EUROPEAN CENTRAL BANK

EUROSYSTEM

DECEMBER 2013 EUROSYSTEM STAFF MACROECONOMIC PROJECTIONS FOR THE EURO AREA[1]

Real GDP is projected to gain some traction from the fourth quarter of the year onwards, shifting into a slightly higher gear at the end of 2014. A gradual recovery in domestic and external demand is expected to be the driving factor behind the projected sustained increase in activity. Domestic demand will benefit from a reduction in uncertainty, an accommodative monetary policy stance – further strengthened by the recent cut in the policy rate and by forward guidance – a lower fiscal drag, and a drop in commodity prices supporting real disposable incomes. It will also benefit over time from fading credit supply constraints. In addition, activity will be supported over the projection horizon by the favourable impact on exports of a gradual strengthening of external demand. However, despite some progress in rebalancing, which has improved the conditions for growth in stressed countries, the medium-term outlook will be dampened by the need for further adjustment of private and public sector balance sheets and high unemployment. Real GDP is projected to decline by 0.4% in 2013, increasing by 1.1% in 2014 and 1.5% in 2015. A significant amount of slack in the economy is expected to persist until the end of the horizon.

Euro area HICP inflation is projected to be 1.4% in 2013, 1.1% in 2014 and 1.3% in 2015. This moderate price outlook is expected to be partly driven by the downward impact on energy price inflation from declining oil price futures, the past appreciation of the euro and persistent slack in the economy. Food price inflation is also expected to decline substantially, reflecting past declines in international food prices and the assumed modest increase over the projection horizon. HICP inflation excluding energy and food is projected to increase only slightly from 1.1% in 2013 to 1.3% in 2014 and 1.4% in 2015, reflecting subdued domestic cost pressures in the context of the moderate recovery in activity.

Compared with the macroeconomic projections published in the September 2013 issue of the Monthly Bulletin, the projection for real GDP growth has been left unchanged for 2013 and has been revised upwards by 0.1 percentage point for 2014. The projection for headline HICP inflation has been revised downwards by 0.1 percentage point in 2013 and by 0.2 percentage point in 2014.

THE INTERNATIONAL ENVIRONMENT

World real GDP growth (excluding the euro area) is projected to pick up gradually over the projection horizon, rising from 3.3% in 2013 to 3.9% in 2014 and 4.1% in 2015. Growth has gained some momentum in advanced economies in the course of 2013. By contrast, growth in emerging markets has softened owing to weaker domestic demand and limited leeway for further supportive domestic policies. In the short term, global sentiment indicators point to an improvement in business conditions, which is consistent with an ongoing pick-up in global activity. Financing conditions have stabilised recently, following the decision of the Federal Open Market Committee to delay the tapering of asset purchases, and this should overall support the world economic recovery. However, the pace of the recovery is expected to remain gradual. Private sector rebalancing, which is progressing but is still incomplete, and fiscal consolidation are expected to weigh on growth in advanced economies, although to a lesser extent than in the past. The upturn in emerging markets is expected to be muted, as structural factors, including infrastructure bottlenecks and capacity constraints, are likely to restrain growth.

1 On the basis of information available up to 22 November 2013, Eurosystem staff have prepared projections for macroeconomic developments in the euro area. 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.

Table 1 The international environment

(annual percentage changes)

	December 2013				Revisions since September 2013		
	2012	2013	2014	2015	2012	2013	2014
World (excluding euro area) real GDP	3.8	3.3	3.9	4.1	0.0	-0.1	-0.1
World (excluding euro area) trade [1)]	4.5	3.9	5.6	6.4	0.2	-0.3	-0.1
Euro area foreign demand [2)]	4.0	3.0	5.0	5.7	0.3	0.1	-0.1

1) Calculated as a weighted average of imports.
2) Calculated as a weighted average of imports of euro area trade partners.

Global trade has picked up since the start of 2013, in line with the slight rebound in economic activity. However, available indicators point to relatively weak developments in the short run. Looking ahead, world trade growth is expected to strengthen gradually over the projection horizon, but to remain below its pre-crisis rates. Global trade (excluding the euro area) is projected to increase by 3.9% in 2013, 5.6% in 2014 and 6.4% in 2015. With demand from the euro area's main trading partners growing at a slower pace than that from the rest of the world, euro area foreign demand is expected to be somewhat weaker than global trade, growing by 3.0% in 2013, and then accelerating to 5.0% in 2014 and to 5.7% in 2015.

