

## Box 5

**PRIVATE SECTOR EXPECTATIONS FOR THE EURO AREA: RESULTS OF THE SURVEY OF PROFESSIONAL FORECASTERS FOR THE SECOND QUARTER OF 2005**

This box reports the results of the 27th Survey of Professional Forecasters (SPF), conducted by the ECB between 18 and 22 April 2005. The SPF gathers expectations for euro area inflation, economic activity and unemployment from experts affiliated to financial or non-financial institutions based in the EU. 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.

**Inflation expectations for 2005 and 2006**

Compared with the previous survey, conducted in January, expectations regarding the inflation outlook remained largely unchanged. SPF panellists expect HICP inflation to be on average 1.9% in 2005 and 1.8% in 2006. The SPF average forecast is 0.1 percentage point higher than that of Consensus Economics for 2005 and that of both Consensus Economics and the Euro Zone Barometer for 2006. According to SPF forecasters, the inflation outlook is mainly shaped by oil price developments. The upward impact of high oil prices is seen as being partly counterbalanced by a number of dampening factors, including increased international competition, the continued strength of the euro and continued wage moderation.

**Results from the SPF, Consensus Economics and the Euro Zone Barometer**

(annual percentage changes, unless otherwise indicated)

HICP inflation	Survey horizon				
	2005	Mar. 2006	2006	Mar. 2007	Longer term <sup>2)</sup>
Q2 2005 SPF	1.9	1.8	1.8	1.8	1.9
Previous SPF (Q1 2005)	1.9	-	1.8	-	1.9
Consensus Economics (Apr. 2005)	1.8	-	1.7	-	1.9
Euro Zone Barometer (Apr. 2005)	1.9	-	1.7	-	1.9
Real GDP growth	2005	Q4 2005	2006	Q4 2006	Longer term <sup>2)</sup>
Q2 2005 SPF	1.6	1.8	2.0	2.0	2.2
Previous SPF (Q1 2005)	1.8	-	2.1	-	2.3
Consensus Economics (Apr. 2005)	1.5	-	1.9	-	2.1
Euro Zone Barometer (Apr. 2005)	1.6	-	1.9	-	2.1
Unemployment rate <sup>1)</sup>	2005	Feb. 2006	2006	Feb. 2007	Longer term <sup>2)</sup>
Q2 2005 SPF	8.8	8.7	8.6	8.5	7.6
Previous SPF (Q1 2005)	8.8	-	8.5	-	7.5
Consensus Economics (Apr. 2005)	8.8	-	8.6	-	-
Euro Zone Barometer (Apr. 2005)	8.9	-	8.7	-	7.7

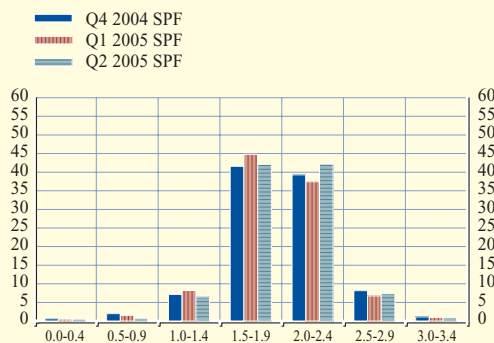
1) As a percentage of the labour force.

2) In the current and the previous SPF round and in the Euro Zone Barometer longer-term expectations refer to 2009. The Consensus Economics forecast refers to the period 2011-15.

SPF participants are also asked to assign a probability distribution to their forecasts. This distribution provides information on the probability, expressed as a percentage, of the future outcome being within a specific interval. The probability distribution resulting from the

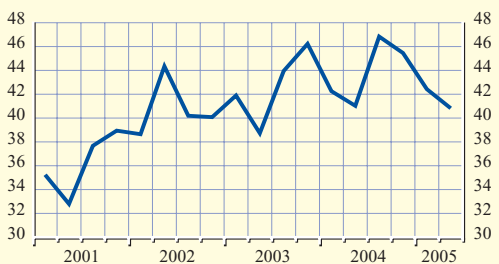
**Chart A Probability distribution for average inflation in 2005 in the last three rounds of the SPF**

(percentages)



**Chart B Probability of five-year ahead inflation being at or above 2%**

(percentages)



aggregation of responses also 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, which shows the aggregate probability distributions for average annual rates of HICP inflation in 2005 in the last three rounds of the survey, highlights an upward shift in the balance of risks in the most recent round. The probability that inflation in 2005 may stand between 2.0% and 2.4% is now very close to that of inflation standing between 1.5% and 1.9% (both around 42%), the former having risen compared with the SPF conducted in February 2005. The probability distribution for 2006, by contrast, has changed very little compared with the previous SPF and continues to assign a high probability (45%) to inflation staying between 1.5% and 1.9%. The major risk cited by SPF forecasters remains oil price developments.

