



EUROPEAN CENTRAL BANK

EUROSYSTEM

EUROSYSTEM STAFF MACROECONOMIC PROJECTIONS FOR THE EURO AREA

On the basis of the information available up to 24 November 2006, Eurosystem staff have prepared projections for macroeconomic developments in the euro area.¹ Average annual real GDP growth is estimated at between 2.5% and 2.9% in 2006. It is projected to be between 1.7% and 2.7% in 2007, and between 1.8% and 2.8% in 2008. The average rate of increase in the overall Harmonised Index of Consumer Prices (HICP) is estimated to be between 2.1% and 2.3% in 2006. It is projected to be between 1.5% and 2.5% in 2007, and between 1.3% and 2.5% in 2008.

Box A

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 regard to short-term interest rates as measured by the three-month EURIBOR, market expectations are measured by forward rates as at 14 November 2006, reflecting a snapshot of the yield curve at that point in time. This implies an increase from an average of 3.1% in 2006 to an average of 4.0% in 2007, and a slight decline to an average of 3.8% in 2008. The market expectations for euro area ten-year nominal government bond yields as at 14 November 2006 imply a flat profile, with an average of 3.8% in 2006, 2007 and 2008. On the basis of the path implied by futures markets in the two-week period ending on 14 November 2006, annual average oil prices are assumed to be USD 65.5 per barrel in 2006, USD 64.6 per barrel in 2007 and USD 67.2 per barrel in 2008. The average annual increase in non-energy commodity prices in US dollars is assumed to be 28.8% in 2006, 15.2% in 2007 and 3.7% in 2008.

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 14 November 2006. This implies a EUR/USD exchange rate of 1.28 and an effective exchange rate of the euro that is 1.6% higher than the average for 2005.

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 parliament or that have been specified in detail and are very likely to pass the legislative process.

THE INTERNATIONAL ENVIRONMENT

The external environment of the euro area is expected to remain favourable over the projection horizon. While real GDP growth in the United States and Japan is expected to moderate somewhat, growth in emerging Asia is expected to remain high, strongly supported by domestic demand. Growth in most other large economies is also projected to remain dynamic. In addition, the countries that joined the European Union on 1 May 2004 are expected to continue to record robust growth rates.

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.

Overall, annual growth in world real GDP outside the euro area is estimated to average about 5.3% in 2006, while it is projected to be about 4.8% in 2007 and 2008. Growth in the euro area's external export markets is estimated at 10.2% in 2006 and projected to be about 7.1% in 2007 and 6.7% in 2008.

REAL GDP GROWTH PROJECTIONS

Following real GDP growth of 1.0% quarter on quarter in the euro area in the second quarter of this year, Eurostat's first estimate for the third quarter is 0.5%. Over the projection horizon, quarterly growth in GDP is expected to remain at 0.5% or slightly above, with the exception of the first quarter of 2007, when it is expected to be dampened somewhat by significant increases in indirect taxes.

Against this background, average annual real GDP growth is estimated to be between 2.5% and 2.9% in 2006, while it is projected to be between 1.7% and 2.7% in 2007, and between 1.8% and 2.8% in 2008. Over the projection horizon, export growth is expected to continue to support economic activity on the back of the assumed continued strength in foreign demand. Notwithstanding the temporary effects from increases in indirect taxes in early 2007, growth in domestic demand should remain broadly stable at a robust level.

Table 1 Macroeconomic projections for the euro area

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

	2005	2006	2007	2008
HICP	2.2	2.1-2.3	1.5-2.5	1.3-2.5
Real GDP	1.5	2.5-2.9	1.7-2.7	1.8-2.8
Private consumption	1.4	1.8-2.2	1.3-2.3	1.2-2.8
Government consumption	1.3	1.4-2.6	0.5-1.5	0.8-1.8
Gross fixed capital formation	2.7	4.4-5.4	2.5-5.5	1.8-5.0
Exports (goods and services)	4.6	6.6-9.4	4.2-7.4	4.2-7.4
Imports (goods and services)	5.5	6.7-9.3	3.9-7.3	4.0-7.4

1) For each variable and horizon, ranges are based on the average absolute difference between the actual outcomes and previous projections by euro area central banks. 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 projections include Slovenia as part of the euro area as of 2007. The weight of Slovenia in euro area GDP in 2005 was 0.3%. The annual percentage changes for 2007 are based on a euro area composition that includes Slovenia already in 2006.