Compared with the macroeconomic projections published in the September 2013 issue of the Monthly Bulletin, the global growth outlook has been revised marginally downwards, as small upward revisions in growth in advanced economies have been offset by downward revisions in activity in emerging economies. The outlook for euro area foreign demand has remained broadly unchanged throughout the projection horizon.

Box 1

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

The technical assumptions about interest rates and commodity prices are based on market expectations, with a cut-off date of 14 November 2013. 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 average level for these short-term interest rates of 0.2% for 2013, 0.3% for 2014 and 0.5% for 2015. The market expectations for euro area ten-year nominal government bond yields imply an average level of 2.9% in 2013, 3.1% in 2014 and 3.6% in 2015.[1] Reflecting the path of forward market interest rates and the gradual pass-through of changes in market rates to lending rates, composite bank lending rates on loans to the euro area non-financial private sector are expected to bottom out in late 2013 and at the start of 2014, gradually rising thereafter. As regards commodity prices, on the basis of the path implied by futures markets in the two-week period ending on the cut-off date, the price of a barrel of Brent crude oil is assumed to fall from USD 112.0 in 2012

1 The assumption for euro area ten-year nominal government bond yields is based on the weighted average of countries' ten-year benchmark bond yields, weighted by annual GDP figures and extended by the forward path derived from the ECB's euro area all-bonds ten-year par yield, with the initial discrepancy between the two series kept constant over the projection horizon. The spreads between country-specific government bond yields and the corresponding euro area average are assumed to be constant over the projection horizon.

Technical assumptions

	December 2013				Revisions since September 2013 [1),2)]	
	2012	2013	2014	2015	2013	2014
Three-month EURIBOR (as a percentage, p.a.)	0.6	0.2	0.3	0.5	0.0	-0.2
Ten-year government bond yields (as a percentage, p.a.)	3.8	2.9	3.1	3.6	-0.1	-0.4
Oil price (in USD/barrel)	112.0	108.2	103.9	99.2	0.4	1.1
Non-energy commodity prices, in USD (annual percentage change)	-7.2	-5.4	-2.6	3.7	0.0	-2.5
USD/EUR exchange rate	1.29	1.33	1.34	1.34	0.5	1.2
Euro nominal effective exchange rate (annual percentage change)	-5.3	3.7	0.8	0.0	0.1	0.1

1) Revisions are expressed as percentages for levels, differences for growth rates, and percentage points for interest rates and bond yields.
2) Revisions are calculated from unrounded figures.

to USD 108.2 in 2013, USD 103.9 in 2014 and USD 99.2 in 2015. The prices of non-energy commodities in US dollars are assumed to fall by 5.4% in 2013 and by 2.6% in 2014 before increasing by 3.7% in 2015.[2]

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 an exchange rate of USD per EUR of 1.33 in 2013 and 1.34 in 2014 and 2015, which is 4.6% higher than in 2012. The effective exchange rate of the euro is assumed to appreciate by 3.7% in 2013 and by 0.8% in 2014 and to remain unchanged in 2015.

The fiscal policy assumptions are based on individual euro area countries' national budget plans that were available on 22 November 2013. They include all policy measures that have already been approved by national parliaments or that have been specified in sufficient detail by governments and are likely to pass the legislative process.

Compared with the macroeconomic projections published in the September 2013 issue of the Monthly Bulletin, the changes in the technical assumptions are relatively small. They include higher US dollar-denominated oil prices, a small appreciation of the exchange rate of the euro and lower interest rates in the euro area.

2 Oil and food commodity price assumptions are based on futures prices up to the end of the projection horizon. The prices of other non-energy hard commodities are assumed to follow futures until the fourth quarter of 2014 and thereafter to evolve in line with global economic activity. EU farm gate prices (in euro), which are used for forecasting food consumer prices, are projected on the basis of an econometric model that takes into account developments in international food commodity prices.

