Box 10

TECHNICAL ASSUMPTIONS ABOUT INTEREST RATES, EXCHANGE RATES, 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 18 May 2011.[1] The assumption about short-term interest rates is of a purely technical nature. Short-term rates are measured by the three-month EURIBOR, with market expectations derived from futures rates. The methodology gives an average level for these short-term interest rates of 1.6% for 2011 and 2.3% for 2012. The market expectations for euro area ten-year nominal government bond yields imply an average level of 4.5% in 2011 and 4.8% in 2012. Regarding financing conditions, the baseline projection assumes that, over the projection horizon, bank lending rate spreads vis-à-vis short-term interest rates will narrow owing to the gradual pass-through of forward market rate increases and a decline in the default risk for both non-financial corporations and private households. Spreads vis-à-vis long-term rates are assumed to increase gradually over the projection horizon, following their marked contraction in the last quarter of 2010, and to have returned to a level in line with their historical average by the end of the projection horizon. Credit supply conditions for the euro area as a whole are expected to normalise further but still to weigh negatively on activity over the projection horizon. As regards commodity prices, on the basis of the path implied by futures markets in the two-week period ending on the cut-off date, the price of a barrel of Brent crude oil is assumed to average USD 111.1 in 2011 and USD 108.0 in 2012. The prices of non-energy commodities in US dollars are assumed to rise by 20.4% in 2011 and by 1.2% in 2012.

1 Oil and food price assumptions are based on futures prices up to the end of the projection horizon. For other commodities, prices are assumed to follow futures until the second quarter of 2012 and thereafter to evolve in line with global economic activity.

Bilateral exchange rates are assumed to remain unchanged over the projection horizon at the average levels prevailing in the two-week period ending on the cut-off date. This implies an exchange rate of EUR/USD 1.42 in 2011 and EUR/USD 1.43 in 2012, and an effective exchange rate of the euro that, on average, appreciates moderately by 0.8% in 2011 and by 0.4% in 2012.

Fiscal policy assumptions are based on individual euro area countries' national budget plans as available on 24 May 2011. 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.