The Macroeconomic Outlook for the Euro Area

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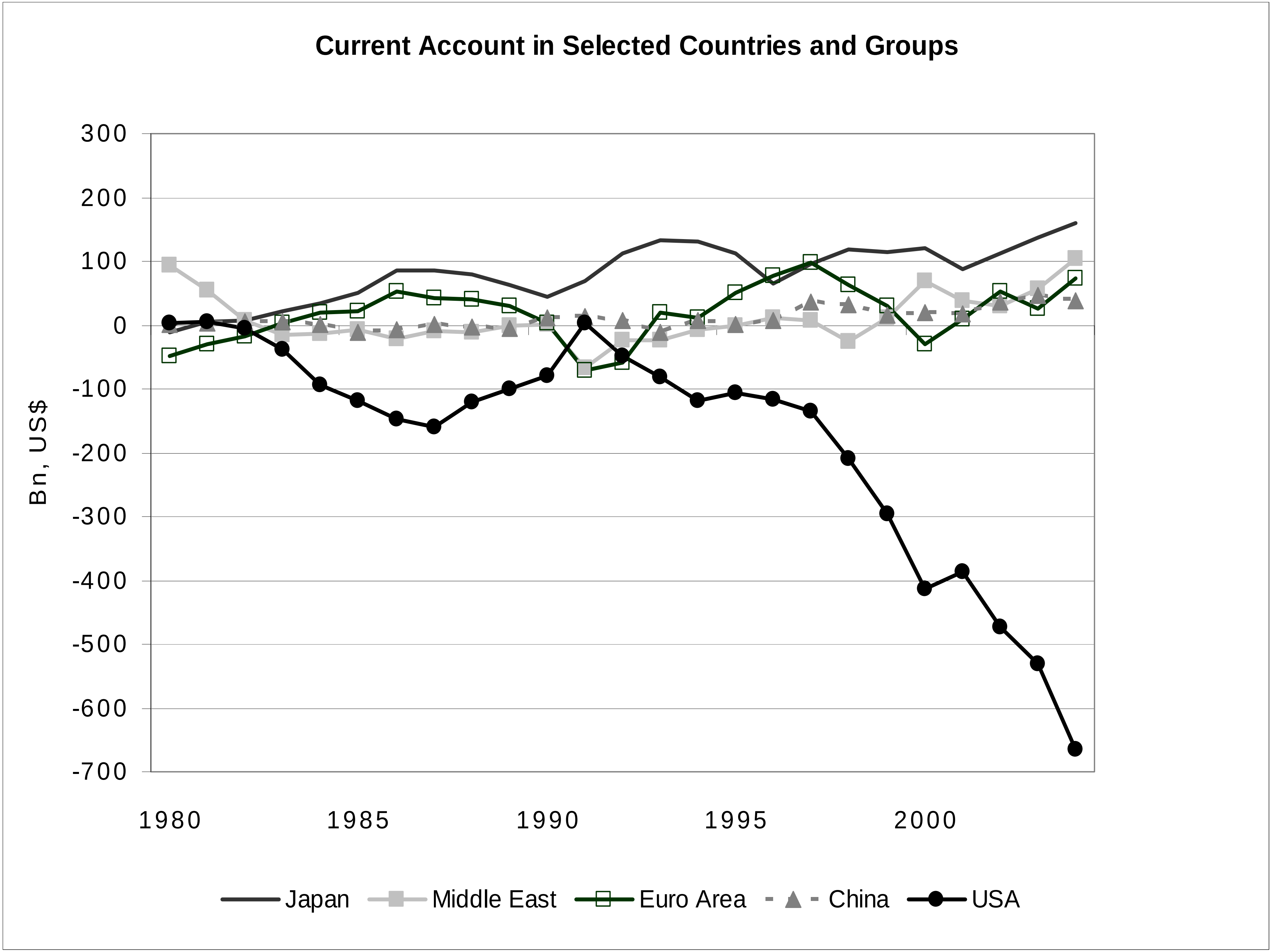
Main External Assumptions

