

Box 5

Private sector expectations for inflation and economic activity in the euro area: results of the 2002 Q4 Survey of Professional Forecasters and other available indicators

This box presents the available indicators of private sector expectations for euro area inflation and economic activity. A summary of the results of the 2002 Q4 Survey of Professional Forecasters (SPF) conducted by the ECB in the second half of October is given below. The survey is called the Survey of Professional Forecasters to reflect the fact that all of the participants are experts affiliated with financial or non-financial institutions based within the European Union. It is also important to bear in mind that, since the participants are not given a common set of assumptions on which to base their forecasts, the SPF aggregate results most likely reflect a relatively heterogeneous set of subjective views and assumptions. Whenever possible, the data have been presented alongside other measures of private sector expectations for the same horizons.¹

Inflation expectations for 2002, 2003 and 2004

SPF participants expect the annual inflation rate in the euro area to average 2.2% in 2002. Thereafter, inflation is expected to decline and remain below 2% over the forecast horizon, at 1.8% in 2003 and 1.9% in 2004 (see the table). This implies a slight upward revision of inflation expectations by 0.1 percentage point for 2002, while expectations for the rest of the horizons remain unchanged from the previous survey conducted in mid-July. However, survey participants stress that the possibility of oil price hikes in the event of a military conflict in the Middle East is a serious risk for this inflation outlook. As shown in the table below, these results are broadly in line with the figures reported in the October 2002 issue of Consensus Economics Forecasts for the same horizons (2.2% for 2002 and 1.9% for 2003). The results from the October 2002 Euro Zone Barometer (2.2%, 1.8% and 1.9% for 2002, 2003 and 2004, respectively) also coincide with the SPF figures.² In the SPF, the inflation rates expected in September 2003 and September 2004 are 1.8% and 1.9%, respectively.

¹ These horizons are the calendar years 2002, 2003, 2004 and 2007. In addition, the expectations from the two additional "rolling horizons" requested in the SPF are also reported. These so-called rolling horizons are set one and two years ahead of the period for which the latest data for each particular variable are available at the time the survey is conducted. In the 2002 Q4 SPF, these rolling horizons were September 2003 and September 2004 for the HICP inflation rate, the second quarters of 2003 and 2004 for the rate of growth in real GDP, and August 2003 and August 2004 for the unemployment rate. These rolling horizons may be useful to identify dynamic patterns that are difficult to detect from calendar year averages.

² Consensus Economics figures are an aggregation of the expected annual rates of growth in the national Consumer Price Indices (CPIs), while the SPF results and the Euro Zone Barometer refer to the Harmonised Index of Consumer Prices (HICP).

Table: Results from the 2002 Q4 SPF, the 2002 Q3 SPF and Consensus Economics (October 2002)

(annual percentage changes, unless otherwise indicated)

	Survey horizon					
	2002	Sep. 2003	2003	Sep. 2004	2004	Longer-term ²⁾
HICP inflation						
2002 Q4 SPF	2.2	1.8	1.8	1.9	1.9	1.9
Previous SPF (2002 Q3)	2.1	-	1.8	-	1.9	1.9
Consensus (Oct. 2002)	2.2	-	1.9	-	-	1.9
Real GDP growth						
2002 Q4 SPF	0.8	1.7	1.8	2.5	2.5	2.4
Previous SPF (2002 Q3)	1.2	-	2.5	-	2.5	2.5
Consensus (Oct. 2002)	0.8	-	1.9	-	-	2.3
Unemployment rate¹⁾						
2002 Q4 SPF	8.3	8.3	8.4	7.9	8.0	7.2
Previous SPF (2002 Q3)	8.4	-	8.1	-	7.8	7.1

