



Euro area overview

The euro area came into existence on 1 January 1999 when the euro was officially launched in 11 EU member states. The euro area now comprises 17 member states and accounts for almost 20% of world GDP – second only to the United States of America.

Prior to the launch of the euro, many critics warned that a monetary union would not work without a fiscal union. The Stability and Growth Pact, which among other things stipulates that government debt should be below 60% of GDP and government deficit below 3% of GDP, was supposed to work as a safeguard ensuring that member states implemented prudent fiscal policies. Fiscal slippage did however take place in a number of countries including France and Germany but the Council failed to apply sanctions. Following the financial crisis, which caused a substantial deterioration in government budgets, the euro area as a whole now breaches both the debt and deficit limits.

The financial crisis became a debt crisis when revisions of Greek budget data in the autumn of 2009 showed that the fiscal situation was substantially worse than previously thought. Greece was granted a EUR110bn EU/IMF package in May 2010. In the meantime, the debt crisis had become contagious and, in an attempt to stop the crisis, on 9 May 2010 the EU and the IMF presented rescue funds (EFSF) totalling EUR750bn and the ECB announced that it would begin to purchase government bonds in the secondary market. Ireland, which had a government budget deficit of 32% of GDP in 2010 caused by one-off expenditures for bank rescues, was the first country to receive a EUR85bn rescue package with contributions from the new funds in November 2010. Portugal received a EUR78bn rescue package in May 2011 and Greece was committed EUR130bn in a second rescue package in February 2012. The euro area and the private sector also agreed on private sector involvement (PSI) in the form of debt restructuring including a 53.5% haircut on Greek government bonds. Collective Action Clauses (CAC) were included in Greek law in last minute changes in order to secure a high participation rate. During the summer of 2012, Spain was granted up to EUR100bn in financial assistance to the country's banking sector funded via the EFSF and in December 2012 the government received the first disbursement of close to EUR39.5bn. In March 2013 a EUR10bn bailout deal for Cyprus was agreed by the Eurogroup. The deal included PSI through losses on deposits above the EUR100,000 deposit guarantee threshold. An initial agreement that included losses for deposits below the threshold was rejected by the Cypriot parliament. Even though Cyprus is described as unique, the risk of bank runs in other countries may have increased as depositors might fear that bank deposits have become less secure.

Substantial fiscal tightening in the PIIGS countries has resulted in a reduction in budget deficits but has also caused severe recessions. At the EU summit on 21 July 2011, it was agreed to enhance the capabilities of the EFSF by increasing its actual lending capacity to EUR440bn and allowing it to purchase government bonds in the secondary market (based on ECB analysis) and for EFSF funds to be used for recapitalisation of banks. The European Financial Stability Mechanism (EFSM), which has EUR60bn administered by the European Commission, has also contributed to the rescue packages as does the IMF, which has committed EUR250bn.

Key facts

- 17 member states
- Population: 319m (2012)
- GDP: EUR9.4trn
- GDP per capita: EUR28,500 (2012)
- European Council President: Herman Van Rompoy
- European Commission President: José Manuel Barroso
- Euro Group President: Jeroen Dijsselbloem
- ECB President: Mario Draghi

Economic characteristics

- Economic and monetary union
- Second-largest GDP in the world
- Four member states have an EU/IMF programme
- Large public sector
- High unemployment rate
- Large government debt

Senior Economist

Frank Øland Hansen
+45 4512 8526
franh@danskebank.dk

Analyst

Pernille Bomholdt Nielsen
+45 4513 2021
perni@danskebank.dk

Assistant Analyst

Mikael Olai Milhøj
milh@danskebank.dk

The *European Stability Mechanism* (ESM) has replaced both the EFSM and EFSF as the new permanent rescue fund for euro member states. The EFSF will no longer take part in new programmes and will only complete its existing programmes. The ESM has a lending capacity of EUR500bn and is located in Luxembourg.

In March 2012, all EU member states, except the UK and the Czech Republic, signed the so called 'Fiscal compact', which came into force on 1 January 2013. The aim is to improve fiscal co-ordination and the fiscal discipline in member states. Some of the main requirements in the new compact are that the structural deficit should not be larger than 0.5%, an annual reduction of the debt ratio by 1/20 of the difference between the actual debt-to-GDP ratio and the 60% threshold, more surveillance and guidance from the European Council as well as more co-ordination between member states, etc. The rules are embedded in domestic laws.

