

Eurosystem staff macroeconomic projections for the euro area

On the basis of the information available up to 23 November 2007, Eurosystem staff have prepared projections for macroeconomic developments in the euro area.¹ Average annual real GDP growth is projected to be between 2.4% and 2.8% in 2007, between 1.5% and 2.5% in 2008, and between 1.6% and 2.6% in 2009. The average rate of increase in the overall HICP is projected to be between 2.0% and 2.2% in 2007, between 2.0% and 3.0% in 2008, and between 1.2% and 2.4% in 2009.

Box I

Technical assumptions

The Eurosystem staff projections are based on a series of assumptions about interest rates, exchange rates, oil prices and fiscal policies.

The technical assumptions about interest rates and both oil and non-energy commodity prices are based on market expectations, with a cut-off date of 14 November 2007. With regard to short-term interest rates, as measured by the three-month EURIBOR, market expectations are derived from forward rates, reflecting a snapshot of the yield curve at the cut-off date. They imply an average level of 4.9% in the fourth quarter of 2007, falling to 4.5% in 2008 and 4.3% in 2009. The market expectations for euro area ten-year nominal government bond yields imply a flat profile at their mid-November level of 4.3%. The baseline projection also includes the assumption that bank lending spreads will rise slightly over the projection horizon, reflecting the current episode of heightened risk consciousness in financial markets. On the basis of the path implied by futures markets in the two-week period ending on the cut-off date, annual average oil prices per barrel are assumed to be USD 72.6 in 2007, USD 88.6 in 2008 and USD 83.7 in 2009. The average annual increase in non-energy commodity prices in US dollars is assumed to be 18.1% in 2007, 8.9% in 2008 and 4.5% in 2009.

The technical assumption is 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 1.46 and an effective exchange rate of the euro that is, on average, 3.8% higher in 2007 than the average for 2006, and 2.6% higher in 2008 and 2009 than the average for 2007.

Fiscal policy assumptions are based on national budget plans in the individual euro area countries. 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.

The international environment

Global economic growth (outside the euro area) is projected to moderate over the projection horizon, while remaining resilient. This is mainly due to continued robust economic expansion in emerging markets, which are partly taking over from the United States as the main engine of global growth.

Overall, annual growth in world real GDP outside the euro area is projected to average about 5.6% in 2007 and 5.2% in both 2008 and 2009. Growth in the euro area's external export markets is projected to be about 6.0% in 2007, 6.9% in 2008 and 7.1% in 2009.

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. 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. At this juncture, however, owing to financial market developments, the uncertainty surrounding the projections is presumably larger than usual.

Real GDP growth projections

Eurostat's flash estimate of euro area real GDP growth in the third quarter of 2007 indicates a quarter-on-quarter growth rate of 0.7%, following 0.3% in the second quarter of this year. Real GDP is projected to expand over the projection horizon at quarterly growth rates of around 0.5%. Against this background, average annual real GDP growth is projected to be between 2.4% and 2.8% in 2007, between 1.5% and 2.5% in 2008, and between 1.6% and 2.6% in 2009.

Table I: Macroeconomic projections for the euro area

(average annual percentage changes^{1), 2)})

	2006	2007	2008	2009
HICP	2.2	2.0-2.2	2.0-3.0	1.2-2.4
Real GDP	2.9	2.4-2.8	1.5-2.5	1.6-2.6
Private consumption	1.9	1.4-1.8	1.4-2.4	1.2-2.8
Government consumption	1.9	1.4-2.6	1.1-2.1	1.0-2.0
Gross fixed capital formation	5.2	4.0-5.0	0.9-3.9	0.7-3.9
Exports (goods and services)	8.0	4.6-7.4	3.5-6.7	3.9-7.1
Imports (goods and services)	7.6	4.0-6.6	3.3-6.7	3.6-7.0

- 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 figures reported include Slovenia from 2006, with the exception of the HICP, where they include Slovenia only from 2007. Since the September 2007 projections Cyprus and Malta have been included as part of the euro area in the projection ranges from 2008 onwards. The annual percentage changes for 2008 are computed using a euro area composition that includes data for Cyprus and Malta for both 2007 and 2008. The weights of Cyprus, Malta and Slovenia in euro area GDP are approximately 0.2%, 0.1% and 0.3% respectively.

Among the domestic components of GDP, private consumption is expected to grow broadly in line with real disposable income, generally reflecting projected developments in employment and real wage growth. The saving ratio is expected to remain largely unchanged. Government consumption is expected to grow moderately over the projection horizon.

