	3.5	4.4	5.4	4.4	4.0	4.4	4.6	4.1	3.7	4.1
Poland	3.6	4.0	3.7	3.3	2.9	2.6	2.6	2.7	2.7	3.0	3.1	2.9
Romania	7.5	8.3	4.2	3.7	2.7	2.8	4.0	3.9	3.4	3.4	3.3	3.3
Sweden	1.3	1.7	1.6	1.2	1.1	1.3	1.5	1.4	1.5	1.5	1.6	1.7
United Kingdom	4.1	4.4	4.7	4.2	3.3	3.0	2.7	2.5	2.1	2.1	1.9	1.9
EU	2.8	3.1	3.0	2.8	2.2	1.9	1.8	1.8	1.7	1.8	1.8	1.8
USA	2.2	3.3	3.8	3.4	2.5	1.9	1.6	1.8	1.9	2.1	2.3	2.4
Japan	-0.5	-0.4	0.1	-0.1	-0.2	-0.3	-0.1	0.2	0.9	1.0	0.8	0.6

TABLE 18 : Price deflator of exports of goods in national currency (percentage change on preceding year, 1992-2013)

		5-year averages						Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-0.7	1.3	1.2	2.0	3.3	-6.4	4.9	**4.9**	**2.2**	**1.9**	*3.5*	*2.0*
Germany	0.4	0.5	0.0	0.7	0.9	-2.4	2.5	**2.8**	**1.8**	**1.6**	*2.9*	*1.9*
Estonia	:	4.5	1.4	7.0	5.1	-5.3	4.9	**4.9**	**1.1**	**1.7**	*6.1*	*1.9*
Ireland	0.9	3.3	-2.5	-2.7	-3.3	1.3	1.1	**0.0**	**0.9**	**1.0**	*2.0*	*1.3*
Greece	7.5	4.1	2.2	2.4	5.4	-5.0	7.9	**3.0**	**0.4**	**0.5**	*0.5*	*1.2*
Spain	3.5	2.1	1.7	2.0	2.0	-4.8	3.1	**5.2**	**2.0**	**0.5**	*3.5*	*1.5*
France	-0.8	0.0	-0.2	2.0	3.4	-4.2	1.8	**3.9**	**2.1**	**2.0**	*3.9*	*2.7*
Italy	4.7	3.0	1.1	2.5	2.8	-3.1	2.9	**6.8**	**3.0**	**2.5**	*5.7*	*2.5*
Cyprus	:	3.7	0.6	2.7	1.6	0.3	1.6	**3.3**	**2.7**	**2.1**	*3.3*	*2.5*
Luxembourg	-0.2	0.5	2.4	2.7	5.9	-4.2	2.5	**3.5**	**3.0**	**2.5**	*3.0*	*2.0*
Malta	:	2.4	-1.1	8.0	-4.5	-6.5	1.7	**6.8**	**4.1**	**1.9**	*2.4*	*1.7*
Netherlands	-0.9	0.9	0.5	1.6	4.6	-8.2	6.8	**5.8**	**0.8**	**0.8**	*4.2*	*1.7*
Austria	0.3	0.5	0.9	1.4	2.0	-4.1	3.5	**4.2**	**1.9**	**1.7**	*1.8*	*1.7*
Portugal	1.2	1.8	0.9	1.3	2.2	-5.0	5.2	**6.7**	**1.6**	**1.7**	*4.2*	*1.7*
Slovenia	39.9	5.3	2.8	2.1	0.7	-1.5	2.4	**2.0**	**1.9**	**1.9**	*2.0*	*1.9*
Slovakia	:	5.0	1.7	0.5	0.9	-5.4	3.1	**5.1**	**0.4**	**1.3**	*3.6*	*1.7*
Finland	3.7	-1.6	-0.6	0.5	-1.8	-8.5	4.8	**7.1**	**1.5**	**2.1**	*6.0*	*2.5*
Euro area	1.6	1.1	0.4	1.4	2.1	-4.1	3.3	**4.3**	**1.9**	**1.6**	*3.6*	*2.0*
Bulgaria	:	:	4.8	5.9	8.1	-13.2	10.4	**10.5**	**1.8**	**3.2**	*4.4*	*2.3*
Czech Republic	:	2.1	-1.7	0.2	-4.8	0.2	-1.1	**1.5**	**-0.2**	**0.3**	*-1.0*	*1.0*
Denmark	0.2	1.3	1.7	2.2	7.1	-6.1	4.6	**4.7**	**2.1**	**2.3**	*4.4*	*3.2*
Latvia	:	-0.2	8.8	13.4	7.7	-9.4	8.7	**11.2**	**1.4**	**2.0**	*8.6*	*1.5*
Lithuania	:	0.8	2.9	5.6	13.2	-16.7	12.4	**13.0**	**2.0**	**2.0**	*7.7*	*2.9*
Hungary	:	8.8	-0.3	-4.5	0.6	2.1	1.7	**2.0**	**7.9**	**1.9**	*1.0*	*1.5*
Poland	21.1	6.5	3.8	2.8	-1.8	13.5	0.4	**3.0**	**3.4**	**1.0**	*1.5*	*2.1*
Romania	114.5	50.8	9.8	0.5	21.0	2.8	5.9	**7.0**	**3.3**	**5.0**	*4.5*	*3.5*
Sweden	2.1	0.0	0.2	1.9	3.1	0.7	-0.8	**-0.7**	**1.0**	**1.5**	*-1.0*	*1.0*
United Kingdom	3.1	-2.5	0.5	-1.0	12.2	2.9	5.6	**6.4**	**0.8**	**1.4**	*9.1*	*3.4*
EU	:	7.2	0.5	1.1	3.0	-2.7	3.3	**4.2**	**1.9**	**1.6**	*3.7*	*2.1*
USA	-0.3	-1.3	2.3	3.4	5.0	-6.8	4.9	**8.0**	**3.2**	**2.2**	*5.9*	*1.6*
Japan	-2.6	-1.9	-0.3	2.2	-4.6	-11.5	-1.2	**-0.7**	**-0.7**	**-0.7**	*-2.5*	*-0.7*

TABLE 19 : Price deflator of imports of goods in national currency (percentage change on preceding year, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-0.5	2.0	1.4	1.7	6.4	-9.5	7.1	**6.5**	**2.5**	**1.9**	*4.8*	*2.1*
Germany	-1.2	1.2	-0.1	0.1	2.7	-8.0	5.2	**6.0**	**1.9**	**1.6**	*5.2*	*1.8*
Estonia	:	2.9	1.2	3.8	5.7	-3.2	6.5	**6.2**	**1.0**	**1.6**	*6.5*	*2.1*
Ireland	3.7	1.4	-2.3	-0.3	2.3	-4.6	4.7	**5.2**	**0.1**	**1.0**	*2.3*	*0.8*
Greece	7.2	4.3	2.4	2.2	5.9	-1.6	6.1	**4.0**	**1.3**	**1.3**	*4.3*	*2.1*
Spain	2.9	2.1	1.1	1.9	4.3	-9.3	4.7	**8.9**	**2.8**	**1.0**	*6.9*	*2.3*
France	-1.0	0.2	0.1	0.4	4.1	-6.3	4.6	**6.7**	**2.5**	**0.9**	*5.2*	*1.8*
Italy	5.0	2.7	2.2	1.4	6.3	-9.6	7.1	**9.0**	**2.0**	**1.0**	*7.8*	*2.0*
Cyprus	:	2.5	1.9	2.0	4.2	-2.3	2.3	**4.0**	**2.7**	**2.0**	*3.5*	*2.5*
Luxembourg	0.4	1.9	1.5	-0.6	5.3	-4.8	0.2	**5.5**	**2.5**	**2.5**	*4.0*	*2.5*
Malta	:	2.4	1.7	8.3	5.7	-2.6	-0.6	**5.4**	**3.5**	**1.8**	*2.8*	*1.3*
Netherlands	-1.3	0.2	0.1	1.7	4.9	-7.3	7.3	**6.5**	**0.7**	**1.2**	*4.2*	*1.5*
Austria	0.4	0.7	0.9	1.9	4.0	-4.7	5.6	**6.6**	**2.0**	**1.8**	*3.7*	*2.2*
Portugal	0.1	1.6	0.9	1.0	5.5	-9.7	5.2	**8.4**	**1.3**	**1.8**	*7.0*	*2.6*
Slovenia	36.0	5.5	3.1	1.6	2.5	-6.0	7.5	**4.3**	**2.0**	**1.8**	*4.3*	*2.2*
Slovakia	:	4.6	2.1	1.6	2.8	-4.8	4.0	**5.5**	**1.1**	**2.1**	*5.5*	*1.9*
Finland	3.2	-1.0	1.9	0.5	0.6	-11.0	8.0	**8.9**	**1.2**	**2.0**	*7.9*	*2.8*
Euro area	1.1	1.3	0.6	1.0	4.2	-7.7	5.7	**6.9**	**1.9**	**1.4**	*5.5*	*1.9*
Bulgaria	:	:	4.0	7.3	10.8	-13.7	5.4	**9.3**	**1.8**	**3.2**	*6.0*	*3.6*
Czech Republic	:	2.1	-1.2	-1.0	-3.0	-2.6	1.7	**2.5**	**-0.2**	**0.1**	*0.6*	*1.0*
Denmark	-0.6	0.2	0.8	1.8	6.0	-9.5	1.8	**4.5**	**1.6**	**1.2**	*4.5*	*2.9*
Latvia	:	2.2	8.6	5.7	9.7	-6.7	7.6	**7.8**	**1.4**	**1.8**	*8.0*	*1.5*
Lithuania	:	-1.5	1.6	5.0	9.3	-11.5	10.9	**11.3**	**1.9**	**2.2**	*7.3*	*2.7*
Hungary	:	9.3	0.6	-4.4	1.7	1.1	1.9	**2.5**	**7.5**	**1.8**	*1.4*	*1.5*
Poland	19.3	7.7	3.5	0.8	0.3	8.7	1.8	**3.5**	**3.6**	**2.4**	*3.0*	*1.7*
Romania	123.6	44.9	6.6	-9.2	17.2	2.6	3.4	**6.3**	**3.5**	**2.5**	*5.9*	*3.0*
Sweden	2.8	1.5	1.3	0.2	4.3	-1.1	-0.2	**0.0**	**1.5**	**1.5**	*0.0*	*2.0*
United Kingdom	3.4	-2.7	0.3	0.1	12.8	2.8	5.0	**7.4**	**1.4**	**1.9**	*8.8*	*1.8*
EU	:	6.5	0.7	0.6	5.2	-5.5	5.1	**6.4**	**2.0**	**1.5**	*5.4*	*1.9*
USA	-0.2	-1.7	3.3	3.5	11.6	-12.4	6.8	**8.3**	**1.5**	**2.3**	*9.7*	*1.2*
Japan	-3.2	-0.8	4.2	6.8	7.6	-23.5	5.3	**1.0**	**0.0**	**0.7**	*8.0*	*1.0*

TABLE 20 : Terms of trade of goods (percentage change on preceding year, 1992-2013)

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-0.1	-0.8	-0.2	0.3	-2.9	3.5	-2.1	**-1.5**	**-0.2**	**0.1**	*-1.2*	*-0.1*
Germany	1.6	-0.7	0.1	0.6	-1.8	6.0	-2.5	**-3.0**	**-0.1**	**0.0**	*-2.2*	*0.0*
Estonia	:	1.5	0.2	3.1	-0.6	-2.2	-1.4	**-1.2**	**0.1**	**0.1**	*-0.4*	*-0.2*
Ireland	-2.7	1.8	-0.2	-2.5	-5.5	6.1	-3.4	**-4.9**	**0.8**	**0.0**	*-0.3*	*0.5*
Greece	0.3	-0.1	-0.1	0.3	-0.6	-3.4	1.7	**-1.0**	**-0.9**	**-0.8**	*-3.6*	*-0.9*
Spain	0.6	0.0	0.5	0.1	-2.3	5.0	-1.6	**-3.4**	**-0.8**	**-0.5**	*-3.2*	*-0.8*
France	0.1	-0.2	-0.3	1.6	-0.7	2.2	-2.6	**-2.6**	**-0.4**	**1.1**	*-1.3*	*0.9*
Italy	-0.3	0.2	-1.1	1.2	-3.4	7.2	-4.0	**-2.0**	**1.0**	**1.5**	*-1.9*	*0.5*
Cyprus	:	1.2	-1.3	0.6	-2.5	2.7	-0.7	**-0.7**	**0.0**	**0.1**	*-0.2*	*0.0*
Luxembourg	-0.6	-1.4	0.8	3.3	0.5	0.7	2.3	**-1.9**	**0.5**	**0.0**	*-1.0*	*-0.5*
Malta	:	-0.1	-2.8	-0.3	-9.7	-4.0	2.3	**1.3**	**0.6**	**0.1**	*-0.4*	*0.4*
Netherlands	0.4	0.7	0.4	-0.1	-0.3	-1.0	-0.5	**-0.7**	**0.1**	**-0.4**	*0.0*	*0.2*
Austria	-0.1	-0.2	0.1	-0.5	-2.0	0.7	-2.0	**-2.3**	**-0.1**	**-0.1**	*-1.8*	*-0.5*
Portugal	1.1	0.2	0.0	0.3	-3.1	5.1	0.1	**-1.6**	**0.3**	**0.0**	*-2.6*	*-0.9*
Slovenia	2.9	-0.2	-0.3	0.6	-1.8	4.7	-4.7	**-2.2**	**-0.1**	**0.1**	*-2.2*	*-0.3*
Slovakia	:	0.4	-0.3	-1.1	-1.9	-0.7	-0.8	**-0.4**	**-0.7**	**-0.8**	*-1.8*	*-0.2*
Finland	0.5	-0.6	-2.5	0.0	-2.4	2.8	-3.0	**-1.7**	**0.3**	**0.1**	*-1.8*	*-0.3*
Euro area	0.5	-0.2	-0.3	0.4	-2.0	3.9	-2.3	**-2.4**	**-0.1**	**0.2**	*-1.8*	*0.1*
Bulgaria	:	:	0.8	-1.3	-2.5	0.6	4.7	**1.1**	**0.0**	**0.0**	*-1.5*	*-1.3*
Czech Republic	:	-0.1	-0.5	1.1	-1.9	2.9	-2.7	**-1.0**	**0.0**	**0.2**	*-1.6*	*0.0*
Denmark	0.8	1.0	0.9	0.5	1.0	3.8	2.7	**0.2**	**0.5**	**1.1**	*-0.1*	*0.3*
Latvia	:	-2.3	0.2	7.2	-1.8	-2.9	1.1	**3.2**	**0.0**	**0.2**	*0.6*	*0.0*
Lithuania	:	2.3	1.2	0.6	3.6	-5.9	1.4	**1.6**	**0.1**	**-0.2**	*0.4*	*0.2*
Hungary	:	-0.4	-0.9	-0.1	-1.1	1.1	-0.2	**-0.5**	**0.4**	**0.1**	*-0.4*	*0.0*
Poland	1.5	-1.1	0.3	2.0	-2.1	4.4	-1.4	**-0.5**	**-0.2**	**-1.4**	*-1.5*	*0.4*
Romania	-4.1	4.0	3.0	10.6	3.2	0.1	2.4	**0.7**	**-0.2**	**2.4**	*-1.3*	*0.5*
Sweden	-0.7	-1.5	-1.1	1.7	-1.2	1.8	-0.7	**-0.7**	**-0.5**	**0.0**	*-1.0*	*-1.0*
United Kingdom	-0.3	0.2	0.2	-1.1	-0.6	0.1	0.6	**-0.9**	**-0.6**	**-0.5**	*0.3*	*1.6*
EU	:	0.6	-0.2	0.5	-2.0	3.0	-1.7	**-2.0**	**-0.1**	**0.1**	*-1.6*	*0.2*
USA	-0.1	0.4	-1.0	-0.1	-5.9	6.3	-1.8	**-0.3**	**1.6**	**-0.2**	*-3.5*	*0.4*
Japan	0.6	-1.1	-4.3	-4.3	-11.3	15.8	-6.2	**-1.7**	**-0.7**	**-1.4**	*-9.7*	*-1.7*

TABLE 21 : Total population (percentage change on preceding year, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	0.3	0.2	0.5	0.7	0.8	0.8	0.9	0.8	0.8	0.8	0.7	0.7
Germany	0.5	0.1	0.0	-0.1	-0.2	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Estonia	-2.0	-0.8	-0.3	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Ireland	0.6	1.3	2.0	2.4	1.8	0.6	0.2	0.3	0.5	0.6	0.3	0.2
Greece	0.9	0.4	0.4	0.4	0.4	0.4	0.2	0.2	0.2	0.2	0.2	0.2
Spain	0.2	0.6	1.6	1.8	1.6	0.7	0.3	0.4	-0.1	-0.1	0.3	0.3
France	0.4	0.5	0.7	0.6	0.6	0.6	0.5	0.6	0.5	0.6	0.5	0.5
Italy	0.0	0.0	0.7	0.7	0.8	0.6	0.5	0.4	0.3	0.3	0.4	0.3
Cyprus	2.1	1.2	1.9	1.5	1.2	0.9	0.5	0.7	0.6	0.7	0.7	0.7
Luxembourg	1.3	1.3	1.4	1.6	1.7	1.9	1.8	1.6	1.5	1.4	1.4	1.3
Malta	0.9	0.7	0.7	0.7	0.8	0.4	0.5	0.5	0.5	0.5	0.4	0.4
Netherlands	0.6	0.7	0.4	0.2	0.4	0.5	0.5	0.1	0.2	0.3	0.3	0.3
Austria	0.5	0.2	0.6	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.4
Portugal	0.2	0.5	0.6	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Slovenia	-0.1	0.0	0.2	0.5	0.2	1.0	0.4	0.2	0.2	0.3	0.2	0.2
Slovakia	0.3	0.0	0.0	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Finland	0.4	0.2	0.3	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Euro area	0.3	0.3	0.6	0.6	0.5	0.4	0.3	0.3	0.2	0.2	0.3	0.2
Bulgaria	-0.6	-1.1	-0.5	-0.5	-0.5	-0.5	-0.7	-0.7	-0.7	-0.7	-0.5	-0.5
Czech Republic	0.0	-0.2	0.1	0.5	1.0	0.6	0.2	0.2	0.3	0.3	0.0	-0.1
Denmark	0.4	0.4	0.3	0.4	0.6	0.5	0.4	0.3	0.3	0.3	0.3	0.3
Latvia	-1.5	-0.8	-0.6	-0.5	-0.4	-0.5	-0.7	-0.7	-0.7	-0.6	-0.7	-0.7
Lithuania	-0.6	-0.7	-0.5	-0.5	-0.5	-0.6	-1.6	-2.0	-0.8	-0.5	-1.2	-0.8
Hungary	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3	-0.2	-0.3
Poland	0.2	0.0	-0.1	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.1	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	0.7	0.8	0.9	0.8	0.8	0.7	0.7	0.3	0.3
United Kingdom	0.3	0.3	0.5	0.7	0.7	0.6	0.3	0.6	0.7	0.7	0.7	0.7
EU	0.2	0.2	0.4	0.5	0.5	0.3	0.2	0.3	0.2	0.2	0.2	0.2
USA	1.2	1.1	0.9	1.0	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.8
Japan	0.3	0.2	0.1	0.0	-0.1	-0.1	0.4	-0.1	-0.1	-0.1	-0.1	-0.1

TABLE 22 : Total employment (percentage change on preceding year, 1992-2013)

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	0.1	1.4	0.7	1.6	1.8	-0.2	0.8	1.2	0.4	0.5	0.8	0.7
Germany	-0.5	0.9	-0.1	1.7	1.2	0.0	0.5	1.3	0.4	0.2	0.9	0.5
Estonia	-5.2	-1.4	2.0	0.8	0.2	-10.0	-4.8	5.9	1.2	1.2	4.2	1.3
Ireland	2.5	5.6	3.2	3.6	-1.1	-8.1	-4.2	-1.9	-0.6	0.6	-1.5	0.4
Greece	0.9	0.7	1.7	1.6	0.8	-0.2	-1.9	-5.7	-2.8	0.4	-2.6	0.1
Spain	-0.3	4.2	2.9	3.0	-0.2	-6.5	-2.6	-1.0	-0.4	0.5	-0.6	0.9
France	-0.4	1.7	0.6	1.4	0.7	-1.4	0.1	0.6	0.4	0.4	0.8	0.9
Italy	-0.9	1.1	0.8	1.0	-0.4	-2.9	-0.7	0.3	-0.2	0.3	0.4	0.9
Cyprus	:	1.6	3.0	3.2	2.8	-0.7	-0.3	-1.0	-0.2	0.4	0.2	0.8
Luxembourg	2.5	4.7	2.7	4.5	4.7	1.0	1.8	2.9	1.7	2.2	2.1	2.3
Malta	1.5	0.8	0.7	3.2	2.6	-0.3	2.3	1.0	0.8	1.4	1.3	1.4
Netherlands	1.0	2.4	-0.2	2.2	1.5	-1.1	-0.5	-0.3	-0.1	0.0	0.5	0.7
Austria	-0.7	0.6	0.5	1.7	1.8	-1.3	0.6	1.4	0.2	0.8	0.8	0.7
Portugal	-0.8	2.1	0.0	0.0	0.5	-2.6	-1.5	-1.1	-1.4	0.2	-1.5	-0.9
Slovenia	:	0.3	0.5	3.3	2.6	-1.8	-2.5	-0.7	-0.1	0.2	-1.3	0.3
Slovakia	:	-1.1	0.9	2.1	2.9	-2.5	-1.4	1.6	0.1	1.1	0.6	0.9
Finland	-2.3	2.2	0.9	2.2	2.6	-3.5	-1.4	1.0	0.3	0.2	0.9	0.7
Euro area	-0.4	1.6	0.7	1.7	0.7	-2.1	-0.5	0.3	0.0	0.3	0.4	0.7
Bulgaria	:	-2.3	2.4	3.2	2.6	-2.6	-5.9	-3.1	0.1	0.9	0.5	1.0
Czech Republic	:	-1.2	0.6	2.1	2.3	-1.2	-1.7	0.8	-0.1	0.3	0.0	0.0
Denmark	0.1	1.0	0.3	2.8	1.9	-3.1	-2.1	-0.3	0.3	0.3	0.2	0.4
Latvia	-7.4	0.0	2.5	3.6	0.9	-13.2	-4.8	2.2	0.7	1.3	1.5	1.7
Lithuania	-2.7	-2.1	2.0	2.8	-0.7	-6.8	-5.1	3.5	2.0	1.9	2.1	2.8
Hungary	:	1.0	-0.2	-0.3	-1.3	-2.8	0.2	0.5	1.1	0.0	0.4	3.0
Poland	:	-1.1	0.4	4.5	3.9	0.4	0.5	1.0	0.2	0.4	1.1	1.0
Romania	-2.8	-2.5	-2.6	0.4	0.0	-1.8	-1.8	0.1	0.6	0.6	0.1	0.6
Sweden	-1.9	1.4	0.1	2.3	0.9	-2.0	1.1	2.2	0.2	0.4	1.9	1.1
United Kingdom	0.0	1.2	0.9	0.7	0.7	-1.6	0.2	0.9	0.5	0.5	0.4	0.5
EU	:	0.9	0.6	1.7	0.9	-1.9	-0.6	0.4	0.1	0.4	0.4	0.7
USA	1.8	1.7	0.7	0.9	-0.7	-5.0	-0.6	0.4	0.4	0.7	0.8	1.3
Japan	0.4	-0.6	-0.2	0.4	-0.3	-1.5	-0.4	-0.2	0.1	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, 1992-2013) [1] 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	8.9	8.1	8.2	7.5	7.0	7.9	8.3	**7.6**	**7.7**	**7.9**	*7.9*	*7.8*
Germany	7.8	8.4	9.8	8.7	7.5	7.8	7.1	**6.1**	**5.9**	**5.8**	*6.4*	*6.0*
Estonia	:	11.3	8.8	4.7	5.5	13.8	16.9	**12.5**	**11.2**	**10.1**	*13.0*	*11.5*
Ireland	13.9	6.2	4.5	4.6	6.3	11.9	13.7	**14.4**	**14.3**	**13.6**	*14.6*	*14.0*
Greece	8.8	10.9	9.9	8.3	7.7	9.5	12.6	**16.6**	**18.4**	**18.4**	*15.2*	*15.3*
Spain	17.8	13.1	10.1	8.3	11.3	18.0	20.1	**20.9**	**20.9**	**20.3**	*20.6*	*20.2*
France	11.0	10.0	9.1	8.4	7.8	9.5	9.8	**9.8**	**10.0**	**10.1**	*9.5*	*9.2*
Italy	10.3	10.5	7.9	6.1	6.7	7.8	8.4	**8.1**	**8.2**	**8.2**	*8.4*	*8.2*
Cyprus	:	3.8	4.4	3.9	3.7	5.3	6.2	**7.2**	**7.5**	**7.1**	*6.3*	*5.6*
Luxembourg	2.7	2.4	4.1	4.2	4.9	5.1	4.6	**4.5**	**4.8**	**4.7**	*4.4*	*4.2*
Malta	5.2	6.8	7.3	6.5	6.0	6.9	6.9	**6.7**	**6.8**	**6.6**	*6.8*	*6.7*
Netherlands	6.0	3.8	4.4	3.6	3.1	3.7	4.5	**4.5**	**4.7**	**4.8**	*4.2*	*4.0*
Austria	3.9	4.0	4.7	4.4	3.8	4.8	4.4	**4.2**	**4.5**	**4.2**	*4.3*	*4.2*
Portugal	6.2	5.3	7.5	8.9	8.5	10.6	12.0	**12.6**	**13.6**	**13.7**	*12.3*	*13.0*
Slovenia	:	6.9	6.4	4.9	4.4	5.9	7.3	**8.2**	**8.4**	**8.2**	*8.2*	*8.0*
Slovakia	:	15.8	16.8	11.1	9.5	12.0	14.4	**13.2**	**13.2**	**12.3**	*14.0*	*13.3*
Finland	14.9	10.6	8.6	6.9	6.4	8.2	8.4	**7.8**	**7.7**	**7.4**	*7.9*	*7.4*
Euro area	10.1	9.3	8.8	7.6	7.6	9.6	10.1	**10.0**	**10.1**	**10.0**	*10.0*	*9.7*
Bulgaria	:	15.7	12.6	6.9	5.6	6.8	10.2	**12.2**	**12.1**	**11.3**	*9.4*	*8.5*
Czech Republic	:	7.3	7.7	5.3	4.4	6.7	7.3	**6.8**	**7.0**	**6.7**	*6.8*	*6.4*
Denmark	7.8	4.8	4.8	3.8	3.3	6.0	7.4	**7.4**	**7.3**	**7.1**	*7.1*	*6.7*
Latvia	13.8	14.0	9.8	6.0	7.5	17.1	18.7	**16.1**	**15.0**	**13.5**	*17.2*	*15.8*
Lithuania	5.0	13.3	10.3	4.3	5.8	13.7	17.8	**15.1**	**13.3**	**11.6**	*15.5*	*12.7*
Hungary	:	7.3	6.5	7.4	7.8	10.0	11.2	**11.2**	**11.0**	**11.3**	*11.0*	*9.3*
Poland	13.4	13.8	18.1	9.6	7.1	8.2	9.6	**9.3**	**9.2**	**8.6**	*9.3*	*8.8*
Romania	5.8	6.1	7.4	6.4	5.8	6.9	7.3	**8.2**	**7.8**	**7.4**	*7.2*	*6.8*
Sweden	8.5	7.2	7.0	6.1	6.2	8.3	8.4	**7.4**	**7.4**	**7.3**	*7.6*	*7.2*
United Kingdom	9.1	5.8	5.0	5.3	5.6	7.6	7.8	**7.9**	**8.6**	**8.5**	*8.0*	*7.8*
EU	:	8.8	8.9	7.2	7.1	9.0	9.7	**9.7**	**9.8**	**9.6**	*9.5*	*9.1*
USA	6.3	4.5	5.4	4.6	5.8	9.3	9.6	**9.0**	**9.0**	**8.8**	*8.7*	*8.1*
Japan	2.8	4.4	4.8	3.9	4.0	5.1	5.1	**4.9**	**4.8**	**4.7**	*4.9*	*4.8*