The next step is to supplement the current monetary union and tougher fiscal discipline with a Banking Union. The first step towards a Banking Union was taken in December 2012 with the creation of a Single Supervisory Mechanism (SSM) which gives the ECB overall responsibility for the supervision of large European banks (approximately 6,000 European banks). The supervisory task is to be separated from the monetary policy to avoid conflicts. The Banking Union is planned to have three different aspects: the SSM, a common bank resolution mechanism and a joint bailout fund. Discussions are still ongoing but are complicated by the German wish for treaty changes.

The *European Central Bank* is in charge of monetary policy within the euro area. Its primary objective is to maintain price stability. The ECB's Governing Council has defined this as keeping euro area inflation (HICP) below, but close to, 2%. The ECB reserves its main policy tool – the interest rate – to achieving this target. Other measures are used to secure the smooth functioning of the financial system. These non-standard measures have included a covered bond programme, a Securities Market Programme (SMP) for government bond purchases in the secondary market, Long-term Refinancing Operations (LTRO) with full allotment and Outright Monetary Transactions (OMT) for buying sovereign bonds in the secondary market under strict and effective conditionality attached to an appropriate EFSF/ESM programme. The ECB Governing Council consists of six executive board members and the governors of the national central banks of the euro area countries. Executive board members including the ECB president serve for eight years. The ECB is located in Frankfurt, Germany.

The *Eurogroup* is the main political body of the euro area and consists of the finance ministers of the euro area, the Commissioner for Economic and Monetary Affairs and the President of the European Central Bank. The Eurogroup meets the day before the regular *Economic and Financial Affairs Council* (ECOFIN). During the debt crisis many key decisions have been taken at the level of the heads of state or government of the euro area at EU summits.

There is still a need for fiscal tightening in the euro area but EU politicians have started focusing more on growth-promoting policies and have moved away from the view of saving its way out of the crisis at any cost. Even though the headwind from fiscal tightening is fading, the recovery in the euro area is likely to be fairly slow. The strengthening of growth abroad will be an essential driver of the euro area recovery while private consumption and investment is only expected to improve slowly as confidence begins to return. The unemployment rate, which currently stands at 12.1% (19.2 million unemployed), is expected to remain elevated and may even climb higher as growth remains subdued.

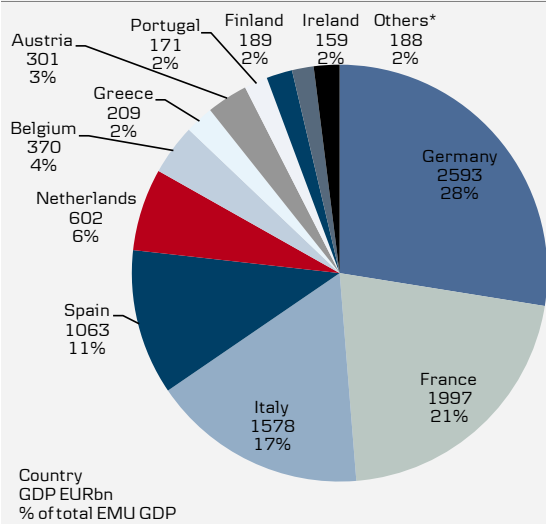
Outlook for key economic variables

EURO	GDP (1)		CPI (1)		Unemployment (2)		Gov. Balance (3)		Gov. Debt (3)	
	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014
Austria	0.6	1.8	2.0	1.8	4.7	4.7	-2.2	-1.8	73.8	73.7
Belgium	0.0	1.2	1.3	1.6	8.0	8.0	-3.1	-3.3	101.4	102.1
Cyprus	-8.7	-3.9	1.0	1.2	15.5	16.9	-6.5	-8.4	109.5	124.0
Estonia	3.0	4.0	3.6	3.1	9.7	9.0	-0.3	0.2	10.2	9.6
Finland	0.3	1.0	2.4	2.2	8.1	8.0	-2.2	-1.9	56.2	57.7
France	-0.1	1.1	1.2	1.7	10.6	10.9	-4.0	-4.3	94.0	96.2
Germany	0.4	1.8	1.8	1.6	5.4	5.3	-0.2	0.0	81.1	78.6
Greece	-4.2	0.6	-0.8	-0.4	27.0	26.0	-3.8	-2.6	175.2	175.0
Ireland	1.1	2.2	1.3	1.3	14.2	13.7	-7.1	-4.2	123.3	119.5
Italy	-1.3	0.7	1.6	1.5	11.8	12.2	-2.7	-2.3	131.4	132.2
Luxembourg	0.8	1.6	1.9	1.7	5.5	5.8	-0.2	-0.4	23.4	25.2
Malta	1.4	1.8	1.9	1.9	6.3	6.1	-3.7	-3.6	73.9	74.9
Netherlands	-0.8	0.9	2.8	1.5	6.9	7.2	-3.6	-3.5	74.6	75.8
Portugal	-2.3	0.6	0.7	1.0	18.2	18.5	-5.5	-4.0	123.0	124.3
Slovakia	1.0	2.8	1.9	2.0	14.5	14.1	-3.0	-3.1	54.6	56.7
Slovenia	-2.0	-0.1	2.2	1.4	10.0	10.3	-5.3	-4.9	61.0	66.5
Spain	-1.5	0.9	1.5	0.8	27.0	26.4	-6.5	-7.0	91.3	96.8
Euro average	-0.4	1.2	1.6	1.5	12.2	12.1	-2.9	-2.7	95.5	96.0
Denmark	0.7	1.7	1.1	1.6	7.7	7.6	-1.9	-2.9	45.0	46.4

