

## Box 9

## TECHNICAL ASSUMPTIONS

The Eurosystem staff projections are based on a series of assumptions about interest rates, exchange rates, oil prices, 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 May 2008.<sup>1</sup> 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 2008, falling to 4.3% in 2009.<sup>2</sup> The market expectations for euro area ten-year nominal government bond yields imply a gradual increase, from an average of 4.4% in 2008 to 4.6% in 2009. The baseline projection also includes the assumption that bank lending spreads will remain at their current level, 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, oil prices per barrel are assumed to average USD 113.3 in 2008 and USD 117.7 in 2009. The average annual increase in the prices of non-energy hard (i.e. non-food) commodities in US dollars is assumed to be 13.8% in 2008 and 6.2% in 2009. International food prices are assumed to increase by 44.0% in 2008 and 6.1% 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 1.54 and an effective exchange rate of the euro that is, on average, 6.4% higher in 2008 than the average for 2007 and 0.4% higher in 2009 than the average for 2008.

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.

1 Oil and food price assumptions are based on futures prices up to end-2009. For other commodities, prices are assumed to follow futures until mid-2009 and thereafter to develop in line with global economic activity.

2 Market expectations as measured by forward rates may deviate slightly from EURIBOR futures rates. See the methodological note in the box entitled "ECB staff macroeconomic projections for the euro area" in the March 2007 issue of the Monthly Bulletin.