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The 2016 Euro Plus Monitor

Coping with the backlash

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Economics

The 2016 Euro Plus Monitor

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Two separate rankings for all 28 EU member countries

Ranking 1: Adjustment Indicator

- Limited number of key measures of adjustment
- Focus: exports, labour costs, fiscal adjustment, structural reforms
- Includes 2016 projections beyond backward-looking hard data
- Describes the pace of change

Ranking 2: Fundamental Health

- Broad array of indicators and long-term trends
- Focus: growth potential, competitiveness, fiscal sustainability, resilience
- Includes data on demographics and education that go beyond mere economics
- Backward looking data
- Describes the recent situation (=starting level)

This time, we include seven countries we had not covered before.

Fundamental health

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Fundamental health indicator

Fundamental Health Indicator																	
Rank		Country	Total Score			Growth			Competitiveness			Fiscal sustainability			Resilience		
2016	2015		2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015
1	2	Czech Republic	7.6	*0.1*	7.5	7.2	*0.1*	7.1	7.4	*0.1*	7.3	8.1	*0.1*	8.0	7.7	*0.1*	7.7
2	3	Luxembourg	7.5	*0.0*	7.5	6.5	*-0.1*	6.7	7.7	*0.2*	7.4	9.7	*0.0*	9.7	6.2	*0.0*	6.2
3	4	Estonia	7.5	*0.1*	7.3	6.9	*0.2*	6.8	5.6	*0.0*	5.6	9.2	*0.2*	9.0	8.1	*0.2*	7.9
4	1	Germany	7.4	*-0.1*	7.5	6.3	*-0.2*	6.5	7.9	*0.0*	7.9	7.8	*0.0*	7.9	7.7	*-0.1*	7.8
5	5	Slovakia	7.0	*0.0*	7.0	5.9	*-0.1*	6.0	7.1	*0.0*	7.0	7.7	*-0.1*	7.8	7.3	*0.2*	7.1
6	6	Netherlands	6.9	*0.0*	6.9	7.1	*-0.2*	7.2	7.6	*-0.2*	7.8	6.8	*0.3*	6.6	6.1	*0.1*	6.0
7	8	Malta	6.8	*0.1*	6.7	7.0	*0.0*	7.0	6.7	*-0.1*	6.8	7.2	*0.3*	6.8	6.4	*0.3*	6.1
8	7	Lithuania	6.8	*0.0*	6.8	6.1	*0.2*	5.9	6.5	*-0.3*	6.7	8.1	*-0.1*	8.1	6.5	*0.3*	6.3
9	11	Ireland	6.8	*0.2*	6.6	7.2	*0.5*	6.8	8.4	*0.1*	8.3	7.0	*0.0*	7.0	4.5	*0.2*	4.3
10	10	Latvia	6.6	*0.0*	6.6	6.3	*0.0*	6.3	4.9	*-0.2*	5.2	8.5	*0.0*	8.5	6.6	*0.2*	6.4
11	9	Poland	6.6	*0.0*	6.6	6.2	*-0.1*	6.3	6.9	*0.1*	6.8	6.5	*-0.2*	6.7	6.6	*0.0*	6.5
12	12	Sweden	6.5	*0.0*	6.5	7.4	*0.4*	7.0	4.2	*-0.1*	4.3	7.1	*-0.2*	7.3	7.3	*0.0*	7.3
13	14	Slovenia	6.3	*0.1*	6.2	6.0	*0.0*	6.0	5.8	*0.1*	5.8	5.8	*-0.1*	5.9	7.7	*0.5*	7.2
14	16	Denmark	6.3	*0.2*	6.1	6.1	*0.1*	6.0	5.0	*-0.2*	5.2	7.5	*0.8*	6.7	6.5	*0.0*	6.5
15	13	Hungary	6.2	*-0.1*	6.3	5.5	*0.1*	5.4	7.6	*-0.2*	7.8	5.3	*-0.4*	5.7	6.5	*0.0*	6.5
16	17	Bulgaria	6.2	*0.1*	6.1	5.1	*-0.2*	5.3	5.3	*0.1*	5.2	7.7	*0.2*	7.5	6.7	*0.3*	6.4
17	15	Romania	5.9	*-0.3*	6.1	4.9	*-0.2*	5.1	4.5	*0.2*	4.3	7.6	*-0.9*	8.5	6.5	*-0.1*	6.6
18	19	United Kingdom	5.6	*0.1*	5.5	5.7	*0.4*	5.3	5.4	*-0.4*	5.8	6.2	*0.3*	5.8	5.2	*0.0*	5.2
19	18	Austria	5.5	*-0.2*	5.8	5.9	*-0.3*	6.2	4.6	*-0.2*	4.7	5.4	*-0.4*	5.8	6.2	*-0.1*	6.3
20	20	Belgium	5.3	*-0.1*	5.4	5.4	*-0.1*	5.5	6.7	*-0.1*	6.8	3.8	*-0.2*	4.0	5.4	*0.1*	5.2
21	21	Croatia	5.0	*-0.1*	5.1	3.6	*-0.2*	3.8	4.3	*-0.2*	4.5	5.0	*0.2*	4.8	7.2	*-0.2*	7.3
22	22	Spain	4.9	*0.0*	4.9	4.2	*0.3*	4.0	4.9	*0.0*	4.9	5.3	*-0.5*	5.8	5.2	*0.2*	5.0
23	24	France	4.9	*0.0*	4.8	5.1	*0.1*	5.0	4.7	*0.0*	4.7	4.4	*0.0*	4.4	5.3	*0.0*	5.3
24	23	Finland	4.8	*-0.1*	4.9	5.4	*-0.3*	5.7	2.3	*0.0*	2.3	5.9	*-0.1*	6.0	5.4	*-0.1*	5.6
25	25	Italy	4.5	*0.0*	4.5	3.3	*-0.1*	3.4	3.9	*0.1*	3.9	5.2	*-0.2*	5.4	5.6	*0.1*	5.5
26	26	Portugal	4.4	*-0.1*	4.5	3.5	*0.0*	3.5	5.6	*-0.3*	5.9	4.5	*-0.1*	4.6	4.1	*0.2*	3.9
27	27	Cyprus	3.9	*-0.2*	4.1	3.0	*-0.2*	3.2	3.2	*-0.1*	3.3	7.0	*-0.2*	7.2	2.3	*-0.4*	2.7
28	28	Greece	3.8	*-0.2*	4.0	1.5	*-0.8*	2.3	4.8	*-0.1*	4.9	4.3	*0.0*	4.3	4.5	*0.0*	4.4
		EZ19	5.9	*-0.1*	5.9	5.1	*0.0*	5.1	6.0	*-0.2*	6.2	6.1	*-0.1*	6.3	6.1	*0.1*	6.1

Scores from 10 (best possible) to 0 (worst). The overall score is the average of four sub-scores for recent growth, competitiveness, fiscal sustainability and resilience to financial shocks. Source: Berenberg calculations

The Czech Republic tops the ranking.

Italy, Portugal, Cyprus and Greece face the most serious long-run problems.

Ireland moves up in the ranking as it reaps the rewards of its adjustment efforts.

Austria is gradually turning into a concern. The lack of adjustment progress does not suit a country with below-average fundamental health.

Adjustment progress: reform countries still in the lead

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Adjustment progress indicator

