

The euro area's economic outlook

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Outline

Part I. Assessing the euro area financial and economic outlook

Part II. Challenges ahead

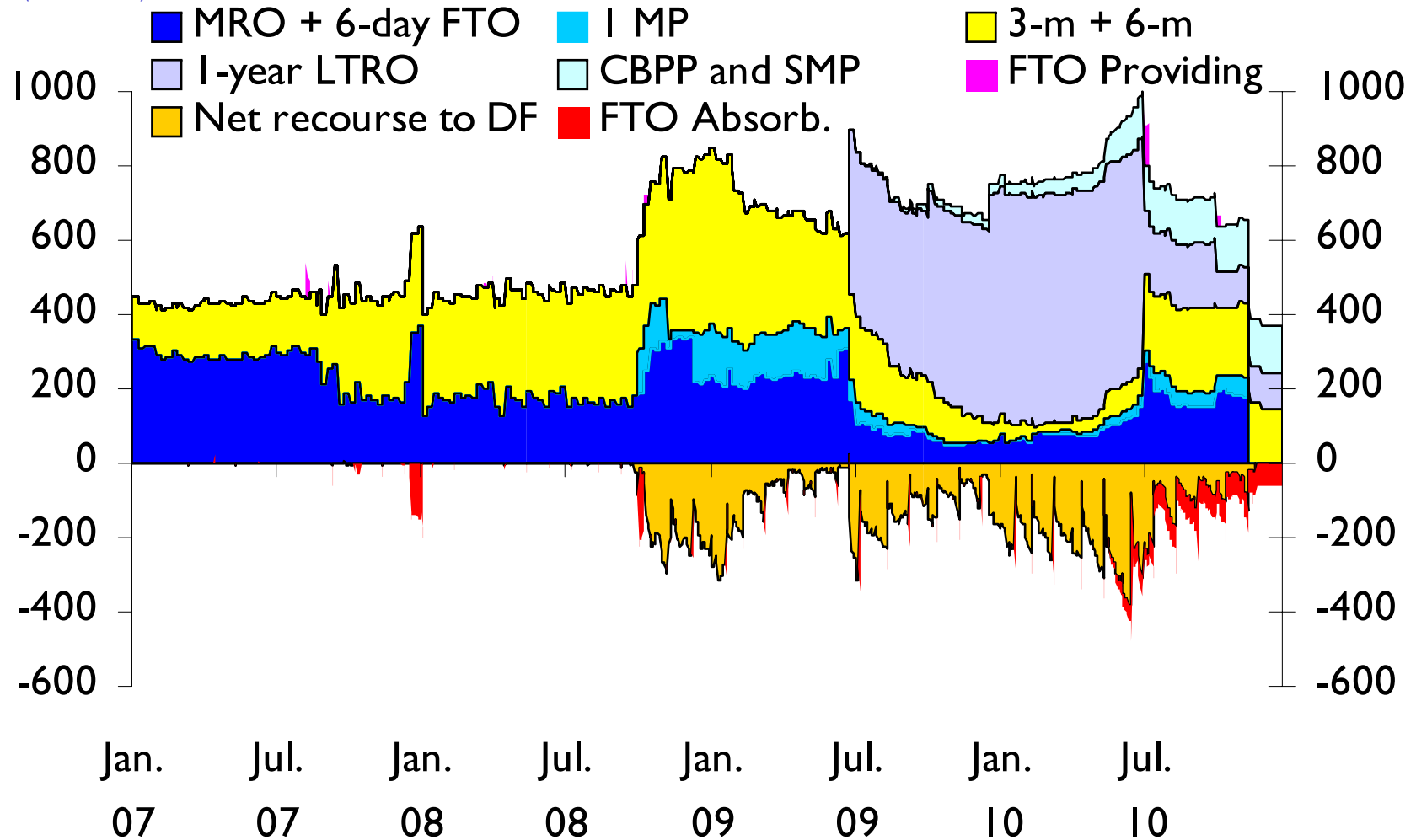
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Reduction of central bank intermediation...

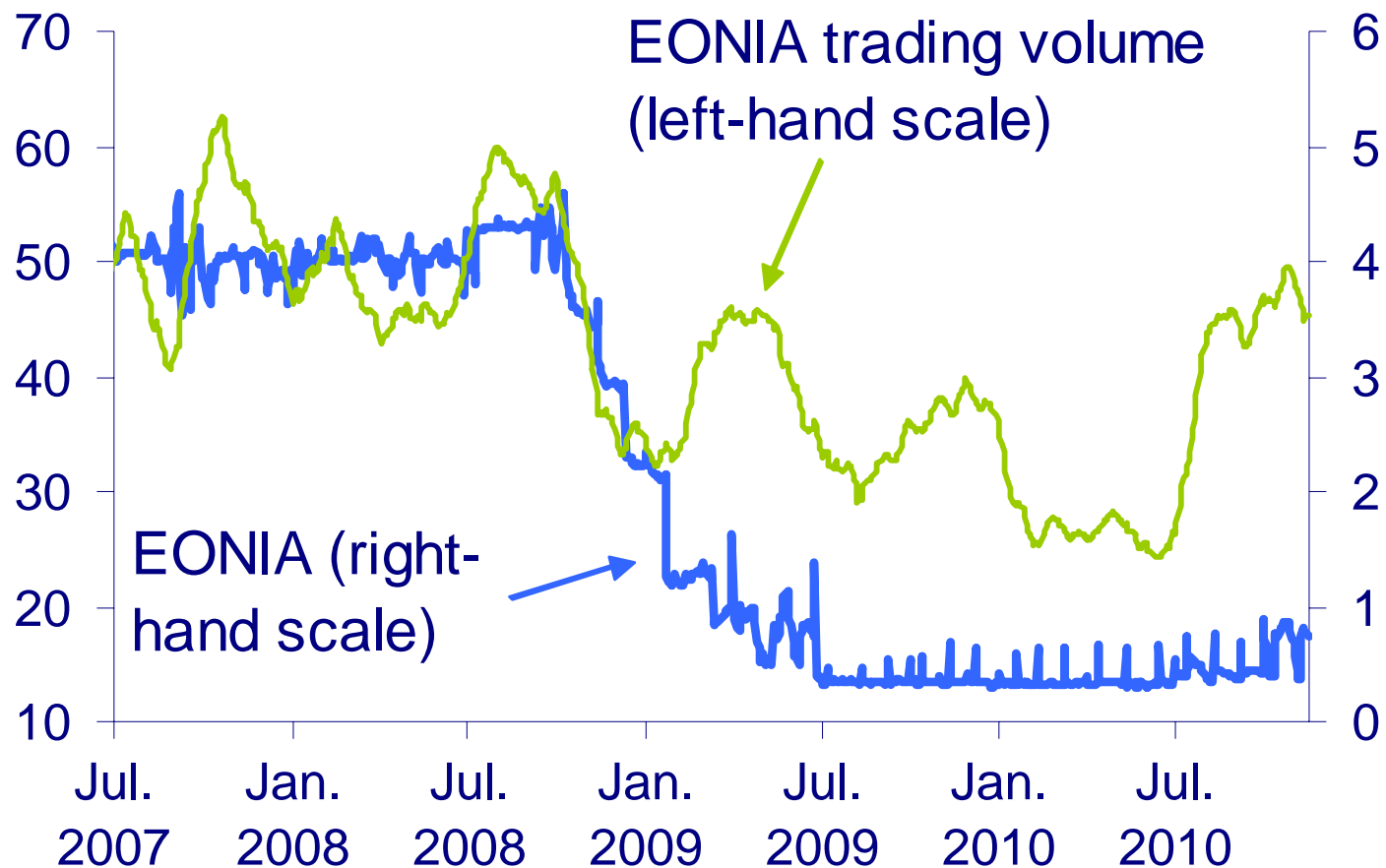
(EUR billion)



