



Rabobank

Political risks in the eurozone

October 2012

Economic Research Department

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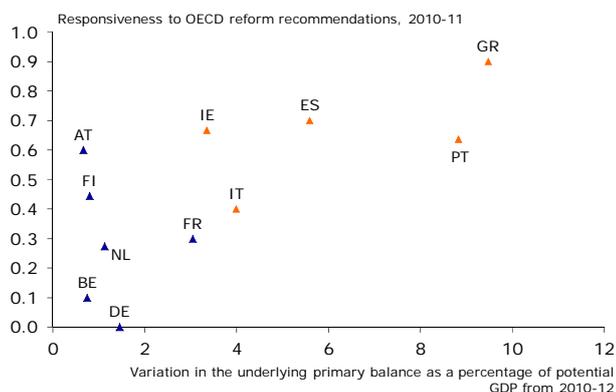
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Introduction

Looming euro-fatigue?

The eurozone's south is implementing austerity measures while the north is buying them the time to do so. Economic issues regarding this approach are usually extensively discussed. But what are the political risks that might render this strategy unfeasible?

Figure 1: Austerity and reform



Source: OECD Going for Growth 2012

From an economic perspective, the current setup of solving the eurozone crisis seems to be clear. As can be seen from figure 1, the Southern European member states and Ireland undergo severe austerity measures and structural reforms in order to reduce budget deficits and to regain competitiveness. By offering financial assistance, the Northern European member states are buying them the time to do so.

This setup, however, is subject to political risks both in the north and in the south. As the BBC notes in an August 2012 article, "there is, of course, the possibility that the Greek [read: Southern Europe and Ireland] people, fed up with rising unemployment and falling living standards, will make it impossible for the government to continue with austerity". Such a scenario would be a classic example of austerity fatigue. More precisely, austerity fatigue can be described as the phenomenon that countries may not be able to implement austerity measures for a sufficiently long period of time to stabilize the public debt ratio and prevent default. Usually this is either due to popular protest of citizens, changes in government or voting power in parliament, or a combination of these factors

On the other hand, however, a phenomenon that we would call support fatigue may emerge in countries providing financial assistance to troubled member states. In line with an 2012 article in The Independent noting that "Greece in particular is testing German [read: Northern European] patience", there is a risk that either citizens oppose further help or that changes in government or voting power may occur. As opposed to austerity fatigue, support fatigue is usually not so much articulated via popular uprisings, let alone violent protest.

This Special aims to identify the political risks in 13 eurozone countries which may lead to either support or austerity fatigue. For each country, a spider web graph is attached, providing a quick overview of each country's score along five risk dimensions. Appendix 1 gives a short explanation of each risk dimension.

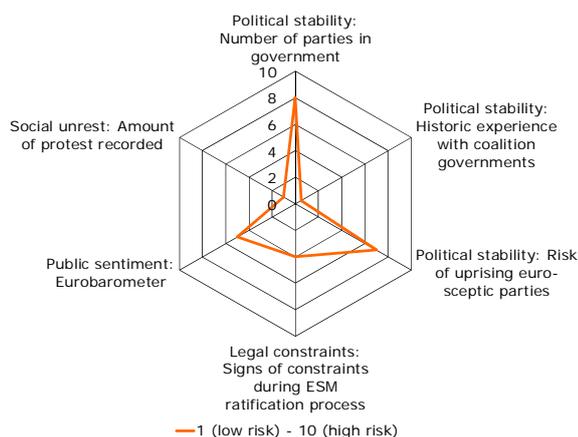
Bastian Halbach
economics@rn.rabobank.nl

Finland

Finland is known for its conservative approach towards support measures, perhaps most descriptively demonstrated when Finland –as only country–requested collateral from Greece and Spain before approving further support. In fact, the

political situation in Finland carries significant risk. After complex negotiations, the 2011 election yielded a six-party coalition government (figure 3). Finland is used to coalition governments and is known for its political pragmatism. As a result, the country has not experienced snap elections since 1983. But a six-party coalition is new, even for the Finns. The Eurosceptic party of the 'True Finns' is the largest opposition party and keeps rising in popularity as the crisis continues. Municipal elections on 28 October 2012 will provide another indication of the current public sentiment in Finland.

Figure 2: Dimensions of risk: Finland

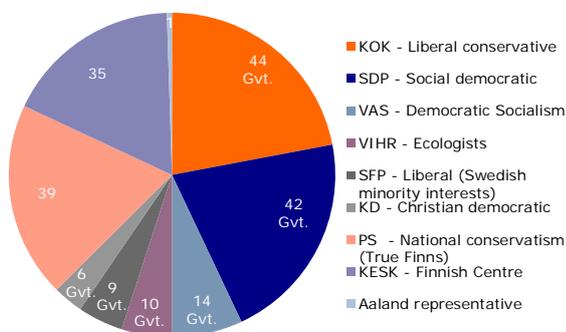


Source: Rabobank

An important aspect to consider in order to understand the Finish sentiment, is the severe

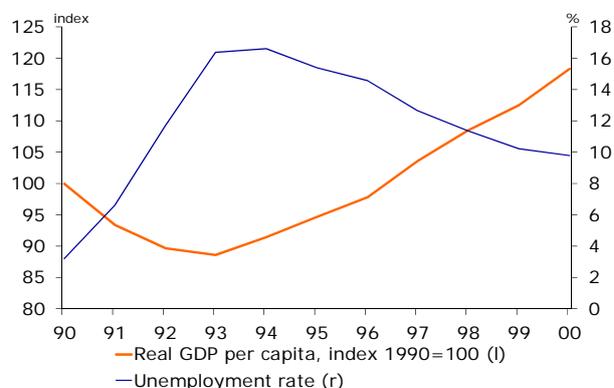
austerity and recession Finland went through in the 1990s (figure 4). Countries with such recent austerity experience tend to be stricter on other countries, in part because they feel to be in a more legitimate state to do so. Recent discussions that Finland may leave the eurozone altogether seem nevertheless unlikely at this point, not least because their entire post-Cold War identity is centered on Europe. Rather, Finland poses a big risk in not approving both further support packages and further EU-integration. Even in case of approval, Finland will likely slow down the process and may require further special treatment to prevent them from blocking solutions to the crisis.

