ALLIANZ ECONOMIC RESEARCH & CORPORATE DEVELOPMENT

European Growth and Jobs Monitor 2009

Autumn 2009 Update

Exit strategy for EMU monetary and fiscal policy

09 November 2009

the Lisbon council
making Europe fit for the future

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THE 2009 EUROPEAN GROWTH AND JOBS MONITOR: AUTUMN UPDATE

Exit strategy for EMU monetary and fiscal policy

In the aftermath of the economic crisis, economic policy in Europe faces a twofold challenge. One is to get medium-term growth for the European economy back on track by fostering competitiveness, innovation and knowledge-based capacities, as was the goal of the original Lisbon agenda. The other challenge is to remove the strong monetary and fiscal stimulus from 2010 onwards and to start consolidating the public budget deficits that have ballooned in the crisis, without disrupting the recovery. The skill with which we meet these twin challenges will determine European prosperity for years to come.

The European Growth and Jobs Monitor

Twice a year, Allianz and the Lisbon Council measure progress on the so-called Lisbon Strategy, Europe's growth and jobs agenda, in The European Growth and Jobs Monitor. In the Spring, we examine how individual countries are faring with the Lisbon Strategy, and rank them based on a composite index made up of six key sub-indicators (Economic Growth, Productivity, Jobs, Human Capital Development, Future-Oriented Investment and Sustainable Public Finances). In the autumn update, we shift the focus, looking briefly at overall progress towards the Lisbon goals in the EU-15 and focusing on the economic outlook for the coming year.

Already, most of the world is experiencing an economic recovery. In the second half of 2009, we expect the euro-area economy to record economic growth for the first time since Q1 2008. What's more, we expect the economy to bounce back even quicker and more strongly than many others have predicted[1]. We forecast 2% economic growth on average in the 16-country eurozone next year, followed in 2011 by slightly slower expansion of 1.5%. In the medium run, the expansion in gross domestic product will remain modest at annual rates of 1.8%.

Sustainable performance of this type will be dependent on clever and prudent management of the quickly evolving fiscal and monetary situation. Given the fragility of the recovery and the risk that a badly-executed exit from the ongoing rescue packages could sow the seeds of future turbulence, we think it important to highlight the following aspects:

- Given the long time lag of monetary policy, an exit from monetary policy expansion should begin earlier than for fiscal policies;

- For Europe, government expenditure starting in 2011 should be held two percentage points below nominal GDP growth (which we expect to be close to 4% per annum over the next four years). This is a winning formula, which would do much to restore sustainability to public finances and safeguard today's recovery;

- A turnaround of monetary policies may be hampered by strong revaluation effects, especially on the euro. Therefore, international coordination is essential;

[1] The European Commission recently revised its 2010 eurozone growth forecast upwards to 0.7%.

- Fiscal policy stimulus will continue in most countries in 2010, and is still needed. But beginning in 2011, when government outlays will rise only slowly due to the termination of demand programmes, active consolidation of government expenses should take place;

- If exit strategies are delayed too long, we risk entering a new boom-bust-cycle.

Macroeconomic policies in the eurozone: Between stimulus and exit strategies

The economic policy challenges confronting Europe today are immense. Policy has to ensure that the crisis will be overcome, but at the same time it has to recognize that the extremely expansionary path of economic policy harbours huge risks in the medium term, with heavy debt increasingly restricting the scope for government action, with the potential for speculative bubbles or inflationary tendencies. A timely exit – not too soon, but not too late, either – from this demand-side policy will be the key to consolidating progress and avoiding a return of turbulence to the markets and economies of Europe.

In recent months it has become clear that the European economy is on the road to recovery. In most EMU countries, indicators point to a fairly strong rebound, which in its first phase will resemble a V-shaped recovery. Of course, for the time being this recovery depends on the stimulus of economic policy to prevent renewed weakness. But this stimulus will be given for 2010, if current fiscal plans are executed. Monetary policy will be expansionary in any case in 2010 as the time lag for monetary policy to feed through fully is at least one year.

The time lags are important for sequencing the exit of fiscal and monetary policy. Long time lags for monetary policy suggest that policy makers should start normalising their monetary stance sooner than fiscal policy. A sudden withdrawal of fiscal stimulus would be felt more quickly, for example if the programmes decided for 2010 were to be trimmed or scrapped.

However, the sequencing of exit strategies also has an international dimension. While the US external deficit has shrunk considerably in 2009 due to the sudden demand shock and import contraction, continued fiscal stimulus will likely push it up again in the years to come (unless the private sector consolidates massively). Therefore – in comparison to monetary policies – relatively strong fiscal consolidation in the US seems appropriate. In surplus countries like China, Japan and Germany, fiscal programmes in the form of higher spending, lower taxes and levies have been helpful in stimulating internal demand. Here, consolidation should start with monetary policies. Of course this is at the risk of currency revaluation, but that has to be accepted in surplus countries.

However, for monetary policy in the eurozone, a major problem is that some countries have sizeable current account surpluses while others are deep in the red. Hence, stepping on the monetary brakes ahead of the US Federal Reserve may push the euro up further, putting pressure on countries such as Spain, Portugal and Greece which are trying to reduce their external deficits.

Any turnaround in ECB policies should therefore be accompanied by similar steps in other surplus countries. If central banks in Japan and China were to remain on an unchanged expansionary path, a change of tack by the ECB would propel the euro to new highs against the US dollar (based on current trends, we forecast an average exchange rate of 1.53 dollars for one euro in 2010. See Chart 16 in Annex). In such circumstances, the ECB would definitely come under pressure not to move because of overvaluation, and to live with market risks. Exit strategies therefore need to be coordinated at the international level.

Economic outlook: Ready for exit

Both monetary and fiscal exit strategies hinge on future economic developments. Any policy recommendations must be based on an economic scenario analysis. Even though at present there are greater risks to forecasts than in normal times, we need to outline the possible economic conditions down the road.

In our forecast we expect a relatively strong rebound in euro area economic activity during the second half of 2009, and a continuation of the recovery in 2010. We factor in a slow increase in the ECB's main interest rate to 1.75% and the planned implementation of fiscal programmes throughout the EU. This will result in growth of 2% on average for next year, followed in 2011 by slightly slower expansion of 1.5%. In the medium run, we believe the expansion in gross domestic product will remain modest at annual rates of 1.8%.

EMU: GDP, production potential[1)], output gap

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
GDP increase (in %)	1.7	3.0	2.8	0.6	-3.7	2.0	1.5	1.8	1.8	1.8
Output gap (% of potential production)	-0.1	1.3	2.5	1.9	-2.7	-1.5	-1.0	-0.3	0.2	0.7
Growth of production potential[1)] (in %)	1.7	1.5	1.6	1.5	0.8	0.8	1.0	1.1	1.3	1.3
Growth contribution (in percentage points)										
▪ Labour	0.4	0.3	0.3	0.3	0.1	0.1	0.2	0.3	0.3	0.3
▪ Capital	0.7	0.8	0.9	0.8	0.3	0.3	0.4	0.4	0.5	0.5
▪ Total factor productivity	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5

1) Based on the concept of the macroeconomic production function, allowing potential growth to be broken down into the contributions of the input factors labor and capital on the one hand and total factor productivity.

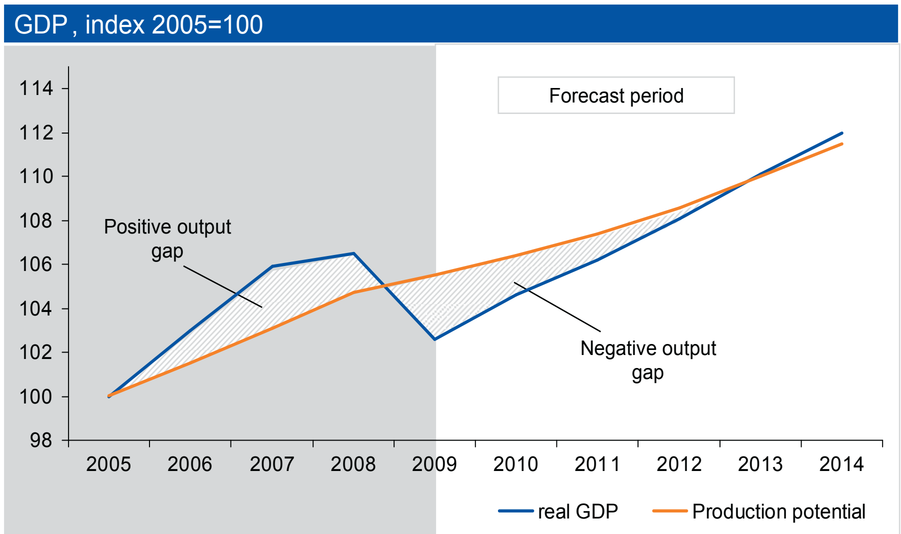
Sources: European Commission (Economic Forecast, Autumn 2009; Occasional Papers No.49, June 2009), from 2008 own estimates (stripping out "NAIRU" estimates of the Commission) and forecasts.

As a result of the economic crisis, we see only very muted potential output growth in the coming years. Our calculations are based on the European Commission's methodological approach, which breaks down potential growth into the contributions by labour, capital and total factor productivity[2]. This approach demonstrates that the sharp drop in investment as from 2009 is reflected in a considerably lower contribution to growth by factor capital; in conjunction with the slightly reduced labour contribution, this is seriously inhibiting the expansion in potential output growth. Our estimates show potential output in the euro area increasing by less than 1% in 2009 and 2010, edging up in the period 2011 to 2014 to between 1.0% and 1.3%. This brings home starkly the importance of switching to an economic policy that will encourage investment and innovation (see especially the final section of this paper on the Lisbon Strategy, which begins on page 9). But another aspect is also significant in this context: owing to the marginal expansion

2 Calculating potential growth rates and output gaps – A revised production function approach,by Cécile Denis, Daniel Grenouilleau, Kieran Mc Morrow and Werner Röger (EU Commission Directorate-General for Economic and Financial Affairs) March 2006.

in production capacities, even moderate GDP growth will still push up utilization rates, whose collapse has been such a potent symptom of the downturn. It is unlikely that capacities will remain underutilized for years. We believe the -2.7% output gap that opened up in 2009 will close again relatively quickly. By 2012, the euro area will probably have returned to normal utilization rates.

Underutilization not set to linger



Sources: European Commission (Economic Forecast, Autumn 2009), from 2008 own estimates (stripping out "NAIRU" estimates of the Commission) and forecasts.

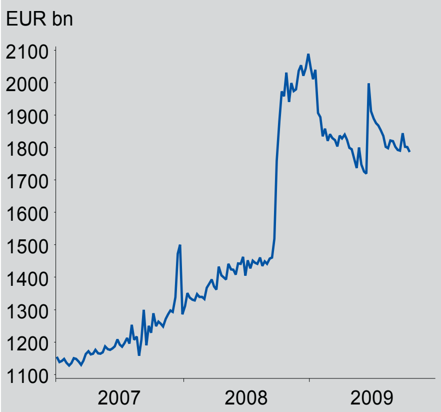
This leads us to question whether it is still appropriate in 2010 for both fiscal and monetary policy to remain so accommodative. In our view, a sensible strategy would be for monetary policy to take the first steps back to normality in 2010 while fiscal policy next year implements the agreed economic stimuli and then embarks on medium-term consolidation in 2011.

So what does this assessment imply specifically for ECB monetary policy in 2010? To avoid any misunderstandings from the outset, we are not advocating the beginning of monetary restriction but are calling on the ECB to start thinking about tempering its expansionary stance. The central bank should consider measures to soak up the extremely abundant supply of liquidity to the banking system as well as a slight increase in the extremely low benchmark interest rate. Just how the ECB chooses to unwind its liquidity policy is of limited macroeconomic relevance. The central bank itself has insisted that it has an exit strategy in the drawer. It possesses a suitably assorted toolkit to siphon off surplus liquidity in good time: phasing out extraordinary refinancing operations; the possibility of issuing ECB bonds or inviting banks to place interest-bearing fixed-term deposits with it; the reversal of its "fixed rate full allotment" tender procedure and narrowing of the broadened range of assets it is prepared to accept as collateral. Precisely how the ECB proceeds should be adjusted flexibly to the prevailing market conditions.

As well as skimming off liquidity, interest rates could also be raised modestly. An overall increase of 75 basis points by the end of next year would bring the key rate roughly in line with the level of inflation expected in late 2010. A short-term real interest rate of zero would still indicate an expansive monetary policy.

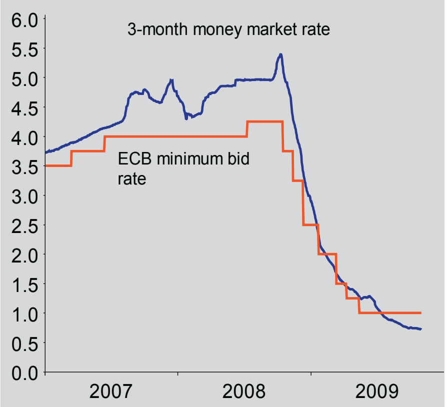
Monetary policy of the ECB

Assets of the Eurosystem*)



*) Consolidated financial statement of the Eurosystem.

Key interest rate



Source: ECB, EcoWin AB, Reuters

Generally speaking, fiscal policy is in an even more difficult situation than monetary policy. In most EMU countries, the public debt-to-GDP ratio will soar by more than 10 percentage points in the two years from 2008 to 2010, with Spain, Greece and Ireland looking at 20 percentage-point gains and more. While public finances are in a sorry state in practically all EMU countries, the scale of the problem differs quite considerably. The consolidation required in Germany (with an expected deficit of 3% in 2009 and 4 - 4½% in 2010) is manageable, even though its economic stimulus packages are more sizeable, at over 3% of GDP, than the euro area average of not quite 2%. National finances are currently at their most critical in Spain, Portugal, Greece and Ireland. For the euro area as a whole we expect the 2009 and 2010 public budget deficit to hit 5.7% of GDP.