[1] Series following Eurostat definition, based on the labour force survey.

TABLE 24 : Compensation of employees per head (percentage change on preceding year, 1992-2013)

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	3.4	2.8	2.5	3.4	3.6	1.1	1.4	**3.0**	**2.9**	**2.4**	*3.1*	*3.6*
Germany	4.3	1.2	0.8	0.8	2.1	0.0	2.0	**3.4**	**2.5**	**2.6**	*2.7*	*2.9*
Estonia	:	13.2	11.6	25.0	9.7	-3.4	1.4	**3.7**	**4.3**	**4.8**	*4.4*	*4.0*
Ireland	4.5	5.9	5.4	5.8	5.4	-1.2	-3.2	**-0.1**	**0.4**	**0.9**	*-0.3*	*0.7*
Greece	10.8	7.0	5.7	5.0	6.1	4.0	-3.3	**-2.7**	**-2.8**	**-1.2**	*-1.0*	*0.1*
Spain	6.0	2.5	3.4	4.7	6.1	4.3	0.0	**0.9**	**1.1**	**1.0**	*0.9*	*1.2*
France	2.6	2.1	3.1	2.5	2.4	1.8	2.1	**2.3**	**2.1**	**2.1**	*2.0*	*2.3*
Italy	4.8	2.2	3.1	2.3	3.8	1.8	2.0	**1.8**	**1.5**	**1.4**	*1.5*	*1.8*
Cyprus	:	4.6	3.8	3.0	2.3	3.2	2.8	**2.6**	**1.9**	**1.8**	*3.8*	*3.2*
Luxembourg	3.9	3.2	2.9	3.7	2.2	1.8	2.6	**2.6**	**4.5**	**3.4**	*2.0*	*4.6*
Malta	7.8	4.9	3.2	1.5	4.5	2.7	-0.4	**2.0**	**2.4**	**2.3**	*2.0*	*3.0*
Netherlands	2.9	4.1	3.4	3.4	3.3	2.5	1.4	**2.6**	**2.3**	**2.1**	*2.9*	*2.5*
Austria	4.8	2.2	2.3	2.6	3.1	2.2	1.4	**2.8**	**1.9**	**1.8**	*2.5*	*2.7*
Portugal	9.4	5.4	3.2	3.6	3.0	3.3	1.7	**0.0**	**-2.3**	**0.8**	*-0.3*	*0.1*
Slovenia	:	10.2	7.0	6.2	7.2	1.8	4.3	**2.5**	**2.1**	**2.8**	*2.4*	*3.6*
Slovakia	:	10.3	8.4	8.4	6.8	4.8	4.3	**2.1**	**2.8**	**2.9**	*3.9*	*5.1*
Finland	2.5	3.3	2.9	3.7	4.4	2.3	3.5	**3.2**	**3.2**	**3.2**	*2.8*	*3.4*
Euro area	4.3	2.2	2.4	2.5	3.3	1.8	1.6	**2.3**	**2.0**	**2.0**	*2.1*	*2.3*
Bulgaria	:	83.1	6.4	12.7	16.3	9.4	7.2	**9.0**	**7.2**	**7.1**	*7.1*	*6.8*
Czech Republic	:	8.3	6.7	6.3	4.2	-1.2	3.7	**2.2**	**2.3**	**1.9**	*2.5*	*4.1*
Denmark	3.2	3.8	3.6	3.6	3.6	2.4	2.7	**1.7**	**2.1**	**2.0**	*1.7*	*2.4*
Latvia	:	7.7	15.0	35.1	15.7	-12.7	-6.0	**4.4**	**2.8**	**3.2**	*1.5*	*1.5*
Lithuania	:	9.1	10.5	13.9	14.3	-9.9	-0.9	**3.0**	**3.0**	**4.5**	*3.4*	*5.8*
Hungary	:	14.7	9.3	6.8	6.6	-1.3	-2.2	**3.6**	**3.2**	**3.8**	*2.6*	*2.0*
Poland	37.8	13.8	1.9	4.9	8.9	3.5	5.7	**5.5**	**4.8**	**6.6**	*5.9*	*6.3*
Romania	118.0	71.2	19.7	22.0	31.9	-6.8	1.6	**4.7**	**6.4**	**8.5**	*2.2*	*6.0*
Sweden	4.8	4.0	3.0	5.2	1.5	1.2	2.7	**2.9**	**2.7**	**2.7**	*2.8*	*3.3*
United Kingdom	3.6	5.1	4.0	4.9	1.7	2.7	3.3	**2.0**	**2.5**	**3.0**	*2.8*	*4.0*
EU	:	3.9	2.8	3.2	3.2	1.7	2.0	**2.4**	**2.2**	**2.3**	*2.3*	*2.7*
USA	3.0	4.4	3.9	3.9	3.3	2.1	2.7	**3.0**	**2.5**	**2.5**	*2.4*	*1.4*
Japan	1.2	0.0	-0.8	-1.3	0.0	-3.1	1.0	**1.1**	**1.2**	**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 [1] (percentage change on preceding year, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	1.6	1.1	0.4	0.5	0.3	2.0	-0.4	**-0.4**	**0.9**	**0.5**	*-0.2*	*1.5*
Germany	1.7	0.2	-0.5	-0.7	0.4	0.0	0.1	**1.2**	**0.9**	**0.9**	*0.5*	*1.2*
Estonia	:	6.6	8.2	15.8	1.1	-2.5	-0.8	**-1.1**	**1.5**	**2.1**	*0.8*	*1.5*
Ireland	2.0	1.8	2.2	2.5	2.2	3.3	-1.1	**-1.4**	**-0.3**	**-0.5**	*-1.3*	*0.0*
Greece	-0.7	2.4	2.4	1.6	1.7	3.2	-7.4	**-5.5**	**-3.6**	**-1.8**	*-3.5*	*-0.5*
Spain	1.0	-0.3	0.1	1.5	2.4	5.6	-2.3	**-2.5**	**0.2**	**-0.5**	*-1.7*	*-0.3*
France	1.0	1.0	1.3	0.5	-0.5	2.4	0.8	**0.4**	**0.7**	**0.9**	*-0.1*	*0.6*
Italy	-0.3	-0.2	0.5	0.0	0.7	1.8	0.5	**-0.9**	**-0.5**	**-0.5**	*-1.0*	*-0.1*
Cyprus	:	2.1	1.3	-0.7	-2.6	3.1	0.3	**-0.8**	**-0.9**	**-0.4**	*0.5*	*1.0*
Luxembourg	1.0	0.9	0.8	1.5	-0.7	0.8	1.2	**-0.7**	**2.3**	**1.5**	*-1.0*	*2.5*
Malta	:	3.1	1.1	-0.2	0.9	0.9	-3.3	**-0.6**	**0.2**	**0.0**	*-0.6*	*0.8*
Netherlands	0.5	1.2	1.3	1.6	2.1	3.1	-0.1	**0.3**	**0.4**	**0.6**	*0.9*	*0.5*
Austria	2.2	0.9	0.5	0.2	1.0	1.6	-0.6	**-0.6**	**-0.3**	**-0.1**	*-0.3*	*0.7*
Portugal	3.6	2.4	0.4	0.6	0.5	5.9	0.0	**-3.3**	**-5.0**	**-1.1**	*-3.6*	*-1.9*
Slovenia	:	2.8	2.9	2.0	1.7	2.3	2.9	**0.6**	**0.8**	**1.6**	*-0.2*	*1.5*
Slovakia	:	2.7	3.5	5.6	2.2	4.8	3.2	**-1.8**	**0.6**	**0.0**	*0.3*	*2.4*
Finland	0.7	0.9	2.1	1.4	0.9	0.7	1.6	**0.4**	**0.3**	**1.3**	*-0.5*	*0.9*
Euro area	1.0	0.4	0.3	0.3	0.6	2.1	-0.1	**-0.2**	**0.4**	**0.4**	*-0.3*	*0.6*
Bulgaria	:	7.7	2.8	3.4	8.6	7.8	6.1	**2.8**	**4.1**	**4.0**	*3.2*	*3.7*
Czech Republic	:	2.9	5.3	3.2	-0.6	-1.4	3.3	**0.7**	**-0.1**	**0.9**	*0.3*	*1.8*
Denmark	1.5	1.7	2.0	2.3	0.6	1.0	0.2	**-0.9**	**0.3**	**0.2**	*-0.8*	*0.4*
Latvia	:	3.5	8.9	22.9	-0.4	-15.5	-5.6	**0.1**	**0.4**	**1.4**	*-1.7*	*-0.3*
Lithuania	:	6.2	9.5	7.5	3.1	-13.8	-2.2	**-1.1**	**-0.5**	**1.8**	*0.2*	*3.3*
Hungary	:	2.2	4.6	-0.1	1.2	-4.8	-6.1	**-0.4**	**-1.3**	**-0.2**	*-1.3*	*-1.4*
Poland	4.7	4.4	-0.1	2.4	4.4	0.9	3.1	**1.8**	**2.0**	**3.5**	*2.0*	*3.0*
Romania	0.0	10.0	6.9	16.5	19.9	-10.2	-3.2	**-1.3**	**2.7**	**4.5**	*-4.2*	*1.7*
Sweden	1.7	2.7	1.8	3.8	-1.5	-0.6	1.4	**1.7**	**1.6**	**1.4**	*1.6*	*2.0*
United Kingdom	0.2	3.7	2.1	2.3	-1.6	1.2	-0.4	**-2.3**	**-0.3**	**1.1**	*-0.1*	*2.4*
EU	:	1.5	0.7	0.8	0.2	1.4	0.0	**-0.5**	**0.3**	**0.6**	*-0.3*	*0.9*
USA	0.7	2.6	1.5	1.2	0.0	1.8	0.9	**0.6**	**0.8**	**0.9**	*0.2*	*-0.1*
Japan	0.6	0.3	0.0	-0.7	-0.4	-1.1	2.6	**1.7**	**0.7**	**1.2**	*1.6*	*0.7*

[1] 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, 1992-2013)

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	1.4	1.3	1.3	1.2	-0.8	-2.7	1.4	**1.0**	**0.5**	**1.0**	*1.6*	*1.5*
Germany	1.7	1.1	1.2	1.5	-0.1	-5.2	3.2	**1.6**	**0.3**	**1.3**	*1.6*	*1.4*
Estonia	:	8.6	6.3	6.6	-3.8	-4.7	7.4	**2.0**	**1.9**	**2.8**	*0.6*	*2.7*
Ireland	3.9	2.8	1.8	1.5	-1.9	1.2	4.0	**3.1**	**1.7**	**1.7**	*2.2*	*1.5*
Greece	0.2	3.1	2.6	1.4	-0.9	-3.0	-1.7	**0.2**	**0.0**	**0.3**	*-0.9*	*1.0*
Spain	1.8	0.2	0.4	0.5	1.1	2.9	2.6	**1.7**	**1.1**	**0.9**	*1.4*	*0.6*
France	1.6	1.2	1.1	0.9	-0.8	-1.3	1.4	**1.0**	**0.2**	**1.0**	*0.9*	*1.2*
Italy	2.2	0.9	0.3	0.7	-0.8	-2.2	2.3	**0.3**	**0.3**	**0.4**	*0.6*	*0.5*
Cyprus	:	2.6	0.2	1.8	0.8	-1.2	1.4	**1.3**	**0.2**	**1.4**	*1.3*	*1.5*
Luxembourg	0.1	1.5	1.3	2.1	-3.8	-6.2	0.8	**-1.2**	**-0.8**	**0.1**	*1.3*	*1.5*
Malta	3.5	2.6	0.9	1.1	1.7	-2.4	0.4	**1.1**	**0.5**	**0.6**	*0.7*	*0.7*
Netherlands	1.4	1.4	1.8	1.7	0.3	-2.5	2.2	**2.1**	**0.6**	**1.3**	*1.4*	*1.0*
Austria	2.7	2.2	1.7	1.9	-0.4	-2.5	1.7	**1.5**	**0.7**	**1.1**	*1.6*	*1.3*
Portugal	2.8	1.7	0.7	2.4	-0.5	0.1	3.0	**-0.8**	**-1.6**	**1.0**	*-0.8*	*-0.8*
Slovenia	:	3.9	3.6	3.4	1.0	-6.3	4.0	**1.7**	**1.1**	**1.3**	*3.3*	*2.1*
Slovakia	:	3.9	4.9	8.2	2.9	-2.4	5.7	**1.2**	**1.0**	**1.7**	*2.9*	*3.5*
Finland	3.7	2.3	2.1	3.1	-1.6	-4.9	5.1	**2.0**	**1.1**	**1.5**	*2.7*	*1.9*
Euro area	1.8	1.3	1.1	1.3	-0.3	-2.2	2.4	**1.2**	**0.4**	**1.0**	*1.2*	*1.0*
Bulgaria	:	4.9	3.5	3.2	3.5	-2.9	6.4	**5.5**	**2.2**	**2.1**	*2.3*	*2.7*
Czech Republic	:	2.7	4.3	3.5	0.8	-3.5	4.5	**1.0**	**0.8**	**1.4**	*2.0*	*2.9*
Denmark	2.5	1.4	1.5	-1.1	-2.9	-2.2	3.9	**1.5**	**1.0**	**1.3**	*1.6*	*1.0*
Latvia	-1.5	5.9	6.3	5.8	-4.2	-5.3	4.7	**2.2**	**1.7**	**2.8**	*1.8*	*2.3*
Lithuania	-5.8	6.9	5.9	6.8	3.6	-8.6	6.9	**2.5**	**1.3**	**1.9**	*2.8*	*1.9*
Hungary	:	2.7	4.5	0.4	2.2	-4.1	1.1	**0.9**	**-0.6**	**1.4**	*2.3*	*-0.3*
Poland	:	5.5	3.6	2.2	1.2	1.2	3.5	**3.0**	**2.3**	**2.4**	*2.9*	*2.7*
Romania	4.1	2.6	9.0	5.9	7.3	-4.9	-0.1	**1.5**	**1.5**	**2.7**	*1.3*	*3.0*
Sweden	3.2	2.0	3.2	1.0	-1.5	-3.2	4.4	**1.7**	**1.2**	**1.7**	*2.2*	*1.4*
United Kingdom	2.5	2.4	1.8	2.8	-1.8	-2.8	1.5	**-0.2**	**0.1**	**1.1**	*1.3*	*1.6*
EU	:	2.0	2.0	1.9	0.0	-2.3	2.5	**1.2**	**0.6**	**1.2**	*1.4*	*1.4*
USA	1.5	2.1	2.0	1.0	0.4	1.6	3.6	**1.2**	**1.1**	**0.7**	*1.7*	*1.3*
Japan	0.9	1.1	1.9	2.0	-0.8	-4.9	4.4	**-0.2**	**1.7**	**0.9**	*0.7*	*1.5*

Note : See note 6 on concepts and sources where countries using full time equivalents are listed.

TABLE 27 : Unit labour costs, whole economy [1] (percentage change on preceding year, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	2.0	1.5	1.2	2.1	4.5	3.9	0.0	**2.0**	**2.4**	**1.4**	*1.5*	*2.0*
Germany	2.6	0.1	-0.4	-0.8	2.3	5.5	-1.1	**1.8**	**2.1**	**1.3**	*1.0*	*1.4*
Estonia	:	4.2	4.9	17.2	14.1	1.4	-5.6	**1.7**	**2.3**	**1.9**	*3.8*	*1.3*
Ireland	0.6	3.1	3.6	4.3	7.5	-2.4	-6.9	**-3.1**	**-1.2**	**-0.8**	*-2.5*	*-0.9*
Greece	10.6	3.7	3.0	3.6	7.1	7.2	-1.6	**-2.9**	**-2.8**	**-1.5**	*-0.1*	*-0.9*
Spain	4.1	2.3	3.0	4.2	4.9	1.4	-2.6	**-0.8**	**0.1**	**0.1**	*-0.4*	*0.6*
France	1.0	0.9	1.9	1.6	3.2	3.2	0.7	**1.3**	**1.9**	**1.1**	*1.1*	*1.1*
Italy	2.6	1.2	2.8	1.5	4.7	4.1	-0.3	**1.5**	**1.2**	**1.0**	*0.9*	*1.3*
Cyprus	:	1.9	3.6	1.1	1.6	4.5	1.4	**1.3**	**1.7**	**0.4**	*2.5*	*1.7*
Luxembourg	3.8	1.7	1.6	1.6	6.2	8.6	1.7	**3.9**	**5.3**	**3.3**	*0.7*	*3.0*
Malta	4.2	2.3	2.2	0.4	2.7	5.2	-0.8	**0.9**	**1.8**	**1.7**	*1.3*	*2.3*
Netherlands	1.5	2.7	1.6	1.7	3.0	5.2	-0.8	**0.4**	**1.7**	**0.8**	*1.4*	*1.6*
Austria	2.0	0.1	0.5	0.7	3.6	4.9	-0.3	**1.2**	**1.2**	**0.7**	*1.0*	*1.4*
Portugal	6.5	3.6	2.5	1.2	3.5	3.3	-1.2	**0.9**	**-0.6**	**-0.2**	*0.5*	*0.9*
Slovenia	:	6.1	3.3	2.6	6.2	8.7	0.3	**0.7**	**1.0**	**1.5**	*-0.8*	*1.4*
Slovakia	:	6.2	3.4	0.1	3.8	7.5	-1.3	**0.8**	**1.7**	**1.2**	*0.9*	*1.6*
Finland	-1.2	1.0	0.8	0.5	6.0	7.6	-1.5	**1.2**	**2.1**	**1.7**	*0.1*	*1.5*
Euro area	2.5	1.1	1.5	1.4	3.7	4.1	-0.8	**1.0**	**1.4**	**0.9**	*0.8*	*1.2*
Bulgaria	:	74.5	2.8	9.3	12.5	12.7	0.8	**3.3**	**4.9**	**4.9**	*4.6*	*4.0*
Czech Republic	:	5.4	2.4	2.6	3.4	2.4	-0.7	**1.2**	**1.5**	**0.5**	*0.5*	*1.2*
Denmark	0.6	2.3	2.1	4.8	6.8	4.7	-1.1	**0.2**	**1.1**	**0.6**	*0.1*	*1.3*
Latvia	:	1.6	8.2	27.7	20.7	-7.9	-10.2	**2.1**	**1.1**	**0.5**	*-0.3*	*-0.8*
Lithuania	:	2.1	4.4	6.6	10.4	-1.4	-7.3	**0.5**	**1.7**	**2.6**	*0.5*	*3.9*
Hungary	:	11.7	4.7	6.3	4.3	2.9	-3.2	**2.7**	**3.9**	**2.4**	*0.3*	*2.3*
Poland	:	7.9	-1.7	2.6	7.5	2.2	2.2	**2.4**	**2.4**	**4.1**	*2.9*	*3.6*
Romania	109.4	66.8	9.8	15.2	22.9	-2.0	1.7	**3.1**	**4.9**	**5.6**	*0.8*	*2.9*
Sweden	1.6	2.0	-0.1	4.2	3.1	4.6	-1.7	**1.1**	**1.5**	**1.0**	*0.6*	*1.8*
United Kingdom	1.1	2.6	2.2	2.1	3.6	5.7	1.7	**2.2**	**2.5**	**2.0**	*1.5*	*2.4*
EU	:	2.1	1.6	1.9	4.1	4.2	-0.4	**1.3**	**1.7**	**1.2**	*0.9*	*1.5*
USA	1.5	2.3	1.8	2.9	2.9	0.5	-0.9	**1.8**	**1.4**	**1.8**	*0.6*	*0.1*
Japan	0.3	-1.1	-2.6	-3.2	0.9	1.8	-3.2	**1.3**	**-0.5**	**0.2**	*0.3*	*-0.4*

[1] 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 [1] (percentage change on preceding year, 1992-2013)