1) % y/y. 2) % of labour force. 3) % of GDP.

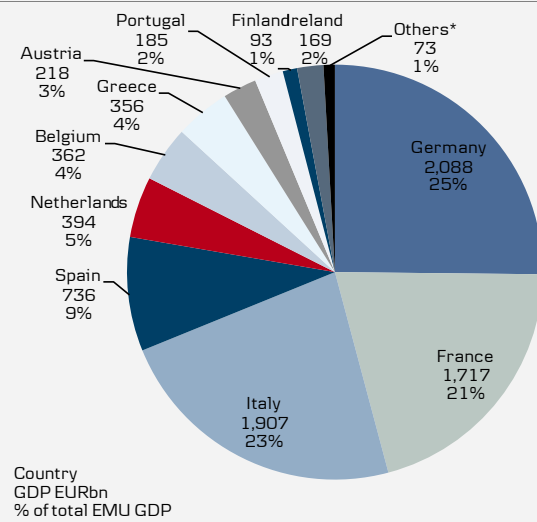
Source: EU Commission (spring 2013)

Share of total EMU nominal GDP (EUR9.4trn)



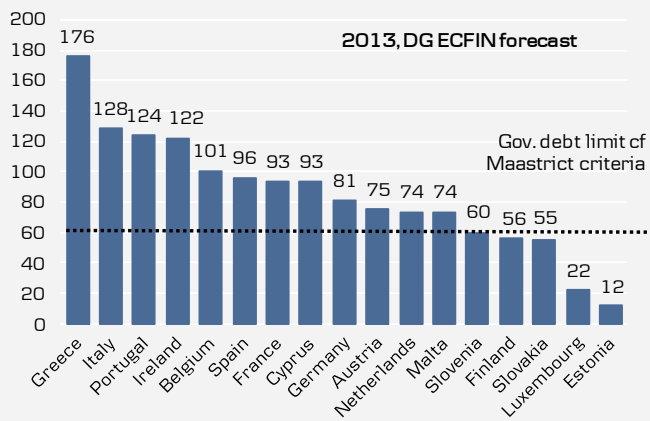
*Slovakia, Slovenia, Luxembourg, Cyprus, Malta, Estonia
Source: Reuters EcoWin

Share of total EMU government debt (EUR8.3trn)



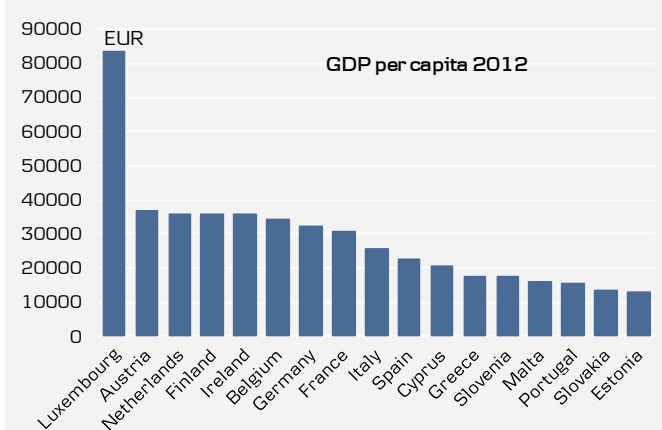
*Slovakia, Slovenia, Luxembourg, Cyprus, Malta, Estonia
Source: Reuters EcoWin

Many euro area countries do not fulfil the debt criteria



Source: Reuters EcoWin

GDP per capita in 2012*



*Data for France is from 2011
Source: Reuters EcoWin

Business Climate: Ranking of economies, sorted by overall 'Ease of Doing Business'

