EUROPEAN CENTRAL BANK

EUROSYSTEM

EUROSYSTEM STAFF MACROECONOMIC PROJECTIONS FOR THE EURO AREA

On the basis of the information available up to 20 November 2009, Eurosystem staff have prepared projections for macroeconomic developments in the euro area.[1] Reflecting the prospects for a slow economic recovery worldwide, average annual real GDP growth is projected to be between -4.1% and -3.9% in 2009, increasing to between 0.1% and 1.5% in 2010 and between 0.2% and 2.2% in 2011. Inflation is projected to remain moderate over the projection horizon, being dampened by the slack prevailing in the euro area. The average rate of overall HICP inflation is expected to be around 0.3% in 2009, rising to between 0.9% and 1.7% in 2010 and between 0.8% and 2.0% in 2011.

Box A

TECHNICAL ASSUMPTIONS ABOUT INTEREST RATES, EXCHANGE RATES, COMMODITY PRICES AND FISCAL POLICIES

The technical assumptions about interest rates and both energy and non-energy commodity prices are based on market expectations, with a cut-off date of 12 November 2009.[1] The assumption about short-term interest rates is of a purely technical nature. Short-term rates are measured by the three-month EURIBOR, with market expectations derived from futures rates. The methodology gives an overall average level of short-term interest rates of 1.2% for 2009 and 2010. They are assumed to increase thereafter to 2.4% in 2011. The market expectations for euro area ten-year nominal government bond yields imply an average level of 4.0% in 2009, increasing slightly to 4.1% in 2010 and to 4.6% in 2011. The baseline projection takes into account the recent improvements in financing conditions and assumes that, over the projection horizon, bank lending rate spreads vis-à-vis the above-mentioned interest rates will narrow somewhat. Similarly, credit supply conditions are assumed to ease gradually over the horizon. As regards commodities, on the basis of the path implied by futures markets in the two-week period ending on the cut-off date, oil prices per barrel are assumed to average USD 62.2 in 2009, USD 81.4 in 2010 and USD 85.9 in 2011. The prices of non-energy commodities in US dollars are estimated to have decreased significantly, by 22.3%, in 2009 and assumed to rise by 24.7% in 2010, followed by a more modest increase of 4.0% in 2011.

Bilateral exchange rates are assumed to remain unchanged over the projection horizon at the average levels prevailing in the two-week period ending on the cut-off date. This implies a EUR/USD exchange rate of 1.39 in 2009 and 1.49 in 2010 and 2011, and an effective exchange rate of the euro that, on average, appreciates by 0.8% in 2009 and by a further 2.2% in 2010.

Fiscal policy assumptions are based on individual euro area countries' national budget plans as available on 20 November 2009. They include all policy measures that have already been approved by national parliaments or that have been specified in detail by governments and are likely to pass the legislative process.

1 Oil and food price assumptions are based on futures prices up to end-2011. For other commodities, prices are assumed to follow futures up to end-2010 and thereafter to develop in line with global economic activity.

[1] The Eurosystem staff macroeconomic projections are produced jointly by experts from the ECB and the euro area NCBs. They are a biannual input into the Governing Council's assessment of economic developments and the risks to price stability. More information on the procedures and techniques used is given in "A guide to Eurosystem staff macroeconomic projection exercises", ECB, June 2001, which is available on the ECB's website. To reflect the uncertainty surrounding the projections, ranges are used to present the results for each variable. The ranges are based on the differences between actual outcomes and previous projections carried out over a number of years. The width of the ranges is twice the average absolute value of these differences. The method used, involving a correction for exceptional events, is documented in "New procedure for constructing Eurosystem and ECB staff projection ranges", ECB, December 2009, also available on the ECB's website.

THE INTERNATIONAL ENVIRONMENT

The global economic outlook continues to show signs of improvement, with the turning-point towards a recovery having emerged in the second quarter of 2009. In the near term, the recovery is expected to be uneven, as it is being driven primarily by the impact of monetary and fiscal stimuli, the rebound in trade and the inventory cycle. While some of the factors have only a temporary impact, the gradual improvement in financing conditions is expected to provide more lasting support to the projected global recovery. Overall, global economic growth is expected to remain below past trends over the whole projection horizon, as advanced economies in particular experience a subdued recovery, being persistently affected by the crisis. World real GDP outside the euro area is estimated to have fallen by 0.6% on average in 2009, but is assumed to grow by 3.5% in 2010 and 3.9% in 2011. Growth in the euro area's export markets is estimated to have fallen even more strongly in 2009, by 12.2%, and is assumed to recover to 4.2% in 2010 and 4.7% in 2011.