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-0.2	0.1	-0.9	-0.2	2.3	2.6	-1.8	**-0.3**	**0.3**	**-0.8**	*-0.4*	*0.0*
Germany	-0.3	-0.2	-1.3	-2.3	1.5	4.2	-1.7	**1.1**	**0.7**	**-0.2**	*0.0*	*-0.1*
Estonia	:	-2.0	-0.1	5.0	8.3	2.4	-6.6	**-1.9**	**-0.6**	**-0.7**	*1.4*	*-0.9*
Ireland	-1.7	-2.7	0.2	2.9	10.1	1.7	-4.6	**-2.1**	**-1.9**	**-2.0**	*-3.1*	*-1.8*
Greece	-0.8	-0.5	-0.1	0.0	2.2	4.3	-3.3	**-4.2**	**-3.0**	**-1.8**	*-0.4*	*-1.3*
Spain	-0.6	-0.7	-1.1	0.9	2.5	1.3	-3.0	**-2.3**	**-1.0**	**-1.2**	*-1.5*	*-0.5*
France	-0.5	-0.2	-0.1	-0.9	0.6	2.7	-0.1	**0.1**	**0.4**	**-0.6**	*-0.7*	*-0.8*
Italy	-1.6	-1.2	0.4	-0.8	2.1	2.0	-0.7	**0.1**	**-0.7**	**-0.9**	*-0.7*	*-0.5*
Cyprus	:	-1.1	0.4	-3.1	-2.9	4.4	-0.3	**-1.8**	**-0.9**	**-1.8**	*-0.6*	*-0.4*
Luxembourg	0.1	0.7	-2.5	-2.0	1.7	8.4	-3.0	**1.7**	**3.5**	**0.6**	*-2.5*	*0.3*
Malta	1.2	-0.1	-0.4	-2.6	0.2	2.5	-3.6	**-1.5**	**-0.7**	**-1.0**	*-1.3*	*0.0*
Netherlands	-0.4	-0.4	-0.6	-0.1	0.8	5.6	-2.1	**-0.9**	**-0.3**	**-0.6**	*-0.4*	*-0.6*
Austria	-0.3	-0.6	-1.0	-1.3	1.8	3.8	-2.0	**-0.9**	**-0.9**	**-1.2**	*-0.8*	*-0.3*
Portugal	0.6	0.0	-0.4	-2.0	1.9	2.7	-2.3	**-0.5**	**-1.7**	**-1.6**	*-0.6*	*-0.3*
Slovenia	:	-1.0	-0.7	-1.5	2.0	5.6	1.4	**0.7**	**-0.1**	**-0.1**	*-1.8*	*-0.4*
Slovakia	:	-0.3	-0.7	-1.0	0.9	8.8	-1.8	**-2.3**	**0.5**	**-0.8**	*-0.6*	*-0.8*
Finland	-2.8	-1.3	0.3	-2.4	3.7	5.8	-1.9	**-1.2**	**-0.7**	**-0.5**	*-2.4*	*-1.0*
Euro area	-0.7	-0.6	-0.7	-1.0	1.7	3.2	-1.5	**-0.2**	**0.0**	**-0.7**	*-0.6*	*-0.4*
Bulgaria	:	1.2	-2.2	0.1	3.7	8.1	-2.1	**-2.4**	**1.5**	**1.7**	*1.5*	*1.5*
Czech Republic	:	0.2	0.8	-0.7	1.5	0.5	1.0	**0.4**	**-0.3**	**-0.6**	*0.3*	*-0.7*
Denmark	-0.8	0.3	-0.2	2.4	2.8	4.3	-4.4	**-1.0**	**-0.6**	**-1.3**	*-1.6*	*-0.7*
Latvia	:	-2.6	1.1	5.8	6.9	-6.7	-8.2	**-1.8**	**-0.6**	**-1.1**	*-2.4*	*-2.3*
Lithuania	:	-0.6	1.4	-1.9	0.6	2.4	-9.1	**-3.3**	**-1.3**	**-0.3**	*-2.7*	*1.0*
Hungary	:	-0.7	-0.3	0.8	-0.9	-0.6	-6.1	**0.4**	**-0.2**	**-1.0**	*-2.2*	*-0.2*
Poland	:	-0.4	-3.8	-1.3	4.3	-1.4	0.8	**-0.9**	**0.4**	**2.1**	*-0.3*	*0.3*
Romania	-2.5	4.6	-6.0	1.5	6.6	-6.0	-2.7	**-1.8**	**1.2**	**0.7**	*-3.5*	*-1.2*
Sweden	-0.6	0.6	-1.4	1.4	-0.1	2.8	-2.9	**-0.3**	**0.5**	**-0.3**	*-0.3*	*0.8*
United Kingdom	-1.7	0.9	-0.4	-0.2	0.5	4.0	-1.1	**-0.7**	**-0.6**	**-0.2**	*-0.5*	*0.3*
EU	:	-0.4	-1.0	-0.8	1.4	2.9	-1.6	**-0.3**	**-0.1**	**-0.5**	*-0.6*	*-0.3*
USA	-0.6	0.5	-0.8	0.0	0.7	-0.6	-2.1	**-0.3**	**-0.4**	**0.4**	*-0.7*	*-1.3*
Japan	0.1	-0.3	-1.4	-2.5	1.9	2.2	-1.1	**1.7**	**-0.8**	**0.2**	*2.3*	*-0.6*

[1] 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 (1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*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	:	:	:	:	:
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	:	:	:	:	:	:	:	:
Luxembourg	39.91	40.43	:	:	:	:	:	:	:	:	:	:
Malta	0.45	0.42	0.42	0.43	:	:	:	:	:	:	:	:
Netherlands	2.17	2.21	:	:	:	:	:	:	:	:	:	:
Austria	13.60	13.79	:	:	:	:	:	:	:	:	:	:
Portugal	190.37	200.35	:	:	:	:	:	:	:	:	:	:
Slovenia	143.42	197.20	235.62	:	:	:	:	:	:	:	:	:
Slovakia	:	41.54	40.01	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	27.77	24.95	26.43	25.28	**24.48**	**24.83**	**24.83**	*24.24*	*24.19*
Denmark	7.53	7.46	7.44	7.45	7.46	7.45	7.45	**7.45**	**7.44**	**7.44**	*7.46*	*7.46*
Latvia	0.75	0.61	0.66	0.70	0.70	0.71	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	251.35	251.51	280.33	275.48	**277.03**	**294.80**	**294.80**	*267.32*	*265.67*
Poland	2.88	3.91	4.14	3.78	3.51	4.33	3.99	**4.10**	**4.33**	**4.33**	*3.95*	*3.95*
Romania	0.20	1.61	3.62	3.34	3.68	4.24	4.21	**4.24**	**4.33**	**4.33**	*4.12*	*4.09*
Sweden	8.73	8.81	9.19	9.25	9.62	10.62	9.54	**9.04**	**9.13**	**9.13**	*8.93*	*8.95*
United Kingdom	0.79	0.65	0.67	0.68	0.80	0.89	0.86	**0.87**	**0.87**	**0.87**	*0.88*	*0.88*
EU	:	:	:	:	:	:	:	:	:	:	:	:
USA	1.25	1.03	1.16	1.37	1.47	1.39	1.33	**1.40**	**1.37**	**1.37**	*1.43*	*1.45*
Japan	135.36	122.59	133.27	161.25	152.45	130.34	116.24	**111.18**	**105.57**	**105.57**	*118.08*	*119.93*

TABLE 30 : Nominal effective exchange rates to rest of a group [1] of industrialised countries (percentage change on preceding year, 1997-2013)

	5-year averages						Autumn 2011 forecast			Spring 2011 forecast	
	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-1.1	1.4	1.2	1.8	1.0	-2.5	**0.4**	**0.0**	**0.0**	*0.7*	*0.3*
Germany	-1.0	1.8	1.8	1.8	1.3	-3.5	**0.4**	**0.1**	**0.0**	*0.8*	*0.4*
Estonia	-0.4	1.0	1.1	1.4	2.2	-3.1	**-0.1**	**0.3**	**0.0**	*-0.1*	*0.2*
Ireland	-1.8	2.4	2.6	4.0	0.8	-3.5	**0.8**	**-0.3**	**0.0**	*1.6*	*0.6*
Greece	0.3	1.7	0.9	2.0	1.9	-2.3	**0.9**	**0.4**	**0.0**	*0.8*	*0.2*
Spain	-1.1	1.4	1.3	2.0	1.2	-2.5	**0.6**	**0.2**	**0.0**	*0.8*	*0.3*
France	-1.0	1.7	1.6	2.1	0.8	-3.0	**0.4**	**-0.1**	**0.0**	*0.9*	*0.4*
Italy	0.1	1.9	1.6	1.9	0.9	-3.1	**0.5**	**0.1**	**0.0**	*0.9*	*0.3*
Cyprus	5.0	1.6	-0.3	2.2	1.8	-2.4	**0.4**	**0.1**	**0.0**	*0.6*	*0.3*
Luxembourg	-1.1	1.4	1.2	1.8	1.0	-2.5	**0.4**	**0.0**	**0.0**	*0.7*	*0.3*
Malta	0.4	1.3	3.1	2.2	-1.2	-4.0	**0.4**	**-0.8**	**0.0**	*1.6*	*0.6*
Netherlands	-1.0	1.2	1.1	2.0	1.4	-2.5	**0.4**	**0.1**	**0.0**	*0.6*	*0.3*
Austria	-0.1	1.1	1.0	0.9	1.2	-2.5	**0.1**	**0.2**	**0.0**	*0.3*	*0.2*
Portugal	-1.1	1.1	1.1	1.6	0.6	-2.0	**0.4**	**0.0**	**0.0**	*0.7*	*0.3*
Slovenia	-3.9	-1.1	0.3	0.5	2.0	-1.9	**0.3**	**0.5**	**0.0**	*0.2*	*0.1*
Slovakia	-1.3	3.6	10.4	8.7	6.5	-2.1	**0.3**	**0.6**	**0.0**	*0.1*	*0.1*
Finland	-1.0	1.7	1.6	1.9	1.5	-3.9	**0.1**	**0.0**	**0.0**	*0.4*	*0.4*
Euro area	-1.7	3.6	3.5	4.2	2.8	-6.7	**0.9**	**0.3**	**0.0**	*1.6*	*0.7*
Bulgaria	-32.2	1.7	0.6	1.8	2.6	-2.5	**1.9**	**1.0**	**0.0**	*1.2*	*0.2*
Czech Republic	0.8	4.5	2.3	12.2	-3.7	2.5	**3.6**	**-1.0**	**0.0**	*4.3*	*0.3*
Denmark	-1.0	1.4	1.4	2.2	2.2	-3.9	**-0.3**	**0.1**	**0.0**	*-0.1*	*0.3*
Latvia	4.3	-3.4	0.0	0.9	2.3	-3.1	**0.2**	**0.6**	**0.0**	*0.0*	*0.0*
Lithuania	8.3	2.1	0.8	1.0	2.7	-2.6	**0.3**	**0.5**	**0.0**	*0.2*	*0.2*
Hungary	-4.7	0.3	5.4	0.9	-8.4	-0.3	**-0.3**	**-5.7**	**0.0**	*3.2*	*0.8*
Poland	-1.1	-0.5	3.4	9.2	-17.7	6.2	**-2.4**	**-5.2**	**0.0**	*1.0*	*0.1*
Romania	-30.1	-4.7	6.2	-8.3	-11.4	-1.5	**0.6**	**-1.5**	**0.0**	*2.9*	*1.0*
Sweden	-2.5	1.8	1.7	-1.8	-8.5	7.6	**6.0**	**-1.1**	**0.0**	*7.6*	*0.0*
United Kingdom	4.8	0.2	1.9	-12.9	-11.5	0.4	**-1.0**	**-0.4**	**0.0**	*-0.9*	*-0.5*
EU	-0.8	5.2	6.6	1.5	-5.4	-7.4	**1.7**	**-0.9**	**0.0**	*3.6*	*0.9*
USA	5.0	-3.9	-5.0	-4.3	6.3	-3.2	**-5.5**	**2.1**	**0.0**	*-6.7*	*-0.8*
Japan	1.5	-2.4	-5.9	11.3	15.9	6.5	**6.3**	**5.0**	**0.0**	*0.7*	*-1.0*

[1] 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 [1] of industrialised countries (nat. curr.) (percentage change on preceding year, 1997-2013) 24.10.2011

	5-year averages						Autumn 2011 forecast			*Spring 2011 forecast*	
	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-0.7	-0.3	0.4	0.8	-0.1	0.4	**1.1**	**0.6**	:	*0.5*	*0.7*
Germany	-3.0	-2.2	-3.1	-1.9	1.9	-0.8	**1.1**	**0.4**	:	*-0.1*	*0.1*
Estonia	1.2	3.3	13.3	7.9	-2.0	-4.1	**0.8**	**0.5**	:	*3.0*	*-0.1*
Ireland	0.9	2.1	2.3	3.9	-5.8	-6.6	**-4.4**	**-3.0**	:	*-3.5*	*-2.1*
Greece	-1.9	0.8	0.9	2.1	2.9	-1.6	**-3.3**	**-4.9**	:	*-1.3*	*-2.4*
Spain	-0.2	1.3	2.3	1.0	-2.5	-2.4	**-1.7**	**-1.6**	:	*-1.5*	*-0.7*
France	-1.6	0.4	-0.2	-0.7	-0.5	1.4	**0.5**	**0.2**	:	*0.1*	*-0.2*
Italy	-1.9	1.2	-0.6	0.6	0.4	0.1	**0.9**	**-0.6**	:	*-0.2*	*0.0*
Cyprus	-6.4	1.7	-1.0	-3.1	0.0	1.8	**1.0**	**0.6**	:	*1.6*	*0.6*
Luxembourg	:	:	:	:	:	:	**:**	**:**	:	*:*	*:*
Malta	0.3	1.0	-0.9	-0.5	1.8	-0.2	**-0.5**	**0.3**	:	*0.3*	*1.2*
Netherlands	0.7	0.3	0.1	-0.8	1.1	-0.4	**-0.7**	**-0.2**	:	*0.4*	*0.2*
Austria	-2.5	-0.8	-1.0	-0.4	0.8	0.3	**0.1**	**-0.7**	:	*-0.1*	*0.0*
Portugal	1.6	0.7	-1.1	-0.4	-0.1	-0.5	**0.2**	**-2.1**	:	*-0.2*	*-0.2*
Slovenia	3.3	1.8	0.9	1.8	4.4	0.8	**-0.2**	**-0.9**	:	*-1.9*	*-0.1*
Slovakia	2.9	2.1	-1.6	-0.3	3.3	-0.9	**-0.2**	**-0.2**	:	*-0.1*	*0.1*
Finland	-1.6	-0.6	-1.8	1.8	3.8	-0.9	**0.2**	**0.3**	:	*-1.0*	*0.1*
Euro area	-3.7	-0.6	-1.9	-0.9	1.2	-1.0	**0.7**	**-0.5**	:	*-0.5*	*-0.2*
Bulgaria	62.8	0.0	6.2	6.7	7.7	0.6	**4.9**	**2.6**	:	*3.6*	*2.7*
Czech Republic	2.7	1.3	1.1	-0.6	-1.8	-0.2	**0.0**	**-0.4**	:	*-0.6*	*-0.3*
Denmark	0.2	0.9	2.6	2.7	0.7	-0.6	**-1.0**	**-0.6**	:	*-0.9*	*0.0*
Latvia	-1.5	6.6	24.1	14.7	-11.2	-9.0	**1.1**	**-0.8**	:	*-1.4*	*-2.5*
Lithuania	-1.8	2.5	2.4	4.3	-4.4	-6.2	**-0.5**	**-0.2**	:	*-0.5*	*2.5*
Hungary	8.4	3.4	4.4	-0.2	-1.2	-2.9	**1.8**	**1.8**	:	*-0.8*	*0.8*
Poland	5.3	-3.1	0.7	3.3	-1.9	2.9	**1.5**	**0.5**	:	*2.0*	*2.1*
Romania	59.6	7.5	12.7	17.8	-6.4	1.7	**3.4**	**2.6**	:	*-0.3*	*1.5*
Sweden	-0.7	-1.6	1.7	-1.3	0.7	-1.4	**0.0**	**-0.2**	:	*-0.4*	*0.5*
United Kingdom	0.2	0.6	0.1	-0.2	2.6	2.7	**1.4**	**0.9**	:	*0.6*	*1.3*
EU	-3.3	-0.5	-0.9	0.1	1.6	-0.6	**2.4**	**-0.4**	:	*-0.5*	*0.7*
USA	-0.7	0.3	1.2	-0.6	-3.4	-0.5	**0.1**	**-0.7**	:	*-0.7*	*-1.6*
Japan	-3.4	-4.4	-5.5	-2.6	-0.7	-3.0	**-0.3**	**-2.4**	:	*-0.9*	*-1.5*

[1] 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 [1] of industrialised countries (USD) (% change on preceding year, 1997-2013)

	5-year averages						Autumn 2011 forecast			*Spring 2011 forecast*	
	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-1.8	1.1	1.6	2.7	0.9	-2.1	**1.5**	**0.6**	:	*1.2*	*1.0*
Germany	-4.0	-0.4	-1.4	-0.1	3.3	-4.3	**1.4**	**0.6**	:	*0.7*	*0.5*
Estonia	0.9	4.3	14.5	9.5	0.2	-7.0	**0.7**	**0.7**	:	*2.9*	*0.2*
Ireland	-0.9	4.5	5.0	8.0	-5.0	-9.9	**-3.6**	**-3.3**	:	*-2.0*	*-1.6*
Greece	-1.6	2.5	1.8	4.2	4.8	-3.9	**-2.4**	**-4.5**	:	*-0.5*	*-2.2*
Spain	-1.3	2.7	3.6	3.0	-1.3	-4.8	**-1.2**	**-1.5**	:	*-0.8*	*-0.4*
France	-2.6	2.1	1.4	1.4	0.2	-1.7	**0.9**	**0.1**	:	*0.9*	*0.1*
Italy	-1.8	3.1	1.1	2.5	1.4	-3.0	**1.4**	**-0.5**	:	*0.7*	*0.4*
Cyprus	-1.7	3.3	-1.3	-1.0	1.8	-0.6	**1.4**	**0.6**	:	*2.2*	*0.9*
Luxembourg	:	:	:	:	::	:	**:**	**:**	:	*:*	*:*
Malta	0.8	2.3	2.2	1.7	0.5	-4.2	**-0.1**	**-0.5**	:	*1.9*	*1.8*
Netherlands	-0.3	1.4	1.2	1.2	2.6	-2.8	**-0.3**	**-0.1**	:	*1.1*	*0.5*
Austria	-2.7	0.3	-0.1	0.5	2.0	-2.2	**0.3**	**-0.4**	:	*0.2*	*0.2*
Portugal	0.5	1.8	0.1	1.2	0.6	-2.4	**0.5**	**-2.1**	:	*0.4*	*0.0*
Slovenia	-0.8	0.7	1.2	2.3	6.4	-1.2	**0.1**	**-0.4**	:	*-1.7*	*0.1*
Slovakia	1.5	5.8	8.6	8.3	10.0	-3.0	**0.0**	**0.4**	:	*-0.1*	*0.2*
Finland	-2.6	1.1	-0.3	3.8	5.3	-4.7	**0.3**	**0.3**	:	*-0.5*	*0.5*
Euro area	-5.3	3.0	1.6	3.2	4.0	-7.5	**1.6**	**-0.3**	:	*1.1*	*0.6*
Bulgaria	10.4	1.8	6.8	8.6	10.5	-2.0	**6.9**	**3.6**	:	*4.9*	*3.0*
Czech Republic	3.6	5.8	3.4	11.6	-5.4	2.2	**3.5**	**-1.4**	:	*3.7*	*0.0*
Denmark	-0.7	2.3	4.0	4.9	3.0	-4.5	**-1.3**	**-0.5**	:	*-1.0*	*0.3*
Latvia	2.8	2.9	24.0	15.7	-9.1	-11.8	**1.3**	**-0.1**	:	*-1.4*	*-2.5*
Lithuania	6.3	4.7	3.2	5.3	-1.8	-8.6	**-0.1**	**0.3**	:	*-0.3*	*2.7*
Hungary	3.3	3.6	10.0	0.7	-9.5	-3.1	**1.5**	**-3.9**	:	*2.4*	*1.6*
Poland	4.2	-3.6	4.1	12.7	-19.2	9.2	**-0.9**	**-4.7**	:	*3.0*	*2.2*
Romania	11.5	2.4	19.7	7.9	-17.1	0.1	**4.0**	**1.1**	:	*2.5*	*2.5*
Sweden	-3.2	0.1	3.4	-3.0	-7.9	6.1	**6.0**	**-1.3**	:	*7.1*	*0.6*
United Kingdom	5.0	0.8	2.0	-13.0	-9.2	3.1	**0.4**	**0.5**	:	*-0.3*	*0.9*
EU	-4.1	4.7	5.7	1.6	-3.9	-8.0	**4.1**	**-1.3**	:	*3.1*	*1.7*
USA	4.3	-3.6	-3.9	-4.8	2.7	-3.8	**-5.4**	**1.4**	:	*-7.4*	*-2.4*
Japan	-2.0	-6.7	-11.1	8.4	15.0	3.3	**6.0**	**2.4**	:	*-0.2*	*-2.5*

[1] 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, 1992-2013) [1] 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	52.8	49.9	50.1	48.3	49.9	53.7	52.8	52.3	53.1	53.0	53.1	53.6
Germany	47.8	47.4	47.1	43.5	44.0	48.1	47.9	45.7	45.5	45.0	45.3	44.3
Estonia	:	37.5	34.4	34.0	39.5	45.2	40.6	38.4	40.4	38.9	39.8	40.4
Ireland	39.4	33.9	33.6	36.6	42.8	48.9	66.8	45.7	43.9	42.9	45.5	43.9
Greece	43.8	45.5	45.2	47.3	50.5	53.8	50.1	50.3	49.5	49.4	49.7	49.5
Spain	44.6	40.1	38.6	39.2	41.5	46.3	45.6	43.0	42.3	41.9	42.9	42.0
France	53.2	52.6	53.2	52.6	53.3	56.7	56.6	56.6	57.1	56.9	55.8	55.4
Italy	53.2	48.1	47.8	47.7	48.6	51.7	50.4	49.7	49.2	48.6	49.9	49.2
Cyprus	:	37.0	42.5	41.3	42.1	46.2	46.4	46.8	45.1	44.8	46.1	45.9
Luxembourg	:	39.3	41.2	36.3	37.1	43.0	42.5	43.2	44.6	44.9	40.3	40.1
Malta	:	42.3	44.7	42.7	44.0	43.3	42.9	42.4	42.7	42.4	42.7	42.4
Netherlands	52.0	45.9	45.9	45.2	46.2	51.6	51.3	50.3	49.9	50.0	50.2	49.4
Austria	53.7	52.6	50.8	48.5	49.3	52.9	52.5	51.5	51.4	51.0	52.4	52.0
Portugal	39.9	41.3	44.2	44.3	44.7	49.9	51.3	49.1	47.2	45.4	47.7	46.9
Slovenia	:	46.0	45.6	42.5	44.2	49.3	50.1	51.0	50.5	50.9	49.1	48.1
Slovakia	:	47.9	39.5	34.2	34.9	41.5	40.0	38.9	38.5	37.7	38.8	37.4
Finland	59.8	51.4	49.5	47.1	48.9	55.2	54.9	54.3	54.4	54.7	53.7	53.5
Euro area	50.0	47.7	47.4	46.0	47.1	51.2	50.9	49.4	49.2	48.8	49.1	48.5
Bulgaria	:	38.8	37.8	39.8	38.3	40.7	38.1	37.0	36.1	35.4	37.4	36.6
Czech Republic	:	42.7	44.8	41.0	41.2	44.9	44.2	43.6	43.7	43.7	45.6	45.2
Denmark	59.0	55.2	53.5	50.8	51.9	58.3	58.3	58.0	58.5	56.7	57.5	56.8
Latvia	:	38.2	36.2	35.9	39.1	44.2	44.4	41.4	40.4	38.5	41.4	40.4
Lithuania	:	40.9	33.5	34.6	37.2	43.8	40.9	38.2	37.1	37.3	39.0	38.3
Hungary	:	49.4	50.4	50.7	49.2	51.5	49.4	48.5	48.8	48.6	50.4	45.3
Poland	:	43.7	43.8	42.2	43.2	44.5	45.4	45.2	44.8	44.0	45.8	43.7
Romania	:	36.9	34.2	38.2	39.3	41.1	40.9	38.8	38.4	37.9	38.8	38.1
Sweden	64.4	57.4	54.2	50.9	51.7	54.8	52.6	51.2	51.4	51.1	51.5	50.6
United Kingdom	42.2	39.2	42.9	43.9	47.9	51.5	50.6	49.8	48.6	47.2	49.8	48.6
EU	:	46.7	46.7	45.6	47.1	51.0	50.6	49.3	49.0	48.4	49.1	48.3
USA	36.5	34.6	36.1	36.8	39.1	42.7	42.5	42.1	41.2	39.3	41.7	40.8
Japan	34.4	38.9	37.8	35.9	37.2	42.0	41.1	42.8	43.4	44.2	44.1	44.8

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 34 : Total revenue, general government (as a percentage of GDP, 1992-2013) [1]

