EUROPEAN CENTRAL BANK

EUROSYSTEM

EUROSYSTEM STAFF MACROECONOMIC PROJECTIONS FOR THE EURO AREA

On the basis of the information available up to 22 May 2009, Eurosystem staff have prepared projections for macroeconomic developments in the euro area.[1] Reflecting the weak outlook for global growth as well as for domestic demand, average annual real GDP growth is projected to be between -5.1% and -4.1% in 2009; as global and domestic conditions improve, GDP growth for 2010 is expected to be between -1.0% and 0.4%. Inflation is projected to be dampened by the slowdown in economic activity and, in the near term, by base effects stemming from commodity prices. The average rate of increase in the overall HICP is expected to be between 0.1% and 0.5% in 2009 and between 0.6% and 1.4% in 2010.

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 13 May 2009.[1] The assumption about short-term interest rates is of a purely technical nature. These rates are measured by the three-month EURIBOR, with market expectations derived from futures rates. The methodology implies that short-term interest rates remain broadly stable at around 1.2% between the second and last quarter of this year. In 2010, they are expected to increase to 1.6% on average. The market expectations for euro area ten-year nominal government bond yields imply a slight increase, from an average of 4.2% in 2009 to 4.6% in 2010. The baseline projection takes into account the current tightness of financing conditions but also includes the assumption that, over the projection horizon, bank lending rate spreads vis-à-vis the above-mentioned interest rates will narrow somewhat. Similarly, credit conditions are assumed to ease gradually over the horizon from their current tightness. 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 54.5 in 2009 and USD 65.5 in 2010. International food prices are assumed to decline by 10.9% in 2009, before increasing again in 2010. The prices of other (i.e. non-energy and non-food) commodities in US dollars are assumed to decrease significantly, by 24.7%, in 2009 and to rise by 9.2% in 2010.

The technical assumption is also made that bilateral exchange rates 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 1.33 in 2009 and 1.34 in 2010, and an effective exchange rate of the euro that is, on average, 0.6% lower in 2009 than the average for 2008 and 0.1% higher in 2010 than the average for 2009.

Fiscal policy assumptions are based on individual euro area countries' national budget plans as available on 13 May 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-2010. For other commodities, prices are assumed to follow futures until the second quarter of 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 for each variable and each horizon correspond to a model-based 75% probability interval. The method used is documented in "New procedure for constructing ECB staff projection ranges", ECB, September 2008, also available on the ECB's website. In view of the prevailing exceptional economic and financial circumstances, the uncertainty surrounding the projections is larger than usual at the current juncture.

THE INTERNATIONAL ENVIRONMENT

The global economic outlook continues to be driven by the impact of the financial crisis. Global trade experienced an unprecedented and synchronised plunge towards the end of 2008 and in early 2009. The downturn has become highly synchronised across countries as the collapse of international trade has amplified the adverse initial effects of the financial turmoil. However, short-term indicators have tended to bottom out in recent months, and global activity is projected to resume growing towards the end of 2009. Nevertheless, reflecting the widespread need to repair balance sheets, global growth is projected to remain sluggish over the projection horizon. Overall, world real GDP outside the euro area is projected to fall by 1.6% on average in 2009, but to grow by 2.1% in 2010. As a result, growth in the euro area's export markets is expected to fall by 13.0% in 2009 before recovering to 1.0% in 2010.

REAL GDP GROWTH PROJECTIONS

The euro area economy has been adversely affected by the global economic weakness, fading confidence and tight financing conditions. According to Eurostat's flash estimate, real GDP in the euro area fell by 2.5% in the first quarter of 2009. This outturn, combined with the negative growth during the final three quarters of 2008, has a large mechanical negative impact, of as much as -4 percentage points, on the annual figure for GDP growth in 2009. The decline seen in euro area GDP reflects an abrupt retrenchment in exports stemming from the collapse in world trade. The sharp fall in exports, in conjunction with low confidence and financing constraints, has also led to a substantial cut-back in business investment, while destocking has weighed down on growth. In line with the recent stabilisation in survey indicators suggesting that the trough in quarterly growth was reached in early 2009, activity over the remainder of this year is expected to decline at much less negative rates than recently experienced. After a stabilisation phase, positive quarterly growth rates are expected by mid-2010. This pattern reflects the projected continued improvement in global and domestic conditions as financial markets normalise and confidence recovers, owing partly to supportive macroeconomic policies. Average annual real GDP growth is projected to be between -5.1% and -4.1% in 2009, before rebounding to between -1.0% and 0.4% in 2010.

In more detail, among the domestic components of GDP, total investment is expected to decline, with the downward adjustment concentrated in 2009, and increasingly less negative growth rates expected in the following year. Non-residential private investment is projected to contract, affected in particular by weak foreign demand, extraordinarily low capacity utilisation and declining profits. Residential investment projections also reflect ongoing adjustments in house prices 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, before decelerating in the following year.

Private consumption growth is also expected to be subdued in the period ahead, but much less so than growth in other demand components. This pattern largely reflects that of real disposable income growth. Real income is projected over the horizon to be broadly stable on balance. It is expected to be negatively affected by the fall in employment over the whole period, notably in 2009, but to be supported by low inflation as well as by the fiscal packages implemented in some euro area countries, which boost transfers and reduce taxes. Over the whole projection horizon, private consumption is assumed to grow somewhat less than real income, as precautionary savings are expected to remain high in the context of strong economic uncertainty, increasing unemployment and declines in household wealth, not least owing to moderating house prices.