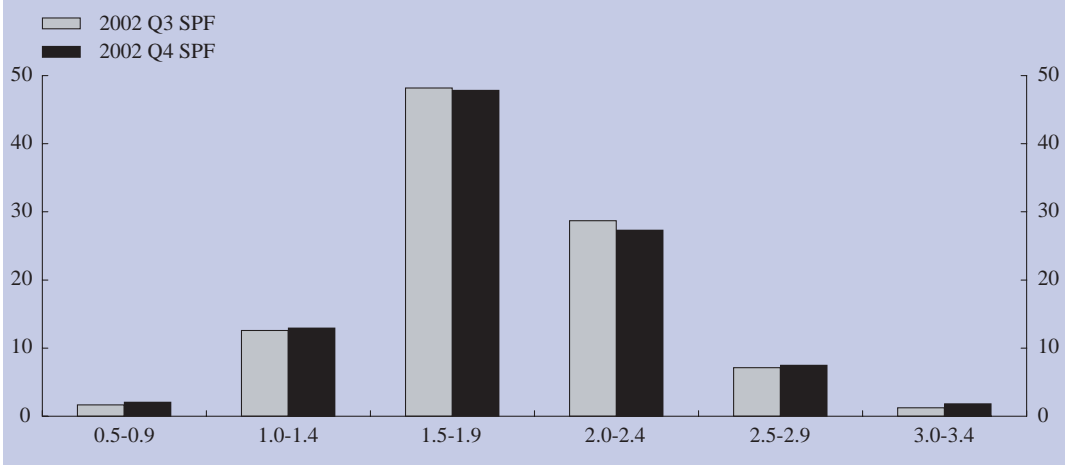
1) As a percentage of the labour force.

2) For the SPF longer-term inflation expectations refer to 2007. Consensus Economics figures refer to the period 2008-12.

The SPF questionnaire also asks survey participants to assign some probability to actual outcomes falling within specific intervals. The probability distribution resulting from the aggregation of responses helps to assess the extent to which survey participants, on average, gauge the risk of the actual outcome being above or below the most likely range. Chart A below shows the aggregate probability distributions for average annual HICP inflation in 2003 in the last two surveys. There have been very marginal changes in the inflation outlook compared with the last survey. Both distributions are centred around the interval 1.5-1.9%, which accounts for about 47% of the probability mass in both cases. Regarding the assessment of risks to the most likely inflation outcome in 2003, inflation outcomes above the central range received a probability of 37%, while outcomes below 1.5% had a probability of around 15%, without any substantial change in the assessment despite the worsening of growth prospects for 2003 (see section on GDP growth expectations below) since the previous survey.

Chart A: Probability distribution for average inflation in 2003 in the last two SPF rounds

(percentages)

