

**Box 6****A review of the prospects for the euro area from 1999 to 2001**

Following a temporary slowdown in the latter part of 1998, euro area output growth strengthened in the first half of 1999, and is expected to have accelerated further in the second half of the year. The outlook for euro area output growth in 2000 and 2001 has also improved in recent months. The brighter outlook reflects improved world trade prospects, as well as a continuation of favourable domestic economic conditions in the euro area. So far world growth in 1999 has been higher than was generally expected earlier in the year. In particular, the US economy has continued to expand robustly, while the recovery in Asian economies has arrived earlier and more forcefully than expected. In addition, the prospects for stable world growth have improved compared with the early part of 1999, as previous uncertainties reflected in developments in world financial markets have diminished.

The table below summarises the outlook for the period from 1999 to 2001, on the basis of the latest autumn forecasts by the IMF, the OECD and the European Commission, as well as the results of surveys of forecasters, i.e. the Consensus Forecast and the Survey of Professional Forecasters. These forecasts are inevitably conditional on a series of more or less different technical assumptions: in particular the forecasts make assumptions of future profiles for euro area short-term and long-term market interest rates, exchange rates and oil prices, all of which may differ between forecasts. Furthermore, the forecasts were completed on different dates and are, therefore, not only based upon slightly different vintages of data releases, but also cannot take full account of the latest developments. In order to derive a broad assessment of the outlook for price developments and the risks to price stability, the Governing Council of the ECB regularly examines forecasts forming part of a wide range of other information on financial and economic developments.

**Comparison of forecasts for the euro area**

(annual percentage changes, unless otherwise indicated)

|  | 1999 |      |                  |                   |                  | 2000 |      |                  |                   |                  | 2001 |                  |
|--|------|------|------------------|-------------------|------------------|------|------|------------------|-------------------|------------------|------|------------------|
|  | IMF  | OECD | EC <sup>1)</sup> | SPF <sup>2)</sup> | CF <sup>3)</sup> | IMF  | OECD | EC <sup>1)</sup> | SPF <sup>2)</sup> | CF <sup>3)</sup> | OECD | EC <sup>1)</sup> |
| Private consumption deflator <sup>4)</sup> | 1.0  | 1.3  | 1.3              | -                 | -                | 1.3  | 1.7  | 1.6              | -                 | -                | 1.7  | 1.6              |
| HICP                                       | -    | -    | 1.2              | 1.1               | 1.1              | -    | -    | 1.5              | 1.5               | 1.5              | -    | 1.5              |
| GDP growth                                 | 2.1  | 2.1  | 2.1              | 2.0               | 2.1              | 2.8  | 2.8  | 2.9              | 2.8               | 2.9              | 2.8  | 2.9              |
| Unemployment rate <sup>5)</sup>            | 10.3 | 10.2 | 10.0             | 10.2              | -                | 9.7  | 9.6  | 9.4              | 9.7               | -                | 9.1  | 8.8              |

Sources: IMF World Economic Outlook (October 1999); OECD Economic Outlook (November 1999); European Commission (autumn 1999); Survey of Professional Forecasters (November 1999) and Consensus Forecasts (November 1999).

Note: The IMF, the Survey of Professional Forecasters and Consensus Forecasts do not provide forecasts for 2001.

1) European Commission.

2) On the basis of a questionnaire submitted by the ECB to 83 professional forecasters across the EU, the Survey of Professional Forecasters provides quantitative information about inflation expectations in the euro area with a horizon of up to two years ahead. To provide the appropriate background for these expectations, the survey also collects estimates for expected growth in area-wide real GDP and expected developments in the euro area unemployment rate. The sample of forecasters is based on recommendations from the respective national central banks in the EU. The forecasters are split fairly evenly between financial institutions (e.g. banks) and others (e.g. research institutes).

3) Consensus Forecasts.

4) For the IMF: CPI.

5) As a percentage of the labour force.