REAL GDP GROWTH PROJECTIONS

Real GDP rose by 0.1% in the third quarter of 2013, following a 0.3% increase in the second quarter (see the chart). Recent survey data point to a moderate strengthening of activity in the fourth quarter of 2013. In the course of 2014 and 2015, the growth momentum is projected to increase somewhat. A gradual recovery in domestic demand is expected to be the main factor behind the pick-up in activity over the projection horizon. Domestic demand will benefit from improving confidence in an environment of declining uncertainty, the accommodative monetary policy stance – further strengthened by the recent cut in the policy rate and by forward guidance – a less restrictive fiscal policy stance, and a drop in commodity price inflation that should support real disposable incomes. Domestic demand is also expected to benefit over time from fading credit supply constraints. In addition, activity will be increasingly supported over the projection horizon by the favourable impact of a gradual strengthening of external demand on exports. However, despite some progress in rebalancing in some stressed euro area countries, which has improved the conditions for export-led growth, the remaining need to adjust private and public sector balance sheets and high unemployment are expected to continue to weigh on the growth outlook over the projection horizon.

Overall, the recovery is projected to remain subdued by historical standards, and euro area real GDP is expected to reach its pre-crisis level (i.e. that of the first quarter of 2008) only by the end of 2015. In annual average terms, real GDP is expected to decline by 0.4% in 2013, largely reflecting a negative carry-over effect stemming from the pattern of activity in 2012, before increasing by 1.1% in 2014 and 1.5% in 2015. This growth pattern reflects a steadily rising contribution from domestic demand combined with an increasing stimulus from exports.

Looking at the growth components in more detail, extra-euro area exports are projected to recover in the fourth quarter of 2013 and to gain momentum in the course of 2014 and 2015, reflecting the strengthening of euro area foreign demand. Intra-euro area exports are projected to grow more slowly than extra-euro area exports, owing to the relative weakness of domestic demand within the euro area.

Business investment is projected to increase in the fourth quarter of 2013, before gaining some momentum in the course of 2014. Over the projection horizon, business investment growth is expected to be supported by a number of factors: the projected gradual strengthening in domestic and external demand; the very low level of interest rates; reduced uncertainty; the need to modernise the capital stock after several years of subdued investment; the reduction of adverse credit supply effects; and some strengthening of profit mark-ups as activity recovers. However, the combined adverse impact of low levels of capacity utilisation, the need for further corporate balance sheet restructuring, adverse financing conditions and a relatively high level of uncertainty in some euro area countries and sectors is assessed to continue to weigh on the outlook. Residential investment is expected to increase modestly in the near term before gaining traction from mid-2014 onwards. Its momentum is expected to remain subdued, however, owing to further adjustment needs in the housing markets of some countries, weak growth in real disposable income, and overall expectations of further house price falls in some countries. Moreover, the relative attractiveness of housing investment in some countries, supported by historically low mortgage rates and rising house prices, can have only a gradual impact, as the construction sector in these countries is already near capacity limits. Government investment is expected to remain weak throughout the projection horizon, owing to the planned fiscal consolidation measures in several euro area countries.

Employment in terms of persons is projected to broadly stagnate over the next quarters, before modestly increasing from mid-2014 onwards. The recovery in employment is expected to be subdued on account of the muted pick-up in activity and of the usual lagged response of employment to output fluctuations, the latter reflecting an increase in hours worked per person before a rise in headcount. However, the output growth threshold for the creation of jobs may have declined in some stressed countries thanks to the impact of labour market reforms. The labour force is expected to stagnate in 2013 and increase modestly thereafter, as certain segments of the population gradually return to the labour market. This should help to dampen wage growth and contribute to potential growth. The unemployment rate is expected to decline modestly over the projection horizon. Labour productivity (measured as output per person employed) picked up during the course of 2013 and

