

Box 2**Private sector expectations for inflation and economic activity in the euro area: the results of the 2003 Q1 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 2003 Q1 Survey of Professional Forecasters (SPF) conducted by the ECB in the second half of January is given below. The survey's name reflects 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 together with other sources of private sector expectations for the same horizons.¹

Inflation expectations for 2003 and 2004

SPF participants expect the annual inflation rate in the euro area to remain below 2% over the entire forecast horizon. Specifically, inflation is expected to be 1.8% both in 2003 and in 2004 (see table below). Inflation expectations for 2003 are therefore unchanged from the previous survey round, while there is a minor downward revision of 0.1 percentage point for 2004, which is in line with participants' comments that the inflation outlook has changed little from the last survey conducted in October 2002. Survey participants stress,

Results from the 2003 Q1 SPF, the 2002 Q4 SPF and Consensus Economics (January 2003)

(annual percentage changes, unless otherwise indicated)

HICP inflation	Survey horizon				
	Dec. 2003	2003	Dec. 2004	2004	Longer term ²⁾
2003 Q1 SPF	1.8	1.8	1.8	1.8	1.9
Previous SPF (2002 Q4)	-	1.8	-	1.9	1.9
Consensus (Jan. 2003)	-	1.7	-	1.7	1.9
Real GDP growth	2003 Q3	2003	2004 Q3	2004	Longer term ²⁾
2003 Q1 SPF	1.5	1.4	2.4	2.3	2.4
Previous SPF (2002 Q4)	-	1.8	-	2.5	2.4
Consensus (Jan. 2003)	-	1.4	-	2.3	2.3
Unemployment rate ¹⁾	Nov. 2003	2003	Nov. 2004	2004	Longer term ²⁾
2003 Q1 SPF	8.4	8.5	8.1	8.2	7.1
Previous SPF (2002 Q4)	-	8.4	-	8.0	7.2
Consensus (Jan. 2003)	-	8.6	-	8.4	-

1) As a percentage of the labour force.

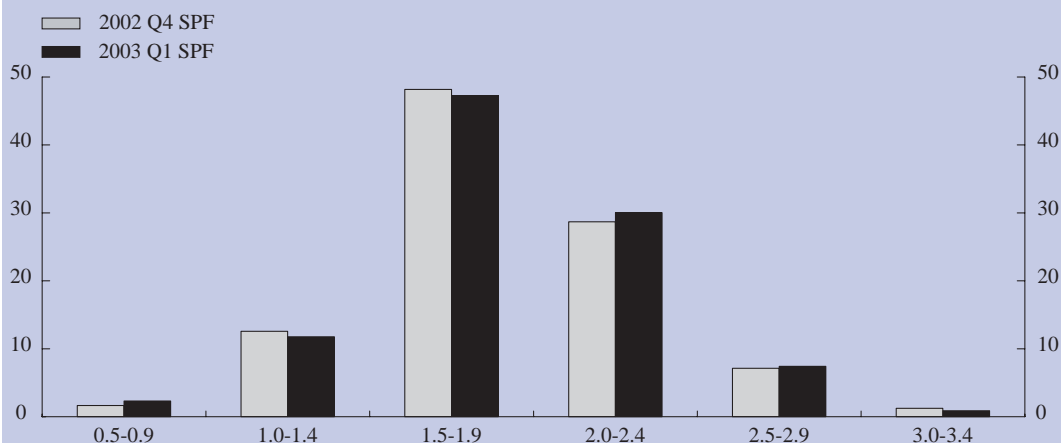
2) For the SPF longer-term inflation expectations refer to 2007. The Consensus Economics figure refers to the period 2008-12 as reported in the October 2002 issue.

however, that the possibility of oil price hikes in the event of an escalation of tensions in the Middle East remains a serious risk over the short run. As shown in the table above, these results are close to the figures reported in the January 2003 issue of Consensus Economics for the same horizons (1.7% for both 2003 and 2004). The results from the January 2003 Euro Zone Barometer (1.8% and 1.7% for 2003 and 2004) also match those of the SPF.² In the SPF the inflation rate expected both in December 2003 and December 2004 is 1.8%.

1) These horizons are the calendar years 2003, 2004 and 2007. In addition, the expectations for the two "rolling horizons" requested in the SPF are also reported. These 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 2003 Q1 SPF, these rolling horizons were December 2003 and 2004 for the HICP inflation rate, the third quarter of 2003 and 2004 for the rate of growth in real GDP, and November 2003 and 2004 for the unemployment rate. These rolling horizons may be useful to identify dynamic patterns that are difficult to detect from averages over calendar years.

2) Consensus Economics figures refer to an aggregation of the expected annual rates of growth of the national CPIs, while the SPF results and the Euro Zone Barometer refer to the HICP.

