

### ECB STAFF MACROECONOMIC PROJECTIONS FOR THE EURO AREA

On the basis of the information available up to 21 August 2009, ECB staff have prepared projections for macroeconomic developments in the euro area.<sup>1</sup> Reflecting the prospects of a slow recovery worldwide, average annual real GDP growth is projected to be negative in 2009, between -4.4% and -3.8%, before moving to between -0.5% and +0.9% in 2010. The currently assumed high level of slack in the euro area economy is expected to dampen inflationary pressures. The average rate of increase in the overall HICP is projected to be between 0.2% and 0.6% in 2009, rising to between 0.8% and 1.6% in 2010.

#### 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 14 August 2009.<sup>2</sup> 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 1.3% for 2009 and 1.6% for 2010. The market expectations for euro area ten-year nominal government bond yields imply an average level of 4.1% in 2009 and 4.3% in 2010. The baseline projection takes into account the recently observed signs of improvement of financial conditions and assumes that, over the projection horizon, short-term bank lending rate spreads vis-à-vis the three-month EURIBOR will narrow further. 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 62.4 in 2009 and USD 78.8 in 2010. The prices of non-energy commodities in US dollars are assumed to fall significantly, by 21.4%, in 2009 but to rise by 17.1% in 2010.

The technical assumptions about 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 1.38 in 2009 and of 1.43 in 2010, and an effective exchange rate of the euro that appreciates by 0.1% in 2009 and by a further 0.6% in 2010.

Fiscal policy assumptions are based on individual euro area countries' national budget plans as available on 14 August 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 The ECB staff macroeconomic projections complement the Eurosystem staff macroeconomic projections that are produced jointly by experts from the ECB and from the euro area national central banks on a biannual basis. The techniques used are consistent with those of the Eurosystem staff projections as described 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, 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.

2 Oil and food price assumptions are based on futures prices up to the end of the horizon. For other commodities, prices are assumed to follow futures until the third quarter of 2010 and thereafter to develop in line with global economic activity.

### Assumptions with regard to the international environment

The global economic outlook continues to be driven by the impact of the financial crisis. However, following the unprecedented synchronised plunge in global trade at the turn of the year, global growth is estimated to have turned positive in the second quarter of 2009 and is expected to be slowly gaining momentum. Nevertheless, in view of the widespread need to restructure 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 1.2% on average in 2009 but to grow by 2.7% in 2010. Reflecting the significant correction in global trade, foreign demand for euro area exports is expected to fall by 13.0% in 2009, before recovering by 1.7% in 2010.

### Real GDP growth projections

Real GDP growth has been negative in the euro area since the second quarter of 2008. Following the strong contraction in activity at the turn of the year, real GDP declined only slightly in the second quarter of 2009. In line with recent short-term economic indicators and surveys, real GDP is expected to continue to stabilise in the second half of the year, before gradually recovering in the course of 2010. The projected improvement is supported by the revival of exports. Domestic demand is expected to benefit from the fiscal impulse measures implemented, a cyclical increase in inventories and the measures taken to facilitate the functioning of the financial system. The recovery is, however, expected to be uneven, given the temporary nature of some of the supporting factors, and rather sluggish, given the weakness of global activity and the high level of uncertainty. Investment, in particular, is expected to decline until mid-2010. Private consumption is projected to be dampened by rising unemployment and weak consumer confidence, even though real incomes are supported by low inflation. Overall, after amounting to 0.6% in 2008, real GDP growth in 2009 is expected to be negative, between -4.4% and -3.8%, before moving to between -0.5% and +0.9% in 2010.

### Price and cost projections

Reflecting base effects related to past hikes in commodity prices, average annual HICP inflation is expected to fall to between 0.2% and 0.6% in 2009, from 3.3% in 2008. While these base effects will reverse in the coming months, the weak economic outlook for the euro area is expected

Table A Macroeconomic projections for the euro area

(average annual percentage changes)<sup>1), 2)</sup>

	2008	2009	2010
HICP	3.3	0.2 - 0.6	0.8 - 1.6
Real GDP	0.6	-4.4 - -3.8	-0.5 - 0.9
Private consumption	0.3	-1.3 - -0.5	-0.8 - 0.6
Government consumption	1.9	1.4 - 2.0	1.0 - 1.8
Gross fixed capital formation	-0.2	-12.1 - -9.9	-5.2 - -1.2
Exports (goods and services)	0.9	-16.2 - -13.6	-0.6 - 2.4
Imports (goods and services)	1.0	-13.6 - -11.0	-2.3 - 2.1

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

2) Data for GDP refer to all 16 countries of the euro area. For the HICP, Slovakia is included as part of the euro area in the projection ranges as of 2009. The average annual percentage changes for 2009 are based on a euro area composition that includes Slovakia already in 2008.

to keep domestic price pressures contained, with inflation projected to be between 0.8% and 1.6% in 2010. The growth of compensation per employee, which registered a strong increase in 2008, is expected to decline significantly in 2009 and to recover slowly thereafter, with contained wage growth in both the public and private sectors as the labour market deteriorates and inflation remains subdued. Lower profit margins are projected to dampen inflation in 2009 before recovering again.

### Comparison with the June 2009 projections

Compared with the Eurosystem staff macroeconomic projections published in the June 2009 issue of the Monthly Bulletin, the ranges projected for real GDP growth in both 2009 and 2010 have been adjusted upwards, reflecting the better than expected GDP outturn for the second quarter of 2009 and slightly more favourable prospects for domestic and external demand in the remainder of this year.

The ranges projected for the annual rate of increase in the overall HICP in 2009 and 2010 have also been adjusted slightly upwards with respect to those of June 2009, reflecting mainly upward revisions to energy prices and, to a lesser extent, the upward revisions to the real GDP growth projections.

**Table B Comparison with the June 2009 projections**

(average annual percentage changes)

	2008	2009	2010
Real GDP – June 2009	0.6	-5.1 - -4.1	-1.0 - 0.4
Real GDP – September 2009	0.6	-4.4 - -3.8	-0.5 - 0.9
HICP – June 2009	3.3	0.1 - 0.5	0.6 - 1.4
HICP – September 2009	3.3	0.2 - 0.6	0.8 - 1.6