THE 2016

EURO PLUS MONITOR

COPING WITH THE BACKLASH

BERENBERG
PARTNERSHIP SINCE 1590

the Lisbon council
think tank for the 21st century

Disclaimer

Policy Brief

The 2016 Euro Plus Monitor
Coping with the Backlash

By Holger Schmieding (principal author) and Florian Hense
Series editor: Paul Hofheinz

Dr Holger Schmieding is chief economist of Berenberg. Previously, he was an economist at the International Monetary Fund, head of research on central and eastern Europe at the Kiel Institute of World Economics and chief economist Europe of a major global investment bank.

Dr Florian Hense is an economist at Berenberg.

The views expressed in this policy brief are those of the authors alone and do not necessarily represent the view of the Lisbon Council, Berenberg or any of their associates.

The 2016 EURO PLUS MONITOR

COPING WITH THE BACKLASH

Contents

BERENBERG
PARTNERSHIP SINCE 1590

the Lisbon council
think tank for the 21st century

Highlights at a Glance

Tracking progress. *The 2016 Euro Plus Monitor* examines the fundamental health and measures the adjustment progress of all 28 members of the European Union. This year, we find a very uneven pattern with further progress in some countries and modest slippage elsewhere amid mounting political risks.

Unemployment is falling. Fiscal repair and structural reforms were difficult. Most reform countries at the periphery are reaping the rewards of their efforts. Serious labour market reforms and wage restraint are paying off.

The wave of reforms triggered by the euro crisis is over. For the second year in a row, almost all of the countries that had to ask for help during the euro crisis slackened their adjustment efforts. For most of them, this is a sign of success. At the euro periphery, a rapid rise in exports has created room for a rebound in imports (see Chart 1 at right).

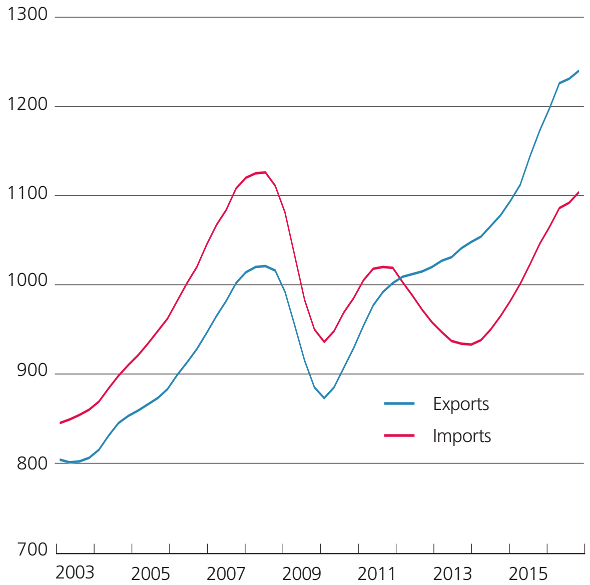
Political backlash. As the sense of crisis has eased, the risk of reform reversals has risen. After a painful setback in **Greece** in 2015 and some backtracking in **Portugal**, even **Spain** now faces pressure to soften rather than deepen some successful reforms.

A new wave of reforms? Even more so than in 2015, we detect signs of progress in **Italy** and **France**, the two major eurozone laggards. Italy's labour market reform 2015 helped to put the country on the right track. France finally started to address some of its structural problems. If it follows up with more serious reforms, it may no longer be the "sick man of Europe" in a few years' time. Whereas elections may strengthen the reform momentum in France decisively in 2017, the opposite may possibly happen in Italy.

Populism is perilous. The surge of populist protest parties across the Western world poses particular risks for reform progress and the cohesion of Europe. Populists can't deliver. But they can still do serious damage before they either get real or lose their appeal as their claims are finally exposed as phoney.

Chart 1. Exports Up, Imports Rebound at the Periphery

Real exports and imports of goods and services of the Reform 5 countries in billions of euros



Four-quarter rolling sum of real exports and imports for Italy, Spain, Greece, Portugal and Ireland in billion of euros, chain-linked (2010 = base year). Source: Eurostat

Success breeds complacency. While still in good shape, **Sweden** and **Germany** are showing signs of complacency. If Sweden does not adjust, it may end up in a Finnish-style crisis some five years from now. **Belgium** and **Austria** may also be at risk eventually.

Brexit doesn't pay. The **United Kingdom** has nothing to gain from leaving the EU. The UK already benefits from light-touch regulation. Its problems lie in policy areas such as macroeconomic management and the housing market over which the European Union has little influence.

Table 1. Adjustment Progress Indicator

Rank			Total score			External adjustment			Fiscal adjustment			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.
		Euro 19	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
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

Table 2. Fundamental Health Indicator

Rank			Total score			Growth			Competitiveness			Fiscal sustainability			Resilience		
2016	2015	Country	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
		Euro 19	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
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

Scores: For the scores, we rank all sub-indicators on a linear scale of 10 (best) to 0 (worst). Having calculated the results of the sub-indicators, we aggregate them into an overall score for each country, separately for the Adjustment Progress Indicator and the Fundamental Health Indicator.
Change refers to the change in score relative to last year. Note that our scores and ranks for 2015 can differ slightly for some countries from those published in *The 2015 Euro Plus Monitor* due to subsequent revisions of back data for labour costs, net exports and some other parameters.
Ranks: Based on the scores, we calculate the relative ranking of each country, with the No. 1 rank assigned to the country with the highest and the No. 28 rank to the one with the lowest score.

I. Key Findings

Europe has come a long way. Following the German renaissance after its 2004 reforms and the Baltic countries' rebound from their post-2007 plunge, most erstwhile euro crisis countries have adjusted so rapidly since 2010 that they have started to feel the first benefits of their painful efforts. Encouragingly, even the two big laggards, **Italy** and **France**, have shown tentative signs of reform progress in the last two years. Economic growth is close to its trend rate of 1.5% in the eurozone and unemployment is falling noticeably across almost the entire region. As a result, the recovery is more broad-based and better entrenched than before.

However, the adjustment remains incomplete. Even worse, the rise of political populism could reverse the progress and dash hopes for a more prosperous and less crisis-stricken future. In addition, the Brexit vote has raised a risk that, for the first time in decades, barriers to the free movement of goods and services, capital and labour may be erected anew instead of being torn down close to the heart of Europe.

Political populism poses a grave threat. But it need not spell the end of the European project. Whatever their overblown claims may be, populists cannot defy economic logic and the political rationale for close cooperation among the heavily interdependent nations of Europe (see Special Focus: Coping with the Politics of Anger, which begins on page 60). After a disastrous encounter with radical populism in the first seven months of 2015, small **Greece** gradually seems to be coming back onto the path of structural reforms and political sanity, showing that there can be life after populism. Also, the significant degree of popular support for centre-right reformers in Spain and France does suggest that the march of the radical populists can be stopped. To contain the threat, Europe has to adjust. Pro-growth reforms and the correction of unsustainable policies need to be part of the answer.

The 2016 Euro Plus Monitor presents the results of an in-depth analysis of the adjustment progress and fundamental economic health of the 28 member countries of the European Union. After rapid advances in the years before, the results for 2016 confirm a trend that had emerged in 2015 already: most of the previous reform leaders in Europe have slackened their adjustment efforts. To some extent, this makes sense. Reform countries such as **Ireland** and **Spain** have overcome their economic malaise. After a brutal front-loaded adjustment which the crisis had forced upon them, they no longer need to tighten their belts any further. Instead, they can afford to return to a neutral or even slightly expansionary fiscal policy and let imports rise slightly faster than exports. With unemployment falling rapidly, albeit from still elevated levels, they have begun to savour the sweet taste of success. If a country has already adjusted a lot in the past, it no longer has to be a leader in new adjustment efforts.

Cyprus, Estonia, Ireland, Latvia, Lithuania and **Spain** show that the pain of adjustment can pay off nicely – just as it did in the **United Kingdom** after the reforms of the 1980s, in **Scandinavia** after the reforms of the 1990s and in **Germany** after the Agenda 2010 reforms of 2004. If applied correctly, the bitter but necessary medicine of fiscal repair and structural reforms does work. However, the medicine needs time to do so. Even more so than last year, the risk of a premature loss of patience and reform reversals looms large. As we warned in *The 2014 Euro Plus Monitor*, preventing such reversals is the key challenge for those countries that have successfully reformed themselves in the wake of the euro confidence crisis.

‘We detect a slower pace of adjustment among the reform leaders but some progress in Italy.’

Chart 2. Adjustment Progress and Fundamental Health

Twenty-eight European countries ranked by the Adjustment Progress Indicator

See notes under Table 2 on page 6.
Source: Berenberg calculations

‘How healthy are the European economies – and how fast are they adjusting?’

In *The 2016 Euro Plus Monitor*, produced by Berenberg and the Lisbon Council, we answer two separate questions. First, we ask whether the 28 European economies surveyed are rising to the challenge posed by globalisation, rapid technological change and the aftermath of the euro confidence crisis of 2011-2013. Whatever the starting situation, are they reforming themselves with visible results or are they failing to adjust? We examine four key aspects of adjustment: 1) change in the fiscal position, 2) swing in the external accounts, 3) change in unit labour costs, and 4) supply-side reforms. We aggregate the results into an **Adjustment Progress Indicator**, which measures the progress that individual countries are making.

Second, we assess the fundamental economic health of the countries in the survey on four long-term criteria: 1) growth potential, 2) competitiveness, 3) fiscal sustainability, and 4) resilience to financial shocks. We aggregate these results into a **Fundamental Health Indicator**, which measures the overall health of an economy, regardless of whether or not it is currently reforming.

The 2016 Euro Plus Monitor is the sixth edition of this annual survey. In the past, we covered 21 countries – made up of 18 members of the **eurozone** as well as **Poland**, **Sweden** and the **United Kingdom**. This year, we extend the analysis to include **Lithuania** – thereby providing coverage of all 19 eurozone members – as well as the six remaining non-eurozone members of the European Union: **Bulgaria**, **Croatia**, the **Czech Republic**, **Denmark**, **Hungary** and **Romania**. Interestingly, the Czech Republic, which appears in *The Euro Plus Monitor* for the first time, leaps to the top of the Fundamental Health Indicator. As it also attains an above-average score for adjustment progress, the Czech Republic seems to be in particularly good shape. By and large, the east European catching-up countries seem to be utilising the opportunity to integrate themselves closely into the European and global supply chain rather well.

Five years ago, we found “progress amid the turmoil,” as the sub-title of *The 2011 Euro Plus Monitor* proposed.[1] Under the pressure of extreme market turbulence, the countries hit hardest by the euro crisis had seriously started to correct their imbalances. Three years ago, we outlined the way “from pain to gain,” suggesting the reform countries could finally leave the harsh adjustment crisis and start to reap the rewards of their efforts shortly.[2] In 2014, we analysed the efforts of “leaders and laggards” on the reform path, noting major improvements in all erstwhile crisis countries but a lack of progress in **France** and **Italy** as well as in **Austria** and **Sweden**.[3] Last year, we unveiled more progress as well as new risks, highlighting a slower pace of adjustment at the euro periphery and the first signs of improvement in France and Italy amid mounting political uncertainties.[4]

1. Holger Schmieding (principal author), Paul Hofheinz, Jörn Quitzau, Anja Rossen and Christian Schulz, *The 2011 Euro Plus Monitor: Progress Amid the Turmoil* (London/Brussels: Berenberg/Lisbon Council, 2011).
2. Holger Schmieding and Christian Schulz (principal authors), Paul Hofheinz and Ann Mettler, *The 2013 Euro Plus Monitor: From Pain to Gain* (London/Brussels: Berenberg/Lisbon Council, 2013).
3. Holger Schmieding and Christian Schulz, *The 2014 Euro Plus Monitor: Leaders and Laggards* (London/Brussels: Berenberg, Lisbon Council, 2014).
4. Holger Schmieding, *The 2015 Euro Plus Monitor: More Progress, New Risks* (London/Brussels: Berenberg/Lisbon Council, 2015).

‘The overall results remain positive. The eurozone is turning into a more balanced economy.’

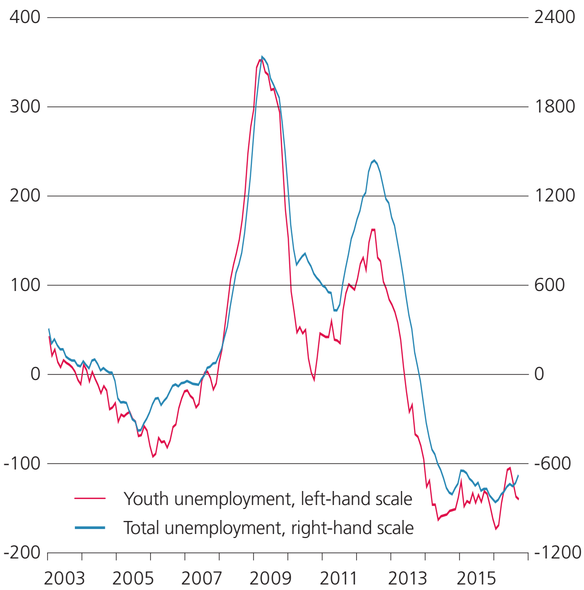
This year, the main findings are:

1. Tough love has worked. Since 2010, the **eurozone** has offered its weaker members a deal: we protect you against market turbulence and help to finance your budget if you slash your fiscal deficit and raise your growth potential through serious structural reforms. By and large, the approach is paying off. Three of the five reform countries that had to take up the offer, namely **Cyprus**, **Ireland** and **Spain**, continue to recover nicely after a difficult transition period. **Portugal** is also advancing despite some self-inflicted damage.

2. After surging to record levels, unemployment has come down noticeably in the reform countries since spring 2013 (see Chart 3 on this page). The countries that stay the course could be in the early stages of a long-term surge in employment and incomes comparable to the one which started in **Germany** two years after its 2004 labour market reforms.

Chart 3. Back to Work – Unemployment is Falling

Year-on-year change in the number of unemployed in Spain, Greece, Portugal and Ireland, in 1000s



Sources: Eurostat, Berenberg calculations

3. The risks of reform reversals have become much more acute. As in the United States and the United Kingdom, populists have made significant strides. The pain of adjustment and a general revolt against “the establishment” have caused a populist backlash against some of the mainstream political parties that had either pushed through reforms in the erstwhile euro crisis countries or are trying to implement them in Italy and France.

4. The overall results for the **eurozone** remain positive. Due to the adjustment efforts of the periphery in the last five years and some progress at the core, the eurozone as a whole is turning into a more balanced and potentially more dynamic economy. Almost all countries in need of adjustment – the ones with low rankings in the **Fundamental Health Indicator** – have slashed their underlying fiscal deficits and improved their external competitiveness with impressive vigour, as shown by their high rankings in the **Adjustment Progress Indicator**. See Tables 1 and 2 on page 6 for a more detailed summary.

5. After three years of quickening progress from 2011 to 2013 and some back-and-forth in 2014 and 2015, the pace of adjustment slowed down slightly in the **eurozone** as a whole in 2016 (see Chart 4 on page 11). Despite significant slippage among some of the erstwhile reform leaders at the euro periphery as well as in **Austria**, **Finland** and **Germany**, a small improvement in **Italy** and a constant score for **France** contained the overall loss of

‘We find some progress in France. But the reform efforts are still far too timid.’

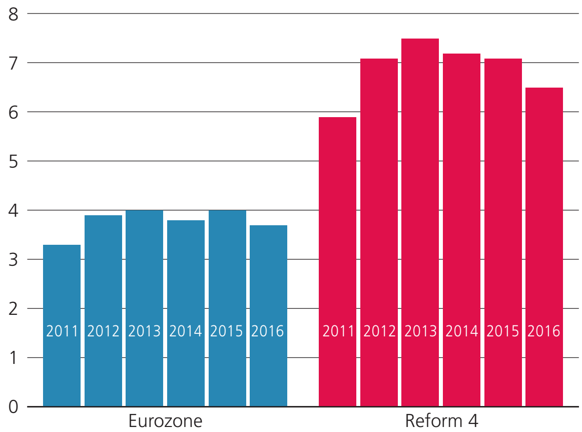
momentum. As in the previous five years, the aggregate score for the eurozone is held back by Germany, the **Netherlands** and **Sweden**, which have only a limited need to adjust. Whereas Germany has indeed done very little to further improve its outlook, the Netherlands at least raised its score slightly in 2016.

6. Taking the years since 2010 together, serious austerity in the fiscally challenged periphery and virtual standstill in parts of core Europe have resulted in a significant fiscal convergence in the eurozone and the European Union as a whole. However, for better or worse, austerity is over. For the second year in a row, many European countries loosened the fiscal reins somewhat in 2016. In some cases such as that of **Germany**, we can applaud that as a welcome fiscal stimulus. In other cases such as those of **Italy**, **Portugal** and **Spain**, the turn away from post-crisis prudence looks a little premature.

7. In *The 2011 Euro Plus Monitor*, we warned that “alarm bells should be ringing for **France**.” Five years later, we find some progress in France on a number of counts including some structural reforms and efforts to rein in government spending. Nonetheless, these are too timid, and the challenges for France remain daunting. Despite rising in the ranking for adjustment progress to No. 21, up from No. 24 in 2015, and a marginal increase in its score for fundamental health, France remains in the bottom third of the Adjustment Progress Indicator and the Fundamental Health Indicator. It is still the only major European economy which is beset by serious economic health problems and is not yet tackling them energetically enough. France still has one of the most bloated shares of public spending as a percentage of gross domestic product among the countries surveyed and suffers from a pronounced lack of competitiveness according to the fundamental health check (see Chapter III which begins on page 38 for a closer look).

Chart 4. The Pace of Adjustment

Adjustment Progress Indicator 2011-2016



Reform 4 are Spain, Greece, Ireland and Portugal.
Scale 0 (worst) to 10 (best).
Source: Berenberg calculations

8. Three other countries show traits of the French malaise. **Austria**, **Belgium** and **Finland** also score below average for both fundamental health and adjustment progress. Their results for adjustment progress this year (with Austria at No. 24, Belgium at No. 25 and Finland at No. 27) are particularly weak despite some small-scale progress in Belgium.

9. **Italy** has been on a promising track under Prime Minister Matteo Renzi. Against the trend of some slippage across much of the eurozone, Italy (No. 15) improved its score for adjustment progress slightly to 3.9 points in 2016, ending up two notches above the eurozone average of 3.7. The fiscal stimuli which Italy granted itself in 2015 and 2016

‘Germany is enjoying the fruits of its post-2003 reforms. But it is showing signs of complacency.’

have prevented a more significant rise in Italy’s score. Fortunately, the sweeping labour market reform that former Prime Minister Renzi pushed through parliament in January 2015 seems to be paying off in terms of higher employment growth. However, the evidence is not yet clear-cut enough to pass a final verdict on how effective the changes have been. Of course, Italy’s high debt burden still makes it vulnerable to potential bouts of market anxiety. Comparatively weak readings for trend growth and competitiveness still keep Italy (No. 25) close to the bottom of the ranking for fundamental health. With its shaky starting situation, Italy cannot afford a period of prolonged political uncertainty, an insufficiently ambitious attempt to sort out its banking problem or genuine reform reversals.

10. **Germany** (No. 4 on the Fundamental Health Indicator, after finishing at No. 1 in 2015) continues to enjoy the fruits of its post-2003 “Agenda 2010” reforms. Although it has fallen back slightly because its growth has only been modestly above the eurozone average recently, its ranking for fundamental health remains stellar, surpassed only by the **Czech Republic** (No. 1), **Luxembourg** (No. 2) and **Estonia** (No. 3). At 7.4, Germany’s score for fundamental health is only slightly below that of the frontrunner, the Czech Republic, at 7.6. Unfortunately, Germany is showing clear signs of complacency, though. It is doing very little to strengthen its position further. Instead, it stays close to the bottom of the adjustment progress ranking (No. 26), with a further drop in its score to 2.0, down from 2.4 for 2015. This year, Germany’s score for fiscal adjustment worsened significantly as the country granted itself a fiscal stimulus. Fortunately, Germany can easily afford such a stimulus for a while, including extra spending on refugees. The greater concern is that Germany largely ceased to implement pro-growth reforms years ago, with only a small uptick in its readiness to reform in the Organisation for Economic Co-operation and Development (OECD)’s 2014-2015 assessment period for such progress.

11. The **eurozone** as a whole did not improve its overall health during 2016. The aggregate score in the Fundamental Health Indicator stays unchanged at 5.9 for the year. Moderate declines in the score by 0.2 points in **Greece** (No. 28 in the ranking for fundamental health), **Cyprus** (No. 27) and **Austria** (No. 19) as well as marginal declines by 0.1 point in **Germany** (No. 4), **Belgium** (No. 20), **Finland** (No. 24) and **Portugal** (No. 26) were largely offset by slight gains in **Estonia** (No. 3), **Malta** (No. 7), **Ireland** (No. 9) and **Slovenia** (No. 13). As in previous years, Ireland continues to rise in the ranking, driven partly by an improvement in trend growth and competitiveness. To be sure, the lower scores in some fast-adjusting former euro crisis countries reflect a so-called “J-curve” impact on some key criteria of fundamental health – losses initially incurred which will be later replaced by significant gains (hence the “J”-like curve of the movement when plotted on a graph). The message is clear: It gets worse before its gets better. For example, the temporary decline in GDP that often accompanies fiscal repair tends to raise the ratio of debt to GDP and hence temporarily lowers one key measure of fiscal sustainability. In the same vein, the number of long-term unemployed usually goes up, too, worsening the score for human capital, another component of the Fundamental Health Indicator. It usually takes at least five years

'For the United Kingdom, the decision to put access to its major market at risk looks foolhardy.'

after a country has left its adjustment recession before the score for fundamental health can improve meaningfully.

12. Judging by its domestic debate, the **United Kingdom** sees itself as a place apart, different and aloof from the remainder of the European Union, from which the United Kingdom now wants to divorce itself. The analysis presented on these pages does not back up this view. Instead, hardly any other country in the survey has overall results that are closer to the eurozone average than the non-euro UK. In terms of fundamental economic health, the UK advances slightly to No. 18, up from No. 19 last year, with a score of 5.6, three notches below the eurozone average of 5.9.

13. The **United Kingdom** gets top marks for its microeconomics, notably for its growth-friendly rules in product, services and labour markets. The common European Union regulations give the United Kingdom sufficient room to set its own polices and shine despite the occasional gripes about meddling from Brussels. The United Kingdom's problems lie in the macroeconomic sphere, especially on the fiscal side, upon which Brussels has virtually no influence at all. The United Kingdom's big macroeconomic imbalances range from a still huge structural fiscal deficit (around 3.8% of GDP in 2016) to a huge current account deficit (around 5.6% of GDP in 2016) and a low household savings rate of just 5.7% of gross disposable income. In terms of adjustment progress, the United Kingdom's score dropped significantly to 3.7 this year, down from 4.2 for 2015, largely because of an above-average rise in labour costs and a significantly reduced pace of pro-growth structural reforms. The United Kingdom score for adjustment progress is now on par with the eurozone average. The combination of labour-cost slippage with a very low score for external adjustment does not bode well for the United Kingdom's competitive position in the future. For a country that needs to do more to improve its competitive position, a decision to put access to its major market at risk looks somewhat foolhardy. In terms of external adjustment, even France is doing less badly than the United Kingdom. For more, see the Special Focus: Notes on the Brexit Debate on page 58 of this report.

14. **Sweden** remains on the wrong track even if it is still far away from the danger zone. With an unchanged score of 6.5 for fundamental health, it still exceeds the eurozone average of 5.9. However, Sweden (No. 12 on fundamental health) is far behind **Germany** (No. 4 with a score of 7.4) and the **Netherlands** (No. 6 with 6.9), thanks mostly to Sweden's relatively low score for competitiveness. More importantly, Sweden stays at the very bottom of the adjustment progress league as No. 28 due partly to an insufficient pace of external and labour cost adjustment and a lack of pro-growth reforms. The Swedish economy is still performing much better than **Finland** (No. 24 for fundamental health and No. 27 for adjustment progress). For Sweden, the recent economic crisis in Finland should serve as a warning. Over time, a lack of adjustment progress can have dire consequences for countries whose fundamental health is not exactly stellar any more.