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



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 how survey participants, on average, gauge the risk of the actual outcome being above or below the most likely range. Chart A shows the aggregate probability distributions for average HICP inflation in 2003 in the last two survey rounds. It confirms that there have been very marginal changes in the inflation outlook since the 2002 Q4 SPF. Both distributions are centred around the interval 1.5-1.9%, which accounts for around 47% of the probability mass in both cases. Regarding the assessment of risks to inflation in 2003, inflation outcomes above the central range received a probability of 39%, while outcomes below 1.5% received a probability of around 14%. This does not represent a substantial change compared with the previous assessment against the background of a further deterioration in growth prospects for 2003, higher oil prices and the stronger euro exchange rate incorporated in this survey round.

Indicators of longer-term inflation expectations

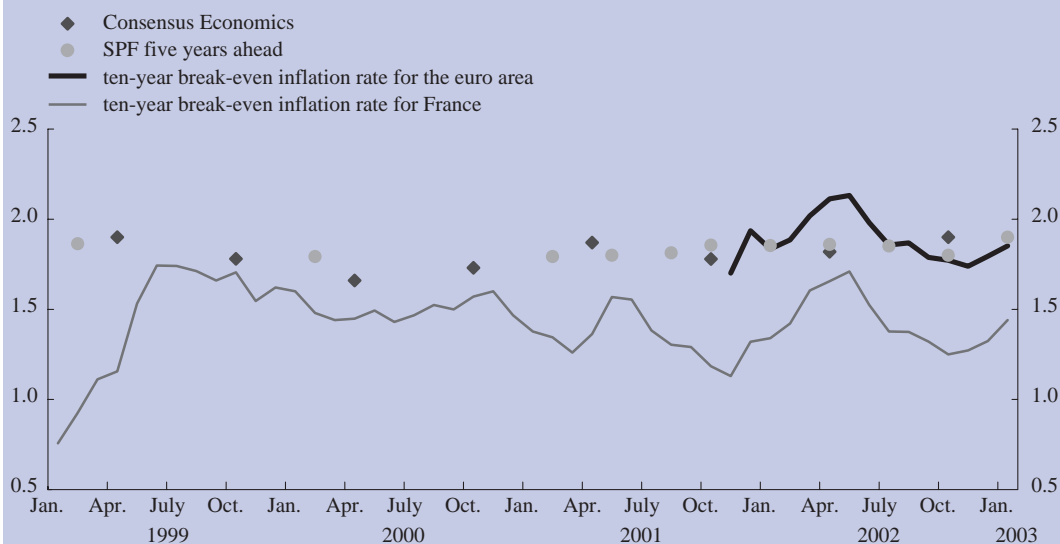
According to the 2003 Q1 SPF, average inflation in 2007 is expected to be 1.9%, unchanged from the previous round. This level of longer-term inflation expectations is consistent with other available measures of inflation expectations. The January 2003 Euro Zone Barometer indicates an expected average rate of inflation of 1.8% in 2007, and the results from Consensus Economics in October 2002 for five euro area countries suggest inflation expectations of 1.9% on average in the euro area as a whole for the period 2008-12.³ Indicators of long-term expected inflation extracted from financial market prices convey a similar message. In particular, Chart B shows that what are known as the ten-year “break-even” inflation rates extracted from French bonds linked to the French CPI and the euro area HICP (both excluding tobacco) have remained over recent months clearly below the levels reached earlier last 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 included in the calculation.⁴

³ The euro area figure was derived using the results for Germany, Spain, France, Italy and the Netherlands, which 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, refer to the box entitled “Deriving long-term euro area inflation expectations from index-linked bonds issued by the French Treasury” on page 16 of the February 2002 issue of the ECB’s Monthly Bulletin.

Chart B: Indicators of long-term inflation expectations

(average annual percentage changes)



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

Expectations for euro area real GDP growth and unemployment

SPF participants revised downwards their expectations for the average annual growth rate of euro area real GDP in 2003 by 0.4 percentage point compared with the previous survey round, to 1.4% (see table above). This downward revision of growth prospects for 2003 seems to be the result of high uncertainty mainly associated with geopolitical tensions which are affecting the global economic and financial situation. For the third quarter of 2004, a growth rate of 2.4% is expected, which is slightly higher than the expected average for that year of 2.3%. According to the January 2003 Consensus Economics forecasts, euro area real GDP growth is expected to average 1.4% in 2003 and to increase to 2.3% in 2004, while the expectations reported in the January 2003 Euro Zone Barometer are 1.3% and 2.3% for these two years. Long-term growth prospects – at 2.4% for 2007 according to the SPF, 2.3% for 2007 according to the January 2003 Euro Zone Barometer and 2.3% on average for the period 2008-12 on the basis of the information published by Consensus Economics – remain in line with 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 rise to 8.5% on average in 2003, reflecting the further downward revision of growth prospects in the euro area in 2003 and the lagged effects of subdued economic activity in 2002. Thereafter it is expected to fall, however, averaging 8.2% in 2004 and 7.1% in 2007. These results are broadly in line with those from the January 2003 Euro Zone Barometer (8.6%, 8.3% and 7.5% in 2003, 2004 and 2007 respectively) and the January 2003 Consensus Economics (8.6% and 8.4% in 2003 and 2004 respectively).