Interim forecast
September 2010

EU recovery progressing within an uncertain global environment

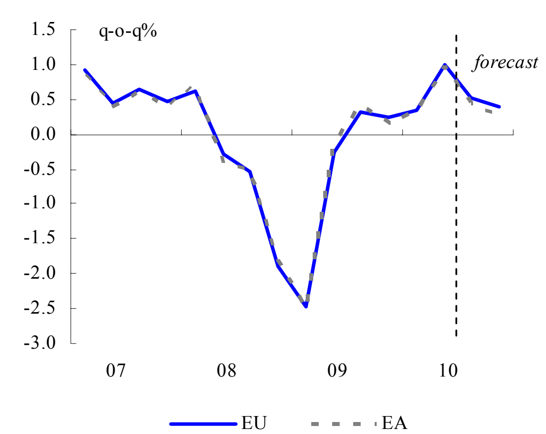
The economic recovery in the EU, while still fragile, is progressing at a faster pace than previously envisaged. In particular, real GDP growth for both the EU and euro area surprised markedly on the upside in the second quarter of 2010. This strong performance stemmed from an export-driven industrial rebound, in line with the continued strong dynamics of global growth and trade in the first half of the year. Encouragingly, signs of a revival in domestic demand, including private consumption, also became evident, particularly in Germany.

While a moderation of EU GDP growth in the second half of the year is still foreseen, some momentum from the second quarter should feed-through to the following quarters, lifting the previously expected quarterly profile somewhat. This improved outlook is supported, inter alia, by sentiment indicators for the EU pointing to continuing expansion of activity in the months ahead, with signs that the recovery is also broadening across sectors. However, the global economy is still expected to go through a soft patch in the second half of the year, implying a dampening effect on EU export growth. In addition, although financial-market conditions have partly recovered from the acute tensions experienced last May, the situation remains tenuous, and adverse effects on bank credit provision to the economy cannot be ruled out.

Based on an update for the seven largest EU Member States focusing on growth and inflation this year, the economic outlook for the EU has been revised up from the Commission's spring 2010 forecast. Real GDP growth is now projected at 1.8% in the EU and 1.7% in the euro area in 2010. Upward revisions are reported for all seven Member States considered in this interim forecast and notably so for Germany, where the underlying dynamics appear to have gained much more strength than earlier anticipated. Notwithstanding exchange-rate developments and the recent weather-related price increases of some agro-commodities, slack in the economy, subdued wage growth and low inflation expectations are keeping inflation in check. The inflation forecasts for 2010 are broadly unchanged, with HICP inflation projected at 1.8% and 1.4% in the EU and euro area respectively.

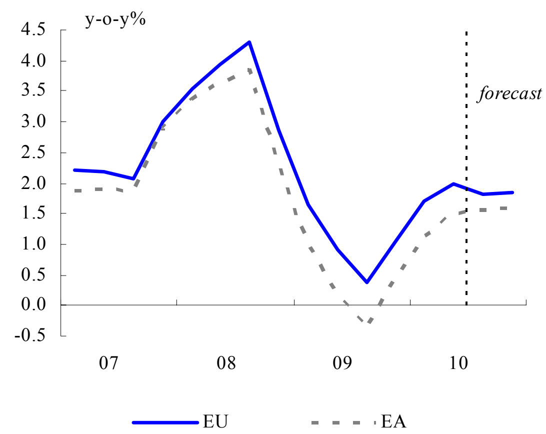
Amid continued high uncertainty, risks to the EU growth outlook remain elevated, even if they are broadly balanced.

Graph 1: Softer GDP growth ahead



Source: European Commission

Graph 2: Continued subdued HICP inflation



Source: European Commission

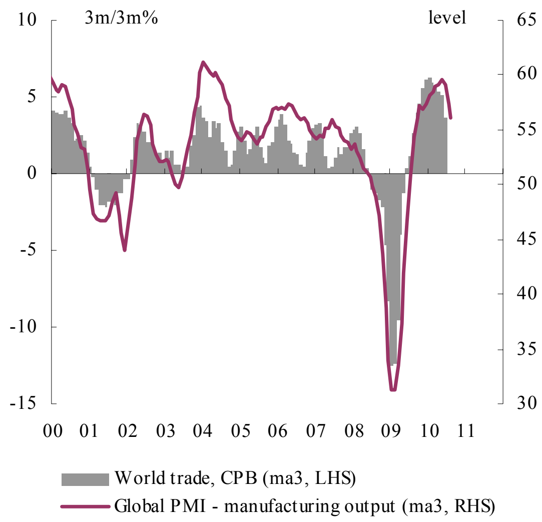
EUROPEAN COMMISSION
Economic and Financial Affairs

Global recovery loosing momentum

The *world economy* recovered by more than expected in the first half of 2010, led by strong growth in emerging market economies, particularly in Asia. World trade also performed strongly, with trade in goods returning to pre-recession levels by mid-year. Despite some loss of momentum in the second quarter, annual growth in global trade (excl. EU) is now expected to average around 12% in 2010 in volume terms, up from about 10% in the spring forecast.

Looking ahead, the global economy is set to moderate somewhat in the second half of 2010, although a 'double-dip' seems unlikely. This follows from the expected weaker support from inventory building going forward and the phasing out of stimulus measures. Leading indicators, such as the global Purchasing Managers' Index (PMI) for manufacturing, though remaining in expansion territory, have declined in recent months, suggesting that the global manufacturing cycle has peaked in the second quarter. Despite the expected soft patch, global GDP (excl. EU) is projected to grow by some 5% in 2010, up by ¼ pp. compared to the spring forecast.