Source: ESCB.

... as money markets are improving.

(left-hand scale: EUR billion; right-hand scale: percentages)

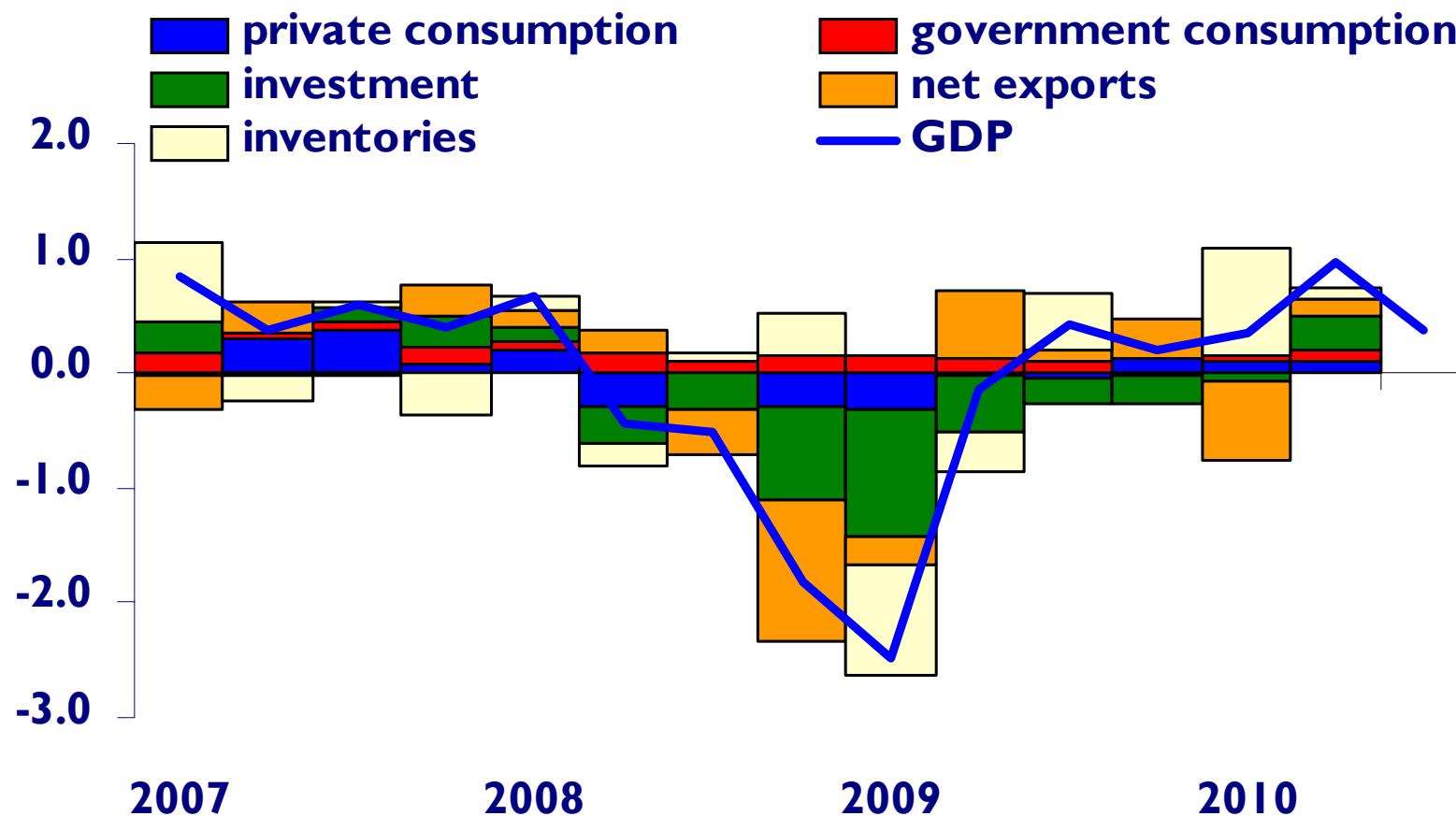


Source: Reuters

Latest observation: 16 November 2010.

Euro area activity recovered in Q2 2010...

(quarter-on-quarter growth rate and quarterly percentage point contributions; seasonally adjusted)