Figure 3: Current parliament composition (seats)



Source: European Election Database

Figure 4: Austerity in Finland during the 1990s



Source: Reuters EcoWin

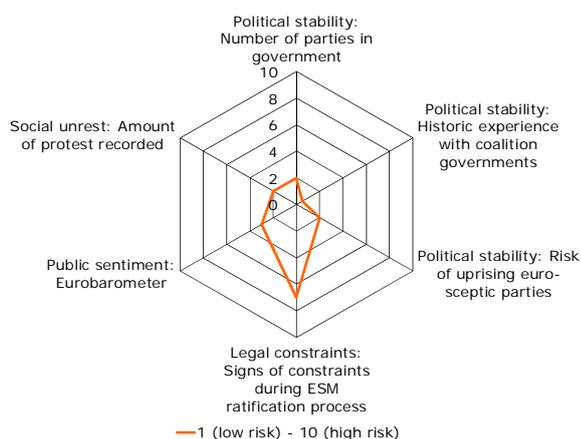
Germany

Germany remains a strong supporter of both the EU and the euro but operates under two constraints. First, recent appeals at the Constitutional Court against EU-related measures have demonstrated the potential legal boundaries for further EU-integration. Second, in the run-up to the September 2013 elections, a degree of gridlock in parliament due to electoral campaigning is to be expected. Major decisions such as to directly capitalize troubled banks through ESM will likely be postponed.

We do not see a risk in the election outcome itself. The two traditional coalitions –SPD/Greens or the currently governing CDU/CSU/FDP (figure 6)– would currently get insufficient votes to form a government (figure 7). A coalition of SPD, Greens and FDP has been ruled out by both SPD and Greens. The Pirate party may pass the five percent hurdle to enter parliament, but the chance that any of the established parties would collaborate with

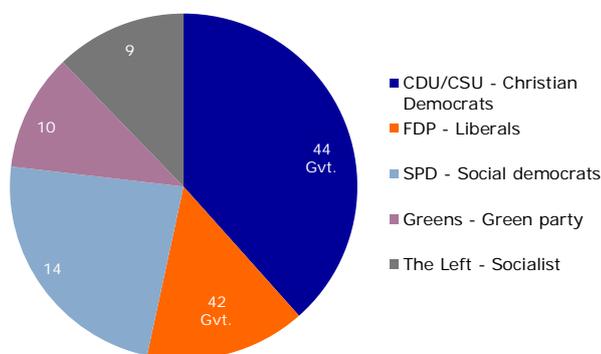
them is very small. A coalition of CDU/CSU and the Greens is an unlikely option based on negative experiences in a regional government. Most powerful would be a grand coalition of CDU/CSU and SPD, which would exhibit a vast majority. For the second time in postwar Germany, a grand coalition has been in power from 2005 to 2009. During this period, the government was able to adopt comprehensive legislation, including measures to fight the immediate consequences of the financial crisis of 2007/08. Based on their common pro-European stance, a grand coalition would make Germany a constructive partner in furthering EU institution building.

Figure 5: Dimensions of risk: Germany



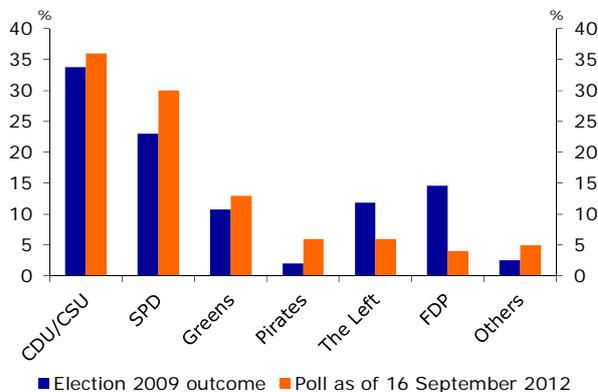
Source: Rabobank

Figure 6: Current parliament composition (seats)



Source: European Election Database

Figure 7: Recent German poll

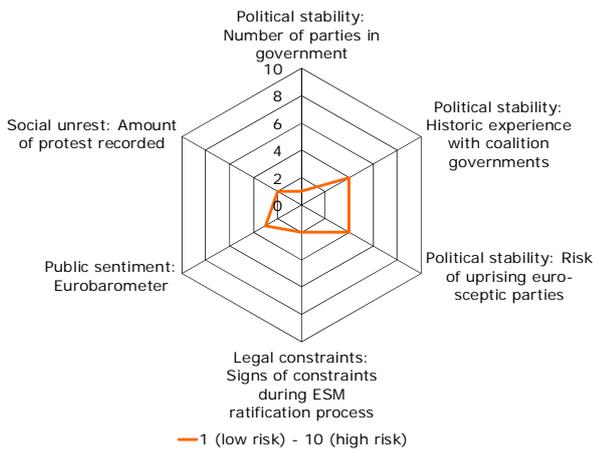


Source: European Election Database; Forsa 2012

Slovakia

Slovakia's 2012 election outcome yielded a single-party absolute majority government of the social democrats with 83 of 150 seats in parliament (figure 9). The right-wing populist party SNS missed the five percent hurdle and did not re-enter parliament (figure 10).

Figure 8: Dimensions of risk: Slovakia

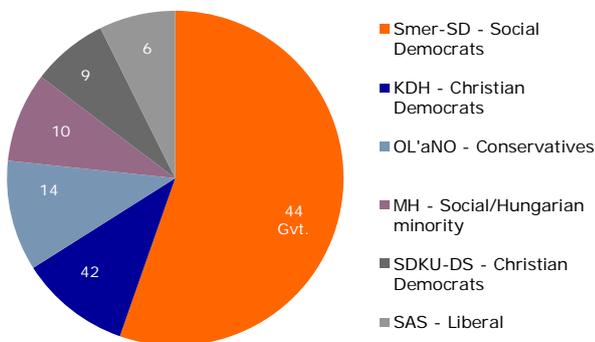


Source: Rabobank

Newly elected Prime Minister Robert Fico leads the first single-party government since Slovakia's independence, reducing the risk of political gridlock. These are favourable outcomes adding to Slovakia's overall stability and supporting a favourable attitude towards the EU. Not least because his election was largely based on votes from the pro-social and pro-European platform, Robert Fico's election points at a pro-European attitude in Slovakia. As a response, shortly after elections, Fico emphasized his country's role within the EU and underlined his support for further EU-integration.

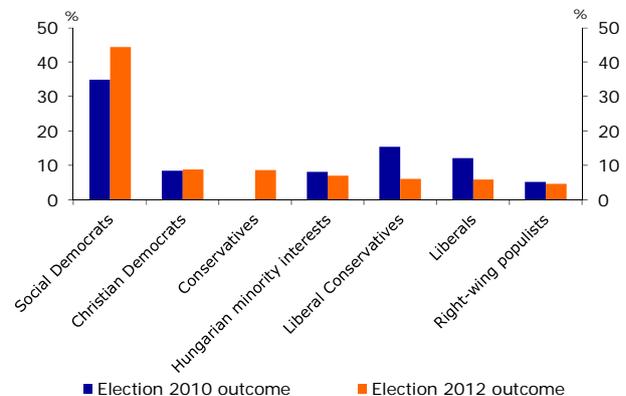
In addition, the voting out of both Iveta Radicova's centre-right government in general and the nationalistic SNS party in particular can be expected to have a further positive impact on the tense foreign relations with Hungary, which in turn may smooth diplomatic relations in the region as a whole.