Real GDP Growth in Major Economies				
	World	OECD	US	Japan
2004	4.6	3.2	4.3	2.6
2005	4.5	2.7	3.6	0.8
2006	4.3	2.9	3.3	2.1
Personal Consumption Deflator				Oil Price ($ per barrel)
	OECD	US	Japan	
2004	2.0	2.2	-0.5	35.9
2005	2.3	2.8	0.3	41.4
2006	2.6	3.3	0.7	38.6

The US

- In the US, growth will slow but inflation will accelerate over the next two years.
- The depreciation of the dollar may reduce economic growth in the Euro Area.
- Imbalances may be unsustainable
  - can only be corrected by a change in the structure of demand in the US (reduce consumption or government spending) or by increased consumption elsewhere


Current Account in Selected Countries and Groups
300
200
100
0
-100
-200
-300
-400
-500
-600
-700
Bn, US$
1980
1985
1990
1995
2000
Japan
Middle East
Euro Area
China
USA

Correcting the US Current Account

- We look at falls in US asset prices and their impacts on consumption, output and the current account
  - If US house prices fell by 10% the current account would improve by 0.25 per cent of GDP in the medium term
  - If equity prices also fell by 10% the impact would four times as large and Euro Area growth would fall by 0.25 in the first year
- A one per cent rise in consumption in Japan and the Euro Area would also improve the US current account by 0.4 per cent of GDP in the medium term

Oil Prices

- Oil prices have risen again since January because of excess demand
- The demand is not from the Euro Area so it is like a 'normal' shock

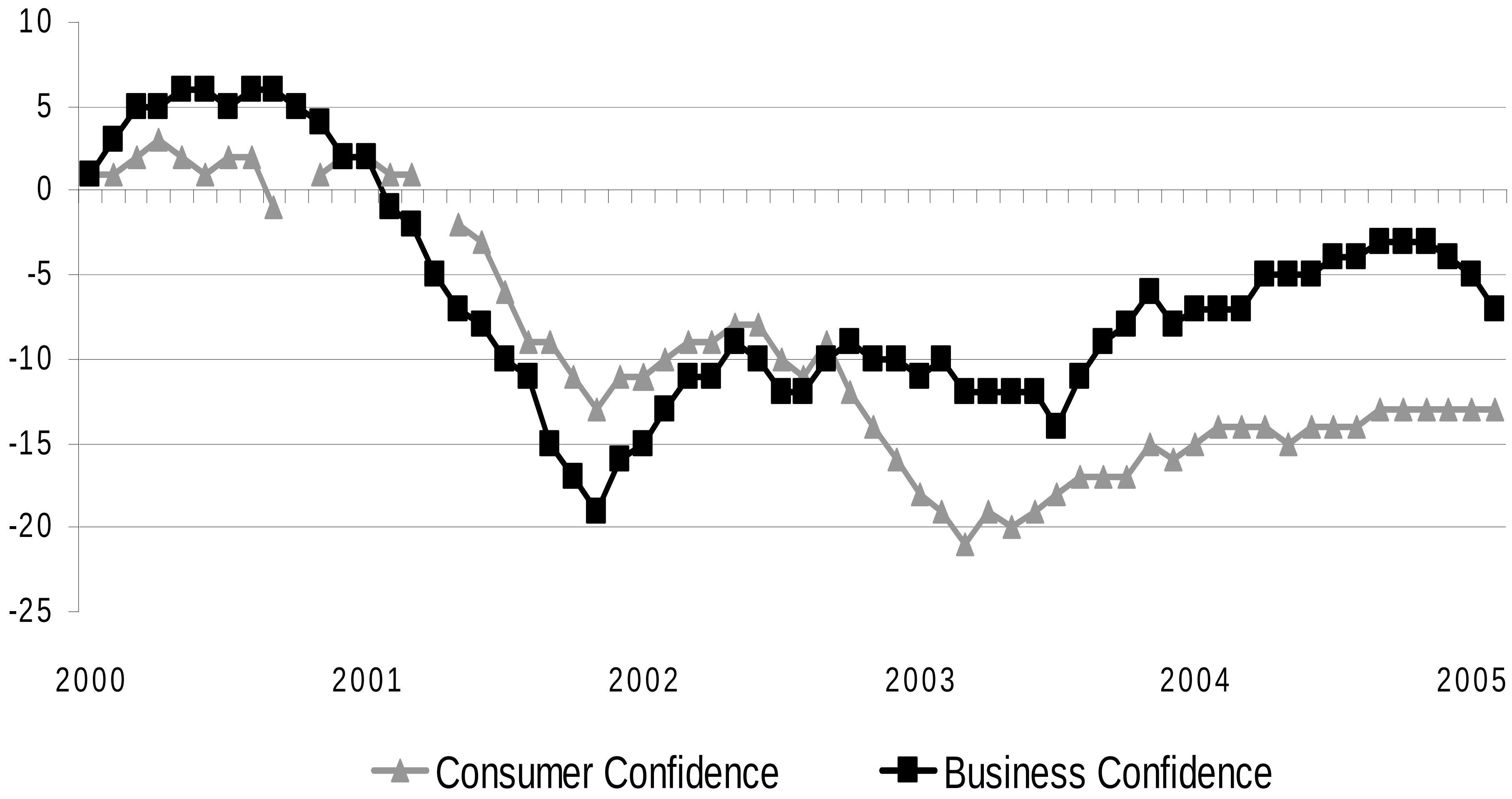
Impact of a permanent $5 increase in the price of oil on GDP

