Research Office
Legislative Council Secretariat

Fact Sheet

Economic landscape in Europe

FSC12/14-15

1. Introduction

1.1 Europe is one of the key economic players in the world. The European Union ("EU"), comprising 28 European countries, accounts for about 30% of global Gross Domestic Product ("GDP") and 20% of global trade flows. The euro, since its first introduction in 1999, has emerged as a key international currency.[1] In the face of economic crisis, Europe entered the deepest recession in 2009 since the end of the Second World War. GDP in EU fell by 4% and industrial production dropped by 20%.

1.2 The economic crisis has led EU, working together with the International Monetary Fund and the European Central Bank, to devise measures to stabilize the fragile economies. Despite the series of bailout measures, the economic recovery in Europe has remained slow. To enhance Members' understanding of the economic landscape in Europe, this fact sheet provides information on three aspects: (a) the economic state in Europe, (b) the performance of Germany since the economic crisis, and (c) the latest development of the Greek bailout issue.

2. Economic state in Europe

2.1 The economies in Europe have been struggling in recent years in the wake of the economic crisis. The crisis was triggered by the credit crunch in the United States' banking sector in 2008.[2] European banks that had invested heavily in the mortgage market in the United States were hit hard. To save

---

[1] The euro area consists of 19 EU countries that have adopted the euro as their currency.

[2] The credit crisis was arising from the burst of the housing bubble in the United States with many homeowners defaulting on their mortgages. Banks with investments linked to those mortgages were in financial turmoil.

banks from failing, the European governments intervened and a total amount of €1.6 trillion (HK$14 trillion) was committed to rescuing the banks between 2008 and 2011.

2.2 In fact, European countries such as Greece, Spain and Portugal had been for years relying on debt to finance their government budgets. Massive public debts accumulated had considerably raised the cost of borrowing, leading to the sovereign debt crisis and financial instability. EU finally stepped in with the International Monetary Fund and the European Central Bank to bail out these countries, by means of the creation of crisis resolution mechanisms and provision of stand-by funds.

2.3 The recession in 2009 has led to soaring unemployment rates and rising poverty, especially in those countries in trouble. The worrying economic situation prompted the EU countries to undertake various forms of fiscal stimulus to restore confidence and bolster demand. As a result, GDP in EU showed a 2% growth in 2010 and 1.7% in 2011. Yet it slipped back into recession in 2012 with GDP falling marginally by 0.3%, owing to the spill-over effect of the deepening crisis in the countries like Greece, Spain and Portugal.

2.4 Economic recovery in Europe is still slow, as reflected in its virtually zero GDP growth in 2013 and 1.3% growth in 2014. Sluggish environment has continued to put downward pressure on inflation. In December 2014, the year-on-year inflation in the euro area was recorded negative (-0.2%), the lowest since September 2009. To address the deflationary pressure arising from the prolonged period of low inflation, starting from March 2015, the European Central Bank will implement additional quantitative easing measures through expanding the asset purchase programme[3] to provide more liquidity in the economy for both investment and consumption. The monthly purchases under the expanded asset purchase programme will amount to €60 billion (HK$541 billion), with the ultimate goal of bringing inflation towards the target level of 2%.

[3] The asset purchase programme was launched in 2014, which focused on purchasing private-sector securities. The expanded asset purchase programme will extend to include public bonds issued by central governments in the euro area, their agencies and European institutions.

3. Performance of Germany since the economic crisis

3.1 Being the largest economy in Europe, Germany has proved to be resilient in the middle of the gloomy environment. Although it experienced immediate recession in 2009 in the aftermath of the crisis, it has demonstrated a strong recovery subsequently, with 3.9% and 3.4% GDP growth in 2010 and 2011 respectively. Impacted by the declining market of its European trading partners and continued slowdown in the world trade flows, Germany experienced economic slowdown in 2012 and 2013, with a mere growth of 0.9% and 0.5% respectively. Despite signs of weakening economy, Germany has overall achieved a better-than-average performance.

3.2 Germany emerged from the crisis quickly is believed to be due in part to its competitive industrial sector[4] which accounts for over 20% of GDP. The industrial sector is export-oriented and has seen growing demand from emerging countries such as Brazil and India. Separately, the introduction of the fiscal tool, which establishes a constitutional limit on the structural deficit to avoid excessive public debt[5], is a factor contributing to its relatively stable economic performance.