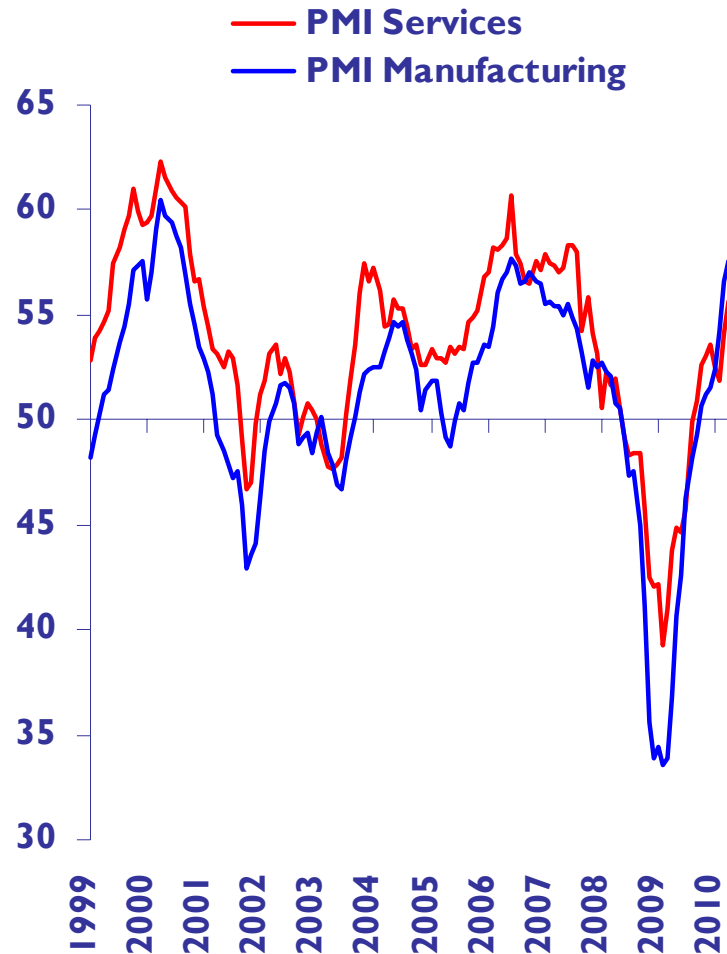


Sources: Eurostat and ECB calculations.
Latest observations: Q2 2010.

... and surveys point to ongoing growth in Q4.

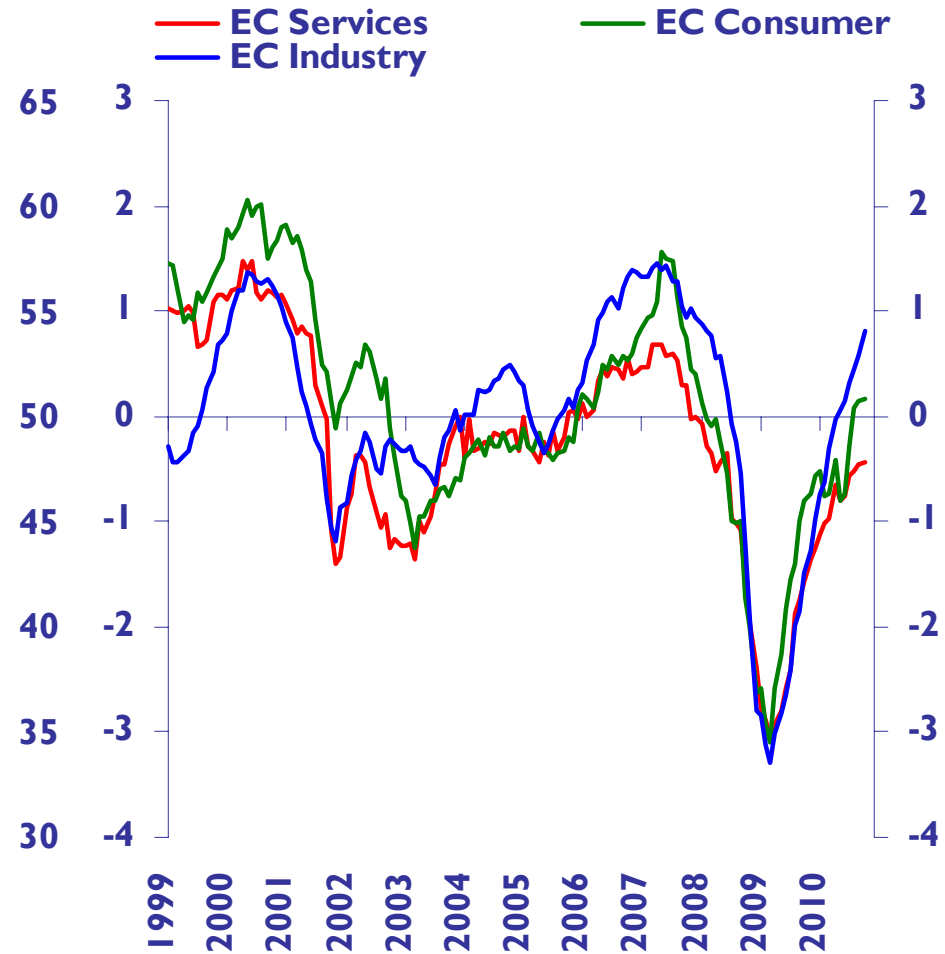
PMI surveys

(diffusion index)



EC surveys

(mean-adjusted percentage balance)



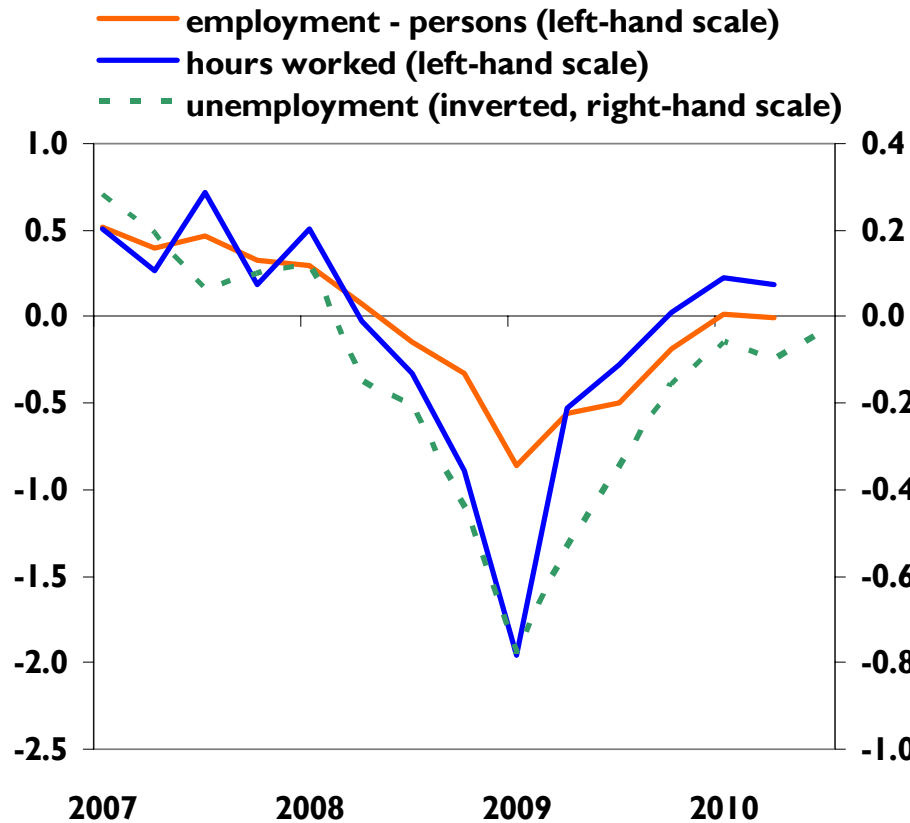
Sources: European Commission (balances adjusted from long-term averages) and Markit.