Government spending will climb by 5% in 2009 and by a good 3% in 2010, while revenues develop roughly in sync with nominal GDP, meaning they will contract roughly 2% in 2009 and then increase by about 3% in 2010.

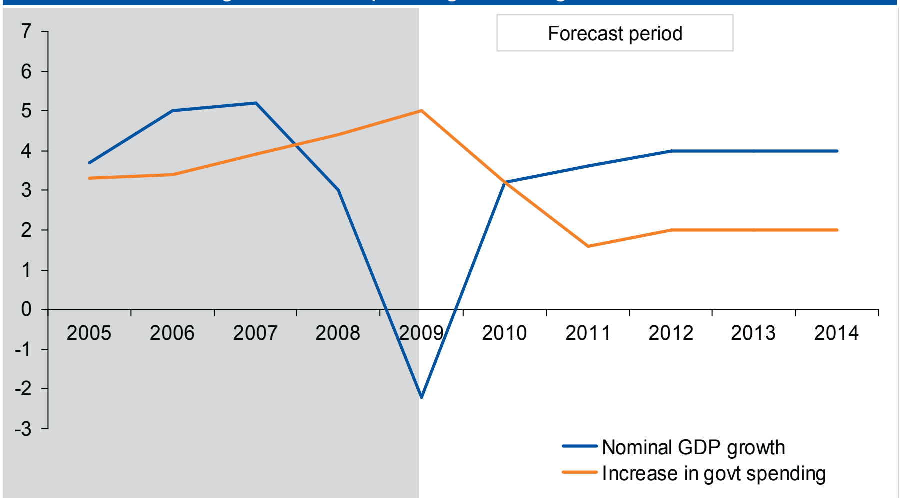
In our view, any meaningful consolidation strategy as from 2011 must begin with expenditure. By 2010, the economic crisis will probably have driven up the government spending ratio by around four percentage points to slightly more than 50%, an extremely high level. Efforts should be directed at a lower ratio in the medium term.

This could be accomplished as follows. From 2011, annual increases in government spending must be two percentage points lower than nominal GDP growth. Consolidation would not resort to putting up taxes and levies, and government revenues would rise at roughly the same rate as gross domestic product. In this scenario, the government-spending ratio would contract by 2014 to approximately its pre-crisis level. New public sector borrowing could fall to 1.8% per annum in 2014, down from 5.7% per annum in 2010. The cyclical budget deficit, calculated using estimates of the output gap, would be cut to 2.1% in 2014, down from 5.0% in 2010. All in all, although it will not be possible to balance the budget within the next five years through moderate curbs on public-sector spending, new borrowing could be reined in significantly.

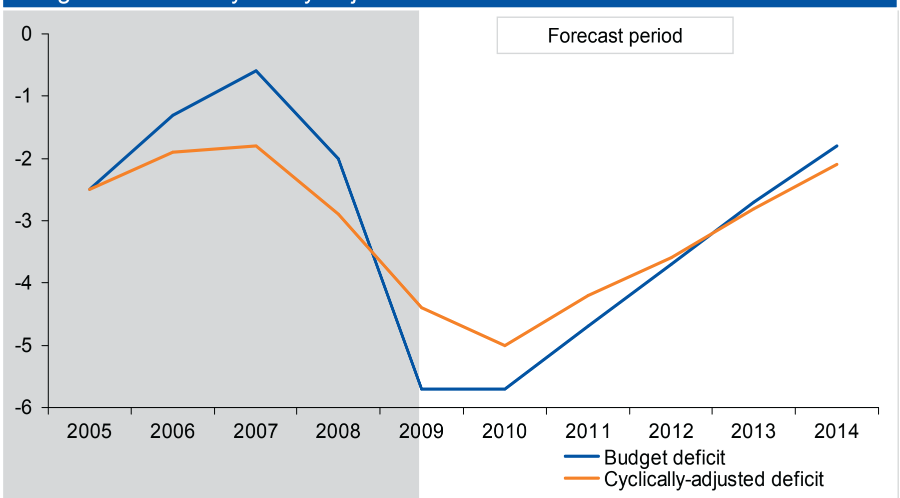
EMU: Development of public finances in scenario of moderate spending growth from 2011[1)]

as % of GDP	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Government budget balance	-2,5	-1,3	-0,6	-2,0	-5,7	-5,7	-4,7	-3,7	-2,7	-1,8
Government revenue	44,8	45,3	45,4	44,8	44,4	44,4	44,4	44,4	44,4	44,4
Government expenditure	47,3	46,6	46,0	46,8	50,1	50,1	49,1	48,1	47,1	46,2
Cyclically-adjusted budget balance	-2,5	-1,9	-1,8	-2,9	-4,4	-5,0	-4,2	-3,6	-2,8	-2,1
Cyclical budget components	0,0	0,6	1,2	0,9	-1,3	-0,7	-0,5	-0,1	0,1	0,3

Nominal GDP and government spending, annual growth in % 1)



Budget deficit and cyclically-adjusted deficit



[1)] Spending growth from 2011 two percentage points below nominal GDP growth rate.
Sources: Eurostat, European Commission (Economic Forecast, Autumn 2009), from 2009 own estimates and forecasts.

This naturally begs the question of how to achieve consolidation through spending discipline given the large number of national decision makers involved – which is where the Stability and Growth Pact (SGP) comes in. Excessive deficit disciplinary procedures have already been launched by the EU Commission against most EU states. However, in keeping with Article 104 (2) of the EU Treaty, excessive deficits in the economic crisis could be tolerated as exceptions which would have the effect of extending deadlines in current actions. The Stability and Growth Pact is very flexible with regard to a country's consolidation path. Using its discretionary scope, the SGP could therefore permit a country whose breach of the 3% threshold in 2009 and 2010 is interpreted as an exception to continue overrunning until 2015 without the imposition of sanctions. Nonetheless, the political pressure brought to bear by a deficit disciplinary procedure should not be underestimated. The various elements of the procedure provided for in the SGP (early warning, publication of recommendations, declaration of breach etc.) are certainly not blunt instruments.

However, the EU has very little influence on how individual member states tackle consolidation. This raises concerns that some countries at least will choose the easier option of raising taxes and levies rather than curbing their expenditure. It is to be hoped that European bodies such as the European Commission, Ecofin and the Eurogroup will work towards reining in not only deficits but also government spending ratios, which have soared in the wake of the economic crisis.

Lisbon – and Beyond

The economic crisis has dealt a severe blow to such key indicators as productivity, employment and government budgets, which are all crucial to the medium-term economic outlook. The impact of the crisis can be seen in our benchmark Lisbon Indicator, which tracks progress towards the so-called Lisbon Strategy based on six criteria (Economic Growth, Productivity, Jobs, Human Capital Development, Future-Oriented Investment and Sustainable Public Finances). In particular, the latest figures for Q2 2009 show that the GDP-related components Economic Growth and Labour Productivity have registered an extreme downturn[3]. With government expenditure soaring on the back of the various economic stimulus packages, and tax revenues dwindling, the component Sustainability of Public Finances has also dropped sharply. Despite the ructions on the labour market, the employment-related components of The European Growth and Jobs Monitor – Employment Ratio compared to a target path of an employment ratio of 70% in 2010 and Employment by Tertiary Education Level – have held more or less steady. The employment ratio is still well above the level at the beginning of the decade, but the 70% target is no longer within reach. The component Investment Activity, measured by investment in machinery and equipment, has shown only a modest decline (See Charts 1 and 2 in Annex).

Looking ahead, the objective of the Lisbon strategy has lost none of its relevance. Nurturing the sources of growth and raising potential output is more important than ever. In the wake of the crisis and the resurrection of Keynesian policies, the emphasis will need to be on fiscal consolidation and the restoration of jobs – for both, dynamic economic growth is essential. But growth needs to be more sustained and we need to move to a knowledge-based economy with sustainable growth and not financially-fuelled growth. The measures for achieving such growth mainly lie at the national level, but it is very important to coordinate and guide these measures by some kind of an overarching strategy like the Lisbon Strategy, which comes up

[3] Please see The 2009 European Growth and Jobs Monitor (Brussels: The Lisbon Council/Allianz, 2009) for a more detailed discussion of the methodology.

for renewal in 2010. After all, the willingness to adopt economic policy reforms on a national level is all the greater if such reforms are part of a joint effort in the EU.

A new Lisbon strategy must eliminate the faults of its predecessor. It should avoid high-flying targets that cannot be reached. It should be more down to earth and give incentives for joint economic reform efforts. In particular one could

- Improve the transparency of the annual review of National Reform Programmes by the European Commission. A more systematic comparability between countries, rankings or grades would be one way of achieving this;

- Better communicate these more transparent results to the public. If the public is made aware of the differences in country-by-country performance, this can create pressure to implement best practices;

- Put more focus on the drivers of growth rather than the outcome in terms of GDP or employment. One should set specific targets for these drivers amongst which are education and skills, R&D and innovation, investment conditions like administrative procedures, infrastructure, taxes, well-functioning and flexible markets, employment participation rates, long-term fiscal consolidation and the like.

All in all, Europe needs an ongoing reform process. The reforms involved cannot always be big-ticket items or spectacular milestones. Often, they will be smaller coordinated measures whose individual contribution to the big picture cannot be measured in isolation but which, in total, have an appreciably positive impact on potential growth. The Lisbon strategy has to be continued because, among other things, it offers a good framework to coordinate measures at the European level. A joint move in the same direction by all member countries can create multiplier effects.

Summary and conclusions

In The 2009 European Growth and Jobs Monitor: Autumn Update, we argue that an exit from extremely expansionary monetary and fiscal policies needs to be ready for execution soon. Given the long time lag of monetary policy, we believe an exit from monetary policy expansion should begin earlier than for fiscal policies. But beginning in 2011, when government outlays will rise only slowly due to the termination of demand programes, active consolidation of government expenses should take place. For Europe we would expect significant progress if government expenditure were to be held 2 percentage points below nominal GDP growth (which we expect to be close to 4% per annum over the next four years). A turnaround of monetary policies may be hampered by strong revaluation effects, especially on the euro. Therefore, international coordination is essential. But, **if exit strategies are delayed for too long, we risk entering a new boom-bust-cycle**. The economies of the world have been recouping some of the losses from the sudden demand shock earlier on this year at quite a considerable pace. They are being fuelled and will continue to be fuelled by massive stimulus from monetary and fiscal policies in 2010. These policies are necessary and helpful for the time being. But, if left unchanged for too long, this could lead to strong momentum of internal demand and more financial market exuberance. We should not again react to the bursting of the credit bubble with overly expansionary monetary and fiscal policies. This lesson should have been learned – and learned clearly – after the experience of recent years.