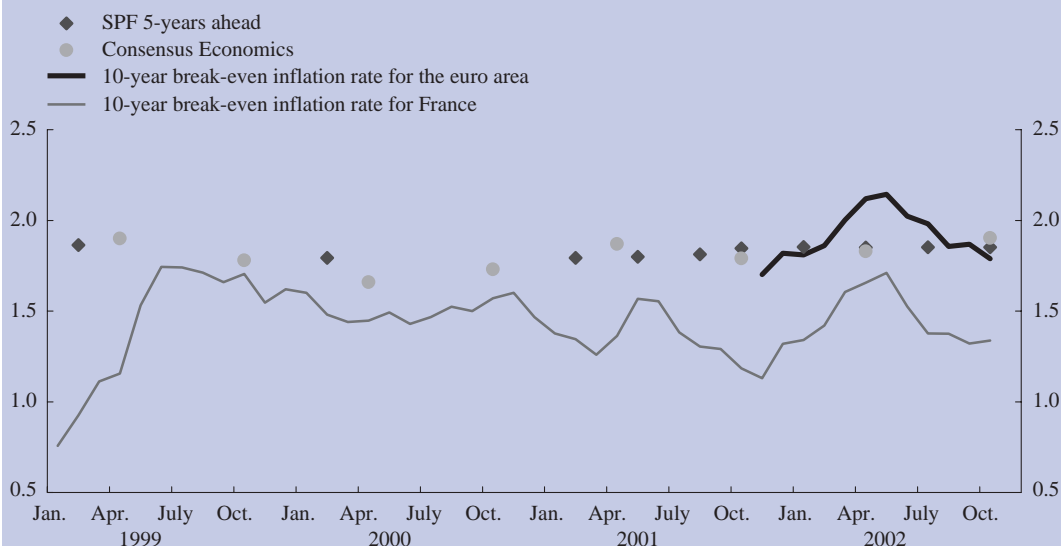


Indicators of longer-term inflation expectations

According to the 2002 Q4 SPF, average inflation in 2007 is expected to be 1.9%, unchanged from the previous survey. This level of longer-term inflation expectations is broadly consistent with other available measures. The October 2002 Euro Zone Barometer indicates an expected average inflation rate of 1.8% in 2006 and the October 2002 Consensus Economics results for five euro area countries for the period 2008-12 suggest an estimate of 1.9% for long-term inflation expectations in the euro area as a whole.³ Indicators of long-term expected inflation extracted from financial market prices convey a similar message. In particular, Chart B below shows the ten-year break-even inflation rates extracted from French bonds linked to the French CPI and the euro area HICP (both excluding tobacco), which have over recent months declined from the fairly high levels reached earlier in the year. However, when interpreting the levels of these measures, it is important to bear in mind that break-even inflation rates are not a direct measure of market inflation expectations. This is because a variety of risk premia, including an inflation uncertainty premium and a liquidity premium, are taken into consideration in the calculation.⁴

Chart B: Indicators of long-term inflation expectations

(average annual percentage changes)



Sources: French Treasury, Reuters, Consensus Economics and the ECB.

Note: For detailed information on these series, see Box 2 in the August 2002 Monthly Bulletin.

Expectations for euro area real GDP growth and unemployment

SPF participants have revised downwards their expectations for the average annual growth rate of real GDP in 2002 to 0.8%, i.e. by 0.4 percentage point compared with the previous survey. However, the most noticeable revision to expectations is for 2003, for which an annual rate of 1.8%, i.e. 0.7 percentage point lower, is now expected. These lower growth prospects for 2003 seem to stem from the high uncertainty associated with the global economic and financial situation and the geopolitical tensions. For 2004 Q2, an annual growth rate of 2.5% is expected, which is also the average expected for the year. According to the October 2002 issue of Consensus Economics Forecasts, annual rates of euro area real GDP growth are expected to average 0.8% and

³ The euro area figure was calculated using national figures for Germany, Spain, France, Italy and the Netherlands, which together represent around 85% of the euro area aggregate.

⁴ It should be noted that the break-even inflation rate reflects the average value of inflation expectations over the maturity of the index-linked bond under consideration and is not a point estimate for a precise year (as is the case for the survey indicators of long-term inflation expectations). For a thorough description of the conceptual nature of the break-even inflation rate, please refer to the box entitled "Deriving long-term euro area inflation expectations from index-linked bonds issued by the French Treasury" in the February 2002 Monthly Bulletin.

1.9% in 2002 and 2003 respectively, while the expectations reported in the October 2002 Euro Zone Barometer are 0.8% and 1.8% for these two horizons and 2.5% for 2004. Longer-term growth prospects – at 2.4% for 2007 according to the SPF, 2.3% on average for the period 2008-12 on the basis of the information published by Consensus Economics, and 2.4% for 2006 according to the October 2002 Euro Zone Barometer – remain in line with the upper end of the range of estimates for trend potential growth in the euro area.

According to the latest SPF, the euro area unemployment rate is expected to average 8.3% in 2002. Reflecting the downward revision to growth prospects in the euro area, the unemployment rate is expected to rise to 8.4% in 2003. Thereafter, it is expected to fall, averaging 8.0% in 2004 and 7.2% in 2007. These results are broadly in line with those from the October 2002 Euro Zone Barometer (8.3%, 8.4%, 7.8% and 7.2% in 2002, 2003, 2004 and 2006, respectively).