Adjustment Progress Indicator																	
Rank			Total Score			External adj.			Fiscal adj.			Labour cost Adj.			Reform drive		
2016	2015	Country	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2014
1	1	Greece	7.9	*-0.6*	8.5	7.5	*0.1*	7.4	9.0	*0.1*	8.9	7.3	*-0.3*	7.6	7.7	*-2.3*	10.0
2	2	Ireland	7.3	*-0.5*	7.8	7.0	*0.2*	6.9	6.9	*-0.2*	7.1	9.2	*0.0*	9.2	6.0	*-2.0*	7.9
3	4	Latvia	6.8	*-0.2*	7.0	9.4	*0.0*	9.4	6.9	*0.1*	6.8	4.1	*-0.7*	4.8	n.a.	*n.a.*	n.a.
4	3	Romania	6.4	*-0.8*	7.2	7.1	*-0.4*	7.5	7.0	*-1.9*	8.9	5.0	*-0.1*	5.1	n.a.	*n.a.*	n.a.
5	6	Portugal	6.1	*-0.4*	6.6	6.2	*0.3*	5.9	6.3	*-0.2*	6.6	5.8	*0.0*	5.8	6.3	*-1.8*	8.0
6	5	Spain	6.1	*-0.7*	6.9	7.2	*0.2*	7.0	5.4	*-1.0*	6.4	5.4	*-0.4*	5.7	6.5	*-1.9*	8.3
7	8	Cyprus	6.0	*0.0*	6.1	4.8	*0.5*	4.3	6.3	*-1.2*	7.5	6.9	*0.5*	6.4	n.a.	*n.a.*	n.a.
8	7	Lithuania	5.5	*-0.8*	6.2	7.8	*0.4*	7.5	6.3	*-0.3*	6.5	2.3	*-2.4*	4.6	n.a.	*n.a.*	n.a.
9	10	Slovenia	5.0	*-0.4*	5.3	7.1	*0.4*	6.7	4.8	*-0.4*	5.1	4.6	*-0.2*	4.8	3.4	*-1.4*	4.8
10	11	Slovakia	4.9	*-0.2*	5.1	7.1	*0.9*	6.2	6.4	*0.1*	6.3	2.1	*-0.7*	2.8	4.3	*-0.8*	5.1
11	12	Croatia	4.9	*0.0*	4.9	6.4	*0.1*	6.3	4.0	*0.2*	3.8	4.2	*-0.3*	4.6	n.a.	*n.a.*	n.a.
12	9	Estonia	4.8	*-0.6*	5.4	6.9	*-0.7*	7.6	2.5	*0.5*	2.0	4.3	*-0.6*	4.9	5.6	*-1.5*	7.1
13	13	Czech Republic	4.8	*0.1*	4.7	6.1	*0.4*	5.7	7.3	*0.1*	7.2	1.1	*-0.9*	2.0	4.6	*0.9*	3.8
14	14	Poland	4.3	*0.0*	4.3	5.1	*0.4*	4.8	6.1	*-0.7*	6.8	0.8	*0.4*	0.4	5.3	*0.0*	5.3
15	16	Italy	3.9	*0.1*	3.8	4.0	*0.0*	4.0	3.3	*-0.9*	4.2	3.5	*0.2*	3.3	4.8	*1.1*	3.8
16	18	Bulgaria	3.9	*0.3*	3.6	8.1	*0.5*	7.6	3.6	*0.4*	3.1	0.0	*0.0*	0.0	n.a.	*n.a.*	n.a.
17	15	United Kingdom	3.7	*-0.5*	4.2	2.5	*0.0*	2.4	5.7	*0.6*	5.1	2.3	*-1.1*	3.4	4.1	*-1.6*	5.7
18	17	Hungary	3.4	*-0.3*	3.7	6.9	*0.1*	6.7	0.2	*-0.4*	0.6	2.5	*-0.3*	2.8	4.2	*-0.5*	4.8
19	19	Luxembourg	3.4	*0.1*	3.3	4.5	*0.2*	4.3	1.6	*-0.2*	1.8	6.1	*0.2*	5.9	1.4	*0.4*	1.1
20	20	Netherlands	3.4	*0.2*	3.2	5.1	*0.1*	5.0	3.4	*0.5*	2.9	1.7	*-0.5*	2.2	3.1	*0.5*	2.6
21	24	France	3.0	*0.0*	3.0	2.5	*-0.3*	2.9	3.8	*0.0*	3.8	1.6	*0.0*	1.6	4.0	*0.4*	3.6
22	21	Malta	3.0	*-0.1*	3.1	4.2	*-0.1*	4.3	2.5	*0.5*	2.0	2.1	*-0.8*	2.9	n.a.	*n.a.*	n.a.
23	22	Denmark	2.7	*-0.4*	3.1	3.5	*0.2*	3.3	0.7	*0.6*	0.1	2.4	*-0.6*	2.9	4.0	*-2.0*	6.0
24	23	Austria	2.7	*-0.4*	3.0	3.4	*0.0*	3.4	1.7	*-1.3*	3.0	1.2	*0.3*	0.9	4.3	*-0.5*	4.8
25	26	Belgium	2.4	*0.2*	2.3	4.3	*0.4*	3.9	0.7	*-0.4*	1.0	2.2	*0.1*	2.2	2.6	*0.5*	2.1
26	25	Germany	2.0	*-0.3*	2.4	3.3	*-0.1*	3.4	1.7	*-1.6*	3.3	0.7	*0.0*	0.7	2.4	*0.4*	2.0
27	27	Finland	1.9	*-0.3*	2.1	1.0	*-0.1*	1.1	0.0	*0.0*	0.0	2.5	*0.2*	2.2	3.9	*-1.3*	5.2
28	28	Sweden	1.6	*-0.3*	1.9	2.2	*-0.2*	2.4	0.0	*0.0*	0.0	1.1	*0.3*	0.8	3.2	*-1.3*	4.5
		EZ19	3.7	*-0.3*	4.0	4.2	*-0.1*	4.3	3.7	*-0.4*	4.2	2.5	*0.1*	2.4	4.4	*-0.7*	5.0

Scores from 10 (best possible) to 0 (worst). The overall score is the average of four sub-scores for external adjustment, fiscal repair, labour cost adjustment and structural reforms. Source: Berenberg calculations

The five countries that had to ask taxpayers of other countries for help remain at the top of our league.

The crisis forced them to adjust – and they did.

But with the end of the acute crisis, adjustment efforts have slowed down in 2015 and 2016.

To some extent, this is a sign of success: countries that have adjusted can return to more normal.

The key question: have the changes been sufficient? In Spain, Ireland and Cyprus, probably yes. The same did hold for Portugal – until some reforms were reversed. Greece is a special case.

Against the trend, Italy, Belgium and the Netherlands have raised their scores a little.

The 2016 Euro Plus Monitor

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Key results

- **Countries with fundamental problems should adjust:** that is mostly the case.
- **Tough love has worked:** most of the erstwhile crisis countries are recovering well.
- **The wave of reforms triggered by the euro crisis is over.**
- **A new wave of reforms?** Signs of progress – or hope - in Italy and France, the big eurozone laggards.
- **Political backlash:** as the sense of crisis has eased, the risk of reform reversals has risen.
- **Success breeds complacency:** While still in good shape, Sweden and Germany need to watch out.
- **Brexit doesn’t pay:** The United Kingdom has nothing to gain from leaving the EU.
- **Populism is perilous:** the surge of protest parties across the western world poses a grave threat for Europe.

Adjustment progress: some slippage

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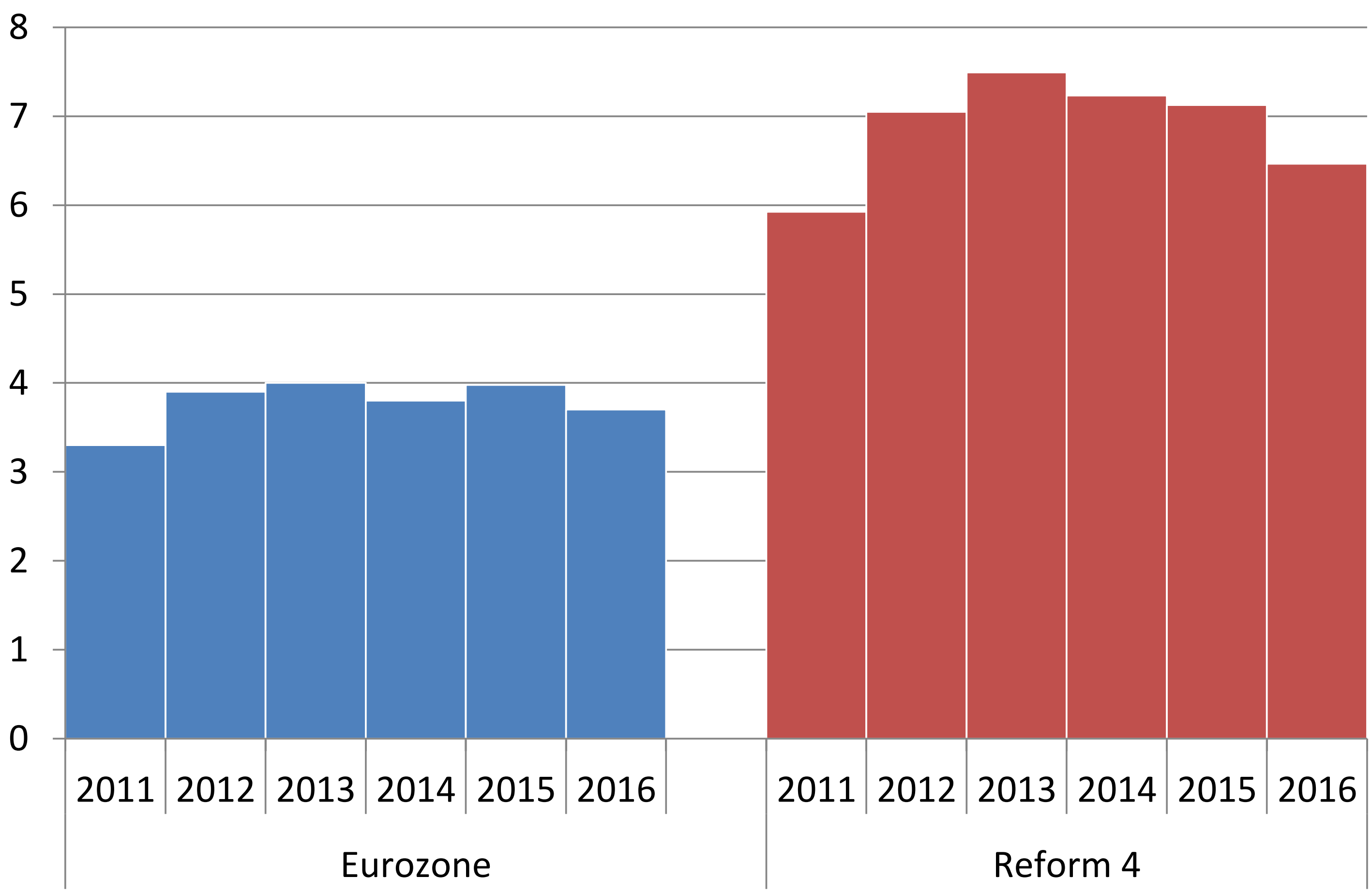
Cumulative adjustment progress in the Eurozone since 2009



Cumulative adjustment progress, scores from 10 (best possible) to 0 (worst). The overall score is the average of four sub-scores for external adjustment, fiscal repair, labour cost adjustment and structural reforms. Reform 4: Greece, Ireland, Portugal and Spain. Source: Berenberg calculations

We regularly track how 28 countries in the EU are adjusting on four separate criteria:

- External adjustment
- Fiscal repair
- Labour costs
- Structural reforms

We aggregate the results into one indicator which sums up the cumulative adjustment progress since 2009 on a scale of 10 (best possible) to 0 (worst).

