

## The Economic Outlook for the Euro Area in 2010 and 2011



The European Forecasting Network (EFN) is a research group of European institutions[1], founded in 2001 under the auspices of the European Commission, and currently partly financially supported by the European University Institute (EUI, based in Florence, Italy), which is coordinating the report under the responsibility of Prof. Massimiliano Marcellino.

The objective of the EFN is to provide updated forecasts and analyses of the macroeconomic situation for the Euro area. It publishes four quarterly reports.

### **The Highlights of the Spring Report are:**

- The world economy will recover during 2010 and 2011 thanks to ultra-low key interest rates in industrial countries and to the strong growth in emerging markets economies. However, the phasing out of expansive fiscal policies and fiscal consolidation will drag down demand in most euro area countries. Rising exports will be the main driver of the recovery in the euro area, although internal demand will have a positive (although small) contribution to growth in 2011. We expect GDP to grow around 1.2% and 1.6% during 2010 and 2011, respectively.
- Due to rising exports, the industrial sector will resume positive growth in the short run but the intensity of the recovery will be moderate and insufficient to compensate the sharp fall of 2009: at the end of 2011, the industrial production index is expected to be still 10% below its pre-crisis levels.
- For the first time in its short history, the euro area is struggling with a crisis of confidence in the sustainability of the monetary union. Our forecast is based on the assumption that, with the help of the program adopted at the beginning of April, Greece will be able to meet its financial obligations and will carry out the required reforms. However, downside risks are high. One adverse effect of the current situation that might gain importance is that the interest rate burden of firms and households could increase quickly in spite of low key interest rates. This will occur if higher yields for government bonds take effect on the financing costs for private agents and it is a cause for concern because debt ratios for firms but also for consumers have been on a rising trend for years in the euro area and are now on record levels.
- Inflation expectations in the euro area continue to be very low. Forecasts were revised downwards after the weak HICP data of January and February. We now expect HICP inflation to be 1.2% in 2010 and 1.3% in 2011. The only risks for inflation come from oil and raw materials prices which are showing signs of significant increases in the world markets. Moreover, the movements in the currency markets that have been protecting the euro area from price fluctuations of crude oil are changing. The price in euros of Brent oil has increased by more than 12% from December 2009.

The SPRING Report 2010/2011 is freely downloadable from the EFN website: <http://efn.eui.eu>

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- Centre d'Etudes Prospectives et d'Informations Internationales (CEPII), France
- The Halle Institute for Economic Research (IWH), Germany
- The Department of Economics, European University Institute (EUI), Italy
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