

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 November 2008.¹ The assumption about short-term interest rates is of a purely technical nature. These rates are measured by the three-month EURIBOR, market expectations being derived from futures rates. The methodology implies an overall average level of short-term interest rates of 4.7% in 2008, which falls to 2.8% in 2009 and rebounds to 3.2% in 2010. The market expectations for euro area ten-year nominal government bond yields imply a slight increase, from an average of 4.4% in 2008 to 4.5% in 2009 and 4.7% in 2010.² The baseline projection also includes the assumption that bank lending spreads increase further from their current level, reflecting the heightened risk consciousness in financial markets. 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 99.9 in 2008, USD 67.3 in 2009 and USD 76.6 in 2010. International food prices are assumed to rise strongly, by 28.9%, in 2008 and to decline by 9.7% in 2009, before increasing again by 4.9% in 2010. The prices of other (i.e. non-energy and non-food) commodities in US dollars are assumed to increase by 3.5% in 2008, to decrease significantly, by 22.9%, in 2009 and to grow by 5.4% in 2010.

The technical assumption is also 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 1.27 and an effective exchange rate of the euro that is, on average, 4.1% higher in 2008 than the average for 2007 and 5.5% lower in 2009 than the average for 2008.

Fiscal policy assumptions are based on individual euro area countries' national budget plans as available on 20 November 2008. 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-2010. For other commodities, prices are assumed to follow futures until end-2009 and thereafter to develop in line with global economic activity.

2 See Box 4 in this issue of the Monthly Bulletin.