Economy	Ease of Doing Business Rank	Starting a Business	Dealing with Construction Permits	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Resolving Insolvency	Corruption index
Finland	11	49	34	24	40	70	23	6	9	5	69
Ireland	15	10	106	53	12	6	6	28	63	9	90
Germany	20	106	14	81	23	100	72	13	5	19	79
Estonia	21	47	35	14	40	70	50	7	31	72	64
Austria	29	134	75	34	23	100	77	26	7	12	75
Portugal	30	31	78	30	104	49	77	17	22	23	71
Netherlands	31	67	89	49	53	117	29	12	32	6	63
Belgium	33	44	57	176	70	19	75	29	18	7	84
France	34	27	52	146	53	82	53	27	8	43	69
Slovenia	35	30	61	83	104	17	63	57	56	42	61
Cyprus	36	37	80	99	53	32	31	18	108	25	66
Spain	44	136	38	57	53	100	34	39	64	20	65
Slovakia	46	83	46	8	23	117	100	98	69	38	46
Luxembourg	56	93	33	134	159	128	14	32	1	52	80
Italy	73	84	103	39	104	49	131	55	160	31	42
Greece	78	146	31	150	83	117	56	62	87	50	36
Malta	102	150	167	80	176	70	27	34	121	67	57
Singapore	1	4	2	36	12	2	5	1	12	2	87
Denmark	5	33	8	6	23	32	13	4	34	10	90
Chad	184	181	127	140	104	158	184	180	167	185	23

Green numbers are the highest score within a category. Red numbers are the lowest.

Source: World Bank Group and Transparency International

Credit ratings and outlook

EURO	Moody's	Outlook	S&P	Outlook	Fitch	Outlook
Austria	Aaa	neg	AA+	stable	AAA	stable
Belgium	Aa3	neg	AA	neg	AA	stable
Cyprus	Caa3	neg	CCC	stable	B-	
Estonia	A1	stable	AA-	stable	A+	stable
Finland	Aaa	stable	AAA	stable	AAA	stable
France	Aa1	neg	AA+	neg	AAA	neg
Germany	Aaa	neg	AAA	stable	AAA	stable
Greece	C	-	B-	stable	CCC	-
Ireland	Ba1	neg	BBB+	stable	BBB+	stable
Italy	Baa2	neg	BBB+	neg	BBB+	neg
Luxembourg	Aaa	neg	AAA	stable	AAA	stable
Malta	A3	neg	BBB+	stable	A+	stable
Netherlands	Aaa	neg	AAA	neg	AAA	neg
Portugal	Ba3	neg	BB	stable	BB+	neg
Slovakia	A2	neg	A	stable	A+	stable
Slovenia	Baa2	neg	A-	stable	A-	neg
Spain	Baa3	neg	BBB-	neg	BBB	neg

Source: Bloomberg

Key macroeconomic indicators

Structural indicators

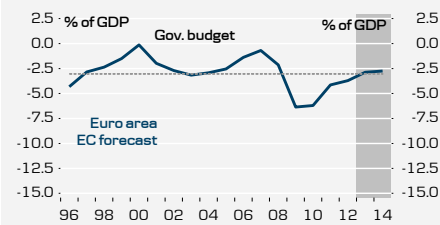
Euro area (EMU) versus the US							
	When	EMU	US		When	EMU	US
GDP(1)	Q4-12	-0.6	0.1	GDP per capita (3)	2012	28,500	38,630
Public sector (2)	Q4-12	53.7	34.7	Unemployment (4)	Mar-13	12.1	7.6
Private cons (2)	Q4-12	57.5	73.1	Inflation (5)	Mar-13	1.7	1.5
Investments (2)	Q4-12	17.9	13.1	Public budget (2, 6)	2013	-2.9	-6.9
Exports (2)	Q4-12	45.9	13.8	Public debt (2, 6)	2013	95.5	110.6
Current account (2), (7)	Q4-12	1.6	-0.7	Long-term interest rates	Mar-13	3.09	1.95

1: % q/q, 2: Pct of GDP, 3: EUR per capita, 4: % of labour force, 5: % y/y, 6: DG ECFIN forecasts, 7: 12M average

Source: Reuters EcoWin, Danske Bank Markets

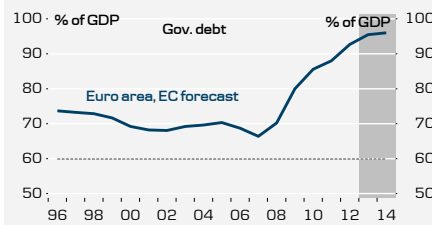
Public finances

Budget deficit



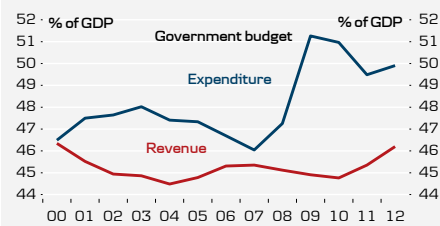
Source: Reuters EcoWin, Danske Bank Markets