	EA	Germany	France	Italy	USA
	per cent difference from base				
2005	-0.1	-0.1	-0.1	-0.1	-0.1
2006	-0.2	-0.2	-0.2	-0.1	-0.3

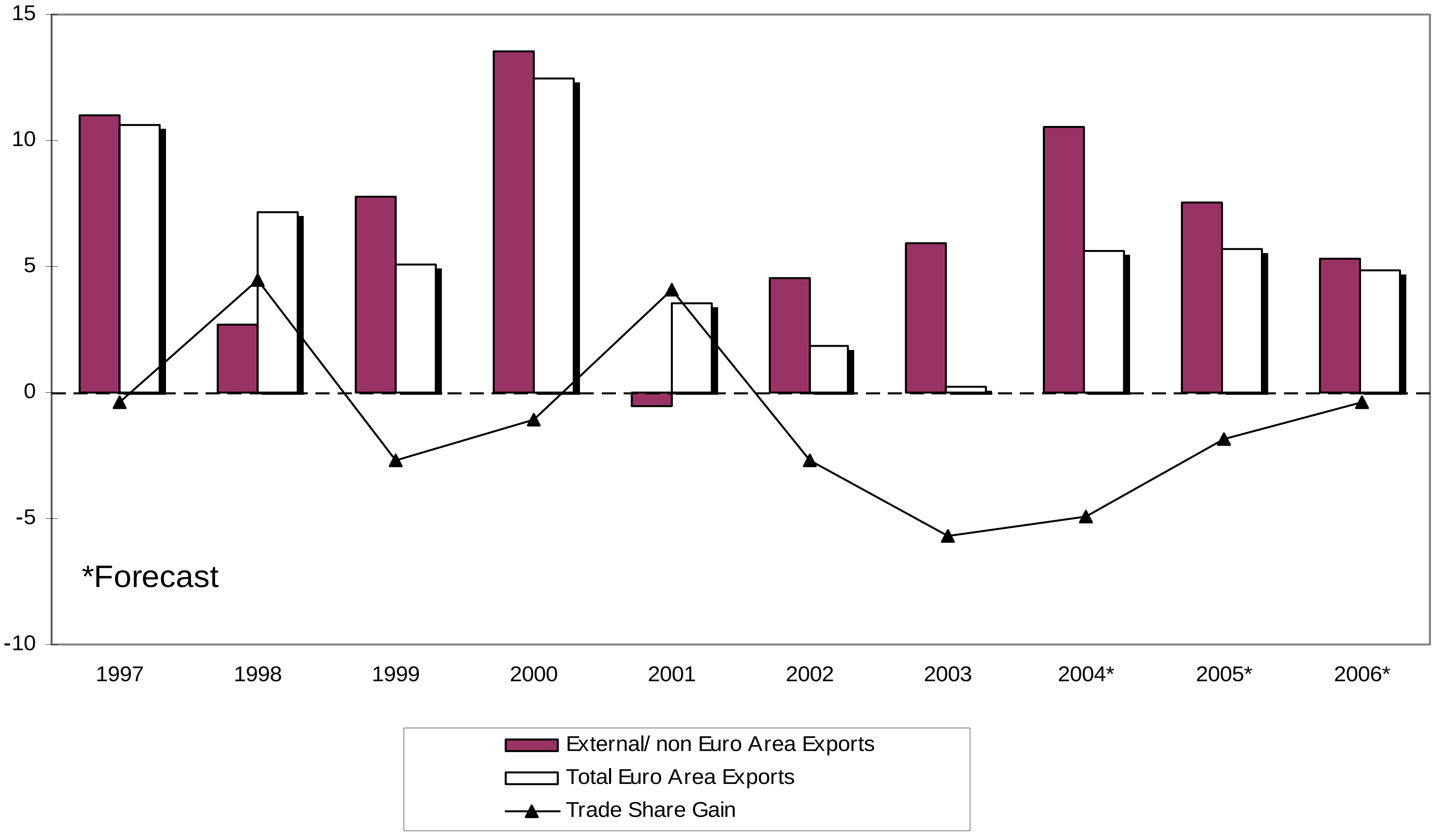
The Euro Area

- The Euro Area will expand only moderately over the next two years.
  - GDP growth will fall from 1.8 per cent in 2004 to 1.5 per cent in 2005 and then rise to 2.0 per cent in 2006.