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	47.4	49.2	49.5	48.0	48.6	48.0	48.8	48.8	48.6	48.5	49.3	49.4
Germany	44.8	45.7	43.8	43.7	44.0	44.9	43.6	44.4	44.5	44.3	43.3	43.2
Estonia	:	37.1	35.9	36.4	36.5	43.2	40.9	39.1	38.7	38.1	39.2	38.0
Ireland	37.8	36.3	34.8	36.7	35.5	34.7	35.5	35.4	35.3	35.0	35.0	35.1
Greece	34.1	41.3	39.3	40.8	40.7	38.0	39.5	41.4	42.5	42.6	40.2	40.2
Spain	38.8	38.2	39.2	41.1	37.0	35.1	36.3	36.4	36.3	36.6	36.5	36.7
France	48.4	50.4	49.9	49.9	49.9	49.2	49.5	50.8	51.8	51.8	50.1	50.1
Italy	44.9	45.9	44.2	46.0	45.9	46.3	45.8	45.8	46.9	47.4	45.9	46.1
Cyprus	:	33.3	38.8	44.8	43.1	40.1	41.0	40.1	40.2	40.2	41.0	41.0
Luxembourg	:	43.8	41.8	39.9	40.1	42.1	41.4	42.6	43.6	44.0	39.3	39.0
Malta	:	34.8	39.6	40.3	39.4	39.6	39.3	39.4	39.2	38.8	39.7	39.4
Netherlands	48.7	46.0	44.6	45.4	46.7	46.0	46.2	46.0	46.8	47.3	46.5	47.1
Austria	49.6	51.0	48.9	47.6	48.3	48.7	48.1	48.1	48.3	48.1	48.7	48.7
Portugal	35.3	37.9	40.3	41.1	41.1	39.7	41.6	43.3	42.7	42.2	41.8	42.4
Slovenia	:	42.9	43.6	42.4	42.4	43.2	44.3	45.2	45.2	45.2	43.3	43.1
Slovakia	:	40.3	35.6	32.4	32.8	33.5	32.3	33.1	33.5	32.7	33.6	32.9
Finland	54.0	54.1	52.6	52.4	53.2	52.7	52.3	53.3	53.6	54.0	52.8	52.9
Euro area	45.0	45.9	44.8	45.3	45.0	44.8	44.7	45.3	45.8	45.9	44.9	44.9
Bulgaria	:	39.4	38.4	40.9	40.0	36.3	34.9	34.5	34.4	34.1	34.7	35.0
Czech Republic	:	38.4	40.4	40.3	38.9	39.1	39.3	39.4	40.0	39.8	41.2	41.2
Denmark	56.5	56.1	56.1	55.6	55.2	55.6	55.7	54.0	54.0	54.6	53.4	53.6
Latvia	:	36.8	35.0	35.6	34.9	34.6	36.1	37.2	37.1	35.3	36.9	36.5
Lithuania	:	36.0	32.4	33.6	33.9	34.3	33.8	33.2	34.1	33.9	33.5	33.5
Hungary	:	44.1	42.4	45.6	45.5	46.9	45.2	52.1	46.0	44.9	52.0	42.0
Poland	:	39.8	38.9	40.3	39.5	37.2	37.5	39.6	40.8	41.0	40.0	40.1
Romania	:	32.8	32.6	35.3	33.6	32.1	34.0	34.0	34.7	34.9	34.1	34.5
Sweden	56.7	58.5	54.8	54.5	53.9	54.1	52.8	52.2	52.1	52.1	52.4	52.7
United Kingdom	36.2	39.7	39.9	41.1	42.9	40.1	40.3	40.4	40.8	41.4	41.2	41.6
EU	:	45.2	44.2	44.7	44.7	44.1	44.1	44.6	45.0	45.2	44.5	44.5
USA	32.3	34.9	32.4	34.1	32.7	31.1	31.8	32.1	32.7	34.3	31.7	32.3
Japan	32.0	31.6	31.7	33.5	35.1	33.3	34.3	35.6	36.0	36.9	34.5	35.0

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 35 : Net lending (+) or net borrowing (-), general government (as a percentage of GDP, 1992-2013) [1] 24.10.2011

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-5.4	-0.7	-0.6	-0.3	-1.3	-5.8	-4.1	-3.6	-4.6	-4.5	-3.7	-4.2
Germany	-3.0	-1.7	-3.3	0.2	-0.1	-3.2	-4.3	-1.3	-1.0	-0.7	-2.0	-1.2
Estonia	:	-0.5	1.5	2.4	-2.9	-2.0	0.2	0.8	-1.8	-0.8	-0.6	-2.4
Ireland	-1.7	2.4	1.2	0.1	-7.3	-14.2	-31.3	-10.3	-8.6	-7.8	-10.5	-8.8
Greece	-9.7	-4.2	-5.9	-6.5	-9.8	-15.8	-10.6	-8.9	-7.0	-6.8	-9.5	-9.3
Spain	-5.8	-1.9	0.6	1.9	-4.5	-11.2	-9.3	-6.6	-5.9	-5.3	-6.3	-5.3
France	-4.9	-2.2	-3.2	-2.7	-3.3	-7.5	-7.1	-5.8	-5.3	-5.1	-5.8	-5.3
Italy	-8.3	-2.3	-3.6	-1.6	-2.7	-5.4	-4.6	-4.0	-2.3	-1.2	-4.0	-3.2
Cyprus	:	-3.6	-3.7	3.5	0.9	-6.1	-5.3	-6.7	-4.9	-4.7	-5.1	-4.9
Luxembourg	1.6	4.5	0.6	3.7	3.0	-0.9	-1.1	-0.6	-1.1	-0.9	-1.0	-1.1
Malta	:	-7.5	-5.1	-2.4	-4.6	-3.7	-3.6	-3.0	-3.5	-3.6	-3.0	-3.0
Netherlands	-3.3	0.0	-1.3	0.2	0.5	-5.6	-5.1	-4.3	-3.1	-2.7	-3.7	-2.3
Austria	-4.1	-1.6	-2.0	-0.9	-0.9	-4.1	-4.4	-3.4	-3.1	-2.9	-3.7	-3.3
Portugal	-4.6	-3.3	-3.9	-3.1	-3.6	-10.1	-9.8	-5.8	-4.5	-3.2	-5.9	-4.5
Slovenia	:	-3.1	-2.0	0.0	-1.9	-6.1	-5.8	-5.7	-5.3	-5.7	-5.8	-5.0
Slovakia	:	-7.6	-3.9	-1.8	-2.1	-8.0	-7.7	-5.8	-4.9	-5.0	-5.1	-4.6
Finland	-5.8	2.7	3.1	5.3	4.3	-2.5	-2.5	-1.0	-0.7	-0.7	-1.0	-0.7
Euro area	-5.0	-1.7	-2.5	-0.7	-2.1	-6.4	-6.2	-4.1	-3.4	-3.0	-4.3	-3.5
Bulgaria	:	0.5	0.6	1.2	1.7	-4.3	-3.1	-2.5	-1.7	-1.3	-2.7	-1.6
Czech Republic	:	-4.2	-4.3	-0.7	-2.2	-5.8	-4.8	-4.1	-3.8	-4.0	-4.4	-4.1
Denmark	-2.5	0.9	2.6	4.8	3.2	-2.7	-2.6	-4.0	-4.5	-2.1	-4.1	-3.2
Latvia	:	-1.4	-1.2	-0.4	-4.2	-9.7	-8.3	-4.2	-3.3	-3.2	-4.5	-3.8
Lithuania	:	-4.8	-1.1	-1.0	-3.3	-9.5	-7.0	-5.0	-3.0	-3.4	-5.5	-4.8
Hungary	:	-5.3	-8.0	-5.1	-3.7	-4.6	-4.2	3.6	-2.8	-3.7	1.6	-3.3
Poland	:	-3.9	-4.9	-1.9	-3.7	-7.3	-7.8	-5.6	-4.0	-3.1	-5.8	-3.6
Romania	:	-4.0	-1.6	-2.9	-5.7	-9.0	-6.9	-4.9	-3.7	-2.9	-4.7	-3.6
Sweden	-7.7	1.0	0.6	3.6	2.2	-0.7	0.2	0.9	0.7	0.9	0.9	2.0
United Kingdom	-6.1	0.5	-3.0	-2.7	-5.0	-11.5	-10.3	-9.4	-7.8	-5.8	-8.6	-7.0
EU	:	-1.4	-2.5	-0.9	-2.4	-6.9	-6.6	-4.7	-3.9	-3.2	-4.7	-3.8
USA	-4.2	0.3	-3.7	-2.8	-6.4	-11.5	-10.6	-10.0	-8.5	-5.0	-10.0	-8.6
Japan	-2.5	-7.3	-6.1	-2.4	-2.2	-8.7	-6.8	-7.2	-7.4	-7.2	-9.7	-9.8

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 36 : Interest expenditure, general government (as a percentage of GDP, 1992-2013) [1]

	5-year averages							Autumn 2011 forecast			*Spring 2011 forecast*	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	9.5	7.0	4.7	3.8	3.8	3.6	3.3	3.2	3.3	3.3	3.4	3.5
Germany	3.3	3.2	2.9	2.8	2.8	2.7	2.5	2.4	2.3	2.3	2.4	2.4
Estonia	:	0.3	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.3
Ireland	5.6	2.6	1.2	1.0	1.4	2.0	3.1	3.6	4.3	5.9	3.8	4.6
Greece	11.2	7.8	4.9	4.5	5.0	5.2	5.7	6.9	8.0	8.9	6.7	7.4
Spain	4.8	3.7	2.1	1.6	1.6	1.8	1.9	2.2	2.4	2.6	2.2	2.5
France	3.4	3.1	2.7	2.7	2.9	2.4	2.4	2.6	2.8	3.0	2.6	2.9
Italy	11.3	7.3	4.9	5.0	5.2	4.6	4.5	4.9	5.4	5.6	4.8	5.1
Cyprus	:	3.1	3.4	3.0	2.8	2.6	2.3	2.4	2.7	2.7	2.4	2.4
Luxembourg	0.3	0.4	0.2	0.2	0.3	0.4	0.4	0.5	0.5	0.6	0.5	0.5
Malta	:	3.3	3.5	3.3	3.2	3.1	3.0	3.2	3.3	3.3	3.1	3.0
Netherlands	5.7	4.1	2.5	2.2	2.2	2.2	2.0	1.9	1.9	2.1	2.1	2.2
Austria	4.0	3.5	2.9	2.7	2.6	2.8	2.7	2.7	2.8	2.9	2.8	3.0
Portugal	5.6	3.1	2.6	2.9	3.0	2.9	3.0	4.2	5.2	5.5	4.2	4.8
Slovenia	:	2.3	1.8	1.3	1.1	1.4	1.6	1.9	2.1	2.2	1.8	2.0
Slovakia	:	3.3	2.3	1.4	1.2	1.4	1.3	1.5	1.5	1.6	1.6	1.7
Finland	4.0	3.2	1.7	1.5	1.4	1.1	1.1	1.1	1.2	1.4	1.2	1.4
Euro area	5.6	4.3	3.1	3.0	3.0	2.9	2.8	3.0	3.1	3.3	3.0	3.2
Bulgaria	:	4.7	1.9	1.2	0.9	0.8	0.6	0.7	0.7	0.8	0.8	0.9
Czech Republic	:	1.0	1.1	1.1	1.1	1.3	1.4	1.4	1.5	1.5	1.8	1.8
Denmark	6.4	4.1	2.3	1.6	1.4	1.8	1.7	1.8	1.8	1.9	1.9	2.0
Latvia	:	0.8	0.6	0.4	0.6	1.5	1.5	1.9	2.0	2.3	1.9	2.1
Lithuania	:	1.3	1.0	0.7	0.7	1.3	1.8	1.9	2.0	2.1	2.0	2.0
Hungary	:	6.7	4.1	4.2	4.2	4.7	4.1	3.9	3.9	3.8	3.8	3.8
Poland	:	3.5	2.8	2.3	2.2	2.6	2.7	2.8	3.0	3.0	2.8	2.7
Romania	:	4.2	1.5	0.7	0.7	1.5	1.6	1.8	1.8	1.8	1.8	1.8
Sweden	5.5	4.0	1.9	1.7	1.7	0.9	0.7	0.7	0.8	0.8	0.7	0.8
United Kingdom	3.1	3.0	2.0	2.2	2.3	1.9	2.9	3.1	3.2	3.2	3.1	3.4
EU	:	4.0	2.9	2.7	2.8	2.6	2.7	2.9	3.0	3.1	2.9	3.0
USA	4.7	3.8	2.7	2.9	2.7	2.5	2.6	3.0	3.1	3.3	2.9	2.9
Japan	3.6	3.4	2.6	2.5	2.5	2.6	2.7	2.7	2.7	2.7	2.7	2.7

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 37 : Primary balance, general government (as a percentage of GDP, 1992-2013) [1] [2] 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	4.1	6.3	4.1	3.5	2.5	-2.2	-0.7	**-0.3**	**-1.3**	**-1.1**	*-0.4*	*-0.7*
Germany	0.3	1.5	-0.4	3.0	2.7	-0.5	-1.8	**1.1**	**1.3**	**1.5**	*0.4*	*1.2*
Estonia	:	-0.2	1.7	2.6	-2.7	-1.8	0.4	**1.0**	**-1.6**	**-0.6**	*-0.4*	*-2.1*
Ireland	4.0	5.0	2.4	1.1	-6.0	-12.1	-28.2	**-6.7**	**-4.3**	**-2.0**	*-6.8*	*-4.2*
Greece	1.6	3.6	-1.0	-2.0	-4.8	-10.6	-5.0	**-2.1**	**1.0**	**2.1**	*-2.8*	*-1.8*
Spain	-1.0	1.8	2.7	3.5	-2.9	-9.4	-7.4	**-4.5**	**-3.5**	**-2.7**	*-4.1*	*-2.9*
France	-1.5	0.9	-0.5	0.0	-0.4	-5.1	-4.6	**-3.2**	**-2.5**	**-2.1**	*-3.1*	*-2.4*
Italy	3.0	5.0	1.3	3.4	2.5	-0.8	-0.1	**0.9**	**3.1**	**4.4**	*0.8*	*1.9*
Cyprus	:	-0.6	-0.4	6.5	3.8	-3.6	-3.1	**-4.3**	**-2.2**	**-1.9**	*-2.7*	*-2.5*
Luxembourg	1.9	4.9	0.8	3.9	3.3	-0.5	-0.7	**-0.1**	**-0.5**	**-0.4**	*-0.5*	*-0.6*
Malta	:	-4.2	-1.6	1.0	-1.4	-0.6	-0.6	**0.2**	**-0.2**	**-0.4**	*0.0*	*0.1*
Netherlands	2.4	4.1	1.1	2.4	2.7	-3.4	-3.1	**-2.4**	**-1.2**	**-0.6**	*-1.6*	*-0.1*
Austria	-0.1	1.8	0.9	1.9	1.7	-1.3	-1.7	**-0.8**	**-0.3**	**0.0**	*-0.9*	*-0.3*
Portugal	1.0	-0.3	-1.3	-0.2	-0.6	-7.3	-6.8	**-1.6**	**0.8**	**2.3**	*-1.7*	*0.3*
Slovenia	:	-0.8	-0.3	1.2	-0.7	-4.7	-4.2	**-3.9**	**-3.1**	**-3.5**	*-4.1*	*-3.1*
Slovakia	:	-4.3	-1.6	-0.4	-0.8	-6.5	-6.3	**-4.3**	**-3.4**	**-3.4**	*-3.6*	*-2.9*
Finland	-1.8	5.9	4.7	6.8	5.7	-1.3	-1.5	**0.1**	**0.5**	**0.7**	*0.2*	*0.7*
Euro area	0.6	2.6	0.6	2.3	0.9	-3.5	-3.4	**-1.2**	**-0.3**	**0.3**	*-1.3*	*-0.4*
Bulgaria	:	5.2	2.5	2.3	2.5	-3.6	-2.5	**-1.7**	**-1.0**	**-0.5**	*-1.9*	*-0.7*
Czech Republic	:	-3.3	-3.2	0.4	-1.2	-4.6	-3.4	**-2.7**	**-2.3**	**-2.4**	*-2.7*	*-2.3*
Denmark	3.9	5.0	4.9	6.4	4.7	-0.9	-0.9	**-2.2**	**-2.7**	**-0.2**	*-2.2*	*-1.2*
Latvia	:	-0.6	-0.5	0.0	-3.6	-8.2	-6.8	**-2.3**	**-1.2**	**-0.9**	*-2.7*	*-1.8*
Lithuania	:	-3.5	-0.1	-0.3	-2.6	-8.2	-5.3	**-3.1**	**-1.0**	**-1.3**	*-3.5*	*-2.8*
Hungary	:	1.4	-3.9	-0.9	0.5	0.1	-0.1	**7.5**	**1.2**	**0.1**	*5.5*	*0.5*
Poland	:	-0.4	-2.0	0.4	-1.5	-4.7	-5.2	**-2.7**	**-1.1**	**-0.1**	*-3.0*	*-0.9*
Romania	:	0.1	-0.1	-2.2	-5.0	-7.5	-5.4	**-3.1**	**-1.9**	**-1.2**	*-2.9*	*-1.8*
Sweden	-2.2	5.0	2.5	5.3	3.9	0.3	1.0	**1.7**	**1.5**	**1.8**	*1.6*	*2.8*
United Kingdom	-2.9	3.5	-1.0	-0.5	-2.7	-9.5	-7.4	**-6.3**	**-4.6**	**-2.6**	*-5.5*	*-3.6*
EU	:	2.6	0.4	1.8	0.4	-4.3	-3.9	**-1.8**	**-0.9**	**-0.1**	*-1.8*	*-0.8*
USA	0.5	4.1	-1.0	0.1	-3.7	-9.0	-8.0	**-7.0**	**-5.4**	**-1.7**	*-7.1*	*-5.7*
Japan	1.1	-3.9	-3.5	0.1	0.4	-6.1	-4.1	**-4.5**	**-4.7**	**-4.5**	*-7.0*	*-7.1*

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

[2] Net lending/borrowing excluding interest expenditure.

TABLE 38 : Cyclically-adjusted net lending (+) or net borrowing (-), general government (as a percentage of GDP, 1992-2013)

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-5.0	-1.0	-0.8	-1.6	-2.1	-4.4	-3.2	**-3.2**	**-4.0**	**-4.0**	*-2.9*	*-3.7*
Germany	-3.3	-1.9	-2.8	-0.8	-1.1	-1.2	-3.5	**-1.3**	**-0.7**	**-0.4**	*-1.4*	*-0.8*
Estonia	:	0.4	-0.6	-1.5	-4.5	1.1	2.7	**1.3**	**-1.7**	**-1.1**	*0.3*	*-2.3*
Ireland	-1.2	0.6	0.7	-1.4	-7.2	-11.9	-29.3	**-9.1**	**-8.0**	**-8.1**	*-9.2*	*-8.5*
Greece	-9.6	-4.2	-6.0	-7.9	-10.6	-15.2	-8.7	**-5.3**	**-2.9**	**-3.4**	*-6.1*	*-6.6*
Spain	-4.7	-2.3	0.0	1.0	-4.6	-9.2	-7.0	**-4.5**	**-4.2**	**-4.3**	*-4.3*	*-3.9*
France	-4.2	-2.6	-4.1	-4.1	-3.9	-6.2	-5.8	**-4.7**	**-4.0**	**-3.9**	*-3.9*	*-3.7*
Italy	-8.0	-2.7	-4.1	-3.0	-3.2	-3.4	-3.3	**-2.8**	**-1.3**	**-0.4**	*-2.6*	*-2.2*
Cyprus	:	-3.7	-3.7	2.6	-0.4	-6.0	-5.1	**-6.3**	**-4.1**	**-4.2**	*-4.5*	*-4.7*
Luxembourg	:	3.6	0.1	1.4	1.7	1.2	0.3	**0.5**	**0.0**	**-0.2**	*0.3*	*-0.4*
Malta	:	-8.1	-4.8	-2.0	-5.0	-2.9	-3.3	**-3.0**	**-3.5**	**-3.8**	*-3.0*	*-3.1*
Netherlands	-3.0	-0.7	-0.8	-1.0	-0.5	-3.9	-3.7	**-3.3**	**-1.8**	**-1.4**	*-2.5*	*-1.3*
Austria	-3.9	-2.0	-1.7	-2.1	-1.9	-2.8	-3.5	**-3.3**	**-2.7**	**-2.8**	*-3.2*	*-2.9*
Portugal	-4.4	-4.3	-3.6	-3.4	-3.5	-9.0	-9.2	**-4.7**	**-2.4**	**-1.8**	*-4.9*	*-3.1*
Slovenia	:	-3.3	-2.5	-3.1	-5.0	-4.2	-3.9	**-4.1**	**-3.8**	**-4.7**	*-3.5*	*-3.3*
Slovakia	:	-7.1	-3.5	-3.7	-4.3	-7.7	-7.7	**-5.7**	**-4.4**	**-4.6**	*-4.8*	*-4.6*
Finland	-3.7	1.6	2.9	2.9	2.5	0.6	-0.6	**0.1**	**0.3**	**0.1**	*0.8*	*0.7*
Euro area	-4.7	-2.1	-2.7	-1.9	-2.8	-4.6	-5.0	**-3.2**	**-2.4**	**-2.1**	*-3.0*	*-2.5*
Bulgaria	:	:	-0.3	-0.3	-0.2	-3.2	-1.5	**-1.2**	**-0.7**	**-0.7**	*-1.2*	*-0.6*
Czech Republic	:	-3.3	-4.4	-3.1	-4.4	-5.2	-4.5	**-3.8**	**-3.1**	**-3.2**	*-3.8*	*-3.8*
Denmark	-1.4	0.1	2.1	2.7	2.8	0.7	-0.1	**-2.1**	**-3.2**	**-1.4**	*-2.2*	*-1.8*
Latvia	:	-1.0	-1.9	-4.2	-6.4	-6.8	-5.7	**-2.9**	**-2.5**	**-3.1**	*-3.1*	*-3.6*
Lithuania	:	-3.4	-2.0	-3.6	-5.5	-7.1	-4.9	**-4.2**	**-2.7**	**-3.5**	*-4.7*	*-4.8*
Hungary	:	-4.8	-9.1	-6.5	-4.9	-2.3	-2.4	**4.8**	**-1.8**	**-3.2**	*2.7*	*-3.3*
Poland	:	-4.1	-4.7	-2.8	-4.6	-7.1	-7.6	**-5.5**	**-3.6**	**-2.5**	*-5.3*	*-3.1*
Romania	:	-2.3	-2.3	-5.3	-8.7	-9.1	-5.9	**-3.7**	**-2.6**	**-2.2**	*-3.3*	*-2.8*
Sweden	-5.7	1.2	0.0	1.5	1.7	2.5	1.3	**0.9**	**0.9**	**1.0**	*1.3*	*2.1*
United Kingdom	-5.5	0.1	-3.9	-4.3	-5.5	-9.7	-8.9	**-8.0**	**-6.3**	**-4.5**	*-6.5*	*-5.3*
EU	:	-1.8	-2.8	-2.2	-3.1	-5.1	-5.3	**-3.7**	**-2.9**	**-2.4**	*-3.3*	*-2.8*

