

Box 5**Private sector expectations for inflation and economic activity in the euro area: results of the 2003 Q4 Survey of Professional Forecasters (SPF) and other available indicators**

This box reports the results of the 21st Survey of Professional Forecasters (SPF) conducted by the ECB between 16 and 28 October 2003. The SPF gathers expectations for euro area inflation, economic activity and unemployment from experts affiliated to financial or non-financial institutions based in the European Union. It is important to bear in mind that, given the diversity of the panel of participants, aggregate SPF results can reflect a relatively heterogeneous set of subjective views and assumptions. Whenever possible, SPF results are compared with other available indicators of private sector expectations for the same horizons.¹

Inflation expectations for 2003, 2004 and 2005

Survey participants adjusted HICP expectations slightly upwards as compared with the previous SPF conducted in July 2003. HICP inflation is now expected to stand at 2.0% in 2003 compared with 1.9% in the 2003 Q3 SPF. Considering this was the last SPF of the year, uncertainty surrounding the final outcome for 2003 remains unusually high. Indeed, many participants raised the possibility of unforeseen developments in oil prices as well as some concern over the likely magnitude of the upward pressure on prices resulting from the lagged impact on food prices of the unusually hot summer weather and droughts in the euro area. HICP inflation expectations for 2004 and 2005 have also been revised upwards by 0.1 percentage point as compared with the previous SPF. They now stand at 1.6% and 1.8% respectively. The expected decline in HICP inflation in 2004 is generally attributed to a further gradual appreciation of the euro and a continuation of relatively subdued economic growth. However, the implementation of a number of fiscal measures (such as the planned increases in petrol and tobacco taxes in France or the reform of the health system in Germany) in early 2004 would pose upside risks to the forecast. Overall, most results tend to be slightly above the figures reported in the October 2003 issues of Consensus Economics (see the table below) and the Euro Zone Barometer (2.0% for 2003 and 1.5% for 2004).

Results from the 2003 Q4 SPF, the 2003 Q3 SPF and Consensus Economics

(annual percentage changes, unless otherwise indicated)

| | Survey horizon | | | | | |
|---------------------------------------|----------------|-----------|------|-----------|------|---------------------------|
| | 2003 | Sep. 2004 | 2004 | Sep. 2005 | 2005 | Longer-term ²⁾ |
| HICP inflation | | | | | | |
| 2003 Q4 SPF | 2.0 | 1.6 | 1.6 | 1.8 | 1.8 | 1.9 |
| Previous SPF (2003 Q3) | 1.9 | - | 1.5 | - | 1.7 | 1.9 |
| Consensus (Oct. 2003) | 2.0 | - | 1.5 | - | 1.7 | 1.8 |
| Real GDP growth | | | | | | |
| 2003 Q4 SPF | 0.5 | 1.6 | 1.7 | 2.2 | 2.3 | 2.4 |
| Previous SPF (2003 Q3) | 0.7 | - | 1.7 | - | 2.3 | 2.4 |
| Consensus (Oct. 2003) | 0.5 | - | 1.7 | - | 2.2 | 2.1 |
| Unemployment rate¹⁾ | | | | | | |
| 2003 Q4 SPF | 8.8 | 8.8 | 8.9 | 8.5 | 8.5 | 7.4 |
| Previous SPF (2003 Q3) | 8.9 | - | 8.9 | - | 8.5 | 7.4 |

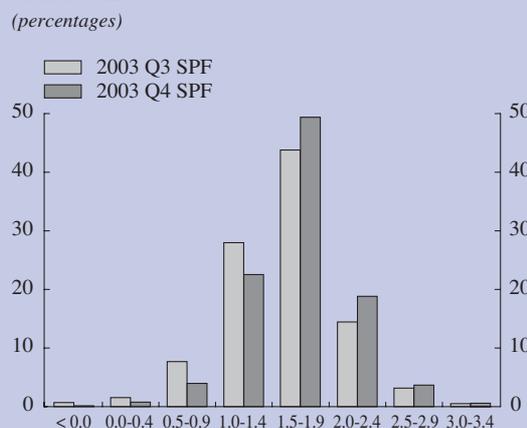
1) As a percentage of the labour force.

