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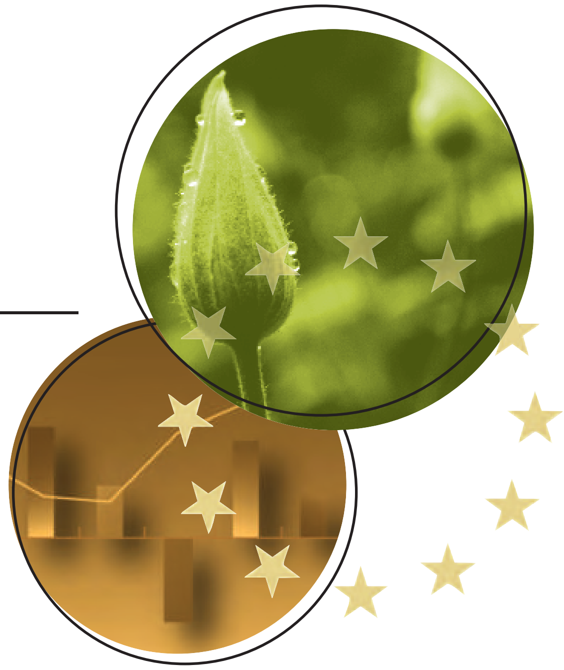
European Economic Forecast - Spring 2010



EUROPEAN ECONOMY 2 | 2010

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European Economic Forecast
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EDITORIAL

The economic recession came to an end in the EU in the third quarter of last year, in large part thanks to the exceptional crisis measures put in place under the European Economic Recovery Plan, but also supported by some other temporary factors. Beyond the initial rebound, the recovery is proving more tentative than in past upturns. This is not surprising given the nature of this crisis. Cyclical rebounds following financial crises tend to be more muted than in other circumstances. Moreover, this was a global financial crisis, the biggest since the Great Depression. Like other developed countries, the EU will grapple with its legacy for some time to come.

The EU economy will thus continue to face headwinds from several directions. The soundness of financial markets has yet to be solidly re-established. Whilst clearly gaining strength, the banking sector still seems fragile and further significant losses cannot be excluded. The necessary deleveraging of banks takes time, and the cost of capital for banks is unlikely to return to its pre-crisis level. Deleveraging among households and firms also has some further way to go, effectively putting a brake on investment. Moreover, despite apparent signs of stabilisation, the labour-market situation will remain weak. The adverse impact of the financial crisis on potential-output growth points to other supply-side constraints going forward.

On the other hand, help has come in the form of stronger-than-expected external demand, particularly from emerging economies, which has boosted EU exports. The outlook for global trade in 2010 is much more favourable than it was last autumn. Confidence has also gained considerable ground over the past year, especially among businesses in the manufacturing sector. That said, the sizeable gap that has opened up between new orders, which are approaching their pre-crisis level, and still (record) low inventories points to a continued high risk aversion among firms. This is not surprising with the renewed turbulence in parts of financial markets illustrating all too well the uncertainty that continues to surround any economic projection at the current juncture. A successful completion of the negotiations on a joint EA-IMF support programme for Greece, containing a credible medium-term strategy ensuring the sustainability of public finances, will certainly tilt risks to the upside for Greece and more broadly for the euro area and the EU as a whole.

The speed of recovery is forecast to increasingly vary across EU countries, reflecting the size of the housing-market correction needed, the size of the financial-services sector and the degree of internal and external imbalances. To stem the risks linked to sovereign debt, a credible exit strategy (from the extraordinary measures of the past two years) will need to be implemented. This will also have to encompass structural-reform strategies to boost potential growth and adjustment capacities. "Europe 2020" provides a common framework for smart and ambitious reforms. A determined implementation of these reforms can ensure that the EU emerges stronger and more dynamic from the crisis.

Marco Buti
Director General
Economic and Financial Affairs

OVERVIEW

Recovery in progress...

Recovery is underway in the EU, albeit a gradual one. Real GDP started to grow again in the third quarter of 2009 (up by 0.3% quarter-on-quarter (q-o-q)), ending the longest and deepest recession in the EU's history. However, growth eased somewhat in the fourth quarter (to 0.1% q-o-q), as the impact of some temporary factors started to fade, including the exceptional crisis measures put in place across the globe to sustain demand. Inventory adjustments were particularly important in shaping short-run dynamics in the EU and globally.

...supported by global demand and improving financial conditions...

Looking ahead, the EU is likely to benefit from a stronger-than-expected turnaround in the global economy, most notably in emerging Asia. In 2010, global trade is set to grow more than twice as fast as projected last autumn. While financial-market conditions have improved markedly since early-2009, volatility increased at the start of 2010, balance-sheet adjustments remain incomplete in several sectors/countries and uncertainty is rife. Future developments as regards both *global imbalances* and *financial markets*, discussed in greater detail in the two analytical chapters, are therefore crucial for the outlook. Global imbalances affect the strength and, especially, the sustainability of the global recovery, while a key question regarding the financial system is whether banks' balance-sheet repair is sufficiently advanced to allow them to respond to a future rebound in credit demand.

...while the EU grapples with the aftermath of the crisis

At the same time, the EU faces headwinds on a number of other fronts that are set to restrain domestic demand for years to come. The downsizing of the construction sector is still ongoing in a number of Member States. The labour market is expected to remain weak: a higher degree of labour hoarding during this recession, which helped stemming the rise in unemployment, points to a potentially jobless recovery ahead. Supply constraints will also be present given the adverse impact of the financial crisis on potential output. In addition, research suggests that, following a period of financial stress, recoveries tend to be more muted, held back by weak private demand, as the economy transits to a new steady state.

Sluggish (post-crisis) recovery ahead...

Indeed, the current upturn is likely to be atypical. The first quarter of the upswing proved unusually marked, boosted by expansionary policy measures, as did the softening in the second. As for demand components, export growth has been stronger than the average of previous recoveries. On the other hand, the weakness of domestic demand, especially investment, is projected to be more pronounced and protracted. This follows from the still very low level of capacity utilisation, the risk of an undershooting in several housing markets, the still ongoing deleveraging process and heightened risk aversion that could weigh on capital spending ahead. Moreover, private consumption growth is forecast to strengthen only gradually, as disposable income is held back by weak wage and employment growth.

...implying GDP growth of 1 and 1½% for this year and next

Overall, EU GDP growth is expected to remain rather subdued during the first three quarters of 2010, on average, and to regain ground only by the end of the year. This follows from, in particular, the fading impact of the temporary support that kick-started the recovery (both within the EU and outside). A temporary hike is expected in the second quarter, however, reflecting in large part a technical rebound in the construction sector that was depressed by unusually adverse weather conditions during this winter. As both external and domestic demand gradually strengthen, GDP growth could recover to about ½% q-o-q during 2011 in both the EU and the euro area. Taking into account the easing in activity towards the end of 2009 (limiting the so-called carry-over to 0.2% in the EU), annual growth rates of about 1% are expected in both regions this year. For 2011, GDP growth could accelerate to, or just above, 1½%, thereby starting to slowly close the sizeable output gap that opened up during the recession.

Increasing differences across EU countries...

While all EU economies were hit by the crisis, there are important differences between them. Factors explaining the divergences include trade openness, exposure to the financial-sector disturbances and the existence of sizeable internal and/or external imbalances. Looking forward, the recovery is expected to advance at different speeds reflecting the challenges individual economies face and the policies they pursue. Mounting concerns about fiscal sustainability, especially in some euro-area Member States, which cause increased turbulence in government-bond markets, and differences in competitiveness positions are among the most important challenges in this regard.

...reflecting individual challenges

Among the largest economies, the upturn is set to be stronger than average for Germany and France this year (at 1¼%), albeit for different reasons, while Spain is projected to remain in recession. The recovery in the United Kingdom is expected to gather momentum during 2010, suggesting that its annual GDP growth could close to double from 1¼% this year to about 2% next. Poland, which was the only EU economy to escape a recession, is forecast to grow relatively fast (at 2¾% and 3¼%, respectively), also reflecting its initially lower GDP-per-capita level. Among the smaller economies, the rebound is particularly pronounced for Luxembourg, Slovakia and Sweden who are all posting GDP growth close to or above 2% this year, while GDP is projected to contract in Cyprus, Greece, Ireland, Latvia and Lithuania. By 2011, all EU countries, with the exception of Greece, are expected to have returned to positive economic growth.

Labour markets hit hard, albeit a bit less than earlier feared...

Labour markets were hit hard by the crisis, albeit somewhat less than initially expected. Job destruction was limited by the use of short-term measures and labour hoarding in some Member States, but also as a result of past reforms. Reflecting the usual lag between employment and output, employment still declined towards the end of 2009, although at a slower pace than before, and signs of stabilisation have begun to emerge: firms' employment expectations have improved and the unemployment rate was levelling off at 9½% in the EU (10% in the euro area) in February 2010, some 2½ percentage points (pps.) above the pre-recession rate. Differences across countries have widened with the rate of unemployment ranging from 4-5% in the Netherlands and Austria to around 20% in Spain and Latvia where a sharp decline in residential construction weighed heavily on the labour market.

...while the outlook is for a jobless recovery

Looking ahead and taking into account a negative carry-over from 2009, employment is expected to fall by around 1% this year, leading to a further rise in the unemployment rate in both the EU and the euro area. The relatively limited labour-market adjustment so far, together with a sectoral reallocation forced by the crisis, suggests a rather jobless recovery and (potentially persistent) high unemployment ahead.

Slack keeps inflation in check

Consumer-price inflation has rebounded somewhat from the very low levels recorded in mid-2009. Sizeable slack in the economy is nevertheless expected to keep both wage growth and inflation in check, partly offsetting expected increases in energy and commodity prices as well as, for the euro area, a weaker euro. HICP inflation is projected to average 1¾% in the EU both this year and next (and 1½% and 1¾%, respectively, in the euro area).

Public deficits tripled...

Public finances were also severely hit by the crisis. The general government deficit has tripled in recent years. The deficit reached 6.8% of GDP in the EU in 2009 (and 6.3% in the euro area), while the debt-to-GDP ratio rose by some 10 pps. to 73.6% in the EU (or 78.7% in the euro area). The surge in the deficit is attributable to the working of automatic stabilisers (such as unemployment benefits) and to the discretionary fiscal-stimulus measures that were taken under the European Economic Recovery Plan to combat the crisis. Moreover, public revenues dropped more than the extent of economic downturn would normally warrant in several countries, reflecting a change in the composition of growth towards less tax-rich components, such as exports.

...but set to improve somewhat, while debt continues to rise in 2011

The deficit ratio is expected to peak this year, with an improvement of about ½ pp. projected for 2011 in both regions, largely reflecting the end of the temporary expansionary measures. The debt ratio, in contrast, remains on an increasing path throughout the forecast horizon (reaching close to 84% of GDP in the EU and over 88½% in the euro area by 2011). Recalling the analysis presented in the autumn European Economic Forecast, a one-off increase in public debt does not necessarily put fiscal sustainability at risk. However, current trends in public debt may jeopardise long-term sustainability given the combination of sustained large deficits, low(er) potential growth than in the past and, in the not too distant future, unfavourable demographic developments.

Continued high uncertainty...

The tensions in the sovereign-debt markets in early 2010 illustrate well the high uncertainty that continues to surround economic projections. Overall, risks to both the growth and the inflation outlook remain broadly balanced.

...with broadly balanced risks for both the growth...

As regards economic activity, the external environment could continue to surprise positively, thereby boosting EU exports further. Moreover, policy measures could prove more effective than assumed (both in the EU and abroad), raising confidence among businesses and consumers further that, in turn, would strengthen domestic demand. Indeed, survey data have recovered firmly over the past year, especially in the manufacturing sector. If sustained, this would point to a stronger activity in the near term than other high-frequency indicators suggest at present. In contrast, the still fragile financial-market situation remains a source of concern. First, risk premium may increase in some Member States, leading to higher financing costs for firms and households, possibly also in other EU Member States. Second, while the banking sector has strengthened, the quality of the loan portfolio could deteriorate further. This could potentially hamper the ongoing process of balance-sheet repair, also endangering banks' capacity to cater for a future rebound in credit demand. In addition, monetary and fiscal policy exit could weigh more on consumption and investment than expected hitherto.

...and inflation outlook

Turning to inflation, the recent rebound in oil and other commodity prices and a lower-than-assumed euro-exchange rate constitute upside risks to the current projection. At the same time, large excess capacity, weak labour-market conditions and well-anchored inflation expectations are likely to contain inflationary pressures in the near term.

PART I

Economic developments at the aggregated level

1. THE EU ECONOMY: A GRADUAL RECOVERY

A recovery is underway in the EU, albeit a gradual one. While near-term growth prospects remain subdued on the whole, reflecting the fading of the temporary factors that kick-started the recovery, a modest improvement is foreseen compared to the autumn forecast. This follows from the stronger rebound in global activity and trade at the turn of the year and an improved external outlook.

Further out, the picture remains largely unchanged as the EU economy faces headwinds on a number of fronts, such as ongoing corrections in housing markets in some Member States, deleveraging and weak labour-market conditions. With lacklustre domestic demand continuing to act as a restraining factor, the recovery is thus set to gain traction only towards the end of 2010 and into 2011. However, given differences in the scale of the adjustment challenge across economies, an increased differentiation in the speed of recovery is projected among Member States compared to the autumn forecast.

Reliant on global growth in the near-term and held back somewhat by weak private demand further out, this recovery is set to mirror previous upturns following financial crises. The high unemployment and large increase in government debt typically associated with the aftermath of such crises are evident at the current juncture, though the rise in unemployment is set to be more contained this time round.

Overall, the EU economy is forecast to grow by some 1% in 2010 and 1¾% in 2011. Risks to this outlook appear broadly balanced, with upbeat survey data of late even pointing to some upside risks in the near-term.

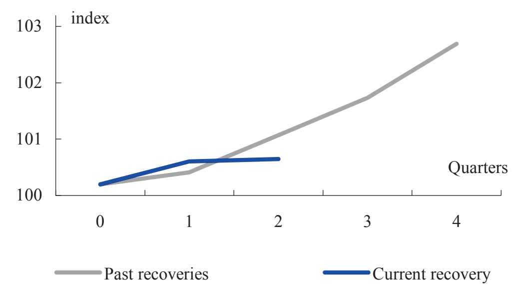
1.1. OUT OF RECESSION

Mirroring the resurgence of growth, albeit uneven, in advanced and emerging economies worldwide, a recovery is underway in the EU. Economic activity expanded in the third quarter of 2009, by 0.3% and 0.4% q-o-q in the EU and euro area respectively. This followed largely from improvements in the external environment and financial conditions, favourable inventory adjustment and, in particular, the significant fiscal and monetary policy measures put in place. However, reflecting the temporary nature of some of these factors, the fourth quarter saw an easing in the pace of growth (+0.1% q-o-q in the EU and flat in the euro area).

With the turnaround in the economy, the deepest and longest recession in the EU's history has come to an end. Progress across Member States appears somewhat uneven though. Among the region's larger economies, Germany, France and the UK have started to grow again; whereas Spain and Italy ended 2009 with their economies still contracting.

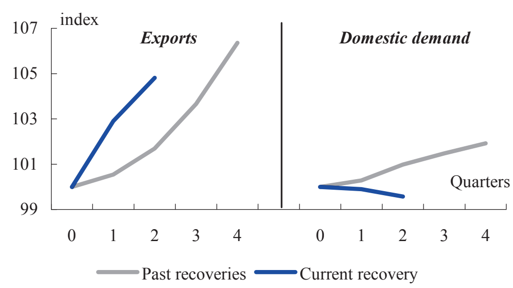
With the recession over, at least at the aggregate EU / euro-area level, attention has begun to shift towards the dynamics of the nascent recovery. *What might this look like? What will drive it? How strong and lasting will it prove to be?*

Graph I.1.1a: **Comparison of recoveries, current against past average - GDP, euro area**



Note: Real GDP following the recessions of the mid 1970s, early 80s and early 90s

Graph I.1.1b: **Comparison of recoveries, current against past average - exports and domestic demand, euro area**



When it comes to questions such as these, history can provide some useful insights. To this end, graph I.1.1a compares trends in economic activity in the initial quarters of this upturn with the average observed at the start of previous recoveries.[1]

Due in large part to the trajectory of policy measures, there was a stronger rebound in activity in the first quarter of this upswing, but a marked atypical softening in the second. This contrasts with the gradual pick-up in GDP seen in the early stages of past recoveries. Turning to the demand components, export growth has been relatively strong this time round. This owes much to the performance of the global economy, which surprised on the upside towards the end of 2009. Conversely, the weakness of domestic demand appears more pronounced and protracted than usual.

So far, this recovery is proving more tentative than the average rebound. This is not surprising given the extraordinary nature of the recent downturn in the EU and the possible breakdown in traditional relationships that has followed from it. Indeed, it may well be that the 'average' recovery is not the appropriate benchmark for assessing what lies ahead. Focussing instead on upturns that follow periods of financial distress might better serve this purpose.

Various research on the characteristics of such recoveries shows that they tend to be slower, held back by weak private demand and tight credit conditions. According to the findings, the time it takes for the economy to return to the level of activity reached in the previous peak is as long as the recession itself.[2] In addition, the aftermath of financial crises is typically associated with asset-price declines, rising unemployment and large increases in government debt; features which are also evident at the current juncture.[3]

A priori, it seems reasonable to expect a sluggish recovery this time round. The indications up to now, muted economic activity and historically weak domestic demand; are in keeping with such a prognosis. Moreover, advanced economies are in general still grappling with the legacy of the crisis. The EU will continue to do so for some time to come; not only in the period immediately ahead, but also over the medium-term as the economy transits to a new steady state.

As discussed last autumn, a number of forces are set to define the contours of this new equilibrium.[4] These include a potentially higher cost of capital; deleveraging on the part of households, firms and governments; and the shadow cast by the crisis on labour markets, public finances and potential growth. Some differentiation in the effect of these forces is however likely across Member States. For example, countries where large-scale deleveraging is needed may face a risk of lower potential growth, if the high indebtedness levels of firms in the pre-crisis period results in a protracted period of debt reduction.

Furthermore, to the extent that unsustainable financial conditions prior to the crisis resulted from excess liquidity generated by global imbalances, the way in which global imbalances, and the financial sector itself, evolve will have important implications for the medium-term growth dynamics of the EU economy. The two analytical chapters that accompany this spring forecast focus specifically on developments in these areas.

The remaining sections of this chapter elaborate on the short-term outlook for the EU economy.

1.2. THE ROAD AHEAD

Given the current starting position of the EU economy, the recovery underway is set to be different, more gradual and more subdued, than previous upturns. The chain of events, however, should be much the same as in the past. Recoveries of the EU economy are typically export-led: first, a pick-up in exports feeds through to (equipment) investment; second, investment growth leads to employment growth which, in turn, stimulates private consumption. Thus, a key condition for the upswing phase of the EU business cycle to take root is an improvement in the external environment. In this respect, developments since the autumn have been largely favourable.

(1) The previous recoveries referred to are those of the mid-1970s, early 1980s and early 1990s.
(2) See, for example, IMF (2009) 'World Economic Outlook', April 2009.
(3) As discussed in Reinhart, C.M. and Rogoff, K.S. (2009) 'The Aftermath of Financial Crises'. *American Economic Review Papers and Proceedings*, 99(2), 466-472.
(4) See chapter 1 in European Commission (2009) 'European Economic Forecast – Autumn 2009'.

A strong rebound in global activity and trade…

Robust global growth has been an important factor in many recoveries associated with financial crises.[5] The recovery now in progress in the EU also reflects a sharp rebound in the world economy. Global activity was in fact stronger towards the end of 2009 than anticipated at the time of the autumn forecast, as was world trade.

Prospects for the global economy also appear brighter at the current juncture. In addition to a higher carry-over from last year, high-frequency indicators are pointing to improvements in the near-term. For example, the global PMI for manufacturing recorded its highest reading in over 5½ years in March 2010. However, a certain softening in the pace of growth can be expected later this year as the effect of temporary factors, such as stimulus measures and inventory adjustment, peter out. All-in-all, having escaped a contraction last year, global GDP (excl. EU) is projected to grow by around 4¾% in 2010-11, though the momentum from this year into next is set to decline somewhat. This aggregate picture also masks a marked differentiation in the speed of recovery across regions.

Reflecting the fading of temporary supports and still significant headwinds, the outlook is for a more modest recovery in advanced economies. In so far as private demand does not recover fast enough to shore up economic growth, activity in parts of the developed world could prove rather sluggish further out. Among the largest non-EU advanced economies, US GDP is projected to rebound from a contraction of 2½% in 2009 to about 2¾% growth in 2010, before easing somewhat in 2011 to 2½%. In Japan, GDP is projected to grow by around 2% this year (following a contraction of over 5% in 2009), but to soften in 2011 to about 1½%.

While the situation in advanced economies is generally improving, the upswing in emerging markets outside the EU and in developing countries is proving much more dynamic. Emerging economies are set to expand strongly over the forecast horizon on the back of buoyant domestic and regional demand, net exports and capital inflows.

This is especially the case for emerging Asia, which is projected to post growth of over 8% in 2010 and 7½% in 2011. Within this region, China is leading the way. GDP growth of around 10¼% is foreseen for 2010 as a whole, though some easing in the pace of activity is expected in the second half of the year and in 2011 (around 9½%). This follows from the monetary policy tightening already initiated by the Chinese authorities and the ending of some stimulus measures. Outside of Asia, the emerging economies of Russia and Brazil are set to return to growth this year, expanding by about 3¾% and 5¾% respectively, due, inter alia, to rebounding commodity prices and improving domestic demand.

(5) See IMF (2009) 'World Economic Outlook', April 2009.

Table I.1.1:

International environment

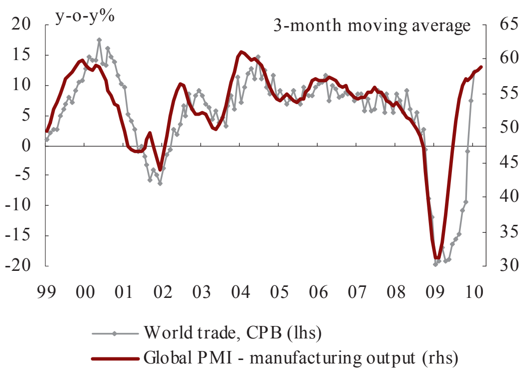
(Real annual percentage change)					Spring 2010 forecast			*Autumn 2009 forecast*	
	(a)	2006	2007	2008	2009	2010	2011	*2010*	*2011*
					Real GDP growth				
USA	20.7	2.7	2.1	0.4	**-2.4**	**2.8**	**2.5**	*2.2*	*2.0*
Japan	6.4	2.0	2.4	-1.2	**-5.2**	**2.1**	**1.5**	*1.1*	*0.4*
Asia (excl. Japan)	24.6	9.1	9.7	6.8	**5.3**	**8.2**	**7.5**	*6.8*	*7.3*
- China	11.6	11.6	13.0	9.7	**8.7**	**10.3**	**9.4**	*9.6*	*9.5*
- India	4.8	9.8	9.0	6.7	**5.7**	**8.1**	**8.0**	*6.4*	*7.4*
Latin America	8.7	5.6	5.8	4.2	**-1.8**	**4.2**	**4.0**	*3.1*	*3.4*
- Brazil	2.9	4.0	6.1	5.1	**-0.2**	**5.7**	**4.5**	*4.2*	*4.2*
MENA	4.9	5.7	5.9	5.0	**1.6**	**4.2**	**5.3**	*4.1*	*5.3*
CIS	4.6	8.3	8.6	5.5	**-7.1**	**3.7**	**4.2**	*2.3*	*3.1*
- Russia	3.3	7.7	8.1	5.6	**-7.9**	**3.7**	**4.0**	*2.3*	*2.7*
Sub-Saharan Africa	2.4	6.7	6.9	5.6	**2.0**	**4.7**	**5.9**	*4.0*	*4.5*
Candidate Countries	1.5	6.7	4.8	1.1	**-4.8**	**4.1**	**4.3**	*2.6*	*3.5*
World (incl. EU)	100	5.2	5.2	2.9	**-0.9**	**4.0**	**4.0**	*3.1*	*3.5*
					World merchandise trade				
World import growth (goods)		9.7	6.5	4.2	**-12.1**	**8.9**	**6.3**	*3.6*	*4.6*
Extra EU export market growth		9.3	8.9	3.6	**-11.0**	**9.8**	**6.5**	*4.2*	*4.5*

(a) Relative weights, based on GDP (at constant prices and PPS) in 2008.

Trade developments since the autumn have also been positive. Following unprecedented declines in the fourth quarter of 2008 and the first quarter of 2009 (of some 8% and 10% q-o-q), world trade staged an impressive rebound in the latter part of last year, rising by 4% q-o-q in the third quarter and by 5% in the fourth (CPB estimates). It seems that the response of trade to economic activity has increased over time as a consequence of globalisation and the greater prevalence of global supply chains, which also offers a possible explanation for the strong recovery in trade volumes seen recently.[(6) (7)]

Looking ahead, the global PMI for manufacturing suggests a continuation of the recovery in world trade, with the OECD leading indicator for global developments also upbeat.[(8)]

Graph I.1.2: **World trade and PMI global manufacturing output**



Overall, global trade (excl. EU) is projected to expand by around 10% in 2010, on the back of a higher carry-over from last year and the resurgence of activity across advanced and emerging economies. Growth of close to 7% is expected in 2011.

This improved outlook for the external environment should bode well for EU exports in the period ahead. Of course, the extent to which individual Member States can be expected to benefit from the global upturn will differ depending on their geographical and product specialisation, as well as on their competitive position (see box I.1.1). For Member States whose exports are directed in a large part towards emerging markets (e.g. Germany and Finland), the impact could be more positive given the strong GDP growth projected for emerging economies over the forecast horizon. A comparative advantage is also likely for countries whose exports are more heavily weighted towards capital goods (as trade in these goods suffered disproportionally during the downturn). For euro-area countries, further gains might come about via the exchange-rate channel, owing to the depreciation of the euro in the first months of this year and that assumed in the forecast (though lagged effects from the past appreciation cannot be excluded either).[(9)] However, estimation results suggest that while fluctuations in the real exchange rate feed through to export performance quite rapidly, the corresponding elasticity is fairly low.[(10)]

The export outlook for the EU economy also depends on how robust the global rebound proves to be. With a deceleration expected in the second half of 2010, the strength of the underlying global recovery has not yet been confirmed. Moreover, the recovery underway appears relatively sluggish in the main advanced economies, though more robust in many emerging markets. In the short term, a strengthening of private demand will be needed for the recovery to become self-sustaining. The possibility of asset-price bubbles in emerging economies generally, together with bouts of volatility in financial markets, is also of concern.

Over the medium-term, the way in which global imbalances are unwound will have implications, notably for the euro-area's tradable goods sector. While the crisis has triggered some correction in global imbalances, this has largely been temporary,

(6) The increased presence of vertical specialisation raises the ratio of trade flows to production, as it involves producing goods in two or more sequential stages, where at least one stage of production relies on imported inputs, and some part of that production is exported. See Yi, K-M. (2009) 'The collapse of global trade: the role of vertical specialisation' in R. Baldwin and S. J. Evenett (eds.) *The collapse of global trade, murky protectionism, and the crisis: Recommendations for the G20*, Voxeu.org.

(7) Freund (2009) estimates that, owing to the fragmentation of production, the elasticity of real world trade to real world income increased from around 2 in the 1960s and 1970s to 3.5 in recent years. Further details can be found in Freund, C. (2009) '*The Trade Response to Global Downturns: Historical Evidence*', Policy Research Working Paper 5015, Development Research Group, The World Bank.

(8) Indicator for the OECD region plus six large emerging markets.

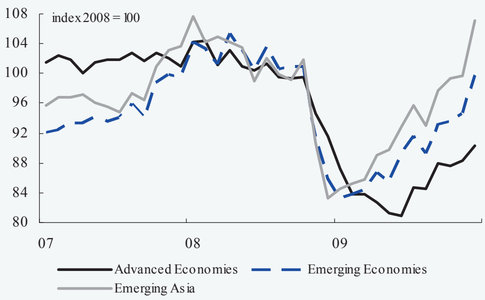
(9) The technical exchange-rate assumptions for 2010-11, as well as other external assumptions, are set out in box I.1.5.

(10) Most of the effect of an exchange-rate shock is reflected in export performance after three quarters. The estimation results also find that a 1% appreciation of the real exchange rate reduces the level of extra-euro-area exports by 0.2% compared to the baseline after one year, and by 0.25% after two years. Further details can be found in European Commission (2007) 'Quarterly Report on the Euro Area', Volume 6, No 2.

Box I.1.1: How well placed is the EU to benefit from the global rebound?

World trade growth in 2010 has been revised up significantly in this forecast, mainly due to a better-than-expected second half of 2009. Most of the positive surprises were, however, concentrated in emerging and developing economies, with advanced economies lagging behind.

Graph 1: **Imports of goods in selected areas, 2006-2009**



Source: CPB Netherlands Bureau for Economic Policy Analysis

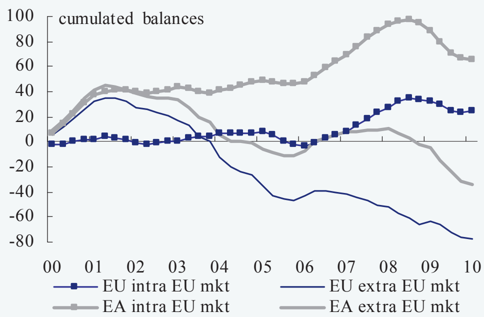
Trade flows in emerging Asia and Latin America are back to pre-crisis levels and their growth rates are expected to decelerate only slightly in 2011. Asia is leading the way, in particular China's trade with other emerging economies, like Indonesia and Brazil, has been booming. A number of free trade agreements are entering into force in 2010 throughout Asia, which will contribute to deeper trade integration there. In other parts of the emerging world, trade flows have been sustained thanks to an upswing of trade in commodities (e.g. Russia, Brazil and Indonesia).

According to the present forecast, the global rebound will allow the EU to reduce its export market losses, from 1 pp. in 2009 to less than ½ pp. in 2010 and 0 pp. in 2011.[1] This aggregate development masks, however, divergent developments at the Member State level. This divergence is most likely linked to differences in competitiveness and in product specialisation. As an example of the latter; trade in capital goods suffered disproportionally from the effects of the financial crisis. As a result, exporters with a large weight of capital goods will have a comparative advantage during the upswing.

Several of the more recently-acceded Members States are set to gain export market share, while most of the older Member States are expected to lose market share over the period 2010-11. Nevertheless, the group of Member States for whom the cumulative export growth rate over this period will be in double-digits includes *Germany* and *the Netherlands*. This is in line with the Commission's forthcoming assessment that these Member States are among the euro-area countries which are well placed in terms of their competitive position (in a more medium-term perspective) to benefit from the global rebound. *Germany* should benefit from its sound overall price and cost competitiveness position and its specialisation in capital goods. In *the Netherlands*, the government announced in 2009 a renewed policy of wage moderation, which should help the country to restore its competiveness position.

The competitiveness issue can also be looked at from a different angle. In the business survey in manufacturing, a set of quarterly questions is asked on competitiveness as perceived by managers.[2] In general, the results for the competitiveness questions correlate strongly, with a short lag, with the reference price competitiveness series. Graph 2 shows that these subjective measures have not yet shown an upturn for the EU and euro-area aggregates (latest observation: January 2010).

Graph 2: **Perceived competitive position in foreign market**



Source: Harmonised business survey in manufacturing

(1) And similarly, in the euro area, from about 2 pps. in 2009 to about ½ pp. in 2010 and about ¼ pp. in 2011. Note, however, that this measure is heavily influenced by intra-EU export performance, as intra-trade accounts for two-thirds of total EU trade.

(2) Managers are asked to evaluate developments in their competitive position in domestic and foreign (inside and outside EU) markets. Perceived changes in competitiveness are measured as balances (e.g. the percentage of positive respondents minus the percentage of negative respondents), while perceived levels of competitiveness are measured through cumulated balances.

with further adjustment of a more structural nature needed. The analytical chapter on global imbalances finds that if such adjustment takes a 'benign' form (i.e. assuming that the correction of the US current-account deficit is offset by an equivalent increase in aggregate demand in emerging Asia, led by China and helped by the removal of de facto exchange-rate pegs to the US dollar), the real effective exchange rate of the euro would remain broadly stable, although the composition of the euro-area's trade balance would change. However, if the adjustment takes a more 'harmful' form (i.e. assuming that emerging Asia maintains its current exchange-rate arrangements and fails to offset a permanent reduction in aggregate demand in the US), the adjustment burden would fall mostly on the euro area, which would see a marked appreciation of its real effective exchange rate and an associated loss of competitiveness. Under this scenario, growth in both the euro area and the world economy would suffer.

As for internal imbalances, divergences within the euro area have also narrowed during the crisis, though again part of this is cyclical. Significant imbalances remain however. As discussed in a recent Commission report, these partly reflect structural weaknesses, such as persisting weaknesses in domestic demand (in surplus countries) and weak price and cost competitiveness (in deficit countries), often combined with high debt levels in the latter.[11] At the aggregate level, the current-account deficit is set to remain relatively small in both the EU and euro area over the forecast horizon, at around 1¼% and ½% respectively.

Lastly, short-term prospects for oil and commodity prices depend on the timing and strength of the global recovery, with upward pressure likely to continue as the recovery gathers pace. However, above average inventories and significant spare capacity are expected to broadly offset such pressure. Oil prices are now assumed to average USD 84.5/bl. in 2010 and USD 89.2/bl. in 2011. Commodity prices more generally, and energy and metal prices in particular, are projected to remain relatively high by historical standards over the forecast horizon.

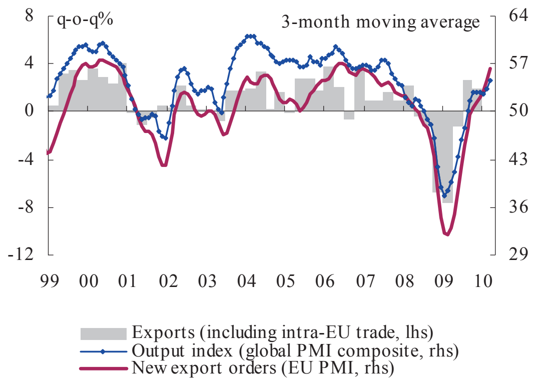
[11] See European Commission (2010) 'Quarterly Report on the Euro Area', Volume 9, No 1.

…triggers a modest upgrading of near-term growth prospects for the EU

These broadly favourable external developments are supporting the initial stage of the typical recovery sequence in the EU economy, that of a pick-up in exports.

Both hard and soft data indicate solid export growth in the EU and euro area at the turn of the year. Monthly data on extra-euro-area exports has been on a broadly upward trend for some time now. On a three-month over three-month basis, the index was up by 2.3% in February (the latest available data), pointing to strong momentum. Signs that the EU is benefitting from the rebound in global activity and trade are also evident in soft data, with recent readings of the new export orders component of the PMI and Commission surveys showing a steady improvement into 2010. However, as discussed earlier, some differentiation in the impact across Member States is to be expected, and is apparent from the data.

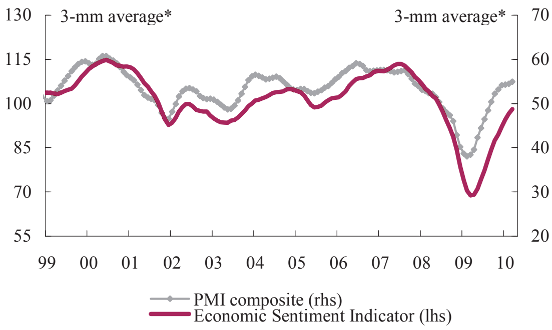
Graph I.1.3: **Global demand, EU exports and new export orders**



On the domestic front, the signals are more mixed. For instance, private consumption was flat in the final quarter of 2009, while investment continued to contract. As a result, GDP was weak, growing by a meagre 0.1% q-o-q in the EU and not at all in the euro area. Construction activity at the turn of the year was also muted, due in part to the unusually cold winter. Together these hard data suggest sluggish output growth in the near-term.

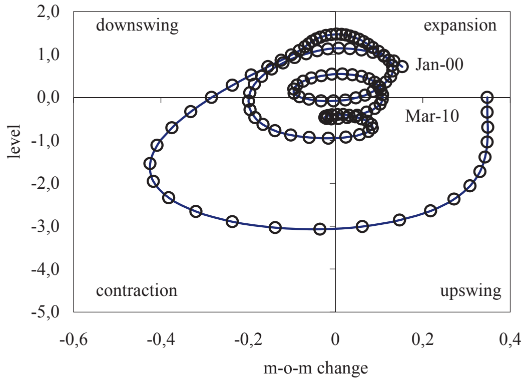
Survey data on the other hand points to a continuing improvement in economic activity. The Commission's Economic Sentiment Indicator (ESI) and the composite Purchasing Managers' Index (PMI) have gained considerable ground over the past year, recovering from the historic lows of

Graph I.1.4a: **Economic Sentiment Indicator and PMI composite index, EU**

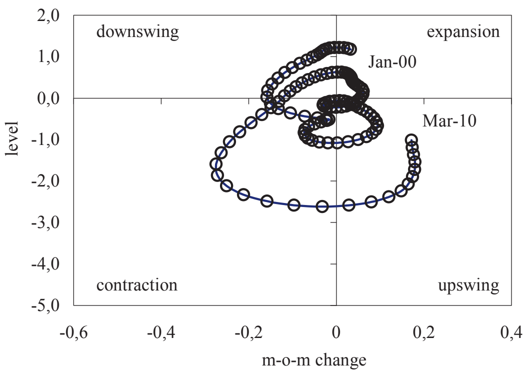


* 3-month moving average

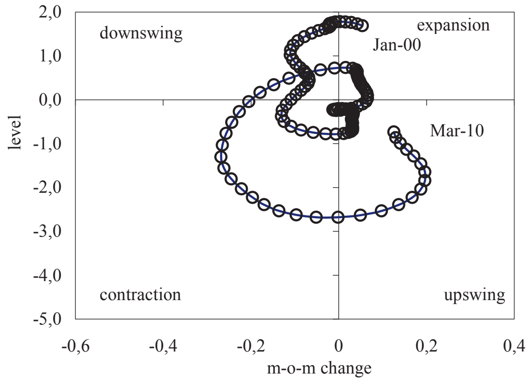
Graph I.1.4b: **Economic climate tracer - industry, EU**



Graph I.1.4c: **Economic climate tracer - services, EU**



Graph I.1.4d: **Economic climate tracer - consumers, EU**



early 2009 to respectively hover around / above their long-run average at present.

As for sectoral patterns, survey indicators are pointing to further improvements in manufacturing activity; with the Commission's economic climate tracer for industry even entering the expansion area (see graph I.1.4b).[12] The latest services readings are also encouraging, suggesting that the spill-over to be expected from a pick-up in manufacturing activity to the rest of the economy is beginning to materialise; though consumer confidence has been more stable of late.

A closer look at the soft data also reveals pronounced cross-country differences. For example, the manufacturing PMI for March 2010 shows that while activity continued to strengthen in Germany, France and the UK among others, the indicator has yet to cross the 50-mark (which separates expansion from contraction) in Greece.

A further factor influencing the short-term outlook for the EU economy relates to fiscal measures. The termination and scaling back of extraordinary schemes is foreseen in a number of Member States this year, along with significant consolidation measures in some. In contrast, further expansionary measures are set to be implemented in a few countries.

Table I.1.2:
Decomposition of the GDP growth forecast

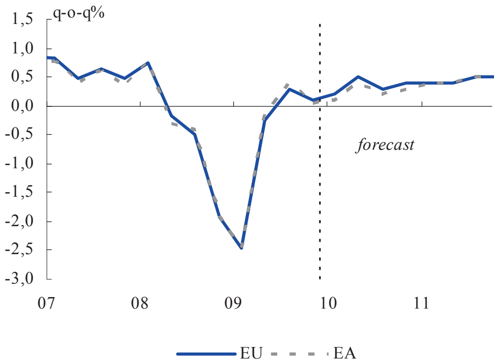
EU	2009	2010	2011
Carry-over from preceding year	-1.7	0.2	0.6
y-o-y in Q4	-2.3	1.4	1.9
Annual average	-4.2	1.0	1.7
Euro area	**2009**	**2010**	**2011**
Carry-over from preceding year	-1.7	0.3	0.5
y-o-y in Q4	-2.2	1.0	1.7
Annual average	-4.1	0.9	1.5

Weighing up these various developments, near-term growth prospects appear rather subdued, though a temporary hike is likely in the second quarter of 2010 (owing largely to a technical rebound in construction activity). For the first three quarters of the year, GDP growth is expected to

[12] Further details can be found in European Commission (2010) 'European Business Cycle Indicators', April.

average in the region of ¼% q-o-q in both the EU and euro area. This represents a modest upward revision compared to the autumn forecast in light of the improved external environment.

Graph I.1.5: **Quarterly GDP profile**



Further, albeit uneven, progress in financial markets is expected

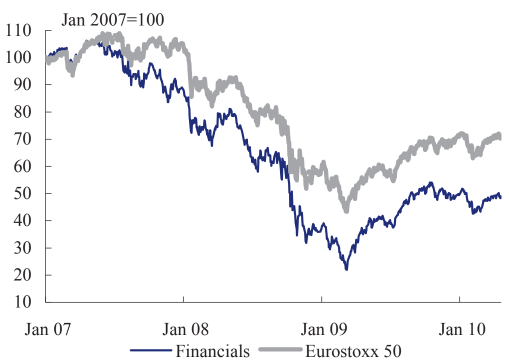
Financial conditions are gradually improving, though developments differ across segments and progress has been unsteady recently owing to bouts of market nervousness (see graphs I.1.6a-c).

While developments have been broadly favourable in money, equity and corporate-bond markets, government-bond markets have come under pressure of late, especially in some euro-area countries. Growing concerns about the fiscal situation led to sharp increases in government-bond spreads in certain Member States (notably Greece and to a lesser extent Portugal) and a flight to quality; accompanied by a substantial pick-up in volatility. Fears of default by companies in the euro-area periphery have also risen, indicating a knock-on effect to the corporate sector.

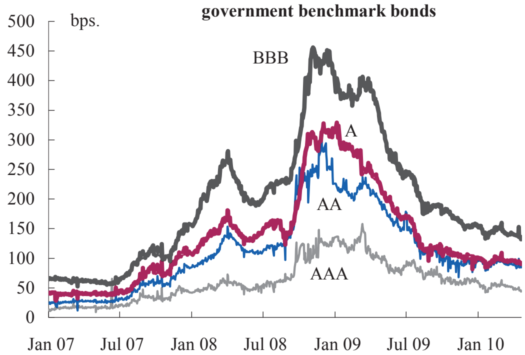
Given the important role played by credit in recoveries associated with financial crises, the situation in the banking sector is of particular relevance.[13] Here conditions appear to have stabilised somewhat lately, which augers well for the real economy. As discussed in the analytical chapter on financial markets, banks have continued to repair their balance sheets on the back of improved earnings and more favourable funding conditions. That said, problems remain in some segments and the recovery of the sector as a whole

[13] See box 3.2 in IMF (2009) 'World Economic Outlook', April 2009.

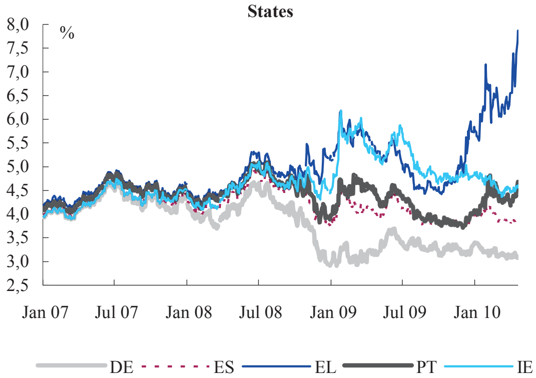
Graph I.1.6a: **Stock market performance**



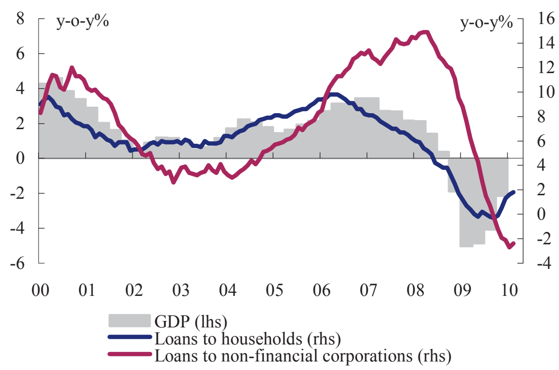
Graph I.1.6b: **Corporate spreads over eurozone government benchmark bonds**



Graph I.1.6c: **Government bond yields, selected Member States**



Graph I.1.6d: **Bank lending to households and non-financial corporations, euro area**



still appears fragile as, inter alia, further loan-loss provisions may have to be booked and bank-refinancing conditions are far from normal.[14] Indeed, improved conditions are to some extent temporary and policy-driven, with the underlying soundness of the banking sector yet to be tested. In addition, the possibility that problems in sovereign issuance could weaken the solvency position of banks holding government bonds cannot be ruled out.

Regarding lending activity, the latest ECB bank lending survey (January 2010) points to a further, albeit slight, tightening of credit standards; though the pace is moderating. Lending to households has recently picked up in the euro area (1.8% y-o-y in February), but continues to decline for non-financial corporations. These developments are broadly in line with past patterns, whereby lending to the private sector typically lags the economic upturn by at least a year. On this basis, bank lending is expected to rebound towards the end of 2010, thus supporting the recovery further out. Moreover, the analytical chapter on financial markets finds that the flow of credit or so-called 'credit impulse' is more closely related to economic activity than the stock of loans.[15] This 'credit impulse' has normalised in the euro area, suggesting that the recovery may also receive some near-term support from the credit-side.

(14) Estimates based on macro-scenarios by the IMF and ECB suggest that total losses in the EU banking sector could be higher than what banks have published so far. See also ECB (2009) 'Financial Stability Review', June and IMF (2010) 'Global Financial Stability Report', April.

(15) However, the difference in terms of correlation coefficients (0.6 for the credit impulse compared to 0.5 for the stock of credit) is not large.

Overall, a further improvement in financial markets is expected over the forecast horizon, on account of strengthening economic activity, the gradual and orderly withdrawal of public support and reduced regulatory uncertainty. However, the road ahead is set to be rough, with progress likely to be accompanied by high market sensitivity to risk and considerable volatility.

Lacklustre domestic demand to hold back the recovery further out...

While the resurgence of export growth underpins the modest upgrading of the EU's near-term growth prospects, some caution is warranted regarding the export outlook going forward. With the global economy set to go through a soft patch in the second half of 2010, and the robustness of the underlying recovery not yet confirmed, EU export growth is expected to firm only gradually over the forecast horizon. As such, the next phase of the typical recovery sequence – in which the pick-up in exports feeds through to (equipment) investment demand – may be less strong this time round. Developments on the domestic front may also serve to weaken this traditional export-investment link. Indeed, upturns that follow financial crises tend to be slower, held back by weak private demand.

Turning to domestic demand prospects at the current juncture, and beginning with gross fixed capital formation which recorded a sharp fall in 2009, of some 11%. Overall investment spending is projected to decline further this year (by around 2¼% in the EU and 2½% in the euro area), before picking up in 2011 by about 2½% and 1¾% in the

Table I.1.3:

Main features of the spring 2010 forecast - EU

(Real annual percentage change unless otherwise stated)				Spring 2010 forecast (a)			*Autumn 2009 forecast*	
	2006	2007	2008	2009	2010	2011	*2010*	*2011*
GDP	3.2	2.9	0.7	**-4.2**	**1.0**	**1.7**	*0.7*	*1.6*
Private consumption	2.2	2.0	0.8	**-1.7**	**0.1**	**1.3**	*0.2*	*1.2*
Public consumption	2.0	1.9	2.3	**2.2**	**1.0**	**0.1**	*1.0*	*0.6*
Total investment	6.1	5.9	-0.6	**-11.5**	**-2.2**	**2.5**	*-2.0*	*2.5*
Employment	1.5	1.7	0.9	**-2.0**	**-0.9**	**0.3**	*-1.2*	*0.3*
Unemployment rate (b)	8.2	7.1	7.0	**8.9**	**9.8**	**9.7**	*10.3*	*10.2*
Inflation (c)	2.3	2.4	3.7	**1.0**	**1.8**	**1.7**	*1.3*	*1.6*
Government balance (% GDP)	-1.4	-0.8	-2.3	**-6.8**	**-7.2**	**-6.5**	*-7.5*	*-6.9*
Government debt (% GDP)	61.4	58.8	61.6	**73.6**	**79.6**	**83.8**	*79.3*	*83.7*
Adjusted current account balance (% GDP)	-1.2	-1.1	-2.0	**-1.4**	**-1.4**	**-1.3**	*-1.5*	*-1.3*
Contribution to change in GDP								
Domestic demand	3.0	2.8	0.8	**-3.0**	**-0.1**	**1.2**	*-0.1*	*1.3*
Inventories	0.1	0.1	-0.1	**-1.1**	**0.5**	**0.2**	*0.4*	*0.2*
Net exports	0.1	0.0	0.1	**-0.1**	**0.6**	**0.3**	*0.4*	*0.2*

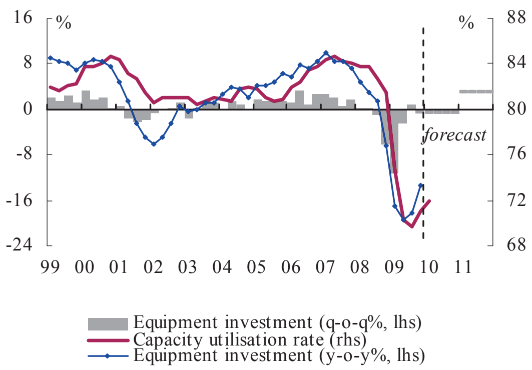
(a) The Commission services' spring 2010 forecast is based on available data up to April 20, 2010.
(b) Percentage of the labour force. (c) Harmonised index of consumer prices, nominal change.

EU and euro area respectively. This reflects a weak outlook for both equipment and construction investment.

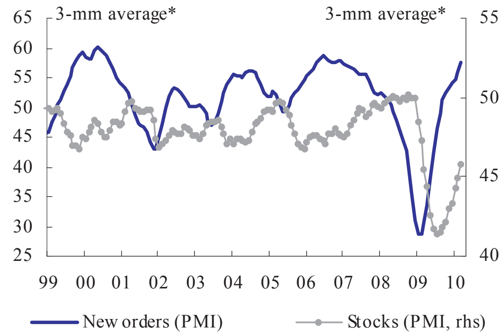
Equipment investment is forecast to remain subdued this year (and relatively so in 2011, notwithstanding a return to positive growth) for a number of reasons, both structural and cyclical. First, the deleveraging process underway will take time, and is likely to be particularly pronounced in Member States where the indebtedness level of firms prior to the crisis was high (e.g. Ireland, Portugal and Spain). Second, the capacity utilisation rate in the EU is still exceptionally low, with the latest reading of 73% (taken in the first quarter of 2010) only marginally above the historic low of 70% reached in the third quarter of 2009.[16] Third, risk aversion on the part of firms – as suggested by survey findings which show that inventories are being kept at a low level, despite relatively strong new orders – is set to weigh on capital spending in the period ahead.

As discussed in box I.1.2, research results point to a negative and statistically significant relationship between uncertainty and investment. To the extent that recent developments in government-bond markets have led to higher financing costs and increased uncertainty in some euro-area Member States, these findings suggest that investment decisions could be delayed. Any such delays would push the recovery in equipment investment out towards the end of the forecast horizon. This appears to be the case in some countries.

Graph I.1.7: **Equipment investment and capacity utilisation in manufacturing, euro area**



Graph I.1.8: **Stocks and new orders, EU**



* *3-month moving average*

(16) In certain industries, the gap between current and normal levels of capacity utilisation represents structural decline rather than cyclical slack; thus it may never close. In such cases, capacity has effectively been rendered obsolete.

Table I.1.4:

Main features of the spring 2010 forecast - euro area

(Real annual percentage change unless otherwise stated)	2006	2007	2008	Spring 2010 forecast (a) 2009	2010	2011	Autumn 2009 forecast 2010	2011
GDP	3.0	2.8	0.6	**-4.1**	**0.9**	**1.5**	*0.7*	*1.5*
Private consumption	2.0	1.6	0.4	**-1.1**	**0.0**	**1.1**	*0.2*	*1.0*
Public consumption	2.1	2.3	2.1	**2.3**	**0.9**	**0.3**	*1.1*	*1.0*
Total investment	5.4	4.8	-0.6	**-10.8**	**-2.6**	**1.8**	*-1.9*	*2.1*
Employment	1.4	1.7	0.6	**-2.1**	**-1.0**	**0.1**	*-1.3*	*0.0*
Unemployment rate (b)	8.3	7.5	7.5	**9.4**	**10.3**	**10.4**	*10.7*	*10.9*
Inflation (c)	2.2	2.1	3.3	**0.3**	**1.5**	**1.7**	*1.1*	*1.5*
Government balance (% GDP)	-1.3	-0.6	-2.0	**-6.3**	**-6.6**	**-6.1**	*-6.9*	*-6.5*
Government debt (% GDP)	68.3	66.0	69.4	**78.7**	**84.7**	**88.5**	*84.0*	*88.2*
Adjusted current account balance (% GDP)	-0.1	0.1	-1.1	**-0.8**	**-0.6**	**-0.5**	*-0.8*	*-0.7*
Contribution to change in GDP								
Domestic demand	2.7	2.4	0.5	**-2.5**	**-0.3**	**1.0**	*0.0*	*1.2*
Inventories	0.1	0.0	0.1	**-0.8**	**0.4**	**0.1**	*0.3*	*0.1*
Net exports	0.1	0.4	0.0	**-0.7**	**0.8**	**0.4**	*0.4*	*0.2*

(a) The Commission services' spring 2010 forecast is based on available data up to April 20, 2010.
(b) Percentage of the labour force. (c) Harmonised index of consumer prices, nominal change.

Box I.1.2: **Uncertainty and investment**

Firms' investment decisions are not only guided by the net present value of future profits of a project, but also by the riskiness of the profit stream. When investment returns are highly uncertain, delaying investment decisions until new information becomes available brings a gain: there is a 'real-option value' of inaction.(1) The higher the level of uncertainty, the larger the probability of 'expensive mistakes' (irreversibility argument) and thus the higher the option value so that firms scale back their plans. As a result, demand shocks have a smaller impact on investment, with implications for overall investment dynamics but not necessarily for long-run capital accumulation, as inaction will usually mean waiting with investment bouncing back as uncertainty subsides.(2)

Uncertainty cannot be quantified with the same precision as other determinants of investment decisions. Empirical research has offered several ways of constructing uncertainty measures e.g. directly asking managers or exploiting survey data, relying on high-frequency financial market data, and generating indicators from the financial statements of individual firms.

Investment decisions are looked at in the more recent empirical literature in the context of a dynamic capital accumulation framework. The 'real option' effect is tested using firm-level panel datasets, for inter alia the US, the UK, Germany and Italy.(3) While most studies look at the average direct impact of uncertainty on investment for a level of demand expectations, a few look instead at the impact of uncertainty on the sensitivity of investment to demand shocks.

Results point towards a significantly negative and quantitatively relevant relationship between uncertainty and the investment share of the capital stock. The above firm level studies report that a one-standard deviation increase in uncertainty from the sample mean would directly reduce investment by at least 3% and up to 6%. Moreover, an increase in uncertainty of the same magnitude would entail a 70% lower impact response of investment to a given increase in demand.(4) This evidence helps in interpreting the current behaviour of investment in the euro area. Uncertainty is probably weighing on business decisions, causing a delayed response of investment to a recovery in orders.

(1) See A. Dixit and R. Pindyck, *Investment under uncertainty*, Princeton University Press, 1994.

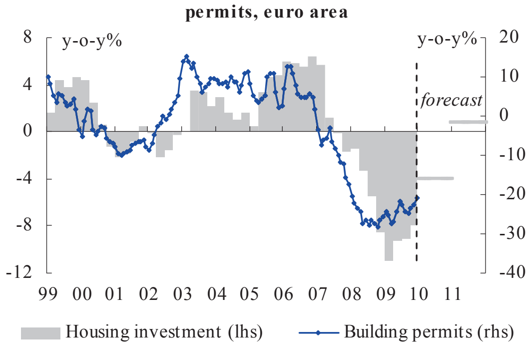
(2) A. Abel and J. Eberly, 'The effects of irreversibility and uncertainty on capital accumulation', *Journal of Monetary Economics*, 1999, 44(3), 339-377; N. Bloom, S. Bond and J. Van Reenen, 'Uncertainty and investment dynamics', *Review of Economic Studies*, 2007, 74 (2), 391-415.

(3) See for the US, S. Bond and J. Cummins, 'Uncertainty and investments: an empirical investigation using data on analysts' profits forecasts', *Finance and Economics Discussion Series* (Board of Governors) no. 20, 2004; for the UK: N. Bloom et al 2007 (see fn. 2); for Germany: von Kalckreuth, U., 'Explaining the role of uncertainty for corporate investment decisions in Germany', *Swiss Journal of Economics and Statistics*, 2003, 139(2), 173-206; and for Italy: L. Guiso and G. Parigi, 'Investment and demand uncertainty', *Quarterly Journal of Economics*, 1999, 114 (1), 185-227.

(4) Bloom et al., (2007) (see fn. 2).

As for construction investment, here too the outlook is muted. On the residential side, the contraction in activity, which began in 2007, is set to continue this year on the back of subdued housing demand(17) and ongoing price corrections in some Member States. While the adjustment process appears to be at an advanced stage in France and Ireland, Commission estimates indicate that more is to come in Spain and the UK (see box I.1.3). This weak supply picture is also supported by leading indicators; for instance, although building permits have started to recover, the number of permits issued in the EU was still down by some 15% y-o-y in December 2009. Moreover, the stock of unsold housing is expected to act as a drag on investment activity for some time to come.

Graph I.1.9: **Housing investment and building permits, euro area**



Note: Forecast figures relate to overall construction investment

(17) For a detailed discussion, see Box 3 'Recent housing market developments in the euro area' in ECB (2010) 'Monthly Bulletin', February.

Box I.1.3: Is house-price adjustment complete?

Movements in house prices have a direct impact on economic activity, in particular on construction activity and residential investment. They may also affect the spending patterns of households and financial institutions through the effects on their balance sheets.

The pronounced correction in house prices in some industrial countries since 2007 has received much attention as it has been one important trigger of the financial crisis in the US, and has served to reinforce the global downturn elsewhere via financial, trade as well as confidence links. A stabilisation of housing markets is therefore an important pre-condition for a return to a self-sustainable recovery.

In the US, real house prices started to fall in the first quarter of 2007, recording a decline of almost 15% by the fourth quarter of 2009. This contraction came after a period of strong growth (1998-2006), with an annual average increase in real house prices of 4.5% and a cumulated rise of almost 50%. In the euro area, real house prices tend to follow the US cycle with a lag. The downward adjustment started at the end of 2007 with a cumulated decline of 8.3% recorded by the third quarter of 2009 (latest available data). During 1998-2006, real house prices in the euro area rose by 4% on average each year and by a cumulated 45%.

The countries that experienced the most pronounced corrections between the second half of 2007 and the first half of 2009 were those that exhibited the strongest house price increases in the previous period. Within the EU, the sharpest drops were observed in Ireland (37%), the UK (23%), Spain (18%) and France (15%). By contrast, real house prices in Germany have fallen almost without interruption since mid-1995, largely as a backlash against the strong construction activity in the post-unification years.

Against this background, this box undertakes an assessment of the house-price corrections recently observed in the US and the EU countries mentioned above. The question is whether house prices still have to fall and by how much to be in line with fundamentals. In a nutshell, the analysis suggests that house-price correction is quite advanced in the US, France and Ireland, while further adjustment seems likely in Spain and the UK, implying a downward risk to growth prospects for these countries. Germany is the usual outlier.

Estimates of house-price imbalances are surrounded by a considerable degree of uncertainty. Nevertheless, once rooted in a well-defined conceptual framework, they provide a useful benchmark for assessing actual price developments. Two broad approaches are adopted to estimate house-price imbalances. The first approach estimates house prices on the basis of three key determinants over the medium term: personal income, credit conditions and the real tax-adjusted mortgage interest rate.[1] The second approach compares house prices with the present value of housing rents.[2] If house prices are significantly above (below) what would be spent by renting housing services, arbitrage would push prices downwards (upwards). This approach is well-founded for countries with an efficient rental market like the US, but less so for other countries.

The following graphs show an overvaluation of house prices – in some cases to a significant extent – since the middle of the last decade in all the EU countries considered, except Germany. The peculiar behaviour of house-price developments in Germany is accounted for in the model by a very low elasticity of house prices to income. The overvaluation in France seems to be moderate but stable. In spite of very rapid growth in house prices in Ireland, the overvaluation appears relatively modest. This finding is explained by strong growth in household disposable income, elastic housing supply vis-à-vis interest rates, as well as the quick correction in house prices after the turning point. Strong income growth and elastic supply also featured in Spain, explaining house price growth in line with fundamentals up to the mid-2000s. Conversely, the large misalignment in the UK appears to be the result of relatively rigid housing supply. Finally, it should be noted that the drop in equilibrium prices at the end of the sample is largely associated with a slowdown in the growth of potential income and tightening credit conditions.

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(1) J. Muellbauer and A. Murphy, (1997) 'Booms and Busts in the UK Housing Market', Economic Journal, 107 (November), 1701-27.

(2) N. Girouard, M. Kennedy, P. van den Noord and C. André, (2006) 'House Price Developments: The role of fundamentals' OECD, Economics Department, Working Papers No. 475.

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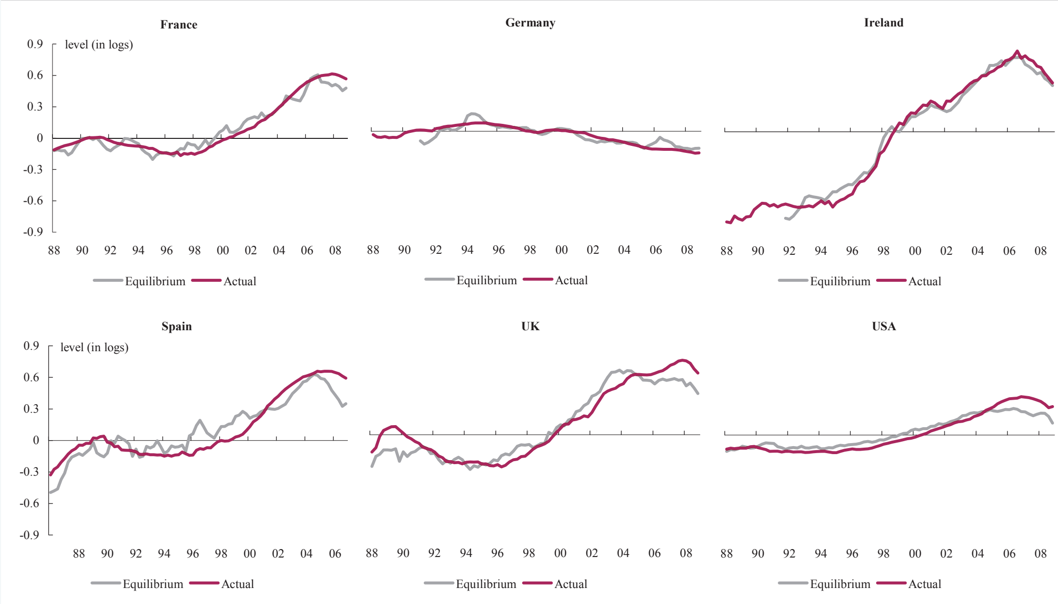
Box (continued)

Actual and equilibrium real house prices



The above results are broadly in line with existing findings.[1]

As a countercheck, information on house-price misalignment was also extracted from price-to-rent ratios, estimating the deviation of actual price-to-rent ratios from the long-term trend.

Overall, results are broadly consistent with the econometrics-based misalignment estimates, with two qualifications. For Ireland, this indicator suggests undervaluation in 2008 as opposed to moderate overvaluation, while for the UK it shows roughly balanced prices as opposed to overvaluation.

Table 1 reports the degree of house-price misalignment as of the fourth quarter of 2008 according to the first approach. The subsequent evolution of house prices appears to have helped close the misalignment gap to some extent.

(1) IMF, 'World Economic Outlook, Sustaining the Recovery', October 2009.

The analysis suggests that while house prices in France and Ireland are probably not far away from levels in line with fundamentals, further correction seems justified in the UK and, to larger extent, in Spain.

These considerations, however, are based on the unlikely assumption that fundamentals have remained broadly unchanged since the end of the crisis. Moreover, the possibility of prices undershooting their equilibrium value for some time cannot be excluded.

Table 1:

House-price misalignment and adjustment

Country	Misalignment (*)	Adjustment (**)
France	8.8	-6.0
Germany	-4.2	NA
Ireland	2.6	-3.0
Spain	24.4	-6.0
UK	18.4	-4.0
US	14.9	-4.0

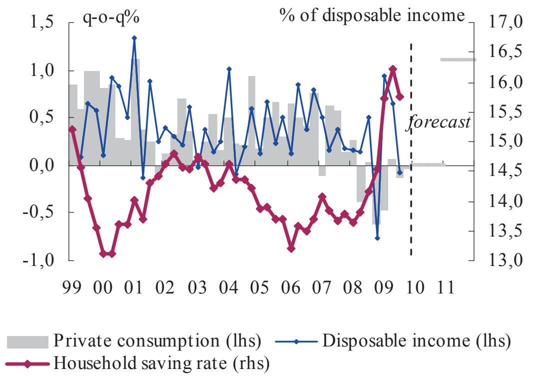
(*) difference (in %) between actual and equilibrium prices in 2008Q4 (**) in % between 2008Q4 and 2009Q3

Non-residential construction investment, on the other hand, is set to hold up somewhat better in 2010 – largely on account of government-financed infrastructure projects – thereby partly offsetting the weakness on the residential side.

Given these constraining factors, total investment is set to gain traction only slowly over the forecast horizon. As such, the last stage of the typical recovery sequence which brings employment, and subsequently private consumption, into the loop is expected to be weaker than in the past.

Turning to the outlook for private consumption, a rather gradual recovery is also foreseen for this component of domestic demand. Having held up comparatively well in 2009 (notably in France and Poland), private consumption is projected to broadly stabilise this year, before expanding in 2011 by around 1¼% in the EU and slightly over 1% in the euro area.

Graph I.1.10: **Private consumption, disposable income and saving rate, euro area**



As with investment, a number of factors are set to weigh on private consumption growth over the forecast horizon. Consistent with the subdued nature of the current recovery, the impetus from the investment-employment-private consumption nexus is proving weaker than usual. As discussed in the next section, the outlook for employment – which is a key driver of consumer spending in the EU and euro area - remains muted, although somewhat less so than at the time of the autumn 2009 forecast. A further constraint relates to the balance-sheet repair that is ongoing in some Member States, particularly those with high levels of household debt in the pre-crisis period, such as Denmark and the Netherlands. More positively, having risen by almost 4 pps. since early 2008, the saving rate for the EU as a whole appears to have peaked in the second quarter of 2009. Additional support for consumer spending going forward is expected to come from subdued inflation, benefitting households' purchasing power.

Going in the opposite direction to its private counterpart, public consumption growth is set to gradually ease over the forecast horizon, as the consolidation phase takes hold. Public consumption is projected to expand by around 1% in the EU and euro area this year, with a scaling back foreseen for 2011, to about ¼% in the euro area and just below that in the EU. This represents a downward revision compared to the autumn forecast (of roughly ¼ pp. in 2010 in the euro area and ½ pp. or so in 2011 in both regions), largely on account of the significant fiscal measures adopted since then. At the country level, marked revisions are evident for the Member States most affected by the government-bond market developments of late.

Finally, the estimated adverse impact of the financial crisis on potential output will act as a further constraint on the recovery. As discussed last autumn,[18] growth rates of potential output may not return to pre-crisis levels on account of a permanent change in financing conditions and / or a sustained need for deleveraging. As a result, capital accumulation will be slower. The impact of this may be reinforced by parts of the capital stock becoming obsolete even faster. This, in turn, would adversely affect total factor productivity growth. Over the forecast horizon, potential growth is estimated at around 1% in the euro area. This compares with a rate of about 1¾% for the period 2000-08.

In sum, various forces are set to restrain investment and consumption growth over the forecast horizon. As a consequence, domestic demand is projected to gain momentum only gradually, recovering to q-o-q growth of close to ½% towards the end of 2011, in the EU and euro area.

As regards overall growth prospects, on the back of steadily strengthening external and, more slowly, domestic demand; annual GDP growth of around 1% and 1½% or so is forecast for both the EU and euro area in 2010 and 2011 respectively. At the aggregate level, the picture is thus somewhat brighter for 2010 compared to last autumn, but remains largely unchanged for 2011. Moreover, the composition of growth has altered, with the contribution of domestic demand revised down since the autumn and the contribution of net exports revised up, implying a greater degree of exposure to external developments. This aggregate EU / euro-area picture also masks divergent developments across Member States – while prospects remain broadly unchanged in Germany, France and Italy, growth has been revised up in Poland and the UK but down in Greece.

(18) See chapter 1 in European Commission (2009) 'European Economic Forecast – Autumn 2009' and European Commission (2009) 'The impact of the financial and economic crisis on potential output', European Economy – Occasional Papers 49.

Lastly, in response to the questions posed at the start of this chapter - W*hat might this recovery look like? What will drive it? How strong and lasting will it prove to be?* – it might be said that the recovery currently underway in the EU will be gradual, reliant on global growth in the near-term and held back somewhat by weak private demand further out. In other words, this recovery is set to mirror previous upturns following financial crises. The high unemployment and large increase in government debt typically associated with the aftermath of such crises are also evident at the current juncture. However, the rise in unemployment is set to be more contained this time round, as discussed below.

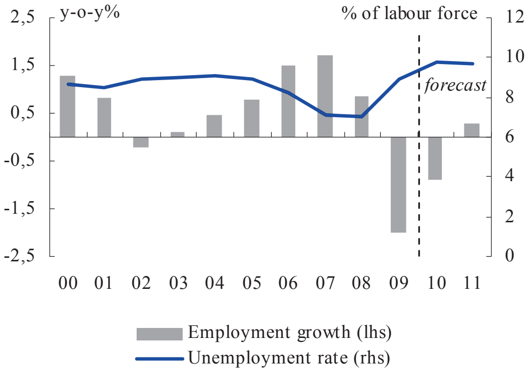
...labour market conditions remain weak...

Labour-market conditions have weakened further since the autumn, albeit to varying degrees across Member States. At the aggregate level, employment fell by 0.3% q-o-q in both the EU and euro area in the fourth quarter of 2009, whereas the unemployment rate rose respectively to 9.4% and 9.9%, some 2½ pps. above the pre-recession rate. However, the pace of the deterioration in the labour-market situation has eased somewhat lately, with emerging signs that a stabilisation is near-at-hand. For instance, survey indicators of firms' employment expectations have improved in recent months, while the PMI employment index is not far off the 50-mark.

Employment is projected to contract again this year by around 1% in the EU and euro area, picking up only slightly in 2011 as the recovery takes hold. This weak outlook is shaped by several factors. First, cyclical developments in the labour market typically follow those in GDP with a time lag of half a year or more. Second, policy measures implemented in response to the recession are expected to be partly unwound in the course of 2010. Thirdly, there is still some structural adjustment across sectors and firms to come, not least in the construction sector in certain countries (e.g. Spain). A fourth factor relates to labour hoarding in some Member States, notably Germany. While this has supported employment so far, it may hamper job creation further out.[19]

Moreover, firms' mounting need to improve profitability and productivity suggests that the further adjustment in the labour market will weigh more heavily on headcount than hours. This apparent trade-off between labour hoarding and productivity is discussed in detail in box I.1.4, which compares recent developments in the euro area and US in this respect.

Graph I.1.11: **Employment growth and unemployment rate, EU**



As for unemployment, prospects over the forecast horizon largely reflect the above employment trends. The unemployment rate is projected to broadly stabilise at about 9¾% in the EU this year. For the euro area, a levelling out is also expected in 2010, at close to 10½%. This outlook is somewhat less pessimistic than the autumn forecast due to the resilience shown in some Member States to date.

According to research findings on the aftermath of financial crises, the unemployment rate rises on average by about 7 pps. during the down phase of the cycle, which lasts on average almost 5 years.[20] While increasing unemployment is also a feature of the recovery now underway in the EU, the magnitude and duration of the current rise appear less pronounced, so far at least. Much of the explanation for the relative resilience of the EU / euro-area labour market to date lies with the short-term policy measures implemented, along with past labour-market reforms and labour hoarding in some Member States. Evidence of the latter can be seen in the fairly limited increase in

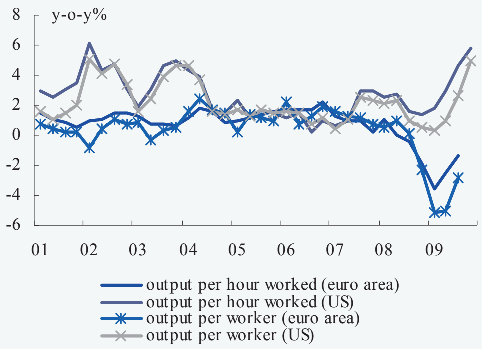
[19] As discussed last autumn, labour hoarding can be beneficial in the short-run, cushioning the impact of the downturn and preventing wasteful labour shedding in the face of a temporary demand shock. However, to the extent that it adversely affects firms' competitiveness and productivity and/or delays the necessary structural adjustment, its medium-term effects may be less benign. See chapter 2 in European Commission (2009) 'European Economic Forecast – Autumn 2009'.

[20] See Reinhart, C.M. and Rogoff, K.S. (2009) 'The Aftermath of Financial Crises'. *American Economic Review Papers and Proceedings*, 99(2), 466-472.

Box I.1.4: **Productivity developments in the euro area and the US**

Poor productivity developments have been the mirror image of relatively more resilient labour markets in Europe compared to the US. Could this bode ill for employment prospects in the recovery? During the recession, euro-area productivity (defined as output per employee) fell at an unprecedented annual rate of -2¾% (2008Q2-09Q2), i.e. about 4 pps. below the pre-crisis average (2000Q1-08Q2). This stands in stark contrast to developments in the US where productivity growth also fell, but only from some 2% (2000Q1-07Q4) to 1½% (2008Q1-09Q2). In terms of output per hour worked the responses were slightly less pronounced, indicating the use of working hours as a cyclical adjustment variable on top of job cuts (graph 1). Sizeable differences also characterise the rebound in productivity growth in the early stages of the recovery, with a much stronger pick-up in the US. The aggregate figures, however, mask considerable differences across EU Member States and US regions.[1]

Graph 1: **Labour productivity in the euro area (excl. GR, ES, LU, ML, SI) and the US**



Cyclical employment adjustment patterns have traditionally differed between the US and the euro area, with firms showing greater reluctance to adjust headcount employment during a downturn in the latter.[2] However, this time the drop in euro-area productivity was exceptionally strong, whereas cyclical labour productivity patterns in the US were fairly similar to those registered in previous cycles.

Among the reasons for the exceptionally strong decline in euro-area productivity are the strength of the recession, the sectoral impact of the shock, endogenous 'labour hoarding' decisions by firms given their environment, including labour market institutions, and unprecedented government measures aimed at supporting employment even at the expense of a fall in productivity. Indeed, extensive use of shorter working hours was registered in several Member States (in particular in Germany and Italy), allowing job stability for insiders and contributing to a relatively muted employment decline.[3]

With participation rates largely unaffected so far, employment dynamics have more or less directly translated into unemployment dynamics. Thus, the US has seen a significantly sharper increase in the unemployment rate (4.7 pps. between early 2008 and February 2010) than the euro area (2.6 pps.) although the contraction in economic activity was more pronounced in the latter.

The jury is still out on the optimality of the European labour-market response to the recession. While the more extensive use of labour hoarding in Europe may delay the necessary structural adaptation, notably in terms of labour reallocation across sectors, it could also be argued that it limits retraining needs and reduces hiring costs. However, the need to recover lost ground in terms of productivity and profitability points to the risk of a jobless recovery. Indeed, employment growth in the euro area is expected to turn positive only in 2011.[4] Looking forward, strengthening productivity growth will be essential for the euro area to raise potential output growth and to cope with the challenge of reducing the productivity gap vis-à-vis the US.[5]

(1) See e.g. A. Arpaia and N. Curci, EU labour market behaviour during the Great Recession, *European Economy Economic Papers* no. 405, 2010; for an analysis of the intra-US labour market see e.g. M. Palacios et al., Measuring labour markets in Canada and the United States, 2009, Fraser Institute: *Studies in Labour Markets* no. 35.

(2) See e.g. R. Inklaar and M. P. Timmer, Resurgence of employment growth in the European Union: The role of cycles and labour market reforms, *Economics Letters*, 2006, 91(1), pp. 61-66.

(3) In Germany, for example, the crisis hit basically export industries operating under imperfect competition with high productivity and profitability, due to significant restructuring efforts and moderate wage increases; many of them went before the crisis through their first recruitment cycle for several years when they found themselves facing some shortages of skilled labour. In response to a temporary external-demand shock it may then indeed be optimal to avoid lay-offs. See e.g. J. Möller, 'The German labor market response in the world recession – de-mystifying a miracle', *Zeitschrift für Arbeitsmarktforschung*, 2010, 42(4), pp. 325-336).

(4) For the US employment outlook, see also ECB, 'Prospects for the labour market recovery in the United States', *Monthly Bulletin*, April 2010, pp. 10-13.

(5) For a comprehensive analysis, see European Commission, 'Moving Europe's productivity frontier. The EU economy: 2007 review', *European Economy*, No.8, 2007.

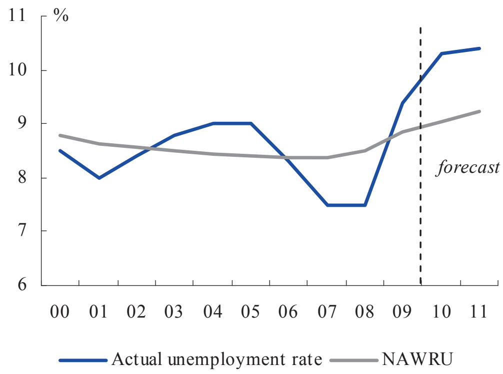
unemployment (given the size of the output loss) but large declines in hours worked in several countries (see graph I.1.12).

Graph I.1.12: **Unemployment rate and average hours worked - change 2008Q2-2009Q3, selected Member States**

Note: GDP growth in brackets

However, the aggregate EU / euro-area picture masks a marked differentiation in the labour-market response across Member States. In February 2010 for example, unemployment rates ranged from 4% in the Netherlands and 7½% in Germany to 19% in Spain and almost 22% in Latvia. This divergence in the labour-market situation across countries is projected to continue over the forecast horizon.

Graph I.1.13: **Actual and structural unemployment rate, euro area**

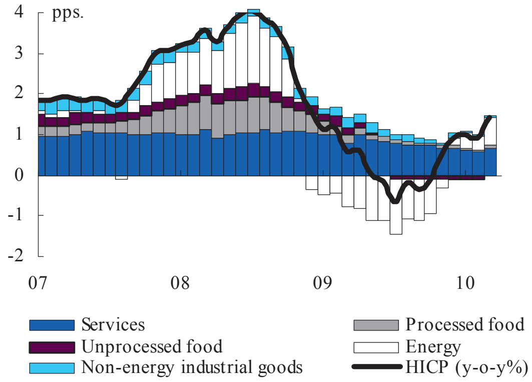


Overall, labour-market conditions are set to remain weak. Drawing on the analytical labour-market chapter that accompanied the autumn forecast, it seems that a rather jobless recovery is in sight, with (potentially persistent) high unemployment.[21] The unemployment rate in the EU and euro area is set to stay above the structural rate (NAWRU i.e. the non-accelerating wage rate of unemployment) going forward. Thus, continuing labour-market slack is to be expected, dampening wage and inflationary pressures in the period ahead, as discussed in the next section.

...a subdued outlook for inflation...

On the nominal side, having declined throughout most of 2009 (as a result of downward energy and food-price base effects and the slack in the economy), recent months have seen a rebound in consumer-price inflation. Inflation turned positive again in the euro area in late autumn, following a temporary dip into negative territory; while in the EU, it has recovered from the trough reached last summer. The upward trend observed lately reflects, in the main, reversing energy base effects and rising commodity prices. At present, the headline rate stands at 1.4% in the euro area and 1.9% in the EU (March 2010).

Graph I.1.14: **Contributions to inflation, euro area**



On the back of the pick-up in economic activity in the second half of last year, the producer-price index has also rebounded over the past months. Industrial prices in the euro area were down by 0.5% (y-o-y) in February, compared to some -8% in July 2009.

As for wage developments, the latest data for the euro area point to a continuing moderation in wage growth. The two main indicators, nominal compensation per employee and hourly labour costs, both posted lower annual growth rates in the fourth quarter of 2009 (1.2% and 2.2% respectively) than in the previous quarter (1.4% and 3%). Partly because of this slowdown in wage growth, but also because of a less pronounced decline in labour productivity, the annual growth rate of unit labour costs has come down markedly,

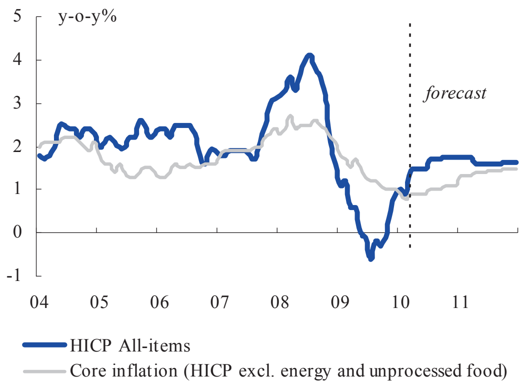
(21) See chapter 2 in European Commission (2009) 'European Economic Forecast – Autumn 2009'.

from some 5.7% in the first quarter of 2009 to 1.3% in the fourth.

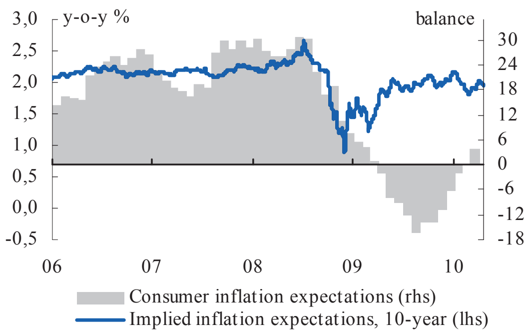
Looking ahead, the rate of inflation is projected to increase relative to 2009, but to remain subdued over the forecast horizon. The sluggish nature of the recovery, combined with the considerable slack in the economy and a muted outlook for wage and unit-labour cost growth, is expected to partly offset upward price pressures stemming from slightly higher oil and commodity prices and a weaker euro. On this basis, HICP inflation is projected to average 1¾% in the EU and 1½% in the euro area this year, and 1¾% in both regions in 2011. In terms of the quarterly profile, an annualised rate of around 1¾% is foreseen from the second half of 2010 on.

Inflation expectations offer further support to this outlook, remaining well-anchored according to most measures.[22]

Graph I.1.15: **Headline and core inflation, euro area**



Graph I.1.16: **Inflation expectations, euro area**



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

As mentioned earlier, the extraordinary nature of the recent downturn in the EU gives rise to the possibility of structural breaks in the traditional relationships among economic variables. Looking more closely at developments in inflation and the output gap / other indicators of the degree of slack in the economy, it might be the case that this link is weaker than in the past. That said, at the current juncture there is some uncertainty surrounding estimates of the output gap in particular. Moreover, administered prices are set to rise over the forecast horizon, as is imported inflation from emerging economies, thus putting some upward pressure on prices.

...public finances under pressure

One of the legacies of the recent economic and financial crisis has been a marked deterioration in the fiscal position. While discretionary fiscal stimulus measures and the working of automatic stabilisers played a key role in stabilising the EU economy, the associated sharp rise in the deficit and debt has cast a shadow on public finances that will be felt over the medium and longer-term.

The general government deficit in the EU is projected to rise from 6.8% of GDP in 2009 to around 7¼% this year (triple the 2008 figure). Similarly, a ¼ pp. or so increase in the euro area deficit is expected, rising from 6.3% of GDP to just over 6½%. At the Member State level, all but three countries – Bulgaria, Estonia and Sweden – are set to record a government deficit this year in excess of the 3% of GDP reference value in the Treaty. As economic activity picks up and consolidation takes hold, an easing in the deficit is projected in 2011, to 6½% in the EU and around 6% in the euro area.[23]

The pronounced increase in the general government deficit during 2009-10 is primarily due to the following developments.

First, automatic stabilisers are operating in full, with social security spending, notably unemployment benefits, rising in response to the downturn in activity.

Second, in line with the European Economic Recovery Plan (EERP), several Member States

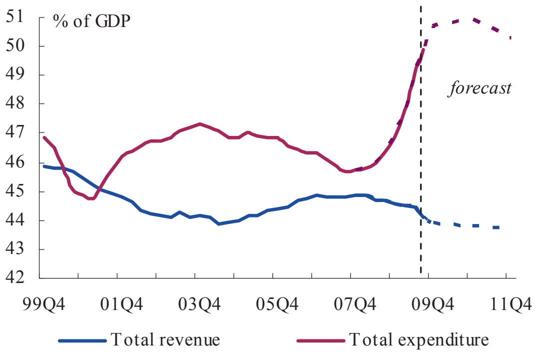
(22) For more information, see Box 5 ‘Recent developments in consumers' and professionals' inflation expectations in the euro area' in ECB (2010) ‘Monthly Bulletin’, March.

(23) Made on the basis of the usual no-policy-change assumption, these projections exclude any budgetary decisions that Member States may take but which are not yet sufficiently known and/or spelled out at this point.

adopted significant fiscal stimulus packages to promote investment, support households' purchasing power, help enterprises and sustain labour markets.[(24)]

Third, the exceptional revenue windfalls seen during the boom continued to reverse in 2009, as evidenced by the relatively strong erosion of some tax bases. The revenue-to-GDP ratio was around ¾ pp. lower in 2009 than in 2008, with discretionary measures accounting for around ½ pp. of this. A further weakening in the ratio is projected for this year, more so in the euro area where additional tax cuts are set to come on board.

Graph I.1.17: **Total revenue and expenditure (four-quarter moving average), EU**



Taking these elements together, the expenditure ratio in the EU and euro area is projected to peak at around 51% this year, while a stabilisation in the revenue-to-GDP ratio is foreseen from 2010, at about 44% in both regions.

Turning to government debt, the debt-to-GDP ratio is set to remain on an increasing path, on the back of negative primary balances and rising interest expenditure this year and next. Risks relating to the extensive guarantees and relief schemes put in place to support the financial sector are also of concern.[(25)] In the EU, the gross debt ratio is projected to rise to a level of almost 84% of GDP by the end of the forecast horizon; and to 88½% in the euro area.

Table I.1.5:
Euro-area debt dynamics

(% of GDP)	average 2003-07	2008	2009	2010	2011
Gross debt ratio[(1)]	**68.6**	**69.4**	**78.7**	**84.7**	**88.5**
Change in the ratio	-0.4	3.4	9.3	6.0	3.8
Contributions[(2)]:					
1. Primary balance	**-0.9**	**-1.0**	**3.5**	**3.6**	**2.9**
2. "Snow-ball" effect	**0.3**	**1.2**	**5.0**	**1.7**	**0.8**
Of which:					
Interest expenditure	3.0	3.0	2.8	3.0	3.2
Growth effect	-1.4	-0.4	2.9	-0.7	-1.2
Inflation effect	-1.4	-1.4	-0.8	-0.6	-1.2
3. Stock-flow adjustment	**0.3**	**3.3**	**0.8**	**0.7**	**0.1**

Notes:
[(1)] End of period.
[(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.

Recalling the analytical government-debt chapter that accompanied the autumn forecast, rising debt is set to place a heavy burden on the long-term sustainability of public finances.[(26)] Further out, the key challenge will be to offset the cost of ageing, the scale of which is projected to be far greater than the 'one-off' amount likely to be spent in support of the financial sector. However, recent developments in government-bond markets also point to a short to medium-term need to tackle the crisis-induced rise in fiscal deficits and debt. While this link between indebtedness and the level and volatility of government risk premia is well-known, recent research goes further, establishing a link between debt and economic growth. The results show that high levels of debt relative to GDP are associated with significantly lower growth outcomes in both advanced and emerging economies.[(27)] Given the high debt-to-GDP ratios projected for the EU and many Member States over the forecast horizon (see graph I.1.18), debt could well act as a drag on economic growth going forward; reinforcing the need to restore order to public finances already.

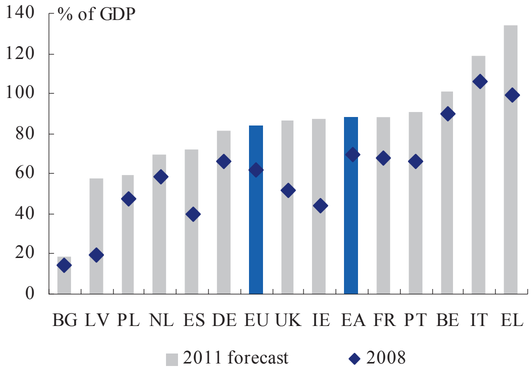
(24) Detailed information at the country level on fiscal stimulus and expansionary structural measures puts their budgetary impact at 1.5% of GDP in 2009 and 1.4% in 2010 in the EU (the corresponding euro area figure is 1.5% for both years). Fiscal stimulus measures alone amount to 1.2% of GDP in 2009 and 1% in 2010. These figures exceed the target set in the EERP, which called for a stimulus of 1.2% of GDP by Member States over the period 2009-10.

(25) Public money amounting to about 2% of EU GDP has been injected into the financial sector in the form of recapitalisation. These measures affect government debt, but not the deficit. Moreover, guarantees to the financial sector of around 24½% of EU GDP have been approved by the European Commission, of which almost 8% of GDP has actually been granted so far. Impaired asset relief and liquidity support to the banking sector, similar in nature to guarantees, amount to almost 4% of GDP (approved). Guarantees represent contingent liabilities which affect the government deficit (and debt) only once they are called on.

(26) See chapter 3 in European Commission (2009) 'European Economic Forecast – Autumn 2009'.

(27) See Reinhart, C.M. and Rogoff, K.S. (2010) 'Growth in a time of debt', *NBER Working Paper* no. 15639.

Graph I.1.18: **Government debt, EU, euro area and selected Member States**



1.3. UNCERTAINTY REMAINS HIGH

The EU economy is facing significant headwinds and unusual impediments as it transits towards a new steady state. The outlook presented here is thus subject to considerable uncertainty and non-negligible risks. Overall, risks to the EU growth outlook for 2010 and 2011 appear broadly balanced.

On the upside, a more pronounced rebound in global demand than projected last autumn has already materialised. The strength of the global recovery, particularly in emerging Asia, may continue to surprise, posing an upside risk for EU export growth. The realisation of this risk would in turn support the export-investment link, strengthening the recovery. Added to this, the turning inventory cycle in the EU could boost domestic demand by more than currently expected.

A further upside risk relates to the labour market which, to date, has held up somewhat better than expected. To the extent that this apparent resilience follows from past reforms which have improved the underlying functioning of the market, the outlook for the labour market over the forecast horizon may be less muted than currently envisaged.

Moreover, a sharper rebound in confidence among consumers and especially businesses, due to e.g. a greater belief in the strength and robustness of the recovery, could have a stronger impact on domestic demand than expected at present. Indeed, sentiment indicators have gained considerable ground over the past year, and are currently suggesting stronger near-term activity than other high-frequency indicators. Policy measures in the EU (and abroad) might also prove more effective in boosting confidence than assumed to date.

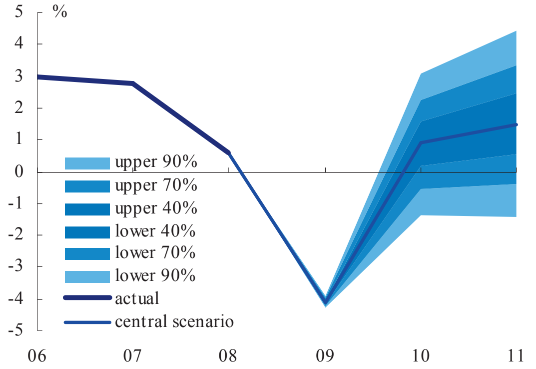
On the downside, the still relatively fragile situation in financial markets is the main concern. While conditions are significantly better than a year ago, uncertainty and downside risks abound. In so far as improved conditions in the banking sector are policy-driven, the premature withdrawal of government support could have adverse consequences. Moreover, the outlook for credit risk is still uncertain – a more protracted recovery than expected could have an adverse impact on the loan or investment portfolio-quality of EU banks; which might hamper and delay the process of balance-sheet repair by more than initially envisaged. Banks could thus be forced into another round of credit tightening, at a crucial phase in the recovery. In addition, there is a possibility of a further sudden reassessment of the degree of fiscal risk in some Member States. This could reduce economic activity in the countries concerned by more than currently assumed, with broader effects also possible, thereby weighing further on the nascent EU recovery.

Headwinds on the domestic demand front pose another downside risk to the growth outlook. The ending of stimulus measures in the course of 2010 and 2011 and the start of the fiscal consolidation phase (and more generally exit strategies, including on the monetary side), could weigh more on domestic demand than anticipated at present. Moreover, the dampening effect of ongoing housing-market corrections in some Member States could prove stronger than assumed, while residential investment might also undershoot following the pre-crisis construction bubble given past experience. The possibility of a permanently higher cost of capital is another negative factor. Of further concern is the recent volcanic ash cloud, though the impact on the wider economy seems small, so far at least.

In terms of the external environment, renewed increases in oil and other commodity prices could mitigate the global recovery, as could a premature exit from stimulus measures in key trading partners. The latter could also undermine confidence. Furthermore, growing social tension in light of high unemployment may trigger an increase in protectionist measures.

Graph I.1.19 quantifies the various risks in terms of the possible deviation of output growth from the central forecast. It shows the impact that different combinations of risks could have on euro-area GDP growth in 2010 and 2011, the outcomes being weighted by the probability of their occurrence.

Graph I.1.19: **Euro-area GDP forecast, uncertainty linked to the balance of risks**



Turning to the inflation outlook, risks also appear broadly balanced for 2010 and 2011. On the one hand, higher oil and other commodity prices, as well as a weaker than expected euro, could pose an upside risk to the outlook. Moreover, to the extent that increases in indirect taxation and administered prices (on account of fiscal consolidation) in the coming years are larger than expected, inflation might also be higher than currently envisaged. On the other hand, the still large slack in the economy should keep inflationary pressures subdued in the period ahead.

1.4. ECONOMIC CHALLENGES

The outlook presented in this spring forecast points to the scale of the economic challenges policymakers face going forward. In order to sustain the recovery and ensure a return to a balanced growth path, a concerted effort will be needed to address the most salient of these. As characteristics and priorities vary across Member States, country-specific challenges are discussed in the accompanying country chapters. At the aggregate level, a number of economic challenges stand out as most urgent.

One such challenge involves securing the long-term sustainability of public finances, with recent developments in government-bond markets also pointing to a pressing need for some countries to tackle rising fiscal deficits and debt in a structured and credible way in the short-term.

Another is to restore the soundness of the banking system so that it is in a position to meet increased credit demand, and thus support the recovery.

Preventing a return to the hysteresis (whereby temporary shocks have permanent effects on unemployment) experienced by Europe in the past is also a challenge. Policies aimed at reducing skills-mismatch and facilitating the re-integration of displaced workers back into employment will be crucial in this respect; with the timing and manner in which support measures are withdrawn also likely to have a bearing on labour-market flexibility going forward.

A further challenge concerns mitigating the adverse impact of the financial and economic crisis on potential growth, along with ensuring a more dynamic EU economy; inter alia, by undertaking the necessary restructuring and structural reform in line with the 'Europe 2020 Strategy'. Measures aimed at raising employment and productivity will be indispensible for growth prospects further out. Reforms of this nature would also help limit the potentially negative impact of unwinding global imbalances on the euro area.

Economic challenges related to adjustment within the euro area also remain relevant. Differentiation in the speed of recovery across Member States reinforces the need to correct persisting imbalances.

Box I.1.5: Some technical elements behind the forecast

The overall cut-off date for taking new information into account in this update of the Commission's macroeconomic outlook was 20 April. The forecast also incorporates validated public finance data from Eurostat's press release 55/2010, dated 22 April 2010.

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 1 and 14 April) were used for exchange and interest rates, and for oil prices.

Exchange and interest rates

The technical assumption as regards exchange rates was standardised using fixed nominal exchange rates for all currencies. This technical assumption leads to implied average USD/EUR rates of 1.36 in 2010 and 1.35 in 2011. The average JPY/EUR rates are 125.85 in 2010 and 125.98 in 2011.

Interest-rate assumptions are market-based. Short-term interest rates for the euro area are derived from future 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, fixed spread vis-à-vis euro-area interest rates is taken for both short- and long-term rates. As a result, short-term interest rates are expected to be 0.9% on average in 2010 and 1.6% in 2011 in the euro area. Long-term interest rates are assumed to be 3.2% on average in 2010 and 3.6% in 2011.

Commodity prices

Commodity price assumptions are also, as far as possible, based on market conditions. According to future markets, prices for Brent oil are projected to be on average 84.5 USD/bl. in 2010 and 89.2 USD/bl. in 2011. This would correspond to an oil price of 62.1 EUR/bl. in 2010 and 66.1 EUR/bl. in 2011.

Budgetary data

Data up to 2009 are based on data notified by Member States to the European Commission on 1 April and validated by Eurostat on 22 April 2010. In validating the data, Eurostat expressed a reservation on the quality of the data reported by Greece, due to uncertainties on the surplus of social security funds for 2009, on the classification of some public entities and on the recording of off-market swaps. Following completion of the investigations that Eurostat is undertaking on these issues in cooperation with the Greek Statistical Authorities, this could lead to a revision for the year 2009 of the order of 0.3 to 0.5 pp. of GDP for the deficit and 5 to 7 pps. of GDP for the debt.

As usual, government deficit data notified by the UK for the years to 2009 have been slightly amended for consistency with Eurostat's view on the recording of UMTS licences proceeds.

For the forecast, measures in support of financial stability have been recorded in line with the Eurostat decision of 15 July 2009.[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 closed. 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 2010, budgets adopted or presented to national parliaments and all other measures known in sufficient detail are taken into consideration. For 2011, 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

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

(Continued on the next page)

Box (continued)

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

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 it is considered as a temporary effect, it should not affect the cyclically-adjusted balances.

2. THE FINANCIAL SECTOR IN THE EU AND ITS LINK TO THE REAL ECONOMY

This chapter elaborates on the finance-credit nexus that underlies the Commission's spring 2010 forecast. The first section is devoted to a discussion of the so-called financial accelerator hypothesis, which offers a suitable analytical framework for assessing the shock propagation mechanism between the economy's financial and non-financial sector. The second section reviews recent developments in the EU financial sector, looking for potential factors that could impair the sector's role in allocating credit to the non-financial sector. The outlook with respect to developments in bank lending and the possibility of the emergence of credit constraints is discussed in the closing third section. The main messages to be drawn from the analysis in the context of the forecast are as follows.

First, the sharp economic slowdown in 2008 and 2009 was triggered by a serious dislocation of key EU credit markets. By implication, a sustained economic recovery will only be possible if these markets fully return to normal functioning.

Second, the recovery in financial asset prices, the decline in corresponding spreads, and re-emerging profitability in financial institutions signalled a financial-sector stabilisation in 2009. Most banks have used this period of stabilisation to reinforce their capital positions. However, evidence suggests a continued heavy reliance on government support measures and income generated via a favourably sloped yield curve.

Third, looking forward, a key question is whether balance-sheet repair is sufficiently advanced for banks to reduce their reliance on government support, while accommodating the rebound in credit demand, which is predicted to materialise once economic activity regains momentum. Otherwise, there is a risk that credit constraints could limit the pace of economic recovery.

Fourth, in a longer term perspective, many of the proposed regulatory reforms are likely to have a negative direct impact on banks capacity to lend, although this impact may be offset by positive indirect effects linked to a more stable and resilient financial sector. It will, however, be important to find the appropriate balance between safeguarding stability and fostering economic growth when implementing the reform agenda.

2.1. INTRODUCTION

The sizeable public support measures, which have been provided to the financial sector, were designed to restore the efficient functioning of the sector and to insulate economic activity from the financial crisis. However, private consumption and gross fixed capital formation deteriorated markedly in 2009, amid a sharp contraction in credit growth. This suggests that massive public intervention has served only to cushion the impact of the financial crisis on the real economy.

Experience of past financial crises indicates that economic recovery following severe banking crises is typically very sluggish, held back by the adjustment in the financial sector and by weak private demand, in particular investment. Given the importance of bank lending for the EU economy, it has been widely assumed that progress with banks' balance sheet repair is a precondition for a strong and sustainable economic recovery. Despite a significant write-down in asset valuations, banks considerably increased their capital buffers in 2008-09. Nevertheless, the deleveraging process in the banking system is ongoing in 2010. Moreover, the capacity of the banking system "to grow out of its problems" is limited by the strength of economic activity in the coming years. Thus, an adverse feedback loop between financial and economic activity represents an important downside risk. Against this background, this chapter expands on the analysis of interdependencies between the financial and the non-financial sectors, which underlie the forecast by shedding some light on the determinants of weak investment and tight credit conditions that are predicted to hamper economic activity in 2010 and possibly also in 2011.

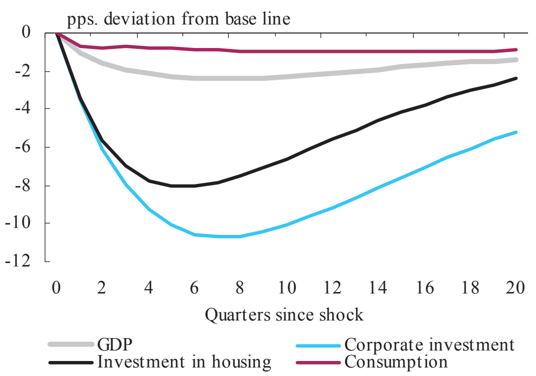
2.2. SHOCK TRANSMISSION BETWEEN THE FINANCIAL AND THE NON-FINANCIAL SECTOR DURING A FINANCIAL CRISIS

The substantial output losses in 2008-09 have underlined the importance of a well-functioning financial system for economic activity. This section explores to what extent the concepts of shocks to capital costs, wealth effects and the financial accelerator help in understanding why the repercussions from financial crises on economic growth have been so severe, and what they imply for the path of economic recovery.

2.2.1. The standard transmission channels: Interest rate and wealth effects

The key variables in the standard macroeconomic analysis of the transmission of financial shocks are interest rates and private sector wealth. In theory, changes in interest rates operate through capital costs, which in turn affect especially private investment and thereby GDP. Indeed, the outcome of a simulation of a 2 pps. increase in the risk premium using the standard version of the Commission's DSGE model is similar to the severe economic slowdown, which was recently observed in the EU.[28] Following such a risk premium shock, which is assumed to last for two years, GDP declines over several quarters and very gradually returns to the baseline scenario (Graph I.2.1). Investment declines more strongly than consumption, inflation becomes temporarily negative, and money market interest rates fall by about 1 pp.

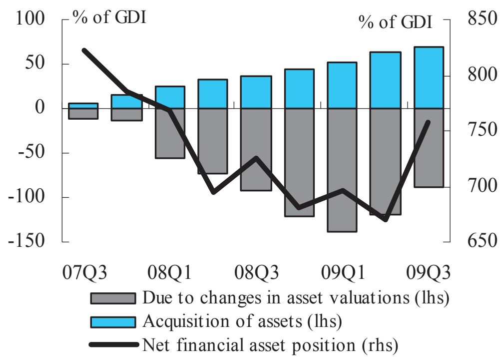
Graph I.2.1: **Impact of 200 pps. risk premium shock in QUEST III**



The second standard macro transmission channel builds on wealth effects. Losses in financial wealth due to a crisis reduce aggregate demand as agents are assumed to increase their savings in order to restore their targeted wealth level. A number of international institutions have come forward with estimates of the financial losses linked to the current financial crisis – an uncertain exercise because the bulk of losses has been related to a lower valuation of assets, which has been partly reversed since the trough in early 2009. Hence, as asset values have evolved over time, there has also been some variation in the estimations of financial losses. For instance, in spring 2009, the IMF estimated a potential write-down or losses in the global financial sector of USD 4100 bn. In spring 2010, this estimate was revised downwards to USD 2300 bn.[29]

As these loss estimates refer to the financial sector, they may not be an appropriate proxy in estimating how changes in financial wealth may have affected aggregate demand in the broader economy. Since households are the ultimate owners of financial wealth, it is more appropriate to use the evolution in their financial wealth instead.[30] Financial accounts data suggest that the financial wealth of euro-area households declined from 820% of gross disposable income in mid-2007 to 750% two years later. This decline was entirely due to valuation effects, in particular with respect to shares and other equity positions (Graph I.2.2).

Graph I.2.2: **Cumulative changes in households' financial position, euro area**



Note: GDI = Gross Disposable Income

[28] The magnitude of the risk premium shock is broadly in line with the observed average increase in corporate bond spreads in 2007-09. A risk premium shock was applied as a) risk-free interest rates are endogenous in the model and b) they have actually fallen.

[29] In December 2009, the ECB estimated that total write downs of the euro-area banking sector over the period 2007-10 could amount to EUR 550 bn.

[30] Although corporations are also holding wealth, they are ultimately owned by households. There is only few data available on non-financial wealth, i.e. house prices and real estate property, which constitutes a large part of households' wealth.

There is ample empirical evidence of the effects of changes in financial wealth on private consumption and aggregate demand in general.[31] On the basis of correlations found in the literature, the loss in households' financial wealth linked to the current financial crisis would imply a reduction in private consumption by about 1%. If a lagged response of consumption to the loss in financial wealth is allowed, this estimate is close to the figures actually observed.

Thus, applying standard elasticities in the assessment of shocks to the risk premium and financial wealth already explains much of the response of the real economy to the recent financial crisis. Nevertheless, these elasticities only provide a partial explanation for two reasons. First, the changes in financial assets' market values used as input in the calculation of risk premia and wealth effects reflect changes in the expected repayment of borrowers.[32] However, these changes may also be due to other factors. One important factor known to have influenced asset prices during the financial crisis was the spike in liquidity premia amid very low transaction volumes on many financial markets. Another relevant factor relates to the dependence of expected repayments on the projected development of the business cycle. The cyclical outlook was very poor at the peak of the crisis, with expected debt defaults correspondingly high. However, projections for near-term economic growth have improved since then. Secondly, risk premia and wealth effects may well explain the recent slump in economic activity, but they are less useful to assess future economic developments. Indeed, not much more can be said about the drivers of the incipient economic recovery than that a decline in uncertainty, more optimistic expectations and a return of confidence would be preconditions for lower risk premia and a further rebound in asset prices.

2.2.2. The financial accelerator mechanism

In the financial accelerator mechanism, asset prices and financial wealth play an important role in transmitting impulses from the financial sector to the rest of the economy.[33] The advantage of this approach to explaining interactions between the financial and real sectors of the economy lies in its focus on the microeconomic functions of the financial system; this allows a deeper examination of the mechanisms that drive financial crises and may equally shape economic recovery. As the term 'accelerator' suggests, the mechanism implies that the financial system can reinforce the impact of different shocks to the economy.

The basic idea behind the financial accelerator is that asset prices are an important determinant of net worth and net worth is an important determinant of access to finance. The microeconomic roots lie in the asymmetric distribution of information between borrowers and lenders that is inherent to any credit contract and which gives rise to moral hazard. In brief, the more the borrower is willing to risk his or her own capital, the more aligned are the incentives between borrowers and creditors and the more willing is the creditor to finance the investments. Deteriorating corporate balance sheets thus hamper corporations' access to credit by reducing creditors' willingness to lend.[34] While most of the available research focuses on the corporate sector, it is relatively straightforward to apply the basic accelerator concept to the availability of credit for households as well as to financial intermediaries. The latter will be further discussed in section 2.4.3.

It should be noted that while the concept of the financial accelerator is well established in economic theory, empirical estimates of its quantitative impact are somewhat inconclusive and its application to macroeconomic forecasting is not yet established. Empirical evidence on the impact

(31) Estimates of the marginal propensity to consume out of wealth range between 0 and 10 percent, with analyses based on continental European data typically yielding a lower elasticity than those based on US and UK data. Furthermore, estimates based on micro data tend to find lower effects than those based on macro data.

(32) Changes in financial wealth have been more strongly determined by changes in the valuation of existing assets than by the acquisition/disposals of new assets.

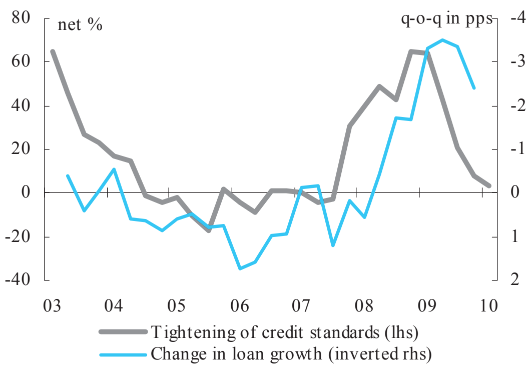
(33) For a concise review of theory and the empirical evidence supporting this approach, see Bernanke, B.(2007), The Financial Accelerator and the Credit Channel, Speech at the "The Credit Channel of Monetary Policy in the Twenty-first Century" Conference, Federal Reserve Bank of Atlanta, June 15, 2007, http://www.federalreserve.gov/newsevents/speech/bernanke20070615a.htm.

(34) The economic literature has identified two mechanisms how net worth affects credit availability. First, costs for obtaining external finance for the borrower are higher the smaller the borrower's net worth. The standard adjustment would work through interest-rate channel, but the tightening of other elements in the loan contract up to the possibility of outright credit rationing can also play this role. Second, net worth serves to secure the loan and any fall in the value of collateral translates into constraints in the availability of credit, which then via weaker economic activity may further depress asset prices and hence investors' value of collateral. The same mechanism impacts on households' borrowing capacity through the value of houses, which serve as collateral to mortgage loans.

of the financial accelerator has been obtained at the disaggregated level, for example with industrial balance-sheet data or when responses of investment to shocks are compared across economies with institutional differences with respect to their financial sectors. There is now broad agreement that a firm's cash flow is an important determinant of its investment decision and that cash flow becomes more important the more limited is a firm's access to capital markets. Hence, the accelerator mechanism is likely to be more relevant in times of financial distress, and it should be of greater importance for smaller enterprises, which are more likely to be financially constrained.

A number of macroeconomic observations appear to confirm the financial accelerator mechanism, including some features of the recent crisis. First, Graph I.2.3 suggests that euro-area banks tightened credit standards before loan growth decelerated. While this lead-lag structure does not necessarily indicate causality running from banks' credit policy to loan developments as both factors may be affected by common third factors, it suggests that banks actively influence credit volumes through the supply side. Moreover, when asked how credit standards have been tightened in the financial crisis, banks have indicated that they tightened collateral requirements, loan covenants and non-interest-rate charges.

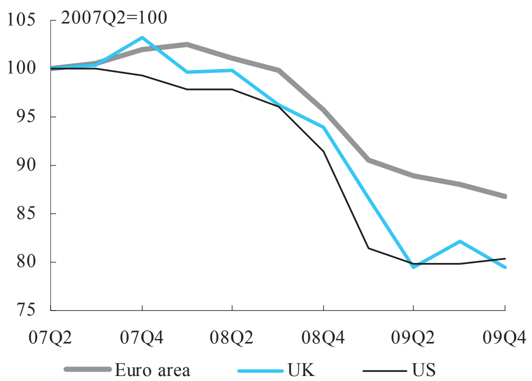
Graph I.2.3: **Lending standards and bank loans to non-financial corporations, euro area**



Second, if a financial accelerator is at work, firms should have an incentive to hold financial assets. National account data indeed show that firms hold a substantial amount of financial assets. In 2009, non-financial corporations in the euro area held EUR 1700 bn (19% of GDP) in currency and deposits. On average, non-financial firms' holdings of currency and deposits have been sufficient to finance the sector's fixed investment over a period of at least one year. Firms' financial positions move closely together with investment activity over time. Amid falling asset prices, euro-area corporate net wealth declined by 60% from summer 2007 to early 2009 accompanied by falling investment growth. A turnaround of both occurred in the course of 2009.

Third, the financial accelerator hypothesis predicts that both credit availability and investment are positively correlated with financial wealth. National accounts data lend some support to the notion that the impact of the banking crisis on investment was more severe in those EU Member States, in which the private sector, in particular non-financial corporations, was highly indebted.

Graph I.2.4: **Investment activity since the outbreak of the financial crisis**

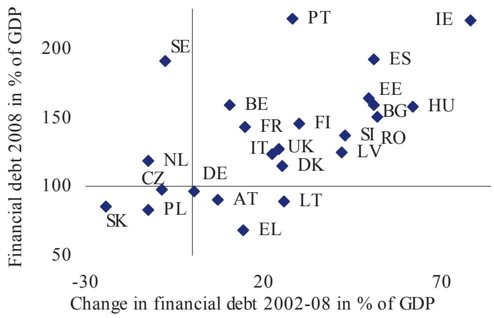


In the US, the United Kingdom and Ireland, a severe banking crisis was accompanied by a strong cumulative deterioration in investment (Graph I.2.4). A similarly abrupt and strong deterioration in investment activity occurred in Spain and Sweden, though their banks were less severely affected from the turmoil on wholesale interbank markets. The investment performance was also below the euro-area average in Portugal amid few reported incidences of stress in banks. In Ireland, Portugal, Sweden and Spain, firms' liability positions reached levels of close to 200% of GDP (Graph I.2.5). Thus, it may well be that high corporate debt aggravated the impact of the financial shock and will also impact these countries' investment behaviour going forward.[35]

[35] An initially mild weakening in investment performance in 2008 that deteriorated disproportionally in 2009 was observed in Greece, Slovenia, Finland and the Netherlands. Problems in the banking system were significant only in the latter.

At the other side of the spectrum, investment decelerated less than the euro-area average in various countries that experienced considerably stress in their banking system (Belgium, Germany, France, Luxembourg and Austria), suggesting that those countries managed the financial turmoil well. The same countries also had low corporate indebtedness either relative to GDP (Germany, Austria, Netherlands, and Poland) or compared to the past cyclical trough (Belgium, France).

Graph I.2.5: **Non-financial corporations' indebtedness**



Note: Financial debt excludes liabilities linked to firms' equity positions. 2007 observations for BG, EE, 2006 for CZ

Similarly, the debt positions at which Member States' households entered the financial crisis seem to have influenced the transmission of the financial crisis to residential investment. By 2008, the latest data available, household debt had increased strongly to levels higher than 100% of GDP in Ireland, Denmark, the Netherlands, the United Kingdom and Portugal, i.e. countries where the financial crisis was accompanied by a deteriorating performance of residential investment. Household debt was relatively low and had increased comparatively little in some Member States, which weathered the financial crisis relatively well despite considerable stress in their banking systems (Germany, Austria, France, Belgium).

Among the more recently acceded Member States, the link between stress in the banking system and investment performance is ambiguous. The financial stress witnessed, for example, in Latvia, Hungary and Romania which led these Member States to request balance of payments assistance was of a different nature than the banking stress experienced in the older Member States. The decline in the investment in the three mentioned Member States is comparable to their neighbouring countries, where financial markets have remained relatively calm in the crisis.

2.3. BALANCE-SHEET REPAIR IN THE BANKING SECTOR

The application of the financial accelerator hypothesis to developments within the financial sector provides a suitable framework for analysing the determinants that shape banks' behaviour in the current juncture.(36) Wholesale financial markets ensure the channelling of funds to the most profitable use and allow banks to realise specialisation advantages, for example by attracting deposits from savers, evaluating and monitoring of loans, issuance of or trading in financial assets etc. Banks with excess deposits provide credit to other banks and thereby face similar issues of asymmetric information, including potential moral hazard behaviour as banks that lend to the non-financial sector. Bank's endowment with capital has the same role as net wealth in their relationships with ultimate borrowers. The higher the bank's capital, which is traditionally equity held by shareholders, the higher is its capacity to absorb losses and the better aligned the incentives between lending and borrowing banks should be in general.(37)

In the financial crisis, numerous banks recorded substantial losses that eroded their capital bases. As other banks were not able to assess whether further losses were to be expected, they became extremely reluctant to lend to banks that they considered undercapitalised. Banks with a funding gap quickly ran into liquidity shortages, which became difficult or impossible to fund on wholesale financial markets. The uncertainty about future losses, which were in the first place centred on the holding of complexly structured financial contracts and often by off-balance sheet vehicles, did not only deteriorate banks' capital. At the same time, it hampered banks' possibilities to improve their loss absorption capacity by raising new

(36) This section focuses on banks as other financial intermediaries, though being less affected by the financial crisis, are not able to provide loans to the real economy sector at a comparable scale. For instance, in the euro area insurances' investment assets amount to EUR 4,400 bn, of which the half is invested in debt securities and other fixed income assets. Loans account for less than 400 bn, i.e. barely 10% in insurers' investment portfolio. This compares with an outstanding amount of loans by euro-area banks to the private sector of close to EUR 11,000 bn. The euro-area investment funds industry is holding assets of about the same amounts as insurers, but again mainly in marketable assets.

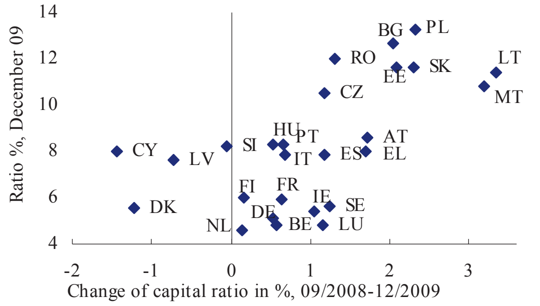
(37) For the so-called capital channel of the transmission mechanism, see Van den Heuvel, S.(2002), “Does bank capital matter for monetary transmission?”, Federal Reserve Bank of New York Economic Policy Review, 8(1), pp. 161–172.

capital from private sources because potential new shareholders were reluctant to invest in firms with unknown future losses. Accordingly, the injection of public capital into banks, the provision of state guarantees on bank liabilities, asset relief and liquidity provisions became crucial policy instruments to support banks' solvency and liquidity.