    - The Euro Area has been hit by the appreciation of the euro in the final quarter of 2004.
- Our quarterly indicators (OFCE, NIESR) suggest that growth in the first quarter could be as low as 0.2% q on q

OECD Consumer and Business Confidence Indicators for the Euro Area



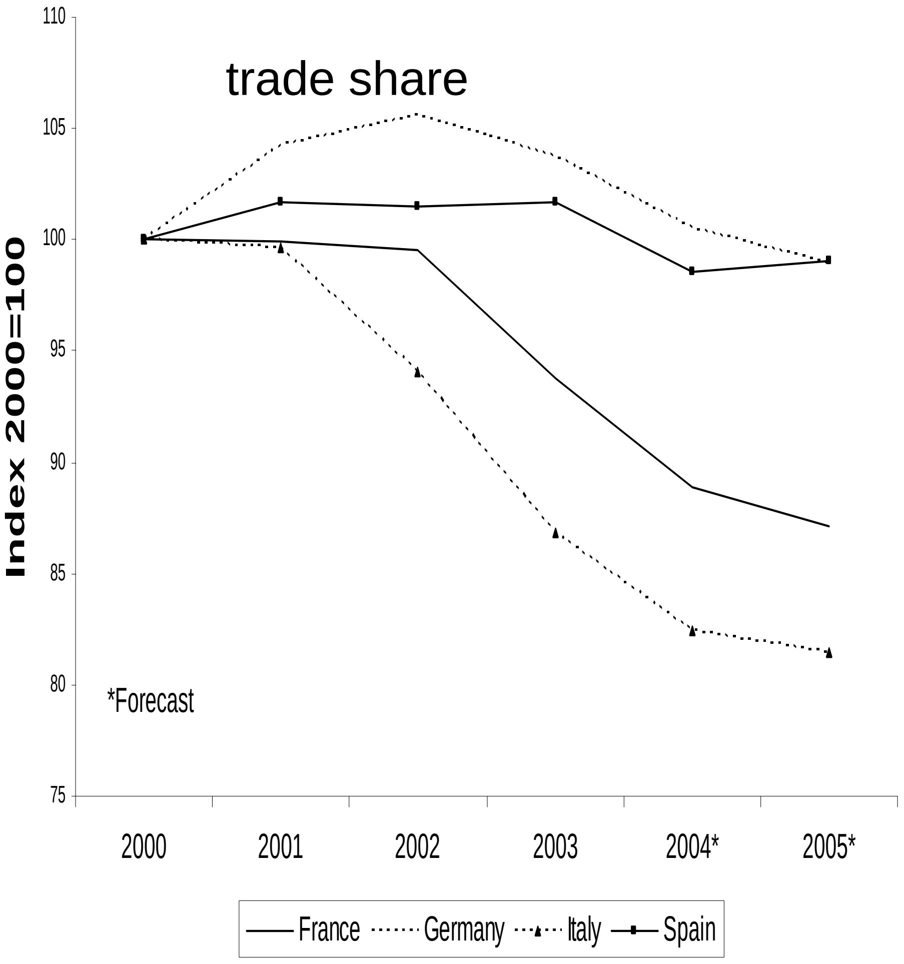
Euro Area exports, export demand and trade share losses