These assessments are, as always, subject to the disclaimer provided below

Annex

Chart 1

Allianz

European Growth and Jobs Monitor
EU15: Overall score

Significant deterioration as a result of the financial crisis

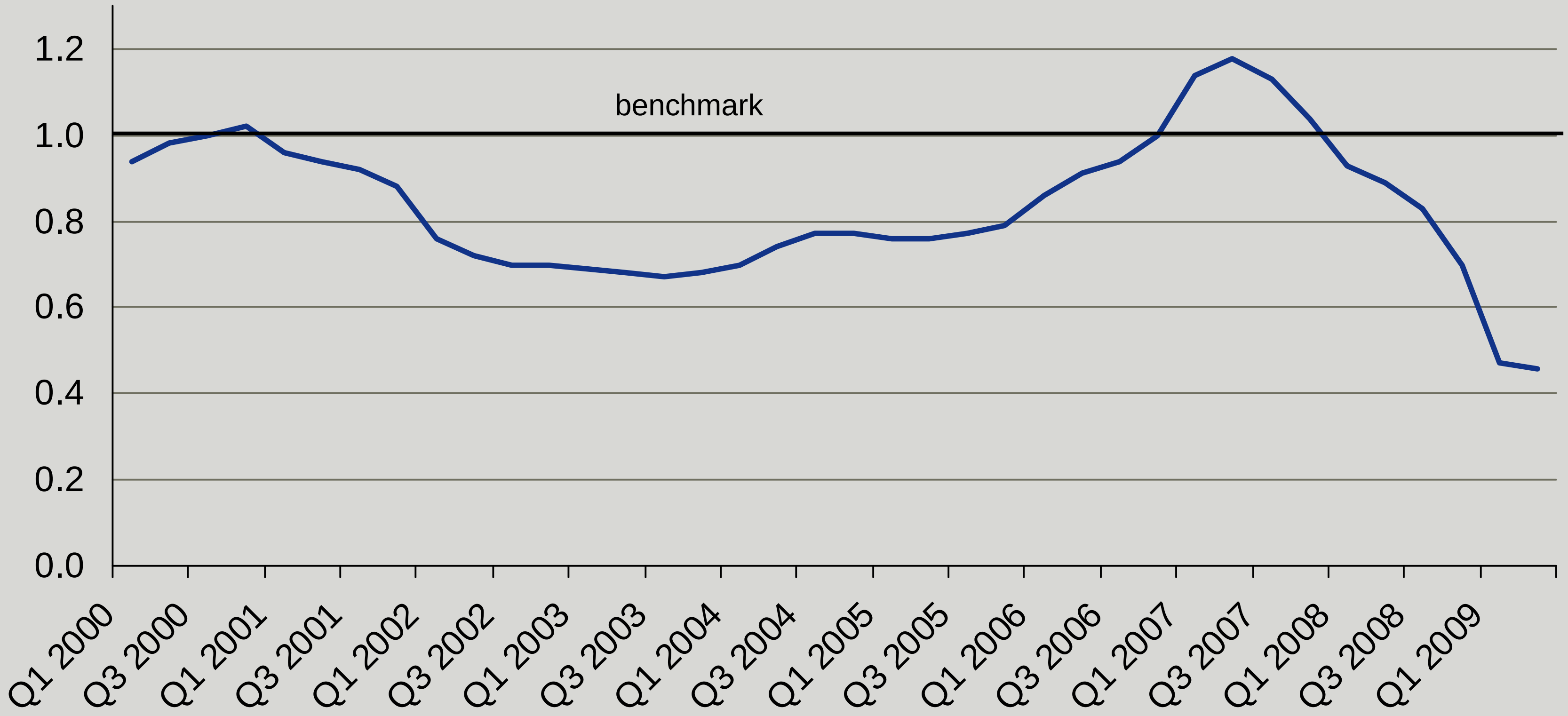
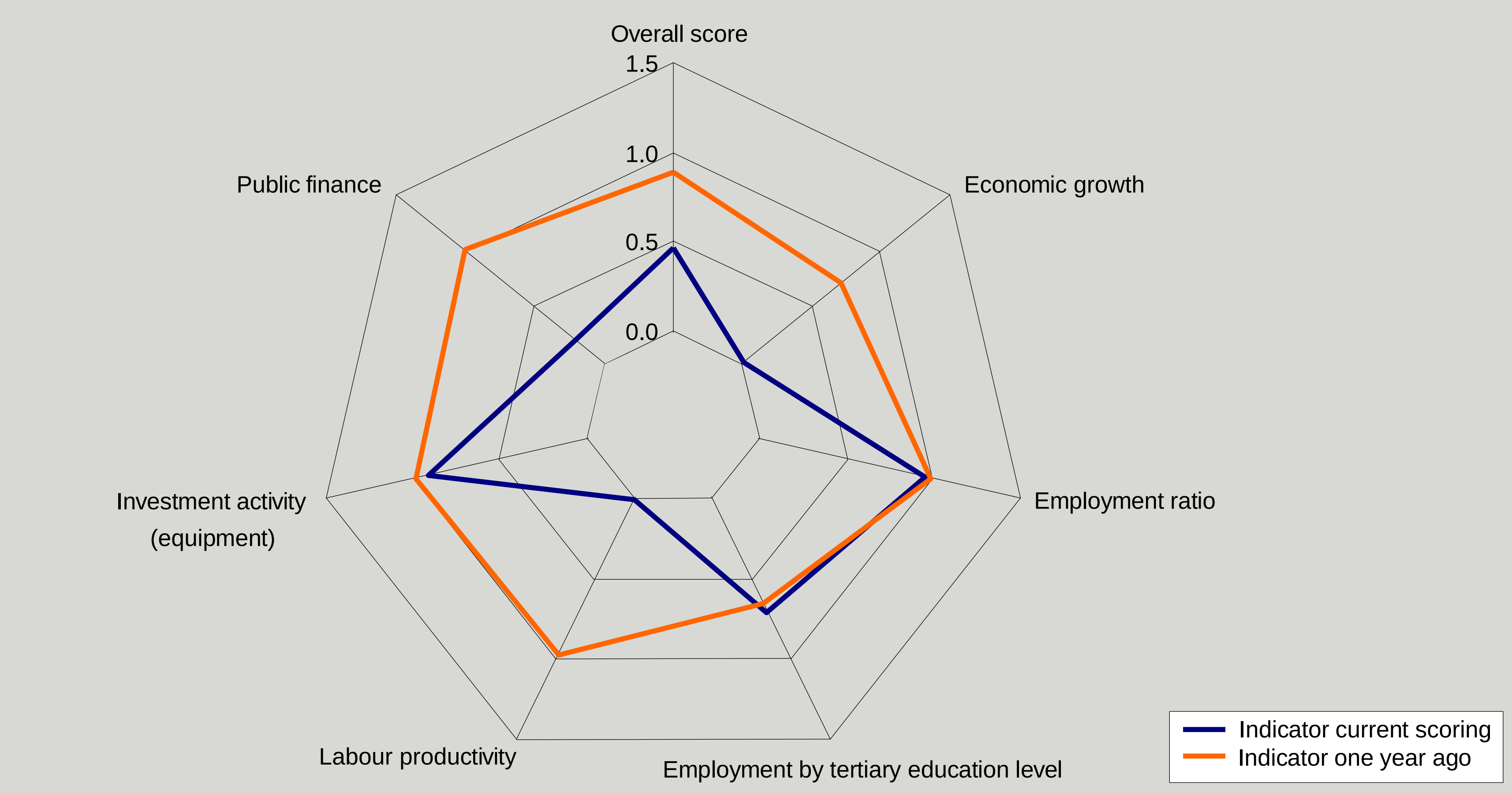


Chart 2

European Growth and Jobs Monitor

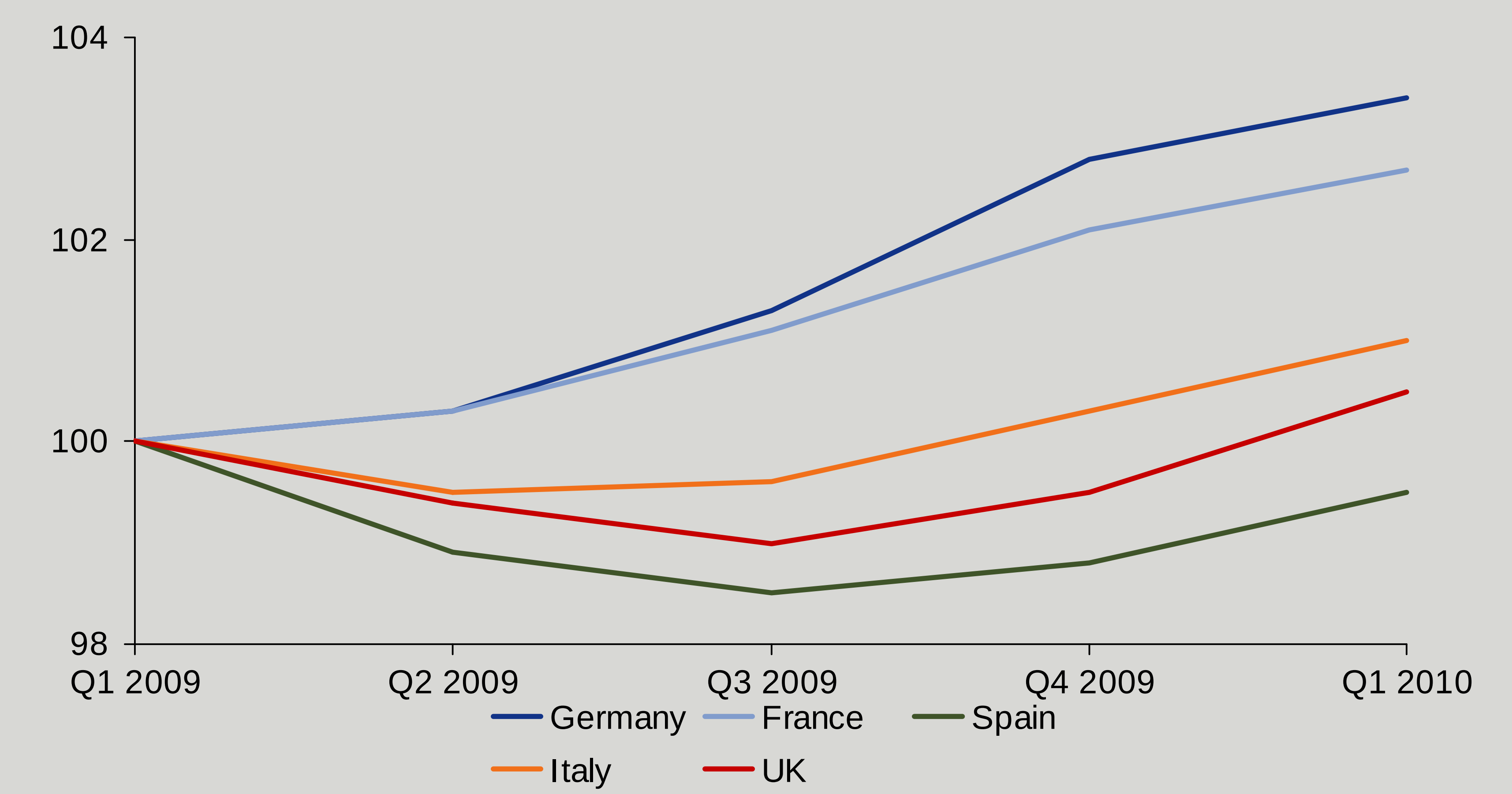
Comparison to previous year



Economic Research & Corporate Development

Diverging growth perspectives in Europe…

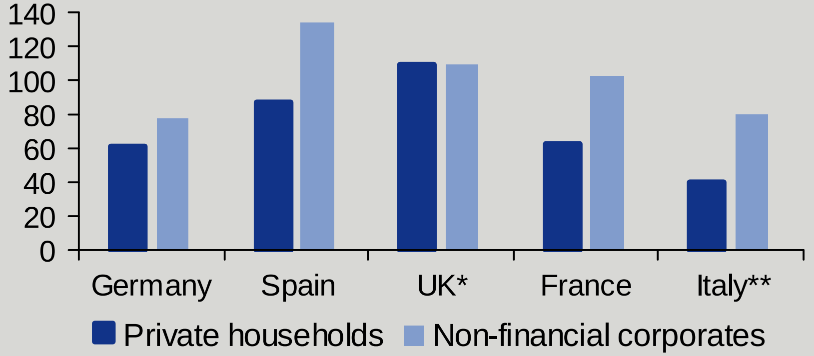
Real GDP , index, Q1 2009=100



Source: Eurostat, country-wise forecasts from third or fourth quarter.

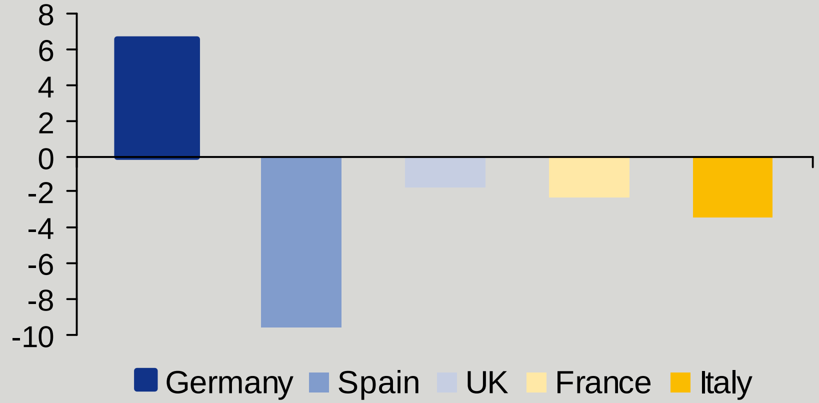
… as problems differ significantly within the region

Private sector debt 2008 (% of GDP)

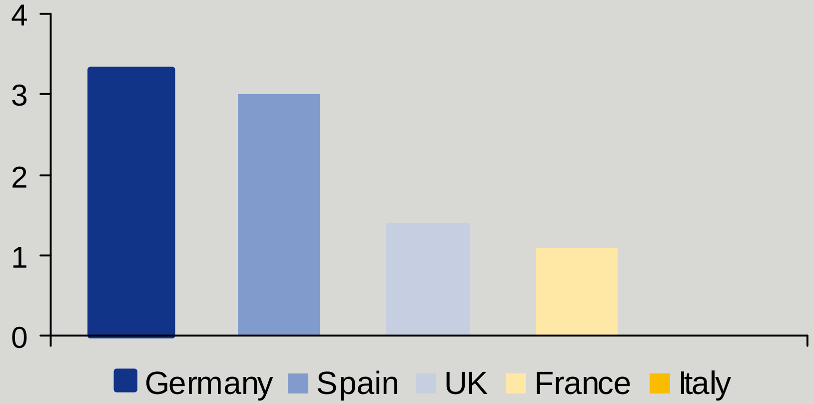


* non-financial corporates as of 2007; ** all data as of 2007

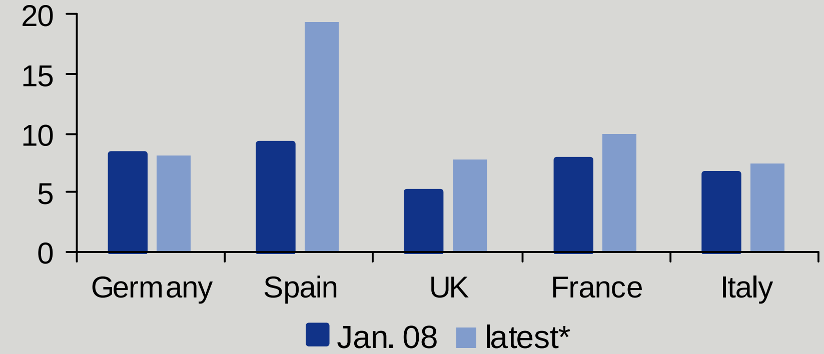
Current account balance 2008 (% of GDP)



Fiscal stimulus 2009/2010 (% of GDP)