The reform countries remain in the lead.

But adjustment efforts slackened visibly in 2016, following a smaller relaxation of the reins in 2014 and 2015.

Adjustment progress (I): external adjustment

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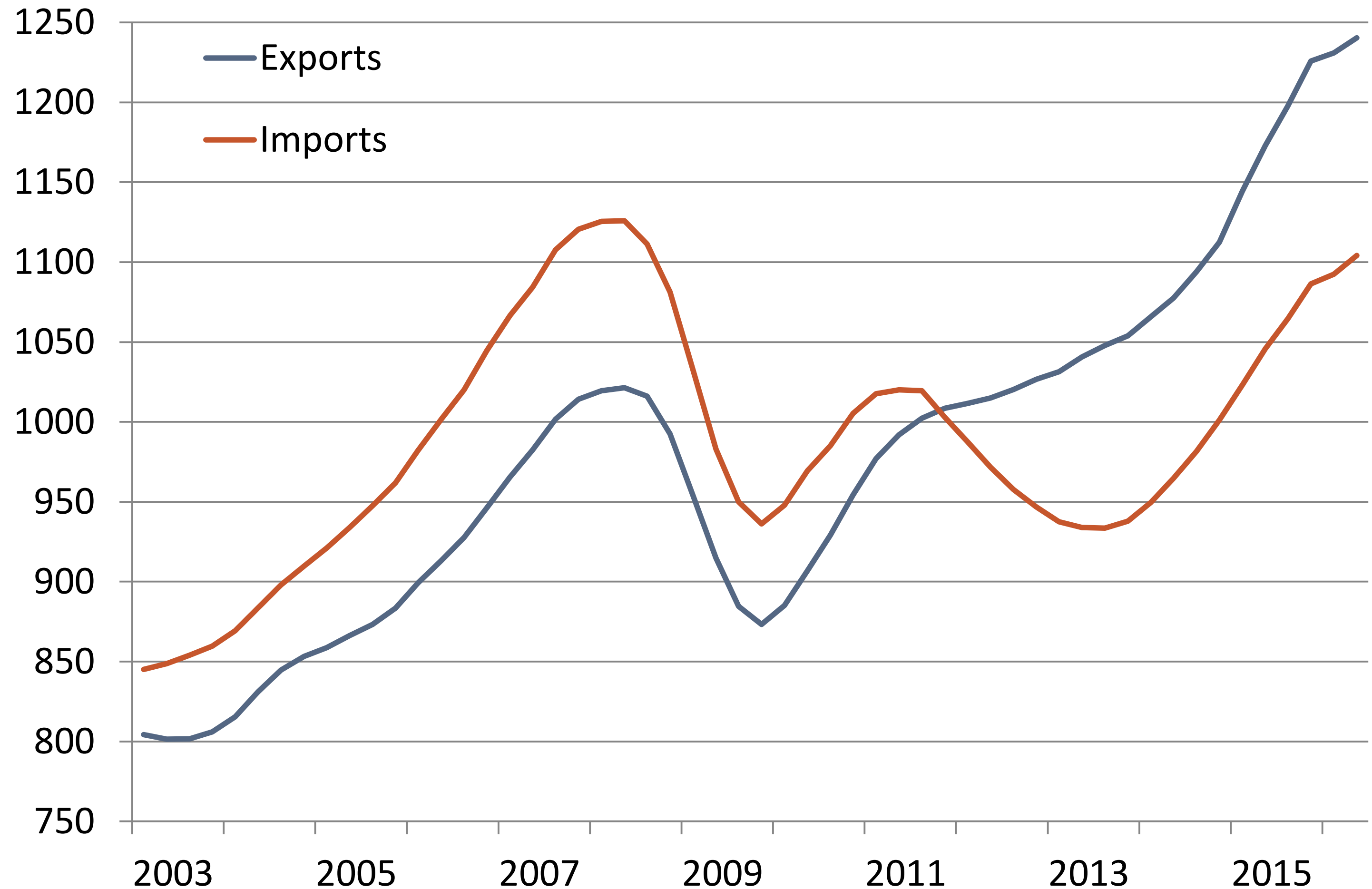
Turnaround in the external account



Real exports and imports of goods and services in chained 2010 prices, 4-quarter rolling sum in billion of euro. Italy, Spain, Greece, Portugal and Ireland.
Source: Eurostat, Berenberg calculations

- The five euro crisis countries have turned their external accounts around very nicely.
- They export more than they import.
- Taken together, the erstwhile crisis countries no longer need to import capital.
- Imports have picked up again since late 2013. This is the sweet taste of success.
- A further rise in exports and a rebound in imports while maintaining the external surplus needed to rebuild credibility on global markets: that is how it should be.
- Greece trails behind. So far, it has adjusted more through a plunge in imports than a rise in exports.

Adjustment progress (II): fiscal repair

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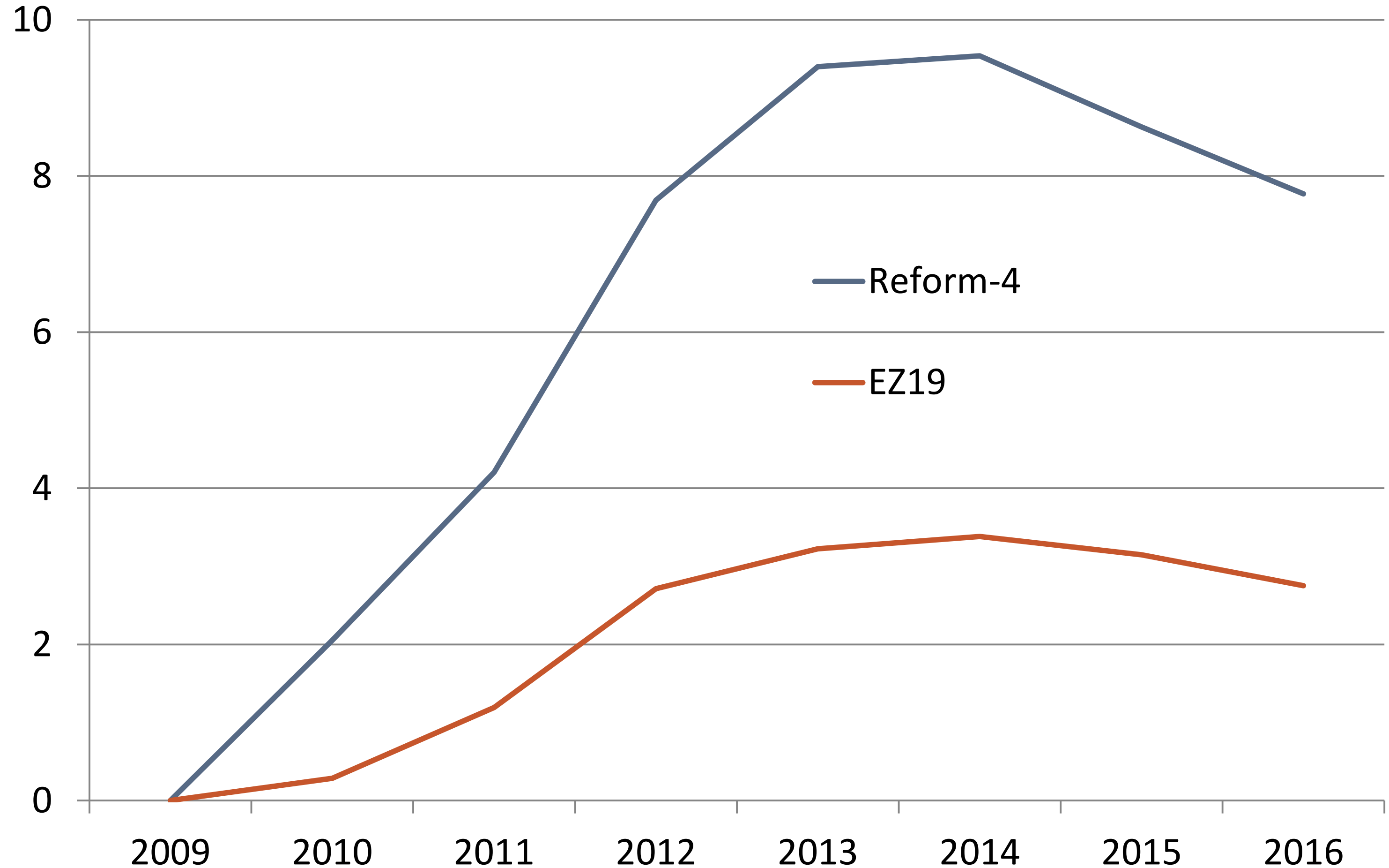
Cumulative change in underlying primary fiscal balance since 2009, in % of GDP



Reform 4 are Spain, Greece, Ireland and Portugal.
Source: European commission, Berenberg calculations

- The countries that had to ask for external help early have tightened their belts significantly.
- With the crisis easing, they have relaxed the reins slightly again in 2015 and 2016.
- Despite the recent slippage, the cumulative adjustment remains impressive.
- Nonetheless, the fiscal stimulus in 2015 and 2016 looks a bit premature.
- The eurozone as a whole has granted itself a small fiscal stimulus in the last two years.
- Expect more of the same for the eurozone average in 2017.

