



EUROPEAN CENTRAL BANK

THE CURRENT ECONOMIC OUTLOOK IN THE EURO AREA AND EU

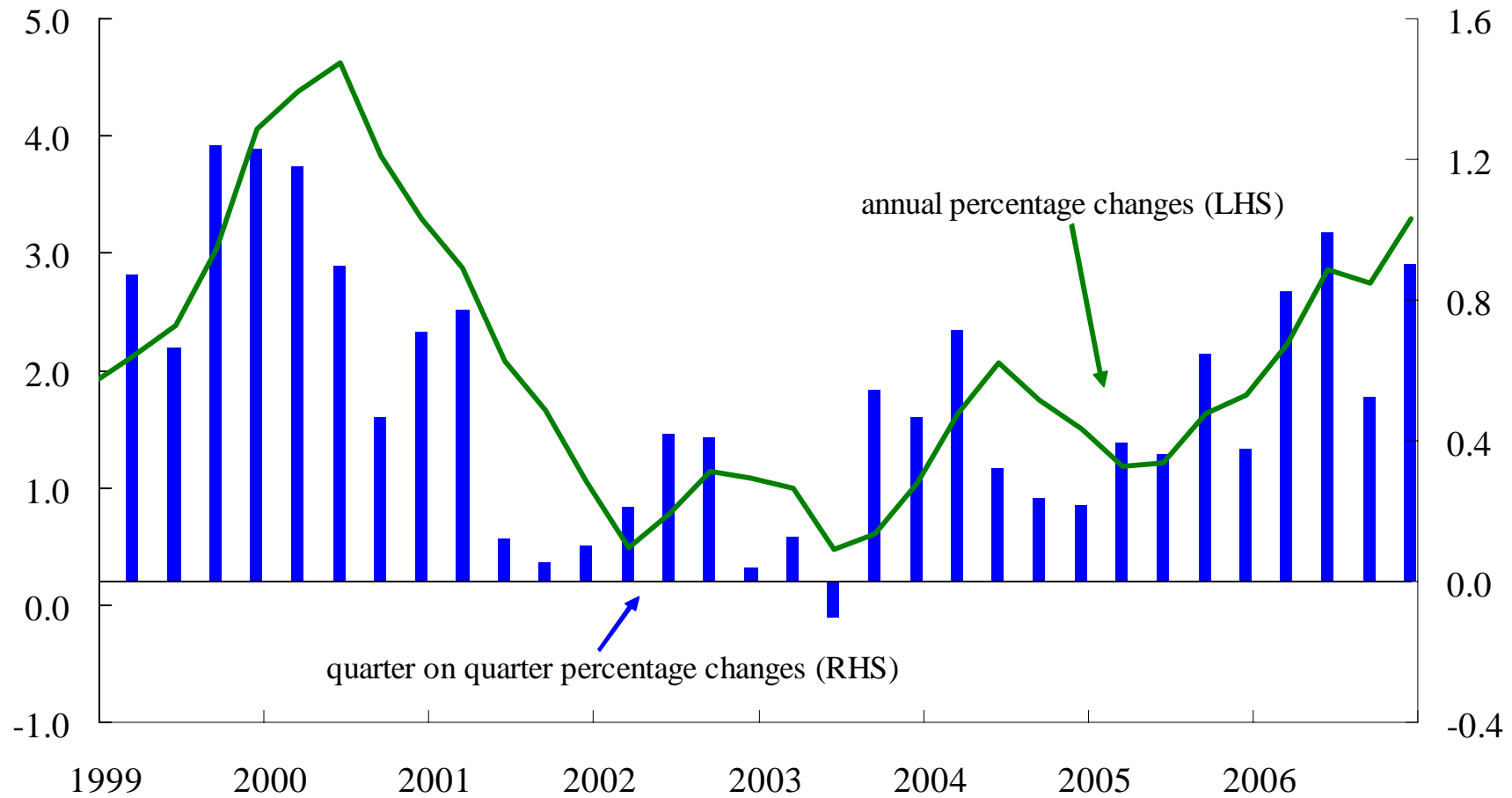
Lorenzo Bini Smaghi
Member of the ECB Executive Board

Business Forecast Event
Graduate School of Business
University of Chicago
Frankfurt am Main, 14 February 2007

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Economic activity continues to expand robustly

