

Box 9

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.