Figure 9: Current parliament composition (seats)



Source: European Election Database

Figure 10: Election outcomes 2010 and 2012

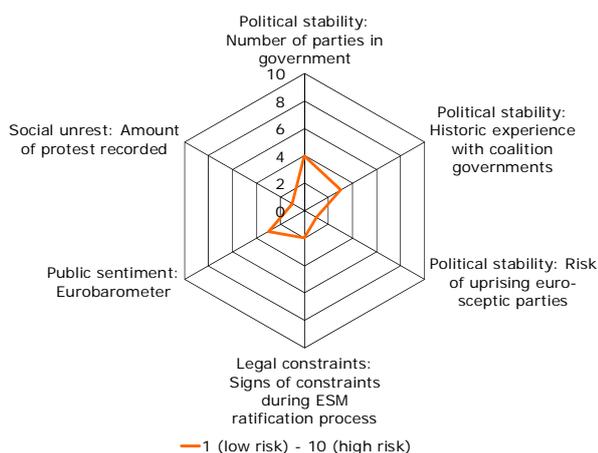


Source: European Election Database

France

France has proven to be a reliable and stable eurozone member. Forecasts that the election of socialist President Hollande, who enjoys a majority government (figure 12), would both slow down eurozone crisis management and distort French-German relations have so far turned out to be wrong. In particular, Hollande and Merkel have demonstrated their willingness for constructive cooperation.

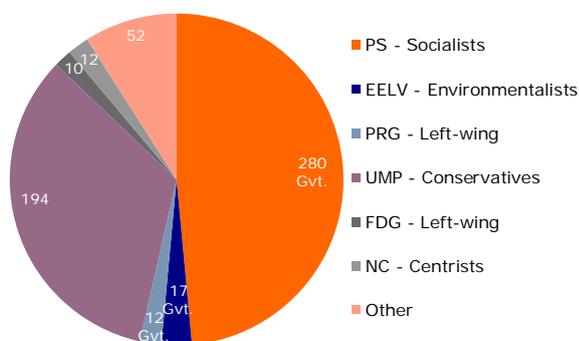
Figure 11: Dimensions of risk: France



Source: Rabobank

Internally, Hollande faced challenges in order to live up to his election pledges and to produce sustainable national finances at the same time. To this point, he was able to fulfill a range of his promises; hence, that case has been sorted out for now. Overall, though difficult, these internal issues are unlikely to affect EU-politics at this point.

Figure 12: Current parliament composition (seats)

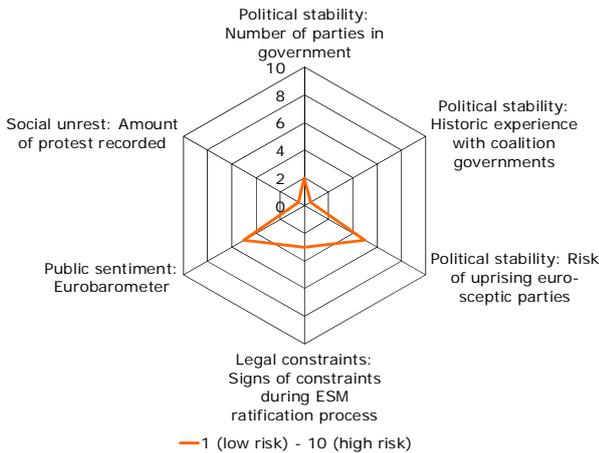


Source: European Election Database

Austria

Like France, Austria has been a stable partner, usually moving closely in line with developments in neighbouring Germany. As Germany, they will hold general elections in September 2013. This is not expected to change the core political landscape much. Social democratic Chancellor Werner Faymann is expected to be confirmed in office (figure 14 and 15).

Figure 13: Dimensions of risk: Austria



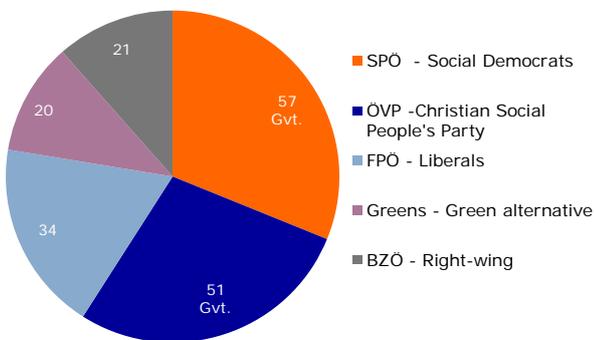
Source: Rabobank

Recently, multi-billionaire Frank Stronach has appeared on the political stage, setting up the new political party Team Stronach. Based on economic liberalism and euro-skepticism, according to recent polls the party is expected to be able to possibly receive more than 10% of votes on a national level, largely by absorbing votes from the somewhat eurosceptic and right wing BZÖ (Alliance for the Future of Austria) which had previously disagreed to an offer to cooperate with Stronach (figure 15).

Overall, therefore, support for euro-sceptic parties remains below 15% at this point; developments until the election in 2013, however, should be monitored.

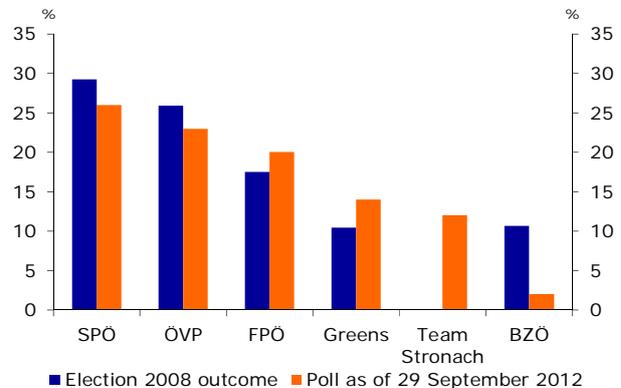
In all, though, Austria is unlikely to change its supportive stance in EMU crisis management.

Figure 14: Current parliament composition (seats)



Source: European Election Database

Figure 15: Poll as of 29 September 2012

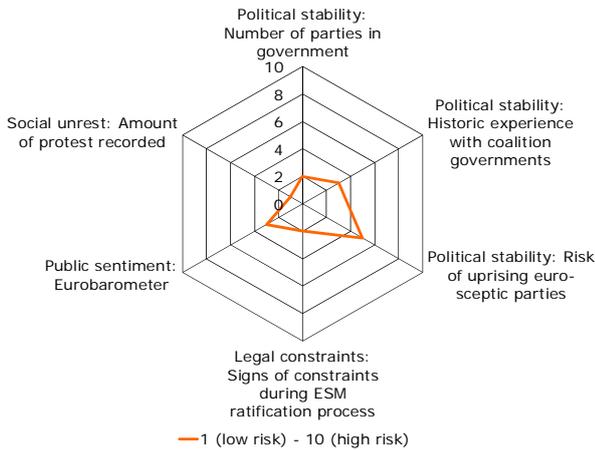


Source: GallupInstitute Austria

The Netherlands

Despite the fact that snap elections had to be announced in early 2012 after the populist PVV party had withdrawn its support for Mark Rutte's minority government, the Netherlands have been a stable and supportive eurozone member, largely moving in line with Germany.