REAL GDP GROWTH PROJECTIONS

Euro area real GDP growth returned to positive territory in the third quarter of 2009, with real GDP rising for the first time since the first quarter of 2008. Available evidence suggests that a number of factors may have boosted growth, such as fiscal stimulus packages, the inventory cycle and the acceleration of trade. Once those partly temporary factors reverse, in early 2010, GDP growth is expected to moderate again. Over the full projection horizon until 2011, activity is projected to be gradually supported by exports and by stronger domestic demand. The lagged effects of monetary policy actions and of the significant efforts to restore the functioning of the financial system support the recovery over the projection horizon. Growth is, however, expected to remain on a weaker path than before the recession, owing to the need for balance sheet repair in various sectors and the fact that consumption is dampened by weak labour market prospects. In annual terms, after growing by 0.5% in 2008, real GDP growth is projected to be between -4.1% and -3.9% in 2009, picking up to between 0.1% and 1.5% in 2010 and between 0.2% and 2.2% in 2011.

In more detail, among the domestic components of GDP, total investment is expected to decline until the beginning of 2011, albeit at a diminishing pace. Non-residential private investment is assumed to be constrained by low capacity utilisation, weak demand, high uncertainty and subdued profits. Residential investment is projected to be dampened by ongoing adjustments in housing markets in some countries. In line with the fiscal packages announced in several euro area countries, government investment in real terms is assumed to grow strongly in 2009 and 2010, before declining the following year.

Private consumption growth is also expected to be subdued. Real labour income is projected to fall over most of the projection horizon, although real incomes are expected to be supported by moderate wage increases, low inflation and government transfers. In addition, the rise in precautionary saving observed in the course of 2009 – in a context of economic uncertainty, increasing unemployment and moderating house prices – is projected to be unwound only to some extent over the projection horizon.

Table 1 Macroeconomic projections for the euro area

(average annual percentage changes) [1), 2)]

	2008	2009	2010	2011
HICP	3.3	0.3 – 0.3	0.9 – 1.7	0.8 – 2.0
Real GDP	0.5	-4.1 – -3.9	0.1 – 1.5	0.2 – 2.2
Private consumption	0.4	-1.2 – -1.0	-0.2 – 0.8	0.2 – 1.8
Government consumption	2.0	2.2 – 3.0	0.5 – 1.7	0.4 – 1.8
Gross fixed capital formation	-0.6	-11.3 – -10.5	-3.1 – -0.1	-1.7 – 2.3
Exports (goods and services)	0.8	-14.5 – -12.5	0.6 – 5.6	0.7 – 6.5
Imports (goods and services)	0.9	-12.6 – -11.0	0.4 – 4.6	0.8 – 5.4

1) The projections for real GDP and its components refer to working day-adjusted data. The projections for exports and imports include intra-euro area trade.

2) The reported figures include Slovakia already in 2008, except with regard to the HICP, where they include Slovakia only from 2009. The average annual percentage changes for 2009 are based on a euro area composition that includes Slovakia already in 2008.

Following sharp declines at the turn of the year, euro area exports started to rebound in mid-2009. A gradual recovery in exports is projected, supported by foreign demand growth, although price competitiveness is expected to weigh somewhat on exports. Euro area imports have decreased markedly in the course of 2009, but are projected to recover in the following two years as final demand picks up. As the projected decline in exports is even stronger than that in imports for 2009, net trade contributes significantly to the decline in GDP in 2009. Slightly positive net trade contributions are expected from 2010 onwards.

Reflecting the lagged adjustment to the sharp drop in output experienced until mid-2009 and the projected weakness in economic activity, total hours worked in the euro area are expected to decline until 2011. While the corresponding adjustment initially arises mostly through a reduction in hours per head, it is increasingly expected to weigh on the number of persons employed. Labour demand is also projected to be dampened by downward wage rigidities in the context of the sharp downturn in activity. Reflecting the fall in employment, the unemployment rate is expected to increase over the projection horizon.

The crisis is expected to dampen potential growth over the projection horizon. The fall in potential growth reflects the inevitable rise in structural unemployment, lower participation rates and the strong decline in investment, which will weigh on the capital stock. The magnitude of these effects, however, is very uncertain and projections of potential growth, and accordingly of the output gap, are surrounded by an even higher degree of uncertainty than usual. This notwithstanding, the estimated output gap is expected to remain significantly negative over the projection horizon.[2]

PRICE AND COST PROJECTIONS

After reaching a low of -0.4% in the third quarter of 2009, annual HICP inflation is expected to turn positive in the fourth quarter of 2009. This pattern is mostly due to strong base effects arising from past falls in commodity prices. Thereafter, inflation is expected to remain moderate, being dampened by the slack prevailing in the euro area. The average annual inflation rate is estimated to be around 0.3% in 2009, and is projected to rise to between 0.9% and 1.7% in 2010, and between 0.8% and 2.0% in 2011. The annual rate of change in the HICP excluding energy is expected to follow a downward pattern until 2010, reflecting the weakness of aggregate demand, and to remain at moderate levels in 2011.