Latest observation: **October 2010.**

Good prospects for households' income from the stabilisation in the labour market...

Employment and unemployment

(left-hand scale: quarterly percentage changes; right-hand side: change of rate in % of active population)

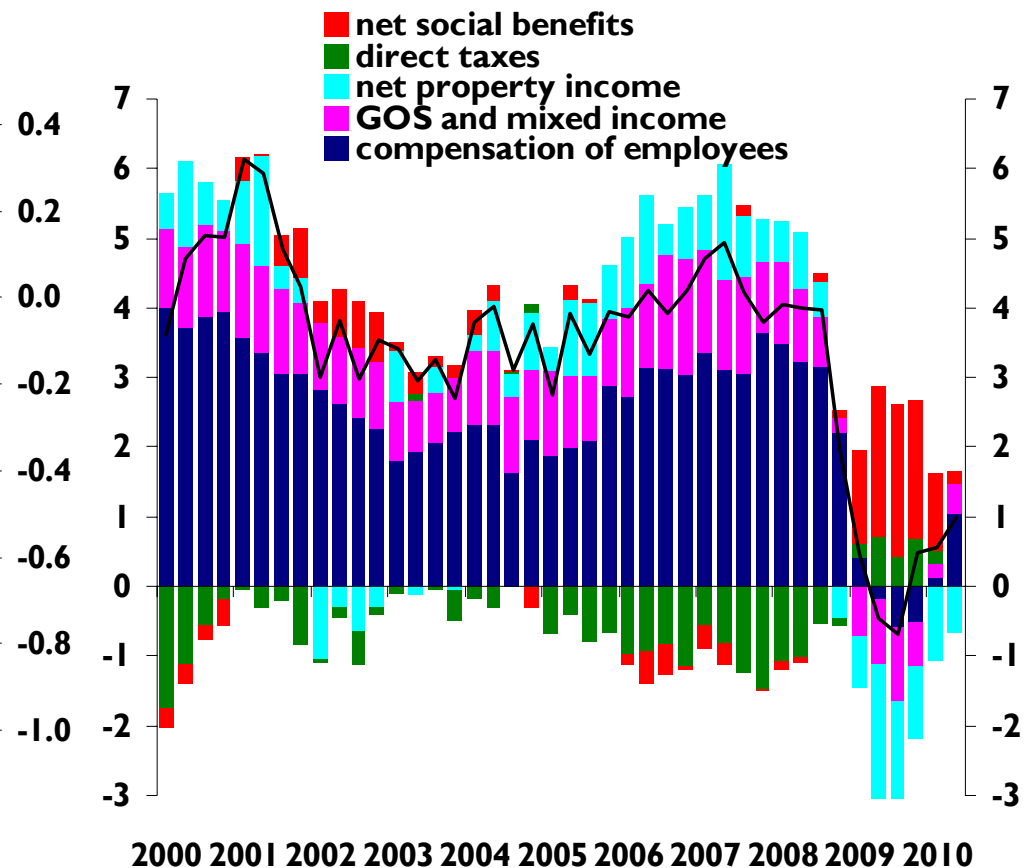


Source: Eurostat.

Latest observations: 2010Q2 for employment, 2010Q3 for unemployment.

Households' nominal gross income by source

(contribution to year-on-year growth rate; percentage point contributions)

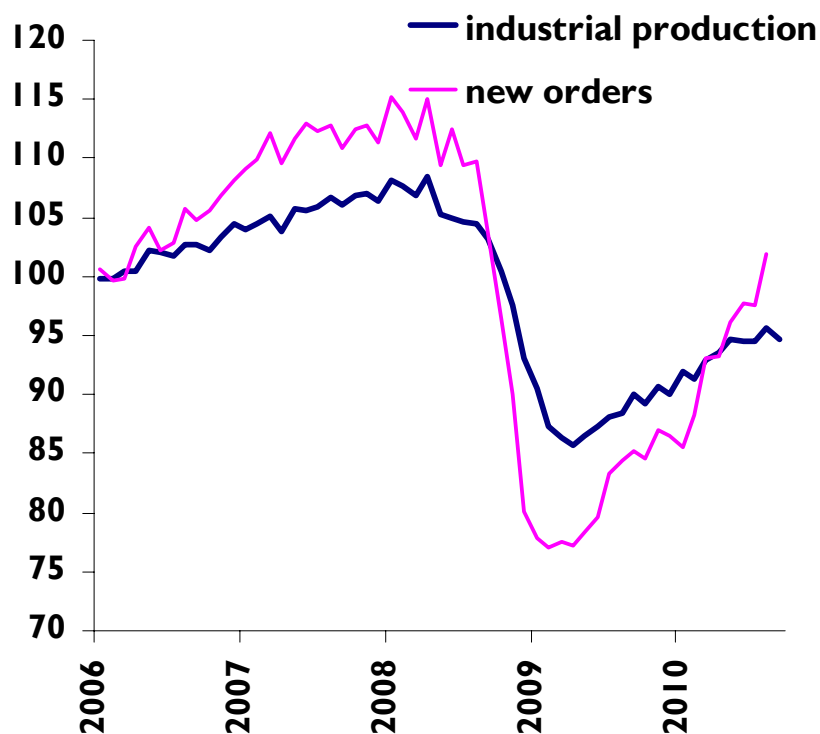


Source: Eurostat, Euro area integrated accounts. Latest observation: 2010Q2.

... and upward trend in production and new orders.