Table 2 Macroeconomic projections for the euro area

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

	December 2013				Revisions since September 2013		
	2012	2013	2014	2015	2012	2013	2014
Real GDP [3)]	-0.6	-0.4	1.1	1.5	-0.1	0.0	0.1
		[-0.5 – -0.3]	[0.4 – 1.8]	[0.4 – 2.6]			
Private consumption	-1.4	-0.6	0.7	1.2	0.0	0.0	0.0
Government consumption	-0.6	0.1	0.3	0.4	-0.1	0.2	-0.3
Gross fixed capital formation	-3.9	-3.0	1.6	2.8	0.1	0.6	-0.1
Exports [4)]	2.7	1.1	3.7	4.8	0.0	0.2	0.0
Imports [4)]	-0.8	-0.1	3.5	4.7	0.1	0.4	-0.3
Employment	-0.6	-0.8	0.2	0.4	0.0	0.2	0.2
Unemployment rate (percentage of labour force)	11.4	12.1	12.0	11.8	0.0	-0.1	-0.2
HICP	2.5	1.4	1.1	1.3	0.0	-0.1	-0.2
		[1.4 – 1.4]	[0.6 – 1.6]	[0.5 – 2.1]			
HICP excluding energy	1.9	1.5	1.3	1.5	0.0	-0.1	-0.2
HICP excluding energy and food	1.5	1.1	1.3	1.4	0.0	0.0	-0.1
HICP excluding energy, food and changes in indirect taxes [5)]	1.3	1.0	1.1	1.4	0.0	0.0	-0.1
Unit labour costs	1.8	1.4	0.9	1.0	0.1	0.1	0.1
Compensation per employee	1.8	1.8	1.8	2.1	0.1	0.0	0.0
Labour productivity	0.0	0.4	0.9	1.1	0.0	-0.1	-0.1
General government budget balance (percentage of GDP)	-3.7	-3.2	-2.6	-2.4	0.0	0.0	0.2
Structural budget balance (percentage of GDP) [6)]	-3.1	-2.5	-2.2	-2.1	0.1	0.0	0.1
General government gross debt (percentage of GDP)	90.6	93.2	93.6	93.1	0.2	0.2	-0.2
Current account balance (percentage of GDP)	1.4	2.0	2.2	2.6	0.0	-0.6	-0.7

1) Latvia is included in the projections for 2014 and 2015. The average annual percentage changes for 2014 are based on a euro area composition in 2013 that already includes Latvia.
2) The ranges shown around the projections 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 for calculating the ranges, 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.
3) Working day-adjusted data.
4) Including intra-euro area trade.
5) The sub-index is based on estimates of actual impacts of indirect taxes. This may differ from Eurostat data, which assume a full and immediate pass-through of tax impacts to the HICP.
6) Calculated as the government balance net of transitory effects of the economic cycle and temporary measures taken by governments. The calculation follows the ESCB approach to cyclically adjusted budget balances (see Bouthevillain, C. et al., "Cyclically adjusted budget balances: an alternative approach", *Working Paper Series,* No 77, ECB, September 2001) and the ESCB definition of temporary measures (see Kremer, J. et al., "A disaggregated framework for the analysis of structural developments in public finances", *Working Paper Series,* No 579, ECB, January 2007).

is projected to gain traction over the remainder of the projection horizon, reflecting the expected acceleration in economic activity and the lagged response of employment.

Private consumption is expected to edge up in late 2013, supported by a declining saving ratio in the context of a decline in real disposable income. Private consumption is expected to gain more momentum from early 2014, as real disposable income growth accelerates owing to gradually improving labour market conditions and low inflation developments, despite a slight rise in the saving ratio. Government consumption is projected to increase moderately over the projection horizon.

Extra-euro area imports are projected to accelerate moderately over the projection horizon, albeit remaining constrained by the subdued overall demand. Net trade is expected to contribute only marginally to real GDP growth over the projection horizon. The current account surplus is expected to increase over the projection horizon, reaching 2.6% of GDP in 2015.

Compared with the macroeconomic projections published in the September 2013 issue of the Monthly Bulletin, the projection for real GDP growth is unchanged for 2013 and has been revised upwards by 0.1 percentage point for 2014, largely reflecting a more positive carry-over effect related to a small upward revision of the outlook at the end of 2013.