TABLE 39 : Cyclically-adjusted primary balance, general government (as a percentage of GDP, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	4.5	5.9	3.9	2.3	1.7	-0.8	0.1	0.1	-0.7	-0.6	0.5	-0.3
Germany	0.0	1.3	0.1	2.0	1.7	1.5	-1.0	1.1	1.6	1.9	0.9	1.6
Estonia	:	0.7	-0.4	-1.3	-4.3	1.3	2.8	1.4	-1.5	-0.9	0.5	-2.0
Ireland	4.4	3.3	1.9	-0.4	-5.9	-9.8	-26.2	-5.5	-3.7	-2.2	-5.4	-3.9
Greece	1.6	3.6	-1.2	-3.5	-5.6	-10.0	-3.1	1.5	5.1	5.5	0.6	0.8
Spain	0.1	1.4	2.1	2.6	-3.0	-7.4	-5.1	-2.3	-1.7	-1.6	-2.1	-1.4
France	-0.8	0.5	-1.4	-1.4	-1.0	-3.8	-3.4	-2.1	-1.2	-0.9	-1.3	-0.8
Italy	3.2	4.6	0.9	2.0	1.9	1.2	1.3	2.1	4.1	5.2	2.2	2.9
Cyprus	:	-0.6	-0.3	5.7	2.5	-3.4	-2.9	-3.9	-1.3	-1.4	-2.1	-2.3
Luxembourg	:	3.9	0.3	1.6	2.1	1.6	0.7	1.1	0.6	0.3	0.8	0.1
Malta	:	-4.8	-1.2	1.3	-1.9	0.3	-0.3	0.2	-0.2	-0.5	0.1	0.0
Netherlands	2.7	3.4	1.7	1.2	1.7	-1.7	-1.7	-1.4	0.1	0.6	-0.4	0.9
Austria	0.1	1.5	1.2	0.7	0.7	0.0	-0.9	-0.6	0.1	0.2	-0.4	0.0
Portugal	1.2	-1.2	-1.0	-0.5	-0.5	-6.1	-6.2	-0.4	2.8	3.8	-0.7	1.7
Slovenia	:	-1.0	-0.8	-1.9	-3.9	-2.8	-2.3	-2.2	-1.7	-2.5	-1.7	-1.3
Slovakia	:	-3.8	-1.2	-2.3	-3.1	-6.3	-6.3	-4.3	-2.9	-2.9	-3.2	-3.0
Finland	0.4	4.9	4.5	4.3	3.9	1.7	0.5	1.2	1.5	1.5	2.0	2.1
Euro area	0.9	2.1	0.5	1.0	0.2	-1.8	-2.2	-0.2	0.8	1.2	0.0	0.6
Bulgaria	:	:	1.6	0.9	0.7	-2.4	-0.9	-0.4	0.0	0.1	-0.4	0.3
Czech Republic	:	-2.3	-3.3	-2.0	-3.3	-4.0	-3.1	-2.4	-1.6	-1.7	-2.0	-2.0
Denmark	5.0	4.2	4.4	4.3	4.3	2.5	1.6	-0.3	-1.4	0.5	-0.3	0.2
Latvia	:	-0.2	-1.3	-3.9	-5.8	-5.3	-4.2	-1.0	-0.4	-0.8	-1.2	-1.5
Lithuania	:	-2.1	-1.0	-2.9	-4.8	-5.8	-3.1	-2.2	-0.6	-1.4	-2.7	-2.8
Hungary	:	1.9	-5.0	-2.4	-0.7	2.4	1.6	8.7	2.1	0.6	6.5	0.4
Poland	:	-0.6	-1.9	-0.5	-2.4	-4.5	-4.9	-2.6	-0.6	0.5	-2.6	-0.3
Romania	:	1.9	-0.8	-4.6	-8.0	-7.5	-4.3	-1.9	-0.8	-0.4	-1.5	-1.0
Sweden	-0.2	5.2	2.0	3.2	3.4	3.4	2.0	1.6	1.7	1.9	2.0	2.9
United Kingdom	-2.4	3.1	-1.9	-2.1	-3.2	-7.8	-6.0	-4.9	-3.1	-1.3	-3.5	-1.9
EU	:	2.2	0.1	0.5	-0.4	-2.5	-2.6	-0.9	0.1	0.7	-0.5	0.3

TABLE 40 : Gross debt, general government (as a percentage of GDP, 2004-2013)

								Autumn 2011 forecast			Spring 2011 forecast	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	94.0	92.0	88.0	84.1	89.3	95.9	96.2	97.2	99.2	100.3	97.0	97.5
Germany	66.2	68.5	67.9	65.2	66.7	74.4	83.2	81.7	81.2	79.9	82.4	81.1
Estonia	5.0	4.6	4.4	3.7	4.5	7.2	6.7	5.8	6.0	6.1	6.1	6.9
Ireland	29.4	27.2	24.7	24.9	44.3	65.2	94.9	108.1	117.5	121.1	112.0	117.9
Greece	99.8	101.2	107.3	107.4	113.0	129.3	144.9	162.8	198.3	198.5	157.7	166.1
Spain	46.2	43.0	39.5	36.2	40.1	53.8	61.0	69.6	73.8	78.0	68.1	71.0
France	65.0	66.7	64.0	64.2	68.2	79.0	82.3	85.4	89.2	91.7	84.7	86.8
Italy	103.4	105.4	106.1	103.1	105.8	115.5	118.4	120.5	120.5	118.7	120.3	119.8
Cyprus	70.9	69.4	64.7	58.8	48.9	58.5	61.5	64.9	68.4	70.9	62.3	64.3
Luxembourg	6.3	6.1	6.7	6.7	13.7	14.8	19.1	19.5	20.2	20.3	17.2	19.0
Malta	71.7	69.7	64.1	62.1	62.2	67.8	69.0	69.6	70.8	71.5	68.0	67.9
Netherlands	52.4	51.8	47.4	45.3	58.5	60.8	62.9	64.2	64.9	66.0	63.9	64.0
Austria	64.7	64.2	62.3	60.2	63.8	69.5	71.8	72.2	73.3	73.7	73.8	75.4
Portugal	57.6	62.8	63.9	68.3	71.6	83.0	93.3	101.6	111.0	112.1	101.7	107.4
Slovenia	27.3	26.7	26.4	23.1	21.9	35.3	38.8	45.5	50.1	54.6	42.8	46.0
Slovakia	41.5	34.2	30.5	29.6	27.8	35.5	41.0	44.5	47.5	51.1	44.8	46.8
Finland	44.4	41.7	39.6	35.2	33.9	43.3	48.3	49.1	51.8	53.5	50.6	52.2
Euro area	69.6	70.2	68.5	66.3	70.1	79.8	85.6	88.0	90.4	90.9	87.7	88.5
Bulgaria	37.0	27.5	21.6	17.2	13.7	14.6	16.3	17.5	18.3	18.5	18.0	18.6
Czech Republic	28.9	28.4	28.3	27.9	28.7	34.4	37.6	39.9	41.9	44.0	41.3	42.9
Denmark	45.1	37.8	32.1	27.5	34.5	41.8	43.7	44.1	44.6	44.8	45.3	47.1
Latvia	15.0	12.5	10.7	9.0	19.8	36.7	44.7	44.8	45.1	47.1	48.2	49.4
Lithuania	19.3	18.3	17.9	16.8	15.5	29.4	38.0	37.7	38.5	39.4	40.7	43.6
Hungary	59.1	61.7	65.9	67.0	72.9	79.7	81.3	75.9	76.5	76.7	75.2	72.7
Poland	45.7	47.1	47.7	45.0	47.1	50.9	54.9	56.7	57.1	57.5	55.4	55.1
Romania	18.7	15.8	12.4	12.8	13.4	23.6	31.0	34.0	35.8	35.9	33.7	34.8
Sweden	50.3	50.4	45.0	40.2	38.8	42.7	39.7	36.3	34.6	32.4	36.5	33.4
United Kingdom	40.9	42.5	43.4	44.4	54.8	69.6	79.9	84.0	88.8	85.9	84.2	87.9
EU	62.3	62.8	61.5	59.0	62.5	74.7	80.3	82.5	84.9	84.9	82.3	83.3

TABLE 41 : Gross national saving (as a percentage of GDP, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	24.8	26.0	25.3	26.8	25.1	20.5	23.4	**23.5**	**23.3**	**23.5**	*22.3*	*22.5*
Germany	21.3	20.6	21.8	26.8	25.6	22.3	23.1	**23.6**	**23.2**	**23.3**	*22.9*	*23.2*
Estonia	:	21.8	22.4	22.9	21.6	23.2	23.9	**26.8**	**26.6**	**26.6**	*26.4*	*25.9*
Ireland	18.6	23.5	22.6	21.1	15.5	10.8	11.6	**11.3**	**12.0**	**12.6**	*11.5*	*12.1*
Greece	18.5	14.0	11.1	8.8	5.8	4.0	3.9	**4.8**	**6.8**	**8.7**	*3.4*	*5.8*
Spain	20.6	22.3	22.5	21.0	19.5	19.3	18.8	**18.5**	**18.9**	**19.1**	*18.2*	*18.6*
France	18.4	20.9	19.4	20.6	20.1	17.0	17.1	**17.5**	**17.4**	**17.9**	*15.5*	*16.2*
Italy	20.6	21.3	20.4	20.8	18.8	17.2	16.9	**16.6**	**16.8**	**17.6**	*17.0*	*17.6*
Cyprus	:	16.0	13.8	10.5	11.7	6.2	8.9	**9.6**	**11.1**	**11.9**	*9.2*	*9.3*
Luxembourg	35.0	33.4	32.3	31.0	26.1	24.1	26.8	**25.5**	**23.1**	**22.5**	*25.2*	*25.3*
Malta	:	14.0	11.4	14.9	12.7	7.4	9.9	**10.0**	**10.4**	**11.3**	*13.4*	*14.1*
Netherlands	25.9	27.1	26.9	28.8	25.2	21.5	23.8	**25.2**	**26.3**	**26.7**	*26.1*	*26.9*
Austria	22.2	23.3	25.1	27.3	27.7	23.9	25.0	**26.1**	**26.1**	**26.7**	*24.8*	*25.4*
Portugal	19.4	19.1	15.1	12.7	10.6	9.2	9.3	**9.6**	**11.3**	**12.6**	*10.3*	*11.5*
Slovenia	23.5	24.3	25.2	27.5	24.9	21.2	21.8	**21.7**	**21.6**	**21.6**	*22.0*	*22.0*
Slovakia	:	23.7	19.9	22.2	21.4	16.3	19.8	**22.7**	**22.2**	**21.8**	*20.8*	*21.4*
Finland	17.8	26.5	25.9	27.1	25.5	21.2	21.4	**20.3**	**20.5**	**20.8**	*22.1*	*22.7*
Euro area	20.8	21.7	21.4	23.1	21.5	18.9	19.4	**19.7**	**19.9**	**20.3**	*19.1*	*19.7*
Bulgaria	:	:	16.0	8.8	14.4	20.4	23.9	**24.9**	**25.2**	**25.4**	*23.8*	*24.0*
Czech Republic	28.2	25.7	23.5	24.7	26.0	20.7	20.7	**21.8**	**21.6**	**21.3**	*20.5*	*21.2*
Denmark	19.9	22.0	24.0	24.7	24.5	20.7	21.6	**22.6**	**22.6**	**22.7**	*21.5*	*21.5*
Latvia	31.2	16.3	19.3	17.6	18.1	29.1	23.9	**23.5**	**23.9**	**24.7**	*21.3*	*21.4*
Lithuania	:	12.9	15.4	16.2	13.9	13.2	17.5	**16.5**	**17.3**	**18.3**	*18.5*	*19.4*
Hungary	:	20.0	16.5	15.0	16.6	17.8	19.4	**19.2**	**20.2**	**20.8**	*20.1*	*20.8*
Poland	16.8	19.0	16.2	18.3	17.3	16.5	16.3	**16.7**	**16.5**	**15.7**	*17.7*	*18.1*
Romania	22.0	13.7	17.2	17.4	19.8	21.2	22.3	**22.0**	**21.5**	**21.9**	*22.2*	*22.8*
Sweden	17.6	22.3	24.3	28.9	29.0	23.1	24.8	**26.1**	**26.0**	**26.3**	*25.6*	*25.9*
United Kingdom	15.2	16.3	14.8	15.7	15.2	12.8	12.7	**12.0**	**13.8**	**14.7**	*13.0*	*14.2*
EU	:	20.9	20.3	21.7	20.7	18.2	18.6	**18.9**	**19.2**	**19.6**	*18.5*	*19.1*
USA	15.0	17.7	14.6	14.1	12.8	10.8	11.9	**11.9**	**12.5**	**12.6**	*12.1*	*12.6*
Japan	31.6	28.5	26.7	28.5	26.8	23.0	23.8	**23.3**	**23.9**	**24.1**	*22.2*	*22.3*

TABLE 42 : Gross saving, private sector (as a percentage of GDP, 1992-2013) [1]

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	28.1	24.2	23.9	25.1	24.4	23.7	25.5	**24.9**	**25.7**	**26.1**	*23.9*	*24.4*
Germany	20.9	20.0	22.6	24.3	23.2	22.9	23.9	**22.4**	**21.9**	**21.8**	*22.7*	*22.4*
Estonia	:	17.7	16.6	15.3	18.5	21.2	21.7	**23.5**	**23.5**	**23.4**	*23.7*	*23.3*
Ireland	18.6	18.1	18.1	16.9	16.9	18.6	19.5	**18.6**	**18.3**	**18.2**	*18.8*	*18.0*
Greece	24.6	14.5	13.6	13.1	12.2	16.0	12.8	**12.0**	**12.6**	**14.0**	*10.8*	*13.9*
Spain	21.8	20.1	17.7	14.2	18.8	24.5	23.2	**21.8**	**21.6**	**21.3**	*20.6*	*20.2*
France	19.5	19.4	19.2	19.5	19.4	20.5	20.5	**19.7**	**19.1**	**19.3**	*18.3*	*18.7*
Italy	25.6	20.7	20.6	18.7	17.9	19.2	18.4	**17.9**	**16.9**	**16.8**	*18.3*	*18.2*
Cyprus	:	16.2	14.1	3.1	6.9	6.9	9.0	**11.3**	**11.6**	**12.2**	*9.9*	*9.9*
Luxembourg	:	24.4	26.1	23.0	18.9	20.0	22.5	**20.5**	**18.7**	**18.0**	*21.2*	*21.7*
Malta	:	17.7	13.1	14.5	14.8	9.2	11.8	**12.0**	**12.8**	**13.8**	*14.9*	*15.4*
Netherlands	26.4	24.1	24.9	25.4	21.1	22.2	24.4	**25.2**	**25.3**	**25.4**	*25.4*	*25.1*
Austria	21.7	21.5	23.5	24.9	25.3	24.4	25.4	**25.7**	**25.8**	**26.3**	*24.8*	*25.1*
Portugal	20.7	18.5	16.8	13.3	11.9	16.2	16.1	**14.5**	**14.1**	**14.6**	*14.7*	*14.8*
Slovenia	:	22.9	23.1	22.7	21.3	21.7	22.7	**21.8**	**22.5**	**23.0**	*22.4*	*22.7*
Slovakia	:	23.6	20.0	21.5	20.4	20.0	24.5	**25.0**	**24.5**	**24.6**	*22.7*	*23.2*
Finland	19.8	21.0	20.5	19.5	19.0	21.1	21.4	**18.8**	**18.8**	**18.9**	*20.4*	*20.7*
Euro area	22.2	20.4	20.7	20.5	20.2	21.5	21.7	**20.9**	**20.4**	**20.5**	*20.5*	*20.5*
Bulgaria	:	:	11.8	0.4	7.8	20.1	22.2	**22.8**	**22.4**	**22.1**	*22.7*	*21.6*
Czech Republic	:	22.4	20.7	20.2	22.8	21.5	21.3	**21.9**	**21.3**	**21.1**	*20.5*	*20.5*
Denmark	20.4	19.4	20.1	18.3	19.0	21.4	21.9	**24.6**	**24.3**	**23.0**	*23.2*	*22.5*
Latvia	:	15.2	16.6	11.8	17.5	34.0	25.7	**21.8**	**22.1**	**23.3**	*21.9*	*21.0*
Lithuania	:	11.6	13.2	12.6	12.8	19.8	22.2	**19.2**	**18.2**	**18.8**	*21.9*	*22.4*
Hungary	:	19.3	18.8	15.4	16.8	19.4	21.8	**22.5**	**20.5**	**21.5**	*23.0*	*21.9*
Poland	:	18.8	17.0	15.8	16.0	18.2	19.1	**17.6**	**16.3**	**15.0**	*18.6*	*17.3*
Romania	:	14.2	13.9	13.8	18.6	24.2	23.3	**20.6**	**19.1**	**19.1**	*20.3*	*19.9*
Sweden	21.4	18.4	20.9	22.2	23.6	20.5	21.4	**22.2**	**22.3**	**22.3**	*21.3*	*20.6*
United Kingdom	18.6	14.6	15.6	16.0	16.8	19.5	19.4	**18.3**	**18.9**	**18.0**	*18.5*	*18.4*
EU	:	19.4	19.7	19.4	19.6	21.1	21.3	**20.5**	**20.2**	**20.1**	*20.2*	*20.1*
USA	17.1	15.3	15.8	14.4	16.2	18.7	19.4	**18.8**	**18.1**	**14.7**	*18.9*	*17.6*
Japan	26.6	27.7	28.4	28.2	27.2	29.2	28.2	**28.6**	**29.1**	**29.2**	*29.8*	*30.0*

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 43 : Saving rate of households (1992-2013) [1] | 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	20.1	17.4	16.1	16.4	16.8	18.4	16.2	**15.9**	**16.9**	**16.8**	*16.5*	*16.5*
Germany	17.0	15.5	16.1	16.8	17.4	17.0	17.0	**16.8**	**16.7**	**16.6**	*17.1*	*16.9*
Estonia	:	4.1	-3.2	-1.8	3.4	11.6	9.6	**7.7**	**6.9**	**6.2**	*7.7*	*5.4*
Ireland	:	:	7.6	7.6	11.1	14.7	13.4	**14.9**	**12.8**	**11.4**	*18.1*	*16.1*
Greece	:	9.1	1.9	8.1	0.3	3.0	-3.0	**-0.1**	**1.3**	**2.3**	*3.2*	*5.0*
Spain	:	11.9	11.1	10.4	13.5	18.5	13.9	**11.8**	**11.7**	**11.2**	*11.0*	*11.0*
France	14.8	14.7	15.1	15.1	15.3	16.2	15.6	**15.5**	**15.6**	**15.5**	*15.3*	*15.7*
Italy	23.3	16.6	16.0	14.7	14.6	14.2	12.6	**11.9**	**11.9**	**11.7**	*13.2*	*13.1*
Cyprus	:	10.6	10.4	6.9	4.9	11.4	11.6	**:**	**:**	**:**	*:*	*:*
Luxembourg	:	:	:	10.9	12.0	13.5	:	**:**	**:**	**:**	*:*	*:*
Malta	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*
Netherlands	18.9	15.1	12.9	13.0	12.2	12.9	10.9	**11.3**	**12.0**	**12.5**	*12.4*	*12.8*
Austria	:	13.5	14.0	16.3	16.3	15.7	13.5	**12.5**	**12.4**	**12.4**	*14.9*	*15.0*
Portugal	:	10.6	9.8	7.0	7.1	10.9	9.8	**9.4**	**9.5**	**9.6**	*10.5*	*11.5*
Slovenia	:	14.2	16.2	16.2	15.2	15.0	15.7	**15.1**	**15.6**	**15.6**	*14.5*	*14.6*
Slovakia	:	11.4	6.7	7.2	6.1	7.8	11.3	**10.9**	**10.6**	**10.4**	*8.6*	*8.2*
Finland	11.6	8.6	8.3	7.2	8.1	11.9	11.3	**7.5**	**7.3**	**7.1**	*9.3*	*8.7*
Euro area	:	:	14.2	14.2	14.6	15.6	14.3	**13.8**	**13.8**	**13.7**	*14.3*	*14.3*
Bulgaria	:	:	-21.3	-27.4	:	:	:	**:**	**:**	**:**	*:*	*:*
Czech Republic	:	10.7	9.4	10.3	9.4	10.7	10.3	**11.0**	**11.4**	**11.4**	*8.8*	*8.3*
Denmark	7.3	5.6	7.0	4.2	5.0	7.7	6.0	**8.5**	**8.7**	**6.6**	*8.0*	*7.1*
Latvia	5.4	-1.1	1.0	-5.7	4.9	10.3	4.2	**2.2**	**3.1**	**2.8**	*-0.1*	*-2.4*
Lithuania	:	4.9	1.9	-4.2	-3.0	7.1	7.9	**:**	**:**	**:**	*:*	*:*
Hungary	:	14.1	10.3	8.4	8.0	9.9	8.1	**:**	**:**	**:**	*:*	*:*
Poland	:	13.5	9.9	8.5	3.7	9.9	9.4	**7.5**	**7.2**	**7.5**	*8.2*	*7.5*
Romania	:	0.3	-8.7	-11.5	-1.1	0.0	:	**:**	**:**	**:**	*:*	*:*
Sweden	10.7	6.9	9.5	11.6	13.9	15.6	13.4	**14.0**	**14.9**	**15.0**	*13.8*	*13.8*
United Kingdom	10.3	6.6	4.2	2.6	2.0	6.0	5.3	**7.7**	**7.3**	**7.6**	*6.1*	*7.1*
EU	:	:	11.6	10.9	11.1	13.2	12.6	**12.5**	**12.6**	**12.5**	*12.7*	*12.9*
USA	9.9	7.8	7.3	7.1	9.9	9.8	9.7	**9.1**	**9.3**	**9.1**	*7.8*	*7.4*
Japan	19.5	15.7	10.9	9.2	8.9	11.3	9.7	**13.3**	**13.7**	**14.5**	*13.6*	*13.7*

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 44 : Gross saving, general government (as a percentage of GDP, 1992-2013) [1]

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	-3.3	1.7	1.4	1.8	0.7	-3.2	-2.1	**-1.5**	**-2.3**	**-2.6**	*-1.5*	*-1.9*
Germany	0.5	0.6	-0.7	2.5	2.4	-0.6	-0.8	**1.1**	**1.3**	**1.6**	*0.2*	*0.8*
Estonia	:	4.0	5.8	7.6	3.2	1.9	2.2	**3.3**	**3.1**	**3.1**	*2.6*	*2.5*
Ireland	0.0	5.4	4.5	4.1	-1.4	-7.8	-7.9	**-7.3**	**-6.3**	**-5.6**	*-7.3*	*-5.9*
Greece	-6.1	-0.5	-2.5	-4.4	-6.5	-11.9	-8.9	**-7.2**	**-5.8**	**-5.3**	*-7.4*	*-8.1*
Spain	-1.1	2.1	4.8	6.8	0.7	-5.3	-4.3	**-3.2**	**-2.7**	**-2.2**	*-2.3*	*-1.5*
France	-1.1	1.4	0.2	1.1	0.6	-3.4	-3.4	**-2.2**	**-1.7**	**-1.4**	*-2.8*	*-2.5*
Italy	-5.0	0.6	-0.2	2.1	0.8	-2.0	-1.5	**-1.3**	**0.0**	**0.9**	*-1.3*	*-0.6*
Cyprus	:	-0.2	-0.3	7.4	4.8	-0.7	-0.1	**-1.7**	**-0.5**	**-0.3**	*-0.6*	*-0.6*
Luxembourg	:	9.0	6.2	8.0	7.1	4.1	4.2	**4.9**	**4.4**	**4.5**	*4.0*	*3.6*
Malta	:	-3.7	-1.7	0.4	-2.0	-1.7	-1.9	**-2.0**	**-2.4**	**-2.5**	*-1.5*	*-1.4*
Netherlands	-0.4	3.0	2.0	3.4	4.1	-0.7	-0.6	**0.0**	**1.0**	**1.2**	*0.7*	*1.8*
Austria	0.5	1.8	1.6	2.5	2.3	-0.5	-0.4	**0.3**	**0.3**	**0.3**	*0.0*	*0.3*
Portugal	-1.2	0.6	-1.7	-0.7	-1.4	-7.0	-6.8	**-4.9**	**-2.8**	**-2.0**	*-4.3*	*-3.3*
Slovenia	:	1.4	2.1	4.7	3.6	-0.5	-0.8	**-0.1**	**-0.9**	**-1.3**	*-0.5*	*-0.7*
Slovakia	:	0.2	-0.1	0.7	1.0	-3.7	-4.7	**-2.3**	**-2.3**	**-2.7**	*-1.9*	*-1.8*
Finland	-2.0	5.5	5.5	7.5	6.5	0.1	0.0	**1.5**	**1.7**	**1.8**	*1.7*	*2.0*
Euro area	-1.5	1.3	0.7	2.6	1.3	-2.6	-2.3	**-1.1**	**-0.6**	**-0.2**	*-1.4*	*-0.8*
Bulgaria	:	4.1	4.1	8.4	6.6	0.3	1.7	**2.1**	**2.8**	**3.3**	*1.1*	*2.3*
Czech Republic	:	3.2	2.8	4.5	3.2	-0.9	-0.6	**-0.1**	**0.3**	**0.2**	*0.0*	*0.6*
Denmark	-0.6	2.6	3.9	6.5	5.5	-0.7	-0.4	**-2.0**	**-1.7**	**-0.4**	*-1.6*	*-0.9*
Latvia	:	1.1	2.8	5.8	0.5	-4.8	-1.8	**1.7**	**1.8**	**1.4**	*-0.6*	*0.4*
Lithuania	:	1.4	2.2	3.6	1.1	-6.6	-4.7	**-2.7**	**-0.8**	**-0.5**	*-3.4*	*-3.0*
Hungary	:	0.6	-2.4	-0.4	-0.2	-1.6	-2.3	**-3.3**	**-0.2**	**-0.7**	*-2.9*	*-1.1*
Poland	:	0.2	-0.8	2.5	1.3	-1.8	-2.8	**-0.9**	**0.2**	**0.7**	*-0.9*	*0.7*
Romania	:	-0.5	3.4	3.6	1.2	-3.0	-1.0	**1.4**	**2.4**	**2.9**	*1.9*	*3.0*
Sweden	-3.8	3.9	3.4	6.7	5.4	2.6	3.4	**3.9**	**3.8**	**4.0**	*4.3*	*5.2*
United Kingdom	-3.4	1.7	-0.8	-0.3	-1.6	-6.7	-6.7	**-6.3**	**-5.1**	**-3.4**	*-5.4*	*-4.3*
EU	:	1.5	0.6	2.3	1.1	-2.9	-2.7	**-1.7**	**-1.0**	**-0.4**	*-1.7*	*-1.0*
USA	-2.0	2.4	-1.3	-0.2	-3.4	-7.9	-7.6	**-6.9**	**-5.6**	**-2.1**	*-6.8*	*-5.1*
Japan	5.0	0.8	-1.7	0.3	-0.4	-6.2	-4.5	**-5.3**	**-5.1**	**-5.1**	*-7.5*	*-7.7*