15. The same finding applies in muted form to **Austria**. The Alpine country scores modestly below average for fundamental health (No. 19) but falls far short of the average on adjustment progress (No. 24). Austria is starting to

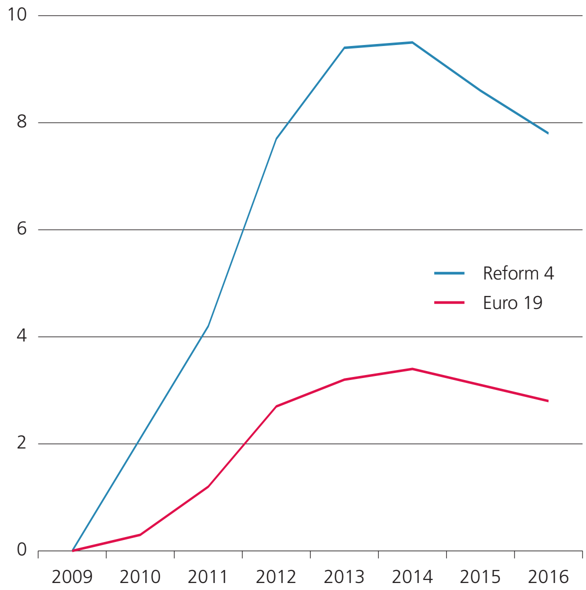
‘Austria is starting to develop a competitiveness problem and needs significant structural reforms.’

develop a potentially serious competitiveness problem and needs significant structural reforms to increase its flexibility and deal with the fiscal consequences of an aging population. Unfortunately, its score for fiscal adjustment worsened significantly in 2016 as the country granted itself a significant fiscal stimulus which, unlike its neighbour Germany, Austria cannot really afford.

16. Poland continues to do fairly well, with scores above average for both its fundamental health (No. 11) and its adjustment progress (No. 14). However, many of the initiatives of the new Polish government to roll back an increase in the retirement age, undo some other reforms and raise welfare spending are not yet included in the analysis. The costs of these initiatives might push Poland significantly lower in the adjustment progress ranking and ultimately also in the fundamental health ranking in the future.

Chart 5. Fiscal Repair

Cumulative change in underlying primary fiscal balance since 2009 in percent of GDP



Reform 4 are Spain, Greece, Ireland and Portugal.
Sources: European Commission, Berenberg calculations

17. *The 2016 Euro Plus Monitor* shows that external imbalances have diminished and that wage pressures have converged somewhat within the **eurozone**. As part and parcel of this adjustment progress, **Ireland**, **Italy**, **Portugal** and **Spain** have managed to turn major current account deficits into small surpluses. In this respect, they are no longer living beyond their means. More than anything else, this shows that serious adjustments have happened and continue to happen within the confines of the monetary union. This result, which we described in all previous five editions of *The Euro Plus Monitor*, is seen clearly again in the 2016 report. The rapid rise in exports creates room for a rebound in imports while maintaining a surplus in net exports. This recovery in domestic demand and imports combined with a rise in employment is the sweet taste of success.

18. Following serious repair in 2010-2014, many countries can afford the switch to a roughly neutral fiscal stance or even a small stimulus as in the case of Germany. But except for countries with excellent fundamental health, they can only do so if they deliver serious pro-growth structural reforms. Unfortunately, the combination of a fiscal stimulus and a slower pace of pro-growth reforms, as we have seen in a number of countries such as **Austria**, **Hungary**, **Portugal**, **Spain** and **Slovenia**, is not a recipe for sustainable growth. For example, the French fiscal problems are a mere reflection of the fact that, because of its excessive labour market regulations and its

‘Despite serious adjustment progress in major parts of the eurozone, the situation remains fragile.’

equally excessive tax burden, **France** is not utilising its potential well. To improve its fiscal outlook, France urgently needs supply-side reforms, not a compression of demand through even higher taxes. Let’s see whether France will push for pro-growth reforms after the presidential elections in May 2017.

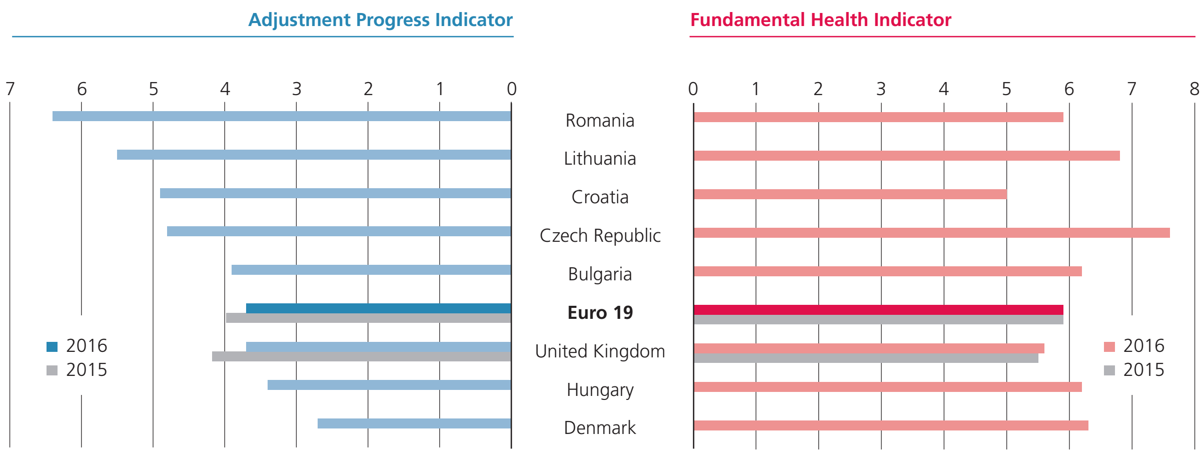
19. On a seven-year view, wage pressures have converged somewhat within the **eurozone**. The erstwhile crisis countries have slashed their unit labour costs significantly. However, the process of labour cost convergence seems to have largely stalled in the last two years. And despite some progress at the margin, the inflexible French labour market has still not responded adequately to the challenge of globalisation.

20. Despite serious adjustment progress in major parts of the eurozone in the last five years, the situation remains fragile. At the eurozone periphery, the major task is to stay the course and prevent reform reversals and the kind of upset which Greece suffered in 2015. That very much includes **Italy**, where Prime Minister Renzi’s work remains unfinished, to put it mildly. Judging by the results of the French Republican primaries which brought François Fillon to the fore, France may finally muster the political will for deeper reforms next year. If not, it could fall further behind Germany and most other countries in the EU which enjoy a better score for fundamental health than France.

21. This year, we have broadened the analysis to include seven additional countries. One of them, rich **Denmark**, is showing many traits roughly in line with the European mainstream. Its 6.3 score for fundamental health (No. 14) is above the eurozone average of 5.9 largely because of Denmark’s comfortable fiscal position. As a result, it can afford to be in the bottom third for adjustment progress (No. 23). However, its low score for labour cost adjustment suggests that it needs to watch its

Chart 6. Adjustment Progress and Fundamental Health

The seven new countries versus the United Kingdom and the eurozone ranked by the Adjustment Progress Indicator



See notes under Table 2 on page 6.
Source: Berenberg calculations

‘The three Baltic countries remain star performers. But they need to take care to avoid new excesses.’

competitive position. Within the Fundamental Health Indicator, Denmark’s score for competitiveness at 5.0 comes in below the eurozone average of 6.0.

22. The other newcomers to the analysis are catching-up economies from the southern, eastern and north-eastern rim of the European Union. With the exception of **Croatia**, all of them achieve a score for fundamental health that is either in line with the eurozone average (**Romania**) or above that average (**Bulgaria**, the **Czech Republic**, **Hungary** and **Lithuania**). Most of them also exceed the eurozone average for adjustment progress, with Romania in the lead ahead of Lithuania, Croatia and the somewhat more mature Czech Republic. As none of these countries falls short of the eurozone average on both counts, they do not seem to pose a particular economic problem for EU policy makers.

23. The three small open Baltic countries remain among the star performers with above-average scores for fundamental health and serious adjustment progress. As in the previous years, **Estonia**, **Latvia** and **Lithuania** continue to slide back in the ranking for adjustment progress. They can afford to relax the reins. Nonetheless, they may soon need to be more careful again in order to avoid a relapse into the excesses of the previous boom, which had to be corrected by a painful bust.

II. Adjustment Progress Indicator

II.1 Overall Results

Europe can adjust. It has done so before. In the 1980s, the United Kingdom's Margaret Thatcher cured the "sick man of Europe." In the 1990s, Scandinavian countries reformed their bloated welfare states. From 2004 to 2006, Germany turned its struggling economy into a new growth engine for Europe through serious labour market and welfare reforms. In many respects, the transformation of most post-communist countries since 1990 dwarfed even these successful examples of change.

From 2010 onwards, the euro confidence crisis forced a brutal front-loaded adjustment on the economies at the southern and western periphery of the eurozone. The reform countries had to correct past excesses in public and private spending, governments and households had to curtail what they consume relative to what they produce and earn. The medicine was bitter. But by and large, it has cured the malaise.

The **Adjustment Progress Indicator** (Table 1 on page 6) tracks the progress countries have made on the four most important measures of short- to medium-term adjustment: 1) the rise (or fall) in exports relative to imports in the external accounts; 2) the reduction (or increase) in the fiscal deficit, adjusted for interest payments as well as cyclical and one-off factors; 3) changes in unit labour costs relative to the eurozone average, and 4) structural reforms. The first three adjustment criteria measure changes that are almost immediately visible in hard economic data. Fiscal tightening affects economic statistics almost instantaneously, repressing domestic demand and steering resources towards export-oriented activities. The structural reforms to which the fourth criterion refers often work with a lag. They may not show up in hard economic data for a year or two after they have been implemented, but they are a crucial element of the repair process.

In *The 2016 Euro Plus Monitor*, we first calculate these four sub-indicators for each country on a scale of 0 (worst) to 10 (best). We then aggregate them to assign an overall Adjustment Progress Indicator score. We then calculate the relative ranking of each country, with the No. 1 rank assigned to the country with the highest and the No. 28 rank to the place with the lowest score. A good score on the Adjustment Progress Indicator shows that countries are improving rapidly and getting results in the key areas that their fiscal repair and structural reforms were meant to address.

The five peripheral countries that received some support from European facilities (such as bilateral loans or European Financial Stability Facility and European Stability Mechanism credits) often topped up by an International Monetary Fund contribution, remain among the star performers in the adjustment ranking. **Cyprus**, **Greece**, **Ireland**, **Portugal**, and **Spain** adjusted faster than almost any other country in the sample. They had to do it. And they did it. This confirms the key results of the analysis in previous years.

‘Greece has put the worst of its 2015 slippage behind it and has started to adjust again.’

But this is now mostly a story of the past. Progress seems to have largely stalled at the eurozone periphery last year. The results of *The 2016 Euro Plus Monitor* confirm a trend that started in 2014 already: We detect a clear slackening of adjustment efforts in the four countries that had fallen into crisis first: **Greece**, **Ireland**, **Portugal** and **Spain**. Of the top performers, only crisis and reform latecomer **Cyprus** kept its score almost constant in the adjustment ranking this year. For Ireland, Spain and to a lesser extent Portugal, the drop in the score is part of the return to a more normal life after the end of the crisis. Having delivered serious fiscal repair and pro-growth reforms, they no longer need to adjust as rapidly as before. Having compressed domestic demands and imports drastically during the crisis, they can afford to relax the fiscal reins slightly and let imports rise faster than exports.

Greece remains a special case. Thanks to its heroic adjustment efforts in the years 2010 through 2014, Greece still leads the overall adjustment league. However, the last two years have seen major shifts. After dramatic slippage in 2015, the score for Greece fell further in 2016. This reflects mostly the stalling of reform efforts in the first half of 2015, which still impact the current rankings for recent reform progress for lack of more recent data on this count. By sowing uncertainty and chasing capital out of the country in record amounts between late 2014 and July 2015, Greece weakened its economic and fiscal position dramatically. Most recent data on fiscal and external adjustment, however, indicate that Greece has put the worst of the slippage behind it and has started to adjust again.

Ireland stays at the No. 2 position in the Adjustment Progress Indicator. **Spain** (No. 6) falls back and switches places with **Portugal**, which moves up to No. 5. The fact that Spain’s score declines by 0.7 points is largely the result of the pre-election fiscal stimulus which the country granted itself this year and an absence of further major pro-growth structural reforms. Fortunately, the rapid decline in Spanish unemployment and the strong rates of GDP growth suggest that Spain can afford some slippage. The reforms put in place in previous years are working. Looking ahead, however, Spain ought to do more to safeguard the progress it has made. Genuine reform reversals could put its position at serious risk.

Beyond the erstwhile euro crisis countries, two other groups of countries shine in our Adjustment Ranking.

- Despite some significant slippage in the last three years, the three small and relatively open Baltic economies remain in the top half of the league, with **Latvia** (No. 3) well ahead of newcomer **Lithuania** (No. 8) and **Estonia** (No. 12). Five years ago, Estonia was at the top of the league. Having successfully concluded their adjustment from its pre-Lehman boom-bust, the Baltic countries can afford to relax their efforts and reap the benefits of what they have achieved. In terms of fundamental health, all three countries are among the top 10.

- Virtually all catching-up economies of southern and eastern Europe are adjusting faster than the eurozone average, with **Romania** (No. 4) as well as **Slovenia** (No. 9), **Slovakia** (No. 10) and **Croatia** (No. 11) doing particularly well. Only **Hungary** (No. 18) gets a score modestly below the eurozone average.

A low score on the Adjustment Progress Indicator can mean two different things. On the positive side, it can signal that countries do not adjust much because they do not need to. This is the case

‘Against the trend, some of the erstwhile laggards are now shaping up at least a little.’

for **Luxembourg** (No. 19), the **Netherlands** (No. 20) and **Germany** (No. 26). These countries score well in the separate Fundamental Health Indicator, where Luxembourg, Germany and the Netherlands take the No. 2, No. 4 and No. 6 slots, respectively. This indicator will be discussed in Chapter III, which begins on page 38.

To some extent, low German and Dutch scores for recent adjustment progress are part of the convergence within the eurozone towards best practice. Their above-average results in the overall Fundamental Health Indicator show that these countries can afford a relatively relaxed fiscal stance and an above-average rise in real unit labour costs. They also have a less pronounced need for immediate structural reforms than countries with lower scores.

Unfortunately, success can breed complacency. While still in good fundamental health for the time being, **Germany**, the **Netherlands** and **Sweden** are showing even more signs of complacency than before. Over time, they will need to stop their slippage and implement more serious pro-growth structural reforms again. Otherwise, they will lose their competitive edge over time.

On the negative side, a low score in the Adjustment Progress Indicator can be a harbinger of trouble to come for countries that are in urgent need of reform, as suggested by a low score in our Fundamental Health Indicator. In the first four *Euro Plus Monitors* (2011, 2012, 2013 and 2014), **France** (No. 21) exhibited the worst combination, showing hardly any adjustment progress despite having the shakiest long-term fundamentals of any major economy in Europe. The situation has not changed much. After slight progress in 2015, France’s score for adjustment progress stays constant at 3.0 this year. Nonetheless, we find two encouraging signs.

1. First, **France** at least bucks the trend. Because of the slippage in most other countries, France moved to No. 21, up from No. 24, leaving Malta (No. 22), Denmark (No. 23) and Austria (No. 24) behind. For example, France did not grant itself a fiscal stimulus in 2015 and 2016 against the trend prevailing elsewhere. While that did not suffice to improve its weak fiscal position very much, France did not join the trend towards a looser fiscal policy. France started the inevitable process of fiscal repair and pro-growth reforms late. Hence it now needs some austerity when others are mostly done with it or can grant themselves a small fiscal stimulus instead.

2. France has finally started to address some of its serious structural problems, delivering somewhat more structural reforms in 2014-2015 than in the largely reform-free years before. If France follows up with more serious labour market and other reforms after its spring 2017 elections, it may no longer be the sick man of Europe in a few years’ time.

Against the trend of reduced adjustment efforts across much of the European Union, some of the erstwhile laggards are now shaping up at least a little. **Italy** (No. 15, up from No. 16) is benefitting from the reforms of Prime Minister Renzi. No other country in the sample has introduced more pro-growth reforms in the 2014/2015 period than Italy. **Belgium** (No. 25) remains close to the bottom of the adjustment league. Fortunately, it has raised its score slightly by 0.2 points to 2.4, still well below the eurozone average of 3.7. All in all, we view the shift of adjustment efforts away from erstwhile euro-crisis countries towards

‘Sweden and Finland are stuck at the bottom position of the Adjustment Progress Indicator.’

the eurozone’s major laggards as a (mostly) positive development.

After a significant gain last year, **Slovenia** (No. 9) maintained a satisfactory pace of adjustment in 2016 with a score of 5.0, well above the eurozone average of 3.7. Having managed to escape troika scrutiny, Slovenia has nonetheless embarked on an impressive course of adjustment and reform. The once sluggish pace of change has quickened. However, the pace remains well below that seen in troika-supervised economies in previous years. While the external adjustment is proceeding well, the fiscal adjustment falls short of what Slovenia needs to make its fiscal position sustainable.

With an unchanged score of 4.3, **Poland** stays in the No. 14 position. The analysis does not yet include the current initiatives by Poland’s new government. The partial reversal of a pension reform, higher minimum wages and more government spending could hurt Poland’s fiscal sustainability and hence its position in the ranking in coming years.

Sweden (No. 28) and **Finland** (No. 27) are stuck at the bottom position of the Adjustment Progress Indicator with another drop in their score largely because both countries have fallen behind even further on pro-growth structural reforms.

The score for the **United Kingdom** (No. 17, down from No. 15) drops to 3.7 (down from 4.2 in 2015). This is the second significant slippage for the United Kingdom in a row. This time, we see two major reasons for the lower outcome. First, labour costs are rising faster in the United Kingdom than in most other countries in our sample. Second, the UK curtailed its structural reforms efforts significantly in the 2014-2015 period on which our assessment of pro-growth reforms is based. Having been above the eurozone average until 2014, the United Kingdom’s overall score for adjustment progress is now in line with the eurozone average.

‘The eurozone has adjusted well largely because the reform countries have shaped up’

II.2 External Adjustment

Table 3. External Adjustment 2007-2016

					Change in net exports H2 2007 - Q3 2016								Rise in export ratio as a percent of GDP		
Rank							Relative to GDP			Relative to starting level			H2 2007 - Q3 2016		
2016	2015	Country	Score	*Change*	Score	*Change*	Percent	Score	*Change*	Percent	Score	*Change*	Percent	Score	*Change*
1	1	Latvia	**9.4**	*0.0*	**9.5**	*-0.2*	17.4	**9.1**	*-0.3*	40.8	**10.0**	*0.0*	17.8	**9.2**	*0.4*
2	3	Bulgaria	**8.1**	*0.5*	**8.4**	*0.4*	15.6	**8.5**	*0.4*	30.2	**8.2**	*0.4*	13.9	**7.7**	*0.8*
3	5	Lithuania	**7.8**	*0.4*	**6.8**	*0.5*	11.0	**6.9**	*0.5*	22.2	**6.6**	*0.6*	30.8	**10.0**	*0.0*
4	6	Greece	**7.5**	*0.1*	**8.5**	*-0.3*	11.6	**7.1**	*-0.6*	49.5	**10.0**	*0.0*	8.0	**5.5**	*0.9*
5	7	Spain	**7.2**	*0.2*	**8.3**	*0.2*	10.1	**6.6**	*0.2*	39.3	**10.0**	*0.3*	6.6	**4.9**	*0.1*
6	10	Slovenia	**7.1**	*0.4*	**6.6**	*0.2*	12.1	**7.3**	*0.2*	18.6	**5.9**	*0.1*	15.2	**8.2**	*1.0*
7	4	Romania	**7.1**	*-0.4*	**6.7**	*-0.9*	8.3	**6.0**	*-0.6*	26.4	**7.5**	*-1.1*	14.1	**7.8**	*0.4*
8	12	Slovakia	**7.1**	*0.9*	**5.8**	*0.8*	10.7	**6.8**	*0.9*	13.3	**4.9**	*0.6*	18.8	**9.6**	*1.1*
9	8	Ireland	**7.0**	*0.2*	**5.6**	*0.3*	10.4	**6.7**	*0.3*	11.3	**4.5**	*0.2*	31.1	**10.0**	*0.0*
10	2	Estonia	**6.9**	*-0.7*	**5.4**	*-1.1*	8.1	**5.9**	*-1.1*	13.1	**4.8**	*-1.0*	26.3	**10.0**	*0.0*
11	9	Hungary	**6.9**	*0.1*	**5.3**	*0.2*	8.6	**6.1**	*0.2*	11.4	**4.5**	*0.2*	25.4	**10.0**	*0.0*
12	11	Croatia	**6.4**	*0.1*	**6.2**	*-0.1*	8.3	**6.0**	*-0.1*	21.6	**6.5**	*-0.2*	11.3	**6.7**	*0.6*
13	13	Portugal	**6.2**	*0.3*	**5.8**	*0.2*	6.2	**5.2**	*0.1*	20.6	**6.3**	*0.3*	11.8	**6.9**	*0.4*
14	14	Czech Republic	**6.1**	*0.4*	**4.1**	*0.3*	4.4	**4.6**	*0.3*	7.1	**3.6**	*0.3*	19.9	**10.0**	*0.4*
15	16	Poland	**5.1**	*0.4*	**4.6**	*0.0*	4.5	**4.7**	*0.0*	11.3	**4.5**	*0.0*	10.1	**6.3**	*1.1*
16	15	Netherlands	**5.1**	*0.1*	**3.6**	*0.0*	2.9	**4.1**	*0.0*	4.2	**3.0**	*0.0*	15.1	**8.2**	*0.3*
17	19	Cyprus	**4.8**	*0.5*	**4.5**	*0.4*	5.0	**4.8**	*0.4*	9.4	**4.1**	*0.4*	8.2	**5.6**	*0.8*
18	18	Luxembourg	**4.5**	*0.2*	**1.7**	*0.3*	-4.2	**1.6**	*0.4*	-2.4	**1.7**	*0.1*	41.0	**10.0**	*0.0*
19	21	Belgium	**4.3**	*0.4*	**2.7**	*0.2*	0.2	**3.2**	*0.2*	0.2	**2.2**	*0.2*	13.6	**7.6**	*1.0*
20	17	Malta	**4.2**	*-0.1*	**3.3**	*0.5*	2.8	**4.1**	*0.7*	2.2	**2.6**	*0.3*	9.1	**5.9**	*-1.4*
		Euro 19	**4.2**	*-0.1*	**3.6**	*-0.2*	2.3	**3.9**	*-0.1*	5.8	**3.4**	*-0.2*	7.7	**5.3**	*0.1*
21	20	Italy	**4.0**	*0.0*	**4.2**	*0.0*	2.8	**4.1**	*0.0*	10.2	**4.2**	*0.0*	3.2	**3.6**	*0.1*
22	24	Denmark	**3.5**	*0.2*	**3.2**	*0.2*	1.5	**3.6**	*0.2*	3.0	**2.8**	*0.2*	4.7	**4.2**	*0.3*
23	23	Austria	**3.4**	*0.0*	**3.0**	*-0.1*	1.0	**3.4**	*-0.1*	1.9	**2.6**	*-0.1*	4.9	**4.3**	*0.3*
24	22	Germany	**3.3**	*-0.1*	**2.6**	*-0.2*	-0.2	**3.0**	*-0.2*	-0.4	**2.1**	*-0.2*	6.2	**4.8**	*0.0*
25	25	France	**2.5**	*-0.3*	**1.9**	*-0.4*	-1.4	**2.6**	*-0.3*	-5.1	**1.2**	*-0.6*	3.5	**3.8**	*-0.1*
26	26	United Kingdom	**2.5**	*0.0*	**2.3**	*0.0*	-0.6	**2.9**	*0.0*	-2.1	**1.8**	*-0.1*	0.8	**2.7**	*0.2*
27	27	Sweden	**2.2**	*-0.2*	**1.8**	*-0.2*	-2.3	**2.3**	*-0.2*	-4.8	**1.2**	*-0.3*	1.3	**2.9**	*-0.1*
28	28	Finland	**1.0**	*-0.1*	**0.6**	*-0.2*	-5.7	**1.1**	*-0.3*	-13.9	**0.0**	*0.0*	-1.6	**1.9**	*0.1*

Ranks, scores and score changes for external adjustment indicator and sub-indicators. Values given in percent are for the average of Q2 and Q3 2016 over H2 2007: (1) change of net exports as % of GDP, (2) change of net export ratio as % of the starting level and (3) rise in the export ratio in percentage points of GDP. For further explanations see notes under Table 2 on page 6 and the Notes on Key Components on page 63. For Cyprus, Estonia, Luxembourg, Malta and Croatia, the scores are based on adjustment up to H1 2016 as Q3 2016 data are not yet available.

‘Most eurozone members have attained a comfortable external position.’

If a country has lived beyond its means, the adjustment after the party should show up most visibly in its external accounts. To track the progress, we examine two different aspects of external adjustment, namely 1) the shift in the balance of exports and imports (net exports), and 2) the rise in the share of exports in a country’s GDP. Beyond looking at the absolute shifts, we also assess them relative to the starting position of each country as measured by the pre-crisis share of exports in GDP in 2H 2007. This year, we add one extra year of data to the previous analysis.

The overall results confirm the pattern we observed in the last five years. The **eurozone** as a whole has improved its external position since 2007 largely because the erstwhile crisis countries have shaped up. All economies that were running excessive external deficits until 2007 (or 2009) have turned their external balance around convincingly.