Graph 3: Softening global growth and trade



Source: CPB - Netherlands Bureau for Economic Policy Analysis, European Commission

The global recovery is still expected to be uneven and is surrounded by major uncertainties. On the one hand, growth in emerging economies remains robust, supported by the rebound in global trade, commodity price developments and solid domestic demand. On the other hand, the recovery is still fragile in several advanced economies. While investment in equipment should continue to benefit with some lag from the increase in global demand, consumption remains constrained in these economies. Moreover, the resurfacing of global imbalances, high debt levels and lingering tensions in sovereign-debt markets are also weighing on the outlook.

Financial markets affected by a retreat from risk

Over the last few months, *financial markets* have partly recovered from the sovereign-debt crisis, though significant challenges remain in place. With concerns about the strength of the economic recovery increasing in some parts of the world, a retreat from risk has become a key determinant of financial-market developments.

While sovereign-bond spreads in most European countries have narrowed somewhat since May 2010, they are still significantly above the levels seen at the beginning of the year. More recently, benchmark sovereign-bond yields have fallen to historic lows in the EU, with spreads vis-à-vis German bunds widening again in some Member States. Similarly, corporate-bond spreads have narrowed since May, but also remain substantially above their levels of early 2010. New bond issuance has resumed on the back of mostly better-than-expected corporate results. With concerns about sovereign debt receding, markets' attention has shifted from banks' solvency positions to banks' refinancing risk.

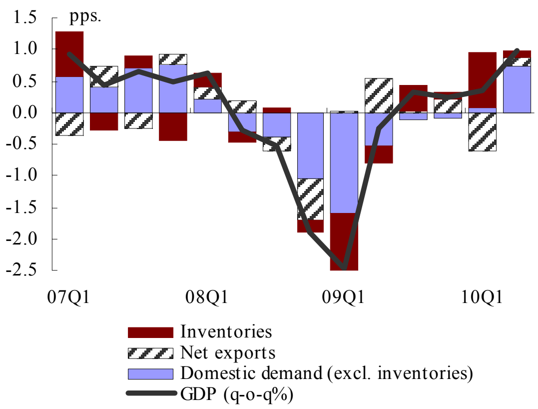
Bank credit provision to the economy has come into focus over the past months. So far lending growth to households has remained very moderate in the euro area and the UK, whereas bank credit to non-financial corporations continued to shrink over the summer. The latest ECB survey provides evidence of renewed tightening of bank credit standards, at least for enterprises. The reported factors behind this are renewed constraints in banks' access to funding and liquidity management, owing to tensions in sovereign-debt markets. These developments suggest that support from the credit side to the economic recovery could materialise somewhat later than envisaged in the spring.

Improved prospects for the EU economy

The recovery of the *EU economy* gained ground in the second quarter of 2010. GDP growth picked up sharply, by 1.0% q-o-q in both regions, after growth of just 0.3% in the first quarter. This outcome was above the consensus estimate (which was 0.6% for the euro area) and the Commission's spring forecast (0.4%).

While exports continued to support the recovery, expanding by a sizeable 4%, the second quarter also saw a rebalancing of growth towards domestic demand. Indeed, the contribution of private investment and consumption to GDP growth (0.6 pp. in the EU and euro area) exceeded the combined contributions of inventories and net exports (0.3 pp.). As expected in the spring, the second quarter figure also partly reflects temporary factors, such as a technical rebound in construction activity following the harsh winter.

Graph 4: A rebalancing of EU growth across demand components



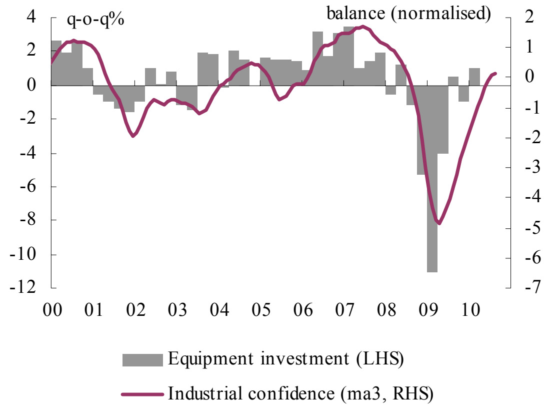
Source: European Commission

Looking ahead, GDP growth is set to moderate in the second half of the year. This stems from the expected softening in the global economy, along with the fading of the temporary factors that kick-started the recovery.

Based on an update of the outlook for the seven largest Member States, GDP is now expected to expand by 0.5% in the EU and euro area in the third quarter, and by 0.4% and 0.3% respectively in the fourth. This represents a slight upward revision compared to the quarterly profile presented in the spring forecast, on account of some spill-over of the momentum from the second quarter.

High-frequency indicators support the improved outlook for the EU economy. For instance, the Commission's Economic Sentiment Indicator (ESI) has recovered from the adverse impact of tensions in financial and sovereign-bond markets in May-June, to currently stand above its long-term average. Similarly, the composite PMI remains firmly in the zone that indicates expansion, despite a slight easing in August. As for sectoral patterns, the broad-based nature of the latest survey readings is also encouraging. It suggests that the expected spill-over from the export-led industrial rebound to the rest of the economy is gradually materialising.