Figure 16: Dimensions of risk: The Netherlands



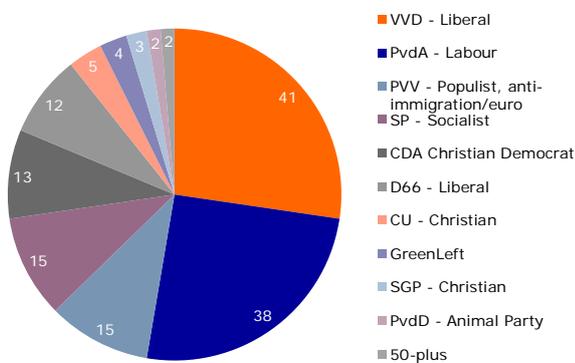
Source: Rabobank

September 2012 snap elections yielded a favourable outcome in terms of EMU crisis management (figure 17 and 18). The two biggest parties –the VVD (conservative liberals) and PvdA (Labour Party) – were able to gain an unexpectedly large share of parliament with an additional ten and eight seats, respectively. At the same time, although remaining the third largest party in parliament, the anti-Islam and anti-EU PVV party led by Geert Wilders lost nine seats. Eurosceptic, or at least sceptic of the current crisis management, SP (Socialist Party) failed

to win the large number of seats that was predicted by the opinion polls months before the election (figure 18).

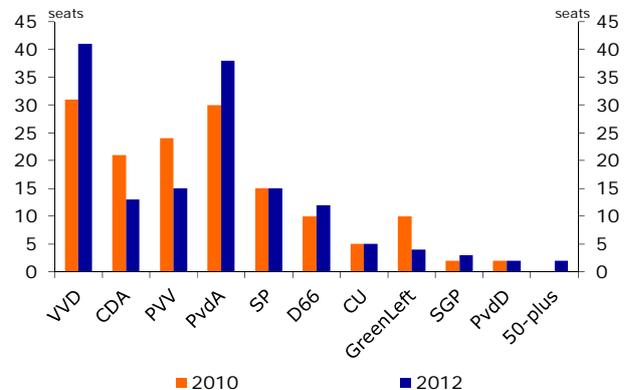
Although coalition talks are ongoing at this point, a stable and EU-supportive government is expected to be formed. The switch from a minority government to a majority government will clearly add to government stability.

Figure 17: Current parliament composition (seats)



Source: European Election Database

Figure 18: Election outcomes 2010 and 2012



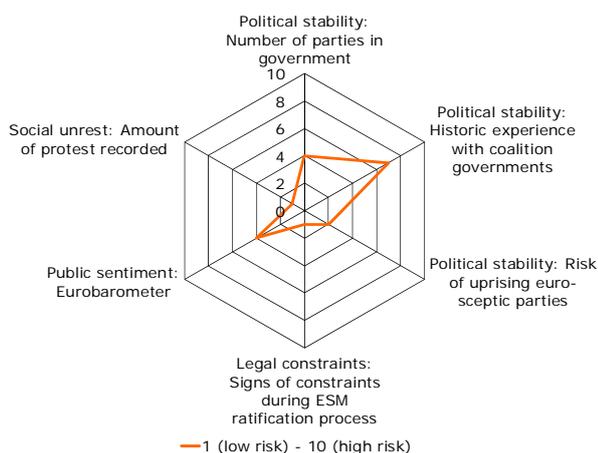
Source: European Election Database

Belgium

Although, or perhaps because of, hosting major EU-institutions, Belgium has adopted a remarkably low-key appearance in terms of EU-politics. Despite

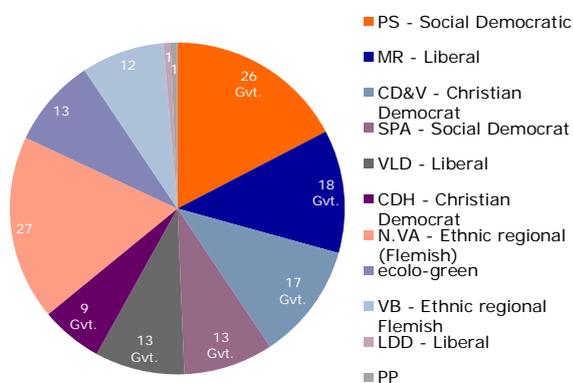
Belgium's well-known internal issues, largely based on ethnical and cultural conflict, it has supported all EU-measures to fight the crisis and deepen integration. After 589 days of being governed by a care-taker administration and lengthy coalition talks, socialist Elio di Rupo became Prime Minister of Belgium (figure 20). At several occasions he stressed the importance of supporting troubled eurozone members, deepening European integration and regulating financial markets in a sensible manner. This underlines the perception of Belgium as reliable EU member, despite its internal issues.

Figure 19: Dimensions of risk: Belgium



Source: Rabobank

Figure 20: Current parliament composition (seats)

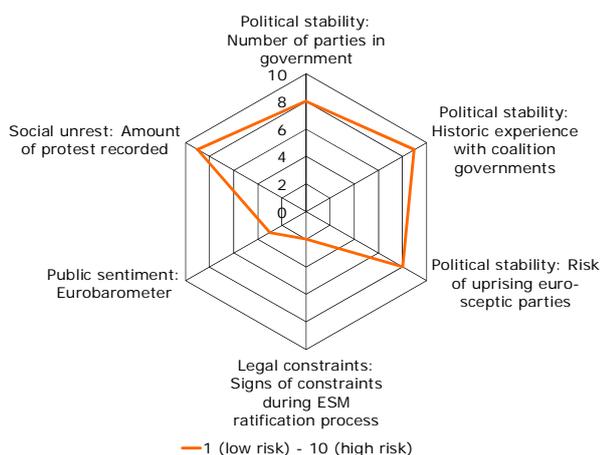


Source: European Election Database

Greece

Greece continues to pose severe political risk. Although the current government can be considered the most favourable outcome after two elections and complex and intricate coalition talks, it is not very stable. First, Greece is not used to coalition governments as it was virtually permanently governed by a single party since 1974.