The severe liquidity shortage that led to rocketing spreads on interbank markets in autumn 2008 has been overcome relatively quickly thanks to policy interventions. On money markets, the ECB assumed the role of a central intermediary (i.e. market maker of last resort), fully satisfying the liquidity needs of the euro area banking system. Longer-term funding markets were supported through the possibility given to banks to issue debt securities with state guarantees and also by the ECB's purchases of covered bonds, which helped vitalise this specific market segment.

The effects of the erosion of banks' capital are still at work and are likely to dampen banks' willingness to expand activity as well as their risk appetite over the forecast period. On a positive note, most banks have used the favourable market developments in 2009 to restore their capital position. Many of the larger banks have even increased their tier-1 capital ratio to above 10%, well above the current regulatory requirement of 4% and also higher than before the crisis.[38] The capital ratio of the euro-area banking system has also improved by 1 pp. since autumn 2008 to 7.5% in December 2009, the highest level ever recorded in the euro area.[39] The visible progress in average ratios, however, masks heterogeneity across banks and Member States. The smaller among the biggest EU banks have not yet seen their tier-1 ratios surpass their autumn 2008 values, and, by December 2009, in the banking systems mostly affected by the financial crisis (Belgium, Germany, the Netherlands, Luxembourg, Ireland, Sweden, Denmark, France), aggregate capital ratios have increased relatively little and were still below those in other EU Member States (Graph I.2.6).[40]

Graph I.2.6: **Banks' total capital asset ratio, aggregate balance sheet data**



Note: Derived from changes in outstanding stocks of non-consolidated data. Approximation as it includes structural breaks in the reporting banks for IE and ES.

While banks' financial accounts showed a substantial rebound in earnings and profits in 2009, leading to markedly improved capital ratios, this development is unlikely to be sustainable for several reasons. First, EU banks may still face further losses from loan defaults as a lagged reflex of weak economic activity and the low profits made by enterprises in the recent past. Macro-scenarios run by the IMF and the ECB suggest that total losses in the EU banking sector could be higher than those which banks have published so far. Although the banks' true exposure to impaired assets has never been fully disclosed, it can be assumed that the amount of impaired assets substantially exceeds the means provided by governments for asset relief, which amount to a total of 2.8% of GDP in the EU and are concentrated on few countries (Belgium, Germany, France, the Netherlands, Austria, United Kingdom) and a dozen financial institutions.

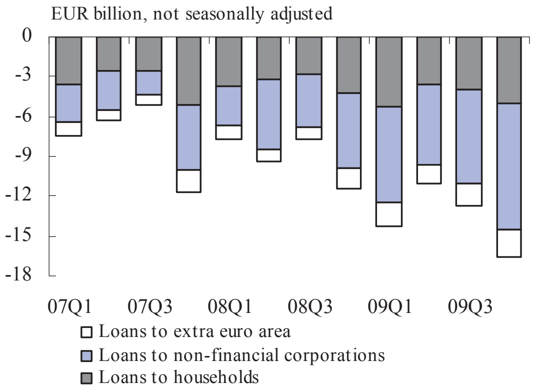
In any case, the financial sector's value added, which is at the source of its profit generating capacity, tends to grow in line with general economic activity and it is implausible that bank profits could durably expand at the current pace in the context of the projected moderate recovery in economic activity. Accordingly, banks have stepped up their provisioning for loan losses (Graph I.2.7).

(38) Tier 1 capital is a measure of the capital adequacy of a bank. The tier 1 ratio is calculated as the ratio of a banks' core equity capital (mainly ordinary shares, retained profits) to its total risk-weighted assets.

(39) In contrast to the tier-1 ratio, this ratio is not adjusted for the risk of the assets. It relates banks' capital and assets in the euro-area banking system's consolidated balance sheet.

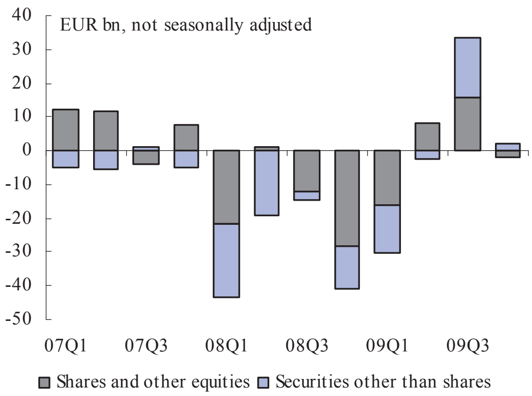
(40) The Member States data is derived from the outstanding stocks of capital and assets in the aggregated balance sheet of the banking system. This data is not consolidated.

Graph I.2.7: **Revaluation of bank loans**



Second, banks benefited from a recovery of financial asset prices, which to some extent may have been a correction of the extreme troughs caused by excessive pessimism and illiquidity in the acute phase of the financial crisis. This correction will phase out at some point in time and the developments of some market data indeed suggest that it may have already taken place. A second driver of this financial market recovery has been the banking rescue schemes enacted by public authorities. Either explicitly or implicitly eliminating the possibility of large financial institutions to default, they have also trimmed the downside risk of financial investments. However, as public support schemes will need to be withdrawn at some point, the downside risk may again come to the fore, thereby depressing financial asset prices. The strong revaluation of security values visible in Graph I.2.8 in 2009 is therefore unlikely to be sustainable and may even reverse, feeding into banks profits.

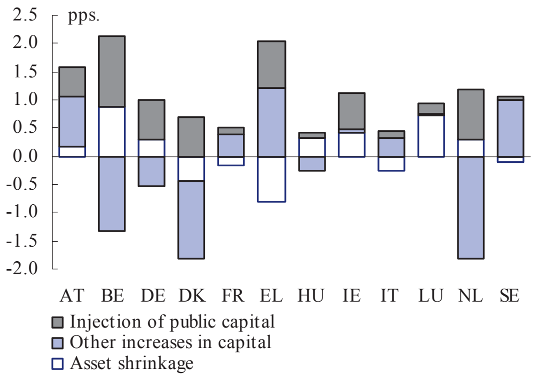
Graph I.2.8: **Revaluation of bank securities**



Third, bank profits have been boosted by trading along a steep yield curve, and this factor will become less relevant in the forecast period. Extremely low central bank interest rates meant low refinancing costs. Any expected future "normalisation" of short-term interest rates would reduce banks' earnings capacity from maturity transformation and, as higher interest rates tend to depress asset prices, reduce their opportunities to take advantage of revenues from trading activity.

A fourth factor that will influence banks future capital position is their incentive to redeem the injected public capital. The repayment would undo a substantial part of the past increase of capital ratios in the Member States concerned (see Graph I.2.9).[41]

Graph I.2.9: **Decomposition of the change in total capital ratios, 09/2008-12/2009**



Both the redemption of public capital and the increase in capital ratios have hitherto been largely financed by retained earnings. Some banks issued new capital on markets, but this was often in the form of hybrid debt securities rather than ordinary shares. To some extent, the public capital injections have contributed to a lack of interest in banks shares by investors as they imply that part of future profits will flow to governments, leaving a smaller share to be distributed to private investors. Banks, therefore, have an incentive to redeem quickly in order to improve their opportunities to tap private capital markets. When the contribution of profits via retained earnings to banks capital position weakens, the trade-off between signalling a strong capital position by maintaining public capital and becoming more attractive for private shareholders by repaying public capital at the expense of a lower capital ratio will intensify.

(41) However, this aspect will be materially relevant for only few banks as public capital injections were highly concentrated. That is, 6 EU institutions received 48% of the total public capital injected.

While many banks succeeded in increasing their capital position, markets at the same time revised upwards the capital ratio they expect banks to target. Thus, banks need to hold more capital than that required by regulators in order to be treated as solvent counterparts by market participants. Moreover, the regulatory reform agenda implies that banks will in the future need to hold capital of better quality (see Box I.2.1). That is, they may need to hold a higher share of capital in ordinary shares, which has a better loss-absorbing capacity than many of the debt-equity hybrids used in the past to boost capital positions.

On a more positive note, higher capital adequacy requirements on banks, irrespective of whether in response to market views or regulation, do not necessarily imply that banks have to step up the deleveraging process. In the past, most banks held capital buffers well above the regulatory requirement. The need for further deleveraging will therefore crucially depend on how capital buffers are adjusted to changes in capital requirements. If banks were to further increase their capital ratios with less scope to do so with retained earnings, they would need to continue deleveraging with possible adverse impact on their position to expand credit to the real economy.

Fifth, other regulatory initiatives, such as bank levies or changes of the perimeters of financial regulation, may affect banks' cost functions or their capability to generate revenues. Regulation of hitherto unregulated activities is likely to trigger shifts in the investment strategies of most types of financial intermediaries, including of banks' lending policies.

2.4. BANK LENDING AND REAL ECONOMIC ACTIVITY

While the previous section focused on how deteriorating real economic conditions have affected the financial sector in the EU, this section explores how financial market conditions have affected the real economy. Some observers claim that instability in the banking sector translated into a credit crunch, i.e. a reduction in the supply of bank loans beyond that which would normally be expected in a cyclical slowdown. At the current juncture it is of particular interest whether credit constraints could slow down the pace of economic recovery.

At the peak of the financial crisis in autumn 2008, the threat of a credit crunch figured high on the policy agenda. Accordingly, it was a declared objective of the bank rescue packages to ensure an appropriate provision of credit to the economy. Consistently high credit growth immediately after the announcement of public rescue measures, i.e. between October and December 2008, indeed suggests that the policy measures did somewhat delay the impact of the financial crisis on the real economy. For example, bank credit in the euro area to non-financial corporations still expanded by 9.5% y-o-y in December 2008 and by 6.2% in March 2009, despite the marked deterioration in economic activity. The growth of credit to enterprises, however, weakened considerably thereafter. It became negative in September 2009 and continued decelerating until January 2010, the most recent date for which data are available.[42] Interestingly, credit growth to households showed a different time profile. It had peaked already in May 2006 and trended thereafter down until spring 2009. In contrast to corporate lending, credit growth to households remained in negative territory only for a short time. It picked up in autumn 2009 and by January 2010 it grew by 1.6% y-o-y.

(42) Some substitution from bank credit was observed in rising issuance of corporate bonds. Non-financial corporations issued twice as much long-term debt securities in 2009 than 2008. By end 2009, the outstanding amount had increased to 726 bn EUR, which is still a small amount compared to outstanding loans to the sector of almost 5000 bn EUR. This form of financing requires a certain size of the issuer and has been largely used by utility firms and large industrials. The increasing issuance volumes led to a slight deterioration of average ratings in this market segment, suggesting that big firms found it increasingly attractive to search for funding via debt issuance. Market volumes seem to be nevertheless too small to provide a material substitute for the provision of bank credit to the total economy in the near term.

Box I.2.1: Regulatory reform initiatives with impact on financial intermediation

The financial crisis has exposed the need for ambitious reforms to substantially improve risk management in the financial system in order to increase financial stability and resilience of financial intermediaries. The following key initiatives are expected to have a direct impact on financial intermediation:

- *prudential requirements for banks in general*. This can take various forms. Among the proposals being discussed are (1) higher capital requirements for trading book activities, (2) introduction of standards to ensure adequate liquidity buffers under stress situations, (3) establishment of a leverage ratio as a complement to the risk-based capital requirements, which would be a non-risk weighted ratio between a bank's capital and its total exposure or assets. (4) harmonisation of the definition of capital, (5) higher capital requirements for counterparty credit risk;

- *the imposition of taxes or levies* on financial transactions, financial liabilities or other measure of banks' size and risk;

- measures to address risk associated with *Systemically Important Financial Institutions (SIFIs), which* could be subject to higher capital requirements, or other specific requirements;

- *measures to reduce pro-cyclicality,* which could include (1) dynamic provisioning, (2) countercyclical capital buffers and the capital conservation buffers;

- measures to encourage *responsible lending,* which could include (1) the introduction of loan-to-income ratios, which would allocate a higher risk weight to large loans to borrowers with low income; (2) stricter capital requirements linked to loan-to-value ratios.

Further policy initiatives aim at developing a more efficient supervisory architecture and extending the perimeter of regulation. In this context, one of the most important steps will be the establishment of a new EU financial supervisory framework that will be based on two pillars. The first pillar will address the weakness of current macro-prudential oversight by creating a European Systemic Risk Board. The second pillar will improve micro-supervision by establishing a new European System of Financial Supervisors. Work is also underway to introduce a new EU crisis management framework, including reforms of bank resolution regimes and deposit guarantee schemes. Since the crisis has exposed gaps in the financial regulatory frameworks, a further set of initiatives covers the regulation of hitherto unregulated financial activities and entities, including OTC derivatives, hedge funds, and credit rating agencies.

Such initiatives have raised concerns about the potential cumulative impact on banks' lending capacity and its implications for economic growth. In particular due to higher capital requirements or levies, banks could be forced to yield higher returns on their equity in order to raise enough additional capital and would at least partly pass on these higher costs onto borrowers, thereby raising the cost of financing for the economy. In addition, other measures, such as the changes to the definition of capital or the introduction of a leverage ratio, could have significant implications on the composition of banks' balance sheets. The interaction of all the proposed measures will most likely trigger shifts in banks' lending and investment strategies.

On the other hand, enhanced financial stability should help mitigating possible future shocks and reduce the probability of crises. Similarly, other types of reforms targeted at dampening pro-cyclicality may not only improve the resilience of financial institutions but also help preserve banks' lending capacity during downturns. The benefits of enhancing the resilience of the financial system are likely to materialise mainly over the medium to long term, but are difficult to measure.

At its meeting on 23 April 2010, the finance ministers of the G20 reaffirmed their commitment to developing rules to improve both the quantity and quality of bank capital and to discourage excessive leverage. They also agreed that the new rules need to be phased in carefully as financial conditions improve and economic recovery is assured and stressed the importance of the impact studies currently carried out on behalf of the G20 governments.

2.4.1. Recent developments in GDP and bank lending in EU Member States

Table I.2.1 summarises the main trends in economic growth and bank lending to the non-financial corporate and to the household sector since 2004. The reference period is split into three parts, so as to distinguish a pre-crisis period (2004-07), a financial crisis episode (2008-09) and most recent developments (the fourth quarter of 2009). This split is based on the observation that real GDP in EU Member States continued to grow even as the financial crisis started to unfold in the second half of 2007, and that it was only in 2008 that the financial crisis began to spill over to the real economy. It should be noted, however, that some Member States still recorded increases in lending when the GDP growth was already trending downward, while others observed a contraction in lending while GDP was still growing.

In order to facilitate the comparison of bank lending developments across Member States, the table reports i) inflation-adjusted loan growth rates in national currencies and ii) real credit and GDP growth differentials, the latter being a rough indicator for tightness of bank lending to the private sector. The loan-GDP growth differential should not be misinterpreted as an indicator of excessive or unsustainable lending. Moreover, it should be noted that several new Member States outside the euro area have been engaged in extensive foreign currency borrowing. Box I.2.2 discusses the factors that have driven foreign-exchange borrowing in those countries.

As regards bank loans to non-financial corporations, almost all new Member States and Ireland and Spain experienced strong increases in the pre-crisis period. It is remarkable that the same Member States clearly outpaced the others in terms of credit expansion even after controlling for their above-average performance in GDP growth in 2004-07. However, Poland and Hungary are an exception in that credit to the corporate sector expanded at much lower rates, more similar to those recorded in the bigger euro area economies.

Member States, in which credit to the corporate sector expanded briskly before the crisis, generally experienced a more severe decline in lending during the crisis period (Cyprus being an exception). Recently, loans to enterprises also slumped in Hungary while they stayed flat in Poland. In the core euro area Member States, the development of credit to the corporate sector was much smoother before as well as during the financial crisis. Austria and Germany stand out as Member States where lending to enterprises in real terms even decreased in 2004-07. The corporate sector in Germany, for instance, achieved a net-lender position due to the huge profits accumulated in the pre-crisis period. As a consequence, enterprises became less reliant on bank loans to finance investment and bank lending to the sector was almost flat. In the euro area as a whole, bank lending to enterprises declined when the financial crisis became more extensive, albeit to a lesser degree than in most of the more recently acceded Member States. In some euro area Member States, credit to the corporate sector only started to decelerate in 2009 so that average lending growth in 2008-09 was still higher than in the pre-crisis period.

The cross-country differences are even more pronounced with respect to bank loans directed to the household sector. Again, more recently acceded Member States, but also Ireland, Greece, Spain and Austria, recorded particularly large increases before the financial crisis. In the crisis, growth decelerated markedly in all Member States, except in Cyprus and Slovakia. Belgium stands out as a country where loan growth contracted significantly during the crisis, although there is no evidence of disproportionately strong lending to households in the pre-crisis period.

2.4.2. Experience from past business cycles

Historical experience indicates a strong correlation between the growth rates of bank lending to the private sector and real GDP within the euro area. However, the synchronisation between the economic and credit cycles appears to be asymmetric insofar as economic downturns are usually accompanied by sharp declines in credit growth, while recoveries in credit growth typically lag economic upturns. Graph I.2.10 illustrates that in the euro area economic downturns at the end of the 1980s, in 2000-01 and during the recent recession were all accompanied by a relatively immediate decline in the growth of bank lending to the private sector. On the other hand, the pick-up in bank lending growth lagged recovery from the first two of these economic downturns by at least

Table I.2.1:
GDP and bank lending to the private sector in EU Member States
(Average real annual percentage change)

	(1) GDP (b)			(2) Loans to non-financial corporations (NFC)			(3) NFC Loans-GDP growth differential = (2) - (1)			(4) Loans to households (HH) (a)			(5) HH Loan-GDP growth differential = (4) -(1)		
	04-07	08-09	09Q4	04-07	08-09	09Q4	04-07	08-09	09Q4	04-07	08-09	09Q4	04-07	08-09	09Q4
BE	2.7	-1.0	-0.8	3.1	2.1	-8.0	0.4	3.2	-7.1	8.1	-15.0	-14.3	5.5	-14.0	-13.5
DE	1.9	-1.9	-2.4	-0.2	2.2	-4.9	-2.1	4.1	-2.5	-1.2	-1.8	-0.8	-3.1	0.1	1.5
IR	5.5	-5.1	-5.0	26.1	1.9	-4.4	20.6	7.0	0.5	19.7	-1.7	0.1	14.2	3.4	5.1
EL	4.0	0.0	-2.5	7.0	1.6	-12.0	3.1	1.6	-9.4	21.3	-0.3	-4.3	17.3	-0.3	-1.7
ES	3.6	-1.4	-3.1	19.7	0.8	-3.4	16.1	2.2	-0.4	15.9	0.9	-0.8	12.3	2.3	2.2
FR	2.2	-0.9	-0.3	6.8	2.8	-2.6	4.5	3.8	-2.4	8.5	2.7	2.1	6.2	3.7	2.4
IT	1.4	-3.2	-3.0	6.8	0.3	-2.7	5.4	3.5	0.3	8.7	0.3	4.1	7.3	3.5	7.1
CY	4.3	0.9	-2.8	17.0	20.0	7.0	12.7	19.1	9.8	10.8	11.0	7.9	6.5	10.1	10.8
LU	5.5	-1.7	1.4	3.6	7.0	-6.7	-1.9	8.7	-8.1	1.2	1.5	7.7	-4.3	3.2	6.3
MT	3.0	0.1	-0.1	7.2	9.3	0.4	4.3	9.2	0.4	11.8	7.9	7.4	8.8	7.8	7.5
NL	2.8	-1.0	-2.6	5.8	7.7	4.3	3.0	8.8	6.9	3.9	-1.6	-1.5	1.1	-0.5	1.1
AT	3.0	-0.8	-1.9	-0.7	4.7	-0.5	-3.7	5.6	1.4	13.6	0.9	-1.9	10.6	1.7	0.0
PT	1.4	-1.3	-1.0	3.9	6.6	3.7	2.5	8.0	4.7	7.5	2.5	2.6	6.1	3.9	3.6
SI	5.3	-2.3	-5.8	20.2	7.8	0.5	14.8	10.1	6.3	20.7	8.3	5.9	15.3	10.7	11.7
SK	7.7	0.6	-3.5	16.7	6.4	-2.4	9.0	5.8	1.2	24.2	17.5	11.5	16.6	16.9	15.0
FI	4.1	-3.4	-5.1	8.5	5.0	-5.9	4.4	8.4	-0.7	11.9	5.8	6.1	7.8	9.2	11.2
BG	6.3	0.3	-6.0	26.9	11.1	0.2	20.6	10.8	6.2	43.1	12.1	4.3	36.8	11.8	10.2
CZ	5.9	-0.9	-3.1	14.3	-0.8	-9.7	8.4	0.1	-6.6	33.2	13.8	9.3	27.3	14.7	12.5
DK	2.5	-2.9	-3.0	10.5	3.3	-3.2	8.0	6.2	-0.2	9.4	2.6	1.8	7.0	5.5	4.8
EE	8.4	-9.0	-9.4	39.2	-1.1	-3.5	30.7	7.8	5.8	45.0	1.7	-1.5	36.5	10.6	7.8
LV	10.4	-11.5	-17.1	31.1	-1.2	0.4	20.7	10.3	17.5	57.2	-5.8	0.8	46.8	5.7	17.9
LT	8.2	-6.5	-13.2	28.4	0.9	-4.7	20.2	7.4	8.5	60.0	5.3	-0.1	51.8	11.8	13.2
HU	3.3	-2.9	-5.3	9.6	1.0	-9.9	6.3	3.9	-4.6	22.8	13.2	-2.8	19.5	16.1	2.5
PL	5.5	3.3	2.8	7.9	8.8	0.2	2.4	5.5	-2.6	27.8	23.3	16.1	22.3	19.9	13.2
RO	6.7	-0.2	-6.9	25.1	9.8	3.5	18.4	9.9	10.4	66.7	13.6	3.9	60.0	13.8	10.8
SW	3.6	-2.6	-1.5	6.9	3.8	-3.1	3.3	6.3	-1.5	9.9	8.2	9.4	6.4	10.8	10.9
UK	2.6	-2.2	-3.1	11.4	4.2	-6.0	8.7	6.5	-2.9	2.1	3.6	9.6	-0.5	5.8	12.7

(a) Loans derived from outstanding amounts in national currency deflated with GDP (b) Seasonally and working day adjusted

Sources: Eurostat, ECB and own calculations

one year, i.e. the early stages of recoveries appear to have been creditless.

The phenomenon of "creditless recoveries" is the subject of several recent empirical studies. Focusing on financial crises in emerging economies, Calvo et al. (2006) confirm that credit growth declines sharply in a financial crisis, thereby causing deep economic recessions and resulting in economic recovery without an immediate rebound in credit.(43) Subsequent studies, inter alia by Claessens et al. (2008, 2009) highlight that "creditless recoveries" are not restricted to emerging economies but can also be found in developed economies.(44)

The notion of a "creditless recovery" has recently been challenged by Biggs et al. (2009) (45), who argue that the change in credit transactions, i.e. the change in the *flow* of credit (called the "credit impulse", see the columns in Graph I.2.10) has a closer relationship with the economic cycle than a change in the *stock* of outstanding credit. They point out that, while the stock of credit is related to the economy's capital stock and hence is an important determinant of potential output, it is the change in credit flows that drives the dynamics of the business cycle. Importantly, they highlight the fact that the flow of credit can be positive even when its stock remains unchanged or declines, giving rise to the appearance of "creditless recoveries".

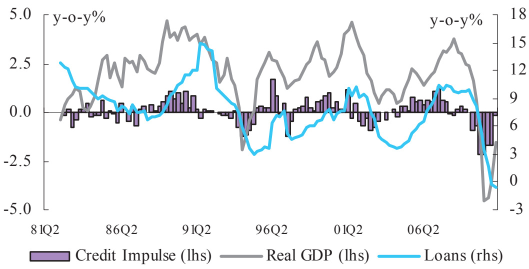
(43) Calvo, G. A.., A. Izquierdo and E. Talvi, 2006, "Phoenix Miracles in Emerging Markets: Recovering without Credit from Systemic Financial Crises," NBER Working Paper No: 12101.

(44) Claessens, S, M. A. Kose and M. E. Terrones, 2008, "What Happens During Recessions, Crunches and Busts?" IMF Working Paper No: 08/274 and Claessens, S., M. A. Kose and M. E. Terrones, 2009, "A recovery without credit: Possible, but…", VoxEU, 22 May 2009.

(45) Biggs, M., T. Mayer and A. Pick, 2009, "Credit and economic recovery", DNB Working Paper No 218.

Graph I.2.10 indeed suggests that, in the past three decades, GDP growth has been more strongly correlated with the credit impulse than with the change in the stock of credit, although the difference in terms of the correlation coefficients (0.6 versus 0.5) is not great. At the current juncture, the gradual recovery in real GDP growth is already reflected in a return to normal credit impulse (posting a slightly negative value of -0.14 in the last quarter of 2009), while growth in outstanding credit is still declining and has even turned negative for the first time in the second half of 2009.

Graph I.2.10: **GDP, loans and credit impulse to non-banks, euro area**

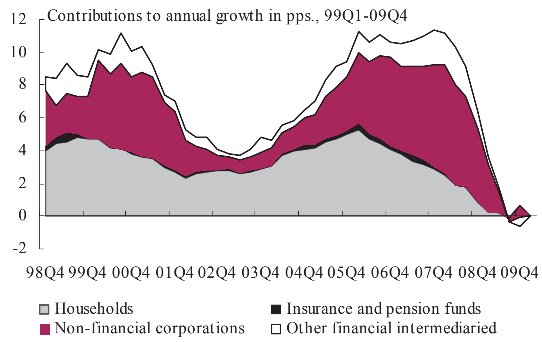


Notes: Real GDP growth before 1996 taken from the ECB Area Wide Model database (see ECB Working Paper N° 42)
MFI loans to households and non-financial corporations

On a sectoral level, loans to households and to non-financial corporations have traditionally been the key drivers of lending to the private sector. Lending to households began to decelerate already in the second quarter of 2006, while lending to non-financial corporations continued to expand strongly until the second half of 2008 (see Graph I.2.11).[46] Lenza and Reichlin (2010) point out that companies usually continue to expand bank borrowing for a period after an adverse shock to the business cycle as internal financing would instantly become less available in an economic downturn. Another important reason for the strong credit dynamics at the end of 2008 was that corporations drew on existing credit lines as they expected financing conditions to deteriorate. Since then, a deceleration in lending to enterprises has become progressively pronounced and has exceeded the deceleration in household borrowing.

The sharp drop in bank lending in the current crisis has been associated with an unprecedented decline in economic activity. This pattern appears to be consistent with developments in previous recessions, which were not accompanied by crises in the banking sector. This suggests that public support measure have mitigated the effects of the banking crisis on bank lending activity.

Graph I.2.11: **Borrowing by selected sectors, euro area**



The significant correlation between bank lending and real economic activity shown above does not establish causality. It is an open question whether bank loans affect output or whether (expected) economic activity determines loan demand and supply. Several studies have questioned the general relevance of credit supply conditions for bank lending. For instance, it is widely acknowledged that as larger banks usually have less difficulty than their smaller competitors in raising non-deposit funds, they appear to be in a better position to shield their lending from shocks to their balance sheets.[47] Hence the bank lending channel would rather operate through smaller banks. As smaller banks only account for a minor share in overall lending, this would make the bank lending channel largely irrelevant. As a further consequence, bank lending would not have leading indicator properties with respect to economic activity.

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(46) See Lenza, M. and L. Reichlin, 2010, "Monetary policy in exceptional times and the economic implications of phasing out in the Eurozone", VoxEU, 16 February 2010.

(47) See Kashyap, Anil K., and Jeremy C. Stein (1995). "The Impact of Monetary Policy on Bank Balance Sheets," Carnegie-Rochester Conference Series on Public Policy, vol. 42, pp. 151-195. Likewise, small under-capitalised or highly leveraged banks may have more difficulties to sustain lending levels following an adverse balance sheet shock; see Kishan, Ruby P., and Timothy P. Opiela (2000). "Bank Size, Bank Capital, and the Bank Lending Channel," Journal of Money, Credit, and Banking, vol. 32, no. 1, pp. 121-141.

Box I.2.2: **Foreign currency lending in the NMS-8**

Between 2004 and 2008, loans denominated in foreign currencies (FX loans) were expanding in the NMS-8,[1] especially in the segment of long-term maturities. During the most of the analysed period FX loans grew faster than loans denominated in local currencies. On average, the share of FX loans is highest for mortgages (about 70%), followed by the segment of credit to non-financial corporations (NFC; 45%) and consumer loans (30%).

The NMS-8 vary with regard to the share of FX loans in the loan stock: from dominating (Latvia and Estonia) to limited (the Czech Republic). The different magnitude and patterns of FX lending are due to various combinations of specific demand and supply factors.

Table 1:
FX loans in total loans to households and NFC (2009)

Magnitude		
Dominating>80%	Latvia	92%
	Estonia	87%
Majority 50%-80%	Lithuania	74%
	Hungary	63%
	Romania	60%
	Bulgaria	59%
Significant 20%-50%	Poland	33%
Limited <20%	Czech Republic	8%

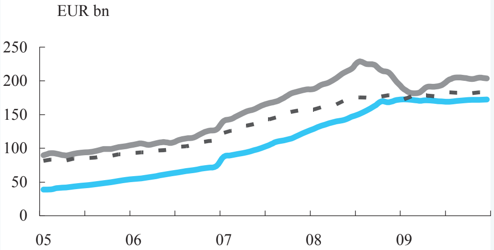
Undoubtedly, the growth of FX lending has been driven by demand factors related to risk and price. It was most prominent in the countries with fixed exchange rate regimes, where the currency risk was perceived to be low (the Baltic states, but also Bulgaria). The political commitment of the respective governments to maintaining the currency board arrangements reinforced such perception.

In the countries with floating exchange rate, it was mostly the price differential between loans in local and foreign currency that influenced the demand. As the bulk of loans in the NMS-8 have been granted at variable interest rates, the price differential can be reflected by the spread between local inter-bank rates and the EURIBOR. In the analysed period, the spreads were relatively high in Romania and Hungary, which corresponds to the high share of FX loans in these two countries. Conversely, the local interest rate in the Czech Republic was lower than the EURIBOR, which largely explains the limited share of FX loans in the Czech market.

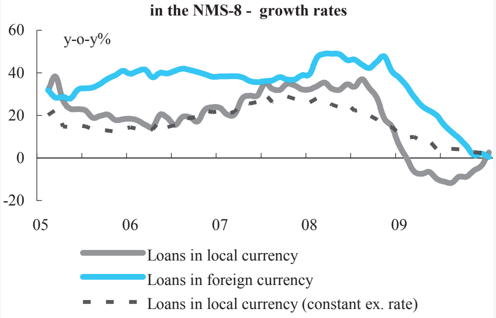
The supply side also played a role in stimulating the expansion of FX lending. One of the specific supply factors was the dependence of banks on external funding in most of the NMS-8. Especially in smaller economies the credit expansion was fuelled by foreign capital, usually provided by the parent banks. Thus, granting FX loans was often a way for the subsidiaries to reduce their currency mismatch – and passing the currency risk onto consumers. Another supply factor was higher profitability of FX loans. Data available for Poland show that the mark-ups set by banks were consistently higher for FX loans than for loans in local currency.

Following the financial crisis, the value of credit in local currencies in the NMS-8 dropped and then partly recovered during 2009. However, if the exchange rate volatility effect is eliminated, both foreign and local currency loan stocks have remained largely stable since the third quarter of 2008. For both types the growth rates were falling rapidly and reached zero level by the end of 2009.

Graph 1a: **Loans to households and NFC in the NMS-8 - levels**



Graph 1b: **Loans to households and NFC in the NMS-8 - growth rates**



Note: data series for Romania start in January 2007

(1) Eight new Member States not in the euro area: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Romania.

However, they also point out that this capacity to "originate and distribute" has not been stable over time and depends on the business cycle conditions and banks' risk situation. Applying this reasoning to the current situation with markets for securitisation still being impaired, the bank lending channel would be back in force again in that credit supply conditions are more relevant than before the financial crisis. Recent analyses by the Commission and Capiello et al.[48] do indeed find evidence for the existence of a bank lending channel of monetary policy in the euro area, highlighting the effects changes in credit supply (both in terms of volumes and in terms of lending standards) have on real economic activity.

Empirical studies on the bank lending channel, in particular those based on aggregate data, face the general difficulty of disentangling supply and demand effects. Based on the presumption that individual features of banks have closer links to credit supply conditions, recent work in the field has increasingly made use of micro data from the banking sector. For instance, Jiménez at al. (2009), using a comprehensive dataset of loan applications in Spain, find that adverse economic shocks lower the probability of loan applications to be approved.[49] In addition, both bank and borrower balance sheet conditions would matter for credit supply.

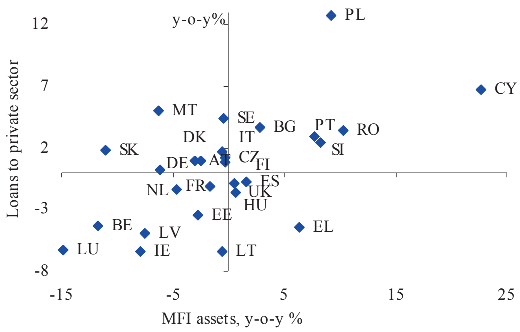
The need for banks to build capital is another potential supply-side factor influencing credit growth. Banks typically hold capital in excess of regulatory requirements and are often required – both by supervisors and markets – to widen this buffer in economic downswings. In the current context where banks are still exposed to significant undeclared losses on their balance sheets and face uncertainty over the ongoing overhaul of capital requirement rules, they may see a need to continue to build capital in spite of the economic upturn, implying a further possible source of lags in the recovery of credit growth.

(48) See European Commission, 2008, Quarterly Report on the Euro Area IV, p. 30 and Cappiello, L., A. Kadareja, C. Kok Sørensen and M. Protopapa, 2010, "Do Bank Loans and Credit Standards have an Effect on Output? A Panel Approach for the euro area," ECB Working Paper no. 1150.

(49) Jiménez, G., S. Ongena, J. L. Peydró, and J.Saurina, 2009, "Credit Availability. Identifying Balance-Sheet Channels with Loan Applications", Paper presented at 4th CEPR-Banca d'Italia Conference on Money, Banking and Finance, Rome, 2-3 October.

The trade-off between the strengthening of capital positions and credit supply by banks partly explains why bank lending has been weak in the ongoing process of deleveraging in the banking system. In an effort to shrink their balance sheets, banks have reduced their assets in many EU Member States in the course of 2009. Graph I.2.12 suggests that although bank asset accumulation and bank loans to the private sector are positively correlated, the variation across Member States is also remarkable. A considerable asset shrinkage accompanied by modestly negative loan growth or even positive overall loan growth can be observed for Germany, the Netherlands, Austria and Slovakia. Banks' assets and loans have recently been strongly declining in Ireland, Belgium, Luxembourg and the Baltic countries. It is worth noting that in those countries that experienced the strongest decline in bank assets, loans to corporations and to households declined (Belgium, Ireland, Latvia, Estonia). However, in the majority of countries, loans to corporations declined while loans households expanded in the final quarter of 2009, leaving most of the adjustment pressure on the corporate sector.

Graph I.2.12: **Bank assets and loans to the private sector, EU Member States 09Q4, annual growth rates**



2.4.3. Bank lending to the private sector

The ECB's Bank Lending Survey has become an important gauge of the extent to which changes in lending volumes are being driven by demand or supply factors. During the financial crisis, banks have indicated that their capital position, their access to market financing and their liquidity position have led to a tightening of credit standards. However, the net percentage of banks mentioning these factors has been considerably smaller than the share of banks that have referred to the general or sector-specific economic outlook. At the same time, supply side factors have been quoted more frequently than in the past as a reason for credit tightening. When compared to historical averages, supply-side factors increased in importance as much as demand-side factors.

Enterprises

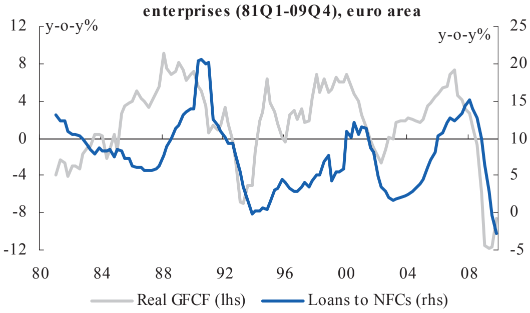
According to the latest ECB Bank Lending Survey from January 2010, net demand for loans by non-financial corporations turned negative in the first quarter of 2008 and declined further until the last quarter of 2008. Since then, net loan demand by enterprises has recovered but was still negative in the last quarter of 2009. The surveyed banks mention several – partly counteracting – forces behind the recent trend in enterprises' loan demand. The net decline in loan demand was in particular driven by weak fixed investment and scarce merger and acquisition activity and, to a lesser extent, by greater use of alternative sources of funding. These dampening factors were only partly counterbalanced by the strong positive impact of debt restructuring on loan demand.

The co-movement of private fixed investment activity and bank lending is illustrated in Graph I.2.13. Two things stand out. Firstly, in economic downswings there appear to be concomitant declines in loan and investment growth. This is in line with the observation in section 2.1.3 that countries featuring a highly indebted corporate sector such as Ireland, Spain, Portugal and Sweden have recently suffered a stronger decline in fixed investment. Secondly, loan growth seems to lag a recovery in private fixed investment growth by about two quarters. This suggests that, at the beginning of an upswing, companies instead of investing in new fixed assets make better use of still under-utilised production capacity. Moreover, corporate profitability usually increases swiftly in a recovery, providing companies with opportunities to tap internal funds to meet rising capital needs before they turn towards banks.

As regards the supply-side determinants of bank lending to the corporate sector, the ECB Bank Lending Survey provides evidence that credit standards and terms and conditions for approving loans to enterprises started tightening in the second half of 2007 when the financial crisis began. Net tightening peaked in the last quarter of 2008 and subsequently the restrictive stance of banks towards lending to enterprises has continuously eased. However, a majority of banks still reported a further tightening in the last quarter of 2009, and the speed of easing has slowed down. Indeed, a majority of banks even expect a slight increase in net tightening in the first quarter of 2010.

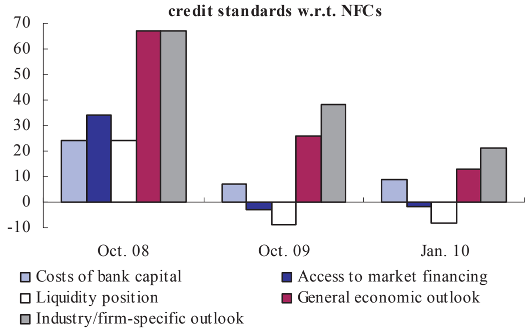
Graph I.2.14 illustrates that the main factors behind the continued tightening of credit standards remain perceptions of an unfavourable economic and industry-specific outlook. These are closely related to enterprises' balance sheet conditions and to their perceived creditworthiness. The importance of this factor may have recently been fading, but enterprises' insolvency rates, which are linked to this factor, usually respond with a lag to cyclical swings and may still increase in the near term. Higher insolvency rates in turn imply that banks face increasing write-downs on their loans and this may force them to tighten credit supply standards. Costs related to banks' capital positions also continue to be a restraining factor for credit supply. In contrast, liquidity or market financing conditions have contributed to an easing of credit standards, helped by massive monetary stimulus and government support in access to funding. Although a majority of banks no longer report an impact of these measures, the number of respondents claiming that these measures facilitate access to wholesale funding remains high at 37%. Also, despite the easing of access to wholesale funding, banks' ability to transfer credit risk off their balance sheets reportedly deteriorated further in the last quarter of 2009.

Graph I.2.13: **Fixed investment and loans to enterprises (81Q1-09Q4), euro area**



Notes: Real gross capital formation growth rates before 1996 taken from Area Wide Model database (see ECB Working Paper N° 42)

Graph I.2.14: **Factors contributing to tightening of credit standards w.r.t. NFCs**



Source: ECB January 2010 Bank Lending Survey

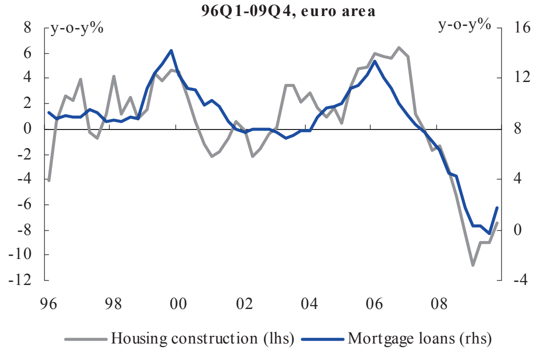
Interestingly, according to the latest ECB Bank Lending Survey, the pace of decline in net credit tightening with respect to large firms and small and medium-sized enterprises (SMEs) has been quite similar and also in terms of credit standards and credit terms and conditions there are no significant differences in the treatment of large firms and SMEs. This finding is by and large corroborated by the results of the new "Survey on the access to finance of small and medium-sized enterprises in the euro area", which is jointly undertaken by the ECB and the Commission.[50] In the second half of 2009, the net percentage of surveyed SMEs reporting an increase in demand for bank loans was 16%, compared to 6% in the case of large firms. Bank loans are by far the most important source of finance for SMEs. In June 2009, 64% of SMEs that expected to grow stated they would apply for bank loans. Large firms, in contrast, had greater recourse to market-based funding, benefiting from more favourable terms of external financing in the second half of 2009. In this period, large firms had a less negative assessment of bank loan availability as compared to the first half of 2009 while the assessment of SMEs remained broadly unchanged. However, a large majority (75%) of SMEs reported that they received full or part of the amount of bank loans they applied for.

Households

Residential mortgage loans have traditionally been the key driver of bank lending to the household sector in the euro area. As a consequence, the marked deceleration in residential mortgage lending was also primarily responsible for the drop in the growth of overall lending to households since 2006. In contrast, consumer and other loans have gradually become less important drivers of overall growth in lending to households in the past ten years.

There appears to be a close relationship between loans for house purchases and housing construction activity. Since the mid-1990s, declines in housing investment were typically preceded by significant slowdowns in the supply of residential mortgage loans. The recent slump in housing investment has even lagged the slowdown in residential mortgage lending, which began in the second quarter of 2006, by about three quarters (see Graph I.2.15). On the other hand, residential mortgage lending does not appear to be a leading indicator with respect to housing investment in periods of credit expansion. While the slump in mortgage loans has recently bottomed and loans for house purchases increased again by 1.7% y-o-y in the final quarter of 2009, housing investment is still declining, though at a diminishing rate.

Graph I.2.15: **Housing construction and mortgage lending 96Q1-09Q4, euro area**



According to the latest ECB Bank Lending Survey, in the last quarter of 2009 the net percentage of banks reporting an increase in demand for housing loans increased for a third quarter in a row and the net contribution of the assessment of housing market prospects was positive for the first time since 2006. Also, net tightening of credit standards on housing loans continued to decline in the final quarter of last year amid lower perception of risks related to the general economic outlook and housing market prospects. However, banks also reported increases in collateral requirements and household savings as factors restraining loan demand. This overall positive assessment of recent housing loan developments does not seem fully consistent with the recent performance of the residential construction sector in the euro area, and there are several reasons why a quick recovery of this sector is unlikely.

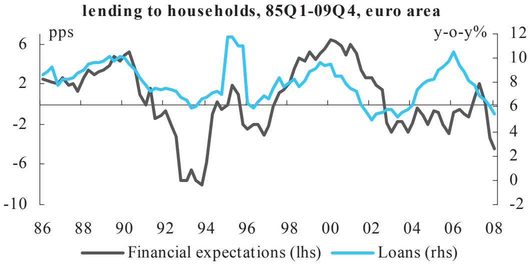
House prices are still elevated in some Member States. That should dampen demand for housing loans. Consumer confidence, according to the Commission Economic Sentiment Indicator, deteriorated in February, reflecting a bleaker assessment of the general economic outlook and increasing unemployment fears. In particular the gloomy outlook for the labour market can be assumed to depress households' willingness to

[50] This survey is a bi-annual exercise covering more than 5000 SMEs and large firms in the euro area. It provides data on financing conditions for SMEs in comparison with those for large firms. Bi-annual updates are being undertaken by the ECB while a more comprehensive survey will be conducted every two years, in collaboration with the Commission.

engage in major purchases including investment in housing.

In general, bank lending to households is closely related to expectations regarding their financial situation, as recorded by the Commission household survey. This relationship was very tight until 2003, but weakened between 2004 and 2006, when lending to households accelerated significantly without a corresponding improvement in financial expectations (see Graph I.2.16). Presumably, the breakdown in this relationship reflects the interaction of a prolonged period of low interest rates and financial innovation, which expanded access to the mortgage market to lower income cohorts of the household sector. In 2007 and 2008, the strong deterioration in households' financial expectations was matched by a deceleration of their bank loans. In 2009, financial expectations improved, but only until September. The recent levelling-off in households' assessment of their past and future financial situation does not bode well for the private demand outlook, in particular housing investment.

Graph I.2.16: **Financial expectations and final lending to households, 85Q1-09Q4, euro area**



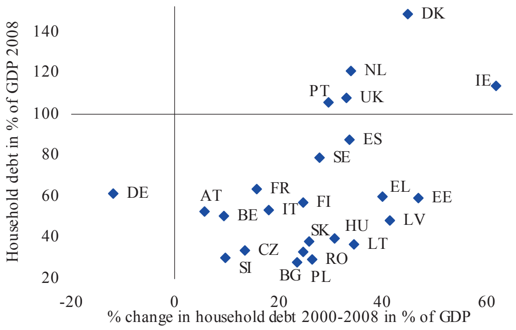
Notes: Financial expectations: Households' expectations of their financial situation over the next 12 months; deviation from long-term average;
Source: DG ECFIN consumer survey, ECB

Household indebtedness increased in all EU Member States except Germany in 2000-08 (see Graph I.2.17). In Denmark, Ireland, Netherlands, Portugal and the United Kingdom it has reached levels above 100% of GDP. Helped by the prolonged deceleration in bank lending to households, household debt ratios have stabilised since 2008. However, there may be a need for further deleveraging of households' balance sheets in several euro-area Member States where debt-income ratios are significantly above the euro-area average, thereby dampening demand for housing loans and investment in those countries.

Securitisation markets are still impaired. When securitisation activity was at its peak, about 60% of the outstanding amounts of securitised assets were collateralised with residential mortgage bonds. As securitisation boosted banks' lending activity, households lending may have increased disproportionally strongly in the past. Therefore, as long as issuance activity on securitisation markets has not recovered, lending to households, and in particular mortgage lending, is likely to be weaker than in the past.

As a consequence, housing demand and hence also households demand for credit is likely to remain subdued at least in the near future. The negative outlook on housing demand is matched by a fall in building permit issuance, which is usually a good indicator of housing supply. Hence, notwithstanding the recent recovery in loans for house purchases, there is only little prospect of an imminent rebound in housing investment despite some signs of a recent bottoming out of its steep decline.

Graph I.2.17: **Household debt in EU Member States**



Notes: 2007 observation for BG, EE, 2006 for CZ, change since 2001 for IE and SI.

2.4.4. Outlook

From a longer-term perspective the recent decline in lending activity – though unprecedented – is consistent with the recent sharp decline in economic activity that is unparalleled of itself. This suggests that even when the financial crisis hit its peak bank lending growth was largely driven by demand factors. This holds both for credit to non-financial corporations and for mortgage loans, where the deceleration in the financial crisis is presumably mostly a reflection of the slump in the demand for corporate investment and housing construction respectively.

A quick recovery in lending activity is unlikely as past experience shows that bank lending growth follows the economic recovery with a lag of at least one year. Extrapolating past trends, bank lending is therefore not likely to accelerate significantly before the end of 2010. This is also confirmed by the results of the latest Bank Lending Survey, according to which banks do not expect a broad-based easing of credit standards in the coming months, except perhaps on mortgage loans. Although competitive forces are expected to contribute to an easing of credit standards, this is counterbalanced by the expected effects of banks' costs of funds and balance-sheet constraints. Hence, supply side constraints to bank lending may become binding as the economic recovery becomes more established but banks need to continue repairing their balance sheets. There is, however, no evidence of an imminent threat of a credit crunch.

3. GLOBAL IMBALANCES STILL CASTING A SHADOW

Divergences in current-account positions across the globe have been the hallmark of economic developments in the past decade and a half or so. This can be seen as a consequence of the globalisation of financial markets, with the home bias in financial investment gradually removed. However, this has not fully delivered the hoped-for favourable reallocation of capital, with low-income emerging economies in Asia massively investing in financial instruments in the US. This development is not sustainable. While some correction in the global imbalances has been triggered by the financial crisis, these adjustments are found to be partly of a temporary nature, pointing to the need for further, and more structural, adjustment beyond the forecast horizon.

A key concern is that a durable unwinding of global imbalances, while necessary, at this stage could be damaging for the EU economy as the recovery is still fragile – dependent also on how the adjustment is shaped. In this chapter two scenarios of adjustment are elaborated: a benign adjustment scenario and a harmful adjustment scenario. Under the benign scenario, the correction of the US current-account deficit is offset by an equivalent increase in aggregate demand in emerging Asia, led by China, helped by the removal of de facto exchange rate pegs to the US dollar. The effects of such a scenario on the EU would be minor, although growth in notably the euro area would remain sluggish in line with weak potential growth, which points to the need for bold structural reform.

The harmful scenario would imply that emerging Asia maintains its exchange rate pegs to the dollar and fails to offset a permanent reduction in aggregate demand in the US. Under this scenario, not only growth in the euro area, but also in the world economy as a whole would suffer. Such a scenario should be avoided, but policy choices can limit the negative implications for the euro area. The removal of rigidities in services, labour and capital markets could ease the adjustment to a persistently higher effective exchange rate and the associated competitiveness losses in tradable industries. Policies to remove skill mismatches of labour supply and demand and to boost innovation and productivity growth would also be extremely welcome in this regard. It points to the importance of moving ahead with the Europe 2020 Strategy.

3.1. INTRODUCTION

Divergences in current-account positions have been the hallmark of global economic developments in the past decade and a half or so. Since the mid-1990s there has been the tendency of current-account positions of major economies to be either in persistent and sizeable surplus or persistent and sizeable deficit.

This constellation of current-account positions across the world can be seen as a consequence of the globalisation of financial markets, with the home bias in financial investment gradually removed. In principle such a development is welcome to the extent it results in better international allocation of capital. This is based on the premise that normally capital "flows downhill", i.e. from high-income to low-income regions in the world where the marginal return on capital is highest. It would thus contribute to the convergence of per capita GDP across the world.

However, this is not exactly how the international constellation of current-account positions has worked out. Home bias in financial investment has surely been reduced, but this has not fully delivered the hoped-for favourable reallocation of capital. Rather than flowing downhill, capital has been flowing uphill to a large extent, with low-income emerging economies in Asia massively investing in financial instruments issued by the largest and most advanced economy in the world, the US.

This paradox can be explained largely by a combination of two factors: (i) the deliberate choice of emerging Asian economies to build up massive foreign exchange reserves after the devastating experience of the Asian crisis of the late 1990s (by way of a war chest against future calamities), and (ii) the fact that the US offers a range of very liquid and comparatively safe financial instruments denominated in the world's most important reserve currency.

The fundamental problem with this development is that it is unsustainable. The net liability position of debtor countries cannot grow indefinitely at a pace that exceeds their rate of growth of nominal GDP, pointing to a correction at some stage. An issue that has been studied extensively in academic and policy-making circles is whether this correction will be 'orderly' or 'disorderly'. An orderly correction would imply a gradual reversal of the downward trend in saving in the US economy and an equivalent gradual decrease in saving in the Asian economies. A disorderly correction would be equivalent to a sudden confidence shock vis-à-vis the US, with the US dollar plummeting, US bond yields soaring, asset market collapsing and global recession unfolding. This is not a scenario that has materialised so far, or projected to materialise in the near term, but it cannot be ruled out that it could still do so beyond the forecast horizon.

Indeed, the financial and economic crisis that has hit the global economy, is not reminiscent of a 'disorderly unwinding' scenario. The crisis did not produce a collapse of the US dollar and treasuries market, as feared, but rather a bursting of the bubbles in real estate markets and a private credit squeeze.(51) Even so, the forces that have shaped the financial crisis are tightly intertwined (and overlap) with the global imbalances. Specifically, the abundant supply of capital flows from emerging Asian economies contributed to the build-up of bubbles in real estate markets in the developed world, especially in the US. Moreover, the fact that exchange rates of Asian currencies have been pegged to the US dollar (to sustain the build-up of foreign reserves), contributed to keep inflation low in the developed world. This enabled monetary policies in developed economies to be relatively accommodative without raising alarm bells.

(51) There is not full agreement on the particular role global imbalances played in the crisis. For some observers, the crisis was fundamentally caused by problems in the behaviour of, and regulatory and supervisory framework for, the financial sector. For others, global imbalances were the major underlying problem. The consensus view is that both factors have been interacting and together produced the conditions that led to the crisis. For a recent survey and discussion on the role played by the global imbalances in the crisis, see Obstfeld M. and K. Rogoff (2009), "Global Imbalances and the Financial Crisis: Products of Common Causes", Paper prepared for the Federal Reserve Bank of San Francisco Asia Economic Policy Conference, October 2009.

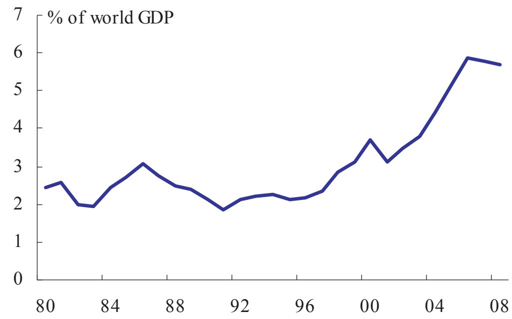
Against this backdrop this chapter will take stock of the stylised developments in global imbalances before and after the crisis. It will examine also what part of the adjustment that has taken place to date since the crisis is durable and what part is likely to be reversed once the world economy has recovered. The way global unbalances further unwind beyond the forecast horizon may have substantial implications of the EU economy. In particular the euro area economy may be adversely affected despite its broadly balanced external position, as will be elaborated in the final section of the chapter.

3.2. STYLISED DEVELOPMENTS

3.2.1. Before the crisis

Current-account imbalances have been trending up since the mid-1990s. A possible gauge of this development is to add up the absolute values of the current-account positions of all countries in the world. As depicted in Graph I.3.1, this aggregate position has been fluctuating around 2.5% of world GDP during the 1980s and first half of the 1990s. Since then and until the crisis broke out, however, it exhibited a clear upward trend, with a short-lived downward correction in 2002, peaking at about 6% of world GDP in 2008.

Graph I.3.1: **Current account imbalances in absolute value 1980-2008**



Source: IMF World Economic Outlook

Three main periods can be distinguished which broadly correspond to global business cycle fluctuations.(52) The rapid increase in imbalances in the second half of the 1990s coincided with the ICT boom in the US. US investment was buoyed by optimistic expectations of productivity and

(52) See Blanchard O. and G. Milesi-Ferretti (2009): "Global imbalances: in midstream", IMF staff position note.

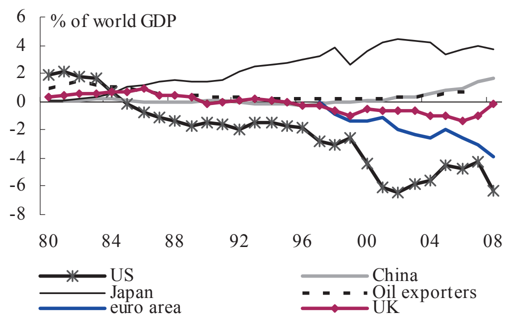
profit growth. Meanwhile investment lost buoyancy in Asia in the wake of the recession in Japan and, subsequently, the Asian crisis. In this period, the US current-account deficit was largely financed by FDI and portfolio equity investment, spurred by the favourable prospects for the US economy. After the ICT bubble burst in 2001, further increases in global imbalances were driven mainly by declines in US saving (both public and private), with China, Japan and the oil exporters becoming the US' main creditors. Capital flows to the Unites States were dominated by investments in government bonds, increasingly by official investors. Finally, between 2005 and 2008, a further decline in US household savings associated with the housing bubble, the dramatic increase in China's saving/investment imbalance and soaring oil prices boosting oil exporters' trade surpluses, became the main drivers of the continued widening of global imbalances. Investment in US treasuries remained important as a counterpart to the US current-account deficit, but also foreign purchases of US corporate bonds increased significantly. During each of these three phases, the current-account position of the EU remained broadly in balance.

China and the oil-exporting countries have become major global creditor countries while the US has become by far the largest debtor. The development of the net international investment position (IIP) of the major economies is shown in Graph I.3.2. The IIP is the value of the assets that a country owns abroad, minus the value of the domestic assets owned by foreigners. The change in the IIP between two years is equal to the current-account balance plus a "valuation effect" which reflects changes in asset prices. In the US, the IIP deteriorated significantly between 1996 and 2002, reflecting a widening current-account deficit. However, it remained broadly stable between 2002 and 2007 despite a further widening of the current-account deficit, due to a positive valuation effect.[53]

The US IIP worsened in 2008, mainly due to the fall in equity prices in global markets. While Japan remained the largest global creditor according to the IIP measure, China's IIP has been rapidly increasing since 2004, mirroring its widening current-account surplus. The oil exporters' IIP had been increasing all along since the mid-1990s as oil prices trended up.

By contrast, and despite its broadly balanced current-account position, the IIP for the euro area has shown a downward trend in recent years. This tendency has been driven by adverse valuation effects associated with the appreciation of the euro since 2002 (given that the euro area has large gross non-euro denominated holdings). This tendency is currently being reversed in part by the recent weakening of the euro exchange rate. The IIP in the UK has been negative since the mid-1990s, reflecting its persistent current-account deficit. However, in 2008 (and, to a lesser extent, in 2007) the UK recorded a significant improvement in its IIP, mainly driven by valuation effects stemming from depreciation of the pound sterling.

Graph I.3.2: **International investment position**



Note: Oil exporters=Saudi Arabia only
Source: Updated and extended version of the External Wealth of Nations Mark II database developed by Lane and Milesi-Ferretti (2007), Commission staff estimates and ECB

3.2.2. The impact of the crisis

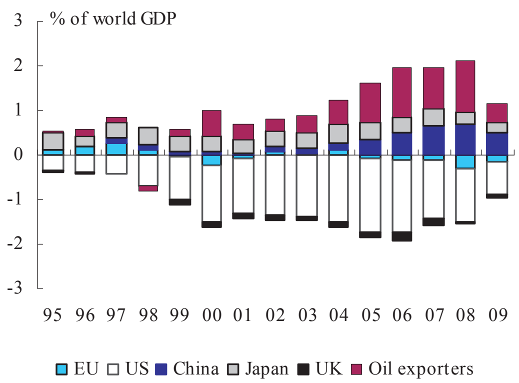
Global imbalances narrowed significantly since the onset of the global financial crisis. According to preliminary estimates for 2009, current-account positions of major economies declined in absolute terms to about 2% of world GDP from 3.3% of world GDP in 2008. The bulk of this correction stemmed from a smaller surplus/deficit of, respectively, the oil exporters and the US, although the correction has been world-wide (Graph

(53) The developments between 2002 and 2007 reflect different factors. First, the dollar depreciated significantly (some 22% in real effective terms between February 2002 and December 2007). Second, there was a much stronger domestic-currency performance of foreign stocks relative to US stocks. A weaker dollar tends to raise the domestic currency value of US assets denominated in foreign currency, thus strengthening the US external position. And faster growth in foreign equity markets relative to the US stock market imply that the value of foreign equities held by US residents increases in value more rapidly than the value of foreign holdings of US equities (see: Lane, P. and G. Milesi-Ferretti (2008) "Where Did All the Borrowing Go? A Forensic Analysis of the US External Position"; IMF Working paper WP/08/28. IMF: Washington DC)

I.3.3).[54] This easing in global imbalances was reflected in an equivalent drop in global cross-border capital flows.[55]

The *US* current-account deficit has halved to 3% of GDP in 2009 from its peak of 6% of GDP in 2006 (Table I.3.1). This largely reflects the weakening in US domestic demand after the bursting of the housing bubble, the lagged effect of dollar weakness in the period 2002 to mid-2008 and, more recently, the sharp decline in oil prices. In the first three quarters of 2008 this correction was interrupted by the hike in oil prices, but it resumed in the fourth quarter of 2008 when US domestic demand sharply weakened and oil prices plunged. After the US deficit troughed in the first half of 2009, it began to widen again in the second half of 2009 as the economy showed signs of recovery.[56]

Graph I.3.3: **Current account balance for key countries**



China's current-account surplus declined from almost 10% of GDP in 2008 (11% in 2007) to just over 6% in 2009. This largely reflects the sharp decline in China's exports to the US and the EU when world trade collapsed in late-2008 and early-2009. The export slump by far outstripped the decline in Chinese imports as its domestic demand held up well.

In *Japan*, the current-account surplus also narrowed, from 4½% of GDP in 2007 to close to 3% of GDP in 2009. The reduction in 2008 was mainly driven by a sharp fall in exports, while in 2009 net investment income became the main driver, led by lower returns on assets abroad. The decline in the net income balances is an interruption of an unabated upward trend (both in absolute terms and as percentage of GDP) since the mid-1980s.

The current-account surpluses of *oil exporters* are estimated to have shrunk from over 16½% of GDP in 2008 to less than 6½% of GDP in 2009. This reflects the steep decline in oil prices that materialised in the second half of 2008 and first months of 2009. Trade data for the Gulf Cooperation Council countries suggest that surpluses are beginning to pick up again, as oil prices have been recovering since March 2009.

Meanwhile the *EU's* current-account deficit narrowed from just over 1% of GDP in 2008 to ½% of GDP in 2009. This largely reflects a decline in the deficit of the euro area (which makes up 75% of the EU GDP). But the correction was EU-wide. A sharp correction in the deficits of central and eastern European countries (CEE) occurred as buoyant domestic credit and foreign borrowing was brutally reversed with the onset of the financial crisis.[57] The UK's current-account deficit also narrowed, from over 2½% of GDP in 2007 to 1½% in 2009. Two main factors explain this roughly in equal proportions: a considerable rise in the surplus on services trade and an increase in the surplus on investment income. The latter was due in part to write-offs of foreign banks in the UK financial sector in 2008.

3.2.3. Main drivers of the adjustment

The steep decline in oil prices from mid-2008 has been a main driver of the adjustment. After increasing in the first half of 2008 to record levels, oil prices declined quickly in the second half of 2008, from a peak of USD 145 to a low of USD 38 per barrel in December. The price recovered during 2009 and stayed in the USD 70-80 range from October till end of 2009. Oil consumption also declined in the wake of the crisis, by nearly 1½% globally in 2009 (OECD -4½%, US -4%; China 7¼%), with production coming down by almost 2% (of which OPEC -6%). The change in

(54) Graph I.3.3 shows the development for key countries that together represent around 70% of both world's deficit and surplus This percentage is calculated considering the euro area as a whole, that is, eliminating intra-euro area imbalances.

(55) Since the spring of 2009, however, portfolio flows, in particular to emerging market economies, have picked up significantly while cross-border bank financing was still contracting in most regions (see: International Monetary Fund (2010): World Economic Outlook, January update).

(56) The US net income balance remained positive during the recent recession despite a large and growing net external debt position.

(57) Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, and Romania. Sweden's current-account surplus dropped from 9½% in 2008 to over 7% of GDP in 2009, while that in Denmark increased from over 2% to almost 4% of GDP.

Table I.3.1:

Current-account balance for major countries

	2005	2006	2007	2008	2009	2010	2011
% of world GDP							
United States	-1.6	-1.5	-1.2	-1.1	-0.7	-0.7	-0.7
Japan	0.3	0.3	0.4	0.2	0.2	0.2	0.2
EU	-0.1	-0.1	-0.1	-0.3	-0.1	-0.1	-0.1
Euro area	0.0	0.1	0.1	-0.2	-0.1	-0.1	-0.1
UK	-0.1	-0.2	-0.1	-0.1	0.0	-0.1	-0.1
China	0.3	0.5	0.6	0.6	0.5	0.5	0.5
Oil exporting countries	0.9	1.0	0.9	1.1	0.4	0.7	0.7
% of national GDP							
United States	-5.9	-6.0	-5.2	-4.9	-3.0	-3.3	-3.4
Japan	3.6	3.9	4.8	3.2	2.8	2.7	2.0
EU	-0.3	-0.4	-0.4	-1.1	-0.5	-0.6	-0.5
Euro area	0.2	0.3	0.4	-0.8	-0.7	-0.5	-0.4
CEE	-5.3	-7.6	-10.0	-9.7	-2.0	-2.3	-2.9
UK	-2.6	-3.3	-2.7	-1.5	-1.4	-1.9	-1.9
China	7.2	9.5	11.0	9.8	6.1	5.9	5.9
Oil exporting countries	14.7	18.6	15.0	16.6	6.3	10.5	11.4

oil prices is estimated to account for about 60% of the improvement in the US trade deficit and for most of the reduction in the surpluses of oil exporting countries in 2009. For current-account surplus countries such as China and Japan, lower oil prices served to partly offset the shrinking of the non-oil trade surplus.

The sharp decline in global trade mechanically contributed to reduce the global imbalances as well. According to estimates by CPB Netherlands, the peak to trough fall in world trade was 20½% from April 2008 and to May 2009, whereas world GDP is estimated to have declined by some 1½% over roughly the same period.[58] Such a more than proportionate reduction in global trade flows relative to the decline in global GDP will mechanically reduce the global current-account imbalances as a per cent of GDP. In this downturn, the "over-reaction" of global trade to global economic activity has been particularly marked.[59] Moreover, the crisis resulted in a sharp contraction in the demand for trade-intensive durable consumption and investment goods.

An additional contributing factor to the reduction in global imbalances stems from the unwinding of asset cycles. As asset price bubbles burst, savings propensities sharply increased in debtor countries. The correction in the external deficit positions experienced by a number of countries, notably the US, the UK and CEE countries was triggered by an upturn in household saving, along with sharp falls in (notably residential) investment in some cases. In the US, in particular, households reacted to their loss of wealth and the recession by significantly increasing their saving rate after residential investment had plummeted (see Graph I.3.4).[60] Business investment also fell sharply while business saving sharply increased in the pursuit of deleveraging. The net improvement in saving-investment balances of the private sector was partly offset by a massive increase in government dis-saving, but not by enough to prevent shrinking of the current-account deficit.

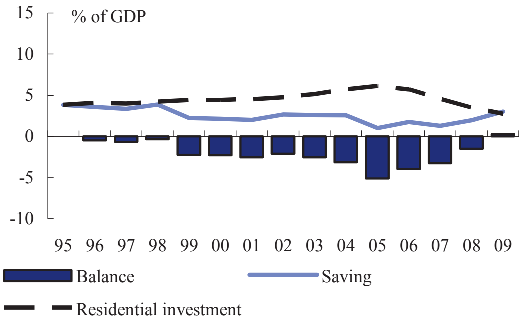
Adjustments in real effective exchange rates went some way to reigning in global imbalances as well. The real effective exchange of the dollar has fallen sharply since mid-2007 and is now about 11% below its long-term average. The main factors of dollar weakness – low US short-term interest rates, the growing US budget deficit and perceptions of the monetary expansion potentially undermining the dollar's role as a reserve currency – are still firmly in place.

(58) Commission staff estimates.

(59) See European Commission (2009): *Quarterly Report on the Euro Area* 8(3), DG ECFIN and Levchenko, A., Lewis L., Tesar L.(2010), "The Collapse of International Trade During the 2008-2009 crisis: In Search of the Smoking Gun", paper presented at Conference "Economic Linkages, Spillovers and the Financial Crisis", January 2010.

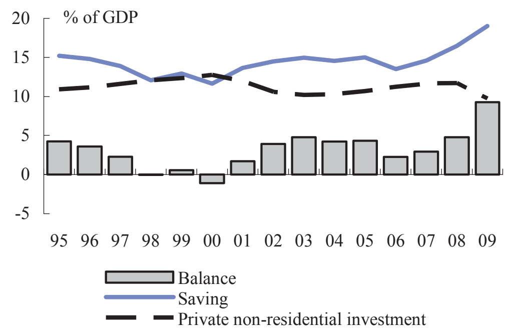
(60) The decline in US government saving, however, more than offset the recovery in US household saving, implying that national saving (private plus public) declined over the period. However, this was amply offset by the sharp decline in domestic investment, resulting in a reduction in the US current-account deficit.

Graph I.3.4a: **Saving-investment balance of US households**



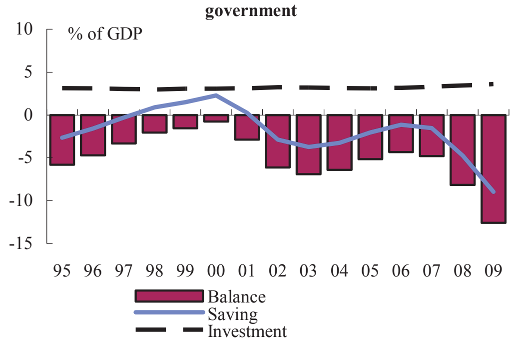
Source: OECD

Graph I.3.4b: **Saving-investment balance of US business sector**



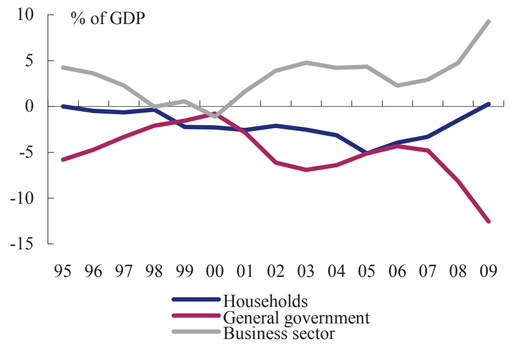
Source: OECD

Graph I.3.4c: **Saving-investment balance of US general government**



Source: OECD

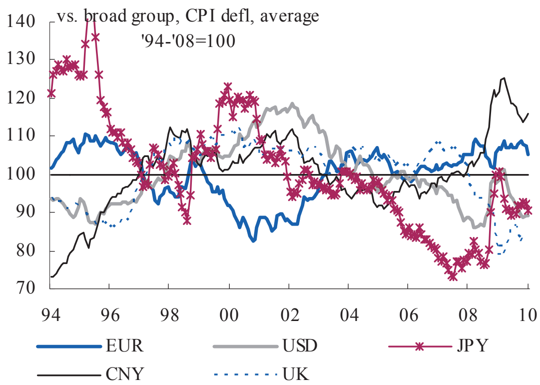
Graph I.3.4d: **US saving-investment balances by sector**



Source: OECD

The real effective exchange rate of the British pound has also depreciated, by 21% from mid-2007, and now stands at around 16% below its historical average.[61] The downward correction of floating CEE currencies since the outbreak of the financial crisis, has also been underpinning a correction of their current-account deficits.[62] The real effective exchange rates of the CEEs with fixed exchange rate regimes vis-à-vis the euro fell in concert, though more moderately, owing to disinflation and wage cuts.[63] Conversely, the real effective exchange rate of the yen has appreciated by 23% since mid-2007, reducing the undervaluation of the Japanese currency after its protracted depreciation since 2000.

Graph I.3.5: **Real Effective Exchange rate**



However, the constellation of bilateral exchange rate movements appears far from appropriate. At first sight, the decline in the US' real effective exchange rate seems conducive to current-account rebalancing. However, a closer inspection shows that the dollar's movements against individual currencies were not conducive to an unwinding of bilateral US positions. The dollar depreciated substantially against some floating currencies of countries with broadly balanced current-account positions, including the euro (see Graph I.3.7),

(61) A recent Bank of England report suggests that part of this decline may be permanent as the pound's equilibrium value may have fallen due to the financial crisis (see: Astley, M. and J. Smith (2009): "Interpreting recent movements in sterling", Bank of England Quarterly Bulletin, Vol. 49, No. 3, pages 202-214).

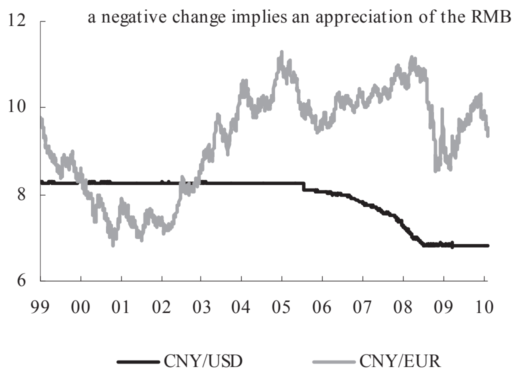
(62) Hungarian forint, Polish Zloty, Czech koruna, Romanian Lei.

(63) In Bulgaria, nonetheless, the adjustment in terms of disinflation and labour costs was less visible in the course of 2009.

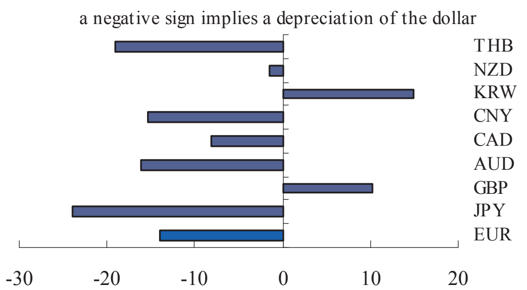
or even against countries with negative current-account positions. Moreover, since July 2008, the exchange rate of the US dollar has been virtually constant against the Chinese currency.

Moreover, the Chinese renminbi remains largely undervalued. The renminbi has appreciated in real effective terms by 15% since mid-2007, and by 21% since China announced a new exchange rate regime in July 2005 (see Graph I.3.5). However, this should not be allowed to conceal a change in China's exchange rate policy since July 2008. After China announced a more flexible regime in July 2005 the renminbi appreciated by 17% against the dollar until July 2008, but since then it has been virtually constant, with the regime de facto returning to a tight dollar peg (see Graph I.3.6). As a result, the dollar slide from March to December 2009 dragged down the effective value of the renminbi, which points to a persistent undervaluation of the Chinese currency.[64]

Graph I.3.6: **Renmimbi against EUR and USD**



Graph I.3.7: **USD cross rates since Jan 2006**



Note: THB=Thai bath; NZD=New Zealand dollar; KRW=South Korean Won; CNY=Chinese renmimbi; CAD=Canadian dollar; AUD=Australian dollar; GBP=British pound; JPY=Japanese yen; EUR=euro

[64] Meanwhile, China's foreign exchange reserves resumed their strong upward trend in March 2009 and stood at USD 2.4 trillion by the end of 2009, a new historical peak.

Conversely, the euro is still strong compared to historical averages. In real effective terms, the euro stood at around 5% above its long-term average in January 2010 and Commission's estimates still point to some overvaluation. The effective euro strength of the euro stems in part from the undervalued Chinese currency, but, more recently, is also a reflection of the downward adjustment of CEE currencies.

3.3. IS THE ADJUSTMENT DURABLE?

3.3.1. A mixed picture

The Commission forecasts that global imbalances will start to widen somewhat again as the recovery takes hold next year, while clearly not returning to the situation in the pre-crisis period. The aggregate measure for global imbalances (obtained by adding-up the current-account surpluses and deficits in absolute value), after falling from 3.4% of world GDP in 2008 to 2% in 2009, is expected to increase to 2.3% in 2010 and 2011. In the US, the current-account deficit as percentage of GDP would increase from 3% of GDP in 2009 to 3½% of GDP in 2011, thus remaining well below its peak level of 6% in 2006 (see Table I.3.1). In oil-exporting countries, the current-account surplus is expected to increase from 6¼% of GDP in 2009 to 11½% as oil prices recover. This is still below the levels of the pre crisis period. China's current-account surplus would increase in dollar terms but decline as a percentage of GDP due to fast GDP growth. An exception is Japan where the current-account surplus would remain stable in 2010 and fall to 2% in 2011. In the EU and the euro area the current account will remain broadly balanced while both the UK and CEE countries would experience a moderate widening of their deficits.

Some factors behind the recent adjustment are indeed likely to prove temporary. *First*, oil prices are expected to pick up as the recovery gathers momentum, widening the deficits of oil-importing countries and the surpluses of oil-exporting countries. Even so, it may take several years for oil prices to increase much further and current-account surpluses to return to the pre-crisis peaks in view of substantial inventories and spare capacity in oil supply. *Second*, in the US, corporate investment and to a lesser extent consumption and residential investment will pick up as the recovery takes hold, again contributing to a widening of the current-account deficit. *Third*, the recovery should also lead to some bounce-back in spending on durables and capital goods, acting to increase the surpluses of exporters of these items, such as Japan and China. *Finally*, the recovery in global trade flows, even if affecting all trade proportionately, will tend to widen global imbalances as a percent of world GDP.

However, other factors may prove more durable, and contribute to an underlying easing of the global imbalances. Several factors stand out. *First*, in countries adjusting to previous asset price bubbles, the household saving rate is expected to remain above pre-crisis levels, notably in the US, but also in the UK and CEE. *Second*, the substantial need for fiscal consolidation in deficit countries in the coming years, notably the US and the UK, should lead to a recovery in public savings in these countries. *Third*, investment rates in some deficit countries are also likely to remain subdued for some time, reflecting over-investment in the residential sector during the boom years, large spare capacity in the industrial sector and uncertainty over the global economic outlook. *Fourth*, China has announced a number of structural reforms, such as pension reform and an improvement in the living conditions of migrant workers that should support domestic demand and contribute to global rebalancing. *Finally*, the crisis has resulted in an increase in risk premia on international borrowing by debtor countries. This should constrain the ability of deficit countries to revert to running large current-account deficits. This is true also for the US to the extent the dollar's international status as a reserve currency would be weakened.

3.3.2. A tentative assessment

Commission analysis suggests that temporary factors dominate the correction in global imbalances so far. To determine the mix of temporary and durable current-account adjustment the Commission has developed a tool based on a methodology proposed by Bayoumi and Faruque (1998, see Box I.3.1).[65] This tool is used to identify the temporary components of current-account balances due to the business cycle and the lagged impact of past exchange rate changes. The residual between the total and the temporary component is then interpreted to be the structural component. Overall, movements in the temporary component appear to be the main driver of the adjustment in global imbalances so far. However, the structural components have also moved somewhat, and – at least in the cases of the US and China – in the right direction.

Looking ahead, the analysis suggests that once temporary factors peter out, global imbalances may return to the fore. The Chinese surplus could fall further as a share of its own GDP, but not in absolute terms or as a share of world GDP since the global output share of China continues to increase. Meanwhile, the US and EU deficits would increase once temporary factors have played out. Worse still, the temporary components of the adjustment may well be under-estimated, given that the methodology does not account for cyclical movements in the elasticity of world trade with respect to world output. If so, the structural adjustment may turn out to be smaller.

A source of some consolation, however, is that permanent shocks that move current-account positions in the desired direction cannot be ruled out. For example, pension reform in China may lead to permanent decreases in the current-account surplus beyond the declines observed so far. But as to when this will have discernable effects is still highly uncertain.

3.4. TWO SCENARIOS

A key concern is that the unwinding of global imbalances, while necessary, at this stage could be damaging with the recovery still fragile. This is true not least for the European economy, which is largely a bystander and yet may be heavily affected. This gives rise to a number of issues which will be developed in more detail in this section:

- How could an unwinding scenario unfold at this juncture? Would the correction of the US current-account deficit be offset by an equivalent increase in aggregate demand in emerging Asia? What would it imply in terms of growth, exchange rate constellations and external positions around the world? Would it, on balance, be favourable or unfavourable for the European economy?

(65) Bayoumi, T. and H. Faruqee (1998), "A Calibrated model of the underlying current account", in: P. Isard and H. Faruqee: Exchange rate assessment. Extensions of the macroeconomic balance approach. IMF Occasional Paper 167

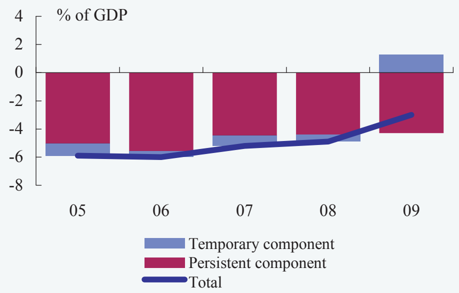
Box I.3.1: **The temporary component of current-account adjustment**

The underlying current-account position may be concealed by temporary factors such as variations in the business cycle and past changes in the real exchange rate that have not fully worked through. This temporary component will disappear once cyclical conditions revert to normal and the effects of past exchange rate movements peter out.

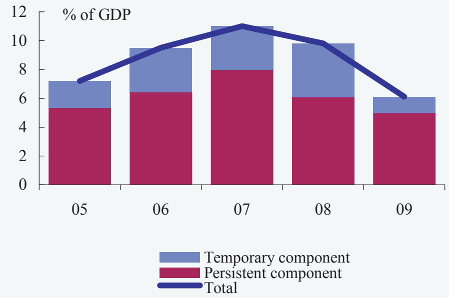
This temporary component is computed for the euro area, the United States and China (see graphs). It comprises: (i) the impact of the domestic business cycle (in an upswing buoyant imports temporarily increase the current account deficit), (ii) the impact of trading partners' business cycles (an upswing among trading partners boosts exports, thereby temporarily adding to the current account surplus), and (iii) the impact of the year-on-year change in real effective exchange rate (REER) at time t and time t-1 whose effects still have to materialise. Once an estimate for the temporary component has been computed, the permanent component can simply be gauged as a residual. The methodology follows Bayoumi and Faruqee (1998)[1] who base their assumptions on the multi-region model as described in Masson, Symansky and Meredith (1990).[2]

The temporary component of *the euro area* is positive and around ½% of GDP for 2009. Both cyclical factors and lagged effects from the real appreciation of the euro (whose impact is still to fully unfold) contribute. As for the *US*, the temporary component is positive and exceeds 1% of GDP. This reflects the weak cyclical position of the economy (compared with its trading partners) and the real appreciation of the dollar in 2009. Regarding *China*, its comparatively strong cyclical position in 2009 contributed to reduce its current account surplus in a temporary manner. Nonetheless, the temporary component remains positive in 2009 owing to the appreciation of its currency in real effective terms in 2008 which still has to work its way through.

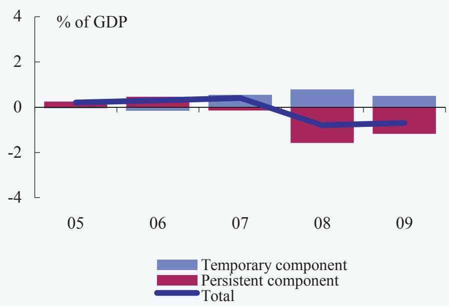
Graph 1a: **Current-account position, United States**



Graph 1b: **Current-account position, China**



Graph 1c: **Current-account position, euro area**



(1) Bayoumi, T. and H. Faruqee (1998), "A Calibrated model of the underlying current account", in: P. Isard and H. Faruqee: Exchange rate assessment. Extensions of the macroeconomic balance approach. IMF Occasional Paper 167

(2) The effects of the REER changes in t and t-1 are taken into account with decreasing weights, meaning that the larger share of REER changes not yet incorporated in current account balances are those pertaining to year t. REER data for China are missing for 1994 and 2010. The foreign output gap is obtained as the trade-weighted average (double export weights) of the output gap of the same 41 trading partners as those used for the REER. The current-account impact of a unit change in the REER and the output gap is captured by means of sensitivity parameters (the current-account semi-elasticity with respect to the REER and the sensitivity of imports and exports to output). See Masson, P., S. Symansky and G. Meredith (1990), "Multimod Mark II: A revised and extended model", IMF Occasional Paper 71

- If, in contrast, emerging Asia fails to offset a permanent reduction in aggregate demand and maintains its exchange rate pegs to the dollar, how would this affect the major economic regions in the world, and especially the EU (including the euro area)?

Two fundamentally different scenarios for further adjustment can be envisaged: a *benign adjustment* and a *harmful adjustment* scenario. In the benign scenario, a reduction in US domestic demand would be offset by an equivalent increase in domestic demand in emerging Asia, with a flexible renminbi facilitating the adjustment. In the harmful scenario, in contrast, the US would still experience a reduction in domestic demand but without an offsetting demand boost in Asia, with the renminbi and other emerging Asian currencies remaining de facto pegged to the US dollar.

It is important to stress that the scenarios are merely illustrative and the quantifications surrounded by wide margins of uncertainty. The scenario simulations are made with the Commission's dynamic stochastic general equilibrium model (QUEST III), its standard tool for shock-response analysis.[66] The effects of the different scenarios are presented as deviations from a baseline. The baseline corresponds to a 'no-policy-change' extrapolation of the forecast beyond 2011, and thus effectively starts in 2012. Uncertainties are large. Importantly, there is some controversy regarding the estimates of the elasticity of exports and imports with respect to exchange rate movements, as explained in more detail in Box I.3.2).

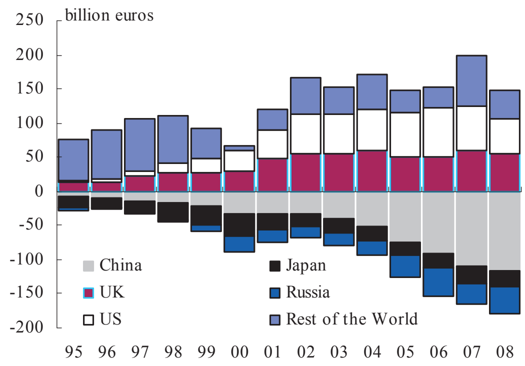
3.4.1. A benign adjustment scenario

Under this scenario, the fall in US domestic absorption is offset by an equivalent increase in demand in emerging Asia, led by China. In the simulation a negative domestic demand shock in the US is engineered to lead to a 1½ pps. improvement in the US current-account position. Accordingly, both the US current-account deficit and Asia's (China's) surplus would be significantly reduced (Graph I.3.9a). The rebalancing of demand and the correction of current-account imbalances is further facilitated by the assumed flexibility of the exchange rate of the renminbi and other emerging Asian currencies, which appreciate against the dollar.

Simulation results indicate that the effects of such a scenario on the euro area would be minor. The euro area's current-account and GDP would be little affected (Graph I.3.9b). From the point of view of the euro area, notably its tradable sector, such a scenario is more favourable than the harmful scenario examined below. Even under this benign scenario, however, euro area growth does not benefit from the rebalancing that takes place globally, underlining the importance of implementing structural reforms in the euro area to boost its growth potential.

The euro's real effective exchange rate would remain practically stable. The euro would appreciate in real terms against the US dollar, but this would be offset by real depreciation against Asian currencies. By contrast, the US real effective exchange rate would depreciate substantially relative to the baseline, because it depreciates not only against the euro, but also against the emerging Asian currencies. The real effective appreciation of the emerging Asian currencies not only helps to shift demand towards the rest of the world but also stimulates domestic consumption and investment in Asia.

Graph I.3.8: **The Euro area trade balance**



In this scenario the constellation of the euro area's bilateral current-account positions would change. As Graph I.3.8 shows, the euro area has been running a trade surplus against the US and the UK, but a large and growing deficit vis-à-vis China. Under this scenario, the strong Chinese domestic expansion and the expenditure-switching effects of the renminbi's appreciation against the euro would reduce significantly the euro-area trade deficit

[66] This version of the model distinguishes four major economic regions: the US, emerging Asia, the euro area and the rest of the world. For a description, see Ratto, M., W. Roeger and In't Veld, J. (2009), "QUEST III: An estimated open-economy DSGE model of the euro area with fiscal and monetary policy", *Economic Modelling*, Elsevier, vol. 26(1), pp. 222-233, January.

Box I.3.2: The impact of exchange-rate adjustment on the balance of trade

Exchange-rate variations can affect the trade balance through various channels which partly offset each other. A depreciation of the nominal exchange rate tends to initially deteriorate the trade balance by lowering the value of exports relative to imports measured in the same currency, known as the *terms-of-trade effect.* Over the longer term, the *expenditure-switching effect* kicks in and the trade balance tends to improve gradually by a subsequent increase in export volumes and reduction in import volumes. Taken together, this is the so-called "J curve effect".

The "Marshall-Lerner condition" determines whether trade elasticities are compatible with the prevalence of the expenditure-switching effect. Under the assumption of full pass-through, depreciating exchange rates would improve the trade balance only if, starting from a balanced external position, the sum of the absolute values of export and import elasticities is above unity. In the opposite case, terms-of-trade effects would prevail and the trade balance would worsen instead.

Table 1:
Trade elasticities

Export equation		Import equation	
Log of foreign income	1.57***	Log of domestic income	2.21***
Log of REER	-0.46***	Log of PPI/import prices	0.57***
No. of obs.	63	No. of obs.	66
R^2	0.995	R^2	0.988

Estimates based on aggregate trade data indicate significant coefficients but the estimated elasticities are generally not much above the Marshall-Lerner thresholds. The table reports estimated trade elasticities based on a dynamic OLS model for quarterly extra-euro-area trade from 1989 to 2009. A 1% appreciation in the real effective exchange rate (REER) is associated with a 0.46% reduction in exports. Imports react by 0.57% to a 1% rise in the ratio of domestic producer prices to import prices.

Estimated elasticities vary quite widely depending on sample and methodology. Most existing studies using aggregate trade data report trade elasticities around unity, but in some cases values well below one can be found.[(1)] For the euro area, the ECB Area Wide Model uses a long-run price elasticity of exports derived from an estimated export equation of about 0.6,[(2)] and a similar value around 0.6 is found in recent IMF estimates of the export elasticity for the US.[(3)] Such low estimates of trade elasticities could lead to puzzling implications of exchange rate changes for current-account balances.

Trade elasticities at lower sectoral aggregation levels tend to be higher, the reason being that, at narrower levels of industry definition, domestic and foreign goods tend to be closer substitutes. Recent estimates of import price elasticities at very disaggregate industry levels yield values of between 3 and 4.5 with high variation across industries.[(4)] Goods with relatively low price elasticities can display the largest variation in prices and exert a dominant effect on the estimated aggregate price elasticity, biasing the estimate downwards.

Imperfect pass-through can affect the adjustment of the trade balance to exchange rate changes. Firms with market power may partially accommodate for exchange rate fluctuations in their price-setting strategies by reducing margins and keeping higher market shares on export markets. Recent estimates report pass-through to import prices after one year of 0.42 for the United States and 0.81 for the euro area, likely to be associated with stronger domestic competition for imported goods in the US and with the use of the dollar as international invoicing currency.[(5)] Contrary to the standard assumption of linear exchange rate pass-through, it has been argued that a sudden strong reduction in exports can occur if the exchange rate goes beyond a certain

(1) Goldstein, M., and M. Kahn (1985): "Income and price effects in foreign trade", in R.W. Jones and P. Kenen (eds.), *Handbook of International Economics*, Vol II, Amsterdam: North Holland

(2) Fagan, G., J. Henry and R. Mestre (2001): "An area-wide model for the euro area", ECB Working Paper 42

(3) International Monetary Fund (2007): "Exchange rates and the adjustment of external imbalances", World Economic Outlook

(4) Broda, C., and D. E. Weinstein (2006): "Globalization and the gains from variety," The *Quarterly Journal of Economics* 121(2), 541-585; Imbs, J. and I. Mejean, 2009, "Elasticity optimism," CEPR Discussion Paper 7177 and Kee, H., L., A. Nicita, and M. Olarreaga (2008): "Import demand elasticities and trade distortions" , *The Review of Economics and Statistics* 90(4), 666-682.

(5) International Monetary Fund (2007): "Exchange rates and the adjustment of external imbalances", World Economic Outlook

(Continued on the next page)

Box (continued)

"pain threshold".[1] In the presence of vertical trade, i.e. two-way trade in intermediate goods, an increase in the international relative price of imports will have a smaller effect on import volumes because a larger amount of imports will at the same time be induced by rising exports.[2]

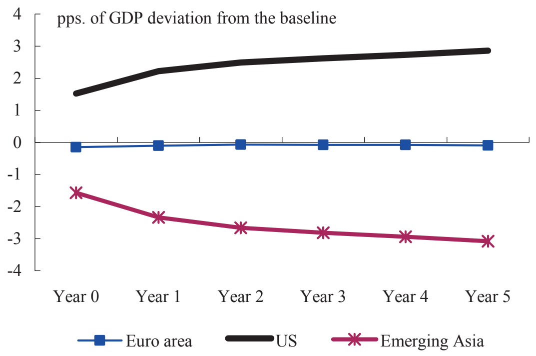
Taken together, although there is substantial uncertainty on the exact value of trade elasticities, evidence based on disaggregate data suggests that the effects of exchange rates on trade balances are probably stronger than found from the estimation of aggregate trade equations, going against the "elasticity pessimism" argument that exchange rates cannot do much for adjusting current-account imbalances in large economic regions. The simulations performed by the QUEST III model presented in this chapter builds on such indications of higher price elasticity of trade by assuming an average value of 1.5.

(1) See Belke, A., M. Goecke and M. Guenther (2009): "When does it hurt? The exchange rate "pain threshold" for German exports", DIW Discussion Paper 943 and Bussière, M. (2007): "Exchange rate pass-through to trade prices: The role of non-linearities and asymmetries" , ECB Working Paper 822

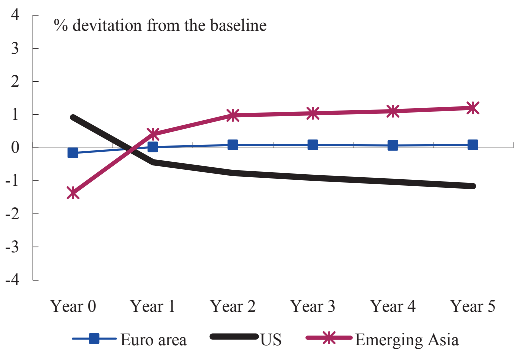
(2) Chinn, M. (2005): "Supply capacity, vertical specialisation, and tariff rates: The implications for aggregate US trade flow equations", NBER Working Paper 11719 and International Monetary Fund (2007): “Exchange rates and the adjustment of external imbalances”, World Economic Outlook

with China. At the same time, the trade surplus with the US would fall due to the euro’s appreciation against the US dollar. The composition of the euro-area trade balances is therefore likely to shift significantly, implying a smaller trade surplus with the US and a smaller trade deficit with emerging Asia than in the baseline.

Graph I.3.9a: **Benign scenario - impact on current-account balance**



Graph I.3.9b: **Benign scenario - impact on real GDP**

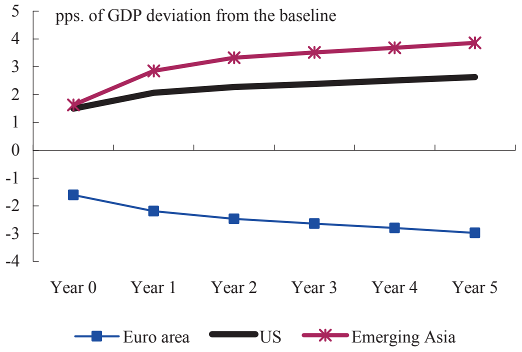


3.4.2. A harmful adjustment scenario

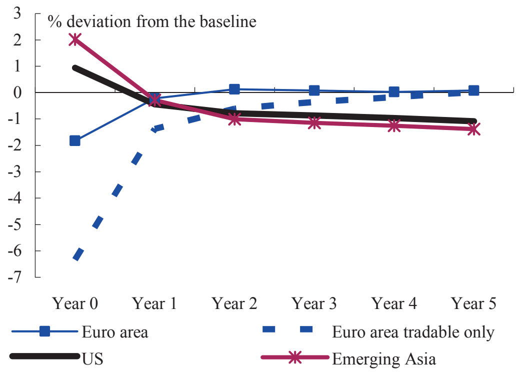
In this scenario emerging Asia fails to offset a permanent reduction in domestic demand in the US. The decline in US domestic absorption needed to engineer a 1½ pps. improvement in the US current-account position is significantly larger than in the benign scenario, in the absence of exchange rate adjustment vis-à-vis emerging Asian currencies. It is assumed that emerging Asia would not adopt policies to stimulate domestic demand either. As a result, the adjustment burden falls entirely on the euro area, which sees a marked appreciation of its real effective exchange rate, a widening in the current-account deficit and a sharp decline in GDP growth in the first few years compared to baseline, particularly in the tradable goods sector. Under this scenario, world GDP growth is also significantly lower.

The euro area's current-account position and GDP growth would be adversely affected. As in the first scenario, a negative domestic demand shock in the US is engineered to lead to a 1½ pps. improvement in the US current-account position. But, contrary to the first scenario, this does not translate into a similar narrowing of emerging Asia's current-account surplus. Rather, the adjustment occurs in the euro area current-account position (and that of the rest of the world), which would show a larger deficit (Graph I.3.10a).

Graph I.3.10a: **Harmful scenario - impact on current-account balance**



Graph I.3.10b: **Harmful scenario - impact on real GDP**



With emerging market currencies remaining pegged to the dollar, the effective depreciation of the US dollar (which is similar as in the previous scenario) is achieved through a more marked appreciation of the euro. The euro appreciates not only against the dollar but also against emerging Asian currencies, with its real effective exchange rate appreciating by about 15% (compared to remaining approximately stable under the first scenario). This loss of external competitiveness, combined with the weaker domestic demand in Asia, results in a significant decline in euro area GDP in the first two years relative to the baseline (see Graph I.3.10b).

The negative impact on output is concentrated in the euro area's tradable goods sector. Output in this sector falls sharply in the first years relative to the baseline, and remains below the baseline until the fifth year (Graph I.3.10b). Euro area Member States that have large tradable goods sectors and/or are less competitive are likely to be particularly affected. The impact also depends on the speed of adjustment, which in the model depends on capital and labour market rigidities across sectors and within the sectors. With higher labour mobility, the negative effect on output (and employment) tends to be smaller.

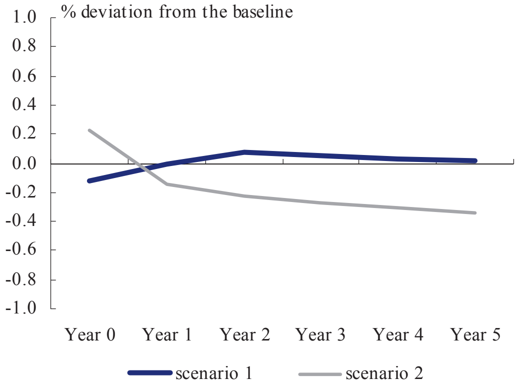
The non-tradable sector would perform better, pulling total GDP gradually back towards the baseline scenario in subsequent years. This reflects not only the fact that the non-tradable sector is not directly affected by the loss of external competitiveness but also by the fact that the current-account deficit implies a significant additional inflow of capital. As capital flows towards the euro area, the interest rate in the euro area decreases, boosting domestic demand, particularly demand for non-tradable goods. However, the shift in resources from tradable to non-tradable sectors does not happen smoothly. Temporary frictions, reflecting lack of appropriate worker skills and other constraints on resource mobility, affect productivity growth negatively.[(67)] Moreover, with productivity developments not being favourable, much of the capital inflow is likely to be directed towards financing consumption rather than productive investment. Indeed, there is evidence that capital inflows accompanied by weak competitiveness are often associated with unproductive consumption booms.

Under this scenario, not only growth in the euro area but also in the world economy would suffer. Global economic growth would be significantly lower in the second scenario in comparison with both the first scenario and the baseline (see Graph I.3.11). This is explained by the combination of lower euro area growth and lower growth in Asia in the second scenario, where weaker domestic demand eventually weighs more on growth than the boost in competitiveness vis-à-vis the euro area contributes to it.

Policy choices can limit the negative welfare implications of this scenario for the euro area. Clearly, the tradable sector will initially be heavily hit by the increased competition from the rest of the world. However, if capital inflows to the euro area are used productively, the negative effect on the tradable sector is gradually offset by the performance of the non-tradable sector. Providing the appropriate incentives for capital to flow into best uses would help mitigate the otherwise strong negative implications for growth and welfare of the euro area.

(67) This was modelled as a negative productivity shock in the non-tradable sector.

Graph I.3.11: **World real GDP**



Moreover, rigidities in labour and capital markets are key factors determining the cost of the competitiveness shock in the tradable sector and the economy at large. Policies aimed at reducing such rigidities and facilitating the shift in resources across sectors (e.g. measures to reduce the skill mismatch of workers moving between sectors) could therefore contribute to limit the costs of this undesirable scenario for the euro area in terms of output and employment. Finally, structural reforms aimed at supporting productivity growth in the euro area could also be a key ingredient of the euro area's policy response. All this underlines the importance of getting the Europe 2020 Strategy right, both in terms of policy priorities and of governance structures to ensure implementation.

Unfortunately, there is reason to attribute a higher probability to the harmful scenario than to the benign scenario. A comparatively strong decline in domestic absorption is the US, as assumed in the harmful scenario, seems to be justified by the still very significant need to improve balance sheets in the US private sector and the increasing need for fiscal consolidation, as highlighted in section 3.2. At the same time, it is unlikely that emerging Asia will be able to compensate for weaker demand in the US – not least since it is unlikely that it will give up its dollar pegs in the near term.

A reduction of the US current-account deficit by 3 pps. of US GDP would amount to an excess of world supply of around USD 430 bn. Given the size of the Chinese economy at around USD 4400 bn, Chinese absorption would need to increase by around 10% of Chinese GDP, essentially eliminating the Chinese current-account surplus. From a policy point of view, this would require a substantial decrease in the corporate and household savings rate as the overall investment rate is already very high. While China has increased the credit supply to its economy in the first half of the 2009 and also stepped up efforts to introduce health care insurance, it may take time to implement these measures and they might not be enough to increase Chinese absorption by that magnitude, in the medium term. The recent concern about inflationary pressure in China is a clear sign of the limitations in this regard.

Finally, although these scenarios are mere illustrations and confined to the euro area, they do give rise to a number of policy issues that are pertinent for the EU as a whole.[68] *First*, the EU would need to ensure that the large shifts in resources that are likely to be required (e.g. from exporting to domestically-oriented sectors in case of an effective appreciation of European currencies) can materialise smoothly, so as to support potential growth and keep structural unemployment low. Such policies are needed anyway and largely coincide with the Europe 2020 Strategy. *Second*, EU governments must make headway with fiscal consolidation and reign in the economic imbalances within its own territory, in order to secure the inflow of foreign capital at favourable conditions in case global exchange rate constellations force it to run an overall current-account deficit. *Third*, the EU should tackle its external agenda vis-à-vis other global players in a coordinated manner so as to maximise its leverage in global fora such as the G20, with a view to ensuring that aggregate demand in emerging Asia offset the correction of the US external deficit.

[68] Trends in and policy challenges related to intra-euro area imbalances are discussed in some detail in other recent Commission publications, see European Commission (2009): *Quarterly Report on the Euro Area* 8(3), March 2009, DG ECFIN and European Commission (2010), "The impact of the global economic crisis on competitiveness and current- account divergences in the euro area" in Quarterly Report on the Euro Area, March 2010.

PART II

Prospects by individual economy

Member States

1. BELGIUM

Back on track for a gradual recovery?

Small, open economy hit by global crisis

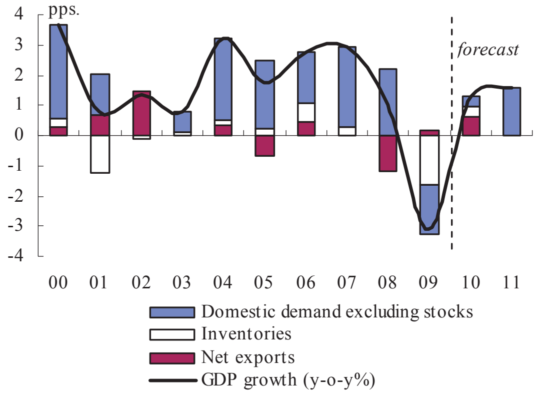
The start of the global financial crisis in the second half of 2008 hit Belgium mainly through two channels. First, the fall in world trade had a strong impact on Belgium's small open economy. Second, the financial crisis and the problems in the banking system triggered a tightening of lending conditions and a fall in confidence and in financial wealth, which depressed domestic demand. At the end of 2008, the recession gained momentum, and GDP markedly contracted for two consecutive quarters as a consequence of the strong fall in investment and inventories. In response to the crisis, the government adopted expansionary fiscal measures in line with the EERP, with an estimated budgetary impact of ½% of GDP in both 2009 and 2010. The package included wage subsidies as well as a delay of tax payments for firms, increases in social benefits, a reduction of the VAT rate for residential construction and an acceleration of public investment. Additionally, a series of actions was taken to support the financial sector.

In the second half of 2009, the interplay of the effects of the measures adopted in the framework of the EERP, the recovery of world trade and the improvement in the balance sheets of financial institutions sustained a gradual recovery in economic activity, which translated into a positive GDP growth in quarterly terms of 0.7% and 0.3% in the last two quarters of the year. The main drivers were net trade and inventories, while domestic demand continued to be subdued. This resulted in an annual contraction of 3.1% in 2009 as a whole.

Gradual recovery ahead

In view of the improved international environment, growth will continue to be supported in 2010 by the positive contribution of net exports and to a lesser extent by the inventory cycle. Domestic demand is foreseen to remain subdued in the first half of the year, as the low capacity utilisation rates will act as a deterrent to new investment, while the labour market, reacting to the crisis with a certain lag, is expected to impact on consumption through negative confidence effects. In the second half of the year, the improvement in the labour market and more generally in internal demand should lead to a gradual recovery which is set to continue in 2011. In this context, GDP is projected to expand by 1.3% in 2010 and by 1.6% in 2011.

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



Belgium's relatively better performance in 2009 compared to neighbouring countries and the euro area average stemmed from a smaller contraction of domestic demand, in particular inventories (their initial level was low) and investment. While the inventory cycle is expected to continue to have a positive impact in the first quarters of 2010, investment is expected to remain weak as firms are likely to adopt a prudent approach as a result of the excess of production capacity, difficulties in accessing credit and uncertain demand prospects. In the second half of the year and in 2011, however, a gradual pick-up is projected as global economic conditions continue to improve. In 2009, housing investment declined by less than in the euro area, since there were much more limited excesses in the residential real estate market and due to the temporary reduction of the VAT rate for residential construction. In 2010, housing investment is forecast to continue to contract but at a slower pace, also in view of cooling of housing prices.

Private consumption recorded a negative growth rate in 2009, shrinking by 1.6%, for the first time since 1993. The negative wealth effect from the decline in the value of financial assets and the deterioration of consumer confidence on the back of a worsening labour market situation more than offset the impact of the increase in real disposable income (2.6%) and led to a sizeable increase in the household saving rate (by 3.5 pps. compared to previous year). Private consumption is projected to expand again in 2010 even if only at moderate pace. Indeed, higher unemployment, less buoyant wage growth and a pick-up in HICP inflation (to 1.6%) will depress real disposable income. The saving rate is expected to remain at a high level compared to the historical average as negative effects of low confidence will persist. In 2011, a more dynamic development of wages and a stabilisation of unemployment are expected to allow for a stronger growth of consumption.

In 2009, the contraction of external demand triggered large drops in exports, which bottomed out in the second half of the year. In 2010, exports are projected to recover steadily but at a moderate pace as the effects of stimulus measures and inventories adjustments in foreign countries are fading out. They are forecast to pick up more strongly in 2011 in a more favourable international context.

The above scenario is subject to both positive and negative risks. On the positive side, a more vigorous recovery of global demand would boost exports, which would have a significant effect on economic activity as a whole. Negative risks could stem from a worse-than-expected development of domestic demand. Confidence and wealth effects as well as a stronger increase in unemployment could lead to higher precautionary savings and to lower consumption, while a stronger-than-projected tightening of lending conditions would depress investment.

The competitive position weakened in recent years and little improvement is expected…

Based on Belgium's export performance in recent years, there are doubts about the country's ability to fully benefit from the rebound in world trade. Over past years, there has been a structural loss of market share for Belgian exports[69] for both goods and services. Their disappointing performance can in part be explained by geographical specialisation. Belgian exports are mainly oriented towards other euro area countries, whose import growth has been considerably lower than world trade growth in recent years. Furthermore, the share of fast-growing markets in Belgian export destinations has remained relatively low. Sectoral specialisation also plays a role: Belgian exports show a specialisation in medium-technology goods that are easy to imitate, such as chemicals and steel.

(69) As calculated by the growth differential between Belgian export markets and Belgian exports.

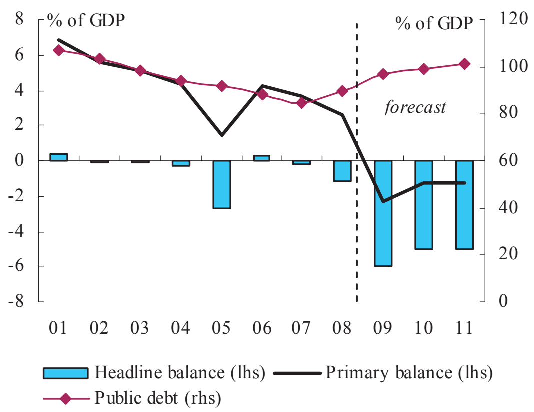
In addition, relatively high wage costs have had a negative impact on Belgium's exports. Since 2005, unit labour costs (ULC) have increased more rapidly than in the euro area, mainly as a result of strong increase in wages.

With an expected fall in ULC in 2010 followed by a moderate increase in 2011, it is expected that the cost competitiveness of Belgium would improve somewhat over the forecast horizon without fully correcting the accumulated losses of the last ten years.

… while labour utilisation is set to remain low,…

In 2009, the impact of the economic downturn on employment has been relatively contained as most employers have resorted to the extended scheme for temporary unemployment, which allows corporations to reduce employees' working time without resorting to dismissals. However, in view of the lagged reaction of employment to changes in economic activity, employment is expected to still contract significantly in 2010 and the unemployment rate is forecast to increase until 2011. Given the characteristics of the Belgian labour market, there is a risk that some of those unemployed become permanently inactive. This would put further downward pressure on labour supply, which is already low as witnessed by the comparatively low employment rate and the high long-term unemployment rate.

Graph II.1.2: **Belgium - Public finance trends**



… the fiscal deterioration is to be reversed

In 2009, the government general balance deteriorated sharply from a deficit of 1.2% of GDP in 2008 to 6.0% of GDP, triggering the excessive deficit procedure. The budget was strongly affected by the economic downturn. In particular, the impact of automatic stabilisers (2¼% of GDP) has been larger than might have been expected on the basis of standard elasticities, mainly reflecting a strong fall in corporate taxation. Furthermore, the deficit includes one-offs that increased the deficit by ½% of GDP, in particular reflecting capital transfers to the private sector following two court rulings. Finally, the increase also reflects the impact of the expansionary measures included in the budget for 2009 (½% of GDP) and the fiscal stimulus packages (½% of GDP).

In 2010, the deficit is projected to improve to 5% of GDP, slightly above the official 2010 budget target of 4.8% of GDP as presented by the Belgian authorities. This is mainly due to somewhat less positive tax elasticity assumptions, notably regarding corporate taxes. The projected improvement mainly results from an improved economic environment and the reverse effects of the one-offs in 2009. This improvement is dampened by increased expenditure, resulting from the delayed impact of past policies, population ageing and rising interest expenditure. The gradual phasing out of the stimulus measures is expected to have only a limited positive impact (0.1% of GDP) as the package included several permanent measures, which continue to adversely affect the budget (0.3% of GDP).

Under the no-policy-change assumption, the headline deficit should stabilise at 5% of GDP in 2011, as further expenditure increases are offset by the somewhat more robust economic recovery.

The government gross debt ratio is expected to increase substantially over the forecast period as a result of deficits in excess of nominal GDP growth. In 2011, it is projected to exceed 100%, returning to a level not reached since 2002.

The main challenges for Belgium's public finances are the correction of the excessive deficit, the reduction of the government gross debt ratio and the improvement of the long-term sustainability of public finances. Budgetary consolidation accompanied by structural reforms should address these challenges. This is important given that expenditure is negatively affected by dynamic expenditure trends, coming from past policies, population ageing and rising interest expenditure and in view of the 2012 deadline for the correction of the excessive deficit set by the Council.

Table II.1.1:

Main features of country forecast - BELGIUM

		2008		Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		344.7	100.0	2.0	2.8	2.9	1.0	**-3.1**	**1.3**	**1.6**
Private consumption		179.1	52.0	1.5	1.8	1.7	1.1	**-1.6**	**0.6**	**1.4**
Public consumption		79.8	23.2	1.7	1.0	2.6	3.3	**1.6**	**1.3**	**1.5**
Gross fixed capital formation		78.0	22.6	2.3	2.7	5.9	4.3	**-5.0**	**-1.5**	**2.1**
of which : equipment		34.5	10.0	2.5	3.7	8.9	5.8	**-6.2**	**-1.2**	**3.9**
Exports (goods and services)		295.6	85.8	4.7	5.0	4.5	1.5	**-10.8**	**4.3**	**4.3**
Imports (goods and services)		292.7	84.9	4.5	4.7	4.7	3.1	**-11.1**	**3.6**	**4.5**
GNI (GDP deflator)		347.0	100.7	2.1	3.0	3.0	0.7	**-3.1**	**1.3**	**1.6**
Contribution to GDP growth :	Domestic demand			1.7	1.7	2.7	2.2	**-1.6**	**0.3**	**1.6**
	Inventories			0.0	0.6	0.3	0.0	**-1.6**	**0.4**	**0.0**
	Net exports			0.3	0.5	0.0	-1.2	**0.2**	**0.6**	**0.0**
Employment				0.7	1.2	1.6	1.9	**-0.5**	**-0.9**	**0.2**
Unemployment rate (a)				8.4	8.3	7.5	7.0	**7.9**	**8.8**	**9.0**
Compensation of employees/head				2.9	3.3	3.5	3.0	**2.0**	**1.6**	**2.1**
Unit labour costs whole economy				1.5	1.7	2.2	3.9	**4.7**	**-0.5**	**0.8**
Real unit labour costs				-0.4	-0.5	-0.1	2.0	**3.6**	**-2.1**	**-1.0**
Savings rate of households (b)				-	-	16.2	16.6	**20.1**	**19.3**	**19.1**
GDP deflator				1.9	2.2	2.3	1.8	**1.1**	**1.6**	**1.8**
Harmonised index of consumer prices (HICP)				1.9	2.3	1.8	4.5	**0.0**	**1.6**	**1.6**
Terms of trade of goods				-0.4	-0.4	0.3	-2.4	**2.4**	**0.5**	**0.4**
Trade balance (c)				3.2	1.9	1.6	-1.6	**-0.3**	**0.1**	**0.2**
Current-account balance (c)				4.6	3.4	3.7	0.2	**2.0**	**3.0**	**3.3**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				4.4	3.3	3.5	-0.2	**1.9**	**2.7**	**3.0**
General government balance (c)				-2.4	0.3	-0.2	-1.2	**-6.0**	**-5.0**	**-5.0**
Cyclically-adjusted budget balance (c)				-2.3	-0.4	-1.4	-2.0	**-4.5**	**-3.7**	**-4.0**
Structural budget balance (c)				-	-1.3	-1.3	-2.1	**-3.9**	**-3.8**	**-4.0**
General government gross debt (c)				114.9	88.1	84.2	89.8	**96.7**	**99.0**	**100.9**

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

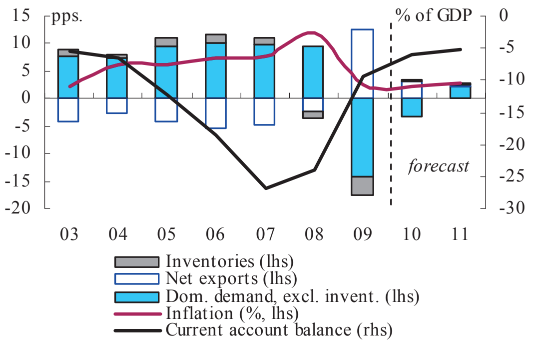
2. BULGARIA

Correcting imbalances in a difficult environment

Weak domestic demand weighs on the economy in 2009

The global economic downturn had a severe effect on the economy of Bulgaria. In the fourth quarter of 2009 the decline of real GDP was still accelerating to a preliminary -6.2% from -5.4% in the previous quarter and reached -5.0% on average as a whole. The growth contribution of domestic demand was negative as all of its components contracted sharply. Gross fixed capital formation registered the highest decline, collapsing by 27%. Private and government consumption expenditures were lower as well, declining by 6.0% and 5.5% respectively. Tight credit market conditions, declining FDI inflows, balance-sheet adjustments and lacklustre medium-term economic prospects were some of the main factors behind the negative dynamics of domestic demand.

Graph II.2.1: **Bulgaria - Inflation, current-account balance and contributions to GDP growth**



At the same time the economic crisis brought about a welcome adjustment in some of the imbalances which started to unwind. Inflation decelerated substantially from 12% in 2008 to 2.5% and is expected to remain subdued over the forecast horizon, while the current-account deficit improved sharply from 22.9% in 2008 to 9.6% in 2009. However, whereas in 2009 the decline of the current-account deficit was driven by the fall in FDI inflows and imports decreasing faster than exports, in the medium term the correction is expected to be the result of exports picking up faster and earlier than imports.

As a result of the downturn the budgetary balance swung from a surplus of 1.8% of GDP at the end of 2008 to a deficit of 3.9% of GDP, as the implemented measures to curb expenditures and improve tax compliance were not enough to offset the significant revenue shortfall. However, the undertaken fiscal consolidation measures helped to stabilise the fiscal position and avoid the accumulation of a much larger general government budget deficit. Reliance on public finances to cushion the negative impact of the crisis has been restricted by the need to maintain sound budgetary position in order to underpin macroeconomic stability.

Stagnation in 2010 before recovery in 2011

Under the impact of the continuing weakness of domestic demand, the economy is likely to start to recover towards the end of 2010 under the impact of the international cycle. Initially, the main driver of the economic recovery is expected to be net exports, while in 2011 it would shift again to domestic demand. Although the growth rate might be slightly higher than in other EU countries, in 2011 it should remain well below the pre-crisis average, thus temporarily slowing the catching-up process.