2) Longer-term inflation expectations refer to 2008. The Consensus Economics forecast refers to the period 2009-13 (data published in the October 2003 Consensus Economics Survey).

1) These horizons are the calendar years 2003, 2004, 2005 and "five years ahead, i.e. 2008". Expectations for two additional "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 Q4 SPF, these rolling horizons were September 2004 and 2005 for the HICP inflation rate, the second quarter of 2004 and 2005 for the rate of growth in real GDP and August 2004 and 2005 for the euro area unemployment rate. These rolling horizons may be useful to identify dynamic patterns that are difficult to detect from averages over calendar years.

SPF participants are also asked to assign a probability distribution to their forecasts. This probability distribution is expressed in percentages falling within specific intervals. The probability distribution resulting from the aggregation of responses thus helps to assess how, on average, survey participants gauge the risk of the actual outcome being above or below the most likely range. Chart A reports the aggregate probability distributions for average annual rates of HICP inflation in 2004 in the last two survey rounds. Even though the bulk of the distribution remains centred in the 1.5-1.9% range for expected HICP inflation in 2004, there has been a clear shift to the right.

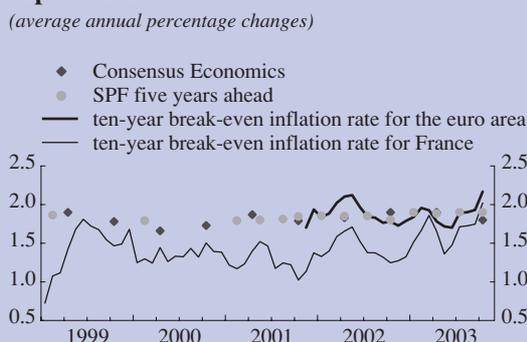
Chart A: Probability distribution for average inflation in 2004 in the last two SPF rounds



Indicators of longer-term inflation expectations

Longer-term inflation expectations (i.e. five-years ahead) reported by SPF participants remained stable at 1.9%, unchanged for the eighth consecutive SPF. This is broadly consistent with other available measures of longer-term inflation expectations. In October 2003 the Euro Zone Barometer forecast an average inflation rate of 1.9% in 2007, and Consensus Economics published a euro area inflation rate of 1.8% for the period 2009-13 as a whole. However, in financial markets, the ten-year break-even inflation rates derived from French government bonds linked to the euro area HICP (excluding tobacco) rose slightly over recent months (see Chart B), although it needs to be noted that these break-even inflation rates are not pure measures of market participants' long-term inflation expectations. They are affected by a variety of risk premia (including inflation uncertainty and liquidity premia) which might be behind the recent increases.²

Chart B: Indicators of long-term inflation expectations



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

Expectations for real GDP growth and unemployment in the euro area

The outlook for economic activity has been revised downwards for the third consecutive SPF. Compared with the previous SPF, real GDP growth has been revised down by 0.2 percentage point, to 0.5% in 2003. For 2004 and 2005, the outlook remains unchanged from the previous SPF, with average GDP growth expected to stand at 1.7% and 2.3%, respectively. The anticipated pick-up in activity in 2004 is mainly based on the assumed recovery of the world economy and an expected gradual decline in oil prices. Domestic demand is projected to lag somewhat in line with the employment outlook. These forecasts are similar to those published in the October issues of Consensus Economics and the Euro Zone Barometer. Both forecast GDP growth of 0.5% in 2003 and 1.7% in 2004. Finally, the expected long-term growth rate five years ahead (i.e. in 2008) stands at 2.4%, unchanged from the previous SPF survey rounds.

² 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.

The unemployment rate in the euro area is now expected to stand at 8.8% in 2003, a slight downward revision as compared with the previous SPF round. The recovery in 2004 is not expected to be strong enough to produce an improvement in the euro area labour market until at least mid-2004. The situation should improve in 2005, as the unemployment rate is expected to decrease to 8.5%. Respondents' optimism with regard to long-term developments nevertheless appears dependent on the implementation of further labour market reforms.