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 45 : Exports of goods and services, volume (percentage change on preceding year, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	4.0	6.3	3.7	5.2	1.7	-11.2	9.9	5.1	2.6	4.7	5.9	5.5
Germany	2.7	8.9	7.6	8.0	2.7	-13.6	13.7	7.8	3.9	6.2	7.6	6.5
Estonia	:	13.0	8.9	3.7	0.6	-18.6	22.5	25.2	3.8	6.0	16.0	6.4
Ireland	14.3	17.0	4.5	8.4	-1.1	-4.2	6.3	4.5	3.8	4.3	6.0	5.2
Greece	4.2	11.2	3.2	6.9	3.0	-19.5	4.2	4.8	6.5	6.5	10.7	6.9
Spain	10.3	8.9	3.8	6.7	-1.0	-10.4	13.5	8.3	3.8	4.5	7.0	5.8
France	5.1	8.0	2.6	2.3	-0.3	-12.4	9.7	4.9	3.5	4.9	6.7	6.6
Italy	7.7	3.4	2.7	6.2	-2.8	-17.5	12.2	3.8	2.3	4.5	6.0	5.7
Cyprus	:	6.1	1.6	6.1	-0.3	-11.3	0.6	3.5	2.5	4.0	4.1	4.3
Luxembourg	4.4	10.7	7.4	9.1	4.0	-10.9	2.8	2.8	-0.6	5.9	6.8	6.5
Malta	:	4.0	3.5	2.7	2.6	-8.9	18.3	4.5	3.9	5.2	6.1	6.1
Netherlands	5.8	8.3	4.7	6.4	2.0	-8.1	10.8	5.5	3.2	4.3	6.4	6.0
Austria	3.2	9.1	6.1	8.9	1.4	-14.3	8.3	6.8	3.8	6.4	7.0	6.8
Portugal	7.5	5.9	4.4	7.6	-0.1	-11.6	8.8	6.6	4.2	6.1	6.2	5.9
Slovenia	-2.1	7.9	9.0	13.7	2.9	-17.2	9.5	7.8	4.2	5.9	6.7	6.9
Slovakia	:	10.8	11.7	14.3	3.1	-15.9	16.5	7.8	2.4	6.3	8.5	8.2
Finland	10.8	10.5	5.6	8.2	5.9	-21.5	8.6	-0.3	3.4	5.0	8.5	5.5
Euro area	5.8	8.0	5.0	6.6	1.0	-12.8	11.3	6.1	3.4	5.3	6.9	6.2
Bulgaria	:	3.2	11.0	6.1	3.0	-11.2	16.2	10.9	4.7	5.9	7.7	7.1
Czech Republic	9.9	11.1	9.7	11.2	4.0	-10.0	16.4	9.8	3.8	7.0	9.8	10.3
Denmark	3.4	7.2	4.5	2.8	2.8	-9.7	3.8	6.5	3.4	4.8	4.7	4.3
Latvia	:	5.8	9.2	10.0	2.0	-14.1	11.5	11.0	5.8	6.2	8.6	6.6
Lithuania	:	6.7	12.0	3.1	11.4	-12.5	17.4	12.2	6.3	6.5	11.2	7.1
Hungary	11.5	15.2	10.9	15.0	5.7	-10.2	14.3	9.1	7.2	7.9	9.6	9.2
Poland	12.2	9.7	11.0	9.1	7.1	-6.8	12.1	7.3	5.1	5.6	7.7	7.6
Romania	11.2	11.1	11.6	7.8	8.3	-6.4	13.1	7.3	4.3	5.9	8.4	7.3
Sweden	7.8	8.3	6.3	5.7	1.7	-13.2	11.1	7.8	3.3	5.0	7.6	5.1
United Kingdom	7.2	5.6	5.6	-1.3	1.3	-9.5	6.2	5.1	3.4	4.8	8.9	7.5
EU	7.0	7.8	5.4	5.8	1.5	-12.0	10.8	6.3	3.6	5.3	7.3	6.5
USA	7.4	4.1	4.9	9.3	6.1	-9.4	11.3	6.6	5.9	7.7	7.8	9.3
Japan	3.7	2.9	9.4	8.4	1.6	-23.9	23.9	1.4	3.2	4.9	1.0	3.8

TABLE 46 : Imports of goods and services, volume (percentage change on preceding year, 1992-2013)

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	4.0	5.8	3.4	5.5	3.1	-10.7	8.7	5.2	2.6	4.5	5.4	5.5
Germany	3.1	7.6	6.0	5.4	3.3	-9.2	11.7	7.9	5.8	7.2	7.5	7.2
Estonia	:	12.4	12.4	6.3	-6.3	-32.4	20.6	26.4	4.7	6.4	16.9	7.1
Ireland	12.0	16.9	5.0	7.9	-3.0	-9.3	2.7	1.6	2.6	3.1	3.2	4.0
Greece	3.8	10.8	2.8	14.6	3.3	-20.2	-7.2	-6.2	-3.2	0.7	-8.4	-3.1
Spain	6.4	11.4	7.5	8.0	-5.2	-17.2	8.9	1.6	1.5	3.2	1.7	3.8
France	3.2	8.6	3.8	5.5	0.9	-10.8	8.8	6.1	3.3	4.6	6.8	7.5
Italy	2.1	6.4	3.7	5.2	-3.0	-13.4	12.7	2.0	0.6	3.4	4.6	5.1
Cyprus	:	4.7	4.0	13.3	8.1	-19.3	3.1	0.8	2.3	2.5	2.2	2.5
Luxembourg	3.6	11.1	7.2	9.3	5.6	-12.0	4.6	4.1	-0.9	6.8	8.0	7.0
Malta	:	1.7	4.4	1.4	-0.4	-10.1	12.9	2.7	3.5	4.9	6.4	5.6
Netherlands	5.5	8.9	4.4	5.6	2.3	-8.0	10.6	5.2	2.2	4.1	5.8	6.1
Austria	3.3	6.7	5.0	7.1	0.0	-13.8	8.0	6.4	3.7	6.4	5.9	6.3
Portugal	7.0	8.0	3.2	5.5	2.3	-10.6	5.1	-5.0	-5.2	1.2	-5.3	-2.8
Slovenia	3.1	7.7	8.7	16.7	3.7	-19.6	7.2	4.4	3.7	6.1	5.2	6.1
Slovakia	:	9.6	10.0	9.2	3.1	-18.1	16.3	4.7	1.6	5.2	5.9	7.3
Finland	6.0	8.4	6.6	7.0	7.3	-16.1	7.4	1.1	3.5	4.8	7.2	5.1
Euro area	3.9	8.3	5.0	6.2	0.9	-11.7	9.6	4.8	3.0	5.0	5.4	5.9
Bulgaria	:	11.5	14.1	9.6	4.2	-21.0	4.5	7.0	4.5	6.2	7.0	6.8
Czech Republic	20.1	9.3	7.7	12.8	2.7	-11.6	16.0	7.7	3.1	7.1	8.4	9.7
Denmark	4.3	7.2	7.5	4.3	2.7	-12.5	3.9	4.4	4.4	6.1	5.0	4.9
Latvia	:	7.3	13.6	16.1	-10.8	-33.3	11.5	14.9	7.0	7.7	8.6	7.7
Lithuania	:	7.5	14.6	10.6	10.3	-28.3	17.3	13.9	6.2	7.0	12.0	8.0
Hungary	11.9	16.0	10.4	12.8	5.5	-14.8	12.8	7.1	6.4	7.9	9.3	8.6
Poland	15.3	9.7	9.9	13.7	8.0	-12.4	13.9	7.0	3.5	5.1	8.5	7.5
Romania	8.1	13.1	17.8	27.3	7.9	-20.5	11.6	4.7	4.5	8.5	6.6	8.1
Sweden	4.5	7.6	5.0	9.0	3.5	-13.8	12.7	7.6	2.9	4.8	7.3	5.0
United Kingdom	6.2	8.2	6.3	-0.9	-1.2	-12.2	8.5	0.2	0.5	1.4	4.0	2.5
EU	5.4	8.4	5.6	6.0	1.2	-12.2	9.8	4.6	2.9	4.8	5.6	5.7
USA	8.8	9.2	6.2	2.4	-2.7	-13.6	12.5	5.8	5.5	8.0	6.7	9.3
Japan	6.5	1.3	4.6	1.6	0.4	-15.3	9.8	4.1	2.5	4.1	4.5	3.7

TABLE 47 : Merchandise trade balance (fob-fob, as a percentage of GDP, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	3.1	3.0	3.4	1.6	-1.5	-0.4	0.3	-0.7	-0.9	-0.7	0.7	0.5
Germany	2.3	3.5	6.6	8.2	7.3	5.7	6.4	5.5	4.9	4.7	5.8	5.7
Estonia	:	-16.6	-15.7	-16.0	-12.1	-4.0	-2.3	-2.7	-3.0	-3.1	-2.6	-3.0
Ireland	16.5	22.9	20.5	10.4	13.2	20.2	23.4	23.7	25.0	25.9	27.1	28.6
Greece	-12.0	-15.4	-17.8	-20.0	-20.8	-16.0	-13.8	-12.8	-11.9	-11.4	-13.0	-12.3
Spain	-3.3	-4.6	-6.5	-8.6	-7.8	-4.0	-4.5	-4.2	-4.0	-3.7	-4.2	-4.0
France	0.7	1.0	-0.5	-2.1	-2.7	-2.2	-2.6	-3.8	-4.0	-3.9	-3.1	-3.3
Italy	2.7	2.1	0.4	0.2	-0.1	0.1	-1.3	-1.6	-0.9	-0.2	-1.5	-1.3
Cyprus	:	-24.8	-26.0	-29.8	-32.2	-25.1	-26.9	-27.1	-28.0	-28.2	-27.0	-27.2
Luxembourg	-10.2	-12.7	-10.5	-8.8	-10.7	-8.6	-9.5	-10.7	-10.1	-9.7	-9.2	-9.4
Malta	-22.4	-17.5	-14.7	-18.0	-21.0	-18.1	-16.0	-15.1	-15.1	-15.2	-16.0	-15.8
Netherlands	5.0	5.3	7.2	7.6	7.3	6.2	6.9	7.3	8.3	8.5	8.3	8.7
Austria	-4.2	-2.2	-0.1	0.4	-0.3	-0.8	-1.1	-1.6	-1.9	-2.1	-1.1	-1.2
Portugal	-9.8	-10.8	-10.1	-10.9	-12.9	-10.1	-10.0	-7.2	-4.0	-2.7	-8.0	-5.9
Slovenia	-1.1	-4.4	-2.9	-4.9	-7.2	-2.1	-3.5	-3.2	-3.1	-3.1	-3.4	-3.3
Slovakia	:	-8.6	-5.2	-1.8	-1.6	1.1	-0.1	1.9	2.0	2.2	0.6	1.2
Finland	7.3	9.8	6.6	5.1	3.7	1.7	1.6	0.6	0.7	0.8	1.6	1.7
Euro area	1.1	1.5	1.5	0.8	0.2	0.7	0.6	0.2	0.3	0.5	0.6	0.7
Euro area, adjusted [1]	:	:	:	:	-0.2	0.4	0.2	-0.2	-0.1	0.1	0.4	0.5
Bulgaria	-2.6	-5.3	-16.8	-23.6	-24.3	-12.0	-6.7	-4.6	-4.4	-4.6	-7.5	-8.2
Czech Republic	-4.9	-4.4	0.0	1.3	0.6	2.3	1.3	2.3	2.6	2.9	3.8	4.4
Denmark	4.1	3.7	3.4	0.1	0.2	2.6	2.9	3.2	3.1	3.0	3.1	3.1
Latvia	-7.0	-14.8	-19.8	-24.0	-17.8	-7.1	-7.1	-8.2	-9.1	-10.0	-6.8	-7.5
Lithuania	:	-11.3	-10.8	-14.9	-12.9	-3.2	-4.6	-5.2	-5.2	-5.7	-5.0	-5.5
Hungary	-5.7	-4.6	-3.3	-0.8	-1.2	2.5	3.2	4.6	6.2	6.7	5.0	5.9
Poland	-0.1	-6.4	-2.3	-4.0	-4.9	-1.0	-1.8	-1.8	-1.3	-1.6	-2.2	-2.0
Romania	-6.3	-5.6	-8.8	-14.3	-13.6	-5.8	-4.8	-3.8	-3.9	-4.0	-4.9	-5.1
Sweden	5.1	7.2	6.4	4.7	3.7	3.3	2.5	2.7	2.6	2.8	2.5	2.3
United Kingdom	-1.8	-2.9	-5.0	-6.4	-6.6	-5.9	-6.8	-6.3	-5.6	-5.0	-6.1	-4.7
EU	-0.4	0.7	0.3	-0.7	-1.1	-0.3	-0.4	-0.6	-0.5	-0.3	-0.3	0.0
EU, adjusted [1]				-1.3	-1.8	-0.7	-1.0	-1.2	-1.0	-0.8	-0.7	-0.5
USA	-2.1	-3.6	-5.7	-6.0	-6.0	-3.8	-4.6	-5.1	-5.0	-5.4	-5.3	-5.6
Japan	2.7	2.5	2.3	2.4	0.8	0.9	1.7	1.2	1.2	1.1	0.2	-0.1

[1] See note 7 on concepts and sources.

TABLE 48 : Current-account balance (as a percentage of GDP, 1992-2013)

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	4.3	4.5	4.5	3.9	1.1	0.7	3.2	2.4	2.1	2.4	2.0	2.0
Germany	-1.0	-0.9	4.0	7.5	6.2	5.8	5.8	5.1	4.4	4.2	4.7	4.6
Estonia	:	-7.4	-11.8	-15.7	-9.1	4.6	3.8	3.1	1.5	0.7	1.8	0.1
Ireland	2.6	1.0	-1.3	-5.5	-5.6	-2.9	0.5	0.7	1.5	1.8	1.2	1.8
Greece	-0.5	-6.7	-11.9	-16.9	-17.9	-14.3	-12.3	-9.9	-7.9	-6.9	-8.3	-6.1
Spain	-1.4	-2.4	-6.0	-10.0	-9.6	-5.1	-4.5	-3.4	-3.0	-3.0	-4.1	-4.1
France	0.7	2.2	0.0	-1.4	-1.9	-2.1	-2.2	-3.2	-3.3	-3.0	-3.9	-4.2
Italy	1.0	1.2	-0.8	-1.3	-2.9	-2.0	-3.5	-3.6	-3.0	-2.3	-3.5	-3.3
Cyprus	:	-1.3	-5.0	-11.7	-11.9	-10.6	-9.0	-7.3	-6.7	-6.1	-8.1	-7.2
Luxembourg	12.8	10.0	10.5	10.1	5.3	7.0	8.1	5.3	3.4	2.9	7.8	7.6
Malta	:	-6.3	-5.0	-6.3	-5.1	-7.3	-4.0	-3.1	-2.9	-2.6	-4.7	-4.5
Netherlands	4.6	4.8	7.5	8.4	4.7	2.9	5.1	5.5	7.0	6.9	7.7	8.3
Austria	-2.5	-1.4	2.4	4.0	4.9	3.0	3.2	2.7	2.8	2.9	2.6	2.8
Portugal	-5.5	-8.8	-8.9	-10.2	-12.6	-10.8	-9.7	-7.6	-5.0	-3.8	-7.5	-5.2
Slovenia	2.5	-1.7	-1.3	-4.5	-7.0	-1.3	-0.8	0.1	0.3	0.5	-1.4	-1.9
Slovakia	:	-6.5	-7.5	-5.6	-6.3	-3.6	-3.6	-0.7	-1.2	-1.9	-2.8	-2.6
Finland	0.1	6.4	5.6	4.2	3.2	2.7	2.8	-0.1	0.0	0.1	2.5	2.5
Euro area	0.3	0.4	0.6	0.4	-0.7	-0.1	0.1	-0.1	0.0	0.2	-0.2	-0.1
Euro area, adjusted [1]	:	:	:	:	-1.5	-0.3	-0.4	-0.6	-0.5	-0.3	0.1	0.2
Bulgaria	-4.3	-2.3	-8.7	-25.2	-23.2	-9.0	-1.0	1.6	1.4	0.9	-2.0	-2.6
Czech Republic	-1.9	-3.6	-3.8	-5.1	-2.9	-3.4	-4.4	-3.6	-3.2	-3.5	-2.5	-1.9
Denmark	1.8	1.2	3.3	1.4	2.7	3.6	5.2	6.3	5.8	5.4	5.2	5.1
Latvia	6.0	-7.3	-12.6	-22.4	-13.1	8.6	3.0	-0.4	-1.1	-2.0	-0.3	-1.6
Lithuania	:	-8.6	-7.3	-15.0	-13.0	2.8	1.1	-1.7	-1.9	-2.3	0.2	-0.6
Hungary	:	-6.3	-8.1	-7.4	-6.9	-0.2	1.0	1.7	3.2	3.8	1.6	1.9
Poland	0.3	-4.8	-3.4	-6.2	-6.6	-3.9	-4.6	-5.0	-4.3	-4.8	-4.1	-4.1
Romania	:	-5.4	-6.3	-13.6	-11.4	-4.2	-4.2	-4.1	-5.0	-5.3	-4.4	-4.8
Sweden	1.2	4.7	6.7	8.6	8.8	6.8	6.3	6.4	6.3	6.4	6.2	5.9
United Kingdom	-1.4	-1.5	-2.3	-2.6	-1.8	-1.4	-2.5	-2.5	-0.9	-0.2	-1.2	-0.1
EU	-0.2	0.0	0.1	-0.4	-1.0	-0.3	-0.2	-0.3	0.0	0.2	-0.2	0.0
EU, adjusted [1]				-1.0	-2.0	-0.8	-0.8	-0.8	-0.4	-0.2	-0.6	-0.3
USA	-2.6	-2.1	-4.7	-5.0	-4.8	-3.3	-3.3	-3.3	-3.1	-3.5	-4.0	-4.0
Japan	2.4	2.5	3.5	4.8	3.2	2.8	3.5	2.9	2.9	2.8	1.4	1.1

[1] See note 7 on concepts and sources.

TABLE 49 : Net lending (+) or net borrowing (-) of the nation (as a percentage of GDP, 1992-2013) 24.10.2011

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	4.1	4.5	4.5	3.6	0.6	0.3	3.1	2.3	2.1	2.3	1.8	1.8
Germany	-1.1	-0.8	4.0	7.5	6.2	5.8	5.8	5.1	4.4	4.2	4.7	4.6
Estonia	:	-7.0	-10.9	-14.7	-7.9	8.1	7.4	6.2	4.0	3.2	5.4	2.4
Ireland	3.4	1.7	-1.1	-5.5	-5.6	-3.7	0.1	0.4	1.4	1.5	0.9	1.4
Greece	:	-5.0	-10.4	-14.7	-16.2	-13.3	-10.6	-7.8	-5.4	-4.4	-6.4	-4.0
Spain	-0.7	-1.4	-5.1	-9.6	-9.2	-4.7	-4.0	-2.9	-2.5	-2.5	-3.6	-3.5
France	0.7	2.2	-0.1	-1.3	-1.9	-2.1	-2.2	-3.1	-3.1	-2.8	-2.9	-2.9
Italy	1.1	1.4	-0.7	-1.2	-2.9	-2.0	-3.5	-3.6	-2.9	-2.3	-3.5	-3.2
Cyprus	:	-1.3	-4.6	-11.6	-11.9	-10.5	-8.8	-7.2	-6.6	-5.9	-7.9	-7.1
Luxembourg	:	:	10.3	9.7	4.7	6.3	7.5	5.3	3.4	2.9	7.8	7.6
Malta	:	-5.9	-3.4	-5.0	-4.6	-5.6	-2.2	-1.7	-1.5	-1.2	-3.3	-3.0
Netherlands	4.2	4.6	7.2	8.2	4.4	2.4	4.6	5.0	6.4	6.5	7.1	7.7
Austria	-2.6	-1.5	2.3	4.0	4.8	3.0	3.3	2.5	2.8	2.9	1.7	2.1
Portugal	-2.9	-6.7	-7.2	-8.9	-11.4	-9.7	-8.4	-6.1	-3.5	-2.4	-6.0	-3.7
Slovenia	2.4	-1.7	-1.8	-4.7	-6.9	-1.3	-0.8	-0.9	0.6	0.8	-2.0	-1.3
Slovakia	:	-6.7	-7.9	-5.2	-5.4	-2.7	-2.0	1.2	0.3	-0.3	-0.7	-0.2
Finland	0.1	6.5	5.7	4.3	3.3	2.8	2.9	0.0	0.1	0.2	2.6	2.6
Euro area	0.3	0.7	0.8	0.7	-0.5	0.0	0.2	0.0	0.2	0.4	0.1	0.3
Euro area, adjusted [1]	:	:	:	:	-1.3	-0.1	-0.3	-0.5	-0.3	-0.1	0.4	0.6
Bulgaria	-4.6	-2.1	-8.2	-27.2	-22.4	-7.6	-0.3	2.1	2.0	1.6	-1.3	-1.8
Czech Republic	-2.8	-3.5	-3.4	-4.5	-2.0	-1.3	-2.3	-1.5	-1.2	-1.6	-0.4	-0.2
Denmark	1.8	1.4	3.3	1.4	2.7	3.5	5.2	6.4	5.9	5.4	4.9	4.8
Latvia	11.9	-7.0	-11.7	-20.4	-11.6	11.1	4.9	1.7	1.0	0.5	3.1	1.5
Lithuania	:	-8.5	-6.6	-12.9	-11.1	7.1	4.9	2.1	2.2	1.7	3.9	2.9
Hungary	:	-6.1	-7.7	-6.6	-5.9	1.0	2.8	3.6	6.5	7.1	3.2	3.9
Poland	2.0	-4.8	-3.1	-5.1	-5.4	-2.2	-2.8	-2.2	-1.4	-2.3	-1.0	-1.3
Romania	-3.8	-5.2	-5.7	-13.0	-11.0	-3.6	-4.0	-3.9	-4.8	-5.1	-4.2	-4.6
Sweden	0.8	4.3	6.6	8.5	8.7	6.6	6.2	6.2	6.1	6.2	6.1	5.8
United Kingdom	-1.3	-1.4	-2.2	-2.4	-1.5	-1.2	-2.3	-2.3	-0.7	0.0	-1.0	0.1
EU	-0.6	-0.6	-0.9	-3.0	-3.0	-0.8	0.0	-0.1	0.3	0.5	0.2	0.4
EU, adjusted [1]				-3.6	-4.0	-1.4	-0.6	-0.5	-0.1	0.1	-0.2	0.1
USA	-2.6	-2.1	-4.6	-5.0	-4.7	-3.3	-3.3	-3.3	-3.2	-3.5	-4.0	-4.0
Japan	2.4	2.3	3.4	4.7	3.1	2.7	3.4	2.8	2.8	2.7	1.3	1.0

[1] See note 7 on concepts and sources.