Stronger economic prospects, accompanied by improved lending conditions and credit easing, are expected to slow the decline in both gross fixed capital formation and private consumption in 2010 and to result in a positive growth rate in 2011. The increase in infrastructure investment, mainly due to the absorption of EU funds, is expected to play a stabilising role at the beginning of the forecast period, but this may not be sufficient to compensate for the slowdown in corporate investment and construction. Fixed investment is expected to continue to decline in 2010, albeit at a slower pace, and to rebound in 2011 when the balance-sheet adjustments of the corporate and households sectors are at a more advanced stage. The brighter economic prospects, milder lending conditions and higher employment towards the end of the forecast period are also expected to support an increase in private consumption expenditure.

Driven by improving external demand, the contribution of net exports is projected to remain positive until 2011 when domestic demand is set to pick up again, thus providing an impulse to imports. This pattern is likely to result in further unwinding of the external imbalances as exports would be rising faster and earlier than imports. Projected gains in price competitiveness stemming from the adjustment in nominal wages are expected to prevent the trade deficit from growing in spite of the predicted stronger import demand. The current-account deficit is expected to shrink from 9.6% of GDP in 2009, to 6% and slightly above 5% of GDP in 2010 and 2011 respectively. Given the monetary regime in place, the sustainability of its adjustment depends crucially on the supply-side response and the ability of the economy to shift from the non-tradable to the tradable sector.

Risks to this baseline scenario are broadly balanced. Foreign capital inflows may turn out to be larger than expected, either through a partial recovery in FDI, or through higher EU funds absorption, which would support domestic demand and mitigate the strong fall in investment. Following the marked drop in 2009, a rebound of inventories could offer an additional boost to growth as the economy starts to recover. A faster-than-projected adjustment in nominal wages could bring unit labour costs lower and lead to improved price competitiveness. On the negative side, the trend of rising unemployment could continue unabated, should the slowdown turn out to be more protracted. A continuing decline in housing prices may involve negative wealth-effects for households and worsen the decline of the construction sector. This could put further pressure on private consumption and fixed investment. At the same time, a weaker-than-expected pick-up in external demand would result in a delayed and less pronounced rebound of economic activity. In addition, within the context of tight credit-market conditions, the servicing of the economy's high foreign debt might crowd out domestic investment and spending. In the event that external financing conditions become even tighter, the external imbalance could narrow more rapidly, but at the expense of a slower economic recovery.

Setback to catching up

With the lowest per-capita GDP in the EU, the main challenge for Bulgaria is to ensure a sustained and quick catching-up process. Given the projected lower contribution of FDI-driven investment to economic activity, the adjustment of the economy is expected to involve a shift to a more export-oriented growth pattern, which would depend to a large extent on a recovery in external demand. In addition, real convergence could be enhanced by improved competitiveness and structural reforms to boost potential growth, such as reforms in the sectors of health care, education, pensions and public administration.

As a result of the lower current-account deficit the downward adjustment of the economy's net borrowing vis-à-vis the rest of the world is expected to continue. However, given the competitiveness challenges in recent years, it remains to be seen how sustainable these adjustments will be. Additionally, the country's gross external debt at above 110% of GDP remains high, but is mitigated by the fact that the current-account deficit has been fully financed through FDI.

The labour market worsened considerably as the downturn led to a fall in employment by 2.9% in 2009 and an increase in unemployment mainly affecting the labour-intensive sectors, in particular construction. Total employment is projected to continue to decline in 2010 and to start increasing slightly only in 2011. Wage growth is set to decelerate further both in 2010 and 2011.

Over the past few years, high unit labour costs have led to a strong appreciation of the real effective exchange rate, worsening the economy's price competitiveness vis-à-vis the EU average. As a result of the significant fall in output, far in excess of the decline in employment, as well as some labour hoarding, productivity declined in 2009. It is expected to re-enter positive territory in 2010 and to gain momentum in 2011. The adjustment in the competitiveness determinants is expected to gather momentum in 2010-11, with productivity increases slightly exceeding real wage growth.

HICP inflation is projected to remain low over the forecast horizon at around 2.5% on average. However, once the global recovery picks up, the prices of oil and other commodities in international markets could be a source of pressure. In addition, core inflation is set to remain above the euro area average over the forecast horizon, reflecting a certain degree of price rigidity in product markets.

Shrinking the budgetary deficit

The economic downturn, which is adversely affecting the tax intensity of the economy, resulted in the accumulation of a deficit of almost 4% of

GDP in 2009 on accrual basis. It led also to a significant shortfall of revenue, particularly from indirect taxes, in the first months of 2010. To avoid a further deterioration of the fiscal position and to set the budget deficit on a declining path in 2010, the government adopted an anti-crisis and fiscal consolidation package. It contains a broad range of further measures both on the expenditure and on the revenue side, in addition to those already envisaged in the 2010 budget. Under the no-policy-change assumption and a prudent assessment of the budgetary impact of the recently announced measures, the general government deficit would reach around 2¾% of GDP in 2010. The small difference of ¾ pp. compared with the authorities' latest projection is mainly due to a more conservative growth scenario. For 2011, the general government deficit is projected to be 2¼% of GDP while government gross debt is set to increase to 18¾% of GDP.

Some of the budgetary components are subject to uncertainties. On the expenditure side, social spending could exceed the funding allocated in the budget for 2010 in case of unfavourable labour-market developments. Downsizing in items such as capital expenditure could affect the economy's potential and growth prospects in the medium term even though they are important for keeping government spending under control. Additionally, freezing salaries, intermediate consumption and pensions could affect negatively the already weak domestic demand in 2010 and trigger further decline in indirect tax revenue.

On the revenue side, Bulgaria could face a protracted period of significantly less tax-intensive growth composition, as the economy shifts to a more export-oriented pattern. At the same time, the envisaged measures to improve tax compliance and collection might have a smaller-than-estimated and/or only temporary impact in the context of the strong downturn. The decline of social contribution rates by 2 pps. is only partially compensated by an increase in the minimum mandatory insurable income.

However, the risks to the budgetary projections are mitigated by the relatively good track record of the authorities in achieving their fiscal targets and the strong commitment to maintaining strict fiscal discipline. Additionally, the government stands ready to implement further discretionary fiscal consolidation measures in case of materialisation of some downside risks.

Table II.2.1:

Main features of country forecast - BULGARIA

	2008		Annual percentage change						
bn BGN	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	66.7	100.0	1.2	6.3	6.2	6.0	**-5.0**	**0.0**	**2.7**
Private consumption	45.5	68.2	1.9	9.5	5.3	4.8	**-6.3**	**-2.3**	**2.1**
Public consumption	10.9	16.3	-2.8	-1.3	3.1	0.1	**-5.5**	**-1.6**	**0.6**
Gross fixed capital formation	22.3	33.4	-	14.7	21.7	20.4	**-26.9**	**-6.3**	**3.2**
of which : equipment	-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)	40.4	60.5	-	8.7	5.2	2.9	**-9.8**	**4.2**	**5.2**
Imports (goods and services)	55.6	83.3	-	14.0	9.9	4.9	**-22.3**	**-2.0**	**4.3**
GNI (GDP deflator)	63.3	94.8	-	2.7	7.6	5.7	**-4.5**	**0.1**	**3.0**
Contribution to GDP growth : Domestic demand			-	10.0	9.9	9.4	**-14.2**	**-3.3**	**2.2**
Inventories			-	1.8	1.2	-1.1	**-3.5**	**0.1**	**0.2**
Net exports			-	-5.4	-4.9	-2.3	**12.6**	**3.3**	**0.3**
Employment			-0.1	3.3	2.8	3.3	**-2.9**	**-1.2**	**0.6**
Unemployment rate (a)			14.4	9.0	6.9	5.6	**6.8**	**7.9**	**7.3**
Compensation of employees/head			-	7.4	17.9	19.3	**8.7**	**4.7**	**4.0**
Unit labour costs whole economy			-	4.4	14.2	16.2	**11.1**	**3.5**	**1.9**
Real unit labour costs			-	-3.8	5.9	4.3	**6.2**	**2.0**	**-0.2**
Savings rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			49.0	8.5	7.9	11.4	**4.6**	**1.5**	**2.1**
Harmonised index of consumer prices (HICP)			-	7.4	7.6	12.0	**2.5**	**2.3**	**2.7**
Terms of trade of goods			-	5.1	-1.4	-2.5	**0.6**	**0.3**	**0.1**
Trade balance (c)			-7.2	-22.0	-25.5	-25.8	**-12.1**	**-9.5**	**-9.3**
Current-account balance (c)			-4.4	-18.6	-22.5	-22.9	**-9.6**	**-6.0**	**-5.2**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-4.3	-17.9	-21.3	-22.1	**-8.2**	**-4.3**	**-3.5**
General government balance (c)			-	3.0	0.1	1.8	**-3.9**	**-2.8**	**-2.2**
Cyclically-adjusted budget balance (c)			-	1.7	-1.5	0.0	**-2.8**	**-1.1**	**-0.8**
Structural budget balance (c)			-	1.8	-1.5	0.0	**-2.8**	**-1.1**	**-0.8**
General government gross debt (c)			-	22.7	18.2	14.1	**14.8**	**17.4**	**18.8**

(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

Improving external conditions support the recovery

Economic rebound supported by policy responses and external demand

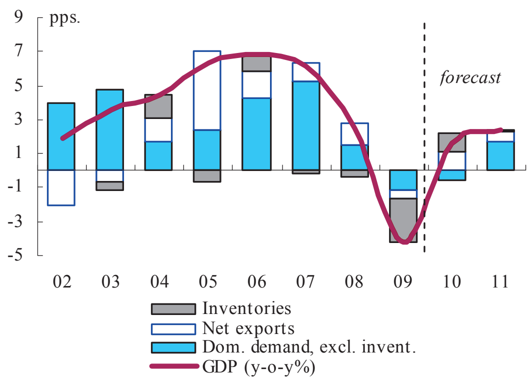
Following EU accession, the Czech economy enjoyed buoyant economic growth of around 6% on average between 2004 and 2007, benefiting from large inflows of foreign direct investments attracted by low inflation, a cost-competitive and well-educated labour force, the country's central location in Europe, and strong macroeconomic fundamentals. Despite these advantages and timely fiscal and monetary policy responses, the economy did not avoid a sharp recession during the crisis. Real GDP started to fall in the fourth quarter of 2008 and this continued up to mid 2009. For the whole year, the drop reached 4.2%. The high degree of openness of the Czech economy, with exports representing more than 75% of GDP, left the country strongly exposed to the slump in global trade. The economy's integration in international supply chains and its specialisation in capital goods were aggravating factors. In parallel, tighter credit conditions for households and non-financial corporations, shrinking foreign investments and uncertain growth prospects triggered a sizeable decline in investment.

In line with the gradually improving global economic environment, real GDP growth became positive in the third quarter of 2009, supported by rebounding exports as well as strong public consumption. This improvement in economic conditions was driven by several factors. An important factor is the sizeable fiscal and monetary stimulus, which helped to cushion the impact of the crisis. The authorities adopted and implemented fiscal stimulus measures totalling around 2% of GDP in 2009. Most measures were temporary and underpinned the recovery mainly through providing support for businesses. In addition, growth of government consumption turned out much higher than expected and was compounded by a surge in social transfers, in particular rising healthcare expenditure. Monetary easing started in August 2008 and the Czech National Bank gradually decreased the key policy interest rate from 3.75% in mid 2008 to 1% in February 2010. Without these measures the deceleration of credit growth to households and non-financial corporation would have been even more pronounced. Another critical factor is the stability of the banking sector. This reflects prudent regulation, a strong domestic deposit base and low exposure to toxic assets and foreign exchange loans. Finally, the recovery in world trade and exchange-rate developments have helped to pull the economy out of the crisis. The Czech koruna depreciated by about one fifth against the euro between mid-July 2008 and mid-February 2009 (it has subsequently appreciated by some 15%).

Gradual recovery ahead

The forecast describes a gradual recovery of the economy over the coming quarters. This reflects the influence of elements going in opposite directions. On the one hand, the recovery in external demand, which seems to be firming up, should support an expansion of exports and a slowdown in the decline of inventories. On the other hand, private consumption and investment are expected to remain weak in the immediate post-crisis period. The former is set to weaken further in the first half of 2010 mainly on the account of low wage growth, rising unemployment and the negative impact of the increase in indirect taxes on consumption. The latter is likely to be depressed by low capacity utilisation, uncertainties on the strength of the recovery, and still restrictive credit supply. For all these reasons, domestic demand should become the main driver of growth only in 2011. Overall, following the sharp contraction of 4.2% in 2009, real GDP is expected to increase by 1.6% in 2010 and to gather pace in 2011 with growth of around 2.4%.

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



The baseline scenario is subject to a number of risks. On the positive side a stronger-than-expected recovery in the country's main trading partners could lead to stronger growth in exports. On the negative side, more pronounced adjustments in the labour market could push the household saving rate higher and delay the recovery in private consumption.

Labour market momentum delayed

In early 2009, the slump in economic activity translated into a rapidly rising unemployment. The unemployment rate increased from 4.4% in 2008 to 6.7% a year later. Anti-crisis measures supporting the labour market, such as cuts in social security contributions and short-time working schemes, are expected to help to partially mitigate the adverse effect of the crisis on the labour market. However, the recovery has not led so far to employment creation and employment is expected to continue to decrease in 2010. The risk of unemployment is likely to further encourage precautionary savings of households. Nominal wage flexibility contributed to facilitating the labour market adjustment. Wage growth diminished significantly in 2009 and is expected to remain low in 2010, before increasing somewhat as of 2011. On the other hand, persistent structural problems in the labour market, such as geographical and professional skill mismatches and low regional mobility, could slow the adjustment. Therefore active labour-market policies designed to combat these shortcomings would be of high importance in the post-crisis period.

Inflation driven by tax rises in 2010

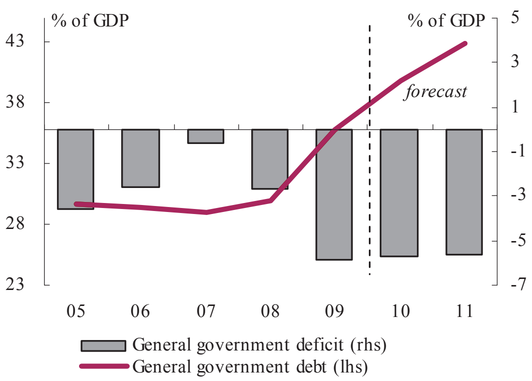
Following a sharp one-off increase in 2008, HICP inflation decelerated substantially in 2009, to 0.5% y-o-y in December. This was due to lower commodity prices, the disappearance of the effects of past changes to indirect taxes, and a sharp decline in core inflation due to the economic downturn. Inflation is expected to accelerate in the course of 2010, mainly on the account of VAT and excise tax hikes implemented as of 1 January 2010. Gradual economic recovery is set to drive inflation to around 1.3% on average in 2011. Moderate wage growth and the likely further appreciation of the Czech currency is projected to contain price pressures. Unit-labour costs growth remained high in 2009, as the slump in productivity outweighed the effect of decelerating wage growth, but the ongoing economic recovery together with subdued wage growth should reverse this in 2010-11.

Going forward, higher productivity and lower unit labour costs are set to influence external cost-competitiveness positively. During the crisis, the openness and specialisation of the Czech economy in manufactured goods, in particular in the automotive sector (accounting for around 16% of total exports), put the economy under significant pressure. On the other hand, in the post-crisis period, when the recovery is driven by vigorously growing emerging economies, the strong comparative advantage in capital-intensive goods, supported by relatively low unit labour costs, should help the economy to gradually gain market shares. Nevertheless, the high export specialisation in the car industry could represent a risk for an export-led growth, especially with the withdrawal of the car scrapping schemes.

Deterioration of public finances and the need for consolidation

With a sharp deterioration of the headline deficit from 2.7% of GDP in 2008 to 5.9% of GDP in 2009, fiscal imbalances represent one of the main concerns in the Czech economy in the short and medium term. The crisis revealed structural problems of Czech public finances which were somewhat masked by strong revenue growth during the preceding boom phase. About half of the increase of the deficit in 2009 was brought about by discretionary stimulus measures focused predominantly on the supply side. The other half can be attributed to the full operation of automatic stabilisers.

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



The revenue ratio declined by about 1.5 pps. to 40.3% of GDP between 2007 and 2009 on account of the unprecedented drop in direct taxation, in particular in corporate income tax revenues and social contributions. The surge of the expenditure ratio by almost 4 pps. to around 46% of GDP was compounded by a sharp increase in government consumption and social transfers. Contrary to many other EU countries, the financial sector in the Czech Republic did not require any rescue operation by the public authorities and does not represent a major risk for public deficit and debt levels in the near future.

Given the potential risks related to sharply rising deficits and debt servicing costs, the Czech government decided to withdraw fiscal stimulus at the end of 2009 and start fiscal consolidation already in 2010. The consolidation package which was adopted as part of the budgetary proposal for 2010 relies predominantly on revenue side measures in the area of indirect taxation. Increases in VAT, excise duties and real-estate tax, together with higher social contributions are expected to boost revenues by more than 1½% of GDP. Overall, the deficit is expected to drop to 5.7% of GDP in 2010, which represents a decrease of 0.5 pp. in structural terms. The difference of -0.4 pp. in the projected deficit for 2010, compared to the latest projection by the national authorities, is explained mainly by lower projected tax revenues, higher expected deficits of local budgets and additional expenditure approved before the parliamentary elections. The debt-to-GDP ratio is set to increase from 35½% of GDP in 2009 to just below 40% in 2010.

Looking further ahead, a more substantial correction of fiscal imbalances will be conditioned by both the speed of the recovery and further consolidation efforts of the government. Assuming a gradual recovery tempered by weak domestic demand and slow employment growth, the main drivers of the strong revenue growth in the past, notably the income taxes and social contributions, are expected to remain below their pre-crisis levels in 2011 (as a ratio to GDP). Expenditure growth will mirror the nominal GDP growth, unless curbed by additional deficit-reducing measures. Under the no-policy-change assumption, the deficit would remain at 5.7% of GDP, and the debt ratio would reach 43½% of GDP in 2011. The government plans for 2011 announced in the February 2010 update of the convergence programme are not taken into account, as they lack sufficient detail – in particular on the expenditure side which is the main focus of the consolidation strategy – and they have not been approved by the relevant public authorities.

Table II.3.1:

Main features of country forecast - THE CZECH REPUBLIC

		2008		Annual percentage change						
		bn CZK	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		3689.0	100.0	2.4	6.8	6.1	2.5	**-4.2**	**1.6**	**2.4**
Private consumption		1834.0	49.7	3.7	5.1	4.9	3.6	**-0.2**	**-0.8**	**1.6**
Public consumption		753.2	20.4	1.0	1.2	0.7	1.0	**4.4**	**0.4**	**1.4**
Gross fixed capital formation		883.2	23.9	4.7	6.0	10.8	-1.5	**-8.3**	**-1.1**	**2.7**
of which : equipment		380.0	10.3	8.5	8.4	16.9	-0.6	**-20.8**	**-4.6**	**4.0**
Exports (goods and services)		2844.0	77.1	10.1	15.8	15.0	6.0	**-10.2**	**6.5**	**6.1**
Imports (goods and services)		2676.0	72.5	13.1	14.3	14.3	4.7	**-10.2**	**5.3**	**5.7**
GNI (GDP deflator)		3426.0	92.9	-	6.3	3.9	2.3	**-3.0**	**2.1**	**2.4**
Contribution to GDP growth :	Domestic demand			3.4	4.3	5.2	1.5	**-1.2**	**-0.6**	**1.7**
	Inventories			0.2	1.0	-0.2	-0.4	**-2.6**	**1.1**	**0.1**
	Net exports			-1.2	1.5	1.1	1.3	**-0.5**	**1.1**	**0.6**
Employment				-	1.9	2.7	1.2	**-1.2**	**-1.9**	**0.4**
Unemployment rate (a)				-	7.2	5.3	4.4	**6.7**	**8.3**	**8.0**
Compensation of employees/head				-	5.9	6.3	6.3	**-0.8**	**2.3**	**3.7**
Unit labour costs whole economy				-	1.1	2.9	5.1	**2.4**	**-1.2**	**1.6**
Real unit labour costs				-	0.0	-0.5	3.2	**-0.3**	**-1.3**	**0.9**
Savings rate of households (b)				-	-	10.7	10.2	**8.9**	**10.8**	**10.5**
GDP deflator				7.3	1.1	3.4	1.8	**2.7**	**0.1**	**0.6**
Harmonised index of consumer prices (HICP)				-	2.1	3.0	6.3	**0.6**	**1.0**	**1.3**
Terms of trade of goods				-	-1.7	1.2	-2.3	**3.0**	**-1.1**	**-0.8**
Trade balance (c)				-4.1	2.0	3.4	2.7	**5.0**	**5.4**	**5.4**
Current-account balance (c)				-3.6	-2.1	-2.6	-3.4	**-1.0**	**-0.3**	**-1.5**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-3.9	-1.7	-1.9	-2.4	**0.8**	**1.3**	**-0.2**
General government balance (c)				-	-2.6	-0.7	-2.7	**-5.9**	**-5.7**	**-5.7**
Cyclically-adjusted budget balance (c)				-	-4.0	-2.9	-4.5	**-5.1**	**-4.7**	**-4.8**
Structural budget balance (c)				-	-3.9	-2.9	-4.5	**-5.4**	**-4.9**	**-4.9**
General government gross debt (c)				-	29.4	29.0	30.0	**35.4**	**39.8**	**43.5**

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

4. DENMARK

Domestic demand drives the recovery

The recession has come to an end…

After having experienced the most severe recession in many decades, lasting four quarters from the middle of 2008 to the middle of 2009, Denmark experienced positive growth in the second half of 2009. Despite the turnaround in growth, the Danish economy still contracted by 4.9% in 2009.

As the global economic and financial crisis unfolded, the Danish economy was hard hit and the recession that began in 2008 deepened significantly. The Danish downturn started before the onset of the global economic crisis, and was initially triggered by domestic factors, as the economy was suffering from a bursting housing bubble and tight labour market. What set Denmark apart from other countries during the crisis was the remarkable weakening of private consumption. Despite rising disposable incomes caused by tax cuts, falling interest rates, initially stable employment and the release of pension funds, falling real estate prices and the bleak global economic outlook led Danish consumers to cut back heavily on spending.

On the back of global government interventions, the extreme economic and financial uncertainty caused by the crisis diminished during 2009. Benefitting from the resumption of international trade, Danish imports and exports stopped falling and private consumption started to grow from the third quarter. Unemployment continued to rise throughout 2009 but the growth in unemployment moderated significantly at the end of year.

Thanks to their strong public-finance position at the beginning of the crisis, the Danish authorities were able to react to the crisis with a significant fiscal expansion in line with the European Economic Recovery Plan (EERP). Tax cuts decided upon in 2007 came into effect in 2009, and a second major tax reform was passed with effect from 2010 onwards, thus significantly reducing the tax on labour. In addition to the tax cuts, the fiscal bills for 2009 and 2010 gave a boost to public consumption and to infrastructure investments in railroads, roads, schools and day-care facilities. On top of the fiscal expansion, the financial system was aided by two bank-rescue packages which provided guarantees, liquidity and capital injections. A third bank-rescue package was adopted in March 2010, aimed at amending the legislation relating to failing financial institutions in order to secure a fast and efficient liquidation.

The Danish fixed exchange rate vis-à-vis the euro has been stable throughout the crisis, although the Central Bank had to intervene and raised interest rates significantly at the end of 2008. Interest rates have since then come down, and are now close to the interest rates in the euro area.

The deep recession and the fiscal expansion have seriously affected public finances. The budget balance is expected to turn from a 3.4% of GDP surplus in 2008 to a deficit close to 3% in 2009 and an expected deficit of 5½% of GDP in 2010 before declining to just below 5% in 2011 as the government stimulus measures expire and the financing elements of the 2010 tax reform begin to come into play.

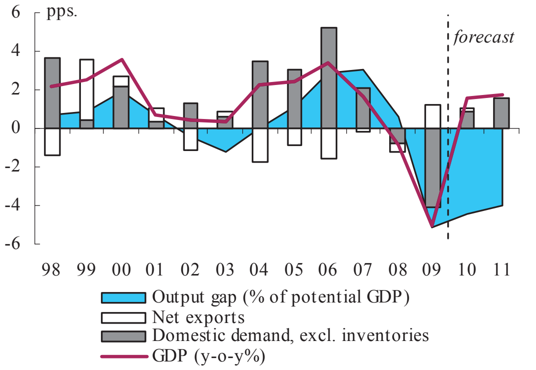
…and domestic demand drives the recovery

This forecast expects the moderate recovery experienced in the second half of 2009 to continue into 2010-11, primarily driven by domestic demand. Rising consumer-confidence indicators point to a rebound in consumer spending. The large public-investment programmes are set to work throughout 2010 and restocking contributes positively to growth in 2010 and to a lesser extent in 2011. The effect on growth from net exports is expected to be neutral.

The resumption of growth in most countries around the world, together with continued low interest rates, a stabilising real-estate market and the rise in disposable incomes have restored consumer confidence. Private consumption, together with restocking in 2010, is therefore expected to become the main driver of the economic recovery in 2010-11.

The large public-investment programmes initiated by the 2009 and 2010 fiscal bills are expected to work throughout 2010 with possible effects on activity in 2011 as well. The exact timing of the investment projects is difficult to predict, as some projects can be initiated almost immediately while others require extensive planning before they can be executed. However, the high level of public investment experienced in 2009-10 is forecast to diminish in 2011.

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



Business investment is expected to lag behind. On the back of low demand, rising unit labour costs, falling profits and the uncertain economic outlook, companies started to cut investments already in 2007, especially in the construction sector due to the cooling real-estate market. Business investment is expected to continue falling in 2010 before recovering in 2011. The crisis has left much spare capacity in the corporate sector and business investment is accordingly expected to be subdued throughout the forecast period.

As the external environment continues to improve, Danish trade is expected to pick up in 2010 and to continue to grow in 2011. However, the global economic crisis has led companies to reassess their supply chains, and due to the loss of competitiveness experienced during the last decade, Danish companies will find themselves in an increasingly difficult situation vis-à-vis their foreign competitors. However, Danish exports comprise a large share of products, such as pharmaceuticals, agriculture and energy-technology, which traditionally are less sensitive to the business cycle. In spite of the favourable product mix in its exports, Denmark is still expected to lose market shares throughout the forecast period.

Unemployment should continue to increase in 2010, reaching a peak at the end of the year. Although the rise in unemployment has been substantial, the flexible Danish labour-market system and active labour-market policies are expected to limit the rise in long-term and structural unemployment. However, population ageing, with fewer people in the working-age group, will reduce the size of the labour force from 2010 onwards. The crisis will also lead more people to leave the labour force voluntarily, opting for retirement or education rather than facing unemployment.

Wage increases in the private sector have declined significantly in 2009 as a consequence of the rising unemployment level. This forecast assumes that this trend will continue with wage increases moderating in 2010-11.

Inflation is set to rise to 2.3% in 2010 reflecting increases in product taxes as a consequence of the most recent tax reform and rising oil prices. With the recovery well under way, a gradual widening of profit margins and diminishing base effects, inflation is set to fall to 1½% in 2011.

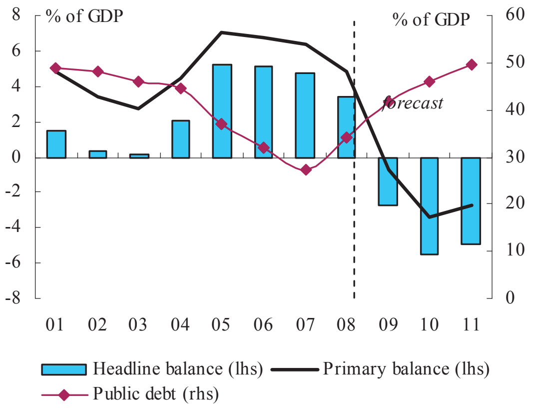
The above scenario is subject to both positive and negative risks. On the positive side, Danish companies might be able to increase exports more than anticipated, especially if they are able to increase exports to the growing economies in East Asia and South America, which would raise the growth prospect for the whole forecast period. With household saving rates historically high, private consumption might grow more rapidly than expected, especially if consumer confidence improves significantly, which could happen if the increase in unemployment remains limited and the real-estate market continues to stabilise. However, renewed uncertainty about the future of the global economy, higher-than-expected unemployment or stagnation on the real-estate market could also lead consumers to cut back or at least postpone consumption, thus negatively affecting demand prospects in this forecast.

Public finances under pressure

The fiscal consolidation and structural reforms implemented in Denmark before the onset of the crisis are serving the country well. They have allowed the authorities room for manoeuvre to support the economy through expansionary fiscal policy and financial sector stabilisation measures.

2010 is expected to see the budget deficit increase to about 5½% of GDP, as automatic stabilisers are set to work freely, stimulus measures from the 2010 fiscal bill are implemented, including the temporary increase in investments, and the tax cuts from the latest tax reform lower income taxes, negatively affecting revenue. As the recovery gets under way in 2011 and the extraordinary high level of public investment comes down, the expenditure ratio is expected to decline. The recovery is likely also to trigger an increase in government revenues as some of the financing elements from the 2010 tax reform become operational and the growth in private consumption leads to higher revenue from indirect taxes. However, the deficit is still projected to stay close to 5% of GDP, and the gross debt is forecast to increase to about 49% of GDP by the end of 2011.

Graph II.4.2: **Denmark - Public finance trends**



The main challenge for the Danish authorities will be to reconcile the needed fiscal consolidation with measures to strengthen the economy's long-term growth potential. Ambitious fiscal policy targets have been put forward in the Danish Convergence Programme and in the government's work programme. 2010 will see the continuation of the expansive fiscal policy in line with the EERP while 2011 is set to be the year fiscal consolidation begins.

Table II.4.1:

Main features of country forecast - DENMARK

	2008			Annual percentage change						
	bn DKK Curr. prices		% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	1737.4		100.0	2.2	3.4	1.7	-0.9	**-4.9**	**1.6**	**1.8**
Private consumption	845.5		48.7	2.0	3.6	2.4	-0.2	**-4.6**	**2.1**	**2.6**
Public consumption	463.8		26.7	2.1	2.8	1.3	1.6	**2.5**	**1.0**	**0.6**
Gross fixed capital formation	362.4		20.9	3.9	14.3	2.8	-4.8	**-12.0**	**-3.7**	**1.7**
of which : equipment	129.8		7.5	3.5	19.1	3.0	-4.3	**-12.5**	**-4.0**	**2.3**
Exports (goods and services)	955.9		55.0	4.8	9.0	2.2	2.4	**-10.3**	**4.8**	**5.2**
Imports (goods and services)	909.2		52.3	5.8	13.4	2.6	3.3	**-13.2**	**4.9**	**5.8**
GNI (GDP deflator)	1771.4		102.0	2.5	3.9	0.9	-0.5	**-4.0**	**1.8**	**1.8**
Contribution to GDP growth :	Domestic demand			2.3	5.2	2.1	-0.8	**-4.1**	**0.6**	**1.8**
	Inventories			0.1	-0.3	-0.3	0.3	**-2.0**	**0.8**	**0.1**
	Net exports			-0.2	-1.5	-0.1	-0.4	**1.2**	**0.1**	**-0.1**
Employment				0.4	2.1	2.9	1.4	**-3.6**	**-1.9**	**-0.1**
Unemployment rate (a)				6.0	3.9	3.8	3.3	**6.0**	**6.9**	**6.5**
Compensation of employees/head				3.5	3.5	3.7	4.1	**3.7**	**1.8**	**1.8**
Unit labour costs whole economy				1.6	2.2	4.9	6.5	**5.1**	**-1.7**	**-0.1**
Real unit labour costs				-0.3	0.1	2.9	2.8	**4.7**	**-2.8**	**-1.7**
Savings rate of households (b)				-	-	4.8	5.5	**9.0**	**10.8**	**9.6**
GDP deflator				1.9	2.1	1.9	3.6	**0.4**	**1.1**	**1.6**
Harmonised index of consumer prices (HICP)				1.9	1.9	1.7	3.6	**1.1**	**2.3**	**1.5**
Terms of trade of goods				1.0	0.7	-0.9	0.3	**3.7**	**-0.5**	**0.0**
Trade balance (c)				3.9	1.1	0.1	-0.2	**2.1**	**2.4**	**2.3**
Current-account balance (c)				2.0	3.0	1.5	2.2	**4.0**	**3.9**	**3.7**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				2.1	3.0	1.5	2.2	**4.0**	**4.2**	**3.9**
General government balance (c)				0.0	5.2	4.8	3.4	**-2.7**	**-5.5**	**-4.9**
Cyclically-adjusted budget balance (c)				0.0	3.5	3.1	3.3	**0.6**	**-3.0**	**-3.1**
Structural budget balance (c)				-	3.5	3.1	3.3	**0.6**	**-2.7**	**-3.1**
General government gross debt (c)				59.0	32.1	27.4	34.2	**41.6**	**46.0**	**49.5**

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

5. GERMANY

Domestic demand eventually driving the recovery

Recovery lost momentum after strong rebound

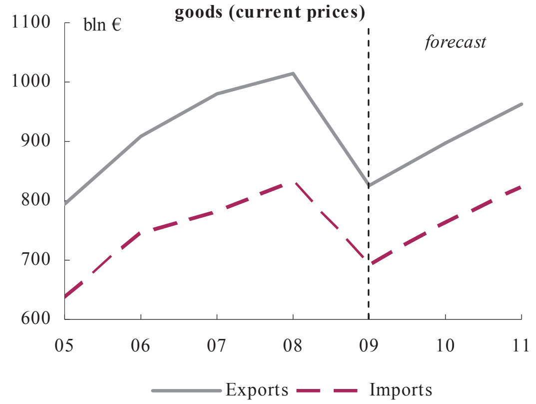
Following the severe slump in economic activity at the end of 2008 and in early 2009, the German economy rebounded vigorously in the second and third quarters on the back of expansionary monetary and fiscal policy, inventory-building and higher exports. However, towards the end of the year, the recovery lost momentum again due to weak domestic demand. After the expiry of the car-scrapping premium, private consumption decreased sharply, while investment stagnated amidst record-low capacity utilisation. Harsh winter conditions additionally burdened the recovery well into the first quarter of 2010.

Exports leading the way, domestic demand to follow

After the sharp contraction in the wake of the financial crisis, world trade started to recover in the course of 2009 – led mainly by buoyant demand from China and other Asian economies. Germany’s export sector thus regained some of the ground lost during the recession. Looking ahead, Germany is still faced with weaker demand from some of its traditional trading partners. Stronger trade with dynamically growing emerging markets may partly compensate for this shortfall. High investment needs in emerging markets could also favour Germany's specialisation in capital goods. German exports are therefore projected to continue their rebound from the trough in 2009, further supporting the recovery of industry. This should help sustain the resilience of the labour market, improve capacity utilisation and lay the basis also for stronger domestic demand.

Private consumption plummeted in the second half of 2009 as the car-scrapping scheme expired. Households had advanced their car purchases in time, which resulted in a subsequent shortfall in demand. Moreover, households started to restore their saving rate again which they had temporarily reduced to take advantage of the scrappage premium. These factors are likely to hold back private consumption also in the beginning of the year. Uncertainties about the labour market and consolidation needs in the public sector could also imply a further rise in the saving rate. However, substantial household relief involving income tax cuts and higher transfers will give a considerable boost to otherwise sluggish income growth in 2010. Also thanks to relatively stable employment, private consumption should therefore pick up noticeably in the course of the year. Nevertheless, for 2010 as a whole, private consumption is still projected to decrease compared with 2009 due to a large negative carry-over.

Graph II.5.1: **Germany - Exports and imports of goods (current prices)**



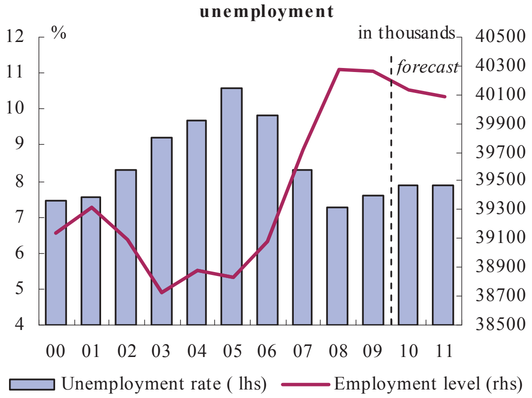
With low capacity utilisation and still difficult financing conditions, the outlook for investment remains subdued. Higher public infrastructure investment as part of the fiscal stimulus package will support construction activity especially in 2010. Equipment investment is projected to gather pace mainly in the course of 2011 as the economic recovery takes hold and additional replacement investments are triggered by structural adjustment needs following the crisis.

The recovery of the German economy is expected to gain traction again during 2010 after a softer patch around the turn of 2009/10. Weaker demand from some trading partners, the expiry of global stimulus measures and fragile financing conditions in the corporate sector are probably going to weigh on economic growth for some time. The resilience of the labour market and strong improvements in business confidence recently could, however, also entail certain upside risks to the forecast.

Labour market remains resilient

The German labour market remained surprisingly resilient during the crisis. Average employment hardly dropped in 2009 and the unemployment rate edged up by less than ½ pp. Instead, the adjustment in the labour market largely took place via lower hours worked, facilitated by increased working time flexibility at company level, the depletion of positive balances on working time accounts and the use of short-time work. Moreover, the drop in productivity per hour worked in 2009 signals a considerable amount of labour hoarding by companies, motivated by difficulties in recruiting highly skilled workers during the previous upswing. Successful labour market reforms and wage moderation in the past are also likely to have played a role in cushioning the impact of the crisis by reducing structural unemployment and enhancing labour market flexibility. Employment thus actually grew again slightly at the end of 2009 and the service sector witnessed lively job creation throughout the downturn, continuing the shift of employment from the manufacturing to the services sector.

Graph II.5.2: **Germany - Employment and unemployment**



Given the severity of the contraction in economic activity, some downward adjustment of employment and a certain increase in unemployment is still to be expected. However, the labour market outlook is considerably more favourable than in previous forecasts, with only a moderate increase in unemployment and limited employment losses projected for 2010 and 2011. Against this improved outlook, a further strengthening of the framework conditions underpinning the recent trend towards more dynamic employment creation and higher labour market participation would help sustain a more permanent recovery of private consumption.

Inflation remains contained despite surge in import prices

The recent depreciation of the euro mainly vis-à-vis the US dollar and the assumed sharp increase in commodity prices are likely to trigger a surge in import prices especially in 2010. However, given the considerable slack in the economy, this is not expected to feed directly and immediately into higher domestic inflation. Consumer-price inflation is projected to remain contained and to increase to around 1.3% in 2010 and 1.5% in 2011.

Recent wage agreements in the private and the public sectors point to only moderate wage growth in 2010 and 2011, reflecting also the prime concern of social partners with stabilising employment levels and avoiding a stronger increase in unemployment. As a result, real unit labour costs are projected to fall again in 2010 and 2011, even though this will not fully compensate the strong hike in unit labour costs in 2009.

Sound fundamentals support the exit from the crisis,...

The recovery of the German economy is aided by overall sound economic fundamentals, including healthy balance sheet positions of households and non-financial corporations, strong price competitiveness, and a reduction in structural unemployment thanks to wage moderation and labour market reforms. Moreover, Germany did not experience any marked asset price bubble or housing boom prior to the crisis that would now require major structural adjustment or entail negative wealth effects on any major scale.

However, deep economic and financial crises carry the risk of having a lasting impact not only on potential output levels but also on potential growth. Moreover, in the case of Germany, potential growth had been on a declining trend before the crisis. Growth enhancing structural reforms in line with the Europe 2020 strategy would therefore be crucial to successfully overcome the crisis and limit its impact on medium-term growth prospects.

...despite fragility in parts of the banking sector,...

Parts of the German banking sector suffered severe losses from investments in subprime loans and structured assets. This has weakened bank balance sheets, which may be further burdened by a possible tightening of regulatory standards or higher, recession-related credit defaults. A further erosion of the capital base could limit the capacity of banks to provide financing to the corporate sector during the upswing. Moreover, while government support schemes helped stabilise financial markets, instruments specifically aimed at bank re-capitalisation were taken up only to a limited extent. Since the onset of the crisis, bank credit standards have become tighter and more enterprises are reporting difficulties in their access to credit, even though the situation has apparently stabilised more recently. The volume of credit to non-financial corporations has decreased since around mid-2009. Given the simultaneous fall in GDP and in particular investment, this is likely to reflect primarily lower credit demand and not so much supply-side constraints.

With a largely bank-based financial system, constraints on credit supply could be particularly harmful for the German corporate sector. However, savings banks and co-operative banks appear to have been less exposed to the financial crisis than other pillars of the banking system. At the same time, these banks provide the majority of financing to SMEs, which play a central role in the German economy. Larger companies are potentially more at risk of facing constraints on bank lending, but may also have easier access to alternative sources of finance. In addition, the German corporate sector as a whole has been in a net lending position for a number of years. With an improving profit situation, the financial position of the corporate sector is expected to strengthen further during the early stages of the recovery, increasing its capacity to finance a larger share of investment from own resources. However, despite these mitigating factors, ensuring banking sector stability and access to finance for companies remains a prerequisite for a sustained recovery.

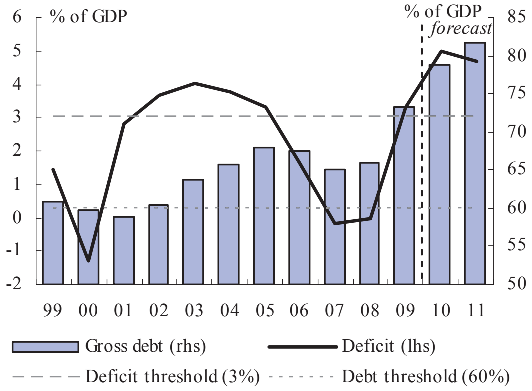
…and the adjustment of external imbalances

In the years prior to the crisis, German exports expanded rapidly to meet rising demand from countries experiencing asset bubbles and strong capital inflows. Even though a recovery of world trade is under way, German exports may not return to pre-crisis levels in the near future, given the need for household and corporate balance sheet repair in countries with high current-account deficits. The German export sector is still likely to benefit from stronger growth in emerging markets. Nevertheless, demand from countries having to correct high external deficits and to accommodate sharp falls in asset prices will probably remain subdued. Hence, the German economy will also be faced with considerable adjustment needs in the years ahead, including a re-allocation of resources from sectors with current over-capacity and also a shift between tradable and non-tradable sectors, which will put increasing demands on the flexibility of product and factor markets.

Germany's budget burdened by the crisis

After a balanced position in 2008, the general government budget turned negative in 2009, reaching a deficit of 3.3% of GDP. Fully operating automatic stabilisers and expansionary discretionary measures adopted in line with the EERP to counter the economic downturn were the main factors driving the deficit in 2009.

Graph II.5.3: **Germany - General government gross debt and deficit**



The slump in GDP in 2009 had a relatively contained impact on the revenue side, since the GDP contraction was mainly driven by lower exports, which are considered to be less tax-rich. At the same time, the remarkably robust labour market dampened expenditure growth, which benefited also from lower interests payments. The 2009 debt-to-GDP ratio rose by 7¼ pps. reaching 73¼%, driven by a sharp increase in net borrowing, financial market stabilisation measures (1½% of GDP) and a decline of the nominal GDP.

General government deficit goes up strongly in 2010

The deficit is projected to increase further in 2010 to 5% of GDP, mainly on the back of further measures to support the economic recovery. While some of the discretionary measures undertaken in 2009 have already expired (e.g. car-scrapping premium), others have continued in 2010 and may even have a higher budgetary impact. For example, the reduced contribution rate to the health-care insurance, initially introduced as of mid-2009, will reveal its full impact only in 2010. Moreover, some measures will come into effect with a lag, e.g. additional infrastructure investment or will only come into effect as of 2010, e.g. tax deductibility of contributions to health-care and long-term care insurance. In addition, the German authorities introduced new fiscal measures as of 2010 (around ¼% of GDP), including increased child allowance and child benefit, modification of parts of the corporate tax reform, changes to the inheritance tax and a reduced 7% VAT rate on hotels and restaurants. The difference of 0.5 pp. in the projected deficit for 2010, compared to the latest projection by the national authorities, is explained mainly by higher projected tax revenues due to a more favourable labour market outlook.

In 2011, the general government deficit is forecast to diminish to 4¾% of GDP also as a result of the expiry of certain stimulus measures, including the reduction of additional public investment. Based on the no-policy-change assumption, the forecast does not take into account measures announced in the government's coalition agreement but not yet adopted. Neither does it include retrenchment efforts related to the new constitutional budgetary rule, given the lack of specified measures so far to underpin the consolidation path. On the back of the higher deficits and the transfer of assets from one of the *Landesbanken* into a "bad-bank",[70] the gross debt is projected to increase from 73¼% of GDP in 2009 to 81½% of GDP in 2011.

The post-crisis budgetary situation reflects revenue shortfalls and significantly higher expenditure levels. The new constitutional budgetary rule, which prescribes a structural deficit ceiling of 0.35% of GDP for the Federal government from 2016 onwards and balanced structural budgets for the *Länder* as of 2020, provides an anchor for a credible consolidation path. The reconciliation of expansionary measures proposed in the new government's coalition agreement with the requirements of fiscal consolidation remains an open issue. At the same time, uncertainties about the financing needs of the social security funds and possible further burden related to financial market stabilisation constitute a potential risk for public finances. Reconciling fiscal adjustment with raising potential growth, including by improving the composition of government spending, will therefore constitute a challenge for public finances in the years ahead.

(70) For the time being, the establishment of the "bad-bank" for one of the *Landesbanken* is assumed to have a direct impact on the debt. This treatment follows the practice currently used by the German statistical authorities and does not prejudge the final accounting decision.

Table II.5.1:

Main features of country forecast - GERMANY

		2008		Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		2495.8	100.0	1.4	3.2	2.5	1.3	**-5.0**	**1.2**	**1.6**
Private consumption		1409.7	56.5	1.3	1.3	-0.3	0.4	**0.2**	**-0.7**	**0.9**
Public consumption		451.8	18.1	1.3	1.0	1.7	2.1	**3.0**	**1.4**	**0.9**
Gross fixed capital formation		474.7	19.0	0.5	7.8	5.0	3.1	**-8.9**	**1.2**	**2.9**
of which : equipment		201.8	8.1	1.3	11.7	11.3	3.8	**-20.5**	**1.1**	**4.5**
Exports (goods and services)		1179.4	47.3	6.0	13.0	7.5	2.9	**-14.2**	**6.2**	**5.5**
Imports (goods and services)		1023.7	41.0	5.0	11.9	4.8	4.3	**-8.9**	**4.6**	**5.3**
GNI (GDP deflator)		2537.0	101.7	1.4	4.1	2.4	0.9	**-4.8**	**1.1**	**1.6**
Contribution to GDP growth :	Domestic demand			1.2	2.3	1.0	1.2	**-1.0**	**0.1**	**1.3**
	Inventories			-0.2	-0.2	-0.1	0.5	**-0.9**	**0.3**	**0.0**
	Net exports			0.4	1.1	1.5	-0.3	**-3.0**	**0.8**	**0.3**
Employment				-0.8	0.2	1.5	1.4	**0.0**	**-0.3**	**-0.1**
Unemployment rate (a)				8.5	9.8	8.4	7.3	**7.5**	**7.8**	**7.8**
Compensation of employees/f.t.e.				3.2	1.5	1.1	2.0	**0.0**	**0.7**	**1.1**
Unit labour costs whole economy				1.0	-1.4	0.2	2.2	**5.2**	**-0.9**	**-0.7**
Real unit labour costs				-0.3	-1.9	-1.7	0.7	**3.6**	**-1.1**	**-1.5**
Savings rate of households (b)				-	-	16.8	17.2	**17.2**	**17.7**	**17.5**
GDP deflator				1.4	0.5	1.9	1.5	**1.5**	**0.2**	**0.9**
Harmonised index of consumer prices (HICP)				-	1.8	2.3	2.8	**0.2**	**1.3**	**1.5**
Terms of trade of goods				0.5	-1.8	0.6	-1.1	**5.8**	**-2.5**	**-0.5**
Trade balance (c)				4.0	7.0	8.2	7.3	**5.6**	**5.5**	**5.6**
Current-account balance (c)				0.3	6.6	7.9	6.6	**5.0**	**4.8**	**4.8**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				0.3	6.6	7.9	6.6	**5.0**	**4.8**	**4.8**
General government balance (c)				-2.7	-1.6	0.2	0.0	**-3.3**	**-5.0**	**-4.7**
Cyclically-adjusted budget balance (c)				-2.6	-2.2	-1.2	-1.5	**-1.8**	**-3.6**	**-3.5**
Structural budget balance (c)				-	-2.2	-1.2	-1.1	**-1.7**	**-3.6**	**-3.5**
General government gross debt (c)				57.7	67.6	65.0	66.0	**73.2**	**78.8**	**81.6**

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

6. ESTONIA

Re-balancing the economy

A sharp adjustment took place in 2009…

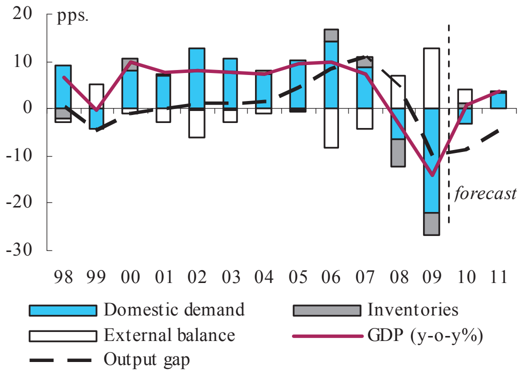
Following years of above-potential growth and a dependence on domestic demand, a transformation of the economy took hold in 2009. Previous high growth had primarily been driven by over-optimistic expectations of economic agents, which in turn reflected an environment of rapid real convergence and financial deepening with low real interest rates and an initially low level of indebtedness of the economy. A reversal in the cycle, already evident from 2008 and aggravated by adverse global developments, led to a sharp turnaround in these expectations and, consequently, to abrupt changes in the structure of the economy. The flexible nature of the Estonian economy allowed the changes to take place within a relatively short period of time and positive growth emerged in the last quarter of 2009.

In 2009 as a whole, the economy contracted by 14.1%, with domestic demand shrinking by almost a quarter. While contributing to the contraction to a lesser extent than the reversal in domestic demand, external demand also acted as a drag on the economy, falling in line with the global trade contraction. An abrupt retrenchment of imports mirroring the correction in domestic demand resulted in a sharp move from the high external-account deficits recorded until 2008 to net lending to the rest of the world of 7.4% of GDP in 2009.

Following a pronounced adjustment in the first half of 2009 and a limited recovery in the summer, employment declined again in the autumn as seasonal contracts ended, falling by 9.9% over the year as a whole. Unemployment increased significantly, despite the entry into force of a more flexible Labour Law and more efficient public employment services. In addition to high levels of collective redundancies, more people who usually worked abroad returned and registered as unemployed in 2009. Nevertheless, the rise in unemployment is expected to abate in 2010, with sustained job creation and an increasing number of vacancies. Wage growth, which had contributed to the erosion of competitiveness in the past overheating period, turned negative in early 2009 and wages declined by 3% over the whole year. Similarly negative wage growth is expected in 2010, before reverting to slightly positive values in 2011.

HICP inflation declined sharply and turned negative in mid-2009, reflecting a rapid fall in world commodity prices and the fading impact of earlier administrative-price increases, as well as negative price pressure from lower wages and subdued domestic consumption. This also helped to limit the impact of indirect tax-rate increases, which took effect from mid-2009, but were partly absorbed in mark-ups.

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



…and competitiveness has improved, supporting short-term growth prospects

The ongoing internal price and wage adjustment is leading to a recovery in the competitive position of the economy. Moreover, the availability of labour resources and spare production capacity, and the high flexibility of the economy are supporting a swift reallocation of resources towards the tradable sector. Exporting enterprises have also benefited from export promotion initiatives through various state programmes – in particular through EU structural funds – as well as from a continuous access to financing via the banking sector, where in particular banks with smaller market shares are already increasing lending. Due to the high degree of integration into the EU markets, Estonia is well positioned to profit early on from the recovery in global and regional demand.

This improved competitiveness is already resulting in gains in some merchandise export market shares, while the traditionally strong export of services has sustained the downturn surprisingly well. Exports are expected to be the main driver of economic growth in the short term, offsetting the ongoing decline in consumption and fixed investment in 2010 and contributing to growth in 2011. Overall, economic growth is expected to be around 1% in 2010 on a full-year basis, accelerating to around 4% in 2011 when domestic demand growth is expected to resume.

The ongoing factor-price adjustment is set to continue in 2010, albeit at a slower pace. Although changes in the domestic price and wage level are likely to remain negative in line with significant economic slack, rising world commodity prices and increases in indirect taxes as part of fiscal consolidation resulted in year-on-year consumer-price inflation turning positive in early 2010. The whole-year change in consumer prices is projected to be around 1¼% in 2010. In 2011, wage and price growth is set to be moderately positive, with an increase in consumer prices of around 2%.

As regards risks to the baseline scenario, exports could suffer from a slower recovery in the main trading partners, implying a possibility of a more delayed recovery. Additionally, an upturn in domestic demand could be delayed, despite a recent strengthening in consumer and business confidence, in particular if banks remain cautious as regards lending.

Raising productivity further is key in the longer term

While improved competitiveness due to internal factor-price adjustment is supporting the economy in the short term, sustained improvement over the medium term will require greater emphasis on raising productivity and moving up the value chain. To facilitate this, higher availability of risk capital appears crucial to finance the necessary investments to re-orient production towards market needs, in particular investment in new equipment. Another key precondition for raising growth potential lies in ensuring that labour supply keeps pace with the change in the economic structure.

The counterparts to the expected increased capital formation in the tradable sector include increased domestic savings and continued reliance on foreign savings, given the catching-up nature of the Estonian economy. The banking sector has weathered the global crisis well and remains well capitalised, with the quality of the loan portfolio currently stabilising. Nevertheless, the pace of the recovery will be, to a notable extent, determined by the banking sector behaviour. Despite some recovery in lending, the banking sector remains cautious. Moreover, relatively high level of private sector indebtedness could entail additional risks to the recovery of domestic demand. A positive impulse to capital formation is at the same time expected from recovering inward investment, given growing confidence in the Estonian economy following the successful fiscal consolidation and improvements in the competitive position of the economy.

The current high level of unemployment poses another risk, given the possibility of skill losses should long-term unemployment become persistent and potential workers become discouraged and leave the labour force, including through a new wave of emigration when more jobs will again be available abroad. Despite population ageing, participation rates nevertheless appear to be relatively resilient so far, reflecting a growing share of second wage earners, a tendency to work longer in life as well as higher social advantages linked to activity.

Fiscal policy a factor of stability in the crisis

The role of the public sector increased significantly during the recent downturn, both in terms of its size in relation to the rest of the economy, as well as a stabilising element. Until end-2007, buoyant private sector activity masked increasing public-sector expenditure, with the share of the public sector in the economy stable at around one third of GDP. The situation changed considerably in 2008 when the contracting private-sector activity led to the emergence of a general government deficit of 2.7% of GDP, following six years of nominal surpluses, while the share of public sector expenditure increased from 34.8% to 39.9% of GDP.

Fiscal consolidation undertaken in 2009 in response to this deterioration resulted in an improvement of the headline deficit to 1.7% of GDP in 2009, despite a 14.6% fall in nominal economic growth. Three major consolidation packages were passed in the course of the year, totalling over 9% of GDP. The main measures with a lasting impact, which accounted for around two-thirds of the overall consolidation, included cuts in public consumption, including the wage bill, limiting the increase in social benefits, increases in the VAT and excise-tax rates and an increase in the unemployment insurance tax. The intensifying absorption of EU structural funds at the same time provided needed counter-cyclical support to the economy. The consolidation also involved measures of a temporary and one-off nature and having a limited negative impact on economic activity, in particular the suspension of state contributions to the mandatory funded pension scheme, higher dividends from state-owned companies and sales of non-financial assets. The resulting improvement in the structural balance was around 3¾ pps.

The consolidation implemented in 2009 helped to strengthen the confidence of economic agents, supporting economic recovery and contributing to the adjustment of the economy. It also contributed to the adjustment of the public finances to expected lower revenues in the medium term. Under the assumption that the currently applicable tax rates will be maintained throughout the whole forecast period, with the exception of a further increase in tobacco excise-tax rate and a partial reversal of suspended payments into the mandatory funded pension fund from 1 January 2011, the headline general government deficit is expected to be 2.4% of GDP in both 2010 and 2011. The projected deficit for 2010 is close to the latest estimate by the national authorities. The effect of temporary measures will maintain the revenue ratio above 43% of GDP in 2010, while the ratio will start to decline in 2011. Nevertheless, the tax burden would remain substantially higher than in pre-crisis years, reflecting tax increases implemented during 2009-11.

Deficits in 2008 and 2009 were partly financed by running down previously accumulated financial assets. Therefore, the change in general government debt – mainly in the form of borrowing from the EIB in late 2009 and, in the case of local governments, bank borrowing – was limited, with debt increasing from an all-time low of 3.8% of GDP in 2007 to 7.2% by end-2009. While general government debt is set to increase further to above 12% of GDP by the end of 2011, the ratio is expected to remain the lowest in the EU. The accumulation of financial assets is expected to resume from 2011, in particular reflecting projected net surpluses in the social security sub-sector.

Table II.6.1:

Main features of country forecast - ESTONIA

	2008		Annual percentage change						
	bn EEK Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	251.5	100.0	-	10.0	7.2	-3.6	**-14.1**	**0.9**	**3.8**
Private consumption	140.6	55.9	-	12.9	9.0	-4.7	**-18.5**	**-4.4**	**2.9**
Public consumption	48.8	19.4	-	3.5	3.7	4.1	**-0.5**	**-0.9**	**0.1**
Gross fixed capital formation	73.7	29.3	-	18.6	9.0	-12.1	**-34.4**	**-2.9**	**8.7**
of which : equipment	29.6	11.8	-	27.2	10.1	-2.9	**-45.6**	**-2.0**	**12.0**
Exports (goods and services)	190.2	75.6	-	14.0	0.0	-0.7	**-11.2**	**6.5**	**5.9**
Imports (goods and services)	200.7	79.8	-	22.9	4.7	-8.7	**-26.8**	**2.4**	**6.0**
GNI (GDP deflator)	236.3	94.0	-	8.3	5.2	-2.6	**-10.7**	**-1.1**	**2.5**
Contribution to GDP growth : Domestic demand			-	14.0	8.9	-6.6	**-22.0**	**-3.2**	**3.4**
Inventories			-	2.8	2.2	-5.7	**-4.6**	**1.1**	**0.0**
Net exports			-	-8.4	-4.4	6.8	**12.9**	**3.0**	**0.4**
Employment			-2.0	5.4	0.8	0.2	**-9.9**	**-2.6**	**1.5**
Unemployment rate (a)			-	5.9	4.7	5.5	**13.8**	**15.8**	**14.6**
Compensation of employees/f.t.e.			-	14.2	24.8	9.8	**-3.0**	**-3.3**	**1.3**
Unit labour costs whole economy			-	9.4	17.3	14.1	**1.7**	**-6.7**	**-0.9**
Real unit labour costs			-	1.7	6.4	6.9	**2.3**	**-5.7**	**-2.8**
Savings rate of households (b)			-	-	-0.5	3.0	**15.7**	**10.6**	**8.7**
GDP deflator			-	7.6	10.2	6.7	**-0.6**	**-1.0**	**1.9**
Harmonised index of consumer prices (HICP)			-	4.4	6.7	10.6	**0.2**	**1.3**	**2.0**
Terms of trade of goods			-	2.7	3.4	-0.7	**-7.0**	**-1.2**	**0.0**
Trade balance (c)			-	-18.1	-17.8	-11.7	**-3.9**	**-2.7**	**-2.6**
Current-account balance (c)			-	-17.1	-17.9	-9.4	**4.6**	**4.9**	**3.8**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-15.0	-16.9	-8.2	**7.4**	**7.4**	**6.2**
General government balance (c)			-	2.5	2.6	-2.7	**-1.7**	**-2.4**	**-2.4**
Cyclically-adjusted budget balance (c)			-	0.0	-0.7	-4.1	**1.3**	**0.2**	**-0.9**
Structural budget balance (c)			-	-0.9	-1.1	-4.3	**-0.6**	**-2.1**	**-1.8**
General government gross debt (c)			-	4.5	3.8	4.6	**7.2**	**9.6**	**12.4**

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.
Note : Contributions to GDP growth may not add up due to statistical discrepancies.

7. IRELAND

Adjusting for recovery

The global crisis came on top of a home-grown downturn

The global economic and financial crisis aggravated what started as a home-grown downturn and turned it into a protracted recession. After over a decade of strong economic growth that had been increasingly driven by domestic demand, a sharp adjustment from its 2006 peak began in the Irish housing market and subsequently spread to the wider economy. This development was amplified by the decline in global demand and especially by the recession in Ireland's main trading partners (euro area, US and UK). Similarly, the international financial crisis contributed to the deepening of the downturn, given the weight of the financial services sector in the Irish economy and banks' high dependence on foreign wholesale funding. The economy entered recession in 2008 and real GDP fell by 3% in 2008 and by a further 7.1% in 2009. The downturn has also produced a dramatic deterioration in the Irish public finances, with a large general government deficit emerging and feeding into a steep increase in the debt ratio from its low pre-crisis level.

Domestic demand is contracting heavily

A further, much less pronounced contraction in real GDP is expected in 2010, before positive growth should resume in 2011. The recession continues to be driven by contracting domestic demand. In 2009, declines in disposable income on the back of falling employment and, to a lesser extent, wages, together with a significant rise in precautionary savings, led to a historic decline in private consumption expenditure. As the pace of deterioration in the labour market has begun to slow, while consumer confidence started to pick up, a less sharp fall in private consumption is forecast for 2010. In 2011, with real disposable income expanding again, consumption growth should resume. Throughout the forecast period, the adjustment of households' balance sheets, following in particular their past over-investment in housing, is expected to continue to weigh on household spending.

Gross fixed capital formation declined by close to one third in 2009 and should contract further by nearly one fifth in 2010 before returning to moderate growth in 2011. The ongoing drastic downsizing of the construction sector is expected to continue well into 2010, after which the cumulative fall in real construction investment since its 2006 peak would stand at close to 60%. On the back of subdued demand developments, equipment and machinery investment has also declined substantially, but is likely to pick up as prospects improve. Given the ongoing consolidation efforts, nominal public investment is expected to continue to fall.

Driven by the good performance of the – relatively acyclical – chemical and pharmaceutical sector, Ireland's exports only recorded a fairly moderate decline in 2009 compared to most euro-area peers. Given the strong decline in domestic demand, imports fell more steeply, implying a strong positive contribution of net external trade to GDP growth. Exports are set to expand again in 2010 and gather strength in 2011. These developments reflect the assumed global recovery and the incipient reversal of past competitiveness losses on the back of domestic price and wage adjustments, and also of a more favourable nominal effective exchange rate, especially due to developments vis-à-vis the USD. With imports recovering more slowly than exports in view of the subdued outlook for domestic demand, the contribution of net exports to growth is forecast to remain markedly positive over the forecast horizon, thereby contributing to the gradual narrowing of the current-account deficit.

As regards risks to the baseline scenario, net exports could suffer from a slower recovery in the main trading partners. At the same time, due to geographical trade patterns, a stronger-than-anticipated depreciation of the euro could boost Irish exports. Concerning the public finance forecast, in line with the usual no-policy-change assumption, the bulk (around 1.2% of GDP) of the consolidation effort for 2011 announced in the December 2009 stability programme update was not taken into account in the forecast as the underlying measures are still to be specified in the budget for 2011 (the exception is the announced retrenchment of public investment). Depending on the specific consolidation measures that are eventually implemented, a dampening effect on domestic demand cannot be excluded. Further, if the ongoing financial sector balance-sheet adjustment were to intensify due to worsening loan quality in the context of the wider recession, subdued lending activity could in turn adversely affect real activity, inter alia through a dampening effect on investment. Finally, a faster-than-assumed pace of sectoral adjustment might provide support to consumption and investment demand.

Employment falls strongly and net migration flows reverse

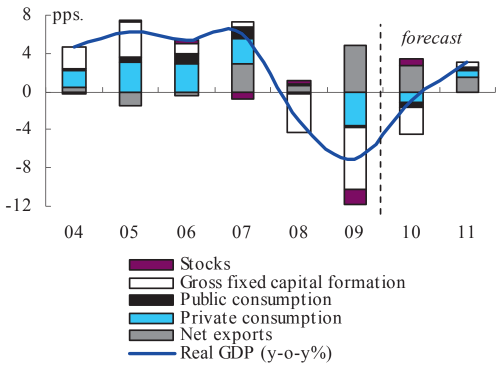
The pace of recovery will depend crucially on the speed at which imbalances accumulated in the past can be corrected. This includes the domestic rebalancing of economic activity from construction to more productive sectors, the recovery of competitiveness, the clean-up of household and corporate balance sheets and further consolidation of the public finances.

At the peak of the housing market cycle in 2006, the construction sector accounted for over 13% of total employment, compared to below 8% in the euro area. The ongoing downsizing of the housing market and the contraction in overall activity are reflected in a large decline in employment, which is set to continue well into 2010. In response to worsening labour-market conditions, the participation rate is falling. At the same time, after over a decade of significant inflows, net outward migration took place in 2009 and is expected to continue over the forecast period as Irish and immigrant workers seek job opportunities abroad. Still, the unemployment rate should rise further and peak at 13¾% in 2010, with young and low-skilled workers being hardest hit. With domestic demand still subdued and given the capital-intensive production in key export sectors, only a very moderate increase in employment is forecast for 2011 despite the return to positive economic growth.

Downward price and wage adjustment is underway to help regain competitiveness

Over the past few years, Ireland suffered significant losses in competitiveness, as reflected in a strong rise in unit labour costs since 2002. The Irish price level was among the highest in the euro area in recent years and a downward adjustment of prices is underway. HICP inflation averaged -1.7% in 2009 and is forecast to be negative again in 2010 before turning mildly positive in 2011. Led by the strong retrenchment in the public sector, there also appears to have been a reduction in nominal wages in the private sector in 2009, which is projected to continue in 2010. Such changes in relative prices would further support resource reallocation towards the tradable sector and help to recover past competitiveness losses. In turn, this would strengthen the potential growth contribution of the external sector. After productivity stagnated in 2008, an apparent pick-up is now in progress, which mainly reflects the ongoing labour shedding.

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



Regaining competitiveness will be important also given that balance-sheet adjustments are likely to continue to weigh on domestic demand over the next few years. After the steep increase in 2009, the household saving rate is set to see a moderate decline over the forecast horizon as confidence improves. This reflects not only precautionary motives but also the need to reduce indebtedness, given that household debt as a share of GDP doubled between 2001 and 2007 in the context of the housing boom. Corporate demand for investment credit is projected to also remain moderate in the short term, while bank deleveraging in the aftermath of the financial sector crisis might weigh on credit supply. The government measures to support the financial sector should facilitate an orderly restructuring process. In particular, in addition to guarantees and capital injections, a bad bank – the National Asset Management Agency (NAMA) – has been set up to purchase impaired assets from banks operating in Ireland in order to revive commercial banking.

Underlying deficit ratio broadly stabilises owing to fiscal consolidation

The crisis has taken a heavy toll on Ireland's public finances. Notwithstanding significant deficit-reducing measures taken since mid-2008, the government deficit widened further in 2009 because underlying budgetary trends continue to be very negative. The deficit ratio reached 14.3% of GDP, but, excluding net deficit-increasing one-offs of around 2% of GDP largely linked to a capital injection into Anglo Irish Bank, it would be around 12.3%. Despite a series of tax-increasing measures, tax revenue is falling more sharply than nominal GDP, reflecting the severe adjustment in tax-rich domestic demand. At the same time, it takes some time to bring expenditure into line with revenue developments, also in view of the increase in social spending and debt-servicing costs.

In 2010, the deficit is expected to improve to 11.7% of GDP. The ongoing adverse underlying budgetary trends are contained by a significant consolidation package of 2½% of GDP. Together with the full-year effect of measures taken in the course of 2009, the net deficit-reducing effect of the measures amounts to 4¼% of GDP. Moreover, the fiscal position is improved by a one-off amounting to 0.6% of GDP in 2010.

In 2011, the deficit ratio is projected to increase to just above 12% of GDP on a no-policy-change basis (and zero one-offs). Relatively sluggish employment and consumption growth is forecast to lead to only a moderate tax revenue increase. Comparatively moderate spending growth is forecast on a no-policy-change basis, also in view of the further cuts to public investment.

The combination of large primary deficits, rising interest expenditure and, until 2010, falling nominal GDP, leads in the forecast to a rise in the debt ratio to around 87% of GDP by 2011 on a no-policy-change basis.

In line with the 19 October 2009 preliminary view of Eurostat,[71] the bonds (around 30% of GDP) expected to be issued by the Special Purpose Vehicle associated with NAMA to finance the purchase of loan books from certain financial institutions are not recorded as government debt, while the majority of those bonds are guaranteed by the Irish State. On 30 March 2010, the authorities announced the transfer of a first tranche of loans to NAMA and the likely need for further capital injections into some banks. An effect of such capital injections on public finance developments within the forecast horizon cannot be excluded. However, in the absence of detailed information on the nature and size of these operations, the forecast does not include any impact.

(71) See http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/Irish_letter_19_10_2009.pdf.

Table II.7.1:

Main features of country forecast - IRELAND

		2008			Annual percentage change					
	bn EUR	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		181.8	100.0	6.9	5.4	6.0	-3.0	**-7.1**	**-0.9**	**3.0**
Private consumption		91.0	50.1	5.4	6.5	5.6	-0.7	**-7.2**	**-2.4**	**1.4**
Public consumption		33.1	18.2	4.7	6.3	7.7	1.5	**-1.3**	**-2.7**	**2.0**
Gross fixed capital formation		39.5	21.7	8.6	3.9	2.4	-15.5	**-29.7**	**-17.6**	**4.2**
of which : equipment		8.6	4.7	9.4	1.9	23.4	-11.1	**-25.0**	**-4.9**	**6.5**
Exports (goods and services)		151.9	83.5	12.3	5.1	8.6	-1.0	**-2.3**	**2.0**	**4.3**
Imports (goods and services)		133.0	73.2	11.5	6.5	5.6	-2.1	**-9.3**	**-1.3**	**3.5**
GNI (GDP deflator)		155.9	85.7	6.4	6.9	4.3	-2.9	**-11.9**	**-2.8**	**2.4**
Contribution to GDP growth :	Domestic demand			5.3	5.0	4.4	-4.1	**-10.4**	**-4.4**	**1.6**
	Inventories			0.0	0.4	-0.8	0.2	**-1.6**	**0.7**	**0.0**
	Net exports			1.9	-0.4	2.9	0.7	**4.9**	**2.8**	**1.4**
Employment				3.7	4.3	3.7	-1.1	**-8.2**	**-3.5**	**0.4**
Unemployment rate (a)				8.5	4.5	4.6	6.3	**11.9**	**13.8**	**13.4**
Compensation of employees/head				5.3	4.5	4.5	3.9	**-1.6**	**-2.5**	**0.8**
Unit labour costs whole economy				2.2	3.5	2.2	5.9	**-2.7**	**-5.0**	**-1.7**
Real unit labour costs				-1.5	0.0	0.9	7.2	**0.5**	**-3.4**	**-2.5**
Savings rate of households (b)				-	-	8.2	10.0	**12.1**	**11.1**	**10.9**
GDP deflator				3.7	3.5	1.3	-1.2	**-3.2**	**-1.7**	**0.8**
Harmonised index of consumer prices (HICP)				-	2.7	2.9	3.1	**-1.7**	**-1.3**	**0.8**
Terms of trade of goods				-0.2	-1.1	-6.5	-2.8	**0.8**	**-0.2**	**-0.2**
Trade balance (c)				20.8	14.2	10.4	13.1	**20.0**	**23.1**	**23.6**
Current-account balance (c)				0.9	-4.1	-5.3	-5.2	**-2.9**	**-0.9**	**-0.6**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				1.7	-4.0	-5.3	-5.2	**-2.8**	**-0.9**	**-0.6**
General government balance (c)				0.5	3.0	0.1	-7.3	**-14.3**	**-11.7**	**-12.1**
Cyclically-adjusted budget balance (c)				0.4	2.1	-1.6	-7.0	**-11.4**	**-8.7**	**-10.2**
Structural budget balance (c)				-	2.1	-1.6	-7.0	**-9.4**	**-9.3**	**-10.2**
General government gross debt (c)				56.4	24.9	25.0	43.9	**64.0**	**77.3**	**87.3**

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

8. GREECE

Deep but inevitable adjustment

Necessary adjustment calls for policy response [72]

The recent downward revision of the GDP data for the first three quarters of 2009, coupled with worse-than-expected fourth quarter, implied a real GDP contraction of 2% in 2009. This deeper-than-expected recession in 2009 will have an impact on real GDP dynamics in 2010, with the carry-over effect at the beginning of the year at almost -1%. Moreover, economic activity is set to lose further steam, due to a number of factors, in particular worsening business and consumer confidence, the developments in financial markets and the implementation of an appropriately restrictive fiscal policy.

Following years of expansionary fiscal policies that resulted in the build-up of fiscal (high general government deficit and gross debt stock, increasing interest payments) and macroeconomic (high current-account deficit and external debt, outflow of income) imbalances, Greece adopted a number of fiscal consolidation measures, which are expected to have an unfavourable impact on real GDP growth in 2010. Successful and credible fiscal adjustment efforts however, should boost confidence and improve sentiment. Credibility gains will compensate the vast economic cost of adjustment and lead to the beginning of a recovery process in the second half of 2011.

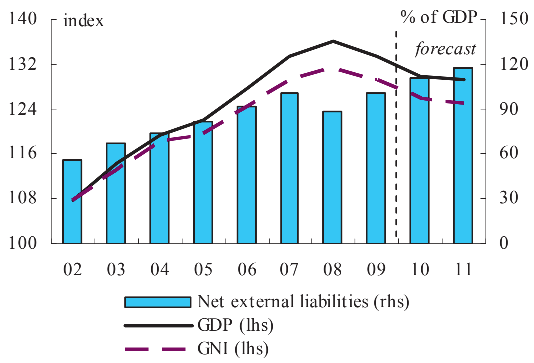
Recession deepens as contraction in domestic demand continues

Economic outlook is for real GDP to contract further in 2010, before starting to recover mildly in the second half of 2011. For the year as a whole, economic activity is set to contract by -3% in 2010. In the short run, fiscal tightening will have a strong contractionary impact on economic activity, on the back of cuts in public wages, increasing tax burden and thus, dragging disposable income down and declining public spending. Market pressure in the form of high spreads on sovereign debt, while likely to reduce as fiscal consolidation proceeds, will continue to hold back economic activity by keeping up the cost and limiting private sector access to financing. With high country risk premia discouraging lending, credit expansion is likely to remain subdued on the back of tighter credit conditions and high household indebtedness.

Falling employment and wage growth, as well as lower non-labour income growth are expected to also weigh on disposable income in 2010, putting a brake on real demand. In view of the highly uncertain environment, the household saving rate might increase, leading to further pressure on private consumption which, as a result, is set to contract by 3.5% in 2010 and decrease further over the forecast horizon.

The immediate outlook for the business sector remains poor; investment is set to decline further in 2010 before showing some positive signs by the end of 2011. In spite of the gradual recovery in external demand, which is expected to support export-oriented sectors, such as chemicals and metals, shipping and tourism, weak domestic demand and financing conditions will continue to weigh heavily on business investment decisions during 2010. Construction sector is set to experience a further downsizing in 2010, as demand remains extremely weak. Public investment activity in turn, although expected to stack in 2010, is likely to start recovering by 2011.

Graph II.8.1: **Greece - Net external liabilities, GDP and GNI**



The weakening domestic demand is forecast to curb imports further, which are projected to continue falling by around 10% in real terms in 2010, inducing also a sizeable reduction in the trade deficit. Total exports in turn, benefiting from the gradual recovery of the world trade and more

(72) As for the rest of the Member States, the cut-off date of this forecast is 20 April 2010. As such, the forecast does not factor in the adjustment package prepared in the context of the euro area-IMF financial support.

favourable world demand prospects, coupled also with a relative decline in unit labour cost, are set to rise by almost 2¾% in 2010 and increase further in 2011. All in all, the contribution of net exports to GDP growth is forecast to be positive both in 2010 and to a lesser extent in 2011, mainly due to the ongoing fall in imports.

The contraction of economic activity, reflected in weakening labour demand from the retail, wholesale and construction sectors, is weighing heavily on employment which is set to fall by almost 3% over the forecast horizon. Shorting employment opportunities in the private sector, along with the recruitment freeze and short-term contracts cuts in the public sector are likely to push the unemployment rate up in 2010-11.

The balance of risks for the baseline scenario remains on the downside especially in 2011 as the estimated confidence gains may be less buoyant or delayed. In addition, the liquidity tightness may have a more profound impact on economic activity through the bank-lending channel, especially in the case of risks associated with the timely and rigorous implementation of the stability programme materialising. On the positive side, if the fall in domestic output is not proportionate to the decline in demand, the increase in net exports may compensate more for the fall in domestic demand, leading to a higher contribution of net exports to GDP growth than assumed. The latter would largely depend on labour-market developments, wage and unit-labour cost adjustment in particular. The announced cuts in public sector remuneration are expected to play an important signalling role that would support private-sector wage moderation.

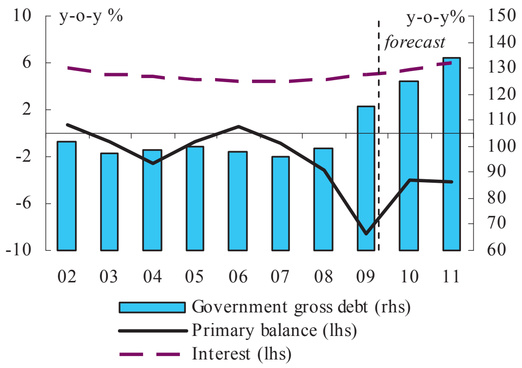
Recovery prospects depend on the correction of domestic and external imbalances…

The significant progress made by Greece in terms of real convergence over the last decade is now considerably challenged. Bringing the Greek economy back to a sustained convergence path involves the prompt correction of the factors underlying domestic and external imbalances.

Developments in the external sector are expected to lead to a partial correction of the external deficit in 2010. Nevertheless, improvement over the medium term is likely to be much more moderate, given the structural weaknesses of the external performance of the economy and past years' accumulated competitiveness losses. Notably, the external imbalance, although improving, may still amount to more than 8% of GDP by 2011. In a recessionary context in both real and nominal terms, external constraints are becoming more severe, leading to the inevitable adjustment.

Widening competitiveness losses over the recent years are also reflected in the sizeable appreciation of the real effective exchange rate (REER) based on unit labour costs. The rapid rise of wage costs and mark-ups in excess of productivity growth, as well as the persistence of the inflation differential with the euro area, has contributed to a wage-price spiral and resulted in high real-wage growth, well above productivity growth. The disconnection between wages and labour-market and productivity developments, including the still weak response of wages growth to the downturn, are set to come to an end in the short term, with positive impact on country's competitive position. Appropriate wage developments, in line with the moderation of public wages, would help to regain part of the lost competitiveness. While inflationary pressures continuing to build up in the following months, fuelled by the adverse base effects of energy prices, the VAT-rates increase and the increase in excise duties on alcohol, tobacco and fuel, core inflation will be reined by the negative output gap and constrained wage growth.

Graph II.8.2: **Greece - General government debt, primary balance and interest**



…and the fiscal consolidation results

Expansionary fiscal policies until recently, contributed to aggravating the external imbalances and to protracted losses in competitiveness. High government deficits have led to one of the highest public debt ratios in the EU, which remains on a steep upward path. While in Greece, as in other EU countries, the most recent deterioration in public finances must be seen in the context of the global economic crisis, fiscal imbalances have been high and persistent for many years, suggesting exceptional structural roots. The ongoing crisis, however, has already made these imbalances unsustainable in the medium-term, with obvious implications for the financing of the large external and public deficits. This not only renders the financing of any additional debt issuance more expensive, but also adds to the cost of refinancing the existing stock of public debt.

In 2009, the Greek public finances have worsened much beyond what could have been expected to result from the downturn and the financial-sector support measures. According to the notification of April 2010, the government deficit has reached 13.6% of GDP in 2009.(73) The January 2010 update of the stability programme set a nominal fiscal adjustment of 4 pps. of GDP, on the back of a detailed set of fiscal consolidation measures. The Council Decision and the Recommendation of 16 February(74) provide a detailed list of fiscal and structural measures to be implemented by 2012. To ensure meeting the budgetary target, the Greek authorities have adopted additional fiscal measures of 0.4 pp. of GDP in February and of 2 pps. of GDP in March.(75) Further substantial measures will be included in the adjustment programme under the euro area - IMF financial-support package. Under the no-policy-change assumption and on the back of the discontinuation of one-off measures in 2010, the headline deficit is projected to remain at around 10% of GDP in 2011. This, combined with the economic downturn, would lead to a sizeable increase in the debt ratio over the forecast horizon.

(73) Eurostat (news release 55/2010 of 22 April 2010) is expressing a reservation on the quality of the data reported by Greece, due to uncertainties on the surplus of social security funds for 2009, on the classification of some public entities and on the recording of off-market swaps. Following completion of the investigations that Eurostat is undertaking on these issues in cooperation with the Greek Statistical Authorities, this could lead to a revision for the year 2009 of the order of 0.3 to 0.5 pps. of GDP for the deficit and 5 to 7 pps. of GDP for the debt.

(74) On 16 February 2010, the Council adopted a Decision under Article 126(9) TFEU giving notice to Greece to take measures for the deficit reduction judged necessary in order to remedy the situation of excessive deficit and a Recommendation under Article 121(4) TFEU with a view to ending the inconsistency with the broad guidelines of the economic policies in Greece and removing the risk of jeopardising the proper functioning of EMU.

(75) On 9 March 2010 the Commission adopted a Communication (COM(2010)91) assessing the decisions taken so far by the Greek authorities in order to achieve the 2010 budgetary target. The Communication concluded that Greece was implementing the Council Decision of 16 February 2010 and the measures outlined in its stability programme. If fully, effectively and timely implemented, the additional fiscal measures of March 2010 appear sufficient to achieve the 2010 budgetary targets.

Table II.8.1:

Main features of country forecast - GREECE

	2008		Annual percentage change						
	bn EUR Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	240.2	100.0	2.9	4.5	4.5	2.0	**-2.0**	**-3.0**	**-0.5**
Private consumption	173.3	72.1	2.9	5.3	3.3	2.3	**-1.8**	**-3.5**	**-2.4**
Public consumption	41.4	17.2	2.7	-0.1	8.4	0.6	**9.6**	**-7.0**	**-3.1**
Gross fixed capital formation	46.3	19.3	4.0	9.8	4.6	-7.4	**-13.1**	**-5.5**	**-0.8**
of which : equipment	21.9	9.1	9.4	4.7	20.9	6.3	**-19.0**	**-5.0**	**-1.7**
Exports (goods and services)	55.5	23.1	6.4	5.3	5.8	4.0	**-18.1**	**2.6**	**4.1**
Imports (goods and services)	80.0	33.3	5.6	9.0	7.1	0.2	**-14.1**	**-10.5**	**-3.4**
GNI (GDP deflator)	232.4	96.7	2.7	4.0	3.7	1.6	**-1.5**	**-3.0**	**-0.6**
Contribution to GDP growth : Domestic demand			3.2	5.8	4.8	0.2	**-2.5**	**-4.8**	**-2.4**
Inventories			-0.1	0.4	0.8	1.0	**-0.1**	**-1.9**	**0.1**
Net exports			-0.3	-1.7	-1.1	0.8	**0.7**	**3.8**	**1.8**
Employment			1.0	2.0	1.4	0.1	**-1.2**	**-1.9**	**-0.8**
Unemployment rate (a)			9.9	8.9	8.3	7.7	**9.5**	**11.8**	**13.2**
Compensation of employees/head			8.2	3.1	6.6	5.9	**5.5**	**-0.8**	**0.4**
Unit labour costs whole economy			6.2	0.7	3.5	3.9	**6.3**	**0.3**	**0.1**
Real unit labour costs			-0.3	-2.3	0.5	0.3	**5.0**	**-2.6**	**-1.6**
Savings rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			6.5	3.1	3.0	3.5	**1.0**	**2.9**	**1.7**
Harmonised index of consumer prices (HICP)			-	3.3	3.0	4.2	**1.3**	**3.1**	**2.1**
Terms of trade of goods			0.0	0.4	0.9	-2.2	**-2.9**	**-2.1**	**-0.5**
Trade balance (c)			-14.8	-17.1	-17.7	-16.6	**-14.0**	**-12.0**	**-10.9**
Current-account balance (c)			-5.9	-12.8	-14.7	-13.8	**-13.1**	**-10.3**	**-8.6**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-10.5	-12.5	-12.4	**-12.3**	**-9.4**	**-7.6**
General government balance (c)			-6.6	-3.6	-5.1	-7.7	**-13.6**	**-9.3**	**-9.9**
Cyclically-adjusted budget balance (c)			-6.3	-4.7	-7.0	-9.6	**-14.1**	**-8.2**	**-8.2**
Structural budget balance (c)			-	-5.2	-6.8	-8.7	**-13.0**	**-8.5**	**-8.2**
General government gross debt (c)			97.1	97.8	95.7	99.2	**115.1**	**124.9**	**133.9**

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

9. SPAIN

Subdued recovery amidst lower imbalances

Economic adjustment in 2009 and policy response

The end of a decade of sustained and strong economic expansion in Spain has unveiled significant external and sector imbalances. The severe economic contraction in Spain since the second half of 2008 has led to partial corrections in some of those imbalances. Cyclical factors led to a reduction of the external deficit. The high household indebtedness has started to adjust and investment growth in the residential building sector has fallen sharply, although the excess of housing supply have increased.

In 2009, economic activity fell by 3.6%. However, this outcome conceals less negative outcomes within the year, especially in the second half of 2009, due to improvements in private consumption, investment in equipment and exports. This is partly explained by the stimulus measures adopted in line with the European Economy Recovery Plan (EERP) and the positive, albeit temporary, impact of the implementation of car-scrapping schemes in Spain and other Member States, investment in equipment and exports. The contribution of domestic demand to GDP posted a record low in the second quarter of 2009. The downturn took a heavy toll on both jobs, especially in low-productivity sectors, and public finances, which may result in high long-term unemployment and a worsening of the sustainability of public finances.

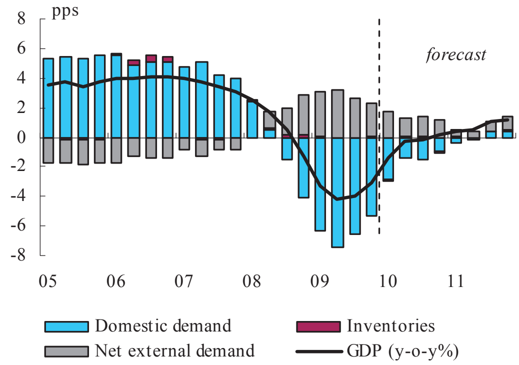
The policy response in Spain to the crisis was twofold. On the one hand, expansionary fiscal measures to stimulate the economy were adopted in line with the EERP. On the other hand, although the direct impact of the financial crisis on the Spanish banking sector has been relatively contained, a series of measures was implemented to support the restructuring of the financial sector.

Economy to come out of recession in the course of 2010

The outlook features positive quarterly growth in the second quarter of 2010, partially reflecting an anticipation of consumption plans driven by the scheduled VAT rate increase on the 1st of July. As a result, quarterly GDP might record a technical fall in the third quarter before recovering again in the last quarter of the year. For 2010 as a whole, real GDP is forecast to contract by ⅓%, followed by a moderate positive growth of ¾% in 2011. Overall, domestic demand is projected to still reduce GDP growth in 2010.

This projection is mainly based on weak private consumption and still shrinking investment. Specifically, private consumption is set to broadly stagnate in 2010 and to increase by 1¼% in 2011. The protracted fall in employment along with limited wage increases are set to produce negative growth in disposable income. Households' balance-sheet ratios might be restored by increasing savings, with an impact on real demand, and thus sustaining precautionary savings. In addition, access to consumer credit still remains more difficult than in the past years when easy access to credit boosted an unsustainable real estate boom. This is due not only to tight credit conditions imposed by financial institutions, but also to lower household' wealth associated to falling asset prices, especially housing, and high household indebtedness. However, low mortgage burdens, consistent with record-low interest rates, and the impact of a partial extension into 2010 of the 2009 public investment package, are expected to yield some support to disposable income. The saving rate of households is projected to start diminishing slowly from a record high of 18¾% of gross disposable income in 2009. By 2011, saving rate is projected to still remain higher than in 2007.

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



Gross fixed capital formation is set to keep on falling in 2010-11, albeit at a slower pace than in 2009. Excess supply in the housing market sector, where a considerable stock of new houses remains unsold, is expected to face a diminishing demand, also driven by negative demographic developments. This will drive the adjustment process in the construction sector. Construction activity is set to contract further – by more than 10% in 2010 and 3½% in 2011 – driven by a reduction of investment growth in housing construction of 15¼% in 2010 and 4¾% in 2011, which should help to reduce the large unsold dwellings stock. Non-residential investment is also expected to fall over the forecast horizon, partly reflecting the gradual withdrawal of public investment plans. However, while equipment investment is expected to still post a contraction in 2010, improving economic prospects are assumed to lead to a mild positive growth by 2011.

In the external sector, imports are expected to shrink less markedly in 2010 and to return to positive growth in 2011 in line with final demand. Exports are projected to show a mild recovery in the medium term, reflecting an improvement of world demand and competitiveness gains. All in all, the positive contribution of net exports to GDP growth is forecast to be positive though decreasing in both 2010 and 2011.

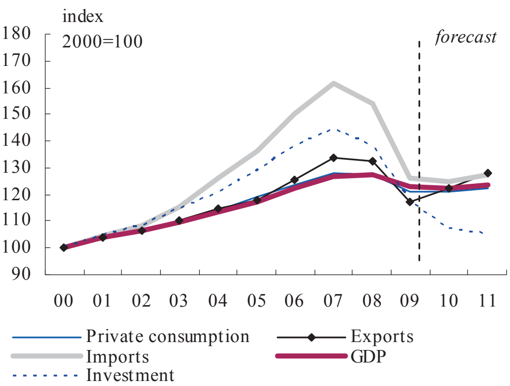
The long period of large external deficits has added to net external liabilities that surpassed 90% of GDP in 2009. The servicing of these liabilities will continue to absorb a non-negligible share of income over the medium term, mirrored in the deficit in the primary income balance. The primary-income deficit is already a major component of the current account as well as an element of rigidity in the narrowing of the overall external deficit.

In the current context of external financing constraints, with a primary-income deficit that remains close to 4%, the cushioning of the real GDP decline at the expense of significant public sector dissaving may require higher financing from households and firms. This financing is not likely to come from saving ratios above the current level, but rather from a further contraction in investment, thus weighing on real GDP growth over the medium term.

The contraction in economic activity, which particularly affects labour-intensive sectors, continues to weigh heavily on employment, which is projected to suffer a cumulative fall of some 2¾% in 2010-11. Despite a projected easing in population growth and in the size of the labour force, the unemployment rate is forecast to rise to 19¾% in 2011.

The present outlook represents a baseline scenario, which is subject to a number of risks that are considered to be broadly balanced. The low interest rates, relatively contained inflation and some growth in nominal wages per head could boost disposable income further, thus strengthening private consumption and accelerating the adjustment of the housing market. Private consumption could thus recover more rapidly. On the other hand, the still subdued employment prospects and currently high unemployment rates might contribute to keeping confidence at a low level, while preventing faster recovery of household expenditure. At the same time, a tightening of credit conditions would further constrain private investment. A lower-than-expected recovery of external demand, resulting from the withdrawal of stimulus measures put in place to tackle the global downturn, would certainly weigh more heavily on economic activity than was projected in the baseline scenario. Delays in the implementation of the ambitious fiscal consolidation plans envisaged by the government could harm internal and external confidence, with negative overall effects on the real economy.

Graph II.9.2: **Spain - GDP and its components**



Correction of imbalances

The challenge of bringing the Spanish economy back to a sustained convergence path could be successfully secured if the recovery were to lead not only to a rebalancing of domestic demand but also to higher export growth and to supporting higher potential growth. In 2010, the net borrowing needs are projected to fall further by ¾ pp. to 4% of GDP, after the sharp reduction recorded in the previous year. By 2011, the net borrowing needs are forecast to remain broadly unchanged, which reflects the fact that the corrections of the imbalances in the Spanish external account might be, at least in part, permanent. Indeed, the trade balance is expected to reduce its deficit, which partially reflects an improvement in the country's competitive position, although the negative net investment position will continue to feed the deficit in the primary incomes account.

Wage moderation is expected to lead to some recovery of competitiveness…

Spain has experienced a real depreciation of the intra-euro-area real effective exchange rate based on unit labour costs since the beginning of the crisis, but the magnitude of correction has so far been rather limited. In 2010 this adjustment is projected to continue via a stronger response of wages. Nominal wages are projected to adjust in 2010-11, at least partly, to labour market conditions, while job losses and unemployment are set to diminish. However, high segmentation in the job market can lead, as in the past, to a significant increase in long-term unemployment, thus reducing the potential growth rate of the Spanish economy. The non-activation of indexation clauses in 2010-11 would imply that nominal wages could grow at rates below the euro-area average and below the expected inflation rate, therefore resulting in a slight fall of real wage growth. The pace of growth of nominal compensation per employee is projected to significantly reduce to 1¼% in 2010, thus below productivity growth. In 2011, compensation per employee growth rate is set to remain moderate. The partial convergence between wages and productivity developments in the forecast horizon are underpinning a significant reduction of unit labour cost developments compared with recent years, which may improve the competitive position of the Spanish economy.

Productivity growth in Spain has been sluggish during the last decade. This mirrors a high allocation of investment to the construction sector and low-productivity services. Although apparent productivity is estimated to grow in 2009 and 2010 above the euro area average, this is mainly due to the sharp contraction of the above-mentioned activities. Consequently, over the medium term, once the adjustment of these low-productivity sectors is over, productivity gains might slow down. By the end of the forecast period, productivity growth is projected to diminish to below 1%. Therefore, the challenge is to increase total factor productivity through enhancing innovation and investment by firms, increasing permanent training of workers, and encouraging competition.

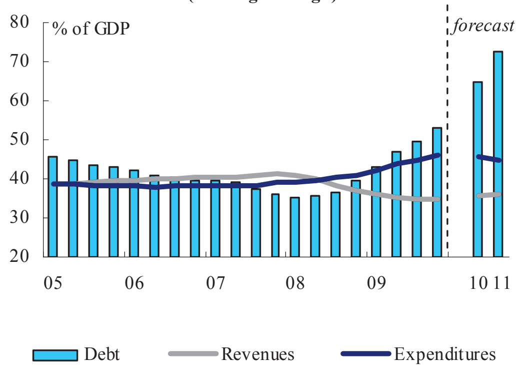
…and inflation control

After a slight fall in 2009, inflation rate is projected to return to positive territory in 2010, when prices are set to increase by just above 1½%, and remain so in 2011. However, the projection for 2011 as a whole conceals a downward trend in the quarterly inflation rate, which is expected to ease to 1¼% by the end of 2011, reflecting a base effect due to the VAT hike by mid-2010. In this respect, the prices of oil and other commodities in international markets represent a significant source of uncertainty.

Restoring public finances' balance

The move away from the highly tax-rich growth composition associated with the fading-out of the asset boom has led to a permanent reduction of tax elasticities. In addition, the economic downturn has significantly increased social protection needs. Both rapidly falling revenue-to-GDP and rising expenditure-to-GDP ratios have resulted in a sharp deterioration in the public accounts. For 2009, the general government deficit outcome was 11.2% of GDP, driven by a contraction of both direct and indirect tax receipts and increases in nominal government consumption, as well as the customary strong anti-cyclical behaviour of social transfers. This deficit outcome included revenue-decreasing one-offs of 0.7% of GDP and discretionary measures amounting to around 2¼% of GDP taken in response to the downturn.

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



The government deficit is projected at 9¾% of GDP in 2010 due to the recessionary growth scenario. This implies a reduction in the headline public deficit of around 1¼ pps., due to the consolidation efforts undertaken by the authorities, including a partial reversal of the 2009 stimulus package. In 2010, total revenues are set to rise by 1¼ pps. of GDP, through both direct and indirect tax revenues, thus reflecting the adoption of revenue-increasing discretionary measures, notably a 2 pps. increase in the general VAT rate. The GDP share of total expenditures should slightly reduce, mostly due to containment of public consumption and a reduction in public investment. In addition to the measures included in the 2010 Budget, expenditure restraint of the central government is expected to be reinforced by the so-called draft 'Immediate Action Plan' for 2010. However, current expenditures are projected to increase, which would still reflect the functioning of automatic stabilisers, and especially higher unemployment benefits, as well as the higher burden of interest expenditure associated with rising debt levels.

The Spanish government has publicly announced an ambitious fiscal consolidation plan for 2011-13 aiming at reducing total expenditure. Expenditure restrains will mainly rely on the effort of central government, although regional governments have recently agreed to contribute to this consolidation. For 2011, based on a prudent assessment of this plan, the GDP share of compensation of employees and intermediate consumption are projected to fall by around ½ pp., which adds to the reversal of the 2010 stimulus package. As a result, based on the customary no-policy-change assumption, the 2011 deficit is forecast at 8¾% of GDP. Amidst a contraction in GDP and high public deficits, government debt is set to increase from 39.7% of GDP at the end of 2008 to 72½% of GDP by the end of 2011.

Given the rise in unemployment, promoting a swift transition into employment, while still reining in public expenditures and ensuring social cohesion, is key for resuming growth in the medium term. Against this setting, reducing budget deficits is key to boost the confidence of economic agents and lead to an expansion of productive investment and consumption. Increasing public saving and improving competitiveness would enhance economic growth, and job creation, while mitigating the existing structural domestic and external imbalances.

Table II.9.1:

Main features of country forecast - SPAIN

		2008			Annual percentage change					
	bn EUR	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		1088.5	100.0	3.0	4.0	3.6	0.9	**-3.6**	**-0.4**	**0.8**
Private consumption		622.8	57.2	2.9	3.8	3.6	-0.6	**-4.9**	**0.2**	**1.2**
Public consumption		211.1	19.4	3.6	4.6	5.5	5.5	**3.8**	**1.0**	**-1.2**
Gross fixed capital formation		314.0	28.8	4.1	7.2	4.6	-4.4	**-15.3**	**-8.3**	**-1.8**
of which : equipment		80.3	7.4	4.2	9.9	9.0	-1.8	**-23.1**	**-4.3**	**0.2**
Exports (goods and services)		289.0	26.5	7.7	6.7	6.6	-1.0	**-11.5**	**4.4**	**4.7**
Imports (goods and services)		353.0	32.4	8.3	10.2	8.0	-4.9	**-17.9**	**-1.1**	**1.8**
GNI (GDP deflator)		1060.6	97.4	2.9	3.8	2.9	0.6	**-3.0**	**-0.7**	**0.3**
Contribution to GDP growth :	Domestic demand			3.4	5.1	4.5	-0.7	**-6.4**	**-1.7**	**0.1**
	Inventories			0.0	0.3	-0.1	0.1	**0.0**	**0.0**	**0.0**
	Net exports			-0.4	-1.4	-0.9	1.4	**2.8**	**1.3**	**0.7**
Employment				2.1	3.3	2.8	-0.6	**-6.7**	**-2.5**	**-0.1**
Unemployment rate (a)				14.0	8.5	8.3	11.3	**18.0**	**19.7**	**19.8**
Compensation of employees/f.t.e.				4.0	4.0	4.5	6.1	**3.7**	**1.1**	**1.2**
Unit labour costs whole economy				3.1	3.3	3.8	4.6	**0.4**	**-1.0**	**0.3**
Real unit labour costs				-0.8	-0.8	0.5	2.0	**0.2**	**-1.3**	**-0.7**
Savings rate of households (b)				-	-	10.6	12.9	**18.8**	**17.3**	**16.5**
GDP deflator				4.0	4.1	3.3	2.5	**0.2**	**0.3**	**1.1**
Harmonised index of consumer prices (HICP)				-	3.6	2.8	4.1	**-0.3**	**1.6**	**1.6**
Terms of trade of goods				0.4	0.6	0.1	-2.3	**4.4**	**-1.9**	**-0.6**
Trade balance (c)				-4.5	-8.4	-8.6	-7.9	**-4.2**	**-3.8**	**-3.3**
Current-account balance (c)				-2.9	-9.0	-10.0	-9.5	**-5.1**	**-4.6**	**-4.5**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-2.0	-8.4	-9.6	-9.1	**-4.7**	**-4.0**	**-4.0**
General government balance (c)				-2.7	2.0	1.9	-4.1	**-11.2**	**-9.8**	**-8.8**
Cyclically-adjusted budget balance (c)				-2.3	1.6	1.2	-4.4	**-9.6**	**-7.8**	**-7.0**
Structural budget balance (c)				-	1.6	1.2	-4.1	**-8.9**	**-7.8**	**-7.0**
General government gross debt (c)				56.5	39.6	36.2	39.7	**53.2**	**64.9**	**72.5**

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

10. FRANCE
Edging towards recovery

Storm successfully weathered; potential growth in need of improvements in the coming years

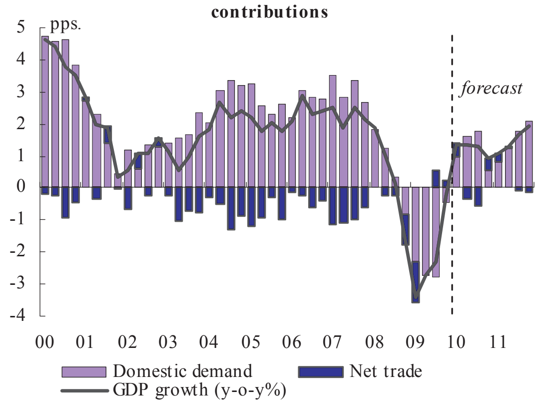
In 2009, the French economy suffered a sharp downturn. The recession was triggered by the free fall in world trade and the financial crisis, as well as their impact on credit conditions and confidence. GDP contracted for four quarters in a row from mid 2008 to the first quarter of 2009, the largest drops being registered in the last two quarters (-1.5% and -1.3% q-o-q respectively). The cumulative loss in GDP over this period reached 3.4%. France came out of the recession in the second quarter of 2009 as GDP rebounded, growing respectively by 0.3%, 0.2% and 0.6% in the last three quarters of 2009. All in all, the contraction of the French economic activity was -2.2% in 2009. Still, France performed much better than the euro-area average as it was relatively less affected by the crisis than its neighbours. This was mainly due to the resilience of private consumption, the relatively low degree of openness of the economy, and the limited size of the manufacturing sector.

Fiscal policy and monetary accommodation contained the economic downturn and added to the sizeable impact of automatic stabilisers. Specifically, the recovery plan got underway in the second quarter of 2009, and succeeded in boosting purchasing power and households' consumption. It amounted to around 1¼% of GDP for 2009-10. Besides, cash-flow support to businesses probably kept numerous companies afloat and limited the impact of the downturn on the French production system. Notwithstanding this, the need to foster potential growth in order to fully benefit from the upcoming recovery is high on the agenda. Indeed, before the recession, French economic performance lagged behind the euro-area average, and good performance during the downturn does not rule out a sluggish recovery, also since the low degree of openness limits the impetus stemming from a rebound of external demand. Reforms aimed at addressing supply-side weaknesses, as well as increasing the utilisation of labour would help the economy enter a virtuous circle by stimulating economic activity and alleviating the challenges facing public finances.

The role played by automatic stabilisers and households' expenditure in the downturn

The resilience of private consumption during the recession, which posted positive growth of above ¾% in 2009, had a stabilising effect on economic activity, whereas in many neighbouring countries households' expenditure shrank and amplified the downturn. Indeed, even if real disposable income growth was almost halved compared to 2008, it remained in positive territory and close to 2% in 2009. The slowdown of earned income, notably due to the substantial rise of unemployment and the recourse to short-time work, and the fall in property income were more than offset by the built-in stabilisers (increase in public transfers and decrease in taxes) and the stimulus measures of the recovery package (payment of one-off bonuses) in conjunction with the drop in inflation. In particular, net cash benefits (social benefits minus taxes) were the key contributor to the growth of households' disposable income in 2009. At the same time, private consumption was successfully boosted by the car-scrapping premium which was part of the stimulus plan. This plan provided rapid support for activity in the short term and attenuated the shock. The good performance of households' consumption in 2009 can thus mostly be explained by temporary factors which can have but a limited impact in the coming quarters.

Graph II.10.1: **France - GDP growth and contributions**



In 2009, the plunge in external demand triggered huge drops in exports, notably of manufactured goods, and in productive investment, both by double digit figures. The large fall in demand, the need for firms to strengthen their balance sheets, and the tight credit conditions also produced a significant reduction in stock building which contributed for more than half of the fall in GDP. All in all, in line with the declining domestic demand, imports fell markedly; thus net trade imposed a rather small drag on growth. The last quarter of 2009 witnessed growth in *trompe l'œil* style: thanks to slightly improved prospects, destocking slowed markedly, thus strongly contributing to growth, while at the same time private consumption surged as households advanced their car purchases in view of the upcoming reduction of the car-scrapping premium.

Uneven recovery in 2010, gaining strength in 2011

The temporary factors, which boosted households' disposable income and private consumption in 2009, will gradually disappear in the course of 2010. Purchasing power growth will be sharply reduced compared to 2009. The upturn in earned income is unlikely to offset the slowdown in social benefits and the acceleration in consumer prices. In particular, social security benefits are expected to slow down in line with unemployment benefits as the labour market is set to deteriorate less sharply than in 2009 and no one-off bonuses are planned for 2010 in the recovery package. The outlook for households' wealth is not bright: uncertainty prevails in both the real-estate and the stock market. Besides, the car-scrapping premium is being steadily reduced and will expire by end-2010. A backlash on car purchases is thus expected with a negative impact on households' expenditures. All in all, due to the weakness of real disposable income and the after effects of the car-scrapping premium, private consumption growth is likely to be feeble and even negative in the summer. It will thus give little support to the economic activity in the coming quarters. In addition, as the global economy will grow moderately, economic activity in France will continue to recover softly in 2010, with GDP growing by around 0.3% each quarter.

Production seems to have bottomed out at the end of the year, notably thanks to temporary measures in favour of the automotive industry in France and in other EU countries, like Germany. This rebound seems to be gaining strength as, according to business leaders questioned in April, the industrial economic situation is still improving and getting closer to its historical trend. However, production capacities remain clearly under-utilised. Although credit conditions seem to have started to ease, credit demand by companies has not yet taken off. Fiscal measures and in particular the cancellation of the business tax are likely to provide limited support to productive investment. All in all, after having sharply dropped in 2009, productive investment growth is set to gradually ease and start increasing in quarterly terms from mid-2010, but it would remain negative on average in 2010. As regards investment in construction, the recently observed upturn in permits and construction starts, together with the slight contraction of stocks of unsold homes seem to indicate a gradual recovery of investment in housing. In the same way, public investment will support the construction activity: indeed, part of the public spending scheduled for 2009 in the recovery plan has been delayed. All in all, growth in investment in construction is expected to be negative again in 2010, but less so than in 2009.

In 2011, quarterly GDP growth is projected to be slightly above potential as the output gap closes gradually. Economic activity is expected to expand by 1.5% on average, supported by domestic demand.

Headline inflation declined markedly in 2009 and was close to zero on average (0.1%) due to the fall in commodity prices and weak demand. Under the assumption of higher oil prices and gradually recovering demand, inflation is projected to rise to 1.4% in 2010 and 1.6% in 2011. In line with the profile for wage costs, core inflation is expected to first fall below 1% in 2010 and then slowly increase to 1.4% in 2011.

Several uncertainties surround this scenario. On the positive side, a more vigorous global recovery would boost the demand for French products, leading to a significantly positive contribution of exports to growth. Negative risks are linked to domestic demand as the disappearance of national car-scrapping allowances could imply a sharper drop in household car purchases, but also impact more negatively the French automotive industry.

Benefitting from the expected pick-up in world demand

While France's relatively low degree of trade openness has helped to weather the storm, without some structural adjustment, the French economy may not fully benefit from the foreseeable pick-up of world trade. The combination of rather sustained domestic demand, feeding in turn relatively dynamic imports, together with continuously declining market shares could lead to increasing external imbalances and a sluggish recovery. Additionally, the geographic specialisation of France's exports is not favourable in the current context: 70% of its exports go to Europe, which is expected to grow at a much slower pace than emerging economies and Asia (the proportion of French exports going to Asia – 10% – is half that of Germany, for instance). In the short run, French exports are set to suffer also from the phasing out of stimulus plans in other countries which sustained car purchases from French manufacturers in particular.

Net trade has hampered French growth in a significant way over the last few years. This can be explained on the basis a series of weaknesses on the supply side. A decomposition of French exports clearly points to the medium-high technology positioning of French products, which, together with relatively low investment in R&D and poor performance as regards high-skill education, is placing the country in a situation of innovation follower. Against this background, French exporters have reduced their profit margins in order to contain the loss in terms of price competitiveness. However, compressed profit margins have been insufficient to limit the rapid loss of market shares, given the pressure on prices from competitors in emerging economies. In addition, France's net exports are held back by the size and the number of exporting firms. For a large majority of firms, exports represent a very limited share of their turnover, contrary for example to German companies.

Increasing labour utilisation – key for a successful recovery

As a result of the strong deterioration in economic activity, the French labour market adjusted sharply. Temporary employment was hit first, in particular in the industrial and construction fields, due to the automotive crisis, the temporary closing of plants, as well as with the reversal in the housing market. As of end 2008, labour shedding spread to all economic sectors. In 2009 as a whole, employment in the market sector declined by 2.2% and 70% of job losses were recorded in the industrial and construction sectors. Job destruction is set to continue throughout 2010, although at a clearly slower pace (-0.7%). In 2011, the French economy should create some jobs again. As the labour force is expected to rise slightly over the forecast horizon, due to an increasing population at working age, the unemployment rate is likely to increase until end 2010, reaching almost 10½%, three percentage points more than before the beginning of the downturn. The unemployment rate is then expected to improve marginally in the course of 2011 in line with the expected recovery.

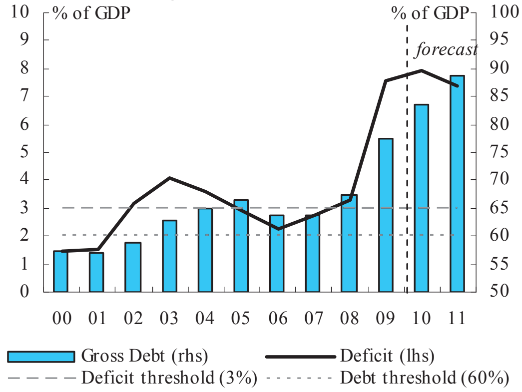
As a consequence of continued job losses, the employment rate will decrease again, to below 64% in 2010. This could add to the historically insufficient utilisation of labour, which is one of the main bottlenecks of the French economy. Poor labour-market functioning in France manifests itself in a rather low participation rate at both ends of the age spectrum (young and older workers), a high unemployment rate, and a low number of average hours worked. Future increases in the minimum wage could also factor in the need to ensure wage differentiation at the lower end of the wage scale. During the crisis, the unemployment rate of the young has jumped from an already high level compared to European standards (24.4% in 2009 from 19.4% in 2007, compared to 15.4% in the EU as a whole). Additionally, it seems that many employers are currently actively encouraging early retirement. Furthermore, tax cuts on overtime hours may incite employers to favour overtime over new recruitment when the recovery is back on track and thus delay job creation. Finally, the re-integration of the low-skilled and the young into the workforce after the crisis is a major challenge. A successful response would avoid permanent destruction in human capital and a durable rise in long-term unemployment.

Deficit to improve in 2011, but debt to approach 90% of GDP

The deficit increased significantly in 2009 and reached 7.5% of GDP, after 3.3% in 2008. This deterioration reflects the working of automatic stabilisers as a result of the economic downturn, as well as the impact of the fiscal package in line with the EERP (European Economic Recovery Plan), which is estimated at 1.1% of GDP. The deficit is expected to further increase in 2010 to 8% of GDP in line with the latest official forecast. This is notably due to the rise in social benefits related to continued job losses and the increase in interest payments. The balance of discretionary measures for 2010 should be neutral: the partial phasing out of the stimulus package (from 1.1% of GDP to 0.4%) together with some further consolidation measures of around 0.1% of GDP (mostly the increase in taxes included in the social security budget) would be compensated by new stimulus measures included in the budget for 2010 amounting to 0.7% of GDP (among which the reform of the local business tax) and by measures stemming from a public loan (*Emprunt national*) amounting to around 0.1% of GDP. A reversal of the deterioration of public finances is anticipated for 2011, mainly due to the complete withdrawal of the fiscal package in line with the EERP on top of the phasing-out of the transitory impact of the reform of the local business tax. The measures stemming from the previously mentioned public loan would worsen the deficit by another 0.1% of GDP.

The debt-to-GDP ratio is foreseen to increase continuously throughout the forecast horizon, eventually reaching 88.6% in 2011. This rise is mainly due to the high expected deficits. The public loan is anticipated to increase the general government debt by around 0.3% of GDP in 2010 and by another 0.2% of GDP in 2011 (including a 0.1% of GDP impact on the deficit in both 2010 and 2011). The sharp increase in debt-service requirements due to the deterioration of public finances could crowd out more productive expenditure necessary to stimulate growth, which underlines the importance of fiscal consolidation.

Graph II.10.2: **France - General government gross debt and deficit**



The French authorities announced that the consolidation strategy would mostly rely on measures aimed at curbing expenditure growth at all sub-government levels. This consolidation strategy would build on the outcome of a conference on public finances organised in January 2010 with the aim of addressing the significant deterioration of French public finances. Several working groups were set up to, *inter alia*, consider new budgetary rules and propose new reforms, notably aimed at further curbing the evolution of health-care spending, or at better controlling local expenditures.

Table II.10.1:

Main features of country forecast - FRANCE

		2008		Annual percentage change						
		bn EUR Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		1950.1	100.0	1.9	2.2	2.3	0.4	**-2.2**	**1.3**	**1.5**
Private consumption		1114.1	57.1	2.0	2.4	2.5	1.0	**0.8**	**0.6**	**1.3**
Public consumption		451.6	23.2	1.5	1.3	1.5	1.2	**1.6**	**1.4**	**0.3**
Gross fixed capital formation		427.2	21.9	2.0	4.1	6.5	0.6	**-6.9**	**-2.4**	**1.9**
of which : equipment		119.9	6.1	3.2	2.2	9.5	2.7	**-10.6**	**-1.2**	**2.7**
Exports (goods and services)		515.6	26.4	5.2	4.8	2.6	-0.2	**-11.5**	**4.7**	**5.1**
Imports (goods and services)		563.8	28.9	5.3	5.6	5.4	0.8	**-9.8**	**4.1**	**4.5**
GNI (GDP deflator)		1963.0	100.7	2.0	2.6	2.4	0.0	**-2.3**	**1.3**	**1.4**
Contribution to GDP growth :	Domestic demand			1.9	2.5	3.1	1.0	**-0.7**	**0.2**	**1.2**
	Inventories			0.0	0.0	0.0	-0.3	**-1.3**	**1.1**	**0.2**
	Net exports			0.0	-0.3	-0.8	-0.3	**-0.2**	**0.1**	**0.0**
Employment				0.6	1.0	1.5	0.6	**-1.3**	**-0.7**	**0.3**
Unemployment rate (a)				10.1	9.2	8.4	7.8	**9.5**	**10.2**	**10.1**
Compensation of employees/f.t.e.				2.6	3.2	2.5	2.7	**1.8**	**1.6**	**1.7**
Unit labour costs whole economy				1.2	2.0	1.8	2.8	**2.8**	**-0.4**	**0.5**
Real unit labour costs				-0.3	-0.3	-0.7	0.3	**2.0**	**-1.2**	**-1.0**
Savings rate of households (b)				-	-	15.3	15.1	**16.3**	**16.5**	**16.5**
GDP deflator				1.5	2.4	2.5	2.5	**0.8**	**0.7**	**1.5**
Harmonised index of consumer prices (HICP)				1.8	1.9	1.6	3.2	**0.1**	**1.4**	**1.6**
Terms of trade of goods				0.0	-0.3	1.1	-1.8	**3.7**	**-2.3**	**0.1**
Trade balance (c)				0.5	-1.5	-2.0	-2.7	**-2.2**	**-2.7**	**-2.6**
Current-account balance (c)				0.8	-1.8	-2.3	-3.3	**-2.9**	**-3.3**	**-3.6**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				0.8	-1.8	-2.2	-3.3	**-3.0**	**-3.4**	**-3.6**
General government balance (c)				-3.5	-2.3	-2.7	-3.3	**-7.5**	**-8.0**	**-7.4**
Cyclically-adjusted budget balance (c)				-3.3	-3.0	-3.7	-3.7	**-6.2**	**-6.6**	**-6.2**
Structural budget balance (c)				-	-3.2	-3.8	-3.8	**-6.2**	**-6.2**	**-6.2**
General government gross debt (c)				56.7	63.7	63.8	67.5	**77.6**	**83.6**	**88.6**

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

11. ITALY

The recovery slowly gains strength

Exports and investment drove the steep fall in real GDP in 2009

The global economic and financial crisis produced a contraction in Italy's real GDP between the second quarter of 2008 and the second quarter of 2009. The GDP outturn in 2008-09 was more negative than the euro area average. Real GDP contracted in 2008 by 1.3%, slightly more than estimated earlier by the statistical office. In 2009, real GDP fell by 5% on an annual basis. In quarterly terms, the contraction was particularly pronounced in the first quarter, while it eased in the second. Growth rebounded in the third quarter, but the fourth quarter is reported to have posted a fresh contraction.

Plummeting global demand seriously affected Italy's exports. Despite some improvement in the second half of the year, export volumes declined by 19% in 2009 as a whole. Demand for goods across most manufacturing sectors was hard hit. Exports of services dropped as well, although the relatively more moderate fall in tourism helped to limit the decline. At the same time, the significant fall in domestic demand in 2009, and in particular the substantial retrenchment in investment, led to a sharp decline in imports. However, this was not enough to fully offset the export drag on the economy, implying a significant negative contribution of net exports to the change in real GDP.