Graph 5: Brighter prospects for EU equipment investment

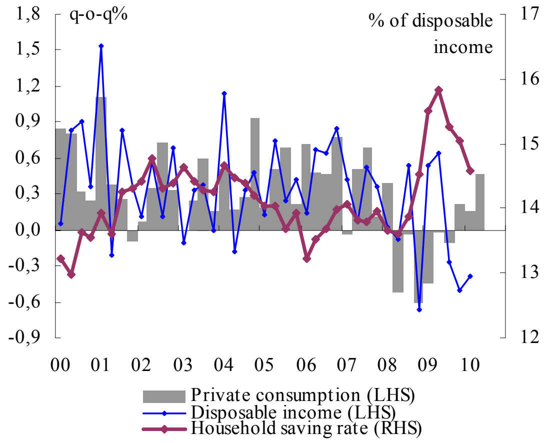


*ma3=3 months moving average

Source: European Commission

Further support to the view that the recovery is broadening can be found in data that are closely correlated with developments in private investment and consumption. For example, the degree of capacity utilisation is approaching a level (just above 80) which traditionally implies expanding equipment investment in the euro area. At the same time, the profit situation of firms has improved. On the consumption side, while disposable income remains weak, the decline in the household saving rate from its peak during the crisis, subdued inflation and stabilising labour-market conditions bode well for consumer spending in the near term.

Graph 6: Private consumption expanding again in the euro area



Source: European Commission

Growth forecast for the EU economy revised up

For 2010 as a whole, GDP growth is now forecast at 1.8% in the EU and 1.7% in the euro area. This represents a sizeable upward revision compared to the spring forecast (1.0% for the EU and 0.9% for the euro area), reflecting a higher carry-over from the first half of the year and the elements discussed above. However, this aggregate picture masks uneven developments across Member States, confirming the Commission's expectation of a multi-speed recovery within the EU. This is not surprising given differences in the scale of adjustment challenges and ongoing rebalancing within the EU and euro area.

Inflation in the EU to remain moderate

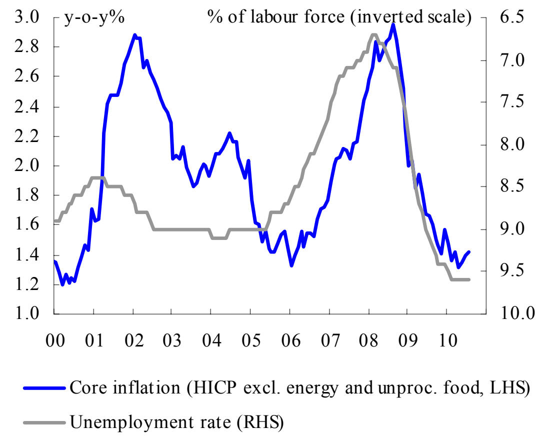
Consumer price inflation increased moderately in the first half of 2010. This upward trend reflected an increase in global commodity prices, as well as the impact of upward base effects from the food and energy components.

Euro-area headline HICP inflation rose to 1.5% in the second quarter of 2010, in line with the spring forecast. Core inflation (i.e. HICP inflation excluding energy and unprocessed food) appears to have bottomed out at 0.8% in the same period, decreasing from 1.5% one year earlier. In the EU, headline inflation was 2.0% in the second quarter, 0.3 pp. higher than in the spring forecast, largely due to a surprise in the UK.

Weak labour-market conditions kept *wage growth* subdued in the euro area in the first quarter of 2010. At the same time, annual unit-labour-cost growth was negative, reflecting improving productivity and only modest growth in compensation per employee.

Looking ahead, the headline inflation rate for 2010 is expected to hold at 1.8% in the EU, while in the euro area it is marginally revised down to 1.4% (-0.1 pp. compared to the spring forecast). However, within the euro area, projected developments are somewhat divergent, with France being the only Member State with an upward revision, following increases in administered prices. Outside the euro area, inflation has been revised up, in particular in the UK on account of a stronger-than-expected pass-through to the headline inflation rate from exchange-rate and commodity-price developments, as well as due to changes in indirect taxation.

Graph 7: EU underlying inflation remains subdued



Source: European Commission

Despite revisions at the Member State level, the underlying inflation trends identified in the spring forecast remain valid. The remaining slack in the economy and weak labour market conditions are expected to keep core inflation at historically low levels, while the headline rate may prove to be volatile in the second half of 2010, driven both by changes in commodity prices related to the outlook in advanced economies and base effects.

Brighter growth outlook bodes well for the labour market and public finances

In keeping with the usual pattern – whereby labour-market developments follow those of GDP with a time lag of half a year or more – the *labour-market* situation has started to stabilise in recent months. The first quarter of 2010 saw job shedding ease to 0.2% q-o-q in the EU (from some 0.8% a year earlier) and come to an end in the euro area. Similarly, the unemployment rate has held steady since the spring, at 9.6% in the EU and 10.0% in the euro area.

As for the outlook, survey indicators of firms' employment expectations point to moderate job creation going forward, as does the PMI employment index which crossed the 50-mark in May. Taken together with the strong upward revision to economic growth in 2010, it seems that the labour market may hold up somewhat better this year than expected at the time of the spring forecast. Nonetheless, conditions are set to remain weak, reflecting, inter alia, the partial unwinding of support measures and ongoing structural adjustment across sectors and firms. At Member State level, a continuation of the divergence observed to date in labour-market performance is also expected.

Turning to *public finances*, additional consolidation measures taken since the publication of the spring forecast and the better-than-expected growth outlook will help improve the 2010 budgetary position in the EU and euro area.

A full assessment of prospects for public finances and the labour market will be carried out in the Commission's upcoming autumn forecast.