Looking at the cumulative adjustment since 2007, three groups of countries dominate the top half of the overall ranking.

1. The three Baltic economies have successfully staged an export-led recovery from their 2007-2009 crisis.

2. The peripheral countries that had to ask for external help during the euro crisis have turned their external positions around convincingly.

3. Most of the catching-up economies in southern and eastern Europe, some of which are included in the analysis for the first time, are integrating themselves well into the European and global economy as seen by the significant rise in the share of exports in their GDP.

Latvia (No. 1) maintains its position as the best of the 28 countries in the sample by a wide margin, well ahead of newcomers **Bulgaria** (No. 2) and **Lithuania** (No. 3), followed by **Greece** (No. 4) and **Spain** (No. 5). **Slovenia** advances to No. 6 ahead of **Romania** (No. 7), **Slovakia** (No. 8) and **Ireland** (No. 9). Of the erstwhile euro crisis countries, **Portugal** (No. 13) and **Cyprus** (No. 17) achieve the least stellar results, although both show overall scores above the eurozone average.

Most eurozone members have attained a comfortable external position. As they no longer need to adjust their external accounts very much, the marginal slippage in the score for the eurozone average to 4.2 in 2016, down from 4.3 in 2015, is no cause for concern. Two reasons largely explain this modest slippage.

1. Weak demand from China and other emerging markets weighed on export growth in late 2015 and early 2016. As a result, the share of exports in GDP for the **eurozone** as a whole rose only marginally to 46.8% in the first three quarters of 2016, up from 46.5% in 2015.

2. With the period of painful belt-tightening largely over, almost all eurozone members including the erstwhile euro crisis countries are raising their imports again in line with a rebound in domestic demand.

Whereas the first reason is simply bad luck, the second reason is mostly a sign of success. After a convincing turnaround in external accounts, many countries in the sample can afford to increase their imports again in line with or slightly ahead of the growth in overall GDP. At least in their external accounts, most eurozone member countries have successfully concluded their impressive external adjustment.

The sad exception is **Greece**. Athens gets excellent marks for its overall external adjustment (7.5), ‘Relative to the results for 2015, we find significant gains for Slovakia, Bulgaria and Cyprus.’

even raising its score slightly in 2016. But most of the improvement in Greece’s external position in recent years has come from a collapse in imports rather than a surge in exports. Political uncertainty, regulatory red tape and excessive taxes are hampering investment into export-oriented activities. That may help to explain why Greek exports are lagging far behind those of other countries at the euro periphery. The strong rise in its export share in GDP to 30.9% in 2015, up from 23.4% of GDP in 2H 2007, has been caused more by a decline in GDP than a rise in real exports. Greece’s export share fell back slightly to 30.7% in the first three quarters of 2016.

The two biggest eurozone members, **Germany** (No. 24, with a score of 3.3) and **France** (No. 25, with 2.5) remain close to the bottom of the league. Their scores declined slightly further in 2016, by 0.1 point for Germany and 0.3 points for France. In the case of Germany, this makes perfect sense. As a country with an exceptionally strong external position, Germany can easily afford to consume more, raising its imports at a faster rate than its exports, as it has done in 2016. That its current account surplus has gone up nonetheless to roughly 9% of GDP in 2016, up from 8.5% in 2015, is simply good luck. Like other countries, Germany paid less for its imports courtesy of low oil prices. For France, the decline in its score should be a reason for concern, though, as the share of exports in French GDP actually receded in the first three quarters of 2016 relative to the 2015 average. France needs to do more to become competitive.

Outside the eurozone, **Poland** (No. 15) managed to raise its above-average score whereas the **United Kingdom** (No. 26) kept its very low score. The United Kingdom has achieved even less than **France** in terms of external adjustment since 2007. **Sweden** (No. 27) and **Finland** (No. 28) remain at the bottom of the ranking with a further slight drop in their scores.

Relative to the results for 2015, we find significant gains in the scores for **Slovakia** (up 0.9 points), **Bulgaria** and **Cyprus** (up 0.5 points each) as well as **Lithuania**, **Slovenia**, the **Czech Republic**, **Poland** and **Belgium** (up 0.4 points each).

Looking at the first sub-criterion – the rise in the share of net exports in GDP – **Latvia** with its small and very open economy managed the most impressive shift to its external balance by a total of 17.4 percentage points of GDP from 2H 2007 to mid-2016 (average of Q2 and Q3 2016). It is followed by newcomer **Bulgaria** (15.6 points), **Slovenia** (a 12.1 point shift), **Greece** (11.6 points), **Lithuania** (11.0 points), **Slovakia** (10.7 points) and **Ireland** (10.4 points). The result is also quite impressive for **Spain** with a shift of 10.1 percentage points as it is a much bigger and hence less open economy than the other top ranked economies.

At the other end of the spectrum, the net export balance has deteriorated significantly in **Finland** (-5.7 percentage points of GDP from 2H 2007 to mid-2016), **Luxembourg** (-4.2 points), **Sweden** (-2.3 points) and **France** (-1.4 points). Data for Luxembourg can be very volatile due the economy’s relatively small size compared to its (net) exports. For Finland, Sweden and France, the shift is too pronounced for comfort. See the column on “change in net exports relative to GDP” in Table 3 on page 21 for more.

Of course, a mere glance at the shift in the balance of exports and imports as a share of GDP is somewhat unfair. Small open economies such as Ireland, Cyprus and the Baltic states find it much easier to shift resources from the domestically oriented to the export-oriented or import-competing sectors than larger and more closed economies. To account for this, we look not just at the shift in the balance of import and exports, but

'Latvia, Bulgaria, Lithuania and Greece are the best performers in terms of external adjustment.'

also at the shift in a country's net export position relative to the starting level of 2H 2007.

To some extent, the results are similar: **Greece** and **Latvia** stay at or close to the top whereas **Finland**, **France**, **Sweden**, the **United Kingdom** and **Germany** remain close to the bottom. Adjusted for their comparatively low starting level, two further eurozone crisis economies beyond Greece – namely **Spain** and, to a lesser extent, **Portugal** – have also achieved impressive shifts. This confirms a major rebalancing within Europe. On this criterion, even **Italy** looks well above average as, relative to its weak starting level, it has turned around its external balance quite decisively.

A closer look at the drivers of adjustment in the first three years of the eurozone confidence crisis reveals a dark side to the external adjustment story: in some countries, the net export position had initially improved more through a collapse in imports and less through an actual rise in exports (see the column on "rise in export ratio as a percent of GDP" in Table 3 on page 21). However, this ceased to be the case in 2014. As the worst of the domestic fiscal squeeze ended in 2014, imports have now rebounded in most reform countries for more than three years already while the share of exports in GDP continued to grow (see Chart 1 on page 5).

While **Spain** and **Portugal** have done well from 2H 2007 to mid-2016, raising their export ratio by 6.6 and 11.8 percentage points of their GDP, respectively, some of the small, open economies in the eurozone managed even more spectacular improvements. This holds especially for outlier **Luxembourg** (+41.0 points), **Ireland** (+31.1 points), **Lithuania** (+30.8 points), **Estonia** (+26.3 points), **Hungary** (+25.4 points), the **Czech Republic** (+19.9 points), **Slovakia** (+18.8 points) and **Latvia** (+17.8).

On the opposite side of the spectrum, **Finland** is the only country that has not yet recouped the post-crisis drop in its export ratio. The results are also very weak for the **United Kingdom** (+0.8 points only) and **Sweden** (+1.3 points). With overall gains in the export ratio by 3.2 and 3.5 percentage points, respectively, **France** and **Italy** also lag well behind the eurozone average of 7.7 points.

Combining the findings from the shift in net exports and the change in the export ratio into one ranking yields the results shown in Table 3 on page 21. **Latvia** (No. 1), **Bulgaria** (No. 2), **Lithuania** (No. 3) and **Greece** (No. 4) are the best performers in terms of overall external adjustment, followed by **Spain** (No. 5), **Slovenia** (No. 6), **Romania** (No. 7) and **Slovakia** (No. 8). However, comparing the countries that recently suffered from the euro confidence crisis such as Greece and Spain to Latvia and Lithuania can be misleading. The time available for adjustment matters. Hit by the bursting of domestic bubbles, the Baltic countries started their wrenching adjustment earlier than most of the countries affected by the euro-confidence crisis. They have had more time to achieve results. **Cyprus** confirms this pattern. As the last country to fall victim to the euro crisis, its overall score for external adjustment was below the eurozone average until 2015. Thanks to ongoing rapid progress from a weak base, Cyprus has now raised its score by a noteworthy 0.5 points. It rises to No. 17 in the ranking, up from No. 19, for data extending to 2016.

Going forward, we expect the pace of external adjustment to remain largely steady in the **eurozone**. Export growth should remain satisfactory as a "Trumponomics" fiscal stimulus in the United States and a competitively valued exchange rate support the outlook. At the same time, in an economic recovery driven mostly by domestic demand, imports will likely rise at least as fast as exports for most countries in the sample. If so, we would view that as a healthy development.

‘For better or worse, austerity is over.
Most countries loosened the reins somewhat in 2016.’

II.3 Fiscal Adjustment

Table 4. Fiscal Adjustment 2009-2016

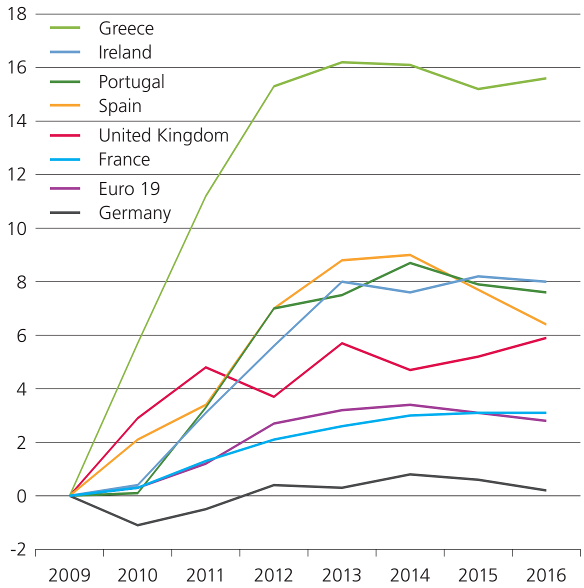
Rank					2009-16 in percent of GDP			in percent of required shift		
2016	2015	Country	Score	*Change*	Percent	Score	*Change*	Percent	Score	*Change*
1	2	Greece	**9.0**	*0.1*	15.6	**10.0**	*0.0*	75.4	**8.0**	*0.2*
2	4	Czech Republic	**7.3**	*0.1*	4.6	**4.7**	*0.2*	115.6	**10.0**	*0.0*
3	1	Romania	**7.0**	*-1.9*	6.9	**6.3**	*-1.5*	72.7	**7.7**	*-2.3*
4	5	Ireland	**6.9**	*-0.2*	8.0	**7.2**	*-0.1*	63.2	**6.7**	*-0.2*
5	6	Latvia	**6.9**	*0.1*	3.2	**3.7**	*0.1*	337.5	**10.0**	*0.0*
6	11	Slovakia	**6.4**	*0.1*	5.7	**5.5**	*0.0*	68.1	**7.2**	*0.1*
7	8	Portugal	**6.3**	*-0.2*	7.6	**6.9**	*-0.2*	54.8	**5.8**	*-0.2*
8	3	Cyprus	**6.3**	*-1.2*	6.8	**6.3**	*-1.2*	n.a.	**n.a.**	*n.a.*
9	9	Lithuania	**6.3**	*-0.3*	5.9	**5.7**	*-0.2*	64.7	**6.9**	*-0.3*
10	7	Poland	**6.1**	*-0.7*	4.6	**4.7**	*-0.4*	70.4	**7.5**	*-1.0*
11	13	United Kingdom	**5.7**	*0.6*	5.9	**5.7**	*0.5*	54.8	**5.8**	*0.7*
12	10	Spain	**5.4**	*-1.0*	6.4	**6.0**	*-0.9*	45.0	**4.8**	*-1.0*
13	12	Slovenia	**4.8**	*-0.4*	3.9	**4.2**	*-0.3*	49.9	**5.3**	*-0.5*
14	16	Croatia	**4.0**	*0.2*	3.6	**4.0**	*0.2*	n.a.	**n.a.**	*n.a.*
15	15	France	**3.8**	*0.0*	3.1	**3.6**	*0.0*	37.7	**4.0**	*0.0*
		Euro 19	**3.7**	*-0.4*	2.8	**3.4**	*-0.3*	37.9	**4.0**	*-0.6*
16	18	Bulgaria	**3.6**	*0.4*	3.0	**3.6**	*0.4*	n.a.	**n.a.**	*n.a.*
17	20	Netherlands	**3.4**	*0.5*	2.8	**3.4**	*0.4*	32.8	**3.5**	*0.6*
18	14	Italy	**3.3**	*-0.9*	2.1	**3.0**	*-0.5*	34.5	**3.7**	*-1.2*
19	21	Malta	**2.5**	*0.5*	1.6	**2.5**	*0.5*	n.a.	**n.a.**	*n.a.*
20	22	Estonia	**2.5**	*0.5*	1.5	**2.5**	*0.5*	n.a.	**n.a.**	*n.a.*
21	17	Germany	**1.7**	*-1.6*	0.2	**1.6**	*-0.3*	17.1	**1.8**	*-2.9*
22	19	Austria	**1.7**	*-1.3*	0.9	**2.1**	*-0.8*	12.8	**1.4**	*-1.8*
23	23	Luxembourg	**1.6**	*-0.2*	0.2	**1.6**	*-0.2*	n.a.	**n.a.**	*n.a.*
24	26	Denmark	**0.7**	*0.6*	0.0	**1.4**	*1.3*	-2.0	**0.0**	*0.0*
25	24	Belgium	**0.7**	*-0.4*	-0.2	**1.3**	*-0.4*	-1.9	**0.0**	*-0.4*
26	25	Hungary	**0.2**	*-0.4*	-1.5	**0.3**	*-0.8*	-115.4	**0.0**	*0.0*
27	27	Sweden	**0.0**	*0.0*	-3.8	**0.0**	*0.0*	0.0	**0.0**	*0.0*
27	27	Finland	**0.0**	*0.0*	-2.1	**0.0**	*0.0*	-177.1	**0.0**	*0.0*

Ranks, scores and score changes for Fiscal Adjustment Indicator and sub-indicators. Values: (1) 2009-2016 change in structural primary balance in percent of GDP and (2) as a share of the required fiscal shift until 2020, adjusted for age-related spending. For further explanations see notes under Table 2 on page 6 and the Notes on Key Components on page 63.

'Despite some slippage, the countries most in need of fiscal repair have made serious progress since 2010.'

Chart 7. Fiscal Adjustment 2009-2016

Cumulative change in underlying primary fiscal balance since 2009 in percent of GDP



Sources: European Commission, Berenberg calculations

For better or worse, austerity is over. For the second year in a row, most European countries loosened the fiscal reins somewhat in 2016. In some cases such as that of Germany, we can applaud that as welcome stimulus. In other cases such as those of Italy, Portugal and Spain, the turn away from their post-crisis fiscal repair looks premature. While politically understandable and – in the case of Spain – possibly inevitable as Spain had no more than a caretaker government for much of the year, these countries have now added to the fiscal challenges they will face in the future.

To analyse shifts in the fiscal-policy stance, we examine the underlying primary balance of the general government accounts. These data adjust the actual fiscal balance for the impact of the short-term business cycle, interest payments and some significant one-off factors such as public funding for a recapitalisation of banks. Using the latest data from the European Commission as the basis for analysis, we draw three major conclusions:[5]

1. Taking the last seven years together, the countries that were most in need of reining in their excessive deficits have made serious progress, with **Greece** (No. 1) still well ahead of **Ireland** (No. 4), **Portugal** (No. 7), **Cyprus** (No. 8) and **Spain** (No. 12). All five eurozone countries that had to ask taxpayers in other countries for support are running a much tighter fiscal policy than they did in 2009 (see Chart 7 on this page).

2. A number of countries with a fairly comfortable fiscal starting position such as **Germany** (No. 21), **Luxembourg** (No. 23) and **Denmark** (No. 24) have hardly changed their fiscal stance over these seven years while **Sweden** and **Finland**, which share the No. 27 position, have even relaxed the fiscal reins noticeably. On a seven-year view, serious tightening in the fiscally challenged periphery and a virtual standstill in parts of the core have resulted in a significant convergence of fiscal policy in the **eurozone** and the European Union as a whole.

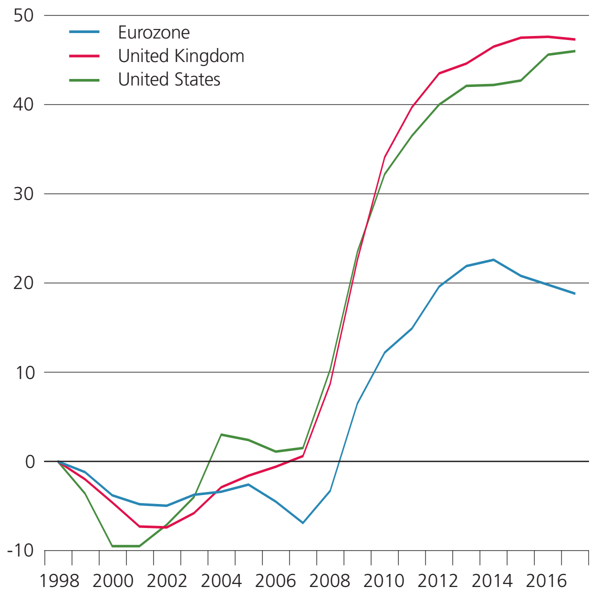
3. By and large, fiscal repair has given way to a looser policy stance in the last two years. After a cumulative fiscal correction of 3.4% of GDP from 2009 to 2014 brought the eurozone's structural primary balance to 1.6% in 2014, governments relaxed the fiscal reins marginally by 0.3% of GDP per year in 2015 and 2016. We expect a slightly smaller stimulus of 0.2% of GDP in 2017.

5. European Commission, Ameco database, November 2016.

‘All in all, the end of austerity makes sense for most countries of the eurozone.’

Chart 8. Debt Burden No Longer Rising in Europe

Change in public debt ratio since 1998 in percent of GDP



Sources: Eurostat, European Commission

All in all, the end of austerity makes sense for most countries of the **eurozone**. As Chart 8 on this page shows, the rise in public debt in the eurozone since 1999 has been far less pronounced than in the **United States** and the **United Kingdom**. Largely because of Germany’s exceptionally strong fiscal position, the ratio of public debt to GDP declined in the eurozone for the second year in a row in 2016. With real GDP growth around trend at 1.5%, we project a further and more broad-based improvement in 2017.

However, this assessment does not hold for all countries. To some extent, fiscal repair has given way to new fiscal concerns.

- After massive progress up to 2014, three of the erstwhile euro crisis countries loosened fiscal policy for the second year in a row in 2016.

  In **Portugal** (fiscal impulse of 0.7% of GDP in 2015 and 0.3% in 2016) and **Spain** (1.3% stimulus per year in 2015 and 2016), the turn away from prudence is politically understandable but economically unfortunate. Fast-growing Spain certainly did not need to stimulate demand artificially. In **Cyprus**, the relaxation of the reins looks mostly like a correction of an unusually and unsustainably tight policy in 2014. For **Italy**, the stimulus of 0.3% of GDP in 2015 and 0.7% in 2016 can be partly justified as a means to offset the impact of a serious labour market reform which might otherwise constrain demand before the full positive supply response becomes visible.

- Outside the eurozone, **Romania** followed a pattern similar to that of many erstwhile euro crisis countries. Having tightened its fiscal stance rigorously from 2009 to 2014, the country granted itself a major stimulus worth 2.1% of its GDP in 2016.

- Following a chaotic 2015 in which the underlying primary fiscal balance deteriorated by 0.9% of GDP, **Greece** had to tighten fiscal policy modestly again in 2016 by 0.4% of GDP. Because its futile confrontation with creditors in the first eight months of 2015 had been so costly, Greece will probably have to run an exceptionally tough fiscal policy in the next few years even if creditors offer further debt relief.

As Table 4 on page 25 shows, the overall change in **Greece**’s underlying fiscal position of 15.6% of GDP since 2009 far exceeds that of any other country in the European Union. With a less dismal starting point and a less-frontloaded approach, the cumulative fiscal repair since 2009 has been less dramatic than in Greece but still quite breath-taking in **Ireland** (8.0% of GDP). Despite their

‘The size of the fiscal shift over time tells only half the story.’

recent fiscal slippage, the overall correction in the underlying fiscal balance between 2009 and 2016 still remains fairly impressive in **Portugal** (7.6%), **Cyprus** (6.8%) and **Spain** (6.4%).

Of course, the size of the fiscal shift over time tells only half the story. We have to relate it to the actual adjustment need. In 2014, the International Monetary Fund estimated how much countries would have to shift their cyclically adjusted primary balance between 2014 and 2020 to get to a deficit-to-GDP ratio of 60% by 2030, also adding an adjustment for age-related spending.[6] We take these numbers – including their underlying assumptions – and add the actual adjustment progress in 2016 over 2009. We then relate the total required shift in stance between 2009 and 2020 to what was already achieved from 2009 to 2016.

On this measure, **Latvia** and the **Czech Republic** made the most progress over the last six years taken together, as shown in the column on “fiscal adjustment in percent of required shift” in Table 4 on page 25.[7] They are followed by **Greece**, **Romania**, **Poland**, **Slovakia**, **Lithuania**, **Ireland**, **Portugal**, the **United Kingdom** and **Slovenia**.

We combine both fiscal adjustment measures, namely the estimated total shift between 2009-2016 in absolute terms and the adjustment so far relative to the total adjustment need until 2020, for the overall fiscal adjustment score. The picture is much more mixed than it had been in previous years. After major gains across the eurozone periphery until 2014 and some slippage in 2015, the overall score worsened significantly for **Cyprus** (No. 8), **Spain** (No. 12) and – less so – for **Portugal** (No. 7) in 2016. However, **Greece** (No. 1) raised its result slightly as it returned to the path of structural reforms and fiscal repair after its confrontation with its creditors in 2015, whereas **Ireland** (No. 4) allowed itself a modest fiscal slippage in 2016. The **United Kingdom** (No. 11) and **Denmark** (No. 24) managed to improve their score in a meaningful way in 2016. On top of a fiscal tightening of 0.8% of its GDP in 2016, the United Kingdom had to cope with the first fallout from the Brexit vote on 23 June 2016. The United Kingdom economy managed to expand at an annualised pace of around 2% even in Q3 2016 – right after the Brexit vote. This shows the remarkable resilience of the UK economy based on its comparatively flexible markets for products, services and labour.

The low ranking for **Germany** (No. 21 after No. 17 before) needs to be seen in context. Although Germany has gone through hardly any austerity since 2009, its sustainability gap remains so small that it could easily afford its small fiscal stimulus of 0.2% of GDP in 2015 and 0.4% in 2016. As it continues to benefit from the rapid rise in employment and tax receipts unleashed by its 2004 labour market reforms, Germany had the fiscal space for the extra spending on refugees in

6. International Monetary Fund, *Fiscal Monitor 2014* (Washington DC: IMF, 2014); *Ibid. Fiscal Monitor 2013* (Washington DC, IMF, 2013). These estimates are subject to change, they also deviate somewhat from those of the European Commission. But the EU and IMF estimates of how much countries are shifting their cyclically adjusted primary balances tend to be similar.
7. The estimate for Greece should be taken with more caution than other estimates. As the IMF has not updated its estimates for the overall adjustment need for Greece, we used the IMF’s 2013 estimates. We corrected these estimates for two factors, namely the fiscal changes that have happened since then and the massive capital flight and relapse into recession caused by political developments at the end of 2014 and early 2015. These developments have weakened the Greek economy to such an extent that, in order to get public debt back on a sustainable track, further fiscal measures will be required. This has raised Greece’s sustainability gap by at least 2% of its GDP. In 2015, we thus added two points to the estimate for the total required fiscal shift for Greece. This year, we maintain that estimate.

‘For Italy, Austria and Belgium, their below-average scores are a much greater concern.’

the last 18 months and for additional initiatives to upgrade its infrastructure. Although real government consumption in Germany has risen by 4.3% year-on-year in the first three quarters of 2016, the country maintains a healthy fiscal surplus of around 0.5% of GDP.

For **Italy** (No. 18), **Austria** (No. 22) and **Belgium** (No. 25), their below-average scores for fiscal adjustment are a much greater concern because these countries have an above-average need to adjust. Unfortunately, these three countries fell back further in 2016.

Sweden (No. 27) relaxed its fiscal stance in 2016 whereas **Finland** (also No. 27) maintained its overly loose fiscal policy.

‘Labour costs matter – but they are an imperfect gauge of competitiveness.’