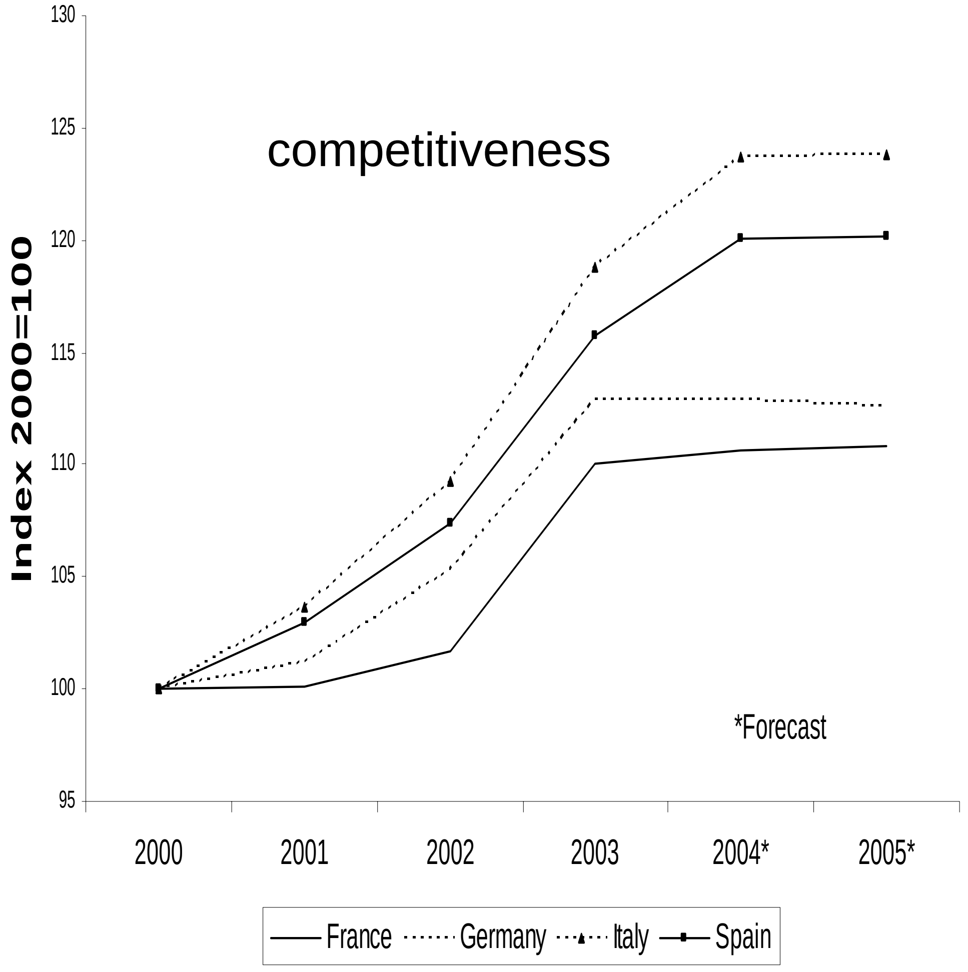


External demand and growth

- External demand growth of 10.6% helped maintain Euro Area growth in 2004
  - 10 year average growth was 7.5%
  - Trade share losses have taken place since 2001 and are expected in 2005
- Import volume growth has been strong in Russia, China, (both over 20% growth in 2004) OPEC, Norway, and developing Europe as well as the US