Fiscal policy: Eurozone prudence

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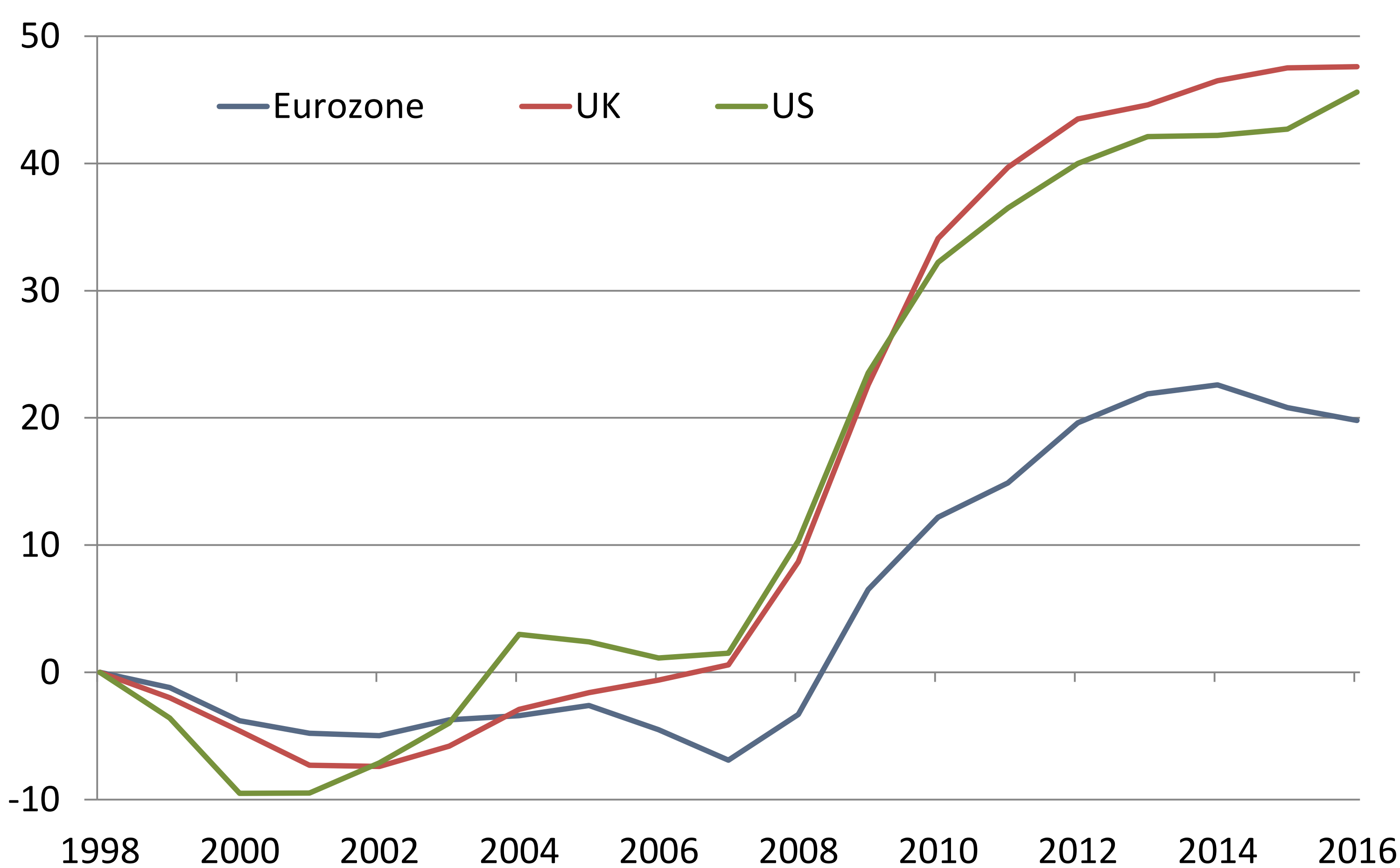
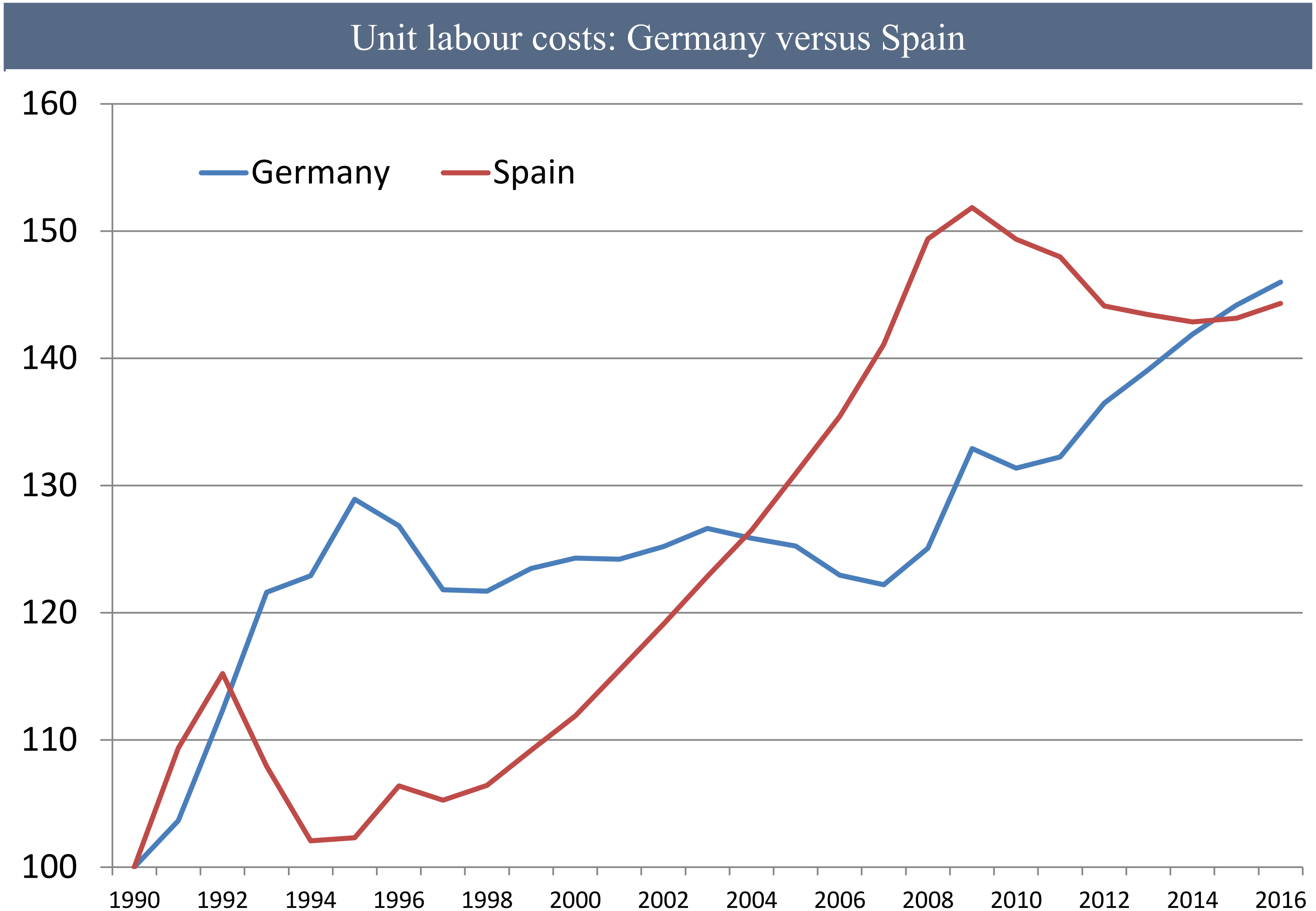
Change in public debt ratio since start of euro, in % of GDP



Increase in the ratio of gross government debt to GDP since the start of the euro, in percentage points of GDP. End-2016 ratios: Eurozone 91.6%, UK 89.2%, US 108.1%, Japan 250.7%. Source: Eurostat, EU Commission projections for 2016.

- After Lehman, the debt ratio surged much less in the Eurozone than in the US and the UK. Japan would be off the charts.
- Until 1998, the UK had been more prudent than the future Eurozone. Since then, it‘s the other way round.
- Less aggressive monetary policy and faster fiscal repair explain why Eurozone demand growth has lagged behind the US and UK since 2011.
- But policy is now different. In 2013, the Eurozone returned to growth around its 1.5% sustainable rate
- Brexit adds to the UK‘s fiscal problems – that‘s not in the chart yet.