TABLE 50 : Current-account balance (in billions of euro, 2004-2013)

								Autumn 2011 forecast			Spring 2011 forecast	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	13.2	9.7	10.8	13.2	3.7	2.3	11.2	8.8	8.1	9.4	7.4	7.8
Germany	102.5	113.3	150.0	182.5	154.1	136.7	143.7	130.3	116.3	112.5	122.9	123.7
Estonia	-1.1	-1.1	-2.1	-2.5	-1.5	0.6	0.5	0.5	0.3	0.1	0.3	0.0
Ireland	-0.2	-4.9	-6.6	-10.4	-10.2	-4.7	0.7	1.2	2.5	3.0	1.8	2.9
Greece	-19.4	-20.9	-27.2	-37.7	-41.7	-33.1	-28.0	-21.7	-16.8	-14.8	-18.6	-13.8
Spain	-49.5	-67.8	-88.9	-105.2	-104.3	-53.8	-47.3	-36.7	-33.3	-33.6	-44.5	-45.2
France	2.9	-13.7	-14.8	-25.7	-36.6	-39.2	-43.3	-64.6	-67.1	-63.6	-78.7	-87.5
Italy	-4.9	-12.8	-22.3	-20.1	-45.2	-30.1	-53.8	-57.6	-48.3	-38.8	-56.4	-54.5
Cyprus	-0.7	-0.8	-1.1	-1.9	-2.0	-1.8	-1.6	-1.3	-1.3	-1.2	-1.5	-1.4
Luxembourg	3.3	3.5	3.5	3.8	2.1	2.6	3.3	2.2	1.5	1.3	3.4	3.6
Malta	-0.3	-0.4	-0.5	-0.3	-0.3	-0.4	-0.3	-0.2	-0.2	-0.2	-0.3	-0.3
Netherlands	42.2	38.4	48.7	48.1	28.1	16.4	30.1	33.4	43.3	44.4	47.6	53.1
Austria	5.2	5.3	8.5	10.9	13.7	8.1	9.3	8.0	8.6	9.2	7.7	8.7
Portugal	-12.3	-15.9	-17.2	-17.2	-21.7	-18.1	-16.8	-13.0	-8.4	-6.6	-12.7	-8.8
Slovenia	-0.7	-0.5	-0.7	-1.6	-2.6	-0.5	-0.3	0.0	0.1	0.2	-0.5	-0.7
Slovakia	-2.3	-3.3	-3.7	-3.1	-4.0	-2.2	-2.4	-0.5	-0.9	-1.4	-1.9	-1.9
Finland	9.6	5.5	7.7	7.6	5.9	4.7	3.3	-0.2	0.0	0.2	4.8	5.0
Euro area	87.4	33.6	44.1	40.2	-62.6	-12.4	8.4	-11.3	4.5	20.3	-19.1	-9.2
Euro area, adjusted [1]	:	:	:	:	-142.4	-25.7	-40.4	-60.1	-44.3	-28.5	11.1	21.0
Bulgaria	-1.3	-2.7	-4.7	-7.8	-8.2	-3.1	-0.4	0.6	0.6	0.4	-0.8	-1.1
Czech Republic	-3.8	-2.1	-3.1	-6.8	-4.5	-4.7	-6.5	-5.7	-5.1	-5.8	-3.8	-3.1
Denmark	5.9	9.0	6.5	3.1	6.2	7.9	12.1	15.0	14.3	13.8	12.7	12.8
Latvia	-1.4	-1.6	-3.6	-4.7	-3.0	1.6	0.5	-0.1	-0.2	-0.4	-0.1	-0.3
Lithuania	-1.4	-1.5	-2.5	-4.3	-4.2	0.7	0.1	-0.5	-0.6	-0.8	0.1	-0.2
Hungary	-7.8	-7.2	-6.8	-7.4	-7.3	-0.2	1.0	1.7	3.1	3.9	1.8	2.2
Poland	-10.8	-5.8	-10.4	-19.2	-23.9	-12.1	-16.4	-18.6	-15.7	-18.5	-15.7	-16.9
Romania	-3.5	-7.1	-10.4	-17.0	-16.0	-4.9	-5.1	-5.3	-6.7	-7.7	-5.8	-6.8
Sweden	19.7	21.1	25.2	29.0	29.4	19.7	22.0	24.6	24.7	25.9	24.0	23.7
United Kingdom	-37.0	-47.9	-64.7	-52.9	-31.6	-22.3	-53.5	-43.8	-15.9	-3.3	-21.2	-2.0
EU	46.0	-12.3	-30.4	-47.8	-125.6	-29.7	-37.7	-43.4	3.0	27.9	-27.9	-1.1
EU, adjusted [1]	:	-83.5	-139.6	-125.9	-251.8	-101.5	-96.7	-102.3	-56.0	-31.1	-71.2	-44.4
USA	-484.2	-519.0	-443.1	-514.0	-461.3	-326.9	-392.6	-356.5	-357.6	-404.4	-426.5	-436.4
Japan	138.5	133.4	136.0	153.8	108.2	102.1	145.6	125.4	132.9	131.7	55.1	43.5

[1] See note 7 on concepts and sources.

TABLE 51 : Export markets (a) (percentage change on preceding year, 2004-2013) 24.10.2011

								Autumn 2011 forecast			Spring 2011 forecast	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	:	6.1	8.8	5.3	2.1	-10.6	10.3	**5.6**	**3.7**	**5.3**	*6.4*	*6.6*
Germany	:	6.2	8.7	6.8	2.2	-11.7	10.5	**5.8**	**3.9**	**5.3**	*6.5*	*6.7*
Estonia	:	9.7	10.0	9.3	1.8	-17.7	9.6	**7.9**	**5.2**	**5.6**	*7.3*	*6.3*
Ireland	:	5.7	8.3	4.1	1.2	-11.5	10.7	**5.0**	**3.8**	**5.4**	*6.2*	*6.4*
Greece	:	6.5	8.7	5.7	1.7	-12.4	10.4	**5.7**	**3.9**	**5.4**	*6.2*	*6.5*
Spain	:	5.6	8.3	5.0	1.9	-10.6	9.8	**4.8**	**3.2**	**4.9**	*5.3*	*5.7*
France	:	6.0	8.6	5.9	1.8	-11.1	10.3	**5.4**	**3.9**	**5.4**	*6.0*	*6.3*
Italy	:	6.7	9.2	6.6	2.7	-11.0	9.9	**5.9**	**4.3**	**5.5**	*6.2*	*6.6*
Cyprus	:	8.3	10.8	6.7	2.2	-13.6	8.1	**6.9**	**5.0**	**5.4**	*4.6*	*5.0*
Luxembourg	:	5.3	7.9	4.9	1.6	-11.2	10.1	**5.0**	**3.6**	**5.0**	*6.0*	*6.1*
Malta	:	6.4	8.6	5.2	1.8	-11.7	10.3	**5.1**	**3.7**	**5.0**	*6.3*	*6.4*
Netherlands	:	5.8	8.8	5.5	2.3	-11.2	10.4	**5.7**	**4.0**	**5.5**	*6.3*	*6.4*
Austria	:	6.0	10.0	6.8	2.8	-11.5	11.3	**6.5**	**4.6**	**6.0**	*6.9*	*6.9*
Portugal	:	6.2	8.7	5.5	0.9	-12.6	9.7	**4.6**	**3.4**	**5.0**	*5.4*	*6.0*
Slovenia	:	5.5	9.3	7.3	2.7	-13.1	9.8	**5.9**	**3.9**	**5.6**	*6.3*	*6.5*
Slovakia	:	5.9	10.8	8.3	3.2	-12.3	11.7	**6.8**	**4.1**	**6.0**	*7.0*	*7.1*
Finland	:	8.4	10.6	8.7	3.6	-12.2	11.9	**7.7**	**4.8**	**5.8**	*7.3*	*6.9*
Euro area (b)	:	6.1	8.8	6.1	2.2	-11.3	10.4	**5.7**	**3.9**	**5.4**	*6.3*	*6.5*
Bulgaria	:	6.6	9.4	8.5	2.4	-12.8	9.4	**6.4**	**3.6**	**5.0**	*5.3*	*5.9*
Czech Republic	:	6.5	10.8	7.0	3.2	-12.3	11.2	**6.5**	**4.3**	**5.7**	*6.7*	*6.7*
Denmark	:	7.0	8.8	6.4	2.4	-11.4	11.4	**6.1**	**4.2**	**5.5**	*6.7*	*6.3*
Latvia	:	9.1	11.8	8.9	3.8	-17.0	12.5	**11.0**	**5.5**	**5.7**	*8.7*	*6.7*
Lithuania	:	10.2	12.0	11.1	2.5	-16.6	11.2	**10.7**	**6.2**	**5.4**	*8.1*	*6.8*
Hungary	:	6.2	10.2	7.8	3.5	-12.5	11.0	**6.5**	**4.3**	**5.7**	*6.5*	*6.7*
Poland	:	7.3	10.5	8.0	3.5	-12.4	11.4	**7.2**	**4.6**	**5.5**	*6.8*	*6.7*
Romania	:	5.6	8.4	7.0	1.7	-12.4	10.2	**6.8**	**3.8**	**5.0**	*6.2*	*6.3*
Sweden	:	7.5	9.0	5.9	2.3	-11.9	9.7	**5.7**	**4.1**	**5.3**	*6.2*	*6.1*
United Kingdom	:	6.5	7.8	6.2	1.6	-11.1	10.5	**5.7**	**4.3**	**5.7**	*6.3*	*6.9*
EU (b)	:	6.3	8.8	6.2	2.2	-11.5	10.5	**5.8**	**4.0**	**5.4**	*6.3*	*6.5*
USA	:	6.7	8.2	7.2	3.5	-11.2	13.1	**6.8**	**5.9**	**6.4**	*7.6*	*7.5*
Japan	:	7.2	8.8	7.7	3.7	-9.0	14.8	**7.3**	**6.2**	**6.9**	*9.1*	*9.1*

(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, 2004-2013)

								Autumn 2011 forecast			Spring 2011 forecast	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
Belgium	:	-1.4	-3.4	-0.1	-0.4	-0.7	-0.3	**-0.5**	**-1.1**	**-0.6**	*-0.5*	*-1.0*
Germany	:	1.4	4.0	1.1	0.5	-2.2	2.9	**1.9**	**0.0**	**0.9**	*1.0*	*-0.2*
Estonia	:	8.1	-3.0	-5.2	-1.1	-1.1	11.8	**15.8**	**-1.3**	**0.4**	*8.3*	*0.1*
Ireland	:	-0.5	-3.2	4.1	-2.3	8.3	-4.0	**-0.5**	**0.0**	**-1.0**	*-0.2*	*-1.1*
Greece	:	-3.8	-3.1	1.2	1.3	-8.1	-5.6	**-0.9**	**2.5**	**1.0**	*4.2*	*0.4*
Spain	:	-2.9	-1.5	1.6	-2.9	0.2	3.3	**3.3**	**0.6**	**-0.5**	*1.6*	*0.1*
France	:	-2.7	-3.5	-3.4	-2.1	-1.5	-0.5	**-0.5**	**-0.4**	**-0.5**	*0.7*	*0.3*
Italy	:	-5.3	-2.7	-0.3	-5.4	-7.3	2.1	**-2.0**	**-1.9**	**-1.0**	*-0.2*	*-0.8*
Cyprus	:	-3.2	-6.6	-0.6	-2.5	2.6	-6.9	**-3.2**	**-2.4**	**-1.3**	*-0.5*	*-0.7*
Luxembourg	:	-0.8	4.7	4.0	2.3	0.4	-6.6	**-2.1**	**-4.1**	**0.9**	*0.8*	*0.3*
Malta	:	-5.5	0.7	-2.4	0.8	3.1	7.3	**-0.6**	**0.2**	**0.2**	*-0.2*	*-0.3*
Netherlands	:	0.2	-1.4	0.8	-0.3	3.5	0.4	**-0.2**	**-0.8**	**-1.1**	*0.1*	*-0.4*
Austria	:	1.3	-2.1	1.9	-1.4	-3.2	-2.7	**0.3**	**-0.8**	**0.3**	*0.0*	*-0.1*
Portugal	:	-4.0	2.7	2.0	-1.0	1.2	-0.9	**1.9**	**0.8**	**1.0**	*0.8*	*-0.1*
Slovenia	:	4.8	3.0	6.0	0.2	-4.7	-0.2	**1.8**	**0.3**	**0.3**	*0.4*	*0.4*
Slovakia	:	3.8	9.2	5.5	-0.1	-4.2	4.3	**0.9**	**-1.6**	**0.3**	*1.4*	*1.0*
Finland	:	-1.3	1.4	-0.5	2.2	-10.6	-2.9	**-7.4**	**-1.3**	**-0.8**	*1.1*	*-1.4*
Euro area (b)	:	-1.0	-0.2	0.5	-1.1	-1.6	0.8	**0.4**	**-0.5**	**-0.1**	*0.6*	*-0.3*
Bulgaria	:	1.8	37.7	-2.2	0.6	1.8	6.3	**4.1**	**1.1**	**0.9**	*2.3*	*1.1*
Czech Republic	:	4.8	4.5	3.9	0.7	2.6	4.7	**3.1**	**-0.5**	**1.2**	*2.8*	*3.3*
Denmark	:	1.0	0.2	-3.4	0.4	1.9	-6.8	**0.3**	**-0.8**	**-0.7**	*-1.9*	*-1.9*
Latvia	:	10.2	-4.7	1.0	-1.7	3.5	-0.9	**0.0**	**0.3**	**0.5**	*-0.1*	*-0.1*
Lithuania	:	6.8	0.0	-7.2	8.7	4.9	5.5	**1.3**	**0.1**	**0.9**	*2.9*	*0.3*
Hungary	:	4.8	7.7	6.6	2.1	2.6	3.0	**2.4**	**2.8**	**2.1**	*2.9*	*2.3*
Poland	:	0.6	3.7	1.0	3.4	6.4	0.6	**0.1**	**0.5**	**0.1**	*0.8*	*0.8*
Romania	:	1.9	1.9	0.8	6.5	6.8	2.7	**0.5**	**0.5**	**0.9**	*2.2*	*0.9*
Sweden	:	-0.8	0.0	-0.2	-0.5	-1.5	1.2	**2.0**	**-0.8**	**-0.3**	*1.3*	*-0.9*
United Kingdom	:	1.3	3.0	-7.1	-0.3	1.9	-3.9	**-0.6**	**-0.9**	**-0.9**	*2.4*	*0.6*
EU (b)	:	-0.4	0.6	-0.4	-0.7	-0.6	0.3	**0.5**	**-0.4**	**-0.1**	*0.9*	*0.0*
USA	:	0.0	0.7	2.0	2.5	2.0	-1.6	**-0.2**	**0.0**	**1.2**	*0.2*	*1.7*
Japan	:	-0.2	0.8	0.7	-2.0	-16.4	8.0	**-5.5**	**-2.8**	**-1.9**	*-7.4*	*-4.9*

(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, 2006-2013) 24.10.2011

							Autumn 2011 forecast			*Spring 2011 forecast*	
	(a)	2006	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
EU	20.7	3.3	3.2	0.3	-4.2	2.0	**1.6**	**0.6**	**1.5**	*1.8*	*1.9*
Euro area	14.7	3.2	3.0	0.4	-4.2	1.9	**1.5**	**0.5**	**1.3**	*1.6*	*1.8*
Belgium	0.6	2.7	2.9	1.0	-2.8	2.3	**2.2**	**0.9**	**1.5**	*2.4*	*2.2*
Bulgaria	0.1	6.5	6.4	6.2	-5.5	0.2	**2.2**	**2.3**	**3.0**	*2.8*	*3.7*
Czech Republic	0.3	7.0	5.7	3.1	-4.7	2.7	**1.8**	**0.7**	**1.7**	*2.0*	*2.9*
Denmark	0.4	3.4	1.6	-1.1	-5.2	1.7	**1.2**	**1.4**	**1.7**	*1.7*	*1.5*
Germany	4.2	3.7	3.3	1.1	-5.1	3.7	**2.9**	**0.8**	**1.5**	*2.6*	*1.9*
Estonia	0.0	10.1	7.5	-3.7	-14.3	2.3	**8.0**	**3.2**	**4.0**	*4.9*	*4.0*
Ireland	0.3	5.3	5.2	-3.0	-7.0	-0.4	**1.1**	**1.1**	**2.3**	*0.6*	*1.9*
Greece	0.4	5.5	3.0	-0.2	-3.2	-3.5	**-5.5**	**-2.8**	**0.7**	*-3.5*	*1.1*
Spain	1.8	4.1	3.5	0.9	-3.7	-0.1	**0.7**	**0.7**	**1.4**	*0.8*	*1.5*
France	3.3	2.5	2.3	-0.1	-2.7	1.5	**1.6**	**0.6**	**1.4**	*1.8*	*2.0*
Italy	2.6	2.2	1.7	-1.2	-5.1	1.5	**0.5**	**0.1**	**0.7**	*1.0*	*1.3*
Cyprus	0.0	4.1	5.1	3.6	-1.9	1.1	**0.3**	**0.0**	**1.8**	*1.5*	*2.4*
Latvia	0.0	11.2	9.6	-3.3	-17.7	-0.3	**4.5**	**2.5**	**4.0**	*3.3*	*4.0*
Lithuania	0.0	7.8	9.8	2.9	-14.8	1.4	**6.1**	**3.4**	**3.8**	*5.0*	*4.7*
Luxembourg	0.1	5.0	6.6	0.8	-5.3	2.7	**1.6**	**1.0**	**2.3**	*3.4*	*3.8*
Hungary	0.2	3.9	0.1	0.9	-6.8	1.3	**1.4**	**0.5**	**1.4**	*2.7*	*2.6*
Malta	0.0	2.2	4.3	4.4	-2.7	2.7	**2.1**	**1.3**	**2.0**	*2.0*	*2.2*
Netherlands	1.0	3.4	3.9	1.8	-3.5	1.7	**1.8**	**0.5**	**1.3**	*1.9*	*1.7*
Austria	0.5	3.7	3.7	1.4	-3.8	2.3	**2.9**	**0.9**	**1.9**	*2.4*	*2.0*
Poland	0.6	6.2	6.8	5.1	1.6	3.9	**4.0**	**2.5**	**2.8**	*4.0*	*3.7*
Portugal	0.3	1.4	2.4	0.0	-2.5	1.4	**-1.9**	**-3.0**	**1.1**	*-2.2*	*-1.8*
Romania	0.2	7.9	6.3	7.3	-6.6	-1.9	**1.7**	**2.1**	**3.4**	*1.5*	*3.7*
Slovenia	0.1	5.8	6.9	3.6	-8.0	1.4	**1.1**	**1.0**	**1.5**	*1.9*	*2.5*
Slovakia	0.1	8.3	10.5	5.9	-4.9	4.2	**2.9**	**1.1**	**2.9**	*3.5*	*4.4*
Finland	0.3	4.4	5.3	1.0	-8.2	3.6	**3.1**	**1.4**	**1.7**	*3.7*	*2.6*
Sweden	0.6	4.3	3.3	-0.6	-5.2	5.6	**4.0**	**1.4**	**2.1**	*4.2*	*2.5*
United Kingdom	2.9	2.6	3.5	-1.1	-4.4	1.8	**0.7**	**0.6**	**1.5**	*1.7*	*2.1*
Candidate countries	1.5	6.7	4.8	0.9	-4.9	7.7	**6.8**	**2.8**	**3.9**	*5.6*	*5.1*
- Croatia	0.1	4.9	5.1	2.2	-6.0	-1.2	**0.6**	**0.8**	**1.2**	*1.1*	*2.0*
- Turkey	1.3	6.9	4.7	0.7	-4.8	8.9	**7.5**	**3.0**	**4.1**	*6.1*	*5.5*
- The former Yugoslav Republic of Macedonia	0.0	5.0	6.1	5.0	-0.9	1.8	**3.0**	**2.5**	**3.5**	*2.5*	*3.3*
- Iceland	0.0	4.7	6.0	1.3	-6.7	-4.0	**2.1**	**1.5**	**2.7**	*1.5*	*2.5*
- Montenegro	0.0	8.6	10.7	6.9	-5.7	2.5	**2.7**	**2.2**	**3.2**	*2.4*	*4.0*
Potential candidates	0.1	4.5	5.7	4.9	-1.8	1.6	**2.5**	**3.2**	**3.7**	*3.2*	*3.7*
USA	19.9	2.7	1.9	-0.4	-3.5	3.0	**1.6**	**1.5**	**1.3**	*2.6*	*2.7*
Japan	5.9	2.0	2.4	-1.2	-6.3	4.0	**-0.4**	**1.8**	**1.0**	*0.5*	*1.6*
Canada	1.8	2.8	2.2	0.7	-2.8	3.2	**2.1**	**1.8**	**2.3**	*3.1*	*2.7*
Norway	0.3	2.3	2.7	0.7	-1.7	0.3	**2.4**	**2.7**	**2.9**	*2.7*	*2.5*
Switzerland	0.4	3.6	3.6	2.1	-1.9	2.7	**1.7**	**1.9**	**1.8**	*1.9*	*1.7*
Australia	1.2	3.8	3.7	1.1	3.0	3.1	**1.8**	**3.3**	**3.0**	*2.1*	*3.3*
New Zealand	0.2	0.9	2.9	-1.4	-1.6	2.6	**1.0**	**3.2**	**2.9**	*1.0*	*3.2*
Advanced economies	51.9	3.0	2.6	-0.1	-4.0	2.8	**1.5**	**1.3**	**1.5**	*2.1*	*2.3*
CIS	4.3	8.8	8.9	5.3	-6.7	4.6	**4.1**	**4.0**	**4.2**	*4.7*	*4.5*
- Russia	3.0	8.2	8.5	5.2	-7.8	4.0	**3.9**	**3.8**	**4.0**	*4.5*	*4.2*
- Other	1.3	10.2	9.8	5.3	-4.0	6.0	**4.7**	**4.3**	**4.5**	*5.3*	*5.2*
MENA	5.1	5.4	5.6	4.4	1.2	3.3	**3.6**	**3.6**	**3.7**	*3.1*	*3.7*
Asia	27.6	9.6	10.3	6.9	6.4	9.1	**7.2**	**7.2**	**7.2**	*7.7*	*7.7*
- China	13.7	12.7	14.2	9.6	9.1	10.3	**9.2**	**8.6**	**8.2**	*9.3*	*9.0*
- India	5.5	9.7	9.2	6.7	8.0	8.5	**7.5**	**7.5**	**8.1**	*8.0*	*8.2*
- Hong Kong	0.4	7.0	6.4	2.2	-2.5	7.0	**4.9**	**4.3**	**4.2**	*6.3*	*5.5*
- Korea	2.0	5.2	5.1	2.3	0.2	6.1	**3.5**	**3.6**	**3.6**	*4.4*	*4.6*
- Indonesia	1.4	5.5	6.4	6.0	4.6	6.1	**6.2**	**6.1**	**6.4**	*6.1*	*6.2*
Latin America	8.6	5.6	5.8	4.3	-1.9	6.0	**4.6**	**4.1**	**4.2**	*4.2*	*3.9*
- Brazil	3.0	4.0	6.1	5.1	-0.6	7.5	**3.6**	**4.0**	**4.5**	*4.4*	*4.3*
- Mexico	2.1	5.1	3.4	1.5	-6.4	5.3	**4.0**	**3.9**	**3.7**	*4.5*	*4.0*
Sub-Saharan Africa	2.5	6.6	7.1	5.6	2.9	5.1	**5.0**	**5.5**	**6.0**	*5.5*	*6.0*
Emerging and developing economies	48.1	8.2	8.7	6.0	3.0	7.3	**6.0**	**5.9**	**5.9**	*6.2*	*6.2*
World	100.0	5.5	5.6	2.8	-0.6	5.0	**3.7**	**3.5**	**3.6**	*4.0*	*4.1*
World excluding EU	79.3	6.1	6.2	3.5	0.4	5.8	**4.2**	**4.2**	**4.2**	*4.6*	*4.7*
World excluding euro area	85.3	5.9	6.0	3.3	0.1	5.6	**4.1**	**4.0**	**4.1**	*4.5*	*4.6*

(a) Relative weights in %, based on GDP (at constant prices and PPS) in 2010.