The plunge in external demand triggered a sharp contraction in investment, in particular in the first half of 2009. For the year as a whole, investment expenditure fell by 12% in volume as the huge contraction of private investment was only partly offset by the acceleration of government capital spending.

Equipment investment dropped very sharply in the first half of the year on the back of historically low capacity utilisation, deteriorating profits and tighter financial conditions, but subsequently stabilised owing to the incipient global recovery. Investment in residential building declined markedly as well, while other construction investment fell more moderately thanks to the support from public spending. The large fall in demand also entailed a significant reduction in firms' inventories in 2009 as a whole; however, in the fourth quarter improved prospects led to a positive contribution from inventories to the change in real GDP.

The decline in private consumption was relatively moderate, also thanks to the resilience of the labour market and measures taken by the government to support household income. Household spending contracted by 1.7% in 2009 as a whole. However, the profile of private consumption was uneven: a sharp fall in the first quarter was followed by a moderate recovery in the second and third quarters – also due to incentives supporting the purchase of energy-efficient durable goods, in particular vehicles – and finally by another marginal contraction in the fourth quarter.

Private consumption and exports sustain a slow-paced recovery

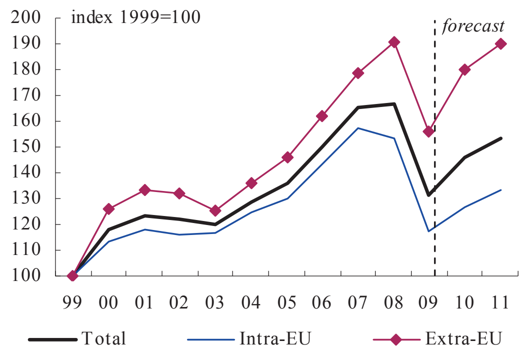
Business and consumer confidence indicators and hard data on industrial production point to strengthening economic activity in the first half of 2010. Thereafter the recovery is expected to decelerate somewhat, due to the fading out of some fiscal incentives to domestic demand. Overall, real GDP growth is forecast to be mild in 2010 and to gain some strength in 2011, largely in line with the euro-area average performance over the forecast horizon. A swift and durable recovery in productivity growth would be key to enhancing competitiveness and raising the country's low potential GDP growth.

Private consumption is expected to be the main driver of growth in 2010. It is set to receive a positive impulse from reduced uncertainty, improved financial market conditions and a slight increase in real disposable income. In 2011, private consumption is bound to benefit from the expected improvement in labour-market conditions.

Investment is projected to remain weak in 2010, mainly due to a still negative outlook for construction, which is also affected by an expected decline in public investment after the acceleration recorded in 2009. Under the assumption of better housing-market conditions, investment in construction is projected to pick up in 2011. Regarding equipment investment, a tax break ending in June 2010 and a gradual easing in credit conditions, together with improved demand prospects, are set to provide a positive impulse. Low capacity utilisation in industry, however, is expected to affect new investment plans.

Exports are expected to return to positive growth over the forecast period, benefitting from the strengthening global recovery. Imports are set to grow slightly less than exports in 2010-11. In both years, net exports are projected to make a small positive contribution to real GDP growth, while net trade in goods and services is set to record a somewhat higher deficit because of worsened terms of trade.

Graph II.11.1: **Italy - Exports of goods by regions (values)**



An upside risk to the GDP growth projections is the possibility of a faster rise in world trade, which could further boost exports and subsequently investment. On the downside, if the negative effects of the crisis on employment prove more persistent than expected, private consumption could be less dynamic.

Geographical trade patterns prevent a stronger pick-up in exports

The geographical pattern of exports prevents Italy from fully reaping the benefits of the ongoing recovery in global trade. The outlook for Italy's exports mainly depends on growth prospects in its euro-area partners and does not benefit much from the more vigorous growth outlook for emerging markets. Indeed, around 44% of Italian exports are directed to the euro area, while barely 2% go to China, although this share is increasing.

While the Italian economy has lost cost and price competiveness over the last decade, other specific factors may reduce the potential for boosting exports to emerging countries. Gaining or increasing access to those fast-growing markets, especially in Eastern Asia, usually involves high initial costs related to setting up new distribution networks and investing in intangible assets such as product characteristics, patents and brand reputation. Indeed, over the last few years, Italian firms that were able to compete in those countries pursued a strategy based more on product quality and innovation than on price competitiveness. However, the small size and undercapitalisation of many Italian firms make it difficult to strengthen Italy's position in emerging markets in the short term.

The crisis had a relatively limited impact on the labour market

In 2009, employment in full-time equivalents declined by 2.7%. The wider use of the wage supplementation scheme (CIG), whereby employees stop working but keep their job and a reduced income, resulted in some labour hoarding. In 2009 the scheme was temporarily extended to additional categories of workers through government funding. The effect of CIG is visible when comparing hours worked with headcount employment. According to national accounts figures, the overall number of hours worked by employees declined by 2.5% in 2009, significantly more than headcount employment (-1.3%). The difference is even more pronounced in the manufacturing sector, where CIG is widely used (-7.1% in hours worked by employees compared with -4.4% in headcount).

The diverging dynamics of real GDP and employment in 2009 intensified the fall in productivity already underway since 2008. In 2010, while real GDP is forecast to gradually recover, further job losses are expected because of the assumed lagged impact of the crisis on the labour market. The forecast recovery in output is expected to translate first into a rebound of productivity, then into an expansion of hours worked and only at a later stage in additional headcount employment, which is set to start rising only in 2011.

Reflecting employment developments, the unemployment rate has increased only moderately so far and reached 7.8% on average in 2009. It stood at 8.5% in February 2010 and is set to continue increasing over 2010 and to stabilise in 2011.

Wage growth per full-time employee outpaced inflation in 2009, also because of the contract renewals incorporating past inflation trends. In 2010-2011, the newly-reformed bargaining framework is expected to start being applied. Contractual wages are thus set to increase in line with projected inflation excluding imported energy goods, while the weak labour market conditions and productivity developments will leave little scope for further increases at the level of firms or sectors. As a result, unit labour costs are expected to increase only moderately after the recent steep rises.

Headline inflation declined markedly in 2009, to 0.8% on average, due to the fall in energy prices and weak demand. It picked up in the last quarter of 2009, as the favourable base effects from energy prices started to fade out. Under the assumption of higher oil prices and recovering demand, inflation is projected to increase to 1.8% in 2010 and 2% in 2011. After falling to 1.6% in 2009, core inflation is anticipated to remain stable in 2010 and to increase again in 2011, to just below 2%.

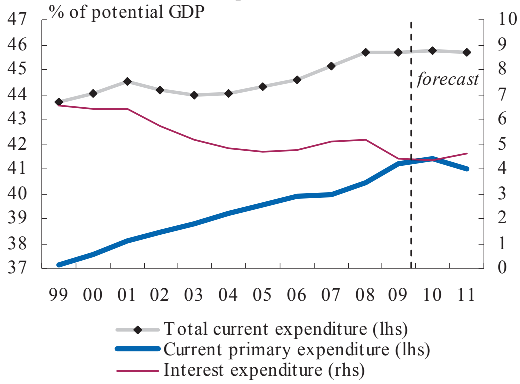
Higher deficit reflecting the slump in economic activity

Throughout the crisis, in a context of persistent risk aversion in the sovereign-bond markets, the government pursued a cautious fiscal policy in view of Italy's fragile public finances, in particular its very high public debt. Still, the economic downturn had a deep budgetary impact and the general government deficit widened to 5.3% of GDP in 2009 from 2.7% in 2008. Sizeable deficit-reducing one-off measures (0.6% of GDP, up from 0.2% in 2008) and a significant fall in interest expenditure (4.7% of GDP from 5.2% in 2008) due to historically low short-term interest rates helped limit the budgetary deterioration. The primary balance turned negative in 2009 for the first time since the beginning of the 1990s.

Primary expenditure rose by around 5% in 2009, considerably faster than the 3% planned by the government in the February 2009 stability programme update. The difference is to a large extent explained by the adopted recovery measures within the European Economic Recovery Plan. The marked growth in social transfers reflected both the indexation of pensions to previous-year inflation and discretionary transfers to households, including the extension of CIG. Large increases were also recorded in intermediate consumption, also because of the substantial growth in defence-related expenditure. Overall, current primary expenditure rose by more than 4% in 2009, close to the annual average recorded over the past decade, while capital spending soared by almost 13%, due to a combination of the acceleration in public investment and buoyant capital transfers.

On the revenue side, shrinking tax bases pulled direct and indirect tax revenues down considerably. In addition, personal income taxes were negatively affected by the postponement to 2010 of part of the payment due by small firms and self-employed people in 2009. The fall in current revenue was however alleviated by sizeable one-off capital taxes (0.8% of GDP) related to the revaluation of companies' assets and to the extraordinary tax on repatriated assets illegally held abroad.

Graph II.11.2: **Italy - Government current expenditure**



In the January 2010 stability programme update, the government plans to reduce the 2010 deficit to 5% of GDP, thanks to the expenditure-restraint measures already adopted in summer 2008 as part of a three-year fiscal consolidation package. On the back of lower output growth (0.8% as against 1.1% in the programme), the spring 2010 forecast projects a slightly higher deficit ratio (5.3%). The primary balance is also anticipated to broadly stabilise at the 2009 level. The spring 2010 forecast expects public wage moderation and contained intermediate consumption dynamics to lead to a historically low annual rise in current primary expenditure (2%). Capital expenditure is set to decrease markedly as recovery measures are withdrawn and the additional restraint adopted in 2008 is implemented. Taken together, primary expenditure is thus forecast to increase by only 1% relative to 2009, entailing a ½ pp. reduction as a share of GDP. Benefiting from still low short-term rates, interest expenditure as a share of GDP is expected to decline by 0.1 pp., despite the expanding debt.

The revenue ratio is set to fall by 0.6 pp. of GDP in 2010, mainly because of the expiry of the one-off capital taxes impacting on 2009. On the other hand, the above-mentioned tax postponement from 2009 will boost current direct taxes.

In 2011, the no-policy-change assumption implies that indirect tax revenues are forecast to grow broadly in line with nominal consumption, while the direct tax base is expected to take longer to return to pre-crisis levels, especially in the corporate component. Expenditure dynamics in 2011 are projected to remain contained due to the measures adopted in 2008. Current primary expenditure is thus set to grow moderately, while capital spending keeps falling. Interest expenditure is forecast to rise as a share of GDP, fuelled both by the still increasing debt ratio and the assumed pick-up in interest rates.

As a result, the 2011 deficit, on a no-policy-change basis, is projected to fall slightly to 5% of GDP. The primary balance is set to record a larger improvement, while remaining marginally negative.

After deteriorating in 2009, the structural balance is forecast to improve by around ¼ pp. of GDP in 2010 and, on a no-policy-change basis, to broadly stabilise in 2011.

The gross government debt-to-GDP ratio climbed by almost 10 pps. in 2009 to 115.8%. The bulk of the increase was due to the fall in nominal GDP, the sizeable interest burden, and the negative primary balance mainly related to the working of the automatic stabilisers. Limited capital injections into the banking sector (0.3% of GDP) and further accumulation of liquidity held by the Treasury with the Bank of Italy (0.7% of GDP) added to gross debt.

Table II.11.1:
Main features of country forecast - ITALY

	2008			Annual percentage change						
	bn EUR Curr. prices	% GDP		92-05	2006	2007	2008	2009	2010	2011
GDP	1567.9	100.0		1.3	2.0	1.5	-1.3	**-5.0**	**0.8**	**1.4**
Private consumption	929.1	59.3		1.3	1.3	1.1	-0.8	**-1.7**	**0.8**	**1.3**
Public consumption	317.3	20.2		0.9	0.5	0.9	0.8	**0.6**	**0.1**	**0.1**
Gross fixed capital formation	324.9	20.7		1.4	2.9	1.7	-4.0	**-12.1**	**-0.1**	**2.5**
of which : equipment	143.7	9.2		2.0	5.1	3.1	-5.0	**-17.7**	**3.0**	**3.2**
Exports (goods and services)	452.7	28.9		4.3	6.2	4.6	-3.9	**-19.1**	**3.4**	**4.1**
Imports (goods and services)	461.7	29.5		3.8	5.9	3.8	-4.3	**-14.5**	**2.8**	**3.5**
GNI (GDP deflator)	1543.6	98.5		1.4	2.2	1.0	-2.2	**-5.2**	**1.1**	**1.4**
Contribution to GDP growth :	Domestic demand			1.2	1.5	1.2	-1.1	**-3.4**	**0.5**	**1.3**
	Inventories			0.0	0.5	0.1	-0.3	**-0.4**	**0.2**	**0.0**
	Net exports			0.1	0.1	0.2	0.1	**-1.2**	**0.1**	**0.1**
Employment				0.2	1.5	1.0	-0.1	**-2.7**	**-0.7**	**0.4**
Unemployment rate (a)				9.8	6.8	6.1	6.7	**7.8**	**8.8**	**8.8**
Compensation of employees/f.t.e.				3.4	2.7	2.4	3.3	**2.2**	**2.0**	**1.7**
Unit labour costs whole economy				2.3	2.2	1.8	4.5	**4.7**	**0.4**	**0.7**
Real unit labour costs				-0.9	0.3	-0.7	1.7	**2.5**	**-0.9**	**-1.2**
Savings rate of households (b)				-	-	14.7	14.7	**14.0**	**13.7**	**13.6**
GDP deflator				3.2	1.8	2.6	2.8	**2.1**	**1.3**	**1.9**
Harmonised index of consumer prices (HICP)				3.1	2.2	2.0	3.5	**0.8**	**1.8**	**2.0**
Terms of trade of goods				-0.2	-3.4	1.5	-2.8	**7.6**	**-2.3**	**0.3**
Trade balance (c)				1.9	-0.7	0.2	-0.1	**0.1**	**-0.1**	**0.0**
Current-account balance (c)				0.6	-2.0	-1.8	-3.1	**-3.2**	**-3.2**	**-2.9**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				0.7	-1.9	-1.7	-3.1	**-3.1**	**-2.9**	**-2.6**
General government balance (c)				-4.8	-3.3	-1.5	-2.7	**-5.3**	**-5.3**	**-5.0**
Cyclically-adjusted budget balance (c)				-4.5	-4.4	-3.0	-3.3	**-3.3**	**-3.6**	**-3.7**
Structural budget balance (c)				-	-4.0	-3.2	-3.5	**-4.0**	**-3.7**	**-3.6**
General government gross debt (c)				112.1	106.5	103.5	106.1	**115.8**	**118.2**	**118.9**

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

12. CYPRUS

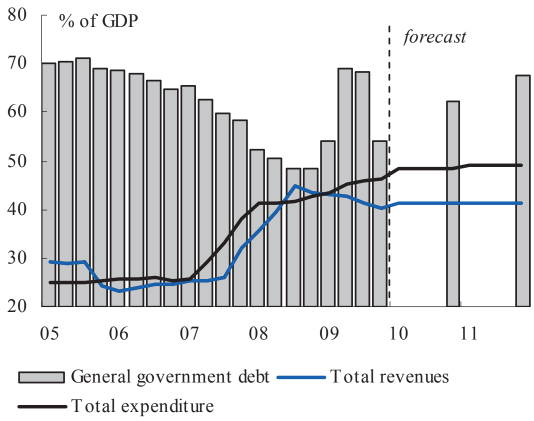
Economic adjustment amid imbalances

A decade of solid growth ended

More than a decade of sustained and strong economic expansion in Cyprus came to an end in 2009. For the first time in 35 years, economic activity in Cyprus fell by 1¾%. Weak domestic demand and an adverse external environment weighed strongly on growth. In particular, high household indebtedness together with tighter lending conditions, a worsening labour market outlook and negative confidence effects led to a decline in private consumption. In parallel, investment recorded a strong correction, amidst a fall in foreign demand for housing, low capacity utilisation and the restructuring of corporate balance sheets. Government consumption was the only demand component supporting economic activity. The crisis has highlighted the accumulation of a high external imbalance, a particularly oversized housing sector and competitiveness losses. These factors set the stage for the structural adjustment of the economy.

The downturn took a heavy toll on public finances. The government deficit outturn was higher than expected and reached 6.1% of GDP in 2009. It is projected to remain above 7% of GDP over the forecast period, reflecting both reduced revenues from the fading away out of the asset boom and higher expenditures. The debt ratio reversed its declining trend and reached 56¼% of GDP.

Graph II.12.1: **Cyprus - Public finances**



The labour market also suffered from the recession, especially in the labour–intensive sectors. The unemployment rate jumped to 5.3% in 2009 from 3.6% a year earlier.

As a response to the crisis, the Cypriot government adopted fiscal stimulus and structural measures amounting to 1½% of GDP, in line with the EERP. The stimulus package was essentially addressed to construction (1¼% of GDP) and tourism (¼% of GDP). Some support measures without a direct impact on the deficit were also targeted at households. Regarding the financial sector, Cypriot banks have not been exposed to toxic assets. However, in order to underpin confidence in the banking system, the government raised the guarantee on bank deposits and issued treasury bills to provide liquidity to the banking system.

Weak growth weighs on the labour market

The outlook features a further shrinking, although to a lesser extent, of the economy in 2010 with activity projected to decline by almost ½%. This is to be followed by a moderate recovery of 1¼% in 2011 as subdued private consumption and investment in tandem with sluggish demand from Cyprus' main trading partners weigh on growth. Specifically, private consumption growth is expected to contract further in 2010 and grow mildly in 2011, reflecting a worsening labour market outlook, including weaker wage growth. A high household debt burden, tight financial conditions and downbeat consumer sentiment are also impinging on consumption. Similarly, prospects for gross fixed capital formation are likely to remain subdued over the forecast period. Given the economic outlook of Cyprus' main trading partners, foreign demand for dwellings by non-residents is likely to remain weak. Domestic demand for housing and activity in real estate is also expected to stay subdued, on the back of high indebtedness and high growth of prices in recent years. Although public spending on infrastructure projects is forecast to support investment somewhat, it is unlikely that it would be sufficient to fully offset the impact of the fall in housing demand on total investment. Investment in equipment, largely associated with construction, is set to follow a similar trend to the latter.

As regards the external sector, imports are projected to shrink in 2010 and resume growth only in 2011 as domestic demand remains muted. Exports of both goods and services, mainly business services, are set to pick up in view of recovering trade flows. All in all, the contribution of net exports to GDP growth is expected to be positive in 2010.

The weak economic outlook is expected to weigh on the labour market in 2010, particularly in labour-intensive sectors such as construction and tourism. Accordingly, employment is projected to decline while the unemployment rate is set to rise to historically high levels, reaching about 7% in 2011.

Overall, the balance of risks appears to be neutral. Higher total demand might materialise due to a faster growth of the economies of Cyprus' major trading partners. Also, a reduction in banking lending rates could underpin private consumption and soften the adjustment of the housing sector. On the negative side, lower-than-expected external demand would certainly weigh on economic activity more than projected in the baseline scenario. At the same time, a tightening of credit conditions coupled with high indebtedness of private agents could lead to a sharper fall in investment and consumption. Furthermore, in a context of weak growth in both real and nominal terms, the external constraint becomes more severe. Eventually, this could lead to either higher cost of debt-financing or higher savings, in each case adversely affecting economic activity.

High external imbalance weighs on recovery

Within this economic outlook, the challenge for the Cypriot economy is to return to a sustained convergence path. This could be tackled more successfully if the recovery were to lead to the correction of the internal and external imbalances, in a context of higher potential growth.

Due to the contraction of economic activity in 2009 there was an important, yet partial, reduction of the current-account deficit. However, it is still set to remain relatively high. In particular, the current-account deficit is still likely to reach 7¼% of GDP by 2011. As a result, the current-account imbalance is likely to weigh on economic growth over the medium-term. High public sector dissavings would need to be financed by either foreign debt or higher domestic private savings. Thus, the adjustment of the current-account deficit would require either higher cost of debt-financing or higher savings from the private sector. The latter would imply lower output growth through crowding-out private consumption or investment. In the medium term, the deficit is set to continue to improve but at a much more moderate rate, reflecting lower GDP growth.

The current-account imbalance to a certain extent reflects a deterioration of competitiveness, partly due to a weak response of wages in both the public and private sectors to the current recession. In particular, nominal compensation per employee is estimated to increase by about 3½% in 2010, which exceeds projected productivity growth. Furthermore, even with the prospect of no or minimal wage growth in the forthcoming sectoral collective agreements, the wage drift and indexation (Cost of living allowance; COLA), which adjusts wages based on inflation in the previous 6 months, would contribute to a sustained wage growth. In line with slowing activity, productivity growth is expected to slump. This, coupled with a minor acceleration in wages, is set to keep unit labour costs rising modestly, yet higher than the euro area. All in all, the disassociation between wages and developments in productivity is undermining the competitiveness of the Cypriot economy.

Although the inflation rate was very low in 2009 (0.2%), a rapid return to the trend rate of 2½% is envisaged over the forecast horizon. A powerful base effect coupled with developments in oil prices, on which Cyprus is highly dependent, are the main reasons behind this. Core inflation should remain above the euro area average, mainly reflecting pressures in product markets, especially services.

Deterioration of public finances

Public finances in Cyprus have deteriorated dramatically, largely as a result of the crisis that affects the country with a lag compared to rest of the EU. They are likely to face a relatively prolonged period of less tax-rich growth composition linked to the fading away of the asset boom. The projected increase of expenditures for this year and next largely reflects the functioning of automatic stabilisers and the continuation of rising growth trends of current primary expenditure, particularly of the continuation of untargeted social transfers.

While the Cypriot budget balance was comfortably in surplus in 2007-08, it moved into a deficit of 6.1% in 2009, on account of both lower-than-expected revenue and higher-than-planned expenditure. Public finances appear to have worsened beyond what would have been expected to result from the cyclical downturn and the fiscal stimulus measures. On the one hand, the slowdown of activity coupled with the fading impact of the asset boom and reduced corporate profitability weighed heavily on tax receipts. Only social contributions posted positive growth, benefiting from the rise of contribution rates adopted in the first half of the year. On the other hand, current expenditure continued to rise, despite the fall in interest paid. In particular, expenditure growth was driven by an increase in the public wage bill and social transfers. Moreover, social cohesion measures and the anticipated increase in the number of new retirees, following the gradual extension of the retirement age from 60 to 63 years introduced in mid-2005, contributed to an acceleration of social outlays. Public investment also increased significantly, due to the stimulus package.

The revised national budgetary target for 2010 is a deficit of about 6% of GDP. This compares with the earlier deficit target of 4.5% of GDP in the 2010 budget law. However, the budget's target was planned on the basis of an estimated deficit outcome for 2009 of 2.9% of GDP. Given that the final outturn was a deficit of 6.1% of GDP, the budget law would imply an even higher deficit for 2010. The government contemplates a series of supplementary measures that could be taken during the course of the year as a means to stabilise the budgetary deficit in 2010 at last year's level. These would include measures aimed at freezing public sector employment and wage growth, targeting social transfers, reduce operational expenditures, fighting tax evasion, a real property amnesty (one-off), the application of the minimum excise duties on petroleum products prescribed by the acquis. This forecast projects the budgetary deficit to reach about 7% of GDP in 2010, reflecting a somewhat gloomier macroeconomic scenario and a more prudent assessment of measures on the revenue and expenditure sides. In particular, this forecast includes only those measures which were adopted up to the cut-off date. Measures which are still under discussion with the social partners, with an uncertain outcome, or measures with no information on the modalities or the timing of implementation are not incorporated in this forecast.

Based on the customary no-policy-change assumption, the deficit is set to increase further to 7¾% of GDP in 2011. This projected fiscal deterioration is driven by rising expenditure, which is only partly offset by modestly increasing revenues. With weak GDP growth and an increasing deficit, the debt-to-GDP ratio is likely to rise and exceed 60% of GDP by 2011.

Table II.12.1:

Main features of country forecast - CYPRUS

		2008		Annual percentage change						
	mio EUR	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		17247.8	100.0	4.4	4.1	5.1	3.6	**-1.7**	**-0.4**	**1.3**
Private consumption		11981.4	69.5	-	4.7	9.4	8.4	**-3.0**	**-1.1**	**2.1**
Public consumption		3091.8	17.9	-	7.3	0.3	6.2	**5.8**	**1.6**	**1.5**
Gross fixed capital formation		4025.6	23.3	-	10.2	13.4	8.6	**-12.0**	**-12.9**	**-3.8**
of which : equipment		1162.2	6.7	-	15.5	11.9	19.7	**-19.5**	**-12.0**	**-4.0**
Exports (goods and services)		7720.4	44.8	-	3.5	6.1	-2.1	**-11.8**	**0.6**	**3.3**
Imports (goods and services)		9701.6	56.2	-	6.7	13.3	8.0	**-19.8**	**-1.3**	**2.4**
GNI (GDP deflator)		16125.0	93.5	4.2	3.5	3.9	2.8	**3.2**	**-0.6**	**1.2**
Contribution to GDP growth :	Domestic demand			-	6.3	8.9	8.6	**-4.0**	**-3.2**	**1.1**
	Inventories			-	-0.5	0.3	0.4	**-4.0**	**1.8**	**0.0**
	Net exports			-	-1.7	-4.0	-5.3	**6.8**	**0.9**	**0.3**
Employment				-	1.8	3.2	2.6	**-0.7**	**-0.7**	**-0.2**
Unemployment rate (a)				-	4.6	4.0	3.6	**5.3**	**6.7**	**7.0**
Compensation of employees/head				-	3.0	3.0	3.4	**5.4**	**3.2**	**3.6**
Unit labour costs whole economy				-	0.6	1.1	2.4	**6.6**	**2.9**	**2.1**
Real unit labour costs				-	-2.3	-3.4	-2.3	**6.6**	**0.8**	**-0.3**
Savings rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				3.2	3.0	4.6	4.8	**0.0**	**2.1**	**2.4**
Harmonised index of consumer prices (HICP)				-	2.2	2.2	4.4	**0.2**	**2.7**	**2.5**
Terms of trade of goods				-	4.5	0.6	-2.5	**2.7**	**-1.0**	**0.0**
Trade balance (c)				-	-27.2	-29.7	-32.2	**-24.8**	**-24.6**	**-25.2**
Current-account balance (c)				-	-7.0	-11.7	-17.7	**-8.5**	**-7.1**	**-7.0**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-6.8	-11.7	-17.6	**-8.2**	**-6.8**	**-6.7**
General government balance (c)				-	-1.2	3.4	0.9	**-6.1**	**-7.1**	**-7.7**
Cyclically-adjusted budget balance (c)				-	-1.3	2.5	-0.4	**-5.8**	**-6.3**	**-7.1**
Structural budget balance (c)				-	-1.3	2.5	-0.4	**-5.8**	**-6.3**	**-7.1**
General government gross debt (c)				-	64.6	58.3	48.4	**56.2**	**62.3**	**67.6**

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

13. LATVIA

After the collapse in 2009, stabilisation is in sight

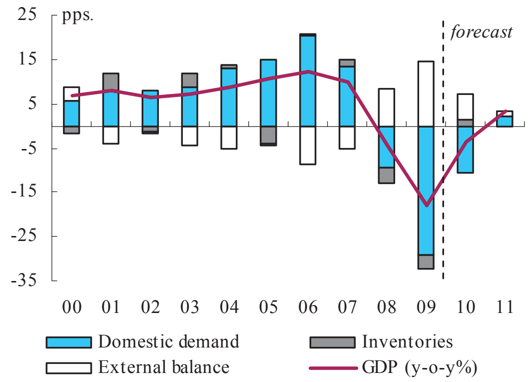
A collapse of demand

For several years before the financial crisis, Latvia registered the highest GDP growth in the EU, driven mainly by a credit-fuelled house-price boom. In contrast, in 2009, Latvia experienced the EU's deepest recession, with output falling by a staggering 18%.(76) The adjustment process that started gradually in 2007 became sharp when Latvia suffered a large export shock following the collapse of global trade in 2008 and funding constraints, linked to the need for financial sector intervention. This need forced the government to turn to international institutional financing and led to credit-rating-agency downgrades. Credit growth in the private sector turned negative in November 2008 and has remained so. The deleveraging process was exacerbated by abruptly tightened lending conditions towards the private sector and a general increase in lending margins on new and outstanding loans, which deepened the downturn on the property market and caused financing difficulties even for firms with viable business models. The provision of international financial assistance supported the Latvian economy with the needed liquidity and helped to stabilise confidence.

After an unprecedented 11% output loss in the first quarter of 2009, GDP fell by a relatively modest 0.4% in the second quarter, but more substantial contractions continued later in the year. Domestic demand was depressed by the high uncertainty about the future, together with tight financing conditions and the direct impact of a large fiscal consolidation. From the second quarter onwards, industrial output and exports started a slow recovery, but the tradable sector is relatively small in Latvia, thus limiting the impact of this favourable development on overall GDP growth.

On the production side, the contraction in 2009 was strongest in hotels and restaurants (-33.9%), the construction sector (-33.6%), and retail and wholesale (-28.7%). Manufacturing output fell by 19.2% (with an improving intra-year profile), as the sector suffered a double-hit from external and internal demand.

Graph II.13.1: **Latvia - GDP growth and contributions**



Confidence is returning

Since hitting an all-time low last March, economic sentiment has been gradually improving. By early-2010, the liquidity situation in the interbank market improved to before-crisis levels and CDS spreads were also falling rapidly, signalling improved market confidence towards Latvia.(77) However, these positive changes have not yet resulted in more lending to the private sector and lending margins remain well above pre-crisis levels, hindering the restructuring of the economy towards the tradable sector. The financial sector is well capitalised after a series of capital increases, but banks expect a further deterioration in the quality of their loan portfolio, which makes them very cautious in taking on new risks.

Retail sales picked up temporarily in the beginning of 2010, reflecting strongly reduced prices during the sales and after the government announced that it would reimburse pension cuts by April to comply with a Constitutional Court decision. Weakness in the labour market, financial deleveraging, looming additional fiscal consolidation measures and the assumed rise in Euribor rates are all expected to hold back domestic demand. On the other hand, exports are projected to grow at a healthy pace, as Latvia's export markets recover and cost competitiveness further improves (see below).

There are recent signs that real-estate investment is slowly restarting, as property prices have stabilised

(76) Caution is needed when interpreting the 2009 statistical figures of Latvia, because the greying of the economy and other rapid structural changes will probably call for large data revisions in the future.

(77) In Q1 2010, both Moody's (Baa3) and S&P (BB) revised the outlook for Latvia's rating from negative to stable.

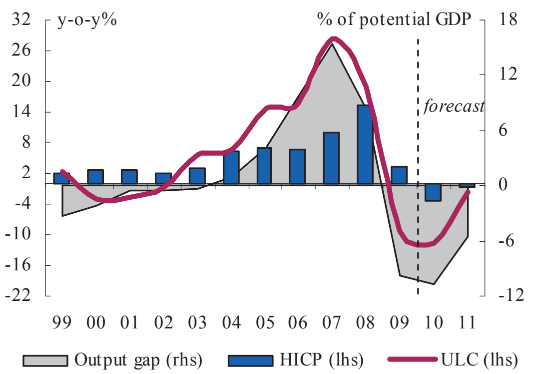
at a level that appears to be in line with long-term local income potential, and construction costs have fallen considerably. The Latvian housing stock is still of relatively poor quality, so there should be a long-term market for appropriately priced real estate. More generally, the recovery of private investment still hinges on a clearer view on public finances and, in particular, future tax policy. Accordingly, some investment decisions might be withheld until after the upcoming parliamentary elections in October 2010. The low absorption of EU structural funds was a concern during 2009, but there was improvement towards the end of the year. Proper budgeting for 2010 is allowing the government to provide resources to proceed with the starting of new projects.

Risks to this scenario are mainly related to the stabilisation of domestic demand and economic confidence. This depends to a great extent on successfully anchoring long-term expectations, for which the implementation of the planned fiscal consolidation by sustaining a tax environment that is attractive for investment is crucial.

External surplus to remain for years

The external balance – substantially negative in the boom years and financed by capital imports associated with the banking sector – reached around 11% of GDP in 2009, and is set to remain in significant surplus over the forecast period. After a persistent increase in the previous years, net external liabilities as a share of GDP are projected to decrease during the forecast horizon.

Graph II.13.2: **Latvia - Output gap, inflation, unit labour cost**



Progress in price and wage adjustment

In 2009, public wages adjusted at a faster pace than in the private sector, as fiscal consolidation efforts concentrated on correcting the large excesses of the boom years. In the private sector, while wages also fell significantly, the adjustment appears to have taken place mainly at the expense of employment, with unemployment rising above 20% and increasing use of part-time work. However, as pointed out by private sector surveys and other research, in reality, wage cuts in the private sector were probably much higher than the official figures. This is partly explained by the role of the large grey economy. A falling participation rate is to continue to absorb some of the rise in the unemployment.

After falling by 12% in 2009, compensation of employees per head is set to fall further in 2010. Similarly, the adjustment in nominal unit labour cost is to continue at an annual pace of over 10% in 2010. Since early-2009, Latvia's external competitiveness position also benefitted from the appreciation of some trade partner currencies. These trends should serve to shift the economy towards the tradable sector.

Consumer prices are set to register further decreases, given the outlook for domestic demand and wages. However, import prices are expected to put a floor under deflation and households will be left to cope with their falling real income by adjusting their expenditure.

Encouraging fiscal outcomes, with still much work ahead

In 2009 the impact of the economic crisis was massive on the revenue side: tax revenues collapsed, falling in nominal terms by one quarter compared to 2008. However, the very restrictive 2009 supplementary budget managed to contain the fiscal deterioration. Expenditure cuts generally held up, at the significant exception of pension reductions, which had to be reversed following a Constitutional Court decision. Overall, the 2009 deficit of 9.0% of GDP complies with the ceiling of 10% recommended by the Council in July 2009. Although the recorded deficit figure is unchanged from the Commission services' autumn 2009 forecasts, it now includes the negative impact of accrued restitution of cuts in pensions, recorded as additional liabilities (-0.5% of GDP); hence, it represents a 0.5% of GDP positive surprise on other budgetary items.

The 2010 State budget adopted by Parliament on 1 December 2009 involves a further discretionary consolidation effort amounting to over 4.2% of GDP, with no significant recourse to one-off measures. The consolidation is distributed fairly evenly between expenditure and revenue. Among the revenue measures there are: an increase of the personal income tax rate, as well as additional taxation of real estate, progressive taxation of car usage, and increased excise duties on gas and tobacco. On the expenditure side, the 2010 State budget introduced significant cuts based to a large extent on structural reforms, while, at general government level, the balance is expected to benefit from wage cuts in local government and targeted reductions of various social allowances.

Despite this very large consolidation effort, the current 2010 general government deficit forecast is slightly above the previously agreed ceiling of 8.5% of GDP recommended by the Council, due to somewhat lower projected tax revenues, as well as the unanticipated impact of the Constitutional Court decision on pension reductions. The deficit for 2011, on the no-policy-change assumption, could increase by 1.3 pps. relative to 2010, and reach 9.9% of GDP, notably due to increased interest payments, lower non-tax revenues and particularly lower dividends (assuming current high pay-out ratios will normalise), and increased second-pillar social contributions (provided the authorities follow their initial timetable in that regard).

Although general government gross debt (36.1% of GDP in 2009) still remains well below the 60% of GDP reference value, it is projected to increase sharply and, depending on further financial sector interventions and the profile of international assistance, could exceed this reference value.

In the medium term, fiscal policy is expected to remain clearly restrictive, given the absence of room for fiscal manoeuvre and the need to correct economic imbalances, in line with the exit strategy for Latvia advocated by the Council, anchored on correcting the excessive deficit by 2012. Current estimates suggest that further adjustment of about 7% of GDP spread over two years, with some frontloading, will be needed to deliver the 2011-12 deficit targets agreed with the EU. The Latvian authorities have already outlined several possible measures, including a broad review of social insurance benefits and pension systems, the goal being to preserve their future sustainability and adequacy.

Table II.13.1:

Main features of country forecast - LATVIA

	2008			Annual percentage change						
mio LVL	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	16274.5	100.0	1.1	12.2	10.0	-4.6	**-18.0**	**-3.5**	**3.3**
Private consumption	10065.4	61.8	-	21.2	14.8	-5.5	**-22.4**	**-8.5**	**2.0**
Public consumption	3208.0	19.7	-	4.9	3.7	1.5	**-9.2**	**-10.0**	**-4.0**
Gross fixed capital formation	4777.3	29.4	-	16.4	7.5	-15.6	**-37.7**	**-14.0**	**7.0**
of which : equipment	-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)	6792.2	41.7	-	6.5	10.0	-1.3	**-13.9**	**6.0**	**6.0**
Imports (goods and services)	8920.8	54.8	-	19.4	14.7	-13.6	**-34.2**	**-6.5**	**4.0**
GNI (GDP deflator)	16030.2	98.5	0.9	10.3	9.6	-2.8	**-10.8**	**-7.2**	**-1.1**
Contribution to GDP growth : Domestic demand			-	20.2	13.5	-9.4	**-29.3**	**-10.8**	**2.2**
Inventories			-	0.7	1.6	-3.7	**-3.1**	**1.5**	**0.0**
Net exports			-	-8.7	-5.1	8.5	**14.4**	**5.8**	**1.1**
Employment			-2.2	4.9	3.6	0.9	**-13.6**	**-7.2**	**0.8**
Unemployment rate (a)			12.9	6.8	6.0	7.5	**17.1**	**20.6**	**18.8**
Compensation of employees/head			-	23.2	35.1	14.5	**-11.9**	**-8.0**	**1.0**
Unit labour costs whole economy			-	15.2	27.2	21.0	**-7.1**	**-11.5**	**-1.5**
Real unit labour costs			-	4.9	5.8	4.9	**-6.4**	**-5.6**	**-0.5**
Savings rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			31.9	9.9	20.3	15.4	**-0.7**	**-6.3**	**-1.0**
Harmonised index of consumer prices (HICP)			-	6.6	10.1	15.3	**3.3**	**-3.2**	**-0.7**
Terms of trade of goods			-	0.0	7.2	0.6	**-3.1**	**-3.5**	**1.3**
Trade balance (c)			-13.0	-25.6	-23.9	-17.0	**-6.6**	**-4.0**	**-3.0**
Current-account balance (c)			-3.3	-22.5	-22.5	-13.0	**8.7**	**8.3**	**4.6**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-0.9	-21.3	-20.6	-11.5	**11.0**	**10.8**	**7.1**
General government balance (c)			-	-0.5	-0.3	-4.1	**-9.0**	**-8.6**	**-9.9**
Cyclically-adjusted budget balance (c)			-	-3.2	-4.5	-6.4	**-6.3**	**-5.7**	**-8.3**
Structural budget balance (c)			-	-3.2	-4.5	-6.4	**-6.9**	**-6.7**	**-9.0**
General government gross debt (c)			-	10.7	9.0	19.5	**36.1**	**48.5**	**57.3**

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

14. LITHUANIA

A fragile recovery follows a major adjustment

A severe aftermath of the crisis

Several years of rapid economic convergence, with growth averaging 7.4% in 2001-08, gave way to a deep economic recession in 2009, when output fell by 15%. The sizeable internal and external imbalances accumulated during the years of high growth ultimately led to a reversal of the cycle, starting with a contraction in domestic demand. The bursting of the domestic bubble was reinforced by the global financial crisis and a fading away of external demand.

The recession has been driven by a plunge in private domestic demand. Credit growth turned negative in 2009 – in the corporate sector in June and in the household sector in September – and has remained so. The deleveraging process, in response to both domestic and international financial pressures deepened the downturn on the property market and caused financing difficulties even for firms with viable business models. Due to wage cuts in the private and public sectors, and the reductions of social benefits and indirect tax increases in 2009, household disposable income fell and borrowing remained restricted.

Overall, a massive adjustment of the Lithuanian economy has been occurring via decreases in prices and wages and a restructuring away from the non-tradable sectors. HICP inflation declined rapidly from over 11% in 2008 to just over 4% in 2009. Gross wages fell by 4.4% in 2009, with wages decreasing in both private and public sectors. Even though nominal wages are adjusting downwards to weak labour-market conditions, job losses are still pronounced. Unemployment reached 13.7% in 2009. The contraction of economic activity is weighing heavily on employment, which is projected to suffer a cumulative fall of some 10% in 2009 and 2010. Youth unemployment is particularly high and reached 30% in 2009, resulting in a fresh emigration surge.

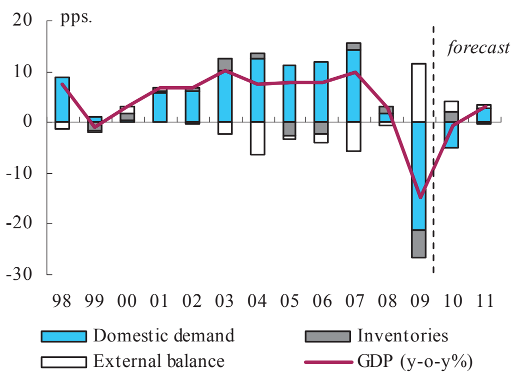
On the external side, trade flows shrank markedly. As imports collapsed, significantly reducing the merchandise-trade deficit, the current-account balance corrected sizeably from a massively negative (-12% of GDP) in 2008 to a positive (4%) position in 2009.

A strong policy response was put in place by the government from end-2009: three successive fiscal consolidation packages were adopted to contain the deterioration in public finances and limit debt accumulation. This policy, also involving some structural reforms, facilitated the adjustment needed in the economy, thereby supporting the credibility of the currency board arrangement.

Economy stabilises in 2010 supported by export growth

The large drop in real GDP in 2009 is expected to be followed by a period of economic stabilisation in 2010 before positive growth resumes in 2011. Despite clear improvements in some economic indicators, such as slightly positive GDP growth in the second half of 2009, a substantial upturn in confidence indicators, moderation in the steep declines in retail sales and a rebound in industrial production, as well as a revival in the global economy, the recovery is likely to be slow. The labour market is still expected to worsen further in the first half of 2010, while fiscal policy is set to remain tight throughout the forecast period.

Graph II.14.1: **Lithuania - GDP growth and contributions**



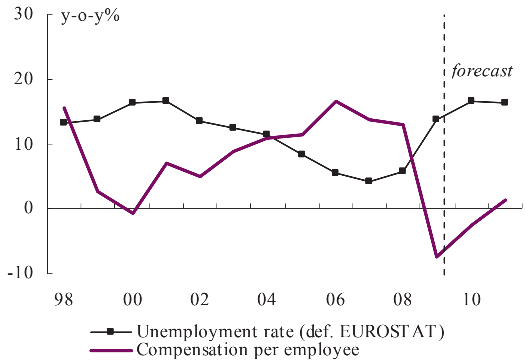
Domestic demand is set to remain very weak in 2010. Consumption expenditure is not expected to recover, due to reduced household disposable income, also affected by the continued fiscal consolidation. After the massive contraction in 2009, private investment is expected to decline further due to tight lending conditions and major uncertainty about future prospects. The real-estate market does not yet seem to have reached the bottom. On the positive side, companies' sentiment has been improving since May 2009 and the cost of credit has fallen significantly, recently reaching pre-crisis levels. Moreover, public investment is projected to be strong as the government is committed to frontloading EU co-financed projects, especially to enhance investments in infrastructure and improve the energy efficiency of public and private buildings.

The external side is also likely to contribute positively to growth in 2010, almost counterbalancing the very low domestic demand. Exports have showed steady monthly positive growth since June 2009. The main exporting sectors have been recovering and Lithuanian companies have started to regain market shares. These developments have been supported by improved cost competitiveness, aided by the strong disinflation. This adjustment is expected to continue throughout the forecast period. The balance of current and capital transfers is set to record substantial surpluses due to continuing inflows of EU funds and private sector transfers. More dynamic developments in exports, due to a faster recovery in global demand, could result in a more positive growth outlook.

Inflation should turn slightly negative in 2010, despite a significant energy price shock. The closure of the Ignalina nuclear power plant at the end of 2009 resulted in a 30% electricity price increase, raising yearly inflation by an estimated under 1pp including second round effects. Higher oil and other commodity prices in international markets will also raise Lithuanian energy prices. However, the extent of the secondary effects, related to higher production costs, and their pass-through to consumers are uncertain. On the other hand, due to the significant slack in the economy, high unemployment and negative wage pressures, leading to reduced consumer spending and an overall very weak domestic demand, core inflation should remain subdued in 2010.

The performance of the labour market will strongly affect the pace and sustainability of the recovery. Unemployment is set to peak in 2010, reaching close to 17% of the labour force. A significant labour-market uncertainty concerns the extent of further emigration. Moreover, stronger increases in unemployment rather than further wage adjustment could hamper future growth prospects. A more rapid rise in unemployment would contribute further to declines in confidence and spending, with negative feedback effects on business revenue, investment and employment.

Graph II.14.2: **Lithuania - Unemployment rate and compensation per employee**



A turnaround expected in 2011

On the back of the global recovery as well as the internal economic transformation, resulting in improved competitiveness, Lithuanian prospects are set to brighten by the end of the forecast period. Due to lower credit cost and improved expectations, credit growth is expected to turn positive and fuel a revival in the economy. GDP is expected to record positive growth in 2011, close to potential.

Both domestic and external demand are expected to contribute positively to growth. Domestic demand is set to recover as positive expectations feed through to private investment and an improved employment outlook. Consumption should be supported by real income increases as wage and employment prospects improve. Investment is set to pick up in the private sector, while public investment should remain positive. The medium-term growth prospects will depend on the degree and pace of economic restructuring. The government has undertaken a major reform in higher education, and has started reforms in healthcare and social security which, once implemented, should help set the economy on a more sustainable footing.

Negative risks to the baseline scenario are a possibly slower than expected recovery of external demand, which would in turn delay the recovery of the economy. A stronger-than-assumed credit tightening or a lack of improvement in the labour market could lead to a more negative outlook. On the other hand, a stronger performance by the exporting sectors could create new job opportunities and reinforce the structural shift of the economy towards the tradable sector. Furthermore, the continuation of fiscal consolidation is crucial for successfully anchoring long-term expectations.

Significant fiscal consolidation efforts have yielded results, but need to continue

The public sector deficit widened significantly to 8.9% of GDP in 2009. This outturn reflects a substantial tax shortfall due to a considerable deterioration in economic outcome (as nominal GDP contracted by 16.9%) and despite substantial consolidation measures adopted by the government during the year. Revenue surprised on the downside, falling significantly beyond what could be expected on the basis of standard elasticities. The rapid deterioration of public finances has been addressed by implementing restrictive initial and supplementary budgets, with fiscal adjustment measures totalling around 8% of GDP in 2009 and achieved through a combination of spending cuts and tax increases and a temporary reduction of transfers to the second-pillar pension funds.

The main measures in the 2010 budget adopted by parliament in December 2009 include further substantial cuts in expenditure amounting to around 4% of GDP, particularly in government current spending, including the public sector wage bill, and social benefits. However, some other expenditure items, including interest payments, health-care spending and capital expenditure, are set to increase in 2010. General government investment is also planned to increase substantially, supported by more rapid absorption of EU structural funds. On the revenue side, changes are limited to a reduction in the corporate income tax rate by 5 pp., after it was raised only in January 2009, and some increases in non-tax revenue, which mainly relate to a higher inflow of EU structural funds. The 2010 budget also reflects the full-year impact of revenue and expenditure consolidation measures implemented in 2009. On the basis of the customary no-policy-change assumption, the general government deficit is expected to narrow to 8.4% of GDP in 2010, somewhat higher compared to the latest projection by the national authorities of 8.1% of GDP, reflecting the slower projected recovery in the economy and thus of tax revenues. It is set to widen again slightly in 2011; while tax revenue is expected to recover, it is outweighed in 2011 by the ending of some temporary measures.

Due to a strong downturn in GDP growth and the high deficit in 2009, government debt almost doubled to 29.3% of GDP in 2009 and is projected to increase to around 45% in 2011.

Table II.14.1:

Main features of country forecast - LITHUANIA

		2008			Annual percentage change					
		bn LTL Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		111.2	100.0	0.8	7.8	9.8	2.8	**-15.0**	**-0.6**	**3.2**
Private consumption		72.4	65.1	-	10.6	12.1	3.6	**-17.0**	**-5.3**	**2.6**
Public consumption		21.5	19.3	-	3.7	3.2	7.9	**-2.3**	**-4.5**	**-2.3**
Gross fixed capital formation		28.0	25.2	-	19.4	23.0	-6.5	**-38.7**	**-1.8**	**8.0**
of which : equipment		7.4	6.7	-	16.8	21.9	-19.8	**-51.4**	**-6.0**	**5.6**
Exports (goods and services)		67.0	60.2	-	12.0	3.0	12.2	**-15.5**	**6.1**	**5.5**
Imports (goods and services)		79.7	71.7	-	13.7	10.7	10.5	**-29.3**	**2.1**	**4.3**
GNI (GDP deflator)		108.3	97.4	-	7.3	8.0	4.2	**-13.1**	**-1.2**	**2.2**
Contribution to GDP growth :	Domestic demand			-	11.9	14.2	1.9	**-21.4**	**-4.8**	**2.6**
	Inventories			-	-2.2	1.3	1.4	**-5.2**	**2.1**	**-0.1**
	Net exports			-	-1.9	-5.7	-0.5	**11.6**	**2.1**	**0.7**
Employment				-1.1	1.8	2.8	-0.5	**-6.9**	**-3.6**	**0.2**
Unemployment rate (a)				9.8	5.6	4.3	5.8	**13.7**	**16.7**	**16.3**
Compensation of employees/head				-	16.7	13.9	12.9	**-7.5**	**-2.4**	**1.5**
Unit labour costs whole economy				-	10.1	6.5	9.3	**1.2**	**-5.5**	**-1.4**
Real unit labour costs				-	3.4	-1.8	-0.3	**3.7**	**-3.5**	**-2.6**
Savings rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				42.9	6.5	8.5	9.7	**-2.3**	**-2.0**	**1.2**
Harmonised index of consumer prices (HICP)				-	3.8	5.8	11.1	**4.2**	**-0.1**	**1.4**
Terms of trade of goods				-	-3.5	0.9	3.5	**-2.6**	**-2.8**	**-0.5**
Trade balance (c)				-	-13.9	-15.0	-12.0	**-3.2**	**-2.8**	**-2.4**
Current-account balance (c)				-	-10.4	-15.1	-11.9	**2.6**	**2.8**	**2.0**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-8.9	-12.9	-10.0	**5.2**	**6.3**	**5.6**
General government balance (c)				-	-0.4	-1.0	-3.3	**-8.9**	**-8.4**	**-8.5**
Cyclically-adjusted budget balance (c)				-	-2.1	-3.7	-5.7	**-6.7**	**-6.1**	**-6.8**
Structural budget balance (c)				-	-2.1	-3.1	-5.6	**-7.1**	**-6.8**	**-6.8**
General government gross debt (c)				-	18.0	16.9	15.6	**29.3**	**38.6**	**45.4**

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

15. LUXEMBOURG

The recession is over but will the country regain the exceptional dynamism of the past?

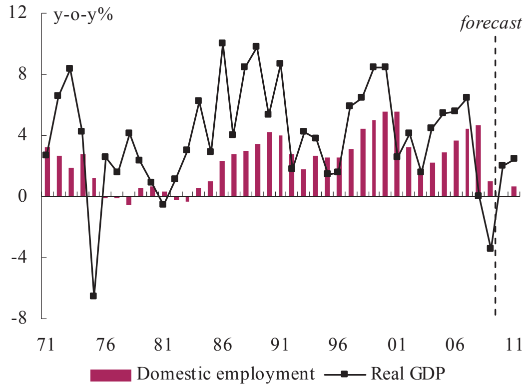
Economic activity is picking up after a very sharp downturn

The recession has taken a high toll on the Luxembourgish economy. After four years of robust growth (5.5% per year on average over the period 2004-07), activity began to contract in the second quarter of 2008 and the decline markedly accelerated in the fourth quarter. Overall, real GDP dropped by a cumulative 8.8% over five consecutive quarters and, for the year 2009 as a whole, it declined by 3.4%. Despite the cuts in income tax enacted in 2008 and 2009, the fall in inflation and the decline in interest rates (most mortgage loans are at a variable rate in Luxembourg), private consumption decreased by 0.5% in 2009, weakened by the general deterioration in the economic environment and the negative developments in the labour market. Investment, which had collapsed at the end of 2008 and the beginning of 2009 – falling by almost 40% in two quarters – recovered somewhat in the third quarter of last year but still dropped by nearly 15% in yearly average. Finally, with markets contracting by more than 12%, exports fell by 7.7% in 2009. However, this fall was partially offset by a parallel drop in imports.

The first victim of the recession was manufacturing industry, which exports almost all of its production and is thus totally dependent on developments in world trade. Industrial production dropped markedly in the fourth quarter of 2008 (-18% q-o-q) and in the first quarter of 2009 (-10%). Luxembourgish industry is heavily concentrated in steel products, car suppliers and glass, which makes it very dependent on the automotive industry and on construction. Construction and services were also hit, in particular services to enterprises but also the financial sector, which, due to its ownership structure (nearly all financial institutions belong to foreign groups) and the international character of its activity, is extremely sensitive to developments abroad. However, it seems to have been less severely affected by the crisis than might have been feared, probably because much of its core business (mainly private banking as well as the management and back-office work of investment funds) has been relatively sheltered from the financial turmoil. Moreover, Luxembourgish financial institutions seem to have shown less appetite than many others for risky assets which eventually proved toxic. However, it is debatable whether financial activities will be able in the future to remain the country's main growth engine as they were since the early 1980s.

Employment remained buoyant for the larger part of 2008, rising by 4.7% over the year. Since the autumn of 2008, the drop in activity has led to a standstill in job creation, but employment has been stagnating rather than really declining (the positive growth rate recorded in 2009 was exclusively due to the large carry-over from 2008). Unemployment, which had been rising since the beginning of 2008, strongly accelerated in the autumn of that year, surging from 4.2% of the active population in January 2008 to 5.9% last summer. However, since then, it has stopped increasing and has broadly stabilised at about 6%. The recession also led to an explosion in part-time employment, which was encouraged by the government in order to limit lay-offs.

Graph II.15.1: **Luxembourg - Domestic employment and real GDP**



A gradual recovery going on

The economy began to revive in the second half of 2009, with a very strong growth in the third quarter (4.2% q-o-q), following the recovery in the EU economy. Most components of domestic demand are set to post only modest positive growth rates with the exception of public expenditure, which is forecast to remain extremely dynamic. However, the recovery in exports is likely to be stronger than expected in the autumn thanks to a more robust growth in exports markets. Activity will progressively accelerate in the course of 2010 but even in 2011 growth is expected to remain below the strong rates recorded a few years ago. In total, real GDP should grow by about 2% this year and 2½% next year. Based on recent developments, employment is projected to stagnate throughout 2010 and to begin to recover in the course of 2011. The rise in unemployment should be limited by the fact that a large share of the workers losing their jobs will be non-residents. Despite this, unemployment is still projected to rise in 2010 and, to a lesser extent, in 2011. By the end of the forecast period it is set to reach a rate not seen for many years, though still significantly lower than in most Member States.

The government surplus turned into a deficit

Thanks to still buoyant tax receipts and employment, the government surplus declined only from 3.6% of GDP in 2007 to 2.9% in 2008, despite the stagnation in activity. This surplus turned into a deficit in 2009, due not only to the impact of the crisis on government revenues and on unemployment outlays but also to tax cuts decided in the 2009 budget before the aggravation of the crisis. Moreover, expenditure rose substantially, reflecting in particular a non-negligible increase in public investment. However, the deficit, which was projected at about 2.3% of GDP in the latest budget, now seems to have been limited to 0.7% of GDP mainly thanks to higher-than-expected revenues. It is forecast to rise to about 3½% in 2010, as a result of the delayed effects of the recession on tax revenues (especially from corporate tax) and social transfers (as well as the departure of three e-commerce firms, which generated VAT revenues for about 0.4% of GDP). However, the drop in revenues and the rise in expenditure expected for this year are likely to be more limited than in the authorities' own forecasts, which project the deficit at 4.2% of GDP. In particular, the forecast foresees a slower rise in expenditure due to lower public investment as a result of emerging bottlenecks. The public finance projection for 2011 is based on a no-policy-change assumption, which does not take into account possible consolidation measures that may be decided after the consultations with social partners. The deficit is forecast to rise to about 4% of GDP, compared with 5% in the "unchanged policy scenario" presented in the stability programme. Like for 2010, this divergence essentially results from more pessimistic revenues projections in the authorities' forecast. The public debt doubled in 2008, due to the financing of the support to the financial sector. It is likely to reach about 24% of GDP in 2011 but would still remain one of the lowest in the EU.

Table II.15.1:

Main features of country forecast - LUXEMBOURG

	2008			Annual percentage change						
	mio EUR	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		39348.4	100.0	4.3	5.6	6.5	0.0	**-3.4**	**2.0**	**2.4**
Private consumption		12741.3	32.4	2.5	2.7	2.8	3.9	**-0.5**	**0.5**	**1.5**
Public consumption		5940.4	15.1	4.3	2.8	2.9	3.0	**2.9**	**2.7**	**2.6**
Gross fixed capital formation		7602.8	19.3	4.5	4.7	12.6	-0.1	**-14.9**	**3.0**	**6.7**
of which : equipment		2561.5	6.5	3.0	7.8	18.5	5.5	**-41.3**	**5.0**	**7.5**
Exports (goods and services)		67996.6	172.8	7.1	13.3	8.8	1.5	**-7.7**	**2.8**	**4.9**
Imports (goods and services)		55196.8	140.3	6.9	12.9	8.3	3.3	**-9.3**	**2.9**	**5.6**
GNI (GDP deflator)		27239.6	69.2	3.5	-6.3	10.7	-4.7	**-4.2**	**3.2**	**3.1**
Contribution to GDP growth :	Domestic demand			2.8	2.4	3.8	1.6	**-3.2**	**1.2**	**2.3**
	Inventories			0.0	-0.8	-0.9	0.5	**-0.2**	**0.1**	**-0.1**
	Net exports			1.5	4.0	3.6	-2.1	**0.9**	**0.6**	**0.1**
Employment				3.3	3.6	4.4	4.7	**0.9**	**0.0**	**0.7**
Unemployment rate (a)				3.0	4.6	4.2	4.9	**5.4**	**6.1**	**6.4**
Compensation of employees/head				3.4	3.3	3.6	2.0	**1.7**	**2.5**	**2.5**
Unit labour costs whole economy				2.4	1.4	1.6	6.8	**6.3**	**0.5**	**0.7**
Real unit labour costs				-0.3	-5.0	-1.4	1.7	**7.0**	**-2.2**	**-2.2**
Savings rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				2.7	6.8	3.0	5.0	**-0.7**	**2.8**	**3.0**
Harmonised index of consumer prices (HICP)				-	3.0	2.7	4.1	**0.0**	**2.6**	**2.0**
Terms of trade of goods				-0.6	3.0	2.6	0.2	**2.5**	**-1.0**	**0.5**
Trade balance (c)				-11.2	-9.3	-8.6	-10.4	**-7.3**	**-7.6**	**-8.3**
Current-account balance (c)				11.1	10.3	9.7	5.3	**-0.4**	**0.9**	**1.5**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-	-	-	**-**	**-**	**-**
General government balance (c)				2.3	1.4	3.6	2.9	**-0.7**	**-3.5**	**-3.9**
Cyclically-adjusted budget balance (c)				-	0.1	1.1	2.0	**1.2**	**-1.4**	**-1.9**
Structural budget balance (c)				-	0.1	1.1	2.0	**1.2**	**-1.4**	**-1.9**
General government gross debt (c)				6.4	6.5	6.7	13.7	**14.5**	**19.0**	**23.6**

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

16. HUNGARY

On its way towards a sustainable growth path?

Worrying signals before the crisis

Hungary was in a fragile economic condition when the financial crisis broke out in autumn 2008. Labour productivity and thus potential output had started to decelerate some years earlier, while lax fiscal policy and growing private sector indebtedness had sustained domestic demand at elevated levels. Moreover, from 2004 onwards, the share of foreign-exchange-denominated debt also increased quickly. Despite the fiscal expansion that raised the general government deficit to 9.3% of GDP in 2006, GDP grew by only 4% in that year, still lower than the average of the preceding years. The mid-2006 fiscal policy reversal, which was aimed at correcting the existing economic imbalances and restraining the accumulation of the public debt, successfully reduced the budget deficit to 3.8% of GDP by 2008. However, these corrective fiscal measures mainly focused on achieving higher revenues and not sufficiently on expenditure cuts based on structural reforms.

The crisis and short-term remedies

In autumn 2008, in a context of reduced risk appetite linked to the global financial crisis, financial market conditions in Hungary rapidly deteriorated to the extent that the external financing needs of the government could no longer be met through market channels. Moreover, due to a sudden decline in external demand and high uncertainty regarding the severity and duration of the crisis, both exports and industrial production dropped at double digit rates in the fourth quarter of 2008. In the context of an absence of fiscal space and financing difficulties, the policy response consisted of continued fiscal consolidation and measures to support the financial sector. In November 2008, acknowledging the government's commitment to maintain the fiscal consolidation process and to prevent a more severe financial market crash, joint financial assistance of up to EUR 20 bn was provided to Hungary by the EU, the IMF and the World Bank subject to certain policy conditions. In order to counteract the decreasing revenues caused by declining output, the government implemented a mix of structural and temporary expenditure saving measures.

The storm continued during 2009

In a controlled deleveraging process, financial institutions tightened credit conditions, which led to a decline in corporate lending and a negligible net flow to households in 2009, also in line with limited demand for credit. Nevertheless, financial market conditions have started to improve over the forecast horizon as uncertainty about the recovery subsides and investor confidence picks up.

Economic activity declined by around 6¼% in 2009 exclusively due to a sharp contraction of domestic demand. Private consumption dropped in 2009 by 7½%, based on diminishing real wages, increasing unemployment and a rising saving ratio. Concomitantly, fixed capital formation also retreated by 6½%, undermined by financing difficulties and low capacity utilisation linked to lack of demand. Additionally, the depletion of inventories was extremely strong during the first half of the year. However, positive net exports almost fully offset the negative impact of inventories and, all in all, the negative contribution of domestic demand (excluding inventories) broadly explains the overall GDP growth rate.

Regaining a positive growth path

In 2010, GDP is projected to stagnate. Given the pronounced activity decline in 2009, this implies that the economy will regain a rather strong growth path measured in quarterly terms, in particular in the second half of 2010, compensating for the negative carry-over. Specifically, GDP growth is projected to accelerate over the year to reach ¾% q-o-q at the end of the year. On the basis of the economic recovery in the EU and the rest of the world, the output of export-driven industries is expected to accelerate faster than that of domestic-driven sectors especially as the latter are heavily affected by the ongoing fiscal adjustment. This duality is expected to be reflected in labour-market developments as well, with labour demand being more elastic in the manufacturing sector, than in services where labour shedding is likely to continue.

In 2011, the country is expected to enter a more sustainable growth path with GDP increasing by 2¾% based on domestic demand. Private consumption is set to become the major contributing factor to economic expansion, once real disposable income starts rising again, mirroring better employment growth prospects. In parallel, investment should also grow strongly, even above GDP growth, reflecting better prospects for both households and companies. Additionally, as the effect of the indirect taxes on prices will cease in 2011, they are expected to increase only by below 3% compared to 4½% in 2010.

There are risks to this scenario. On the one hand, private consumption could turn out to be more dynamic than projected on the basis of increasing consumer confidence coupled with a decline of the saving rate. Exports could also accelerate further supported by higher external demand. On the other hand, insufficient credit could put a brake on the recovery of domestic demand and exports might grow less than projected in case global downward risks materialise.

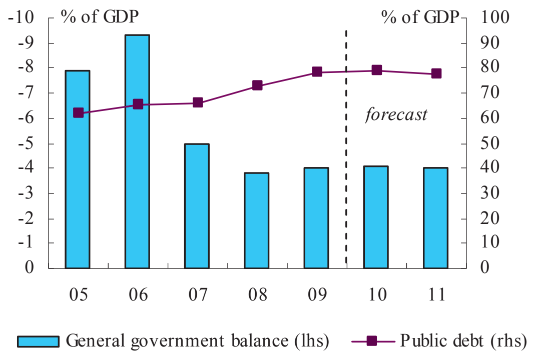
Sharp adjustment of external imbalances

The rapid adjustment in consumption and thus imports led to a remarkable turnaround in the current-account balance in 2009, which improved from a deficit of 7.2% of GDP in 2008 to around a surplus of ½% last year. It is expected to remain at around that level in 2010 and 2011. It is worth mentioning some developments underlying this. Although constrained by worsening labour-market conditions, net financial savings of households reached 4.5% of GDP in the third quarter of 2009. The corporate sector also strongly improved its financial position in 2009. Overall, this led to the above-mentioned strong improvement in the current-account balance, a surplus in 2009 for the first time in over 15 years (the period for which data are available).

Focus on consolidation of public finances

The deficit target of 3.9% of in 2009 GDP is estimated to have been almost met (4.0% in the April EDP notification). Although the central government cash deficit of 3.5% of GDP is better than expected, this largely reflects factors, such as the advance payments of dividends and late payments of certain tax refunds, which have no impact in national-accounts terms. Additionally, the deficit of the local authorities is expected to be in line with the earlier estimations. Although some negative risks materialised (e.g. the revenue shortfall in income taxes and the expenditure overrun at the budget chapters), their magnitude was limited and some other factors (e.g. higher-than-expected VAT, interest revenues as well as one-off revenues from the switch from the private pillars of the pension system to the public "pay-as-you-go" system) broadly offset them. Additionally, higher revenues stemming from the advance purchase of excise stamps by the tobacco companies should contribute to the achievement of the deficit target. Finally, the dividend revenue from the state-owned enterprises significantly exceeded the budgeted level, which may affect their capital level unfavourably and thereby also their future profitability.

Graph II.16.1: **Hungary - General government balance and public debt**



For 2010, Parliament adopted on 30 November a budget in compliance with the general government deficit target of 3.8% of GDP, underpinned by a number of legal decisions on the specific announced measures, which include a freeze of the public sector wage bill, the reform in the pension system, saving measures in the area of social benefits as well as reduction in the level of housing subsidies and gas- and district- heating supports. It also encompasses reserves amounting to HUF 206 bn (0.8% of GDP). The budget also aims at respecting the strict management of central budget chapters (notably thanks to the newly established Treasurers system) and lower expenditures of the local governments, reflecting reduced transfers from the central budget as well as the more efficient operation of the long-distance public transport system.

The Convergence programme (confirming the fiscal target of 3.8% of GDP) already incorporated that revenue could turn out lower than expected in the budget by ⅓% of GDP as implied by last year's worst outcome. It also foresaw higher-than-budgeted expenditure of 0.1% of GDP linked to the additional subsidy to the Budapest transport company. This was compensated by (i) lower-than-budgeted net interest expenditures of 0.15% of GDP, (ii) a one-off revenue of ¼% of GDP from the shift of the eligible employees and pensioners from the private pillar into the public pension system, and (iii) a freezing of 0.2% of budgetary reserves.

This forecast projects a deficit that is 0.3 pp. higher than the deficit target in the budget and the convergence programme for the following reasons: On the one hand, further expenditure slippages are likely to occur linked to the currently re-nationalised airline company MALEV and the fact that the planned reduction of the subsidy for the long-distance public transport system is not fully underpinned by structural measures; furthermore, further slippages are expected as the new Treasurers' system may not be sufficient to fully ensure the control of the expenditures by line ministries against the background of substantial cuts in the past. Revenue shortfalls are expected due to the Constitutional Court's decision of revoking the general value-based property tax adopted by the Parliament and due to the fact that the projected income from the sale of (mobile-telephone) licences seems to be overestimated. On the other hand, budgetary reserves of around ½% of GDP are still available and could be frozen.

The government also announced that it could make contingency expenditure cuts of 0.2% of GDP to at least partly compensate for adverse developments, but based on the no-policy-change assumption this has not been incorporated in the forecast.

All in all, the 2010 the forecast projects a general budget deficit of 4.1% of GDP, which in structural terms can be characterised as broadly neutral.

Hungary has to put an end to its excessive deficit by 2011 at the latest, which implies a need for further deficit-reducing measures at the latest next year of more than 1% of GDP. These measures are necessary not only to reduce the deficit compared to 2010 but also to compensate the deficit-increasing effect of the already adopted personal income tax decrease (½% of GDP) as of 2011 and the highly probable accumulated loss as of the central bank.

Regarding the implementation of the new fiscal framework adopted in November 2008, the 2010 budget has already been prepared broadly in line with this. To ensure the success of the implementation phase, 2011 will be crucial as next year's budget must be fully in compliance with all the elements of the fiscal framework.

Table II.16.1:

Main features of country forecast - HUNGARY

	2008			Annual percentage change						
	bn HUF	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		26543.3	100.0	3.0	4.0	1.0	0.6	**-6.3**	**0.0**	**2.8**
Private consumption		14331.8	54.0	-	1.7	0.4	-0.5	**-7.5**	**-3.2**	**2.6**
Public consumption		5743.1	21.6	1.2	3.8	-7.4	-0.8	**-1.1**	**-0.4**	**1.8**
Gross fixed capital formation		5559.1	20.9	5.7	-3.6	1.6	0.4	**-6.5**	**1.0**	**3.6**
of which : equipment		2231.2	8.4	-	-	-	-	**-3.8**	**3.1**	**4.5**
Exports (goods and services)		21804.9	82.1	12.5	18.6	16.2	5.6	**-9.1**	**6.6**	**8.7**
Imports (goods and services)		21545.5	81.2	12.9	14.8	13.3	5.7	**-15.4**	**5.4**	**9.1**
GNI (GDP deflator)		24761.6	93.3	-	3.6	-0.4	1.1	**-5.5**	**-0.7**	**2.8**
Contribution to GDP growth :	Domestic demand			3.1	0.9	-1.1	-0.4	**-5.7**	**-1.6**	**2.5**
	Inventories			0.2	0.8	0.0	1.0	**-5.7**	**0.2**	**0.0**
	Net exports			-0.3	2.3	2.2	0.0	**5.1**	**1.4**	**0.3**
Employment				-	0.6	-0.3	-1.3	**-3.6**	**-0.9**	**0.8**
Unemployment rate (a)				-	7.5	7.4	7.8	**10.0**	**10.8**	**10.1**
Compensation of employees/f.t.e.				-	5.3	6.7	6.5	**-0.2**	**-0.3**	**3.7**
Unit labour costs whole economy				-	1.9	5.4	4.5	**2.7**	**-1.2**	**1.7**
Real unit labour costs				-	-1.9	-0.5	0.7	**-2.2**	**-3.6**	**-0.6**
Savings rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				13.2	3.9	5.9	3.8	**4.9**	**2.6**	**2.2**
Harmonised index of consumer prices (HICP)				-	4.0	7.9	6.0	**4.0**	**4.6**	**2.8**
Terms of trade of goods				-	-1.4	-0.1	-1.4	**1.8**	**-0.5**	**-0.4**
Trade balance (c)				-4.5	-2.3	0.2	-0.1	**4.9**	**5.7**	**5.7**
Current-account balance (c)				-	-7.5	-6.5	-7.2	**0.4**	**-0.2**	**-0.3**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-6.9	-5.5	-5.9	**1.8**	**1.4**	**1.5**
General government balance (c)				-	-9.3	-5.0	-3.8	**-4.0**	**-4.1**	**-4.0**
Cyclically-adjusted budget balance (c)				-	-10.9	-6.4	-5.1	**-2.2**	**-2.1**	**-3.0**
Structural budget balance (c)				-	-10.6	-5.5	-4.7	**-2.2**	**-2.3**	**-3.0**
General government gross debt (c)				-	65.6	65.9	72.9	**78.3**	**78.9**	**77.8**

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

17. MALTA
Exports and investment drive the recovery

Private consumption proved resilient in 2009…

In the period 2005-07, Malta's economic growth averaged 3.7%, well above the rate recorded for the euro area as a whole (2.5%). The economic expansion was mainly driven by domestic demand. Household consumption was buoyed by an improving labour market while exports expanded steadily due to the remarkable performance of the services sector. Total investment growth nonetheless decelerated over the period, on the back of the shrinking role of the manufacturing sector, and was sharply negative in 2008, leading the slowdown of the economy as a whole. With the global crisis hitting the Maltese economy mainly through the trade channel, exports performance came under significant strain from early 2008. With private consumption continuing to increase rapidly, overall economic growth remained, however, strong compared to the rest of the euro area (2.1% versus 0.6%). The impact of the global financial turmoil on the banking system was limited although the cooling real-estate market implies some increased vulnerability. In this context, Malta's euro-area membership since 2008 has helped to limit economic agents' uncertainty during the crisis.

Measured by the scale of the contraction in real GDP in 2009, Malta was one of the euro area countries least affected by the global crisis. Real GDP fell by 1.9%, compared to 4.1% for the euro area. Investment contracted sharply and acted as a major drag on domestic demand, as weak external demand and lower profits induced companies to scale back their investment plans. The huge depletion of inventories and the reduction in government consumption also contributed to the fall in real GDP. By contrast, private consumption proved resilient, increasing by 1.2% in real terms, supported by lower inflation after the spike in 2008, growing wages and some recovery measures. The fall in exports was less negative than could have been expected given the sharp contraction in world trade, primarily reflecting the relative resilience of merchandise exports, especially for electronics, machinery and transport equipment and chemical products. On the services side, the drop in tourism exports was partly offset by a slight increase in exports of transport and other services. With imports shrinking more markedly as a result of the contraction in investment and stockbuilding, net exports contributed positively to real output growth. The external balance of goods and services moved into surplus for the first time since 2002 also thanks to lower energy prices.

…but it is exports and investment that should drive the recovery

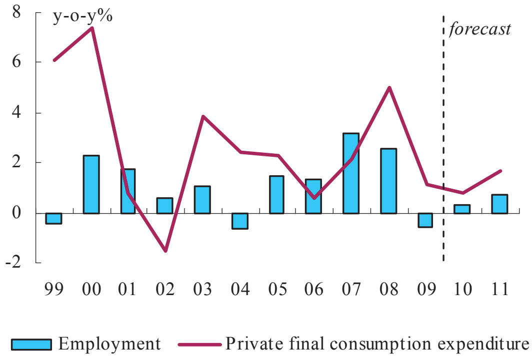
The recovery underway since the second half of 2009 is expected to gradually gain strength over the forecast horizon. Real GDP is anticipated to expand by just above 1% in 2010 and to accelerate in 2011 to 1.7%, well below the average over the last decade. Still, Malta continues to outperform the euro area as a whole, albeit less markedly than in recent years.

Domestic demand is projected to recover gradually over the forecast horizon, mainly driven by a marked pick-up in investment already in 2010. This owes to a significant increase in public capital spending in environment and construction. In 2011, a stronger and more broad-based recovery in private investment is projected as capacity utilisation returns to its historical average and the profitability of foreign-owned companies improves due to the assumed global economic turnaround. Private consumption is expected to weaken slightly in 2010 given subdued consumer confidence from still weak labour market conditions but the improved economic outlook more generally, together with continued real wage growth, should boost it in 2011.

Benefitting from the assumed expansion of world trade, specifically in non-EU markets, exports growth is anticipated to gradually gain strength in 2010 and to stabilise in 2011. Imports are set to outperform exports, supported by the pick-up in investment, thus leading to a negative contribution of net exports to output growth. The external balance of goods and services is projected to remain slightly positive over the forecast period.

The main downside risk to the macroeconomic outlook stems from uncertainties surrounding Malta's ability to benefit from the global upturn. The private sector will need to respond flexibly to counteract the erosion in competitiveness witnessed in recent years and to possible changes in the composition of external demand for goods and services produced in Malta.

Graph II.17.1: **Malta - Private consumption and employment**



Unit-labour cost growth decelerates somewhat

After averaging almost 3% in the period 2005-08, somewhat above the euro-area average, per capita wage growth moderated markedly in 2009. This also reflects the slightly negative development of public wages following the exceptional increases in 2008 related to the voluntary redundancy schemes provided to the workers of Malta Shipyards Ltd. ahead of its liquidation. From 2010, wage growth per capita is projected to pick up again, to a level above the euro-area average, reflecting inflation trends rather than productivity gains, thus putting some pressure on Malta's competitiveness.

Though decelerating from the peak reached in 2008, HICP inflation is projected to stay above the euro-area average but close to 2%. In line with recent experience demonstrating sticky domestic food prices in spite of increased competition in the distribution trade, food inflation is expected to remain relatively firm over the forecast horizon. Core inflation is projected to increase only marginally (from 1.5% in 2009 to 1.6% in 2011) mainly thanks to the expected stabilisation in prices of non-energy industrial goods. Services inflation is set to remain below overall HICP inflation, also reflecting increased competition in the tourism sector.

After a relatively strong performance in the years preceding the crisis, labour productivity declined in 2008 as slowing output was accompanied by relatively strong employment growth and in 2009 as the scale of the output contraction exceeded the fall in employment. The latter reflects support measures to retain workers and labour hoarding, especially in those sectors characterised by a high incidence of skilled workers. Employment is projected to improve only moderately over the forecast period, with some lag compared to the expected turnaround in output growth. As a result, productivity gains are set to reappear but at a lower pace than witnessed in the pre-crisis period.

Against this background, unit labour cost growth is projected to moderate somewhat over the forecast horizon, but to remain well above the euro-area average. Although these developments would weigh on Malta's competitive position, some gains might arise from the recent appreciation of the USD that is the transaction currency used by the important electronics sector.

Public finances under stress

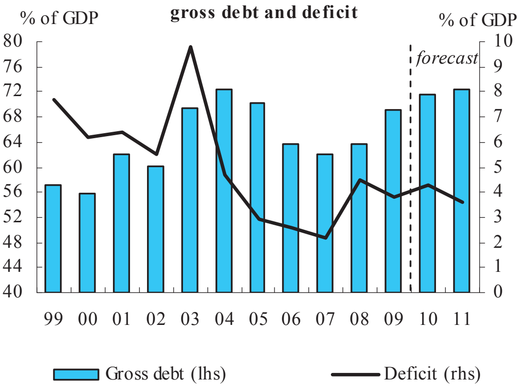
Following several years of fiscal consolidation, the general government deficit increased to 4.5% of GDP in 2008 mainly due to some exceptional expenditure-increasing items, such as the above-mentioned voluntary redundancy schemes for shipyards' employees, the reclassification of the yards into the general government sector and temporary subsidies to the energy provider.

The deficit declined to 3.8% of GDP in 2009. The improvement relative to 2008 is explained to a large extent by the non-recurrent nature of the above-mentioned exceptional expenditure items weighing on the 2008 outcome (although some further exceptional outlays for shipyards workers were recorded in 2009). In addition, public investment contracted significantly compared with 2008. Finally, while direct taxes were supported by the one-off proceeds of a tax amnesty on penalties for unpaid taxes and a relatively strong performance of income tax from international companies registered in Malta, the economic downturn hit revenue from indirect taxation, including taxes on property transactions.

In 2010, the deficit is expected to widen to 4.3% of GDP, also because of lower deficit-reducing one-offs. Helped by favourable base effects related to the liquidation of the shipyards and the measures adopted with the 2010 budget to restrict recruitment, compensation of employees is set to fall further in 2010. Intermediate consumption is projected to increase markedly, mainly because of the additional recovery measures in the 2010 budget, including funds to enhance the quality of health-care services. Social transfers other than in kind are projected to keep increasing significantly due to the dynamics of age-related entitlements. Capital spending is also expected to increase substantially mainly thanks to public investment projects in environment and infrastructure and support to private investment in part financed with the EU funds. Overall revenue is projected to rise very strongly reflecting primarily the assumed buoyant absorption of EU funds. Tax revenue is expected to remain more subdued: indirect taxes are affected by moderate consumption dynamics (but at the same time benefit from some revenue-enhancing measures), while the one-off effect of the 2009 tax amnesty weighs on direct taxes. Finally, social contributions are set to increase broadly in line with the economy-wide wage bill.

Based on the no-policy-change assumption, the deficit is projected to narrow to 3.6% of GDP in 2011, mainly thanks to the expiry of some temporary support measures adopted with the 2010 budget. More specifically, current expenditure is set to increase by just above 3% relative to 2010, while capital expenditure is expected to stabilise after the strong increase expected in 2010. Overall, the expenditure-to-GDP ratio is projected to fall by around ½ pp. to 45.5%. On the revenue side the projected economic upturn and improved employment outlook are likely to entail an acceleration in revenue growth from tax collection as well as social contributions. As a result, current revenue is set to increase by close to 5% relative to 2010, while capital transfers received are expected to broadly stabilise at a high level mainly due to the assumed support from EU funds. The overall revenue-to-GDP ratio is projected to increase slightly, to some 42%.

Graph II.17.2: **Malta - General government gross debt and deficit**



General government debt is expected to continue on an upward path over the forecast horizon, increasing on a no-policy-change assumption to around 72½% of GDP by 2011 as the primary balance remains negative.

Table II.17.1:

Main features of country forecast - MALTA

		2008			Annual percentage change					
		mio EUR Curr. prices	**% GDP**	**92-05**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
GDP		5696.8	100.0	3.5	3.6	3.8	2.1	**-1.9**	**1.1**	**1.7**
Private consumption		3609.7	63.4	-	0.6	2.2	5.0	**1.2**	**0.8**	**1.7**
Public consumption		1220.3	21.4	-	5.9	0.0	12.9	**-1.9**	**0.5**	**0.2**
Gross fixed capital formation		926.5	16.3	-	3.2	0.4	-21.9	**-19.3**	**6.5**	**4.5**
of which : equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		4608.9	80.9	-	10.5	2.7	-7.2	**-3.1**	**4.4**	**4.1**
Imports (goods and services)		4777.5	83.9	-	9.5	0.4	-7.4	**-8.7**	**5.1**	**4.2**
GNI (GDP deflator)		5511.9	96.8	2.7	3.7	4.8	2.4	**-4.9**	**1.8**	**2.1**
Contribution to GDP growth :	Domestic demand			-	2.2	1.5	1.2	**-2.7**	**1.5**	**1.8**
	Inventories			-	1.3	0.2	0.5	**-4.5**	**0.1**	**0.0**
	Net exports			-	0.1	2.2	0.5	**5.2**	**-0.5**	**-0.1**
Employment				1.0	1.3	3.2	2.5	**-0.6**	**0.3**	**0.7**
Unemployment rate (a)				6.4	7.1	6.4	5.9	**6.9**	**7.3**	**7.2**
Compensation of employees/head				5.2	3.5	1.8	3.8	**1.3**	**2.2**	**2.3**
Unit labour costs whole economy				2.6	1.2	1.2	4.2	**2.6**	**1.4**	**1.3**
Real unit labour costs				0.1	-1.9	-1.6	1.9	**0.4**	**-0.3**	**-0.8**
Savings rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				2.5	3.1	2.9	2.2	**2.2**	**1.8**	**2.1**
Harmonised index of consumer prices (HICP)				-	2.6	0.7	4.7	**1.8**	**2.0**	**2.1**
Terms of trade of goods				-	-2.5	1.5	0.6	**-4.1**	**-1.2**	**-0.1**
Trade balance (c)				-18.2	-18.9	-18.0	-19.4	**-13.5**	**-14.7**	**-15.2**
Current-account balance (c)				-	-9.2	-6.2	-5.4	**-3.9**	**-4.9**	**-4.4**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-6.2	-5.2	-4.9	**-2.6**	**-3.4**	**-2.7**
General government balance (c)				-	-2.6	-2.2	-4.5	**-3.8**	**-4.3**	**-3.6**
Cyclically-adjusted budget balance (c)				-	-2.5	-2.5	-4.9	**-3.1**	**-3.8**	**-3.4**
Structural budget balance (c)				-	-3.1	-3.1	-5.2	**-3.8**	**-4.0**	**-3.4**
General government gross debt (c)				-	63.7	61.9	63.7	**69.1**	**71.5**	**72.5**

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

18. THE NETHERLANDS
Domestic demand dampening recovery

First signs of recovery after deep recession

As one of the most open economies in Europe the Netherlands could not remain untouched by the global financial and economic crisis. Economic activity experienced a severe contraction of 4% in 2009. The economic downturn started in the second half of 2008 and accelerated in the first quarter of 2009. While the second quarter of 2009 still posted a significant negative growth, the economy rebounded in the final two quarters of the year, recording positive growth again. The rebound came in large part from a recovery in world trade, which had a significant upward effect on exports and showed again the particular sensitivity of the Dutch economy to changes in global demand.

Negative confidence and wealth effects triggered a strong decrease in private consumption, with the annual growth rate at -2½% and all four quarters posting negative growth. Wealth effects had an important impact on consumption in the Netherlands, mostly through falling asset prices, which influenced households' wealth both directly via their role as investor and indirectly through the impact on pension fund assets.

The sharp decrease in production caused by weak global demand and tightening credit conditions resulted in a historically low capacity utilisation rate (less than 75%). This, combined with widespread declines in profits and the need to strengthen their balance sheets, meant that businesses sharply cut their investment by over 15%.

In addition to a fiscal stimulus package aimed at limiting the contraction of the real economy, the government helped to stabilise financial markets and provided support for Dutch financial institutions to cope with the crisis. Although part of the government support was repaid towards the end of 2009, Dutch financial institutions remain vulnerable to risks in the financial markets.

Gradual recovery ahead

The rebound in economic growth in the second half of 2009, mainly resulting from the improvement in global demand, explains why the outlook for GDP growth for 2010 and 2011 is positive at 1¼% and 1¾% respectively. Since exports dropped less sharply than world trade in 2009, partly due to the favourable composition of Dutch exports, and given the continuous gain in market share over the past years, the Netherlands is in a good position to profit from the revival of world trade. A projected decrease in unit labour costs in both 2010 and 2011 is foreseen to provide support to competitiveness again, as wage growth is set to decrease in view of the loosening labour market, which is adjusting to lower production levels. In 2010, the rebound in exports is expected to be more pronounced than that of imports, as the latter is linked to the projected continuation of falling domestic demand.

The recovery of asset prices towards the end of 2009 and in the first quarter of 2010, in particular in the stock market, improved the financial wealth of Dutch households and enabled pension funds to improve their asset position to some extent. These encouraging developments in the stock market are expected to have a positive impact on private consumption. However, the financial wealth position of Dutch households is still below its pre-crisis level. Furthermore, consumers' employment expectations have improved over the past few months, although they still point to an overall increase in unemployment.

The improvement is linked to the apparent resilience of the Dutch labour market, and is foreseen to reduce the need for precautionary saving. On the other hand, real disposable income is expected to decrease slightly in both 2010 and 2011, as a result of decreasing wage growth and, in particular in 2010, rising unemployment. Overall, private consumption is foreseen to continue to decrease in 2010 by ½% before returning to positive growth of 1¼% in 2011.

The tightened credit conditions and the reduced profitability, could lead to a prolonged deleveraging of corporate balance sheets, which would adversely affect private investment growth. Ongoing weak domestic demand, combined with the still very low capacity utilisation rate, contribute further to a negative outlook for gross fixed capital formation. Construction is especially projected to impose a drag on investment, given its relatively long planning horizon. All in all, private investment is projected to decrease by 9% in 2010. Led by a recovery in equipment purchases, investment is foreseen to grow again in 2011, by 3½%.

Inflation is projected to remain relatively subdued in 2010 and 2011 and is projected to reach 1¼% and 1½% respectively. Energy prices are expected to have a depressing effect on inflation in the first half of 2010. This can be ascribed to the decrease in oil prices in 2009, which was passed through into consumer prices with a relatively long lag, as energy prices are only adjusted twice a year. Services are expected to put some upward pressure on inflation, given the significant increase in unit labour cost in 2009. However, this increase may not be fully reflected in prices, given the highly competitive environment.

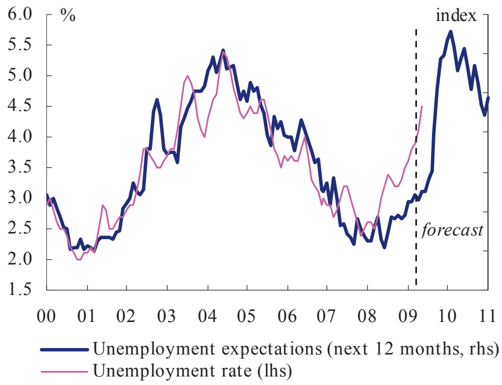
This scenario is subject to both positive and negative risks. On the positive side, a further recovery of asset prices could have a positive impact on private consumption, while this could also fuel investment. On the other hand, risks to the stability of the financial sector have not yet fully disappeared. This may lead to a structural decrease in the supply of credit, which could hamper a sustained economic recovery.

Labour market remaining rather resilient

The Dutch labour market seems to be rather resilient. Despite the severe economic crisis, the unemployment rate increased by only 0.6 pp. to 3.4% in 2009 and remained one of the lowest in the EU. One of the main elements explaining the relatively limited increase in unemployment is labour hoarding. At the dawn of the crisis, the labour market was extremely tight, with an unfilled vacancy rate roughly equalling the unemployment rate. This situation proved to be very difficult for employers to attract and retain qualified personnel. When demand decreased, employers were (initially) reluctant to let personnel go.

The flexible working arrangements, together with the part-time working scheme introduced by the government, also played an important role in dampening the rise in unemployment. The high share of self-employed in the labour force was an additional mitigating factor, as they were able to easily adjust their hours worked. Finally, there was also an effect coming from a decrease in labour supply, mainly resulting from discouraged workers, but also from students who chose to continue studying, and elderly workers who decided to retire earlier. Some of these mitigating factors are likely to disappear gradually in 2010. Most importantly, the corporate sector will find it difficult to sustain labour hoarding, given the sharp rise in unit labour costs in 2009, the associated drop in productivity and the limited recovery of demand. As a result, the unemployment rate is expected to grow to 5% in 2010 and to increase slightly further to 5¼% in 2011.

Graph II.18.1: **The Netherlands - Unemployment leading indicator**

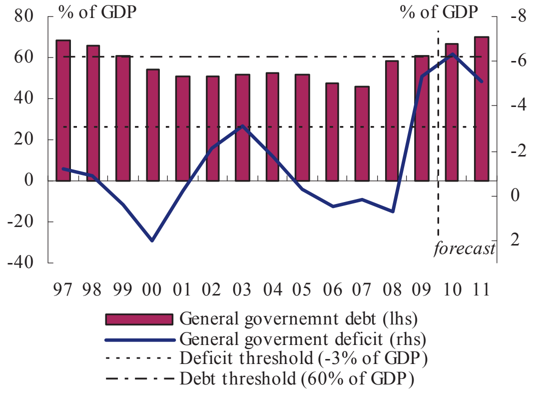


The sharp decrease in economic activity and the contraction in employment are forecast to negatively impact labour supply, also in view of some existing rigidities in the labour market. This could eventually have a negative impact on potential output and is gaining greater significance in view of the approaching effects of population ageing. As ageing will lead to a structural decrease in labour supply, the labour market is expected to tighten again in the medium to long run.

Deterioration of public finances to be halted in 2011

In 2009, the Dutch budget deteriorated sharply from a small surplus in 2008 to a general government deficit of 5.3% of GDP, thus triggering the excessive deficit procedure. Automatic stabilisers have operated fully and were even strengthened by the removal of cyclically sensitive social benefits from under the expenditure ceiling. Furthermore, the Netherlands has implemented a set of measures in response to the crisis covering financial market support, fiscal stimulus, and structural measures. This package amounted to 1% of GDP in 2009 and will be continued in 2010.

Graph II.18.2: **The Netherlands - Government balance and debt**



Despite the expected rebound in real GDP growth in 2010, the public finances are expected to deteriorate further. Most importantly, besides the continuation of the 1% of GDP stimulus package, this is the result of various lagged effects, in particular the projected further increase in unemployment.

In 2011, the deficit is expected to decrease by 1¼ pps. to 5% of GDP. Apart from the positive contribution from cyclical conditions, the improvement mainly results from the withdrawal of stimulus measures and the additionally planned consolidation package amounting to ¼% of GDP.

The government gross debt ratio, which breached the 60% Treaty reference value in 2009 on the back of significant financial support measures in 2008, is expected to increase substantially over the forecast period as a result of deficits in excess of nominal GDP growth. It is projected to come out at almost 70% of GDP in 2011, a level not recorded since 1996.

The main challenges for public finances are the correction of the excessive deficit by 2013 and the improvement of the long-term sustainability of public finances. Budgetary consolidation accompanied by structural reforms would address these challenges.

To this end the Dutch authorities carried out a fundamental budget review, which identified structural reforms and savings options in a wide range of policy areas totalling 20% of government expenditure. An increase in the pension age by 2 years (from 65 to 67), as proposed by the previous government, would also be a first step in improving the long-term sustainability of public finances, should it be adopted.

Table II.18.1:

Main features of country forecast - THE NETHERLANDS

	2008		Annual percentage change						
	bn EUR Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	595.9	100.0	2.6	3.4	3.6	2.0	**-4.0**	**1.3**	**1.8**
Private consumption	272.5	45.7	2.3	-0.3	1.7	1.3	**-2.5**	**-0.4**	**1.3**
Public consumption	151.8	25.5	2.1	9.5	3.7	2.0	**3.2**	**2.0**	**0.2**
Gross fixed capital formation	121.7	20.4	2.6	7.5	4.8	4.9	**-13.0**	**-9.7**	**3.6**
of which : equipment	40.4	6.8	3.6	12.0	7.8	3.9	**-20.8**	**-10.4**	**6.9**
Exports (goods and services)	457.4	76.8	6.2	7.3	6.7	2.7	**-8.2**	**5.9**	**5.2**
Imports (goods and services)	407.6	68.4	6.0	8.8	5.1	3.7	**-8.7**	**3.1**	**5.1**
GNI (GDP deflator)	580.2	97.4	2.6	5.7	2.4	-2.1	**-3.7**	**2.2**	**1.8**
Contribution to GDP growth : Domestic demand			2.2	3.5	2.7	2.1	**-3.0**	**-1.5**	**1.3**
Inventories			0.0	0.2	-0.6	0.3	**-0.7**	**0.6**	**0.0**
Net exports			0.4	-0.3	1.5	-0.4	**-0.3**	**2.2**	**0.6**
Employment			1.0	1.6	2.3	1.2	**-0.9**	**-1.6**	**-0.2**
Unemployment rate (a)			4.5	3.9	3.2	2.8	**3.4**	**4.9**	**5.2**
Compensation of employees/f.t.e.			3.6	2.4	3.4	3.8	**2.3**	**1.8**	**1.7**
Unit labour costs whole economy			2.0	0.7	2.1	2.9	**5.6**	**-1.1**	**-0.3**
Real unit labour costs			-0.4	-1.1	0.5	0.2	**5.9**	**-2.1**	**-1.9**
Savings rate of households (b)			-	-	13.8	13.1	**15.6**	**15.4**	**13.7**
GDP deflator			2.4	1.8	1.6	2.7	**-0.3**	**1.0**	**1.6**
Harmonised index of consumer prices (HICP)			2.2	1.7	1.6	2.2	**1.0**	**1.3**	**1.5**
Terms of trade of goods			0.5	-0.3	-0.3	-0.1	**-1.0**	**-1.1**	**0.1**
Trade balance (c)			5.7	7.7	8.0	7.4	**6.6**	**8.3**	**8.5**
Current-account balance (c)			5.4	9.0	8.5	4.2	**3.9**	**5.9**	**6.4**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			5.1	8.7	8.1	3.9	**3.6**	**5.6**	**6.0**
General government balance (c)			-1.7	0.5	0.2	0.7	**-5.3**	**-6.3**	**-5.1**
Cyclically-adjusted budget balance (c)			-1.5	0.3	-1.0	-0.5	**-3.6**	**-4.9**	**-4.0**
Structural budget balance (c)			-	0.3	-1.0	-0.5	**-3.6**	**-4.9**	**-4.0**
General government gross debt (c)			63.4	47.4	45.5	58.2	**60.9**	**66.3**	**69.6**

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

19. AUSTRIA

Gradual, but steady recovery

A deep recession in 2009

The global financial and economic crisis has pushed the Austrian economy into the deepest recession for decades. In response to the downturn, the Austrian government introduced discretionary fiscal measures providing a timely stimulus, as a large part of these took effect in the first four months of 2009. Two economic recovery programmes, income tax cuts and two labour-market support packages were introduced which focused on supporting income, reducing lay-offs and improving access to training, sustaining investment and facilitating access by the private sector to finance. Support to credit-constrained enterprises came mainly in off-budget form as guarantees and subsidised loans. To support the automotive sector, a premium was offered for scrapping old cars in conjunction with the purchase of new ones. Overall, fiscal support provided in 2009 amounted to 1½% of GDP. In addition, it is estimated that the domestic stimulus was reinforced to almost equal size by that undertaken by Austria's European partners.

The economic and financial crisis started taking its toll on activity in Austria in the third quarter of 2008 (GDP growth at -0.6% q-o-q). It gained momentum in early 2009 and reached a trough in the second quarter of that year. Overall, GDP declined by 3.6% in 2009. The downturn was primarily transmitted to Austria by falling exports, reflecting the collapse in world trade. The strongly export-oriented manufacturing sector has suffered most, as merchandise exports declined by almost 18%.

As a consequence, private investment in equipment fell by over 12% on the back of weakening corporate profits, low capacity utilisation, higher lending margins and tighter credit conditions. Due to several fiscal measures (such as infrastructure investment and subsidies for energy-saving renovation of buildings), the decline in construction investment was less severe. Drops in both categories of investment, although quite large, were relatively benign in comparison with other euro-area countries.

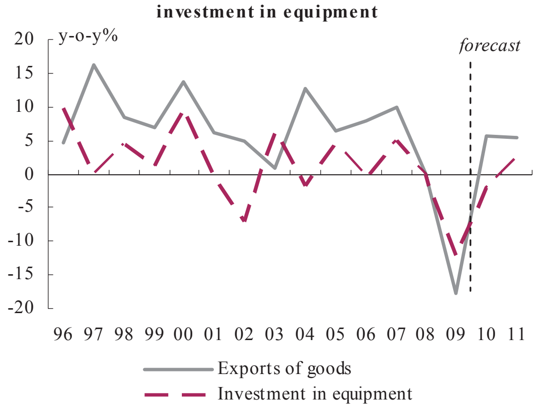
Private consumption growth, even though much lower than in recent years, became a stabilising factor. In fact, Austria was one of few EU countries which enjoyed a real increase in private consumption expenditure in 2009. The supporting factors behind this were, *inter alia*, low inflation, cuts in income tax and increased transfer payments.

Timid but steady recovery in 2010 and beyond

For 2010 and 2011, GDP is expected to grow by about 1¼% and by 1½% respectively. The recovery will be led first by net exports. Subsequently, domestic demand is expected to take over as the main driver of growth on the back of gross fixed capital formation returning to positive growth rates.

Growth in private consumption expenditure is expected to accelerate slightly in 2010, inter alia because fiscal policy is still set to stimulate domestic demand since parts of the 2009 tax reform only come into force in 2010 (in particular, relief for families with children and tax cuts for the self-employed). A deceleration in private consumption growth is foreseen for 2011, as the temporary stimulus measures are phased out and the situation on the labour market remains tense. Public consumption expenditure is assumed to develop in a similar manner. Both private and public consumption are subject to downside risks, if the Austrian authorities proceed, from 2011 onwards, with the consolidation plans described below.

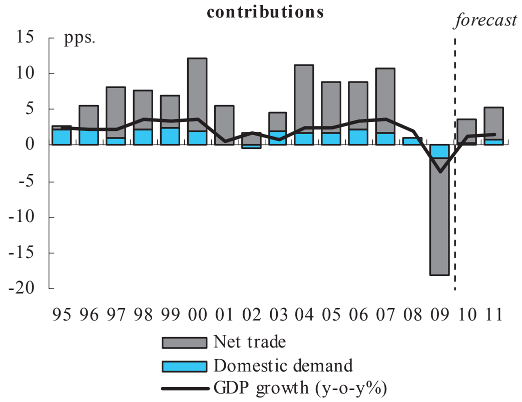
Graph II.19.1: **Austria - Exports of goods and investment in equipment**



Foreign demand is set to strengthen gradually as a result of support from policy across the world.

The nascent recovery in Austria's main trading partners, Germany and Italy, as well as in the Central and Eastern European countries is of particular importance. Growing orders point to a pick-up in Austrian exports. As a result, domestic industrial output is forecast to start growing once again. The slump in investment in machinery and equipment is expected to come to an end with the revival of industrial production and gradually rising capacity utilisation. The advanced depreciation provision, which came into force in 2010, is as well likely to encourage companies to invest in new production facilities, while also replacing old capital stock vintages. Equipment investment is thus expected to edge up slightly in the course of the year, but due to a strong negative carry-over from 2009, the annual growth rate is likely to be still negative in 2010, while turning positive in 2011. It is expected that investment in construction will follow a similar pattern.

Graph II.19.2: **Austria - GDP growth and contributions**



Moderate inflation and wages

Consumer prices rose by a mere 0.4% in 2009, mainly on the back of strong base effects from declining fuel and heating oil prices and the downward pressure on profit margins from weak demand conditions. In 2010, it is assumed that oil and food prices will exercise upward pressure, while the profile for services and industrial goods inflation is assumed to be flat. Dampening effects are set to come from wages growing more slowly than in the previous year. Overall, inflation is forecast to rise to 1.3%. The core inflation rate is expected to be just under 1%. With the recovery gaining ground and a gradual rebound in profit margins, a further, yet small increase in inflation is expected in 2011.

Wage settlements negotiated for 2009 were based on a higher inflation rate and strong productivity growth of the previous years. In response to the deterioration of economic activity in 2009, government policy measures to shield the labour market dampened the fall in employment. As a result of these two factors, productivity fell sharply while unit labour costs rose. It should be noted, though, that the increase in unit labour costs was overstated to some extent as part of the wage costs for employees in short-time work was borne by the government. For 2010 and 2011, rising unemployment and low inflation are likely to contain wage pressures.

Decelerating unemployment growth

As the recession began to take its toll on the labour market, employment decreased by almost 1% in 2009, pushing the unemployment rate up to almost 5% (from 3.8% in the previous year). Short-time work and extended training in particular contributed to a smaller fall in employment than might have been expected given the scale of the contraction in activity. Total employment is forecast to fall somewhat further in 2010, before picking up gently in 2011. The unemployment rate is projected to continue growing throughout the forecast period, in spite of the pick-up in job creation in 2011. This is linked to a growing domestic labour force and the phasing-out of measures aimed at stabilising the labour market. In addition, in 2011, foreign labour supply may rise with the expiry of the seven-year-long transition period during which Austria restricted access to its job market for citizens of the new EU Member States, though the impact of this is difficult to quantify.

Deficit to widen in 2010 before narrowing again

The general government deficit rose to 3½% of GDP in 2009, as a result of the free operation of automatic stabilisers and the above-mentioned stimulus packages adopted by the Austrian authorities. In 2010, the deficit is set to widen further, to 4¾% of GDP, partly due to negative composition effects with growth drivers shifting towards net exports and some discretionary measures. In particular, parts of the 2009 tax reform, namely relief for families with children and tax cuts for the self-employed, came into force only in 2010 and are expected to burden the budget by about ¼% of GDP. The accelerated depreciation provision, adopted in January 2009, will also weigh somewhat on the budget in 2010.

For 2011, on a no-policy-change assumption, only a slight consolidation is forecast, as the deficit-increasing and the deficit-decreasing measures almost offset each other. On the one hand, the budget will be burdened by, among others, additional revenue shortfall following from the 2009 tax reform as well as the cost of the prolongation of the access to a special early-retirement channel for workers with very long insurance period *(Hacklerregelung)*. On the other hand, a small decrease in health-care expenditure was agreed on by the federal government and the public health funds. On top of that, less money is projected to be spent on labour market relief as the short-time work scheme is being phased out.

The budgetary target for 2011 is subject to an upside risk. In early March 2010, the government coalition partners agreed on a new strategy, which aims at bringing the general government deficit below 3% of GDP by 2013, in line with the Council recommendation under the excessive deficit procedure. According to the new plan, 60% of the earlier-planned consolidation will take place on the expenditure side, with the remaining 40% falling on the revenue side. Almost all ministries are required to cut their expenditure by 3.6%. It has not been decided yet where the additional revenue would come from, but some of the currently discussed sources are: changes to the rules governing the capital income tax and the tax on foundations, introduction of a special bank levy and financial transactions tax, a rise in the petrol tax, an increase in the tax rate for high-income earners. No concrete measures had been announced so far, but the above-described agreement constituted the basis for the preparation of the 2011-14 federal expenditure framework law *(Bundesfinanzrahmengesetz)*, currently under debate by the Austrian Parliament.

Gross government debt went up by 4 pps. in 2009, reaching 66½% of GDP. Apart from the increase in the deficit and the decline in GDP growth, a significant stock-flow adjustment, primarily reflecting bank-rescue operations contributed to the rise in the debt-to-GDP ratio. Throughout the forecast period, the debt ratio is projected to continuously rise and reach almost 73% of GDP in 2011.

Table II.19.1:
Main features of country forecast - AUSTRIA

		2008		Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		281.9	100.0	2.1	3.5	3.5	2.0	**-3.6**	**1.3**	**1.6**
Private consumption		148.8	52.8	1.7	1.8	0.8	0.8	**0.4**	**0.8**	**0.6**
Public consumption		52.9	18.8	1.9	2.7	1.7	3.2	**1.2**	**1.2**	**1.0**
Gross fixed capital formation		61.5	21.8	1.4	2.4	3.8	1.0	**-7.8**	**-1.4**	**1.7**
of which : equipment		23.0	8.2	1.4	-0.5	5.0	0.0	**-12.1**	**-2.2**	**2.5**
Exports (goods and services)		167.3	59.4	6.0	7.5	9.4	0.8	**-15.5**	**4.2**	**4.9**
Imports (goods and services)		151.1	53.6	5.0	5.3	7.3	-0.7	**-13.6**	**2.5**	**3.8**
GNI (GDP deflator)		277.4	98.4	2.2	3.3	2.6	2.5	**-2.7**	**1.3**	**1.6**
Contribution to GDP growth :	Domestic demand			1.6	2.0	1.6	1.2	**-1.3**	**0.4**	**0.9**
	Inventories			0.0	0.2	0.1	-0.1	**-0.4**	**0.0**	**0.0**
	Net exports			0.5	1.4	1.5	0.8	**-1.9**	**0.9**	**0.7**
Employment				0.4	1.0	1.6	1.8	**-0.9**	**-0.1**	**0.2**
Unemployment rate (a)				4.1	4.8	4.4	3.8	**4.8**	**5.1**	**5.4**
Compensation of employees/f.t.e.				2.6	3.4	3.0	3.1	**2.4**	**1.6**	**2.1**
Unit labour costs whole economy				0.9	1.0	1.0	2.9	**5.3**	**0.1**	**0.7**
Real unit labour costs				-0.6	-0.7	-1.1	0.8	**3.3**	**-0.5**	**-1.0**
Savings rate of households (b)				-	-	16.0	16.7	**17.1**	**16.8**	**16.7**
GDP deflator				1.6	1.6	2.1	2.0	**1.9**	**0.6**	**1.7**
Harmonised index of consumer prices (HICP)				1.9	1.7	2.2	3.2	**0.4**	**1.3**	**1.5**
Terms of trade of goods				-0.1	-0.7	-0.5	-2.1	**0.9**	**-1.7**	**1.0**
Trade balance (c)				-2.3	0.3	0.7	0.1	**-0.9**	**-0.6**	**0.2**
Current-account balance (c)				-0.7	3.0	3.4	3.6	**2.9**	**3.1**	**4.1**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-0.9	2.7	3.3	3.6	**2.9**	**3.1**	**4.1**
General government balance (c)				-2.6	-1.5	-0.4	-0.4	**-3.4**	**-4.7**	**-4.6**
Cyclically-adjusted budget balance (c)				-2.5	-1.9	-1.6	-1.7	**-2.4**	**-3.6**	**-3.6**
Structural budget balance (c)				-	-1.9	-1.6	-1.7	**-2.4**	**-3.6**	**-3.6**
General government gross debt (c)				64.9	62.2	59.5	62.6	**66.5**	**70.2**	**72.9**

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.
Note : Contributions to GDP growth may not add up due to statistical discrepancies.

20. POLAND

Leading the pack in the recovery phase

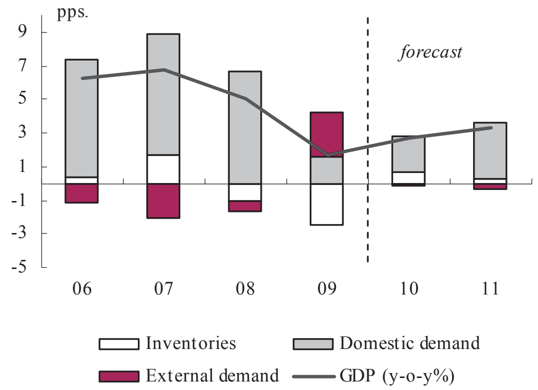
Resilience confirmed

The economic performance of the Polish economy was strong in 2009, with real GDP increasing by 1.7%, the only positive growth rate in the EU. Real GDP growth remained positive throughout the year and accelerated in the last quarter of 2009, when it reached 1.2% q-o-q. This exceptional performance during the crisis reflects a constellation of favourable factors including sound fundamentals at the onset of the crisis, a well-capitalised and sound financial sector, the relatively low degree of openness of the economy, a sizeable depreciation of the Polish currency at an early stage of the crisis, the cushioning effect of real-wage adjustment on employment, and timely reactions from monetary and fiscal policies. While some of these factors are temporary in nature – with the worsening of the fiscal position the margin for supportive fiscal policy disappeared, and the exchange rate has been appreciating since the spring – most of them are set to continue to fuel growth in the coming quarters.

In addition, the effects of the global crisis on potential growth are expected to be less pronounced than in other countries of the region. First, the lower dependence of the Polish economy on the financial services, construction and automotive industries has led to a lower incidence of bankruptcies and more limited destruction of capital stock. Second, there are indications that Poland's flexible wage setting mechanism (compared with the previous slowdown of 2000-01) is likely to help limit the increase in structural unemployment through hysteresis. The sharper-than-anticipated adjustment of real wages has indeed mitigated the effects of the downturn on employment leading to a less-pronounced rise in the unemployment rate than was initially expected. Moreover, labour supply will benefit in coming years from recent structural reforms (reduction of the tax wedge, abolition of special early pensions for a majority of beneficiaries, and effects of the pension reform). Finally, the pronounced increase of public investment is also expected to boost potential output.

Another reason for optimism is that the Polish financial system has resisted the global financial crisis well. This owes largely to the conservative behaviour of banks before the crisis in terms of lending practices and investment strategies. Moreover, prudent financial system supervision and the incentive to build up capital by retaining profits accumulated in the previous year have contributed to reinforcing the robustness of the banking system (the capital adequacy ratio reached 13.3% at the end of 2009). The impact of financial stress on the economy, although reflected in tightened credit conditions, has been limited by the low indebtedness of the private sector, in particular corporates, and the lower-than-expected impact of the slowdown on profitability. All in all, following the moderate decline of credit to enterprises towards the end of 2009,[78] the most recent bank-lending survey points to a possible stabilisation in the coming quarters. Credit growth to households could still decelerate in response to the labour-market situation, the increased share of non-performing loans, and the tightened regulatory framework.

Graph II.20.1: **Poland - GDP growth and contributions**



Poland to fully benefit from the improvement in the global economic environment

The outlook features a continued recovery in 2010 and 2011. Real GDP is projected to increase by 2.7% in 2010 and 3.3% in 2011. The main drivers of this recovery are the ongoing rebound in global trade and foreign capital inflows, the latter reflecting the lower risk aversion in international capital markets and the improved perception of the Polish economy among foreign investors. The smooth adjustment of the labour market to the crisis and still-accommodative monetary

(78) Nominal lending denominated in PLN to non-financial corporations declined by ca. 3% at the end of 2009.

conditions are also expected to support the recovery.

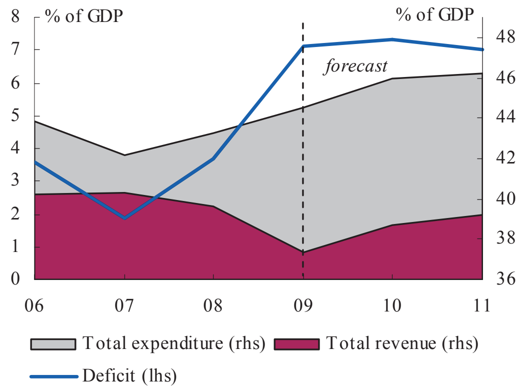
Like elsewhere in the region, rising external demand is projected to boost exports. However, this demand effect is likely to be partly offset by the impact of the appreciating currency (14% against the euro over February 2009 - February 2010), which may also stimulate imports following the large drop observed in 2009. While it is still forecast to weigh on real disposable income and consumption, the situation of the labour market is less of a concern than initially expected. The prospects of recovery and the recent reforms that reduced labour costs and favoured adjustment of real wages, seem to be mitigating the effects of the downturn on employment. The unemployment rate is now expected to peak at about 9.4% of the labour force, instead of 10% in the autumn forecast. Finally, investment spending is set to be positive in 2010, with the planned acceleration of capital formation in the public sector and higher FDI inflows compensating for the weakness of domestic private investment in the immediate post-crisis environment. Inflation is expected to fall in 2010, reflecting the large negative output gap following the crisis, contained wage pressure, a limited rise in administered prices and the appreciating currency.

The recovery is expected to gain momentum in 2011. This reflects external factors (continued recovery of the world economy and a further increase in FDI), but also the stabilisation of the situation in the labour market (which will stimulate demand by households), and the improved absorption of EU funds (several projects will need to be finalised ahead of the 2012 European soccer championship). Moreover, with a more sustained recovery, projected loosening of credit conditions and growing capacity utilisation, corporates should start to invest again.

The sizeable current-account deficit of 5% of GDP in 2008 improved to 1.6% of GDP in 2009 amid a sharp contraction in domestic demand for durable and investment goods (which constitute the majority of Polish imports), and a less-pronounced decline in external demand for Polish consumption goods, not least because of a strong zloty depreciation. The current-account deficit is expected to gradually increase to 3.3% of GDP over the forecast horizon, reflecting the rebound in domestic demand, the lagged effects of appreciating zloty, and improved profitability of foreign-owned companies.

This scenario is subject to both upside and downside risks. On the positive side, a stronger rebound in global demand would boost exports and investments. The steady improvement in growth and employment prospects could also imply lower precautionary savings by households than assumed in the forecast. On the negative side, a delayed loosening of credit conditions could hamper investment and consumption in the quarters ahead. In addition, the public finances' situation, if not addressed, could affect market sentiment adversely, and increase the costs of borrowing also for the private sector.

Graph II.20.2: **Poland - General government finances**



While the Polish economy has remained surprisingly resilient during the crisis, key challenges for the years ahead will be to secure steady competitiveness gains, continue the catching-up process and maintain macroeconomic stability. Exchange-rate depreciation has played a key role in supporting growth during the crisis, but its role will gradually vanish with the return of foreign capital to emerging markets (this will put upward pressure on the zloty). Thus, the competitive position of the Polish economy will depend on the continuous upgrade of the export structure towards capital-intensive and high-technology industries. To this end, domestic driven productivity improvements, generated by investments in R&D and fostered by more flexible labour and product markets, will have to play an even more important role than in the past. This would also contribute to fostering the sustainable convergence of Polish GDP per capita towards the average EU level.

Public finances in the red

The headline government deficit, which had been reduced to below 2% of GDP in 2007 after several years of strong growth, widened to 7.1% of GDP in 2009. This very sizeable increase in the deficit reflects the operation of automatic stabilisers during the crisis as well as the impact of stimulus measures of about 2% of GDP, which included a cut in personal income tax and an increase of investment in infrastructure. Despite measures taken to contain the increase in the deficit in 2009 (reduction of administrative expenditure and increase of dividends from state-owned enterprises), the structural balance deteriorated by more than 2 pps., reaching about 7¼% of GDP.

Under current policies and growth forecasts, the headline government deficit is set to stabilise over 2009-11. It should deteriorate marginally from 7.1% of GDP in 2009 to about 7⅓% of GDP in 2010, and advance to 7% of GDP in 2011. The difference of -0.4 pp. in the projected deficit for 2010, compared to the latest projection by the national authorities, is explained mainly by lower projected tax revenues due to a less dynamic growth scenario. The structural deficits are set to decrease moderately from 7¼% to 5¾% of GDP over the period, reflecting favourable growth composition towards end of the forecast horizon and the impact of consolidation measures announced so far. The foreseen worsening of government finances in 2010 mainly reflects an increase in government expenditure, which is not fully compensated on the revenue side. Both the expenditure and the revenue ratios are forecast to grow in 2010, reflecting the financing by EU structural funds of public investment projects. The projected rise in the revenue ratio also reflects an increase in excise and quasi-excise duties (on cigarettes and fuel). In 2011, the expenditure ratio is projected to grow marginally by 0.2 pp., mainly on the back of rising investment and interest expenditure. Developments in expenditure in 2010 and 2011 may be worse than projected in this forecast, given a possible escalation of spending pressures ahead of and after presidential and general elections.

As a consequence of the high deficits, gross debt is forecast to increase from slightly more than 47% of GDP in 2008 to approximately 59⅓% in 2011. The projected debt figures are subject to significant uncertainty because of the high volatility of the exchange rate and the ensuing valuation effects of the foreign-denominated part of the debt. Finally, interest expenditure may turn out to be higher than projected, which would further limit the room for manoeuvre on the fiscal side.

