

Box 1.5: Some technical elements behind the forecast

Given the ongoing ratification process of the Withdrawal Agreement in the UK, projections for 2019 and 2020 are based on a purely technical assumption of status quo in terms of trading relations between the EU27 and the UK. This is for forecasting purposes only and has no bearing on future negotiations between the EU and the UK.

The cut-off date for taking new information into account in this European Economic Forecast was 24 April 2019. The forecast incorporates validated public finance data as published in Eurostat's news release 67/2019 of 23 April 2019.

External assumptions

This forecast is based on a set of external assumptions, reflecting market expectations at the time of the forecast. To shield the assumptions from possible volatility during any given trading day, averages from a 10-day reference period (between 14 and 24 April) were used for exchange and interest rates, and for oil prices.

Exchange and interest rates

The technical assumption regarding exchange rates was standardised using fixed nominal exchange rates for all currencies. This technical assumption leads to an implied average USD/EUR rate of 1.13 both in 2019 and in 2020. The average JPY/EUR is 125.57 in 2019 and 125.73 in 2020.

Interest-rate assumptions are market-based. Short-term interest rates for the euro area are derived from futures contracts. Long-term interest rates for the euro area, as well as short- and long-term interest rates for other Member States are calculated using implicit forward swap rates, corrected for the current spread between the interest rate and swap rate. In cases where no market instrument is available, the fixed spread vis-à-vis the euro area interest rate is taken for both short- and long-term rates. As a result, short-term interest rates are assumed to be -0.3% in 2019 and -0.3% in 2020 in the euro area. Long-term euro area interest rates are assumed to be 0.1% in 2019 and 0.2% in 2020.

Commodity prices

Commodity price assumptions are also based on market conditions. According to futures markets, prices for Brent oil are projected to be on average 69.19 USD/bbl in 2019 and 67.84 USD/bbl in 2020. This would correspond to an oil price of 61.28 EUR/bbl in 2019 and 60.19 EUR/bbl in 2020.

Trade policies

On what trade policy is concerned, this forecast pencils in only the measures that have been implemented until the cut-off date. Compared to the winter interim forecast, there were a number of limited changes to the baseline scenario.

- US 10% tariffs on \$200 billion of imports from China took effect on 24 September 2018 are taken into account. China retaliated by imposing countermeasures on \$60 billion of imports from the US (with tariff rates of 5% and 10%). The US administration announced an increase of the tariffs to 25% on 1 January 2019, which was subsequently postponed first until 1 April 2019 and then without specifying a new date. The initially announced increase to 25% on 1 January and then 1 April was incorporated in the baseline in previous forecasts; it is no longer included in this forecast.
- On 17 February, the US authorities submitted a report to the President concluding an investigation under Section 232 of the Trade Expansion Act of 1962 into whether automotive imports into US threatened national security. The President has now time until 18 May to take a the decision whether to impose tariffs on US imports of autos and car parts from all or some of its trade partners.

Budgetary data and forecasts

Data up to 2018 are based on data notified by Member States to the European Commission before 1 April and validated by Eurostat on 23 April 2019.⁽¹⁾

⁽¹⁾ Eurostat News Release No 67/2019.

(Continued on the next page)

Box (continued)

Table 1:
Technical assumptions

| | Spring 2019 forecast | | | | Autumn 2018 forecast | | |
|--|-------------------------|--------|--------|--------|-------------------------|--------|--------|
| | 2017 | 2018 | 2019 | 2020 | 2018 | 2019 | 2020 |
| 3-month EURIBOR (percentage per annum) | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.2 | 0.2 |
| 10-year government bond yields (percentage per annum) (a) | 0.3 | 0.4 | 0.1 | 0.2 | 0.5 | 0.7 | 0.9 |
| USD/EUR exchange rate | 1.13 | 1.18 | 1.13 | 1.13 | 1.18 | 1.15 | 1.15 |
| JPY/EUR exchange rate | 126.61 | 130.38 | 125.57 | 125.73 | 130.74 | 130.10 | 130.10 |
| GBP/EUR exchange rate | 0.88 | 0.88 | 0.86 | 0.86 | 0.88 | 0.88 | 0.88 |
| EUR nominal effective exchange rate (annual percentage change) (b) | 2.4 | 4.8 | -1.5 | -0.1 | 5.3 | 0.6 | 0.0 |
| Oil price (USD per barrel) | 54.8 | 71.5 | 69.2 | 67.8 | 75.1 | 80.6 | 76.7 |
| Oil price (EUR per barrel) | 48.5 | 60.6 | 61.3 | 60.2 | 63.4 | 70.0 | 66.5 |

(a) 10-year government bond yields for the euro area are the German government bond yields.

(b) 42 industrial countries EU-28, TR CH NR US CA JP AU MX NZ KO CN HK RU BR.

Eurostat is **expressing a reservation** on the quality of the data reported by Hungary in relation to the sector classification of the Hungarian Association for the Stockpiling of Hydrocarbons (MSZKSZ). Eurostat considers that this entity should be classified inside general government. This would lead to an increase in government debt in 2015 by 0.3% of GDP, in 2016 and in 2017 by 0.4% of GDP and in 2018 by an estimated 0.3% of GDP. The deficit figures would remain virtually unchanged.

Eurostat is **maintaining the reservation** on the quality of the data reported by Hungary in relation to the sector classification of the foundations created by the Hungarian National Bank. Eurostat considers that these foundations, including their subsidiaries, should be classified inside general government. This would lead to an estimated increase in government deficit in 2015 by 25.3 bn HUF (0.1% of GDP), in 2016 by 54.0 bn HUF (0.2% of GDP) and in 2017 by 33.7 bn HUF (0.1% of GDP). The debt figures would remain unchanged.

Eurostat is **expressing a reservation** on the quality of the data reported by Slovakia in relation to the recording of certain expenditures incurred by government, which could increase the deficit by 0.3% of GDP in 2018. Eurostat will investigate the issue in cooperation with the Slovak statistical authorities.

The public finance forecast is made under the ‘no-policy-change’ assumption, which extrapolates past revenue and expenditure trends and relationships in a way that is consistent with past policy orientations. This may also include the adoption of a limited number of working assumptions, especially to deal with possible structural breaks. The forecast includes all fiscal policy measures that imply a change to these past policy orientations on the condition that they are sufficiently detailed as well as adopted or at least credibly announced. For

2019 in particular, the annual budgets adopted or presented to national parliaments are taken into consideration.

EU and euro area aggregates for general government debt in the forecast years 2019-20 are published on a non-consolidated basis (i.e. not corrected for intergovernmental loans, including those made through the European Financial Stability Facility). To ensure consistency in the time series, historical data are also published on the same basis. For 2018, this implies an aggregate debt-to-GDP ratio which is somewhat higher than the consolidated general government debt ratio published by Eurostat in its news release 67/2019 of 23 April 2019 (by 2.0 pps. in the EA19 and by 1.5 pps. in the EU).

ESA 2010

The current forecast is based on the ESA 2010 system of national accounts for all Member States, the EU and the euro area aggregates.

Calendar effects on GDP growth and output gaps

The number of working days may differ from one year to another. The Commission’s annual GDP forecasts are not adjusted for the number of working days, but quarterly forecasts are.

The working-day effect in the EU and the euro area is estimated to be limited in 2018 and 2019, implying that adjusted and unadjusted annual growth rates differ only marginally (by up to ±0.1 pps.). In 2020, this difference will be close to ¼ pps. in the euro area.

Estimations of potential GDP and output gaps are not adjusted for working days. Furthermore, since the working-day effect is considered temporary, it is not expected to affect cyclically-adjusted balances.