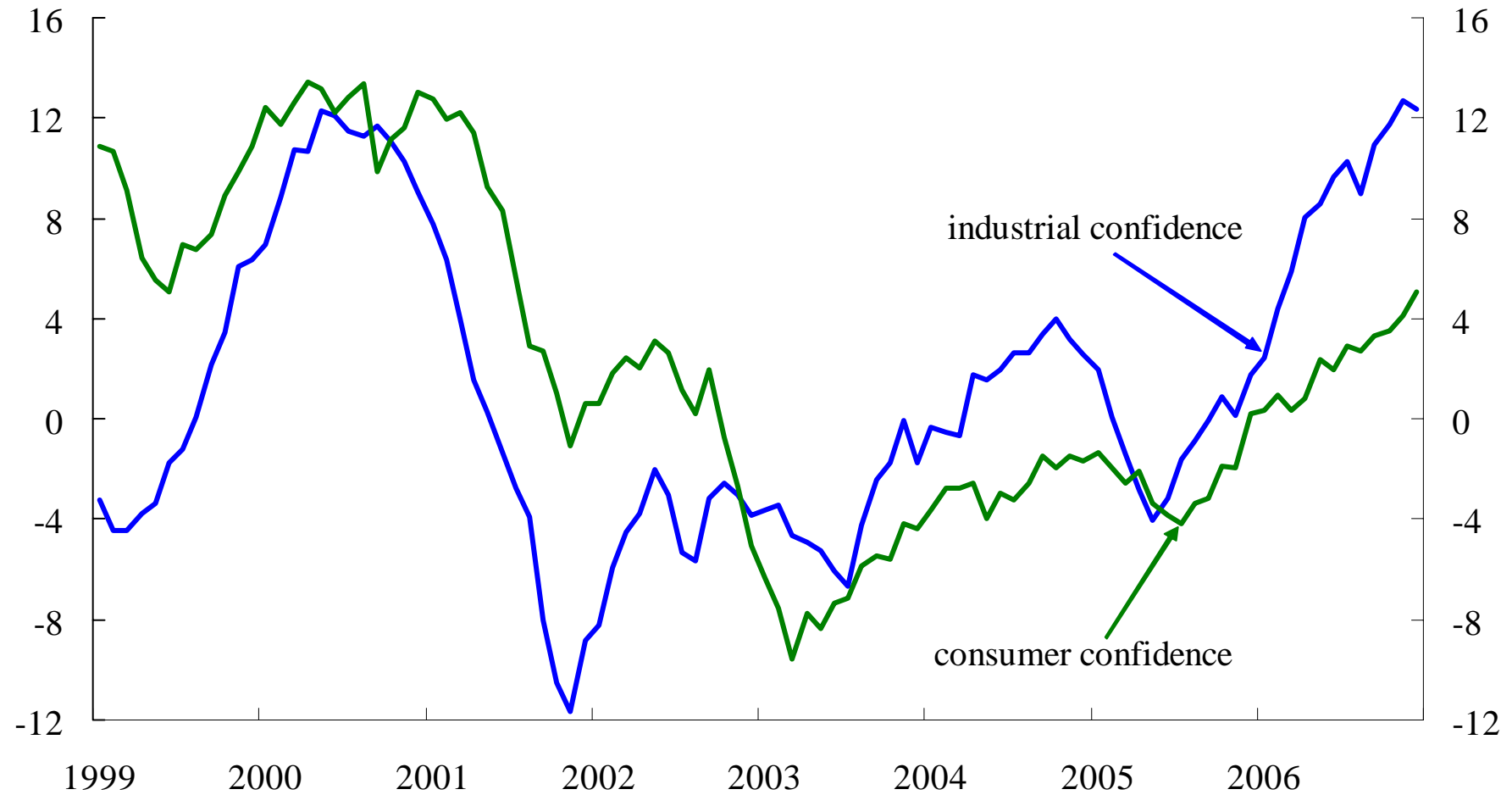
Real GDP growth



Source: Eurostat. Figures for Q4 2006 are based on Eurostat's Flash Estimate

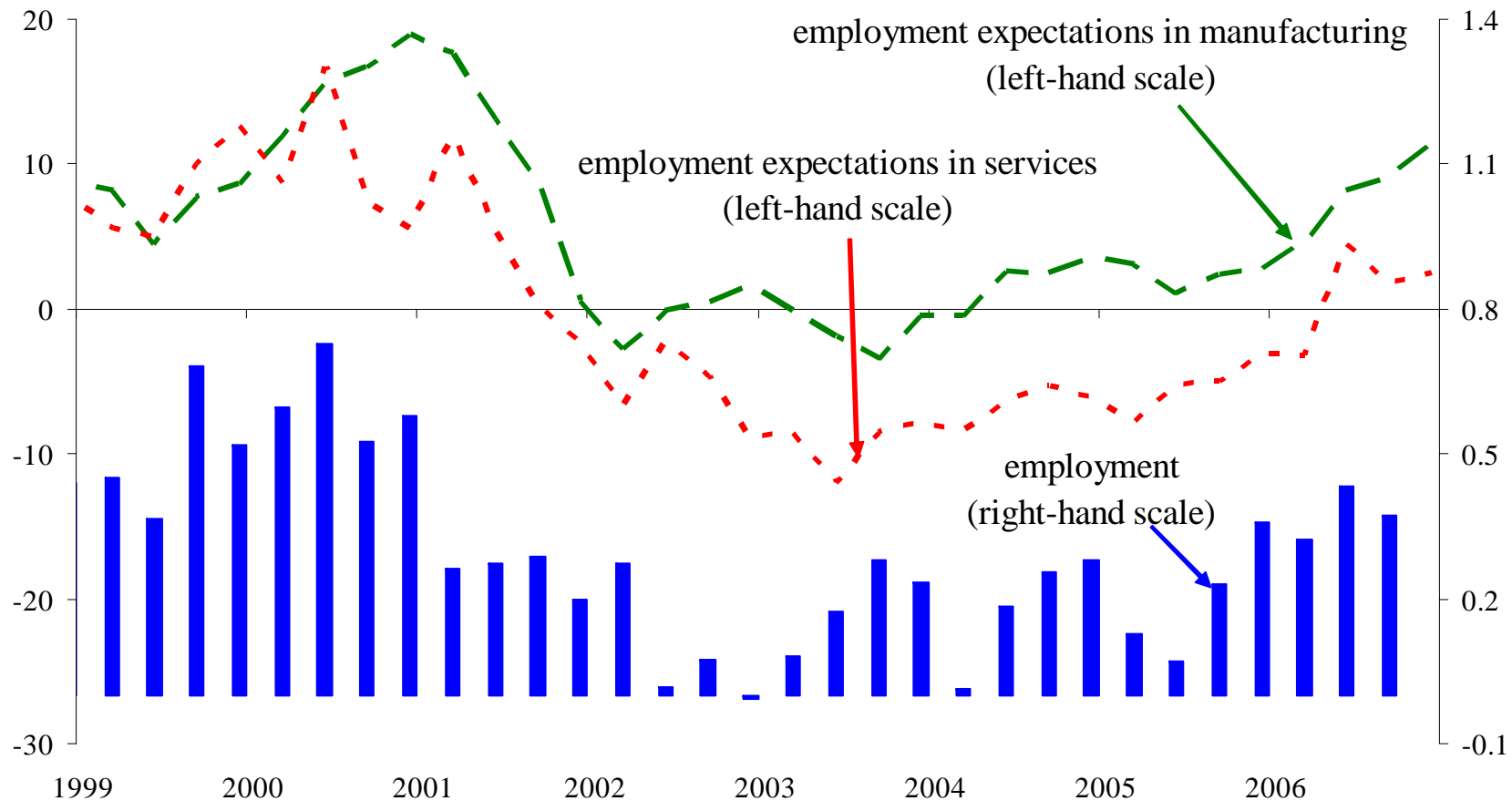
Economic expansion is becoming increasingly self-sustaining. Confidence remains high....

(percentage deviations from the average over the period starting in January 1985)



Source: European Commission; Latest observation: December 2006.