Table II.20.1:
Main features of country forecast - POLAND

	2008		Annual percentage change						
bn PLN	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	1272.8	100.0	4.3	6.2	6.8	5.0	**1.7**	**2.7**	**3.3**
Private consumption	785.2	61.7	4.2	5.0	4.9	5.9	**2.3**	**1.5**	**2.7**
Public consumption	236.3	18.6	3.1	6.1	3.7	7.5	**1.2**	**3.0**	**-0.1**
Gross fixed capital formation	280.9	22.1	6.3	14.9	17.6	8.2	**-0.3**	**3.0**	**8.0**
of which : equipment	107.9	8.5	-	17.1	22.3	10.9	**-6.9**	**-1.0**	**4.5**
Exports (goods and services)	508.9	40.0	10.7	14.6	9.1	7.1	**-9.1**	**6.0**	**5.8**
Imports (goods and services)	559.5	44.0	11.2	17.3	13.7	8.0	**-14.3**	**6.3**	**6.7**
GNI (GDP deflator)	1243.8	97.7	4.5	5.5	5.6	6.4	**0.7**	**2.2**	**3.3**
Contribution to GDP growth : Domestic demand			4.5	7.0	7.2	6.7	**1.6**	**2.1**	**3.4**
Inventories			0.0	0.4	1.7	-1.1	**-2.5**	**0.7**	**0.3**
Net exports			-0.2	-1.1	-2.1	-0.6	**2.7**	**-0.1**	**-0.4**
Employment			-	3.2	4.4	3.8	**0.4**	**0.0**	**0.6**
Unemployment rate (a)			15.2	13.9	9.6	7.1	**8.2**	**9.2**	**9.4**
Compensation of employees/head			18.0	1.8	4.9	8.1	**3.7**	**3.2**	**4.4**
Unit labour costs whole economy			-	-1.1	2.6	6.9	**2.4**	**0.5**	**1.7**
Real unit labour costs			-	-2.5	-1.3	3.8	**-1.2**	**-1.7**	**-0.7**
Savings rate of households (b)			-	-	9.5	6.3	**8.3**	**8.2**	**7.8**
GDP deflator			13.8	1.5	4.0	3.0	**3.7**	**2.2**	**2.4**
Harmonised index of consumer prices (HICP)			-	1.3	2.6	4.2	**4.0**	**2.4**	**2.6**
Terms of trade of goods			0.2	-0.3	2.0	-2.1	**5.0**	**-1.0**	**-0.5**
Trade balance (c)			-3.0	-2.0	-4.0	-4.9	**-1.0**	**-1.2**	**-1.7**
Current-account balance (c)			-1.9	-3.0	-5.2	-5.0	**-1.6**	**-2.8**	**-3.3**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-1.2	-2.1	-4.1	-4.2	**0.0**	**-0.8**	**-1.0**
General government balance (c)			-	-3.6	-1.9	-3.7	**-7.1**	**-7.3**	**-7.0**
Cyclically-adjusted budget balance (c)			-	-4.0	-2.8	-4.6	**-6.9**	**-6.5**	**-5.7**
Structural budget balance (c)			-	-4.0	-2.8	-4.6	**-7.2**	**-6.3**	**-5.7**
General government gross debt (c)			-	47.7	45.0	47.2	**51.0**	**53.9**	**59.3**

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

21. PORTUGAL

Modest recovery ahead

Impact of the crisis in 2009 and policy response

The Portuguese economy recorded a contraction of 2.7% in 2009, largely driven by a shrinking domestic demand. The downturn is having a significant impact on jobs and unemployment has reached historical highs. Imbalances existing before the crisis, notably the external deficit, have remained sizeable, even if slightly reduced, reflecting low domestic savings, low productivity growth and eroded competitiveness. At the same time, the current crisis is severely affecting public finances, with the government deficit and the debt reaching also record highs in recent decades.

The policy response to the crisis has consisted mainly of the implementation of discretionary measures to stimulate the economy, together with the pursuit of some structural reform efforts. The fiscal measures focused on public investment, social protection and support to employment, investment and exports by the private sector. At the same time, while the direct impact of the financial crisis on the Portuguese banking sector has been contained and no credit crunch has been observed, a series of measures were implemented to strengthen financial stability.

Against this backdrop, the challenge is to improve competitiveness and narrow macroeconomic imbalances, which is a necessary condition for a sustained reduction of the large external deficit as well as to put the Portuguese economy on a footing of higher and steady long-term GDP growth.

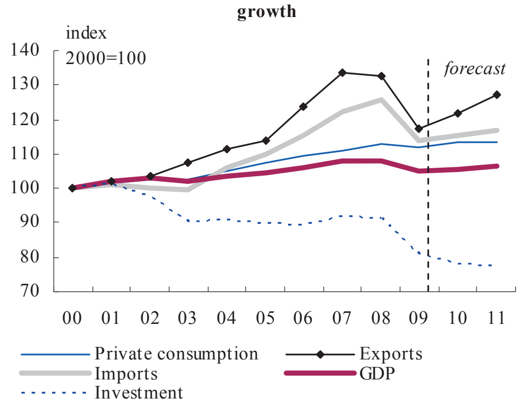
Back to slow growth path

The outlook features a modest recovery over the forecast period, with GDP growing by ½% in 2010 and ¾% in 2011. That is projected to be driven by external trade as domestic demand is set to essentially stagnate, mirroring weak consumption and still shrinking investment.

Sluggish labour income with high unemployment is expected to lead private consumption to stagnate in 2011. In addition, as interest rates gradually rise from current lows, the burden of servicing the relatively high level of household debt at floating rates will dampen disposable income, especially in 2011. At the same time, access to credit remains tighter than before the crisis. Household saving rate is expected to recede marginally from the 2009 level, yet to remain above the rates recorded before the onset of the current crisis.

Investment is projected to continue to fall in 2010 and to broadly stagnate in 2011. Against still weak demand prospects and dampened profitability, opportunities for investment will be limited. In addition, average credit conditions are likely to continue to be stricter than before the crisis. As a result, the coming years are expected to be characterised by the consolidation of corporate balance sheets. This consolidation is set to lead to a deleveraging process and to limit the room for private investment.

Graph II.21.1: **Portugal - Contributions to GDP growth**



The current outlook for domestic demand represents a baseline scenario, which is subject to a number of risks that are considered to be broadly balanced. On the one hand, the record-low interest rates could still relieve debt-service burdens for both households and corporations well into 2010 and early 2011. Moreover, low inflation rates could underpin real disposable income growth more than assumed in the current outlook. On the other hand, subdued labour-market prospects might lead to a further rise in household savings. Given the large external borrowing needs of the Portuguese economy and the implied interest payments, stress on financial conditions would limit the spending capacity of the Portuguese private sector

The outlook for exports is very much determined by the recovery of external demand. In this respect, the subdued outlook for the country's main trading partners, notably for Spain as it accounts for a quarter of Portuguese exports, is expected to hinder exports prospects. In addition, the competitive position of the economy is not projected to change, consequently limiting the rebound in exports in the medium term. Furthermore, as the economy's degree of openness is somewhat lower than the euro-area or EU averages, it may benefit less than others from the ongoing recovery in world trade. Overall, as GDP growth is expected to be determined by trade developments, the current outlook is very much subject to the risks for export performance.

The crisis continues to weigh on employment, which is projected to shrink further in 2010 and to stabilise in 2011, yielding a cumulative contraction of 3% over last year and this year. On the whole, the unemployment rate may increase to just below 10%. As a result, wages are expected to moderate this year and the next, after a relative resilience up to 2009.

External deficit slightly lower…

After a small fall to 10½% of GDP in 2009, the current-account deficit is projected to diminish little over the forecast period. Overall, this unsustainable external deficit path highlights the insufficiency of domestic savings, against a backdrop of relatively resilient consumption given fundamentals, and the weak competitiveness position. The long period of large external deficits has added to net external liabilities that surpassed 110% of GDP by end 2009. The service of these liabilities will continue to absorb a non-negligible share of income over the medium term, mirrored in the growing primary income deficit. In fact, the primary income deficit is already a major component of the current account as well as an element of rigidity in the narrowing of the overall external deficit. As a result, the gap between the levels of gross domestic product and gross national income will remain wide and growing.

…while low productivity growth hampers competitiveness gains

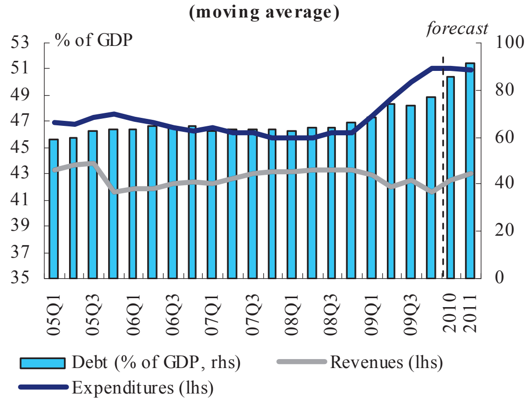
Thus, addressing the external imbalance hinges upon a marked and sustained recovery in net exports, which in turn depends on improvements in the competitiveness position. Productivity growth in Portugal has been sluggish and below the euro area average during the last decade, reflecting also structural weaknesses, such as a relatively high weight of labour-intensive sectors, insufficient human capital accumulation, or labour market rigidities such as high employment protection.

From a long-term perspective, the challenge is to lift productivity growth in a sustained way and for the supply side to move up in the value chain. Achieving that would support potential GDP growth, boost competitiveness and help the much needed exports-driven GDP growth pattern over the coming years.

Cost developments have not helped competitiveness, reflecting also an apparent weak response of wages to productivity and labour market developments. Wages are projected to decelerate in 2010 and 2011, yet exceeding productivity growth and inflation. Combined productivity and wage developments are set to lead unit labour costs to increase still slightly more than in most of the country's main trading partners, thereby possibly limiting the potential of the external sector to contribute more to the overall economic recovery.

After falling prices in 2009, inflation is projected to return to positive territory. The inflation differential with the euro area is set to remain negative, albeit small, in 2010 and 2011. Whereas prices for oil and other commodities have been a key driver of the negative inflation rate in 2009, they may create some inflationary pressures in 2010-11. However, sluggish demand and some wage moderation are offsetting factors.

Graph II.21.2: **Portugal - Public finances (moving average)**



Public finances starting to adjust

Public finances have been visibly affected by the current crisis with the government deficit representing 9.4% of GDP in 2009. This figure compares with deficit outturns marginally below 3% of GDP in 2007 and 2008 (in the latter year with the help of deficit-reducing one-off measures worth ¾% of GDP) and is explained by both hiking expenditure and falling revenue ratios in 2009. Discretionary measures (some of them in the context of the European Economic Recovery Programme) taken since mid 2008 on both the revenue and expenditure side of the budget, and amounting to around 1½% of GDP in 2009, weighted further on the budgetary position. In addition, an expansion of spending was observed in most expenditure categories, reflecting also higher increases in nominal government wages and social benefits outlays when compared with earlier years, as well as the customary anti-cyclical behaviour of a number of social transfers. The increase in the expenditure-to-GDP ratio was further aggravated by the fall in nominal GDP.

The government deficit is projected to decrease to 8½% of GDP in 2010. Against a very weak GDP growth outlook, this improvement in the budget balance is expected to result from a number of factors. First, the withdrawal over 2010 of temporary stimulus measures implemented in 2009. Second, the expiration of some deficit-increasing one-off measures in 2009 and the implementation of deficit-reducing ones in 2010. Third, some additional consolidation measures taken already this April, representing a front loading of fiscal consolidation efforts in comparison with earlier plans.

The government deficit is expected to narrow somewhat further in 2011. This reflects consolidation measures on both the revenue and the expenditure side of the budget. The former focuses on reducing tax benefits on personal income or broadening contributions, while the latter include, for instance, containment of the government wage bill or cuts in some social transfers. Yet the sluggish economic activity continues to weight on the budget balance: on the revenue side, tax inflows are expected to be constrained mainly by stagnating consumption. On the spending side, the expenditure-to-GDP ratio is set to be little changed with primary expenditure restraint being jeopardised by rising interest spending.

With continued high deficits and low GDP growth, government debt is projected to rise to 86% of GDP in 2010 and, under the no-policy change assumption, to 91% of GDP in 2011, after an average of some 65% of GDP in pre-crisis years.

Table II.21.1:
Main features of country forecast - PORTUGAL

		2008				Annual percentage change				
		bn EUR Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		166.4	100.0	2.2	1.4	1.9	0.0	**-2.7**	**0.5**	**0.7**
Private consumption		110.7	66.5	2.5	1.9	1.6	1.7	**-0.8**	**1.0**	**0.0**
Public consumption		34.5	20.8	2.7	-1.4	0.0	1.1	**3.5**	**-0.3**	**-0.2**
Gross fixed capital formation		36.1	21.7	2.2	-0.7	3.1	-0.7	**-11.1**	**-4.2**	**-0.6**
of which : equipment		12.2	7.3	3.0	6.6	8.1	4.6	**-12.8**	**-5.2**	**-1.0**
Exports (goods and services)		54.9	33.0	5.3	8.7	7.8	-0.5	**-11.6**	**3.8**	**4.4**
Imports (goods and services)		70.8	42.5	5.8	5.1	6.1	2.7	**-9.2**	**1.1**	**1.5**
GNI (GDP deflator)		159.7	96.0	2.1	-0.3	1.7	-0.3	**-2.7**	**0.4**	**0.2**
Contribution to GDP growth :	Domestic demand			2.7	0.8	1.8	1.2	**-2.4**	**-0.2**	**-0.1**
	Inventories			0.2	0.1	0.1	0.3	**-0.4**	**0.1**	**0.1**
	Net exports			-0.7	0.6	0.0	-1.2	**0.1**	**0.7**	**0.7**
Employment				0.5	0.5	0.0	0.4	**-2.5**	**-0.5**	**0.0**
Unemployment rate (a)				5.8	7.8	8.1	7.7	**9.6**	**9.9**	**9.9**
Compensation of employees/head				6.3	2.1	3.4	3.3	**4.3**	**1.6**	**1.6**
Unit labour costs whole economy				4.5	1.3	1.4	3.7	**4.5**	**0.6**	**0.9**
Real unit labour costs				0.3	-1.5	-1.5	1.6	**3.3**	**-0.5**	**-0.7**
Savings rate of households (b)				-	-	6.1	6.4	**8.8**	**8.1**	**7.8**
GDP deflator				4.2	2.8	3.0	2.0	**1.2**	**1.1**	**1.6**
Harmonised index of consumer prices (HICP)				3.7	3.0	2.4	2.7	**-0.9**	**1.0**	**1.4**
Terms of trade of goods				0.4	0.4	1.5	-2.3	**4.8**	**-1.4**	**-0.3**
Trade balance (c)				-9.9	-10.1	-10.1	-12.1	**-10.0**	**-9.6**	**-9.1**
Current-account balance (c)				-7.4	-10.4	-9.8	-12.1	**-10.5**	**-10.1**	**-10.0**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-5.1	-9.3	-8.4	-10.2	**-9.4**	**-8.8**	**-8.6**
General government balance (c)				-4.0	-3.9	-2.6	-2.8	**-9.4**	**-8.5**	**-7.9**
Cyclically-adjusted budget balance (c)				-4.0	-3.7	-3.0	-2.9	**-8.3**	**-7.5**	**-7.0**
Structural budget balance (c)				-	-3.7	-3.1	-3.8	**-8.1**	**-7.7**	**-7.0**
General government gross debt (c)				56.1	64.7	63.6	66.3	**76.8**	**85.8**	**91.1**

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

22. ROMANIA

Increased stability nurtures a nascent economic recovery

Deep recession caused by the crisis

With an average annual real GDP growth of 6.8% between 2004 and 2008, Romania was one of the fastest growing EU Member States. However, this strong growth went hand in hand with growing external and fiscal imbalances. The sudden increase in risk aversion during the financial crisis caused market participants to become increasingly concerned about these imbalances. Capital inflows fell markedly and the exchange rate of the RON against the euro depreciated by more than 30% between August 2007 and January 2009. Tighter access to financing, balance-sheet effects of the currency depreciation, and the sharp decline in exports due to the slump in global trade triggered a strong contraction of real GDP, which fell by 7.1% in 2009.

The contraction in economic activity led to an increase of the unemployment rate from 5.8% in 2008 to 6.9% in 2009. However, in spite of easing wage pressures, HICP inflation (5.6% in 2009) remained relatively high compared to regional peers, reflecting rigidities in labour and product markets. The crisis also triggered a pronounced adjustment of external imbalances. The current-account deficit is estimated to have fallen from 12.7% of GDP in 2008 to 4.4% in 2009.

The benefits from the adoption of the comprehensive economic policy programme, agreed as a condition for the medium-term financial assistance from the EU and international financial institutions, started to become evident in the second half of 2009. Against this background, pressures on the exchange rate eased and the National Bank of Romania (NBR) was able to stabilise and recently even increase its stock of international reserves.

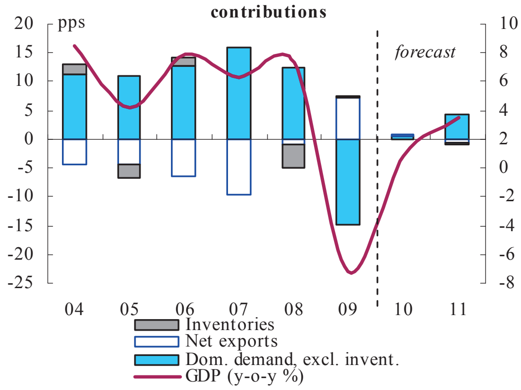
Although much of the GDP decline associated with the economic and financial crisis is cyclical, it may also have negative consequences for potential growth over the medium term, notably through slower capital accumulation (i.e. due to the sharp fall in investment flows and constraints on credit availability) and increasing structural unemployment through hysteresis. Moreover, the impact of the economic crisis coincides with the negative effects of ageing and emigration on potential output.

Gradual recovery driven by exports and foreign direct investment

Real GDP growth is expected to recover moderately to 0.8% for 2010 as a whole, gradually accelerating to 3.5% in 2011. The expected improvement in economic conditions in 2010 is due to a recovery of external demand and foreign direct investment. Private consumption growth is not expected to recover firmly until later in the year, because of slower wage increases, the continued high rate of unemployment and difficult access to credit. Similarly, investment should remain weak, being held back by low capital utilisation rates, credit constraints and market uncertainty. All this implies that the recovery is likely to remain shallow at least during the current calendar year.

The situation is expected to improve in 2011, when GDP growth is forecast to accelerate, fed by a 4.2% increase in private consumption expenditures as well as by a 5.8% increase in investment spending. Government consumption expenditures are projected to remain weak because of a continued need for fiscal consolidation. The external sector is projected to make a negative contribution to GDP growth as the recovery of domestic demand should give a significant boost to import growth.

Graph II.22.1: **Romania - GDP growth and contributions**



The external and fiscal imbalances that contributed to the severity of the recession in Romania are expected to continue to unwind. The current-account deficit is now expected to remain flat at 4.4% in 2010. With a strengthening of domestic demand in the following year, the current-account balance is forecast to deteriorate to 5.6% of GDP in 2011, thus remaining at readily financeable levels.

The macroeconomic scenario is subject to both positive and negative risks. A positive risk is that the recovery in the EU economy will be stronger than expected. This would lead to a stronger increase in external demand which can have positive spillovers on domestic demand. A negative risk is that fiscal consolidation will be weaker than planned. This could have a negative impact on household and business confidence and further delay the recovery of domestic demand.

Supportive monetary policy

The banking system has weathered the downturn relatively well. However, the share of non-performing loans has increased and credit for private sector investment remains at a low level. Nevertheless, the steady decline in private credit growth appears to have bottomed out. The NBR recently cut its key refinancing rate, allowing short term interest rates to fall. The increased political stability and the disbursement of medium term financial assistance from the IMF and the EU have contributed to this easing of financial market pressures.

Inflation remains stubbornly high

CPI inflation at the end of 2009 reached 4.7%, which is slightly above the NBR's tolerance band of 3.5% +/- 1%. The central bank has now missed its end-year inflation target for three years in a row, reflecting continued rigidities in product and labour markets, as well as increases in fuel prices and indirect taxes. The inflation projections for 2010 are affected by recent increases in excise taxes on tobacco and petrol as well as the recovery in international energy prices. On the other hand, inflationary pressures may be somewhat offset by the sluggishness in domestic demand, particularly in the first half of the year. As a result of these movements, HICP inflation is expected to fall slightly to 4.3% in 2010. Inflation is likely then to decrease further to 3% in 2011.

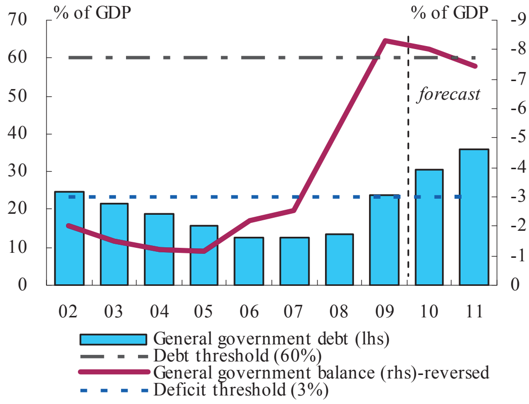
Slowly improving labour markets

For 2010, it is anticipated that the private sector would be able to compensate for the expected job losses in the public sector, at least towards the end of the year. However, a reduction in the unemployment rate is not envisaged at this early stage of the economic recovery. Given the usual lag between the recovery in economic activity and the decrease in the unemployment rate, the latter is still expected to inch up to 8.5% on average in 2010. The unemployment rate should start coming down in the second part of the year and into 2011, when it is projected to register an average rate of 7.9%.

Further fiscal consolidation ahead

The main objective of the March 2010 update of the convergence programme of Romania is the reduction of the general government budget deficit, which had expanded significantly with the sharp growth contraction of 2009. According to the latest data, the deficit increased from 5.4% of GDP in 2008 to 8.3% in 2009, significantly above the Government's deficit target of 7.8% of GDP. This gap was caused on the one hand by payment arrears in areas such as health care and on the other hand by the lower than expected nominal GDP.

Graph II.22.2: **Romania - Government balance and debt**



Within the context of the medium-term financial-assistance programme, the government made a commitment to take measures to achieve a budget deficit of 6.4% of GDP in 2010. The 2010 budget adopted by Parliament in January is consistent with this commitment and includes a package of measures to cut expenditure by about 2% of GDP and raise revenue by about ½% of GDP. On the expenditure side, measures consist of further reductions in the public sector wage bill (including a nominal freeze in public wages), a pension freeze and cuts in expenditure on goods and services. On the revenue side, excise taxes have been raised and a tax on medical distributors will be introduced. The budget also includes the one-off positive effect from the reimbursement of tax arrears (the Rompetrol bond), representing about ½% of GDP.

The measures included in the 2010 budget may not be sufficient to achieve the agreed budgetary target because of: (1) the base effect from the higher 2009 deficit; (2) lower GDP growth in 2010, which is now expected to be 0.5% less than assumed when drafting the budget; (3) significant revenue shortfall in the first quarter of 2010, particularly from VAT, social security contributions and income tax; (4) the fact that the government is only expected to receive around half of the initially expected revenue from the Rompetrol bond; and (5) possible expenditure overruns. Without further measures, the 2010 general government deficit could reach 8% of GDP. During the Balance-of-Payments mission to Romania an agreement is expected to be reached with the government for additional compensation measures to reduce the budget deficit.

With a view to correcting the excessive deficit by 2012, policies aimed at fiscal consolidation are planned to continue in 2011. In particular, the consolidation measures taken to control the 2010 budget should also help reduce deficits in later years. This together with faster real GDP growth explains the current projection of a continued decline in the general government deficit from 8% of GDP in 2010 to 7.4% in 2011. More rapid progress in reducing the deficit and achieving the 2012 deadline for the correction of the excessive deficit would require the adoption of additional consolidation measures.

Government gross debt is estimated at 23.7% of GDP in 2009, up from 13.3% the year before. The main drivers of the increase in the debt-to-GDP ratio in 2009 were the sharp rise in the deficit, the decline in GDP, the rise in interest payments and the valuation effect stemming from the depreciation of the exchange rate. While remaining well below the Treaty reference value, the debt ratio is projected to increase by 6.8 pps. in 2010 and a further 5.3 pps. in 2011 when it is forecast to reach 35.8% of GDP. These increases are mainly driven by the continued high government deficits.

Table II.22.1:
Main features of country forecast - ROMANIA

		2008		Annual percentage change						
	bn RON	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		514.7	100.0	1.8	7.9	6.3	7.3	**-7.1**	**0.8**	**3.5**
Private consumption		333.7	64.8	4.3	12.7	11.9	9.5	**-10.5**	**0.7**	**4.2**
Public consumption		87.1	16.9	0.0	-4.1	-0.1	7.1	**0.8**	**-2.5**	**1.0**
Gross fixed capital formation		164.3	31.9	7.2	19.9	30.3	16.2	**-25.3**	**2.3**	**5.8**
of which : equipment		78.9	15.3	9.6	23.5	28.3	19.0	**-32.7**	**3.0**	**4.3**
Exports (goods and services)		156.6	30.4	11.0	10.4	7.8	8.7	**-5.5**	**5.5**	**6.5**
Imports (goods and services)		223.7	43.5	12.0	22.6	27.3	7.8	**-20.6**	**3.9**	**7.6**
GNI (GDP deflator)		494.3	96.0	1.6	7.4	6.0	7.0	**-5.1**	**-0.2**	**2.4**
Contribution to GDP growth :	Domestic demand			5.1	12.9	15.9	12.4	**-14.8**	**0.6**	**4.3**
	Inventories			-1.8	1.4	0.0	-4.2	**0.4**	**0.0**	**0.0**
	Net exports			-1.3	-6.3	-9.6	-0.8	**7.3**	**0.3**	**-0.8**
Employment				-2.9	0.7	0.4	-0.2	**-1.0**	**-1.7**	**0.8**
Unemployment rate (a)				6.6	7.3	6.4	5.8	**6.9**	**8.5**	**7.9**
Compensation of employees/head				69.0	12.4	22.0	24.2	**3.1**	**2.3**	**2.5**
Unit labour costs whole economy				61.3	4.9	15.2	15.4	**9.9**	**-0.2**	**-0.1**
Real unit labour costs				-1.7	-5.1	1.5	0.2	**7.0**	**-4.6**	**-4.0**
Savings rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				64.1	10.6	13.5	15.2	**2.7**	**4.6**	**4.0**
Harmonised index of consumer prices (HICP)				-	6.6	4.9	7.9	**5.6**	**4.3**	**3.0**
Terms of trade of goods				0.9	7.2	10.6	3.2	**0.1**	**1.3**	**1.2**
Trade balance (c)				-7.2	-12.0	-14.3	-13.6	**-5.8**	**-5.1**	**-5.1**
Current-account balance (c)				-	-10.6	-13.6	-12.7	**-4.4**	**-4.4**	**-5.6**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-4.5	-10.4	-13.0	-12.3	**-3.9**	**-3.9**	**-5.1**
General government balance (c)				-	-2.2	-2.5	-5.4	**-8.3**	**-8.0**	**-7.4**
Cyclically-adjusted budget balance (c)				-	-4.1	-4.7	-8.2	**-7.8**	**-6.9**	**-6.4**
Structural budget balance (c)				-	-3.5	-4.7	-7.7	**-8.3**	**-7.1**	**-6.4**
General government gross debt (c)				-	12.4	12.6	13.3	**23.7**	**30.5**	**35.8**

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

23. SLOVENIA

Trade leads the recovery, followed by domestic demand

Coming from falling trade and tighter credit…

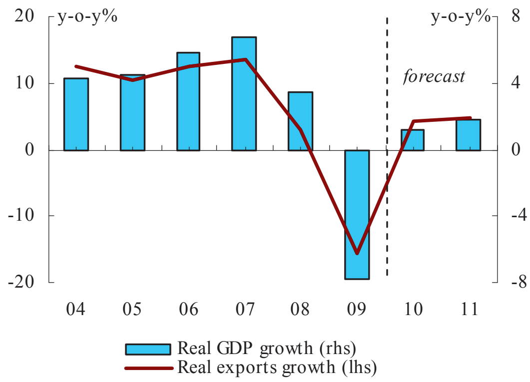
After several years of buoyant economic growth and, latterly, mounting inflationary pressures, the Slovenian economy was hit hard and rather abruptly by the global crisis in the fourth quarter of 2008. Given Slovenia's high degree of openness, the recession was propagated chiefly through the trade channel: over the final quarter of 2008 and the first quarter of 2009, the collapse in export volumes caused a contraction in overall activity of close to 10%. The depth of this output contraction implied that over 2009 as a whole the Slovenian economy contracted by 7.8%, one of the sharpest falls in the euro area.

The recession has been broad-based, affecting all demand components except for government consumption. However, the massive contraction in imports (in line with falling domestic and external demand) outweighed the decline in exports, resulting in a positive contribution of net exports to growth as well as a marked narrowing of the current-account deficit.

The global financial turmoil also led the banking system to experience some refinancing difficulties in foreign markets resulting in tightening of credit conditions. Exacerbated by this, as well as by low capacity utilisation and weaker profitability, the drop in demand triggered a sharp contraction in private investment in construction and equipment. Public investment, while continuing to grow, did not cushion the impact of the downturn on the construction sector to any great extent. Over 2009 as a whole, gross fixed capital formation dropped by more than one fifth in real terms. The large fall in demand also led to significant destocking by firms. Finally, even though average wages continued to outpace inflation and consumer confidence gradually recovered from the record lows at the beginning of the year, consumer demand was constrained by a significant drop in employment and increased precautionary savings. As a result, private consumption fell by around 1½%.

A gradual recovery has been underway since the second quarter of 2009 when stimulus measures supporting demand in Slovenia's main trading partners helped real GDP growth to turn mildly positive on a quarterly basis. Despite a deceleration in the fourth quarter related to sharp depletion of inventories, this modest recovery in 2009 is providing some momentum to real GDP growth in 2010. The projected drivers of growth are a rebound in exports exceeding that in imports and – despite continued retrenchment in construction – a limited revival of gross fixed capital formation.

Graph II.23.1: **Slovenia - GDP and exports growth, volumes**



A more robust rebound is expected in 2011, as the construction sector comes out of recession and as private consumption returns to positive growth, spurred by average wage increases and a stabilising labour market. Meanwhile, it is projected that the recovery of imports and worsening terms of trade will erode the positive contribution of net exports to real GDP, bringing to an end the improvements in the current-account balance that occurred in 2009.

…accompanied by ongoing adjustment

After a phase of emerging risks of overheating and competitiveness losses, the economic downturn brought about some adjustment of the domestic economy in 2009, in terms of the narrowing of the inflation gap vis-à-vis the euro-area average and an improving external balance.

Inflation decreased by more than 4 pps. in 2009, in line with lower commodity prices and weakening economic activity. Still, at 0.9%, inflation remained at around ½ pp. above the euro-area average (compared to over 2 pps. in 2008), reflecting, *inter alia*, increases in excise duties throughout the year. In 2010 and 2011, inflation is projected to accelerate mainly due to increases in commodity prices and reviving economic activity. In the absence of further major increases in excise duty rates, the inflation gap with the euro area should continue to narrow.

As regards Slovenia's net external position, the forecast embodies a further rise in private sector net lending in 2010, due to households' sustained precautionary savings and enterprises' efforts to restore their balance sheets. Reflecting this, as well as an increase of the general government deficit, net borrowing from the rest of the world is set to slightly decrease in 2010. Although the general government deficit is expected to fall in 2011, the external position of the Slovenian economy is set to marginally deteriorate owing to recovering domestic demand and worsening terms of trade.

Decelerating unemployment growth

The economic downturn is impacting on the labour market with some lag. Employment decreased by 2.2% in 2009 as a result of the downturn. The contraction was more pronounced for wage and salary earners, particularly those in the manufacturing sector, than for the self-employed. Reflecting employment developments, the unemployment rate rose from a low of just above 4% in December 2008 to around 6¼% going into 2010. Measures to stem the impact of the crisis on the labour market, in the form of subsidy schemes for reduced working hours and for workers on forced leave, have favoured labour hoarding. In light of the gradual expiry of these temporary schemes starting in 2010, and factoring in the potential effects of legislated increases of the minimum wage over the period 2010-12, employment is projected to continue declining – and unemployment to continue rising – up to 2011, albeit at a diminishing pace.

As the fall in output outpaced that of employment in 2009, labour productivity declined sharply and unit labour costs recorded a further steep rise. In 2010, labour productivity is projected to start growing again, as output growth resumes while employment continues to fall. This will bring about some containment of unit labour cost growth.

The forecast assumes that average wage growth in the private sector in 2010 will strengthen relative to 2009, as a result of the higher minimum wage, the skill composition of job losses and the modest economic recovery more than offsetting the dampening effects of competitive pressures and rising unemployment. For similar reasons, average wage growth is projected to strengthen slightly more in 2011, when it exceeds productivity growth as it did in 2009. Further factors, including a public sector wage agreement signed in autumn 2009, are expected to push wage growth in the public sector above that in the private sector in 2011, thus slightly raising overall wage growth. Regaining competitiveness by better aligning wage and productivity developments would, given the openness of its economy, help Slovenia to benefit fully from the global economic recovery.

As regards risks to the baseline scenario, exports could suffer from a slower recovery in Slovenia's main trading partners, especially given the geographical orientation towards the EU and the Western Balkans, where the upturn is expected to be milder than in the rest of the world. Furthermore, continuing subdued lending could adversely affect real activity, mainly through a dampening effect on investment. Meanwhile, private consumption could recover more strongly than predicted if the labour market can successfully accommodate the increased minimum wage and the expiry of employment support measures.

A narrowing general government deficit, but only from 2011

From 1.7% of GDP in 2008, the general government deficit is estimated to have widened to around 5.5% of GDP in 2009. Both the primary balance and interest expenditure as a share of GDP deteriorated strongly relative to 2008. The revenue ratio increased in 2009, despite increased tax relief for companies, because the worst-hit demand components – namely exports and investment – are not tax-rich. However, the expenditure ratio increased by even more (over 5 pps.), due to the working of the automatic stabilisers, the strong inherent dynamics of social transfers and the public sector wage bill, as well as discretionary expenditure. The latter includes stimulus measures adopted in line with the European Economic Recovery Plan amounting to some 1½% of GDP. This policy stance and the measures to stabilise the financial sector were adopted in view of low government debt and deficit levels at the onset of the crisis.

For 2010, the government has adopted measures to restrain growth of primary expenditure, confirming the intention to pursue an expenditure-based fiscal consolidation. These measures include an agreed postponement of public sector wage increases, less generous indexation of social benefit rates, including pensions, and lower capital transfers due to increased reliance on EU funds. Together, these measures are expected to generate savings of around 1¼% of GDP compared to a no-policy-change scenario. However, given strong inherent expenditure dynamics and the ongoing cost of temporary stimulus measures, the primary expenditure ratio is still set to rise slightly in 2010.

The stability programme targets the deficit ratio in 2010 at 5.7% of GDP. By contrast, this forecast projects the deficit ratio to increase to 6.1% in 2010, corresponding to lower nominal GDP and slightly higher capital expenditure projections, in the expectation of remaining gaps in absorption capacity of EU funds. A reduction of the general government deficit is projected in 2011, but still to a higher level than planned by the government (5.2% of GDP *vs.* 4.2%). This difference is mainly due to the fact that this forecast, which is based on the usual no-policy-change assumption, incorporates a still higher level of capital expenditure and, in the absence of a full specification of the measures underpinning the planned containment in public employment and wage growth, a higher public sector wage bill. The rest of the difference between the government target for the deficit ratio in 2011 and the Commission services' projection is due to less buoyant growth in the latter.

The gross government debt ratio rose sharply in 2009, to around 36% of GDP from as low as 22½% of GDP in 2008. The main drivers of this increase were the primary deficit and a significant stock-flow adjustment, reflecting recapitalisations and liquidity operations to stabilise the financial sector. The debt ratio is projected to grow further, to around 45½% of GDP in 2011, as a result of persisting primary deficits.

Table II.23.1:

Main features of country forecast - SLOVENIA

	2008		Annual percentage change						
	bn EUR Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	37.1	100.0	3.3	5.8	6.8	3.5	**-7.8**	**1.1**	**1.8**
Private consumption	19.6	52.7	3.8	2.9	6.7	2.0	**-1.4**	**-0.2**	**1.2**
Public consumption	6.7	18.1	3.0	4.0	0.7	6.2	**3.1**	**0.4**	**0.2**
Gross fixed capital formation	10.7	28.9	6.5	9.9	11.7	7.7	**-21.4**	**1.6**	**3.5**
of which : equipment	4.0	10.8	9.1	20.2	5.2	4.2	**-26.1**	**10.9**	**5.2**
Exports (goods and services)	25.1	67.7	4.3	12.5	13.7	2.9	**-15.6**	**4.3**	**4.9**
Imports (goods and services)	26.3	70.7	6.1	12.2	16.3	2.9	**-17.9**	**3.4**	**4.9**
GNI (GDP deflator)	36.3	97.6	3.3	5.4	5.8	3.2	**-6.9**	**0.8**	**1.7**
Contribution to GDP growth : Domestic demand			4.1	4.9	6.8	4.3	**-6.4**	**0.3**	**1.5**
Inventories			0.4	0.7	1.9	-0.7	**-3.5**	**0.2**	**0.3**
Net exports			-1.0	0.2	-1.8	-0.1	**2.1**	**0.6**	**0.0**
Employment			-	1.5	3.0	2.8	**-2.2**	**-2.3**	**-0.5**
Unemployment rate (a)			-	6.0	4.9	4.4	**5.9**	**7.0**	**7.3**
Compensation of employees/head			-	5.3	6.4	7.0	**3.0**	**2.9**	**3.4**
Unit labour costs whole economy			-	1.0	2.6	6.2	**9.3**	**-0.6**	**1.0**
Real unit labour costs			-	-1.0	-1.5	2.3	**7.2**	**-0.7**	**-0.7**
Savings rate of households (b)			-	-	15.4	16.5	**17.3**	**17.6**	**17.4**
GDP deflator			19.4	2.1	4.2	3.8	**1.9**	**0.0**	**1.8**
Harmonised index of consumer prices (HICP)			-	2.5	3.8	5.5	**0.9**	**1.8**	**2.0**
Terms of trade of goods			0.9	-0.4	0.2	-1.8	**4.6**	**-2.2**	**-0.3**
Trade balance (c)			-2.8	-3.8	-4.9	-7.2	**-1.6**	**-2.0**	**-2.2**
Current-account balance (c)			0.0	-2.4	-4.5	-6.2	**-0.9**	**-1.4**	**-1.6**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-0.2	-2.8	-4.7	-6.1	**-0.9**	**-0.7**	**-1.0**
General government balance (c)			-	-1.3	0.0	-1.7	**-5.5**	**-6.1**	**-5.2**
Cyclically-adjusted budget balance (c)			-	-2.6	-2.9	-4.8	**-3.8**	**-4.4**	**-3.8**
Structural budget balance (c)			-	-2.6	-2.9	-4.8	**-3.7**	**-4.4**	**-3.8**
General government gross debt (c)			-	26.7	23.4	22.6	**35.9**	**41.6**	**45.4**

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

24. SLOVAKIA

Moderate growth ahead

First GDP contraction in modern history

In 2009, the Slovak economy contracted for the first time since its formation in 1993. Real GDP fell by 4.7%, mainly driven by a collapse of industrial production by over 15%. This large collapse came after several years of fast real convergence, with GDP per capita (in PPS) increasing from 47% to 65% of the EU-15 average over the period 2002-08. During the boom years, the prospect of joining the euro area had stimulated large inflows of foreign direct investment in Slovakia. These inflows played an important role in the convergence process. They contributed to strong productivity growth by allowing faster build-up of the capital stock and transfer of technology and know-how. At the same time, sound macroeconomic and structural policies allowed large macroeconomic imbalances to be avoided and strong external competitiveness to be maintained. The buoyant economic growth also led to a continuous fall of the unemployment rate, from 18.7% in 2002 to 9.5% in 2008.

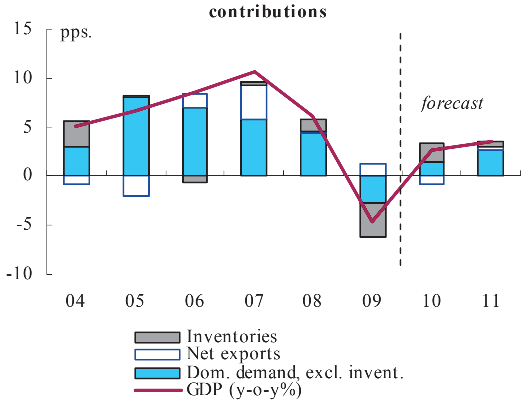
Given its large degree of trade-openness, Slovakia was strongly exposed to the slump in global trade, with exports tumbling by some 25% in the first quarter of 2009 compared to the same period of 2008. In the subsequent quarters of 2009, exports stabilised and gradually recovered reflecting a pick up in foreign demand for electronic products and cars, the latter being sustained by the implementation of car-scrapping schemes in several EU countries. At the same time, the crisis triggered a large increase in savings of households and non-financial corporations and a sharp fall in their investments. Households' consumption fell by 0.7% and fixed total investment by 10.5% in 2009. Companies also reduced their inventories at an unprecedented pace which acted as an "accelerator" of the contraction.

Despite government efforts to mitigate the impact of crisis on the labour market, the unemployment rate increased to 12% in 2009. The reaction of the labour market to the downturn was strong and almost immediate. This can be explained by the abruptness of the downturn and the flexibility of the labour market. However, employees' average compensation per head continued to increase, mainly as a result of application of pre-crisis wage agreements, an increase in severance payments and dismissal of mainly low-paid workers. The resulting large increase in real unit labour costs, may have negatively affected Slovakia's competitiveness in 2009.

Despite the large shock to the real economy and severe stress in global financial markets, the Slovak banking sector has remained strong. This reflects the good liquidity situation of credit institutions and low dependence on cross-border lending. A tightening of lending conditions was observed for households and businesses, but this was primarily due to an expected increase in non-performing loans and more uncertain growth prospects, rather than to liquidity constraints on banks.

In response to the slump in external demand, the Slovak government implemented a policy strategy to support domestic demand. On the fiscal side, the authorities allowed the automatic stabilisers to operate fully and adopted anti-crisis measures totalling roughly ½% of GDP for both 2009 and 2010. The measures targeted specific sectors of the economy (car-scrapping scheme) and disadvantaged groups (increased tax credit for low earners), and aimed at supporting employment (contributions for retention of employees) and R&D activities.

Graph II.24.1: **Slovakia - GDP growth and contributions**



An externally-driven recovery

Real GDP is projected to increase by 2.7% in 2010 and 3.6% in 2011. While positive, these figures are much lower than those during the boom phase.

The ongoing recovery is mainly driven by rising demand for exports and a gradual re-building of inventories. Exports volumes grew by 8.6% in the second half of 2009 compared to the first half of the year, and business confidence indicators in the tradable sector have continued to improve in the first few months of 2010. Moreover, the recovery in exports is observable in all sectors, and is not limited to the car industry, which benefited in 2009 from exceptional one-off subsidies in several EU countries. Despite existing spare capacities in the manufacturing sector, investment is expected to rise by 3.6% in 2010. The main drivers should be the implementation of public-private partnership (PPP) projects focused on highways construction (2.4% of GDP), the rebuilding of the production facilities of the Volkswagen plant and green-field investment of the electronics producer AU Optronics. As the recovery in exports and inventories is also likely to result in a hike of imports, the overall contribution of net export to growth is projected to turn negative in 2010.

Households' consumption is projected to pick up only in 2011 after virtually no growth in 2010. This reflects still fragile, although recovering, consumer confidence and a further deterioration of the labour market. Employment is expected to fall further in 2010 and to rebound only in 2011. The unemployment rate is likely to peak in 2010, reaching 14%. Moreover, persistent structural problems in the labour market, such as professional-skill mismatches, which led to significant labour shortages at the end of the previous boom, could slow down the adjustment. Despite a minimum wage increase of over 4%, average wages are expected to record moderate growth in 2010, thus weighing on growth of real disposable income. The latter should, however, be supported by only modestly increasing inflation, which was pushed down significantly by the downturn. In 2010, inflation is projected to remain low at 1.3% due to envisaged developments in energy prices and household demand, as well as a decrease in excise duties on diesel fuels. In 2011, prices are expected to pick up in view of accelerating economic activity.

Slovakia's high reliance on exports exposes this forecast to some uncertainties. The continuation of the export-led recovery is conditioned on a rebound of the EU economy in 2010-11. A faster economic recovery is possible should exports demand and total investment benefit from ongoing PPP projects for motorways construction and further foreign direct investment prove higher than expected. At the same time the withdrawal of fiscal stimulus measures in 2010-11 in most EU countries (in particular the car-scrapping schemes) may affect the external demand for cars by more than expected in this forecast. Overall, the risks to the baseline scenario of macroeconomic forecast appear to be balanced.

Strengthening potential growth and competitiveness

The crisis led to a sizeable reduction of potential growth in Slovakia. Current estimates suggest that potential growth will drop from an average of 5% in 2004-2008 to 3% in 2009-13. This decline is driven by a fall in labour utilisation, a much slower accumulation of productive capital and sluggish productivity growth.

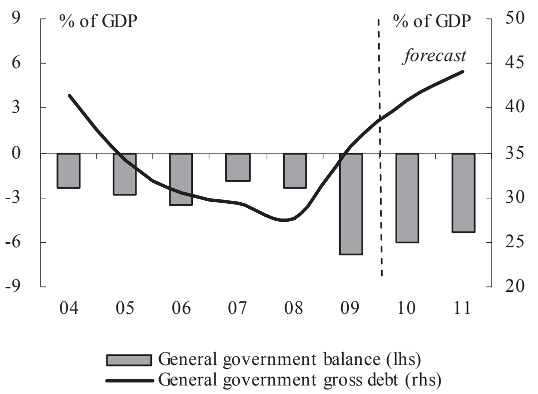
Slovakia's specialisation in automotive industry has proved to be an asset to the economy. Car-scrapping schemes in several EU countries limited the fall of the Slovak car production to about 20% in 2009. Moreover, announced large foreign investments for 2010 are largely linked to car production. This supports the argument that the adoption of the euro, a favourable location and lower labour costs compared to regional peers continue to make Slovakia an attractive destination for foreign capital. However, the resulting increase in the already high specialisation of Slovakia in the car industry will make it even more vulnerable to swings in foreign demand for this specific type of good. A priority should accordingly be to develop new areas of specialisation, in particular by attracting foreign capital through skills upgrading and improvements of the education system.

Slovakia's competitiveness position is expected to remain strong. Depreciating exchange rates of neighbouring countries' currencies vis-à-vis the euro in the first half of 2009 and strong growth of real unit labour costs in Slovakia resulted in a sizeable deterioration of Slovakia's external price competitiveness in 2009. However, the ongoing appreciation of exchange rates in Slovakia's neighbours since the spring of 2009, the projected slowdown in wages and the rebound of productivity in 2010 should largely offset last year's developments. Ensuring moderate developments in domestic prices and costs, as well as improvements in non-price competitiveness, will be crucial for retaining and further enhancing Slovakia's competitiveness and attractiveness.

Stabilisation of public finances

Years of pro-cyclical policies during the boom – the structural deficit deteriorated from 1.8% of GDP to 4.8% of GDP over the period 2005-08, when growth averaged 8% per year – had left Slovakia's government finances in a vulnerable position at the onset of the crisis. The recession unmasked these looming imbalances. The headline deficit soared from 2.3% in 2008 to 6.8% of GDP in 2009.

Graph II.24.2: **Slovakia - Public finances**



The full operation of automatic stabilisers triggered a sizeable increase in social spending and a marked decline in revenue. The stimulus measures announced in the context of the EERP package were broadly neutral for the deficit.

Announced consolidation efforts to cut expenditure on goods and services and capital, together with the recovery of the economy in 2010-11, are expected to contribute to a reduction of the headline deficit to 6.0% of GDP in 2010 and 5.4% of GDP in 2011. The higher projection of the 2010 general government deficit compared to the most recent update of the stability programme (5.5% of GDP) reflects primarily a base effect given an upward revision of the headline deficit for 2009 notified in April and lower revenue expectations. The largest part of the improvement in the deficit would reflect a decline of the structural deficit. This forecast is, however, subject to risks. In particular, spending pressure may intensify ahead of and after the general elections in June 2010, and the projected balanced fiscal position of local governments seems optimistic in view of the impact of the crisis on the revenues of these entities. The high deficits and capital injections in two state-owned banks will cause general government gross debt to rise from 35.7% of GDP in 2009 to 40.8% of GDP in 2010. Under the no-policy-change assumption, government debt is expected to reach 44% of GDP in 2011.

Table II.24.1:

Main features of country forecast - SLOVAKIA

	2008			Annual percentage change					
bn EUR	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	67.2	100.0	-	8.5	10.6	6.2	**-4.7**	**2.7**	**3.6**
Private consumption	38.2	56.8	-	5.9	6.9	6.0	**-0.7**	**0.1**	**2.1**
Public consumption	11.7	17.4	-	9.7	0.1	5.3	**2.8**	**2.5**	**2.2**
Gross fixed capital formation	16.7	24.9	-	9.3	9.1	1.8	**-10.5**	**3.6**	**3.9**
of which : equipment	7.1	10.5	-	-6.3	4.3	15.4	**4.0**	**3.5**	**3.5**
Exports (goods and services)	55.8	83.0	-	21.0	14.3	3.2	**-16.5**	**5.7**	**5.9**
Imports (goods and services)	57.3	85.3	-	17.8	9.2	3.1	**-17.6**	**6.8**	**5.2**
GNI (GDP deflator)	65.4	97.3	-	8.2	11.1	6.1	**-3.2**	**2.3**	**3.4**
Contribution to GDP growth : Domestic demand			-	7.6	6.4	4.8	**-2.5**	**1.4**	**2.6**
Inventories			-	-0.7	0.3	1.3	**-3.4**	**2.0**	**0.6**
Net exports			-	1.6	3.9	0.1	**1.3**	**-0.7**	**0.4**
Employment			-	2.3	2.1	2.8	**-2.4**	**-1.9**	**1.2**
Unemployment rate (a)			-	13.4	11.1	9.5	**12.0**	**14.1**	**13.3**
Compensation of employees/head			-	7.7	8.4	5.9	**4.7**	**3.5**	**4.2**
Unit labour costs whole economy			-	1.5	0.1	2.5	**7.2**	**-1.1**	**1.7**
Real unit labour costs			-	-1.4	-1.0	-0.3	**8.5**	**-2.3**	**-1.2**
Savings rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			-	2.9	1.1	2.9	**-1.2**	**1.3**	**3.0**
Harmonised index of consumer prices (HICP)			-	4.3	1.9	3.9	**0.9**	**1.3**	**2.8**
Terms of trade of goods			-	-1.8	-1.1	-1.9	**0.8**	**-1.8**	**0.2**
Trade balance (c)			-	-5.4	-1.8	-1.5	**1.6**	**-0.2**	**0.3**
Current-account balance (c)			-	-8.2	-5.1	-6.7	**-3.1**	**-4.5**	**-4.1**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-7.8	-4.7	-5.8	**-2.4**	**-3.7**	**-3.2**
General government balance (c)			-	-3.5	-1.9	-2.3	**-6.8**	**-6.0**	**-5.4**
Cyclically-adjusted budget balance (c)			-	-3.9	-3.7	-4.5	**-6.4**	**-5.4**	**-4.7**
Structural budget balance (c)			-	-3.6	-3.7	-4.7	**-6.6**	**-5.4**	**-4.7**
General government gross debt (c)			-	30.5	29.3	27.7	**35.7**	**40.8**	**44.0**

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

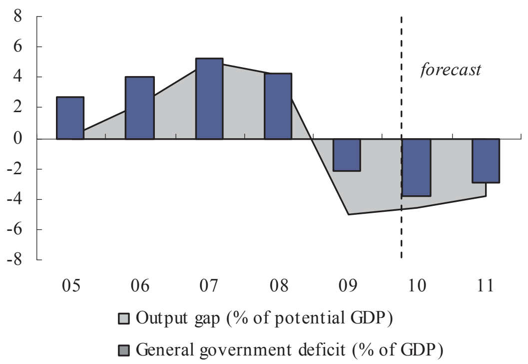
25. FINLAND

Recovery taking hold after a record fall in GDP

Record GDP contraction in 2009

Even though Finland entered the global crisis in 2008 from a relatively strong position, having built up a substantial surplus in the current account and in the government finances, GDP declined in 2009 by 7.8%. This exceeds even the decline observed in 1991, which was the worst year of GDP decline in the economic crisis of the early 1990s. In early 2009 the major export industry branches of metal engineering, electronics and forestry all experienced a particularly sharp drop in global demand. Total export volumes dropped by about one quarter in 2009, the strongest decline in the euro area. However, given that the import content of exports is relatively high and that domestic consumption was also depressed over the year, the fall in exports was similarly mirrored in imports and a current-account surplus position of about 1½% of GDP was still maintained.

Graph II.25.1: **Finland - Output gap and general government deficit**



The global economic turmoil had immediate consequences also for domestic sectors through negative confidence effects. Investment fell rapidly by over 13%, especially due to cuts in corporate investment. Household purchasing power was supported by relatively strong wage rises agreed in the previous collective wage agreement round and tax cuts arising from the stimulus programme. Having accumulated sizeable surpluses in public finances over the previous economic upswing, Finland allowed the automatic stabilisers to operate fully and in addition provided for a relatively large discretionary fiscal stimulus amounting to slightly below 2% of GDP in 2009 and above 1% of GDP in 2010. This has helped to cushion the impact of the crisis on the domestic market. Nevertheless, private consumption contracted as households increased saving in an uncertain economic environment.

Labour market has remained resilient

The impact on the labour market has been more subdued than might be expected from the historically steep contraction in economic activity. Unemployment increased from an average of 6.4% of the labour force recorded in 2008 to 8.2% in 2009. Additionally, temporary lay-offs and various schemes to reduce working time have been widely used, amounting to about 2% of the labour force, but which to a large extent are not reflected in unemployment statistics. To some extent the effects of these schemes might eventually be reflected in unemployment statistics in 2010. While the number of employed persons fell by 3% in 2009, hours worked fell by 6%, which reflects more accurately the drop in output.

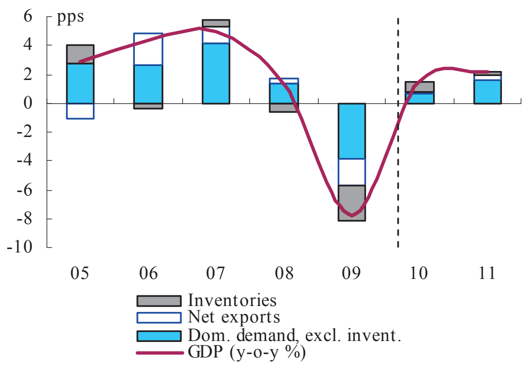
Favourable prospects for recovery

In spite of the exceptionally rapid drop in GDP, the economy has maintained solid fundamentals and is well placed to return to a growth path slightly above the EU average. Even though exports are expected to recover with a lag, domestic demand is forecast to initially drive growth. Consumer confidence quickly rebounded in the course of 2009 to levels exceeding the long-term average. Consumers' purchasing power is being supported by further tax cuts in 2010 and still relatively strong wage growth carrying over from the previous comprehensive multiannual wage agreement. With the saving rate stabilising in an environment of stronger economic confidence, private consumption is set to turn to growth in 2010.

The Finnish financial sector has remained on solid footing throughout the crisis and is in a strong position to respond to the expected upturn in credit demand for both the household and corporate sectors. Overall, corporate balance sheets have withstood the global crisis relatively well, as revealed by the modest rise in non-performing loans. While household indebtedness rose over the past decade to historically high levels by Finnish standards – about 100% of annual disposable income – it is still around average compared to most other euro-area countries. Since about 90% of mortgages have variable interest rates, the currently low interest rates are effectively passed on to mortgage holders. As furthermore the margins on top of the reference rate have been low by euro-area standards, housing finance has become very cheap.

The real-estate market has rebounded strongly from the dip in early 2009. Both house prices and new building permits have increased strongly over past months, pointing to a resumption of residential investment activity. Housing investment is being additionally boosted by government stimulus measures. However, given that corporate investments are still expected to decline in 2010 due to current manufacturing overcapacity, in the aggregate investment is projected to grow only in 2011. The inventory cycle is also forecast to contribute strongly to growth after sharp destocking over 2009.

Graph II.25.2: **Finland - GDP growth and contributions**



Exports are expected to recover with a lag after global economic recovery takes hold. While a moderate recovery in industry confidence indicators is already apparent, the upturn in exports in recent months has lagged the global and European recovery in trade. A strike disrupting Finnish seaports for two weeks in March will also delay the rebound in trade. While the external trade volumes are forecast to rebound to some extent from the present exceptional lows, the contribution to growth from external trade is expected to turn only slightly positive in 2010-11. A stronger contribution to growth is expected to be hindered by the current export structure, with the investment goods sector recovering with a lag and the maturing electronics and forest industry sectors facing longer term structural changes due to globalisation pressures. Additionally, due to the rapid rise of unit labour costs over 2008-09, Finland has sharply lost external price competitiveness. The main risk to the recovery of domestic consumption is seen to stem from the performance of exporting industries and unemployment developments, which have traditionally played an important role in influencing consumer behaviour.

Wages set to moderate, inflation to remain relatively high

After the relatively fast wage rises over 2008-10, decided under the previous multiannual wage agreements, the next wage negotiation rounds are expected to respond to the change in economic conditions and to result in moderate wage increases for the coming years. While annual wage growth in 2010 is still affected by wage rises carried over from the previous wage agreements, wage growth in 2011 should be already substantially lower, in line with the new agreements. However, aggregate incomes would still rise faster in 2011 compared with 2009-10 on account of the predicted growth in employment and hours worked.

While inflation remained below the euro area average in 2002-08, thereafter it has consistently exceeded the benchmark. Inflation is expected to remain higher also in 2010, partly due to the rapid rise in unit labour costs being passed on to services prices. In addition, an increase in VAT rates in mid 2010 is estimated to contribute to inflation 0.4 pp. and a tax on sugar products from the beginning of 2011 would contribute another 0.1 pp.

Population ageing starting to impact on the labour market and public finances

Finland will be one of the first countries in the EU affected by the ageing of the population, whereby the working age population would be in continuous decline from 2010 onwards. This is expected to have gradual repercussions on the labour market. The costs of population ageing will start to impact government finances already over the forecast period. The surplus in social security funds would gradually decrease as more people take up pensions and local governments will face upward expenditure pressures since they are in charge of providing most of the ageing related services.

The economic crisis has considerably weakened general government fiscal balances, adding to the challenge of restoring long-term sustainability to public finances. Reflecting the operation of automatic stabilisers and the relatively large fiscal stimulus, general government finances weakened by about 6½ pps. in 2009, falling into a deficit of 2.2% of GDP. The weakening of fiscal balances is largely explained by a shortfall in tax revenues, with expenditure increases accounting only for a minor part. About a half of the tax revenue decline in 2009 was explained by corporate income tax accrual plummeting by over 40%, representing almost 2% of GDP. The deficit is forecast to widen to below 4% of GDP in 2010, led by further stimulus measures of about 1% of GDP and expenditure pressures arising from public sector wage rises and social expenditure. Based on current policies (including the rise in VAT and some product taxes worth 0.2% of GDP) the deficit would be reduced in 2011 to slightly below 3% of GDP. The government has not yet designed a fully-fledged medium-term consolidation strategy. Driven largely by central government lending, the general government debt ratio would rise by over 20 pps. from close to 34% of GDP recorded in 2008 to about 55% of GDP by 2011.

Table II.25.1:

Main features of country forecast - FINLAND

	2008		Annual percentage change						
	bn EUR Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	184.2	100.0	2.9	4.4	4.9	1.2	**-7.8**	**1.4**	**2.1**
Private consumption	95.5	51.8	2.3	4.3	3.4	1.7	**-2.1**	**1.7**	**1.7**
Public consumption	41.6	22.6	1.1	0.4	1.1	2.7	**0.7**	**0.6**	**0.8**
Gross fixed capital formation	39.9	21.6	2.2	1.9	10.6	-0.2	**-13.4**	**-1.8**	**2.1**
of which : equipment	10.2	5.6	2.1	-1.1	17.9	3.6	**-13.6**	**-4.0**	**2.5**
Exports (goods and services)	86.7	47.1	8.7	12.2	7.9	6.5	**-24.3**	**4.8**	**6.8**
Imports (goods and services)	79.3	43.1	6.9	7.9	6.0	6.6	**-22.3**	**5.0**	**6.3**
GNI (GDP deflator)	185.1	100.5	3.2	4.9	4.0	1.7	**-8.3**	**1.4**	**2.1**
Contribution to GDP growth : Domestic demand			1.8	2.7	4.1	1.4	**-3.9**	**0.7**	**1.6**
Inventories			0.3	-0.4	0.5	-0.6	**-2.5**	**0.6**	**0.2**
Net exports			0.9	2.1	1.2	0.3	**-1.8**	**0.1**	**0.4**
Employment			0.1	1.8	2.2	1.6	**-3.0**	**-2.1**	**0.4**
Unemployment rate (a)			11.7	7.7	6.9	6.4	**8.2**	**9.5**	**9.2**
Compensation of employees/head			2.9	2.9	3.7	5.1	**2.4**	**2.6**	**2.1**
Unit labour costs whole economy			0.2	0.3	0.9	5.5	**7.7**	**-1.0**	**0.4**
Real unit labour costs			-1.3	-0.5	-2.3	4.0	**7.0**	**-2.3**	**-1.6**
Savings rate of households (b)			-	-	7.2	7.9	**10.3**	**10.6**	**9.1**
GDP deflator			1.6	0.9	3.3	1.4	**0.6**	**1.4**	**2.0**
Harmonised index of consumer prices (HICP)			1.7	1.3	1.6	3.9	**1.6**	**1.7**	**1.9**
Terms of trade of goods			-0.6	-4.1	-0.5	-3.3	**1.6**	**-1.9**	**-0.7**
Trade balance (c)			8.1	5.2	5.1	3.7	**2.3**	**1.9**	**1.9**
Current-account balance (c)			4.2	4.6	4.3	3.5	**1.5**	**1.1**	**1.3**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			4.0	4.7	4.0	2.5	**1.6**	**1.2**	**1.4**
General government balance (c)			-0.3	4.0	5.2	4.2	**-2.2**	**-3.8**	**-2.9**
Cyclically-adjusted budget balance (c)			0.3	2.8	2.6	2.1	**0.3**	**-1.4**	**-1.0**
Structural budget balance (c)			-	2.8	2.6	2.1	**0.4**	**-1.3**	**-1.0**
General government gross debt (c)			48.1	39.7	35.2	34.2	**44.0**	**50.5**	**54.9**

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.
Note : Contributions to GDP growth may not add up due to statistical discrepancies.

26. SWEDEN

Consumption-led recovery helps reducing fiscal deficit

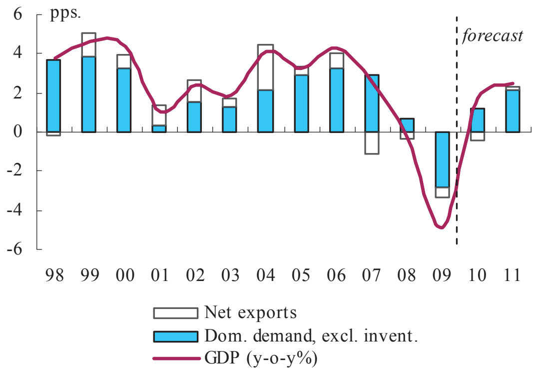
2009 characterised by continued recession

While the Swedish economy has stabilised somewhat after the rapid contraction at the end of 2008, a strong recovery has so far proved elusive. Last year ended with a disappointing 0.6% fall in output in the fourth quarter (q-o-q, s.a.), the seventh consecutive quarter with negative or no GDP growth. The only source of strength stemmed from household consumption. Spending has benefitted from a significant rebound in consumer confidence, since the labour market outlook has improved, fiscal and monetary policy stimulus is having its full effect and equity indices and house prices have regained the lost ground. Industrial production, investment and exports, on the other hand, all remain at depressed levels. Overall, GDP fell by 4.9% in 2009.

Consumption-led recovery from 2010 onwards

Since spring 2009, soft indicators have pointed to a gradual recovery of the Swedish economy. Partly thanks to a swift and powerful policy reaction to the financial crisis, the situation in the financial markets gradually normalised in the course of 2009. Financial market spreads have come down substantially and companies have to a great extent been able to tap capital markets once again. The improved financing conditions and improved outlook are also reflected by the fact that the main Swedish stock market index has risen by about 75% since the trough in early 2009. Survey results indicate that business and, as noted, consumer confidence has recovered strongly from the very low levels recorded earlier in the year.

Graph II.26.1: **Sweden - GDP growth and contributions**



The burgeoning optimism of households is also underpinned by the apparent resilience of the housing market, where prices – contrary to what has happened in many other countries – have started to rise again after falling back somewhat in the autumn of 2008. In 2009, house prices rose by 7%. Moreover, the number of redundancy notices has fallen back significantly, which is raising hopes that employment soon may start to rise again. While a recovery is not yet evident in actual production and trade data, there has been a pick-up in new orders over the last couple of months, pointing to a possible strengthening of activity in the months ahead. As the krona depreciated in the early phase of the crisis, export companies chose to maintain their foreign-currency prices, thus benefitting from wider profit margins. With the krona now strengthening again margins may erode somewhat.

The outlook for the forecast period is likely to be characterised by a recovery that is gradually gaining momentum, as buoyant consumer demand is reinforced by strengthening exports on the back of more rapid global growth. Given the currently low level of capacity utilisation, investment growth is expected to lag behind, with the exception of residential construction, which is set to react positively already in 2010 to the revived strength of house prices. Private consumption should be sustained by more optimistic households, who are expected to reduce their high saving rate as the labour market outlook improves and real disposable income continues to grow, albeit at a slower pace. Overall, annual GDP growth is forecast to reach 1¾% and 2½% in 2010 and 2011 respectively.

It cannot be excluded that private consumption in Sweden will grow faster than foreseen, given the current upsurge in consumer confidence. The household saving rate is at a historically high level, which creates room for increased consumption. The wealth effect from rising house prices and stock-market indices could prove stronger, in particular since survey data indicate that households foresee house prices to continue to rise over the coming year. Moreover, as the general government balance has not deteriorated as much as previously expected, consumers may feel more confident that fiscal policy may not become restrictive in the near term. They may even expect further short-term stimulus. On the other hand, the currently strong demand for housing, which is sustaining the rise in house prices, is to a large extent built on increasing household indebtedness, which has reached 160% of disposable income and continues to rise. Households have been taking up mortgage loans at a double-digit annual growth rate over the last year. This process is to a large extent driven by the currently exceptionally low interest rates. Once interest rates normalise, an increased debt service burden could weigh on household consumption in the medium term.

While the financial sector has stabilised, there are still government support measures in place, which makes it difficult to fully assess how strong the banking sector would be in absence of these measures. Renewed global financial market turmoil could once again lead to strains within the financial sector.

Inflation to remain below target

After reaching a high in the autumn of 2008, consumer-price inflation subsequently fell in the course of 2009 as energy prices reversed their previous strong upward movement. This has masked an increase in core inflation, which has edged up in the second half of last year, as productivity gains were weak and the previous weakening of the krona fed through to import prices.

Given the large output gap and the recent strengthening of the krona, price pressures are however likely to subside going forward. The ongoing wage-bargaining round between the social partners on a new set of collective agreements covering about 3 million wage earners, i.e. the bulk of the labour force, seem to result in moderate wage increases over the forecast period. However, the negotiations are proving more difficult than usual because of the wide difference in expectations between the employers and the unions regarding the available room for wage increases. This is further complicated by the widely contrasting situations in the so far slow-growing export-oriented sectors on the one hand and the more buoyant domestic-oriented sectors on the other. Traditionally, the heavily export-oriented industrial sector has set the tone for the rest of the labour market, thus safe-guarding export competitiveness. At the current juncture, however, this policy has been difficult to maintain, with at least some of the domestically-oriented sectors signing new agreements before the industrial sector. A further issue of discord is the practice of some employers of dismissing their own employees and then re-hiring them via replacement firms in order to circumvent employment protection laws. This is heavily resisted by the unions. Despite increased risks related to a difficult bargaining round, including strikes, high unemployment is nevertheless expected to result in historically low wage increases over the forecast period. The agreements signed so far, however, cover a shorter period than the usual three years, with many agreements expiring in early 2012.

While volatile energy prices can affect the headline inflation number, as witnessed by this winter's peak in electricity prices, annual HICP inflation is nevertheless expected to fall to slightly above 1½% in 2010 and to remain at that level in 2011.

Avoiding hysteresis in the labour market still key policy challenge

As a result of the recession, the situation in the Swedish labour market has deteriorated significantly, with unemployment rising from an average level of 6.2% in 2008 to above 9% in early 2010. So far, most of the labour shedding has taken place in the manufacturing industry, with the public sector and the private services sector proving more resilient than many forecasters believed during the most acute phase of the recession. While the number of redundancy notices has diminished significantly since the peak levels of more than a year ago and the number of vacancies has increased, an unusual amount of labour hoarding during the crisis could imply that the early phase of the recovery may be rather job-anaemic. Nevertheless, unemployment looks set to peak at around 9¼% in 2010 before decreasing to slightly below 9.0% in 2011.

A key challenge will be to prevent potentially jobless growth from leading to hysteresis in the labour market with permanent loss of labour supply. This is also important in order to ensure a continued and sufficient improvement in the fiscal position as GDP growth gains momentum. Ensuring that active labour-market policies remain of high quality even as they expand in scope will be important in this regard.

Modest fiscal deficit to peak in 2010

Due to a combination of cyclical effects, reflecting a high tax elasticity, and discretionary fiscal measures (in the form of various fiscal packages totalling about 1¾% of GDP in 2009), public finances swung from a surplus of 2.5% of GDP in 2008 to a deficit of 0.5% of GDP in 2009. Tax revenues came in somewhat better than most forecasters expected earlier in the year, mainly thanks to higher income tax and VAT revenues. Further stimulus measures introduced with the 2010 Budget Bill, amounting to about 1.0% of GDP, combined with an expected further rise in unemployment in 2010, are likely to widen the deficit to around 2% of GDP in 2010. Stronger GDP growth combined with an improvement in the labour market situation should contribute to bringing the deficit down to around 1½% of GDP in 2011. This includes additional measures of about 0.2% of GDP announced in mid-April as part of the Spring Budget Bill. The announced measures consist mostly of lower taxes for pensioners. With unemployment still high, a relatively contained deficit and parliamentary elections due in mid-September, it is likely that the 2011 Budget Bill to be presented this autumn might contain further stimulus measures, regardless of the outcome of the elections. This could lead to somewhat stronger GDP growth than forecast for 2011, but also carries with it a risk of a slightly wider deficit.

The return of deficits, combined with negative or slow nominal GDP growth, has stopped the previous trend towards a lower government debt ratio, with the debt ratio rising from 38% in 2008 to 42% in 2009. The government has also put further privatisations on hold until after the general elections of this autumn. Over the forecast period, the gross public debt ratio is forecast to fall marginally to around 42% in 2011.

Table II.26.1:

Main features of country forecast - SWEDEN

		2008			Annual percentage change					
		bn SEK Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		3154.6	100.0	2.4	4.2	2.5	-0.2	**-4.9**	**1.8**	**2.5**
Private consumption		1466.9	46.5	1.8	2.3	3.0	-0.2	**-0.8**	**2.4**	**2.2**
Public consumption		833.3	26.4	0.6	2.0	0.3	1.4	**2.1**	**1.3**	**0.5**
Gross fixed capital formation		614.5	19.5	2.0	9.1	7.5	2.6	**-15.3**	**-1.9**	**5.4**
of which : equipment		260.1	8.2	5.1	9.3	10.1	5.8	**-27.4**	**-4.0**	**6.5**
Exports (goods and services)		1711.5	54.3	7.3	8.9	5.8	1.8	**-12.5**	**3.9**	**6.7**
Imports (goods and services)		1476.8	46.8	5.4	8.7	9.4	3.0	**-13.4**	**5.7**	**7.3**
GNI (GDP deflator)		3264.7	103.5	2.7	6.2	3.2	0.8	**-6.8**	**0.8**	**2.6**
Contribution to GDP growth :	Domestic demand			1.3	3.2	2.9	0.7	**-2.8**	**1.2**	**2.1**
	Inventories			0.1	0.2	0.8	-0.6	**-1.5**	**1.0**	**0.2**
	Net exports			1.0	0.8	-1.1	-0.4	**-0.5**	**-0.5**	**0.2**
Employment				-0.2	1.7	2.2	0.9	**-2.0**	**-0.9**	**0.3**
Unemployment rate (a)				7.6	7.0	6.1	6.2	**8.3**	**9.2**	**8.8**
Compensation of employees/head				4.1	2.1	5.1	1.7	**1.7**	**2.1**	**2.5**
Unit labour costs whole economy				1.4	-0.4	4.7	2.8	**4.8**	**-0.5**	**0.3**
Real unit labour costs				-0.3	-2.1	1.7	-0.4	**2.9**	**-2.9**	**-1.8**
Savings rate of households (b)				-	-	12.0	14.1	**16.3**	**14.5**	**13.2**
GDP deflator				1.6	1.7	3.0	3.2	**1.9**	**2.4**	**2.1**
Harmonised index of consumer prices (HICP)				1.9	1.5	1.7	3.3	**1.9**	**1.7**	**1.6**
Terms of trade of goods				-1.1	-0.3	2.7	-0.7	**1.6**	**1.0**	**0.0**
Trade balance (c)				6.1	5.6	4.6	4.0	**3.6**	**3.3**	**3.2**
Current-account balance (c)				3.9	8.5	9.1	9.5	**7.1**	**6.1**	**6.1**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				3.6	7.9	9.0	9.3	**7.1**	**6.0**	**6.1**
General government balance (c)				-2.2	2.5	3.8	2.5	**-0.5**	**-2.1**	**-1.6**
Cyclically-adjusted budget balance (c)				-1.5	0.3	1.6	1.4	**1.9**	**-0.2**	**-0.5**
Structural budget balance (c)				-	0.3	1.6	1.1	**1.9**	**-0.2**	**-0.5**
General government gross debt (c)				62.1	45.7	40.8	38.3	**42.3**	**42.6**	**42.1**

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

27. THE UNITED KINGDOM

Fragile recovery in the face of headwinds

Assessing the fallout from the recession

After more than a decade of stable output growth, the UK economy passed through its most challenging year in 2009. As financial market stress mounted from autumn 2007 and negative feedback loops began to weaken balance sheets, restrict lending and reduce demand, output falls accelerated in early 2009 to their fastest rate in post-war history. Although the contraction is estimated to have bottomed out in the third quarter with modest growth in the fourth, the annual GDP contraction hit almost 5%.

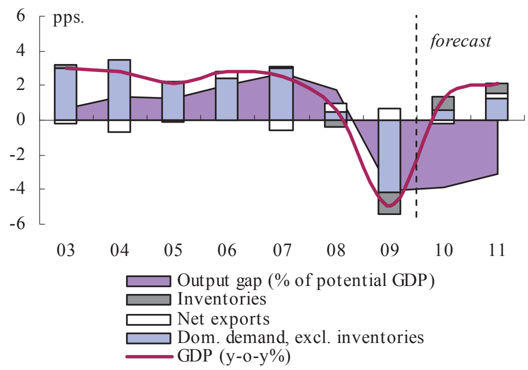
While unemployment rises have been smaller than expected for such a large contraction, the number unemployed has increased by half since the start of the crisis and 800,000 workforce jobs have been lost. One of the greatest challenges for the UK economy will be to redeploy spare capacity, reverse the fall in aggregate supply and improve employment prospects. Restoring the UK public finances is a central task, as they have been greatly weakened, by a combination of the severe downturn, its impact on previously tax-rich income and expenditure, the operation of automatic stabilisers and the fiscal stimulus.

A slow start to a protracted recovery

Economic output passed through its lowpoint in the second half of 2009, with 0.4% quarterly growth in the fourth quarter, the first quarterly growth since the start of 2008. GDP expanded at a somewhat slower rate in the first quarter of 2010, at least partly reflecting a negative impetus from poor weather and the re-increase in VAT.(79) Output is expected to pick up gradually over the forecast horizon as the corporate and – to a lesser extent – the household sector begin to increase their investment and (for households) consumption expenditure. Overall, GDP growth of 1¼% is expected for 2010, followed by 2% the year after.

Domestic demand, the weakness of which was the principal driver of the UK recession, is set to return to growth in 2010. By contrast, net external demand will provide a small negative contribution due to a negative carry-over from the relatively stronger rebound in imports than in exports in the second half of 2009, but on a quarterly basis net trade is expected to already make a positive contribution during the course of 2010 as export volumes rebound from still-depressed levels. Nonetheless, sterling's depreciation has not yet been reflected in more competitive terms of trade. An important growth stimulus will come from the turning of the stockbuilding cycle, which will add ¾ pp. to GDP growth in both forecast years.

Graph II.27.1: **The United Kingdom - Output gap, GDP growth and contributions**



The outlook for private consumption, the biggest GDP component, remains muted. Consumer spending increased slightly in the fourth quarter of 2009, but this is likely to have included some expenditure brought forward by households to avoid the re-increase of VAT to 17% in January 2010. While consumer sentiment has improved since the start of 2010 and points towards continuing household spending growth in the short term, the strength of the spending recovery will be limited by negative real average earnings growth in 2010 and very limited job creation over the forecast horizon. The latter reflects the fact that during 2009 companies reduced employment by far less than the fall in output, which led to a marked fall in labour productivity. Coupled with positive earnings growth, this resulted in a considerable rise in unit wage costs, which is likely to reduce the demand for additional labour. Furthermore, households' expectations of weak job prospects and the adverse impact of future interest rate rises on debt servicing costs are likely to encourage continued saving, keeping the household saving rate at 6½% of household resources. (see Graph II.27.2)

(79) GDP data published on 23 April, after the forecast cut-off date, showed slightly weaker output growth in Q1 2010 than incorporated in the forecast, thus increasing downside risks to the forecast.

Fixed investment spending by corporations and households fell sharply during the recession as demand expectations weakened and cash-flow pressures intensified. Tighter credit conditions further dampened investment spending. Spare capacity reduced the investment necessary to offset depreciation. This suggests that demand expectations and credit conditions will be key determinants of fixed investment spending. The expected resilience of corporate gross operating surpluses will allow for moderate rises in business investment, but – given the strong negative carry-over from 2009 – annual growth will remain negative in 2010. Residential investment levels will be dictated mainly by the housing market, where following a slight recovery in transactions and prices during 2009 recent mortgage approvals data suggest more subdued housing demand, thus limiting housing investment growth.

Changes in inventories accounted for a considerable share of the 2009 output fall, driven partly by producers' desire to support their cash flow positions by running down large inventories built up in better times. With business surveys signalling increased new orders, changes in inventories are likely to turn positive towards the end of 2010, and to make positive contributions to growth throughout 2010 and 2011.

Government consumption expenditure grew on a quarterly basis throughout 2009, supporting domestic demand, especially in the final quarter. Looking ahead, the latest Budget projections imply falls in spending that create a drag on demand in financial years 2010/11 and 2011/12.

Net external demand supported growth in the early part of the recession, as imports fell further than exports. However, in the second half of 2009 imports grew more rapidly than exports, subtracting ¼ pp. from growth in each quarter. Sluggish export performance following sterling's depreciation of over 20% since mid-2007 is in part attributable to the relative stability of the UK's terms of trade. While some remaining pricing lags still delay an adjustment of export prices in the short term, the central scenario is for a moderate terms of trade deterioration over the forecast horizon. This should help increase export growth relative to that in imports enough to generate a moderate improvement in net external demand, thereby supporting growth in the medium term.

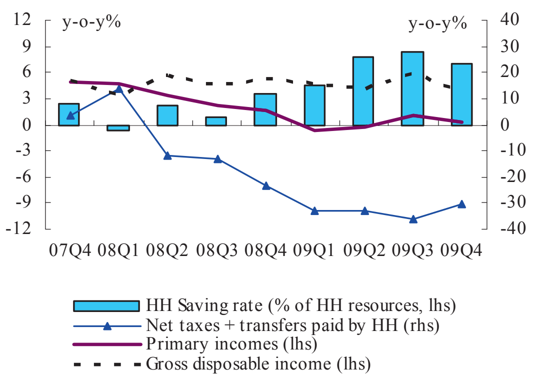
Moderate job losses but higher inactivity

Since mid-2009 harmonised UK unemployment levels have remained relatively stable at around 2.5 million persons, with the narrower claimant count measure showing slight falls in 2010. However, the apparent stability of the unemployment rate at around 8% must be seen in its broader context. Notably, full-time employment levels have continued falling throughout 2009 but were largely offset by rising part-time employment. Growth in the working age population since early 2009 was outweighed by a 1 pp. rise in inactivity to 21.5%. While much of this increase is due to rising student numbers, inactivity may have also increased due to lower perceived employment prospects. Stemming rising inactivity and preserving full-time employment is an important challenge facing the UK labour market, with repercussions for tax revenues, benefit payments and household income.

Households' finances supported by stabilisers

During 2009 aggregate household income was supported by rises in benefit payments and lower tax payments and social contributions. Real household gross disposable income continued to grow throughout the recession (Graph II.27.2). As private consumption spending fell during 2009, household gross saving increased to a ten-year high of 8.4% in the third quarter, moderating only slightly thereafter. Most of this rebalancing is attributable to increases in disposable income. However, transfer payments are unlikely to grow further given the stagnating UK labour market, and the (re-)increases in VAT and social contributions in 2010 will depress disposable income growth. This suggests that the current high saving rate cannot be maintained without significantly constraining household spending growth.

Graph II.27.2: **The United Kingdom - Household saving rate and its drivers**



From quantitative easing to lending growth

Since the Bank of England's March 2009 decision to begin purchasing assets financed by the creation of reserves, GBP 200 bn (14% of GDP) worth of mainly UK government bonds have been purchased. The policy pursued multiple objectives, amongst these an increase in nominal spending and greater credit provision by banks to the private sector. The purchases to date have raised the monetary base by the amount of the purchases, but annual growth in broad money supply (M4, i.e. including lending) has slowed to almost zero. Bank lending to private non-financial companies contracted during 2009, and lending to households stagnated, partly due to the weak housing market. The Bank of England's credit conditions surveys suggests that after a tightening of the price and availability of credit in 2009, conditions for households had stabilised and improved for corporations in the first quarter of 2010. A further easing in lending conditions would support domestic demand without necessarily jeopardising the longer-term household sector deleveraging.

Inflation story: VAT, sterling and spare capacity

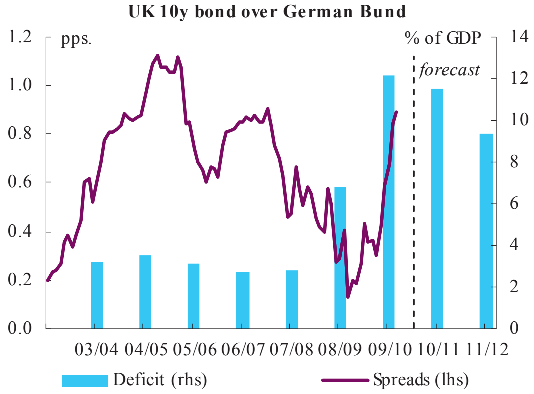
Data released since the autumn have shown a strong increase in inflation in the final months of the year, in part due to base effects from 2008 energy price falls and the December 2008 VAT reduction. However, a significant part of the rise in inflation seems due to an unexpectedly long-lagged effect of sterling's depreciation since mid-2007. Given a higher price level than previously expected, this implies year-on-year inflation for much of 2010 will be higher as well, even on a broadly unchanged view of monthly price movements. The temporary effects should soon give way to deflationary pressures from significant spare capacity, particularly in the labour market. This is likely to bear down on factor costs, particularly average earnings growth, leading to inflation of around 1½% in 2011.

From stimulus to limited consolidation in public finances

After a significant stimulus in 2009, the government has initiated a fiscal consolidation in 2010 with the deficit expected to fall from 12.2% of GDP in 2009/10 to just under 9½% of GDP by 2011/12, though most of the fiscal effort is backloaded to the end of the forecast period. The reduction in the deficit by 2011/12 primarily reflects the combined effects of better economic conditions and unprecedented restraint in discretionary expenditure. However, the government's plans for non-cyclical primary expenditure in 2011/12, which the forecast assumes will be adhered to, are not yet backed by detailed departmental spending limits. In addition, government financial sector interventions undertaken during the crisis have generated large contingent liabilities.

The deficit in financial year 2009/10 is estimated at 12.2% of GDP, around ¾ pp. lower than projected by the Commission services in autumn 2009, primarily due to a weaker contraction in revenue growth. In 2010/11 the primary deficit is expected to fall by 1½% of GDP, though the reduction in the total deficit – at ¾% of GDP – will be smaller as a result of higher debt servicing costs. The reduction in the deficit is driven by an increase in revenue by 6⅓% in nominal terms, around one-thirds of which is due to the increase in the VAT rate to its pre-stimulus level. Expenditure is projected to continue growing at a slower rate, up by around 4% over the preceding year, in part reflecting a deceleration in cyclical expenditure. Front-loading of capital expenditure to 2008 and 2009 should also contribute to lower investment spending in 2010/11 by almost 1% of GDP. The spring 2010 deficit forecast for 2010/11 is 0.2 pp. higher than that projected in the 2010 Budget, primarily reflecting the projection of slightly lower economic growth and weaker tax elasticities.

Graph II.27.3: **The United Kingdom - Spread of UK 10y bond over German Bund**



Overall, the discretionary measures that will come into effect in 2010/11 will reduce the deficit by around 1% of GDP. The structural budget deficit, however, is estimated to decline only slightly from 2009/10, reflecting low revenue elasticity as a result of continued weak activity in the financial and housing markets, each of which had hitherto been major sources of revenue.

Table II.27.2:
General government projections on a financial year basis

	2007/08	2008/09	2009/10	2010/11	2011/12
General government balance[1]	-2.8	-6.8	-12.2	-11.5	-9.4
Structural budget balance	-3.8	-6.2	-10.2	-10.0	-8.2
General government gross debt	43.7	55.8	71.4	80.9	87.9

[1] Data adjusted for the consistent recording of UMTS licence proceeds.

With unchanged policies, in 2011/12 the deficit is projected to drop by around 2 pps. from the previous year, while the structural deficit ratio is estimated to improve by 1¾ pps. The planned increase in social security contribution rates is expected to raise revenue by 0.4% of GDP, while an increase in tax rates on high incomes is expected to yield an additional 0.2% of GDP. Current expenditure is planned to grow by 2¾% in 2011/12, or 1¼% in real terms, while investment spending is planned to be reduced by around ¾% of GDP.

The forecasts for interest payments in 2010/11 are based on an assumed increase in 10-year interest rates from an average of 3.4% in 2009 to 4.1% in 2010 and 4.5% in 2011.

The debt ratio in 2010/11 is estimated to increase by 9½ pps. of GDP, driven by the high primary deficit. In 2011/12 the debt ratio, at around 88% of GDP, is set to overtake the EU average.

Table II.27.1:
Main features of country forecast - THE UNITED KINGDOM

	2008			Annual percentage change						
	bn GBP Curr. prices		% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	1448.4		100.0	2.8	2.9	2.6	0.5	**-4.9**	**1.2**	**2.1**
Private consumption	928.5		64.1	3.2	1.5	2.1	0.9	**-3.2**	**0.6**	**1.5**
Public consumption	313.6		21.6	1.8	1.6	1.2	2.6	**2.2**	**1.5**	**-1.5**
Gross fixed capital formation	242.8		16.8	3.7	6.5	7.8	-3.5	**-14.9**	**-0.9**	**4.4**
of which : equipment	83.9		5.8	5.0	4.5	11.5	-3.2	**-22.7**	**-3.9**	**6.3**
Exports (goods and services)	422.4		29.2	5.6	11.3	-2.8	1.1	**-10.6**	**5.2**	**5.4**
Imports (goods and services)	460.6		31.8	6.6	8.8	-0.7	-0.5	**-11.9**	**5.3**	**4.1**
GNI (GDP deflator)	1478.7		102.1	3.0	1.8	3.3	1.2	**-5.0**	**1.2**	**2.0**
Contribution to GDP growth :	Domestic demand			3.1	2.4	3.0	0.5	**-4.2**	**0.6**	**1.3**
	Inventories			0.1	0.1	0.2	-0.4	**-1.2**	**0.8**	**0.6**
	Net exports			-0.3	0.4	-0.6	0.4	**0.7**	**-0.2**	**0.2**
Employment				0.7	0.9	0.7	0.7	**-1.6**	**-0.3**	**0.7**
Unemployment rate (a)				6.8	5.4	5.3	5.6	**7.6**	**7.8**	**7.4**
Compensation of employees/head				4.2	4.2	4.9	2.6	**1.4**	**1.4**	**1.6**
Unit labour costs whole economy				2.1	2.2	3.0	2.7	**4.9**	**-0.1**	**0.2**
Real unit labour costs				-0.4	-0.6	0.1	-0.2	**3.5**	**-2.5**	**-1.3**
Savings rate of households (b)				-	-	2.2	1.5	**7.1**	**6.5**	**6.3**
GDP deflator				2.5	2.8	2.9	3.0	**1.4**	**2.5**	**1.4**
Harmonised index of consumer prices (HICP)				1.9	2.3	2.3	3.6	**2.2**	**2.4**	**1.4**
Terms of trade of goods				0.1	-0.1	0.6	0.3	**-0.3**	**-0.4**	**-1.2**
Trade balance (c)				-3.1	-5.8	-6.4	-6.4	**-5.9**	**-6.4**	**-6.7**
Current-account balance (c)				-1.6	-3.3	-2.7	-1.5	**-1.3**	**-1.8**	**-2.0**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-1.5	-3.2	-2.5	-1.3	**-1.1**	**-1.6**	**-1.7**
General government balance (c)				-2.9	-2.7	-2.8	-4.9	**-11.5**	**-12.0**	**-10.0**
Cyclically-adjusted budget balance (c)				-2.8	-3.5	-3.9	-5.7	**-9.7**	**-10.4**	**-8.7**
Structural budget balance (c)				-	-3.5	-3.9	-5.2	**-9.5**	**-10.4**	**-8.7**
General government gross debt (c)				43.6	43.5	44.7	52.0	**68.1**	**79.1**	**86.9**

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

Candidate Countries

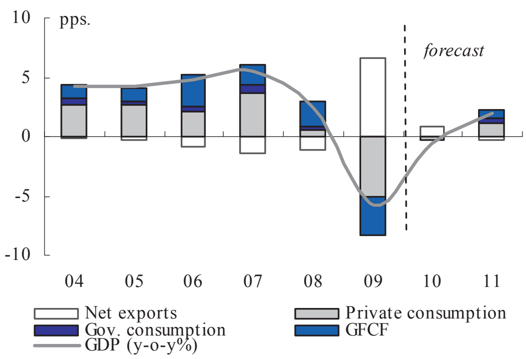
28. CROATIA

Another critical year ahead, after severe recession

Croatia was severely hit by the crisis

Over the last few years and before its economy was hit by the global crisis, Croatia enjoyed relatively strong economic growth, averaging 4.3% in 2004-08. The growth performance was primarily domestic-demand driven, fuelled by large capital inflows and strong credit growth. This was accompanied by a marked expansion of non-tradable industries, such as retail, construction and the financial sector. The global crisis severely affected the Croatian economy which went into a deep recession. Real GDP declined by 5.8% in 2009, driven by a strong fall in domestic demand. Private consumption declined by around 8.5% and total investment by 11.8%. As a result, domestic demand posted a huge negative contribution to GDP growth (around 8 pps.), whereas net exports provided some compensation, as losses in total exports were lower than the reduction in imports.

Graph II.28.1: **Croatia - GDP growth and contributions**



Prospects for a short-term economic recovery remain highly uncertain

At the current stage, there is no clear evidence that economic recovery has started to unfold. Indeed, high frequency indicators suggest that economic activity continued to fall year-on-year in the first two months of 2010, reflecting ongoing real sector restructuring and deleveraging. At the same time, it is noticeable that the pace on contraction has eased and the worst of the current recession seems to be over. However, a clear turnaround has not yet been reached and marked stimulation of economic activity over the short term is currently not to be expected.

Small output losses in 2010 to be followed by a moderate recovery

The outlook for 2010 remains uncertain. Domestic confidence may not recover quickly and expectations are expected to remain subdued. This does not bode well for a strengthening of domestic demand. The effects of the recession on the labour market, i.e. declining employment and rising unemployment, will continue to be felt in 2010. Bleak job prospects and lower wage growth will hamper growth in disposable income. Private consumption is forecast to register a small negative growth rate.

Domestic credit growth has decelerated significantly during the crisis, due to both demand and supply factors. Lower demand for loans as well as tighter financing constraints and higher risk awareness by banks have led to a slowdown in bank lending, particularly to private households. Although the banking sector is well-capitalised, sound and profitable, risk perception by banks remain elevated. The share of non-performing loans has been rising and the quality of the loan portfolio of banks may further deteriorate, also as a result of liquidity problems of the corporate sector. Recent government measures to stimulate lending through lower market interest rates and risk sharing may turn out to have a small effect on corporate sector lending. However, banks are expected to remain reluctant to accelerate lending activity quickly as they have to cope with further loss absorption.

The relatively low growth of private sector borrowing, in combination with higher interest rates, is expected to continue to put a brake on economic activity, particularly over the first part of the forecast horizon. In addition, important public-sector borrowing requirements have limited the availability of credit to the private sector.

External financing constraints have eased somewhat in the course of last year. However, higher risk awareness among potential investors and the huge debt amortisation obligations weighing on both the private and general government sectors are likely to constrain financing for new private investment.

Support from the fiscal side is not expected to get stronger over the short term. Public consumption and investment are unlikely to accelerate in view of the fiscal constraints and huge refinancing needs of the public sector.

Over the short term, it appears that the main impetus for the Croatian economy may come from net exports. However, it is still to be seen to what extent improvements in the external environment, notably a recovery of global and EU demand, will translate into a strengthening of export growth.

Overall, the Croatian economy is projected to record a small negative growth rate in 2010. Upside risks are mainly related to a faster-than-projected economic recovery in the EU, as well as to the clear prospect of Croatia's accession in the near future, which may provide additional impetus to the economy through, inter alia, stronger net FDI flows. But there are also significant downside risks, which are mostly related to the process of real sector restructuring, inter-company payments problems and subdued investor confidence. For 2011, the forecast projects positive growth of around 2%, mainly based on a slight acceleration of private consumption and investment growth, while net exports are set to contribute negatively to output growth.

External deficits will rise again, but remain significantly below pre-crisis levels

As a result of the financial crisis, the high external deficits of the past years have undergone severe adjustments. Reduced capital inflows and a contraction of domestic demand have led to a sharp reduction in the trade and current-account deficits. In 2009, the latter fell to 5.1% of GDP, compared to 9.3% a year before. As for the outlook, total exports are expected to recover slowly in 2010, in line with an expected strengthening of foreign demand in key trading partners. Also total imports will pick up only slowly thereafter. In light of expected trade flows and on the assumption that external financing constraints may persist somewhat, the current-account deficit is projected to remain below 6% of GDP in 2010.

Inflation pressures stay low

As a result of rapidly contracting domestic demand and lower commodity prices, average inflation came down significantly in 2009, to 2.2% compared to 5.8% a year before. Inflationary pressures are expected to remain low over the forecast horizon. Domestic demand is set to only slowly and gradually recover. Cost push pressures are expected to remain limited as the growth of unit labour costs will slow down. Upside risks are related both to foreign and domestic factors. On the external front, somewhat higher prices for imported raw materials are likely to have an effect on the domestic price level. Moreover, some mild inflationary pressures will result from further adjustments in administrative prices which will be necessary in the context of EU accession. At the same time, it is reasonable to assume that a stability-oriented monetary policy framework will help to prevent a significant re-acceleration of inflation over the medium term.

Labour market performance to suffer eventually

Wage developments have so far been moderate and remained in line with productivity growth. The government has made an attempt to reverse earlier public sector wage increases which should contribute to limiting wage pressures in 2010. In addition, the economic slowdown means that only moderate increases in labour costs in the private sector are expected over the forecast horizon.

As elsewhere, slowing growth and investment dynamics will have an impact on labour market developments with some delay. In 2010, employment is set to fall markedly again, and the unemployment rate (labour force survey) will continue to increase. The slight recovery of economic activity forecast for 2011 is expected to ease the pressure on the labour market somewhat, but not yet support a significant growth of employment.

Fiscal deficit widened significantly despite re-balancing measures…

The global crisis brought Croatia's public finances under severe pressures, necessitating subsequent budgetary adjustments in the course of 2009. The government adopted a first budget revision in April, followed by two further revisions in July with revised growth assumptions. In this context, a number of fiscal adjustment measures were taken to compensate for rapidly falling revenues, such as a VAT increase, a special tax on income and higher excises. Efforts to contain current spending (decrease in public-sector wages, suspension of pension indexation, cuts in material spending) were however partly offset by additional outlays (e.g. increases in agricultural and employment subsidies). Thus total spending in the third revised budget remained at the level of the original budget, while budgeted revenues were reduced by around 10%. As a result, the planned balance deteriorated markedly to 3.4% of (the revised) GDP, raising gross financing requirements in times of tight financing constraints.

The actual budget implementation appears to have been rather in line with the third revised budget, however, in late 2009 some overruns in current spending occurred, in particular on wages, pensions as well as on social transfers, which necessitated some budget adjustments at the end of the year. According to preliminary date, the budget deficit exceeded the planned level markedly, mainly due to activations of state guarantees. The deficit reached 4.1% of GDP, which is 0.7 pp. above the target.

...and there are little prospects for rapid fiscal consolidation due to the lack of public expenditure reforms

The forecast projects that the fiscal deficit in 2010 will stay close to the 2009 level as a relation to GDP. The forecast is largely based on the budget framework adopted by the Croatian authorities. The latter foresees a lower deficit of 3.3% of GDP. However, it is grounded on more optimistic GDP growth projections (compared to the Commission's forecast) and on the 2009 budget plan, which was more favourable than the actual outcome. The general government debt-to-GDP ratio is set to increase markedly, driven by new net borrowing, while the nominal GDP effect, "below-the-line-revenues" and other adjustments are expected to be small.

Overall, public finances in Croatia will remain under pressure as downside risks are evident on both the revenue and spending sides of the budget. Therefore, a key challenge will be to design and implement a credible medium-term fiscal strategy, aimed at reducing budget rigidities and enhancing the efficiency and quality of public spending. Such a strategy would need to be supported by a continuation and acceleration of economic restructuring on a broader front, as well as by deeper reforms of the social benefit system.

Table II.28.1:

Main features of country forecast - CROATIA

	2008			Annual percentage change					
	bn HRK Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	342.2	100.0	-	4.7	5.5	2.4	**-5.8**	**-0.5**	**2.0**
Private consumption	202.2	59.1	-	2.7	6.2	0.8	**-8.5**	**-0.5**	**2.0**
Public consumption	63.5	18.6	-	5.0	3.4	1.9	**0.2**	**0.2**	**2.0**
Gross fixed capital formation	94.3	27.6	-	10.9	6.5	8.2	**-11.8**	**0.5**	**3.0**
of which : equipment	-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)	143.4	41.9	-	6.5	4.3	1.7	**-16.2**	**2.4**	**2.5**
Imports (goods and services)	172.0	50.3	-	7.4	6.5	3.6	**-20.7**	**0.2**	**3.0**
GNI (GDP deflator)	330.7	96.6	-	4.6	5.8	1.7	**-6.1**	**-0.5**	**2.2**
Contribution to GDP growth : Domestic demand			-	5.3	6.1	3.0	**-8.3**	**-0.1**	**2.3**
Inventories			-	0.4	0.8	0.4	**-1.2**	**-1.2**	**0.0**
Net exports			-	-0.9	-1.4	-1.1	**3.7**	**0.8**	**-0.3**
Employment			-	3.9	3.5	1.1	**-2.5**	**-2.0**	**0.5**
Unemployment rate (a)			-	11.2	9.6	8.4	**10.4**	**11.5**	**11.0**
Compensation of employees/head			-	2.9	4.0	7.1	**2.2**	**0.6**	**3.0**
Unit labour costs whole economy			-	2.1	2.0	5.7	**5.8**	**-0.9**	**1.5**
Real unit labour costs			-	-1.3	-2.0	-0.6	**2.4**	**-1.4**	**-1.0**
Savings rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			-	3.4	4.0	6.4	**3.4**	**0.4**	**2.5**
Harmonised index of consumer prices (HICP)			-	3.3	2.7	5.8	**2.2**	**1.5**	**3.0**
Terms of trade of goods			-	-	-	-	**-**	**-**	**-**
Trade balance (c)			-	-21.3	-22.0	-22.9	**-16.1**	**-16.1**	**-16.4**
Current-account balance (c)			-	-7.0	-7.6	-9.3	**-5.1**	**-5.5**	**-5.9**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-7.3	-7.5	-9.2	**-**	**-**	**-**
General government balance (c)			-	-3.0	-2.5	-1.4	**-4.1**	**-4.0**	**-3.9**
Cyclically-adjusted budget balance (c)			-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)			-	-	-	-	**-**	**-**	**-**
General government gross debt (c)			-	35.7	33.0	33.5	**38.5**	**42.5**	**44.5**

(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

A mild recession, followed by a mild recovery

Output decline remained moderate

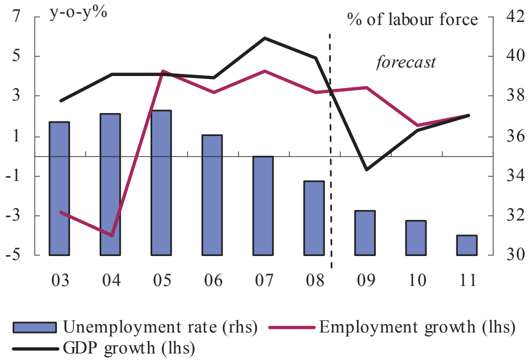
So far, the impact of the global financial crisis has remained rather moderate, with output declining by only about 0.7% in 2009. Private consumption remained rather resilient, benefiting from a reduction in the saving rate and slightly increasing private transfers, rising to 17% of GDP. Furthermore, increased public transfers helped to stabilise domestic income and demand. Investment dropped markedly during 2009 in response to sharply declining export demand and continued uncertainty. The financial sector's lending slowed down markedly, but due to a practically non-existing exposure to toxic assets, the direct impact of the global financial crisis has remained minor.

In response to the financial crisis, the government adopted so far four anti-crisis packages: one in December 2008, claiming a volume of some 5% of GDP, another in March 2009 in the form of an extended investment programme which envisages an increase in public investment from some 3% of GDP in the past to 7% of GDP in 2009, a third package in September and another support package in March 2010. However, the actual impact of all four packages on public revenue and expenditure so far has been very limited: Total government spending actually dropped by nearly 1 pp. of GDP, while revenues declined by 2½ pps., bringing the fiscal deficit from 1% of GDP in 2008 to 2.7% in 2009. Within the various spending categories there was a strong shift, with increasing public sector wages and transfers, and reduced capital spending.

Consumer-price inflation was slightly negative during most of 2009, leading to an average decline of consumer prices by 0.8% for the whole year. In the first months of 2010, inflation remained low, as the continued decline in food prices helped to compensate rising costs for housing and transport.

Official labour-market data point to a continued increase in overall employment, despite significant job losses in those industries primarily affected by the global crisis, namely steel and textile. However, employment at municipalities and in the trade sector appears to have increased markedly. The former is probably due to increased public spending, the latter probably due to strengthened registration procedures. Unemployment continued to drop slightly, but still remained at the alarmingly high level of some third of the labour force. Youth unemployment stayed at some 55%.

Graph II.29.1: **The former Yugoslav Republic of Macedonia - Labour market**



The exchange rate of the Denar has remained largely unchanged against the euro at a level of 61.4 MKD/EUR. The Central Bank intends to maintain its current informal peg to the euro.

A moderate recovery but protracted structural challenges remain

In 2010, the main shock of the global crisis is expected to subside, which should allow the economy to expand by around 1¼%. The main sources for this recovery will be private and public consumption, while exports are likely to remain sluggish. In 2011, economic activity is expected to increase by some 2%, benefiting from the recovery in the country's export markets.

Given the uncertainties related to the global economy, domestic demand and, in particular, real disposable income will be key factors for the country's growth dynamics. Overall, real disposable income is expected to remain fairly stable, benefiting from relatively low inflation and the stabilising impact of workers' remittances, even though labour income is likely to stagnate.

In recent years, workers' remittances and other private capital inflows have increased to more than 18% of GDP. During the forecast period, these inflows are expected to return to previous levels of some 15% of GDP, reflecting the more difficult labour market situations in host countries. Nevertheless, this source of income is expected to remain at a very significant level. As long as international prices for energy and raw materials remain moderate, inflation will probably remain low during the forecast period. This should support the real income of households.

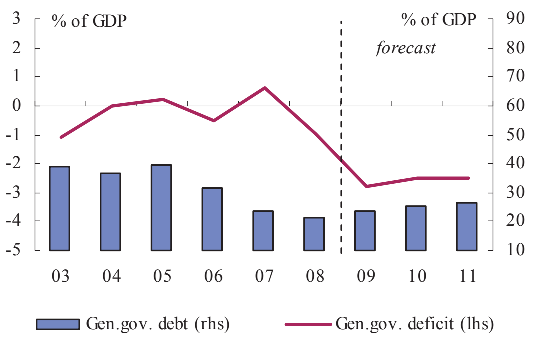
Labour income is likely to stagnate in the near future resulting from low growth of employment and wages. During recent years, employment growth has been rather high at some 3% annually. However, a significant share of those additional jobs are a result of a stricter registration procedure and do not necessarily reflect newly created employment. In view of the likely still difficult international environment in 2010-11, the country's potential for creating employment or raising real wages will remain limited. Improving the country's labour income is thus closely linked to improving productivity by modernising and deepening the capital stock.

The current-account deficit is likely to deteriorate, due in particular to increasing equipment investment in 2010 and 2011.

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 2¾% of GDP in 2009 to 2½% in 2010 and 2011. The budget for 2010 and programmes for 2011 envisage a significant increase in public spending. However, accelerating domestic activity and improved efficiency in tax collection should help to reconcile both targets. The forecast expects that in case of spending constraints, the authorities will reduce capital spending, as has happened in the past at similar occasions. However, as a result, the quality of public spending might deteriorate further.

Graph II.29.2: **The former Yugoslav Republic of Macedonia - Public finances**



Protracted fiscal deficits and rather low nominal GDP growth will lead to a marked rise in public sector debt, reaching some 27% of GDP by 2011.

Table II.29.1:

Main features of country forecast - THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

		2008			Annual percentage change				
	bn MKD	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		398.6	100.0	-	4.0	5.9	4.9	**-0.7**	**1.3**	**2.0**
Private consumption		312.9	78.5	-	6.0	9.8	6.9	**0.2**	**1.0**	**2.0**
Public consumption		75.7	19.0	-	1.8	0.4	9.7	**-4.7**	**-1.5**	**-0.5**
Gross fixed capital formation		97.6	24.5	-	11.6	13.1	20.3	**-9.2**	**4.0**	**6.0**
of which : equipment		40.1	10.1	-	8.0	22.7	-	**-**	**-**	**-**
Exports (goods and services)		209.6	52.6	-	8.4	14.3	-4.3	**-8.2**	**5.5**	**7.0**
Imports (goods and services)		313.2	78.6	-	10.9	17.4	5.8	**-10.7**	**4.0**	**6.1**
GNI (GDP deflator)		392.9	98.6	-	5.4	1.4	8.7	**-0.7**	**1.5**	**2.0**
Contribution to GDP growth :	Domestic demand			-	7.0	10.1	11.1	**-3.0**	**1.4**	**2.9**
	Inventories			-	0.0	0.5	0.3	**-1.9**	**0.0**	**-0.1**
	Net exports			-	-3.1	-4.7	-6.5	**4.1**	**-0.2**	**-0.9**
Employment				-	4.6	3.5	3.2	**3.4**	**1.5**	**2.0**
Unemployment rate (a)				-	36.0	34.9	33.8	**32.2**	**31.7**	**31.0**
Compensation of employees/head				-	-	-	7.5	**1.0**	**0.7**	**0.9**
Unit labour costs whole economy				-	-	-	5.7	**5.3**	**1.0**	**0.9**
Real unit labour costs				-	-	-	-1.4	**2.5**	**-1.1**	**-2.2**
Savings rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				-	4.4	7.5	7.3	**2.8**	**2.1**	**3.2**
Harmonised index of consumer prices (HICP)				-	3.2	2.3	8.3	**-0.8**	**1.3**	**2.0**
Terms of trade of goods				-	2.4	8.4	-0.7	**0.0**	**-0.2**	**-0.2**
Trade balance (c)				-	-20.2	-20.3	-26.9	**-21.4**	**-21.9**	**-22.3**
Current-account balance (c)				-	-0.9	-7.2	-13.1	**-4.2**	**-6.2**	**-7.9**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-	-	-	**-**	**-**	**-**
General government balance (c)				-	-0.5	0.6	-1.0	**-2.7**	**-2.5**	**-2.5**
Cyclically-adjusted budget balance (c)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				-	31.4	23.4	21.4	**23.7**	**25.4**	**26.7**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

30. TURKEY

A solid recovery after a severe contraction

Return to positive and robust growth

The Turkish economy is recovering strongly after severely contracting in 2009. GDP tumbled 4¾% last year, a sharp contrast to the 6% average annual growth rate in 2004-08. The global financial crisis hit the economy hard, thereby reducing fixed investment and external demand dramatically. Fiscal and monetary stimuli, combined with a healthy banking sector, helped cushion the blow. In Turkey's case, the crisis had a silver lining as it highlighted the economy's enhanced resilience to external shocks.

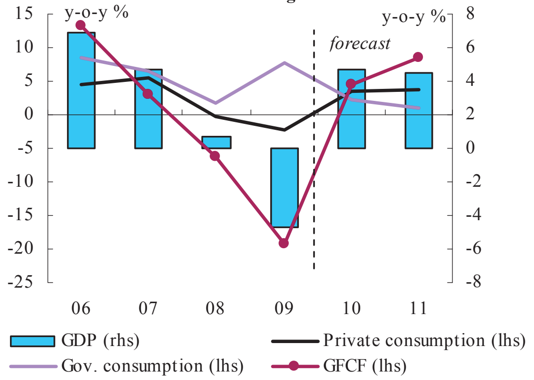
The Commission foresees a return to positive and robust annual growth in 2010. While still low levels of capacity utilisation are an obstacle to investment, and exports growth may suffer from a more gradual recovery in Turkey's chief export' markets, GDP growth could be close to 5% in 2010, helped by base effects and the turn in the inventories cycle. Ultimately, a sustained upturn in growth hinges on a lasting global recovery.

Due to strong base effects, which in part reflect the severity of the 2009 downturn

The trough of the current cycle came in the first quarter of 2009 when GDP tumbled 14.5% y-o-y. The economy has since shown steady improvement, helped by stimulus measures and a solid banking sector. In contrast to emerging European peers, Turkish banks are relatively less reliant on external funding (the sector's loan-to-deposit ratio is well below 100%), and have only experienced limited asset quality deterioration. As a result, GDP in the fourth quarter of 2009 showed strong positive annual growth, amounting to 6% y-o-y and 2% q-o-q (s.a.).

Therefore, a relatively robust recovery is expected. All components of domestic demand will show positive year-on-year growth in 2010, in large part due to strong base effects, reflecting the severity of the 2009 downturn.

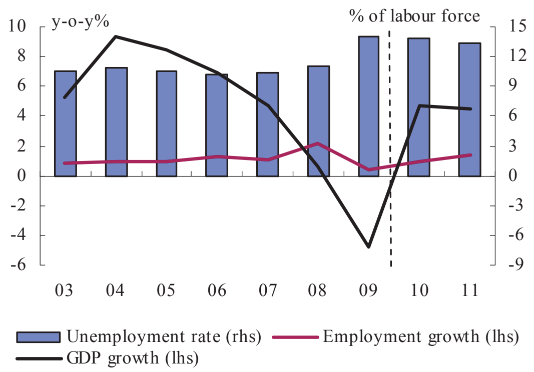
Graph II.30.1: **Turkey - GDP, consumption and investment growth**



And consumption and investment as the driving forces behind the recovery

Labour market developments, credit growth, and consumer and business confidence point to a gradual recovery in consumption in 2010. The jobless rate has risen to 14% in 2009 from 11% in 2008, but started decreasing slightly in the first months of 2010.

Graph II.30.2: **Turkey - Labour market**



Meanwhile, credit growth started to increase in the fourth quarter of 2009, albeit from very low levels, and still below the double-digit credit growth of the previous year. Both consumer and business confidence indices suggest a recovery in consumption is underway, but may take time.

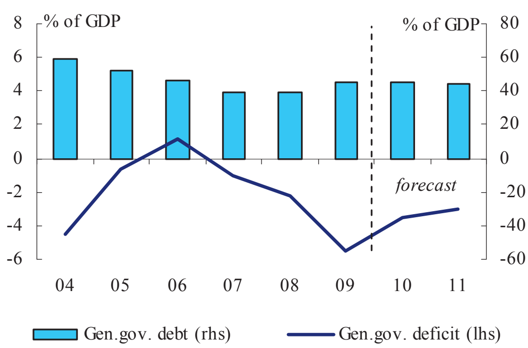
A recovery in investment is expected to be somewhat stronger. The low capacity utilisation rate (70% in early 2010) suggests considerable excess capacity. Meanwhile, industrial production trends and Turkey's Purchasing Managers' Index

(PMI) present a more positive picture. Industrial production surprised on the upside in the first two months of 2010 as it rose at double digit rates. The most recent PMI increases indicate a marked improvement of business conditions and significant growth of new orders in the Turkish manufacturing sector.

Fiscal rebalancing may be challenging…

Compared to the fiscal consolidation that took place in 2001-08, the budgetary performance has deteriorated markedly in 2009, and the general government budget deficit increased to 5½% of GDP from 2.2% in 2008. The main contributors were the acceleration of public spending, in particular of transfers to social security institutions, which recorded a deficit of 3% of GDP, and the impact of the various stimulus packages, which amounted to about 2% of GDP. Some of these stimulus measures have already been withdrawn. In addition, the strengthening economy may positively affect budget revenues. It is therefore forecast that the budget deficit will narrow to around 3½% of GDP in 2010 and 3% of GDP in 2011. However, only a credible, strong and binding fiscal rule may lead to the forecast fiscal outcome.

Graph II.30.3: **Turkey - Public finances**



In the past, the IMF programme, in addition to the EU-accession process, supported the economy in Turkey by providing a strong policy anchor. Turkey's last Stand-By Agreement expired in May 2008, and in mid-March 2010 both the government and the IMF announced that there is no successor arrangement to be expected anytime soon. The government plans to announce the details of a fiscal rule sometime in the first half of 2010, which is expected to serve as a potential fiscal anchor. Yet such a rule won't be put into effect until 2011.

Indeed, in terms of downside risks, the spectre of fiscal deterioration is of paramount importance. In tandem with the rising budget deficit, the public debt level has increased rapidly. The public debt stock rose to 45½% of GDP at the end of 2009, a jump from 39½% of GDP level a year earlier. While fiscal deterioration occurred around the world due to the sharp downturn in 2009, the danger in Turkey is that the deterioration trend might continue.

The government's Pre-accession Economic Programme for 2010-12 shows real expenditures remaining high even as growth returns. The specific concern is that the government will ramp up spending ahead of 2011 parliamentary elections in a bid to shore up support. Such a ramp-up would likely pressure interest rates and dent investor confidence, thereby slowing or even undermining the recovery.

… while monetary policy may affect the recovery prospects

In addition, the country's dramatic economic contraction in the fourth quarter of 2008 and the first half of 2009 year spurred the central bank to cut the total overnight rates by 1025 bps to an all-time-low of 6½% in the first quarter of 2010. The near doubling in inflation between October 2008 and March 2010 – from 5% to 10% – now urges the bank to back away from overly relaxed monetary policies.

Inflation is expected to remain at elevated levels in 2010 owing to base effects, higher commodity prices and the pass-through from administrative price adjustments as well as excise tax hikes. Food-price inflation constitutes an additional risk factor. Against this backdrop, inflation is expected to be close to 8½% by December 2010, exceeding the central bank's inflationary end-year target of 6½%. A key question, which poses both upsides and downside risks to the forecast, is now how the new economic and inflationary developments will be reflected in monetary policy.

The other major downside risk to the baseline scenario would be a renewed bout of global risk aversion. Any major cutback in investors' appetite for emerging market assets would negatively affect Turkey's recovery prospects. Meanwhile, political risks continue to lurk in the background. Any potentially escalating political tensions, which are not a part of the baseline scenario, pose a downside risk to the growth outlook.

External imbalances widening again

The correction in external accounts represented the silver lining of the recession. The positive terms-of-trade shock resulting from the collapsing oil prices combined with the decline in domestic demand and imports led to a major contraction of the trade and current-account deficits, from 5¾% in 2008 to 2¼% in 2009.

The forecast expects an increase of the current-account deficit to 4½% of GDP in 2010 due to stronger domestic demand and higher energy prices. With the recovery underway, the current-account deficit is likely to widen further in 2011.

However, the outlook for exports remains somewhat mixed. Exports declined by 5½% in 2009 and are forecasted to increase by 5½% in 2010. Of particular concern is the impact on the automotive sector, Turkey's top export earner. Roughly three-quarters of autos manufactured in Turkey are exported to Europe. Special schemes supporting car sales in EU markets, which have now expired, brought forward future sales.