Industrial production and new orders

(index Q1 2006 = 100)

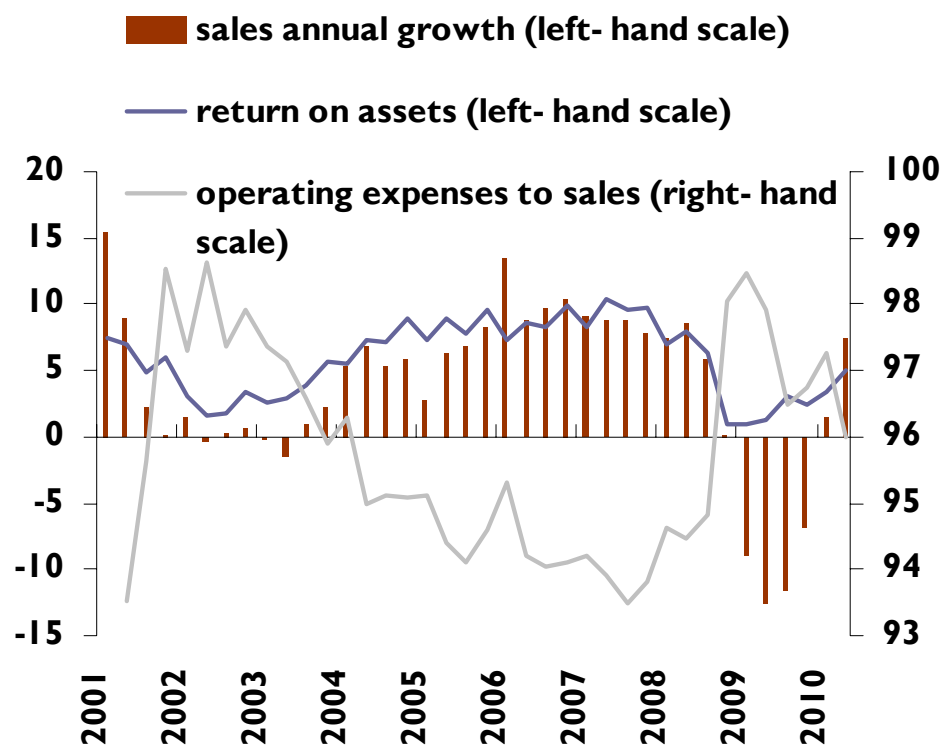


Sources: Eurostat and ECB staff calculations

Latest observations: September for industrial production (excluding construction) and August for new orders (excl. ships, railway and aerospace equipment).

Sales growth, return on assets and cost/sales ratio of listed non-financial firms in the euro area

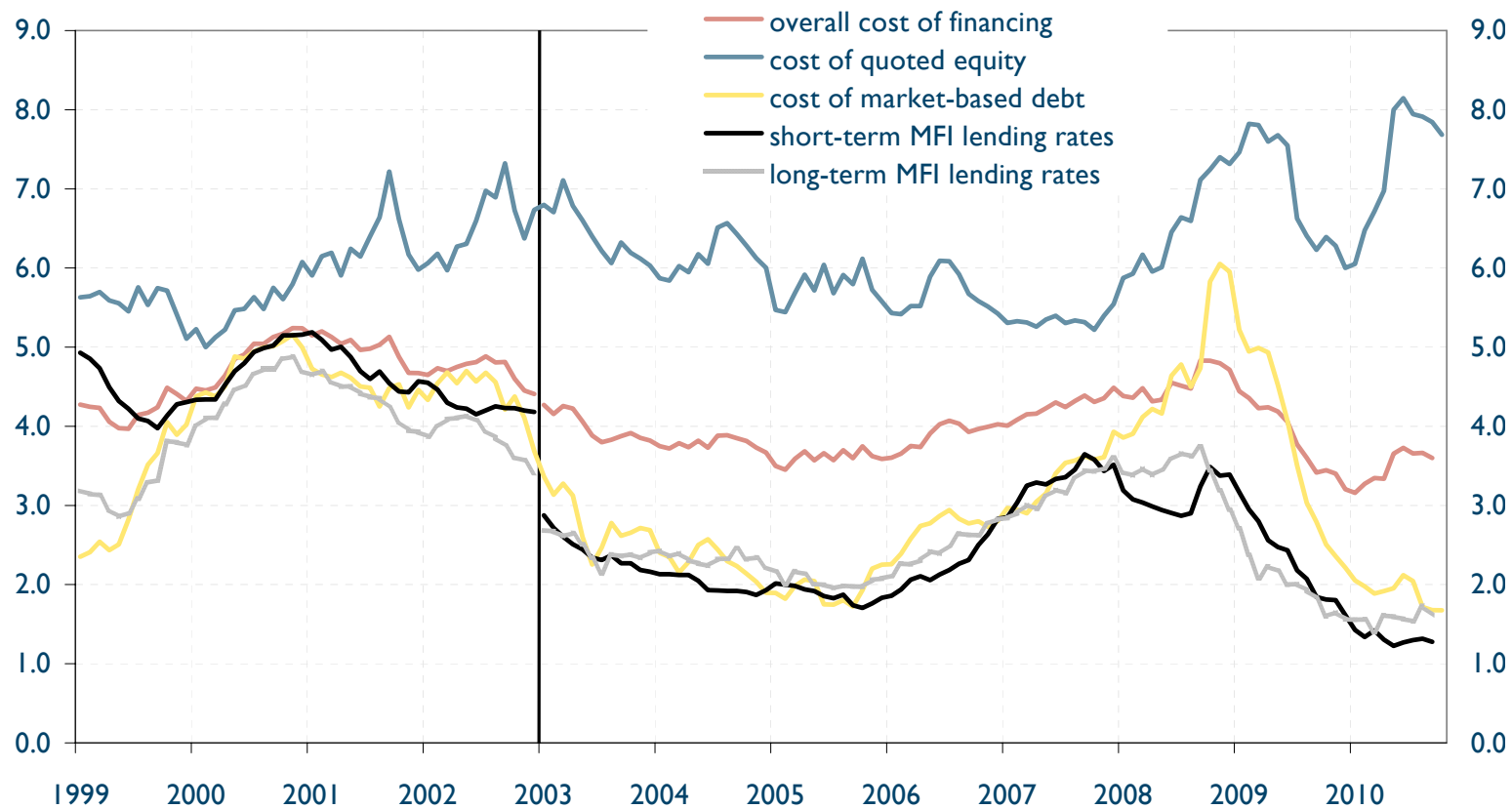
(Q1 2001 – Q2 2010; percentages; medians)



Sources: Thomson Reuters Datastream and ECB calculations

Financing conditions show signs of improvement...