Government debt



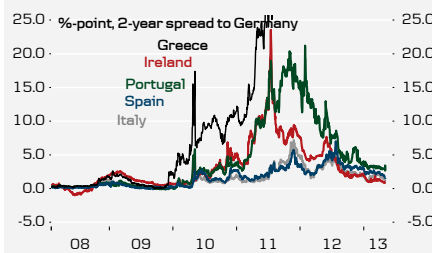
Source: Reuters EcoWin, Danske Bank Markets

Public revenue and expenditure



Source: Reuters EcoWin, Danske Bank Markets

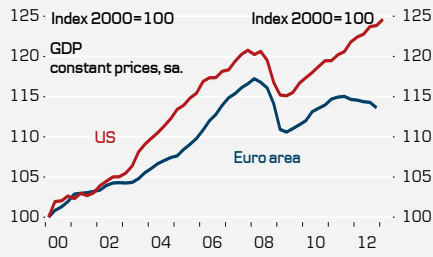
Sovereign spreads



Source: Reuters EcoWin, Danske Bank Markets

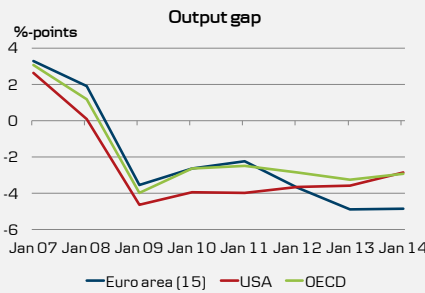
National account

Real GDP



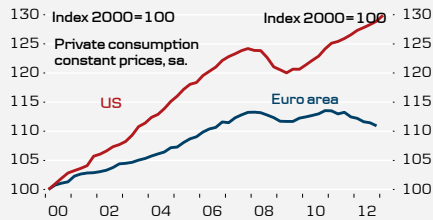
Source: Reuters EcoWin, Danske Bank Markets

Output gap



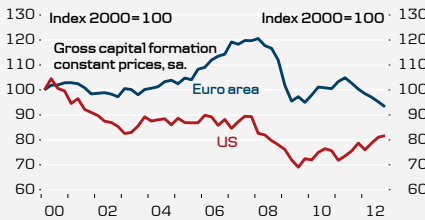
Source: OECD

Private consumption



Source: Reuters EcoWin, Danske Bank Markets

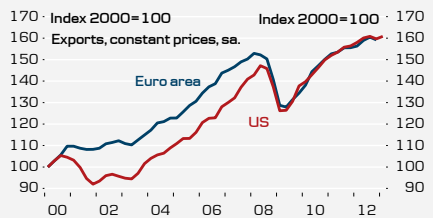
Investments



Source: Reuters EcoWin, Danske Bank Markets

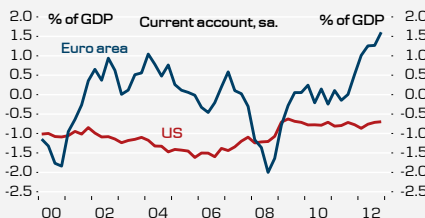
Export and trade

Exports



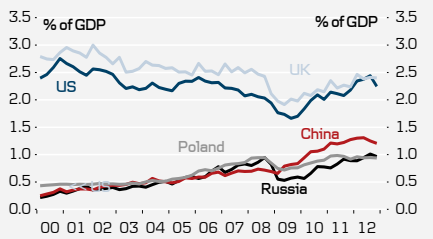
Source: Reuters EcoWin, Danske Bank Markets

Current account



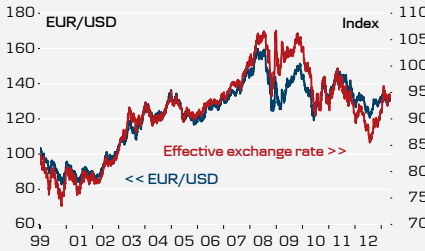
Source: Reuters EcoWin, Danske Bank Markets