Figure 21: Dimensions of risk: Greece



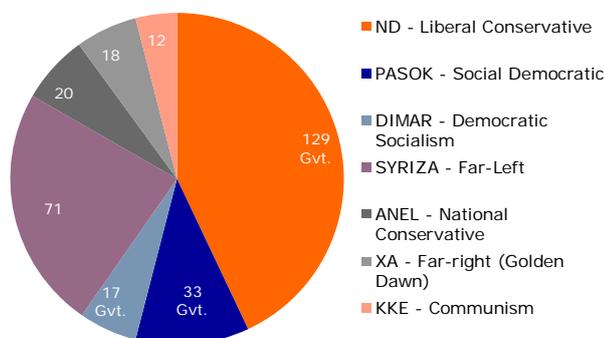
Source: Rabobank

Second, the current coalition is not intrinsically motivated to cooperate but rather has been formed under outside pressure, which makes it more fragile. Then again, the coalition boasts a sizeable majority (figure 22), which allows for some defections within the parties when voting on hard measures.

Recently, the leaders of Prime Minister Samaras' coalition parties had a very hard time agreeing to another austerity plan, indicating first signs of dissonance. From a positive perspective, it can be expected that the Troika, recently reviewing Greece's austerity efforts, will take this situation into account and will not demand too harsh measures in order to not jeopardize coalition stability. Further, recent polls indicate that the major government party, New Democracy, still lies slightly ahead of the main opposition party, Syriza (figure 23).

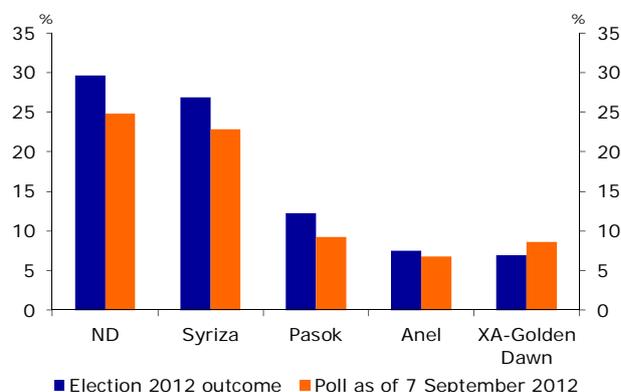
Greece continues to be most likely to suffer from popular protest. After protests had slowed down throughout 2011, the latest talks about the Troika findings and the announcement of further austerity measures have started a new wave of more broad based demonstrations. Given the size of the economic adjustment and the fragility of the government, Greece will continue to be most susceptible to austerity fatigue.

Figure 22: Current parliament composition (seats)



Source: European Election Database

Figure 23: ND only slightly ahead of Syriza



Source: European Election Database; Proto Thema, AFP

Portugal

Portugal exhibits a stable two-party Social- and Christian-Democratic government (figure 25) with the next elections far ahead in 2015. It has been a remarkable case in that hitherto not only almost the whole parliament, but also unions

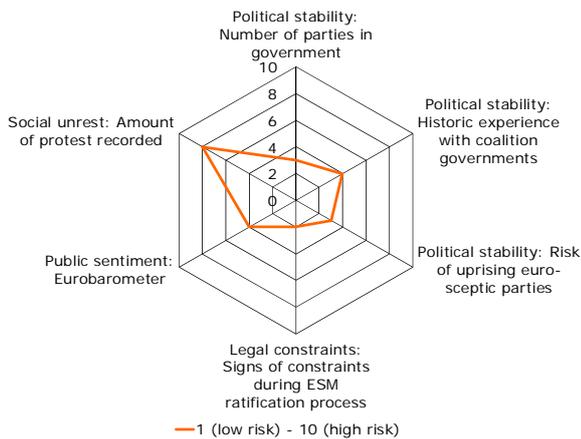
and business associations supported all austerity measures. Even voters acknowledged the need for reform and increasing belt-tightening except for comparatively minor protests.

A recent decision of Prime Minister Coelho to reduce company costs and refund them via cuts in workers' take-home pay, however, drastically altered this situation. All actors strongly opposed his plans and the largest public protest so far emerged. Most importantly, even some government MPs articulated their discontent with the proposed measures. The opposition Socialists, which up to now had supported the government, announced that they would not vote in favour of such a measure. In the end, the plan has been abandoned.

This can actually be seen as a clear example of austerity fatigue at work.

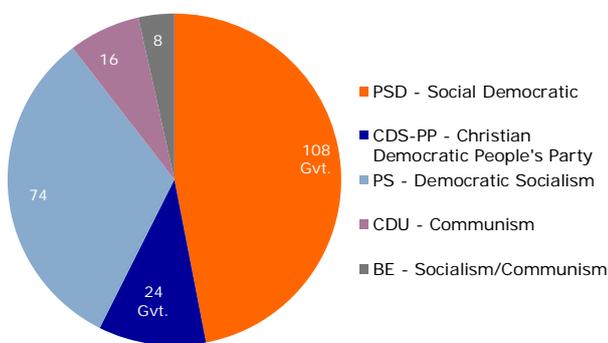
We expect the Portuguese government to be able to come up with other measures to keep the reduction of the budget deficit on track. However, resentment has been ignited and is likely to stay. As can be seen from figure 26, recent polls show that Coelho's party's (PSD) voting share fell from 39% in 2011 elections to just 24%. The need for continued austerity and reform will continue to put pressure on the governing coalition. Therefore, despite the generally favourable setting up to now, government stability should be closely monitored.

Figure 24: Dimensions of risk: Portugal



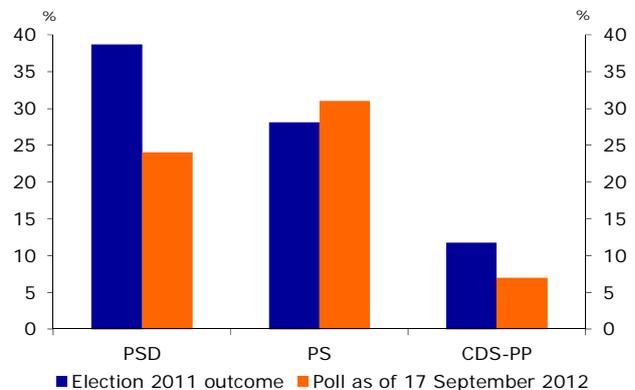
Source: Rabobank

Figure 25: Current parliament composition (seats)



Source: European Election Database

Figure 26: Governing coalition losing in polls



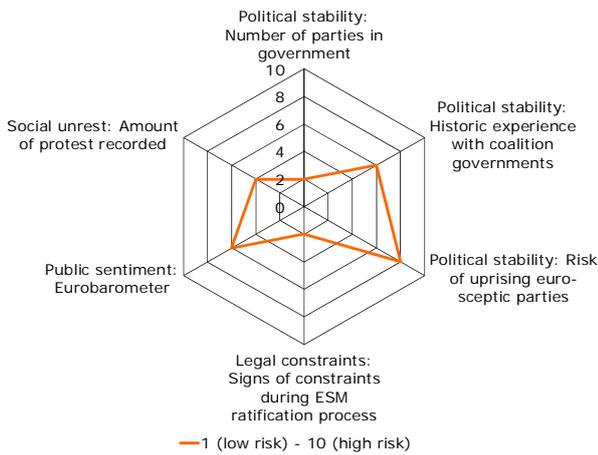
Source: European Election Database; Reuters

Ireland

Ireland has historically had a rather fragmented political landscape, with many minority governments or coalition governments with only a small majority. As a positive development, 2011 elections have yielded a politically stable government coalition of two parties (figure 28).