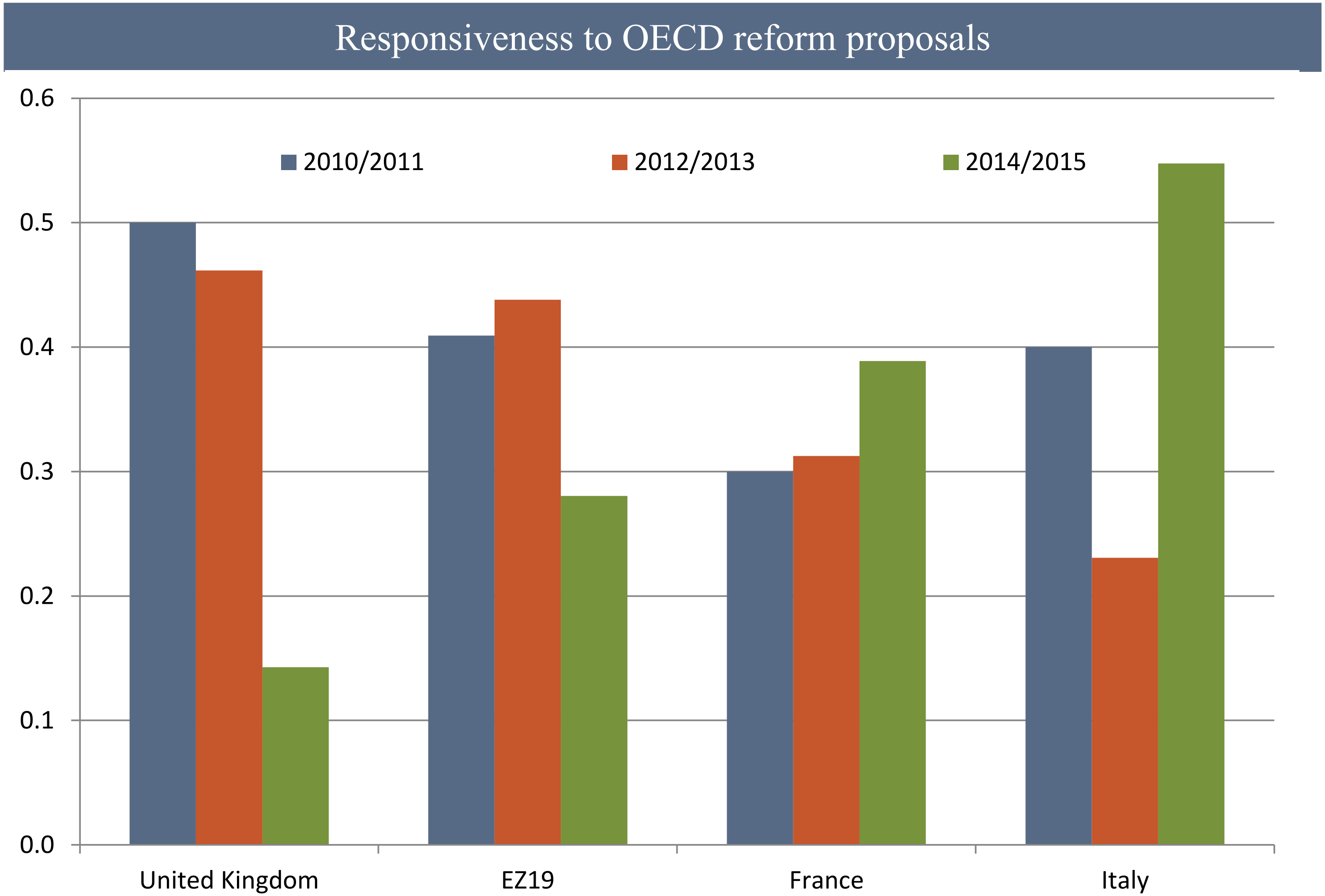
Adjustment progress (III): Labour costs



Nominal unit labour costs, 1990=100.
Source: European Commission.

- Turnaround at the euro periphery…
- …where unit labour costs have fallen sharply in erstwhile crisis countries..
- Turnaround in Germany as well…
- …where labour costs are rising at an above-average pace.
- In the 1990s, Germany refused to deal with the costs of unification. It turned into the "sick man of Europe".
- After a long period of wage restraint and the reforms of 2004, Germany became competitive again…
- …while Spain let its labour costs surge until 2009.
- Spain has now corrected its excesses.
- In relative terms, Spain and Germany are back to 1990!

Adjustment progress (IV): structural reforms - Italy moves up



Responsiveness to OECD's Going for Growth reform recommendations. Average results for 2010/11 and 2012/13 and for 2014/15. The OECD has constructed the 2014-15 reform responsiveness result by combining information on reform actions assessed in the 2015 Going for Growth report with the 2016 interim assessment, which observes progress in reform priorities laid out in the 2015 Going for Growth recommendations. The data are not directly comparable to the past reform responsiveness data that are based on the full-fledged exercises rather than an interim assessment. Source: OECD

- Who is implementing pro-growth structural reforms?
- The OECD regularly makes detailed reform proposals.
- Once a year, the OECD checks whether countries are heeding such advice.
- Under the pressure of crisis, the euro periphery refomed at a rapid pace.
- The pace slackened a lot in the 2014/15 period.
- Italy stepped up its efforts noticeably under former Prime Minister Renzi.
- No country in our sample has introduced more pro-growth reforms in the last two years than Italy.

Reaping the rewards: more jobs at the periphery

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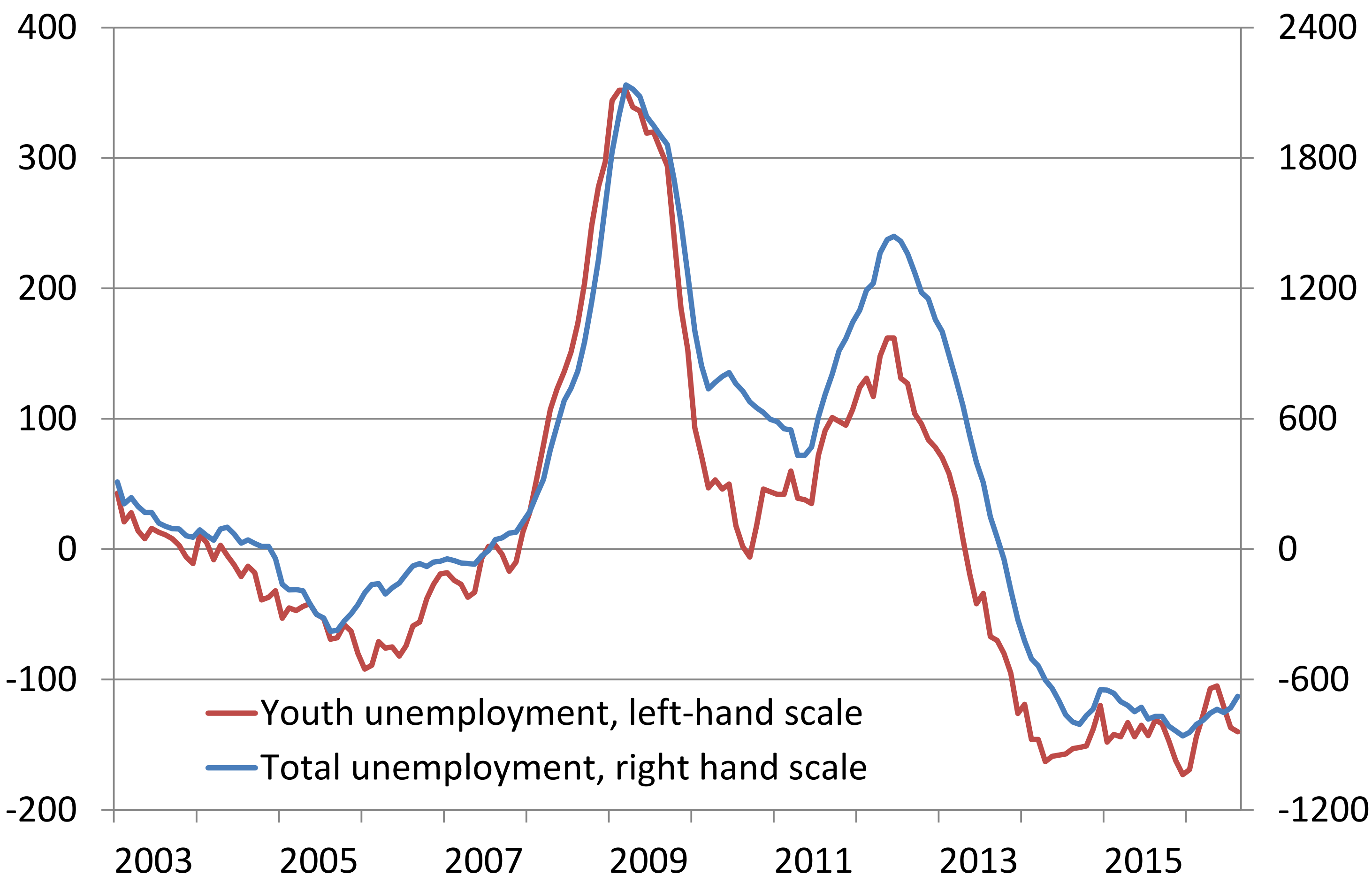
Unemployment is falling fast in the reform countries



- The worst is over for the labour market of the reform countries.
- Since the peak in February 2013, the number of unemployed in Spain, Greece, Portugal and Ireland has fallen by 2.0mn to a still-high 6.7 mn.
- Youth unemployment remains very high, with a total of 1 million. But the number of unemployed aged 16-24 age has declined by 430k since the peak.
- The labour market reforms support sustainable jobs growth.
- The challenge now: preventing reform reversals.