Exports by country



Source: Reuters EcoWin, Danske Bank Markets

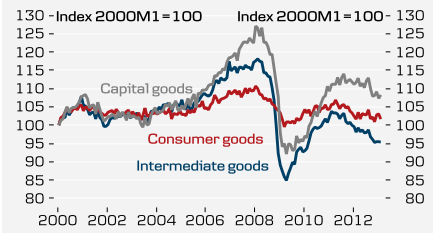
Exchange rate



Source: Reuters EcoWin, Danske Bank Markets

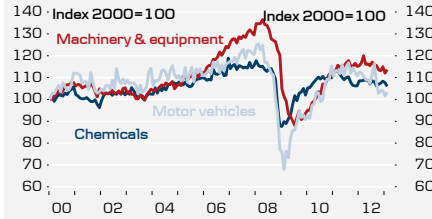
Industrial activity indicators

Industrial production



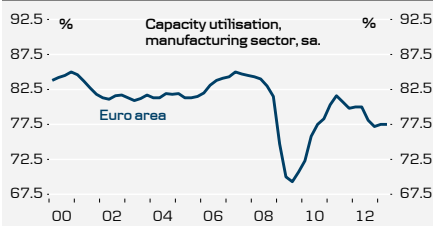
Source: Macrobond, Danske Bank Markets

Industrial production, sectors



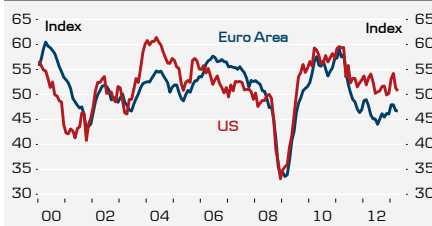
Source: Reuters EcoWin, Danske Bank Markets

Capacity utilisation



Source: Reuters EcoWin, Danske Bank Markets

Manufacturing PMI



Source: Reuters EcoWin, Danske Bank Markets

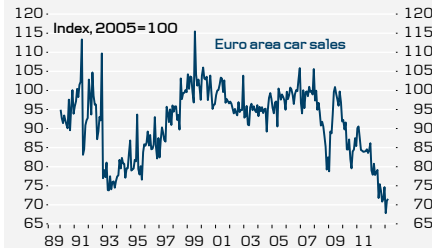
Private consumption

Retail sales



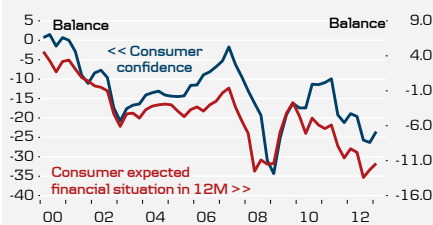
Source: Reuters EcoWin, Danske Bank Markets

Car sales



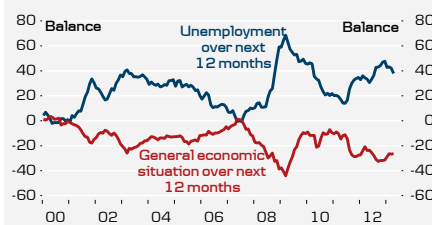
Source: Reuters EcoWin, Danske Bank Markets

Consumer confidence



Source: Reuters EcoWin, Danske Bank Markets

Consumers confidence, economic outlook



Source: Reuters EcoWin, Danske Bank Markets

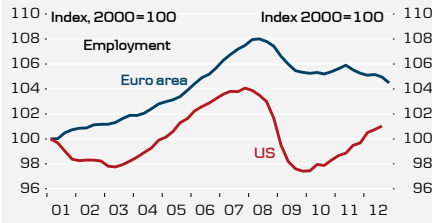
Labour market

Unemployment



Source: Reuters EcoWin, Danske Bank Markets

Employment



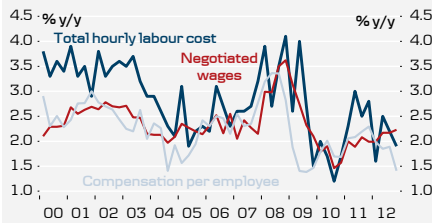
Source: Reuters EcoWin, Danske Bank Markets