Unemployment rate



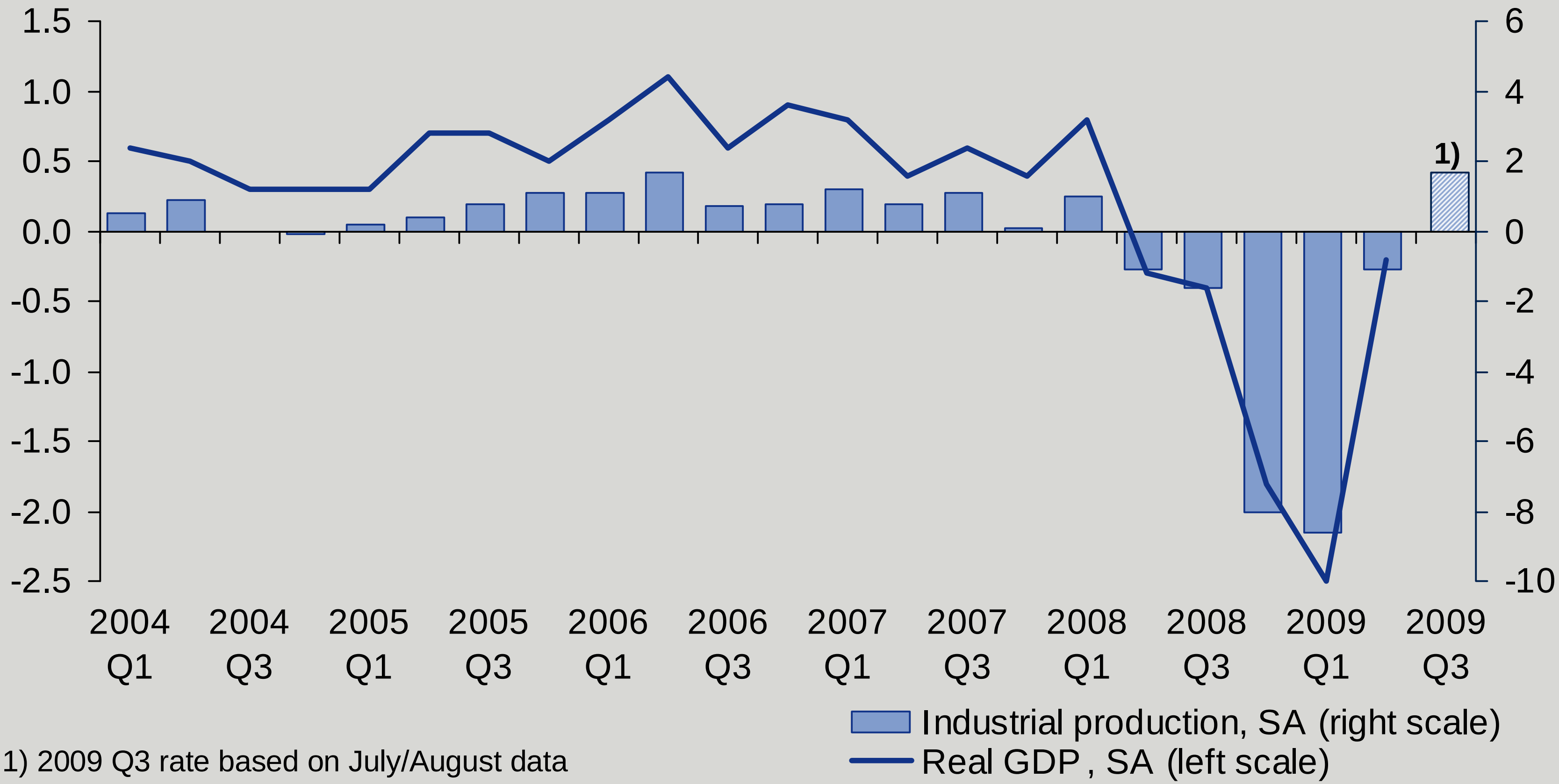
* Germany: Oct., Spain/France: Sep., UK: July, Italy: June

Source: Eurostat.

Economic Research & Corporate Development

EMU: GDP likely to register first positive growth since 2008Q1…

Real GDP and industrial production, % change over previous quarter

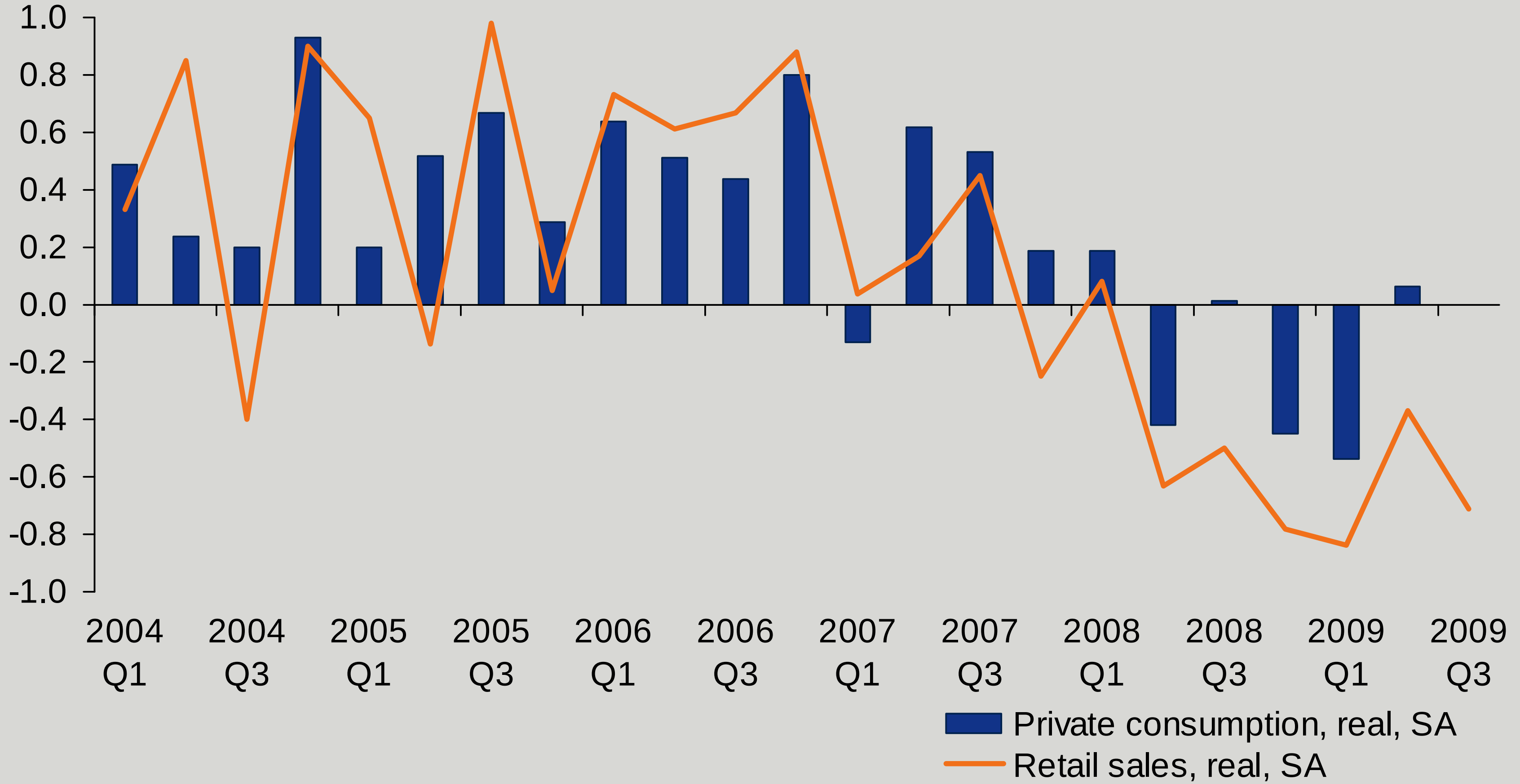


1) 2009 Q3 rate based on July/August data

Source: Eurostat.

… but consumption probably on the weak side

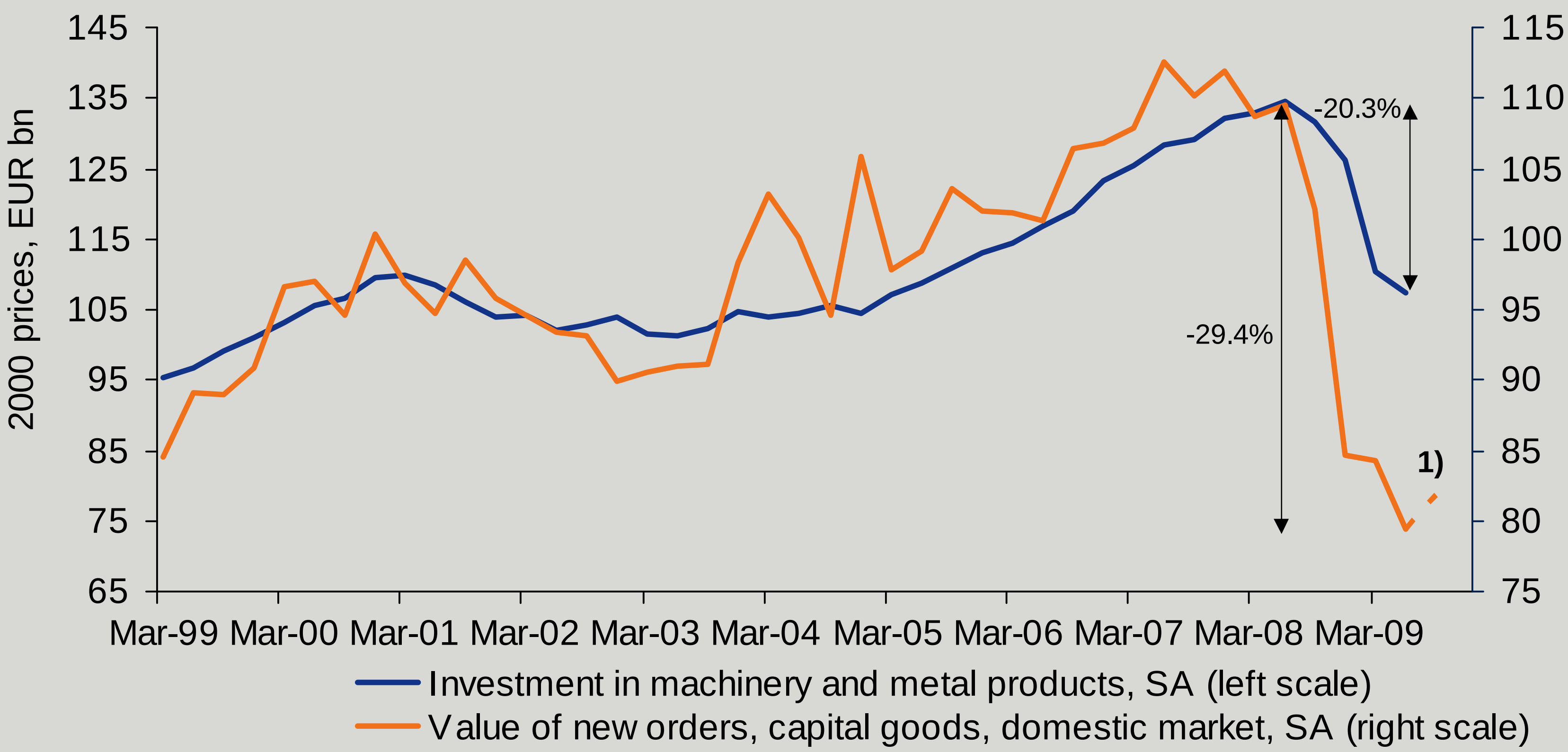
Private consumption and retail sales, % change over previous quarter



Source: Eurostat.

EMU: Signs of stabilisation after equipment investment crash

Investment and new orders

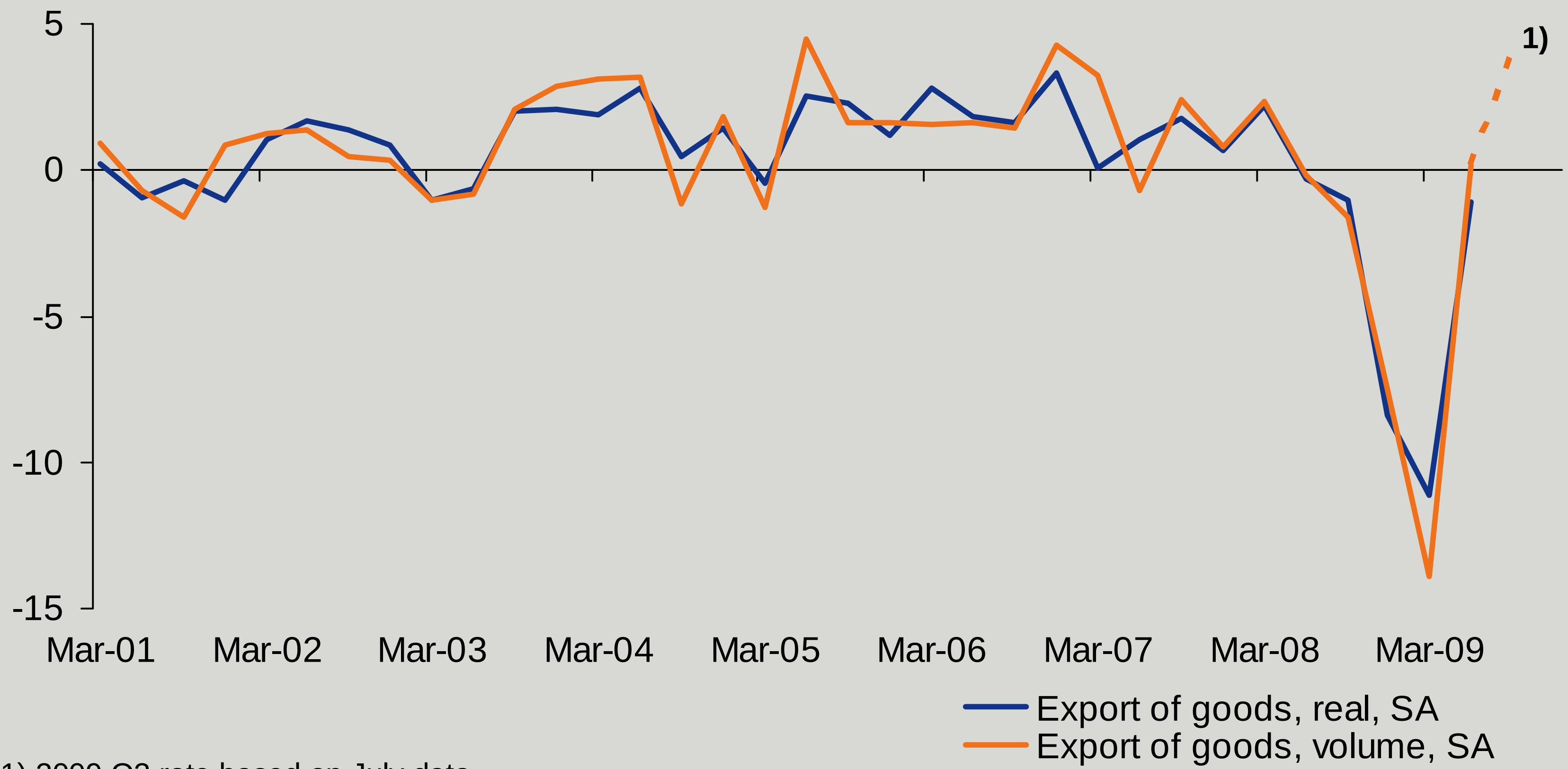


1) 2009 Q3 rate based on July/August data

Source: Eurostat.