In more detail, the decline in external price pressures observed during 2009 is expected to reverse in the near future, reflecting mainly the assumed path of commodity prices but also a pick-up in competitors' prices. Turning to domestic price pressures, wage pressures have fallen markedly in the course of 2009, in

[2] See the box entitled "Potential output estimates for the euro area" in the July 2009 issue of the Monthly Bulletin.

view of the deterioration of the labour market and the fall in inflation. Looking ahead, wage growth is projected to remain moderate. However, annual unit labour cost growth has risen sharply in 2009, largely owing to the decline in productivity and to the fact that wages have reacted only slowly to the fall in economic activity. Looking ahead, given that productivity should rebound with the cyclical improvement, unit labour costs are projected to decline in 2010 and to rebound only moderately in 2011. While profit margins have largely absorbed the sharp increase in unit labour costs in 2009, they are expected to grow again later in the projection period as companies try to recover part of the earlier decline when activity gradually picks up.

COMPARISON WITH THE SEPTEMBER 2009 PROJECTIONS

With regard to real GDP growth, the projection range for 2009 has been slightly narrowed compared with that published in the September 2009 issue of the Monthly Bulletin. The range for 2010 has been revised upwards. This reflects, in part, the carry-over from revisions for the end of 2009.

With regard to HICP inflation, the figure for 2009 is within the range published in September 2009, while the range for 2010 is now somewhat higher.

Table 2 Comparison with the September 2009 projections

(average annual percentage changes)

	2009	2010
Real GDP – September 2009	-4.4 – -3.8	-0.5 – 0.9
Real GDP – December 2009	-4.1 – -3.9	0.1 – 1.5
HICP – September 2009	0.2 – 0.6	0.8 – 1.6
HICP – December 2009	0.3 – 0.3	0.9 – 1.7

Box B

FORECASTS BY OTHER INSTITUTIONS

A number of forecasts for the euro area are available from both international organisations and private sector institutions. However, these forecasts are not strictly comparable with one another or with the Eurosystem staff macroeconomic projections, as they were finalised at different points in time. Additionally, they use different (partly unspecified) methods to derive assumptions for fiscal, financial and external variables, including oil and other commodity prices. Finally, there are differences in working day adjustment methods across different forecasts (see the table below).

In the forecasts currently available from other institutions, euro area real GDP is expected to fall by between 3.8% and 4.2% in 2009. GDP growth is expected thereafter to be positive, ranging between 0.3% and 1.2% in 2010 and between 1.3% and 1.7% in 2011. All these forecasts are broadly in line with the ranges of the Eurosystem staff projections.

As regards inflation, available forecasts from other institutions anticipate average annual HICP inflation to be between 0.2% and 0.3% in 2009, between 0.8% and 1.2% in 2010, and between 0.7% and 1.6% in 2011. These forecasts for inflation are broadly in line with the ranges of the Eurosystem staff projections.

Comparison of forecasts for euro area real GDP growth and HICP inflation

(average annual percentage changes)

	Date of release	GDP growth			HICP inflation		
		2009	2010	2011	2009	2010	2011
IMF	October 2009	-4.2	0.3	1.3	0.3	0.8	0.8
Survey of Professional Forecasters	October 2009	-3.9	1.0	1.6	0.3	1.2	1.6
European Commission	November 2009	-4.0	0.7	1.5	0.3	1.1	1.5
Consensus Economics Forecasts	November 2009	-3.8	1.2	1.5	0.3	1.1	1.5
OECD	November 2009	-4.0	0.9	1.7	0.2	0.9	0.7
Eurosystem staff projections	December 2009	-4.1 – -3.9	0.1 – 1.5	0.2 – 2.2	0.3 – 0.3	0.9 – 1.7	0.8 – 2.0

Sources: European Commission Economic Forecasts, Autumn 2009; IMF World Economic Outlook, October 2009; OECD preliminary Economic Outlook, November 2009; Consensus Economics Forecasts; and the ECB's Survey of Professional Forecasters.

Note: The Eurosystem staff macroeconomic projections and the OECD forecasts both report working day-adjusted annual growth rates, whereas the European Commission and the IMF report annual growth rates that are not adjusted for the number of working days per annum. Other forecasts do not specify whether they report working day-adjusted or non-working day-adjusted data.

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