PRICE AND COST PROJECTIONS

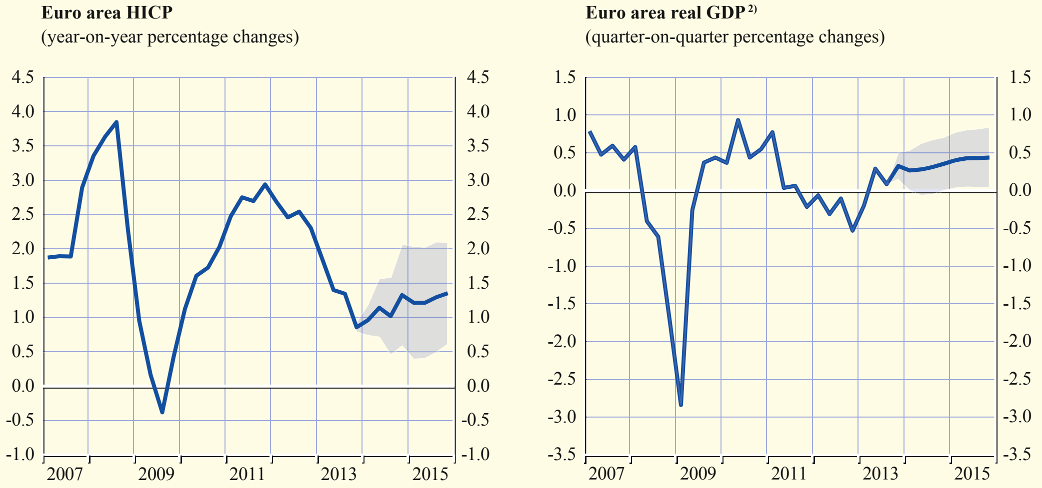
Overall HICP inflation stood at 0.9% in November 2013, down from 2.5% in 2012. The decline in inflation over the course of 2013 reflects, to a large extent, weaker contributions from energy and food prices as well as a subdued trend in services prices and in non-energy industrial goods prices (see Section 3 of this issue of the Monthly Bulletin).

Looking ahead, HICP inflation is expected to remain at low levels, rising slightly in late 2014 and picking up further in 2015, as activity gradually recovers. The annual inflation rate is projected to be 1.4% in 2013, 1.1% in 2014 and 1.3% in 2015.

The moderate outlook for inflation reflects the downward impact from energy prices due to declining oil price futures, the past appreciation of the euro and persistent slack in the economy. In more detail, energy prices are expected to decline further in 2014 and 2015, reflecting the assumed path of oil prices. The contribution of the energy component to overall HICP inflation is therefore expected to be negligible in 2014 and slightly negative in 2015, which is significantly below historical averages. Food price inflation is expected to decline over the first three quarters of 2014, owing to downward base effects and to the expected decline in international and European food commodity prices, before picking up somewhat in 2015 as food commodity prices are assumed to increase again (see the chart). HICP inflation excluding energy and food is expected to increase

Macroeconomic projections [1]

(quarterly data)



1) The ranges shown around the central projections 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 for calculating the ranges, 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.
2) Working day-adjusted data.

moderately during the course of 2014 and to reach an annual rate of 1.4% in 2015. As the upward impact of past indirect tax hikes is assumed to diminish in 2014 and 2015, inflation as measured by the HICP excluding energy, food and changes in indirect taxes is projected to pick up somewhat more strongly over the projection horizon (see also Box 5 in this issue of the Monthly Bulletin).

External price pressures eased during the first three quarters of 2013, owing to sluggish global demand, the appreciation of the effective exchange rate of the euro and declines in oil and non-oil commodity prices. The import deflator is thus estimated to have declined in year-on-year terms over this period. While it will continue to fall in the following quarters as a result of these factors, the import deflator is expected to increase slightly from mid-2014 onwards, as the downward impact of the previous appreciation of the euro fades away, as non-energy commodity prices increase and as import demand gains momentum, allowing for stronger mark-ups.

Turning to domestic price pressures, the annual growth rate of compensation per employee is expected to remain unchanged at 1.8% in 2013 and in 2014, before increasing to 2.1% in 2015. Unit labour cost growth is projected to decelerate from 1.8% in 2012 to 1.4% in 2013 and to 0.9% in 2014, owing to the cyclical increase in productivity growth, reflecting the lagged response of employment to a pick-up in activity, combined with a broadly unchanged growth rate of compensation per employee. In 2015 a slightly stronger pick-up in the growth rate of compensation per employee than in the growth rate of labour productivity is expected to lead to a small rebound in unit labour cost growth.

Following a strong decline in 2012, the profit margin indicator (as measured by the difference between the GDP deflator at factor cost and unit labour cost growth) is expected to stabilise in 2013, thanks to the gradual, albeit modest, improvement in activity in the course of this year. Thereafter, gradually improving economic conditions are expected to support a modest recovery in profit margins.

