



Council of the  
European Union

Brussels, 22 March 2016  
(OR. en)

7352/16

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**NOTE**

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From:	General Secretariat of the Council
To:	Delegations
Subject:	Letter received by the Presidency of the Council on the calculation on the estimation of potential output

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Delegations will find attached the letter signed by the Ministers of Spain, Italy, Latvia, Lithuania, Luxembourg, Portugal, Slovenia and Slovakia addressed to the President of the ECOFIN.



Prot 589/nis

March 22, 2016

Dear President,

We kindly ask you to circulate to all ECOFIN members the letter on the extension of the EC's potential output forecasting horizon, we have addressed last Friday to VP Dombrovskis and Commissioner Moscovici, and copied to you.

For your convenience, find attached a copy of the letter.

Yours sincerely,

Luis de Guindos Jurado

Pier Carlo Padoan

Dana Reizniece-Ozola

Rimantas Šadžius

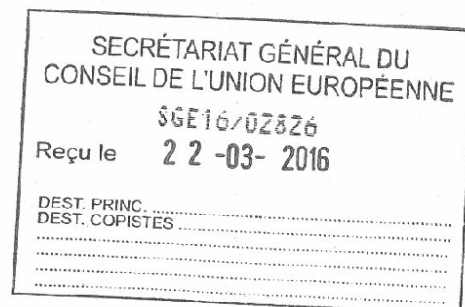
Pierre Gramegna

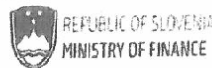
Mário Centeno

Dušan Mramor

Peter Kažimir

Mr. Jeroen DIJSSELBLOEM  
President of the ECOFIN  
The Hague





Prot 586/MIS

March 18, 2016

Dear Vice President, Dear Commissioner,

the estimation of potential output – with the aim to measure the cyclical component of the budget balance – is crucial to assess structural budget balances under the Stability and Growth Pact.

As an economy's potential output is unknown, its estimate is associated with a high degree of uncertainty. Identifying the cyclical and trend components of output, a complex task even in normal conditions, becomes particularly challenging in times of persistently weak economic growth, in times of changes in economic cycles and when implementation of reforms bring about structural shifts.

In recent years the agreed methodology shared at the EU level to gauge potential output has come under scrutiny and the relevant working groups have been discussing possible adjustments to the model.

We do not wish to discuss here possible revisions of the model but address a specific inconsistency that we could rapidly fix without altering the EU shared methodology. We refer to the harmonization of the time horizon adopted by the Commission in its macroeconomic and public finance forecasts with those of the Stability/Convergence programs so as to perform potential output and structural balances estimations on the basis of the same time horizon.

At the moment the Commission estimates potential output using the projection horizon of the most recent forecast exercise, that is two years (2017 in the case of the most recent Commission's Forecasts), while Member States use a range of four years (2019 in the case of the next Stability/Convergence program updates).

Mr. Valdis DOMBROVSKIS  
Vice President of the European Commission  
Brussels

Mr. Pierre MOSCOVICI  
Commissioner Economic and Financial Affairs, Taxation and Customs  
European Commission  
Brussels

Cc  
Mr. Jeroen DIJSSELBLOEM  
President ECOFIN  
The Hague

SECRETARIAT GÉNÉRAL DU CONSEIL DE L'UNION EUROPÉENNE	
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With similar macroeconomic assumptions for the intermediate years, a difference in the time horizon of the estimates of potential output produces relevant discrepancies in structural balances, generating confusion in the evaluation of key public finance variables, particularly in the assessment of compliance with the Stability and Growth Pact, including when assessing the Draft Budgetary Plans of euro area Member States. These discrepancies should be eliminated.

There are two ways to proceed: either the Member States shorten their time horizon or the Commission lengthens it. We consider the use of fully-fledged medium term macroeconomic and fiscal projections based on longer forecast horizon a plus for the sound and sustainable management of public finances; we therefore strongly suggest that the Commission extends its forecast horizon from two to four years in line with the forecast horizon of the Member States.

More substantial doubts have been raised about the commonly agreed methodology and it has also been suggested to complement the output gap with other indicators. While these concerns are not the topic of this letter we support an intensification of the technical work on the matter.

Yours sincerely,

Luis de Guindos Jurado




Pier Carlo Padoan



Dana Reizniece-Ozola



Rimantas Šadžius



Pierre Gramegna



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Dušan Mramor



Peter Kažimír