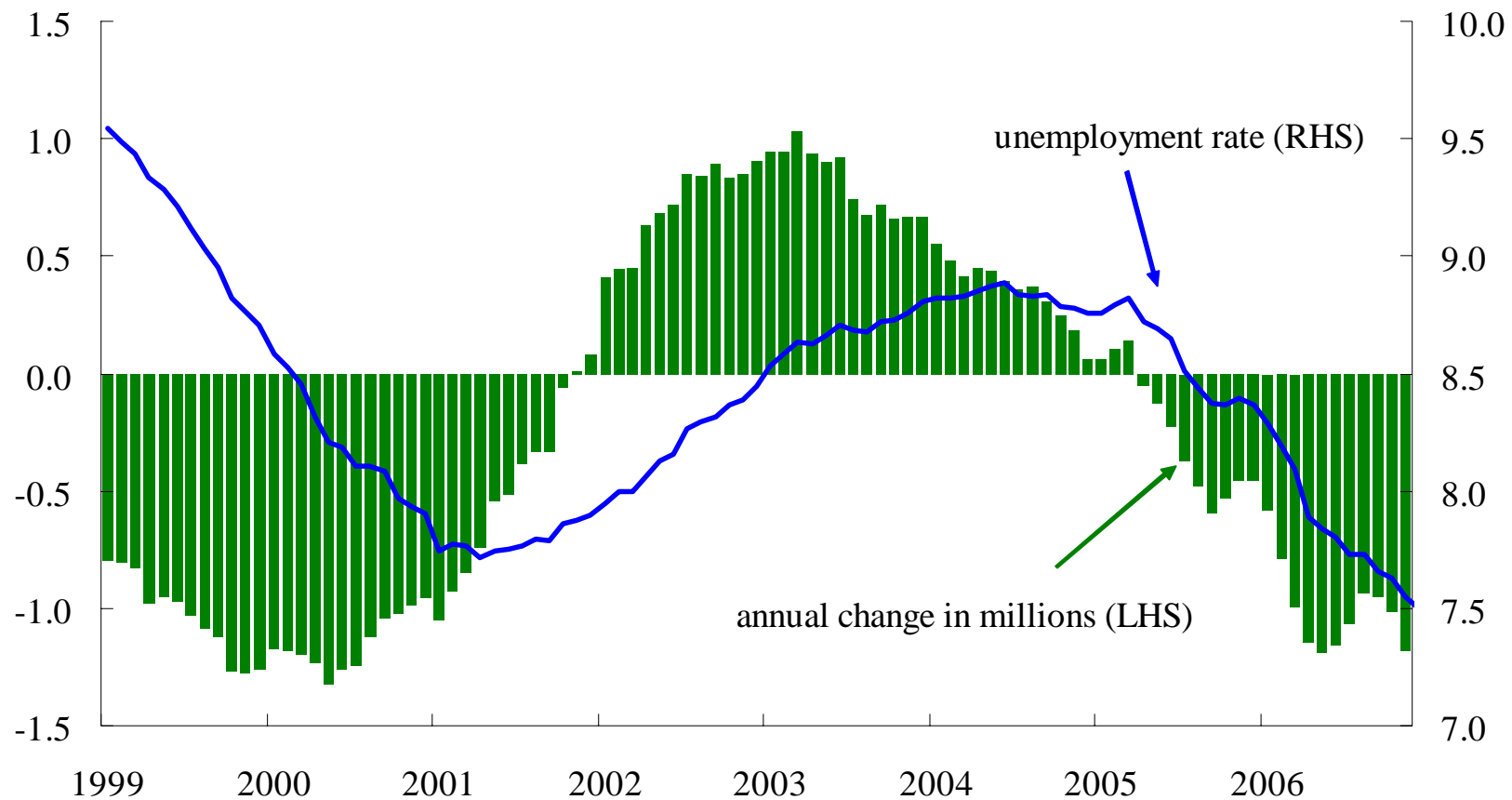
... and labour market conditions continue to improve, with an increase in employment of 0.4% q-on-q both in Q2 and Q3 2006...



Sources: Eurostat, European Commission Business and Consumer Survey and ECB calculations. Latest observation: 2006Q3 (employment), December 2006 (employment expectations in manufacturing and services). Percentage balances are man-adjusted.

... and a decline in the unemployment rate in December 2006 to 7.5%

(change in millions; percentage of the labour force)



Source: Eurostat; Latest Observation: December 2006.

Factors indicating that this recovery is sustainable relative to the recent past include:

1. A positive and broadly based outlook for the global economy
2. Supportive stock markets
3. Favorable financing conditions (short and long term rates)
4. Moderate wage developments
5. High corporate profitability following corporate restructuring
6. Strong growth in euro area investment
7. Signs that euro area labour markets have become more flexible
(increase in employment)

Conditions remain in place for growth rates around potential. Projections for real GDP growth in 2006/2007 adjusted slightly upwards

December 2006 Eurosystem staff macroeconomic 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 (2.7)	1.7 - 2.7 (2.2)
Private consumption	1.4	1.8 - 2.2 (2.0)	1.3 - 2.3 (1.8)
Government consumption	1.3	1.4 - 2.6 (2.0)	0.5 - 1.5 (1.0)
Gross fixed capital formation	2.7	4.4 - 5.4 (4.9)	2.5 - 5.5 (4.0)
Exports (goods and services)	4.6	6.6 - 9.4 (8.0)	4.2 - 7.4 (5.8)
Imports (goods and services)	5.5	6.7 - 9.3 (8.0)	3.9 - 7.3 (5.6)

Note: The midpoint is given in brackets, calculated as: (the figure at the top of the range + the figure at the bottom of the range) / 2. For each variable and horizon, ranges are based on the average absolute difference between the actual outcomes and past projections by euro area central banks. For each variable and horizon, ranges are based on the average absolute difference between the actual outcomes and past projections by euro area central banks. The projections for real GDP and its components refer to working-day-adjusted data.

The Eurosystem's real GDP growth projections for the euro area are broadly in line with other forecasts

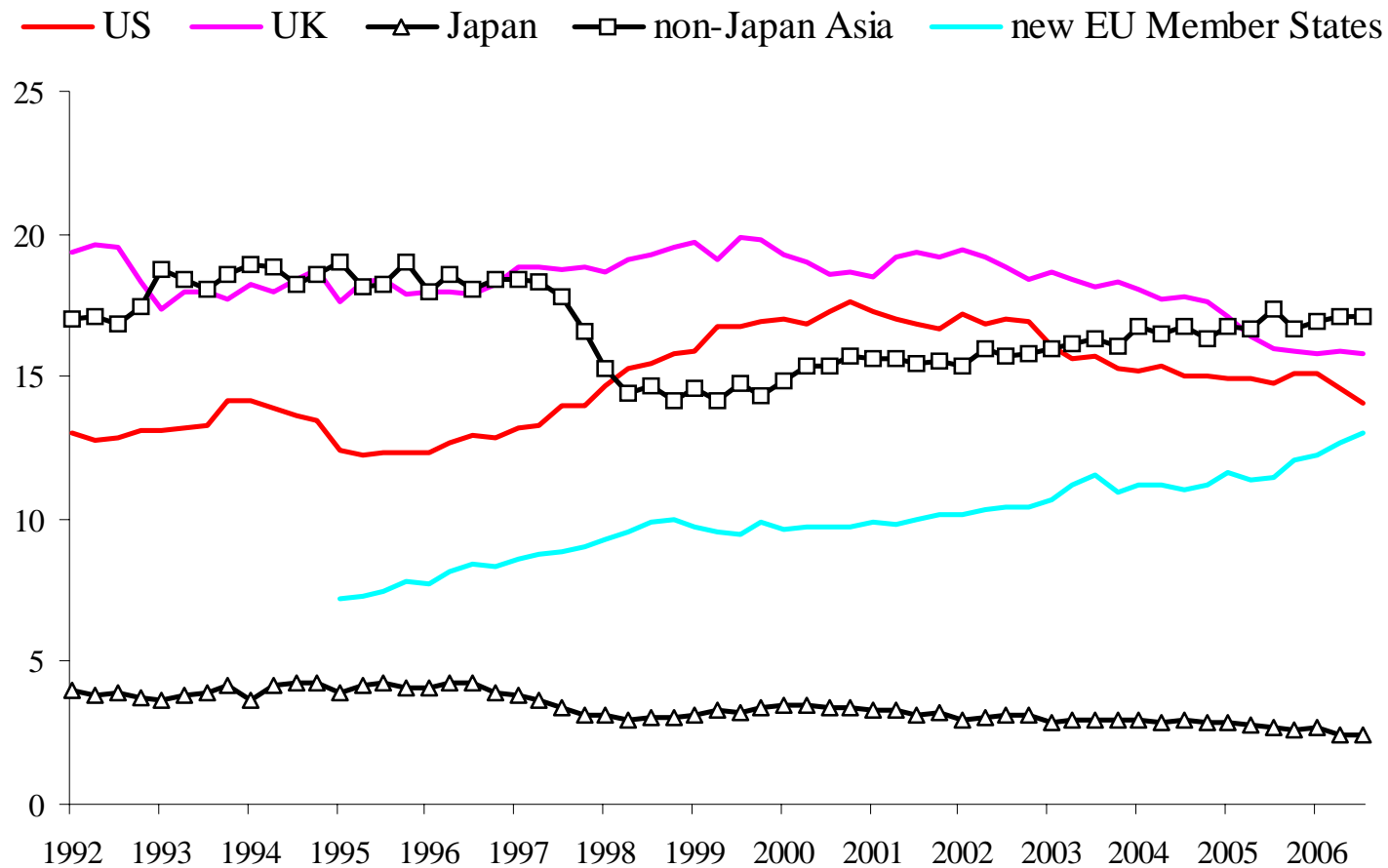
(average annual percentage changes)