Table II.30.1:

Main features of country forecast - TURKEY

	2008			Annual percentage change						
	bn TRY	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		948.7	100.0	4.2	6.9	4.7	0.9	**-4.7**	**4.7**	**4.5**
Private consumption		663.0	69.9	4.3	4.6	5.5	-0.1	**-2.3**	**3.5**	**3.7**
Public consumption		121.9	12.8	3.8	8.4	6.5	1.9	**7.8**	**2.2**	**1.0**
Gross fixed capital formation		188.8	19.9	5.5	13.3	3.1	-5.0	**-19.2**	**4.6**	**8.4**
of which : equipment		98.4	10.4	-	10.2	1.2	-3.4	**-21.4**	**5.0**	**10.0**
Exports (goods and services)		227.7	24.0	9.5	6.6	7.3	2.3	**-5.4**	**5.7**	**7.2**
Imports (goods and services)		275.3	29.0	10.6	6.9	10.7	-3.8	**-14.4**	**9.5**	**9.6**
GNI (GDP deflator)		938.6	98.9	4.2	6.8	4.8	0.9	**-4.7**	**4.7**	**4.5**
Contribution to GDP growth :	Domestic demand			4.7	7.4	5.4	-1.1	**-5.0**	**3.7**	**4.3**
	Inventories			0.0	-0.1	0.6	0.3	**-2.4**	**2.1**	**1.0**
	Net exports			-0.4	-0.4	-1.3	1.7	**2.8**	**-1.1**	**-0.9**
Employment				0.8	1.3	1.1	2.2	**0.4**	**0.9**	**1.4**
Unemployment rate (a)				7.8	10.2	10.3	11.0	**14.0**	**13.9**	**13.4**
Compensation of employees/head				55.3	12.7	12.7	8.6	**-0.8**	**6.4**	**7.2**
Unit labour costs whole economy				50.2	6.8	8.9	10.0	**4.6**	**2.5**	**4.0**
Real unit labour costs				-2.6	-2.3	2.5	-1.5	**-0.2**	**-3.5**	**-2.0**
Savings rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				54.3	9.3	6.2	11.7	**4.7**	**6.3**	**6.2**
Harmonised index of consumer prices (HICP)				-	9.3	8.8	10.4	**6.3**	**9.0**	**7.8**
Terms of trade of goods				-0.1	-4.9	3.3	-2.7	**-0.5**	**-1.0**	**-1.0**
Trade balance (c)				-4.8	-7.5	-7.3	-7.0	**-4.5**	**-5.4**	**-6.1**
Current-account balance (c)				-0.5	-6.1	-5.9	-5.7	**-2.2**	**-4.5**	**-5.4**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-	-	-	**-**	**-**	**-**
General government balance (c)				-	-1.2	-1.0	-2.2	**-5.5**	**-3.5**	**-3.0**
Cyclically-adjusted budget balance (c)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				-	46.1	39.4	39.4	**45.5**	**45.1**	**44.5**

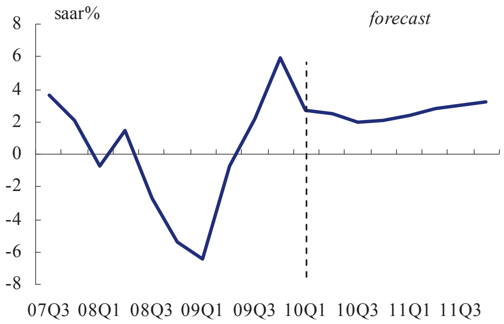
(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Other non-EU Countries

31. THE UNITED STATES OF AMERICA
Settling into subdued recovery mode

Since the presumed end of the "Great Recession" in the summer of 2009 the output of the US economy has expanded at a decent pace. A main contribution to GDP growth has come from the inventory cycle which saw a sharp fall in the recession-induced rate of destocking in the second half of last year. Final domestic demand has only increased slowly in spite of massive support from macroeconomic policies. Three quarters into the recovery the labour market, as well as the housing market, remain weak. Monetary policy continues at an ultra-accommodative setting and the ongoing fiscal stimulus has pushed the budget deficit to the highest level since World War II. The main point of the forecast is that the strong headwinds facing the US economy will result in a relatively subdued recovery until the end of next year. Output is projected to increase only moderately in the second half of 2010. Subsequently, GDP growth is expected to accelerate on a quarterly basis, but still less than in previous recovery episodes. Unemployment will remain at around the current level while disinflation continues throughout the forecast period.

Graph II.31.1: **USA - Annualised quarterly growth rate of real GDP**



A slow emergence from the 2008/09 recession

Economic growth resumed in mid-2009 thanks to strong doses of monetary and fiscal stimulus. Real GDP accelerated from an annualised growth rate of 2.2% in the third to 5.9% in the fourth quarter. Industrial production started to increase in July and the purchasing managers' index for the manufacturing sector has returned to readings consistently above 50 in August and remained there since. Business activity in the services sector remained more subdued. Consumer spending increased at annual rates of 2.8% in the third and 1.7% in the fourth quarter following tax cuts and government incentives for car purchases. Business outlays for new equipment and software increased at a robust rate in the fourth quarter, but investment in non-residential structures continued to decline. Residential investment rose from an extremely low level in the second half of 2009 following 3½ years of uninterrupted decline. Both exports and imports have rebounded strongly since mid-2009. The strongest contribution to GDP growth came from the turnaround in the inventory cycle. Two thirds of the high growth rate in fourth quarter was due to the sharp decline in the rate of destocking while final domestic demand increased at an annual rate of just 1.5%.

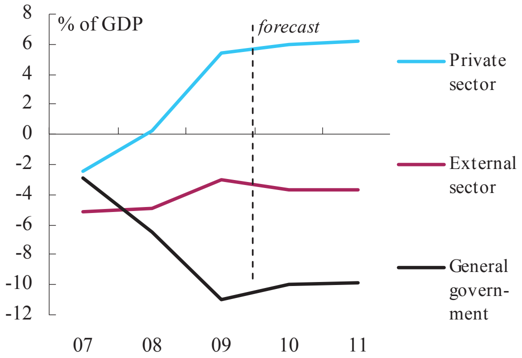
In spite of renewed output growth, payroll employment changed little over the winter months. The unemployment rate rose to 10% in the fourth quarter of 2009 before receding slightly in early 2010. Apparently responding to the large negative output gap, inflationary pressures have clearly diminished in recent months with core CPI inflation falling to 1.1% y-o-y in March. The fiscal situation deteriorated further in 2009 with the deficit of general government rising to 11.6% of GDP in the middle quarters before receding somewhat in the final quarter. The current-account deficit fell below 3% of GDP in the first quarter of 2009, but has widened slightly again in the second half of the year.

Some high-frequency indicators pointed to a softening of economic activity in early 2010 although unusually severe winter weather complicates the interpretation of the data. Most importantly, following a clear downward trend between April and December last year, initial unemployment claims moved back up again in the first quarter. Various indicators for the housing market showed renewed signs of weakness. Consumer confidence continued to fluctuate in a range normally associated with recessions. Nevertheless, consumer spending has been surprisingly strong in recent months – at least according to currently available estimates – in spite of the weakness in household income and the loss of wealth during the recession. The mirror image of this is a renewed decline of the household saving rate in the first quarter following the rise during the recession.

Diminishing impact from inventories and fiscal stimulus

The economy was lifted out of recession in the second half of 2009 by strong, but temporary, boosts from the government's fiscal stimulus and from the inventory cycle. Certainly, inventories still declined, but at a lower rate than previously, particularly in the fourth quarter. In early 2010 the inventory cycle should move to the phase in which stocks will increase again, but the pace of the changes is likely to be significantly smaller than at the end of last year. The forecast projects that the positive contribution to GDP growth will diminish gradually this year and next as the inventory/sales ratio stabilises.

Graph II.31.2: **USA - The changing balance of the economy (net lending by sector)**



The fiscal stimulus was mainly contained in the *American Recovery and Reinvestment Act* (ARRA) which was adopted in February 2009. Its total budgetary cost of more than $860 billion (6.0% of current annual GDP) will predominantly be spent in 2009-11. ARRA started to contribute significantly to GDP growth in the second quarter of 2009 and reached a peak impact in the following quarter (with an estimated 3-4 pps. contribution to the annualised growth rate). The impact remains significantly positive, but at a diminishing rate, until around mid-2010 when it turns negative. However, Congress has passed (or is in the process of passing) significant additional stimulus measures. Already last November fiscal measures costing $46 billion were adopted (a prolongation of a tax credit scheme for homebuyers and a two-month extension of unemployment benefits). In March the "Jobs Bill" was passed and two more stimulus bills are close to adoption. The additional spending is for extending unemployment benefits and related health insurance subsidies for unemployed workers, Medicaid funding for states, a highway infrastructure programme, and for tax breaks for business conditioned on additional hiring. Overall, the various bills sum up to around $200 billion (1.4% of current annual GDP) of additional federal spending until the end of 2011. This is likely to postpone the time when the impact of the combined fiscal stimulus legislation on GDP growth turns negative towards the end of 2010. In 2011, the emerging fiscal drag from the fiscal stimulus will be worsened by the expiration of the 2001/2003 tax cuts. Although the Administration's budget foresees the extension of these cuts for all but the top two tax brackets, it will nevertheless result in an estimated $30 billion increase in paid income tax in 2011. Assuming this, fiscal drag would subtract around 1 pp. from annual GDP growth in 2011.

Cyclical momentum is also facing other headwinds

The recovery is currently at the crucial point where employment growth resumes. Although hourly wages are close to stagnation, a lengthening work week and rising employment can be expected to translate into higher real-consumer spending since recent data suggest that households are not inclined to increase their saving rate. Together with recovering business investment in equipment and software, mutually reinforcing growth of employment and consumption is expected to provide the cyclical momentum for output growth when the temporary boost from stimulus and inventories fade out later this year. However, this dynamism is expected to be relatively weak because the two preceding recessions suggest that employment will only increase sluggishly in this phase of the business cycle. At the same time, net exports are expected to remain broadly neutral in terms of contribution to GDP growth.

The upturn of the economy is supported by the extremely accommodative stance of monetary policy as the Federal Reserve has maintained the target range for the federal funds rate at 0-0.25% since late 2008 and continues to expect that economic conditions are likely to warrant this exceptionally low level for an extended period. Although overall financial conditions have eased significantly over the past year, credit availability for households and small business remains relatively restricted. This is likely to curb the growth of consumer spending as well as residential and non-residential investment.

Another serious headwind is the suppressed state of the housing market. The number of vacant homes is only just beginning to recede from a level that has been substantially above its longer-term trend and the rate of home foreclosures remains very high. These factors will probably depress both residential investment and house prices into 2011.

Net result of opposing forces: a subdued recovery

The balance and sequence of driving forces and headwinds suggests that quarterly GDP growth will moderate to close to 2% at an annual rate in the second half of 2010 when fiscal stimulus and the inventory cycle lose much of their power while employment growth is still weak. Next year, the recovery should be able to pick up some steam with quarterly annualised GDP growth rising gradually to 3.2% at the end of the forecasting period. This, however, will be far from sufficient to close the output gap. Such a growth profile would result in annual average growth of 2.8% in 2010 (heightened by a large carry-over from 2009) and 2.5% in 2011. This would represent a very subdued performance by historical standards and in view of the depth of the preceding recession.

In this scenario, the unemployment rate will remain around the current level of just below 10% throughout the forecast period. The large slack in resource utilisation should push headline inflation decisively below 1% by next year. The household saving rate will remain at the current level, i.e. about 2 pps. higher than before the recession. The fiscal deficit of general government will narrow to 10% of GDP this year and slightly further in 2011. The current-account deficit will widen to 3.7% of GDP this year and next, not at least because of the higher oil price.

Risks

The risks associated with this forecast appear to be balanced between upside and downside. The main upside risk to GDP growth is that employment could increase faster than expected in a pattern similar to recovery periods before the 1990s. On the downside, there is risk that the household saving rate resumes its upward crawl which was discontinued when the recovery started in mid-2009. Another major downside risk is related to the housing market where it is conceivable that foreclosures accelerate in a way which leads to further significant decline in house prices.

Table II.31.1:

Main features of country forecast - THE UNITED STATES

		2008		Annual percentage change						
	bn USD	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		14441.2	100.0	3.3	2.7	2.1	0.4	**-2.4**	**2.8**	**2.5**
Private consumption		10129.9	70.1	3.7	2.9	2.6	-0.2	**-0.6**	**2.1**	**1.3**
Public consumption		2386.8	16.5	1.5	1.2	1.5	3.4	**1.9**	**2.3**	**2.7**
Gross fixed capital formation		2667.1	18.5	5.7	2.3	-1.4	-4.2	**-14.8**	**0.3**	**4.3**
of which : equipment		1264.9	8.8	7.4	8.2	1.5	-4.4	**-14.0**	**6.7**	**4.5**
Exports (goods and services)		1831.1	12.7	5.2	9.0	8.7	5.4	**-9.7**	**11.3**	**8.1**
Imports (goods and services)		2538.9	17.6	8.2	6.1	2.0	-3.2	**-13.9**	**10.1**	**5.7**
GNI (GDP deflator)		14583.1	101.0	3.5	3.5	0.9	-0.2	**-2.7**	**2.7**	**2.4**
Contribution to GDP growth :	Domestic demand			3.8	2.7	1.8	-0.4	**-2.9**	**1.9**	**2.1**
	Inventories			0.1	0.1	-0.3	-0.4	**-0.6**	**1.0**	**0.3**
	Net exports			-0.5	-0.1	0.6	1.2	**1.0**	**-0.1**	**0.1**
Employment (*)				1.3	2.1	1.1	-0.5	**-3.8**	**-0.4**	**0.6**
Unemployment rate (a)				5.4	4.6	4.6	5.8	**9.3**	**9.7**	**9.8**
Compensation of employees/head				3.8	4.1	3.7	2.6	**0.7**	**1.5**	**0.7**
Unit labour costs whole economy				1.7	3.5	2.7	1.7	**-0.7**	**-1.6**	**-1.1**
Real unit labour costs				-0.4	0.2	-0.2	-0.5	**-1.8**	**-1.8**	**-1.2**
Savings rate of households (b)				-	-	4.5	5.4	**7.0**	**6.8**	**7.0**
GDP deflator				2.1	3.3	2.9	2.1	**1.2**	**0.2**	**0.1**
General index of consumer prices				-	3.2	2.8	3.8	**-0.4**	**1.7**	**0.3**
Terms of trade of goods				-0.2	-0.8	-0.1	-5.7	**5.8**	**-4.6**	**-0.6**
Trade balance (c)				-3.6	-6.5	-6.1	-6.0	**-3.8**	**-4.5**	**-4.5**
Current-account balance (c)				-3.0	-6.0	-5.2	-4.9	**-3.0**	**-3.7**	**-3.7**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-3.1	-6.0	-5.2	-4.9	**-3.0**	**-3.8**	**-3.8**
General government balance (c)				-2.6	-2.0	-2.7	-6.4	**-11.0**	**-10.0**	**-9.9**
Cyclically-adjusted budget balance (c)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				64.5	61.2	62.2	70.7	**84.0**	**93.6**	**102.5**

(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.

32. JAPAN

Recovery on the back of rising exports

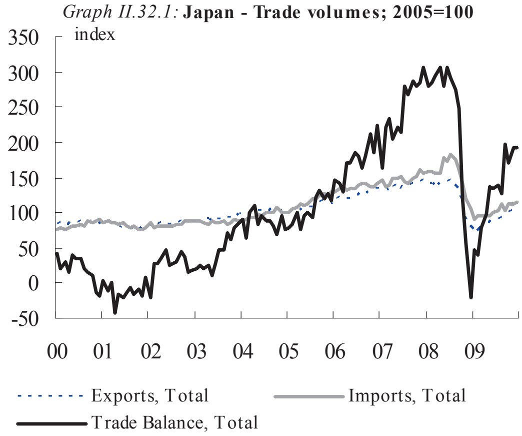
Deflation, fiscal woes but growth resumes

After the near-stagnation following the burst of the asset bubbles in 1990-91, the Asian crisis in 1997-98 prolonged this situation. Following this and the burst of the dotcom bubble in 2000, the Japanese economy entered its longest post-war expansionary phase, which lasted from early 2002 until early 2008. Japan was the only G3 country which posted negative growth in 2008 (-1.2%). Starting with the second quarter of 2008, i.e. well before the Lehman shock, Japan posted four consecutive quarters of negative GDP growth, ending in an 8.9% y-o-y decline of GDP in the first quarter of 2009.

Compared to other large industrial countries, Japan managed to emerge from the crisis earlier. Already in the second quarter of 2009 GDP grew by 1.5% q-o-q. Following a soft patch (-0.1% q-o-q) in the third quarter, growth resumed in the fourth quarter of 2009 (0.9% q-o-q). Exports, one of the components which had driven down GDP until early 2009 and had slumped by 36.5% y-o-y in the first quarter of 2009, staged a strong rebound from the second quarter of 2009 onwards. Private non-residential investments, which fell by around a quarter from its peak in the 18 months until the third quarter of 2009 improved later than exports but seem to have finally bottomed out and grew in the fourth quarter of 2009 (0.9% q-o-q).

Partly due to a strong base effect, exports were up very strongly by 43.5% y-o-y in March, in particular exports to Asia grew by 52.9% y-o-y. Exports to Indonesia almost doubled in the year to March 2010. Despite the recent recovery in exports the export value in March 2010 was still 22% below the peak reached two years earlier. On the back of the projected brisk growth in many Asian economies, Japanese exports to them are expected to post further strong growth in 2010. Rising exports to Asia are also seen as the main reason behind a projected strong increase in exports and are set to contribute significantly to growth in 2010. The recent emphasis by Prime Minister Hatoyama on increased cooperation and openness towards Asia might further support this trend by making disrupting frictions less likely and by improving operational conditions for Japanese companies. It is remarkable that the rebound in exports occurred although the yen was relatively strong vis-à-vis most currencies in 2009. Exports could therefore not benefit so far from the same tailwinds as existed in 2006 and 2007 when Japanese exports grew strongly.

Graph II.32.1: **Japan - Trade volumes; 2005=100**

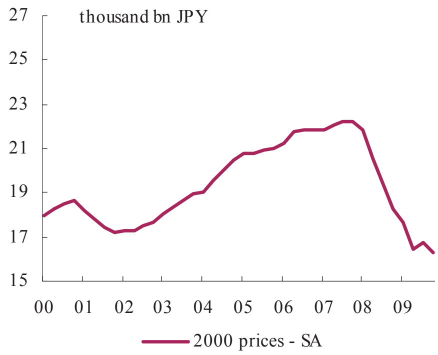


Terms of trade are expected to deteriorate significantly in 2010 after a marked improvement in the previous year. Strongly falling import prices contributed to reinstating the deflationary trend in Japan which appeared to be finally overcome just before the crisis started. With its perilous effects on allocation and investment decisions entrenched deflationary expectations are a major risk in Japan. While deflation is unlikely to be overcome in the course of the year, a much milder and therefore less distorting deflation is expected compared to last year, when the magnitude and effect were more damaging.

Investment may have bottomed out

A number of factors make it likely that private non-residential investments have finally bottomed out. Large manufacturing companies, from which the bulk of these investments originate, face an improved profit situation. The capital stock has been declining slightly in recent months, indicating that current investments are below replacement level. In the same period the decline in outstanding credit reflected base effects, a lack of interesting investment opportunities and for large companies better access to finance other than bank credit. The improved financing situation of large companies is another illustration of a slowly improving investment outlook. Before the crisis many large manufacturing companies had reached relatively slim staff structures and some further shedding of labour happened during the crisis.

Graph II.32.2: **Japan - Gross Fixed Capital Formation, Non-residential Investment**



Some hiring and investment is likely this year. After some shedding of labour during the crisis, as the recovery gains traction, more companies will face a shortage of labour. Investment will be supported by fierce competition with Asian competitors. Those competitors are quickly moving up the value chain and Japanese producers depend more than ever on success in export markets. This leaves them with no choice but to innovate and make production processes more efficient. Still, a return to the almost 5% average annual growth of non-residential investment between 2002 and 2007 is unlikely, given the high capital stock combined with the slump in long-term investor confidence during the crisis.

Wages do not support consumption

While employment held up better than expected during the crisis nominal wages declined by 4% in 2009. The usually delayed reaction of wages to economic developments, ongoing structural developments in the labour market (the still growing number of temporary workers) and the replacement of many highly-paid workers born in the late 1940s by younger and less qualified workers, all point to a further decline in nominal wages in 2010. But a further reduction is likely to be much smaller than in 2009. Nominal wage developments in Japan since the crisis started demonstrate that the concept of "sticky wages" is not useful in the case of Japan. Against the backdrop of a large bonus component, nominal wages have always been more flexible than in other industrial countries. The recent marked decline even points to increased flexibility, maybe on the back of "deflation expectations" on the side of the employees. In this context the steep price decline of "highly visible goods", such as durable goods, and the significant shift of consumption to those products with falling prices might have influenced workers' perceptions and made nominal wage expectations more flexible. Further reasons for this development are the still relatively weak social safety net, the social stigma which goes along with unemployment and the relatively high transaction costs which a change of job brings about for Japanese employees. The negative impact of deflation on allocation and consumption decisions is somewhat lower in Japan because of this flexibility of nominal wages than it otherwise would be.

In 2010, consumption will be supported by rising social expenditure and other stimulating measures which will gain steam in the course of the year. The bleak prospects for household income and the already low saving rate limit consumption growth. The significant deflation in 2009 also means that owners of cash or bank deposits had a relatively good real return after taxes last year (compared to previous years), which might generate a small positive wealth effect. Households have incurred limited losses in the financial crisis and should not refrain from consuming. With this in mind and with employment prospects improving somewhat it seems reasonable to expect slightly rising consumption in 2010. This forecast is further supported by the fact that private consumption declined for two consecutive years in 2008 and 2009 and (following past behaviour) households will try to recapture some of the lost consumption. A factor that further complicates the outlook for consumption is the worsening pension outlook for workers in their forties and fifties. Not only do they see the reserves of the social security scheme dwindling, but they also cannot count on generous lump-sum payments upon retirement as just a few years ago. Government consumption is likely to rise in 2010, partly reflecting ageing, automatic stabilisers, as well as discretionary social spending decisions by the new government. Public investments on the other hand are likely to fall, but maybe less than projected by the government.

In 2011 private and government consumption are expected to grow steadily but gradually. Private investments are expected to grow after several years of weak performance. Public investment is expected to subtract from growth. Exports will continue to grow, but due to a stronger rise in imports, growth in net exports will be limited.

Risks to this forecast are broadly balanced. Household consumption has limited potential to surprise on the upside. Even in upswings household consumption rarely rose briskly over the last two decades. There are few conceivable reasons why that pattern should change this time around, as people feel more insecure than before and thrift became much more fashionable than only a few years ago. In 2010 major surprises regarding government spending are unlikely as long as the pace of moderate recovery continues. Consumption might be flat or even slightly negative, if incentives for non-durable items vanish, or saturation for certain goods arises, or fewer technical innovations appear which would cause consumers to open their purse. An unforeseen tightening of fiscal policy, leading to lower GDP growth than anticipated, is another downside risk. A further appreciation of the yen coupled with a less brisk demand for investment goods from Asia could result in a much less buoyant export performance than projected. Such a scenario would most likely also result in lower profits for companies and in a further decline in investments.

On the upside, exports to Asia have the potential to grow even more than expected in 2010, if growth in Asia remains strong and inflation pressures remain contained. Stronger-than-expected investments represent another upside risk. As investments tend to move in cycles the fact that investment seems to have bottomed out has a bearing on future prospects. After the deep slump in investment over the last few quarters, a relatively healthy financial situation of companies, improving access to finance and a better business outlook are all elements that could support a shift in business sentiment, which could bring about better investment results than projected.

For 2011 the crucial question is whether or not an improved situation of large manufacturing companies with rising exports and rising investments has sufficient impact on the employment situation and on wages to improve households' income situation and sentiment, to raise consumption and kick-start a more home-grown and sustainable growth pattern.

Table II.32.1:

Main features of country forecast - JAPAN

	2008			Annual percentage change						
	bn JPY	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP		505113.9	100.0	1.1	2.0	2.4	-1.2	**-5.2**	**2.1**	**1.5**
Private consumption		291750.7	57.8	1.2	1.5	1.6	-0.7	**-1.0**	**1.2**	**0.9**
Public consumption		93374.6	18.5	2.7	0.4	1.5	0.3	**1.6**	**1.1**	**0.9**
Gross fixed capital formation		117755.3	23.3	-0.7	0.5	-1.2	-2.6	**-14.8**	**-1.7**	**2.7**
of which : equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		88493.0	17.5	5.0	9.7	8.4	1.6	**-24.2**	**21.5**	**7.7**
Imports (goods and services)		87758.0	17.4	4.1	4.2	1.6	0.9	**-17.1**	**8.2**	**8.4**
GNI (GDP deflator)		521861.8	103.3	1.2	2.5	2.9	-1.2	**-5.8**	**2.1**	**1.4**
Contribution to GDP growth :	Domestic demand			0.9	1.0	0.9	-0.9	**-3.5**	**0.6**	**1.2**
	Inventories			0.0	0.2	0.3	-0.4	**-0.3**	**0.0**	**0.0**
	Net exports			0.2	0.8	1.1	0.1	**-2.0**	**2.0**	**0.3**
Employment				-0.2	0.4	0.4	-0.3	**-1.6**	**-1.0**	**-0.2**
Unemployment rate (a)				4.0	4.1	3.9	4.0	**5.1**	**5.3**	**5.3**
Compensation of employees/head				0.1	0.2	-1.1	-0.4	**-3.1**	**-0.1**	**0.9**
Unit labour costs whole economy				-1.2	-1.4	-3.0	0.4	**0.5**	**-3.1**	**-0.8**
Real unit labour costs				-0.6	-0.5	-2.3	1.3	**1.5**	**-2.0**	**-1.5**
Savings rate of households (b)				-	-	9.2	9.3	**9.5**	**9.6**	**9.2**
GDP deflator				-0.6	-0.9	-0.7	-0.8	**-0.9**	**-1.2**	**0.8**
General index of consumer prices				-	0.3	0.0	1.4	**-1.4**	**-0.5**	**-0.4**
Terms of trade of goods				-1.1	-8.0	-4.3	-10.9	**13.6**	**-11.1**	**-1.8**
Trade balance (c)				2.6	1.9	2.4	0.8	**0.9**	**1.0**	**0.8**
Current-account balance (c)				2.7	3.9	4.8	3.2	**2.8**	**3.1**	**2.5**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				2.6	3.8	4.7	3.1	**2.7**	**2.9**	**2.4**
General government balance (c)				-5.5	-1.6	-2.5	-2.0	**-6.9**	**-6.7**	**-6.6**
Cyclically-adjusted budget balance (c)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (c)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				127.2	191.3	187.8	172.0	**189.2**	**193.5**	**194.9**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

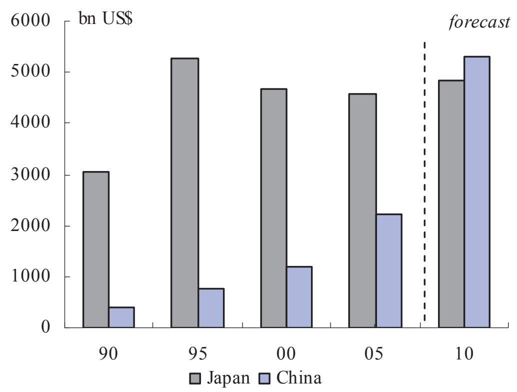
33. CHINA
Fighting the negative consequences of very loose monetary policies

Strong growth performance in 2009…

China has been one of the first countries to overcome the consequences of the financial crisis which hit the world after the failure of Lehman Brothers in September 2008. While quarterly growth is estimated to have been weak in the last quarter of 2008, available estimates show that since the second quarter of 2009, seasonally-adjusted quarterly growth has been clearly higher than 2%.

Due to the fast implementation of the fiscal stimulus package, China's GDP growth decelerated only from 9.7% in 2008 to 8.7% in 2009. In spite of a negative contribution to growth by net exports of -3.9 pps., stimulus-driven investment contributed 8 pps. to GDP growth, with resilient private consumption adding another 4.6 pps. The strong growth performance in 2009 was also supported by monetary policy, which had turned very loose at the end of 2008. As a consequence of this policy, new loans were up by RMB 9.6 trillion, bringing the total outstanding loans to RMB 40 trillion, and the supply of broad money M2 increased by 27.7% y-o-y at the end of 2009.

Graph II.33.1: **Nominal GDP Japan vs China**



For the year 2009 as a whole, China's exports reached USD 1201.7 bn, down by 10.3% in value terms on 2008. With imports increasing 1.9% on the year to USD 1005.6 bn, the trade surplus for 2009 reached USD 287.6 bn, down by 20.3% compared to the 2008 record surplus of USD 360.7 bn (Chinese statistics). While this decline in the trade surplus is clearly welcome from the point of view of global imbalances, the 2009 surplus is still among the highest on record. With the current-account surplus still high at 6.1% of GDP, China's foreign exchange reserves rose by USD 453 bn in 2009 to reach USD 2.4 trillion at the end of last December.

…continuing into 2010

In the first quarter of 2010, Chinese exports were actually up by 31.4% on the year, while imports rose by 63.6%. The trade surplus in the first quarter of this year reached USD 14.5 bn. This surplus should, however, be interpreted with extreme caution, because the recent strong rise in imports was driven by the knowledge, that with the beginning of the new year, a rush on new bank loans was to be expected as well as the ensuing launch of many new (stimulus driven) investment projects.(80)

With an overall trade volume of USD 101.5 bn in the first quarter 2010, the EU remained by far the single most important trade partner of China, followed by the US (USD 78.1 bn), Japan (USD 63.6 bn) and ASEAN (USD 62.9 bn.). The trade surplus of Japan reached USD 12.2 bn and the deficits of the EU and the US respectively USD 29.3 bn and USD 30.8 bn.

Among EU Member States, Germany posted a surplus of USD 1.8 bn, while France (USD 2.7 bn) and Italy (USD 3.1 bn) continued to see a rise in their bilateral trade deficits with China.(81)

GDP in the first quarter of 2010 was up by 11.9% y-o-y. This strong growth performance was driven by equipment investments, which were up by 26.4% (in nominal terms) in the first quarter of this year compared to the same period of last year. As a consequence of the early launch of the Chinese stimulus package (4 November 2008), fixed asset investment had already jumped by 24.2%y-o-y in early 2009. Therefore, no base effect can be called upon in this case. The fact that local government investment was up by 28.2% y-o-y (compared to a growth rate for central government investment of 9.1%) underlines the fast growing risk to local

(80) Given that the central government has fixed an annual target for new loans and that people are afraid of too much credit demand, everybody felt obliged to get a loan as early as possible at the beginning of 2010.

(81) All 2010 trade figures according to China's custom authority.

government finances (assuming that the marginal profitability of investment decreases).

Policy stimulus exacerbated internal imbalances

Investment in real estate also increased strongly in the first two months of 2010, rising 31.1% y-o-y (this time, however, against the background of stagnation in the same period of 2009). In February, the sales price of buildings in the 70 biggest cities was up by 1.2% on the month and by 10.7% on the year. There are large discrepancies among these cities, the rises ranging from 50% and more in the 'trendy' southern cities like Haikou and Sanya and declines also observed in some other cities. Many observers claim that these statistics do not fully reflect actual developments and that there is already a real-estate bubble. However, the government has just introduced new measures to avoid the building up of a real-estate bubble like raising the required down-payment and increasing interest rates for second mortgages.

Price developments

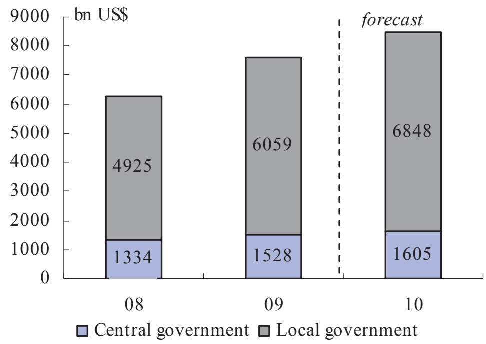
Developments on the price front are worse than anticipated in the autumn. Due primarily to the impact of bad weather on food prices and to the rise in the price of housing, consumer prices in March were still up by 2.4% on the year. What is more, the attainment of the 3% inflation target for 2010 will now have to rely to a large degree on the slightly optimistic assumption that weather conditions in the rest of the year will be favourable and will again ensure good harvests in 2010.

The inflationary risks are also evident from producer prices, which in March were up by 5.4% on the year. Developments on the monetary side do not really feed optimism either, given that new loans in February still reached around RMB 700 bn. Although this is clearly lower than the rise in January (RMB 1390 bn), the combined number still comes close to 30% of the 2010 target of RMB 7.5 trillion. Not surprisingly under these circumstances, M2, the relevant indicator for money supply, was also up 25.5% y-o-y.

High carry-over into 2010

China's economy is likely to show very strong quarterly growth rates in the second quarter of 2010. However, in the second half of the current year, quarterly growth is expected to decline somewhat as a consequence of the running out of the stimulus' measures and of the monetary tightening started by the People's Bank of China (PBC) early this year (rise in the reserve requirement ratio by 100 basis points since 18 January). With a carry-over currently estimated at around 4 pps. of GDP, China's growth rate in 2010 is still likely to reach double-digit figures again: while private consumption is foreseen to remain resilient, the growth contribution of investment to GDP growth could decline compared to the extremely high contribution reached last year. On the other hand, the external environment is likely to be more favourable to Chinese exporters which would imply a less negative contribution to growth from net exports. On the basis of these factors, China's growth rate in 2010 is likely to be close to 10½%, making China the second largest economy in the world (at market exchange rates).

Graph II.33.2: **China - Government spending**



Source: Ministry of Finance China

While the general government deficit in 2009 was probably lower than the official target of 3% of GDP and is likely to remain below 3% also in the current year, the financing via the banking system of many measures of the stimulus package might in the medium-term cause the ratio of non-performing loans to rise considerably.

Local governments might also end up with considerable fiscal problems, if currently launched projects yield less than optimistically anticipated. Sub-central levels of government are normally not allowed to incur debt, although this rule was relaxed for the years 2009 and 2010, when the central government allowed them to issue bonds of RMB 200 bn per year. As this amount turned out not to be sufficient to finance all the envisaged projects, these levels of government set up 'special vehicles' which then asked for normal bank loans. Given that the amounts involved are estimated to be very high (some analysts give a figure of new loans to local levels of government of up to RMB 7 trillion), there is rising concern about defaults.

However, the low debt level at the general government level and the huge accumulation of foreign-exchange reserves (close to USD 2.5 trillion as of end March 2010) would probably allow China's central government to bail out again the banking system (and local governments) in case of need.

Developments in 2011

On the basis of the no-policy-change assumption China's economy is likely to see slightly lower growth rates in 2011. Given the expected slowdown in growth in the second half of the current year, the carry-over into 2011 could be considerably lower than the carry-over into 2010. Furthermore, the expiry of the stimulus package should imply another decline in the growth contribution from investments. The growth contribution from private consumption and net exports, however, is projected to remain close to the 2010 level. All in all, GDP growth next year is forecast to ease to around 9.4%.

Risks for 2011 are slightly biased to the upside: According to available information, the new Five-year-plan starting in 2011 will put a stronger focus on the promotion of private demand, although the measures on how to achieve this are only partially known and remain to be elaborated in more detail.

Table II.33.1:
Main features of country forecast - CHINA

	2008			Annual percentage change						
	bn CNY	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	31404.5	100.0		10.2	11.7	13.0	9.7	**8.7**	**10.3**	**9.4**
Private consumption	10839.2	34.5		-	-	-	-	-	-	-
Public consumption	4072.0	13.0		-	-	-	-	-	-	-
Gross fixed capital formation	110919.4	43.1		-	-	-	-	-	-	-
of which : equipment	-	-		-	-	-	-	-	-	-
Change in stocks as % of GDP	-	-		-	-	-	-	-	-	-
Exports (goods and services)	14306.9	45.6		-	17.2	35.0	13.4	**-10.3**	**12.3**	**8.4**
Final demand	-	-		-	-	-	-	-	-	-
Imports (goods and services)	9559.5	30.4		-	16.5	11.3	14.0	**1.9**	**18.0**	**7.0**
GNI (GDP deflator)	-	-		-	-	-	-	-	-	-
Contribution to GDP growth :		Domestic demand		-	-	-	-	-	-	-
		Stockbuilding		-	-	-	-	-	-	-
		Foreign balance		-	-	-	-	-	-	-
Employment				1.1	0.8	0.8	0.6	-	-	-
Unemployment (a)				3.3	4.1	4.0	4.2	-	-	-
Compensation of employees/head				-	-	-	-	-	-	-
Unit labour costs				-	-	-	-	-	-	-
Real unit labour costs				-	-	-	-	-	-	-
Savings rate of households				-	-	-	-	-	-	-
GDP deflator				-	3.6	7.4	6.5	**-1.9**	**2.4**	**2.6**
Private consumption deflator				-	-	-	-	-	-	-
Index of consumer prices (c)				5.6	1.5	4.8	5.9	**0.7**	**3.9**	**4.9**
Trade balance (b)				2.7	8.2	9.3	8.3	**6.1**	**4.3**	**4.9**
Current-account balance (b)				2.1	9.5	11.0	9.8	**6.1**	**5.6**	**5.7**
Net lending(+) or borrowing(-) vis-à-vis ROW (b)				-	-	-	-	-	-	-
General government balance (b)				-1.5	-0.8	0.6	-0.4	-	-	-
General government gross debt (b)				-	-	-	-	-	-	-

(a) urban unemployment, as % of labour force. (b) as a percentage of GDP. (c) national indicator.

34. EFTA
Past the crisis

The EFTA countries are slowly rebounding from the crisis, however, challenges remain and vary by country. A common challenge of all EFTA states is the mounting unemployment. Norway enjoys the relatively comfortable position related to its substantial oil-income, which continues to allow for a strong fiscal stimulus to support its economy. Switzerland has its banking sector still under pressure, following the eroding bank secrecy, and battles the effects of the strength of the Swiss franc. The outlook for the forecast period shows a return to moderate growth in Switzerland and Norway. Iceland is slowly stabilising after a deep recession. Iceland's GDP is forecast to stagnate in 2010 but is expected to return to growth in 2011, pending rigorous implementation of the internationally supported recovery plan.

Growth depends largely on fiscal spending in Norway

Norway has been hit hard by the global economic downturn even though it has fared better then most EU Member States. The export sector is severely affected, and domestic demand, in particular investment, has been contracting rapidly.

Domestic demand decreased through all its components, apart from government spending, and also external trade contributed to the contraction in 2009. Real GDP is forecast to return to moderate growth by the end of 2010. This growth is expected to be mostly driven by domestic demand, particularly government spending. Consumer spending, traditionally a driver of domestic growth in Norway, should pick up again but is constrained by high household indebtness and rising interest rates. The challenge for Norway will be to keep growth momentum, when the fiscal stimulus fades towards the end of the forecast period.

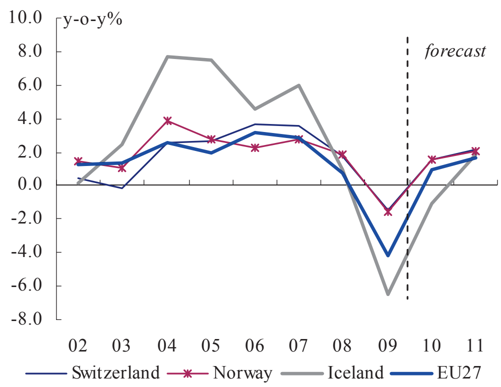
The decline in investments in Norwegian mainland industries that started in 2009 is expected to continue into 2010. The investments in the mainland industries should show a rebound in 2011 also due to growing foreign demand; however, they will remain de-leveraged, below the record high level of 2008. Investments in petroleum are expected to fall somewhat in the first half of 2010, but on an annual basis will increase slightly during the year and will remain slightly positive in 2011.

The fiscal policy stance is expected to change from very expansionary (during the crisis) to somewhat less expansive in 2010 and to relatively neutral in 2011.

Household consumption, which accounts for around 55% of the GDP in mainland Norway, is rebounding from its fall during the crisis. Low interest rates, increased incomes, increased wealth and better prospects all contributed to increased household consumption already in the second half of 2009. However, for 2010 and 2011 consumer spending is expected to be under pressure by the gradual withdrawal of fiscal stimulus measures and increasing policy rates. This, in combination with the high consumer-debt levels in Norway, could pose a downside risk to growth in consumer spending.

Housing prices are expected to continue to increase in 2010 and 2011. Due to the relatively low interest rates the improvement in the housing market, which is financed largely by flexible interest rate mortgages, is expected to contribute to increased investments in housing, thus turning the decline of the past two years into a possible upswing in the next two years.

Graph II.34.1: **EFTA - GDP growth**



Unemployment is a main challenge

The Norwegian government budget for 2010 aims to secure a healthy labour market. Norway is among the countries in Europe with the lowest unemployment rates. Nevertheless, the unemployment rate in Norway is expected to rise in the forecast years, from 3.1% last year to 4.3% in 2010. In 2011 it is forecast to fall slightly.

The recent slump in the Norwegian economy is partly responsible for the clear fall in wage growth. Wage growth is expected to slow down further in the forecast period. Consumer inflation is likely to fall, with an annual expected average in 2010 of 1.6%. The strength of the Norwegian Krona is expected to contribute to inflation falling below 2% in 2010 and 2011.

Switzerland, exports are the key

Switzerland's economy slipped into the worst recession in over three decades in mid-2008 as the global economic slump hit severely its exporters. Still, as compared to its European trade partners the economic dip was significantly less severe. Domestic demand did not collapse during the crisis, also due to the absence of a boom-bust cycle in residential construction as observed elsewhere before and during the crisis. The second half of 2009 already showed improvement in domestic demand whilst exports were outperforming imports. GDP shrunk by 1.5% in 2009, a much better outcome than expected in autumn 2009. Moderate growth, almost fully driven by domestic demand, is expected to reach 1.6% in 2010 and to accelerate slightly in 2011, with GDP growth increasing to 2.2%.

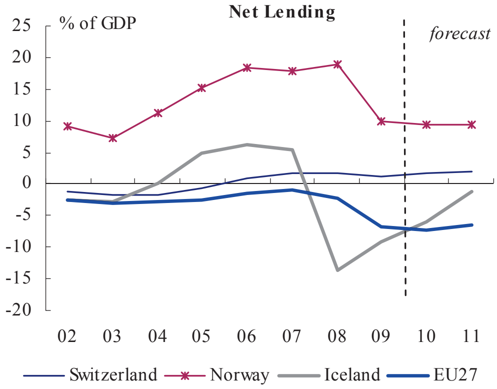
The biggest challenge for Switzerland might be to reverse the decline in exports of goods and services. In particular export of services is expected to return to growth only in 2011. The service sector remains a source of a serious downside risk to the total export growth in relation to the eroding of bank secrecy, which may have a significant and permanent impact on the contribution of the financial sector to GDP in the longer term. Overall, net exports weighed on growth in 2009 but its contribution is projected to turn positive from 2010 onwards.

With the household saving rate increasing and consumer confidence being low, growth of household consumption decelerated in 2009 but is expected to increase again slightly in 2010-11. Growth in public investment is expected to be modest in the forecast years despite the increased government focus on infrastructure investments. Weak export demand for Swiss machinery and equipment will cause little extra incentive for Swiss corporations to invest. However, government investments are expected to offset the sharp fall in investment of the private sector. The Swiss National Bank is likely to continue fighting the threat of deflation using all available means, including currency interventions. Inflation rates are forecast to stay close to 1% both in 2010 and 2011.

Continued pressures in the labour market

The unemployment rate will rise significantly, and will be around 5% by the end of 2010, which has not happened since the mid-1990s. For 2011 unemployment is expected to decrease slightly, though to remain high.

Graph II.34.2: **EFTA - General Government Net Lending**



Iceland's road to recovery

After a period of high growth rates supported by large investment projects and strong domestic demand, which have generated significant imbalances, Iceland is now facing the consequences of the currency crash of 2008 and the ensuing economic crisis. The shock to the economy should be regarded as permanent and the economy has deleveraged to the level of around the year 2006. Domestic demand declined sharply in 2009 but is forecast to slightly increase in the forecast years driven mostly by investments in 2011, particularly in the energy sector. However, incomes are still under pressure and specifically pensioners are facing benefit cuts due to the worsened position of the Icelandic pension fund. Inflation remained high in 2009, averaging an increase of more than 16%, but is expected to ease to below 6% by the end of 2011. Following decreasing imports the high current-account deficit from previous years, is expected to turn into a small surplus by the end of 2010, continuing into 2011.

Unemployment on a historic high

Unemployment rate in Iceland increased rapidly from a low of 1% in early 2008 to around 8.7% by the end of 2009. It is now at a similar level, on average, as in the neighbouring Sweden and Finland. However, due to the fact that the increase is relatively recent in Iceland, long-term unemployment is still considerably lower than in the euro area, or the EU as a whole. This should make it somewhat easier to reduce the present high unemployment as the economic situation improves. For 2010 and 2011, however, the unemployment rate is still expected to remain high, close to 10% of the workforce.

Debt cloud over Iceland

Downside risks to this forecast stem mainly from high debt and increased emigration that would have a bearing on economic growth. Iceland's total external gross debt recorded a level of about three times its GDP at the end of 2009 and it is likely to remain around that level in 2010 before easing somewhat in 2011. Private and corporate-sector external debt is responsible for about two thirds of the overall debt, mostly reflecting old bank assets. Therefore, debt restructuring in 2010-11 will be key to reduce the burden and provide solid ground to support domestic demand growth. General government debt is increasing slower than expected in the previous forecast. At the end of 2009, it stood at about 108% of GDP which included about 15% of GDP of debt related to the much disputed Icesave financing. The improved outlook for public debt is likely to allow for a faster return in 2010-11 to lower and more sustainable deficits than previously anticipated. In particular interest expenditure is projected at a lower level, following extensive negotiations on the financing terms of the foreign depositor reimbursements.

Iceland will be slowly recovering from this crisis, pending risks generated by the lack of access to credit, the high debt levels and possible further sliding of the Krona. The high unemployment rate entails a significant challenge to the economic recovery. However, Iceland has been able to turn around crisis situations rather smoothly in the past. Overall, the impact of the present crisis has been much less severe than previously anticipated which gives hope for a relatively fast recovery.

Table II.34.1:

Main features of country forecast - EFTA

		Iceland			Norway			Switzerland		
(Annual percentage change)		**2009**	**2010**	**2011**	**2009**	**2010**	**2011**	**2009**	**2010**	**2011**
GDP		-6.5	-1.1	1.9	-1.5	1.6	2.1	-1.5	1.6	2.2
Private consumption		-14.6	1.8	1.8	0.0	3.5	3.1	1.2	1.8	1.5
Public consumption		-3.0	-2.5	-2.0	5.2	2.7	2.1	2.5	0.6	2.4
Gross fixed capital formation		-49.9	-4.5	16.7	-7.9	-2.8	0.6	-3.7	2.4	2.1
of which : equipment		-49.9	2.5	27.0	-11.1	-2.1	0.9	-3.7	1.5	2.5
Exports (goods and services)		6.2	0.8	0.9	-4.3	2.6	3.1	-10.0	1.7	3.5
Imports (goods and services)		-24.0	2.6	3.2	-9.7	3.4	4.1	-5.9	2.3	2.7
GNI (GDP deflator)		-1.3	7.9	-0.1	-1.3	1.5	2.3	5.8	1.6	2.2
Contribution to GDP growth :	Domestic demand	-20.4	-0.4	2.6	-0.6	1.5	1.9	0.1	1.6	1.6
	Inventories	-	-	-	-	-	-	-	-	-
	Net exports	14.1	-0.7	-1.0	0.8	0.2	0.2	-2.9	0.0	0.6
Employment		-6.0	-0.8	1.4	-0.4	-0.3	1.8	0.9	-2.5	1.5
Unemployment rate (a)		7.2	9.7	9.0	3.1	4.3	4.1	4.1	4.8	4.4
Compensation of employees/head		-	-	-	3.5	1.8	3.4	2.5	2.7	3.4
Unit labour costs whole economy		-	-	-	4.7	-0.1	3.2	4.9	-1.4	2.6
Real unit labour costs		-	-	-	8.9	-3.5	0.8	4.6	-1.4	2.0
Savings rate of households (b)		-22.6	-10.1	-19.1	12.4	9.9	11.1	-	-	-
GDP deflator		8.6	1.7	7.8	-3.8	3.5	2.3	0.3	0.0	0.6
Harmonised index of consumer prices (HICP)		16.3	8.7	5.7	2.3	1.6	1.8	-0.7	0.9	1.2
Terms of trade of goods		-12.2	-7.5	10.2	-16.5	4.7	0.1	5.5	-0.7	-2.3
Trade balance (c)		5.8	2.8	5.0	13.2	13.8	13.5	3.0	2.8	2.6
Current-account balance (c)		-3.3	0.3	1.5	13.0	14.4	14.3	7.5	6.9	6.5
Net lending(+) or borrowing(-) vis-à-vis ROW (c)		-2.1	1.6	1.8	13.0	14.4	14.3	7.0	6.4	5.9
General government balance (c)		-9.1	-6.7	-2.1	9.8	9.3	9.3	1.2	1.7	2.1
Cyclically-adjusted budget balance (c)		-	-	-	-	-	-	-	-	-
Structural budget balance (c)		-	-	-	-	-	-	-	-	-
General government gross debt (c)		107.7	124.8	118.2	51.2	53.1	51.0	40.4	38.2	35.3

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

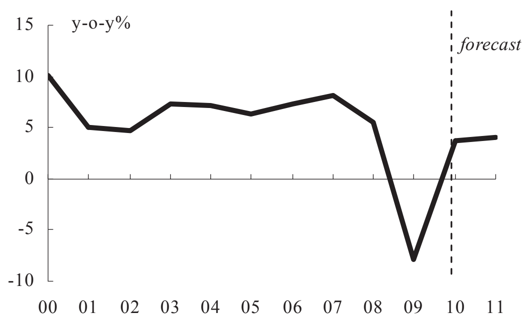
35. RUSSIAN FEDERATION

Seemingly V-shaped recovery has started

The Russian economy experienced a contraction estimated at -7.9% in 2009 (after the 5.6% growth in 2008). It will experience an almost V-shaped recovery, with growth rebounding to an expected 3.7% in 2010 and to 4% in 2011.

This sharp downturn was the result of the twin shocks that hit the Russian economy in 2008-09, namely the sudden stop in international capital flows and the sharp fall in commodity prices. In addition, some specific features of the initial policy response may have contributed to the depth of the contraction.(82) By contrast, the recovery will be underpinned by the stabilisation in international capital markets, the increase in energy prices and a more supportive and balanced policy mix (especially on the monetary side). Domestic demand (investment and consumption), which collapsed in 2009, is also set to rebound.

Graph II.35.1: **Russia - GDP growth**



This fall in GDP was accompanied by a reduction of the current-account and trade surpluses, and by a swing from large fiscal surpluses to significant fiscal deficits.

The budget recorded a deficit of around 5% of GDP in 2009, due to the reduction in commodity prices and in economic activity, and the large fiscal stimulus package. Nevertheless, these deficits are forecast to be significantly reduced, to below -2% in 2010 and 2011, and are expected to be *fully* financed from one of the Russian Oil Stabilisation Funds. This means that there will be no significant increase in the stock of domestic and foreign sovereign debt, which is in any case set to remain around 10% of GDP.(83)

While both the current-account and trade surpluses fell in 2009, both remained strongly positive. Respectively, the current-account surplus is expected to grow from around 3.5% to 3.9% and then fall to around 2.0%, while the trade surplus is expected to grow from 9.1% in 2009 to almost 10% in 2010, falling to 8% in 2011. This is due to the petering off of the effects from the increases in commodity prices and the rouble devaluation.

It is noteworthy that a sharp nominal fall in trade of around 30% has not affected Russia's position as the EU's third most important trading partner, with close to 8% of the EU's total external trade. Equally, the EU's position as the most important trade partner of Russia (with around 50% of its total trade) was also not affected by the crisis.(84)

Unemployment by end-2009 reached 8.2% (a 50% increase on the 2008 figure), but is seen as falling towards 6.5% by 2011. Inflation is expected to slow from around 12% to below 8% in 2011, as the deep economic contraction counteracted the inflationary effects of the rouble devaluation.

Financial and real sector developments

The Central Bank of Russia (CBR) targets a nominal USD-EUR currency basket (set at 45 cents of the EUR and 55 cents of the USD). Faced with the 2008 terms-of-trade shock, the CBR eventually opted for greater flexibility, announcing in January 2009 a 26-41 rouble "band" to the basket in which the currency has been allowed to float mostly freely.(85) While the rouble is still 14%

(82) The 2009 contraction was somewhat mitigated by net exports, which posted a positive contribution to GDP growth for the first time since 2005.

(83) In late April 2010, Russia taped into the sovereign Eurobond market with a placement worth around EUR 4 bn, the first in a decade. This was seen more as an attempt to create a benchmark for Russian public debt than reflecting actual fiscal financing needs.

(84) This dominant position of the EU in Russian external trade is seen by some as "non-optimal", as model estimates indicate that the EU share should be around a third. This largely reflects the still underdeveloped state of Russian trade relations with China, which is due to transport infrastructure constraints.

(85) The economic rationale behind the initial defence of the peg was to allow Russian banks and companies an orderly and staggered deleveraging of their external liabilities. Since no major bankruptcies were observed and that the Russian private sector significantly cut their external exposure, this strategy did achieve its aims.

down against the basket since mid-2008, the exchange rate appreciated by almost 18% between the introduction of the band and mid-April 2010. As a matter of fact, the CBR even had recently to counteract what it perceived as excessive appreciation, by both limited market interventions and by pushing downward the "intra-band" intervention reference triggers.

Russian hard currency reserves fell from a peak of almost USD 600 bn in the summer of 2008 (mostly due to the CBR's attempt to defend the peg), but have been increasing again since early 2009, reaching over USD 456 bn by mid-April 2010, and are still the third largest in the world (after China and Taiwan).

After massive liquidity provisions by the CBR, the overnight "Mosprime" interest rates declined from the highs of 25% to 3.5% by mid-April 2010. Parallel to that and to the fall in inflation, the CBR reduced its own overnight rates thirteen times between April 2009 and late April 2010, resulting in a cumulative fall of 500 basis points. They had been hiked in late 2008, as part of its initial strategy to defend the peg.[86]

Nevertheless, this reduction in interest rates has yet to spur a true resumption of bank lending activities, and that in spite of the relatively solid position of the Russian banking system: its capital adequacy ratio rose from just below 13% in mid-2008 to around 21% by January 2010. On the other hand, "bad and problem" loans indeed rose significantly, from 2.5% in early 2008 to 9.6% in early 2010, albeit this figure seems largely manageable due to the capitalisation ratio.

Recovery in real variables started in mid-2009. The "Basic Sectors" monthly index, a composite indicator that proxies GDP, hit its nadir in mid-2009, with double-digit falls, recovering progressively and re-entering into positive territory only by year-end. Initial estimates show a year-on-year GDP growth of 4.6% in March 2010. Industrial production shows a similar pattern.[87]

Similarly to other countries, Russia enacted an extensive set of anti-crisis policy measures, from the provision of liquidity to direct support to the banking sector, the more flexible exchange rate described above and a discretionary fiscal stimulus. Some of these were discontinued as the economic situation stabilised, notably, the auctioning of fiscal funds by the Ministry of Finance to banks and the provision of uncollateralised short term funds by the CBR. The additional *announced* headline fiscal impulse for 2008-10 is estimated at around 6% of the 2008 GDP, and included a significant component of social expenditures. Nevertheless, it was plagued by several delays in the actual disbursements.[88]

Policy issues and overall prospects till 2011

Russia was significantly affected by the global downturn, albeit a clear recovery is foreseen for 2010-11. Russian policies used to counteract the downturn are very similar to the ones pursued in more mature economies, with the notable difference of the initial use of interest rate hikes to defend the peg.

With the recovery phase of the crisis now under way, different policy concerns come to the fore. One of those are the implementation of the **"**exit strategies**"**, which are also part of G20 discussions and commitments, undertaken by Russia as a G20 member. Essentially they are about a coordinated and staggered withdrawal of the monetary and fiscal stimuli, so also about the use of a consistent "policy mix".

As an example of that, the *net* external liabilities of the Russian banking system fell from USD 130 bn in mid-2008 to USD 1.3 bn by September 2009. Given this enormous adjustment it was only possible to avoid widespread bank failures by the massive transfer of hard currency reserves from the CBR to the Russian banking system. As a matter of fact, the figure for the net reduction of external liabilities of Russian banks closely mirrors the one for Russia's loss of hard currency reserves.

(86) The use of high interest rates to defend the peg, parallel to persistent devaluation expectations in late 2008/early 2009 led to a significant contraction of money supply. The low point of the contraction was April 2009, when money supply was a remarkable 23% below the January 2009 value: only by December 2009 did the monetary base regain the January amount. This monetary contraction has also been partially blamed by some analysts for the strength and duration of the downturn.

(87) The Russian Statistical Office (Rosstat) changed the methodology it uses to calculate the industrial production index in January 2010, but still has not published revised series for the previous years. This makes any comparison between the 2010 data and the previous ones difficult. This said, industrial production rose 5.7% y-o-y in March 2010.

(88) Some commentators also link the scale of the economic contraction to these perceived deficiencies of the support package. Additionally, similarly to other regions, there is a large difference between the announced amounts of the stimulus and the totals actually committed. For instance, the values of capital injections in the banking sector are around 40% of the ones announced, while for the purchase of assets and lending by the Ministry of Finance, this is even lower, at around 31%.

Concerning the monetary stimulus, beyond the interest-rate reductions, which seem set to continue (again, in a contrary timeframe to what was observed globally), the CBR has begun already to roll back part of the additional liquidity measures. The more flexible exchange-rate framework is also expected to make the conduct of monetary policy easier going forward, although the appreciation pressures related to the increased commodity prices do pose some policy challenges.

Concerning the fiscal part of the "exit strategies", the Russian government has approved a relatively conservative budget for 2010-12. Russia has a rolling 3-year budget framework, a so-called Medium Term Expenditure Framework or MTEF. This framework, beyond facilitating fiscal planning, can also be an effective tool in conveying to economic agents a progressive fiscal retrenchment path. All in all, the Russian fiscal frameworks (the Oil Funds and the METF) performed according to plan during the crisis, and the underlying fiscal position and low debt stock will also facilitate the coming adjustment.

Additionally, there is a part of the "exit strategies" [89] which relates to the still ongoing reform of the international financial architecture, a multilateral effort under the aegis of the G20.

In a longer-term perspective, that perennial question for Russia, economic "modernisation", was again raised by policy announcements, including high-profile plans announced by the Russian President in late 2009. Modernisation in Russia is also understood as implying a reduction in its dependency on primary sectors.

Unfortunately, necessary components of the modernisation agenda related to further international trade integration and liberalisation seem at a deadlock. The Russian WTO accession (which has now the dubious distinction of being the longest one on record) was further complicated by a sudden announcement in mid-2009 that Russia would aim for a joint WTO entry with Belarus and Kazakhstan. Such a process has never been attempted in the WTO's history. Also, in January 2010 Russia formed with those two countries a customs union, within the framework of the so-called Eurasian Economic Community (EURASEC).

[89] The EU aims to also support Russia in this process, via an initiative called "Partnerships for Modernisation", announced in early 2010.

Table II.35.1:

Main features of country forecast - RUSSIA

	2008				Annual percentage change				
	bn RUB Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	41256.0	100.0	-	7.7	8.1	5.6	-7.9	3.7	4.0
Private consumption	19964.7	48.4	-	11.2	13.8	10.6	-8.5	4.8	5.3
Public consumption	7142.0	17.3	-	2.4	3.7	2.9	1.9	1.5	1.0
Gross fixed capital formation	9595.6	23.3	-	18.0	21.1	10.6	-21.0	4.5	5.5
of which : equipment	3445.3	8.4	-	-	-	-	-20.0	5.0	6.0
Exports (goods and services)	12980.4	31.5	-	7.3	6.3	0.6	-8.1	3.4	2.0
Imports (goods and services)	9140.4	22.2	-	21.3	26.6	14.9	-17.9	5.7	3.3
GNI (GDP deflator)	40034.8	97.0	-	7.2	8.8	5.0	-7.7	1.9	4.2
Contribution to GDP growth : Domestic demand			-	9.2	11.2	7.8	-8.7	3.6	3.9
Inventories			-	-	-	-	-	-	-
Net exports			-	-2.0	-3.5	-3.1	1.4	-0.2	-0.1
Employment			-	0.6	1.3	0.6	-2.9	0.6	0.0
Unemployment rate (a)			-	6.7	5.7	7.0	7.5	7.0	6.5
Compensation of employees/head			-	-	-	-	-	-	-
Unit labour costs whole economy			-	-	-	-	-	-	-
Real unit labour costs			-	-	-	-	-	-	-
Savings rate of households (b)			-	-	-	-	-	-	-
GDP deflator			-	15.5	13.8	18.0	5.4	9.8	5.9
General index of consumer prices			-	9.7	9.0	14.1	11.7	9.0	7.8
Terms of trade of goods			-	-	-	-	-	-	-
Trade balance (c)			-	14.1	10.1	10.8	9.1	9.9	8.0
Current-account balance (c)			-	9.6	5.9	6.2	3.5	3.9	2.2
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	9.6	5.2	6.2	-	-	-
General government balance (c)			-	-	-	-	-5.1	-1.6	-1.8
Cyclically-adjusted budget balance (c)			-	-	-	-	-	-	-
Structural budget balance (c)			-	-	-	-	-	-	-
General government gross debt (c)			-	-	-	-	7.3	9.8	10.4

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

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TABLE 1 : Gross domestic product, volume (percentage change on preceding year, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	1.5	2.7	2.0	1.8	2.8	2.9	1.0	**-3.1**	**1.3**	**1.6**	*0.6*	*1.5*
Germany	1.4	2.1	1.0	0.8	3.2	2.5	1.3	**-5.0**	**1.2**	**1.6**	*1.2*	*1.7*
Ireland	5.9	9.1	5.4	6.2	5.4	6.0	-3.0	**-7.1**	**-0.9**	**3.0**	*-1.4*	*2.6*
Greece	1.1	3.8	4.1	2.2	4.5	4.5	2.0	**-2.0**	**-3.0**	**-0.5**	*-0.3*	*0.7*
Spain	1.5	4.4	3.3	3.6	4.0	3.6	0.9	**-3.6**	**-0.4**	**0.8**	*-0.8*	*1.0*
France	1.2	3.0	1.7	1.9	2.2	2.3	0.4	**-2.2**	**1.3**	**1.5**	*1.2*	*1.5*
Italy	1.2	2.0	0.9	0.7	2.0	1.5	-1.3	**-5.0**	**0.8**	**1.4**	*0.7*	*1.4*
Cyprus	5.5	4.2	3.3	3.9	4.1	5.1	3.6	**-1.7**	**-0.4**	**1.3**	*0.1*	*1.3*
Luxembourg	2.6	6.3	4.2	5.4	5.6	6.5	0.0	**-3.4**	**2.0**	**2.4**	*1.1*	*1.8*
Malta	5.0	3.4	2.1	3.9	3.6	3.8	2.1	**-1.9**	**1.1**	**1.7**	*0.7*	*1.6*
Netherlands	2.5	3.7	1.6	2.0	3.4	3.6	2.0	**-4.0**	**1.3**	**1.8**	*0.3*	*1.6*
Austria	1.8	2.6	2.2	2.5	3.5	3.5	2.0	**-3.6**	**1.3**	**1.6**	*1.1*	*1.5*
Portugal	2.0	3.8	0.7	0.9	1.4	1.9	0.0	**-2.7**	**0.5**	**0.7**	*0.3*	*1.0*
Slovenia	2.0	4.2	4.3	4.5	5.8	6.8	3.5	**-7.8**	**1.1**	**1.8**	*1.3*	*2.0*
Slovakia	:	2.7	5.9	6.7	8.5	10.6	6.2	**-4.7**	**2.7**	**3.6**	*1.9*	*2.6*
Finland	1.3	4.5	3.0	2.9	4.4	4.9	1.2	**-7.8**	**1.4**	**2.1**	*0.9*	*1.6*
Euro area	1.5	2.8	1.7	1.7	3.0	2.8	0.6	**-4.1**	**0.9**	**1.5**	*0.7*	*1.5*
Bulgaria	-2.8	2.0	5.7	6.2	6.3	6.2	6.0	**-5.0**	**0.0**	**2.7**	*-1.1*	*3.1*
Czech Republic	2.3	1.2	4.6	6.3	6.8	6.1	2.5	**-4.2**	**1.6**	**2.4**	*0.8*	*2.3*
Denmark	2.6	2.4	1.8	2.4	3.4	1.7	-0.9	**-4.9**	**1.6**	**1.8**	*1.5*	*1.8*
Estonia	:	7.0	8.4	9.4	10.0	7.2	-3.6	**-14.1**	**0.9**	**3.8**	*-0.1*	*4.2*
Latvia	-8.8	6.3	9.0	10.6	12.2	10.0	-4.6	**-18.0**	**-3.5**	**3.3**	*-4.0*	*2.0*
Lithuania	-8.3	4.7	8.0	7.8	7.8	9.8	2.8	**-15.0**	**-0.6**	**3.2**	*-3.9*	*2.5*
Hungary	0.6	4.6	4.2	3.5	4.0	1.0	0.6	**-6.3**	**0.0**	**2.8**	*-0.5*	*3.1*
Poland	4.9	4.4	4.1	3.6	6.2	6.8	5.0	**1.7**	**2.7**	**3.3**	*1.8*	*3.2*
Romania	1.4	-0.9	6.2	4.2	7.9	6.3	7.3	**-7.1**	**0.8**	**3.5**	*0.5*	*2.6*
Sweden	1.2	3.3	3.2	3.3	4.2	2.5	-0.2	**-4.9**	**1.8**	**2.5**	*1.4*	*2.1*
United Kingdom	2.5	3.4	2.6	2.2	2.9	2.6	0.5	**-4.9**	**1.2**	**2.1**	*0.9*	*1.9*
EU	1.4	2.9	2.0	2.0	3.2	2.9	0.7	**-4.2**	**1.0**	**1.7**	*0.7*	*1.6*
USA	3.3	3.8	2.7	3.1	2.7	2.1	0.4	**-2.4**	**2.8**	**2.5**	*2.2*	*2.0*
Japan	1.3	0.5	1.7	1.9	2.0	2.4	-1.2	**-5.2**	**2.1**	**1.5**	*1.1*	*0.4*

TABLE 2 : Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter, 2009-2011)

	2009/1	2009/2	2009/3	2009/4	2010/1	2010/2	2010/3	2010/4	2011/1	2011/2	2011/3	2011/4
Belgium	-1.7	-0.1	0.7	0.3	0.1	0.4	0.5	0.5	0.4	0.4	0.3	0.4
Germany	-3.5	0.4	0.7	0.0	-0.1	0.7	0.2	0.3	0.4	0.5	0.5	0.6
Ireland	-2.0	-0.7	-0.1	-2.3	:	:	:	:	:	:	:	:
Greece	-1.0	-0.3	-0.5	-0.8	-1.0	-0.8	-0.5	-0.1	-0.1	0.1	0.1	0.2
Spain	-1.7	-1.0	-0.3	-0.1	0.0	0.1	-0.2	0.2	0.2	0.3	0.3	0.3
France	-1.3	0.3	0.2	0.6	0.3	0.3	0.2	0.3	0.4	0.4	0.5	0.5
Italy	-2.7	-0.5	0.5	-0.3	0.4	0.4	0.2	0.3	0.4	0.4	0.4	0.5
Cyprus	-0.6	-1.2	-0.8	-0.3	0.1	0.2	0.3	0.4	0.3	0.3	0.4	0.4
Luxembourg	-1.3	-1.6	4.8	-0.2	:	:	:	:	:	:	:	:
Malta	-1.0	-0.5	0.6	0.9	:	:	:	:	:	:	:	:
Netherlands	-2.3	-1.1	0.5	0.2	0.3	0.6	0.4	0.4	0.4	0.4	0.5	0.6
Austria	-2.2	-0.5	0.5	0.4	0.5	0.5	0.5	0.5	0.3	0.3	0.5	0.5
Portugal	-1.9	0.6	0.5	-0.2	0.0	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Slovenia	-6.8	0.3	0.6	0.1	0.1	0.4	0.3	0.4	0.4	0.5	0.6	0.6
Slovakia	-8.1	1.2	1.6	2.0	-0.8	0.2	1.0	0.9	0.7	0.9	1.3	1.2
Finland	-5.2	-0.3	0.3	0.0	0.1	0.7	0.7	0.9	0.4	0.4	0.3	0.3
Euro area	-2.5	-0.1	0.4	0.0	0.1	0.4	0.2	0.3	0.4	0.4	0.5	0.5
Bulgaria	-7.9	0.8	0.6	0.6	-0.6	-0.5	0.0	0.0	0.5	1.0	1.8	2.5
Czech Republic	-4.1	-0.3	0.6	0.7	0.2	0.4	0.5	0.6	0.6	0.6	0.8	1.0
Denmark	-1.8	-1.9	0.4	0.2	-0.2	0.3	0.4	0.9	0.3	0.3	0.2	0.2
Estonia	-9.0	-2.3	-0.5	2.5	-0.4	0.2	0.3	0.5	1.0	1.3	1.5	1.5
Latvia	-10.7	-0.4	-4.0	-2.9	-0.1	0.3	0.6	0.8	0.9	0.9	0.9	0.9
Lithuania	-13.7	-1.0	1.0	0.5	:	:	:	:	:	:	:	:
Hungary	-2.3	-1.4	-1.2	-0.4	0.5	0.7	0.9	0.9	0.8	0.6	0.5	0.5
Poland	0.3	0.7	0.6	1.2	0.5	0.7	0.5	0.7	0.9	0.9	0.9	1.0
Romania	-4.1	-1.5	0.1	-1.5	0.5	1.2	1.5	1.5	0.5	0.5	0.5	0.5
Sweden	-0.9	0.0	-0.1	-0.6	0.4	1.4	1.1	0.9	0.5	0.4	0.4	0.4
United Kingdom	-2.6	-0.7	-0.3	0.4	0.4	0.5	0.5	0.5	0.5	0.6	0.6	0.6
EU	-2.4	-0.3	0.3	0.1	0.2	0.5	0.3	0.4	0.4	0.4	0.5	0.5
USA	-1.6	-0.2	0.6	1.4	0.7	0.6	0.5	0.5	0.6	0.7	0.7	0.8
Japan	-3.6	1.5	-0.1	0.9	0.3	0.5	0.5	0.5	0.3	0.3	0.2	0.3

TABLE 3 : Profiles (yoy) of quarterly GDP, volume (percentage change from corresponding quarter in previous year, 2009-2011) 20.04.2010

	2009/1	2009/2	2009/3	2009/4	2010/1	2010/2	2010/3	2010/4	2011/1	2011/2	2011/3	2011/4
Belgium	-3.7	-4.2	-3.2	-0.8	1.0	1.5	1.3	1.4	1.8	1.8	1.6	1.5
Germany	-6.7	-5.8	-4.8	-2.4	1.0	1.3	0.8	1.2	1.7	1.5	1.7	2.0
Ireland	-8.6	-7.3	-7.4	-5.0	:	:	:	:	:	:	:	:
Greece	-1.0	-1.9	-2.5	-2.5	-2.6	-3.1	-3.1	-2.4	-1.5	-0.6	-0.1	0.1
Spain	-3.3	-4.2	-4.0	-3.1	-1.4	-0.2	-0.2	0.2	0.4	0.5	1.0	1.1
France	-3.4	-2.8	-2.3	-0.3	1.4	1.3	1.3	0.9	1.1	1.3	1.7	1.9
Italy	-6.2	-6.1	-4.8	-3.0	0.1	1.0	0.7	1.3	1.3	1.4	1.6	1.8
Cyprus	0.4	-1.7	-2.7	-2.8	-2.2	-0.8	0.3	1.0	1.2	1.3	1.4	1.4
Luxembourg	-6.0	-7.6	-1.1	1.4	:	:	:	:	:	:	:	:
Malta	-1.7	-3.0	-2.2	-0.1	:	:	:	:	:	:	:	:
Netherlands	-4.1	-5.2	-4.0	-2.6	-0.1	1.7	1.6	1.9	2.0	1.8	1.8	2.0
Austria	-3.8	-4.6	-3.5	-1.9	0.9	1.9	1.9	2.0	1.9	1.7	1.7	1.7
Portugal	-3.8	-3.4	-2.5	-1.0	0.9	0.4	0.1	0.4	0.6	0.7	0.8	0.9
Slovenia	-8.7	-9.0	-8.7	-5.8	1.1	1.3	1.0	1.2	1.6	1.7	2.0	2.2
Slovakia	-4.9	-5.3	-4.9	-3.5	4.1	3.0	2.4	1.3	2.8	3.6	3.9	4.1
Finland	-8.0	-9.0	-8.8	-5.1	0.1	1.2	1.6	2.5	2.8	2.5	2.1	1.5
Euro area	-5.0	-4.9	-4.1	-2.2	0.4	0.9	0.7	1.0	1.3	1.3	1.6	1.7
Bulgaria	-4.2	-4.9	-5.5	-6.0	1.4	0.1	-0.5	-1.1	0.0	1.5	3.3	5.9
Czech Republic	-4.0	-4.9	-4.5	-3.1	1.2	1.9	1.7	1.6	2.0	2.2	2.6	3.0
Denmark	-4.1	-7.0	-5.4	-3.0	-1.5	0.7	0.7	1.4	2.0	2.0	1.7	1.0
Estonia	-14.7	-16.3	-15.7	-9.4	-0.8	1.7	2.5	0.5	2.0	3.2	4.4	5.5
Latvia	-18.5	-17.0	-19.2	-17.1	-7.2	-6.6	-2.1	1.7	2.7	3.3	3.6	3.7
Lithuania	-15.3	-16.6	-14.7	-13.2	:	:	:	:	:	:	:	:
Hungary	-5.6	-6.8	-7.1	-5.3	-2.5	-0.4	1.7	3.0	3.3	3.2	2.8	2.4
Poland	1.5	1.5	1.3	2.8	3.0	3.0	2.8	2.2	2.7	3.0	3.4	3.8
Romania	-5.2	-8.0	-7.6	-6.9	-2.4	0.3	1.7	4.8	4.8	4.1	3.0	2.0
Sweden	-6.1	-5.8	-5.4	-1.5	-0.3	1.1	2.3	3.8	3.9	2.9	2.2	1.7
United Kingdom	-5.3	-5.9	-5.3	-3.1	-0.2	1.0	1.8	2.0	2.1	2.1	2.2	2.2
EU	-5.0	-5.0	-4.3	-2.3	0.3	1.0	1.0	1.4	1.6	1.6	1.8	1.9
USA	-3.3	-3.8	-2.6	0.1	2.5	3.3	3.2	2.3	2.3	2.3	2.6	2.8
Japan	-8.4	-6.0	-4.9	-1.4	2.7	1.6	2.2	1.8	1.8	1.6	1.3	1.2

TABLE 4 : Gross domestic product per capita (percentage change on preceding year, 1992-2011)

	5-year averages							Spring 2010 forecast			Autumn 2009 forecast	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	1.2	2.5	1.5	1.2	2.1	2.2	0.2	**-3.7**	**0.6**	**0.9**	*-0.1*	*0.8*
Germany	0.9	1.9	1.0	0.8	3.3	2.6	1.4	**-4.7**	**1.6**	**1.9**	*1.3*	*1.8*
Ireland	5.3	7.8	3.4	3.8	2.9	3.5	-4.7	**-7.5**	**-1.0**	**2.9**	*-1.6*	*2.5*
Greece	0.2	3.4	3.8	1.9	4.1	4.1	1.6	**-2.5**	**-3.4**	**-1.0**	*-0.7*	*0.3*
Spain	1.3	3.7	1.7	1.9	2.4	1.7	-0.7	**-4.9**	**-0.7**	**0.5**	*-1.7*	*0.2*
France	0.8	2.4	1.0	1.1	1.5	1.7	-0.1	**-2.7**	**0.8**	**1.0**	*0.7*	*1.0*
Italy	1.2	2.0	0.2	-0.1	1.5	0.7	-2.1	**-5.6**	**0.4**	**1.1**	*0.2*	*1.0*
Cyprus	3.3	3.0	1.3	1.4	2.1	3.6	2.4	**-2.7**	**-1.1**	**0.6**	*-0.8*	*0.4*
Luxembourg	1.1	5.1	2.8	3.8	3.9	4.8	-1.7	**-4.6**	**0.8**	**1.3**	*0.0*	*0.7*
Malta	4.1	2.7	1.3	3.3	2.4	3.2	1.3	**-2.3**	**0.7**	**1.3**	*-0.1*	*0.8*
Netherlands	1.9	3.1	1.2	1.8	3.2	3.4	1.6	**-4.5**	**1.1**	**1.6**	*-0.1*	*1.2*
Austria	1.3	2.4	1.6	1.8	2.9	3.1	1.6	**-3.9**	**1.0**	**1.3**	*0.8*	*1.2*
Portugal	1.8	3.3	0.2	0.5	1.0	1.6	-0.1	**-2.8**	**0.4**	**0.6**	*0.2*	*0.9*
Slovenia	2.1	4.2	4.1	4.3	5.4	6.2	3.2	**-8.6**	**1.5**	**1.6**	*1.2*	*1.8*
Slovakia	:	2.7	5.9	6.6	8.4	10.5	6.0	**-4.9**	**2.6**	**3.5**	*1.8*	*1.4*
Finland	0.9	4.3	2.7	2.6	4.0	4.5	0.7	**-8.2**	**0.9**	**1.6**	*0.6*	*1.4*
Euro area	1.2	2.5	1.1	1.1	2.4	2.2	0.1	**-4.4**	**0.6**	**1.2**	*0.3*	*1.1*
Bulgaria	-2.2	3.1	6.4	6.8	6.9	6.7	6.5	**-4.6**	**0.5**	**3.2**	*-0.6*	*3.6*
Czech Republic	2.3	1.4	4.5	6.0	6.5	5.6	1.4	**-5.0**	**1.3**	**2.1**	*0.5*	*2.0*
Denmark	2.2	2.1	1.5	2.1	3.1	1.3	-1.4	**-5.2**	**1.3**	**1.6**	*1.3*	*1.6*
Estonia	:	7.9	8.8	9.7	10.2	7.4	-3.5	**-14.1**	**1.0**	**3.8**	*-0.1*	*4.2*
Latvia	-7.4	7.2	9.6	11.2	12.8	10.6	-4.1	**-17.6**	**-3.0**	**3.8**	*-3.5*	*2.5*
Lithuania	-7.8	5.5	8.6	8.5	8.5	10.4	3.3	**-14.5**	**0.0**	**3.8**	*-3.3*	*3.2*
Hungary	0.7	4.8	4.4	3.7	4.1	1.1	0.8	**-6.2**	**0.1**	**2.9**	*-0.4*	*3.1*
Poland	4.7	4.4	4.2	3.7	6.3	6.8	5.0	**1.6**	**2.6**	**3.2**	*1.8*	*3.2*
Romania	1.8	-0.7	7.0	4.4	8.1	6.5	7.5	**-6.9**	**1.0**	**3.7**	*0.7*	*2.8*
Sweden	0.7	3.1	2.8	2.9	3.7	1.8	-1.4	**-6.1**	**1.6**	**2.5**	*1.2*	*2.1*
United Kingdom	2.3	3.0	2.1	1.5	2.3	1.9	-0.1	**-5.6**	**0.5**	**1.4**	*0.2*	*1.2*
EU	1.1	2.7	1.6	1.5	2.8	2.4	0.3	**-4.5**	**0.7**	**1.5**	*0.4*	*1.4*
USA	2.1	2.6	1.8	2.1	1.7	1.1	-0.5	**-3.3**	**1.9**	**1.6**	*1.3*	*1.1*
Japan	1.0	0.2	1.6	1.9	2.0	2.4	-1.2	**-5.1**	**2.2**	**1.7**	*1.2*	*-0.5*

TABLE 5 : Domestic demand, volume (percentage change on preceding year, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	1.4	2.2	1.7	2.6	2.4	3.1	2.3	-3.3	0.7	1.6	0.1	1.6
Germany	1.5	1.5	0.1	0.0	2.2	1.0	1.7	-2.1	0.4	1.4	0.9	1.4
Ireland	4.2	8.2	5.5	8.6	6.1	4.1	-4.4	-13.4	-4.4	2.0	-3.8	2.4
Greece	1.2	4.3	3.9	1.5	5.7	5.0	1.1	-2.4	-6.1	-2.2	-1.7	0.5
Spain	0.8	5.0	4.4	5.1	5.2	4.2	-0.5	-6.1	-1.7	0.1	-1.8	0.7
France	0.7	3.0	2.2	2.6	2.5	3.1	0.7	-2.0	1.2	1.4	1.1	1.6
Italy	0.0	2.6	1.3	0.9	2.0	1.3	-1.5	-3.8	0.7	1.3	0.8	1.4
Cyprus	:	3.5	4.4	3.4	5.7	8.8	8.4	-7.1	-1.3	1.0	-0.9	1.0
Luxembourg	1.6	5.9	2.7	5.2	2.2	4.2	3.2	-4.6	1.8	3.1	1.1	2.0
Malta	:	1.4	2.8	6.1	3.2	1.5	1.5	-6.8	1.6	1.8	1.0	1.5
Netherlands	2.1	3.9	1.2	1.3	4.1	2.3	2.7	-4.0	-0.9	1.4	-0.9	0.5
Austria	2.0	1.6	1.5	1.9	2.3	1.7	1.1	-1.8	0.4	0.9	0.8	1.2
Portugal	2.4	4.6	0.6	1.5	0.8	1.7	1.3	-2.5	-0.1	0.0	0.1	0.8
Slovenia	5.2	4.2	4.1	2.3	5.6	8.6	3.5	-9.6	0.5	1.8	0.2	1.7
Slovakia	:	2.5	4.8	8.6	6.6	6.4	6.0	-5.8	3.4	3.1	1.8	2.6
Finland	0.2	3.7	3.0	4.3	2.4	4.8	0.8	-6.5	1.4	1.8	0.6	1.3
Euro area	1.1	2.7	1.7	1.9	2.9	2.4	0.6	-3.4	0.1	1.1	0.3	1.3
Bulgaria	:	5.2	8.4	10.0	10.2	9.3	6.8	-14.4	-3.0	2.3	-3.5	2.0
Czech Republic	6.2	1.2	3.6	1.7	5.4	5.2	1.2	-4.0	0.5	2.0	0.6	2.2
Denmark	2.9	2.2	2.9	3.4	5.2	1.9	-0.5	-6.3	1.5	2.0	1.5	1.6
Estonia	:	6.4	10.9	9.5	15.8	10.0	-10.9	-25.3	-2.2	3.6	-0.7	4.0
Latvia	:	6.9	11.2	9.3	18.1	12.4	-10.5	-27.8	-9.1	2.3	-8.9	0.9
Lithuania	:	5.3	9.6	7.7	9.1	14.1	2.9	-23.9	-2.7	2.5	-4.8	2.1
Hungary	0.6	4.9	3.9	1.0	1.7	-1.2	0.7	-11.5	-1.5	2.7	-1.5	3.1
Poland	5.4	4.5	3.9	2.5	7.3	8.7	5.5	-0.9	2.8	3.6	2.0	3.6
Romania	1.4	0.5	9.0	7.9	12.9	14.2	7.2	-12.8	0.6	4.1	1.3	3.6
Sweden	0.0	2.6	2.4	3.1	3.8	4.0	0.2	-4.7	2.4	2.5	1.0	1.6
United Kingdom	2.3	4.1	2.8	2.1	2.4	3.0	0.1	-5.3	1.3	1.9	0.4	1.5
EU	1.5	3.0	2.1	2.1	3.1	2.9	0.7	-4.0	0.4	1.4	0.4	1.5
USA	3.5	4.4	3.0	3.2	2.6	1.4	-0.8	-3.3	2.8	2.3	2.3	1.8
Japan	1.5	0.3	1.0	1.7	1.2	1.3	-1.3	-4.0	0.6	1.2	0.4	0.8

TABLE 6 : Final demand, volume (percentage change on preceding year, 1992-2011)

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	2.5	4.0	2.7	3.5	3.6	3.7	1.9	-6.8	2.3	2.8	0.7	2.1
Germany	1.7	3.2	2.3	2.3	5.7	3.2	2.2	-6.4	2.1	2.7	1.4	2.4
Ireland	8.3	11.9	5.1	7.0	5.6	6.2	-2.8	-8.0	-1.1	3.2	-1.2	3.1
Greece	1.6	5.3	3.9	1.6	5.6	5.1	1.6	-5.2	-4.7	-1.2	-0.9	0.9
Spain	2.3	5.8	4.3	4.6	5.5	4.6	-0.6	-7.1	-0.5	1.0	-1.2	1.2
France	1.5	4.0	2.3	2.7	3.0	3.0	0.5	-3.9	1.9	2.1	1.4	1.9
Italy	1.3	2.9	1.3	0.9	2.9	2.0	-2.0	-7.1	1.2	1.9	0.9	1.9
Cyprus	:	4.4	3.4	3.8	5.0	7.9	5.2	-8.5	-0.7	1.7	-0.4	1.7
Luxembourg	3.0	8.9	5.9	4.7	9.8	7.5	2.0	-6.8	2.5	4.4	1.6	2.8
Malta	:	2.7	2.9	3.5	6.5	2.1	-2.6	-5.2	2.9	2.9	1.3	2.0
Netherlands	3.4	5.6	2.7	3.4	5.6	4.3	2.7	-6.1	2.0	3.1	0.3	2.1
Austria	2.3	3.8	3.1	3.8	4.1	4.6	1.0	-7.1	1.7	2.3	1.2	2.0
Portugal	3.2	4.8	1.3	1.6	2.6	3.2	0.9	-4.8	0.7	0.9	0.2	1.3
Slovenia	2.7	5.4	5.9	5.3	8.3	10.6	3.2	-12.0	2.0	3.0	1.0	2.5
Slovakia	:	5.5	7.7	9.1	12.7	9.9	4.7	-10.6	4.4	4.3	2.1	3.6
Finland	2.4	5.7	3.9	5.2	5.6	5.9	2.9	-13.1	2.3	3.2	1.6	2.3
Euro area	2.0	4.1	2.6	2.8	4.5	3.6	0.7	-6.3	1.4	2.2	0.8	2.0
Bulgaria	:	5.5	8.6	9.5	9.7	7.9	5.5	-12.9	-0.7	3.3	-1.7	2.8
Czech Republic	7.3	4.4	6.7	5.8	9.8	9.6	3.4	-6.8	3.1	3.8	1.2	3.7
Denmark	3.0	3.7	3.5	5.0	6.5	2.0	0.5	-7.8	2.6	3.1	1.7	2.5
Estonia	:	8.9	10.7	13.2	15.0	5.7	-6.8	-19.2	1.5	4.7	0.2	4.7
Latvia	:	6.6	10.7	12.1	14.9	11.8	-8.2	-24.1	-4.5	3.5	-5.8	2.2
Lithuania	:	5.8	10.4	11.0	10.1	10.2	5.9	-20.9	0.3	3.6	-2.7	2.8
Hungary	:	9.1	7.1	5.6	9.6	7.6	3.3	-10.2	2.2	5.5	0.8	4.4
Poland	6.4	5.5	5.6	3.9	9.3	8.8	5.9	-3.2	3.7	4.2	2.2	4.2
Romania	0.9	2.6	9.6	7.8	12.3	12.8	7.5	-11.2	1.7	4.7	1.7	4.0
Sweden	2.3	4.3	3.8	4.4	5.7	4.7	0.8	-7.9	2.9	3.9	1.3	3.5
United Kingdom	3.3	4.4	3.3	3.2	4.2	1.8	0.3	-6.4	2.1	2.6	0.7	2.1
EU	2.3	4.2	3.0	3.1	4.9	3.7	0.9	-6.5	1.6	2.5	0.8	2.2
USA	3.9	4.4	3.2	3.5	3.2	2.1	-0.1	-4.0	3.7	2.9	2.8	2.5
Japan	1.7	0.5	1.9	2.3	2.3	2.2	-0.9	-6.9	3.0	2.1	1.3	1.0

TABLE 7 : Private consumption expenditure, volume (percentage change on preceding year, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			Autumn 2009 forecast	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	1.5	2.1	1.1	1.0	1.8	1.7	1.1	**-1.6**	**0.6**	**1.4**	*0.6*	*1.4*
Germany	1.9	1.9	0.2	0.3	1.3	-0.3	0.4	**0.2**	**-0.7**	**0.9**	*-0.2*	*0.8*
Ireland	4.1	7.8	4.6	6.6	6.5	5.6	-0.7	**-7.2**	**-2.4**	**1.4**	*-2.4*	*1.8*
Greece	1.8	3.1	4.3	4.6	5.3	3.3	2.3	**-1.8**	**-3.5**	**-2.4**	*-1.3*	*0.8*
Spain	1.1	4.3	3.6	4.2	3.8	3.6	-0.6	**-4.9**	**0.2**	**1.2**	*-0.5*	*0.9*
France	1.0	2.8	2.4	2.6	2.4	2.5	1.0	**0.8**	**0.6**	**1.3**	*0.8*	*0.8*
Italy	0.5	2.5	0.9	1.2	1.3	1.1	-0.8	**-1.7**	**0.8**	**1.3**	*0.8*	*1.3*
Cyprus	:	4.4	3.7	4.2	4.7	9.4	8.4	**-3.0**	**-1.1**	**2.1**	*0.3*	*0.6*
Luxembourg	1.7	4.3	1.5	2.6	2.7	2.8	3.9	**-0.5**	**0.5**	**1.5**	*0.8*	*1.5*
Malta	:	3.6	1.5	2.3	0.6	2.2	5.0	**1.2**	**0.8**	**1.7**	*0.4*	*1.1*
Netherlands	2.1	3.9	0.5	1.0	-0.3	1.7	1.3	**-2.5**	**-0.4**	**1.3**	*-0.6*	*0.6*
Austria	1.9	1.6	1.7	2.1	1.8	0.8	0.8	**0.4**	**0.8**	**0.6**	*0.5*	*0.6*
Portugal	2.0	3.8	1.5	2.0	1.9	1.6	1.7	**-0.8**	**1.0**	**0.0**	*0.6*	*0.7*
Slovenia	5.1	3.2	2.8	2.6	2.9	6.7	2.0	**-1.4**	**-0.2**	**1.2**	*-0.2*	*1.6*
Slovakia	:	3.7	4.9	6.5	5.9	6.9	6.0	**-0.7**	**0.1**	**2.1**	*0.5*	*2.2*
Finland	0.6	3.2	3.6	3.1	4.3	3.4	1.7	**-2.1**	**1.7**	**1.7**	*1.0*	*1.4*
Euro area	1.4	2.7	1.5	1.8	2.0	1.6	0.4	**-1.1**	**0.0**	**1.1**	*0.2*	*1.0*
Bulgaria	-1.4	2.0	6.8	6.1	9.5	5.3	4.8	**-6.3**	**-2.3**	**2.1**	*-2.1*	*2.0*
Czech Republic	6.2	1.5	3.7	2.5	5.1	4.9	3.6	**-0.2**	**-0.8**	**1.6**	*-0.5*	*1.7*
Denmark	2.4	1.0	2.9	3.8	3.6	2.4	-0.2	**-4.6**	**2.1**	**2.6**	*2.3*	*1.7*
Estonia	:	6.5	10.2	9.8	12.9	9.0	-4.7	**-18.5**	**-4.4**	**2.9**	*-1.9*	*2.9*
Latvia	:	4.7	11.4	11.2	21.2	14.8	-5.5	**-22.4**	**-8.5**	**2.0**	*-11.0*	*0.5*
Lithuania	:	5.0	10.2	12.2	10.6	12.1	3.6	**-17.0**	**-5.3**	**2.6**	*-6.3*	*1.2*
Hungary	:	4.8	5.4	3.2	1.7	0.4	-0.5	**-7.5**	**-3.2**	**2.6**	*-2.5*	*3.0*
Poland	4.8	4.6	3.4	2.1	5.0	4.9	5.9	**2.3**	**1.5**	**2.7**	*1.3*	*3.3*
Romania	3.1	1.2	10.6	10.1	12.7	11.9	9.5	**-10.5**	**0.7**	**4.2**	*2.2*	*3.6*
Sweden	0.0	3.0	2.4	2.7	2.3	3.0	-0.2	**-0.8**	**2.4**	**2.2**	*1.0*	*1.5*
United Kingdom	2.4	4.2	2.7	2.2	1.5	2.1	0.9	**-3.2**	**0.6**	**1.5**	*-0.3*	*1.5*
EU	1.7	3.0	2.0	2.1	2.2	2.0	0.8	**-1.7**	**0.1**	**1.3**	*0.2*	*1.2*
USA	3.4	4.4	3.0	3.4	2.9	2.6	-0.2	**-0.6**	**2.1**	**1.3**	*-0.2*	*0.4*
Japan	1.9	0.6	1.2	1.3	1.5	1.6	-0.7	**-1.0**	**1.2**	**0.9**	*0.9*	*1.0*

TABLE 8 : Government consumption expenditure, volume (percentage change on preceding year, 1992-2011)

	5-year averages							Spring 2010 forecast			Autumn 2009 forecast	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	1.2	2.0	1.7	1.2	1.0	2.6	3.3	**1.6**	**1.3**	**1.5**	*1.4*	*1.5*
Germany	2.4	1.1	0.5	0.4	1.0	1.7	2.1	**3.0**	**1.4**	**0.9**	*1.5*	*0.8*
Ireland	2.3	7.9	4.2	3.8	6.3	7.7	1.5	**-1.3**	**-2.7**	**2.0**	*1.4*	*2.1*
Greece	1.0	4.3	2.1	1.1	-0.1	8.4	0.6	**9.6**	**-7.0**	**-3.1**	*-0.1*	*0.7*
Spain	2.1	3.8	5.1	5.5	4.6	5.5	5.5	**3.8**	**1.0**	**-1.2**	*1.7*	*2.2*
France	1.8	1.0	1.7	1.2	1.3	1.5	1.2	**1.6**	**1.4**	**0.3**	*0.9*	*1.1*
Italy	-1.0	1.7	1.8	1.9	0.5	0.9	0.8	**0.6**	**0.1**	**0.1**	*0.4*	*0.3*
Cyprus	:	5.3	3.5	3.4	7.3	0.3	6.2	**5.8**	**1.6**	**1.5**	*3.1*	*2.4*
Luxembourg	4.1	4.8	3.8	3.3	2.8	2.9	3.0	**2.9**	**2.7**	**2.6**	*2.0*	*1.8*
Malta	:	0.0	2.5	-0.8	5.9	0.0	12.9	**-1.9**	**0.5**	**0.2**	*1.5*	*1.5*
Netherlands	1.7	2.9	3.2	0.5	9.5	3.7	2.0	**3.2**	**2.0**	**0.2**	*0.7*	*0.4*
Austria	2.6	2.0	1.4	1.7	2.7	1.7	3.2	**1.2**	**1.2**	**1.0**	*1.4*	*1.1*
Portugal	2.0	3.8	1.4	3.2	-1.4	0.0	1.1	**3.5**	**-0.3**	**-0.2**	*0.7*	*0.7*
Slovenia	2.2	3.7	3.3	3.4	4.0	0.7	6.2	**3.1**	**0.4**	**0.2**	*0.6*	*0.5*
Slovakia	:	1.6	3.5	3.9	9.7	0.1	5.3	**2.8**	**2.5**	**2.2**	*3.5*	*2.8*
Finland	-0.4	1.8	1.7	2.2	0.4	1.1	2.7	**0.7**	**0.6**	**0.8**	*0.7*	*0.6*
Euro area	1.5	1.8	1.9	1.6	2.1	2.3	2.1	**2.3**	**0.9**	**0.3**	*1.1*	*1.0*
Bulgaria	-15.4	5.2	3.4	2.5	-1.3	3.1	0.1	**-5.5**	**-1.6**	**0.6**	*-0.1*	*0.2*
Czech Republic	-1.7	1.9	2.8	2.9	1.2	0.7	1.0	**4.4**	**0.4**	**1.4**	*0.1*	*0.8*
Denmark	2.6	2.2	1.7	1.3	2.8	1.3	1.6	**2.5**	**1.0**	**0.6**	*1.3*	*1.4*
Estonia	:	0.1	1.7	-0.2	3.5	3.7	4.1	**-0.5**	**-0.9**	**0.1**	*-3.5*	*1.5*
Latvia	:	2.8	2.7	2.7	4.9	3.7	1.5	**-9.2**	**-10.0**	**-4.0**	*-10.3*	*-4.0*
Lithuania	:	0.7	4.1	3.5	3.7	3.2	7.9	**-2.3**	**-4.5**	**-2.3**	*-7.9*	*0.1*
Hungary	-1.7	2.2	3.6	2.1	3.8	-7.4	-0.8	**-1.1**	**-0.4**	**1.8**	*-1.6*	*1.8*
Poland	3.3	2.4	4.1	5.2	6.1	3.7	7.5	**1.2**	**3.0**	**-0.1**	*1.0*	*1.8*
Romania	3.6	-3.5	-0.9	3.8	-4.1	-0.1	7.1	**0.8**	**-2.5**	**1.0**	*-4.0*	*-1.4*
Sweden	0.4	0.8	0.9	0.4	2.0	0.3	1.4	**2.1**	**1.3**	**0.5**	*0.6*	*0.5*
United Kingdom	0.6	1.9	2.7	2.0	1.6	1.2	2.6	**2.2**	**1.5**	**-1.5**	*1.4*	*-1.8*
EU	0.8	1.8	2.0	1.7	2.0	1.9	2.3	**2.2**	**1.0**	**0.1**	*1.0*	*0.6*
USA	-0.1	2.4	2.2	0.7	1.2	1.5	3.4	**1.9**	**2.3**	**2.7**	*4.1*	*2.9*
Japan	3.1	2.8	1.7	1.6	0.4	1.5	0.3	**1.6**	**1.1**	**0.9**	*0.7*	*0.9*

TABLE 9 : Total investment, volume (percentage change on preceding year, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	0.8	3.6	2.6	7.1	2.7	5.9	4.3	**-5.0**	**-1.5**	**2.1**	*-2.8*	*2.2*
Germany	0.7	1.8	0.3	0.9	7.8	5.0	3.1	**-8.9**	**1.2**	**2.9**	*2.1*	*3.9*
Ireland	7.2	10.1	7.4	14.7	3.9	2.4	-15.5	**-29.7**	**-17.6**	**4.2**	*-15.0*	*5.1*
Greece	-0.2	8.2	5.4	-4.5	9.8	4.6	-7.4	**-13.1**	**-5.5**	**-0.8**	*-3.9*	*1.3*
Spain	-0.3	7.6	5.7	7.0	7.2	4.6	-4.4	**-15.3**	**-8.3**	**-1.8**	*-8.4*	*-1.3*
France	-0.9	5.0	2.5	4.4	4.1	6.5	0.6	**-6.9**	**-2.4**	**1.9**	*-1.6*	*2.2*
Italy	-0.8	3.7	1.7	0.8	2.9	1.7	-4.0	**-12.1**	**-0.1**	**2.5**	*0.1*	*2.4*
Cyprus	:	1.3	7.3	4.1	10.2	13.4	8.6	**-12.0**	**-12.9**	**-3.8**	*-9.0*	*0.9*
Luxembourg	1.1	8.2	4.3	2.5	4.7	12.6	-0.1	**-14.9**	**3.0**	**6.7**	*0.3*	*2.9*
Malta	:	-0.1	2.7	12.5	3.2	0.4	-21.9	**-19.3**	**6.5**	**4.5**	*1.6*	*3.1*
Netherlands	3.3	4.9	0.6	3.7	7.5	4.8	4.9	**-13.0**	**-9.7**	**3.6**	*-6.0*	*0.4*
Austria	1.8	1.6	0.9	1.2	2.4	3.8	1.0	**-7.8**	**-1.4**	**1.7**	*-0.3*	*3.0*
Portugal	1.7	7.2	-2.5	-0.9	-0.7	3.1	-0.7	**-11.1**	**-4.2**	**-0.6**	*-4.1*	*1.1*
Slovenia	6.9	7.8	5.5	3.7	9.9	11.7	7.7	**-21.4**	**1.6**	**3.5**	*-0.6*	*2.5*
Slovakia	:	1.4	5.6	17.5	9.3	9.1	1.8	**-10.5**	**3.6**	**3.9**	*2.5*	*3.3*
Finland	-1.9	6.8	1.9	3.6	1.9	10.6	-0.2	**-13.4**	**-1.8**	**2.1**	*-2.4*	*1.9*
Euro area	0.3	4.0	2.1	3.2	5.4	4.8	-0.6	**-10.8**	**-2.6**	**1.8**	*-1.9*	*2.1*
Bulgaria	:	13.0	14.7	23.3	14.7	21.7	20.4	**-26.9**	**-6.3**	**3.2**	*-8.7*	*3.1*
Czech Republic	10.9	0.3	3.4	1.8	6.0	10.8	-1.5	**-8.3**	**-1.1**	**2.7**	*0.3*	*4.5*
Denmark	4.3	4.8	4.4	4.7	14.3	2.8	-4.8	**-12.0**	**-3.7**	**1.7**	*-4.1*	*2.1*
Estonia	:	10.2	16.2	15.3	18.6	9.0	-12.1	**-34.4**	**-2.9**	**8.7**	*-3.2*	*8.8*
Latvia	:	17.4	17.7	23.6	16.4	7.5	-15.6	**-37.7**	**-14.0**	**7.0**	*-12.0*	*3.0*
Lithuania	:	8.0	14.1	11.2	19.4	23.0	-6.5	**-38.7**	**-1.8**	**8.0**	*-7.3*	*5.4*
Hungary	2.7	8.1	4.4	5.7	-3.6	1.6	0.4	**-6.5**	**1.0**	**3.6**	*1.0*	*4.3*
Poland	9.9	6.6	4.0	6.5	14.9	17.6	8.2	**-0.3**	**3.0**	**8.0**	*1.9*	*5.0*
Romania	10.4	1.3	12.7	15.3	19.9	30.3	16.2	**-25.3**	**2.3**	**5.8**	*1.1*	*5.8*
Sweden	-1.4	4.4	4.6	8.9	9.1	7.5	2.6	**-15.3**	**-1.9**	**5.4**	*-1.5*	*3.2*
United Kingdom	2.3	5.7	3.7	2.4	6.5	7.8	-3.5	**-14.9**	**-0.9**	**4.4**	*-3.8*	*3.0*
EU	2.3	4.3	2.7	3.5	6.1	5.9	-0.6	**-11.5**	**-2.2**	**2.5**	*-2.0*	*2.5*
USA	7.0	6.6	2.7	5.3	2.3	-1.4	-4.2	**-14.8**	**0.3**	**4.3**	*4.6*	*4.5*
Japan	-0.2	-1.6	-0.1	3.1	0.5	-1.2	-2.6	**-14.8**	**-1.7**	**2.7**	*0.2*	*-0.3*

TABLE 10 : Investment in construction, volume (percentage change on preceding year, 1992-2011)

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	1.8	0.4	2.4	7.0	1.2	3.0	2.7	**-2.9**	**-1.8**	**0.4**	*-3.4*	*0.3*
Germany	2.9	-1.6	-2.0	-3.0	4.6	0.0	2.6	**-0.8**	**0.6**	**1.6**	*2.7*	*1.5*
Ireland	7.1	10.3	8.2	13.4	5.1	-6.8	-20.6	**-31.0**	**-22.8**	**2.9**	*-18.9*	*4.7*
Greece	-3.1	6.6	3.2	-6.2	14.3	-5.3	-19.1	**-11.3**	**-6.6**	**-0.3**	*-3.3*	*1.3*
Spain	-0.9	6.6	6.0	6.1	6.0	3.2	-5.5	**-11.2**	**-10.7**	**-3.4**	*-10.4*	*-3.9*
France	-2.5	2.8	3.1	4.7	4.9	5.1	-1.0	**-5.8**	**-3.2**	**0.8**	*-1.9*	*1.6*
Italy	-2.0	2.2	2.4	0.5	1.0	0.3	-3.4	**-7.9**	**-2.7**	**1.8**	*-0.6*	*0.6*
Cyprus	:	-0.3	8.5	8.2	8.0	14.1	3.9	**-8.6**	**-12.5**	**-3.7**	*-6.8*	*0.6*
Luxembourg	4.1	6.2	5.0	0.7	3.6	7.5	-1.5	**-3.0**	**0.8**	**5.4**	*1.0*	*2.4*
Malta	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*
Netherlands	1.4	3.7	-0.6	3.7	4.2	5.2	4.6	**-8.5**	**-10.0**	**2.1**	*-6.0*	*-1.3*
Austria	2.1	-0.4	0.8	-0.7	2.8	2.9	1.8	**-6.1**	**-1.3**	**1.0**	*-1.1*	*2.2*
Portugal	2.3	6.5	-4.7	-3.2	-5.4	-0.2	-5.7	**-11.6**	**-4.0**	**-0.6**	*-3.7*	*1.4*
Slovenia	2.3	4.5	3.9	6.2	2.9	17.1	10.2	**-19.9**	**-4.7**	**2.2**	*-0.6*	*2.0*
Slovakia	:	1.7	6.8	13.1	31.0	4.9	-5.8	**-22.3**	**4.1**	**4.6**	*2.4*	*3.2*
Finland	-4.3	6.7	3.0	3.8	3.0	8.8	-1.2	**-16.9**	**-1.4**	**1.9**	*-2.1*	*1.8*
Euro area	:	2.2	1.6	1.7	4.0	2.1	-1.2	**-6.5**	**-4.0**	**0.8**	*-2.4*	*0.6*
Bulgaria	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*
Czech Republic	4.3	-4.9	3.9	2.5	4.2	5.8	-2.8	**-0.5**	**0.8**	**2.0**	*0.7*	*3.6*
Denmark	3.2	2.3	4.3	7.2	11.4	2.7	-7.0	**-14.0**	**-3.7**	**1.4**	*-3.5*	*2.1*
Estonia	:	6.9	16.1	26.5	10.7	8.3	-16.9	**-26.8**	**-3.5**	**7.0**	*-1.7*	*7.0*
Latvia	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*
Lithuania	:	4.1	13.9	11.3	22.0	21.5	0.2	**-35.6**	**-0.4**	**9.2**	*-5.9*	*6.0*
Hungary	:	:	:	:	:	:	:	**-8.8**	**0.7**	**2.8**	*-0.2*	*4.5*
Poland	:	5.6	3.7	5.0	13.0	13.4	6.9	**4.6**	**5.6**	**10.1**	*2.8*	*5.3*
Romania	15.0	:	11.4	17.0	15.3	37.3	19.7	**-20.9**	**1.7**	**7.1**	*1.2*	*5.7*
Sweden	-7.4	0.8	4.2	4.7	10.3	6.4	0.9	**-8.0**	**0.4**	**4.3**	*-0.7*	*1.9*
United Kingdom	0.8	2.6	4.6	2.5	7.7	6.3	-4.3	**-12.2**	**0.7**	**3.7**	*-1.3*	*3.6*
EU	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*
USA	3.9	3.6	1.3	2.9	-1.7	-4.8	-6.3	**-15.6**	**-6.3**	**4.0**	*5.3*	*4.7*
Japan	:	:	:	:	:	:	:	**:**	**:**	**:**	*:*	*:*

TABLE 11 : Investment in equipment, volume (percentage change on preceding year, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			Autumn 2009 forecast	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	2010	2011
Belgium	-0.9	6.9	1.9	7.4	3.7	8.9	5.8	-6.2	-1.2	3.9	-2.2	3.9
Germany	-3.1	6.3	2.8	5.4	11.7	11.3	3.8	-20.5	1.1	4.5	1.0	7.0
Ireland	9.2	8.8	8.6	28.4	1.9	23.4	-11.1	-25.0	-4.9	6.5	-5.0	6.0
Greece	7.4	10.9	8.9	-2.6	4.7	20.9	6.3	-19.0	-5.0	-1.7	-4.8	1.1
Spain	-0.1	9.1	5.0	9.2	9.9	9.0	-1.8	-23.1	-4.3	0.2	-6.0	2.2
France	0.8	7.6	1.1	3.2	2.2	9.5	2.7	-10.6	-1.2	2.7	-1.4	2.0
Italy	0.1	5.2	1.3	1.7	5.1	3.1	-5.0	-17.7	3.0	3.2	0.9	4.6
Cyprus	:	5.0	5.1	-3.9	15.5	11.9	19.7	-19.5	-12.0	-4.0	-14.0	1.5
Luxembourg	-4.2	11.0	3.6	1.3	7.8	18.5	5.5	-41.3	5.0	7.5	-0.5	4.0
Malta	:	:	:	:	:	:	:	:	:	:	:	:
Netherlands	4.7	6.0	1.9	2.8	12.0	7.8	3.9	-20.8	-10.4	6.9	-6.1	3.1
Austria	0.9	2.9	0.1	4.3	-0.5	5.0	0.0	-12.1	-2.2	2.5	0.6	4.0
Portugal	1.1	9.1	-0.2	1.0	6.6	8.1	4.6	-12.8	-5.2	-1.0	-6.8	0.6
Slovenia	9.6	11.8	8.2	1.7	20.2	5.2	4.2	-26.1	10.9	5.2	-0.7	3.3
Slovakia	:	1.8	4.4	22.0	-6.3	4.3	15.4	4.0	3.5	3.5	2.7	3.5
Finland	1.0	6.1	-1.2	0.9	-1.1	17.9	3.6	-13.6	-4.0	2.5	-4.4	2.5
Euro area	:	6.9	2.5	4.7	7.0	9.3	1.1	-17.3	-0.7	3.1	-1.3	4.1
Bulgaria	:	:	:	:	:	:	:	:	:	:	:	:
Czech Republic	17.0	5.6	3.2	1.2	8.4	16.9	-0.6	-20.8	-4.6	4.0	-0.5	5.8
Denmark	3.4	6.2	3.8	1.6	19.1	3.0	-4.3	-12.5	-4.0	2.3	-5.2	1.9
Estonia	:	13.9	15.5	2.5	27.2	10.1	-2.9	-45.6	-2.0	12.0	-5.0	11.0
Latvia	:	:	:	:	:	:	:	:	:	:	:	:
Lithuania	:	13.5	15.2	11.5	16.8	21.9	-19.8	-51.4	-6.0	5.6	-11.1	5.0
Hungary	:	:	:	:	:	:	:	-3.8	3.1	4.5	2.7	3.9
Poland	:	7.1	4.8	9.9	17.1	22.3	10.9	-6.9	-1.0	4.5	0.5	4.5
Romania	6.2	10.5	14.9	18.9	23.5	28.3	19.0	-32.7	3.0	4.3	1.0	6.0
Sweden	5.1	5.9	5.2	12.3	9.3	10.1	5.8	-27.4	-4.0	6.5	-3.2	5.0
United Kingdom	4.5	8.1	2.5	2.9	4.5	11.5	-3.2	-22.7	-3.9	6.3	-9.3	2.3
EU	:	:	:	:	:	:	:	:	:	:	:	:
USA	10.0	8.2	4.1	8.9	8.2	1.5	-4.4	-14.0	6.7	4.5	3.9	4.4
Japan	:	:	:	:	:	:	:	:	:	:	:	:

TABLE 12 : Public investment (as a percentage of GDP, 1992-2011)

	5-year averages							Spring 2010 forecast			Autumn 2009 forecast	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	2010	2011
Belgium	1.6	1.8	1.7	1.8	1.6	1.6	1.7	1.8	1.9	2.1	1.9	2.0
Germany	2.4	1.8	1.5	1.3	1.4	1.4	1.5	1.7	1.9	1.7	1.9	1.6
Ireland	2.2	3.2	3.8	3.6	3.7	4.4	5.1	4.5	4.5	3.9	4.1	3.7
Greece	2.9	3.3	3.2	2.8	3.0	2.9	2.8	2.9	2.8	2.8	3.0	3.0
Spain	3.7	3.2	3.6	3.6	3.7	4.0	3.8	4.4	4.0	3.2	3.9	3.5
France	3.2	3.0	3.1	3.3	3.2	3.3	3.3	3.3	3.4	3.2	3.3	3.3
Italy	2.4	2.3	2.3	2.4	2.3	2.3	2.2	2.4	2.2	2.0	2.2	2.1
Cyprus	:	2.9	3.3	3.1	3.0	2.9	3.0	4.1	4.1	4.1	3.5	3.5
Luxembourg	4.2	4.0	4.4	4.5	3.6	3.3	3.2	3.6	3.7	3.5	4.5	4.5
Malta	:	4.0	4.3	4.7	3.9	3.7	2.3	2.2	3.0	2.9	3.4	3.4
Netherlands	2.5	3.1	3.4	3.3	3.3	3.4	3.5	4.0	4.1	4.1	3.9	3.9
Austria	3.1	1.6	1.2	1.1	1.1	1.0	1.1	1.1	1.1	1.1	1.2	1.2
Portugal	3.7	4.0	3.0	2.9	2.4	2.3	2.3	2.4	2.2	2.1	2.3	2.3
Slovenia	:	3.1	3.3	3.2	3.7	4.2	4.3	4.9	4.9	4.7	4.5	4.5
Slovakia	:	3.6	2.5	2.1	2.2	1.9	2.0	2.3	2.3	2.3	1.9	1.8
Finland	2.9	2.7	2.6	2.5	2.3	2.4	2.5	2.8	2.8	2.6	2.8	2.7
Euro area	2.8	2.5	2.5	2.5	2.5	2.6	2.5	2.8	2.7	2.5	2.7	2.6
Bulgaria	:	3.1	3.4	4.2	4.2	4.8	5.7	4.8	4.5	4.5	7.0	7.1
Czech Republic	:	3.8	4.6	4.9	5.0	4.7	4.9	5.4	5.6	5.7	5.4	5.4
Denmark	1.8	1.7	1.8	1.8	1.9	1.9	1.8	2.1	2.4	1.9	2.5	2.3
Estonia	:	4.2	4.4	4.0	4.7	5.2	5.3	4.9	5.6	5.4	7.2	7.2
Latvia	:	1.3	2.9	3.1	4.6	5.7	4.8	3.9	4.1	4.0	3.9	3.9
Lithuania	:	2.4	3.4	3.4	4.1	5.2	5.0	3.9	4.7	4.7	5.6	5.8
Hungary	:	3.1	4.1	4.0	4.4	3.6	2.9	2.7	2.7	2.4	2.6	2.2
Poland	:	3.4	3.5	3.4	3.9	4.2	4.6	5.3	6.3	7.4	6.6	7.0
Romania	:	2.5	3.8	3.9	5.1	5.7	5.5	5.4	5.4	5.4	5.7	5.7
Sweden	2.7	3.0	3.0	3.0	3.1	3.1	3.3	3.6	3.6	3.6	3.6	3.6
United Kingdom	1.8	1.3	1.5	0.7	1.8	1.9	2.3	2.7	2.6	2.0	2.5	2.0
EU	:	2.4	2.4	2.3	2.5	2.6	2.7	2.9	2.9	2.7	2.9	2.7
USA	2.4	2.4	2.5	2.4	2.4	2.5	2.5	3.6	4.0	4.1	4.7	4.8
Japan	6.1	5.5	4.0	3.6	3.3	3.1	3.0	3.2	3.0	2.9	4.3	4.1

TABLE 13 : Output gap relative to potential GDP (deviation of actual output from potential output as % of potential GDP, 1992-2011) [1] 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	-0.8	0.5	0.1	0.3	1.3	2.3	1.5	**-2.7**	**-2.4**	**-1.9**	*-2.8*	*-2.4*
Germany	0.2	0.1	-0.4	-1.1	1.2	2.7	3.0	**-2.9**	**-2.7**	**-2.3**	*-2.6*	*-2.2*
Ireland	-2.9	2.2	1.9	1.7	2.2	4.4	-0.5	**-7.2**	**-7.3**	**-4.7**	*-7.8*	*-5.4*
Greece	-1.8	-1.3	1.1	1.1	2.6	4.5	4.5	**1.1**	**-2.7**	**-4.0**	*-2.1*	*-2.9*
Spain	-2.3	0.1	0.1	0.0	1.0	1.7	0.8	**-3.6**	**-4.6**	**-4.2**	*-3.6*	*-2.6*
France	-1.9	0.1	0.9	1.0	1.4	1.9	0.8	**-2.7**	**-2.7**	**-2.3**	*-2.5*	*-2.4*
Italy	-1.5	-0.2	0.8	0.6	2.1	3.0	1.2	**-3.9**	**-3.4**	**-2.6**	*-3.2*	*-2.5*
Cyprus	:	0.1	0.0	-0.6	0.2	2.4	3.4	**-0.7**	**-2.1**	**-1.6**	*-1.2*	*-0.8*
Luxembourg	-0.5	0.2	0.4	0.5	2.5	5.2	1.7	**-3.9**	**-4.1**	**-4.1**	*-4.6*	*-5.0*
Malta	:	1.7	-0.6	-1.2	-0.2	0.9	1.1	**-2.0**	**-1.6**	**-0.7**	*-0.9*	*0.1*
Netherlands	-1.0	1.1	-1.0	-1.1	0.4	2.2	2.3	**-3.0**	**-2.6**	**-2.0**	*-3.1*	*-2.4*
Austria	-0.6	0.8	-0.6	-0.7	0.9	2.6	2.7	**-2.3**	**-2.3**	**-2.1**	*-2.6*	*-2.7*
Portugal	-0.7	1.2	-0.6	-1.0	-0.4	0.8	0.2	**-2.5**	**-2.4**	**-2.2**	*-3.0*	*-2.6*
Slovenia	:	0.0	0.1	0.4	2.7	6.3	6.6	**-3.7**	**-3.7**	**-3.2**	*-3.3*	*-2.8*
Slovakia	:	-1.6	-1.2	-1.0	1.5	6.3	7.6	**-1.2**	**-2.3**	**-2.3**	*-2.1*	*-3.0*
Finland	-4.0	1.4	0.1	0.2	2.3	5.0	4.1	**-5.0**	**-4.6**	**-3.8**	*-4.3*	*-3.8*
Euro area	-1.2	0.2	0.2	0.0	1.4	2.5	1.8	**-3.1**	**-3.1**	**-2.6**	*-3.0*	*-2.5*
Bulgaria	:	-3.0	2.6	3.1	3.7	4.3	5.0	**-2.9**	**-4.8**	**-4.0**	*-6.0*	*-5.1*
Czech Republic	:	-2.5	-0.3	1.0	3.9	6.0	4.8	**-2.2**	**-2.7**	**-2.5**	*-2.9*	*-2.5*
Denmark	-1.1	1.1	0.2	0.8	2.5	2.6	0.2	**-5.1**	**-3.9**	**-2.7**	*-4.1*	*-3.2*
Estonia	:	-1.1	3.3	4.3	8.3	11.0	4.5	**-10.1**	**-8.6**	**-4.8**	*-9.1*	*-5.4*
Latvia	:	-1.4	2.8	4.1	9.7	15.3	8.3	**-9.8**	**-10.7**	**-5.6**	*-10.7*	*-7.0*
Lithuania	:	-3.9	3.1	4.7	6.2	10.1	9.0	**-8.2**	**-8.6**	**-6.4**	*-10.8*	*-8.2*
Hungary	:	-0.9	1.4	1.8	3.6	3.0	2.7	**-4.0**	**-4.3**	**-2.1**	*-4.7*	*-2.0*
Poland	:	0.5	-0.4	-0.4	0.9	2.4	2.2	**-0.6**	**-2.1**	**-3.4**	*-2.2*	*-2.3*
Romania	:	-6.4	1.9	3.5	6.6	7.4	9.3	**-1.8**	**-3.9**	**-3.4**	*-4.4*	*-4.3*
Sweden	-3.8	-0.6	1.3	2.2	3.8	3.9	1.8	**-4.3**	**-3.3**	**-1.8**	*-4.1*	*-3.3*
United Kingdom	-1.7	0.5	1.1	1.2	2.0	2.7	1.8	**-4.1**	**-3.9**	**-3.1**	*-3.7*	*-2.9*
EU	:	0.2	0.4	0.3	1.6	2.7	1.9	**-3.3**	**-3.3**	**-2.7**	*-3.2*	*-2.7*
USA	-1.1	0.5	0.4	1.1	1.3	1.3	-0.2	**-3.8**	**-2.6**	**-1.9**	*-2.7*	*-2.5*
Japan	0.0	-1.2	0.4	1.5	2.5	4.0	1.8	**-3.8**	**-2.1**	**-1.1**	*-2.4*	*-3.0*