Real cost of external financing *(in annual percentage change)*

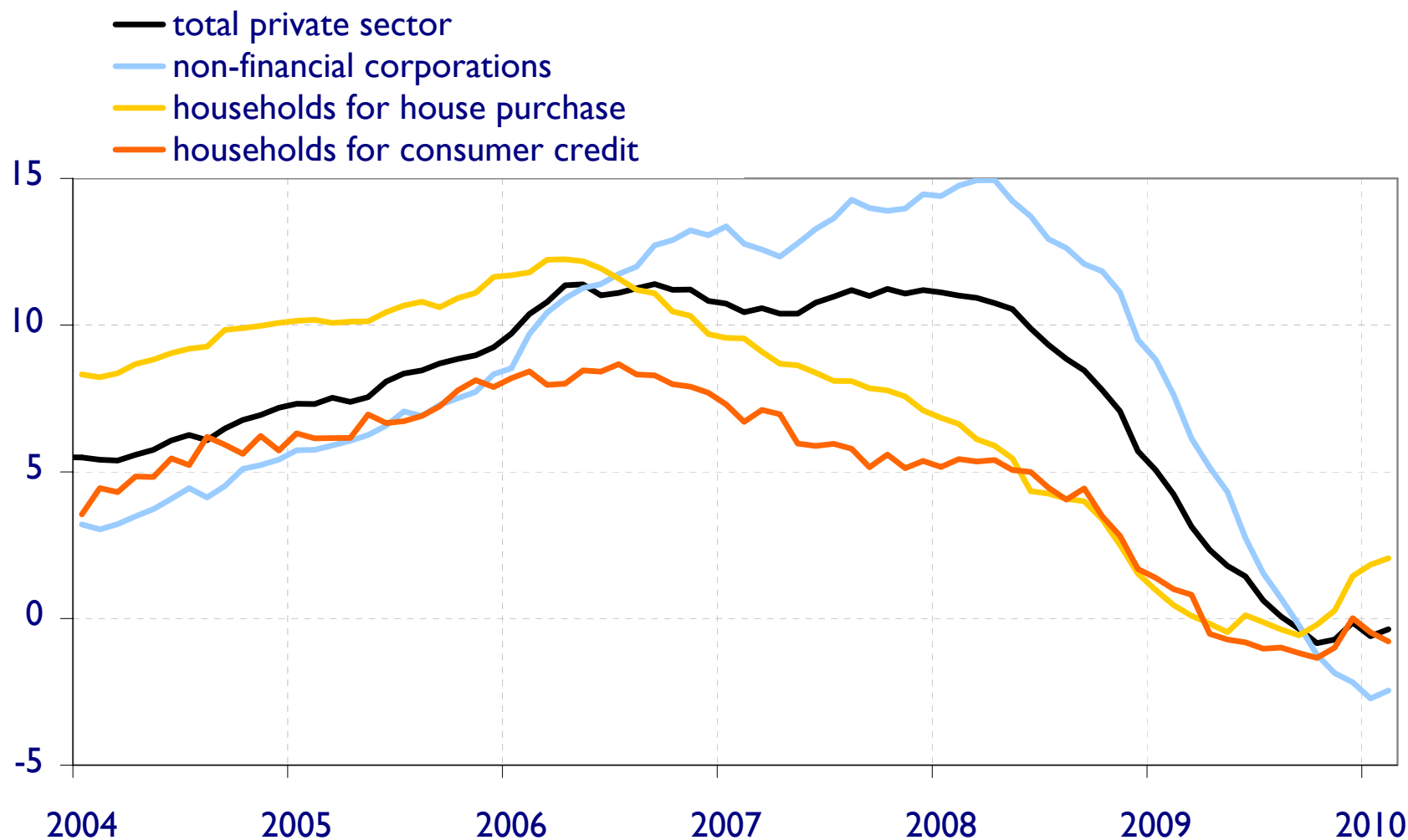


Latest observation: Sept. 2010 for bank lending rates and Oct. 2010 for cost of equity and market securities.

Sources: ECB, Thomson Financial Datastream, Merrill Lynch, Consensus Economics Forecast and ECB calculations.

...supporting the turnaround in the growth of lending to households and non-financial corporations.

Private sector loans developments in the euro area (in annual percentage change)



Sources: ECB.

Outline

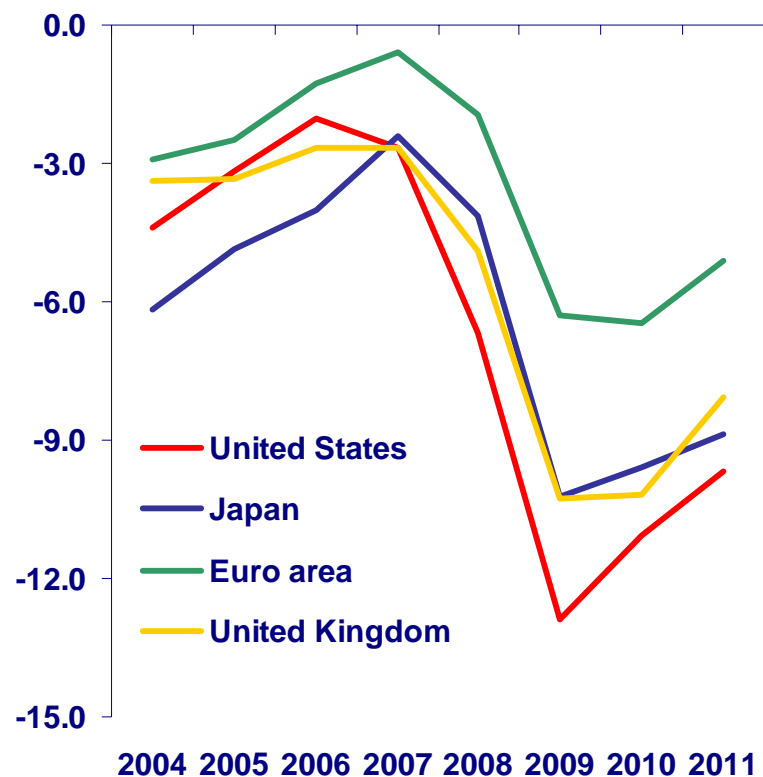
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Consolidation of public finances...