Institution	Date of release	2006	2007	2008
Eurosystem staff projections (BMPE)	December 2006	2.5 - 2.9 (2.7)	1.7 - 2.7 (2.2)	-
European Commission	November 2006	2.6	2.1	2.2
IMF	September 2006	2.4	2.0	
OECD	November 2006	2.6	2.2	2.3
ECB Survey of Professional Forecasters	2006 Q4	2.6	2.0	2.0
Consensus Economics Forecasts	December 2006	2.7	2.0	2.1

Note: The midpoint of the BMPE forecast is given in brackets, calculated as: (the value at the top of the range + the value at the bottom of the range) / 2.

The share of exports to new Member States and non-Japan Asia is increasing

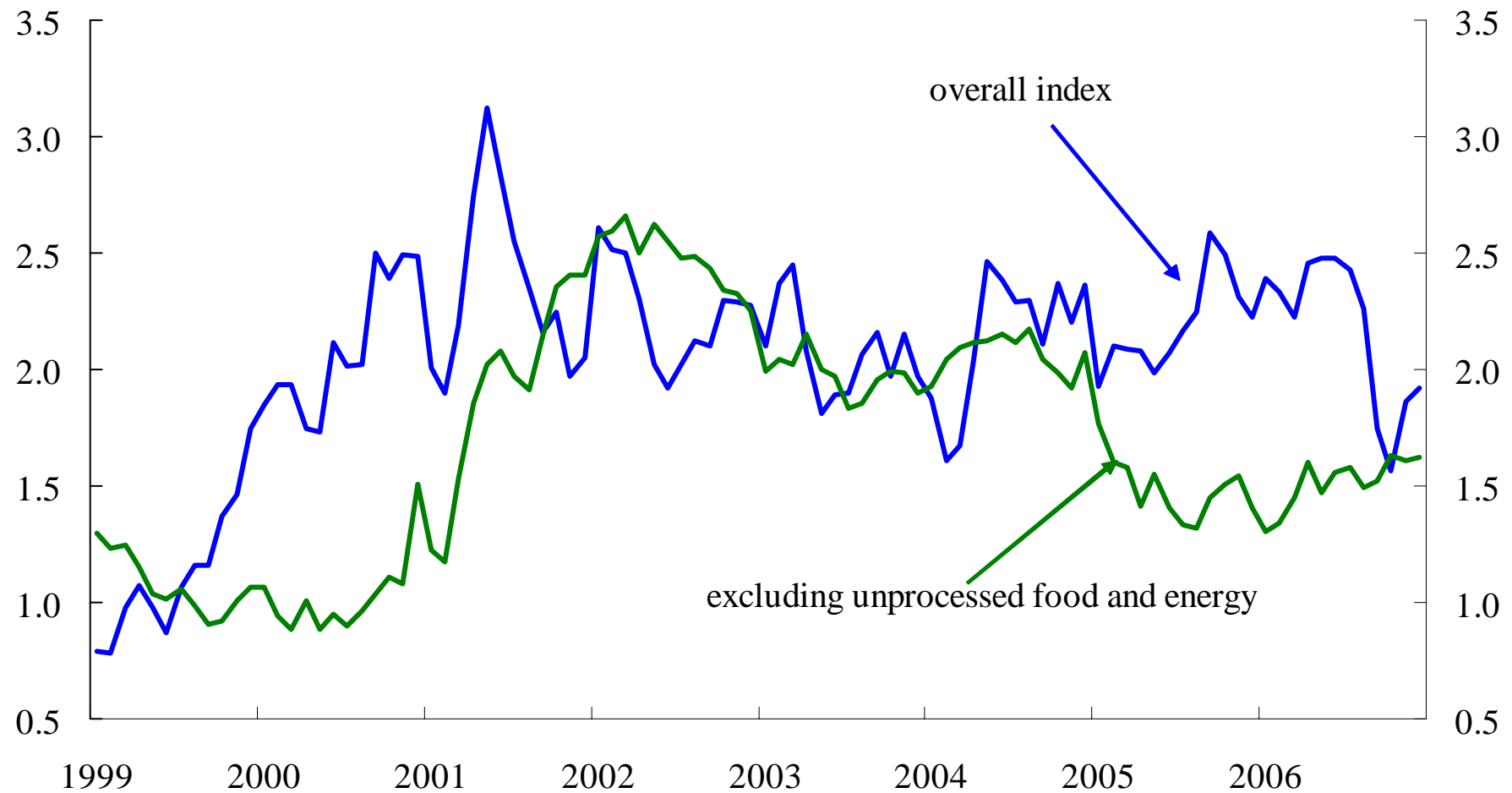
Export shares of extra euro area goods, in values (quarterly data, seasonally adjusted, percentage)



Source: ECB calculations based on Eurostat data. Last observation refers to Q3 2006.

HICP inflation has remained elevated in 2006, largely driven by energy prices. In January 07, it stood at 1.9%, unchanged from Nov/Dec 06.