Increases in administered prices and indirect taxes that are included in fiscal consolidation plans are expected to make significant upward contributions to HICP inflation in 2013 and 2014. In 2015 such contributions are expected to be less strong in the baseline of this projection. This is, however, partly due to a lack of detailed information on fiscal measures for that year.

Compared with the macroeconomic projections published in the September 2013 issue of the Monthly Bulletin, the projection for headline HICP inflation has been revised downwards by 0.1 percentage point in 2013, reflecting recent lower than expected outturns. The inflation projection for 2014 has been revised downwards by 0.2 percentage point, also reflecting lower commodity prices.

FISCAL OUTLOOK

On the basis of the assumptions outlined in Box 1 above, the general government deficit for the euro area is projected to decrease from 3.7% of GDP in 2012 to 3.2% in 2013 and to decline further to 2.6% in 2014 and 2.4% in 2015. The projected lower deficit for 2013 reflects fiscal consolidation efforts in many euro area countries and a partial unwinding of government assistance to the financial sector. In 2014 and 2015 the projected fall in the general government deficit is driven by a favourable contribution of the cyclical component and a continued improvement in the structural component. The latter, however, is projected to improve at a slower pace than in 2013 and is essentially driven by continued moderate growth in government expenditure.

As a result, the structural budget balance, i.e. the cyclically adjusted balance net of all temporary measures, is projected to improve perceptibly in 2013 and to a lesser extent in the remainder of the horizon. The euro area general government gross debt-to-GDP ratio is projected to peak at 93.6% in 2014, declining thereafter to 93.1% in 2015.

Box 2

FISCAL SENSITIVITY ANALYSIS

Sensitivity analyses are generally conducted in order to quantify risks to the projection baseline stemming from alternative paths of certain underlying assumptions. This box presents the results if additional fiscal consolidation were to be implemented in order to reach fiscal targets.

As mentioned in Box 1, the fiscal policy assumptions include all policy measures that have already been approved by national parliaments or that have been specified in sufficient detail by governments and are likely to pass the legislative process. For most countries, the measures included in the baseline projection fall short of the fiscal consolidation requirements under either the corrective or the preventive arm of the Stability and Growth Pact. The commitment to comply with these requirements is broadly reflected in the fiscal targets outlined by governments in their 2013 stability programme updates, in EU-IMF programme documents and, to some extent, in the recent 2014 draft budgetary plans. However, the underlying measures to achieve these targets are often either missing or not sufficiently well specified, and they are thus not taken into account in the baseline projection, especially for 2015, which in most countries is not covered by the current budget exercises. It is therefore not only necessary but also likely that additional fiscal consolidation measures, as compared with those embedded in the baseline, will be adopted by governments by 2015. The impact of such additional consolidation measures on real GDP growth and HICP inflation can be gauged by means of a fiscal sensitivity analysis. Conducting such a sensitivity analysis is important in order to assess the risks surrounding the baseline projection.

Assumptions underlying the fiscal sensitivity analysis

The fiscal sensitivity analysis takes as a starting point the "fiscal gap" between governments' budgetary targets and the baseline budget projections. Country-specific conditions and information in terms of both size and composition are used to gauge the likely additional fiscal consolidation. In particular, country-specific information aims to capture uncertainties surrounding fiscal targets, the likelihood of additional fiscal consolidation measures and the associated macroeconomic feedback effects.

On the basis of this approach, the additional consolidation for the euro area is assessed to be broadly zero in 2013 and about 0.2% of GDP in 2014, while a larger amount of additional measures is assessed to be likely in 2015 (about 0.6% of GDP, bringing the cumulative amount of additional consolidation to around 0.8% of GDP by end-2015). As regards the composition of fiscal measures, the sensitivity analysis seeks to incorporate country and time-specific profiles of the most likely additional consolidation efforts. In this exercise, at the euro area aggregate level, fiscal consolidation is assessed to be tilted somewhat to the expenditure side of the budget, but it also includes increases in indirect and direct taxes and social security contributions.