Change in total unemployment in Spain, Portugal, Ireland and Greece, in 1000s, 12-month sum, based on monthly nsa data.
Source: Eurostat

The blueprint for European reforms: the German turnaround

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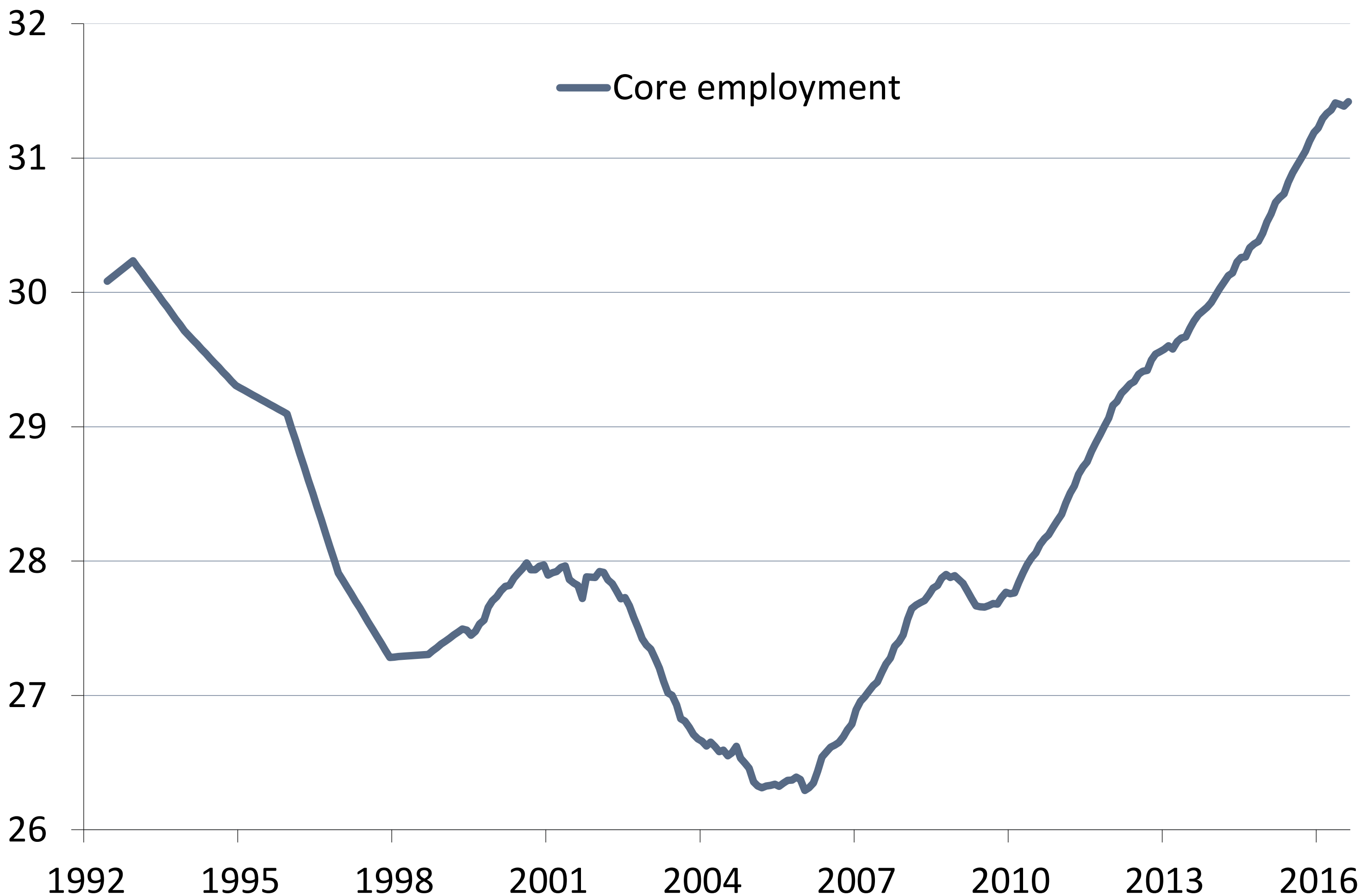
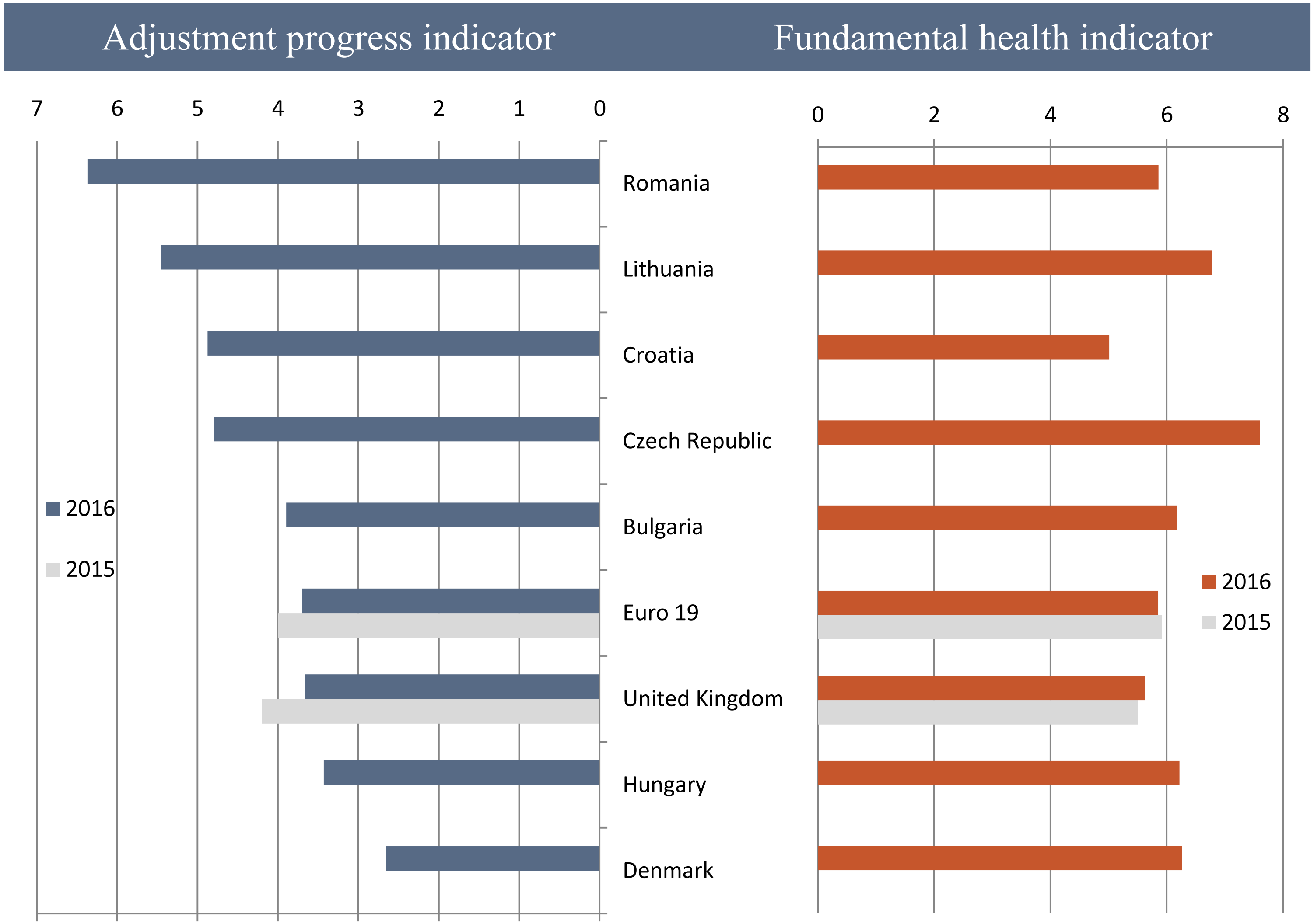
Core employment: strong increase since 2006



Core employment: subject to social security contributions, in million.
Source: Bundesagentur für Arbeit, Bundesbank.

- It's the labour market, stupid.
- After four decades of rising joblessness, Germany turned its labour market around with the reforms of 2004.
- Since early 2006, core employment has risen by 5 million (+19%) to a new record of 31.4mn.
- More employment = more taxpayers = balanced budget
- The German experience shows: labour market reforms work after a lag. More than 30% of recent new hires are immigrants.
- Strong employment gains bode well for German consumption.
- The rewards of prudence: Germany can afford the extra spending on refugees and infrastructure.

Newcomers



We extend our analysis to seven further countries.

Denmark shows traits in line with the core European mainstream. With a fundamental health score above average, it can afford a slower pace of adjustment.

The Czech Republic excels with a top position for fundamental health and above-average adjustment efforts.

Except for Croatia, the other catching-up economies are also adjusting faster than the eurozone average..

Scores from 10 (best possible) to 0 (worst). The overall score is the average of four sub-scores for external adjustment, fiscal repair, labour cost adjustment and structural reforms. Source: Berenberg calculations

Waves of reforms

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Countries usually adjustt only when they have to

United Kingdom under Thatcher in the 1980s: from "sick man of Europe" to growth leader

Scandinavia in the early 1990s: making the Nordic model work after a serious financial crisis

Post-communist transition in central and eastern Europe from 1990 onwards – the biggest challenge

Germany's "Agenda 2010" reforms of 2004: from "sick man of Europe" to pillar of strength

Baltic countries after 2007: tough adjustment to cope with the fall-out from boom-bust

Eurozone periphery: serious progress 2010-2014 among those countries that had to ask for help

Italy and France: a new wave?