II.4 Labour Cost Dynamics

Table 5. Labour Cost Adjustment 2009-2016

					Real Unit Labour Costs 2009-2016						Nominal Unit Labour Costs 2009-2016					
Rank					Absolute			Shift from 2000-2009 relative to Euro 19			Absolute			Shift from 2000-2009 relative to Euro 19		
2016	2015	Country	Score	*Change*	Percent	Score	*Change*	Percent	Score	*Change*	Percent	Score	*Change*	Percent	Score	*Change*
1	1	Ireland	**9.2**	*0.0*	-18.9	**10.0**	*0.0*	28.2	**10.0**	*0.0*	-14.9	**10.0**	*0.0*	29.1	**6.9**	*0.1*
2	2	Greece	**7.3**	*-0.3*	-6.8	**5.5**	*-0.5*	12.9	**6.4**	*-0.4*	-10.9	**8.8**	*-0.2*	39.6	**8.3**	*0.0*
3	3	Cyprus	**6.9**	*0.5*	-8.2	**6.5**	*0.2*	12.8	**6.4**	*0.7*	-7.5	**7.5**	*0.5*	33.0	**7.4**	*0.8*
4	4	Luxembourg	**6.1**	*0.2*	-10.1	**7.9**	*0.8*	21.0	**9.0**	*0.1*	6.1	**2.3**	*0.3*	17.6	**5.3**	*-0.3*
5	5	Portugal	**5.8**	*0.0*	-11.2	**8.7**	*0.4*	3.6	**3.4**	*0.0*	-5.0	**6.5**	*-0.4*	11.3	**4.4**	*-0.1*
6	6	Spain	**5.4**	*-0.4*	-6.4	**5.2**	*-0.5*	4.4	**3.7**	*-0.4*	-4.9	**6.5**	*-0.5*	23.5	**6.1**	*-0.1*
7	7	Romania	**5.0**	*-0.1*	-17.9	**10.0**	*0.0*	-8.0	**0.0**	*-0.4*	19.8	**0.0**	*0.0*	138.9	**10.0**	*0.0*
8	10	Slovenia	**4.6**	*-0.2*	-3.8	**3.3**	*0.2*	2.6	**3.1**	*-0.1*	0.6	**4.4**	*-0.7*	34.3	**7.6**	*-0.2*
9	8	Estonia	**4.3**	*-0.6*	-1.7	**1.8**	*-1.5*	9.9	**5.5**	*-0.8*	20.2	**0.0**	*0.0*	51.8	**10.0**	*0.0*
10	12	Croatia	**4.2**	*-0.3*	-9.6	**7.6**	*-0.5*	1.6	**2.8**	*-0.4*	3.5	**3.3**	*-0.4*	3.2	**3.3**	*-0.1*
11	9	Latvia	**4.1**	*-0.7*	-1.5	**1.6**	*-1.6*	7.3	**4.6**	*0.0*	12.0	**0.0**	*-1.4*	69.8	**10.0**	*0.0*
12	14	Italy	**3.5**	*0.2*	-2.5	**2.3**	*0.7*	6.4	**4.3**	*0.1*	4.4	**2.9**	*0.0*	12.5	**4.6**	*0.1*
		Euro 19	**2.5**	*0.1*	-2.4	**2.2**	*0.4*	0.0	**2.3**	*0.0*	4.9	**2.7**	*-0.1*	0.0	**2.9**	*0.0*
13	18	Hungary	**2.5**	*-0.3*	-5.2	**4.3**	*-0.4*	-2.5	**1.4**	*-0.4*	20.0	**0.0**	*0.0*	10.0	**4.2**	*-0.4*
14	19	Finland	**2.5**	*0.2*	-2.7	**2.5**	*1.1*	6.9	**4.5**	*0.3*	10.5	**0.6**	*-0.3*	-3.5	**2.4**	*-0.1*
15	16	Denmark	**2.4**	*-0.6*	-2.9	**2.6**	*-1.2*	9.4	**5.3**	*-0.7*	16.7	**0.0**	*0.0*	-9.4	**1.6**	*-0.4*
16	13	United Kingdom	**2.3**	*-1.1*	-3.1	**2.8**	*-2.8*	6.5	**4.4**	*-0.5*	12.8	**0.0**	*-0.9*	-6.7	**2.0**	*-0.4*
17	11	Lithuania	**2.3**	*-2.4*	-1.8	**1.9**	*-4.0*	2.5	**3.1**	*-2.0*	13.0	**0.0**	*-2.5*	8.8	**4.1**	*-1.0*
18	21	Belgium	**2.2**	*0.1*	-2.3	**2.2**	*0.4*	1.5	**2.7**	*0.0*	7.9	**1.6**	*-0.2*	-3.9	**2.3**	*0.0*
19	15	Malta	**2.1**	*-0.8*	-2.7	**2.5**	*-1.2*	3.1	**3.3**	*-0.7*	14.0	**0.0**	*-0.8*	-1.0	**2.7**	*-0.5*
20	17	Slovakia	**2.1**	*-0.7*	1.3	**0.0**	*-1.1*	-3.6	**1.1**	*-0.9*	4.7	**2.8**	*-0.8*	11.3	**4.4**	*-0.2*
21	20	Netherlands	**1.7**	*-0.5*	1.1	**0.0**	*-0.9*	-3.0	**1.3**	*-0.7*	5.5	**2.5**	*-0.4*	1.7	**3.1**	*-0.1*
22	23	France	**1.6**	*0.0*	0.7	**0.0**	*0.0*	-0.9	**2.0**	*0.0*	6.9	**2.0**	*0.1*	-2.5	**2.5**	*0.1*
23	24	Austria	**1.2**	*0.3*	-1.5	**1.6**	*1.3*	-2.9	**1.3**	*0.4*	10.9	**0.4**	*-0.3*	-11.7	**1.3**	*-0.1*
24	22	Czech Republic	**1.1**	*-0.9*	1.4	**0.0**	*-0.9*	-0.2	**2.2**	*-0.8*	11.5	**0.2**	*-1.2*	-4.9	**2.2**	*-0.4*
25	25	Sweden	**1.1**	*0.3*	-1.2	**1.4**	*1.0*	1.9	**2.9**	*0.2*	18.1	**0.0**	*0.0*	-20.7	**0.0**	*-0.1*
26	27	Poland	**0.8**	*0.4*	-3.4	**3.0**	*1.2*	-14.1	**0.0**	*0.0*	11.1	**0.3**	*0.3*	-22.8	**0.0**	*0.0*
27	26	Germany	**0.7**	*0.0*	-1.2	**1.4**	*0.5*	-5.4	**0.5**	*0.0*	9.9	**0.8**	*-0.3*	-20.1	**0.1**	*-0.1*
28	28	Bulgaria	**0.0**	*0.0*	19.9	**0.0**	*0.0*	-25.9	**0.0**	*0.0*	53.8	**0.0**	*0.0*	-28.9	**0.0**	*0.0*

Ranks, scores and score changes for Labour Cost Adjustment Indicator and sub-indicators. Values: (1) 2009-2016 cumulative change in real unit labour costs, in %; (2) shift in cumulative real unit labour cost change between periods 2000-2009 and 2009-2016, relative to the Eurozone, in %; (3) 2009-2016 cumulative change in euro nominal unit labour costs, 2007-2016 for non-eurozone countries, in %; (4) shift in cumulative euro nominal unit labour cost change between periods 2000-2009 and 2009-2016, relative to the eurozone, 2000-2007 to 2007-2016 for non-eurozone countries, in % . For further explanations see notes under Table 2 on page 6 and the Notes on Key Components on page 63.

‘Most of the euro members with excessive wage increases until 2009 have gone through a big correction.’

Labour costs are an imperfect gauge of competitiveness. The ultimate yardstick of competitiveness is whether or not a company or country can profitably sell its wares. But as other factors such as changes in product quality, brand value, consumer tastes and the mix of goods and services offered by a company or a country are often shaped by longer-term processes and are more difficult to quantify, changes in nominal and real unit labour costs do provide some useful insights into the near-term adjustment dynamics of a country. This holds especially true if a decline in unit labour costs goes along with a rise in net exports, indicating that a country has indeed improved its competitive position.

To evaluate adjustment progress, we examine how much changes in nominal and real unit labour costs are deviating from the eurozone average. We conduct the analysis in three steps. First, we calculate the cumulative change in real unit labour costs between 2009 and 2016 and rank countries according to their deviation from the eurozone average, awarding the highest score to the country with the biggest relative decline. Second, we relate this to what happened in the 2000-2009 period, assigning the best score to the country which made the biggest shift from an above-average cumulative rise in unit labour costs in the earlier period to a below-average increase thereafter. Third, we repeat the exercise for nominal unit labour costs. We then derive an overall score and ranking by combining these components.

Overall, six results stand out:

1. On a seven-year view, wage pressures have converged within the **eurozone**: most of the euro members with excessive wage increases until 2009 have gone through a big correction. Under the pressure of record unemployment and the lagging impact of a deep adjustment crisis that lasted until 2013, the five countries that had to ask taxpayers elsewhere for help have slashed their labour costs the most. **Ireland** (No. 1) tops the ranking for labour cost adjustment ahead of **Greece** (No. 2), **Cyprus** (No. 3), **Portugal** (No. 5) and **Spain** (No. 6).

2. Conversely, nominal unit labour costs have risen significantly in many core countries such as **Germany** (No. 27), **Austria** (No. 23), **France** (No. 22) and **Belgium** (No. 18) during the last seven years. For Germany and to a lesser extent Austria, it makes sense to be close to the bottom of the European league table as their labour markets are comparatively healthy. For France and Belgium, the low scores are more problematic.

3. The process of labour cost convergence seems to have largely stalled in the last two years, though. Instead of the clear core versus periphery split that had been apparent until 2014, the picture has become much more nuanced in 2015 and 2016. Whereas the scores for **Ireland** and **Portugal** remain almost unchanged in 2016, **Spain** and **Greece** fall back slightly as wages started to rebound in Spain while the relapse into recession hurt productivity in Greece.

4. The real problem in the eurozone remains **France** (No. 22). The inflexible French labour market has still not responded adequately to the challenge of globalisation. In France’s rigid labour market, labour costs remain excessive. As a result, French unemployment – at 10.1% in Q3 2016 – remains stubbornly high. Fortunately, France is at least taking some steps in the right direction. Taking two

‘France still has a long way to go towards a well-functioning labour market.’

years together, that is comparing 2016 with 2014, French nominal unit labour costs rose by merely 0.6%, below the 1.3% cumulative increase for the eurozone. However, this did not suffice to raise the French score for overall labour cost adjustment which, at 1.6, remains well below the 2.5 average for the currency area as a whole. France still has a long way to go towards a well-functioning labour market.

5. Like France, **Italy** (No. 12, up from No. 14) also managed to correct its labour cost disadvantage relative to **Germany** slightly. In 2016, the increase in nominal unit labour costs in Italy (+0.5%) trailed behind the eurozone average of +1.0% whereas German unit labour costs rose by an above-average 1.3%.

6. Having been among the star performers until 2014, **Estonia** (No. 9, down from No. 8), and **Latvia** (No. 11, down from No. 9) continue to slide downwards in the ranking with a drop in their scores by 0.6 points and 0.7 points, respectively. They are joined by newcomer **Lithuania** (No. 17), whose score for 2016 is a full 2.4 points below the hypothetical score it would have achieved a year ago if we had already included it in our 2015 exercise. Up to a point, this makes sense. The three small, open economies on the Baltic Sea had successfully concluded their own post-bubble adjustment process two years ago. As they started to relax the reins somewhat since 2014, they are falling behind in the adjustment ranking, including for labour costs. Nonetheless, these countries may soon need to be more careful again. They had best avoid a relapse into the excesses of the previous boom - which then had to be corrected by a bust.

Romania (No. 7) and **Hungary** (No. 13), which we include in the analysis for the first time this year, look similar to the three Baltic countries and **Poland** (No. 26) in one key respect: although their nominal unit labour costs have risen much faster than the eurozone average since 2009, they nonetheless managed to reduce their real unit labour costs by more than the eurozone average. This is a typical feature of catching-up economies as described by the Balassa-Samuelson theorem. From a low starting level, prices for non-tradable goods tend to rise faster in catching-up economies than in more developed economies. As long as these catching-up economies maintain a competitive edge in tradable goods, usually by productivity gains in this sector in line with the overall rise in wages, the resulting gap between higher overall inflation in the catching-up economies and more subdued inflation in the more mature economies is a by-product of development rather than a concern.

To gauge whether these countries have lost competitiveness, we need to look at their export performance. Reassuringly, the three Baltic countries as well as **Romania** rank among the top 10 for external adjustment, with **Hungary** following as No. 11 and **Poland** as No. 15. This suggests that, at least so far, they can afford their above-average wage dynamics.

This even seems to hold for **Bulgaria**. On labour cost adjustment, Bulgaria graces the bottom of the league table (No. 28), just below **Germany** (No. 27), **Poland** (No. 26) and **Sweden** (No. 25). Bulgaria is the only country in the sample with a major increase in real unit labour costs since 2009. Its cumulative increase in real unit labour costs of 19.9% since 2009 makes it an outlier in this category. Nonetheless, Bulgaria managed to raise its exports so substantially over

'The United Kingdom plainly needs to do more rather than less to improve its competitive position.'

this period that comes in at No. 2 in the external adjustment ranking.

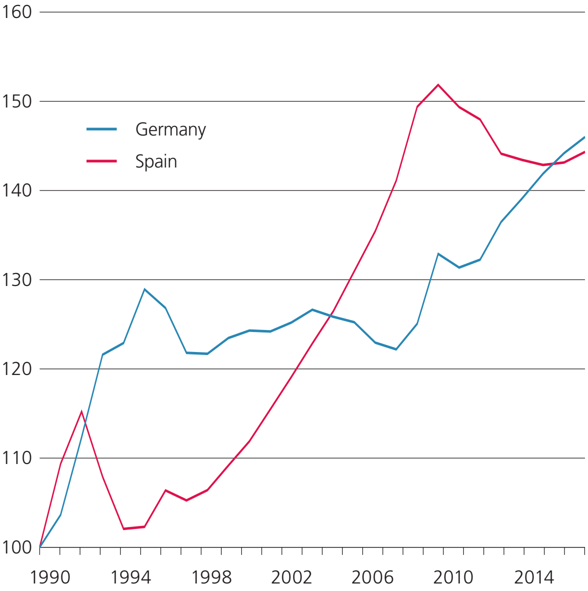
The results are less reassuring for the **United Kingdom**. In the overall ranking for labour cost adjustment, the United Kingdom falls back to No. 16, down from No. 13, largely because its rise in nominal unit labour costs of 1.6% in 2016 outpaced that of the **eurozone** (+1.0%). Unlike Poland, the Baltics and the emerging markets of South-East Europe, the United Kingdom is close to the cutting edge of economic development rather than a catching-up country. The United Kingdom cannot count on above-average productivity gains in export-oriented industries to offset wage cost pressures. Instead, the combination of labour cost competitiveness slippage with a very low score for external adjustment, where the United Kingdom ranks No. 26 out of the 28 members of the European Union, does not bode well for the United Kingdom's competitive position in the future.

Of course, the significant decline in the sterling exchange rate after the vote to leave the European Union on 23 June 2016 will probably help, at least to the extent that it is not eroded over time by a resulting rise in wage and price inflation. But for a country that plainly needs to do more rather than less to improve its competitive position, a decision to put access to its dominant export market at risk looks somewhat foolhardy.

A comparison of the changes in nominal unit labour costs in **Germany** and **Spain** brings out the return to a better balance within the eurozone (see Chart 9 on this page). After serious swings in their relative competitive positions in the past, both countries are now good places for job-creating inward investment. In the wake of the German unification boom, labour costs surged across much

Chart 9. Back to Balance

Nominal Unit Labour Costs Germany versus Spain, 1990=100



Sources: European Commission, Berenberg calculations

of Europe. After Spain devalued the peseta in various steps from September 1992 to March 1995, the temporary boost to its competitive position allowed the country to outgrow Germany by a wide margin. But through wage restraint enforced by mounting unemployment and serious labour market reforms, Germany restored its competitive position over time while Spain became careless in its credit-driven heyday until 2007. With German wage costs rebounding on the back of virtual full employment and Spanish workers forced to tighten their belts, the relative position of Spain versus Germany is now back where it was some 25 years ago. Looking ahead, a simple extrapolation of trends would suggest that German workers need to take care not to allow themselves too much of a party. Otherwise, German employment gains may be much less spectacular in a few years' time than they have been since 2006.

‘The adjustment at the eurozone periphery that we described in the past has largely stalled.’

The analysis of nominal labour costs confirms the key result we had emphasised in the years before. Under the pressure of crisis, those countries that had to ask foreign taxpayers for help have tried hard to regain competitiveness by slashing their labour costs since 2009. **Ireland** with a cumulative drop in unit labour costs by 14.9% since 2009, **Greece** (-10.9%), **Cyprus** (-7.5%), **Portugal** (-5.0%) and **Spain** (-4.9%) are the only countries in the expanded sample with a decline in nominal unit labour costs from 2009 to 2016. Only **Slovenia** (No. 8) – which managed to avoid having to ask for external help by a whisker – comes close with a mere 0.6% increase in its labour costs (see the column on “nominal unit labour costs 2009-2016, in percent” in Table 5 on page 30).

However, the adjustment at the eurozone periphery that we have described above for the full 2009 to 2016 period has largely stalled. For 2016, the European Commission projects a rise in nominal unit labour costs for all of the five former euro crisis countries, with **Greece** (+2.7%) and **Portugal** (+1.3) outpacing the eurozone average (+1.0%) while **Ireland** (+0.9), **Spain** (+0.8%) and **Cyprus** (+0.3%) continue to lag behind.

For the overall analysis, we look at both nominal and real unit labour costs. In terms of the absolute changes in real unit labour costs between 2009 and 2016 (see the column on “real unit labour costs 2009-2016, absolute in percent” in Table 5 on page 30), **Ireland** made the most heroic adjustment (-18.9%), followed by **Romania** (-17.9%), **Portugal** (-11.2%), **Luxembourg** (-10.1%), **Croatia** (-9.6%), **Cyprus** (-8.2%), **Greece** (-6.8%) and **Spain** (-6.4%). The only countries with a cumulative rise in real unit labour costs are **France** (0.7%), the **Netherlands** (1.1%), **Slovakia** (1.3%), the **Czech Republic** (1.4%) and outlier **Bulgaria** (19.9%).

‘Crises are handmaidens of change.
But what happens once the crisis is over?’

II.5 Reform Drive

Table 6. Reform Drive

Rank					OECD reform responsiveness indicator		
2016	2014	Country	Score	Change	Average 2010-2015	2014/2015	Average 2010-2013
1	1	Greece	**7.7**	*-2.3*	0.64	0.30	0.87
2	2	Spain	**6.5**	*-1.9*	0.54	0.30	0.70
3	3	Portugal	**6.3**	*-1.8*	0.53	0.30	0.68
4	4	Ireland	**6.0**	*-2.0*	0.50	0.25	0.67
5	5	Estonia	**5.6**	*-1.5*	0.47	0.27	0.60
6	8	Poland	**5.3**	*0.0*	0.44	0.44	0.45
7	16	Italy	**4.8**	*1.1*	0.41	0.55	0.32
8	15	Czech Republic	**4.6**	*0.9*	0.39	0.50	0.32
		Euro 19	**4.4**	*-0.7*	0.37	0.28	0.42
9	11	Austria	**4.3**	*-0.5*	0.36	0.30	0.40
10	10	Slovakia	**4.3**	*-0.8*	0.36	0.25	0.43
11	11	Hungary	**4.2**	*-0.5*	0.35	0.28	0.40
12	7	United Kingdom	**4.1**	*-1.6*	0.35	0.14	0.48
13	17	France	**4.0**	*0.4*	0.34	0.39	0.31
14	6	Denmark	**4.0**	*-2.0*	0.34	0.08	0.50
15	9	Finland	**3.9**	*-1.3*	0.33	0.17	0.44
16	11	Slovenia	**3.4**	*-1.4*	0.28	0.10	0.40
17	14	Sweden	**3.2**	*-1.3*	0.27	0.10	0.38
18	18	Netherlands	**3.1**	*0.5*	0.26	0.33	0.22
19	19	Belgium	**2.6**	*0.5*	0.22	0.28	0.18
20	20	Germany	**2.4**	*0.4*	0.20	0.25	0.17
21	21	Luxembourg	**1.4**	*0.4*	0.12	0.17	0.09
		Bulgaria	**n.a.**	*n.a.*	n.a.	n.a.	n.a.
		Croatia	**n.a.**	*n.a.*	n.a.	n.a.	n.a.
		Cyprus	**n.a.**	*n.a.*	n.a.	n.a.	n.a.
		Latvia	**n.a.**	*n.a.*	n.a.	n.a.	n.a.
		Lithuania	**n.a.**	*n.a.*	n.a.	n.a.	n.a.
		Malta	**n.a.**	*n.a.*	n.a.	n.a.	n.a.
		Romania	**n.a.**	*n.a.*	n.a.	n.a.	n.a.

Ranks, score and score changes for the reform drive indicator. The values given for the OECD reform responsiveness indicator refer to the average results from the OECD’s Going for Growth data for 2010-11 and 2012-13 combined (last column) and 2014-15 (second last column). The 2010-15 aggregate is a weighted average of the three two-year periods before, with 2014-15 given slightly more weight (40%) than the two previous periods (30% each). 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 until the end of 2015 as 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, Berenberg calculations. For further explanations see notes under Table 2 on page 6.

'The good news comes from Italy. Under Prime Minister Renzi, Italy finally moved in the right direction.'

To seize the opportunities of globalisation and rapid technological change, countries need to adjust. In addition, countries that have lived beyond their means also need to tighten their belts. But squeezing domestic demand, slashing labour costs and raising exports are only part of the solution. To make their fiscal positions sustainable in the long run without excessive pain, countries need to raise their long-term growth potential. In short, they need pro-growth structural reforms.

Crises are handmaidens of change. Under the pressure of crisis, governments at the euro periphery have taken many steps to make their economies leaner and fitter for growth. They have reformed labour markets, cut pension and other welfare entitlements, streamlined administrative procedures and deregulated product markets. While the benefits of such reforms only show up with a lag, typically only when the initial adjustment recession has given way to a new upswing, such reforms ultimately matter more than the initial readiness to rein in excesses in public or private spending.

To measure how much countries have done, we employ the expertise of the OECD: the OECD regularly identifies five priority areas for reform for most of its member countries. In each of these areas it makes a number of concrete recommendations and subsequently measures whether these have been followed up (Score 1) or not (Score 0) with a full assessment every two years and an interim assessment in between. We use the data for three two-years periods, 2010/11, 2012/13 and 2014/15. The latest data draw on the results of the February 2016 interim assessment "Going for Growth" report, with the cut-off date 31 December 2015. As the OECD has not yet published an assessment for 2015/16, the analysis in this section is almost identical with the results we presented in *The Euro Plus Monitor Spring 2016 Update* on 23 May 2016.

The OECD data reveal some dramatic changes for the 2014-2015 assessment period relative to the years before. With some notable exceptions, most countries in the sample felt less compelled to pursue pro-growth structural reforms in 2014-2015 than before. This holds even more so for the **United Kingdom** than the **eurozone**.

Within the **eurozone**, the countries that were the focus of the euro crisis at the time and had to ask other countries' taxpayers for help did reform at an impressive speed in the four years from 2010 to 2013. They had little choice than to do what was needed. In the 2014-2015 period, however, they became far less responsive to reform recommendations. Having implemented 87% of the OECD recommendations to a significant extent on average in the 2010-2013 period, **Greece** followed the OECD's advice only to 30% in the 2014-2015 period. Separate OECD data for the two-year average of 2013-2014 suggest that, within the two-year period of 2014-2015, the slippage was worse in 2015 than in 2014. **Spain**, **Ireland** and **Portugal** also scaled back their reform efforts in 2014-2015 significantly.

The good news comes from **Italy** (No 7, up from No. 16). Judging by its consistently low score in the fundamental health assessment (No. 25 in 2016 and 2015), Italy's economy is one of the most structurally challenged in Europe. Under Prime Minister Renzi, Italy finally moved in the right direction in 2014 and 2015. Having implemented only 32% of OECD recommendations in 2010-2013, its responsiveness to reform recommendations rose to 55% in 2014-2015. For these two years, Italy has thus been the reform leader among all 21 countries in our sample. Even **France** (No. 13 after No. 17) became a bit more serious about reforms, following up on 39% of OECD recommendations in 2014-2015 after 31% in the four years before.

'Countries with a major loss of reform momentum include the United Kingdom, Estonia, Sweden and Finland.'