The estimated macroeconomic impact of additional fiscal consolidation on real GDP growth and HICP inflation in the euro area

Assumptions (% of GDP)	2013	2014	2015
Government budget targets[1)]	-3.1	-2.4	-1.6
Baseline fiscal projections	-3.2	-2.6	-2.4
Additional fiscal consolidation (cumulative)[2)]	0.0	0.2	0.8
Effects of additional fiscal consolidation (percentage points)[3)]			
Real GDP growth	0.0	-0.1	-0.3
HICP inflation	0.0	0.0	0.2

1) Nominal targets as included in the latest EU-IMF programme documents for the relevant countries; latest excessive deficit procedure recommendations for countries under an excessive deficit procedure; 2014 draft budgetary plans and 2013 stability programme updates for countries not under an excessive deficit procedure.
2) Sensitivity analysis based on assessments by Eurosystem staff.
3) Deviations from the baseline in percentage points for real GDP growth and HICP inflation (both on an annual basis). The macroeconomic impact is simulated using the ECB's New Area-Wide Model.

Macroeconomic impact from additional fiscal consolidation

The simulation results of the impact from the fiscal sensitivity analysis on real GDP growth and HICP inflation for the euro area using the ECB's New Area-Wide Model[1] are summarised in the table above.

The macroeconomic impact from the additional fiscal consolidation is limited in 2013 and 2014. In 2015 the impact on real GDP growth is estimated at about -0.3 percentage point, while the impact on HICP inflation is estimated at around 0.2 percentage point. The analysis therefore points to some downside risks to the baseline projection for real GDP growth especially in 2015, since not all of the intended fiscal consolidation measures are yet included in the baseline. At the same time, there are also upside risks to inflation, as part of the additional consolidation is assessed to originate from increases in indirect taxes.

It should be stressed that this fiscal sensitivity analysis focuses only on the potential short-term effects of likely additional fiscal consolidation. While even well-designed fiscal consolidation measures often have negative short-term effects on real GDP growth, there are positive longer-term effects on activity that are not evident in the horizon of this analysis.[2]

Finally, the results of this analysis should not be interpreted as calling into question the need for additional fiscal consolidation efforts over the projection horizon. Indeed, further consolidation efforts are necessary to restore sound public finances in the euro area. Without such consolidation, there is a risk that the pricing of sovereign debt could be adversely affected. Furthermore, effects on confidence may be negative, hindering the economic recovery.

1 For a description of the New Area-Wide Model, see Christoffel K., Coenen G. and Warne A., "The New Area-Wide Model of the euro area: a micro-founded open-economy model for forecasting and policy analysis", *Working Paper Series*, No 944, ECB, 2008.
2 For a more detailed analysis of the macroeconomic effects of fiscal consolidation, see the box entitled "The role of fiscal multipliers in the current consolidation debate", *Monthly Bulletin*, ECB, December 2012.

Box 3

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 decline by 0.4% in 2013, which is identical to the Eurosystem staff projection. Real GDP growth is projected to gradually increase to between 0.9% and 1.1% in 2014 and to between 1.3% and 1.7% in 2015, similar to the path entailed in the Eurosystem staff projections.

As regards inflation, the forecasts from other institutions point to average annual HICP inflation of between 1.4% and 1.5% in 2013, which is close to the Eurosystem staff projection. HICP inflation is expected to average between 1.2% and 1.5% in 2014 and between 1.2% and 1.6% in 2015 in the other available projections.

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

(annual percentage changes)

	Date of release	GDP growth			HICP inflation		
		2013	2014	2015	2013	2014	2015
Eurosystem staff projections	December 2013	-0.4	1.1	1.5	1.4	1.1	1.3
		[-0.5 – -0.3]	[0.4 – 1.8]	[0.4 – 2.6]	[1.4 – 1.4]	[0.6 – 1.6]	[0.5 – 2.1]
European Commission	November 2013	-0.4	1.1	1.7	1.5	1.5	1.4
OECD	November 2013	-0.4	1.0	1.6	1.4	1.2	1.2
Euro Zone Barometer	November 2013	-0.4	1.1	1.5	1.5	1.4	1.6
Consensus Economics Forecasts	November 2013	-0.4	0.9	1.3	1.4	1.3	1.6
Survey of Professional Forecasters	November 2013	-0.4	1.0	1.5	1.4	1.5	1.6
IMF	October 2013	-0.4	1.0	1.4	1.5	1.5	1.4

Sources: European Commission Economic Forecasts, Autumn 2013; IMF World Economic Outlook, October 2013; OECD Economic Outlook, November 2013; Consensus Economics Forecasts; MJEconomics; and the ECB's Survey of Professional Forecasters.
Notes: 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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