

### Box 3

#### The Survey of Professional Forecasters

As described in the article entitled “Price and cost indicators for the euro area: an overview” in the August 2000 issue of the ECB Monthly Bulletin, the ECB compiles a quarterly survey of inflation expectations in the euro area known as the Survey of Professional Forecasters (SPF). The results of the SPF have often been presented in the ECB Monthly Bulletin and have been compared with the short-term outlook for inflation obtained from other sources, including the forecasts of other international institutions. In the December 2000 issue of the ECB Monthly Bulletin some of the results of the latest SPF were presented in Box 7, entitled “Forecasts by other institutions”. Below, the nature of the SPF is briefly recalled and further details on the results of the latest survey carried out in November 2000 are presented.

Based on the replies to a questionnaire submitted to 84 forecasters throughout the European Union (EU), the SPF provides a quantitative estimate of the expected future change in the euro area HICP. The horizons for which respondents are asked to report their expectations are normally set at one and two years, although once a year – usually in February – inflation expectations for a five-year horizon are also requested. The sample of respondents includes experts from both financial and non-financial institutions, who base their replies on techniques ranging from the application of formal econometric models to the use of more simple “rules of thumb” or subjective judgement. The wide variety of approaches used, coupled with the fact that a number of different assumptions often underlie the reported expectations, means that the SPF should be viewed more as an estimate of average inflation expectations than as a forecast or a projection in the traditional sense.

In addition to the estimate of the expected rate of HICP inflation, respondents to the SPF are asked to provide information on the broader economic context by reporting their expectations for growth in area-wide real GDP and developments in the euro area unemployment rate over one-year and two-year horizons. For all three variables, respondents are also asked to provide their outlook over “rolling horizons” set one and two years ahead of the latest period for which published data for each particular variable are available. The forecasts for these rolling horizons help identify expected patterns in inflation, GDP growth and the unemployment rate, which are difficult to detect from forecasts for annual average developments in the calendar years.

#### Results of the November 2000 Survey of Professional Forecasters

In early November 2000 the ECB undertook its eighth quarterly SPF. The results of the November survey are based on 64 replies to a questionnaire submitted to 84 forecasters, giving a response rate of 76%. According to the November 2000 SPF, *HICP inflation in the euro area* is expected to have risen on average from 1.1% in 1999 to 2.3% in 2000, and to fall thereafter to 2.0% in 2001, and further to 1.8% in 2002 (see the table below). Compared with the August 2000 survey, these results represent a 0.2 percentage point upward revision of the expected rate of inflation for 2000 and 2001, while for 2002 the expected rate of HICP inflation in the euro area remains unchanged.

According to respondents, the main factors behind the upward revision of expected inflation in 2000 appear to have been the rise in oil prices as well as a further depreciation of the euro exchange rate which occurred between August and early November 2000. In 2001 and 2002, forecasters expect that a decline in oil prices together with an appreciation of the euro will have a downward impact on inflation. However, from 2001 onwards most forecasters expect indirect effects associated with oil price and exchange rate developments in 1999 and 2000 to gradually pass through to consumer prices. In addition, they mention the risk of second-round effects on inflation via wages in the light of current high inflation and also domestic inflationary pressures associated with the prospects of relatively high economic growth. However, some forecasters expect

**Table: Results from the Survey of Professional Forecasters***(annual percentage changes, unless otherwise indicated)*

	Survey horizon				
	2000	2001	Sep. 2001	2002	Sep. 2002
<b>Overall HICP</b>					
Latest survey, November 2000	2.3	2.0	1.8	1.8	1.7
Previous survey, August 2000	2.1	1.8	-	1.8	-
	2000	2001	2001 Q2	2002	2002 Q2
<b>Real GDP growth</b>					
Latest survey, November 2000	3.5	3.1	3.1	2.8	2.9
Previous survey, August 2000	3.5	3.2	-	2.9	-
	2000	2001	Aug. 2001	2002	Aug. 2002
<b>Unemployment rate <sup>1)</sup></b>					
Latest survey, November 2000	9.1	8.5	8.5	8.1	8.1
Previous survey, August 2000	9.1	8.4	-	8.0	-

1) *As a percentage of the labour force.*

wage growth in the euro area to remain subdued. In addition, a few forecasters explicitly mention competition and “new economy” features as having a downward effect on inflation in the euro area. It should be noted that the expectations of the professional forecasters were formed before the decline in oil prices and the appreciation of the euro that took place in late November and December 2000. These developments will reduce the direct impact on HICP inflation of import prices in general and energy prices in particular. However, they will not eradicate the delayed indirect effects on inflation (via the domestic chain of production) associated with the earlier rise in oil prices and the depreciation of the euro.

The November 2000 SPF shows that professional forecasters expect *real GDP growth* to rise to 3.5% in 2000, but to decline to 3.1% in 2001 and again to 2.8% in 2002. This implies that the expected rate of growth for 2000 remains unchanged from the August 2000 SPF, while for 2001 and 2002 it has been revised downward by 0.1 percentage point. The downward revisions to the growth expectations of respondents appear to be related to the terms of trade loss associated with the rise in oil prices, to indicators pointing to lower growth in the euro area released shortly before the November SPF was concluded and to firmer expectations of a slowdown in growth in the United States. The most common factor mentioned by forecasters for supporting euro area growth in 2001 and 2002 is a relaxation of fiscal policy as a result of planned tax reductions. This, together with employment growth, is expected to support private consumption.

The current survey indicates that the *unemployment rate* is expected to fall gradually from 9.1% on average in 2000 to 8.5% and 8.1% in 2001 and 2002 respectively. While euro area unemployment is foreseen to be on a downward trend, the expectations for 2001 and 2002 have been revised upwards by 0.1 percentage point, which may be linked to the downward revision of expectations for euro area GDP growth.