Budget balance, general government

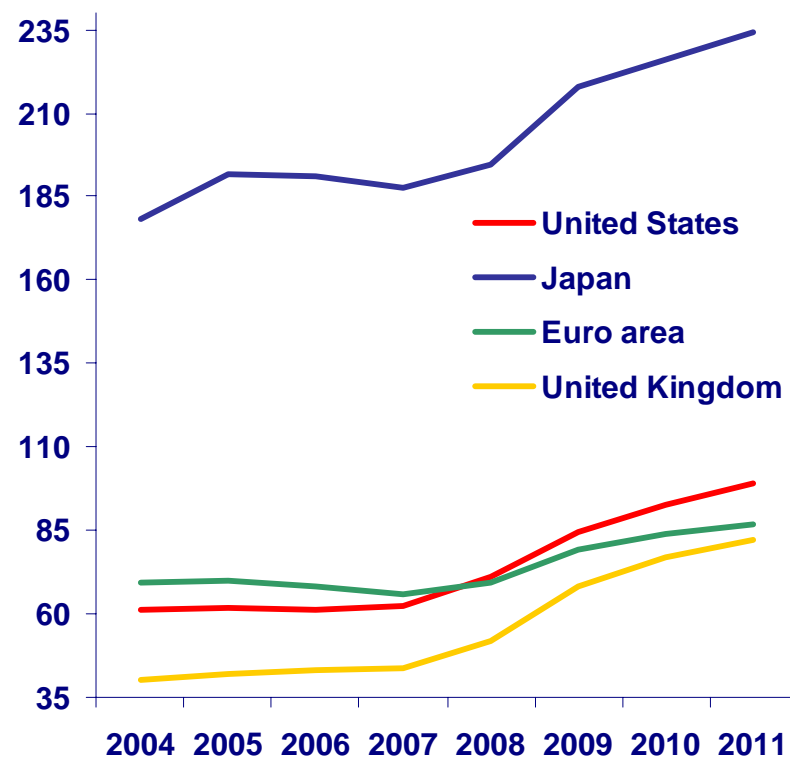
(2004-2011, percentage of GDP)



Source: IMF World Economic Outlook, October 2010

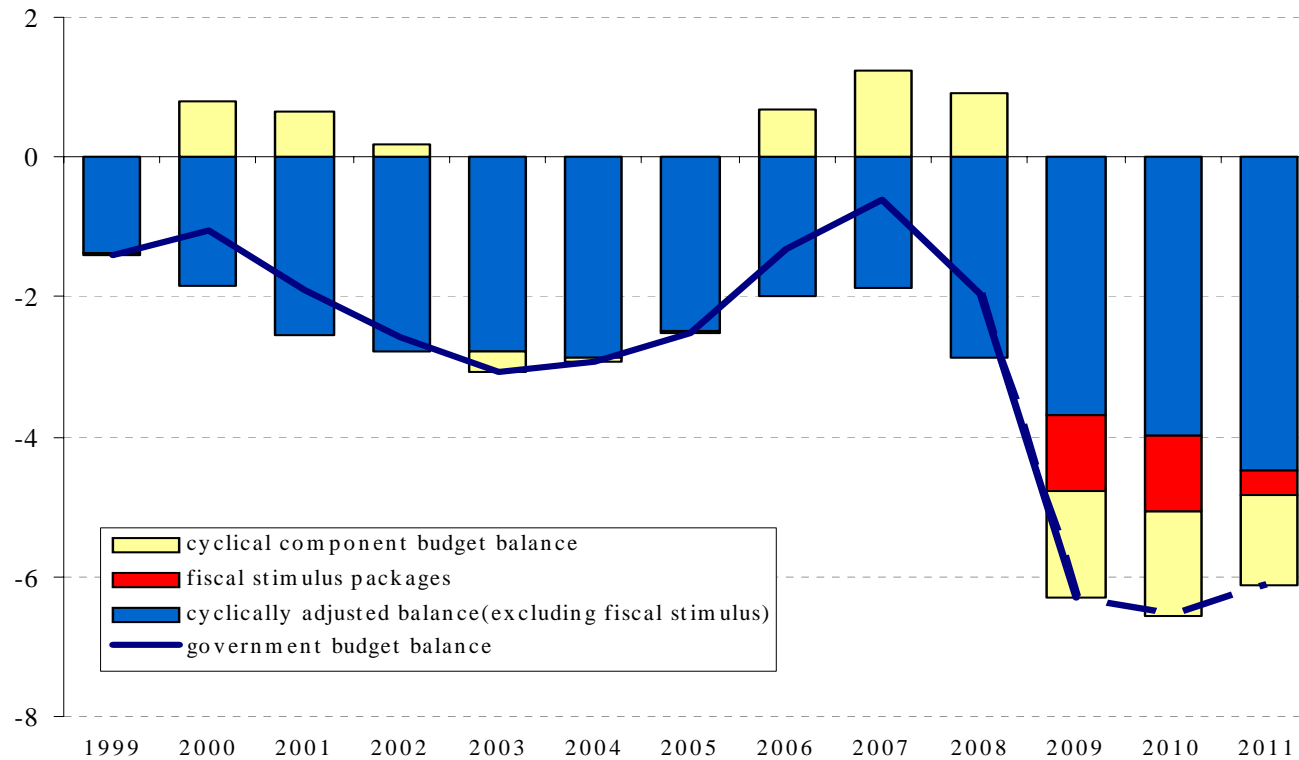
Gross debt, general government

(2004-2011, percentage of GDP)



... and its underlying factors

Government deficit (as a percentage of GDP)