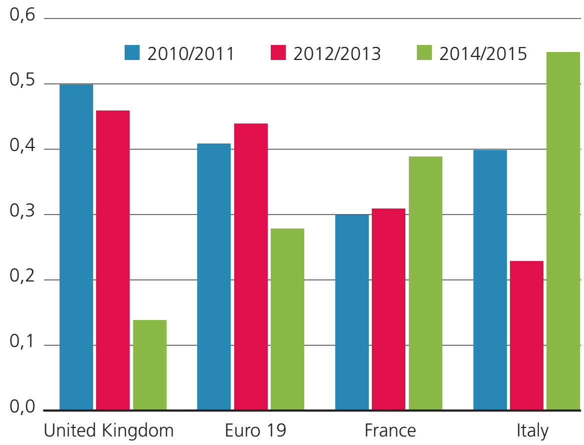
Countries with a major loss of reform momentum in the 2014/15 period include the **United Kingdom**, **Estonia**, **Slovenia**, **Sweden** and **Finland**. For Estonia, which had reformed itself thoroughly and successfully in the wake of the Baltic crisis almost 10 years ago, this may be understandable. For Slovenia, Sweden, Denmark and Finland, however, we view this as a sign of complacency. Especially Finland, which is currently one of the weakest members of the eurozone, ought to do much better to get back on track.

For the overall assessment of adjustment progress since 2010, we take the weighted average of all reform efforts of the last six years, giving slightly more weight to the 2014-2015 period than to the years before. Because the erstwhile euro-crisis countries did reform at such a rapid pace from 2010 to 2013, they stay at or close to the top in the reform league. However, their scores drop significantly relative to last year. While progress continues, the pace of additional reforms has slowed down substantially. In some cases, we can find a positive interpretation for that. Because **Spain** (No. 2) and **Ireland** (No. 4) have reformed themselves successfully, they no longer need to do as much as before. In the case of **Greece** (No. 1), the story is different. When the Greek economy returned to growth in early 2014, the previous Greek government may have believed that it could afford to implement reforms slightly less diligently than before. This caused the OECD's score to decline marginally. With the change in government in early 2015, reforms stalled almost across the board. Even worse, by threatening serious reform reversals, the new Greek government aborted the fragile recovery.

Some comparatively healthy core eurozone countries which need few reforms feature at the bottom of the table with the **Netherlands** at No. 18, **Germany** at No. 20 and **Luxembourg** at the bottom at No. 21. Because of its below-average ranking for fundamental health overall (No. 20), the lack of serious reforms in **Belgium** (No. 19) is more worrisome. Whereas Belgium's score has improved modestly against the overall trend in Europe, it remains far too low for comfort.

Chart 10. Pace of Pro-Growth Reforms

Responsiveness to OECD reform recommendations during the various two-year periods



Scale of 0 (no progress) to 1 (excellent pace of reforms).
Source: OECD

The OECD measures the responsiveness to reform recommendations for three of the six countries that we have included in our analysis for the first time. All three are close to the middle of the range, with the **Czech Republic** (No. 8) somewhat above the eurozone average whereas **Hungary** (No. 11) and **Denmark** (No. 14) score slightly below the average. In terms of their recent momentum, the Czech Republic became more responsive in 2014-2015 than it had been in the four years before while Hungary and, even more so, Denmark implemented fewer reforms in the 2014-2015 period than they had before.

III. Fundamental Health Indicator

III. 1 Overall Health

Table 7. Fundamental Health Indicator

Rank			Total score			Growth			Competitiveness			Fiscal sustainability			Resilience		
2016	2015	Country	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
		Euro 19	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
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

Ranks, scores and score changes for the Overall Health Indicator and sub-indicators. For further explanations see notes under Table 2 on page 6 and the Notes on Key Components on page 63.

'The top spot this year goes to a newcomer in the ranking, the Czech Republic.'

The **Fundamental Health Indicator** is designed to identify underlying strengths and weaknesses of European countries. It complements the Adjustment Progress Indicator. Ideally, countries with below-average scores for their fundamental health should be reforming and feature above average in the separate adjustment scores. While the criteria to assess the health of countries are inspired by the European Union's Euro Plus Pact (2011), their selection owes as much to the factors that contributed so greatly to the European and global financial crises since 2008.

Since we look at long-run averages and slow-moving aggregates like debt levels, changes from year to year tend to be small even for those countries with deep economic crises and fast adjustment processes. In addition, deep adjustment crises tend to have a "J-curve" impact on some key criteria of fundamental health – meaning initial losses are often followed later by significant up-ticks; the situation often gets worse before its gets better. For example, the temporary decline in GDP that often goes along with fiscal repair will raise the ratio of debt to GDP in the short term, but have a long-term positive impact on the debt-to-GDP ratio over time and hence on one key measure of fiscal sustainability. In the same vein, the number of long-term unemployed usually goes up in the initial adjustment crisis, too, worsening the score for human capital. It usually takes at least five years after a country has left its adjustment recession and starts to reap the rewards of its efforts for debt ratios to fall below the pre-crisis level. For long-term unemployment, the lag can be significantly longer, especially if the labour market has not been made sufficiently flexible.

The primary purpose of the Fundamental Health Indicator is not to look at such J-curve effects but to analyse the longer-term issues that will shape the economic outlook for European economies well beyond their current immediate challenges.

Because of the longer-term focus, the results of the Fundamental Health Indicator do not change much from year to year. In some cases, data revisions affect the ranking by as much as the most recent changes in actual economic performance.

As in 2015, the analysis shows that **Luxembourg** (No. 2), **Estonia** (No. 3), **Germany** (No. 4), **Slovakia** (No. 5) and the **Netherlands** (No. 6) are among the most fundamentally sound economies in the Euro Plus Monitor sample. Germany excels in terms of competitiveness with its strong export sector. It also scores exceptionally well for fiscal sustainability because of its fiscal surplus and its rapidly declining ratio of public debt to GDP. The Netherlands look somewhat similar to Germany in terms of competitiveness. They score significantly lower for fiscal sustainability, but partly offset this by stronger growth potential.

However, the top spot this year goes to a newcomer in our ranking, the **Czech Republic** (No. 1). On most counts, its scores are similar to that of neighbouring Germany except for its significantly better rate of trend growth. Most other newcomers also do fairly well. **Lithuania** (No. 8) comes in slightly above **Latvia** (No. 10) which, like its Baltic neighbour **Estonia** (No. 3), had been included in the 2015 analysis already. The scores for **Denmark** (No. 14), **Hungary** (No. 15) and **Bulgaria** (No. 16) exceed the eurozone average whereas **Romania** (No. 17) matches that average. Of the newcomers, only **Croatia** (No. 21) faces more long-term fundamental problems than the eurozone average with low scores especially for trend growth and competitiveness. Except for Croatia and Hungary, all newcomers have a significantly more sustainable fiscal position than the **eurozone**

‘Encouragingly, Ireland moves up again in the ranking for fundamental health.’

average and the **United Kingdom** (No. 18). Hungary, the Czech Republic and Lithuania are also among the most competitive economies in the expanded sample of 28 countries.

With an almost unchanged score of 5.6, up from 5.5 in 2015, the **United Kingdom** (No. 18 after No. 19 last year) comes in modestly below the **eurozone** average of 5.9 largely because of its comparatively mediocre results for competitiveness and resilience. While the UK has improved its fiscal health with further fiscal repair in 2016, its huge current account deficit (an estimated 5.6% of GDP in 2016) and a low personal savings rate weigh on the ranking of the UK. That the UK’s growth potential exceeds that of the **eurozone** average mitigates the damage but does not suffice to close the gap to the eurozone average.

Italy (No. 25), **Portugal** (No. 26), **Cyprus** (No. 27), and **Greece** (No. 28) remain at the bottom of the league. All four countries, Greece in particular, have very low scores for trend growth. In the case of Cyprus, an insufficient resilience against future financial crises due to a high level of private debt and a still outsized financial sector remains a major concern. Cyprus shares a weak competitiveness score with Italy.

France (No. 23) and **Finland** (No. 24) also look sickly on their long-term fundamentals. In the case of France, we are particularly concerned about a fiscal position that is less sustainable than that of most other Euro Plus Monitor countries except **Belgium** and **Greece**. Of course, fiscal tightening need not be the remedy. If France could unlock its growth potential through supply-side reforms, its fiscal position could improve significantly without any need for tax hikes. France also needs major efforts to become more competitive. For Finland, the lack of competitiveness is by far the biggest single problem. On all other counts, Finland equals or is not too far away from the eurozone average.

The results for fundamental health change only slowly over time. Nonetheless, comparing the 2016 results to those of 2015, we find some significant changes.

The fundamental health of **Greece**, **Cyprus** and **Portugal** has deteriorated further in the last few years. For Portugal, this largely reflects an insufficient rise in exports. For Greece, the lower score comes mostly from a downward revision to its rate of potential growth. Both countries, which had made headlines with some reform reversals in 2015, need to do more to become more attractive for inward investment, especially in export-oriented industries.

Encouragingly, **Ireland** moves up again in the ranking for fundamental health to No. 9, up from No. 11, with a rise in its score by 0.2 points. Ireland’s sub-indicator for trend growth improved strongly in 2016 owing to its continuing rapid recovery from its crisis of 2012-2013.

For **Spain** (No. 22), the 2015 pre-election fiscal stimulus and the inability to control regional expenditures during the political uncertainty of 2016 have impaired the long-term fiscal sustainability slightly. However, the advance in the country’s trend rate of economic growth and the stronger resilience score offset the damage. As a result, Spain’s overall score for fundamental health remains unchanged at 4.9, below the eurozone average of 5.9 but in line with the result for **France** (No. 23).

Although the countries at the **eurozone** periphery except Ireland remain in the bottom third of the ranking for fundamental health, they have

‘Austria’s consistently low scores for adjustment progress have begun to affect its fundamental health.’

made progress over the last five years. Their fiscal sustainability still looks shaky as the progress in bringing down underlying fiscal deficits has gone along with a rise in the debt ratios caused by the severe adjustment recession. But they have turned their external accounts around convincingly, improving their positions by more than Germany and the eurozone average. If they stay the course, they should see their score for fundamental health improve over further time, as it did for Ireland in the last two years already.

Austria (No. 19) is gradually turning into a concern. Its consistently low scores for adjustment progress have begun to impact its fundamental health. With modest slippage on almost all counts, Austria’s score falls by 0.2 points to 5.5. While not yet in the danger zone, the score is now visibly below the eurozone average of 5.9.

To assess the fundamental health of the 28 European countries surveyed in *The 2016 Euro Plus Monitor*, we look at four sub-indicators: 1) long-term growth potential, 2) competitiveness, 3) fiscal sustainability, and 4) fundamental resilience to financial shocks. We assess countries on each of these four sub-indicators, and assign a score from 0 (the worst possible) to 10 (the best possible). Then we bring the four sub-indicators together in one overall score and rank the countries according to that.

The four pillars of the analysis largely overlap with the four goals of the Euro Plus Pact, adopted by the European Council in 2011: 1) to foster employment, 2) foster competitiveness, 3) contribute further to the sustainability of public finances and 4) reinforce financial stability.[8] The guiding ideas of the Pact still make fundamental sense. More importantly, many European Union members are making great strides towards putting them into practice.

As the results do not change much within one year, we present the findings in a more summary way than we had done in the years 2011 to 2014. We look at the four pillars in turn but do not add in-depth discussions of all components that make up these pillars. For more details, see the Methodological Notes on page 63 as well as previous editions of *The Euro Plus Monitor*. After explaining the separate scores for each of the four pillars, we discuss the aggregate results for the Fundamental Health Indicator.

8. European Council, *European Council Conclusions EUCO 10/1/11 REV 1, 24-25 March 2011* (Brussels: European Council, 2011).

‘Growth does not cure all economic and social ills. But it helps.’

III. 2 Growth Potential

Table 8. Growth Potential

Rank			Total score			Recent growth			Human capital			Employment			Consumption		
2016	2015	Country	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015
1	3	Sweden	7.4	*0.4*	7.0	8.2	*1.0*	7.2	5.6	*0.3*	5.2	7.1	*0.1*	7.0	8.7	*0.1*	8.5
2	5	Ireland	7.2	*0.5*	6.8	6.7	*1.8*	4.9	7.1	*-0.3*	7.4	5.1	*0.2*	4.9	10.0	*0.1*	9.9
3	2	Czech Republic	7.2	*0.1*	7.1	8.2	*0.2*	8.0	3.8	*-0.2*	4.1	6.7	*0.2*	6.5	10.0	*0.0*	10.0
4	1	Netherlands	7.1	*-0.2*	7.2	6.4	*-0.5*	6.9	5.1	*-0.3*	5.5	7.6	*0.1*	7.6	9.0	*0.1*	9.0
5	4	Malta	7.0	*0.0*	7.0	10.0	*0.0*	10.0	4.4	*-0.1*	4.4	6.5	*0.1*	6.4	7.0	*-0.1*	7.1
6	6	Estonia	6.9	*0.2*	6.8	8.1	*0.8*	7.3	5.8	*-0.1*	5.9	6.8	*0.1*	6.6	7.1	*-0.2*	7.3
7	7	Luxembourg	6.5	*-0.1*	6.7	n.a.	*n.a.*	n.a.	4.2	*-0.3*	4.5	6.4	*-0.2*	6.6	9.0	*0.1*	8.9
8	10	Latvia	6.3	*0.0*	6.3	9.6	*0.5*	9.2	4.1	*-0.3*	4.4	5.9	*0.2*	5.7	5.7	*-0.3*	6.0
9	8	Germany	6.3	*-0.2*	6.5	6.4	*-0.6*	7.0	3.8	*-0.2*	4.0	7.8	*0.1*	7.7	7.3	*-0.2*	7.4
10	9	Poland	6.2	*-0.1*	6.3	8.7	*0.0*	8.7	4.2	*-0.5*	4.7	4.6	*0.2*	4.4	7.5	*0.0*	7.5
11	15	Lithuania	6.1	0.2	5.9	10.0	*0.9*	9.1	3.6	-0.2	3.9	5.9	*0.3*	5.6	4.7	*-0.3*	5.1
12	14	Denmark	6.1	0.1	6.0	4.6	*0.2*	4.5	5.2	0.2	5.0	7.6	*0.2*	7.5	6.8	*-0.1*	6.8
13	12	Slovenia	6.0	*0.0*	6.0	6.0	*-0.5*	6.4	4.0	*0.4*	3.6	6.0	*0.1*	5.9	8.0	*0.0*	8.0
14	11	Austria	5.9	*-0.3*	6.2	5.0	*-0.9*	5.9	3.1	*-0.2*	3.4	7.6	*0.0*	7.7	7.8	*0.0*	7.8
15	13	Slovakia	5.9	*-0.1*	6.0	8.9	*-0.7*	9.6	2.8	*0.0*	2.9	3.4	*0.3*	3.2	8.4	*0.1*	8.3
16	19	United Kingdom	5.7	*0.4*	5.3	5.1	*1.6*	3.5	6.1	*-0.2*	6.3	7.1	*0.1*	7.0	4.4	*-0.1*	4.4
17	18	Hungary	5.5	*0.1*	5.4	4.5	*1.0*	3.4	3.4	*-0.6*	4.0	5.8	*0.3*	5.4	8.3	*-0.4*	8.7
18	17	Belgium	5.4	*-0.1*	5.5	4.3	*-0.1*	4.5	4.9	*-0.3*	5.2	5.0	*0.0*	5.0	7.6	*0.1*	7.4
19	16	Finland	5.4	*-0.3*	5.7	4.3	*-1.1*	5.3	6.0	*-0.3*	6.3	6.3	*0.0*	6.3	5.0	*0.0*	5.1
		Euro 19	5.1	*0.0*	5.1	4.5	*0.2*	4.3	4.1	*-0.1*	4.2	5.3	*0.1*	5.3	6.6	*0.0*	6.6
20	20	Bulgaria	5.1	*-0.2*	5.3	6.2	*-1.1*	7.3	3.6	*-0.1*	3.7	5.1	*0.1*	5.0	5.4	*0.3*	5.1
21	22	France	5.1	*0.1*	5.0	4.0	*0.4*	3.6	5.6	*-0.1*	5.8	5.1	*0.0*	5.1	5.4	*0.0*	5.4
22	21	Romania	4.9	*-0.2*	5.1	7.2	*-0.5*	7.7	3.8	*0.0*	3.8	5.2	*0.0*	5.2	3.3	*-0.5*	3.7
23	23	Spain	4.2	*0.3*	4.0	4.2	*0.7*	3.4	3.3	*0.1*	3.2	2.7	*0.1*	2.6	6.7	*0.1*	6.6
24	24	Croatia	3.6	*-0.2*	3.8	2.3	*-0.5*	2.8	3.3	*-0.2*	3.5	2.3	*0.1*	2.2	6.5	*-0.1*	6.6
25	25	Portugal	3.5	*0.0*	3.5	2.0	*-0.4*	2.4	4.1	*0.2*	3.9	3.9	*0.1*	3.8	3.8	*-0.1*	3.9
26	26	Italy	3.3	*-0.1*	3.4	1.1	*-0.1*	1.2	3.4	*-0.1*	3.4	3.5	*0.0*	3.5	5.3	*-0.1*	5.4
27	27	Cyprus	3.0	*-0.2*	3.2	0.8	*-0.9*	1.7	3.1	*0.0*	3.1	5.1	*0.0*	5.1	3.1	*0.2*	2.9
28	28	Greece	1.5	*-0.8*	2.3	0.4	*-3.4*	3.8	2.4	*-0.1*	2.4	0.8	*0.1*	0.7	2.5	*0.1*	2.4

Ranks, scores and score changes from last year for the Growth Potential Indicator and sub-indicators. For further explanations see notes under Table 2 on page 6 and the Notes on Key Components on page 63.

‘By and large, Malta and Lithuania seem to have the policies in place to utilise their catching-up potential.’

Growth does not cure all economic and social ills. But it helps. To gauge the long-term ability of an economy to expand, we assess four major factors: 1) recent trend growth, 2) human resources, 3) the labour market, and 4) a country’s propensity to save rather than consume. We first present the key overall results before we look more closely at the four sub-criteria.

Overall assessment of trend growth
Combing the sub-criteria for growth potential, we find three countries with excellent scores at the top, namely **Sweden** (No. 1), **Ireland** (No. 2) and the **Czech Republic** (No. 3). The **Netherlands** (No. 4) fall back slightly largely because of sluggish growth in the last few years. At the bottom of the league, **Portugal** (No. 25), **Italy** (No. 26), **Cyprus** (No. 27) and **Greece** (No. 28) have the lowest growth potential for the time being, and hence a strong need to do something about it. Of course, this long-term analysis is shaped by the data for recent years. Once reforms in Italy, Cyprus and – hopefully – in Greece bear fruit, their scores can improve.

Recent trend growth
The obvious starting point to analyse the long-term growth potential of a country is the actual recent performance. To correct for boom-bust cycles in real estate – a common problem of some economies inside and outside the eurozone at least until 2008 – we look at the trend in real gross value added (GVA) outside the construction sector. We also adjust the data for increases in labour supply. By relating a measure of actual output to a measure of potential input, we calculate a variant of productivity. But this variant takes the available pool of labour (total number of 15-64 year-olds, i.e, the potential labour force) rather than actual use of labour (number of employed) as its base.
We will deal with the way a country utilises its human resources in a paragraph on the labour market on page 44.

For the overall ranking of recent trend growth, we combine two sub-indices, namely 1) the actual average annual increase in GVA per 15-64 year-olds, and 2) the deviation of that growth from our model estimate of how fast a European country with that starting level should expand. Simply comparing growth rates can be misleading. Mature economies with high levels of productivity typically find it more difficult to grow fast than less mature economies, which are exploiting their potential to catch up.

Malta and **Lithuania** top the league for recent trend growth, followed by **Latvia**, **Slovakia**, **Poland**, **Sweden**, the **Czech Republic** and **Estonia**. With the exception of rich Sweden, these are all economies with significant potential to catch up with the more advanced members of the European Union. By and large, these countries seem to have the policies in place that are required to utilise that potential. **Greece**, **Cyprus** and **Italy** languish at the bottom of the league for recent trend growth. For *The 2016 Euro Plus Monitor*, we have extended the base period to calculate trend growth by six years to include the full 2002-2016 period.[9] So far, we had used the data until 2010 to calculate the underlying trend. This change has affected the score for Greece significantly. While all other countries had at least some recovery from their euro crisis setback during this period, Greece’s futile confrontation with its creditors in early 2015 had pushed the country back so much

9. For Ireland, we use the period only until 2014 to exclude those years which are heavily influenced by the outlier in Q1 2015 when the Irish economy expanded by more than 20% quarter on quarter, see also the notes on Methodology on page 63.

‘Germany makes better use of its human resources than any other country in the sample.’

that it affected the overall estimate for recent trend growth significantly. Arguably, if Greece does not repeat such a policy mistake but stays on the path of recovery, the estimate of Greek trend growth as derived from the backward-looking methodology could improve in coming years.

Human resources

The assessment of human resources includes data for fertility, educational achievement according to the OECD’s Programme for International Student Assessment (PISA) as well as an index to measure how well countries are integrating immigrants into their labour market.

Ireland gets top marks for its human resources largely because of its comparatively high fertility rate of 2.0 and its proven record of integrating immigrants. The **United Kingdom** and **Finland** also score fairly well whereas the results are particularly bad for **Greece** and **Slovakia** (its very low PISA scores are not offset by any strength in other categories). That some of the catching-up economies at the eurozone periphery such as **Croatia**, **Hungary**, **Bulgaria** and **Lithuania** have a lot of room to improve the use of their human resources may be almost understandable, although the much better results for **Estonia** show that it can be done in economies with per-capita GDP well below the eurozone average. The dismal results for **Cyprus** and **Austria** (below average PISA score, significant problems in integrating immigrants) are more difficult to justify. They seem to reflect deep-seated structural problems.

Labour market

To analyse whether countries make use of their human potential, we look at overall employment, the share of young people and long-term unemployed in total joblessness as well as measures of labour market flexibility.

Germany makes better use of its human resources than any other country in the sample, closely followed by **Austria**, **Denmark** and the **Netherlands**. These comparatively advanced countries offer sufficient jobs to combine a high employment rate with comparatively low rates of unemployment for young people. Conversely, some of the emerging markets on the Southern and Eastern periphery still have rather low rates of employment as much of the transition to a modern service economy with a high rate of female employment still lies ahead for these countries. Reflecting its deep crisis of recent years and a labour market that is only gradually becoming more flexible, **Greece** suffers from an unusually high degree of youth unemployment and a large number of long-term unemployed.

Consumption

We round off our analysis of long-term growth potential with a look at total final consumption. The smaller the share of total consumption in GDP, the more a country saves, allowing it to invest its savings either at home or abroad. We aggregate household and government consumption and examine both the share of total final consumption in GDP and the change in this share over time. We combine these scores into one joint ranking.

Ireland and the **Czech Republic** excel on this criterion. Although the scores for **Greece** and **Cyprus** have improved slightly, they remain at the bottom of the league for this sub-criterion. The fall in income during their adjustment crises has left consumers with little room to save, forcing them to spend virtually all they earn – and sometimes draw down their savings – in order to get by. As Cyprus has returned to satisfactory growth – and as Greece may be on the verge of turning the corner as well – their scores could improve in coming years if some rebound in income allows households to save a little more.

‘The ultimate proof of competitiveness is whether a company or country can profitably sell its wares.’