However, the left-wing republican and euro-sceptic Sinn Féin party receives increasing support. Most recently, debates in the run-up to the referendum about the Fiscal Compact have amplified Sinn Féin's popularity. With their critical stance on the Fiscal Compact and the EU in general, they receive 18% of votes in recent polls (figure 29). The fact that the next general elections are only scheduled for 2016, works as a risk mitigant. The referendum for the Compact itself yielded 60% of votes in favour. While this is not a large majority, it should nevertheless be seen as positive outcome as the Irish voted in favour of tighter European fiscal rules while undergoing severe austerity and reforms.

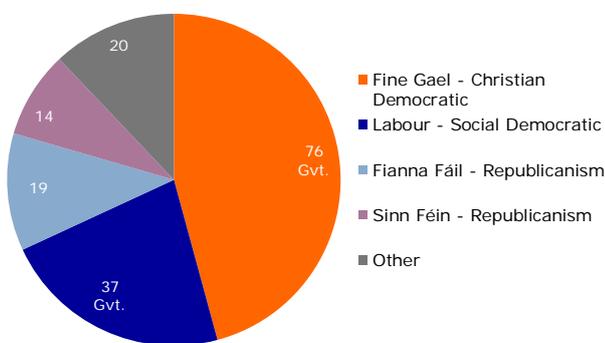
Figure 27: Dimensions of risk: Ireland



Source: Rabobank

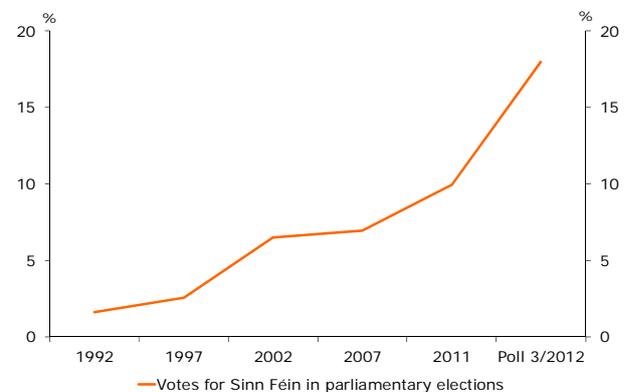
On the other hand, the need to enact further austerity and reform in the years to come will make it increasingly harder for the coalition to cooperate. This is evidenced by the recent tensions between the coalition partners surrounding health care measures. Also, the pushback of Germany, The Netherlands and Finland on the possibility of directly and retroactively recapitalizing banks by the ESM will make changing the terms of the bank bailout for Ireland harder. This has the potential to further undermine the popularity of the government. As such, despite the relative success of the governing coalition to date, the stability of this coalition and the rise of Sinn Féin should be further monitored.

Figure 28: Current parliament composition (seats)



Source: European Election Database

Figure 29: Sinn Féin receives increasing support



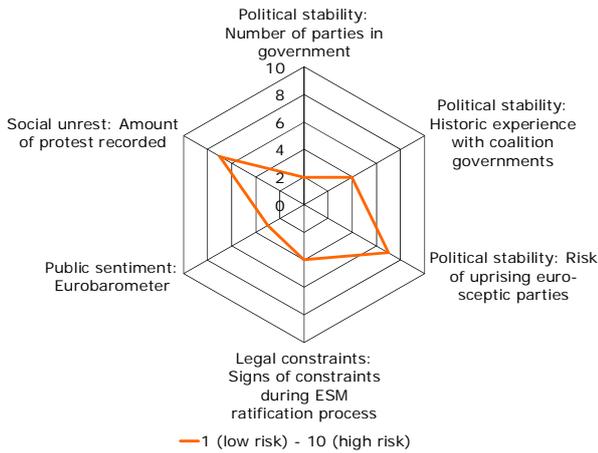
Source: European Election Database; RedC Research

Italy

After the resignation of former Prime Minister Silvio Berlusconi in 2011, a technocratic cabinet with the support of three parties has been put in place led by Mario Monti (figure 31). He has been able to push through a range of austerity

measures and reforms, but much remains to be done on (implementing) structural reforms. It is likely, however, that pressure on Italy must increase before stricter measures will be applied. Monti recently announced that he will not run in the next election, which will be held in April 2013, although the UdC party had offered to him to run as its top candidate. He has, however, indicated that he would consider a new term as Prime Minister if the political situation would mandate that. A possible renewal of the electoral law and future opinion polls will give an indication of the possibility of an election outcome that yields a stable coalition government.

Figure 30: Dimensions of risk: Italy



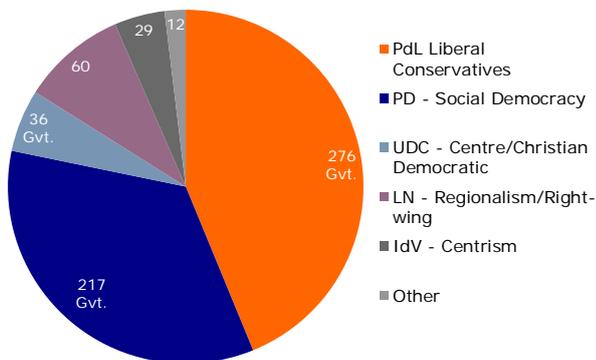
Source: Rabobank

A newly founded party –the Five Star

Movement– receives some 15% of the votes in recent polls (figure 32). The Five Star Movement, founded and led by former comedian and artist Beppe Grillo, is an anti-establishment and euro-sceptic party. In some speeches, an exit from the eurozone has been proposed.

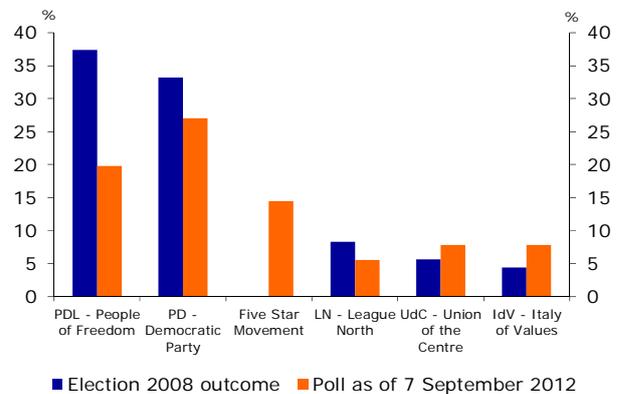
The rise of this party leads to a further dispersion of the political landscape and elections resulting in a stable government are not very likely. Therefore, the 2013 election carries considerable risk. Reform efforts may well slow down after the elections while at the same time the political uncertainty may well put renewed pressure on Italy's government bond yields.

