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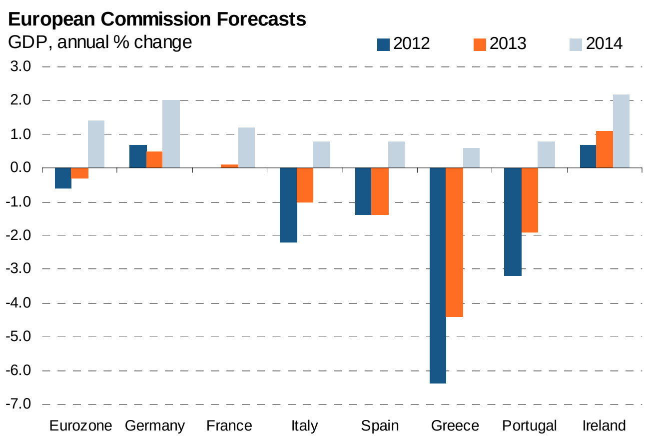
Eurozone

European Commission sees eurozone contraction in 2013

- **Eurozone GDP expected to fall 0.3% against prior forecasts of 0.1% growth**
- **2013 expansion dependent upon reviving German economy**
- **Gloomier assessment opens door for relaxation of deficit reduction targets**

A downward revision to the European Commission's economic growth forecasts for the eurozone suggest that governments will be given more time to reduce budget deficits without implementing harsher austerity measures, while at the same time putting more pressure on the European Central Bank to provide a further boost of stimulus, perhaps via a cut in its main policy rate.



	GDP % change			Previous forecasts		
	2012	2013	2014	2012	2013	2014
Eurozone	-0.6	-0.3	1.4	-0.4	0.1	1.4
Germany	0.7	0.5	2.0	0.8	0.8	2.0
France	0.0	0.1	1.2	0.2	0.4	1.2
Italy	-2.2	-1.0	0.8	-2.3	-0.5	0.8
Spain	-1.4	-1.4	0.8	-1.4	-1.4	0.8
Greece	-6.4	-4.4	0.6	-6.0	-4.2	0.6
Portugal	-3.2	-1.9	0.8	-3.0	-1.0	0.8
Ireland	0.7	1.1	2.2	0.4	1.1	2.2
EU27	-0.3	0.1	1.6	-0.3	0.4	1.6

The eurozone is expected to recover slower than anticipated, returning to growth in 2014 instead of this year. Whereas the Commission previously expected the single currency area's GDP to rise by 0.1% in 2013, a 0.3% contraction is now pencilled-in, following the 0.6% decline seen in 2012.

The EC recognises that growth has so far disappointed due to the greater than anticipated damage caused by the 2008-9 financial crisis, and is likely to continue to do so in 2013. The finger is pointed at high unemployment, set to peak at 12.2%, weak investment and a lack of bank lending to households and businesses.

This therefore opens the door to the possibility that governments will be granted more time to reduce their budget deficits, meaning they may not be forced to implement further, more aggressive austerity measures. This will clearly help to ease some of the political and social tensions that are apparent in the peripheral countries of Italy, Spain, Portugal and Greece.

Also, the lowering of the growth forecasts will inevitably put further pressure on the ECB to do more in terms of stimulus, lowering the bar to a cut in interest rates.

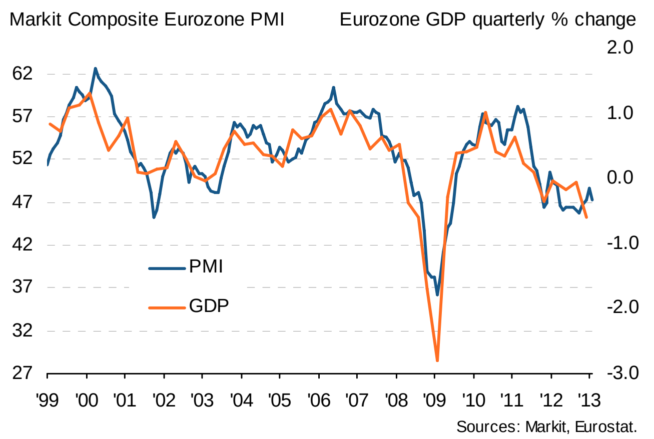
The forecasts also reinforce the picture of an increasingly polarised Eurozone. Germany is expected to grow by 0.5% this year while France will manage a mere 0.1% expansion. Spain and Italy are meanwhile forecast to contract by 1.4% and 1.0% respectively, though all of the four largest euro members are expected to return to growth in 2014. Greece and Portugal are likewise expected to contact again in 2013, though are also set to grow in 2014.

The forecasts look reasonable given the economic indicators that we have seen at the start of 2013, with the possible exception of France, where the PMIs are suggesting that the economy is facing a deepening downturn, and that a contraction in 2013 is more likely than the small expansion that the Commission is anticipating.

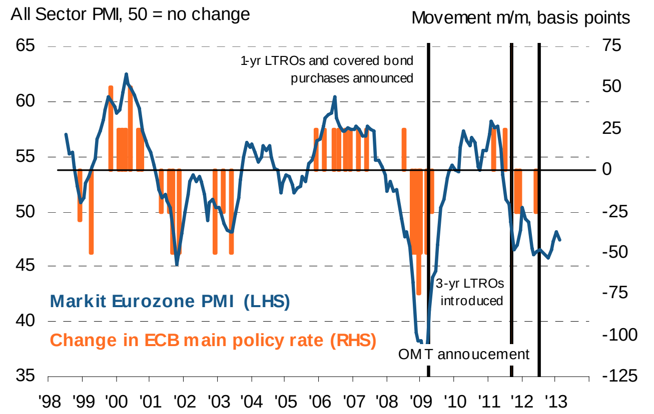
Government borrowing as % of GDP
(minus sign indicates surplus)

	2012	2013	2014
Germany	-0.1	0.2	0.0
Spain	10.2	6.7	7.2
France	4.6	3.7	3.9
Italy	2.9	2.1	2.1
Greece	6.6	4.6	3.5
Portugal	5.0	4.9	2.9
Ireland	7.7	7.3	4.2

Lower EC forecast tallies with ongoing downturn signalled by business surveys



Weak growth opens door for further ECB stimulus



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