### Indicators of longer-term inflation expectations

The latest results of the SPF show five-year ahead inflation expectations unchanged at 1.9% for the 14th consecutive round. These expectations are fully in line with the recently published estimates from Consensus Economics and Euro Zone Barometer. While the probability distribution assigned to longer-term inflation continues to point to an upward risk, there has been some easing in the assessment of such a risk over recent SPF rounds (see Chart B).<sup>1</sup>

SPF survey results can be compared with long-term inflation expectations as measured by the spread between nominal and inflation-linked bonds. In April 2005 the break-even inflation rates derived from French government inflation-linked bonds (linked to the euro area HICP excluding tobacco) maturing in 2012 or 2015 continued to be higher than survey measures of inflation expectations (see Chart C).<sup>2</sup> However, the break-even inflation rate extracted from financial markets is not simply a measure of inflation expectations; it also includes various risk

1 Additional data are available on the ECB's website, at [www.ecb.int/stats/prices/indic/forecast/html/index.en.html](http://www.ecb.int/stats/prices/indic/forecast/html/index.en.html).

2 It should be noted that the break-even inflation rate reflects average expected inflation over the (residual) maturity of the bonds used in its construction and is not a point estimate for a precise year (as is the case for some of the survey indicators of long-term inflation expectations). For a description of the conceptual nature of the break-even inflation rate, refer to the article entitled "Extracting information from financial asset prices" in the November 2004 issue of the Monthly Bulletin.

premias (such as inflation uncertainty and liquidity premia). Consequently these measures are affected when investors become more uncertain about their forecasts and are willing to pay a premium for a hedge.

### Expectations for real GDP growth and unemployment in the euro area

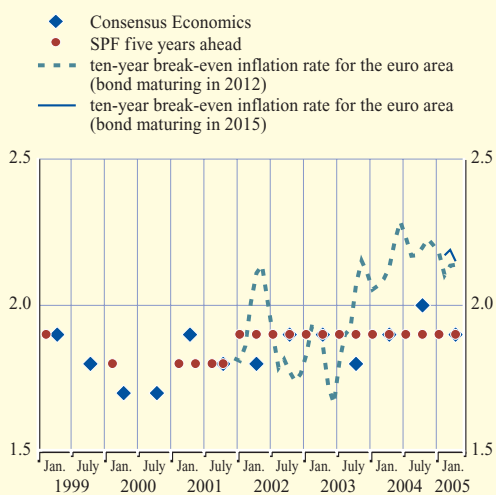
Expected GDP growth in 2005 was revised downwards to 1.6%, i.e. 0.2 percentage point lower than in the previous SPF. The point estimate for 2006, at 2.0%, was also revised down by 0.1 percentage point compared with the previous SPF round. These downward revisions are partly accounted for by lower than expected growth at the end of 2004, higher than expected oil prices and the strength of the euro. According to SPF participants, the overall balance of risks is on the downside and closely related to the above factors. Fiscal developments in some countries are also cited as weighing on confidence and thus on economic growth expectations. Forecasters nevertheless reported a number of upward risks to their assessment, in particular favourable financing conditions and improvements in profitability.

The SPF forecast for real GDP growth is in line with the most recent 2005 estimate published by the Euro Zone Barometer and 0.1 percentage point higher than the latest Consensus Economics 2005 estimate. Regarding 2006, the SPF forecast is 0.1 percentage point higher than those of the two other surveys (see table above). Five-year ahead real GDP growth expectations stand at 2.2%, 0.1 percentage point lower than in the previous round. Many SPF forecasters expressed the view that longer-term prospects hinge upon the success of structural reforms.

SPF respondents' expectations for unemployment in 2005 were unchanged compared with the previous round, at 8.8%. Forecasters mentioned the expected moderate increase in GDP growth and continued low capacity utilisation as the main factors preventing unemployment from declining faster in the coming years. This is also reflected in the upward revision of expectations for unemployment in 2006, which were 0.1 percentage point higher than in the previous SPF round, at 8.6%. The expected rate of unemployment in 2009 stood at 7.6%, up by 0.1 percentage point compared with the previous round. Respondents continued to stress that the decline in the unemployment rate over the long-term horizon is dependent on further labour market reforms.

Chart C Indicators of long-term inflation expectations

(average annual percentage changes)



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