TABLE 54 : World exports of goods and services, volume (percentage change on preceding year, 2006-2013) 24.10.2011

							Autumn 2011 forecast			Spring 2011 forecast	
	(a)	2006	2007	2008	2009	2010	2011	2012	2013	2011	2012
EU (b)	35.6	9.7	5.8	1.5	-12.0	10.8	6.3	3.6	5.3	7.3	6.5
Euro area (b)	26.8	8.9	6.6	1.0	-12.8	11.3	6.1	3.4	5.3	6.9	6.2
Candidate countries	1.0	6.2	7.3	2.6	-6.4	4.1	3.8	4.5	7.8	6.2	6.6
- Croatia	0.1	5.8	3.7	2.2	-17.3	6.0	0.9	2.5	4.5	4.0	4.3
- Turkey	0.8	6.6	7.3	2.7	-5.0	3.4	4.1	4.9	8.5	6.7	7.1
- The former Yugoslav Republic of Macedonia	0.0	8.2	11.8	-6.3	-16.2	23.4	9.9	6.0	6.5	6.7	8.4
- Iceland	0.0	-4.6	17.7	7.0	6.6	0.4	2.0	2.2	3.0	2.3	3.4
- Montenegro	0.0	:	:	:	:	:	13.6	9.2	10.2	12.0	11.3
USA	9.9	9.0	9.3	6.1	-9.4	11.3	6.6	5.9	7.7	7.8	9.3
Japan	4.5	9.7	8.4	1.6	-23.9	23.9	1.4	3.2	4.9	1.0	3.8
Canada	2.5	0.6	1.2	-4.7	-13.8	6.4	6.4	6.1	6.3	7.3	7.4
Norway	0.9	0.0	2.3	1.0	-3.9	-1.7	1.1	1.1	1.6	1.8	1.9
Switzerland	1.5	10.3	9.6	3.1	-8.6	8.4	4.2	3.8	3.3	3.5	5.1
Australia	1.6	2.2	2.9	5.8	-5.2	12.9	5.0	4.9	5.3	6.2	4.5
New Zealand	0.2	1.9	3.9	-1.3	3.2	-5.0	5.8	5.2	5.2	5.9	4.7
Advanced economies	57.8	8.7	6.4	2.2	-12.0	11.3	5.8	4.1	5.7	6.7	6.6
CIS	3.5	6.6	5.1	9.7	-15.2	11.0	6.9	6.5	6.3	8.8	6.2
- Russia	2.4	7.3	6.3	0.6	-4.7	7.1	5.4	5.5	5.4	7.7	4.5
- Other	1.1	5.2	2.7	29.2	-37.6	19.3	10.0	8.5	8.4	11.0	9.6
MENA	5.6	6.1	7.2	9.5	-10.4	4.2	4.4	4.3	4.3	4.5	5.3
Asia	25.7	12.5	19.4	6.1	-10.4	16.0	8.0	7.2	6.6	10.5	9.9
- China	9.5	16.9	36.1	5.9	-11.5	12.6	9.8	8.6	7.6	12.4	11.2
- India	1.8	21.1	7.8	16.9	-5.7	16.2	4.8	5.8	6.2	16.3	16.6
- Hong Kong	2.7	9.3	8.0	2.9	-12.5	18.4	7.4	6.8	6.8	9.9	9.8
- Korea	3.3	12.2	11.7	15.3	0.4	13.1	8.6	6.7	5.0	11.1	8.2
- Indonesia	0.9	7.3	6.6	12.3	-17.5	22.3	10.9	5.8	7.0	7.3	5.8
Latin America	5.4	7.7	6.7	11.8	-12.7	12.9	7.7	6.6	6.9	5.8	6.8
- Brazil	1.3	5.9	7.8	3.2	-3.4	10.7	8.0	7.2	7.7	7.6	8.0
- Mexico	1.7	11.2	5.6	1.1	-10.2	25.5	6.8	6.0	8.1	7.9	7.5
Sub-Saharan Africa	1.9	0.8	6.4	16.9	-32.8	17.2	5.8	5.2	6.9	7.8	8.1
Emerging and developing economies	42.2	10.0	14.4	8.1	-12.1	13.7	7.3	6.6	6.3	8.8	8.5
World	100.0	9.3	9.8	4.7	-12.1	12.3	6.4	5.1	5.9	7.5	7.4
World excluding EU	64.4	9.0	12.0	6.4	-12.1	13.2	6.5	6.0	6.3	7.7	7.9
World excluding euro area	73.2	9.5	11.0	6.1	-11.8	12.7	6.5	5.8	6.2	7.7	7.8

(a) Relative weights in %, based on exports of goods and services (at current prices and current exchange rates) in 2010.

(b) Intra- and extra-EU trade.

TABLE 55 : Export shares in EU trade (goods only - 2010)

	EU	Euro area	Candidate countries	USA	Japan	Other advanced economies	China	Rest Asia	CIS	MENA	Latin America	Sub Saharan Africa
EU	66.5	50.1	1.9	6.0	1.2	5.4	3.0	4.5	3.2	4.4	2.3	1.6
Euro area	66.2	49.8	1.9	5.9	1.2	5.2	3.3	4.6	2.9	4.7	2.6	1.6
Belgium	75.8	62.6	1.2	4.9	0.8	2.8	1.8	4.7	1.6	3.4	1.5	1.5
Bulgaria	66.3	48.6	12.1	1.5	0.2	1.2	1.5	3.5	7.2	4.6	0.7	1.3
Czech Republic	84.0	66.9	1.3	1.8	0.4	2.6	1.1	1.6	4.0	1.8	0.9	0.5
Denmark	66.8	40.5	1.2	6.3	2.2	9.2	2.6	4.2	2.2	2.7	1.8	0.7
Germany	61.6	41.8	1.9	6.1	1.3	6.9	5.4	5.3	3.8	3.6	2.8	1.2
Estonia	70.0	32.1	1.6	3.5	0.6	4.9	1.3	1.7	14.6	0.8	0.6	0.4
Ireland	58.3	39.8	0.7	22.9	2.6	6.8	2.1	3.2	0.5	1.2	1.2	0.6
Greece	67.4	46.5	9.2	4.0	0.2	2.6	1.4	2.4	2.8	7.3	1.4	1.2
Spain	69.6	58.1	2.2	3.5	0.9	3.7	2.0	2.7	1.4	6.9	5.5	1.6
France	60.8	48.4	1.7	6.3	1.7	5.1	3.0	5.7	2.0	8.1	2.8	2.9
Italy	57.0	43.5	3.1	6.3	1.4	6.8	2.9	5.3	3.6	8.9	3.4	1.4
Cyprus	75.7	57.0	0.2	0.8	0.0	1.1	0.9	5.6	2.8	11.1	0.2	1.6
Latvia	66.9	32.6	0.9	1.7	0.5	3.0	0.4	2.3	19.9	3.6	0.4	0.4
Lithuania	61.1	31.9	0.9	3.1	0.1	4.4	0.2	1.0	27.2	0.8	0.4	0.7
Luxembourg	83.7	70.5	1.0	2.1	0.3	3.5	1.1	1.7	2.0	2.4	1.6	0.6
Hungary	77.2	56.1	2.8	2.5	0.8	2.1	2.0	2.5	6.5	2.2	0.8	0.6
Malta	53.9	43.7	4.7	6.1	2.4	1.8	9.8	13.8	0.3	4.8	1.3	1.0
Netherlands	78.2	62.7	1.1	3.8	0.7	2.8	1.2	3.8	2.0	2.6	1.8	2.1
Austria	72.1	55.0	1.9	4.1	0.9	6.5	2.5	3.5	3.8	2.3	1.8	0.6
Poland	80.3	56.9	2.0	1.7	0.3	2.6	1.1	1.1	8.4	1.2	0.7	0.5
Portugal	74.4	64.3	1.0	4.2	0.5	2.2	1.1	1.1	0.5	3.3	3.7	8.1
Romania	72.5	54.8	8.0	1.9	0.5	1.6	1.2	2.0	6.0	4.8	0.6	0.9
Slovenia	75.5	57.6	8.5	1.7	0.1	1.8	0.6	1.6	6.0	3.2	0.7	0.4
Slovakia	87.2	49.7	2.0	1.3	0.1	1.7	1.7	0.6	4.0	0.6	0.6	0.2
Finland	55.4	32.5	1.9	6.3	1.9	6.3	5.3	5.8	10.0	3.1	2.6	1.3
Sweden	60.1	40.9	1.5	6.7	1.3	11.9	3.4	4.9	2.1	3.9	2.6	1.6
United Kingdom	57.6	50.9	1.4	12.3	1.5	6.9	2.5	7.0	1.5	4.6	2.0	2.6

TABLE 56 : World imports of goods and services, volume (percentage change on preceding year, 2006-2013) 24.10.2011

							Autumn 2011 forecast			*Spring 2011 forecast*	
	(a)	2006	2007	2008	2009	2010	2011	2012	2013	*2011*	*2012*
EU (b)	35.6	9.6	6.0	1.2	-12.2	9.8	**4.6**	**2.9**	**4.8**	*5.6*	*5.7*
Euro area (b)	26.5	8.7	6.2	0.9	-11.7	9.6	**4.8**	**3.0**	**5.0**	*5.4*	*5.9*
Candidate countries	1.3	7.2	10.0	-3.6	-15.2	17.7	**16.0**	**-1.4**	**2.4**	*5.7*	*4.9*
- Croatia	0.1	8.3	6.2	3.3	-20.4	-1.3	**-2.0**	**1.0**	**5.0**	*2.5*	*4.2*
- Turkey	1.1	6.9	10.7	-4.1	-14.3	20.7	**18.8**	**-2.1**	**1.9**	*6.3*	*5.0*
- The former Yugoslav Republic of Macedonia	0.0	10.1	16.1	0.8	-15.3	10.9	**6.7**	**4.9**	**7.1**	*6.1*	*7.5*
- Iceland	0.0	11.3	-1.5	-18.4	-24.0	4.0	**3.4**	**3.3**	**3.9**	*4.0*	*4.8*
- Montenegro	0.0	:	:	:	:	:	**1.1**	**4.8**	**7.9**	*11.4*	*12.4*
USA	13.0	6.1	2.4	-2.7	-13.6	12.5	**5.8**	**5.5**	**8.0**	*6.7*	*9.3*
Japan	4.2	4.2	1.6	0.4	-15.3	9.8	**4.1**	**2.5**	**4.1**	*4.5*	*3.7*
Canada	2.7	4.9	5.9	1.5	-13.4	13.1	**8.4**	**8.0**	**8.2**	*8.0*	*8.0*
Norway	0.7	8.4	8.6	4.3	-11.7	9.0	**6.2**	**2.7**	**2.9**	*2.4*	*1.0*
Switzerland	1.2	6.5	6.1	0.3	-5.5	7.3	**4.1**	**4.8**	**4.9**	*6.4*	*5.1*
Australia	1.4	6.9	10.4	11.5	-11.2	9.6	**7.0**	**7.4**	**7.9**	*9.5*	*7.5*
New Zealand	0.2	0.3	7.1	-2.9	-9.9	4.1	**5.9**	**5.5**	**5.5**	*5.8*	*5.0*
Advanced economies	60.3	8.0	5.1	0.5	-12.6	10.6	**5.3**	**3.7**	**5.6**	*5.9*	*6.4*
CIS	2.9	15.7	20.6	13.4	-28.1	19.0	**17.5**	**11.2**	**5.0**	*9.5*	*7.8*
- Russia	1.8	21.3	26.2	14.8	-30.4	25.6	**15.2**	**9.4**	**8.1**	*7.7*	*7.0*
- Other	1.1	6.7	11.5	11.2	-24.3	8.4	**21.3**	**14.0**	**0.0**	*11.9*	*9.0*
MENA	4.7	8.4	11.1	11.7	0.2	0.6	**4.9**	**5.4**	**5.3**	*4.4*	*5.5*
Asia	24.5	11.4	7.4	7.8	-6.5	20.7	**8.0**	**6.8**	**7.1**	*11.1*	*10.4*
- China	8.4	16.1	10.3	6.9	1.6	23.8	**10.1**	**7.9**	**8.4**	*12.3*	*12.0*
- India	2.4	23.9	11.8	27.3	-1.1	13.4	**3.9**	**4.7**	**6.2**	*17.2*	*18.4*
- Hong Kong	2.7	9.2	8.2	2.1	-10.6	17.2	**7.6**	**7.7**	**7.7**	*9.0*	*9.1*
- Korea	3.2	9.6	9.7	5.4	-3.4	15.1	**9.4**	**6.3**	**5.4**	*13.9*	*8.5*
- Indonesia	0.8	-1.8	5.5	20.8	-15.8	27.3	**10.7**	**6.5**	**7.1**	*7.2*	*6.4*
Latin America	5.5	11.6	13.5	6.7	-17.4	32.1	**8.1**	**8.2**	**7.2**	*8.9*	*9.0*
- Brazil	1.3	6.2	13.8	6.8	-12.0	26.0	**7.9**	**8.2**	**7.6**	*12.2*	*10.4*
- Mexico	1.8	12.0	7.0	3.2	-15.9	82.3	**7.0**	**8.5**	**8.5**	*7.1*	*8.6*
Sub-Saharan Africa	2.1	8.8	8.1	12.3	-18.5	7.6	**5.6**	**4.0**	**7.6**	*7.1*	*8.1*
Emerging and developing economies	39.7	11.3	9.7	8.8	-9.4	19.1	**8.2**	**7.0**	**6.8**	*9.5*	*9.2*
World	100.0	9.3	6.9	3.8	-11.4	14.0	**6.5**	**5.0**	**6.1**	*7.3*	*7.4*
World excluding EU	64.4	9.2	7.5	5.2	-10.9	16.3	**7.5**	**6.2**	**6.8**	*8.3*	*8.5*
World excluding euro area	73.5	9.6	7.3	4.8	-11.2	15.6	**7.0**	**5.7**	**6.4**	*8.0*	*8.0*

(a) Relative weights in %, based on imports of goods and services (at current prices and current exchange rates) in 2010.

(b) Intra- and extra-EU trade.

TABLE 57 : Import shares in EU trade (goods only - 2010)

	EU	Euro area	Candidate countries	USA	Japan	Other advanced economies	China	Rest Asia	CIS	MENA	Latin America	Sub Saharan Africa
EU	64.4	50.0	1.3	4.3	1.6	5.1	6.6	4.8	4.7	3.4	2.3	1.4
Euro area	64.4	49.9	1.3	4.3	1.7	4.6	6.6	4.7	4.4	4.1	2.6	1.6
Belgium	70.4	59.9	0.8	6.1	2.0	3.0	4.0	4.5	2.2	3.2	2.6	1.4
Bulgaria	60.8	43.2	7.0	0.7	0.3	1.4	2.7	1.6	21.0	1.4	2.9	0.2
Czech Republic	76.7	61.8	0.6	1.2	1.4	1.7	6.6	3.9	7.1	0.3	0.2	0.1
Denmark	73.6	48.1	1.1	2.8	0.5	7.2	6.6	4.0	1.3	0.6	1.9	0.4
Germany	65.5	46.5	1.3	4.1	2.0	6.1	7.3	5.0	4.4	1.3	1.9	1.1
Estonia	82.3	39.5	0.6	1.2	0.6	2.3	4.7	1.6	6.1	0.1	0.4	0.1
Ireland	70.1	26.2	0.5	12.8	1.4	4.7	3.7	3.8	0.3	1.2	1.0	0.4
Greece	66.0	53.3	3.6	2.3	1.2	3.0	7.5	7.4	3.1	2.9	2.3	0.6
Spain	60.4	50.1	1.3	3.1	1.1	2.9	6.2	4.1	2.9	9.2	5.2	3.5
France	70.2	58.9	1.1	4.0	1.1	4.3	4.8	3.7	3.4	4.5	1.4	1.7
Italy	57.3	46.3	1.9	2.9	1.2	4.4	7.4	4.2	5.9	10.5	2.7	1.5
Cyprus	67.0	53.9	0.7	1.3	1.6	1.5	9.3	4.8	2.7	10.0	0.9	0.2
Latvia	71.5	38.3	0.6	1.7	0.2	3.4	4.5	1.7	16.0	0.3	0.2	0.1
Lithuania	55.2	31.6	0.9	1.7	0.2	1.1	3.4	1.1	34.9	0.8	0.6	0.1
Luxembourg	83.2	79.5	0.6	4.7	0.7	1.1	6.6	1.4	0.1	0.2	1.3	0.0
Hungary	69.3	54.5	0.9	1.5	2.3	1.1	9.0	6.1	9.0	0.2	0.5	0.1
Malta	52.6	42.5	4.9	4.1	1.7	5.0	15.1	13.8	0.4	1.1	0.7	0.5
Netherlands	48.7	36.5	0.9	6.9	3.0	5.1	11.3	7.4	6.0	3.7	4.9	2.3
Austria	81.3	69.0	1.4	1.6	0.7	5.7	2.0	2.0	3.0	1.5	0.3	0.5
Poland	74.2	59.1	1.0	1.5	1.1	1.9	5.5	3.6	9.9	0.4	0.7	0.3
Portugal	75.7	68.1	0.7	1.4	0.6	2.4	3.1	2.2	2.4	3.6	3.5	4.3
Romania	73.2	51.7	4.3	1.2	0.5	1.5	5.3	3.0	9.0	0.8	0.9	0.3
Slovenia	74.2	62.2	7.0	1.3	0.4	1.5	4.8	4.5	1.6	2.2	2.0	0.3
Slovakia	76.4	40.0	0.9	0.4	1.0	0.8	3.6	6.1	10.4	0.3	0.1	0.0
Finland	63.3	38.8	0.5	2.5	1.0	4.1	6.1	3.2	16.5	0.4	1.8	0.7
Sweden	69.8	48.9	0.8	3.2	1.3	9.2	4.5	4.0	5.0	0.5	1.3	0.4
United Kingdom	54.6	46.8	1.5	7.5	2.2	11.1	8.2	6.9	1.5	2.2	2.5	1.8

TABLE 58 : World merchandise trade balances (fob-fob, in billions of US dollar, 2005-2013) 24.10.2011

							Autumn 2011 forecast			Spring 2011 forecast	
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2011	2012
EU	-14.7	-88.7	-120.4	-205.3	-41.3	-70.4	-112.4	-79.4	-45.6	-52.1	-4.2
EU, adjusted [1]	-120.6	-204.9	-212.1	-326.3	-114.8	-159.4	-206.5	-171.5	-137.7	-137.3	-90.6
Euro area	107.3	64.9	101.7	28.8	81.7	77.0	27.7	42.3	65.5	84.8	105.8
Euro area, adjusted [1]	:	:	:	-33.0	52.2	25.8	-26.3	-10.5	12.7	55.6	76.2
Candidate countries	-44.9	-55.0	-65.4	-71.5	-36.9	-66.1	-94.1	-85.9	-91.6	-95.3	-106.7
USA	-801.9	-860.5	-838.7	-848.8	-522.6	-668.7	-764.8	-780.9	-872.0	-814.4	-882.6
Japan	93.9	81.4	104.7	39.0	43.2	91.2	71.3	74.4	72.6	8.6	-7.3
Norway	46.8	55.9	53.2	77.6	44.5	52.2	60.4	59.7	59.7	64.7	67.5
Switzerland	2.4	4.0	7.8	14.0	15.4	15.9	38.6	42.3	39.8	25.0	25.2
Advanced economies	-682.8	-830.7	-834.1	-959.3	-504.8	-625.5	-759.0	-753.2	-861.2	-841.0	-904.3
CIS	124.0	142.8	121.8	213.9	103.6	153.2	205.3	171.8	203.1	228.0	260.3
- Russia	118.5	139.6	130.9	177.8	110.7	141.5	184.9	158.5	172.6	209.5	239.6
MENA	212.0	292.8	275.1	409.6	156.2	253.4	541.2	675.0	528.3	379.5	170.0
Asia	213.3	314.7	421.5	341.4	315.7	294.4	134.6	149.8	384.5	-73.0	-27.7
- China	134.2	217.7	315.4	360.7	249.5	254.2	206.4	302.1	383.2	72.6	81.7
Latin America	81.3	100.1	71.6	47.4	55.5	51.6	106.9	85.0	64.0	56.0	20.0
Sub-Saharan Africa	37.0	46.7	50.3	64.8	22.5	40.9	105.1	92.9	78.7	100.1	87.7
Emerging and developing economies	667.6	897.1	940.3	1077.0	653.5	793.4	1093.1	1174.4	1258.7	690.6	510.2
World	-15.2	66.3	106.2	117.7	148.7	168.0	334.2	421.3	397.4	-150.4	-394.1

[1] See note 7 on concepts and sources.

TABLE 59 : World current-account balances (in billions of US dollar, 2005-2013)

							Autumn 2011 forecast			Spring 2011 forecast	
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2011	2012
EU	-15.3	-38.1	-65.4	-184.2	-41.4	-50.0	-60.7	4.1	38.2	-39.9	-1.6
EU, adjusted [1]	-103.8	-175.2	-172.4	-369.3	-141.2	-128.2	-143.3	-76.7	-42.6	-101.8	-64.4
Euro area	41.8	55.3	55.1	-91.8	-17.3	11.1	-15.8	6.2	27.8	-27.3	-13.4
Euro area, adjusted [1]	:	:	:	-208.8	-35.8	-53.5	-84.1	-60.7	-39.0	15.9	30.5
Candidate countries	:	:	-48.2	-55.5	-20.7	-50.6	-78.9	-70.1	-75.2	-66.0	-76.7
USA	-645.5	-556.1	-704.0	-676.5	-454.8	-520.3	-499.2	-489.9	-554.0	-609.9	-632.8
Japan	165.9	170.6	210.7	158.7	142.1	192.9	175.6	182.1	180.5	78.7	63.1
Norway	49.1	58.1	54.8	79.1	43.8	51.3	44.4	43.8	42.9	59.8	62.9
Switzerland	53.5	52.3	39.3	13.5	62.3	77.7	93.1	95.8	96.8	51.2	58.5
Advanced economies	:	:	-574.7	-721.2	-362.2	-386.1	-369.7	-307.8	-389.6	-585.1	-607.6
CIS	86.4	94.3	66.4	98.7	33.2	58.8	111.3	67.2	94.7	143.8	165.9
- Russia	84.5	95.2	78.0	102.0	48.5	65.2	104.5	72.8	78.8	132.3	153.1
MENA	189.3	266.0	239.6	351.8	81.5	183.2	314.1	322.1	265.8	220.8	176.8
Asia	242.4	375.0	539.4	515.7	420.4	425.5	304.9	308.1	495.0	284.4	360.9
- China	160.8	253.3	371.8	436.1	261.1	305.4	266.7	356.9	416.4	325.0	370.0
Latin America	36.9	50.9	15.3	-26.7	-20.3	-52.0	-19.4	-53.5	-82.7	-66.2	-114.6
Sub-Saharan Africa	20.8	21.0	-0.3	-6.7	-31.4	-35.8	38.5	25.3	4.9	39.0	20.4
Emerging and developing economies	575.8	807.2	860.4	932.9	483.4	579.7	749.6	669.1	777.7	621.9	609.3
World	:	:	285.7	211.6	121.2	193.6	379.9	361.3	388.1	36.8	1.7

[1] See note 7 on concepts and sources.

TABLE 60 : Primary commodity prices (in US dollar, percentage change on preceding year, 2005-2013)

SITC							Autumn 2011 forecast			Spring 2011 forecast	
Classification	2005	2006	2007	2008	2009	2010	2011	2012	2013	2011	2012
Food (0 + 1)	2.3	10.3	12.6	21.6	-11.1	10.9	23.8	0.0	-0.4	19.2	-2.3
Basic materials (2 + 4)	8.3	32.5	12.3	8.8	-23.6	39.9	21.5	-2.8	-0.2	28.9	-4.9
- of which :											
Agricultures non-food	-2.4	9.1	11.3	7.7	-20.2	29.7	24.8	-2.9	0.5	35.2	-10.4
- of which :											
Wood and pulp	3.5	8.5	0.3	3.0	-10.3	6.2	6.2	1.7	3.2	12.2	-3.9
Minerals and metals	20.0	53.4	12.9	9.5	-25.7	46.6	19.5	-2.7	-0.6	25.2	-1.5
Fuel products (3)	44.0	19.7	9.0	36.4	-13.9	-16.3	55.6	-6.3	-3.8	45.6	-0.3
- of which :											
Crude petroleum	44.7	20.2	9.5	35.9	-37.1	29.5	38.5	-6.6	-3.9	46.4	-0.2
Primary commodities											
- Total excluding fuels	5.5	22.3	12.4	14.1	-18.0	25.9	22.5	-1.6	-0.3	24.8	-3.9
- Total including fuels	35.8	20.1	9.6	32.4	-33.7	28.2	34.6	-5.5	-3.2	41.9	-0.8
					Crude petroleum - price per barrel						
Brent (usd)	55.1	66.2	72.5	98.5	62.0	80.2	111.1	103.8	99.7	117.4	117.2
Brent (euro)	44.3	52.7	52.9	67.2	44.6	60.5	79.4	75.8	72.8	82.1	80.8