Annex 1

18 March 2011

General features of the baseline macro-economic scenario

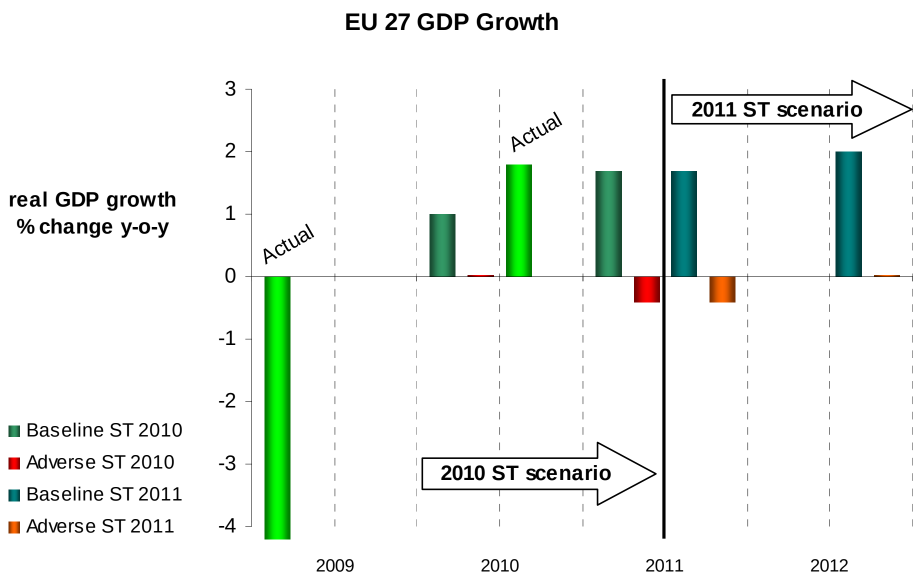
1. The baseline scenario is mainly based on the Autumn 2010 European Commission forecast[1]. Assumptions for market interest rates as well as for exchange rates and commodity prices have been set in line with the methods employed by the European Commission to construct their forecast. Short-term interest rates in euro area are expected to increase gradually to 1.5% and 1.8% in 2011 and 2012 in the euro area. Long-term interest rates for the same region are assumed to be 2.5% in 2010, 2.7% in 2011 and 2.9% in 2012 the gradual slight increase reflecting the global increase in risk pricing for financial assets.

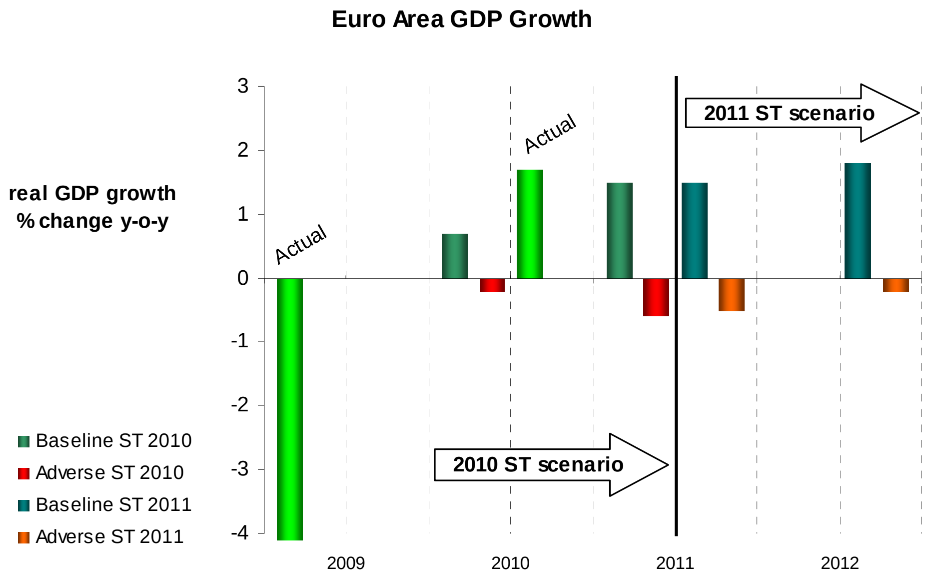
2. Regarding foreign exchange assumptions, the dollar is expected to depreciate against Euro from 1.33 in 2010 to 1.39 in 2011 and 2012 which is in line to the expected accommodative monetary policy in the US.