Figure 31: Current parliament composition (seats)



Source: European Election Database

Figure 32: Election 2008 and poll for 2013



Source: European Election Database; Ipsos 2012

Slovenia

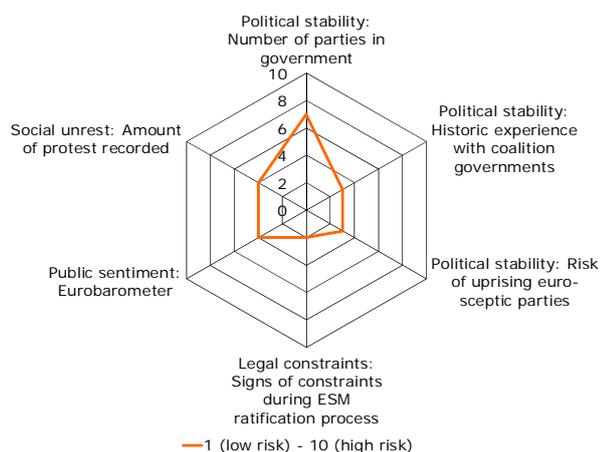
Slovenia, having entered the EU in 2004 and subsequently introducing the euro in 2007, has proven to be a stable country in terms of supporting the EU and EU integration despite unfavourable economic conditions. Slovenia has regularly

been referred to as pole of stability in the region as it did not get so much involved in regional-ethnic conflict. This is at least partially due to its location being somewhat at the border of the Balkan conflict region and the fact Slovenia was the most ethnically homogenous region.

Although Slovenia is currently governed by a five-party governing coalition, there is no worrying sign of instability (figure 34). The next parliamentary elections are scheduled for 2015, hence giving this government some time to further implement austerity and reform measures.

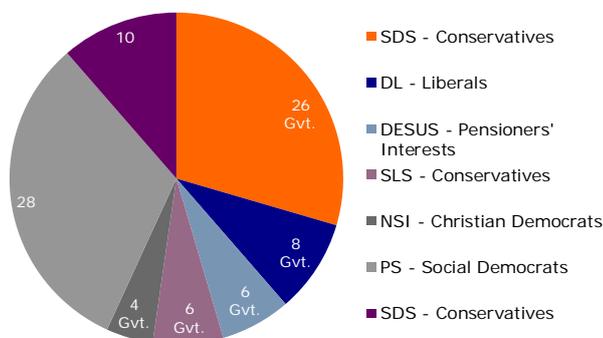
In fact, as another positive development, the populist right-wing party SNS has lost votes since 2004. In the 2011 election, it missed the five percent hurdle to enter parliament (figure 35). This further underlines Slovenia's pro-EU attitude after having voted with 90% in favour for the EU accession in 2003. Further, Slovenia has also become a NATO member and is, for example, involved in the ISAF mission in Afghanistan, which can be seen as another effort to become a respected player on a global scale. In all then, we see Slovenia to continue having a government in favour of further EU integration and to be able to push through the necessary austerity and reform. But given the task at hand, it should be monitored for the risk of austerity fatigue setting in at some point.

Figure 33: Dimensions of risk



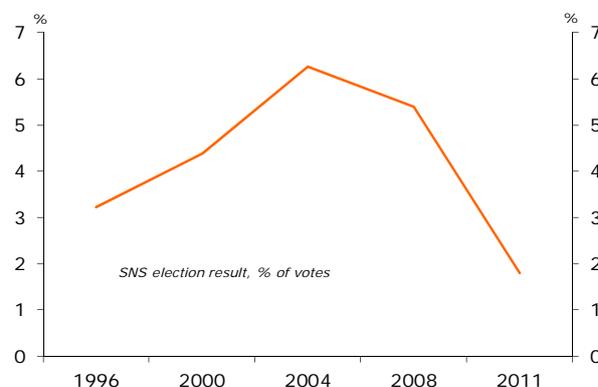
Source: Rabobank

Figure 34: Current parliament composition (seats)



Source: European Election Database

Figure 35: Right-wing party SNS in decline

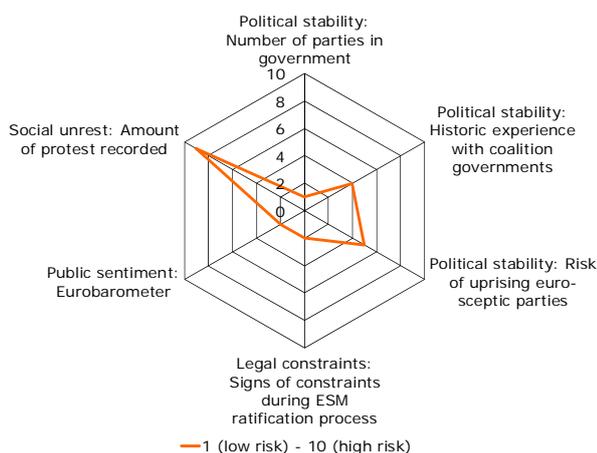


Source: European Election Database

Spain

In Spain, Prime Minister Mariano Rajoy operates under the favourable setting that he leads a single-party majority government (figure 37). The term runs until 2015, thus leaving a lot of time to implement further reforms. Rajoy himself, however, is highly unpopular among Spanish voters currently, as figure 38 indicates. As long as his People's Party remains showing unity, this does not pose a risk though. Compared to Greece, popular protest in Spain has been modest. New consolidation measures have recently led to renewed protest. Given the continued need for austerity and reform, a rise in the frequency and size of demonstrations is likely. This would be in line with what we have observed in Portugal.

Figure 36: Dimensions of risk

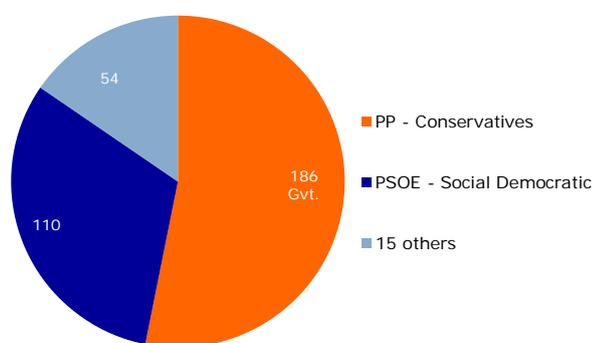


Source: Rabobank

Further, Spain is facing early elections in three regions –the Basque Country, Galicia, and Catalonia– in October and November 2012, respectively. Prime Minister Rajoy is born in Galicia and it has been one of the Partido Popular (PP) strongholds. That makes it very important to him to see the PP remain the biggest party there, especially since it will be seen as a referendum on his policies. Losing the elections in Catalonia does not pose a direct threat to government finances since we do not expect the region to declare independence anytime soon and the region is in fact working on reducing its budget deficit. It does reinforce the image of a Prime Minister that seems not to be in control. Overall, thanks to the single-party government, the situation can still be regarded as stable. However, given the renewed wave of protest and uncertainty with respect to regions, these aspects need to be further monitored.