3.3 On the labour market, Germany has performed well compared with other European countries, attributable to the implementation of the labour reforms in the past decade, for instance, providing greater incentives to work and increasing working time flexibility. Over the past few years, the unemployment rate in Germany has remained relatively low, reflecting the outcome of labour reforms. The unemployment rate has also been on a gradual decline. As at end-2014, the rate was further down to 4.8%, the lowest among the EU countries.

4. Latest development of the Greek bailout issue

4.1 Greece entered profound recession with an exceptionally high level of government debt standing at over 120% of GDP in 2009. In the face of the economic crisis, Greece has received bailouts from EU, the International

---

[4] Major industrial sectors are automobiles, machinery and electronics.

[5] The fiscal rule, the so-called "debt brake", was incorporated in 2009 in the German Constitution which limits the structural deficit to 0.35% of GDP starting from 2016. Since the incorporation of the fiscal rule, Germany has steadily reduced its structural deficit. In 2013, the deficit was reduced to 0.24% of GDP.

Monetary Fund and the European Central Bank. The first bailout programme began in 2010 and funds were disbursed by installment. In 2012, the worsened recession led to the second bailout programme. In return, Greece had to undertake structural reforms and austerity measures including tax hikes, freeze on state pensions, etc. The entire bailout programme was set to expire at the end of February 2015.

4.2 The recent change of government has made Greece again a focal point. In the election held in January 2015[6], the political party, Syriza, which had promised in its pre-election pledge to end the austerity measures, succeeded in attracting voters and won. It has subsequently formed a new government and commenced talks with the leaders in the euro area to re-negotiate the terms of the bailouts.

4.3 During the initial negotiation, the Greek government requested to extend the bailout funds for six months without adhering to strict conditions, the purpose of which was to gain more time to develop anti-austerity reforms. However, Germany, the largest creditor in the bailouts, rejected the request of Greece. After several rounds of talks, Greece and the EU leaders have finally come to an agreement in principle to extend the bailout programme by four months to end-June 2015, subject to the satisfaction of the creditors on the economic reforms that Greece will take during the remainder of the bailout period. The agreement is considered to have eased off the immediate risk that Greece might run out of money, leading to default and possible exit from the euro area and EU.

[6] The election took place due to the dissolution of the Greek parliament in December 2014.

References

1. CNBC. (2015a) *Greece readies reform promises after Eurogroup climbdown*. Available from: http://www.cnbc.com/id/102445259 [Accessed February 2015].

2. CNBC. (2015b) *Deal reached between Greece, creditors*. Available from: http://www.cnbc.com/id/102441980 [Accessed February 2015].

3. European Central Bank. (2015) *Press Release, ECB announces expanded asset purchase programme.* Available from: http://www.ecb.europa.eu/press/pr/date/2015/html/pr150122_1.en.html [Accessed February 2015].

4. *European Commission.* (2015a) Available from: http://ec.europa.eu/index_en.htm [Accessed February 2015].

5. European Commission. (2015b) *European Economic Forecast Winter 2015*. Available from: http://ec.europa.eu/economy_finance/publications/european_economy/2015/pdf/ee1_en.pdf [Accessed February 2015].

6. Federal Ministry for Economic Affairs and Energy. (2015) *2015 Annual Economic Report.* Available from: http://www.bmwi.de/English/Redaktion/Pdf/jahreswirtschaftsbericht-2015-englische-zusammenfassung,property=pdf,bereich=bmwi2012,sprache=en,rwb=true.pdf [Accessed February 2015].

7. International Monetary Fund. (2015) *World Economic Outlook Update*. Available from: http://www.imf.org/external/pubs/ft/weo/2015/update/01/pdf/0115.pdf [Accessed February 2015].

Research Office
Information Services Division
Legislative Council Secretariat
25 February 2015
Tel: 2871 2122

Fact sheets are compiled for Members and Committees of the Legislative Council. They are not legal or other professional advice and shall not be relied on as such. Fact sheets are subject to copyright owned by The Legislative Council Commission (The Commission). The Commission permits accurate reproduction of fact sheets for non-commercial use in a manner not adversely affecting the Legislative Council, provided that acknowledgement is made stating the Research Office of the Legislative Council Secretariat as the source and one copy of the reproduction is sent to the Legislative Council Library.