(annual percentage changes)



Source: Eurostat

Looking forward, HICP inflation may be volatile in the short term

In the short term:

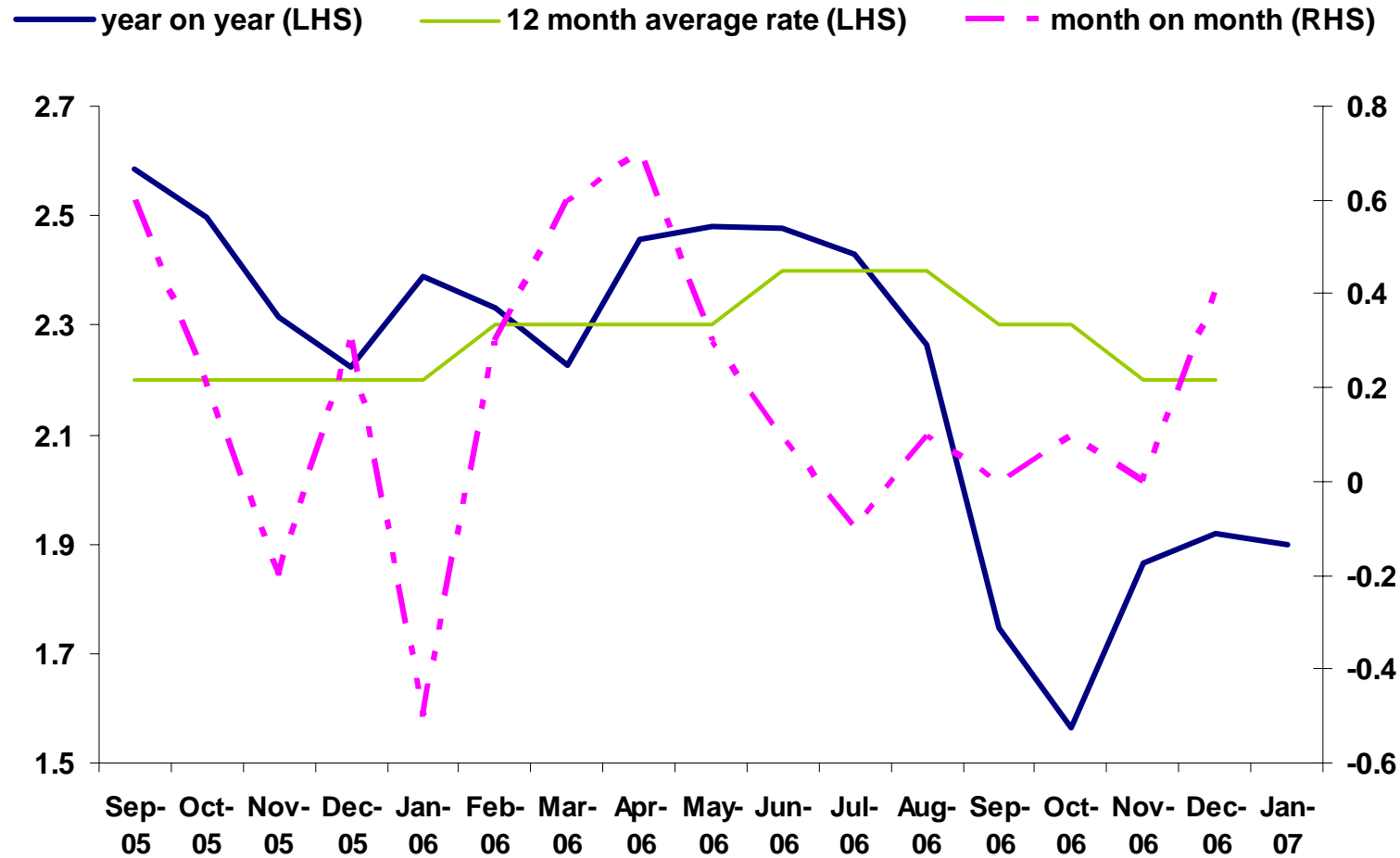
- Changes in VAT in a large euro area country were not fully reflected in prices in January
- Thereafter, on the basis of current prices for oil, and oil futures and previous oil developments, favourable base effects may progressively lead to lower inflation rates in the spring and summer
- These effects will be temporary

Later in 2007:

- Inflation rates are expected to rise again as a result of unfavourable base effects

HICP base effects and monthly rates of change

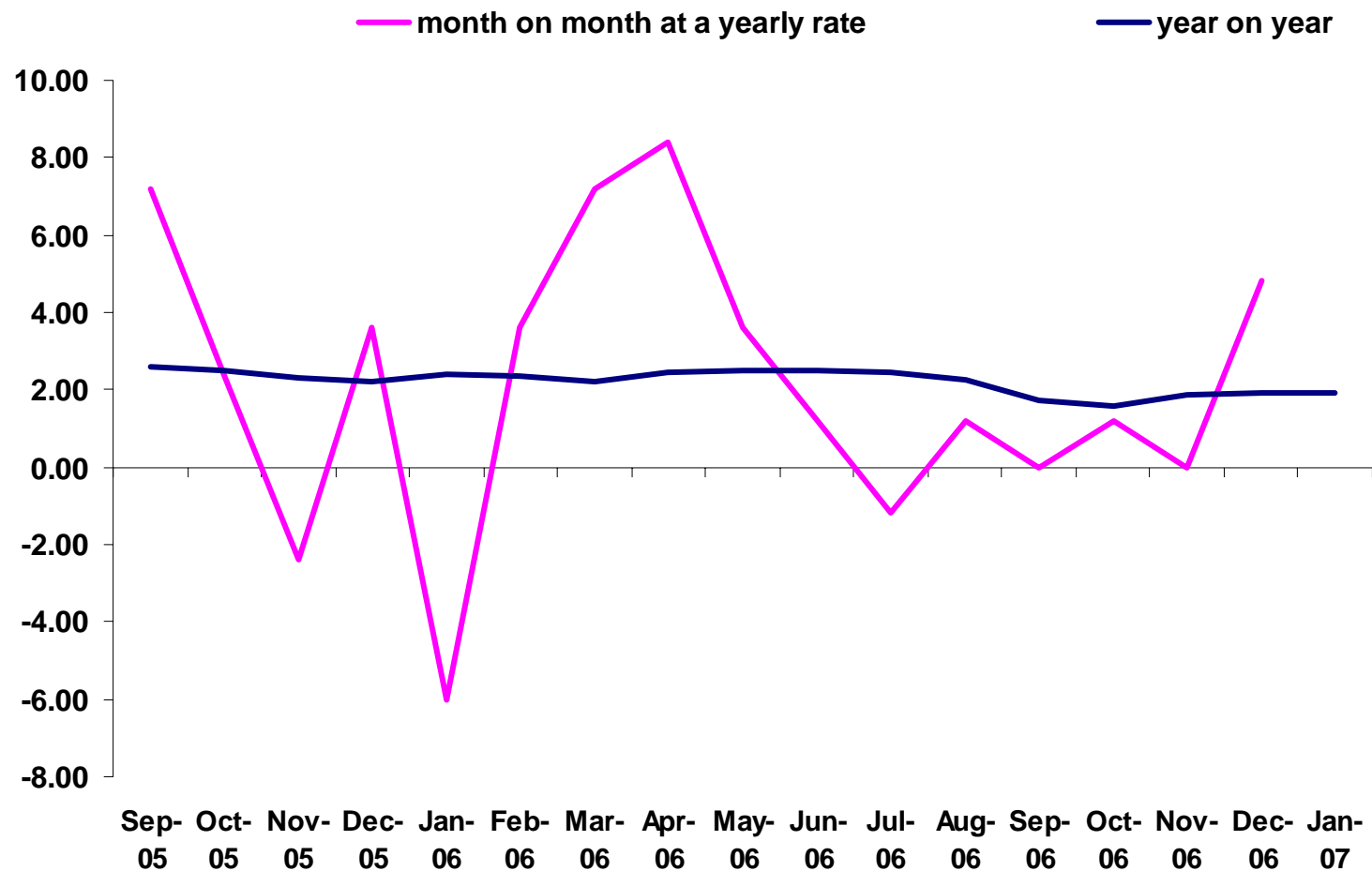
(HICP, overall index, percentage changes)