Productivity and unit labour cost



Source: Reuters EcoWin, Danske Bank Markets

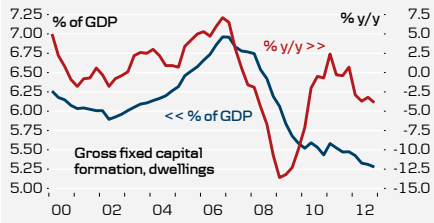
Wage growth



Source: Reuters EcoWin, Danske Bank Markets

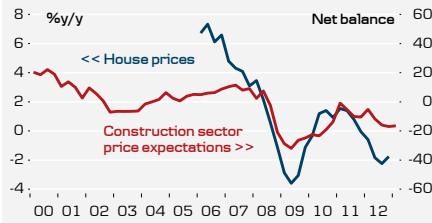
Housing market

Housing investments



Source: Reuters EcoWin, Danske Bank Markets

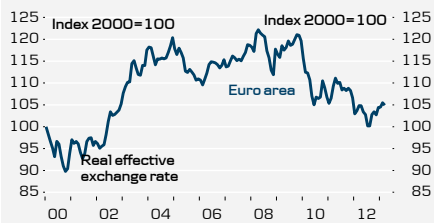
House and construction prices



Source: Reuters EcoWin, Danske Bank Markets

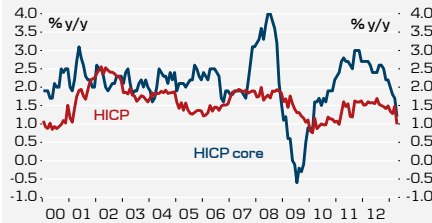
Competitiveness indicators

Real effective exchange rate



Source: Reuters EcoWin, Danske Bank Markets

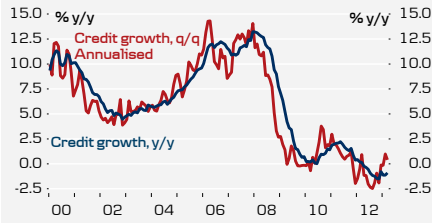
Inflation



Source: Reuters EcoWin, Danske Bank Markets

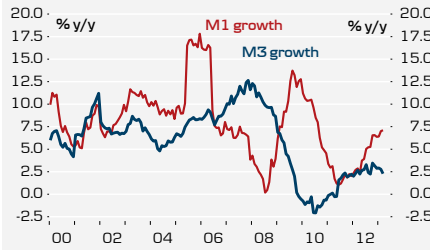
Money and credit

Credit growth



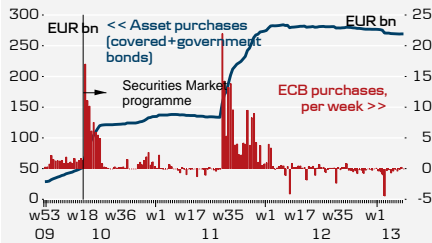
Source: Reuters EcoWin, Danske Bank Markets

Money growth



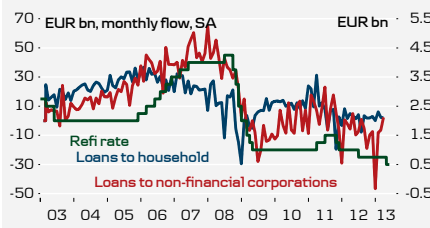
Source: Reuters EcoWin, Danske Bank Markets

ECB asset purchases



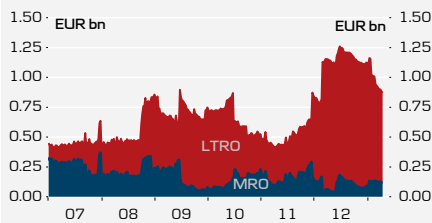
Source: Reuters EcoWin, Danske Bank Markets

Monthly loan flows



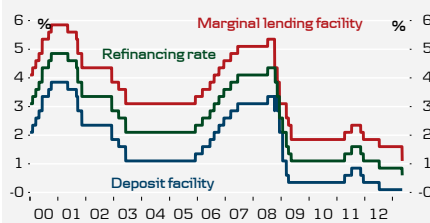
Source: Reuters EcoWin, Danske Bank Markets

ECB refinancing operations



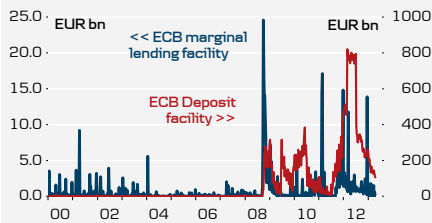
Source: Reuters EcoWin, Danske Bank Markets

ECB policy rates



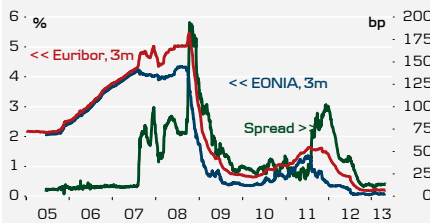
Source: Reuters EcoWin, Danske Bank Markets