EMU: Exports look set to rebound

Export of goods, % change over previous quarter

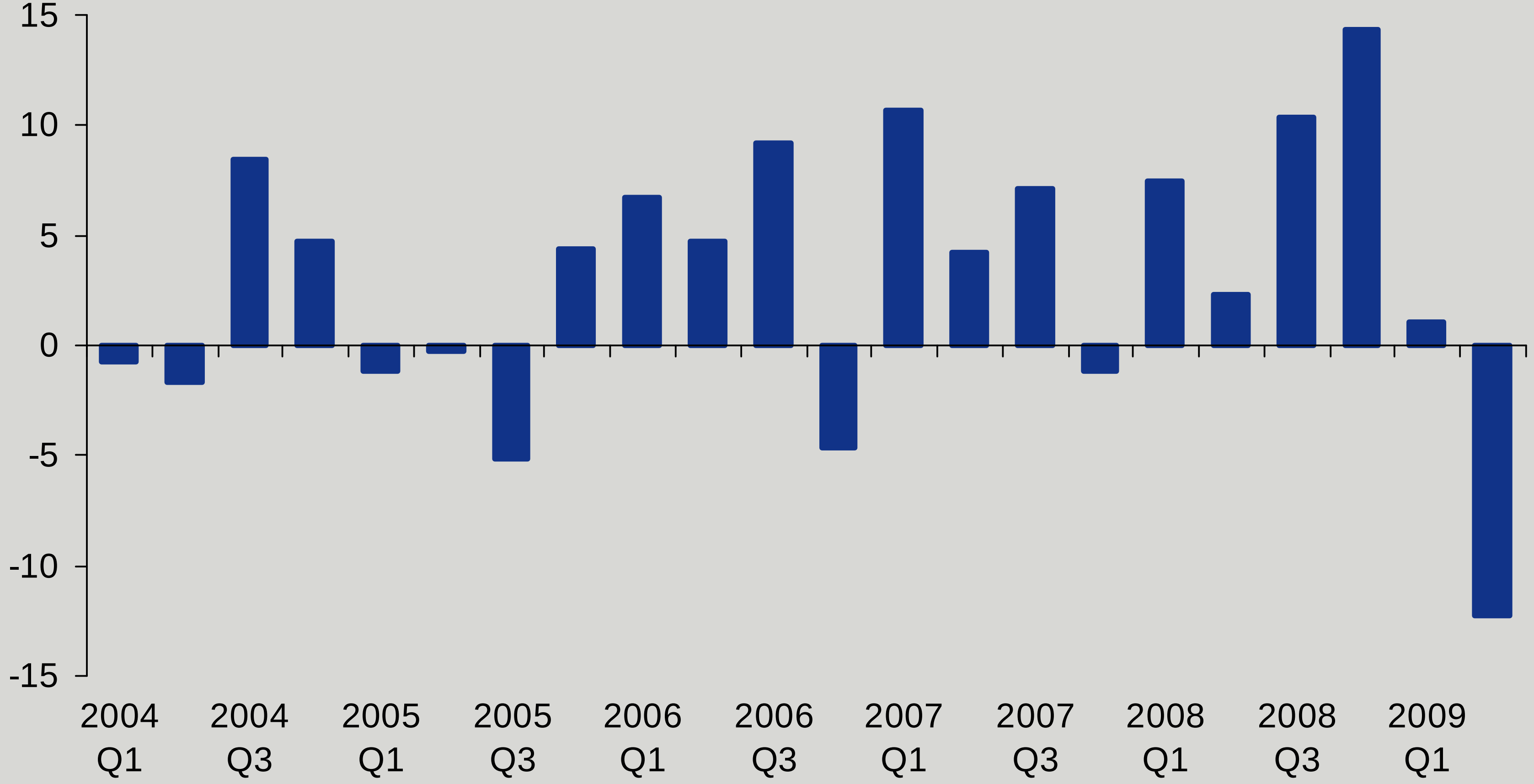


1) 2009 Q3 rate based on July data

Source: Eurostat.

EMU: Progress in inventory adjustment

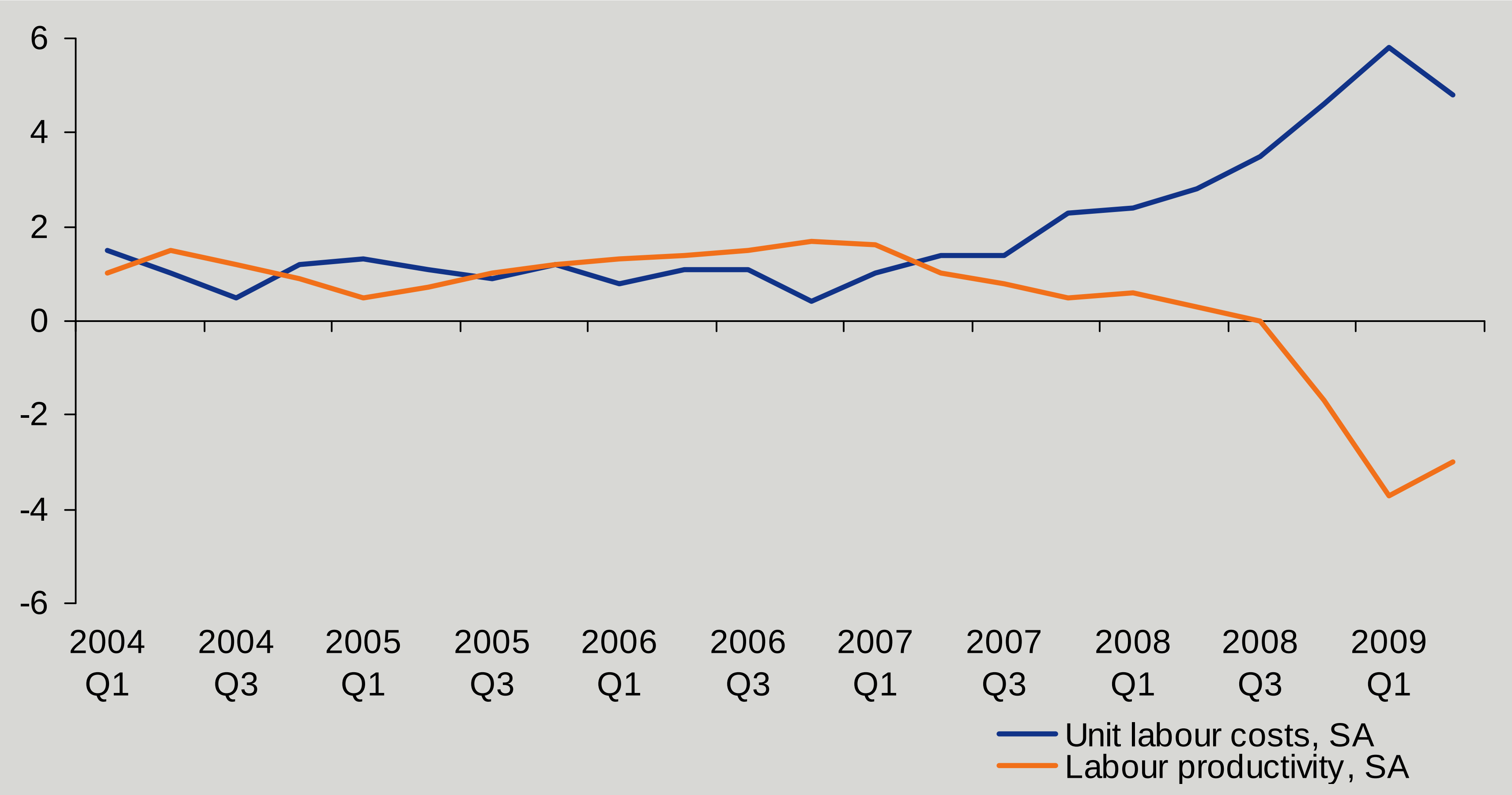
Change in real inventories, SA, EUR bn



Source: Eurostat.

EMU: Labour costs set to decline tangibly as economy recovers

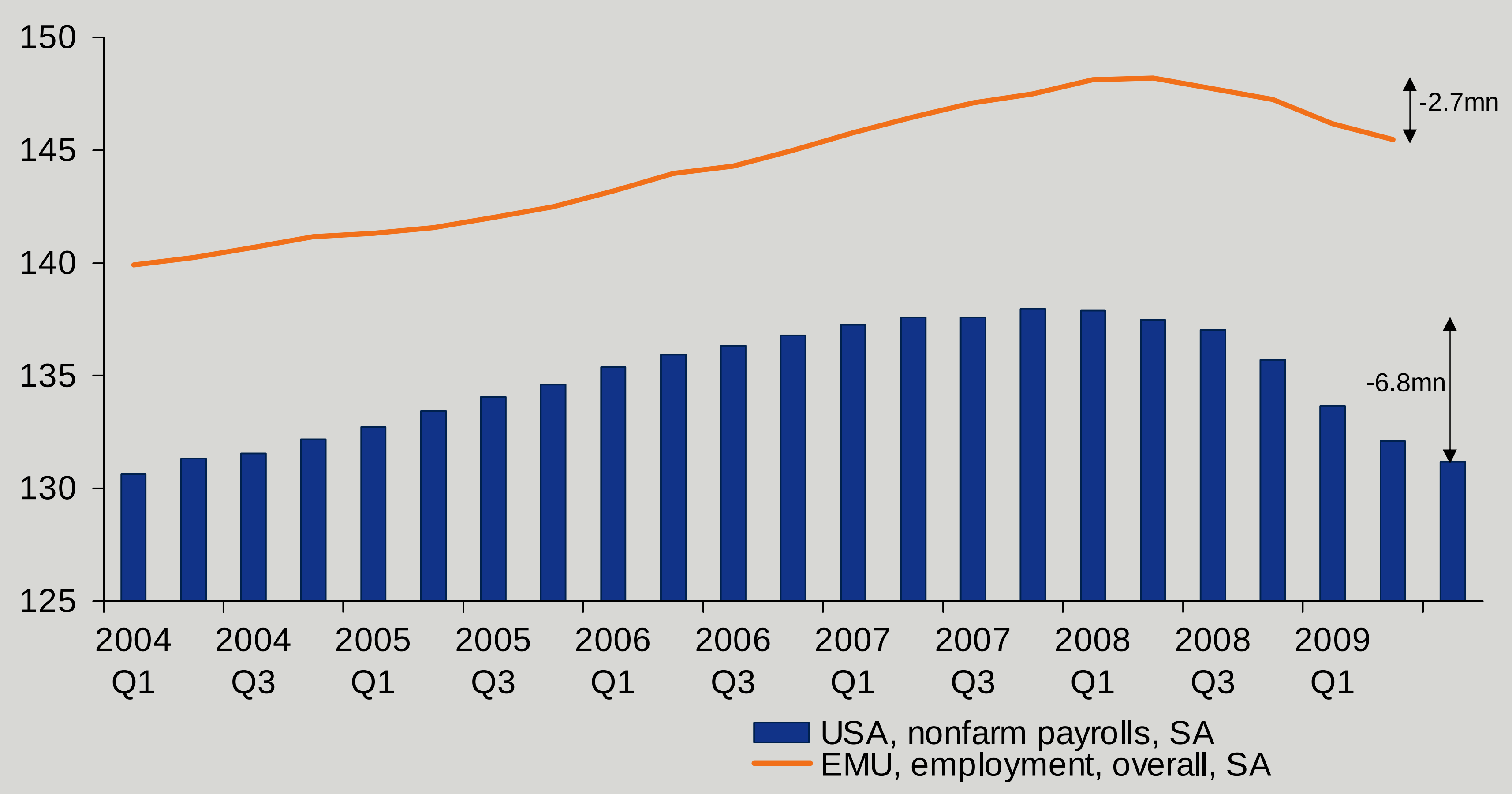
Unit labour costs and labour productivity, % change over previous year



Source: ECB.