Table 1 Macroeconomic projections for the euro area

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

	2008	2009	2010
HICP	3.3	0.1 – 0.5	0.6 – 1.4
Real GDP	0.6	-5.1 – -4.1	-1.0 – 0.4
Private consumption	0.3	-1.3 – -0.5	-1.1 – 0.3
Government consumption	2.0	1.4 – 2.0	0.9 – 1.7
Gross fixed capital formation	-0.3	-12.3 – -10.1	-6.1 – -2.1
Exports (goods and services)	0.8	-16.6 – -14.0	-2.0 – 1.0
Imports (goods and services)	0.9	-13.8 – -11.2	-3.0 – 1.4

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.

Euro area exports are projected to fall markedly in the first half of 2009, reflecting the ongoing decline in foreign demand. Thereafter, following the expected rebound in world demand, export growth rates are projected to progressively return to positive figures. Similarly, euro area imports are projected to decrease in 2009, outpacing the expected decline in domestic demand, but are projected to recover in the following year as final demand picks up. Given that the expected decrease in exports exceeds the fall in imports, net trade significantly contributes to the decline in GDP in 2009. The contribution of net trade is expected to be broadly neutral in 2010.

Reflecting the projections for economic activity, total hours worked in the euro area are expected to decline over the whole projection horizon. While the adjustment is initially projected to arise 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 the typical stickiness of wages in the context of the sharp downturn in activity. Reflecting the employment projections, the unemployment rate is expected to increase over the projection horizon.

PRICE AND COST PROJECTIONS

Following the sharp fall in HICP inflation since mid-2008, inflation rates are expected to continue to decline until mid-2009, temporarily reaching rates below zero during the summer and autumn of the year. Thereafter, inflation is projected to rise again. The short-run pattern is mostly due to strong downward base effects and past falls in commodity prices. The average annual inflation rate is projected to be between 0.1% and 0.5% in 2009, before rebounding to between 0.6% and 1.4% in 2010. The HICP excluding energy is expected to follow a downward pattern until 2010, reflecting the weakening of aggregate demand.

In more detail, external price pressures are projected to diminish in 2009, mostly reflecting past and future assumed developments in commodity prices. Thereafter, import prices are expected to recover moderately as both commodity prices and competitors' prices pick up slightly worldwide.

Turning to domestic price pressures, compensation per employee is expected to markedly decelerate in 2009, in view of the deterioration of the labour market, the fall in inflation and the reduction in the number of hours worked per employee. Wage growth is projected to decline particularly significantly in the private sector, while wages in the public sector are assumed to react more sluggishly. Annual unit labour cost growth is projected to grow strongly in 2009, reflecting wage stickiness – owing inter alia to the use of two-year contracts – and the sluggish workforce adjustment in the face of a sharp fall in GDP, resulting in negative productivity growth. However, as productivity rebounds in line with the cyclical improvement in 2010, unit labour costs are projected to be broadly stable. Profit margins are expected to absorb the sharp increase in unit labour costs in 2009. Subsequently, as activity gradually recovers, profit margins are expected to grow again as companies try to recover part of the earlier declines.

COMPARISON WITH THE MARCH 2009 PROJECTIONS

With regard to real GDP growth, the projection range for 2009 has been adjusted downwards compared with that published in the March 2009 issue of the Monthly Bulletin. The revision almost exclusively reflects the markedly weaker growth than earlier expected in the first quarter of 2009, related to lower activity worldwide, which reduced exports substantially and also domestic demand. There has only been a very small downward shift in the ranges for 2010, reflecting the lagged effects of the slower economic momentum in 2009.

With regard to HICP inflation, the projection range is slightly below that of the March 2009 projections for 2009 and broadly unchanged for 2010. The largely unchanged projections reflect the fact that the impact of lower than earlier expected activity is broadly offset by the assumed higher commodity prices, particularly oil prices.

Table 2 Comparison with the March 2009 projections

(average annual percentage changes)

	2009	2010
Real GDP – March 2009	-3.2 – -2.2	-0.7 – 0.7
Real GDP – June 2009	-5.1 – -4.1	-1.0 – 0.4
HICP – March 2009	0.1 – 0.7	0.6 – 1.4
HICP – June 2009	0.1 – 0.5	0.6 – 1.4

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 3.4% and 4.2% in 2009. Growth is expected to range between -0.4% and 0.3% in 2010. While most of the forecasts fall within the ranges of the Eurosystem staff projections, some of the forecasts are above the range for 2009. Among other things, this most likely reflects the fact that they were completed before the flash estimate for real GDP growth in the first quarter of 2009 was known. At the same time, for 2010, all forecasts fall within the range of the Eurosystem projections.

As regards inflation, available forecasts anticipate average annual HICP inflation to be between 0.4% and 0.6% in 2009, and between 0.6% and 1.3% in 2010. Most available forecasts for inflation are therefore broadly consistent 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	2009	2010
IMF	16 April 2009	-4.2	-0.4	0.4	0.6
European Commission	3 May 2009	-4.0	-0.1	0.4	1.2
Survey of Professional Forecasters	14 May 2009	-3.4	0.2	0.5	1.3
Consensus Economics Forecasts	15 May 2009	-3.7	0.3	0.4	1.2
OECD	31 March 2009	-4.1	-0.3	0.6	0.7
Eurosystem staff projections	4 June 2009	-5.1 – -4.1	-1.0 – 0.4	0.1 – 0.5	0.6 – 1.4

Sources European Commission Economic Forecasts, Spring 2009; IMF World Economic Outlook, April 2009; OECD Interim Economic Outlook, March 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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