Notes on the Brexit debate

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The United Kingdom has nothing to gain from leaving the EU

A place apart? Few countries have scores closer to the eurozone average than the UK

Fundamental health: the UK ranks slightly below the eurozone because of its twin deficits

Adjustment progress: in line with the eurozone average

Strong points: The UK gets tops marks for microeconomics despite gripes about EU regulations

Weak points: macroeconomic imbalances which reflect domestic policies, not EU regulations

External adjustment: UK does even worse than France

Competitiveness: the UK has a problem to start with; putting access to its major market at risk looks foolhardy

The cost of Brexit: UK public debt dynamics

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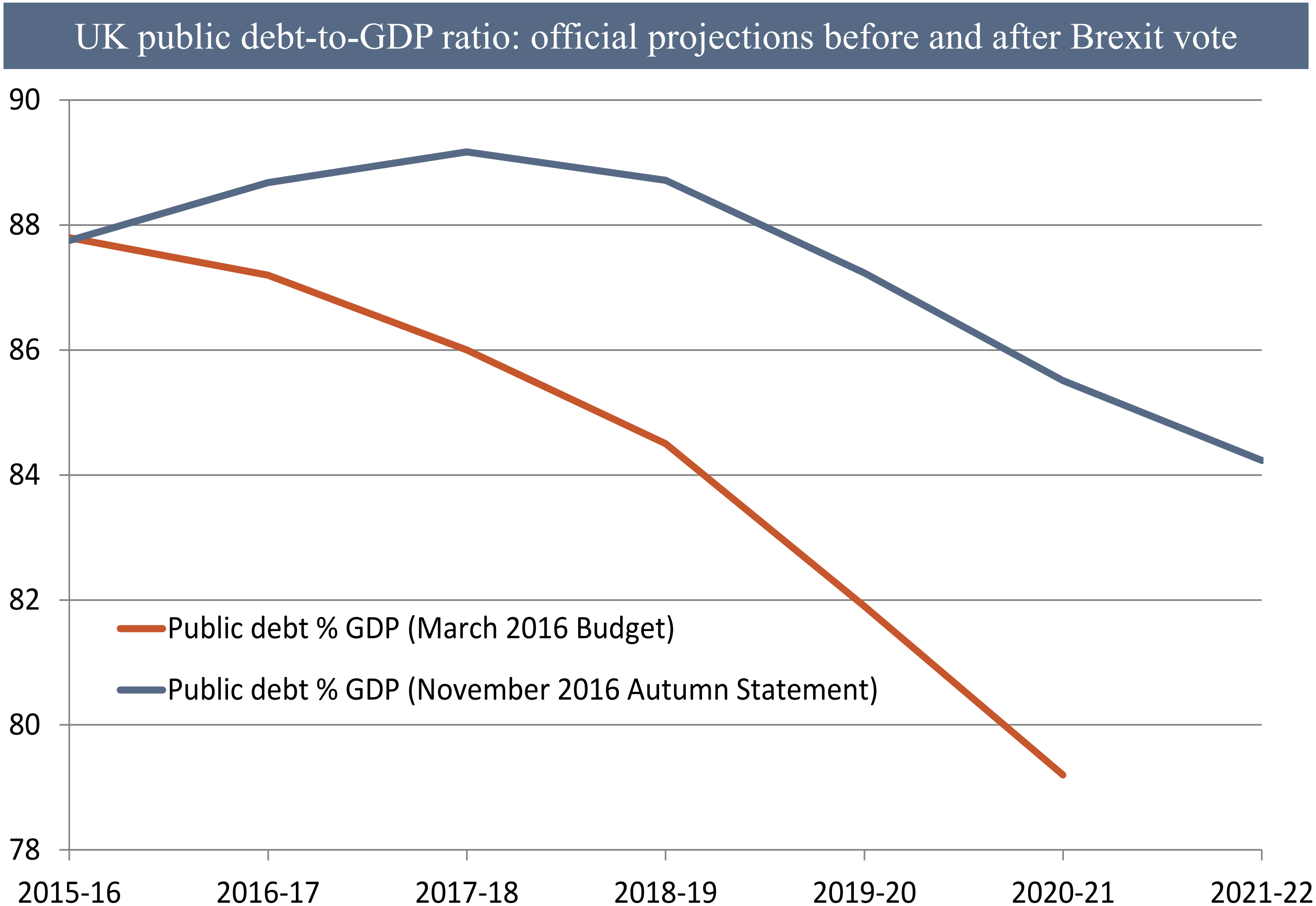

Official projections of the UK's debt-to-GDP ratio, Maastricht definition; March 2016 projection adjusted for the revised 2015/16 outcome.
Source: Office for Budget Responsibility

- Brexit is expensive.
- It raises the UK debt ratio in two ways, by reducing GDP growth and by raising the fiscal deficit.
- Before the Brexit vote, the UK's official fiscal watchdog had expected the debt ratio to fall by 8.6 percentage points of GDP from fiscal year 2015/16 to 2020/21.
- The OBR now expects merely a drop by 2.2 points. Brexit could thus add around £140bn to government borrowing over the next five years.

Britain beware: the power of trade diversion

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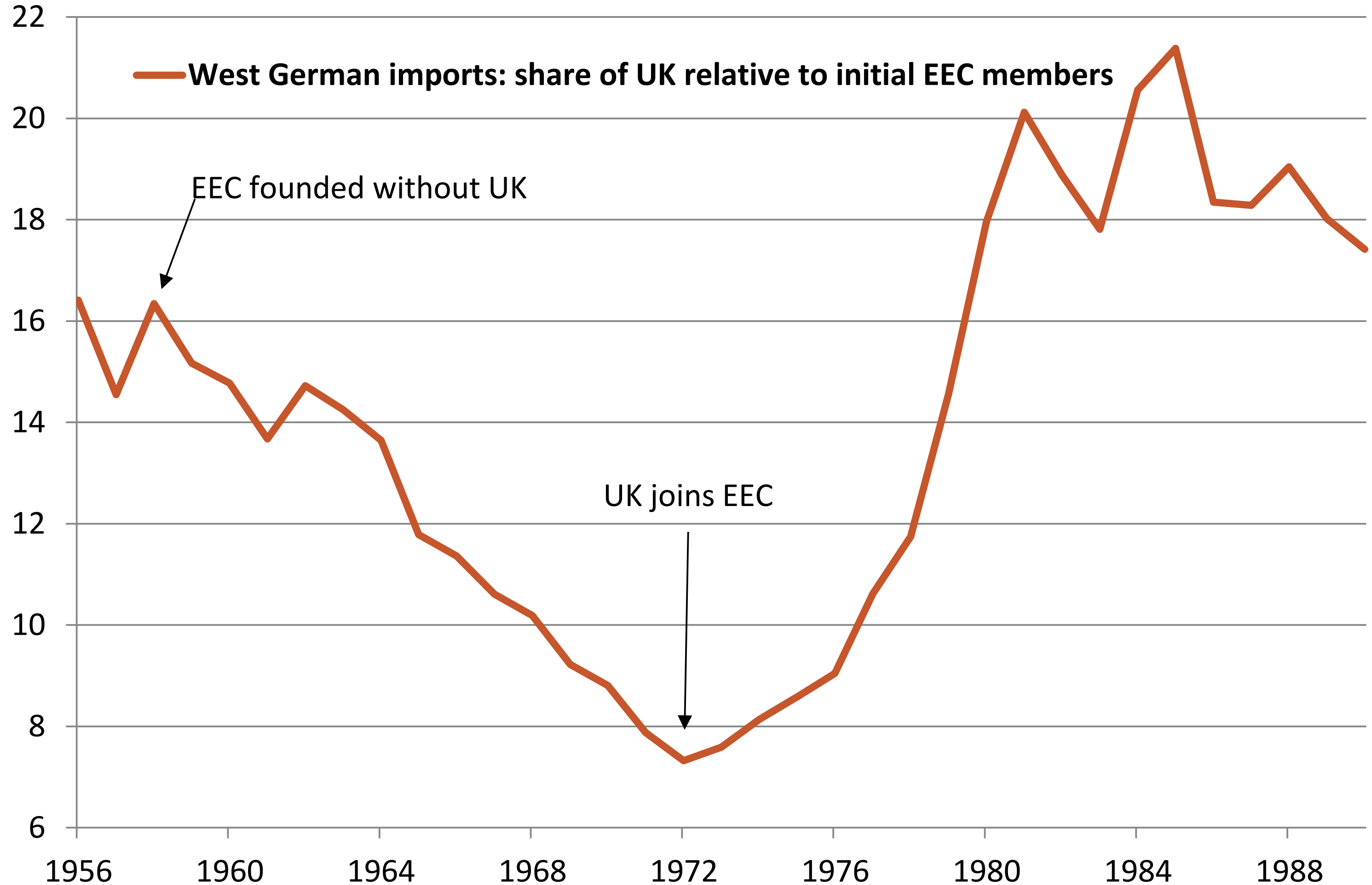
UK share in West German imports



UK share in West German imports of goods, in % of West German imports from original EEC members France, Italy, Benelux. Source: Bundesbank

- How would Britain fare outside the EU? Nobody knows for sure. But history holds a clear lesson.
- From 1958 to 1972, Britain had stayed outside the European Economic Community (EEC). As EEC members traded more with each other, Britain lost market share so badly that it soon begged to be admitted.
- After Europe finally allowed the UK to join in 1973, its market share rebounded sharply.
- Outside the EU, Britain would be at