Impact of crisis on employment – an international comparison

Employment in the EMU and the US, quarterly averages, mn

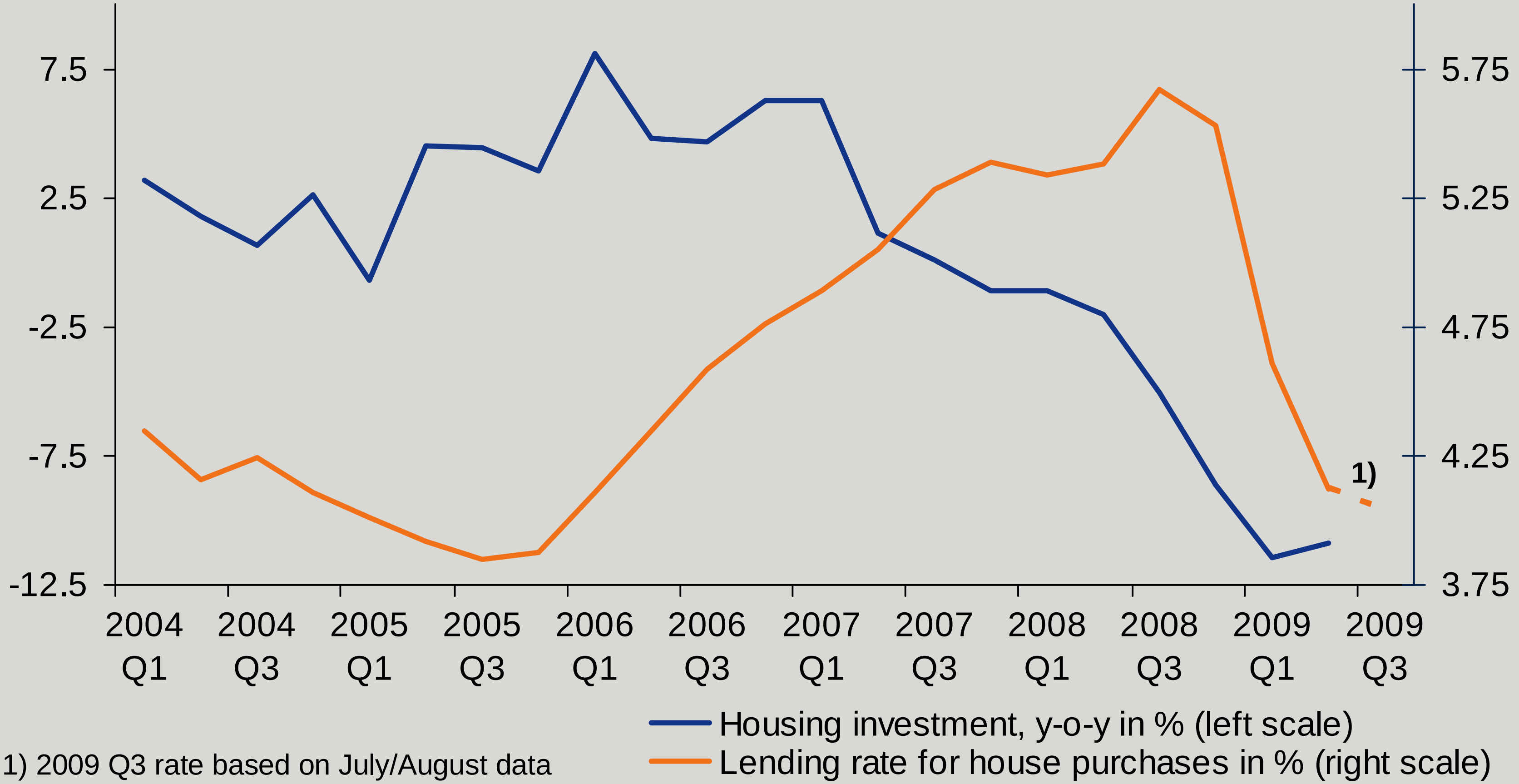


Sources: Eurostat, U.S. Bureau of Labor Statistics.

Chart 12

EMU: Low lending rates will eventually support housing activity

Housing and mortgage

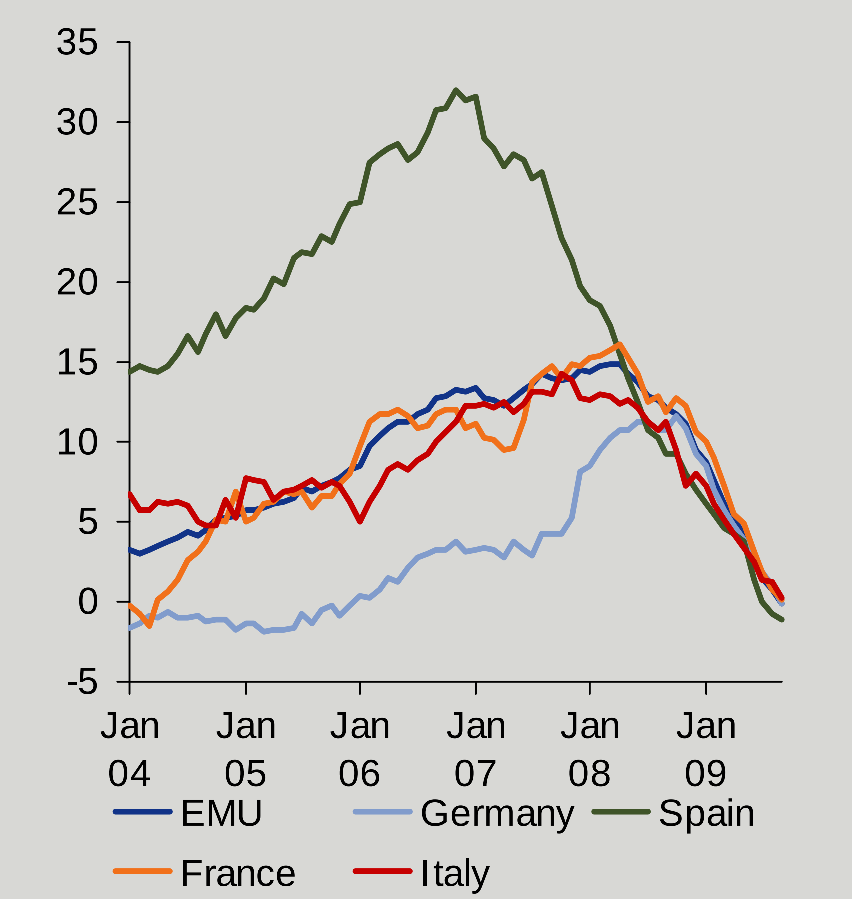


1) 2009 Q3 rate based on July/August data

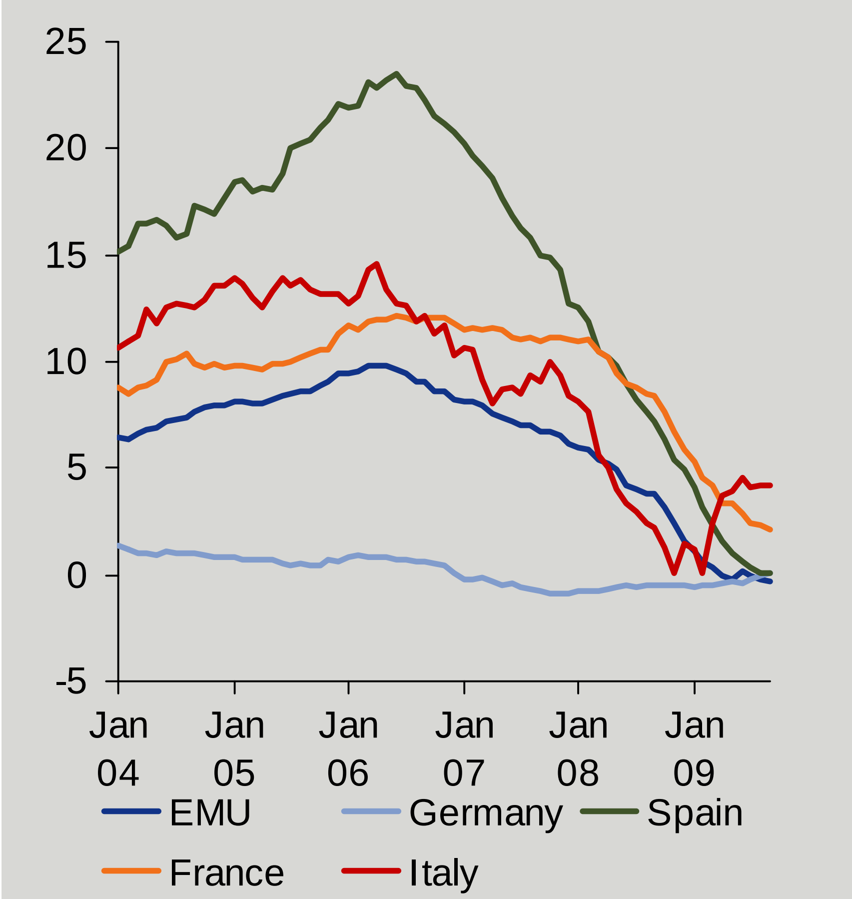
Sources: Eurostat, ECB.

EMU: Lending activity I
- percentage change over previous year -

Loans to non-financial corporations



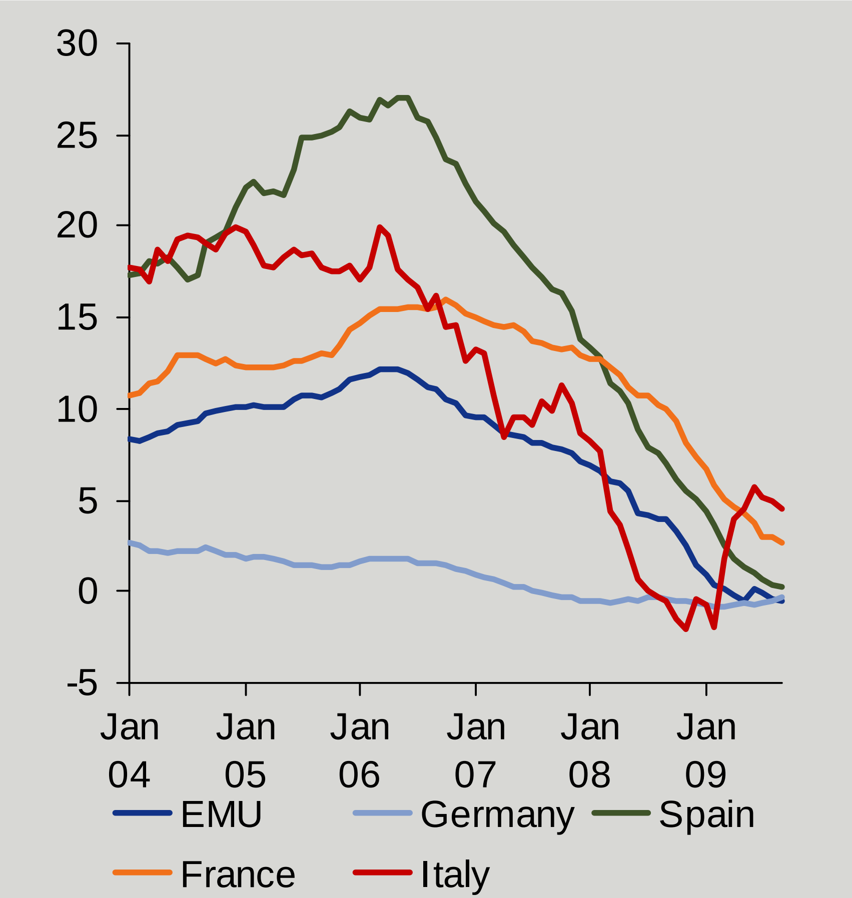
Loans to private households



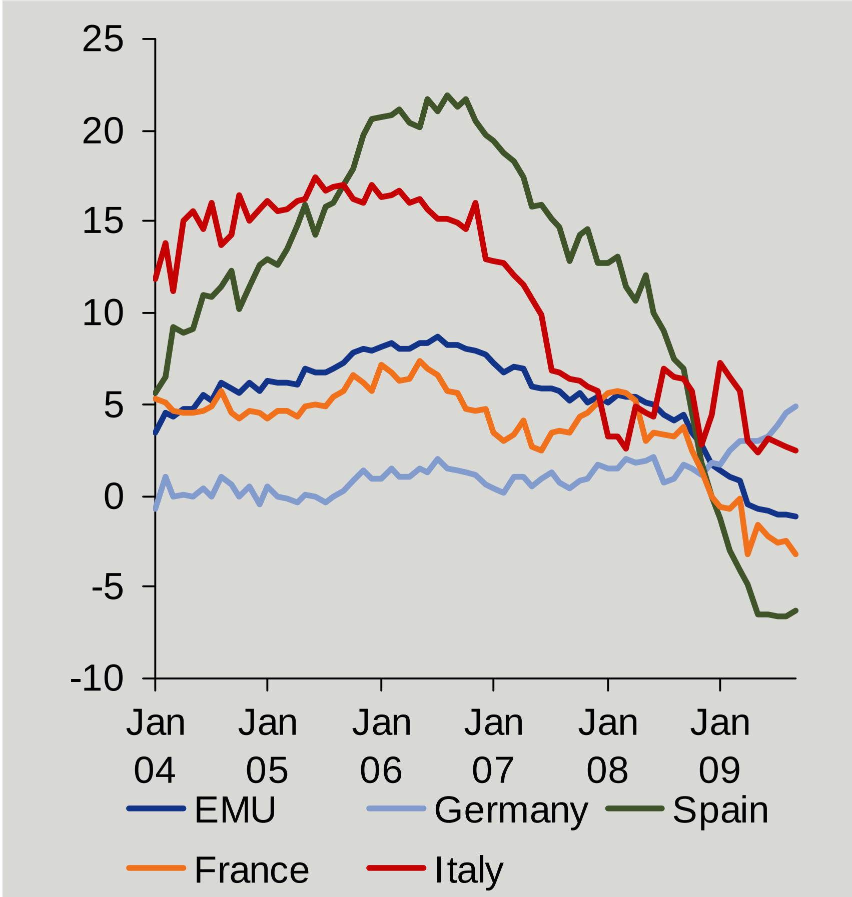
Source: ECB Statistical data warehouse.