[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, 1992-2011)

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	2.2	1.4	2.1	2.3	2.2	2.3	1.8	**1.1**	**1.6**	**1.8**	*1.3*	*1.6*
Germany	2.7	0.3	0.9	0.7	0.5	1.9	1.5	**1.5**	**0.2**	**0.9**	*0.6*	*0.5*
Ireland	3.0	5.2	3.1	2.4	3.5	1.3	-1.2	**-3.2**	**-1.7**	**0.8**	*-0.9*	*1.1*
Greece	11.5	4.3	3.2	2.8	3.1	3.0	3.5	**1.0**	**2.9**	**1.7**	*1.4*	*2.3*
Spain	4.7	3.0	4.2	4.3	4.1	3.3	2.5	**0.2**	**0.3**	**1.1**	*0.5*	*1.4*
France	1.6	1.1	2.1	2.0	2.4	2.5	2.5	**0.8**	**0.7**	**1.5**	*1.2*	*1.7*
Italy	4.3	2.4	2.6	2.1	1.8	2.6	2.8	**2.1**	**1.3**	**1.9**	*1.8*	*1.8*
Cyprus	3.6	3.0	3.0	2.4	3.0	4.6	4.8	**0.0**	**2.1**	**2.4**	*3.2*	*3.0*
Luxembourg	3.7	1.0	4.3	4.6	6.8	3.0	5.0	**-0.7**	**2.8**	**3.0**	*3.2*	*2.8*
Malta	3.0	2.1	2.7	2.5	3.1	2.9	2.2	**2.2**	**1.8**	**2.1**	*2.3*	*2.4*
Netherlands	1.9	3.1	2.2	2.4	1.8	1.6	2.7	**-0.3**	**1.0**	**1.6**	*1.0*	*1.4*
Austria	2.4	0.7	1.6	2.1	1.6	2.1	2.0	**1.9**	**0.6**	**1.7**	*0.9*	*1.7*
Portugal	5.9	3.5	3.0	2.5	2.8	3.0	2.0	**1.2**	**1.1**	**1.6**	*0.8*	*1.6*
Slovenia	47.9	7.2	4.0	1.6	2.1	4.2	3.8	**1.9**	**0.0**	**1.8**	*1.1*	*1.9*
Slovakia	:	6.6	4.1	2.4	2.9	1.1	2.9	**-1.2**	**1.3**	**3.0**	*3.0*	*2.9*
Finland	1.7	2.4	0.5	0.5	0.9	3.3	1.4	**0.6**	**1.4**	**2.0**	*1.5*	*1.5*
Euro area	3.4	1.6	2.1	2.0	1.9	2.4	2.2	**1.0**	**0.7**	**1.4**	*1.1*	*1.4*
Bulgaria	71.8	72.6	4.7	3.8	8.5	7.9	11.4	**4.6**	**1.5**	**2.1**	*1.9*	*2.5*
Czech Republic	13.4	5.7	1.8	-0.3	1.1	3.4	1.8	**2.7**	**0.1**	**0.6**	*1.3*	*1.7*
Denmark	1.4	2.1	2.3	2.9	2.1	1.9	3.6	**0.4**	**1.1**	**1.6**	*1.1*	*2.2*
Estonia	:	6.4	4.8	5.5	7.6	10.2	6.7	**-0.6**	**-1.0**	**1.9**	*-3.1*	*1.9*
Latvia	98.5	4.3	6.8	10.2	9.9	20.3	15.4	**-0.7**	**-6.3**	**-1.0**	*-5.0*	*-1.3*
Lithuania	160.2	2.7	3.0	6.6	6.5	8.5	9.7	**-2.3**	**-2.0**	**1.2**	*-1.5*	*0.4*
Hungary	21.8	11.8	4.8	2.1	3.9	5.9	3.8	**4.9**	**2.6**	**2.2**	*2.6*	*1.8*
Poland	30.3	8.3	2.2	2.6	1.5	4.0	3.0	**3.7**	**2.2**	**2.4**	*1.5*	*2.6*
Romania	115.1	62.5	16.7	12.2	10.6	13.5	15.2	**2.7**	**4.6**	**4.0**	*5.3*	*5.0*
Sweden	2.3	1.4	1.3	0.9	1.7	3.0	3.2	**1.9**	**2.4**	**2.1**	*2.3*	*2.0*
United Kingdom	2.9	2.1	2.7	2.0	2.8	2.9	3.0	**1.4**	**2.5**	**1.4**	*1.7*	*2.0*
EU	22.8	2.3	2.3	2.0	2.2	2.7	2.6	**1.2**	**1.1**	**1.5**	*1.2*	*1.6*
USA	2.1	1.8	2.6	3.3	3.3	2.9	2.1	**1.2**	**0.2**	**0.1**	*0.0*	*-0.1*
Japan	0.2	-0.8	-1.3	-1.2	-0.9	-0.7	-0.8	**-0.9**	**-1.2**	**0.8**	*-1.0*	*-0.5*

TABLE 15 : Price deflator of private consumption (percentage change on preceding year, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	1.8	1.6	2.2	2.7	3.0	2.8	3.8	-0.1	1.6	1.6	*1.3*	*1.5*
Germany	2.4	1.0	1.3	1.4	1.0	1.8	2.1	0.1	1.0	1.2	*0.6*	*0.7*
Ireland	2.6	3.8	3.1	1.8	2.4	3.5	3.1	-3.4	-1.4	0.9	*-0.8*	*1.2*
Greece	11.6	4.5	3.1	3.3	3.4	3.0	4.1	1.3	3.5	1.8	*1.4*	*1.9*
Spain	4.9	2.8	3.3	3.4	3.6	3.2	3.7	-0.6	1.5	1.6	*0.8*	*1.8*
France	1.6	0.9	1.7	1.8	2.1	2.1	2.8	-0.1	1.3	1.5	*1.1*	*1.6*
Italy	5.1	2.4	2.6	2.3	2.7	2.3	3.2	-0.1	1.8	2.0	*1.8*	*2.0*
Cyprus	:	2.4	2.5	2.4	2.1	3.7	4.8	0.3	3.0	2.8	*3.3*	*2.8*
Luxembourg	2.8	2.3	2.0	2.8	2.2	2.0	3.7	0.0	2.1	1.9	*1.7*	*1.7*
Malta	:	1.9	2.0	2.5	2.3	1.6	3.1	0.5	2.0	2.1	*1.6*	*2.3*
Netherlands	2.4	2.9	2.1	2.1	2.2	1.6	2.1	-0.5	1.7	1.5	*1.2*	*1.4*
Austria	2.5	1.4	1.8	2.6	2.1	2.6	2.6	1.2	1.3	1.4	*1.3*	*1.6*
Portugal	5.6	2.8	2.9	2.7	3.1	2.7	2.6	-1.8	1.1	1.5	*1.1*	*1.6*
Slovenia	45.8	7.3	4.0	2.1	2.2	4.1	5.3	-0.9	1.8	2.0	*1.7*	*2.0*
Slovakia	:	7.5	4.8	2.6	4.9	2.6	4.5	1.0	1.5	2.8	*2.3*	*2.8*
Finland	1.9	2.4	0.8	0.8	1.4	2.3	3.5	1.1	1.5	2.1	*1.4*	*1.3*
Euro area	3.5	1.7	2.1	2.1	2.2	2.3	2.9	-0.1	1.4	1.5	*1.1*	*1.4*
Bulgaria	80.5	70.1	3.9	5.2	5.7	6.8	11.0	1.7	1.5	1.9	*1.3*	*2.0*
Czech Republic	11.2	5.3	1.3	0.8	1.4	2.9	5.0	0.4	0.7	1.1	*1.4*	*1.6*
Denmark	1.7	2.1	1.5	1.5	1.9	2.0	3.2	1.3	2.0	1.8	*1.6*	*1.7*
Estonia	:	6.2	3.1	3.6	5.3	7.4	9.2	-0.8	0.9	2.1	*0.5*	*2.1*
Latvia	:	4.1	5.4	8.7	6.0	10.3	15.6	3.2	-3.3	-0.6	*-3.7*	*-1.2*
Lithuania	:	2.8	0.9	1.7	4.0	6.4	9.7	4.5	0.5	1.3	*-1.2*	*0.5*
Hungary	:	11.7	3.9	3.8	3.4	6.2	5.6	4.4	4.2	2.3	*4.2*	*2.5*
Poland	31.6	9.0	2.0	2.1	1.2	2.4	4.2	2.7	2.4	2.6	*2.0*	*2.1*
Romania	117.3	59.1	12.0	6.9	4.9	4.8	9.5	3.2	4.0	3.3	*3.6*	*3.5*
Sweden	3.1	1.3	1.3	1.2	1.0	1.1	2.8	2.2	1.9	1.9	*1.9*	*1.9*
United Kingdom	3.4	1.8	2.0	2.4	2.7	2.9	3.0	1.3	2.4	1.4	*1.4*	*1.6*
EU	23.2	2.5	2.1	2.2	2.3	2.5	3.1	0.4	1.6	1.6	*1.2*	*1.5*
USA	2.3	1.8	2.3	3.0	2.7	2.7	3.3	0.2	1.1	0.4	*0.2*	*0.0*
Japan	0.6	-0.3	-0.8	-0.8	-0.2	-0.6	0.4	-2.2	-1.5	-0.2	*-0.9*	*0.0*

TABLE 16 : Harmonised index of consumer prices (national index if not available), (percentage change on preceding year, 1992-2011)

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	2.2	1.7	2.0	2.5	2.3	1.8	4.5	0.0	1.6	1.6	*1.3*	*1.5*
Germany	3.1	1.2	1.6	1.9	1.8	2.3	2.8	0.2	1.3	1.5	*0.8*	*1.0*
Ireland	2.2	3.0	3.2	2.2	2.7	2.9	3.1	-1.7	-1.3	0.8	*-0.6*	*1.0*
Greece	11.6	3.7	3.4	3.5	3.3	3.0	4.2	1.3	3.1	2.1	*1.4*	*2.1*
Spain	4.7	2.4	3.3	3.4	3.6	2.8	4.1	-0.3	1.6	1.6	*0.8*	*2.0*
France	2.0	1.2	2.1	1.9	1.9	1.6	3.2	0.1	1.4	1.6	*1.1*	*1.4*
Italy	4.6	2.1	2.4	2.2	2.2	2.0	3.5	0.8	1.8	2.0	*1.8*	*2.0*
Cyprus	4.3	2.7	2.6	2.0	2.2	2.2	4.4	0.2	2.7	2.5	*3.1*	*2.5*
Luxembourg	1.8	1.9	2.9	3.8	3.0	2.7	4.1	0.0	2.6	2.0	*1.8*	*1.7*
Malta	3.3	3.1	2.5	2.5	2.6	0.7	4.7	1.8	2.0	2.1	*2.0*	*2.2*
Netherlands	2.5	2.6	2.1	1.5	1.7	1.6	2.2	1.0	1.3	1.5	*0.9*	*1.2*
Austria	2.9	1.3	1.7	2.1	1.7	2.2	3.2	0.4	1.3	1.5	*1.3*	*1.6*
Portugal	5.6	2.7	2.9	2.1	3.0	2.4	2.7	-0.9	1.0	1.4	*1.3*	*1.4*
Slovenia	:	8.0	4.3	2.5	2.5	3.8	5.5	0.9	1.8	2.0	*1.7*	*2.0*
Slovakia	:	8.5	5.3	2.8	4.3	1.9	3.9	0.9	1.3	2.8	*1.9*	*2.5*
Finland	1.5	1.9	1.1	0.8	1.3	1.6	3.9	1.6	1.7	1.9	*1.6*	*1.5*
Euro area	3.4	1.7	2.2	2.2	2.2	2.1	3.3	0.3	1.5	1.7	*1.1*	*1.5*
Bulgaria	87.7	:	5.5	6.0	7.4	7.6	12.0	2.5	2.3	2.7	*2.3*	*2.9*
Czech Republic	:	5.6	1.5	1.6	2.1	3.0	6.3	0.6	1.0	1.3	*1.5*	*1.8*
Denmark	1.9	2.1	1.8	1.7	1.9	1.7	3.6	1.1	2.3	1.5	*1.5*	*1.8*
Estonia	120.7	6.1	3.3	4.1	4.4	6.7	10.6	0.2	1.3	2.0	*0.5*	*2.1*
Latvia	70.3	3.9	4.9	6.9	6.6	10.1	15.3	3.3	-3.2	-0.7	*-3.7*	*-1.2*
Lithuania	179.8	3.9	1.4	2.7	3.8	5.8	11.1	4.2	-0.1	1.4	*-0.7*	*1.0*
Hungary	23.2	12.3	4.8	3.5	4.0	7.9	6.0	4.0	4.6	2.8	*4.0*	*2.5*
Poland	31.4	9.8	1.9	2.2	1.3	2.6	4.2	4.0	2.4	2.6	*1.9*	*2.0*
Romania	116.9	63.2	12.9	9.1	6.6	4.9	7.9	5.6	4.3	3.0	*3.5*	*3.4*
Sweden	2.4	1.5	1.5	0.8	1.5	1.7	3.3	1.9	1.7	1.6	*1.7*	*1.7*
United Kingdom	2.8	1.3	1.7	2.1	2.3	2.3	3.6	2.2	2.4	1.4	*1.4*	*1.6*
EU	24.4	4.3	2.3	2.3	2.3	2.4	3.7	1.0	1.8	1.7	*1.3*	*1.6*
USA	2.9	2.5	2.6	3.4	3.2	2.8	3.8	-0.4	1.7	0.3	*0.8*	*0.1*
Japan	0.7	0.1	-0.2	-0.3	0.3	0.0	1.4	-1.4	-0.5	-0.4	*-0.4*	*0.3*

TABLE 17 : Profiles of quarterly harmonised index of consumer prices (percentage change on corresponding quarter in previous year, 2009-2011) 20.04.2010

	2009/1	2009/2	2009/3	2009/4	2010/1	2010/2	2010/3	2010/4	2011/1	2011/2	2011/3	2011/4
Belgium	1.6	-0.2	-1.2	-0.2	1.2	1.5	1.9	1.9	1.5	1.5	1.6	1.7
Germany	0.8	0.2	-0.4	0.3	0.8	1.3	1.6	1.6	1.7	1.4	1.5	1.6
Ireland	0.2	-1.6	-2.6	-2.8	-2.4	-1.6	-0.9	-0.1	0.4	0.7	0.9	1.1
Greece	1.8	0.8	0.8	2.0	3.0	3.4	2.9	2.7	2.4	2.1	2.0	1.7
Spain	0.5	-0.7	-1.0	0.2	1.1	1.5	1.9	2.0	2.1	1.9	1.2	1.2
France	0.7	-0.2	-0.5	0.4	1.5	1.5	1.4	1.4	1.3	1.5	1.8	1.8
Italy	1.4	0.9	0.1	0.7	1.3	1.8	2.1	2.2	2.2	1.9	1.9	1.8
Cyprus	0.8	0.4	-1.0	0.5	2.5	3.2	3.0	2.5	3.0	2.6	2.4	2.0
Luxembourg	0.2	-0.7	-0.7	1.3	2.8	2.7	2.4	2.6	2.5	2.0	1.8	1.8
Malta	3.5	3.4	0.9	-0.3	0.9	2.2	2.4	2.4	2.1	2.1	2.2	2.1
Netherlands	1.8	1.6	-0.1	0.6	0.5	0.7	1.9	1.9	1.8	1.5	1.4	1.4
Austria	1.0	0.1	-0.1	0.6	1.3	1.4	1.3	1.3	1.4	1.5	1.5	1.4
Portugal	-0.1	-1.1	-1.5	-0.8	0.3	0.8	1.2	1.5	1.3	1.2	1.3	1.6
Slovenia	1.7	0.6	-0.2	1.4	1.7	1.8	1.8	1.9	1.9	1.9	2.0	2.0
Slovakia	2.3	1.1	0.4	0.0	0.0	1.0	2.0	2.3	2.6	2.7	2.9	3.0
Finland	2.4	1.7	1.1	1.3	1.5	1.3	1.7	2.3	2.0	1.9	1.9	1.9
Euro area	1.0	0.2	-0.4	0.4	1.1	1.5	1.7	1.7	1.7	1.6	1.6	1.6
Bulgaria	5.1	3.1	0.8	0.9	1.9	2.0	2.5	2.7	2.5	2.7	2.7	3.0
Czech Republic	1.5	1.0	-0.1	0.0	0.4	0.7	1.2	1.5	1.2	1.3	1.3	1.4
Denmark	1.7	1.1	0.6	0.9	1.9	2.3	2.4	2.5	2.1	1.4	1.2	1.2
Estonia	3.7	0.2	-0.9	-2.0	0.0	2.3	1.1	1.6	2.1	1.7	2.0	2.3
Latvia	9.0	4.4	1.2	-1.3	-3.9	-3.3	-3.0	-2.0	-1.5	-1.1	-0.3	0.4
Lithuania	8.4	4.9	2.4	1.1	-0.4	-0.3	-0.1	0.1	0.1	0.8	1.9	2.7
Hungary	2.7	3.6	4.9	4.9	5.9	5.0	3.5	3.7	3.1	3.0	2.5	2.6
Poland	3.6	4.3	4.3	3.8	3.4	2.4	2.0	2.0	2.1	2.5	2.8	3.1
Romania	6.9	6.1	5.0	4.6	4.6	4.5	4.2	3.8	2.8	3.0	3.0	3.1
Sweden	2.1	1.7	1.7	2.3	2.7	1.4	1.4	1.4	1.5	1.6	1.7	1.7
United Kingdom	3.0	2.1	1.5	2.1	3.3	2.6	2.2	1.5	1.5	1.3	1.3	1.4
EU	1.6	0.8	0.2	0.9	1.6	1.7	1.8	1.8	1.7	1.6	1.6	1.7
USA	-0.2	-1.0	-1.6	1.5	2.4	2.2	1.4	0.8	0.5	0.4	0.3	0.2
Japan	-0.1	-1.0	-2.2	-2.0	-1.3	-1.1	-0.6	-0.2	-0.1	-0.5	0.3	1.2

TABLE 18 : Price deflator of exports of goods in national currency (percentage change on preceding year, 1992-2011)

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	-0.7	1.3	1.3	4.9	3.2	1.8	3.9	**-5.6**	**3.3**	**2.0**	*0.9*	*2.1*
Germany	0.4	0.5	-0.1	0.6	1.3	0.4	0.3	**-2.4**	**1.0**	**1.2**	*0.5*	*1.3*
Ireland	1.1	3.2	-2.5	0.3	1.1	-3.0	-2.3	**1.1**	**2.0**	**0.8**	*-1.6*	*0.0*
Greece	7.5	4.1	2.3	4.2	4.3	3.0	2.7	**-4.7**	**2.1**	**1.5**	*1.0*	*1.9*
Spain	3.5	2.1	1.7	5.0	4.5	2.0	2.3	**-4.8**	**1.0**	**0.7**	*0.4*	*1.2*
France	-0.8	0.0	0.0	1.5	2.9	1.5	2.5	**-4.6**	**1.5**	**1.8**	*1.3*	*2.0*
Italy	4.7	2.0	2.6	4.4	5.2	4.7	5.4	**-0.7**	**3.9**	**2.0**	*2.1*	*2.5*
Cyprus	:	3.7	0.6	2.5	6.8	2.7	1.6	**0.3**	**2.5**	**3.0**	*3.2*	*3.5*
Luxembourg	-0.2	0.5	2.1	5.7	2.5	4.6	5.8	**-6.5**	**1.0**	**1.5**	*2.0*	*3.0*
Malta	:	1.4	-0.4	-3.0	8.2	8.8	2.7	**-15.9**	**2.9**	**1.6**	*1.2*	*1.8*
Netherlands	-0.9	0.9	0.5	3.7	3.2	1.6	4.5	**-8.4**	**3.3**	**1.7**	*0.5*	*1.7*
Austria	0.3	0.5	0.9	2.1	2.9	1.4	2.2	**-2.6**	**1.1**	**2.4**	*1.1*	*2.4*
Portugal	1.2	1.9	0.8	1.8	4.5	2.7	2.4	**-4.9**	**0.9**	**1.3**	*0.9*	*1.9*
Slovenia	39.9	5.3	2.8	2.7	2.8	2.2	1.2	**-4.7**	**1.3**	**1.5**	*0.5*	*0.9*
Slovakia	:	5.0	1.7	1.5	1.8	0.5	0.9	**-5.2**	**1.3**	**1.5**	*0.8*	*1.2*
Finland	3.7	-1.6	-0.6	1.0	2.2	0.9	-3.0	**-8.1**	**2.2**	**2.1**	*1.0*	*1.2*
Euro area	1.6	1.0	0.5	2.3	2.8	1.5	2.1	**-3.9**	**1.9**	**1.5**	*0.8*	*1.7*
Bulgaria	:	:	4.8	7.5	17.0	5.9	8.1	**-13.2**	**7.1**	**1.8**	*3.1*	*4.2*
Czech Republic	:	2.0	-1.8	-2.8	-1.5	-0.2	-5.8	**-0.4**	**-0.3**	**0.3**	*-1.8*	*1.7*
Denmark	0.2	1.3	1.7	5.0	4.4	1.8	6.9	**-6.0**	**3.5**	**1.7**	*2.5*	*1.8*
Estonia	:	4.5	2.1	4.0	7.6	6.7	6.0	**-13.8**	**2.9**	**1.9**	*-3.1*	*2.2*
Latvia	:	-0.2	8.8	10.2	9.7	13.4	9.8	**-9.5**	**3.0**	**3.0**	*0.0*	*2.0*
Lithuania	:	0.8	2.9	9.6	4.9	5.8	12.9	**-12.9**	**3.3**	**2.0**	*2.1*	*3.2*
Hungary	:	8.6	-0.3	-0.7	6.5	-4.5	1.3	**2.3**	**-0.9**	**1.8**	*-3.3*	*1.8*
Poland	21.1	6.5	3.8	-3.3	2.5	2.8	-1.8	**14.8**	**-2.5**	**1.5**	*-2.9*	*2.3*
Romania	115.2	49.6	9.8	-0.2	5.8	0.5	21.0	**2.9**	**3.1**	**2.8**	*3.9*	*3.8*
Sweden	2.1	0.0	0.2	2.9	3.7	2.1	3.4	**0.5**	**-1.0**	**2.0**	*-1.0*	*2.0*
United Kingdom	3.1	-2.7	1.2	1.8	3.3	0.6	13.5	**2.5**	**3.0**	**1.4**	*3.5*	*2.8*
EU	:	6.5	0.7	2.1	2.9	1.4	3.1	**-2.5**	**1.8**	**1.5**	*0.8*	*1.8*
USA	-0.3	-1.3	2.3	3.2	3.3	3.6	5.0	**-6.7**	**2.4**	**0.7**	*0.7*	*0.2*
Japan	-2.6	-1.9	-0.3	1.4	3.7	2.2	-4.6	**-11.4**	**-3.2**	**0.0**	*-0.4*	*0.0*

TABLE 19 : Price deflator of imports of goods in national currency (percentage change on preceding year, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	-0.5	2.0	1.5	4.9	3.6	1.5	6.5	**-7.9**	**2.8**	**1.6**	*1.2*	*2.2*
Germany	-1.2	1.2	-0.2	2.4	3.1	-0.1	1.3	**-7.8**	**3.6**	**1.7**	*0.9*	*2.0*
Ireland	1.7	3.3	-2.5	0.6	2.2	3.7	0.5	**0.3**	**2.2**	**1.1**	*0.1*	*1.5*
Greece	7.2	4.3	2.4	4.2	3.9	2.1	5.1	**-1.9**	**4.3**	**2.0**	*1.9*	*2.2*
Spain	2.9	2.1	1.1	4.2	3.9	1.9	4.8	**-8.9**	**3.0**	**1.3**	*1.0*	*1.9*
France	-1.0	0.2	0.0	2.8	3.1	0.4	4.4	**-8.0**	**3.9**	**1.7**	*1.3*	*1.7*
Italy	5.0	2.1	3.3	6.8	8.9	3.1	8.5	**-7.7**	**6.4**	**1.7**	*1.7*	*2.3*
Cyprus	:	2.5	1.9	5.9	2.2	2.0	4.2	**-2.3**	**3.5**	**3.0**	*3.5*	*3.8*
Luxembourg	0.4	1.9	1.0	6.1	-0.5	1.9	5.6	**-8.8**	**2.0**	**1.0**	*2.0*	*1.5*
Malta	:	2.5	1.9	1.6	10.9	7.1	2.1	**-12.2**	**4.2**	**1.7**	*0.6*	*2.2*
Netherlands	-1.3	0.2	0.1	3.2	3.5	1.9	4.5	**-7.4**	**4.5**	**1.6**	*1.0*	*1.6*
Austria	0.4	0.7	0.9	2.7	3.7	1.9	4.4	**-3.5**	**2.8**	**1.4**	*1.8*	*2.0*
Portugal	0.1	1.7	0.9	3.0	4.0	1.2	4.9	**-9.3**	**2.3**	**1.6**	*2.3*	*2.1*
Slovenia	36.0	5.5	3.1	5.2	3.3	2.0	3.1	**-8.9**	**3.6**	**1.8**	*1.1*	*2.0*
Slovakia	:	4.6	2.1	1.7	3.6	1.6	2.8	**-6.0**	**3.2**	**1.3**	*0.1*	*0.6*
Finland	3.2	-1.0	1.9	5.8	6.5	1.5	0.4	**-9.5**	**4.2**	**2.8**	*2.0*	*2.2*
Euro area	1.1	1.3	0.7	3.6	4.1	1.3	4.1	**-7.5**	**3.9**	**1.6**	*1.2*	*1.9*
Bulgaria	:	:	4.0	10.0	11.4	7.3	10.8	**-13.7**	**6.8**	**1.7**	*1.9*	*3.1*
Czech Republic	:	1.9	-1.7	-1.1	0.2	-1.4	-3.6	**-3.3**	**0.8**	**1.1**	*-2.2*	*1.6*
Denmark	-0.6	0.2	0.8	3.5	3.6	2.8	6.7	**-9.4**	**4.0**	**1.7**	*2.2*	*0.8*
Estonia	:	2.9	1.4	2.8	4.8	3.2	6.7	**-7.3**	**4.2**	**1.9**	*1.6*	*2.5*
Latvia	:	2.2	8.6	12.3	9.6	5.7	9.2	**-6.7**	**6.7**	**1.7**	*1.0*	*2.0*
Lithuania	:	-1.5	1.6	9.0	8.8	4.9	9.1	**-10.6**	**6.3**	**2.5**	*1.9*	*3.5*
Hungary	:	9.1	0.6	1.5	8.0	-4.4	2.7	**0.5**	**-0.4**	**2.2**	*-2.7*	*2.9*
Poland	19.3	7.7	3.5	-4.2	2.8	0.8	0.3	**9.3**	**-1.5**	**2.0**	*-2.0*	*2.0*
Romania	125.4	41.5	6.6	-3.6	-1.2	-9.2	17.2	**2.7**	**1.7**	**1.6**	*2.0*	*1.9*
Sweden	2.9	1.5	1.3	5.1	3.9	-0.5	4.1	**-1.1**	**-2.0**	**2.0**	*-2.0*	*2.0*
United Kingdom	3.4	-2.7	0.6	4.0	3.4	0.0	13.2	**2.7**	**3.4**	**2.6**	*3.2*	*2.3*
EU	:	5.8	0.8	3.4	3.9	0.8	5.1	**-5.4**	**3.4**	**1.8**	*1.1*	*2.0*
USA	-0.2	-1.7	3.3	6.5	4.2	3.7	11.4	**-11.8**	**7.4**	**1.3**	*3.2*	*1.1*
Japan	-3.2	-0.8	4.2	9.3	12.6	6.8	7.1	**-22.0**	**8.9**	**1.8**	*1.6*	*1.8*

TABLE 20 : Terms of trade of goods (percentage change on preceding year, 1992-2011)

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	-0.1	-0.8	-0.2	0.0	-0.4	0.3	-2.4	**2.4**	**0.5**	**0.4**	*-0.2*	*-0.1*
Germany	1.6	-0.7	0.1	-1.8	-1.8	0.6	-1.1	**5.8**	**-2.5**	**-0.5**	*-0.4*	*-0.7*
Ireland	-0.5	-0.1	0.0	-0.2	-1.1	-6.5	-2.8	**0.8**	**-0.2**	**-0.2**	*-1.7*	*-1.5*
Greece	0.3	-0.1	-0.1	0.0	0.4	0.9	-2.2	**-2.9**	**-2.1**	**-0.5**	*-0.9*	*-0.3*
Spain	0.6	0.0	0.5	0.8	0.6	0.1	-2.3	**4.4**	**-1.9**	**-0.6**	*-0.6*	*-0.7*
France	0.1	-0.2	0.0	-1.3	-0.3	1.1	-1.8	**3.7**	**-2.3**	**0.1**	*0.0*	*0.3*
Italy	-0.3	-0.1	-0.7	-2.3	-3.4	1.5	-2.8	**7.6**	**-2.3**	**0.3**	*0.4*	*0.2*
Cyprus	:	1.2	-1.3	-3.2	4.5	0.6	-2.5	**2.7**	**-1.0**	**0.0**	*-0.3*	*-0.3*
Luxembourg	-0.6	-1.4	1.0	-0.4	3.0	2.6	0.2	**2.5**	**-1.0**	**0.5**	*0.0*	*1.5*
Malta	:	-1.1	-2.2	-4.5	-2.5	1.5	0.6	**-4.1**	**-1.2**	**-0.1**	*0.5*	*-0.4*
Netherlands	0.4	0.7	0.4	0.5	-0.3	-0.3	-0.1	**-1.0**	**-1.1**	**0.1**	*-0.5*	*0.1*
Austria	-0.1	-0.2	0.0	-0.6	-0.7	-0.5	-2.1	**0.9**	**-1.7**	**1.0**	*-0.7*	*0.4*
Portugal	1.1	0.2	-0.1	-1.2	0.4	1.5	-2.3	**4.8**	**-1.4**	**-0.3**	*-1.4*	*-0.2*
Slovenia	2.9	-0.2	-0.3	-2.4	-0.4	0.2	-1.8	**4.6**	**-2.2**	**-0.3**	*-0.6*	*-1.1*
Slovakia	:	0.4	-0.3	-0.2	-1.8	-1.1	-1.9	**0.8**	**-1.8**	**0.2**	*0.7*	*0.6*
Finland	0.5	-0.6	-2.5	-4.6	-4.1	-0.5	-3.3	**1.6**	**-1.9**	**-0.7**	*-1.0*	*-1.0*
Euro area	:	-0.3	-0.2	-1.2	-1.3	0.2	-1.9	**3.9**	**-1.9**	**-0.1**	*-0.4*	*-0.3*
Bulgaria	:	:	0.8	-2.2	5.1	-1.4	-2.5	**0.6**	**0.3**	**0.1**	*1.2*	*1.1*
Czech Republic	:	0.1	-0.1	-1.7	-1.7	1.2	-2.3	**3.0**	**-1.1**	**-0.8**	*0.4*	*0.1*
Denmark	0.8	1.0	0.9	1.5	0.7	-0.9	0.3	**3.7**	**-0.5**	**0.0**	*0.3*	*1.0*
Estonia	:	1.5	0.7	1.2	2.7	3.4	-0.7	**-7.0**	**-1.2**	**0.0**	*-4.6*	*-0.3*
Latvia	:	-2.3	0.2	-1.8	0.0	7.2	0.6	**-3.1**	**-3.5**	**1.3**	*-1.0*	*0.0*
Lithuania	:	2.3	1.2	0.6	-3.5	0.9	3.5	**-2.6**	**-2.8**	**-0.5**	*0.2*	*-0.3*
Hungary	:	-0.4	-0.9	-2.2	-1.4	-0.1	-1.4	**1.8**	**-0.5**	**-0.4**	*-0.6*	*-1.1*
Poland	1.5	-1.1	0.3	1.0	-0.3	2.0	-2.1	**5.0**	**-1.0**	**-0.5**	*-0.9*	*0.3*
Romania	-4.5	5.8	3.0	3.5	7.2	10.6	3.2	**0.1**	**1.3**	**1.2**	*1.9*	*1.9*
Sweden	-0.7	-1.5	-1.0	-2.0	-0.3	2.7	-0.7	**1.6**	**1.0**	**0.0**	*1.0*	*0.0*
United Kingdom	-0.3	0.1	0.6	-2.1	-0.1	0.6	0.3	**-0.3**	**-0.4**	**-1.2**	*0.3*	*0.5*
EU	:	:	-0.1	-1.2	-1.0	0.5	-1.9	**3.0**	**-1.6**	**-0.2**	*-0.3*	*-0.1*
USA	-0.1	0.4	-1.0	-3.2	-0.8	-0.1	-5.7	**5.8**	**-4.6**	**-0.6**	*-2.5*	*-0.9*
Japan	0.6	-1.1	-4.3	-7.2	-8.0	-4.3	-10.9	**13.6**	**-11.1**	**-1.8**	*-2.0*	*-1.8*

TABLE 21 : Total population (percentage change on preceding year, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	0.3	0.2	0.5	0.5	0.7	0.7	0.8	**0.7**	**0.7**	**0.7**	*0.7*	*0.7*
Germany	0.5	0.1	0.0	0.0	-0.1	-0.1	-0.2	**-0.3**	**-0.3**	**-0.3**	*-0.2*	*-0.2*
Ireland	0.6	1.3	2.0	2.3	2.4	2.4	1.8	**0.4**	**0.1**	**0.2**	*0.2*	*0.2*
Greece	0.9	0.4	0.4	0.4	0.4	0.4	0.4	**0.5**	**0.4**	**0.4**	*0.4*	*0.4*
Spain	0.2	0.6	1.6	1.7	1.5	1.8	1.6	**1.3**	**0.4**	**0.3**	*0.9*	*0.7*
France	0.4	0.5	0.7	0.7	0.7	0.6	0.6	**0.5**	**0.5**	**0.5**	*0.5*	*0.5*
Italy	0.0	0.0	0.7	0.7	0.6	0.7	0.8	**0.6**	**0.4**	**0.4**	*0.4*	*0.4*
Cyprus	2.1	1.2	1.9	2.4	2.0	1.5	1.2	**1.0**	**0.7**	**0.7**	*0.9*	*0.9*
Luxembourg	1.4	1.2	1.4	1.5	1.6	1.6	1.8	**1.3**	**1.1**	**1.1**	*1.1*	*1.1*
Malta	0.9	0.7	0.7	0.6	1.1	0.6	0.8	**0.4**	**0.4**	**0.4**	*0.8*	*0.8*
Netherlands	0.6	0.7	0.4	0.3	0.1	0.2	0.4	**0.5**	**0.2**	**0.2**	*0.3*	*0.3*
Austria	0.5	0.2	0.6	0.7	0.5	0.4	0.4	**0.3**	**0.3**	**0.3**	*0.3*	*0.3*
Portugal	0.2	0.5	0.6	0.5	0.3	0.2	0.1	**0.1**	**0.2**	**0.2**	*0.2*	*0.2*
Slovenia	-0.1	0.0	0.2	0.2	0.4	0.5	0.3	**1.0**	**-0.4**	**0.2**	*0.1*	*0.2*
Slovakia	0.3	0.0	0.0	0.1	0.1	0.1	0.2	**0.2**	**0.1**	**0.1**	*0.1*	*1.2*
Finland	0.4	0.2	0.3	0.3	0.4	0.4	0.5	**0.5**	**0.5**	**0.5**	*0.4*	*0.2*
Euro area	0.3	0.3	0.6	0.6	0.5	0.6	0.5	**0.4**	**0.2**	**0.2**	*0.3*	*0.3*
Bulgaria	-0.6	-1.1	-0.6	-0.5	-0.5	-0.5	-0.4	**-0.5**	**-0.5**	**-0.5**	*-0.5*	*-0.5*
Czech Republic	0.0	-0.2	0.1	0.3	0.3	0.5	1.0	**0.8**	**0.3**	**0.3**	*0.3*	*0.3*
Denmark	0.4	0.4	0.3	0.3	0.3	0.4	0.6	**0.3**	**0.3**	**0.3**	*0.2*	*0.2*
Estonia	-2.0	-0.8	-0.3	-0.3	-0.2	-0.2	-0.1	**0.0**	**0.0**	**0.0**	*0.0*	*0.1*
Latvia	-1.5	-0.8	-0.6	-0.5	-0.5	-0.5	-0.4	**-0.5**	**-0.5**	**-0.5**	*-0.5*	*-0.5*
Lithuania	-0.6	-0.7	-0.5	-0.6	-0.6	-0.5	-0.5	**-0.6**	**-0.6**	**-0.6**	*-0.6*	*-0.6*
Hungary	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	**-0.1**	**-0.1**	**-0.1**	*0.0*	*0.0*
Poland	0.2	0.0	-0.1	0.0	-0.1	0.0	0.0	**0.1**	**0.1**	**0.0**	*0.0*	*0.0*
Romania	-0.3	-0.2	-0.7	-0.2	-0.2	-0.2	-0.2	**-0.2**	**-0.2**	**-0.2**	*-0.2*	*-0.2*
Sweden	0.5	0.1	0.4	0.4	0.6	0.7	1.2	**1.3**	**0.2**	**0.0**	*0.2*	*0.0*
United Kingdom	0.3	0.3	0.5	0.7	0.6	0.6	0.7	**0.7**	**0.7**	**0.7**	*0.7*	*0.7*
EU	0.2	0.2	0.4	0.5	0.4	0.5	0.5	**0.4**	**0.2**	**0.2**	*0.3*	*0.3*
USA	1.2	1.1	0.9	0.9	0.9	1.0	0.9	**0.9**	**0.9**	**0.9**	*0.8*	*0.8*
Japan	0.3	0.2	0.1	0.1	0.0	0.0	0.0	**-0.1**	**-0.1**	**-0.2**	*-0.1*	*0.9*

TABLE 22 : Total employment (percentage change on preceding year, 1992-2011)

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	0.1	1.4	0.7	1.4	1.2	1.6	1.9	**-0.5**	**-0.9**	**0.2**	*-1.4*	*0.1*
Germany	-1.4	0.0	-0.7	-0.6	0.2	1.5	1.4	**0.0**	**-0.3**	**-0.1**	*-1.9*	*-0.3*
Ireland	2.5	5.6	3.2	4.9	4.3	3.7	-1.1	**-8.2**	**-3.5**	**0.4**	*-3.9*	*0.7*
Greece	0.9	0.7	1.7	0.9	2.0	1.4	0.1	**-1.2**	**-1.9**	**-0.8**	*-0.8*	*-0.2*
Spain	-0.3	4.1	2.8	3.2	3.3	2.8	-0.6	**-6.7**	**-2.5**	**-0.1**	*-2.3*	*-0.4*
France	-0.5	1.7	0.5	0.6	1.0	1.5	0.6	**-1.3**	**-0.7**	**0.3**	*-0.9*	*0.4*
Italy	-0.9	1.1	0.8	0.2	1.5	1.0	-0.1	**-2.7**	**-0.7**	**0.4**	*-0.4*	*0.4*
Cyprus	:	1.6	3.0	3.6	1.8	3.2	2.6	**-0.7**	**-0.7**	**-0.2**	*-0.1*	*0.6*
Luxembourg	2.5	4.7	2.8	2.9	3.6	4.4	4.7	**0.9**	**0.0**	**0.7**	*-1.3*	*0.0*
Malta	1.5	0.8	0.7	1.5	1.3	3.2	2.5	**-0.6**	**0.3**	**0.7**	*0.3*	*0.6*
Netherlands	1.0	2.4	-0.2	0.0	1.6	2.3	1.2	**-0.9**	**-1.6**	**-0.2**	*-2.1*	*-0.9*
Austria	0.0	0.8	0.5	1.2	1.0	1.6	1.8	**-0.9**	**-0.1**	**0.2**	*-0.7*	*0.3*
Portugal	-0.8	2.1	0.0	-0.3	0.5	0.0	0.4	**-2.5**	**-0.5**	**0.0**	*-0.4*	*0.1*
Slovenia	:	0.2	0.5	-0.2	1.5	3.0	2.8	**-2.2**	**-2.3**	**-0.5**	*-2.0*	*-0.3*
Slovakia	:	-1.1	0.9	1.4	2.3	2.1	2.8	**-2.4**	**-1.9**	**1.2**	*0.0*	*0.6*
Finland	-2.3	2.2	0.9	1.4	1.8	2.2	1.6	**-3.0**	**-2.1**	**0.4**	*-2.5*	*0.1*
Euro area	-0.6	1.4	0.6	0.7	1.4	1.7	0.6	**-2.1**	**-1.0**	**0.1**	*-1.3*	*0.0*
Bulgaria	0.3	-2.3	2.4	2.7	3.3	2.8	3.3	**-2.9**	**-1.2**	**0.6**	*-1.3*	*0.8*
Czech Republic	:	-0.9	0.5	1.0	1.9	2.7	1.2	**-1.2**	**-1.9**	**0.4**	*-1.4*	*0.3*
Denmark	0.1	1.0	0.3	1.0	2.1	2.9	1.4	**-3.6**	**-1.9**	**-0.1**	*-2.1*	*-0.1*
Estonia	-5.2	-1.4	2.0	2.0	5.4	0.8	0.2	**-9.9**	**-2.6**	**1.5**	*-2.5*	*1.6*
Latvia	-7.4	0.0	2.5	1.6	4.9	3.6	0.9	**-13.6**	**-7.2**	**0.8**	*-5.6*	*-0.2*
Lithuania	-2.7	-2.1	2.0	2.5	1.8	2.8	-0.5	**-6.9**	**-3.6**	**0.2**	*-2.4*	*-0.2*
Hungary	:	3.3	-0.2	-0.2	0.6	-0.3	-1.3	**-3.6**	**-0.9**	**0.8**	*-0.8*	*0.9*
Poland	:	-1.1	0.5	2.2	3.2	4.4	3.8	**0.4**	**0.0**	**0.6**	*-1.1*	*0.1*
Romania	-2.8	-2.5	-2.6	-1.5	0.7	0.4	-0.2	**-1.0**	**-1.7**	**0.8**	*0.8*	*0.9*
Sweden	-1.9	1.4	0.1	0.3	1.7	2.2	0.9	**-2.0**	**-0.9**	**0.3**	*-1.8*	*0.0*
United Kingdom	0.0	1.2	0.9	1.0	0.9	0.7	0.7	**-1.6**	**-0.3**	**0.7**	*-0.9*	*1.3*
EU	:	0.8	0.5	0.8	1.5	1.7	0.9	**-2.0**	**-0.9**	**0.3**	*-1.2*	*0.3*
USA	1.8	1.7	0.6	1.3	2.1	1.1	-0.5	**-3.8**	**-0.4**	**0.6**	*-0.5*	*0.3*
Japan	0.4	-0.6	-0.2	0.4	0.4	0.4	-0.3	**-1.6**	**-1.0**	**-0.2**	*-1.2*	*-0.2*

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, 1992-2011) [1] 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	8.9	8.1	8.2	8.5	8.3	7.5	7.0	**7.9**	**8.8**	**9.0**	*9.9*	*10.3*
Germany	7.8	8.4	9.6	10.7	9.8	8.4	7.3	**7.5**	**7.8**	**7.8**	*9.2*	*9.3*
Ireland	13.9	6.2	4.5	4.4	4.5	4.6	6.3	**11.9**	**13.8**	**13.4**	*14.0*	*13.2*
Greece	8.8	10.9	9.9	9.9	8.9	8.3	7.7	**9.5**	**11.8**	**13.2**	*10.2*	*11.0*
Spain	17.8	13.1	10.1	9.2	8.5	8.3	11.3	**18.0**	**19.7**	**19.8**	*20.0*	*20.5*
France	11.0	10.0	9.1	9.3	9.2	8.4	7.8	**9.5**	**10.2**	**10.1**	*10.2*	*10.0*
Italy	10.3	10.5	7.9	7.7	6.8	6.1	6.7	**7.8**	**8.8**	**8.8**	*8.7*	*8.7*
Cyprus	:	3.8	4.5	5.3	4.6	4.0	3.6	**5.3**	**6.7**	**7.0**	*6.6*	*6.7*
Luxembourg	2.7	2.4	4.1	4.6	4.6	4.2	4.9	**5.4**	**6.1**	**6.4**	*7.3*	*7.7*
Malta	5.2	6.8	7.4	7.2	7.1	6.4	5.9	**6.9**	**7.3**	**7.2**	*7.4*	*7.3*
Netherlands	6.2	3.4	3.9	4.7	3.9	3.2	2.8	**3.4**	**4.9**	**5.2**	*5.4*	*6.0*
Austria	3.9	4.0	4.7	5.2	4.8	4.4	3.8	**4.8**	**5.1**	**5.4**	*6.0*	*5.7*
Portugal	6.2	4.9	6.7	7.7	7.8	8.1	7.7	**9.6**	**9.9**	**9.9**	*9.0*	*8.9*
Slovenia	:	6.9	6.4	6.5	6.0	4.9	4.4	**5.9**	**7.0**	**7.3**	*8.3*	*8.5*
Slovakia	:	15.8	16.8	16.3	13.4	11.1	9.5	**12.0**	**14.1**	**13.3**	*12.8*	*12.6*
Finland	14.9	10.6	8.6	8.4	7.7	6.9	6.4	**8.2**	**9.5**	**9.2**	*10.2*	*9.9*
Euro area	10.2	9.3	8.7	9.0	8.3	7.5	7.5	**9.4**	**10.3**	**10.4**	*10.7*	*10.9*
Bulgaria	13.8	15.7	12.6	10.1	9.0	6.9	5.6	**6.8**	**7.9**	**7.3**	*8.0*	*7.2*
Czech Republic	:	7.3	7.7	7.9	7.2	5.3	4.4	**6.7**	**8.3**	**8.0**	*7.9*	*7.4*
Denmark	7.8	4.8	4.8	4.8	3.9	3.8	3.3	**6.0**	**6.9**	**6.5**	*5.8*	*5.6*
Estonia	:	11.3	8.8	7.9	5.9	4.7	5.5	**13.8**	**15.8**	**14.6**	*15.2*	*14.2*
Latvia	13.8	14.0	9.8	8.9	6.8	6.0	7.5	**17.1**	**20.6**	**18.8**	*19.9*	*18.7*
Lithuania	5.0	13.3	10.3	8.3	5.6	4.3	5.8	**13.7**	**16.7**	**16.3**	*17.6*	*18.2*
Hungary	:	7.3	6.5	7.2	7.5	7.4	7.8	**10.0**	**10.8**	**10.1**	*11.3*	*10.5*
Poland	13.4	13.8	18.1	17.8	13.9	9.6	7.1	**8.2**	**9.2**	**9.4**	*9.9*	*10.0*
Romania	5.8	6.4	7.6	7.2	7.3	6.4	5.8	**6.9**	**8.5**	**7.9**	*8.7*	*8.5*
Sweden	8.5	7.2	7.0	7.7	7.0	6.1	6.2	**8.3**	**9.2**	**8.8**	*10.2*	*10.1*
United Kingdom	9.1	5.8	5.0	4.8	5.4	5.3	5.6	**7.6**	**7.8**	**7.4**	*8.7*	*8.0*
EU	:	8.8	8.8	8.9	8.2	7.1	7.0	**8.9**	**9.8**	**9.7**	*10.3*	*10.2*
USA	6.3	4.5	5.4	5.1	4.6	4.6	5.8	**9.3**	**9.7**	**9.8**	*10.1*	*10.2*
Japan	2.8	4.4	4.8	4.4	4.1	3.9	4.0	**5.1**	**5.3**	**5.3**	*6.3*	*7.0*

[1] Series following Eurostat definition, based on the labour force survey.

TABLE 24 : Compensation of employees per head (percentage change on preceding year, 1992-2011)

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	3.4	2.8	2.5	1.8	3.3	3.5	3.0	**2.0**	**1.6**	**2.1**	*1.7*	*2.0*
Germany	5.4	2.3	1.6	0.5	1.5	1.1	2.0	**0.0**	**0.7**	**1.1**	*1.3*	*1.6*
Ireland	4.5	5.9	5.4	6.1	4.5	4.5	3.9	**-1.6**	**-2.5**	**0.8**	*-1.8*	*1.1*
Greece	10.8	7.0	5.8	4.3	3.1	6.6	5.9	**5.5**	**-0.8**	**0.4**	*1.4*	*1.8*
Spain	6.0	2.5	3.5	3.7	4.0	4.5	6.1	**3.7**	**1.1**	**1.2**	*2.2*	*2.5*
France	2.8	2.1	3.1	3.1	3.2	2.5	2.7	**1.8**	**1.6**	**1.7**	*1.5*	*1.5*
Italy	4.8	2.1	3.1	3.2	2.7	2.4	3.3	**2.2**	**2.0**	**1.7**	*1.6*	*1.9*
Cyprus	:	4.6	3.8	1.8	3.0	3.0	3.4	**5.4**	**3.2**	**3.6**	*1.8*	*2.2*
Luxembourg	3.9	3.2	3.1	4.6	3.3	3.6	2.0	**1.7**	**2.5**	**2.5**	*1.8*	*2.0*
Malta	7.8	4.5	2.9	2.3	3.5	1.8	3.8	**1.3**	**2.2**	**2.3**	*2.1*	*2.2*
Netherlands	2.9	4.1	3.4	1.7	2.4	3.4	3.8	**2.3**	**1.8**	**1.7**	*2.5*	*1.7*
Austria	3.9	1.9	2.3	2.5	3.4	3.0	3.1	**2.4**	**1.6**	**2.1**	*2.0*	*2.6*
Portugal	9.4	5.4	3.3	4.7	2.1	3.4	3.3	**4.3**	**1.6**	**1.6**	*2.0*	*2.0*
Slovenia	:	10.4	7.1	5.6	5.3	6.4	7.0	**3.0**	**2.9**	**3.4**	*1.7*	*3.1*
Slovakia	:	10.3	8.5	9.7	7.7	8.4	5.9	**4.7**	**3.5**	**4.2**	*3.9*	*4.3*
Finland	2.5	3.3	2.9	3.7	2.9	3.7	5.1	**2.4**	**2.6**	**2.1**	*2.7*	*1.9*
Euro area	4.6	2.5	2.6	2.2	2.6	2.6	3.3	**1.9**	**1.3**	**1.5**	*1.6*	*1.8*
Bulgaria	:	80.9	5.8	5.9	7.4	17.9	19.3	**8.7**	**4.7**	**4.0**	*2.5*	*5.1*
Czech Republic	:	7.9	6.5	4.9	5.9	6.3	6.3	**-0.8**	**2.3**	**3.7**	*1.6*	*3.3*
Denmark	3.2	3.8	3.6	3.6	3.5	3.7	4.1	**3.7**	**1.8**	**1.8**	*3.0*	*2.9*
Estonia	:	13.2	11.6	10.8	14.2	24.8	9.8	**-3.0**	**-3.3**	**1.3**	*-2.7*	*1.4*
Latvia	:	7.7	15.0	25.1	23.2	35.1	14.5	**-11.9**	**-8.0**	**1.0**	*-8.0*	*1.0*
Lithuania	:	9.1	10.5	11.5	16.7	13.9	12.9	**-7.5**	**-2.4**	**1.5**	*-5.7*	*0.9*
Hungary	:	12.0	9.4	7.1	5.3	6.7	6.5	**-0.2**	**-0.3**	**3.7**	*0.0*	*3.9*
Poland	37.8	13.8	1.9	1.7	1.8	4.9	8.1	**3.7**	**3.2**	**4.4**	*1.5*	*3.1*
Romania	117.4	71.2	19.6	28.6	12.4	22.0	24.2	**3.1**	**2.3**	**2.5**	*5.5*	*6.0*
Sweden	4.8	4.0	3.1	3.1	2.1	5.1	1.7	**1.7**	**2.1**	**2.5**	*2.1*	*2.3*
United Kingdom	3.6	5.1	3.9	3.3	4.2	4.9	2.6	**1.4**	**1.4**	**1.6**	*1.2*	*2.3*
EU	:	4.1	2.9	2.6	2.7	3.2	3.3	**1.8**	**1.4**	**1.6**	*1.5*	*2.0*
USA	3.0	4.3	3.9	3.5	4.1	3.7	2.6	**0.7**	**1.5**	**0.7**	*0.6*	*0.7*
Japan	1.1	-0.2	-0.7	0.5	0.2	-1.1	-0.4	**-3.1**	**-0.1**	**0.9**	*0.5*	*0.9*

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, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	1.6	1.1	0.3	-0.9	0.3	0.6	-0.7	**2.1**	**0.0**	**0.6**	*0.4*	*0.4*
Germany	2.8	1.3	0.3	-0.8	0.5	-0.7	-0.1	**-0.2**	**-0.3**	**-0.1**	*0.7*	*0.9*
Ireland	1.8	2.0	2.2	4.2	2.0	0.9	0.7	**1.8**	**-1.1**	**-0.1**	*-1.0*	*-0.1*
Greece	-0.7	2.4	2.6	1.0	-0.2	3.5	1.7	**4.2**	**-4.1**	**-1.4**	*0.0*	*-0.1*
Spain	1.0	-0.3	0.2	0.2	0.4	1.2	2.3	**4.4**	**-0.4**	**-0.4**	*1.4*	*0.7*
France	1.1	1.2	1.4	1.3	1.1	0.5	-0.1	**1.9**	**0.3**	**0.2**	*0.4*	*-0.1*
Italy	-0.3	-0.2	0.5	0.9	0.0	0.0	0.1	**2.4**	**0.1**	**-0.2**	*-0.2*	*-0.1*
Cyprus	:	2.1	1.3	-0.6	0.8	-0.7	-1.3	**5.2**	**0.2**	**0.8**	*-1.5*	*-0.6*
Luxembourg	1.0	0.9	1.0	1.7	1.1	1.6	-1.6	**1.7**	**0.4**	**0.6**	*0.1*	*0.3*
Malta	:	2.5	0.9	-0.3	1.1	0.2	0.6	**0.8**	**0.2**	**0.2**	*0.5*	*-0.1*
Netherlands	0.5	1.2	1.3	-0.4	0.3	1.8	1.6	**2.8**	**0.1**	**0.2**	*1.3*	*0.3*
Austria	1.4	0.6	0.5	-0.1	1.3	0.3	0.5	**1.3**	**0.3**	**0.7**	*0.7*	*1.0*
Portugal	3.7	2.5	0.4	1.9	-1.0	0.6	0.6	**6.2**	**0.5**	**0.1**	*0.8*	*0.4*
Slovenia	:	2.8	2.9	3.5	3.0	2.2	1.5	**4.0**	**1.1**	**1.3**	*0.0*	*1.1*
Slovakia	:	2.7	3.5	6.8	2.7	5.6	1.3	**3.6**	**2.0**	**1.4**	*1.5*	*1.5*
Finland	0.6	0.9	2.1	2.9	1.4	1.3	1.6	**1.3**	**1.1**	**0.0**	*1.4*	*0.7*
Euro area	1.4	0.7	0.5	0.1	0.4	0.3	0.4	**2.1**	**0.0**	**0.0**	*0.5*	*0.4*
Bulgaria	:	6.4	1.9	0.7	1.6	10.5	7.4	**6.9**	**3.2**	**2.0**	*1.2*	*3.0*
Czech Republic	:	2.4	5.2	4.1	4.4	3.3	1.3	**-1.1**	**1.6**	**2.5**	*0.2*	*1.7*
Denmark	1.5	1.7	2.0	2.1	1.5	1.6	0.9	**2.4**	**-0.2**	**0.0**	*1.3*	*1.2*
Estonia	:	6.6	8.2	6.9	8.4	16.2	0.6	**-2.2**	**-4.1**	**-0.8**	*-3.2*	*-0.7*
Latvia	:	3.4	9.2	15.0	16.3	22.5	-1.0	**-14.6**	**-4.9**	**1.6**	*-4.5*	*2.2*
Lithuania	:	6.2	9.6	9.7	12.1	7.0	2.9	**-11.5**	**-2.9**	**0.2**	*-4.6*	*0.4*
Hungary	:	0.3	5.3	3.2	1.9	0.5	0.9	**-4.5**	**-4.3**	**1.4**	*-4.0*	*1.3*
Poland	4.7	4.4	-0.1	-0.4	0.6	2.4	3.8	**1.0**	**0.8**	**1.8**	*-0.5*	*1.0*
Romania	0.0	7.7	6.8	20.3	7.2	16.5	13.5	**-0.1**	**-1.6**	**-0.8**	*1.8*	*2.5*
Sweden	1.7	2.6	1.7	1.9	1.1	3.9	-1.1	**-0.5**	**0.2**	**0.6**	*0.2*	*0.3*
United Kingdom	0.2	3.2	1.8	0.9	1.5	1.9	-0.5	**0.0**	**-1.0**	**0.2**	*-0.2*	*0.7*
EU	:	1.6	0.8	0.5	0.4	0.7	0.2	**1.4**	**-0.2**	**0.0**	*0.3*	*0.4*
USA	0.7	2.5	1.6	0.5	1.3	1.0	-0.8	**0.5**	**0.4**	**0.3**	*0.3*	*0.7*
Japan	0.5	0.1	0.1	1.3	0.4	-0.5	-0.9	**-1.0**	**1.4**	**1.1**	*1.4*	*0.9*

[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, 1992-2011)

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	1.4	1.3	1.3	0.4	1.6	1.3	-0.8	**-2.6**	**2.2**	**1.4**	*2.0*	*1.4*
Germany	2.8	2.0	1.7	1.3	2.9	0.9	-0.1	**-4.9**	**1.6**	**1.7**	*3.1*	*2.0*
Ireland	3.3	3.3	2.1	1.2	1.0	2.3	-1.9	**1.2**	**2.6**	**2.6**	*2.6*	*2.0*
Greece	0.2	3.1	2.4	1.3	2.4	3.1	1.9	**-0.8**	**-1.1**	**0.3**	*0.5*	*0.9*
Spain	1.8	0.2	0.5	0.4	0.7	0.7	1.5	**3.3**	**2.1**	**0.9**	*1.5*	*1.4*
France	1.6	1.2	1.2	1.3	1.2	0.8	-0.1	**-1.0**	**2.0**	**1.2**	*2.1*	*1.1*
Italy	2.2	0.9	0.1	0.5	0.5	0.5	-1.2	**-2.4**	**1.6**	**1.0**	*1.1*	*1.0*
Cyprus	:	2.6	0.2	0.3	2.3	1.8	1.0	**-1.1**	**0.3**	**1.5**	*0.2*	*0.7*
Luxembourg	0.1	1.5	1.4	2.5	1.9	2.0	-4.5	**-4.3**	**1.9**	**1.7**	*2.4*	*1.8*
Malta	3.5	2.6	1.3	2.3	2.2	0.6	-0.4	**-1.3**	**0.8**	**1.0**	*0.4*	*1.0*
Netherlands	1.4	1.4	1.8	2.1	1.7	1.3	0.8	**-3.1**	**3.0**	**2.0**	*2.4*	*2.5*
Austria	1.8	1.8	1.6	1.2	2.4	2.0	0.2	**-2.7**	**1.5**	**1.4**	*1.8*	*1.2*
Portugal	2.7	1.6	0.7	1.2	0.9	1.9	-0.4	**-0.1**	**1.0**	**0.7**	*0.8*	*0.9*
Slovenia	:	4.0	3.7	4.7	4.2	3.7	0.7	**-5.8**	**3.5**	**2.3**	*3.4*	*2.3*
Slovakia	:	3.8	4.9	5.2	6.1	8.3	3.3	**-2.4**	**4.7**	**2.4**	*1.9*	*2.0*
Finland	3.7	2.3	2.1	1.5	2.5	2.7	-0.3	**-4.9**	**3.6**	**1.7**	*3.4*	*1.5*
Euro area	2.1	1.5	1.2	1.1	1.7	1.1	0.0	**-2.0**	**1.8**	**1.3**	*2.1*	*1.5*
Bulgaria	-3.1	4.4	3.3	3.5	2.9	3.3	2.7	**-2.2**	**1.2**	**2.0**	*0.3*	*2.2*
Czech Republic	:	2.1	4.1	5.2	4.8	3.4	1.2	**-3.1**	**3.6**	**2.1**	*2.2*	*2.0*
Denmark	2.5	1.4	1.5	1.4	1.3	-1.2	-2.2	**-1.3**	**3.6**	**1.9**	*3.7*	*1.9*
Estonia	:	8.6	6.3	7.3	4.3	6.4	-3.7	**-4.6**	**3.7**	**2.2**	*2.4*	*2.6*
Latvia	-1.5	6.2	6.3	8.9	7.0	6.2	-5.4	**-5.1**	**4.0**	**2.5**	*1.7*	*2.2*
Lithuania	-5.8	6.9	5.9	5.2	5.9	6.9	3.3	**-8.7**	**3.2**	**3.0**	*-1.5*	*2.7*
Hungary	:	1.3	4.5	3.8	3.3	1.3	1.9	**-2.8**	**0.9**	**2.0**	*0.3*	*2.1*
Poland	:	5.5	3.6	1.4	2.9	2.3	1.2	**1.3**	**2.7**	**2.7**	*2.9*	*3.1*
Romania	4.3	1.7	9.0	5.8	7.1	5.9	7.6	**-6.2**	**2.5**	**2.6**	*-0.3*	*1.7*
Sweden	3.1	1.8	3.0	3.0	2.5	0.4	-1.1	**-2.9**	**2.7**	**2.2**	*3.2*	*2.1*
United Kingdom	2.5	2.1	1.6	1.1	2.0	1.9	-0.2	**-3.4**	**1.5**	**1.5**	*1.8*	*0.5*
EU	:	2.0	2.1	1.7	2.2	1.6	0.4	**-2.2**	**1.9**	**1.6**	*2.0*	*1.5*
USA	1.5	2.0	2.1	1.7	0.6	1.0	0.9	**1.4**	**3.2**	**1.9**	*2.8*	*1.6*
Japan	0.9	1.1	1.9	1.5	1.6	2.0	-0.8	**-3.6**	**3.1**	**1.7**	*2.3*	*0.6*

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, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	2.0	1.5	1.2	1.4	1.7	2.2	3.9	**4.7**	**-0.5**	**0.8**	*-0.2*	*0.6*
Germany	2.5	0.3	-0.1	-0.8	-1.4	0.2	2.2	**5.2**	**-0.9**	**-0.7**	*-1.8*	*-0.4*
Ireland	1.2	2.5	3.2	4.8	3.5	2.2	5.9	**-2.7**	**-5.0**	**-1.7**	*-4.2*	*-0.9*
Greece	10.6	3.7	3.3	3.0	0.7	3.5	3.9	**6.3**	**0.3**	**0.1**	*0.9*	*0.9*
Spain	4.1	2.3	3.0	3.3	3.3	3.8	4.6	**0.4**	**-1.0**	**0.3**	*0.6*	*1.1*
France	1.1	0.8	1.9	1.8	2.0	1.8	2.8	**2.8**	**-0.4**	**0.5**	*-0.6*	*0.4*
Italy	2.6	1.2	3.0	2.7	2.2	1.8	4.5	**4.7**	**0.4**	**0.7**	*0.5*	*0.9*
Cyprus	:	1.9	3.5	1.4	0.6	1.1	2.4	**6.6**	**2.9**	**2.1**	*1.6*	*1.5*
Luxembourg	3.8	1.7	1.7	2.1	1.4	1.6	6.8	**6.3**	**0.5**	**0.7**	*-0.6*	*0.2*
Malta	4.2	1.9	1.6	0.0	1.2	1.2	4.2	**2.6**	**1.4**	**1.3**	*1.7*	*1.2*
Netherlands	1.5	2.7	1.6	-0.4	0.7	2.1	2.9	**5.6**	**-1.1**	**-0.3**	*0.1*	*-0.8*
Austria	2.0	0.1	0.6	1.2	1.0	1.0	2.9	**5.3**	**0.1**	**0.7**	*0.2*	*1.3*
Portugal	6.5	3.8	2.5	3.4	1.3	1.4	3.7	**4.5**	**0.6**	**0.9**	*1.2*	*1.0*
Slovenia	:	6.2	3.3	0.9	1.0	2.6	6.2	**9.3**	**-0.6**	**1.0**	*-1.6*	*0.8*
Slovakia	:	6.3	3.4	4.2	1.5	0.1	2.5	**7.2**	**-1.1**	**1.7**	*2.0*	*2.3*
Finland	-1.2	1.0	0.8	2.2	0.3	0.9	5.5	**7.7**	**-1.0**	**0.4**	*-0.7*	*0.5*
Euro area	2.5	1.1	1.6	1.3	1.1	1.6	3.4	**4.0**	**-0.6**	**0.1**	*-0.5*	*0.3*
Bulgaria	:	73.3	2.5	2.4	4.4	14.2	16.2	**11.1**	**3.5**	**1.9**	*2.2*	*2.8*
Czech Republic	:	5.7	2.4	-0.3	1.1	2.9	5.1	**2.4**	**-1.2**	**1.6**	*-0.7*	*1.3*
Denmark	0.6	2.3	2.1	2.2	2.2	4.9	6.5	**5.1**	**-1.7**	**-0.1**	*-0.7*	*1.0*
Estonia	:	4.3	5.0	3.3	9.4	17.3	14.1	**1.7**	**-6.7**	**-0.9**	*-5.0*	*-1.2*
Latvia	:	1.3	8.2	14.8	15.2	27.2	21.0	**-7.1**	**-11.5**	**-1.5**	*-9.5*	*-1.2*
Lithuania	:	2.1	4.4	6.0	10.1	6.5	9.3	**1.2**	**-5.5**	**-1.4**	*-4.3*	*-1.8*
Hungary	:	10.7	4.7	3.2	1.9	5.4	4.5	**2.7**	**-1.2**	**1.7**	*-0.3*	*1.7*
Poland	:	7.9	-1.7	0.3	-1.1	2.6	6.9	**2.4**	**0.5**	**1.7**	*-1.4*	*0.0*
Romania	108.4	68.5	9.7	21.6	4.9	15.2	15.4	**9.9**	**-0.2**	**-0.1**	*5.8*	*4.3*
Sweden	1.6	2.1	0.0	0.1	-0.4	4.7	2.8	**4.8**	**-0.5**	**0.3**	*-1.1*	*0.2*
United Kingdom	1.1	2.9	2.2	2.1	2.2	3.0	2.7	**4.9**	**-0.1**	**0.2**	*-0.6*	*1.7*
EU	:	2.2	1.7	1.6	1.3	2.2	3.6	**4.2**	**-0.5**	**0.2**	*-0.5*	*0.6*
USA	1.5	2.3	1.8	1.8	3.5	2.7	1.7	**-0.7**	**-1.6**	**-1.1**	*-2.1*	*-0.9*
Japan	0.2	-1.3	-2.5	-1.1	-1.4	-3.0	0.4	**0.5**	**-3.1**	**-0.8**	*-1.8*	*0.3*

[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, 1992-2011)

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	-0.2	0.1	-0.9	-0.9	-0.5	-0.1	2.0	**3.6**	**-2.1**	**-1.0**	*-1.6*	*-1.0*
Germany	-0.2	-0.1	-1.0	-1.4	-1.9	-1.7	0.7	**3.6**	**-1.1**	**-1.5**	*-2.4*	*-0.9*
Ireland	-1.7	-2.5	0.1	2.4	0.0	0.9	7.2	**0.5**	**-3.4**	**-2.5**	*-3.4*	*-2.0*
Greece	-0.8	-0.5	0.1	0.1	-2.3	0.5	0.3	**5.0**	**-2.6**	**-1.6**	*-0.5*	*-1.3*
Spain	-0.6	-0.7	-1.2	-0.9	-0.8	0.5	2.0	**0.2**	**-1.3**	**-0.7**	*0.1*	*-0.3*
France	-0.4	-0.2	-0.1	-0.3	-0.3	-0.7	0.3	**2.0**	**-1.2**	**-1.0**	*-1.8*	*-1.3*
Italy	-1.6	-1.2	0.4	0.6	0.3	-0.7	1.7	**2.5**	**-0.9**	**-1.2**	*-1.3*	*-0.9*
Cyprus	:	-1.1	0.6	-0.9	-2.3	-3.4	-2.3	**6.6**	**0.8**	**-0.3**	*-1.6*	*-1.5*
Luxembourg	0.1	0.7	-2.5	-2.4	-5.0	-1.4	1.7	**7.0**	**-2.2**	**-2.2**	*-3.7*	*-2.5*
Malta	1.2	-0.2	-1.1	-2.5	-1.9	-1.6	1.9	**0.4**	**-0.3**	**-0.8**	*-0.6*	*-1.1*
Netherlands	-0.4	-0.4	-0.6	-2.7	-1.1	0.5	0.2	**5.9**	**-2.1**	**-1.9**	*-0.8*	*-2.2*
Austria	-0.3	-0.6	-0.9	-0.9	-0.7	-1.1	0.8	**3.3**	**-0.5**	**-1.0**	*-0.7*	*-0.3*
Portugal	0.6	0.2	-0.4	0.8	-1.5	-1.5	1.6	**3.3**	**-0.5**	**-0.7**	*0.4*	*-0.6*
Slovenia	:	-1.0	-0.8	-0.7	-1.0	-1.5	2.3	**7.2**	**-0.7**	**-0.7**	*-2.7*	*-1.1*
Slovakia	:	-0.3	-0.6	1.8	-1.4	-1.0	-0.3	**8.5**	**-2.3**	**-1.2**	*-1.0*	*-0.6*
Finland	-2.8	-1.3	0.3	1.7	-0.5	-2.3	4.0	**7.0**	**-2.3**	**-1.6**	*-2.1*	*-1.1*
Euro area	-0.6	-0.5	-0.6	-0.8	-0.9	-0.8	1.1	**2.9**	**-1.2**	**-1.2**	*-1.5*	*-1.0*
Bulgaria	:	0.4	-2.1	-1.3	-3.8	5.9	4.3	**6.2**	**2.0**	**-0.2**	*0.3*	*0.2*
Czech Republic	:	0.0	0.5	0.0	0.0	-0.5	3.2	**-0.3**	**-1.3**	**0.9**	*-2.0*	*-0.4*
Denmark	-0.8	0.3	-0.2	-0.7	0.1	2.9	2.8	**4.7**	**-2.8**	**-1.7**	*-1.8*	*-1.2*
Estonia	:	-2.0	0.1	-2.1	1.7	6.4	6.9	**2.3**	**-5.7**	**-2.8**	*-2.0*	*-3.1*
Latvia	:	-2.8	1.3	4.2	4.9	5.8	4.9	**-6.4**	**-5.6**	**-0.5**	*-4.8*	*0.1*
Lithuania	:	-0.7	1.4	-0.6	3.4	-1.8	-0.3	**3.7**	**-3.5**	**-2.6**	*-2.9*	*-2.1*
Hungary	:	-1.1	-0.1	1.1	-1.9	-0.5	0.7	**-2.2**	**-3.6**	**-0.6**	*-2.8*	*-0.1*
Poland	:	-0.4	-3.8	-2.3	-2.5	-1.3	3.8	**-1.2**	**-1.7**	**-0.7**	*-2.8*	*-2.6*
Romania	-3.1	3.7	-6.0	8.4	-5.1	1.5	0.2	**7.0**	**-4.6**	**-4.0**	*0.5*	*-0.7*
Sweden	-0.6	0.7	-1.3	-0.8	-2.1	1.7	-0.4	**2.9**	**-2.9**	**-1.8**	*-3.3*	*-1.8*
United Kingdom	-1.7	0.8	-0.5	0.1	-0.6	0.1	-0.2	**3.5**	**-2.5**	**-1.3**	*-2.2*	*-0.3*
EU	:	-0.3	-0.9	-0.6	-1.2	-0.6	0.8	**2.9**	**-1.5**	**-1.3**	*-1.6*	*-1.0*
USA	-0.6	0.5	-0.8	-1.5	0.2	-0.2	-0.5	**-1.8**	**-1.8**	**-1.2**	*-2.1*	*-0.8*
Japan	0.0	-0.5	-1.2	0.2	-0.5	-2.3	1.3	**1.5**	**-2.0**	**-1.5**	*-0.8*	*0.8*

[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 (1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	39.91	40.43	:	:	:	:	:	:	:	:	:	:
Germany	1.93	1.96	:	:	:	:	:	:	:	:	:	:
Ireland	0.79	0.78	:	:	:	:	:	:	:	:	:	:
Greece	282.43	328.65	:	:	:	:	:	:	:	:	:	:
Spain	152.86	166.45	:	:	:	:	:	:	:	:	:	:
France	6.62	6.58	:	:	:	:	:	:	:	:	:	:
Italy	1888.18	1936.35	:	:	:	:	:	:	:	:	:	:
Cyprus	0.59	0.58	0.58	0.58	0.58	0.58	:	:	:	:	:	:
Luxembourg	39.91	40.43	:	:	:	:	:	:	:	:	:	:
Malta	0.45	0.42	0.42	0.43	0.43	0.43	:	:	:	:	:	:
Netherlands	2.17	2.21	:	:	:	:	:	:	:	:	:	:
Austria	13.60	13.79	:	:	:	:	:	:	:	:	:	:
Portugal	190.37	200.35	:	:	:	:	:	:	:	:	:	:
Slovenia	143.42	197.20	235.62	239.57	239.60	:	:	:	:	:	:	:
Slovakia	:	41.54	40.01	38.60	37.23	33.77	31.24	:	:	:	:	:
Finland	6.05	5.94	:	:	:	:	:	:	:	:	:	:
Euro area	:	:	:	:	:	:	:	:	:	:	:	:
Bulgaria	0.09	1.95	1.95	1.96	1.96	1.96	1.96	**1.96**	**1.96**	**1.96**	*1.96*	*1.96*
Czech Republic	34.86	35.71	30.53	29.78	28.34	27.77	24.95	**26.43**	**25.40**	**25.25**	*25.79*	*25.79*
Denmark	7.53	7.46	7.44	7.45	7.46	7.45	7.46	**7.45**	**7.44**	**7.44**	*7.44*	*7.44*
Estonia	15.36	15.68	15.65	15.65	15.65	15.65	15.65	**15.65**	**15.65**	**15.65**	*15.65*	*15.65*
Latvia	0.75	0.61	0.66	0.70	0.70	0.70	0.70	**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	248.05	264.26	251.35	251.51	**280.33**	**266.24**	**265.49**	*268.36*	*268.36*
Poland	2.88	3.91	4.14	4.02	3.90	3.78	3.51	**4.33**	**3.89**	**3.85**	*4.22*	*4.22*
Romania	0.20	1.61	3.62	3.62	3.53	3.34	3.68	**4.24**	**4.12**	**4.12**	*4.28*	*4.28*
Sweden	8.73	8.81	9.19	9.28	9.25	9.25	9.62	**10.62**	**9.77**	**9.71**	*10.33*	*10.33*
United Kingdom	0.79	0.65	0.67	0.68	0.68	0.68	0.80	**0.89**	**0.88**	**0.88**	*0.92*	*0.92*
EU	:	:	:	:	:	:	:	:	:	:	:	:
USA	1.25	1.03	1.16	1.24	1.26	1.37	1.47	**1.39**	**1.36**	**1.35**	*1.48*	*1.48*
Japan	135.36	122.59	133.27	136.85	146.02	161.25	152.45	**130.34**	**125.85**	**125.98**	*132.82*	*132.82*

TABLE 30 : Nominal effective exchange rates to rest of a group [1] of industrialised countries (percentage change on preceding year, 1997-2011)

	5-year averages						Spring 2010 forecast			*Autumn 2009 forecast*	
	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	-1.1	1.4	-0.3	0.4	1.2	1.8	**1.0**	**-1.6**	**-0.2**	*0.7*	*0.0*
Germany	-1.0	1.8	-0.6	0.5	1.8	1.8	**1.3**	**-2.4**	**-0.3**	*0.8*	*0.0*
Ireland	-1.8	2.4	-0.1	0.6	2.6	4.0	**0.8**	**-2.0**	**-0.3**	*1.7*	*0.0*
Greece	0.3	1.7	-0.8	0.6	0.9	2.0	**1.9**	**-1.6**	**-0.2**	*0.6*	*0.0*
Spain	-1.1	1.4	-0.4	0.4	1.3	2.0	**1.2**	**-1.7**	**-0.2**	*0.7*	*0.0*
France	-1.0	1.7	-0.3	0.6	1.6	2.1	**0.8**	**-1.9**	**-0.2**	*0.9*	*0.0*
Italy	0.1	1.9	-0.6	0.6	1.6	1.9	**0.9**	**-2.1**	**-0.2**	*0.8*	*0.0*
Cyprus	5.0	1.6	0.7	0.6	-0.3	2.2	**1.8**	**-1.4**	**-0.1**	*0.7*	*0.0*
Luxembourg	-1.1	1.4	-0.3	0.4	1.2	1.8	**1.0**	**-1.6**	**-0.2**	*0.7*	*0.0*
Malta	0.4	1.3	-0.4	1.0	3.1	2.2	**-1.2**	**-2.1**	**-0.2**	*1.5*	*0.0*
Netherlands	-1.0	1.2	-0.3	0.3	1.1	2.0	**1.4**	**-1.6**	**-0.2**	*0.6*	*0.0*
Austria	-0.1	1.1	-0.7	0.3	1.0	0.9	**1.2**	**-1.8**	**-0.2**	*0.4*	*0.0*
Portugal	-1.1	1.1	-0.2	0.3	1.1	1.6	**0.6**	**-1.2**	**-0.1**	*0.7*	*0.0*
Slovenia	-3.9	-1.1	-1.1	0.2	0.3	0.5	**2.0**	**-1.6**	**-0.2**	*0.1*	*0.0*
Slovakia	-1.3	3.6	2.4	3.7	10.4	8.7	**6.5**	**-1.8**	**-0.2**	*0.0*	*0.0*
Finland	-1.0	1.7	-0.4	0.5	1.6	1.9	**1.5**	**-2.7**	**-0.3**	*0.5*	*0.0*
Euro area	-1.7	3.6	-1.0	1.2	3.5	4.2	**2.8**	**-4.5**	**-0.5**	*1.6*	*0.0*
Bulgaria	-32.2	1.7	-1.2	0.8	0.6	1.8	**2.6**	**-1.9**	**-0.2**	*0.5*	*0.0*
Czech Republic	0.8	4.5	6.2	5.2	2.3	12.2	**-3.7**	**2.4**	**0.5**	*2.6*	*0.0*
Denmark	-1.0	1.4	-0.5	0.3	1.4	2.2	**2.2**	**-2.7**	**-0.3**	*0.3*	*0.0*
Estonia	-0.4	1.0	-0.1	0.2	1.1	1.4	**2.2**	**-2.3**	**-0.2**	*0.2*	*0.0*
Latvia	4.3	-3.4	-5.0	0.0	0.0	0.9	**2.3**	**-2.4**	**-0.1**	*-0.3*	*0.0*
Lithuania	8.3	2.1	-0.6	0.1	0.8	1.0	**2.7**	**-2.1**	**-0.2**	*0.2*	*0.0*
Hungary	-4.7	0.3	0.7	-6.1	5.4	0.9	**-8.4**	**3.6**	**0.1**	*4.6*	*0.0*
Poland	-1.1	-0.5	12.1	3.5	3.4	9.2	**-17.7**	**9.8**	**0.7**	*3.1*	*0.0*
Romania	-30.1	-4.7	11.2	3.6	6.2	-8.3	**-11.4**	**1.3**	**-0.2**	*-0.6*	*0.0*
Sweden	-2.5	1.8	-2.4	0.8	1.7	-1.8	**-8.5**	**6.1**	**0.4**	*3.4*	*0.0*
United Kingdom	4.8	0.2	-1.2	1.0	1.9	-12.9	**-11.5**	**-1.3**	**-0.1**	*-2.2*	*0.0*
EU	-0.8	5.2	-0.8	2.8	6.6	1.5	**-5.4**	**-4.5**	**-0.5**	*2.3*	*0.0*
USA	5.0	-3.9	-2.0	-0.8	-5.0	-4.3	**6.3**	**-3.5**	**0.1**	*-5.9*	*0.0*
Japan	1.5	-2.4	-2.4	-5.8	-5.9	11.3	**15.9**	**-0.3**	**-0.6**	*0.0*	*0.0*

[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, 1997-2011) 20.04.2010

	5-year averages						Spring 2010 forecast			*Autumn 2009 forecast*	
	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	-0.7	-0.4	0.2	0.4	0.2	0.6	**1.1**	**0.2**	**0.6**	*0.5*	:
Germany	-2.8	-1.9	-2.6	-3.4	-2.3	-1.5	**1.9**	**-0.2**	**-1.1**	*-1.3*	:
Ireland	0.3	1.6	3.4	1.7	0.0	2.9	**-5.7**	**-4.3**	**-1.8**	*-3.4*	:
Greece	-1.9	1.1	1.0	-1.1	0.4	-0.5	**2.0**	**0.5**	**-0.4**	*1.0*	:
Spain	-0.3	1.1	1.7	1.7	1.6	1.1	**-3.2**	**-0.5**	**-0.1**	*1.2*	:
France	-1.7	0.3	0.3	0.5	-0.4	-0.7	**-0.6**	**0.3**	**0.4**	*0.1*	:
Italy	-2.0	1.3	1.1	0.6	-0.5	1.0	**1.4**	**1.1**	**0.4**	*1.3*	:
Cyprus	-6.4	1.6	-0.4	-1.0	-1.4	-1.3	**2.1**	**3.4**	**1.8**	*1.9*	:
Luxembourg	:	:	:	:	:	:	**:**	**:**	**:**	*:*	:
Malta	-0.1	0.2	-1.3	-0.4	-0.3	1.4	**-0.2**	**2.4**	**1.4**	*2.8*	:
Netherlands	0.6	0.2	-1.6	-0.5	0.1	-0.4	**1.9**	**-0.4**	**-0.5**	*1.0*	:
Austria	-2.5	-0.8	0.0	-0.1	-1.0	-0.7	**1.4**	**0.8**	**0.5**	*1.0*	:
Portugal	1.7	0.7	1.7	-0.6	-0.9	0.2	**1.5**	**1.4**	**0.7**	*1.7*	:
Slovenia	3.2	1.7	-0.5	-0.1	0.5	2.2	**4.9**	**-0.1**	**0.7**	*-1.1*	:
Slovakia	2.9	2.1	3.3	0.7	-2.0	-1.2	**3.0**	**-0.5**	**1.4**	*2.7*	:
Finland	-1.6	-0.6	0.8	-1.2	-1.7	1.7	**4.2**	**0.0**	**0.2**	*0.2*	:
Euro area	-3.7	-0.5	-1.0	-1.6	-1.8	-0.7	**1.9**	**0.1**	**-0.5**	*0.1*	:
Bulgaria	61.7	-0.4	0.3	2.5	10.8	11.1	**6.5**	**3.7**	**1.3**	*2.1*	:
Czech Republic	2.9	1.1	-1.3	0.3	0.9	1.5	**-1.7**	**-0.6**	**1.4**	*0.1*	:
Denmark	0.1	0.8	1.0	0.8	2.4	2.9	**1.4**	**-1.0**	**-0.3**	*0.1*	:
Estonia	1.2	3.3	1.2	7.2	13.0	8.4	**-1.7**	**-5.1**	**-1.1**	*-3.7*	:
Latvia	-1.8	6.5	13.1	13.0	23.3	15.4	**-10.5**	**-10.3**	**-1.6**	*-8.5*	:
Lithuania	-1.9	2.4	3.8	7.7	2.1	3.6	**-1.7**	**-3.8**	**-1.6**	*-2.9*	:
Hungary	7.3	3.3	1.8	0.9	3.1	0.5	**-1.5**	**-0.6**	**1.4**	*0.2*	:
Poland	5.2	-3.2	-0.9	-2.3	0.3	3.0	**-1.7**	**1.3**	**1.5**	*-0.7*	:
Romania	61.2	7.3	19.6	3.2	12.3	10.9	**5.6**	**0.1**	**-0.7**	*6.0*	:
Sweden	-0.6	-1.6	-1.5	-2.3	2.0	-1.0	**1.1**	**0.3**	**-0.1**	*-0.5*	:
United Kingdom	0.5	0.6	0.7	0.4	0.9	-0.5	**2.3**	**1.0**	**0.2**	*0.4*	:
EU	-3.2	-0.5	-0.5	-1.9	-0.4	0.3	**3.1**	**0.3**	**-0.4**	*0.1*	:
USA	-0.7	0.1	0.4	1.1	0.7	-1.9	**-4.0**	**-1.3**	**-1.9**	*-1.6*	:
Japan	-3.6	-4.3	-2.8	-3.9	-5.4	-2.5	**-1.6**	**-2.4**	**-0.7**	*-0.7*	:

[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, 1997-2011)

	5-year averages						Spring 2010 forecast			*Autumn 2009 forecast*	
	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	-1.9	1.0	-0.1	0.8	1.4	2.5	**2.1**	**-1.4**	**0.4**	*1.2*	:
Germany	-3.8	-0.1	-3.2	-2.8	-0.6	0.3	**3.3**	**-2.6**	**-1.4**	*-0.4*	:
Ireland	-1.5	4.0	3.3	2.3	2.6	7.0	**-4.9**	**-6.2**	**-2.1**	*-1.7*	:
Greece	-1.6	2.8	0.2	-0.6	1.3	1.5	**3.9**	**-1.2**	**-0.5**	*1.6*	:
Spain	-1.3	2.5	1.3	2.1	2.9	3.1	**-2.0**	**-2.2**	**-0.2**	*1.9*	:
France	-2.7	2.0	-0.1	1.1	1.2	1.4	**0.2**	**-1.6**	**0.2**	*1.0*	:
Italy	-1.9	3.2	0.5	1.2	1.1	2.9	**2.4**	**-1.0**	**0.2**	*2.1*	:
Cyprus	-1.7	3.2	0.3	-0.4	-1.6	0.8	**4.0**	**1.9**	**1.7**	*2.7*	:
Luxembourg	:	:	:	:	::	:	**:**	**:**	**:**	*:*	:
Malta	0.3	1.5	-1.7	0.6	2.8	3.6	**-1.4**	**0.2**	**1.2**	*4.3*	:
Netherlands	-0.4	1.3	-1.9	-0.2	1.1	1.6	**3.3**	**-2.0**	**-0.6**	*1.7*	:
Austria	-2.6	0.2	-0.7	0.3	-0.1	0.2	**2.6**	**-1.1**	**0.3**	*1.4*	:
Portugal	0.6	1.8	1.5	-0.3	0.2	1.8	**2.2**	**0.1**	**0.6**	*2.4*	:
Slovenia	-0.8	0.5	-1.6	0.1	0.8	2.8	**7.0**	**-1.7**	**0.6**	*-0.9*	:
Slovakia	1.5	5.7	5.8	4.4	8.2	7.3	**9.7**	**-2.3**	**1.3**	*2.7*	:
Finland	-2.7	1.1	0.5	-0.7	-0.2	3.7	**5.8**	**-2.7**	**-0.1**	*0.7*	:
Euro area	-5.3	3.0	-2.0	-0.4	1.6	3.4	**4.7**	**-4.4**	**-1.0**	*1.7*	:
Bulgaria	9.6	1.4	-1.0	3.3	11.4	13.0	**9.3**	**1.7**	**1.1**	*2.5*	:
Czech Republic	3.7	5.7	4.8	5.5	3.2	13.8	**-5.4**	**1.8**	**1.8**	*2.6*	:
Denmark	-0.8	2.2	0.5	1.1	3.9	5.2	**3.7**	**-3.7**	**-0.6**	*0.4*	:
Estonia	0.8	4.3	1.1	7.5	14.3	9.9	**0.5**	**-7.3**	**-1.3**	*-3.5*	:
Latvia	2.5	2.8	7.5	13.1	23.2	16.5	**-8.5**	**-12.4**	**-1.7**	*-8.8*	:
Lithuania	6.3	4.6	3.2	7.8	2.9	4.6	**0.9**	**-5.8**	**-1.8**	*-2.7*	:
Hungary	2.3	3.6	2.5	-5.2	8.7	1.4	**-9.8**	**3.0**	**1.6**	*4.8*	:
Poland	4.1	-3.7	11.0	1.1	3.7	12.5	**-19.1**	**11.2**	**2.2**	*2.3*	:
Romania	12.6	2.3	33.0	6.9	19.3	1.7	**-6.5**	**1.4**	**-0.9**	*5.3*	:
Sweden	-3.1	0.2	-3.8	-1.5	3.7	-2.8	**-7.5**	**6.4**	**0.3**	*2.9*	:
United Kingdom	5.3	0.8	-0.6	1.4	2.8	-13.3	**-9.5**	**-0.3**	**0.1**	*-1.8*	:
EU	-3.9	4.7	-1.2	0.8	6.2	1.8	**-2.5**	**-4.2**	**-0.9**	*2.4*	:
USA	4.3	-3.8	-1.6	0.3	-4.3	-6.1	**2.1**	**-4.8**	**-1.9**	*-7.4*	:
Japan	-2.2	-6.6	-5.1	-9.5	-11.0	8.5	**14.1**	**-2.7**	**-1.3**	*-0.6*	:

[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 : Short term interest rates (1992-2009) 20.04.2010

	5-year averages											
	1992-96	1997-01	2002-06	2001	2002	2003	2004	2005	2006	2007	2008	2009
Belgium	6.2	3.7	2.6	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2
Germany	6.0	3.7	2.6	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2
Ireland	7.8	4.6	2.6	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2
Greece	20.3	9.8	2.6	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2
Spain	10.0	4.2	2.6	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2
France	7.1	3.7	2.6	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2
Italy	10.3	4.7	2.6	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2
Cyprus	:	:	4.1	5.9	4.4	3.9	4.7	4.3	3.4	4.2	4.6	1.2
Luxembourg	:	:	:	:	:	:	:	:	:	4.3	4.6	1.2
Malta	:	5.1	3.4	4.9	4.0	3.3	2.9	3.2	3.5	4.3	4.6	1.2
Netherlands	5.7	3.7	2.6	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2
Austria	5.9	3.7	2.6	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2
Portugal	11.5	4.3	2.6	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2
Slovenia	:	:	5.4	10.9	8.0	6.8	4.7	4.0	3.6	4.3	4.6	1.2
Slovakia	:	15.0	5.2	7.8	7.8	6.2	4.7	2.9	4.3	4.3	4.6	1.2
Finland	7.1	3.7	2.6	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.6	1.2
Euro area	7.9	4.1	2.6	4.3	3.4	2.4	2.2	2.2	3.1	4.3	4.6	1.2
Bulgaria	:	:	3.9	5.1	4.9	3.7	3.7	3.6	3.7	4.9	7.1	5.7
Czech Republic	:	9.5	2.5	5.2	3.5	2.3	2.4	2.0	2.3	3.1	4.0	2.2
Denmark	7.8	4.2	2.7	4.7	3.5	2.4	2.2	2.2	3.2	4.4	5.3	2.5
Estonia	:	8.3	3.0	5.3	3.9	2.9	2.5	2.4	3.2	4.9	6.7	5.9
Latvia	:	7.0	4.0	6.9	4.4	3.8	4.2	3.1	4.4	8.7	8.0	13.1
Lithuania	:	:	3.0	5.9	3.7	2.8	2.7	2.4	3.1	5.1	6.0	7.1
Hungary	:	15.1	8.6	10.9	9.2	8.5	11.5	6.7	7.2	7.9	8.8	9.2
Poland	:	18.7	6.1	16.1	9.0	5.7	6.2	5.3	4.2	4.7	6.4	4.4
Romania	:	64.4	16.1	41.3	27.3	17.7	19.1	8.4	8.1	7.2	12.3	11.4
Sweden	8.9	4.1	2.9	4.1	4.3	3.2	2.3	1.9	2.6	3.9	4.7	0.9
United Kingdom	6.8	6.2	4.4	5.0	4.1	3.7	4.6	4.8	4.9	6.0	5.5	1.2
EU	:	9.0	3.3	5.4	4.1	3.0	3.1	2.9	3.5	4.6	5.1	1.5
USA	4.7	5.4	2.7	3.8	1.8	1.2	1.6	3.6	5.2	5.3	2.9	0.7
Japan	2.3	0.4	0.1	0.2	0.1	0.1	0.1	0.1	0.3	0.8	0.9	0.5

TABLE 34 : Long term interest rates (1992-2009)

	5-year averages											
	1992-96	1997-01	2002-06	2001	2002	2003	2004	2005	2006	2007	2008	2009
Belgium	7.5	5.2	4.1	5.1	5.0	4.2	4.2	3.4	3.8	4.3	4.4	3.9
Germany	6.9	5.0	4.0	4.8	4.8	4.1	4.0	3.4	3.8	4.2	4.0	3.2
Ireland	8.0	5.3	4.1	5.0	5.0	4.1	4.1	3.3	3.8	4.3	4.5	5.2
Greece	19.9	7.2	4.3	5.3	5.1	4.3	4.3	3.6	4.1	4.5	4.8	5.2
Spain	10.4	5.3	4.1	5.1	5.0	4.1	4.1	3.4	3.8	4.3	4.4	4.0
France	7.3	5.0	4.1	4.9	4.9	4.1	4.1	3.4	3.8	4.3	4.2	3.7
Italy	11.3	5.4	4.2	5.2	5.0	4.3	4.3	3.6	4.1	4.5	4.7	4.3
Cyprus	:	7.2	5.1	7.6	5.7	4.7	5.8	5.2	4.1	4.5	4.6	4.6
Luxembourg	7.0	5.1	4.0	4.9	4.7	4.0	4.2	3.4	3.9	4.6	4.6	4.2
Malta	:	:	4.9	6.2	5.8	5.0	4.7	4.6	4.3	4.7	4.8	4.5
Netherlands	6.9	5.0	4.1	5.0	4.9	4.1	4.1	3.4	3.8	4.3	4.2	3.7
Austria	6.9	5.1	4.1	5.1	5.0	4.2	4.2	3.4	3.8	4.3	4.3	3.7
Portugal	10.8	5.4	4.1	5.2	5.0	4.2	4.1	3.4	3.9	4.4	4.5	4.2
Slovenia	:	:	5.5	:	8.7	6.4	4.7	3.8	3.9	4.5	4.6	4.4
Slovakia	:	:	5.0	8.0	6.9	5.0	5.0	3.5	4.4	4.5	4.7	4.7
Finland	9.1	5.2	4.1	5.0	5.0	4.1	4.1	3.4	3.8	4.3	4.3	3.7
Euro area	8.6	5.2	4.1	5.0	4.9	4.2	4.1	3.4	3.8	4.3	4.3	3.2
Bulgaria	:	:	5.6	:	8.3	6.5	5.4	3.9	4.2	4.5	5.4	7.2
Czech Republic	:	:	4.2	6.3	4.9	4.1	4.8	3.5	3.8	4.3	4.6	4.8
Denmark	7.9	5.4	4.2	5.1	5.1	4.3	4.3	3.4	3.8	4.3	4.3	3.6
Estonia	:	:	5.4	10.2	8.4	5.3	4.4	4.2	5.0	6.1	8.2	7.8
Latvia	:	:	4.6	7.6	5.4	4.9	4.9	3.9	4.1	5.3	6.4	12.4
Lithuania	:	:	4.7	8.2	6.1	5.3	4.5	3.7	4.1	4.6	5.6	14.0
Hungary	:	:	7.2	8.0	7.1	6.8	8.2	6.6	7.1	6.7	8.2	9.1
Poland	:	:	6.1	10.7	7.4	5.8	6.9	5.2	5.2	5.5	6.1	6.1
Romania	:	:	:	:	:	:	:	:	7.2	7.1	7.7	9.7
Sweden	9.3	5.4	4.3	5.1	5.3	4.6	4.4	3.4	3.7	4.2	3.9	3.3
United Kingdom	8.2	5.6	4.7	5.0	4.9	4.6	4.9	4.5	4.4	5.1	4.5	3.4
EU	:	:	:	:	:	:	:	:	4.1	4.6	4.5	4.0
USA	6.7	5.7	4.4	5.0	4.6	4.0	4.3	4.3	4.8	4.6	3.7	3.2
Japan	4.0	1.7	1.4	1.3	1.3	1.0	1.5	1.4	1.7	1.7	1.5	1.4

TABLE 35 : Total expenditure, general government (as a percentage of GDP, 1992-2011) [1] 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	52.8	50.0	50.1	52.1	48.5	48.4	50.0	**54.2**	**53.7**	**53.9**	*53.8*	*54.0*
Germany	47.8	47.4	47.2	46.8	45.3	43.7	43.7	**47.6**	**48.0**	**47.2**	*48.3*	*47.5*
Ireland	39.3	34.0	33.7	34.0	34.4	36.6	42.0	**48.4**	**47.1**	**46.0**	*49.1*	*48.4*
Greece	43.4	45.1	44.3	43.7	42.9	44.7	46.8	**50.5**	**48.4**	**48.4**	*49.4*	*49.8*
Spain	44.6	40.0	38.6	38.4	38.4	39.2	41.1	**45.9**	**45.7**	**44.7**	*45.6*	*45.3*
France	53.3	52.5	53.0	53.3	52.7	52.3	52.8	**55.6**	**56.1**	**55.9**	*55.1*	*54.8*
Italy	53.2	48.3	48.0	48.1	48.7	47.9	48.9	**51.9**	**51.3**	**50.5**	*50.8*	*50.5*
Cyprus	:	37.0	43.0	43.6	43.4	42.2	42.6	**46.4**	**48.3**	**49.0**	*47.8*	*48.0*
Luxembourg	:	39.3	41.1	41.5	38.3	36.2	37.2	**42.4**	**43.2**	**42.9**	*43.9*	*43.6*
Malta	:	42.6	45.0	44.8	43.7	42.4	44.8	**44.3**	**46.0**	**45.5**	*46.3*	*46.4*
Netherlands	52.0	45.9	45.9	44.8	45.5	45.5	45.9	**51.6**	**52.3**	**51.7**	*50.9*	*50.7*
Austria	53.7	52.9	51.1	50.1	49.4	48.5	48.9	**51.8**	**52.5**	**52.2**	*52.6*	*52.4*
Portugal	41.4	43.3	46.0	47.7	46.3	45.7	46.1	**51.0**	**51.0**	**50.9**	*51.5*	*52.0*
Slovenia	:	46.3	45.7	45.2	44.5	42.4	44.3	**49.9**	**50.7**	**49.9**	*50.2*	*49.9*
Slovakia	:	47.9	39.6	38.0	36.9	34.4	34.8	**40.8**	**40.3**	**39.3**	*37.5*	*36.9*
Finland	59.8	51.4	49.5	50.0	48.9	47.3	49.4	**55.3**	**55.9**	**55.3**	*55.0*	*55.0*
Euro area	50.1	47.7	47.4	47.3	46.6	46.0	46.8	**50.7**	**50.8**	**50.2**	*50.5*	*50.2*
Bulgaria	:	:	39.2	39.3	36.5	41.5	37.3	**40.7**	**39.7**	**39.1**	*39.5*	*38.7*
Czech Republic	:	43.0	45.5	45.0	43.8	42.5	42.9	**46.2**	**47.0**	**47.4**	*46.5*	*46.6*
Denmark	59.0	55.2	53.5	52.6	51.5	50.9	51.9	**58.5**	**59.2**	**58.1**	*57.6*	*56.4*
Estonia	:	37.5	34.4	33.6	34.0	34.8	39.9	**45.4**	**45.8**	**44.1**	*46.7*	*45.4*
Latvia	:	38.0	36.0	35.5	38.1	35.7	38.6	**43.0**	**44.8**	**44.4**	*45.7*	*45.1*
Lithuania	:	41.1	33.6	33.3	33.6	34.8	37.4	**43.0**	**42.5**	**41.7**	*46.0*	*46.0*
Hungary	:	49.1	50.3	50.1	51.9	49.8	49.2	**49.8**	**48.8**	**48.1**	*49.4*	*49.0*
Poland	:	43.7	43.8	43.4	43.9	42.2	43.3	**44.5**	**46.0**	**46.2**	*46.1*	*45.9*
Romania	:	36.8	34.1	33.5	35.3	36.0	37.6	**40.4**	**39.9**	**38.8**	*38.6*	*37.9*
Sweden	64.4	57.9	55.5	55.0	54.0	52.5	53.1	**56.3**	**55.9**	**54.8**	*55.6*	*54.6*
United Kingdom	42.2	39.2	42.9	44.1	44.0	44.2	47.4	**51.7**	**52.6**	**51.3**	*52.1*	*50.7*
EU	:	46.7	46.8	46.8	46.3	45.7	46.9	**50.7**	**51.0**	**50.3**	*50.6*	*50.1*
USA	36.5	34.6	36.1	36.3	36.0	36.7	38.8	**39.8**	**39.3**	**40.0**	*41.2*	*41.7*
Japan	:	38.9	37.8	38.4	36.2	36.0	37.3	**42.6**	**43.0**	**42.9**	*44.0*	*44.7*

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 36 : Total revenue, general government (as a percentage of GDP, 1992-2011) [1]

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	47.5	49.3	49.6	49.4	48.7	48.2	48.8	**48.2**	**48.7**	**48.8**	*48.0*	*48.2*
Germany	44.8	45.9	43.9	43.5	43.7	43.9	43.7	**44.3**	**43.1**	**42.5**	*43.3*	*42.9*
Ireland	37.7	36.4	34.9	35.5	37.4	36.7	34.7	**34.1**	**35.4**	**33.9**	*34.4*	*33.8*
Greece	33.8	40.9	39.0	38.5	39.3	39.7	39.1	**36.9**	**39.0**	**38.5**	*37.2*	*37.0*
Spain	39.1	38.1	39.0	39.4	40.4	41.1	37.0	**34.7**	**35.9**	**35.9**	*35.6*	*36.0*
France	48.4	50.4	49.8	50.4	50.4	49.6	49.5	**48.1**	**48.2**	**48.6**	*46.8*	*47.1*
Italy	44.9	46.1	44.5	43.8	45.4	46.4	46.2	**46.6**	**46.0**	**45.5**	*45.5*	*45.4*
Cyprus	:	33.3	39.3	41.2	42.2	45.5	43.5	**40.3**	**41.2**	**41.3**	*42.1*	*42.1*
Luxembourg	:	43.8	41.7	41.5	39.7	39.8	40.1	**41.6**	**39.7**	**39.0**	*39.7*	*39.4*
Malta	:	35.0	39.9	42.0	41.2	40.3	40.3	**40.5**	**41.7**	**41.9**	*41.9*	*42.1*
Netherlands	48.7	46.0	44.6	44.5	46.1	45.7	46.6	**46.3**	**46.0**	**46.6**	*44.8*	*45.1*
Austria	49.6	51.2	49.2	48.4	47.9	48.1	48.4	**48.3**	**47.8**	**47.6**	*47.1*	*47.1*
Portugal	36.7	40.0	42.2	41.6	42.3	43.2	43.2	**41.6**	**42.5**	**43.0**	*43.5*	*43.3*
Slovenia	:	43.2	43.6	43.8	43.2	42.4	42.6	**44.4**	**44.6**	**44.7**	*43.2*	*42.9*
Slovakia	:	40.3	35.7	35.2	33.5	32.5	32.5	**34.0**	**34.3**	**33.9**	*31.4*	*31.4*
Finland	54.0	54.1	52.6	52.7	52.9	52.5	53.6	**53.2**	**52.1**	**52.4**	*50.5*	*50.6*
Euro area	45.1	46.0	44.9	44.8	45.3	45.4	44.9	**44.4**	**44.2**	**44.1**	*43.7*	*43.7*
Bulgaria	:	:	40.3	41.2	39.5	41.5	39.1	**36.9**	**36.8**	**36.8**	*38.4*	*38.4*
Czech Republic	:	38.6	41.0	41.4	41.1	41.8	40.2	**40.3**	**41.4**	**41.7**	*41.0*	*40.9*
Denmark	56.5	56.1	56.1	57.8	56.6	55.7	55.3	**55.8**	**53.7**	**53.3**	*52.8*	*53.0*
Estonia	:	37.1	36.0	35.2	36.5	37.4	37.1	**43.6**	**43.4**	**41.7**	*43.5*	*42.4*
Latvia	:	36.5	34.8	35.1	37.7	35.4	34.4	**34.0**	**36.2**	**34.5**	*33.4*	*32.9*
Lithuania	:	36.2	32.5	32.8	33.1	33.8	34.2	**34.1**	**34.1**	**33.2**	*36.8*	*36.3*
Hungary	:	43.8	42.3	42.2	42.6	44.8	45.4	**45.8**	**44.7**	**44.2**	*45.1*	*45.1*
Poland	:	39.8	38.9	39.4	40.2	40.3	39.6	**37.4**	**38.7**	**39.3**	*38.6*	*38.3*
Romania	:	32.7	32.5	32.3	33.1	33.5	32.1	**32.1**	**31.9**	**31.3**	*31.8*	*32.0*
Sweden	56.7	59.1	56.2	57.2	56.5	56.3	55.5	**55.7**	**53.9**	**53.2**	*52.3*	*52.0*
United Kingdom	36.2	39.7	39.8	40.7	41.3	41.4	42.4	**40.2**	**40.6**	**41.3**	*39.2*	*39.6*
EU	:	45.3	44.3	44.4	44.8	44.9	44.6	**43.9**	**43.8**	**43.8**	*43.2*	*43.2*
USA	32.3	34.9	32.4	33.1	33.9	34.0	32.4	**28.8**	**29.3**	**30.1**	*28.2*	*28.6*
Japan	:	31.6	31.7	31.7	34.5	33.5	35.2	**35.7**	**36.2**	**36.3**	*35.1*	*35.7*

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 37 : Net lending (+) or net borrowing (-), general government (as a percentage of GDP, 1992-2011) [1] 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	-5.4	-0.7	-0.6	-2.7	0.3	-0.2	-1.2	**-6.0**	**-5.0**	**-5.0**	*-5.8*	*-5.8*
Germany	-3.0	-1.6	-3.3	-3.3	-1.6	0.2	0.0	**-3.3**	**-5.0**	**-4.7**	*-5.0*	*-4.6*
Ireland	-1.7	2.4	1.2	1.6	3.0	0.1	-7.3	**-14.3**	**-11.7**	**-12.1**	*-14.7*	*-14.7*
Greece	-9.6	-4.2	-5.3	-5.2	-3.6	-5.1	-7.7	**-13.6**	**-9.3**	**-9.9**	*-12.2*	*-12.8*
Spain	-5.6	-1.9	0.4	1.0	2.0	1.9	-4.1	**-11.2**	**-9.8**	**-8.8**	*-10.1*	*-9.3*
France	-4.9	-2.1	-3.2	-2.9	-2.3	-2.7	-3.3	**-7.5**	**-8.0**	**-7.4**	*-8.2*	*-7.7*
Italy	-8.3	-2.2	-3.5	-4.3	-3.3	-1.5	-2.7	**-5.3**	**-5.3**	**-5.0**	*-5.3*	*-5.1*
Cyprus	:	-3.6	-3.7	-2.4	-1.2	3.4	0.9	**-6.1**	**-7.1**	**-7.7**	*-5.7*	*-5.9*
Luxembourg	1.6	4.5	0.6	0.0	1.4	3.6	2.9	**-0.7**	**-3.5**	**-3.9**	*-4.2*	*-4.2*
Malta	:	-7.6	-5.1	-2.9	-2.6	-2.2	-4.5	**-3.8**	**-4.3**	**-3.6**	*-4.4*	*-4.3*
Netherlands	-3.3	0.0	-1.3	-0.3	0.5	0.2	0.7	**-5.3**	**-6.3**	**-5.1**	*-6.1*	*-5.6*
Austria	-4.1	-1.6	-1.9	-1.7	-1.5	-0.4	-0.4	**-3.4**	**-4.7**	**-4.6**	*-5.5*	*-5.3*
Portugal	-4.7	-3.4	-3.8	-6.1	-3.9	-2.6	-2.8	**-9.4**	**-8.5**	**-7.9**	*-8.0*	*-8.7*
Slovenia	:	-3.1	-2.0	-1.4	-1.3	0.0	-1.7	**-5.5**	**-6.1**	**-5.2**	*-7.0*	*-6.9*
Slovakia	:	-7.6	-3.9	-2.8	-3.5	-1.9	-2.3	**-6.8**	**-6.0**	**-5.4**	*-6.0*	*-5.5*
Finland	-5.8	2.7	3.1	2.7	4.0	5.2	4.2	**-2.2**	**-3.8**	**-2.9**	*-4.5*	*-4.3*
Euro area	-5.0	-1.6	-2.5	-2.5	-1.3	-0.6	-2.0	**-6.3**	**-6.6**	**-6.1**	*-6.9*	*-6.5*
Bulgaria	:	1.4	1.1	1.9	3.0	0.1	1.8	**-3.9**	**-2.8**	**-2.2**	*-1.2*	*-0.4*
Czech Republic	:	-4.4	-4.5	-3.6	-2.6	-0.7	-2.7	**-5.9**	**-5.7**	**-5.7**	*-5.5*	*-5.7*
Denmark	-2.5	0.9	2.6	5.2	5.2	4.8	3.4	**-2.7**	**-5.5**	**-4.9**	*-4.8*	*-3.4*
Estonia	:	-0.5	1.5	1.6	2.5	2.6	-2.7	**-1.7**	**-2.4**	**-2.4**	*-3.2*	*-3.0*
Latvia	:	-1.5	-1.2	-0.4	-0.5	-0.3	-4.1	**-9.0**	**-8.6**	**-9.9**	*-12.3*	*-12.2*
Lithuania	:	-4.9	-1.1	-0.5	-0.4	-1.0	-3.3	**-8.9**	**-8.4**	**-8.5**	*-9.2*	*-9.7*
Hungary	:	-5.3	-8.0	-7.9	-9.3	-5.0	-3.8	**-4.0**	**-4.1**	**-4.0**	*-4.2*	*-3.9*
Poland	:	-3.9	-4.9	-4.1	-3.6	-1.9	-3.7	**-7.1**	**-7.3**	**-7.0**	*-7.5*	*-7.6*
Romania	:	-4.0	-1.6	-1.2	-2.2	-2.5	-5.4	**-8.3**	**-8.0**	**-7.4**	*-6.8*	*-5.9*
Sweden	-7.7	1.2	0.7	2.3	2.5	3.8	2.5	**-0.5**	**-2.1**	**-1.6**	*-3.3*	*-2.7*
United Kingdom	-6.1	0.5	-3.0	-3.4	-2.7	-2.8	-4.9	**-11.5**	**-12.0**	**-10.0**	*-12.9*	*-11.1*
EU	:	-1.4	-2.5	-2.5	-1.4	-0.8	-2.3	**-6.8**	**-7.2**	**-6.5**	*-7.5*	*-6.9*
USA	-4.2	0.3	-3.7	-3.2	-2.0	-2.7	-6.4	**-11.0**	**-10.0**	**-9.9**	*-13.0*	*-13.1*
Japan	-2.5	-7.3	-6.1	-6.7	-1.6	-2.5	-2.0	**-6.9**	**-6.7**	**-6.6**	*-8.9*	*-9.1*

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 38 : Interest expenditure, general government (as a percentage of GDP, 1992-2011) [1]

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	9.5	7.0	4.8	4.2	3.9	3.8	3.8	**3.7**	**3.8**	**3.8**	*4.0*	*4.1*
Germany	3.3	3.2	2.9	2.8	2.8	2.8	2.7	**2.6**	**2.6**	**2.7**	*2.8*	*2.9*
Ireland	5.6	2.7	1.2	1.1	1.0	1.0	1.4	**2.1**	**2.9**	**3.5**	*3.3*	*4.0*
Greece	11.1	7.7	4.8	4.4	4.1	4.1	4.6	**5.1**	**5.4**	**5.8**	*5.6*	*6.1*
Spain	4.8	3.7	2.1	1.8	1.6	1.6	1.6	**1.8**	**2.2**	**2.6**	*2.5*	*2.9*
France	3.4	3.1	2.7	2.6	2.5	2.7	2.9	**2.3**	**2.6**	**2.9**	*2.9*	*3.0*
Italy	11.3	7.3	4.9	4.6	4.6	5.0	5.2	**4.7**	**4.6**	**4.8**	*4.7*	*5.1*
Cyprus	:	3.1	3.3	3.5	3.3	3.0	2.8	**2.5**	**2.7**	**2.9**	*2.2*	*2.2*
Luxembourg	0.3	0.4	0.2	0.2	0.2	0.2	0.3	**0.5**	**0.5**	**0.6**	*0.6*	*0.7*
Malta	:	3.3	3.6	3.7	3.5	3.3	3.3	**3.2**	**3.3**	**3.3**	*3.2*	*3.3*
Netherlands	5.7	4.1	2.5	2.3	2.2	2.2	2.1	**2.3**	**2.3**	**2.3**	*2.4*	*2.5*
Austria	4.0	3.5	2.9	2.9	2.8	2.7	2.5	**2.7**	**2.8**	**2.9**	*3.0*	*3.2*
Portugal	5.8	3.2	2.7	2.6	2.7	2.8	2.9	**2.8**	**3.1**	**3.5**	*3.1*	*3.5*
Slovenia	:	2.3	1.8	1.6	1.4	1.3	1.1	**1.4**	**1.8**	**2.0**	*1.9*	*2.0*
Slovakia	:	3.3	2.3	1.7	1.5	1.4	1.2	**1.5**	**1.5**	**1.5**	*1.3*	*1.4*
Finland	4.0	3.2	1.7	1.5	1.4	1.5	1.4	**1.2**	**1.1**	**1.2**	*1.4*	*1.5*
Euro area	5.6	4.3	3.1	2.9	2.9	2.9	3.0	**2.8**	**3.0**	**3.2**	*3.2*	*3.4*
Bulgaria	:	4.7	1.8	1.7	1.4	1.0	0.8	**0.8**	**0.8**	**0.9**	*0.9*	*0.9*
Czech Republic	:	1.0	1.2	1.2	1.1	1.1	1.1	**1.3**	**1.7**	**2.1**	*1.6*	*1.6*
Denmark	6.4	4.1	2.3	1.9	1.6	1.6	1.5	**2.0**	**2.1**	**2.2**	*1.5*	*1.5*
Estonia	:	0.3	0.2	0.2	0.2	0.2	0.2	**0.3**	**0.4**	**0.4**	*0.5*	*0.7*
Latvia	:	0.8	0.6	0.5	0.4	0.3	0.6	**1.6**	**2.4**	**2.9**	*2.4*	*3.8*
Lithuania	:	1.3	1.0	0.8	0.7	0.7	0.6	**1.0**	**1.6**	**1.9**	*2.2*	*2.6*
Hungary	:	6.6	4.1	4.1	3.9	4.1	4.2	**4.7**	**4.5**	**4.1**	*4.2*	*3.8*
Poland	:	3.5	2.8	2.8	2.7	2.3	2.2	**2.6**	**2.9**	**3.0**	*3.0*	*3.0*
Romania	:	4.2	1.5	1.1	0.8	0.7	0.7	**1.5**	**1.9**	**2.1**	*1.8*	*2.0*
Sweden	5.5	4.0	2.0	1.6	1.6	1.8	1.7	**0.9**	**0.8**	**0.8**	*1.2*	*1.2*
United Kingdom	3.1	3.0	2.0	2.1	2.0	2.2	2.3	**2.0**	**2.7**	**3.2**	*2.7*	*3.0*
EU	:	4.0	2.9	2.7	2.6	2.7	2.7	**2.6**	**2.8**	**3.1**	*3.0*	*3.2*
USA	4.7	3.8	2.7	2.6	2.7	2.9	2.7	**2.7**	**2.9**	**3.0**	*2.9*	*3.2*
Japan	3.6	3.4	2.6	2.4	2.4	2.5	2.5	**2.7**	**2.8**	**2.9**	*2.8*	*2.8*

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 39 : Primary balance, general government (as a percentage of GDP, 1992-2011) [1] [2]

20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	4.1	6.3	4.2	1.5	4.2	3.6	2.6	**-2.3**	**-1.3**	**-1.2**	*-1.8*	*-1.7*
Germany	0.3	1.7	-0.4	-0.5	1.2	3.0	2.7	**-0.7**	**-2.3**	**-2.0**	*-2.2*	*-1.7*
Ireland	4.0	5.0	2.4	2.7	4.0	1.2	-5.9	**-12.2**	**-8.8**	**-8.6**	*-11.3*	*-10.6*
Greece	1.6	3.5	-0.5	-0.7	0.6	-0.9	-3.1	**-8.5**	**-4.0**	**-4.1**	*-6.6*	*-6.7*
Spain	-0.8	1.8	2.5	2.8	3.7	3.5	-2.5	**-9.4**	**-7.6**	**-6.2**	*-7.6*	*-6.3*
France	-1.5	1.0	-0.5	-0.3	0.3	0.0	-0.5	**-5.2**	**-5.4**	**-4.5**	*-5.4*	*-4.7*
Italy	3.0	5.1	1.4	0.3	1.3	3.5	2.5	**-0.6**	**-0.7**	**-0.2**	*-0.6*	*0.1*
Cyprus	:	-0.5	-0.4	1.1	2.1	6.4	3.7	**-3.6**	**-4.4**	**-4.8**	*-3.6*	*-3.7*
Luxembourg	1.9	4.9	0.8	0.2	1.5	3.9	3.2	**-0.2**	**-3.0**	**-3.3**	*-3.6*	*-3.6*
Malta	:	-4.3	-1.5	0.8	1.0	1.2	-1.2	**-0.6**	**-1.1**	**-0.4**	*-1.2*	*-1.0*
Netherlands	2.4	4.1	1.1	2.1	2.7	2.4	2.8	**-3.0**	**-4.0**	**-2.8**	*-3.7*	*-3.1*
Austria	-0.1	1.9	1.0	1.2	1.3	2.3	2.1	**-0.7**	**-1.8**	**-1.7**	*-2.5*	*-2.1*
Portugal	1.1	-0.1	-1.1	-3.5	-1.2	0.2	0.1	**-6.6**	**-5.5**	**-4.4**	*-4.9*	*-5.2*
Slovenia	:	-0.8	-0.3	0.1	0.1	1.3	-0.6	**-4.1**	**-4.3**	**-3.3**	*-5.1*	*-4.9*
Slovakia	:	-4.3	-1.6	-1.1	-2.0	-0.5	-1.1	**-5.3**	**-4.5**	**-3.9**	*-4.7*	*-4.1*
Finland	-1.8	5.9	4.8	4.2	5.5	6.7	5.6	**-1.0**	**-2.6**	**-1.7**	*-3.1*	*-2.9*
Euro area	0.6	2.6	0.7	0.4	1.6	2.3	1.0	**-3.5**	**-3.6**	**-2.9**	*-3.7*	*-3.1*
Bulgaria	:	6.1	2.9	3.6	4.4	1.1	2.7	**-3.1**	**-2.0**	**-1.4**	*-0.3*	*0.5*
Czech Republic	:	-3.3	-3.3	-2.4	-1.5	0.5	-1.6	**-4.6**	**-3.9**	**-3.6**	*-3.9*	*-4.1*
Denmark	3.9	5.0	4.9	7.1	6.8	6.3	4.8	**-0.7**	**-3.4**	**-2.7**	*-3.3*	*-1.9*
Estonia	:	-0.2	1.7	1.8	2.7	2.8	-2.5	**-1.4**	**-2.0**	**-1.9**	*-2.6*	*-2.3*
Latvia	:	-0.7	-0.5	0.1	0.0	0.0	-3.5	**-7.4**	**-6.2**	**-6.9**	*-9.9*	*-8.3*
Lithuania	:	-3.6	-0.1	0.3	0.3	-0.3	-2.6	**-7.9**	**-6.8**	**-6.6**	*-7.0*	*-7.1*
Hungary	:	1.3	-3.9	-3.8	-5.4	-0.9	0.4	**0.7**	**0.5**	**0.1**	*-0.1*	*-0.2*
Poland	:	-0.4	-2.0	-1.3	-1.0	0.4	-1.5	**-4.5**	**-4.5**	**-4.0**	*-4.6*	*-4.6*
Romania	:	0.1	-0.1	-0.1	-1.3	-1.8	-4.7	**-6.8**	**-6.2**	**-5.4**	*-5.0*	*-3.9*
Sweden	-2.2	5.3	2.6	3.9	4.2	5.6	4.1	**0.4**	**-1.2**	**-0.7**	*-2.1*	*-1.4*
United Kingdom	-2.9	3.5	-1.0	-1.3	-0.7	-0.6	-2.6	**-9.5**	**-9.3**	**-6.9**	*-10.3*	*-8.1*
EU	:	2.6	0.4	0.3	1.2	1.9	0.5	**-4.2**	**-4.3**	**-3.5**	*-4.5*	*-3.7*
USA	0.5	4.1	-1.0	-0.6	0.7	0.2	-3.7	**-8.4**	**-7.2**	**-6.8**	*-10.1*	*-10.0*
Japan	1.1	-3.9	-3.5	-4.3	0.8	0.0	0.5	**-4.2**	**-4.0**	**-3.7**	*-6.1*	*-6.2*

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

[2] Net lending/borrowing excluding interest expenditure.