The politics of anger

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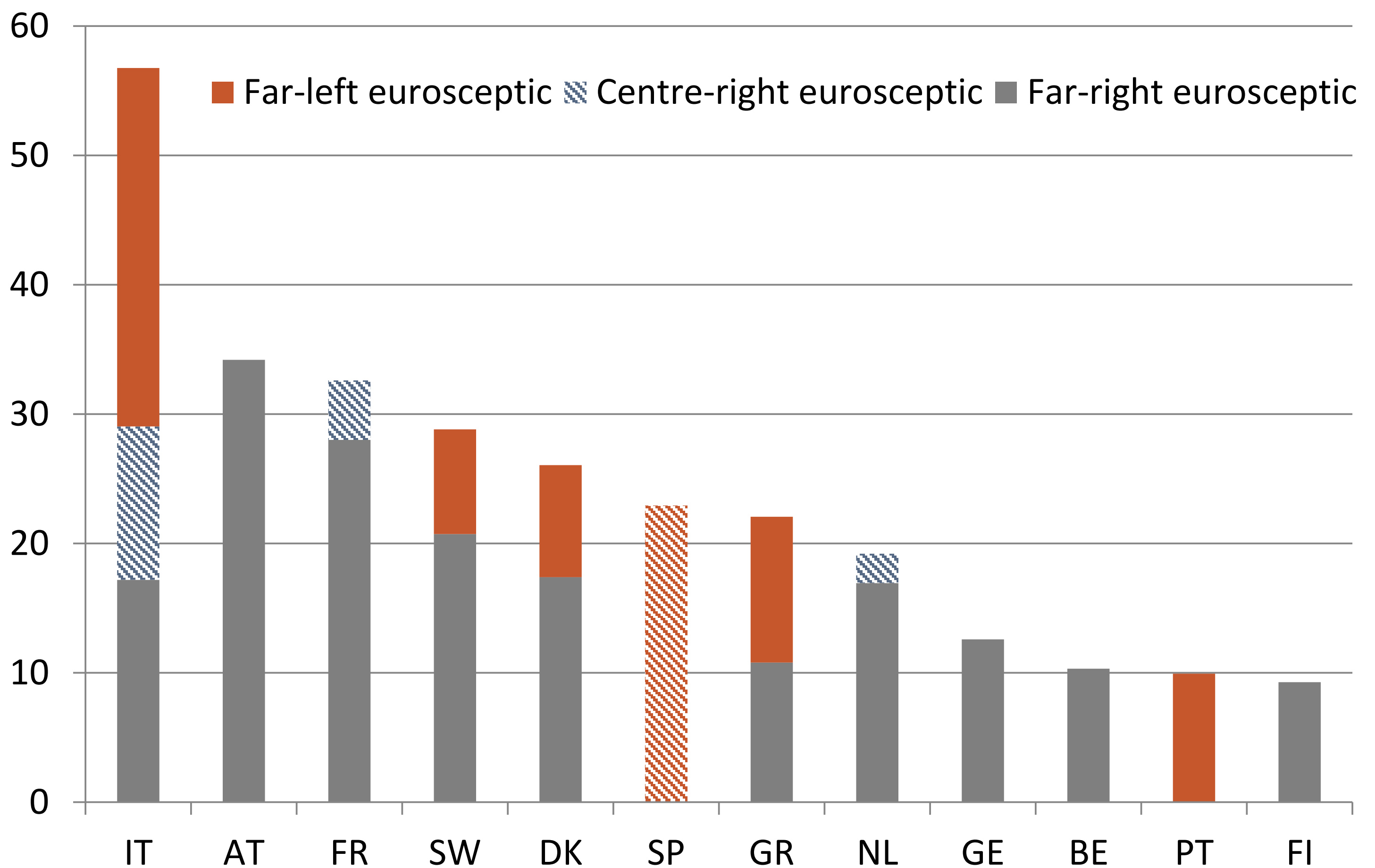
Share of vote for EU- or euro-sceptic populists in national opinion polls



Italy: Lega Nord, FdI, Forza Italia (striped), Five Stars; Austria: FPÖ; France: Front National, DLF (striped); Denmark: DPP, Red-greens; Sweden: Sweden Democrats, Left Party; Netherlands: PVV, SGP (striped); Greece: Golden Dawn, LAEN, EE, KKE, PE; Spain: Unidos Podemos (striped); Germany: AfD; Belgium: Vlaams Belang; Portugal: BE; Finland: PS; relevant parties only; average of last five polls; striped means position somewhat unclear. Source: national opinion polls, Wikipedia, Berenberg calculations.

- The cohesion of Europe depends on the political will of its members to stay in the club and accept its rules.
- Populists from the left and the right have gained votes in the wake of the great financial crisis.
- The sorry fate of Greece has dampened the allure of left-wing populists somewhat.
- Extremes do meet. Classifying radical populist movements is not always easy. Italy‘s Five Stars are showing traits of hard left and hard right populism.
- Although many Italians support protest parties, most Italians want to stay in the euro.

Greece: The Varoufakis effect

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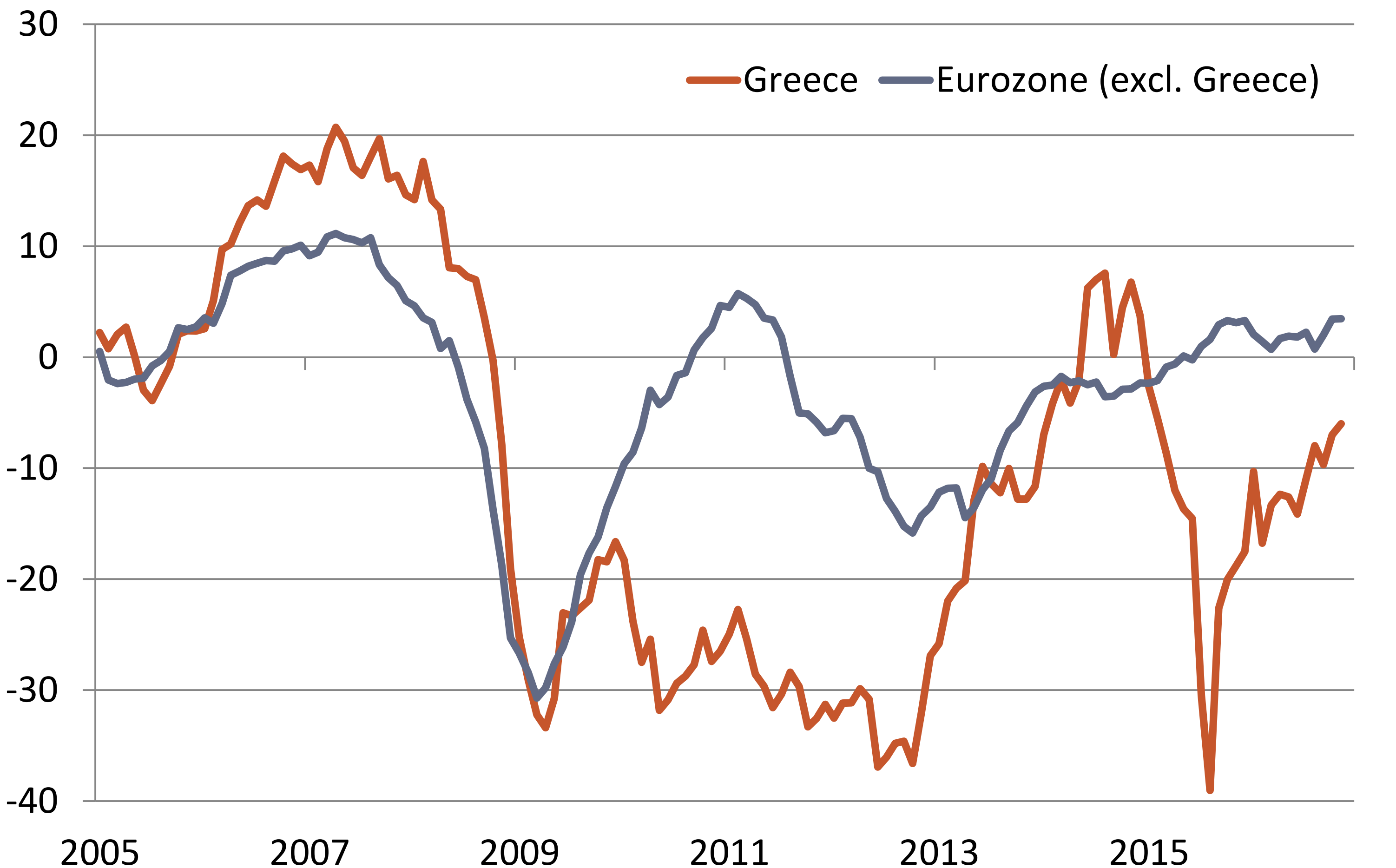
Greek rebound choked off by politics in early 2015, mediocre rebound since autumn 2015



Corporate confidence: average of industrial, services, retail and construction confidence.
Source: European Commission, Berenberg calculations

- After the ECB stopped the rot in August 2012, sentiment turned up.
- **2014 Recovery:** on the back of a major surge in confidence, Greek GDP expanded at a 2.5% pace in Q1-Q3 of 2014.
- But when the political risk came to the fore in late 2014, Greek confidence collapsed.
- **2015 recession:** While Spain and Cyprus roar ahead, Greece has fallen back into a deep crisis.
- Populism doesn't work.
- When Tsipras fired Varoufakis and signed a new deal with creditors, confidence recovered.
- But the risk of a new confrontation with creditors prevents a genuine recovery.

The 2016 Euro Plus Monitor

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Key lessons

- **Austerity** is a necessary and potent medicine, but an **overdose** can kill the patient.
- **Optimum austerity:** No country should be asked to reduce its underlying primary fiscal deficit by more than 2% of GDP per year (unless it had relaxed policy by more than 1% of GDP in the previous year).
- **Fiscal shortfalls** caused by **recession** ought to be tolerated as long as the overall direction of policy stays on course.
- **Pro-growth structural reforms** matter more than austerity.
- **Keep it simple:** Reform proposals must take the administrative capacity of the country into account.
- **Tax reform:** simpler tax systems needed, not higher tax rates.
- **Delaying inevitable reforms** makes matters worse: see France

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