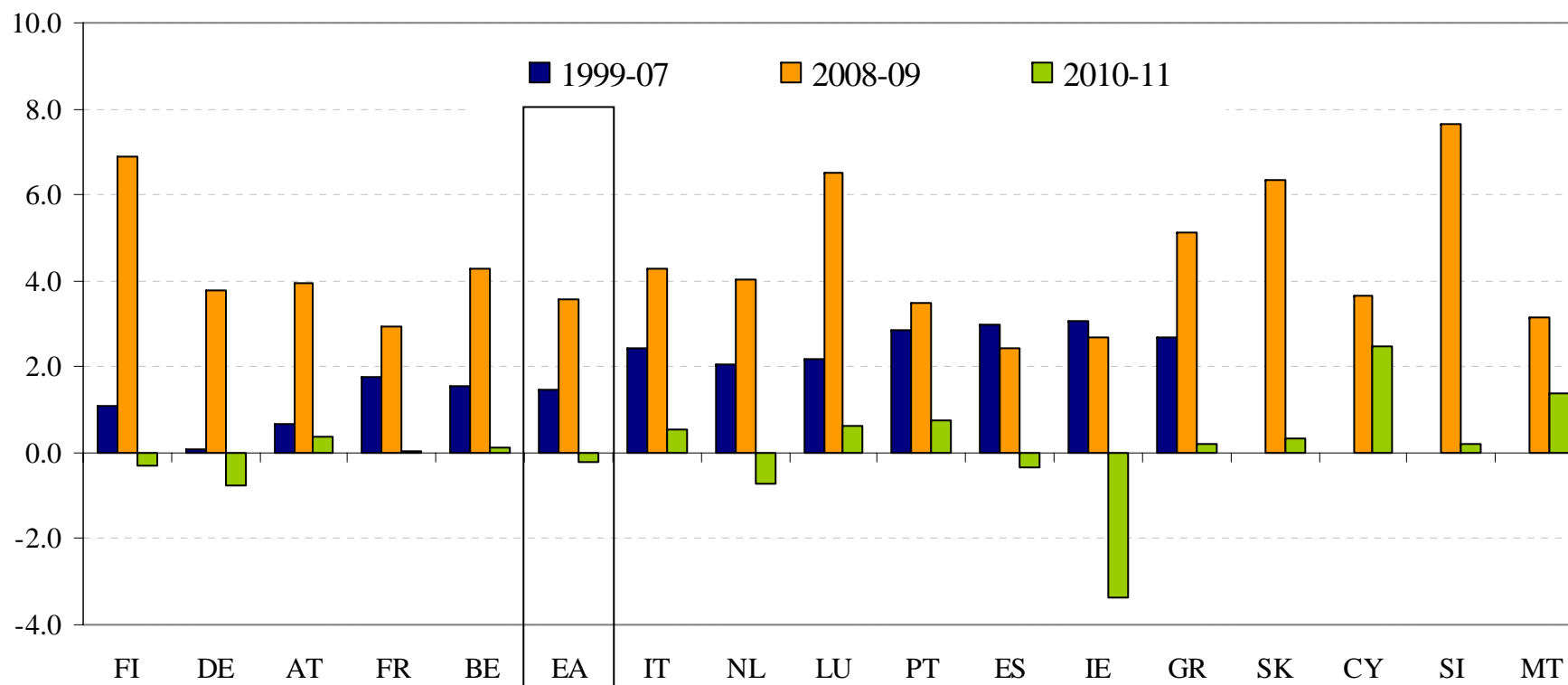


Source: European Commission Forecast (Spring 2010).

Note: for 2011 it has been assumed that a third of the fiscal stimulus packages is still in place.

Diverse developments in unit labour costs across countries.

ULC growth (annual averages)



Sources: Eurostat and European Commission. Notes: Countries are ranked in ascending order according to the average HICP increase in 1999-2007 (2001-2007 for Greece). The new euro area countries have been added at the end of the chart.

Reform of economic governance in the EU...

The European Council endorsed the report of the van Rompuy Task Force at its meeting on 28-29 October 2010.

The proposals put forward by President van Rompuy represent a strengthening of the existing framework in the European Union.

What is needed:

- Effective fiscal surveillance
- Effective macroeconomic surveillance
 - For euro area countries experiencing sustained losses of competitiveness and large current account deficits
 - Procedure should be determined by transparent and effective trigger mechanisms

... with a special focus on financial surveillance

- **Three ESAs (banking, insurance and securities markets) will enhance micro-prudential supervision**
 - **The ESRB will be the new macro-prudential supervisory body in the EU**
 - The ECB will provide the secretariat to the ESRB
 - There are clear institutional separation lines between the ECB and the ESRB
- ➔ both institutions are independent and have clearly defined separate mandates: price stability for the ECB and mitigating systemic risk for the ESRB**

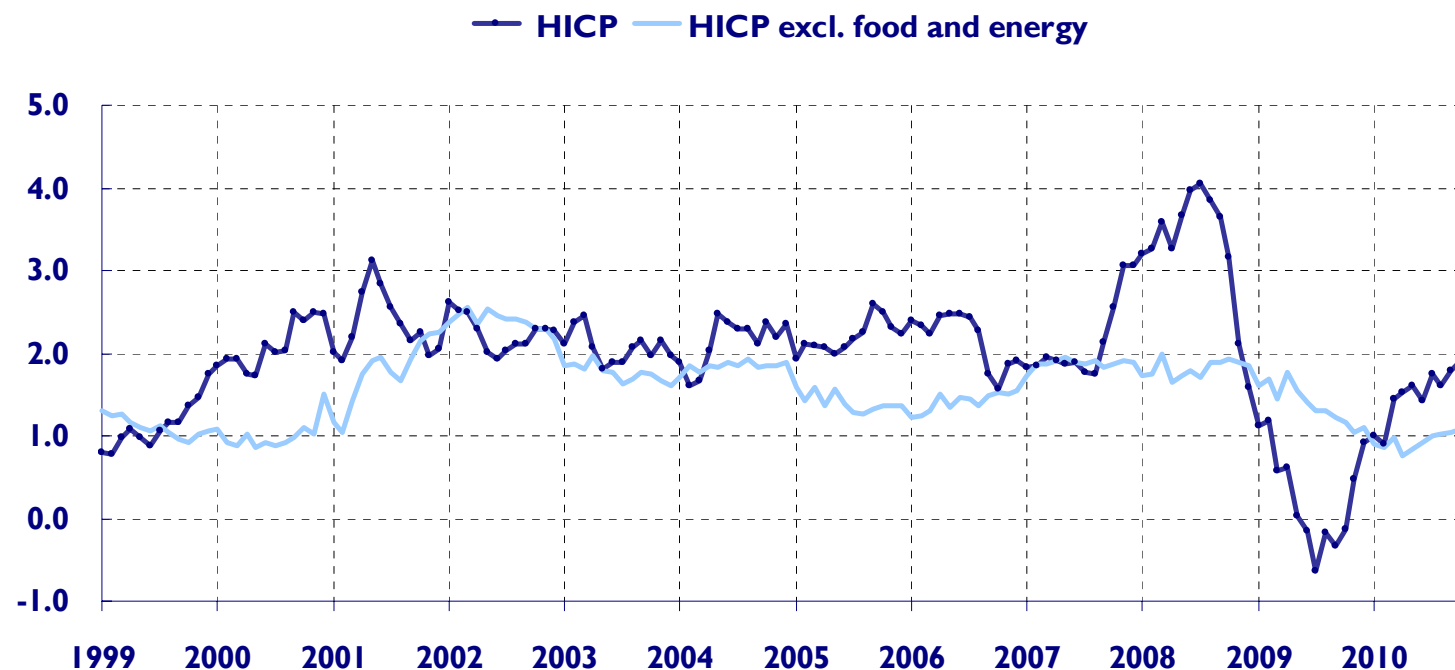


Thank you for your attention!

Inflation expected to remain moderate

Headline and underlying inflation

(annual percentage changes)



Source: Eurostat. Latest observations: October 2010.

Overall HICP inflation has steadily increased since the summer of 2009, reaching 1.9% yoy in October.

HICP inflation excl. food and energy is creeping up since April 2010 and stood at 1.1% in October.

HICP inflation rates are expected to hover around current levels, before moderating again in the course of next year.

Inflation expectations over the medium to longer term continue to be firmly anchored.