Source: Eurostat

HICP base effects and monthly rates of change

(HICP, overall index, percentage changes)



Source: Eurostat

December 06 Eurosystem projections are broadly in line with other forecasts for euro area consumer price inflation

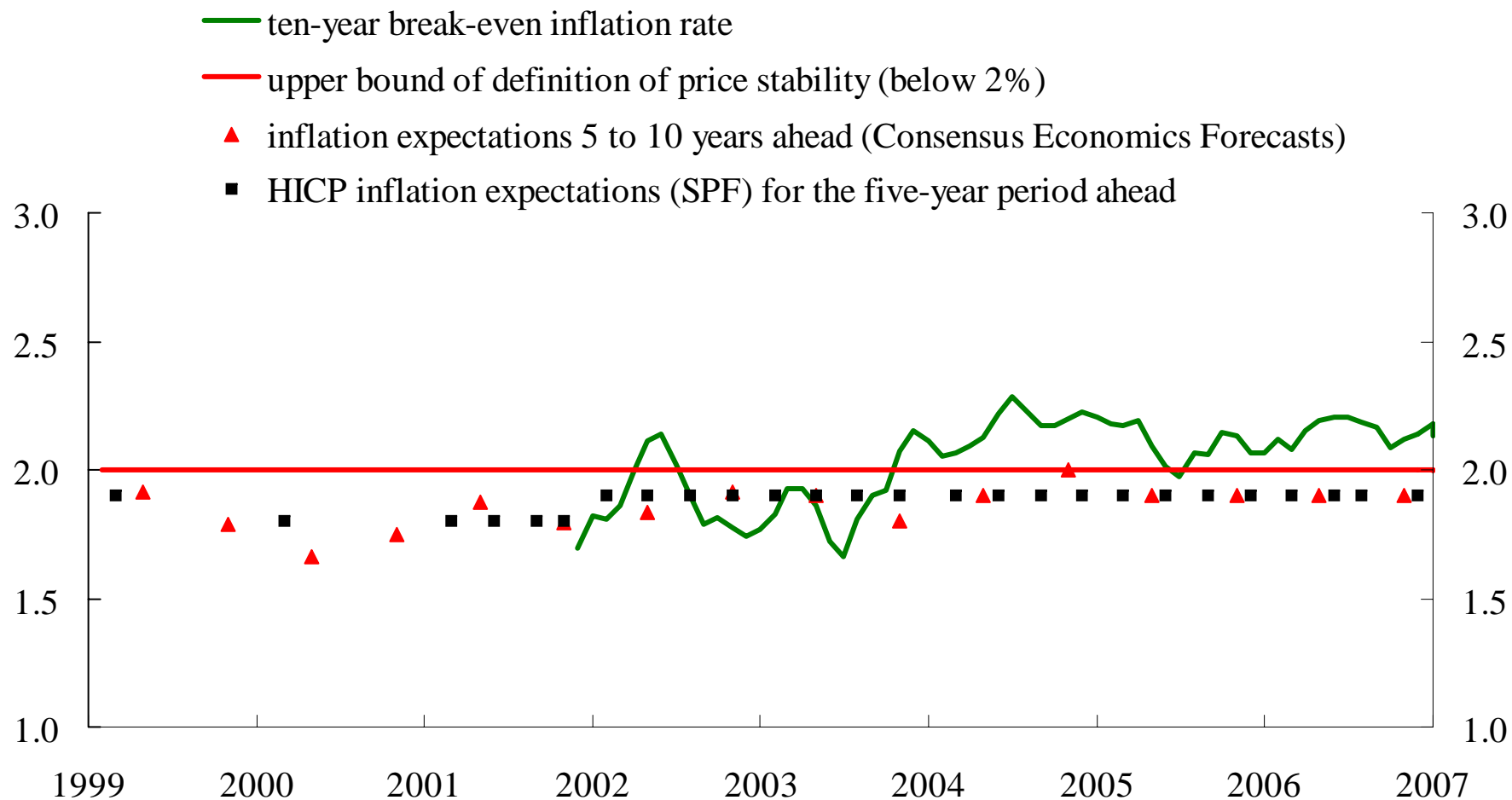
(average annual percentage changes)

Institution	Date of release	2006	2007	2008
Eurosystem staff projections (BMPE)	December 2006	2.1 - 2.3 (2.2)	1.5 - 2.5 (2.0)	-
European Commission	November 2006	2.2	2.1	1.9
IMF	September 2006	2.3	2.4	
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Note: The midpoint of the BMPE forecast is given in brackets, calculated as: (the value at the top of the range + the value at the bottom of the range) / 2.

Inflation expectations are solidly anchored at levels consistent with price stability

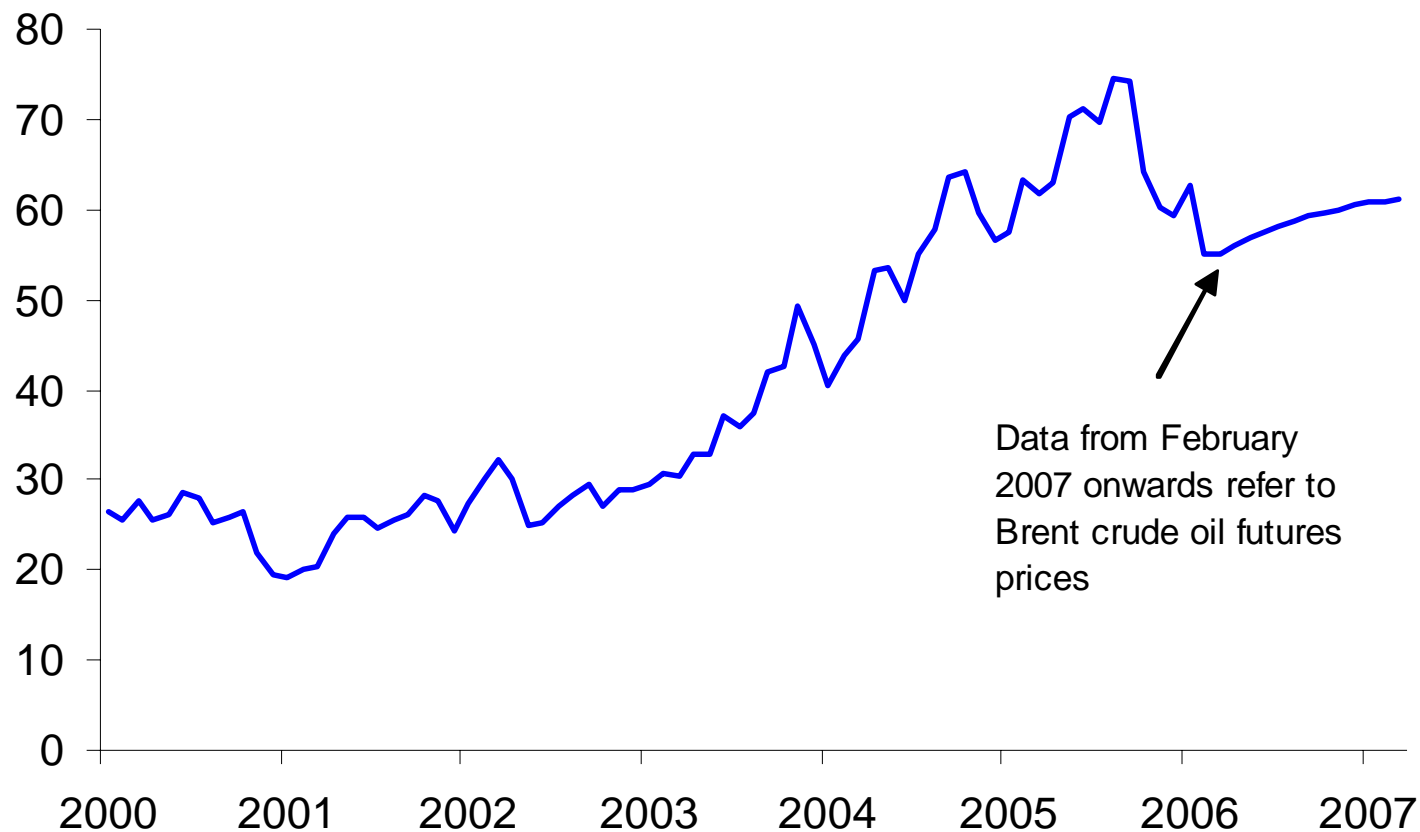
(annual percentage)