Use of ECB marginal lending and deposit facilities



Source: Reuters EcoWin, Danske Bank Markets

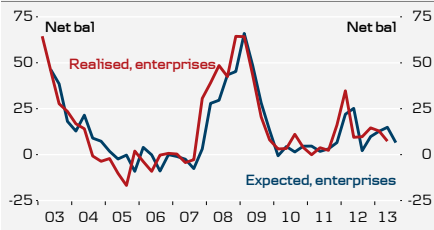
Euribor-Eonia 3M spread



Source: Reuters EcoWin, Danske Bank Markets

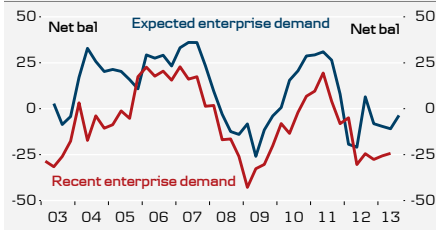
Bank lending survey

Tightening in credit standards on loans to enterprises



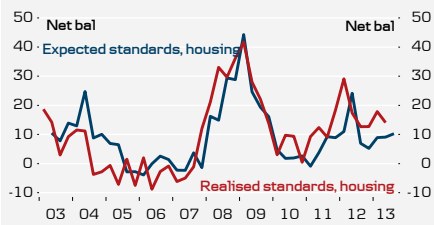
Source: Reuters EcoWin, Danske Bank Markets

Enterprise demand for loans



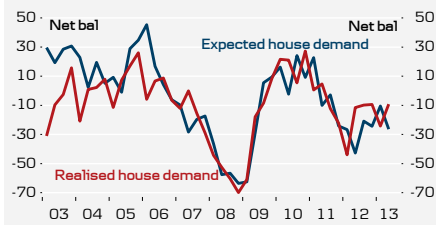
Source: Reuters EcoWin, Danske Bank Markets

Tightening in credit standards on loans for house purchase



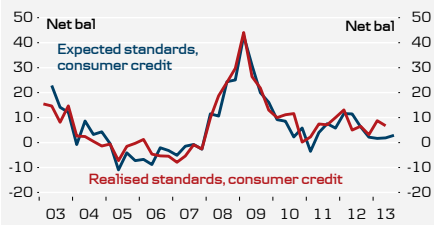
Source: Reuters EcoWin, Danske Bank Markets

Demand for loans for house purchase



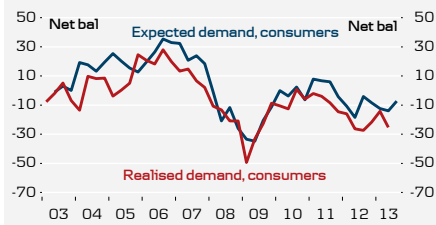
Source: Reuters EcoWin, Danske Bank Markets

Tightening in credit standards on consumer credit



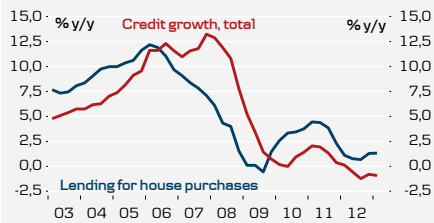
Source: Reuters EcoWin, Danske Bank Markets

Demand for consumer credit



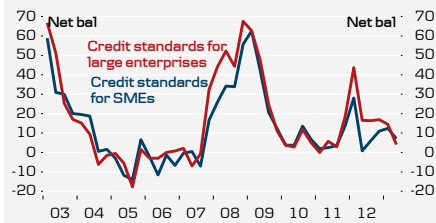
Source: Reuters EcoWin, Danske Bank Markets

Credit growth



Source: Reuters EcoWin, Danske Bank Markets

Credit standards for SMEs



Source: Reuters EcoWin, Danske Bank Markets

Disclosure

This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The authors of the research report are Frank Øland Hansen, Senior Analyst, Pernille Bomholdt Nielsen, Analyst and Mikael Olai Milhøj, Assistant Analyst.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Services Authority (UK). Details on the extent of the regulation by the Financial Services Authority are available from Danske Bank upon request.

The research reports of Danske Bank are prepared in accordance with the Danish Society of Financial Analysts' rules of ethics and the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from and do not report to other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors upon request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including a sensitivity analysis of relevant assumptions, are stated throughout the text.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank Markets (a division of Danske Bank A/S). It is provided for informational purposes only. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

The research report has been prepared independently and solely on the basis of publicly available information that Danske Bank considers to be reliable. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and Danske Bank, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts responsible for the research report and reflect their judgement as of the date hereof. These opinions are subject to change, and Danske Bank does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for retail customers in the United Kingdom or the United States.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank's prior written consent.

Disclaimer related to distribution in the United States

This research report is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank who have prepared this research report are not registered or qualified as research analysts with the NYSE or FINRA but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.