High uncertainty, but broadly balanced risks

Uncertainty at the current juncture is high, with non-negligible risks to the EU *growth outlook* clearly evident. While these risks go in both directions, they appear broadly balanced for 2010.

On the *upside*, the impetus from the export-led industrial rebound to private consumption could prove stronger than assumed in the baseline, as was the case in the first half of the year. The broad-based improvement in sentiment indicators of late bodes well for a similar outcome in the period ahead. Moreover, in so far as the labour market continues to surprise on the upside – as it has done for some time now – the feed-through to private consumption could be even more pronounced. The materialisation of these risks would add to the self-sustainability of the EU recovery. Likewise, the spill-over to be expected from the pick-up in activity in Germany to other Member States may materialise to a greater extent than expected at present, further strengthening the recovery.

On the *downside*, softening global demand in the second part of 2010 – beyond that allowed for in the baseline – poses a risk for EU export growth. Second, the still relatively fragile financial-market situation remains a concern. While markets have recovered somewhat from the recent crisis, renewed turbulence in sovereign-debt markets could trigger further increases in funding costs and additional credit tightening, with adverse consequences for confidence and economic activity. A third downside risk relates to the fiscal consolidation underway in a number of Member States. This should help dissipate market concerns about fiscal sustainability, but may weigh more on domestic demand in the short term than currently envisaged.

Regarding the *inflation outlook*, risks also appear to be broadly balanced for 2010. While strengthening activity and a weaker than previously assumed euro represent upside risks, weak labour-market conditions, as well as low inflation expectations, suggest that these pressures are likely to be offset in the near term.

Growth and inflation prospects in the seven largest Member States

1. Germany – strong recovery becoming more broad-based

The German economy has rebounded vigorously from the crisis, posting five consecutive quarters of robust growth since the second quarter of 2009. Despite the harsh weather conditions around the turn of 2009-10, the underlying growth momentum remained largely intact and turned out considerably stronger than projected in the Commission's spring forecast. A brisk rebound in world trade and expansionary monetary and fiscal policy were the main driving forces behind this turnaround. The initially largely export-driven recovery is increasingly becoming more broad-based with domestic demand contributing more strongly to growth in the second quarter than net exports.

In the second quarter of 2010 real GDP growth culminated at over 2%, the highest quarterly rate since reunification. A particularly sharp increase in exports and a surge in construction activity – reflecting a rebound after the impact of severe winter weather and the kicking-in of public infrastructure projects as part of the fiscal stimulus – contributed to this exceptionally brisk pace. The weaker economic outlook for the US and a possible moderation of growth in Asia are likely to imply a softening of the export dynamics in the second half of the year. However, domestic demand components are set to gather further strength and to sustain a relatively lively recovery. The robust labour market which, despite the scope of the downturn, was barely affected should boost household confidence. Thus, private consumption will continue to be buoyed by falling unemployment, stronger wage growth as working hours are being extended again, still moderate inflation and fiscal relief measures. Rising capacity utilisation, low interest rates and the strong financial position of the corporate sector should support private investment activity, which will additionally be boosted by the expiry of favourable depreciation rules at the end of the year. Hence, despite some slowdown in the quarterly growth rates, real GDP is projected to grow by close to 3½% in 2010.

Despite higher energy prices and a depreciation of the euro, HICP inflation has remained contained so far and is expected to accelerate only moderately in the coming months. Annual average HICP inflation is projected at just above 1.0% this year.

2. Spain – temporary setback in mid-2010

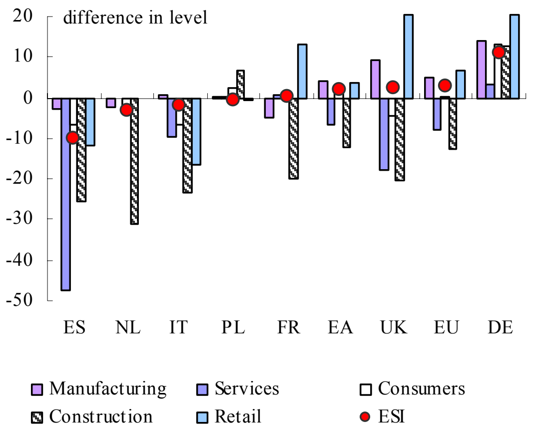
Economic activity in 2010 is forecast to decline by 0.3% following a fall of 3.7% in the previous year. Specifically, the first and second quarters of 2010 recorded positive quarterly growth, largely driven by temporary factors, though these positive effects will fade over the second half of the year.

The VAT-rate increase which became effective on 1 July, led to a front-loading of consumption plans from the second to the first half of 2010, which seems consistent with the deterioration observed in retail sales in the third quarter. After growing significantly in the beginning of the year, car sales are also dropping sharply in the third quarter, reflecting the end of the car-scrapping schemes. Thus, private consumption is projected to contract in the second half of the year. Investment will remain weak: while the ongoing adjustment in the housing sector is projected to continue, public investment is set to fall as a result of the cut in public spending scheduled for the second half of 2010. Therefore, quarterly GDP growth is expected to record a temporary fall in the third quarter, but should turn positive in the fourth. For the year as a whole, domestic demand is set to lower GDP growth by nearly 1¼ pps.

In the external sector, exports recorded better-than-expected growth at the beginning of 2010, consistent with the recovery of world demand. However, the growth contribution of net exports is expected to be close to 1 pp. compared to 2.7 pps. in 2009 as a result of an important rebound of imports in 2010, driven by a positive evolution of final demand.