Among the domestic expenditure components of GDP, average annual growth in private consumption is estimated to be between 1.8% and 2.2% in 2006, while it is projected to be between 1.3% and 2.3% in 2007, and between 1.2% and 2.8% in 2008. The expected increases in indirect taxes in 2007 are projected to lead to a moderation in consumption growth in that year, while anticipation effects are expected to bring about slightly higher consumption growth before the turn of the year. Over the projection horizon, households' disposable income is projected to be supported by improvements in the labour market, and to some extent also by increases in non-labour income growth in the context of high corporate profit rates. The saving ratio is expected to remain broadly stable over the horizon.

The average annual rate of growth in total fixed investment is estimated to be between 4.4% and 5.4% in 2006, while it is projected to be between 2.5% and 5.5% in 2007, and between 1.8% and 5.0% in 2008. Business investment should continue to benefit from strong external demand, favourable financing conditions and robust corporate profits. Residential private investment is projected to grow at moderate rates over the projection horizon.

The average annual rate of change in total exports, which includes intra-euro area trade, is estimated to be between 6.6% and 9.4% in 2006, and is projected to be between 4.2% and 7.4% in both 2007 and 2008.

Extra-euro area export market shares are expected to decline slightly over the projection horizon, owing to increased global competition and to lagged effects from past losses in price competitiveness. The average annual rate of growth in total imports is expected to be just below that of exports. The contribution from net trade is projected to be roughly neutral over the projection period.

Following favourable developments in 2006, total employment is projected to continue to grow steadily over the projection period. At the same time, labour supply is expected to increase as a result of improved job prospects and structural 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

The average rate of increase in the overall HICP is estimated to be between 2.1% and 2.3% in 2006, while it is projected to be between 1.5% and 2.5% in 2007, and between 1.3% and 2.5% in 2008. The large contribution from increasing energy and non-oil commodity prices to price developments in recent years is expected to diminish over the projection horizon, given the recent fall in oil prices and the only moderate increases embedded in current oil futures prices. At the same time, the projections are based on the expectation that wage growth will remain moderate and increase only marginally towards the end of the projection period. As productivity growth is projected to remain roughly stable, this implies a projection of moderately increasing unit labour cost growth over the horizon. A major factor affecting HICP inflation in 2007 will be higher indirect taxes (with an aggregate euro area contribution of 0.5 percentage point to HICP inflation). For 2008, by contrast, no effects from indirect taxes are currently embedded in the projections. Finally, the HICP projections are based on expectations of a steady growth in profit margins and no major price pressures from non-commodity imports.

COMPARISON WITH THE SEPTEMBER 2006 PROJECTIONS

Compared with the ECB staff macroeconomic projections published in the September 2006 issue of the Monthly Bulletin, the ranges projected for real GDP growth in 2006 and 2007 have been adjusted slightly upwards, reflecting recent data and the anticipated effects of lower energy prices than previously assumed. With regard to HICP inflation, the ranges projected for 2006 and 2007 have been shifted downwards, reflecting mainly the assumption of lower energy prices.

Table 2 Comparison with the September 2006 projections

(average annual percentage changes)

	2005	2006	2007
Real GDP – September 2006	1.5	2.2-2.8	1.6-2.6
Real GDP – December 2006	1.5	2.5-2.9	1.7-2.7
HICP – September 2006	2.2	2.3-2.5	1.9-2.9
HICP – December 2006	2.2	2.1-2.3	1.5-2.5

Box B**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 prices.

In the forecasts currently available from other institutions, euro area annual GDP growth is seen to be between 2.4% and 2.6% in 2006, between 1.9% and 2.2% in 2007, and between 2.0% and 2.3% in 2008. The forecasts anticipate annual average HICP inflation to be between 2.2% and 2.3% in 2006, between 1.9% and 2.4% in 2007, and between 1.8% and 2.1% in 2008. While the IMF forecast for GDP growth in 2006 is slightly below the Eurosystem range, all other forecasts 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		
		2006	2007	2008	2006	2007	2008
European Commission	Nov. 2006	2.6	2.1	2.2	2.2	2.1	1.9
IMF	Sep. 2006	2.4	2.0	2.0	2.3	2.4	2.1
OECD	Nov. 2006	2.6	2.2	2.3	2.2	1.9	1.8
Consensus Economics Forecasts	Nov. 2006	2.6	1.9	n.a.	2.2	2.1	n.a.
Survey of Professional Forecasters	Nov. 2006	2.6	2.0	2.0	2.2	2.1	1.9

Sources: European Commission Economic Forecasts, Autumn 2006; IMF World Economic Outlook, September 2006; OECD Economic Outlook No 80 – Preliminary version; Consensus Economics Forecasts; and the ECB's Survey of Professional Forecasters. 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.

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