III.3 Competitiveness

Table 9. Competitiveness

Rank			Total score			Export ratio			Export rise			Labour costs			Regulation		
2016	2015	Country	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015
1	1	Ireland	8.4	*0.1*	8.3	9.6	*0.2*	9.3	8.4	*-0.5*	8.9	9.3	*0.5*	8.8	6.2	*0.0*	6.1
2	2	Germany	7.9	*0.0*	7.9	9.5	*0.2*	9.3	8.0	*-1.0*	9.0	7.4	*0.9*	6.5	6.7	*-0.2*	6.9
3	5	Luxembourg	7.7	*0.2*	7.4	10.0	*0.0*	10.0	10.0	*0.0*	10.0	6.1	*0.4*	5.7	4.6	*0.5*	4.1
4	4	Netherlands	7.6	*-0.2*	7.8	9.6	*0.1*	9.5	7.0	*-0.9*	8.0	5.9	*0.3*	5.5	7.9	*-0.3*	8.2
5	3	Hungary	7.6	*-0.2*	7.8	9.9	*0.2*	9.7	10.0	*0.0*	10.0	6.5	*0.0*	6.5	3.9	*-1.0*	4.9
6	6	Czech Republic	7.4	*0.1*	7.3	8.5	*0.3*	8.3	10.0	*0.0*	10.0	4.9	*-0.3*	5.1	6.1	*0.3*	5.7
7	7	Slovakia	7.1	*0.0*	7.0	9.0	*0.3*	8.7	10.0	*0.0*	10.0	4.2	*-0.2*	4.4	5.2	*0.1*	5.0
8	8	Poland	6.9	*0.1*	6.8	7.8	*0.4*	7.4	10.0	*0.0*	10.0	8.2	*0.1*	8.1	1.8	*0.0*	1.8
9	10	Belgium	6.7	*-0.1*	6.8	9.4	*0.1*	9.3	4.8	*-0.3*	5.1	5.8	*0.4*	5.4	6.9	*-0.4*	7.4
10	9	Malta	6.7	*-0.1*	6.8	9.7	*0.1*	9.6	5.4	*-1.2*	6.6	6.0	*-0.2*	6.2	5.8	*1.0*	4.8
11	11	Lithuania	6.5	*-0.3*	6.7	5.0	*0.3*	4.8	9.9	*-0.1*	10.0	3.2	*-0.9*	4.1	7.7	*-0.3*	8.0
		Euro 19	6.0	*-0.2*	6.2	5.3	*0.0*	5.3	7.0	*-0.7*	7.7	6.0	*-0.1*	6.1	5.8	*0.0*	5.7
12	14	Slovenia	5.8	0.1	5.8	4.1	*0.3*	3.8	9.8	-0.2	10.0	4.2	*0.0*	4.2	5.3	*0.2*	5.1
13	12	Portugal	5.6	-0.3	5.9	0.0	*0.0*	0.0	9.2	-0.8	10.0	7.6	*-0.2*	7.8	5.4	*-0.1*	5.6
14	15	Estonia	5.6	0.0	5.6	4.5	*0.2*	4.3	7.3	-0.7	8.1	3.5	*-0.2*	3.6	6.9	*0.5*	6.4
15	13	United Kingdom	5.4	-0.4	5.8	2.7	*0.1*	2.6	4.1	-0.2	4.3	7.1	*-0.7*	7.8	7.8	*-0.8*	8.6
16	17	Bulgaria	5.3	0.1	5.2	5.5	*0.4*	5.1	10.0	0.0	10.0	2.3	*-0.1*	2.4	3.3	*0.0*	3.3
17	16	Denmark	5.0	-0.2	5.2	2.1	*0.1*	1.9	4.6	-1.1	5.8	6.3	*-0.2*	6.5	6.9	*0.2*	6.7
18	18	Latvia	4.9	-0.2	5.2	0.0	*0.0*	0.0	10.0	0.0	10.0	2.6	*-0.7*	3.3	7.2	*-0.2*	7.3
19	20	Spain	4.9	*0.0*	4.9	2.1	*0.4*	1.7	6.1	*-0.5*	6.5	6.2	*0.1*	6.1	5.2	*-0.1*	5.3
20	19	Greece	4.8	*-0.1*	4.9	0.0	*0.0*	0.0	9.8	*-0.2*	10.0	5.2	*-0.2*	5.5	4.4	*0.1*	4.3
21	22	France	4.7	*0.0*	4.7	3.4	*0.2*	3.2	3.8	*-0.5*	4.3	4.3	*-0.1*	4.4	7.2	*0.5*	6.7
22	21	Austria	4.6	*-0.2*	4.7	3.6	*0.1*	3.5	4.6	*-0.3*	5.0	5.4	*-0.3*	5.7	4.7	*-0.2*	4.9
23	25	Romania	4.5	*0.2*	4.3	3.8	*0.5*	3.3	4.3	*-0.4*	4.7	5.1	*-0.1*	5.2	4.7	*0.7*	4.0
24	23	Croatia	4.3	*-0.2*	4.5	0.0	*0.0*	0.0	7.3	*0.3*	7.0	5.8	*-0.2*	6.0	4.1	*-1.0*	5.1
25	24	Sweden	4.2	*-0.1*	4.3	2.2	*0.1*	2.1	2.8	*-0.7*	3.5	5.4	*0.1*	5.3	6.5	*0.1*	6.4
26	26	Italy	3.9	*0.1*	3.9	2.6	*0.2*	2.4	5.5	*-0.6*	6.1	4.0	*0.4*	3.6	3.6	*0.2*	3.4
27	27	Cyprus	3.2	*-0.1*	3.3	0.0	*0.0*	0.0	2.1	*0.3*	1.8	5.8	*-0.7*	6.6	4.9	*0.1*	4.9
28	28	Finland	2.3	*0.0*	2.3	0.0	*0.0*	0.0	0.8	*-0.5*	1.3	4.8	*0.2*	4.6	3.5	*0.1*	3.4

Ranks, scores and score changes from last year for the Competitiveness Indicator and sub-indicators. For further explanations see notes under Table 2 on page 6 and the Notes on Key Components on page 63.

‘Most catching-up economies are integrating themselves into the European and global market rather well.’

Competitiveness is an elusive concept. The ultimate proof of whether a company can compete is whether it can successfully sell its wares to customers who have a choice. The wares may or may not be expensive, the company may or may not pay premium wages. What counts is whether customers value its products or services enough to pay the requested price for them.

We analyse the competitiveness of a country in a similar way: does the country find buyers for its exports? Whether or not wages or unit labour costs are high plays a role, but only a secondary. Many other aspects, ranging from the perceived quality of a product to the value of a brand, also determine whether the good or the service can be sold to a willing buyer. In the analysis of competitiveness, we thus focus on two measures of export success: 1) the share of exports in a country’s GDP and 2) the rise of this share over time. We adjust these export prowess data for the fact that small and rich countries tend to have a higher share of exports in GDP than big or less advanced countries and compare the actual data to a model-based benchmark. Subsequently, we add labour cost dynamics and the level of product and service market regulation for an overall assessment of competitiveness. We first present the key overall results before we look more closely at the various sub-criteria.

Overall assessment of competitiveness
Combining the various criteria, we find that **Ireland** (No. 1) and **Germany** (No. 2) remain the most competitive countries in the league table, ahead of **Luxembourg** (No. 3), and the **Netherlands** (No. 4). The newcomers **Hungary** (No. 5) and **Czech Republic** (No. 6) also achieve results far above the eurozone average. Once again, **Finland** (No. 28), **Cyprus** (No. 27), **Italy** (No. 26) and **Sweden** (No. 25) fare worst in this long-term ranking for competitiveness (see Table 9 on page 45).

For the **eurozone** as a whole, the score for competitiveness slipped slightly in 2016 due to a weakness in export growth reflecting partly the crisis in emerging markets and the temporary slowdown in U.S. economic growth in the first half of 2016. The **United Kingdom** (No. 15) falls back from its previous No. 13 position with a significant drop in its overall score to 5.4, down from 5.8, largely because of an above-average increase in labour costs and because of a somewhat less liberal regulatory regime as captured by the OECD’s index for services trade restrictiveness.

Export prowess
Judging by their export performance in terms of 1) the share of exports in GDP and 2) the rise of this share over time, **Luxembourg**, **Ireland** and **Germany** remain the most competitive economies in Western Europe, followed by the **Netherlands** and **Belgium**. **Finland**, **Cyprus** and **Sweden** face serious competitiveness problems. Except for Cyprus, these economies saw their performance deteriorate further in 2016.

Extending the sample from 21 to 28 countries has a much bigger impact on the ranking for export prowess than on any other aspect of the overall analysis. With the exception of **Denmark**, the newcomers are all catching-up economies that have joined the European Union only recently. Most of them are using the opportunity to integrate themselves into the European and global supply chain rather well. Like **Poland**, **Slovakia** and **Latvia**, which had been part of the analysis in 2014 and 2015 already, **Hungary**, the **Czech Republic** and **Bulgaria** get top marks for the rise in their export ratio since 2002. The results for **Lithuania** and **Slovenia** are almost equally stellar.

‘Due to an increase in labour costs, the United Kingdom drops in the ranking for cost competitiveness.’

Greece plays a somewhat sad role in the ranking for export prowess. While it gets a very low score for its very low export ratio, the methodology actually awards Greece a good score for the increasing share of exports in its GDP. Unfortunately, this has come about largely for the wrong reason, namely more through a plunge in GDP rather than a significant rise in exports. Fortunately, the recovery in GDP, which had been delayed by Greece’s confrontation with its creditors in the first half of 2015, seems to be finally arriving.

Labour costs

In a currency union with no internal exchange rates, nominal unit labour costs are arguably a better gauge of competitiveness than real unit labour costs. But nominal units are also a problematic concept. As prices for domestic goods usually rise significantly in fast-growing catching-up countries, an apparent loss of competitiveness as measured in terms of rising nominal unit labour costs may just reflect this “Balassa-Samuelson” effect and not be a cause for concern.[10] We thus aggregate the results for both nominal and real unit labour costs, which both have their imperfections, into one overall score for unit labour costs.

In addition, unit labour costs are only one labour-related aspect that can shape the decision of companies where to invest and create jobs. Employment protection, including the implicit costs of such regulations and the legal uncertainty created by the regulatory regime, also play a role. The flexibility of companies to adjust the labour force, in particular downwards, matters a lot for hiring decisions. To quantify this flexibility, we add the hiring and firing practices survey of the World Economic Forum 2016/2017 Global Competitiveness Report.[11]

Two results stand out. First, the excellent score for labour cost competitiveness in **Germany** improves further. Although wages in Germany are rising faster than in most other countries – as discussed in the Adjustment Progress Indicator – the resulting slippage in German labour cost competitiveness is more than offset by a significantly better score for hiring and firing practices in the World Economic Forum’s Global Competitiveness Report 2016-17. Second, due to an increase in its nominal and real unit labour costs above that of the eurozone average, the **United Kingdom** drops in the ranking for labour cost competitiveness.

Market regulation

Overly regulated markets which protect incumbent business interests and deter new entrants and competition make it difficult to thrive for companies that are not yet well established. Such regulations also constrain the ability of an economy to adjust and grow. To facilitate structural change in an economy, would-be entrepreneurs must be able to establish and drive growth in new companies easily. We take data from three sources to assess the weight of red-tape on the economies:

10. In fast-growing economies, productivity usually rises faster in the tradable goods sector exposed to global competition than in the more sheltered non-tradables sector. Whereas wage increases in the tradable sector are thus mostly offset through stronger productivity gains and do not translate into higher prices for these goods, this is not the case in the non-tradables sector where unit labour costs and hence prices do go up. A rise in prices for non-tradables relative to tradables does not impair the international competitiveness of an economy. This effect has first been pointed out by Bela Balassa and Paul Samuelson and is hence know as the Balassa-Samuelson effect.
11. World Economic Forum, *The Global Competitiveness Report 2016-2017* (Geneva: World Economic Forum, 2016).

‘It takes 37 days to register a business in Poland, by far the worst result in this category.’

- From the World Economic Forum, we take the survey value for local competition intensity from the **product market** pillar.

- From the OECD, we take the **Service Trade Restrictiveness Indicator** (STRI) for 2015.

- From the World Bank, we combine the surveys of what it costs and how many days it takes to **register a new business** as a third component for the comparison of market regulation

We give all three sub-indices equal weight for the aggregate ranking.

The **United Kingdom** (No. 2) remains one of most deregulated economies in Europe. However, it trades places with the **Netherlands** (No. 1, after finishing No. 2 in 2015 and 2014 for market regulations) because of a less stellar indicator for service trade restrictiveness as calculated by the OECD. Interestingly, even **France** (No. 4) does quite well in terms of market regulations, partly because it takes only four days to register a business in France, one day less than in the United Kingdom and on par with Estonia, Belgium and the Netherlands. Only in Denmark can would-be entrepreneurs register a business faster (three days).

The bottom of the league for market regulation features **Italy** (No. 25), **Finland** (No. 26), **Bulgaria** (No. 27) and **Poland** (No. 28). According to the World Bank, it takes 37 days to register a business in Poland, by far the worst result in this sub-category.

‘Luxembourg, Estonia and Latvia lead the ranking for fiscal sustainability courtesy of their low public debt.’

III.4 Fiscal Sustainability

Table 10. Fiscal Sustainability

Rank			Total score			Government outlays			Structural deficit			Debt			Sustainability gap		
2016	2015	Country	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015
1	1	Luxembourg	9.7	*0.0*	9.7	10.0	*0.0*	10.0	10.0	*0.0*	10.0	9.1	*-0.1*	9.1	n.a.	*n.a.*	n.a.
2	2	Estonia	9.2	*0.2*	9.0	8.8	*-0.1*	8.9	8.8	*0.7*	8.2	10.0	*0.0*	10.0	n.a.	*n.a.*	n.a.
3	3	Latvia	8.5	*0.0*	8.5	8.7	*0.1*	8.6	7.5	*0.2*	7.3	7.9	*-0.3*	8.1	10.0	*0.0*	10.0
4	6	Czech Republic	8.1	*0.1*	8.0	6.2	*0.1*	6.1	8.5	*0.3*	8.2	7.9	*0.0*	7.8	10.0	*0.0*	10.0
5	5	Lithuania	8.1	*-0.1*	8.1	9.1	*0.2*	8.9	8.1	*-0.3*	8.4	7.8	*0.1*	7.7	7.3	*-0.2*	7.5
6	7	Germany	7.8	*0.0*	7.9	6.9	*0.0*	6.9	9.5	*-0.1*	9.5	5.8	*0.2*	5.6	9.0	*-0.3*	9.3
7	8	Slovakia	7.7	*-0.1*	7.8	9.0	*-0.4*	9.4	7.2	*0.2*	7.1	6.9	*-0.1*	7.0	7.8	*0.1*	7.7
8	9	Bulgaria	7.7	*0.2*	7.5	6.4	*0.2*	6.3	8.0	*0.6*	7.4	8.6	*-0.2*	8.9	n.a.	*n.a.*	n.a.
9	4	Romania	7.6	*-0.9*	8.5	7.9	*0.1*	7.8	6.7	*-1.9*	8.6	7.9	*-0.1*	8.0	7.9	*-1.8*	9.6
10	15	Denmark	7.5	*0.8*	6.7	2.7	*0.0*	2.7	9.4	*1.7*	7.7	7.9	*0.1*	7.8	9.9	*1.5*	8.4
11	13	Malta	7.2	*0.3*	6.8	6.9	*0.1*	6.8	8.4	*0.8*	7.6	6.3	*0.1*	6.1	n.a.	*n.a.*	n.a.
12	10	Sweden	7.1	*-0.2*	7.3	3.6	*0.1*	3.6	8.2	*-0.6*	8.8	7.7	*0.2*	7.6	8.7	*-0.6*	9.3
13	11	Cyprus	7.0	*-0.2*	7.2	8.7	*-0.1*	8.8	9.3	*-0.6*	9.9	3.1	*0.0*	3.0	n.a.	*n.a.*	n.a.
14	12	Ireland	7.0	*0.0*	7.0	10.0	*0.0*	10.0	7.9	*-0.1*	8.0	3.9	*0.3*	3.6	6.1	*-0.2*	6.3
15	16	Netherlands	6.8	*0.3*	6.6	7.5	*0.0*	7.5	8.3	*0.5*	7.8	6.2	*0.2*	6.1	5.3	*0.4*	4.9
16	14	Poland	6.5	*-0.2*	6.7	4.1	*0.2*	3.9	6.6	-0.5	7.0	6.9	*-0.2*	7.1	8.4	*-0.5*	8.9
17	20	United Kingdom	6.2	*0.3*	5.8	8.3	*0.0*	8.3	6.0	0.6	5.4	4.3	*0.0*	4.4	5.9	*0.6*	5.3
		Euro 19	6.1	*-0.1*	6.3	5.7	*0.0*	5.7	8.2	*-0.3*	8.5	4.3	*0.1*	4.3	6.2	*-0.4*	6.6
18	17	Finland	5.9	*-0.1*	6.0	2.7	*-0.2*	3.0	7.6	*0.0*	7.6	6.0	*-0.1*	6.2	7.2	*0.0*	7.2
19	18	Slovenia	5.8	*-0.1*	5.9	3.8	*0.1*	3.7	7.8	*-0.3*	8.0	5.0	*0.2*	4.8	6.8	*-0.3*	7.1
20	21	Austria	5.4	*-0.4*	5.8	3.4	*0.1*	3.3	8.5	*-0.8*	9.2	4.8	*0.1*	4.6	5.0	*-0.9*	6.0
21	22	Hungary	5.3	*-0.4*	5.7	0.7	*0.0*	0.7	7.5	*-0.8*	8.4	5.5	*0.1*	5.4	7.6	*-0.9*	8.5
22	19	Spain	5.3	*-0.5*	5.8	7.8	*-0.1*	7.9	6.3	*-1.0*	7.3	3.6	*0.0*	3.6	3.5	*-1.1*	4.6
23	23	Italy	5.2	*-0.2*	5.4	4.2	*-0.1*	4.3	8.6	*-0.2*	8.8	1.2	*-0.1*	1.3	6.6	*-0.6*	7.2
24	24	Croatia	5.0	*0.2*	4.8	2.0	*0.2*	1.8	8.3	*0.3*	8.1	4.6	*0.1*	4.5	n.a.	*n.a.*	n.a.
25	25	Portugal	4.5	*-0.1*	4.6	3.6	*0.0*	3.5	8.3	*0.0*	8.3	1.4	*-0.1*	1.5	4.8	*-0.2*	5.0
26	26	France	4.4	*0.0*	4.4	1.1	*-0.1*	1.2	7.0	*0.0*	6.9	3.8	*0.0*	3.8	5.7	*0.0*	5.8
27	27	Greece	4.3	*0.0*	4.3	1.4	*-0.5*	2.0	10.0	*0.0*	10.0	0.0	*0.0*	0.0	5.7	*0.3*	5.4
28	28	Belgium	3.8	*-0.2*	4.0	2.9	*-0.1*	2.9	7.1	*-0.3*	7.4	3.1	*-0.1*	3.2	2.1	*-0.4*	2.5

Ranks, scores and score changes from last year for the Fiscal Sustainability Indicator and sub-indicators. For further explanations see notes under Table 2 on page 6 and the Notes on Key Components annex on page 63.

‘After two years on the right track, the eurozone’s adjustment process paused in 2016.’

Safeguarding fiscal sustainability became a key thrust of eurozone macroeconomic policy after 2009. Where do countries stand after seven years of adjustment? To answer this question, we examine 1) the share of government outlays in GDP, taking a high share of expenditures as a signal of potential fiscal overstretch; 2) the structural fiscal deficit as a share of GDP; 3) the ratio of public debt to GDP; and 4) the sustainability gap, i.e., the required amount of fiscal tightening in the years to 2020 to hypothetically bring the debt ratio down to 60% by 2030. We then aggregate the four sub-indicators into an overall score and ranking for fiscal sustainability.

Overall results

In our overall ranking for fiscal sustainability, the clear leaders are **Luxembourg** (No. 1), **Estonia** (No. 2) and **Latvia** (No. 3) courtesy of their very low levels of public debt. They are closely followed by two newcomers, the **Czech Republic** (No. 4) and **Lithuania** (No. 5). Because it has achieved a small fiscal surplus and has put its debt ratio on a nicely declining trajectory, **Germany** comes in at No. 6. As in previous years, **Portugal** (No. 25), **France** (No. 26), **Greece** (No. 27) and **Belgium** (No. 28) are facing the gravest fiscal challenges. Belgium has the strongest need to adjust its fiscal stance as measured by the sustainability gap whereas France suffers from its bloated public sector with the worst ranking for the share of public spending in GDP after **Hungary** (No. 21; see Table 10 on Fiscal Sustainability on page 49 for more).

Reflecting the turn away from austerity and a modest fiscal stimulus in many countries, the fiscal sustainability of the **eurozone** and most of its member countries deteriorated slightly in 2016. Among the countries that used to be the focus of the euro confidence crisis in 2011-12, we find significant fiscal slippage in **Spain** (No. 22) and, to a lesser extent, in **Portugal** (No. 25), **Italy** (No. 23) and **Cyprus** (No. 14).

Government Outlays

Excessive government spending can impair the sustainability of public finances. It constrains the room for expansion of the private sector and hence of the tax base. It can also signal that interest groups have successfully used the coercive power of government to further their own private ends.

As a general rule, rich countries tend to have a greater share of government outlays in GDP, partly because the demand for education and health services – often provided by the public sector – and for welfare provision rises with income levels. We thus adjust the raw data for the share of general government outlays in GDP (the 2002-2016 average) for differences in per capita income.

After two years following the right track of less public spending compared to GDP, the **eurozone**’s adjustment process paused in 2016, with the share of government outlays remaining basically unchanged at 48.6% after 48.5% in 2015. Contrary to the trend among most western European countries, **Germany** raised its government spending slightly faster than the overall increase in GDP in 2016, probably driven by extra outlays for the 890.000 migrants and refugees which the country had admitted in 2015. The share remains, however, below the long-term average.

As in all previous editions of *The Euro Plus Monitor*, **France** gets the Leviathan “award” for the biggest share of public spending in GDP for the overall period of 2002 to 2016. Adjusted for differences in per-capita income, however,

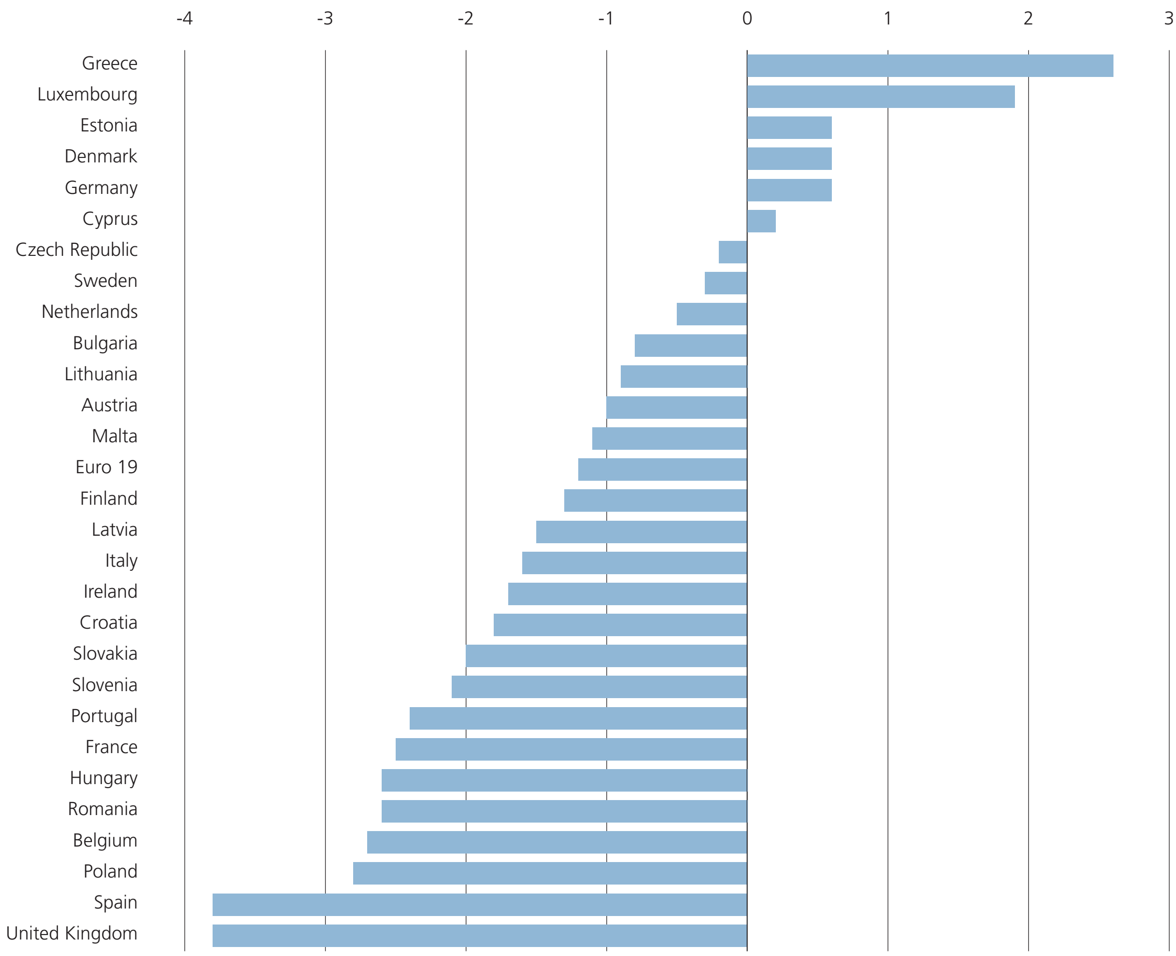
'Since 2013, Finland has a bigger share of public spending in its GDP than France.'

newcomer **Hungary** looks even worse on this criterion than France. Fortunately, France is trying to address its problem, though very timidly. Since 2013, **Finland** exceeds France's share of government spending in annual GDP. Finland made no progress in 2016, with the share of government spending remaining in 2016 at its 2015 level of 57.7%, which is modestly above France's 56.4%. In **Greece**, the unusually volatile share of government spending in GDP surged from a post-2007 trough of 50.6% of GDP in 2014 to 55.5% in 2015 and an estimated 62.4% in 2016, apparently somewhat distorted by some special factors. All these countries still have a long way to go to match the eurozone average of 48.6%.

The leanest governments can be found mostly around the edges of the EU, with comparatively rich **Ireland** even having a smaller share of government spending in its GDP than much poorer **Lithuania**, **Bulgaria** and **Romania** in 2016.