The inflation rate continued to increase, to 1¼% and above 1½% in the two first quarters of 2010 respectively. It is expected to rise to 1¾% at the end of the year, with an annual average of just above 1½% for 2010, on the back of higher oil prices and the VAT hike. After a significant increase in 2009, real wages are expected to stagnate in 2010, following higher inflation and lower nominal wage increases included in recent agreements.

Graph 8: Commission's Economic Sentiment Indicators (ESI) and components: differences from the long-term averages (last obs. Aug. 2010)



Source: European Commission

3. France – gradual recovery on the back of subdued demand

The French economy has been gradually recovering from recession since the second quarter of last year. For 2009 as a whole, however, it experienced a significant decline of GDP (-2.6%), though less so than the euro area (-4.1%). This was mainly due to the absence of major domestic imbalances, relatively large economic stabilisers, the comparatively low degree of openness of the economy, combined with the limited size of the manufacturing sector, as well as the resilience of private consumption. Unlike the case in several other EU countries, there has been almost no acceleration in growth in the first half of 2010, with GDP expanding at an average quarter-on-quarter rate of 0.4%. In the second quarter of 2010, activity grew by 0.6% q-o-q. As before, domestic demand was the main driver of growth, complemented by the impact of a deceleration in destocking. In spite of the recovery in world trade and the depreciation of the euro, net trade was a drag on growth, as imports expanded strongly.

The same structural features that partly shielded the French economy during the crisis will continue to contain the pace of expansion. Although business climate indicators are close to their long-term average, they have recently levelled off and remain below their historical recovery levels. This suggests a slowdown of economic expansion compared to the second quarter of 2010. Domestic demand is also set to grow at a moderate pace because the inventory cycle is becoming less supportive. Private consumption will mirror the weakness of disposable income and the after-effects of the car-scrapping premium. Investment growth should be limited given still large spare capacity. The still favourable developments in world trade combined with the euro depreciation are expected to have a positive but limited effect. All in all, GDP is likely to grow by 0.4% and 0.3% in the third and fourth quarter respectively, implying an annual growth rate of 1.6% for 2010 as a whole.

HICP inflation reached 1.8% in the second quarter as the rise in oil prices was amplified by a base effect from last year. In 2010, inflation is set to average 1.6% while core inflation is expected to remain subdued. The high unemployment rate and the need for firms to remain competitive in an export-led recovery are likely to weigh on prices.

4. Italy – exports contribute to a moderate upturn

Italy's real GDP expanded by almost ½ pp. in both the first and the second quarter of 2010 and is expected to grow by 1.1% in the year as a whole. The 0.3 pp. upward revision compared with the Commission's spring 2010 forecast is explained by the better-than-anticipated growth impulse from external demand and a revised 2009 quarterly growth profile.

The moderate recovery of the Italian economy is projected to be mainly driven by the industrial sector, thanks to the rebound in exports after the collapse recorded in 2009. The upturn in external demand is providing some support to investment in equipment, which also benefited from tax incentives that expired at the end of June. By contrast, investment in construction is expected to remain weak in the coming quarters. Finally, the still fragile labour-market situation is set to continue weighing on the dynamics of private consumption.

As regards the quarterly profile of GDP growth, the most recent data on industrial production and business confidence suggest economic expansion in the third quarter of 2010 to continue at broadly the same pace as in the first two quarters of the year. The recovery is then projected to ease somewhat in the last quarter of 2010, due to the expected deceleration in global demand.

The short-term outlook for the Italian economy appears subject to both upside and downside risks. On the one hand, global demand could prove stronger than anticipated, with positive spillovers also for firms' investment. On the other hand, possible renewed tensions and uncertainty in financial markets might affect economic agents' confidence.

After declining markedly in 2009, HICP inflation picked up in the first half of 2010, due to the fading of favourable base effects from energy prices. In 2010 as a whole, inflation is projected to increase to 1.6% on average. This is 0.2 pp. lower than in the Commission's spring 2010 forecast, mainly because of less dynamic commodity prices.

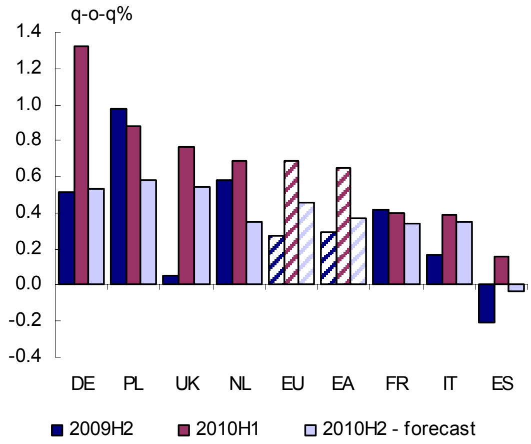
5. The Netherlands – maintaining moderate momentum

The recovery of the Dutch economy, which started in the second half of 2009, gained momentum in the first half of 2010, resulting in quarter-on-quarter GDP growth of 0.5% and 0.9% in the first and second quarter, respectively. Economic activity benefitted from a strong upswing in the inventory cycle and a rebound of investment in the second quarter, due mainly to a replacement of equipment. Although exports proved to be an important growth driver again – taking advantage of the acceleration in world trade and reflecting the sensitivity of the Dutch economy to external demand – net exports were a drag on growth, as imports posted even stronger growth in both the first and the second quarter of 2010. Private consumption showed some signs of recovery, especially in the first quarter, but this was in large part due to the low temperatures boosting households' energy consumption.