Sources: Reuters, Consensus Economics and ECB.

In the medium to longer term, the outlook for price stability remains subject to upside risks, e.g the possibility of renewed oil price increases..

Brent crude oil prices (USD per barrel)



Source: Bloomberg, ECB

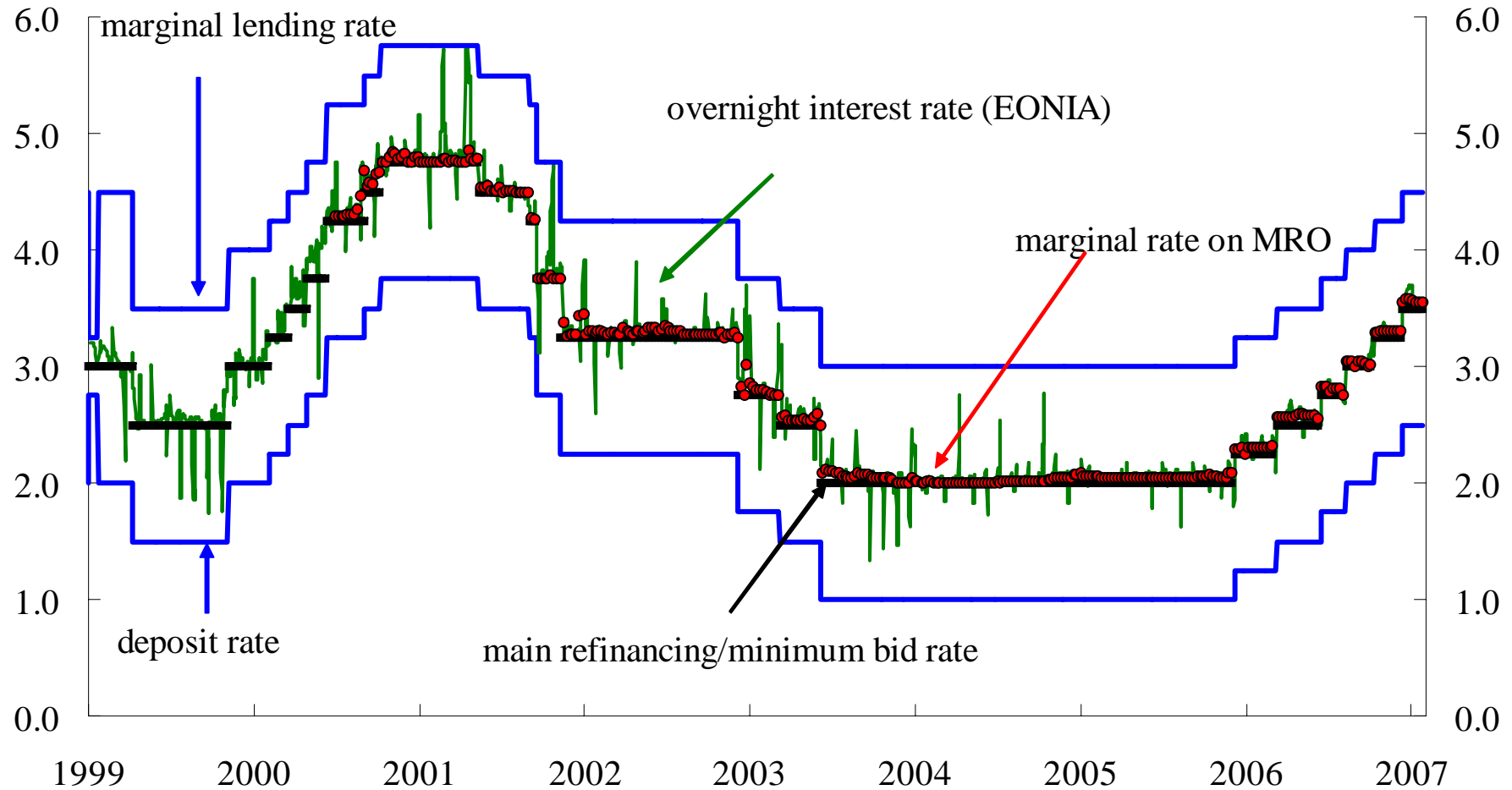
...and...