Chart 11. Guess Who is Prudent Now

Structural fiscal balance 2016 in percent of GDP



Sources: European Commission, Berenberg calculations

‘Whereas the eurozone reduced its debt burden in 2016, the United Kingdom did not get on the right track yet.’

Structural fiscal deficits
To assess the underlying fiscal situation excluding mere cyclical and one-off factors, we examine the structural and the primary structural fiscal balances. Naturally, the difference between the two measures – interest payments on public debt – is most pronounced for the highly indebted economies of Portugal and Italy whereas it is barely visible for the almost debt-free governments of Estonia and Luxembourg. We combine the separate scores for the two components into one overall score for the structural fiscal balance.

As many countries granted themselves a small stimulus in 2016, the **eurozone**’s structural fiscal deficit rose to 1.2% of potential GDP in 2016, up from 1.0% in 2015. The slippage is particularly pronounced in **Spain**, with an increase in the structural deficit from 2.8% to 3.8% of potential GDP.

Measured solely by their current structural public deficits, **Luxembourg** (No. 1) and **Greece** (No. 2 on the criterion for structural deficits) have the strongest current fiscal position among the 28 countries in the sample, the difference between them being that Greece carries a huge debt burden of 181.6% of its GDP whereas Luxembourg seems almost debt-free with a debt ratio of just 23.2% by comparison.

Behind **Greece** and **Luxembourg**, the usual fiscally responsible suspects line up – **Germany** (No. 3) and **Denmark** (No. 4). With significant fiscal tightening, Denmark raised its score in this category by a whopping 1.7 points this year. **Cyprus** (No. 5) remains among the frontrunners although, after serious fiscal tightening from 2012 to 2014, it relaxed the reins in 2016 for the second time in a row, bringing its structural surplus to 0.2%, from 1.7% last year and a peak of 3.0% in 2014.

Despite some further slippage in 2016, **Italy** (No. 7) would have fared even better had we only evaluated the primary balance, where Italy is running a structural surplus of 2.4% of GDP, behind only **Cyprus** (2.8%) and **Greece** (5.9%). But because of Italy’s huge debt, its interest expenditures drive a wedge of four percentage points between its primary and its actual structural fiscal balance.

Despite raising its score by 0.6 points from 5.4 to 6.0 with a significant fiscal tightening in 2016, the **United Kingdom** retains the unwanted prize of most fiscally challenged country as measured in terms of its structural fiscal deficit.

Public debt
The level of public debt is one of the most prominent factors determining fiscal sustainability. With an estimated debt ratio of 181.6% of GDP in 2016, **Greece** (No. 28 on the public debt criterion) kept the red lantern at the bottom of the public debt league, ahead of **Italy** (No. 27, with 133.0%) and **Portugal** (No. 26, with 130.3%). The position of **Ireland** (No. 18) continues to improve rapidly with a fall in its debt ratio to 95.7% in 2016 after 99.8% last year and a peak of 119.5% in 2012 and 2013. The marked improvement was partly the result of the liquidation of the Irish Banking Resolution Corporation, which was initiated in 2013.

Whereas the **eurozone** as a whole reduced its debt burden slightly in 2016 to 89.4% of GDP after 90.4% in the year before, the **United Kingdom** did not manage to get on the right track yet as its debt burden rose slightly further to 89.3%, up from 89.1% in 2015, of its GDP according to the European Commission’s autumn 2016 forecast.

‘While the former crisis countries remain at the bottom of the table, their scores have improved.’

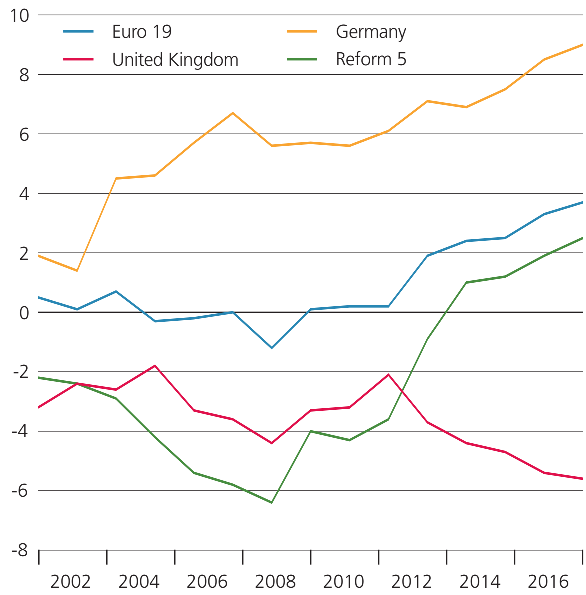
III.5 Resilience

To analyse the vulnerability to sudden shifts in market sentiment, we look at six separate sub-indicators: 1) the debt redemptions over the next three years as a share of GDP, 2) public debt held abroad as a share of GDP, 3) the household savings rate, 4) current account deficit, 5) the debt of households and non-financial corporations, and 6) the size of the banking system as a multiple of GDP.

To some degree, the adjustment efforts made over the past five years continue to shine through. While the former crisis countries remain at the bottom of the table, most of their scores have improved. Current account deficits have turned into surpluses, the private sector is repairing its balance sheet, savings rates have risen and banks keep deleveraging. However, debt ratios have continued to increase in most cases except Ireland, where the debt ratio has fallen, and Spain, where strong growth has helped to stabilise the debt ratio despite some significant fiscal slippage.

Chart 12. External Divergence

Current account balance in percent of GDP



Reform 5 are Italy, Spain, Ireland, Greece and Portugal.
Sources: Eurostat, European Commission, Berenberg calculations

Overall results
Best placed to weather potential future shocks would be **Estonia** (No. 1 again for resilience) ahead of **Germany** (No. 2), the **Czech Republic** (No. 3), **Slovenia** (No. 4), **Sweden** (No. 5) and **Slovakia** (No. 6). This resilience allowed Slovenia to master its serious financial crisis in 2013-2014 without having to call in the troika. At the other end of the spectrum, **Ireland** (No. 25), **Greece** (No. 26), **Portugal** (No. 27) and **Cyprus** (No. 28) face the most severe challenges. For the **United Kingdom** (No. 23), the big current account deficit and the low savings rate weigh on the score, putting the United Kingdom in terms of resilience to financial shocks into a group which otherwise includes mostly countries that made negative headlines during the euro crisis or other fiscally challenged countries such as **France** (No. 22) and **Belgium** (No. 21). As the United Kingdom is not part of the eurozone, economic and financial shocks would likely show up more in a serious plunge in the exchange rate than in protracted financial turbulence. After all, an aggressive central bank can defuse any financial turbulence by buying assets in exchange for the money it can print itself. In a way, the Bank of England proved this point in its swift reaction to the Brexit vote.

Current account
One gauge of a country’s vulnerability to shifts in market sentiment is its annual external financing need as expressed in its current account deficit. Updating the database with the 2016 European

'Best placed to weather potential future shocks would be Estonia, Germany and the Czech Republic.'

Table 11. Resilience

Rank			Total score			Debt redemptions			Debt held abroad			Savings rate		
2016	2015	Country	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015
1	1	Estonia	8.1	*0.2*	7.9	10.0	*0.0*	10.0	9.2	*0.3*	8.9	5.3	*1.2*	4.2
2	2	Germany	7.7	*-0.1*	7.8	5.1	*-1.3*	6.4	5.4	*0.4*	4.9	9.6	*0.1*	9.5
3	3	Czech Republic	7.7	*0.1*	7.7	5.8	*0.2*	5.6	8.3	*-0.2*	8.5	7.0	*0.2*	6.7
4	6	Slovenia	7.7	*0.5*	7.2	4.6	*0.9*	3.7	3.5	*-0.7*	4.1	9.6	*1.3*	8.3
5	5	Sweden	7.3	*0.0*	7.3	6.8	*0.1*	6.7	7.7	*0.0*	7.7	10.0	*0.0*	10.0
6	7	Slovakia	7.3	*0.2*	7.1	6.4	*0.3*	6.0	6.3	*0.4*	5.9	5.6	*0.4*	5.2
7	4	Croatia	7.2	*-0.2*	7.3	3.7	*0.1*	3.6	6.1	*-0.4*	6.4	8.2	*0.1*	8.2
8	13	Bulgaria	6.7	*0.3*	6.4	8.6	*0.1*	8.5	n.a.	*n.a.*	n.a.	0.0	*0.0*	0.0
9	12	Latvia	6.6	*0.2*	6.4	7.2	*-0.7*	7.9	6.8	*0.5*	6.3	0.7	*0.7*	0.0
10	9	Poland	6.6	*0.0*	6.5	4.9	*-0.1*	5.0	6.8	*0.0*	6.8	2.0	*0.4*	1.6
11	10	Denmark	6.5	*0.0*	6.5	7.0	*-0.6*	7.6	8.5	*0.6*	7.9	6.2	*-0.1*	6.3
12	15	Lithuania	6.5	*0.3*	6.3	7.5	*0.8*	6.7	5.8	*-0.3*	6.2	0.1	*0.1*	0.0
13	8	Romania	6.5	*-0.1*	6.6	6.4	*-0.3*	6.7	7.9	*0.1*	7.9	0.0	*0.0*	0.0
14	11	Hungary	6.5	*0.0*	6.5	1.4	*-0.7*	2.2	5.4	*0.5*	4.9	5.0	*-0.6*	5.6
15	17	Malta	6.4	*0.3*	6.1	6.2	*0.5*	5.7	9.3	*0.0*	9.2	n.a.	*n.a.*	n.a.
16	16	Luxembourg	6.2	*0.0*	6.2	10.0	*0.0*	10.0	9.0	*0.0*	9.0	10.0	*0.0*	10.0
17	14	Austria	6.2	*-0.1*	6.3	4.8	*-1.0*	5.8	2.4	*-0.6*	2.9	7.9	*0.6*	7.4
		Euro 19	6.1	*0.1*	6.1	3.7	*-0.1*	3.8	4.4	*0.0*	4.4	7.3	*0.2*	7.1
18	18	Netherlands	6.1	*0.1*	6.0	5.4	*0.2*	5.2	6.1	*0.0*	6.1	7.6	*0.4*	7.2
19	20	Italy	5.6	*0.1*	5.5	0.0	*0.0*	0.0	4.4	*-0.3*	4.7	6.2	*0.2*	6.0
20	19	Finland	5.4	*-0.1*	5.6	6.0	*0.6*	5.4	4.2	*-0.5*	4.7	3.9	*-0.2*	4.1
21	22	Belgium	5.4	*0.1*	5.2	3.2	*0.4*	2.8	2.9	*-0.1*	3.0	7.2	*0.5*	6.7
22	21	France	5.3	*0.0*	5.3	3.8	*0.4*	3.4	3.4	*-0.1*	3.5	8.0	*0.1*	8.0
23	23	United Kingdom	5.2	*0.0*	5.2	6.2	*0.4*	5.8	6.9	*-0.3*	7.2	3.5	*-0.2*	3.7
24	24	Spain	5.2	*0.2*	5.0	1.7	*0.8*	0.9	4.4	*-0.8*	5.3	4.9	*0.1*	4.8
25	26	Ireland	4.5	*0.2*	4.3	6.2	*0.3*	5.9	2.6	*-0.5*	3.1	6.2	*0.0*	6.2
26	25	Greece	4.5	*0.0*	4.4	5.1	*-0.2*	5.3	0.0	*0.0*	0.0	0.0	*0.0*	0.0
27	27	Portugal	4.1	*0.2*	3.9	3.0	*-0.2*	3.2	0.0	*0.0*	0.0	2.9	*0.1*	2.9
28	28	Cyprus	2.3	*-0.4*	2.7	5.3	*-1.5*	6.8	1.1	*-1.6*	2.7	0.0	*0.0*	0.0

Ranks, scores and score changes from last year for the Resilience Indicator and sub-indicators. For further explanations see notes under Table 2 on page 6 and the Notes on Key Components on page 63.

Commission estimates for the current account balances confirms the big improvements in the former crisis countries in the years 2010 to 2014. In fact, only three of the 19 eurozone countries are running a current account deficit and of those, only **France** (2.1% of GDP in 2016 according to European Commission projections) and **Cyprus** (2.8%) are substantial in the wider scheme of things whereas **Finland**'s deficit (0.8% of GDP) looks too small to matter very much. Relative to last year, the changes in current account positions are mostly minor. The period of belt-tightening is over.

That shows up in a roughly parallel expansion of exports and imports across much of the eurozone, leaving the current account position more or less stable. Helped by the plunge in its oil import bill, **Germany** raised its current account surplus to 9% of GDP from 8.5% in 2015 despite rapid increases in real German government consumption by 4.3% year-on-year in the first three quarters of 2016.

Largely due to the oil effect, the current account surplus of the **eurozone** rose to 3.7% in 2016, up from 3.3% last year. To a degree, this comfortable

‘Germany raised its current account surplus despite rapid increases in government consumption.’

Table 11. (Continued)

Rank			Current account			Bank assets			Private debt		
2016	2015	Country	2016	*Change*	2015	2016	*Change*	2015	2016	*Change*	2015
1	1	Estonia	6.6	*-0.1*	6.7	10.0	*0.0*	10.0	7.8	*0.0*	7.8
2	2	Germany	10.0	*0.2*	9.8	7.7	*0.0*	7.7	8.6	*0.0*	8.6
3	3	Czech Republic	5.3	*0.2*	5.1	10.0	*0.0*	10.0	10.0	*0.1*	9.9
4	6	Slovenia	9.2	*1.0*	8.3	10.0	*0.0*	10.0	9.2	*0.5*	8.7
5	5	Sweden	8.1	*-0.2*	8.3	7.2	*0.1*	7.1	4.4	*0.2*	4.1
6	7	Slovakia	6.0	*0.2*	5.8	10.0	*0.0*	10.0	9.5	*-0.2*	9.6
7	4	Croatia	7.1	*-1.1*	8.2	10.0	*0.0*	10.0	7.9	*0.2*	7.6
8	13	Bulgaria	6.7	*0.8*	5.9	10.0	*0.0*	10.0	8.1	*0.6*	7.4
9	12	Latvia	5.7	*0.4*	5.3	10.0	*0.0*	10.0	9.1	*0.4*	8.7
10	9	Poland	6.1	*0.0*	6.1	10.0	*0.0*	10.0	9.6	*0.0*	9.6
11	10	Denmark	8.8	*-0.2*	9.0	5.2	*-0.1*	5.3	3.4	*0.3*	3.1
12	15	Lithuania	5.8	*1.1*	4.7	10.0	*0.0*	10.0	10.0	*0.0*	10.0
13	8	Romania	4.7	*-0.5*	5.2	10.0	*0.0*	10.0	10.0	*0.0*	10.0
14	11	Hungary	7.7	*0.5*	7.2	10.0	*0.0*	10.0	9.3	*0.3*	9.0
15	17	Malta	6.7	*-0.3*	7.0	3.3	*1.1*	2.1	6.7	*0.4*	6.3
16	16	Luxembourg	8.4	*0.2*	8.2	0.0	*0.0*	0.0	0.0	*0.0*	0.0
17	14	Austria	7.0	*0.1*	6.9	7.9	*0.2*	7.7	7.3	*0.0*	7.3
		Euro 19	7.5	*0.2*	7.3	6.9	*0.0*	6.9	7.1	*0.1*	7.0
18	18	Netherlands	9.8	*0.0*	9.8	5.5	*-0.2*	5.6	2.4	*0.0*	2.4
19	20	Italy	7.0	*0.6*	6.5	8.1	*0.1*	8.0	7.8	*0.1*	7.6
20	19	Finland	5.3	*0.0*	5.3	7.2	*-0.2*	7.5	5.9	*-0.4*	6.3
21	22	Belgium	6.0	*0.2*	5.8	7.5	*-0.1*	7.5	5.4	*-0.1*	5.5
22	21	France	4.7	*0.0*	4.8	5.1	*-0.3*	5.4	6.5	*-0.1*	6.6
23	23	United Kingdom	3.0	*-0.1*	3.1	5.9	*0.4*	5.6	5.8	*0.1*	5.7
24	24	Spain	6.5	*0.2*	6.3	7.9	*0.3*	7.5	6.0	*0.5*	5.5
25	26	Ireland	7.9	*0.1*	7.8	4.1	*1.2*	3.0	0.0	*0.0*	0.0
26	25	Greece	5.7	*0.0*	5.7	8.6	*0.2*	8.3	7.3	*0.1*	7.2
27	27	Portugal	6.0	*0.4*	5.6	8.1	*0.3*	7.8	4.7	*0.5*	4.2
28	28	Cyprus	4.4	*0.1*	4.3	3.2	*0.7*	2.5	0.0	*0.0*	0.0

external position protects the eurozone against sudden shifts in global portfolio flows such as those that may emanate from significant Fed tightening over the course of a “Trumponomics” fiscal stimulus in the U.S.

The **United Kingdom** with its flexible exchange rate continues to grace the bottom of the current account league by a mile. The current account deficit worsened further to 5.6% of GDP in 2016, up from 5.4%. As an oil-producing country, the United Kingdom benefits less from a fall in oil prices than most other nations. Despite the significant drop of the sterling exchange rate after the Brexit vote, the external deficit is unlikely to vanish any time soon. Except for tourism, British service exports are not very sensitive to exchange rate moves.

Debt profile

Having a comparatively low fiscal deficit does not suffice to maintain market confidence when investors are nervous. At times when investors want to reduce exposure to countries that have come under suspicion, the sheer need to roll over maturing debt can pose a major challenge. Also, confidence among foreign investors can be more fickle than

‘In severe financial crises, the lines between private and public debt can become blurred.’

that of domestic savers and institutions. Financial market contagion seems to be mostly driven by investors from abroad who do not bother to study carefully all the differences between countries which they may summarily lump into one category.

We look at two aspects of a country’s debt profile as a share of GDP:

- How much public debt has to be redeemed in 2017-2019?
- How much public debt is held abroad?

We then combine these two aspects into a single ranking.

Unsurprisingly, countries with little public debt (such as **Estonia** and **Luxembourg**) excel in this ranking whereas highly indebted countries such as **Italy** and **Portugal** end up at the bottom of this league table. Because of the generous debt-service conditions granted by its official external creditors, the debt redemption schedule for the next three years is significantly less challenging for **Greece** than it is for the **eurozone** average.

Private debt

In severe financial crises, the lines between private and public debt can become blurred. Most obviously, if an economic boom fuelled by private debt turns to bust, sovereign debt often surges as tax revenues plunge while social outlays rise. In addition, the sovereign is often tempted to deliver an expensive fiscal stimulus and may have to spend money to bail out parts of the private sector. Ahead of the post-Lehman financial crises, the very comfortable fiscal positions of Ireland and Spain had obscured a serious underlying vulnerability stemming from the massive build-up of household debt.

Updating the analysis with 2015 data from Eurostat, the European Union’s statistical agency, the trend towards modest deleveraging in the eurozone as a whole and serious deleveraging in many of the most indebted countries continued in 2015, albeit at a reduced pace.

Unsurprisingly, the lowest private sector debt ratios can be found in central and eastern Europe, with **Lithuania** (55.0% of its 2015 GDP), **Romania** (59.1% of 2015 GDP), the **Czech Republic** (68.6%) and **Poland** (78.6%) being the best in class. To some extent, this criterion may be a little unfair, though. Poorer countries tend to have lower debt ratios. A country that has less income, fewer assets and a less developed financial system tends to be less creditworthy and less indebted than a more advanced economy.

Greece (private debt of 126.4% of its GDP) and **Italy** (117.0%) have many problems, but over-indebtedness of the private sector is not one of them. Both easily remain in the top bracket of the private debt league. Both countries even managed to reduce their private debt burden slightly in 2015. Judging by their private debt burdens, **Cyprus** (353.7%), **Luxembourg** (343.1%), **Ireland** (303.4%) and the **Netherlands** (228.8%) remain most vulnerable on this count. Dutch private debt largely reflects a mortgage market that is deeper and more developed than in most other eurozone member countries.

Household savings rate

Having a high level of private-sector debt can be mitigated by thrift, that is by a high propensity to save money out of current income. The extension of the analysis to more emerging markets at the southern and eastern rim of the European Union changes the ranking substantially. With a negative savings rate of 14.3% in 2016, **Bulgaria** ends up at the bottom of the league table, ahead of its neighbour **Romania** with a savings rate of -9.1%. In two erstwhile euro crisis countries, households also spent more than they earned in 2016, with savings rates of -5.4% for **Greece** and -2.5% for **Cyprus**. **Lithuania** completes the group of net negative savers with a rate of -0.9%.

‘An oversized financial sector makes countries more vulnerable to shocks of confidence.’

The most thrifty households in the European Union can be found in **Sweden** (savings rate of 18.6% of gross income), **Germany** (17.3%), **Slovenia** (17.2%) and **France** (14.3%). No new data are available for **Luxembourg** which – otherwise – could have graced the top of the league judging by its high household savings rates in the past.

On average, **eurozone** households raised their savings rate in 2016 modestly to 12.9% from 12.5% in the three years before as they decided to save rather than spend part of the windfall gain from low oil prices. Once again, the **United Kingdom** bucked the trend that prevailed elsewhere in Europe as United Kingdom households reduced their savings rate further to 5.7% in 2016, down from 6.1% in 2015. A low savings rate contributes to the macroeconomic vulnerability of the United Kingdom.

Bank assets

During the Lehman and euro crises, the eurozone’s banking system was a transmitter of tensions. In several cases (namely, **Ireland**, **Spain** and **Cyprus**), it even became a source of trouble. The eurozone left the cleaning up of the sector to national initiatives with varying success in the immediate aftermath of the Lehman crisis. Despite various initiatives to erect and complete a banking union, the banking sector remains fragmented. Amid rising political risks in key countries, most notably **Italy**, the banking sector arguably became even more fragmented in 2016 than it had been before.

An oversized banking sector makes countries more vulnerable to shocks of confidence – the more the financial system has outgrown the country’s potential safety net, which corresponds to the country’s economic power, the more prone this country is. The ratio of bank assets to GDP thus features on our list of criteria to assess the resilience of a country to shocks.[12] The broad thrust of the ranking remains unchanged this year based on data for October 2016. Many Eastern European countries with relatively undeveloped banking systems remain near the top of the ranking. In many cases, their banks are mostly in foreign hands, further reducing vulnerability. This also holds for the newcomers to our analysis such as **Romania** (54% ratio of bank assets to GDP), **Lithuania** (69%) and **Hungary** (103%), roughly in line with **Poland** (95%), which we had already included in the analysis two years ago. The bottom of the ranking is graced by countries with important financial centres, such as outlier **Luxembourg** (a whopping 1969%), **Ireland** (436%), **France** (387%) and the **United Kingdom** (344%), as well as special cases such as **Malta** (481%) and **Cyprus** (484%).

Bank balance sheets are moving slowly, so changes in the ranking are limited. Nonetheless, the October 2016 data suggest a rough pattern: in core Europe, bank balance sheets are expanding modestly while they continue to shrink in most of the former crisis countries. Examples for the former are **Germany**, **France** and the **Netherlands**. Very cheap borrowing costs and improving economic conditions may be helping. In **Portugal**, **Spain**, **Greece** and **Ireland**, bank balance sheets continued to shrink in the first nine months of 2016. In these countries, banks are increasingly successfully ridding themselves of problematic portfolios by selling them or taking write-downs. Unfortunately, **Italy** is now lagging behind with a marginal 0.1% increase in its bank balance sheets in the first 10 months of 2016 after substantial declines of a cumulative 7% in the three years before.

12. European Central Bank. Total assets/liabilities of monetary financial institutions (MFIs)

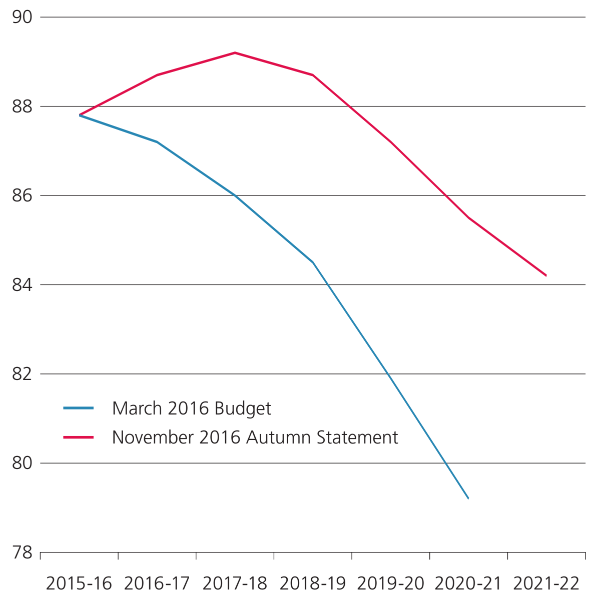
IV. Special Focus: Notes on the Brexit Debate

On 23 June 2016, a narrow majority of British voters decided that they want their country to leave the European Union. Our analysis does not yet include a significant impact of that vote for a British exit ("Brexit") as the data extend only up to Q3 2016. However, we can use our data and tools to shed light on some aspects of the Brexit debate.