EMU: Lending activity II
- percentage change over previous year -

Lending for house purchase



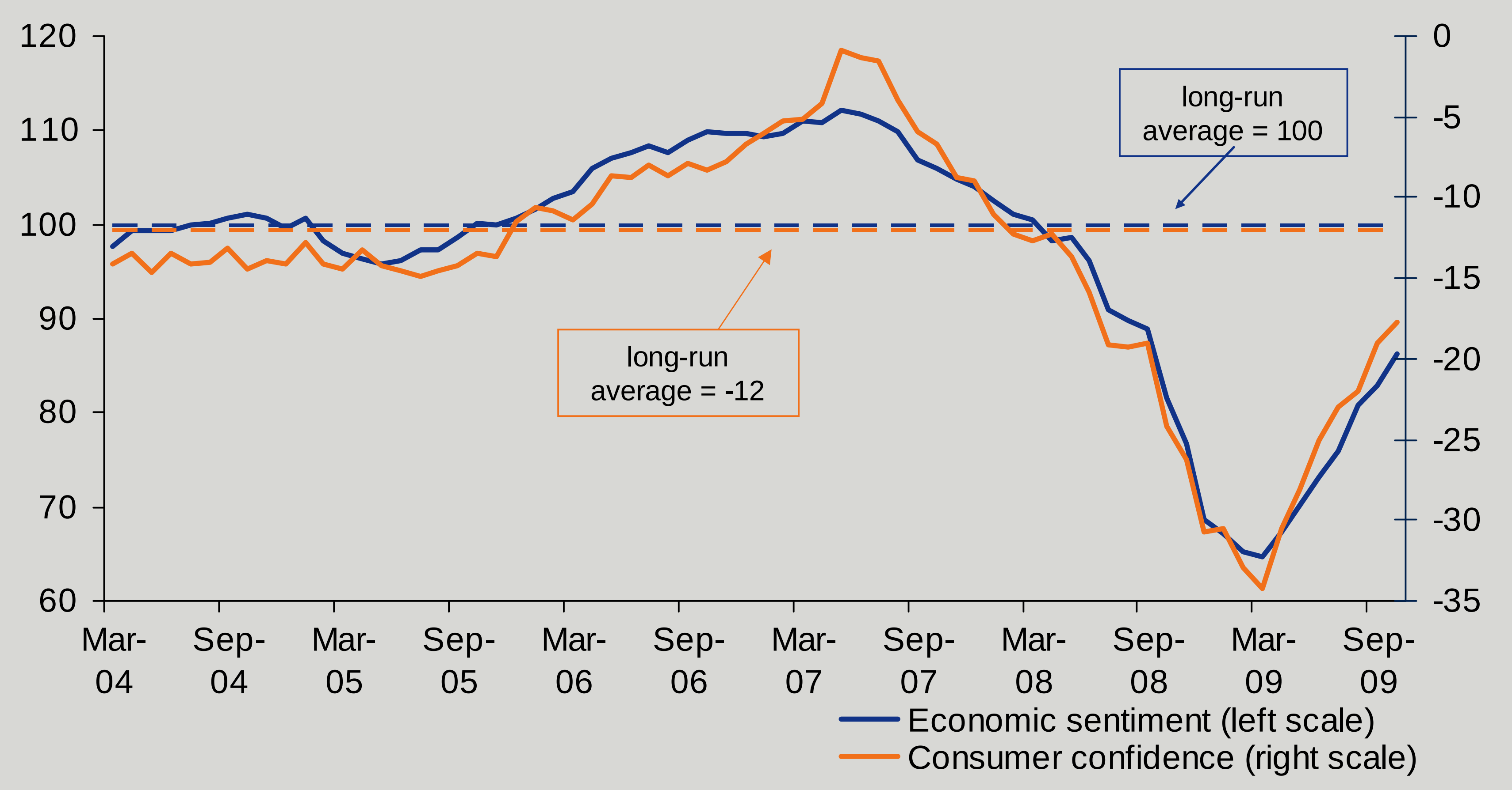
Consumer loans



Source: ECB Statistical data warehouse.

EMU: Sentiment improving

EMU economic indicators



Source: Directorate-General for Economic and Financial Affairs, European Commission.

EMU: Economic recovery set to continue

EMU economic indicators and forecasts

		2008				2009				2010						
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2008	2009f	2010f
GDP real		0.8	-0.3	-0.4	-1.8	-2.5	-0.2	*0.6*	*0.9*	*0.6*	*0.4*	*0.3*	*0.3*	0.7	*-3.7*	*2.0*
Private consumption		0.2	-0.4	0.0	-0.5	-0.5	0.1	*0.2*	*0.4*	*0.3*	*0.3*	*0.3*	*0.2*	0.3	*-0.8*	*1.1*
Government spending		0.5	0.8	0.5	0.6	0.6	0.7	*0.6*	*0.7*	*0.6*	*0.5*	*0.4*	*0.5*	2.1	*2.6*	*2.3*
Investment		0.7	-1.3	-1.5	-3.5	-5.4	-1.5	*0.9*	*0.9*	*0.5*	*0.6*	*0.5*	*0.5*	-0.6	*-9.3*	*2.1*
Exports		2.0	-0.5	-1.0	-7.0	-9.2	-1.5	*2.5*	*2.5*	*1.5*	*1.2*	*0.8*	*0.7*	1.0	*-14.0*	*5.8*
Imports		1.8	-1.1	0.3	-4.6	-7.9	-2.9	*1.6*	*1.5*	*1.4*	*1.2*	*0.9*	*0.9*	1.0	*-12.1*	*4.2*
Industrial production (excl. construction)		1.0	-1.1	-1.6	-8.0	-8.6	-1.1	*2.2*	*2.4*	*1.0*	*0.8*	*0.5*	*0.5*	-1.8	*-14.5*	*4.8*
Unemployment rate	%	7.2	7.4	7.6	8.0	8.8	9.3	9.6	*9.9*	*10.3*	*10.5*	*10.6*	*10.6*	7.6	*9.4*	*10.5*
Consumer prices	y-o-y	3.4	3.6	3.8	2.3	1.0	0.2	-0.4	*0.4*	*1.2*	*1.4*	*1.7*	*1.7*	3.3	*0.3*	*1.5*
Producer prices	y-o-y	5.4	7.0	8.4	3.4	-2.0	-5.7	-7.9	*-4.3*	*-0.2*	*1.7*	*2.6*	*2.5*	6.0	*-5.0*	*1.7*
Current account balance	EUR bn, nsa	-31.4	-28.9	-37.5	-42.8	-37.4	-11.8	*-5.0*	*0.0*	*-5.0*	*-10.0*	*-10.0*	*-10.0*	-143.3	*-54.2*	*-35.0*
	% of GDP													-1.5	*-0.6*	*-0.4*
Budget balance	% of GDP													-2.0	*-5.7*	*-5.7*
3m money market rate**)	%	4.7	4.9	5.3	2.9	1.5	1.1	0.8	*0.9*	*1.3*	*1.6*	*1.8*	*1.9*	4.6	*1.3*	*1.5*
10yr gov. bond yield***)	%	3.9	4.6	4.0	2.9	3.0	3.4	3.2	*3.6*	*4.0*	*4.3*	*4.2*	*4.1*	4.0	*3.3*	*4.0*
Trade-weighted euro **)	nominal	116.5	116.3	111.7	115.4	114.6	114.2	115.6	*116.5*	*117.0*	*118.0*	*119.0*	*119.0*	113.0	*115.3*	*117.9*
Exchange rate**)	USD per EUR	1.58	1.58	1.43	1.39	1.33	1.41	1.46	*1.50*	*1.52*	*1.54*	*1.55*	*1.55*	1.47	*1.39*	*1.53*

*) quarterly values: percentage change over previous period, seasonally adjusted, except where noted; annual GDP not adjusted; foreign trade incl.intra-trade.
) end of quarter, yearly average. *) Germany as benchmark; end of quarter, yearly average.

f = forecast.

EMU: GDP, production potential[1], output gap

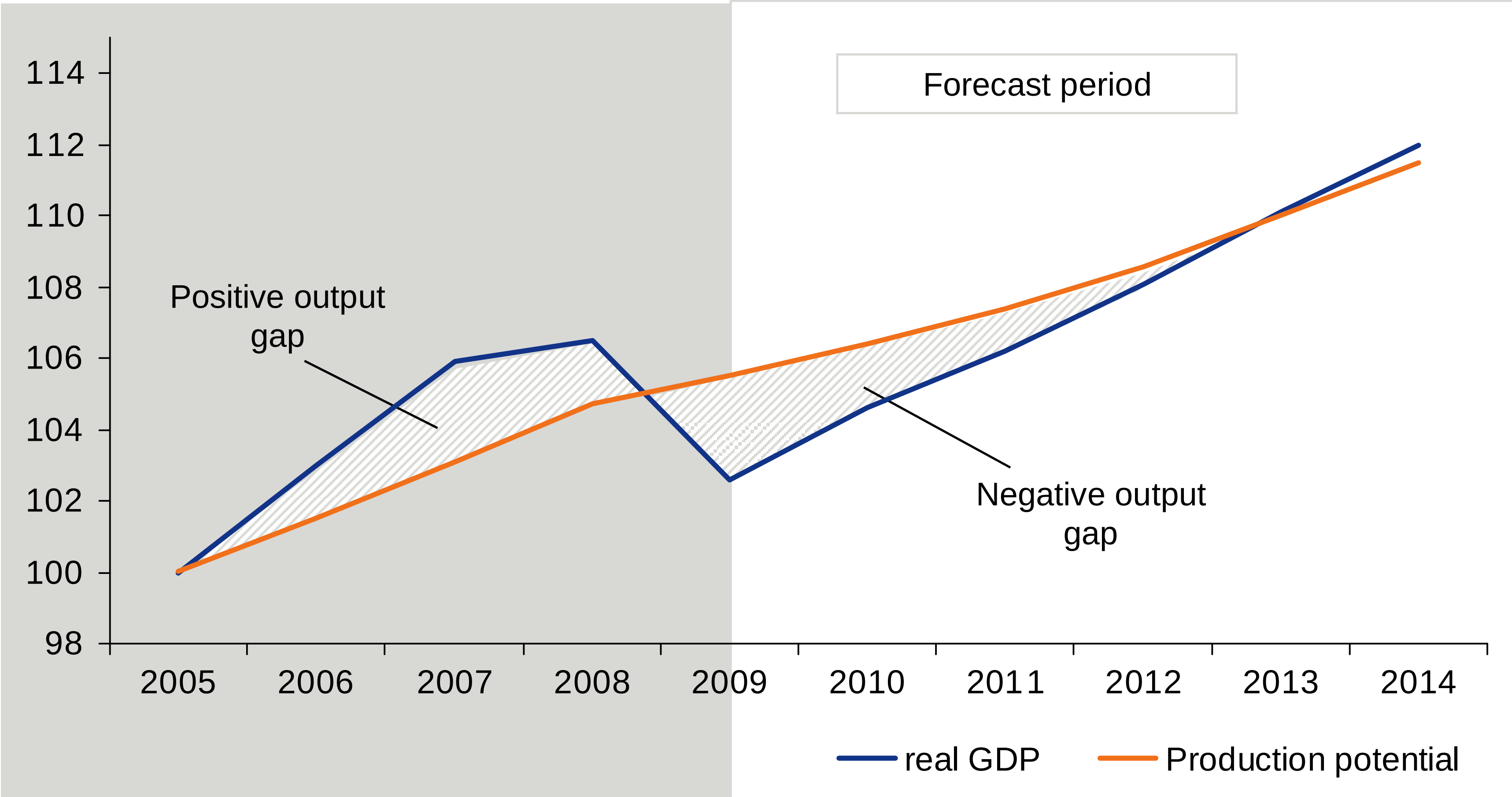
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
GDP increase (in %)	1.7	3.0	2.8	0.6	-3.7	2.0	1.5	1.8	1.8	1.8
Output gap (% of potential production)	-0.1	1.3	2.5	1.9	-2.7	-1.5	-1.0	-0.3	0.2	0.7
Growth of production potential[1] (in %)	1.7	1.5	1.6	1.5	0.8	0.8	1.0	1.1	1.3	1.3
Growth contribution (in percentage points)										
§ Labour	0.4	0.3	0.3	0.3	0.1	0.1	0.2	0.3	0.3	0.3
§ Capital	0.7	0.8	0.9	0.8	0.3	0.3	0.4	0.4	0.5	0.5
§ Total factor productivity	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5

[1] Based on the concept of the macroeconomic production function, allowing potential growth to be broken down into the contributions of the input factors labor and capital on the one hand and total factor productivity.