The momentum of economic growth created in the second quarter is expected to continue partially in the third quarter, leading to quarter-on-quarter growth of 0.4%. With the fading of some temporary growth drivers, such as stock building, real GDP growth is expected to weaken again in the fourth quarter to 0.3% q-o-q, so that annual real GDP growth is projected to reach 1.9% in 2010. Private consumption is likely to remain subdued throughout the second half of 2010, given a strong and rapid decline in wage growth, as reflected in recent wage agreements. Additionally, limited support for private consumption is expected to stem from labour-market developments, in spite of the latter having outperformed expectations. The positive growth dynamics of investment displayed in the second quarter are likely to slow down, especially towards the end of 2010, reflecting a loss of demand momentum and a below-average capacity utilisation. Net trade is most likely to contribute to growth only moderately, given the expected softening of world-trade growth.

The annual HICP inflation rate was historically low in the first half of 2010, reaching 0.4% in the second quarter. It is projected to increase in the third quarter, mainly as a result of a positive contribution of energy prices coming from a base effect. Overall, for 2010, inflation is expected to reach 1.1%.

Graph 9: Uneven GDP developments across Member States



Source: European Commission

6. Poland – manufacturing sector leads the recovery

Economic activity continued to be strong in the second quarter of 2010, with GDP growth reaching 1.1% q-o-q. The upswing was driven by a strong manufacturing sector (industrial production (s.a.) grew by 10.5% y-o-y in the second quarter of 2010) and a sharp rebound in world trade that brought Polish exports to their pre-crisis levels. Moreover, domestic demand increased on the back of rebuilding inventories and accelerating private consumption, fuelled by improving confidence as the recovery becomes firmer, and the overall resilience of the labour market. However, private investment continued to suffer from uncertainties regarding the global recovery and low capacity utilisation levels.

In 2010 real GDP growth is expected to accelerate to 3.4%, ¾ pp. higher than expected in the Commission's spring forecast. This follows from the better-than-expected result in the first half of 2010.

Quarterly real GDP growth is projected to slow somewhat in the third quarter of 2010 and remain stable in the final quarter of the year. The recovery is likely to be mild in the second half of the year, as the impetus from stock-building is likely to peter out and employment growth will remain sluggish towards the end of 2010. Although part of the labour-market adjustment was achieved through real wages, labour hoarding during the slowdown will imply less employment-rich growth and some re-adjustment of wages in the years to come. Stagnating employment and real wages will weigh on real disposable income and, combined with necessary fiscal consolidation, limit the potential for a strong rebound of domestic consumption. Investment growth will mainly reflect robust public spending in capital expenditure, while tight financing conditions and excess capacity in certain sectors will hamper growth in private investment.

The annual HICP inflation rate reached 2.5% in the second quarter of 2010, a notch higher than in the spring forecast. It is expected to remain below the central bank's inflation target of 2.5% within the forecast horizon, reflecting the remaining slack in the economy.

7. The United Kingdom – inventory build-up helps sustain economic recovery

In the second quarter of 2010, the UK's quarter-on-quarter GDP growth accelerated sharply and unexpectedly to 1.2% from 0.3% in the preceding quarter. The rate of growth was the highest since 2001 and more than twice that projected by the Commission services in spring 2010. Output growth was primarily driven by the turning of the inventory cycle and resilient household spending, which contributed 1.0 pp. and ½ pp. to growth respectively. Net trade, which had contributed negatively to growth in the previous three quarters, made a neutral contribution to second quarter growth, with export performance strengthening.

Economic growth is expected to slow down in the second half of 2010. Although inventory investment is expected to increase further, the extraordinary boost to second quarter growth from the turning of the inventory cycle will not be repeated in the third quarter. The announced increase in the VAT rate in January 2011 should encourage higher private consumption in the fourth quarter of 2010. This is expected to lead to some acceleration in growth in the fourth quarter, although it will also curtail economic activity in the first quarter of 2011.

Investment spending by businesses is expected to remain constrained by weak demand expectations and tight credit conditions. Export growth relative to that of imports is expected to generate a moderate contribution to growth in the second half of 2010, in part supported by improving economic conditions in some of the UK's European export markets. In 2010 as a whole GDP is expected to increase by 1.7%, up by ½ pp. when compared to the spring 2010 forecast.

Annual HICP inflation in the second quarter of 2010, at 3.4%, was 0.8 pp. higher than projected in spring 2010. The greater part of the inflation overshoot was due to higher retail energy prices and a stronger pass-through from the sterling depreciation and the VAT rise to consumer prices. The inflation rate is expected to decelerate in the third quarter as a result of the large amount of spare capacity, although price increases pre-empting the VAT rise in January 2011 could prevent a further moderation of inflation in the fourth quarter.