Following the Brexit referendum, the Office for Budget Responsibility (OBR), the official fiscal watchdog in the **United Kingdom**, changed its fiscal projections. In its last pre-referendum analysis for the March 2016 budget, the OBR projected a decline in the United Kingdom's debt-to-GDP ratio by 8.6 percentage points over the next five fiscal years. In its first post-vote analysis for the November 2016 autumn statement, the OBR revised that to a decline of a mere 2.2 points (see Chart 13 at right). If we add the difference of 6.6 percentage points to the data for United Kingdom public debt which we use for the Euro Plus Monitor analysis, the United Kingdom's score for fiscal sustainability would deteriorate from 6.2 to 5.8 over the next five fiscal years, ending up below rather than marginally above the eurozone average of 6.1.

Chart 13. Brexit Impact on UK Public Debt

Projections for UK debt as a percent of GDP before and after the Brexit vote



March 2016 projection adjusted for subsequent revision of 2015/2016 outcome. Data shows fiscal year April to April. Maastricht Treaty defintion of public debt.
Sources: Office for Budget Responsibility (UK), Berenberg calculations

Those in favour of a British exit ("Brexit") often argue that supposedly excessive European Union regulations are holding Britain back. However, the rich variety of results on adjustment progress and fundamental health for all 28 European Union members and the significant changes in *The Euro Plus Monitor* results over time show that, even within the framework of the European Union, countries remain the master of their own fate.

The common rules and regulations that underpin the common market are far from optimal. Some regulations may be almost as damaging as Britain's own regulations of its land and housing markets. But claims that European Union rules are holding Britain back decisively or that they prevent Britain from dealing more with fast-growing Asia are not supported by the facts. For example, **Germany** exports three times more than the United Kingdom to China.

‘On the morning after the Brexit vote, we reduced the estimate for future trend growth from 2.1% to 1.8%.’

In terms of microeconomics, the common European Union regulations still give the United Kingdom ample room to set its own polices and shine despite the occasional gripes about meddling from Brussels. Britain gets top marks for its microeconomics, notably for its growth-friendly rules in product, services and labour markets (No. 2 in the analysis for market regulations). Instead, the United Kingdom’s problems lie in its housing market and the macroeconomic sphere over which Brussels has virtually no influence at all. The United Kingdom’s big macroeconomic imbalances range from a still huge structural fiscal deficit (around 3.8% of GDP in 2016 versus the **eurozone**’s average of 1.2%) to a huge current account deficit (around 5.6% of GDP in 2016 versus the eurozone’s surplus of 3.7%) and a low household savings rate of just 5.7% of gross disposable income (eurozone: 12.9%).

In a similar vein, the slippage in Britain’s adjustment efforts in the last three years, as described in this report and in previous editions of *The Euro Plus Monitor*, is the result of domestic policy choices, not the consequence of any meddling from its European partners. Ejecting itself from its major trading market does not sound like a strategy to improve Britain’s economic outlook or raise its rankings for fundamental health or adjustment progress.

To which extent Brexit will damage the United Kingdom economy depends very much on its future access to the European Union market and on the stability of such an arrangement. On the morning after the Brexit vote, Berenberg reduced its estimate for future trend growth in the United Kingdom to 1.8%, down from 2.1%. We see no reason to revise this assessment.

Note that the estimate for United Kingdom trend growth in *The 2016 Euro Plus Monitor*, which is part of our backward-looking analysis of fundamental health, is built on actual growth in the past and other supply factors that have not yet been affected by the Brexit vote. It does not incorporate any change in the forward-looking assessment as described above. If we were to put a lower estimate for UK trend growth and – as a result thereof – a more pronounced need to tighten fiscal policy by more into our analysis, the United Kingdom’s score for fundamental health would drop from 5.6 to 5.4, ending up even further below the eurozone average of 5.9.

V. Special Focus: Coping with the Politics of Anger

For better or worse, we are living in exciting times. Globalisation and rapid technological change are creating huge opportunities. However, the gains are not evenly distributed. The major winners are 1) the hundreds of million people in formerly closed and backward economies who have been lifted out of extreme poverty in the last two decades on an unprecedented scale and 2) those in the advanced world who drive innovation, have the required skills or at least the flexibility to adjust to the new global division of labour. Those who see themselves as losers of change are concentrated in the advanced world among those lacking the opportunity, skills or flexibility to adjust. Their plight is often made worse by regulations and by education and welfare systems that hinder rather than promote the required flexibility.

As usual in history, rapid change and significant immigration generate a political backlash among those who see themselves as the losers of change. Across much of the Western world, this backlash has been exacerbated by the legacy of the post-Lehman Brothers collapse mega-recession. The crisis itself was caused by a twin U.S. policy mistake – inflating a big credit bubble until 2007 and then letting it burst in a way that triggered the worst recession in most developed countries in almost 80 years. Sadly, the surge in public debt in the wake of this mega-recession by 45 percentage points of GDP in the US, 47 percentage points in the UK and 26 percentage points in the eurozone from 2007 to 2016 left hardly any room for governments to compensate the actual or perceived losers of globalisation (see also Chart 8 on page 27). The financial crisis and the extraordinary measures needed to contain it have also fed a pervasive "anti-establishment" sentiment.

As a result, disenchanted voters have been drawn to populists from the ultra-right and ultra-left of the political spectrum on both sides of the Atlantic. Short on arguments but long on rhetoric, the populists have skilfully harnessed stratified social media in which mainstream views are often drowned out in favour of echo chambers whose members reinforce each other's views. The radicals from the left and the right have their differences. But as they rebel against the perceived indignities of globalisation, they largely agree on one point: they reject the open societies and the free economic exchanges that underpin the prosperity of advanced countries and offer the emerging economies the only feasible path to catch up with the free societies of the Western world.

The populist backlash against liberal and open societies poses the most serious long-term risk to our modestly positive economic and financial outlook.

It's not about Europe

The surge in populist sentiment is similar in the U.S. (Donald Trump, Bernie Sanders) and Europe (Marine Le Pen, Beppe Grillo, Jeremy Corbyn). It can be found inside the eurozone (Geert Wilders in the Netherlands, Austria's FPÖ) and outside (Sweden Democrats). In the U.S., many right-wingers rail against the "beltway insiders" of Washington, DC. In the same vein, their counterparts in Europe protest against an imaginary EU "superstate" run from Brussels or Frankfurt.

‘In the European club of nation states, the same kind of populism could do more damage than in the United States.’

That the rise in right- and left-wing populism is a problem for much of the economically advanced world leads to one major conclusion. As the European institutions are not the major problem, there is no magic “reform” of the European Union or the eurozone which could thwart the populist threat. Of course, some reforms would be useful, in the U.S. as well as in the EU and the United Kingdom. But don’t expect any such reform to suffice to stop the tide of populist anger.

In one respect, Europe differs from the U.S., though. In Europe, the same kind of populism could do much more damage than in the U.S. As clubs of sovereign nations, the European Union and the eurozone are easier to break than a nation state. Whatever his anti-establishment rhetoric may have been, President Donald Trump will still reside in the White House in Washington, DC. Even if he were to start some trade wars, the U.S. would remain a large common market. But if populists win decisive votes in Europe, the European Union and its common market may fracture, destroying the wealth-generating machine of free commerce in Europe.

Once the post-Lehman crisis had erupted in late 2008, policymakers have – to their great credit – by and large avoided the twin mistakes that had turned the crisis of 1929/1930 into a devastating depression. Instead of letting the money supply contract, they switched to ultra-loose monetary policies, with only the European Central Bank trailing behind until it finally started to act as the chief guardian against financial turmoil with its “whatever it takes” outright monetary transactions (OMT) announcement in the summer of 2012. So far, policymakers have also avoided any serious rise in protectionism. This is one of many reasons why the Western world remains far away from the dark ages of the 1930s with its rampant economic and political nationalism. But as the Brexit vote in the United Kingdom and some pronouncements of U.S. presidential candidate Trump have shown this year, the echoes of these dark ages are now a little less faint than they were before.

Base case: populism will peak within a few years

Trends continue – until they have run their course. Simply projecting recent developments into the future usually doesn’t work for long. We see four major reasons why the more dangerous kinds of populism will likely peak within the next few years before they can do much more damage.

1. **Employment rates are rising** across most of the Western world. As labour markets tighten, average and median real wages will likely increase over time. Although perceptions often lag behind reality, a rebound in the share of wages in gross value added could eventually take the edge out of the current debate about income inequalities. In some European countries such as **Spain** and **Italy**, the long-term results of recent labour market reforms may add to this.

2. **Austerity is over** in most advanced economies. Instead, falling unemployment and the gains from much lower interest payments have created some fiscal scope to improve education and fund other measures to support those hardest hit by the dislocations of globalisation. In most cases, the modest fiscal slippage which we find in *The 2016 Euro Plus Monitor* is not alarming *per se*. The real question is whether countries are using their fiscal space wisely to improve their long-term growth potential by focussing on education, infrastructure and other measures to make their economies more flexible.

‘Populists cannot deliver on their pompous promises. That should help to arrest their rise eventually.’

3. **Even some populists can change**, for instance in response to a reality shock. The erstwhile “True Finns” have become less radical after joining the national government as a junior partner. After first inflicting massive damage upon taking power, the bulk of Greece’s radical Syriza is gradually turning into a more mainstream centre-left party. In Italy, the task of governing Rome and some other major cities may well instil a greater sense of realism into parts of the Five Star Movement protests over time. Although the FPÖ’s Norbert Hofer almost won the presidential election in Austria, he came that far only by renouncing his party’s earlier demand for a referendum on European Union membership.

4. Most importantly, **populists cannot deliver on their pompous promises**. The havoc which Syriza initially wreaked on Greece in 2015 did not exactly help left-wing populists elsewhere in Europe. In the same vein, the contrast between the loud words of the Brexiteers ahead of the United Kingdom referendum on 23 June and their failure to come up with any coherent idea of how to actually go about it does not make it easy for anti-European Union populists elsewhere to argue the case for leaving the EU.

In the end, some economic and social progress and a growing realisation that neither the right-wing nor the left-wing populists can deliver on their promises should help to arrest and partially reverse the rise of the populists over time. That is our base case.

Correction on Chart 12 of *The 2015 Euro Plus Monitor*

On the horizontal axis of Chart 12 on page 41 of *The 2015 Euro Plus Monitor: More Progress, New Risks*, the mark to denote the start of the year 2015 was incorrectly placed beneath the data for November 2014 rather than for January 2015. The main text of the paper described the sequence of events correctly, but the chart itself could have wrongly suggested that the dramatic plunge in Greek corporate confidence, a movement which we described as the “Varoufakis effect,” happened in the second half of 2014 rather than the first eight months of 2015. For the record, the plunge described in the chart took place in the first eight months of 2015. This seems to have caused a little confusion in some quarters. See The Varoufakis Effect – Revisited.

Methodology

For the scores, we rank all sub-indicators on a linear scale of 10 (best) to 0 (worst). In most cases, we calibrate the linear scale so that the top-performing country is slightly below the upper bound and the worst country slightly above the lower bound of the 10-0 range to leave room for subsequent data revisions. For some indicators, small countries had results so far outside the range of the readings for others that we did not use these outliers to define the range. Instead, we accorded these outliers the top score of 10 or the bottom score of 0, respectively.

We compare the current scores and the ranks to those of last year. However, due to revisions to back data for labour costs, exports, imports and some other parameters, the values we give for 2015 scores and ranks can differ slightly from those published in *The 2015 Euro Plus Monitor* on 14 December 2015. We have recalculated the 2015 results on the basis of the revised data. We have also calculated hypothetical 2015 results for the seven newcomers.

To ensure a rough consistency of the data over time, we have adjusted the Irish national accounts data for 2015 and 2016 for the strong upward revision in Irish GDP in Q1 2015 that reflected the restructuring of large multinational enterprises in Ireland rather than any underlying sudden surge in Irish output.

Notes on Key Components

I. Adjustment

1. External Adjustment

1.1 Change in net exports (real, GDP definition) as a percent of GDP. Source: Eurostat.

1.2 Change in net exports for average of Q2 and Q3 2016 over H2 2007, ESA2010, as a percent of starting level. Source: Eurostat.

1.3 Rise in export ratio, percent of GDP, ESA2010, average of Q2 and Q3 2016 over H2 2007. Source: Eurostat.

2. Fiscal Adjustment

2.1 2009-2016 shift in structural primary fiscal balance, percentage of GDP. Source: European Commission Autumn 2016 forecasts, November 2016; Berenberg calculations.

2.2 Fiscal shift 2009-2016 as a percent of shift required 2009-2020 to achieve 60% public debt-to-GDP ratio by 2030, adjusted for age-related spending. Sources: European Commission Autumn 2016 forecasts, November 2016; IMF Fiscal Monitor October 2014 (Greece, Latvia, Lithuania, Bulgaria October 2013); Berenberg calculations.

3. Labour Cost Adjustment

3.1 Cumulative change in Real Unit Labour Costs (RULC), 2009-2016, in percent.

3.2 Shift in RULC trend = cumulative change in RULC 2000-2009 minus the cumulative change in RULC 2009-2016, each minus eurozone changes in same period. Source: European Commission Autumn 2016 forecasts, November 2016.

3.3 Cumulative change in Nominal Unit Labour Costs (NULC) in euros, 2009-2016, in percent. Non-eurozone countries: 2007-2016.

3.4 Shift in NULC (euros) trend = cumulative change in NULC (euros) 2000-2009 minus the cumulative change in NULC (euros) 2009-2016, each minus eurozone changes in same period. Non-eurozone countries: 2000-2007 minus 2007-2016 changes, each minus eurozone average. Source: European Commission Autumn 2016 forecasts, November 2016.

4. OECD Reform Responsiveness Indicator

4. OECD Reform Responsiveness Indicator Average 2010/11, 2012/13 and 2014/15, 0-1 range index. Source: OECD, *Economic Policy Reforms 2015: Going for Growth* (Paris: OECD, February 2015).

II. Fundamental Health Indicator

1. Growth Potential

1.1 Trend growth
1.1.1 Average annual rise in gross value added ex construction, 2002-2016, in percent, ESA2010. Source: Eurostat.
1.1.2 Deviation of annual average rise in gross value added ex construction from income-adjusted norm, 2002-2016, percentage points. Sources: Eurostat; Berenberg calculations.

1.2 Human capital
1.2.1 Fertility rate, 2009-2016 average. Source: United Nations.
1.2.2 Integration of immigrants (1) deviation of *employment* rates of foreign born population from native population, 2011-2015 average, in percentage points; *education*: average of score based on deviation between immigrants and natives in (2a) change in education attainment rates between primary and tertiary education, 2011-2015 average, and (2b) early school leaver rates, 2011-2015 average; *social inclusion*: average score based on deviation between immigrants and natives in (3a) median equalised net incomes, 2011-2015 average, and (3b) at-risk-of-poverty-rates, 2011-2015 average, (3c) home ownership rates, 2011-2015 averages. (4) citizenship acquisition rates, 2010. All based on Eurostat "Migrant Integration Indicators." Sources: Eurostat, Berenberg calculation.
1.2.3 Education: 2015 score in OECD's Programme for International Student Assessment (PISA) study (average of reading, science and mathematics scores). Source: OECD.

1.3 Employment
1.3.1 Employment rate, average 2002-2016, in percent of all 15-64 year-olds. Source: Eurostat.
1.3.2 Average annual change in employment rate, 2002-2016, percentage points. Source: Eurostat.
1.3.3 Youth (15-24 year-olds) unemployment rate, average 2002-2016. Source: Eurostat.
1.3.4 Long-term (more than 12 months) unemployment rate (15-64 year-olds), average 2002-2016, in percent of active population. Source: Eurostat.

1.4 Consumption
1.4.1 Total public and private consumption, average 2002-2016, in percent of GDP, ESA2010. Source: Eurostat.
1.4.2 Average annual change in consumption rate, 2002-2016, percentage points, ESA2010. Source: Eurostat.

2. Competitiveness

2.1 Export ratio, average 2002-2016, percent of GDP, ESA2010. Score based on deviation of export ratio from adjusted norm based on GDP (size) and GDP per capita (income). Outlier Luxembourg excluded from norm regression. Source: Eurostat; Berenberg calculations.

2.2 Average annual rise in export ratio, 2002-2015, percentage points of GDP, ESA2010. Score based on average annual rise relative to starting point average 2002/2003. Source: Eurostat.

2.3 Labour costs
2.3.1 Real Unit Labour Costs (RULC), annual average change 2002-2016, in percent. Source: European Commission Autumn 2016 forecasts, November 2016.
2.3.2 Nominal Unit Labour Costs (NULC), (national currency), annual average change 2002-2016, in percent. Source: European Commission Autumn 2016 forecasts, November 2016.
2.3.3 World Economic Forum Global Competitiveness Report: Hiring and Firing Practices Survey, 2016. 1 (heavily impeded by regulations) - 7 (extremely flexible) range. Source: World Economic Forum Global Competitiveness Report 2016/2017, September 2016.

2.4 Market regulations
2.4.1 World Economic Forum Product Market local competition intensity survey score 2016/17, 0 (not intense at all) -7 (extremely intense) range. Source: World Economic Forum Global Competitiveness Report 2016/2017, September 2016.
2.4.2 OECD service trade restrictiveness indicator 2015. Source: OECD.
2.4.3 World Bank Doing Business Report 2017, days to open a new business. Score also includes cost of opening new businesses, in percent of income per capita. Source: World Bank Doing Business Report, October 2016.

3. Fiscal Sustainability

3.1 Government outlays, average 2002-2016, in percent of GDP, ESA2010. Source: European Commission Autumn 2016 forecasts, November 2016.

3.2 Structural fiscal balance
3.2.1 Structural fiscal balance, 2016, in percent of GDP, ESA2010. Source: European Commission Autumn 2016 forecasts, November 2016.
3.2.2 Structural primary fiscal balance, 2016, in percent of GDP, ESA2010. Source: European Commission Autumn 2016 forecasts, November 2016; Berenberg calculations.

3.3 Public debt end of 2016, in percent of GDP, ESA2010. Source: European Commission Autumn 2016 forecasts, November 2016.

3.4 Sustainability gap 2017-2020, adjusted for age-related spending, in percent of GDP. Source: IMF Fiscal Monitor, October 2014 (Greece, Latvia, Lithuania, Bulgaria October 2013); European Commission Autumn 2016 forecasts, November 2016; Berenberg calculations.

4. Resilience

4.1 Total government bond and bill redemptions, 2017-2019, in percent of 2015 nominal GDP, ESA2010. Source: Bloomberg.

4.2 Share of public debt held by foreigners, 2015, in percent of GDP. Source: IMF Fiscal Monitor, October 2016; Eurostat.

4.3 Gross household savings rate, 2016, in percent of disposable income. Source: European Commission Autumn 2016 forecasts, November 2016.

4.4 Current account balance, 2016, in percent of GDP, ESA2010. Source: European Commission Autumn 2016 forecasts, November 2016.

4.5 Monetary Financial Institutions total assets/liabilities, October 2016, in percent of 2015 nominal GDP, ESA2010. Sources: ECB, Eurostat.

4.6 Private sector debt, 2015, in percent of GDP, ESA2010. Source: Eurostat.

VI. References and Additional Reading

- Caldera-Sánchez, Aida, Alain de Serres, Filippo Gori, Mikkel Hermansen and Oliver Röhn. *Strengthening Economic Resilience: Insight from the Post-1970 Record of Severe Recessions and Financial Crises* (Paris: OECD, forthcoming)
- Conway, Paul, Véronique Janod and Giuseppe Nicoletti. "Product Market Regulation in OECD countries: Measurement and Highlights," *OECD Economics Department Working Paper No. 530* (Paris: OECD, 2006)
- European Commission. "European Economic Forecasts Autumn 2016," *European Economy 11/2016 November 2016* (Brussels: European Commission, 2016)
- European Council. *European Council Conclusions EUCO 10/1/11 REV 1, 24-25 March 2011* (Brussels: European Council, 2011)
- International Monetary Fund. *Fiscal Monitor October 2013: Taxing Times* (Washington, DC: IMF, 2013)
- -----------. *Fiscal Monitor October 2014: Back to Work: How Fiscal Policy Can Help* (Washington, DC: IMF, 2014)
- -----------. *Fiscal Monitor October 2015: The Commodities Roller Coaster* (Washington, DC: IMF, 2015)
- -----------. *Fiscal Monitor October 2016: Debt: Use It Wisely* (Washington, DC: IMF, 2016)
- Organisation for Economic Co-operation and Development. *Programme for International Student Assessment (PISA) 2009 Results: What Students Know and Can Do: Student Performance in Reading, Mathematics and Science, Vol. 1* (Paris: OECD, 2010)
- -----------. *PISA 2012 Results: What Students Know and Can Do: Student Performance in Reading, Mathematics and Science, Vol. 1* (Paris: OECD, revised edition, February 2014)
- -----------, *PISA 2015 Results: What Students Know and Can Do: Student Performance in Reading, Mathematics and Science, Vol. 1* (Paris: OECD, December 2016)
- -----------. *Ten Years of Product Market Reform in OECD Countries – Insights from a Revised PMR Indicator* (Paris: OECD, 2008)
- -----------. *Economic Policy Reforms 2015: Going for Growth* (Paris: OECD, 2015)
- Schmieding, Holger. "Tough Love: The True Nature of the Euro Crisis," *Berenberg Macro Views* (London: Berenberg, 2012)
- -----------. "Saving the Euro: The Case for an ECB Yield Cap," *Berenberg Macro Views* (London: Berenberg, 2012)
- -----------. "Coping with the Politics of Anger", *Berenberg Macro Views* (London, Berenberg, 2016)

- Schmieding, Holger, Paul Hofheinz, Jörn Quitzau, Anna Rossen and Christian Schulz. *The 2011 Euro Plus Monitor: Progress Amid the Turmoil* (London/Brussels: Berenberg/Lisbon Council, 2011)
- Schmieding, Holger, Christian Schulz and Paul Hofheinz. *The 2012 Euro Plus Monitor: The Rocky Road to Balanced Growth* (London/Brussels: Berenberg/Lisbon Council, 2012)
- -----------. *The 2013 Euro Plus Monitor: From Pain to Gain* (London/Brussels: Berenberg/Lisbon Council, 2013)
- Schmieding, Holger and Christian Schulz. *The 2014 Euro Plus Monitor: Leaders and Laggards* (London/Brussels: Berenberg/Lisbon Council, 2014)
- Schmieding, Holger. *The 2015 Euro Plus Monitor: More Progress, New Risks* (London/Brussels: Berenberg/Lisbon Council, 2015)
- Schmieding, Holger. *The Euro Plus Monitor Spring 2016 Update: Economic Progress amid Rising Political Risk* (London/Brussels: Berenberg/Lisbon Council, 2016)
- United Nations, *United National World Population Prospects: The 2015 Revision* (New York: United Nations, 2015)
- World Bank, *Doing Business 2016: Measuring Regulatory Quality and Efficiency* (Washington, DC: World Bank, 2015)
- -----------. *Doing Business 2017: Measuring Business Regulations* (Washington, DC: World Bank, 2016)
- World Economic Forum, *Global Competitiveness Report 2016-2017* (Geneva: World Economic Forum, 2016)

Acknowledgements

The authors would like to thank Sergey Filippov, Stéphanie Lepczynski, Catherine L. Mann, Chrysoula Mitta and Alain de Serres.

Lisbon Council Policy Brief, Vol. 10, No. 1 (2016)
ISSN: 2031-0943 (print); 2031-0951 (digital)

Published 14 December 2016
Responsible Editor: Paul Hofheinz

First published in Belgium and the United Kingdom by the Lisbon Council and Berenberg

Design by karakas

About Berenberg
Founded in 1590, Berenberg is one of Europe's leading private banks today, offering services in the divisions of private banking, investment banking, asset management and corporate banking. Headquartered in Hamburg and led by managing partners, Berenberg maintains a strong presence in the financial centres of Frankfurt, London, New York and Zurich. More than 1,500 employees carry the bank's long tradition of success into the future. Its website is www.berenberg.com.

About the Lisbon Council
The Lisbon Council for Economic Competitiveness and Social Renewal asbl is a Brussels-based think tank and policy network. Established in 2003 in Belgium as a non-profit, non-partisan association, the group is dedicated to making a positive contribution through cutting-edge research and by engaging political leaders and the public at large in a constructive exchange about the economic and social challenges of the 21st century. Its website is www.lisboncouncil.net.

BERENBERG
PARTNERSHIP SINCE 1590

Berenberg
Neuer Jungfernstieg 20
20354 Hamburg, Germany
T. +49 40 350 600
F. +49 40 350 60 900

the Lisbon council
think tank for the 21st century

The Lisbon Council asbl
IPC-Résidence Palace
155 rue de la Loi
1040 Brussels, Belgium
T. +32 2 647 9575
F. +32 2 540 9828