### **Favourable growth prospects**

The latest projections for euro area output growth for 2000 have been subject to some upward revisions since the spring. In general, forecasts currently point to euro area output growth of around 2% for 1999, and an increase in real GDP growth to around 3% in both 2000 and 2001. The improved outlook for world trade as well as continued competitiveness in the euro area can be expected to have a positive impact on euro area exports, thereby supporting the ongoing strengthening of economic activity. In addition, domestic conditions for growth can be regarded as remaining favourable for a cyclical upswing within the euro area. Financial conditions remain healthy for investment and private consumption, while continued employment growth is expected to contribute to maintaining consumer confidence at a high level and also to sustaining private consumption growth. This would be consistent with a certain degree of slowing down of domestic demand growth in some of the previously faster growing economies. Overall, the projections predict that steady growth in domestic demand will remain at rates above 2½% over the entire forecast horizon, which is similar to the rate of growth observed in 1998. The contribution to growth of net exports is expected to turn positive in 2000 and 2001, after having made a negative contribution in 1999.

The uncertainties surrounding the recent growth projections can be regarded as more balanced than those made in the spring, and further upward adjustments to the growth forecasts may be envisaged. In particular, in an environment characterised by robust consumer and business confidence, domestic demand in the euro area may turn out to be stronger than expected in current forecasts. Uncertainties related to the future development of the external environment are more mixed. Export performance could be stronger if last year's losses in market shares are reversed more rapidly than expected. Downside risks stem from possibly slower than expected external demand expansion in the medium term in the United States or in emerging market economies. Finally, some short-term and presumably minor effects on the quarterly growth profile could emerge as a result of economic agents' behaviour around the end of the year, associated with the century date change.

### **Employment growth expected to continue**

Despite weaker real GDP growth, employment growth in the euro area in 1999 is estimated at above 1%. Relatively high employment growth has been attributed to a variety of factors, including the lagged and relatively low response of employment growth to the recent cyclical downturn, wage moderation in previous years, and an increase in part-time work related to active labour market measures. Nominal wages are expected to grow by 2-2½% this year.

The pick-up in economic activity is expected to result in a cyclical rise in productivity. On the basis of the moderate rise in nominal wage growth in the forecasts available, unit labour costs could increase by around 1% a year in 2000 and 2001. Employment growth over this period is, therefore, projected to be broadly similar to that experienced this year.

The unemployment rate has continued to fall in the course of 1999. Forecasts project a decline in the unemployment rate to close to 9% by 2001, a return to levels experienced at the beginning of the 1990s. While past efforts to reform labour markets appear to have been effective in raising employment growth, progress with regard to reforms is uneven across countries. Further progress in removing obstacles to a better functioning of labour markets would significantly contribute to increasing the potential for sustained non-inflationary growth in the euro area.

### **The rate of increase in consumer prices expected to rise somewhat, while remaining below 2%**

According to available forecasts, the rate of increase in consumer prices is expected to rise in 2000 and 2001, but to remain below 2%. Recent forecasts suggest that consumer prices are expected to rise by around 1½% on

average in both 2000 and 2001. The recent increase in oil prices is likely to cause a temporary rise in the rate of increase in the energy price component of consumer prices, peaking in early 2000 and falling back in the course of the year. Nevertheless, as the strengthening of economic growth gathers pace, the rate of increase in consumer prices is expected to rise over the forecast horizon to reach a rate of above 1½% towards the end of 2001. Partially offsetting the cyclical rise in profit margins, ongoing deregulation in utilities is likely to continue to play a role in reducing the rate of price increases.

Several factors are contributing to increasing uncertainty with regard to the outlook for consumer prices as compared with earlier forecasts compiled this spring. First, uncertainties are arising as a result of the behaviour of monetary and credit developments. Another source of uncertainty stems from import prices, as a result of the rise in oil prices and the recent decline in the effective exchange rate of the euro. While the direct impact of developments in import prices on the rate of increase in consumer prices should be largely temporary, the degree to which they would feed further into domestic wage costs and prices remains somewhat uncertain and this may also depend on the evolution of output growth rates. Finally, price reductions resulting from deregulation in utilities could exert stronger downward pressure on consumer prices than anticipated in current forecasts.