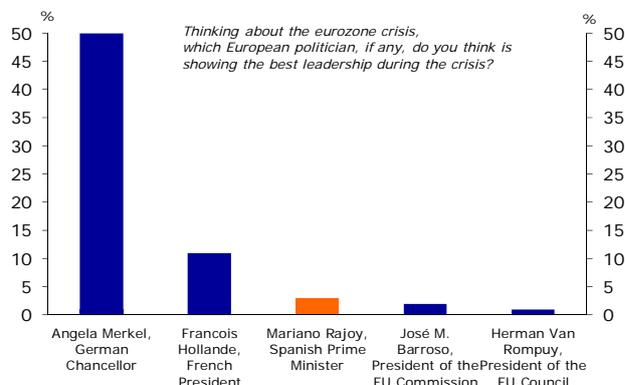
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Figure 37: Current parliament composition (seats)



Source: European Election Database

Figure 38: Spanish people unhappy with Rajoy



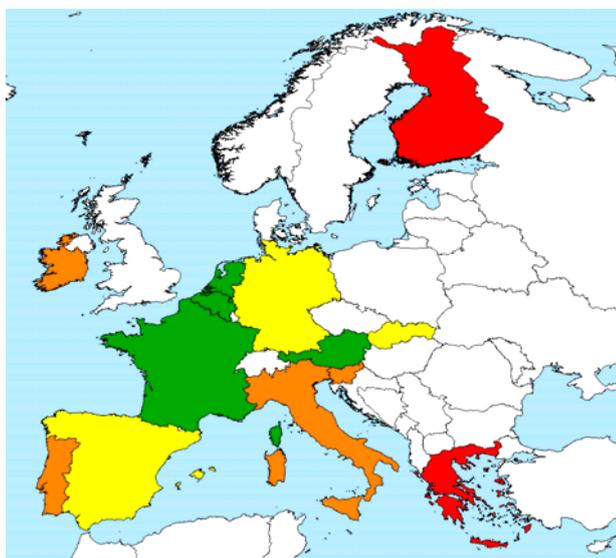
Source: Cicero Research 2012

Summing up

Figure 39 visualizes the preceding discussion of political risks in 13 eurozone member states. In addition to this overall risk assessment of each country, there are several upcoming events that should be monitored. First, in October there will be several EU-level meetings. The Eurogroup and ECOFIN Council of 8 and 9 October together with the European Council of October 18 will give an indication of how EMU crisis-management will be continued, specifically as to how the ESM will be put into use and how the roadmap towards further EU integration will be laid out.

Then, as mentioned before, there will be regional elections in Spain in October and November as well as in Finland in October. These elections will provide an indication of the current public sentiment in these countries.

Figure 39: Political risks in the eurozone



Source: Rabobank

Further, the importance of April 2013 parliamentary election in Italy has been pointed at. In addition, the run-up to this election should be monitored, as it will be interesting to see whether or not Prime Minister Monti will be able to implement unpopular further reforms before he steps down. A possible renewal of the electoral law and future opinion polls will give an indication of the possibility of a hung parliament

As for Austria and Germany, national elections will take place in September 2013. The fairly low risk of these elections themselves has been pointed out above. However, as for Italy, the run-up to elections should be monitored. Particularly in Germany we might see a political gridlock situation, as parties will attempt to

differentiate themselves from each other during electoral campaigns. Further, Chancellor Merkel should not be expected to take any unpopular decisions shortly before election, such as for example to allow to directly recapitalizing troubled banks via the ESM. Therefore, Germany might slow down EMU's crisis-management process until end-2013.

Lastly, although we have focussed on possible support-fatigue in a number of member states, it should be monitored whether some northern eurozone countries may experience austerity fatigue as well. Such a combination of both fatigues would considerably increase the risk of non-supportive behaviour in furthering EMU crisis-management and EU integration.

Bastian Halbach
economics@rn.rabobank.nl

Appendix 1

This appendix gives a short explanation of the risk dimensions in the spider-web graphs used in the study.

Political stability 1: *Number of parties in government*

As a simple measure of political stability, the number of parties currently forming the government has been looked at. It is important to note that the mere number of parties can be considerably mitigated or amplified by, among others, the overall political landscape and historic experience with different types of governments.

Political stability 2: *Historic experience with coalition governments*

Countries' political landscapes and cultures differ, which can be seen –among others- by looking at how many parties used to form the government in a historic perspective. Combining this risk dimension with the number of parties in the current government provides a good indication of the current political stability.

Political stability 3: *Risk of uprising euro-sceptic parties*

For each country, it has been identified whether or not small and rising or established euro-sceptic parties exist in the country's political landscape. Then, to evaluate the actual risk of such a party, the party's popularity has been assessed by means of election outcomes and polls and its level of euro-scepticism has been looked at.

Legal constraints: *Signs of constraints during ESM ratification process*

The ESM ratification process has been chosen as proxy for potential legal constraints. This makes sense because future EU-integration can be expected to require a similar legal type of ratification process as the ESM process, for example including further transfers of budgetary autonomy to the EU-level. The more obstacles had to be overcome for the ESM, the higher the risk score for future legal constraints.

Public sentiment: *Eurobarometer*

In order to measure public sentiment, two recurrent Eurobarometer survey questions have been used: 1. "There should be more coordination among euro-area governments." 2. "Having the euro is good for the EU." The higher the approval ratings of these statements, the lower the according risk scores.

Social unrest: *Amount of protest recorded*

The amount of social unrest has been measured by a type of word-counting approach. A ratio has been created of the number of relevant results of the Google search for "[country] protest against EU austerity 2012" on the first results page, divided by total results. As a second, somewhat difficult to measure input, it can be looked at the type of protest. It is important to differentiate between 'constructive' protest, i.e. directed against a specific measure, and protest which is getting closer to a 'rebellion'.

Colophon

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For other information, please call the KEO secretariat on tel. +31 (0)30 – 2162666 or send an email to 'economics@rn.rabobank.nl'.

Author:
Bastian Halbach

Editor-in-chief:
Allard Bruinshoofd

Graphics:
Reinier Meijer

Production coordinator:
Christel Frentz

Economic Research on the internet

www.rabobank.com/economics

Postal address

Rabobank Nederland
KEO (UC.T.04.11)
Postbus 17100
3500 HG Utrecht
The Netherlands

Visitors address

Rabobank Nederland
Croeselaan 18
3521 CB Utrecht
The Netherlands



Rabobank