- A stronger than expected pass-through of past oil price increases into consumer prices
- Additional increases in administered prices and indirect taxes beyond those announced so far
- Stronger than currently expected wage developments, given the favorable momentum of real GDP growth and high capacity utilisation

The ECB's horizon for price stability is the medium term – focusing on current inflation is insufficient

To contain risks to price stability, ECB has increased its key interest rates by 150 bps since December 05, including a 25 bps in December 06

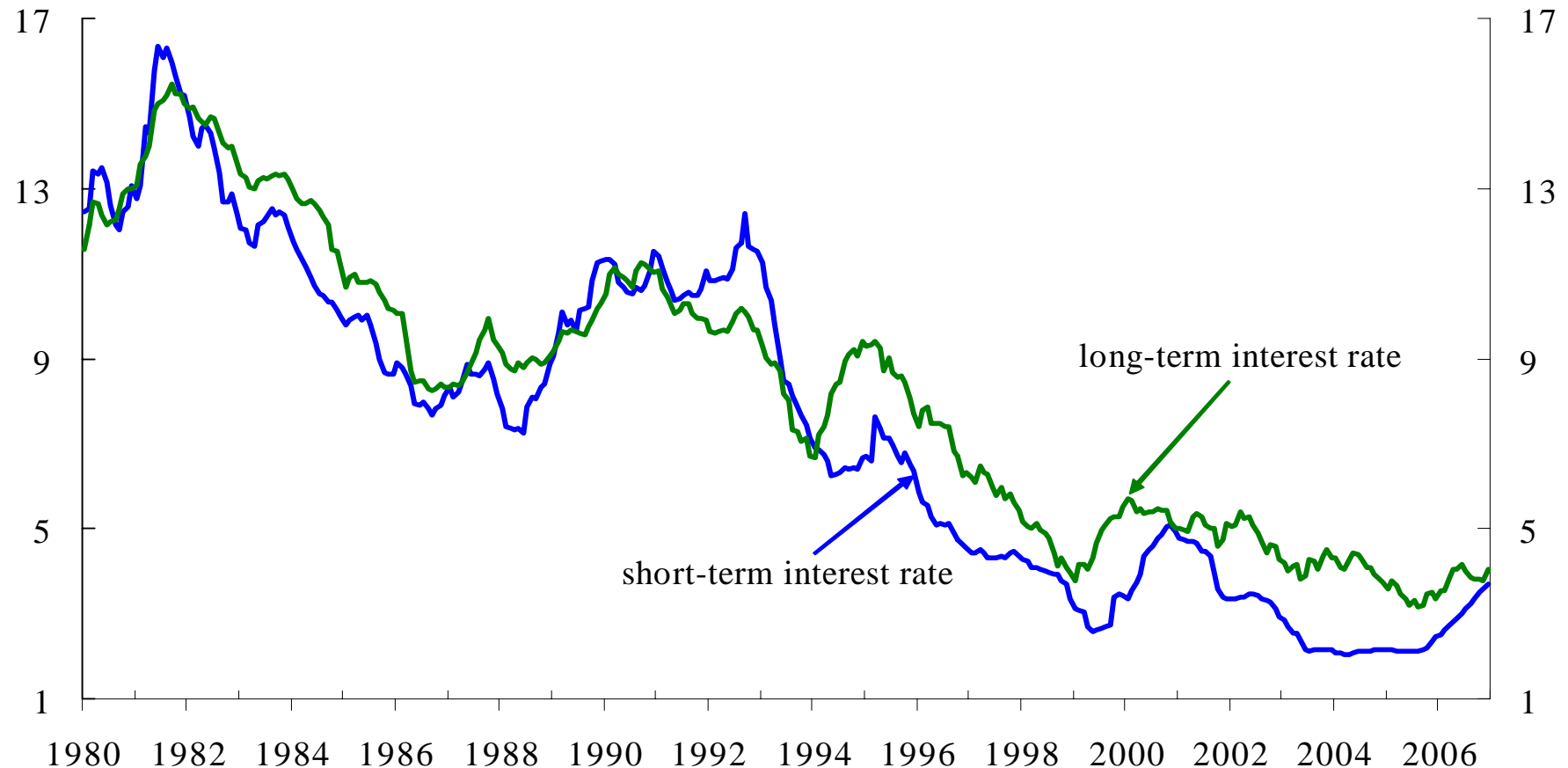
(annual percentage changes)



Source: ECB; Latest observation: 25 January 2007.

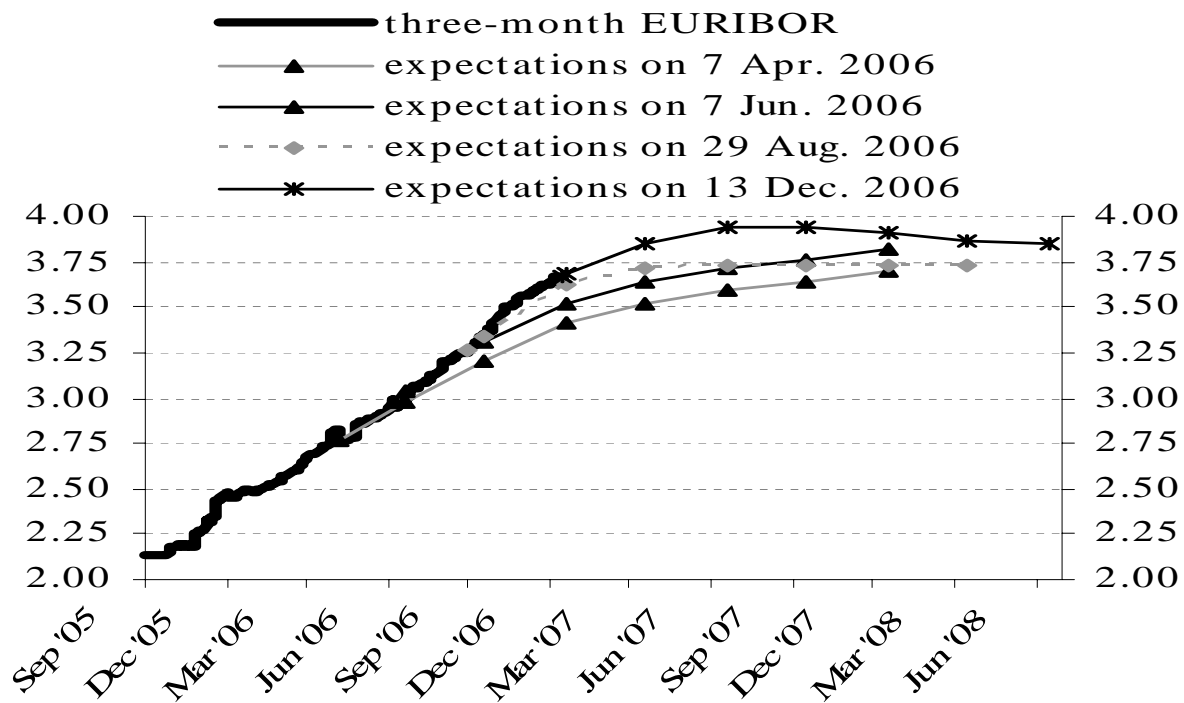
With low interest rates along the maturity spectrum, and with very ample liquidity, monetary conditions remain accommodative

(annual percentage changes; nominal interest rates deflated with headline consumer price inflation)



*Sources: NCBs, Eurostat, Bis, Reuters, Global Financial data and ECB;
Latest observation: December 2006.*

Predictability of the ECB Monetary Policy



Spot three-month EURIBOR and interest rate expectations derived from EURIBOR futures contracts (percentages per annum)

Outlook in non euro area EU Member States

- In most other EU countries outside the euro area, output growth remained strong in the third quarter of 2006
- Domestic demand remains the main driver of growth in most of these countries, more recently accompanied by strong export growth
- Risks to GDP are broadly balanced in most countries
- HICP hovered around 2.5% on average in 2006
- Risks to inflation are broadly contained



Thank you