TABLE 40 : Cyclically adjusted net lending (+) or net borrowing (-), general government (as a percentage of GDP, 1992-2011)

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	-5.0	-1.0	-0.6	-2.9	-0.4	-1.4	-2.0	**-4.5**	**-3.7**	**-4.0**	*-4.3*	*-4.5*
Germany	-3.1	-1.6	-3.1	-2.7	-2.2	-1.2	-1.5	**-1.8**	**-3.6**	**-3.5**	*-3.6*	*-3.5*
Ireland	-0.4	1.4	0.4	0.9	2.1	-1.6	-7.0	**-11.4**	**-8.7**	**-10.2**	*-11.5*	*-12.5*
Greece	-9.0	-3.7	-5.8	-5.6	-4.7	-7.0	-9.6	**-14.1**	**-8.2**	**-8.2**	*-11.3*	*-11.6*
Spain	-4.6	-2.0	0.3	1.0	1.6	1.2	-4.4	**-9.6**	**-7.8**	**-7.0**	*-8.5*	*-8.1*
France	-4.0	-2.2	-3.7	-3.4	-3.0	-3.7	-3.7	**-6.2**	**-6.6**	**-6.2**	*-7.0*	*-6.5*
Italy	-7.5	-2.1	-3.9	-4.6	-4.4	-3.0	-3.3	**-3.3**	**-3.6**	**-3.7**	*-3.7*	*-3.8*
Cyprus	:	-3.7	-3.7	-2.2	-1.3	2.5	-0.4	**-5.8**	**-6.3**	**-7.1**	*-5.2*	*-5.6*
Luxembourg	:	4.4	0.4	-0.3	0.1	1.1	2.0	**1.2**	**-1.4**	**-1.9**	*-2.0*	*-1.8*
Malta	:	-8.1	-4.9	-2.5	-2.5	-2.5	-4.9	**-3.1**	**-3.8**	**-3.4**	*-4.1*	*-4.4*
Netherlands	-2.7	-0.6	-0.8	0.3	0.3	-1.0	-0.5	**-3.6**	**-4.9**	**-4.0**	*-4.4*	*-4.3*
Austria	-3.9	-2.0	-1.6	-1.3	-1.9	-1.6	-1.7	**-2.4**	**-3.6**	**-3.6**	*-4.3*	*-4.0*
Portugal	-4.4	-3.9	-3.6	-5.7	-3.7	-3.0	-2.9	**-8.3**	**-7.5**	**-7.0**	*-6.7*	*-7.5*
Slovenia	:	-3.1	-2.1	-1.6	-2.6	-2.9	-4.8	**-3.8**	**-4.4**	**-3.8**	*-5.4*	*-5.6*
Slovakia	:	-7.1	-3.6	-2.5	-3.9	-3.7	-4.5	**-6.4**	**-5.4**	**-4.7**	*-5.4*	*-4.6*
Finland	-3.7	1.9	3.0	2.6	2.8	2.6	2.1	**0.3**	**-1.4**	**-1.0**	*-2.3*	*-2.4*
Euro area	-4.4	-1.8	-2.6	-2.5	-2.0	-1.9	-2.9	**-4.8**	**-5.1**	**-4.8**	*-5.4*	*-5.3*
Bulgaria	:	:	0.1	0.8	1.7	-1.5	0.0	**-2.8**	**-1.1**	**-0.8**	*1.0*	*1.5*
Czech Republic	:	-3.5	-4.4	-3.9	-4.0	-2.9	-4.5	**-5.1**	**-4.7**	**-4.8**	*-4.5*	*-4.8*
Denmark	-1.8	0.2	2.4	4.7	3.5	3.1	3.3	**0.6**	**-3.0**	**-3.1**	*-2.1*	*-1.3*
Estonia	:	-0.1	0.5	0.3	0.0	-0.7	-4.1	**1.3**	**0.2**	**-0.9**	*-0.4*	*-1.3*
Latvia	:	-1.1	-1.9	-1.5	-3.2	-4.5	-6.4	**-6.3**	**-5.7**	**-8.3**	*-9.3*	*-10.2*
Lithuania	:	-3.8	-1.9	-1.8	-2.1	-3.7	-5.7	**-6.7**	**-6.1**	**-6.8**	*-6.3*	*-7.5*
Hungary	:	-4.9	-8.6	-8.7	-10.9	-6.4	-5.1	**-2.2**	**-2.1**	**-3.0**	*-2.1*	*-3.0*
Poland	:	-4.1	-4.7	-3.9	-4.0	-2.8	-4.6	**-6.9**	**-6.5**	**-5.7**	*-6.6*	*-6.7*
Romania	:	:	-2.2	-2.2	-4.1	-4.7	-8.2	**-7.8**	**-6.9**	**-6.4**	*-5.5*	*-4.6*
Sweden	-5.6	1.6	-0.1	1.0	0.3	1.6	1.4	**1.9**	**-0.2**	**-0.5**	*-1.0*	*-0.7*
United Kingdom	-5.4	0.3	-3.5	-4.0	-3.5	-3.9	-5.7	**-9.7**	**-10.4**	**-8.7**	*-11.4*	*-9.9*
EU	:	-1.5	-2.7	-2.6	-2.2	-2.1	-3.2	**-5.2**	**-5.6**	**-5.2**	*-6.0*	*-5.7*

TABLE 41 : Cyclically adjusted primary balance, general government (as a percentage of GDP, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	4.6	6.0	4.1	1.3	3.5	2.4	1.8	**-0.9**	**0.0**	**-0.2**	*-0.3*	*-0.4*
Germany	0.2	1.6	-0.2	0.0	0.6	1.6	1.2	**0.8**	**-1.0**	**-0.8**	*-0.8*	*-0.6*
Ireland	5.3	4.1	1.6	2.0	3.1	-0.6	-5.7	**-9.3**	**-5.9**	**-6.7**	*-8.2*	*-8.5*
Greece	2.1	4.0	-1.0	-1.2	-0.6	-2.9	-5.0	**-9.0**	**-2.8**	**-2.4**	*-5.7*	*-5.5*
Spain	0.2	1.7	2.4	2.8	3.2	2.8	-2.8	**-7.8**	**-5.7**	**-4.4**	*-6.1*	*-5.2*
France	-0.6	1.0	-0.9	-0.8	-0.4	-1.0	-0.8	**-3.9**	**-4.1**	**-3.3**	*-4.1*	*-3.5*
Italy	3.8	5.2	1.0	0.0	0.2	2.0	1.8	**1.4**	**1.0**	**1.1**	*1.0*	*1.3*
Cyprus	:	-0.6	-0.4	1.3	2.0	5.5	2.4	**-3.3**	**-3.6**	**-4.2**	*-3.1*	*-3.3*
Luxembourg	:	4.8	0.6	-0.1	0.3	1.3	2.3	**1.7**	**-1.0**	**-1.3**	*-1.4*	*-1.1*
Malta	:	-4.8	-1.3	1.2	1.0	0.8	-1.6	**0.1**	**-0.5**	**-0.1**	*-0.9*	*-1.0*
Netherlands	3.0	3.5	1.7	2.7	2.5	1.2	1.6	**-1.4**	**-2.6**	**-1.7**	*-2.0*	*-1.8*
Austria	0.2	1.5	1.3	1.6	0.8	1.1	0.8	**0.3**	**-0.8**	**-0.7**	*-1.3*	*-0.8*
Portugal	1.3	-0.7	-0.9	-3.1	-1.0	-0.1	0.0	**-5.4**	**-4.4**	**-3.4**	*-3.6*	*-4.1*
Slovenia	:	-0.8	-0.3	-0.1	-1.2	-1.6	-3.7	**-2.3**	**-2.5**	**-1.8**	*-3.6*	*-3.6*
Slovakia	:	-3.8	-1.3	-0.8	-2.4	-2.3	-3.3	**-4.9**	**-3.9**	**-3.2**	*-4.1*	*-3.3*
Finland	0.3	5.2	4.7	4.1	4.3	4.1	3.5	**1.5**	**-0.3**	**0.2**	*-0.9*	*-0.9*
Euro area	1.2	2.5	0.6	0.5	0.9	1.1	0.1	**-1.9**	**-2.1**	**-1.7**	*-2.2*	*-1.9*
Bulgaria	:	:	2.0	2.5	3.1	-0.5	0.9	**-2.0**	**-0.3**	**0.1**	*1.9*	*2.4*
Czech Republic	:	-2.5	-3.2	-2.8	-2.9	-1.7	-3.4	**-3.8**	**-2.9**	**-2.6**	*-2.9*	*-3.2*
Denmark	4.6	4.3	4.7	6.5	5.2	4.7	4.7	**2.6**	**-0.9**	**-1.0**	*-0.6*	*0.2*
Estonia	:	0.2	0.8	0.5	0.2	-0.5	-3.9	**1.7**	**0.6**	**-0.5**	*0.1*	*-0.7*
Latvia	:	-0.2	-1.3	-1.0	-2.7	-4.2	-5.8	**-4.7**	**-3.3**	**-5.4**	*-6.9*	*-6.4*
Lithuania	:	-2.4	-0.9	-1.0	-1.4	-3.0	-5.0	**-5.7**	**-4.5**	**-4.9**	*-4.1*	*-4.9*
Hungary	:	1.7	-4.5	-4.6	-7.0	-2.3	-0.9	**2.5**	**2.4**	**1.1**	*2.1*	*0.7*
Poland	:	-0.6	-1.9	-1.1	-1.3	-0.5	-2.3	**-4.3**	**-3.6**	**-2.6**	*-3.7*	*-3.7*
Romania	:	:	-0.7	-1.1	-3.3	-4.0	-7.5	**-6.3**	**-5.0**	**-4.4**	*-3.7*	*-2.6*
Sweden	-0.1	5.6	1.9	2.7	2.0	3.3	3.1	**2.8**	**0.7**	**0.3**	*0.3*	*0.5*
United Kingdom	-2.3	3.3	-1.5	-1.8	-1.5	-1.7	-3.4	**-7.8**	**-7.6**	**-5.6**	*-8.7*	*-6.8*
EU	:	2.5	0.2	0.1	0.4	0.6	-0.5	**-2.6**	**-2.8**	**-2.2**	*-3.0*	*-2.5*

TABLE 42 : Gross debt, general government (as a percentage of GDP, 2002-2011)

								Spring 2010 forecast			*Autumn 2009 forecast*	
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	103.5	98.5	94.2	92.1	88.1	84.2	89.8	**96.7**	**99.0**	**100.9**	*101.2*	*104.0*
Germany	60.4	63.9	65.7	68.0	67.6	65.0	66.0	**73.2**	**78.8**	**81.6**	*76.7*	*79.7*
Ireland	32.2	31.0	29.7	27.6	24.9	25.0	43.9	**64.0**	**77.3**	**87.3**	*82.9*	*96.2*
Greece	101.7	97.4	98.6	100.0	97.8	95.7	99.2	**115.1**	**124.9**	**133.9**	*124.9*	*135.4*
Spain	52.5	48.7	46.2	43.0	39.6	36.2	39.7	**53.2**	**64.9**	**72.5**	*66.3*	*74.0*
France	58.8	62.9	64.9	66.4	63.7	63.8	67.5	**77.6**	**83.6**	**88.6**	*82.5*	*87.6*
Italy	105.7	104.4	103.8	105.8	106.5	103.5	106.1	**115.8**	**118.2**	**118.9**	*116.7*	*117.8*
Cyprus	64.6	68.9	70.2	69.1	64.6	58.3	48.4	**56.2**	**62.3**	**67.6**	*58.6*	*63.4*
Luxembourg	6.3	6.1	6.3	6.1	6.5	6.7	13.7	**14.5**	**19.0**	**23.6**	*16.4*	*17.7*
Malta	60.1	69.3	72.3	70.1	63.7	61.9	63.7	**69.1**	**71.5**	**72.5**	*70.9*	*72.5*
Netherlands	50.5	52.0	52.4	51.8	47.4	45.5	58.2	**60.9**	**66.3**	**69.6**	*65.6*	*69.7*
Austria	66.5	65.5	64.8	63.9	62.2	59.5	62.6	**66.5**	**70.2**	**72.9**	*73.9*	*77.0*
Portugal	55.6	56.9	58.3	63.6	64.7	63.6	66.3	**76.8**	**85.8**	**91.1**	*84.6*	*91.1*
Slovenia	28.0	27.5	27.2	27.0	26.7	23.4	22.6	**35.9**	**41.6**	**45.4**	*42.8*	*48.2*
Slovakia	43.4	42.4	41.5	34.2	30.5	29.3	27.7	**35.7**	**40.8**	**44.0**	*39.2*	*42.7*
Finland	41.5	44.5	44.4	41.7	39.7	35.2	34.2	**44.0**	**50.5**	**54.9**	*47.4*	*52.7*
Euro area	68.0	69.1	69.5	70.1	68.3	66.0	69.4	**78.7**	**84.7**	**88.5**	*84.0*	*88.2*
Bulgaria	53.6	45.9	37.9	29.2	22.7	18.2	14.1	**14.8**	**17.4**	**18.8**	*16.2*	*15.7*
Czech Republic	28.2	29.8	30.1	29.7	29.4	29.0	30.0	**35.4**	**39.8**	**43.5**	*40.6*	*44.0*
Denmark	48.3	45.8	44.5	37.1	32.1	27.4	34.2	**41.6**	**46.0**	**49.5**	*35.3*	*35.2*
Estonia	5.7	5.6	5.0	4.6	4.5	3.8	4.6	**7.2**	**9.6**	**12.4**	*10.9*	*13.2*
Latvia	13.5	14.6	14.9	12.4	10.7	9.0	19.5	**36.1**	**48.5**	**57.3**	*48.6*	*60.4*
Lithuania	22.3	21.1	19.4	18.4	18.0	16.9	15.6	**29.3**	**38.6**	**45.4**	*40.7*	*49.3*
Hungary	55.6	58.4	59.1	61.8	65.6	65.9	72.9	**78.3**	**78.9**	**77.8**	*79.8*	*79.1*
Poland	42.2	47.1	45.7	47.1	47.7	45.0	47.2	**51.0**	**53.9**	**59.3**	*57.0*	*61.3*
Romania	24.9	21.5	18.7	15.8	12.4	12.6	13.3	**23.7**	**30.5**	**35.8**	*27.4*	*31.3*
Sweden	52.6	52.3	51.1	50.8	45.7	40.8	38.3	**42.3**	**42.6**	**42.1**	*43.6*	*44.1*
United Kingdom	37.5	38.7	40.6	42.2	43.5	44.7	52.0	**68.1**	**79.1**	**86.9**	*80.3*	*88.2*
EU	60.4	61.8	62.2	62.7	61.4	58.8	61.6	**73.6**	**79.6**	**83.8**	*79.3*	*83.7*

TABLE 43 : Gross national saving (as a percentage of GDP, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	24.8	25.9	25.3	25.1	25.9	26.6	24.2	**22.5**	**23.0**	**23.2**	*22.3*	*22.4*
Germany	21.2	20.3	21.4	22.1	24.3	26.3	25.8	**22.0**	**22.3**	**22.6**	*21.8*	*22.1*
Ireland	18.6	23.6	23.1	23.6	24.6	21.6	16.9	**10.7**	**10.4**	**11.0**	*11.4*	*11.9*
Greece	18.5	14.0	10.5	9.3	8.9	7.6	7.1	**5.0**	**6.4**	**8.5**	*7.9*	*8.2*
Spain	20.6	22.3	22.5	22.0	22.0	21.0	19.7	**19.8**	**18.0**	**17.5**	*17.7*	*17.6*
France	18.9	21.1	19.1	18.5	19.3	19.9	18.9	**16.3**	**16.4**	**16.4**	*17.5*	*17.9*
Italy	20.6	21.3	20.0	19.5	19.6	20.1	18.0	**15.8**	**15.9**	**16.5**	*16.8*	*17.2*
Cyprus	:	13.8	14.7	14.1	13.8	10.7	6.4	**8.7**	**9.0**	**7.9**	*8.4*	*10.1*
Luxembourg	35.0	33.4	32.1	33.5	30.5	29.8	25.3	**15.6**	**17.0**	**18.2**	*28.5*	*29.4*
Malta	:	14.2	13.2	11.7	13.0	15.7	12.8	**7.7**	**8.2**	**9.1**	*11.6*	*12.2*
Netherlands	25.9	27.1	26.9	26.5	29.0	28.2	24.7	**22.1**	**22.7**	**23.4**	*20.9*	*21.6*
Austria	22.1	23.1	24.9	24.7	25.4	26.1	26.4	**24.4**	**24.1**	**25.0**	*23.6*	*24.3*
Portugal	19.3	18.4	14.6	12.8	11.7	12.4	10.2	**8.6**	**8.0**	**8.1**	*7.5*	*7.6*
Slovenia	23.5	24.3	25.2	25.5	26.5	27.2	26.0	**22.6**	**22.3**	**22.6**	*22.5*	*22.3*
Slovakia	:	23.8	20.0	20.4	19.8	22.7	21.3	**17.0**	**18.9**	**19.9**	*19.9*	*20.1*
Finland	17.8	26.5	26.0	25.3	25.9	27.1	25.0	**18.4**	**18.1**	**18.6**	*20.5*	*20.8*
Euro area	20.9	21.6	21.2	21.0	22.0	22.5	21.2	**18.5**	**18.5**	**18.8**	*18.7*	*19.0*
Bulgaria	:	:	15.8	16.5	13.1	14.3	15.4	**16.5**	**18.6**	**19.4**	*16.3*	*18.0*
Czech Republic	28.1	24.9	22.7	23.9	24.7	24.4	21.9	**20.5**	**21.8**	**20.9**	*20.1*	*21.2*
Denmark	19.9	22.0	24.0	25.2	25.7	24.5	24.1	**21.6**	**21.0**	**21.0**	*20.1*	*20.8*
Estonia	:	21.8	22.3	23.7	22.5	21.3	19.5	**24.1**	**24.8**	**24.7**	*21.6*	*21.1*
Latvia	31.2	16.6	20.0	21.9	17.2	17.9	18.5	**27.6**	**26.2**	**23.9**	*25.5*	*24.6*
Lithuania	:	13.1	15.7	16.8	16.0	15.8	15.1	**15.0**	**17.3**	**17.4**	*12.1*	*12.3*
Hungary	:	20.3	16.9	15.8	16.5	17.0	16.2	**18.9**	**18.8**	**19.4**	*19.3*	*20.0*
Poland	17.2	19.9	17.1	18.0	18.1	19.3	18.7	**18.4**	**18.3**	**19.0**	*18.3*	*18.8*
Romania	22.9	13.6	17.2	14.4	15.9	17.3	18.6	**20.8**	**21.0**	**20.3**	*23.7*	*24.7*
Sweden	17.5	21.9	23.8	23.4	26.8	28.8	29.1	**23.0**	**22.4**	**23.1**	*24.1*	*24.8*
United Kingdom	15.2	16.2	14.8	14.4	14.2	15.6	15.4	**12.3**	**12.0**	**12.8**	*12.0*	*13.3*
EU	:	20.9	20.1	19.9	20.7	21.4	20.4	**17.7**	**17.6**	**18.0**	*17.8*	*18.3*
USA	15.0	17.7	14.5	14.6	15.8	14.0	12.1	**12.0**	**11.8**	**12.2**	*13.2*	*14.0*
Japan	31.6	28.5	26.7	27.2	27.7	28.5	26.9	**23.2**	**24.0**	**24.9**	*22.8*	*21.7*

TABLE 44 : Gross saving, private sector (as a percentage of GDP, 1992-2011) [1]

	5-year averages							Spring 2010 forecast			*Autumn 2009 forecast*	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	28.0	24.2	23.7	23.4	23.8	24.7	23.4	**25.6**	**25.7**	**25.7**	*26.0*	*25.9*
Germany	20.8	19.6	22.2	23.0	23.7	23.9	23.4	**22.7**	**24.5**	**24.9**	*23.9*	*24.3*
Ireland	18.6	18.2	18.5	18.6	18.3	17.4	18.2	**18.4**	**18.6**	**19.6**	*21.7*	*22.6*
Greece	24.6	14.5	12.5	11.7	11.0	10.8	12.3	**15.4**	**13.1**	**15.7**	*17.2*	*18.1*
Spain	21.8	20.1	17.8	16.9	15.6	14.1	18.7	**25.0**	**22.8**	**22.0**	*23.1*	*22.5*
France	20.0	19.7	18.9	18.2	18.0	18.7	18.2	**19.7**	**20.2**	**19.8**	*21.7*	*21.6*
Italy	25.6	20.5	20.0	20.1	18.2	17.8	17.2	**17.8**	**17.8**	**18.2**	*18.5*	*18.8*
Cyprus	:	14.0	14.9	13.9	11.3	3.7	2.1	**10.0**	**11.3**	**10.8**	*10.1*	*11.9*
Luxembourg	:	24.4	25.9	27.8	24.1	21.8	18.3	**11.5**	**15.5**	**17.3**	*27.2*	*28.2*
Malta	:	17.9	15.0	13.3	14.3	15.2	15.0	**9.6**	**10.6**	**10.8**	*13.5*	*14.0*
Netherlands	26.4	24.1	24.8	23.7	25.5	24.8	20.3	**22.3**	**24.3**	**23.8**	*22.9*	*23.1*
Austria	21.6	21.2	23.0	23.2	23.8	23.4	23.9	**25.1**	**26.1**	**27.0**	*25.9*	*26.4*
Portugal	20.5	17.7	16.4	16.0	13.4	12.4	11.2	**14.9**	**14.4**	**13.8**	*13.0*	*13.8*
Slovenia	:	22.9	23.0	23.0	23.7	22.4	22.3	**22.2**	**23.2**	**22.9**	*23.8*	*23.6*
Slovakia	:	23.7	20.2	19.4	20.3	22.0	20.3	**19.9**	**21.1**	**21.6**	*22.7*	*22.2*
Finland	19.8	21.0	20.4	20.2	19.8	19.5	18.4	**17.6**	**19.0**	**18.8**	*22.3*	*22.5*
Euro area	22.2	20.2	20.4	20.3	20.0	19.9	19.7	**21.0**	**21.5**	**21.6**	*22.0*	*22.1*
Bulgaria	:	:	10.4	9.8	5.6	6.7	8.4	**15.0**	**17.1**	**17.6**	*11.4*	*12.5*
Czech Republic	:	21.5	19.8	20.4	21.0	19.7	18.9	**21.4**	**22.4**	**21.4**	*19.3*	*20.6*
Denmark	20.4	19.3	19.9	18.5	18.9	18.1	18.6	**22.1**	**24.2**	**24.0**	*21.9*	*21.4*
Estonia	:	17.7	16.6	18.4	15.7	13.5	16.2	**21.9**	**22.3**	**22.4**	*18.5*	*18.0*
Latvia	:	15.6	17.2	18.4	11.7	12.1	18.4	**32.6**	**32.3**	**31.1**	*35.4*	*34.2*
Lithuania	:	11.7	13.5	14.4	12.9	12.2	14.0	**21.1**	**22.9**	**23.1**	*18.9*	*20.0*
Hungary	:	19.9	19.3	19.0	20.5	17.3	16.6	**20.3**	**20.3**	**21.1**	*20.9*	*21.4*
Poland	:	19.7	17.9	18.3	17.4	16.8	17.3	**19.9**	**20.3**	**20.5**	*20.4*	*21.2*
Romania	:	14.1	13.9	11.0	11.6	13.1	17.3	**23.3**	**23.7**	**21.9**	*23.6*	*23.7*
Sweden	21.3	17.8	20.1	18.0	21.1	21.9	23.5	**19.9**	**20.7**	**20.9**	*23.9*	*23.9*
United Kingdom	18.6	14.5	15.6	15.6	14.4	15.9	16.9	**19.1**	**19.5**	**19.1**	*21.3*	*21.4*
EU	:	19.4	19.5	19.3	18.9	19.0	19.2	**20.5**	**21.0**	**21.0**	*21.6*	*21.8*
USA	17.1	15.3	15.7	15.3	15.6	14.2	15.4	**18.5**	**18.1**	**17.9**	*21.4*	*22.4*
Japan	26.6	27.7	28.4	28.6	27.6	28.3	27.1	**28.0**	**28.8**	**30.0**	*28.0*	*27.3*

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 45 : Gross saving, general government (as a percentage of GDP, 1992-2011) [1] 20.04.2010

	5-year averages							Spring 2010 forecast			Autumn 2009 forecast	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	-3.3	1.8	1.5	1.7	2.1	1.9	0.9	**-3.1**	**-2.7**	**-2.4**	*-3.6*	*-3.5*
Germany	0.4	0.7	-0.7	-0.9	0.6	2.4	2.4	**-0.7**	**-2.2**	**-2.3**	*-2.2*	*-2.2*
Ireland	0.0	5.4	4.6	5.0	6.3	4.3	-1.3	**-7.8**	**-8.1**	**-8.6**	*-10.3*	*-10.7*
Greece	-6.1	-0.5	-2.0	-2.3	-2.1	-3.3	-5.2	**-10.4**	**-6.6**	**-7.2**	*-9.3*	*-9.9*
Spain	-1.1	2.1	4.7	5.1	6.4	6.9	1.1	**-5.2**	**-4.8**	**-4.5**	*-5.3*	*-4.9*
France	-1.1	1.5	0.2	0.3	1.3	1.1	0.6	**-3.4**	**-3.8**	**-3.4**	*-4.2*	*-3.7*
Italy	-5.0	0.8	0.0	-0.6	1.4	2.3	0.8	**-2.0**	**-1.8**	**-1.7**	*-1.7*	*-1.6*
Cyprus	:	-0.2	-0.3	0.2	2.5	7.0	4.4	**-1.3**	**-2.3**	**-2.9**	*-1.7*	*-1.9*
Luxembourg	:	9.0	6.2	5.7	6.5	8.0	7.0	**4.1**	**1.5**	**0.8**	*1.3*	*1.3*
Malta	:	-3.7	-1.8	-1.6	-1.3	0.4	-2.2	**-1.8**	**-2.4**	**-1.8**	*-1.9*	*-1.8*
Netherlands	-0.4	3.0	2.0	2.8	3.5	3.4	4.3	**-0.2**	**-1.6**	**-0.4**	*-2.1*	*-1.5*
Austria	0.5	1.9	1.9	1.5	1.6	2.7	2.5	**-0.7**	**-2.0**	**-2.0**	*-2.2*	*-2.1*
Portugal	-1.2	0.6	-1.8	-3.2	-1.6	0.0	-0.9	**-6.4**	**-6.3**	**-5.7**	*-5.5*	*-6.2*
Slovenia	:	1.4	2.1	2.5	2.8	4.7	3.7	**0.3**	**-0.9**	**-0.3**	*-1.3*	*-1.2*
Slovakia	:	0.2	-0.2	1.0	-0.5	0.6	1.0	**-2.9**	**-2.2**	**-1.7**	*-2.7*	*-2.1*
Finland	-2.0	5.5	5.6	5.2	6.2	7.6	6.6	**0.7**	**-0.9**	**-0.2**	*-1.8*	*-1.7*
Euro area	-1.4	1.4	0.7	0.7	2.0	2.7	1.4	**-2.5**	**-3.0**	**-2.8**	*-3.3*	*-3.1*
Bulgaria	:	5.4	5.4	6.6	7.5	7.6	7.0	**1.5**	**1.5**	**1.9**	*5.0*	*5.5*
Czech Republic	:	3.3	2.9	3.5	3.7	4.7	3.0	**-0.9**	**-0.6**	**-0.5**	*0.8*	*0.6*
Denmark	-0.6	2.7	4.1	6.7	6.8	6.4	5.6	**-0.5**	**-3.1**	**-3.0**	*-1.8*	*-0.6*
Estonia	:	4.0	5.8	5.3	6.8	7.8	3.3	**2.2**	**2.5**	**2.4**	*3.1*	*3.1*
Latvia	:	1.0	2.8	3.5	5.5	5.7	0.1	**-5.0**	**-6.2**	**-7.2**	*-9.9*	*-9.6*
Lithuania	:	1.4	2.2	2.4	3.0	3.6	1.1	**-6.1**	**-5.6**	**-5.7**	*-6.8*	*-7.7*
Hungary	:	0.4	-2.4	-3.2	-4.0	-0.4	-0.3	**-1.5**	**-1.5**	**-1.7**	*-1.6*	*-1.4*
Poland	:	0.2	-0.8	-0.2	0.7	2.5	1.3	**-1.4**	**-2.1**	**-1.5**	*-2.1*	*-2.4*
Romania	:	-0.5	3.4	3.4	4.3	4.2	1.3	**-2.4**	**-2.7**	**-1.6**	*0.1*	*1.0*
Sweden	-3.8	4.1	3.7	5.4	5.7	7.0	5.7	**3.2**	**1.7**	**2.2**	*0.2*	*0.8*
United Kingdom	-3.4	1.7	-0.8	-1.1	-0.2	-0.3	-1.6	**-6.8**	**-7.4**	**-6.2**	*-9.3*	*-8.1*
EU	:	1.5	0.6	0.6	1.8	2.4	1.2	**-2.9**	**-3.4**	**-3.0**	*-3.8*	*-3.5*
USA	-2.0	2.4	-1.3	-0.7	0.2	-0.1	-3.4	**-6.4**	**-6.4**	**-5.7**	*-8.2*	*-8.4*
Japan	5.0	0.8	-1.7	-1.4	0.1	0.2	-0.3	**-4.8**	**-4.8**	**-5.2**	*-5.2*	*-5.6*

[1] ESA 79 up to 1994, ESA 95 from 1995 onwards.

TABLE 46 : Exports of goods and services, volume (percentage change on preceding year, 1992-2011)

	5-year averages							Spring 2010 forecast			Autumn 2009 forecast	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	4.0	6.3	3.9	4.6	5.0	4.5	1.5	**-10.8**	**4.3**	**4.3**	*1.4*	*2.8*
Germany	2.8	9.1	7.5	7.7	13.0	7.5	2.9	**-14.2**	**6.2**	**5.5**	*2.6*	*4.7*
Ireland	14.2	16.9	4.7	5.2	5.1	8.6	-1.0	**-2.3**	**2.0**	**4.3**	*1.2*	*3.7*
Greece	4.2	11.2	3.6	2.4	5.3	5.8	4.0	**-18.1**	**2.6**	**4.1**	*2.7*	*3.1*
Spain	10.3	8.9	3.8	2.5	6.7	6.6	-1.0	**-11.5**	**4.4**	**4.7**	*1.3*	*3.3*
France	5.2	8.1	2.4	3.1	4.8	2.6	-0.2	**-11.5**	**4.7**	**5.1**	*2.8*	*3.4*
Italy	7.7	4.3	1.4	1.1	6.2	4.6	-3.9	**-19.1**	**3.4**	**4.1**	*1.6*	*3.7*
Cyprus	:	6.1	1.6	4.9	3.5	6.1	-2.1	**-11.8**	**0.6**	**3.3**	*0.7*	*3.4*
Luxembourg	4.4	10.7	7.5	4.5	13.3	8.8	1.5	**-7.7**	**2.8**	**4.9**	*1.8*	*3.2*
Malta	:	4.8	3.0	0.6	10.5	2.7	-7.2	**-3.1**	**4.4**	**4.1**	*1.6*	*2.8*
Netherlands	5.8	8.3	4.7	6.0	7.3	6.7	2.7	**-8.2**	**5.9**	**5.2**	*1.9*	*4.1*
Austria	3.2	9.1	6.0	7.4	7.5	9.4	0.8	**-15.5**	**4.2**	**4.9**	*2.1*	*3.5*
Portugal	7.2	5.5	4.0	2.0	8.7	7.8	-0.5	**-11.6**	**3.8**	**4.4**	*0.7*	*3.3*
Slovenia	-2.1	7.9	9.0	10.6	12.5	13.7	2.9	**-15.6**	**4.3**	**4.9**	*2.4*	*4.0*
Slovakia	:	10.8	11.7	10.0	21.0	14.3	3.2	**-16.5**	**5.7**	**5.9**	*2.4*	*5.0*
Finland	10.8	10.5	5.6	7.0	12.2	7.9	6.5	**-24.3**	**4.8**	**6.8**	*4.6*	*4.8*
Euro area	5.8	8.2	4.8	5.1	8.5	6.3	1.0	**-13.0**	**4.9**	**5.0**	*2.1*	*3.9*
Bulgaria	:	5.5	9.2	8.5	8.7	5.2	2.9	**-9.8**	**4.2**	**5.2**	*2.3*	*4.5*
Czech Republic	9.7	10.3	11.3	11.6	15.8	15.0	6.0	**-10.2**	**6.5**	**6.1**	*2.1*	*5.8*
Denmark	3.4	7.2	4.5	8.1	9.0	2.2	2.4	**-10.3**	**4.8**	**5.2**	*2.1*	*4.4*
Estonia	:	13.0	10.5	18.6	14.0	0.0	-0.7	**-11.2**	**6.5**	**5.9**	*1.6*	*5.8*
Latvia	:	5.8	9.2	20.2	6.5	10.0	-1.3	**-13.9**	**6.0**	**6.0**	*1.5*	*5.0*
Lithuania	:	6.7	11.9	17.7	12.0	3.0	12.2	**-15.5**	**6.1**	**5.5**	*1.3*	*3.9*
Hungary	11.7	16.3	10.9	11.3	18.6	16.2	5.6	**-9.1**	**6.6**	**8.7**	*3.6*	*6.0*
Poland	12.2	9.7	11.0	8.0	14.6	9.1	7.1	**-9.1**	**6.0**	**5.8**	*2.9*	*5.7*
Romania	10.4	10.8	11.6	7.6	10.4	7.8	8.7	**-5.5**	**5.5**	**6.5**	*3.1*	*5.0*
Sweden	7.7	8.2	6.3	6.6	8.9	5.8	1.8	**-12.5**	**3.9**	**6.7**	*1.9*	*7.1*
United Kingdom	7.2	5.4	5.3	7.9	11.3	-2.8	1.1	**-10.6**	**5.2**	**5.4**	*1.8*	*4.6*
EU	6.9	7.9	5.3	5.9	9.3	5.5	1.5	**-12.3**	**5.0**	**5.2**	*2.1*	*4.2*
USA	7.4	4.1	4.9	6.7	9.0	8.7	5.4	**-9.7**	**11.3**	**8.1**	*7.7*	*8.4*
Japan	3.7	2.9	9.4	7.0	9.7	8.4	1.6	**-24.2**	**21.5**	**7.7**	*7.9*	*3.1*

TABLE 47 : Imports of goods and services, volume (percentage change on preceding year, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			Autumn 2009 forecast	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	4.0	5.8	3.7	5.9	4.7	4.7	3.1	**-11.1**	**3.6**	**4.5**	*0.8*	*2.9*
Germany	3.2	7.5	5.9	6.7	11.9	4.8	4.3	**-8.9**	**4.6**	**5.3**	*2.0*	*4.3*
Ireland	12.0	16.8	4.9	8.4	6.5	5.6	-2.1	**-9.3**	**-1.3**	**3.5**	*-1.0*	*3.7*
Greece	3.8	10.8	3.1	-0.3	9.0	7.1	0.2	**-14.1**	**-10.5**	**-3.4**	*-3.1*	*1.9*
Spain	6.4	11.4	7.5	7.7	10.2	8.0	-4.9	**-17.9**	**-1.1**	**1.8**	*-2.7*	*2.2*
France	3.2	8.6	4.3	5.9	5.6	5.4	0.8	**-9.8**	**4.1**	**4.5**	*2.2*	*3.7*
Italy	2.1	7.0	2.7	2.1	5.9	3.8	-4.3	**-14.5**	**2.8**	**3.5**	*2.0*	*3.9*
Cyprus	:	4.7	4.0	3.7	6.7	13.3	8.0	**-19.8**	**-1.3**	**2.4**	*-1.5*	*2.4*
Luxembourg	3.6	11.1	7.2	4.2	12.9	8.3	3.3	**-9.3**	**2.9**	**5.6**	*1.9*	*3.5*
Malta	:	2.4	3.7	3.2	9.5	0.4	-7.4	**-8.7**	**5.1**	**4.2**	*1.9*	*2.5*
Netherlands	5.5	8.9	4.4	5.4	8.8	5.1	3.7	**-8.7**	**3.1**	**5.1**	*0.5*	*2.9*
Austria	3.3	6.7	5.1	6.4	5.3	7.3	-0.7	**-13.6**	**2.5**	**3.8**	*1.6*	*3.1*
Portugal	6.8	7.7	2.7	3.5	5.1	6.1	2.7	**-9.2**	**1.1**	**1.5**	*-0.2*	*2.2*
Slovenia	3.1	7.7	8.7	6.6	12.2	16.3	2.9	**-17.9**	**3.4**	**4.9**	*0.5*	*3.5*
Slovakia	:	9.6	10.0	12.4	17.8	9.2	3.1	**-17.6**	**6.8**	**5.2**	*2.4*	*4.9*
Finland	6.0	8.4	6.6	11.4	7.9	6.0	6.6	**-22.3**	**5.0**	**6.3**	*3.8*	*4.2*
Euro area	3.9	8.3	4.9	5.8	8.5	5.5	1.1	**-11.5**	**2.9**	**4.2**	*1.1*	*3.6*
Bulgaria	:	13.1	12.7	13.1	14.0	9.9	4.9	**-22.3**	**-2.0**	**4.3**	*-2.8*	*2.3*
Czech Republic	20.1	9.8	9.9	5.0	14.3	14.3	4.7	**-10.2**	**5.3**	**5.7**	*1.8*	*5.9*
Denmark	4.3	7.2	7.5	11.2	13.4	2.6	3.3	**-13.2**	**4.9**	**5.8**	*2.0*	*4.1*
Estonia	:	12.4	14.1	17.5	22.9	4.7	-8.7	**-26.8**	**2.4**	**6.0**	*0.8*	*5.5*
Latvia	:	7.3	13.6	14.8	19.4	14.7	-13.6	**-34.2**	**-6.5**	**4.0**	*-9.7*	*2.6*
Lithuania	:	7.5	14.6	16.4	13.7	10.7	10.5	**-29.3**	**2.1**	**4.3**	*-0.5*	*3.2*
Hungary	12.0	16.9	10.3	7.0	14.8	13.3	5.7	**-15.4**	**5.4**	**9.1**	*2.5*	*6.2*
Poland	15.3	9.7	9.9	4.7	17.3	13.7	8.0	**-14.3**	**6.3**	**6.7**	*3.3*	*6.7*
Romania	8.1	12.3	17.8	16.0	22.6	27.3	7.8	**-20.6**	**3.9**	**7.6**	*5.0*	*7.5*
Sweden	4.4	7.6	4.9	7.0	8.7	9.4	3.0	**-13.4**	**5.7**	**7.3**	*1.3*	*7.0*
United Kingdom	6.2	8.1	5.9	7.1	8.8	-0.7	-0.5	**-11.9**	**5.3**	**4.1**	*0.1*	*3.0*
EU	5.4	8.4	5.6	6.3	9.2	5.5	1.4	**-12.1**	**3.4**	**4.6**	*1.1*	*3.8*
USA	8.8	9.2	6.2	6.1	6.1	2.0	-3.2	**-13.9**	**10.1**	**5.7**	*7.5*	*5.7*
Japan	6.5	1.3	4.6	5.8	4.2	1.6	0.9	**-17.1**	**8.2**	**8.4**	*2.9*	*7.6*

TABLE 48 : Merchandise trade balance (fob-fob, as a percentage of GDP, 1992-2011)

	5-year averages							Spring 2010 forecast			Autumn 2009 forecast	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	3.1	3.0	3.4	2.1	1.9	1.6	-1.6	**-0.3**	**0.1**	**0.2**	*-0.7*	*-1.0*
Germany	2.2	3.6	6.7	7.1	7.0	8.2	7.3	**5.6**	**5.5**	**5.6**	*4.7*	*4.7*
Ireland	16.5	24.0	20.6	17.4	14.2	10.4	13.1	**20.0**	**23.1**	**23.6**	*22.5*	*22.2*
Greece	-12.0	-15.4	-17.6	-16.3	-17.1	-17.7	-16.6	**-14.0**	**-12.0**	**-10.9**	*-10.3*	*-10.5*
Spain	-3.3	-4.6	-6.5	-7.5	-8.4	-8.6	-7.9	**-4.2**	**-3.8**	**-3.3**	*-3.2*	*-3.2*
France	0.6	1.0	-0.5	-1.3	-1.5	-2.0	-2.7	**-2.2**	**-2.7**	**-2.6**	*-1.4*	*-1.4*
Italy	2.7	2.1	0.4	0.0	-0.7	0.2	-0.1	**0.1**	**-0.1**	**0.0**	*0.2*	*0.2*
Cyprus	:	-24.6	-25.8	-25.0	-27.2	-29.7	-32.2	**-24.8**	**-24.6**	**-25.2**	*-23.6*	*-24.1*
Luxembourg	-10.2	-12.7	-10.4	-11.9	-9.3	-8.6	-10.4	**-7.3**	**-7.6**	**-8.3**	*-8.6*	*-8.1*
Malta	-22.4	-17.6	-14.8	-18.9	-18.9	-18.0	-19.4	**-13.5**	**-14.7**	**-15.2**	*-15.4*	*-15.7*
Netherlands	5.0	5.3	7.2	7.9	7.7	8.0	7.4	**6.6**	**8.3**	**8.5**	*6.2*	*6.8*
Austria	-4.2	-2.2	-0.1	-0.4	0.3	0.7	0.1	**-0.9**	**-0.6**	**0.2**	*-2.4*	*-2.1*
Portugal	-9.8	-10.6	-9.6	-10.3	-10.1	-10.1	-12.1	**-10.0**	**-9.6**	**-9.1**	*-9.7*	*-9.7*
Slovenia	-1.1	-4.4	-2.9	-3.6	-3.8	-4.9	-7.2	**-1.6**	**-2.0**	**-2.2**	*-1.3*	*-1.5*
Slovakia	:	-8.6	-5.2	-5.4	-5.4	-1.8	-1.5	**1.6**	**-0.2**	**0.3**	*-0.5*	*-0.1*
Finland	7.3	9.8	6.6	4.7	5.2	5.1	3.7	**2.3**	**1.9**	**1.9**	*1.9*	*1.9*
Euro area	1.1	1.5	1.5	1.1	0.7	1.0	0.4	**0.7**	**0.8**	**1.0**	*0.8*	*0.8*
Euro area, adjusted [1]				0.5	0.1	0.5	-0.1	**0.3**	**0.4**	**0.6**	*0.3*	*0.4*
Bulgaria	-2.6	-5.6	-16.4	-20.2	-22.0	-25.5	-25.8	**-12.1**	**-9.5**	**-9.3**	*-12.9*	*-11.7*
Czech Republic	-5.2	-5.3	-0.4	2.0	2.0	3.4	2.7	**5.0**	**5.4**	**5.4**	*3.5*	*3.6*
Denmark	4.1	3.7	3.4	2.8	1.1	0.1	-0.2	**2.1**	**2.4**	**2.3**	*0.2*	*0.5*
Estonia	:	-16.6	-15.8	-14.0	-18.1	-17.8	-11.7	**-3.9**	**-2.7**	**-2.6**	*-5.4*	*-5.5*
Latvia	-7.0	-14.8	-19.7	-18.9	-25.6	-23.9	-17.0	**-6.6**	**-4.0**	**-3.0**	*-4.6*	*-4.3*
Lithuania	:	-11.3	-10.8	-11.3	-13.9	-15.0	-12.0	**-3.2**	**-2.8**	**-2.4**	*-0.1*	*0.1*
Hungary	-5.6	-4.4	-3.1	-2.5	-2.3	0.2	-0.1	**4.9**	**5.7**	**5.7**	*3.0*	*2.3*
Poland	-0.1	-6.4	-2.3	-0.9	-2.0	-4.0	-4.9	**-1.0**	**-1.2**	**-1.7**	*-3.1*	*-3.4*
Romania	-7.3	-6.5	-8.8	-9.8	-12.0	-14.3	-13.6	**-5.8**	**-5.1**	**-5.1**	*-6.2*	*-6.5*
Sweden	5.0	6.9	6.2	5.8	5.6	4.6	4.0	**3.6**	**3.3**	**3.2**	*5.7*	*6.0*
United Kingdom	-1.8	-2.9	-5.0	-5.5	-5.8	-6.4	-6.4	**-5.9**	**-6.4**	**-6.7**	*-5.5*	*-5.2*
EU	-0.4	0.7	0.3	-0.1	-0.5	-0.6	-1.0	**-0.1**	**-0.1**	**0.0**	*-0.1*	*0.0*
EU, adjusted [1]				-0.8	-1.4	-1.3	-1.6	**-0.8**	**-0.8**	**-0.7**	*-0.8*	*-0.7*
USA	-2.1	-3.6	-5.7	-6.4	-6.5	-6.1	-6.0	**-3.8**	**-4.5**	**-4.5**	*-4.2*	*-4.2*
Japan	2.7	2.5	2.3	2.1	1.9	2.4	0.8	**0.9**	**1.0**	**0.8**	*0.9*	*0.5*

[1] See note 8 on concepts and sources.

TABLE 49 : Current account balance (as a percentage of GDP, 1992-2011) 20.04.2010

	5-year averages							Spring 2010 forecast			Autumn 2009 forecast	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	4.3	4.6	4.6	3.3	3.4	3.7	0.2	**2.0**	**3.0**	**3.3**	*0.9*	*0.8*
Germany	-1.1	-0.8	4.2	5.2	6.6	7.9	6.6	**5.0**	**4.8**	**4.8**	*3.8*	*3.7*
Ireland	2.5	0.5	-1.4	-3.3	-4.1	-5.3	-5.2	**-2.9**	**-0.9**	**-0.6**	*-1.8*	*-1.5*
Greece	-0.5	-6.7	-11.8	-11.0	-12.8	-14.7	-13.8	**-13.1**	**-10.3**	**-8.6**	*-7.9*	*-7.7*
Spain	-1.4	-2.4	-6.0	-7.5	-9.0	-10.0	-9.5	**-5.1**	**-4.6**	**-4.5**	*-4.6*	*-4.2*
France	0.5	1.9	-0.6	-1.8	-1.8	-2.3	-3.3	**-2.9**	**-3.3**	**-3.6**	*-2.2*	*-2.4*
Italy	1.0	1.2	-1.0	-1.2	-2.0	-1.8	-3.1	**-3.2**	**-3.2**	**-2.9**	*-2.4*	*-2.4*
Cyprus	:	-4.3	-4.8	-5.9	-7.0	-11.7	-17.7	**-8.5**	**-7.1**	**-7.0**	*-9.0*	*-7.7*
Luxembourg	12.8	10.0	10.4	11.0	10.3	9.7	5.3	**-0.4**	**0.9**	**1.5**	*11.2*	*12.2*
Malta	:	-6.4	-4.9	-8.8	-9.2	-6.2	-5.4	**-3.9**	**-4.9**	**-4.4**	*-2.8*	*-2.5*
Netherlands	4.6	4.8	7.5	7.5	9.0	8.5	4.2	**3.9**	**5.9**	**6.4**	*3.1*	*3.9*
Austria	-2.5	-1.4	2.4	2.2	3.0	3.4	3.6	**2.9**	**3.1**	**4.1**	*1.4*	*1.8*
Portugal	-5.4	-8.7	-8.6	-9.8	-10.4	-9.8	-12.1	**-10.5**	**-10.1**	**-10.0**	*-10.2*	*-10.2*
Slovenia	2.5	-1.8	-1.4	-1.8	-2.4	-4.5	-6.2	**-0.9**	**-1.4**	**-1.6**	*-0.2*	*-0.6*
Slovakia	:	-6.4	-7.4	-8.5	-8.2	-5.1	-6.7	**-3.1**	**-4.5**	**-4.1**	*-5.3*	*-5.0*
Finland	0.5	6.6	5.6	3.5	4.6	4.3	3.5	**1.5**	**1.1**	**1.3**	*1.2*	*1.3*
Euro area	0.2	0.4	0.5	0.2	0.3	0.3	-0.9	**-0.6**	**-0.4**	**-0.3**	*-0.5*	*-0.5*
Euro area, adjusted [1]				0.1	-0.1	0.1	-1.1	**-0.8**	**-0.6**	**-0.5**	*-0.8*	*-0.7*
Bulgaria	-4.3	-2.7	-9.0	-11.5	-18.6	-22.5	-22.9	**-9.6**	**-6.0**	**-5.2**	*-9.8*	*-7.9*
Czech Republic	-2.1	-4.1	-4.4	-1.7	-2.1	-2.6	-3.4	**-1.0**	**-0.3**	**-1.5**	*-1.4*	*-0.8*
Denmark	1.8	1.2	3.3	4.3	3.0	1.5	2.2	**4.0**	**3.9**	**3.7**	*2.2*	*2.9*
Estonia	:	-7.4	-12.1	-10.1	-17.1	-17.9	-9.4	**4.6**	**4.9**	**3.8**	*1.3*	*-0.3*
Latvia	6.0	-7.3	-12.5	-12.5	-22.5	-22.5	-13.0	**8.7**	**8.3**	**4.6**	*5.4*	*3.4*
Lithuania	:	-8.5	-7.4	-7.1	-10.4	-15.1	-11.9	**2.6**	**2.8**	**2.0**	*0.3*	*-0.4*
Hungary	:	-7.8	-8.0	-8.1	-7.5	-6.5	-7.2	**0.4**	**-0.2**	**-0.3**	*-1.7*	*-1.8*
Poland	0.6	-4.0	-2.4	-1.2	-3.0	-5.2	-5.0	**-1.6**	**-2.8**	**-3.3**	*-2.8*	*-3.2*
Romania	:	-5.4	-6.3	-8.9	-10.6	-13.6	-12.7	**-4.4**	**-4.4**	**-5.6**	*-5.5*	*-5.7*
Sweden	1.3	4.6	6.7	6.1	8.5	9.1	9.5	**7.1**	**6.1**	**6.1**	*7.9*	*8.3*
United Kingdom	-1.4	-1.5	-2.3	-2.6	-3.3	-2.7	-1.5	**-1.3**	**-1.8**	**-2.0**	*-1.6*	*-0.9*
EU	-0.2	0.0	0.0	-0.3	-0.4	-0.4	-1.1	**-0.5**	**-0.4**	**-0.4**	*-0.5*	*-0.4*
EU, adjusted [1]				-0.7	-1.2	-1.1	-2.0	**-1.4**	**-1.4**	**-1.3**	*-1.5*	*-1.3*
USA	-1.3	-3.0	-5.2	-5.9	-6.0	-5.2	-4.9	**-3.0**	**-3.7**	**-3.7**	*-3.4*	*-3.3*
Japan	2.4	2.5	3.5	3.6	3.9	4.8	3.2	**2.8**	**3.1**	**2.5**	*2.0*	*1.0*

[1] See note 8 on concepts and sources.

TABLE 50 : Net lending (+) or net borrowing (-) of the nation (as a percentage of GDP, 1992-2011)

	5-year averages							Spring 2010 forecast			Autumn 2009 forecast	
	1992-96	1997-01	2002-06	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	4.1	4.5	4.4	3.1	3.3	3.5	-0.2	**1.9**	**2.7**	**3.0**	*0.4*	*0.3*
Germany	-1.1	-0.7	4.2	5.2	6.6	7.9	6.6	**5.0**	**4.8**	**4.8**	*3.8*	*3.7*
Ireland	3.7	1.4	-1.2	-3.2	-4.0	-5.3	-5.2	**-2.8**	**-0.9**	**-0.6**	*-1.8*	*-1.4*
Greece	:	-5.0	-10.3	-9.7	-10.5	-12.5	-12.4	**-12.3**	**-9.4**	**-7.6**	*-6.8*	*-6.7*
Spain	-0.7	-1.4	-5.1	-6.5	-8.4	-9.6	-9.1	**-4.7**	**-4.0**	**-4.0**	*-3.7*	*-3.3*
France	0.5	2.0	-0.7	-1.8	-1.8	-2.2	-3.3	**-3.0**	**-3.4**	**-3.6**	*-2.3*	*-2.3*
Italy	1.1	1.4	-0.9	-1.1	-1.9	-1.7	-3.1	**-3.1**	**-2.9**	**-2.6**	*-2.3*	*-2.3*
Cyprus	:	-4.3	-4.3	-5.3	-6.8	-11.7	-17.6	**-8.2**	**-6.8**	**-6.7**	*-8.8*	*-7.5*
Luxembourg	:	:	10.1	13.9	9.4	9.3	4.7	**-0.4**	**0.9**	**1.5**	*11.2*	*12.2*
Malta	:	-6.0	-3.3	-5.5	-6.2	-5.2	-4.9	**-2.6**	**-3.4**	**-2.7**	*-1.8*	*-1.4*
Netherlands	4.2	4.6	7.2	7.1	8.7	8.1	3.9	**3.6**	**5.6**	**6.0**	*2.7*	*3.6*
Austria	-2.6	-1.5	2.2	2.1	2.7	3.3	3.6	**2.9**	**3.1**	**4.1**	*1.3*	*1.7*
Portugal	-2.7	-6.4	-6.9	-8.3	-9.3	-8.4	-10.2	**-9.4**	**-8.8**	**-8.6**	*-8.6*	*-8.6*
Slovenia	2.4	-1.7	-1.8	-2.1	-2.8	-4.7	-6.1	**-0.9**	**-0.7**	**-1.0**	*-0.1*	*-0.5*
Slovakia	:	-6.6	-7.8	-8.9	-7.8	-4.7	-5.8	**-2.4**	**-3.7**	**-3.2**	*-4.3*	*-4.2*
Finland	0.1	6.5	5.7	3.6	4.7	4.0	2.5	**1.6**	**1.2**	**1.4**	*1.2*	*1.3*
Euro area	0.3	0.6	0.7	0.4	0.5	0.6	-0.7	**-0.4**	**-0.3**	**-0.1**	*-0.4*	*-0.3*
Euro area, adjusted [1]				0.3	0.1	0.4	-0.9	**-0.6**	**-0.5**	**-0.3**	*-0.7*	*-0.6*
Bulgaria	-4.6	-2.5	-8.6	-10.6	-17.9	-21.3	-22.1	**-8.2**	**-4.3**	**-3.5**	*-8.7*	*-6.7*
Czech Republic	-3.0	-4.0	-4.1	-2.3	-1.7	-1.9	-2.4	**0.8**	**1.3**	**-0.2**	*-0.7*	*-0.4*
Denmark	1.8	1.4	3.3	4.5	3.0	1.5	2.2	**4.0**	**4.2**	**3.9**	*0.5*	*1.0*
Estonia	:	-7.0	-11.1	-9.4	-15.0	-16.9	-8.2	**7.4**	**7.4**	**6.2**	*3.7*	*2.4*
Latvia	11.9	-7.0	-11.6	-11.2	-21.3	-20.6	-11.5	**11.0**	**10.8**	**7.1**	*8.0*	*6.1*
Lithuania	:	-8.5	-6.6	-6.1	-8.9	-12.9	-10.0	**5.2**	**6.3**	**5.6**	*4.8*	*4.3*
Hungary	:	-7.5	-7.6	-7.5	-6.9	-5.5	-5.9	**1.8**	**1.4**	**1.5**	*0.3*	*0.4*
Poland	2.4	-4.0	-2.2	-0.9	-2.1	-4.1	-4.2	**0.0**	**-0.8**	**-1.0**	*-0.3*	*-0.7*
Romania	-3.8	-5.3	-5.7	-7.9	-10.4	-13.0	-12.3	**-3.9**	**-3.9**	**-5.1**	*-5.1*	*-5.2*
Sweden	0.9	4.3	6.6	6.2	7.9	9.0	9.3	**7.1**	**6.0**	**6.1**	*7.7*	*8.1*
United Kingdom	-1.3	-1.4	-2.2	-2.5	-3.2	-2.5	-1.3	**-1.1**	**-1.6**	**-1.7**	*-1.4*	*-0.7*
EU	-0.6	-0.6	-0.9	-1.4	-2.1	-2.5	-3.0	**-1.0**	**-0.2**	**-0.1**	*-0.3*	*-0.2*
EU, adjusted [1]				-1.9	-2.9	-3.2	-3.9	**-1.9**	**-1.1**	**-1.0**	*-1.3*	*-1.1*
USA	-2.6	-2.1	-5.0	-5.2	-6.0	-5.2	-4.9	**-3.0**	**-3.8**	**-3.8**	*-3.4*	*-3.3*
Japan	2.4	2.3	3.4	3.5	3.8	4.7	3.1	**2.7**	**2.9**	**2.4**	*1.9*	*0.9*

[1] See note 8 on concepts and sources.

TABLE 51 : Merchandise trade balance (fob-fob, in billions of euro, 2002-2011) 20.04.2010

								Spring 2010 forecast			*Autumn 2009 forecast*	
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	12.9	12.3	10.2	6.4	6.2	5.3	-5.4	-1.1	0.3	0.8	-2.4	-3.4
Germany	136.6	131.9	154.0	158.7	162.0	199.1	181.3	134.5	135.1	140.3	114.6	117.1
Ireland	35.4	32.6	31.4	28.2	25.0	19.8	23.8	32.6	36.8	39.1	36.0	37.0
Greece	-30.0	-30.9	-32.3	-31.9	-35.9	-40.0	-39.7	-33.3	-28.5	-26.3	-25.1	-26.2
Spain	-36.6	-40.2	-53.2	-67.9	-82.5	-90.8	-86.4	-44.0	-39.7	-35.8	-33.9	-34.1
France	8.4	2.4	-5.1	-21.6	-27.1	-38.8	-53.1	-42.0	-53.4	-52.2	-28.8	-28.1
Italy	14.3	9.5	8.8	0.4	-10.2	3.2	-2.1	2.2	-2.0	0.7	3.9	3.9
Cyprus	-3.0	-2.8	-3.3	-3.4	-4.0	-4.7	-5.5	-4.2	-4.2	-4.5	-4.2	-4.5
Luxembourg	-2.5	-2.7	-2.7	-3.6	-3.2	-3.2	-4.1	-2.8	-3.0	-3.5	-3.4	-3.3
Malta	-0.4	-0.6	-0.7	-0.9	-1.0	-1.0	-1.1	-0.8	-0.9	-0.9	-0.9	-1.0
Netherlands	31.2	31.0	35.4	40.7	41.5	45.6	44.3	37.9	48.2	51.5	36.2	40.9
Austria	1.4	-1.5	-0.6	-1.0	0.7	1.9	0.2	-2.5	-1.7	0.6	-6.6	-6.2
Portugal	-13.1	-11.2	-13.7	-15.4	-15.7	-16.4	-20.2	-16.3	-16.0	-15.6	-15.9	-16.4
Slovenia	-0.3	-0.6	-1.0	-1.0	-1.2	-1.7	-2.7	-0.6	-0.7	-0.8	-0.5	-0.6
Slovakia	-2.4	-0.7	-1.3	-2.1	-2.4	-1.0	-1.0	1.0	-0.1	0.2	-0.3	-0.1
Finland	13.1	11.0	9.8	7.4	8.6	9.1	6.9	3.9	3.3	3.5	3.5	3.4
Euro area	164.8	139.6	135.9	92.9	60.9	86.5	35.1	64.7	73.4	97.1	72.3	78.6
Euro area, adjusted [1]	:	98.8	94.3	43.7	12.3	46.4	-6.0	23.6	32.3	56.0	30.1	36.4
Bulgaria	-1.9	-2.4	-3.0	-4.4	-5.6	-7.4	-8.8	-4.1	-3.3	-3.3	-4.4	-4.2
Czech Republic	-2.3	-2.2	-0.4	2.0	2.3	4.3	4.0	6.8	7.8	8.1	4.9	5.3
Denmark	8.7	8.9	7.3	5.9	2.4	0.3	-0.5	4.8	5.4	5.4	0.5	1.2
Estonia	-1.2	-1.4	-1.6	-1.6	-2.4	-2.8	-1.9	-0.5	-0.4	-0.4	-0.7	-0.8
Latvia	-1.6	-1.8	-2.3	-2.5	-4.1	-5.1	-3.9	-1.2	-0.7	-0.5	-0.8	-0.7
Lithuania	-1.4	-1.5	-1.9	-2.4	-3.3	-4.3	-3.9	-0.9	-0.7	-0.6	0.0	0.0
Hungary	-2.3	-2.9	-2.9	-2.2	-2.1	0.2	-0.1	4.6	5.8	6.0	3.0	2.4
Poland	-7.7	-5.1	-4.6	-2.2	-5.5	-12.3	-17.8	-3.2	-4.5	-6.4	-10.2	-11.7
Romania	-2.8	-4.0	-5.3	-7.8	-11.8	-17.9	-19.0	-6.7	-6.3	-6.9	-7.7	-8.6
Sweden	17.4	17.5	19.7	17.1	17.6	15.1	13.2	10.3	10.6	11.0	17.8	19.6
United Kingdom	-75.9	-70.3	-89.8	-100.3	-111.9	-131.2	-117.4	-91.9	-105.7	-113.8	-85.4	-84.6
EU	94.0	74.4	51.2	-5.5	-63.5	-74.3	-120.8	-17.3	-18.5	-4.4	-10.8	-3.6
EU, adjusted [1]	:	:	-43.1	-96.0	-165.0	-160.1	-206.3	-102.8	-104.1	-89.9	-96.3	-89.1
USA	-522.0	-497.9	-551.0	-644.8	-685.6	-619.4	-586.2	-386.4	-488.4	-507.4	-411.5	-421.0
Japan	97.8	91.5	103.5	75.5	64.8	76.4	26.6	31.2	39.5	31.7	34.2	17.8

[1] See note 8 on concepts and sources.

TABLE 52 : Current account balance (in billions of euro, 2002-2011) 20.04.2010

								Spring 2010 forecast			*Autumn 2009 forecast*	
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	16.2	15.4	13.5	10.0	10.8	12.4	0.7	6.9	10.4	11.7	3.1	2.7
Germany	46.1	44.4	106.5	117.3	154.2	192.1	165.8	120.0	117.4	121.3	92.7	92.6
Ireland	-0.5	1.2	-0.2	-5.4	-7.3	-10.1	-9.5	-4.7	-1.5	-1.1	-2.9	-2.6
Greece	-19.8	-21.1	-19.1	-21.5	-26.9	-33.2	-33.0	-31.2	-24.4	-20.7	-19.3	-19.3
Spain	-27.4	-31.6	-49.5	-67.8	-88.9	-105.4	-103.9	-53.6	-48.1	-48.3	-47.8	-44.5
France	12.2	3.9	-9.7	-30.8	-33.0	-43.0	-64.7	-56.3	-64.8	-73.5	-44.4	-48.4
Italy	-4.3	-12.0	-7.6	-17.1	-29.5	-28.1	-48.7	-48.0	-50.3	-47.2	-37.0	-38.6
Cyprus	-0.4	-0.3	-0.6	-0.8	-1.0	-1.9	-3.0	-1.4	-1.2	-1.3	-1.6	-1.4
Luxembourg	2.5	2.1	3.3	3.3	3.5	3.6	-1.2	-0.2	0.3	0.6	4.4	5.0
Malta	0.1	-0.1	-0.3	-0.4	-0.5	-0.3	-0.3	-0.2	-0.3	-0.3	-0.2	-0.1
Netherlands	28.2	29.2	42.2	38.4	48.7	48.6	25.2	22.0	34.7	38.5	17.9	23.6
Austria	6.0	3.9	5.2	5.3	7.6	9.1	10.2	8.1	8.7	12.0	3.9	5.3
Portugal	-11.5	-8.9	-11.3	-14.6	-16.2	-16.0	-20.1	-17.2	-16.9	-17.1	-16.8	-17.1
Slovenia	0.2	-0.2	-0.7	-0.5	-0.7	-1.6	-2.3	-0.3	-0.5	-0.6	-0.1	-0.2
Slovakia	-1.9	-1.9	-2.2	-3.3	-3.7	-2.8	-4.5	-2.0	-3.0	-2.9	-3.7	-3.7
Finland	12.2	7.4	9.6	5.5	7.7	7.7	6.3	2.5	1.9	2.3	2.2	2.4
Euro area	58.0	31.5	79.0	17.6	25.0	31.1	-83.0	-55.5	-37.6	-26.3	-49.5	-44.4
Euro area, adjusted [1]	:	20.7	60.6	9.2	-10.5	11.1	-101.0	-73.5	-55.6	-44.3	-73.8	-68.7
Bulgaria	-0.4	-1.0	-1.3	-2.5	-4.7	-6.5	-8.7	-3.3	-2.1	-1.9	-3.3	-2.8
Czech Republic	-4.9	-5.3	-4.8	-1.7	-2.4	-3.3	-5.1	-1.4	-0.5	-2.3	-1.9	-1.1
Denmark	4.6	6.5	5.9	9.0	6.5	3.4	6.3	8.9	9.0	8.7	5.0	6.9
Estonia	-0.8	-1.0	-1.1	-1.1	-2.3	-2.8	-1.5	0.6	0.7	0.5	0.2	0.0
Latvia	-0.7	-0.8	-1.4	-1.6	-3.6	-4.8	-3.0	1.6	1.4	0.8	0.9	0.6
Lithuania	-0.8	-1.1	-1.4	-1.5	-2.5	-4.3	-3.8	0.7	0.7	0.5	0.1	-0.1
Hungary	-4.8	-6.2	-7.6	-7.2	-6.8	-6.6	-7.6	0.4	-0.2	-0.3	-1.6	-1.8
Poland	-4.5	-3.3	-8.4	-3.0	-8.1	-16.1	-18.3	-4.9	-10.1	-12.7	-9.2	-11.0
Romania	-0.5	-2.6	-3.5	-7.1	-10.4	-17.0	-17.7	-5.0	-5.5	-7.6	-6.8	-7.5
Sweden	14.4	18.9	19.2	18.1	26.7	30.2	31.5	20.5	19.9	21.1	24.7	27.1
United Kingdom	-29.7	-26.5	-36.7	-48.0	-64.3	-55.1	-27.6	-20.7	-30.2	-33.5	-25.2	-14.4
EU	29.9	9.1	37.8	-29.2	-46.8	-51.8	-138.4	-58.1	-54.4	-52.8	-66.8	-48.7
EU, adjusted [1]	:	:	-37.2	-83.8	-148.5	-140.4	-255.0	-174.7	-171.0	-169.4	-186.9	-168.8
USA	-477.6	-456.9	-502.7	-595.4	-636.1	-529.1	-482.4	-309.4	-403.6	-417.1	-330.4	-329.6
Japan	119.8	120.5	138.6	133.4	136.0	153.8	109.2	103.2	116.1	98.2	71.4	36.0

[1] See note 8 on concepts and sources.

TABLE 53 : Export markets (a) (percentage change on preceding year, 2002-2011) 20.04.2010

									Spring 2010 forecast		*Autumn 2009 forecast*	
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	:	:	:	6.1	8.8	5.3	2.1	**-10.6**	**5.0**	**5.2**	*2.0*	*4.0*
Germany	:	:	:	6.2	8.7	6.8	2.2	**-11.7**	**5.6**	**5.2**	*2.2*	*4.1*
Ireland	:	:	:	5.7	8.3	4.1	1.2	**-11.5**	**6.2**	**5.2**	*2.4*	*4.1*
Greece	:	:	:	6.5	8.7	5.7	1.7	**-12.4**	**5.5**	**5.3**	*2.5*	*4.2*
Spain	:	:	:	5.6	8.3	5.0	1.9	**-10.6**	**5.0**	**4.9**	*2.0*	*3.8*
France	:	:	:	6.0	8.6	5.9	1.8	**-11.1**	**5.4**	**5.2**	*1.9*	*4.0*
Italy	:	:	:	6.7	9.2	6.6	2.7	**-11.0**	**5.2**	**5.2**	*2.1*	*4.0*
Cyprus	:	:	:	8.3	10.8	6.7	2.2	**-13.6**	**3.1**	**3.7**	*1.2*	*3.5*
Luxembourg	:	:	:	5.3	7.9	4.9	1.6	**-11.2**	**4.4**	**4.8**	*1.6*	*3.9*
Malta	:	:	:	6.4	8.6	5.2	1.8	**-11.7**	**6.0**	**5.6**	*2.1*	*4.1*
Netherlands	:	:	:	5.8	8.8	5.5	2.3	**-11.2**	**5.1**	**5.1**	*1.9*	*4.0*
Austria	:	:	:	6.0	10.0	6.8	2.8	**-11.5**	**5.2**	**5.3**	*2.2*	*4.3*
Portugal	:	:	:	6.2	8.7	5.5	0.9	**-12.6**	**4.3**	**4.5**	*1.1*	*3.6*
Slovenia	:	:	:	5.5	9.3	7.3	2.7	**-13.1**	**4.3**	**4.9**	*2.1*	*4.0*
Slovakia	:	:	:	5.9	10.8	8.3	3.2	**-12.3**	**5.0**	**5.4**	*2.0*	*4.5*
Finland	:	:	:	8.4	10.6	8.7	3.6	**-12.2**	**6.4**	**5.6**	*2.2*	*4.4*
Euro area (b)	:	:	:	6.1	8.8	6.1	2.2	**-11.3**	**5.3**	**5.2**	*2.1*	*4.0*
Bulgaria	:	:	:	6.6	9.4	8.5	2.4	**-12.8**	**4.1**	**4.9**	*1.9*	*4.1*
Czech Republic	:	:	:	6.5	10.8	7.0	3.2	**-12.3**	**5.1**	**5.2**	*2.0*	*4.3*
Denmark	:	:	:	7.0	8.8	6.4	2.4	**-11.4**	**6.1**	**5.8**	*2.3*	*4.6*
Estonia	:	:	:	9.7	10.0	9.3	1.8	**-17.7**	**4.9**	**5.4**	*1.6*	*4.2*
Latvia	:	:	:	9.1	11.8	8.9	3.8	**-17.0**	**5.0**	**5.1**	*1.7*	*4.1*
Lithuania	:	:	:	10.2	12.0	11.1	2.5	**-16.6**	**5.2**	**5.0**	*1.2*	*4.0*
Hungary	:	:	:	6.2	10.2	7.8	3.5	**-12.5**	**5.1**	**5.2**	*2.1*	*4.3*
Poland	:	:	:	7.3	10.5	8.0	3.5	**-12.4**	**5.3**	**5.1**	*1.9*	*4.1*
Romania	:	:	:	5.6	8.4	7.0	1.7	**-12.4**	**4.9**	**5.1**	*2.0*	*4.1*
Sweden	:	:	:	7.5	9.0	5.9	2.3	**-11.9**	**5.7**	**5.4**	*2.4*	*4.1*
United Kingdom	:	:	:	6.5	7.8	6.2	1.6	**-11.1**	**5.7**	**5.5**	*2.5*	*4.3*
EU (b)	:	:	:	6.3	8.8	6.2	2.2	**-11.5**	**5.4**	**5.2**	*2.1*	*4.1*
USA	:	:	:	6.7	8.2	7.2	3.5	**-11.2**	**8.5**	**6.7**	*3.8*	*5.1*
Japan	:	:	:	7.2	8.8	7.7	3.7	**-9.0**	**10.6**	**7.0**	*4.1*	*4.7*

(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 54 : Export performance (a) (percentage change on preceding year, 2002-2011)

									Spring 2010 forecast		*Autumn 2009 forecast*	
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Belgium	:	:	:	-1.4	-3.5	-0.8	-0.6	**-0.2**	**-0.7**	**-0.9**	*-0.6*	*-1.2*
Germany	:	:	:	1.4	3.9	0.7	0.7	**-2.8**	**0.6**	**0.3**	*0.4*	*0.6*
Ireland	:	:	:	-0.5	-3.0	4.3	-2.2	**10.4**	**-4.0**	**-0.9**	*-1.2*	*-0.4*
Greece	:	:	:	-3.8	-3.1	0.1	2.2	**-6.5**	**-2.7**	**-1.1**	*0.2*	*-1.1*
Spain	:	:	:	-2.9	-1.5	1.6	-2.8	**-1.0**	**-0.5**	**-0.2**	*-0.7*	*-0.5*
France	:	:	:	-2.7	-3.5	-3.2	-2.0	**-0.4**	**-0.7**	**-0.1**	*0.8*	*-0.6*
Italy	:	:	:	-5.3	-2.7	-1.9	-6.4	**-9.1**	**-1.7**	**-1.0**	*-0.5*	*-0.3*
Cyprus	:	:	:	-3.2	-6.6	-0.6	-4.2	**2.1**	**-2.4**	**-0.4**	*-0.5*	*-0.1*
Luxembourg	:	:	:	-0.8	5.0	3.8	-0.1	**3.9**	**-1.5**	**0.1**	*0.2*	*-0.7*
Malta	:	:	:	-5.5	1.7	-2.4	-8.9	**9.7**	**-1.5**	**-1.4**	*-0.5*	*-1.2*
Netherlands	:	:	:	0.2	-1.4	1.1	0.4	**3.4**	**0.9**	**0.2**	*0.0*	*0.1*
Austria	:	:	:	1.3	-2.3	2.4	-2.0	**-4.5**	**-1.0**	**-0.4**	*-0.1*	*-0.8*
Portugal	:	:	:	-4.0	0.0	2.2	-1.4	**1.3**	**-0.5**	**-0.1**	*-0.4*	*-0.3*
Slovenia	:	:	:	4.8	3.0	5.9	0.2	**-2.9**	**0.1**	**0.0**	*0.3*	*0.0*
Slovakia	:	:	:	3.8	9.2	5.5	0.0	**-4.8**	**0.8**	**0.5**	*0.4*	*0.5*
Finland	:	:	:	-1.3	1.4	-0.7	2.8	**-13.9**	**-1.4**	**1.2**	*2.3*	*0.4*
Euro area (b)	:	:	:	-1.0	-0.3	0.2	-1.2	**-1.9**	**-0.4**	**-0.2**	*0.1*	*-0.1*
Bulgaria	:	:	:	1.8	-0.6	-3.1	0.5	**3.4**	**0.3**	**0.4**	*0.5*	*0.4*
Czech Republic	:	:	:	4.8	4.5	7.5	2.7	**2.2**	**1.3**	**0.9**	*0.1*	*1.4*
Denmark	:	:	:	1.0	0.2	-4.0	0.0	**1.2**	**-1.3**	**-0.6**	*-0.2*	*-0.2*
Estonia	:	:	:	8.1	3.6	-8.5	-2.4	**7.9**	**1.5**	**0.6**	*0.0*	*1.5*
Latvia	:	:	:	10.2	-4.7	1.0	-4.9	**3.7**	**1.0**	**0.9**	*-0.2*	*0.9*
Lithuania	:	:	:	6.8	0.0	-7.3	9.4	**1.4**	**0.8**	**0.5**	*0.1*	*-0.1*
Hungary	:	:	:	4.8	7.7	7.8	2.0	**3.8**	**1.5**	**3.3**	*1.5*	*1.6*
Poland	:	:	:	0.6	3.7	1.0	3.4	**3.7**	**0.7**	**0.7**	*1.0*	*1.5*
Romania	:	:	:	1.9	1.9	0.8	6.9	**7.8**	**0.6**	**1.3**	*1.1*	*0.9*
Sweden	:	:	:	-0.8	-0.1	-0.1	-0.4	**-0.8**	**-1.7**	**1.2**	*-0.5*	*2.9*
United Kingdom	:	:	:	1.3	3.2	-8.5	-0.5	**0.6**	**-0.5**	**-0.1**	*-0.7*	*0.3*
EU (b)	:	:	:	-0.4	0.5	-0.7	-0.7	**-1.0**	**-0.4**	**0.0**	*0.1*	*0.1*
USA	:	:	:	0.0	0.7	1.4	1.8	**1.7**	**2.6**	**1.3**	*3.8*	*3.1*
Japan	:	:	:	-0.2	0.8	0.7	-2.0	**-16.7**	**9.9**	**0.7**	*3.7*	*-1.5*

(a) Index for exports of goods and services divided by an index for growth of markets.

(b) Intra- and extra-EU trade.

TABLE 55 : World GDP, volume (percentage change on preceding year, 2004-2011) 20.04.2010

	(a)	2004	2005	2006	2007	2008	2009	Spring 2010 forecast 2010	2011	Autumn 2009 forecast *2010*	*2011*
EU	22.1	2.5	2.0	3.2	2.9	0.7	**-4.2**	**1.0**	**1.7**	*0.7*	*1.6*
Euro area	15.7	2.2	1.7	3.0	2.8	0.6	**-4.1**	**0.9**	**1.5**	*0.7*	*1.5*
Belgium	0.6	3.2	1.8	2.8	2.9	1.0	**-3.1**	**1.3**	**1.6**	*0.6*	*1.5*
Bulgaria	0.1	6.6	6.2	6.3	6.2	6.0	**-5.0**	**0.0**	**2.7**	*-1.1*	*3.1*
Czech Republic	0.3	4.5	6.3	6.8	6.1	2.5	**-4.2**	**1.6**	**2.4**	*0.8*	*2.3*
Denmark	0.4	2.3	2.4	3.4	1.7	-0.9	**-4.9**	**1.6**	**1.8**	*1.5*	*1.8*
Germany	4.4	1.2	0.8	3.2	2.5	1.3	**-5.0**	**1.2**	**1.6**	*1.2*	*1.7*
Estonia	0.0	7.2	9.4	10.0	7.2	-3.6	**-14.1**	**0.9**	**3.8**	*-0.1*	*4.2*
Ireland	0.3	4.6	6.2	5.4	6.0	-3.0	**-7.1**	**-0.9**	**3.0**	*-1.4*	*2.6*
Greece	0.4	4.6	2.2	4.5	4.5	2.0	**-2.0**	**-3.0**	**-0.5**	*-0.3*	*0.7*
Spain	1.9	3.3	3.6	4.0	3.6	0.9	**-3.6**	**-0.4**	**0.8**	*-0.8*	*1.0*
France	3.4	2.5	1.9	2.2	2.3	0.4	**-2.2**	**1.3**	**1.5**	*1.2*	*1.5*
Italy	2.8	1.5	0.7	2.0	1.5	-1.3	**-5.0**	**0.8**	**1.4**	*0.7*	*1.4*
Cyprus	0.0	4.2	3.9	4.1	5.1	3.6	**-1.7**	**-0.4**	**1.3**	*0.1*	*1.3*
Latvia	0.0	8.7	10.6	12.2	10.0	-4.6	**-18.0**	**-3.5**	**3.3**	*-4.0*	*2.0*
Lithuania	0.1	7.4	7.8	7.8	9.8	2.8	**-15.0**	**-0.6**	**3.2**	*-3.9*	*2.5*
Luxembourg	0.1	4.4	5.4	5.6	6.5	0.0	**-3.4**	**2.0**	**2.4**	*1.1*	*1.8*
Hungary	0.2	4.9	3.5	4.0	1.0	0.6	**-6.3**	**0.0**	**2.8**	*-0.5*	*3.1*
Malta	0.0	0.7	3.9	3.6	3.8	2.1	**-1.9**	**1.1**	**1.7**	*0.7*	*1.6*
Netherlands	1.1	2.2	2.0	3.4	3.6	2.0	**-4.0**	**1.3**	**1.8**	*0.3*	*1.6*
Austria	0.5	2.5	2.5	3.5	3.5	2.0	**-3.6**	**1.3**	**1.6**	*1.1*	*1.5*
Poland	0.6	5.3	3.6	6.2	6.8	5.0	**1.7**	**2.7**	**3.3**	*1.8*	*3.2*
Portugal	0.3	1.5	0.9	1.4	1.9	0.0	**-2.7**	**0.5**	**0.7**	*0.3*	*1.0*
Romania	0.2	8.5	4.2	7.9	6.3	7.3	**-7.1**	**0.8**	**3.5**	*0.5*	*2.6*
Slovenia	0.1	4.3	4.5	5.8	6.8	3.5	**-7.8**	**1.1**	**1.8**	*1.3*	*2.0*
Slovakia	0.1	5.0	6.7	8.5	10.6	6.2	**-4.7**	**2.7**	**3.6**	*1.9*	*2.6*
Finland	0.3	4.1	2.9	4.4	4.9	1.2	**-7.8**	**1.4**	**2.1**	*0.9*	*1.6*
Sweden	0.6	4.1	3.3	4.2	2.5	-0.2	**-4.9**	**1.8**	**2.5**	*1.4*	*2.1*
United Kingdom	3.2	3.0	2.2	2.9	2.6	0.5	**-4.9**	**1.2**	**2.1**	*0.9*	*1.9*
Candidate countries	1.5	8.8	8.0	6.7	4.8	1.1	**-4.8**	**4.1**	**4.3**	*2.6*	*3.5*
- Croatia	0.1	4.2	4.2	4.7	5.5	2.4	**-5.8**	**-0.5**	**2.0**	*0.2*	*2.2*
- Turkey	1.3	9.4	8.4	6.9	4.7	0.9	**-4.7**	**4.7**	**4.5**	*2.8*	*3.6*
- The former Yugoslav Republic of Macedonia	0.0	4.1	4.1	4.0	5.9	4.9	**-0.7**	**1.3**	**2.0**	*1.5*	*2.5*
Potential candidates	0.1	6.9	5.0	5.7	6.6	5.8	**-1.8**	**2.0**	**3.2**	*1.4*	*2.5*
USA	20.7	3.6	3.1	2.7	2.1	0.4	**-2.4**	**2.8**	**2.5**	*2.2*	*2.0*
Japan	6.4	2.7	1.9	2.0	2.4	-1.2	**-5.2**	**2.1**	**1.5**	*1.1*	*0.4*
Canada	1.9	3.1	3.0	2.9	2.5	0.4	**-2.6**	**2.9**	**3.1**	*2.1*	*2.4*
Norway	0.4	3.9	2.7	2.3	2.7	1.8	**-1.5**	**1.6**	**2.1**	*0.6*	*2.0*
Switzerland	0.5	2.5	2.6	3.6	3.6	1.8	**-1.5**	**1.6**	**2.2**	*-0.1*	*1.1*
Iceland	0.0	7.7	7.5	4.6	6.0	1.0	**-6.5**	**-1.1**	**1.9**	*1.9*	*2.9*
Australia	1.2	2.8	3.0	3.3	3.7	3.0	**1.3**	**3.2**	**3.5**	*2.7*	*3.4*
New Zealand	0.2	3.8	3.0	1.8	3.1	-1.0	**-1.6**	**2.5**	**3.1**	*2.1*	*2.5*
Advanced economies	54.7	3.2	2.6	2.9	2.6	0.5	**-3.4**	**2.0**	**2.1**	*1.5*	*1.7*
CIS	4.6	8.2	6.6	8.3	8.6	5.5	**-7.1**	**3.7**	**4.2**	*2.3*	*3.1*
- Russia	3.3	7.2	6.4	7.7	8.1	5.6	**-7.9**	**3.7**	**4.0**	*2.3*	*2.7*
- Other	1.3	10.8	7.1	9.9	9.7	5.2	**-5.1**	**3.6**	**4.8**	*2.4*	*4.4*
MENA	4.9	9.0	5.4	5.7	5.9	5.0	**1.6**	**4.2**	**5.3**	*4.1*	*5.3*
Asia	24.6	8.0	8.3	9.1	9.7	6.8	**5.3**	**8.2**	**7.5**	*6.8*	*7.3*
- China	11.6	10.1	10.4	11.6	13.0	9.7	**8.7**	**10.3**	**9.4**	*9.6*	*9.5*
- India	4.8	7.5	9.5	9.8	9.0	6.7	**5.7**	**8.1**	**8.0**	*6.4*	*7.4*
- Hong Kong	0.5	8.5	7.1	7.0	6.4	2.4	**-2.7**	**6.8**	**4.9**	*2.9*	*3.9*
- Korea	1.9	4.6	4.0	5.2	5.1	2.2	**0.2**	**5.0**	**4.7**	*2.1*	*2.0*
- Indonesia	1.3	5.0	5.7	5.5	6.3	6.1	**4.6**	**5.4**	**4.9**	*5.1*	*5.6*
Latin America	8.7	6.0	4.7	5.6	5.8	4.2	**-1.8**	**4.2**	**4.0**	*3.1*	*3.4*
- Brazil	2.9	5.7	3.2	4.0	6.1	5.1	**-0.2**	**5.7**	**4.5**	*4.2*	*4.2*
- Mexico	2.3	4.0	3.3	5.0	3.4	1.3	**-6.5**	**4.0**	**4.2**	*3.1*	*3.3*
Sub-Saharan Africa	2.4	6.0	6.0	6.7	6.9	5.6	**2.0**	**4.7**	**5.9**	*4.0*	*4.5*
Emerging and developing economies	45.3	7.6	7.0	7.8	8.3	5.9	**2.1**	**6.3**	**6.2**	*5.2*	*5.7*
World	100.0	5.2	4.6	5.2	5.2	2.9	**-0.9**	**4.0**	**4.0**	*3.1*	*3.5*
World excluding EU	77.9	5.9	5.3	5.7	5.8	3.5	**0.0**	**4.8**	**4.6**	*3.8*	*4.1*
World excluding euro area	84.3	5.8	5.2	5.6	5.6	3.4	**-0.3**	**4.6**	**4.5**	*3.6*	*3.9*

(a) Relative weights, based on GDP (at constant prices and PPS) in 2008.

TABLE 56 : World exports of goods and services, volume (percentage change on preceding year, 2004-2011) 20.04.2010

								Spring 2010 forecast		*Autumn 2009 forecast*	
	(a)	2004	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
EU (b)	38.9	7.6	5.9	9.3	5.5	1.5	**-12.4**	**5.0**	**5.2**	*2.2*	*4.2*
Euro area (b)	29.2	7.4	5.1	8.5	6.3	1.0	**-13.0**	**4.9**	**5.0**	2.2	3.9
Candidate countries	1.1	10.3	7.3	6.6	6.8	2.2	**-7.0**	**5.2**	**6.5**	*1.8*	*3.7*
- Croatia	0.1	5.4	3.7	6.5	4.3	1.7	**-16.2**	**2.4**	**2.5**	*1.0*	*1.1*
- Turkey	0.9	11.2	7.9	6.6	7.3	2.3	**-5.4**	**5.7**	**7.2**	*1.9*	*4.1*
- The former Yugoslav Republic of Macedonia	0.0	12.9	11.2	8.4	14.3	-4.3	**-8.2**	**5.5**	**7.0**	*1.6*	*4.6*
USA	9.4	9.5	6.7	9.0	8.7	5.4	**-9.7**	**11.3**	**8.1**	*7.7*	*8.4*
Japan	4.4	13.9	7.0	9.7	8.4	1.6	**-24.2**	**21.5**	**7.7**	*7.9*	*3.1*
Canada	2.7	5.0	1.9	0.8	1.1	-4.7	**-14.0**	**7.4**	**5.3**	*5.0*	*5.6*
Norway	1.1	1.1	1.1	0.0	2.3	0.9	**-4.3**	**2.6**	**3.1**	*0.6*	*3.8*
Switzerland	1.5	7.9	7.8	10.3	9.5	2.9	**-10.0**	**1.7**	**3.4**	*0.8*	*2.1*
Iceland	0.0	8.4	7.5	-4.6	17.7	7.1	**6.3**	**0.8**	**0.9**	*1.9*	*2.9*
Australia	1.2	2.8	3.1	2.6	4.8	3.7	**0.6**	**7.6**	**8.2**	*5.1*	*7.0*
New Zealand	0.2	5.7	-1.2	1.8	4.6	-1.0	**-1.1**	**2.5**	**4.4**	*3.3*	*4.0*
Advanced economies	60.6	8.1	5.8	8.5	6.0	1.9	**-12.3**	**7.2**	**5.9**	*3.6*	*4.9*
CIS	4.0	13.9	4.6	6.4	5.5	4.9	**-8.5**	**3.5**	**2.4**	*3.0*	*2.5*
- Russia	2.7	11.8	6.5	7.3	6.3	0.6	**-8.1**	**3.5**	**2.0**	*3.0*	*2.5*
- Other	1.4	18.0	0.8	4.5	3.9	13.5	**-9.4**	**3.5**	**3.2**	*3.0*	*2.5*
MENA	6.3	10.3	10.7	6.1	6.1	12.4	**-6.2**	**2.9**	**5.3**	*2.5*	*5.0*
Asia	22.0	19.6	11.6	12.5	18.5	8.8	**-9.6**	**11.1**	**8.0**	*4.3*	*5.5*
- China	8.1	23.4	15.1	17.2	35.0	13.4	**-10.3**	**12.3**	**8.4**	*4.5*	*5.1*
- India	1.5	24.5	20.3	21.0	5.7	15.3	**-6.8**	**14.4**	**11.0**	*3.8*	*7.2*
- Hong Kong	2.4	16.0	10.8	9.3	8.1	2.4	**-10.3**	**9.0**	**7.8**	*3.4*	*3.9*
- Korea	2.6	21.2	8.2	12.2	11.7	13.0	**-7.4**	**10.4**	**8.3**	*8.2*	*7.7*
- Indonesia	0.8	11.6	60.2	7.1	7.2	16.0	**-9.7**	**9.1**	**5.8**	*2.5*	*5.8*
Latin America	5.2	15.9	8.8	7.7	7.2	1.7	**-12.5**	**9.3**	**6.2**	*4.8*	*4.5*
- Brazil	1.2	15.8	4.3	6.1	8.5	3.1	**-10.9**	**8.6**	**6.2**	*3.7*	*4.3*
- Mexico	1.6	11.8	6.0	11.0	6.0	-1.2	**-14.5**	**9.6**	**5.9**	*7.0*	*4.9*
Sub-Saharan Africa	1.9	10.9	24.5	1.0	6.5	16.1	**-10.9**	**9.6**	**5.8**	*4.0*	*4.5*
Emerging and developing economies	39.4	16.6	11.0	9.7	13.1	8.4	**-9.4**	**8.7**	**6.7**	*4.0*	*5.0*
World	100.0	11.4	7.8	9.0	8.8	4.5	**-11.2**	**7.8**	**6.2**	*3.7*	*4.9*
World excluding EU	61.1	13.9	9.1	8.8	11.0	6.3	**-10.4**	**9.6**	**6.8**	*4.7*	*5.3*
World excluding euro area	70.8	13.3	9.0	9.2	10.0	5.9	**-10.4**	**9.0**	**6.7**	*4.4*	*5.3*

(a) Relative weights, based on exports of goods and services (at current prices and current exchange rates) in 2008.

(b) Intra- and extra-EU trade.

TABLE 57 : Export shares in EU trade (goods only - 2008)

	EU	Candidate countries	USA	Japan	Other advanced economies	China	Rest Asia	CIS	MENA	Latin America	Sub Saharan Africa	World
EU	67.3	1.8	6.4	1.1	5.4	2.1	4.1	3.6	4.4	2.2	1.6	100
Belgium	77.8	1.0	4.5	0.6	3.0	1.1	3.9	1.5	3.4	1.5	1.6	100
Bulgaria	62.1	13.1	1.9	0.2	1.6	0.9	3.6	7.0	6.7	1.2	1.8	100
Czech Republic	84.6	1.3	1.8	0.4	2.6	0.6	1.5	4.6	1.6	0.6	0.5	100
Denmark	69.0	1.0	5.7	2.1	9.3	2.1	3.9	2.3	2.2	1.6	0.9	100
Germany	63.3	1.8	7.1	1.4	6.6	3.6	4.6	4.2	3.7	2.5	1.2	100
Estonia	70.9	2.2	4.3	0.5	5.1	0.7	1.0	12.0	0.9	0.8	1.6	100
Ireland	60.7	0.7	20.2	2.5	5.8	1.8	4.4	0.5	1.5	1.2	0.8	100
Greece	68.2	8.0	5.0	0.3	3.2	0.7	2.1	3.4	6.2	1.0	1.9	100
Spain	70.1	1.9	4.3	0.9	3.4	1.6	2.2	2.0	6.8	5.3	1.5	100
France	63.1	1.6	6.6	1.6	5.2	2.3	5.0	2.3	7.0	2.7	2.6	100
Italy	58.1	3.1	6.7	1.3	6.6	2.0	4.6	3.8	9.1	3.2	1.4	100
Cyprus	75.5	0.3	0.5	1.0	2.7	0.4	6.2	2.9	9.1	0.1	1.2	100
Latvia	70.7	0.2	1.8	0.3	4.0	0.2	1.3	15.8	3.6	1.8	0.2	100
Lithuania	62.8	0.9	3.5	0.1	5.4	0.1	3.1	21.3	1.4	0.9	0.4	100
Luxembourg	89.2	1.0	1.9	0.2	2.6	0.9	1.2	0.9	1.3	0.6	0.3	100
Hungary	78.5	2.8	2.7	0.6	2.3	1.2	1.3	6.9	2.6	0.6	0.6	100
Malta	49.4	4.0	6.8	4.5	1.9	4.6	20.1	0.5	4.9	1.4	1.9	100
Netherlands	79.4	0.9	3.9	0.7	2.9	0.9	3.2	2.0	2.6	1.6	2.0	100
Austria	72.0	2.0	4.7	0.9	6.5	1.7	3.3	4.0	2.5	1.6	0.8	100
Poland	77.6	1.6	1.6	0.3	3.1	0.8	1.0	10.5	1.9	1.1	0.4	100
Portugal	73.6	0.8	4.3	0.5	2.2	0.6	3.3	0.7	2.8	2.3	8.9	100
Romania	69.0	8.0	2.2	0.4	2.4	0.6	1.9	7.7	5.3	1.3	1.2	100
Slovenia	74.6	9.7	1.6	0.2	1.7	0.6	1.0	7.1	2.9	0.5	0.2	100
Slovakia	84.2	1.9	1.9	0.3	1.7	1.2	0.7	6.3	1.0	0.6	0.2	100
Finland	56.8	1.2	6.3	1.9	5.8	3.2	4.4	11.8	4.7	2.5	1.4	100
Sweden	61.0	1.2	6.7	1.1	11.8	2.4	4.6	3.1	3.7	2.4	1.9	100
United Kingdom	56.9	1.2	13.1	1.5	6.8	2.0	6.8	2.2	5.1	1.8	2.6	100

TABLE 58 : World imports of goods and services, volume (percentage change on preceding year, 2004-2011) 20.04.2010

							Spring 2010 forecast			*Autumn 2009 forecast*	
	(a)	2004	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
EU (b)	39.4	7.6	6.3	9.2	5.5	1.4	**-12.2**	**3.5**	**4.6**	*1.2*	*3.8*
Euro area (b)	29.0	7.0	5.8	8.5	5.5	1.1	**-11.5**	**2.9**	**4.3**	*1.1*	*3.6*
Candidate countries	1.3	18.6	11.0	7.0	10.1	-2.7	**-15.3**	**8.2**	**8.6**	*4.5*	*6.0*
- Croatia	0.2	4.7	3.9	7.4	6.5	3.6	**-20.7**	**0.2**	**3.0**	*2.5*	*2.5*
- Turkey	1.1	20.8	12.2	6.9	10.7	-3.8	**-14.4**	**9.5**	**9.6**	*4.8*	*6.5*
- The former Yugoslav Republic of Macedonia	0.0	16.7	6.2	10.9	17.4	5.8	**-10.7**	**4.0**	**6.1**	*1.4*	*2.8*
USA	13.3	11.0	6.1	6.1	2.0	-3.2	**-13.9**	**10.1**	**5.7**	*7.5*	*5.7*
Japan	4.5	8.1	5.8	4.2	1.6	0.9	**-17.1**	**8.2**	**8.4**	*2.9*	*7.6*
Canada	2.7	8.0	7.1	4.7	5.8	0.8	**-13.4**	**10.5**	**7.1**	*7.1*	*7.8*
Norway	0.7	8.8	8.7	8.4	8.6	2.2	**-9.7**	**3.4**	**4.1**	*1.5*	*3.7*
Switzerland	1.2	7.3	6.6	6.5	6.0	0.4	**-5.9**	**2.3**	**2.7**	*-0.6*	*2.6*
Iceland	0.0	14.5	29.3	10.4	-0.7	-18.2	**-24.0**	**2.6**	**3.2**	*3.7*	*4.7*
Australia	1.3	13.3	7.6	7.2	10.6	11.0	**-7.8**	**8.6**	**8.6**	*4.8*	*7.0*
New Zealand	0.2	13.1	5.9	0.0	6.8	5.6	**-11.4**	**5.3**	**6.7**	*4.1*	*5.3*
Advanced economies	64.6	8.8	6.4	7.9	4.7	0.5	**-12.8**	**5.7**	**5.3**	*3.0*	*4.7*
CIS	3.3	19.2	9.9	15.8	20.1	13.8	**-17.2**	**9.4**	**3.6**	*2.5*	*3.0*
- Russia	1.9	23.3	16.6	21.3	26.6	14.9	**-17.9**	**5.7**	**3.3**	*2.0*	*3.0*
- Other	1.3	13.2	0.0	7.7	10.5	12.2	**-16.3**	**14.9**	**4.0**	*3.4*	*2.9*
MENA	4.4	6.8	14.0	10.9	11.1	20.1	**0.9**	**4.9**	**6.7**	*2.3*	*3.1*
Asia	20.7	13.7	12.7	11.4	8.2	9.8	**-6.7**	**13.6**	**8.1**	*3.8*	*4.6*
- China	6.5	13.7	15.0	16.5	11.3	14.0	**1.9**	**18.0**	**7.0**	*5.9*	*5.1*
- India	2.0	15.2	48.1	24.5	19.9	25.1	**-10.3**	**21.0**	**14.3**	*2.6*	*3.3*
- Hong Kong	2.3	14.6	7.5	9.2	8.3	1.6	**-10.3**	**8.1**	**9.2**	*1.8*	*2.0*
- Korea	2.7	12.2	5.8	9.6	9.7	5.7	**-0.2**	**9.9**	**8.7**	*6.5*	*7.4*
- Indonesia	0.8	12.0	25.7	-3.2	7.5	9.6	**-16.9**	**17.0**	**5.2**	*1.3*	*5.2*
Latin America	5.2	11.2	5.8	11.8	12.9	5.6	**-13.9**	**10.4**	**7.5**	*5.4*	*4.7*
- Brazil	1.2	7.6	-6.1	6.6	15.1	6.9	**-9.0**	**13.3**	**7.9**	*5.9*	*5.5*
- Mexico	1.8	11.3	7.4	12.4	7.3	2.1	**-16.7**	**11.0**	**6.5**	*7.6*	*5.6*
Sub-Saharan Africa	1.9	8.9	15.7	8.1	10.5	10.9	**-10.6**	**9.4**	**5.4**	*3.5*	*3.9*
Emerging and developing economies	35.4	12.8	11.7	11.6	10.5	10.9	**-8.0**	**11.5**	**7.3**	*3.7*	*4.2*
World	100.0	10.2	8.3	9.2	6.8	4.2	**-11.1**	**7.7**	**6.0**	*3.2*	*4.6*
World excluding EU	60.6	11.8	9.6	9.2	7.6	6.0	**-10.4**	**10.5**	**6.9**	*4.6*	*5.0*
World excluding euro area	71.0	11.6	9.4	9.6	7.4	5.5	**-10.9**	**9.7**	**6.7**	*4.1*	*5.0*

(a) Relative weights, based on imports of goods and services (at current prices and current exchange rates) in 2008.

(b) Intra- and extra-EU trade.

TABLE 59 : Import shares in EU trade (goods only - 2008)

	EU	Candidate countries	USA	Japan	Other advanced economies	China	Rest Asia	CIS	MENA	Latin America	Sub Saharan Africa	World
EU	64.0	1.2	4.5	1.8	5.1	5.4	4.7	5.5	3.8	2.4	1.6	100
Belgium	71.0	0.7	6.1	2.3	3.1	3.8	4.5	1.7	2.9	2.5	1.4	100
Bulgaria	56.8	7.3	1.3	0.5	1.3	3.1	1.8	23.4	1.2	3.2	0.1	100
Czech Republic	78.0	0.6	1.1	2.2	1.6	4.6	3.2	8.0	0.2	0.3	0.1	100
Denmark	74.1	1.0	2.8	0.7	7.7	5.6	3.8	1.9	0.5	1.7	0.4	100
Germany	65.6	1.3	4.5	2.1	6.4	5.8	4.7	4.7	1.8	2.1	1.0	100
Estonia	79.2	1.0	1.2	0.6	1.5	3.0	2.4	10.7	0.1	0.3	0.1	100
Ireland	72.3	0.7	10.9	1.5	3.7	4.2	4.8	0.2	0.5	0.8	0.3	100
Greece	64.0	3.7	2.7	1.6	2.6	5.7	5.8	6.4	5.5	1.4	0.6	100
Spain	60.3	1.2	3.2	1.3	2.4	5.7	4.3	3.3	9.1	5.3	4.0	100
France	69.2	1.0	4.3	1.2	4.9	3.7	3.4	3.2	5.4	1.6	2.1	100
Italy	55.5	1.9	2.9	1.3	4.5	5.6	4.1	8.0	11.6	2.7	1.8	100
Cyprus	63.5	0.8	1.6	3.9	1.5	5.5	5.5	7.0	9.1	1.4	0.2	100
Latvia	60.8	0.5	1.4	0.3	1.8	2.7	1.7	30.4	0.2	0.2	0.0	100
Lithuania	59.9	0.7	2.4	0.3	1.5	3.2	1.8	29.4	0.5	0.4	0.1	100
Luxembourg	77.7	0.2	3.0	0.5	1.6	15.3	1.1	0.1	0.2	0.3	0.0	100
Hungary	69.7	1.0	1.4	2.5	1.0	6.9	5.2	11.4	0.3	0.4	0.0	100
Malta	60.0	8.7	2.5	2.1	2.1	7.3	11.0	5.0	0.8	0.5	0.1	100
Netherlands	48.8	0.6	7.1	3.3	4.6	9.2	7.4	7.9	4.3	4.7	2.1	100
Austria	80.5	1.4	1.7	0.8	5.7	2.0	2.0	2.8	2.1	0.6	0.3	100
Poland	72.2	0.9	1.7	0.9	2.0	4.3	3.6	12.5	0.4	1.0	0.4	100
Portugal	72.6	0.7	2.4	0.9	2.3	2.4	3.1	1.3	5.5	3.9	5.0	100
Romania	69.9	5.2	1.4	0.6	1.5	4.1	2.6	12.3	1.0	1.2	0.1	100
Slovenia	76.6	6.9	1.4	0.6	1.3	2.7	5.0	1.9	1.9	1.5	0.2	100
Slovakia	75.0	0.6	0.7	0.8	0.7	3.7	6.8	11.3	0.1	0.1	0.0	100
Finland	59.9	0.4	2.9	1.8	5.0	5.9	5.0	16.5	0.2	1.8	0.5	100
Sweden	71.6	0.7	3.2	1.6	9.2	3.7	3.4	4.0	0.4	1.5	0.6	100
United Kingdom	54.8	1.3	8.4	2.4	10.7	6.7	7.1	2.3	2.0	2.2	2.2	100

TABLE 60 : World merchandise trade balances (fob-fob, in billions of US dollar, 2003-2011) 20.04.2010

							Spring 2010 forecast			Autumn 2009 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
EU	84.1	63.7	-6.9	-79.7	-101.8	-177.1	**-24.1**	**-25.2**	**-5.9**	*-16.0*	*-5.3*
EU, adjusted [1]	:	-53.6	-119.4	-207.1	-219.3	-302.5	**-142.9**	**-141.5**	**-121.4**	*-142.5*	*-131.8*
Euro area	157.7	168.8	115.5	76.5	118.5	51.5	**90.0**	**99.8**	**131.0**	*106.9*	*116.3*
Euro area, adjusted [1]	111.6	117.2	54.3	15.4	63.5	-8.8	**32.9**	**43.9**	**75.6**	*44.5*	*53.8*
Candidate countries	-13.5	-23.7	-32.3	-39.8	-47.3	-72.8	**-39.7**	**-50.0**	**-60.3**	*-44.5*	*-53.0*
USA	-562.5	-684.7	-801.9	-860.5	-848.3	-859.6	**-537.1**	**-664.2**	**-685.1**	*-609.1*	*-623.0*
Japan	103.4	128.6	93.9	81.4	104.7	39.0	**43.3**	**53.7**	**42.7**	*50.6*	*26.4*
Norway	27.0	32.4	46.8	55.9	53.2	79.7	**50.8**	**59.2**	**60.5**	*48.0*	*54.7*
Switzerland	3.2	5.4	2.4	4.0	7.8	13.9	**14.7**	**14.4**	**13.6**	*25.6*	*26.0*
Advanced economies	-334.1	-447.8	-664.0	-808.8	-805.3	-939.2	**-502.0**	**-577.7**	**-604.5**	*-535.6*	*-569.6*
CIS	62.0	93.3	129.3	150.3	136.2	203.3	**142.8**	**166.1**	**146.2**	*103.7*	*125.6*
- Russia	59.9	85.8	118.4	139.3	130.9	179.7	**114.6**	**152.1**	**137.3**	*94.0*	*119.5*
MENA	111.7	144.7	248.2	323.1	311.5	439.5	**217.0**	**289.7**	**306.8**	*240.0*	*271.2*
Asia	143.9	140.1	198.3	292.8	384.9	312.2	**387.6**	**249.5**	**277.5**	*344.9*	*374.5*
- China	44.7	59.0	134.2	217.7	315.4	360.7	**287.6**	**228.6**	**292.3**	*264.3*	*270.2*
Latin America	43.2	58.9	81.3	100.0	71.3	43.0	**21.4**	**55.3**	**50.9**	*18.3*	*16.5*
Sub-Saharan Africa	12.2	22.2	37.0	36.6	46.9	67.9	**48.8**	**73.8**	**76.4**	*26.5*	*28.6*
Emerging and developing economies	373.0	459.2	694.0	902.8	950.8	1065.8	**817.5**	**834.5**	**857.7**	*733.5*	*816.4*
World	38.8	11.5	30.1	94.0	145.5	126.6	**315.6**	**256.8**	**253.2**	*197.9*	*246.8*

[1] See note 8 on concepts and sources.

TABLE 61 : World current account balances (in billions of US dollar, 2003-2011)

							Spring 2010 forecast			Autumn 2009 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
EU	10.3	47.0	-36.3	-58.7	-70.9	-203.0	**-80.8**	**-74.0**	**-71.3**	*-98.8*	*-72.1*
EU, adjusted [1]	:	-46.2	-104.2	-186.4	-192.3	-374.0	**-242.8**	**-232.6**	**-228.7**	*-276.6*	*-249.8*
Euro area	35.6	98.1	21.8	31.3	42.6	-121.7	**-77.1**	**-51.1**	**-35.5**	*-73.3*	*-65.7*
Euro area, adjusted [1]	23.4	75.3	11.4	-13.2	15.2	-148.1	**-102.2**	**-75.6**	**-59.8**	*-109.2*	*-101.6*
Candidate countries	-7.5	-14.4	-22.1	-32.1	-38.2	-50.3	**-17.3**	**-35.5**	**-46.9**	*-25.2*	*-34.4*
USA	-516.1	-624.6	-740.5	-798.3	-724.6	-707.4	**-430.2**	**-548.9**	**-563.1**	*-488.9*	*-487.9*
Japan	136.1	172.2	165.9	170.6	210.7	160.1	**143.4**	**157.9**	**132.6**	*105.6*	*53.2*
Norway	27.7	32.9	49.1	58.1	54.8	82.5	**49.9**	**62.0**	**63.8**	*58.4*	*65.0*
Switzerland	39.0	41.6	51.9	50.4	38.5	10.1	**37.1**	**35.5**	**34.2**	*36.8*	*37.0*
Advanced economies	-331.2	-369.6	-565.1	-646.5	-593.7	-761.2	**-377.6**	**-452.5**	**-507.6**	*-469.3*	*-502.5*
CIS	36.1	63.5	87.7	93.2	65.2	94.9	**64.6**	**66.8**	**40.5**	*37.4*	*57.2*
- Russia	35.4	59.5	84.6	94.7	77.0	102.4	**43.7**	**59.8**	**37.4**	*47.1*	*70.5*
MENA	86.8	124.6	229.6	303.2	287.8	389.8	**138.9**	**130.2**	**111.2**	*136.4*	*142.8*
Asia	164.6	170.6	239.4	367.1	510.8	459.0	**415.2**	**347.0**	**348.7**	*379.0*	*411.2*
- China	45.9	68.7	160.8	253.3	371.8	426.1	**284.1**	**300.0**	**340.0**	*335.0*	*350.0*
Latin America	10.0	22.8	37.5	51.2	15.9	-29.8	**-33.5**	**-37.3**	**-50.0**	*-50.8*	*-56.1*
Sub-Saharan Africa	-5.1	2.5	21.6	16.8	1.4	6.7	**4.7**	**30.1**	**30.4**	*-13.7*	*-13.8*
Emerging and developing economies	292.4	384.1	615.9	831.5	881.1	920.6	**589.9**	**536.9**	**480.9**	*488.4*	*541.4*
World	-38.8	14.4	50.8	184.9	287.4	159.4	**212.3**	**84.3**	**-26.7**	*19.1*	*38.9*

[1] See note 8 on concepts and sources.

TABLE 62 : Primary commodity prices (in US dollar, percentage change on preceding year, 2003-2011)

SITC Classification							Spring 2010 forecast			Autumn 2009 forecast	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	*2010*	*2011*
Food (0 + 1)	3.1	12.4	4.2	11.4	9.2	20.7	**-9.8**	**21.0**	**2.9**	*4.0*	*1.1*
Basic materials (2 + 4)	7.5	16.9	6.9	31.7	13.4	8.7	**-25.3**	**24.9**	**0.4**	*7.4*	*0.7*
- of which :											
Agricultures non-food	6.0	6.7	-4.5	7.4	16.8	10.9	**-15.9**	**19.5**	**-2.8**	*6.0*	*1.1*
- of which :											
Wood and pulp	7.1	13.5	3.3	8.5	0.6	3.2	**-10.9**	**9.5**	**-9.1**	*4.3*	*2.9*
Minerals and metals	9.9	32.2	20.4	54.7	11.1	7.1	**-32.0**	**29.6**	**3.0**	*8.6*	*0.4*
Fuel products (3)	13.4	32.3	44.0	19.7	9.0	36.4	**-36.5**	**35.4**	**6.0**	*24.1*	*5.4*
- of which :											
Crude petroleum	13.9	33.4	44.7	20.2	9.5	35.9	**-37.1**	**36.3**	**5.6**	*24.8*	*5.1*
Primary commodities											
- Total excluding fuels	5.5	14.9	5.7	22.9	11.7	13.3	**-19.0**	**23.1**	**1.5**	*5.8*	*0.9*
- Total including fuels	11.9	27.7	35.9	20.2	9.5	32.2	**-33.9**	**33.1**	**5.3**	*20.8*	*4.7*
Crude petroleum - price per barrel											
Brent (usd)	28.5	38.0	55.1	66.2	72.5	98.5	**62.0**	**84.5**	**89.2**	*76.5*	*80.5*
Brent (euro)	25.2	30.6	44.3	52.7	52.9	67.2	**44.6**	**62.1**	**66.1**	*51.7*	*54.4*

[1] See note 8 on concepts and sources.

Note on concepts and sources

1. The directorate general for economic and financial affairs (DG ECFIN) produces, under its own responsibility, short-term fully-fledged economic forecasts twice a year : in the spring and in the autumn. These forecasts cover the principal macroeconomic aggregates for the Member States, the candidate countries, the European Union as a whole, the euro area and the international environment. Interim forecasts, updating the outlook for the seven largest Member States, EU and the euro area, are presented in between the fully-fledged forecasts.

2. Data for 2009, 2010 and 2011 are forecasts.
   The sources for all tables are the Commission services, unless otherwise stated.
   Historical data for the Member States are based on the European System of Accounting (ESA 1995). Most Member States have now introduced chain-linking in their national accounts to measure the development of economic aggregates in volume terms.
   For the USA and Japan the definitions are as in the SNA.

3. Tables 5 and 6 on domestic demand and final demand respectively, present data including inventories.

4. In Tables 16 and 17, the data are based on the national index for USA and Japan, and for EU Member States and aggregates prior to 1996.

5. The potential output gap is calculated with reference to potential output as estimated via a production function, where the increase in the capital stock and the difference between actual unemployment and the NAWRU play a key role.

6. Employment data used in tables 21-25, 27 and 31-32 are based on full-time-equivalents (FTEs), where available. Currently, Germany, Estonia, Spain, France, Italy, Hungary and the Netherlands report FTE data (taken together, these countries represent over 85% of euro-area GDP and more than 65% of EU GDP). In the absence of FTE data, employment is based on numbers of persons. In the calculation of EU and euro-area aggregates, priority is given to FTE data, as this is regarded as more representative of diverse patterns of working time.

7. The nominal short term interest rates are defined as the 3-month inter-bank rates. The nominal long term interest rates are defined as the yield on the central government benchmark 10-year bond. For Estonia, where no appropriate benchmark government bond is available, the indicator provided in Table 34 is a weighted average of MFI interest rates for new EEK-denominated loans to households and non-financial businesses.

8. EU and euro-area data are aggregated using exchange rates. World GDP is aggregated using Purchasing Power Standards (PPS). In the tables on world trade and international payments, the aggregation is carried out on the basis of current exchange rates. Tables 48 - 52, 60 and 61 show also EU and euro-area "adjusted" balances. Theoretically, balances of EU and euro area vis-à-vis third countries should be identical to the sum of the balances of the individual countries in the EU or the euro area. However, intra-EU or intra-euro-area balances are non-zero because of reporting errors. The creation of the internal market in 1993 reduced border controls and formalities, and accordingly the scope and precision of intra-EU trade coverage. Typically, intra-EU imports are underestimated compared to intra-EU exports, leading to an overestimation of the surplus. For the past the "adjusted" balances are Eurostat estimates for EU and ECB estimates for the euro area. For the future, they are ECFIN's forecasts based on the extrapolation of the discrepancies observed in 2008.

9. With respect to the 12 RAMS (recently-acceded Member States), which are currently in a transition phase, the quality of statistical data may not always be directly comparable to most EU15 Member States.

10. Geographical zones are defined as follows :
    - Euro area :
      - EA16 (BE,DE,IE,EL,ES,FR,IT,CY,LU,MT,NL,AT,PT,SI,SK,FI)
    - Candidate countries :
      - Croatia, Turkey and the former Yugoslav Republic of Macedonia.
    - Potential candidates :
      - Albania, Bosnia-Herzegovina, Kosovo, Montenegro and Serbia.
    - Advanced economies :
      - EU, candidate countries, USA, Japan, Canada, Norway, Switzerland, Iceland, Australia and New Zealand.
    - MENA (Middle East and Northern Africa) :
      - Algeria, Bahrain, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, and the United Arab Emirates.
    - Asia :
      - All countries in that region except Japan and the Asian MENA countries.
    - Latin America :
      - All countries in that region.
    - Sub-Saharan Africa :
      - All countries in that region except the African MENA countries.

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