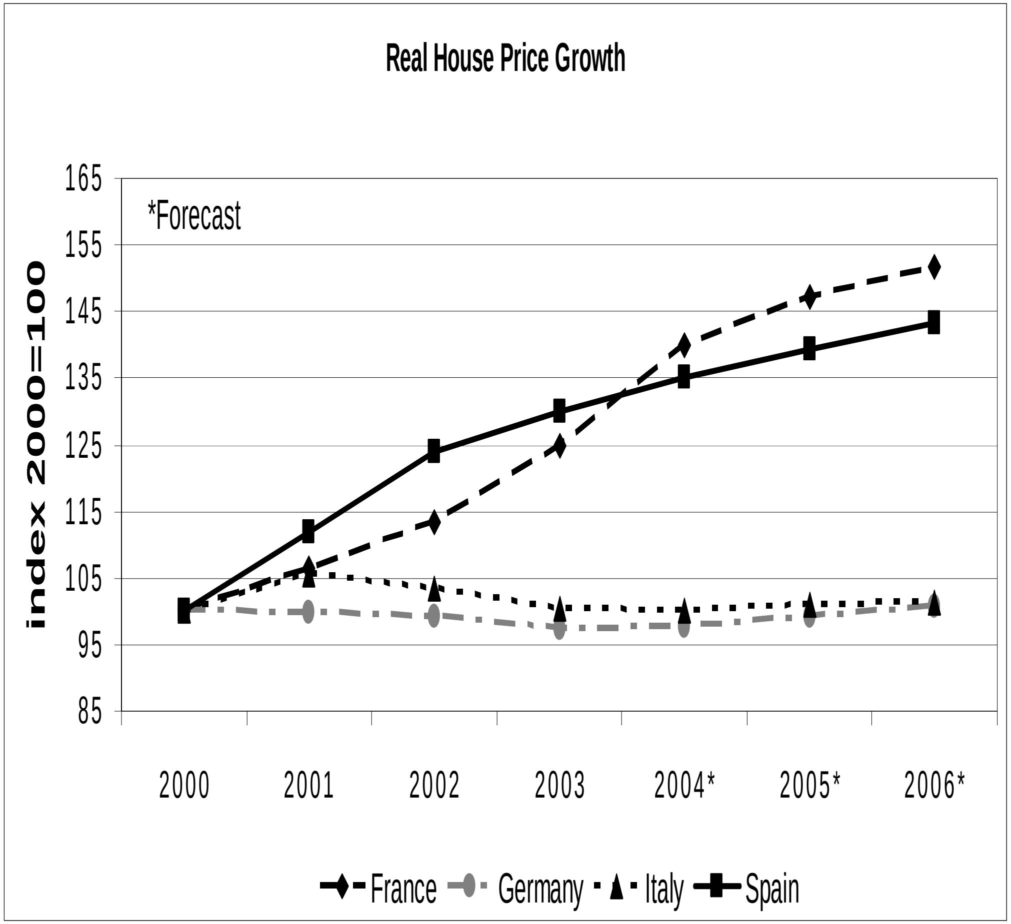
Export Market Shares and Price Competitiveness





Why is domestic demand weak in Germany and strong in France

- Differences in house price developments are important, but they may be the result of differences in demand
- Prospects on the labour market might matter – Harzt has very different impacts from clawing back 35 hour weeks



Conclusions

- Growth prospects in the Euro Area look relatively robust but could be stronger
  - Fiscal policy has been broadly neutral
  - Monetary policy is not tight
  - The exchange rate appears to affect market share and reducing demand
- Domestic uncertainties may be raising saving
  - Pensions issues, public debt, labour market reforms