3. The baseline scenario foresees a continuation of the economic recovery currently underway in the EU. GDP is projected to grow by around 1.7 in 2010-11 and by around 2% in 2012 (1.5% and 1.8% respectively for the euro area countries). A better than expected performance so far underpins the significant upward revision to annual growth in 2010 compared to the spring forecast. While the recovery is becoming increasingly self-sustaining at the aggregate level, progress across Member States remains uneven, with the recovery set to continue advancing at a relatively fast pace in some, but to lag behind in others. This reflects differences in the scale of adjustment, challenges across economies and ongoing rebalancing within the EU and euro area.

4. As compared with the 2010 EU-wide exercise (based on the 2009 Autumn forecast) the 2011 baseline scenario is built on improved baseline conditions while projected growth ratios still remain more conservative than actual figures (in light green on the chart below).

[1] See: http://ec.europa.eu/economy_finance/eu/forecasts/2010_autumn_forecast_en.htm





5. However, amid a softening global environment and the onset of fiscal consolidation, activity is expected to moderate in 2011, but to pick up again in 2012 on the back of strengthening private demand. With the economic recovery taking hold in the EU, labour-market conditions are expected to slowly improve over the forecast horizon, as is the budgetary situation. The unemployment rate is projected to fall to around 9% in 2012 (against 9.5% in 2011), and the public deficit will gradually decline to 5% of GDP in 2011 and about 4¼% in 2012.

6. Developments in the labour market typically lag those in GDP by half a year or more. In keeping with this pattern, recent months have seen labour-market conditions start to stabilize in the EU, with a modest improvement expected over the forecast horizon. Employment growth of almost ½% and around ¾% is expected in 2011 and 2012 respectively, while the unemployment rate is projected to gradually fall, from some 9½% this year to about 9% by 2012. Overall conditions are set to remain weak though, reflecting, inter alia, the

unwinding of policy measures taken in response to the recession and ongoing structural adjustment, not least in the public sector.

7. Public deficits are starting to decline thanks to the consolidation measures taken and to the return of economic growth. Around half of EU Member States set to post a lower general government deficit this year than in 2009. As stimulus measures come to an end and the consolidation phase increasingly takes hold, the deficit is projected to fall in 24 Member States next year. For the EU as a whole, a deficit of slightly above 5% of GDP is expected in 2011, with a further decline of about 1 percentage point in 2012 as the recovery gains ground. The debt ratio, however, is set to remain on an upward path over the forecast horizon. However, this recovery is uneven, and many Member States are going through a difficult period of adjustment. A determined continuation of fiscal consolidation and frontloaded policies to enhance growth, are essential to set the sound basis for sustainable growth and jobs. The turbulence in sovereign debt markets underlines the need for robust policy action.

8. Relatively subdued consumer-price inflation is in sight in both the EU and euro area over the coming period. HICP inflation is projected to average 2% in the EU this year and next, easing to around 1¾% in 2012 (for the euro area, a rate of 1¾% is expected in 2011-12). The remaining slack in the economy, along with fairly moderate wage and unit-labour cost growth were expected to keep inflation in check going forward, notwithstanding slightly higher commodity prices and increases in indirect taxation and administered prices in some Member States. It should be also noted that the interim forecast issued on 1 March 2011 suggests upward revision of both inflation and GDP growth figures[2].

9. Nevertheless, in line with the characteristics of previous recoveries following financial crises, the current upturn is proving rather muted overall. While export growth – the first stage of the traditional recovery pattern – has been solid for some time, the EU economy is now entering the next phase - whereby the pick-up in exports starts to spur (equipment) investment demand.

10. With the projected slowdown in global activity dampening export growth and temporary supports running their course, near-term prospects for the EU economy appear more subdued. The contribution of net exports to GDP growth is set to diminish over the forecast horizon; whereas the contribution of domestic demand is set to increase, owing to a gradual firming of investment and private consumption growth. On the investment front, improvements in the capacity utilisation rate and the profit situation of firms are among the factors expected to support growth, while ongoing balance-sheet adjustment and fiscal consolidation are set to act as constraints. As for private consumption, a slowly improving employment outlook, moderate income growth and subdued inflation underlie the projected pick-up, though consolidation and deleveraging on the part of households are set to have a dampening effect here too.

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[2] See: http://ec.europa.eu/economy_finance/articles/eu_economic_situation/2011-03-01-interim_forecast_en.htm