Table 1: Real GDP growth

	Quarterly GDP (%, quarter-on-quarter) Outturn		Forecast		Annual GDP (%, year-on-year) Outturn	2010 (forecast)	
	2010/1	2010/2	2010/3	2010/4	2009	*Spring forecast May 2010*	Interim forecast Sep. 2010
Germany	0.5	2.2	0.6	0.4	*-4.7*	*1.2*	3.4
Spain	0.1	0.2	-0.1	0.1	*-3.7*	*-0.4*	-0.3
France	0.2	0.6	0.4	0.3	*-2.6*	*1.3*	1.6
Italy	0.4	0.4	0.5	0.2	*-5.0*	*0.8*	1.1
Netherlands	0.5	0.9	0.4	0.3	*-3.9*	*1.3*	1.9
Euro area	**0.3**	**1.0**	**0.5**	**0.3**	***-4.1***	***0.9***	**1.7**
Poland	0.7	1.1	0.6	0.6	*1.7*	*2.7*	3.4
United Kingdom	0.3	1.2	0.5	0.6	-4.9	*1.2*	1.7
EU27	**0.3**	**1.0**	**0.5**	**0.4**	**-4.2**	***1.0***	**1.8**

Source: European Commission

Table 2: Consumer price inflation

	Quarterly HICP (%, year-on-year) Outturn		Forecast		Annual HICP (%, year-on-year) Outturn	2010 (forecast)	
	2010/1	2010/2	2010/3	2010/4	2009	*Spring forecast May 2010*	Interim forecast Sep. 2010
Germany	0.8	1.0	1.2	1.4	0.2	*1.3*	1.1
Spain	1.2	1.6	1.9	1.8	-0.2	*1.6*	1.6
France	1.5	1.8	1.7	1.6	0.1	*1.4*	1.6
Italy	1.3	1.6	1.8	1.8	0.8	*1.8*	1.6
Netherlands	0.5	0.4	1.5	1.9	1.0	*1.3*	1.1
Euro area	**1.1**	**1.5**	**1.6**	**1.6**	**0.3**	***1.5***	**1.4**
Poland	3.4	2.5	2.1	2.3	4.0	*2.4*	2.6
United Kingdom	3.3	3.4	2.8	2.7	2.2	*2.4*	3.0
EU27	**1.7**	**2.0**	**1.8**	**1.8**	**1.0**	***1.8***	**1.8**

Source: European Commission

Questions and comments on the September 2010 Interim forecast should be directed to:
ECFIN-INTERIM-FORECAST@ec.europa.eu

BOX: TECHNICAL BACKGROUND TO THE INTERIM FORECAST

Technical background

In February 2006, the Commission presented the first of what are now twice-yearly interim forecasts with the objective of updating its comprehensive spring and autumn economic forecasts (with the next fully-fledged forecast scheduled for 29 November 2010). This interim forecast updates the outlook of the spring 2010 economic forecast of 5 May 2010. The cut-off date for this interim forecast to take new information on board was 6 September 2010.

The interim forecast updates the outlook for the largest seven EU Member States, i.e. Germany, Spain, France, Italy, the Netherlands, Poland and the United Kingdom (which are the largest in the EU based on an average of the ranking in terms of both population and nominal GDP). The update covers real GDP growth and HICP inflation for the current year. These updates are prepared using indicator-based forecasting models and/or judgemental forecasting techniques.

Estimates for the European Union and the euro area are prepared using the nominal GDP-weighted updates for the largest Member States. In terms of nominal GDP, these countries account for 79% of the European Union, while the five euro-area Member States account for 83% of the euro-area aggregate. The outlook for the smaller Member States has not been individually updated. The Commission has made projections for the euro area and the EU using the updates for the five and seven largest Member States respectively, and assuming that the revisions to GDP and inflation for the smaller Member States are proportionate to those of the larger ones.

Quarterly data are updated with the latest available information. When comparing quarterly with annual GDP growth it must be kept in mind that, whenever possible, quarterly data are adjusted for both seasonal influences and the number of working days while annual data is presented in unadjusted form. Calendar factors are, however, relatively small in 2010.

External conditions

This forecast is based on a set of external assumptions. Technical assumptions are used for exchange rates, interest rates and oil prices. These assumptions are based on market expectations at the time of the forecast. To shield these assumptions from possible volatility during one specific trading day, averages from a 10-day reference period have been used.

The technical assumption as regards exchange rates has been standardised using fixed nominal exchange rates for all currencies. They are kept constant based on the averages from 10 days up to 3 September, implying e.g. an annual average of USD/EUR of 1.30.

Interest-rate assumptions are, since spring 2007, market-based instead of expert-based. These assumptions should be interpreted with caution, as market-based assumptions do not only reflect policy rate expectations, but also liquidity conditions in a period of market uncertainty. 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 Poland and the UK are calculated using implicit forward swap rates, corrected for the spread between the 3-month interbank interest rate and the 3-month swap-rate. In this forecast, the short-term rate is assumed to be at 0.8% and the long-term interest rates at 2.6% in 2010 for the euro area.

The outlook for oil prices is based on futures prices. The price per barrel of Brent crude oil is projected at 77.1 USD/barrel in 2010 (corresponding to 58.9 EUR/barrel). This would be 7.4 USD/barrel lower (or 3.2 EUR/barrel lower) than assumed in the spring 2010 forecast.

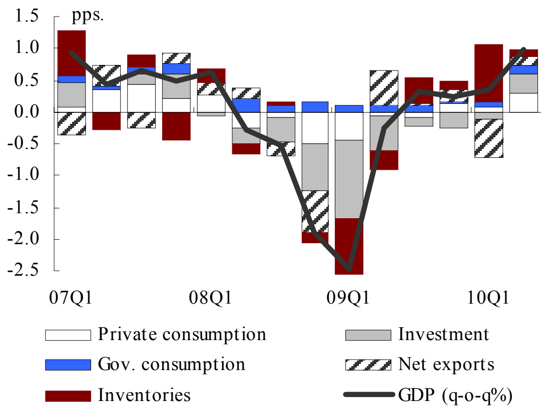
Global demand in 2010 is revised upwards, following the somewhat stronger-than-expected growth in the first half of 2010, specifically in emerging economies, and a rebound in world trade and industrial production. Global GDP growth, excluding the EU, is now forecast to accelerate to around 5% in 2010, about ¼ pp. higher than expected in the spring forecast. World trade is set to rise substantially in 2010, with growth in export and import volumes (excluding the EU) estimated at around 12% (up from about 10% in the spring forecast).