Business investment is expected to slow down somewhat as the support from favourable demand and profit prospects is dampened by lower global growth and tighter financing conditions. Residential private investment growth in particular is expected to moderate, reflecting a normalisation in the housing markets of several euro area countries. Overall, the average annual growth rate of total fixed investment is projected to be between 4.0% and 5.0% in 2007, between 0.9% and 3.9% in 2008, and between 0.7% and 3.9% in 2009.

Export growth is expected to continue to support economic activity, although the euro area's export market shares are projected to decline slightly, owing to increased global competition and to losses in price competitiveness. The average annual rate of growth in total imports is projected to be slightly below that of total exports, resulting overall in a slightly positive contribution from net trade to real GDP growth over the projection period.

The favourable trends in the labour market are projected to continue. Total employment growth is expected to moderate in 2008, in line with the pattern projected for economic activity. Labour supply is expected to increase as a result of improved job prospects and labour market reforms in a number of euro area countries. The unemployment rate is projected to decline further over the projection horizon.

Price and cost projections

Since August 2007 annual HICP inflation has increased substantially, due essentially to additional pressures from food and energy prices. Looking ahead, projected inflation continues to be affected for some time by such pressures. External price pressures are expected to remain strong until mid-2008, owing largely to the assumed path of oil and non-energy commodity prices, in particular for food commodities. In 2008 and 2009, indirect taxes and administered prices are expected to have an upward impact on HICP inflation, albeit to a lesser extent than in 2007 when there was a significant increase in German VAT. Moreover, the projections are based on the expectation that total economy wage growth will be stronger over 2008-09 than in previous years, while labour productivity growth is not expected to increase markedly over the horizon. The effects on inflation of the resulting higher growth of unit labour costs are, however, expected to be dampened by declining growth in profit margins. As a result of these various elements, the average rate of increase in the overall HICP is projected to be between 2.0% and 2.2% in 2007, between 2.0% and 3.0% in 2008, and between 1.2% and 2.4% in 2009.

Comparison with the September 2007 projections

With regard to real GDP growth, the current range projected for 2007 is within the upper part of the range contained in the ECB staff macroeconomic projections published in the September 2007 issue of the Monthly Bulletin. The range for 2008 has been adjusted downwards, reflecting the anticipated effects of higher energy and food prices and a stronger exchange rate of the euro than previously assumed. With regard to HICP inflation, the range projected has been shifted upwards for both 2007 and 2008, mainly reflecting the assumption of higher energy and food prices than in the September projections.

Table 2 Comparison with the September 2007 projections

(average annual percentage changes)

	2006	2007	2008
Real GDP – September 2007	2.9	2.2-2.8	1.8-2.8
Real GDP – December 2007	2.9	2.4-2.8	1.5-2.5
HICP – September 2007	2.2	1.9-2.1	1.5-2.5
HICP – December 2007	2.2	2.0-2.2	2.0-3.0

Box 2**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 and are therefore partly outdated. 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 grow by between 2.5% and 2.6% in 2007, by between 1.9% and 2.2% in 2008, and by between 2.0% and 2.2% in 2009. The forecasts anticipate average annual HICP inflation to be between 2.0% and 2.1% in 2007, between 2.0% and 2.5% in 2008, and at 2.0% in 2009. All available forecasts thus fall within the ranges of the Eurosystem projections.

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

(average annual percentage changes)

	Date of release	GDP growth			HICP inflation		
		2007	2008	2009	2007	2008	2009
IMF	Oct. 2007	2.5	2.1	n.a.	2.0	2.0	n.a.
European Commission	Nov. 2007	2.6	2.2	2.1	2.0	2.1	2.0
OECD	Dec. 2007	2.6	1.9	2.0	2.1	2.5	2.0
Consensus Economics Forecasts	Nov. 2007	2.6	2.0	n.a.	2.0	2.0	n.a.
Survey of Professional Forecasters	Oct. 2007	2.6	2.1	2.2	2.0	2.0	2.0
Eurosystem staff projections	Dec. 2007	2.4-2.8	1.5-2.5	1.6-2.6	2.0-2.2	2.0-3.0	1.2-2.4

Sources: European Commission Economic Forecasts, Autumn 2007; IMF World Economic Outlook, October 2007; OECD Economic Outlook No 82, December 2007, Preliminary edition; 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.