Sources: European Commission (Economic Forecast, Autumn 2009; Occasional Papers No.49, June 2009), from 2008 own estimates (stripping out "NAIRU" estimates of the Commission) and forecasts.

Underutilization not set to linger

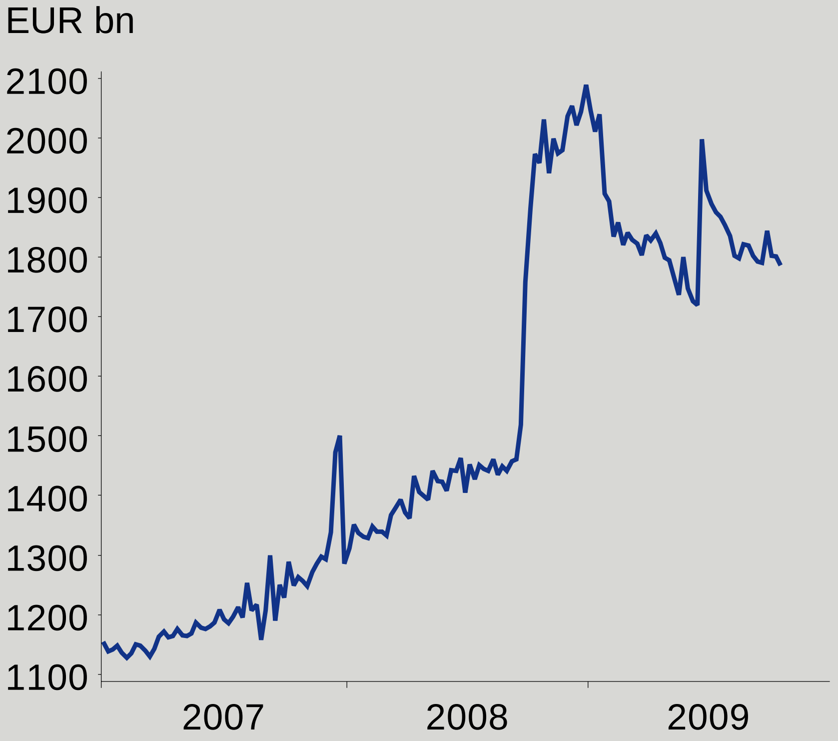
GDP , index 2005=100



Sources: European Commission (Economic Forecast, Autumn 2009), from 2008 own estimates (stripping out “NAIRU“ estimates of the Commission) and forecasts.

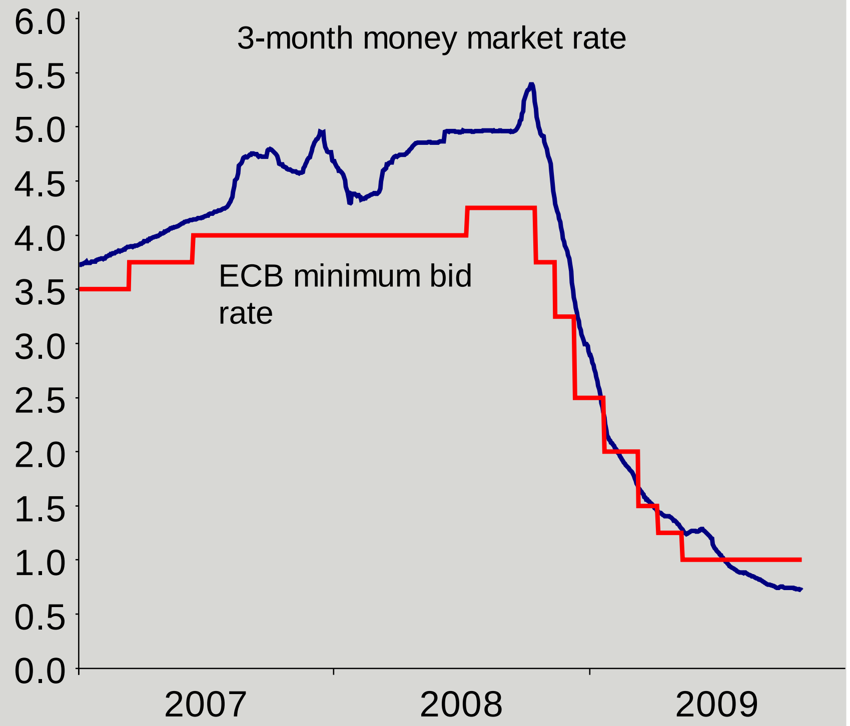
Monetary policy of the ECB

Assets of the Eurosystem*)



*) Consolidated financial statement of the Eurosystem.

Key interest rate



Source: ECB, EcoWin AB, Reuters

EMU: Development of public finances in scenario of moderate spending growth from 2011[1)]

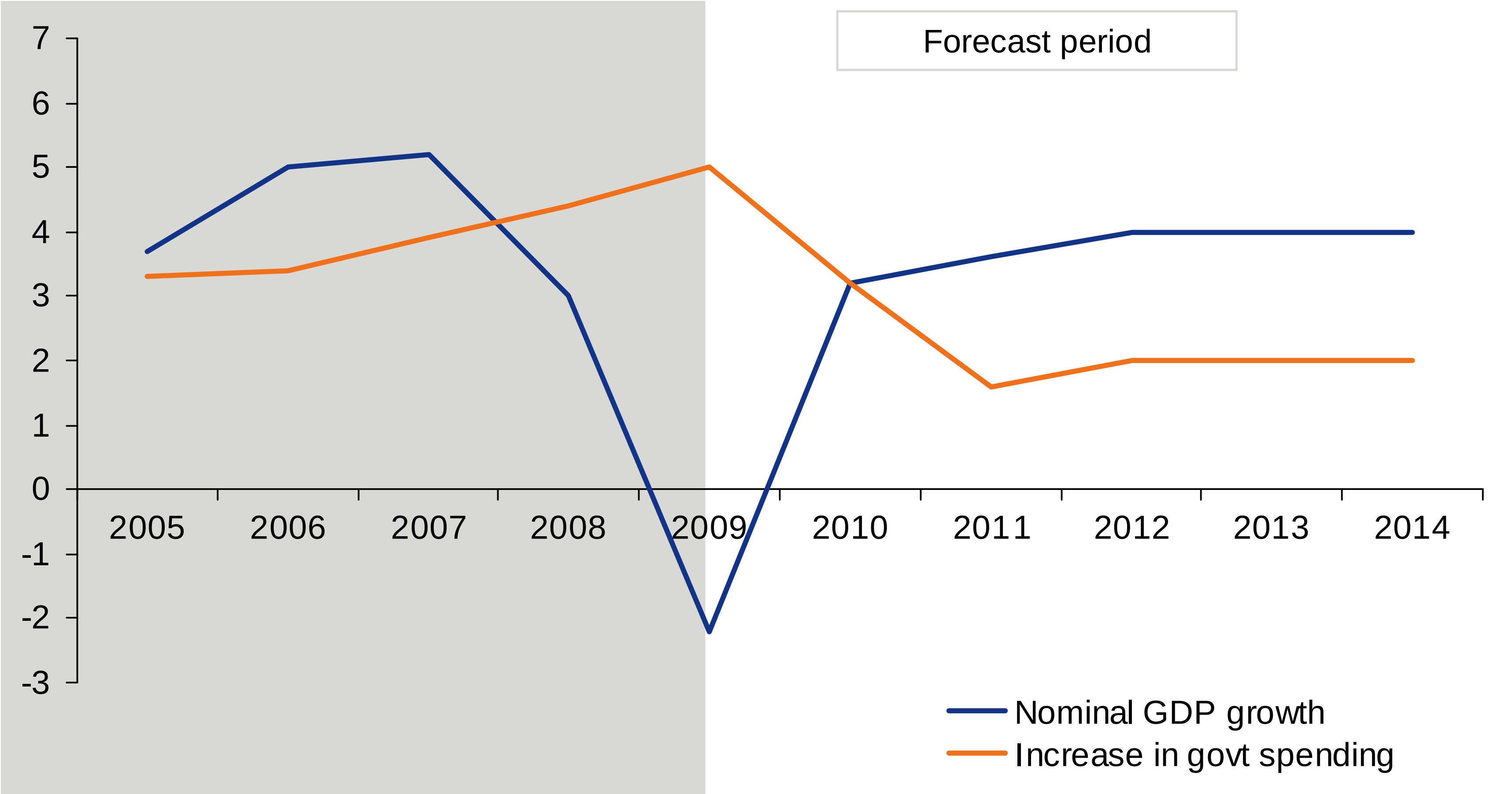
as % of GDP	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Government budget balance	-2.5	-1.3	-0.6	-2.0	-5.7	-5.7	-4.7	-3.7	-2.7	-1.8
Government revenue	44.8	45.3	45.4	44.8	44.4	44.4	44.4	44.4	44.4	44.4
Government expenditure	47.3	46.6	46.0	46.8	50.1	50.1	49.1	48.1	47.1	46.2
Cyclically-adjusted budget balance	-2.5	-1.9	-1.8	-2.9	-4.4	-5.0	-4.2	-3.6	-2.8	-2.1
Cyclical budget components	0.0	0.6	1.2	0.9	-1.3	-0.7	-0.5	-0.1	0.1	0.3

[1)] Spending growth from 2011 two percentage points below nominal GDP growth rate.

Sources: Eurostat, European Commission (Economic Forecast, Autumn 2009), from 2009 own estimates and forecasts.

EMU: Scenario moderate spending growth from 2011

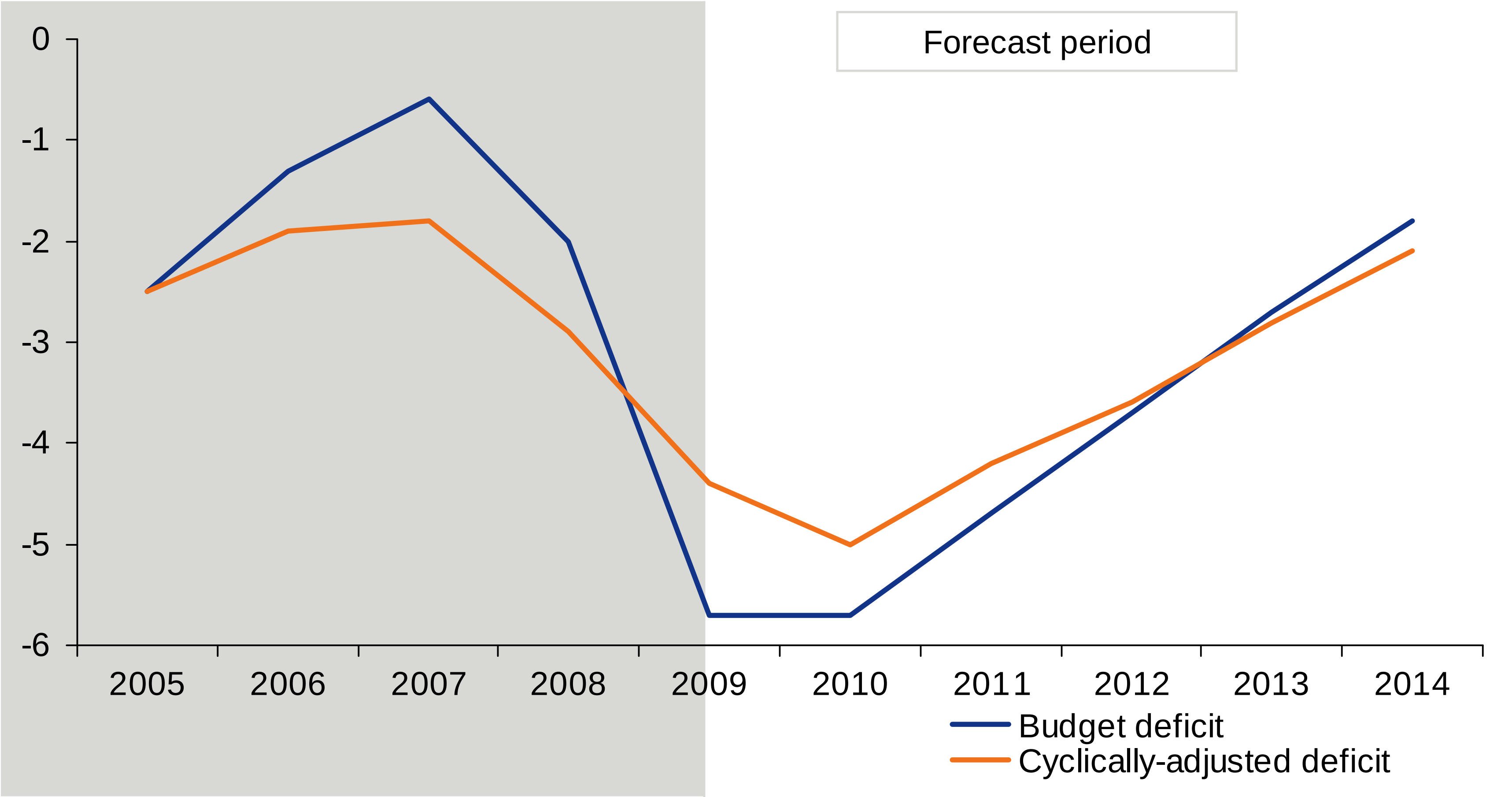
Nominal GDP and government spending, annual growth in % [1)]



[1)] Spending growth from 2011 two percentage points below nominal GDP growth rate.
Sources: Eurostat, European Commission (Economic Forecast, Autumn 2009), from 2009 own estimates and forecasts.

EMU: Trend in deficit given moderate spending growth

Budget deficit and cyclically-adjusted deficit



Sources: Eurostat, European Commission (Economic Forecast, Autumn 2009), from 2009 own estimates and forecasts.