Acknowledgements

This report was prepared in the Directorate-General for Economic and Financial Affairs under the direction of Marco Buti, Director-General, and István P. Székely, Director of the "Economic studies and research". Executive responsibilities were attached to Moisés Orellana, acting Head of Unit for "Forecasts and economic situation", and the forecast coordinator Michał Narożny.
The report benefited from contributions by Paolo Battaglia, Piotr Bogumił, Chris Bosma, Mateo Capó Servera, Suzanne Casaux, Samuel de Lemos Peixoto, Oliver Dieckmann, Pierre Ecochard, Javier Jareño Morago, Karolina Leib, Guy Lejeune, Maarten Masselink, Marco Montanari, Michał Narożny, Moisés Orellana, Loretta O'Sullivan, Manuel Palazuelos Martińez, Dario Paternoster, Vito Ernesto Reitano, Karl Scerri, Thomas Springbett, Jonathan van der Heijden and Norbert Wunner.
Statistical and layout assistance was provided by Daniela Porubská.

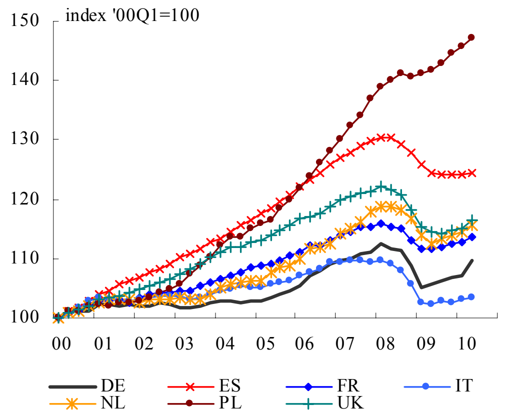
Annex: Selected graphs

Graph A.1: Contributions to GDP growth in the EU



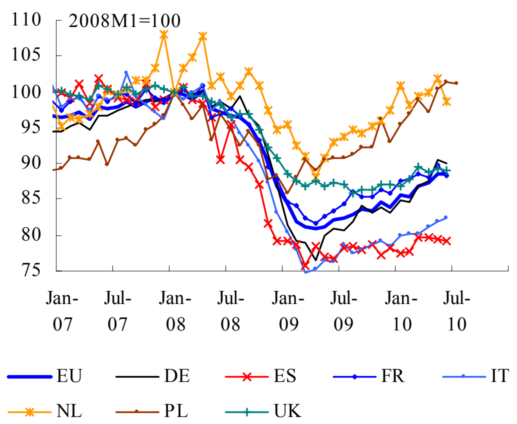
Source: European Commission

Graph A.2: GDP levels in selected Member States



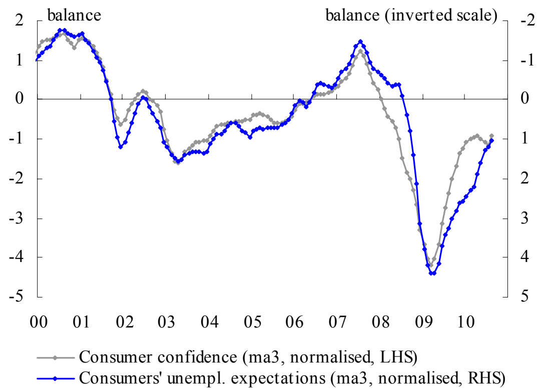
Source: European Commission

Graph A.3: Industrial production levels in the EU and selected Member States



Source: European Commission

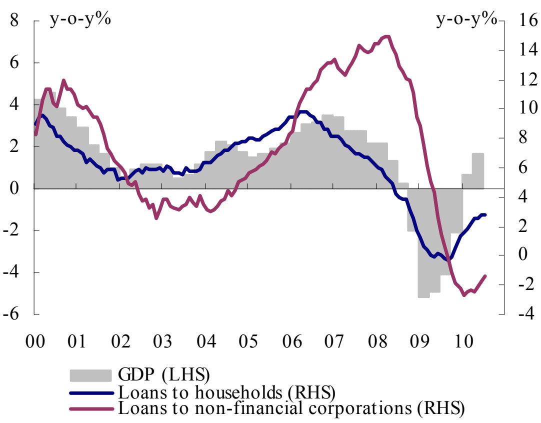
Graph A.4: Consumer confidence and unemployment expectations in the EU



**ma3= 3 month moving average*

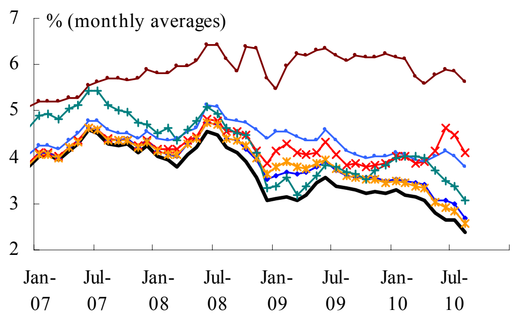
Source: European Commission

Graph A.5: Bank lending to households and non-financial corporations in the euro area



Source: European Commission

Graph A.6: Sovereign-bond yields in selected Member States



** for PL denominated in PLN, for UK in GBP*

Source: European Commission